

THE RHODES REPORT

TRADING RULES

I must admit, I am not smart enough to have devised these ridiculously simple trading rules—a great trader was kind enough to give them to me over 15 years ago. However, I will tell you—they work. If you follow these rules, breaking them as infrequently as possible, you will make money year in and year out, some years better than others, some years worse—but you will make money. The rules are simple. Adherence to the rules is difficult.

"Old Rules...but Very Good Rules"

If I've learned anything in my 17 years of trading, I've learned that the simple methods work best. Those who need to rely upon complex stochastics, linear weighted moving averages, smoothing techniques, fibonacci numbers etc., usually find that they have so many things rolling around in their heads that they cannot make a rational decision. One technique says buy; another says sell. Another says sit tight while another says add to the trade. It sounds like a cliché, but simple methods work best.

1. The first and most important rule is - in bull markets, one is supposed to be long. This may sound obvious, but how many of us have sold the first rally in every bull market, saying that the market has moved too far, too fast. I have before, and I suspect I'll do it again at some point in the future. Thus, we've not enjoyed the profits that should have accrued to us for our initial bullish outlook, but have actually lost money while being short. In a bull market, one can only be long or on the sidelines. Remember, not having a position is a position.
2. Buy that which is showing strength - sell that which is showing weakness. The public continues to buy when prices have fallen. The professional buys because prices have rallied. This difference may not sound logical, but buying strength works. The rule of survival is not to "buy low, sell high", but to "buy higher and sell higher". Furthermore, when comparing various stocks within a group, buy only the strongest and sell the weakest.
3. When putting on a trade, enter it as if it has the potential to be the biggest trade of the year. Don't enter a trade until it has been well thought out, a campaign has been devised for adding to the trade, and contingency plans set for exiting the trade.
4. On minor corrections against the major trend, add to trades. In bull markets, add to the trade on minor corrections back into support levels. In bear markets, add on corrections into resistance. Use the 33-50% corrections level of the previous movement or the proper moving average as a first point in which to add.
5. Be patient. If a trade is missed, wait for a correction to occur before putting the trade on.
6. Be patient. Once a trade is put on, allow it time to develop and give it time to create the profits you expected.
7. Be patient. The old adage that "you never go broke taking a profit" is maybe the most worthless piece of advice ever given. Taking small profits is the surest way to ultimate loss I can think of, for small profits are never allowed to develop into enormous profits. The real money in trading is made from the one, two or three large trades that develop each year. You must develop the ability to patiently stay with winning trades to allow them to develop into that sort of trade.

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8. Be patient. Once a trade is put on, give it time to work; give it time to insulate itself from random noise; give it time for others to see the merit of what you saw earlier than they.
9. Be impatient. As always, small losses and quick losses are the best losses. It is not the loss of money that is important. Rather, it is the mental capital that is used up when you sit with a losing trade that is important.
10. Never, ever under any condition, add to a losing trade, or "average" into a position. If you are buying, then each new buy price must be higher than the previous buy price. If you are selling, then each new selling price must be lower. This rule is to be adhered to without question.
11. Do more of what is working for you, and less of what's not. Each day, look at the various positions you are holding, and try to add to the trade that has the most profit while subtracting from that trade that is either unprofitable or is showing the smallest profit. This is the basis of the old adage, "let your profits run."
12. Don't trade until the technicals and the fundamentals both agree. This rule makes pure technicians cringe. I don't care! I will not trade until I am sure that the simple technical rules I follow, and my fundamental analyses, are running in tandem. Then I can act with authority, and with certainty, and patiently sit tight.
13. When sharp losses in equity are experienced, take time off. Close all trades and stop trading for several days. The mind can play games with itself following sharp, quick losses. The urge "to get the money back" is extreme, and should not be given in to.
14. When trading well, trade somewhat larger. We all experience those incredible periods of time when all of our trades are profitable. When that happens, trade aggressively and trade larger. We must make our proverbial "hay" when the sun does shine.
15. When adding to a trade, add only 1/4 to 1/2 as much as currently held. That is, if you are holding 400 shares of a stock, at the next point at which to add, add no more than 100 or 200 shares. That moves the average price of your holdings less than half of the distance moved, thus allowing you to sit through 50% corrections without touching your average price.
16. Think like a guerrilla warrior. We wish to fight on the side of the market that is winning, not wasting our time and capital on futile efforts to gain fame by buying the lows or selling the highs of some market movement. Our duty is to earn profits by fighting alongside the winning forces. If neither side is winning, then we don't need to fight at all.
17. Markets form their tops in violence; markets form their lows in quiet conditions. The final 10% of the time of a bull run will usually encompass 50% or more of the price movement. Thus, the first 50% of the price movement will take 90% of the time and will require the most backing and filling and will be far more difficult to trade than the last 50%.

There is no "genius" in these rules. They are common sense and nothing else, but as Voltaire said, "Common sense is uncommon." Trading is a common-sense business. When we trade contrary to common sense, we will lose. Perhaps not always, but enormously and eventually. Trade simply – avoid complex methodologies concerning obscure technical systems and trade according to the major trends only.