Principles of Trading Series:

Critical Trading Strategy Components – Part 2a

By Thomas Poh – 6 Apr 2020

We have covered the importance of selecting the correct product to express our market view in our 2 previous sessions (click here for link to Part 1a and Part 1b). Picking the wrong product is comparable to choosing the wrong tool for the task. The next component to be discussed is one that is VERY personal to the individual trader. It varies across traders and yet it seems to be the least discussed or mentioned when traders exchange their views or trading strategies. It is not an exaggeration to state that most traders do not even see this as a critical component of any trading strategy. This component is that of **"Time Horizon"**.

A trading strategy's time horizon defines the time perspective in which we start building our market view. It would also set the timing of which we would expect the various scenarios, which we have envisioned, to pan out. When we have a bullish view and thinks that the market is heading up, we must set a time perspective to that statement. Do we think it is going up within the day, which would make us a day trader? Or do we think it would go up within the next 3-5 years, which will make us a medium term investor? Without taking different time horizons into consideration while comparing trading strategies, will like comparing a day-trader with Warren Buffett. The latter is an investor with an ultra-long term view based on the fundamental valuations. A day-trader will be concerned about the returns for his trades before the market even closes. It is like comparing chalk with cheese.

Our trading time horizon sets the timing parameters in which we see how events should unfold according to on our analysis. For example, if we enter into a bullish trade on a particular stock due to an upcoming M&A announcement, that sets the time horizon for our long trade. Once that announcement has been made, regardless of the outcome, and when the market has digested and priced in that announcement, the very reason for us to initiate our trade is over. We should now exit the trade.

Hence the benefit of setting a time horizon to our trading strategy allows us to stay disciplined. Countless stories (and jokes) are out there where many of us kept trading positions longer than planned. This is especially common for money losing trades which had conveniently become "long-term" investments. Having a pre-set time stop, forces us to re-assess and re-justify why that position is worth keeping. **To-emphasize, when the market scenarios that we had initially planned out had already happened (or never happen), within the time frame, that we thought they might happen, the reason to keep that trade has gone.**

Besides keeping us disciplined, our trading strategy's time horizon will also directly affect how we look at the market and the tools that we use in our analysis. This will be covered in part 2b of Critical Trading Strategy Components – Time Horizon. Please stay tuned!

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