
Tips for Beginners

Preparing yourself before trading options

Len Yates

11/01/2004

Many people ask how they should prepare themselves to trade. That's a good sign. It's right that you should prepare yourself before jumping in. Here are some of the steps I consider important:

Read a book or two. Read Jack Schwager's Market Wizards. Read a good book about options. For a list of some of the best, see the bibliography at the end of this article. When you read about the experiences of seasoned traders, you benefit from their mistakes without having to pay for it by losing your own money. In short, you skip right past several years of the "school of hard knocks", and move quickly towards successful trading. (By the way, after you're an experienced trader, you should still read a book (about trading) once in a while!)

Attend a seminar. You can learn valuable information from instructors who have traded successfully for years. Just as importantly, you can meet some people who have workable methods, and swap valuable ideas with them.

Do some paper trading. Decide on a period of time in which you will restrict yourself to mock trades (no real money involved). After you decide on a period of time, double it. There is no reason to be in a hurry. There will always be more money-making opportunities tomorrow. Odds are you will be glad you weren't using real money during this training time!

Some doubt the value of paper trading. However, if handled properly, it can be good practice, and an excellent representation of how you would actually perform. You obviously have to be honest with yourself. A specific decision to trade must be accompanied by an immediate entry in the log. No entry – no trade! Once a trade is entered, you're stuck with it. No fair using the eraser! Enter the current date and time with every trade. As for price, to be conservative, you should enter the "asked" on purchases, the "bid" on sales.

One of the problems people have with paper trading is maintaining their motivation. Here's an idea: You might tell yourself that unless you achieve a certain profit objective during the trial period, you're not going to allow yourself to get started with real money. Instead, you're going to have to go around again and do another trial period. This creates an incentive to do well in the trial period.

Select and use good trading tools from the start. Get into the groove with good software and favorite Internet sites, so that you build confidence to make sound trading decisions – decisions based on discipline. This will enable you to make profits regularly, and be in the game for the long run.

A good record keeping system, for example, will make it easy to keep track of your paper trading, and get you into the habit of good record keeping. A good record keeping system should also provide you with the mechanism for another good habit to get into – setting an objective and a stop for every position you enter. The program should then be able to alert you when any of your positions hits its objective or stop, so you can take action.

When you start trading, start small. Trade in lots of just 2 – 4 contracts at first. Again, there is no reason to be in a hurry. We hear horror stories of beginners who get greedy and place large initial orders. After two or three mistakes, they're out of trading capital and out of the game!

If you will place just a small part of your capital at risk at any one time, in any one thing, you'll give yourself the space to make a few mistakes and still have the capital to continue trading and apply what you've learned. You'll also be able to survive a streak of just plain bad luck. The markets are fairly random, and your decision-making system, whatever it may be, can sometimes fail several times in a row. You have to be able to survive these streaks.

In conclusion, if you will approach the market as something you should prepare for, instead of rushing in willy nilly, you'll have much better success. Novice traders should seriously consider following these steps in order to become sound, consistent traders.

Here are some excellent materials on options:

The CBOE Prospectus from the Chicago Board Options Exchange

McMillan on Options by Lawrence McMillan

Trading Options the Delta Neutral Way by Paul Forchione

The Option Advantage by David Caplan

The Commodity Options Market by Kermit C. Zieg Jr.

Also, you may want to visit the [OptionVue Bookstore](#) for these and other selections of trading books and resources.