

## POSITIVE AND NEGATIVE EXPECTATION GAMES

By Tom D'Angelo

### SUBJECT SUMMARY

#### THE BUSINESS OF TRADING

Trading is a business. The trader deals in buy and sell contracts and has an inventory of shares that are the same as the 'stock' in a retail shop. His customers do not walk in the door. They are found throughout the country and are connected by a broker and an exchange which facilitates the sale of 'shares'. Every business has its profitable and less profitable sections. Trading is no different and our profits come from particular techniques and processes. Successful traders create a professional trading environment to manage their trading activities similar to a successful business.

Good software assists in this process. These articles explain how ManusRisco money management software is used to improve the business control and management of trading.

Failure to adopt a professional, disciplined businesslike approach towards speculation and investment will significantly decrease your chances of achieving long term profitability in today's volatile trading arena. These articles are designed to teach you how to create a professional trading environment so you can manage your trading activities similar to a successful business and make confident, disciplined trading decisions.

Over the next few weeks we will cover these topics:

- Introduction - How successful businesses are organised
- The Profit Centre business model applied to trading
- A professional, disciplined money management methodology
- **Positive and negative expectation games**
- Drawdown
- Return on Investment
- PTR / UTR
- Breakeven Analysis
- The edge: Who has it and how to get it.

In the previous three articles, we learned how to create a professional business structure designed to provide the information required to manage your trading similar to a successful business.

In this article, we will discuss positive and negative expectation games. A positive expectation game is simply a situation where you have the advantage and which will result in long term profitability if played using a disciplined money management methodology. A negative expectation game will result in the loss of all your trading capital in the long run. You may experience short periods of profit, but in the long run, you are guaranteed to go broke, regardless if you are gambling in Las Vegas or trading the Forex, stocks or futures.

The difference between Las Vegas casino games and trading, is that the casino advantage is "hard wired" into most of the games through unfavourable rules of payoffs, whereas the trader's advantage is constantly changing; a positive expectation situation may be becoming more positive or less positive, or a negative expectation situation may be becoming more negative or less negative.

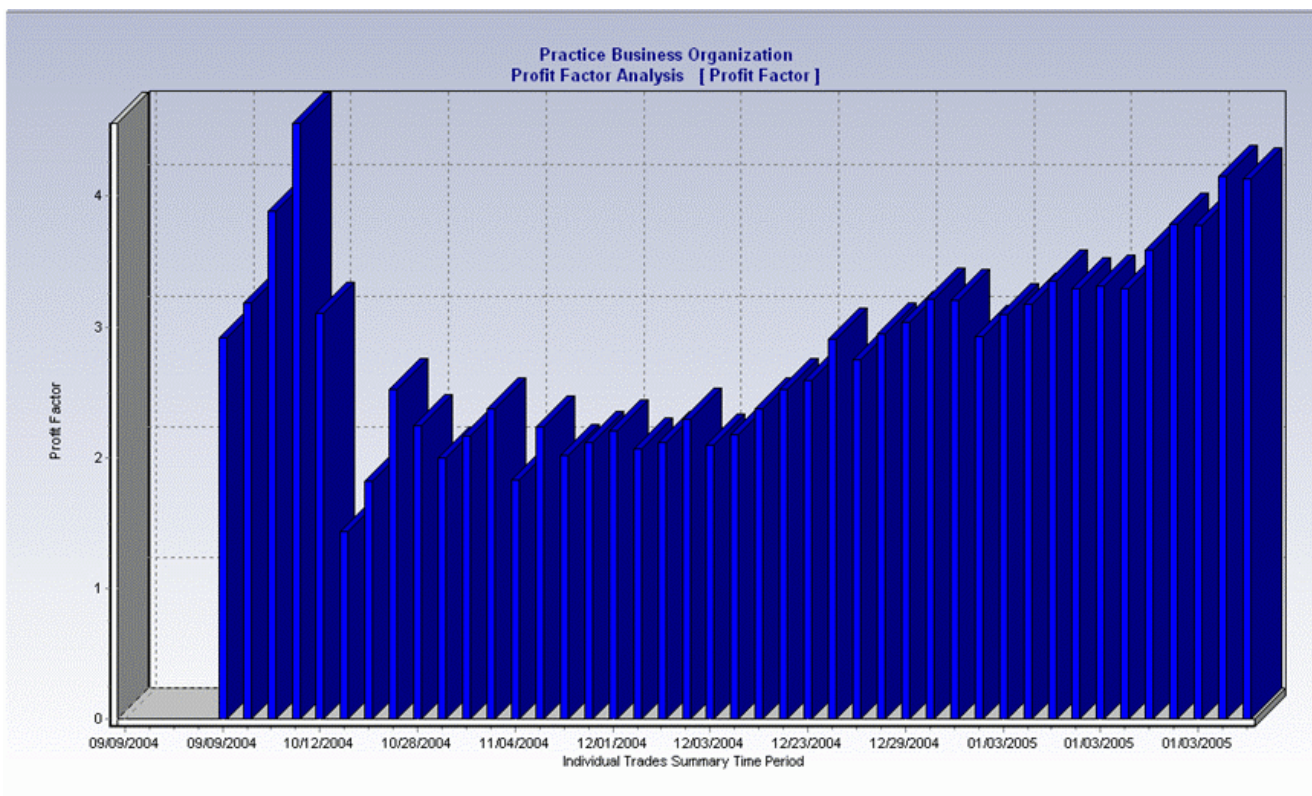
The previous three articles described the business structure required to organise your trading results and provide the information necessary to determine when, where and why you have the advantage, or if you are playing at a disadvantage. If you do not organise your trading using proven business models, you will never be able to determine if you are playing as the customer or the casino.

There are many methods to determine if you have the advantage and one of the most popular is the Profit Factor. The Profit Factor is calculated as:

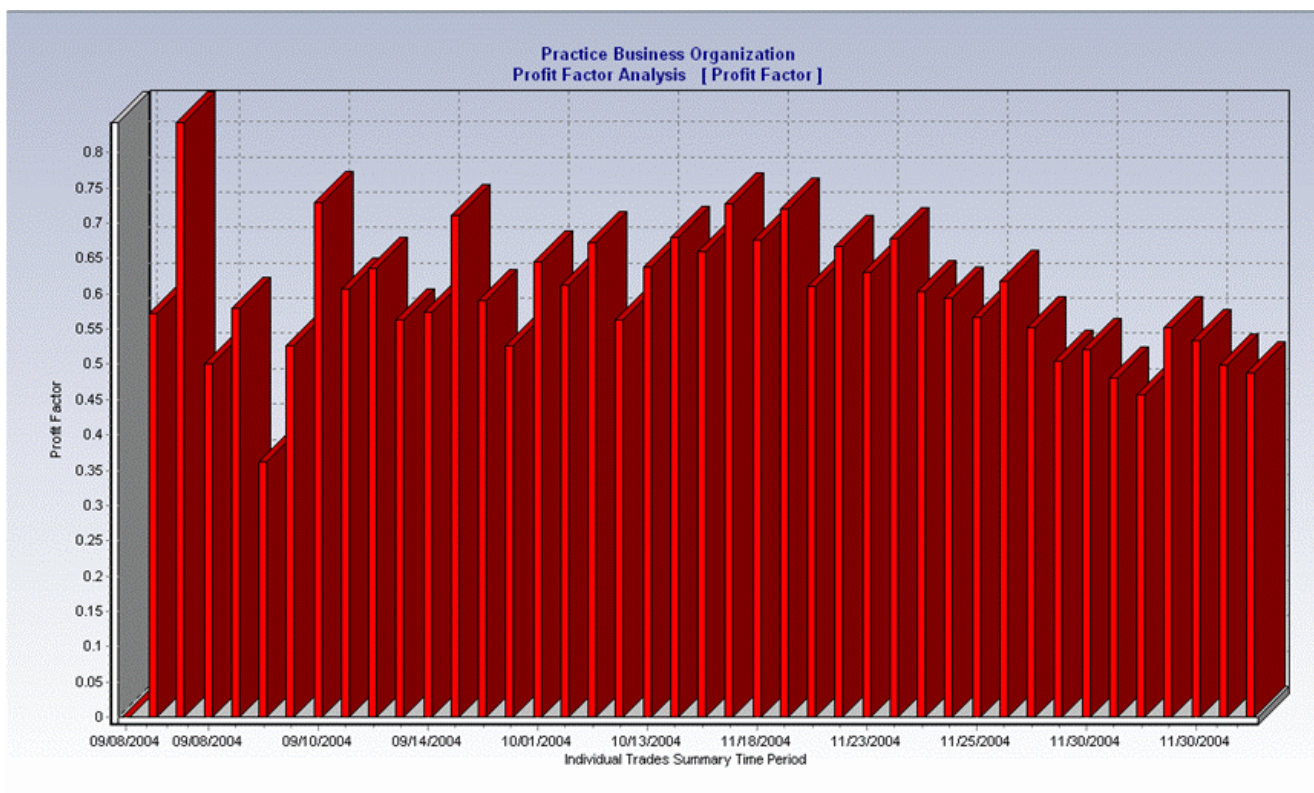
$$\frac{(\% \text{ Profitable Trades} \times \text{Average Unprofitable Trade})}{(\% \text{ Unprofitable Trades} \times \text{Average Unprofitable Trade})}$$

A Profit Factor greater than 1.00 indicates a profitable situation and a Profit Factor less than 1.00 indicates an unprofitable situation. If the trader adopts the business model described in previous articles, he can determine which Profit Centres are profitable and which are not. More importantly, a graph of the Profit Factor reveals the trend: Are you becoming more or less profitable, or are you becoming more or less unprofitable? Are you playing as the customer or the casino? Where are your trading strengths which should be capitalised on, and where are your trading weaknesses which should be eliminated?

The first image displays a graph of the Profit Factor statistic which is greater than 1.0 and increasing. This is a positive expectation game which is becoming more positive. This is the type of game you should be playing.



The second image displays a graph of the Profit Factor which is below 1.0 and decreasing. If you continue to play this game, you will definitely go broke.



A report which calculates all the statistics which comprise the Profit Factor statistic can be seen below.

Practice		Individual Trades Profit Factor Analysis												
ALL Trade Dates														
Trade Date	Symbol	Pos	# Traded	\$ P/L	% Prof	% Change	% Unprof	% Change	Avg Prof Trade	% Change	Avg Unprof Trade	% Change	Profit Factor	% Change
09/08/2004	ES	Buy	2	(\$ 318)	0 %		100 %				(\$318)		0.00	
09/08/2004	ES	Buy	2	\$ 182	50 %		50 %	(50 %)	\$182		(\$318)		0.57	
09/08/2004	ES	Buy	2	\$ 82	67 %	34 %	33 %	(34 %)	\$132	(27 %)	(\$318)		0.84	47 %
09/08/2004	ES	Sell	1	(\$ 209)	50 %	(25 %)	50 %	52 %	\$132		(\$264)	(17 %)	0.50	(41 %)
09/08/2004	ES	Buy	1	\$ 41	60 %	20 %	40 %	(20 %)	\$102	(23 %)	(\$264)		0.58	16 %
09/08/2004	ES	Buy	2	(\$ 318)	50 %	(17 %)	50 %	25 %	\$102		(\$282)	7 %	0.36	(38 %)
09/08/2004	ES	Buy	1	\$ 141	57 %	14 %	43 %	(14 %)	\$112	10 %	(\$282)		0.53	46 %
09/08/2004	ES	Buy	1	\$ 191	62 %	9 %	38 %	(12 %)	\$127	13 %	(\$282)		0.73	40 %
09/08/2004	ES	Buy	1	(\$ 209)	56 %	(10 %)	44 %	16 %	\$127		(\$264)	(6 %)	0.61	(17 %)
09/08/2004	ES	Buy	1	\$ 91	60 %	7 %	40 %	(9 %)	\$121	(5 %)	(\$264)		0.69	12 %
09/08/2004	ES	Sell	1	(\$ 209)	55 %	(8 %)	45 %	12 %	\$121		(\$253)	(4 %)	0.58	(15 %)
09/08/2004	ES	Buy	3	(\$ 252)	50 %	(9 %)	50 %	11 %	\$121		(\$252)		0.48	(18 %)
09/08/2004	ES	Buy	1	\$ 91	54 %	8 %	46 %	(8 %)	\$117	(3 %)	(\$252)		0.55	14 %
09/08/2004	ES	Buy	1	\$ 91	57 %	6 %	43 %	(7 %)	\$114	(3 %)	(\$252)		0.60	10 %
09/08/2004	ES	Sell	2	\$ 182	60 %	5 %	40 %	(7 %)	\$121	6 %	(\$252)		0.72	20 %
09/08/2004	ES	Buy	1	(\$ 109)	56 %	(7 %)	44 %	10 %	\$121		(\$232)	(8 %)	0.66	(8 %)
09/09/2004	ES	Buy	1	\$ 141	59 %	5 %	41 %	(7 %)	\$123	2 %	(\$232)		0.76	15 %
09/09/2004	ES	Buy	2	\$ 382	61 %	3 %	39 %	(5 %)	\$147	20 %	(\$232)		0.99	30 %
09/09/2004	ES	Sell	1	\$ 141	63 %	3 %	37 %	(5 %)	\$146	(1 %)	(\$232)		1.07	8 %
09/09/2004	ES	Buy	1	\$ 91	65 %	3 %	35 %	(5 %)	\$142	(3 %)	(\$232)		1.14	6 %
09/09/2004	ES	Buy	1	(\$ 259)	62 %	(5 %)	38 %	9 %	\$142		(\$235)	1 %	0.99	(13 %)
09/10/2004	ES	Buy	1	\$ 91	64 %	3 %	36 %	(5 %)	\$138	(3 %)	(\$235)		1.04	6 %
09/10/2004	ES	Buy	1	\$ 191	65 %	2 %	35 %	(3 %)	\$142	3 %	(\$235)		1.12	7 %
09/10/2004	ES	Buy	1	\$ 66	67 %	3 %	33 %	(6 %)	\$137	(4 %)	(\$235)		1.18	5 %
09/10/2004	ES	Buy	1	\$ 141	68 %	1 %	32 %	(3 %)	\$137		(\$235)		1.24	5 %

Only the information provided by a suitably designed business structure can provide the answers. If you trade in a haphazard non-businesslike environment, do you think you can intelligently and profitably manage your trading business? Do you think the lack of a professional business approach to trading is the primary reason for the tremendously high failure rate of individuals who decide to play the trading game?

A properly designed business structure is the foundation for producing the Analysis Reports that management (that is, you) requires to make the critical operating (trading) decisions necessary to successfully compete in the marketplace.

One of the most important Analysis Reports which can be produced from our business structure is the Drawdown report. Every trader should have a complete drawdown history at his fingertips at the beginning of each trading day. And what should the Drawdown report contain? Well, that's the subject of our next article.

Tom D'Angelo is the CEO of ManusRisco Inc. The money management methodology described in these articles is used by ManusRisco money management software which can be found at [www.manusrisco.com](http://www.manusrisco.com). This software adds an important business dimension to the business of share trading.

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