

# Paper Trading and the Transition to Real Money Trading

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Paper trading is widely discussed regarding its merits, and whether it is of value to a trader as they try to make the transition to real money trader. One viewpoint is that since paper trading is not real, the profits are meaningless, and are no indication of real money profitability. An opposite viewpoint would state that paper trading is an important step in the trader's learning progression, and regardless of whether it is real, if the trader cannot 'properly' paper trade, then they will not be able to real money trade.

I began trading in early 1995, with the intentions of becoming an options trader; my first trading education was through an oex options teaching service. Besides options training, the service included 'tape' reading, trade management AND sp500 index futures trading – also included in the service was the prevalent attitude that paper trading was for 'sissies'.

So I was a new trader, trying to learn and understand completely new concepts and ideas - what was called a trading method AND I was 'practicing' with real money – because paper trading was for 'sissies'. What did I accomplish, besides a big draw down in my account? I quickly introduced to trading psychology and the related implications – something else I also knew nothing about. Losing money and a trading psychology 'wreck', both from the losses and thoughts like I was too 'stupid' to ever learn how to trade, became a combination which took me out of futures trading, and then unfortunately carried over into my options trading which I had previously been doing well with. I just couldn't take it any more – I had to somehow start all over, or just quit for good.

## Paper Trading Viewpoints

Consider: simulator fill prices are not real and won't be attainable with real money. Even if this is correct, is it really an issue unless the trader intends to be a scalper, trading for very small profits, and thus each tick is critical? Granted, but shouldn't a beginning trader be very selective, focusing on learning their method and the 'best' setups that method provides? This would be my viewpoint, and in this capacity paper trading fill prices are not an issue.

Consider: the trades are being done with no risk. No, there isn't any financial risk in paper trading, but I actually haven't met nearly as many profitable paper traders as one might expect. Why would this be the case if being able to trade without risk was such an easy thing to do? As well, what about self-esteem risk, and an attitude like - how can I be so bad that I can't even paper trade? The risk feelings like these are probably greater than that of financial risk, and if they are going to surface, you would want to encounter them before trading real money. As well, even if the issue was only one of financial risk – wouldn't you want to begin with the confidence of knowing that you were paper trading profitable? It would be hard to imagine a losing paper trading being able to profitably trade real money.

Consider: there is no emotion involved with paper trading. I was in our chat room watching a paper trader post their trades in order for me to give them feedback, and I noticed that one of their specific plan setups wasn't done. When I asked why, the trader told me that

they were ahead for the day and didn't want to risk those profits. But the profits aren't real – how can you not take a 'base' method setup when paper trading – isn't that the point? Would you be in agreement, that if paper trading profits could be viewed in this fashion, that it has the ability to become very real and thus emotional to the trader? I would suggest that this is related to paper trading really not being 'so easy', and as mentioned above, self-esteem risk can be very emotional.

Besides examples like this, emotions can be added to the paper trading process. Throw away your simulator, and then go into a chat room and post all of your trades – no 'youknowwhating' around where you wait to see if the trade was profitable before you post it, like a number of traders that I have seen. What's the point, and when you consider the underlying implications of 'needing' to do this – the issue certainly isn't about whether paper trading is of value or not, but certainly best to find out before trading real money. You must post immediately and without lag, giving your direction and entry price, along with subsequent posts of any partial profits, and of course your exit, which ultimately is the determinant of whether the trade was profitable. There is no need to make any comments, or answer any questions regarding your trades – simply post the particulars as fast and real time as possible AND see if you feel any emotions doing this in front of the rest of the room while you go through a series of losses. Do you want to add even more emotions? Go through the same posting process, but do so where the rest of the room actually knows the method that you are trading, and what the trades 'should' be. You will quickly find out just how emotional paper trading can be – actually a very valuable exercise for the paper trader to do.

### **Paper Trading And Making It Further Beneficial**

I have two predominant problems with paper trading, but this is with the trader's approach, and not with paper trading by definition: (1) the trader does 'things' paper trading that they would-could not do with real money (2) the trader views paper trading profitability, instead of paper trading proficiency, as the guideline of whether they are ready to begin trading real money.

I have seen too many paper traders, continuously and knowingly, over trade 'non-plan' trades, with trading size that is greater than they could afford the margin for in a real account – let alone accept the risk of loss, while also holding trades for risk amounts that they would not accept with real money. Viewing paper trading as a 'step' in the learning progression and transition to real money trading, it is critical that the paper trader only trades exactly what, and how they would trade with real money. Don't allow yourself to turn paper trading into a game, supposedly because there is no risk – the risk of making bad habits that you can't correct is tremendous, and will circumvent any attempt to trade real money. This is the time to learn YOUR basic trading setups, and make necessary adjustments to them and your entry-exit timing, in order to then make money trading them – this is NOT the time to turn your simulator into a pinball machine flipping at any ball that comes near you.

There is a problem with focusing on trading profitability -vs- trading proficiency. To begin with, profitability places the focus on money instead of on plan. And what is profitability – if

you take 10 trades and make \$75 are you profitable? Technically, if you are net ahead you are profitable, but what if those same 10 trades had a potential of \$1,500, and you only made \$75 – are you really profitable? This is what I am referring to when I think of trading proficiency. Instead of focusing on the common metrics, such as win:loss or win size:loss size ratios, I am most concerned with the win size:potential win size ratio, and want to maximize this percentage to the extent that is possible.

For instance, when a trader asks about adding trading size, taking the attitude that if they can make \$100 trading 3 contracts, then they can make \$1,000 by trading 30 contracts, the first thing I ask them is what is their proficiency ratio – why increase contract size and the corresponding trading risk, if you ‘should’ be able to make more money from smaller size? This is especially important for the paper trader, where they should not regard simple profitability as an indication of readiness to trade real money, but consider proficiency – for instance, begin trading real money when you are 60-70 percent proficient with your paper trades.

### **So What Is Your Viewpoint Regarding Paper Trading?**

I never thought that I would ever make a dime trading, let alone be able to trade for a living or become involved with trying to teach others to trade – was this simply a function of starting over and paper trading? Granted that is too simplistic, however, I do know that it would have certainly changed the beginnings that I had, while very much shortening my learning curve, and reducing a lot of pain.

Clearly, I am on the ‘side’ that believes that paper trading is not only beneficial, but that paper trading is also necessary – however the value received will be dependant upon the trader’s approach and attitude. Needless to say, paper trading as described is something that I have always strongly recommended.