TRADE PSYCHOLOGY OF A TRADER AND INVESTOR

The Essence of Psychology in Trading and Investing

Psychology in trading and investing revolves around understanding and managing emotions, biases, and decision-making processes that influence financial decisions. The financial markets are driven not just by technical and fundamental factors but also by human behavior, collective sentiment, and psychological patterns. Traders and investors who master their psychology gain a significant edge by making rational, disciplined, and strategic decisions rather than being swayed by emotions like fear, greed, anger, revenge, hope, or overconfidence.

How Trading Psychology Provides an Edge

1. Emotional Awareness and Discipline

Successful market participants control fear and greed, allowing them to follow a well-defined strategy without reacting impulsively to short-term market movements. This prevents panic selling or FOMO-driven (fear of missing out) buying, over-risks, and self-sabotage.

2. Consistency Over Time

The ability to stick to a strategy and execute trades based on a proven system, rather than gut feelings, ensures long-term success. Consistency in execution increases the probability of making profits.

3. Risk Management

It is vital to understand your risk profile as a trader and investor. Understanding psychological biases like loss aversion helps traders set realistic risk-reward ratios and adhere to stop-loss levels, preventing unbearable losses.

4. Mastering Market Sentiment

Recognizing when markets are in a state of euphoria or panic helps traders take contrarian positions: buying when others are fearful and selling when greed is palpable in the financial markets.

5. Cognitive Bias Awareness

Market participants who understand biases like confirmation bias, recency bias, and anchoring make objective, data-driven decisions rather than emotionally or recklessly-driven ones.

6. Patience and Timing

Psychology helps traders and investors wait for high-probability setups rather than forcing trades to satisfy short-term gratification. This reduces overtrading and improves the profitability of winning trades.

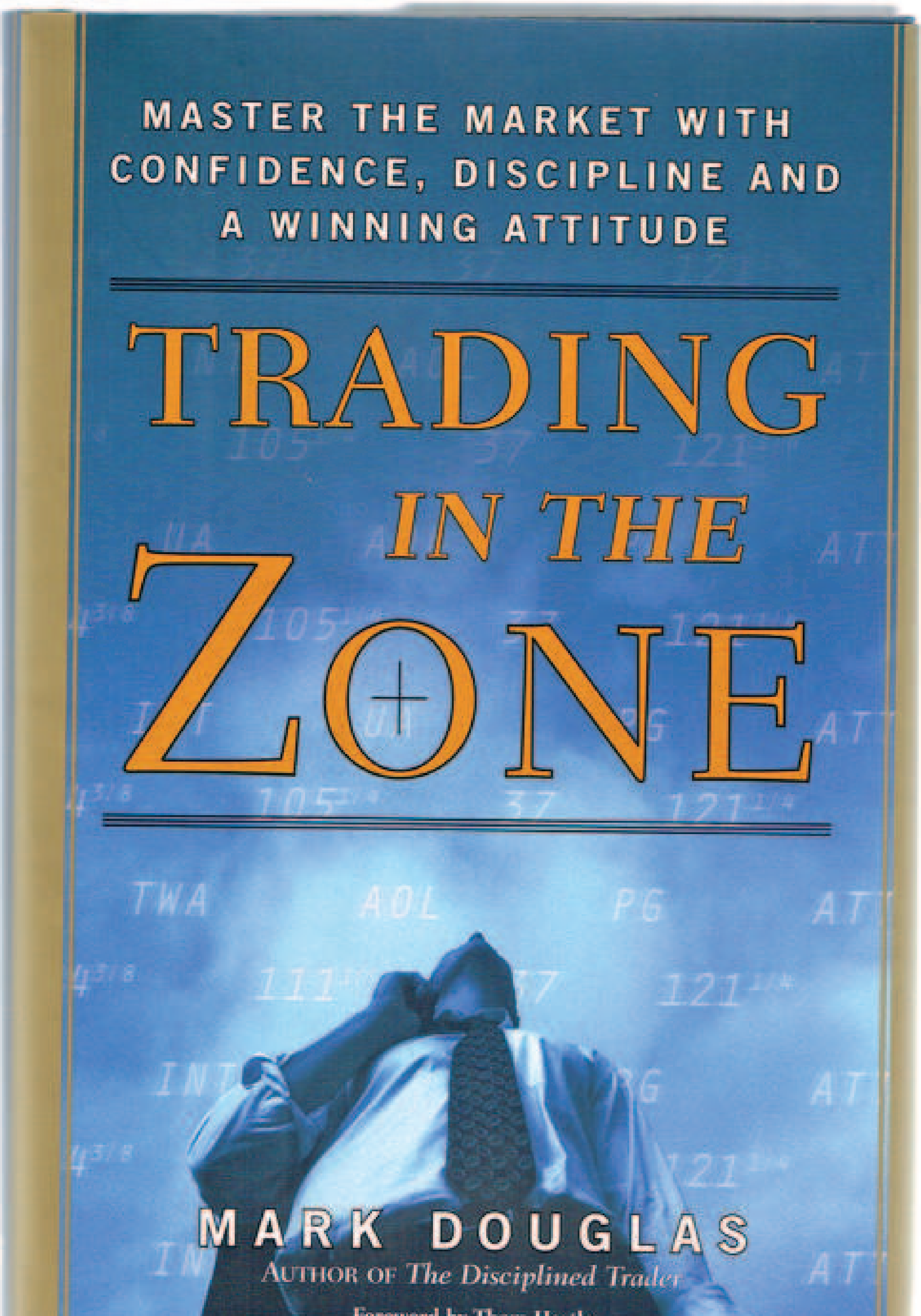
7. Mental Resilience

Markets are uncertain and probabilistic, and losses are unavoidable. Psychological strength allows traders to stay focused and recover from losses without swaying from their strategy or engaging in revenge trading.

Conclusion

Mastering trading psychology is as important as understanding technical and fundamental analysis. The edge comes from emotional discipline, self-awareness, and the ability to think independently, allowing traders and investors to act rationally in an environment driven by irrational human behavior. It is a market of human participants who make decisions at any time about price movements, and we are all emotional beings. Those who develop strong psychological control navigate volatility better, control risk, capitalize on opportunities, and achieve consistent profitability over time.

Hence, we have put together a collection of phenomenal books (in PDF format) on this essential part of trading. We strongly advise you to study them thoroughly and apply the knowledge gained in your trading and investing career for success.


MASTER THE MARKET WITH CONFIDENCE, DISCIPLINE AND A WINNING ATTITUDE
TRADING IN THE ZONE
MARK DOUGLAS
AUTHOR OF The Disciplined Trader
Foreword by Thom Hartle

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DEDICATION

This book is dedicated to all of the traders I have had the pleasure of working with over the last 18 years as a trading coach. Each of you in your own unique way is a part of the insight and guidance this book will provide to those who choose to trade from a confident, disciplined, and consistent state of mind.

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FOREWORD

The great bull market in stocks has led to an equally great bull market in the number of books published on the subject of how to make money *trading* the markets. Many ideas abound, some good, some not, some original, some just a repackaging of earlier works. Occasionally, though, a writer comes forward with something that really sets him or her apart from the pack, something special. One such writer is Mark Douglas. Mark Douglas, in *Trading in the Zone,* has written a book that is the accumulation of years of thought and research—the work of a lifetime—and for those of us who view trading as a profession, he has produced a gem.

Trading in the Zone is an in-depth look at the challenges that we face when we take up the challenge of trading. To the novice, the only challenge appears to be to find a way to make money. Once the novice learns that tips, brokers' advice, and other ways to justify buying or selling do not work consistently, he discovers that he either needs to develop a reliable trading strategy or purchase one. After that, trading *should* be easy, right? All you have to do is follow the rules, and the money will fall into your lap.

At this point, if not before, novices discover that trading can turn into one of the most frustrating experiences they will ever face.

This experience leads to the oft-started statistic that 95 percent of futures traders lose all of their money within the first year of trading. Stock traders generally experience the same results, which is why pundits always point to the fact that most stock traders fail to outperform a simple buy and hold investment scenario.

So, why do people, the majority of whom are extremely successful in other occupations, fail so miserably as traders? Are successful traders born and not made? Mark Douglas says no. What's necessary, he says, is that the individual acquire the trader's mindset. It sounds easy, but the fact is, this mindset is very foreign when compared with the way our life experiences teach us to think about the world.

That 95-percent failure rate makes sense when you consider how most of us experience life, using skills learned as we grow. When it comes to trading, however, it turns out that the skills we learn to earn high marks in school, advance our careers, and create relationships with other people, the skills we are taught that should carry us through life, turn out to be inappropriate for trading. Traders, we find out, must learn to think in terms of probabilities and to surrender all of the skills we have acquired to achieve in virtually every other aspect of our lives. In *Trading in the Zone,* Mark Douglas teaches us how. He has put together a very valuable book. His sources are his own personal experiences as a trader, a traders coach in Chicago, author, and lecturer in his field of trading psychology.

PREFACE

The goal of any trader is to turn profits on a regular basis, yet so few people ever really make consistent money as traders. What accounts for the small percentage of traders who are consistently successful? To me, the determining factor is psychological—the consistent winners think differently from everyone else.I started trading in 1978. At the time, I was managing a commercial casualty insurance agency in the suburbs of Detroit, Michigan. I had a very successful career and thought I could easily transfer that success into trading. Unfortunately, I found that was not the case.

By 1981, I was thoroughly disgusted with my inability to trade effectively while holding another job, so I moved to Chicago and got a job as a broker with Merrill Lynch at the Chicago Board of Trade. How did I do? Well, within nine months of moving to Chicago, I had lost nearly everything I owned. My losses were the result of both my trading activities and my exorbitant life style, which demanded that I make a lot of money as a trader. From these early experiences as a trader, I learned an enormous amount about myself, and about the role of psychology in trading. As a result, in 1982, I started working on my first book, *The Disciplined Trader: Developing Winning Attitudes.*

When I began this project I had no concept of how difficult it was to write a book or explain something that I understood for myself in a manner and form that would be useful to other people. I thought it was going to take me between six and nine months to get the job done. It took seven and a half years and was finally published by Prentice Hall in 1990. In 1983, I left Merrill Lynch to start a consulting firm, Trading Behavior Dynamics, where I presently develop and conduct seminars on trading psychology and act in the capacity of what is commonly referred to as a trading coach. I've done countless presentations for trading companies, clearing firms, brokerage houses, banks, and investment conferences all over the world.

I've worked at a personal level, one on one, with virtually every type of trader in the business, including some of the biggest floor traders, hedgers, option specialists, and CTAs, as well as neophytes As of this writing, I have spent the last seventeen years dissecting the psychological dynamics behind trading so that I could develop effective methods for teaching the proper principles of success.

What I've discovered is that, at the most fundamental level, there is a problem with the way we think. There is something inherent in the way our minds work that doesn't fit very well with the characteristics shown by the markets. Those traders who have confidence in their own trades, who trust themselves to do what needs to be done without hesitation, are the ones who become successful. They no longer fear the erratic behavior of the market. They learn to focus on the information that helps them spot opportunities to make a profit, rather than focusing on the information that reinforces their fears. While this may sound complicated, it all boils down to learning to believe that: (1) you don't need to know what's going to happen next to make money; (2) anything can happen; and (3) every moment is unique, meaning every edge and outcome is truly a unique experience. The trade either works or it doesn't. In any case, you wait for the next edge to appear and go through the process again and again. With this approach you will learn in a methodical, non-random fashion what works and what doesn't. And, just as important, you will build a sense of self-trust so that you won't damage yourself in an environment that has the unlimited qualities the markets have.

Most traders don't believe that their trading problems are the result of the way they think about trading or, more specifically, how they are thinking while they are trading. In my first book, *The Disciplined Trader*, I identified the problems confronting the trader from a mental perspective and then built a philosophical framework for understanding the nature of these problems and why they exist.

I had five major objectives in mind in writing *Trading in the Zone:*

To prove to the trader that more or better market analysis is not the solution to his trading difficulties or lack of consistent results.

To convince the trader that it's his attitude and "state of mind" that determine his results.

To provide the trader with the specific beliefs and attitudes that are necessary to build a winner's mindset, which means learning how to think in probabilities.

To address the many conflicts, contradictions, and paradoxes in thinking that cause the typical trader to assume that he already does think in probabilities, when he really doesn't.

To take the trader through a process that integrates this thinking strategy into his mental system at a functional level.

(Note: Until recently, most traders were men, but I recognize that more and more women are joining the ranks. In an effort to avoid confusion and awkward phrasing, I have consistently used the pronoun "he" throughout this book in describing traders. This certainly does not reflect any bias on my part.)

Trading in the Zone presents a serious psychological approach to becoming a consistent winner in your trading. I do not offer a trading system; I am more interested in showing you how to think in the way necessary to become a profitable trader. I assume that you already have your own system, your own edge. You must learn to trust your edge. The edge means there is a higher probability of one outcome than another. The greater your confidence, the easier it will be to execute your trades. This book is

designed to give you the insight and understanding you need about yourself and the nature of trading, so that actually doing it becomes as easy, simple, and stressfree as when you're just watching the market and thinking about doing it.
In order to determine how well you "think like a trader," take the following Attitude Survey. There are no right or wrong answers.
Your answers are an indication of how consistent your current mental framework is with the way you need to think in order to get the most out of your trading.

ATTITUDE SURVEY

1. To make money as a trader you have to know what the market is going to do next.
Agree Disagree

2. Sometimes I find myself thinking that there must be a way to trade without having to take a loss.
Agree Disagree

3. Making money as a trader is primarily a function of analysis.
Agree Disagree

4. Losses are an unavoidable component of trading.
Agree Disagree

5. My risk is always defined before I enter a trade.
Agree Disagree

6. In my mind there is always a cost associated with finding out what the market may do next.
Agree Disagree

7. I wouldn't even bother putting on the next trade if I wasn't sure that it was going to be a winner.
Agree Disagree

8. The more a trader learns about the markets and how they behave, the easier it will be for him to execute his trades.
Agree Disagree

9. My methodology tells me exactly under what market conditions to either enter or exit a trade.
Agree Disagree

10. Even when I have a clear signal to reverse my position, I find it extremely difficult to do.
Agree Disagree

11. I have sustained periods of consistent success usually followed by some fairly drastic draw-downs in my equity.
Agree Disagree

12. When I first started trading I would describe my trading methodology as haphazard, meaning some success in between a lot of pain.
Agree Disagree

13. I often find myself feeling that the markets are against me personally.
Agree Disagree

14. As much as I might try to "let go," I find it very difficult to put past emotional wounds behind me.
Agree Disagree

15. I have a money management philosophy that is founded in the principle of always taking some money out of the market when the market makes it available.
Agree Disagree

16. A trader's job is to identify patterns in the markets' behavior that represent an opportunity and then to determine the risk of finding out if these patterns will play themselves out as they have in the past.
Agree Disagree

17. Sometimes I just can't help feeling that I am a victim of the market.
Agree Disagree

18. When I trade I usually try to stay focused in one time frame.
Agree Disagree

19. Trading successfully requires a degree of mental flexibility far beyond the scope of most people.

Agree Disagree

20. There are times when I can definitely feel the flow of the market; however, I often have difficulty acting on these feelings.
Agree Disagree

21. There are many times when I am in a profitable trade and I know the move is basically over, but I still won't take my profits.
Agree Disagree

22. No matter how much money I make in a trade, I am rarely ever satisfied and feel that I could have made more.
Agree Disagree

23. When I put on a trade, I feel I have a positive attitude. I anticipate all of the money I could make from the trade in a positive way.
Agree Disagree

24. The most important component in a trader's ability to accumulate money over time is having a belief in his own consistency.
Agree Disagree

25. If you were granted a wish to be able to instantaneously acquire one trading skill, what skill would you choose?

26. I often spend sleepless nights worrying about the market.
Agree Disagree

27. Do you ever feel compelled to make a trade because you are afraid that you might miss out?
Yes No

28. Although it doesn't happen veiy often, I really like my trades to be perfect. When I make a perfect call it feels so good that it makes up for all of the times that I don't.
Agree Disagree

29. Do you ever find yourself planning trades you never execute, and executing trades you never

planned?
Yes No

30. In a few sentences explain why most traders either don't make money or aren't able to keep what they make.

Set aside your answers as you read through this book. Afte you've finished the last chapter ("Thinking Like a Trader"), take the Attitude Survey again—it s reprinted at the back of the book. You may be surprised to see how much your answers differ from the first time.

ACKNOWLEDGMENTS

I would especially like to thank all of the traders who bought the signed limited edition manuscript of the first seven chapters of this book. Your feedback gave me the inspiration to add the additional four chapters.
Next, I would like to thank fellow traders Robert St. John, Greg Bieber, Larry Pesavento, and Ted Hearne for their friendship and the special ways in which each of them contributed to the development of this book.
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CHAPTER 1

THE ROAD TO SUCCESS: FUNDAMENTAL, TECHNICAL, OR MENTAL ANALYSIS?

IN THE BEGINNING: FUNDAMENTAL ANALYSIS

Who remembers when fundamental analysis was considered the only real or proper way to make trading decisions? When I started trading in 1978, technical analysis was used by only a handful of traders, who were considered by the rest of the market community to be, at the very least, crazy. As difficult as it is to believe now, it wasn't very long ago when Wall Street and most of the major funds and financial institutions thought that technical analysis was some form of mystical hocus-pocus.

Now, of course, just the opposite is true. Almost all experienced traders use some form of technical analysis to help them formulate their trading strategies. Except for some small, isolated pockets in the academic community, the "purely" fundamental analyst is virtually extinct. What caused this dramatic shift in perspective? I'm sure it's no surprise to anyone that the answer to this question is very simple: Money! The problem with making trading decisions from a strictly fundamental perspective is the inherent difficulty of making money consistently using this approach.

For those of you who may not be familiar with fundamental analysis, let me explain. Fundamental analysis attempts to take into consideration all the variables that could affect the relative balance or imbalance between the supply of and the possible demand for any particular stock, commodity, or financial instrument. Using primarily mathematical models that weigh the significance of a variety of factors (interest rates, balance sheets, weather patterns, and numerous others), the analyst projects what the price should be at some point in the future.

The problem with these models is that they rarely, if ever, factor in other traders as variables. People, expressing their beliefs and expectations about the future, make prices move—not models. The fact that a model makes a logical and reasonable projection based on all the relevant variables is not of much value if the traders who are responsible for most of the trading volume are not aware of the model or don't believe in it.

As a matter of fact, many traders, especially those on the floors of the futures exchanges who have the ability to move prices very dramatically in one direction or the other, usually don't have the slightest concept of the fundamental supply and demand factors that are supposed to affect prices. Furthermore, at any given moment, much of their trading activity is prompted by a response to emotional factors that are completely outside the parameters of the fundamental model. In other words, the people who trade (and consequently move prices) don't always act in a rational manner.

Ultimately, the fundamental analyst could find that a prediction about where prices should be at some point in the future is correct. But in the meantime, price movement could be so volatile that it would be very difficult, if not impossible, to stay in a trade in order to realize the objective.

THE SHIFT TO TECHNICAL ANALYSIS

Technical analysis has been around for as long as there have been organized markets in the form of exchanges. But the trading community didn't accept technical analysis as a viable tool for making money until the late 1970s or early 1980s. Here's what the technical analyst knew that it took the mainstream market community generations to catch on to.

A finite number of traders participate in the markets on any given day, week, or month. Many of these traders do the same lands of things over and over in their attempt to make money. In other words, individuals develop behavior patterns, and a group of individuals, interacting with one another on a consistent basis, form collective behavior patterns. These behavior patterns are observable and quantifiable, and they repeat themselves with statistical reliability. Technical analysis is a method that organizes this collective behavior into identifiable patterns that can give a clear indication of when there is a greater probability of one thing happening over another. In a sense, technical analysis allows you to get into the mind of the market to anticipate what's likely to happen next, based on the kind of patterns the market generated at some previous moment.

As a method for projecting future price movement, technical analysis has turned out to be far superior to a purely fundamental approach. It keeps the trader focused on what the market is doing *now* in relation to what it has done in the past, instead of focusing on what the market should be doing based solely on what is logical and reasonable as determined by a mathematical model. On the other hand, fundamental analysis creates what I call a "reality gap" between "what should be" and "what is." The reality gap makes it extremely difficult to make anything but very long-term predictions that can be difficult to exploit, even if they are correct.

In contrast, technical analysis not only closes this reality gap, but also makes available to the trader a virtually unlimited number of possibilities to take advantage of. The technical approach opens up many more possibilities because it identifies how the same repeatable behavior patterns occur in every time frame—moment-tomoment, daily, weekly, yearly, and every time span in between. In other words, technical analysis turns the market into an endless stream of opportunities to enrich oneself.

THE SHIFT TO MENTAL ANALYSIS

If technical analysis works so well, why would more and more of the trading community shift their focus from technical analysis of the market to mental analysis of themselves, meaning their own individual trading psychology? To answer this question, you probably don't have to do anything more than ask yourself why you bought this book. The most likely reason is that you're dissatisfied with the difference between what you perceive as the unlimited potential to make money and what you end up with on the bottom line. That's the problem with technical analysis, if you want to call it a problem. Once you learn to identify patterns and read the market, you find there are limitless opportunities to make money. But, as I'm sure you already know, there can also be a huge gap between what you understand about the markets, and your ability to transform that knowledge into consistent profits or a steadily rising equity curve.

Think about the number of times you've looked at a price chart and said to yourself, "Hmmm, it looks like the market is going up (or down, as the case may be)," and what you thought was going to happen actually happened. But you did nothing except watch the market move while you anguished over all the money you could have made.

There's a big difference between predicting that something will happen in the market (and thinking about all the money you could have made) and the reality of actually getting into and out of trades. I call this difference, and others like it, a "psychological gap" that can make trading one of the most difficult endeavors you could choose to undertake and certainly one of the most mysterious to master.

The big question is: Can trading be mastered? Is it possible to experience trading with the same ease and simplicity implied when you are only watching the market and thinking about success, as opposed to actually having to put on and take off trades? Not only is the answer an unequivocal "yes," but that's also exactly what this book is designed to give you—the insight and understanding you need about yourself and about the nature of trading. So the result is that actually doing it becomes as easy, simple, and stress-free as when you are just watching the market and thinking about doing it.

This may seem like a tall order, and to some of you it may even seem impossible. But it's not. There are people who have mastered the art of trading, who have closed the gap between the possibilities available and their bottom-line performance. But as you might expect, these winners are relatively few in number compared with the number of traders who experience varying degrees of frustration, all the way to extreme exasperation, wondering why they can't create the consistent success they so desperately desire.

In fact, the differences between these two groups of traders (the consistent winners and everyone else) are analogous to the differences between the Earth and the moon. The Earth and moon are both celestial bodies that exist in the same solar system, so they do have something in common. But they are as different in nature and characteristics as night and day. By the same token, anyone who puts on a trade can claim to be a trader, but when you compare the characteristics of the handful of consistent winners with the characteristics of most other traders, you'll find they're also as different as night and day.

If going to the moon represents consistent success as a trader, we can say that getting to the moon is possible. The journey is extremely difficult and only a handful of people have made it. From our perspective here on Earth, the moon is usually visible every night and it seems so close that we could just reach out and touch it.

Trading successfully feels the same way. On any given day, week, or month, the markets make available vast amounts of money to anyone who has the capacity to put on a trade. Since the markets are in constant motion, this money is also constantly flowing, which makes the possibilities for success greatly magnified and seemingly within your grasp. I use the word "seemingly" to make an important distinction between the two groups of traders. For those who have learned how to be consistent, or have broken through what I call the "threshold of consistency,"the money is not only within their grasp; they can virtually take it at will. I'm sure that some will find this statement shocking or difficult to believe, but it is true. There are some limitations, but for the most part, money flows into the accounts of these traders with such ease and effortlessness that it literally boggles most people's minds.

However, for the traders who have not evolved into this select group, the word "seemingly" means exactly what it implies. It seems as if the consistency or ultimate success they desire is "at hand," or "within their grasp," just before it slips away or evaporates before their eyes, time and time again. The only thing about trading that is consistent with this group is emotional pain. Yes, they certainly have moments of elation, but it is not an exaggeration to say that most of the time they are in a state of fear, anger, frustration, anxiety, disappointment, betrayal, and regret. So what separates these two groups of traders? Is it intelligence? Are the consistent winners just plain smarter than everyone else? Do they work harder? Are they better analysts, or do they have access to better trading systems? Do they possess inherent personality characteristics that make it easier for them to deal with the intense pressures of trading?

All of these possibilities sound quite plausible, except when you consider that most of the trading industry's failures are also some of society's brightest and most accomplished people. The largest group of consistent losers is composed primarily of doctors, lawyers, engineers, scientists, CEOs, wealthy retirees, and entrepreneurs.

Furthermore, most of the industry's best market analysts are the worst traders imaginable. Intelligence and good market analysis can The Road to Success certainly contribute to success, but they are not the defining factors that separate the consistent winners from everyone else. Well, if it isn't intelligence or better analysis, then what could it be?

Having worked with some of the best and some of the worst traders in the business, and having helped some of the worst become some of the best, I can state without a doubt that there are specific reasons why the best traders consistently out-perform everyone else.

If I had to distill all of the reasons down to one, I would simply say that the best traders think differently from the rest. I know that doesn't sound very profound, but it does have profound implications if you consider what it means to think differently.

To one degree or another, all of us think differently from everyone else. We may not always be mindful of this fact; it seems natural to assume that other people share our perceptions and interpretations of events. In fact, this assumption continues to seem valid until we find ourselves in a basic, fundamental disagreement with someone about something we both experienced. Other than our physical features, the way we think is what makes us unique, probably even more unique than our physical features do.

Let's get back to traders. What is different about die way the best traders think as opposed to how those who are still struggling think? While the markets can be described as an arena of endless opportunities, they simultaneously confront the individual with some of the most sustained, adverse psychological conditions you can expose yourself to. At some point, everyone who trades learns something about the markets that will indicate when opportunities exist. But learning how to identify an opportunity to buy or sell does not mean that you have learned to think like a trader.

The defining characteristic that separates the consistent winners from everyone else is this: The winners have attained a mind-set—aunique set of attitudes—that allows them to remain disciplined, focused, and, above all, confident in spite of the adverse conditions. As a result, they are no longer susceptible to the common fears and trading errors that plague everyone else. Everyone who trades ends up learning something about the markets; very few people who trade ever learn the attitudes that are absolutely essential to becoming a consistent winner. Just as people can learn to perfect the proper technique for swinging a golf club or tennis racket, their consistency, or lack of it, will without a doubt come from their attitude Traders who make it beyond "the threshold of consistency" usually experience a great deal of pain (both emotional and financial) before they acquire the land of attitude that allows them to function effectively in the market environment. The rare exceptions are usually those who were born into successful trading families or who started their trading careers under the guidance of someone who understood the true nature of trading, and, just as important, knew how to teach it.

Why are emotional pain and financial disaster common among traders? The simple answer is that most of us weren't fortunate enough to start our trading careers with the proper guidance.

However, the reasons go much deeper than this. I have spent the last seventeen years dissecting the psychological dynamics behind trading so that I could develop effective methods for teaching the principles of success. What I've discovered is that trading is chock full of paradoxes and contradictions in thinking that make it extremely difficult to learn how to be successful. In fact, if I had to choose one word that encapsulates the nature of trading, it would be "paradox."

(According to the dictionary, a paradox is something that seems to have contradictory qualities or that is contrary to common belief or what generally makes sense to people.)

Financial and emotional disaster are common among traders because many of the perspectives, attitudes, and principles that would otherwise make perfect sense and work quite well in our daily lives have the opposite effect in the trading environment. They just don't work. Not knowing this, most traders start their careers with a fundamental lack of understanding of what it means to be a trader, the skills that are involved, and the depth to which those skills need to be developed.

Here is a prime example of what I am talking about: Trading is inherently risky. To my knowledge, no trade has a guaranteed outcome; therefore, the possibility of being wrong and losing money is always present. So when you put on a trade, can you consider yourself a risk-taker? Even though this may sound like a trick question, it is not.

The logical answer to the question is, unequivocally, yes. If I engage in an activity that is inherently risky, then I must be a risktaker. This is a perfectly reasonable assumption for any trader to make. In fact, not only do virtually all traders make this assumption, but most traders take pride in thinking of themselves as risk-takers. The problem is that this assumption couldn't be further from the truth. Of course, any trader is taking a risk when you put on a trade, but that doesn't mean that you are correspondingly accepting that risk. In other words, all trades are risky because the outcomes are probable—not guaranteed. But do most traders really believe they are taking a risk when they put on a trade? Have they really accepted that the trade has a non-guaranteed, probable outcome? Furthermore, have they fully accepted the possible consequences?

The answer is, unequivocally, no! Most traders have absolutely no concept of what it means to be a risk-taker in the way a successful trader thinks about risk. The best traders not only take the risk, they have also learned to accept and embrace that risk. There is a huge psychological gap between assuming you are a risk-taker because you put on trades and fully accepting the risks inherent in each trade.

When you fully accept the risks, it will have profound implications on your bottom-line performance.

The best traders can put on a trade without the slightest bit of hesitation or conflict, and just as freely and without hesitation or conflict, admit it isn't working. They can get out of the trade—even with a loss—and doing so doesn't resonate the slightest bit of emotional discomfort. In other words, the risks inherent in trading do not cause the best traders to lose their discipline, focus, or sense of confidence.

If you are unable to trade without the slightest bit of emotional discomfort (specifically, fear), then you have not learned how to accept the risks inherent in trading. This is a big problem, because to whatever degree you haven't accepted the risk, is the same degree to which you will avoid the risk. Trying to avoid something that is unavoidable will have disastrous effects on your ability to trade successfully.

Learning to truly accept the risks in any endeavor can be difficult, but it is extremely difficult for traders, especially considering what's at stake. What are we generally most afraid of (besides dying or public speaking)? Certainly, losing money and being wrong both rank close to the top of the list. Admitting we are wrong and losing money to boot can be extremely painful, and certainly something to avoid. Yet as traders, we are confronted with these two possibilities virtually every moment we are in a trade. Now, you might be saying to yourself, "Apart from the fact that it hurts so much, it's natural to not want to be wrong and lose something; therefore, it's appropriate for me to do whatever I can to avoid it." I agree with you. But it is also this natural tendency that makes trading (which looks like it should be easy) extremely difficult.

Trading presents us with a fundamental paradox: How do we remain disciplined, focused, and confident in the face of constant uncertainty? When you have learned how to "think" like a trader, that's exactly what you'll be able to do. Learning how to redefine your trading activities in a way that allows you to completely accept the risk is the key to thinking like a successful trader. Learning to accept the risk is a trading skill—the most important skill you can learn. Yet it's rare that developing traders focus any attention or expend any effort to learn it.

When you learn the trading skill of risk acceptance, the market will not be able to generate information that you define or interpret as painful. If the information the market generates doesn't have the potential to cause you emotional pain, there's nothing to avoid. It is just information, telling you what the possibilities are. This is called an objective perspective—one that is not skewed or distorted by what you are afraid is going to happen or not happen.

I'm sure there isn't one trader reading this book who hasn't gotten into trades too soon—before the market has actually generated a signal, or too late—long after the market has generated a signal. What trader hasn't convinced himself not to take a loss and, as a result, had it turn into a bigger one; or got out of winning trades too soon; or found himself in winning trades but didn't take any profits at all, and then let the trades turn into losers; or moved stoplosses closer to his entry point, only to get stopped out and have the market go back in his direction? These are but a few of the many errors traders perpetuate upon themselves time and time again. These are not market-generated errors. That is, these errors do not come from the market. The market is neutral, in the sense that it moves and generates information about itself. Movement and information provide each of us with the opportunity to do something, but that's all! The markets don't have any power over the unique way in which each of us perceives and interprets this information, or control of the decisions and actions we take as a result. The errors I already mentioned and many more are strictly the result of what I call "faulty trading attitudes and perspectives." Faulty attitudes that foster fear instead of trust and confidence.

I don't think I could put the difference between the consistent winners and everyone else more simply than this: The best traders aren't afraid. They aren't afraid because they have developed attitudes that give them the greatest degree of mental flexibility to flow in and out of trades based on what the market is telling them about the possibilities from its perspective. At the same time, the best traders have developed attitudes that prevent them from getting reckless. Everyone else is afraid, to some degree or another. When they're not afraid, they have the tendency to become reckless and to create the kind of experience for themselves that will cause them to be afraid from that point on.

Ninety-five percent of the trading errors you are likely to make—causing the money to just evaporate before your eyes—will stem from your attitudes about being wrong, losing money, missing out, and leaving money on the table. What I call the four primary trading fears.

Now, you may be saying to yourself, "I don't know about this: I've always thought traders should have a healthy fear of the markets." Again, this is a perfectly logical and reasonable assumption. But when it comes to trading, your fears will act against you in such a way that you will cause the very thing you are afraid of to actually happen. If you're afraid of being wrong, your fear will act upon your perception of market information in a way that will cause you to do something that ends up making you wrong. When you are fearful, no other possibilities exist. You can't perceive other possibilities or act on them properly, even if you did manage to perceive them, because fear is immobilizing. Physically, it causes us to freeze or run. Mentally, it causes us to narrow our focus of attention to the object of our fear. This means that thoughts about other possibilities, as well as other available information from the market, get blocked. You won't think about all the rational things you've learned about the market until you are no longer afraid and the event is over. Then you will think to yourself, "I knew that. Why didn't I think of it then?" or, "Why couldn't I act on it then?"

It's extremely difficult to perceive that the source of these problems is our own inappropriate attitudes. That's what makes fear so insidious. Many of the thinking patterns that adversely affect our trading are a function of the natural ways in which we were brought up to think and see the world. These thinking patterns are so deeply ingrained that it rarely occurs to us that the source of our trading difficulties is internal, derived from our state of mind. Indeed, it seems much more natural to see the source of a problem as external, in the market, because it feels like the market is causing our pain, frustration, and dissatisfaction.

Obviously these are abstract concepts and certainly not something most traders are going to concern themselves with. Yet understanding the relationship between beliefs, attitudes, and perception is as fundamental to trading as learning how to serve is to tennis, or as learning how to swing a club is to golf. Put another way, understanding and controlling your perception of market information is important only to the extent that you want to achieve consistent results.

I say this because there is something else about trading that is as true as the statement I just made: You don't have to know anything about yourself or the markets to put on a winning trade, just as you don't have to know the proper way to swing a tennis racket or golf club in order to hit a good shot from time to time. The first time I played golf, I hit several good shots throughout the game even though I hadn't learned any particular technique; but my score was still over 120 for 18 holes. Obviously, to improve my overall score, I needed to learn technique. Of course, the same is true for trading. We need technique to achieve consistency. But what technique? This is truly one of the most perplexing aspects of learning how to trade effectively. If we aren't aware of, or don't understand, how our beliefs and attitudes affect our perception of market information, it will seem as if it is the market's behavior that is causing the lack of consistency. As a result, it would stand to reason that the best way to avoid losses and become consistent would be to learn more about the markets.

This bit of logic is a trap that almost all traders fall into at some point, and it seems to make perfect sense. But this approach doesn't work. The market simply offers too many—often conflicting—variables to consider. Furthermore, there are no limits to the market's behavior. It can do anything at any moment. As a matter of fact, because every person who trades is a market variable, it can be said that any single trader can cause virtually anything to happen. This means that no matter how much you learn about the market's behavior, no matter how brilliant an analyst you become, you will never learn enough to anticipate every possible way that the market can make you wrong or cause you to lose money. So if you are afraid of being wrong or losing money, it means you will never learn enough to compensate for the negative effects these fears will have on your ability to be objective and your ability to act without hesitation. In other words, you won't be confident in the face of constant uncertainty. The hard, cold reality of trading is that every trade has an uncertain outcome. Unless you learn to completely accept the possibility of an uncertain outcome, you will try either consciously or unconsciously to avoid any possibility you define as painful. In the process, you will subject yourself to any number of self-generated, costly errors.

Now, I am not suggesting that we don't need some form of market analysis or methodology to define opportunities and allow us to recognize them; we certainly do. However, market analysis is not the path to consistent results. It will not solve the trading problems created by lack of confidence, lack of discipline, or improper focus. When you operate from the assumption that more or better analysis will create consistency, you will be driven to gather as many market variables as possible into your arsenal of trading tools. But what happens then? You are still disappointed and betrayed by the markets, time and again, because of something you didn't see or give enough consideration to. It will feel like you can't trust the markets; but the reality is, you can't trust yourself.

Confidence and fear are contradictory states of mind that both stem from our beliefs and attitudes. To be confident, functioning in an environment where you can easily lose more than you intend to risk, requires absolute trust in yourself. However, you won't be able to achieve that trust until you have trained your mind to override your natural inclination to think in ways that are counterproductive to being a consistently successful trader. Learning how to analyze the market's behavior is simply not the appropriate training. You have two choices: You can try to eliminate risk by learning about as many market variables as possible. (I call this the black hole nf analv<!i<: bpoanif* it is fhp nafh nf ultimate frustration.) Or you can learn how to redefine your trading activities in such a way that you truly accept the risk, and you're no longer afraid.

When you've achieved a state of mind where you truly accept the risk, you won't have the potential to define and interpret market information in painful ways. When you eliminate the potential to define market information in painful ways, you also eliminate the tendency to rationalize, hesitate, jump the gun, hope that the market will give you money, or hope that the market will save you from your inability to cut your losses.

As long as you are susceptible to the lands of errors that are the result of rationalizing, justifying, hesitating, hoping, and jumping the gun, you will not be able to trust yourself. If you can't trust yourself to be objective and to always act in your own best interests, achieving consistent results will be next to impossible. Trying to do something that looks so simple may well be the most exasperating thing you will ever attempt to do. The irony is that, when you have the appropriate attitude, when you have acquired a "trader s mind-set" and can remain confident in the face of constant uncertainty, trading will be as easy and simple as you probably thought it was when you first started out.

So, what is the solution? You will need to learn how to adjust your attitudes and beliefs about trading in such a way that you can trade without the slightest bit of fear, but at the same time keep a framework in place that does not allow you to become reckless. That's exactly what this book is designed to teach you. As you move ahead, I would like you to keep something in mind.

The successful trader that you want to become is a future projection of yourself that you have to grow into. Growth implies expansion, learning, and creating a new way of expressing yourself. This is true even if you're already a successful trader and are reading this book to become more successful. Many of the new ways in which you will learn to express yourself will be in direct conflict with ideas and beliefs you presently hold about the nature of trading. You may or may not already be aware of some of these beliefs. In any case, what you currently hold to be true about the nature of trading will argue to keep things just the way they are, in spite of your frustrations and unsatisfying results.

These internal arguments are natural. My challenge in this book is to help you resolve these arguments as efficiently as possible. Your willingness to consider that other possibilities exist—possibilities that you may not be aware of or may not have given enough consideration to—will obviously make the learning process faster and easier.

CHAPTER 2

THE LURE
(AND THE DANGERS)
OF TRADING

In January 1994, I was asked to speak at a trading conference in Chicago, sponsored by *Futures Magazine.* At one of the luncheons I happened to be sitting next to an editor for one of the major publishers of books about trading. We were having a lively conversation about why so few people become successful at trading, even people who are otherwise very accomplished. At one point, the editor asked me if a possible explanation for this phenomenon might be that people were getting into trading for the wrong reasons.

THE ATTRACTION

I had to pause for a moment to think about this. I agree that many of the typical reasons people are motivated to trade—the action, euphoria, desire to be a hero, the attention one can draw to himself by winning, or the self-pity that comes from losing—create problems that will ultimately detract from a traders performance and overall success. But the true underlying attraction to trading is far more fundamental and universal. Trading is an activity that offers the individual unlimited freedom of creative expression, a freedom of expression that has been denied most of us for most of our lives.

Of course, the editor asked me what I meant by this. I explained that in the trading environment, we make almost all of the rules. This means there are very few restrictions or boundaries on how we can choose to express ourselves. Of course there are some formalities such as having to become a member of an exchange to be a floor trader, or meeting the minimum financial requirements to open a brokerage account if you're an off-the-floor trader. But otherwise, once you are in a position to start trading, the possibilities that exist for how you go about doing it are virtually limitless.

I went on to give him an example from a seminar I attended several years ago. Someone had calculated that, if you combined bond futures, bond options, and the cash bond markets, there would be over eight billion possible spread combinations. Now add the timing considerations based on how you read the revailing market conditions, and the various ways to trade become virtually limitless.

The editor paused for a moment and asked, "But why would having access to such an unrestricted environment result in fairly consistent failure?" I answered, "Because unlimited possibilities coupled with the unlimited freedom to take advantage of those possibilities present the individual with unique and specialized psychological challenges, challenges that very few people are properly equipped to deal with, or have any awareness of for that matter, and people can't exactly work on overcoming something if they don't even know its a problem."

The freedom is great. All of us seem to naturally want it, strive for it, even crave it. But that doesn't ean that we have the appropriate psychological resources to operate effectively in an environment that has few, if any, boundaries and where the potential to do enormous damage to ourselves exists. Almost everyone needs to make some mental adjustments, regardless of their educational background, intelligence or how successful they've been in other endeavors.

The kind of adjustments I'm talking about have to do with creating an internal mental structure that provides the trader with the greatest degree of balance between the freedom to do anything and the potential that exists to experience both the financial and psychological damage that can be a direct result of that freedom.

Creating a mental structure can be difficult enough, especially if what you want to instill is in conflict with what you already believe. But for those of us who want to be traders, the difficulty of creating the appropriate structure is invariably compounded by a backlog of mental resistance that starts developing at the very earliest stages of our lives.

All of us are born into some sort of social environment. A social environment (or society), whether it's a family, city, state, or country, implies the existence of structure. Social structures consist of rules, restrictions, boundaries, and a set of beliefs that become a code of behavior that limits the ways in which individuals within that social structure can or cannot express themselves. Furthermore, most of the limitations of social structure were established before we are born. In other words, by the time any of us get here, most of the social structure governing our individual expression is in place and well entrenched. It's easy to see why a society's need for structure and the individual's need for self-expression can conflict. Every person who wants to master the art of trading faces just such a fundamental conflict. I'd like you to ask yourself what one characteristic (a form of personal expression) is common to every child born on this planet, regardless of the location, culture, or social situation the child is born into. The answer is curiosity. Every child is curious. Every child is eager to learn. They can be described as little learning machines.

Consider the nature of curiosity. At its most fundamental level, it is a force. More specifically, it is an inner-directed force, which means there's no necessity to motivate a child to learn something. Left on their own, children will naturally explore their surroundings. What is more, this inner-directed force also seems to have its own agenda; in other words, even though all children are curious, not all children are naturally curious about the same things. There's something inside each of us that directs our awareness.

Even infants seem to know what they want and don't want. When adults encounter this unique display of individuality expressed by an infant, they're usually surprised. They assume that infants have nothing inside of them that makes them uniquely who they are. How else would infants express their individuality than by what in their environment attracts or repels them? I call this inner-directed guidance the force of natural attractions.

Natural attractions are simply those things about which we feel a natural or passionate interest. Ours is a big and diverse world, and it offers each of us a great deal to learn about and experience. But that doesn't mean each of us has a natural or passionate interest in learning about or experiencing all there is. There's some internal mechanism that makes us "naturally selective."

If you think about it, I'm sure you could list many things to do or be that you have absolutely no interest in. I know I could. You could also make another list of the things you are only marginally interested in. Finally, you could list everything you have a passionate interest in. Of course, the lists get smaller as the interest levels rise. Where does passionate interest come from? My personal view is that it comes from the deepest level of our being—at the level of our true identity. It comes from the part of us that exists beyond the characteristics and personality traits we acquire as a result of our social upbringing.

THE DANGERS

It is at the deepest level of our being that the potential for conflict exists.The social structure that we're born into may or may not be sensitive to these inner-directed needs and interests. For example, you may have been born into a family of extremely competitive athletes, but feel a passionate interest in classical music or art. You may even have natural athletic ability, but no real interest in participating in athletic events. Is there any potential for conflict here?

In a typical family, most members would put a great deal of pressure on you to follow in the footsteps of your brothers, sisters, or parents. They do everything possible to teach you their ways and how to get the most out of your athletic ability. They discourage you from seriously pursuing any other interests. You go along with what they want, because you don't want to be ostracized, but at the same time, doing what they want you to do just doesn't feel right, although everything you've learned and been taught argues in favor of becoming an athlete. The problem is, it doesn't feel like who you are.

The conflicts that result from what we're taught about who we're supposed to be and the feeling that resonates at the deepest levels of our being is not at all uncommon. I would say that many, if not most people, grow up in a family and cultural environment that gives little, if any, objective, nonjudgmental support to the unique ways in which we feel compelled to express ourselves. This lack of support is not simply an absence of encouragement. It can be as deep as the outright denial of some particular way in which we want to express ourselves. For example, let's look at a common situation: A toddler, who for the first time in his life, notices "this thing," which we call a vase, on the coffee table. He is curious, which means there's an inner force that's compelling him to experience this object. In a sense, it's as if this force creates a vacuum in his mind that has to be filled with the object of his interest. So, he focuses on the vase, and, with deliberate intent, crawls across the vast expanse of the living room floor to the coffee table. When he gets there, he reaches up to the edge of the table to pull himself to his feet.

With one hand firmly on the table to maintain his balance, his other hand reaches out to touch this thing he has never experienced. Just at that moment, he hears a scream from across the room, "NO! DON'T TOUCH THAT!"

Startled, the child falls back on his butt, and begins to cry. Obviously, this is a very common occurrence and one that is completely unavoidable. Children have absolutely no concept of how they can injure themselves or how valuable something like a vase can be. In fact, learning what is safe and what isn't and the value of things are important lessons the child must learn. However, there are some extremely important psychological dynamics at work here that have a direct effect on our ability to create the kind of discipline and focus necessary to trade effectively later in life.

What happens when we're denied the opportunity to express ourselves in the way we want to, or we're forced to express ourselves in a way that doesn't correspond with the natural selection process?

The experience creates an upset. Being "up-set" implies an imbalance. But what exactly is out of balance? For something to be out of balance, there has to be something that's in balance or in equal proportion in the first place. That something is the relative degree of correspondence that exists between our inner, mental environment and the exterior environment where we experience our lives. In other words, our needs and desires are generated in our mental environment, and they are fulfilled in the exterior environment . If these two environments are in correspondence with one another, we're in a state of inner balance and we feel a sense of satisfaction or happiness. If these environments are not in correspondence, we experience dissatisfaction, anger, and frustration, or what is commonly referred to as emotional pain.

Now, why would not getting what we want or being denied the freedom to express ourselves in some particular way cause us to experience emotional pain? My personal theory is that needs and desires create mental vacuums. The universe in which we live has a natural tendency to not tolerate a vacuum and moves to fill it, whenever one exists. (The philosopher Spinoza observed centuries ago that, "Nature abhors a vacuum.")

Suck the air out of a bottle and your tongue and lips will stick to the mouth of the bottle, because you have created an imbalance (a vacuum), which now must be filled. What are the dynamics behind the expression "Necessity is the mother of all invention"? The recognition that a need creates a mental vacuum that the universe will fill with inspiring thoughts (if your mind is receptive). The thoughts, in turn, can inspire movement and expression that result in the fulfillment of that need.

In this respect, I think our mental environment works like the universe at large. Once we recognize a need or desire, we move to fill the vacuum with an experience in the exterior environment. If we are denied the opportunity to pursue the object of this need or desire, it literally feels as if we are not whole, or that something is missing, which puts us into a state of imbalance or emotional pain. (Do our minds also abhor a vacuum, once one has been created?) Take a toy away from a child who is not finished playing with it (regardless of how good your reasons may be for doing so) and the universal response will be emotional pain.

By the time we're 18 years old, we've been on Earth approximately 6,570 days. On average, how many times per day does the typical child hear statements like:

"No, no, you can't do that."
"You can't do it that way. You have to do it this way."
"Not now; let me think about it."
"I'll let you know."
"It can't be done."
"What makes you think you can do it?"
"You have to do it. You have no choice."

These are just a few of the relatively nice ways in which all of us are denied individual expression as we grow up. Even if we only heard such statements once or twice a day, that still adds up to several thousand denials by the time we reach adulthood.

I call these lands of experiences "denied impulses" to learn— impulses that are based on an inner need, originating from the deeper part of our identity, from the natural selection process.

What happens to all of these impulses that have been denied and left unfulfilled? Do they just go away? They can, if they are reconciled in some way: if we do something, or someone else does something, to put our mental environment back into balance. What can put our mental environment back into balance? There are a number of techniques.

The most natural one, especially for a child, is simply to cry. Crying is a natural mechanism (nature's way) for reconciling these denied, unfulfilled impulses. Scientific researchers have found tears to be composed of negatively charged ions. If allowed to take its natural course, crying will expel the negatively charged energy in our minds and bring us back to a state of balance, even though the original impulse was never fulfilled.

The problem is that, most of the time, events are not allowed to take their natural course and the denied impulses are never reconciled (at least, not while we're still children). There are many reasons why adults don't like it when their children (especially boys) cry, and do everything they can to discourage this behavior. There are just as many reasons why adults will not bother to explain to children why they are being forced to do something they don't want to do. Even if adults do try, there are no assurances that they will be effective enough to reconcile the imbalance. What happens if these impulses aren't reconciled?

They accumulate and usually end up manifesting themselves in any number of addictive and compulsive behavior patterns. A very loose rule of thumb is: Whatever we believe we were deprived of as children can easily become addictions in adulthood. For example, many people are addicted to attention. I am referring to people who will do most anything to draw attention to themselves. The most common reason for this is that they believe they either didn't get enough attention when they were young or didn't get it when it was important to them. In any case, the deprivation becomes unresolved emotional energy that compels them to behave in ways that will satisfy the addiction. What's important for us to understand about these unreconciled, denied impulses (that exist in all of us) is how they affect our ability to stay focused and take a disciplined, consistent approach to our trading.

THE SAFEGUARDS

To operate effectively in the trading environment, we need rules and boundaries to guide our behavior. It is a simple fact of trading that the potential exists to do enormous damage to ourselves—damage that can be way out of proportion to what we may think is possible. There are many kinds of trades in which the risk of loss is unlimited.

To prevent the possibility of exposing ourselves to damage, we need to create an internal structure in the form of specialized mental discipline and a perspective that guides our behavior so that we always act in our own best interests. This structure has to exist within each of us, because unlike society, the market doesn't provide it. The markets provide structure in the form of behavior patterns that indicate when an opportunity to buy or sell exists. But that's where the structure ends—with a simple indication. Otherwise, from each individual's perspective, there are no formalized rules to guide your behavior. There aren't even any beginnings, middles, or endings as there are in virtually every other activity we participate in.

This is an extremely important distinction with profound psychological implications. The market is like a stream that is in constant motion. It doesn't start, stop, or wait. Even when the markets are closed, prices are still in motion. There is no rule that the opening price on any day must be the same as the closing price the day before. Nothing we do in society properly prepares us to function effectively in such a "boundary-less" environment. Even gambling games have built-in structures that make them much different from trading, and a lot less dangerous. For example, if we decide to play blackjack, the first thing we have to do is decide how much we are going to wager or risk. This is a choice we are forced to make by the rules of the game. If we don't make the choice, we don't get to play.

In trading, no one (except yourself) is going to force you to decide in advance what your risk is. In fact, what we have is a limitless environment, where virtually anything can happen at any moment and only the consistent winners define their risk in advance of putting on a trade. For everyone else, defining the risk in advance would force you to confront the reality that each trade has a probable outcome, meaning that it could be a loser. Consistent losers do almost anything to avoid accepting the reality that, no matter how good a trade looks, it could lose. Without the presence of an external structure forcing the typical trader to think otherwise, he is susceptible to any number of justifications, rationalizations, and the kind of distorted logic that will allow him to get into a trade believing that it can't lose, which makes determining the risk in advance irrelevant.

All gambling games have specified beginnings, middles, and endings, based on a sequence of events that determine the outcome of the game. Once you decide you are going to participate, you can't change your mind—you're in for the duration. That's not true of trading. In trading, prices are in constant motion, nothing begins until you decide it should, it lasts as long as you want, and it doesn't end until you want it to be over. Regardless of what you may have planned or wanted to do, any number of psychological factors can come into play, causing you to become distracted, change your mind, become scared or overconfident: in other words, causing you to behave in ways that are erratic and unintended.

Because gambling games have a formal ending, they force the participant to be an active loser. If you're on a losing streak, you can't keep on losing without making a conscious decision to do so. The end of each game causes the beginning of a new game, and you have to actively subject more of your assets to further risk by reaching into your wallet or pushing some chips to the center of the table.

Trading has no formal ending. The market will not take you out of a trade. Unless you have the appropriate mental structure to end a trade in a manner that is always in your best interest, you can become a passive loser. This means that, once you're in a losing trade, you don't have to do anything to keep on losing. You don't even have to watch. You can just ignore the situation, and the market will take everything you own—and more.

One of the many contradictions of trading is that it offers a gift and a curse at the same time. The gift is that, perhaps for the first time in our lives, we're in complete control of everything we do. The curse is that there are no external rules or boundaries to guide or structure our behavior. The unlimited characteristics of the trading environment require that we act with some degree of restraint and self-control, at least if we want to create some measure of consistent success. The structure we need to guide our behavior has to originate in your mind, as a conscious act of free will. This is where the many problems begin.

PROBLEM: The willingness to Create Rules

I have not yet encountered a person interested in trading who didn't resist the notion of creating a set of rules. The resistance isn't always overt. Quite the contrary, it's usually very subtle. We agree on the one hand that rules make sense, but we really have no intention of doing whatever is being suggested. This resistance can be intense, and it has a logical source.

Most of the structure in our minds was given to us as a result of our social upbringing and based on choices made by other people. In other words, it was instilled in our minds, but did not originate in our minds. This is a very important distinction. In the process of instilling structure, many of our natural impulses to move, express, and learn about the nature of our existence through our own direct experience were denied. Many of these denied impulses were never reconciled and still exist inside of us as frustration, anger, disappointment, guilt, or even hatred. The accumulation of these negative feelings acts as a force inside our mental environment causing us to resist anything that denies us the freedom to do and be whatever we want, when we want.

In other words, the very reason we are attracted to trading in the first place—the unlimited freedom of creative expression—is the same reason we feel a natural resistance to creating the kinds of rules and boundaries that can appropriately guide our behavior. It's as if we have found a Utopia in which there is complete freedom, and then someone taps us on the shoulder and says, "Hey, you have to create rules, and not only that, you also have to have the discipline to abide by them."

The need for rules may make perfect sense, but it can be difficult to generate the motivation to create these rules when we've been trying to break free of them most of our lives. It usually takes a great deal of pain and suffering to break down the source of our resistance to establishing and abiding by a trading regime that is organized, consistent, and reflects prudent money-management guidelines. Now, I'm not implying that you have to reconcile all of your past frustrations and disappointments to become a successful trader, because that's not the case. And you certainly don't have to suffer.

I've worked with many traders who have achieved their objectives of consistency and haven't done anything to reconcile their backlog of denied impulses. However, I am implying that you can't take for granted how much effort and focus you may have to put into building the kind of mental structure that compensates for the negative effect denied impulses can have on your ability to establish the skills that will assure your success as a trader.

PROBLEM: Failure to Take Responsibility

Trading can be characterized as a pure, unencumbered personal choice with an immediate outcome. Remember, nothing happens until we decide to start; it lasts as long as we want; and it doesn't end until we decide to stop. All of these beginnings, middles, and endings are the result of our interpretation of the information available and how we choose to act on our interpretation. Now, we may want the freedom to make choices, but that doesn't mean we are ready and willing to accept the responsibility for the outcomes. Traders who are not ready to accept responsibility for the outcomes of their interpretations and actions will find themselves in a dilemma: How does one participate in an activity that allows complete freedom of choice, and at the same time avoid taking responsibility if the outcome of one's choices are unexpected and not to one's liking?

The hard reality of trading is that, if you want to create consistency, you have to start from the premise that no matter what the outcome, you are completely responsible. This is a level of responsibility few people have aspired to before they decide to become traders. The way to avoid responsibility is to adopt a trading style that is, to all intents and purposes, random. I define random trading as poorly-planned trades or trades that are not planned at all. It is an unorganized approach that takes into consideration an unlimited set of market variables, which do not allow you to find out what works on a consistent basis and what does not.

Randomness is unstructured freedom without responsibility.

When we trade without well-defined plans and with an unlimited set of variables, it's very easy to take credit for the trades that turn out to our liking (because there was "some" method present). At the same time, it's veiy easy to avoid taking responsibility for the trades that didn't turn out the way we wanted (because there's always some variable we didn't know about and therefore couldn't take into consideration beforehand). If the markets behavior were truly random, then it would be difficult if not impossible to create consistency. If it's impossible to be consistent, then we really don't have to take responsibility. The problem with this logic is that our direct experience of the markets tells us something different. The same behavior patterns present themselves over and over again. Even though the outcome of each individual pattern is random, the outcome of a series of patterns is consistent (statistically reliable). This is a paradox, but one that is easily resolved with a disciplined, organized, and consistent approach.

I've worked with countless traders who would spend hours doing market analysis and planning trades for the next day Then, instead of putting on the trades they planned, they did something else. The trades they did put on were usually ideas from friends or tips from brokers. I probably don't have to tell you that the trades they originally planned, but didn't act on, were usually the big winners of the day.

This is a classic example of how we become susceptible to unstructured, random trading—because we want to avoid responsibility. When we act on our own ideas, we put our creative abilities on the line and we get instant feedback on how well our ideas worked. It's very difficult to rationalize away any unsatisfactory results. On the other hand, when we enter an unplanned, random trade, it's much easier to shift the responsibility by blaming the friend or the broker for their bad ideas.

There's something else about the nature of trading that makes it easy to escape the responsibility that comes with creating structure in favor of trading randomly: It is the fact that any trade has the potential to be a winner, even a big winner. That big winning trade can come your way whether you are a great analyst or a lousy one; whether you do or don't take responsibility. It takes effort to create the kind of disciplined approach that is necessary to become a consistent winner. But, as you can see, it's very easy to avoid this kind of mental work in favor of trading with an undisciplined, random approach.

PROBLEM: Addiction to Random Rewards

Several studies have been done on the psychological effects of random rewards on monkeys. For example, if you teach a monkey to do a task and consistently reward it every time the task is done, the monkey quickly learns to associate a specific outcome with the efforts. If you stop rewarding it for doing the task, within a very short period of time the monkey will simply stop doing the task. It won't waste its energy doing something that it has now learned it won't be rewarded for. However, the monkey's response to being cut off from the reward is very different if you start out on a purely random schedule, instead of a consistent one. When you stop offering the reward, there's no way the monkey can know that it will never be rewarded again for doing that task. Every time it was rewarded in the past, the reward came as a surprise. As a result, from the monkey's perspective, there's no reason to quit doing the task. The monkey keeps on doing the task, even without being rewarded for doing it. Some will continue indefinitely.

I'm not sure why we're susceptible to becoming addicted to random rewards. If I had to guess, I would say that it probably has something to do with the euphoria-inducing chemicals that are released in our brains when we experience an unexpected, pleasant surprise. If a reward is random, we never know for sure if and when we might receive it, so expending energy and resources in the hope of experiencing that wonderful feeling of surprise again isn't difficult. In fact, for many people it can be very addicting. On the other hand, when we expect a particular outcome and it doesn't come about, we're disappointed and feel bad. If we do it again and get the same disappointing outcome, it isn't likely that we will keep doing something we know will cause us emotional pain.

The problem with any addiction is that it leaves us in a state of "choicelessness." To whatever degree the addiction dominates our state of mind, to that same degree our focus and efforts will be geared toward fulfilling the object of that addiction. Other possibilities that exist in any given moment to fulfill other needs (like the need to trust ourselves and not to subject too many of our assets to risk) are either ignored or dismissed. We feel powerless to act in any other way than to satisfy the addiction. An addiction to random rewards is particularly troublesome for traders, because it is another source of resistance to creating the kind of mental structure that produces consistency.

PROBLEM: External versus Internal Control

Our upbringing has programmed us to function in a social environment, which means we've acquired certain thinking strategies for fulfilling our needs, wants and desires that are geared toward social interaction. Not only have we learned to depend on each other to fulfill the needs, wants and desires we cannot fulfill completely on our own, but in the process we've acquired many socially-based controlling and manipulating techniques for assuring that other people behave in a manner that is consistent with what we want.

The markets may seem like a social endeavor because there are so many people involved, but they're not. If, in today's modern society, we have learned to depend on each other to fulfill basic needs, then the market environment (even though it exists in the midst of modern society) can be characterized as a psychological wilderness, where it's truly every man or woman for himself or herself. Not only can we not depend on the market to do anything for us, but it is extremely difficult, if not impossible, to manipulate or control anything that the market does. Now, if we've become effective at fulfilling our needs, wants and desires by learning how to control and manipulate our environment, but suddenly find ourselves, as traders, in an environment that does not know, care, or respond to anything that is important to us, where does that leave us? You're right if you said up the proverbial creek without a paddle.

One of the principal reasons so many successful people have failed miserably at trading is that their success is partly attributable to their superior ability to manipulate and control the social environment, to respond to what they want. To some degree, all of us have learned or developed techniques to make the external environment conform to our mental (interior) environment. The problem is that none of these techniques work with the market. The market doesn't respond to control and manipulation (unless you're a very large trader). However, we can control our perception and interpretation of market information, as well as our own behavior. Instead of controlling our surroundings so they conform to our idea of the way things should be, we can learn to control ourselves. Then we can perceive information from the most objective perspective possible, and structure our mental environment so that we always behave in a manner that is in our own best interest.

CHAPTER 3

TAKING RESPONSIBILITY

Although the words "taking responsibility" sound simple, the concept is neither easy to grasp nor easy to put into practice in your trading. We have all heard the words and been confronted with the need to take responsibility so many times in our lives that it is easy to take for granted that we know exactly what the phrase means.

Taking responsibility in your trading and learning the appropriate principles of success are inextricably connected. You have to understand, with every fiber of your being, the ways in which you are and are not responsible for your success as a trader. Only then can you take on the characteristics that will allow you to join the select group of traders who are consistently successful in the markets.

At the end of Chapter 1, I introduced the idea of stepping into a future projection of yourself. In other words, the consistently successful trader that you want to become doesn't exist yet. You must create a new version of yourself, just as a sculptor creates a likeness of a model.

SHAPING YOUR MENTAL ENVIRONMENT

The tools you will use to create this new version of yourself are your willingness and desire to learn, fueled by your passion to be successful. If the willingness and desire to learn are your primary tools, then what is your medium? An artist creating a sculpture can choose to work in a number of mediums—clay, marble, or metal, for example— but if you want to create a new version of your personality that expresses itself as a consistently successful trader, you have only your beliefs and attitudes. The medium for your artistic endeavor will be your mental environment, where with your desire to learn, you can restructure and install the beliefs and attitudes that are necessary to achieve your ultimate goal.

I am assuming your ultimate goal is consistency. If you're like most traders, you don't realize the fullest potential of the opportunities available to you. To realize more and more of that potential, to make it more and more of a reality in your life, your primary goal has to be to learn how to think like a consistently successful trader. Remember, the best traders think in a number of unique ways. They have acquired a mental structure that allows them to trade without fear and, at the same time, keeps them from becoming reckless and committing fear-based errors. This mind-set has a number of components, but the bottom line is that successful traders have virtually eliminated the effects of fear and recklessness from their trading.

These two fundamental characteristics allow them to achieve consistent results.

When you acquire this mind-set, you, too, will be able to trade without fear. You will no longer be susceptible to the multitude of fear-based errors that come from rationalizing, subconsciously distorting information, hesitating, jumping the gun, or hoping. Once the fear is gone, there just won't be a reason to make these errors and, as a result, they will virtually disappear from your trading.

However, eliminating fear is only half the equation. The other half is the need to develop restraint. Excellent traders have learned that it is essential to have internal discipline or a mental mechanism to counteract the negative effects of euphoria or the overconfidence that comes from a string of winning trades. For a trader, winning is extremely dangerous if you haven't learned how to monitor and control yourself.

If we start from the premise that to create consistency traders must focus their efforts on developing a trader's mind-set, then it is easy to see why so many traders don't succeed. Instead of learning to think like traders, they think about how they can make more money by learning about the markets. It's almost impossible not to fall into this trap. There are a number of psychological factors that make it very easy to assume that it's what you don't know about the markets that causes your losses and lack of consistent results.

However, that's just not the case. The consistency you seek is in your mind, not in the markets. It's attitudes and beliefs about being wrong, losing money, and the tendency to become reckless, when you're feeling good, that cause most losses—not technique or market knowledge.

For example, if you could choose one of the following two traders to manage your money, which one would you pick? The first trader uses a simple, possibly even mediocre trading technique, but possesses a mind-set that is not susceptible to subconsciously distorting market information, hesitating, rationalizing, hoping, or jumping the gun. The second trader is a phenomenal analyst, but is still operating out of the typical fears that make him susceptible to all of the psychological maladies that the other trader is free of. The right choice should be obvious. The first trader is going to achieve far better results with your money.

Attitude produces better overall results than analysis or technique. Of course, the ideal situation is to have both, but you really don't need both, because if you have the right attitude—the right mind-set—then everything else about trading will be relatively easy, even simple, and certainly a lot more fun. I know for some of you this may be difficult to believe, or even distressing especially if you've been struggling for years to learn everything you can about the market.

Interestingly, most traders are closer to the way they need to think when they first begin trading than at any other time in their careers. Many people begin trading with a very unrealistic concept of the inherent dangers involved. This is particularly true if their first trade is a winner. Then they go into the second trade with little or no fear. If that trade is a winner, they go into the next trade with even less concern for what would otherwise be the unacceptable possibility of a loss. Each subsequent win convinces them that there is nothing to fear and that trading is the easiest possible way to make money. This lack of fear translates into a carefree state of mind, similar to the state of mind many great athletes describe as a "zone." If you've ever had the occasion to experience the zone in some sport, then you

know it is a state of mind in which there is absolutely no fear and you act and react instinctively. You don't weigh alternatives or consider consequences or second-guess yourself. You are in the moment and "just doing it." Whatever you do turns out to be exactly what needed to be done.
Most athletes never reach this level of play, because they never get past the fear of making a mistake. Athletes who reach the point where there is absolutely no fear of the consequences of screwing up will usually, and quite spontaneously, enter into "the zone." By the way, a psychological zone is not a condition you can will yourself into, the way you can will yourself into a feat of endurance. It is a state of mind you find yourself in that is inherently creative, and usually if you start thinking about your actions at a rational or conscious level, you pop right out of it.
Even though you cannot force or will yourself into a zone, you can set up the kind of mental conditions that are most conducive to experiencing "the zone," by developing a positive winning attitude. I define a positive winning attitude as expecting a positive result from your efforts, with an acceptance that whatever results you get are a perfect reflection of your level of development and what you need to learn to do better. That's what the great athletes have: a winning attitude that allows them to easily move beyond their mistakes and keep eoine.
Others get bogged down in negative self-criticism, regret, and selfpity. Not many people ever develop a positive winning attitude. The curious anomaly of trading is that, if you start with a winning trade, you will automatically experience the kind of carefree mind-set that is a by-product of a winning attitude, without having developed the attitude itself. I know this may sound a bit confusing, but it has some profound implications.
If a few winning trades can cause you to enter into the kind of carefree state of mind that is an essential component to your success, but is not founded on the appropriate attitudes, then -what you have is a prescription for extreme misunderstanding about the nature of trading that inevitably results in both emotional and financial disaster. Putting on a few (or more) winning trades does not mean you have become a trader, but that's the way it feels, because it taps us into a state of mind that only the most accomplished people experience on a consistent basis. The fact is, you don't need the slightest bit of skill to put on a winning trade, and if it's possible to put on one winning trade without the slightest bit of skill, it is certainly possible to put on another and another. I know of several people who started their trading careers with fairly substantial strings of winning trades.
When you're feeling confident and unencumbered by fears and worries, it isn't difficult to put on a string of winning trades because it's easy to get into a flow, a kind of natural rhythm, where what you need to do seems obvious or self-evident. It's almost as if the market screams at you when to buy and when to sell, and you need very little in the way of analytical sophistication. And, of course, because you have no fear, you can execute your trades with no internal argument or conflict.
The point I am making is that winning in any endeavor is mostly a function of attitude. Many people are certainly aware of this, but at the same time, most people don't understand the significant part attitude plays in their results. In most sports or other competitive activities, participants must develop

physical skills as well as mental skills in the form of strategies. If opponents are not evenly matched in the skills department, the one with superior skills usually ("but not always) wins. When an underdog beats a superior opponent, what's the determining factor? When two opponents are evenly matched, what's the factor that tips the balance one way or the other? In both cases, the answer is attitude.

What makes trading so fascinating and, at the same time, difficult to learn is that you really don't need lots of skills; you just need a genuine winning attitude. Experiencing a few or more winning trades can make you feel like a winner, and that feeling is what sustains the winning streak. This is why it is possible for a novice trader to put on a string of winning trades, when many of the industry's best market analysts would give their right arms for a string of winning trades. The analysts have the skills, but they don't have the winning attitude.

They're operating out of fear. The novice trader experiences the feeling of a winning attitude because he's not afraid. But that doesn't mean he has a winning attitude; it only means he hasn't experienced any pain from his trading activities to make him afraid. Eventually, our novice trader will experience a loss and being wrong, regardless of how positive he's feeling. Losing and being wrong are inevitable realities of trading. The most positive attitude imaginable coupled with the best analytical skills can't prevent a trader from eventually experiencing a losing trade. The markets are just too erratic and there are too many variables to consider for any trader to be right every time.

What happens when the novice trader finally does lose? What effect will it have on his carefree state of mind? The answers will depend on his expectations going into the trade and how he interprets the experience. And how he interprets the experience is a function of his beliefs and attitudes.

What if he is operating out of a belief that there's no possible way to avoid a loss, because losing is a natural consequence of trading — no different from, let's say, a restaurant owner incurring the expense of having to buy food? Furthermore, suppose that he has completely accepted the risk, meaning that he has considered and accounted for all of what would otherwise be the unacceptable possibilities in the market's behavior, both financially and emotionally.

With these beliefs and expectations, it is unlikely that he would experience a deterioration of his attitude, and would simply go on to the next trade. By the way, this is an example of an ideal set of trading beliefs and attitudes.

Now suppose that he hasn't completely accepted the risk. What if his expectations didn't take into account any market behavior other than what he wanted? From this mental perspective, if the market doesn't do what he wants, he is going to feel pain—emotional pain.

Expectations are our mental representations of how some future moment in the environment is going to look, sound, feel, smell, or taste. Depending upon how much energy is behind the expectation, it can hurt a lot when it isn't fulfilled. Of the two different perspectives I just described, which one is likely to be held by our novice trader? The latter, of course. Only the very best traders have acquired the perspective described in the first scenario. And, as I indicated in Chapter 1, unless these very best traders grew up in successful trading families or had super traders for mentors (where appropriate attitudes about risk and loss were instilled in them from the very beginning of their careers), virtually every one of them had the common experience of losing one or more fortunes before they realized how they needed to think in order to be consistently successful.

It's a fundamental shift in attitude that accounts for their success, not some brilliant realization about the market, as most people erroneously assume. This erroneous assumption is prevalent among traders simply because very few of them really understand, at the deepest levels, just how critical a component attitude is in determining one's success.

We can safely assume that after a loss, our novice trader will be in a state of emotional pain. As a result, his trading will take on a whole new quality. He'll definitely lose that carefree state of mind, but more important, he will feel that the market did this to him: The market caused him to feel the pain he is experiencing; the market took away his winning feeling by subjecting him to a loss.

Notice how our trader is blaming the markets for losing or what he didn't get. Notice, too, how natural it is to feel the way he does. Think about how many times in our lives, especially as children, we were doing something we really enjoyed, like playing with a toy or with our friends, and someone with more power and authority forced us to stop what we were doing and do something we didn't want to do. All of us have lost things, had things taken away from us, been denied things we wanted or believed we deserved, been prevented from continuing an activity we were in the middle of, or been blocked from pursuing an idea we were passionate about. The point is that in many of these situations, we did not need to take personal responsibility for what happened to us or for the pain we experienced, because we were powerless to do anything about it.

We didn't choose to be forced out of a state of joy and happiness, into a state of emotional pain. The decision was out of our hands, against our will, and usually quite abrupt. Even though we may have been told we were responsible for what was happening to us, we may not have believed it or understood what it meant. What's tangible, and what we can most easily relate to, is that we were having fun, and someone or something took us out of that fun and into pain. It wasn't our choice. The cause of our pain came to us from the outside; therefore, whatever force acted upon us in that moment was to blame. We learned not only that feeling good can instantly be replaced with feeling bad through no fault of our own; we also learned about betrayal. We felt betrayed because many of these situations were completely unexpected or unanticipated, meaning, we were unprepared for how some people in our lives had the potential to behave. If their behavior caused us to flip into a state of emotional pain, then we quite naturally would have felt betrayed.

As a side note, I feel it is important to say that many of our past, emotionally painful experiences were the result of well-meaning parents, teachers and friends, many of whom were only doing what they K/^lie»i7QH of fho fimo ix7oc Vv^ct *fcir* nc Trip nn<;t pyamrtle is a child playing with a toy that is inherently dangerous. Take the toy away, and the child will cry to express the emotional pain he is experiencing, and, if we are dealing with a very young or immature child, in all likelihood he will not listen to anything reasonable that we say about why he cannot play with that toy.

But, at the same time, many people are born to immature and unreasonable parents, or encounter emotionally disturbed teachers, coaches, and employees who subconsciously or intentionally inflict their personal problems on anyone they perceive as having less power. What's even worse is many of the people who have a tendency toward victimizing others are also clever enough to do it in a way that makes their victims believe they caused their own pain. In any case, whether our painful experiences are the result of an act of love or intentionally inflicted is something each of us will have to determine for ourselves. The bottom line is that, as adults when we get into a trading mode, we don't realize how natural it is to associate the instantaneous shift from joy to pain that we experienced so often as children with the same instantaneous shift from joy to pain that occurs when we trade. The implications are that if we haven't learned to accept the inherent risks of trading and don't know how to guard against making these natural connections between our past and the present, we will end up blaming the market for our results instead of taking responsibility for them.

Even though most people who trade consider themselves responsible adults, only the very best traders have reached a point where they can and do accept complete responsibility for the outcome of any particular trade. Everyone else to one degree or another assumes they are taking responsibility; but the reality is that they want the market to do it for them. The typical trader wants the market to fulfill his expectations, his hopes, and dreams.

Society may work this way but the markets certainly don't. In society, we can expect other people to behave in reasonable and responsible ways. When they don't, and if we suffer as a result, society makes remedies available to rectify the imbalance and make us whole again. The market, on the other hand, has no responsibility to give us anything or do anything that would benefit us. This may not be the way markets are advertised and certainly not the impression they want to project, but the reality is, every trader who participates in the markets does so for his own benefit. The only way one trader can benefit is if some other trader loses, whether the loss is in actual dollars as in a futures trade, or lost opportunity as in a stock trade. When you put on a trade, it is in anticipation of making money. Every other trader in the world who puts on a trade does so for the same reason. When you look at your relationship with the market from this perspective, you could say that your purpose is to extract money from the markets, but, by the same token, the market's sole purpose is to extract money or opportunity from you.

If the market is a group of people interacting to extract money from one another, then what is the market's responsibility to the individual trader? It has no responsibility other than to follow the rules it has established to facilitate this activity. The point is, if you have ever found yourself blaming the market or feeling betrayed, then you have not given enough consideration to the implications of what it means to play a zero-sum game. Any degree of blaming means you have not accepted the reality that the market owes you nothing, regardless of what you want or think or how much effort you put into your trading.

In the market, typical social values of exchange do not come into play. If you don't understand this and find a way to reconcile the differences between the social norms you grew up with and the way the market works, you will continue to project your hopes, dreams, and desires onto the market believing it's going to do something for you. When it doesn't, you'll feel angry, frustrated, emotionally distraught, and betrayed.

Taking responsibility means acknowledging and accepting, at the deepest part of your identity, that *you*—not the market—are completely responsible for your success or failure as a trader. Granted, the market's purpose is to separate you from your money; but in the process of doing so, it also provides you with an endless stream of opportunities for you to take money from it. When prices move, that movement represents the collective actions of everyone narticioating at that moment. The market also generates information about itself, and makes it extremely easy to enter and exit trades (depending, of course, on the number of people participating).

From the individuals perspective, price movement, information, and the ability to enter and exit trades represent opportunities to see something and to act on what you perceive. During each moment the markets are open, you have an opportunity to enter a position, lighten up a position, add to a position, or exit a position. These are all opportunities to enrich yourself by taking profits or, at least, cutting your losses. Let me pose a question. Do you feel responsible for fulfilling some other traders expectations, hopes, dreams, and desires? Of course you don't. It sounds absurd to even ask. However, if you ever find yourself blaming the market and feeling betrayed, that is essentially what you are doing. You are expecting the collective actions of everiyone participating in the market to make the market act in a way that gives you what you want. You have to learn for yourself how to get what you want out of the markets. The first major step in this learning process is taking complete and absolute responsibility.

Taking responsibility means believing that all of your outcomes are self-generated; that your results are based on your interpretations of market information, the decisions you make and the actions you take as a result. Taking anything less than complete responsibility sets up two major psychological obstacles that will block your success.

First, you will establish an adversarial relationship with the market that takes you out of the constant flow of opportunities. Second, you will mislead yourself into believing that your trading problems and lack of success can be rectified through market analysis.

Let's consider the first obstacle. When you project any degree of responsibility onto the market for giving you money or cutting your losses, the market can all too easily take on the quality of an adversary or enemy. Losing (when you expected the market to do something different from what it did) will tap you into the same childlike feelings of pain, anger, resentment, and powerlessness that all of us felt when someone took something away from us, didn't give us what we wanted, or wouldn't let us do what we wanted.

No one likes to feel denied, especially if we believe that getting what we want will make us happy. In each of these situations, something or someone outside of us prevented us from expressing ourselves in some particular way. In other words, some outside force was acting against the inner force of our desires and expectations. As a result, it feels natural to assign the market the power of an outside force that either gives or takes away. But consider the fact that the market presents its information from a neutral perspective. That means the market doesn't know what you want or expect, nor does it care, unless, of course, you trade the kind of position that can have a major impact on prices. Otherwise, each moment, each bid, and each offer gives you the opportunity to do something. You can put on a trade, take profits, or take off a loser. This is also true for those of you who are floor traders and are personally known to other floor traders, who may also know your position and, to your detriment, purposely take advantage of that knowledge. It just means that you have to be faster and more focused, or take whatever limitations you have in these areas into consideration and trade accordingly.

From the market's perspective, each moment is neutral; to you, the observer, every moment and price change can have meaning. But where do these meaning exist? The meanings are based on what you've learned, and exist inside your mind, not in the market. The market doesn't attach meanings or interpret the information it generates about itself (although there are always individuals who will offer an interpretation if you're willing to listen). Furthermore, the market doesn't know how you define an opportunity or a loss. The market doesn't know whether you perceive it as an endless stream of opportunities to enter and exit trades for both profits and losses at each and every moment, or whether you perceive it as a greedy monster ready and willing in any given moment to devour your money.

If you perceive the endless stream of opportunities to enter and exit trades without self-criticism and regret, then you will be in the best frame of mind to act in your own best interest and learn from your experiences. On the other hand, if what you perceive in market information is painful in some way, then you will naturally try to avoid that pain by either consciously or subconsciously blocking that information from your awareness. In the process of blocking that information, you'll systematically cut yourself off from any number of opportunities to enrich yourself. In other words, you cut yourself off from the opportunity flow Furthermore, it will feel like the market is against you but only if you expect it to do something for you, or if you believe that it owes you something. If someone or something is against you and causes you pain, how are you likely to respond? You'll feel compelled to fight, but what exactly are you fighting? The market is certainly not fighting you. Yes, the market wants your money, but it also provides you with the opportunity to take as much as you can. Although it may feel as if you are fighting the market, or it is fighting you, the reality is you are simply fighting the negative consequences of not fully accepting that the market owes you nothing; and that you need to take advantage of the opportunities it presents by yourself, 100 percent and not one degree less.

The way to take maximum advantage of a situation where you are being offered unlimited opportunities to do something for yourself is to get into the flow. The market does have a flow. It is often erratic, especially in the shorter time frames, but it does display symmetrical patterns that repeat themselves over and over again. Obviously, it's a contradiction to flow with something you are against. If you want to start sensing the flow of the market, your mind has to be relatively free of fear, anger, regret, betrayal, despair, and disappointment.

You won't have a reason to experience these negative emotions when you assume absolute responsibility. Earlier, I said that when you don't take responsibility, one of the major psychological obstacles that can block your success is that you will mislead yourself into believing that your trading problems and lack of consistency can be rectified through market analysis. To illustrate this point, let's go back to our novice trader who started out with a carefree state of mind until he experienced his first loss. After winning with such ease and effortlessness, the abrupt shift to emotional pain can be quite shocking—not shocking enough, however, to quit trading. Besides, in his mind the situation wasn't his fault anyway; the market did it to him. Instead of quitting, the great feeling that he experienced when he was winning will be fresh in his mind, and will inspire him with a sense of determination to continue trading.

Only now he's going to be smarter about it. He's going to put some effort into it and learn everything he can about the markets. It's perfectly logical to think that if he can win not knowing anything, he'll be able to clean up when he does know something. But there's a big problem here that very few, if any, traders will have any awareness of until long after the damage is done. Learning about the markets is fine and doesn't cause a problem in itself. It's the underlying reason for learning about the market that will ultimately prove to be his undoing.

As I said a moment ago, the sudden shift from joy to pain usually creates quite a psychological shock. Very few people ever learn how to reconcile these kinds of experiences in a healthy way.

Techniques are available, but they aren't widely known. The typical response in most people, especially in the type of person attracted to trading, is revenge. For traders, the only way to extract that revenge is to conquer the market, and the only way to conquer the market is through market knowledge, or so they think. In other words, the underlying reason for why the novice trader is learning about the market is to overcome the market, to prove something to it and himself, and most important, to prevent the market from hurting him again. He is not learning the market simply as a means to give himself a systematic way of winning, but rather as a way to either avoid pain or prove something that has absolutely nothing to do with looking at the market from an objective perspective. He doesn't realize it, but as soon as he made the assumption that knowing something about the market can prevent him from experiencing pain or can help satisfy his desire for revenge or to prove something, he sealed his fate to become a loser.

In effect what he has done is set up an irreconcilable dilemma.

He is learning how to recognize and understand the market's collective behavior patterns, and that's good. It even feels good. He's inspired because he assumes he's learning about the market in order to become a winner. As a result, he will typically go on a knowledge quest, learning about trend lines, chart patterns, support and resistance, candlesticks, market profiles, point and line charts, Elliott waves, Fibonacci retracements, oscillators, relative strength, stochastics, and many more technical tools too numerous to mention.

Curiously, even though his knowledge has increased, he now finds that he's developed problems executing his trades. He hesitates, second guesses himself, or doesn't put on a trade at all, in spite of any number of clear signals to do so. It's all frustrating, even maddening, because what's happened doesn't make sense. He did what he was supposed to do—he learned—only to find that the more he learned, the less he took advantage of. He would never believe that he did anything wrong by devoting himself to learning; he simply did it for the wrong reasons.

He won't be able to trade effectively if he is trying to prove something or anything for that matter. If you have to win, if you have to be right, if you can't lose or can't be wrong, you will cause yourself to define and perceive categories of market information as painful. In other words, you will view as painful any information the market generates that is in opposition to what will make you happy.

The dilemma is that our minds are wired to avoid both physical and emotional pain, and learning about the markets will not compensate for the negative effects our pain-avoidance mechanisms have on our trading. Everybody understands the nature of avoiding physical pain. Accidentally set your hand on a hot burner, and your hand moves away from the heat automatically; its an instinctive reaction.

However, when it comes to avoiding emotional pain and the negative consequences it creates, especially for traders, very few people understand the dynamics. Its absolutely essential to your development that you understand these negative effects and learn how to take conscious control in a way that helps you fulfill your goals.

Our minds have a number of ways to shield us from information that we have learned to perceive as painful. For example, at a conscious level, we can rationalize, justify, or make a case for staying in a losing trade. Some of the more typical ways we do this are to call our trading buddies, talk to our broker, or look at indicators we never use, all for the express purpose of gathering nonpainful information in order to deny the validity of the painful information. At a subconscious level, our minds will automatically alter, distort, or specifically exclude information from our conscious awareness. In other words, we don't know at a conscious level that our pain-avoidance mechanisms are either excluding or altering the information being offered by the market.

Consider the experience of being in a losing trade when the market is making consistently higher highs and higher lows or lower highs and lower lows against your position, while you refuse to acknowledge you are in a losing trade because you have focused all your attention on the tics that go in your favor. On the average, you are only getting one out of four or five tics in your direction; but it doesn't matter because every time you get one, you are convinced the market has reversed and is coming back. Instead the market keeps going against you. At some point, the dollar value of the loss becomes so great that it cannot be denied and you finally exit the trade. The first reaction that traders universally have when looking back at such a trade is, "Why didn't I just take my loss and reverse?"

The opportunity to put on a trade in the opposite direction was easily recognized once there was nothing at stake. But we were blinded to this opportunity while we were in the trade, because at that time the information indicating it was an opportunity was defined as painful, so we blocked it from our awareness.

When our hypothetical trader first started trading, he was having fun; he was in a carefree state of mind; he had no personal agendas and nothing to prove. As long as he was winning, he put his trades on from a "let's see what will happen" perspective. The more he won, the less he considered the possibility of ever losing. When he finally did lose, he was probably in a state of mind where he least expected it. Instead of assuming that the cause of his pain was his erroneous expectation about what the market was supposed to do or not do, he blamed the market, and resolved that by gaining market knowledge, he could prevent such experiences from recurring. In other words, he made a dramatic shift in his perspective from carefree to preventing pain by avoiding losses.

The problem is that preventing pain by avoiding losses can't be done. The market generates behavior patterns and the patterns repeat themselves, but not every time. So again, there is no possible way to avoid losing or being wrong. Our trader won't sense these trading realities, because he is being driven forward by two compelling forces: (1) he desperately wants that winning feeling back, and (2) he is extremely enthusiastic about all of the market knowledge he is acquiring. What he doesn't realize is that, in spite of his enthusiasm, when he went from a carefree state of mind to a preventand-avoid mode of thinking, he shifted from a positive to a negative attitude.

He's no longer focused on just winning, but rather on how he can avoid pain by preventing the market from hurting him again. This kind of negative perspective isn't any different from the tennis player or golfer who is focused on trying not to make a mistake, the more he tries not to make a mistake, the more mistakes he makes. However, this mode of thinking is much easier to recognize in sports because there's a more discemable connection between one's focus and one's results. With trading, the connection can be obscured and more difficult to recognize as a result of the positive feelings being generated from discovering new relationships in market data and behavior.

Since he is feeling good, there's no reason to suspect that anything is wrong, except that the degree to which his focus is weighted toward pain-avoidance is the same degree by which he will create the very experiences he is trying to avoid. In other words, the more he has to win and not lose, the less tolerance he will have for any information that might indicate he is not getting what he wants. The mor information that he has the potential to block, the less he will be able to perceive an opportunity to act in his own best interests.

Learning more and more about the markets only to avoid pain will compound his problems because the more he learns, the more he will naturally expect from the markets, making it all the more painful when the markets don't do their part. He has unwittingly created a vicious cycle where the more he learns, the more debilitated he becomes; the more debilitated he becomes, the more he feel compelled to learn. The cycle will continue until he either quits trading in disgust or recognizes that the root cause of his trading problems is his perspective, not his lack of market knowledge.

WINNERS, LOSERS, BOOMERS, AND BUSTERS

It takes some time before most traders either throw in the towel or find out the true source of their success. In the meantime, some traders manage to get enough right about trading to enter into what is commonly referred to as the "boom and bust cycle."

Contrary to what some of you may have inferred from the example of the novice trader, not everyone has an inherently negative attitude and is therefore doomed to lose consistently. Yes, it is true that some traders do consistently lose, often until they lose everything or quit trading because they can't tolerate any more emotional pain. However, there are also many traders who are tenacious students of the market and have a sufficiently winning attitude going into trading so that, in spite of the many difficulties, they eventually learn how to make money. But, and I want to emphasize this, they learn how to make money only on a limited basis; they haven't yet learned how to counteract the negative effects of euphoria or how to compensate for the potential for self-sabotage.

Euphoria and self-sabotage are two powerful psychological forces that will have an extremely negative effect on your bottom line. But, they are not forces you have to concern yourself with until you start winning, or start winning on a consistent basis, and that's a big problem. When you're winning, you are least likely to concern yourself with anything that might be a potential problem, especially something that feels as good as euphoria. One of the primary characteristics of euphoria is that it creates a sense of supreme confidence where the possibility of anything going wrong is virtually inconceivable.

Conversely, errors that result from self-sabotage have their root in any number of conflicts that traders have about deserving the money or deserving to win. It's when you're winning that you are most susceptible to making a mistake, overtrading, putting on too large a position, violating your rules, or generally operating as if no prudent boundaries on your behavior are necessary. You may even go to the extreme of thinking you are the market. However, the market rarely agrees, and when it disagrees, you'll get hurt. The loss and the emotional pain are usually significant. You will experience a boom, followed by the inevitable bust.

If I were to classify traders based on the kind of results they achieve, I would put them into three broad categories. The smallest group, probably fewer than 10 percent of the active traders, are the consistent winners. They have a steadily rising equity curve with relatively minor drawdowns. The drawdowns they do experience are the type of normal losses that any trading methodology or system incurs.

Not only have they learned how to make money, but they are no longer susceptible to the psychological forces that cause the boomand-bust cycle.

The next group, which consists of between 30 and 40 percent of the active traders, are consistent losers. Their equity curves are mirror images of the consistent winners' curves, but in the opposite direction—many losing trades with an occasional winner. Regardless of how long they have been trading, there's much about it that they haven't learned. They either have illusions about the nature of trading or are addicted to it in ways that make it virtually impossible for them to be winners.

The largest group, the remaining 40 to 50 percent of the active traders, are the "boom and busters." They have learned how to make money, but they haven't learned there s a whole body of trading skills that have to be mastered in order to keep the money they make. As a result, their equity curves typically look like roller-coaster rides, with a nice, steady assent into a steep dropoff, then another nice, steady assent into another steep dropoff. The roller-coaster cycle continues on and on.

I have worked with many experienced traders who have put together incredible winning streaks, sometimes going months without a losing day; having fifteen or twenty winning trades in a row is not unusual for them. But for the boom and busters, these streaks always end the same way—in huge losses that are the result of either euphoria or self-sabotage.

If the losses are the result of euphoria, it really doesn't matter what form the streak takes—a number of wins in a row, a steadily rising equity curve, or even one winning trade. Everyone seems to have a different threshold for when overconfidence or euphoria starts to take hold of the thinking process. However, the moment euphoria takes hold, the trader is in deep trouble. In a state of overconfidence or euphoria, you can't perceive any risk because euphoria makes you believe that absolutely nothing can go wrong. If nothing can go wrong, there's no need for rules or boundaries to govern your behavior. So putting on a larger than usual position is not only appealing, it's compelling.

However, as soon as you put on the larger-than-usual position, you're in danger. The larger the position, the greater the financial impact small fluctuations in price will have on your equity. Combine the largerthan- normal impact of a move against your position with a resolute belief that the market will do exactly as you expect, and you have a situation in which one tic in the opposition direction of your trade can cause you to go into a state of "mind-freeze" and become immobilized.

When you finally do pull yourself out of it, you'll be dazed, disillusioned, and betrayed, and you'll wonder how something like that could have happened. In fact, you were betrayed by your own emotions. However, if you're not aware of or don't understand the underlying dynamics I just described, you'll have no other choice but to blame the market. If you believe the market did this to you, then you'll feel compelled to learn more about the market in order to protect yourself. The more you learn, the more confident you will naturally become in your ability to win. As your confidence grows, the more likely that at some point you will cross the threshold into euphoria and start the cycle all over again.

Losses that result from self-sabotage can be just as damaging, but they're usually more subtle in nature. Making errors like putting in a sell for a buy or vice versa, or indulging yourself in some distracting activity at the most inopportune time are typical examples of how traders make sure they don't win.

Why wouldn't someone want to win? It's really not a question of what someone wants, because I believe that all traders want to win. Yet, there are often conflicts about winning. Sometimes these conflicts are so powerful that we find our behavior is in direct conflict with what we want. These conflicts could stem from religious upbringing, work ethic or certain types of childhood trauma. If these conflicts exist, it means that your mental environment is not completely aligned with your goals.

In other words, not all parts of you would argue for the same outcome. Therefore, you can't assume that you have the capacity to give yourself an unlimited amount of money just because you have learned how to trade and the money is there for the taking.

A futures broker at one of the major brokerage firms once commented that when it comes to his customers, he lives by the motto that all commodity traders are terminal, and it is his job to keep them happy until they're gone. He said this facetiously, but there is a lot of truth to his statement. Obviously, if you lose more money than you make, you can't survive. What's less obvious, and one of the mysteries of being successful, is that if you win, you may still be terminal; that is, if you win and you haven't learned how to create a healthy balance between confidence and restraint, or you haven't learned how to recognize and compensate for any potential you have to self-destruct, you will sooner or later lose.

If you are among those in the boom-and-bust cycle, consider this: If you could redo every losing trade that was the result of an error or recklessness, how much money would you have now? Based on these recalculated results, what would your equity curve look like? I'm sure many of you would fall into the category of consistent winners. Now think about how you responded to your losses when they occurred. Did you assume complete responsibility for them? Did you try to identify how you might change your perspective, attitude, or behavior? Or did you look to the market and wonder what you might learn about it to prevent such a thing from happening again? Obviously, the market has nothing to do with your potential for recklessness, nor does it have anything to do with the errors you make as a result of some internal conflict about deserving the money.

Probably one of the hardest concepts for traders to effectively assimilate is that the market doesn't create your attitude or state of mind; it simply acts as a mirror reflecting what's inside back to you. If you are confident, it's not because the market is making you feel that way; it is because your beliefs and attitudes are aligned in a way that allows you to step forward into an experience, take responsibility for the outcome, and extract the insight that's been made available. You maintain your confident state of mind simply because you are constantly learning. Conversely, if you're angiy and afraid, it's because you believe to some degree that the market creates your outcomes, not the other way around. Ultimately, the worst consequence of not taking responsibility is that it keeps you in a cycle of pain and dissatisfaction. Think about it for a moment. If you're not responsible for your results, then you can assume there's nothing for you to learn, and you can stay exactly as you are.

You won't grow and you won't change. As a result, you will perceive events in exactly the same way, and therefore respond to them in the same way, and get the same dissatisfying results. Or, you might also assume the solution to your problems is to gain more market knowledge. It is always virtuous to learn, but in this case if you don't take responsibility for your attitudes and perspective, then *I* you're learninc* snmpfhinff valuaVilp fnr wrnnrr that will cause you to use what you've learned in inappropriate ways. Without realizing it, you'll be using your knowledge to avoid the responsibility of taking risks. In the process, you end up creating the veiy things you are trying to avoid, keeping you in a cycle of pain and dissatisfaction. However, there is one tangible benefit to be gained from blaming the market for what you wanted and didn't get.

You can temporarily shield yourself from your own harsh self-criticism. I say "temporarily" because, when you shift responsibility, you cut yourself off from whatever you needed to learn from the experience. Remember our definition of a winning attitude: a positive expectation of your efforts with an acceptance that whatever results you get are a perfect reflection of your level of development and what you need to learn to do better. If you shift the blame in order to block the painful feelings that result from beating yourself up, all you've done is put an infected Band-Aid on the wound. You may think you have solved the problem, but the problem is only going to resurface later, worse than before. It has to, simply because you haven't learned anything that would cause you to make the land of interpretations that would result in a more satisfying experience.

Did you ever wonder why leaving money on the table is often more painful than taking a loss? When we lose, there are any number of ways in which we can shift the blame to the market and not accept responsibility. But when we leave money on the table, we can't blame the market. The market didn't do anything but give us exactly what we wanted, but for whatever reason, we weren't capable of acting on the opportunity appropriately. In other words, there's no way to rationalize the pain away. You are not responsible for what the market does or doesn't do, but you are responsible for everything else that results from your trading activities. You are responsible for what you have learned, as well as for everything you haven't learned yet that's waiting to be discovered by you. The most efficient path to discovering what you need to be successful is to develop a winning attitude, because it's an inherently creative Dersoective. Not onlv does a winnin? attitude onen vou un to what you need to learn; it also produces the land of mind-set that is most conducive to discovering something no one else has experienced. Developing a winning attitude is the key to your success. The problem for many traders is that either they think they already have one, when they don't, or they expect the market to develop the attitude for them by giving them winning trades. You are responsible for developing your own winning attitude. The market is not going to do it for you, and, I want to be as emphatic as I can, no amount of market analysis will compensate for developing a winning attitude if you lack one.

Understanding the markets will give you the edge you need to create some winning trades, but your edge won't make you a consistent winner if you don't have a winning attitude. Certainly one could argue that some traders lose because they don't understand enough about the markets and therefore they usually pick the wrong trades. As reasonable as this may sound, it has been my experience that traders with losing attitudes pick the wrong trades regardless of how much they know about the markets. In any case, the result is the same—they lose.

On the other hand, traders with winning attitudes who know virtually nothing about the markets can pick winners; and if they know a lot about the markets, they can pick even more winners. If you want to change your experience of the markets from fearful to confident, if you want to change your results from an erratic equity curve to a steadily rising one, the first step is to embrace the responsibility and stop expecting the market to give you anything or do anything for you. If you resolve from this point forward to do it all yourself, the market can no longer be your opponent. If you stop fighting the market, which in effect means you stop fighting yourself, you'll be amazed at how quickly you will recognize exactly what you need to learn, and how quickly you will learn it. Taking responsibility is the cornerstone of a winning attitude.

CHAPTER 4

CONSISTENCY: A STATE OF MIND

I hope that after reading the first three chapters you are getting die idea that just because you are acting in the capacity of a trader, doesn't mean that you've learned the appropriate ways to think about what you do. As I have already stressed several times, what separates the best traders from everyone else is not what they do or when they do it, but rather how they think about what they do and how they're thinking when they doit. If your goal is to trade like a professional and be a consistent winner, then you must start from the premise that the solutions are in your mind and not in the market. Consistency is a state of mind diat has at its core certain fundamental thinking strategies that are unique to trading. Experiencing a few or more winning trades can convince almost anyone that trading is easy. Recall your own experiences; think back to those trades that brought a stream of money flowing into your account when all you had done was make a simple decision to buy or sell.

Now, combine the extremely positive feeling you get from winning and getting money with no effort, and it's almost impossible not to conclude that making money as a trader is easy. But if that's the case, if trading is so easy, then why is it so difficult to master? Why are so many traders at their wits' end, grappling with the obvious contradiction? If it is true that trading is easy — and traders know it is because they've had the direct experience of how easy and effortless it is — then how can it also be possible that they can't make what they've learned about the markets work for them over and over again? In other words, how do we account for the contradiction between what we believe about trading and our actual trading results over time?

THINKING ABOUT TRADING

The answers are all in the way you think about it. The irony is that trading can be as much fun and as effortless as your experience of it has been on occasion; but experiencing these qualities consistently is a function of your perspective, your beliefs, your attitudes, or your mindset.

Choose the term you are most comfortable with; they all refer to the same thing: Winning and consistency are states of mind in the same way that happiness, having fun, and satisfaction are states of mind. Your state of mind is a by-product of your beliefs and attitudes. You can try to create consistency without having the appropriate beliefs and attitudes, but your results won't be any different than if you tiy to be happy when you're not having fun. When you're not having fun, it can be very difficult to change your perspective to one where you, all of a sudden, start enjoying yourself. Of course, the circumstances of your situation could suddenly shift in a way that causes you to experience joy. But then your state of mind would be the result of an external shift in conditions, not a result of an internal shift in your attitude. If you depend on outside conditions and circumstances to make you happy (so that you always are enjoying yourself), then it is extremely unlikely that you will experience happiness on a consistent basis.

However, you can greatly increase the possibility of your being happy by developing fun-type attitudes and, more specifically, by working on neutralizing the beliefs and attitudes that prevent you from having fun or enjoying yourself. Creating consistent success as a trader works the same way. You can't rely on the market to make you consistently successful, any more than you can rely on the outside world to make you consistently happy. People who are truly happy don't have to do anything in order to be happy.

They are happy people who do things. Traders who are consistently successful are consistent as a natural expression of who they are. They don't have to try to be consistent; they are consistent. This may seem like an abstract distinction, but it is vitally important that you understand the difference. Being consistent is not something you can try to be, because the very act of trying will negate your intent by mentally taking you out of the opportunity flow, making it less likely that you will win and more likely you will lose. Your veiy best trades were easy and effortless. You didn't have to try to make them easy; they were easy. There was no struggle. You saw exactly what you needed to see, and you acted on what you saw. You were in the moment, a part of the opportunity flow. When you're in the flow, you don't have to try, because everything you know about the market is available to you. Nothing is being blocked or hidden from your awareness, and your actions seem effortless because there's no struggle or resistance. On the other hand, having to try indicates that there is some degree of resistance or struggle. Otherwise, you would just be doing it and not have to try to be doing it. It also indicates that you're trying to get what you want from the market. While it seems natural to think this way, it's a perspective fraught with difficulties.

The best traders stay in the flow because they don't try to get anything from the market; they simply make themselves available so they can take advantage of whatever the market is offering at any given moment. There's a huge difference between the two perspectives.

In Chapter 3, I briefly illustrated how our minds are wired to avoid both physical and emotional pain. If you trade from the perspective of trying to get what you want or what you expect from the markets, what happens when the market doesn't behave in a way that will fulfill your expectations? Your mental defense mechanisms kick in to compensate for the difference between what you want and what you're not getting, so that you don't experience any emotional pain.

Our minds are designed to automatically block threatening information or find a way to obscure that information, in order to shield us from the emotional discomfort we naturally feel when we don't get what we want. You won't realize it in the moment, but you will pick and choose information that is consistent with what you expect, so that you can maintain a pain-free state of mind.

However, in the process of trying to maintain a pain-free state of mind, you also take yourself out of the opportunity flow and enter the realm of the "could have," the "should have," the "would have," and the "if only." Everything that you could have, should have, or would have recognized in the moment appeared invisible, then all becomes painfully evident after the fact, after the opportunity is long gone.

To be consistent, you have to learn to think about trading in such a way that you're no longer susceptible to conscious or subconscious mental processes that cause you to obscure, block, or pick and choose information on the basis of what will make you happy, give you what you want, or avoid pain.

The threat of pain generates fear, and fear is the source of 95 percent of the errors you are likely to make. Certainly, you can't be consistent or experience the flow if you're consistently making errors, and you will make errors, as long as you're afraid that what you want or what you expect won't happen.

Furthermore, everything you attempt to do as a trader will be a struggle, and it will seem as if you are struggling against the market or that the market is against you personally. But, the reality is that it's all taking place inside your mind. The market doesn't perceive the information it makes available; you do.

If there's a struggle, it is you who are struggling against your own TV^^oT*n 11 T-acic^onoo /">r^T-iTlir»l-c anri r^avc

Now, you may be asking yourself, how can I think about trading in such a way that I'm no longer afraid and, therefore, no longer susceptible to the mental processes that cause me to block, obscure, or pick and choose information? The answer is: Learn to accept the risk.

REALLY UNDERSTANDING RISK

Other than the many issues surrounding responsibility that we discussed in Chapter 3, there isn't anything about trading that is more central to your success and also more misunderstood than the concept of accepting the risk. As I mentioned in the first chapter, most traders erroneously assume that because they are engaged in the inherently risky activity of putting on and taking off trades, they are also accepting that risk. I will repeat that this assumption couldn't be further from the truth.

Accepting the risk means accepting the consequences of your trades without emotional discomfort or fear. This means that you must learn how to think about trading and your relationship with the markets in such a way that the possibility of being wrong, losing, missing out, or leaving money on the table doesn't cause your mental defense mechanisms to kick in and take you out of the opportunity flow. It doesn't do you any good to take the risk of putting on a trade if you are afraid of the consequences, because your fears will act on your perception of information and your behavior in a way that will cause you to create the very experience you fear the most, the one you are trying to avoid. I am offering you a specific thinking strategy composed of a set of beliefs that will keep you focused, in the moment, and in the flow. With this perspective, you will not be trying to get anything from the market or to avoid anything. Rather, you will let the market unfold and you will make yourself available to take advantage of whatever situations you define as opportunities. When you make yourself available to take advantage of an opportunity, you don't impose any limitations or expectations on the market’s behaviour. You are satisfied to let the market do whatever it's going to do.

However, in the process of doing something, the market will create certain conditions you define and perceive as opportunities. You act on those opportunities to the best of your ability, but your state of mind is not dependent upon or affected by the market's behavior. If you can learn to create a state of mind that is not affected by the market's behavior, the struggle will cease to exist. When the internal struggle ends, everything becomes easy. At that point, you can take full advantage of all your skills, analytical or otherwise, to eventually realize your potential as a trader. Here's the challenge! How do you accept the risks of trading without emotional discomfort and fear, when at the moment you perceive the risk, you simultaneously feel discomfort and fear? In other words, how do you remain confident and pain-free when you are absolutely certain you can be proved wrong, lose money, miss out, or leave money on the table?

As you can see, your fear and feeling of discomfort are completely justified and rational. Each of those possibilities becomes real the moment you contemplate interacting with the market. However, as true as all of these possibilities are for every trader, what isn't true or the same for every trader is what it means to be wrong, lose, miss out, or leave money on the table. Not everyone shares the same beliefs and attitudes about these possibilities and, therefore, we don't share the same emotional sensitivities. In other words, not everyone is afraid of the same things.

This may seem obvious, but I assure you it is not. When we're afraid, the emotional discomfort we feel in the moment is so real that it's beyond question, and it's natural to assume that everyone shares our reality. I will give you a perfect example of what I am talking about. I recently worked with a trader, who was deathly afraid of snakes. As far as he was concerned, he had always been afraid of snakes because he couldn't recall a time when he wasn't. Now he is married and has a three-year-old daughter. One evening, while his wife was out of town, his daughter and he were invited to a friend's house for dinner. Unbeknownst to my client, his friends child had a pet snake.

When the friends child brought out the snake for everyone to see, my client freaked and practically leapt to the other side of the room to get as far away from the snake as possible. His daughter, on the other hand, was completely enthralled with the snake, and wouldn't leave it alone. When he related this story to me, he said that he was not only shocked by the unexpected confrontation with the snake, but that he was just as shocked by his daughter's reaction. She wasn't afraid and he assumed that she would be. I explained to him that his fear was so intense and his attachment to his daughter was so great that it was inconceivable to him that his daughter would not automatically share his reality about snakes. But then I pointed out, there really wasn't any way she could have shared his experience, unless he specifically taught her to be afraid of snakes or she had had her own painful frightening experience. Otherwise, without anything to the contrary in her mental system, the most likely reaction to her first encounter with a living snake would be pure, unadulterated fascination.

Just as my client assumed that his daughter would be afraid of snakes, most traders assume the best traders, like themselves, are also afraid of being wrong, losing, missing out, and leaving money on the table. They assume that the best traders somehow neutralize their fears with an inordinate amount of courage, nerves of steel, and self-control.

Like many other things about trading, what seems to make sense, just isn't the case. Certainly, any one or all of these characteristics may be present in any top trader. But what is not true is that these characteristics play any role in their superior performance. Needing courage, nerves of steel, or self-control would imply an internal conflict where one force is being used to counteract the effects of another. Any degree of struggle, trying, or fear associated with trading will take you out of the moment and flow and, therefore, diminish your results. This is where professional traders really separate themselves from the crowd. When you accept the risk the way the pros do, you won't perceive anything that the market can do as threatening. If nothing is threatening, there's nothing to fear. If you're not afraid, you don't need courage. If you're not stressed, why would you need nerves of steel? And if you're not afraid of your potential to get reckless, because you have the appropriate monitoring mechanisms in place, then you have no need for self-control.

As you contemplate the implications of what I am saying, I want you to keep something in mind: Very few people who go into trading start out with the appropriate beliefs and attitudes about responsibility and risk. There are some who do but it's rare. Everyone else goes through the same cycle I described in the example of the novice trader: We start out carefree, then become scared, and our fears continually diminish our potential. The traders who break through the cycle and ultimately make it are the ones who eventually learn to stop avoiding and start embracing the responsibility and the risk.

Most of those who successfully break the cycle don't make the shift in thinking until they have experienced so much pain from large losses that it has the positive effect of stripping away their illusions about the nature of trading. With respect to your development, the *how* of their transformation is not that important, because in most cases it happened inadvertently. In other words, they weren't completely aware of the shifts that were taking place inside their mental environment until they experienced the positive effects their new perspective had on the ways in which they interacted with the market. This is why very few top traders can really explain what accounts for their success, except to speak in axioms like "cut your losses" and "go with the flow."

What is important is that you understand it is completely possible to think the way the professionals do and to trade without fear, even though your direct experience as a trader would argue otherwise.

ALIGNING YOUR MENTAL ENVIRONMENT

Now we're going to start zeroing in on exactly how you can align your mental environment in order to accept the risk and function like a professional trader. Most of what I've discussed up to this point was designed to get you ready to do the real work. I'm going to teach you a thinking strategy that has, at its core, a firm belief in probabilities and edges.

With this new thinking strategy, you'll learn how to create a new relationship with the market, one that disassociates your trading from what it typically means to be wrong or to lose, and that precludes you from perceiving anything about the market as threatening. When the threat of pain is gone, the fear will correspondingly disappear, as will the fear-based errors you are susceptible to. You will be left with a mind that is free to see what is available and to act on what you see. Getting to this carefree, fearless state of mind, in spite of being burned over and over again, will take some work, but it's not going to be so difficult as you may think. In fact, by the time you've finished reading this book, most of you will be amazed at how simple the solutions to your problems really are. In many respects, a state of mind or perspective is like software code.

You could have several thousand lines of perfectly written code, with only one flawed line, and in that one flawed line there might be only one character out of place. Depending on the purpose of the software and where that flaw is in relation to everything else, that one misplaced character could ruin the performance of an otherwise perfectly written system. You see, the solution was simple: Fix the misplaced character, and everything runs smoothly. However, finding the error or even knowing it exists in the first place can take considerable expertise.

When it comes to the ideal trading mentality, everybody is a certain psychological distance away. In other words, virtually everyone starts out with flawed software code. I use terms like clicks or degrees to indicate psychological distance but these terms don't imply a specific distance. So, for example, many of you will find that you are only, let's say, one click away in perspective from the ideal mind-set. That one click could represent one or two erroneous or misplaced assumptions you have about the nature of trading. As you reflect upon some of the ideas presented in this book, your perspective may shift.

To use the analogy of software code, that shift would be equivalent to finding the flawed line in your mental system and replacing it with something that works properly. People normally describe this kind of internal mental shift as an "ah, ha" experience, or the moment when the light goes on. Everyone has had these kinds of experiences, and there are some common qualities associated with them. First, we usually feel different. The world even seems different, as if it had suddenly changed. Typically, we might say at the moment of the breakthrough something like, "Why didn't you tell me this before?" or, "It was right in front of me the whole time, but I just didn't see it" or, "It's so simple; why couldn't I see it?"

Another interesting phenomenon of the "ah, ha" experience, is that sometimes within moments, although the amount of time can vary, we feel as if this new part of our identity has always been a part of who we are. It then becomes difficult to believe that we were ever the way we were before we had the experience. In short, you may already have some awareness of much of what you need to know to be a consistently successful trader. But being aware of something doesn't automatically make it a functional part of who you are. Awareness is not necessarily a belief. You can't assume that learning about something new and agreeing with it is the same as believing it at a level where you can act on it. Take the example of my client who is afraid of snakes. He is certainly aware that not all snakes are dangerous, and that learning how to make a distinction between the ones that are dangerous and the ones that aren't would not be difficult.

Will learning how to make these distinctions suddenly cause him not to be afraid of "non-dangerous snakes"? Can we assume that his awareness will drop down to a level in his mental environment where he can now interact with snakes without fear or immobility? No, we cannot make this assumption. His awareness that some snakes aren't dangerous and his fear of snakes can exist side by side in his mental environment, as a contradiction to each other. You could confront him with a snake and he might readily acknowledge that he knows the snake is not dangerous and wouldn't hurt him; but, at the same time, he would still find it extremely difficult to touch the snake, even if he wanted to. Does this mean that he is doomed to be afraid of snakes for the rest of his life? Only if he wants to be. It's really a matter of willingness.

It's certainly possible to neutralize his fear, but he will have to work at it, and working at anything requires sufficient motivation. Many of us have what we know to be irrational fears and simply choose to live with the contradiction because we don't want to go through the emotional work that is necessary to overcome the fear. In this example, the contradiction is obvious. However, in my many years of working with traders, I have uncovered several typical contradictions and conflicts surrounding the issues of risk and responsibility, where holding two or more conflicting beliefs can easily cancel out your positive intentions, no matter how motivated you are to be successful.

The problem is that none of these contradictions are really obvious, at least not at first glance. Contradictory beliefs, however, aren't the only problems. What about assertions like "I'm a risk taker," that traders typically assume have dropped down to the functional level of a belief when, in fact, the underlying dynamics of the way they perceive the market indicates they are doing everything possible to avoid risk. Contradictory beliefs and nonfunctional awareness represent flawed mental software code; code that destroys your ability to stay focused and accomplish your goals; code that makes it seem as if you simultaneously have one foot on the accelerator and the other on the brake; code that gives learning how to trade a mysterious quality that will be challenging in a fun way at first, but usually turns into pure, unadulterated exasperation. When I was in college in the late 1960s, one of my favorite movies was *Cool Hand Luke,* starring Paul Newman. It was a very popular movie back then, so I'm sure some of you have seen it on late-night TV.

Luke was in a Georgia chain gang. After he escaped and was caught for the second time, the warden and guards were determined not to let Luke make fools of them a third time. So while forcing him to do an inordinate amount of work with no rest and giving him intermittent beatings, they kept asking, "Have you got your mind right yet, Luke?" Eventually, after considerable suffering, Luke finally told the prison bosses that he had his mind right. They said that if he didn't, and tried to escape again, they'd kill him for sure. Of course, Luke attempted another escape, and true to their word, the guards killed him. Like Luke, many traders, whether they realize it or not, are trying to have it their way by beating the market; as a result, they get financially and emotionally killed. There are easier, infinitely more satisfying ways of getting what you want from the market, but first you have to be willing to "get your mind right."

CHAPTER 5

THE DYNAMICS OF PERCEPTION

One of the primary objectives of this book is to teach you how to take the threat of pain out of market information. The market doesn't generate happy or painful information. From the markets perspective, it's all simply information. It may seem as if the market is causing you to feel the way you do at any given moment, but that's not the case. It's your own mental framework that determines how you perceive the information, how you feel, and, as a result, whether or not you are in the most conducive state of mind to spontaneously enter the flow and take advantage of whatever the market is offering. Professionals don't perceive anything about the markets as painful; therefore, no threat exists for them. If there's no threat, there's nothing to defend against. As a result, there isn't any reason for their conscious or subconscious defense mechanisms to kick in. That's why professionals can see and do things that mystify everyone else. They're in the flow, because they're perceiving an endless stream of opportunities, and when they're not in the flow, the very best of the best can recognize that fact and then compensate by either scaling back or not trading at all.

If your goal is to be able to trade like the professionals, you must be able to see the market from an objective perspective, without distortion. You must be able to act without resistance or hesitation, but with the appropriate amount of positive restraint to counteract the negative effects of overconfidence or euphoria. In essence, your objective is to be able to create a unique state of mind, a traders mentality. When you've accomplished this, everything else about your success as a trader will fall into place. To help you achieve that objective, I'm going to give you a way to redefine your relationship to market information so that there will be little or no potential to perceive any of it as threatening.

By "redefine," I mean to change your perspective and operate out of a mental framework that keeps you focused on the opportunities available instead of tapping you into emotional pain.

DEBUGGING YOUR MENTAL SOFTWARE

In other words, we want to get the bugs out of our mental software code and get our minds right. Doing this effectively will require an understanding of the nature of mental energy and how you can use that energy to change a perspective that is generating an unwanted, negative, emotional response to market information. There's much to learn, but I think you will be amazed at how some simple changes can make a huge difference in your trading results. The process of trading starts with perceiving an opportunity. Without the perception of an opportunity, we wouldn't have a reason to trade. So I think it is only fitting that we start our examination of mental energy by breaking down the process of perception.

What are the underlying dynamics of perception? What factors determine how we perceive information or what we perceive in relationship to what is available? How is perception connected with what we experience at any given moment? Probably the easiest way to understand the dynamics of perception and answer these questions is to think of everything (and I do tion of forces—forces that generate information about the properties, characteristics, and traits that make them uniquely what they are. Everything that exists outside of our bodies—all plants and all categories of life; all planetary phenomena in the form of weather conditions, earthquakes, and volcanic eruptions; all active and inert physical matter; and all noncorporeal phenomena such as light, sound waves, microwaves, and radiation—generates information about the nature of its existence. That information has the potential to act as a force on one of our five physical senses. Before we go any further, notice that I use the verb "generate" in an all-inclusive way implying that everything is in an active state of expression, including inanimate objects.

To illustrate why I do that, let's look at something as simple as a rock. It's an inanimate object, composed of unique atoms and molecules expressing themselves as a rock. I can use the active verb "expressing" because the atoms and molecules that make up the rock are in constant motion. So, even though the rock doesn't appear active except in the most abstract sense, it has characteristics and properties that will act as forces on our senses, causing us to experience and make distinctions about the nature of its existence. For example, a rock has texture, and that texture acts as a force on our sense of touch if we run our fingers across the rock's surface.

A rock has shape and color, which act as a force on our vision; the rock takes up space that no other object can occupy, so that we see it instead of an empty space or some other object. A rock can also have an odor that acts as a force on our sense of smell, or taste like something, although I haven't licked any rocks lately to find out. When we encounter anything in the environment that expresses its properties and characteristics, an exchange of energy takes place. Energy from the outside, in the form of whatever is expressing itself, gets transformed by our nervous system into electrical impulses and then gets stored in our inner, mental environment. To be more specific, whatever we are seeing, hearing, tasting, smelling, or feeling through our senses gets transformed into electrical impulses of energy and stored in our mental environment as a memory and/or dis- I think all of this is fairly self-evident to most people, but there are some profound implications here that aren't self-evident, and we typically take them completely for granted.

First of all, there's a cause-and-effect relationship that exists between ourselves and everything else that exists in the external environment. As a result, our encounters with external forces create what I am going to call "energy structures" inside our minds. The memories, distinctions, and, ultimately, the beliefs we acquire throughout our lives exist in our mental environment in the form of structured energy. Structured energy is an abstract concept. You might be asking yourself, "How does energy take shape or form?" Before I answer this question, an even more fundamental question needs to be addressed.

How do we know that memories, distinctions, and beliefs exist in the form of energy in the first place? I don't know if it's been scientifically proven or completely accepted by the scientific community, but ask yourself in what other form could these mental components exist? Here's what we know for sure: Anything composed of atoms and molecules takes up space and, therefore, can be observed. If memories, distinctions, and beliefs existed in some physical form, then we should be able to observe them. To my knowledge, no such observations have been made.

The scientific community has dissected brain tissue (both living and dead) examined it at the level of the individual atom, mapped various regions of the brain in terms of their functions, but nobody, as yet, has *observed* a memory, distinction, or belief in its natural form. By "in its natural form" I mean that although a scientist can observe the individual brain cells that contain certain memories, he can't experience those memories first hand. He can only experience them if the person to whom the memories belong is alive and chooses to express them in some way. If memories, distinctions, and beliefs don't exist as physical matter, then there really isn't any alternative way for them to exist except as some form of energy. If this is in fact the case, can this energy take on a specific shape? Can it be structured in a way that reflects the external forces that caused it to come into existence? Most definitely! Is there anvthing in the environment that is analogous to energy having shape

Thoughts are energy. Because you think in a language, your thoughts are structured by the limitations and rules that govern the particular language in which you think. When you express those thoughts aloud, you create sound waves, which are a form of energy. The sound waves created by the interaction of your vocal cords and tongue are structured by the content of your message. Microwaves are energy. Many phone calls are relayed by microwaves, which means that the microwave energy has to be structured in a way that reflects the message it is carrying.

Laser light is energy, and if you've ever witnessed a demonstration of a laser light show, or laser art, what you've seen is pure energy taking a shape that reflects the creative desires of the artists. All of these are good examples of how energy can take shape, form, and structure. Of course, there are many more, but there is one more example that illustrates the point in the most graphic way. At the most fundamental level, what are dreams? I am not asking you what dreams mean or what you think their purpose is, but rather, what are they? What are their properties? If we assume that dreams take place within the confines of our skulls, then they can't be composed of atoms and molecules, because there wouldn't be enough space for all of the things that exist and take place in our dreams. Dream experiences seem to have the same proportions and dimensions as the things we perceive when we are awake and experiencing life through our five senses.

The only way this could be possible is if dreams were a form of structured energy, because energy can take on any size or dimension, but, in doing so, doesn't actually take up any space. Now, if it hasn't already occurred to you, there's something here that's really profound. If the memories, distinctions, and beliefs we've acquired as a result of our encounters with the external environment represent what we've learned about that environment and how it works; and if these memories, distinctions, and beliefs exist in our mental environment as energy; and if energy doesn't take up any space; then it also could be said that we have an unlimited capacity for learning.

Well, not only do I think it could be said, I'm saying it. Consider the development of human consciousness and what to know to function effectively compared to just 100 years ago. There is absolutely nothing to indicate that we don't have an unlimited capacity to learn. The difference between what we are aware of now and what we can do as a result of this expanded awareness would boggle the mind of anyone living 100 years ago.

PERCEPTION AND LEARNING

However, we must be careful not to equate storage capacity with learning capacity. Learning, and becoming aware of what is available to be learned, is not just a function of storage capacity. If it were, then what would stop us from knowing everything? And if we knew everything, then what would stop us from perceiving every possible characteristic, property, or trait of everything that is expressing itself in any given moment? What stops us now? These questions get to the very heart of why you have to understand that mental components like memories, distinctions, and beliefs exist as energy. Anything that is energy has the potential to act as a force expressing its form, and that is exactly what our memories, distinctions and beliefs do.

They act as a force on our senses from the inside, expressing their form and content, and, in the process of doing so, they have a profoundly limiting effect on the information we perceive in any given moment, making much of the information that is available from the environment's perspective, and the possibilities inherent within that information, literally invisible.

I am saying here that, in any given moment the environment is generating an enormous amount of information about its properties, characteristics, and traits. Some of that information is beyond the physiological range of our senses. For example, our eyes can't see every wavelength of light nor can our ears hear every frequency of sound the environment produces, so there's definitely a range of information that is beyond the physiological capabilities of our senses. What about the rest of the information the environment is generating about itself? Do we see, hear, taste, smell, or feel through our senses every possible distinction, trait, and characteristic being senses? Absolutely not! The energy that's inside of us will categorically limit and block our awareness of much of this information by working through the same sensory mechanisms the external environment works through. Now, if you take a moment and think about it, some of what I just said should be self-evident. For example, there are many ways in which the external environment can express itself that we don't perceive simply because we haven't learned about them yet.

This is easy to illustrate. Think back to the first time you ever looked at a price chart. What did you see? Exactly what did you perceive? With no previous exposure, I'm sure, like everyone else, you saw a bunch of lines that had no meaning. Now if you're like most traders, when you look at a price chart you see characteristics, traits, and behavior patterns that represent the collective actions of all the traders who participated in those particular trades. Initially, the chart represented undifferentiated information. Undifferentiated information usually creates a state of confusion, and that's probably what you experienced when you first encountered a chart.

Gradually, however, you learned to make distinctions about that information, such as trends and trend lines, consolidations, support and resistance, retracements or significant relationships between volume, and open interest and price action, just to name a few. You learned that each of these distinctions in the market s behavior represented an opportunity to fulfill some personal need, goal, or desire. Each distinction now had a meaning and some relative degree of significance or importance attached to it. Now, I want you to use your imagination and pretend that I just set before you the very first price chart you ever saw. Would there be a difference between what you see now and what you saw then? Absolutely. Instead of a bunch of undifferentiated lines, you would see everything you've learned about those lines between then and now. In other words, you would see all the distinctions you've learned to make, as well as all the opportunities those distinctions represent.

Yet, everything you can see as you look at that chart now existed then, and, furthermore, was available to be perceived. What's the difference? The structured energy that's inside of you now—the knowledge you have gained—acts as a force on your eyes, causing you to recognize the various distinctions that you've learned about. Since that energy wasn't there the first time you looked at the chart, all the opportunities that you now see were there, but at the same time invisible to you. Furthermore, unless you've learned to make every possible distinction based on every possible relationship between the variables in that chart, what you haven't learned yet is still invisible. Most of us have no concept of the extent to which we are continually surrounded by the invisible opportunities inherent in the information we're exposed to.

More often than not, we never learn about these opportunities and, as a result, they remain invisible. The problem, of course, is that unless we're in a completely new or unique situation or we're operating out of an attitude of genuine openness, we won't perceive something that we haven't learned about yet. To learn about something, we have to be able to experience it in some way. So what we have here is a closed loop that prevents us from learning. Perceptual closed loops exist in all of us, because they are natural functions of the way mental energy expresses itself on our senses. Eveiyone has heard the expression, "People see what they want to see."

I would put it a little differently: People see what they've learned to see, and everything else is invisible until they learn how to counteract the energy that blocks their awareness of whatever is unlearned and waiting to be discovered. To illustrate this concept and make it even clearer, I am going to give you another example, one that demonstrates how mental energy can affect how we perceive and experience the environment in a way that it actually reverses the cause-and-effect relationship. Let's look at a very young child's first encounter with a dog. Because it's a first-time experience, the child's mental environment is a clean slate, so to speak, with respect to dogs. He won't have any memories and certainly no distinctions about a dog's nature. Therefore, up to the moment of his first encounter, from the child's perspective, dogs don't exist. Of course, from the environment's perspective, dogs do exist and they have the potential to act as a force on the child's senses to create an experience. In other words, dogs expressing their nature can act as a cause to produce an effect inside the child's mental environment. What kind of effect are dogs capable of producing? Well, dogs have a range of expression. By range of expression I mean dogs can behave in a number of ways toward humans.

They can be friendly, loving, protective, and fun to play with; or they can be hostile, mean, and dangerous—just to name a few of the many behaviors they're capable of. All of these traits can be observed, experienced, and learned about. When the child sees the dog for the first time, there is absolutely nothing in his mental environment to tell him what he is dealing with. Unfamiliar, unknown, and unclassified environmental information can generate a sense of curiosity—when we want to find out more about what we're experiencing—or it can generate a state of confusion, which can easily turn to fear if we can't place the information into an understandable or meaningful organizational framework or context. In our example, the child's sense of curiosity kicks in and he rushes to the dog to get more sensory experience.

Notice how children are literally compelled to thrust themselves into a situation they know nothing about. However, in this example, the environmental forces at hand do not react favorably to the child's advances. The dog the child is interested in is either inherently mean or having a bad day. In any case, as soon as the child gets close enough, the dog bites him. The attack is so severe that the dog has to be pulled off the child. This kind of unfortunate experience is certainly not typical, but it's not that uncommon either. I chose it for two reasons: First, most people can relate to it in some way either from their own direct experience or through the experience of someone they know. Second, as we analyze the underlying dynamics of this experience from an energy perspective, we're going to learn about

1) how our minds are designed to think,

2) process information,

3) how these processes affect what we experience and

4) our ability to recognize new possibilities.

I know this mav seem like a lot of insieht from iust one example, but the principles involved apply to the dynamics beneath virtually all learning. As a result of being physically and emotionally traumatized, the little boy in our example now has a memory and one distinction about the way dogs can express themselves.

If the boys ability to remember his experiences is normal, he can store this incident in a way that represents all of the senses the experience had an impact on: For example the attack can be stored as mental images based on what he saw, as well as mental sounds representing what he heard, and so on. Memories representing the other three senses will work the same way.

However, the kind of sensory data in his memory is not as important as the kind of energy the sensory data represents. We basically have two kinds of mental energy: positively charged energy, which we call love, confidence, happiness, joy, satisfaction, excitement, and enthusiasm, to name a few of the pleasant ways we can feel; and negatively charged energy, representing fear, terror, dissatisfaction, betrayal, regret, anger, confusion, anxiety, stress, and frustration, all representing what is commonly referred to as emotional pain. Because the boy's first experience with a dog was intensely painful, we can assume that regardless of what senses were affected, all of his memories of this experience will be in painful, unpleasantfeeling, negative energy.

Now, what effect will this negatively charged mental energy have on his perception and behavior if and when he encounters another dog? The answer is so obvious that it may seem ridiculous even to ask, but the underlying implications are not obvious, so bear with me. Clearly, the moment he comes into contact with another dog, he will experience fear. Notice that I used the word "another" to describe the next dog he has any contact with. What I want to point out is that *any* dog can cause the boy to feel fear, not just the one that actually attacked him. It won't make a bit of difference if the next dog he comes into contact with is the friendliest dog in the world, one whose nature is only to express playfulness and love. The child will still be afraid, and furthermore, his fear could quickly turn to unrestrained terror especially if the second dog (seeing a child and wanting to play) attempts to approach him. Each of us has at one time or another witnessed a situation in which someone was experiencing fear, when from our perspective there wasn't the least bit of danger or threat. Although we may not have said it, we probably thought to ourselves that this person was being irrational.

PERCEPTION AND RISK

If we tried to point out why there was no need to be afraid, we probably found that our words had little, if any, impact. We could easily think the same thing about the boy in our example, that he is just being irrational, because it's clear from our perspective that other possibilities exist than the one his mind has focused on. But is his fear any less rational than, let's say, your fear (or hesitation) about putting on the next trade, when your last trade was a loser?

Using the same logic, a top trader would say that your fear is irrational because this "now moment" opportunity has absolutely nothing to do with your last trade. Each trade is simply an edge with a probable outcome, and statistically independent of every other trade. If you believe otherwise, then I can see why you're afraid; but I can assure you that your fears are completely unfounded. As you can see, one person's perception of risk can easily be perceived as irrational thinking by another. Risk is relative, but to the person who perceives it in the moment, it seems absolute and beyond question. When the child encountered his first dog, he was bubbling with excitement and curiosity. What is it about the way our minds think and process information that could automatically flip the boy into a state of fear the next time he encounters a dog, even if it's months or years later? If we look at fear as a natural mechanism warning us of threatening conditions, then what is it about the way our minds function that would automatically tell the boy that the next encounter with a dog is something to be afraid of? What happened to the boy's natural sense of curiosity? There is surely more to learn about the nature of dogs than this one experience has taught him, especially in light of the fact that our minds seem to have an unlimited capacity for learning. And why would it be virtually impossible to talk the boy out of his fear?

THE POWER OF ASSOCIATION

As complex as these questions may seem at first glance, most of them can be answered quite easily. I'm sure many of you already know the answer: Our minds have an inherent design characteristic that causes us to associate and link anything that exists in the external environment that is similar in quality, characteristics, properties, or traits to anything that already exists in our mental environment as a memory or distinction. In other words, in the example of the child being afraid of dogs, the second dog or any other dog he encounters thereafter, doesn't have to be the dog that attacked in order for him to experience emotional pain.

There just has to be enough of a likeness or similarity for his mind to make a connection between the two. This natural tendency for our minds to associate is an unconscious mental function that occurs automatically. It's not something we have to think about or make a decision about. An unconscious mental function would be analogous to an involuntary physical function such as a heartbeat. Just as we don't have to consciously think about the process of making our hearts beat, we don't have to think about linking experiences and our feelings about them. Its simply a natural function of the way our minds process information, and, like a heartbeat, it's a function that has a profound effect on the way we experience our lives.

I'd like you to try and visualize the two-way flow of energy that reverses the cause-and-effect relationship that will make it difficult (if not impossible) for the boy to perceive any other possibilities than the one that's in his mind. To help you, I'm going to break this process down into its smallest parts, and go through what happens step by step, All of this may seem a bit abstract, but understanding this process plays a big part in unlocking your potential to achieve consistent success as a big trader. First, let's get right down to the basics. There's structured energy on the outside of the boy and structured energy on the inside of the boy. The outside energy is positively charged in the form of a friendly dog that wants to express itself by playing.

The inside energy is a negatively charged memory in the form of mental images and sounds that represent the boy's first experience with a dog. Both the inside and the outside energy have the potential to make themselves felt on the boy's senses and, as a result, create two different kinds of situations for him to experience. The outside energy has the potential to act as a force on the boy in a way that he could find very enjoyable. This particular dog expresses behavior characteristics like playfulness, friendliness, and even love. But keep in mind that these are characteristics that the child still has not experienced in a dog, so from his perspective they don't exist. Just as in the price chart example I presented earlier, the child won't be able to perceive what he hasn't yet learned about, unless he is in a state of mind that is conducive to learning.

The inside energy also has potential and is just waiting, so to speak, to express itself. But it will act on the boy's eyes and ears in a way that causes him to feel threatened. This in turn will create an experience of emotional pain, fear, and possibly even terror. From the way I've set this up, it may seem as if the boy has a choice between experiencing fun or experiencing fear, but that's really not the case, at least not in the moment. Of the two possibilities that exist in this situation, he will undoubtedly experience the pain and fear, instead of the fun. This is true for several reasons. First, as I've already indicated, our minds are wired to automatically and instantaneously associate and link information that has similar characteristics, properties, and traits. What's outside of the child in the form of a dog, looks and sounds similar to the one that's in his mind. However, the degree of similarity that is necessary for his mind to link the two is an unknown variable, meaning

I don't know the mental mechanism that determines how much or how little similarity is required for our minds to associate and link two or more sets of information. Since everyone's mind functions in a similar way, but, at the same time is unique, I would assume there is a range of tolerance for similarity or dissimilarity and each of us has a unique capacity somewhere within the range. Here's what we do know: As this next dog comes into contact with the boy's eyes or ears, if there is enough similarity between the way it looks or sounds and the dog that's embedded in his memory, then his mind will automatically connect the two.

This connection, in turn, will cause the negatively charged energy in his memory to be released throughout his body, causing him to be overcome with a very uncomfortable sense of foreboding or terror. The degree of discomfort or emotional pain that he experiences will be equivalent to the degree of trauma that he suffered as a result of his first encounter with a dog. What happens next is what psychologists call a projection. I'm going to refer to it simply as another instantaneous association that makes the reality of the situation from the boy's perspective seem like the absolute, unquestionable truth. The boy's body is now filled with negatively charged energy.

At the same time, he is in sensory contact with the dog. Next, his mind associates whatever sensory information his eyes or ears perceive with the painful energy he's experiencing inside himself, which makes it seem as if the source of his pain and fear is the dog he is seeing or hearing in that moment. Psychologists call the dynamics of what I just described a projection because, in a sense, the boy is projecting the pain he is experiencing in the moment onto the dog. That painful energy then gets reflected back to him, so that he perceives a dog that is threatening, painful, and dangerous. This process makes the second dog identical in character, properties, and traits to the one that is in the boy's memory bank, even though the information the second dog is generating about its behavior is not identical, or even similar, to the behavior of the dog that actually attacked the boy.

Since the two dogs, the one in the boy's mind and the one outside of the boy's mind, feel exactly the same, it's extremely unlikely the boy will be able to make any type of distinctions in the second dog's behavior that would suggest to him that it is any different than the one in his mind. So, instead of perceiving this next encounter with a dog as an opportunity to experience something new about the nature of dogs, he perceives a threatening and dangerous dog. Now, if you think about it for a moment, what is it about this process that would indicate to the boy that his experience of the situation was not the absolute, unquestionable truth? Certainly the pain and fear that he experienced in his body was the absolute truth. But what about the possibilities that he perceived? Were they true? From our perspective, they weren't.

However, from the boy's perspective, how could they be anything but the true reality of the situation? What alternatives did he have? First, he can't perceive possibilities that he hasn't learned about yet. And it is extremely difficult to learn anything new if you're afraid, because, as you already well know, fear is a very debilitating form of energy. It causes us to withdraw, to get ready to protect ourselves, to run, and to narrow our focus of attention —all of which makes it veiy difficult, if not impossible, to open ourselves in a way that allows us to learn something new. Second, as I have already indicated, as far as die boy is concerned, the dog is the source of his pain, and in a sense this is true.

The second dog did cause him to tap into the pain that was already in his mind, but it was not the true source of that pain. This was a positively charged dog that got connected to the boy's negatively charged energy by an automatic, involuntary mental process, functioning at speeds faster than it takes to blink an eye (a process that the boy has absolutely no awareness of). So as far as he's concerned, why would he be afraid if what he perceived about the dog wasn't the absolute truth? As you can see, it wouldn't make any difference how the dog was acting, or what someone might say to the contrary about why the boy shouldn't be afraid, because he will perceive whatever information the dog is generating about itself (regardless of how positive) from a negative perspective. He will not have the slightest notion that his experience of pain, fear, and terror was completely self-generated.

Now, if it's possible for the boy to self-generate his own pain and terror and, at the same time, be firmly convinced that his negative experience was coming from the environment, is it also possible for traders to self-generate their own experiences of fear and emotional pain as they interact with market information and be thoroughly convinced that their pain and fear was completely justified by the circumstances? The underlining psychological dynamics work in exactly the same way. One of your basic objectives as a trader is to perceive the opportunities available, not the threat of pain. To learn how to stay focused on the opportunities, you need to know and understand in no uncertain terms the source of the threat. It's not the market.

The market generates information about its potential to move from a neutral perspective. At the same time, it provides you (the observer) with an unending stream of opportunities to do something on your own behalf. If what you perceive at any given moment causes you to feel fear, ask yourself this question: Is the information inherently threatening, or are you simply experiencing the effect of your own state of mind reflected back to you (as in the above illustration)? I know this is a difficult concept to accept, so I'll give you another example to illustrate the point. Let's set up a scenario, where your last two or three trades were losers.

You are watching the market, and the variables you use to indicate that an opportunity exists are now present. Instead of immediately executing the trade, you hesitate. The trade feels very risky, so risky, in fact, that you start questioning whether this is "really" a signal. As a result, you start gathering information to support why this trade probably won't work. This is information you normally wouldn't consider or pay attention to, and it's certainly not information that is part of your trading methodology. In the meantime, the market is moving. Unfortunately, it is moving away from your original entry point, the point at which you would have gotten into the trade if you hadn't hesitated. Now you are conflicted, because you still want to get in; the thought of missing a winning trade is painful. At the same time, as the market moves away from your entry point, the dollar value of the risk to participate increases. The tug of war inside your mind intensifies.

You don't want to miss out, but you don't want to get whipsawed either. In the end, you do nothing, because you are paralyzed by the conflict. You justify your state of immobility by telling yourself that it's just too risky to chase the market, while you agonize over every tic the market moves in the direction of what would have been a nice winning trade. If this scenario sounds familiar, I want you to ask yourself whether, at the moment you hesitated, were you perceiving what the market was making available, or perceiving what was in your mind reflected back to you? The market gave you a signal. But you didn't perceive the signal from an objective or positive perspective. You didn't see it as an opportunity to experience the positive feeling you would get from winning or making money, but that's exactly what the market was making available to you.

Think about this for a moment: If I change the scenario so that your last two or three trades were winners instead of losers, would you have perceived the signal any differently? Would you have perceived it more as an opportunity to win than you did in the first scenario? If you were coming off three winners in a row, would you have hesitated to put that trade on? Very unlikely! In fact, if you're like most traders, you probably would have been giving very strong consideration to loading up (putting on a position much larger than your normal size). In each situation, the market generated the same signal. But your state of mind was negative and fear-based in the first scenario, and that caused you to focus on the possibility of failure, which in turn caused you to hesitate. In the second scenario, you hardly perceived any risk at all. You may even have thought the market was making a dream come true.

That, in turn, would make it easy, if not compelling, to financially overcommit yourself. If you can accept the fact that the market doesn't generate positively or negatively charged information as an inherent characteristic of the way it expresses itself, then the only other way information can take on a positive or negative charge is in your mind, and that is a function of the way the information is processed. In other words, the market doesn't cause you to focus on failure and pain, or on winning and pleasure. What causes the information to take on a positive or negative quality is the same unconscious mental process that caused the boy to perceive the second dog as threatening and dangerous, when all the dog was offering was playfulness and friendship.

Our minds constantly associate what's outside of us (information) with something that's already in our mind (what we know), making it seem as if the outside circumstances and the memory, distinction, or belief these circumstances are associated with are exactly the same. As a result, in the first scenario, if you were coming off two or three losing trades, the next signal the market gives you that an opportunity was present will feel overly risky. Your mind is automatically and unconsciously linking the "now moment" with your most recent trading experiences. The link taps you into the pain of losing, creating a fearful state of mind and causing you to perceive the information you're exposed to in that moment from a negative perspective. It seems as if the market is expressing threatening information, so, of course, your hesitation is justified. In the second scenario, the same process causes you to perceive the situation from an overly positive perspective, because you are coming off three winners in a row.

The association between the "now moment" and the elation of the last three trades creates an overly positive or euphoric state of mind, making it seem as if the market is offering you a riskless opportunity. Of course, this justifies overcommitting yourself. In Chapter 1, I said that many of the mental patterns that cause traders to lose and make errors are so self-evident and deeply ingrained that it would never occur to us that the reason we aren't consistently successful is because of the way we think. Understanding, becoming consciously aware of, and then learning how to circumvent the mind's natural propensity to associate is a big part of achieving that consistency. Developing and maintaining a state of mind that perceives the opportunity flow of the market, without the threat of pain or the problems caused by overconfidence, will require that you take conscious control of the association process.

<u>CHAPTER 6</u>

THE MARKET'S PERSPECTIVE

For the most part, a typical traders perception of the risk in any given trading situation is a function of the outcome of his most recent two or three trades (depending on the individual). The best traders, on the other hand, are not impacted (either negatively or too positively) by the outcomes of their last or even their last several trades. So their perception of the risk of any given trading situation is not affected by this personal, psychological variable. There's a huge psychological gap here that might lead you to believe that the best traders have inherent design qualities in their minds that account for this gap, but I can assure you this is not the case. Every trader I've worked with over the last 18 years has had to learn how to train his mind to stay properly focused in the "now moment opportunity flow." This is a universal problem, and has to do both with the way our minds are wired and our common social upbringing (meaning, this particular trading problem is not personspecific).

There are other factors relating to self-esteem that may also act as obstacles to your consistent success, but what we are going to discuss now is the most important and fundamental building block to your success as a trader.

THE "UNCERTAINTY" PRINCIPLE

If there is such a thing as a secret to the nature of trading, this is it: At the very core of one's ability 1) to trade without fear or overconfidence, 2) perceive what the market is offering from its perspective, 3) stay completely focused in the "now moment opportunity flow," and 4) spontaneously enter the "zone," it is a strong virtually unshakeable belief in an uncertain outcome with an edge in your favor. The best traders have evolved to the point where they believe, without a shred of doubt or internal conflict, that "anything can happen."

They don't *just suspect* that anything can happen or give lip service to the idea. Their belief in uncertainty is so powerful that it actually prevents their minds from associating the "now moment" situation and circumstance with the outcomes of their most recent trades.By preventing this association, they are able to keep their minds free of unrealistic and rigid expectations about how the market will express itself. Instead of generating the kind of unrealistic expectations that more often than not result in both emotional and financial pain, they have learned to "make themselves available" to take advantage of whatever opportunities the market may offer in any given moment. "Making yourself available" is a perspective from which you understand that the framework from which you are perceiving information is limited relative to what's being offered.

Our minds don't automatically perceive every opportunity that presents itself in any given moment. (The "boy and the dog" illustration from Chapter 5 is a perfect example of how our own personal versions of the truth are reflected back to us.) This same land of perceptual blindness happens all the time in trading. We can't perceive the potential for the market to continue to move in a direction that is already against our position if, for example, we are operating out of a fear of being wrong. The fear of admitting we are wrong causes us to place an inordinate amount of significance on information that tells us that we're right. This happens even if there's ample information to indicate that the market has in fact established a trend in the opposite direction of our position.

A trending market is a distinction about the market's behavior we can ordinarily perceive, but this distinction can easily become invisible if we are operating out of fear. The trend and the opportunity to trade in the direction of that trend don't become visible until we are out of the trade. In addition, there are opportunities that are invisible to us because we haven't learned to make the distinctions that would allow us to perceive them. Recall our discussion in Chapter 5 of the first price chart you ever looked at. What we haven't learned yet is invisible to us, and remains invisible until our minds are open to an exchange of energy. A perspective from which you make yourself available takes into consideration both the known and the unknown: For example, you've built a mental framework that allows you to recognize a set of variables in the markets behavior that indicates when an opportunity to buy or sell is present. This is your edge and something you know.

However, what you don't know is exactly how the pattern your variables identify will unfold. With the perspective of making yourself available, you know that your edge places the odds of success in your favor, but, at the same time, you completely accept the fact that you don't know the outcome of any particular trade. By making yourself available, you consciously open yourself up to find out what will happen next; instead of giving way to an automatic mental process that causes you to think you already know. Adopting this perspective leaves your mind free of internal resistance that can prevent you from perceiving whatever opportunity the market is making available from its perspective (its truth). Your mind is open for an exchange of energy. Not only can you learn something about the market that you previously didn't know, but you also set up the mental condition most conducive to entering "the zone."

The essence of what it means to be in "the zone" is that your mind and the market are in sync. As a result, you sense what the market is about to do as if there is no separation between yourself and the collective consciousness of everyone else participating in the market. The zone is a mental space where you are doing more than just reading the collective mind, you are also in complete harmony with it. If this sounds a bit strange to you, ask yourself how it is that a flock of birds or a school of fish can change direction simultaneously. There must be a way in which they are linked to one another. If it is possible for people to become linked in the same way, then there will be times when information from those with whom we are linked can and will bleed through to our consciousness.

Traders who have experienced being tapped into the collective consciousness of the market can anticipate a change in direction just as a bird in the middle of a flock or a fish in the middle of a school will turn at the precise moment that all of the others turn. However, setting up the kind of mental conditions most conducive to experiencing this seemingly magical synchronicity between you and the market is no easy task. There are two mental hurdles to overcome.

The first is the focus of this chapter: learning how to keep your mind focused in the "now moment opportunity flow." In order to experience synchronicity, your mind has to be open to the market's truth, from its perspective. The second hurdle has to do with the division of labor between the two halves of our brain. The left side of our brain specializes in rational thought, based on what we already know. The right side specializes in creative thought. It is capable of tapping into an inspiration, an intuition, a hunch, or a sense of knowing that usually can't be explained at a rational level. It can't be explained because if the information is really creative in nature, then it is something that we wouldn't know at a rational level. By definition, true creativity brings forth something that didn't previously exist. There's an inherent conflict between these two modes of thought, that the rational, logical part will almost always win, unless we take specific steps to train our minds to accept and trust creative information. Without that training, we will usually find it very difficult to act on our hunches, intuitive impulses, inspirations, or sense of knowing.

Acting appropriately on anything requires belief and clarity of intent, which keeps our minds and senses focused on the purpose at hand. If the source of our actions is creative in nature, and our rational mind hasn't been properly trained to trust this source, then at some point in the process of acting on this information, our rational brain will flood our consciousness with conflicting and competing thoughts. Of course, all of these thoughts will be sound and reasonable in nature, because they will be coming from what we already know at a rational level, but they will have the effect of flipping us out of "the zone" or any other creative state of mind. There are few things in life more frustrating than recognizing the possibilities evident from a hunch, intuition, or an inspired idea, and not taking advantage of that potential because we talked ourselves out of it. I realize that what I've just said is still much too abstract to implement on a practical basis. So, I'm going to take you step-by-step through what it means to be completely focused in the "now moment opportunity flow."

My objective is that by the time you've read this chapter and Chapter 7, you will understand without a shred of doubt why your ultimate success as a trader cannot be realized until you develop a resolute, unshakeable belief in uncertainty. The first step on the road toward getting your mind and the market in sync is to understand and completely accept the psychological realities of trading. This step is where most of the frustrations, disappointments, and mysteriousness associated with trading begin.

Very few people who decide to trade ever take the time or expend the effort to think about what it means to be a trader. Most people who go into trading think that being a trader is synonymous with being a good market analyst. As I have mentioned, this couldn't be further from the truth. Good market analysis can certainly contribute to and play a supporting role in one's success, but it doesn't deserve the attention and importance most traders mistakenly attach to it. Beneath the market behavior patterns that are so easy to become fixated on are some very unique psychological characteristics. It's the nature of these psychological characteristics that determines how one needs "to be" in order to operate effectively in the market environment.

Operating effectively in an environment that has qualities, traits, or characteristics that are different from what we're used to requires making some adjustments or changes in the way we normally think about things. For example, if you were to travel to an exotic place with certain objectives or goals to accomplish, the first thing you would do is familiarize yourself with the local traditions and customs. By doing so, you would leani about the various ways in which you would have to adapt in order to function successfully in that environment. Traders frequently ignore the fact that they may have to adapt in order to become consistently successful traders. There are two reasons for this.

The first is that you need absolutely no skill of any kind to put on a winning trade. For most traders it usually takes years of pain and suffering before they figure out or finally admit to themselves that there's more to being consistent than the ability to pick an occasional winner. The second reason is that you don't have to travel anywhere to trade. All you need is access to a phone. You don't even have to roll out of bed in the morning. Even traders who normally trade from an office don't have to be in the office to put on or take off their trades. Because we can access and interact with the market from personal environments that we are intimately familiar with, it seems as if trading won't require any special adaptations in the way we think.

To some degree, you are probably already aware of many of the fundamental truths (psychological characteristics) about the nature of trading. But having an awareness or an understanding of some principle, insight, or concept doesn't necessarily equate to acceptance and belief. When something has been truly accepted, it isn't in conflict with any other component of our mental environment. When we believe in something, we operate out of that belief as a natural function of who we are, without struggle or extra effort. To whatever degree there is a conflict with any other component of our mental environment, to the same degree there is a lack of acceptance. It isn't difficult, therefore, to understand why so few people make it as traders.

They simply don't do the mental work necessary to reconcile the many conflicts that exist between what they've already learned and believe, and how that learning contradicts and acts as a source of resistance to implementing the various principles of successful trading. Getting into and taking advantage of the kind of free-flowing states of mind that are ideal for trading requires that those conflicts be thoroughly resolved.

MARKETS MOST FUNDAMENTAL CHARACTERISTIC
(IT CAN EXPRESS ITSELF IN AN ALMOST INFINITE COMBINATION OF WAYS)

The market can do virtually anything at any time. This seems obvious enough, especially for anybody who has experienced a market that has displayed erratic and volatile price swings. The problem is that all of us have the tendency to take this characteristic for granted, in ways that cause us to make the most fundamental trading errors over and over again. The fact is that if traders really believed that anything could happen at any time, there would be considerably fewer losers and more consistent winners. How do we know that virtually anything can happen? This fact is easy to establish. All we have to do is dissect the market into its component parts and look at how the parts operate. The most fundamental component of any market is its traders. Individual traders act as a force on prices, making them move by either bidding a price up or offering it lower.

Why do traders bid a price up or offer it lower? To answer this question we have to establish the reasons why people trade. There are many reasons and purposes behind a person s motivation to trade in any given market. However, for the purposes of this illustration, we don't have to know all the underlying reasons that compel any individual trader to act because ultimately they all boil down to one reason and one purpose: to make money. We know this because there are only two things a trader can do (buy and sell) and there are only two possible outcomes for every trade (profit or loss). Therefore, I think we can safely assume that regardless of one's reasons for trading, the bottom line is that everyone is looking for the same outcome: Profits. And there are only two ways to create those profits: Either buy low and sell high, or sell high and buy low. If we assume that everyone wants to make money, then there's only one reason why any trader would bid a price up to the next highest level: because he believes he can sell whatever he's buying at a higher price at some point in the future.

The same is true for the trader who's willing to sell something at a price that is less than the last posted price (offer a market lower). He does it because he believes he can buy back whatever he's selling at a lower price at some point in the future. If we look at the market's behavior as a function of price movement, and if price movement is a function of traders who are willing to bid prices up or offer them lower, then we can say that all price movement (market behavior) is a function of what traders believe about the future. To be more specific, all price movement is a function of what individual traders believe about what is high and what is low. The underlying dynamics of market behavior are quite simple. Only three primary forces exist in any market: traders who believe the price is low, traders who believe the price is high, and traders who are watching and waiting to make up their minds about whether the price is low or high. Technically, the third group constitutes a potential force. The reasons that support any given traders belief that something is high or low are usually irrelevant, because most people who trade act in an undisciplined, unorganized, haphazard, and random manner. So, their reasons wouldn't necessarily help anyone gain a better understanding of what is going on. But, understanding what's going on isn't that difficult, if you remember that all price movement or lack of

movement is a function of the relative balance or imbalance between two primary forces: traders who believe the price is going up, and traders who believe the price is going down.
If there's balance between the two groups, prices will stagnate, because each side will absorb the force of the other side's actions. If there is an imbalance, prices will move in the direction of the greater force, or the traders who have the stronger convictions in their beliefs about in what direction the price is going. Now, I want you to ask yourself, what's going to stop virtually anything from happening at any time, other than exchange-imposed limits on price movement. There's nothing to stop the price of an issue from going as high or low as whatever some trader in the world believes is possible—if, of course, the trader is willing to act on that belief. So the range of the market's behavior in its collective form is limited only by the most extreme beliefs about what is high and what is low held by any given individual participating in that market. I think the implications are self-evident:
There can be an extreme diversity of beliefs present in any given market in any given moment, making virtually anything possible. When we look at the market from this perspective, it's easy to see that every potential trader who is willing to express his belief about the future becomes a market variable. On a more personal level, this means that it only takes one other trader, anywhere in the world, to negate the positive potential of your trade. Put another way, it takes only one other trader to negate what you believe about what is high or what is low. That's all, only one! Here's an example to illustrate this point. Several years ago, a trader came to me for help. He was an excellent market analyst; in fact, he was one of the best I've ever met. But after years of frustration during which he lost all his money and a lot of other people's money, he was finally ready to admit that, as a trader, he left a lot to be desired. After talking to him for a while, I determined that a number of serious psychological obstacles were preventing him from being successful.
One of the most troublesome obstacles was that he was a know-it-all and extremely arrogant, making it impossible for him to achieve the degree of mental flexibility required to trade effectively. It didn't matter how good an analyst he was. When he came to me, he was so desperate for money and help that he was willing to consider anything. The first suggestion I made was that instead of looking for another investor to back what ultimately would be another failed attempt at trading, he would be better off taking a job, doing something he was truly good at. He could be paid a steady income while working through his problems, and at the same time provide someone with a worthwhile service. He took my advice and quickly found a position as a technical analyst with a fairly substantial brokerage house and clearing firm in Chicago.
The semiretired chairman of the board of the brokerage firm was a longtime trader with nearly 40 years of experience in the grain pits at the Chicago Board of Trade. He didn't know much about technical analysis, because he never needed it to make money on the floor. But he no longer traded on the floor and found the transition to trading from a screen difficult and somewhat mysterious. So he asked the firm's newly acquired star technical analyst to sit with him during the trading day and teach him technical trading. The new hire jumped at the opportunity to show off his abilities to such an

experienced and successful trader. The analyst was using a method called "point and line," developed by Charlie Drummond. (Among other things, point and line can accurately define support and resistance.) One day, as the two of them were watching the soybean market together, the analyst had projected major support and resistance points and the market happened to be trading between these two points.

As the technical analyst was explaining to the chairman the significance of these two points, he stated in very emphatic, almost absolute terms that if the market goes up to resistance, it will stop and reverse; and if the market goes down to support, it will also stop and reverse. Then he explained that if the market went down to the price level he calculated as support, his calculations indicated that would also be the low of the day. As they sat there, the bean market was slowly trending down to the price the analyst said would be the support, or low, of the day. When it finally got there, the chairman looked over to the analyst and said, "This is where the market is supposed to stop and go higher, right?"

The analyst responded, "Absolutely! This is the low of the day." "That's bullshit!" the chairman retorted. "Watch this." He picked up the phone, called one of the clerks handling orders for the soybean pit, and said, "Sell two million beans (bushels) at the market." Within thirty seconds after he placed the order, the soybean market dropped ten cents a bushel. The chairman turned to look at the horrified expression on the analysts face. Calmly, he asked, "Now, where did you say the market was going to stop? If I can do that, anyone can."

The point is that from our own individual perspective as observers of the market, anything can happen, and it takes only one trader to do it. This is the hard, cold reality of trading that only the very best traders have embraced and accepted with no internal conflict. How do I know this? Because only the best traders consistently predefine their risks before entering a trade. Only the best traders cut their losses without reservation or hesitation when the market tells them the trade isn't working. And only the best traders have an organized, systematic, money-management regimen for taking profits when the market goes in the direction of their trade. Not predefining your risk, not cutting your losses, or not systematically taking profits are three of the most common—and usually the most costly—trading errors you can make. Only the best traders have eliminated these errors from their trading. At some point in their careers, they learned to believe without a shred of doubt that anything can happen, and to always account for what they don't know, for the unexpected. Remember that there are only two forces that cause prices to move: traders who believe the markets are going up, and traders who believe the markets are going down. At any given moment, we can see who has the stronger conviction by observing where the market is now relative to where it was at some previous moment. If a recognizable pattern is present, that pattern may repeat itself, giving us an indication of where the market is headed. This is our edge, something we know. But there's also much that we don't know, and will never know unless we learn how to read minds. For instance, do we know how many traders may be sitting on the sidelines and about to enter the market? Do we know how many of them want to buy and how many want to sell, or how many shares they are willing to buy or sell? What about the traders whose

participation is already reflected in the current price? At any given moment, how many of them are about to change their minds and exit their positions?
If they do, how long will they stay out of the market? And if and when they do come back into the market, in what direction will they cast their votes? These are the constant, never-ending, unknown, hidden variables that are always operating in every market—*always]* The best traders don't try to hide from these unknown variables by pretending they don't exist, nor do they try to intellectualize or rationalize them away through market analysis. Quite the contrary, the best traders take these variables into account, factoring them into every component of their trading regimes. For the typical trader, just the opposite is true. He trades from the perspective that what he can't see, hear, or feel must not exist. What other explanation could account for his behavior? If he really believed in the existence of all the hidden variables that have the potential to act on prices in any given moment, then he would also have to believe that every trade has an uncertain outcome. And if every trade truly has an uncertain outcome, then how could he ever justify or talk himself into not predefining his risk, cutting his losses, or having some systematic way to take profits? Given the circumstances, not adhering to these three fundamental principles is the equivalent of committing financial and emotional suicide. Since most traders don't adhere to these principles, are we to assume that their true underlying motivation for trading is to destroy themselves? It's certainly possible, but I think the percentage of traders who either consciously or subconsciously want to rid themselves of their money or hurt themselves in some way is extremely small. So, if financial suicide is not the predominant reason, then what could keep someone from doing something that would otherwise make absolute, perfect sense? The answer is quite simple: The typical trader doesn't predefine his risk, cut his losses, or systematically take profits because the typical trader doesn't believe it's necessary. The only reason why he would believe it isn't necessary is that he believes he already knows what's going to happen next, based on what he perceives is happening in any given "now moment."
If he already knows, then there's really no reason to adhere to these principles. Believing, assuming, or thinking that "he knows" will be the cause of virtually eveiy trading error he has the potential to make (with the exception of those errors that are the result of not believing that he deserves the money). Our beliefs about what is true and real are very powerful inner forces.
They control every aspect of how we interact with the markets, from our perceptions, interpretations, decisions, actions, and expectations, to our feelings about the results. It's extremely difficult to act in a way that contradicts what we believe to be true. In some cases, depending on the strength of the belief, it can be next to impossible to do anything that violates the integrity of a belief. What the typical trader doesn't realize is that he needs an inner mechanism, in the form of some powerful beliefs, that virtually compels him to perceive the market from a perspective that is always expanding with greater and greater degrees of clarity, and also compels him always act appropriately, given the psychological conditions and the nature of price movement. The most effective and functional trading belief that he can acquire is "anything can happen." Aside from the fact that it is the truth, it will act as a solid

foundation for building every other belief and attitude that he needs to be a successful trader. Without that belief, his mind will automatically, and usually without his conscious awareness, cause him to avoid, block, or rationalize away any information that indicates the market may do something he hasn't accepted as possible.

If he believes that anything is possible, then there's nothing for his mind to avoid. Because *anything* includes everything, this belief will act as an expansive force on his perception of the market that will allow him to perceive information that might otherwise have been invisible to him. In essence, he will be making himself available (opening his mind) to perceive more of the possibilities that exist from the markets perspective. Most important, by establishing a belief that anything can happen, he will be training his mind to think in probabilities. This is by far the most essential as well as the most difficult principle for people to grasp and to effectively integrate into their mental systems.

CHAPTER 7

THE TRADER'S EDGE: THINKING IN PROBABILITIES

Exactly what does it mean to think in probabilities, and why is it so essential to one's consistent success as a trader? If you take a moment and analyze the last sentence, you will notice that I made consistency a function of probabilities. It sounds like a contradiction: How can someone produce consistent results from an event that has an uncertain probabilistic outcome? To answer this question, all we have to do is look to the gambling industry. Corporations spend vast amounts of money, in the hundreds of millions, if not billions, of dollars, on elaborate hotels to attract people to their casinos.

If you've been to Las Vegas you know exactly what I am talking about. Gaming corporations are just like other corporations, in that they have to justify how they allocate their assets to a board of directors and ultimately to their stockholders. How do you suppose they justify spending vast sums of money on elaborate hotels and casinos, whose primary function is to generate revenue from an event that has a purely random outcome?

PROBABILITIES PARADOX: RANDOM OUTCOME, CONSISTENT RESULTS

Here's an interesting paradox. Casinos make consistent profits day after day and year after year, facilitating an event that has a purely random outcome. At the same time, most traders believe that the outcome of the market's behavior is not random, yet can't seem to produce consistent profits. Shouldn't a consistent, nonrandom outcome produce consistent results, and a random outcome produce random, inconsistent results? What casino owners, experienced gamblers, and the best traders understand that the typical trader finds difficult to grasp is: even that have probable outcomes can produce consistent results, if you can get the odds in your favor and there is a large enough sample size. The best traders treat trading like a numbers game, similar to the way in which casinos and professional gamblers approach gambling. To illustrate, let's look at the game of blackjack. In blackjack, the casinos have approximately a 4.5-percent edge over the player, based on the rules they require players to adhere to. This means that, over a large enough sample size (number of hands played), the casino will generate net profits of four and a half cents on every dollar wagered on the game. This average of four and a half cents takes into account all the players who walked away big winners (including all winning streaks), all the players who walked away big losers, and everybody in between. At the end of the day, week, month, or year, the casino always ends up with approximately 4.5 percent of the total amount wagered.

That 4.5 percent might not sound like a lot, but let's put it in perspective. Suppose a total of $100 million dollars is wagered collectively at all of a casino's blackjack tables over the course of a year. The casino will net $4.5 million. What casino owners and professional gamblers understand about the nature of probabilities is that each individual hand played is statistically independent of every other hand. This means that each individual hand is a unique event, where the outcome is random relative to the last hand played or the next hand played. If you focus on each hand individually, there will be a random, unpredictable distribution between winning and losing hands. But on a collective basis, just the opposite is true. If a large enough number of hands is played, patterns will emerge that produce a consistent, predictable, and statistically reliable outcome.

Here's what makes thinking in probabilities so difficult. It requires two layers of beliefs that on the surface seem to contradict each other. We'll call the first layer the micro level. At this level, you have to believe in the uncertainty and unpredictability of each individual hand. You know the truth of this uncertainty, because there are always a number of unknown variables affecting the consistency of the deck that each new hand is drawn from. For example, you can't know in advance how any of the other participants will decide to play their hands, since they can either take or decline additional cards. Any variables acting on the consistency of the deck that can't be controlled or known in advance will make the outcome of any particular hand both uncertain and random (statistically independent) in relationship to any other hand. The second layer is the macro level. At this level, you have to believe that the outcome over a series of hands played is relatively certain and predictable. The degree of certainty is based on the fixed or constant variables that are known in advance and specifically designed to give an advantage (edge) to one side or the other.

The constant variables I am referring to are the rules of the game. So, even though you don't or couldn't know in advance (unless you are psychic) the sequence of wins to losses, you can be relatively certain that if enough hands are played, whoever has the edge will end up with more wins than losses. The degree of certainty is a function of how good the edge is. It's the ability to believe in the unpredictability of the game at the micro level and simultaneously believe in the predictability of the game at the macro level that makes the casino and the professional gambler effective and successful at what they do. Their belief in the uniqueness of each hand prevents them from engaging in the pointless endeavor of trying to predict the outcome of each individual hand. They have learned and completely accepted the fact that they don't know what's going to happen next. More important, they don't need to know in order to make money consistently.

Because they don't have to know what's going to happen next, they don't place any special significance, emotional or otherwise, on each individual hand, spin of the wheel, or roll of the dice. In other words, they're not encumbered by unrealistic expectations about what is going to happen, nor are their egos involved in a way that makes them have to be right. As a result, it's easier to stay focused on keeping the odds in their favor and executing flawlessly, which in turn makes them less susceptible to making costly mistakes.

They stay relaxed because they are committed and willing to let the probabilities (their edges) play themselves out, all the while knowing that if their edges are good enough and the sample sizes are big enough, they will come out net winners. The best traders use the same thinking strategy as the casino and professional gambler. Not only does it work to their benefit, but the underlying dynamics supporting the need for such a strategy are exactly the same in trading as they are in gambling.

A simple comparison between the two will demonstrate this quite clearly. First, the trader, the gambler, and the casino are all dealing with both known and unknown variables that affect the outcome of each trade or gambling event. In gambling, the known variables are the rules of the game. In trading, the known variables (from each individual trader's perspective) are the results of their market analysis. Market analysis finds behavior patterns in the collective actions of everyone participating in a market. We know that individuals will act the same way under similar situations and circumstances, over and over again, producing observable patterns of behavior. By the same token, groups of individuals interacting with one another, day after day, week after week, also produce behavior patterns that repeat themselves. These collective behavior patterns can be discovered and sub- «pnii<=-nflv identified bv nsinf analvtical tools such as trend lines, moving averages, oscillators, or retracements, just to name a few of the thousands that are available to any trader. Each analytical tool uses a set of criteria to define the boundaries of each behavior pattern identified. The set of criteria and the boundaries identified are the trader's known market variables.

They are to the individual trader what the rules of the game are to the casino and gambler. By this I mean, the trader's analytical tools are the known variables that put the odds of success (the edge) for any given trade in the trader's favor, in the same way that the rules of the game put the odds of success in favor of the casino. Second, we know that in gambling a number of unknown variables act on the outcome of each game. In blackjack, the unknowns are the shuffling of the deck and how the players choose to play their hands. In craps, it's how the dice are thrown. And in roulette, it's the amount of force applied to spin the wheel. All these unknown variables act as forces on the outcome of each individual event, in a way that causes each event to be statistically independent of any other individual event, thereby creating a random distribution between wins and losses. Trading also involves a number of unknown variables that act on the outcome of any particular behavior pattern a trader may identify and use as his edge. In trading, the unknown variables are all other traders who have the potential to come into the market to put on or take off a trade.

Each trade contributes to the market's position at any given moment, which means that each trader, acting on a belief about what is high and what is low, contributes to the collective behavior pattern that is displayed at that moment. If there is a recognizable pattern, and if the variables used to define that pattern conform to a particular trader's definition of an edge, then we can say that the market is offering the trader an opportunity to buy low or sell high, based on the trader's definition. Suppose the trader seizes the opportunity to take advantage of his edge and puts on a trade. What factors will determine whether the market unfolds in the direction of his edge or against it? The answer is: the behavior of other traders!

At the moment he puts a trade on, and for as long as he chooses to stay in that trade, other traders will be participating in that market. They will be acting on their beliefs about what is high and what is low. At any given moment, some percentage of other traders will contribute to an outcome favorable to our traders edge, and the participation of some percentage of traders will negate his edge. There's no way to know in advance how everyone else is going to behave and how their behavior will affect his trade, so the outcome of the trade is uncertain.

The fact is, the outcome of every (legal) trade that anyone decides to make is affected in some way by the subsequent behavior of other traders participating in that market, making the outcome of all trades uncertain. Since all trades have an uncertain outcome, then like gambling, each trade has to be statistically independent of the next trade, the last trade, or any trades in the future, even though the trader may use the same set of known variables to identify his edge for each trade. Furthermore, if the outcome of each individual trade is statistically independent of every other trade, there must also be a random distribution between wins and losses in any given string or set of trades, even though the odds of success for each individual trade may be in the traders favor.

Third, casino owners don't try to predict or know in advance the outcome of each individual event. Aside from the fact that it would be extremely difficult, given all the unknown variables operating in each game, it isn't necessary to create consistent results. Casino operators have learned that all they have to do is keep the odds in their favor and have a large enough sample size of events so that their edges have ample opportunity to work.

TRADING IN THE MOMENT

Traders who have learned to think in probabilities approach the markets from virtually the same perspective. At the micro level, they believe that each trade or edge is unique. What they understand about the nature of trading is that at any given moment, the market may look exactly the same on a chart as it did at some previous moment; and the geometric measurements and mathematical calculations used to determine each edge can be exactly the same from one edge to the next; but the actual consistency of the market itself from one moment to the next is never the same.

For any particular pattern to be exactly the same now as it was in some previous moment would require that every trader who participated in that previous moment be present. What's more, each of them would also have to interact with one another in exactly the same way over some period of time to produce the exact same outcome to whatever pattern was being observed. The odds of that happening are nonexistent. It is extremely important that you understand this phenomenon because the psychological implications for your trading couldn't be more important.

We can use all the various tools to analyze the market's behavior and find the patterns that represent the best edges, and from an analytical perspective, these patterns can appear to be precisely the same in eveiy respect, both mathematically and visually. But, if the consistency of the group of traders who are creating the pattern "now" is different by even one person from the group that created the pattern in the past, then the outcome of the current pattern has the potential to be different from the past pattern. (The example of the analyst and chairman illustrates this point quite well.) It takes only one trader, somewhere in the world, with a different belief about the future to change the outcome of any particular market pattern and negate the edge that pattern represents. The most fundamental characteristic of the market's behavior is that each "now moment" market situation, each "now moment" behavior pattern, and each "now moment" edge is always a unique occurrence with its own outcome, independent of all others. Uniqueness implies that anything can happen, either what we know (expect or anticipate), or what we don't know (or can't know, unless we had extraordinary perceptual abilities). A constant flow of both known and unknown variables creates a probabilistic environment where we don't know for certain what will happen next.

This last statement may seem quite logical, even self-evident, but there's a huge problem here that is anything but logical or selfevident. Being aware of uncertainty and understanding the nature of probabilities does not equate with an ability to actually function effectively from a probabilistic perspective. Thinking in probabilities can be difficult to master, because our minds don't naturally process information in this manner. Quite the contrary, our minds cause us to perceive what we know, and what we know is part of our past, whereas, in the market, every moment is new and unique, even though there may be similarities to something that occurred in the past. This means that unless we train our minds to perceive the uniqueness of each moment, tiiat uniqueness will automatically be filtered out of our perception. We will perceive only what we know, minus any information that is blocked by our fears; everything else will remain invisible.

The bottom line is that there is some degree of sophistication to thinking in probabilities, which can take some people a considerable amount of effort to integrate into their mental systems as a functional thinking strategy. Most traders don't fully understand this; as a result, they mistakenly assume they are thinking in probabilities, because they have some degree of understanding of the concepts. I've worked with hundreds of traders who mistakenly assumed they thought in probabilities, but didn't. Here is an example of a trader I worked with whom I'll call Bob. Bob is a certified trading advisor (CTA) who manages approximately $50 million in investments. He's been in the business for almost 30 years. He came to one of my workshops because he was never able to produce more than a 12- to 18-percent annual return on the accounts he managed.

This was an adequate return, but Bob was extremely dissatisfied because his analytical abilities suggested that he should be achieving an annual return of 150 to 200 percent. I would describe Bob as being well-versed in the nature of probabilities. In other words, he understood the concepts, but he didn't function from a probabilistic perspective. Shortly after attending the workshop, he called to ask me for some advice. Here is the entry from my journal written immediately after that phone conversation.

9-28-95: Bob called with a problem. He put on a belly trade and put his stop in the market. The market traded about a third of the way to his stop and then went back to his entry point, where he decided to bail out of the trade. Almost immediately after he got out, the bellies went 500 points in the direction of this trade, but of course he was out of the market. He didn't understand what was going on. First, I asked him what was at risk. He didn't understand the question. He assumed that he had accepted the risk because he put in a stop. I responded that just because he put in a stop it didn't mean that he had truly accepted the risk of the trade. There are many things that can be at risk: losing money, being wrong, not being perfect, etc., depending on one's underlying motivation for trading. I pointed out that a person's beliefs are always revealed by their actions.

We can assume that he was operating out of a belief that to be a disciplined trader one has to define the risk and put a stop in. And so he did. But a person can put in a stop and at the same time not believe that he is going to be stopped out or that the trade will ever work against him, for that matter. By the way he described the situation, it sounded to me as if this is exactly what happened to him. When he put on the trade, he didn't believe he would be stopped out. Nor did he believe the market would trade against him. In fact, he was so adamant about this, that when the market came back to his entry point, he got out of the trade to punish the market with an "I'll show you" attitude for even going against him by one tic. After I pointed this out to him, he said this was exactly the attitude he had when he took off the trade. He said that he had been waiting for this particular trade for weeks and when the market finally got to this point, he thought it would immediately reverse.

I responded by reminding him to look at the experience as simply pointing the way to something that he needs to learn. A prerequisite for thinking in probabilities is that you accept the risk, because if you don't, you will not want to face the possibilities that you haven't accepted, if and when they do present themselves. When you've trained your mind to think in probabilities, it means you have fully accepted all the possibilities (with no internal resistance or conflict) and you always do something to take the unknown forces into account. Thinkine this way is virtually impossible unless you've done the mental work necessary to "let go" of the need to know what is going to happen next or the need to be right on each trade. In fact, the degree by which you think you know, assume you know, or in any way need to know what is going to happen next, is equal to the degree to which you will fail as a trader. Traders who have learned to think in probabilities are confident of their overall success, because they commit themselves to taking every trade that conforms to their definition of an edge.

They don't attempt to pick and choose the edges they think, assume, or believe are going to work and act on those; nor do they avoid the edges that for whatever reason they think, assume, or believe aren't going to work. If they did either of those things, they would be contradicting their belief that the "now" moment situation is always unique, creating a random distribution between wins and losses on any given string of edges. They have learned, usually quite painfully, that they don't know in advance which edges are going to work and which ones aren't. They have stopped trying to predict outcomes. They have found that by taking every edge, they correspondingly increase their sample size of trades, which in turn gives whatever edge they use ample opportunity to play itself out in their favor, just like the casinos. On the other hand, why do you think unsuccessful traders are obsessed with market analysis.

They crave the sense of certainty that analysis appears to give them. Although few would admit it, the truth is that the typical trader wants to be right on every single trade. He is desperately trying to create certainty where it just doesn't exist. The irony is that if he completely accepted the fact that certainty doesn't exist, he would create the certainty he craves: He would be absolutely certain that certainty doesn't exist. When you achieve complete acceptance of the uncertainty of each edge and the uniqueness of each moment, your frustration with trading will end. Furthermore, you will no longer be susceptible to making all the typical trading errors that detract from your potential to be consistent and destroy your sense of self-confidence. For examnle not rlefminff the risk before crRftincr into a trarle is hv far rhp most common of all trading errors, and starts the whole process of trading from an inappropriate perspective. In light of the fact that anything can happen, wouldn't it make perfect sense to decide before executing a trade what the market has to look, sound, or feel like to tell you your edge isn't working? So why doesn't the typical trader decide to do it or do it every single time?

I have already given you the answer in the last chapter, but there's more to it and there's also some tricky logic involved, but the answer is simple. The typical trader won't predefine the risk of getting into a trade because he doesn't believe it's necessary. The only way he could believe "it isn't necessary" is if he believes he knows what's going to happen next. The reason he believes he knows what's going to happen next is because he won't get into a trade until he is convinced that he's right. At the point where he's convinced the trade will be a winner, it's no longer necessary to define the risk (because if he's right, there is no risk). Typical traders go through the exercise of convincing themselves that they're right before they get into a trade, because the alternative (being wrong) is simply unacceptable. Remember that our minds are wired to associate.

As a result, being wrong on any given trade has the potential to be associated with any (or every) other experience in a trader's life where he's been wrong. The implication is that any trade can easily tap him into the accumulated pain of every time he has been wrong in his life. Given the huge backlog of unresolved, negative energy surrounding what it means to be wrong that exists in most people, it's easy to see why each and every trade can literally take on the significance of a life or death situation. So, for the typical trader, determining what the market would have to look, sound, or feel like to tell him that a trade isn't working would create an irreconcilable dilemma. On one hand, he desperately wants to win and the only way he can do that is to participate, but the only way he will participate is if he's sure the trade will win. On the other hand, if he defines his risk, he is willfully gathering evidence that would negate something he has already convinced himself of.

He will be contradicting the decision-making process he went through to convince himself that the trade will work. If he exposed himself to conflicting information, it would surely create some degree of doubt about the viability of the trade. If he allows himself to experience doubt, it's very unlikely he will participate. If he doesn't put the trade on and it turns out to be a winner, he will be in extreme agony. For some people, nothing hurts more than an opportunity recognized but missed because of self-doubt. For the typical trader, the only way out of this psychological dilemma is to ignore the risk and remain convinced that the trade is right. If any of this sounds familiar, consider this: When you're convincing yourself that you're right, what you're saying to yourself is, "I know who's in this market and who's about to come into this market. I know what they believe about what is high or what is low. Furthermore, I know each individual's capacity to act on those beliefs (the degree of clarity or relative lack of inner conflict), and with this knowledge, I am able to determine how the actions of each of these individuals will affect price movement in its collective form a second, a minute, an hour, a day, or a week from now."

Looking at the process of convincing yourself that you're right from this perspective, it seems a bit absurd, doesn't it? For the traders who have learned to think in probabilities, there is no dilemma. Predefining the risk doesn't pose a problem for these traders because they don't trade from a right or wrong perspective. They have learned that trading doesn't have anything to do with being right or wrong on any individual trade. As a result, they don't perceive the risks of trading in the same way the typical trader does. Any of the best traders (the probability thinkers) could have just as much negative energy surrounding what it means to be wrong as the typical trader.

But as long as they legitimately define trading as a probability game, their emotional responses to the outcome of any particular trade are equivalent to how the typical trader would feel about flipping a coin, calling heads, and seeing the coin come up tails. A wrong call, but for most people being wrong about predicting the flip of a coin *would not* tap them into the accumulated pain of every other time in their lives they had been wrong. Why? Most people know that the outcome of a coin toss is random. If you believe the outcome is random, then you naturally expect a random outcome. Randomness implies at least some degree of uncertainty. So when we believe in a random outcome, there is an implied acceptance that we don't know what that outcome will be. When we accept in advance of an event that we don't know how it will turn out, that acceptance has the effect of keeping our expectations neutral and open-ended. Now we're getting down to the very core of what ails the typical trader. Any expectation about the markets behavior that is specific, well-defined, or rigid—instead of being neutral and open-ended—is unrealistic and potentially damaging. I define an unrealistic expectation as one that does not correspond with the possibilities available from the market's perspective. If each moment in the market is unique, and anything is possible, then any expectation that does not reflect these boundary-less characteristics is unrealistic.

MANAGING EXPECTATIONS

The potential damage caused by holding unrealistic expectations comes from how it affects the way we perceive information. Expectations are mental representations of what some future moment will look, sound, taste, smell, or feel like. Expectations come from what we know. This makes sense, because we can't expect something that we have no knowledge or awareness of. What we know is synonymous with what we have learned to believe about the ways in which the external environment can express itself. What we believe is our own personal version of the truth. When we expect something, we are projecting out into the future what we believe to be true.

We are expecting the outside environment a minute, an hour, a day, a week, or a month from now to be the way we have represented it in our minds. We have to be careful about what we project out into the future, because nothing else has the potential to create more unhappiness and emotional misery than an unfulfilled expectation. When things happen exactly as you expect them to, how do you feel? The response is generally wonderful (including feelings like happiness, joy, satisfaction, and a greater sense of well-being), unless, of course, you were expecting something dreadful and it manifested itself. Conversely, how do you feel when your expectations are not fulfilled? The universal response is emotional pain.

Everyone experiences some degree of anger, resentment, despair, regret, disappointment, dissatisfaction, or betrayal when the environment doesn't turn out to be exactly as we expected it to be (unless, of course, we are completely surprised by something much better than we imagined). Here's where we run into problems. Because our expectations come from what we know, when we decide or believe that we know something, we naturally expect to be right. At that point, we're no longer in a neutral or open state of mind, and it's not difficult to understand why. If we're going to feel great if the market does what we expect it to do, or feel horrible if it doesn't, then we're not exactly neutral or open-minded. Quite the contrary, the force of the belief behind the expectation will cause us to perceive market information in a way that confirms what we expect (we naturally like feeling good); and our pain-avoidance mechanisms will shield us from information that doesn't confirm what we expect (to keep us from feeling bad).

As I've already indicated, our minds are designed to help us avoid pain, both physical and emotional. These pain-avoidance mechanisms exist at both conscious and subconscious levels. For example, if an object is coming toward your head, you react instinctively to get out of the way. Ducking does not require a conscious decision-making process. On the other hand, if you clearly see the object and have time to consider the alternatives, you may decide to catch the object, bat it away with your hand, or duck. These are examples of how we protect ourselves from physical pain. Protecting ourselves from emotional or mental pain works in the same way, except that we are now protecting ourselves from information. For example, the market expresses information about itself and its potential to move in a particular direction. If there's a difference between what we want or expect and what the market is offering or making available, then our pain-avoidance mechanisms kick in to compensate for the differences. As with physical pain, these mechanisms operate at both the conscious and subconscious levels.

To protect ourselves from painful information at the conscious level, we rationalize, justify, make excuses, willfully gather information that will neutralize the significance of the conflicting information, get angry (to ward off the conflicting information), or just plain lie to ourselves. At the subconscious level, the pain-avoidance process is much more subtle and mysterious. At this level, our minds may block our ability to see other alternatives, even though in other circumstances we would be able to perceive them. Now, because they are in conflict with what we want or expect, our pain-avoidance mechanisms can make them disappear (as if they didn't exist). To illustrate this phenomenon, the best example is one I have already given you: We are in a trade where the market is moving against us. In fact, the market has established a trend in the opposite direction to what we want or expect. Ordinarily, we would have no problem identifying or perceiving this pattern if it weren't for the fact that the market was moving against our position. But the pattern loses its significance (becomes invisible) because we find it too painful to acknowledge.

To avoid the pain, we narrow our focus of attention and concentrate on information that keeps us out of pain, regardless of how insignificant or minute. In the meantime, the information that clearly indicates the presence of a trend and the opportunity to trade in the direction of that trend becomes invisible. The trend doesn't disappear from physical reality, but our ability to perceive it does. Our pain-avoidance mechanisms block our ability to define and interpret what the market is doing as a trend. The trend will then stay invisible until the market either reverses in our favor or we are forced out of the trade because the pressure of losing too much money becomes unbearable. It's not until we are either out of the trade or out of danger that the trend becomes apparent, as well as all the opportunities to make money by trading in the

All the distinctions that would otherwise be perceivable become perfectly clear, after the fact, when there is no longer anything for our minds to protect us from. We all have the potential to engage in self-protective painavoidance mechanisms, because they're natural functions of the way our minds operate. There may be times when we are protecting ourselves from information that has the potential to bring up deepseated emotional wounds or trauma that we're just not ready to face, or don't have the appropriate skills or resources to deal with. In these cases, our natural mechanisms are serving us well. But more often, our pain-avoidance mechanisms are just protecting us from information that would indicate that our expectations do not correspond with what is available from the environments perspective. This is where our pain-avoidance mechanisms do us a disservice, especially as traders. To understand this concept, ask yourself what exactly about market information is threatening. Is it threatening because the market actually expresses negatively charged information as an inherent characteristic of the way it exists?

It may seem that way, but at the most fundamental level, what the market gives us to perceive are uptics and down-tics or up-bars and down-bars. These up and down tics form patterns that represent edges. Now, are any of these tics or the patterns they form negatively charged? Again, it may certainly seem that way, but from the market's perspective the information is neutral. Each up-tic, down-tic, or pattern is just information, telling us the market's position. If any of this information had a negative charge as an inherent characteristic of the way it exists, then wouldn't everyone exposed to it experience emotional pain? For example, if both you and I get hit on the head with a solid object, there probably wouldn't be much difference in how we would feel. We'd both be in pain. Any part of our bodies coming into contact with a solid object with some degree of force will cause anyone with a normal nervous system to experience pain.

We share the experience because our bodies are constructed in basically the same way. The pain is an automatic physiological response to the impact with a tangible object. Information in the form of words or gestures expressed by the environment, or up and down tics expressed by the market, can be just as painful as being hit with a solid object; but there's an important difference between information and objects. Information is not tangible. Information doesn't consist of atoms and molecules. To experience the potential effects of information, whether negative or positive, requires an interpretation. The interpretations we make are functions of our unique mental frameworks. Everyone's mental framework is unique for two fundamental reasons.

First, all of us were born with different genetically encoded behavior and personality characteristics that cause us to have different needs from one another. How positively or negatively and to what degree the environment responds to these needs creates experiences unique to each individual. Second, everyone is exposed to a variety of environmental forces. Some of these forces are similar from one individual to the next, but none are exactly the same. If you consider the number of possible combinations of genetically encoded personality characteristics we can be born with, in relation to the almost infinite variety of environmental forces we can encounter throughout our lives, all of which contribute to the construction of our mental framework, then it's not difficult to see why there is no universal mental framework common to everyone.

Unlike our bodies, which have a common molecular structure that experiences physical pain, there is no universal mind-set to assure us that we will share the potential negative or positive effects of information in the same way. For example, someone could be projecting insults at you, intending to cause you to feel emotional pain. From the environment's perspective, this is negatively charged information. Will you experience the intended negative effects? Not necessarily! You have to be able to interpret the information as negative to experience it as negative. What if this person is insulting you in a language you don't understand, or is using words you don't know the meaning of? Would you feel the intended pain? Not until you built a framework to define and understand the words in a derogatory way. Even then, we can't assume that what you'd feel would correspond to the intent behind the insult. You could have a framework to perceive the negative intent, but instead of feeling pain, you might experience a perverse type of pleasure. I've encountered many people who, simply for their own amusement, like to get people riled up with negative emotions.

If they happen to be insulted in the process, it creates a sense of joy because then they know how successful they've been. A person expressing genuine love is projecting positively charged information into the environment. Let's say the intent behind the expression of these positive feelings is to convey affection, endearment, and friendship. Are there any assurances that the person or persons this positively charged information is being projected toward will interpret and experience it as such? No, there aren't. A person with a very low sense of self-esteem, or someone who experienced a great deal of hurt and disappointment in relationships, will often misinterpret an expression of genuine love as something else. In the case of a person with low self-esteem, if he doesn't believe he deserves to be loved in such a way, he will find it difficult, if not impossible, to interpret what he is being offered as genuine or real. In the second case, where one has a significant backlog of hurt and disappointment in relationships, a person could easily come to believe that a genuine expression of love is extremely rare, if not non-existent, and would probably interpret the situation either as someone wanting something or trying to take advantage of him in some way.

I'm sure that I don't have to go on and on, sighting examples of all the possible ways there are to misinterpret what someone is trying to communicate to us or how what we express to someone can be misconstrued and experienced in ways completely unintended by us. The point that I am making is that each individual will define, interpret, and consequently experience whatever information he is exposed to in his own unique way. There's no standardized way to experience what the environment may be offering—whether it's positive, neutral, or negative information—simply because there is no standardized mental framework in which to perceive information. Consider that, as traders, the market offers us something to perceive at each moment. In a sense, you could say that the market is communicating with us.

If we start out with the premise that the market does not generate negatively charged information as an inherent characteristic of the way it exists, we can then ask, and answer, the question, "What causes information to take on a negative quality?" In other words, where exactly does the threat of pain come from? If it's not coming from the market, then it has to be coming from the way we define and interpret the available information. Defining and interpreting information is a function of what we assume we know or what we believe to be true. If what we know or believe is in fact true—and we wouldn't believe it if it weren't—then when we project our beliefs out into some future moment as an expectation, we naturally expect to be right. When we expect to be right, any information that doesn't confirm our version of the truth automatically becomes threatening. Any information that has the potential to be threatening also has the potential to be blocked, distorted, or diminished in significance by our pain-avoidance mechanisms.

It's this particular characteristic of the way our minds function that can really do us a disservice. As traders, we can't afford to let our pain-avoidance mechanisms cut us off from what the market is communicating to us about what is available in the way of the next opportunity to get in, get out, add to, or subtract from a position, just because it's doing something that we don't want or expect. For example, when you're watching a market (one you rarely, if ever, trade in) with no intention of doing anything, do any of the up or down tics cause you to feel angry, disappointed, frustrated, disillusioned, or betrayed in any way? No! The reason is that there's nothing at stake. You're simply observing information that tells you where the market is at that moment. If the up and down tics that you're watching form into some sort of behavior pattern you've learned to identify, don't you readily recognize and acknowledge the pattern? Yes, for the same reason: There's nothing at stake.

There is nothing at stake because there's no expectation. You haven't projected what you believe, assume, or think you know about that market into some future moment. As a result, there's nothing to be either right about or wrong about, so the information has no potential to take on a threatening or negatively charged quality. With no particular expectation, you haven't placed any boundaries on how the market can express itself. Without any mental boundaries, you will be making yourself available to perceive everything you've learned about the nature of the ways in which the market moves.

There's nothing for your pain-avoidance mechanisms to exclude, distort, or diminish from your awareness in order to protect you. In my workshops, I always ask participants to resolve the following primary trading paradox: In what way does a trader have to learn how to be rigid and flexible at the same time? The answer is: We have to be rigid in our rules and flexible in our expectations. We need to be rigid in our rules so that we gain a sense of self-trust that can, and will always, protect us in an environment that has few, if any, boundaries. We need to be flexible in our expectations so we can perceive, with the greatest degree of clarity and objectivity, what the market is communicating to us from its perspective. At this point, it probably goes without saying that the typical trader does just the opposite: He is flexible in his rules and rigid in his expectations. Interestingly enough, the more rigid the expectation, the more he has to either bend, violate, or break his rules in order to accommodate his unwillingness to give up what he wants in favor of what the market is offering.

ELIMINATING THE EMOTIONAL RISK

To eliminate the emotional risk of trading, you have to neutralize your expectations about what the market will or will not do at any given moment or in any given situation. You can do this by being willing to think from the markets perspective. Remember, the market is always communicating in probabilities. At the collective level, your edge may look perfect in every respect; but at the individual level, every trader who has the potential to act as a force on price movement can negate the positive outcome of that edge. To think in probabilities, you have to create a mental framework or mind-set that is consistent with the underlying principles of a probabilistic environment. A probabilistic mind-set pertaining to trading consists of five fundamental truths.

1. Anything can happen.
2. You don't need to know what is going to happen next in order to make money.
3. There is a random distribution between wins and losses for any given set of variables that define an edge.
4. An edge is nothing more than an indication of a higher probability of one thing happening over another.
5. Eveiy moment in the market is unique.

Keep in mind that your potential to experience emotional pain comes from the way you define and interpret the information you're exposed to. When you adopt these five truths, your expectations will always be in line with the psychological realities of the market environment. With the appropriate expectations, you will eliminate your potential to define and interpret market information as either painful or threatening, and you thereby effectively neutralize the emotional risk of trading. The idea is to create a carefree state of mind that completely accepts the fact that there are always unknown forces operating in the market. When you make these truths a fully functional part of your belief system, the rational part of your mind will defend these truths in the same way it defends any other belief you hold about the nature of trading.

This means that, at least at the rational level, your mind will automatically defend against the idea or assumption that you can know for sure what will happen next. It's a contradiction to believe that each trade is a unique event with an uncertain outcome and random in relationship to any other trade made in the past; and at the same time to believe you know for sure what will happen next and to expect to be right. If you really believe in an uncertain outcome, then you also have to expect that virtually anything can happen. Otherwise, the moment you let your mind hold onto the notion that you *know*, you stop taking all of the unknown variables into consideration. Your mind won't let you have it both ways. If you believe you know something, the moment is no longer unique.

If the moment isn't unique, then everything is known or knowable; that is, there's nothing not to know. However, the moment you stop factoring in what you don't or can't know about the situation instead of being available to perceive what the market *is* offering, you make yourself susceptible to all of the typical trading errors. For example, if you really believed in an uncertain outcome, would you ever consider putting on a trade without defining your risk in advance? Would you ever hesitate to cut a loss, if you really believed you didn't know? What about trading errors like jumping the gun? How could you anticipate a signal that hasn't yet manifested itself in the market, if you weren't convinced that you were going to miss out? Why would you ever let a winning trade turn into a loser, or not have a systematic way of taking profits, if you weren't convinced the market was going your way indefinitely? Why would you hesitate to take a trade or not put it on at all, unless you were convinced that it was a loser when the market was at your original entiy point? Why would you break your money management rules by trading too large a position relative to your equity or emotional tolerance to sustain a loss, if you weren't positive that you had a sure thing? Finally, if you really believed in a random distribution between wins and losses, could you ever feel betrayed by the market? If you flipped a coin and guessed right, you wouldn't necessarily expect to be right on the next flip simply because you were right on the last.

Nor would you expect to be wrong on the next flip if you were wrong on the last. Because you believe in a random distribution between the sequence of heads and tails, your expectations would be perfectly aligned with the reality of the situation. You would certainly like to be right, and if you were that would be great, but if you were wrong then you would not feel betrayed by the flip, because you know and accept that there are unknown variables at work that affect the outcome. Unknown means "not something your rational thinking process can take into consideration in advance of the Hi-r" ?jXCi>v'L ^ fu!Iv accept that you don't know As a result, there is little, if any, potential to experience the kind of emotional pain that wells up when you feel betrayed. As a trader, when you're expecting a random outcome, you will always be at least a little surprised at whatever the market does— even if it conforms exactly to your definition of an edge and you end up with a winning trade. However expecting a random outcome doesn't mean that you can't use your full reasoning and analytical abilities to project an outcome, or that you can't guess what's going to happen next, or have a hunch or feeling about it, because you can. Furthermore, you can be right in each instance.

You just can't *expect* to be right. And if you are right, you can't expect that whatever you did that worked the last time will work again the next time, even though the situation may look, sound, or feel exactly the same. Anything that you are perceiving "now" in the market will never be exactly the same as some previous experience that exists in your mental environment. But that doesn't mean that your mind (as a natural characteristic of the way it functions) won't try to make the two identical. There will be similarities between the "now moment" and something that you know from the past, but those similarities only give you something to work with by putting the odds of success in your favor. If you approach trading from the perspective that you don't know what will happen next, you will circumvent your mind's natural inclination to make the "now moment" identical to some earlier experience.

As unnatural as it seems to do so, you can't let some previous experience (either negative or extremely positive) dictate your state of mind. If you do, it will be very difficult, if not impossible, to perceive what the market is communicating from its perspective. When I put on a trade, all I expect is that something will happen. Regardless of how good I think my edge is, I expect nothing more than for the market to move or to express itself in some way. However, there are some things that I do know for sure. I know that based on the markets past behavior, the odds of it moving in the direction of my trade are good or acceptable, at least in relationship to how much I am willing to spend to find out if it does. I also know before getting into a trade how much I am willing to let the market move against my position. There is always a point at which the odds of success are greatly diminished in relation to the profit potential. At that point, it's not worth spending any more money to find out if the trade is going to work. If the market reaches that point, I know without any doubt, hesitation, or internal conflict that I will exit the trade.

The loss doesn't create any emotional damage, because I don't interpret the experience negatively. To me, losses are simply the cost of doing business or the amount of money I need to spend to make myself available for the winning trades. If, on the other hand, the trade turns out to be a winner, in most cases I know for sure at what point I am going to take my profits. (If I don't know for sure, I certainly have a veiy good idea.) The best traders are in the "now moment" because there's no stress. There's no stress because there's nothing at risk other than the amount of money they are willing to spend on a trade. They are not trying to be right or trying to avoid being wrong; neither are they trying to prove anything. If and when the market tells them that their edges aren't working or that it's time to take profits, their minds do nothing to block this information. They completely accept what the market is offering them, and they wait for the next edge.

CHAPTER 8

WORKING WITH YOUR BELIEFS

Now the task before you is to properly integrate the five fundamental truths presented in Chapter 7 in your mental environment at *a* functional level. To help you do that, we will take an in-depth look at beliefs—their nature, properties, and characteristics. However, before we do that I will review and organize the major concepts presented thus far into a much clearer and more practical framework. What you learn from this and the next two chapters will form the foundation for understanding everything you need to do to achieve your goals as a trader.

DEFINING THE PROBLEM

At the most fundamental level, the market is simply a series of up and down tics that form patterns. Technical analysis defines these patterns as edges. Any particular pattern defined as an edge is simply an indication that there is a higher probability that the market will move in one direction over the other. However, there is a major mental paradox here because a pattern implies consistency, or, at least, a consistent outcome. But the reality is each pattern is a unique occurrence. They may look (or measure) exactly the same from one occurrence to the next, but the similarities are only on the surface. The underlying force behind each pattern is traders, and the traders who contribute to the formation of one pattern are always different from the traders who contribute to the next; so the outcome of each pattern is random relative to one another.

Our minds have an inherent design characteristic (the association mechanism) that can make this paradox difficult to deal with. Now these edges, or the patterns they represent, flow by in every time frame, making the market a never-ending stream of opportunities to get in, get out (scratch a trade), take profits, cut losses, or add to or detract from a position. In other words, from the market's perspective, each moment presents each one of us traders with the opportunity to do something on our own behalf.

DEFINING THE TERMS

What prevents us from perceiving each "now moment" as an opportunity to do something for ourselves or to act appropriately even when we do? Our fears! What is the source of our fears? We know its not the market, because from the market's perspective, the up and down tics and the patterns they create are neither positively or negatively charged.

As a result, the up and down tics themselves have no capacity to cause us to enter into any particular state of mind (negative or positive), lose our objectivity, make errors, or take us out of the opportunity flow. If it's not the market that causes us to experience a negatively charged state of mind, then what does cause it? The way we define and interpret the information we perceive. If that's the case, then what determines what we perceive and how we define and interpret that information? What we believe or what we assume to be true. Our beliefs working in conjunction with the association and pain-avoidance mechanisms act as a force on our five senses, causing us to perceive, define, and interpret market information in a way that is consistent with what we expect. What we expect is synonymous with.what we believe or assume to be true. Expectations are beliefs projected into some future moment.

Each moment from the market's perspective is unique; but if the information being generated by the market is similar in quality, properties, or characteristic to something that is already in our minds, the two sets of information (outside and inside) automatically become linked. When this connection is made, it triggers a state of mind (confidence, euphoria, fear, terror, disappointment, regret, betrayal, etc.) that corresponds to whatever belief, assumption, or memory the outside information was linked. This makes it *seem as* if what is outside is exactly the same as whatever is already inside of us. It's our state of mind that makes the truth of whatever we're perceiving outside of us (in the market) seem indisputable and beyond question.

Our state of mind is always the absolute truth. If I feel confident, then I am confident. If I feel afraid, then I am afraid. We can't dispute the quality of energy flowing through our mind and body at any given moment. And because I *know* as an indisputable fact how I feel, you could say that I also know the truth of what I'm perceiving outside of me in the same moment. The problem is that how we feel is always the absolute truth, but the beliefs that triggered our state of mind or feeling may or may not be true relative to the possibilities that exist in the market at any given moment. Recall the example of the boy and the dog.

The boy "knew" for an absolute fact that each dog he encountered after the first was threatening, because of the way he felt when one came into his field of awareness. These other dogs did not cause his fear; his negatively charged memory working in conjunction with the association and his pain-avoidance mechanism caused his fear. He experienced his own version of the truth, although that did not correspond with the possibilities that existed from the environment's perspective. His belief about the nature of dogs was limited relative to the possible characteristics and traits expressed by dogs. Yet the state of mind he experienced eveiy time he encountered a dog caused him to believe thats he "knew" exactly what to expect from them.

This same process causes us to believe that we "know" exactly what to expect from die market, when the reality is there are always unknown forces operating at every moment. The trouble is, the instant we think we "know" what to expect, we simultaneously stop taking all the unknown forces and die various possibilities created by those forces into consideration. The unknown forces are other traders waiting to enter or exit trades, based on their beliefs about the future. In other words, we really can't know exactly what to expect from the market, until we can read the minds of all the traders who have the potential to act as a force on price movement. Not a very likely possibility. As traders, we can't afford to indulge ourselves in any form of "I know what to expect from the market." We can "know" exactly what an edge looks, sounds, or feels like, and we can "know" exactly how much we need to risk to find out if that edge is going to work.

We can "know" that we have a specific plan as to how we are going to take profits if a trade works. *But that's it!* If what we think we know starts expanding to what the market is going to do, we're in trouble. And all that's required to put us into a negatively charged, "I know what to expect from the market" state of mind is for any belief, memoiy, or attitude to cause us to interpret the up and down tics or any market information as anything but an opportunity to do something on our own behalf.

What Are the Objectives? Ultimately, of course, making money is everyone's objective. But if trading were only a matter of making money, reading this book wouldn't be necessary. Putting on a winning trade or even a series of winning trades requires absolutely no skill. On the other hand, creating consistent results and being able to keep what we've created does require skill. Making money consistently is a by-product of acquiring and mastering certain mental skills. The degree to which you understand this is the same degree to which you will stop focusing on the money and focus instead on how you can use your trading as a tool to master these skills.

What Are the Skills? Consistency is the result of a carefree, objective state of mind, where we are making ourselves available to perceive and act upon whatever the market is offering us (from its perspective) in any given "now moment."

What Is a Carefree State of Mind? Carefree means confident, but not euphoric. When you are in a carefree state of mind, you won't feel any fear, hesitation, or compulsion to do anything, because you've effectively eliminated the potential to define and interpret market information as threatening. To remove the sense of threat, you have to accept the risk completely. When you have accepted the risk, you will be at peace with any outcome. To be at peace with any outcome, you must reconcile anything in your mental environment that conflicts with the five fundamental truths about the market. What's more, you also have to integrate these truths into your mental system as core beliefs.

What Is Objectivity? Objectivity is a state of mind where you have conscious access to everything you have learned about the nature of market movement. In other words, nothing is being blocked or altered by your painavoidance mechanisms.

What Does it Mean to Make Yourself Available? Making yourself available means trading from the perspective that you have nothing to prove. You aren't trying to win or to avoid losing. You aren't trying get your money back or to take revenge on the market. In other words, you come to the market with no agenda other than to let it unfold in any way that it chooses and to be in the best state of mind to recognize and take advantage of the opportunities it makes available to you.

What Is the "Now Moment'? Trading in the "now moment" means that there is no potential to associate an opportunity to get into, get out of, add too, or detract from a trade with a past experience that already exists in your mental environment.

HOW THE FUNDAMENTAL TRUTHS RELATE TO THE SKILLS

1. Anything can happen. Why? Because there are always unknown forces operating in every market at every moment, it takes only one trader somewhere in the world to negate the positive outcome of your edge. That's all: only one. Regardless of how much time, effort, or money you've invested in your analysis, from the market's perspective there are no exceptions to this truth. Any exceptions that may exist in your mind will be a source of conflict and potentially cause you to perceive market information as threatening.

2. You don't need to know what is going to happen next in order to make money. Why? Because there is a random distribution between wins and losses for any given set of variables that define an edge. (See number 3.) In other words, based on the past performance of your edge, you may know that out of the next 20 trades, 12 will be winners and 8 will be losers. What you don't know is the sequence of wins and losses or how much money the market is going to make available on the winning trades. This truth makes trading a probability or numbers game.

When you really believe that trading is simply a probability game, concepts like right and wrong or win and lose no longer have the same significance. As a result, your expectations will be in harmony with the possibilities. Keep in mind that nothing has more potential to cause emotional discord than our unfulfilled expectations. Emotional pain is the universal response when the outside world expresses itself in a way that doesn't reflect what we expect or believe to be true. As a result, any market information that does not confirm our expectations is automatically defined and interpreted as threatening. That interpretation causes us to adopt a negatively charged, defensive state of mind, where we end up creating the very experience we are trying to avoid. Market information is only threatening if you are expecting the market to do something for you.

Otherwise, if you don't expect the market to make you right, you have no reason to be afraid of being wrong. If you don't expect the market to make you a winner, you have no reason to be afraid of losing. If you don't expect the market to keep going in your direction indefinitely, there is no reason to leave money on the table. Finally, if you don't expect to be able to take advantage of every opportunity just because you perceived it and it presented itself, you have no reason to be afraid of missing out. On the other hand, if you believe that all you need to know is:

1. the odds are in your favor before you put on a trade;
2. how much it's going to cost to find out if the trade is going to work;
3. you don't need to know what's going to happen next to make money on that trade; and
4. anything can happen;

Then how can the market make you wrong? What information could the market generate about itself that would cause your pain-avoidance mechanisms to kick in so that you exclude that information from your awareness? None that I can think of.

If you believe that anything can happen and that you don't need to know what is going to happen next to make money, then you will always be right. Your expectations will always be in harmony with the conditions as they exist from the market's perspective, effectively neutralizing your potential to experience emotional pain. By the same token, how can a losing trade or even a series of losers have the typical negative effect, if you really believe that trading is a probability or numbers game? If your edge puts the odds in your favor, then every loss puts you that much closer to a win. When you really believe this, your response to a losing trade will no longer take on a negative emotional quality.

3. ***There is a random distribution between wins and losses for any given set of variables that define an edge.***

If every loss puts you that much closer to a win, you will be looking forward to the next occurrence of your edge, ready and waiting to jump in without the slightest reservation or hesitation. On the other hand, if you still believe that trading is about analysis or about being right, then after a loss you will anticipate the occurrence of your next edge with trepidation, wondering if it's going to work. This, in turn, will cause you to start gathering evidence for or against the trade. You will gather evidence for the trade if your fear of missing out is greater than your fear of losing. And you will gather information against the trade if your fear of losing is greater than your fear of missing out. In either case, you will not be in the most conducive state of mind to produce consistent results.

4. An edge is nothing more than an indication of a higher probability of one thing happening over another.

Creating consistency requires that you completely accept that trading isn't about hoping, wondering, or gathering evidence one way or the other to determine if the next trade is going to work. The only evidence you need to gather is whether the variables you use to define an edge are present at any given moment. When you use "other" information, outside the parameters of your edge to decide whether you will take the trade, you are adding random variables to your trading regime.

Adding random variables makes it extremely difficult, if not impossible, to determine what works and what doesn't. If you're never certain about the viability of your edge, you won't feel too confident about it. To whatever degree you lack confidence, you will experience fear. The irony is, you will be afraid of random, inconsistent results, without realizing that your random, inconsistent approach is creating exactly what you are afraid of. On the other hand, if you believe that an edge is simply a higher probability of one thing happening over another, and there's a random distribution between wins and losses for any given set of variables that define an edge, why would you gather "other" evidence for or against a trade? To a trader operating out of these two beliefs, gathering "other" evidence wouldn't make any sense.

Or let me put it this way: Gathering "other" evidence makes about as much sense as trying to determine whether the next flip of a coin will be heads, after the last ten flips came up tails. Regardless of what evidence you find to support heads coming up, there is still a 50-percent chance that the next flip will come up tails. By the same token, regardless of how much evidence you gather to support acting or not acting on a trade, it still only takes one trader somewhere in the world to negate the validity of any, if not all, of your evidence. The point is *why bother!* If the market is offering you a legitimate edge, determine the risk and take the trade.

5. Every moment in the market is unique.

Take a moment and think about the concept of uniqueness. "Unique" means not like anything else that exists or has ever existed. As much as we may understand the concept of uniqueness, our minds don't deal with it very well on a practical level. As we have already discussed, our minds are hardwired to automatically associate (without conscious awareness) anything in the exterior environment that is similar to anything that is already inside of us in the form of a memory, belief, or attitude. This creates an inherent contradiction between the way we naturally think about the world and the way the world exists. No two moments in the external environment will ever exactly duplicate themselves. To do so, every atom or every molecule would have to be in the exact same position they were in some previous moment.

Not a very likely possibility. Yet, based on the way our minds are designed to process information, we will experience the "now moment" in the environment as being exactly the same as some previous moment as it exists inside our minds. If each moment is like no other, then there's nothing at the level of your rational experience that can tell you for sure that you "know" what will happen next. So I will say again, why bother trying to know?! When you try to know, you are, in essence, trying to be right. I am not implying here that you can't predict what the market will do next and be right, because you most certainly can. It's in the trying that you run into all of the problems. If you believe that you correctly predicted the market once, you will naturally try to do it again.

As a result, your mind will automatically start scanning the market for the same pattern, circumstance, or situation that existed the last time you correctly predicted its movement. When you find it, your state of mind will make it seem as if everything is exactly as it was the last time. The problem is that, from the market's perspective, it is not the same. As a result, you are setting yourself up for disappointment. What separates the best traders from all the rest is that they have trained their minds to believe in the uniqueness of each moment (although this training usually takes the form of losing several fortunes before they "really" believe in the concept of uniqueness). This belief acts as a counteracting force, neutralizing the automatic association mechanism. When you truly believe that each moment is unique, then by definition there isn't anything in your mind for the association mechanism to link that moment to. This belief acts as an internal force causing you to disassociate the "now" moment in the market from any previous moment filed away in your mental environment. The stronger your belief in the uniqueness of each moment, the lower your potential to associate. The lower your potential to associate, the more open your mind will be to perceive what the market is offering you from its perspective.

MOVING TOWARD "THE ZONE"

When you completely accept the psychological realities of the market, you will correspondingly accept the risks of trading. When you accept the risks of trading, you eliminate the potential to define market information in painful ways. When you stop defining and interpreting market information in painful ways, there is nothing for your mind to avoid, nothing to protect against.

When there's nothing to protect against, you will have access to all that you know about the nature of market movement. Nothing will get blocked, which means you will perceive all the possibilities you have learned about (objectively), and since your mind is open to a true exchange of energy, you will quite naturally start discovering other possibilities (edges) that you formerly couldn't perceive. For your mind to be open to a true exchange of energy, you can't be in a state of knowing or believing that you already know what's going to happen next. When you are at peace with not knowing what's going to happen next, you can interact with the market from a perspective where you will be making yourself available to let the market tell you, from its perspective, what is likely to happen next. At that point, you will be in the best state of mind to spontaneously enter "the zone," where you are tapped into the "now moment opportunity flow."

CHAPTER 9

THE NATURE OF BELIEFS

At this point, if you can sense the benefits of adopting the five fundamental truths about trading, then the task is to learn how to properly integrate these truths into your mental system as core beliefs that are not in conflict with any other beliefs you may hold. At first glance, this may seem like a daunting task and under other circumstances I would agree with you, but it won't be, because in Chapter 11 I'll give you a simple trading exercise specifically designed to properly install these truths as beliefs at a functional level.

A functional level is, one where you find yourself just naturally operating out of a carefree state of mind, perceiving exactly what you need to do and doing it without hesitation or internal conflict. However, I do have a word of caution for those of you who have already looked at the exercise. On the surface, the trading exercise looks so simple that you may be tempted to do it now, before you thoroughly understand the implications of what you are doing. I strongly suggest that you reconsider. There are some subtle yet profound dynamics involved in the process of learning how to install new beliefs and change any existing beliefs that are in conflict with the new ones. Understanding the trading exercise itself is easy. Understanding how to use the exercise to change your beliefs is another matter entirely. If you do the exercise without understanding the concepts presented in this chapter and the next, you will not achieve the desired results. It is also important that you not take for granted the amount of mental effort you may have to expend to train your mind to fully accept these principles of success, regardless of how well you understand them. Remember Bob, the CTA who believed he thoroughly understood the concept of probabilities, but didn't have the ability to function from a probabilistic perspective. Many people make the mistake of assuming that once they understand something, the insight inherent in their new understanding automatically becomes a functional part of their identity.

Most of the time, understanding a concept is only a first step in the process of integrating that concept at a functional level. This is especially true of concepts that deal with diinking in probabilities. Our minds are not naturally wired to be "objective" or to stay in the "now moment." This means we have to actively train our minds to think from these perspectives. In addition to the training involved, there may be any number of conflicting beliefs to work through. Conflicting beliefs will have the effect of sabotaging your best intentions to operate from an objective state of mind or to experience the "now moment opportunity flow." For example, let's say you've spent years learning how to read the markets, or spent large sums of money developing or buying technical systems, just so you could find out what was going to happen next.

Now you have come to understand that you don't have to know what's going to happen next, and that even trying to know will detract from your ability to be objective or to stay in the moment. What we have is a direct conflict between your old belief that you need to know what will happen next to be successful and your new understanding that you don't need to know. Now, will your new understanding suddenly neutralize all the time, money, and energy expended on reinforcing the belief that you "need to know"? I wish it were that easy. And for some lucky few, it may be. If you will recall in Chapter 4 when I talked about psychological distance in relationship to software code, I said that some traders may already be so close to these new perspectives that all they need is to put together a few of the missing pieces to create a mindaltering, "ah, ha" experience. However, based on my experience of working with well over a thousand traders, I can say that most are not close to these perspectives at all. For those of you who are not, it may take a considerable amount of mental work (over a considerable amount of time) to properly integrate your new understandings about trading into your mental environment.

The good news is that, ultimately, the exercise I present in Chapter 11 will install the five fundamental truths and resolve many of the potential conflicts, but only if you know exactly what you are doing and why you are doing it. That is the subject of this and the next chapter.

THE ORIGINS OF A BELIEF

What can we learn about the nature of beliefs, and how can we use that knowledge to create a mind-set that fosters our desire to be a consistently successful trader? These are the two questions I am going to focus on answering in this chapter. First, let's look at the origin of our beliefs. As you may recall, memories, distinctions, and beliefs exist in the form of energy— specifically, structured energy. Earlier, I lumped these three mental components together to illustrate:

1. that memories, distinctions, and beliefs do not exist as physical matter;
2. that the cause-and-effect relationship that exists between ourselves and the external environment brings these components into existence; and
3. how the cause-and-effect relationship reverses so that we can perceive in the external environment what we have learned about.

To get at the origins of our beliefs, we're going to have to unbundle these components to illustrate the difference between a memory and a belief. The best way to do this is to imagine ourselves in the mind of an infant. I would think that at the very beginning of a child's life, the memories of his experiences would exist in their purest form. By that I mean that the memories of what he has seen, heard, smelled, touched, or tasted exist in his mind as pure sensory information that is not organized or attached to any specific words or concepts. Therefore, I am going to define a pure memory as sensory information stored in its original form. A belief, on the other hand, is a concept about the nature of the way the external environment expresses itself.

A concept combines pure sensory information with a symbol system we call language. For example, most infants have a pure memory of how it feels to be lovingly nurtured by a parent, but it isn't until the infant is taught to link or associate certain words with the pure sensory information stored in his memory that he will form a concept about how it feels to be lovingly nurtured. The phrase "Life is wonderful" is a concept. By themselves, the words make up a meaningless collection of abstract symbols. But if a child is either taught or decides to connect these words to his positively charged feelings of being nurtured, then the letters are no longer a collection of abstract symbols and the words are no longer an abstract phrase. "Life is wonderful" becomes a definitive distinction about the nature of existence or the way the world works. By the same token, if the child didn't get enough nurturing, relative to his needs, he could just as easily link his feelings of emotional pain to a concept like "Life isn't fair" or "The world is an awful place." In any case, when the positive or negative energy from our memories or experiences become linked to a set of words we call a concept, the concept becomes energized and, as a result, is transformed into a belief about the nature of reality. If you consider that concepts are structured by the framework of a language and energized by our experiences, it becomes clear why I refer to beliefs as "structured energy."

When a belief comes into existence, what does it do? What is its function? In some ways it seems ludicrous to ask those questions. After all, we all have beliefs. We are constantly expressing our beliefs both verbally and through our actions. Furthermore, we are constantly interacting with other peoples beliefs as they express them. Yet, if I ask, "What exactly does a belief do?" chances are your mind will go blank. On the other hand, if I were to ask about the functions of your eyes, ears, nose, or teeth, you would have no problem answering. Since beliefs are such important component parts of our make-up (in terms of their impact on the quality of our lives), it certainly has to be one of life's great ironies that they are also the least thought about and understood. What I mean by "least thought about" is, if we have a problem with one of our body parts, we naturally focus our attention on that part and think about what we need to do to fix the problem.

However, it doesn't necessarily occur to us that the problems we may be having with the quality of our lives (for example, lack of happiness, a sense of dissatisfaction, or lack of success in some area) are rooted in our beliefs. This lack of consideration is a universal phenomenon. One of the prominent characteristics of beliefs is that they make what we experience seem self evident and beyond question. In fact, if it weren't for your intense desire to experience consistent success as a trader, it's unlikely you would be delving into this topic at all. Usually, it takes years of extreme frustration before people begin examining their beliefs as the source of their difficulties. However, even though beliefs are an intricate part of our identity, you don't have to take this process of self analysis so personally. Consider the fact that none of us was born with any of our beliefs. They were all acquired in a combination of ways. Many of the beliefs that have the most profound impact on our lives were not even acquired by us as an

act of free will. They were instilled by other people.
And it probably won't come as a surprise to anyone that usually the beliefs that cause us the most difficulty are those that were acquired from others without our conscious consent. By that I mean beliefs that we acquired when we were too young and uninformed to realize the negative implications of what we were being taught. Regardless of the source of our beliefs, once they are born into existence they all basically function in the same way. Beliefs have certain characteristic ways in which they do their jobs, not unlike the various parts of our bodies.
For example, if you compare my eyes and your eyes, or my hands and your hands, or my red blood cells and your red blood cells, we can see that they are not exactly the same, but they have characteristics in common that cause them to function in similar ways. By the same token, a belief that "Life is wonderful" will perform its function in the same way as a belief that "Life is awful." The beliefs themselves are different and the effect that each has on the quality of the holder's life will be vastly different, but both beliefs will function in exactly the same manner.

BELIEFS AND THEIR IMPACT ON OUR LIVES

In the broadest sense, our beliefs shape the way we experience our lives. As I have already said, we're not born with any of our beliefs. They're acquired, and as they accumulate, we live our lives in a way that reflects what we have learned to believe. Consider how different your life would be if you had been born into a culture, religion, or political system that has very little, if anything, in common with the one you were born into. It might be hard to imagine, but what you would have learned to believe about the nature of life and how the world works may not be remotely similar to what you currently believe. Yet you would hold these other beliefs with the same degree of certainty as your current beliefs.

How Beliefs Shape Our Lives

1. They manage our perception and interpretation of environmental information in a way that is consistent with what we believe.
2. They create our expectations. Keep in mind that an expectation is a belief projected into some future moment. Since we can't expect something we don't know about, we could also say that an expectation is what we know projected into some future moment.
3. Anything we decide to do or any outward expression of behavior will be consistent with what we believe.
4. Finally, our beliefs shape how we feel about the results of our actions.

There isn't much about the way we function that beliefs don't play a major role in. So what I am going to do now is give you an example I used in my first book, *The Disciplined Trader,* to illustrate the various functions of a belief. In the spring of 1987, I was watching a locally produced television program called "Gotcha Chicago." It was about some local celebrities who played practical jokes on one another. In one segment of the program, the TV station hired a man to stand on the sidewalk along Michigan Avenue holding a sign that read "Free money. Today only." (For those of you who are not familiar with Chicago, Michigan Avenue is home to many fashionable, exclusive department stores and boutiques.) The TV station gave the man a considerable amount of cash, with instructions to give money to anyone who asked for it.

Now, when you consider that Michigan Avenue is one of the busiest areas of the city, and if we assume that most of the people who passed the man on the street could read the sign, how many people would you think took him up on his offer and asked for some money? Of all the people who walked by and read the sign, only one person stopped, and said, "Great! May I have a quarter to buy a bus transfer?" Otherwise, no one would even go near the man. Eventually, the man grew frustrated because people weren't reacting the way he expected them to. He started crying out, "Do you want any money? Please take my money; I can't give it away fast enough." Everyone just kept walking around him as if he didn't exist. In fact, I noticed that several people went out of their way to avoid him.

As a man wearing a suit and carrying a briefcase approached, he went right up to him and said, "Would you like some money?" The man responded, "Not today." Really frustrated now, he shot back, "How many days does this happen? Would you please take this?" as he tried to hand the man some cash. The man responded with a terse "No" and walked on. What was going on here? Why wouldn't anyone (except for the person who needed a bus transfer) ask for the money? If we assume that most or all of the passersby could read the sign, but still didn't make any effort to get the money, then one possible explanation for their behavior is that they just didn't care about money.

This is extremely unlikely, though, considering how much of our lives is devoted to the pursuit of money. If we agree that people could read the sign and that money is very important to most of us, then what could have stopped these people from helping themselves? The environment was making available an experience that most people would love to have: someone giving them money with no strings attached. Yet everyone walked by, oblivious to what was awaiting them. They must not have been able to perceive what was available. That's hard to imagine, because the sign clearly stated "Free money. Today only." However, it's not hard to imagine if you consider that most people have a belief (an energized concept about how the world works) that "Free money doesn't exist." If free money really doesn't exist, then how does someone reconcile the obvious contradiction between that belief and the sign saying that it does? That's easy, just decide the man with the sign is crazy; what else could account for such bizarre behavior if, in fact, free money doesn't exist? The reasoning process that could compensate for the contradiction might go something like this: "Everyone knows getting money with no strings attached rarely happens.

Certainly not from a stranger on one of the busiest streets in the city. In fact, if the man were really giving away money, he would already be mobbed. He might even be endangering his life. He must be crazy. I had better take a wide path around him; who knows what he might do?" Notice that every component of the thought process described is consistent with the belief that free money doesn't exist.

1. The words "free money" were neither perceived nor interpreted as they were intended from the environment s perspective.
2. Deciding the person with the sign must be crazy created an expectation of danger, or at least a perception that caution was warranted.
3. Purposefully altering one's path to avoid the person with the sign is an action that is consistent with the expectation of danger.
4. How did each person feel about the outcome?

That's difficult to say without knowing each person individually, but a good generalization would be that they felt relieved that they successfully avoided an encounter with a crazy person. The feeling of relief that resulted from avoiding a confrontation is a state of mind. Remember that how we feel (the relative degree of positively or negatively charged energy flowing through our bodies and minds) is always the absolute truth.

But the beliefs that prompt any particular state of mind may not be the truth with respect to the possibilities available from the environment's perspective. Relief from confrontation was not the only possible outcome in this situation. Imagine how different the experience would be if they believed that "free money exists." The process described above would be the same, except it would make the belief that "free money exists," seem self-evident and beyond question, just as it made the belief that "free money doesn't exist," seem self-evident and beyond question. A perfect example would be the one person who said "great, may I have a quarter for a bus transfer." When I saw this, I had the anybody for a quarter. A panhandler is someone who definitely believes in the existence of free money. Therefore, his perception and interpretation of the sign were exactly what was intended by the TV station.

His expectation and behavior were consistent with his belief that free money exists. And how would he feel about the results? He got his quarter, so I would assume he felt a sense of satisfaction. Of course, what he didn't know is that he could have gotten a lot more. There's another possible outcome for our scenario. Let's look at a hypothetical example of someone who believes that "free money doesn't exist," but who takes a "what if approach to the situation. In other words, some people can be so intrigued and curious about the possibilities that they decide to temporarily suspend their belief that "free money doesn't exist." This temporary suspension allows them to act outside the boundaries created by a belief, in order to see what happens.

So instead of ignoring the man with the sign, which would be our hypothetical person’s first inclination, he walks up to him and says, "Give me ten dollars." The man promptly pulls a ten-dollar bill out of his pocket and gives it to him. What happens now? How does he feel, having experienced something unexpected that completely contradicted his belief? For most people, the belief that free money doesn't exist is acquired through unpleasant circumstances, to put it mildly. The most common

way is being told that we can't have something because it's too expensive.
How many times does the typical child hear, "Who do you think you are anyway? Money doesn't grow on trees, you know." In other words, it is probably a negatively charged belief. So the experience of having money handed to him with no strings attached and without any negative comments would likely create a state of mind of pure elation. In fact, most people would be so happy that they'd feel compelled to share that happiness and this new discovery with everyone they knew. I can imagine him going back to his office or going home, and the moment he encounters someone he knows, the first words out of his mouth will be “You won’t believe what happened to me today," and even though he desperately wants those he meets to believe his story, they probably won't. Why? Because their belief that free money doesn't exist will cause them to interpret his story in a way that negates its validity.
To take this example a little further, imagine what would happen to this person's state of mind if it occurred to him that he could have asked for more money. He is in a state of pure elation. However, the moment the thought either pops into his mind or someone he relates his story to offers the idea that he could have asked for a lot more money, his state of mind will immediately shift to a negatively charged state of regret or despair. Why? He tapped into a negatively charged belief about what it means to miss out on something or not get enough. As a result, instead of being happy over what he got, he will lament what he could have had but didn't get.

BELIEFS VS. THE TRUTH

In all three of these examples (including the hypothetical one), everybody experienced their own unique version of the situation. If asked, each person would describe what he or she experienced from their perspective, as if it were the only true and valid version of the reality of the situation. The contradiction between these three versions of the truth suggests to me a larger philosophical issue that needs to be resolved. If beliefs limit our awareness of the information being generated by the physical environment, so that what we perceive is consistent with whatever we believe, then how do we know what the truth is? To answer this question, we have to consider four ideas:
1. The environment can express itself in an infinite combination of ways. When you combine all the forces of nature interacting with everything created by humans, then add to that the forces generated by all the possible ways people can express themselves, the result is a number of possible versions of reality that would surelv overwhelm even the most onen-minded nerson.
2. Until we have acquired the ability to perceive eveiy possible way in which the environment can express itself, our beliefs will always represent a limited version of what is possible from the environment's perspective, making our beliefs a statement *about* reality, but not necessarily a definitive statement of reality.
3. If you find yourself taking exception to the second statement, then consider that if our beliefs were a true, 100-percent accurate reflection of physical reality, then our expectations would always be

fulfilled. If our expectations were always fulfilled, we would be in a perpetual state of satisfaction. How could we feel other than happy, joyful, elated, and with a complete sense of well-being if physical reality was consistently showing up exactly as we expected it to?
4. If you can accept the third statement as being valid, then the corollary is also true. If we are not experiencing satisfaction, then we must be operating out of a belief or beliefs that don't vork very well relative to the environmental conditions. we Taking these four ideas into consideration, I can now answer the question, "What is the truth?" The answer is, whatever works. If beliefs impose limitations on what we perceive as possible, and the environment can express itself in an infinite combination of ways, then beliefs can only be true relative to what we are attempting to accomplish at any given moment. In other words, the relative degree of truth inherent in our beliefs can be measured by how useful they are. Each of us has internally generated forces (curiosity, needs, wants, desires, goals, and aspirations) that compel or motivate us to interact with the physical environment. The particular set of steps we take to fulfill the object of our curiosity, needs, wants, desires, goals, or aspirations is a function of what we believe to be true in any given circumstance or situation. That truth, whatever it is, will determine:

1. the possibilities we perceive in relation to what is available from the environment's perspective,
2. how we interpret what we perceive,
3. the decisions we make,
4. our expectations of the outcome,
5. the action we take, and
6. how we feel about the results of our efforts.

At any given moment, if we find ourselves in a state of satisfaction, happiness, or well-being in relation to whatever we are attempting to accomplish, we can say that our truth (meaning whatever beliefs we are operating from) are useful because the process, as stated above, worked. What we perceived was not only consistent with our objective, it was also consistent with what was available from the environment's perspective. Our interpretation of the information we perceived resulted in a decision, expectation, and action that were in harmony with the environmental situation and circumstance. There was no resistance or counteracting force offered by the environment (or in our own mind) that would diminish the outcome we were trying to achieve. As a result, we find ourselves in a state of satisfaction, happiness, and well-being.
On the other hand, if we find ourselves in a state of dissatisfaction, disappointment, frustration, confusion, despair, regret, or hopelessness, we can say that relative to the environmental situation and circumstances, the beliefs we are operating from don't work well or at all, and therefore are not useful. Simply put, the truth is a function of whatever works in relation to what we are trying to accomplish at any given moment.

CHAPTER 10

THE IMPACT OF BELIEFS ON TRADING

If the external environment can express itself in an infinite combination of ways, then there's really no limit to the number and types of beliefs available to be acquired about the nature of our existence. That is an elaborate way of saying that there's a lot out there to be learned about. Yet, to make a general observation about the nature of humanity, I would say that we certainly don't live our lives in a manner that is consistent with that statement. If it's true that it's possible to believe almost anything, then why are we always arguing and fighting with each other? Why isn't it all right for all of us to express our lives in a way that reflects what we have learned to believe? There has to be something behind our relentless attempt to convince others of the validity of our beliefs and to deny the validity of theirs. Consider that every conflict, from the smallest to the largest, from the least to the most significant, whether between individuals, cultures, societies, or nations, is always the result of conflicting beliefs. What characteristics of our beliefs make us intolerant of divergent beliefs?

In some cases, we are so intolerant that we are willing to kill each other to get our point across. My personal theory is that beliefs are not only structured energy, but also energy that seems to be conscious, at least to the extent of having some degree of awareness.

Otherwise, how can we account for our ability to recognize on the outside what is on the inside? How would we know our expectations are being fulfilled? How would we know when they are not? How would we know we are being confronted with information or circumstances that contradict what we believe? The only explanation I have is that each individual belief has to have some quality of either awareness or self-awareness that causes it to function as it does.

The idea of energy that has some degree of awareness may be difficult for many of you to accept. But there are several observations we can make about our individual and collective natures that support die possibility. First, everyone wants to be believed. It doesn't matter what the belief is; the experience of being believed feels good. I think these positive feelings are universal, meaning that they apply to everyone. Conversely, no one likes to be disbelieved; it doesn't feel good. If I said, "I don't believe you," the negative feeling that would resonate throughout your body and mind is also universal. By the same token, none of us likes to have our beliefs challenged. The challenge feels like an attack. Everyone, regardless of the belief, seems to respond in the same way: The typical response is to argue, defend ourselves (our beliefs), and, depending on the situation, attack back. When expressing ourselves, we seem to like being listened to. If we sense our audience isn't paying attention, how does it feel? Not good! Again, I think this response is universal.

Conversely, why is it so difficult to be a good listener? Because to be a good listener, we actually have to listen, without thinking about how we are going to express ourselves the moment we can either politely or rudely interrupt the person who's speaking. What's the compelling force behind our inability to listen without waiting to interrupt? Don't we like being with people with similar beliefs, because it feels comfortable and secure? Don't we avoid people with dissimilar or conflicting beliefs, because it feels uncomfortable or even threatening? The bottom line implication is, the moment we acquire a belief, it seems to take on a life of its own, causing us to recognize and be attracted to its likeness and repelled by anything that is opposite or contradictory.

Considering the vast number of divergent beliefs that exist, if these feelings of attraction or comfort and being repelled or threatened are universal, then each belief must somehow be conscious of its existence, and this conscious, structured energy must behave in characteristic ways that are common to all of us.

THE PRIMARY CHARACTERISTICS OF A BELIEF

There are three basic characteristics you need to understand in order to effectively install the five fundamental truths about trading at a functional level in your mental environment:

1. Beliefs seem to take on a life of their own and, therefore, resist any force that would alter their present form.
2. All active beliefs demand expression.
3. Beliefs keep on working regardless of whether or not we are consciously aware of their existence in our mental environment.

1. *Beliefs resist any force that would alter their present form. We* may not understand the underlying dynamics of how beliefs maintain their structural integrity, but we can observe that they do so, even in the face of extreme pressure or force. Throughout human history, there are many examples of people whose belief in some issue or cause was so powerful that they chose to endure indignities, torture, and death rather than express themselves in a way that violated their beliefs. This is certainly a demonstration of just how powerful beliefs can be and the degree to which they can resist any attempt to be altered or violated in the slightest way.

   Beliefs seem to be composed of a type of energy or force that naturally resists any other force that would cause them to exist in any form other than their nresent form. Does this mean that thev can't be altered? Absolutely not! It just means that we have to understand how to work with them. Beliefs can be altered, but not in the way that most people may think. I believe that once a belief has been formed, it cannot be destroyed. In other words, there is nothing we can do that would cause one or more of our beliefs to cease to exist or to evaporate as if they never existed at all. This assertion is founded in a basic law of physics. According to Albert Einstein and others in the scientific community, energy can neither be created nor destroyed; it can only be transformed.

If beliefs are energy—structured, conscious energy that is aware of its existence—then this same principle of physics can be applied to beliefs, meaning, if we tiy to eradicate them, it's not going to work. If you knew someone or something was trying to destroy you, how would you respond? You would defend yourself, fight back, and possibly become even stronger than you were before you knew of the threat. Each individual belief is a component of what we consider to be our identity. Isn't it reasonable to expect that, if threatened, each individual belief would respond in a way that was consistent with how all the parts respond collectively? The same principle holds true if we tiy to act as if a particularly troublesome belief doesn't exist. If you woke up one morning and everyone you knew ignored you and acted as if you didn't exist, how would you respond? It probably wouldn't be long before you grabbed someone and got right in their face to try to force them to acknowledge you. Again, if purposely ignored, each individual belief will act in the very same way. It will find a way to force its presence into our conscious thought process or behavior. The easiest and most effective way to work with our beliefs is to gently render them inactive or nonfunctional by drawing the energy out of them. I call this process de-activation. After de-activation, the original structure of the belief remains intact, so technically it hasn't changed. The difference is that the belief no longer has any energy. Without energy, it doesn't have the potential to act as a force on our perception of information or on our behavior. Here is a personal illustration:

As a young child, I was taught to believe in both Santa Claus and the Tooth Fairy. In my mental system, both of these are perfect examples of what are now inactive, nonfunctional beliefs. However, even though they are inactive, they still exist inside my mental system, only now they exist as concepts with no energy. If you recall from the last chapter, I defined beliefs as a combination of sensory experience and words that form an energized concept. The energy can be drawn out of the concept, but the concept itself remains intact, in its original form. However, without energy, it no ! T.gCI h-15 th? nOt?ptial to act on my perception of inforlYiation or on my behavior. So, as I'm sitting here typing into my computer, if someone came up to me and said that Santa Claus was at the door, how do you think I would define and interpret this information? I would treat it as being irrelevant or a joke, of course. However, if I were five years old and my mother told me that Santa Claus was at the front door, her words would have instantly tapped me into a huge reservoir of positively charged energy that would have compelled me to jump up and run to the front door as fast as I could.

Nothing would have been able to stop me. I would have overcome any obstacle in my path. At some point, my parents told me Santa Claus didn't exist. Of course, my first reaction was disbelief. I didn't believe them, nor did I want to believe them. Eventually, they convinced me. However, the process of convincing me did not destroy my belief in Santa Claus or cause it not to exist any longer; it just took all the energy out of the belief. The belief was transformed into a nonfunctional, inactive concept about how the world works. I'm not sure where all that energy went, but I know that some of it was transferred to a belief that Santa Claus doesn't exist.

Now I have two contradictory distinctions about the nature of the world that exist in my mental system: one, Santa exists; two, Santa doesn't exist. The difference between them is in the amount of energy they contain. The first has virtually no energy; the second has energy. So from a functional perspective, there is no contradiction or conflict. I propose that, if it's possible to render one belief inactive, then it's possible to de-activate any belief, despite the fact that all beliefs seem to resist any force that would alter their present form. The secret to effectively changing our beliefs is in understanding and, consequently, believing that we really aren't changing our beliefs; we are simply transferring energy from one concept to another concept, one that we find more useful in helping us to fulfill our desires or achieve our goals.

2. *All active beliefs demand expression.* Beliefs fall into two basic categories: active and inactive. The distinction between the two is simple. Active beliefs are energized; they have enough energy to act as a force on our perception of information and on our behavior. An inactive belief is just the opposite. It is a belief, that for any number of reasons, no longer has energy, or has so little energy that it's no longer able to act as a force on how we perceive information or how we express ourselves. When I say that all active beliefs demand expression, I don't mean to imply that every belief in our mental environment is demanding to express itself simultaneously. For example, if I ask you to think about what's wrong with the world today, the word "wrong" would bring to your mind ideas about the nature of the world that reflect what you believe to be troubling or disturbing. Unless, of course, there is nothing about the state of the world you find troubling. The point is, if there is something you do believe is wrong, you weren't necessarily thinking about those ideas before I asked the question; but the moment I did, your beliefs about these issues instantly moved to the forefront of your conscious thinking process. In effect, they demanded to be heard. I say that beliefs "demand" to be expressed because once something causes us to tap into our beliefs, it seems as if we can't stop the flood of energy that's released. This is especially true of emotionally sensitive issues or beliefs we feel particularly passionate about. You might ask, "Why would I want to hold back expressing my beliefs?" There could be several reasons. Consider a scenario in which you're this person is saying something that you completely disagree with, or even find utterly absurd. Will you express your truth or hold back? That will depend on the beliefs you have about what is proper in such a situation. If your beliefs dictate that speaking up would be inappropriate, and those beliefs have more energy than the ones that are being contradicted, then you'll probably hold back and not argue openly.

You might be looking at this person (the boss) and nodding your head in agreement. But is your mind in agreement? More to the point, is your mind silent? Absolutely not! Your position on the issues being presented are effectively countering each point the boss is making. In other words, your beliefs are still demanding expression, but they aren't being expressed externally (in the environment) because other beliefs are acting as a counteracting; force. However O O ' they will soon find a way to get out, won't they? As soon as you are out of the situation, you will probably find a way to "unload," or even spew out your side of the argument. You will probably describe what you had to endure to anyone you think will lend a sympathetic ear. This is an example of how our beliefs demand to be expressed when they are in conflict with the external environment. But what happens when one or more of our beliefs are in conflict with our intents, goals, dreams, wants, or desires? The implications of such a conflict can have a profound effect on our trading. As we have already learned, beliefs create distinctions in how the external environment can express itself. Distinctions, by definition, are boundaries.

Human consciousness, on the other hand, seems to be larger than the sum total of everything we have learned to believe. This "larger than" quality of human consciousness gives us the ability to think in any direction we choose, either inside or outside of the boundaries imposed by our beliefs. Thinking outside of the boundaries of our beliefs is commonly referred to as creative thinking. When we purposely choose to question a belief (question what we know), and sincerely desire an answer, we make our minds available to receive a "brilliant idea," "inspiration," or "solution" to the issue at hand. Creativity, bv definition, brings forth something- that didn't we will (by definition, automatically) receive ideas or thoughts that are outside of anything that already exists in our rational mind as a belief or memory.

As far as I know, there is no consensus among artists, inventors, or the religious or scientific communities as to exactly where creatively generated information comes from. However, what I do know is that creativity seems to be limitless and without boundaries. If there are any limits on the ways we can think, we certainly haven't found them yet. Consider the staggering pace at which technology has developed in the last 50 years alone. Every invention or development in the evolution of humanity was born in the minds of people who were willing to think outside the boundaries dictated by what they had learned to believe. If all of us have the inherent ability to think creatively (and I believe that we do), then we also have the potential to encounter what I call a "creative experience." I define a creative experience as the experience of anything new or outside the boundaries imposed by our beliefs. It could be a new sight—something we've never seen before, but from the environment's perspective was always there.

Or we could experience a new sound, smell, taste, or touch. Creative experiences, like creative thoughts, inspirations, hunches, and brilliant ideas, can occur as a surprise or can be the result of our conscious direction. In either case, when we experience them we can be confronted with a major psychological dilemma. A creative occurrence, whether in the form of a thought or an experience, can cause us to be attracted to or desire something that is in direct conflict with one or more of our beliefs. To illustrate the point, let's return to the example of the boy and dog. Recall that the boy has had several painful experiences with dogs. The first experience was real from the environment's perspective. The others, however, were the result of how his mind processed information (based on the operation of the association and painavoidance mechanisms). The end result is that he experiences fear every time he encounters a dog. Let's suppose that the boy was a toddler when he had his first negatively charged experience.

As he grows up and begins associating specific words and concepts with his memories, he will form a belief about the nature of dogs. It would be reasonable to assume that he adopted a belief something like, "All dogs are dangerous." With the use of the word "all," the boy's belief is structured in a way that assures that he will avoid all dogs. He has no reason to question this belief, because every experience has confirmed and reinforced its validity. However, he (and everyone else on the planet) is susceptible to a creative experience. Under normal circumstances, the boy will do everything possible to make sure he does not encounter a dog. But what if something unexpected and unintended occurs? Suppose the boy is walking with his parents and, as a result, feels safe and protected. Now, suppose he and his parents come to a blind corner and cannot see what is on the other side. They encounter a scene in which several children of about the same age as the boy are playing with some dogs and, furthermore, they are obviously having a great deal of fun. This is a creative experience. The boy is confronted with indisputable information that what he believes about the nature of dogs isn't true. What happens now? First, the experience was not at the boy's conscious direction. He didn't make a decision to willingly expose himself to information that contradicted what he believed to be true. We might call this an inadvertent creative experience, because the external environment forced him to confront other possibilities that he didn't believe existed. Second, the experience of seeing other children playing with dogs and not getting hurt will throw his mind into a state of confusion.

After the confusion wears off, meaning as he begins to accept the possibility that not all dogs are dangerous, several scenarios are possible. Seeing other children his own age (with whom he could strongly identify) having such a great time playing with dogs could cause the boy to decide that he wants to be like the other children and have fun with dogs, too. If that's the case, this inadvertent creative encounter has caused him to become attracted to express himself in a way that he formerly didn't believe was possible (interacting with dogs). In fact, the notion was so impossible that it wouldn't have even occurred to him to consider it. Now, he not only considers it, he desires it. Will he be able to express himself in a way that is consistent with his desire? The answer to this question is a matter of energy dynamics.

There are two forces within the boy that are in direct conflict with each other, competing for expression: his belief that "all dogs are dangerous" and his desire to have fun and be like the other children. What he will do the next time he encounters a dog will be determined by which has more energy: his belief or his desire. Given the intensity of the energy in his belief that "All dogs are dangerous," we can reasonably assume that his belief will have far more energy than his desire. If that's the case, then he will find his next encounter with a dog very frustrating. Even though he may want to touch or pet the dog, he'll find that he can't interact with it in any way. The word "all" in his belief will act as a paralyzing force, preventing him from fulfilling his desire.

He might be well aware of the fact that the dog he wants to pet is not dangerous and won't hurt him;

but he won't be able to pet it until the balance of energy tips in favor of his desire. If the boy genuinely wants to interact with dogs, he will have to overcome his fear. This means that he will have to de-activate his belief that all dogs are dangerous so he can properly install a belief about dogs that is more consistent with his desire. We know that dogs can express themselves in a wide range of ways, from loving and gentle to mean and nasty. However, very few dogs on a percentage basis fall into the mean and nasty category. A good belief for the boy to adopt, then, would be something like, "Most dogs are friendly, but some can be mean and nasty."

This belief would allow him to learn to recognize characteristics and behavior patterns that will tell him which dogs he can play with and which ones to avoid. However, the larger issue is, how can the boy de-activate the "all" in the belief that "All dogs are dangerous" so he can overcome his fear? Remember that all beliefs naturally resist any force that would alter their present form, but, as I indicated above, the appropriate approach is not to try to alter the belief, but rather to draw the energy out of it and channel that energy into another belief that is better suited to our purposes. To de-activate the concept the word "all" represents, the boy will have to create a positively charged experience with a dog; at some point, he will have to step through his fear and touch one. Doing this might require a great deal of effort on the boy's part over a considerable amount of time.

Early in the process, his new realization about dogs might be strong enough only to allow him to be in the presence of a dog, at a distance, and not run away. However, each encounter with a dog, even at a distance, that doesn't result in a negative outcome will draw more and more of the negative energy out of his belief that "All dogs are dangerous." Eventually, each new positive experience will allow him to close the gap between himself and a dog, little by little, to the point that he can actually touch one. From an energy dynamics perspective, he will be able to touch a dog when his desire to do so is at least one degree greater in intensity than his belief that all dogs are dangerous.

The moment he actually does touch a dog, it will have the effect of drawing most of the remaining negative energy out of the "all" concept and transfer it to a belief that reflects his new experience. Although it's probably not that common, there are people who, for various reasons, are motivated enough to purposely put themselves through the above described process. However, they may not be consciously aware of the dynamics involved. People who work through a childhood fear of this magnitude usually do so somewhat haphazardly over a period of years, without knowing for sure exactly how they did it (unless they seek and get competent professional help). Later on, as adults, if they are asked or if they happen to encounter a situation that reminds them of their past (for instance, observing a child who is terrified of dogs), they typically characterize the process they went through as "I remember when I was afraid of dogs, but I grew out of it." The end result of the first scenario was that the boy worked through his fear by de-activating his limiting belief about the nature of dogs. This allowed him to express himself in a way that he finds pleasing and that otherwise would have been impossible. The second scenario that could result from the child's inadvertent creative experience with dogs is that he isn't attracted to the possibility of playing with a

dog. In other words, he could not care less about being like the other children or interacting with dogs. In this case, his belief that all dogs are dangerous and his new realization that all dogs are not dangerous will exist in his mental environment as contradictory concepts.
This is an example of what I call an active contradiction, when two active beliefs are in direct conflict with each other, both demanding expression. In this example, the first belief exists at a core level in the boy's mental environment, with a great deal of negatively charged energy. The second belief is at a more superficial level, and has very little positively charged energy. The dynamics of this situation are interesting, and extremely important. We have stated that beliefs control our perception of information. Under normal circumstances, the boy would have been perceptually blinded to the possibility of interacting with dogs, but the experience of seeing other children playing with them created a positively charged concept in his mental environment that dogs are not all dangerous; some can be friendly. However, he hasn't done anything to de-activate the "all" in his belief that "All dogs are dangerous," and, as far as I know, beliefs have no capacity to de-activate themselves.
As a result, beliefs exist in our mental environment from the moment they are born to the moment we die, unless we consciously take steps to deactivate them. However, in this scenario, the boy has no desire and consequently no motivation to step through his fear. Therefore, the boy is left with an active contradiction where his minimally charged belief that not all dogs are dangerous gives him the ability to perceive the possibility of playing with a dog, but his powerfully charged belief that all dogs are dangerous still causes him to experience some level of fear every time he encounters a dog (maybe not enough fear to cause him to run in terror, because some of that fear will be offset by the other belief, but there will certainly be enough fear to cause a great deal of discomfort).
The ability to "see" and consequently know that a situation is not dangerous, but at the same time find ourselves immobilized with fear, can be quite baffling if we don't understand that what we discover as the result of thinking creatively or realize from an inadvertent creative experience doesn't necessarily have enough energy to become a dominant force in our mental environment. In other words, our new awareness or discovery could very well have enough energy to act as a credible force on our perception of information, thereby causing us to perceive possibilities that would otherwise be invisible; but it might not have enough energy to act as a credible force on our behavior. In making this statement, I am operating out of the assumption that it takes more energy to act or express ourselves than the amount of energy it takes to observe something.
On the other hand, new awareness and discoveries instantly and effortlessly become dominant forces if there's nothing inside us that's in conflict with them. But if there are conflicting beliefs and we aren't willing to de-activate the conflicting forces (expending some effort), especially if they're negatively charged, then acting on what we've discovered will be a struggle at the very least, and perhaps down right impossible. What I have just described is the psychological dilemma that virtually every trader has to resolve. Let's say you have a firm grasp of the nature of probabilities

and, as a result, you "know" that the next trade is simply another trade in a series of trades that has a probable outcome. Yet you find you're still afraid to put that next trade on, or you're still susceptible to several of the fear-based trading errors we've discussed in previous chapters. Remember that the underlying cause of fear is the potential to define and interpret market information as threatening. What is the source of our potential to interpret market information as threatening? Our expectations! When the market generates information that doesn't conform to what we expect, the up and down tics seem to take on a threatening quality (become negatively charged). Consequently, we experience fear, stress, and anxiety. What is the underlying source of our expectations? Our beliefs.

In light of what you now understand about the nature of beliefs, if you are still experiencing negative states of mind when you trade, you can assume there's a conflict between what you "know" about probable outcomes and any number of other beliefs in your mental environment that are arguing (demanding expression) for something else. Keep in mind that all active beliefs demand expression, even if we don't want them to. To think in probabilities, you have to believe that every moment in the market is unique, or more specifically, that every edge has a unique outcome. When you believe at a functional level that every edge has a unique outcome (meaning that it's a dominant belief without any other beliefs arguing for something different), you will experience a state of mind that is free of fear, stress, and anxiety when you trade. It really can't work any other way. A unique outcome is not something we have already experienced, therefore it is not something we can already know. If it were known, it could not be defined as unique.

When you believe that you don't know what is going to happen next, what exactly are you expecting from the market? If you said "I don't know," you are absolutely right. If you believe that something will happen and that you don't need to know exactly what that something is to make money, then where s the potential to define and interpret market information as threatening and painful? If you said "There is none," you are absolutely right again. Here is one more example of how beliefs demand expression. Let's look at a situation where a child's first encounter with a dog was a very positive experience. As a result, he has absolutely no problem interacting with dogs (any dog for that matter), because he has not encountered one that's unfriendly. Therefore, he has no concept (an energized belief) that it is possible for a dog to inflict any damage or cause him to experience pain. As he learns to associate words with his memories, he will probably acquire a belief along the lines of "all dogs are friendly and fun." Therefore, every time a dog comes into his field of awareness, this belief will demand expression. From the perspective of someone who fi with a do?, it will seem as if this child has an attitude of reckless abandon.

If you tried to convince the child that he'll get bitten someday if he doesn't exercise caution, his belief will cause him to either discount or completely disregard your advice. His response would be something like "No way!" or "It can't happen to me." Let's say at some point in his life he approaches an unfamiliar dog that wants to be left alone. The dog growls. The warning will go unheeded and the dog attacks the boy. From the perspective of the boy's belief system, he's just had a creative experience. What effect will this experience have on his belief that "all dogs are friendly"? Will he now be afraid of all dogs as the child in the first example was?

Unfortunately, the answers to these questions are not cut and dried, because there may be other beliefs, also demanding expression, that don't have anything specifically to do with dogs that come into play in a situation like this. For example, what if this child has a highly developed belief in betrayal (he believes he's been betrayed by some very significant people in some very significant situations that have caused him to experience intense emotional pain). If he associates the attack by this one dog as a "betrayal" by dogs in general (in essence a betrayal of his belief in dogs), then he could easily find himself afraid of all dogs.

All of the positive energy contained in his original belief could instantly be transformed into negatively charged energy. The boy could justify this shift with a rationalization like "If one dog can betray me, then any dog can." However, I do think this is an extreme and very unlikely occurrence. What is more likely is the word "all" in his original belief will instantly be de-activated and that energy will get transferred to a new belief that better reflects the true nature of dogs. This new experience caused an energy shift that forced him to learn something about the nature of dogs that he otherwise refused to consider possible.

His belief in the friendliness of dogs remains intact. He will still play with dogs, but he will now exercise some discretion by consciously looking for signs of friendliness or unfriendliness. I think that a fundamental truth about the nature of our existence is every moment in the market, as well as in evervdav life, has elements of what we know (similarities) and elements that we don't or can't know because we haven't experienced it yet. Until we actively train our minds to expect a unique outcome, we will continue experiencing only what we know; everything else (other information and possibilities that are not consistent with what we know and expect) will pass us by, unperceived, discounted, distorted, outright denied, or attacked. When you truly believe that you don't need to know, you will be thinking in probabilities (the market perspective) and will have no reason to block, discount, distort, deny, or attack anything the market is offering about its potential to move in any particular direction. If you are not experiencing the quality of mental freedom implied in that statement, and it is your desire to do so, then you must take an active role in training your mind to believe in the uniqueness of each moment, and you must de-activate any other belief that argues for something different. This process isn't any different from the one the boy in the first scenario went through, nor is it going to happen by itself. He wanted to interact with dogs without fear, but to do so he had to create a new belief and de-activate the conflicting ones. This is the secret to achieving consistent success as a trader.

3. ***Beliefs keep on working regardless of whether we are consciously aware of their existence in our mental environment.*** In other words, we don't have to actively remember or have conscious access to any particular belief for that belief to act as a force on our perception of information or on our

behavior. I know it s hard to "believe" that something we can't even remember can still have an impact on our lives. But when you think about it, much of what we learn throughout our lives is stored at an unconscious or subconscious level. If I asked you to remember each specific skill you had to learn so that you could drive a car with confidence, chances are you wouldn't remember all the things you needed to concentrate and focus on while you were in the process of learning. The first time I had the opportunity to teach a teenager how to drive, I was absolutely amazed at how much there was to learn, how much of the process I took for granted and no longer thought about at a conscious level. Possibly the best example that illustrates this characteristic is people who drive under the influence of alcohol. On any given day or night, there are probably thousands of people who have had so much to drink that they have no idea that they have no conscious awareness of how they drove from point A to point B. It is difficult to imagine how this is possible, unless you consider that driving skills and one's belief in his ability to drive operate automatically on a much deeper level than waking consciousness. Certainly, some percentage of these drunk drivers get into accidents, but when you compare the accident rate with the estimated number of people driving under the influence of alcohol, it's remarkable that there aren't a great many more accidents. In fact, a drunk driver is probably most likely to cause an accident when he either falls asleep or something requires a conscious decision and a fast reaction. In other words, the driving conditions are such that operating out of one's subconscious skills is not enough.

SELF EVALUATION AND TRADING

How this characteristic applies to our trading is also quite profound. The trading environment offers us an arena of unlimited opportunities to accumulate wealth. But just because the money is available and we can perceive the possibility of getting it, that doesn't necessarily mean that we (as individuals) have an unlimited sense of selfvaluation. In other words, there could be a huge gap between how much money we desire for ourselves, how much we perceive is available, and how much we actually believe we are worth or deserve. Everyone has a sense of self-valuation. The easiest way to describe this sense is to list every active belief, both conscious and subconscious, that has the potential to argue either for or against accumulating or achieving greater and greater levels of success and prosperity. Then match the energy from the positively charged beliefs against the energy from the negatively charged beliefs. If you have more positively charged energy arguing for success and prosperity than negatively charged energy arguing against them, then you have a positive sense of self-valuation. Otherwise, you have a negative sense of self-valuation. The dynamics of how these beliefs interact with one another is not nearly so simple as I'm making it sound. In fact, it can be so complex that it could take years of sophisticated mental work to organize and sort out. What you need to know is that it's almost impossible to grow up in any social environment and not acquire some negatively charged beliefs that would argue against success or accumulating vast sums of money.

Most of these self-sabotaging beliefs have long been forgotten and operate at a subconscious level, but the fact that we may have forgotten them doesn't mean they've been de-activated. How do we acquire self-sabotaging beliefs? Unfortunately, it's extremely easy. Probably the most common way is when a child engages in some activity that a parent or teacher doesn't want him to do and the child accidently injures himself. Many parents, to get their point across to the child, will respond to a situation like this by saying, "This (whatever pain you are experiencing) wouldn't have happened to you if you didn't deserve it," or "You disobeyed me and look what happened, God punished you." The problem with making or hearing statements like this is that there's a potential for the child to associate every future injury with these same statements and, subsequently, form a belief that he must be an unworthy person, undeserving of success, happiness, or love. Anything we feel guilty about can have an adverse effect on our sense of self-worth.

Usually guilt is associated with being a bad person, and most people believe that bad people should be punished, certainly not rewarded. Some religions teach children that having a lot of money isn't godly or spiritual. Some people believe that making money in certain ways is wrong, even though it may be perfectly legal and moral from society's perspective. Again, you may not have a speoifir recollection of learning something that would argue against the success you perceive as possible, but that doesn't mean that what you learned is no longer having an effect. The way these subconscious self-sabotaging beliefs manifest themselves in our trading is usually in the form of lapses in focus or concentration, resulting in any number of trading errors, like putting in a buy for a sell or vice versa, or allowing yourself to give in to distracting thoughts that compel you to leave the screen, only to find out when you return that you missed the big trade of the day.

I've worked with many traders who achieved various levels of consistent success, but found they just couldn't break through certain thresholds in acquiring equity. They discovered an invisible but very real barrier similar to the proverbial glass ceiling that many women executives experience in the corporate world. Every time these traders hit the barrier, they experienced a significant draw down, regardless of the market conditions. However, when asked about what happened, they typically blamed their sudden run of bad luck on just that—luck or the vagaries of the market. Interestingly, they typically created a steadily rising equity curve, sometimes over a period of several months, and the significant draw down always occurred at the same spot in their equity curve.

I describe this psychological phenomenon as being in a "negative zone." As magically as money can flow into a trader's accounts when he is "in the zone," it can just as easily flow out, if he is in a negative zone where unresolved self-valuation issues mysteriously act on his perception of information and behavior. I am not implying here that you have to de-activate every belief that would argue against your ever-expanding positive sense of selfvaluation, because you don't. But you must be aware of the presence of such beliefs, and take specific steps in your trading regimen to compensate when they start expressing themselves.

CHAPTER 11

THINKING LIKE A TRADER

If you asked me to distill trading down to its simplest form, I would say that it is a pattern recognition numbers game. We use market analysis to identify the patterns, define the risk, and determine when to take profits. The trade either works or it doesn't. In any case, we go on to die next trade. It's that simple, but it's certainly not easy. In fact, trading is probably the hardest thing you'll ever attempt to be successful at. That's not because it requires intellect; quite the contrary! But because the more you think you know, the less successful you'll be.

Trading is hard because you have to operate in a state of not having to know, even though your analysis may turn out at times to be "perfectly" correct. To operate in a state of not having to know, you have to properly manage your expectations. To properly manage your expectations, you must realign your mental environment so that you believe without a shadow of a doubt in the five fundamental truths. In this chapter, I am going to give you a trading exercise that will integrate these truths about the market at a functional level in your mental environment. In the process, I'll take you through the three stages of development of a trader.

The first stage is the *mechanical* stage. In this stage, you:

1. Build the self-trust necessary to operate in an unlimited environment.
2. Learn to flawlessly execute a trading system.
3. Train your mind to think in probabilities (the five fundamental truths).
4. Create a strong, unshakeable belief in your consistency as a trader.

Once you have completed this first stage, you can then advance to the *subjective* stage of trading. In this stage, you use anything you have ever learned about the nature of market movement to do whatever it is you want to do. There's a lot of freedom in this stage, so you will have to learn how to monitor your susceptibility to make the kind of trading errors that are the result of any unresolved self-valuation issues I referred to in the last chapter. The third stage is the *intuitive* stage. Trading intuitively is the most advanced stage of development. It is the trading equivalent of earning a black belt in the martial arts.

The difference is that you can't try to be intuitive, because intuition is spontaneous. It doesn't come from what we know at a rational level. The rational part of our mind seems to be inherently mistrustful of information received from a source that it doesn't understand. Sensing that something is about to happen is a form of knowing that is very different from anything we know rationally. I've worked with many traders who frequently had a very strong intuitive sense of what was going to happen next, only to be confronted with the rational part of themselves that consistently, argued for another course of action. Of course, if they had followed their intuition, they would have experienced a very satisfying outcome. Instead, what they ended up with was usually very unsatisfactory, especially when compared with what they otherwise perceived as possible. The only way I know of that you can try to be intuitive is to work at setting up a state of mind most conducive to receiving and acting on your intuitive impulses.

THE MECHANICAL STAGE

The mechanical stage of trading is specifically designed to build the kind of trading skills (trust, confidence, and thinking in probabilities) that will virtually compel you to create consistent results. I define consistent results as a steadily rising equity curve with only minor draw downs that are the natural consequence of edges that didn't work. Other than finding a pattern that puts the odds of a winning trade in your favor, achieving a steadily rising equity curve is a function of systematically eliminating any susceptibility you may have to making the kind of fear, euphoric or self-valuation based trading errors I have described throughout this book. Eliminating the errors and expanding your sense of self-valuation will require the acquisition of skills that are all psychological in nature.

The skills are psychological because each one, in its purest form, is simply a belief. Remember that the beliefs we operate out of will determine our state of mind and shape our experiences in ways that constantly reinforce what we already believe to be true. How truthful a belief is (relative to the environmental conditions) can be determined by how well it serves us; that is, the degree to which it helps us satisfy our objectives.

If producing consistent results is your primary objective as a trader, then creating a belief (a conscious, energized concept that resists change and demands expression) that *"I am a consistently successful trader"* will act as a primaiy source of energy that will manage your perceptions, interpretations, expectations, and actions in ways that satisfy the belief and, consequently, the objective. Creating a dominant belief that "I am a consistently successful trader" requires adherence to several principles of consistent success. Some of these principles will undoubtedly be in direct conflict with some of the beliefs you've already acquired about trading. If this is the case, then what you have is a classic example of beliefs that are in direct conflict with desire.

The energy dynamic here is no different from what it was for the boy who wanted to be like the other children who were not afraid to play with dogs. He desired to express himself in a way that he found, at least initially, virtually impossible. To satisfy his desire, he had to step into an active process of transformation. His technique was simple: He tried as hard as he could to stay focused on what he was trying to accomplish and, little by little, he de-activated the conflicting belief and strengthened the belief that was consistent with his desire.

At some point, if that is your desire, then you will have to step into the process of transforming yourself into a consistent winner. When it comes to personal transformation, the most important ingredients are your willingness to change, the clarity of your intent, and the strength of your desire. Ultimately, for this process to work, you must choose consistency over eveiy other reason or justification you have for trading. If all of these ingredients are sufficiently present, then regardless of the internal obstacles you find yourself up against, what you desire will eventually prevail.

Observe Yourself

The first step in the process of creating consistency is to start noticing what you're thinking, saying, and doing. Why? Because everything we think, say, or do as a trader contributes to and, therefore, reinforces some belief in our mental system. Because the process of becoming consistent is psychological in nature, it shouldn't come as a surprise that you'll have to start paying attention to your various psychological processes. The idea is eventually to learn to become an objective observer of your own thoughts, words, and deeds. Your first line of defense against committing a trading error is to catch yourself thinking about it. Of course, the last line of defense is to catch yourself in the act. If you don't commit yourself to becoming an observer to these processes, your realizations will always come after the experience, usually when you are in a state of deep regret and frustration.

Observing yourself objectively implies doing it without judging about yourself. This might not be so easy for some of you to do considering the harsh, judgmental treatment you may have received from other people throughout your life. As a result, one quickly learns to associate any mistake with emotional pain. No one likes to be in a state of emotional pain, so we typically avoid acknowledging what we have learned to define as a mistake for as long as possible.

Not confronting mistakes in our everyday lives usually doesn't have the same disastrous consequences it can have if we avoid confronting our mistakes as traders. For example, when I am working with floor traders, the analogy I use to illustrate how precarious a situation they are in is to ask them to imagine themselves walking across a bridge over the Grand Canyon. The width of the bridge is directly related to the number of contracts they trade. So, for example, for a one-contract trader the bridge is very wide, say 20 feet. A bridge 20 feet wide allows you a great deal of tolerance for error, so you don't have to be inordinately careful or focused on each step you take. Still, if you do happen to stumble and trip over the edge, the drop to the canyon floor is one mile.

I don't know how many people would walk across a narrow bridge with no guardrails, where the ground is a mile down, but my guess is relatively few. Similarly, few people will take the kinds of risks associated with trading on the floor of the futures exchanges. Certainly a one-contract floor trader can do a great deal of damage to himself, not unlike falling off a mile-high bridge. But a one-contract trader also can give himself a wide tolerance for errors, miscalculations, or unusually violent market moves where he could find himself on the wrong side. On the other hand, one of the biggest floor traders I ever worked with trades for his own account with an average position of 500 Treasury bond futures at a time. He often puts on a position of well over a thousand contracts.

A position of 1,000 T-bond contracts amounts to $31,500 per tic (the smallest incremental price change that a bond contract can make). Of course, T-bond futures can be very volatile and can trade several tics in either direction in a matter of seconds. As the size of a traders position increases, the width of our bridge over the Grand Canyon narrows. In the case of the large bond trader, the bridge has narrowed to the size of a thin wire. Obviously, he has to be extremely well-balanced and very focused on each step that he takes. The slightest misstep or gust of wind could cause him to fall off the wire. Next stop, one mile down. Now, when he's in the trading pit, that tiny misstep or slight gust of wind is the equivalent to one distracting thought. That's all, just a thought or anything else where he allows himself to lose his focus for even a second or two. In that moment of distraction, he could miss his last favorable opportunity to liquidate his position.

The next price level with enough volume to take him out of his trade could be several tics away, either creating a huge loss or forcing him to give a substantial winning trade back to the market. If producing consistent results is a function of eliminating errors, then it is an understatement to say that you will encounter great difficulty in achieving your objective if you can't acknowledge a mistake. Obviously, this is something very few people can do, and it accounts for why there are so few consistent winners. In fact, the tendency not to acknowledge a mistake is so pervasive throughout mankind, it could lead one to assume that it's an inherent characteristic of human nature. I do not believe this is the case, nor do I believe we are born with the capacity to ridicule or think less of ourselves for making a mistake, miscalculation, or error. Making mistakes is a natural function of living and will continue to be until we reach a point at which:

1. all our beliefs are in absolute harmony with our desires, and
2. all our beliefs are structured in such a way that they are completely consistent with what works from the environment's perspective.

Obviously, if our beliefs are not consistent with what works from the environments perspective, the potential for making a mistake is high, if not inevitable. We won't be able to perceive the appropriate set of steps to our objective. Worse, we won't be able to perceive that what we want may not be available, or available in the quantity we desire or at the time when we want it.

On the other hand, mistakes that are the result of beliefs that are in conflict with our objectives aren't always apparent or obvious. We know they will act as opposing forces, expressing their versions of the truth on our consciousness, and they can do that in many ways.

The most difficult to detect is a distracting thought that causes a momentary lapse in focus or concentration. On the surface this may not sound significant. But, as in the analogy of the bridge over the canyon, when there's a lot at stake, even a slightly diminished capacity to stay focused can result in an error of disastrous proportions. This principle applies whether it's trading, sporting events, or computer programming. When our intent is clear and undiminished by any opposing energy, then our

capacity to stay focused is greater, and the more likely it is that we will accomplish our objective.
Earlier I defined a winning attitude as a positive expectation of our efforts, with an acceptance that whatever results we do get are a perfect reflection of our level of development and what we need to learn to do better. What separates the "consistently great" athletes and performers from everyone else is their distinct lack of fear of making a mistake. The reason they aren't afraid is that they don't have a reason to think less of themselves when they do make a mistake, meaning they don't have a reservoir of negatively charged energy waiting to well up and pounce on their conscious thought process like a lion waiting for the right moment to pounce on its intended prey. What accounts for this uncommon capacity to quickly move beyond their errors without criticizing themselves?
One explanation may be that they grew up with extremely unusual parents, teachers, and coaches, who by their words and examples taught them to correct their miscalculations and errors with genuine love, affection, and acceptance. I say "extremely unusual" because many of us grew up with just the opposite experience. We were taught to correct our mistakes or miscalculations with anger, impatience, and a distinct lack of acceptance. Is it possible that, for the great athletes, their past positive experiences with respect to mistakes caused them to acquire a belief that mistakes simply point the way to where they need to focus their efforts to grow and improve themselves? With a belief like that, there's no source of negatively charged energy and consequently no source for self-denigrating thoughts.
However, the rest of us, who did grow up experiencing a plethora of negative reactions to our actions, would naturally acquire beliefs about mistakes: "Mistakes must be avoided at all costs," "There must be something wrong with me if I make a mistake," "I must be a screw-up," or "I must be a bad person if I make a mistake." Remember that every thought, word, and deed reinforces some belief we have about ourselves. If, by repeated negative self-criticism, we acquire a belief that we're "screw-ups," that belief will find a way to express itself in our thoughts, causing us to become distracted and to screw up; on our words, causing us to say things about ourselves or about others (if we notice the same characteristics in them) that reflect our belief; and on our actions, causing us to behave in ways that are overtly self-sabotaging. If you're going to become a consistent winner, mistakes can't exist in the kind of negatively charged context in which they are held by most people.
You have to be able to monitor yourself to some degree, and that will be difficult to do if you have the potential to experience emotional pain if and when you find yourself in the process of making an error. If this potential exists, you have two choices:

1. You can work on acquiring a new set of positively charged beliefs about what it means to make a mistake, along with de-activating any negatively charged beliefs that would argue otherwise or cause you to think less of yourself for making a mistake.
2. If you find this first choice undesirable, you can compensate for the potential to make errors by the way you set up your trading regime.

This means that if you're going to trade and not monitor yourself, but at the same time you desire consistent results, then trading exclusively from the mechanical stage will resolve the dilemma.

Otherwise, learning how to monitor yourself is a relatively simple process once you have rid yourself of negatively charged energy associated with mistakes. In fact, it's easy. All you have to do is decide why you want to monitor yourself, which means you first need to have a clear purpose in mind. When you're clear about your purpose, simply start directing your attention to what you think, say, or do.

If and when you notice that you're not focused on your objective or on the incremental steps to accomplish your objective, choose to redirect your thoughts, words, or actions in a way that is consistent with what you are trying to accomplish. Keep redirecting as often as necessary. The more willfully you engage in this process, especially if you can do it with some degree of conviction, the faster you will create a mental framework free to function in a way that is consistent with your objectives, without any resistance from conflicting beliefs.

THE ROLE OF SELF-DISCIPLINE

I call the process I just described *self-discipline.* I define self-discipline as a mental technique to redirect (as best we can) our focus of attention to the object of our goal or desire, when that goal or desire conflicts with some other component (belief) of our mental environment. The first thing you should notice about this definition is that self-discipline is a technique to create a new mental framework. It is not a personality trait; people aren't born with self-discipline. In fact, when you consider how I define it, being born with discipline isn't even possible. However, as a technique to be used in the process of personal transformation, anybody can choose to use self-discipline. Here is an example from my life that illustrates the underlying dynamics of how this technique works. In 1978 I decided that I wanted to become a runner.

I don't exactly remember what my underlying motivation was, except that I had spent the previous eight years in a very inactive life style. I wasn't involved with any sports or hobbies, unless you call watching television a hobby. Previously in both high school and at least part of college I was very active in sports, especially ice hockey. However, coming out of college, my life was unfolding in the way that was very different from what I had expected. It was not to my liking, but at the time I felt powerless to do anything about it. This led to a period of inactivity, which is a nice way of saying that I was severely depressed. Again, I'm not sure what prompted me to suddenly want to become a runner (maybe I saw some TV program that sparked my interest).

I do, however, remember that the motivation was verv strong. So, I went out and bought myself some running shoes, put them on, and went out to run. The first thing I discovered was that I couldn't do it. I didn't have the physical stamina to run more than fifty or sixty yards. This was very surprising. I didn't realize, nor would I have ever believed, that I was so out of shape that I couldn't run even a hundred yards. This realization was so disheartening that I didn't attempt to run again for two or three weeks.

The next time out, I still couldn't run more than fifty or sixty yards. I tried again the next day with, of course, the same result.

I became so discouraged about my deteriorated physical condition that I didn't run again for another four months. Now, it's the spring of 1979. I'm once again determined to become a runner, but, at the same time, very frustrated with my lack of progress. As I was contemplating my dilemma, it occurred to me that one of my problems was that I didn't have a goal to work towards. Saying that I wanted to be a runner was great, but what did that mean? I really didn't know; it was too vague and abstract. I had to have something more tangible to work towards.

So I decided that I wanted to be able to run five miles by the end of the summer. Five miles seemed insurmountable at the time, but thinking that I might be able to do it generated a lot of enthusiasm. This increased level of enthusiasm gave me enough impetus to run four times that week. At the end of this first week, I was really surprised to discover even a little bit of exercise improved my stamina and ability to run a little farther each time. This created even more enthusiasm, so I went out and bought a stop watch and blank book to be used as a running diary. I set up a two-mile course, and marked off each quarter mile. In the diary I entered the date, my distance, my time, and how I felt physically each time I ran. Now I thought I was well on my way to the five miles, until I literally ran into my next set of problems.

The biggest were the conflicting and distracting thoughts that flooded my consciousness every time I decided I wanted to go out and run. I was amazed at the number (and intensity) of the reasons I found for not doing it: "It's hot [or] cold outside," "It looks like it's going to rain," "I'm still a little tired from the last time I ran (even though it was three days ago)," "Nobody else I know is doing this," or the most prevalent, "I'll go as soon as this TV program is over" (of course I never went). I didn't know any other way to deal with this conflicting mental energy except to redirect my conscious attention on what I was trying to accomplish. I really wanted to get to five miles by the end of the summer. I found that *sometimes* my desire was stronger than the conflict. As a result, I managed to get my running shoes on, actually step outside, and start running. However, more times than not, my conflicting and distracting thoughts caused me to stay put. In fact, in the beginning stages, I estimate that two-thirds of the time I was unable to get past the conflicting energy.

The next problem I encountered was that when I started approaching the point where I was able to run one mile, I was so thrilled with myself that it occurred to me I was going to need an additional mechanism to get me to the five miles. I reasoned that once I got to the point where I could run two or maybe three miles, I would be so overwhelmingly pleased with myself that I wouldn't feel any need to fulfill my five-mile objective. So I made a rule for myself. You could call it the five-mile rule. "If I managed to get my running shoes on and get outside in spite of all the conflicting thoughts trying to talk me out of it, I committed myself to running at least one step farther than the last time I ran." It was certainly all right if I ran more than one step further, but it couldn't be less than one step, no matter what. As it turns out, I never broke this rule, and by the end of the summer, I made it to five miles.

But then, something really interesting and completely unanticipated happened before I got there. As I got closer to fulfilling my five-mile objective, little by little, the conflicting thoughts began to dissipate. Eventually they didn't exist at all. At that point, I found that if I wanted to run, I was completely free to do so without any mental resistance, conflict, or competing thoughts. Given what a struggle it had been, I was amazed (to say the least). The result: I went on to run on a very regular basis for the next 16 years. For those of you who may be interested, I don't run so much now because five years ago I decided to start playing ice hockey again.

Hockey is an extremely strenuous sport. Sometimes I play as many as four times a week. Considering my age (over *u\j)* and the level of exertion the sport requires, it usually takes me a day or two to recover, which doesn't leave much room for running any more. Now, if you take these experiences and put them into the context of what we now understand about the nature of beliefs, there are a number of observations we can make:

1. Initially, my desire to be a runner had no foundation of support in my mental system. In other words, there was no other source of energy (an energized concept demanding expression) consistent with my desire.
2. I actually had to do something to create that support. To create a belief that "I am a runner" required that I create a series of experiences consistent with the new belief. Remember that everything we think, say, or do contributes energy to some belief in our mental system. Each time I experienced a conflicting thought and was able to successfully refocus on my objective, with enough conviction to get me into my running shoes and out the door, I added energy to the belief that "I am a runner." And, just as important, I inadvertently drew energy away from all of the beliefs that would argue otherwise. I say inadvertently because there are various techniques specifically designed to identify and de-activate conflicting beliefs, but at that time in my life, I didn't understand the underlying dynamics of the process of transformation I was going through. So, it wouldn't have occurred to me to avail myself of such techniques.
3. Now I can effortlessly (from a mental perspective) express myself as a runner, because "I am a runner." That energized concept is now a functioning part of my identity. When I first started out, I happened to have a number of conflicting beliefs about running. As a result, I needed the technique of self-discipline to bfCCITic One. Now I don't need self-discipline because "bHn" a. rj^iicr" 'c "who I *L* -~o am." When our bfeliers are completely aligned with our goals or desires, there's no source of conflicting energy. If there's no source of conflicting energy, then there's no source of distracting thoughts, excuses, rationalizations, justifications, or mistakes (conscious or subconscious).
4. Beliefs can be changed, and if it's possible to change one belief, then it's possible to change any belief, if you understand that you really aren't changing them, but are only transferring energy from one concept to another. (The form of the belief targeted for change remains intact.) Therefore, two completely contradictory beliefs can exist in your mental system, side by side. But if you've drawn the

energy out of one belief and completely energized the other, no contradiction exists from a functional perspective; only the belief that the energy will have the capacity to act as a force on your state of mind, on your perception and interpretation of information, and your behavior. Now, the sole purpose of trading mechanically is to transform yourself into a consistently successful trader. If there's anything in your mental environment that's in conflict with the principles of creating the belief that *"I am a consistently successful trader,"* then you will need to employ the technique of self-discipline to integrate these principles as a dominant, functioning part of your identity. Once the principles become "who you are," you will no longer need self-discipline, because the process of "being consistent" will become effortless. Remember that consistency is not the same as the ability to put on a winning trade, or even a string of winning trades for that matter, because putting on a winning trade requires absolutely no skill. All you have to do is guess correctly, which is no different than guessing the outcome of a coin toss, whereas consistency is a state of mind that, once achieved, won't allow you to "be" any other way. You won't have to try to be consistent because it will be a natural function of your identity. In fact, if you have to try, it's an indication that you haven't completely integrated the principles of consistent success as dominant, unconflicted beliefs. For example, predefining your risk is a step in the process of "being consistent." If it takes any special effort to predefine your risk, if you have to consciously remind yourself to do it, if you experience any conflicting thoughts (in essence, trying to talk you out of doing it), or if you find yourself in a trade where you haven't predefined your risk, then this principle is not a dominant, functioning part of your identity. It isn't "who you are." If it were, it wouldn't even occur to you not to predefine your risk. If and when all of the sources of conflict have been de-activated, there's no longer a potential for you to "be" any other way. What was once a struggle will become virtually effortless. At that point, it may seem to other people that you are so disciplined (because you can do something they find difficult, if not impossible), but the reality is that you aren't being disciplined at all; you are simply functioning from a different set of beliefs that compel you to behave in a way that is consistent with your desires, goals, or objectives.

CREATING A BELIEF IN CONSISTENCY

Creating a belief that *"I am a consistent winner"* is the primary objective, but like my intention to become a runner, it's too broad and abstract to implement without breaking it down into a step-by-step process. So what I'm going to do is break this belief down into its smallest definable parts and then give you a plan to integrate each part as a dominant belief. The following sub-beliefs are the building blocks that provide the underlying structure for what it means "to be a consistent winner."

I AM A CONSISTENT WINNER BECAUSE:

1. I objectively identify my edges.
2. I predefine the risk of every trade.
3. I completely accept risk or I am willing to let go of the trade.
4. I act on my edges without reservation or hesitation.
5. I pay myself as the market makes money available to me.
6. I continually monitor my susceptibility for making errors.
7. I understand the absolute necessity of these principles of consistent success and, therefore, I never violate them.

These beliefs are the seven principles of consistency. To integrate these principles into your mental system at a functional level requires that you purposely create a series of experiences that are consistent with them. This is no different from the boy who wanted to play with dogs or my desire to be a runner. Before he could play with a dog, the boy first had to make several attempts just to get close to one. Eventually, as the balance of energy in his mental system shifted, he could play with dogs without any internal resistance. To become a runner, I had to create the experience of running in spite of everything inside me that argued otherwise. Eventually, as the energy shifted more and more in favor of this new definition of myself, running became a natural expression of my identity.

Obviously, what we're trying to accomplish here is far more complex than becoming a runner or petting a dog, but the underlying dynamics of the process are identical. We'll start with a specific objective. The first principle of consistency is the belief, "I objectively identify my edges." The key word here is *objectively*. Being objective means there's no potential to define, interpret, and therefore perceive any market information from either a painful or euphoric perspective.

The way to be objective is to operate out of beliefs that keep your expectations neutral and to always take the unknown forces into consideration. Remember, you have to specifically train your mind to be objective and to stay focused in the "now moment opportunity flow." Our minds are not naturally wired to think this way, so to be an objective observer you have to learn to think from the market's perspective. From the market's perspective, there are always unknown forces (traders) waiting to act on price movement. Therefore, from the market's perspective, "every moment is truly unique," even though the moment may look, sound, or feel exactly the same as some moment logged away in your memory bank.

The instant you either decide or assume you know what's going to happen next, you will automatically expect to be right. However, what you know, at least at the rational level of thinking, can only take into consideration your unique past, which may not have any relationship to what is actually happening from the markets perspective. At that point, any market information that is not consistent with your expectation has the potential to be defined and interpreted as painful. To avoid experiencing the pain, your mind will automatically compensate, with both conscious and subconscious pain-avoidance mechanisms, for any differences between what you expect and what the market is offering. What you will experience is commonly referred to as an "illusion." In a state of illusion, you are neither objective nor connected to the "now moment opportunity flow."

Instead, you become susceptible to committing all the typical trading errors (hesitating, jumping the gun, not predefining your risk, defining your risk but refusing to take the loss and letting the trade turn into a bigger loser, getting out of a winning trade too soon, not taking any profits out of a winning trade, letting a winning trade turn into a loser, moving a stop closer to your entry point, getting stopped out and watching the market trade back in your favor, or trading too large a position in relationship to your equity). The five fundamental truths about the market will keep your expectations neutral, focus your mind in the "now moment opportunity flow" (by disassociating die present moment from your past), and, therefore, eliminate your potential to commit these errors. When you stop making trading errors, you'll begin trusting yourself. As your sense of self-trust increases, so will your sense of selfconfidence. The greater your confidence, the easier it will be to execute your trades (act on your edges without reservation or hesitation).

The five truths will also create a state of mind in which you will genuinely accept the risks of trading. When you genuinely accept the risks, you will be at peace with any outcome. When you're at peace with any outcome, you will experience a carefree, objective state of mind, where you make yourself available to perceive and act upon whatever the market is offering you (from its perspective) at any given "now moment." The first objective is to integrate as a dominant belief, "I objectively identify my edges." The challenge now is, how do you get there? How do you transform yourself into a person who can consistently think in the market's perspective? The process of transformation starts with your desire and your willingness to refocus on the object of your desire (self-discipline). Desire is a force. It does not have to coincide or agree with anything that you currently believe to be true about the nature of trading.

A clear desire aimed squarely at a specific objective is a very powerful tool. You can use the force of your desire to create an entirely new version or dimension to your identity; shift energy between two or more conflicting concepts; or change the context or polarity of your memories from negative to positive. I'm sure you are familiar with the saying, "Make up your mind." The implication of "making up our minds" is that we decide exactly what we desire with so much clarity (absolutely no lingering doubts) and with so much conviction that literally nothing stands in our way, either internally or externally. If there's enough force behind our resolve, it's possible to experience a major shift in our mental structure virtually instantaneously.

De-activating internal conflicts is not a function of time; it's a function-focused desire (although it can take a considerable amount of time to get to the point where we really make up our minds). Otherwise, in the absence of extreme clarity and conviction, the technique of self-discipline, over time, will do the job quite nicely (if, of course, you're willing to use it). To get there, you must "make up your mind," with as much conviction and clarity as possible, that more than anything else you desire consistency (the state of mind of trust, confidence, and objectivity) from your trading. This is necessary because if you're like most traders, you're going to be up against some very formidable conflicting forces. For example, if you've been trading to get high from the euphoria of catching a big move, to impress your family and friends, to be a hero, to fulfill an addiction to random rewards, to be right about your predictions, or for any other reason that has nothing to do with being consistent, then you'll find the force of these other motivations will not only act as an obstacle making the trading exercise I'm about to give you veiy difficult, but it could very well be strong enough even to keep you from doing the exercise at all. Remember the boy who had no desire to be like the other children and interact with dogs? In essence, he decided to live with the active contradiction between his minimally charged positive belief that not all dogs are dangerous and his core, negatively charged belief that all dogs are dangerous. He had the ability to perceive friendly dogs, but at the same time found it impossible to interact with them. Unless he desires to change it, the imbalance of energy between these two beliefs will stay exactly as it is for his entire life.

To even start this process, you have to want consistency so much that you would be willing to give up all the other reasons, motivations, or agendas you have for trading that aren't consistent with the process of integrating the beliefs that create consistency. A clear, intense desire is an absolute prerequisite if you're going to make this process work for you.

EXERCISE: LEARNING TO TRADE AND EDGE LIKE A CASINO’

The object of this exercise is to convince yourself that trading is just a simple game of probabilities (numbers), not much different from pulling the handle of a slot machine. At the micro level, the outcomes to individual edges are independent occurrences and random in relationship to one another. At the macro level, the outcomes over a series of trades will produce consistent results. From a probabilities perspective, this means that instead of being the person playing the slot machine, as a trader, you can be the casino, if:

1. you have an edge that genuinely puts the odds of success in your favor;
2. you can think about trading in the appropriate manner (the five fundamental truths); and
3. you can do everything you need to do over a series of trades. Then, like the casinos, you will own the game and be a consistent winner.

SETTING UP THE EXERCISE

Pick a market.

Choose one actively traded stock or futures contract to trade. It doesn't matter what it is, as long as it's liquid and you can afford the margin requirements for trading at least three hundred shares or three futures contracts per trade.

Choose a set of market variables that define an edge. This can be any trading system you want. The trading system or methodology you choose can be mathematical, mechanical, or visual (based on patterns in price charts). It doesn't matter whether you personally design the system or purchase it from someone else, nor do you need to take a long time or be too picky trying to find or develop the best or right system. This exercise is not about system development and it is not a test of your analytical abilities. In fact, the variables you choose can even be considered mediocre by most traders' standards, because what you are going to learn from doing this exercise is not dependent upon whether you actually make money.

If you consider this exercise an educational expense, it will cut down on the amount of time and effort you might otherwise expend trying to find the most profitable edges. For those of you who might be wondering, I'm not going to make any specific recommendations about what system or variables you should use, because I assume that most of the people reading this book are already well schooled in technical analysis. If you need additional assistance, there are hundreds of books available on the topic, as well as system vendors who are more than willing to sell you their ideas. However, if you've made a genuine attempt to do this on your own but are still having problems picking a system, you can contact me at *markdouglas.com* or *tradinginthezone.com* and I will make some recommendations. Whatever system you choose to use has to fit within the following specifications.

Trade Entry. The variables you use to define your edge have to be absolutely precise. The system has to be designed so that it does not require you to make any subjective decisions or judgments about whether your edge is present. If the market is aligned in a way that conforms with the rigid variables of your system, then you have a trade; if not, then you don't have a trade. Period! No other extraneous or random factors can enter into the equation.

Stop-Loss Exit. The same conditions apply to getting out of a trade that's not working. Your methodology has to tell you *exactly* how much you need to risk to find out if the trade is going to work. There is always an optimum point at which the possibility of a trade not working is so diminished, especially in relationship to the profit potential, that you're better off taking your loss and getting your mind clear to act on the next edge. Let the market structure determine where this optimum point is, rather than using an arbitrary dollar amount that you are willing to risk on a trade. In any case, whatever system you choose, it has to be absolutely exact, requiring no subjective decision making.

Again, no extraneous or random variables can enter into the equation.

Time Frame. Your trading methodology can be in any time frame that suits you, but all your entry and exit signals have to be DUSCCi Hi cne same time frame. For example, if you use variables that identify a particular support and resistance pattern on a 30-minute bar chart, then your risk and profit objective calculations also have to be determined in a 30-minute time frame. However, trading in one time frame does not preclude you from using other time frames as filters. For example, you could have as a filter a rule that states you're only going to take trades that are in the direction of the major trend. There's an old trading axiom that "The trend is your friend." It means that you have a higher probability of success when you trade in the direction of the major trend, if there is one. In fact, the lowest-risk trade, with the highest probability of success, occurs when you are buying dips (support) in an up-trending market or selling rallies (resistance) in a down-trending market. To illustrate how this rule works, let's say that you've chosen a precise way of identifying support and resistance patterns in a 30- minute time frame as your edge. The rule is that you are only going to take trades in the direction of the major trend. A trending market is defined as a series of higher highs and higher lows for an up-trending market and a series of lower highs and lower lows for a downtrending market. The longer the time frame, the more significant the trend, so a trending market on a daily bar chart is more significant than a trending market on a 30-minute bar chart. Therefore, the trend on the daily bar chart would take precedence over the trend on the 30-minute bar chart and would be considered the major trend.
To determine the direction of the major trend, look at what is happening on a daily bar chart. If the trend is up on the daily, you are only going to look for a sell-off or retracement down to what your edge defines as support on the 30-minute chart. That's where you will become a buyer. On the other hand, if the trend is down on the daily, you are only going to look for a rally up to what your edge defines as a resistance level to be a seller on the 30-minute chart. Your objective is to determine, in a down-trending market, how far it can rally on an intraday basis and still not violate the symmetry of the longer trend. In an up-trending market, your objective is to determine how far it can sell off on an intraday basis without violating the symmetry of the longer trend. There's usually very little risk associated with these intraday support and resistance points, because you don't have to let the market go very far beyond them to tell you the trade isn't working.

Taking Profits. Believe it or not, of all the skills one needs to learn to be a consistently successful trader, learning to take profits is probably the most difficult to master. A multitude of personal, often very complicated psychological factors, as well as the effectiveness of one's market analysis, enter into the equation. Unfortunately, sorting out this complex matrix of issues goes way beyond the scope of this book. I point this out so that those of you who might be inclined to beat yourselves up for leaving money on the table can relax and give yourselves a break. Even after you've acquired all the other skills, it might take a very long time before you get this one down pat. Don't despair. There is a way to set up a profit-taking regime that at least fulfills the objective of the fifth principle of consistency ("I pay myself as the market makes money available to me").

If you're going to establish a belief in yourself that you're a consistent winner, then you will have to create experiences that correspond with that belief. Because the object of the belief is winning consistently, how you take profits in a winning trade is of paramount importance. This is the only part of the exercise in which you will have some degree of discretion about what you do. The underlying premise is that, in a winning trade, you never know how far the market is going to go in your direction. Markets rarely go straight up or straight down. (Many of the NASDAQ Internet stocks in the fall of 1999 were an obvious exception to this statement.) Typically, markets go up and then retrace some portion of the upward move; or go down and then retrace some portion of the downward move. These proportional reiracerr^nts can make it very difficult to stay in a winning trade. You would have to be an extremely sophisticated and objective analyst to make the distinction between a normal retracement, when the market still has the potential to move in the original direction of your trade, and a retracement that isn't normal, when the potential for any further movement in the original direction of your trade is greatly diminished, if not nonexistent.

If you never know how far the market is going to go in your direction, then when and how do you take profits? The question of when is a function of your ability to read the market and pick the most likely spots for it to stop. In the absence of an ability to do this objectively, the best course of action from a psychological perspective is to divide your position into thirds (or quarters), and scale out the position as the market moves in your favor. If you are trading futures contracts, this means your minimum position for a trade is at least three (or four) contracts. For stocks, the minimum position is any number of shares that is divisible by three (or four), so you don't end up with an odd-lot order. Here's the way I scale out of a winning position. When I first started trading, especially during the first three years (1979 through 1981), I would thoroughly and regularly analyze the results of my trading activities. One of the things I discovered was that I rarely got stopped out of a trade for a loss, without the market first going at least a little way in my direction. On average, only one out of every ten trades was an immediate loser that never went in my direction. Out of the other 25 to 30 percent of the trades that were ultimately losers, the market usually went in my direction by three or four tics before revising and stopping me out. I calculated that if I got into the habit of taking at least a third of my original position off every time the market gave me those three or four tics, at the end of the year the accumulated winnings would go a long way towards paying my expenses. I was right. To this day, I always, without reservation or hesitation, take off a portion of a winning position whenever the market gives me a little to take.

How much that might be depends on the market; it will be a different amount in each case. For example, in Treasury bond futures, I take a third of my position off when I get four tics. In the S&P futures, I take a third off for a profit of one and a half to two full points. In a bond trade, I usually don't risk more than six tics to find out if the trade is going to work. Using a three-contract trade as an example, here's how it works: If I get into a position and the market immediately goes against me without giving me at least four tics first, I get stopped out of the trade for an 18-tic loss, but as I've indicated, this doesn't happen often. More likely, the trade goes in my favor by some small amount before becoming a loser. If it goes in my favor by at least four tics, I take those four tics on one contract. What I have done is reduce my total risk on the other two contracts by 10 tics. If the market then stops me out of the last two contracts, the net loss on the trade is only 8 tics. If I don't get stopped out on the last two contracts and the market moves in my direction, I take the next third of the position off at some predetermined profit objective.

This is based on some longer time frame support or resistance, or on the test of a previous significant high or low. When I take profits on the second third, I also move the stop-loss to my original entry point. Now I have a net profit on the trade regardless of what happens to the last third of the position. In other words, I now have a "risk-free opportunity." I can't emphasize enough nor can the publisher make the words on this page big enough to stress how important it is for you to experience the state of "risk-free opportunity." When you set up a situation in which there is "risk-free opportunity," there's no way to lose unless something extremely unusual happens, like a limit up or limit down move through your stop. If, under normal circumstances, there's no way to lose, you get to experience what it really feels like to be in a trade with a relaxed, carefree state of mind. To illustrate this point, imagine that you are in a winning trade; the market made a fairly significant move in your direction, but you didn't take any profits because you thought it was going even further.

However, instead of going further, the market trades all the way back to or very close to your original entry point. You panic and, as a result, liquidate the trade, because you don't want to let what was once a winning trade turn into a loser. But as soon as you're out, the market bounces right back into what would have been a winning trade. If you had locked in some profits by scaling out, putting yourself in a riskfree opportunity situation, it s very unlikely that you would have panicked or felt any stress or anxiety for that matter. I still have a third of my position left. What now? I look for the most likely place for the market to stop. This is usually a significant high or low in a longer time frame. I place my order to liquidate just below that spot in a long position or just above that spot in a short position. I place my orders just above or just below because I don't care about squeezing the last tic out of the trade. I have found over the years that trying to do that just isn't worth it. One other factor you need to take into consideration is your risk-to-reward ratio. The risk-to-reward ratio is the dollar value of how much risk you have to take relative to the profit potential. Ideally, your risk-to-reward ratio should be at least 3:1, which means you are only risking one dollar for every three dollars of profit potential. If your edge and the way you scale out of your trades give you a 3:1 risk-to-reward ratio, your winning trade percentage can be less than 50 percent and you will still make money consistently. A 3:1 risk-to-reward ratio is ideal. However, for the purposes of this exercise, it doesn't matter what it is, nor does it matter how effectively you scale out, as long as you do it. Do the best you can to pay yourself at reasonable profit levels when the market makes the money available. Every portion of a trade that you take off as a winner will contribute to your belief that you are a consistent winner. All the numbers will eventually come into better alignment as your belief in your ability to be consistent becomes stronger.

Trading in Sample Sizes. The typical trader practically lives or dies (emotionally) on the results of the most recent trade. If it was a winner, he'll gladly go to the next trade; if it wasn't, he'll start questioning the viability of his edge. To find out what variables work, how well they work, and what doesn't work, we need a systematic approach, one that doesn't take any random variables into consideration. This means that we have to expand our definition of success or failure from the limited trade-by-trade perspective of the typical trader to a sample size of 20 trades or more. Any edge you decide on will be based on some limited number of market variables or relationships between those variables that measure the market's potential to move either up or down. From the market's perspective, each trader who has the potential to put on or take off a trade can act as a force on price movement and is, therefore, a market variable. No edge or technical system can take into consideration every trader and his reasons for putting on or taking off a trade. As a result, any set of market variables that defines an edge is like a snapshot of something very fluid, capturing only a limited portion of all the possibilities. When you apply any set of variables to the market, they may work very well over an extended period of time, but after a while you may find that their effectiveness diminishes. That's because the underlying dynamics of the interaction between all the participants (the market) is changing. New traders come into the market with their own unique ideas of what is high and what is low, and other traders leave.

Little by little, these changes affect the underlying dynamics of how the market moves. No snapshot (rigid set of variables) can take these subtle changes into consideration. You can compensate for these subtle changes in the underlying dynamics of market movement and still maintain a consistent approach by trading in sample sizes. Your sample size has to be large enough to give your variables a fair and adequate test, but at the same time small enough so that if their effectiveness diminishes, you can detect it before you lose an inordinate amount of money. I have found that a sample size of at least 20 trades fulfills both of these requirements.

Testing. Once you decide on a set of variables that conform to these specifications, you need to test them to see how well they work. If you have the appropriate software to do this, you are probably already familiar with the procedures. If you don't have testing software, you can either forward test your variables or hire a testing service to do it for you. If you need a recommendation for a testing service, contact me at *markdouglas.com* or *tradinginthezone.com* for a referral. In any case, keep in mind that the object of the exercise is to use trading as a vehicle to learn how to think objectively (in the market's perspective), as if you were a casino operator. Right now, the bottom-line performance of your system isn't very important, but it is important that you have a good idea of what you can expect in the way of a win-to-loss ratio (the number of winning trades relative to the number of losing trades for your sample size).

Accepting the Risk. A requirement of this exercise is that you know in advance exactly what your risk is on each trade in your 20- trade sample size. As you now know, knowing the risk and accepting the risk are two different things. I want you to be as comfortable as possible with the dollar value of the risk you are taking in this exercise. Becuse the exercise requires that you use a 20-trade sample size, the potential risk is that you will lose on all 20 trades. This is obviously the worst-case scenario. It is as likely an occurrence as that you willwin on all 20 trades, which means it isn't very likely. Nevertheless, it is a possibility. Therefore, you should set up the exercise in such a way that you can accept the risk (in dollar value) of losing on all 20 trades.

For example, if you're trading S&P futures, your edge might require that you risk three full points per contract to find out if the trade is going to work. Since the exercise requires that you trade a minimum of three contracts per trade, the total dollar value of the risk per trade is $2,250, if you use big contracts. The accumulated dollar value of risk if you lose on all 20 trades is $45,000, You may not be comfortable risking $45,000 on this exercise.

If you're not comfortable, you can reduce the dollar value of the risk by trading S&P mini contracts (E-Mini). They are one-fifth the value of the big contracts, so the total dollar value of the risk per trade goes down to $450 and the accumulated risk for all 20 trades is $9,000. You can do the same thing if you are trading stocks: Just keep on reducing the number of shares per trade until you get to a point where you are comfortable with the total accumulated risk for all 20 trades. What I don't want you to do is change your established risk parameters to satisfy your comfort levels.

If, based on your research, you have determined that a three-point risk in the S&Ps is the optimum distance you must let the market trade against your edge to tell you it isn't worth staying in the position, then leave it at three points. Change this variable only if it is warranted from a technical analysis perspective. If you've done everything possible to reduce your position size and find that you still aren't comfortable with the accumulated dollar value of losing on all 20 trades, then I suggest you do the exercise with a simulated brokerage service. With a simulated brokerage service, everything about the process of putting on and taking off trades, including fills and brokerage statements, is exactly the same as with an actual brokerage firm, except that the trades are not actually entered into the market. As a result, you don't actually have any money at risk. A simulated brokerage service is an excellent tool to practice with in real time, under real market conditions; it is also an excellent tool for forward testing a trading system. There may be others, but the only service of this nature that I know of is *Auditrack.com.*

Doing the Exercise. When you have a set of variables that conforms to the specifications described, you know exactly what each trade is going to cost to find out if it's going to work, you have a plan for taking profits, and you know what you can expect as a win-loss ratio for your sample size, then you are ready to begin the exercise. The rules are simple: Trade your system exactly as you have designed it. This means you have to commit yourself to trading at least the next 20 occurrences of your edge—not just the next trade or the next couple of trades, but all 20, no matter what. You cannot deviate, use or be influenced by any other extraneous factors, or change the variables that define your edge until you have completed a full sample size. By setting up the exercise with rigid variables that define your edge, relatively fixed odds, and a commitment to take every trade in your sample size, you have created a trading regime that duplicates how a casino operates.

Why do casinos make consistent money on an event that has a random outcome? Because they know that over a series of events, the odds are in their favor. They also know that to realize the benefits of the favorable odds, they have to participate in every event. They can't engage in a process of picking and choosing which hand of blackjack, spin of the roulette wheel, or roll of the dice they are going to participate in, by trying to predict in advance the outcome of each of these individual events. If you believe in the five fundamental truths and you believe that trading is just a probability game, not much different from pulling the handle of a slot machine, then you'll find that this exercise will be effortless—effortless because your desire to follow through with your commitment to take every trade in your sample size and your belief in the probabilistic nature of trading will be in complete harmony. As a result, there will be no fear, resistance, or distracting thoughts. What could stop you from doing exactly what you need to do, when you need to do it, without reservation or hesitation? Nothing!

On the other hand, if it hasn't already occurred to you, this exercise is going to create a head-on collision between your desire to think objectively in probabilities and all the forces inside you that are in conflict with this desire. The amount of difficulty you have in doing this exercise will be in direct proportion to the degree to which these conflicts exist. To one degree or another, you will experience the exact opposite of what I described in the previous paragraph. Don't be surprised if you find your first couple of attempts at doing this exercise virtually impossible. How should you handle these conflicts? Monitor yourself and use the technique of self-discipline to refocus on your objective. Write down the five fundamental truths and the seven principles of consistency, and keep them in front of you at all times when you are trading.

Repeat them to yourself frequently, with conviction. Every time you notice that you are thinking, saying, or doing something that is inconsistent with these truths or principles, acknowledge the conflict. Don't try to deny the existence of conflicting forces. They are simply parts of your psyche that are (understandably) arguing for their versions of the truth. When this happens, refocus on exactly what you are trying to accomplish. If your purpose is to think objectively, disrupt the association process (so you can stay in the "now moment opportunity flow"); step through your fears of being wrong, losing money, missing out, and leaving money on the table (so you can stop making errors and start trusting yourself), then you'll know exactly what you need to do. Follow the rules of your trading regime as best you can. Doing exactly what your rules call for while focused on the five fundamental truths will eventually resolve all your conflicts about the true nature of trading. Every time you actually do something that confirms one of the five fundamental truths, you will be drawing energy out of the conflicting beliefs and adding energy to a belief in probabilities and in your ability to produce consistent results. Eventually, your new beliefs will become so powerful that it will take no conscious effort on your part to think and act in a way that is consistent with your objectives.

You will know for sure that thinking in probabilities is a functioning part of your identity when you will be able to go through one sample size of at least 20 or more trades without any difficulty, resistance, or conflicting thoughts distracting you from doing exactly what your mechanical system calls for. Then, and only then, will you be ready to move into the more advanced subjective or intuitive stages of trading.

A FINAL NOTE

Try not to prejudge how long it will take before you can get through at least one sample size of trades, following your plan without deviation, distracting thoughts, or hesitation to act. It will take as long as it takes. If you wanted to be a professional golfer, it wouldn't be unusual to dedicate yourself to hitting 10,000 or more golf balls until the precise combination of movements in your swing were so ingrained in your muscle memory that you no longer had to think about it consciously. When you're out there hitting those golf balls, you aren't playing an actual game against someone or winning the big tournament. You do it because you believe that skill acquisition and practice will help you win. Learning to be a consistent winner as a trader isn't any different. I wish you great prosperity, and would say "good luck," but you really won't need luck if you work at acquiring the appropriate skills.

ATTITUDE SURVEY

1. To make money as a trader you have to know what the market is going co do next.
Agree Disagree

2. Sometimes I find myself thinking that there must be a way to trade without having to take a loss.
Agree Disagree

3. Making money as a trader is primarily a function of analysis.
Agree Disagree

4. Losses are an unavoidable component of trading.
Agree Disagree

5. My risk is always defined before I enter a trade.
Agree Disagree

6. In my mind there is always a cost associated with finding out what the market may do next.
Agree Disagree

7. I wouldn't even bother putting on the next trade if I wasn't sure that it was going to be a winner.
Agree Disagree

8. The more a trader learns about the markets and how they behave, the easier it will be for him to execute his trades.
Agree Disagree

9. My methodology tells me exactly under what market conditions to either enter or exit a trade.
Agree Disagree

10. Even when I have a clear signal to reverse my position, I find it extremely difficult to do.
Agree Disagree

11. I have sustained periods of consistent success usually followed by some fairly drastic draw-downs in my equity.
Agree Disagree

12. When I first started trading I would describe my trading methodology as haphazard, meaning some success in between a lot of pain.
Agree Disagree

13. I often find myself feeling that the markets are against me personally.
Agree Disagree

14. As much as I might try to "let go," I find it very difficult to put past emotional wounds behind me.
Agree Disagree

15. I have a money management philosophy that is founded in the principle of always taking some money out of the market when the market makes it available.
Agree Disagree

16. A trader s job is to identify patterns in the markets' behavior that represent an opportunity and then to determine the risk of finding out if these patterns will play themselves out as they have in the past.
Agree Disagree

17. Sometimes I just can't help feeling that I am a victim of the market.
Agree Disagree

18. When I trade I usually try to stay focused in one time frame. Agree Disagree
19. Trading successfully requires a degree of mental flexibility far beyond the scope of most people.
Agree Disagree

20. There are times when I can definitely feel the flow of the market; however, I often have difficulty acting on these feelings.
Agree Disagree

21. There are many times when I am in a profitable trade and I know the move is basically over, but I still won't take my profits.
Agree Disagree

22. No matter how much money I make in a trade, I am rarely ever satisfied and feel that I could have made more.
Agree Disagree

23. When I put on a trade, I feel I have a positive attitude. I anticipate all of the money I could make from the trade in a positive way.
Agree Disagree

24. The most important component in a trader's ability to accumulate money over time is having a belief in his own consistency.
Agree Disagree

25. If you were granted a wish to be able to instantaneously acquire one trading skill, what skill would you choose?

26. I often spend sleepless nights worrying about the market.
Agree Disagree

27. Do you ever feel compelled to make a trade because you are afraid that you might miss out?
Yes No

28. Although it doesn't happen very often, I really like my trades to be perfect. When I make a perfect call it feels so good that it makes up for all of the times that I don't.
Agree Disagree

29. Do you ever find yourself planning trades you never execute, and executing trades you never planned?
Yes No

30. In a few sentences explain why most traders either don't make money or aren't able to keep what they make.

TraderTom

Best Loser Wins

Part 1

By Tom Hougaard

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FREEDOM ROAD

What you become in life is dependent on the decisions you make and how you react to decisions made on your behalf.

At Stanford University, Steve Jobs, standing at the podium in front of the class of 2005, gave the new graduates their commencement speech — advice on how to live life.

It went something like this:

"Remembering that you're going to die is the best way I know to avoid the trap of thinking you have something to lose. You are already naked. There is no reason not to follow your heart."

Few can walk the walk when money is on the line. The main contributor to not having the life you want is fear. Most play this game, called life, safely within the boundaries they set while growing up, boundaries built by avoiding pain and anxiety.

They come up with excuses for why they made one choice over another — the voice inside keeping them on the safe side of the fence.

The average seeks average lives, but the world is not built by average people — it is built by the unreasonable who dare to elevate themselves, who reject the average and go all-in for success.

I am often asked how I made it to the top of the trading pyramid, so I decided to put it down on paper. I am not here because of IQ; I tell you that immediately.

I am here because of my relationship with pain.

Our brains so hate the idea of losing something that is valuable to us that we abandon all rational thought and make some really poor decisions.

The success you desire is closer than you think on the other side of this door, but if I hand you the key, will you open the lock?

It's your choice. Nobody can do it for you. Unlocking the door is only the beginning. You have to walk through it.

It requires attention, focus, dedication, and sacrifice. It takes courage.

I am giving you the key, and the only question now is will you use it?

My name is Tom Hougaard.

I'm a financial trader — an inspiration to many, and, no doubt, the envy of some.

I don't work for anyone, I work when I want to, I own more than one expensive car, I live in a big house, and I have no debt.

For many, that is living the dream. The definition of success is subjective, yet for me, personally, it is not about the money.

It's about one word.

Freedom. The freedom to spend time with my family and live life on my terms.

Many desire the lifestyle I lead, seeing only the outward symbols of success, but few are prepared to acknowledge the dualistic and interconnected opposites that are required to build it.

The markets never sleep, so my sleep suffers regularly. I don't work for anyone, and I rely 100% on what I make from trading. If I don't feel well and I'm forced to stay in bed, there is no sick pay.

Every day, I have the opportunity to make or lose a fortune, but to do so means I have to live with and accept risk — risk like an unexpected news event that will violently move the market against my position.

I am constantly battling the odds.

95% who attempt to do what I do fail. Probably even more.

THE INCONVENIENT TRUTH

In financial markets, the traders that win, the 5%, make all their money from the 95% that lose.

Every year, I'm contacted by thousands and thousands of people who want to know my secret.

Why?

Because I make money trading.

Do you know why I win consistently over time?

Is it because I'm an expert at technical analysis? No.

Is it because I've purchased an expensive, exclusive piece of software that gives me great trading signals?

No.

Is it because I have friends in high places who feed me insider information?

No.

Is it because I have discovered a secret charting method? No.

Do you want to know why I am so good at trading, and why I make the big bucks?

Lean in now, because, right here, you're going to learn the number one secret of success in trading.

Ready?

I am exceptionally good at losing.

When speculating in financial markets — The Best Loser Wins.

Don't underestimate these four words.

Going against the conditioning that life, in our modern world, has programmed you with, success in financial market speculation is not about being the best, coming first, and winning.

Instead, it's about losing.

And that's why I win.

I win because I'm really good at losing.

In trading, unlike life, it's the best loser that wins.

MANY ARE CALLED FEW ARE CHOSEN

Trading attracts many people who shouldn't be there.

They are led to believe that trading is easy. Maybe the broker is tempting them; I'm sure you've seen the broker advertisements where a calm, confident actor, knowingly pressing buttons in front of a bedazzling array of screens, walks away victorious with a confident smirk.

If you look at the trading industry, we are led to believe it's built on trader tools, hundreds of built-in indicators, and more recently even programming languages to enable you to code your own.

And, with the ability to back test, traders can look back and see how much they'd make or lose, giving them the confidence to take action.

It's an illusion.

How do I know?

Because, for years, I was an insider working at one of the largest financial market brokers in the City of London.

During my 10 years in London, the stock market rallied, nose-dived, rallied again and then crashed.

Gold went from $250 to almost $2000 an ounce, a spectacular bull market.

After the fact it looked like child's play to make money. But here's the thing...

Almost everyone lost.

Out of the thousands and thousands of people who opened an account, only around four percent managed to keep their money, let alone make enough to replace their day job.

Did you know that Harvard University received a total of 43,500 applications for their courses in 2020?

Out of all of those applications, Harvard will only accept 1,950 students. The success rate is just 4.5%.

The success rate in trading is about the same.

The success ratio isn't broker specific. It's systemic, happening everywhere inside all brokerages — not because the broker is cheating in any way, in fact, the broking industry is highly regulated, and it's not because they take the other side of your trade and run your stops, the exit position you advertise to them when you take a position.

So, if the reason is not the broker, then what is the problem?

Why do so many people lose?

Statistically speaking, it should be impossible for so many people to lose. If the market is random, and market movement is, most of the time, random, why do 95% of clients consistently lose a 50:50 bet?

The answer is as simple as it is complex.

It isn't the market-beating them.

They are beating themselves.

I wasn't always a successful trader. To become successful, I had to break down the barrier that separates the many from the few, in a business where there is no instruction manual, and where the lesson comes after the test.

In 1997, with a master's degree in Economics, I got my start at Chase Manhattan Bank as an analyst. In my late twenties, and driven to succeed, after three years at Chase, I handed in my notice, having saved enough to start the business of my dreams.

Excited and full of hope, I began my new career as a day trader. It took thirteen months to lose it all. Reality's bite is worse than its bark. Needing a job, I began work at a CFD broker based in London.

My official title was market analyst, but a large part of my responsibilities was to be the educational bridge between the company and its customers. While working with trading clients, it didn't take long for their behavioral patterns to get my attention.

I was headhunted to another brokerage in 2002, where, for the next seven years, I continued my role working with trading clients.

Almost immediately, even though I was working for another broker with an entirely different group of traders, I noticed the same patterns of behaviour.

My observations converged into insight.

As a group, traders are predictable.

Or, more accurately, their outcome is predictable, because everyone is doing the same thing.

Over a decade working as an insider in London brokerage houses, working with the public, watching markets from 7am - 9pm, I witnessed first-hand the misfortunes of others.

I saw what trading with the wrong mindset could do — the damage some clients had inflicted on themselves, the unleashing of raw emotions from people completely unable to accept responsibility for the consequences of their actions.

It was upsetting and very unpleasant, and there was nothing I could do. Clients would beg us to reverse their positions, breaking down and in tears, or shouting and abusing us, unable to come to terms with the amount they had racked up in losses.

It was as if the light had gone out of their eyes.

I saw thousands of clients, many of them highly intelligent people, who, outside of trading and speculation held down positions of great responsibility, yet, engulfed by the market, they were completely unable to manage themselves while their trades were losing money.

After observing over 100,000 people, and close to 100 million trades, over a decade on the trading floor, predictable patterns of human behaviour came into the light.

Watching thousands of traders execute millions of trades, their behaviour, almost as if they were connected together in one hive mind was predictable in that, week after week, and month after month, year in, year out, when they were making a loss, they hoped the market would give them back their losses, yet, when they were making a profit, they feared the market would take it away.

They were fearful when they should have been hopeful.

They were hopeful, when, in fact, they should have been fearful.

These human experiences helped make me the trader I am today. Watching them struggle, I realised they were searching in the wrong place.

The answer they were so desperate to find is not found in the external.

It's not found in the software, or in any of the tools; instead, I realised, the answer, if not found in the objective, must be internal inside the self.

GLADIATOR

In the silence of the early morning, I'm in my office, preparing for the day's trading. Minimal and uncluttered, with four screens, you won't find water-cooled computers with flashing lights, no systems with monitors arranged like a drum-kit running news feeds and indicators.

Instead, apart from my screens, the keyboard and a mouse, there is a PowerPoint presentation on a screen. It is the key to my success. I should say it is MY key to success.

The PowerPoint file is my cue. At game time, before I begin to trade, it's time to become someone else.

In the movie Gladiator, why does Maximus Decimus Meridius engage in the ritual of rubbing dirt in his hands before combat?

It's a ritual.

He must immunise himself before battle, to feel nothing, to become an instrument of death, indestructible, so that he can survive another day.

Rubbing dirt on his hands is his ritual of leaving his old self behind.

Every day from 5am until 9pm, even late into the night, I am battling myself.

Trading is a battle of the self.

The PowerPoint file contains old trades, mistakes, triumphs, inspirations, and warnings visually arranged to prepare me for the day ahead.

I need to become something else; otherwise, I will not make money. This is why trading, when looked at from the outside looks simple, but it's not easy because trading successfully goes counter to virtually every piece of DNA stored in your body.

THE REPTILE MIND — WHO'S REALLY IN CHARGE?

In the 1960s, neuroscientist, Paul Maclean, proposed the human brain has evolved with three areas of function: The reptile brain, the limbic brain, and the neocortex.

The neocortex is the area that deals with logic, the part of your mind you can hear, the part you think is in charge.

It's not.

So, who's really in charge?

It's not the limbic brain. The limbic mind deals with belonging and status.

If you're driving a car with a BMW or Mercedes badge, it signals to everyone you have a higher status in life.

It's tribal.

Brokers target the limbic brain in their advertising, flashing images of success, using perfectly dressed, good-looking models, to entice you to join their tribe, implying that by doing so you'll belong to a high-status group.

It's your reptile brain, your base-self that's really in charge.

When you are startled, and you react, perhaps you detect a wobble in your stomach, a vibration in the lower back — that's your reptile mind preparing you for survival, triggering a fight or flight response.

Will you run, or will you fight?

Your subconscious reptile mind has only one function, and that is to protect you.

It does this whether you want it to or not.

And this is a problem because to be successful as a trader, you need to be very good at losing, and this means constant conflict with your built-in subconscious protection system.

A system that protected you from death as a caveman guarantees you'll not survive as a trader — unless you can learn to overcome it.

And overcoming it begins with accepting pain.

RUN TOWARDS THE DANGER

The perfect speculator is made, not born.

Neurobiology has shown we experience a financial loss 250% more intensely than a financial gain.

Lean in, because here's the kicker — the loss does not have to be real. It can be in your mind, yet just as powerful.

And this causes behaviour patterns to show up, and be exploited, in any liquid market.

Just before you pull the trigger, have you ever asked yourself if anyone else feels this way? When you can't take it anymore, do you ever wonder if there's anyone else on the same emotional rollercoaster as you?

The intensity spike of a loss, real or otherwise, is an emotional cocktail that causes an otherwise intelligent person to act impulsively.

People will do anything to end the pain. Like a crack addict looking for an axe, their brain short circuits and they react.

Pain is inevitable to some degree in life. Someone lets you down, you feel pain. Someone hurt you emotionally or physically, you feel pain.

In life, outside of trading, one way to deal with the pain is to talk to someone, as the saying goes — a problem shared is a problem halved.

Why a painful experience feels less potent after we have shared it with a friend I don't know. Maybe the act of verbalising the disappointment puts the problem into a healthier perspective.

Either way, you feel better, and the pain subsides.

But, when I'm trading, while the majority look to run away and rid themselves of pain, I do the opposite. I run towards it. I embrace it.

Whether you are new to trading and speculation, or you have years of experience, you should give this question some serious thought:

If you want to be a success in a field where 95% or more fail, how do you think you should approach this task?

Trading looks easy on the outside, but, in reality, it's much more challenging than people expect because we are hard-wired to do the opposite of what we should be doing, and this is why ninety-five out of every one hundred people end up losing.

The road to consistency, success, and enlightenment in trading begins in the last place you'd ever think to look.

Inside yourself.

THE KEY

So, here it is. What follows is the key to unlock the door to your success, the key to breaking down the barrier between the life you want and the life you are leading now.

If you want to succeed in an endeavour where 95% are failing, you have two choices.

You can study the large 95% losing group and do the opposite of what they do, or you can replicate what the 5% do.

If you are not as successful as you want to be, at some point, sooner or later, you need to change your behaviour.

It doesn't matter if you've been trading unsuccessfully for three months or thirty years, you are much closer to success than you realise.

The 95% fail because they interpret the pain messages received automatically from our hard-wired reptile brain without any modification.

You need to learn to recode your brain's messages when pain comes knocking.

Instead of reacting and running away, a small group of consistent traders, the 5%, hold fast and run towards the danger — not away from it.

The 5% succeed because they have learned to flip the switch.

Flip the switch!

This will feel very uncomfortable, but it is a discomfort you must accept and embrace if you want to succeed in the game of financial speculation.

It is the reason why trading looks simple but is not easy.

The paradox of trading is this: By doing what the 95% cannot do, you will become successful.

RECODE

Now you know what you must do, how do you go about doing it? Let me get specific!

A master trader from the Chicago Mercantile Exchange trading pits gave a talk to his trading colleagues.

Everyone knew he was the best trader, and packed into a tiny auditorium they hung on every word, hoping they could extract the key to success.

They didn't leave disappointed.

He gave them three commands that dictated his trading life — Commands that I use as the backbone of my trading philosophy — commands that you should use too.

1: I assume I am wrong – until proven otherwise. 2: I expect to be uncomfortable.

3: I add when you subtract, and I subtract when you add.

The commands are the difference between winning and losing, between consistency and success, between the large group that fail and the 5% that don't.

Here's how the 95% losing group behave when they trade, compared and contrasted against the mindset and the actions of the 5%.

COMMAND 1: ASSUME YOU ARE WRONG

Remember, I've watched thousands of traders execute millions of trades, and I noticed when most traders enter into a position, they assume they are right.

In a business where 95% of people fail, your recoding process begins by flipping the switch.

Flip the switch!

It starts with this: Assume you are wrong.

You should assume you are wrong – until proven right.

Through years of observation, here's how the typical member of the 95% group trades.

TRADE ENTRY: 95% BEHAVIOUR

The 95% enter a trade.

The trade moves in their favour, and they're happy. But their happiness doesn't last long.

Almost immediately, after their position goes into profit, they wonder how far the market will move, and they begin to worry where the move will stop, causing them to feel pain.

Wanting the pain to stop, they close the position, and, removing their pain, they're happy again.

But, by exiting the trade based on the need to end their pain, 95% behaviour now bifurcates into two equally destructive pathways depending on what the market they've just exited does next.

PATHWAY ONE

The market continues moving in the same direction in what would have been in their favour, and they begin to feel anxiety because they're no longer in the market.

With their pain increasing, they regret closing the trade, and they contemplate going back in. They are no longer trading the market. They are trading with their emotions.

PATHWAY TWO

The market reverses, and they feel elation having got out in time. They saved their open profits by closing the trade, telling themselves how good they are at timing the market.

They acknowledge their pain command centre. It was right, but they are now ruled by their pain threshold.

Now it's only a question of time before their emotionally driven pain threshold centre sends them a false signal, causing them to lose.

Welcome to the 95% group — a rollercoaster ride of disappointment, losing money, and pain.

Instead of assuming they are right, here's the mindset of the 5% when they enter a trade.

TRADE ENTRY: 5% BEHAVIOUR

They enter a trade, and the trade moves in their favour.

They're not trading their account size or the available profit — they are trading the market because they understand the size of their profit is irrelevant to the market.

Knowing their profit and loss has no influence on the market, and recognising the fear in their mind as the move continues, they too worry the move will stop, and just like the 95%, they feel their brain's automatic pain receptor kick in causing an in-built safety reflex to register pain.

The 5% are subject to the same built-in automatic pain receptor as everyone else, but the difference lies in how they handle the pain. Instead of giving in to it, instead of being ruled by their emotional responses, they have flipped the switch, they have trained themselves to expect the pain.

Flip the switch!

They're aware of the pain. They don't ignore it, they accept it.

They remind themselves that their actions, if based on the need to end the pain, will dictate which group they will end up in, either the 95% or the 5%.

Maybe the market continues higher. Perhaps it doesn't. It doesn't matter because the 5% are not shaped by the outcome, they are shaped by their continuous process.

They understand if they focus on the process, the outcome will take care of itself.

The big difference between the few and the many is how they deal with emotional pain.

COMMAND 2: EXPECT TO BE UNCOMFORTABLE

First, here's how the majority of traders deal with being fearful in a trade.

HOW THE 95% NEGOTIATE WITH PAIN

Some day traders and swing traders attempt to negotiate with their mind's inability to handle discomfort and pain by using logic to trade.

It's a flawed process. Yes, of course, it makes sense to risk ten to make twenty, but the 95% never let the market get to twenty, having closed the profitable position long before it gets there.

Others take half profits along the way, compromising, giving in to the pain, they close half their position, telling themselves it's part of the plan.

They're still in the market but have a smaller position; their pain subsides, and they feel better.

As the market moves further in their favour, the pain builds up again, and, with the voice in their head telling them the move is surely over, they exit the trade, closing the other half of the position.

Justifying their actions, they repeat the mantra, 'you can't go broke taking a profit' to ward off the encroachment of pain as the market continues moving further and further in their favour — without them.

Their pain becomes ever more intense as they count the potential paper profits they would have made — if only they had stayed in — but they didn't.

Remember the pain receptor kicks in whether the loss is real or virtual.

They didn't exit the position because of a signal from the market. They exited because of a signal from their emotional brain.

They traded on emotion, assuring their permanent membership of the 95% club.

In contrast, this is how the 5% deal with their trading emotions.

HOW THE 5% NEGOTIATE WITH PAIN

The market moves in their favour, and just like the 95%, they feel pain. The difference is the 5% expect the pain and embrace it.

What if the market takes some of the profits away?

They understand the feeling of pain is a built-in instinct, part of the mind that's there to ensure their survival.

Again, the 5% flip the switch. They don't trade their pain; they use the pain as a guide.

As the market moves in their favour, the 5% aren't impervious to their in-built emotional safety switch, but they don't snatch their profit by exiting all, or a percentage of their position like the 95% do.

Instead, they add to their position.

If the market is going up and they're long, they buy more. If the market is going down and they're short, they sell short more.

As the market is proving them right, they focus on the process.

The pain builds up as the market moves further and further in their favour, their protective mind telling them to take profits, but, aware of the pain and the consequences of making decisions based on it, they flip the switch.

Instead of exiting all or part of the position, they add more.

While the 95% justify their actions, telling themselves they'd go broke by not taking a profit, the 5%, flip the switch.

Repeat after me: You can go broke taking a profit.

As you've just seen, the 5% add to their positions when the market moves in their favour, juxtaposed to the 95% who react to their emotional safety switch and exit or reduce their position size when they are showing a profit.

What happens when a trade doesn't go your way — what happens when you're losing?

Let's talk about command number three.

COMMAND 3: I ADD WHEN YOU SUBTRACT AND SUBTRACT WHEN YOU ADD

First, here's how the 95% react when they're losing. And, remember, I'm not repeating factoids from a book, what I'm showing you comes from years of empirical observations from my time working in the brokerage business.

HOW THE 95% REACT TO A LOSING TRADE

They buy. The market falls, and their mind tells them to buy again.

Outside of trading, in ordinary everyday life, your mind looks for bargains. Marketers know it, enticing you with special offers. You love saving 25%. It might work in the supermarket. Thinking this way, the 95% decide to buy more. But, the "supermarket effect" does not work in the trading business.

The market falls again, locking the 95% into a single emotionally driven thought: Where is the low?

Flip the switch! It can go lower.

With their thoughts controlled by the fear of the pain caused by taking a loss, all they can think about is how they'll feel if they get out now just when the market is about to make a low and turn higher.

Adding when the market goes against them, they are locked into inaction, their brains short-circuiting, as they are unable to flip the switch to counter their in-built safety mechanism.

Focusing on the low, their capital at risk, and the need to be right, is why they lose — sometimes everything — I've seen it happen.

Instead of this inner conflict, how do the 5% deal with losing?

HOW THE 5% REACT TO A LOSING TRADE

They buy. The market falls. Their mind tells them to buy again — but they don't.

Aware of the supermarket effect, aware of the pain receptors, aware of their endocrine system pumping adrenaline and cortisol preparing them to fight and combat stress, they expect this reaction and have learned to live with it.

The 5% understand the financial markets are not like a supermarket and have no memory of past prices; instead, the 5% know supply and demand dictate the price.

Just because something has fallen in price does not make it cheap.

The 5% start by assuming they are wrong when they enter a trade.

And, if the position is losing, it has proven their initial assumption right.

With conflict neutralised, they take the loss.

This is the key to successful market speculation — it's what the 5% know.

HOPE IS NOT A STRATEGY

At any given point in time, you have three options as a trader.

You can buy.

You can sell.

You can do nothing.

For nearly a decade, I observed tens of thousands of people execute millions of trades. Their behaviour falling into three broad categories:

1: The market was falling significantly, so it appeared cheap. The clients were buying. They LOVED trying to find the low of a move.

2: The market was rising significantly, so it appeared expensive. The clients were selling short. They couldn't conceive the idea they should be buying.

3: The clients were entering into an existing trend, but their entry was a reaction to watching prices move without them. Entering at any price was the only way they could end their pain.

Trading like this kills client accounts.

If you've been around long enough, you'll know the market has many aphorisms that have become axioms.

Probably the two most common are 'trade with the trend', and 'keep your losses small and let your profits run'.

If this advice is easy to follow, how can you explain why 95% of traders end up losing money.

When the loss is small, there is no urgency. There is just complacency.

As the losses rise, the sense of urgency rises with it, but still, 95% of traders don't act; instead, another emotion kicks in.

Hope.

But, hope is not a strategy.

When losing, initially, the 95% hope the loss will become a profit. They are not afraid yet and hoping they are right, they have no fear that their loss will become much bigger.

Only when the pain of being in a losing position becomes unbearable, do they act. As a group, you can see the footprint of their collective panic and emotionally driven action as price reverses on huge volume.

Emotions kill trading accounts. It isn't the lack of knowledge that's stopping you from winning big. It's the way you handle yourself when you are in a trade.

I spent a decade observing traders lose money. They were intelligent people who often had great hit-ratios, but they couldn't lose.

After reading this far, if you remember only one thing, remember this: In trading, unlike life, the best loser wins.

THE £100,000 DAY

Like most people, I assumed by studying I would become a successful trader — and I've studied technical analysis.

They say you become an expert once you have done something for 10,000 hours. By the time my first decade in trading was over, I had spent 25,000 hours watching live charts, yet I was still nowhere near making the money I knew I could make.

The next decade was spent working with charts and my mental make-up in equal parts — Equal parts, with emphasis on mental preparation.

I remember my first £100,000 day.

To make that kind of money you need the right type of day — a day where the market trends in one direction all day from the open to the close.

I was short that day. The market kept falling and falling. I remember thinking only one thing: Where can I add to my short positions?

Just before the close, I closed out all my open positions and, when the day was over, it occurred to me I had not felt fear — not once.

I had stayed so focused in the present moment, so completely in line with the rhythm of the market, that when the market moved counter to my position, I used it as an opportunity to enter a new short position.

Not once did I think about buying the low. After spending years observing people trade, the most common mistake is trying to pick the low, so you can buy in cheap.

As a private trader, trading from home, £100,000 days like this don't just happen.

You need to be ready on so many levels. When I look back over my trading diaries, I can identify five barriers, or road blocks that adversely affected my trading performance, and I didn't begin to make good money until I understood their influence over me and how each one affected my decision making.

ROAD BLOCKS

Let's talk about fear.

FEAR

Fear is unavoidable in trading and in life. Accept it.

Accepting a certain level of anxiety is to be expected, as long as it doesn't paralyse you.

Some years ago, while on holiday with my family, my young son fell into the swimming pool at the deep end.

There were four adults in very close proximity to him, as well as the lifeguard. I was fully clothed from a business meeting: suit, tie, the works. I was 20 meters away.

Time stopped. Before anyone could react or move, I had jumped over four sun loungers and dived feet first into the pool. My son was not in there for more than a few seconds before I had him safely back in my arms.

Like the adults who froze when my son fell into the pool, when I was trading, I had to learn to recognise the situation, realise the fear and react to it, much more quickly.

In trading, fear comes when you're losing.

I had to learn to lose before the market gave a reason to be fearful.

This meant taking lots of small losses before any of them had the chance to manifest in a large paralysing loss.

Over time, I became an expert at taking losses, and once I did, counter-intuitively, my trading results improved dramatically.

Next, the main reason the majority fail.

HOPE

Hope is the main reason why the 95% never make money trading. They hope their small loss will turn into a winner, never entertaining the idea their small loss will

become a big loss, overwhelming and paralysing them with fear, leading to, more often than not, complete account destruction.

Hope and fear are two dancing partners that I had to learn to keep in balance.

In trading, it's easy to be fearful and hopeful at the same time. I've spent countless hours visualising trading situations, running large profitable positions and managing my emotions in my mind, readying me for optimal personal performance when I trade for real — a technique I learned from Formula One drivers who also use this technique to enhance their performance.

Another trait you'll need to overcome is what some call boredom, but if you go deeper, it's nearly always this.

GUILT

Outside of trading, Western societal norms adhere to the Protestant work ethic.

We are programmed from birth that nothing is free, and you must work hard and be a productive member of society.

In short, when they do nothing, a lot of people feel guilty. And, when the market opens, they think they have to be productive and do something.

This is something I struggled with at first, and I had to really fight my desire to do something just because the market was open.

The mind doesn't like to be idle, and to learn to still the mind is a lifelong endeavour.

At the beginning of my trading career, like a young over excited child, I threw myself into all sorts of trades without much thought of the outcome. I wasn't trading to make money. I was trading to be productive.

Going over my old trades made me realise this flaw.

Some people might say they trade out of boredom, but that's only the excuse, dig a little deeper, and you'll find it's nearly always guilt.

The market does not pay by the hour. A large part of trading success comes from doing nothing. My trading performance improved once I was aware of this trait.

The trading business attracts a lot of Alpha personality types who have been very successful in other areas of their lives, yet, Alpha, or not, one thing that needs to be kept in check is self-confidence.

CONFIDENCE

Over the years, I've observed myself and other trading friends go through transformations. Some of us have experienced great success. Some haven't. Some gave up for a while. Some persisted. Some had great results for a time, only to lose it all again.

You need to have faith that your process and your trade plan can generate consistent results. To trade well, you need to be confident.

You'll need all your confidence when one trade after another ends in losses. Remember though, by starting right, by assuming you're wrong, you are going to avoid the constant conflict, the confidence-sapping grind that 95% of traders are going through.

However, what I learned the hard way, the times I was most vulnerable was not when I was at my lowest.

I was most at risk when I was feeling overconfident, usually right after a big winning trade.

My biggest losing days always came after big winning days. Confidence is good. Overconfidence leads to ignoring your vital brain signals.

Put simply, when you're overconfident, you'll forget to flip the switch.

MARKET LOGIC

The financial markets operate perfectly, but the reasoning behind the movement is much more difficult to interpret when engaging with the market in real-time — so don't try.

Even after two decades of trading, I am still surprised by what can happen.

On Christmas Eve 2018, I had one of my biggest trading profits ever, as the Dow Jones Industrial Average fell almost 800 points — even though the market closed early for the holidays.

I remember closing my positions via my mobile phone, as I tucked into my Christmas dinner, smiling.

It felt good.

Two days later, on the 26th December, the Dow staged the biggest one-day rally ever. I caught half of it, and then I turned to shorting again.

I remember thinking that logic had to prevail at some point, as the rally just couldn't continue higher, but it did.

I lost because I expected the market to be logical. It isn't.

And, as the old saying goes, the market can remain illogical longer than you can stay solvent.

FINAL THOUGHTS

One last thing, a word to the wise.

As a consistent, successful trader, you will continuously be at war with your in-built defense mechanisms.

You'll have personal flaws, and trading is where you'll find out what they are.

Accept them and work to neutralise them. I work on mine every day before I trade — even after decades in the market.

It's impossible to completely remove all your flaws, so think of it as a continuous never-ending process. Don't think you can "dabble" in improvement.

And don't worry if you find out you're not perfect because no one is. Certainly not me.

Always remember, the perfect trade does not exist. So don't try and fill a hole you can't fill.

I've made many mistakes along the way; my success certainly wasn't overnight.

I took years to break through the market dogma and my own personal biases to realise the elegant simplicity of successful trading.

Don't underestimate what it takes to become a successful trader. It's simple, but not easy.

Success is not found spending 25,000 hours staring at charts, it's not found in software — no matter how expensive, in newsletters, indicators, or seminars.

It's found by accepting we all feel pain when putting capital at risk and in giving up control and trying to be right.

By flipping the switch and assuming you are wrong and not right when you enter a position, you can neutralise the combative emotions that rob success from so many.

Fear, hope, boredom, overconfidence, and logical thinking are always there, waiting for the unwary.

Instead, success is found by flipping the switch. I wish you the best.

Tom Hougaard.

Introduction

“Removing fear from trading is a function of learning how to think in probabilities.”

-Mark Douglas

Do you constantly feel fearful or hesitant before pulling the trigger on trades?

Do losses shatter your confidence?

This is likely because you are still stuck in thinking about trading on an individual outcome basis rather than probabilistically.

Expecting to be "right" on each trade is an unrealistic goal given the inherent randomness and unpredictability in markets.

But when you shift to a probabilities paradigm, consistency and emotional control become possible.

Because you reach a state of carefree trading.

Trading without fear is a LEARNED skill.

This guide will help you overcome trading fears by developing the mindset of a professional trader - thinking in terms of edge, risk management, and long-term probability distributions rather than hoping to predict each tick.

You will learn that flawless execution of your edge over many trades is the only reliable path to profitability.

The outcome of any single given trade is largely outside your control. But your actions are completely within your control.

Along with foundational principles, you will get concrete exercises to start practicing probabilistic thinking right away.

This will transform your mentality from nervous speculating to confident expectancy executing.

If you dedicate yourself to mastering the probabilities paradigm, you will gain the perspective and skills to act decisively amidst uncertainty.
Your trading fears will rapidly fade in the face of rational process orientation.

Let this book guide you down the path of thinking, planning, and behaving like a professional trader.

You already have immense potential - now it's time to unlock it.

Let's begin the journey…

Section 1 - The Probabilities Paradigm

The root of most trading fears is the expectation that you should be able to predict the outcome of each individual trade.

This mindset assumes markets move in a fully predictable way and that you can determine the result of every setup in advance.

But the truth is far messier.

Markets have a built-in randomness - you never know the exact buy and sell orders queuing up that will influence price action.

At best, you can determine probabilities through having a trading edge.

That's why the professionals operate within a probabilities paradigm.

They understand there will always be a random distribution of wins and losses. Any edge just provides improved odds over a series of trades.

Your trading method could give you a historical win rate of 60%, 70%, or whatever number.

Expect this to hold true over 100+ trades. But in the short run, there will be fluctuations.

It's crucial to detach emotionally from the result of any single given trade.

One win or loss means nothing by itself. Your focus should be flawless execution of setups matching your criteria.

Over time, if you maintain consistency in applying your edge, the law of large numbers ensures your probabilities will play out as expected. But it takes patience and mental discipline.

The probabilities paradigm aligns your expectations with how markets actually behave.

This grants the perspective needed to act decisively without hesitation or fear. You accept uncertainty and randomness.

So embrace thinking in terms of probabilities rather than obsessing over predicting each tick.

This opens the door to fearlessness and consistent profits.

Section 2 - Developing an Edge

To operate within a probabilities framework, you first need a statistically valid trading edge.

An edge is essentially your trading strategy combined with sound risk management.

The first step is extensively backtesting your strategy over a large sample size of trades.

Be sure to use appropriate position sizing.

From this backtest, you should be able to quantify your edge's win rate, risk/reward ratio, expectancy, drawdowns, and other key metrics. There will be an exercise in section 5 that will walk you through this process.

For example, you might determine that historically your edge achieves 65% winning trades at a 3:1 risk/reward ratio resulting in solidly positive expectancy.

Keep in mind markets evolve, so expect some deviations from backtest results. But they provide an invaluable quantitative starting point in the absence of real trade data.

It's also essential to understand conceptually how your trading edge interfaces with market dynamics.

For instance, are you aiming to capitalize on momentum, supply/demand, support/resistance?

Know how profits will theoretically be generated.

A sound trading edge is grounded in market principles, not just backtested results.

This allows you to trust it and act without hesitation when statistically favorable setups appear.

So spend time rigorously developing and quantifying your edge.

It's the foundation for embracing a probabilities paradigm rather than fearfully guessing which way markets will bounce next.

Section 3 - Trading is Execution

Once you have a statistically valid trading edge, the real skill becomes flawless execution.

Trading ceases to be about analysis and forecasting, but rather about disciplined implementation after your edge is established.

Markets can seem chaotic minute-to-minute.

But your edge provides improved odds - if you take 100 trades adhering to your plan, the probabilities inevitably play out in your favor.

The professionals know trade outcomes on and trade by trade basis cannot be predicted.

So they save mental energy by not even attempting to guess which setups will win or lose.

They purely execute.

This means taking every high-probability setup your system identifies, without hesitation or second-guessing.

Additional discretionary analysis is often fear in disguise.

Trading requires courage - the willingness to act without knowing the outcome.

But courage is easier when you have confidence in the probabilities on your side.

Flawless execution also means adhering strictly to your risk and money management rules.

Never adjust stops or size in an attempt to control results.

Outcome cannot be controlled, only process. So direct all focus and discipline into perfect entry and exit execution according to your plan.

Detach from win/loss thinking.

Don't celebrate or beat yourself up over the results of a single trade.

Remember, the distributions of wins/losses in your trading edge are RANDOM.

Remain centered on the process rather than prediction.

Trading is not a thinking endeavor, but an acting endeavor.

Develop your edge, plan your trades, then thoughtlessly pull the trigger.

Outcomes take care of themselves over time.

Section 4 - Planning and Reviewing Trades

To master execution, your edge must translate into a clear trading plan.

Every trade should have defined parameters for entry, stop loss, take profit, and position sizing.

Before entering each trade, walk through your plan again.

Visualize the ideal execution.

This mental rehearsal installs the pattern, making adherence easier.

Plan entries proactively based on setups, not reactively on a "feel" for the market. Let your quantified edge identify opportunities - don't force or chase trades.

Set stop losses according to your risk management rules rather than randomly. Determine upside targets based on probabilities, not greed or impatience.

Stick to your plan once in the trade. Avoid the urge to manually adjust stops or limits once the trade is live.

You lose objectivity after entry.

Review your trades like a machine afterward - dispassionately.

Compare actions taken to your trading plan. Did you execute properly? If not, make notes for improvement.

The key is removing emotion by planning trades methodically based on your edge. Then review trades against this plan.

Over time, executing your edge becomes automatic.

Planning converts abstract probabilities into concrete actions. Review keeps performance accountable to the plan, ensuring consistency.

Together they breed trust in the probabilities.

Section 5 - Probabilistic Thinking Mini-Exercises

Simply understanding probabilistic principles intellectually is not enough.

You need concrete practice to retrain your mind and override emotional habit patterns.

Use the following exercises to actively build skills for thinking rationally in probabilities rather than unhelpfully obsessing over predicting each outcome:

Track Stats in Trading Journal

Record key metrics like win rate, avg profit per win, average loss over sample sizes of 25 to 50 trades.

Watch probabilities emerge over time through ups and downs.

Catch Judgmental Thoughts

Notice when you label market moves or have an emotional response to an outcome. Ask if these align with probabilistic thinking. Release judgments.

Reframe Outcomes

When you win or lose, intentionally reframe your internal dialogue to be process focused.

"I executed my plan properly"

rather than celebratory or regretful thinking.

Focus on the Process

Make an intentional practice of directing mental energy solely into proper execution. Actively ignore projecting ahead or dwelling on what just happened.

The present moment and action is all that matters.

Building new habits requires dedication and patience.

But with deliberate practice, probabilistic thinking will transform you into a confident, consistent trader.

Conclusion

Developing a probabilities paradigm is the key to overcoming fear, hesitation, and inconsistency in trading.

But it requires commitment and discipline.

Thinking in probabilities means accepting uncertainty, randomness, and that the market outcome cannot be precisely predicted.

You detach from unhelpful concepts like being "right" or wrong" on trades.

Instead, your goal becomes flawless execution of a statistically valid edge while allowing wins and losses to fluctuate randomly around an average.

You act without needing to know the result.

This equanimity comes from aligning your expectations with how markets actually work. Probabilities are the lens bringing your actions and experience into focus.

While adopting this paradigm takes dedication, the payoff is immense. You gain the perspective and skills to act decisively in trading. No more analysis paralysis or hesitation.

Follow the principles and exercises in this book persistently rather than passively.

Know that some discomfort comes with developing any new habit. But probabilistic thinking will propel your profits if you stick with it.

You now have a roadmap to trade fearlessly like a professional. So commit to the probabilities paradigm and let it guide you to new heights of performance.

The time for change is now,

Trader Mind Mastery

The Disciplined Trader

Developing Winning Attitudes

Mark Douglas

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To Paula Webb for her love, understanding and being there throughout the process of writing this book.

Contents

Foreword

My unique position in the financial community has allowed me the rare opportunity to talk to and question thousands of traders, brokers, and trading advisors since 1979. I am not a broker or a letter writer. I am the chief executive officer of CompuTrac, a company that supplies technical analysis to stock and futures traders. I perceive my position as being neutral, one that allows people to open up and talk to me freely. I started trading for my own account in 1960 and very quickly became aware of the underlying psychological blocks to good trading and money management. This realization has been confirmed by all who have counseled with me.

As a result, I sincerely feel that success in trading is 80 percent psychological and 20 percent one's methodology, be it fundamental or technical. For example, you can have a mediocre knowledge of fundamental and technical information, and if you are in psychological control, you can make money. Conversely, you may have a great system, one that you have tested and has performed well for a long period of time, yet if the psychological control is not there, you will be the loser.

A good trader knows from experience that over a period of time he may engage in more losing trades than winning ones. But money management, and a careful assay of the risks protected by realistic stops, will keep the trader out of trouble and ensure that on the "big" moves, he will profit. Money management is composed of two essential elements: psychological management and risk management. Risk management stems from the psychological factors being truly understood by the trader and "in place" before risk is even considered.

I would especially caution new traders and market participants that reading and passively analyzing your motivations are certainly a necessity, but the acid test comes with active trading under pressure. Start slowly. Question every trade. What motivated it? How was the trade managed? Was it successful? Why? Did you lose? Why? Write down your assessment and refer to your comments before making your next trade.

At all major CompuTrac seminars I try to have a workshop leader address the attendees on the psychological aspects of trading. The grim reaper who kills off "your equity" and disappears with your profits is not the mysterious and ubiquitous "they" but a simple misguided "you." Medea said just before she murdered her children, "I know what evil I'm about to do, but my irrational self is stronger than my resolution." If this sentiment reflects your mind set when you trade, then The *Disciplined Trader* is definitely the type of book you should be reading.

What a pleasure to read this book. My own education cost me a lot "the hard way." I can read myself into the pages - that's me, that's me! Mark has carefully fashioned his book into a comprehensive logical dialogue. It reads as if you are at his side and he is explaining it as a friend, which I know you will enjoy. You are fortunate because you are taking the time now, before you have made a serious mistake, I hope, to learn about yourself and to study your craft. The traders who take the time to reflect and practice will survive and possibly prosper.

TIMOTHY SLATER
President
CompuTrac Software, Inc.

Preface

The Disciplined Trader is a comprehensive guide to understanding the psychology of self-discipline and personal transformation needed to become a successful stock or futures trader. This book will serve as a step-by-step guide to adapting successfully to the unusual psychological characteristics of the trading world.

I say "adapting" because most people venturing into the trading environment don't recognize it as being vastly different from the cultural environment in which they were brought up. Not recognizing these differences, they would have no way of knowing that many of the beliefs they acquired to enable them to function effectively in society will act as psychological barriers in the trading environment, making their success as traders extremely difficult to achieve. Reaching the level of success they desire as traders will require them to make at least some, if not many, changes in the ways they perceive market action.

Unlike other social environments, the trading arena has many characteristics requiring a very high degree of self-control and self-trust from the trader who intends to function successfully within it. However, many of us lack this self-control because as children we learned to function in a structured environment where our behavior was controlled by someone more powerful than ourselves, whose purpose was to manipulate our behavior to conform to society's expectations.

Thus, we were forced by external forces to behave in certain ways through a system of rewards and punishments. As a reward, we would be given the freedom to express ourselves in some desired manner. As a punishment, we would either be prevented from getting what we wanted, causing emotional pain, or we were inflicted with various forms of corporal punishment, causing physical pain. As a result, the only form of behavior control that we typically learned for ourselves was based on the threat of pain - either emotional or physical - from someone or something we perceived as having more power than ourselves. And since we were forced to relinquish our personal power to other people, we naturally developed many of our traditional resources for success (the particular ways in which we learned to get what we want) from the same mental framework. Accordingly, we learned that acquiring power to manipulate and force changes upon things outside of us was the only way to get what we wanted.

One thing you will learn as a trader is that the mental resources you use to get what you want in your everyday life will not work in the trading environment. The power and control that are necessary to manipulate the markets (make them do what you want them to do) are beyond all but a handful of individuals. And the external constraints that exist in society to control your behavior don't exist in the market environment. The markets have absolutely no power or control over you, no expectation of your behavior, and no regard for your welfare.

If, in fact, you can't control or manipulate the markets and the markets have absolutely no power or control over you, then the responsibility for what you perceive and for your resulting behavior resides only in you. The one thing you can control is yourself. As a trader, you have the power either to give yourself money or to give your money to other traders. And the ways in which you choose to do this will be determined by a number of psychological factors that have little or nothing to do with the markets. And this will be so until you acquire some new skills and also learn how to adapt yourself to suit conditions as they exist in the market environment.

To operate successfully in this environment you will need to learn how to control yourself in ways that may be completely alien to you.

You will also have to learn how to grant yourself the mental freedom to shift your perspective to notice alternative possibilities to getting what you want in the trading arena, regardless of your expectations of how you are going to get it. There are only a few traders who have come to the realization that they alone are completely responsible for the outcome of their actions. Even fewer are those who have accepted the psychological implications of that realization and know what to do about it.

Rarely do any of us grow up learning how to operate in an arena that allows for complete freedom of creative expression, with no external structure to restrict it in any way. In the trading environment, you will have to make up your own rules and then have the discipline to abide by them. The problem is, price movement is fluid, always in motion, quite unlike the highly structured events that most of us are accustomed to. In the market environment, the decisions that confront you are as endless as the price movements you intend to take advantage of. You don't just have to decide to participate, you also have to decide when to enter, how long to stay in, and under what conditions to get out. There is no beginning, middle, or end - only what you create in your own mind.

In addition to the negative psychological implications that accompany these decisions, you must be aware that even if you make the minimum financial commitment of one contract per trade (as in the futures market), there is an unlimited potential for profit as well as an unlimited potential for loss. From a psychological perspective, this means that each trade has the possibility of fulfilling your wildest dreams of financial independence, and simultaneously presents you with the risk of losing everything you own. The constantly changing price movement makes it extremely easy for you to ignore the risk and tempt yourself into believing you don't have to follow your own rules, this time.

Here is an environment that offers complete freedom of expression combined with unlimited possibilities and unlimited risk. If you place in it a participant who is oblivious to these psychological conditions (one who operates from a mental framework oriented toward external structure, constraints, and expectations), then what you have is a formula for emotional and financial disaster.

This grim scenario certainly explains why so few people ever make money as traders. Actually, almost all of those who make an attempt at trading completely underestimate the difficulty and consequently overestimate their ability to fulfill their inflated expectations. Therefore, most, if not all, people who trade inflict some degree of psychological damage upon themselves. I am defining "psychological damage" as any mental framework that has potential for generating fear.

Fear results from any belief about environmental conditions that has the potential to cause either physical or emotional pain such as stress, anxiety, confusion, disappointment, or betrayal. Painful emotional conditions are basically the result of unfulfilled expectations. Unfulfilled expectations create a conflict between a person's beliefs about the way things should be and the actual environmental conditions that don't match those beliefs. This conflict is expressed through our emotions in the form of pain that we generally label as stress, anxiety, confusion, and so on.

People seem to avoid pain instinctively by building up mental defenses against the intrusion of environmental information that would confirm the existence of any conflict. These defenses consist of denials, rationalizations, and justifications - all of which will result in perceptual distortion.

"Perceptual distortion" occurs when our mental system automatically distorts environmental information by shaping and selectively excluding certain information to compensate for the conflict between what we expect and what the environment is offering us. This will be done in such a way that we will believe a shared reality exists between ourselves and the outside environment, thus avoiding any pain. I am defining a "shared reality" as a correspondence between one's beliefs about the environment and the actual environmental conditions that exist.

If you are distorting market information, you are not sharing a reality with the markets, and you are also indulging yourself in an illusion, to the extent that you hide from the possibility of disappointment. At this point, you would be setting yourself up for what could be called a "forced awareness." Obviously, if the markets are doing something other than what you are allowing yourself to perceive (because some, if not most, of the information the markets have to offer won't validate what you want or hope), then something has to give. These distortions will continue until there is such a disparity between your acquired mindset and the conflicting market information that the mental defenses (illusions) will break down. This usually creates a state of shock, where you may wonder how things could get so bad so quickly.

In such a situation, the market forces you to confront your illusions of a shared reality, creating a painful forced awareness. At some point in your trading career you will need to understand how all of us, because of our common upbringing, try to control market events through our perception of what we think will happen next and then rigidly hold on to these expectations. This is where you need to learn how to gain the kind of mental flexibility that allows you to shift your perspective to be aware of other alternatives and possibilities. You may not be able to control the markets, but you can control your perception of them in order to achieve a higher degree of objectivity, resulting in a higher degree of shared reality with the markets.

As painful as these forced awarenesses may be, they are not likely to deter you from being attracted to the opportunities the markets have to offer. However, the cumulative psychological effect on you will be very negative. If you have suffered through several forced awarenesses, your perception of market activity will eventually become heavily weighted towards avoiding pain instead of seeking opportunity. Your fear of losing money, being wrong, or missing an opportunity will become your primary motivation to act or not act.

Now, there are several major problems that result when fear becomes a motivation to do or not do something. First, it will limit your range of perceived opportunities by narrowing your focus of attention, keeping it on the object of your fear. This means that out of all available market information, you will only perceive information that will, in effect, validate what you fear the most. Your fear will systematically exclude from your awareness market information that would indicate the existence of other alternatives and opportunities.

As you begin to understand the negative relationship between fear and perception, you might be surprised to learn that in your attempts to avoid losses, you actually create them. Fear will also limit your range of responses to any given situation. Many traders suffer considerably when they know exactly what they want to do but, when the moment to execute arrives, find themselves completely immobilized.

Before anyone can become successful in an environment with the unstructured character of the trading environment, one needs to develop a supreme sense of self-confidence and self-trust. I am defining self-confidence as an absence of fear and self-trust: knowing what to do at the moment it needs to be done, and then doing it without hesitation. Any hesitation will only create self-doubt and fear. To whatever degree self-doubt exists as a state of mind, to that same degree you will feel fear, anxiety, and confusion.

The negative experiences that result from trading in a state of fear, anxiety, and confusion, will create or add to an already-existing belief of inadequacy and powerlessness. Regardless of how hard any of us may try to hide from others what is going on, we obviously can't hide our results from ourselves If the market's behavior seems mysterious to you, it's because your own behavior is mysterious and unmanageable. You can't really determine what the market is likely to do next when you don't even know what you will do next, regardless of what you may perceive or want.

The few successful traders who have, in some way, transcended these psychological obstacles have been generous with their one-line gems of trading wisdom: "Learn to take a loss," "Go with the flow," "The trend is your friend," "Cut your losses and let your profits run," "To know the markets you need to know yourself," and on and on. The *Disciplined Trader* fully explores, breaks down, and then organizes the psychological components of this advice into a step-by-step learning process, a process that takes you through the various stages necessary to orient yourself successfully to the trading environment. This book will explain to you what skills are necessary, why you need to understand them, and most important, how to go about learning them.

This book is organized in four sections. The first consists of the first two chapters and serves as an introduction. The second consists of Chapters 3 through 8 and defines the problems or challenges of becoming a successful trader. The third section consists of six chapters that will give you the basic insight you will need to identify what has to be changed in your mental environment and what you can do to change it. The fourth section consists of Chapters 15 and 16 which put everything together into a unified framework to develop specific trading skills. You will learn how to observe market action from an objective perspective, determine where you need to limit yourself, and establish the steps you will need to take to expand those limitations in a productive and psychologically healthy way.

Acknowledgments

Most people are probably well aware that writing a book is a very difficult task, one that often requires the help and support of a number of people in the author's life. There are a number of people I want to acknowledge as being instrumental in helping me make this book a reality including my parents, John and Helen Yosin; my brothers and sister - Craig, Dean, and Sandy Yosin - for all their love and support; Brad Johnson, my partner in Trading Behavior Dynamics, for all of his patience and kindness; Jim Sutton, Bonnie Marlowe, Jake Bernstein, Elizabeth McKinsey, Michael Headley, Steve Sukenik, and Jack Carl for helping me get started; all of the traders that I have worked with over the last six years, especially Jim Griswold, Jerry Stahlnecker, Jack Brassuel, Steve Bianucci, Mike Gamble, and Chuck Pettet for their friendship and support; Tim Slater for giving me the opportunity to express myself as a speaker and a writer; Rich Miller for his support and being a good friend; Lori and Nikki Marlowe for the happiness they brought into my life; and most of all, my friend and fellow author Kurt Leland for everything he has taught me and for showing me the way.

PART I

Introduction

CHAPTER **1**

Why I Wrote This Book

Since I started working on this book - in the summer of 1982 - nearly every dimension of futures trading has exploded in growth. There are brand new exchanges, new contracts, more advisory and news services, an increasing variety of books and publications, and ever more sophisticated technical trading systems, most all of them with computer applications to make it easy to track the markets. However, even with this tremendous growth in services related to trading, one inescapable fact remains: there is still a very small group of sophisticated traders who take the greatest percentage of profits out of the markets, making well over 90 percent of all the other traders net losers year-in and year-out.

In futures trading for every dollar of profit gained by one trader, there has to be an equivalent dollar lost by another trader. If a few traders are consistently making money on a grand scale, then their profits have to be coming directly out of the pockets of the thousands of other traders who very faithfully contribute to their daily winnings. Some of these very successful traders are public figures, but most are only known in the Chicago or New York areas. Needless to say, everyone wants to know what they do and how they do it.

There must be a difference between these two groups of traders - the small minority of winners and the vast majority of losers who want to know what the winners know. The difference is that the traders who can make money consistently on a weekly, monthly, and yearly basis approach trading from the perspective of a mental discipline. When asked for their secrets of success, they categorically state that they didn't achieve any measure of consistency in accumulating wealth from trading until they learned self-discipline, emotional control, and the ability to change their minds to flow with the markets.

First, I want to point out that self-discipline, emotional control, and learning to change one's mind after making a commitment are all psychological issues that have nothing to do with news services, advisory services, new exchanges, or technical or fundamental trading systems - computerized or not.

Second, from my trading experiences, observations, and research, I have discovered that all traders - both winners and losers - seem to share some very common experiences. Either in the beginning or at some point early in their trading career, all traders experience confusion, frustration, anxiety, and the pain of failure. The few-traders who pass through this phase to accumulate wealth are those who eventually confront and work through some very difficult psychological issues about what it means to be a trader, and this process of realization and change normally takes several years, even for the best of them.

If self-discipline and emotional control are the keys to success, they are also not necessarily traits any of us are born with. On the contrary, they are characteristics we acquire by learning certain mental skills. Acquiring these mental skills is often the result of a trial-and-error learning process that can be very costly financially and usually filled with emotional pain and suffering. The biggest problem with a trial and error approach in trading is that most people lose all their money before they get through the process. And other traders who have enough money to keep on trading never fully recover from the effects of the psychological trauma they have inflicted on themselves to ever learn how to trade successfully on a consistent basis. This leaves only a relatively small number of people who make it.

All the great traders, both past and present, have found it very difficult to explain what it is they do, how they do it, and more important, the progression of steps they took to get where they got. Many would gladly share with others what they know about the market and its behavior but not necessarily about their behavior as individuals. They would, however, often caution those who sought their wisdom to understand that all the market knowledge in the world won't do them any good until they learned what can be called self-discipline and emotional control, without necessarily being able to explain what they were.

For instance, "Cut your losses short" is great advice that is often given as an axiom of trading wisdom. But how do you explain to someone the steps needed to learn how to do that? Especially when he is interacting with an environment that is in perpetual motion and will always offer him the possibility that the market can come back and make him whole, if he is in a losing trade. If you take into consideration that his money and self-esteem are at stake and the market coming back is always a viable possibility, regardless of how remote it may be, then you can see how difficult it is to explain why he needs to "cut his losses." It is even more difficult to explain how he can do it in a way that suits his unique psychological makeup.

The easiest way to explain how to apply this type of wisdom, without actually explaining it at all, is to say, "Well, if you want to be a successful trader, you need to learn self-discipline and emotional control." I don't believe this type of vague advice was intentional, however, for principally two reasons. First, self-discipline and emotional control are abstract concepts that are not easily explained or understood. We all hear or read the words a lot, but ask anyone you know to define either of these concepts, and you'll probably get a blank stare.

Second, today's successful traders started out their journey without maps, signposts, or guidelines or the benefit of knowing exactly where they had to end up, from a psychological perspective, to accumulate their fortune. They had to explore the trading world through a means of self-reflection and readjustment that was very demanding and time consuming. One could say they more or less stumbled through it learning from each mistake, many small and others that were devastating both financially and emotionally.

At some point, they probably realized that something about themselves had changed because the normal kind of market activity that once had a very negative emotional impact on them, like anger, stress, anxiety, and fear, just didn't have that same effect any longer. They must have gained some measure of confidence in themselves to respond appropriately to all possible market conditions because there is a direct correlation between a person's level of confidence and the negative emotions mentioned. Confidence and fear are states of mind that are similar in nature, only separated by degree. As a person's level of confidence increases, his or her degree of confusion, anxiety, and fear dissipates proportionately.

This confidence would naturally develop as people learned to trust themselves to do whatever needed to be done, without hesitation. As a result of this kind of self-trust, they would no longer need to fear the seemingly unpredictable and erratic behavior of the markets. However, the main point I am making here is that the process of change that took place was in the mental environment and psychological makeup of each individual trader; the markets didn't change, the tools that were used didn't change, the trader did.

Now, when traders go through a transition in their personal development and learn a new skill on a trial-and-error basis, it is unlikely that they would keep a detailed record of the steps to that learning process, especially if that process was characterized by pain, anxiety, and frustration. Obviously, if someone doesn't know exactly how they acquired the skills they now have, then, naturally, it would be extremely difficult for them to explain to someone else how they got them.

Besides, when it comes to trading, once someone is making the kind of money he had always dreamed of, there isn't much incentive to spend the time and energy necessary to break down these abstract skills into an effective learning process from which others can derive some benefit. Developing educational programs to explain how to become a successful trader requires a completely different set of skills from the skills necessary to be a trader. As will be explained in a moment, the learning process and the kind of personal transformation that was necessary to enable me to write this book was distinctly different from the kind of learning process I experienced as a trader to realize why a book like this needed to be written. One learning process was chosen and the other was forced.

What I mean by forced is, I had to lose my house, my car, and practically everything else I owned to learn some of the ways in which I needed to change my perspective to operate in the trading environment effectively. Losing all my possessions was a complete life-altering experience, an experience that taught me a lot about the nature of fear and the debilitating effects it has on a person's ability to trade effectively.

The kind of insight I gained as a result of this experience is the type of learning process I call a forced awareness. This is where the nature and characteristics of the environment I was operating in were much different from what I believed they were, first out of ignorance, and because I put up mental defenses to block my perception of certain information. Eventually I was forced by the markets to acknowledge many things about myself that I otherwise wouldn't consider. When all the external symbols that represented a major part of my identity were gone, I didn't have any other choice and was forced to perceive myself in new and different ways.

These events occurred in March 1982. At the time, I was an account executive with Merrill Lynch Commodities at its Chicago Board of Trade office. Less than a year before, in June 1981, I moved from the suburbs of Detroit where I was enjoying, at least financially, a very successful career in commercial property and casualty insurance. I left Michigan and success to move to Chicago and be a trader. I went to work for Merrill Lynch because I didn't have enough money to buy a seat at the Board of Trade or the Chicago Mercantile Exchange and didn't know that you could lease seats at that time.

I had an expensive apartment on the gold coast of Chicago and a Porsche; I was maintaining a house in an affluent suburb of Detroit that my girlfriend and her two daughters were living in; and I was driving or flying back and forth between the two cities almost every weekend to visit them. I was under extreme financial pressure to succeed because my life-style expenditures were far and away in excess of what I could afford. Unless I made it big as a trader, it would be very hard to reconcile some of the decisions I made to put myself in that kind of a situation.

By the time I moved to Chicago I had already been trading for over two years. Twice, before moving, I lost all my trading capital. Of course, I would quickly save up and start again. My brief periods of success and few winning trades were enough to justify that I continue trying. Once I was very close to making over a quarter of a million dollars on a trade, but I pulled out of it just before the big move. This devastated me, but I also became completely hooked on trading and even more determined to be successful. From that experience I decided to buy all the books I could get and attend all the seminars I could afford.

Something stated in virtually all the books I read was that it is very difficult to learn how to trade or sustain any success if one is under a great deal of financial pressure—meaning don't expect to become a successful trader if you have limited trading capital or if you are trading with money you can't afford to lose. I was obviously violating both these rules because I had very little trading capital relative to my life-style that I absolutely could not afford to lose. Also I had a lot of other evidence that the odds were not exactly in my favor.

I came to Chicago because I believed that if I could get close to the action and meet people who knew how to trade, I could then learn from them. I was in for a very rude awakening. I was at Merrill Lynch Commodities, its second largest commodity office, with 38 account executives. At first I was shocked to find out only one of the account executives had any experience trading his own money. Then I was further shocked to learn that none of these account executives had any customers who were making any money. In fact, the typical customer lost his original stake within an average of four months.

My next major disappointment came when I began to meet and make friends with as many floor traders as possible, believing that if the guys up in the offices don't know how to make money, the floor traders certainly must. Again, I found the same conditions that existed up in the offices. Other than a handful of floor traders who had a reputation and a mystique that everyone seemed to be in awe of, I couldn't find one person who was making money consistently, who wasn't confused or knew what he wanted to do and then did it, without first having to ask everyone around him for confirmation that he was doing the right thing. I am not implying that I didn't meet traders who at some point in the day hadn't made money. They just couldn't keep it. I knew many traders who could make $2,000 or $3,000 the first couple of hours of trading. But they would always lose it back, plus more, a short time afterward.

Everybody seemed to be suffering from the same kinds of problems and mistakes that nobody really recognized as problems. Obviously, the nature of the markets made it easy not to have to confront anything that otherwise might be perceived as a problem because the next trade always had the possibility of making everything else in one's life seem irrelevant. Why deal with anything if the next trade can make you rich? All the traders I knew, including myself, were affected by this type of "big-trade" mentality. In fact, my big-trade mentality was so pervasive that I would refuse to take profits of $500 or $750 in many trades even when I knew that's all there was to be made. This may sound absurd, but I wouldn't take profits of such small amounts, because, at that time, it felt as if the market was insulting me by offering such paltry sums compared to what I needed or expected.

As my financial problems grew, so did my desperation. And I certainly wasn't comforted by anything I saw going on around me. But I still held on to the belief that I could trade out of these difficulties. That is until March 1982; by then it was all over. A mere eight months after moving to Chicago to pursue my dreams of financial independence, I had nothing left except my job, apartment, clothes, a television, and a bed.

Practically overnight, almost all the symbols that validated my identity were gone. What I mean is, a big part of my self-concept was made up of my possessions like my house, my car, and especially my credit. Maintaining flawless credit was something I had always been proud of. Now I found myself without any of these things. As I've already pointed out, it's not as if there hadn't been plenty of evidence to suggest the possibility of this happening, because there had been. But there was a part of me that wouldn't allow a direct confrontation with this evidence or the implications. It was just too easy to make excuses for all the things going on around me that didn't add up.

Refusing to confront or consider the implications of all the conflicting information created a great deal of stress. And to compound the situation, I had this intense fear that I would lose everything. But again, I did everything possible to hide this fear and put it somewhere in my mind where I couldn't feel it. Yet, there must have been a part of me that sensed my impending fall. Why else would I have been so consumed with fear? But how could I face any of this when I had no way of reconciling the imbalance that losing all of these things would create? What I mean is the imbalance between what I believed about myself and the things that validated these beliefs. Who would I be after all these things were gone?

Well it didn't take me very long to find out. As my financial condition deteriorated to critical levels, my mental defenses also began to break down. I eventually accepted the inevitability of doing what I believed was the ultimate act of failure and filed for bankruptcy.

There were a lot of things that changed inside of me as a result of this experience. And like any one else forced to deal with major changes in his or her life, I learned a lot about myself. The first thing that happened, which was quite surprising, was that the stress dissipated. Actually I was overcome with a great sense of relief with nothing to anticipate, dread, or try so desperately to defend against. I was living through my worst fear and found there really wasn't anything about the situation that I couldn't deal with. It wasn't nearly as bad in reality as I imagined it would be. I was still alive and healthy, I was able to think and function, and I started to appreciate my ability to think as my greatest asset.

This sense of appreciation began to grow into a deeper level of understanding about the basic nature of my identity. For the most part, I grew up believing that who I was consisted of the things that I owned. The more possessions I owned, the more of a person it made me. What I began to realize is that I was more than the things I had accumulated. When the facade was stripped away, it allowed me to sense this deeper dimension that, up to this point, I had only the slightest inkling of These new awarenesses, in turn, helped me understand how being wrong and losing something didn't in any way diminish me as a person. I was beginning to learn that there was a certain freedom in granting myself permission to be wrong and maybe there was no such thing as a failure, unless something positive and useful isn't learned from the experience.

However, I didn't relate these personal experiences because I thought they were particularly unusual, except for one. Everyone knows there are many traders who lose everything they own, and even though some of them will come to the same kind of awarenesses about themselves, they wouldn't necessarily be able to do it as a trader, considering the financial requirements. I, too, was not in a financial position to keep on trading, except that I still had my job at Merrill Lynch. In fact, for me it was business as usual, as if nothing at all had happened. I certainly wasn't about to announce to my customers or anyone in the office that I had just filed for bankruptcy. My job as an account executive was one of the few things I had left, and as far as I was concerned, it depended on me being a good trader.

This is the one key difference for me that ultimately lead to the creation of this book. I was fortunate enough to be able to keep on trading (although not with my own money) while these major psychological changes were taking place, putting me in a unique position to examine and study the various ways in which the condition of my inner psychological environment affected what I experienced in the outer physical environment.

This relationship between inner and outer isn't always that apparent but in this situation it was inescapable. I learned that the markets offer the trader an opportunity to profit from price movement, and these opportunities are basically in perpetual motion. It is an environment where the individual has the freedom to create his own results, unimpeded by many of the constraints that exist in everyday social life. These never ending opportunities make the market a perfect mirror of the trader's attitude. What the trader sees in that movement and what he can do about it the markets have no control over. All the choices and all the power to turn these choices into experience reside in the mind of each trader.

For example, if I perceived the market as a threat, afraid of what it might take away from me, it wasn't because the outside conditions were actually threatening me in some way. It became very apparent to me that my fear was a result of my inability to anticipate events or act in a way that most appropriately served my best interests. It was only the lack of trust I had in myself to do what needed to be done that I was really afraid of.

Furthermore, I discovered that my mental framework was structured to avoid losses at all costs and in my desperate attempts to do so, I actually created them. You can think of it this way: none of us has the mental capacity to be aware of everything going on in the environment at once. The environmental information we focus our attention on, out of all that exists, will be the information that has the most importance to us. As we allocate more and more of our attention to certain kinds of information, because of its importance, we are at the same time systematically excluding other types of information from our awareness. I created my losses instead of avoiding them simply because I was trying to avoid them.

Instead of being positively focused on market information that would indicate the potential for opportunity, I was more concerned with information that validated what I feared the most. As a result, a great deal of market information pertaining to other possibilities and opportunities that existed in any given moment completely escaped my attention, passing me by. The only way I could have perceived these opportunities (other than after the fact) would have been to let go of whatever was causing me to divert my attention away from what was happening in the market "now."

I had no way of knowing what I was missing out on until my beliefs about the significance of losses and being wrong started changing. Once this shift in perspective occurred, I started to notice behavior characteristics of the market and relationships between those characteristics that I was otherwise totally oblivious to.

At some point, I realized that because I had already lost everything, I really didn't have anything to fear, and, as a result, I inadvertently learned one of the most important lessons to becoming a successful trader: how to "accept" a loss without any negative consequences. No guilt, anger, shame, or self-punishment.

As my fear of losing dissipated, I was seeing and experiencing a different market because I was different. It was as if someone had removed blinders, which I didn't know existed, from my eyes. Up till then, my trading had always been affected by my fears. I didn't have the slightest notion of what it would be like to trade without fear or that doing it was even a possibility and least of all, that it was, in fact, necessary to be successful.

What also became very apparent to me was the extent to which all of my fears had effectively blocked me from understanding why it was so absolutely necessary to have some clearly defined trading and money management rules that must be followed. It was all starting to make sense. The more I followed my rules the more I trusted myself. The more I trusted myself the more I could focus my attention on subtle relationships in the market's behavior to learn new things about the market helping me become a better trader. Eventually I could gauge the positive effects these new attitudes had on my ability to shift my perspective and flow with the markets. The less I cared about whether or not I was wrong, the clearer things became, making it much easier to move in and out of positions, cutting my losses short to make myself mentally available to take the next opportunity.

By June 1982 I was starting to make consistent money for my customers who relied on me for their trades. Not a lot of money by most trader's standards, but steady. I was having winning days that were turning into winning weeks and months. Then sometime in August 1982 I thought of writing a book or at the very least developing a seminar to explain to other traders what I had discovered for myself.

In the area of education there was a definite void in the market. There really wasn't any material that addressed trading psychology at a deep enough level of insight to effectively help someone understand why success was so elusive. I wrote this book to address what I believe is a critical need for people who want to trade the futures of stock markets to have an organized, systematic, step-by-step approach to learn the mental skills necessary to accumulate wealth as a trader. The secret to this approach is learning a new thinking methodology.

CHAPTER 2

Why a New Thinking Methodology?

It is my intention in this chapter to demonstrate clearly how a typical social upbringing that instills in the individual certain values and beliefs that make up a thought methodology used for being successful is not practical or functional and is inconsistent with the methods necessary to be successful in the trading environment. Someone attempting to operate in the trading environment in all the familiar ways that would assure getting what they want will likely find themselves in a constant state of frustration, anxiety, and fear, wondering what is wrong or thinking something must be wrong with them.

The irony is, of course, that, on the surface, trading looks so simple, when in fact most people will find it to be the most difficult endeavor they ever undertake. Success will always seem so close, and yet always so elusive. And this frustration will continue until the trader adapts to the conditions that exist in the trading environment by learning a new thinking methodology, one that works most effectively in that environment and not what he thinks will work based on his cultural and social upbringing.

Perhaps many of you reading this book have heard about a seminar being offered where you can learn how to walk barefoot over a 20-foot bed of red-hot coals. The people who developed the method to make it possible did so on the assumption that the achievements of people who do things very well and excel beyond what other members of the same culture of society would consider possible do so as the result of a specific way they think—a methodology in which their beliefs are in some way different from everyone else's. This methodology can be broken down into a system that can be learned and subsequently taught to others. The only difference between those who excel and those of mediocre achievement is that one group has learned a thinking methodology that has not occurred to the other.

With this hypothesis, it is my understanding that the people who developed the program went to the South Pacific and sought out those who demonstrated an ability to walk over hot coals with their bare feet—without any physical damage whatsoever. Upon finding a few of these South Pacific "fire-walkers," the program developers proceeded to analyze their beliefs and attitudes so as to arrive at a thinking methodology they could teach in the United States.

I'm sure I don't have to point out the physical and emotional implications of attempting to walk over a red-hot bed of coals with your bare feet. The fear generated over just the thought of doing it would normally be overwhelming. The potential physical damage to your feet—with the possibility of being crippled for the rest of your life—is quite real. And yet, as presented by several news organizations, both television and print, people from all walks of life involved in the seminar accomplished what we would universally agree to be a tremendous feat. They overcame their fear and walked 20 feet over a bed of hot coals.

Now, I'm not going to have you fire-walking the futures pit, but habits of thought die hard. And to make way for the new thinking methodology I offer as a means of excelling as a trader, you will have to question some of your beliefs and probe deeply rooted concepts of what is possible. Sometimes only a thorough mental "house cleaning" can help you throw away failure to make room for success. And exposing yourself to information that may cause you to ask yourself "what if it were true" is the first step to any mental cleansing process.

For many reasons, which will be explored in greater depth in Part II, it rarely, if ever, occurs to the beginning trader that the markets confront him with an environment that is categorically different from anything he is accustomed to or trained to deal with effectively by society. For example, the markets can be looked at as a never-ending event, always changing, virtually without structure, in perpetual motion, with an unlimited potential for profit as well as loss in every trade.

The psychological impact on the individual interacting with such an environment is formidable—especially when you consider the many ways in which all of us typically go about structuring our lives with highly defined boundaries, limits, and rules, so things stay basically the same. For most people, a static environment is a fundamental component of their sense of security and well-being.

Not only can the markets destroy a person's sense of security by forcing the trader to confront, on a moment-to-moment basis, his lack of acceptance of change, but they also produce an emotional environment of considerable competitiveness and stress. There's the compulsive need to win millions, with the simultaneous fear of financial devastation. The markets tease a trader with the very real possibility of fulfilling his grandest dreams of financial independence and at the same time stand ready and willing to take away everything he owns—and more.

Furthermore, the principles of time, effort, and reward associated with most job situations simply do not apply with the markets. For example, many jobs offer an unchanging reward, regardless of effort, because of hourly wages or yearly salaries. For a trader, effort can be irrelevant, and there is virtually no relationship between time and reward. A trader can be stunned with a windfall profit in a matter of seconds for making one simple decision and the only energy expended was mental.

Initially, you may think what could be wrong with making a lot of money in minutes or seconds. A lot! Whether you're aware of it or not, most if not all of us grow up with highly structured belief systems about the conditions under which we deserve to receive money. In fact, many people because of their childhood conditioning and religious training believe they don't deserve any money they didn't work for.

Certainly, making a lot of money in a very short period of time with no effort expended does not fall within the definition most people have about working for their money. So how does someone reconcile windfall profits against these structured work beliefs, especially when they're probably not even aware of them or would not take them into consideration if they were? This kind of mental conflict usually gets reconciled by the trader finding some clever, ingenious, or mundane way of giving his money back to the markets.

Not adjusting to the differences between the cultural and trading environments or just being unaware that differences exist can certainly account for many of the trading errors committed by the majority of traders. Yet, a thinking methodology can not only redefine the market's behavior in understandable terms to avert such mistakes, it can also manage most, if not all, typical undisciplined, emotional reactions to that behavior.

CULTURALLY LEARNED BEHAVIOR THAT RESULTS IN AN UNSUCCESSFUL TRADING EXPERIENCE

In an emotionally charged situation that requires split-second decision making (which could lead to failure of some kind), there's little time to compare the present event with previous market experiences. You probably wouldn't even notice if you had behaved similarly in the past and suffered the same disastrous consequences. Because the present situation is so immediate, you may have no concept of how typical and even thoughtless your behavior may be.

In fact, it may be news to you that there are only a limited number of such typical reactions leading to failure. Being able to recognize them can prevent you from repeating past mistakes without losing any of that time so necessary for split-second decisions.

The following typical trading errors have a specific cause rooted in a thinking methodology that can be changed.

1. Refusing to define a loss.
2. Not liquidating a losing trade, even after you have acknowledged the trade's potential is greatly diminished.
3. Getting locked into a specific opinion or belief about market direction. From a psychological perspective this is equivalent to trying to control the market with your expectation of what it will do: "I'm right, the market is wrong."
4. Focusing on price and the monetary value of a trade, instead of the potential for the market to move based on its behavior and structure.
5. Revenge-trading as if you were trying get back at the market for what it took away from you.
6. Not reversing your position even when you clearly sense a change in market direction.
7. Not following the rules of the trading system.
8. Planning for a move or feeling one building, but then finding yourself immobilized to hit the bid or offer, and therefore denying yourself the opportunity to profit.
9. Not acting on your instincts or intuition.
10. Establishing a consistent pattern of trading success over a period of time, and then giving your winnings back to the market in one or two trades and starting the cycle over again.

SKILLS TO BE ACQUIRED

To excel in any activity—whether it is mental, such as trading, or physical, such as swimming—we need to learn specialized skills. These skills give us the necessary requirements to look at, think about, and behave toward events in a manner different from what we may be used to or what we may have been taught.

However, beyond the sheer mechanics of the activity—which just about anyone can master—lies a particular thinking methodology or strategy that leads to excellence. Although few people have it, such a thinking methodology can nevertheless be learned.

Any thinking methodology requires a series of approaches to goals and problems. These approaches might be better described as mental techniques, even skills of thought application. For example, one such skill might be the ability to identify those conditions that are conducive to making a common trading error before it actually happens. Other techniques or skills include:

1. Learning the dynamics of goal achievement so you can stay positively focused on what you want-not what you fear.
2. Learning how to recognize the skills you need to progress as a trader and then stay focused on the development of those skills, instead of the money, which is merely a by-product of your skills.
3. Learning how to adapt yourself to respond to fundamental changes in market conditions more readily.
4. Identifying the amount of risk you are comfortable with - your "risk comfort level"-and then learn how to expand it in a way that is consistent with your ability to maintain an objective perspective of market activity.
5. Learning how to execute your trades immediately upon your perception of an opportunity.
6. Learning how to let the market tell you how much is enough, instead of assessing the potential from your personal value system of how much is enough.
7. Learning how to structure your beliefs to control your perception of market movement.
8. Learning how to achieve and maintain a state of objectivity.
9. Learning how to recognize "true" intuitive information and then learning how to act on it consistently.

HOW IS THIS DIFFERENT FROM A TRADING SYSTEM?

Trading systems give us a way to define, quantify, and categorize market behavior. Since the markets offer traders a seemingly infinite combination of behaviors, all with their corresponding opportunities and risks, it is easy to understand how our minds can become overwhelmed. Trading systems limit the scope of market behavior, and therefore make this activity a little easier for our minds to manage. They also give us direction and suggestions about what to do in a given market situation. Without them traders could easily feel as if they are floating aimlessly in an endless sea of possibilities and opportunities with no land in sight.

Since trading systems define opportunity and offer suggestions, following these suggestions can lead to the development of skills, even though as suggestions they merely point the way for your awareness to be directed. A true skill not only points the way, but almost automatically begins to direct awareness as well. And a thinking methodology controls the selection of which skills should be used and when.

I do not offer a trading system in this book. It's more a means of interfacing a trading system with the mind's psychological structure. If a trading system provides awareness of market signals, and suggests behaviors appropriate for any given market situation, then the thinking methodology I will share with you teaches skills and processes of skill application.

Having the skills necessary to consciously manipulate one's psychological environment is essential for the trader who recognizes how ineffectual a trading system can suddenly become whenever a tense situation demands a split-second decision.

Most everyone reading a book of this nature would consider himself as successful to one degree or another, either through trial and error, or the rigorous application of some proven formula, through which each has learned—intentionally or not—skills or methodologies of thought to achieve this success.

In any case, we all have a natural tendency not only to want to achieve success in something, but also to apply the principles of success that work very well in one situation to practically everything else. It often doesn't occur to us that some environments may require very different psychological resources to achieve success.

Suppose, for example, that you arbitrarily tried to apply a certain thought system of success to trading futures or stocks without first investigating the usefulness or validity of that system in relationship to the actual conditions as they exist in the markets. More than likely, you would be doomed to failure before you even started.

Obviously people don't consciously start trading with the belief that they don't have the right resources or that they're going to fail. In fact, it is just the opposite. Because most traders come from or still enjoy very successful careers outside of trading, they have a great deal of confidence in their ability to extend this success in the trading environment. This unfounded confidence, coupled with the way the markets distort a person's concept of reward in relationship to time and effort expended, will cause the trader to form some very unrealistic expectations about the kind of results he should achieve.

Believing that trading is easy is the reason for the unrealistic expectations. And they are probably the single biggest reason why most traders never make it beyond the initial levels of development before they lose all their money.

Starting out believing that trading is easy is a psychological trap that entices almost all traders. But it isn't too difficult to understand why, when you examine the dynamics of the process of how we set up a standard of performance for ourselves by which to gauge our progress. There are four basic components that make up a person's standard of performance or expectations for results.

First is our basic concept of time; most people believe that it is limited, passing nonstop and will eventually run out. Second is our concept of effort—our supply of personal energy is not inexhaustible; it runs out, we tire, and we may even become ill if we don't rest properly. The third is our concept of expertise—the number of skills we have learned and our degree of proficiency in using these skills; it usually takes a great deal of time and energy to acquire expertise.

Now one of the primary ways we learn to value ourselves is based on our belief about how much work we do and the amount of time it takes to do it. Which brings us to the fourth component in the equation; reward. To determine the amount of reward we should receive, we will make an assessment about how hard or easy a job is by determining how much effort (personal energy) we will need to expend and to assess how long the job will take (using up our limited time), so we can then determine how much we should be compensated. It is like our own personal supply and demand formula for our time and energy.

Now I am going to put all this together to demonstrate how trading distorts all these components in a way that allows someone to believe that trading is easy. First, to function in the market environment requires very little if any physical effort, especially for the off — the — floor trader. Second, time is not a relevant factor because a trader can be stunned with thousands of dollars in profits in a matter of moments. Conceivably, you could put on a trade, never have the market go against your position, and be rewarded at levels far beyond your expectations of what is possible. A person can't help but make the association between the speed at which something like this could happen and how easy it must be because there was no physical effort required.

Most people don't have to experience this personally to make the erroneous assumption that trading is easy. They will just naturally do it the first time they experience market action. They will assume that they would have been a buyer at some low point and held on to liquidate the trade for a profit. Even if it's just for a couple of ticks, invariably they will multiply those ticks by several contracts to come up with these mental windfall profits for themselves. These profits could represent an exotic trip, a dream car, or thoughts of financial independence. Then they will compare how long and how hard they normally have to work to get the same amount of money, and what will result is a completely erroneous conclusion that trading is easy.

The problem is that it is almost impossible for the beginning trader to make a reasonable assessment of the level of expertise that is required to function in the trading environment, like learning to limit oneself in an unlimited environment, when possibly for the first time in the trader's life he has the freedom to express himself creatively without any social constraints, or the amount of the time it takes to acquire this expertise, especially when it looks as if the profits should just roll in so easily and so fast. These kinds of assumptions will blind the trader to the true nature of the endeavor. Time is certainly a factor in learning to perceive opportunity or learning how to execute one's trades flawlessly. Both these skills could take a great deal of time to learn. However, neither time nor effort is a factor in relationship to the potential for reward.

So what happens when we don't live up to our own expectations?—especially, when most everyone starts their trading career thinking it's a piece of cake and that they're only moments away from fulfilling their financial dreams? Regardless of how long it may take any individual to admit that he's not making it, the experience is painful and invariably generates feelings of inadequacy, guilt, and even shame. When one fails, especially when the expectations for success are so high, it will create three major psychological obstacles that have to be overcome before any measure of success will be realized.

First, you will need to learn how to release yourself from any feelings of inadequacy, guilt, or shame. Second, you will need to learn how to identify and repair the residual psychological damage caused by the emotionally painful experiences because painful experiences have the potential to generate fear. Finally, you will need to undo any inappropriate trading habits and learn the appropriate skills that will help you eventually to accumulate the wealth you desire from trading.

For many, what I have outlined may seem like an overwhelming task, and I'm not going to downplay it in the slightest. Even if you haven't as yet subjected yourself to any emotional trauma, just learning the appropriate skills will be no easy task. However, you should keep in mind that the rewards can be astronomical. Would any other endeavor having the unlimited potential of trading in futures or stocks be easy?

As you proceed through this book, it is very important to keep in mind that neither I nor anyone else can deny what you consider to be the structure of reality—even though what I hold to be true and what you hold to be true may differ by a wide margin. Force, violence, or even torture will not cause you or anyone else to give up your beliefs if you don't want to. However, if what I offer will produce a result you desire, then you may be quite willing to suspend, at least temporarily, what you hold to be true and see if what works for me will also work for you.

The fire-walkers I mentioned earlier demonstrated how a thinking methodology could suspend their belief that walking on abed of hot coals would severely damage their feet—even though they had learned early in their lives the dangers and pain of intense heat Perhaps you too can suspend some of your beliefs about what makes trading successful. You could find out how your own early training—before you ever considered becoming a trader—may have produced contradictory attitudes and beliefs that cancel all good intentions and optimistic trading, and thus lead to failure.

Understandably, before you even consider the possibility of changing some of your innermost beliefs, you will certainly want to know not only how the process of altering beliefs works but also what benefits it will have for you as a trader.

Like all traders, you have probably read repeatedly what it takes to be successful at trading: "Trade with the trend," "Cut your losses and let your profits run," "Money management is the key," and so on. As true as these adages are, they are too vague to give you a clear understandable connection between the application of these principles and their benefits: a positive and successful trading experience. If you will recall, I listed resistance to accepting a loss among the most common trading errors. If you have ever experienced such resistance, you have probably also encountered the following thought: "How do I accept small losses when what I want to do is make money, and I feel like a failure every time I lose."

Your helplessness in such a situation and the disastrous consequences for your finances are at the essence of this discussion. If, for example, you can change what losses mean to you and how you represent them mentally, then to whatever degree you can accomplish this, you will be releasing yourself from the stress and anxiety experienced when you have to acknowledge any given trade is a loser and take the appropriate action.

The few individuals who have achieved astronomical success in trading at some point learned to stop trying to conquer the markets or make them conform to their expectations or mental limitations. At some point in their trading careers, they understood the psychological implications of an event that is never ending, that begins only when one decides to participate, that ends only when one has had enough, and behaves without the slightest regard for individual survival. Eventually they adapted to these unusual and demanding psychological conditions by changing their perspective, although, as I have already pointed out from my experiences, the process of change usually isn't the result of making a conscious choice to take a step-by-step approach, as this book is designed to give you.

In our everyday lives it is much easier to control the external environment to satisfy our desires. What I mean is, if something has to change to get what we want, we will find it much easier to change the external conditions to suit our needs before we attempt to change our mental perspective. Changing ourselves would seem like the absolute last resort as a solution to any problem. So, why would you consciously go about the task of learning how to change yourself from the inside? I have three reasons for you.

First, because you decide to learn new skills or ways of expressing yourself. Second, because you may have any number of beliefs acting as resistance in the acquisition of the new skills you are attempting to learn. The third I will get to in a moment.

Right now I want to give you an example to illustrate these first two points. A client of mine lost an uncle that he was very close to while he was still a child. His uncle was very much of a father figure to him, where his own father was not. The uncle died of a heart attack at a young age while doing some very strenuous exercise. Because of this experience my client grew up believing he would also die of a heart attack, if he exercised too strenuously.

What would have been just normal heart pounding, to anyone else, after working up a sweat, he would perceive as the beginning of a heart attack. He would start to hyperventilate and stop doing whatever he was doing. Obviously, his belief about dying was very limiting. As a result, he never participated in any sports as a child or well into his adult life.

Well, by the time he was in his late thirties, he decided that he was not going to die prematurely of a heart attack like his uncle. Actually he didn't make this decision until after he passed the age in which his uncle had died. (His uncle's age at the time of his death was the age at which my client thought that he would also die.) When it didn't happen, he gave up the whole notion. Deciding to build up his stamina, he asked me for some tips on how to become a runner, since he knew I had been running for years. In a sense running was a new skill for him and definitely a new way of expressing himself. So we went running together. Of course, what he found out was that he couldn't run. Not that he couldn't take the steps in the fashion of a runner; it is just that every time his heart rate started to climb, he would stop dead in his tracks, even though his intent was to keep on going. His beliefs about dying from exercise still had a great deal of power in his mental environment. This belief acted as resistance, working against his conscious intent to run. Consciously, he was giving his body instructions to keep on going; his conflicting belief, however, was saying. "No way, pal; you're staying right here until your heart rate goes down." In this situation it was very easy to determine what component of his mental system had more power over his behavior.

The third reason why you would want to learn to change from the inside instead of forcing the environment to conform to your psychological makeup relates strictly to trading. The markets are just too big for one person or even a group of individuals to prevail for long. That is, if you don't have the financial power to move prices in your direction, then you are going to have to learn how to flow with and constantly adapt to the outer conditions.

The choice is you can either adapt or continue to experience some very painful lessons. A quick hint: the intensity of your emotional discomfort and pain you experience as a trader is an excellent indication of how much you will have to change to trade without fear and be consistently successful.

You might ask, "Why consider the market from a psychological perspective at all? Doesn't the market behave as it does regardless of what a single individual thinks or feels about it?"

My answer is this: "The market behaves as it does because of the interactions of hundreds of thousands of people. And since all these individuals are members of the human race, regardless of national origin, religious conviction, or what have you, they will all have one thing in common—the psychological structure of the human mind." This psychological structure behaves in certain highly predictable ways whenever it encounters stress or split-second decisions. In the market, the fear of losing one's fortune is every bit as intense as the fear of losing one's life from an attack by a wild animal.

However, even though we all participate collectively, the market is not the same for all of us. Every move the market makes has a different meaning and impact on each of us as individuals. And every trader's experience of this movement is the result of his individual mental process of inputting environmental information (perception) and all the unique internal psychological factors that affect his behavior. So, even though two or more traders can agree on what the current price is, they will not be sharing the same experience of how that price is impacting them personally.

The meaning you place on any particular price change is the result of your beliefs. As a trader you constantly have to define what is high and what is low relative to your beliefs about the future. That is the only way you can make money: buy low and sell it back at a higher price (in the future) or sell high and buy it back at a lower price (in the future). As long as prices continue to move, that movement will create opportunities to buy low and sell high or sell high and buy low, and these opportunities are available for all traders. You *create* the game in *your own mind based on your beliefs, intents, perceptions, and rules.* It is your own unique perspective and no one else's and the secret is, you can and do choose how you perceive events. Even if you are not aware of exactly how to control and change your perception to make other choices available to yourself, you are still choosing, even if it is out of ignorance.

Until you learn the appropriate skills, your success as a trader will he determined by a number of psychological factors that often have little or nothing to do with the markets.

UNSUCSESSFUL TRADERS

There are many reasons why traders are not successful. These reasons can be broken down into three broad categories.

Lack of Skills

The trader is generally not aware that the trading environment is different from all other environments. Trading has the appearance of something that should be easy to do coupled with the possibility of making vast amounts of money in a relatively short period of time.

The trader will thus create some inflated expectations of success. Adherence to these inflated expectations without the appropriate skills equals disappointment which equals pain which equals psychological damage which equals fear. Fear diminishes the trader's ability to be objective, execute his trades, or learn about the fundamental nature of the markets.

Of course, it is possible to make money without the appropriate skills. However, without these skills the trader will invariably lose what he made back to the markets plus more. The result is disappointment, pain, psychological damage, and fear.

People generally don't know how to repair psychological damage and as a result don't know how to release themselves from their fear. To compensate, we learn some very sophisticated ways of covering our fear up. In society we can get by and even be successful with a facade of confidence because people will generally support each other's illusions about themselves. The market, however, has no vested interest in supporting anyone's illusions about himself. If a trader is feeling fearful, he can try to cover it up all he wants but his trading results will readily reflect his true feelings.

Limiting Beliefs

Most people have a whole assortment of beliefs that argue against their success as a trader. Some of these beliefs you may be consciously aware of, most of them you may not be aware of. In any case, you cannot negate their significance in how they will determine and affect your behavior as a trader.

Many traders will try to circumvent confronting these limiting beliefs by becoming an expert market analyst. It doesn't matter how good a market analyst you become; if you don't release yourself from the effects of these beliefs, you won't be successful to the extent these limiting beliefs have power in your mental system. There are many market gurus who can predict market moves with uncanny accuracy but can't make money as a trader. Either they don't know the nature of beliefs and how they affect and determine behavior, or they don't want to confront the issues surrounding these beliefs. You have to want to do it or nothing will happen. And if you choose not to, you will be subjecting yourself to the same recurring cycles of negative experiences again and again until you either decide to work through whatever issues are necessary or lose all your money and have to give it up.

Lack of Self-Discipline

If the type of environmental conditions exist that are beyond your skill level to respond to appropriately (without doing harm to yourself), then you will need to institute some rules and limitations to guide your behavior until you learn how to act in your best interests. When you were a child your parents didn't let you cross the street by yourself because the consequences of your inability to cross safely might have precluded your getting a second chance. When you were able to make the appropriate distinctions about the nature of traffic, your parents trusted you enough to cross the street on your own.

Until they trusted you, they always feared the possibility of your getting hit by a car. As a result of their fear, they restricted your freedom of movement, regardless of the opportunities that may have existed for you across the street. Your interaction with the trading environment works the same way. The difference is that no one is stopping you from standing in the middle of the street (metaphorically) to get hit by a truck. You are the only one who can stop yourself. After you have been hit once or twice, it might not be so easy to cross the street, regardless of how good the opportunities look on the other side.

What makes it even more difficult (continuing with the traffic metaphor) to step out into the street is when you further realize that the cars and trucks can come at you in a seemingly random fashion. All of a sudden you're lying on the street not even knowing what hit you because you thought you were being careful.

PART II

The Nature of the Trading Environment from a Psychological Perspective

In Chapters 1 and 2 the material presented outlined some of the difficulties of trading. In the next six chapters, I will get much more specific by explaining the characteristics of the market environment from the psychological perspective of the individual trader. From this perspective it will become clear to you how the market environment is much different from the cultural environment you learned to function within. This will confront you with some very unusual psychological challenges.

My primary objective is for you to understand clearly why any degree of success as a trader is so elusive, attained by so few, and why you may need to change some deeply ingrained cultural attitudes and beliefs to function successfully in the trading environment.

CHAPTER 3

The Market Is Always Right

If all trading stopped at any particular price, what would this last posted price represent? At the most fundamental level, this last price (or any current price) would represent the consensus belief about value, relative to the future, of all the traders who are in the market in that moment. The current price is a direct reflection of the beliefs of all the traders who choose to act as a force on prices by putting on a trade. So, when there are two traders, one wanting to buy and one wanting to sell at a price and do so, they have made a trade, and they have also made a market.

All that is needed to make the market right are two traders willing to trade at a price. Regardless of the criteria they used to determine value, how rational, irrational, meaningful, or meaningless by your or anyone else's belief system, if two traders are willing to express their belief in future value by making a trade, they have made a market. Unless the trade can be undone, it has to be right by virtue of the fact that it was made.

What you wanted, thought, believed, or expected is of no consequence in the overall scheme of things unless you can trade with enough volume to control the market and move prices in the direction you deem to be correct. To do this, you would personally have to represent a buying or selling force strong enough to absorb all the counteracting buying or selling represented by the traders who didn't happen to agree with you, at any given moment, with enough financial power left over to bid or offer the price where you want it to be.

For an observer of market behavior, each trade that is made and the type of movement it creates in prices can tell you something about the consistency of the market and potential for movement in a direction—if you can discern the meaning and put that meaning within some framework defining opportunity. Price movement creates opportunities to buy low and sell high, or vice versa, if you can perceive what is likely to be high and low relative to some point in the future. Movement in any given direction is equivalent to the amount of force that is being applied to create that movement.

For example, if prices penetrated all-time lows, the fact that you may have believed that they would not do it is meaningless, unless you can personally trade with enough volume to move the price back above the old low. You have to consider that for prices to have penetrated all-time lows, there must have been more traders who believed that the current price was above what they considered to be of value, at least enough to where they believed the all-time low was a selling opportunity or they would not have sold. For prices to follow through and continue to go lower would indicate that there are more traders willing to act on their belief that prices are high and as a result sell than there are traders who are willing to buy at those prices (all-time lows).

What you believed about value and your reasons for believing it may be of highest quality, but if the market doesn't share your belief, it doesn't really matter how "right" you are based on your superior reasoning process or what you believe to be the quality of your information, because prices are going to go in the direction of the greatest force.

The point here is that right and wrong as you may traditionally think of them don't exist in the market environment. Academic credentials, degrees, reputations, even a high I.Q. don't make you right in this environment as they would in society. Traders, acting on their belief in the future by putting on a trade, are the only force that can act on prices to make them move. Movement creates opportunity to make money, and making money is what trading is all about. This is also true for the hedger trading to protect the value of his assets.

Each individual trader will define what market condition represents enough of an opportunity to put on a trade for whatever reason suits him. Regardless of how wrong you think he may be, if the net result of the collective actions of all the traders participating is moving prices against your position, then they're right and you're the one who is losing money.

The market is never wrong in what it does; it just is. Therefore, you as an individual trader interacting with the market—first as an observer to perceive opportunity, then as a participant executing a trade, contributing to the overall market behavior—have to confront an environment where only you can be wrong, and it's never the other way around. As a trader, you have to decide what is more important—being right or making money—because the two are not always compatible or consistent with one another.

CHAPTER **4**

There Is Unlimited Potential for Profit and Loss

The most effective manner to illustrate the "unlimitedness" of the market environment is to compare it to gambling. With any gambling game you will always know exactly how much you can win or lose each time you play. You decide exactly how much you want to wager, you know exactly how much you can win as well as lose, and you may even know the mathematical odds of either possibility.

This is not the case in market environment. In any particular trade you never really know how far prices will travel from any given point. If you never really know where the market may stop, it is very easy to believe there are no limits to how much you can make on any given trade.

From a psychological perspective this characteristic will allow you to indulge yourself in the illusion that each trade has the potential of fulfilling your wildest dream of financial independence. Based on the consistency of market participants (ratio between buyers and sellers) and their potential to act as a force great enough to move prices in your direction, the possibility of having your dreams fulfilled may not even remotely exist. However, if you believe it does, then you will have the tendency to gather only the kind of market information that will confirm and reinforce your belief, all the while denying vital information that may be telling you the best opportunity is in the opposite direction.

If you are in a losing trade, the market could be moving farther and farther away from your entry point, increasing your potential loss by the moment. While this is happening, however, you may only be able to imagine it coming back in your favor, instead of confronting the possibility of the market continuing against your position. This type of thought process will continue until the sheer magnitude of the loss overwhelms you, and the possibility of the loss increasing is suddenly more pertinent than the possibility of the market coming back. You finally exit the trade never intending or ever imagining you could have allowed yourself to take such a large loss.

From a psychological perspective, the possibility for unlimited profits, happiness, power, and so on, whatever it means to you when you imagine making all the money you ever wanted to make, can be extremely dangerous. The possibility may in fact exist, but how realistic it is in any given trade is another matter.

There are several psychological factors that go into being able to assess accurately the market's potential for movement in any given direction. One of them is releasing yourself from the notion that each trade has the potential to fulfill all your dreams. At the very least this illusion will be a major obstacle keeping you from learning how to perceive market action from an objective perspective. Otherwise, if you continually filter market information in such a way as to confirm this belief, learning to be objective won't be a concern because you probably won't have any money left to trade with.

CHAPTER 5

Prices Are in Perpetual Motion with No Defined Beginning or Ending

The markets are always in motion; they never stop, only pause. As long as there are traders who, for whatever reasons, are willing to buy higher than the last price and, as a result, bid the price up, or traders willing to sell for less than the last price and offer the marker lower, prices will remain in perpetual motion. Even when the markets are closed, prices are theoretically in motion. For example, what price traders may be willing to buy or sell at on the opening the next day does not have to be at the price level the market closed at the previous day.

What are usually thought of as three simple decisions of enter, hold, or liquidate a trade become a perpetual process of deciding how much is enough from both a profit and a loss perspective. If you are in a profitable trade, is there ever enough? Greed stems from a belief that there is never enough or there won't be enough. In an unlimited environment that is in perpetual motion, isn't there always the possibility of getting more? The appetite of true greed can never be satisfied; it will always leave the greedy ones with a feeling of lacking regardless of how much they have acquired. If you are in a losing trade, you won't want it to exist because it represents failure, so you can just act as if it doesn't, by convincing yourself that you are in a winning trade that hasn't gone in your favor yet.

The "how much is enough" question can be answered in an infinite number of ways relative to your beliefs on the value of money, what you need it for, how important it is, can you really risk it, how secure do you feel, and what is enough today may not be enough tomorrow because of other factors in your life—all relative questions that have no definitive answers and change with the changing environmental conditions. Having to confront these personal issues as a trader will only contaminate your observations of market movement because they have nothing to do with market direction and the potential or lack of potential of any particular market move. This is why successful traders have always stated emphatically, "Only trade with money you can afford to lose," meaning money that has little or no value in your life. The less meaning the money has, the less potential there is for your personal "how much is enough" issues to contaminate your perception of market movement.

Thus, if you allow it, the market can always tempt you into thinking there may be more to be had in a winning trade and always give you something to hang on to in order to justify your hope that it will come back and make you whole, if you are in a losing trade. Succumbing to either one of these temptations subjects you to the possibility of some very negative and painful consequences.

The market environment is also unstructured in such a way that, from a psychological perspective, there is no beginning and there is no ending. What I mean by this statement (before you think that it's not true, the market opens and closes at a specified time every day) is that from the perspective of the individual trader, the game only begins when you decide to enter and ends only when you decide to exit irrespective of market openings and closings.

You have the freedom to structure the game inside your mind in any particular way you please. You can get in whenever you want for whatever reasons are good enough to justify your actions. You can get out whenever you want. In fact the game only ends when you have decided that you've had enough and take the appropriate action to end it. The psychological implications to the individual confronting these conditions are staggering.

Entering a trade will involve all your beliefs about opportunity in relationship to risk, missing out, needing a sure thing, and not being wrong. Exiting a trade will involve all your beliefs about loss, greed, failure, and control.

Considering the unlimited potential for profit, entering the market will be much easier for most traders than will be getting out. This is because exiting the trade will require that you confront your beliefs about greed, loss, and failure in relationship to the constant temptation of the possibility for unlimited profits.

These individual psychological issues are completely independent of objective market action. And even more significant, as I will explain in Part III, your beliefs about loss, being wrong, failure, and control will operate independently of your conscious intent. For example, think of the last time you perceived an opportunity to profit and the fear of being wrong, or losing, and so on, immobilized you, keeping you from putting on the trade.

To the extent that these issues exist as a component of your mental environment, they will determine the effect they have on your perception of market activity, the decisions you make, and your ability to act on what you decide.

However, one of the most significant and potentially damaging factors related to this no beginning and no ending characteristic of the market environment is that it allows you to be a passive loser. The best way to illustrate this concept is to compare the markets with any form of gambling games. For example, with blackjack, horse racing, or craps the player has to make a conscious choice to play and decide before the event exactly how much he will wager. The event begins and ends according to the rules of the game, and the risk of loss is limited to the size of the wager.

Each new event is a fresh start, where the odds of winning may be determined by mathematical probabilities and the rules of the game automatically take the player out after each event. When the game ends, the player knows exactly what the outcome is and then must make a conscious decision to participate again. Therefore, the structure of the game forces the player to be an active loser. To subject himself to the possibility of losing any more money than he has already lost requires that he place a wager for a specified amount. He has to actively participate to lose and do nothing to stop losing. Obviously, if the player does nothing, he will not be subjecting his assets to the possibility of loss.

If the player is losing consistently, he will need to confront his beliefs about loss and failure to quit playing altogether. This could be difficult because he can always rationalize that, based on the *odds,* he is bound to win eventually and that he can always quit after the next game. But he does not need his own mental structure to end any particular game because it's automatic.

This is very much different from the market environment where you can be a passive loser. Once you put on a trade, you have to actively participate to end your losses. You don't need to do anything to continue to lose, and the market could go against your position indefinitely. If for any reason you choose not to act or can't act, you could lose everything you own and more. Depending on the size of your position and the volatility of the market, this could happen very quickly. The only way out is to confront your personal issues about greed, loss, and failure. What specific issues or combination of them come into play in each trade will depend on whether you are in a winning or losing position.

Since, all of us seem instinctively to avoid confronting any issue that could cause pain, such as getting out of a winning trade too soon or having to admit we were wrong to get out of a loser, the easiest way out of a situation like this is to convince ourselves (indulge ourselves in the illusion) we are in a winning trade that will never end or gather all the evidence possible to suggest that we really aren't in a losing trade. Therefore, in either case we will have no reason to confront the forces inside of us that keep us from objectively perceiving what the market is telling us about the possibilities and potential for profit in any given moment.

The markets make it extremely easy for you not to have to confront these very tough psychological issues. For example, if you focus your attention on price movement at the tick-by-tick level, the market can graphically display billions of combinations of behavior characteristics and price patterns to get from one point to the next. It is very easy to use this type of information to support any belief, rationalization, justification, distortion, or illusion you need to want to have about where it is going in the future.

Most traders will attempt to simplify price movement by thinking the price can only do three things. Go up, go down, or stay basically the same. Some traders may even carry this distorted logic to the point where they believe there is a 50/50 probability for success in any give trade. This of course couldn't be further from the truth. For example, let's say that prices stayed within a 10-tick trading range for an entire trading session, if you take into account each tick, how many price patterns is it possible for the market to display going from the top to bottom of the range and then back again? I'm not a statistician, but I'm sure it's at least millions. To illustrate this a little further, if point A is the bottom of the range, prices could have changed up one tick, down two, up one, down three, up two, down one, up one, down two, up three, down one, up two, down one, up one, down one, up two, down one, up three, down one, up two, down one, up three, down one, up one, down one, up two, down one, up three to point B, ten ticks up from point A. This is obviously a very shortened version of the way prices usually move, but it does represent one pattern out of millions of possible pattern combinations, and each pattern you identify can repeat itself at some point in the future.

If you are a buyer at point A, what are the odds the price will stay above your entry point? What are the odds that the price will be above or significantly above your entry point tomorrow or the next day without having gone below your entry point first, by two ticks, five ticks, or ten ticks, before it goes back up again above your entry point? Once prices go below your entry point, what are the odds they never go above your entry point? What are the odds they never go below? To answer these questions, you would have to know a great deal about the consistency of the market and its potential to behave in certain ways. In any case, relative to most traders' emotional disposition to deal with this kind of movement and within the context that most people think of as 50/50 odds, it definitely doesn't apply in the markets.

To illustrate another point, if you got short halfway between points A and B, which ticks would you have the tendency to place greater weight on in terms of market information? The down ticks naturally. They confirm what you believe and the up ticks don't Yet each in relationship to one another can tell you something about the consistency of the market and its potential to move in any given direction. How can you begin to assess that potential accurately if you place a greater significance specifically on the information that confirms what you want or believe? In effect, you would be using the information to suit your hopes, dreams, wishes, and desires instead of perceiving it in a manner to assess the market's actual potential to do any of the foregoing.

Thus, what you have in the market environment is a deadly combination of the market forcing you to confront difficult personal issues to survive, an event that produces information in a wide variety of forms that can be used to support any illusion, distortion, or expectation, therefore, making it easy to avoid confronting these potentially painful issues. Furthermore the event continues on until you come to terms with whatever is inside of you to end it. Unless your brokerage firm liquidates your position, you are the only one who can make it stop.

Among many other factors, to become a consistently successful trader your objective has to be to learn how to let the market tell you what it may do next and how much is enough. This is extremely difficult when you consider there is absolutely no relationship between what the market may do next and your personal belief system on what it means to lose, what it means to be wrong, greed (fear founded in a belief there will never be enough), and revenge.

I can anticipate a lot of readers saying to themselves "I can understand the loss, being wrong, and greed issues, but where does revenge come into this?" This can best be illustrated by going back to the gambling game example. In a gambling game you can only lose what you decide to risk. You bet the money and it's difficult not to accept the responsibility for any losses. As a trader, however, you could easily lose far more than you intended to risk, based on your inability to perceive the possible or your inability to execute a trade to get out of your position, or a combination of both.

You may have been willing to take responsibility for what you originally intended to risk on a trade (although most traders are not willing to take this responsibility, which I will demonstrate further on); however, it might not be so easy to take responsibility for losing more than what you intended to risk. This is where the revenge factor comes into play. If you don't take responsibility for what you lost, then who or what can you blame—the markets, of course. The markets took your money. If the markets took from you more than you originally intended to risk, then you will likely feel compelled to get it back.

For example, is a 10-tick profit enough in the trade you are currently in if you lost 20 in the last trade? The market may be giving the objective observer a very clear indication that where the price is now is all that is left in the move and the highest probability for success is to take profits now. If you lost 20 ticks in the last trade and you only intended to risk 5 and the market is now offering you 10, are you going to take it. If you believe in "getting back," 10 won't be enough regardless of what the market is doing or telling you. You will need at least 15 and preferably 20 to make you whole.

Your last trade obviously has nothing to do with the potential that exists in the market at any given moment. When you feel compelled to get back, it puts you in an adversary relationship with the market. The market becomes your opponent, it is you against it, instead of being in harmony with it. The market can't take anything away from you that you don't allow; if you lost money or lost more than you intended to risk, you gave your money to other traders. Ultimately, however, revenge creates an adversary relationship with yourself. If you're the one who gives your money to the market, you are also the one who gives yourself money out of the market. If you are angry with yourself for letting the last trade get so out of hand, whatever the market is offering you "now" in terms of an opportunity won't be enough. From a psychological perspective, you won't take the opportunity for a profit or otherwise because you haven't accepted the last trade as being all right. In effect, you will be denying yourself the current or next opportunity to punish yourself for the past mistake. In reality you can't get back at the market, and a belief in revenge only allows you to get back at yourself.

There is a direct correlation between your ability to let the market tell you what it is likely to do next and the degree to which you have released yourself from the negative effects of any beliefs about losing, being wrong, and revenge on the markets. Not being aware of this relationship, most traders will continue to observe the market from a contaminated perspective until they either make the association through trial and error or become aware of this relationship through a book such as this. In any case, by the time those who figure it out do so, they have usually subjected themselves to so much psychological damage that it adds a much more difficult dimension to the process of becoming successful.

This is the principal reason why this book had to address the areas of personal transformation in such depth: you need to know if there is any damage, how to identify it, and most important, how to release yourself from it.

CHAPTER **6**

The Market Is an Unstructured Environment

Unlike structured social activities that have defined beginnings and endings and rigid rules to guide your behavior, the market environment is more like a river constantly flowing, with no beginning or ending with almost no structure. Once you jump in the river, it can change directions at any moment. It may have been flowing north when you jumped in; however, without any notice, it can start flowing south. It's unstructured to the point where you make up all your own rules to play by, with a great deal of latitude to do so.

You will have to decide if and when you're going to jump in and with how much force. If you are already in, you have the option of increasing the force you apply at any time or of decreasing it. There are no rules preventing you from jumping out at any moment to change your intended direction to flow with the market, or you can jump out and stay out, and the market just keeps on flowing.

In an unstructured and unlimited environment, it is essential that you establish rules to guide your behavior. You will need to create definition and give yourself direction. Otherwise, you will feel overwhelmed with too many possibilities. Without these rules one of the most likely possibilities is that you will create devastating losses for yourself. The big psychological problem here is, if you make up and have to play by your own rules, you also have to take total and complete responsibility for your actions as well as the outcome of your actions. The degree to which you do assume responsibility is the same degree to which you can't shift it to the market and be its victim.

The typical trader will do most anything to avoid creating definition and rules because he does not want to take responsibility for the results of his trading. If he knows exactly what he is going to do and under what conditions, then he would have something by which to measure his performance, thus making himself accountable to himself. This is exactly what most traders don't want to do, preferring instead to keep their relationship with the market somewhat mysterious.

This creates a real psychological paradox for traders, because the . only way to learn how to trade effectively is to make oneself accountable by creating structure; but, with accountability comes responsibility. The typical trader desperately wants to make money, but he has to do it in a way where there is no direct connection between what he does and the outcome that it produces, thereby avoiding responsibility if things don't turn out satisfactorily.

To develop a plan, you have to anticipate events to some extent relative to the depth of your plan. When you plan your trades in advance, you are putting your vision of the future and creative abilities on the line, so to speak, and making yourself accountable to yourself. Your plan either works or it doesn't; you either have the ability to execute your plan or you don't. In any case, it is your plan and your ability to follow it and, therefore, it is difficult to shift responsibility and lay the blame somewhere else if things don't work out.

Now, when a trader doesn't understand market behavior well enough to know what he is going to do and under what market conditions he is going to do it—but if at the same time, he is very attracted to the action and the opportunities he knows exist and if he is also impatient with the learning process—his impatience and attraction will make him feel compelled to do something, even if he doesn't know what he should do. How do you think the typical trader will resolve this dilemma? He will play follow the leader, rationalizing that everybody else is doing something and, furthermore, all these people waving their hands and screaming can't be as afraid and unknowing as himself, so they must know what they are doing or at least they know more than him. If he does what they do, or better yet, identifies the most successful trader and does what that trader does, then he too can make money.

This type of rationale creates a herd mentality (extremely prevalent on the floor of the exchanges), where most everyone is looking for direction, assuming everyone else must know something they don't, otherwise why would they be doing anything. In a group, this collective mentality is very volatile, where one key trader can start an endless series of chain reactions where everyone mirrors everyone else, all assuming that the other guy must have some rational reason for doing what he is doing.

In fact, I wouldn't even describe what goes on down on the trading floor as follow the leader. It is actually better described as "follow the follower," because most traders don't know what the leader is doing or who the leader may be at any given moment. Therefore, the group's behavior is like these endless waves of back and forth movement, where the traders closest to the leaders (the leaders being those who know exactly what they want to do and why they want to do it) will have the first opportunity to get on the bandwagon at the best price and those next closest have diminished opportunities and so on down the line until you get to the least skilled trader, who doesn't have much of a chance at all. When there is no leadership in the market, the prices usually drift back and forth in a small range until someone who knows what he is doing comes into the market.

If the prices have made any significant move during or at the end of the trading day, all the crowd followers get together to find any reason or rationale that might explain their (the market's) behavior and put it into some understandable context. Basically, what they come up with is a consensus reason for the market's behavior that day. However, the leaders (those traders who take responsibility for their trades and know exactly why they did what they did) do not feel compelled to talk to anyone and usually don't. The typical crowd follower feels compelled to find reasons outside of himself because these reasons don't exist inside of himself and he doesn't want to think he is irrational and acts randomly.

For the crowd follower, trading this way serves many functions. It keeps his relationship with the market mysterious. If he makes money, he must have done something right. If he loses money, he can blame the market, which is obviously very acceptable behavior among traders, since so many of them do it. The rational or logical explanation for the individual's part in the collective behavior will be decided on later (after the fact) by the consensus opinion of the group. This way he can maintain an illusion of being rational and responsible and whatever happened to him also happened to a lot of other traders, so at least he knows he is not alone, which then creates a sense of comradeship among competitors.

Outside of the world of trading, most people think that traders are rugged individualists, associating them with the characteristics of the entrepreneurial types, like being decisive and persevering. Most outside people would be shocked to learn that except for a small minority of successful traders, the rest fall into a group that, at any given moment, have no idea about what they are going to do next or know why they are even doing what they are doing. If you asked them to tell you specifically how they make money or lose money, they couldn't tell you. In addition, as a group, traders (except for the leaders) are indecisive and impatient to an extreme. It isn't too difficult to determine why, if you consider that under normal conditions, the frame of mind of the average trader is one notch away from unrestrained terror. Getting organized and creating structure is one obvious solution to the many psychological problems the typical trader heaps on himself. But that would also force him to cross that psychological boundary line into the realm of accountability and responsibility.

Besides the outright refusal to plan trades, most traders go to great lengths to put as much psychological distance as possible between what they do and the outcome of their actions. I know many traders who can do extremely good market analysis on their own but still seek opinions of other traders on what to do and then take those trades instead of their own, simply because they don't want to take responsibility if the trade doesn't work out. And, more often than not, sticking with their own analysis would have produced far better results.

There are many floor traders who trade hundreds of contracts a day, and although they have to record each trade on a trading card, they will not keep an accurate account of their net trading position, claiming they get too busy or that they added wrong. At the end of the day, they count their cards with intense anxiety, hoping or praying to whatever unseen forces that they are flat (not carrying a net long or short position).

Obviously, if they were that concerned, the simple solution to their problem would be to trade only at a volume level where they can always keep track of where they are at and if they lose track to stop trading until they get a correct count. But they wouldn't want to do that because, if they kept track of their position, then they would have to take the responsibility for what they end up with. What if they inadvertently end up with a net long position at the end of the day and the market opens several ticks higher the next morning? The unseen market forces have thus blessed these traders with a winning position, or conversely if the market opens lower, they can always find someone or something to blame for their bad fortune. Maybe their lucky tie was sent to the dry cleaners by mistake or they hit three red lights in a row on the way to the exchange. Any reason or excuse to shift responsibility will do. These reasons can range from the most eloquent academic jargon to the most superstitious beliefs, but in essence, they all focus blame outside of oneself for unsatisfactory results.

In an unlimited environment, the less structure you create for yourself, the less accountable you are, the more easily you will be swept along by the force of events, and the less control you seem to have over your life. However, having less structure has the benefit of shifting the responsibility for the events in your life to other unidentified forces. This is precisely why so many traders have such a strong belief in superstitions. If a person refuses to make any connection between his thoughts, intents, skills, and results, then it is very easy to associate one's success or failure to something like the tie one had on that day or inadvertently making some gesture and then finding oneself in a losing trade and associating the gesture with the loss.

I have a personal story to illustrate a typical superstitious belief that traders have. One morning I went into the men's bathroom at the Chicago Mercantile Exchange, and as I approached the only urinal not in use, a floor trader using the urinal next to the one I was about to use turned his head, looked at me, and said in a very cautious tone, "Don't use that one, you can wait for mine, I'll be done in a second." I gave him a puzzled look, and he then pointed to a penny that was at the bottom of the urinal. I gave him another puzzled look because I didn't have the slightest idea about what he was trying to communicate to me. As I proceeded to use the urinal with the penny in it, he turned with a nervous expression on his face and strode away from me as quickly as he could.

Later on that day, I told one of my floor trader clients about this experience and asked if he knew what was going on. He said certainly, that it was very common knowledge that money at the bottom of a urinal is a bad omen and *certainly* something to be avoided. After I thought about it for a moment, I wondered what would happen if I went through the entire exchange and put pennies in all the urinals.

This story illustrates how the typical trader is caught in a psychological trap of refusing to plan and create structure for his trading activity, so that he can avoid taking responsibility for his results. And by doing so, he is subjecting himself to being tossed around by the whims of the crowd, at the mercy of his own unrestrained impulses, finding himself in winning and losing positions, not knowing why or what to do next. This trap is extremely negative because it creates a potentially damaging psychological condition I call random winning and random losing. If you can't define your own behavior and that of the markets, you can't learn how to repeat your wins or prevent your losses.

When you win it is so pleasurable, it creates a need to repeat it and compels you to try again. When you follow the crowd (instead of anticipating the crowd, which would take planning) or trade off news items, tips, or isolated signals from technical systems, the anticipation of the next attempt to win automatically produces fear and anxiety.

Why? Because, you can't define the market conditions or the decision-making process that produced the last win, and so you can't assure yourself of the next.

If you don't know what you did to win the last time, you obviously don't know what to do to keep from losing this time. The end result is intense anxiety, frustration, confusion, and fear. You feel out of control, experiencing a sense of powerlessness as you are swept along by the ensuing events and wondering what is the market going to do to you today.

Consider that the markets can't do anything to any trader who completely trusts himself to act appropriately, in his best interests, under all market conditions. And before people can trust themselves in this manner, they would first have to define all those conditions and be able to recognize them.

Understandably, taking responsibility is something that is extremely difficult to do. We don't live in a society that has a highly evolved concept of the growth process, and as a result, we learn to become very intolerant of "mistakes." I say this because we are basically taught as children and, therefore, in turn teach our children through our ridicule of them that mistakes are something that diminish one as a person. Ridicule does not enhance a child's willingness to accept responsibility, and if he doesn't, the typical parent will then criticize the child for being irresponsible.

Taking responsibility is a function of self-acceptance. You can measure this degree of self-acceptance by how positively or negatively you think of yourself when you make what you perceive as a mistake. The more negatively you think of yourself, the greater your tendency to avoid taking responsibility, so you can avoid the pain of your harsh thoughts, thus generating a fear of making mistakes. However, the greater the degree of self-acceptance you have for yourself, the more positive your thoughts will be and the greater the degree of insight you will be able to extract from an experience, instead of generating fear. The more self-accepting you are, the easier it is to learn because you are not trying to avoid certain information.

I don't know of any national prerogative to teach children how to accept themselves in spite of their "shortcomings" as perceived by the adults in their lives. If people had a more accepting attitude about the outcome of their actions, they wouldn't have a need to avoid taking responsibility.

To be successful, the market forces you, as a trader, to be responsible in completely new ways. For example, you can't put on a trade and then release your responsibility to the market to do something for you, like give you money. The market is a fluid, ever-changing event, where at any moment some other trader may decide to jump in with enough force to change the expectations of other traders participating to the point where they reverse their positions and as a result completely negate the potential you believed existed a moment ago, when you put on your trade.

In our everyday lives, objects are very stable, and day-today events do not change at anywhere near the rate and frequency that conditions change in the market environment. Relative to the nature of the market environment, all of us take it completely for granted that the buildings, trees, traffic lights, and streets we all know are completely stationary and will be there from one moment to the next. You didn't walk out of your front door this morning to discover the street you live on doesn't look just as it did the previous evening when you walked inside your home. If getting to the office or your place of employment represents an opportunity to make money, you would take it completely for granted that it would be possible to get there in familiar ways.

However, as a potential opportunity to make money comparable to that afforded in the markets, what if the location changed on a moment-to-moment basis, what if the streets also changed their location in relationship to each other, and, furthermore, what if no one cared if you ever found your way there, making you and you alone completely responsible for where you end up?

It just makes sense that to function in the market environment effectively you will need to make yourself accountable. Otherwise, how could you ever learn how to trade, if you allow yourself to be swept into or out of something by forces outside of you and inside of you that you can't identify and don't want to? The market's behavior will seem mysterious because your own behavior is mysterious. You will be in a constant state of confusion, anxiety, and fear because you don't know what to do next—the kind of state of mind that breeds superstition.

Understanding yourself is synonymous with understanding the markets because as a trader you are part of the collective force that moves prices. How could you begin to understand the dynamics of group behavior well enough to extract money from the group, as a result of their behavior, if you don't understand the inner forces that affect your own? When you do understand the inner forces that affect your behavior and take responsibility for what you do and don't do, and what you can or can't do, you will begin to perceive how and why other traders comprising the group behave the way they do.

When you attain some degree of control over yourself, you can then see how other traders are not in control of what happens to them, like blades of grass, all bending to the force of the prevailing wind and constantly being stepped on. You won't be able to see this until you are no longer a blade of grass yourself by evolving beyond the group mentality. Then it becomes much easier to understand the group's behavior, anticipate what they will likely do next, and take advantage of it to the best of your ability. You will understand the group, certainly, to no greater degree than you understand yourself Creating definition and rules to make yourself accountable is but a first step on the road to lasting success. You could acknowledge their necessity and establish them, but then find to your dismay, it is extremely difficult to abide by them. In Part III we will examine the interacting mental forces that make it difficult to follow your own rules.

CHAPTER 7

In the Market Environment, Reasons Are Irrelevant

I have titled this chapter "In the Market Environment Reasons Are Irrelevant" in recognition of the traders who believe that if they can ascertain the reasons why the market did what it did, these reasons will help them to determine what the market will do next. To believe this assumes that traders know why they behaved as they did and that the reasons they give for their actions will aid in determining their future behavior

The reasons traders would give for their actions are irrelevant. Most traders don't know why they did what they did because most traders don't plan their trades, thus eliminating any connection between themselves and the results of their trades. Most traders act spontaneously and impulsively and then ascribe the rationale for their behavior after the fact. Most of these after-the fact reasons are either justifications for what traders did or excuses for what traders didn't do.

Fundamentally people trade to make money. And to make money, traders have to cake positions, hold their positions for some length of time, and then exit their positions. When traders enter and exit positions, they act as a force on prices, making them move. When they are observing the market, waiting to enter or holding a position, traders are a potential force that can act on prices at any given moment. If traders planned what they were going to do before they did it, then the reasons they would give for why they act as they do could definitely help other traders to anticipate how prices will be affected by their actions. This, of course, assumes that they will reveal their plans and that they will be telling the truth. There are only a few traders who make money on a consistent basis, and rarely will they reveal their reasons unless it suits their purposes.

In fact, traders who are confident in their ability and know they can have a significant impact on price movement go to great lengths to keep information about their plans away from other traders because that would diminish the possibility of executing these plans. However, this is not to say that after they have taken their positions they won't purposely reveal what they have done to then draw other traders into the same position, forcing them to compete among each other to create price movement in their direction. On the other hand, traders who are not confident about what they want to do will gladly share their trading ideas with anyone who will listen, hoping to get some sort of confirmation that what they are about to do will work. So the after-the-fact reasons they offer for why they acted as they did usually just serve the purpose of easing the pain of what they perceive as their mistakes, which isn't particularly useful information. What is useful is understanding that traders typically act as a group, very similar to a school of fish or herd of cattle. Individual traders fall into specific groups that tend to perceive the same kind of market conditions as opportunities or disappointments. As a result, they will act in unison to upset the balance of the market, causing the prices to move in predominately one direction. The various groups take positions because they believe they can make money, and they get out because they are either losing money or perceive the possibility of making any more money as diminished in relationship to the perceived risk of losing money. For example, the locals on the floor of the exchanges have the least amount of patience, are the most impulsive, are the most easily disappointed, and consequently have the smallest price objectives and shortest time frame perspectives. As a result, they are the most active and will all be trying to do the same thing at the same time.

Commercials and off-the-floor retail traders are two other groups that have different price objectives and time frame perspectives from each other. Individuals within these groups will also tend to act in unison, upsetting the balance in the market by their degree of participation or lack of participation at any given moment. You can determine what market conditions in which they are most likely to participate, what conditions will confirm their beliefs about the future, and what will disappoint them. Once you learn their unique characteristics, you can anticipate how one or more groups are likely to act and determine how their activity will affect the balance of the market and the potential for price movement.

WHY DO WE TRADE?

Every moment we exist we are interacting with the environment, expressing ourselves in our own unique way, and thus creating our lives by the way we live it. Everything we do in every moment is some form of the way we express ourselves. We express ourselves to fulfill our needs, wants, desires, and goals. Today most individuals can channel their energies to fulfill needs beyond the requirements of food and shelter, but to do so requires money.

Money allows for a system of exchange where we can trade the goods and services created from individuals expressing themselves in highly specialized ways. Money has evolved to become the object of our needs because it represents the means or path by which we can express ourselves as individuals. All behavior is a form of self-expression, and almost any way in which an individual wants to express himself in our society requires money. So at the most fundamental level of cultural existence, money represents freedom of expression.

Individuals expressing themselves in specialized ways create a highly complex system of interdependency. To exchange goods and services, individuals have to agree on the value of those goods and services to make an exchange. I am defining "value" as the relative degree of importance or potential something has in fulfilling a need. The actual price at which goods and services are then exchanged will be determined by the fundamental economic law of supply and demand. In psychological terms, the law of supply and demand is founded in human fear and greed. Both fear and greed will compel people to act or not act depending on their needs in relation to the perceived external conditions. The price for goods and services will be determined by the individual's needs in relationship to their belief in their ability to fulfill those needs. Implied within that belief is their perception of the availability of the goods and services they need.

Greed is founded in a belief in scarcity and insecurity. Both beliefs generate fear. I am defining "greed" as a belief that there will never be enough available to fulfill oneself in combination with a belief that one always needs more to feel secure or satisfied. The perception that these conditions exist either internally or externally will generate a fear that will compel one to act or not act, depending on who controls the supply. The behavior someone displays will be consistent with what they believe they must do to satisfy the deficit. If two or more people have the same fears, they will typically compete among one another for the existing supply.

If the supply of something is limited in relationship to the need, those that are in need will compete for the available supply. They will compete by their willingness to exchange more resources (pay more money) than will someone else who may also be in need. If, however, the supply is great in relationship to the need (demand), there will be no fear of scarcity; consequently, people will conserve their resources (money) by diverting them to other needs or just waiting for the possibility that the price may come down.

Any system of interaction founded in individual fears of lack or scarcity will cause the price of goods and services to fluctuate in relationship to the relative degree of security or insecurity that is being experienced by the collective masses at any given moment. These fluctuating prices create economic risk for all those dependent on others to fulfill a need that they cannot fill themselves. What is risk? Risk is the possibility of a net loss of personal resources (energy, money etc.) in the exchange or pursuit of fulfilling a need. Fluctuating prices also create opportunities for those who are willing to assume the risk created by price movement. As long as there is disagreement between individuals about the value of goods and services, prices will fluctuate, thereby creating opportunities for traders to make money if they will assume the risks.

DEFINITION OF TRADING

I define trading as two parties exchanging something of value to fulfill some need or goal. In the context of the stock or futures markets, participants trade for the sole purpose of accumulating wealth or protecting physical assets from deteriorating in value. In essence, all traders in these markets, whether they are labeled speculators or hedgers, trade to accumulate wealth; it is only a matter of perspective. For the hedger the motivation to protect the value of an asset from economic risk is still to accumulate wealth.

Hedgers will trade for a higher degree of economic certainty by transferring the risk created by changing prices to another willing trader. Typically, it will be the speculator on the other side of the trade willing to assume the risk of changing prices for the opportunity to accumulate wealth from those changes. For example, stock owners will sell their stock because they believe the possibilities for the future appreciation of the stock are either nonexistent or minimal in relationship to their assessment of the risk to keeping it. They may also sell even with expectations of future appreciation if there is a need to liquidate to satisfy other needs. The buyers (the other side of the trade) believe that the stock will appreciate in value. We can assume that the buyer believes this because people trade to accumulate wealth.

Since the goal of a trader is to satisfy a need to accumulate wealth, we can assume that people will not consciously enter into a trade believing they will lose or fail at satisfying their needs. Because all traders have basically the same goals (to win), we can then state that no two traders enter into a trade unless they have opposing beliefs about the future value of whatever is being traded. Keep in mind that the current price of anything is always a reflection of what someone is willing to pay and what someone is willing to sell for in that moment. So, although there must be agreement between two parties for a trade to exist at a price, inherent within the transaction is complete disagreement between buyer and seller on the future value of what they are trading. For example, would I be incorrect in stating that any stock owner will not sell his stock if he believed it had potential for future appreciation. When he sells he has basically given up on the possibilities of future appreciation. Why did the buyer buy? To lose money? To be wrong? No, of course not. The buyer's belief in the future value of the stock is opposite that of the seller's. This disparity is illustrated even more clearly with futures trading.

Of real interest is the academic community's belief that the markets are efficient, which assumes that traders have rational reasons for their behavior, knowing what they are doing and having a good reason for doing it. Academicians also believe that the markets are basically random, which seems to be a complete contradiction to a market that is supposed to be efficient. In fact, however, the market's behavior is mostly irrational, if you define rational as any action that is the result of a specific methodology or is planned in advance and definitely not random because irrational behavior is very predictable. If you want to learn to predict price movement, you don't need to pay attention to reasons. What you need to do is determine how the majority of traders perceive the external conditions in relationship to either their fear of scarcity, or their fear of missing out, or both.

CHAPTER **8**

The Three Stages to Becoming a Successful Trader

Before we cover the three stages to becoming a successful trader, it would be a good idea to review some of the material already covered. In the market environment you have to make the rules to the game and then have the discipline to abide by these rules, even though the market moves in ways that will constantly tempt you into believing you don't need to follow your rules *this* time. This movement allows you to indulge in any illusion or distortion that suits you in any given moment. Certainly you wouldn't choose to feel pain (confronting your illusions about the market) if there is any reasonable information that would support the possibility of your expectation being fulfilled.

In an unlimited environment, if you can't confront the reality of a loss, then the possibility exists for you to lose everything, in each and every trade. If you believe trading is like gambling, it isn't. In any gambling game you have to actively participate to lose and do nothing to stop losing. In the market environment, you have to actively participate to get into a trade and actively participate to end your losses. If you do nothing, the potential exists to lose everything you own.

When you participate in gambling games, you know exactly what your risk is *and* the event always ends. With the markets you don't ultimately know what your risk is, even if you are disciplined enough to use stops, because the market could gap through your stops. Also because the event never ends and is in constant motion, there is always the possibility of getting back what you are losing in any trade. You won't need to actively participate to get back what you are losing; you just have to stay in your trade and let the market give it to you. As a result, there is the constant temptation not to cut your losses which is very difficult to resist. Why choose pain over the possibility of being made whole, when all you need do is ignore the risk.

YOU CREATE YOUR EXPERIENCE OF THE MARKET

Each equilibrium (the current price) presents every trader with an opportunity to either buy low or sell high relative to the next change. Except for the time it takes to execute a trade, it is basically the same market for all of us. You are either able to perceive any given equilibrium as opportunity to execute a trade, or you can agonize over what you believe is a missed opportunity from the last price change, or you can refrain from taking the trade at the current price—even though you perceive it as an opportunity—because you fear the market might make you wrong. The market does not create the ways in which you perceive it; it merely reflects what is going on inside of you in any given moment.

Whether you perceived the current market condition as an opportunity and didn't act on your perception, or didn't realize it was an opportunity until after the move occurred is, again, a direct reflection of your unique psychological makeup. You attach the meaning to any particular move.

From an objective perspective the next tick up can be described as the price just moved one tick up from the previous price. That is a reality about that one-tick price change we all share. However, to one trader that one up tick could be the final defeat in a short position he had been carrying. To another trader, it could mean a perfect selling opportunity because the market just can't go higher.

To a third trader it could mean a buying opportunity because the market broke out of a resistance area, based on the way he defines resistance.

The market neither chooses nor has any way of choosing the meaning you attach to any particular price change or market condition. For example, you could perceive an opportunity to sell high and act on that perception by entering the market with a short position. From the point you entered, let's say the market went in your favor and then violently reversed itself. In doing so, it very quickly went through your entry point and kept on going up with only a few rest periods and minor little retracements.

Each rest or retracement could have been an opportunity to get out of your short position and reverse yourself. What would stop you? The answer is inside of you. If you breathed a sigh of relief each time the market paused or retraced a bit, choosing to believe it was finally all over, then I ask you, What is all over? Is it possibly the fact that you won't have to confront yourself and say I'm wrong. That again is inside of you. You choose (based on the makeup of your mental environment) to believe the pauses were stopping points, relief from confrontation, instead of a possibility to take advantage of an opportunity to eliminate your risk and a high probability to accumulate a profit by reversing yourself.

The way the market seemed to you was actually the way you created it in your own mind. Out of all the available choices and alternate ways of considering the possibilities, you choose one particular way. Your own mental framework (controlling what and the ways in which you perceive information) locked you into that losing trade. The unique way you define a loss (your beliefs about it) and what it means to you is a component part of your psychological makeup. Your beliefs will interact with your perception of environmental information to form the particular way you pick and choose whatever information you happen to focus your attention on. The market has nothing to do with this process, even though that is where the information is coming from.

In the trading environment the outcome of your decisions is immediate, and you are powerless to change anything except your mind. The power you have to create more fulfilling outcomes from your trading resides in your degree of mental flexibility. You have to learn how to flow with the markets; you are either in harmony with them or you are not. The less acceptance you have for different types of market behavior, the more the market seems to turn on you like Dr. Jekyll and Mr. Hyde. In one moment it is satisfying all your needs; in the next it is like a greedy monster taking everything away. This Dr. Jekyll/Mr. Hyde characteristic of the markets only represents your own mental inflexibility to flow with the changes and your lack of understanding—that you give yourself to the best of your ability what you end up with, out of what is available. And by the same token, what you lost, you gave away.

You can't change what the market is doing. You can only change yourself in a way that allows you to perceive what it may do next with increased clarity and objectivity. As a trader you want to know what is going to happen next, yet, how can you begin to know what could happen next, if you refuse to open yourself up mentally in ways that allow you to perceive the most likely possibilities? It is a complete contradiction in thought to want to know what is going to happen next in an event over which you have no control and at the same time to maintain a rigid mental structure that allows for only a very limited number of possibilities.

This contradiction in thought is the result of not understanding the nature of beliefs and how they limit a person's perception of environmental information. When you put on the trade, you had to have some belief about the future. What you need to do is learn how to release yourself from the demand your expectations be fulfilled exactly the way you expect them to be. Releasing yourself from the demand will allow you to shift your perspective to perceive whatever opportunities exist in the market now, as if you didn't have a trade on at all.

All of us are in a position of having to pick and choose environmental information because we can't be aware of everything at once. If you pick and choose market information on the basis of having to justify your beliefs, you are putting yourself at an extreme disadvantage. You will be excluding from your awareness information that may be more indicative of the consistency of the market and its potential to move in any given direction. And it will be extremely difficult to learn how to develop a perspective for the "big picture," by expanding your time frame perspective.

So even though you can't actually control the market's movement, you can learn how to control your perception of the market's movement in a way that allows you the maximum objectivity. Learning to perceive objectively will increase your ability to let the market tell you when to get in and when to get out. You can learn how to trade where you won't be using information to justify your beliefs but rather to perceive the most likely possibilities in any given moment. As you build a solid foundation of insight and understanding into the workings of your mental environment (which I will present in Chapters 9 through 14), you will learn how to change yourself in ways that will allow you to perceive the markets from an objective perspective and eventually trade intuitively.

What I will be offering you in the remainder of the book is a step-by-step process of how to adapt yourself to function more effectively in the trading environment. Essentially it is a process that will enable you to identify and manipulate your beliefs to be more consistent with your goals.

There are two dominant themes that form the foundation for this approach. The first we have already briefly covered, that you create the market that you experience in your own mind based on your beliefs, perceptions, intents, and rules. And, second, your trading results will be a function of the degree of skills you develop in three primary areas: perception, or your ability to perceive opportunity; execution, or your ability to execute a trade; and accumulation, or your ability to allow your account balance to grow over a period of time or series of trades.

PERCEIVING OPPORTUNITY

Your perception of opportunity is a function of the depth of insight into the market's behavior. The depth of your insight into the market's behavior is equivalent to the number of distinctions you can make and the quality of these distinctions. Perception of opportunity is synonymous with your expectation of what the market will do next. To be effective, you will need to learn how to make kinds of distinctions that will provide you with an indication of a high-probability opportunity from an objective perspective, what I call making an uncommitted assessment of the probabilities.

To be able to make some kind of quality distinctions that will eventually develop into a "vision" of the broader perspective, you will need to learn how to expand your time frame perspective of market activity. There are several components to this process, but the two most important are (1) instituting a completely disciplined trading approach and (2} learning how to release yourself from the negative emotional energy stored in the memories of any past trading experiences.

The disciplined approach will naturally help you develop the degree of self-trust essential to function effectively in an environment that does not provide any external constraints to limit or control your behavior, as society does. Without the discipline, you will be at the mercy of your own unrestrained impulses and basically out of control. Consequently, without the self-trust that develops from the self-discipline, you will fear the unpredictability of your own behavior. At the same time, you will likely project this fear into the markets as being erratic and seemingly unpredictable, when it is your own behavior you fear the most.

It would be ludicrous to think that you could understand the market's behavior to any degree greater than you understand your own behavior first. To grasp the fundamental nature of your own behavior, you will need to understand thoroughly all the effects fear has on your perception of environmental information.

At the most fundamental level, fear will limit your awareness of market information that could clearly indicate those possibilities that are in your favor and those that are not. How could any deep level of insight into the market's behavior ever develop if you are constantly worried about what the market may do to you and cannot stay focused on the consistency and structure of the market itself. The market can't do anything to you if you trust yourself to act appropriately under any market condition. Learning this is the key to gaining the level of confidence every trader needs to be successful.

In the larger perspective, fear will reduce the likelihood of you ever developing to the point of making the kinds of distinctions in market behavior where you acquire a "vision" of the big picture. When you understand how fear operates in your trading and have conquered it, you will be able to see how fear operates in the market as a whole and then be able to anticipate the group's reaction to certain kinds of information.

If you did not start your trading career with the proper mental perspective or with a disciplined approach, then it is likely you have suffered some degree of psychological damage. I define *psychological damage* as any mental condition that has the potential of generating fear. The negative energy stored in these experiences (that create and support a belief about the threatening nature of the environment) will generate fear to the same extent as the degree of energy stored in the memory.

By learning to release yourself from the pain, you will be reducing the fear and automatically opening yourself up to new awarenesses about the nature of the markets. You will be opening yourself up because fear will not be causing you to narrow your focus of attention. Instead of being focused on pain avoidance, you can be focused on what the markets are telling you. Learning how to release yourself from fear will also free you up to think of creative ways in which you can respond to the new relationships you are perceiving in the market's behavior. As a result, you will be increasing your confidence in your ability to respond appropriately to any given market situation.

EXECUTING YOUR TRADES

Your ability to execute your trades is a function of the amount of fear you generate or the lack of it. Fear is always the result of your beliefs about the threatening nature of the environment. What could be threatening about the market? Nothing, if you had the confidence and completely trusted yourself to act appropriately under any given set of market conditions. Essentially, what you fear is not the markets but rather your inability to do what you need to do, when you need to do it, without hesitation.

In your relationship with the markets you had to learn what to fear. What you learned to fear was a result of whatever you did that caused pain. Your pain was the result of your not knowing what to do next that resulted in an outcome you neither expected nor intended. In the market environment you are free to act or not to act; the markets cannot do anything to you that you don't allow, even if it is out of ignorance or a complete sense of powerlessness.

The effects of fear on one's behavior are obvious, limiting one to the point of complete immobility. If you can't execute your trades properly, even when you perceive the most perfect opportunity, it is because you have not released yourself from the pain contained in the memories of past trading experiences and because you still don't trust yourself to act appropriately in any given set of conditions. If you did, there would be no fear or immobility.

ACCUMULATING PROFITS

Your ability to accumulate profits either in a single trade or cumulatively with several trades over a period of time is a function of your degree of self-valuation. This sense of self-valuation is, in fact, the most important psychological component of success and will override all others in determining your results.

Your degree of self-valuation will regulate how much money you will give yourself (the market doesn't give you the money, you give it to yourself based on your ability to perceive opportunity and execute a trade) out of the maximum potential available or perceivable at any given moment or time frame perspective. Regardless of the depth of understanding you have of market behavior or what you consciously intend, you will only "give" yourself the amount of money that corresponds to your level of self-valuation.

This concept can be explained with a simple illustration. If you perceive an opportunity, based on your definition or what market conditions constitute an opportunity, and do not follow through by executing a trade, what stopped you? In my mind, there can be only two possible reasons. You were either immobilized by the fear of failure or you are struggling with a belief (value) system that says you don't deserve the money. Otherwise, you would have acted on your perception.

SELF-ACCEPTANCE

The second theme that provides a foundation for the belief system I am offering is that personal transformation, growth, and learning new skills are a function of self-acceptance. Your intent of learning a new skill or way of expressing yourself is in essence an attempt to create a new dimension of yourself. It is a goal you have projected out into the future that you will then attempt to fulfill by growing into it.

The market will quite naturally make you face what is inside of you on a moment-to-moment basis. What is inside of you could be confidence or fear, a perception of opportunity or loss, restraint or uncontrollable greed, objectivity or illusion. The market just reflects these mental conditions, it does not create them.

Therefore, to grow into a new expression of yourself (fulfill your goal of being a more successful trader), you will need to learn how to accept the existence of any of these negative mental conditions and the psychological components that create them. Cultivating a belief in accepting whatever you find inside of yourself will give you the base you need to work from to change these conditions.

To illustrate this concept of self-acceptance, I will relate to you an example of a floor trader who came to me for assistance because he wanted to change his trading style. When he first went down to the floor he got caught up in scalping because it seemed like the easiest way to make money. However, he soon found that trying to scalp for one or two ticks in the bond pit was just too physically exhausting because he had to compete with so many traders. So he decided that he needed to learn how to hang on to his trades for more than one or two ticks.

The first thing we did was to preplan his trades. We used some fairly simple techniques to identify intraday support and resistance points within a 7- to 10-tick range. The plan was for him to stand in the pit and wait for the price to hit his target (buy support or sell resistance), execute the trade, wait for the market to hit his objective, and then exit the trade. If the market traded through his entry point in the opposite direction by more than two or three ticks, he was supposed to execute the loss without hesitation. Based on our assessment of the reliability of the support and resistance numbers, we believed he didn't need to risk more than two or three ticks to know if the trade was going to work or not.

The first day that he tried to execute his plan, he did very well waiting for the market to hit his entry point. However, when it came time to execute the trade, he couldn't do it. He was supposed to buy at a support level, and he didn’t do it because he thought it was going to keep on going lower. When the market didn't keep on going lower and bounced two and three ticks higher than what was his original entry point, he went ahead and bought one contract. From there he was supposed to wait until the market rotated back up to test the resistance which was 10 ticks higher than his originally intended entry point, but now it was only seven ticks away.

Instead of waiting for the market to rotate to his objective, he got out of the trade as soon as he had a two-tick profit. A short time Later when the market rotated up to the resistance area, he did the same thing that he did in the first trade. He didn't get in at his price because he thought the market was going to keep on going; it didn't, and he sold three ticks lower than he originally intended and then got out for a one-tick profit, not waiting for a full rotation.

When we talked about what he did later on that day, he was extremely displeased with himself. He made himself accountable, but he did not do what he was supposed to. He didn't get in at the price he intended or out where he intended, "leaving several ticks on the table," so to speak. This is a very wealthy man who only had to risk two or three ticks at the most to find out if the trade was going to work and couldn't do it. By the same token, he was so desperate for a win that he couldn't wait for his profit objective, stating that he couldn't hang on because he has been burned too many times.

Obviously his backlog of negative experiences had nothing to do with the market's behavior or the probability of any particular strategy working or not. What was even more important, however, was his lack of acceptance for his current level of skill development. His intense anger over his performance clearly indicated that he could not accept where he was at or the results it produced. That first day was not a positive experience for him, even though he had his first winning day in a long time. His lack of self-acceptance certainly won't help him hang on to winning trades in the future; in fact, he will be digging himself into a deeper hole that he will eventually have to work his way out of if he wants to achieve the success he desires.

As time went by, he became increasingly more confident with his ability to define an opportunity with a high probability of success. Almost every trade he put on would immediately go in his favor, so he would rarely find himself in a losing trade. But each day was also becoming ever more exasperating because he was still only holding on for a one- or two-tick profit and leaving several ticks on the table as the market rotated to test the next level of support or resistance.

What was even more difficult for him to deal with was that many times he had bought the low or sold the high of the day. Of course, he didn't know at the time it was going to be the high or low of the day, but looking back, he just couldn't deal with the fact that he only got one or two ticks out of it.

I knew the pressure was building inside of him because each day he had more excuses related to the market for why he wasn't doing what he was supposed to and had less and less tolerance to listen to anything I had to say about the situation. All these excuses were just an indication that he would not accept who he was in relationship to who he desperately wanted to believe that he already was. He was obviously indulging himself in illusion. To be the person he wanted to believe he already was would require that he learn how to be patient, acknowledge who he now was so he could concentrate on what he needs to learn and forgive himself for what he believed to be his past mistakes and inadequacies.

However, this would be very difficult because being impatient with other people had always got him what he wanted as long as he was dealing with people who perceived themselves as weaker than he. So why should he have to learn how to be patient now? Besides if he was patient with himself, it would make it difficult to justify his impatient, intolerant stance toward others who didn't "learn" fast enough or made "mistakes."

I didn't hear from him for a while and I just assumed that he wasn't doing anything different. Then one day after the close he called to tell me that he was going to start trading a 20-contract position. Otherwise nothing else about what he was doing had changed, except that he had several winning days in a row consisting of one- and two-tick winners.

I knew he was setting himself up for a big losing day, although I didn't indicate this to him in our conversation. In his mental system he was reasoning that by trading a larger contract size he would make enough money to prove to himself and everyone else that he had finally arrived, that he was a successful trader and that he was not a person subject to deep-rooted fears. Not being one to stand in the way of "progress," all I said was that I didn't think it was very prudent for him to be trading a 20-contract position, since he hadn't developed the psychological or mechanical skills to handle a position of that size. He grunted and hung up the phone.

The next day he lost almost $3,000.00 trading 20-contract positions. He gave back to the markets all his profits, plus more, from all his successful efforts over the last two and a half weeks of trading. At that point he was ready to listen to a plan on how he could learn how to be more accepting of himself and how to hang on to his winning trades.

The following is another example of a trader who has learned self-acceptance. This trader works for a local brokerage firm, manages hedge positions for financial institutions, and also trades for his own account. I started working with him on a fairly regular basis about three years before the experience I am about to relate.

He called me one day to tell me how proud he was of reversing his position on his last trade of the day. He said he cut his losses without hesitation and reversed his position from being short to going long. He was delighted that he felt no conflict, resistance, or mental anguish. He recognized what needed to be done and he did it. However, shortly after he did his reversal, one of the floor traders, who worked for the same firm filling customer orders, called him from the floor with some friendly advice that he should get out of his long position.

Now, my client had resolved long ago that he would not place any significance on another trader's perception of the market. He had excellent knowledge of the markets and believed he could trust his ability completely to define opportunity and make assessments of the potential for the market to move. At least he thought he believed he trusted himself. After he got the phone call, he knowingly allowed himself to be influenced by what this floor trader had to say and exited his position. Within 10 minutes of doing so the market (bond) rallied 15 ticks, just about what my client originally thought it had the potential to do when he put the position on.

He left 15 ticks on the table because he let another trader influence his perception of the market. However, he did not view this experience as a missed opportunity. He viewed it as an example of how he hadn't, as of yet, completely released himself from other people's opinions of the market. He didn't miss an opportunity because given the environmental conditions he was working under (someone calling him was an environmental condition he had no control over other than not to place any significance on the information); he simply was not psychologically prepared to take advantage of the opportunity. If he had been psychologically prepared, he would have stayed with his original plan, realizing that someone else's perception of the market isn't going to be any more objective than his. Furthermore, considering the skills he had already developed, their objectivity would usually be a lot less.

As you cultivate a stronger belief in self-acceptance, you will then realize how the market reflects back to you your level of skill development along with the information that will indicate what you need to work on to become ever more successful. Each moment will then become a perfect indication of your skills and your degree of self-valuation, giving you a solid base from which to improve and learn.

You will eventually understand at a very practical level how you are always doing the best you can because your outcomes will be the result of your depth of insight into the nature of the market environment and your ability to act on whatever you perceive.

There won't be any reason not to accept these results as you increase your understanding of how to adapt yourself to suit any particular set of environmental conditions and realize the power inherent within this understanding. If you were to deny this perfection of the moment (a lack of self-acceptance), you would, in effect, be denying yourself the kind of information you need to grow into the skills you are attempting to learn. You can't grow or expand if you are denying the existence of environmental information that would clearly indicate your level of development. Nor can you acquire effective skills when you try to build from a base of illusion about the nature of the environment and yourself. If you won't acknowledge your true starting point, you cannot take the next most appropriate step in the development of any skill you intend to learn.

The most essential component in the process of transformation is learning how to recognize and then clear out beliefs that argue for the status quo, beliefs that defend against the intrusion of environmental information you refuse to consider, and learning how to read the environment in a way that will clearly point to the most appropriate path to fulfilling yourself.

PART III

Building a Framework for Understanding Ourselves

At the start of this book, I said it would be a step-by-step guide in the process of adapting yourself to the trading environment. The first step in this process of adaptation is recognizing the need to adapt. If you can't manipulate or force the markets to change in a way that suits your needs, then you will need to learn how to change yourself to suit the conditions. The market places no limits or constraints on the ways in which you choose to express yourself, in that respect; unlike in the cultural environment, you have all the power. The primary purpose of Part II, The Nature of the Trading Environment from a Psychological Perspective, was to point out some of the vast differences between the trading environment and the social environment we were taught to function in and to demonstrate clearly a need for a new perspective.

The next two steps in this process are to learn how to (1) identify exactly what changes you need to make to function successfully in the trading environment and (2) how to effect any mental changes that are necessary. Manipulating the physical environment is as easy as moving a chair from one place to another because that's where you want or need to sit. However, to consciously change yourself to function more effectively in a market environment that will not respond to your attempts to manipulate it will require a thorough understanding of the nature and functioning of your mental environment.

The types of changes you will need to make will fall into two broad categories. First, you will need to learn some sophisticated mental skills to adapt yourself more readily to the constant changes with which the market confronts you—which will require neutralizing some commonly held cultural beliefs about success. (These are the beliefs that have the potential to distort market information.) Second, you will likely need to undo any psychological injury you may have sustained from your previous trading activity. Any psychological injury diminishes your capacity to execute your trades properly.

There are obviously a multitude of substeps to learn how to identify what you need to learn, what you need to change, and how to make those changes. The six chapters in this part are organized to take you through this process of adaptation by providing you with the insight you will need to understand what you have to do and why.

The first thing you will need is a structural framework to make the things that go on in your mental environment more tangible and concrete. To give you this framework, I will describe, define, and organize the component parts of the mental environment into a manageable context to where you can (1) understand your behavior, (2) learn the various techniques for manipulating your mental environment at your conscious direction to be more consistent with the environmental conditions and your goals, and (3) learn how to monitor your relationship with the exterior environment.

It is essential that you learn how to monitor your relationship between the interior and exterior environment because our goals, intents, expectations, needs, and wants are all component parts of our mental environment that we project out into the physical environment for fulfillment in some future moment. In other words, they are all components of the mental environment that either happen or don't happen in the outside physical world. You need to be able to recognize immediately (especially as a trader) when you have the potential to distort the outside information to be consistent with the inner components. These distortions will inevitably result in pain and psychological injury.

What I intend to demonstrate in the following chapters is even though you cannot turn your eyes inward to actually see these mental component parts of the mental environment, it doesn't make them any less real. Besides, it isn't necessary to turn our eyes inward because we can just as easily learn to define what is inside of our mental environment by what we see and experience in the outside physical environment. By making the connection between what we believe and what we experience, it will be a lot easier to change what we experience by learning how to manipulate our beliefs.

We will examine the nature of beliefs and how they act as environmental information management systems. I will demonstrate how our individual beliefs about the nature of the market, and our expectations of what it will do next, manage and control the type and quality of information we perceive about it. By breaking down the dynamics of perception, you will be able to identify the various ways in which all of us place mental limitations on the market's behavior and how these limitations cause us to distort market information.

We will thoroughly explore the nature of fear and how it compels all of us to act without a perception of choice. The predominate underlying force behind most traders' actions causing prices to move is fear—the fear of missing out (competing for the supply) and the fear of loss. If you really want to understand the market's behavior to anticipate what it will do next, then you will first have to learn about and understand the underlying forces beneath your own behavior and how you process and manage information.

When you understand how any number of typical market-related fears operate in your life and learn to release yourself from them, you will, in effect, be separating yourself from the "crowd." When you separate yourself from the "crowd" and expand what you know about the forces affecting your behavior to encompass the group, it will be much easier to anticipate what the group will do because they will merely represent a larger (collective) version of the way you used to be. In other words, you will know how other traders will behave before they do because you will be able to observe them from a detached perspective—due to your having evolved beyond the choiceless state of operating out of fear.

As you gain in your understanding of how beliefs interact with environmental information to control your perception and form your experience, along with learning how to distinguish between wishful thinking and what the market is indicating about itself, you will eventually be able to learn how to control your perception of the market activity in a way that allows you the greatest amount of mental flexibility, where you will be able to shift your perspective to flow with the markets and execute your trades without hesitation. If you can't change or control what the market is doing, then the only option you have left is to control yourself in a way that allows you to perceive what the market may do next with increased clarity and objectivity, requiring a thorough working knowledge of the nature of your inner environment in relationship to the outer physical environment.

CHAPTER 9

Understanding the Nature of the Mental Environment

Understanding yourself and learning how to function inside your mental environment is not as difficult as you may think it is. It does, however, require that you gain a thorough understanding of the general characteristics of the mental environment, its component parts, and how they work, which is exactly what this part of the book is designed to give you.

The only reason why any of this would seem so difficult is because we aren't taught how to do it when we are young. In fact, we are usually taught exactly the opposite—that the mental environment is a mysterious place that can't be understood. As a result, we end up defining mental components in a haphazard fashion without ever really understanding the relationship between the components, or the relationship these components have with the outside physical environment in the ways that determine how we experience our lives. So, if you are going to consciously transform or adapt yourself to function more effectively as a trader, you will need a very fundamental and practical understanding of the nature of these mental components and how they operate. As will be explained in a moment, there are vast differences in the characteristics of the mental environment (inner) and physical environment (outer) in which our bodies occupy space. Understanding these differences is a key ingredient in the process of changing yourself.

As a simple example, the book you are reading exists on the outside of you, whereas the label of book (i.e., your mind's perception of the book) or any other thoughts or sensations you would experience as a result of that label and the meaning you attach is all occurring on the inside of you. Anything that goes on or that happens on the inside of you would constitute your mental environment; all your experiences and memories of those experiences, all your beliefs, all the emotional energy attached to those beliefs, all your feelings, needs, wants, expectations, and goals, and all your thoughts, regardless of whether or not you have expressed these thoughts into the environment, make up your mental landscape.

However, before we explore the differences between the inner and outer environments, I want to point out one characteristic common to the two. They are both constructed of many independently functioning parts ("regions" would be a better word to describe the inner environment) that cooperate to make up the whole. Most people are very familiar with their body parts, even the ones en-closed within the body cavity. These parts are made up of cells that have distinct functions. They operate independently and cooperate with the other body parts. The sum total of these cooperating parts is our body. A simple illustration would be that eyes are not ears or lungs, they are distinct parts having unique functions within the whole.

By the same token, the mental environment is composed of a number of cooperative but independently functioning regions that make-up the whole of who we are. For example, a belief is not a dream, nor is a thought an emotion. Beliefs, dreams, thoughts, and emotions are all separate parts of the mental environment that interact in the same manner (at least conceptually) that your hands will interact with your eyes or your finger with your nose or your lungs with your heart. I am pointing this out because most people do not think of their mental environments in such specific ways with highly refined distinctions among the various regions and the ways the components within those regions function.

The following list provides some of the categories into which I have divided the mental environment and the components associated with each category that will be explained in the next five chapters.

Positively Charged Emotions: Love, happiness, joy, confidence, peace, acceptance

Negatively Charged Emotions: Fear, anger, hatred, jealousy, disappointment, confusion, impatience, stress, anxiety, betrayal

Illusions: Denials, rationalizations, intellectualizations, distortions

Beliefs

Intents: Goals, aspirations

Expectations: Wants, desires, demands

Needs

Dreams: Sleeping dreams, daydreams

Thoughts

Attractions

Memories

Creativity

Intuition

This is not intended to represent a complete list of components and categories of the mental environment. However, it is comprehensive enough to serve the objectives of this book, which is to give you enough of a working knowledge of how they operate and interact to effect any changes you determine are necessary to trade successfully.

WHAT EXACTLY IS THE MENTAL (INNER) ENVIRONMENT?

I am defining the mental environment as a place where all the sensory information from the physical environment (sensory information being the way in which the physical environment acts as a force on our eyes, ears, nose, taste, and touch) gets sorted, categorized, labeled, organized, associated with, and stored. Beliefs are formed and meanings get attached. The mental environment is where our experiences of the outside world form into a complex belief structure about the nature of the physical environment and our relationship with it.

There are two things that I want you to note about this definition. First, it is limited, because it doesn't take into account mental activities that generate from within, exclusive of outside sensory information. This is something I will expand on later. Second, I am not including the brain as part of the mental environment, even though the activity of the mental environment takes place inside of the brain. (Why I am not including it will become clear in a moment.)

One of the first characteristics you may notice about the mental components listed is that they are all intangible. You can't see, hear, touch, taste, or smell them, at least not as they exist in the mental environment. For example, no surgeon operating on living brain tissue has ever encountered his patient's beliefs, thoughts, dreams, or memories, even though he knew they were in there somewhere. Biochemists have discovered DNA (deoxyribonucleic acid) while working at the molecular level of tissue make-up and as of yet have not encountered one of the mental components listed earlier. Yet we know they exist because we can experience the results of someone's beliefs or thoughts as they are expressed outwardly in the physical environment through their behavior.

Now, for those of you who are asking yourself how do these mental components exist if they aren't tangible and no one has ever directly experienced them? The answer is, they exist as a form of energy (and energy doesn't have mass). For example, light will pass through physical objects or reflect off them, but light will not displace anything, and electricity will pass through objects, not displace them. Entities made up of atoms and molecules will displace one another as they move into each other's space.

For a long time the scientific community believed that the atom was the smallest, most fundamental building block of existence, only to discover later that within an atom is energy. What scientists haven't figured out yet is how does something that exists without mass (the energy within the atom) become something that does have mass—the atom. In other words, how does energy go from being non-physical to physical. Albert Einstein was once asked to give his definition of matter and he said "Matter is merely energy in a form that we can perceive by our senses." Even at the atomic level the book you are now reading and the chair you are sitting on to read it appear to your senses as if they are solid. However, that is not the case at all. Our senses cannot perceive things as they exist at the atomic level where everything is spinning and there is space between the atoms. However, the point I am making is that all matter exists as energy at the very deepest level of existence (within the atom), but not all energy exists as matter, as with light and electricity.

In very general terms, mental energy, as it exists in its various, intangible forms as beliefs, feelings, emotions, and so on has the potential to act as a force on our behavior and consequently as a force on the outside physical environment corresponding to the way in which this energy is expressed. For example, mental energy in the form of a belief or memory of an experience can motivate a person to walk across a room to change the channel on his television set because he believes a program on another channel is more worthwhile or pleasurable, bid the price of a stock higher than the last price because he believes it serves his best interests, or motivate masses of people to go *to* war to defend or promote whatever they believe needs to be defended or promoted. These actions and their effects on the environment are the result of this mental energy expressed outwardly.

WHAT IS EXPERIENCE?

We experience the world with our five physical senses. This is common knowledge. But, when you get down to the very basics, what actually happens to our experiences of the environment as they go from the outer (physical) to the inner (mental) environment? What we see, hear, touch, taste, and smell at a physical level is transformed into electrical impulses of *energy* and is sent to the brain via the nervous system. That is, at the most basic level, tangible experience of the outside world is transformed into intangible electrical energy, meaning that the tangible medium where we experience our lives (the physical environment) does not have the same characteristics and properties of the medium that represents and stores these experiences on the inside of us (the mental environment). We will examine these differences on a more practical level in a moment.

If, at first, it seems preposterous to think that our experiences (environmental information) are transformed into electrical energy, then consider that we have been using an analogous form of technology mechanically for years in the form of telephones and computers. Computers store information, sounds, and images in a number of different energy media. Telephones transport sounds and images in the form of electricity, light, or microwaves. As common-place as all this is, there is still something fascinating about a living process that transforms sensory information (tangible experience) into electricity and stores it that way. Everything that we have learned (as individuals) about the nature of our existence is stored in our mental environment at an intangible level, in a nonphysical reality (energy is real, yet it is nonphysical because it doesn't consist of atoms and molecules, thus it can be said that energy exists in a nonphysical reality).

Earlier, I did not include the brain as part of the mental environment because it exists at the tangible level of atoms and molecules (physical reality), whereas the mental environment (energy in the form of beliefs, memories, emotions, and so on, about the nature of physical environment resulting from our experiences) does not exist at this tangible level. To help you understand this distinction between the brain and the mental environment, consider that the brain exclusive of the mental environment is no different from a computer that is not plugged into some electrical power source. In this analogy, the mental environment would correspond to the electrical energy that makes the computer run as well as store and carry the various forms of information the computer is designed to handle and the computer hardware (physical, mechanical, atoms, and molecules) would correspond to the brain.

This is the reason why I stated in the beginning of the chapter that there are vast differences between the mental and physical environments. All the mental components I listed exist at the intangible level of energy and, more important, function with the same properties and characteristics of energy. To understand the nature of the mental environment, you need to understand the characteristics of energy. Thus, what I intend to do next is examine the properties and characteristics of typical energy forms like light and electricity and then compare them to the characteristics of the mental environment to establish a correspondence between the two.

Finally, in the next five chapters I will tie all this material together to give you some very practical techniques to improve your ability to trade effectively.

HOW DOES THE MENTAL ENVIRONMENT CORRESPOND TO THE CHARACTERISTICS AND PROPERTIES OF ENERGY?

Energy Is Nondimensional

As we already know, energy doesn't take up space in the physical environment because it doesn't displace anything that does take up space. This "no space" characteristic of energy gives it a nondimensional quality. In other words, anything that doesn't take up space also won't have any tangible dimensions of height, length, width, or circumference, at least not in the ways in which we would normally think of these properties. This nondimensional quality is probably the hardest concept to grasp about the nature of energy, because even though energy is nondimensional, it can take some form that is visible to our eyes. And anything that is visible should have dimensions that we can measure. It may seem like an obvious contradiction to say that energy can take a visible form and yet still not have dimension, but it is not.

The best example to illustrate this is with holograms or holographic photography. With a holographic process you can create a three-dimensional image in light projected into space that can be seen with the eyes, and it will appear to have length, width, and circumference. You could even measure the length or width of the image; however, your hands would pass right through the image if you tried, because there really isn't anything there, at least not in a physical sense. Images in light have no physical substance, so from a physical perspective, they also don't have any dimension. (Relative to physical objects, energy doesn't have dimension.)

Memories or mental images (anything that we can see with our inner eye, like visualizations, daydreams, or night dreams) could operate very much like a hologram of laser light—an image of light that has no physical substance—where space as it relates to distance or dimension is not a consideration. The total area available inside of our skulls is quite small, especially in relationship to what will fit from a mental perspective. We can create mental images of any size or proportion, with none of the dimensional limitations that exist in the physical environment because these images, as an energy form, have no physical substance and thus exist in a state of form without dimension, taking up "no space."

You can easily demonstrate this concept with a simple mental exercise. Close your eyes and picture the last place where you went on a vacation. Where did you stay? What side trips did you take? When you imagined where you went, did you get up and move from your present location in the physical environment. Did you imagine yourself getting up out of your chair to make all the preparations that would be necessary for such a trip? Did you get in your car and mentally drive each mile to your destination, as you would if you were actually going? Probably not; the image of your last vacation most likely just popped into your consciousness. It is as if you were instantaneously transported to these locations, without regard to the space or distance that you would need to travel to get there in the physical environment. There was "no space" between your present location and the image of the vacation spot you hold in your memories.

The nature of our dreams also illustrates this nondimensional characteristic. First, there is no known limit to the type of dream landscape we could find ourselves in. Dreams can be as varied and diverse, if not more so, as the physical environment and all much larger than the space available inside of our skull cavity. Furthermore, in our dreams we can instantaneously change locations without actually traveling any distance. For example, you could dream that you are in the basement of your house and then in the next instant be in your living room, without actually having walked up your basement stairs or through other rooms to get to there.

Speed

The second characteristic the mental environment shares with energy is speed. Energy travels at an incredibly high rate of speed. Light, for example, travels at a rate of 186,000 miles per second, fast enough to travel around the Earth approximately eight times in 1 second. This is so fast that to our physical senses, it appears instantaneous or simultaneous. What I mean is, it moves so fast that our physical senses cannot detect the motion. Obviously, we can see the light, but we cannot actually see it moving from any given source to some distant point. For example, when you turn on a light in a dark room, does the room become illuminated in stages as the light travels from its source to the walls? No, to our eyes the room fills with light instantaneously, seeming to be everywhere at once, in a flash. Our eyes are not constructed in a manner where we can make any distinctions in movement, so it seems as if it doesn't move at all.

This instantaneous characteristic of light relates quite well to the mental environment. As I pointed out earlier, dream travel can be and usually is instantaneous. While you're having a dream, in one instant you could be in a house and the next you could be on the other side of the world. There really isn't any travel time between these dream locations. Whatever, mental mechanism prompts the change, it creates a simultaneous transfer, probably taking as much physical (clock) time as it does for light to fill up a dark room.

However, there is another mental characteristic (actually more of a phenomenon) that best illustrates the speed at which the mental environment operates. This is something that is not experienced by very many people, but nevertheless reported by enough people in completely separate, unrelated incidents to confirm its validity. What I am referring to is the phenomenon of having one's life flash before one's consciousness in the form of a continuous mental image, from birth to the present. Something like this usually only happens in extreme life-threatening situations where the person believes that he is only moments from death. In those few moments before the expected death, the sights, sounds, tastes, smells, feelings, and emotions of one's entire life are reexperienced.

Personally whenever I've read of or heard someone's recounting of such an experience, it baffled me. I didn't understand how a person's whole life could scroll before his consciousness in a matter of moments, when it took years to experience. However, after a great deal of contemplation, it occurred to me that the energy in which our experiences are stored moves at speeds that are so incredibly fast that it would make our lives seem quite short in comparison, thus making it possible for all our experiences to scroll by in moments, regardless of how long it took actually to have the experiences.

All this might be a little easier to understand if you imagine, as I did, experiences stored in a stream of light very much like what you would see when you look at a distant star. There is a very good correlation here. For example, scientists tell us that many of the closest stars to the Earth, other than our sun, are so far away, that even at the incredible speed of 186,000 miles per second, it still takes the light emanating from these stars hundreds of years to reach the Earth. This distance between the stars and Earth is so vast that it creates a steady beam of light, billions of trillions of miles long. So, when we look at any star other than our sun, what we are actually seeing is the light that left it hundreds or even thousands of years ago, thus what we are seeing is light from the star's distant past. Now, if we could travel along this beam of light back to its source, what we would be seeing is light from the star's more recent past (or future from the perspective of traveling toward the star) the closer that we got to it, until we arrived at the star's present. Light from the past, future (depending on one's perspective), and present would exist simultaneously within that beam.

Now, imagine the sights, sounds, tastes, smells, feelings, and emotions of our experiences stored in energy as a stream of memories that we can travel along very much like this beam of light, where we can use our consciousness to roam between the distant past to the more recent past up to the present moment or project these memories out into the future. If the energy in which our experiences are stored can move at speeds that are equal to or approach the speed of light, then it would offer a credible explanation as to how it is possible for one's whole life to scroll before one's consciousness in a matter of moments. To illustrate this for yourself further, imagine all your experiences stretched out like a beam of light that you could travel along at the speed of light. At that speed, at even a couple of seconds of travel time, you could get through a great deal of information. For example, if we just arbitrarily decided that it took 10,000 miles of mental energy stretched out to hold 1 year's worth of experience, then, at the speed of light, you could get through almost 19 years of memories in 1 second.

Recognition of this phenomenon helps us to grasp one of the most difficult concepts about the nature of the mental environment—that it exists outside of time, as we know it. That is, our physical senses lock us into perceiving an environment bounded by the limitations of time and three-dimensional space. We have to experience each moment in a linear sequence. We can't go backward and experience the past as it existed in the physical environment; once it passes, it's gone forever. Nor can we move ahead into the future. The past doesn't exist anymore, and the future doesn't exist yet. What does exist are these seemingly endless sequences of "now moments" in which we experience our lives. However, the mental energy our inner components consist of operates outside of our normal concept of time and space as it is experienced in the physical environment. In the mental environment there are no spatial boundaries or time constraints; we can think in any direction we please: past, present, or future. And, theoretically, there would be no limits or boundaries as to how much information could be stored.

Simply stated, time is a function of our perception of movement over distance or three-dimensional space. In other words, to perceive time, you need two key components: space that has dimensions, and movement. Both these properties obviously exist in the physical environment. It has characteristics of three-dimensional space consisting of length, height, width or thickness, and circumference. Also the physical environment is in constant motion. The sun, other stars, the planets, and their moons are all in motion. And even though we can't directly perceive it, everything physical is in motion at the atomic and molecular level. Everything is spinning around something larger from the tiniest atoms and molecules to the largest stars and solar systems, including the atoms and molecules in our own bodies.

This spinning motion of the Earth and its orbit around the sun acts as a force on the environment, changing day to night and night to day, creating the weather and the seasons as well as an endless number of other environmental cycles. All these cycles of environmental changes (including our own bodily cycles of growth, age, respiration, digestion, and so on, resulting from the movement of the atoms and molecules of our cells) act as a force on our physical senses, causing us to experience a constantly changing environment, one cycle after another, in straight linear fashion, thus giving us our perception of time that is always moving forward. If we couldn't perceive motion or some sort of movement over three-dimensional space to act as reference points to measure this movement, then we wouldn't be able to perceive the passing of time. For example, if we were conscious but somehow fixed in a state of suspended animation where we had no sensory input, no perception of movement of any kind, not even a heartbeat, it would be impossible to tell the difference between a few seconds or a few days. To measure time, you need a point to start from and a point to get to; these points can be measured off in distance or time, but you need three-dimensional space to get your points.

We think in an environment that is more like a stream where our consciousness can roam freely between the past, present, and future without regard to time or space. Furthermore, the actual sequences of moments that exist in the physical environment have no effect on the energy our memories are stored in. Sequences of time only have an effect on the mental environment relative to the impact the environment is having on our senses in energy terms. You can easily demonstrate this to yourself by trying to reconstruct from your memory the last 24 hours, moment for moment. Difficult, isn't it. Now try to do it for a week ago today. The only things we remember are the significant events, the experiences that had the most impact on our senses, the ones with the most energy connected with them. That's because experiences are not recorded in our memories as moments of time; they are stored as charges of energy. And as such they have no relationship to the passing of physical clock time.

Remember, energy doesn't exist as atoms and molecules and therefore relative to our perception of the passing of time, it is not subjected to this nonstop spinning of everything that is physical. Energy can remain static or be active. For example, someone or something could remind you of an experience that happened 20 years ago, an experience that you haven't thought of since it happened. When you tap into the energy of those memories, you will reexperience the sights, sounds, tastes, smells, and most important, the emotions of that time, as if nothing had changed. In your mind nothing has changed. The energy remained dormant for 20 years. It becomes active either when we choose to think or reflect about what is inside of us or when we are inadvertently reminded of what is inside of us.

Significantly positive (pleasurable: happy, joyful, etc.) or negative (painful: terrorizing, angry, hateful) experiences are easily recalled because of the amount or intensity of the energy involved with the event. These types of experiences will pop into our conscious recollection, at will. But, try to remember every time in your life that you brushed your teeth, took a drink of water, opened your refrigerator door, or put your shoes and socks on and it's not so easy. These events are difficult to recall because there is very little energy connected with each of these types of experiences.

Our memories are like pockets of energy that we may organize chronologically by date and time, as in the stream-of-light example. However, all the uneventful moments between the eventful moments seem to disappear without a trace or get compressed as if they never happened, even though we know that they did. We must have put on our shoes and socks a month ago today because we probably would remember walking around without them; that might be significant enough to remember.

What we read, as an example, is usually quickly forgotten because there is very little impact the environment is having on our senses. Printed words on a page have very little visual impact in relationship to activities of a more experiential nature. For example, actually participating in a biology experiment will have a much greater impact from an energy perspective than will reading about one. The energy required to remember something that we read has to be generated from within in the form of concentration.

So, the way in which we experience clock time is in relationship to what we are feeling (either physical or emotional impact) in any given moment. If, for example, you were experiencing terror, each second of clock time could easily seem like an hour or day. Each moment of a terrorizing experience seems to last forever because the environment is assaulting our senses. The impact is so painful that we can't wait for the experience to end to be out of that situation. We would therefore focus our attention on how long the event is lasting, while we were waiting for it to end, thus slowing down our sense of time.

Pleasurable experiences seem to fly by (we have no concept of time passing) because we are in a state of joy and happiness, and nothing takes us out of these moments to feel something less than the joy. We come out of that state of mind when the experience starts to diminish in its degree of happiness causing us to focus more on the unpleasantness of what we are experiencing (some degree less than joy, even if it is boredom) compared to the happiness we were feeling. When our focus shifts from joy (no concept of time passing) to "I can't wait for this to end," our sense of time slows down in proportion to the unpleasantness of the experience.

In the physical environment, experiences take place in moments of time that pass one after another, in linear fashion. What we experience in moments of time (through our physical senses) is transformed into electrical energy and stored as a memory relative to the degree of impact of the experience. Memories don't have any restrictions imposed on them by time because energy isn't physical. Time is one directional, whereas in our mental environment we are free to think about our memories at will or by just wanting to. We can experience them as a mental image, mental sounds, mental tastes, and so on. *Each of our memories makes up a part of our identity, and because they exist as an energy form, they have the potential to act as a force on our behavior*. Regardless of whether we are conscious of these specific forces or not they cause us to move through the environment in certain ways corresponding to what we have already experienced to create more experiences and more memories.

Essentially, what I am stating is that our existence straddles two very different dimensions simultaneously. We live in and perceive three-dimensional space, and, as a result, our physical senses are subject to the limitations of time, where one moment passes after another in straight linear fashion, whereas we think in a dimension where time and space as it is perceived in the physical environment doesn't exist. Now, there are some very important psychological implications within the concept that time and space don't exist in the mental environment, implications that have to do with our ability to experience happiness, fulfill our needs, and achieve our goals, which are all basically synonymous. However, before we address these implications, you will need to understand how experiences are stored in varying degrees of positively or negatively charged energy, what I call the "quality of energy" our memories are stored in.

CHAPTER **10**

How Memories, Associations, and Beliefs Manage Environmental Information

From the moment we are born into this world, our existence acts as a force on the physical environment. We take up space that cannot be occupied by anyone or anything else. And, in turn, the physical environment acts as a force on our physical senses, creating a cause-and-effect relationship between ourselves and the environment. It is important for you to note now and for the rest of the book that I am defining the physical environment in the broadest sense possible, as everything outside of ourselves, including other people. Now, at the most basic level, we create experience for ourselves by the mere fact that we exist. To exist implies that our senses are alive and that we are interacting (acting as a force) with the environment, altering its makeup and consistency as we move through it. For example, our movement and behavior set off an endless series of chain reactions that alter the landscape in some way, shape, or form. And even when we aren't actively changing or manipulating the environment in some way, we are still taking up space and thus subjecting ourselves to atmospheric forces, as well as causing changes in the makeup of the atmosphere from our breathing.

MEMORIES ARE STORED AS CHARGED ENERGY

The experiences that result from this constant interaction with the environment will be transformed into electrical impulses of energy. As electrical impulses of energy, the experiences will carry an electrical charge. The charge will be either positive or negative, depending on the kind of impact the environment had on our senses. For example, a crying baby is acting as a force on the environment. More specifically, the baby is creating a sound that is acting as a force on the eardrums of everyone in his vicinity. How the environment responds to this force will create experience for the child and determine the electrical charge or quality of energy that is recorded in the baby's memory.

"Quality of energy" is the relative degree of positively or negatively charged energy in which the experience is recorded. For example, if the environment responds to the child with a soothing caress, expressing love and a sense that his needs will be taken care of, then the experience will be recorded in the child's memory with some degree of positively charged emotional energy. The degree of positiveness will depend on the intensity of the experience, that is, the degree of impact the environment had on the child's senses. Pleasant, happy, joyful, and loving experiences will result in the storage of positively charged energy. If, however, the environment responds harshly, in such a way as to have a violent impact on the child's senses, by screaming (assaulting his eardrums) or slapping him to produce physical pain, then the experience will be recorded in the child's memory with negatively charged emotional energy to the same degree as the intensity of the experience.

There are two basic components that make up the quality of energy in which our memories are stored. The first is the polarity of the charge, which could be positive, neutral, or negative. The second component is the intensity of the charge ranging from extreme positive, which would be an experience of maximum intensity creating a feeling of elation, to extreme negative, which would be an experience of unbridled terror. Quality of energy is an important concept for you to understand because it affects the type of beliefs we form about the nature of the environment, which in turn affects how we perceive information and interact with the environment.

The Characteristics of Positively Charged Energy

Positive energy is expansive. It promotes mental growth or learning by creating a sense of confidence, which in turn results in an openness to explore and discover the unknown. I am defining the unknown as anything that exists as a possibility in the physical environment that does not yet reside in some form in one's mental environment. Positive energy perpetuates our natural, childlike sense of curiosity and wonderment toward the environment that we are all born with.

By following the interests of our natural sense of curiosity, we interact with the environment to create experience and learn something previously unknown to ourselves, thus generating a sense of excitement about life, as well as increasing our ability to operate in the environment more effectively because we are continuing to learn more about the way things exist. There is a direct relationship between how much we have allowed ourselves to learn about the nature of the environment and the degree of negatively charged energy in our mental environment. I am stating it this way with the emphasis on the negative because learning will take place quite naturally if there isn't anything in the inner environment to stop it. In other words, an absence of fear (negatively charged energy) is a critical factor in determining whether or not we will make ourselves available to learn anything new and continue to grow mentally.

For example, playfully throw a child up in the air and catch him and he will beg you to do it over and over again. This is his way of interacting with the environment to perpetuate the feelings of a positively charged experience. Positive energy is expansive, compelling us to interact with the environment to create more experience for ourselves. The more we experience the more we learn about the nature of the environment. The more we learn about the nature of the environment, the better able we are to interact with it more effectively to fulfill our needs and achieve our goals. Positively charged memories give us that sense of confidence that allows to step out to try something new resulting in mental growth.

The Characteristics of Negatively Charged Energy

Now, throw the same child up in the air for the first time, as in the earlier example, but instead of catching him, accidentally drop him, and not only will he not ask you to do again, he will cower in terror at the very suggestion. The difference in his behavior, of course, is the result of the differences between the two experiences. In the first example, the experience was pleasurable, resulting in the storage of positively charged energy. In the second example, the experience was painful, resulting in the storage of negatively charged energy.

Regardless of whether we were acting as a force on the environment (behavior motivated by our sense of curiosity) and got an unexpected or unintended painful reaction, or the environment, uninitiated by ourselves (other than the fact that we exist), acted as a force on us in a way that resulted in pain, the experience will result in the formation of a negatively charged memory. Painful memories will generate fear, causing us to perceive the environment as threatening in its ability to cause more pain in some future moment. The way we will perceive it as threatening will correspond to our memories of the experiences that resulted in pain in similar circumstances or conditions (the things we fear in the environment are those things we have learned to recognize as threatening).

In contrast to the feelings of confidence and well-being that result from positively charged experiences, fear acts as a limiting or inhibiting force on both our behavior and our perception of environmental information. I am sure that everyone reading this book at some point has experienced the effects that fear can have on one's behavior. It can cause us to run from an obviously dangerous situation or completely immobilize us to the point where our body will not respond to any conscious command. Fear drastically limits our choices. It causes us to interact with the environment in ways that are limited to the structure of our memories, regardless of what the environment may be offering in the way of a new experience, or it causes us to avoid an experience completely. Interacting with the environment results in experience, and experience results in learning. If we experience the environmental present based on our individual past, or completely avoid experience altogether, we aren't learning what is being offered or available to be learned about the nature of the environment.

The net result of a painful experience is that it creates a negatively charged memory, which in turn creates and perpetuates a cycle of fear. Cycles of fear then create cycles of discontent and dissatisfaction because we avoid experience. When we avoid experience, we cut ourselves off from the joy we feel when we are learning. Just as positive cycles are expansive, negative cycles are degenerative. Our painful memories keep us from learning how to interact with the environment in effective and satisfying ways that would result in happier and more fulfilling lives because we aren't learning what we need to know to experience something different.

Fear limits both our range of behavior and our perception of environmental information. The ways in which it limits our behavior are obvious. However, there are many ways in which fear acts on our perception that aren't so obvious; in fact some of the ways can be very subtle and difficult to recognize, until one learns what to look for. As traders, it is essential that you be able to observe the market's behavior from an objective perspective. To observe objectively you will need to learn how to recognize a variety of subtle fears that will destroy your ability to be objective without really knowing it. This is a subject I will cover in much greater depth a little further on. However, before I can do so you need to understand the nature of associations and how perception creates an energy loop between the inside mental environment and the outside physical environment.

ASSOCIATIONS

Associations seem to be a natural characteristic of the way in which we think. That is, our brains are wired in such a way as to link similar forms of environmental information together automatically. We do this in basically two ways. First, there is a natural propensity to label people and objects based on some prominent characteristic and then categorize them into associative groups. After we categorize the groups by sex, hair color, skin color, profession, economic status, educational background, and so on, we then associate whatever experience or knowledge we have about the group with everyone and everything that has those same characteristics. For example, if we have a painful experience with a person who has a skin color different from that of our own, we will automatically associate everyone with that skin color with the qualities of that one experience.

The second way we associate is by linking extraneous sensory information with some event. We will automatically associate what we are smelling, tasting, hearing, or seeing along with the quality of energy of the primary experience. For example, a child getting spanked will associate all the other environmental information that his senses are inadvertently picking up with the pain he is feeling from the spanking. What he hears, smells, tastes, and sees will all be connected with the intensity of the force being applied to his body. So if there was some song playing on the radio or a distinctive odor in the air at the same time that he was experiencing pain, he will associate the song or the odor with the pain.

Now, both these environmental distinctions (a certain song and a certain smell) will be connected with negative energy in his mental environment. When the child was getting his spanking he may not have even noticed either the song or the smell because his attention was obviously focused in other directions. However, in the future whenever he hears that song or smells that particular odor, they will automatically cause him to experience the negative energy connected with the spanking. Even if it is years later, and he is enjoying himself with the last thing on his mind being the memory of that spanking, if he hears that particular song or smells that particular odor, it will carry him back to that time as if it were the present moment, changing his experience from happiness to anger, sadness, or guilt.

Of course, this same principle also works for positive experiences. A perfect example is many couples have "a song" that they associate with some intense sexual or loving experience. When they hear "their song," it will mentally put them into the feelings of the experience the song is associated with. In fact, the song can eventually come to symbolize the quality of the entire relationship where all the memories and emotions connected to those memories will run though their consciousness upon hearing the song.

Associations are an automatic function of the way in which information gets organized in our mental systems. Most of these associations are inadvertent, meaning we have positively or negatively charged energy connected to various elements of the environment, and we aren't consciously aware of it. We can see, hear, taste, or smell certain things that, in turn, cause us to feel emotions and not know why because we don't consciously remember connecting the extraneous sensory information with the primary event.

THE ENERGY LOOP BETWEEN THE PHYSICAL AND MENTAL ENVIRONMENTS

None of us has access to "all" the environmental information that exists in any given moment. Our senses aren't constructed to allow us to pick up (see, hear, touch, taste, or smell) everything at once. If we can't be aware of it all, then we must have some mechanism by which we pick and choose what we do become aware of and give our attention and consideration to. What we learn creates an energy loop between the inner and outer environment. We can call this energy loop perception. "Perception" is recognizing—with our eyes, ears, nose, taste, and touch—in the physical environment what we have already learned about it. Mental energy works in conjunction with our physical senses to separate, categorize, and organize environmental information based on the distinctions we have learned to make. We recognize what we have learned in the environment because it is already inside of us. There has to be a mental framework to accept the information; otherwise, it gets rejected, labeled as meaningless, or not perceived at all, unless of course we are willing to construct a framework for it—being open to learn.

Distinctions

Distinctions make separations in environmental information where no previous separation existed. A child won't make a distinction between a spoon and pencil until someone teaches him the difference. Otherwise, he will instinctively put both in his mouth, until the information stored in his mental environment acts as a force on his perception to distinguish between the two. Environmental objects give off information about themselves, but the information that is perceived already exists inside of each individual, unless it is a first-time experience. The spoon and the information about what it is create an energy loop between the inside and the outside, where before the distinction was learned the spoon and he pencil would fall into the same category as something to put into the mouth. Anything we don't know, but exists in the environment as a possibility, is a distinction that we haven't learned to make yet. If we haven't learned to make the distinction, we won't perceive the various types of information the environment is giving off about itself.

For example, if I were to open up my computer, what I would perceive would be very different from that of a skilled computer repair technician. All the various parts giving off information about themselves would mean almost nothing to me because there is no meaning inside of me. All the parts my eyes would be seeing would fall into that one large category because I haven't learned to make any distinctions between the various parts, whereas the technician would perceive the parts in a very different way because he understands the functioning of the parts and the relationship that they have with one another. That understanding is the mental framework that structures the particular way in which he perceives the parts. The parts would be giving off information about themselves that I couldn't perceive because I don't have the mental structure to perceive it.

Learning how to read the markets to recognize an opportunity is another example to illustrate this energy loop between the inside and outside that we call perception. Traders act as a force on the market to move prices. Since most traders don't plan their trades or want to take responsibility for their outcomes they are highly susceptible to acting out of any number of fears. Traders who are motivated to act out of fear generally aren't aware that their fear drastically reduces the choices they perceive as available, making their behavior very predictable to an objective observer (someone not caught in the same cycles of fear). So under certain market conditions large groups of traders will all be trying to do the same thing—because of what they fear will or won't happen—upsetting the equilibrium, forcing prices to move in one direction. If you haven't yet learned to identify these conditions, you naturally won't perceive them when they exist because there has to be an energy loop between the inner and outer environments for perception to occur.

I am sure everyone has had the experience of reading unfamiliar material a second, third, or fourth time and perceiving something new with each subsequent reading. What is happening here? With each reading you are building a mental framework that enables you to recognize what was available but unperceivable to you when it was read previously. That is, all the new insight that you garner with each reading was available from the book the moment you picked it up the first time. However, you weren't able to perceive what it had to offer in the way of insights or understandings until you created an energy loop that enabled you to perceive it; otherwise, the words get read but the insight goes by completely unnoticed even though you are looking right at it.

In any given moment there is a vast difference between what each of us perceives and what is actually available in the way of possible distinctions from the environment's perspective. Take, for example, a salesperson who has learned to recognize the exact, most appropriate moment to ask for the order and close a sale. Or an auto mechanic who knows exactly what is wrong with a car by the kind of sounds that it makes. To the inexperienced salesperson or auto mechanic, these abilities will seem like magic because they will assume that they are hearing or seeing the same things as their experienced counterparts. However, that is not the case. They are not hearing or seeing the same information even though they are in the same sales interview or listening to the same car at the exact same moment. They are actually perceiving different environmental information because of the differences in the structure of their respective mental environments. The information that indicates the exact moment to ask for the order to close the sale is indistinguishable from everything else to the inexperienced salesperson. The same is true for the inexperienced auto mechanic. Consequently, neither one will perceive the existence of this information until they learn to make the appropriate distinctions. If someone wasn't there to teach them how to make these more refined distinctions that indicate the most appropriate moment to ask, they may never know about the existence of such information. By learning to make more distinctions, we increase the depth of our level of understanding of the cause-and-effect relationship between everything that exists.

How Our Perceptions Shape Our Experiences

We experience the environment through our senses. At the most fundamental level the world gets transformed into electrical impulses of energy, energy that carries information, as well as feelings and emotions ranging from extreme happiness to rage, elation to despair, love to hate, and all the degrees of feelings and emotions in between. Each first-time encounter with the environment creates a memory, distinction, or association that didn't exist previously. A first-time encounter is any experience that is completely unique, like learning the meaning of a word that we have never heard before, and there is nothing in our mental environment to relate it to. These new memories, distinctions, and associations build into a mental framework that constitute what we have learned about the nature of the outside environment.

Once we learn something, mental energy will then act as a force on our senses to recognize in the environment what we have learned about it. So there is a two-way flow of energy; first, we learn something through some unique experience; then, we perceive what we have learned in the environment. Fear is a perfect example for illustrating this concept. We feel fear when we recognize in the environment anything that we have learned can cause us pain. We will feel this fear and consequently have a fearful experience because the negatively charged energy in our memories, distinctions, and associations will act as a force on our eyes, ears, nose, and sense of touch to recognize in the environment anything that is similar to what we have already learned can cause pain.

So when we perceive something (recognizing what we have already learned) in the environment, mental energy is acting as a force on our senses, instead of the environment acting as a force on our senses. In other words, the conditions are similar or identical to what we already know, and we can therefore attach some meaning to the information. The environment isn't creating the meaning as in a first-time encounter; the meaning is already inside of us, and in essence we create the experience by the way in which we perceive it, through our memories, distinctions, and associations.

This is why a group of people can all be in the same location, be exposed to the same environmental information, and then afterward describe the event in a different way. The event was different for each individual because everyone experienced it differently. Their experience was a function of the structure of their mental environment. Each individual will make different associations with the same information and then experience the varying degrees of positive or negative energy connected with those associations. Each individual will make different distinctions with the same information, in effect placing a different meaning on it. Each meaning will be composed of varying degrees of positive or negative energy, thereby creating a different experience relative to everyone else's. Each person will experience the amount of time the event took differently, depending on whether they are perceiving the experience with predominately positively charged energy (time speeds up) or negatively charged energy (time slows down). Without taking all these mental variables into consideration, it is little wonder why people get so frustrated with one another when they can't agree on what happened. Everybody's version of what happened was unique, because the way each of us experience the outside environment is determined by how we perceive it, and how we perceive it is a function of what is already inside of us unless we are in the process learning something new.

The implications are that much of what we experience of the outside environment is shaped from the inside, not from the outside as most people would assume. In other words, our first-time experiences shape the meaning, as well as determine the quality of energy connected with that meaning, and then once the meaning exists inside of us, it shapes our experience of the outside by the way we pick and choose information and how we feel about that information.

This is a very important concept, so I will give you another example to illustrate how our perceptions shape the way we experience the environment. Let's say that I am approaching a statue of a man. At first, I look at the statue face to face, and I experience indifference; that is, what I am seeing does not evoke any particular emotion. Then, I walk around the statue, and change my viewing angle until I look at it in profile. As I look at the profile, the face reminds me of a someone (an association) whom I like very much and whom I haven't seen for years. From this new perspective the statue would take on a new meaning changing my experience from emotionally neutral to some strong feelings of nostalgia as I think about how much I miss this person.

The energy for how I experienced that statue and that particular moment in the environment was inside of me before I even looked at it. The energy that changed the feelings I was experiencing did not come from the statue or really have anything to do with that statue. My unique mental structure caused me to experience that statue the way in which I did. It took on a new meaning as I changed my perspective because of the way the energy that was already inside of me acted on my perception. If I hadn't had the positive experiences with the person the statue reminded me of, then I would have continued to experience indifference as I looked at it.

THE RELATIONSHIP BETWEEN PERCEPTIONS AND EMOTIONS

The energy that determines how we feel (love/hate, happiness/ anger, confidence/fear, etc.) in many circumstances and situations does not come from the environment. These feelings and emotions are already part of us, and we will automatically feel them when there is a matchup (perception) between what is outside in the now moment with what is already inside of us as a result of our past experiences. For example, imagine a father holding his five-year-old son with one hand, screaming "you stupid idiot" while spanking him with the other hand. And let's assume that this is the first time the child has heard the words stupid or idiot. Now he may not know what the words mean in an adult context, but he will most certainly connect the words with pain he is feeling through both his body as well as his ears. From that point forward these words will have a strong negative charge attached to them in his mental environment. Now, when he encounters these words in the environment again in some future moment he will be able to recognize them because he has experienced these words—they exist as a distinction in his mental environment. As a result of the way in which he learned the meaning of these words, how will his perception of them affect his experience of them? Whenever he hears the words "stupid" or "idiot" he will feel the negatively charged energy connected to these words in his mental environment and consequently experience the physical environment in a painful way. Does the environment need to physically assault him, as in the first experience, for him to feel this pain? No. All he has to do is hear the words and he will experience pain. After his first encounter with these words, the pain doesn't have to come directly from the environment because it is already inside of him. Would it make any difference if from the environment's perspective that the words were spoken with absolutely no intent to cause him any pain or without any awareness that they could, in fact, cause him to feel pain. Again, no. He would not be able to perceive the intent of the environment as anything but wanting to cause him pain because that is exactly what he experiences when he hears those words. How could he know that other alternative meanings exist for these words or that they can also be used within a context of good-natured fun? He couldn't, because he has never experienced those words in any kind of fun context, he hasn't learned to make that distinction yet. From the perspective of his mental environment, there are no other alternative possibilities for the meaning of these words. Furthermore, he may never learn to make any alternative distinctions, because every time he hears the words "stupid" or "idiot," he will perceive them in a painful way, thereby creating an experience of pain, which will in turn reinforce the negative energy already connected to the meaning for those words. From the first experience forward into the future, he will be locked into only one version of the way he can experience those words.

In any given moment, there are a whole range of experiences available from the environment. What we experience as individuals will be a function of what we perceive, unless we are in a learning mode. In other words, what we are experiencing in any given moment is being shaped by what is already inside of us (memories, distinctions, associations, and beliefs), and what is already inside of us may not be remotely close to what the environment is offering in the way of experience. When we are in a learning mode we open ourselves up to learn new distinctions and alternative meanings to expand what we know about the nature of the environment.

Our experiences shape our meanings and then the meanings shape our experiences of the future. Let me illustrate this concept for you. I was watching a local television program in spring 1987 called "Gotcha Chicago." It was about some local celebrities who played practical jokes on other Chicago notables. In one segment of the program the TV station hired a man to stand on the sidewalk along Michigan Avenue holding a sign that read "FREE MONEY— TODAY ONLY." (For those of you who are not familiar with Chicago, Michigan Avenue is home to many of the most expensive and fashionable department stores and boutiques in the city.) The man's pockets were stuffed with cash, and he had been instructed to give money to anyone who asked for it. Considering that Michigan Avenue is one of the busiest areas of the city, how many people do you think took him up on his offer and asked for some money?

Out of all the people who walked by and read the sign, only one person stopped and said, "Great! May I have a quarter to buy a bus transfer?" Otherwise, no one would even go near him. Eventually he grew frustrated and started crying out, "Do you want any money? Please take my money. I can't give it away fast enough." Everybody just walked around him as though he didn't exist. He approached one businessman asking, "Would you like some money?" And the man responded, "Not today." The "plant" said, "How many days does this happen?" as he tried to give him a handful of cash, while continuing to say "Would you please take this?" The businessman responded with a terse "no" and walked on.

Now here is a situation where the environment was expressing itself in a way that only one person had the mental structure to perceive. For the rest of the people, there was no meaning inside of them that they could directly correlate with the actual environmental conditions. Other than the one person who asked for a quarter, nobody looked at the sign and said to themselves "Great! Somebody is giving away free money, I wonder how much he will give me."

People's responses to the conditions shouldn't be too surprising because we generally don't believe that money is ever free. And we can know what people believed about the situation by just observing their behavior. If they thought that it was possible to get free money, we can assume that they would not have walked by, ignoring the opportunity to get some. So the meaning they attached and what they experienced corresponded to their belief that "free money" isn't possible or nobody gives away money on the street—no strings attached. In fact, most people probably thought he was crazy, which would explain why people went out of their way to walk around him to avoid contact.

However, the environment was expressing itself in exactly the way in which it was representing itself. The sign reading "free money" was the truth, but the information "free money" did not connect with anything in anyone's mental environment so that it could be perceived as the truth. There was a direct one-to-one relationship between what any given individual believed, what he perceived, and what he experienced Except for one man, everyone else obviously did not believe in the possibility of free money; they probably perceived a crazy man and thus had an erroneous experience relative to the conditions. Now, the environment did not choose the meaning any of these people placed on the information it was offering. And if the environment did not choose, then each individual created his own experience out of the situation that was presented to him. There were a number of alternate experiences available and each alternate experience would correspond to the type of belief someone would have about the possibilities.

BELIEFS

Beliefs create definitions, make distinctions, and shape our perception of environmental information by programming our senses to hear, see, and select information that corresponds with what we believe. Our experience of the environment will correspond to the choices we make, and these choices will correspond to the information that is perceivable. What is perceivable to each individual, however, may not have much of a relationship to what is available or possible from the environment's perspective. Each person in the illustration of free money would claim that what he experienced was, in fact, the true reality of the situation. What would cause them to believe anything different? People think of their beliefs and subsequent experiences as a fact of reality instead of a belief about reality. This is natural because beliefs create a relationship with the environment that is best described as circular or a closed loop.

What I mean by a closed loop is that every component part in the process of how we experience the environment supports every other component, making everything seem self-evident or beyond question. These closed-loop systems that beliefs create are extremely difficult to open up. The belief controls the information coming into the mental system, the information that is actually perceived will be consistent with the belief, the course of action taken will be consistent with the information perceived, and the subsequent experience will support and reinforce the validity of the belief. This is a closed system that will not allow for the possibility of other alternatives because the experiences keep on reinforcing the beliefs, making the beliefs seem increasingly more self-evident and beyond question. Unless we are open or even know how to be open to new information that could lead to new experiences, we will experience the closed-loop nature of our beliefs every moment, assuming the whole time that what we experienced in each situation was the only possibility available.

The people who walked by the man giving away free money didn't know they were completely oblivious to the possibility of the environment expressing itself in such a manner, even though the sign said "Free Money." And if confronted with the same set of environmental conditions again, they would behave the same way as the first time, not knowing that other distinctions are possible, even if they are remote. The perception and the experience have to match up because we can't experience something that we don't know about yet, unless we are open to the possibility that what we believe might be very limiting in relationship to what the environment is offering. Remember the man who refused to take the money even when it was being handed to him? He was being offered an experience that would have increased the number of distinctions he could make about the nature of the environment (free money does exist), and he would have grown mentally as a result. Being given free money was obviously a distinction he didn't know about yet. And even though it would seem that free money would be a powerful incentive to question one's belief that it doesn't exist, it wasn't enough for this man. His beliefs obviously did not allow him to even remotely consider the possibility, again creating this closed loop, leading him to believe that what he ended up with or experienced out of this situation was the true nature of his existence, when all it really was was a reflection of the true nature of his beliefs and how they manage environmental information.

Beliefs define the parameters in which we perceive environmental information. All definitions by definition create boundaries. Beliefs will manage information in various ways to maintain a balance between the inner and outer environment. Any perceived imbalance will result in some degree of either stress or illusion. In maintaining a balance, many of our responses to environmental conditions are automatic because our beliefs make the response seem self-evident, when, in fact, under any given set of environmental conditions alternate experiences exist along side of the experiences our beliefs locked us into.

By inhibiting the flow of information into the mental system, beliefs do exactly what they are supposed to do. They limit our awareness of data so that we can learn in stages. If we believe that things exist in only one particular way, then our beliefs will act as a natural mechanism to block the acceptance of any conflicting information.

Considering or accepting any new or conflicting information would open up choices that we ordinarily would not have to consider. Too many choices too soon can cause confusion and mental overload. If it were not for the limiting nature of beliefs, what would happen to our minds would probably be similar to what it would be like if a television set picked up all the information being broadcast from all the TV stations and projected that information on to the screen simultaneously on the same channel. Beliefs allow us to tune into one channel of environmental information at a time so that we can learn about the nature of the environment through that one channel. Then we can expand our awareness to pick up another channel as we learn how to deal with the additional choices we are confronted with as we become aware of the additional possibilities.

HOW OUR FEARS FUNCTION TO CREATE THE EXPERIENCE WE ARE TRYING TO AVOID

What we perceive is a function of the distinctions that we have learned to make. What we focus our attention on—out of all the distinctions we have learned to perceive—is a function of the intensity of the energy in the perception loop. We only have so much of our conscious attention to give to whatever information happens to be available in any given moment. Fear (high degree of negatively charged energy) has a profoundly limiting effect on the range of information that we can pay attention to. It causes us to narrow our range of perception to focus our attention on to the object of our fears. How else could we avoid what we perceive as threatening?

Learning to drive is an excellent example that illustrates how fear narrows our focus of attention. The dangers of driving are obvious even to someone who has never driven before. It isn't too difficult to imagine the harmful effects of a head-on collision. Without having developed the necessary skills to control the car, the new driver would lack the confidence to know that he can respond appropriately to any given situation. That is, he doesn't trust himself. As a result, he will feel some degree of uncomfortableness or fear when he drives. The fear will, in turn, cause him to focus his attention on the oncoming traffic or concentrate on the eye/hand coordination necessary to keep the car in the appropriate lane. Because he is so focused on what he can't do and what may happen as a result, he has little if any of his attention available to do anything else, like carry on a conversation with a passenger, notice the scenery in his peripheral vision, or even read road signs. All this other environmental information is available and perceivable, but in his case it is either blocked or unnoticed because he has to devote so much of his attention to the object of his fear (the lack of control he has over the car). At the point where he becomes comfortable with his ability to drive safely, his field of awareness will open up allowing him to perceive all this other information.

The purpose of fear is to help us avoid those things in the environment we have learned to perceive as threatening. However, when we couple our painful memories with our natural propensity to associate and group environmental components together— instead of avoiding the object of our fears—we will actually create the very experiences we are trying to avoid. For example, a child severely bitten by a dog will quite naturally associate all dogs with the threat of pain and consequently generate an intense fear or even terror whenever he encounters any dog in the future. The child's fear of all other dogs other than the one that bit him is real. He has no way of making a distinction between a friendly and a dangerous dog because his personal experience has taught him that all dogs are dangerous. Because of this natural propensity to associate, all we need is one first-time experience to believe that all dogs are dangerous. That is his truth about the nature of the environment. However, his truth is not all the environment has to offer in the way of experiences in relationship to dogs. Not every dog that exists is dangerous. Quite the contrary, very few would be considered threatening; most see a child and want to play.

Now, in every chance encounter the child has with a dog in the future he will create an experience of terror, regardless of the disposition of any particular dog he happens to run into. If a dog makes any movement toward the child, the child will perceive that movement as an actual attack when all the dog wanted to do was play or be petted. In fact, the child could become so afraid of being attacked that he will devote most if not all of his attention to scanning the surrounding environment for dogs. Eventually his senses will become attuned to picking up their sights and sounds. And every time he sees or hears one, he will create another terrifying experience that just reinforces his fears. His focus of attention will attract to his attention the object of his fears so that he can avoid what he has learned is threatening. The problem is that what he has learned is erroneous in relationship to the conditions, that not all dogs are dangerous. Not knowing that, he will naturally believe that his terror is coming from outside him instead of inside him. In effect his fears are acting on his perception to create the very experiences he is trying to avoid by causing him to hone in on all the dogs in the environment.

What we focus our attention on in the environment is what we will usually get. The dog-biting example is a graphic illustration of this. However, there are other ways that our fears act as a cause to create what we are trying to avoid that aren't so obvious. Remember that all fears act on our perception as a warning mechanism to help us avoid what we believe to be threatening. One way to avoid the object of our fears is simply to refuse to acknowledge the existence of threatening information. Another more subtle way that will create some real blind spots in our perception is to focus all our attention on alternative - nonthreatening - information to the exclusion of everything else. These blind spots will exclude whole categories of perceivable information from our awareness, which can result in some disastrous consequences, especially in the trading environment.

For example, let's say that the market is offering us what we believe to be a good opportunity to make some money, so we go ahead and put on a trade, but at the same time we are also operating out of a fear of being wrong. We will fear being wrong because, if we are, it will force us to feel whatever negative energy has accumulated inside of us as a result of being wrong in the past. Now, if the market offers us a choice between information that would indicate we are right or information that would indicate that we are wrong, what information will we naturally focus our attention on? The information that will make us right, without acknowledging or considering the implications of the information that would indicate otherwise. Again, those implications could be disastrous.

Let's look at another example of a trader who is afraid of losing. A fear of losing presents an obvious conflict because it would be difficult to put on a trade in the first place. However, for the sake of this example, let's say this trader was so attracted to a specific opportunity that he managed to operate outside of his fear long enough to put on a trade. Now, the kind of information he focuses his attention on will depend on what the market does. If the market goes against him, he will be afraid to confront the possibility of another loss, so he will focus his attention on any other nonthreatening information. If the market happens to come back to his entry point, he will exit the trade in a sigh of relief, regardless of what the potential is for any further movement in his direction. But, if the market continues to go against him, his mental defenses will begin to break down as the threatening information becomes just too overwhelming for him to be able to block from his awareness any longer. At that point he could easily become paralyzed and not be able to do anything on his behalf. Eventually his stress and anxiety will become so acute that the only way he can relieve it is by getting out of the trade.

On the other hand, if he finds himself in a winning trade he will focus on completely different information. His fear of losing will cause him to focus his attention on what the market can take away from him. In a winning trade he will exclude from his awareness any information that would indicate what the potential is for the market to continue to move in his direction, which is the only information he focused on in a losing trade, and instead focus exclusively on information that will confirm his fears of the market, retracing back to his entry point or beyond. In effect, his fear of losing causes him to exit the trade early for a small profit regardless of whatever the possible profit potential was in that trade. Once he is out, if the market continues to move in his original direction, he will agonize over the profits he left on the table and wonder why he just couldn't hang in there just a little longer, not realizing that his fear of losing actually caused him to lose all those additional profits.

What you have just been given is an example of why the vast majority of traders cut their profits short and let their losses run. In a winning trade, the fear of losing will cause us to focus our attention on information that the market is going to take our profits away, compelling us to get out early. In a losing trade we will focus our attention on just the opposite information—anything other than that which would indicate the trade is a loser. Fear causes us to act without a perception of choice. When we are afraid to confront certain categories of market information, it drastically limits the choices that we perceive as available. Cutting a loss isn't a choice if we systematically block from our awareness any information that would indicate that we are in a losing trade. Staying in a winner isn't a choice if we are consumed with the fear that the market is going to take away our money.

To prevent these blind spots in our perception, we have to learn to trade without fear. And to trade without fear we need to completely trust ourselves to confront and accept whatever information the market is offering about itself, and we need to be able to trust ourselves to know that we will always act in our best interests without hesitation, regardless of the conditions. Any endeavor will require some degree of trust. We would find it difficult to cross the street it we didn't trust ourselves to be able to get out of the way of the oncoming traffic. From a psychological perspective, the market environment can wreak just as much havoc in our lives as getting hit by a car. To be successful as traders, we need to believe that we can win with an absence of fear so we can make better assessments of the conditions and perceive more choices. What this means is that we have to do the necessary mental work to release ourselves from anything within us that would cause us to narrow our focus of attention or specifically block certain categories of information from our awareness.

CHAPTER 11

Why We Need to Learn How to Adapt

There is a direct relationship between our ability to adapt to changing environmental conditions and the level of satisfaction we feel about our lives. To adapt to the changes occurring in the outside environment implies that we are changing ourselves as we learn more and more of what the environment has to offer in terms of distinctions about its nature. The more distinctions we can make between the various components of the environment and how they act as a force on one another, the more information becomes available to us through our perception. As we expand our perception of information available, we will gain a deeper level of understanding and insight into the cause-and-effect relationship that we have with the outside environment, that is, how the environment has the potential to act as a force on us and how the environment will react to the force of our behavior.

The deeper the level of our understanding and insight, the more effectively we can interact with the environment to fulfill our needs and achieve our goals. Fulfilling our needs and achieving our goals create within us a feeling of well-being, confidence, and satisfaction about our lives that would otherwise be characterized by feelings of dissatisfaction, disappointment, and deterioration when we can't fulfill ourselves. Success, confidence, and satisfaction are all synonymous. They breed from one another to create and perpetuate a positive cycle of expansion and mental growth. And, by the same token, disappointment, dissatisfaction, and deterioration also feed on one another to create negative cycles of emotional pain, anxiety, and depression.

To fulfill our needs and achieve our goals, there has to be some level of correspondence or balance between the inner mental environment and the outer physical environment. What I mean by "correspondence" is some level of understanding of how the outer environment works. Our needs, intents, goals, and desires—all— exist first in the mental environment. Then one of three things can happen in some future moment in the physical environment; they are either 100 percent fulfilled, partially fulfilled, or not fulfilled at all, resulting in feelings of satisfaction or dissatisfaction equivalent to the degree of fulfillment.

To fulfill ourselves, we need to interact with the outside environmental forces. The extent to which we fulfill ourselves is a function of knowing the most appropriate set of steps to take in relationship to the outer conditions and to what extent we can act on what we know. Knowing the most appropriate set of steps to take in relationship to the prevailing conditions is a function of how much or little we have learned in relationship to what is available to be learned.

> *Example:* Draw a large circle with a diameter of approximately 6 feet. This circle will represent everything that is available to be learned about the nature of the universe, not limited by what we know of it, but as it exists in every way as yet to be discovered. Now, draw a smaller circle within the larger one, with a diameter of approximately 2 feet. This smaller circle will represent all the accumulated knowledge of humankind since the dawn of our existence, in other words, what we have learned in relationship to what we have yet to discover about the interacting forces of our environment and ourselves. Now, place a dot within the smaller circle. This dot would probably be a fair representation of what each of us as individuals has accumulated in knowledge, insight, and understanding, in relationship to what has already been discovered and learned by others (both in the past and present), in relationship to everything else that is still waiting to be discovered.
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> The empty space between the inside boundaries of the larger circle and the smaller circle is basically everything we don't know or haven't learned about yet, either individually or collectively. There are many things in the environment available to be experienced. However, until we learn about them, we won't experience them, just as people couldn't experience atomic energy until it was discovered. Yet it existed in the environment, waiting to be experienced and learned about for hundreds of thousands of years before we actually discovered it. These were hidden components that had to be actively uncovered by someone. Otherwise, if the environment acts as a force on us in ways that we haven't learned to understand yet, we will either dismiss the experience as not real or form some superstition or think of it as some unknown or random force, until we investigate and understand the

phenomena. When we investigate, we learn to make enough distinctions to recognize all the interacting components acting as a force on one another to create the effect that we also believed was random, until we learned about the experience. For years, many people in the academic community believed that the markets were random; this is a perfect example of their general lack of understanding of human nature. People act as a force on prices in perfectly logical ways, when you understand the logic of their fears.

The small circle represents what has been discovered and experienced by somebody at sometime in human history. All the discoveries throughout human history have expanded the small circle to include more and more of the larger one. For example, the small circle would probably have been a tenth of its present size during the Middle Ages. Each discovery since then changed the environment that we could experience because it added something to the mental environment that didn't previously exist in it. In other words, as we learned, we changed the way we perceived the world around us, resulting in the evolution of the thinking of humankind overall.

There is no question that the accumulated knowledge of humankind has increased to levels that would be completely inconceivable to or boggle the mind of even the broadest, most progressive thinking person alive just 100 years ago. Everything that exists now that didn't exist then (cars, planes, phones, computers, etc.) is the result of what someone learned and shared with others, and consequently it changed the consistency and makeup of the environment we live in. And yet all of what we have now existed as possibilities since the beginning of humankind. The possibility for manned space flight existed from the first moment that a person looked up into a star-lit sky and wondered what it would be like to be on the moon. Of course, we didn't even attempt to do it until our knowledge evolved to a point where mere wishing could be turned into a reality. But what if we could go back to 1889 and tell the typical 40-year-old person about the world their great, great, great-grandchildren will grow up in? There is no way he would believe how different things will be. He wouldn't believe it because he wouldn't have the mental framework to believe it, just like we would have a very difficult time believing what we will have evolved into 100 years from now.

The dot simply represents the world we experience as individuals in relationship to what would be possible to experience if we had inside of our mental environment all the accumulated knowledge of humankind. Everything you and I know as individuals in relationship to everything we haven't learned yet would represent the current set of limitations that we operate from. That is, all our individual accumulated knowledge—every memory, belief, distinction, association, insight, or understanding—about the nature of the physical environment would all represent our personal limitations compared to what is available in the environment to experience, believe, and understand. That is, there will always be more information available in the environment than what our personal limitations will allow us to perceive or experience.

Just contemplate the immensity of what we don't know yet; consider that every person who exists acts as a force on the environment to change it in some way that can affect us as individuals in some gratifying or unsatisfying way. The way in which each individual acts as a cause to change the environment, which in turn, affects everyone else, will correspond to the makeup of his mental environment. So, until you or I understand every facet of everyone else's behavior and the ways in which they can express themselves to act as a force on the environment (meaning the rest of us), then every other person that exists would represent an unknown outside force to the extent that we haven't learned about human nature or understand it.

We could start filling in the small circle with dots to represent the knowledge of each individual that exists on the planet, until the circle was almost filled. The blank space left in the small circle would represent knowledge that exists in some form that is not inside the mind of some person alive today. We could also organize the dots into clusters, where each dot would overlap a bit to represent the shared knowledge and beliefs of different cultures, although they couldn't overlap too much because we all know something different because of our individual differences in experiences. The dots would also have to be different sizes to represent the increased or decreased levels of understanding and insight that we operate out of in relationship to one another. For example, the dot of a child would be much smaller than the dot of a typical adult.

The physical environment was here before we were born—and we certainly weren't born with the insight that we need to interact with it in such a way that we can assure ourselves of experiencing high levels of satisfaction. For example, if there was a 100 percent correspondence between our mental and physical environment, then everything there is to know about the nature of the physical environment we would have already learned, and this knowledge would be a component part of the mental environment. Implied within this perfect correspondence would be a complete understanding of all the forces that operate in the physical environment, coupled with a complete understanding of their cause-and-effect relationship. We would know exactly how the environment would act as a force on us to create experience and how the environment would respond as a counteracting force to the force we apply to it through our behavior. And, therefore, with this perfect understanding we would know the most appropriate set of steps to take to fulfill our needs, intents, goals, and desire, resulting in a complete state of satisfaction. I am defining behavior as the outward physical expression of mental energy acting as a force on the outside environment.

Obviously, none of us possesses this kind of perfect correspondence with the environment, and, as a result, it is probably safe to say that none of us lives our lives in a complete state of satisfaction. However, the more we understand and know about the interacting forces behind our own behavior and the interacting environmental forces outside of us, the easier it is to fulfill our needs and achieve our goals, resulting in greater levels of satisfaction that we will experience in our lives. Conversely, if we don't understand our own behavior, we certainly can't begin to understand or anticipate anyone else's, and the less we understand and know about the rest of the environmental components that have a potential to act as a force on us, then it would stand to reason that the less potential we have to fulfill our needs and achieve our goals, resulting in feelings of disappointment, stress, anxiety, unhappiness, and fear.

LEARNING AND THE QUALITY OF OUR EXPERIENCES

As I have mentioned, we aren't born with the knowledge that we need to operate effectively in the physical environment to fulfill ourselves. However, we are born with the need to know. This need to know operates as a driving force in our lives coming from the innermost depths of who we are. Our natural sense of curiosity compels us to explore and learn. For example, once we have learned the nature of something or accomplished some task, we quickly become bored and go on to something different. Boredom acts as an inner force compelling us to look for something new to discover and learn about.

Attractions also act as an inner force, compelling us to move through the environment to discover and create experience. Take the object of a child's curiosity (something he is attracted to) away from him and what will happen? He will usually start crying or even throw a fit His crying is an indication that his inner needs are not being fulfilled. Crying is a form of grieving to compensate for the lack of balance between the inner and outer environments. When we have explored the object of our attraction to our satisfaction, it means the inside has been filled with what the outside has to offer in terms of experience. When that happens we simply lose interest, become bored, and start to scan the environment for something else that might attract our attention.

There is another characteristic of our nature that supports our need to learn. Whenever we learn a skill, the steps involved in the operation of that skill drop down to an unconscious level of operation, so we are then free to learn something new. To learn a skill, we usually have to break the skill down into a series of small steps and concentrate on each individual step until we can put all the steps together into a series of effective movements. By concentrating on each small step, we narrow our focus of attention to the point where we are oblivious to anything else going on in the environment. For example, think of a time in your life when you were tying to learn a new skill, say, in some sport, and while you were trying to put all the movements together, someone was attempting to get your attention on some completely unrelated matter. In such a situation we would find it extremely difficult, if not impossible, to stay focused on one without destroying our concentration on the other. However, after we have successfully made the skill a learned resource, we could easily perform the movements while focusing our attention elsewhere.

Without this characteristic of our nature, where our skills drop to an unconsciousness level of operation, we would find it nearly impossible to move beyond the performance level of a typical infant. Just think what it would be like if we had to concentrate on all the movements necessary just to pick something up the way a typical infant does. We didn't always have the eye/hand coordination that we take completely for granted. We had to learn it. We learned it because we were attracted to things in the environment we wanted to experience with our sense of touch. As we learn each skill, we can automatically access the series of movements to execute the skill so we don't have to concentrate on any of the individual steps, which then frees our attention to explore and continually expand what we can become aware of.

Learning is a function of our existence. It will occur quite naturally through our powerful sense of curiosity and what we find ourselves attracted to in the environment that we just need to know everything about. At the most fundamental level, learning will happen just because we are alive and have to interact with the environment to stay alive. So we will learn something. However, that doesn't necessarily mean that what we have learned is very useful with respect to how we might go about fulfilling ourselves in some satisfactory way. We have very little control in our early years over what we learn about the nature of the outside world and how it works. I will discuss this in more detail in a moment.

As we expand our personal dot (as in the example) to learn more and more of what the environment has to offer in the way of insight about itself, we increase our level of correspondence with it When we learn, we change the makeup and consistency of our inner environment. Each change we make on the inside simultaneously changes our perspective and perception of the outside. The outside environment is different because we are operating out of new insights and understandings as a result of what has been added to or changed on the inside. Each new insight makes available to us new and different choices on how to interact more appropriately with the environment to change the quality of our experiences.

This may seem like an obvious correlation between what we have learned and how much satisfaction we experience in our lives, but I assure you it is not. If it was so obvious, then most people wouldn't have such a difficult time making the connection between the deteriorating conditions, lack of happiness or satisfaction in their lives and their lack of insight, coupled with a refusal to acknowledge there is something they don't know and need to learn.

There are always greater levels of satisfaction available in every experience until we reach the point where we know everything there is to know. If we did know everything there is to know, we could expect outcomes from the outside that would correspond exactly with the inside mental environment. This kind of perfect correspondence between inner and outer would be the result of our perfect understanding of ourselves—the inner forces that act on our behavior—in relationship to the outer environmental forces that act on us. Since none of us is at the level of perfect knowledge, we can assume that within every experience we have with the physical environment there are other probable experiences resulting from other choices that were available but unknown to us at the time, the point being that what we end up with in any given situation will correspond exactly with our level of understanding, insight, and ability to act on what we know.

The more we allow ourselves to learn, the better able we are at making assessments about the possibilities that exist in some future moment. However, implied within the foregoing statement is that we are, first, willing to acknowledge that other possible futures exist, not just the one future that our expectations and beliefs about what we have already learned lock us into. Keep in mind that everything we know in relationship to everything we haven't learned yet would represent the current set of limitations that we operate out of. Conceptually, these individual limitations are no different from the choices people in the Middle Ages were blinded to by believing that the Earth was flat.

If we aren't willing to acknowledge that in any given situation more information and choices exist than what our beliefs allow us to perceive, then we will never learn to recognize or anticipate the existence of these other more satisfying possibilities. By acknowledging the possibility that a more appropriate set of steps exists, we open ourselves up to perceive and then learn the steps that can lead to greater levels of satisfaction. Refusing to acknowledge the existence of these possibilities would be the same as claiming that electricity didn't exist before it was discovered. When we continually argue for the status quo by defending what we already believe we know, the environment will seem to be constantly assaulting us, resulting in feelings of stress and anxiety. The outer environment becomes assaulting because it is offering us more to learn about the nature of the ways in which things exist and we are simply refusing to learn.

In fact, we can easily determine if we need to learn something to operate in the environment more effectively by just monitoring the way we feel. If there were never an imbalance or lack of correspondence between the mental and the physical environments, then theoretically we wouldn't ever have a reason to feel disappointment, frustration, confusion, stress, or anxiety. It is only because there is an imbalance, a lack of harmony or correspondence, between the mental and physical that we ever experience any of these unpleasant, negative emotions. Because when there is a balance between the inside and outside, we experience the opposite feelings of joy, happiness, and satisfaction. So it would stand to reason that any time we feel these negative emotions, it is because we either didn't know the most appropriate set of steps, resulting in frustration and disappointment, or we don't know what to do next, resulting in stress, anxiety, and confusion. *In any case, our feelings will always tell us about the state of our relationship with the environment and point the way to what we need to learn to experience greater degrees of satisfaction.*

For example, if we aren't experiencing satisfaction in our personal relationships, would it be too simple to assume that the reason is because we haven't developed the appropriate interpersonal skills? Is it possible that there are certain communication skills available that—once learned and used—can result in much more satisfying personal relationships and deeper levels of intimacy? The problem is that it is just as easy to assume that the appropriate skills leading to greater levels of satisfaction don't exist or that we already know what we need to know and if we aren't experiencing satisfaction now, it must therefore not be possible to experience it at all. When we operate out of the last assumption, even if the environment presents us with evidence that deeper levels of satisfaction are possible (observing another couple who are experiencing satisfaction), we would probably assume that they are acting as if they were happy for appearance's sake. That way, we won't have to take responsibility for learning something they might know.

The first assumption would result in investigation, learning, and expansion, leading to greater levels of effectiveness and satisfaction. The last two assumptions would obviously lead to more dissatisfaction. The names and places may change, but we will experience the same kind of painful conditions over and over again. These cycles of dissatisfaction will continue until we acknowledge there is something we need to learn and go about the task of learning it.

WHAT WE ALREADY KNOW WILL BLOCK WHAT WE HAVEN'T LEARNED YET

Obviously, acknowledging there is something that we need to learn is not as easy as it sounds. In fact, acknowledging that we don't know something or that what we do know isn't very useful or effective presents us with one of the major paradoxes of life. The dilemma we are confronted with is how can we know what we don't know when what we have already learned will block our perception of what we haven't learned yet. For example, once we learn that trading is easy (the first few quick winning trades will establish that belief), it will block our perception of information to the contrary, that trading is probably one of the hardest endeavors one could choose to undertake. Each of these beliefs—that trading is easy or trading is hard—would result in the perception of completely different choices as being available from the environment, resulting in very different outcomes based on the choices perceived and acted on.

We don't question the usefulness or effectiveness of something we have already learned, simply because what each of us has learned we experienced in some way. That is, we won't question what we have experienced just because we experienced it, meaning the reality of the experience is based in our five senses: what is inside of us we either, felt, saw, heard, smelled, or tasted. That's real enough. Once an experience becomes a component part of our mental environment in the form of a memory, belief, or association, it becomes a part of what is commonly believed to be our identity and beyond question.

However, we are open to learn practically anything the environment has to offer, if we haven't been previously exposed in some way. We will soak up first-time information like a sponge, regardless of what it is. However, once it is inside of us, we will either defend it or defend against it (hide from information in the environment that we don't want to acknowledge as a part of our mental environment), instead of making ourselves available to learn more of what the environment has to offer in the way of insight about itself or ourself as the case may be.

To defend against the intrusion of information requires energy. This investment in energy is commonly referred to as stress. The simplest definition that I can think of for stress is that it is what we feel when we are actively blocking information from the environment. In physical terms stress is really no different from walking against the wind. Symbolically, the wind would represent various categories of environmental information we don't want to confront; our bodies walking against the wind would represent what we have already learned—what is already inside of us that blocks what is outside of us. The two forces clash and we feel stress.

One of the biggest ironies of life is that everyone wants to be right. In other words, everyone assumes what they have experienced and learned about the nature of the way things exist to be the true and correct version. The irony is everyone's version is correct by virtue of the fact that what is inside all of us was experienced by our physical senses—if we saw it, if we read it, if we heard it, if we felt it, if we tasted it, if we smelled it, or any combination thereof, we experienced it. However, not everybody's version (of what the environment has to offer in the way of experiences) is particularly useful or effective as a resource for interacting with the environment in a way that would lead to satisfactory outcomes. Just because something gets input into our mental environment doesn't mean that it's of any real value in helping us to fulfill ourselves.

A child has no way of conceptualizing how his experiences are forming beliefs about the nature of reality, concepts that would, in fact, be much different under different environmental conditions.

He unquestioningly takes an experience as a fact of reality because the beliefs he is forming are founded in feelings and emotions. He does not reflect on his experiences to assess the quality of the beliefs he is forming. He has no way of determining how these beliefs will either act as resources or obstacles to self-expression in the future.

The child doesn't understand that any belief that he forms will define reality in a way that excludes other possibilities or that he will make associations with experiences, lumping components of the environment together in ways that are very limiting and not practical. Many of these beliefs will just naturally be decharged as his attractions cause him to interact with the environment in new ways. All of us will just naturally grow into a new set of limitations as we expand our awarenesses by learning, which in turn releases us from things we used to believe. However, if the quality of the energy in many of our beliefs is negatively charged, then our fear will act as an obstacle to self-expression, limiting what we can perceive from the environment as possibilities.

For example, someone who grew up constantly being belittled or criticized by his parents knows exactly how that feels. The beliefs he forms about himself and his relationship with the environment, as a result, were formed in a reality of pain. Certainly he wouldn't know, while growing up, that he was forming a belief about his relative unworthiness as a person. Unworthiness is a concept that he may not learn about well into his adult years, and he may never learn how to release himself from the damaging effects. But in the meantime, his fear of being ridiculed and belittled will drastically limit the possibilities he perceives in the environment for self-expression. Many possibilities that seem self-evident to someone without this fear would be totally out of the realm of possibility for him.

An even bigger irony is that the more we acknowledge the possibility that our version of the way things exist isn't as effective of a resource as it could be, the more we make ourselves available to learn from the environment. By expanding our personal dot to include more of what is outside of us inside of us, the more it increases our level of correspondence with the outside, leaving less and less of what is out there that we don't know about, thereby increasing our ability to be right.

The more we allow ourselves to learn, the better able we are at making assessments about the probabilities that exist in some future moment. How could we not be better off by learning something when you consider that the environment can act as a force on us in an almost infinite variety of ways, some of which we know about, many others we couldn't begin to anticipate unless we keep on learning in spite of what we already know? The more we believe we know, the more we make the environment prove to us that what we know isn't particularly useful or effective. The problem is that proof could be right in front of our noses and we wouldn't have the mental framework to recognize it, unless we willingly allowed ourselves to confront it and consider it. Otherwise, if we all knew so much, we wouldn't ever experience emotional pain, because it is a perfect indication that we don't know how to interact with the environment to our satisfaction—because if we did, we would.

All this should be somewhat apparent because it is not a typical human characteristic to actively gather and consider information that conflicts with what we already know and believe to be true. However, consider that hidden within the environmental information that we haven't learned to perceive yet, either because we haven't learned to make the appropriate distinctions or because the information is being blocked by our current set of beliefs, are a more appropriate set of steps to fulfilling ourselves. What we haven't learned yet is outside of each one of us waiting to become a part of our personal dot. What we don't know represents all the information that could result in choices that have much more satisfying outcomes. However, since we can't know what we haven't learned yet and what we do know blocks the perception of other alternatives that exist for satisfaction, we easily get caught in these terribly unsatisfying life cycles, believing that is all the world has to offer, when our predicament is merely the result of our inability to adapt ourselves. When we do allow ourselves to adapt, we learn that there are always more choices available than our beliefs will allow us to perceive. What I mean by adapt is to identify and actively change something that is already inside of us so there is a higher degree of correspondence between the inside and outside.

Each first-time experience with the physical environment creates a distinction in the mental environment about its nature. All information or possibilities that exist in the same category as that first experience will then be filtered perceptually through what we learned from that experience. Again I will use the example of a child whose first experience with a dog is a painful one, meaning that the first dog the child attempted to play with, out of his natural sense of curiosity, bit him. As a result of this one experience the child will "naturally associate" all dogs with the one that bit him. What he learned will then act as a mental barrier to anything else the environment may have to offer with respect to all other dogs.

I have used the words "naturally associate" to point out that the child will not have to actively think about the limiting way in which dogs will be characterized in his mental environment. The associations will occur automatically, as a natural function of the way our minds are wired. So he will not have to see "the" dog that bit him; any dog will cause him to remember the pain of his previous experience. As a result of his first experience with a dog being painful, he will automatically associate any future encounters with dogs with his one painful experience. Regardless of how erroneous his association is or how the environment may try to prove to him that most dogs are friendly and will not cause him pain, he won't believe it, because what he has already learned about dogs (not one dog, but all dogs) will cause him to block the acceptance of this new information into his mental system.

However, if the child's first experience with a dog is positive, he will obviously have no reservations to play with any dog until he has a painful experience. In this case, however, if he is bitten, he will not automatically associate all other dogs with the one that bit him because he has already learned that the environment has more to offer than this one painful experience. What he will learn, that is new for him, is that not all dogs are friendly and that he must use some caution when interacting with them until he can determine their disposition.

The child whose first experience was painful doesn't know that he can experience happiness and joy with dogs. He doesn't know it because he hasn't experienced it; it isn't something he has learned yet, regardless of the evidence the environment may be presenting him. Nor will he likely learn it until he is willing to step through his fear. All other information being offered to him about the nature of dogs will be blocked or rejected by the energy of what he has already learned.

You can teach a child anything you please, regardless of how erroneous or dysfunctional it is relative to the environmental conditions. The child will believe what you teach him because what he experiences becomes a part of his identity. Anything we experience will become a functioning part of our identity. When I say "functioning," I mean that once something is inside of us, regardless of what it is, it then has the potential to act as a force on our behavior. All these functioning parts that we call memories of experiences, beliefs, and associations, in turn then act as an internal force to shape our perception of the environment we experience out of what is available to experience.

As you already know, what each one of us fears as individuals is something that we have at some point in our lives learned to fear, as a result of our experiences. When we feel fear, it is because we have learned to perceive the environmental conditions as threatening in some way, whereas someone who hasn't had a painful experience associated with those same environmental conditions has learned to perceive the environment conditions in a completely different way, a way that corresponds with his previous experience. One person can perceive the conditions as a threat, the other as an opportunity, in the same moment, based on what is already inside of them. In other words, what they have already taken into their mental environment as experience will determine how they perceive the environmental conditions, whether as an opportunity to experience joy or as a threat to experience pain and all the degrees in between. What is really interesting is that neither one would be able to convince the other of the validity of his perception, because what they are experiencing at the moment is directly related to what they have already learned.

We will usually only question the value of something that is inside of us, if we are forced to, as an absolute last resort. What would be the ultimate proof that we need to finally make us acknowledge that there is something we need to learn? Pain! We will acknowledge the need to learn when we are experiencing the emotional pain of a great disappointment or stress and anxiety because we don't know what to do next, and we are finding it increasingly difficult to shift the responsibility for what we are ending up with.

If we go back to the "believing that trading is easy" example, why would we consider that trading is difficult when we already know that it is easy? What would cause us to question the usefulness of such a belief? The emotional pain of disappointment as a result of not being able to achieve our goals? Once we question the usefulness, what happens? A whole world of information opens up to us on how we can learn to interact with the trading environment more effectively by increasing our level of correspondence. However, everything we would find in the environment to increase our understanding already existed, unless we think of something completely new on our own. The only thing that stopped us from finding it before was the energy of what we already knew, blocking what we haven't learned yet. The problem is that if learning something new means that we have to change what we have already learned, we instinctively seem to refuse to do it, regardless of how inappropriate what we have learned may be relative to what we would need to know to experience satisfaction. Once we have learned something, it will act as a force to block other information that would result in the perception of other choices. Even children will resist the acceptance of information that is contrary to what they have already learned, regardless of how dysfunctional their knowledge may be.

All learning is synonymous with change, whether we are changing something we already know or learning something completely new. If we refuse to change (adapt) the inside—adding to what we know to create more distinctions and change our perspective—then we are not learning what we need to know to experience something different in the outer environment. If there is no change on the inside, there will be no perceived change in the outside, thereby locking us into recurring cycles of pain and dissatisfaction. What's more, we will continue to suffer until the pain becomes so great that we are left with no choice other than to reassess how we go about managing our lives, that is, reassessing the usefulness of our beliefs.

WHAT WE DO KNOW BECOMES OBSOLETE

Besides the cycles of dissatisfaction that our current set of limitations locks us into (what we know blocks what we haven't learned yet), there is an even more practical reason for learning how to adapt. All of us are forced to interact with a constantly changing physical environment to fulfill our needs and achieve our goals. The way we interact with the environment, what choices we perceive in relationship to what is actually available from the environment's perspective, and what we do in relationship to what we perceive are all a function of what we have learned. Now, if you will recall, everything that constitutes the physical environment is in constant motion. Anything that is in motion (which includes everything made of atoms and molecules) is also changing over time. So change is an automatic function of the physical environment.

However, the mental environment is composed of positively or negatively charged energy that carries information about our experiences, what we have learned that forms into organizational patterns that we call beliefs and concepts about the nature of the physical environment. Energy is not made of atoms and molecules and therefore does not change over time. In fact, energy exists in a nonphysical dimension outside of time as we perceive it with our senses. Electrical energy or chemically produced electrical energy can be stored just the same as in a battery and the information it carries is stored with it. That is, time has no effect on the quality of this energy (the degree of the positive or negative charge) and the ways in which it affects our perception of environmental information and how it acts as a force on our behavior.

Changing our mental environment to correspond with the constant external changes going on in the physical environment is not automatic. The information stored in our mental environment about the nature of the physical environment can remain unchanged for years or a lifetime, for that matter, regardless of how outdated, useless, or even harmful it may be. And furthermore this outdated knowledge will continue to act as a force on our behavior, causing us to interact with the environment in completely inappropriate ways relative to the conditions. So even if we are experiencing satisfaction in certain areas of our lives, we cannot take it for granted that the conditions that we have learned to interact with will stay as we know them to exist. The outside conditions are in constant motion, presenting us with different forces to learn about and adapt to. In the market environment, for example, the changes in conditions are highly visible and usually moment to moment, whereas in other types of environments that we typically operate in, the forces of change work a little slower and are less visible, but they are changing nevertheless. The problem is that the conditions will change and we won't necessarily recognize these changes even if we start to experience some degree of dissatisfaction, unless we are constantly vigilant that even though we have learned something that works, it can still become obsolete.

CHAPTER 12

The Dynamics of Goal Achievement

The extent to which we fulfill our needs and achieve our goals with any degree of satisfaction is, first, a function of our being able to recognize our needs and formulate our goals. This is not as simple as it sounds. Our natural sense of curiosity and our attractions are very powerful inner forces that create a state of need or put us in a state of imbalance with the physical environment until the needs are satisfied. When we feel these attractions to certain activities, people, or objects in the environment, it is often difficult to visualize the possibilities or formulate any plans because of other inner forces in the form of beliefs, associations, or memories that act as barriers. We need to understand the relationship and possible conflicts between what we need or feel very attracted to and these other inner forces that in a sense say no.

The extent to which we fulfill our needs and achieve our goals with any degree of satisfaction is, second, a function of the degree to which we understand the nature of the external environmental forces we have to interact with to fulfill our needs and achieve our goals. (The depth of our understanding will correlate directly with the way in which we express ourselves in the environment to create the effect that we want.) Third, it is a function of the repertoire of skills that we have developed to interact with the environment and, fourth, a function of our ability to execute those skills.

Any differences between what we wanted, expected, desired, or needed and what we got is simply an indication of the degree to which we haven't learned what we needed to know or evidence that we don't have the appropriate skills to do what needed to be done. Included as a factor in the first category—where we haven't learned what we needed to know—is our ability or lack thereof to objectively (without illusion) assess the availability of what we wanted or needed from the environment's perspective. In other words, what we wanted may have not been available to begin with or available in the quantity we wanted or in the time frame we wanted or needed, and we didn't have the mental framework to make the kinds of distinctions to indicate the actual availability beforehand.

We also have to consider that what we wanted may have actually been available but unperceivable, as a result of not having learned to make the appropriate distinctions, which would, in turn, give us the kind of perspective where we could notice its availability. In these kinds of situations we usually end up saying to ourselves, "I wish," or "If only I had known that then," when we find out afterward what we didn't know at the time would have made a difference on how we "saw" things. Often, however, we never find out that what we wanted and didn't get was only one minor shift in perspective. Not knowing, of course, that the reason why we didn't get it was because we just didn't know there was something more we needed to learn. If we had the mental framework to make the appropriate distinctions, we can assume that we would have, unless something was blocking our perception.

I might add here that when we interact with other people, if we use force and manipulation to get what otherwise would be unavailable, what we are doing is forcing them to behave outside of their beliefs. If their beliefs were consistent with what we wanted from them, then we wouldn't need to use force or manipulation because a state of harmony would exist. We don't need to use force or manipulation on someone to do something that they already believe in. Whenever we do, it creates a state of imbalance in them that they would normally rectify by some means of revenge that we would just have to deal with at some point in the future. As a general observation of the human condition that goes along with this, most of us spend our lives trying to change what is in front of us to suit the makeup of our inner environment, when all we need to do is change the way we think about what is in front of us and we will change the quality of our experience of it.

In the second category—where we don't have the appropriate skills to do what needed to be done—we may recognize the most appropriate set of steps to take and also objectively assess the availability of what we want, but that doesn't mean that we have the skills to execute those steps. It is possible to underestimate the skills required in relation to the conditions to accomplish what we want (i.e., we don't know any better) or we could overestimate our abilities in relation to the conditions. Furthermore, even if we have learned the appropriate skills, there may be any number of beliefs or fears that act as barriers or limiting forces that will prevent us from properly executing the steps leading to what we want to accomplish. These beliefs or fears can be something that we have a conscious awareness of, or they can be completely subconscious. I am defining subconscious as any experience that we don't have immediate access to with our conscious thought process. For example, someone could be afraid of going into the water, be conscious of the fear itself, but not have the slightest recollection of a painful experience associated with water to know why he can't express himself in that way.

There is a very important distinction here that you need to make between recollection and memories. What we experience in the environment becomes a memory. Our ability to bring that memory into our conscious thought process is recollection. Some memories are easy to recall because the pathways to wherever the memory is stored are used a lot. In other words, we remember how to remember certain memories. However, there are many other experiences that become subconscious. These are memories that we have either forgotten how to remember because we don't use the pathways or we were never really fully aware of what was being perceived by our senses in the first place. However, the point here is that none of what goes in to the mental environment disappears or no longer exists just because we don't remember it. Our ability to recall consciously any particular belief that we are taught as a child or our ability to recall any particular experience is not a factor in the dynamics of how any of these mental components act as a force on our behavior. Neither is physical clock time for that matter. Our conscious recollection of experiences may fade with time, but time has no impact on the electrical charge (quality of energy) or the amount of emotional force behind the charge. For example, the old adage that time heals all wounds is not applicable to the mental environment. Time will heal wounds to the body because the body is a part of a physical reality where everything is in motion and changing over time. However, time has no impact on the memories stored in our mental environment because the mental environment is not composed of physical matter. It is composed of stored energy that does not change with the passing of time.

Emotional wounds (negatively charged mental energy) will never go away unless we learn how to release ourselves from them or change them. People think time heals emotional wounds, because after years of experiences they either inadvertently let go of the pain or build a system of beliefs as a defense to shield themselves from it. In fact, our seemingly infinite capacity to resist acknowledging the injury and hiding the effects of emotional wounds makes them very elusive. We almost always know when we have injured our bodies in some way. If you break your leg, you know it because you won't be able to walk. If it doesn't heal properly, you will know that too because you won't be able to walk the same as before or it may still hurt to walk. Yet, emotional wounds are not always so self-evident, because we can always structure our beliefs to make it seem as if we are not responsible for the cycles of dissatisfaction and emotional pain we experience in our lives, thus insulating ourselves from the effects of our own negatively charged energy.

This is being pointed out because I have found that most people have a great deal of difficulty believing that something that happened to them in their childhood can still affect how they perceive their environment and how they express themselves now. Although, when you think about it, how could it be any other way? Everything that we experience becomes a component part of our mental environment. All the parts then act as an inner cause, affecting how we experience the outside environment. Again, we don't have to be able to remember why we learned to be afraid of something to feel the fear. We don't even have to consciously acknowledge to ourselves that the fear exists because we can always rationalize that it is something else or use drugs or alcohol to block our awareness of it. However, regardless of how hard we try to stop ourselves from feeling what is inside of us, the feelings are still there; otherwise our efforts to block them wouldn't be necessary in the first place. The fear will exist because the energy, somewhere in our memory of some previous experience, will cause us to feel it, regardless of whether or not we allow ourselves to have a recollection of the source.

Memories, beliefs, and associations do not go away with time, substance abuse, or trying to put them somewhere in the subconscious that makes it more difficult to gain a conscious awareness. They will continue to act as a source of energy for the way in which we pick and choose information from the environment and how we express ourselves, for as long as we live, unless we learn how to manage them. Did you ever wonder why it was so difficult to break an unwanted habit or why it can be so difficult to execute some well-thought-out plan you were really committed to? It is difficult because of what is already inside of us that acts as resistance to our intent. An intent to do something is not necessarily a belief. In other words, out of everything we intend to do, some of those intentions will be supported by our beliefs, memories, and associations, and some will not. When there is support, our efforts will seem effortless, because there is no conflict between any beliefs, memories, and associations and what we intend to do. However, if our intents are not in harmony with our beliefs, memories, or associations, doing becomes a struggle, where we can't stay focused, become easily distracted, or make what most people would characterize as "stupid mistakes."

Take, for example, someone who smokes, decides it's a bad habit, and as a result, commits himself to quitting. Thus his intent is to express himself as a nonsmoker. However, after he has smoked his last cigarette, his beliefs in being a smoker will immediately start drawing his attention to cigarettes until it builds to the point where he craves a cigarette and then has one. What we have here is a classic conflict between an intent that is not only in conflict with other beliefs but the intent itself has no real structural support. That is, there isn't a corollary belief that says, "I am a nonsmoker." The energy for his behavior not to smoke will have to come from his conscious willingness to be a different person in this area of his life. However, his willingness doesn't instantly negate all the energy in the beliefs he has built up over the years in being a smoker. These beliefs will have a great deal of energy to act on his conscious attention (noticing cigarettes in the environment and thinking about cigarettes) and his behavior (to pick one up and smoke it).

We could even have inner support (beliefs, memories, and associations) for what we intend to do and still have difficulties following through with our plans because of other conflicting beliefs. Behavior that would fall into the "stupid mistake" category is most often the result of subconscious or forgotten beliefs that are in direct conflict with our intents. Trading is a perfect example to illustrate this. Many people devote a great deal of their time, energy, and financial resources to expressing themselves as traders. They learn a lot about trading—they are even highly regarded by their peers for what they know about the market—but still can't execute their trades properly or the way they planned. There are traders who can consistently make money day after day until they get to certain threshold levels and then promptly give all their profits back to the market in one or two trades. The way they give their money back is completely inconsistent with their trading style while they were making money. After they have lost a sufficient amount of money, they go back to the way they normally trade and start the process all over again. This kind of behavior is no accident. It happens for a reason.

In each of these situations these traders certainly had developed effective, workable strategies to be successful—they definitely had some highly structured beliefs to support their expression as a trader. However, what they haven't done is identify and decharge a whole host of other beliefs (both conscious and subconscious) that are in direct conflict with the endeavor of trading or making money as a trader. For example, there are many beliefs related to one's religious upbringing that are in direct conflict with the whole concept of speculating. And what is trading but taking money away from other traders with no services rendered? This kind of activity isn't consistent with most religious teachings. Another typical example is most people grow up with very powerful beliefs related to the work ethic. They have very rigid definitions about what constitutes work and how one earns one's money. Trading doesn't exactly fit into most of these definitions either.

So regardless of how highly developed one's trading strategies become, the act of trading will still violate the integrity of any belief that is in conflict with the act of trading or making money from trading. Eventually the unexpressed energy accumulating in these conflicting beliefs will build to the point where the trader will find himself behaving in a manner completely inconsistent with his trading rules or intent to make money. Often, he will even be aware that he is about to make a trading error, watch himself do it, and at the same time either feel powerless to stop himself or won't stop himself until he has lost enough money to compensate for the imbalance in his mental environment.

Now when these kinds of things happen, if we don't understand what is going on, it could cause us to feel inadequate in some way, if we judge ourselves harshly. Or we could be overcome by a sense of powerlessness and fear because we seemingly have no control over these unidentified internal forces that can exert so much control over our behavior. Without any awareness of the problem or effective tools for dealing with it, most people will attempt to build mental barriers to try and block these forces from manifesting in their behavior. Obviously, they don't work, which makes the whole situation even scarier. This is where the substance abuse comes into play. For example, a person who is an alcoholic knows he is a heavy drinker. At the most fundamental level a person drinks obsessively to separate his intellect from these inner forces he believes he has no control over. The more he blocks, the more the forces build and the more he has to drink to block. The more he drinks, the more everything deteriorates in his outer environment as a reflection of his inner environment. Eventually, the physical environment, his body, or both deteriorate so badly that he can no longer block the true state of his condition. He then acknowledges that "Yes, I am an alcoholic, and I need to change," meaning that "Yes, I need to address the issues in my life that caused me to start drinking in the first place."

The point of all this is: learning how to forget our painful memories or ignoring the existence of beliefs that don't support our intents does not in anyway reduce their potential to cause us to behave in certain ways. If we want to change unwanted behavior, we have to change the internal source of that behavior. Releasing ourselves from the limitations of our fears by healing our emotional wounds, changing the polarity of a belief, or decharging it altogether is something that we have to learn how to do by learning how to manage mental energy. If people knew of some way of managing their beliefs, memories, and associations, then the kind of painful cycles of forced awareness described earlier would never get started in the first place.

Thus far I have identified three forces in constant operation in our lives. First are all the external environmental forces that have the potential to act as a cause, where we, as individuals, experience an effect. Some of these outside environmental forces we will have some degree of understanding of and others we will not. Our degree of understanding and insight along with the extent to which we can act on what we know is directly proportional to the degree of satisfaction we will experience as we interact with the environment to fulfill our needs and achieve our goals. Implied within all the external forces—whether we understand them or not—are all the forces of change that automatically alter everything made of atoms and molecules consequently making what we do know—in terms of usefulness—obsolete at some point in time. For example, the chair you are sitting in to read this book is deteriorating over time. At some point it will no longer be able to support any weight, making your belief in its stability obsolete.

Second are the deep inner forces of curiosity and attraction that compel us to explore, learn about, and interact with the environment in seemingly predetermined ways. For example, there are things that we are naturally interested in learning about or learning how to do in relationship to all the other things that are available to learn about in the environment, but we have no natural interest— like someone who always wanted to be a musician, fire-fighter, actor, or doctor and pursues these vocations resulting in feelings of deep satisfaction about their lives. However, if the environment forces us into areas where there is no natural interest, we will experience an emptiness that can be very difficult to identify, only that it feels like something is missing in our lives. What each of us as individuals is naturally curious about and attracted to in the environment come from the deepest levels of our existence. They act as very powerful forces of self-expression, compelling us to create in the physical environment the object of our imagination or to pursue in the physical environment the object of our interests, often in direct conflict with outside environmental forces as well as inner mental forces in the form of what we have been taught to believe.

Third are the mental forces represented by our beliefs, memories, and associations. Even though beliefs, memories, and associations are mental forces, they are not the same as the forces of curiosity and attraction. Beliefs, memories, and associations exist exclusively as a result of the kinds of experiences we have with the physical environment. This is in contrast to the forces of curiosity and attraction that are in us before we are born and would seem to be either predetermined in a spiritual sense or genetically encoded. Some of our beliefs, memories, and associations will act as positive resources for interacting with the physical environment effectively and with some degree of satisfaction. Others, however, will have just the opposite effect. Many of our beliefs, memories, and associations are resources for failure, pain, and dissatisfaction because they lock us into only perceiving what we already know as well as cutting us off from our natural sense of curiosity. In other words, they specifically act as forces to prevent any further mental growth.

Now, since we have to interact with the physical environment to fulfill our needs and achieve our goals, the key to doing it to assure ourselves of experiencing greater levels of satisfaction is to acquire deeper levels of insight and understanding into the nature of these forces. That is, we need to stay in a constant state of learning. The only thing that really stops us from continuing to learn about the nature of these outside forces is the mental forces in the form of beliefs, memories, and associations that build up and as a result block our natural sense of curiosity, sometimes to the point of shutting down the learning process altogether.

There is some element of truth to the saying that you can't teach an old dog new tricks, except that it should really read "An old dog won't learn new tricks." It's not that it is impossible for someone regardless of their age to learn something new; the issue isn't ability. It is more a matter of resistance and refusal. That refusal comes from the sum total of everything we already believe, in essence saying, "Forget it—I already know everything I need to know." Of course, the consequences to such a stance toward the environment can be and often are devastating. And it invariably always takes some truly devastating event or a series of them before someone who has this kind of attitude will acknowledge that the reason for their plight is that they just refuse to allow any changes in their mental environment. Of course, this know-it-all attitude is very easy to recognize in someone else; the trick is learning how to recognize it ourselves, because it exists in all of us as a natural function of the ways in which beliefs, memories, and associations manage information.

To stay in a constant state of learning we need to learn how to adapt. To adapt we need to learn some specific mental techniques on how to consciously apply our thoughts to upgrade, modify, replace, or change the polarity (electrical charge; of various components in our mental environment that act as limiting or inhibiting forces on our perception and behavior, preventing us from gaining greater levels of correspondence with the physical environment. By consciously adapting, we are making ourselves available to learn how to fulfill our needs and achieve our goals in increasingly more satisfying ways. Note: Implied within fulfilling our needs and achieving our goals is the need to explore the object of our curiosities and attractions, which also get blocked by our beliefs, associations, and memories.

To adapt, we need to choose not to resist learning and change. This requires a willingness on our part to think outside of the limitations established by our beliefs, associations, and memories and a willingness to learn how to manage mental energy so we can release ourselves from the negative effects of our painful memories. When we learn how to change the polarity of a painful memory, it isn't painful any longer. When the memory is decharged or drained of the negatively charged energy, it will no longer have the potential to generate fear. Fear always limits the number of choices we perceive as available from the environment by the way it causes us to focus our attention on the object of our fear. The net effect is we end up creating for ourselves exactly what we are trying to avoid. It is important for you to note that, when we change the polarity of a memory, it doesn't actually change the structure of the memory. In other words, we don't forget the experience, so we can still use it as a part of our repertoire of what we know about the nature of the physical environment. When we change the quality of energy of a memory from negative to positive, we negate the memory's potential to generate fear, thereby allowing us to perceive all the other choices for experience available from the environment in the same moment.

Preferably this willingness to change will come from somewhere other than out of desperation. The idea is to learn how to recognize what we need to know long before the conditions deteriorate to the levels of desperation. To do this requires that we incorporate into our mental system three very fundamental assumptions that will help us to maintain a healthy relationship with the environment and generate the energy behind the willingness that we will need to start such a process, after which experiencing the benefits will act as the driving force behind our willingness.

The first assumption is that we haven't learned everything there is to know. And, as a result, there are always going to be unknown forces acting upon us until our understanding of everything outside of us evolves to the point where we have simultaneous awareness of everything going on in the environment. The implications here are that we need to be in a constant state of learning from the moment we are born to the moment we die because our intellect has not yet evolved to the point of simultaneous perception of all information that is available in any given moment. Until then, we are forced to pick and choose the information we experience based on what we have learned to believe.

The second assumption is that what we have learned to believe either by force—unwillingly thrust upon us, as an expression of the outside environment—or by choice—as an expression of inner forces that operate within us like our curiosity and attractions—may not be very useful with respect to fulfilling ourselves in some satisfying manner.

The third assumption is that what we have learned that is useful and works to our satisfaction is still subject to change because of the changing environmental conditions. In other words, what we may need to know to experience more satisfaction and happiness in our lives will often have to replace partially or invalidate completely what we have already learned. Refusing to change what we have already learned is virtually the same as saying that we already know everything there is to know and don't need to learn anything further. Of course, we could easily know if we didn't need to adapt because we would be in a perpetual state of satisfaction. Anything less than a feeling of satisfaction from our interaction with the environment is an indication that we need to learn something.

THE PERFECTION OF THE MOMENT

If you operate out of the foregoing assumptions, you will begin to recognize how every moment becomes a perfect indication of your state of development and what you need to do to improve yourself. For example, let's look at a hypothetical trader whose goal is to make money from his trading. He perceives what he believes to be an opportunity to do so and puts on a trade. However, he is operating out of a fear of being wrong. As a result, his fear will act on his perception of information to block from his awareness any evidence that would indicate that he is wrong. Remember that fear is a natural mechanism to warn us of threatening conditions so that we can avoid them. Now what is threatening about being wrong? In this case, as in most all cases, it is all the accumulated pain and humiliation inside of him from his past experiences. If the market—or anyone else for that matter—presents him with any information that conflicts with what he wants, his fear will cause him to distort it perceptually or he will angrily scream at the person who offered such information "Don't tell me that" so that he can avoid feeling the pain already inside of him from his past. In effect, his fears will create for him the very experience that he is trying to avoid because he is avoiding information that would indicate what the markets have to offer in relationship to what he wants or expects. If the market does move against him, he probably won't confront the evidence until the pain of doing so is less than the pain of not confronting it, meaning that his losses accumulate to the point where it is easier to admit he is wrong than to suffer any more losses. The results of our efforts will be reflected in the environment as the sum total of who we are in any given moment, as it was for our trader in the foregoing example. A goal is an intent that we have projected out into the environment. It is a need to be fulfilled in some future moment. The need arises out of a recognition of some lack. Recognizing the need automatically focuses our attention to scan the environment for ways (paths) to fulfill that need. The environmental information we perceive (quality and depth of insight) will be a function of the number of distinctions we can make minus any information that gets blocked by any fears we are operating out of. How we express ourselves to fulfill the need will be function of (1) our perceptions, (2) the steps that we choose as a result of those perceptions, and (3) the skills we have developed minus any conflicting beliefs, memories, and associations, making each moment that we interact with the environment a perfect indication of what we know and how well we can act on what we know.

When we refuse to acknowledge or accept the perfection of each moment in our lives, we deny ourselves access to the information that we need to expand ourselves. Any skill that we need to learn to express ourselves more effectively has a true starting point. To find that true starting point requires our acceptance of each outcome as a reflection of the sum total of who we are so that we can first identify what skill needs to he learned and how we might go about the task of learning it. Without this true starting point, we will operate from a base of illusion.

Illusions result from beliefs that we know more than we do and can do more than we can. We erroneously assume the environment shares our perception of it or of ourselves and then we actively block any information to the contrary. Illusions are the difference between accepting each moment as a perfect indication of who we are so that we can identify what we need to learn to move forward and believing we are already perfect the way we are, in which case we need learn nothing. Certainly if any of us were in a perfect state of knowledge and abilities, then we would never need to complain about anything or make excuses, rationalizations, or justifications for why things didn't turn out as we planned.

Every "should have," "could have," "would have," or "if only" is an indication of the degree of illusion in which we are indulging ourselves. If we could have, we would have, meaning that at each moment we are doing the best we can when taking into account all the components—both conscious and subconscious—that affect what we perceive and do. Acknowledging and accepting this perfection will always give us our true starting point to indicate what we need to learn so that we can perceive the conditions differently or what resources we need to develop to respond differently.

If our hypothetical trader wants to develop into an effective and consistently successful trader, he will need to engage in some self-improvement. He will need to understand that the market is always right and that he can profit from that tightness if he doesn't impose a rigid mental structure on its behavior. He needs to release himself from his fear of being wrong so that he can observe the market's behavior from an objective perspective. Otherwise, his fear of being wrong will have the effect of making him wrong. He will also need to establish some definite trading rules to guide his own behavior and learn how to adhere to those rules. If he had been operating out of a definite set of trading rules he would have never let the loss accumulate sufficiently that his pain would take him out of the trade. If, however, he refuses to acknowledge and accept his current state of development by blaming the market for his losses or trying to convince himself that somehow he wasn't responsible for what he ended up with, then he would be indulging himself in illusion. He would be denying who he is and, in effect, cutting himself off from the information he needs to become who he wants to be.

We have to be willing to confront the truth about ourselves so that we can confront the truth outside of ourselves. The less illusion we indulge ourselves in, the more our perceptions of the outside environment will reflect the actual conditions, because we won't be blocking so much available information. By available information I mean information we are capable of perceiving. The less we block, the more we learn. The more we learn, the easier it is to anticipate how the outside environment will react or respond under any given set of conditions. Otherwise, we will not allow ourselves to perceive in the environment what we refuse to know about ourselves.

None of us likes to acknowledge what we perceive to be our weaknesses. Yet it is exactly what we need to do to grow beyond them. Otherwise, we keep building our lives on this base of illusion that requires so much energy, alcohol, or drugs to maintain that it eventually has to crumble, leading to these very painful forced awarenesses. Confronting the truth in the environment or the truth about ourselves is no more painful than are the forced awarenesses that result from these illusions. It's just more immediate. However, when we do confront what is inside of us, it is the first step in the process of breaking a cycle of dissatisfaction to turn it into an expansive cycle of success. What better form of goal achievement could there be than to confront conditions as they exist, identify what we need to learn to operate most effectively, and then go about the task of learning it, making our adjustments along the way?

ALL TRADERS GIVE THEMSELVES EXACTLY WHAT THEY DESERVE

Traders put on trades and then take them off when they choose. That decision-making process is the result of the sum total of all the mental components interacting with one another. If we were to inventory all these components, measure the energy they hold, and then balance the components that contribute to a positive sense of self-valuation against the components that contribute to a negative sense of self-valuation, what would be left is a net amount that we value ourselves. This net amount will correspond directly with how much money we give ourselves out of what is available in any given trade, in any day, month, or year, or by the same token how much of our money we give away.

I know that this can be a very difficult concept to accept. However, other than taking into account what we haven't learned yet in terms of insights and skills, how could it be any other way? We make up all our own rules when we trade. No one forces us in or out of the markets, unless a position is liquidated by a brokerage firm for lack of margin. In any given trade, there are a number of possibilities to take profits or cut losses. What we decide to do in each instance with respect to each possibility will be the result of our perceptions and all the internal components affecting those perceptions. What we actually end up doing will be the result of what we decide and our ability to execute our decisions, which again will be determined by a number of mental factors, all of which contribute to our sense of self-valuation.

Trading is an exercise in accumulating money. Once we have learned how to trade (perceive opportunity and execute our trades), who else or what else could be responsible for what we end up with? In fact, if traders were to chart their equity, it would reflect their internal conflicts and what they think of themselves on a day-to-day, month-to-month, or year-to-year basis. These charts would look very much like the typical bar or point and figure charts of the markets themselves, with support and resistance levels, consolidation zones, rallies, selloffs, and retracements. All these patterns would reflect the trader's state of mind, just as the markets themselves reflect the collective state of mind of all its participants.

Charts like these also can have the same predictive value as in the markets, if one learns what to look for. Some of the more sophisticated brokerage firms that manage large funds keep these kinds of charts on the CTAs that they employ to trade their money under management. They will switch the amount of equity available for each CTA to manage based on each individual's chart formations. In other words, once you build up some history it isn't too difficult to determine when someone is about to take a big hit because of the psychological forces building inside of him, just as the collective forces of the market build before a big move.

As individual traders if we want to give ourselves more and more money out of the markets, we have to learn how to value ourselves more and more so that we believe we deserve what we want or deserve what we get. Trading can result in the fast accumulation of windfall profits. To keep those profits, we have to have inner support. Most of the time, that support doesn't exist, and that accounts for all the rags to riches to rags stories that can be told in the trading world. Of course the first step in the process of valuing ourselves more is to accept our true starting point; that is, we have to take complete responsibility for what we end up with as being a reflection of what we need learn about the markets, about ourselves, or both. Ultimately, everything that we do contributes to or detracts from our sense of self-valuation. That is why it can fluctuate from day to day or moment to moment. The best way that I know of to add to our sense of valuation is to commit ourselves to the process of growth.

CHAPTER 13

Managing Mental Energy

What do I mean by "managing mental energy," you ask? There are many ways that we already manage mental energy but probably wouldn't think of it in such a way. For example, isn't it possible to take what starts out to be a slight emotional wound (like some minor insult) and intensify the emotional energy behind that wound to the point where we could end up in a state of emotional frenzy? How do we accomplish this? By our willingness to think about whatever caused us to feel insulted. Our thoughts can add energy to or detract energy from the wound, depending on what kind of thoughts we choose to think. If we think destructive thoughts, we will be adding negatively charged energy to intensify the wound. And it goes without saying that we can carry this to whatever extreme we choose and, furthermore, stop whenever we choose or whenever we are willing to. However, stopping does become more difficult in direct proportion to the amount of energy involved. Aren't we, in effect, managing or manipulating mental energy when we purposefully make ourselves more angry than when we started out by channeling negative thoughts through an experience?

By the same token, if we think positive thoughts, we will detract emotional energy from the wound. I am sure anyone reading this book has noticed that when a person wants to stay angry, he will refuse to listen to *anything* that might defuse his anger. When we refuse to listen to "the voice of reason" so to speak, we are making a choice not to manage mental energy. The only reason why an angry person has to shut out "the voice of reason" is because he knows the information has the potential to change the way he feels. He knows that if he changes his perspective—which will, in turn, change the way he feels—he will experience a different environment on the outside. If he isn't "willing" to change—regardless of what the benefits may be—he will refuse to use his thoughts in a way that would allow him to experience those benefits. These examples are just a few of the many ways in which we already manipulate our mental environment to suit our purposes based on our willingness *to* do so. Certainly, if it is possible to manage mental energy for destructive purposes, it must also be possible to manage it for constructive purposes. The key concepts here are willingness and purpose. The willingness is to consciously direct our thoughts toward a specific intent to change something on the inside that isn't useful.

Thoughts are a very powerful tool to effect changes in the mental environment. We can use them to shift, rearrange, add to, detract from, or change the polarity of various mental components. Thoughts are a form of energy, probably no different from electricity or light. They can act as a cause to produce some effect in the physical environment, as when we speak our thoughts, for example, as well as act as a cause to produce an effect in the mental environment. When we use our thoughts directed inward, we are basically using one form of energy as a tool to change the consistency and makeup of another form of energy, like using our thoughts to change a belief or release the negative energy out of a painful memory.

It is precisely because of the inherent power within thoughts that people are so protective of themselves with the kinds of information (others people's thoughts expressed physically) they will expose themselves to. Everyone instinctively knows that if we allow ourselves to think about something, the thoughts have the power to change the way things exist inside of us. And once things change on the inside, we know we will perceive and experience a different outside. If we don't want to disturb the current relationship between inner and outer, we will consciously do whatever is necessary to make sure that we don't expose ourselves to anything that might threaten that relationship or think about anything in a way that would change the relationship. Change is the result of, first, a willingness to think.

Personally, I believe that if we weren't meant to keep on growing mentally (adding to who we are by transcending what we have already learned) and furthermore if we weren't meant to direct that growth at a conscious level, then we would not have been given the ability to think, reason, and create. Implied within our ability to think, reason, and create is the inherent capability to learn our way out of the painful situations and dissatisfying life cycles in which we find ourselves. Painful life cycles begin with and are perpetuated by painful memories. So in essence what I am stating is that inherent within our ability to think and reason is the capability to heal our emotional wounds so that we can perceive what is available from the environment beyond our fears. Healing emotional wounds is something that we have to learn how to do by learning how to manage mental energy. Learning how to forget our painful memories by making them subconscious does not in any way reduce their significance on our perception of environmental information, or their potential to cause us to behave in certain ways.

This is the gift of creativity that we were all born with. It is the capability to think beyond what our current beliefs, memories, and association would dictate as being true about the environment. *The capability to reason beyond our current set of limitations* (beliefs, painful memories, and erroneous associations) *or use our imaginations creatively is the one compensating force that allows us to grow, improve, and evolve beyond the painful and destructive life cycles that we get caught in, both as individuals and as a culture.* However, there is something here that you may need to be mindful of: a capability to do something is not necessarily an ability to do something. Before a capability becomes an ability, it has to be cultivated into a skill. For example, we can use our imaginations to visualize and then project into the environment the fulfillment of some need or goal in some future moment. But that doesn't mean we are using our imaginations creatively. We may just be using our imaginations to project what is already in our memories or what we already believe. The same is true for our thoughts. Most of the time, they will originate out of our current set of beliefs and memories, so that what we will be thinking will correspond with the status quo. To create a more satisfying future for ourselves, we need to be able to imagine this future and project it out into the environment as some future moment. There is a direct correlation between what we project and what is already inside of us, unless of course, we are imagining something beyond what we already know.

The only real limitations that exist with respect to thought are those rules that were either taught to us or the ones we made up for ourselves. We are not in any way restricted to just thinking about what we already believe is true or what we have already experienced. We are free to roam anywhere in our thoughts to explore any number of possibilities and choose to act on one of them, regardless of whether it is inside or outside of the current set of rules from which we operate, even to the point of using our thoughts to change any rules that we may have that says we can't. If we weren't meant to direct our own changes by thinking about how we might learn how to lead happier and more satisfying lives, then thinking, reasoning, and creativity wouldn't exist.

To experience the same kind of painful conditions over and over again, in an environment that is in constant motion, implies that we don't perceive any other choices as being available that would result in more satisfying outcomes. What we perceive is directly connected to what we already know. To perceive other choices, other than the ones our beliefs, memories, and associations lock us into, we have to know something we haven't learned yet. So, learning our way out of a situation that is perpetually dissatisfying requires that we be open to thinking beyond what we already know. The environment will always offer us an opportunity for some degree of love, harmony, happiness, and success or some degree of despair, disappointment, anger, hate, and betrayal. What we end up with from each of these moments has to be a reflection of what is inside of us because the environment does not interpret the information it has to offer in any given moment. That process happens exclusively in each one of us. Remember the free money example in Chapter 10? The reality of pleasure existed right along with the reality of indifference or fear. The man was there to give money to anyone who wanted. How each person interpreted the data determined what reality they experienced.

Creativity is synonymous with growth and change. Doesn't the word "create" imply bringing into existence something that did not previously exist? If it already existed, then it would have already been created. To use our imaginations creatively, we must to be willing to think outside of what we already know to be true or possible. For those of you who are not that familiar with various forms of creative thinking, you would be surprised how just the willingness to question the usefulness of something inside of us will bring forth an avalanche of inspiring alternatives. Otherwise, our memories and beliefs will cause us to think of the future in ways that directly correspond with our past, thus having the effect of locking us into the same recurring experiences. The names and places may change but the situations and circumstances and conditions always remain the same because we aren't changing our mental framework to perceive anything different.

"Necessity is the mother of invention!" In other words, the need to create some new machine, device, or process to save time, save money, or make money isn't any different from the need to "create a new you" to experience success and a more satisfying life. The need will act as a force behind our thoughts to think beyond our current barriers so that we can expand. The barriers that act as a resisting force preventing us from expanding consist of many of our beliefs and all our painful memories. So we need a force to counteract and penetrate those barriers. That force is our thoughts and our willingness to use them in creative ways.

AH our lives would become a lot easier to live and potentially more satisfying if we operated out of the belief that we are in a state of imperfect knowledge, evolving toward something that we haven't become yet. Everything is evolving into something that it isn't yet. It may not seem like it at times, but each moment of each day, we change into someone who was not the person we were a moment ago. At the physical level new cells are born and old cells die. At the mental level each moment that passes we experience something. Each experience adds to the inner environment in the form of a memory or belief. Each memory and belief builds a self-concept that acts as a force on how we interact with the environment. Then as we interact with the environment, we change it in some way, creating a new environment for us to discover and experience. Everything that exists is evolving, because everything that exists is in motion, and motion creates change. Even the grandest mountain will eventually wear away into small rocks, which will themselves turn into sand and then dust.

However, the main point here is that implied within this concept of evolution (where we are in a state of imperfect knowledge) is the view that mistakes don't exist. Mistakes just point the way to something that we haven't learned yet and obviously need to know. What exactly is a mistake anyway? We certainly weren't born with a concept or definition of what a mistake is. If left alone, all children will naturally keep on interacting with the environment to satisfy their own inner needs to learn and grow until they start to learn that what they are doing isn't quite up to the standards set by the people who are watching them. And all children just loved to be watched.

The criteria that we use for how we define a mistake is something that we had to learn from someone. In other words, our parents and teachers passed their definitions on to us. These definitions would represent the mental framework for their unresolved painful experiences and what they themselves haven't learned about as being available from the environment beyond their pain. In other words, we pass on our ignorance, as well as our wisdom, without knowing at the time the difference between the two. And what was passed on that was dysfunctional will be regarded as the truth just the same as the wisdom.

When we as adults instill in our children our rigid definitions of what constitutes a mistake (thinking that what we are going to do is save them), all we are really doing is perpetuating our pain in the next generation. A mistake isn't resolved until we evolve in our understanding to the point where we can garner the insight that is available from the experience. When that point is reached, what we experienced is no longer a mistake or painful because of what we have learned. However, until that point is reached, if ever, we will feel compelled to save others from the painful lessons of our mistakes, even to the point of beating it into them—for their own good, of course. By using pain, either emotional or physical as a means to save others from our mistakes, in effect what we are really doing is creating a cycle of fear. We ensure that our limited level of understanding and insight will be maintained in them because fear is a contracting force that stifles the learning process. In a very real way, we inflict the pain of our unresolved mistakes on our children just as our parents inflicted the pain of their unresolved mistakes on us. And it goes on generation after generation until someone decides to use their creative powers to break the cycle.

To operate out of this belief in evolution so that we can naturally learn from the choices that we make, we have to first change our definitions of what constitutes a mistake. It is precisely these kinds of beliefs that act as mental blocks to perceive a more satisfying way of living. Mistakes are virtually synonymous with pain. We can find any number of ways to avoid acknowledging a mistake so we don't have to confront the pain, and in the process we cut ourselves off from what we need to know to grow, expand, and improve our lives. Even when we make a mistake where we supposedly knew better, if we really knew better, then we wouldn't have made the choices that we did that resulted in an outcome we define as a mistake. So we can assume that there is something inside of us that conflicts with our "better judgment" that has more power to influence our behavior.

It isn't any less possible to change our definition of what constitutes a mistake than it is to intensify the emotional energy behind an insult as in the example. To change these definitions requires learning some techniques in mental energy management to de-energize or draw the negatively charged energy out of them. By doing so we will allow ourselves to learn from all our experiences instead of hiding from them, feeling pain, or punishing ourselves in some way. "Without the effects of these self-defeating definitions of mistakes, it is much easier to objectively monitor our progress toward the fulfillment of some goal. If we find our behavior inconsistent with the steps to achieving our goals it would tell us that our beliefs are not in harmony with those steps or the goal itself or that we don't have the appropriate resources. In any case, it is much easier to identify what we need to learn to accomplish our objective.

THE BENEFITS OF LEARNING HOW TO MANAGE MENTAL ENERGY

Increased Sense of Security and Confidence

You will develop a sense of security and confidence knowing that you can confront conditions as they exist, identify what you need to learn to operate most effectively, and learn it. What better way to develop a sense of security than by learning how to develop the ability to adapt to the prevailing conditions to fulfill your needs satisfactorily.

In the mental environment the memories of our experiences don't change over time, but the physical environment where our goals are fulfilled does. It is constantly moving forward, offering us new conditions, which, in turn, offer us different possibilities and opportunities, if we are open to being able to perceive them. What better form of goal achievement than to be able to change our mental perspective "at will" to be able to perceive these new conditions and use our imaginations creatively to determine the most appropriate set of steps to fulfill our needs or achieve our goals, even if we have never actually taken those steps before?

For a truly successful trader, this form of thinking is essential. The possibilities of the type of movement the markets can display are almost endless because of the diverse number of forces affecting it. All of us have this tendency to mentally lock ourselves into only a very limited number of those ways. And when the market doesn't conform to our preconceived mental image, we make up the difference with distortions and illusions and suffer the consequences later. Trading doesn't have to be painful and devoid of fun. We make it that way for ourselves because of our mental inflexibility and inability to adapt.

Increased Levels of Satisfaction

As long as we are alive, we will have needs, and as long as we have needs, we are not whole the way we are. Our needs compel us to interact with the environment to achieve this state of wholeness. Growing into this state of wholeness requires that we keep on learning. To keep on learning we need to adapt. Learning is a primary function of our existence. When we fulfill this function, we are rewarded with feelings of happiness, well-being and satisfaction, all of which are by-products of the quality of our experiences with the outer environment and a function of how much we have learned.

The antithesis of learning is resistance. When we resist what is being offered by the environment in the way of lessons, learning, and change we experience stress. Stress is the opposite of the sense of well-being, happiness, and excitement that we feel when we are learning. If we refuse to adapt, we shut down the learning process. The quality of our experiences deteriorates because our relationship with the outer environment deteriorates. The outer environment keeps on changing, while we remain unchanged, resulting in less of a correspondence between what is out there and what we know. Ultimately, we end up punishing ourselves for our resistance to adapt because what we experience is pain, disappointment, stress, anxiety, and dissatisfaction, which are all by-products of our lack of insight, understanding, and what we won't allow ourselves to do because of fear.

Increased Intuition

As you gain in your confidence to change the inside to experience a different outside, you will also increase your ability to confront difficult issues that all of us would have a tendency to avoid. Instead of confronting, we learn a number of avoidance techniques like alcohol, drugs, distortions, rationalizations, or even wishing and hoping, all of which can result in painful forced awarenesses. We eventually have to confront these issues anyway because they rarely if ever (just) go away. The longer we wait, the worse the conditions usually get, making it increasingly more difficult to resolve.

However, there is another less obvious problem with avoidance, especially with respect to wishing and hoping. A true intuitive impulse—a deeper level of knowledge and wisdom that will indicate the next most appropriate step to take—that will always be in our best interests feels very much like wishing and hoping. In other words, it is very difficult to distinguish between the two, making it very easy to mix them up, which is one of the reasons why we find it so difficult to trust our intuition. The way you can know for sure that you are getting a true intuitive impulse is to clear out of your mental environment anything that would cause you to wish and hope that something will happen instead of confronting the issue head on to find out what needs to be done. You can wish and hope that the market will come back, or you can cut your loss and make yourself ready to take the next opportunity. To be able to cut your loss and be ready to take the next opportunity requires that you change anything in your mental environment that would cause you to avoid confrontation and consequently wish and hope. The less cause you have for wishing and hoping that something will happen, the more you will know that when you get that certain feeling, it is a true intuitive impulse, and the more confidence you will have to follow it. Intuition will always guide you in the most appropriate way to fulfill your needs.

Just so there is no misunderstanding here, I am not stating that there is anything inherently wrong with wishing and hoping. There are some ways in which wishing and hoping can be very useful. As traders, however, we cannot afford the luxury of wishing and hoping because it puts us in a passive relationship with the markets. When we wish and hope, we are shifting responsibility on to the markets for making something happen instead of confronting the conditions and doing something about it ourselves. If we find ourselves wishing and hoping, it is an excellent indication that we don't know what is going on and as a result need to get out of the markets until we do.

Wisdom

When we step through our fears to break some cycle of frustration and dissatisfaction or change the polarity of a painful memory to break a cycle of pain, we gain in wisdom because we learn all sides of an issue. Wisdom is not afraid, angry, intolerant, or prejudiced because there is a deep level of understanding, confidence, and trust, all coming from having experienced the full range of possibilities from extreme negative to increasingly greater degrees of positive. If we have experienced only the negative side of a certain type of experience, we feel fear. If we have experienced only the positive (never having had a painful experience in certain area), we won't have that particular fear, but we do develop an intolerance or even a disdain for anyone who has had a negative experience.

This intolerance stems from our own underlying fear of vulnerability. For instance, it is clear that the negative exists in the environment as a possibility, but since it has never happened to us, we either don't understand "their fear" or don't want to confront any information that would indicate the same possibilities for a painful experience also exist for us. Anyone who has truly transcended a fear doesn't look down upon those who haven't because they don't have anything to fear. When we step through some fear to experience other possibilities, not only do we give ourselves more choices, we also gain in wisdom. Wisdom is the by-product that results when we retain a distinction about the nature of the environment without the negative energy or fear associated with that distinction. Wisdom is ultimately the silver lining in every dark cloud.

However, to gain this wisdom we have to actively change our negatives into positives, because if we are offered a positive experience in an area where we have only experienced the negative, we wouldn't believe it. Actually we couldn't believe it, because we wouldn't have the mental framework to accept it for what it is. The environment will be as we perceive it, and the way we perceive information and events is controlled by the energy already inside of us, unless it is a first-time experience. When we don't actively work at turning our negatives into positives, we just stay angry and afraid. It's our choice. We were all given the gift of creativity and the free will to think any way in which we choose, and we can use our thoughts to change the quality of our lives, if we want to.

CHAPTER **14**

Techniques for Effecting Change

This chapter offers various techniques for effecting change. Also included are various exercises to implement these changes.

DIRECTING A CONSCIOUS SHIFT IN BELIEF SYSTEMS

The conscious mind (that part of us that is aware of the our surroundings and what we are thinking at any given moment) can generate thoughts outside of the framework of our beliefs or belief systems. In other words, we can ask questions about the validity or usefulness of any belief and purposefully direct our attention to any area where we might discover something more useful or better suited to the conditions. Any new knowledge comes from those who question the status quo and have a willingness to go beyond and a willingness to accept the next answer.

I know this is probably going to sound overly simplistic to most readers, and it is also something everybody already knows, but not everybody knows it within the context of changing beliefs: *The wanting to is the how.* To identify or change anything in the mental environment requires that you *want to,* because to want something you have to think about it, and when we think about something, we are generating thought energy. This is the same energy that our beliefs, memories, and associations are composed of, and, as such, thoughts have the power to change, reorganize, add to, detract from, or change the polarity of anything in the mental environment. In essence you can use our thoughts to create a new identity because we *want to.*

Each choice we make on a conscious level, even just to choose to redirect our thoughts from an inappropriate belief (relative to our needs now), will start to make a neurological change in the electrical circuitry of our brain. If you go as far as to make a choice that is inconsistent with a belief you want to decharge and then act out of that belief, it will eventually lose its power and consequently lose its potential to affect our behavior.

It is important for you to understand that beliefs cannot be destroyed; once we have formed one, it will be with us for the rest of our lives. However, we can draw all the energy out of them. For example, a pile of wood set on fire will release the energy of the wood into the atmosphere as heat. The wood will be transformed into ashes. The ashes do not have the potential to produce any heat and, thus, will have little if any effect on the environment. Yet the ashes still exist. De-energized beliefs work the same way. They will always exist but no longer have any effect on our perception of information or our behavior. Many of us once believed in the tooth fairy and the bogeyman in the closet. Eventually these beliefs just naturally collapsed as we learned more about the nature of the environment. Up to that point, however, they definitely had an effect on our perception of information and behavior. Now, we can say I remember when I used to believe that. To remember that we used to believe something means that the belief still exists; it just no longer has any power in our mental system.

Each belief you identify will form a comfort zone. The boundaries of this comfort zone are set by the limitations inherent within any belief that make up the zone. All definitions set boundary tines and make distinctions. Each belief is our truth about reality. Beliefs define not only our environment, but also who we are in relation to that environment. These definitions establish the amount of tolerance for awareness that we have for what exists in both the internal and external environment. For example, do you have a belief that would allow for the possibility of the market doing anything at any given moment? If not, what do you believe can't happen? If what you believe can't happen did happen, how long would it take you to be able to recognize it, if at all? Notice the boundary lines in awareness created by the structure of the belief.

There is one thing you should keep in mind as you learn to change your beliefs to be more reflective of your intents and goals. With all change there is struggle. Volcanos, childbirth, social revolution, wind, rain, and waves are all examples of the violent nature of the forces of change. That is why so many people find it difficult to be creative. We are attracted and compelled toward creativity, on the one hand, because it is an inherent part of our nature. However, on the other hand, we don't want to confront the conflict and ensuing struggle between the old and the new. It is essentially the same when you change a belief. There will be some conflict or some degree of uncomfortableness as you move from one set of beliefs to another. However, the uncomfortableness does pass, and just like anything else, the more you do it, the easier it gets, until it becomes a learned skill that you can use just like any other that is a part of who you are.

EXERCISE TO IDENTIFY CONFLICTING BELIEFS

Set a timer for 10 minutes.

Write a series of statements that begin with "I am."

Write as fast as you can and let every thought come to your conscious attention. It is extremely important that you do not censor any statements, especially the contradictory ones.

At the end of the 10 minutes, look at the list and cross out everything that is a fact. For example, you would cross out statements such as I am a man/woman, I am blue-eyed, I am brown-haired.

All the statements that remain are the beliefs you are looking for. The beliefs that contradict each other are of particular importance. Contradictory beliefs cancel your energy because you have a built-in mental conflict between the validity of one belief expressing itself only at the direct expense of another belief.

What are some examples of conflicting or contradictory beliefs?

I have to win./I may be undeserving.

I am a winner./I am a loser.

I am successful./I've missed my chance to be successful.

I deserve more./I am guilty.

I am a perfectionist./I believe humans are inherently imperfect.

I am trusting./I am untrustworthy or people are generally untrustworthy.

I believe there is no middle ground of satisfaction between winning and failure./I am pleased with myself and my progress.

I am honest./I am dishonest or people are generally dishonest.

I believe working is the honest way of making money./I believe trading is easy money, not work.

Asking Yourself Questions

Here are some questions you can ask yourself that will help you to identify some beliefs that may argue against your giving yourself more money.

What do you believe about guilt? How do you know when to feel guilty?

Under what conditions would you not feel guilty, even if someone else wanted you to?

Is it possible to transfer those same standards to areas where you would feel guilty?

What would stop you?

Who or what out of your past says it is wrong and you can't do that?

Is their assessment of reality any more valid than yours? If so, why?

Do you find these beliefs useful? If so, in what ways? Do you find them limiting? If so, in what ways?

If you could identify and change the experience that created the belief, how would you change it?

What would stop you from changing it?

For the following questions you can substitute the words "is true" for the words "do you believe."

What do you believe about competition?

What do you believe about taking money from other people as a result of your superior trading skills?

What do you believe about losses? What do you believe about other people's opinions? When are they valid? When aren't they valid? What do you believe about being wrong?

By answering these questions, you will begin to gain a sense of your own particular behavior and the range of choices you allow for yourself, or do not allow for yourself, as a result of your beliefs.

Sometimes it is easier to identify a belief by trying to notice what you specifically believe is not true. You could also look at your beliefs as if they belonged to someone else. If they did belong to someone else, think of an experience in which this other person responded to certain life situations in very typical ways (because of your beliefs). Then think of ways he or she could respond if he or she had different beliefs.

When you discover some beliefs that aren't particularly useful or are inconsistent with your goals, then use an affirmation or collapsing technique to decharge the energy out of it.

WRITING AS A TECHNIQUE TO EFFECT CHANGE

Every movement we make alters the physical landscape in some way. The more dramatic or expressive our movements, the greater the alterations. By the same token, every thought alters the mental landscape in some way. The more expressive our thoughts, in other words, the more energy we generate in our willingness to think, the greater the potential to effect some change. The change comes from what we are willing to think. Wanting to direct your conscious thought process toward a specific intent is what effects this change. I have found writing is one of the most powerful tools available to focus my thinking and effect some change I desire.

When we write it is a physicalized version of what is going on inside of our mental environment. Your willingness to write about certain issues directs your attention and gives the rest of the parts of your mental environment instructions. What flows up or out of your consciousness is what is there. Once you find out what is there, you can then direct any changes by writing back instructions into the mental environment. This can be a very powerful technique, depending on how much power you put into it.

If I were to do a schematic of the process it would look something like this:

Consciousness → to → Mental environment (instructions for certain information).

The information flows to consciousness (maybe not right away). Consciousness physicalizes the information by writing it; this makes it real and tangible. Consciousness becomes aware of the information (self-discovery). Consciousness makes the connections between the nature of the information and the life conditions one has been experiencing. Consciousness assesses the current structure of the mental environment for its usefulness. Consciousness wants to create new conditions. Consciousness asks, "What beliefs do I need as resources to be more effective or create the conditions I desire?" This is the beauty and essence of the creative process—to ask yourself a question and wait for the answer to pop into your consciousness or allow yourself to be directed to the answer. Consciousness will know when it has found the most appropriate answer because it will ring true in your mind or you will feel the truth of it in your body. Consciousness then formulates these new awarenesses into instructions for change. Then consciousness writes these changes back into the mental environment, giving yourself instructions to accept these new awarenesses as truth. The act of writing forces us to focus our thoughts in a manner that is consistent with what we want to create, and those thoughts alter the mental landscape.

AN EXERCISE TO DEVELOP SELF-DISCIPLINE

Self-discipline is a word used to describe a process of learning how to take conscious control of your actions. It is not a personality trait or something you are born with. It is a specific thought methodology, a mental resource, that allows you to change a belief or belief system when it is in conflict with some goal or objective. Self-discipline is a more direct method of effecting some change because you would be purposefully acting in a manner that is in direct conflict with whatever you want to change.

So I would define self-discipline as willfully behaving outside of the boundaries of some belief (dealing with the emotional discomfort your actions will produce) to accomplish a certain goal or task that is inconsistent with that belief. If you work outside of that belief long enough, it will eventually de-energize. The rate at which the underlying belief will de-energize is really not a function of time but rather intensity. In other words, the greater the intensity of our willingness and resolve, the faster the conflicting belief will lose its power.

For example, let's say you want to quit smoking or lose weight. These are conscious goals. Your beliefs (at least some of them) will be in conflict with these goals. The belief system supporting the smoker definition will probably have a great deal of power in your mental system. You can gauge the power of these beliefs or any beliefs by paying attention to how much discomfort and resistance you feel when you attempt to act (a conscious decision) in a way that is inconsistent with them. It is very difficult thing to do. It's as if beliefs take on a life of their own and demand expression both in our thoughts and behavior.

You can change these or any other definitions of yourself. However, you must first identify them and then determine how useful they are in helping you get what you want. You could ask yourself, "Is this belief a resource or obstacle to the successful fulfillment of my goal?" One way you can change these definitions is to build a mental resource for the sole purpose of changing beliefs that are not useful. I am going to call this mental resource "self-discipline."

Here is an exercise that will help you learn specifically how to develop and use self-discipline in your life. The purpose of this exercise is to help you learn how to use your mind in different ways. You'll be training your mind to stay positively focused on what you consciously want. You will also learn how to gauge internal resistance from belief systems, and how to build mental resources for taking conscious control of your life.

1. Make a list of several things you dislike doing, feel you can't do, or would like to stop doing or some things you have never done before and think you might enjoy You could start a jogging or exercise program or take out the garbage on a regular basis, for example.
2. Once you have your list, look it over and pick a task that has a very low priority in your life or one of the least important items.
3. Next, tell yourself in the most positive way that doing this new task you have consciously decided upon is something you now want in your

life. Don't say you are going to try and do it. A commitment to try to fulfill a goal is not strong enough.

4. Set up a rigid schedule for yourself to accomplish this new goal.
5. With each attempt to adhere to your schedule, keep track of your thought process or stream of thoughts by writing them down. At this point you might be saying to yourself, "How do I keep track of my thought process?"

In the physical environment we are constantly being bombarded with all sorts of information competing for our attention. We are aware of many things going on around us simultaneously. In effect our consciousness is split in many different directions at the same moment. Use a part of your consciousness to pay attention to what is going on inside of your head. You will be using a part of yourself to monitor your stream of thoughts as if they didn't belong to you. If you can temporarily act as if you were monitoring someone else's stream of thoughts, it may be much easier to gather the information you need to make this exercise meaningful.

6. As you attempt to adhere to your schedule, do you find yourself experiencing resistance, excuses, or rationalizations? If so, notice how these thoughts divert your conscious attention away from your goal. This is a classic example of a conflict between the conscious goal you have set for yourself and your belief system that doesn't have a belief or definition that corresponds with what you consciously want to do.
7. At this point you need to redirect your attention to the task you have chosen for yourself. What is most important is that you understand the necessity of directing as much energy toward the fulfillment of your goal as possible. You will have to generate more power toward keeping your attention focused on your goal than the amount of energy being directed through the beliefs that distract your attention away from your goal.

However, there is one aspect to this exercise I must caution you about. Redirecting your attention away from what distracts you to what you consciously want, does not mean that you suppress or deny what may be distracting you. Acceptance and acknowledgment of what exists within you will allow you to work with it. Suppression and denial require a lot of energy; this has the effect of supporting the beliefs you are trying to suppress. Be gentle with yourself.

Each time you set out to accomplish your task, and do so, you create a resource that helps you do it again. Each success will draw some energy away from the beliefs that acted as obstacles. With each success you will also be allocating energy to the new definition of yourself. This new definition allows you to start the task each time with greater and greater ease until the definition becomes a fundamental part of your mental system. When that happens, your actions concerning this task will seem automatic.

The most important aspect of this exercise is the experience you gain in understanding the process of changing beliefs. Each time you set out to change a belief or set of beliefs, you'll gain a resource that enables you to do it again. Each success you experience will help develop another set of beliefs that allow you to change more beliefs if and when it suits your purposes. You will establish a new definition of yourself that says: "I believe I can identify and change any belief about myself that may be in conflict with my conscious goals." For this exercise to be effective, you must keep a few rules in mind. First, start the exercise with a task or goal that is truly insignificant and has little meaning in your life. The objective of the exercise is learning how to manipulate your inner environment consciously and direct your conscious focus of attention. The goal you decide upon as the object of the exercise should not have a lot of value attached to the outcome. If it does, that would be an indication you may be taking on some very powerful and entrenched belief systems. This is something you definitely want to avoid until you have developed the necessary skills and resources.

Then, recognize that from the moment we are born, we are taught how to manipulate the outer physical environment; however, you may not have the resources to be even minimally effective at manipulating the mental environment. As a result, it is extremely important that you do not judge your ability to execute the schedule you set up according to the standards of performance you expect of yourself in the physical environment. If you expect too much and judge your ability harshly, it will only negate your efforts and set up a fear and inadequacy cycle. The less you expect of yourself, the faster you will progress. An expectation can easily become a demand that it be fulfilled. Demands usually generate a certain amount of fear that the demands will not be met. When you are working in the inner environment, fear will always negate your positive efforts unless your intent is to identify the source of your fear.

Finally, not having any expectations from your efforts to carry out your plan will also have the secondary benefit of helping you to learn to accept whatever you accomplish as being all right. Any step, no matter how small, is a step. Just deciding you want to do this exercise is significant, even if you don't follow through with it right away. You may come back to it some day when you have more of a "sense" of the power you will acquire from the ability to manipulate your inner environment consciously to be consistent with your goals. So, to keep yourself from having any expectation about how well you should do at this or any other exercise I offer you, I suggest you consider yourself an infant in a brand new environment. You will have to learn how to stand up before you can begin to walk or run.

SELF-HYPNOSIS

Self-hypnosis is a relaxation technique that allows one to bypass the reasoning process of the conscious mind to make it easier to accept some message. So it is an excellent technique for establishing new beliefs or collapsing old beliefs. For those of you who are interested, I have a self-hypnosis tape specifically designed to make it easier to learn how to cut your losses, reverse yourself, trust your intuition, and value yourself more. For more information, you can contact me at Trading Behavior Dynamics, Inc., in Chicago or through the publisher.

POSITIVE AFFIRMATIONS

When you are in a trade and start to experience anxiety about what is happening in the market, you will likely take those anxious thoughts and start running them through a negative loop—like thinking about money instead of the structure of the market or what the market is doing to you. Eventually you will run enough thought energy through your consciousness that it will cause you to act in a way that is not in your best interests. A positive affirmation will work the same way. Formulate a positive affirmation of some trait or characteristic of the way in which you want to be. For example, you may want to become a more patient person and wait for the market to give the signals to act. With an affirmation like "I am becoming a more patient person every day," you will eventually become that person. In other words we will behave in a manner that is consistent with the affirmation, if we run enough thought energy through that affirmation. Eventually, the affirmation becomes a belief with enough energy to affect our behavior.

The following are affirmations that, once turned into beliefs, will be very effective resources in helping you to work in your inner environment.

1. All beliefs are about reality, and are not necessarily predominate characteristics of reality. I will examine and question my beliefs in relationship to their usefulness in achieving my goals.
2. I believe in the power of my conscious mind to make available to me all the information I need to know.
3. I have the power to change any belief in a way that would make it more useful in achieving my goals of happiness, harmony, financial wealth, and being more productive.
4. I believe I am free to change the way I feel about any past experience.
5. I believe I have the ability to examine the contents of my mind.
6. I trust that all my beliefs about the way I trade will become known to me.
7. I place no particular importance on these beliefs about trading other

than the fact that they exist.

8. I have chosen these beliefs at certain points in my life and accepted them as true at the time. As I examine them, I realize that they may not be particularly useful or true for me now. I accept this and I feel free to change all those beliefs that are inconsistent with my current goals.
9. My first and immediate goal is to identify all my beliefs that may be in conflict with my long-term objectives of_______________.
10. I trust myself to become consciously aware of these beliefs in many different ways. Once I become aware of these beliefs, I can just as easily let them go to make space for new beliefs that are more consistent with my current goals.
11. I believe that changing and expanding my awareness and comfort zones are a necessary aspect of my growth and survival, and I welcome these opportunities to identify old beliefs and consequently grow and expand.
12. I feel an intense desire to succeed and achieve my goal of ___________. Consequently I have an intense desire to clear my inner path of any resistance or obstructions that stand in the way of the fulfillment of my goal.

PART IV

How to Become a Disciplined Trader

CHAPTER 15

The Psychology of Price Movement

My objective for this chapter is to break down and analyze the dynamics and psychology of price movement, first, at its most fundamental level, that of the individual trader; then I will broaden the explanation by examining the behavior of traders collectively as a group. I want to demonstrate that, if you understand the psychological forces inherent within traders' actions, you can easily determine what they believe about the future by just observing what they do. Once you know what traders believe about the future, it's not that difficult to anticipate what they are likely to do next, under certain circumstances and conditions.

What is really important about this insight is that it will help you to understand the distinctions between wishful thinking and the actual potential that exists for the market to move in any given direction. You will be learning to let the market tell you what to do by understanding the forces behind its behavior and then learning to differentiate between pure, uncontaminated market information and how that information is distorted once it starts doing something to you.

The most fundamental component of the markets is traders. Keep in mind that traders are the only force that can act on prices to make them move. Everything else is secondary. What makes a market? Two traders willing to trade, one wanting to buy and one wanting to sell, who agree on a price and then make a trade.

What does the last posted price represent? The last posted price is what someone was willing to pay and what someone was willing to sell for at the moment the two traders agreed on the trade. It reflects an agreement in present value between those traders acting at that price.

What is the bid? A trader announcing the price at which he is willing to buy. What is the offer? A trader announcing the price at which he is willing to sell. How do traders make money? There are only two ways to play this game to make money. To buy at a price you believe is low relative to where you can sell it back at some future point in time. Or to sell at a price you believe is high relative to where you can buy it back at some future point in time.

Now, let's take a look inside the pit to see what has to happen for prices to move off equilibrium and how this will tell us what traders believe.

98-18 The offer, sellers attempting to sell high.

98-17 Equilibrium, the last price.

98-16 The bid, buyers attempting to buy low.

Since the only object to trading is to make money we can assume that a trader will not knowingly enter into a trade believing he is going to lose. And for a trade to exist requires two traders who agree on a price. However, from the moment two traders agree to the trade, they are both subjecting themselves to market risk. In other words, the next tick is going to make one of them a winner and the other a loser. Since we know that both traders want to win and neither trader wants to lose, we can assume that both traders have completely opposite beliefs about the future value of the contract. So for two traders to agree on a price and make a trade, they have to have diametrically opposing beliefs about the future. The buyer believes he is buying low relative to where he can sell back at some point in the future, and the seller believes he is selling high relative to where he can buy back at some point in the future.

If the next tick is going to make one of them a winner and one a loser, we can assume that neither one of them believes he is going to be that loser. If the seller believed the next tick was going to be up, why wouldn't he have waited to sell it higher? The same is true for the buyer. That is the object of the game and the only way to make money. Basically what we have is a situation where two opposing forces are clashing; both believe they are right about the future, and only one side can profit at the direct expense of the other.

If the last price of a bond future was 99-14, what has to happen for the price to move to 99-15? Very simply, some trader has to be willing to bid and pay higher than the last price. This means that relative to the last posted price, he has to be willing to do the opposite of buying low. Any trader or group of traders willing to buy high or sell low relative to the last posted price is very significant for several reasons.

First, a trader willing to buy high or sell low instead of buy low or sell high has to have a stronger conviction in his belief in the future value, even if his conviction is out of panic. Second, he is making the last price a bottom.

Third, he is aggressively taking the initiative and is making losers out of everyone who sold at the last price and deepened the losses of those who sold lower. Fourth, he is creating price movement that can possibly gather momentum if other traders perceive the new price as low relative to the future. This will also be true for the trader who is paying up to liquidate a position. On the other hand, the seller on the other side of his trade is being lured into the market by the attractiveness of the high price at which he can sell. He believes he is getting the edge. He is in fact selling high, but he is not creating movement or much of a possibility for momentum in his direction. He is picking a top and waiting for something to happen, hoping it won't go any higher.

Now, what do the actions of the two traders represent about the market in its collective form? First, this trade tells us that nobody had a strong enough belief in the future value to risk selling it to him at the last price or lower. Second, nobody was aggressive enough to want to enter the market short or liquidate an existing long position by offering to sell it at the last price or lower. A consummated trade at the next higher level creates a new equilibrium. This new equilibrium makes winners out of all the buyers at the last level and losers of all the sellers at the last level.

All of the losers at the last price level or lower would have to maintain a belief in the future value to stay in their position or demonstrate a conviction in this future value by adding on to their positions. This is because each new level the price is bid up makes it that much more attractive to them. If they believed it was high at lower levels, at each higher level, it's even a better trade. However, at the same time, each move the market makes against their position invalidates the sellers' expectation of future value. Each move clearly demonstrates that the sellers are passive, that the buyers are the aggressors, and that the buyers have a greater potential to move the market in their direction.

The fact that buyers are aggressively bidding up the price and paying more and more again tells the observer something. It tells him there aren't enough sellers to meet the buyers' demand for a trade at each new price level. If there is a limited supply of sellers, those traders wanting to buy will have to compete among one another for the limited number of sellers available willing to take the other side of the trade.

Just observing this price action tells you that at the present moment, the momentum is in favor of the buyers. Prices would not be bid up unless there were fewer sellers in relation to the buyers. If traders continue to pay more and more, the price gets further away from old sellers. Eventually their belief in future value will erode, and one by one the sellers will join the existing pool of buyers competing against one another for the fewer and fewer traders willing to sell. As long as the ratio between buyers and sellers remains as I have just described, there is very little potential for downward price momentum to be established.

Now what will start to tip the balance to cause the market to fall back?

For one thing, old buyers will eventually take profits. When they do, they will be joining the existing pool of sellers, thereby increasing the number of traders available to sell. If a move gathers enough steam, it can become similar to a frenzied shark feeding. Eventually, prices will be driven way out of line with some economic factors other traders perceive as relevant compelling them to enter the market in the opposite direction. If these new traders enter with enough force, it will likely cause old buyers to panic adding to the downward momentum.

Maybe you can visualize this back and forth action. When there are more sellers than there are buyers to take the other side of the trade, the balance will be tipped. Sellers will then aggressively offer to sell lower than the last price, responding to what they perceive as a limited number of buyers to take the other side of the trade.

All price movement is a function of group behavior. The market prices flow back and forth like a tug of war between those who believe and expect the market to go up—and consequently buy— and those that believe the market will go lower—and consequently sell.

If there is no balance between the two forces, one side will gain dominance over the other. As prices move farther and farther away from the weak group, the emotional pain of admitting they are wrong will be in direct conflict with their need to avoid losses. Eventually, one by one they will lose faith in their position and liquidate their trade, adding to the momentum of the dominant force.

The prevailing force will continue to dominate until there is a general perception that prices have gone too far and are out of line with other related factors. The members of the dominant force will have to switch sides to liquidate their positions, creating momentum in the opposite direction.

As individuals, if we do not have the strength actually to move prices in the direction we would most benefit from, then the next best thing is to learn to identify and align ourselves with the side that has established dominance until the balance shifts and again align ourselves with the side establishing the strength.

As prices move back and forth in this tug of war, it creates an ebb and flow that is easily identifiable in price charts or point and figure charts. These charts will show us in graphic terms how the forces interact and counteract. They are a visual representation of traders' beliefs in the future and the intensity in which they have been willing to act on those beliefs.

If, for example, a market has been making consistently higher highs and higher lows, to determine what is likely to happen next, ask yourself the following questions:

1. What kind of price action will sustain the buyers' beliefs that they can make more money?
2. When are sellers likely to come into the market in force?

3. Where are old buyers likely to take profits? Where are old sellers likely to lose faith in their positions and bail out?
4. What would have to happen for buyers to lose faith? What would have to happen to draw new buyers into the market?

You can answer all these questions by identifying certain significant reference points where buyers' and or sellers' expectations are likely to be raised and where they are likely to be disappointed if they don't get their way.

Actually, all this works quite nicely in the typical market behavior patterns and price formations with which we are all familiar. So, we are going to look at the psychological makeup of some of these typical patterns. However, before we do, I want to cover a few more definitions.

MARKET BEHAVIOR

The market's behavior can be defined as the collective action of individuals acting in their own self-interest to profit from future price movement while simultaneously creating that movement as an expression of their beliefs about the future.

Behavior patterns result from the collective actions of individual traders doing one of three things: initiating positions, holding positions, and liquidating positions.

What will cause a trader to enter the market? A belief that he can make money and that the current state of the market offers an opportunity to enter into a trade at a price level that is higher or lower than the price at which it can be liquidated.

What will cause a trader to hold a position? A sustained belief that there is still potential for profit in the trade.

What will cause a trader to liquidate a trade? A belief that the market no longer provides an opportunity to make money. This would mean in a winning trade that the market no longer has the potential to move in a direction that will allow the trader to accumulate additional profits or that the risk of staying in the trade is too great in relation to the potential for additional profit. In a losing trade, the trader believes that the market no longer has the potential to move in a direction that will allow him to recover his losses or the trade was a calculated risk in which a predetermined loss level was set in advance.

If you look at any price chart, you notice that over a period of time, prices will form patterns in a very symmetrical fashion. These kinds of symmetrical-looking price patterns are not an accident. They are a visual representation of the struggle between two opposing forces—traders squaring off, so to speak, taking sides and then having to switch sides to liquidate their trades.

Now, what you would be looking for in these charts are significant market reference points. These are defined as anything that causes traders' expectations to be raised about the possibility of something happening. They are points where a large numbers of traders have taken opposing positions. Based on those expectations, they will continue to hold a position in the belief that the expectation will be fulfilled, and most important, they will likely liquidate a position as a result of the expectation being unfulfilled

Significant reference points are places where the opposing forces (traders with opposite beliefs about the future) have taken a stand, where they have, in their minds, prescribed for the market very limited ways for it to behave, an either/or situation.

The more significant the reference point, the greater the effect traders will have on prices, as the balance of power will shift dramatically between the two opposing forces at these points.

These expectations about what the market will do, projected into price levels, are especially significant because both sides, buyers and sellers, have decided in advance their degree of importance, where one trader is taking one position, betting the market can't or won't do something, and the trader taking the opposite side of the trade is betting that it will.

So, reference points are price levels where many traders on one side of the market are very likely to give up their beliefs about the future, whereas the other side will have their beliefs about the future reinforced. It is where each side expects the market to confirm what they believe to be true. You could say it is a place where the traders' expectations about the future and the future actually meet.

This means for one side, in their minds, that "the market" will make them winners; their beliefs will be validated. All the traders on the other side, however, will be made losers; they will feel the market took something away from them and will naturally be disappointed. I want to point out here that the "objective observer" doesn't care one way or the other; she would just be looking for signs and opportunities.

The greater the expectation traders have about something happening, the less tolerance they have for disappointment. On a collective basis, if you have a whole group of traders who expect something to happen and it doesn't, they will have to trade from the opposite direction of their original trade to get out of their position.

On the other hand, the winners had their beliefs validated, consequently leaving fewer and fewer traders available to let the losers out of their trades. The losers will have to compete among one another for the limited supply of traders willing to take the other side of the trade, the side they originally believed would be successful. For example, if buyers are the losers, they will need other traders to buy from them to get out of their positions. All this activity will result in a great deal of movement in one direction.

Balance Areas

J. Peter Steidlmayer and Kevin Koy in their book *Markets and Market Logic* (Chicago: Porcupine Press, 1987) refer to a "value area," where they discovered that the majority of trading activity on any given day takes place in a normal bell curve distribution pattern. This is very easy to see day after day when you organize trading activity so that you can see how price corresponds with time.

I don't want to get into a lengthy discussion of their methods of organizing market data, which I recommend you learn, other than to distinguish between what they call a "value area" and what I call a "balance area." Steidlmayer and Koy say that most of the trading volume takes place within a specific price range because that range is what the market has established as a fair price representing the value of whatever is being traded.

The distinction I want to make is that the majority of traders don't specifically relate to a fair price or value; they relate to comfort. What gives them comfort is doing what everyone else is doing. In a balance area, traders are basically absorbing each other's orders or energy (their beliefs about the future expressed in the form of energy). When I say that traders relate to comfort, I mean some degree less of the fear they normally feel. Most of the trades take place in a value or balance area because it is where most of the traders feel the least fear, somewhere in the middle of the trading range between an established high or low. This is precisely why there are fewer trades outside the value or balance area and why, as Steidlmayer and Koy say, these trades represent the best opportunities to make money, "to buy or sell away from value." And that is why these are the scariest trades to make because the trader who can make them is all alone; there is no safety in numbers.

There are traders who relate to value by making comparisons between various interrelated contracts and the cash markets. There are the professional commercial or institutional arbitrage traders who will put on or take off positions based on sophisticated mathematical formulas that determine the present value of something as it relates to something else. Otherwise, the majority of traders don't have the slightest concept of value. The more time the market spends at a certain price or in a price range, the more balance, agreement, or comfort there is in the market. Traders are absorbing each other's orders, and nobody is willing to bid the price higher or offer the price lower.

Eventually someone will enter the market who doesn't agree with everyone else and believes there is a possibility for the prices to move much higher or lower. This person or group of traders will basically upset the balance with their buying or selling activity. If their activity is forceful enough, it will set off a series of chain reactions as it causes other traders, who are either holding positions or watching the market for opportunities, to confront these new conditions.

If the balance is tipped in favor of the buyers, for example, it may attract new buyers into the market, creating more buying force and, hence, more disequilibrium. This may cause the traders who are holding short positions to liquidate. To do that they will need to be buyers, leaving fewer and fewer sellers willing to take the other side of the trades the buyers want to get into and the old sellers want to get out of. These traders will compete among one another for the dwindling supply of sellers, bidding the price higher and higher to make it more attractive for someone to sell.

While these traders are in their own little bidding war, they usually lose sight of the fact that the rest of the world is watching what is going on. There could be a trader who is looking to put on a massive hedge to protect the value of an investment portfolio or crop. He is observing this price action from a completely different perspective than the traders on the floor. The floor traders are just concerned with getting their share and not missing out on the opportunity these rapidly rising or falling prices represent. The hedger, on the other hand, is looking at the price rise as an unexpected gift. The rally could have provided much higher prices than he anticipated for locking in the value of something he already owns.

So the commercial trader decides to put on a hedge. And you can assume if one commercial thinks the price is good, others will too. Anyway, if the hedger has an order he perceives to be big enough to stop the rally, he will give instructions to the floor brokers handling his order to do scale in selling, the purpose being to get as much of the order sold as possible without ruining the rally.

However, it won't take long for the other floor traders to figure out what is going on. They are very aware of which floor brokers fill orders for big commercial and institutional customers. Once they find out someone "big" is in the market selling into the rally, few if any of the floor traders will go against them by continuing to buy. No one wants to get caught at the top. So as each group of traders finds out who is selling, they will all try to reverse their positions by selling, and the cycle starts all over again.

Watching this happen from the outside of the pit, it would seem that the reversal is instantaneous, but it isn't. It occurs in waves, as the information about who is selling spreads from the source outward, very much like the waves that result from throwing a stone in a pond.

This leads me to the observation that few traders have any concept of value. They know that price movement creates an opportunity to make money, and it can just as easily take the money away if they don't know what they are doing. If the price trades within a certain range for a period of time, traders will become comfortable with that balance area, making it easier for the trader to trade. As prices move out of the balance area, fewer traders will participate because of what they perceive as more risk than they are comfortable with.

Highs and Lows

Probably the most prominent of these significant reference points are previous highs and lows. If prices are moving steadily higher, buyers will begin to anticipate whether or not prices can penetrate the last high, and sellers will be looking for another top.

In the mind of the seller, that last top, or other tops in the distant past, was a place where the market met enough resistance to stop the rally. In other words, enough traders thought the price was expensive the last time it was there, and they will begin to anticipate whether the same will happen again.

Both buyers and sellers will have raised expectations about the likelihood of the market doing one of two possible things—making new highs or failing to make new highs. As the market approaches this high, if some of them are willing to bid the price past it to some significant level, it could make believers out of other traders who were on the sidelines. If these new traders come into the market as buyers, it will add to the upward momentum, possibly causing old sellers to bail out of their positions. This will also add to the upward momentum of price movement.

Support and Resistance

In a falling market, support is a price level where buyers entered the market or old sellers liquidated their shorts with enough force to keep prices from going any lower. In a rising market, resistance is a price level where sellers entered the market or old buyers liquidated their longs with enough force to keep prices from going any higher.

Support and resistance levels are significant reference points because many traders recognize support and resistance on charts and believe in their significance.

That statement may seem redundant to some people, but it really illustrates a very important point about the nature of the markets (traders acting on their belief in future value). All beliefs eventually become self-fulfilling prophecies. If enough traders believe in the significance of support and resistance, and demonstrate their belief by making trades at those levels, they are in effect fulfilling their own beliefs about the future.

As observers, if we know that each side (in the perpetual tug of war between buyers and sellers) expects one thing to happen, then we will know who will be the winner, who will be the loser, what they will likely do in each case, and how it will affect the balance between the two forces.

For example, if buyers are bidding up a market, causing prices to rise, and all of a sudden many traders are willing to sell for less than the last price (or one trader comes into the market with a big order to sell), causing an immediate price reversal, the price level at which the market stopped is resistance.

Now, it really doesn't matter why the balance of forces shifted from buyers to sellers. Everybody will have his own reasons for what caused prices to reverse. All of them will usually be way beyond the simplest and most obvious reason—that enough traders were displaying a strong enough conviction in their belief in future value to stop the upward price momentum and create downward price momentum.

What is really important about this, however, is that many traders will remember the market reversed at that price level. As a result, that price will then have a degree of significance in the minds of those traders who experienced the reversal.

This first reversal is a top. What we don't know is whether it will remain a top, how long it will take before it is challenged again, or whether it will ever be challenged again.

If the buyers are dominant enough to bid the market back up to the previous high, they will consider this second attempt a test and begin to anticipate whether or not prices can exceed the previous high. The only way that can happen is if these higher prices actually attract additional traders into the market on the buy side because they believe it is an opportunity to buy low relative to the future. Floor traders are especially aware of whether or not new traders are being attracted into the market from off the floor and act on this information.

For the sake of this example, if the market reversed very strongly the last time prices approached this level, there will be many traders who will think it will probably reverse again. As a result, they may act on their belief about the low probability of prices trading beyond the last high and thereby prevent it from happening. If more traders are willing to act on the belief that it won't in relation to those who act on the belief that it will, then prices will stop again.

Technically, once the market tests a previous high or low and fails to penetrate, you then have a defined support and resistance area. Support and resistance are most easily identified in point-and-figure charts because they graphically represent price movement in reversals. Once support and resistance are established and identified, it can be very easy to trade by putting your orders on either side of the support or resistance line.

For example, if over the last two weeks, every time the bonds rallied to 95-25, then fell back significantly to some support level, like 94-10, what I have just described is a support and resistance zone, commonly referred to as a trading range. The significance of either end of the zone would be determined by how many times prices rallied to 95-25 and failed to penetrate, and how many times prices fell to 94-10 and failed to penetrate. Obviously, the more attempts and failures, the more weight these points will have in the minds of the traders who experience these tests and subsequent failures.

For an objective observer with no bias toward any particular direction, trading ranges can be very easy ways to make money. As the market approaches 95-25, put in an order to sell somewhere around 95-21. Since we know the markets are not precise, you don't want to put your order exactly at the upper end of the range, because each time the market makes an attempt to penetrate there will be many traders who will be anticipating a failure. As a result, they will start selling early and the price may never get to 95-25 for you to get filled, if you had placed your order there.

Also, put an order in the market to stop and reverse (buy two) possibly around 95-31. Each circumstance will be different. In this example, the 6 ticks that I have given the market to define itself may not be enough. The object would be to put your orders in a place where the highest probability is that it will continue in the direction of your trade. If the market trades to 95-31, it still may not be enough for old sellers to become disappointed and bail out of their positions en masse, causing prices to rise even further.

This trade will work if the resistance level has a high degree of significance in the minds of enough traders for them to act and sell against it in relation to those who are willing buy. Each time the market approaches this area, traders will expect either one of two possible things to happen. The market will penetrate, or it will fail again. In any case the price move that results will be significant because one side of the market will be disappointed. And if we know what will validate and disappoint each group, then we can determine how they will likely behave and thereby affect the balance of the market.

Since the market can display billions of combinations of behaviors from one point to the next, significant reference points like support and resistance narrow those behaviors down to two likely possibilities. By putting your order on both sides, you can take advantage of the situation, regardless of what happens.

Support Becomes Resistance and Resistance Becomes Support

Many traders have read or heard that old support becomes resistance and old resistance becomes support. This bit of market insight is valid for some very sound psychological reasons.

If resistance has been established at 95-25, it is because there were enough traders who sold at that price to make it resistance. In fact, it would probably be the same group of traders who sold at 95-25 each time the market approached that price. So, every time the market rallied up to 95-25 and sold off, it made winners out of all those traders who chose to sell at or near that price. As a result, 95-25 will take on a great deal of significance in the minds of the traders who were successful. Each subsequent time they are successful will only strengthen their belief and faith in that price level.

Now, the prices rally up to 95-25 again, maybe for the fourth or fifth time, and like the last time, you will have a group of traders who believe in that resistance level and will sell against it. Only this time the buyers are very strong on the way up and continue to buy right on through the resistance level.

All the traders who choose to sell at 95-25 are now faced with having to deal with a losing trade. Some will get out with a small loss, others will hang on hoping the market will come back. In any case, the market invalidated their beliefs about the future, and they are suffering considerably. They had faith in 95-25, and in their minds the market betrayed them.

If the market happens to come back to 95-25 after rallying for several days, how do you think the group of traders who sold at 95-25 the last time—the ones who believe they were betrayed—are going to behave? First, the traders who were hanging on in hopes of the market coming back will bail out as soon as they are close to being made whole. They are so grateful for getting their money back, there is no way they will stay in that trade regardless of what the possibilities are for additional profits. They will have to be buyers to liquidate their shorts and will be all too happy to end their suffering.

The traders who originally cut their losses when the market blew through 95-25 won't consider selling at that price again because of the emotional pain of being wrong the last time they sold at that price. I am not saying they will in turn be buyers at that level, but they are very likely not to sell. The overall effect this will have on the balance of the market is to take away from the existing pool of available sellers at 95-25 (old resistance), thereby causing the balance to be tipped in favor of the buyers. Hence, old resistance becomes support, and old support becomes resistance for the same reasons.

Trends and Trendlines

Trends, a series of higher highs and higher lows, or lower highs and lower lows over a period of time, work because there aren't enough sellers to absorb the number of buyers competing with each other to get into the market during that period of time. Adding to this buying force will be old sellers at lower levels who finally lose faith and bail out of their positions. They will do this in significant numbers when the prices penetrate what they believe to be significant reference points.

Keep in mind that trends are a function of time. The next tick up could be defined as a one-tick trend. How long will the imbalance between buyers and sellers last?

In an upward-trending market, prices will retrace because buyers are taking profits. This will create some counteracting pressure, but if the trend continues after a normal retracement, it just tells you there still aren't enough sellers around to absorb all the buyers, with enough left over to create downward momentum. You will know when that has happened when the trending market breaks its normal ebb and flow pattern. That is why markets that break trendlines have a tendency to keep on going in the direction of the break, because it signals a significant shift in the balance of forces.

After a certain period of time, you can notice how trending markets will develop a certain rhythm and flow, making the price movement look very symmetrical on a bar chart. You really don't have to know why this is so, you just have to notice that it exists. When this flow is broken (the market trading above or below a significant trend line), it is a good indication the balance of the market forces has shifted. Then ask yourself, what is the likelihood the shift will gain hold and continue trending in the direction of the break?

You don't even have to know the answer to that question. Put in an order at a spot that would confirm the highest probability of a change in the balance. Then wait for the market to define itself. If your order is filled, put a stop where the market shouldn't be to confirm that your trade is still valid. "What is a valid trade?" you ask. One where the highest probabilities for price movement are in the direction of the prevailing force.

High → Retrace → Rally to a Lower High

I will give you an example. No matter how simple a trade this is, it has very sound psychological reasons for working. In this example, the market made new highs and sold off. The sell-off could be the result of new sellers corning into the market in force, or old buyers selling to take their profits, or a combination of both. Prices will continue to drop until enough traders believe the price is cheap and are willing to take the initiative and bid the price back up. As the price approaches the last previous high, buyers will begin to anticipate whether or not prices can penetrate, and sellers will be looking for another top.

In either case expectations by both will be raised. If some buyers are willing to bid the price past the previous highs to some significant level, it will make believers out of others who were on the sidelines. If they do come in, it will add to the momentum.

Some old sellers will admit to being wrong and will have to buy to get out of their trades, thus adding to the upward momentum.

However, what if the market approaches the highs the second time, and sellers come back into the market again with enough force to keep the price from exceeding or equaling the previous high? Buyers will start to become disappointed. Where will they really be disappointed?—if enough buyers don't come into the market to support the price at the previous low. If prices penetrate that low, watch for buyers to bail out en masse. For them to get out of their position, who is going to buy it from them? If everybody is trying to sell and no one is available to buy, what are prices going to do? Fall like a rock.

The reason why a bull market is ready to turn into a bear market when the general public gets involved is because the general public has the least tolerance for risk and consequently needs the most reassurance and confirmation that what they are doing is a sure thing. As a result, they will be the last to be convinced that the rising market represents an opportunity. If a bull market has lasted for any length of time, the general public will feel compelled to jump on the bandwagon so to speak, because of their perception that everyone else is doing it and making money. They will pick up on any reason that sounds the most rational to justify their participation, when in reality, they will know very little about what they are doing, but since everyone else is doing it, how can they go wrong.

A continuing bull market requires the continual infusion of new traders who are willing to pay higher and higher prices. The longer a bull market lasts, the greater the number of people who are already participating as buyers, leaving fewer and fewer traders who haven't already bought and fewer and fewer traders who are willing to bid the price up. These older buyers obviously want to see the market keep on going up, but they also don't want to get caught holding the bag, if the market stops going up. As their profits accumulate from the higher prices, they start to get nervous about taking their profits.

By the time the general public starts buying en masse, the professional traders knows the end is near. How does the professional know this? Because the professional knows that there is a practical limit to the number of people who will participate to bid the price up. There will come a point where everyone who is likely to be a buyer will have already bought, quite literally leaving no one else to buy. The professional trader would like the market to continue to go up indefinitely just like all the other buyers. However, he also understands the impracticality of that happening, so he starts taking his profits while there are still some buyers available to sell to. When the last buyer has bought, the market has no place to go but down.

The public gets stuck because they weren't willing to take the risk when there was still potential for the market to move. For the market to sustain itself, it needs to attract more and more people. As big as this country is or the world for that matter, there are only so many people who will buy. Eventually the supply of buyers runs out, and when it does the market falls like a rock.

The professionals have been selling out their positions before this happens, but once the supply of buyers runs out, the professionals start to compete among one another for the available supply of buyers which is dwindling fast, so they offer lower and lower prices to attract someone into the market so they can get out. At some point, instead of the lower prices being attractive to people, it panics them. The public didn't anticipate losing. Their expectations are very high with very little toleration for disappointment. The only reason they got in was because it was a sure thing. When the public starts to sell, it starts a stampede.

Again, people will ascribe their actions to some rational reason because nobody wants to be thought of as irrational and panic-stricken. The real reason why people panicked and the prices fell is simply because prices didn't keep on going up.

CHAPTER 16

The Steps to Success

Self-discipline is simply a mental technique to stay focused on what you need to learn, or do, to accomplish your goals. There will be times when you won't have the resources to function effectively relative to the external conditions. Other times the resources you do have will be in conflict with both the conditions and your goals. So to accomplish your goals, you will need to adapt. In other words, you will need to change the way you interact with the environment. To change your behavior and how you experience the environment (feelings and emotions), you will have to change your perspective. To change your perspective, you will have to change the mental components that effect your perception of environmental information. Keep in mind that you can't physically control what the markets do; you can only learn to control your perception of the markets to share the highest degree of reality (the least amount of distortion) with everyone else who is participating or has the potential to participate. The more sophisticated you become as a trader, the more you will realize that trading is completely mental. It isn't you against the markets, it's just you. All the other traders participating to make the market provide you with an opportunity to make money from their divergent beliefs about the future. If people didn't disagree about the future value of any particular commodity or stock, then there would be nothing to compel them to either bid a price higher or offer it lower, and the opportunity to profit from these changes would cease to exist. So the markets just offer the individual trader opportunity. They don't choose the data on which you focus your attention, and they certainly don't interpret the data you perceive. Nor are the markets responsible for what you can't perceive because of the distinctions you haven't learned to make yet. They also don't choose when you put on a trade, how long you stay in, when you get out, or how many contracts you buy or sell.

Each individual trader creates his own experience of the markets based on this picking and choosing process and the decisions that result. If you accept this concept as valid, then the implications are that you will never have a valid reason to blame the markets for your unsatisfying results. The markets don't owe you anything (regardless of how hard you work to be successful) because every other trader participating is doing so to take your money away. You and you alone are completely responsible for whatever you end up with. The sooner you accept that responsibility (if you haven't already), the easier it will be to identify what skills you need to learn to interact with the markets more successfully. Even if you can't identify the mental components responsible for what you ended up with, at least by assuming that you are responsible, you will be opening yourself up to find out.

To be a successful trader you need to trade without fear. As you have already learned when you use fear as a resource to limit yourself, you will create the very conditions you are trying to avoid. Or to say this another way, you will experience your fears. You also can't learn anything new because fear will force you to perceive the environmental "now" from your individual past. You will experience that past regardless of the opportunities the environment may have to offer in that same moment. Your individual history will repeat itself until you change your history, which will then allow you to learn and experience something new. Evolving beyond your fears is also the best way to learn how to predict market behavior. The more fearful traders are, the fewer the choices they perceive as available to themselves and the easier it is to predict their behavior. You will be able to recognize this clearly in others when you recognize it yourself and work your way out of the condition where you trade with fear.

However, you will need some resource to limit yourself so that you don't get reckless. Getting reckless is exactly what people have a tendency to do if they don't feel any fear, especially if there is a potential for thrilling results, as there is in trading. The resource you need to limit yourself is self-trust. You will gain that self-trust when you establish a set of rules and guidelines to trade by and know that you will always follow those rules without hesitation, regardless of the temptations to do otherwise.

Once you trust yourself to always do what needs to be done, there will be nothing to fear because the markets won't be able to do anything to you, as a result of your inability to respond appropriately. Consequently, with nothing to fear, you are then free to observe the markets free of distortions. There won't be any need to avoid certain categories of information because of how that information will make you feel. The less reason you have to avoid or distort information, the more you make yourself available to learn about the nature of the markets. The more you learn, the easier it will be to anticipate what the market will do next. If you can accurately anticipate what will happen next, the easier it will be to give yourself more and more money (notwithstanding any mental components that would argue against giving yourself more money).

It is very important for you to understand that these new insights about the market's behavior will come in stages as you learn to trust yourself more and more. There is no "get rich quick" scheme being offered here. There are enough rags to riches to rags stories to attest to the fact that get rich quick doesn't work anyway. Getting rich quick can only lead to a great deal of anxiety and frustration if you don't have the skills to keep it. There isn't much point to making a lot of money if you are a susceptible to making that one trading error that can give it all back plus more. Once you have made a fortune and lost it, the psychological work that you will need to do to get it back is enormous compared to work that is necessary to keep yourself from losing it in the first place. *As a trader it is more important to know that you will always follow your rules than it is to make money, because whatever money you make, you will inevitably lose back to the market if you can't follow your rules*.

You also need to understand that your rules will change as your understanding and insights evolve. Many people don't like to establish trading rules because they believe that once made, they can't be changed. Any exercise that I offer you or rule that you select to guide your trading behavior is only transitory. They are methods and techniques to get you beyond certain fundamental stages of development so that you can recognize for yourself their value and what you need to do next to be more successful. In fact, a good rule of thumb to use to determine your readiness to move beyond a certain rule or exercise and to the next challenge is the recognition that you can do what you set out to learn so well that it becomes second nature. Otherwise, keep working at it until you don't have to think about it any longer.

STEP ONE: STAYING FOCUSED ON WHAT YOU NEED TO LEARN

First and foremost, you may need to change your perspective or the focus of your trading. Until now your focus may have been to make money. If this is so, you will need to change your perspective to "What do I need to learn or how will I have to adapt myself to interact more successfully?" You need to stay focused on mastering the steps to achieving your goal and not the end result, knowing that the end result, money, will be a by-product of what you know and how well you can act on what you know.

There is a tremendous difference between focusing on money and focusing on using your trading as an exercise to identify what you need to learn. The first will cause you to focus on what the markets are giving you or are taking away from you. The second perspective causes you to focus your attention on your ability to to give yourself money. With the first perspective, you are placing some of the responsibility onto the markets to do something for you. With the second perspective, you assume all the responsibility.

Always keep in mind that each moment is a perfect reflection of your level of development. If you look at each moment that things don't turn out as you want or expect as a mistake, then you will usually cut yourself off from the insight about yourself contained within each moment. The reason why we will cut ourselves off from this information is because we typically associate mistakes with pain. We will instinctively avoid pain and in doing so also avoid what we need to know about ourselves to interact more effectively in similar circumstances in the future.

To evolve beyond pain and our fear of mistakes, our mistakes have to be resolved. This could be a big task and you may not want to tackle it at this time. So what you will need to do is build a corollary framework to place all of your trading experiences. This framework needs to be defined in such a way that all experiences are valid and have meaning, and, as such, mistakes don't exist—they just point the way.

As part of this framework you may also need to change your definition of a missed opportunity. Except for the inability to accept a loss, there isn't anything that has the potential to cause more psychological damage than a belief in missed opportunities. Missed opportunities are trades that would have always turned out perfectly because they only occurred in our minds, where we can make anything be as we want it to be. Of course, we would have responded exactly as the conditions warranted without flaw. The problem is we didn't do it, and the resulting sense of loss we feel is difficult to reconcile. Therefore, these missed opportunity trades have the potential to cause more anxiety and stress than the trades we actually do take that turn out to be losers.

Nothing's worse than missing a "perfect" opportunity. However, if you could have, you would have; it's that simple. The sooner you accept this, the sooner you will be able to take advantage of these missed opportunities instead of beating yourself up over them. Besides there really isn't anything to miss because the markets are in perpetual motion and will continue to be until everyone agrees on value. As long as the price keeps changing, there will always be another opportunity.

When you start trading from the perspective that mistakes don't exist, you will be amazed at the sense of freedom you will feel to grow by accepting your results as a reflection of who you are in that moment, which then allows you to determine what you need to learn to do better. When you release the energy out of the belief that it is possible to miss anything, you will no longer feel compelled to do something, like getting into trades too early or too late. In other words, you will be giving yourself additional choices (not doing something is often the most appropriate choice) where only one choice existed.

You need to constantly keep in mind that the professional traders from whom you are trying to extract money already know and are using many of the principles put forth in this book. They understand the concept of objectivity, have learned how to trade without fear, and know how to execute their trades properly. Before you can begin to take money out of the markets consistently instead of the markets taking yours, you will also have to learn these skills.

So, I would suggest that you set aside a certain amount of trading capital as tuition for your education. How much you set aside will be a function of how many skills you need to learn. What is most important is that you make a firm commitment to your education as a trader. Even if you have been trading for years and you are successful, but not as successful as you would like to be, setting aside money that you will trade with as an exercise to learn some needed skill is a very powerful symbol of your commitment to learning that skill. The stronger your commitment, the faster you will learn.

STEP TWO: DEALING WITH LOSSES

Trading Rule 1

Predefine what a loss is in every potential trade. By "predefine," I mean determine what the market has to look like or do, to tell you that the trade no longer represents an opportunity, at least not an opportunity in the time frame in which you trade.

When your beliefs about losses are restructured, the possibility of a losing trade will not create any threat of pain. Most successful traders restructured their beliefs about losses after they lost one or more fortunes. They experienced their worst fears about losing and then came to the realization that they didn't have anything to fear if they just did what needs to be done. What needs to be done? Confront the possibility of being wrong and consequently not avoid the inevitability of taking a loss. So confronting and accepting the inevitability of a loss is a trading skill, certainly a skill learned the hard way for most, but nevertheless an essential component at the foundation of virtually everything you need to learn to become a successful trader.

The relatively few successful traders in the market today did it the hard way. You, on the other hand, have the opportunity to do it much more easily. There will be two mental components at work to help you acquire this skill. First is *your* understanding of why it is so essential to confront the possibility of a loss. If you don't, you will generate fear and end up creating the very experience that you are trying to avoid. When you really understand this concept, it will become unacceptable to you to trade from the old perspective of loss avoidance.

The second is *your willingness* to change your definitions of what it means to lose. By using some of the mental exercises in Chapter 14 you can change these definitions by using your thoughts instead of having to lose everything or practically everything you own to get to the same place. That place is "losses do not diminish me (you) as a person." The sooner you believe it, the easier it will be to identify and execute a losing trade. By making the execution of a losing trade an automatic function of your trading strategy, you make yourself psychologically available to take advantage of the next opportunity, even if that opportunity is in the same direction of the losing trade you just got out of.

Trading Rule 2

Execute your losing trades immediately upon perception that they exist. When losses are predefined and executed without hesitation, there is nothing to consider, weigh, or judge and consequently nothing to tempt yourself with. There will be no threat of allowing yourself the possibility of ultimate disaster. If you find yourself considering, weighing, or judging, then you are either not predefining what a loss is or you are not executing them immediately upon perception, in which case, if you don't and it turns out to be profitable, you are reinforcing an inappropriate behavior that will inevitably lead to disaster. Or if you don't and the loss worsens, you will create a negative cycle of pain, that once started will be difficult to stop. The next error after letting a loss get out of hand is usually not taking the next opportunity, which invariably is always a winning trade. After which, we get so angry at ourselves for passing up that opportunity that we make ourselves susceptible to any number of other trading errors, like taking a trade that was a tip from another trader, which invariably is always a loser.

It is important for you to note that once you completely trust yourself to cut your losses, you will eventually get to the point where you may not have to predefine what a loss is. There are traders who have reached such a high degree of objectivity and trust that they can get into a trade and know when it is a loser without having to predefine it for themselves. They let the market define it for them based on their comprehensive knowledge of the various participants involved and their knowledge of the various relationships between price movement and time. However, the reason why they were able to learn what they know about the nature of the markets is because their focus of attention widened to include more undistorted information leading to greater insights, once they learned, first, however, to trust themselves. Keep in mind, that fear is really the only thing that keeps us from learning anything new. You can't learn anything new about the nature of the market's behavior if you are afraid of what you may do or can't do that is not in your best interests. *By predefining and cutting your losses short, you are making yourself available to learn the best possible way to let your profits grow.*

STEP THREE: BECOMING AN EXPERT AT JUST ONE MARKET BEHAVIOR

Generally, most of us grow up believing that when we have to make a decision, the more relevant information we can gather, the better our decisions will be. This isn't necessarily true with trading, especially in the beginning stages of one's career. In most market situations, there is an even number of traders who have a propensity to buy and those who have a propensity to sell or those who need to buy and want someone to take the other side of the transaction and vice versa. Everyone will have his reasons and rationalizations for all this trading activity, creating about as much conflicting information as there are participants. Because there is so much information and because so much of that information is conflicting, the beginning trader will need specifically to limit his awareness of the market information to which he allows himself to be exposed. More is not better; it just creates confusion and overload that will ultimately lead to losses.

You need to start as small as possible and then gradually allow yourself to grow into greater and greater amounts of market information. What you want to do is become an expert at just one particular type of behavior pattern that repeats itself with some degree of frequency. To become an expert, choose one simple trading system that identifies a pattern, preferably one that is mechanical, instead of mathematical, so that you will be working with a visual representation of market behavior. Your objective is to understand completely every aspect of the system—all the relationships between the components—and its potential to produce profitable trades. In the meantime, it is important to avoid all other possibilities and information.

Out of all the combinations of behavior possible, you are going to limit your focus of attention to just one combination. Consequently, you will be letting all the other opportunities go by. Starting small and gradually working into other combinations is a real exercise in discipline that has a couple of important psychological benefits. First, you will be building a base of confidence as you learn that you can, in fact, accurately assess what will most likely happen next. It is much easier to gain this confidence if you don't overwhelm yourself with the market's seemingly infinite possibilities. Second, by passing up other opportunities that you are not an expert at yet, you will be releasing yourself from any compelling desire to trade. Any compelling behavior is usually the result of some fear. That fear, in turn, will cause you to behave in many inappropriate ways.

If the idea of letting go of opportunities that don't fit into your framework is troubling to you, then ask yourself, what is the rush? If you are confident in your ability to transform yourself into a successful trader, what difference could it make that you let go of some opportunities now for educational purposes? Once you learn to become the trader you want to be, you can then give yourself as much money as you desire. However, to get to that point, your objective should be to plan your development in such a way that you do the least amount of damage to yourself, both financially and psychologically. Then after you have developed the appropriate skills, taking money out of the markets can be as easy as almost everyone believes it is before he started trading.

If, on the other hand, you end up doing a lot of damage to yourself, you will have to undo that damage before you can accumulate wealth as a trader. After the damage is done, it won't make any difference how much you learn about the nature of the markets or how well you learn to perceive an opportunity. There are many traders who end up becoming expert market analysts but can't make a dime as traders because of all the damage they did to themselves in the early part of their trading careers. What happens in these situations is a trader's "past" will generate so much fear that he won't be able execute his trades properly or not at all, regardless of how well he learned to predict what the market will do next. Nothing is more frustrating than to know what is going to happen next and not be able to do anything about it.

You need to understand that the ability to perceive an opportunity, based on the quality of distinctions that you can make and your ability to execute a trade, are not automatic functions of one another. Perception and execution are separate skills. They can and do work in tandem, if there are no mental components blocking execution. Otherwise, the "intent" to take advantage of what you perceive as an opportunity may not have any inner support or the kind of inner support that is necessary to execute your intent properly. If there are mental obstacles preventing the proper execution of a trade, then learning how to perceive better opportunities is not going to solve the problem.

So the object of this exercise is to help you learn how become an expert and stay healthy while you are doing it. And when you do become one, there will be much less standing in the way of your taking maximum advantage of your perceptive skills. If you are already looking at or trading several markets and you are not successful or not as successful as you desire, then I would suggest that you scale back to just one market or two at the most. Don't expand until you thoroughly understand the markets' characteristics.

STEP FOUR: LEARNING HOW TO EXECUTE A TRADING SYSTEM FLAWLESSLY

The proper execution of your trades is one of the most fundamental components of becoming a successful trader and probably the most difficult to learn. It is certainly much easier to identify something in the market that represents an opportunity than it is to act upon it. However, there are some good reasons why it is so difficult to act on a trading signal other than what has already been identified as mental obstacles. To understand these reasons, you need to understand the nature of trading systems (defined as any methodology that consistently identifies an opportunity to buy or sell with a potential profit in some future moment), and how they interact with the markets and ourselves.

Most good trading systems, technical or otherwise, will take consistent money out of the markets over the long run. Many of these good systems have been available to the public for years, and yet, there is still a huge gap between what is possible and what almost everyone ends up with. The problem with trading systems is they define market behavior in limited ways when the market can behave in an infinite combination of ways. Systems mathematically or mechanically reduce relationships in human behavior characteristics to percentage odds of what could happen next. They can only capture a very limited number of these behavior characteristics compared to the billions that are possible. Any identified pattern may or may not be repeating itself with respect to the way the pattern or relationship progressed when it was observed in the past. Therefore, we never really know if it is valid or not until it has actually completed itself. The big psychological problem here is that people have difficulty acting on opportunities with probable outcomes.

Most people like to think of themselves as risk takers, but what they really want is a guaranteed outcome with some momentary suspense to make them feel as if the outcome had been in doubt. The momentary suspense adds the thrill factor necessary to keep our lives from getting too boring. When it comes right down to it, no one trades to lose, no one puts on a trade believing it is going to be a loser, and all systems will definitely have some percentage of losing trades. So it's difficult not to be tempted into trying to guess which ones are going to be the losers and not participate.

As most of you reading this book already know, trying to outguess your trading system is an exercise in extreme frustration. Sometimes the system will give you signals to trade in ways that are completely contrary to your logic and reasoning. Sometimes the system will defy your reasoning and be right, and sometimes you will agree with the system and it will be wrong. You need to understand that technical trading systems are not designed to be outguessed. What I mean is, they aren't designed to give you isolated signals of an opportunity to be taken when it seems right. What they do is mathematically define, quantify, and categorize past relationships in collective human behavior to give you a statistically probable outcome of the future.

As a comparison to trading, it is much easier to take risks and participate in a gambling event with a purely random outcome based on statistical probabilities, simply because it is random. What I mean is, if you risk your money on a gambling event that you know has a random outcome, then there's no rational way you could have predicted what that outcome would be. Therefore, you don't have to take responsibility for the outcome if it isn't positive.

Whereas, with trading, the future is not random, price movement, opportunity, and outcomes are created by traders acting on their beliefs and expectations of the future. Every trader contributes to the outcome of the future by putting on and taking off trades in accordance with their beliefs. Because traders actually create the future by collectively acting on their beliefs about the future, the outcome of their actions is not exactly random. Why else would traders try to outguess their systems, unless they had some concept of the future and how that future will affect the markets?

This adds an element of responsibility to trading that doesn't exist with a purely random event and that is difficult to avoid. This higher degree of responsibility means that more of your self-esteem is at stake, making it much more difficult to participate. Trading gives you all kinds of ways to beat yourself up for all of the things you should have or could have considered that would have resulted in a more satisfying outcome.

Furthermore, you don't trade in an information vacuum. You form your expectations about the future with information technical systems don't take into consideration. Consequently, this sets up a conflict between what your intellect says should be happening and the purely mathematical means of predicting human behavior afforded by your technical system. This is precisely why technical systems are so difficult to relate to and execute. People aren't taught to think in terms of probabilities—and we certainly don't grow up constructing a conceptual framework that correlates a prediction of mass human behavior in statistical odds by means of a mathematical formula.

To be able to execute your trading systems properly, you will need to incorporate two concepts into your mental framework—thinking in terms of probabilities and correlating the numbers or the mechanics of your system to the behavior. Unfortunately, the only way you can really learn these things is actually to experience them by executing your system. The problem is that rarely will the typical trader stay with his system beyond two or three losses in a row, and taking two or three losses in a row is a very common occurrence for most trading systems. This creates something of a paradox or Catch 22. How do you do it if you don't believe it, and you won't learn to believe it unless you do it long enough for it to become a part of your mental framework? This is where you employ mental discipline to make flawless execution a habit.

Exercise

Take some of the trading capital that you set aside for your education to buy and trade a simple trading system with well-defined entry and exit points. Make a commitment to trade this system exactly according to the rules. You need to make a very strong commitment here and not play any games with yourself. The object of this exercise is to work through any resistance you may have to following your rules.

This system does not have to be expensive. You can get one out of many of the books on technical analysis available today. I think it is important to buy one instead of devising one of your own because it might be a little easier to stay focused on the objectives of this exercise. With any system you devise, you are naturally going to want to make money. Save it for later, after you have learned how to execute properly.

You also need to find a system that suits your unique tolerance for taking a loss. The amount of money you risk per trade should be an amount that you are completely comfortable with, at least at first. If you don't stay within this tolerance level, you will be, at the very least, uncomfortable, in which case to whatever degree you are uncomfortable, you shut down the learning process. When you are feeling pain, instead of being focused on what the market is teaching you about itself and yourself, you will be focused on information that will ease your pain. Which usually results in a painful lesson.

Your objectives are to (1) learn the skill of flawless execution by learning that you can follow the rules you set forth for yourself (I am defining "flawless execution" as executing a trade immediately upon perception of an opportunity; inclusive within opportunity is the opportunity to exit a losing trade.) and (2) to incorporate a belief into your mental system about the nature of probable outcomes so that you believe that you can make money in the long run with your trading system, if, of course, you can execute it properly.

You will likely encounter many beliefs arguing against flawless execution. Here are few suggestions to help you work through this resistance:

First, understand that this exercise (at least for most people) is not going to be easy, so be easy on yourself. The more accepting you are of your mistakes, the easier it will be to make the next attempt. If your child were learning how to ride a bike, I'm sure you wouldn't scold him for falling off and tell him not to try again. You would encourage him and eventually he'd learn. Give yourself the same kind of understanding and consideration.

Second, taking all the signals generated by your system is the only way you can get the firsthand experience you need to establish a belief in probable outcomes, and relating the mathematics or the mechanics to the behavior. You have to do it in spite of your resistance, and you have to do it long enough for the system to become a part of your mental framework. When that happens, you will have the force of habit working for you, and the struggle will cease. Just do the best you can and look for ways to improve your performance. Constantly keep in mind that what you are doing is more of an exercise in learning trading discipline and the skill of flawless execution, which in the long run is far more important than your immediate desire to make money. So keep your contract size light. You can always increase it later, when you have learned to trust yourself completely to always do what needs to be done without hesitation.

Stay with the exercise until it becomes second nature or a part of who you are. As you gain in your confidence, you will learn more and consequently learn how to make money as a trader. As you make money you will gain in your confidence. This positive cycle will expand your ability to be successful just as easily as a negative cycle will feed on itself to end in despair.

STEP FIVE: LEARNING TO THINK IN PROBABILITIES

After you have mastered the more fundamental skills, in other words, once you have acquired the discipline necessary to interact with the trading environment effectively, you can start to use your reasoning skills and intuitive powers to determine what the market is likely to do next. This will entail learning to think in probabilities. What I mean by this is, if you can't personally move the market, then you will want to be able to identify the group that is demonstrating the greatest possibility of moving the market and you will want to trade with that group. Or you will want to determine the prevalent beliefs being expressed in the market and how those beliefs will affect price movement. That identification process requires a detached objective perspective, where you are watching and listening to what the market is telling you, instead of being focused on what the market is doing to you personally.

Remember, two traders willing to trade at a price make a market. Whatever the extreme ends of human expression are is what the market is capable of doing. For example, have you ever said, "The market can't break contract lows, it's never been there before"? If you bought those lows based on your belief of its impossibility, then consider that all it takes is one trader who is willing to sell lower to make you wrong. The fact that the market did it makes it right. You could have been a seller at the all-time lows and been a one-tick winner when the next trader broke those lows, if you could have perceived selling as an opportunity.

If prices were to penetrate those lows with any kind of followthrough, it would indicate that there are plenty of traders who believe it wasn't going higher. These sellers obviously acted on their beliefs with enough force to outnumber the buyers available to take the other side of the trade. Regardless of the criteria the sellers used to justify their actions, how rational or irrational by anyone else's standards, nothing will alter the fact the market traded lower. The fact that you believed it couldn't do it is of no consequence, unless you can trade big enough numbers to reverse it. Otherwise, you can either be with it or against it.

To help you learn how to be with the flow of the market, I pose a series of questions that are designed to keep you focused in the "now moment" to determine what is true about the market.

1. What is the market telling me at this moment?
2. Who is paying up to get in or get out?
3. How much strength is there?
4. Is momentum building?
5. Can it be measured relative to something?
6. What would have to happen to indicate the momentum is changing?

7. Is the trend weakening or is this a normal retracement?
8. What would show that? If the market has displayed a fairly symmetrical type of pattern and that pattern has been disturbed, then it is a good indication the balance of forces has shifted.
9. Are there any places where one side will definitely gain dominance over the other? If that point is reached, it still may take sometime for the other side to be convinced they are losers. How long are you willing to give them to stampede out of their positions?
10. If they don't stampede out of their positions, what will that tell you?
11. What did traders have to believe to form the current pattern relative to the past? Remember that people's beliefs don't change easily unless they are extremely disappointed. People are disappointed when their expectations aren't fulfilled.
12. What will disappoint the predominate force?
13. What is the likelihood of that happening?
14. What is the risk of finding out in a trade?
15. Is there enough potential for movement to make the trade worth the risk?

We may never know what traders will in fact do. But we can determine what they will likely do if certain things happen first. For example, if traders push the price lower than the previous low, what will likely occur? Is this new low significant enough to cause traders holding long positions to bail out? Will it cause new shorts to enter the market or attract existing shorts to add to their positions? New shorts may be attracted to the market, and old shorts will add to their position. This price slide will stop when enough traders believe the price is cheap relative to something. That reference point will likely be some other previous old high or low.

If you can't determine the significance of any particular high or low or any other significant reference point for that matter, then you have to ask yourself if it is worth the risk of finding out How much room will you have to give the market to define itself before it is evident that the flow of the market is not in the direction of that trade?

Ask yourself this question: For this trade to be valid or continue to be valid, the market shouldn't trade to what point? If it trades within that point, then the trade still has potential for working. Beyond that point, it is no longer valid in the direction that I started.

Keep in mind that the amount of price movement that you determine is necessary for the market to define itself has to correspond with your emotional tolerance to accept the dollar value of a loss that size. Otherwise, don't take the trade regardless of how much potential you think it might have, unless you can realistically change the foregoing parameters to fit your capacity for a potential loss.

Let the market define itself and then apply whatever criteria you use to define an opportunity. Identify your significant reference points and place your orders on either side of the point; then wait for the market to do whatever it is going to do. Try putting your orders in the market in advance of whatever you perceive as having a high probability of occurring based on the existing market conditions. By putting your orders in advance of some anticipated move, you will be learning how to let the market work for you Placing your orders in advance will also help to keep you from having an opinion, and you won't be subjecting yourself to the moment-to-moment conflict inherent within all price movement.

Keep in mind that since the market is in perpetual motion, it puts you in a position of having to make never-ending assessments of the current risk in relationship to the current possibilities for reward. To do this effectively, you will have to learn to observe the market as if you were not in a position. This perspective will free you to take whatever action is appropriate for the situation instead of hesitating, hoping, and wishing that the market will make you right.

The market doesn't make you right, you make yourself right. Your inability to execute or the degree to which you hesitate after you perceive an opportunity to get in or out of a trade or reverse your position will be an excellent gauge as to how locked in you are mentally. Making note of these occurrences of hesitation or immobility will give you an indication of the exact state of your mental resources to execute. You need this information to use as a reference point to build from.

When you are about to enter into a position, ask yourself, by imagining, what the next five minutes or tomorrow (depending on your time frame) would have to look like to validate your trade, to confirm that the trend is still intact. What would the next five minutes or tomorrow have to look like to indicate the opposite. Then, again, place your orders at the appropriate price in advance of the market's getting there.

All these questions will keep reminding you that anything can happen, and you will be preparing yourself in advance for those possibilities. Also, if anything can happen, then of course, you will have to consider that there will always be something you haven't taken into consideration, had absolutely no awareness of or could have no prior knowledge of, for example, such as how many traders may enter the market for the first time with enough force to reverse its direction.

Keep in mind that prices move in the direction of the greatest force (traders fulfilling their beliefs about the future). Or said in its converse form, prices will move in the direction of the least resistance to the prevailing force. Significant reference points give you the opportunity to make high probability assessments of the degree of balance or imbalance between the two forces, the point at which it is likely to shift, and in whose favor.

By learning to identify significant reference points, you can determine what each group will do based on what they already believe about future value. If you can determine on a collective basis what will validate or invalidate those beliefs, then you will know how each group is likely to behave.

I want to remind you that this approach is to help you stay detached and understand that price movement is a function of traders acting individually and collectively as a force expressing their beliefs in future value. The greatest number with the strongest belief will always be right. The easiest way to make money is to go with the flow. To identify the flow, you need to stand apart from the crowd and suspend what you believe about relative value so that you can determine who is likely to do what and with how much force, how is everyone else likely to react, and if it doesn't happen, what will traders do then?

By asking yourself these questions you are automatically keeping your focus of attention on the market and what the possibilities are. Any limitations you place on the market's behavior will cause you to focus on the impossibility instead of the possibility of something happening. Your belief that the market has to behave in certain ways proscribed by your mental structure will cause you to focus your attention on what the market is doing to you, and if what it is doing is causing pain, then the potential exists for you to avoid or distort information, usually resulting in a painful forced awareness.

STEP SIX: LEARNING TO BE OBJECTIVE

To achieve a state of objectivity you need to operate out of beliefs that allow for anything to happen, as opposed to beliefs that allow only for the market to express itself in a limited fashion. If you operate out of a belief that anything can happen, then whatever does happen won't be threatening to you in any way, thereby causing you to avoid or distort certain categories of market information. Any limits you place on the market's behavior will be a compensating factor for your lack of trust and confidence to act appropriately in any given situation. This will be evidenced by the fear, stress, and anxiety that you will feel when the market expresses itself beyond your mental limits and you can't do anything to control the situation.

However, you do have to have some belief or expectation about the future or you wouldn't ever put on a trade in the first place. To be objective, you will need to release yourself from "demand-backed expectations" and make what I call "uncommitted assessments of the probabilities." Unlike the markets, in our everyday social lives we can and do exert control over the environment to assure ourselves of the outcomes that we desire. The rules we learn to abide by in order to interact with one another are our expectations about the future. Once we learn these rules, especially if we have learned them in a painful way, we can demand certain outcomes from the environment. Hence, our expectations of the future are actually demands that the environment conform to our expectations of it.

Without really thinking about it, we will carry these same kinds of demands with us into the trading environment because of our natural resistance to letting go of our expectations. That is, staying committed to any limited belief about the possibilities that exist in the markets is virtually the same as making a demand.

If you have any doubts about this, consider that if we weren't demanding that the market conform to our expectations, then we wouldn't ever have a reason to get angry when it doesn't. Have you ever gotten angry at the market? Anger is a natural defense mechanism. When we feel anger, it is an indication that the environment is assaulting us in some way, creating an imbalance between the mental and outer environments. The outer environment is either showing us something about itself or ourselves that we don't want to accept. We protect ourselves with our anger to ward off this assault. In our everyday lives our anger can be an effective tool to get what we want (change what the outer environment is showing us about itself that we can't accept) or to ward off what the environment is showing us about ourselves that we can't accept.

However, if we interact with the market with demand-backed or committed expectations of its behavior, we will cut ourselves off from the information that we need to make accurate assessments of its potential to move in any given direction. If we don't have the power to control the markets in such a way as to make them do what we expect them to do and at the same time we aren't willing to give up our expectations and accept the way things are, then it would create what would otherwise be an irreconcilable dilemma if it weren't for our ability to distort, alter, or exclude information from our awareness. Perceptual distortion is the one compensating factor that will, at least temporarily, correct the imbalance between what we expect and what the market is offering, when there is a difference between the two.

Our committed expectations about the future will act as a force on our perception of market information to control its flow into our mental system in such a way as to avoid a confrontation with anything that doesn't conform with what we already believe is possible.

Which, of course, is always going to be less than what is possible from the market's perspective. If we are perceiving much less than what is available, then we are out of touch with what is possible from the market's perspective and setting ourselves up for a painful forced awareness. To be objective you have to make "uncommitted assessments of the probabilities." Which simply means that you have no commitment to any particular outcome. You just observe what is happening in each moment as an indication of what will probably happen next.

Here is what objectivity feels like, so that you can recognize when you have achieved it.

You feel no pressure to do anything

You have no feeling of fear

You feel no sense of rejection

There is no right or wrong

You recognize that this is what the market is telling me, this is what I do

You can observe the market from the perspective as if you were not in a position, even when you are

You are not focused on money but on the structure of the market

To stay objective anticipate as many possibilities as you can and how probable each of these possibilities are. Then decide in advance what you are going to do in each situation. If none of your scenarios is working out as you anticipated, then get out. Release yourself from the need to be right. The more uncommitted your assessments are the less potential for distortion and experiencing a painful forced awareness.

STEP SEVEN: LEARNING TO MONITOR YOURSELF

As outlined in the exercise to develop self-discipline in Chapter 14, you need to start paying attention to what you are thinking about and what market information you are focused on.

Trading Rules

When you are in a trade constantly ask yourself if anything "has to happen." Obviously, you want the market to go in your direction; however, what I want you to do is monitor how you feel, your Level of commitment to what has to happen. Remember there is a big difference in perspective between "what is happening" and something that "has to happen." If you find that your commitment levels are rising, keep on telling yourself that it is all right for anything to happen because you are confident in your ability to respond appropriately to whatever does happen.

Ask yourself what can't happen? What can't the market do? When you find yourself rationalizing the market's behavior to support your position, you are operating in the realm of illusion and setting yourself up for a painful forced awareness. Remember the market can do anything, even take your profits away if you allow it. Always take something out of the markets when you find yourself in a winning trade.

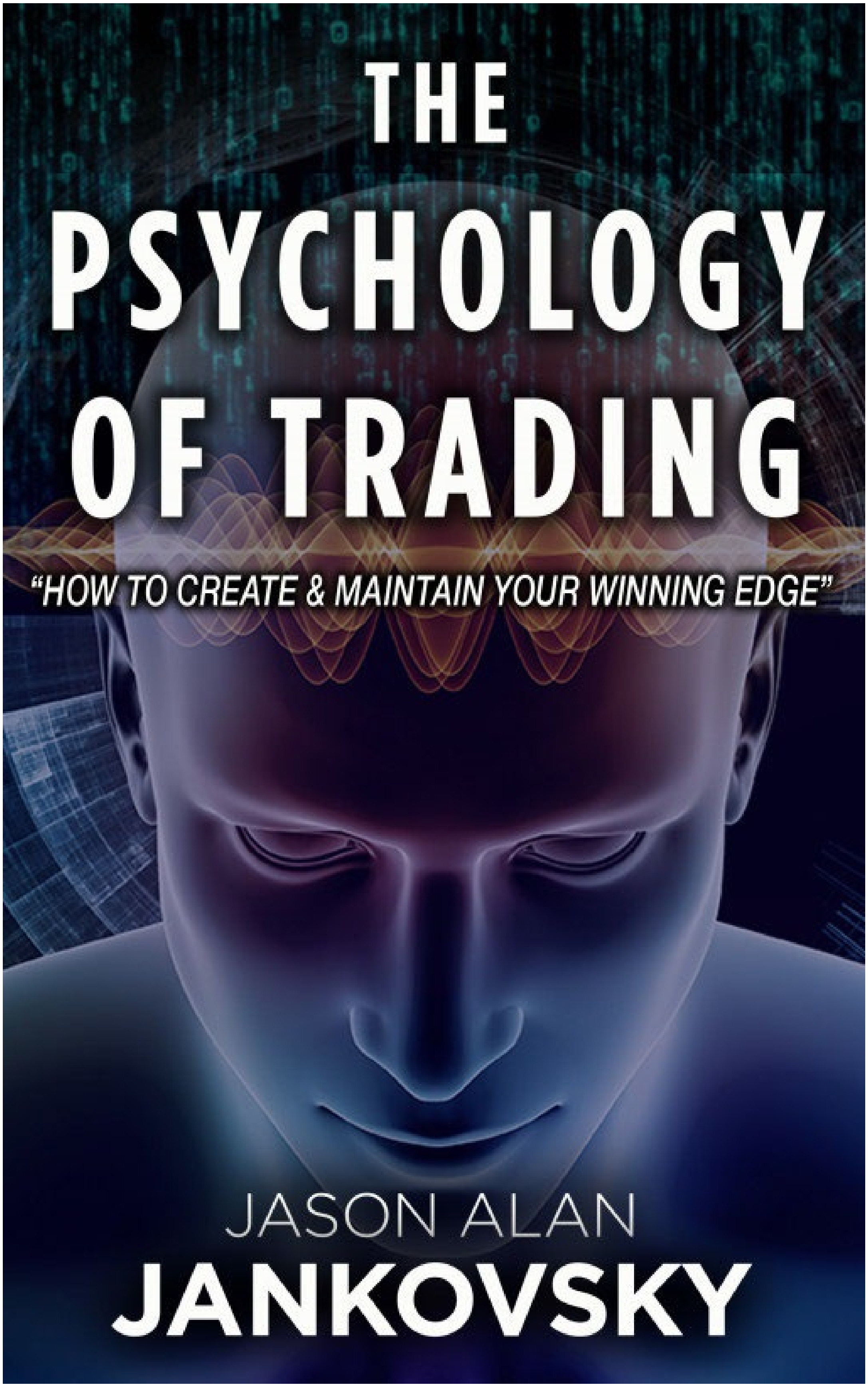
A question to ask yourself is if you are prepared to give yourself money today. If the answer doesn't come back a resounding yes, then find out why before you trade. If you can't reconcile the issue or set it aside, then you would be better off not trading, until you do. If you are determined to trade anyway, at the very least make a substantial reduction in the number of contracts you normally trade.

When you find yourself focused on the monetary value of a trade instead of the structure of the market (i.e., what the trade is worth to you in dollar terms, dreams, goals, and so forth instead of what the market is telling you about its potential to move in any given direction) then assume you are distorting or avoiding certain information and either don't put the trade on or take what you have off until you become more objective.

CHAPTER 17

Final Note

Even after you have learned all of the skills set forth in this book, at some point in time it will probably occur to you that your trading is simply a feedback mechanism to tell you how much you like yourself in any given moment. After you have learned to trust yourself to always act in your best interests, the only thing that will hold you back is your degree of self-valuation. That is, you will give yourself an amount of money that directly corresponds with what you believe you deserve based on some value system you acquired at some point in your life. The more positive you feel about yourself, the more abundance that will naturally flow your way as a by-product of these positive feelings. So, in essence, to give yourself more money as a trader you need to identify, change or decharge anything in your mental environment that doesn't contribute to the highest degree of self-valuation that is possible. What's possible? Stay focused on what you need to learn, do the work that is necessary, and your belief in what is possible will naturally expand as a function of your willingness to adapt.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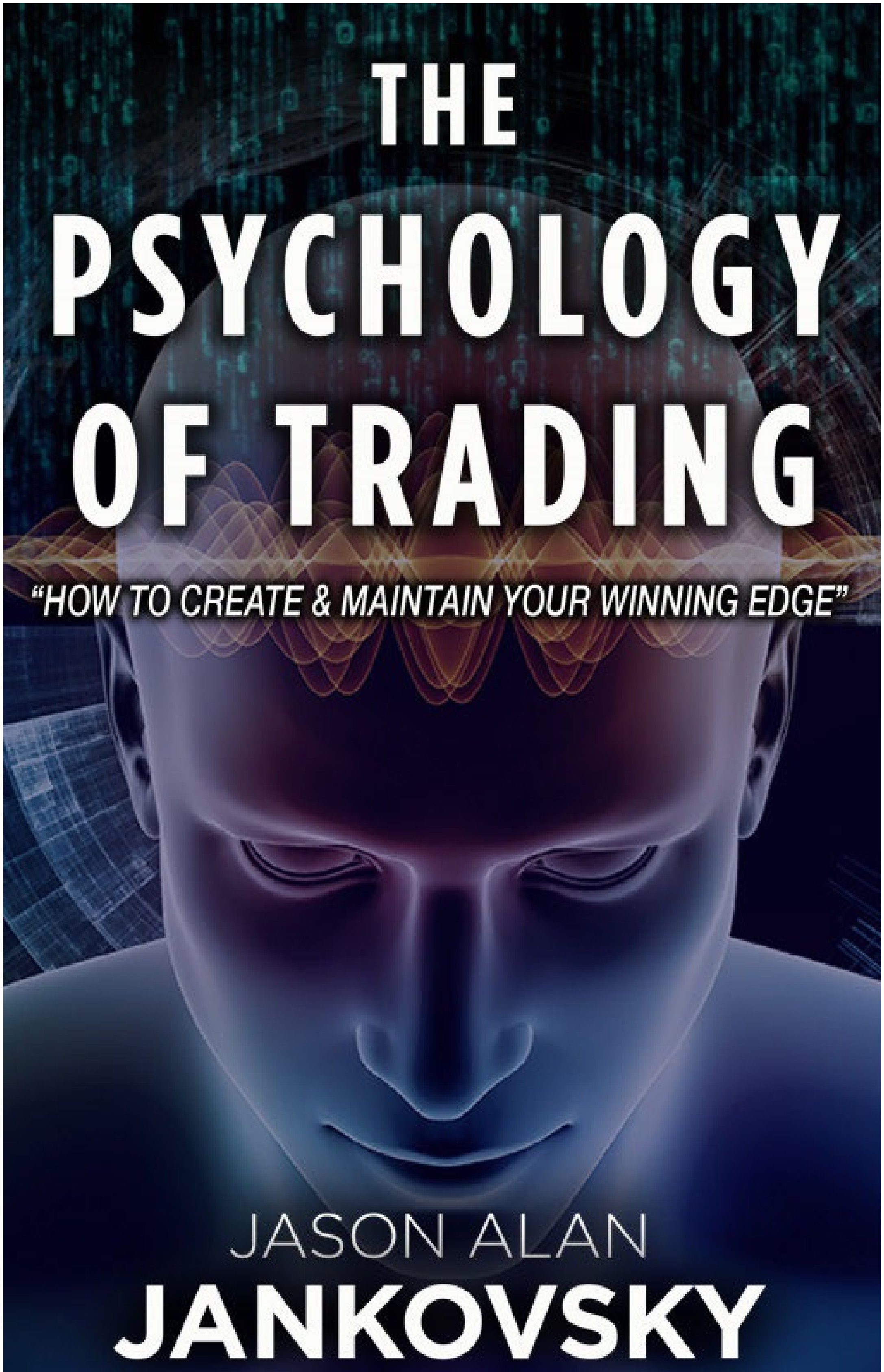
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Preface

"Those who have knowledge, don't predict. Those who predict, don't have knowledge."

Lao Tzu The, The Tao de Ching

The reader needs to understand something about how this book came to be. At the time I am writing this I am about to turn sixty-years-old. The perspective a 60-yr. old has on his life, the world around him, his future, his past; his accomplishments or failures, his money, etc., is remarkably different than the perspective the exact same individual would have had when they were in, say, their 30's…I don't think I am any different.

If I would have made different choices when I was in my early life—I suppose my experiences would have been dramatically different. I am OK with all that—although I really think I would have been very good as an Astronaut…but you have to let go of the past I am told…

Because I chose to invest my life in trading and the markets, I can honestly say that my life unfolded in a way that was unexpected. It has been a wonderful set of experiences, and I never would trade one part of it for anything…even floating weightless wondering how to get home…

My career in the markets hasn't ended. And the markets themselves will never end. But sooner or later I will come to an end. That's just how it works. My account will be replaced by someone else's account. The markets will say to that trader: "So, whatta YOU got?" and that individual will start out on perhaps the most remarkable journey of his life…maybe to end up in ruin; financially anyway. Maybe to reach the heights of success and prosperity; wasn't that your hope when you opened your account?

Well, for me, it was somewhere in between. All the time. If one part of my life was reaching for the moon—another was crashing into tiny pieces. If I made a million…maybe my love life sucked. If my health was in perfect condition, maybe I just got screwed by a business partner and I have nothing now. Or maybe everything worked—and I thought that meant "God was blessing me" …. only to be followed by nothing working a week later and that meant "God is judging me…" Or maybe I was just an incredibly naive individual with absolutely no background for what I was getting into…or worse yet…. someone who thought they knew what they were doing…. ouch.

I decided to write this book because the fact is—and I mean this with every fiber of my being—what I know about the markets and trading is priceless. I don't mean that I know more than you, or that what I know is better than what others know. What I mean is that I have discovered something about the nature of reality that was unexpected for me. The markets taught me that. I chose to take my intellect, my discipline, my education, my tenacity, and carry it into that unexpected something. What I discovered is what some people call "enlightenment"; although I wouldn't call it that. I would call it something closer to "Finally putting it all together"

I decided to write enough of what I have learned into this book so that anyone—and I mean ANYONE—with enough of the desire to know will uncover for themselves what it is that they need; so they can get to that place where they really they want to be. The world is not unfair—unless you think it is. If you want to get to that place you are thinking of right now—you can get started on the pathway to that place today. Are you prepared for the process of getting there? What if the journey is longer than you can make? Would you still get started? What if it was shorter once you discovered something you didn't know before? What if you could make the change in one day and start making your fortune tomorrow?

You see, trading isn't really about the money. At least for me. It's about reaching your full potential at something—and knowing it. It's about having complete control over yourself—so that nothing—and I mean nothing can break you. It's about having the ability to do anything you want—but choosing the power to do as you ought. It's about walking on water if you have the balls to try it. It's about sinking to the bottom if you have the balls to accept that risk too. It's about unlimited ability and the knowledge that you have earned it without sacrificing any part of yourself to do it.

How high is high? How far is success? How far down is failure? Does any of that matter once you see the sunrise over a perfect beach holding the hand of someone you know really loves you? And you know you don't deserve her but there she is? And it never would have happened if you hadn't been trading?

I said at the beginning of this preface that my perspective on things as an older man is different than when I was a younger man; but is it really different? Or is it just looking at the same thing from two different angles? Are both points of view accurate? Just separated by time? Why is a distance in time required for you to change your point of view? What if you could change your point of view without investing all the time most people need to? Could you create an advantage for yourself others don't have? Right now?

Well—could you?

I wish there was some way to fully communicate to you the power I feel in my daily life. I put everything aside and focused on how to win at trading. What I discovered was a reality that I never knew existed—and it was always there all the time; for everyone. Why are so many unable to tap into this reality?

I believe it is because they simply don't know it's there. Worse yet—they won't open the door to finding out. Probably because they don't think they need to.

And that brings us to this book. I am going to fully document my thinking for you. Starting out with the beginning point and following through to the endpoint. I will show you everything that I discovered for myself—and why it matters. I am going to show you how to make lasting changes in your life that lead to better trading. I am going to open a new door for you in hopes that you might see more of what is already out there waiting for you. Quite frankly—it doesn't matter if you see trading like I do at all. Or if your priorities change like mine did. Let's be brutally honest: You invested in this book (hopefully) to get something that will help your trading make more money; right? You might not be interested in all the "fluffy-feel-good" perspective I have at this point. That's cool. It only matters that you open the door for yourself to find out if this material can assist you. It's OK to close the door too. But the fact is—there is an answer out there for you somewhere. Anyone—and I mean ANYONE—can discover what they need to excel at trading. I sincerely hope you find at least some of the parts you are looking for inside the pages of this book. It's my pleasure to at least point you in the right direction. I think you will find that I am on to something much more than making money. But let's be frank, it's all about the money right now. So, let's get to work making that next million—and when you do…

Come find me on that perfect beach if you can, (but bring your own babe).

Introduction

"All our knowledge has its origins in our perceptions"

Leonardo Da Vinci

It was the fall of 2019 and I was looking out the window of my office at my home in Bradenton, Florida. I usually take time at the end of every year and attempt to refocus my thinking on the deep issues of trading. I like to use the New Year as a starting point for fresh beginnings; or sometimes a review of an old beginning that isn't doing so well. Mostly my intention is to find a better way to stay as sharp as I possibly can for the upcoming year; and commit to trading my opportunities at the highest level I can. Staring out the window seems to help with this for me.

I don't think what I am trying to do is unique or different from anyone else and what THEY are trying to do with THEIR next block of usable time and/or potential money-making opportunities. Sometimes I have to remind myself that not everyone is a trader attempting to exploit price action in Equities, Interest Rates, Futures, Options, Currencies or Round Blue Bricks…I think everyone has some sort of process they like to use for the purpose of making certain progress is being made regularly. I would like to believe that people seeking a high-level achievement take time to reflect and re-consider things along their pathway. I think those individuals prefer to evaluate their progress regularly. They need to know if they are wasting effort or going in circles. Most traders would agree that the question of wasted effort is one of our biggest concerns.

So, I sat gazing out the window and found myself really looking at the old tree in our backyard. I just had to have it trimmed because parts of it have had issues and was dead; large chunks of dead tree could just drop on my head if I ignored this for too long. After I had the tree-trimming-service complete a major overhaul of this huge growth I was really surprised at what was the difference. The whole tree looked different; not smaller—just different. A large amount of usable firewood had been cut down and piled up for our use if we wanted it. I don't think I would ever need firewood again. Firewood in South Florida is usually used in the colder months for outdoor entertainment around a bonfire firepit; I probably had a few years or so worth of bonfire wood now.

I found out from the tree-guy that this tree is a "Laurel Oak" tree and this particular Laurel Oak is likely over 200 years old. That is really old for this type of tree he told me; which explains the large amount of deadwood. This tree was quietly growing on the North American continent when native American Indians still roamed this whole area; this tree pre-dates almost everything we see as "normal" or "modern" All the accepted "norms" of business, finance, technology, transportation, communication, medicine, industry or anything else you can think of as "modern" or daily life. I suddenly realized this tree was already old and suffering parts of itself to death when the computer was invented—what if this tree could talk?

What I am trying to say is this: "What are the odds?"

What are the odds that I personally would be looking out this particular window at this particular tree awestruck by the enormity of the history behind and before this tree; suddenly aware of my own insignificance in the process of seeing "How Things Work"? All because I thought it wise to avoid a dead tree branch from falling on my head today….

How much of what goes on around us all day, every day, is staggeringly complex, hugely unfathomable anyway, and totally beyond our comprehension? Yet it goes unnoticed for the most part simply because we choose to let things go unnoticed around us for the most part.

If we take the blinders off our eyes and our minds, we discover that we are living in a very improbable place after experiencing a very improbable series of events; most likely missing the cues that could elevate us to a level of living & thought currently beyond our ability to even believe possible. Our lives become what they become despite our regular attempts at staying on a pathway that we believe is good for us—while all around us there is something happening, and we might not even know it is happening. But there are things right here in plain sight that speak of those things. It is right in front of all of us all the time…and yet we still miss it. What are those clues? Why do we miss them? What is life trying to tell you?

It's my point of view that trading is exactly like this concept—there is a much larger and significant way to see what is going on around you and within you when you trade. It has nothing to do with "market study" or "analysis"; it has to do with your perceptions and how you manage them.

The reason some people succeed at things that others fail at is because they possess a certain "something" that is not present in the loser-group. We can call this a lot of different things—but it all represents the same similar quality, I believe. Some people possess the ability to "think outside the box" for example, but isn't that really the same thing as saying they have a "better attitude" toward something or a "positive attitude" about something? I meet people who are "single minded" about something; winning athletes tend to be "aggressive" toward their sport. It seems to me that this are all really attempts at saying the same thing in a similar manner.

What is that something? I believe it is this: The winners behave differently than the losers.

Yes, winners tend to think differently but at the bottom core—they behave differently. The winning boxer takes that one more punch when he is exhausted—and the observer might say he is "not a quitter" when describing him. But what is someone who isn't a quitter? Someone who throws that one extra punch…Your thinking might be "I will never quit" but that would MEAN "I am going to throw one more punch no matter how tired I am" Your behavior shows that you think a different way. And it is your behavior that really matters.

One of the greatest musicians of all time still is Wolfgang Mozart. When asked privately why he wrote the music he wrote the way he wrote it—he replied, "I listen to the birds singing and I imagine what that sounds like to the ear of God" OK…what does that mean? That means he didn't really write music the way most musicians write music, he listened to the music that was already happening around him and then WROTE DOWN what he heard inside his own head. He was doing something different than other people. Mozart was probably asking questions differently than other people. Maybe when he wanted to write his next great symphony, he would go out into the woods looking to find new birds he hadn't heard sing before. Maybe "A little Night Music" is really what he heard when he came across two jaybirds arguing with a Seagull. He did SOMETHING DIFFERENT with the same skills as others.

This difference in the way certain people behave can be just astounding in some ways. For example, Jackson Pollack was an absolute Genius in my opinion. Ask yourself "What is it exactly that painters do?" They put paint on a canvas in order to create an image they hope will invoke something in the viewer. Pollack did that without letting the paintbrush touch the canvas. He painted by walking all over a canvas laid out horizontally on the floor rather than hung vertically in front of the artist. No one before or since has been able to create what he did. Simply amazing…He did SOMETHING DIFFERENT with the same tools.

Henry Ford—same thing. People want to move things from one location to another. Ford said "I have a better idea for doing that" at a time when the "horseless carriage" was seen as a minor fancy, something more like a fad or only for those silly enough to throw away money on funny contraptions that don't do anything valuable. Ford took the basic idea and created a way to make those contraptions efficient and build them for a low cost. He didn't do anything new—in fact he was late to the party as far as car manufacturing was concerned around the turn of the 19th century—but he figured out how to build a lot of cars quickly and cheaply. He did SOMETHING DIFFERENT with the same tools as others.

We could invest a lot of time looking at various industries and arts looking for special people we could call successful; those who have reached levels of performance or influence beyond the average individual. In my view, we would be looking for the same basic underlying "something" that is expressed in an unlimited number of ways. It's the "something" that matters; the basic stuff that achievement seems to be cognizant of when the rest of the participants do things along the status quo. I really hate the status quo. In fact, one of my pet-peeves—one of the things that will infuriate me instantly—is when I offer a trader a solution to a trading problem, but it is met with the response: "I've never done it that way"

My hope is to communicate to you that your acceptance of the status quo might be part of your problem if you can't make consistent money from your trading. You need to find some way to enhance your participation into the realm of the high-achievers you want to emulate; you need to accept that the average way of doing things—the typical method espoused by the typical average performer—is simply not going to offer you a viable pathway to your fortune. What you need to do is something different. How are you going to learn to do something different if your thinking is really no different than the typical losing trader? How can you reach the top of your potential if you are doing the exact same thing every other average person is doing?

What specifically are you going to do that sets you apart from the rest of the players?

Before we start getting into the material, I want to offer you a final observation about trading. Bear in mind, I've invested more than 35 years of my life in the business of trading. What I say next could be considered heavily vetted; it could be carrying a lot of credibility. I don't want you to accept it because it might be heavily vetted or credible. I want you to consider it because it makes sense to you without needing to explain why. It just resonates with the feeling of "Yeah—I get that"

No one in the business of trading knows any more than you do right now. In fact, most of them probably know less. There is a fundamental problem inside the mind of humans as a group. This fundamental psychological problem is responsible for all the major conflicts we all have to invest regular effort into solving. Specifically, one of the ways this fundamental problem comes out in the trading arena is a focus on the assumption of a "benevolent authority" working behind the scene somewhere. In other words, there is some sort of a final authority that is generally working in everyone's best interest; this authority somehow knows everything or controls everything relating to the markets. For example, people generally believe that the U.S. Federal Reserve Bank is an authority in the banking system; and therefore, can be trusted as far as how the Fed performs relative to the markets. Traders tend to believe that the Fed is a positive influence on the financial marketplace. The Fed can be trusted. The Fed works on the behalf of the citizens. The Fed is responsible to "control" the money supply. All of this is considered a positive and healthy environment for the purpose of managing the U.S. economy; and keeping the integrity of the U.S. Banking System intact. We need the Fed. The Fed is "good" and works for all of us.

But the fact is, nothing could be farther from the truth. The U.S. Federal Reserve is really a private bank owned by a handful of (mostly) foreign nationals. It isn't part of the U.S. Government. It doesn't have the authority to issue currency. It routinely interferes in the equities & interest rate markets to prevent collapses; and among other things, The Fed operates on a fractional reserve method of accounting for assets & liabilities; making it basically a house of cards. It is loosely founded on a concept called "The Land Bank", an idea created by an 18th century criminal named John Law—who was a murderer and a thief. Right now, The Fed has hundreds of times more obligations than cash to meet them with. If only a small fraction of U.S. Citizens were to withdraw their money from wherever it was inside our financial system—the U.S. economy could collapse completely. The U.S. economy could collapse to the point where the U.S. Dollar might become worthless across the globe. This is not my opinion—go read The Creature from Jekyll Island (Amer Media, 5th edition, C. 2010) if you can find an uncensored copy of it…

I am not trying to scare you—I am trying to enlighten you to the fact that things are not what they seem. The problems we have with the Federal Reserve don't really matter in the long run because when THAT institution fails, another will take its place. And whatever negative consequences develop—those will be met with an equal but opposite positive from somewhere else. A lot of money will be made when the #@*% hits the fan here in the U.S.A. someday. The question is from where? And by whom? How bad will it really be? Will you and I get rich when the #@*% hits the fan? I am certainly going to try…

What I hope to communicate is that as far as trading the markets goes, no one really knows what they are doing. They may sound very convincing and very credible; but the fact is—they want you to believe everything is under control because they are terrified you will find out it isn't. And it really isn't. Nowhere is this truer than inside the markets. The financial markets are populated and run by people who really are hoping against hope that nothing "goes wrong" while they are in charge or playing the game; because if that happens—the gallows await…

What I am trying to say, the final thought I have for you before we get started on building your fortune, is really very simple. Don't put your confidence easily in experts, gurus, officials, governments, or any other group of people who hold out their hand in friendship proposing to help you. The only person you need to have confidence in is YOU. YOU are the architect of your own fortune and your own future. Develop your own method of better thinking—develop your own method of behaving differently. Create something that is yours and is not beholden to anyone else for any reason. Your perception plus your actions creates the circumstances you call “your life”. That is where your fortune comes from.

And believe me—it is out there waiting for you.

So, let’s get started….

Part I

Understanding the Traders' Problem

You Are the Problem

"It is better to conquer yourself than to win a thousand battles"

--The Buddha

If you had met me at my 18th birthday party and told me where I would be when I was 60 years old—I would have laughed so hard I would have hurt myself—then dismissed you. I would have said something like: "Hey—I know EXACTLY how my life is going to go and I have BIG plans (sir); Thank You for your (HA) insights but I don't really think you are in a position to offer me a credible assessment of my future…GOOD BYE!"

Then I would have turned my back on you and left. No one is going to tell me what time it is…

Childhood arrogance aside, the fact is I really believed I could achieve anything I set my mind to; and I still do. For a time in my early years as a businessman/salesman/entrepreneur I did very well for myself. I was what they used to call a "Whiz Kid" … At school, I got very good grades. In general, I had a nice personality, was articulate and usually was an enthusiastic individual. If you want more details, I discuss some of my starting points in my second book The Art of the Trade (Wiley & Sons Publishing, C. 2008) but I just want to make the point that MOST people with some (or all) of those kinds of abilities tend to do very well for themselves over the course of a career at something. They are good skills to have and develop. They are skills that the management-types know lead to "success"; and by the word "success" we mean things like better sales, better business relationships, better problem-solving skills, etc. Starting at a young age at something you love and pouring your whole heart into it will certainly open a few doors for you at the very least. This is the frame of mind I had when I started out in life looking to make my mark and get rich doing it.

Then I got into the markets…

As I discuss in The Art of the Trade, I was completely unprepared for the world I was getting into. I don't want to go into all the intimate details of my early years in the markets other than to say not one skill I was born with, or had developed, ever helped me take any money from the markets. That is the bottom line. And if you are honest with yourself and your current results as a trader—you will agree that your situation is exactly the same; or very similar. Nothing you brought to the table when you started trading ever helped you earn dime one. Which is usually beyond confusing for most people. Maybe you have asked yourself: "How can I do so well at (fill in the blank) and have such losing results at something that appears to be so simple?"

When I was a registered broker, I saw this situation every day. I've had clients that were Ph.D.'s in their fields close account after account with net losses. I've had clients that were Board Members at Dow Jones listed companies go debit in their trading accounts. I had one client who was a technical engineer at the Jet Propulsion Laboratory in Pasadena, CA., he "flew" the Hubble Space Telescope—not a dumb guy—this man still lost his entire account in less than 3 months buying a market that went his way more often than not; he just kept over-leveraging against everyone's instructions; including the compliance office at the exchange.

All of these people, and many others, were just like you. Smart, degreed, successful in their field, articulate, financially secure, happily married and sometimes well-groomed… they just couldn't trade their way out of a wet paper bag.

Statistically, this is nothing new. The government sanctioned regulators and other watchdog organizations will tell you that about 85% of trading accounts opened at any time during the past 150 years or so of organized exchange trading have closed out at a net loss; some small losses and some big losses—but losses regardless. As far as the markets are concerned, whatever you bring to the table in hopes that it will make your cash grow, is either not needed (and something else is needed) or makes no difference to results. It seems that the markets don't respect anything about the participants; or what they bring to the table when they play. The only thing that apparently matters is your cash, which apparently is a food source or something for the markets.

If you are a new trader trying to determine if trading is really something that is right for you, it's important for you to know I am not trying to discourage you. In fact, I think trading is right for everyone. Sooner or later any person with at least something on the ball will find themselves in a cash position where taking a little risk makes sense. Done properly, trading can be a HUGE advantage to your growing portfolio. Dr. Harry Markowitz shared the 1990 Nobel Prize in Economic Sciences for his ground-breaking work in the field of Modern Portfolio Theory. He showed conclusively that diversifying part of your existing portfolio of equities, bonds and real estate into leveraged investments (such as professionally managed Futures/Options/FOREX) will decrease portfolio volatility over the life of your investment career and also add a significant percentage gain to it. He didn't say trading in these markets was "less risky"; he said trading "can be worth the risk when done right" YOU are hoping to do it right, I believe. So why are the statistics what they are? Why do individual traders, just like you the reader, still suffer large losses?

I'll tell you why:

Because you (and everybody else) are thinking the wrong way. You have absolutely no clue about the real nature of the trading environment. Worse yet, you think you do because of the alleged "market knowledge" you have been absorbing over the course of your trading career so far. But the fact is, nothing you have learned has made the difference and you already know that. None of the skills you brought to the table has helped either. You have done everything you knew how to do—and the results are not what you thought they would be. Maybe you still don't see a way out of this problem—and you are discouraged enough to quit altogether. It wouldn't surprise me if you did quit. Some people won't pay the price of admission in this field.

But the good news is, if you are willing to make the changes that need to be made, and willing to get the knowledge you really need to win, the markets will open their doors to you just like they have for all the winners that are out there. The small percentage of winners is a relative thing; it's not about what is possible. The reason the percent of winners is small is because most people will quit after losing something. If you don't quit—you could put yourself in the winning group. The question is: "Will you run out of money before you figure it out for yourself?" Some people are forced to quit, hopefully that won't be you if you are committed enough to the learning curve to become a solid winner.

Before we get started on the rest of this book, which is the pathway I personally discovered by studying myself along with other winning traders, I think it is crucial for you to take some time and reflect on what it means to experience what is referred to as a "Paradigm Shift" I personally feel that the bulk of this material is going to do several things at once for the reader. I believe it is to your advantage to be prepared for a significant change that may happen; either slowly or all at once. I personally had an epiphany-type experience; an awakening "A-HA!" moment. My life changed very dramatically from that moment on and some of it I wasn't prepared for. But it was the ride I was looking for.

This material is going to challenge your existing beliefs about a lot of things. It will completely alter your beliefs about the markets. Some of those things might upset you in some way. You might discover a lot of things about yourself that you never knew your trading was exposing and confronting. As you will most certainly discover at some point, trading isn't really about the markets anyway;

in fact, the markets themselves are incidental. Once you fully understand what the paradigm shift is and why it has to happen to win, you might find that you can accomplish a lot of things successfully in addition to trading any market any time you want no matter what is happening “out there” in the real world. You won’t need a “system”, you won’t need “courses”, books, lessons, software or even charts…which I know is a bold statement but I assure you—what you are going to learn has the potential to change everything about you and your relationship to the markets you trade. It’s the right change in the right direction if your intention remains to take money out of the markets.

Your key takeaway from this chapter:

YOU are the problem. Your results suffer because your entire thinking is not congruent with the needs of the market. Figuring out what that means and adapting to a needed change is what the pathway is all about. The problem is YOU and how YOU THINK…nothing else.

Market Price Action is not Definable

"There is no 'Bull' side or 'Bear' side of the market; there is only the right side…"

--Jesse Livermore

For those of you reading who have not been introduced to Jesse Livermore I strongly suggest you stop reading right now and get a copy of at least one of his books; and I would suggest you start with his most popular one: Reminiscences of a Stock Operator (Fraser Publishing, C. 1980) He wrote it under the nom de plume "Edwin LeFevre" This book is the biography of his trading career starting from the age of about 10. When I teach The Psychology of Trading course to students live, I use Reminiscences as one of our textbooks. In my opinion, Livermore said everything you need to know about the markets and the frustrations of trading. What he describes in the pages of Reminiscences happens every day and you will see yourself on many of the pages I am sure; and all this was written about events that happened before WWI in many cases. The markets and the challenges of trading are truly timeless. In fact, one of the errors many people make when attempting to trade is developing the unshakeable belief that all the "new" technologies such as Computers/Automated Trading/Artificial Intelligence/High Frequency Trading, etc., bring some sort of progress to the trading arena and that Traders & Trading are "evolving"; but in my view, nothing ever changes, it just becomes more of what it already is.

So, what do we mean by "definable"?

I equate the word “definable” to the process of making comparisons. It is my belief that making comparisons is a healthy thing to do in the “real world” but it will result in your trading account disappearing into thin air if you attempt it in the markets. For example, if you are a small business owner in a small town with a regular customer base, it is an important thing to know what your customers will buy and how often. If you sell cut flowers and you already know that your customers want to buy healthy cut flowers that are “fresh”, it would not be a good idea to put “old” flowers out in the window for sale. Your customers will walk by, look in the window and say to themselves: “Those flowers don’t look fresh—I’ll try another store”

Part of your regular and healthy way of selling a lot of flowers would be to start each day early and separate the “old” flowers from the “fresh” ones. To cut your costs and maybe add a few percent to the bottom line you might offer the “old” flowers at a nice discount. You will need to make a comparison when you look at each flower in the morning and say: “This one is fresh, this one is old—put that one in the window and put that one in the ‘day old discount’ bin…” The comparison is part of the daily business day to define what you need to do. You make that comparison intending to help your customer buy the best products for their needs; and to help keep your business profitable. No surprises there.

In the case of the markets this relationship doesn’t exist. You might think it does, but the only place it exists is inside your head. When you try to define price action, you are making comparisons to something else. What you are really doing is trying to attach meaning to a particular price in relationship to another price (historical or soon-to-be-historical). You are making a comparison between prices in the attempt to postulate what prices are coming next. Your comparison is supposed to mean something, but there is a problem with that comparison-making process.

Here’s what I mean by that: Who decides what the price means?

- Who specifically determines that a price is “too low” or “too high” relative to some price that is coming later? Or a price is “too low” or “too high” compared to a previous historical price level?

- Who specifically determines what information is needed (or not needed) to assist the choice in thinking that the price is “too low” or “too high”?

- Why are you even thinking that the price is “too low” or “too high” in the first place?

- Who decides what…and why is that important to prices?

YOU are deciding that. What comparisons are YOU making?

In order for you to take a position in the markets, that you expect will profit if the price is “too low” for some reason, would require you to enter a BUY ORDER and for you to hold the point of view that the market price action would become “bullish” from that point forward. For you (or any trader) to profit you MUST decide if a price that exists right now is “too high” or “too low” relative to some other price that will be coming later. In other words, you the trader must determine (however you do it—we will cover that in detail later) what that price means and then make a comparison to some other price, real or imagined. The important consideration is the mistake of determining what the price means to you rather than what it means to the market (again, more on that later). By making comparisons between this price and that price, how the price got to that price, why it will move, what the news will be, if conditions are “bullish” or “bearish”, etc., etc., will ultimately lead you to a comparison of what will be later; which is another comparison to the current price, that eventually will be in the past at some point forward, meaning every price has to be considered as important on some level compared to every other price.

The reason I used the quote by Livermore to start this chapter is because Livermore understood one of the critical and most important factors to profitable trading and that is this: Prices are not important, and they are not definable. No price is “too high” to buy (or sell) and no price is “too low” to sell (or buy). Prices have no meaning. What Livermore meant by the right side (rather than the bull or bear side) is the direction the market MUST move based on how it got to be where it is now. What he means is that whatever created the price is what has to be considered—not the price itself. Because whatever created that price would change. Anticipating the change is where the money is. The price the change occurs at is not important—only that you are ahead of the change when it happens.

People who make comparisons about price are always wrong at the turns—and that is where the most money to be taken from the market exists. That doesn’t mean that your style of trading has to be looking for ultimate tops or bottoms to execute your trades from—it means your focus on what matters to make money remains OUTSIDE of the price. More importantly—it has to be OUTSIDE of your entire process of making comparisons and determining what something means.

The Problem of Shared Data

Price is undefinable because your particular process to determine what the price means will be different from another traders’ process of what price means to him (or her). This is why two traders can look at the EXACT same price chart—read the EXACT same set of news reports, look at the EXACT same quality of market tools (such as Technical Analysis); and one of those traders will conclude that the price is “too low” (and buy), and the other will conclude the price is “too high” (and sell). Once the market moves—one trader will have a profit and the other will have a loss; because the price in the future will be different than the price is in the past—we just don’t know what that will be yet. Ask yourself: “How do two reasonably intelligent people look at the SAME information and come to equal yet opposite conclusions?” The two traders in question have concluded that the time is NOW to make money (The information all boiled around inside their heads and they both became willing to execute opposite positions at about the same time), one concluded prices will move higher; and the other believes prices will move lower. They came to those equal yet opposite conclusions by making comparisons to something else using the same information. Whatever those comparisons are really doesn't matter and the information used really doesn't matter, because both pathways of comparisons can't be profitable. The market can't go higher AND lower at the same time in order for both positions to profit. No matter who you are or how "accurate" you believe your particular analysis to be, only one market point of view can be profitable at any one time.

I am not saying that you can't make money using commonly accepted analysis tools—what I am saying is that: "If price were definable—you wouldn't need to use ANY tools to help you figure that out. Your comparisons would ALWAYS be accurate. 100% of the time. Because you don't know what the price will be in the future until the market gets there—you can't make any comparisons that will be profitable with reasonable certainty. If you could do that—there wouldn't be any losers. It is an illusion to think that your "analysis" and comparison-making process is "accurate". The fact is, you were guessing anyway you look at it, and because the market went your way you think that profitable trade had something to do with your analysis/comparison making. You were just lucky—but it looks like you did "something right"; which is part of the illusion of "reducing the risk" we will cover in the next few chapters.

In the case of the flower shop, making comparisons is definable and directly related to profit; and it is ALWAYS accurate. You can know with absolute certainty if a flower is "old" or "fresh" just by looking at it; and plan your profits accordingly. For as long as people buy flowers. In the case of the markets—you can't define price with enough certainty that you can profit all the time reasonably well—all things considered. This is another reason why traders lose, they do "something" that creates a profit often enough, and in a big enough size, that they conclude they can define price really well anytime they want. Then something changes. They give back all the money they made plus more, and they can't understand why because from their point of view—nothing has changed with how they are defining price. They are doing their "analysis" or "studies" exactly the same way as they did when the trades worked—so why is it not working now? This is all part of the illusion of "market study", and we will cover that in more detail later too.

As we get deeper into the material this book covers, we are going to discuss all of the important topics we touched on here in this brief chapter. Things like Technical Analysis, fundamentals relating to the market you trade, how you reach accurate conclusions and how you don’t, and much more. I want you to take a deep breath and just accept the fact that the process of becoming a winning trader and staying there is exactly that: a PROCESS. You may not get some parts until later and you may not understand something completely until other holes are filled in. I am not asking the reader to accept what I am offering at face value. What I am asking you to do is consider the possibility that conventional wisdom is not necessarily wisdom when dealing with trading and the markets. It is possible that your existing paradigm is in conflict with a winning paradigm; and the path to creating a winning paradigm is going to take a different pathway than you currently expect. It might include changing your belief about market analysis.

It is very important to your developing new paradigm for you to consider that price is not definable as you have been using the concept now. Price is VERY definable under different concepts we are going to discuss later. In the meantime, here is an illustration to help you with the concept of defining something that appears to have no apparent way to be defined.

Any meteorologist will tell you that the weather is very difficult to predict past a certain point. They appear very accurate only because they know about variance. Simply put, variance is a certain deviation from the “normal”; which is really just averages. If the normal temperature is, say, 70 degrees for your town on July 1st, then all things considered a prediction of 70 degrees for next July 1st could be comfortably made months in advance. Here’s the fun part…if, say, a week before July 1st, a very strong cold front was moving across the country and was expected to reach your city on July 1st, any meteorologist would instantly look at the percent difference between “norms” and “actuals” as the front moved across the country each day and notice a variance of, say, a 4% average….most likely a prediction of temperatures on July 1st for your city would start around 4% lower; now if OTHER things start showing up, then the variance could change more or less. The game is ON….and so at NOON on July 1st the temperature was 68 degrees; well within the normal variance and about accurate for the prediction of slightly cooler weather. The local meteorologist looks like he is very accurate. But there is no way to REALLY know what the temperature will be until it gets there, and ALL conditions relating to the temperature might need to be considered. Under certain conditions—the meteorologist would be WAY OFF. This is why you can't predict where landfall will be for a hurricane that just formed a thousand miles away; but you can "sort-of" determine where it MIGHT go. When it gets within 50 miles of you, you can pretty much say where it will go next. But by then you don't need the prediction at all.

I spent most of my life living in Chicago, Illinois. I can tell you with absolute certainty that the winters in "Chi-town" are brutal. Which is easier to predict? "When will the temperature drop below freezing for the first time in the fall?" Or "Will there be snow on the ground by January 20th?" One year I remember it was 70 degrees on Thanksgiving Day, then it snowed the following Monday. Who can predict that? Six months in advance? No matter how much they know about the weather in Chicago or how many supercomputers they have? But if you predicted: "There will be snow in Chicago this winter" you would likely have an accuracy of 99% or better every year. It has ALWAYS snowed in Chicago every winter…because that is the nature of winter. You don't need to be a meteorologist to make that prediction. There is no prediction to make.

The point I want to make is that predicting price action is a lot like forecasting the weather. Some things are really well known, and can help, but other things are not known at all and will never be known. Because of this reality, it is almost impossible to define prices past a certain accuracy and the fact is you really won't know for certain until prices get to where they are going. In many cases, prediction isn't even needed at all because it is an absolute certainty the price will change; and the direction prices will go is really clear. As far as the total market environment is concerned, no one can define price action accurately enough to make sound profitable predictions most of the time; otherwise 85% of people trading wouldn't have been losers over the past 150 years. Don't forget this little often-overlooked fact: NONE of the technology being used, NONE of the highly valued analysis, NONE of the AI-based automated trading programs, NOT ANY OF THIS B.S. has contributed any lasting value or helped make people consistent money—otherwise the 85/15 ratio would have changed by now.

If I stood in the moonlight holding a 1964 penny in my left hand while dancing in a circle reciting the Gettysburg Address in French, and I told you that doing this helped me define the price of Gold so you could make money—you would think I was a raving lunatic, wouldn't you? But if I told you that I have a Ph.D. in advanced mathematics with a master in physics, and I could use science to PROVE to you that dancing in a circle in the moonlight holding a penny in one hand while speaking French has an accurate correlation to the price of Gold… what now? Will you look at that data and put yourself at risk? OK—I will make it easy for you—I can show you back-tested data that conclusively proves that there is a 42% statistical correlation between moonlight-penny-dancing (Or MPD analysis) and rises/falls in the historical price of Gold. Furthermore, if you had bought Gold when the MPD analysis was done on a full moon in August or September, you would have made money 7 of the last 10 years.

Do you see what I am getting at? Anyone can say anything using any data he wants for any reason he wants, invent some statistics by cherry-picking only the data he wants to use; and when you boil it all down it becomes some sort of a price comparison that proves the analysis "works" some amount of the time. But in reality—none of that really matters because the FACT STILL REMAINS 85% of people trading close their accounts at a net loss of some amount; no matter what analysis/data/comparison-maker they are using. If there was some method of defining price that actually worked—that ratio would be different today. If the markets have actually evolved into something "more definable" then that ratio would have changed by now. If computers and number crunching and artificial intelligence made a difference, then that ratio would have changed by now.

But it hasn't. And it never will. 500 years from now—if humanity hasn't imploded on itself by then—no matter what the markets are or what is being traded, 85% of people participating will have losses. NOTHING can change that ratio until PEOPLE THINK DIFFERENTLY. And that includes YOU. Price action is simply not definable enough using conventional tools to make any lasting difference. You won't make a fortune for yourself (and keep it) using some attempt to define price just like everybody else does. In fact, you have an 85% chance of losing money if you attempt to define price or forecast price; because that is what everyone is getting for their results. Exactly what do you think will be different for your account when you are using the same tools the same way as the existing 85% losers use them?

To participate in such a way that your account can grow consistently requires that you consider thinking in a way that looks more into what is creating prices more so than predicting where prices will go.

Your key takeaway from this chapter:

The price in the market doesn't matter. What created the price is what is important to the process of finding the right side of the market for the coming price change. Predicting price direction or distance by comparing prices to other prices in some fashion is an illusion at best.

Why Most Traders Fail

"If there is more than one cure for a disease—it means there is no cure for the disease"

--Anton Chekov

We talked briefly in the preface about the percentage winners versus losers in the business of trading. For the past 150 years or so of exchange-based leveraged zero-sum trading—as long as records have been kept—the ratio between winners and losers is about 85/15. About 85% of traders lose money trading; only about 15% make any money consistently. Most people usually stop right there and never really think through the implications of those percentages. In fact, the normal response in most trading circles for any discussion of these percentages is usually a nervous and guarded laughter followed closely by an admission that we all know someone who has lost all their money; but no discussion of our own losses. Most traders just nod and watch the other traders in the group hoping that the "negative" conversation stops right there, and we can all move on to a fun discussion of how we all are going to make lots of money ASAP.

Personally, I like asking people if they are aware of the winner/loser relationship in the markets. You would be surprised to discover how many people trading with an active account right now have no idea that so many people are losers. Most traders have no idea that this winner-to-loser ratio exists at all. When talking with other traders I always ask what specifically someone might be doing to avoid being in the loser-group. Most of the responses I get are vague, non-committal and usually involve unresearched potentials. What I mean by that, is most of the responses I get seem to center around opinions (Such as subscribing to newsletters or following an "expert"), some sort of a "wait-and-see" position on some new trading tool (Such as the latest software or analysis), and/or unproven theories or observations about price action (Something like: "Most Retirement Fund traders get their money to buy their stocks from the employees in the fund around the 1st and the 15th of the month. That's when workers get the money deducted from their paychecks. I've noticed the S & P index usually rallies around those date as the money from all those fund managers becomes buy orders" …Which really was an intriguing observation I actually heard from a student once—that's why I included it here).

The common thread behind all these sorts of answers is the underlying belief that information is a very important and necessary tool, the belief that electronic machines can take a lot of guesswork out of the problem of where to execute, and the belief that somebody, somewhere, has some or all the answers—if only I could find that person. If you dig a little deeper and observe the focus of this sort of thinking—the responsibility always lies OUTSIDE of the trader. Can you see where it would be very easy for someone to say: "I am losing money because I don't know enough about (Fill in the blank)" "I need a more sophisticated software" "So-and-so has been trading for 30 years—I like what he says—his daily newsletter will help"?

Apparently, the trader only has to make ONE choice; the trader has only ONE responsibility to accept, only has ONE need: the trader only has to CHOOSE to put more effort in. But the actual information/solution to the problem is still external—the "stuff" we are all seeking that will help us avoid losses—all that comes from books, software, other people, published sources, radio/TV broadcasts, Government-release data, technical analysis, number-crunching, Artificial Intelligence, etc., etc., etc. The thinking is predominantly: "The 'stuff' I need is out there; or I can learn to create it myself. All I have to do is go look for it and given enough time/effort/commitment I will eventually find enough of that 'right stuff' to make my trading really take off" This is the illusion of "Market Study"

If the information needed to make winning trades was really already in existence, and all that was required was for you and me to go look for it, then wouldn't it be reasonable to assume that sooner or later SOMEONE would have found that information? Now—here's the really interesting part: the answer is "YES" but the "yes" is not what you think it is. Ergo—you won't find it by looking in the places that you think will have it. Otherwise—you and everybody else would have found it by now. And the winner-to-loser ratio would have improved by now.

Let's boil this down to the absolutely essential and completely irrevocable. I mean let's "bottom-line" this issue like no one ever has before. Let's get as real as it gets, fair enough?

Here's the question/problem we want an answer for. We really don't care if other people can't solve this problem or answer this question. You want an answer for YOU so that YOU don't end up in the losing group no matter how committed you are to be in the winning group:

Here's the question:

Why do most traders fail? How do I stay out of that group?

Answer:

Most traders fail because their paradigm for creating success in their daily life in not congruent with the paradigm for creating success in the markets. You can't get out of the loser-group until you change your paradigm. Most traders don't know they have this problem.

Say that again?

Most traders fail because they are ignorant that there is a difference between the "real world" paradigm (which they function under all the time and because it is so familiar they can't really see it distinctly anymore) and the paradigm that the markets function under (which they have never seen before). This problem I call: Cultural Myth & Self Sabotage. Most traders fail because they are either ignorant of the real change they need to make or refuse to consider that they need to make that change; or a combination of both to some degree.

Say that AGAIN—I am not sure I heard that right:

Most traders fail because they believe in something that they are absolutely certain is accurate—or real—or true—or confirmed—or accepted—or known—or genuine—or valid—or actual—or sincere—or authentic—or bona fide—or documented—or sanctioned—or ratified—or authorized—or verified—or established—or back-tested—or endorsed—or approved—or corroborated….shall I go on?

NO—but please explain this to me one more time:

Most traders fail because their belief structures are tied into all these hundreds of ways of saying the same thing: "The solution to this problem is outside of me—all I have to do is find it—or have someone else find it for me" Most traders fail because they are all really just looking for the next "tip"; regardless of whether or not they would call it that.

Really think this through: All of the accepted methods of Market Analysis is just a “tip” if you do it right; a handful of “experts” sitting in a room promising you profitable insights if you buy their opinions is just a “tip”; combing through thousands of pages of exhausting data hoping to find some anomaly is just a “tip” if you can find it; buying someone else’s back-tested and verified neural-net machine-learning artificial Intelligence software is really just a “tip” maker; ….ALL OF IT---all the “looking for something that will make the difference” is really just an over-exposed inflated way of saying… “I can’t figure this out using all my existing thinking or tools; so, I am willing to accept and trust in some sort of a tip-generator about where to place myself at risk”

As long as any trader continues to operate from this paradigm the potential for loss is huge. Statistically, there is almost no hope for a profit. The ONLY way to create a winning trade method is to operate from the paradigm the markets themselves function under. Anything else means you are trying to create a tip-generator or buy a tip-generator. Until you personally confront your own Cultural Myth and Self-Sabotage—you have little chance of winning. Every trader has to make the choice to confront his existing paradigm of participation —and replace it with a market-centric paradigm of participation. Why do most traders fail? Because they don’t change the paradigm they function under. That’s the bottom line. Whether YOU believe it or not, whether YOU accept it or not. It doesn’t matter if you agree with my hypothesis or not because, statistically, you are going to lose while playing a game that certain others have learned to win at. What is it that the winners have learned to do that you have not learned to do yet?

Your key takeaway from this chapter:

Most traders lose in the markets because they fail to examine the thinking they operate under. Most traders fail because they think by using a paradigm of thought that isn’t designed for the markets. Most traders fail because they don’t even know that they have this problem. Most traders fail because they refuse to accept this reality as a condition for improving their results. Most traders believe the solution to this problem lies OUTSIDE of them; not INSIDE of them.

How Losing Traders Think

"Losers are people who are afraid of losing..."

--Robert Kiyosaki

Sometimes the best way to describe something is to describe what it is not. There is a lot of information and documentation available out there about what makes a winning trader. Market "gurus" are always philosophizing about the skills and talents "All winning traders have in common" hoping to communicate that there is some sort of baseline to trading success that you must adhere to for your trading to work, and maybe that is true. But losing traders also have things in common as well. Comparing losing behavior can be very insightful in the process of making a paradigm shift. Remember, comparisons are part of the real-world paradigm that confuses and defeats so many willing and qualified trading participants. Learning to make needed comparisons and learning to know when comparisons are not helpful is part of creating a winning market-based paradigm. Showing you how most losing traders approach their actions, the very actions leading to their financial demise, might encourage you to take this material more completely. I don't mean to suggest that every losing trader is exactly like every other losing trader; but rather I hope to describe to you certain things that ALWAYS lead to market losses in the hope that you will recognize something in yourself. You need the courage to confront your own thinking and your own actions. Maybe one of the comparisons you need to consider is this one: "Do I have any of these behavior qualities shared by losing traders?"

One of the things we are going to do a lot of during the course of this book is dig deeply into emotions and motivations. During the process of training other traders, it has been my experience to learn that most people are almost completely unaware of the relationship between their emotions and their behavior. Part of the paradigm shift that needs to occur for you to reach your full trading potential is the ability to completely understand your emotions as something sperate from your behavior—both of which are completely within your control; and the market itself has nothing to do with how you manage either. Losing traders are not in control of the process that creates their emotions or how their behavior is managed. Losing traders are often very confused about the relationship between their behavior and their "needs" as it relates to the markets. Losing traders "see" the markets and their relationship to the markets differently than winning traders tend to. Often the errors in thinking that losing traders make and their confusion about what they believe they "need" from the markets sets the stage for an emotional cycle that breeds losses so consistently that losing traders actually become afraid of executing because losses are so predictable for them. If any of this sounds familiar you are in great company—all winning traders have experienced what I have just described in intimate detail. The difference for the winners is that they have left certain things behind and learned to adapt to what is required for market success—and they do it without an emotional attachment.

While you are reading the following insights on how losing traders think I want you to take your first step into the paradigm shift we hope you will make. Try to see past the behaviors or even the emotions and ask yourself: "What is the underlying belief here?" because it is the underlying belief—the cultural myth—that is motivating the losing trader to accept these behaviors and do them over and over again no matter how much money is lost. The losing trader is actually operating from a paradigm of thinking that is probably unknown enough on the individual level that he/she cannot actually verbalize it. They do what they do because it is "right" but cannot tell you why it is "right" or why they continue to believe it is "right" despite losing thousands of dollars by doing what they believe is "right". Ask yourself: "How much money do I have to lose before I can accept that my thinking is causing me to behave in a way that is hurting me?" Here's the really big question most losing traders never ask themselves because the implications are just too painful for many of them to accept about themselves: "What if it is my thinking and my behavior that is causing me my losses and not the markets?"

Answering this question honestly will always lead you the trader to accept the possibility that you have no idea what you are doing when you trade. Your results clearly show that you don't know what you are doing—but you are excusing that reality for some reason. So, it becomes clear that making excuses for your results is one of the things losing traders will do. In reality, I have identified 12 basic separate "things" or "events" or "emotions" or "behaviors" (however you want to label these things is fine) that lead to losses and I will list them here:

Anger

Assumptions

Excuses

Illusions

Justifications

Exceptions

Fear

Greed

Hope

Evaluations

Expectations

Misconceptions

At this point—we need to take a step back and re-clarify some things to make sure that we aren't moving too fast into areas that will cause the reader to feel overwhelmed (another losing trader issue). First of all—losing traders will have some or all of these "things" active in their thinking almost all the time—but they can’t see that for themselves. If you think that you personally don’t have any of these things active in your thinking when you trade, then it is very likely that some or all of them are already dominating your approach without you even knowing it. You need to take a step back and allow for some serious discussion about how these “things” come out of you and become “your trading approach”

Second—for the sake of making the point I want to make—we are going to refer to these “things” as emotions. You are free to consider them anyway you like but I want you to remember that when I use the word emotions during the course of this material, I want you to understand I am referring to these 12 “things”. People are individuals and as such we all will find different meanings inside words we all use together and sometimes those meanings are very different from each other. For example, when I use the word “Cold” to describe the winter in Chicago—I mean it is like being inside a walk-in freezer all the time. To someone who is from the deep south—they usually think of something more like a Currier & Ives porcelain figure; someone smiling as they try to catch snowflakes on their tongue. To me, THAT image is similar to the word “Frosty”; which is more like taking a three-minute walk around the yard before a night of sipping hot-chocolate in front of a roaring fire. Whereas “Cold” in Chicago is a brutal experience, something like being locked inside a walk-in freezer with no hope of warmth until someone comes to get you out; and “Frosty” is a pleasant prelude to a night of good clean fun & soon forgotten once your toes are warm. Two words that are close in meaning at first blush—but might mean something considerably different depending on who was using them. Because of this issue—I want you the reader not to “read” too much into the use of the word emotions to describe these 12 “things”; try to accept them at face value in general terms. Also, if you find you don’t agree with the use of the word emotions that is OK too. What I am hoping for is that you will have an open mind to my argument concerning the attributes of a losing trader. As long as that is happening, I think we will make some progress.

Third—losing in the markets is really no different than losing at anything else. If you have ever tried to excel at anything but instead you failed, you will find that certain things are absolutely true about the experience. Your failure was probably unexpected, you had a misconception about how easy it probably was going to be, you evaluated whatever the reason was that caused the failure, you probably justified your effort in some way. If you kept trying only to fail again and again you probably got angry at your lack of progress meaning you had an expectation about how soon you would succeed…. you get the picture. Trying to accomplish something will likely create an environment where these emotions described above can flourish.

None of what I just described is inaccurate about the process of "winning" at something either. All success at anything that requires work or effort is the same for everybody who ever goes down that path; you are going to meet with various levels of "successes" or "failures" along the way of trying to achieve something you set out to achieve. The process of becoming a success at something is the same for everybody and everybody will experience the same kinds of emotions at various levels of achievement while along that pathway. Once someone does something for the first time…they then can continue doing it again and again depending on how much "practice" duplicating that success requires. If they get really good at duplicating that success—they might be able to teach others how to acquire that skill and/or show you how to shorten your own learning curve a bit.

The important consideration in this thinking is that this is the real-world paradigm and it is completely accurate. It does not matter what it is that you or anyone would want to try and achieve. If someone else has done it—the potential exists for another person to do it too. Can that person be you personally? Sure—absolutely. Then again—maybe not; depending on variables we might or might not be able to control. For example, win a Nobel Prize in Chemistry. SOMEONE is going to win a Nobel Prize in Chemistry…. are you that person if you have NO BACKGROUND AT ALL in Chemistry? Probably not. But if you studied Chemistry you whole life and became a research Chemist, and then got involved with people trying to make a significant step forward in the use of Chemistry.…MAYBE then it could be you. The point I am making is that for the most part—you can do anything with your life you want, and you have the potential to excel at anything you choose—if you are willing to work at it. Sometimes circumstances and variables help or hinder us; but in the long run—if we take the risks, we get some results. Maybe those results are what we are looking for—maybe they aren't. But that isn't really that conclusive because all we have to do is take the results we actually get—study how they got that way—make some changes—and our results can improve along the lines we are seeking.

So, let's talk about trading. People have become successful at trading. You want to become successful at trading too. But you have little background in the markets. In fact—none at all really, other than reading the stock tables in the newspaper or watching the market news channels on cable. Since other people have done it—you figure you should be able to do it too.

Assumption.

You don't know what is required—so you better start learning. You decide to read a few market related books and maybe take a few courses on the markets.

Expectation.

You decide to pick a market and focus on what is required in that particular market. You decide on an "easy" market—something like Stock Indices or maybe the Grain Markets.

Misconception.

Do you see where I am going with this? The important consideration is that the process being described as the Potential Pathway for Success at Something is what I have come to call The Real-World Paradigm. This paradigm is exactly what people use every day to begin and maintain the process of getting somewhere after deciding that where they are needs to change. The real-world paradigm is well-understood and highly documented. In fact, it is so well-defined and useful that it is never questioned by anyone. The only thing people do when using the real-world paradigm is trying to adapt it to the particular course of success they are trying to create. For the most part—it becomes a very helpful tool for anyone trying to get from “here” to “there” at something. And—no one ever questions it. That is the reason why losing traders lose. No one ever really questions this process of attempting to make something positive happen.

What is never considered or explored by most people attempting to learn how to trade is that the real-world paradigm might be incompatible with success in the markets. It might be possible that the environment for successful trading is something that requires its own paradigm to function under. It might be possible that trying to adapt what worked for you before in another field is a futile lesson in how to accelerate your losses when you trade.

What I find fascinating about asking those questions is how many people simply will not consider them to be valid questions in need of an answer. Most people will reject any dissection of the real-world paradigm. In fact, the real-world paradigm is so completely operative that many people will conclude that I am asking them to “give up” a very important part of “who they are” when I tell them they need to change their thinking in order to win. They don’t need to change anything about themselves to trade. They think that is just preposterous.

But that is exactly the case.

This is why people who are considered to be top in their field or people considered higher than highly successful will fail at trading. All of us can tell stories of people who have been at the height of their game and decided it was time to trade—and fail miserably. Lawyers, Doctors, Airline Pilots, Professional

Athletes, Movie Stars; all people making solid six-figures a year or significantly more, will open trading accounts and within 3-4 months lose all the money in those accounts. Nothing that made them successful in the real-world could help them in the trading world. But for some reason—they thought they would be successful at trading just like they were successful at other things. Why didn't that happen? Because the real-world paradigm is incompatible with the trading-world paradigm. If you fail to adapt—you will lose all your money. End of story. But they didn't see it that way coming in.

If you look at the underlying psychology behind the real-world paradigm, I think it bears mentioning that there is a certain unspoken issue regarding control to some degree. What is it that we are trying to accomplish when we do all those things we take from the real-world paradigm? AT THE CORE…what is this supposed to do for us?

Give us control.

Worse yet—give us an expectation of control. We are using all of our mental and emotional tools—the ones we have learned work for us from the real-world paradigm—and used them in the trading world for the express purpose of extending out a sense of control over our results. We believe that the more we study—the more we can control our results. The more we learn—the easier it is to control our results. For some reason, we cannot expose our money and our future into an environment that we have no control over. For example, we as businesspeople operate all day, every day, using contracts everywhere. You and I won't put our money into a bank unless it is a "safe" bank…meaning it abides by the contractual agreement of what it will do with a deposit—and nothing more. Although we don't really have control over what the bank actually does with our money, we believe that the bank will abide by the agreement anyway and so we gladly deposit our paychecks every week. In fact, what we are doing is placing a belief structure into an action resulting in an emotion. Why do we do that? Because we believe we need a place to keep our money "safe" other than in a jar on the table or under our mattress; which we have complete control over. Banks offer a lot of daily benefits if we continue to use them. We are in control; as long as everybody follows the agreement.

But you really aren't in control. Banks fail every day. Money is embezzled from banks every day. People working at banks make errors every day. The services banks offer can change; and costs go up all the time. Regulations change; and banks can't serve certain kinds of accounts anymore. All sorts of things can go wrong and basically—we all just hope it doesn't happen to our bank or show up in our accounts. We think we have control, but we aren't really in control…

In the trading environment, all of the thinking and creating of belief structures will result in an emotion being charged. It's only after we take some action that all this thinking boils down to "taking less risk" Most losing traders believe they can "reduce the risk" in the trading environment by actively "doing something" that seems to satisfy their sense of hope, reduce their fear of loss, or maybe a combination of the two to some degree. For example, most losing traders are very effective and highly motivated chart-makers. They seem to believe that all of what is going on inside the markets can be reduced down to lines, dots, ratios, and formulas all placed on a map of an OPEN-HIGH-LOW-CLOSE price chart. They believe that drawing these charts (either by hand or by using a computerized charting software) they can "reduce the risk" in the markets substantially, and therefore make very accurate price points to buy or sell. In other words, charting gives them a strong sense of control over what is happening in order to improve their trading and "reduce their risk". Who wouldn't want that? Doesn't that sound just like a successful individual at work?

But you can't reduce the risk in the markets. All the charting ability in existence cannot change the fact that when all your "doing something" tells you it is time to BUY the market—you could be wrong and have an open-trade loss at any moment. You cannot reduce that risk because price is determined by only one reason: how orders are placed in the market. If at THIS EXACT MOMENT 200 buy orders come into the market AT THE EXACT SAME TIME as 100 sell orders, the market will match 100 buy orders against 100 sell orders and then price will move higher looking for more sell orders to fill the remaining left-over buy orders. If the opposite has occurred, the market will tic lower looking for more buy orders.

That is what creates price action—orders coming into the markets in an uneven fashion getting filled first and then looking for more orders. If no orders come in—the market "sits" there….if 100 times more buy orders come in against existing sell orders…the market "rallies" really fast…if a constant level of buy orders are larger than a constant level of sell orders…the market "trends" higher…all the price action you see all day—every day—are just orders coming in and being matched with other orders. Whatever orders are left over causes price to tic in one direction until more orders are matched. How are you going to "chart" that activity at any time with any degree of "control" enough to "reduce risk" when you have no idea what size orders will be placed or when they will be placed? You might as well be gazing into a crystal ball…

In my other books I go into much deeper detail regarding the structure of the markets and how zero-sum transactions are managed inside the marketplace. I would suggest you review that information completely if you can because it will clarify a lot of thinking that most losing traders have about "analyzing" price; which in the markets is all about "reducing the risk", which is all about extending control into a place you perceive you have no control over. Until you fully understand the zero-sum marketplace, just try to accept the fact that all of what you have been taught or currently believe about analyzing price in order to "reduce the risk" is really just an illusion. One of the reasons losing traders lose is because they really believe that studying the markets will help them "reduce the risk" enough to find more winning trades than losing trades.

Moving on to more losing trader behavior; let's discuss "waiting for confirmation" many losing traders have taken courses taught by supposed "experts"; people who hold themselves out to the public as qualified coaches for trading. They portend with great enthusiasm that their knowledge passed on to you will help you "reduce the risk"—and they prove that to you by showing you reams of data from their own trading. That data most likely shows a profit because what person looking to reduce risk would take advice from someone who apparently can't make money from his/her own trading?

When dealing with one of these supposed "experts" The typical "winning trade" goes something like this: "My system gave me a signal to BUY the market at XXX price…to reduce the risk, I first waited until the market was rising to confirm that the signal was accurate. I then entered the market a short time after confirmation at YYY price. …then liquidated at ZZZ price later for a profit of $$$ amount"

Interesting word isn't it? CONFIRM. What images or emotions does that word generate? A feeling of safety, a feeling of certainty. When put inside the context of "reducing the risk", and now that "reducing the risk" is confirmed…. why, then it is apparent that the certainty of making money is really good, doesn't it? Because most losing traders are afraid of losing money—they want to avoid that at all costs—then the more confirmation a trade will work, the better. In fact, once confirmation reaches a certain point inside the loser's head—the trade now becomes "a sure thing"; but in fairness to the losing traders out there—they don't use the words "a sure thing" They use words like "high probability", "strong favorable price action", "highly accurate", or some other hyperbole but it really means the same thing; the losing trader is so convinced that the trade will work he finally decides to buy that rising market. He/she has "reduced the risk" all the way to the point the trade is now a "sure thing" by waiting until it was a "sure thing" What happens next? Most of you who have gone through this process already know. Usually within as short a time as a minute or two after this trade is executed, the market will trade lower. The losing trader fixates on this and becomes confused; "How can this trade be losing? It was confirmed" Because the "sure thing" isn't happening now, the trader feels like he is losing control of the situation and/or doesn't know what to do next. Some traders immediately execute for a small loss, some "freeze" and literally just stare as their money goes away, some wait and begin silently "hoping" that the trade will at least return to even so they can get out without losing any money; and some poor souls just keep hoping until they are on a margin call or closed out after going debit in their account. Happens every day, sorry to say.

Here's where the losing behavior gets even worse. If this trade worked from the moment of execution, then the trader believes he did everything RIGHT and can now count on this working all the time. Losing traders get really excited about "confirmation" because they have found some sort of "certainty" about participating. All they have to do is "wait for this to work" and the money will roll in.

Waiting for confirmation cannot possibly help a trader develop a winning approach because all that it really does is re-enforce a belief structure inside the mind of the trader built on assumptions plus the false belief that you can somehow "reduce the risk" on a trade. When "confirmation" doesn't work—it creates the very environment that TAKES AWAY any feeling of "control", making the situation worse for the trader. If "waiting for confirmation" does work, it creates a false sense of control or confidence. Then when it doesn't work (which is only a matter of time) it ADDS to the confusion most traders are trying to avoid. Why are we doing all this studying and confirmation for? To reduce the risk…but that isn't happening. I can't count on that. So now what???!!!

I won't go into the issue of buying lows and selling highs (which is what all this mental gymnastics is really trying to do) because the losing traders all use the same argument to avoid buying lows or selling highs: "How do you know that is the actual high/low? You can't know that until it is confirmed" In other words, "Because we can't know something in advance—we can't reduce the risk enough to get involved"….which is just circular reasoning anyway….I always answer by saying—"If you can't trust the signal to be accurate UNTIL AFTER the market moves your way—then the signal is just a guess anyway, isn't it?"

I don't want to get too far off the subject, but do you know what really amazes me? There are THOUSANDS AND THOUSANDS of "systems developers" out there; which is just a fancy name for "chartist trying to reduce risk and gain control". Some of these people are really proud and excited to tell you that they have something like a 41% winning trade rate. Or worse. Do you know what is really interesting? Flipping a coin consistently will actually provide you a 48-52% winning trade rate. Since charting in all its many forms and incarnations cannot reduce risk in the first place and many of the “systems” are less successful than chance, why not just skip the whole B.S. “studying the markets” argument and go right to exploiting chance? Think this through: “If all your charting/analysis/technology produces a result worse than chance—why make the investment in it?” There are better odds at a casino you fruitcake…

It doesn’t matter what market you trade, but let’s pick one. Let’s say you have a love affair with the European common currency; the EURO. So, let’s go to work: if you flipped a coin every trading day at 10:00 AM, and if the flip was heads you went long; but if the flip was tails you went short. According to the mathematics of probabilities and chance, you would have a winning trade on roughly 48 to 52 times out of 100 flips (you won’t get exactly 50/50 heads-to-tails ratio due to the entropy of time but that comes out as the variance seen between 48-52). Now let’s suppose you were smart enough to hold your winners and cut your losses…and say you took a 2% gain out of the market on each of your winning trades for every 1% in equity you risk on your losing trades. You know where you would be every 100 trades? Your equity would increase by roughly 45% every 100 trades. Here’s the math: 48 x 2 = 96 – 52 = 44% There are a SOLID 220 trading days every year (Not including holidays, weekends and vacations). That would equate to roughly a 100% gain a year on equity. To add insult to injury—I know people who do this. I am not kidding. They flip a coin to establish their positions and they just hold on when they have a winner; otherwise they are out at a pre-determined loss-level all the time. As long as they do the exact same thing, exactly the same way, all the time, they are using a “system” Yes, this is an unorthodox system by market standards; but a system, nonetheless. In fact, it is so easy compared to everything else I have seen, I considered doing it myself; but I don’t do it because I can create significantly MORE THAN a 100% a year growth due to the knowledge ABOUT how the markets trade. Markets aren’t random and I know how to exploit the losing trader; which is a significant advantage beyond chance. We will discuss all that later in great detail I promise you.

Getting back to losing traders and their behavior. It is really important that you understand the problem for them. They are already doing everything they can to become winners—they just don't see that what they are doing is coming from inside a point of view that isn't accurate about the markets. They are using the real-world paradigm. They are using it just like they are supposed to if they were dealing with a real-world issue. This is why it is so confusing and difficult for most people to develop into winning traders. Most people run out of money BEFORE they come to understand this issue for themselves. If you personally are a losing trader at this moment you are at a crisis point. Here's why: either this material is beginning to resonate with you positively…. or something else… and right now—if you are honest—you probably are feeling some sort of negative emotion about me or this material. You are probably angry at this point of view because it goes against everything you perceive is "true" or "accurate" about the markets. Many losing traders simply cannot accept the possibility they have been outright lied to by "professionals" they trusted, or that they have been sold "a bill of goods" by people claiming to have "answers" for them. Many losing traders have years of emotional investment in addition to tens-of-thousands of dollars in cash investment in market education/training, etc.; not to mention the cash lost by trading. Maybe you are thinking something like this:

"What a crock of (@#^*&…this guy is nuts"

"All those quants out there can't be wrong; those people are computer geniuses —they must

know something"

"Make 100% or more a year?! That's B.S.; If you could, I would know someone who does it."

"Larry Williams has been trading forever—his info is more accurate than this mumbo-jumbo"

"Waiting for confirmation has saved me lots of losing trades. It works"

"I don't wait for confirmation, my charting is better than most peoples' anyway, I don't need any help from any this psychology crap”

“If you are so smart—how come you still have so many losing trades?”

“Sounds to me you have an axe to grind; you hate it when people don’t buy your material”

If the truth were told I have only just begun to scratch the surface of how deep your illusions, misconceptions, excuses, assumptions, justifications, etc., etc., really go. Some of the material we will cover can be really enlightening but also very confronting. That’s why I suggested earlier that you begin preparing yourself for the possibility that you will find yourself emotionally agitated over something we discuss. That is part of the real-world paradigm as well. Nobody likes being confronted or challenged. In fact—the stronger your personality the harder it is to hear: “You are dead wrong and that is why you are losing money” Try telling that to someone who is a self-made millionaire at 35 years old…that person isn’t listening to you or anyone. No need to quite frankly; obviously that person’s paradigm is working just fine. Until they step into a world, they know nothing about. Is that person ready to hear things that no one tells them now?

Again, getting back to how a losing trader thinks, there are a few more behaviors I would like to discuss. I feel that the more complete your understanding of losing behavior the easier it will become to make the paradigm shift you personally need to make. The fact that we spend less time on these remaining behavior-constants does not mean they are less important or less valuable to decoding your own behavior. It is a critical factor for the evolution from losing trader to winning trader to include some flexibility and creativity. Sometimes all you need to do is fix one small something, but you never saw that small something in context before. You need to see that all of the “things” we have defined as emotions are all connected and included in each other. It is very helpful to break things down into their component parts before reassembling them into a functioning machine operating with a defined purpose. I think we all could agree that there are many parts to a clock. But when it is taken apart, we wouldn’t recognize some of those parts at all; we probably wouldn’t see them as important to the function of a timepiece. But when all those little pieces are put back together into the places they are designed to go, you now have a functioning solution for your need to measure the hours as they go by. Sometimes seeing the solution without understanding how it is a solution confuses the issue even further. So, although we don't spend a lot of time on these particular issues—they are all related to the bigger problem: the emotional need to gain control. Try to see this in the context of how a losing trader loses.

Misconceptions/Illusions

Losing traders have their heads full of misconceptions/illusions about almost everything relating to the markets. These are illusions because they are assumptions about things that aren't readily apparent until examined from a different point of view. The most common illusion is the belief that price action is completely explainable and if anything happens to price that doesn't exactly fit with the preconception a trader holds already—then that is also explainable. Losing traders feel a need to explain losses and they need to explain "why" something happened the way it did. The reason they need to explain price action and answer the question "why" something happened the way it did, is because they can't accept a world where things don't go as planned. We need to have an environment that is under control. Someone has to have answers. Someone needs to be in charge or have answers for all of us.

For example, everybody really believes that news drives the market pricing. That is why there are business news cable channels. They say this because most of the time the price of a given market will make dramatic moves around major news events, sometimes completely reversing "without warning" (again, something not going according to a plan somewhere). The illusion is that a loss under such circumstances is completely explainable and outside the control of the trader—otherwise the trader wouldn't have had the loss. It happened because the "unexpected" came from XXXX source and if they would have known that was coming, obviously, they would have been on the other side of that trade; or out of the market until "things settle down" enough to make a new plan that includes that new information. This particular illusion sounds like this: "I was on a solid winner until that jackass at the European Central Bank started blabbing about interest rates. If I would have known he was going to "talk up rates" I never would have been on that side—market always go the other way under those conditions—we know that. That loss isn't my fault" Sometimes the trader will go so far as to suspect that someone somewhere knew that was going to happen and was on the right side ahead of time, those dirty conspirators. The additional verbiage sounds like this: "Somebody leaked the news to someone. The pros obviously were short coming into the news; they knew he was going to talk up rates; those bastards took my money—I should have won on that one; but what can you do?"

The markets don't move because of the news. The markets move because of what people believe the news will do to them personally; therefore, they take some sort of action to place orders. They do something to either take advantage of what they perceive is an advantage, or to protect themselves from a disadvantage. Because everybody playing is doing the same thing at the same time—it only appears that the news had anything to do with it. You see the news come out and then –almost instantly—every trader in the globe watching that news concludes that it will either HELP his position or HURT his position; and then enters an order. In this case, the flood of sell-side orders overwhelms the buy-side orders and the price drops very quickly. Inside the head of the losing trader it plays out like this: "The news comes out, the price drops, therefore the bearish news drove the market lower. I was expecting bullish news and that would have happened, but instead I have a loss- so it is so-and-so's fault." Also, because the problem of shared data exists, there are always traders who watched the exact same thing happen and saw the exact same news come out, but concluded the event was "bullish" Their reaction becomes "Why did the market drop on bullish news? Something is wrong. Maybe someone is manipulating the market! I should stay out until things settle down" They form a conclusion that satisfies their need for all price action to have a definition that offers a sense of control about what this all means to them. Everything has to have an explanation; because we can't have all this activity being just some random event we can't predict and no one understands.

There are probably thousands of illusions we could fill hundreds of pages discussing if we wanted to. This is only one, but it touches on so many others that we should at least discuss a few more. Misconceptions/Illusions are manifested in a traders' thinking by the use of certain words during the assumptive process of evaluating a market price potential. These are: "Should", "Shouldn't", "Would", "Wouldn't", "Must", or "Can't"

For example—if a market moves to a particular price level—that is what "should" happen and therefore, the analysis done to create that predictive knowledge is validated. The Illusion is then more fully believed. In the losing traders thinking it runs similar to this: "The price was at the two-year low and all the news is very bearish—if price breaks below XXX—then it should go to YYY very quickly" If at this point the market trades lower, and then drops farther, the trader becomes absolutely convinced that his analysis is "correct" and so he will participate by going short as soon as the trade is "confirmed" for him. The opposite also occurs in the thinking process: "The price shouldn't go any farther…" "The price can't do this-or-that" "If S/R is broken the price must do XXX" Misconceptions and Illusions are often disclosed by using the words; "Should", "Shouldn't", "Would", "Wouldn't", "Must", or "Can't" when describing the relationship between prices or the expectations adhered to after doing some sort of analysis or study to help "reduce the risk" somehow.

Expectations

This thinking is especially dangerous to the trader because once an expectation is held in the

mind—very little other data will be absorbed. Expectations result in the trader putting confidence in something that he is not completely understanding. For example—the purchase of a "new" trading system that predicts a significant gain over time. The expectation is for a lot of money to be made very easily and that profit (that is sure to come) justifies the price paid. Additionally, the "reason" the trader decided on this particular trading system is because the available data to "confirm" the viability of the system was also at or beyond the expectation level of the trader. By that I mean, the trader has done what he feels is independent “research” of some kind comparing various systems over time. This particular system has a “Beta” that the trader think is “really good”, the “Sharpe Ratio” is within acceptable parameters and better than most he has seen; things of this sort. The most common expectation vocalized by most losing traders is the issue of “Back-Testing” to verify system potential. If a system has been properly “Back-Tested” then the expectation for gains are even more certain in the mind of the trader.

When the trader begins using this system and the system begins losing—the expectation is under threat enough for the trader to stop using it until he gets “answers” for this loss. After the trader spends enough time with the system developer often times the system needs a fresh upgrade and/or testing before gains can be expected. Now the potential gains vs. losses ratio becomes “skewed” in some fashion because the trader should have been using it during the “downtime” Therefore the results are not typical of the system and it will need more time to get back on track. At some point the system simply doesn’t perform and the trader fully believes everything that could have been done WAS done to avoid losses. Perhaps the trader ran out of money before the system could work. In any case—the expectation was so strong that the system would work, and so much effort went into the expectation of better results, PLUS the “we were so close this time” thinking, the trader becomes more fully convinced in this strategy and continues looking for a new system to try.

Expectations can create bias. For example, if a trader is expecting a price rise, he will do his analysis looking for clues that support a bullish view and tend to ignore data that suggests a price fall is more likely. We will discuss more about expectations under “Cultural Myth & Self Sabotage”

Exceptions/Excuses/Blame

The basic issue at risk for the trader with these problems is the lack of personal responsibility. We all know people who won’t take responsibility for themselves under certain conditions. They continuously create problems for themselves and those around them until they can't excuse themselves out of the issues anymore. I personally have a friend who has been married and divorced four times. He has been married to some really nice women. But there were problems and the bottom line was: He blamed "her" for the problems. When I said to him: "You have been divorced four times, don't you think the problem might be you somewhere?" he got furious with me for "taking that bitches side" In the markets the traders with losses who blame something other than themselves for those losses are the problem. Losses don't come from "the news", "the reports", the comments made by so-and-so, the charts, the analysis, etc. Nothing but trading creates losses. If you decided to BUY the market—it doesn't matter WHY—YOU decided to buy, and the market went against you—YOU are the problem. No one twisted your arm to do the trade—you voluntarily and with complete expectation of profit put yourself in harm's way and you are the only person responsible for your loss. Your thinking created the loss and your belief/expectation created the reason for the loss to happen.

Exceptions or excuses are no different. It is still placing the reason for losses someplace other than into your own two hands. There really isn't anything to discuss further on the matter. People who make excuses, people who make exceptions and those placing blame are all doing the same thing. They are saying: "I am not responsible" That might be true in the real-world; such as your car getting wrecked by someone who borrowed it without your knowledge. I don't think anyone would expect you to pay for the damages yourself. You could make a really strong case that the person who borrowed your car without your knowledge is really guilty of theft in addition to the responsibility of the repairs needed. But in the trading arena the trader is responsible for losses. And that is that. Please don't be the trader who constantly tries to create exceptions, excuse losses, or place blame for losses on something "outside" of himself.

As you can see—all of these various methods of thinking are interrelated and often involve more than one kind of thinking operating at the same time. The end result is virtually no potential for a trader to make consistent gains because his thinking will most likely lead to placing trades for reasons that have little or nothing to do with actual price potential. Things like; "waiting for confirmation”, “advanced analysis”, “waiting for the news first”, etc. are all attempts to “reduce the risk” based on assumptions, illusions, misconceptions, etc. in the first place.

All of these critical loser-thinking processes are the same for anyone facing a failure in any area of his/her life. Our external reality is what it is for us largely due to how we structure our internal world (our thinking). To excel at anything, we MUST change and adapt our thinking to the requirements of that success. This is why trading is so difficult for most losing traders; they either don’t know they must change their thinking to succeed—or simply refuse to believe they need to. They continue to lose while all the time getting ever-more market knowledge when in fact—the real problem is WITHIN THEM.

Your key takeaway from this chapter:

Losing traders think a certain way and they are dominated by an overwhelming need for a sense of control, a sense of certainty; which they believe is “reducing the risk” This sense of certainty and need for control comes from the real-world paradigm. Losing traders do not know they have this relationship active in their thinking and are unaware of their need to change their thinking away from the real-world paradigm into something else. Losing traders are unaware that the limitations of their own thinking as being the true issue preventing them from winning.

Opening the Door to a Different Future

"I cannot say whether things will get better if we change; what I can say is they must change if they are to get better."

--Georg Christoph Lichtenberg

In my view, you are never going to reach your full potential at trading without making a few changes. I think you would agree with me. The really big question is: "Which changes to make?" Obviously, some changes will be better than others and some changes won't help at all. How can we know which changes to make? Again, in my view, answering the question "Which changes to make?" shows exactly where the problem lies for most people. This is the kind of question that comes from your existing paradigm for problem-solving. It is a great question to ask, and in 99% of most cases, will lead you to rapid progress in the direction of the goals you have set. Why am I suggesting that even as good as this potential problem-solving process appears to be it won't help the trader?

Because making changes isn't really the issue. We all know that has to happen.

It's the kind of change that is at issue. And the kind of change you need to make you aren't even aware of; otherwise you would have already made it and your success would be on its way. I say "You already would have made it" because that is the truest statement you can make about a trader who wants to win. They are already ready & willing to make any change that will move them forward. They are already trying lots of ways to change at this moment. The very fact that they aren't reaching their expectations is the best clue that they aren't making the changes that will make the difference, and they know it. As I have already mentioned, part of the problem is the expectation for a particular change. What happens when the particular change you expect to have can't help you? But you think it will?

One of the conditions for being a fanatic about something is how a fanatic behaves. It really isn't their fanaticism about something that could be considered "off" but it is their behavior that shows their thinking has an error in it. You really can't tell someone is a fanatic in their thinking until they do something to demonstrate how they think. You can look at their behavior and conclude that their thinking going on inside their head—at least for that short period of time—has a serious problem. The longer they continue to think that way, the more frequent their behavior will become. As long as the thinking isn't changing—the behavior won't change either. Eventually, this person will become an "expert" at whatever it is they are fanatical about. They will spend an exorbitant amount of time refining what they believe in minute detail. They will attempt to convert you to their method of thinking/behavior. They will be able to show you huge amounts of information and data supporting their point of view. They will vehemently reject anything that contradicts or questions their point of view. Eventually, they will become violent in protecting what they believe including physical violence against total strangers suspected of not agreeing with them. Part of fanaticism is an expectation that all this effort in the direction of the fanatic's belief will eventually create a change that will "prove" or "validate" the fanatical belief on a grand scale; at least to the individual.

The fact that the change the fanatic expects never happens, people resist the change, people have really good arguments against the change, in all of history a change like what is expected has never happened before to anyone, the change itself is physically impossible, or any other way of demonstrating what this fanatic believes is simply not credible; that part is never seen by the fanatic. It doesn't matter what the opposing evidence is—the fanatic is never going to consider it.

The expectation that all this effort will result in "progress" toward the change is the problem. In fact, one of the ways you know that the fanatic is never going to consider anything else but their existing thinking is when they use the words: "It's different this time" or "Yet" Take whatever crazy belief you want and confront it by saying: "That will never work" and the fanatic will answer back: "It hasn't worked yet, we have further to go" My favorite response from a fanatical believer in something is: "Well, it's different this time; what we need to do is return to the core values…" or something that avoids the actual discussion of how screwy the idea is while at the same time making an excuse for the non-performance of the fanatical belief.

What does this have to do with trading you are probably asking?

Various levels of fanaticism exist all around us. Fanatical beliefs exist everywhere inside the markets too. I personally believe one compelling reason so many losing traders remain the way they are is because they have a particular fanatical belief at a certain level. They really believe that they can "study" enough about the markets and eventually find/buy/create some sort of a winning "system" that exploits price action for a profit. They possess a fanatical belief about it. No matter how much evidence is presented to them that it is simply not possible to predict price action with any degree of consistency—they will absolutely remain steadfast in their belief that they just haven't found the answer "yet". Or that somehow "it is different this time" If you confront them with evidence that they are WAY off track they will usually respond with anger and change the subject to how you personally don't know anything about trading.

It is important for you the reader to remember I am not "bashing" analysis or market study. What I am hoping to communicate to you is that it is the KIND of market study you are doing that makes a difference. You don't know the kind of study to make—otherwise you would already be doing it for consistent profit. You haven't considered the real change you need to make, and you might already be inside a fanatical belief to a certain level without even knowing it.

If you are like a lot of losing traders, you have been “studying” the markets for years. You attend countless events (webinars, chat rooms, local meetups, trade shows and the like), take all sorts of courses, read books, evaluate systems, etc., ad nauseum. You are still losing money but you believe all of this effort will payoff soon; it just hasn’t worked “yet” One of the reasons you continue to feel this way is because you hear constantly about other traders making lots of money with whatever it is they are doing. It hasn’t occurred to you that they could be outright lying because they provide so much supporting documentation; things like “Back-Testing” or “Comparative Non-Correlated Analysis” (What is THAT?) It also hasn’t occurred to you that perhaps the documentation might be fabricated; or created in some way that won’t hold up under deeper scrutiny. In a later chapter I will show you how to lie using statistics...fun stuff.

If you look very closely at the previous paragraph you will see that underlying all the hyperbole is the very sincere expectation that all of this will work toward your advantage. But the fact still remains that around 85% of traders with an open account right now are losing and will close that account for a net-loss sooner or later. If all the market study you could do really worked for people—then that ratio would be the other way around. But the ratio of winners to losers has been the same for well over 150 years; around 85% lose and less than 15% are ever significant or lasting winners. That is statistical fact and that information is not my opinion. Go look it up yourself if you doubt what I say here.

Your study of the exact same thing everyone else is studying is not going to help you. Ever. It’s not different this time. There is no “advanced” level you have “yet” to reach. You are trapped inside some level of fanatical belief holding on to an expectation that you are going to eventually figure out how to win at a game that almost 9-out-of-10 people lose at believing the same thing you do.

It’s time to make a change. What is the change you need to make?

I can answer that question, but the better question is: “Will YOU accept the answer?”

Remember, I have been trading for over 35 years and I have invested a good portion of those years to educating other traders. This book—cover to cover—continues the bulk of what I teach people when I coach them personally. For every student I eventually accepted I probably spoke to a hundred or more individuals. Every single one of them had the same issues, all of them believed they could chart their way to profits, all of them were confronted on the same problems. Only a handful ever had the courage to accept that the problem was theirs to resolve. Only a handful accepted that the problem was inside their own head. Most of them initially got excited for the possibility of making a paradigm shift; and most saw the benefit to a fresh perspective on themselves and the markets. But of those handful of traders who took that step—most of those would not stay the course and do the actual work. People ask me all the time: “Why did you quit teaching/training other traders?” My answer is really simple: “It took a lot of time and money to find qualified students. Most people would rather fail at trading than do the work needed to win. It’s a waste of time to teach people who deep inside really don’t want to learn”

So, if that’s you—stop reading right now and go watch TV.

But if you want to do the work needed to win—then we are going to take the first step on creating your new paradigm right now. This is how you open a new door to a different future.

Thinking in Probabilities versus Thinking in Certainties

In the chapter How losing Traders Think I touched on one of the losing behaviors common to most traders: the issue of “waiting for confirmation” Waiting for confirmation is really an admission that you really don’t know if your “Get me in!” signal is any good—it has to be “confirmed” first before you can do anything. But deeper down from that convoluted thinking is the real issue as far as I can see. The real problem is you “Want to be sure” before doing anything. You need a sense of certainty before you can take any risk for yourself. You need to “know” what is happening before you can try for a profit. If you put these exact emotions into a negative frame of reference, you are likely “afraid” of losing money, you don’t want to be “wrong”, or you need to have “hope” that something will work before you can put yourself at risk. Of course, you justify your behavior (another losing behavior) by saying: “It’s irresponsible to lose money without knowing your risk”; rather than admitting to yourself: “It’s irresponsible to assume an 85% chance against you”

Now, the important thing to remember is that this waiting for confirmation issue isn’t the only thing that points to the need for certainty. I would have to say that close to 100% of everything traders use as tools, or rules they use to participate, or the systems they buy/create; all boil down to giving the trader a sense of certainty that once that trade is executed they are going to win. Again, the losing trader will admit that he isn’t going to win on every trade—that wouldn’t be reasonable to expect—but the losing trader has done EVERYTHING they could to “reduce the risk” so if this trade doesn’t work—that’s OK; they will go back to the charts/analysis/news/etc., and find out “what they missed” so they can get better at “reducing the risk” Just the extra study alone helps them feel like they are in control over their results to some extent and increases their sense of certainty.

The sense of certainty is what prevents traders from finding the best places to buy/sell for an entry because a sense of certainty can’t exist without documentation of some kind. That means information must be compiled and sourced, organized and indexed, and/or verified and you can’t do that without gathering the information, comparing it to something, then confirming that the information is accurate; all of which means some sort of time is involved and prices will move in the meantime. The thinking is something like this: “I can’t just jump in and buy/sell that price—it could move against me, so I need to know if I have a really good chance to make money before I do anything. So, we have to make sure that this price level is the right level to be too high/low" And of course, by the time this process goes on between the thinking of the trader and the "stuff" that must be considered (all the data/rules/charts/info/blah-blah-blah) it is certain the market will have moved in price—leaving the best point to buy/sell in the past. It's always going to be in the past anyway; we can't take the trade when it is there NOW—because it isn't confirmed yet.

If instead the trader was operating from a different paradigm, he/she wouldn't need a sense of certainty before executing for an entry. The trader would only need to know the probability that price action would eventually go favorably after the entry.

At this point—I want you to leave behind the "how" on determining probabilities. I am not asking you to learn how to measure or create probabilities in the markets. What I want you to consider is the huge difference in how you would behave if you switched your thinking from "needing to be certain" to something more like "This could be a great place to try for an entry" Moving your thinking from "For sure" before I do something to "Maybe" this is the best place to enter. In effect, Changing your paradigm from Certainties to Probabilities…

Look at the difference in how you would need or use information. Instead of considering reams and reams of data, instead of compiling tons of information, instead of spending hours in front of the screen watching price action to determine what all this means; instead of all this losing behavior (and thinking) you instead said something more like "If I make money great—if I don't that is OK too. But this looks like a great place to get in and try"

Remember when we discussed flipping a coin? And that the probabilities of heads or tails was something a bit more/less than 50/50? Ask yourself a factual question and then ask yourself the next probability. For example, how often does a market make a 12-year-high? I would hazard to guess it would be once in a 12-year-period-of-time. So, what are the probabilities that a market would be BELOW a 12-year-high at some point in the future? I would say that they are close to 100% for most of the next 12-year period of time; depending on how you measure it. So—if a market scored a 12-year-high TODAY…. what is the probability the market would be lower by NEXT YEAR? I would say they could be very good; maybe close to 100% probability the price will be lower. Couldn't you short that market with a high degree of probability that one year from now—you would have a profit of some amount?

SO—why don't people do that? Well, some of them do. But most of them won't. First, waiting a year for them to profit is "too long" for some reason. Even a gain of hundreds of percent. Second, because no one knows if the market will continue higher to make a 13 year high or more—it is "too risky"…UNLESS… the data/facts/analysis/etc. suggest otherwise; but we have to wait for confirmation first before we can know if this 12-year-high will hold. The need for certainty forces us to miss the best place to sell that market.

In fact, most traders won't even look at the short side of a market in this condition. They will still be long or looking to get long because by this point there will be a HUGE amount of bullish data/charting/analysis/information/reports/etc., suggesting that this 12-year-high is only a stepping stone to an attempt at a 13-year-high or higher; because reaching this 12-year-high AFTER trading at the 11-year-high CONFIRMS that this market is bullish! When in reality, the need for certainty increases our potential for losses from the same probabilities. Think about it; despite all this HUGE bullish argument, all this "confirmation", all this analysis; the bottom line is that the market has spent more time below these price levels than above it. Continuing to remain long is really a low probability trade.

Do you see what I am getting at?

It's all opinion anyway, but the prevailing data is all being created in one direction because people "need to know with certainty" what is going to happen and the more data we can acquire or create that provides a sense of certainty the better. But the fact is, the probability of the market being lower next year is almost 100% if you look historically at what prices have traded in that market. One year out of 12 is about 8.3% of 12 years. If the market has spent 91.7% of its time BELOW the high prices paid for less than one year, then I would suspect there is a 91.7% chance at having a profit within one year by selling that market at the 12 -year-high. There is no certainty that the market will trade lower…but the odds are really good that it will at some point. Most traders will ignore or not even consider this simple probability because EVERYTHING they consider part of the tool-set that leads to an overwhelming sense of certainty is BETTER than a "just a guess"; especially if all the data has been CONFIRMED already by industry gurus/charts/TV shows/etc.

How far down does this rabbit hole go? Let me offer you a quote:

"Besides, 'guessing' is irresponsible. Why 'guess' at what the market will do? Especially since we have hundreds of different tools and mega-flops of data to confirm what the market will do moving forward. Don't forget—we have hundreds of pages of government data, billions of Gigabytes of processing power and state-of-the-art Artificial Intelligence software to show us where the markets will trade. Obviously, YOU can't handle all this technology and progress. Oh sure, you claim to make hundreds-of-percent a year on your equity without all of these extra advantages, but we all know you are cheating or lying. You're just an A@#&%$* Mr. Jankovsky"

(Paraphrased from an actual conversation I had with J%$# B$%#@&%$ at the New York Trader's Expo one year…Don't think for a minute that those people are really on your side).

The first step in creating a winning trade paradigm is to switch your thinking from a need for certainty to one that thinks in terms of probability. We all give lip-service to the fact that there are no certainties in the markets—yet most of us continually behave as if we are seeking a sense of certainty. Maybe we are all confused because we call this need to find certainty something else—we call it "reducing the risk" We all behave this way because we think we are reducing our risk; but that is an illusion.

As I have mentioned before—you can't reduce the risk any more than it is now. All the analysis and charting, use of technology and software will NEVER reduce the risk you have now. You can't know with any degree of certainty what the market will do next. The risk in the markets is ALWAYS the same, every moment of every day: If you buy/sell for an entry, you could be wrong about where the price will go next. That's the bottom line. That risk will never change, and you can't reduce it by looking into all those different-colored crystal balls you think will make a difference somehow. "Confirmation" is an illusion as well, you can't use "confirmation" to help "reduce the risk" either.

Thinking in certainties increases the potential to execute in places where the price has a higher potential to go against you. Thinking in probabilities allows you to take advantage of price points that have a higher potential to go in your favor. Seeking certainty reduces opportunity. Seeking probabilities increases potential.

To finish out this chapter, I want you to consider if you have a need for certainty when you participate. You have to be brutally honest with yourself. Get really clear, get absolutely white-hot with the heat and confront yourself from toes to forehead:

- "Am I looking for any level of certainty about my execution?"
- "What do I expect my analysis to do for me?"

• “Do I think I am reducing risk by my study?”

There are all kinds of questions you could ask yourself about your need for certainty. Take some time and evaluate your level of certainty. Replacing your level of certainty with an open-ended paradigm that focuses only on probability will take some time; and that is OK. Learning to win at trading is really a journey more so than a destination.

Opening the door to a different future is about accepting the possibility that you need to alter this fundamentally basic part of yourself and how you approach your actions. Up until now, you have accepted the real-world paradigm as accurate for your needs as a trader. Maybe now you are beginning to see that a fresh perspective will really accelerate your progress. Maybe you can accept that what you really need to improve your trading is something that initially you didn’t see as important or valuable.

If creating a winning trade paradigm is still your goal—finding out how much of your trader thinking/behavior is centered around a need for certainty is the first step. Once you have discovered your personal starting point you can begin, with total confidence, on the work you need to do creating your probability paradigm. It will take some time so please don’t get discouraged. Never get frustrated with how long something of value will take to accomplish; the time will pass anyway. Perseverance is often the only skill you need to have on the pathway to success; just keep working on yourself every day.

Your key takeaway from this chapter:

You need to change your thinking from a need for certainty to the openness of probabilities. Your real-world paradigm has a need for certainty built in—and that is just fine for the real world. But this often leads to losses in the markets. A winning trading paradigm operates from a sense of probabilities first.

Part II

Global Constructs Common to All Trading Participants

Introduction to Part II

"Sometimes there is no next time, no second chance, no time out. Sometimes it is now or never. Don't play to win—play so hard that the other team quits in embarrassment to even be on the same field with a champion like you…"

--Attributed to Vince Lombardi

We are going to cover a lot of interesting ground through the chapters of this section. I feel that if I set the stage properly in Part I for you, most of this material will be both challenging and exciting to absorb. Our goal is to provide you with the tools you need to create and exploit a winning trading paradigm. Part of what is exciting in this process for me is the foreknowledge of already knowing a few things that are related to your best interests. One of which is the issue of control. Right now, the issue of having control is inside the context of the wrong things. Once we put "control" inside the issue of the right things—it becomes a sense of power. Nothing feels as good or feels so right as knowing with absolute certainty that the markets cannot hurt you in any way ever again. There is no battle to fight in order to win. There is only the kingdom to rule in order to profit. I mean this with all my heart—once you fully absorb this material and complete the work—you can expect to be a net winning trader for the rest of your life. If that isn't your goal, what's the point? This isn't about "adding" something to your existing skill set, it's not about getting better at "Technical Analysis"; this isn't even about "winning"… this book and the lessons to learn are about radically altering your ability to participate so you can take the most amount of money from any market you want, any time you want, any way you want. This is about dominating.

One thing I am very excited about in my own life is growth. Growth is something that is really not on the agenda properly for most people. Growth is not an optional thing in my view. Very few people ever really reach their true potential. Usually, we all become satisfied with enough self-actualization to lead a fairly happy and productive life. And maybe it is true that we all can't be someone like Michelangelo—but we all have levels of performance in areas of our lives that we could (and should) be doing better at. If you were completely honest with yourself, you would likely say that there are areas of your life that need improvement. Maybe even areas of your life that you feel slow you down in some way.

Have you ever considered that those things that appear non-market related in your life might actually be the very things that once properly dealt with will get out of the way of your profitability? Simply put: You aren't doing well at the markets because you have unresolved issues somewhere else in your life? Have you considered that as a possibility?

I'm not saying that the contents of this book are some sort of mystical thing—or that I am trying to proselytize you in some underhanded way; I am saying that if this material truly was something that could help you excel at trading—then it must be able to address every one of those issues that hold you back from better performance. By definition, that would include non-market related issues; like personal issues maybe. I want you to consider that your "personal life" might have something to do with how well you perform in the markets. Remember, if you are a male trader, men tend to compartmentalize their lives. Men tend to put everything into nice neat little boxes inside their head. Many times, that means men tend to believe that what is inside one box doesn't have anything to do with what is in another box. I hate to say it—but this is how some men can love their wives very much but still have a mistress "on the side". One kind of relationship is in one box; another kind is in a different box. And never do the two meet (Hopefully, for those men anyway). It could be that something in one of your boxes inside your head is something that needs to connect with one of your trading related boxes in order for you to take the next step. It needs to be OK for that to happen. By the way, if you are one of those traders who actually does have a "piece on the side" I want you to raise the bar on your personal integrity level. That's called Adultery. I don't care if you think that word is "outdated" or that you believe it is all OK to cheat on your spouse. The bottom line is that you are compromising on the integrity you promised someone else; what else are you compromising on? People with low integrity don't tend to prosper—it offends the universe. Don't become an embarrassment to yourself and your family.

We talked before about sometimes the best way to describe something was to discuss what it is not. I think it is important that we take a moment and describe what the next chapters here in Part II are not; and what they are. I think it will help you open the door to change a bit easier. If we really are in a position to make a radical and lasting change intending to create a permanent ability for profit, then we should be able to concisely communicate what "it" is; and what "it" is not, agreed?

What the material is not:

- Not a system or mathematical model.
- Not a "rehash" of well-known technical analysis tools.
- Not an assortment of opinions from other traders.

The material is not designed to change you. The material is not designed to change your method of trading. The material is not designed to degrade or diminish other methods of trading assistance. The material is not designed to discredit what you know to be of assistance to you now.

What the material is:

- A compilation of factual conditions surrounding the arena of trading.
- A collection of observations made by scientific study.

- A series of conclusions distilled from discussions between winning traders.
-

The material is designed to complement and complete what you already know. The material is more like a road map rather than a set of directions. If you can read a map—you can go anywhere. If you ask for directions, you are at the mercy of the knowledge one individual has. This material is more like a roadmap to the markets; rather than a set of directions about the markets.

The material is divided into two main parts of study:

1. The constant of the markets.
2. The non-constant of YOU.

The material is designed to challenge and help you alter your existing belief structures; the material is designed to help you correlate and confirm your relationship to yourself and your relationship to the markets. The material is divided into component pieces that are all interrelated; all parts contribute and point to a holistic understanding of who you are and how you participate when you are attempting to profit from your buying/selling behavior inside a non-changing machine whose operation & function is fully understood. When you are congruent with the material and your understanding of your own participation is complete, the results can best be described as a behavior modification that functions something like this: “This is what the market says; this is what I do.”

The first part of that phrase This is what the market says needs to be taken in the context of: your ability to understand and listen to something you are not understanding or listening to very well at all right now. Simply put: The market is going to speak to you in such a way that you can understand it fully. It’s like learning a new language; you will develop new associations on how to understand what you are hearing. Once you can hear the specifics that make your particular set of trading skills create more winning trades, you will be in the enviable position of never needing to go look for trading opportunities again; they will come to you regularly without having to do anything except wait for them.

The second part of the phrase this what I do is about following through perfectly once you have found a market opportunity. Following through perfectly means doing the same thing the same way all the time. This becomes—effectively—perfect discipline. Perfect discipline is not an easy thing to develop and enforce for most people. In fact, it's my opinion the reason why the world operates the way it does and the reason there are so few people like Mozart, Michelangelo, DaVinci, Einstein, etc., is because most people will not develop enough discipline in their lives to reach their full potential. In fact, most people do not possess enough discipline to keep themselves out of trouble in the first place, if the truth were told. Now, nobody is suggesting you have to shave your head, dress in sackcloth and join a monastery that focuses on trading (although I would be first in line to join if there were such a place), but what I am suggesting is that developing a fresh level of discipline in your trading is going to produce some amazing positive results. It will add to your ability to find profitable trades, it will help you stay out of low-probability trades and it will help you cut losses faster.

Between developing the new ability to listen to the voice of the markets better and adding a fresh level of personal trade discipline to your efforts, your results will start moving over to the growth side of the ledger very quickly. This next part is very important—read this very carefully because we will spend a lot of time on this concept: Once you know WHY you do—WHAT you do—the WAY you do it—trading will become effortless. You are looking to develop a sense of personal control over your behavior and your thinking to the point where participation in the markets becomes effortless.

To close out this introduction I want to remind the reader that the purpose of this material is to shorten the learning curve most traders have between their first losing trade and developing the ability to take money out of the markets consistently. I didn’t say eliminate the learning curve or make it any less intensive of a process. The point is to awaken something fresh inside of you so that your results can start improving right now. Once you find out you have been on the wrong pathway for a very long time doesn’t automatically mean that the right pathway will be easier or less effort will be required. In fact, it is probably going to be the opposite; it will take more effort for a longer time to fully appropriate the skills you need to manage. But the difference in the quality of the experience will be HUGE. You will see real progress, you will enjoy the journey, you will start making some money finally, and your life as a whole might improve too.

In my own life, before I had my catharsis in experience & understanding, trading was a very stressful process even when I made big money at it. Instead of knowing I was creating something I could duplicate anytime I wanted, my life was more like a serious of train wrecks interspersed with brief moments of being a rock-star. Once I got on the right pathway my results became much more consistent and the “downs” were significantly fewer with very long periods of time where I was the only train on the track; so-to-speak. At this point—at 60 years of age—my discipline is still growing as is my ability to profit from my approach. I am still developing new edges, I am creating additional money management tools, and I am still growing. The process is probably a never-ending one and it is possible I will still be growing when I finally check out. I never anticipated that might happen. But I am OK with it.

My point is I can promise you with absolute certainty that if you will fully grasp this material and apply what you learn consistently—your potential to make money from your trading could reach the level of absolute effortless unlimited money-making for yourself. Isn’t that the whole point? Isn’t that WHY we all got started at this in the first place?

I think in order to get to that place starting from where you are now, you need to take the point of view that the time is NOW, there is no second chance, and you must play your heart out at it. Champions are made—not born. It’s a personal choice made by YOU.

The Arena of Conflict

"When a man's knowledge is not in order, the more of it he has the greater will be his confusion"

--Herbert Spencer

Knowledge is a wonderful thing, until it isn't knowledge anymore and becomes something else. Like an outdated belief system. Thousands-of-years ago most common Europeans believed the Earth was flat. Some very intelligent people who actually helped in the discovery of the scientific process we have today believed the Earth was flat; until the Greeks thought otherwise. One man, a Greek named Eratosthenes, believed the Earth was a sphere and actually proved exactly how big the Earth was; to within an accuracy of about 1%. He did this about 250 years before Christ. Other Greeks believed this too, but that knowledge was destroyed when Julius Caesar burned down the Library of Alexandria in 43 B.C. When the European Dark Ages came—people forgot a lot of things; like what was in the library of Alexandria. Again, most people returned to believing something that later would be seen as untrue. The Catholic Church controlled knowledge during this time and when scientific people, like Galileo Galilee, presented facts to support the belief that the Earth was spherical (among other things), they were routinely persecuted. Galileo himself was sentenced to death for "Heresy" He reluctantly agreed to recant, some sort of compromise was made for his life and this knowledge about the Earth being spherical (among other things) was again suppressed. This sort of re-writing of history went on for centuries until the overwhelming evidence gathered by men who were not controlled by the Catholic Church (or controlled by others) conclusively proved that the Earth was a sphere. The next question was—how big is it? Enter Columbus, and a new chapter in knowledge expansion; sadly, still fraught with the same sort of ignorance and control issues the previous chapters were.

The point is—something as simple as the true nature of the Earth we live on has been in debate for centuries; even for centuries after men discovered the truth. Why is that? As a side note—there are still people alive today who believe the Earth is flat. Some people just don't get it.

How much of reality is commonly accepted as "true" and told to you as "true" when the facts all point to something else? But you can't see all the facts because somebody somewhere doesn't think you can be trusted with the truth? Or maybe, somebody somewhere just doesn't want you to know for reasons of his own. Or maybe the "facts" don't look like facts to you personally because you can't accept that particular possibility for some reason of your own?

In the Bible's New Testament, the Apostle Paul talks about men whose minds are so corrupted by fighting against what they cannot accept that they would rather die than change their minds. He calls them "Ever learning but never coming to the knowledge of the truth"

Is it possible that something about the nature of the financial markets is right there in front of all of us; but we can't see it because we have all been taught for decades something else? And, of course, because our knowledge is not founded on the actual reality of the markets the more we teach ourselves about the wrong elements, the more confused we become?

What I am hoping to do is challenge your thinking to the point where you begin to actually think. And I want you to think about things you have never thought about before. I don't want you to tell me how much you already know about the things that you believe you have some knowledge in. Your knowledge maybe in error without you even realizing it. When we discuss knowledge about the markets your ability to think is even more significant because what you have been told so far is largely half-truths and opinions. Even the Series III test required before you can service accounts as a broker in the Futures Markets is full of errors in thinking about the nature of financial transactions. The errors and mistakes are not really about hiding something from you. It is more like an omission based on ignorance. You need to think more completely about what you are being told is factual. Because they are facts; just not all the facts in context. Remember, a collection of facts doesn't mean there is a truth there; just like a collection of bricks is not necessarily a house. And no one really cares if you get it all completely; because, statistically, you are going to lose anyway. Regardless, here are the facts:

When you trade, most financial markets (meaning Exchanges) facilitate what is called a zero-sum transaction. Within the markets is a separate entity called the clearing corporation. In a zero-sum transaction, any buy-order from a trader is matched with a sell-order from another trader equal in size and price provided by the clearing corporation. The same is true in the case of any sell-order. The clearing corporation becomes a buyer for every seller and a seller for every buyer. So, when these orders are matched by the clearing corporation the amount of cash on deposit with the exchange never changes—but individual accounts are assigned open trades that are either buying the market (Long positions) or are selling the market (Short positions). Everyone is playing against each other and the exchange is merely guaranteeing that one side or the other will be paid from the other side.

At this point everyone with even a small amount of trading experience will say "Yeah? So What? I already know that there is a buyer for every seller…" But what is never considered or even discussed for the most part is the next part about zero-sum transactions: When you liquidate your open position using an opposite order—the clearing corporation assigns the cash difference to your account by EITHER debiting the money you lost from your account or crediting the money you made into your account FROM ANOTHER ACCOUNT under the authority of the exchange. The losers pay the winners. I can't win unless you lose.

It’s as simple as this: If I buy Wheat for some amount per bushel—and then liquidate that trade for 7C. a bushel LOST….the clearing corporation takes that loss from my account and places that cash into the account of someone who made a profit of 7C. a bushel, or maybe divides it between one trader with a 3C gain and another with a 4C gain; or some combination that maintains the 7C gain paid to SOMEONE(s) with a 7C loss TAKEN from ME.

Most people say they understand this concept by saying “For every buyer there is a seller” and traders for the most part understand what a zero-sum transaction is. But in order to bring this full circle for you—remember when we discussed that 85% of people are losing at the business of trading? That means that 85%of the accounts that are losing are paying that money into the accounts of those who are winning. 15% of the traders out there are being paid their profits from the exact same money the other 85% are losing. The losers are paying the winners. You cannot profit from trading unless a losing trader pays you. All you need to know is who the loser is. All you really need to do is take money from the loser.

That means—in order to profit in a zero-sum environment—you have to be the trader that trades opposite of how the 85% of people are trading. To win, you have to be on the other side of the losers trade. There is no other way to profit from the markets.

You really don’t need to “study” the markets in order to take money from them; all you need to do is find out where the losing traders are getting positioned—and go the other way. The losers lose with such consistency it is a sure thing. When I teach this material live to my students I tell them to take the point of view that the only thing your analysis needs to do is expose at what price levels the losers are going long or short— just execute the other side and wait. I call it “Find the loser and take his money” I even go so far as suggest: “If whatever analysis tool you are using can’t help you find the loser—don’t waste time with it”

In other words, if “Point and Figure” charting doesn’t help you find where the loser is taking positions—why use it? If “Gann Analysis” doesn’t help you find where the loser is taking positions—why use it? The same could be said for any form of analysis: “If it doesn’t help you find the loser—why use it?”

Now—to be fair—I know that for the most part almost every trader reading this right now is going to have an issue with this point of view. And to be fair to all the winning traders out there—you want the typical trader to take issue with this point of view. You want the losing trader to stay trapped inside his antiquated knowledge. You want the 85% of other traders out there to continue to believe that sooner or later they will figure out how to make money by using all the same tools every other loser is using. You want the 85% of other traders to accept their frustrating results as a series of “yets” (“I haven’t found it YET for such-and-such reason…”). You want the 85% of other traders to get angry when confronted with the fact that they have been lied to by the “experts” You want the 85% of other traders to remain ignorant of the true nature of zero-sum trading; because that is the only way to profit. Winning traders want the losing traders to remain ignorant of the true nature of the zero-sum environment.

But here YOU are reading this book—and trying to decide whether or not to go down this road, aren’t you? Right now—you are probably one of the 85% of traders who currently have losses from their trading, no matter what your experience or time invested has been. I just told you that I personally want you to remain ignorant of why you are losing so consistently. I personally want you to continue believing that you can “analyze” the markets in order to win. I want you to stay thinking exactly like you do now…because I intend to take all your money sooner or later anyway. Because I know how to find out what side of the market you are on when you trade. I know how to go against you. I know how you think, and I know where you are.

The true nature of the market is a battlefield that only one side will win. If you are on the wrong side—your money is paid to the people who are on the right side. That is a zero-sum transaction. Nothing will ever change that and there is no discussion about how you can mitigate that reality or somehow “reduce the risk” of that environment. Bottom line: In order to win by trading in a zero-sum market, you must be doing something different than the loser is doing.

YOU are not going to win until you start doing something different than the other 85% are doing. If you continue doing the same thing, or a variation on the same thing, your results will be the same as theirs. You will trade for net-losses until you quit.

Right now, most of the traders reading this are in the 85% losing group. If you are one of them, I want you to stop and take a few moments to reflect on what I have just told you because this is one of the cornerstones to developing your winning trade paradigm; a key to flipping the switch from “lose” to “win” Take a moment to really read the next paragraph and then reflect for a few moments on what you have heard:

I just told you that you are losing because you have been misled about the true nature of the trading environment. Zero-sum markets are structured in such a way that the winners are paid by the losers no matter what happens in the markets as far as prices are concerned. No amount of study or analysis can change this relationship or alter it for an advantage to you or anyone. 85% of people trading are losing money all the time and paying that money to the 15% of winners, all the time. All of those losers are using the same tools and the same teaching as every other loser; and they all think it will help them win. In order for you to make a million, another person (Or groups of persons), must lose that exact same million. You can never make a million for yourself until you start thinking differently than all the other losers.

I want this to really soak in…

The trading markets are constructed in such a way that the losers MUST pay the winners. So, in order to win—the winners MUST do something different than the losers. What are they doing?

If you have experienced any of my other material available for training one thing you will find I discuss with great enthusiasm is the fact that most people are NEVER going to win at trading. I like to emphasize this point because it has been my privilege to discuss the markets with literally tens-of-thousands of people over my 35+ years of being in the markets. Of those thousands of people, I can honestly say that only a few percent ever had the capacity for success as a trader. I am not saying that to discourage you the reader, I am saying that because I think it proves my point very well that the typical individual is not thinking outside the box enough to understand this problem:

“I can’t win at trading unless I take that money from another trader who is himself expecting to win. We are both using the same data and using the same tools. Despite the huge amount of information, training, discussion and analysis—85% of people just like me are losing all the time. Where is that money going and to whom? HOW DO I GET MY UNFAIR SHARE?”

I would hazard to bet that NO ONE reading this book right now ever has thought to put the problem of making money from his trading into the context I just did; but the fact remains—that is the problem. If you aren’t winning—you are doing everything the same way everyone else is doing it, therefore, the winner is exploiting your ignorance in same way as he is exploiting everyone else’s ignorance. The winner wants you to stay that way.

Can you see now why I said earlier that if you expect to eventually become a winning trader you need a paradigm shift? The trading arena is not constructed like the real world—you need a different set of tools, a different point of reference and a different method of participation if you expect to win.

85% of people trading (or more) do not even see this problem for themselves. They simply do not accept that the markets are structured differently than other things and a different method of thinking is needed to succeed. I personally don't believe that these individuals are "stupid" or "unintelligent" or any number of other ways of saying the same thing—I personally believe they can't "see" what is right in front of them because they can't see what is right in front of them. Some people use the phrase "Can't see the forest for the trees" to describe similar issues. Therefore, they make choices and reach conclusions based on a method of thinking that has always been in their minds but is incomplete. To use a popular phrase I like from recent pop-psychology: "You don't know what you don't know" How can someone whose mind stops at 7 understand what an 8 might be like?

If your knowledge is incomplete—your confusion will be greater. For you to complete your knowledge you have to have a willingness to accept new points of view, understand fresh perspectives and generally be open to a potential for growth in areas you didn't at first consider. As you complete your knowledge your confusion will end. Part of your incomplete knowledge is a true understanding of what it means to participate in a zero-sum transaction.

Your key takeaway for this chapter:

Zero-sum transactions operate differently than just "a buyer for every seller", the losers must always pay the winners. The only thing I need to discover to win in a zero-sum market is who the loser is. Because all conventional education, teaching, training, and analysis is based on price study and price prediction; none of it can help me find where the loser is in the market, otherwise the percent of losers using those resources wouldn't be so high and so consistent. To win, I have to take money from the losing trader—not predict which way prices will go.

The Psychology of Price Movement

"True self-discovery begins where your comfort zone ends."

--Adam Braun

You may have noticed that in the last chapter I didn't go into the "science" of how zero-sum markets are priced. In fact, I didn't go into anything technical at all; nothing about how orders are entered, details of what a Commodity Futures Contract is, how much time is expected before fills, etc., absolutely none of the commonly discussed parts of what is involved in participating—and nothing about how the marketplace is constructed. All I basically said is something you already know:

"The markets are a zero-sum game—the losers always have to pay the winners"

What I wanted you to do is see what the markets are in context of what happens to people who play in them. Most people lose and that never changes. Statistically—the odds for success are worse than almost anything you could ever do in order to prosper financially. The odds of starting a business and failing are about the same, but that is usually for first-time business owners. Second time around the odds are much better, so is investing in collectables or maybe Real Estate. In fact, you could likely build a fortune with much more security and with less downside risk in almost any other business venture. Heck, even a casino has better odds than playing in a zero-sum market environment.

So why do people do it? Trade I mean…

Because they all think they can win. How most players come to that conclusion is up to them, and there are lots of ways to convince yourself you know what you are doing. But in the final analysis, those who are losing are using their real-world paradigm and they don't really understand how their losses are directly related to their thinking from inside that old outdated paradigm. If you ask them "What happened?" after they closed their account out at a loss, they will answer something like: "I didn't think it would happen to me" The honest ones say: "I don't know"

But it did happen—and you aren't getting the money back. Someone who knows how to win traded against you and they know the game better than you do. That's the bottom line.

What was that other trader thinking?

And that brings us to the psychology of price movement. What I want to do here is remove all the discussion about "making money" for a short time and simply focus on what is happening when prices are trading and what that means to the overall psychology of those who are participating. I want you to remember that from the loser's point of view—prices have a "meaning"; whatever that meaning is will create how the loser decides to participate. Because the loser is not in control of his thinking or understands how his thinking creates his emotions, the first thing you must come to understand about the loser's participation is that it is reactionary. The thing to always remember is that the loser is not in control of his decision-making process; the process of reaching a conclusion. The losing trader is driven by emotions he views as painful enough in order to create an urge to liquidate.

The winner on the other hand is participating from a sense of control. Not a sense of control about prices and where they will go, but a sense of control over his actions; what he needs to do (or not do) in order to win. A winner in the markets is thinking proactively. The thing to remember is that the winner is in control of his decision-making process. A winning trader might feel the same emotions—but a winning trader does not let those emotions control his execution or his liquidation. The winner is driven by discipline.

When you put these two types of market participants next to each other you will see clearly the issue of price movement and how traders use price movement. The psychology of price movement is actually a point of view based on how you personally participate. One point of view is a proactive point of view—and the other is a reactive point of view. One participant has made the choice to participate in such a way that prices are tools…. the other has made the choice to participate in such a way that prices are threats.

Every one of us knows someone who no matter what is happening around him—it's always bad. If it is negative—this person will find it. And of course, we all know someone who is the opposite; no matter what is happening—it's always something good that will come of it. The eternal question is: "Is the glass half empty—or is it half-full?"

Earlier we discussed briefly the idea that prices have no meaning to the enlightened trader. If you look at prices proactively you would be seeing opportunity developing based on a "something" that you value. No matter what it is that is used to establish value—the point is that certain traders will look at price action and eventually find a situation that will offer an opportunity to profit. The proactive trader knows this because he is not looking for certainty—he is looking for probabilities. He has already decided which probabilities he will take, and he already knows that prices will sooner or later reflect that probability. When it shows up—he takes it and waits for whatever will happen to happen.

When we discuss price action to a losing trader—the issue is completely different. The losing trader has no idea if a trade will work because every single price that trades has to be explained or could possibly have a meaning he hasn't yet considered. All the prices have to be compared to all the other prices until an entry for a "bullish" or "bearish" market can be attempted. Once that price trades—it still needs to be confirmed before he can do anything and even if the price movement is confirmed there is still a risk…so prices are never certain enough…but they will be, once enough study is done. No matter what the criterion is for an attempt at a profit there is a possibility of a loss…so the risk must be reduced somehow; otherwise the market will take away our money and WE CAN' T HAVE THAT!

Remember—the market itself is trading all the time these two types of thinking are happening. The price chart itself will have a series of O-H-L-C bars that would have been there the same way anyway and still look the same on everybody's charts. It doesn't matter what the market does because everyone playing will see it differently. The prices will mean something different to everybody. All the time. There is always something that needs to be considered. By someone.

The only difference is in how the two competing traders have chosen to look at it. The winning trader looks for a set of probabilities he knows has a better-then-chance potential. The losing trader tries to explain the meaning of every price change in order to "reduce the risk" and if he can't do that he can't trade—because he might lose—so he must wait for confirmation. One individual sees the markets as a daily opportunity base. The other sees the markets as a potential daily threat to his account balance. These two kinds of thinking are watching all the time as prices trade the way they would have anyway. The winning traders see opportunity as a set of probabilities waiting to show up; the losing traders see a threat to their money until they can "reduce the risk" enough to create a sense of certainty.

In either case, sooner or later traders with either kind of thinking will decide that prices have done enough of the “something” they are watching for and they decide to execute for an entry and place themselves at risk. It’s very important for the creation of your new paradigm of thought that you completely understand that the price itself doesn’t matter. The “why?” behind the choice to enter the market doesn’t matter either—the only thing that matters is THE FACT that the order was placed (and filled). The market is only a machine. The only thing it does is process orders as they are entered by people (Volume). The thinking of the people and how it came to be that those orders went into the machine doesn’t matter to the market in the least—it only matters to YOU. If people decide to stay in the market (Open Interest) it can only mean they are confident enough in what they believe they are seeing to wait for the profit they are expecting from the future (Time must pass).

So when you count the orders going into the machine, compare that to how many people are willing to remain at risk, and observe how much time is needed for those at risk to decide they must get out; you have the beginnings of understanding The Psychology of Price Movement.

The first and foremost thing you need to understand about the psychology of price movement is that prices don’t matter; prices mean something different to everybody playing and THAT is what creates price movement—the issue of what it means to YOU is a different problem. You need to become “price agnostic” (No care at all for the price except for what it means to the losers).

I want to take a moment and discuss price from a different point of view. Remember, our goal is to create a paradigm that is more closely aligned with the nature of the zero-sum transaction markets. If we freely admit that whatever it is we are doing now is not helping us to profit, then I don’t think we would be spinning our wheels if we looked at the game a little differently, would you?

The Nature of Market Structure

It would be more helpful to your developing paradigm if you thought of price not as something that “is” but rather something that “is the result of”

If we look at any market and take it apart into its individual pieces, what do we find? First, we find people. People who choose to participate in something. How many people are we discussing here? Well, that can be a factor of a market specific—such as Soybeans or Stock Indices—but for now let’s label the people as “Volume” How many people want to trade right now?

The next important variable might be how many people want to stay in the market for some period of time. Why would they want to do this? Well, if I was very confident I would make money I might want to stay in the market for a longer period of time. Let’s call those people “Open Interest”

Speaking of time—how much time is required to make a profit or decide a loss is “too big” and I have to exit the market? Suppose I didn’t have a specific amount of time in mind? Apparently—some amount of TIME must pass before a choice to liquidate must happen; either for a gain or for a loss. TIME is important for both the losers and the winners.

So if you take all the people who want to play—and consider the number who are willing to wait for a profit—and consider how much time they are willing to wait….then you would have a price that everybody might agree on as “fair” or not agree on at all as being “too low” or “too high”

That is market structure—Volume, Open Interest and Time all combining together resulting in a price after everyone playing has placed their competing orders.

How did that price get to that point? By all the players playing. And how do they do that? By placing an order.

As traders look at any price…they decide what that price means…they then place an order to either "Get Me In!" or "Get Me Out!" All those competing price orders are matched against each other and if there are some leftover orders on one side or the other the market tics higher or lower looking for more orders to fill. As those orders continue to get placed and filled all day, every day, they are being counted. Whatever prices are traded just happen to be the points where orders came in and were filled.

As this relationship continues moment-to-moment eventually some price will trade that causes a whole lot of people to decide they have to do something. At that price/time relationship an abundance of orders comes in overwhelming one side or the other side. The market either rallies very quickly—or breaks lower very quickly.

It doesn't matter what the reason was or why the orders came in the way they did—the only thing that matters is that sooner or later enough orders will come in from one side and that will force a price change in the opposite direction. All that any trader wants is a reasonable chance that they are ahead of that price change when it happens. And on the right side of the change, of course.

For a more complete discussion of market structure and how prices move please see my book Time Compression Trading (Wiley & Sons Publishing, C. 2010). For now, the important thing is that you must understand that the price itself has no meaning to the machine (the market). It doesn't matter what the price is because all the price does is encourage people to either get into the market or leave the market. It really doesn't even matter what the group of people behind the orders are thinking when they place them; it only matters that they place them. At some point—sooner or later—everyone who is IN the market MUST get out.

Do you see what I am getting at? Price is more like a fruit…it is the result of all these other factors being played out. If you think of an apple tree in the spring, once the buds come out on the tree, the only thing that has to happen for the apples to be harvested later in the fall is the passage of time. So, while the tree lives through the summer into the fall, the tree is hard at work taking nutrients and water from the soil, waiting for the sun to shine on the leaves while the process active inside the tree eventually produces a finished fruit.

The ground, water, sun and air are not apples; but the process inside the tree takes those things and creates the fruit as time goes by. The same could be said of the markets; volume, open interest, and time all combine together through the process of offsetting orders inside the market and eventually produce the price (the fruit of the market).

What does that price mean to YOU?

If you want to win—that price should mean nothing to you, and you don't care which way the market could go when it comes time for it to move. What you want is to be on the side the market is prepared to go when all the losers decide to take their losses. That brings us to:

Liquidation Pressure and Price Direction

So far in this chapter we have discussed that there are roughly two kinds of thinking active in the markets; a reactive kind of thinking used by losers, and a proactive kind of thinking used by winners. When these two kinds of thinking reach a conflict area over an existing price point usually a liquidation move by the losers results in a price move that is normally very predictable.

Let's use a "for example" process to understand more of this concept. Let's suppose that a particular market is at a significant low price point; let's suppose it is a one-year low. That one-year low price point is the SAME FOR EVERYBODY…it doesn't matter how the market got to that low price area other than the fact if Open Interest was rising as the price reached that level it can only mean that "bearish" traders were holding their shorts and some bears were confident in lower price action to keep opening new positions all the way to the low print. So, we have a market that has "trended" to some low price and ONLY the Bears have open trade profits…what happens at this point? Well, people begin thinking….

"I don't want to give back this gain—maybe I should get out now?"

"I missed most of this trend waiting for a rally to sell into—I can't miss any more of this sure thing—I need to sell now"

"We must be near a bottom—it is time to get long"

"So-and-so said this move is over, I am going to buy on Friday's close"

"The charts are really negative, if price goes to a fresh low it could go south for months!"

The point I am making is that, for some reason, right now at this low print EVERYBODY is all excited about what could happen next ENOUGH TO CONSIDER doing something right now. In the case of the bears—it is to keep what they have or try to exploit a further trend lower; in the case of the bulls it is to find the turn in the market and buy near the low for the year resulting in the best possible upside potential. It doesn't matter what the reason(s) are—it only matters that if there is enough interest by traders—that will become a lot of orders (from both sides). Now, what we need, is a precipitating event, such as a surprise news event.

Suppose the unexpected news is “Bullish”, what would likely happen?

Most likely some of the “late shorts” (people who only got in recently and don’t have a big gain yet) will get afraid of a rally against them…so they liquidate their losing trade AND HERE IS THE KEY POINT: they liquidate their trade placing a BUY ORDER (that’s how you exit a short position). The older shorts from above the market might have buy-stop orders placed slightly above recent price action. If those orders are triggered—they are out now as well ADDING more buy orders to the upside pool of order-flow. Aggressive “bullish” traders might open new long positions ADDING to the pool of buy orders. When the market traded to a significant enough price point where enough people were becoming nervous about what was coming next—something caused them all to think “This news could hurt me” or “This news could help me” and the market itself had nowhere to go but higher because the pool of un-entered orders by the losers were all on the buy side to start with. Who is going to sell a one-year low? On a day when the news was very bullish and unexpected at that? So, the potential for a price rise is GREATER than a price fall because the market can’t move lower UNLESS sell orders are more in number than the buy orders….but on a day when the news is bullish, most traders who are already short are nervous anyway, fresh longs want to get positioned, and no one is going to sell a price break that never showed up because of the bullish news—the potential for a whole lot more buy orders than sell orders exists in that market at that point. If buy orders are larger than sell orders—the machine causes prices to rise until it finds enough sell orders to match against the buy orders. What if there were no sell orders today?

It doesn’t matter if you personally think the news is “B.S.” today, or if so-and-so expert/official/talking head says the bearish trend is still intact, or if your $10M Cray Supercomputer has just analyzed prices and predicts a further low is coming, or if you danced in the moonlight with a 1964 penny in your left hand;

blah—blah—blah…that particular market CANNOT go lower because of the amount of unused buy orders that WILL come into the market sooner or later. It just so happened that today was the day when all the losers decided to liquidate (they expected the news to hurt them—so they quit). Liquidation Potential caused the price rally. The news was just the excuse for everyone to finally use their order to liquidate.

In the case of this illustration, this particular market structure was set-up for a rally that sooner or later would have happened for any reason that wasn't to the liking of the bears (as a group). The losers on the bear side panicked and entered all their buy orders to cover losing shorts. All at once because of an unexpected news event. If that news event never happened—then it would have been some other reason eventually; maybe a reason like: "Support is really strong at this one-year low; I should cover", "The market tried three times to break support and it just isn't dropping any farther", or "This price level means farmers can't make any money next year…time to get out"

Or any number of other ways of thinking "I am at risk and I don't want to lose what I have" THAT is how the loser sees prices—as a potential threat. The winner on the other hand is thinking more like this: "All those bears have to cover sooner or later…a lot of buy orders will be coming in…when could that happen?" And our winning trader is looking to be long before that big rush of orders hits the market. So, our winner might look ahead at the next few important government release dates and decide to get long about one hour before the news comes out on one of those dates. If he is wrong—he will have a small loss when he is stopped-out. Maybe he tries again on the next "Moving Average Crossover" the bears agree portends lower prices; if he is stopped-out again, so what? Sooner or later, the lower the market goes, eventually all those bears will get really nervous and want to cover. It is only a matter of time. The winner is playing that probability. He wants to buy against all those late sellers because he knows sooner or later all those late sellers will have to use a buy order to get out; creating an order-flow imbalance to the buy-side. He might have four or five different "Bottoming Edges" he uses to try and buy the final bottom before the turn—but one thing is for certain: The winning trader KNOWS the bears will quit sooner or later and when they do—the path of least resistance will be a price rise. He doesn’t really know when or at what price that will happen; but it will happen. All the winner is doing is trying to find it before it happens. If you are a Bass fisherman, think of it this way: “How many casts do you need to make to get that big one you already know is hiding up under that same log as last time?”

While our losing trader is agonizing over what each potential low print means and how the market could hold support or not, and when or if that will happen, charting himself into more and more confusion; our winning trader is quietly going long near the lows with a high probability of a rally happening sooner or later. Our winning trader doesn’t know when it will happen or even care if it does. He knows it will eventually happen…like snow during the Chicago winter. If it isn’t “today”, that’s OK. He will keep looking for the clues that the rally is due.

I am not saying that every market bottoms like this and it is always this clear, what I am asking you is “Can you see how orders come into the market—can you see how they have an imbalance at critical points and that creates a probability for a definable price change?”

You can’t “study price” to find those places. You have to be thinking on a much bigger paradigm. Your thinking is the critical thing to developing a winning trading paradigm. Can you begin to see the need for a fresh perspective on price action?

In my book Time Compression Trading (Wiley & Sons Publishing, C. 2010) I go into a lot of critical detail about how order-flow is created and how it resolves conflict in the minds of traders. I discuss balanced and imbalanced markets, I talk about what creates and maintains trends, reversals, topping and bottoming and of course range trading. A lot of what I discuss is very useful for the purpose of analyzing a market well enough to find price areas for a probable change. I would strongly suggest that you get a copy of Time Compression Trading to help you with a deeper understanding of order-flow. For today’s purposes, the issue is about realizing what kind of thinking you personally are using when you look at price action.

Remember, our goal is to awaken a new paradigm of thinking when you are trading. In this chapter, my intention was not to confuse the issue of price movement with “making money” from price action. Making money is the result of doing things better to begin with. In other words, once you are thinking and behaving according to your new trading paradigm, money will flow into your account(s) just as quickly as it was going out before you knew you needed to change. What we need to do with this chapter is ask the questions:

“Is my thinking probability-based or am I more prone to seeking out a sense of certainty?”

“Am I reactionary or am I proactive when I manage my thinking?”

Maybe you are somewhere between the two—it really doesn’t matter. All that matters is that you choose to become probability-based in all your trade-related activities. It will take some time to fully control that process and I will offer you some tools for that later in the book. Right now, take a few minutes and reflect on the contents of this chapter.

Your key takeaway from this chapter:

Price doesn’t matter, it matters what is going on behind the price in the form of who is entering orders and how those orders came into the machine of the market. As orders get processed prices will move and that movement has meaning to how people decide to place themselves at risk. Losers trade from a paradigm of certainty resulting in a reactionary participation. Winning traders remain proactive in their participation and are looking for probabilities they know how to define. Losing traders see price action as a threat to their account balance; winning traders see price action as potential opportunity.

Clarity of Observation and the Desire for Profit

"I think investment psychology is by far the more important element, followed by risk control, with the least important consideration being the question of where you buy and sell."

--Tom Basso

Up to this point in our study of The Psychology of Trading we have focused more on the problems that most losing traders have when they participate, and the preliminary thinking that prevents profitability while often leading to confusion for most traders. In other words, we have been discussing many things that are common to almost all participants almost all the time; but are often misunderstood or outright unknown to most participants. We as traders don't really know what we need to do in order to profit consistently, our trading is often a confusing & difficult thing to do every day. Consequently, all the time, we are doing everything we know how to do to solve this problem. We study what we believe will help us reduce our losses and help us keep more of our gains, but that usually doesn't create any lasting net gains. There is an almost unlimited & overwhelming amount of information available to us that all promises to be "the one thing" we are lacking, but in the final analysis very little of what we have learned and almost nothing of what we have brought to the table has made any real or lasting difference to our results. We started with high hopes and strong expectations that we would succeed; but after years of trying, we are at a net loss in our account(s), spent a lot of money trying to learn the markets; and very discouraged about ever getting this right.

I bet I just described most of the people reading this—and if it is you—welcome to the war. Every winning trader has felt this way at one point in his career. And there is a way out of this problem, so keep reading.

When I was a young trader living in Downtown Chicago, Illinois, I was very fortunate to work with a trader that you might already be familiar with, Mark Douglas. Mark and I met after I had read his book The Disciplined Trader (New York Institute of Finance/Simon & Schuster Inc., C. 1990). When I found out that he lived and worked in Chicago at the time, I simply went over to his office and asked to see him. We talked and he agreed to mentor me. For the next two years I met with Mark almost every Friday afternoon for about an hour to discuss my trading. In my view, a proper mentor can take years off your learning curve if you can find one; I consider myself very fortunate to be one of Mark's students, and that he didn't quit on me. One of the more memorable moments in my coaching was during a period of time when my confusion about actual steps to take to improve my results was at a zenith. I was almost in despair when I kept asking him questions along these lines: "How do I learn to place stops better?", "How can you reduce the risk?", "How do I learn to make better entries?" etc., etc. Every time Mark would quietly and confidently reply: "The wanting to, IS the 'how'" It took me some time to fully grasp what he was teaching me. In the end, I believe what Mark was hoping to communicate to me is literally this simple:

"The willingness to learn & adapt is all the skill you need to become a successful trader"

Everything else is incidental, really. All the books, classrooms, educators, programs, seminars, shows, etc., all don't matter to your success. The trading method or the timeframes you choose to operate under to find your trades doesn't matter either. Bottomline: If you are willing to make some changes—you can make your trading become everything you want it to become. You just need to be willing to do the work.

And it all starts with how you see things…

What we are going to do right now is begin the process of learning and adapting so you can begin creating your personal winning trade paradigm. I say “Your Personal” because it really is a personal choice and a personal result. No two traders ever see the markets or the opportunities in the same way. Every winning trader has a slightly different paradigm for success; but they all fall into a process that remains very similar across all success levels. For example, I personally don’t believe that day-trading is a consistent way to grow wealth. I personally think it is the hardest money to make consistently, and I personally think that a focus on day-trading prevents a trader from seeing the really big opportunities; it prevents you from staying positioned for the huge gains when they are available. There, I said it. If you day-trade—I think you are making this harder than it needs to be. I think you are crazy for putting in that much effort every day for such a small payoff. But that’s just me. There are a lot of traders out there who are very profitable as day-traders.

There are traders who only trade consumables; such as Grains, Meats or Crude Oil and won’t touch anything else. There are successful traders who focus on just one side of the market; such as the short side. When you find successful traders—people who are consistently in the top 15% of participants—you will discover that they cover the entire database of market possibilities. Some are longer-time-frame players, some are scalping. Some are highly technical—some flip a coin every morning. There is no such thing as a “right” way to exploit market potentials. Or for that matter—there is no “wrong” way either. No matter how you personally want to participate—there is a pathway to uncover a winning approach for yourself. You don’t have to do it any other person’s way. You can do it your way; all the way.

In other words, there is an unlimited number of ways to participate and you can choose any way that makes you feel the most in control of yourself and best suits your personality. All you need to do is be open to change and be willing to enforce the changes you discover. To do that, we need a starting point.

Understanding the Existing Paradigm

You, and everybody else, has a “decision-making-process” inside their thinking. This process happens at the speed of thought and therefore is mostly unrealized or unknown by the person doing the thinking. Studies have shown that human beings typically think at about 800/1000 words a minute (depending on things like age, intelligence, education, disease, etc.). You can typically hear or understand someone speaking at an accelerated rate of around 350/400 words a minute; a very good speaker might be able to speak at around 200/225 words a minute, a very good typist might be able to type at 125 words a minute—and last, the typical human can write with a pen & paper at about 55-75 words a minute. That means most people NEVER slow their thinking down to actually understand what they are communicating to themselves within their thinking; to observe inside their decision-making process. Most people don’t actually “hear” themselves thinking…it’s more like an impression or an emotion for most of us.

By the way—this is EXACTLY why I tell my students to keep a hand-written journal everyday while they are trading. I tell them to physically write down everything they are thinking about when they trade. The purpose of this is to force the trader to slow down his thinking process so he can accurately observe what is REALLY going on in his head when he executes. A proper mentor can go back and read this journal of thinking and show the trader places where he loses control of his thoughts and/or emotions. The typical person cannot see this for themselves because they don’t know what the clues are.

Remember when we discussed: “You don’t know what you don’t know”? This is why journaling is such a powerful way to effect permanent and lasting change. I will show you samples of proper journaling in the appendix section of this book later, for now just open the door to adding it to your daily routine.

Regardless of whether you journal now or not, the issue of profitability lies outside of your existing paradigm. We want to break down our existing paradigm so we can see where we are creating our losses from. We don’t need to be journaling to do that, so let’s do a hypothetical trade together starting from the absolute very beginning:

Why do we trade?

“To make money”

Would you agree? Therefore, we begin the process of thinking about going into the market (either long or short) because we have a desire to profit. We aren’t even at the actual trade part of planning an execution yet—I am talking about the why behind having your account in the first place.

Where did that desire to profit come from?

From inside your head. Somehow—YOU and YOU alone decided that making money was part of your existence and somehow you decided that having an account open to trade in a zero-sum market was a pathway to fulfill your desire to make money. It doesn’t matter if you believe that a desire for profit is “normal” or “everybody has the same desire” Those things are incidental to this process. We are talking about how you personally came to the conclusion it was time to get started trading and why. It was just like everybody else, wasn’t it?

I would challenge you to really think about what is written above. WHY do you have an open account in the first place? What were you thinking when you signed the account forms and sent in the cash? You probably have never really thought about it other than having a general impression about “making more money” somehow.

Now—bear in mind—all of this is just fine up until this point. Your existing paradigm of thought (which might be sort of fuzzy to you or in the background because you have never really examined it before) helped you come to a conclusion, and that conclusion resulted in you taking some action. I.E. Opening an account. Wonderful. So, this whole thing started with your desire for profit. Would you agree that is true?

Your desire for profit is the first bedrock issue for you. And It is the main reason you can’t make money consistently. Your desire for profit is interfering with your clarity of observation. Reaching a conclusion that you can profit is coming from how you think right now. And that is not compatible with where opportunity to profit forms in the marketplace.

Profit opportunities develop in the markets through the process of creating a perfectly balanced inequality. In other words, for every buyer there is a seller. That is the job of the clearing corporation. What isn’t so clear in the process of trading is what happens when someone who is IN the markets wants to get OUT…at some point every single long MUST use a sell order to liquidate their open long(s). The same is true for every single open short—they must use and Opposite but Equal order to liquidate. No matter what is happening inside the market—eventually everyone must get out. While the market exists, the inequality of orders being placed at different times and in different sizes all day, every day, all night & forever…create price changes we traders want to profit from. Pay really close attention right now:

Profit opportunity in the markets exists when an order imbalance leads to a liquidation event—and that doesn’t happen because of price. That happens because losers can’t emotionally handle an open trade loss anymore…

Your desire for profit is coming from inside your existing paradigm. The function of opening your account was done just fine according to your existing paradigm. It needs to stop right there. Finding a true market profit-opportunity is a different process than agreeing that profit opportunities exist inside the markets. Your existing paradigm agrees that your desire for profit is a good one, and that opening a trading account will get you there. But that has nothing to do with finding those opportunities. If you now expect your existing desire for profit to assist you in finding places to execute winning trades; how is it going to do that if you feed it the wrong information?

Profit opportunity exists when the loser in the markets decides he has had enough. Think of it this way: When the market has run out of buy orders—how can it go higher? It can't move higher UNLESS buy orders are bigger than the sell orders, correct? Well, what will happen to price when the market has run out of buy orders? Nobody wants to buy any more. At some point the sell orders will become larger than the buy orders and the market will reverse.

How do you make money in a market that has run out of buy orders and has a huge imbalance of unfilled sell orders waiting to happen? You would need to be short, correct? And what price would that be?

Your desire to open an account because you want to make money is a different thinking process than observing where the market has run out of orders on one side so you can make a profit. Just because you want to make money doesn't mean you can observe where and order-flow imbalance is forming. Just because you want to make money doesn't mean you know how to make money.

If you take your existing desire for profit and continue to use your existing paradigm of thought—your paradigm would lead you to believe you need to "figure out where prices will go" therefore, you will begin the process of market study by analyzing price in some fashion. But to really profit—you don't need to know what the prices are or where they will go—you only need to know where the imbalance is forming. So, if you study price—and price only—you will most likely be in error about where the imbalance in the order-flow is developing. You can't make money at trading unless you take it from another trader—so if you know where that loser is ready to say: "I can't take it anymore—get me out"—you will be the trader on the other side of his liquidation order—who cares what the price is trading at when that happens? All you need to do is be slightly ahead of the loser (in time) and roughly at his "Get Me Out!" price level. If you can combine both of those variables really well—you can make a lot of money all the time. isn't that the idea?

Let me put it another way: "If you absolutely knew that the market had run out of buy orders and was about to turn offer right now, what would you do?"

How about enter a sell order? I mean, you want to make money, right? How do you make money in the markets? You need to be long a market that is rising, or short a market that is falling. So, if you absolutely knew the market was about to turn seller, what would you need to do to make money (if that was your goal)? And, by the way—what price would matter at that point? As long as you are ahead of this coming wave of sell-orders, your short should do nicely from any price ahead of that wave of liquidation orders. Now let me really drive this home….

What study would you have to do if you already knew the market was about to turn seller?

How about NONE? If I already knew the market was about to turn seller, what study would I need to do? What to do next is self-evident; just open a short position.

The only question at this point is "How can I learn how to see where the markets have run out of orders on one side?" That will require Clarity of Observation.

Not a desire for profit.

Analyzing price can offer you very little in finding those points in the market's time/price relationship. The reason is because price is not the motivating factor for people to participate. As we have seen before, the reason people trade is to "make money", so if that doesn't happen—they are motivated to get out at some point and take a loss. Price isn't the issue—getting rid of the emotional pain of losing is the issue. If it does happen that they make money—they are still motivated to get out anyway at some point because they don't want to lose what little profit they have. In any case, almost all traders (even a lot of the winning ones) are all motivated more to get out then they are to get in. That's why trading is about finding liquidation potential and not about prices. Once you know how to find liquidation potential, you don't need to do any additional studies about price(s) because what you need to do is already self-evident. In your new paradigm of thinking it runs something like this:

"I want to make money. I see that the market is out of buy orders at roughly (time/price relationship); I will sell at that point and wait for the liquidation to run its course—then cover my short" How about this?

"This is what the market says—this is what I do"

Remember when we discussed that? You see, for most traders, their desire for profit is interfering with their clarity of observation. They can't really see how simple it is to "make money" because they don't understand that all the price study in the world will not help you find liquidation potential; most traders don't understand they need to be looking for liquidation potential to begin with! They believe (because it fits neatly inside their existing thought process—meaning the real-world paradigm) that all they have to do is enough market study and analysis and then they will "make money". Most traders have their entire daily focus on "making money" (They focus on their desire for profit). They are not observing anything.

But making money will naturally happen all the time for the trader that is focused on clarifying his ability to observe liquidation potential in the order-flow—because that is the only thing that can create profit potential anyway—so why waste your time with anything else? If your observation about order-potential is perfectly clear—you don't need to concern yourself with making money because what to do next is self-evident. This is why thinking in probabilities is so important. We already know that no one has a perfect observational bias. And we can never really know if we are positioned properly for a liquidation event until later after the market moves. All we really need to do is find as many "better than chance" probabilities that a liquidation event is about to happen. The rest is just money management.

This is why when you find truly enlightened traders—people who understand and know how to exploit the markets—they really don't care about what prices are trading, they don't care about what news is coming out, they don't care who said what at what conference or news program, they don't care what the reports are, what the Technical Analysis is, etc.; none of it. They don't care if they go into the office today—they don't care if they "miss a trade"; they don't even care about their losses—they don't care about any of the same things all the losers care about. The don't have to. They already know where the loser is—and they trade against him. That's it. There is nothing more to do no matter how you slice it. Why would someone in that position take hours out of every day to "study" price action? It doesn't make a difference to his bottom-line profit anyway. It can't make a difference to anyone's profit…

So why do you insist on making this harder than it needs to be? Could it be your inability to grasp (and accept) the essential central issue to trading is the real reason why you can't profit? Is the problem YOU?

Let's take a step back and let this soak in…

What we have been discussing does not fit in your thinking very well—if at all, correct? That feeling of “this doesn’t fit” is the clearest and most forthcoming evidence you will ever have that there is something about how you see things—how you process information—that is not congruent with the true nature of the markets. Depending on how aggressively you will eventually protect your existing paradigm of thinking—the real-world paradigm—you will experience all sorts of emotions from deeper discussions along the lines of the true nature of the markets. Some traders get really angry, even hostile when discussing their desire for profit, some people outright reject any part of this discussion as being “too simplistic” or even “juvenile” I have had people tell me that they think I “invented” all this “hyperbole & hype” in order to appeal to novices and sell them things; all sorts of petty and ridiculous ways of hiding themselves from the reality that is right there in front of them. People “shoot the messenger” rather than accept the message.

On the other hand, if you are open and willing to accept this new paradigm and begin the process of appropriating this for yourself—the pathway will eventually lead you to creating a winning trade approach you can enforce daily. It will evolve along whatever pathway you want—sooner or later—trading will become effortless once you know why you do—what you do—the way you do it.

This isn’t my opinion—I am telling you how winning traders think and what motivates them. I studied every winning trader I could find, and this is the common thread. First and foremost, on their list of things to do, is completely eliminate any desire for profit from their thinking—because it prevents them from seeing clearly where the order-flow has potential to change. Whatever tools they might use to help them find those points in the time/price relationship is up to them—they usually have very good reasons for using their tools…even if it is the SAME tools you want to use (like moving averages or something). Winning traders will use those tools differently than how you might be using them. They are using those tools to find a place where there is liquidation potential—not trying to find a price that “reduces the risk” Winning traders don’t need to reduce the risk because they aren’t taking risk—they are taking probabilities. What winning traders want is for YOU (the loser), to all think the same way—use all the tools the same way—and execute all the same way. That means all the losers will be in the same spot at roughly the same time/price relationship, and then liquidate; creating the opportunity to take the losers' money (meaning your money). Until that time/price point for a liquidation surge is clear to the winning traders—they don't do anything. To take it to an even further level of trading psychology—if they know themselves well enough—if their clarity of observation is being impeded in some way, on any level, for any reason, they will remain flat. The winners are thinking something like this: "There is ONLY ONE WAY TO PROFIT. If I can't find it because I'm bothered by (fill in the blank) then it is better to do nothing. Why put myself in and take a loss if I could just wait until I am over (fill-in-the-blank)?"

We will get to all the other parts of a winning trade paradigm as we continue through each of the remaining chapters. There are lots of related tools in Part III as well. For right now, I would encourage you to start a trading journal and begin documenting how you think each day while you are trading. At some point, you will want to go through those pages and look for certain things—which we will discuss when the time comes. For now—you want to at least begin a process that you will learn how to refine later. Bear in mind—creating a winning paradigm takes time and effort. All you have to do is today's part. Sooner or later you will put it all together.

Your key takeaway from this chapter:

Your clarity of observation is clouded by your desire for profit. The more you focus on making money the harder it is for you to clearly see the real issues for profitability in the markets; because what creates opportunity in the markets is different than what creates opportunity in the real world. Once you can clearly see where opportunity is developing in the market for the reasons the market functions under, you won't need your desire for profit anymore because what to do next becomes self-evident.

Cultural Myth and Self-Sabotage

"How did I make my fortune? Simple, really…I started on a street corner selling apples. I bought the apples from a wholesaler for a nickel apiece; then I polished them real good and arraigned them in neat pretty rows on my cart. I sold them three-for-a-quarter. I continued in this manner until I had amassed over $300.00. Then my uncle died and left me $1.7 Million"

--Attributed to P.T. Barnum

I don't know if the above quote is really true—but it makes for a great illustration for this part of The Psychology of Trading. Making a fortune is what, exactly? We all would like to believe there is some wonderful back-story to how so-and-so became wealthy. I personally like the story of how in the early days of Federal Express it was difficult for the founder, Fred Smith, to make payroll or even buy fuel for his jets. When he was almost at the breaking point, but he knew he was right at that corner, all he needed to do was get past the next week or two and everything would fall into place. Unfortunately, he was out of real money. He was up against the wall and he knew it. FEDEX could be finished; he was feeling the heat. All the options to raise capital were in the works and would be decided in the next week or two; but he needed something to get through until then. Nothing anywhere except for that last little $5,000 or so in petty cash….in a flash, Smith took that cash on a Friday afternoon and went to Las Vegas. He sat down in a casino and played Blackjack with the company funds. By Sunday morning he was up enough to at least pay his fuel bill. He returned back to Memphis and he got through those last few weeks until that crucial bridge loan was in place. Then FEDEX never looked back….

Talk about risk taking! In this case, Fred Smith was on the winning side; so it is a great back-story. Maybe in the case of John DeLorean selling Cocaine to make his payroll… not such a good ending…

The world is full of successful people with a great back-story. There are just as many successful people with no back-story to speak of. If the truth were told—some of the most boring people I know with some of the least-impressive back-stories are the more successful at what they do. What is the reason why the back-story is so impressive to most of us? Is it about overcoming adversity? Is it about succeeding when the odds are against you? Is it about that "one special moment" when all was lost BUT THEN things changed unexpectedly?

When we talk about Cultural Myth and Self-Sabotage, to a large extent we are really discussing our personal back-stories. We are taking the past parts of our lives that we feel have meaning of some kind to them and transposing them onto our current daily trading life. We do this to create a story that is engaging to a potential listener; most notably, the listener inside of us. We are creating something of value when we are creating our story. Everyone loves a great story.

For example, I used to love listening to my Uncle Fred tell stories of when he was a young man growing up in Calumet City, Illinois. He was a stand-up guy, but he was rough around the edges I suppose you would say. He was building hot rods before there were police radios so he would tell stories of out-running police during high-speed chases through downstate Illinois in the 40's and 50's; why? Because he was running moonshine from Alabama to the south side of Chicago regularly. He had stories like that every time we got together at a family event—stories of him jumping ship in the Philippines because he got tired of the Merchant Marines, or meeting the president of some tiny country because he got caught stealing his car to get to the airport…all sorts of back-stories that made my Uncle Fred a blue-collar hero. When he passed away, I wish someone would have written all of those stories down; he called it "kid-stuff" and that was the end of it. But those were the defining things about him. His back-story was illuminating to his character. It helped to make him who he was.

When we discuss traders and how they got to be where they are (win-lose-or-draw) part of the issue is the back-story. But most importantly, the back-story they themselves believe to be the one that matters to them. We tell ourselves a back-story about how we got to be who and what we are at this moment; and much of that back-story is based on, and contributes to, our real-world paradigm. That back-story is the "self-talk" we have; our inner voice that speaks to us.

For example, let's suppose you personally come from a middle-class family living in the mid-west with a total of three other siblings. Your father owned the local Grocery store that was founded by your grandfather. While you were still in high school, the family business began expanding to several stores in the state. Your grandfather stayed active in the business every day until he passed away while you were in college. You eventually went to work for the family business after getting your business degree from a state university. Your siblings all followed in your footsteps as well, so by the time you decided that trading was something you wanted to do, you were already financially successful, and the family business was indeed run by the whole family.

How does this sound so far? Not anything overly dramatic or sensational—very common sort-of story you might typically hear from any mid-westerner. But let's dig a little deeper…

Every Sunday after church the whole family would have dinner and grandpa would tell the old-worn-out stories of how he got started in the grocery business; how he worked 10-12 hours a day, maybe more during the holidays, how he went out of his way to visit local farmers to get the best produce, etc., etc. You learned how your dad came home after the war and joined the business after serving in the Army Air Corps. Stories that were always summed up the same way: "Hard work my boy! That's how you make it in this world! You get up early—put in the extra effort—people love that!" and you might hear "If you aren't making it happen (yet)…get more knowledge! You're nothing without an education…"

At this point—I would say you were the basic White Anglo-Saxon Protestant living with the Protestant Work Ethic seared into your consciousness. If nothing else—you are going to get great grades at university but likely won't qualify for financial aid; your family has enough cash to pay for the full ride—no problem because that is the pathway that will assure your success. So, what does this have to do with trading? Here's where this back-story collides with your desire for profit and creates your self-sabotage:

You can't "work hard" at trading and expect a profit like you can in the grocery store business.

In the markets, there is no work to do. Just click the mouse—and you could make $250,000 in the next day or so; maybe the next 20 minutes. There are no discussions to have with educators over some difficult section of your course work to make money; there is no course work. Basically, get on the right side of the market and you win. There is no "hard work" to master. There is no "midnight oil" to burn. A complete bum with no education or family support could buy or sell and do just as well. In fact, there are a few already out there.

Right now—the trader in our story—has a set of blueprints in his head about becoming successful. Ever since he was young his entire family worked long hours and put a lot of effort into the family business. The business grew and it was because of this work ethic. At school, he probably studied more hours per week than the typical student in order to get good grades—meaning "be a success at college", he put in a lot of extra effort. This paradigm for success works just fine in the real world where hard work and extra effort will usually result in someone being ahead of the pack sooner or later; but in the trading arena none of it matters to your results. I call this thinking a Cultural Myth and it creates Self-Sabotage.

The above back-story will likely cause this trader to approach his interest in the markets from the point of view that goes something like this: “If I work hard enough, I can learn the markets. All I have to do is put in the extra effort like I always do, and I am sure to figure out how to do this quickly”

If you were to meet this particular trader later, this person is set-up to become a “tech-head” in the markets. He buys countless books on market study, he attends numerous online training webinars every week, he invests in high-powered computers and buys the most advanced software, he runs simulations and back-tests every little potential edge he finds; by the end of his first year he has made the spare bedroom into his trading room and when you open the door it looks like the flight deck of the Space Shuttle in there. He is working hard with extra effort to make it in the markets. Of course, by the end of his second or third year —he has lost considerable money to the markets and his wife is asking him why he stays with it if he is losing so often. He believes he is constantly on the edge of a breakthrough because all this hard work and extra effort must payoff sooner or later; just like it always has. It hasn’t happened “yet’. He sabotaged himself by following through on his existing work ethic expecting it to function like it always does in the real world.

But as we have discussed before—the markets are not the real world. All the study you can possibly do, all the midnight oil you could possibly burn, cannot help you predict prices or provide you a method to “reduce the risk”. The only way to profit is to find the loser and take the other side of that trade. The cultural myth present inside the head of this person has led this trader down the path of losses because he really doesn’t know any different. The trader doesn’t know he has this problem.

I am going to give you a short list of cultural myths. You will likely recognize yourself or someone you know inside some of these basic myths. That’s OK—there is a solution to this problem and we will be discussing that in greater detail as we move on; but for now I want you to accept the possibility that your personal back-story has a base inside something you were taught, or something you allowed yourself to believe, as “true” in such a way that it is showing itself through your trading.

A Few Basic Cultural Myths:

- Work Ethic I.E. “If I work hard, I will succeed” There is no work level in the markets, you succeed by positioning yourself against the losing trader, not by studying harder than him.

- Starting Point Comparisons I.E. “I come from a special background—therefore I have a better advantage over everyone else” Intellect, education or genetic breeding don’t make any difference to the markets. Harvard Business School graduates, Kings/Queens, and Nobel Laurates have all lost money trading because the markets are a machine—not a country club.

- Affiliation Priority I.E. “Who you know matters. I will join with other like-minded people” It doesn’t matter to the markets who you know or why you hang out with them; this isn’t the Jaycees or the Lion’s Club. Where you buy/sell has nothing to do with how connected you are.

- Assumptive Comparisons I.E. “The last time conditions were like this, the market did such-and-such” Your assessment of conditions is only your opinion and is always subject to error. There is no “past predicts the future” scenario in the markets. There is only one side gaining or losing dominance over the other side. How that happened before doesn’t mean it will happen the same way again. It might not ever happen again.

- Data Comparisons I.E. “In order to win, I must have the most current information” Information is not relevant to how prices move. Prices move because traders do something. The orders come into the machine and that is the only thing that matters; why they come into the machine makes no difference. All “the latest information” can offer you is the same thing it offers everyone else; the potential to be seen as “Bullish” or “Bearish” by all the same people.

- Conflict Resolution Priority I.E. “There is no reason for someone to lose, we can find a win/win solution” The markets function by taking money from one side and giving it to the other, there is no potential for everyone to win.

There are probably thousands of ways for these basic cultural myths to become active in someone’s paradigm. There are thousands of Cultural Myths to consider too. For example, if someone has been a divorce attorney their entire life as a legal professional, they will likely have the “Conflict Resolution” paradigm firmly burned into their thinking. That’s all they do all day long—try to find a “win/win” situation for their clients. When someone with this paradigm begins trading they typically are attracted to things like option strategies—because they “don’t have to pick a side; I can just let the markets run out of time…” or something else that tries to resolve or mitigate the winner vs. loser environment for them in their minds. I’m not saying that option strategies that capture time decay are “bad”, I’m saying that because an existing point of view has been validated regularly in the real world it is very common for it to be the same point of reference for someone entering the trading world. Cultural Myth and Self-Sabotage means the trader tends to use his existing validated paradigm of thinking when attempting to find reasons to trade.

Before we begin the process of identifying where cultural myths might be active in your particular thinking let me clarify something.

Your existing real-world paradigm is not a bad thing. There are no “good” or “bad” real-world paradigms. Your existing paradigm is a necessary and helpful thing. It allows people to create meaning in their lives, it gives you purpose, it can help with creating happiness and all sorts of other positive things. In the big picture it allows we as human beings to create a society we can all live and function in, for the benefit of everyone. Allowing for the percent of us who might have some active dysfunction we need to address, for the most part, our real-world paradigm is a solid foundation with which we can build a satisfying, happy and successful life.

So, it is normal and natural for any of us to assume that our expected needs as a trader would be no different than our expected needs as an everyday person. In other words, we really don't even stop to consider that being a trader could be more or less distinctive than anything else; it's just different. In most cases, our real-world paradigm functions so well for us and operates non-stop all day, every day, that we don't even know it is there anymore. Sometimes, we are genuinely surprised to find we are thinking a certain way about something automatically until something else comes along to force a new look at things. I am sure you have had this experience: "WOW! I never considered that before. What was I thinking?"

Confronting our existing paradigm is really what we need to do. We don't need to replace it or even change it—all we need to do is become aware enough of what we are doing/thinking when we trade to make a change to our trading behavior. In other words, we want to eliminate our real-world paradigm from influencing our trading. We want to create a new trading paradigm; one that becomes active when we are actually participating in the markets.

Cultural Myth is our real-world paradigm when it is active in our trading. Self-Sabotage is the result to our trading out of an active real-world paradigm.

And where is cultural myth and self-sabotage coming from?

It comes from our personal back-story of who and what we perceive ourselves to be when we step into the trading arena. It is our "self-talk" and what we consider to be our inner voice; it is how we communicate with ourselves. It includes our upbringing, our religious training, our parents, our culture we were born into, our education, our personal choices, our hurts/pains/emotional scars, our expectations for our future; everything inside your head that you perceive as "Who you are", "Where you came from", "Where you are going", and "How you got that way". it is the sum-total of your consciousness, your inner dialogue with yourself. The markets don't recognize any part of that back-story, and the markets don’t respond to any of our efforts to enforce what we believe are the advantages we get from our back-story. It’s like showing up for a gunfight with a chocolate cake. All it does is interfere with our ability to discern where the order-flow might have liquidation potential. Our back-story interferes because How You See Things is what makes all the difference. How You See Things must become congruent with how the market is structured.

Your key takeaway from this chapter:

Most traders approach trading from the same real-world paradigm they approach everything else with in their life. Your real-world paradigm is not a bad thing; it is just not compatible with the trading environment. When you trade using your real-world paradigm you will likely suffer losses because your real-world paradigm is functioning from the past story of who and what you are; not from a market-centric paradigm that creates gains. When your real-world paradigm is active in your trading it is called Cultural Myth and it creates your Self-Sabotage.

Gains and Losses

"I could publish my system on the front page of the Chicago Sun-Times and people would still lose money trying to use it."

--Richard Dennis

One of the things I teach when I do The Psychology of Trading course live to students is the concept that there is no "right" or "wrong" way to trade. There is no "good" or "bad" price action. There aren't any rules you could invent that will provide you a "better" or "worse" edge for yourself. I know these concepts might seem hard to grasp at first but what we are hoping to achieve is a completely market-congruent method of behavior through the creation of a new trading paradigm. Labeling things as good/bad, right/wrong, bullish/bearish, etc., are all methods of interpretation and subject to a sense of certainty; they are all part of the real-world paradigm and therefore unneeded where we are going. In the trading world you don't need to make any of these assessments. You don't need to define anything in order to participate. All you need to do is place an order and wait. If you have done your homework properly—that order will be on the side of the next wave of orders that are overwhelming the other side. The trade will profit and that is all that needs to happen. You don't need to do anything more or anything less. You don't need to know anything or explain anything. You don't need to answer any "How?" or "Why?" questions, you don't need to do any market study, and you don't need to feel any emotions of any kind no matter what happens.

Put that in contrast with what most people are doing when they trade, and you will see a very big difference.

For those readers who may not be familiar with the trader mentioned in the above quote let me introduce him to you. Richard Dennis was a pit trader at the CBOT during the 1970's into the 1980's. He started with next to nothing and lived in a cheap Lincoln Park apartment furnished with milk crates and spool tables even when his net-worth reached beyond seven-figures. He retired with a fortune conservatively estimated at $400 Million but he is best known for coaching "The Turtles", a group of personally selected traders he privately taught; most of the turtles are retired now too and if you have time you should learn a bit about that whole story—it's quite interesting. As far as his trading is concerned, Dennis understood the above "non-attachment" philosophy very well and the above quote was his answer when asked "What is so special about your approach to trading?" At the time, Dennis was one of the most successful traders in the public eye; bigger than Paul Tudor Jones, Peter Lynch or any of those 80's "rock star" traders. Naturally, people wanted to know what he did that made so much money and he would always say the same sort of thing—nothing. He said it lots of different ways. But he basically said nothing. Why is that?

Because there is nothing to say. Well, maybe there IS something to say—and the better answer is "No one would understand it" Follow me on this…

The market is a machine. All it is doing is processing orders from buyers and sellers. At some point, the machine (market) will have an order-flow imbalance built into itself; all the buyers will have to use a sell order to get out and/or vice-versa. When that order-flow imbalance shows up the prices will reverse. Once the reversal happens, the machine (market) will eventually create an imbalance in that direction too. This process of order-flow imbalance trying to resolve itself never stops. Therefore, the market never runs out of opportunities (You are not going to miss anything), you can trade from either side equally (There is unlimited opportunity), and you can participate any time you want or stay out for whatever time you want (there is no pressure to do anything).

How do you make money, Mr. Dennis?

“I buy low and sell high”

How do you know how to do that, Mr. Dennis?

“I buy when everyone else is selling and I sell when everyone else is buying”

How often do you trade, Mr. Dennis?

“When I see my opportunity”

Can you see the problem here? In the trading arena, any trader (not just Dennis) would say that all of the above discussion along with the Q & A test to see if you understood any of it, is absolutely correct and accurate. Furthermore, based on the discussion above, there is absolutely no emotional experience connected to the participation process. AND…the marketplace is so simple to understand you don’t need any more knowledge or study to grasp how profit opportunity presents itself. Anyone can understand and anyone can profit.

So why do most traders have such a hard time making consistent money?

As we have discussed before, it is how they see things that is the problem for them. It isn’t the markets—it’s the trader that creates the losses. Richard Dennis could publish his trading method on the front page of the newspaper and people who follow it would still lose money. Why? Because the typical person using any method brings all his cultural myth to the table when he trades; sabotaging himself in the process. No one wants to believe it really is so simple a child could do it. That doesn’t fit into their heads.

As a side note, Jesse Livermore published his method for stock trading almost 100 years ago. Most people who review the Livermore method and then decide not to use it say something like: “The market has evolved past this method—there are better ways now” or “This method is too complicated for the average person to use; plus it takes a lot of capital to do it right. It’s not practical anymore” or some other lame excuse why the method that made one man fabulously wealthy can’t possibly be for them. Dennis taught The Turtles exactly what he did and why/when he did it; none of the turtles had the same or better results than Dennis had. They all did fairly well—but no one applied the process exactly as Dennis had. In other words, systems apparently are not the issue for success in the markets either; because different people using the same system will all have differing results. it’s something else. One individual can use a system better or worse than another. What is the essential difference between winners and losers?

Your Market-Centric Trading Paradigm

As I have said before, the problem is how you see things. I wanted to start this conversation with a brief introduction using systems because it is very important that you understand that everything we will discuss from here forward is all about developing a market-centric paradigm of thinking. A market-centric trading paradigm not a trading system. It is a way of thinking. We are not going to even start the process of creating a winning system until we get to part three so just relax and stop focusing on making money—let’s deepen the discussion about market simplicity and profitability; because it is the same thing.

The zero-sum environment is incredibly simple, and it is because it is so simple that most traders can’t initially see how to develop a profitable approach. Prices and price action have no meaning other than the meaning you decide to give them. Your market-centric trading paradigm must start from a non-attachment point of view. The reason people experience losses so consistently is that they possess a sense of attachment to their results that (again) comes from their real-world paradigm. A sense of attachment can take many forms, but I will give you a brief illustration that most traders will probably recognize easily:

Let's suppose you believe the market you are looking at is due for a rally. By that I mean it is ready for a lift higher in price. You came to that conclusion how? Maybe by reading a very persuasive bullish argument from a respected individual or listening to a news program that reported the supply of something is at a 20-year low. Your very first mistake is placing your confidence in someone else's' point of view or what you see/hear on the news; but that is a different issue—right now we are concerned with how a sense of attachment can lead to losses. In any case—you "connected" with the bullish point of view. If you are like most traders you reviewed whatever you reviewed in such a way that you "agree" with it; and this point of view is so connected inside of you that you feel you have reached this conclusion with an equal amount of effort and authority as the original author did ("You know, he's right—that is a solid argument for a price rise—I agree that this potential is really strong to the upside—that's obvious now"). Your problem started right here. Because there is no "bullish" argument other than the fact that someone (meaning YOU) can't just look at the market and find the order-flow imbalance. They (meaning YOU) have to find a meaning to price. It must be "Bullish" or "Bearish" because we have to know what should happen in order to profit (A Cultural Myth).

After reaching this conclusion you begin your very own "research" into the potential bullishness of this particular market because you want to be sure (sense of certainty). After extensive analysis and historical study, you have come to believe that the bullish point of view is certainly the correct one (meaning you think you have "reduced the risk"). So, you decide to buy. Within a day or two of buying that market the price has continued to decline and is now testing a recent historically low price. You aren't too worried yet because you just started this trade and you expect to be in it for some time. You think "It should hold support" Two more weeks go by and the price is again lower. You go back through all your research and adjust your analysis to include the two fresh 20-year lows that seem to offer no "support", just in case the two of you missed something.

Within a month or so you have a sizable open-trade loss. You can't understand why because the research you did clearly shows the bullish potential that should be there. You aren't looking at anything else. All the news reports say the same thing; these fresh lows are "temporary" according to most analysts. Additionally, the "guru" who first sold you on the bullish scenario has even more supporting documentation and argument as to why the market is a better buy now than it ever was. Although you are losing big money, you still hold on because you don't want to liquidate right when the market could be due to finally turn. After enough pain—meaning another low print—you just can't take it anymore and you bail. You take your loss and it hurts…and you just can't understand why. So, you go back to all those charts and stuff and try to figure out what you missed; because if you would have known the difference you would have waited to get in later. Then the market quietly starts to rally, making weekly highs again and again, until three months later it is soaring; well above your original entry price. But you have nothing on because your previous losses were really painful; you didn't want to jump right back in until you had confirmation that the trade was now bullish for certain. The market never pulled back enough for you to get in comfortably and it "just ran away from you" leaving you with a loss when you "Should have had a profit"

Do you see the ridiculousness of this whole thing yet?

You wanted the market to be "bullish" and you built an entire trade scenario around why the market would rally. You didn't consider anything else and just hoped you were right because you expected to make money. To make matters worse, you were absolutely correct about what would eventually happen, but you never made any money from your analysis. You couldn't get back in because of your attachment to what had to happen first "according to plan" When nothing went "according to plan" you had no point of reference with which to make a fresh commitment. You had to re-examine everything and find out "what went wrong" so you could avoid that mistake in the future. You had already lost some capital and you didn't want to throw "good money after bad" at this point. Additionally, if you would have waited—you could have bought near the absolute lows, but the emotional pain of your first loss caused you to be "more cautious" until the trade was "confirmed" before doing anything. Then the market “got away from you” and never gave you another chance to get in (need for certainty) before establishing a trend higher. So now you are still waiting for that market to return to the “trend line” but it never seems to get close enough to it before rallying away again—so now you are angry and frustrated.

You were so attached to what the market was doing to you that you couldn’t see what was actually happening inside the market. The order-flow was still net offer up until a certain point. Then the order-flow went bid. If that was what you were focusing on in the first place there would have been only two choices available at the start with no “research” needed at all. First, if you had the point of view something like this: “If the order-flow is still net offer, and I want to make money today, then I need to put out a short position” all you needed to do was sell. If you wanted to wait for the market to turn net bid and not trade the short side right now, then there is nothing to do until the market goes net bid—then you would need to open a long position. What can “research” add to that simple process of observational thinking?

Your sense of attachment to what “should” happen based on all this study created a whole other universe of needs, unmet expectations, justifications, fear, hope, disappointments and financial loss for no reason at all; other than the reasons you gave it due to your point of view. If you had no point of view to defend—you wouldn’t have had the losses and the entire emotional experience including all the ups & downs. All of that losing behavior happened because you don’t possess a market-centric paradigm that doesn’t require anything to happen in any particular order or go according to any particular plan. You approached your participation in the markets from your existing real-world paradigm with its host of cultural myths. You need to develop a proper market-centric paradigm of participation devoid of any sense of attachment to anything; otherwise you will continue to lose money.

The importance of Gains and Losses

Gains and losses are two very powerful data points that can tell you in very intimate detail how you are developing your market-centric paradigm. Both can tell you exactly how far along you are on the creation of your non-attachment mindset. Both can disclose how deep your sense of non-attachment is becoming; or how shallow it still remains. Gains and losses are not about money; they are about collecting data.

In order for these pieces of information to offer their greatest benefit we need to set some ground rules for the collection of your personal data. Up until now we have only loosely referred to journaling as a necessary part of developing your winning approach. You actually need to create two kinds of journaling for yourself. You need a “Thinking Journal”; which is the one where you slow down your thought-stream by writing everything you think about when trading down in a book by hand. The second kind of documentation is your “Trading Log” or “Trading Journal” where you document specific data about your trading and your trade results. We will discuss these two kinds of written documentation in the chapter on Record Keeping and I will provide samples of all this documentation in the appendix. At this point—I just want you to understand how important this information is so that you will be excited about recording the data correctly for yourself.

Why are gains and losses so important? Why do we need to see them as something other than money made or lost?

First of all, gains and losses need to be redefined according to your new market-centric paradigm of thinking. It is in the re-defining of these two data points that your market-centric trading paradigm will provide the strongest early benefit. When gains or losses become simply information, they become neutral to your sense of attachment. Gains and losses are no longer money made or lost; they become a measure of discipline performed or not. Developing and using a market-centric trading paradigm takes discipline to create. The entire process of trading for consistent profitability is an exercise in applied discipline. Gains and Losses are about collecting data to enforce new levels of discipline. There needs to be no attachment to money made or lost. Gains and losses represent Discipline performed or not.

We are going to discuss discipline in detail in part III. Discipline makes the process a skill; but you don't have this skill yet—so we need to ALWAYS start at the beginning. The process of trading is very simple and must remain clear from any sense of attachment (which includes expected profit). For now, let's review again how we make money from our participation in the markets. We MUST be on the right side of the order-flow. ANYTHING that prevents us from finding the right side of the order-flow will eventually interfere with our clarity of observation and cause us to sabotage our trading. ANYTHING means ANYTHING…if I just had a fight with my wife and I am all emotionally flustered ten minutes before some report is due to be released; maybe I am not in the best frame of mind to take a risk this morning. Maybe I won't see it right… So, if I trade—and I have a loss—that can only mean ONE THING…. something interfered with my clarity of observation. I was thinking about my wife—not the markets' structure and how it might be changing ahead of or during a report. I absolutely KNOW that something was interfering with my trade, otherwise...

Why would I do something to hurt myself if I really knew better?

Seriously, none of us woke up this morning with the intention of losing in the markets. We don't get up and entertain the thinking: "You know, I feel like I am too successful in my life—it's time to lose some money. I feel emotionally distraught and disgusted with myself. That's my plan for today"

Our intentions are always to do our best at this today. But when you lose money in the markets—you are on the wrong side of the order-flow. That's it—there is NO OTHER reason, and nothing needs to be "researched", studied or explained using any other rationale. It's that simple. You lose cash from your account when you are on the wrong side of the order-flow. That's it. It doesn't matter how much you invested into your education, research, training, software, etc., it doesn't matter if you are in therapy with your wife and expect to be happy again next week; whatever you did inside your thinking right now caused you to place yourself at risk in the wrong spot. If your whole goal was to make money—do it correctly—and not make any mistakes…if YOU REALLY BELIEVED THAT…. how did that loss happen?

It happened because you simply didn't see it clearly. That's it. The problem is inside your head. So, a loss is what? A failure to see things clearly.

A loss is not a financial thing. It is a failure in observation. A failure in your discipline. A failure in "how you see things", it is not about money—it's about thinking and why you are motivated to take action at the exact time/price area you decided was the absolute best place to be….You did what you did—and the bottom line was it was on the wrong side of the order-flow at that particular time/price relationship.

A loss is a failure in objectivity. Nothing more; nothing less.

A loss teaches you that something in your market-centric paradigm is still not functioning properly. If you saw it correctly—you would have a gain. A loss says you didn't see it correctly—so what did you miss? Whatever it was that you missed—it is inside your head. It is something interfering with your clarity of observation; what is it?

A gain, on the other hand, is more problematic and gains are the real reason most people can't make money consistently from their trading. Most traders have gains so infrequently that they are more concerned about giving them back than holding them for their true potential. Most traders will cut their gains short very quickly due to the emotional pressure of not knowing where the best place to liquidate really is.

But we already know where the best place to liquidate is.

It’s at the point where the order-flow will change to an imbalance on the other side. In fact, if you were really good at finding those time/price relationships; couldn’t you be long up to the highest high price—then close and reverse to hold shorts from the highs until the market reaches some distant low price? Then do it again; and again? Couldn’t you be at every turn all the time—I mean if you were really good at finding the imbalance in the order-flows? If you could see things that clearly—how much money could you make all the time?

A gain is a complete clarity of observation. All you need do to make money is get on the right side of the order-flow imbalance. Making money is the inevitable result of seeing things clearly. Therefore—gains basically say “I am seeing things really clearly right now”

Or it is a complete accident...

“Wait—what was that?”

Yes—you can make money by accident. But it gets worse. You can make money by accident and then confuse that with having a true skill. This is why gains can be so difficult for most traders. If they make money—they really aren’t sure how that happened and therefore can’t repeat the behavior that created the gain; assuming their behavior or study had anything to do with finding that particular order-flow imbalance in the first place. Most traders have gains by accident—whatever they did to convince themselves that it was time to buy or sell, those permutations just happened to exist at the same price/time relationship that the actual order-flow imbalance happened to be at. A soon as the market structure changes to something their particular analysis doesn't find by accident—those traders give back the money they made plus more.

Remember my illustration earlier about "Moonlight Penny Dancing" analysis? I think we all would agree it is fairly clear that there is absolutely ZERO chance that "MPD" analysis would ever be able to accurately forecast price action in any market. But someday—sooner or later—there will be an APPARENT correlation between "MPD" analysis and the price change in some market. In other words, it will "look like" MPD analysis was "correct" in forecasting a BUY signal somewhere only BECAUSE shortly after the MPD analysis was done there was a price rise on the market the forecasting was used on. Again, the only reason the price rise occurred is because the order-flow imbalance went bid. But because this happened in such an apparent close proximity to when the MPD analysis was done, traders believed that there was a direct correlation that "validated" the MPD analysis. In other words, traders who bought that market made money by accident, but they confused that with having a true skill (correctly doing the MPD analysis).

So, you can begin to see where developing a truly non-attached market-centric paradigm can require a lot of effort when discussing your gains, correct? A gain is either a perfect assessment of order-flow conditions—or it is a complete accident. There are no other ways to profit. Either you did it perfectly for market conditions as they were at that time; or it was a complete accident you just happened to be on the right side of.

I would like to propose to you that it really doesn't matter which sort of gain you have. Accidental gains are OK. What you are working towards—and will eventually create for yourself—is a market-centric paradigm. A non-attached and neutral method of seeing how the market is constructed at a particular moment. That means you will eventually acquire the ability to create gains by design—not by accident. But in the meantime—take those accidental gains. Making money is the inevitable result of participating according to your non-attachment market-centric paradigm. If some of those gains come by accident and you simply can't determine if you saw things clearly or you were in the right place at the right time solely by accident; who cares?

The purpose of studying your gains and your losses is to discover exactly where your developing clarity of observation is strong and where is it weak. 100% of your losses disclose your weaknesses. It will ALWAYS be unknown what percent of your gains are by design or by accident. That makes no difference to you bottom line because the best part of your gains vs. losses argument is this:

The Probability of Ruin Matrix

The best part of trading from a non-attachment mindset is the freedom from having to explain every little thing you do or experience because you wrongly think it contributes to your bottom line somehow. Gains and losses are just information that tell you how clearly you are thinking and how disciplined your participation behavior is becoming. But what are we measuring this data against? What is the frame of reference we want to eventually acquire?

If you learn to properly observe order-flow potential, then you will make money—making money is the natural result of seeing thing clearly. When you don't see things clearly—you will hand yourself a loss. As long as your gains are consistently larger than your losses—your account(s) will grow at some definable rate. Between the two lies the extent of your true potential for consistent account growth.

Outlined below is the "Probability of Ruin Matrix" This is a chart of the potential you have to lose money based on the percentages and ratios you create from a reasonable sample set of your trade results. For example, if you did 100 trades and had 60% winning trades against 40% losing trades, AND, you made three dollars on your winners for every dollar you lost on your losers—you would have a zero-percent-chance of “ruin” in your account. “Ruin” is defined as a 50% draw down from starting equity. In other words—you have very little chance of ever losing money net in your account.

PROBABILITY OF RUIN* MATRIX

PROFIT/LOSS RATIO	% WINNING TRADES 30	35	40	45	50	55	60
1:1	99	88	88	73	50	27	12
1.5:1	98	85	50	17	4	1	0
2:1	74	38	14	5	2	1	0
2.5:1	40	17	7	3	1	1	0
3:1	23	11	5	3	1	1	0
3.5:1	17	8	5	3	1	1	0
4:1	14	8	5	3	1	1	0

* Ruin is defined as a 50% drawdown from starting equity

Conversely, if you made one dollar on your winning trades for every dollar you lost on your losing trades, AND, you had a 50% winning-trade-to-losing-trade ratio, your percent chance of ruin would be 50%. In other words, you have a strong potential to suffer losses; because your gains are too small, and your losses are too often. BOTTOM LINE—you don't make enough on your winners to overcome the potential losses. Your goal is to stay somewhere in the gray area of the matrix. Some sort of combination between percentage of winning trades and the combination of dollars won against dollars lost. Notice also that you can have below 50% winning trades and that is OK; you still have a very low percent chance of ruin, as long as you make more than a certain amount from your winners all the time.

In other words, as long as your gains are mostly larger than your losses and you have somewhere better than about 48% winners…you should be OK as far as growth is concerned. All you need to do is develop enough clarity of observation to reach that level. And discipline yourself to perform at that level too (more on that later).

Here's the interesting part—and I would like you to REALLY pay attention because what I am about to say next simply doesn't fit inside most people's heads. 48% winners are really no better than chance. Your "system" is really no better than flipping a coin. However, flipping a coin is a system too, if it is done consistently the same way all the time. If you flipped a coin and went LONG every time the coin flip was heads; and went SHORT every time the coin flip was tails; and you did this at the same time every day, you would eventually have somewhere closer to 50% winners vs. losers. If all you did was hold your winners for twice what you gave back on your losers—most likely you would make money every 100 trades. That's not my opinion—that is the mathematics of the probability of ruin matrix.

It doesn't matter what your system is to exploit price action. Whatever it is it will have some percentage of winning trades. Even the worst systems have some number of winners. What is that percentage and how many trades are needed to have that percentage? The winning trades take care of themselves. Losing trades need to be liquidated at a predetermined point that never varies. If you hold your winners for twice what you give back on your losers—you will likely make money every 100 trades. Would that work for you? Oddly enough, you can start today with no more skill than the ability to flip a coin and if you just learned to hold you winners long enough to pay for your losers plus a little more—you are on your way to the top if you can avoid making all the other stupid mistakes we traders learn to make over time.

You see, what you want is for the probabilities to work FOR you. In order to do that—you need to know what your particular probabilities are. You can't know that until you study your gains and losses enough to know when you are duplicating winning behavior—or just guessing. Even if you have accidental gains—that still drops to your bottom line as some amount of money made. We will take them until we can up our percentages to beyond chance; and increase our observational skill to time our entries so we can get 3-4 dollars in gains for every dollar we give back.

Your key takeaway from this chapter:

Gains and losses point the way towards your personal non-attachment mindset; your market-centric trading paradigm. Systems, information, training and the whole host of other related "tools" really don't offer any advantage over the most basic and simple understanding required to grow your account balance: When the order-flow is preparing to change, you have an opportunity. How clearly you think determines how clearly you see things to find those turning points. Gains and losses tell you how well you are thinking in that direction; and how close you are to finding liquidation order-flow regularly.

Accumulating Profit

"Money, as it turns out, was exactly like sex; You thought of nothing else when you didn't have it and everything else if you did…"

--Charles Bukowski

Accumulating profit is a study in self-awareness. Like we discussed in the last chapter, developing a market-centric paradigm requires refocusing your mind away from traditional roles of thinking we usually take for granted. Gains and losses are no longer about the money—they are about information to establish our discipline. Our discipline leads to keeping more money from our behavior as our market-centric paradigm grows.

How are you going to measure your discipline?

This chapter is that discussion. When traders ask me: "How do I make more money?" I usually respond with: "That's like asking a doctor 'How do you make a sick person well?'" or "That's like asking an attorney: 'How do you win a lawsuit?'" There is no one-size-fits-all answer to a general question that requires a specific set of conditions to be met.

Let's go back briefly and review what we have learned so far and sort-of generalize it enough that we can begin to answer the hardest question of all for traders to answer: "How do I make more money?"

- We can’t make money from our trading unless we take it from another trader—that is just how zero-sum markets work.

- 100% of the people trading have access to all the same information and tools—everyone sees the same news, has access to the same training/education and everyone does some sort of analysis.

- 100% of the people are trying to profit from their use of information, news and training but statistically only about 15% are winning consistently. The other 85% of traders are paying their money to the first 15% all the time.

- In order for this ratio to exist, the winners MUST be doing something different than the losers all the time. The winners MUST be taking the other side of the losers trades with enough frequency to remain in the 15% all the time.

- The winners MUST be buying when the majority of traders are selling and vice-versa. There is no other way to profit.

- No matter what the result is to any one trading account over time—whenever any trader is LONG the market; he must use a SELL ORDER to liquidate (either to take a profit or take a loss). The opposite is the same for SHORT positions.

- These liquidation orders eventually will pile together until there is an imbalance in the orders big enough to reverse price direction. This potential never stops.

- To consistently profit, any trader has to have some method of seeing where these price areas of liquidation potential exist in the market. Without that knowledge taking a position is just a guess and likely will result in loss.

- To see where liquidation potential exists, a trader must have a market-centric paradigm that is not attached to any particular activity/action or bias. This paradigm is not the same paradigm we as humans use to function in the real world.

- Until any trader can operate exclusively from this non-attachment mindset using a market-centric paradigm 100% of the time he is actively participating, his potential for losses remains higher than his ability to make money net.

• To create this non-attachment mindset and develop a market-centric paradigm, any trader must study his actions and his thinking. The trader is looking for ways his real-world paradigm interferes with his trading-world paradigm. Those points require discipline and practice to remove and/or get under control so he can fully control his execution and his results.

In reality—a winning trader is operating within a set of behavioral conditions. His new method of thinking has created a different way of seeing opportunity. 100% of his actions taken from that moment forward are based on his best understanding of where the liquidation potential exists that will create an order-flow imbalance. A winning trader has developed the skill to know exactly when his point of view is constructed from his market-centric paradigm and when it is not. A winning trader has created a set of boundaries for himself that prevent him from hurting himself. A winning trader's behavior operates from a sense of probabilities and his probabilities are well-defined.

A winning trader is disciplined to behave only according to his plan—and nothing else. How are you going to measure that discipline?

Remember when we discussed how our thinking is constructed and how our minds can operate so fast that we have trouble slowing down our thoughts to see how they are connected? That is why we need to start developing our non-attachment mindset and our new market-centric paradigm from a hand-written journal. More on that later. But for now, let's do a basic process of reaching a conclusion together. Let's talk about how to measure our growing discipline.

Let's start with a few facts:

• “If I am on the right side of the order-flow—I will make money”

• “My gains tell me I am on the right side of the order-flow”

• “My losses tell me I missed seeing where the order-flow was”

And now let’s ask those tough questions:

• “What was my thinking that led me to believe a profit-opportunity existed?”

• “What was it about my behavior that put me in the proper spot to profit?

• “What part of that behavior process can I duplicate over and over for an edge?”

• “What part of my thinking led me to the wrong spot for a loss?”

• “What controls can I place on my thinking and behavior to avoid duplicating losses?”

• “What controls can I place on my thinking and behavior so I can duplicate gains?”

If you are doing this exercise you should start to feel like your mind is opening up a bit and different information might be available to you. I didn’t say you would like this process or like what you find when you do it; I said that accumulating profit is a study in self-awareness. That might mean you have to bring things to the table that you don’t want to bring to the table. To answer those questions well enough for you to break the cycle of trading losses might mean you need to have some candid discussions with yourself on a level that is typically unpleasant. If you are not feeling that way—good for you—but please keep an open mind to taking this process as far as it might go; all the way back to the real “psychic wound” that might be preventing your gains if needed. In any case, let me give you a “for instance” of how this process might play out for you the reader.

Let's use some "If—then" correlations to get the ball rolling:

"If I make more money than I lose—I will see consistent net gains"

How do you know this? Well, you can use basic math to determine that if you make $500 on one winning trade and lose $250 on two trades total; between the three you would have a net gain of PLUS $250…what else do we know at this point? We know that your winning trade ratio is low according to the probability of ruin matrix (About 33% winners-to-losers ratio) but your money gained versus money lost ratio is excellent; closer to 4-to-1 ($500 earned on the winner against an average loss of $125).

Now—if we can keep all these ratios working for the next 100 trades or so there is a very good chance that you will make some very good money. So, let's create a plan and some sort of method to find out if we are on track. First, we need to find out what happened on our winner(s). Is this an accident or did we really demonstrate winning behavior that we can now duplicate? We go through our journal notes and discover that we observed a strong sell-off in the market that ended at a low print that equaled the previous week's low print. Obviously, we can't know that this week's low print will remain equal to last weeks until later, but it is apparent that the market ran out of sell orders at the same price point twice now. The market rallied within 24 hours, so you bought the market on the close of the day it sold-off into the low prints. Your risk-stop was under the low where the market hadn't traded yet, so it was a good probability that there weren't enough sell-orders to create a fresh low and threaten your stops; at least not yet. Now we have some things with which to try and create and maintain an edge for our trading.

We do the same thing for our losses. One of the things we notice about one of our losses is that you placed a sell order right after reading an article about bearish conditions in a market you really know nothing about. You don’t know anything about how buyers and sellers would view conditions, review fundamentals, or what technical factors tend to be active. You didn’t even look at any price action—you just read a bearish article and just because you read it at 10:30 AM this morning you decided it was a good time to sell. The market continued moving higher until you were stopped out and the total time in the trade was less than 3 hours. Also, your exit stop was inside the range of the previous week at a price level the market has already traded at consistently—so there was a good probability that price could trade again (and it did, handing you a loss). Your other loss was in the same market about an hour later after you came back from lunch. You returned to your desk to see the order for your liquidation filled and you got angry you didn’t make any money on that trade—so you entered another sell-order in the same market once you looked at the prices because your fill on the first loss was the traded high for the day and the market was down to a price level below that. You felt as if you could have made money except for your stop being tagged as the highs…that is just “bad luck” so you tried to get your money back. Later, that market rallied to fresh daily highs taking you out for a second time.

So now we have some things to consider about our losses. First, both trades were done because you were thinking about SOMETHING ELSE instead of the market structure and the probabilities being in your favor. The first loss was done because something “sounded good” about why the market might be bearish. The second loss was done because after your loss you looked at price action and saw “you could have made money”, which is a sense of attachment to results. You got angry because your sense of entitlement to a gain was offended. You should have made money on that trade—so the market owes you. Both trades were losses because the order-flow was in the opposite direction for the time you were in them. You were not looking for that—you were looking for an opinion to be correct and when it wasn’t you your emotions over what “should” be happening influenced your decision-making process. All of the above actions/emotional interference/assumptions about price; all came from your Cultural Myths—you sabotaged yourself.

The first trade was done based on a rudimentary approach to understanding how order-flow develops along with some solid probabilities (If this low holds like last time—perhaps it will attract the buyers like last time—my stop is in a place the market can't get to easily unless something changes, but if everything remains as it was, a rally could be due).

The second two trades were done for emotional reasons and therefore would never have worked except by accident. In which case—the problem becomes worse. You might be tempted to trade from an angry bias again because it worked previously for you.

At this point you have the beginnings of a winning paradigm combined with clues to how you self-sabotage yourself. As far as creating an edge is concerned—one winning trade is not enough to determine if you have a solid edge with which to trade from consistently—but you DO have some solid behavior you can repeat in order to discover if you can make an edge out of what you saw. Later, when we discuss creating edges, we will go into this deeper but for now the thing you need to focus on is repeating favorable behavior and mitigating & eliminating losing behavior.

How are you going to do that unless you remain in a state of self-awareness as to what you are doing and how you are thinking?

Here's what I mean: If you don't journal honestly then your notes won't tell you enough about your thinking to confront it. If you never wrote down "I was angry that the market stopped me out and then went my way so I got back in right away" then you might never uncover how that loss happened. How honest are your notes? Are you self-aware enough to know you are "B.S.ing" yourself about why you are losing? What if your notes said something else entirely—like how self-congratulatory they are about how smart you are to have done something so quickly that made your money back. "I am really getting the hang of this!" "Next time I will double-up on my position!" or something else that shows you have some sort of a juvenile need for approval. How much money will you lose because daddy didn’t hug you enough when you were a child? Maybe you should clean that crap up before exposing you and your family to more risk you don’t understand(?).

When you take apart your winners—what do you see? In this case I see a very discernible potential edge. When the market makes a try for a weekly low and stalls, maybe the order-flow is running out on the sell-side. If that is true—then it is only a matter of time before the market goes bid. In this case, this market went bid within 24 hours. This is a slam-dunk; no effort at all to define this edge. Here it is:

“On Monday morning I look at last week’s low. I place an entry buy-limit a few points off that low price with a resting stop-loss order under that low. Then I wait. If the order isn’t filled by Friday, I cancel it. If I am filled, I get out once I earn $500 because that is what it paid last time”

That’s it—no emotional handwringing, no study to see what could happen, no wishing/hoping/praying once I am in, no pain if I don’t get filled, none of that ridiculous hyperbole surrounding 99% of the dopes you compete with. This is a calculated try to exploit a probability that worked once before. After you try it for 100 times you will know exactly what this edge can pay you for the rest of your life; assuming you continue to use it EXACTLY the same way all the time; which is why you are journaling everything as honestly as you can. You want to create the self-awareness to know exactly what you are doing and why, so you can learn to discipline and duplicate your winning behavior.

Which brings me to this issue of “Enhancing” your edges or “Improving your system” or “Fine tuning your approach” Why would you need to do that? Because you discovered by reading your journals that you personally keep “fudging” your entries and/or your exits. You discover that you don’t really follow your edge or your system all the time because you keep second-guessing what the edge is doing. You think that “Maybe market conditions are different this time” and so you don’t follow through like you promised yourself you would. Instead of making money with your edge—you lost money because you did something outside of your discipline. Maybe your edge is fine—but you have an issue enforcing it. How do you intend to get to the bottom of that issue if you aren’t fully disclosing it? Again, what if you were not honest in your journaling?

When you know why you do—what you do—the way you do it—trading becomes effortless and profitable. Anything else will lead to a loss. To get to a perfectly disciplined individual, someone who is capable of full knowledge about their participation, you must study yourself enough to change what needs to change and keep what works for you. You must become a person of full disclosure. You need to fully disclose yourself TO yourself.

How are you going to do that unless you enhance your level of self-awareness?

Accumulating profit means that you are consistently doing more of the right things for you and few or none of the wrong things. It means that you have developed the skill to instantly know when you are about to make a trading error and either stop the behavior from happening or change your thinking; or both. You can’t accumulate profit if you don’t know WHY you make a profit to begin with, if you don’t know HOW to duplicate that winning behavior, if you don’t know WHY you have losses, and if you don’t know HOW to stop that losing behavior.

If you don’t make the choice to become self-aware—and I mean really get to the heart of the issues that you personally face when you trade—how are you going to enforce the changes you need to make if you don’t know what the changes are you need to make?

Your key takeaway from this chapter:

To accumulate profit consistently you must have more consistent behavior that is predicated on your market-centric paradigm. You must do the right behavior for you without exception and mitigate or eliminate your losing behavior. You must develop the skill of self-awareness otherwise you cannot know with certainty that you are operating from your market-centric paradigm. You need to fully disclose yourself to yourself in order to know why you do—what you do—the way you do it. Self-awareness leads to profitability and it assures you will keep more of those profits.

Part III

Creating and Enforcing a Winning Trade Paradigm

Introduction to Part III

"There comes a time when the mind takes a higher plane of knowledge but can never prove how it got there."

--Albert Einstein

Up to this point in The Psychology of Trading we have focused on parts of the trading experience that are mostly common to everyone. By that I mean, things like how the environment of zero-sum transactions are the same for everybody, how information is the same for everyone participating; although they all interpret it differently. How the difficulty of developing a winning approach is the same for everybody, etc., etc. There is only one way to profit but there seems to be an infinite number of arguments about how best to get there. Part of what makes the trading world such a challenging place to be a part of is the never-ending flow of "new" things that really aren't "new", but are all trying to solve the same problem: "How do I make more money?" I bet most of the readers out there would even settle for a solution to: "How can I just stop losing so often?"

In this section we are going to discuss some things that you probably have a degree of familiarity with and some things that you might be seeing for the first time. I want to make a distinction here before we begin and make the point once again that there is nothing really "new" in the trading world. Just because you are seeing something for the first time doesn't mean it is "Fresh", "New" or represents "Progress" in some way. It might just be "new" to YOU. Human beings keep going over the same ground all the time, generation after generation; and as a group are making very little progress. Everything you see today is not new, it is the same basic discussion we have always had; it's just a different color this time around. The same can be said in the markets. There really isn't anything new. I think it is important for you to know that everything we discuss in this section has already been discussed somewhere at least once before. I personally have taken some of the material and put my own point of view on it; and that is what I hope will resonate with you. I really want to impress upon you that the last conclusion I want you to make is to think that I am trying to push an agenda. I just want you to learn.

I really believe that any trader reading this can develop a net-winning trading approach for himself and do it anyway he wants. There is no “right” or “wrong” way to trade. There are only things that lead closer to a winning approach and things that lead farther away. When I teach this material to students as a live course I am always surprised as to what resonates with particular traders, but I am never surprised with the resolve those traders have to take it as far as they can go. In the long run, I believe that the resolve to win is more important than the edges you develop or anything else. Tenacity toward reaching a goal is the only skill you really need because it leads to all the other skills. Like Mark Douglas said: “The wanting to, IS the how…” If you absolutely refuse to quit on something you are trying to excel at, sooner or later, you will experience everything there is to experience and be forced to adapt to whatever you need to adapt to. That means sooner or later you will acquire the skills required to win in that arena. In the markets it is the same way. Our hope is that we just don’t run out of money before we finally have our breakthrough.

The reason I want to bring this to your attention again is because I don’t want you to get complacent or discouraged by investing time or effort into things you might be already familiar with. For instance, maybe you have been doing a lot of journaling over the years, but you feel it has never helped you. Try to see the material in a different light if that is the case. Don’t make the mistake of thinking you already know something and therefore it doesn’t apply to you. Everything in here regardless of how familiar to you it might be, can really help you in creating your edge—maybe a fresh perspective on the basics would do you a world of good. Try to see all the data for the first time and see if it becomes a better source of help to developing your market-centric paradigm.

Additionally, the material that might be new to you is (for the most part) could be considered my personal take on what you might find in the available market-related material that is out there. I don't believe I am presenting proprietary material you can't get anywhere else. No one has a mortgage on the truth. I feel fairly confident everything we are going to discuss here has been discussed somewhere by someone at some point in the past; maybe not as concisely or with my degree of thinking, but it is the common ground needed to win. Everything in here I personally learned through the same process you are learning through. I read countless books, attended countless seminars/webinars, listened to countless audio tapes, watched hundreds of instructional videos; I absorbed so much material that I believe if there were a Ph.D. in Markets and Trading, I would have it. Most of the material I found was basically saying the same thing over and over again and what I learned is that most of what it was saying wasn't congruent with how money is really made. THAT is the fresh perspective and THAT is what would be "new" to you. I try to put the intention of all the material I have found (or have created) into the context of the zero-sum environment.

I think it is important for you to know that every winning trader I spoke with or read about did basically the same process for the most part. Not one person tried to communicate that they had some "secret" about the markets. In fact, quite the opposite. If I sat down with a winning trader and asked him one of those freshman-level questions (like: "How do you make money?") I was always surprised to hear how forthcoming they were. Most of them would talk for hours if they had the time. Not one asked me for any money. I probably learned more that way if the truth were told. The point is that those traders with the knowledge needed to win already know what they need to know and don't need anything more from anyone. They were happy to share their knowledge if you were willing to listen. I consider myself in that group today, but I still offer additional tools and help for traders wishing to invest in that direction. I said that because I don't want you to think that if you continue to finish this book and apply what you have learned—that there is something still more I am going to ask from you. That isn't the case at all.

I want you to know that everything from here forward is material that is common to all the winners and is really the sum total of what I personally learned to apply for myself daily. It isn't a "prelude" to investing more money to get "The Whole Story" like some other author/traders have tried to do. If the material resonates with you—there is a reason for that. Look for the reason. If it doesn't resonate with you—or seems like you have heard it all before—take a fresh look at it anyway and look for the clues. When we put it all together it will make perfect sense. In the meantime, the pieces are like a jigsaw puzzle in a box; you have to figure out how it all fits together. In the case of the markets, most traders already have most of the pieces they need to make a winning approach, they just don't know that. Unlike the jigsaw puzzle, they have no picture on the box-top to compare their pieces to. Part of the intention of the material in this section is designed to produce a picture of what your winning paradigm "looks like". Once you have a better idea of what the construct will be for you, what your Box-Top looks like, I think you will be pleasantly surprised to learn that you were very close to putting it all together anyway—you just were missing one or two reference points and/or missing one or two pieces of the puzzle. Once you can observe everything in context it will all make perfect sense.

As you work through the material in this section you might already have a baseline of comparison; that's good. If you don't, that's OK too; it's all there sooner or later in my opinion. Some parts of the material might make better sense than other parts at first so just keep reviewing everything until you can see all of it in context. Think of this next section as providing you with a clear image for the box-top of your personal trading jigsaw puzzle. Once you know what your paradigm is supposed to look like and how you keep it functioning, you might be surprised at how little you really need to do to flip your switch from "lose" to "win".

Proper Record Keeping

"Keeping a journal implies hope."

--Erica Jong

In this chapter we are going to discuss proper record keeping. I am going to introduce you to some specific kinds of record keeping in addition to just your daily journal. During my journey to develop a winning market-centric trading paradigm I discovered many things about information and how it is used. You would be amazed at the kinds of information compiled from some places and even more amazing is what it is supposed to provide to someone. For example, did you know the U.S. Government employs a person whose job includes compiling information on how many truck tires are sold? The idea behind the data is that somehow counting truck tires and then comparing that data to something else is supposed to provide a good projection or clue on how healthy the US economy might be. In my view, that is sort of like trying to project how big a heard of cows might be by counting the legs and dividing by four…just more redundant B.S. that circumvents the real issue if you ask me.

During my journey I also came across a book titled How to lie with Statistics (W.W. Norton & Company, re-issue edition C. 1993) by an author named Darrel Huff. I found it a fascinating read because when I was younger, I had always assumed that information presented as "statistically accurate" really meant something accurate. Why would someone like the USDA lie to me about the health benefits of dairy? As I became closer and closer to my goal of being a winning trader I discovered that statistical data from almost anywhere that is supposed to be accurate is really compiled to support only one point of view; and usually it is for the point of view of the person paying for the data. Data used by the markets is even more head-spinning because it doesn't matter what the data is—it can ALWAYS be seen in two different ways: either "bullish" for people who want to see a price rise and "bearish" for people looking for a price decline.

Information that is compiled and then statistically massaged by some rational is really just an invented tool that rarely tells you anything about the issue it is supposed to tell you about. I'm not trying to split hairs, but when someone like the Peace Corps, for example, is using information about how many people are starving in Africa as a reason to increase their budget—wouldn't you want to know how they got the statistics about how many people are starving in Africa? Did they actually send a group of people out to count starving people? Where did they send them to? Who decides what line has to be crossed for someone to be considered "starving"? How big was the sample set? How long was the data compiled for? What about the starving people in Detroit? Will the money given to the Peace Corps reduce the money sent to our own children here in the USA? All you need do when someone tells you their information is "statistically accurate" is ask a few questions about where their data came from and why it justifies some action or expense, and their argument will unravel in most cases; including the "bullish" or the "bearish" one.

I am not saying that statistical information is "bad" or always meant to deceive. I am not saying the Peace Corps is a "bad" program, I am saying that if you aren't careful you will assume things that are not really accurate if your statistical information is not properly compiled according to a pathway that leads to healthy conclusions. Your record keeping is subject to the same rules. Collecting information about your trading participation has to be the sort of information that will stand up to scrutiny. You can deduce some very accurate things about your trading that require only simple little fixes when the bulk of your data is the right kind of data. Compiling information and reviewing information needs to be done under the guidelines of a serious discipline. You need to compile lots of different kinds of data but the most critical thing about the information you compile from your record keeping is accuracy. You don't want to lie to yourself by compiling inaccurate data.

You need complete accuracy from all your record keeping because the data you are compiling for yourself is the absolute most important and significant data you can possibly create in hopes of building your winning paradigm. It is without a doubt the most crucial part of your success and if you miss the mark on any of it you could set yourself back years. Your data, when properly compiled and analyzed, will show you precisely the changes you need to enforce to earn your fortune; if you collect inaccurate data you will form inaccurate conclusions leading to a greater potential for loss. I really can't overemphasize how critical proper record keeping is to a market-centric paradigm. It must be done, and it must be done right.

When we discuss proper record keeping and accuracy with compiling our records it is important for you to know exactly what that means so you can start right from the beginning without duplicating errors. As time goes on you will likely want to ADD parts to your record keeping once you have identified potential for growth in your paradigm. For example, you might be doing a great job of keeping perfect records…. then you notice something different about some price action you hadn't seen before. What is really happening is that your mental acuity working in the background (your subconscious) alerted you to something it has "seen" and exposed your waking mind to it. That "something" you are now aware of has ALWAYS been there, but it wasn't until your paradigm was "big enough" to handle it that you "saw" it. Your mind had to grow into that potential. You now ADD that information to your record keeping and you now are beginning to collect slightly different data in order to create and test a new potential edge. That edge wasn't available to you before—so why would you be recording data for it? Now, if you begin recording very accurate data to test that potential edge; suppose it has 3X the profit potential than your existing edge?

Therefore, at the start of this process, we are going to create and enforce data collection according to an open-ended format. That format will include a high degree of accuracy for what is being collected and it will leave the door open for greater detail and more comprehensive information later if you require it. So, let's confirm the proper format(s) for data collection. We will discuss each of these in more critical detail later in the chapter; plus, I will provide samples of proper record keeping in the appendix.

You are going to require THREE kinds of information/data. They are as follows:

1. Personal Thinking Journal

This is a daily, hand-written (for now) log of everything that goes on in your head when you trade. You will write down your logic and tool use (what analysis you do and why you value it) for every trade. You will write down what you are thinking about when you are not trading also; such as when you wake up in the morning or just before you go to sleep at night.

2. Trade Execution log

This is a written log of every execution you do. It will include a lot of data and you most likely will want to create this using something like “Excel” or another electronic format. I personally keep two of these—a handwritten log AND an electronic log.

3. After Trade Data

Once you liquidate a trade you will need to collect price action & other data from the market after you no longer have your position on. This information is very important to increasing the viability and profitability of your edge(s).

These three forms of data collection need to be compiled regularly and they need to be reviewed regularly. What we are going to do right now is look at each of these formats in detail before we begin the discussion of how to use the data together.

Your Personal Thinking Journal

When I was first exposed to the need for a thinking journal the image I had in my head was one of a 12-year-old pre-teen female writing stories about meeting the perfect boyfriend where each page all began with: “Dear Diary—today in class he looked at me….”; complete with rainbows in the margins and ticket stubs taped to the “our first date” page…NO FREAKIN’ WAY I WAS DOING THAT…

If you have a similar image of journaling I totally understand; it is very unusual to find anyone who journals today with any regularity. Aside from other winning traders, I personally have rarely met anyone who keeps a journal; certainly not any professional-level or C-suite men. The professional level women all say “I did that when I was a kid”—very few do it now I suppose. As a side note, it is interesting to find that in certain high-risk environments journaling is not optional. For example, one nuclear submarine carries enough firepower to kill a third of our planet. The captain is expected to not only keep a journal (they call it a “Logbook”) but so are all of the top staff onboard. Those Journals are reviewed regularly by other top-commanders too—looking for things that need to be “ship-shape” because no one wants any loopholes existing that might lead to a vessel like that falling into the wrong hands; or lost at sea. Formula One race teams keep logs on how their racing cars are performing; looking for a way to gain a better edge over their competitors. Brain Surgeons keep logs on procedures and patient responses to prevent injury or death; the list is huge of high-risk professions where journaling is not optional. Maybe they don’t call it “journaling”, but it provides the same function.

In trading, the risk is very high that we could lose a lot of money; you would think that journaling might be done more often. Sadly, almost no one does it and even if they do—they aren’t recording the real data they need to improve their results. If you personally are resistant to the concept of journaling and/or have never done it before remember this: you are creating an advantage over your competitor that when used properly will become a source of skill and performance that your competitor cannot possibly stand up against. If it came in a bottle everyone would have it. It takes effort to become a winner and this is one of the tools that will put you on top. If it is uncomfortable to start journaling, then try to remember how it is going to eventually empower you to better performance; which is what you want.

So, what goes into our thinking journal? What should we record?

For starters, you should record the date and time you are writing an entry. You should find a time where you regularly start your journaling for the day and when you end it. I open my journal each morning on my desk and I start the day with an entry. At the very least, I journal at the top of the hour after I do my signal check for my proprietary system. In between signal checks or during the hour if I find I should write something down—then I record the time of the entry again. Date and time are important because it discloses continuity in your effort and when you do it. If I have executed a trade, I note exactly why the trade was done and my thinking behind it (At that point I also log the trade in my trade logs).

When I am writing down my thoughts, I make them as specific as I can and record as close to my emotions as I possibly can. A typical journal entry might be this:

“10:00 AM I just did my signal check, and nothing is active still. No signals anywhere for the past 24 hours. This is really frustrating because I really feel that XXX is ready to drop in price. I thought about just doing a manual entry but that would be breaking my entry rules. I really want to break the rules, but I am going to take a walk and clear my head. I got up late today and I think I might be coming down with something. I am glad it is Friday because I need the rest. If I am still fuzzy on Monday, I am going to take a day off.”

I will record everything—that might include the results of a 10-minute phone call, what I had for lunch, how I felt about visiting a friend the other day—anything and everything.

All of this is recorded because I have found that the less focus I have to what I am doing the harder it is for me to hold winning trades. If I find that a friend is calling me three times a week and every day I am executing a losing trade—maybe that conversation is taking me off my game. So, I might turn on caller ID for that friend’s number and let those calls go to voice mail. That might be because he is going through a divorce and that is just a negative call for me; and that is taking me off my game—breaking my concentration. I have also discovered that I can produce a lot of winning trades when I am feeling very focused after doing my trade reviews. So, I do my reviews every Saturday morning from the past week. It sets the stage for Monday morning better. I tend to make money on Mondays I find. I am getting ahead of the game a bit by providing samples here, but I think you are getting the picture. Please review the larger samples available through the appendix too; there are a lot of suggestions for you.

The actual journal you select to use needs to be one that you are comfortable using daily. I personally used loose-leaf paper in a three-ring binder because I could add or remove pages as I did my reviews or edits. Sometimes I would remember more detail about something, and I would add it to that day’s entries later in the week—so it was just easier to add a page or take one out. Any office supply store will give you a few selections of blank journals you could use. Some people invest in beautiful leather-bound blank books; as long as it still allows you to record the important details you need to compile; I don’t think it matters. Any journal you are comfortable with will do.

I had one client who used a voice-recognition software package and just spoke into a microphone all day. He then printed out the conversation and put it in a binder for review every afternoon. He would study it like a college textbook and highlight the important issue for him regularly. If you feel that would be a better option that is fine, I suppose, but I really feel that taking the time to physically write in a book will provide you with better discipline at first. You can always switch to a journaling software of voice software at a later time once you have the basics firmly in hand.

Again, I would encourage you to review the journal samples provided in the appendix. I have taken some actual samples from my own records as well as from students. They are highlighted with notations showing the value of the particular entries as well as the potential to be used when enhancing your edge. Remember, most traders do not do this discipline. That in itself should tell you how far you could advance when journaling properly.

Your Trade Execution Log

Your trade execution log is a very simple document, but you are going to want to eventually create it inside some sort of spreadsheet software. I suggest using hand generated spreadsheets at first until you are disciplined to compiling the data in your final format. I found that handwriting them created a firm discipline to acquire the data constantly. Once I had the final format completed I would just enter the trades into the computer but I found I was still writing everything down by hand on note paper regardless; I would always have a stack of notes to review in order to upload everything….so I just kept the hand written logs and did the data-entry at the end of the day. I found recording everything twice actually improved my "paying attention" to what I was doing.

The data you want to record is probably something already known to you, but you want to include more details. Additionally, when you start using your after-trade logs together with your execution logs you will see the benefit to collecting all this additional detail. I would suggest at the very least to record the following data in your Trade Execution Log:

Date/Time of entry

Position (L or S)

Market Entry Price

Type of Entry Order

Initial Stop-Loss order

Size of Position

Date/Time of Exit

Exit Price

Net gain/loss in Price

Net G/L in Cash

Type of Exit Order

Limit Exit Price (if used)

Date/time of Limit Order

Additionally, you will want to include this data when you move stops:

Date/Time of Stop-Loss Oder

Price of Stop-loss Order

Date/Time if Stop-Loss Executed

There is other data you could include if you were trading certain markets or certain instruments. For example, if you were a trader looking to write options you might want to include your time-to-expiration, what your “Greeks” were at entry, or you might want to use additional data from Futures or the underlying stocks such as 52-week highs/lows against the position, etc., There is a lot of available information inside your executions to help your profitability but it has to be recorded before it can be analyzed. We are going to get to this in more detail later but for now remember this: Analyzing the relationship between your results and your thinking is the key to improving your entries and your exits, as well as increasing your dollars won-to-lost ratio and your winners-to-losers ratio. Your data needs to be complete and accurate otherwise your attempts at making better performance won’t reflect your true needs. Again, please see the Trade Execution Logs samples in the appendix for additional clues on how to collect this part of the data you need.

Your After-Trade Data

Every trader has had the experience of liquidating a trade only to watch the market continue in the intended direction for much longer; resulting in lower profits or losing trades that could have been winners. Every one of us knows the frustration of getting stopped out for a loss and that exit price was the high/low of the move against us before the market reversed; and now we have nothing on when the “big trade” of the day or week was happening. In fact, these sorts of trading problems happen with enough frequency that it can really make an impact on our bottom line. Every one of us has looked at those results and asked ourselves: “How can I fix this problem?” “Look at the gains I am missing”

The answer to addressing this issue comes from your after-trade data. The data you want to collect includes price action post-trade but also involves time. You need to know what your average “time-in-trade” data is from both your winning trades and your losing trades. As a rule of thumb, until you decide to do otherwise for some reason relating to your personal results, I have found that using a “2X” number on time is about right for acquiring useful after-trade time data. For example, if your average time in a winning trade is eight hours, you would look to collect price action data out another 16 hours or so after you liquidated each winner. The data you want to collect is the “worst price” and the “best price” relative to the position, and the date/time each of those data points happened after the trade is liquidated. For example, if you were long a market and liquidated at four hours into the trade, you would look ahead 16 hours and find the best price that trade would have traded to if you were still in it, and the worst price in the trade if you were still in it. By using only that data and nothing else, we can hypothetically find an easy fix to a common problem. If you discovered that out of the last 20 winning trades that averaged 8 hours each, on all the ones you took off below that average time, If you would have held them to the eight-hour mark, some would have been stopped out for a loss and most would have captured more money than you received by liquidating early. In other words, by simply holding winning trades longer you will make more money on those winners, but the downside is a few will be taken out at a loss. Maybe making that one change to your behavior is a good thing—if the net gain between holding everything longer after deducting out a few losers is higher than what you are getting now from your winners.

I will give you a simple illustration of how collecting after-trade data can help remedy a reoccurring trade error. Bear in mind, I am assuming that you have been properly collecting your Thinking Journal data and your Trade Execution data because the starting point for resolving a simple issue like this one lies in seeing all three pieces of data in context with each other. If you aren’t collecting the proper data you can’t really begin to dissect how the problem is created by you, the trader; and you won’t be able to see how the issue is resolved by you, the trader. YOU create the problem that YOU need to solve—so you need to really have it clear in your mind and in your behavior how you are creating the very problem you now wish to solve.

So, let’s assume you have been collecting the data properly. We open the notes and review each trade where this problem happens. The first thing we notice from your thinking journal is that you had placed these trades almost always on a Friday morning and slightly before a major news event was to happen. Your notes on the trade analysis have a lot of “market should do this” or “The market is ready for that” verbiage. We read your notes after getting stopped out and we find a lot of “If only” wording…”, “I knew I should have waited until such and such first”, or “This happens every time! I need to stop putting trades out there before the right time” basically you are looking at “missing” the trade more so than observing the structure of the markets. If you are placing trades because you “don’t want to miss it” you are trading from fear. Fear is an emotion, not a probability. At this point, we can assume this much so far: You really don’t know the probabilities of this trade—and you enter based on fear. This is part of the problem we need to address.

Next, we look at price action and your notes from your after-trade data. Usually, after you are stopped out each time, we notice that about 60% of the time if you were never stopped out—those trades would have worked by the close of the week. In other words, Friday appears to be really important to this market; and if you are taking a stand early in the morning that becomes a solid edge by the end of the day more often than not—the problem is you are getting taken out too early before the trade works. Also, we notice that your typical entry price about an hour from the news event appears to be on the losing side of the market compared to the previous days’ closing price. In other words; the previous day’s close appears to be a great price-point to enter the trade, but you are usually in too early compared to that reference point.

So—let’s develop a strategy from this data….

Let’s take Thursday’s close as our entry price for this trade all the time, but we will use a market entry ahead of the news. Let’s look at the price of the market about 10 minutes before the news and see if the market is above or below our “Thursday’s Close” reference price. If we feel that the market is due for a sell-off, we want to SELL that Thursday close reference price; but the market ahead of the news is at some other price-point on Friday morning. How could we sell it? Well—if the market is BELOW that reference price 10 minutes before the news—we would enter a sell-limit order to sell on a price push higher. If the market was ABOVE that reference price, we would enter a sell-stop order for an entry as the market dropped in price. If we felt the market was due for a rise in price our strategy would be to use either a buy-limit or a buy-stop for an entry based on the same criteria. In this particular case, whatever analysis you are doing to determine a price potential appears to be operating fine—at least with this market on this day every week because YOU created the ability to find a trade potential that appears to be about 60%; that is significantly above chance. Therefore, we don't need to change anything in our study at least for this particular trade every week. In other words, your study isn't the problem and has never been the problem. The problem is how you are acting on it.

We now have a strategy for entering a market based on the probabilities we observed from comparing our accurate trade logs to our accurate after-trade data; not a strategy driven by emotion. Furthermore, we have a set of rules to enforce upon our behavior to avoid trading from fear or any other emotion every time we want to exploit this edge. We have a probability that is better-than-chance that the trade will work six out of ten times. We can do this trade 12 times a quarter for a likely win number of around 7 against a likely lose number of around 5. If we risk the exact same amount each time and wait for the close on Friday every single time, we have a likely chance at a net profit every quarter from this one edge. That means no matter what is happening during the day our exit is "market on close" and the stop is never moved. These rules might become different for other trades—but this one edge would need this sort of approach to work for a maximum profit potential.

Obviously—there is no way to know for certain what the actual outcome of this strategy might be until it actually trades every Friday; but the fact is by proper record keeping you discovered why you were losing so consistently in a market opportunity where you had a solid chance of net gains. By proper record keeping compared against the actual history of that market you also could find a strategy to exploit the actual events that seem to transpire regularly. Again, nothing is certain, and we already know that. But by using our collected data, and properly applying our new paradigm, we are able to put the probabilities on our side without any emotional interference. By using your head for more than a hat rack you now have at least one solid edge you can exploit once a week. How many more edges can you find? That is how a winning trader thinks. The problem isn't "more study" or changing anything you are doing to find an opportunity. The problem is you and how you behave. Find out what you are doing as accurately as you can, and you can dissect your behavior to see where you are hurting yourself. It becomes a simple matter to fix the behavior—as long as you follow through.

I want you to notice also that at no point in the discussion was any sort of "technical analysis" or market study performed to find a solution to the problem. We never discussed price either. The reason is because the ENTIRE EVENT occurred inside the mind of the trader. The COMPLETE BEHAVIOR by the trader created the opportunity that he saw, the method of trying to capture the profit, and the entire entry-to-exit results. The trader saw what he saw however it was determined to be seen. All of his actions were based on how he saw things —nothing else. All that needed to be done was find a better way of behaving by studying the self-created results. Your record keeping holds the key to finding those needed data points.

To close this chapter, let me remind you again that your record keeping is the number one item on your arsenal of tools needed to create a winning market-centric trade paradigm. You have to have the real, accurate data that shows you exactly where you are on track and where you are off track with your trading. Your record keeping will expose the true quality of your thinking and your behavior, so you can clearly see how your thinking becomes your behavior and how both need to change. Your after-trade data becomes especially useful when you want to pose some hypothetical questions to explore solutions. You might find that fixing whatever is missing requires only a minor thoughtful change; nothing really major at all, but enough to make a difference so your probabilities start dropping to the bottom line. The more accurate you make this data the faster you can begin creating useful changes.

Your key takeaway from this chapter:

Your record keeping can be a powerful method to assist you in developing a winning trading approach. The most significant part of record keeping is accuracy. The more accurate you can create your records the more likely you can improve your results and the more possible those results will be repeatable. Because you create 100% of your results within your own mind, more market analysis/study won’t help you improve your results. Only self-study can improve your results; and you can’t do that without solid accurate records of what you are thinking AND doing when you trade.

Identifying Opportunity to Profit

"Unless you have prepared yourself to profit by your chance, the opportunity will only make you ridiculous. A great occasion is valuable to you just in proportion as you have educated yourself to make use of it."

--*Orison Swett Marden*

In the last chapter we explored how keeping very accurate records can be one of the best tools you could have in your quest to refine your trading. The key is in understanding how to use those tools effectively in order to exploit the opportunities you discover. As we discussed, most traders have no idea how useful those tools can really be, but we still need something to consider as a profit opportunity; otherwise those tools have no meaning and can't help us at all. Up until now our conversation has not included how to find those profit opportunities. What is the point of perfectly recorded data if you don't know how to find a real opportunity? This chapter is going to provide you with some basic constructs for discovering real opportunity.

Remember, real opportunity is really only a function of probabilities. No one can know with any degree of certainty that any market will move in an intended or expected manner. All the of the generally agreed upon research/analysis/training etc., has no potential to predict or project price action beyond a certified "maybe". Everything we could possibly do to help our trading really lies within the confines of our own craniums; there really isn't anything we can rely on past our own thinking except our own understanding of the probabilities.

Understanding probabilities combined with our highly accurate record keeping will create a huge advantage for any trader willing to do the work involved. If you have committed to writing everything down when you execute, writing everything down about your results, and then asking good questions after you review that data in context with your post-trade market data; all you need now is a solid better-than-chance profit opportunity to apply all this to. Combine all that together and you have a winning formula for success; assuming you don't screw it up re-thinking it all or second-guessing what you find. Yes, we will provide some tools to help in those areas too once we get to the appendix; for now, we need to create a better market-centric paradigm for profit opportunity. We need to know what exactly constitutes an opportunity when we are trading.

Opportunity as a Function of Environment

People have gotten rich by doing some very unorthodox behavior; sometimes to the point of hilarity. If you have the time, I encourage you to study The Mississippi Scheme as a point of reference leading up to the French Revolution; around the period just before the rise of Napoleon. At the time, there existed a virtual frenzy of speculative fever running rampant through the populace of France. Putting aside all the other huge impact this time in financial history provided, there is this unique story of an old man with a hunchback living in Paris during this wild speculative event.

People were buying and selling shares in the Mississippi Company with an absolute frenzy. The price of shares could rise or fall anytime for any reason or because of any silly rumor running through the streets—a very similar environment seen during the tulip mania in Holland a century or two before; or in New York City a century or two later…People were making or losing fortunes almost daily some historians recorded.

During this time, a peasant farmer with no skills or money saw all this happening around him. He suffered from a medical condition leaving him with a pronounced hunchback. He noticed that people were yelling at each other all day long and agreeing to the most radical financial commitments all around him in hopes of securing a part of the money-making craze for themselves. According to history, this uneducated illiterate peasant man with a debilitating medical condition apparently is one of the few people who lived through the Mississippi Scheme and died with a small fortune. Apparently, he never bought or sold shares. Rather, he rented out his hump as a place where people striking deals in the street could sign contracts. The man charged a fee to use his hump as a flat surface to execute legal documents. This man simply saw that other people were willing to do something that he himself had no interest in doing. He provided them a place to do what he himself wouldn't do. It's like a Vegan running a roadside bar-be-que stand. Some people get rich by watching the world around them and finding an opportunity where others don't see one.

Opportunity is a function of the environment you are in. If you are in an environment where contracts need to be signed—you can make money by offering a place to sign contracts. If you live on a tropical island, you could make money by selling cold drinks to hot tourists. If you live in a war zone—you can sell bullets to both sides and double your money-making potential…opportunity is everywhere.

Creating opportunity is a factor of environment and observation. We as traders live in an environment where we have to do exactly what? What is it that you and I need to do? We need to observe an opportunity to get on the right side of the order-flow. That's it. How do we do that? We do that by making observations that have a degree of probability to them. The probability is a function of the environment. To identify a profit opportunity, we need a clear understanding of the probabilities that are available in the zero-sum environment.

What are the opportunities offered inside a zero-sum environment?

The ONLY way to profit is to buy a low price and sell a high price. Inside a zero-sum market you can do this in any order. You can BUY or SELL any zero-sum market anytime and wait for the price to move in your favor. If you BUY first—you need to wait for the price to rise to profit; if you SELL first—you need to wait for the price to fall to profit.

Therefore, you have two profit opportunities with which to exploit potential price action. However, because we can't know which way the market will move in price until it actually moves, we need some sort of projection of a likely price move in an intended direction. Postulating this intended price change and taking a position ahead of the change will increase our profits when we are correct in our price-direction guestimate.

But we have a problem. No one can accurately produce a consistent projection of a price move. So, as we have discussed before, the most accurate projection of a price move is to somehow gain the knowledge of where the order-flow will develop into a loser-driven liquidation imbalance causing a significant change in price. Where do those price points develop?

I'm going to offer a solution to this problem, and I need you the reader to follow me closely. Many traders make the mistake of thinking what I am going to discuss now is a rudimentary technical analysis method or a hypothesis on how to find order-flow. That is not what we are going to explore. We are going to explore how you see things to create your opportunity so you can duplicate high-probability behavior once you know what it clearly is for you specifically.

First, to begin with, the market itself can only do THREE things as far as price action is concerned:

1. The market can trend HIGHER in price over time.

2. The market can trend LOWER in price over time.

3. The market can trend SIDEWAYS in price over time (Trade in a Range).

Each of these three kinds of price potential contains and either/or scenario. Either the trend will continue, or it will end (reverse or resume).

In other words, if a market is trending higher it will sooner or later stop moving higher and reverse, or it will resume moving higher after some amount of time when price isn't moving. The same scenario exists for a down-trending market; it will either continue to move lower in price or it will reverse. A sideways market will either continue to range-trade or it will end by breaking higher in price or breaking lower in price (in other words END range trade and RESUME with a fresh trend higher or lower). A range is a "pause" before up/down trend resumes.

Additionally, you the trader, are under no obligation to join any of these three price-potentials until you want to, and you are free to stand aside as long as you want. Between these three market states and your personal choices you have a total of 12 potential opportunities developing all the time. Here's the math:

Join the trend in progress equals THREE potential opportunities:

1. BUY an uptrend

2. SELL a downtrend

3. STAY IN RANGE (Buy the bottom of the range and/or sell the top of the range)

Reject the trend in progress anticipating an end to the trend equals THREE potential opportunities:

1. SELL an uptrend expecting that to be the final top in the market for a period of time

2. BUY a downtrend expecting that to be the final bottom in the market for a period of time

3. Expect a range to end with an upside breakout OR a downside breakout

That provides you with SIX potential opportunities and you can choose to get in or stay out for a total of 12 choices present at any one time providing you with12 profit opportunities at any time. Staying out of a market until the probabilities are more favorable for a particular choice is also considered a profitable execution. More on that later when we get to execution in part four.

Here is the part you really need to think through:

You and you alone must decide when a market is trending and in which direction, and when it is in a range. Some people watch price action and conclude the market is in range but someone else would look at the same price action and conclude the market is trending. It doesn’t matter what criterion you use to create a market opportunity as long as you use the same criterion consistently all the time; otherwise your record-keeping will not accurately inform you of the probabilities your observation has. Every method of consistent market observation has a degree of probability to it. You must do your observation the same way all the time in order for your record-keeping to show you those probabilities.

For example, suppose you decide to look at an O-H-L-C price chart on the 60M timeframe for the Soybean Futures market at the CBOT. The market appears to be trending upward because you notice that the series of higher lows and higher highs has continued after making a three-week low last Friday. Fine. Might be an opportunity.

Once you make this observation—that is how you need to look at the potential for an uptrend on this market every time. You must use the 60M timeframe again, you must start the process from a three-week low that happens on a Friday. If you use the 30-minute chart—your probabilities will be different. If you start from a monthly low—your probabilities will be different. If you use the same conditions on another market such as Crude Oil Futures, your probabilities will be different. If you are one of those traders who might say: “But conditions in the markets are ever-changing; the market might make a solid low any number of ways so doing it the same way every time might cause me to miss a really good trade” I would agree with you but I would also ask you: Why would you risk a loss on a probability you know nothing about? Maybe you need to develop four or five different scenarios for bottoming in the Soybean Futures market; all with very well-defined probabilities so you know EXACTLY what you stand to gain or lose if you choose to put that long on. If you did that it is the SAME set of choices present at all times: You wish to buy an up-trending market and do it as soon as you can after a low print. THAT is your best probability—the fact that the Soybean market makes the turn to “uptrend” slightly differently each time might be important, or it might not be; that is for you to decide. But to take an undefined risk because you “don’t want to miss something” MEANS you are trading from fear of missing out—not from defined probabilities about a potential change in the order-flow. YOU—and only you—have to define exactly how you will observe “Uptrend”, “Downtrend”, and “Range”; then you must use that definition every single time you attempt to find an opportunity. In my third book, Time Compression Trading (Wiley & Sons Publishing, C. 2010), I discuss details about how to better exploit these three market conditions and the psychology behind them. I would suggest you consider getting a copy and thoroughly review that discussion.

YOU—and only you—must decide ahead of time exactly which probabilities you feel are the most suited to your observation and then build an execution formula around them. You must then enforce those choices exactly the same way each time. For example, if you decide that your best probability is to BUY when the market is in uptrend—you now need a method of getting into an upward-trending-market. But you must use that method the same way all the time—otherwise your probabilities are not consistent.

The point I am hoping to communicate to you is that all of this is happening inside your head and nowhere else. The way you see things is the way YOU see things; not the way someone else would see them. Therefore, you must know which probabilities are best suited for how you see things. You have 12 choices to participate; 6 active choices and 6 passive choices. You can either go in the SAME direction as the trend or FADE that trend (3x2=6); you can get in or stay out (6x2=12). Which choice today, right now, is your strongest probability? That is the only choice to make.

If you—not someone else—YOU—have decided that buying an up trending market is your best opportunity for how you see things AND you have decided that you will only get into the market when the price has sold-off some amount and touched the up trending line you personally have created the way you see it; then there is nothing to do until the price reaches that point. Your best opportunity is to stay out for now. No matter what the price does you aren't missing anything because YOU defined your opportunity the way YOU did. Whatever the market is doing before it reaches your best-probability buy point is someone else's' opportunity for the way he sees it. That's not your opportunity. Your opportunity you have already defined and there is nothing to do until the market trades that particular price for YOUR probability.

Once the price has declined to the point where it touches the uptrend line YOU personally have decided should be where the uptrend resumes; then the best probability is to BUY the market right there. Or if you are particularly comfortable with how well you have identified the opportunity, you could place a price buy-limit order at a point somewhere along the uptrend line you have created. In any case, there is nothing to do (one of your choices) until the price reaches your price-level that you decided was the best level to participate (another choice). From here forward, you need to record everything that happens until you liquidate. Was the trade a winner? If you followed that exact method 100 times, what percent were your winners? Again, your record-keeping provides you with solid data with which to augment something to reach a better probability with this edge.

Most traders never do a controlled process of defining opportunity according to what the best probabilities in the markets are for them; they use all sorts of price-dependent ruminations based on obscure mathematical concepts or use methods that others have told them will work; or God only knows what they do. If you define opportunity as a function of the environment the market creates for you—then what to do next is self-evident and requires very little effort. The market provides you three conditions to participate with: Uptrend, Downtrend and Range. You provide the choice to participate according to the probabilities you feel work best for you. Now there is nothing to do until those probabilities show up.

You don’t have a choice to “go long” or “go short” today; you have 12 choices that define probabilities on your behalf until the best probability tells you what to do at this moment. You create that potential completely by yourself entirely for your own benefit—so you should have no trouble enforcing it. You should have no emotion interfering with it either.

Your key takeaway from this chapter:

Identifying opportunity is a function of how the zero-sum market environment is constructed. The market can only do one of three things at a time—trend up, trend down, or trend sideways. When you personally define each of those market conditions for yourself, only you can decide how to exploit a coming price change based on what you feel are the best probabilities offered; go with the trend or against the trend—or stay out completely. These 12 conditions become your probabilities and there is nothing to do every trading day except enforce the best one as defined by you.

Money Management

"Good money management alone isn't going to increase your edge at all. If your system isn't any good, you're still going to lose money, no matter how effective your money management rules are. But if you have an approach that makes money, then money management can make the difference between success and failure"

--Monroe Trout

In my second book, The Art of the Trade (Wiley & Sons Publishing, C. 2008), I discuss some of my early years in the trading business working in downtown Chicago. Aside from the massive heartbreak and financial losses I had for years until I finally had my "epiphany"; I did experience a handful of times when I experienced solid opportunity; both in the markets and with the people I was associated with. One time in particular I began working for a very well-respected man who owned a brokerage house clearing trades through the CBOT. This was just after the new year of 1988 and just before the drought hit that devasted the grain markets that year. It was a huge mistake to quit working at that company and got to work for a "boiler-room"; but that is a different story. One of the traders I worked with at that company gave me a piece of advice that I never forgot. He said this: "When you have a winner on, roll your protective stops regularly to lock in some gains; then just let it ride… The big money is in sitting tight doing nothing."

Oddly enough, that is the same advice Jesse Livermore gave to traders more than 100 years ago and it is still almost universally ignored by traders who compete every day in the markets. Part of your using money management tools is the knowledge that most traders you compete with are closing trades WAY TOO

SOON and giving up a huge amount of their potential gains by doing so. Although this chapter is on basic Money Management, I feel that we should look at this issue through different eyes with different motivations. Money Management is another one of those things that you as a trader need to make personal choices about. Money Management is slightly different for everyone and the only money management that matters is the type of control you personally want to use. It’s OK for your personal money management to be different from someone else’s.

It’s my view that money management needs to be seen in a different light for leveraged transactions than for other kinds of financial arenas. Executing trades in a zero-sum market requires a different deployment of capital than other kinds of investments. When discussing money management for your trades I feel there are certain ground rules you should consider but the final authority has to be your own tolerance for risk.

Bear in mind, there are lots of existing discussions floating around the financial community that break down Money Management into a very specific set of rules/instructions that all will allegedly help you get more positive results for your investment. The fact is, most of those discussions are not considering the specifics of speculation in zero-sum markets and most do not understand the relationship of risk capital to your overall investment potential.

Money management rules often make assumptions about results and the marketplace in general that are not common in the trading community. For example, a common rule is “Take a percentage of your gains and put them in low-risk areas, such as bonds.” In my view, what is the point of that? First, most traders don’t have profits to begin with so suggesting to them that they need to be prepared to move funds to low-risk environments becomes a non-essential thing to discuss. In fact, that isn’t really money management help at all; that is more like investment advice.

I think it is crucial for your developing market-centric trading paradigm to redefine your understanding of money management to something else; something better suited exclusively for trading. Forget everything you have heard about capital controls and start thinking like something else. Think like someone who is willing to make the hard choices required to get rich.

Let’s discuss goals, motivations and the unexpected. What we need as traders is an understanding of how our participation creates opportunity outside of the markets as well as how to protect and grow our capital within the markets.

Why are we doing this?

We trade because we want to make money; a lot of money. However, trading is a very difficult thing to do well for most people. I believe this is true because most people who get started have no real education for trading at all. As we have discussed throughout this book, the vast majority of traders are taught things from mostly well-meaning people that have nothing to do with taking money out of the markets. As a consequence, most traders’ expectations are shifted to capital growth instead of capital preservation. You (and everyone else) will have a learning curve that might exceed your trading stake if you aren’t careful. Instead of a focus on wealth creation you really should have a focus on wealth preservation. It is simply unrealistic to think that you will be making regular and consistent gains during your first few years in the markets. I would strongly suggest that you plan on a learning curve of around three to five years of “clock time” You would therefore need a plan to help you preserve your trading capital so you can continue to trade for several years without a net gain. Your focus should be more on “What could I lose?” as opposed to “What could I make?” when opening a trade. That would mean ignoring one of the big things people are attracted to the markets for:

Leverage

Most traders are exposed to leverage for the very first time when they open their first trading account; they have never seen it anywhere else. Because of their unfamiliarity, most traders typically over-leverage their positions. When they suffer a solid loss it often results in a really big hit to their equity; 20% or more might go up the chimney from a single loss. That is just not acceptable if you intend to make a career out of this. Additionally, larger losses tend to help in the process of creating emotional attachment; by that I mean large losses tend to exacerbate the emotional instability traders experience. It adds pressure to the “Now I have to get my money back” thinking. Losses are part of the business of participating. Most traders who have a net-winning approach usually have a win/loss ratio that rarely exceeds 55%. That means even if you become one of the best ever in this field you will lose almost half the time anyway. What do you think will be more common if you are a newcomer to this game? Most likely you will lose on more than half your trades and sometimes you will have a lot of losers in a row. That can be very discouraging and frustrating to begin with—now add a drop of 50% to your equity on top of it because you are using leverage incorrectly. The best solution is not to leverage at all, in my opinion. View your first few years at this as an education your losses are paying for—like going to college. My personal suggestion is to not use leverage in your trading at all until you know how to duplicate winning behavior regularly enough to put in a few back-to-back winning quarters. I personally trade only at 2X up to 3X leverage to keep my downside capital preservation at its highest; and I only use this much leverage because I know how to do this really well. For many years I didn’t leverage at all. Here’s what I mean by that:

If my account balance is $50,000 then the absolute LARGEST initial trade I might make would have a contract value of $100,000 or so. Usually I would start a trading campaign with a smaller position, but I am trying to keep the numbers easy for you. Let’s say I wanted to trade Crude Oil and the price of Crude is $60/BBL today. The CL contract size at the NYMEX is 1000 Barrels. That means the contract value of ONE contract is $60,000. I might open a position with a two-lot, meaning two Futures contracts that have a combined total value together of $120,000. If the trade worked, I might ADD one more contract later according to my rules—but the point is that a one-contract position is barely leveraged at all if I have a $50K balance to start with.

The exchange will typically require a margin of around $2500 per position for someone like me so if I had a two-lot on I would have a margin requirement of about $5000. Most traders confuse the margin required for the position with the leverage involved and this is why they have such huge losses when they are on the wrong side. I have seen people with a $10,000 account trade a three or four-lot of Crude Oil; people who have never traded before. This account will have an exposure to the market of 4000 barrels of CL with a market value approaching $240,000! (When CL is around $60.00/BBL) A 1% change in the market value of this position will create an Open-Trade loss of almost 25% to the account equity! The price of crude would only need to change about $0.60 for that to happen. Yes—a move in the right direction would create an open-trade gain of around 25% too—but you and I both know it is more realistic that a favorable price move won't happen; at least not at first. This is a typical case of over-leveraging. In my case, a $0.60 move against me will expose me to an OTE loss of around $600 typically; maybe as much as $1200 if I was trading larger. Against a $50,000 account size that is a very manageable position and very manageable equity exposure.

I think your fist choice when it comes to the money management you personally are going to use is a very serious discussion about whether or not your account should be using leverage. You don't have to use leverage. In today's markets there are all kinds of smaller/mini/micro contract sizes that allow you to get very good market exposure while controlling your equity risk so you can participate without leveraging if you so choose.

Diversification

In my view, diversification is for investments; not for speculation. The thinking behind diversification is to spread your market risk over as many different places within the economic growth picture as possible; the intention is to avoid putting "all your eggs in one basket" because something, somewhere is going to lose;

and we need to have as many gains working to overcome that loss. It would be terrible for our one basket to be the loser (and I agree). On the other hand, when you are speculating, you are supposed to be OK with the risk in the first place—otherwise you wouldn't have an account open. It isn't about avoiding a risk—it's about knowing which risk to take and getting paid a lot to do it. The better advice in zero-sum speculative markets is "Put everything into one basket—then WATCH that basket!" In fact, that is what Phillip L. Carret says in his book, The Art of Speculation (Barron's C. 1930).

When you think of diversification in the investment community it is more like saying you will invest a lot of little amounts into 20 different car-makers because you expect the car-making sector as a group to do well; but you just don't know which car-maker will out-perform all the others. So, it is safer to just "buy the whole sector" than to pick one car-maker. Obviously, this is where Mutual Funds, ETF's and SPDR's all came from—the desire to spread the risk around a whole sector that includes everybody. It is a great idea for investments—but a horrible idea for speculation.

What creates an opportunity for a really big move that can make you rich (whether you leverage or not) is the concept of a supply/demand imbalance. I am not discussing a specific day-to-day market with a reoccurring liquidation order-flow imbalance; that is how you can get positioned WITHIN the larger over-reaching reason to be involved in the first place. Let me give you an example, suppose there was another really big shooting war in the Middle East—something that involved half the worlds' countries on one side and the rest on the other; something like the first Persian Gulf War in 1991. The price of Crude Oil is going to change; I think you could safely assume that. A situation like this has the potential for the price of the underlying commodity affected to double or triple in price (or more), for supply disruptions to make the price of energy everywhere spike so high that people start looking for other forms of energy, to cause political changes that might last a lifetime; it is a BIG DEAL….it is not time to trade a one-lot if you can afford to do better. If you can afford to plunge—there is a time and place to do it.

Every year the zero-sum markets produce two or three really big opportunities. Those are your “one basket” opportunities. You want a larger portion of your available capital committed to those potential trades. Obviously, you don’t have to trade them if you don’t want the risk—if you do want those trades you still don’t have to leverage—and besides those two-or-three big opportunities there are daily/weekly/monthly/seasonal etc., opportunities all the time anyway.

So, don’t think about diversification the same way you do when thinking about your traditional investment portfolio. If you think diversification at all, I suggest you think about it in terms of “non-correlation” I personally don’t believe that there are “correlations” in the markets anyway but there are enough people who do. It tends to appear as if some markets behave opposite to each other or lag each other. Meaning if something like the price of Gold rises; the stock market will fall, etc., etc., there are hundreds of such comparisons that I think really do more harm than good, but that is a different issue. If you think about diversification more along the lines of “non-correlation” you might be able to help your trading a bit with the bottom line; although I personal believe the “one basket” approach is the better one.

“Non-correlation” means that you will be oppositely involved with one thing against something else just so if one trade loses the other might make up that loss plus more. Richard Dennis said that if he was short something like Grains; he always wanted to be Long something that wasn’t influenced by grains against it; like maybe a stock index or lumber. If you decide to use some sort of “non-correlation” method with your money management just remember it is only a point of view on how best to exploit the markets. Your best probabilities come from a deep understanding of why you do—what you do—the way you do it. It really doesn’t matter what you finally decide on as being important for your money management as long as it is founded on common sense to avoid over-leveraging, and you have some sort of downside protection on for when trades go against you. After you explore your options, if correlation or non-correlation doesn’t resonate with you—that’s OK. If the issue of whether to leverage or not, or the diversification question simply doesn’t resonate with you—that’s OK too. You are free to do something else that does make better sense to you. All of these money management ideas are just people’s attempt to solve a seemingly insurmountable problem: how do I make the most money with the smallest risk? You have to find your own balance, but these three initial concepts at least give you a place to start the conversation for yourself. Once you have these issues decided you need to adapt your daily money management rules to your own personal style of trading. That brings us to:

Record Keeping and Money Management

In my opinion, this is where the fun begins. Record keeping can add a lot of powerful data to your considerations for a better market presence. You are attempting to answer the above question for yourself I am sure—how to make the most money with the least amount of risk? Everyone asks that question. But most traders don't understand the importance of self-study to get a reasonable answer. If you have been paying attention up until now you will have noticed I believe that almost 100% of your results happen the way they do because of the way you think. EVERYTHNG happens after you have some thoughts in your head, which then become actions; that will then result in a change to your account balance. Every time you trade your account balance changes. Your actions determine that result. If you think a certain way you will get certain results. Change your thinking to something else; you will get different results. I didn't say "better results"; I said "different results" if you want "better results" you need to better define what you are looking for and know how to ask the right questions that will get you there. This is the place where your accurate record keeping touches your money management.

If you have been collecting accurate data, we can now begin asking some important questions that will help us create some different scenarios for our participation. Since all of our money management boils down to when we get in and when we get out combined with the size of our trade, what we need is to understand how we are creating our results. Let's look at some of the data we are collecting and see how that will help us improve our participation.

One of the basic pieces of data we collect is the amount of money each trade wins or loses. We can easily calculate our average gain or loss, our largest gain or loss and the time we are in our average gain/loss. Why would we want to know this data? For starters, our risk on each trade should always be the same, roughly. We should not have a very large variance between our average loss and our largest loss. Why? Because we will have a known number of losses over each sample set and we need to know what our loss-potential is; otherwise we can’t make changes to overcome those losses. We have to hold our winners to pay for our losses. Our average winner needs to be at least twice what our average loser is; otherwise we can’t collect a net gain over a large enough sample set. In this case we find that for our first 100 trades had 48% winners against 52% losers. Our average gain was $300 with the largest being $600; our average loser was $250 with the largest being $400. With these two data point we know that we need to do at least two things: increase our average win and decrease our average loss; and maybe find out how to uncover more $600 winners.

First—we need to create a money management rule that must be enforced at 100% from this moment on. Our risk-limit on every trade must be $200. If that means we need to change our trading to a smaller contract size—then we need to do that. If it means we place a risk-stop on every trade that is never moved—then we do that. If it means that our average loss happens in the first three hours of a trade and we aren’t stopped out for a loss at the three-hour mark—then we liquidate the losing trade at three hours and take whatever loss is there. We can creatively figure out a combination of trade size, trade length and risk amounts together if we want; but the general idea is to find a way to reduce our average loser to a number that our winners can overcome AND keep those losing trades to roughly the same amount all the time.

Second, we need to compare our profit-exit price level to our after-trade data and see if we typically have more potential in our winning trades that we are leaving on the table. We discover that our average winning trade is around four hours long, but if we hold them to around seven hours, they usually have at least another $100 profit potential. Additionally, we discovered that most of the winners worked within the first hour and our market order to liquidate was on a reversal bar—meaning we panicked out too early when we mistakenly thought the trade was over. To resolve our winners a bit better we have some new winner-management rules; we hold our winners to the seven-hour mark every time or we hold it to when it makes $400; then we liquidate. To help with actualizing this potential on our winners, we place a $400 profit-limit exit order on every trade. Our winners typically give us a lead within the first hour, so at the two-hour mark the trade should have a reasonable gain in it; therefore, we will move our risk-stop to B/E. Some trades that would have been losers will now be break even, improving our bottom line.

At this point we have a solid plan to reduce losers to the $200 mark on average by never varying the risk-stop placement again. We have a solid plan to improve our winners to the $400 mark. We even have as part of our new money management plan a method to have a few break-even trades that will reduce our loss-potential a bit too. Now all we need is 100 more trades done EXACTLY according to this plan. Once we have that data—we can see what improvements we could make next—if we need to. Right now—if this plan can be enforced the existing numbers from the probability of ruin matrix say that there is a very strong potential probability that these changes have solved this traders problem enough to start making consistent gains. Again, this potential isn't because the trader is doing some radical technical analysis or market study—the trader is studying his own created data that comes from how he participates day-to-day. It's not hypothetical "testing" of ideas that have no basis other than some guess. Therefore, it is a very enforceable method, and it is really the issue that needs to be addressed.

In the appendix there are samples of record keeping that show you all sorts of data that can be used to create a set of money management rules based on the data that you, the trader, are collecting. Remember, your money management rules don't have to follow any specific method or plan, they only need to produce a result that can fit on the best side of the probability of ruin matrix for you. If that means your method of participation (meaning entry, exit and net change to your balance) is completely different than some other traders method—that is just fine. As long as you produce more money made from your winners than you lose on your losers, you will make money net—that is the only thing that matters.

To close this chapter, let me give you a few basic Money Management techniques that seem to help the typical trader stay in the game comfortably while they are creating their winning market-centric paradigm. These basics have been discussed in many formats, but I think these concise steps are very good at distilling the complex question of good Money Management to a simple and enforceable level for most traders.

1. Never risk more than 1.5% of your equity on any one trade. It is better to place an exit stop for this amount and never move the stop. The only choice is to move the stop to breakeven when the trade gives you a lead, never move a stop-loss order to assume more downside risk on an open trade.

2. Look for opportunities to make an average gain of around 3% or more on your equity. If the potential is not there—don't take that trade. When you enter the trade, always place a price-limit exit order at the objective.

3. Have some method where you are allowed to ADD to winning trades.

4. Have a rule set where you can and cannot liquidate your trades ahead of the objective or before the protective stops. In other words, when the probabilities you identified are not playing out as you had first observed. I.E. "All trades must be liquidated by Friday's close to avoid risk over the weekend" or something similar that allows you to take off trades for a solid reason you can enforce.

5. Once you reach a certain number of losing trades in a row—take a trading break and study your trades against your after-trade data. You might discover why you had a draw down and when the best time/price relationship exists to begin trading again.

6. Know the intended method of your system or approach. Only use it when it is most likely to win. Is your method a trend-following method? A reversal method? Or a breakout method? I.E. If a market isn't trending you shouldn't be executing with a trend-following system.

7. Set a time when you will take a trading break to keep your focus. It doesn't matter if you are ahead or behind in your equity growth. Take the break regularly to re-focus.

8. Once you reach a certain amount of winnings—take some money out of your account(s) and reward yourself for your gains. That's the whole point of participating.

As you can see—most of these money management rules are really designed to help you avoid stress and to keep you thinking clearly. That is where the money is anyway.

Your key takeaway from this chapter:

Your money management is a subjective thing that helps you maximize the results from your participation. You create beneficial money management by actualizing some underlying facts about the zero-sum trading environment; which is different from the money management needs of other kinds of investment arenas. The rest of good money management comes from asking good questions and reviewing your trading records together in hopes of discerning changes you need to make to your participation. As your money management grows and as your market-centric trading paradigm grows, together they are designed to improve your net gains.

Physical Health

"Physical fitness is not only one of the most important keys to a healthy body, it is the basis of dynamic and creative intellectual activity"

--John F. Kennedy

People always ask me why I include a section on Physical Health in The Psychology of Trading when I do the course live. Most of the time the traders attending are looking for something—anything—to turn their trading into the powerhouse financial machine they know it can be. Sometimes the answer for what we are looking for comes out of a place we didn't expect. I would say that 99% of attendees never considered that what they needed to do in order to flip the switch from "lose" to "win" was to start working out regularly.

Studies have shown that people who exercise regularly along with consuming a healthy diet have lower potential to develop serious illness or diseases (like heart problems or diabetes), they are typically not overweight, they have more daily energy and typically have better control over their finances. Compare that with someone who is 80 pounds overweight or more and the statistics reverse completely; those people typically are consuming a non-healthy diet, they don't exercise, they are developing or already have a serious illness, and they tend to carry a lot of debt.

Before people start ripping me a new one and go ballistic because I bring up the status quo for the typical lazy resident of my home country, I want to make sure we are all on the same page. I am not a doctor and I am not going to offer you medical advice. All I intend to do is make the point that everyone reading this could do a better job at taking care of his/her physical health. I think I can show you that your trading can do nothing but get better if you take your own body seriously as an equal partner in your trading program. You know it and I know it so let's talk candidly about the mind/body connection.

I suggest this hypothesis: If you want to improve your trading—start working out & eating right.

If you go do some personal research, you will find that a high percentage of millionaires make time every day to physically do some sort of a workout. Physical exercise including active sports like Tennis, Swimming, Running, or Biking are all more common activities among higher income and higher net worth individuals. Also, more common is better control of their diet, consuming more plant-based foods and less red-meats; or even no animal sourced foods at all. Daily herbal supplements are more common too. The fact is people who take time to actively manage their health tend to be better performing at their income-and-wealth side of their lives.

Do I even have to mention smoking?

The absolute healthiest thing you can do for yourself and your trading is to stop smoking if you currently are a smoker. The link between serious health problems and smoking is a very defined one—smoking is simply not congruent with total body fitness and total financial fitness. There are absolutely no benefits to smoking; it can only do harm to you and your future the more you allow it into your life. If you smoke—please consider quitting today. I am not talking about the cigars at the holidays smoking, I mean the pack-a-day (or more) cigarette smoking. Smoking will kill you physically sooner or later and you will just have too much to live for when you get your trading to where you want it to be. It would be tragic to finally make the millions you have been working toward only to be forced to carry around an oxygen tank everywhere, or deal with some form of cancer; or something else as serious. Just quit smoking—you can do it. Listed in the Recommended Reading section of the Appendix is a book that helped me finally quit smoking for good. Please consider reading it.

The complete issue surrounding these component parts of our health is the relationship between how our bodies function and how our minds function. There is a very well-known link between the human mind and the human body. The mind/body connection is a very real thing and it can be cultivated to produce greater and greater performance because the mind/body connection is symbiotic. One works with and for the other; one leads and the other follows. If you mentally demand better performance from your body—your body will increase its ability as you train it for more and more of whatever you are looking for. If you train the body to become faster and stronger—your mind will become clearer and sharper over time. The ancient Greeks called this “A healthy mind in a healthy body” One little known fact about the early Olympic Games is that they were not just games of physical strength or skill; they included the arts—such as poetry or drama. Athletes were expected to also shine in areas of the mind; such as mathematics or philosophy in addition to their physical excellence.

I have been very fortunate as it regards my physical health. I can count on one hand the number of times I have been sick in my life. I don’t get the flu, common colds, or allergies like other people seem pressed to deal with. I have been in a hospital, as a patient, only four times—three for accidents where I was physically injured enough to require medical care, and the other was for the one and only time I have ever gotten seriously sick. That one event was life-changing for me.

Severe pain in my gut led me to visit the emergency room on a Friday afternoon—by 6:00 PM I had been admitted with a life-threatening case of Pancreatitis. I had no idea what that meant. After I was given a lot of pain meds, I was given the whole story on what causes people to get this illness and what happens to most people who contract it. The doctor told me that Sudden-Onset Pancreatitis was the kind that often killed people and there was a serious chance that I might be at risk. Only after the doctor told me to contact my next of kin did it really dawn on me that I was dying and that was that.

I got really angry at myself because I discovered that my “fast-track” trader lifestyle was to blame and because I had never had any health issues my entire life, I really wasn’t prepared for someone to tell me that my health was now in jeopardy. I was released after eight solid days of treatment including time in the ICU. I was given instructions about the critical post-treatment time that leads to relapse. Basically—I was confronted with the results of some really poor lifestyle choices that I didn’t even know could be that serious. Why? Because I never had any issues before. I sat in my living room a changed man. That was it—things needed to change and if they didn’t—I could see myself pushing up daisies…. I had too much to live for.

I decided to study my body and how it functions. I learned a lot about nutrition, exercise and sleep. One thing that really hit home for me was the number of billionaires who are obese. The number is zero. Most highly successful people have an equally successful physical health level. To reach your full potential requires a physically fit body for your entire life. You can’t be a top performer at anything if you are fat, sick, on drugs, or otherwise compromised in your physical health. Sorry—it just isn’t going to happen. I am not saying that you have no chance of leading a better or satisfying life if you have those issues; I’m saying that there is a reason why most top performers at anything are usually physically fit people. I decided right there to get back in shape and start honoring my body for what it is: the only vehicle for my profits. I quit smoking, changed my diet, started exercising and quit partying/binge-drinking.

What does this have to do with trading?

Successful trading is perhaps the single most difficult activity any person can attempt to do with any consistency. The very nature of the environment is really a combat zone every waking moment you are there. The mental gymnastics most traders go through for a regular profit can just be exhausting. Anyone who desires to make trading their number one activity is going to need every advantage they can get. How are you going to perform at your best—in the world's most difficult financial environment—if you are tired at noon every day, don't get enough sleep, are living on caffeine/donuts/nicotine, and take pills for your anxiety condition? You could ruin your life living like that. During my most active years inside the trading industry I personally knew pit-traders who went insane, committed violent crimes, developed incurable diseases in their 20's, beat their wives, became addicted to cocaine or alcohol—just so they could function when the bell rang every morning. The list of adversities could go on for pages. One guy poured gasoline over himself and lit himself on fire after suffering a debit in the grain pits; just tragic to even think about.

Now that the markets are all-electronic, and trading is done in cyberspace it is even worse. There is no one to talk to or trade with; just you at your home-office desk with the radio on because the silence is so unnerving to say the least. The environment to actually participate has become void of human interaction, drained of anything of human value—like discussing yesterday's game or going to lunch together; and has become completely impersonal. You can open an account over the internet, with a broker you never have to talk to or even see, and lose all your cash without ever speaking to another human being for any part of the whole experience. Even as I write this the silence in my office makes me nervous…

We as human beings cannot function in an environment like this for very long. Our mind/body connection suffers. The mental side of our body is not being stimulated by having a "real life" interaction regularly with our own kind; our bodies grow old and fat because we just sit there doing physically nothing for hours every day.

The imbalance we bring to the markets

Think of it this way: The human body has evolved over hundreds of thousands of years to be the machine it is today. During the early years of our development we lived outside in the same environment we shared with predators. Part of our daily life was out-running predators. As our brains got bigger, we could think better than those very same predators. We could gain an advantage over them; sometimes kill them. At one point we began manipulating our food supply by caging animals we intended to eat—which we couldn't do unless we could figure out how to catch them and breed them. Suddenly there exists an environment where we have a lot of time free for other pursuits; not just using up our whole day running from predators and hoping to find enough to eat. The physical demands on our bodies dropped a small amount as we gained a small amount of control over our environment. Some people believe this is how civilization started; more free time available for other things by certain humans.

Fast forward to the 1800's and the advances in technology brought about by the industrial revolution. Virtually overnight, based on the time scale of evolutionary development, we humans could replace the use of our muscles with machines driven by steam power. Instead of taking months to walk or ride a horse across the country to get somewhere—you could ride in a train and do it in four days. Just sit there while something else did the work. To keep your mind busy, you might read a good book or have a conversation with the person sitting next to you.

Move ahead only another generation or two, which is only a heartbeat in evolutionary time, and we have jet airplanes to take us anywhere on earth in 12 hours, man has walked on the moon, we have eradicated several diseases (like smallpox), we have learned more about the universe we live in than ever before, know more about our home planet, invented electronic machines that can not only replace our muscles but replace our brains; we have truly evolved into something completely unique and with even bigger potential than we can yet imagine. What are you going to keep your mind busy with now?

Enter the iPhone. We haven’t even begun to witness the social and psychological impact of this little beauty. Yes, you can entertain yourself for hours on end just sitting there, you can use it to buy anything you want and it will just show up at your front door in an hour; yes, you can watch the news for an update of what’s happening half-a-world-away. Wonderful. But you know what you can’t do? You have a conversation with the person sitting next to you at the food court. You know what you aren’t doing? Going dancing with a friend—if you have any left. Read any good books lately? Of course not, everyone is staring at their hands like a zombie while this tiny electronic device rules their lives…

As a species, our mind/body connection is suffering because our bodies are not keeping up with our minds, and our minds are not honoring our bodies. Albert Einstein said it best when he said “If we aren’t careful we will evolve our technology to the point where we lose control of it” At this moment, the thousands of years of genetic programming we have that tells us to use our muscles every day for our benefit, is being systematically ignored by the incessant use of technology. I can’t remember the last time I saw any of my neighbors out taking a walk…

The point I want to make is really very simple. At this particular time in human history we as a species have advanced technology to the point where our bodies are really suffering because there are no demands placed on them anymore. “Going to work” everyday has replaced “Working everyday” Most jobs involve very little hard physical labor anymore. When I say “hard physical labor” I mean breaking a serious sweat and going home physically exhausted—like people had to do for centuries until just recently. In 1880, digging a well for the homestead so you didn’t die out on the prairie this winter might take several days of 2-3 men using hand tools. Today, that job would be done in an hour by a well-digging machine operated by one overweight person. Everybody back to their iPhone…job’s done…

Think of the calories burned when you as a trader decide to buy or sell. What do you have to do? Click the mouse. I bet you burned 3-6 calories pushing your index finger once on your mouse key. You see, “making a living” for most people, including traders, doesn’t require any physical work anymore, all we really do at this point is manipulate machines who are doing the work. Even work we consider to be “head work”; such as accounting or bookkeeping. All that is done by machines and the human operator just sits in front of a computer all day. Our day-to-day life for most people in the western world(s) is a life lived among machines who are doing most of the work for us while we stand by and watch. I can’t remember the last time I actually saw a bank teller. All my banking is done online or through an ATM machine. If I have any issues, I call customer service; which is basically a person sitting in front of a computer somewhere looking at the same data I see on my computer while we discuss what the problem is. If there is no problem—no phone call to another human being. No “Hi Janet—how’s the family?” while I deposit my paycheck. No paycheck to deposit anyway—that is done by direct deposit now. All I have to do is keep my head down and stare at my iPhone…all is well…

We as traders cannot afford to live in a world that ignores the needs of our physical bodies. Your muscles were made to be used every day to do something useful. Your body was designed to run on certain fuels—not everything that can pass through your digestive trac is food your body needs or can use. Not everything you put into your mind can assist your brain to function at its best. Do you really need a TV in your back pocket? You don’t need a “5-hour Energy”; you need a solid night of sleep after a healthy dinner.

I know from personal experience that my near-death illness was created by me, because I was living like my body would never suffer the consequences of how I was treating it. Once I quit smoking and eating cheeseburgers every day, once I reduced my drinking to something other than the “sailor on leave” level, once I started training with free weights again—everything in my life began to improve—not just my health but everything. I began a detoxification process while I changed my diet and I dropped 20 pounds without doing one sit-up. Now—I am looking at my goal weight being the same weight I was in high school. The cost of living every day has dropped because I no longer eat expensive things that are really just fat calories (like fast food) and I don’t spend $10/day on cigarettes anymore. I consume a lot of salads and fruits. I make fresh juice every day. I look and feel like I am 20 years younger. The blood flow to my brain increased providing me with more benefits for my trading. Let me repeat that: The blood flow to my brain has increased providing me with more benefits for my trading.

The only real trading tool you have is your mind. Your mind must think at its optimum level for you to get your best results. Your mind lives inside your body. If you feed your body crap—your mind doesn't get the best fuel it needs to help you make the best trading choices you can make. If your body is supporting extra weight for no benefit, the blood flow you do have now goes to support that extra unneeded weight. If you drop the weight, increase your blood flow by solid heart-pumping exercise, and feed your mind the real fuel it really needs…how is this bad for your trading presence? How does this work against you? It doesn't. Your healthy mind in your healthy body opens better trading opportunity. You will have every advantage you can when you step into the kill-or-be-killed environment of the markets.

Remember, I am not a doctor, so I am not giving you medical advice. This is my personal experience for my own account(s) when I started taking my health very seriously and made a few changes. I really think it is very realistic for you to experience some positive results if you choose to improve your physical health too. I would certainly recommend a positive health program if you have a family of your own you care about. None of us will live forever but that doesn't mean our lives have to end in sickness and disease either. Our families probably want us around as long as possible. For me, I took my health seriously because I had a very scary health problem when I was only 49 years old. I know that I won't ever be in the same shape I was when I was 17—but that doesn't mean I have to be a walking corpse at 65 either. Think about your health—and think about how your trading might improve if you begin honoring the mind/body connection better. Go see your doctor and find out what you can do to start improving your overall health. If nothing else, knowing that you might be years away from something serious gives you times to make better choices. Nothing bad can come from better choices I am happy to say. Make your health and well-being a priority and it will help your trading. You need every advantage you can find.

Your key takeaway from this chapter:

The only trading tool you have is your mind. Your thinking determines the results you get from participating in the world's most difficult financial environment. Your mind lives inside your body; and at this point in human history—the mind/body connection is out-of-balance due to how much we have come to rely on technology. We as traders need to honor the mind/body connection better. Consider an active exercise & diet program as a way to help benefit your trading. Your improving health picture can only produce positive lifestyle/trading changes.

Technical Analysis

"I've never met a rich market technician…"

--Marty Zweig

During the European Middle Ages and through the Renaissance Age of Enlightenment there was a pseudo-science practiced for centuries called Alchemy. The basic idea behind the "science" was a belief that some sort of transmutive power existed that could be harnessed creating vast unlimited wealth and providing health benefits leading to immortality. People who practiced Alchemy believed they could turn base metals (like lead) into precious metals (like gold) thereby creating wealth out of worthless items; as well as brew something called an elixir-vitae that would give whoever drank it eternal life. Pretty strong stuff. And, of course, who wouldn't want those benefits?

The belief got started when a magician from the Middle East or Northern Africa showed up in a European King's Palace and claimed he could perform this miracle, if he was paid of course. So—he apparently performed this miracle for the king, got paid, and went on his way. That was about 900-to-1000 A.D. according to most accounts. Shortly thereafter there began appearing other people who claimed they could perform the same miracle. As the centuries passed this belief continued to take hold on popular culture until, at the height of the belief in Alchemy, there was even a university in Amsterdam, Holland offering a degree program in Alchemy. That was around 1650 A.D. or so.

During this time, and to this date, not one credible case of transmutation of lead into gold or the creation of the elixir vitae has ever been documented. Every single Alchemist has been discredited based on his results and/or examination of his historical writings. During the 1000 years that people believed Alchemy was a real science, Europe was in a state of constant conflict between warring nations; and the Catholic Church controlled the dissemination of information under the threat of excommunication. Therefore, it was easy to suppress or ignore information that suggested Alchemy was not credible; or it was credible. When this belief served to further the position of someone—alchemy was accepted and lauded. When it didn't serve the needs of The State or The Church, Alchemy was suppressed. What seems to have slipped from everyone's mind was that during the time Alchemy was accepted as a legitimate science—no one had ever made any gold using any Alchemical process and everyone who practiced it died—no elixir-vitae either. In reality, Alchemy is a complete fraud based on an idea that is not physically possible. Apparently, that didn't seem to matter.

People believed Alchemy would work—and when it didn't—there was always some reason why it didn't work, and that "something" could be fixed given enough time to work on the problem. People spent their whole lives trying to turn lead into gold and died penniless; still believing it could be done. Popes paid fortunes to men who claimed to be Alchemists hoping to increase the coffers of the Church; so did monarchs like Louis 10th of France. The belief grew so strong that the missing ingredient was actually named (although no one to date has ever found this missing ingredient), it was called the "Philosopher's Stone"; wars were fought over land that was supposed to have the "Philosopher's Stone" buried in it. All this frenzied activity and passionate belief in something that had never have been done, and never could be done. Ever. In fact, unless you happen to have a 2.5 Solar Mass or larger collapsing star in your back pocket, turning lead into gold is impossible to do anyway under any known conditions mankind could realistically create.

Does any of this sound familiar?

Right now, today, as you read these pages, there exists a very similar conviction.

Within the minds of the participants who trade the markets every day, there lies an unshakeable belief in a pseudo-science called “Technical Analysis” (TA).

I put the quote from Marty Zweig at the top of this chapter because Marty is considered one of the best traders of recent memory. To the best of my knowledge by reading his works he doesn’t use technical analysis to find his trading opportunities. I don’t use TA at all to produce my results either. The fact is, anyone who is a top performer in the markets rarely uses any accepted form of TA; if they do, they use it from a completely different perspective and not at all like the rest of the participants might be taught to use it.

If you are going to pursue making your millions by trading zero-sum markets (like Marty Zweig, myself, and others do), then you need to be aware of things that can prevent you from getting where you want to go. As we have been discussing for many chapters now, almost everything in the trading world can be boiled down to something involving your personal point of view as the foundation to success or failure. How you see things is the most significant point of reference to discovering a trading method that will be enforceable for you so you can win. It is the signpost for when you are sabotaging yourself; setting up your losses. How you see it, becomes everything.

Before you decide to accept the hyperbole & hype about the “validity” of Technical Analysis I want you to give some serious thought to what I say in this chapter. There are very serious flaws in the argument for the use of TA and I personally believe using it is the single biggest reason why traders suffer losses. Remember, statistically speaking, around 85% of people who open a trading account to trade in zero-sum markets close their accounts at a net loss. That statistic has never changed despite the huge use of mountains and mountains of data created by countless forms of TA systems, algorithms, charting, artificial Intelligence, and so on. Every one of those losers has access to all the same information as everyone else. How they use that information is why they have losses. Their belief that they can chart their way to a fortune is the single biggest reason people fail in the markets.

If you could exploit Technical Analysis to create consistent gains, then people would be doing it and the 85/15 distribution of winners vs. losers would have changed by now. I believe the TA problem is two-fold. First is the basic assumption the whole “science” operates from and the second problem is how traders are taught to use it. Between these two serious flaws in approaching your market participation, the typical trader has no hope for a profit. In fact—I would hazard to guess that the typical losing trader using some method of TA will execute less than 100 trades before his equity has dropped to levels he can’t participate with. Combine the two basic issues with poor money management (such as over-leveraging) and you have a recipe for a whale of a “WOW!” story at the next cocktail party...

Let’s start with the basic premise most technicians are operating from. All the markets are prices. Prices are numbers and numbers can be analyzed; they can be seen in context with each other, and they can be used for the calculation of things we need to know. That is the proven science of Mathematics. Proponents of TA all argue that mathematics is a proven science and can be used to prove things that are abstract, like the markets. Sir Isaac Newton invented calculus and he used math to prove physics. Mathematics works. Period. If someone like Sir Isaac Newton can use mathematics to predict the curve of a baseball in flight by knowing its mass, velocity, angle of trajectory, and the gravitational constant all rolled together into a formula/algorithm; then that documents that anything can be proven (or disproven) using math. However—there is a serious flaw to this logic when applied to the markets.

Markets are not prices. Markets are people arguing over prices. The correct mathematical model (if you could create one) would be to use math to predict how people will argue prices. Not a model to predict the prices they will argue about. The first part of the first flaw is a misplaced focus as to what is really the significant variable you are trying to predict. Predicting people’s behavior is the real issue—not the prices they are fighting over. Group behavior is not easy to predict under any conditions. Mathematics really can’t be used in a predictive manner when attempting to predict what a crowd will do consistently.

The next part of the first flaw is the issue of a closed loop in a logical argument. This is called “circular” reasoning. If you are using price as a variable in your attempt to predict what prices are coming next, you can’t use the same variable in the equation or the algorithm.

For example: A= A+B

It doesn’t matter how complex your equation is, or the rationale behind the attempt at mathematically expressing whatever variable you want to predict—you can’t use the same variable inside the equation in order to predict what that exact variable will be after the “equals” sign. Ask any engineer or someone else who has to use math every day to solve complex issues and they will all agree that the above assertion is absolutely true; you can’t use variable “A” in an equation attempting to predict variable “A” Therefore, you can’t predict prices using math to predict prices. I even wrote it redundantly so you can get the point like I wrote it for you while I was writing it for you so you could get it.

The other issue is how people are taught to use Technical Analysis. I have attended countless seminars, reviewed countless audio/video recordings, and read hundreds of books on Technical Analysis, prediction of price action, trading systems, and anything else you can think of about “figuring out where prices will go next” NOT A SINGLE CLASS or BOOK discussed the implications of zero-sum markets and the structure that completes trading; except one; The Disciplined Trader by Mark Douglas (New York Institute of Finance, C. 1980). 100% of EVERTHING presented to you as a viable method of making your fortune misses the EXACT reason WHY prices move and how to see that change coming. You as a trader are NEVER exposed to the knowledge of what the markets really are and how they move in price. I have actually met traders at industry events who have been trading for decades that had never even heard the term “Zero-Sum Transaction” and didn’t even know that the markets they were trading in were zero-sum markets. That’s like a heart surgeon NEVER being told that the heart circulates blood through the body. How could you miss that?

As a corollary problem to the main issue of never being taught how zero-sum markets are constructed and how they move, in every one of those TA educational forums I attended there was ALWAYS someone who looked at the same data being taught and saw it the other way. In other words, if some sort of TA was being done on a market we all were going to trade next week, and the conclusion of that TA taught to us by some “expert” was that the market should rise in price (bullish scenario for next week) there would be another trader who saw a bearish scenario for the next week using the same information and the same analysis.

I need to make this really clear: No matter what the Technical Analysis done suggests for price action moving forward, there will always be another way to look at the same data. No matter how simple or how sophisticated the analysis is when it is done—it will always be inconclusive about forward price action.

In addition to this problem, you have the inconsistency of all traders with excusing their results. Most traders will accept that “some trades won’t work” because they are told that is part of the business. They are never told that by studying your participation along with studying how markets move in price you can increase your probabilities of winning trades to above 90%; and if you tell most traders that they can learn to do that too, they reject that knowledge out of hand as “unrealistic” or as an outright lie. So when they have a dozen losing trades in a row after using some TA analysis they see that as “just part of the business” as opposed to “something is not right” If they come to the conclusion that “something is not right” on any level they typically mean they haven’t done the analysis “‘correctly”; so the double-down on the time/expense of learning that particular TA perfectly so they won’t make those mistakes again. But that thinking is part of the problem too—the thinking that you can become an expert at some kind of analysis and “reduce your risk” in the process. They never stop to think that “something is not right” might mean TA is a fallacy and trusting it in the first place is what is leading them to consistent losses.

At this point I want to draw this argument together for a conclusion then offer you some additional insights on how to exploit Technical Analysis as a tool to help with your participation. What I am suggesting is not going to be easy for some traders to accept—likely because they have a lot invested in believing TA is viable; both emotional investment and financial investment. If you will open the door to understanding the flaws in the TA argument, I believe you will save yourself a lot of headache, time & money. Once you lose your trading capital it is too late; but if you can prevent yourself from throwing it away on some fantasy, you can really give yourself a fair shot at creating wealth for yourself.

In Summary:

1. TA is based on a fallacy regarding the interpretation of the science of mathematics. All lies are based on some amount of truth and the more truth the lie contains the harder it is to expose the lie for what it is. TA focuses on mathematically trying to express forward prices; however, markets are not prices. Markets are people arguing over prices. Predicting the behavior of crowds is a completely different mathematical environment with a completely different set of variables.

2. At the core of the TA fallacy is an error in logic, it is the "closed loop error"; commonly called circular reasoning. You can't use variable "A" in an equation or algorithm designed to predict variable "A"; it is mathematically impossible to reach an accurate prediction.

3. The typical trader being taught TA as a viable method of making money is never shown the true structure of the markets and how prices will move. Therefore, the typical trader is in error by trusting TA to help find viable entry or exit points for his trades.

4. The traders own mindset about how valuable TA can be as a trading tool complicates his reasoning, adding to the potential for net losses while using it. The typical trader never considers that TA might be non-viable.

To put my conclusion into a context that might be more familiar to the reader, let's talk about dying. In the trading arena it is kill-or-be-killed. If you are not on the right side of the price action—your money belongs to someone else. If you don't figure it out—you end up with ZERO money. You're dead, financially speaking.

Now let's compare that to another environment where you could really die. If you are a solider in a war—someone is going to try and kill you; physically kill you. Your General hands you a gun and says "Go take that hill. By the way, the enemy is going to try and kill you." You say, "Yes sir!" and turn to go; but the General stops you and says: "Oh by the way—that gun I gave you only works about half the time. Just do your best and if the gun doesn't work—we will talk about that if you come back—OFF YAH GO!!"

Wouldn't you stop right there and be just a little concerned about going up that hill to face the enemy? That is the same environment Technical Analysis offers you. Why would you be willing to expose your money to a kill-or-be-killed battlefield 100% of the time when your only weapon doesn't work about half the time? You have very little chance of winning in that case. Why would you be OK with this scenario?

That is the conclusion I want you to consider. Technical Analysis is a flawed idea just like Alchemy was. It is based on some things that sound really good until you look at the statistical facts underlying all the hype. Both "sciences" promise some really great benefits—if we all can figure out how to get to those benefits—but the fact is, both Alchemy and Technical Analysis are based on belief systems that are in conflict with the underlying facts that exist; Chemistry can't turn lead into gold, you need the heat of a collapsing star to create elements out of another element. Technical Analysis can't predict pricing because markets are made of people not prices; you need a crowd behavior mathematical model (which hasn't been created yet). Until someone has developed something that can predict crowd behavior on a moment-to-moment basis there won't be a way to mathematically attempt a prediction on which way a market will go in price;

and/or how much time a price change might last. The existing pseudo-science of Technical Analysis is not even close enough to that benefit to be considered viable. It really is no better than chance. In fact, if you perform every kind of technical analysis exactly how the creators of that analysis suggest you use it, none of those TA methods have a success rate of more than 52% over a reasonable sample set of, say, 1000 trades; unless you “massage” the indicator or study with some sort of variable you have discovered by “experience”, which is just a convoluted way of saying you are combining two non-correlated probabilities until they overlap on the plus side of their exclusive probabilities. A 52% probability is no better than chance. While we are on the subject, please don’t forget our discussion on how to lie using statistics. Almost all the “systems” you see available using some method of analysis or combination of methods is sold to you because it has some sort of statistical verification that it works. It still amazes me how people justify what they do and how easily those statistics fall apart under the most basic scrutiny.

How Best to use Technical Analysis

I would like to ask you to use some common sense with me while I make my final argument(s) on the validity of Technical Analysis. As I mentioned before, I don’t use any TA to find my opportunities. I have also discovered that very few net-winning traders use any TA either. That can only mean the users of TA must be those in the losing group. That can only mean that the losing traders are trusting TA to place themselves at risk and that happens (apparently) right about the time/price areas where a reversal is due to happen; otherwise they wouldn’t be losing so consistently. What is the value of Technical Analysis? The value of TA is that 100% of the losers are using it. So, if I could see what the loser is looking at when he decides to place himself at risk—all I would need do is take the other side. ERGO—I need to see what the loser is looking at. The first advantage TA can give a winning trader is not to use it to find trades for himself—but to use it to uncover how the losing trader is thinking. Don’t use TA to find trades; use TA to find traders.

I was told not to name names when this book was reviewed before publishing. We live in a sue-happy society I am afraid to say—However—in the case of this illustration—I think naming names is OK because I don't think the people in this story are intending any harm to their customers; of which I am one of them. One of the skills I developed over the years was directly related to an experience I had in 2005. I attended a weekend seminar on basic Technical Analysis offered by the Online Trading Academy. The illustration below is an example of the style of TA they suggested for "beginning traders" (I still attend education seminars offered by organized groups of "educators"; I like to stay current on what is being taught to the loser-group so I can stay sharper on potential price action).

Start of Day
End of Day
2nd Sell Signal "confirmed" by MA cross
Exit 2nd short for a loss
Exit 1st short for a loss
Sell Signal "confirmed" by MA cross
Entry bar for Short Position
Blue line is 7-bar MA
Red line is 21-bar MA
Sell Signal on MACD
2nd Sell Signal from MACD
Buy Signal from MACD
No entry taken

This is a five-minute Silver Futures chart showing the typical losing day-traders start to the day, the end of the day, Technical Analysis done using “slow” & “fast” Moving Averages and a typical “Over-bought/Over-sold” indicator (MACD). The way the typical trader is taught to use this “Simple Moving Average Crossover System” Is to key in on when the MACD “signals a turning point in the market”, then the trader is to do nothing and wait for “confirmation”, which is when the two moving averages cross each other, then enter on the next bar. The first trade of the day was a short signal which resulted in a loss as the market made a fresh daily high after stalling briefly at the first daily high; the corresponding MACD “signal” to BUY the market wasn’t taken because the trader already had an open-short on (Can’t do both). The next short signal was again at the market highs but later in the day yet again another fresh daily high takes out the 2nd short with a loss also. To make matters worse, inside the head of this trader, the only signal he DIDN’T take was the buy-signal that appeared 10-minutes after he had his first open short working; and that missed trade could have been a healthy gain.

The important thing for you to understand about this chart is that the Online Trading Academy was very proud to tell me that they have graduated over 250,000 seminar attendees over the years. This was part of the sales pitch offered to me so I would be convinced that the OTA had a really valuable something for me to buy. However, as an already net-winning trader looking for more ways to uncover how the losing trader is “out there” so I can take his money; here is the real benefit I found to the course I took almost 20 years ago:

The OTA has taught over 250,000 traders the exact same information and those traders are using that exact same information the exact same way. That means the exact same price chart for the market looks exactly the same way on each of those 250,000 desktops right now. So, when that particular price chart, using that exact method of TA, tells 250,000 traders it is time to BUY right now—all those traders will likely enter a buy order at that exact time/price point.

Since I already know that 85% of people are losing, and 100% of the people who trust any form of Technical Analysis are likely to lose on any one transaction, by looking at the TA those losers are likely reviewing at the same time gives me (the winner) a place to consider as a great entry the opposite way. In other words, when the typical “Loser Chart” (like the one pictured above) says it is time to buy—in reality that might be a very good place to sell. One very good way to exploit Technical Analysis is to review it in the exact same manner that the loser is taught to use it. Your “loser charts” often disclose price/time relationships that losing traders are instructed to value. Do a little research of your own to find out what the most popular forms of Technical Analysis are and how they are taught to most traders. Then create 2-3 typical “loser charts” that show you what the average losing trader would be seeing regularly when he does his “analysis” You should be able to find solid entry points to go the other way often enough to make it a valuable tool to add to your market-centric paradigm; which is always based on the concept of: Find the loser.

Now, it is very likely that the total number of OTA students who are actually still executing exactly as instructed according to the above chart formation is probably much lower than 250,000; and I am not using that number literally. Every losing system and every losing trader has its share of winning trades; using TA profitably is more about probabilities when looking for the losing trader. What I am hoping to communicate to you is that relationship; that reality between how losing traders see the market and how winning traders see the market. Traders who put their confidence in TA consistently are usually losing in the markets all the time. Those losers have chart analysis done certain ways. What do their charts look like and can you find something that can help you uncover how the loser is thinking? Don’t use TA to find trades, use TA to find traders.

Losers study the markets; winners study the losers. Winning traders watch for losing traders to be active. In my view, using Technical Analysis to uncover how losing traders are thinking and where they might be opening positions is the most valuable part of TA. I wouldn't use it to find trades for your own opportunity or your own trading. Use TA to uncover where losing traders are getting positioned.

Another consistently profitable method of finding the losing traders is participating with them side-by-side every day. This method is something many of my students find highly profitable and I developed this strategy after my own experience. It requires you to have a degree of technical ability and maybe a few dollars to invest every month. It is really simple to do but requires you to actively pay attention to what is happening moment-to-moment; this isn't a very workable strategy for someone who is not going to be seated in front of a screen for the entire trading day. Personally, I would rather not be trading by sitting in front of the screen for 8-10 hours at a stretch, but if you are one of those traders that enjoys a daily trading day that includes hour after hour of sitting there while smaller opportunities come and go—this method might be perfect for you. If you consider yourself a "Scalper" or a "Day Trader" this strategy can really increase your weekly take-home winnings.

How to Implement this strategy:

First, take some time to search for free trading chat rooms on the internet. There are literally thousands of them all devoted to helping traders become more profitable. The best ones are the ones that some “guru/expert” has set-up to help his victims—I mean STUDENTS—make more money. Those usually involve a small monthly fee, or you are given free access after you buy some course or daily education webinar the “guru/expert” provides regularly. If you want to focus your opportunity on only one area of the markets you can find all sorts of free chat rooms that are sponsored by brokers or educators specifically focused on individual markets like Crude Oil, FOREX, Stock Indices, etc., etc.

After you have found 2-3 chat rooms to your liking simply sign up and begin listening in every day. Your “listening in” is going to be different than the other chat-room participants because you aren’t going to be following along with whatever argument is the one for profitability today; you are going to be listening for code words AND you want to find the loudest and most over-confident individual you can find in that chat room to start a relationship with. After a few days of saying hello—listening to what the other traders are discussing—asking a few “where are you from?” type questions—you are ready to execute this strategy.

Begin a relationship with the loud individual you have found. Take that person into your confidence. Ask him questions that let him talk and talk about his analysis and why it works, what the profits are like, etc. This individual will usually tell you exactly where he will be trading and why all the time. Take a notebook and write down his key data points for yourself. As you watch this trader, also watch how the other traders will argue their point of view and notice how many eventually cave in to the “conventional wisdom” each day. Notice the entry and exit points being discussed. You want to listen for code words; words like “should”, “must”, or “can’t”; you want to listen for “confirmation” and “back-testing” some of these chat-room participants will still be doing a lot of “paper-trading”; look for their specific reasons for getting in or out of a “paper-trade”; most have to do with creating a sense of certainty.

After you have a week or two of data—compare the entry and exit points offered by the loud trader and some of the other traders in the room. What you will notice is that the entry points to go long are usually right about the best place to enter a short for the day; and vice versa. The exit points are often the best place to actually enter the trade being discussed. In other words, if you “fade” the trade that is supposed to be the “big” winner today, you usually will have a profit. If you wait until everyone else is stopped out for a loss on that long, for example, usually right around there is a great long entry.

Remember, nothing is for certain and net-losing traders have their share of winning trades; which is another thing—notice how many winning trades are taken off early by the group—if you are doing a similar trade you often can hold for a bit more after they exit. My point is, this strategy will help you uncover where losing traders are executing and the discussion they all have in the chat room will show you how they think. By studying what they are doing and how they are thinking when they do it—you can get great clues for your own trading at little to no cost. Additionally, taking their money will become so consistent that you will eventually get banned from those chat rooms if you discuss any of your real trading or why you are really subscribing to that service. I tell all my students to never discuss their own trading except maybe in very general terms. Certainly, never mention me or any of my education products/books/services.

If you are going to attempt using this strategy to exploit “Loser Chat Rooms” there are a few things to help you get the most out of it. First, always describe yourself as a “newbie” who is really trying to learn this. The loud people in the rooms love to unload their “wisdom” for you. It can be a never-ending source of information about the loser’s trading. Occasionally offer an opposing point of view but always retract it after the entire room tells you why that won’t work. For example, perhaps the discussion in the room is all about where the market will go after the big news event due shortly comes out. There will be all sorts of discussion about the actual number, why that will be bullish/bearish, blah, blah, blah. When you can put something in say something like: “Well, so-and-so said that this report isn’t even important—the real report will be the XXX report due Friday” ….and watch the fur fly! You will get every possible argument for or against that statement, you will be called every name in the book for being so audacious as to think that anyone would know more than they guy who runs the chat-room, and on-and-on it will go with more non-essential and ridiculous crap that has nothing to do with trading. But one thing will happen—someone in that room will openly commit to taking one side or the other at a particular price. THAT could be a huge clue for you. If that losing trader decides to go long at that price he is so sure about—it will likely turn out to be near the daily high; or vice-versa. A great place to go the other way.

Bear in mind, there is a downside to this strategy. First—the loud people always end up losing all their money and they eventually have to quit; so, you need to be constantly looking to start new relationships with the next loud person. Second, if anyone suspects that you are not “one of the group” you will get banned. That means if they suspect you are snooping for another vendor or in some way trying to “steal” what they have—you will be banned. If they think you are a “shill” and you are trying to sell them something or represent some other “guru”, you will get banned. If they think you are not offering enough “positive information” to the whole group, you will get banned. You will get banned instantly if you tell them that you are regularly taking the other sides of their trades and you are taking more money from them then they are from the markets. In other words, you need to participate regularly in a fairly innocuous way and offer something to the group regularly. Don’t get into fights with the other participants, don’t argue their positions with them; don’t be a difficult person. Just take what you can learn about the state of mind most losing traders operate with. I think you will be surprised at how simple the process is.

To close out this chapter, I want to offer you some final insights into the Technical Analysis problem. Although there are significant flaws in the arguments to support TA as a serious trading tool there are parts of chart activity aside from analysis that can be very helpful to your developing market-centric paradigm. Some of these observations are discussed in greater detail in my first book Trading Rules that Work (Wiley & Sons Publishing, C. 2006). To close this chapter, I am going to outline one kind of “Technical Analysis” and one important thing to remember. Both offer benefits. Bear in mind—these are only two kinds of help; there are all kinds of things out there to assist you so I would refer to the recommended reading section as well in the appendix. There is a lot of market-related data a winning trader will find useful that are not considered “Technical Analysis” As you create your market-centric paradigm those resources will start becoming more valuable to you. So, take these two “TA’s” in context.

Enter the market on a 50% pullback

I want to make one thing abundantly clear: 50% retracements are not Fibonacci study, projections or retracements. Fibonacci was a pre-renaissance mathematician. He was interested in uncovering the grand harmony and design of the universe. He wanted to find the all-pervading bedrock factual component to the nature of physical reality; what you and I would call the nature of the physical universe. He lived in a time when money was a very unsophisticated concept. The general level of ignorance people existed under at the time just before he lived was profound. Fibonacci’s discoveries would have been seen as dramatic leaps forward, so much so that it “looked like” magic and bordered on “Heresy” as far as the Catholic Church was concerned. Still, Fibonacci believed things about the nature of reality that you and I know today are completely erroneous. For example, Fibonacci was an Alchemist. He believed with all his heart that he would discover through, mathematical design and prayer, the very nature of reality. When he did, he could exploit this knowledge turn lead into gold; thereby ending his money problems. If I told you that as a trained trader I will trade for you and I will execute for your account by studying the flights of bees; you would be no worse off than if you followed Fibonacci through his day as he tried to turn lead into gold. Fibonacci never applied the golden ratio or the Fibonacci Progression to markets or trading. None of that existed yet. Fibonacci discovered a part of mathematics that is accurate for the study of nature, nothing else. He didn’t know that at the time. He himself lived under a cultural myth and wasted a lot of his knowledge pursuing something that couldn’t physically be done.

Why am I telling you this?

Because Fibonacci Retracement study is an accepted method of simple technical analysis. All successful traders use some form of retracement analysis in their simple methodology. Except Fibonacci never intended his discoveries to be developed or applied to trading. That was W.D. Gann's idea so your best bet in understanding retracements is to study W.D. Gann, not Fibonacci.

Gann discovered a unique relationship between time and price that is still considered accurate today. That relationship is apparent across all markets in all time frames; no successful trader should ignore it. The relationship is very simple and actually was initially discovered by Fibonacci except Fibonacci had no use for this knowledge—he was trying to turn lead into gold.

The time/price relationship follows the rule of 72 and 50% ratios. Some of this is also covered in Elliot Wave analysis but I want to make this simple. Anytime pundits of Elliot Wave, W.D. Gann or Fibonacci start talking they complicate this whole retracement thing so dramatically that you would think the sun rotated around the earth just prior to the moon eating it. People need to just relax and focus on the main issues.

50% retracements are important because they temporarily balance the net inequality between the competing net order-flows. That's it. Retracements do not predict price action or portend new highs/lows. Retracements are not predictive. They are historical. The reason Gann, Elliot or Fibonacci are included in all this discussion is because they happened to notice the related relationships first—not necessarily understand what it might be saying. Fibonacci noticed that a mathematical ratio existed in nature. He assumed that lead and gold would also be subject to this natural ratio somehow but, as we know now, this is not true. This ratio is apparent in nature and in the way things grow; it is not apparent in crowd behaviors and markets are about crowd behaviors. Gann asked the question “What if the markets have a ratio/rhythm in and of itself?” Gann thought he had found an answer to that question when he and Elliot noticed that markets appear to have waves that occur with regular frequency and repetitiveness. By combining these two assumptions into a larger assumption, we now have a “verified” mathematical model to follow in pursuing our trading success. The apparent relationship is not the same thing as the real relationship. The real relationship is what we want to discuss.

50% retracements happen because once enough buyers square off against enough sellers, only half of those contracts will be profitable. At the 50% number, exactly half the bulls have a profit and half the bears have a profit. When I say this, it is important to note that this is a net perspective. The actual result to any single trading account isn’t the issue. If you could find a way to look into the total number of open trades you will see that of the sum total of the open longs, about half of that total number of open contracts will an open trade profit—the others have losses. In other words, if there were 10,000 open longs, around 5000 of them will have some open trade gain and the other 5000 will have some open trade loss. The exact same situation will be accurate for the shorts. The market is now temporarily balanced from the net perspective.

This situation won’t last long; it will only take a short time for new buying/selling pressure to come in. Whoever has the net advantage at that point will tip the balance. Most of the time it is in the original direction back towards the previous high or low because from the net perspective the late loser entered from the short-term trend, that is the few days or so just before the 50% level is reached. This is a factor of the rule of 72. Most market participants operate on a time frame of 72 hours or less. That means all the various ways of creating a market timing signal that now is the time to initiate a position; most traders have gotten at least one signal and have executed creating net order-flow every 72 hours of “clock time” Once they have initiated, they must liquidate to accept their open trade profit or loss. Most methodologies will have given the exit signal within in that time frame as well. So, the net result: Almost everybody has gotten in and out within a 72-hour period of time at least once. If this process happens at a 50% balance point—the net result is usually a resumption of previous trend. See figure below.

Stall on a price rally
Stall on a price rally
Stall on price rally
50% Pullback
50% Pullback
50% pullback
Significant low based on previous trade

Don’t Take Tips

One of my earliest trading experiences involved taking a tip. The tip was to buy silver, and this was the early 1980’s. For those of you out there who have no knowledge of the attempted corner in the silver market by the Hunt Brothers, I would suggest you take a few extra minutes when you have time and look up the details; it is a fascinating story. For me personally it is more than a fascinating story because somewhere in the world, there is someone who has my $500. I was a sophomore in college, and I had a few bucks saved. I was sitting in class before the bell and one of my classmates was extolling the profit potential in the silver market. As it turns out, he was from a family on the wealthier side and apparently his father had made a killing in the silver market. Maybe it was silver that was paying his tuition. I decided to head over to the local jewelry store and ask about buying some silver. I carried $500 worth of silver bullion home that afternoon. That silver lost 80% of its value within a year.

I didn’t consider it a trade; I was not a trader at that point. I had no idea how investments, trading or the markets worked yet. I really just bought into the story that silver was going to trade higher. I never thought for a moment about what creates prices, who told me the data or if it was true; nothing. I listened to the common sense of the argument and went with it. The whole experience became part of the catalyst to become a trader when I learned about Silver Futures. I discovered someone could be SHORT. As my silver bullion declined in value there was someone getting rich. WOW!

In choosing to listen to a tipster, the problem is not the information. The problem is not the quality of the stock or commodity market. The problem is not even if the tip is wrong. The problem is within us as traders. When we fail to do our own homework and let someone else's' thinking become our guide; our results will never be any better than the thinking of the tipster. It really doesn't matter if the tip is a winner or how persuasive the tipster is. When we as traders let someone else do our thinking for us, we run the risk that the quality of that thinking is nowhere near accurate for the market in question. The problem is in failing to think—not in the tip. Let me illustrate.

No matter how you choose to participate in the markets, you are ultimately responsible. When you finally decide that the time is now to execute, it is your money at risk. If you have a gain or a loss, the credit or debit is assigned to your account; no one else's.

Why would you let the thinking of somebody else determine your results?

The problem with tips is not the data because that data is really the same for any point of view. No matter how you want to come to a conclusion, there will always be another point of view that is created from the exact same set of data. If you and me both compile all the data available in the Meat Futures complex, compare that to the technical picture the charts have at that moment, you may come to the bearish conclusion while I come to the bullish conclusion. The important thing is that neither conclusion matters to make a profit. The only thing that matters is being on the right side of the net order-flow. If your analysis helps you come to a conclusion and it happens to be the correct side of the order-flow, money will flow into your account. If your conclusion is not the correct one, money will leave your account. In either case, putting your account balance at risk without knowing for certain what the potential is within the underlying net order-flow is simply reckless. When you take a tip, you are increasing your risk because you are accepting the responsibility for a loss without the corresponding knowledge of the markets' underlying potential. Taking a tip is really just gambling with your money.

If technical analysis is a sort of tip, and whispers overheard in the CBOT men's room are tips, and government reports are tips, and reading trade journals are tips; where is the real data to trade with?

Inside your head. No matter what you read, study or absorb; you personally have to choose if the time is now or not to execute. The moment you pass from thinking for yourself to trusting something outside of yourself; you are taking a tip. If you trust technical or fundamental analysis past a certain point; charts then become a tipster for you. If you compile reams of data and economic fundamentals, crunch those numbers according to some formula and trade on that data; government reports are your tipster. If you go to a psychic and ask to see the future waiting ahead in the Meat Futures Complex; you are definitely taking a tip.

I think we as traders are susceptible to tips because we really would like to believe that there is just one more piece of data that will disclose where the winning trade is. We desperately want to feel like we have covered every possible piece of information and haven't left anything out. We have really done our homework and no stone was left unturned. Yet so-and-so said...

In my view, the psychology behind this thinking is really two-fold. First, it prevents us from putting ourselves at a needless risk or trading for reasons that are not our own. We need to focus on market structure and trade from a sense of discipline, not gamble and hope someone else is right. Second, we need to constantly remind ourselves that our account balance is ultimately our responsibility and we are fully in control when we execute. Nothing determines our results except our actions and those actions need to be well thought out, proactive, and in harmony with the market we trade; not some mumbo-jumbo we overheard at a bar, read in a book or created for ourselves by running a computer simulation. Successful trading is a factor of several things all working at once, not a factor of opinion or conjecture—even if the source of that opinion or conjecture has an impressive set of credentials. A tip is only one point of view. Right or wrong, the problem with the tip is not the data; it is the fact that the choice to assume the risk was not ours.

One other thing about tips I think is critical to keep in mind. As you get older in the trading arena and become more experienced, there will be times when a trade seems to jump off the screen at you. It is abundantly clear which direction that market has potential in and better yet, you can see that far enough in advance to really hammer the order-flow. You are going to make a lot of money on this one and you know it. Now the phone rings and it is one of your trading associates. A conversation starts about various opportunities you both have working and what you see coming down the pipeline. In a very excited voice, you begin to extol the virtues of the trade you have just identified. With great confidence you tell your friend exactly what you see coming and why that trade will be one of the "home runs" this year. After you finish your dissertation there is silence from your friend for a moment, then you hear a voice with more confidence than your own speak, "You are nuts! That market is dead. I saw a report on CNBC last month about that entire industry and you might as well stand in the street tearing up $100 bills; you will have more fun"

You are stunned but still confident and you restate your argument; and after another 15-minute heated debate you both hang up. Now you are in trouble because the trade that appeared to be so certain to you 20 minutes ago is in question. Your friend raised some good points. He is not going to take the trade even though he asked what you saw coming. Basically, because you offered someone a "tip" when asked, you opened your mind up to an argument about the quality of the "tip". You had to defend and justify your trade conclusion to someone who has no intention of seeing it objectively. The emotional tug-of-war leaves you a bit drained and God forbid six weeks from now if that trade hasn't worked as you expected. You will never hear the end of it. Of course, if you are a really weak trader you might decide to skip that trade anyway after listening to your friend; which is also taking a "tip" Letting yourself get talked out of a potential trade is also a form of "tip" taking.

The point is don't take tips includes the rule don't give tips. The mindset of the tip-giver and the tip-taker are symbiotic and counterproductive to lasting success. If your goal is to remain a net winning trader part of your daily trade strategy must include some form of discipline where you neither give nor receive “tips”

Your key takeaway from this chapter:

Technical Analysis, in all of it simple or complex forms, is a flawed pseudo-science that cannot help you, the trader, make your fortune. There are very few parts to Technical Analysis that offer any consistent potential for you unless you choose to use it differently than the losing traders do. Your best use of Technical Analysis is to use it to find losing traders, not to find trade opportunities for yourself. Losing traders study the markets, winning traders study the losers.

Brief Introduction to the Theory of Time Compression

"Time is money…."

--Old Business Adage

The theory of time compression is a social-economic theory I personally have been developing for decades. Because this information is not in the main stream of trading consciousness at the time of publication, you won't find any supporting documentation on it anywhere except for commentary (both supporting the theory and otherwise) created by people who are attempting to understand the theory themselves or who are attempting to use the theory to construct trading systems in some way. Most of those people are former and current customers/clients of mine and they are attempting to ADD to the understanding of the theory by using it regularly. I want to make this really clear: This is not a discussion on a new form of Technical Analysis. This is a theory attempting to quantify crowd behavior. I am attempting to offer a solution to the real problem Technical Analysis has missed and can't offer you.

I am going to strongly encourage you to purchase a copy of my third book Time Compression Trading (Wiley & Sons, C. 2010) The book offers complete details on what the theory is in its entirety, as well as a much deeper discussion of how time compression is created and exploited in a zero-sum market. I think it is to your advantage to absorb that data completely because this book, The Psychology of Trading, is more of a global over-look of the challenges present in developing a winning trading approach. You need as much depth as you can get to learn certain things. Understanding Time Compression will most likely take a little more work than other things in the development of your market-centric trading paradigm. I personally feel it is more "graduate level" material and will require you to already have solid market-centric insights before you will fully grasp the theory.

Time Compression is a factor (or a result) of how people behave when stimulated a certain way. Crowd behavior is a difficult thing to forecast. There is no certain way to know what someone is going to do until they do it; but one thing is certain: they will do something. There is a need inside people to do certain things when they feel they have an opportunity, or when they feel threatened. Of course, all of this is based on perception; and perception is what makes markets move. Why is perception so important? Because, when a person believes there is an opportunity, they will do something; when they feel they are under threat they will do something. All the various kinds of reactions people can have to what they feel is an important event for them all boil down to whether or not they feel under threat or feel there is an opportunity. There is no reason to do anything without one of these two motivating perceptions. When discussing the markets and those who are participating, once those perceptions have been processed through our decision-making process it results in an order being placed. That is what we want to know; when those orders have the potential to be placed.

A lot of study has been done on motivation and perception. Most of it continues to divide actions done by people into either a desire to gain pleasure or a need to avoid pain. No matter how you slice those two basic motivators, everything we as humans do falls into one of those two categories. Either we want to get something we feel is positive for us or we want to avoid what we feel is negative for us. In the markets, this would naturally be defined as a profit or a loss.

When attempting to define a time compressed market it is critical that you always remember that someone somewhere is placing his order into the market with the intention of receiving pleasure (a profit) or avoiding pain (a loss). There is no other motivator other than these two.

In this section we are going to look at how Time Compression is created based on the perceptions held by the people participating in that particular market event. It doesn't matter if the event is market related or not, when groups of people are stimulated a certain way by events around them, they will behave in a predictable way; either to gain pleasure or to avoid pain. As this plays out in the markets is what we are interested in although time compression happens around us all the time.

What is Time Compression?

Time Compression is the end result of what happens when everyone wants to do the roughly the same thing at about the same time for roughly the same reasons. Time Compression is around us all the time. In fact, it is a natural process that has its start just from the very basic fact that there is more than one person living on the earth today. You cannot get through your day without seeing some sort of time compression at work sooner or later.

For example—the lunch rush at a restaurant. At 11:00 AM the number of people trying to buy lunch suddenly jumps from three or four to maybe several hundred if the restaurant is big enough and well-known enough. In this case, the restaurant knows this and plans their day accordingly for this eventual change in the number of patrons. The cooks arrive and start making the salads early, the servers start around 10:00 getting the tables ready; and the manager makes sure that someone has gotten a starting bankroll for the cash register. None of this is happening at 8:00 in the morning or at midnight the night before. The restaurant knows that they will make most of their money between 11:00 AM and 2:00 PM; they plan for the staff to start as this need arises and not before to control costs, they run regular specials to move older products to control costs, etc. The restaurant can't make a cost-control model or a profit model if they take their daily receipts and divide by the total number of hours they are open; they must plan for time compression in some fashion or risk not having enough staff, food, or change available when the opportunity to make money is there.

The restaurant has found a way to exploit time compression and it works fairly well to keep people employed, customers happy and the bank account growing. What kind of restaurant owner would ignore this eventuality? They don't—it is the very nature of the restaurant business to be available when people want to eat. Sure, you can be available at all times, such as a 24-hour diner, but in the end in that case there likely will be three cases of time compression working everyday: the breakfast rush, the lunch rush, and the dinner rush. That's when people want to eat. The rest is incidental to running a restaurant.

Time compression takes many forms with all parts of our lives. If you want to be at your desk by 8:30 AM in the city, just like everybody else, then you will likely get caught in "rush hour" traffic if you commute from the suburbs. You could leave a little earlier and miss the traffic jam created by everyone else wanting to be at work by 8:30 but you don't; you know how much time rush hour traffic takes from your day and that is how you make it to work each day. So does everybody else.

The form of time compression that always amazes me is what happens on April 15th every year here in the United States. That is when every U.S. citizen must have his yearly income tax return filed with the Internal Revenue Service. Every year, the attendance at sporting events goes down, movie theaters are half-full, restaurants are empty, and dogs aren't walked between April 10th and the 15th. Almost every single tax paying citizen is at home trying to finish his tax return before the deadline. The Post Office is even open until midnight on the 15th with people outside on the curbs taking returns from cars that drive by so that people won't pay a penalty for being late. What amazes me is how many people still wait until the very end knowing that they have a refund due. Wouldn't you want that cash now? I have my income tax form filed with the IRS every year before the end of January and if I am getting a refund I have it in three days instead of three months only because no one at the IRS has anything to do but my return; no one else has filed yet this year.

There are all kinds of examples of time compression at work all around us every day. The grocery store is packed between 5:00 PM and 7:00 PM as people on the way home from work stop to get a quart of milk, long lines at the hot night spot around 10:00 PM Saturday night, the beach is packed at 2:00 PM on a sunny Sunday, the list goes on and on.

In fact, in order to keep society functioning and avoid the delays that time compression can impose on us, people go to great lengths to avoid it or profit from the lack of it. There is the “early bird” special at restaurants, there is the “midnight bowling league”, and there are “special markdowns” at Macy’s if you shop after 8:00 PM for example. People can get great deals on airfare or a vacation if they are willing to travel Tuesday through Thursday instead of Saturday through Monday. Enterprising people can even get things completely free if they buy certain products at certain times just so the vendors have cash coming in when no one else is buying. How many times have you heard someone say they won’t do something because they want to avoid the crowds?

Time Compression is a fact of life because sometimes things happen in such a way that a very large group of people are all motivated in the same direction to the point where there exists a conflict no one in the group wants but must endure. If we could avoid it, we would, but we can’t so we must endure it. Do you know how much money it costs me to get my driver’s license renewed? If the DMV would only have a few hours open in the evenings or weekends I would gladly wait in line; but they don’t. Its 8:30 to 4:30, Monday through Friday; weekends and holidays excluded with them. If I want to drive legally, I have to take a working day off and stand in line. No way around it.

The important thing to remember is that time compression is part of our life, and that includes the markets. When time compression develops in the market it creates a similar experience that we have with other forms of time compression except that we can profit by it instead of being annoyed by it. In fact, you can’t avoid time compression happening in the markets at all. It happens all the time in the markets and is part of how the markets function. Of course, the key is learning how to see it happening and be ready to take advantage of it. Before we start discussing a market-specific form of Time Compression I want to provide a few underlying details that appear to be common with all forms of time compression. These are important in that they help us recognize ways in which time compression develops, how much time is needed for it to be expressed, and what clues to look for to confirm we are seeing time compression and not something else.

In order for time compression to develop, there needs to be an underlying belief structure present in the individual. This belief structure is often based on fear, greed and/or hope. There also must be a tangible benefit to the individual that is readily apparent to the individual; in other words, a sense of certainty about something, the individual must see what they feel is an opportunity brewing in some fashion. It doesn't even have to be a REAL opportunity; they just have to believe it is real for them.

For example, suppose you open your newspaper and there is an advertisement from your local shoe store. It says that between 9:00 and 11:00 AM this Saturday they are having a 2-for-1 sale that includes everything in the store. This is a classic form of time compression potential. First, there is the greed factor of getting more for your money than usual. Second, you must be there at a certain time to get the benefit, and last you hope that the shoes you want will be among the stores current inventory. If you get there early you have a better chance of getting two pairs of shoes you want in your size and if that is the case—you have already decided to buy. Of course, everyone reading that ad is thinking the same thing and reaching the same conclusion. The line at the shoe store starts forming early and is huge at 8:00 AM. Once the doors are opened there is a mad rush to find the shoes you want before someone else finds them. You might even tip the salesperson to ensure that your interests are respected first—thereby erasing the benefit of a 2-for-1 sale actually provides you; but you get your shoes and saved at least something

In this case, time compression was set-up a few days before 9:00 AM on Saturday for all the reasons needed to create it. Time compression began to show up before 8:00 AM only because the conditions dictated a 9:00 AM start to the sale. By 11:00 it was all over and the patrons at the shoe store were likely no larger than they would have been on any given Saturday. End result: a lot of shoes were sold in a short period of time to people who normally wouldn't have bought them. Or likely wouldn't have bought them on that particular Saturday at that particular time. If we look at parallels between time compression developing outside the shoe store and inside the markets, we can find a lot of similarities. In the case of the markets, time compression develops fairly much in the same way but with some different variables that make it unique.

First, there needs to be a precipitating event, like the ad in the newspaper for the shoe store. Usually this is an unexpected event. Suppose there is a headline news story that will be very important to a particular market. If we use the Corn market as an example, let's say that the US Congress has passed a bill that allows Corn farmers to sell old Corn still in the bins as animal feed to Asia. Prior to this—they weren't allowed to do this for some reason—but that has changed. Let's say that China needs about 200% more Corn in the next four months and China will take all the Corn we can sell them if we can ship it in the next 90 days. The price of Corn is $3.00/BU when this event passes in front of the Corn market. For the most part, this would be seen as a bullish development because a sharp increase in demand for a short period of time means that a lot of Corn will go away quickly; high demand will equal rising prices.

In this case, Corn traders will have their greed stimulated because it is a good bet the price will rise, the time is short for the opportunity, the individual trader will likely have a sense of certainty about a potential profit but he has to act fast. Every trader out there is thinking the exact same thing if they have a bullish bias to begin with and most likely there will be a rush to buy the market. A seller probably wouldn't want to sell the market because he knows a higher price is coming and he wants that anyway. So now we have an order-flow imbalance heavily favored to the buy side creating a tremendous surge higher in price. The market trades limit up quickly and stays there for three or four days. That means a lot of buyers are out there and they all want to buy Corn "before it's too late" Again, time is the issue; not price. The perception of potential price later is what is motivating the buyer now.

This is time compression driving price higher. Now, the interesting thing about this scenario is that it happens all the time in the markets and it is only when the event is in the public eye quite dramatically do you get a sharper and more consistent rise; a front-page drought for example. But in any case, the market is becoming time compressed as everybody who has an urge to action is on the buy side of the order-flow. What happens when all those potential buyers have finally had their order filled—and there is no one left to buy Corn anymore? Well, that becomes the top in price. Now you get an equal and dramatic move lower right back to where the market started from. In the final analysis, the four-month average price for the Corn in the bins is about the same before the time-compressed buy-side opportunity resulted in a time-compressed sell-side opportunity. China doesn't actually pay any significantly higher price for the Corn they buy; same as you didn't really get a savings on your shoes.

The perception of the entire event happened inside the mind of the trader and when everyone wanted to buy Corn at the same time no one wanted to sell; the price rallied until it found sellers. Who, because the market is a zero-sum game, are the late buyers who believed they had a sure thing (sense of certainty). They now must exit the market and you can't get out of a buy-side trade unless you use a sell order. The market now falls back to the non-time compressed price area (where it all started from) as those sell orders can't find buyers this time. The whole thing is over in a short period of time and the net result is a transfer of wealth from the loser to the winner—while Corn itself remains at a fairly close average in price.

In most markets, time compression happens with a more subtle character and is usually creating solid highs and lows that can be exploited quite regularly. The purpose of the Corn market illustration is to show you the basic concept and provide you with the things needed for time compression to develop. Again, those basics are:

- Precipitating event (news, change in fundamentals, catastrophic event).

- Greed, fear, and/or hope stimulated (emotions more a priority than price).

- Timeline that requires action done quickly (TIME more important than price).

- Sense of certainty by the individual (everyone expects to make money NOW).

As we look deeper into time compression and how it develops in the market it is important to remember that the individual trader is where all this starts. When the market group of traders all come to the fairly same conclusion is when you get a time compressed market. But there doesn't need to be a big move in price for this to happen. There needs to be a sense of certainty by the individual and that sense of certainty needs to be shared by a large part of the entire group. Remember, nothing happens until an order is placed so we begin understanding time compression by observing and deducing the order-flow. How one individual thinks is a clue to how the whole group is thinking because they all think the same way.

Your key takeaway from this chapter:

Time Compression is a way of understanding how a market develops order-flow and a way of understanding when liquidation potential has reached an exhaustion level resulting in a 100% reversal potential. Time Compression happens in markets with a certain regularity and the key to using it for your trading is understanding how people are motivated to protect themselves and how they are motivated to place themselves at risk. Traders either want to get pleasure (make money) or avoid pain (not have a loss); these motivators help you understand where time compression might be developing leading up to a liquidation event.

Part IV

Putting it All Together

Introduction to Part IV

"There is no greater challenge to a man than successful speculation"

--Robert Rhea

When I first was introduced to the trading arena I was completely ignorant about the markets and trading; I had absolutely no idea what I was eventually getting into. The whole environment was really intoxicating to me, especially when I learned that profit opportunities could be found as prices declined in addition to when prices would rise; unlimited opportunity! Who wouldn't want that? Once I had done just enough homework to be dangerous, I simply could not understand why everyone who was working on building their fortune didn't trade; what was wrong with those people? You can make all kinds of money no matter what happens to the price—why don't you have at least a small account open somewhere?

Once I had begun trading for myself, I got a few "gut punches" fairly quickly; losing a large percent of my trading stake. All of a sudden trading didn't seem so easily exploited. I decided to begin a learning process in addition to banking some cash. I hoped I could "fill in a few holes" in my understanding on the way to my first million. As I discuss in my book The Art of the Trade (Willey & Sons Publishing, C. 2008) I began a journey that became losing year after losing year until I reached an emotional boiling point before things finally turned for me. I can't even begin to communicate how distressed I felt in those early years. You probably feel at least something like I did if you are still experiencing losses. I feel for you. It's horrible but there is a way out and there is a way to learn what you need to learn. It just will happen along a pathway you aren't expecting.

As I discovered, the experience I had was no different than anyone else's experience. The only difference I can ascertain between what I personally endured and what everyone else endures is that I never quit until I had my turning point. I really believe that I eventually learned to start asking the right questions more so than anything else; and that is what led me to my "epiphany" of understanding. Once that happened, I never looked back. My tenacity to never quit, combined with the ability to ask the right questions conspired together to create an environment where I could finally uncover the skills I needed to uncover so I could make more money than I lost. This didn't happen right away, but I was OK with that—I had been on the wrong track for years; now I was on the right track and I didn't care if it still took years to reach my goals. I was going to get there, and nothing was going to stop me.

The important lesson for you to have firmly in your mind as we complete The Psychology of Trading together is that what you need to acquire in your search to become a net-winning trader is the same thing every other net-winning trader has had to acquire: a better way to look at things and the discipline to enforce it. After you acquire a better way to look at things, you need to develop the discipline to execute a winning plan perfectly all the time. No exceptions. When you combine your better point of view with a perfectly executed plan, the probability of your observation paying you more money on winning trades than you will lose on losing trades goes up dramatically. Once you are somewhere north of 44% winning-trades-to-losing-trades ratio, AND, are somewhere better than two-dollars made on your winning trades for every one-dollar you lose on your losing trades; your success probability rises to above 95%. Remember, that is not my opinion, that is the undeniable mathematical reality of the Probability of Ruin Matrix.

In this section we are going to walk through some tools you can implement for yourself that will help you create and enforce a winning approach to participating. We are also going to provide resources and methods for controlling your behavior as well as confronting your behavior when it is not congruent with success. All of this will come from your record-keeping so you need to commit to keeping the most accurate records you can; both your thinking journals and your trade-related records. Those different yet complimentary materials will start coming alive for you when seen in context; and we are going to create the context in the next few chapters. By the end of this book—you should have a very good idea of what you need to do to both FIND the winning pathway for you, as well as STAY ON the winning pathway for you.

I can't emphasize enough that there is no "right" way or "wrong" way to trade; there are only things that lead closer toward and things that lead farther away from optimal performance. You need to become sensitive to what those things are because everyone is slightly different. Until now, we have been discussing things that are accurate for anyone who trades; now we are going to start the process of becoming specific to an individual; meaning you. You might find that things you discover make your approach radically different than someone else's approach. You might find that there isn't really much you have to change at all, but what you have to change is significant enough to prevent you from actualizing the high side of the probability matrix right now. The point is, let your market-centric paradigm grow along the pathway that makes it the most prolific and profitable for you, even if that seems strange to you at first. In other words, if your self-created data and your thinking suggest a radical solution might work—don't reject that potential because it is unfamiliar or might take you in a direction you hadn't planned.

For example, I had one client who discovered that his point of view combined with his developing discipline exposed many opportunities to exploit price changes while the markets were trading in Asia and Europe. He really wasn't looking to stay up all night trading the Japan or London markets, until he saw his profitability going up dramatically because of it. He became a "Night Owl" trader and eventually moved to Hawaii so he could exploit those markets on a more reasonable timescale. Plus, he could afford living in Hawaii at that point too. His trading became what it is because he let it develop along the lines that were best; for him, not necessarily best for you or me.

Take this material in context. It is assuming that you have already begun the process of creating your market-centric trading paradigm. It assumes that you are trading regularly. It assumes that you are both willing and able to make needed changes to your thinking and your behavior. Look at this material as a viable solution for you trading needs if you can appropriate it correctly. There are some very challenging concepts in these next few pages. It would be a good thing for your method if you found something of value for yourself in each chapter.

Again, as we have discussed before, not everything will resonate with you right away—that is fine. Take the material in pieces and re-read what you find more difficult as time goes on. The most critical thing I can communicate to you in this last section of The Psychology of Trading is that it might take only one small thing; something you hadn't even considered before. I have had many students who flipped their switch from "lose" to "win" by applying only one or two vital concepts they discovered after they went through this entire process. How much could that one or two small things be worth to you if you had a similar experience?

Mental Ascent vs. True Discipline

"Whether our action is wholesome or unwholesome depends on whether that action or deed arises from a disciplined or undisciplined state of mind. It is felt that a disciplined mind leads to happiness and an undisciplined mind leads to suffering, and in fact it is said that bringing about discipline within one's mind is the essence of the Buddha's teaching."

--Dalai Lama XIV, The Art of Happiness

Read the above quote slowly and very carefully. I personally am not a Buddhist for very sound reasons that tend to make most Buddhists' nervous, but I find value in most everything that has a connection with some form of self-improvement. Sometimes there is no "self" in "self-improvement" meaning we need guidance by an actual someone to help us reach wherever it is we are trying to go; and we will discuss mentoring later in the appendix. In this chapter, we want to bring 100% of our focus onto the things that are most under our control. We want "our self" to bring something to the table in order to assist our drive for trading success. As far as the Dalai Lama is concerned, our success or failure lies in how disciplined our minds are. He calls it "happiness"; but we are traders. We are happy when we are making money; and we are unhappy when we are not. As far as Buddhist teachings are concerned—and I am not ashamed to suggest that I have taken the great thoughts of the Buddhist tradition and transferred those into a 100% unadulterated drive for profit—my wholesome action and unwholesome action means I have gotten on the right side of the order-flow or I have not; that's it. I am happy when I am on the right side of the order-flow; I am unhappy when I am not. I don't have control of the order-flow; but I do have control over how I see things and how I decide to discipline myself. My happiness is profits, which comes from the right side of the order-flow, which comes from discipline behavior, which comes from disciplined thinking.

In reality, there exists only one thing that is absolutely under our control. As people, who must live on and share a planet with almost 7 billion others of our own kind, we have about zero control of anything going around us about 100% of the time. Meaning, there is no control even when you think there is. There is an illusion we all operate under that suggests we have a modicum of control, but the fact is, those are really just probabilities playing out around us. Don’t think for a minute that because you are not caught up in the result of a negative probability that you personally had anything to do with avoiding that. You didn’t “avoid” anything. In a world where we seek control, even the control we actually do have is almost insignificant to the lack of control around us. And because the worst normally doesn’t happen to us—we have a false sense of certainty and control about what we believe makes the difference. We think we are disciplined when in fact all we have done is stay out of the way of the probabilities that are sure to happen to someone, sooner or later. Sometimes we have contributed to those probabilities, sometimes we haven’t, but that changes nothing. We have no control in any case.

Let me illustrate this by using a scenario that is probably fairly common. Every day there are general aviation pilots that climb inside a small airplane and go flying. A small percentage of those pilots will crash and burn every year. Why does this happen? Because it is statistically impossible for it to be any other way. Flying an airplane is a complicated process that involves many disciplines all working together to avoid a catastrophe. All it takes is ONE of those disciplines to be ignored (or fail) and it could then make another one of those disciplines fail; if enough of those disciplines fail—an accident will result. It’s just probabilities. And it will happen.

For example, if I as a pilot fail to do a proper “preflight” inspection on my airplane, I might miss that a bird has built a nest in my air intake manifold for my engine. I might be able to start my engine and even get it up to power enough for me to take off—but once that bird’s nest gets swallowed by my engine; my engine is likely to fail. Suppose it fails on take-off and I don’t have enough power to clear the power lines at the end of the runway? I will crash and burn. Why? A lack of discipline to do what is expected of anyone who is a pilot. Make sure your airplane is airworthy. Someone will crash this year and failure to do a proper pre-flight inspection will add to that probability.

There is a pilot, someone, somewhere in the world, sooner or later, who is going to ignore doing a preflight check and will miss the bird’s nest in his air intake manifold. Don’t think for a minute that because you are not that pilot that somehow you had anything to do with avoiding that probability. That probability exists for everyone. Just because you have never flown on a small airplane has nothing to do with the fact that a small airplane could drop out of the sky on top of your head because some pilot, somewhere, didn’t do a preflight looking for bird’s nests in his air intake manifold. You have no control. Anywhere. Ever. Even when you think you do. Except one place. That is inside your own head.

Rene Descartes famously said: “I think; therefore, I am…” Descartes crawled into a pizza oven and stayed there for days until he had a breakthrough in his quest for self-understanding. He didn’t know if he was thinking about anything that was true or even real—but he knew he was thinking about it. Therefore, something must exist; that would be the one doing the thinking.

The only control you will ever have is over your own thinking. Your discipline must conform to this reality; otherwise your discipline is wasted and misplaced. For example, if you were to commit to three hours a day, every morning, to uninterrupted market study using Technical Analysis. And, you never wavered on that commitment; rain or shine, during holidays, even when the markets were closed, each and every day you commit to three uninterrupted hours of market study using Technical Analysis. Most people would say that you have great discipline to your method.

Except those three hours of discipline can’t help you gain an advantage over your market competition; nothing you can study in the traditional sense of Technical Analysis can assist your understanding of where the liquidation potential in the order-flow will develop. Those three hours of discipline are creating the illusion of control over your trading; but in reality, you are doing nothing different than the other losers in the market. Your attempt at discipline is misplaced. It has become “Mental Ascent”, not true discipline. Mental Ascent is the process of agreement with what is being discussed or is “at hand” There is a world of difference between talking and agreeing about something and actually changing your behavior for the better.

For example, you might agree that writing bad checks is a bad thing to do. When confronted with your own bounced checks you quickly agree that it would be good to stop writing bad checks. You can clearly discuss the savings in banking fees and how you would avoid causing problems for people who accept your checks. Still, every week, you have one or two bounced checks. You agree that it is a bad thing for you and every week you commit to getting help to avoid the problem; but it really never changes. You keep bouncing checks.

Why is this happening?

When you have a trusted friend look at your finances, that person notices that you keep spending money on movies through your cable service. Your pay-per-view fees using your debit card connected to your checking account are higher than anything else on your cable bill. Your friend says the problem can be solved by simply canceling your debit account connected with pay-per-view. You agree that is a good idea, but you never cancel your account. The problem continues despite more information about where the problem is coming from, despite a third pair of eyes helping you see the problem, and despite your own personal belief or commitment to do better.

Why is that?

Because you simply are too lazy to follow through. Or you want to watch pay-per-view events more than NOT paying bounced check fees. Or something else where staying in front of your TV while paying for shows you can't afford continues regardless of how it hurts you personally in your finances. You don't want to make a change in your behavior. It doesn't matter "why?" you don't want to make a change in your behavior; until you do, your bad-check problem will continue. End-of-story…

The whole conversation about making some sort of a change, but not actually following through, is called Mental Ascent. Mental Ascent is the process of making an emotional or mental agreement with what is best for you but lacking the actual change in your behavior. In reality, it doesn't matter how much you agree that a change would be a good thing for you. Until you actually make a change, the additional knowledge or information you acquire in the process is wasted. There is no point to it. True discipline, on the other hand, is different.

True discipline is the process of bringing permanent change to your behavior; regardless of how you feel about it or what you personally might believe. None of that matters. Regardless of how you feel about it. You don't have to agree with the change. You don't even have to plan for it. It becomes a lasting change to your behavior because you have decided to make it a lasting change to your behavior. True discipline is deciding, in advance, exactly how you will behave/take action when the time comes. True discipline is taking control of your thinking so you can control your behavior.

For example, if you have decided that you need to exercise more, and you agree that it would be good to work out three days a week; a true discipline would be deciding (in advance) that you are going to go to the gym every Monday, Wednesday, and Friday at 5:00 pm on the way home from work; and that is that. Once you get there, you are going to push some weights around. Now is the time to write down exactly what weights you are going to push and for how long. But you have decided, in advance, that you are beyond Mental Ascent, you are beyond agreeing with how good for you it would be to get some exercise. You have decided to take positive action and you are going to the gym M-W-F; and that is that. Until your mental ascent goes a step further and becomes a change in your behavior—you gain nothing.

The only control you have is in your thinking. Your thinking must become a change to your behavior. You can't control your behavior until you control your thinking.

For you to create and enforce a winning trading paradigm, something that you can have a real degree of confidence in, to begin the process of actualizing winning behavior, you have to take control of your thinking until it becomes a change to your behavior. You can't control what happens in the markets. You can't control what happens in the news. You can't control what other traders do. You can't control what the government does, what your kids do, what your boss does, what other drivers on the road do, ad infinitum…. you have no control over anything in your life. Except your own thoughts. Which become your actions. The only control you will ever have is the decision to control your thinking, so you can control your actions better. That is the state of true discipline.

The failure to make this choice is the root problem all traders have. As long as you continue to believe that your trading issues are somehow "outside" of you, you will never see the need to control your thoughts. As long as you believe your losses come from "something out there" that you feel you can somehow extend a sense of control over; your losses will continue to mount until your money is gone.

You cannot extend control to your results by better study, or control reducing your risk through a better strategy, or control your results by paper-trading first, or waiting for confirmation, or any number of external non-essential things that have nothing to do with profits. If you want to win, and win consistently, you have to decide now, right now, that the only thoughts you will allow in your thinking from here forward are those thoughts that assist you in finding the order-flow first; anything else is not going to be tolerated and will be removed. Only those thoughts will lead to making behavior changes that lead to more money in your account. Your behavior becomes your account balance. You have a huge amount of control over your account balance when you fully discipline your trading behavior; until you then, you don't. The key to wealth is disciplined behavior. Nothing else.

You must move past Mental Ascent and move into a state of True Discipline. That is the only choice you have any control over.

Once you have identified which thoughts move you closer to understanding order-flow you will find behavior changes that assist you in keeping those thoughts. For example, if you find that you are afraid of entering the markets once the news comes out—even though you see opportunity all the time after the news comes out—and the only reason you aren't getting paid is because your emotions are interfering—by making the choice that you MUST begin entering the market after the news comes out will lead you to asking questions about where to get in, how to get in, when to get in, and for how long to stay in. You will compile your after-trade data and compare it to your actual executions and find out where best to place your trades. You will find that waiting a certain amount of time will help you get better positioned. After a reasonable number of trades—regardless of results—you will uncover the best time to enter, the best amount of time to hold the trades, what to ignore while you are in, what to watch for should something change; whatever it takes. By making the choice that you must change your behavior—you now begin changing your behavior. After enough trades go by—you discover exactly what changes you need to make in critical detail. At that point—you have a winning edge. The winning edge was developed because you decided, in advance, to develop the winning edge. You stopped agreeing that it was a good idea to make a change, and then continue to do the same thing you always do; instead, you decided to change your behavior and the better results followed.

The first step in creating a personal and effective winning approach is making the choice to move beyond making an agreement with yourself into changing your actual behavior. That is the difference between Mental Ascent and True Discipline.

Your key takeaway from this chapter:

You have no control over anything in your world except your own thoughts. By controlling your thoughts, you create different behaviors. The more you control your thoughts to reflect the true nature of the markets the more likely your behavior can exploit the order-flow potential. Your choice is to make your thoughts congruent with the markets, so your behavior becomes profitable participation. If you don’t make that choice, and then follow through, your results cannot change.

"The Circle of the Trade"

"You have power over your mind, not outside events. Realize this, and you will find strength."

--Marcus Aurelius, Emperor of Rome

In the last chapter, we talked about the bedrock issue of true discipline. We discussed changing your thinking and how that will lead to a change in your behavior. In this chapter, we are going to discuss the changes in your thinking that point the way to better trading success. In the next chapter, we will talk about better trading behavior, but for now, I want to create a picture of how your market-centric trading paradigm might look like if it were an image you could actually look at every day. This is your winning paradigm disclosed in a global fashion; what it would "look like" for any consistently profitable trader. Obviously, there are parts of this paradigm that might not resonate with you at first, and there are parts of the paradigm that might be confusing, but the bottom line is once you begin appropriating the knowledge disclosed in this image you will begin to take control of your thinking at a much more market-centric level than you have before. It is one thing to agree with the need for changing your thinking; it is another when you actually take the steps and follow a program of modifying and controlling how you think. You need tools for that, and this image is one of them.

(Click Here and navigate to "Bonus Material" to download the FREE "Circle of the Trade" poster)

If your system can support it, please print this image and have it near you while you are trading; such as posted on the wall in front of your desk or inside a plastic sheet protector so you can refer to it. As you go through your trading day refer back to this image and ask yourself how well you are following the “Circle of the Trade” and managing your emotions as they come into your thinking. Your goal is to develop a non-attachment mindset completely; absolutely no emotional interference of any kind at all. To do that requires practice and reinforcement.

Let’s start the process of uncovering how you develop a non-attachment mindset. Look at the center of the image and focus on this concept; that you are ALWAYS participating. You are EITHER initiating or you are liquidating; but you are ALWAYS participating. You are not necessarily entering or leaving the market when you participate; but you are always participating:

- Initiation is: “Getting In” or “Staying Out”
- Liquidation is: “Getting Out” or “Staying In”

If you are waiting to enter a position you are initiating by Staying Out; maybe that is days or weeks (or maybe you are away on vacation), it doesn’t matter because you are participating all the time. When your opportunity is present to take an active position, you initiate by Getting In. You actively take a position when your edge shows up. Once you have an active position on, you must now liquidate again, and you start liquidating immediately by Staying In. You continue to Liquidate by Staying In until your exit price/time relationship provides you with the opportunity to take the most money possible from that active trade or to limit your money lost if the trade went against you; you then liquidate by Getting Out. This choice can be disciplined in advance if you choose by placing a stop-loss order to limit downside risk, and/or a price-limit order to liquidate a winning trade.

You complete the Circle of the Trade all day, every day, by participating all the time; whether you have an active position on or not. An active trade occurs when your daily moment-to-moment participation meets a time/price relationship triggered by your edge; the opportunity you create by your impartial observational non-biased method you have developed for yourself. Until that price/time relationship is triggered there is nothing active to do so you are initiating by Staying Out. Once your edge has discovered an opportunity defined by your probabilities, your initiation executes an entry by Getting In. Now there is nothing to do so you liquidate by Staying In until your edge has discovered your exit point in the time/price relationship; then you liquidate by Getting out. This circle of activity is happening all the time all day, every day. You are either actively participating or you are actively sitting on the sidelines waiting for your edge to show; in either case, you are doing nothing the whole time as the never-ending sequence of unlimited opportunity unfolds around you. The only thing "to do" is take the money the market offers you while you remain in a state of complete emotional discipline and non-attachment. You are sitting there quietly doing nothing as the market unfolds around you—you are just watching & waiting for your edge to show up—then giving the market your edge.

It doesn't matter what the market does—because you are only waiting for the probabilities you personally have decided are the ones for you to show up (Your edge). Otherwise you wait.

It doesn't matter what other traders do—because they have no effect on creating your probabilities (Other than becoming the order-flow); which you have already decided what has a probability for you so you don't need "more" from other traders in some fashion.

There are no missed opportunities—because you are always participating. How can you miss anything if you are always involved?

There is no conflict from your emotions—because you have already decided ahead of time what you will do, when you will do it and how you will do it. There is nothing to do—and no missed opportunities—until your edge show up. The only opportunity is YOUR edge, so where could there be a conflict?

You are always at rest, always in a state of emotional peace, always anticipating the next set of probabilities, and always doing nothing until those probabilities show up. You are always at rest

As a perfectly disciplined trader executing his plan perfectly—all you need do all day, every day, is follow the Circle of the Trade and accept what your results are as you create them. Whatever probabilities you have discovered and decided to use will have a percentage of successful trades and a series of losing trades. We already know that, so any one transaction doesn't really matter, because your probabilities exist over a reasonable sample set that is usually no less than 100 individual trades. Whatever happens on any one trade doesn't matter because you can only measure your success when you complete your total sample set. Until that point there is nothing to do but execute your edge with perfect discipline, there is nothing to think about except to follow through when your edge shows up.

Maybe you could improve those probabilities by making needed changes—but that is a different issue than following your trading plan at 100% discipline. To do that—you must follow the Circle of the Trade. Once you have collected enough data, then you can consider making enhancements or changes to your edge, money management, or other trading issues; all of which will be implemented the same way: by following the Circle of the Trade all day, every day.

Notice as you move around the other images on the page. You have clues to self-sabotage—which is listening to your self-talk. When you find that your inner voice is speaking in certain words or using certain thinking-patterns you can instantly see where that has the potential to take your eyes off the ball (so to speak). You must immediately re-focus your thinking back to the non-attachment state of following the Circle of the Trade all day, every day.

While we are on the subject of non-attachment, I want to introduce you to an Eastern/Taoist concept called “The Principle of the Uncarved Block” I am not suggesting that trading has mystical roots or that The Psychology of Trading is a pathway to an obscure religious practice; or that you will be expected to become some sort of monk to become a winner—nothing of the sort. What I discovered about winning in the markets and what I learned from studying winning traders was an underlying principle of non-attachment that can be clearly defined. That definition is very close to the Taoist tradition; and in fact, would be considered one of the central themes of Buddhism. The only part of any pre-existing thinking pattern or belief structure that we are concerned with is how something like non-attachment allows us to better execute a winning trading approach.

The Principle of the Uncarved Block

This is also defined as “A thing in its natural state” If you were intending to pass through life and be in as much harmony as possible with everything around you, you would not want to disrupt the flow of “How Things Are” A very basic example might be: water flowing down hill to meet the ocean eventually. By forcing water into a man-made canal and directing it to where you wanted it to go, you would be interrupting the path that water would naturally take on its own; thereby depriving something downstream of the water it ordinarily would have. That would be interrupting something in its natural state; creating disharmony and conflict. Water is a thing in its natural state; it flows downhill and, by its nature, will collect and flow the easiest pathway it can find downhill until it reaches the ocean and stops flowing. OTHER THINGS IN THEIR NATURAL STATE—like seeds and plants, will grow along the pathway where the water flows, because that is the nature of “How Plants Grow”; they require water to grow. So—if you change the flow of water to suit your own needs—you deprive something else from becoming what they are designed to be, and the potential to produce fruit/food goes down because something, somewhere, is no longer in its natural state.

The basic idea is that when something is in its natural state, it flows in harmony with everything else and produces abundance because that is “How Things Are” when they are left to exist without interference. If you take a piece of wood and decided to carve it into a box for keeping something in; that would be disrupting the natural state of the wood as it exists in harmony with the world around it; by leaving the block uncarved when you find it—you are leaving things in a state of harmony. Your goal is to trade by the principle of the uncarved block.

A market is a thing in its natural state. All price action is in perfect harmony with the market as it seeks to balance the never-ending order-flow imbalance; all price action is correct. The market is a perfectly balanced inequality seeking to fill orders placed into it. There is nothing else. The market is a machine and this machine operates perfectly.

When you as a trader, become a thing in its natural state, you can interface with the market as you see the opportunity unfolding. If you are emotionally at peace with the market, willing to accept what the market will give you, or take away from you, not willing to impose your own thinking on the natural state of the market, not willing to force your own participation from something that would disrupt your understanding of how the market is flowing; you become a thing in its natural state seeking to keep a harmonious relationship with the world (market) around you. You and the market become the same thing; a thing in its natural state.

By letting the market just be whatever it is going to be, and just letting yourself be whatever you need to be; you participate with perfect clarity and perfect discipline, there will be no conflict in your participation. Trading becomes effortless as you simply do what you do when you do it and wait for the market to do whatever it is going to do when it does what it does. If you don’t see anything according to your plan, you remain at rest, doing nothing, executing your initiation by Staying Out. If you have taken an active position because you perceived an opportunity was there, but the market has begun going against you; there is nothing to do but liquidate according to your plan. So, you do nothing until your exit stop-loss order is triggered and then you have liquidated by Getting Out shortly after you remained liquidating by Staying In. If the trade was going favorably you would liquidate by Staying In until the market reached your exit point, then you liquidate by Getting Out using a market order, a price-limit order, or perhaps a stop-loss order if you had chosen to use a "rolling stop" strategy for Staying In; until then you are at rest doing nothing. If it takes two weeks for that trade to make the most out of the potential you found, that simply doesn't matter; because you are always participating and always at rest. Those two weeks would have passed anyway. You are a thing in its natural state. You and the market are the uncarved block; a thing in its natural state together.

As you control your thinking at a deeper and deeper level the markets will cease to agitate you or cause you emotional pain. Because—in reality—all the market is doing is what it would always have done regardless of whether you are participating along with it or not. Anything you perceive as "being done to you" argues that you have a sense of attachment to results or to price action. If you place a trade, and it goes against you, then you immediately feel a sense of panic—where is that coming from? It isn't coming from the market because all the market is doing is processing orders and the market doesn't know you have a position on. Whatever you are feeling is happening inside of your mind—and nowhere else. YOU are creating whatever emotions or pain you are feeling because YOU have a sense of attachment to what the market should have done for you—when that didn't happen; you had an unmet expectation. All of that happened inside your head—it didn't happen in the markets. The market is a perfect thing in its natural state in perfect harmony with everything else. If you can't harmonize with the market—who has the problem?

Contrast that experience with the one of quietly sitting doing nothing. No matter what happens, you feel no conflict of any kind; just a sense of peace and serenity as the never-ending event of price action continues to play out forever. With or without you AND with or without you.

That sense of complete harmony and non-attachment is the market-centric paradigm of a winning trader. The practice of enforcing the Circle of the Trade moment-to-moment creates that harmony and sense of non-attachment. This becomes the fully disciplined state of “This is what the market says; this is what I do”. Think of it as: Dancing While Someone Else Leads…

Your key takeaway from this chapter:

The market is a never-ending unfolding event that is a perfectly balanced inequality of correct price action. It is a thing in its natural state. When you choose to operate in complete harmony with the market you become the same thing as the market, a thing in its natural state. To properly interface with the market, you need to be participating all the time and executing all the time by sitting quietly doing nothing until your opportunity shows up. What to do next is self-evident and there is no need for emotions or other distractions to play any role in your participation. When you feel emotions or distractions that only means that something is interfering with your sense of harmony—and that has nothing to do with the market.

Creating and Testing an Edge

"Time is an illusion—timing is an art…"

--Stefan Emunds

When I was a younger trader, I would get very confused when I had conversations with older, more experienced traders; they tended to look at the markets through the lens of something they called "their edge". Bear in mind, like most people with little trading experience at the time, I thought the goal of all this analysis stuff was to figure out "which way the market would go" so that all I had to do was go "long" or "short" to profit. After I learned the lessons like "being right too soon" and "waiting for retracements" I began to understand the concept of "an edge" and why the need to be very defined. What is an edge?

An edge is nothing more than one set of probabilities being more likely than another set of probabilities. You could say that our conversation earlier about the 12 choices present in finding opportunity would be something like an edge; anything that helps you narrow down probabilities for you could be considered part of your edge. The important issue for creating an edge is that it needs to have a probability that is better than chance whenever possible. Now, there are a lot of very experienced traders who have created edges that are actually worse than chance, and typically the reason they use them is because when they are correct about the price action moving forward, it often is a price move of epic proportions; if you could buy the low for the year, for example, and hold that trade for several months; you might make hundreds of percent on your account balance. Maybe that edge needs to try buying a low print 7-or-8 times before it finally buys the actual bottom. That is a low-probability edge but when it hits—WOW…it is a monster edge. Part of refining your edge is understanding what the edge is really doing. You can have a lower probability edge that is highly profitable if you know how to correctly deploy that edge; no one would say that is a bad thing. For now, I would suggest you focus on higher-probability edges and wait until you have a lot more experience if you wish to use a lower-probability edge for some reason at a later time.

An edge is just a probability. In order for the edge to have a probability that is higher, it needs to be congruent with the structure of the market. As we have discussed before, the structure of the market is a function of the underlying order-flow. Your edge needs to be something that understands a few things about the order-flow as it either could be changing or as it could be remaining the same. If we look at the markets as a whole, we already know there are only three things any market can do as the underlying order-flow keeps presenting itself:

1. If the order-flow is basically larger on one side than the other side as time moves on; then the market is trending higher or lower; depending on whether sell orders are mostly larger than buy orders OR buy orders are mostly larger than sell orders.

2. If the order flow is basically the same from both sides most of the time the market is temporarily balanced, and the market is trading in a range.

Therefore, a market can do only three things: Trend UP, Trend DOWN, or Trend SIDEWAYS.

With that in mind, you only need to decide how to participate in those three market scenarios and you can begin creating and testing an edge. As we discussed in Part III there are a total of 12 choices present in creating opportunity. Six of those choices have to do with something remaining the same and six are anticipating something might be changing. If you narrow your choices down to the best one for you within the three kinds of market price action, creating and testing your edge become a very simple thing to do. Before we create and test a basic edge for you, we need to have a short discussion about how the market delineates time.

Understanding Multiple Timeframes

The average market participant operates on a time frame of 72 hours or less. The Typical losing trader, someone who buys into the "Technical Analysis" argument, someone who plots hundreds of charts expecting them all to help him make money, someone who is allowing his emotions to control when he trades; all operate on lower timeframes. In fact, they "study" the market on 1/3/5-minute time scales and rarely look at anything above a 15-minute time scale. The winning trader, on the other hand, typically operates on time scales that are 60-minutes or more. The simplest reason "why?" is because winning traders know it takes days or weeks for any market to process enough orders to create a liquidation scenario big enough to make a larger move. Winning traders are OK with taking time to win; losing traders all want to make money "right now" and they define "right now" as the next few minutes; in rare cases they define "right now" as meaning "by the end of the day" or something.

You need to think of the larger, more defined market move that happens over days or weeks as the underlying "theme" to the market's "music"; whereas the moment-to-moment chop and switchbacks in price as the "random noise" inside of the music. Part of the reason why losing traders lose so consistently is that they are trying to exploit price action that is really just random noise and is not significant or definable enough to represent the overall price potential. If you go back to our illustration of a "loser chart" you will notice that the timeframe for the chart is the 5-minute time scale. If you look at the typical "buy-point" on the "loser chart" and then scale out to the 60-minute or the 120-minute price chart you will see that usually the 5-minute "buy point" on the "loser chart" is right about where the highs form on the larger timeframe charts for a good-quality "sell" opportunity. You will find that typically the market is lower in price from the 5-minute buy-point 24 hours later—and often by the end of the current trading period; say a week or so. The winner has a short positioned for a larger move as the losing trader begins liquidating his losing longs from a buy-point that didn't see "the big picture" potential as being more likely. Probabilities tend to favor the higher timeframes.

Your best potential for creating an edge is to use the largest timeframe you are comfortable with and consider how the losing trader would be getting positioned in the same market if he was using a smaller timeframe to find his entries.

Context and Deployment of an Edge

To reach your full potential as a trader, you need to see the issue of trading more as a specific and particular way of seeing things, combined with a high probability of exploiting what you see when the conditions are right for you.

Let me illustrate:

If a market can only do one of three things at a time—what is it doing now? Let’s suppose the market is trending higher. How do you make money in a market that is trending higher in price? You have to be long that market. Where is the best place to buy an up-trending market? The lowest price possible before it rises in price. Where is that price point?

I can hear all the heads spinning out there right now. “Of course, I know that! But how do I find that low price to get in?” “Well, that depends…how long has the trend been in place? Maybe it is near ending.” “That is just great—except how do I know the trend isn’t over when it sells off to that buy point, if I can even find that buy point?” Do you see what I am getting at? The above illustration is an entirely accurate reasoning process to join an uptrend…except that everyone sees it differently and doesn’t know how to get positioned. That’s why they rely on things “outside” of themselves to “study”. It helps them form a context; except they are approaching the context all wrong. It’s OK for everyone to see it differently—because the only person we care about seeing it correctly is YOU.

What is the correct way of seeing it? Any way you want to…as long as it is consistent from your point of view and from your urge to action. In other words, it doesn’t matter how you personally choose to look at the market opportunity as long as you do it the same way all the time and when you place trades you are also doing it the same way all the time. Doing your actions all the same way all the time increases the potential for the probabilities you have identified to fall to the bottom line as a profit. It is similar to when a professional baseball player will “wait for his pitch” or when a professional racing driver will “drive his line” It doesn’t matter what other traders see or don’t see—it doesn’t matter how other traders participate. They don’t know anything of value anyway, otherwise they wouldn’t be losing 85% of the time.

How you consistently see things is the starting point for developing your edge. With that in mind, let's pick up with creating you first edge. What is the market doing now?

1. Use the SAME timeframe every time to decide what the market is doing right now.

2. Use the SAME criteria to define what the market is doing all the time.

3. Ask the SAME question: "Is anything changing or are things staying the same?"

A trend can only continue as long as the order-flow imbalance continues the same way. A trend will end when the order-flow goes temporarily into a balanced state (in which case the trend will end in range for a period of time) or when the order-flow imbalance reverses completely (in which case the market trend will end abruptly and prices will reverse quickly).

Now, as long as you are viewing the market under the same timeframe and conditions all the time, identifying uptrend, downtrend and range are all very simple because you already know what that looks like. An uptrend is prices mostly rising with a consistent ebb-and-flow of prices providing opportunity to buy the dips regularly. A downtrend is basically the opposite of that price action as prices decline consistently. A range is when prices stay in the same general area trading up to the top and then down to the bottom price areas regularly. Now, you can create your edge.

If you have decided that "going with the trend" is your best opportunity; then you need to decide how and when you will buy a price sell-off during uptrend and sell a price-rally during downtrend. So, you need one edge expressed two ways. What is that edge for you?

Here are a few samples of entry rules developed by my students as guidelines for you. Remember, how you see things is all that matters—you want your edge to be as congruent with the market structure as you can make it:

“I draw a trendline on the 60-minute chart using the last two rejected lows; as long as the 50 bar Moving Average stays above that trendline—I am OK to buy dips. I buy each time the market trades to my trendline—goes below it—then closes back above it—I buy the close of that bar with a 1% stop on my equity.”

“I buy every sell-off that includes a test of the previous weeks closing range. If the market can’t go any lower than last week’s close—nothing is changing as far as I can tell.”

“My best entry is a 50% pullback from a weekly high price that includes the monthly low price. I figure the losers are all short by then, but the big money is still sitting tight. I buy on the daily close and run a 1.5% risk-stop…the trade is even better if that stop can be UNDER the monthly low.”

As you can see, price action is what is important to these traders—not what the price is. Price action is a discussion about what is more likely and not a search for certainty.

Now, if you see things a different way—that is fine. As long as you define that observation very well—and follow it the same way every time. You then will have no trouble creating a few edges for yourself as time goes on. But for the sake of clarity—you need only a handful of edges to make your fortune. Let’s put some basic edges on the table to give you a starting point. These edges are only for the illustration of how to create edges; I don’t expect you to take these edges as described here and begin trading them exactly as we discuss here. These are guidelines for creating edges; they can be very accurate guidelines, but they are still guidelines. You need to take the guidelines and decide on an execution timeframe for your entries/exits, decide how to define “a pullback”, how to define “staying the same”, and how to define “something is changing”; you need to make these specifics very clear so that you can enforce them.

Basic Edges:

1. Join a trend in progress I.E. BUY a sell-off during uptrend, SELL a rally during downtrend. This is the same edge but written inversely for each market condition.

2. Join a RANGE in progress: I.E. BUY the bottom of the range and/or sell the top of the range with a protective risk-stop outside the range (less probability of getting hit). I personally do my buy-entries and sell-entries inside the top or bottom 5-10% of the price range.

How will you choose to define uptrend, downtrend, and range? What will you say constitutes a pullback so you can get positioned? What size leverage (if any) to use on your first entry using these edges? What will tell you the trend or range is over and something else is coming next? How can you tell if something is changing or if it is remaining the same?

The number and depth of your questions to create your edge will help you in refining it so that the probabilities will get better with use. Remember, there is no perfect edge and there are no 100% probabilities. This is why you must keep meticulous records and review them regularly searching for cultural myth and self-sabotage. You want to create a working edge without any interference from your emotions or sense of attachment, without a need for certainty, etc. Your edge is YOUR edge; keep working on it until you are making consistent and solid winning trades with it. Make it enforceable by being very specific and disciplining yourself to take every signal. If you “fudge” on your plan—write that down too and ask yourself: “What was I thinking here?” You need a lot of accurate data to help enforce your edge as it unfolds. DO NOT listen to other traders for “help” in refining your edge(s). They don’t know what they are doing in the first place, most of them.

As your market knowledge grows and your skill level becomes more disciplined you can start the process of finding and creating edges that are more detailed and specific. Perhaps your next edge might be finding a way to exploit reversal potential. Very dangerous if you don’t know what you are doing—but the most profitable method out there. Maybe you might want to try your hand at a breakout trade—again, very dangerous but highly profitable. If you take some time to think it through, you could do very well exploiting option-time-decay if you could sell premium during periods of high volatility; again—everyone knows about that potential in these types of trades, but how would YOU create YOUR edge in order to take advantage of what you already know? The upside for edge creation is really unlimited except for our own thinking. If you can begin the process of creating better and more lucrative edges by simply getting very good at making your basic edges profitable; how far could you go?

Liquidation

Probably the hardest part of creating your edges is the issue of liquidation. When do I get out??? The answer is the same as creating your edge—how do you see it? At what point will it (meaning the current trade you have on) be over? Whenever you think that it is—that is the right answer. As you do more and more entries/exits you will compare that data to your “after-trade data” for clues to how solid of an entry your edge really is and how much opportunity it really does uncover. You might find that holding your trades longer would have resulted in a significantly higher profit level; so how can you write better rules for holding your trades? What are the clues to look for before getting out of a trade?

I sincerely wish I could give you more help with this issue in these pages—but I really can't. This part of The Psychology of Trading is a very personal part and most of the time it requires a solid process of mentoring for a trader to learn his/her best strategies for liquidation. "Getting out" of a market is the most difficult part of the "Circle of the Trade" but it is still important that it be done according to a process and a plan. Your process and your plan start by just doing what you think is the right thing, then comparing it to your data. Now—you need to look for clues that will lead to better liquidation and sometimes those clues will not be apparent to you right away. Mentoring is the process of helping the trader see what he/she can't see without help. Once you see it properly—you don't need help. Remember, liquidation is both "Staying In" and "Getting Out"; part of your liquidation process is a way for you to hold your winners for as long as the potential is still there for order-flow to remain net-in-your-favor BEFORE actually exiting the market. You need to keep highly accurate records of WHY you feel the need to liquidate the way you do. Do a lot of comparing of what you actually create to what the market did AFTER your exit using your accurate "After Trade" data.

My suggestion is to learn how your personal liquidation style plays out by using it in real-time to the absolute best potential you can manage. Once you have a solid sample set of your behavior compared with your after-trade data you can take that information to a qualified mentor. But in any case—some of the clues will be apparent to you right away—keep following the process of observation and record keeping. Eventually everything you need will be right there in front of you—assuming you have been as accurate as you could be with your record keeping. You will find that as time goes on and you continue to improve your exit strategies, your willingness to stay in trades longer will cause you to increase your active participation timeframes. If your edge provides a trade and you find that you are getting out too early most of the time—you will naturally want to expand your time horizons. That is a really good thing to do because your edge will eventually uncover some really big trades—those trades will need a lot of time to pay you really big wins. They are worth finding and holding.

However, there is one form of trade-liquidation that I would suggest you try implementing right away and that is the "rolling stop" strategy. This is not the same as a “trailing stop” strategy, which is a highly effective method for cutting profits short. The “rolling stop” strategy is a way of letting profits run.

The basic strategy involves attempting to hold a trade forever; as long as the market is continuing to move favorably. Simply put—if a market is trending lower you would want to stay short forever until the price reaches zero. Most likely, that won’t actually happen—but a trending market can go one-way for quite a long time; even to the point where it surprises the most seasoned traders. Why not try to get most of that move?

I found that if I roll my stop to protect open-trade gains it is best to look back about 72 hours or more and place my exit stop somewhere beyond the reach of price action during the past 72 hours. Sometimes that means that very little of my open trade gains are actually protected but that is OK because if this trade really has potential then it will take weeks or longer to play out and it will need room to maneuver anyway. As long as the weekly high/low for that trade continues to get better and better every week—I just roll the stop to lock about a 1% gain on equity each week. If it turns out that I have a really big open-trade gain that might be something like 15% of my account balance or more I will move the stop to lock about half of that—and then just let it ride. Additionally, I ALWAYS look to ADD to open-trade winners; and I have a whole rule set for that—but first the initial trade has to be holding a big win.

Along with the rolling-stop and the let-it-ride liquidation strategy I often employ an option strategy. If I am long a Futures market and I have a nice gain locked in—I will look to see when put-options for that market are set to expire. When the options have less than a month to expiration—I will buy an at-the-money or one-strike out-of-the-money put option against my open futures position. Basically—I can lock a permanent profit for the next 30 days or so with absolutely no downside risk. It will cost a few dollars for the expiring premium but that will be really cheap by then anyway. Once this trade is locked up—I can let it ride for 30 days no matter what the market is doing. It’s cheap insurance that allows me to sit through ANYTHING that happens in that market waiting for further price action my way. Sometimes I go on vacation when I have trades locked-up like this. Nothing to do but wait anyway. This is a great strategy to hold winners through something that might cause a LOT of volatility; like a central bank changing interest rates or a government starting a war. All of these strategies and techniques have their basis in the assumption that we have an idea of what we are doing first; so, don't try any of this until your skill at managing your basic edges is well-defined.

Testing Your Edges

It is my opinion that you cannot reasonably test your edges any other way except by taking real trades in real time with them. Paper-trading and "back-testing" are all forms of mental masturbation that can provide you with no real help. All they will do is create a false sense of security about the "validity" of your edges and shield you from the real risks of trading while they do it.

Let's talk about "Back-Testing" first. This is the process where someone finds what they believe is an edge, and then compares it to what the market did in the past in order to see how successful it would have been. None of these hypothetical trades were ever done by anyone. How easy is it to say: "Since we know the market was eventually moving lower—I would have found a way to be short"? or vice versa. "Back testing" is just a method of convincing yourself you have found something that will be profitable. Once you begin using it in real-time you will find that it doesn't do so well. Why? Because there never was any risk to the trader and conditions are never exactly the same twice. Once you begin trading in real-time, with real money, you begin to experience all the emotions and issues related to live trading—nothing can prepare you for that—not even reams of old data that says "You could have been successful already!" You will have things begin to happen that you weren't prepared for—including price action that didn't appear to be the same as it was in the past, stops that are too close, volatility that wipes out gains, etc. "Back-Testing" doesn't consider all the far more critical components of trading—the day-to-day management of your thinking, emotions and actions. "Back-Testing" suggests you could have made money if only you had done such-and-such. Well, Guess what? We already know that. Any one of us could make money if we get on the right side of the market. All “Back-Testing” does is provide a level of false confidence to someone who otherwise lacks the real confidence to test his market-hypothesis in real time with real money. Additionally, “Back-Testing” operates from an assumption that is REALLY dangerous to the trader. The price action that happened in the past happened because certain traders placed orders a certain way; assuming that the orders placed moving forward will be placed the exact same way by the exact same traders. It is completely possible that the actual traders who placed the orders in that market last year are wiped out already and they won’t be there to place any more orders this year; conditions in the market moving forward are not “static” like the historical records are.

Think of it this way: The market can only trade the orders that are placed into it. If the people trading now think differently this year from last year, then their order-placement will be different. If there are different people trading entirely—the order-flow could be dramatically different. All back-testing says is this: “If you would have traded the order-flow as it actually was in the past using the trade rules we are testing now—you would have made money” All Back-Testing does is provide you with this scenario: “If the order-flow moving forward is exactly like it was in the past—then using these trade rules we just tested should provide you with similar trading results”

But the order-flow is NEVER going to be exactly like it was in the past, because the people trading in the market are different, the fundamentals that drive people’s assumptions will be different, the people using certain size trades will be different; there are a whole group of variables that exist constantly that make it virtually impossible to know what conditions or prices in the markets will be until after the market gets there. The order-flow moving forward is never going to be exactly like it was in the past—"Back-Testing” an edge to see how it performed on a historical level can’t provide you with anything more than a “maybe” it has any potential moving forward. “Back-Testing” assumes conditions in all markets are exactly the same moving forward as they were in the past; and we all know that is not true. This is why heavily “Back-Tested” systems never do as well moving forward as the systems-developer claims they do. In fact, as most traders who buy these heavily “Back-Tested” systems can tell you, they almost never make anywhere near the money claimed by the developers; rather most of them have losses.

In my view, paper-trading does even more damage and is just a ridiculous waste of time & effort. In this case, the trader who “paper-trades” is not even intending to get into the market at all. The idea behind this form of Bull-Cookies is: “If I PRETEND to be a successful trader—eventually I can become one.” By that reasoning—if you play enough Microsoft Flight Simulator—you could learn enough about an F-16 to go into LIVE COMBAT with a Russian MIG-29 pilot trained to kill you—and do it just as well as Chuck Yeager. It is an absolute fantasy to think you can learn to trade by pretending to trade. If you are paper-trading now—just go hang yourself. You have a better shot at seeing God than you do making any consistently winning trades. Besides, talking with God will be more fun than watching your money evaporate once you have convinced yourself that paper-trading has made you a real pro at this.

One of the funniest statistics I ever saw was the actual percentage of losing traders who had “Graduated” from the online paper-trading forum/classroom/division offered by Alaron Trading, Chicago, IL. Alaron Trading is gone now, so I feel I can discuss what I discovered about how they did business. I happened to personally know one of the managers who previously worked with Alaron Trading and he told me about the paper-trading division of the company. This is where the company offered to train/educate/help anyone who thought they needed the help by offering an online classroom/chat room where people were encouraged to paper-trade their trading ideas and discuss it with the entire group of paper-traders. They even had “expert” traders hold regular education webinars for these people. Once someone felt they had enough confidence to begin trading for real, the company would have them open a real-money trading account. The failure rate was 100%. That is not an exaggeration. 100% of the people who invested time in the paper-trading forum before trading a real-money account lost money when they finally stopped pretending to trade and began actually trading. The reason I thought it was funny is because I didn’t think there really were people who actually paper-traded anymore. I thought people were smart enough to see what they were doing.

Playing “HALO” online with a bunch of your computer-geek friends is not going to actually qualify you as a real Navy SEAL. I thought it was clear that “B.S.ing” yourself was a sure-fire way to lose all your trading capital. But I guess people will believe anything if money could be involved. I think that says it all.

The only way to really test your edge is to trade it. You will learn more about yourself and how the market works the more time you invest in the real world. There are things you can do to help with the real risks of trading, and I would suggest a few for you:

1. If you think you can afford to open a $10,000 account somewhere—try opening a $1000 account and trade the absolute smallest size your broker will allow. If possible—don’t use any leverage at all for at least a period of time. Add money to your account(s) only when you have proven to yourself that your edge is viable and will identify opportunities for you.

2. Don’t trade more than 2-3 markets at a time. If the truth were told, you really only need one market to excel at. Get really good at one market at a time.

3. Don’t reevaluate the quality of your edge until you have a solid sample set—usually 100 trades or more; and don’t forget to use your “after-trade” data for additional clues.

4. If you have earned gains; it’s OK to celebrate. I always suggest to my students that they plan on taking some amount of money home from their account to reward themselves for a winning month, or a winning quarter.

5. It takes time to become consistently profitable. Have low expectations for your account growth—BUT—have high expectations for your personal growth.

To close out this chapter it is very important that you learn to have a reasonable expectation of your edge potential. It might take a few tries before you finally settle on the best way to express your edge. The reason why I suggest that you start small and give yourself some time before you make any changes is because slow, solid growth is lasting growth. I can tell you from personal experience that learning to trade needs to be a process that you honor with solid effort and solid time. When you finally “get it” you likely will have the ability to pay yourself anything you want anytime you want by exploiting a well-defined edge. Look at this like a true professional. Make time to learn, take time to learn. Use your edge in real-time with real money. Losses are part of the business and everyone has them. Learn to make your losses pay you a benefit by teaching you something. Your profits will take care of themselves.

Your key takeaway from this chapter:

Your edge comes from inside you and there is no right or wrong way to create it. Your edge needs to be congruent with the structure of the market for it to have the highest probability of success. Test your edge in real time with real money for the best data to refine the edge. Make your edge definition simple until you have mastered regular profit. Start small but consistently until you have regular gains.

Proper Execution

"It does not do to leave a live dragon out of your calculations; if you live near one…"

--J.R.R. Tolkien, The Hobbit

I would like to believe that everyone has read The Lord of the Rings trilogy, including the prequel The Hobbit. I personally feel that The Hobbit was the best book in the series although the whole trilogy is a masterwork of literary fiction/fantasy. If you think about the risk you would be taking in an attempt to rid yourself of a dragon, it might actually be a better strategy to pass by without ever engaging a dragon in battle. Dragons have to be one of the most difficult adversaries around, I would think. Better to let sleeping dragons lie…

In the markets, your biggest adversary as a trader is YOU, actually. Learning to master yourself, your choices, your thinking, your behavior, and the whole host of inequalities you bring to the table when you have a bad day, or a conflict with a loved one, etc.; is the hardest part of trading. The list is endless. You are your own worst enemy and YOU are the dragon that must be tamed or slain. Make no mistake, mastering your participation means mastering your executions. Proper execution is a gateway to permanent success; without this discipline your risk of catastrophic loss is higher.

Most of the time when losing traders experience losses their emotions get more and more heated until they lose control of their participation. Stories are told of Pit-Traders working on the exchange floors having very heated days due to something outside of everyone’s control; something like a war or a hurricane affecting some market. Some of these men would completely lose control of what they were doing; traders stumbling out of the pits, staring nervously into space and declaring “I have no idea what my position is…” Can you imagine? Someone so emotionally upset that they don’t even know if they are long or short! Or, even how big their position is! How do you lose control that far? Who is going to pay for that?!

Losing control of your execution is one of the worst mistakes a trader can make because it leads to exacerbating losses. Once those losses happen—there is no coming back from it. You have to have controls in place.

Before you begin trading you must prepare for proper execution. You must minimize the potential for you to lose control of your execution and end up unleashing the dragon who will burn through your equity in just minutes if you aren’t careful.

If you are already trading, then I want you to take a step back and review how you execute your transactions in the market. First, if we are using true discipline and developing our non-attachment mindset through the Circle of the Trade, then your execution will follow along a disciplined pathway that needs very little to remain effective. Basically, everything about that execution will lead back to a sense of serenity. The first step is to create your execution rules and make certain they are followed. More on creating rules in the appendix.

Creating execution rules is slightly different than signal rules. A signal rule has to do more with when the market is at an entry area and your reason for entry has been satisfied. Your execution rules are the steps needed to take advantage of the signal. Think of execution rules as participation rules. When followed, they steer you through emotions that if left undisciplined could shipwreck your trading. They are controls on your behavior to manage daily effort.

For example, I personally have a proprietary signal I use for reversals. You can calculate the signal using any timeframe but because it is designed to point out a price/time relationship that suggests a reversal is due; it is best used on a higher timeframe; the bulk of a liquidation order-flow comes from traders using the higher timeframes I have discovered. So I calculate the signal on an hourly timeframe; when it shows up it might be the turning point for that market “near-term” By “near-term” I mean “within 12 hours” That means, I have identified a price/time relationship that has a better-than-chance potential for a reversal within 12 hours.

Next, I compare the signal bar to the next higher timeframes, and I look for what I call “congruence”; which is basically the same signal but calculated on the 120-minute timeframe, the 180-minute timeframe and the 240-minute timeframe. Which means that I am expecting to see the exact same signal fire off on at least one of those timeframes during the next 2-4 hours. If I see that congruence, I now have a really reliable signal, so I will place an order to enter the market at several different prices that are based on the 60-minute timeframe signal bar. If the signal bar is less than a certain range, I enter a market order based on the close of the next timeframe signal bar. If the signal bar has a range greater than a certain width, I enter a limit order to enter based on the market falling back to the signal bar area. If I wrote out the execution rule in English, it might read like this:

“When the X reversal shows up on the 60M timeframe; look for congruence on the 120/180/240 timeframes. If there is at least one more signal active, then enter the market at the close of the 120M active bar, IF the 60M timeframe signal bar is less than 22 PIPS wide. If the 60M signal bar is wider than 22 PIPS; enter a limit order on the close of the 120 when the market re-tests the opening range of the 60M timeframe signal bar”

Basically, what I am saying is that I want to get in for a potential reversal but not unless more than one timeframe shows that potential. If it does—I get in right away unless the range is too wide; then I wait for the reasonable re-test of the opening range. Now, here is the important part. Once the orders are placed—that's it. There is nothing else to do but wait for the next 12 hours. Also, I write down exactly what the orders are and compare them to my entry rules. If I am "fudging" on the entry rules somehow—I want to bring that to my attention. ANY TIME AND EVERY TIME I have changed the entry rules "on the fly" or said to myself—"just this once I don't have to follow the rules exactly" I have lost money. At the end of the week, when I do my weekly checkout of my results and my performance, I look for times when I have not followed the rules. By confronting myself when I am compromising, I increase the probability for success. Your first clue that you are properly executing according to the "Circle of the Trade" is that you are following the rules you created for yourself completely and without error. If you are breaking any rules—your rules that make your edge work or your execution management rules—you are hurting yourself.

Now, I know that some readers don't have a set of execution rules just yet and many don't know how to tell the difference between signal rules and execution rules. What we are going to do today is provide you with a set of instructions to help you create your rule set and learn to enforce it. Don't forget, there is more on rules in the appendix.

Let's start with a premise or two:

Here's how you can know you are inside the "Circle of the Trade" and building the proper execution process for your trading:

1. You feel no conflict when you trade.
2. Your follow the rules as you have them completely—no compromises.
3. Willingness to liquidate at any point if needed.

4. Immediate price action in your favor after you have gotten into the market.

Let’s take these in order and discuss them a bit, starting with the first benefit, feeling no conflict:

1. When you do something you absolutely know is the right thing to do, what do you experience emotionally? Normally, for most people, a feeling of control, maybe a sense of finality; often people experience a sense of anticipation. But one thing should definitely be your feeling—nothing negative. When you have done the right thing for YOU—there should never be any stress, no fear, no emotional “what if?”, no mental agitation of any kind. If you are executing like you should—you should feel nothing negative and whatever you feel should be relaxing and pleasant. So, if you are feeling something other than a sense of serenity—something is wrong, and you need to liquidate and “reset” yourself. Ask yourself: “Why am I feeling like this if I am doing everything I have agreed with myself to do that is supposed to be in my favor?”

2. Did you follow your rules? This one is fairly clear. All you have to do is compare your written rules with your behavior and your journal. Is anything different? If you have gotten into the market and did it by breaking your rules—you need to liquidate (stand aside) and ask yourself: “Why did I break my rules?” The most common reason is because trader’s let their greed get ahold of them. They believe they “saw” something “right now” and they “didn’t want to miss it” before the market ran away from them. But all that is based on emotions or something else; it isn’t based on a solid understanding of the order-flow potential.

3. You should have a feeling that if anything—and I mean ANYTHING—gets in the way of your clarity of observation—you will immediately stand aside. You will instantly liquidate your position. The reason you need to be in this frame of mind is because the ONLY time you are not at risk for losing all your

money is when you are not in the market. Think of it this way: You got into the market because you believed that you had a better-than-chance probability to make money. You were willing to accept the risk you could be wrong—but you have done everything you can, to make as sure as you possibly can, that you have the probabilities on your side for at least some period of time. Now you discover that you got into the market for some reason that had nothing to do with defining the probabilities. That means, you are in a market, at risk for losing your money, and you are there because of something other than a clear sense of how to win. The probabilities have now dropped to below chance for a win on this trade. Why would you stay at risk when you have done something that will most surely lead to a loss? In other words, why take a loss that is avoidable by simply just getting out?

At this point, if you begin thinking things like: “Well, I am in now so let’s just see what happens” or “I have a small loss—let me just see if it comes back to even and then I will get out” or any number of emotional or conditional events, then you are exhibiting a sense of attachment to the results. The instant you discover you are doing a trade, staying in a trade, or attempting to get out of a trade but only after something else happens first; all because of something other than following your rules, what you are really doing is placing your expectation into the boundaries of an intended result. I call that a demand-back expectation. Something has to go your way, or be validated according to your terms, before something else can be done. That means something is affecting your clarity of observation. That means the trade is being done—or held on to—for some reason OTHER than a solid probability of where the order-flow liquidation pressure might be. That means you have just dropped your participation down to the level of the typical loser. A loss is more likely now.

Let me make it more convoluted for you. Suppose you are watching the market and suddenly you realize “I got in this trade too early because I forgot to follow my limit-order entry rule. I used a market order just this once…” This is a typical trading error. You broke a rule and that should NEVER be done. However—the trade is showing a small profit. If you are like most traders, you would just let that go because “the trade is working according to plan—getting in early was what was needed this time” But you are in that trade because you broke a rule. You need to liquidate and WAIT for the proper time to get in that trade by following the rule you created to maximize your probabilities. If you don't follow the rules—you aren't trading your plan. That trade is a losing trade despite the fact it has a small open trade profit. You need to liquidate right now and study why you felt the need to break a rule.

4. The whole point of learning to observe the market order-flow potential and observe yourself is to avoid any observational bias so you can make your move at the proper time to make money from that point forward. Your ultimate goal is to place your orders or have your orders filled right at the moment the force in the order-flow changes in your favor. That means the moment you are in—the market starts going your way. If you did everything perfectly according to your plan, followed your edge perfectly, and the immediate result was order-flow in your favor—you correctly executed at the proper point. Maybe that is behavior you can learn to duplicate. Study that trade all the way; can you discover something about what led up to that point that you can effect a permanent change in your participation with? Suppose you can create an edge with an 85% probability from whatever it was that you did? Remember when we discussed that winning trades can sometimes be just dumb luck? Well—if that is the case—so what? Manage that win as if it was a well-defined trade and take the cash. But study it anyway—because if what you are doing is the kind of behavior you can duplicate; you have just found a way to increase your probabilities. As a side note, I teach my students that "immediate" price action means according to your execution timeframe. If you are executing your entries using the 60-minute timeframe, then "immediate price action your way" would mean within the first hour of you having the trade active.

Now, supposing all of the post-entry experience is basically along the lines I describe above, you need to continue executing inside the "Circle of the Trade" You do this by noting your personal feelings for this trade and what you are prepared to do if anything changes. Your thinking needs to be something along these lines:

“I executed perfectly according to my rules and I followed my edge perfectly. The trade is working, and I feel no conflict that I can tell. There is nothing to do but wait—so I am liquidating by staying in until something changes. I am watching for that change. The change could be in conditions leading to a change in the order-flow—and just in case I don’t see that coming soon enough to protect myself with a market-exit-order—I have my protective risk-stop active. I am also watching for a change in myself. If I start wishing/hoping/praying I am breaking my focus. I will liquidate by getting out immediately and I will write everything down in my journal(s).”

Everything is going just fine; but suppose now you get a phone call that your parents just died in a plane crash. Your emotions will suddenly and without warning be all over the place. Before you grab the box of Kleenex, grab the mouse and liquidate everything you are holding. You will not be in the frame of mind to clearly observe order-flow when your thinking is under duress. That sort of thing can happen at any time for any reason. Suppose the market moves against you instantly and 30 seconds later the news comes out that the president has just been shot. The entire world will be in a panic for at least a day or so—no one can predict what people will do under those sorts of conditions. Using probabilities to help discover order-flow imbalances might not be very accurate for a few days. Maybe you should just stand aside.

The point I am making is that it doesn’t matter if the issue is from inside you or it is an external thing that stimulates you to try and do something. If it is something that is not within your control—meaning how you behave—then you are at a greater risk for loss. When everything is “normal” according to your plan, and you can control how you participate fairly well, that environment can change very quickly and you MUST have a pre-determined point where no matter what is happening—no matter how “bad” or “good” for profits it might be—no matter what—you are going to close all your positions and walk away. You are going to turn off your screen and close your office door when you leave.

If you don’t plan for this eventuality—here’s what will happen:

You will lose 100% of your account balance in hours or sometimes minutes. It will happen very quickly. It will happen because you start breaking all the rules that are in place to protect you. You start breaking those rules because your emotions get thrown into a state of agitation and that level of agitation comes with a HUGE desire to make things whole again.

When a human being suffers what they perceive as a major loss that is outside of their control, they also experience a strong desire to “fix” this problem so that things can go back to “normal” for them. When we can’t fix the issue—because the major loss is outside of our control—we begin to act irrationally in some attempt to ease the suffering we feel in order to bring our emotions back under balance. You probably know someone you would describe as level-headed and normal; until his wife died unexpectantly in a car accident. Then he lost control, lost his job and is now addicted to cocaine. He was looking to ease the pain from a loss outside of his control—a big loss, but he was unable to “fix” the pain.

When it involves trading, almost without exception—you will be on the “wrong side” of something when this catastrophe to your emotions occurs. You have an instantaneous loss—and that hurts. You will try to get your money back; you might double up on the next trade (increasing your size of the trade)—but that loses too as the volatility is now immeasurable; the market whipsaws between highs and lows by the minute. You try again and get hammered a third time. All of a sudden, it is four trades in six minutes—each one larger than the last one—all losers and all done because you feel strong emotions; not because of anything else. You broke all your rules—and blew up your account.

You lost control of your execution. You let the dragon loose.

To avoid losing control of your execution you need to put controls in place that you will follow at absolutely zero tolerance. You cannot break this rule.

Personally, I have a “walk away” rule that I put in place for my trading. If ANYTHING happens in my world that causes me to suffer an emotional high or an emotional low—I close all my positions that are not option-hedged. In other words, when something happens that is not a normal thing, I hit the liquidate button and that is that. I know what my normal day is—and I know that drama is not part of it. I have created a work environment that makes it almost impossible for the real world to force its way into my trading space. But when it does—it could be a big deal—and it will likely be something that requires my full attention. Since the markets don’t have my full attention at that point—I don’t let them take anything from me.

What is your “walk away” rule going to be? How will you be able to enforce it? To help you prepare for this eventuality we will discuss proper work environments as a tool but for the most part you need to do some advance planning for yourself. You don’t need to speculate on what the catastrophe might be, but you need to have a plan in place in the event something big for you to handle shows up when you are trading.

To close out this chapter, proper execution is a process of applying your edge in a way that allows for maximum control of your behavior. As the “Circle of the Trade” is followed, our thinking becomes more and more market-centric. As we follow a method of Proper Execution, our behavior becomes more and more market-centric. Proper execution involves creating a set of participation rules designed to implement our edge according to the probabilities and not anything else. Those execution/participation rules are designed to fully control our execution for two reasons:

1. We want to control our executions so we can duplicate winning behavior.

2. We want to control our executions to prevent losing behavior and/or minimize the effect of losing behavior.

Because these two conditions could apply at any time we are prepared to fully accept how we must participate, including the potential of getting out of trades if we haven't followed the rules all the way; even to the point of not participating at all if we run the risk of losing control of our execution.

Your key takeaway from this chapter:

Proper execution is a method of behavior control. Your account balance is solely determined by the difference between your entry price and your exit price. You must fully control your entry so that it is executed according to the probabilities inside your edge. If your entry is not done under this degree of control, or trades are done for any other reason, your potential for loss is greater and you must liquidate those low-potential trades quickly; or not do them at all if conditions are poor. Liquidation of your trades is mandated by following the "Circle of the Trade" until something changes. "Something is changing" can mean both inside your understanding of the order-flow AND inside your understanding of yourself; you must protect what you have if you sense "something is changing"

Proper Work Environments

"Empathic, emotionally intelligent work environments have a good track record of increasing creativity, improving problem solving and raising productivity"

--Daniel Golman

Most traders never really stop to consider how best to work every day. Their work environment sort of evolves out of what they believe they need and typically doesn't really address the entire experience of trading. I personally have a very well-defined and developed work area in my home, and I feel very much like my work environment contributes to my general overall positive market presence. I think that because we are discussing the underlying psychology required to make our trading the most profitable, a short discussion centered around our physical workspace and how it could affect our performance would be very beneficial. It's up to you to decide how much impact your personal workspace actually affects your performance, and if you personally don't feel that your workspace is all that crucial to maintaining your performance, I think that is OK too. I think the conversation is a good one to have and it is your call if you feel you need to make some changes to your work area.

The key fundamental of your workspace is to allow you to function with no distractions.

When you consider how many things can derail you as a trader and wreck your performance, it is critical to operate with as many positive components all working together as you can. You must reduce or eliminate anything from your environment if it has any capacity at all to break your concentration, cause you to forget something, increase your potential for procrastination, lead you to excuse some behavior, take your mind off critical items, or any number of other ways of increasing your potential for loss. When you lose your focus, your potential for loss increases. What you want from your work environment is something that helps you stay focused and doesn't make it easy to break your concentration when you are participating in the market.

Jesse Livermore was a man far ahead of his time as it pertains to creating a winning trade approach. In addition to creating a huge data base of written records (most, sadly, are all lost) he spared no expense in creating a workspace that served his needs as a trader in a way that was truly spectacular for its time.

He had constructed a private office/library on the top floor of his Manhattan Penthouse not far from the New York Stock Exchange. It was a complete copy of a trading floor, it had upper & lower quote floors where Livermore had private "chalk boys" writing prices on blackboards positioned where he could view them from a huge centrally located desk. He had a stock ticker machine in the center of the room where he had a "pit boss" calling out prices of stocks & commodities constantly during the trading day, and he had several telegraph wires all directly linked to his floor brokers where he had a personal assistant placing orders and reporting orders all day long. It was the 1910 equivalent of an online trading account. From this private office he executed his trades and tracked his performance using huge volumes of blank books he filled in with his notes and records all day long. He refused to have any telephones installed when that technology became available because the ringing was a distraction. All the "chalk boys" and "pit bosses" worked in shifts so they wouldn't get tired on the job. Livermore enforced one strict rule—breaking it could get you fired—there was to be no talking at all when the markets were open. Not a sound. Livermore worked in that office all day long and the only sound was the clicking of the ticker and the sound of the private telegraph wires. Absolute silence otherwise. Nothing was going to distract him from what he was doing, and he used every tool available to keep him on top of what was happening every day.

I think there is a huge lesson to be learned from Livermore's commitment to his trading. This man was not "poking it with a stick" on any level. Whatever it took to make certain he controlled the one environment he had control over—that was going to be done without any question of expense. He didn't go into an office where others would distract him, he didn't have to worry about what he wore to work every day, he made sure his employees were not wasting his time, etc., he really took the idea of "no distractions" to a higher level than most traders would.

I don't expect you the reader to make that level of commitment because, quite frankly, you don't have to. You can invest in a reasonable computer hardware/software set-up and as long as you have reasonable internet access—you can download a trading platform for free, in many cases, as well as find many resources and tools to use at little or no cost to you. What you can get for free today over the internet dwarfs what I had to pay thousands of dollars for when I first got started in the business. From the standpoint of "market access", the cost is minimal. The expense of setting up your own private trading facility might vary a bit depending on how complex or sophisticated you would like it to be; but a functional workspace that offers true benefits doesn't have to be expensive either.

To give you a few clues to a proper work area, I thought I would just describe my work area and the reasons behind why I have it configured the way I do. I really don't think there is any one perfect way to create your trading office but there are a few things I think would be very helpful based on your unique circumstances. In my case, I don't have some of the circumstances other traders do. As such, some things that I include as part of a functional space for me might not be something you would require. Again, that is OK as long as you feel that you are in an environment where you can perform at your best.

I have taken the spare bedroom of our home and created my trading office within it. I have my desk facing a blank wall with the only window behind me and to the side; I don’t want to be distracted by what might be happening in the back yard—which includes a firepit, outdoor furniture, and BBQ grill in sight. My wife and I often entertain on weekends and evenings and there are times when I am trading overnight/overseas markets when we have guests. I will politely excuse myself for a moment if needed and then check the markets. I never discuss trading with anyone on any level. All guests might know is that “Jason is checking something” I don’t want to be distracted by a freshman level discussion about a particular stock/Futures/FOREX opportunity I might be trying to capture. I don’t hang out with other traders for very sound reasons. First, there is very little they can offer me as far as market insights are concerned; no one I know my age is still trading anyway. Second, most traders want to discuss price direction and they don’t really understand you don’t need to know anything about prices to win. Last, they all want to waste huge amounts of time looking at charts and analysis. It bores me no end to hang with most other traders, so NO ONE gets access to my trading office and I don’t discuss trading with anyone. I personally believe you would benefit as well if you made the same level of commitment.

I have installed low-level lighting for nighttime as it is more comfortable than the harsh bright light of a day-time office; and I prefer natural lighting anyway. I also have candles for nighttime trading. All the cats and the dog can come and go anytime and a few of them make it a point to hang out with me all day and/or all night in my office. I rarely close the door or lock it unless I have a large group of people over, I don’t want to be disturbed if my wife has a client over to the house, or we have a contractor working on something. If you are a trader who has children I would make some sort of house rule that your kids can’t disturb you when the door to your office is closed or something—there are times when your children will be a big distraction from your trading and you need to have some control over how that happens.

I have an ergonomic chair that cost a lot of money—I can sit in it for hours without getting tired. You never know when you might need to be awake and fully functioning if you are involved in a 24-hour market like FOREX. I wanted to have one less reason for becoming tired. I also keep a dorm-refrigerator and food in my office—I make regular time to eat/drink/care for my physical needs. I have an attached bathroom so I don’t have to wander through the house and get dragged into a conversation or an issue with someone when I would rather not. Although I have a television in my office, I rarely turn it on. I never turn on the radio or other form of entertainment. If I am currently flat and waiting for an opportunity—then maybe I might allow some music or maybe watch a movie. But either is rare.

I have a complete set-up for my library—if I do anything at my trading desk it is read. I also have my trading records available too, and when things are slow, I might review past performance from the previous trading events for clues to my behavior. Everything in my office is trading related—I have clocks set to different time zones, I have wall art and posters that are trading-themed, there is nothing in my office or on my desk that is of a different theme. No pictures of friends/family, no personal stuff, no jar of pennies or any of that typical “man cave” crap people surround themselves with. I do have my currency collection in my office—but that is only because I wanted it somewhere I could work on it when I wasn’t busy in a trade. Because I trade the FOREX markets almost exclusively now, I thought it was apropos. I also have a back entrance to the house so I can leave without disturbing anyone or anything inside the house if I need to. Sometimes I want to just go outside and take a walk or play with the dog.

This sort of set-up works fine for me. I don’t have a huge space—with a giant desk and a dozen monitors; nothing of that sort. I think I spent a total of $250 at IKEA for my office furniture. The important things for me are the ability to lock myself away without interruption if needed, I don’t have to leave for any reason should something develop while I am there, and I can control people’s access to me if needed. Like Livermore, I don’t allow a telephone in my trading office. I leave my cell phone outside on the side of my bed, or I turn it off when I am in my office. When I am in my office—I am trading and looking to build wealth. I am not interested in anything else—not friends, family, personal interests, hobbies, problems, mail, guests, etc., Once I leave my office—all of that is all good. But when I am in there—It would take the second coming of Jesus Christ to break my focus; and even then—he needs to wait until I get my fills back.

Your key takeaway from this chapter:

Take time to consider if your trading environment is working for you or against you. Your trade office should be a place that will prevent or minimize distraction. As long as you feel that condition is being met—however you want to set it up and what you want to include is really up to you.

Staying on Course

"If you don't know where you are going, any road will take you there."

--Anonymous

Any sailor will tell you that there is a world of difference between setting a course and staying on a course. Setting a course could be compared to book knowledge or "mental ascent" and staying on a course could be compared to the experience of knowing a particular part of the ocean because you sail it all the time. In one case, it takes very little experience or skill to take a set of variables and plot a solution to the question: "How do we get there?" In the other case, it takes the ability to know the difference between types of wind, tides and currents; it might mean sailing a different route if the seas get too rough, or not going at night if a lee shore is involved. All things that book knowledge can't tell you about. In the trading environment, setting the course is the easy part. All you have to do is create a reasonable edge with a solid probability of winning trades. Then—execute flawlessly both your entry and your exit. Next—just don't do anything stupid…that is where the work is.

And that brings us to real tools for staying on course. Staying on course could be called the solutions for the "don't do anything stupid" part of your plan to make your fortune. Any number of things you would never think about being an issue can suddenly take you off course if you aren't careful and you fail to plan ahead. It involves so many variables it is scary to try and substantiate all of them in one place. I think we would all get very discouraged in that case. Staying on course is a lot harder than coming up with trades; but using a few simple tools can reduce the risk that something you never considered could cost you money.

What we need are some tools to assist us in the goal of keeping focused. In the last chapter we discussed how a proper work environment can help us by reducing the number of distractions that might come our way each day. In this chapter, we are going to discuss additional tools that keep us on track if we do them regularly. Distractions take us off our path; everything else causes us to simply fail to walk the path each day. Or get lazy with the work we need to do. So, in this chapter I am going to show you some tools that myself and other winning traders use to keep our focus sharp. Bear in mind, not all traders use 100% of this information all the time. A lot of this is totally subjective—you can choose to use it or not. You might not find value in some of it. For the most part, these tools are designed to assist traders who are doing this full-time and consider themselves occupational traders; they are not doing anything else to earn their income/wealth. If you are not a full-time trader at this point—no worries. Please consider using these tools anyway. Anything and everything you could use to improve your market presence is a good thing. Remember, what we need as traders is absolute disciplined behavior arising from a completely disciplined thinking. This is not a simple thing to create for most of us—and it is not an easy thing to do every day, day in and day out. Implementing these tools can help reduce the potential for “missing” something, forgetting something, or breaking your discipline.

Checklists

Checklists are great tools for anyone involved in a high-risk environment with several variables that need to be considered. Before an airline pilot decides to do his takeoff roll, there is a checklist that needs to be done. Some things on that checklist have nothing to do with the takeoff but have something to do with the question: “What if something goes wrong?” For example, testing a backup hydraulic pump. No need for that item if everything is working OK but if something breaks when we are taking off—we need to know the backup pump is working—just in case.

In the trading environment there are several variables that could lead to a loss. It is always a good idea to consider those variables as part of your daily participation and check to see if those variables might make a difference right now. For example, I have an “AM Checklist” and a “PM Checklist” that I have written down and posted on one of my monitors. It is impossible not to see it each and every day when I start my trading day. One of the things on those checklists is the question “How much did you journal today?” It isn’t even a “Y/N” question for me, it’s a “how much?” question. I journal every day; it is really rare to miss a day—so the question for me is: “How well are you doing this?”

Some students of mine have created a “Pre-Trade” checklist of items they need to have before they take a position, an “Entry Checklist” with items that should be done for every trade entry, an “Exit Checklist” for items that should be done when trades are liquidated. Additionally, I have a quarterly record keeping spreadsheet I use to record my daily activities on. Both my checklists and my quarterly trade logs are hand-written notes that require me to review necessary items I find are crucial to my success. For me, I need to know that all of these variables are being considered each day and that I am not compromising on any of my record keeping each and every day.

You might find that having other things on your checklists can be helpful to focusing your mind while you are trading. These listed here are from actual students who developed daily working checklists for themselves:

Office door locked

Cell phone OFF

“Loser Charts” updated for reference

Kids off to school OK

Updated personal exercise/workout log

Ate breakfast

No more than three cups of coffee

Checked personal notes for after-trade needs (this student constantly forgets to return calls)

Be in bed by 9:00

Did I follow my plan at 100% today?

These are just a few of what could be considered more personal in nature, but the idea should be clear. In the appendix I have sample checklists for you to review.

AM Ritual/PM Ritual

Every morning I get up at the same time each and every day. I start my day with my "AM Rituals" which includes my AM checklist, my daily "to do" checklist, I read my 3x5 cards, and any notes from the previous trading day. All of my notes are put in my thinking journal and all of my trade logs are updated each morning and each afternoon.

Included in my daily AM ritual is my daily health plan, including workouts, diet, juicing, herbal tea, and my supplements. Every day I exercise, eat healthy, do my herbal supplements and drink my organic juice. Although I am 60 years old, my body is in better condition than many people my age and that helps with my trading mindset. My AM ritual helps me maintain my trading focus and helps me stay disciplined to avoid trading errors.

My PM rituals are used at the end of my trading day. I try to consider the 3:00

PM time as my “end of day” and that is my preferred time to “checkout” for the day. I have a checklist that I refer to and I have a final entry to my journal. Once I am done for the day—that’s it. I leave the office and I close the door. I consider that part of my day over and I am not going to be involved with any more market-related work. I feel it is very important to do that because otherwise—I would never get any sleep, have any sort of positive relationship with my spouse, or I would likely never have another friendship with any of my neighbors; it could be really unsettling to think that I was unavailable for any sort of well-rounded lifestyle. My PM ritual and checklist helps me to keep a sense of balance by having a “stop-doing-things” time that keeps me grounded. In the appendix are samples of my AM & PM ritual reminders as well as my log sheets.

Weekly Discipline Spreadsheets

I use custom 11x17 spreadsheets for my discipline record keeping. I use others for my daily health tracking, my weekly performance tracking, and my quarterly performance summary. Samples are included with the other samples in the appendix.

I include everything I feel is significant enough to push me forward on my trading. Anything that includes my physical health, my work effort each day, and my trading results each day including each and every execution and the results of the trade. I even use these logs on the weekends because how I invest my time/effort on weekends helps me maintain my performance during market hours. My intention with this data is to physically hand-write everything that pertains to my state of mind. By reviewing it regularly I can see where my discipline is strong and where it is getting weak. As long as I have a check on my intended discipline, I can make certain I never get too far off track during any one day or any one week.

I take these hard-written logs/spreadsheets and compile them into a quarterly summary at the end of each trading quarter. I collect all my trade signal logs, I collect my execution logs by traded market, I collect my 11x17 custom spreadsheets of my health plan, my daily discipline plan, and my quarterly trade results. Additionally, I print out a complete copy of my daily “thinking journal” along with my weekly checkouts by traded market, my weekly summary, and my trade error log. I take all this data and I bind it into an 11x17 portfolio binder along with my weekly account statements from my broker. I also take all this information and burn it to a DVD in case anything should happen to the hand-written records.

I now have a complete quarterly record of each and every day I was trading, my results, my after-trade data, my execution notes and my thinking journal all in one big “book” of data. I usually take this huge binder of data and head down to the beach. I typically sit on the beach off-and-on for a few days each quarter and review my notes. I keep a highlighter handy and yet ANOTHER hand-written notebook of observations I find about myself, my thinking, my behavior, and my trade results. Often times I find a lot of inconsistencies in what I am doing and/or what I was thinking at the time. Also, I am amazed at how many missed opportunities I typically have every quarter. I find that I have missed trades, early exits, losing trades that could have been winners, etc. almost every quarter. Despite my health program being better than a lot of people’s plan for health—I typically lack some follow through somewhere each quarter. All of this insight helps me stay better prepared for the challenges of trading and the changes that inevitably occur when you are trying to exploit a dynamic environment like the markets. In the appendix I have samples of my custom spreadsheets and my quarterly summary logbook.

Flash Cards

When I have suggested to my students that they consider using regular daily positive affirmations each and every day, twice every day, they usually agree it is a good idea. When I give them specifics as to how to actually do this every day, they usually have some hesitation. When I help them create their daily affirmations, they all remember when this was called “flash cards” back when they were in school. I personally call them “3x5’s” and I have at least a thousand of them all indexed and organized in a file drawer. I use them for everything in my life—and I ALWAYS have a group of them with me all the time. I keep about 10-12 on my desk every day and I review them daily, twice a day, by reading them out-loud to myself.

I learned this technique for training your mind and your behavior from Anthony Robbins in his book Unlimited Power (Ballentine Books, C. 1986); which he calls “State Management” This book is a great read for those finding it harder to get and stay motivated every day. Here’s how “Flash Cards” contribute to effective state management. Ask yourself exactly what it is you want to change or what you want to appropriate for yourself. It doesn’t matter what it is—just write it down as concisely as you can. Once you have it written down, either pick out a sentence that is the sum-total of what you are looking to positively impact or sum up your notes in one sentence. Write that one sentence down and put it in quotes—as if you were writing down a quote you heard someone say. Transfer that quote to a 3x5 index card and read it to yourself outloud in the morning when you start your day; and then again in the evening when you end your day. You need to fully focus your mind and “see” yourself already in possession of the desired skill, change, or thinking. Your mind will see and hear you creating a new mental discipline and change for yourself. Your subconscious will “agree” with what you are re-programming your thinking to become and will now begin motivating you to follow-through. If you do this, fully focused twice a day, typically within 3-4 weeks you will notice changes beginning in your life.

When done right, your 3x5 cards (Your “Flash Cards”) can be a powerful tool to keep your mind focused on doing what you know is the right thing for you. They can help you modify and change your behavior into the kind of thing that leads to lasting success. Listed here are a few sample cards taken from my own collection. These are trading-related and work-related; there are more samples in the appendix:

• “I never compromise on placing a protective stop. I use a stop-loss order on every trade”

• “I am responsible for my success; I always follow my plan”

• “I write all my thinking into my thinking journal every day; I value myself enough to do

the things I need to do to get the right data I need to win”

• “I don’t care what happens on each trade; I only need to follow my probabilities”

• “Today I begin a new life, my future is what I make it today”

• “I cannot break discipline. The moment I do that I lose.”

• “I never liquidate trades manually. I always wait for my stops or limits to get filled”

There are many more in the appendix. The point is that you can use these 3x5 “Flash Cards” for any part of your life. You need to write them in a positive light, you need to write them in quotes whenever possible, and you need to write them as if you have already accomplished what you are looking to produce. When you write a positive affirmation down it becomes very motivating. When you put it in writing and keep it in front of you constantly—it becomes unstoppable. Using your 3x5’s daily will help you stay focused and will help you enforce your rule set.

Visual Aids

I have a picture of Jesse Livermore when he was near the height of his trading career; circa 1922. I have a quote from Livermore printed under the picture and the picture is nicely framed. I hung it on the wall where I can see it regularly when I am sitting at my desk. Every time I look at it, I ask myself: “If Livermore was alive right now, watching me trade, would he think I was on the right path with how I trade?” I have studied quite a few winning traders and I can say with absolute certainty they all would answer that question differently; but Livermore’s answer would matter to me. I find that having that “pretend” relationship helps me review my thinking and my focus. It’s like having a mentor looking over your shoulder.

Visual aids can be anything that you feel assists your focus in some way. Some students of mine have had framed artwork in their office, some have had “desk trinkets” that remind them of positive behaviors or positive events they are working to enjoy again. One client had a golf ball that he had used when he scored a hole-in-one; he was planning a trip to play golf at Pebble Beach that year and he was working so that his trading could allow him to go first-class all the way. I personally have a coffee mug with a picture of Albert Einstein on it; although I don’t drink coffee from it—I use it to hold pens. Einstein is someone I consider a mentor of mine too.

One client had several large poster-size O-H-L-C charts printed of big winning trades he had done during his career. These were to remind him that no matter what was happening right now, another huge winner was going to show up again soon. Will he be ready? Will he find it?

I personally don’t believe any trader needs to have massive displays of monitors and market analysis spread out over his entire desk area so that his workspace looks like launch control for NASA; I feel like I can get by just fine with one monitor for the market and one monitor for me. If you feel that having multiple displays of all kinds of market-related information is a visual aid that helps you stay focused, then so be it. Visual aids are visual.

A Trading Plan

Suppose you owned a small business and you were hoping to use it to make enough cash so you could retire. If someone asked you “So, what’s your plan to get there?” and your response was “Well, I plan to work every day until I make enough money—then retire”; can you see where that isn’t really a plan yet? What specifically are you intending to do? Is any of this written down anywhere? Do you have any notes to refer back to?

Studies have shown that people who physically write down their goals and plans have somewhere around 9 times the probability of reaching those goals. The trading environment is no different than any other enterprise when it comes to planning and reaching milestones along the way. It is my opinion that you must have a written plan that you intend to enforce for your daily participation.

A trading plan is about controlling the things that are most likely within your control and not about making forecasts on your performance. You will never know how well you could do over the course of time because you really don’t know what any market will do or how much opportunity your edge will uncover. You could make significantly more than you think is “out there” to get over a given time period—can you plan for that? I don’t believe you can. I think your trading plan needs to address the things you are most vulnerable to messing up and reinforce the things you are really good at. A trading plan is an active performance measurement tool.

For example, in my personal trading, one of the things I know I am really susceptible to doing is “overtrading” Most of you might know what that is but for the reader who isn’t familiar with the term it basically means trading “too much” for your edge or skill set. If for some reason on a particular day I enter a trade that immediately goes against me and stops me out; I get mildly annoyed. If the market comes right back to my entry price—now I get angry. I am upset that the market took money from me so quickly—didn't even give me a chance to think—and then teased me by coming back to where I got in just as fast. Now, if you have been paying attention, that is an emotional response to price action—it has nothing to do with finding opportunity or staying focused on the next probability. Which is what I need to be doing. But occasionally—I will slip and fall into the emotional trap. Now I will quickly execute again, and once again—I hand myself a loss. I might do this 4-5 times before I realize I am just not doing it right; I am trading from emotions and not from my edges' defined probabilities. Now—my plan comes in—when I have more than 3 losing trades in a row—I take a trading break. I study those losses and I would very quickly come to the same conclusion anyone else would come to—I was emotionally involved, and it led to over-trading. "3 losers in a row—take a trading break" is one of my rules. My daily trading plan is to enforce the rules every day without compromise. I read my rules and my trading plan every morning as part of my AM Ritual. Included in the appendix in the "Tools" section is a sample trading plan. Please review it and notice that it is written to include all the things I can personally do to control my bad behavior; and it is designed to enhance all my winning behavior. Also, I personally use a trading plan designed around a quarterly basis. That means I have four of them every year and I change/enhance them every 90 days; usually at the start of every quarter.

In my view, staying on course is really about a daily ritual and daily discipline that promotes your willingness to do whatever needs to be done in order for you to keep your developing market-centric trading paradigm growing. No one is a perfect trader. But we don't have to be. All we have to do is perfect follow-through on our plan.

I look at it this way:

My trading career is only one day long. Everything I did yesterday created a set of results. Those results are in the past and have nothing to do with what my results could be today. Tomorrow's results cannot influence my day today because they don't exist yet. The only thing I need to do is be 100% disciplined just for today; just for only this one day. All I have to do is today's part of whatever plan I have in place. It is one-day-at-a-time.

No one can be a 100% winning trader, but I can be 100% disciplined for one day. If I put together 6 days of 100% discipline; then I have had a 100% disciplined week. I don't have to do that on Monday—all I have to do is Monday's discipline. A disciplined day can become a disciplined week; which can become a disciplined month, which can become a disciplined quarter; finally ending in a completely disciplined year. If you tried to visualize all that on January 1st last year, you likely would have overwhelmed yourself with the appearance of this mountain of activity. But it isn't really like that. It's only one-day-at-a-time. Just do your plan at 100% for just today's opportunities. Then burn the past when you leave the office. No matter what your results, positive of negative—it's over until tomorrow.

Vince Lombardi said it best: "Practice doesn't make perfect; perfect practice makes perfect."

If you take these suggestions for tools into your own trading, or come up with a few on your own, the important consideration is to make them a daily practice. The art of remaining focused, and Staying on Course, is all about bringing your day into the discipline of a mindful non-attached person who operates with the daily practice of doing it right every day. You only have to do it one-day-at-a-time. Anyone can do a 100% disciplined plan for only one day.

Your key takeaway from this chapter

Staying on course is about the daily practice of doing the right thing for yourself without compromise. Using effective tools includes putting as much of your daily activity into the place where it can be confronted and reviewed by you without fail every day. That might include using checklists, rituals, notes, or visual aids; but whatever it is that you decide to use as your tool set, remember it is about bringing yourself into a 100% daily disciplined practice.

In Conclusion

"He will win who, prepared himself, waits to take the enemy unprepared."

-- Sun Tzu, The Art of War

I can't tell you how many books I have read on the markets and business in general. Some have been powerful reads on significant topics; some a complete waste of time. The ones that I felt had timeless insights, or were of special value to me, I kept in my library; the rest I threw away. Looking back, many of the books I threw away I should have kept, but that is a different issue. I learned what I learned and maybe I will learn more still, but there isn't any need to replace those discarded items. If a book was something I found less than valuable—that was that. Why waste time going back for something that most likely isn't going to be of value to me anyway? But every now and then something will surprise me. Very few books have gone from "completely irrelevant" to me all the way back up the ladder to "masterwork" on my shelves; one of them being The Art of War by Sun Tzu.

Sun Tzu was a Chinese military general during the time when parts of China were ruled by the Wu emperor, roughly 2500 years ago. The Art of War is really a collection of his military observations and was well known in the orient for centuries but was never translated into English until 1905. His wisdom is basically new to the West and yet it is almost universally ignored for some reason. I personally think it is because it is considered "old" and it comes from China. Most people in the West have a view of China that is based solely on their knowledge of Chairman Mao Tse-Tung; who was a criminal and a communist (like most politicians). Most people don't like Mao, so they don't have a real positive affinity for China either. What isn't so well known is that Mao's "Little

Red Book" is filled with several quotes and sayings stolen by Mao yet attributed to Sun Tzu. It seems that Sun Tzu has enjoyed more fame than previously known about. Perhaps Marxists are interested in winning wars too...

I first read The Art of War when I was a U. S. Air Force ROTC cadet. Although I was a good student and had an active/inquisitive mind when I was younger, I felt the material was dry and uninteresting. I didn't see the value to all the mystical cloak & dagger rhetoric as I saw it; if I was going to be a fighter pilot what is the point of studying the pots and pans of the enemy?

It wasn't until after I had my catharsis in thinking that I re-read The Art of War. It was like reading it for the first time. I saw it completely differently. For me now, the insights are very relevant, and I see a lot value in his principles. The experience of having one point of view on something, and then having a 180-degree change to a completely different point of view on the same material, is really enlightening. That is the fascinating part for me: the material is the same material. It was ME who was different. No matter who or what we are, no matter the point of view we bring to the table, no matter how complex or simple something might really be; the bedrock bottom line to our existence is this: Reality is what we choose it to be. And it's that way for everyone. Things are what you think they are. Things are the way you are.

What is truly fascinating to me is that it doesn't matter how insane someone's point of view might be. That is reality for them and that is how they are going to see you. Knowing you can change your thinking anytime to create a new reality seems to be lost on most people. Or they just don't see the value in making a change to their thinking. So, reality stays the same for those people. No matter what they do, no matter the actions they take. That is why no matter the desire someone has for things to become "better" (however they are defining "better") "things" never get any better. No matter what they do. They don't change what's on the inside so the outside circumstances never can change.

As I discuss in The Art of the Trade (Wiley & Sons Publishing, C. 2008), in my case, my inner world changed dramatically enough to have a completely different sense of reality and how I see the world; so much so that my perspective on some things would change completely, like my point of view on Sun Tzu. But the initial major benefit for me was how I see the markets. The change that happened to me was literally the difference between being in the dark and being in the light. That kind change is something most people won't have happen to them. But the fact is, a change that dramatic and powerful could happen to you, if you were looking for it. Are you looking for it?

The reason you purchased a copy of The Psychology of Trading is because you hope to find something—anything—that will help your own trading improve. Inside these pages are things that can help you become a better trader and your results will improve. The information you have reviewed has the potential to change your entire life, if you let it. Whatever it is that you desire, the answer is there—somewhere—to create the changes you need to make for that to become a reality in your life. Some of what you need is in this book, some of it might be in other places; but it is all available to you sooner or later if you keep looking for it. You can do anything you want with your life and experience anything you want. Trading opens the door to reaching those goals because you can do anything you can imagine when you have enough money. Isn't that the whole point of your trading?

In my opinion, and as I stated in the introduction, you might need to undergo a catharsis of thinking for yourself in order to get there; to reach those goals. A complete change in the paradigm of your thinking is going to put you in a place that might be uncomfortable at first. But this is a needed and necessary process, and I really don't think you can become a truly consistent trader without developing some other personal growth attributes. I think you need to be ready for them because as you develop better thinking, and become a better person, it is going to cause all sorts of conflict in your world. You need to be ready for those conflicts.

For example, if you are a younger trader who enjoys spending time with friends and you value those late nights out, those weekend getaways, those Sundays watching football; all that could go away. You might find that you can't really stay out partying on a Thursday night because reports are due out early on Friday morning and you need to be ready to adjust or take positions after the news drives pricing. Maybe you can't commit to a Sunday BBQ because you need to finish doing your record-keeping before the markets open on Sunday night. You might really want to do something with you friends, but the time lost from maintaining your trading business could mean a financial loss in the following week. It's happened to me—you think it would be different for you? Your buddies will put tremendous pressure on you to "be one of the guys" and hassle you for all the time you spend "Wasting your time with that market stuff" "Nobody wins at that—don't you know that?" "My uncle tried stocks once—he'll never do that again!"

Once you commit to becoming the best trader you can be you are going to have to make some changes in how you behave every day. Those behavior changes will arise from changes you must make in your thinking. That process of making real and lasting change is going to put you in conflict with the world you are currently in. Eventually that will change—but you have to be ready for the conflict because it is going to happen. It's going to happen everywhere.

Suppose you conclude that in order to free your thinking better you absolutely must get rid of your credit card debt and never go into debt again? You might just cancel your all your credit cards or at least a few of them. Your wife wants to know when the trip to Italy is coming—so when you tell her "I think it is better for me and my trading to get rid of all this debt—not spend another four-grand on a 2-week trip to Italy this summer" what will happen? Suppose she tells you: "Just forget that trading business—you aren't making any money at it anyway—you promised me we would take a trip to Europe"; what would be your response? Are you ready for a conflict that might mean the relationship could be over? I've seen stuff like that happen; don't think for a minute it is off the table.

Suppose it would be better for your trading to sell-off a lot of unneeded crap that is hovering around your life; like the ski-boat you used only twice in the past year, the second car; maybe cancel the lawn service (It would be good exercise to cut the grass yourself). Maybe you should quit your job (the one you hate anyway and the one you want trading to replace) right now. Maybe it is time to take that risk—scary as it might be.

The change you make in you is going to create change in the world around you. Are you ready for that change? Suppose it costs you something you didn't expect it would cost you? On the other hand—suppose that change created benefits you didn't expect?

That is what you need to focus on. The change you are making will create benefits—some you are expecting to see, others will be completely unexpected and maybe those will be the best ones of all.

In my life, that is what happened to me. When my thinking became market-centric enough to really see how my trading needed to be done in order to profit from it consistently, it brought with it other benefits I never saw coming. Those benefits—the unexpected ones—were the really important benefits. Those benefits were not about money—those benefits were enhanced with money. Those benefits were about better friendships, better relationships, better experiences; better life all around. Yes, better finances certainly didn't hurt—but as I learned after one of my blow-outs and career reversals, the really important things stick around. Money comes and goes; AND YES—trading is about making money, a lot of money. But what really are you going to spend it on?

You are going to invest it in the people that matter to you, the places that matter to you. Maybe you will invest that money into the "things" that matter to you; whatever that is. What really matters? You can't find out what really matters until you risk everything to find out what really matters. I personally can tell you what matters for me—because I didn't do this process half-way. You need to find out for YOU—so don't do it half-way either. Be the person you need to be because that is the only trader you want to be. Part of becoming a great trader is becoming a great person. I don't think you will reach your true potential in the markets without bringing your soul along for the ride. Please consider the human side of your market presence as being equally important as the profit side; because in the final analysis—it already is more significant. The market will eventually show you the true cost of trading and the true profits—right now it's all about the green (I get it). Your adversary, the trader on the other side, doesn't understand what he is doing let alone the true pathway to winning. Now that you do—go forth and conquer. Take the losers money. Take all his money. Please leave some for the rest of us to get.

So, to conclude The Psychology of Trading for you, let me say thank you for investing part of your capital with me. As you already know, I am out there trading every day—just like you—trying to take your money from you anyway. It is nice to get some of it without a lot of work. Please don't forget to review the data in the appendix; there are a lot of samples and examples there to highlight some of what we have been discussing. Also, I have a lot of completely FREE additional material for you, all of it designed around improving your personal trading psychology and your daily market presence. Just follow the links provided in the appendix. Or contact me through my website if you wish: www.TheLionOnline.com

Until we meet again,

Jason Alan Jankovsky

"The Lion of LaSalle Street"

Spring 2020

Appendix

Recommended Reading

"There is no end to the expressing of ideas. Excessive devotion to books and the studying of opinion is tiresome and wearing to the mind…"

--King Solomon, The Book of Ecclesiastes 12:12

I am going to provide a short list of recommended reading. You will find that there are more than just trading related books on this list and that is because I believe that trading is really an Art Form; not just something you "do" and then stop doing. Real trading, like a real artist, comes from inside you, and you express what you see by your act of buying & selling; more is involved than just your wallet. A really solid trader is also a solid person and often has a real appreciation for things that require time & effort to produce. Most really good traders I have known are what you would call "well-rounded" people who have varied interests in life; and one of the very important things for them is acquiring a sense of balance. I think you will find that the top performers in any field are very much the same way. Highly successful people in all disciplines of business, arts and the sciences, physical skill, etc., are all seeking more than just the next dollar, the next win, or the next discovery. They tend to see what they "do" as more of a journey; it's a kind of exploration, if you will.

In my journey to become a winning trader, I was exposed to all sorts of ideas and opinion; and a lot of it was really just the same sort of material wrapped with a different bow. I discovered a whole other world of opportunity and excellence once I developed the thinking process required to be a consistent winning participant in the markets. I don't think I would have ever developed that thinking process if I had not walked the path I walked. I can tell you with complete authority that the way you think will determine the reality & circumstances you will live under. All of the books on this list influenced me to go down the pathway of high-achievement and develop my thinking into what it is now. Some methods of thought are immediately transferrable to the markets and trading, some are more to help with maintaining a strong sense of self; and/or of purpose. I don't think you would still think the same way you do now if you truly opened your mind and heart to some of the things these volumes can show you. I would hope you will make the time to read all of them.

The list is not in any particular order of value to me. I just started with the books that were on the closest bookshelf in my office and went through my entire library. If you already own some of these titles, I hope that shows you something. I believe it shows you that you are already on the right pathway—or at least heading in the right direction. Stay with it.

I don't believe any of these titles are out of print. If they are—nothing I can personally do to help with that (I don't think). If there is a particular book on this list that isn't available from its publisher anymore—try writing to the publisher directly. Oftentimes they will still have a few copies lying around if they check—plus—some publishers contract out their older titles to "print on demand" companies. You might still be able to find that title with a little work.

There is always the local "Used Book" store and the regular sale that libraries have every year to clear the shelves of older books. Don't be afraid to start shopping at the local "Goodwill" or thrift shop too, I have found some great books that way; including a first edition I was looking for. Of course, you can find anything on the internet if you are willing to look.

I've grouped the titles together for reference and I listed them as: "Book Title, Author, Publisher, Copyright Date" The date listed is the date for the edition I personally own, in some cases the book was published earlier by another publisher; so I am assuming that there might be many editions or print runs of these books. Some of these might have newer updated versions available as of todays' date, but the titles are the same ones I personally found beneficial to my growth.

Financial/Market Related History and Commentary

Reminiscences of a Stock Operator, Edwin LeFevre, Fraser Publishing Company, 1980

The Art of Speculation, Phillip J. Carret, Fraser Publishing Company, 1979

The Art of Contrary Thinking, Humphrey B. Neill, Trader's Press INC, 1985

How Shrewd Speculators Win, Fred C. Kelly & Sullivan Burgess, Fraser Publishing Comp., 1990

The Predators Ball, Connie Bruck, The American Lawyer/Simon & Schuster, 1988

Where are all the Customers' Yachts?, Fred Schwed, Jr., Wiley & Sons Publishing, 1995

The Predictors, Thomas A. Bass, Henry Holt & Company, 1999

The Vandals' Crown, Gregory J. Millman, The Free Press/Simon & Schuster, 1995

The Origin of Wealth, Eric D. Beinhocker, Harvard Business School Press, 2006

Extraordinary Popular Delusions and the Madness of Crowds, Charles Mackay, Harmony Books/Crown Publishers, INC, 1980

The Richest Man in Babylon, George S. Clason, Signet/Penguin Publishing, 1988

Interviews and Top Traders

Market Wizards, Jack D. Schwager, NY Institute of Finance/Harper Business, 1989

The New Market Wizards, Jack D. Schwager, HarperCollins Books, 1992

Methods of a Wall Street Master, Victor Sperandeo, Wiley & Sons Publishing, 1993

Master Traders, Fari Hamzei, Wiley & Sons Publishing, 2006

Viewpoints of a Commodities Trader, Roy W. Longstreet, Trader’s Press INC, 1986

Volume and Open Interest, Kenneth H. Shaleen, Probus Publishing Company, 1991

The Disciplined Trader, Mark Douglas, NY Institute of Finance, 1990

Trading in the Zone, Mark Douglas, NY Institute of Finance, 2000

The Psychology of Risk, Ari Kiev MD, Wiley & Sons Publishing, 2002

The Tao of Trading, Robert Koppel, Dearborn Financial Publishing, 1998

The Inner Voice of Trading, Michael Martin, FT Press, 2012

Zen in the Markets, Edward Allen Toppel, Samurai Press, 1992

Trading Chicago Style, Neal Weintraub, McGraw Hill Publishing, 1999

Psychology, Self-Improvement, Strategies for Excellence

The Crowd, Gustave Le Bonn, Cherokee Publishing Company, 1982

Evolve Your Brain, Joe Dispenza D.C., Health Communications, INC, 2007

FLOW, Mihaly Csikszentmihalyi, Harper Perennial, 1990

Talent is Overrated, Geoff Colvin, Penguin Books, 2010

The 4-Hour Workweek, Timothy Ferriss, Crown Publishers, 2007

How to Think Like Leonardo Da Vinci, Michael J. Gelb, Delacorte Press/Bantam Doubleday, 1998

Inner Simplicity, Elaine St. James, Hyperion, 1995

Man’s Search for Meaning, Viktor E. Frankl, Simon & Schuster, 1984

Bushido-The Way of the Samurai, Tsunetomo Yamamoto, Square One Publishing, 2002

Zen and the Art of Motorcycle Maintenance, Robert M. Pirsig, Harper Perennial, 2005

The Power of Now, Eckhart Tolle, Namaste Publishing, 1999

Unlimited Power, Anthony Robbins, Ballentine Books, 1986

Awaken the Giant Within, Anthony Roberts, Fireside/Simon & Schuster, 1992

Biographies

Peter the Great, Robert K. Massie, Ballentine Books, 1980

Alexander the Great, John Maxwell O’Brien, Routledge Publishing, 1994

Tesla, Margaret Cheney, Barnes & Noble/Prentice Hall, 1981

Personal Memoirs, Ulysses S. Grant, Penguin Classics Publishing, 1999

Health & Lifestyle

Ageless Body, Timeless Mind, Deepak Chopra, Harmony Books/Crown Publishers, 1993

The China Study, T. Colin Campbell, PhD & Thomas M Campbell II, BenBella Books, INC, 2006

Prevent and Reverse Heart Disease, Caldwell B. Esselstryn, Jr. MD, Penguin Group Pub., 2007

Eat and Heal, The Editors of FC & A Medical Publishing, FC & A Medical Publishing, 2007

The Easy Way to Stop Smoking, Allen Carr, Sterling Publishing, 2004

While reviewing this list please remember that in earlier chapters I specifically wanted to draw your attention to the issue of there being “nothing new” available to us as traders, and that there is really “nothing new” at all inside the human experience except that we are developing technologies that if left unbalanced could create an environment where we (the human race) end up losing control of our technology and/or destroying ourselves by advancing beyond what we can handle.

While reviewing the market-related books I want you to try and see that almost everything of value in those books speaks of the human element of inner control and discipline applied to the outer method of making sense of price action (Market Analysis). In many cases—different authors make the same observations. THAT is the point I was referring to. There really isn’t anything “new” in the way of market thought or analysis; everything you have access to is really the same thinking being expressed in different ways. You need to develop you own personal method of thinking to exploit the loser/winner relationship. That is the essence of this book.

I purposely left out books related to advances in technology in general. I left out books on Industry specific advances in the understanding of various disciplines; such as Physics/Artificial Intelligence/Religion/Exobiology, etc. If the truth were told, I left out more books than I included in this list. I am telling you this because I didn’t want you to view the education process I personally chose to accept as being something I believe is “mandatory” for any new trader looking to create a winning method. I included the books I think adequately support my hypothesis for personal growth and market-related growth; the essentials If you will. I don’t expect you or anyone to share my wider point of view on other topics.

FREE Tools for Disciplined Psychology

"Discipline is the foundation upon which all success is based. Lack of discipline inevitably leads to failure"

--Jim Rohn

I love the fact that Mark Douglas titled his first book The Disciplined Trader. I personally believe with all the hyperbole & hype surrounding the use of Technical Analysis, Artificial Intelligence, Automated Systems, and the countless numbers of online webinars/sources of training and "help" to win at trading; it is becoming an obsolete thought to include "Discipline" in your winning method. People really want to believe that trading is "easy" and that all these "tools" are going to make trading even easier than ever…. "You don't need discipline! You need more computing power! And, of course, my latest software…" Personally, I think that is the wrong pathway and I sincerely hope you won't make the mistake of thinking you are going to become a successful trader without doing the work the rest of us have had to do.

People don't seem to believe that the basics of success are the same and they never change. All the tools in the world will not help you if you can't stay focused enough to use them correctly. Plus, you need a solid grasp of the basics before any of the "state-of-the-art" equipment can be of any help anyway. How are you going to acquire that knowledge without discipline?

Outlined for you are some things I found very helpful relating to the development of my daily trading discipline. Most of these tools are "low-tech";

meaning they are at the pen and paper level. Believe me when I tell you they can be more significant to you than you probably would like to accept at first. Please try them out. Give yourself a fair chance to absorb what these tools can assist you with. I think you will see the value over time.

To view the material, you need to visit my website: www.TheLionOnline.com and register. Once you are registered you can visit the page titled “Tools for Disciplined Psychology” and scroll through all the samples provided. Feel free to use the “Contact Me” form if you have questions about any of my documentation or how to use these tools.

Also, don’t forget, I have some Bonus FREE Material in addition to Samples of my Personal Trading Records and the tools listed on this page. Once you register you will have access to all of those pages as well.

FREE Samples of my Personal Trading Records

"Anything you can do to stay organized and free up the creative side of your brain is a good thing."

--Chuck Hogan

I like to consider myself one of the more organized persons you might know; I find that when I am very organized, I operate with a lot more freedom. By that I mean mental freedom. There is a certain feeling of power I seem to get when I know that my mind is free to dwell on highly creative thoughts and I know I don't have to worry about things getting in the way of my trading.

All of the records I keep are organized by trading quarter. I have included a short video that goes through one entire quarter's worth of material after it has been compiled, and I have blank documents & files to show you. I think it should be very clear that the material I am recording and compiling is designed to offer insights into my trading mindset and my trading results. There are times when my thinking is very clear and times when I can see I am not thinking in a very focused way at all. All of these different kinds of documentation and record-keeping make it very easy for me to get back on track when I fall off the pathway; as well as keep me very focused when I am right on track. I also feel that because I keep so much of my material so well-organized, I can change things in my approach or my thinking very quickly and prove those changes out (or invalidate them) very quickly.

To view the material, you need to visit my website: www.TheLionOnline.com and register. Once you are registered you can visit the page titled “Samples of my Personal Trading Records” and scroll through all the samples provided. Feel free to use the “Contact Me” form if you have questions about any of my documentation or how I do my record-keeping.

Also, don’t forget, I have some Bonus FREE Material in addition to Samples of my Personal Trading Records and the Tools for Disciplined Psychology. Once you register you will have access to all of those pages as well.

Bonus FREE Material

"Free stuff always comes with the biggest cost. Be mindful, some people don't do anything without wanting something in return"

--Jazz Zo Marcellus

You got me.

I have some FREE stuff for you but there are some strings attached. First—you have to register with my website: www.TheLionOnline.com. Once you follow that link and get to the website, there is a page titled "Bonus FREE Material" On that page you will be prompted to register. Once you are registered, you will find a list of items you can review anytime. Yes, I am going to send you emails on a regular basis. But in fairness to you, this is a two-way street. I have a "Contact Me" page for you to reach out to me if you wish as well. I welcome the dialogue with other like-minded traders, and I continue to offer my personal mentoring/coaching options.

Second, I have selected some of my better recordings and materials from over the years for you to review. It's not everything. However, there is a possibility I will ADD more material to the "Free Stuff" page as time goes on. You are welcome to ask for older materials if you know specifically what they are (which happens occasionally from traders who know me and have followed me for years). If I can find that older content, I will be happy to pass it along.

Last, you are welcome to follow my on Twitter and LinkedIn. I don’t do a lot on social media at this point, but I am told that as I get more familiar with the benefits it is a great way to stay in touch with my audience.

Both my handles for Twitter and LinkedIn are the same: TheLionOnline

Feel free to sign up with me. I have a YouTube channel with the same handle, but I haven’t posted anything there in quite a long time. I might take that page down in the future, but for now—feel free to have a look at what is there. Please feel-free to use the “Contact Me” form if you would like to discuss mentoring/coaching or have questions about any of my material.

About the Author

Jason Alan Jankovsky is a 30+ year veteran of leveraged transaction trading. Trading extensively in Futures, Options, and FOREX since 1986; first as a customer and then as a registered Series III broker. He is self-taught and self-educated. Working in almost all facets of the trading business, he has authored several trading systems, trained other successful traders and has had his insights published in many industry periodicals. His numerous articles on global cash FOREX and trading issues have appeared in "Traders Savvy", "The Perspective", “SFO Magazine”, “Futures Magazine”, "FX Magazine" and other industry publications. He is a regular guest on The Timing Research Show as well as other business radio and television shows. He is the author several titles, "Trading Rules that Work: The 28 essential lessons every trader must master" (John Wiley & Sons, October 2006), "The Art of the Trade: What I learned (and lost) trading the Chicago futures markets" (John Wiley & Sons, October 2008), which is the autobiography of his education as a trader; and his third book, titled "Time Compression Trading: Exploiting multiple time frames in zero sum markets" (John Wiley & Sons, October 2010). He has focused on the Psychology of Trading as the key component to a successful trading methodology and teaches an eight-week course on trading psychology regularly to traders around the world. He appears regularly as a guest speaker at many public and private trading forums and has been invited to speak at round table discussions offered by events such as “The Orlando MoneyShow” and “The New York Trader’s Expo” He regularly offers trade coaching & mentoring; working directly with traders of all skill levels. He trades his own accounts every day. Born and raised in Chicago, IL, he is an avid Sailor, Private Pilot, and occasionally gets into the cockpit of a Formula Ford open-wheel racing car.

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Read my interview at Smashwords: https://www.smashwords.com/interview/Thelion5464 Smashwords profile page: https://www.smashwords.com/profile/view/Thelion5464

Discover my other titles:

“Trading Rules that Work--the 28 essential lessons every trader must master”

“The Art of the Trade--What I learned (and lost) trading the Chicago Futures Markets”

“Time Compression trading--Exploiting multiple timeframes in zero-sum markets”

Thank you for reading my book. If you enjoyed it, won’t you please take a moment to leave me a review at your favorite retailer?

Thanks!

Jason Alan Jankovsky

“The Lion of LaSalle Street”