Electronic Trading 'TNT' II How-To-Win Trading Stuff

JOE ROSS
MARK CHERLIN

ELECTRONIC TRADING 'TNT' II — GORILLA TRADING STUFF™

BACK COVER GORILLA PHOTO BY WRPRC AUDIO VISUAL ARCHIVES

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To our families and friends who helped us along the way

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CAUTION

CAUTION: THIS IS A COURSE INTENDED TO HELP TEACH YOU HOW TO TRADE STOCKS, IMPROVE YOUR TRADING SKILLS, OR BOTH. THERE ARE SECTIONS OF THIS COURSE THAT ARE DIFFICULT TO UNDERSTAND UPON FIRST READING. IT IS A MANUAL MEANT TO BE STUDIED. THE CONCEPTS CONTAINED IN THIS COURSE TOOK MANY YEARS TO DEVELOP. MOST TRADERS WILL NOT BE ABLE TO GRASP THESE WITH JUST A CURSORY READING OF THE TEXT. IN THE PAST, MUCH OF THIS MATERIAL WAS RESERVED EXCLUSIVELY FOR PRIVATE SEMINARS WHICH COST $10,000 PER STUDENT.

Books for stock traders by Joe Ross and Mark Cherlin:

- Electronic Trading 'TNT' I — Gorilla Trading Stuff
- Electronic Trading 'TNT' II — How-to-Win Trading Stuff
- Electronic Trading 'TNT' III — Technical Trading Stuff
- Electronic Trading 'TNT' IV — Tips-Tricks and Other Trading Stuff

To the Ladies who are taking this course: We tried to write the manuals in a way that is gender neutral. Ladies, it just didn't work. So please forgive the fact that we used the masculine gender throughout. It is not our intent to offend you in any way.

Foreword

As a professional stock trader for over 25 years, and presently an "electronic" stock trader using the Internet, I've seen a lot of books about trading and investing, and I've attended more seminars than I can count. But never in my long career have I seen any material that can compare with the incisive perceptions presented in this "How-to-Win" manual. Most traders spend most of their time pursuing all the things they shouldn't in a frantic effort to get rich. But they have it all wrong, as Joe and Mark point out in "How-to-Win."

There have been dozens of great teachers who have pointed out the reality that you will become what you think. In this manual, in fact in their entire four volume course on trading, Joe and Mark never let you lose sight of what is important – the correct mind set needed to make money and win at trading.

They do a superb job of teaching you not only how to trade, but also how to manage every aspect of your trading. You learn business management, money management, risk management, and trade management. But most of all, you learn the one and only thing that can bring it all together – personal management.

As I read through this absolutely splendid presentation, I couldn't help but wonder how many traders, both new and experienced, would truly understand the precious gems that have been placed in their hands.

The truly wise trader will read it many times over and enjoy it more with each reading.

Joe and Mark, you are to be congratulated for this very fine and wonderful work.

Hans Schwimmer

Germany

PLEASE READ THE FOLLOWING

A Special Message from the Authors

There is a different free gi... in the contents of each
of our man... ...inning trading strategy
that has ma... ...have used it. Since
we feel it is ... ...e manual, we are not
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THE AUTHORS

JOE ROSS

Joe Ross, trader, author, and educator, has been an active trader since 1957, when he began his trading career in the commodity futures markets. In 1982, when it became possible to daytrade the S&P 500 stock index futures via a live data feed, he successfully made the transition from full-time position trader to full-time daytrader. In 1988 he formed Trading Educators for the purpose of training aspiring traders in the futures, bonds, and currency markets. Since 1988, Joe has written seven major texts on futures trading. All have become classics. An eighth text is distributed only to students who take his private daytrading course. In 1991, in addition to private tutoring, Joe began to give seminars and to write Trader's Notebook, a teaching newsletter. He did this in order to keep his students apprised of new trading techniques, and global situations that can affect all markets. Joe teaches that a trader should be able to live anywhere in the world where he can obtain trading facilities, and be able to trade any market at any time whether it be stocks, futures, currencies on the Forex, or interest rate contracts. To prove that he means it, Joe moved to the Bahamas. "The phones are lousy, and I can barely get data," Joe says. But he successfully trades from there.

Although Joe's career has centered mostly on the trading of futures, and in recent years more particularly on daytrading the S&P 500 futures, he has also been a successful trader in the stock market. In fact, many active and successful stock market traders have read Joe's books on their way to becoming profitable. As Joe likes to say, "A market is a market, and a chart is a chart. Given those two and a way to enter an order, a trader should be able to make his money."

Joe holds a Bachelor of Science degree in Business Administration from the University of California at Los Angeles. He did his Masters work in Computer Sciences at the George Washington University extension in Norfolk, Virginia.

MARK CHERLIN

Mark Cherlin trader, money manager, and educator, began trading other people's money immediately after graduation from the renowned A.B. Freeman School of Business at Tulane University.

In addition to owning and operating an investment advisory firm and being trader for a hedge fund, Mark started a daytrading firm which quickly became one of the most successful in the country.

Mark used his trading and educational skills to develop training seminars specifically designed to teach the daytrading of stocks using various electronic trading systems. He provided this course to aspiring traders through his daytrading firm. People from all walks of life traveled from various cities in the United States to his office for trading and training.

Mark has been deeply involved with electronic trading and has himself successfully daytraded various electronic systems as well as having contributed greatly to the success of scores of daytraders.

Mark's other accomplishments are equally impressive. He has been a Vice-President/Investments with both Shearson Lehman Brothers and Oppenheimer & Co., and First Vice-President/Investments with Lehman Brothers.

His articles, views, and accomplishments have been noted or published in such leading journals and periodicals as Investors Business Daily, Barron's, The Houston Business Journal, and Institutional Investors Portfolio Letter, to name but a few. He has made numerous appearances on the national television show Inside Money, and has been mentioned or featured on radio stations around the country. He has also, upon request, written published editorials about trading and investing.

Mark is considered by many to be one of the most energetic and exciting traders / educators in the Electronic Daytrading community. He is happy to share with all aspiring traders, both beginners and experts, this, his latest venture, as co-author of this course, Electronic Trading **'TNT.'**

Chapter 1

LET'S GET ON WITH IT

This manual is part of the course entitled Electronic Trading 'TNT' and is about problems traders have when trading in the equity markets.

But before we really get into the problems, We want to ask you a question: ***Why would anyone want to earn his living as a trader?***

Here is the answer as we see it: **TRADING OFFERS THOSE WHO SUCCEED AT IT THE UTMOST FREEDOM TO HAVE A COMFORTABLE LIFESTYLE IN WHICH THEY CAN LIVE AND WORK ALMOST ANYWHERE IN THE WORLD.**

PROBLEMS OF TRADERS

In tutoring and giving seminars, we have learned an amazing truth: Most traders do not have the proper mindset needed for good trading.

The knowledge we've gained through teaching the business of trading far surpasses what we knew prior to becoming educators. We like to teach because we learn so much from our students. Through teaching, we've become better traders.

This course, ELECTRONIC TRADING 'TNT' II — HOW-TO-WIN TRADING STUFF is written because we could find no one else who teaches others how to make money trading electronically in the stock market! That is specifically because virtually all the books that have ever been written deal with investing in the stock market, not trading in the stock market from a live data terminal. Those few books written about stock trading do not teach you the details you need about handling your trading in a businesslike manner in order to produce profits. What is available for daytrading stocks is usually rudimentary, and often only a marketing piece for the author's trading system,.

In this second volume of the course, we are going to teach how to identify, and then handle and deal with, the many hang-ups that cause traders to lose in the markets. In this book, we want to pull it together in the context of equity trading so that it will be more useful to you. What you are going to get here is a good dose of homespun wisdom, philosophy, and psychology. Much of what we write here, will be new to most of you.

We have focused this particular volume of 'TNT' on business concepts because, in teaching, we find there are few indeed who even begin to take a self-controlled, business-like approach to trading. Virtually all traders abandon the solid principles of sound personal management that make for successful careers in the business and professional world. For most traders, trading is a fantasy land. Their trading has nothing to do with reality. They are whipped mercilessly, not only by the market, but by their emotions and psychological make up. Their mindset is all wrong for trading. No matter how it got that way, the reality is that it ***is*** that way, much to the misfortune of the average trader.

It has become apparent that just teaching others how to trade and how to operate their trading as a business is not sufficient. We also have to teach people how to think — to give the proper mindset.

These are not at all the same. You must be a good trader, a good business person, and think properly. The three go together — they are inseparable. You must shed your old bugaboos before you can trade and win.

This book comes with a warning: The only way we know to teach you the correct mindset is to dissect your innermost being. We're going to take you apart at the seams. We're going to tell it as it is. In this book, a lot of fun is poked at professionals. It is done it to get your attention. Please don't be offended by the sarcastic tone of some of the things that are said. Consider them the impersonation of a couple of cynics.

Don't take anything we say personally unless, of course, it fits. We promise we'll attempt to put you back together again before this volume ends. We promise to give you everything we possibly can give to make sure your trading will be successful in the future. Your success will make the markets better for everyone, ourselves included.

Let's get on with it.

Joe Ross Mark Cherlin

Chapter 2

MOST TRADERS KNOW HOW TO TRADE

Knowledge of trading is not a problem for most of the participants in the market. That's right, most traders know at least something of how to trade. You know what you are supposed to do. You just don't have the right mindset for trading the markets.

We would venture to say that most of the people we tutor are very astute and could be better traders than they are. Their problem is that they don't know how to think when they are trading. They don't have the correct approach to the markets. They don't have the appropriate anticipation for trading, and they don't have the correct expectations. Much of this is due to the hype and hoopla that is allowed in the marketing of trading methods and materials.

A principal of one of the largest brokerage firms wrote an article declaring that eighty percent of traders are on the right side of the trade when they enter the market. Why then, do so many lose?

Where do they go wrong? Ah! That's the jackpot question. The answers to that question are manifold. We will address as many of the psychological ones as we can think of within this part of the course. The business reasons are covered afterwards.

TRADERS ARE EXCELLENT STUDENTS

Most of you are terrific students. You are generally willing to buy books, tapes, and courses on how to trade. You spend money to lease or buy equipment, charting services, and various devices to help you become better traders. You subscribe to available magazines and newsletters, buy computer software, trading systems, and attend seminars, all in the quest of becoming better traders.

You spend hour upon hour poring over charts, contemplating markets, devising all manner of techniques and methods for winning.

You count and measure, you back-test and project. You know more about markets and how they work than the vast majority of people who have ever lived on Earth. You even know what ECN stands for, which is more than can be said for most of the people living on this planet.

You know about trend lines, and in some cases, speed lines. Some of you know how to spell Fibonacci, and you've read about "Fib Ratios." You might know about waves and wave theory and the "January Effect." You know what "cyclicals" are and you've read about chaos theory.

You can spot a fifty percent retracement without even a calculator. You know what an oscillator is, and you understand "relative strength." You know the parameters for any number of technical studies by heart, you know how to punch a single button to buy the stock you want to buy. You know about protective stops, and know that being "long" or "short" does not refer to a person's height. Some of you are diligently studying Bollinger bands.

You can sling around terms like momentum, support, resistance, overbought, oversold, trendline, channel, breakout, etc....., ad nauseum, and ad inifinitum.

But you don't know as much about market perception and expectation as did Grandma Tate when she bought AT&T stock and just held onto it until the kids were old enough to go to college.

No, it's not your lack of knowledge about trading that keeps you from succeeding in the markets. You know ***how*** to trade. You are right about direction eighty percent of the time. So what's stopping you? Do you secretly ***not*** want to win?

Is it fear? Is it greed? Is it, perhaps, impatience? Is it lack of managerial skills — planning, organizing, directing, controlling, delegating? Is it that you don't have the proper attitude? Is it because you lack an economic motivation?

The truth is that it is not only some combination of all of the above, but it is also because you lack understanding of some of the most fundamental personality skills that are known to man in the area of self-discipline. In addition, you also have never really understood the nature of business, money, risk, trade, and personal management — or the differences among them.

Chapter 3

MENTAL GRIDLOCK

There are far too many traders who suffer from mental gridlock. Chances are you are one of them. In part this handicap stems from the educational system extant in much of the world today. That's a great excuse, go ahead, blame your lousy trading on the education system. But after you get that off your chest, start figuring out how to be healed from the damage done.

We have been taught that there is a right and correct answer for most problems. Our educational system turns out to be a game of guessing what the teacher is thinking. We have been taught to think that the best ideas are in someone else's head. That's Gibberish! In school, good grades are earned by vomiting the standard answers that are in both the textbooks and in the teacher's mind.

Were you an outstanding student in school? Good for you! You can pat yourself on the back. You are a first class regurgitater.

THE RIGHT ANSWER

For instance, if you were asked the color of the sky, most of you would answer "the sky is blue." That's the correct textbook answer to a question about the color of the sky. But *stop*, *think*, is the sky really blue?

Is blue the right and correct answer? In some parts of the world the sky is gray far more often than it is blue. If you don't believe that, live in Seattle, Washington for awhile. Gray is just as correct an answer as is blue. Have you ever seen a red sky? Have you ever seen a yellow sky? How about a multicolored, mackerel blue-gray and red sunset? How often have you seen a blue and white polka-dot sky? At night, the sky is generally black with white polka dots!

The sky is no more blue than grass is green. As this is written, one-hundred percent of the grass on our office lawn is the color of light straw. There is not a single blade of green. This grass will stay straw colored for several months. Who says grass is green? Even during the season that grass is green, it is not green at sunrise; then, the early morning light causes it to appear gray.

Okay, here's another question for you, what color is the ocean? Do still believe it's the deep blue sea??!!

Most of you are looking for the *right* answer when you are trading. The truth is that in trading there are often no right answers. In trading, you can be long and someone else can be short, and you can both be correct within the time frame you are trading.

This leads to a great truth about stocks and the trading of them:

> **THE ONLY WAY TO SUCCESSFULLY TRADE STOCKS IS TO CHANGE YOUR BEHAVIOR RELATIVE TO THEIR PRICE MOVEMENT!**

Our society and its educational process has taught us that the way to solve problems is to either change the environment, become a part of the solution, or both. Society also teaches us to run from problems, hence the ever increasing number of divorces and abortions.

However, when it comes to trading equities, none of these solutions will work. With few exceptions (those with sufficient capital to move a share's price), we cannot become part of the solution. We cannot tame the market for a particular stock. In general, no individual act of ours can make share prices move up or down. Therefore, we cannot be part of the solution. Neither can we change the environment to solve our problems with the market for a particular equity. For most of us, the market for a particular equity constitutes an overwhelming environment in and of itself.

There is no right answer when trading stocks. That is the plain and honest truth. Some find success with one method and some with another. A method may work for awhile and then stop working. You can trade from fundamentals, technicals, a combination of both, or neither, and still be right. "Right," when trading, is determined by whether or not you made a profit from a trade. Profit is the bottom line in trading. Either your trading is profitable or it is not! If it is profitable, then you are right. If you are losing and are unprofitable, you are wrong. What can you do?

Since we cannot change the trading environment, nor can we become part of the solution, the only thing left for us to do is to ***change our own behavior relative to the price action.***

In so doing, we must deal with a number of areas of mental gridlock that prevent us from changing our behavior. The first of these we dealt with when we talked about blue skies, green grass, and the deep blue sea. We can term this particular mental hang-up "trying to find the right answer." Finding the right answer is only one of the mental gridlocks. The remaining mental gridlocks may be termed:

- Patterns, Rules, and Procedures
- Expecting Markets to Be Logical
- Thinking You Have to Trade
- Making a Science Out of an Art Form
- Trying for Perfection

These and much more will be discussed in the following chapters.

Chapter 4

PATTERNS, RULES, AND PROCEDURES

Human beings excel at pattern recognition. Let's give you an example. Here is a series of numbers:

2 4 8 16 32 64 128

Within a short period of time you would probably guess that each number was twice the value of the preceding number. You could even be confident in predicting the next number in the series as being 256, and the next after that as 512, and so on.

The ability to recognize patterns is one evidence of what we call human intellect.

The ability to recognize patterns has resulted in the studies done on cycles and cyclical trading, seasons and seasonal trading, waves and wave trading, Gann ratios and Gann trading, Elliott counts and Elliott wave trading, Fibonacci's series of numbers and Fibonacci trading, etc.

Channel lines, heads and shoulders, pennants, flags, megaphones, cups with handles, trading ranges, saucer bottoms, etc., are all examples of man's ability to recognize patterns.

These patterns result in our ability to cope with and understand the world around us. As a consequence, they ***rule*** our thinking. They become the rules according to which we *play* the game of trading.

One problem with this is that trading is not a game to be played. Trading equities is serious business — a great deal can be and often is at stake when trading. In fact, more than money is at stake. Your mental, emotional, and even the spiritual aspects of your life can be a part of the stakes involved with trading.

These are serious matters, issues that are not to be taken lightly. Not only can trading and losing affect your financial affairs, but you can receive terrible and possibly irreversible emotional and psychological damage. In some cases, the result has been the breaking of the human spirit to the point of devastation.

petrified PETE

We personally have known a man we'll call Petrified Pete. Pete traded very successfully for many years following certain patterns and rules. He had an excellent way of trading. But then the market changed, and his rules failed. Pete failed to change his behavior relative to the new market reality. Pete, after taking a $2.7 million dollar loss in the stock market, found himself not only financially destitute, but also suffering the loss of his family (his wife walked out on him taking their child), the loss of his clientele (most of the money lost was theirs), and the breaking of his spirit.

He became an alcoholic, went on a year long drunk, and had no idea how he ended up in the geographical location in which he found himself at the end of that year — he found himself living in another nation. He lost his self esteem, pride, and confidence in what he could do, and never has fully recovered mentally, emotionally, or psychologically.

For the following seven years he was unable to earn a living, and became a professional con-artist, until he was finally able to obtain and maintain a job in sales. He went from successful millionaire to barely scraping out a living as a furniture salesman.

Petrified Pete's story points up the human need for pattern recognition, which often results in the rules by which we proceed in our trading. When this happens, we run the risk of making these patterns our god. When the market refuses to follow the pattern, we are in trouble. Why? Because in many instances we've never figured how to trade without them. We blindly follow the rules, rules we ourselves or others have made. The blind following of rules can lead to our ultimate destruction. This is seen in the markets every day. There is a steady stream of losers leaving the markets. They have lost their money and their confidence. They are beaten, and they can't understand why. After all, they reason, ***"I followed the rules!"***

"I simply can't understand it! I'm at a total loss for what to do now. I want to give up —yes I want to give it all up. But I can't. I have five years of my life tied up in this trading business, not to mention all the money I've lost. I'm so confused. I don't know what else to do. Doggone it, I followed every rule — but the markets always go against me!

Well pal, it looks as if you're going to have to change a few rules. Either ***you'll*** have to bend, the ***rules*** will have to bend, or both!

The problem is that rules do not always work when trading stocks. When the rules don't work, you must change them. Rules must be challenged. The trading of stocks will constantly challenge your rules and procedures that are based upon pattern recognition. That is because share prices do not really behave strictly according to the way we would like them to function. Think about it! If share prices always did follow a pattern or patterns, those patterns would long ago have been discovered and it would be ***easy*** to make money in the markets. All you would have to do is follow a set of rules and procedures based upon pattern recognition. You would be extremely rich, with all the money you could ever want! However, believing that trading is easy money is exactly what the purveyors of "magic" trading systems and methods want you to believe.

How long will you continue to chase your tail? How much time and how much money will you waste in a vain attempt to find the Holy Grail of trading — the perfect pattern — the golden rule? How long before you admit to yourself that the only solution to the problem of making profits when trading is to change your behavior? You must bend, you must become flexible. You must be willing to challenge and break the rules the moment you see they are not working. Bend those rules when it is required! **CHANGING YOUR BEHAVIOR <u>IS</u> CHANGING THE RULES!**

Listen as we explain to you a great truth about trading.
THERE ARE TWO GREAT AREAS OF CONCERN AND PROCEDURE in the ***JOB*** of trading. The first is ***method***, the second is ***management***. Of these, ***method*** is only 10% of the job. ***Management*** is 90% of the task at hand.

Management may be further broken into five categories: ***business*** management, ***risk*** management, ***money*** management, ***trade*** management, and ***self*** management.

Of these, business, risk, money, and trade management comprise 50% of the ***management*** job, and ***self management*** accounts for the remaining 50%. Moreover, without ***self management***, the other four will fail.

Yet most traders spend 90% of their time with method and procedure based upon some type of pattern recognition, signals from an oscillator, the crossover of moving averages, or the breaking of a trend line which they themselves drew. A scant 10% of their time is spent in self-management. Is it any wonder that so many fail? One-third of all would-be traders leave the markets every year. In a three year span of time, there is a huge turnover of people who come to the markets full of hope and enthusiasm for the ***art*** of trading. All too many try to convert this ***art*** into a ***science*** and thereby seal their eventual doom.

The following quotation is an excerpt from an author who apparently writes about the subject of creativity and is an advocate of challenging rules. S/he wrote (the name was Leslie), "There is a lot of pressure in our culture to 'follow the rules.' This value is one of the first things we learn as children. We are told such things as: 'No orange elephants,' and 'Don't color outside the lines.' Our educational system encourages further rule-following. Students are usually better rewarded for regurgitating information than for playing with ideas and thinking originally. As a consequence, people feel more comfortable following the rules than challenging them.

"From a practical standpoint, this value makes sense. In order to survive in society, you have to follow all kinds of rules. Shouting in a library, crying out "fire" in a packed theater, or cheating on your income taxes are three things ***not*** to do."

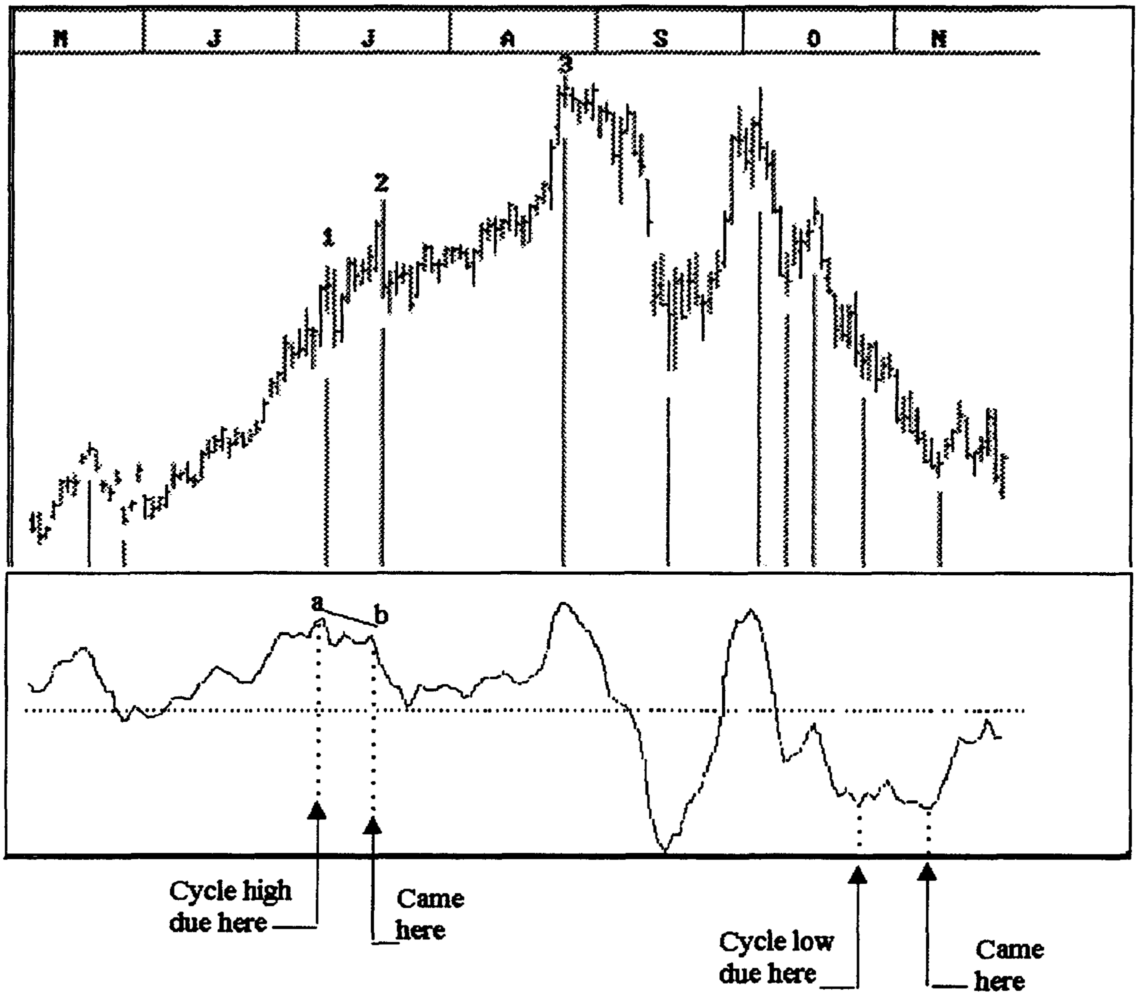
However, following rules does not always make sense when trading stocks, especially rules based upon pattern recognition and any kind of mathematical formulation, oscillator, or study derived from those patterns.

Pattern recognition falls within the realm of knowledge. But it takes more than knowledge to be a successful trader. It takes the right and correct application of knowledge if you want to attain the status of profitable trader. The right and correct application of knowledge goes by another name — ***wisdom***.

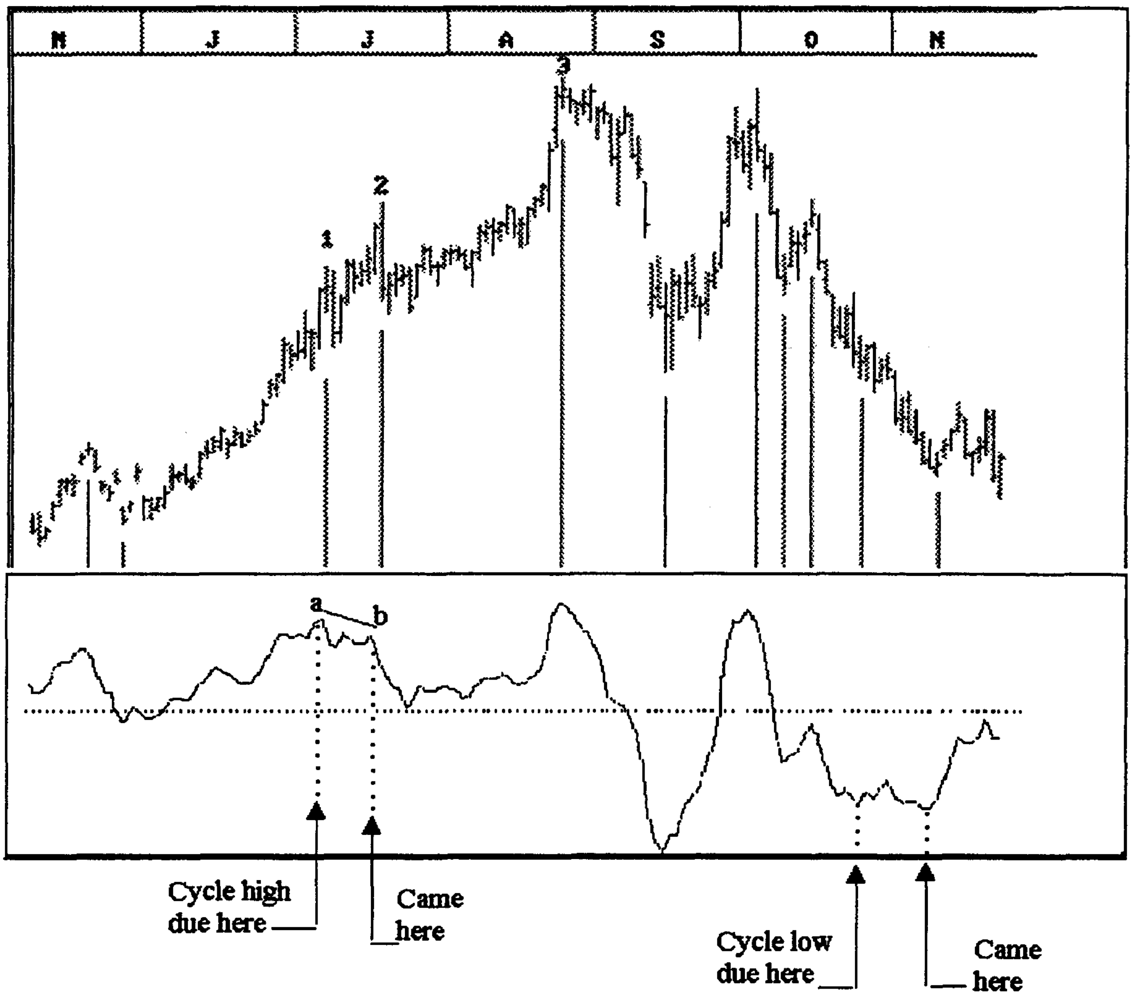
Wisdom is the appropriate application of knowledge. Wisdom is knowing when, where, how, and why to apply knowledge. Wisdom is knowing when knowledge alone will not get the job done. Our advice to you is to *wise up*! Yes, begin now to become wise.

Sometimes knowing the right answer, following the rules, or both, is simply not enough. There are times when, to be a profitable trader, you must change your behavior relative to what is happening with the price action. You must discard what was previously perceived to be "the right answer." You must be willing to challenge or change the rules. Finally, you must use wisdom in your trading.

On the following page is an example. What is seen is all too often in the eye of the beholder.



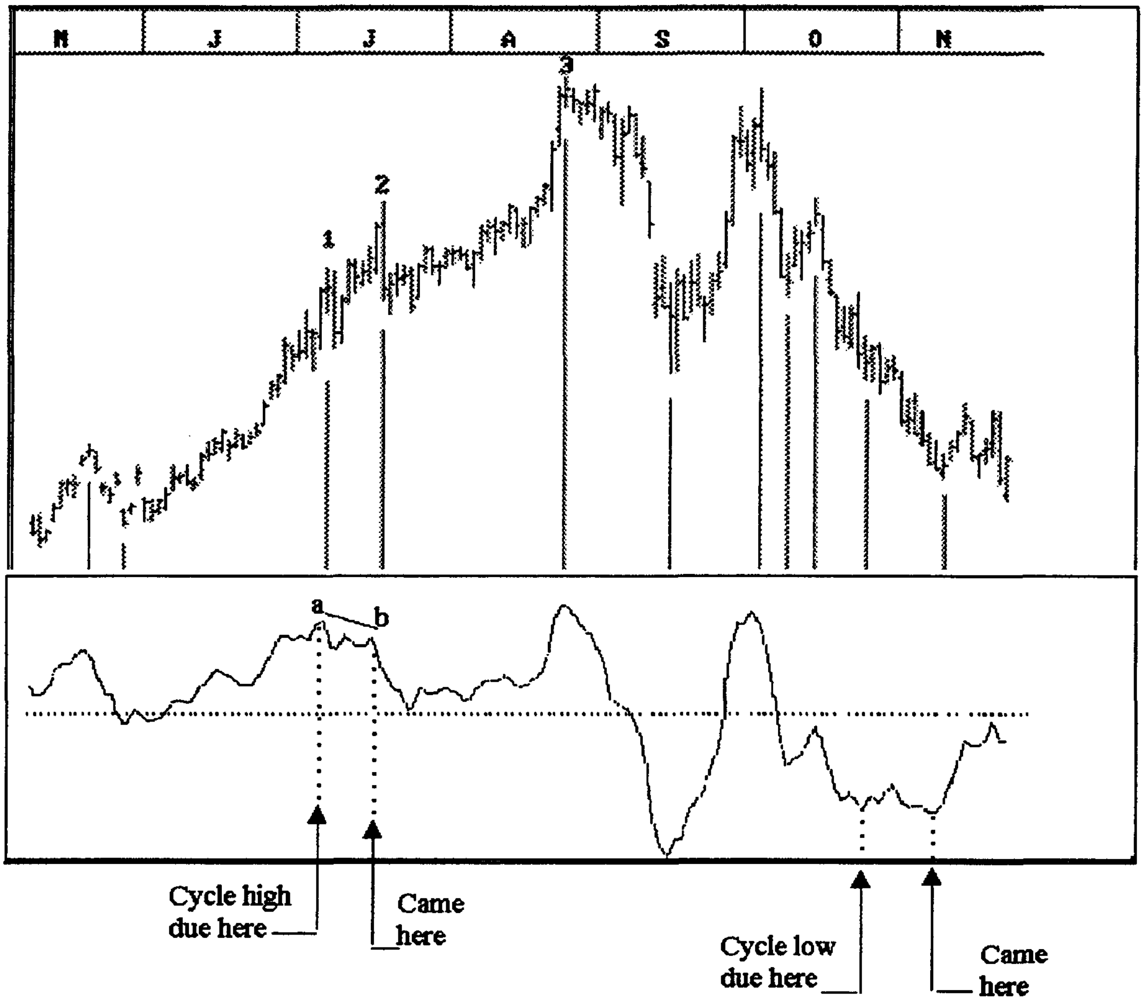
The chart above shows a Moving Average Convergence and Divergence (MACD) study which *periodically* does a fine job of calling cycle highs and lows in the equities markets. We usually set the parameters at 5-10-1 when using our trading software. The "1" eliminates one of the dual lines normally seen with this study. The "10" represents the number of bars in one of the moving averages from which this oscillator is constructed, and the "5" represents the number of bars in the other. Another way to accomplish the job of eliminating dual lines, when using a computer and a color monitor, is to set the color (if possible) of one of the dual lines to the same color as the background of the screen so that it becomes invisible.



One could argue that the setting should have been other than 5-10-1, but we had every reason to believe that, based on past performance, this setting would produce the desired result. Its ***pattern*** of prior successes was a part of our knowledge. However, had we created a rule based on that pattern, we could have sustained some major losses.

There are a number of problems with this chart, especially one we want you to see. Notice that in most cases, the cycle highs and lows, shown by the vertical lines, come just about where they should. But where the dotted lines are shown, they did not.

There was a cycle high due at point 1. It failed to occur. The cycle high came at point 2. Wonderful!



We now have what many analysts would call divergence from a-b on the oscillator. Prices have made a higher high but the cycle oscillator has made a lower high. So why did prices not soon come down? Why did they continue climbing all the way to point 3?

Note also that we would have twice expected a bottom at the last two cycle lows. Yet prices continued on to even lower lows.

Chapter 5

EXPECTING MARKETS TO BE LOGICAL

Observation should immediately tell you that markets are emotional and not logical. How can you tell? How can you know this for certain? All you have to understand is the primary underlying principle of traditional logic — the **law of non-contradiction.**

It might help to look at a few synonyms for the word logical: rational, cogent, understandable, clear, coherent, sensible, direct, easy, elementary, intelligible, lucid, simple.

Do any of these describe the market action you see on your charts? ***Logic can comprehend only those things that have a consistent and non-contradictory nature***. But markets are ambiguous and inconsistent. In fact, the closest anyone has come to explaining the action of markets is through a medium called chaos theory. Markets definitely ***appear*** chaotic. But even chaos theory does not adequately explain market action. Why? Because chaos theory is just what it says it is, **theory**. A theory is not fact. A theory is lack of fact. A theory is something not proven.

ENGINEERED MARKETS

In reality, much of a stock's price action is "*engineered.*" With the exception of real changes in the fundamentals driving price, the majority of each day's price action is the direct result of the deliberate movement of price as an outcome of "*engineering*" by some person or persons who have a direct interest in causing prices to go up or down. These market makers, shakers, specialists, or market movers if you will, are able to move markets virtually at will. They may move prices up because they have previously bought low and now want to take a profit. They may move prices up because in reality they want to sell at a higher price than where the current price action is so they can buy a bit later at lower prices. The problem is, you don't know their motivation.

If markets are not engineered, how else can you account for the following true scenario in one of the world's largest and most liquid stocks.

It came at a time when the company wanted to buy back a lot of their outstanding shares. The market opened and the stock began to drop steadily in one-quarter jumps. Someone was taking the price down hard and quite purposefully. A friend of ours who is a specialist in the shares of the stock informed us that, through various brokers, the company was dumping stock into the market by steadily selling below market. This was strange behavior for a company that was rumored to be wanting to buy in their shares.

Suddenly, as if by magic, the same brokers began buying the company's shares in huge quantities. We called our specialist friend wanting to know "what's going on?" He said, "Oh, the company is buying back in spades what they previously sold. They just wanted to start their buying at a lower level!"

Does that send shivers up and down your spine? It should. Are you one who thinks that markets are random? Are you one who thinks the market for a heavily traded stock is too big and too liquid for someone to move? Just remember what happened within the first two hours of trading on the day we were told the above information. Could chaos theory have explained that market action? First the strong hands handling the company's stock scared all the weak longs out of the market. Then they themselves went long at a much better price. By the end of the session, the company had bought in thousands of shares more than they had sold at the beginning of the day.

Expecting the market to be logical leads to one of the saddest consequences experienced by losing traders suffering from mental gridlock. By trying to apply hard logic to solve the problems that markets present, they miss out on one of the mind's most valuable creations: the intuitive hunch.

Next, let's talk about intuitive trading and an erroneous belief held by many traders.

Chapter 6

BELIEVING YOU ARE NOT INTUITIVE.

Whether you think you **are** intuitive or whether you think you **are not** intuitive is to a large extent dependent upon your belief system.

If you believe you are not intuitive, then you will never put yourself in a position where you can use your intuition.

The philosopher Epictetus once said, "What concerns me is not the way things are, but rather the way people think things are." This, of course, is one of the great truths that drives markets. It is people's perception of what is happening that causes movement of price. Price movement is the most important action of markets. Everything else that happens or can be measured in markets is a derivative of price and its movement. What people ***think*** is the causative factor in price movement.

What you think also drives your own actions in the market. If you think that you cannot trade intuitively, then you probably never will.

Ancient wisdom taken from Bible scripture states: "As a man thinks, so he is."

In other words, you become what you think about. This great truth is the so called "secret" buried in the book **Think and Grow Rich** written by Napoleon Hill.

You are now and you will ***become*** what you think about. Hill got that from the Bible, "As a man thinks, so he is!" Whether you can trade intuitively or not is all in your mind. Humans are goal oriented creatures. Our thoughts become our realities. Your mind will find a way to get you where you want to go. If you want to become an intuitive trader, you must set that in your mind as a goal. You might even attempt for awhile to become obsessed with the idea of becoming intuitive.

In our private trading seminars, we show our students how they can learn to become intuitive in their trading. Suffice it for now to say that, because intuition is somewhat of a *feeling*, in order to accomplish becoming intuitive one must get in touch with one's feelings. If you are interested in attending one of our private trading seminars, please contact us at the numbers given at the front of this book.

Why would you want to trade intuitively? Because intuition is what enables you to challenge the rules. Intuition is what tells you this pattern is not quite right — "*What I'm seeing now does not quite fit my trading rules!*"

Intuition is what prevents you from plunging into a losing trade just because your rules say there now exists such and such pattern, therefore I should take this trade.

The human mind is constantly recording, connecting, interrelating, and storing unrelated knowledge, experiences, and feelings. It then combines this seemingly disparate information into answers in the form of hunches as a means of solution to the problems created by the price action of markets. To take advantage of these hunches, you simply learn to ***ask***, ***trust***, and ***listen***. These hunches, for no apparent logical reason, might lead you to trying a different problem-solving approach in dealing with the movement of prices.

These hunches might even lead to the behavioral changes so necessary to trading successfully. Intuition is what causes you to take a wonderfully winning trade even though there is no *apparent* reason for entering that trade. Intuition allows you to sometimes trade against the rules.

Intuition is not opinion, far from it. Many of you trade your opinions. For most traders that is tantamount to a death sentence in the market. Notice we did not say ***all*** traders. Some traders are blessed with marvelously wonderful opinions and those who have such a gift, even if they do not have the discipline to trade well, should consider making their living advising others.

To trade intuitively, picture in your mind that you ***can***. See yourself taking intuitive trades. If you can picture something in your mind, you can depend upon the goal seeking mechanism that is a part of your mind to eventually get you to the point where you can trade from intuition.

The worlds of thought and action overlap. What you think has a way of becoming true. If you want to be more intuitive, believe that it is worthwhile to be intuitive, and have the persistence to keep trying until you become intuitive.

With such an attitude, you will be less afraid to occasionally break your self-imposed rules (although breaking rules is at times dangerous). You'll look for more than one right answer and be willing to go with your gut feelings.

You will be better able to tolerate the ambiguity that is inherent in trading. You'll be motivated to go beyond the status quo.

The intuitive person has the self-faith that he can go with his feelings, that his hunches will take him where he wants to go. In the markets, the pursuit of trading intuitively is well worth the effort made in developing an intuitive capability.

Chapter 7

THINKING YOU HAVE TO TRADE

It has been said that necessity is the mother of invention. Many good trading ideas and rules come when there is the need for a solution. Some of the best trades have come under pressure. Some of the best ideas and strategies have come when there has been a need to "fix" a broken trade.

But if necessity is the mother of invention, then surely relaxation is the father.

Far more pleasurable and more far-reaching are the trading ideas we get when we are away from the markets.

It's the old wisdom that says, "All work and no play makes Jack a dull boy." It's too bad that so many of you Jacks and Janes have become dull.

You have become dull to the point of sterility. Dull, flat, and unproductive.

Do you ever relax?

You trade as though there were no tomorrow. Trade, trade, trade! When you are not actually trading, you are paper trading. Trade, trade, trade! Testing and back-testing, you go at it as though it were frivolous to relax.

Yes, some of you actually think it's sinful to relax. You feel that if you are not working hard at something, you are wasting time. You view work and relaxation as two mutually exclusive boxes, and if you aren't working, you feel that you aren't producing hard, tangible results.

Well we've got news for you, friend, some of the best ideas and greatest inventions have come from people when they were relaxed.

Do you ever just get away from it all? The problem with a lot of you is that you need to take a hike. That's right! You need to slap on that old backpack that's sitting up in the attic or out in the garage, and take yourself for a two week hike along a mountain trail.

Don't like to hike? Then you can bike! Yes, that's it, you need to bicycle down to the seashore, or to a lake. When you get there, practice not trading. Practice not even thinking about markets. Don't watch the news on TV. Don't read a newspaper. Simply relax. Relax long enough that you forget all about markets and trading. Relax until you've rejuvenated your mind.

While you're relaxing, get into some humor. Read a funny book. Go see a comedy at the cinema. Indulge yourself in a humorous play. When you are laughing, it is much easier to relax.

Laughter puts you at ease. Getting into a humorous frame of mind not only loosens you up, it enhances your creativity. Humor stretches your thinking. It forces you to combine ideas that are usually not associated with one another. Humor allows you to take things less seriously.

As one writer put it, "There is a close relationship between the 'ha ha' of humor and the 'aha' of discovery."

If you apply the same thinking that you use in humor, and employ it to better managing your trades, then you are likely to come up with some fresh approaches to your trading and any strategies upon which you are working.

Humor may not solve your trading problems, but it will put you in a more conducive mood to do so.

Relaxation works wonderfully well to stimulate the flow of ideas. Humorous relaxation does even more to encourage this process. You will find that you are more candid in your approach to the markets.

Some of you are so serious about your trading, that it is laughable. You have become so married to the ideas of others in the area of pattern recognition and its derivatives in the form of oscillators, mathematical formulas and weird theories, that it's difficult for you to be candid, creative, and relaxed about your trading.

Step back, loosen up, take a look at yourself. Go stand in front of a mirror and ask yourself what possible market application is there in theories based on astrology, cycles, chaos, wave counting, etc.

While your standing there, smile at yourself. Then laugh at yourself. That clown in the mirror is you.

How many traders can you count who are actually making money trading with theories? Now, ask yourself how many vendors of publications and systems based on such theories are making money selling you on the idea that theories really work!!

That should get you laughing. The vendors are laughing — all the way to the bank.

Chapter 8

MAKING A SCIENCE OUT OF AN ART FORM

Markets are ambiguous and must be treated as such. Ambiguous means enigmatic, puzzling, cryptic, mystifying, and vague. How in the world do you expect to apply scientific principles to something that constantly changes shape, momentum, and direction?

Markets constantly beg the questions, "What's going on here?" "What does this mean?" and "How else might this be interpreted?"

One person sees a trading range while another sees a head and shoulders formation. Still another sees a coil. Is any one of them right? Are they all wrong? Would the whole thing better be termed distribution or accumulation? How do you measure a market?

Science demands that given the same set of variables, the answer will always be the same. Does your view of the markets allow you to expect the same answer from seemingly identical situations? If it does, then you need to see an eye specialist. While you are there, you might also have your head examined.

Do prices *always* turn at the square of price and time? Do prices *always* stop at a Fibonacci retracement ratio? Can very many people agree as to which wave they are in when counting in "Elliott" fashion? Where do you begin to draw a trendline? Do cycles always come on time? Do share prices *always* move strongly up or down on the announcement of some news?

The markets are a paradox. They ***seem*** to flow according to some order, but do they? Historically you can make a case for almost any way you care to measure price action. Historically, stocks make 50% retracements, but it is rarely exactly 50%. Retracements tend to fall within the 50th percentile. That means anywhere from 50%-59.9%. At times, though, they somehow do not want to cooperate.

Fully realizing the paradoxical nature of stock prices should cause you to critically question the plethora of false information that abounds stating things like "Gann's trading secrets revealed at last!," or "Now you can know equity tops and bottoms to the penny and the day!"

"Nonsense!"

Look carefully at the following mathematical equation. This equation has been handed down through the centuries, you might say it has its origins in antiquity. The solution to this equation will reveal the scientific order of the markets. Of course the variables have until now been kept a secret. However, out of the kindness of our hearts we are going to reveal them to the first 100 people who send us $35,000:

$$\mathop{S}_{j-r}^{144} \frac{R_n}{J_n} = \frac{12(b_s)^3}{vn^2\{l+r\}}$$

Some of you get so excited when you see something like the above that you can hardly contain yourselves. We can't blame you. We're excited about it too. The originators would turn over in their graves if they knew we were giving away the secret formula, the key to the true order of markets. But actually, we're not really giving it away. At $35,000 apiece, that is hardly a giveaway.

One thing that is scientifically correct about this offer is that someone, somewhere, is going to take us up on it. Will it be you?

The rest of the offer is an art. The art of tempting suckers to buy what you are selling.

Trading is an art. Art is able to deal with ambiguity. Is there anything more ambiguous than the Mobius Curve? It is a loop with only a single side.

There's a science fiction story about this interesting phenomenon. A roller coaster track was made with such a loop, and the people who rode on it would disappear into the fourth dimension.

You can make a strip in the form of the Mobius Curve by taking a strip of paper and make a loop out of it. But before connecting the two ends, give one of them a half-twist. Go ahead and make one to see what I mean. As with any loop, it also has no end. Such a strip is infinite. Science can't deal with infinity. But art can. It can not only deal with it, but in the case of the Mobius strip, it can create it.

Many of you are under the impression that if something isn't scientific it has no practical value. That's okay. Go ahead and blame it on the educational system. That's more than likely the mode under which you were taught.

But art has many practical applications. Conveyor belts are now being manufactured in the form of a Mobius strip. The belts last longer because both sides are actually one and so the belt wears evenly. In the field of electronics, engineers have found that a resistor with a twist bent back upon itself will perform its function more efficiently. A continuous loop in a cassette cartridge will pay twice as long if it has a twist in it. Chemists are exploring ways of making molecules in the shape of the Mobius strip. When they split, they get bigger rather than smaller.

Art has practical applications in trading as well. The depiction of price over time in the form of a bar chart represents an art form. Candlestick charts, point and figure charts, and equi-volume charts are all art forms representing the price action in markets. Candlesticks highlight the relationship of the open to the close. Point and figure charts are a form of detrending the price action. Equi-volume depicts a price-volume relationship over time. Whenever you are dealing with charts, you are dealing with graphic representations. Graphic representations derive from art, not science.

We're not saying there are no scientific applications that may be derived from market action. What we're trying to show is that it is foolish to deal with the market as though the problems of trading could be solved using the scientific method. It just isn't so. Markets are far too inexact to do that.

When dealing with something inexact, we often make mistakes. Since some of you are perfectionists, you have a serious problem.

Chapter 9

TRYING FOR PERFECTION

It is difficult to find perfection in the markets. It is virtually impossible to find perfection in your trading. No human being is perfect. Perfection is the carrot dangled before us throughout our human existence. Perfection is always just out of reach.

Yet some of you think that the method you use to trade has to or needs to be perfect. You refuse to accept that, as a human being, you will make mistakes. You refuse to accept the truth that from time to time all traders suffer losses. You refuse to accept that you will, at times, be wrong.

Your dilemma arises from the fact that most people consider success and failure as opposites. In actuality, they are both products of the same process. Think about this for a moment or two. Trading is an activity that produces both wins and losses. Refusing to accept losses is illogical. Yet some of you get completely bent out of shape when you suffer a loss. We've seen you go off in the corner and sulk for months because you took a hit in the markets. We've seen you practically go catatonic over a single loss. In some cases, you are never again able to pull the trigger on a trade.

You're just not comfortable with having made an error. Part of this stems from our educational system based on the concept of a "right answer."

From childhood we are taught that right answers are good and wrong answers are bad. This value is deeply ingrained in the incentive system used in most schools.

We have learned that to err is wrong. In reality, to err is human. We strive hard to keep our mistakes to a minimum and to be right as often as possible. The reality of the markets makes mincemeat out of our quest to be right all the time.

Your predicament is indeed ironic. You were trained by education and experience that failing even a little penalizes you. Being wrong only 15% of the time lowers your school grades from the best "A" to second best "B." You've been conditioned to not take many chances. Yet trading exists because someone is willing to take risk.

Do you see what a problem this creates for you when you trade? You have learned to not put yourself in situations where you might fail. And yet when you trade equities, every situation is one in which you might fail. In the case of failure in trading, the outcome is painful indeed. You are risking your money, your reputation, your ego, and your self-confidence. You have been taught that such action is not only dangerous, but wrong.

You have been brainwashed to avoid the stigma our society places on failure. This avoidance leads to conservative thought patterns. Yet to trade well you must be willing to take risk and confront failure with each and every trade.

Some of you professionals — those of you who did extremely well in school — those of you who had the highest scores on your examinations — those of you who went through your entire schooling without ever failing to obtain a passing score on a quiz or a paper — simply don't know how to fail. You have come to the belief that failure is bad in and of itself. But you are wrong. Failure is the stepping stone to success, the pathway to new and better trading ideas and strategies.

A trader is simply a person who cannot take his education too seriously. A trader fails much of the time. A trader can actually make money while failing more often than he succeeds. The solution is found in the area of properly managing your trading.

Our trading errors serve a useful purpose: they tell us when to change direction. In trading we constantly have to change and adjust our behavior relative to the market action. That doesn't mean we have to start all over again with a new method. Usually all we need is to make an adjustment. Too many are willing to throw out the baby with the bath-water the first time we suffer a loss or series of losses in the markets.

When we goof on our trades, we receive negative feedback in the form of being upside-down in the trade. This forces us to learn. We learn by trial and error, not by trial and rightness.

AFRAID TO BE WRONG

A few years ago we met Fred Toby Rhongg. Fred was a high-paid professional who was thoroughly disgusted with the way events were moving within his field of endeavor. Consequently, he wanted to find another way to make his living.

When one is able to earn fifty percent or more based on a billing of over a million and a half dollars a year in client fees, it is not easy to find another occupation that pays as well.

Yet Fred was so miserable and disenchanted with his chosen profession that he felt a compelling need to find something else. That is when he decided to become a trader.

Fred had always been a quick study. His keen mind and intellectual capacity had served him well most of his adult life. Fred was definitely head and shoulders above others when it came to brain power.

Society rewards men like Fred by paying them great sums of money for their apparent expertise. Fred had followed the normal course of education for his field, was licensed, and had paid his dues.

Fred plunged into the realm of daytrading stocks wholeheartedly, expecting to quickly become filthy rich.

Fred followed one of the common routes into his newly chosen endeavor. He went to the library to find books on daytrading stocks. Admittedly, the selection was slim. Fred then went to the book store and found a couple of beginner's level books, purchased them, and began reading and studying.

Based on what he read, Fred contacted various brokers offering trading rooms with electronic terminals for daytraders.

When the packets arrived, Fred delved into them and began poring over the material. He found out there was even more "free" information available from the exchange. He promptly sent for the additional information.

Within a matter of weeks, Fred had become quite knowledgeable about the little known field of electronic trading.

Fred mentioned his newly discovered love to some of his fellow professionals. *"Oh, I've heard about 'those terminals',"* he was told, *"You're sure to lose your shirt messing around with those."*

Somehow Fred was stimulated by the fear, concern, and caution expressed by his associates. Their comments made it all the more challenging to succeed as an electronic trader. The more negative the commentary by others, the more Fred became excited. His intellectual prowess was being challenged. Fred was aroused. The boring hum-drum of his present profession would soon be a thing of the past.

Fred was determined to put his superior brain to good use. Surely there was order to the markets. Surely a proper application of mathematics and science would soon see him blazing his path to his piece of the billions available in the markets.

As a professional, Fred was unaware of a major problem in his personality — he detested being wrong. Over the years, Fred had learned to skillfully maneuver others into the position of scapegoat.

As a child, Fred outsmarted his siblings, and they often were blamed for things Fred was guilty of doing.

In school, Fred was a model student and his instructors would not think of blaming Fred for doing anything inordinate. Fred was seldom in the position of being wrong. He usually had the right answers and was adept at staying out of trouble.

The unfortunate consequence of his actions was that Fred did not learn to deal with adverse situations. He simply hated any challenge that was not mostly intellectual.

It was no wonder then that Fred pursued and married a mousy, meek, and introverted young lady of his choosing. He was able to dominate his mate, and maneuver her into the position of taking the blame most of the time when things didn't go quite right.

After a few months, Fred was ready to open his trading account. Being a man of some considerable means, Fred opened with a considerable amount of money. This greatly endeared him to his brokerage firm, who was abundantly encouraging and supportive in their statements to Fred.

Fred made his first trade. Sure enough, the market went Fred's way and in just a few minutes he picked up a nice profit. "*Oh, boy*!" thought Fred, "*This is going to be easy*!!"

Fred always knew he was smart, and the market had proved him right. Fred's next few trades had mixed results, but over all he was ahead in his trading. The few things that were wrong, although they alarmed him, Fred chalked off to "learning experience." Fred was beginning to find out that there was more to trading than what seemed immediately apparent.

Then Fred took his first real hit in a stock. It happened this way: Fred had gotten long a thousand shares of Microsoft. As Fred checked share prices, Microsoft began moving up and Fred was overjoyed to see a quick unrealized paper profit. Then quite suddenly, Microsoft began to move down. By the time Fred decided to get out, his trade was down several points, representing a loss of $4,750.

"Why didn't I react sooner?" thought Fred, a bit outraged by the turn of events. He had determined beforehand that if the trade ended in a loss, it would be the fault of the brokerage firm who was providing the trading terminal for not training him more completely.

Fred didn't sleep well that night. He hated to lose. Losing meant being wrong. Fred was quite angry with his brokerage firm, and at the electronic trading system in general. Why, Fred was even angry at the market maker. Surely, ***he*** was at fault, too.

Fred called his trading office early the next morning to let them know that he was coming in and was going to "get that money back!" The trading office manager wasn't in yet, but Fred gave his order to the manager's secretary to reserve him terminal time so he could trade. Fred was lucky that morning, he made a small but quick profit shortly after the open, which turned out to be the high of the day. The only problem was that, on his next long entry, share prices shot down a full point from where he had entered. Now Fred had another trading loss.

Fred had a few choice words for the office manager when he next spoke with him. The office manager seemed genuinely concerned and sympathized with Fred. However, he reminded Fred that he had other customers to take care of, and was unable to sit and watch the market exclusively with Fred and his trades. It was a case of Fred's having to admit that keeping track of his trades was his own responsibility. Fred had been wrong in his assumptions. Rather than admit he was wrong, Fred decided to change trading firms.

The process took almost two weeks, and during that time Fred diligently studied his charts. He came up with a couple of innovative trading ideas involving the interaction of a combination of oscillators. By the time he was able to trade his new account, at another trading firm, Fred was excitedly ready to go. This time he would stay on top of the market. He would be quick to exit if he was losing, and he would ride his winners.

Fred's oscillator combination indicated that Microsoft's share prices were making an intermediate low, and so he went long the 1,000 shares. The trade went almost immediately against him. Fred gritted his teeth and, losing all his intended discipline, decided to give the trade "more room." Prices went down almost all day, making new lows for the month. Finally, when Fred could stand the pain no longer, he sold out his long position. He had lost another bundle of money trading Microsoft. With the realization of his loss, Fred had a sudden urge to use the lavatory.

At home that night, Fred decided that what happened was the fault of his oscillator combination. He would have to either fine-tune it more accurately, or he would have to discard it. He really didn't know which choice to make, so he did nothing.

The next day the people at Fred's new trading firm were sympathetic. They mentioned to Fred that they had some experienced traders who were looking for money to trade. One of those traders offered to manage some money for Fred. Fred would have the right to sit with the trader, but once the trade was in effect, the trader would have discretion over the trade since he was able to watch the screen during the day. Fred would have to give the trader a percentage of the profits, but Fred would have the benefit of seeing and participating in the trading decisions of a more seasoned trader.

This sounded like a splendid idea to Fred. He had begun to doubt his ability as a trader, and he could, so to speak, "trade along with a professional." This would give him a chance to improve his own trading decisions, and to gain more market experience.

A few days later, after submitting the signed discretionary authorization to the broker, Fred was ready to come in and watch the trader trade.

The next few days saw the trader getting in and out of Intel's shares. However, it seemed that he was always going the wrong way. Each day Fred's brokerage firm assured him that he knew what he was doing, and that he had a good trading record. "*There's no way I could have lasted this long unless I knew my stuff,*" said Fred's trader. "*I'm just playing the odds. Intel has to go my way at least two out of ten tries, and then we'll get it all back plus a profit too!*"

At the end of the week, Fred's account was down $10,000 more than when he himself traded it. Fred was hopping mad. He called his trader and closed out the account.

Fred told his wife about the lost money, and blamed it on both the trading firm and the trader. Fred said, *"If I'm going to lose money in the market, I can do it myself! That *(&^%#! trader didn't know any more about trading than I do."* Fred thought about quitting trading, but then he thought about how much he hated his present profession. Besides that, how could he deal with the embarrassment of telling his associates about his failure?

Fred opened an account with a third broker. He wanted only to place his trades and be done with it. So he had a terminal installed in his home. He wanted no advice, no recommendations, no comments, and no sales pressure or opinions of any kind.

Fred began to watch the market. But, when it came time to trade, Fred simply could not muster up the conviction needed to pull the trigger on the trade. He was quite frustrated, and decided to call it quits. However, something told him that he hadn't tried every possible avenue, and so he left his money in the account. Then Fred got a brilliant idea. He would purchase a mechanical trading system. He had received literature on it in the mail. Surely this gentlemen had solved the problem of the markets. *"Now where did I put that flier?"* thought Fred. Fred found and re-read the flier. It sure did sound good. The flier said that a $50,000 account had made over $1,000,000 in less than two years. Since Fred's account was considerably more than $50,000, Fred again began to glow with a warm feeling of anticipation as to how he could become a free man.

The mechanical system arrived a few days later. Fred excitedly studied over the literature and instructions. He loaded the system software onto his computer, and wouldn't you know it, the system was giving a him a sell signal in Dell Computers. The suddenness of the trading signal startled Fred. He looked at his Dell chart. He wondered why the system was giving a sell signal in a downtrend that seemed to have already gone quite a distance down. He could not muster the discipline to take the trade, and so he decided to observe the system for a period of time until he could understand it better.

As the weeks passed, Fred found that he didn't always agree with the rationale behind the system nor the signals it gave. Yet overall, the system was winning more than it was losing. That was when Fred got another brilliant idea. He would train a member of his staff to execute the signals given by the system. Without really realizing it, Fred was setting up the usual situation in which he could place the blame for failure squarely on someone else in the event that he was wrong.

He selected someone whom he felt he could trust, taught him the system, and when he was sure his employee understood everything, Fred gave his employee written authority with the broker to enable him to trade Fred's account.

Was it the system that suddenly went wrong, the employee, the trading firm, or what? The system began to lose money. Even on trades that were correct, there were often losses due to poor timing. Fred would check and double check with his employee about the trading signals he was taking. Invariably he would discover that the employee was following the system exactly.

Fred began to be very upset. He called the broker repeatedly questioning the speed at which the terminal operated.

Fred became quite exasperated. He descended on the employee and asked him how in the world he could have missed out on wonderful trades that the system also missed. Couldn't he see that the market was going to explode upward? He would question why the employee took certain trades that were obviously bad. He said, "*I don't care what signals the d___n system is giving, couldn't you see that it was a dumb trade*?"

It wasn't long before the loyal staff member turned in his resignation. Fred was aghast at the way his life was evolving. He hated his profession more than ever now. A new government regulation was making it harder and harder for him to be profitable in his chosen field. Paper work at the office was becoming overwhelming, so many new government forms to file. What made it all the worse was that the employee he had driven to resignation was the only one on his staff who really knew how to handle compliance, and he was now daytrading on his own and making a lot of money.

Fred decided to take a vacation from his profession. He would take a month and do nothing but trade the system.

At the end of the month, Fred was down another $19,000. Any courage or conviction he had was gone. He was stumped. He was wrong at every turn. The drawdowns required by the system were excessive. However, he was able to blame it all on the system. Fred returned to his office to clean up the backlog of work that had accumulated.

Several months later, after reading a few more books and attending a trading seminar, Fred had another great insight. He would teach his wife how to trade. He would sit her down at the terminal and teach her everything he knew, send her to a seminar, and have her read his trading books. He gave her his notes to study.

His sweet wife was the only one in the whole world he felt he could trust. The process of her training took a little over 2 months. Fred went to the office each day and worked hard to build his account to a respectable level. His actual losses plus expenses had been far greater than he had wanted to admit.

At first, Fred's wife traded carefully in small whole lot sizes managing her trades and money quite well. She had good discipline and self-control. This was probably because she'd learned these living all those years married to Fred. She was patient and unassuming, and went about her trading quite methodically. This lasted a couple of weeks until Fred started chastising her for missing trades. He would come home each evening and look over the markets. "*How could you have possibly missed this 4 point move in Asarco*?" Fred asked. "*Well, honey, it didn't look that way when it was happening,*" said his wife. "*The market was all congested and chopping up and down just before that big move. It had acted similarly at least three times earlier in the day, and each time I would have taken a serious loss. So the last time the market came down to the same place I had every reason to believe it would repeat the same pattern of retreat that it had before.*"

Fred began coming home from the office at noon to give her a little coaching. He just couldn't understand how she was missing so many good trades and catching only the ones that made small profits.

In the course of several months, Fred's wife missed a couple of 5 point moves in various stocks. On each occasion, the market simply shot up, giving her little opportunity to get in. She even missed a 6 point move when a stock she had been watching exploded upward. Fred could hardly contain his agony at her missing those moves. He consistently criticized her trading, even though she usually caught the trend and turned those trades into profitable adventures.

He would call some of the acquaintances he had made since beginning trading and tell them how ***he*** would have gotten into all those big moves. It seems no one could really understand the market as well as he could. He could look back over dozens, even hundreds of charts, and knew that if only he had time to trade them, he would have been rich many times over by now.

Apparently Fred had forgotten that he was a total coward in the market. He had forgotten that it was he who couldn't pull the trigger on a trade. He had convinced himself that he was now so important to the well-being of his clients that he ***had*** to spend his entire day doing business with them.

After work he would come home, lecture his wife, and then spend half the night pouring over charts on his computer.

One evening when Fred came home, his wife tendered her resignation as a trader. She'd simply had enough. She told him if he was such a fantastic trader, then he'd better trade for himself. She would no longer take the blame for everything that went wrong. The amazing thing is that, at first, she had done quite well in the market. But with Fred driving her to distraction, she began to lose. When she lost, she had to face even greater wrath from Fred.

Where will it all end up for Fred? Who knows!

The last we heard, Fred had become a registered investment adviser, and convinced some of his friends and his mother to set up some accounts for him to trade as managed money. His latest theory is that if he can't pull the trigger on his own account, maybe he could do it for others. Who can tell, maybe you will be one of his ~~victims~~ er... clients?

Chapter 10

SELF EXAMINATION

Why are you trading? Really, WHY are you trading? Can you write it down? Can you explain in a hundred words or less why you trade? Are you trading for the thrill of it? Are you trading because you're bored? Are you trading because it's a challenge — because here is something to master that has so far defied your ability to do so?

If you've never figured out exactly why you trade, then you'd better do so right now — unless, that is, you enjoy losing money on a steady basis.

I know of no successful trader who hasn't gone through this process, some of them on their knees, crying out to be shown what it is they are doing wrong. How about you? Have you put yourself through this process?

And do you know what? Usually you will find out you are doing NOTHING wrong. It's your thinking that is wrong. You have a wrong mindset. It is your attitude that is all screwed up. You are living in a fantasy land, with wrong thoughts, perceptions, and expectations.

When you enter a trade, is it with the expectation of making the big score on this one? You'd better find out! You'd better write down exactly what you are thinking when you make that trade.

Let me ask you something. From where you stand, can you clearly see a big score? You know, it's like the guy who has a factory job and is making $18 an hour, and he thinks he's going to be a millionaire. Can he see a million bucks from where he is? No! Can you see a clear profit coming out of the trade you are in? Yes? No? You're not sure? What are you doing in there anyhow?

When you are about to enter a trade, do you have a clear cut profit objective? Is it realistic? You need to know that! Is it too much work to figure it out? If it is, then you're not in this business to make money, you're just another gambler.

The only difference between you and the guy at the slot machines in Vegas or New Jersey is that you do your gambling by computer, on the Internet, or in a trading office.

And while you're at it, you'd better ask yourself if you've got the gambler's disease. Are you a compulsive gambler? Well? Check it out, pal, you've got to know.

What about risk? Do you seriously think about the consequences of the trade you are about to enter? If you are wrong, how much is it going to cost you? Come on now, how much? If you have to take that hit, what will it do to your trading? Will it destroy you? Are you so absolutely sure of this trade that you'd be willing to take that kind of destructive hit just to find out if you're right?

Is being right all the time really important to you? If you answered "yes" to this one, you are in real trouble. You might as well leap off a cliff right now. It's easier to get your brains smashed that way than it is to have your head handed to you in the markets. It's quicker, too!

How do you feel about losing? Do you have to win — all the time, some of the time? How much of the time do you have to win to make money? You don't know? You do know! Is that number of times going to satisfy you, or do you need to win more often? Examine yourself and find out. Do it now!

What about a trade would cause you to become hysterical, angry, or irrational. What is your fear threshold? What would cause you to cry out "*Oh please, dear God, save me. I promise I'll never trade again. Save me just this once! I swear I'll never do it again. Oh, please, please!*"

Are you greedy? What does it mean to be greedy? What are the consequences of avarice? Are you satisfied to get your piece of the pie, or do you want our piece too? If you want ours and yours, we're going to have YOU for lunch.

Do you overtrade? Do you think you have to take every trade that comes along? Worse than that, do you feel you have to take every trade that meets a particular specification? *"Oh wow! My indicators show oversold. And just look at that divergence! This market's got to go up! Buy, buy, buy!"*

If that's you, you've got big problems. What, you are not sure if that's you? Better find out quickly, or you'll soon be financially dead!

Do you blindly follow trading signals? Yes? Then you are worshipping a false god. What is the basis for those signals? Is it a moving average? Who decided how many bars should be in it? Was it you? Worse, was it someone else?

How about oscillator signals, do you take trades because the oscillator says so? Whose oscillator is it? Who decided on the formula? Are you a crusader? Are you running around looking for the Holy Grail — the perfect system?

What are your weaknesses? You need to know. Are you selfish, are you self-indulgent? Are you fearful? Are you proud? How about impatient, irritable, careless, or just plain messy? Are you a perfectionist?

You have a choice, either you engage in self-examination, or the market will do it for you. If the market does it for you, you won't like it a bit. The market is rough. The market is ruthless, unrelenting, and cruel. The market will take all your fantasy land dreams and smash them on the rocks of reality. Believe me, as painful as it is to do self-examination, it is a picnic compared with the discipline that the market will shove down your throat.

Examine, think, meditate. Who are you? What makes you tick? What are your weaknesses? What are your strengths? Why are you trading?

You say you want to be a successful trader? Then you had better know the answers to the questions we've posed. You'd better know, and know that you know. You should keep them in writing somewhere handy, and refer to them constantly.

Read them every day before you trade. Be hard on yourself. Be truthful. If you are a liar, the big bad markets will come along and blow your house down. The worst thing you can do is lie to yourself. Do you so very much want to be a trader you are willing to die trying? You may get your wish. If you have an economic death wish, the markets will certainly help you fulfill it.

Trading is a test in which you can't cheat. Every trade is an examination. Every grade is pass or fail. You either made money or you didn't. No, don't give us any of this nonsense about "I broke even." If you break even long enough, you will be broke, flat broke.

If you are one of those people who sits around and says "I could have", "I should have", "if only", "I ought to have" or "I knew where that market was going..." and you didn't go with it, then you need a whole lot more of the self-examination exercise.

And if you, in many of your endeavors (not just trading), tend to snatch defeat out of the jaws of victory, you need to find out why you are your own worst enemy. You might even need some help in finding out.

Are you with us so far? Okay! Let's get down to business. We need to chop you up some more.

Chapter 11

IT'S A BUSINESS

The following paragraphs were presented in ELECTRONIC TRADING 'TNT' I — GORILLA TRADING STUFF. They are so important, that we want to share them again. It's important that you realize the benefits of this business.

Electronic trading is a business. In our opinion it is one of the best businesses in the world — for a great many reasons! It has a very high profit potential against a very low overhead. Risk can be tremendously reduced by taking only high probability trades. In fact, electronic trading is a relatively low-risk business when approached with the right attitude and the right planning.

Trading is eclectic. You can pick and choose which equities to be in, You can choose when to be in them, and generally under what circumstances your entry will be. If traders in ABC company are making money, you can make money in it too. If you want to trade the XYZ's shares because they are moving, you can. Any trending market is making money for someone, so you can also have a piece of the action. You can be a bull or a bear as the mood suits you. You can be a happy bull or bear if you're going with the trend.

You can earn your living in an essentially free marketplace. You can live by your wits, and reap the fruit of your labors.

You have no customer problems: no customer relations, no customer complaints, no customer theft, no customers returning anything.

There are no employee problems other than yourself. No unions to contend with, no negotiations, no strikes. No employee benefit plans other than what you give to yourself. No employees stealing from you. No collective bargaining, and no stockholders.

There are no merchandising costs, no damaged goods, no vandalism, no service calls, no repairs to make, and no guarantees to honor.

You don't have to advertise in the traditional sense, and you have no marketing headaches. There is almost always a buyer if you want to sell, and almost always a seller if you want to buy — no purchasing and procurement problems, and no salesmen making mistakes.

There are no manufacturing problems, no production schedules to meet, no shipping, no receiving, no product liability, and no insurance policies to carry.

You don't have storage problems either. No warehouse, no spoilage, no items to discontinue or mark down. No bills of lading, no freight or freight damage, no trucks to load or to unload.

You're free of invoicing, accounts payable, payroll, inventories, accounts receivable, billing, dunning, bad checks, and bad debts.

There are no salesmen to call on you, although occasionally an investment salesman will call on the telephone. As soon as you tell him you are a professional trader doing quite nicely in the market, hopefully he will quickly excuse himself and hang up.

You will have no direct competition in the traditional sense. It's true. You have to deal only with someone who is willing to sell to you or buy from you. You settle your business transactions with money. If you're right about the direction of prices, you get paid. If you're wrong about the direction of prices, someone else gets paid. Business is resolved in a polite and courteous fashion. Both parties put their money on the line according to the rules. You don't know each other. The exchange acts as the neutral party.

The person on the other side of your trade can't offer better service, he can't scoop you in the marketplace with a new innovation on an existing product or get one-up on you with an entirely new product. He can't steal your customer lists, because you don't have any. He can't lure away your best salesman either. He can't even plant a spy to discover your trade secrets, because he doesn't know who you are. He can't seduce your top research scientist, and you can never directly be the victim of a hostile take-over. You will never worry about corporate spies.

Now ask yourself, "Self, where else can I find a business like this?" The answer is an overwhelming "Virtually nowhere! It's the most perfect business in the world!!"

When you decided to learn how to daytrade stocks, you may have had some sound business reasons that were the motivation behind your desire to become a trader. ***ON THE OTHER HAND***, you may not have! Your only reason for taking up daytrading may have been anything other than a sound business decision based upon economic reality. In all too many cases, the decision to daytrade derives from unbridled greed. Do you know what greed is? Do you know what selfish is? They are quite different! Greed can never get enough. Selfish wants it all. Are you one of these?

If you recognize this as being true for you, then you need to rethink the business of trading.

If you don't recognize this as being what motivates you, then it is time for some real self-examination. If, upon deep introspection of your motives, you find you are not motivated solely by greed or selfishness, then you may have taken a giant step towards success in the markets.

Electronic trading is a business. Got that? It ***is*** a ***BUSINESS***. It is not a game, it is not a crap-shoot, it is not a cheap roller coaster ride, unless ***YOU*** make it so.

We regularly speak with and teach successful industrialists, farmers, doctors, dentists, lawyers, brokers, engineers, accountants, consultants, and other professionals.

Many of you professionals are tremendously successful in your chosen field of endeavor. Often, you appear to be astute businessmen. You are able to turn a profitable dollar in your ***own*** business.

So why can't you do the same thing when you are trading stocks? I'll tell you why, and the answer will in many cases bend your brain. If you are one of these, listen carefully. If the shoe fits, wear it.

The ability of many of the professions to make profits is not a function of the professional, it is a function of the system. What do we mean by that?

In many of the professions, you go to school, you get good grades, you do some sort of apprenticeship, you pay your dues in terms of meeting the required minimum of education, years, money invested, or all three. You get licensed, and then you open up your own practice or go to work for someone else. The system then rewards you.

The system, through restrictive licensing, sees to it you don't have much direct competition. The system sees to it you get a certain amount of recognition and esteem. The system allows you to carry a title that others cannot legally use. The system allows you to impress everyone by having fancy initials after your name. The system shrouds what you do with cryptic language and terminology that only you and your colleagues can understand. The system lobbies on your behalf, so you can operate in a profitable environment. For the most part, the system works to lock in fat fees or profits for what you do.

Lavish government contracts, price regulation, set-asides, subsidy programs, licensing boards, etc., lull you into thinking you know how to make money.

You fancy yourself an entrepreneur. You visualize yourself as being a successful businessperson. But in reality, you are so only because the system, set up by those who preceded you, has made it nearly impossible for you to fail once you've paid your dues.

But now, you enter the business of trading equities. A business largely unregulated, and totally out of your control. You have entered a world where there is no system to be your crutch. No system to pay you for not planting, no system to lock in a monopolistic profit, no system to set minimum or fixed prices, no system to say what is acceptable practice, no system to hold your hand in any way, shape, or form. You don't even have the benefit of professional lobbying to get what you want or need.

You have entered a world unlike the one in which you were nurtured. You, the innocent, professional lamb, have entered into the wolves' den. Believe it when we say you don't know how to operate in that world.

You have entered a world where you can't tell anyone else what to do. You can't write a prescription. You can't file a brief. You can't make an organization chart, a schematic, or a balance sheet, and you can't get any cheap help to do your nitty-gritty work. The only way you can give orders is through your trading terminal. You are pitting yourself against professionals who thrive in a dog-eat-dog world with which you are essentially unfamiliar. You have entered a world in which even your money can't help. The markets are a yawning gut, ready to devour every penny you throw at them.

You have no customary fees for your efforts, no one is sitting and cooling his heels waiting for you to show up, or to finish your phone call, or to come out of a meeting or consultation. No. Now the shoe is on the other foot. It is ***YOU*** who have to wait to see which way prices will move. It is ***YOU*** who have to wait to see the price at which you were filled, and how much you are at risk. It is ***YOU*** who are at the mercy of the market, and ***YOU*** who have the dread of what it might end up costing you. It is ***YOU*** who sit uptight waiting for the market to bring in the verdict on your trade, to reveal to you its prognosis and analysis of your trading acumen.

You are like a beached whale frantically squirming in the sand, unable to do anything to get ahead. Every time you try to get into the water, you are thrown back onto the sand. Your ego is battered and bruised. Try as you will, you cannot control the situation. The shore upon which you are stranded is like quicksand, and you are being sucked deeper and deeper into its embrace.

BT (i.e., BEFORE TRADING), you succeeded in almost everything you set your hand to do. Your talents, your money, the system, or some combination thereof, have made you look good. Now comes the terrible realization you are up against something that is a lot bigger than you are. But, ***DO YOU KNOW WHAT? YOUR*** pride won't let you admit it. Surely that wonderful brain you were gifted with will bail you out. It always did before. Why not now?

You see, trading ***is*** a business, but it is a business for which you are woefully unprepared.

Not only that, but if your reasons for trading are not economic, you have a snowball's chance in a fiery furnace of becoming a consistent winner. Remember, trading ***is*** a business? How many people do you know who go into business for reasons that are not economic? Let me ask you: Why are you in the business you are in now? Are you there just for grins?

Here's a question for you. If your trading is not for sound business purposes, how in the world do you expect to make money doing anything in an endeavor in which those who are making money are ready to slit your economic throat in order to make their own living in the markets?

The professionals in equities trading are there to make their living trading. They need to make lots of money so they can pay your fees. They need lots of money to pay architect fees when they build their homes.

They need money to pay for exorbitant accounting, legal, medical, and dental fees; money to pay outlandish hospitalization costs; money to pay skyrocketing automobile costs; money to pay their taxes and utilities which are too high. They need money, just as you do, to live the great and modern lifestyle.

Do they care if it's your money they get? No! When they go to you, they are at your mercy. When you come to them, you are at their mercy. Have you, as a professional, had that much compassion on them that they should be merciful to you? What do you think you are going to get in return — especially since they don't know who you are? They are probably never going to meet you. The markets are impersonal. The markets don't care about what a great and generous guy you are who gives legal aid to the poor, who devotes one day a week to running a free clinic, who provides free rent to the homeless, who works in the soup line at the church when they give out a free Thanksgiving meal to the destitute and the aged.

Wake up, **wake up**, WAKE UP! Trading is a business, a fierce, competitive, cutthroat business. You are not in your protected, restricted, licensed market, where you can pretty much call the shots. You are on the wrong train. This is NOT the gravy train. No! When you trade, you are in the vast, relentless, overpowering, quasi-free, capitalistic market. You have no protection other than often violated ethics, and a few regulatory agencies which, for reasons with which we totally agree, want to see the least possible amount of regulation in the markets.

If you are ready to trade as a business person, with sound economic planning, organizing, controlling, directing, and delegating, then read on. If not, then you have gotten your money's worth out of this course. You're better off not trading. You're better off treating trading as something to be left alone, or as gambling, recreational fun, a way to punish yourself, a way to give back some of what you've been taking from others, penance, self-flagellation, or giving to charity — ours, to name one.

Chapter 12

MISTAKES

OVERTRADING

We've watched a lot of you trade. We've been in your homes, we've traded together. You've telephoned and talked with us about your trades.

What is one of the biggest mistakes you make? You overtrade! Yes, you trade too much. By that, we mean you trade too often. By that, we mean you are not selective. By that, we mean you don't understand quality. By that, we mean you add on shares and additional risk when you have no reason to do so.

If you just glossed over that last paragraph and didn't see yourself, then you are blind. Love is blind. You love yourself too much to see that we're talking about you.

You also overtrade because some of you trade money you really can't financially afford to lose, or that would kill you emotionally to lose. You take losses that, if you really thought about them ahead of time, you would have realized were going to turn your stomach inside out. You take losses that have such an emotional impact on you that you go numb, you panic, and then you vow to find a better way to trade. At that juncture, you are entirely vulnerable to the latest miracle trading system offered by mail or advertised in one of the magazines that deal with trading.

So, to further enhance your foolishness, you blow a couple of grand or so on Peter Prophet's Pentagonal Parabolic Profit Prognosticator System, thereby reducing the family finances a bit more, on the promise to your mate that, "This guy must have something real good."

Oh yes, we can hear you now. "Just look at those testimonials! Not only that, but he's going to sell only 99 of them. Oh please, *Sweetheart, just this one last time. If it works like he says it will, there will be only 100 of us millionaires who have the secret.*

"Not only that, but he backs it up with over five years of simulated trading. What's that you say, 'Does it come with a guarantee?' Well no, honey, it doesn't, but I think I've heard of this guy and, you know, his ad is in a highly reputable publication."

You overtrade when you are under-margined. You over-commit your account, and all too often you have to take a hit and get out too soon. For a lot of you, under-margined is not necessarily a matter of money. Some of you just can't take the heat or stand the pain when a trade goes against you. In other words, you are mentally rather than financially under-margined. The trite, sarcastic answer to that is, *"If you can't stand the heat, friend, stay out of the kitchen."*

You are careless in your trading. Yes, many of you are trading slobs. You trade right up into so-called resistance and right down into so-called support. You wouldn't drive on the highway with a blindfold on, but you trade as though you were wearing one.

The market is a lover, but you don't treat it as such. You want to rape the market. You want to satisfy your lust for more, at the expense of the market.

You are in such a hurry to get into bed with a trade, you forget to examine the merchandise. You forget to look in the closet to see if there's a photographer hiding in there.

You dive into a trade expecting a succulent gourmet dinner, but instead you end up with a burger and fries, and too often nothing at all. Yes, all too often you go hungry. To add insult to injury, you end up having to pay for the fine dinner you anticipated, but didn't get.

You simply don't understand how to pick out quality trades. You are not fussy enough. You need to learn to select well defined formations on the charts. You need to learn to select trades that are cleanly filtered by whatever filtering devices you use. You have to recognize which chart patterns have the best chance of giving you winners.

Quit taking every trade that comes along! You don't have to trade every day, you most certainly don't have to be in more than one position at a time. Are you worried your money is not working? Then, if you can afford it, keep some of it in a T-Bill, or get a broker who uses a money market fund, so you can earn interest. Let your broker know that you want and expect the interest earned on your account. Then you will have your money working without your having to be in a trade.

You overtrade because you think you have to trade all the time. You forget to take a vacation away from the market. You get dull, you lose your sharpness. If you go on vacation, some of you actually trade while you are there. What kind of vacation is that?

When we tell people we trade only a few days out of the week, they look aghast. What? Can you really make a living trading only a few days a week? Yes! We take time to teach other traders. That gives us a break from our own trading.

You need to take time to fool around. Go shopping, go to the beach, the market place, the theater, a movie, or go dancing. Mess around with things that are fun, read a lot. Catch up on your mail, go fishing, or travel.

In addition, we take a week off in the Fall and the Spring, completely away from trading. And almost always, we don't trade in the last two weeks of December. We rarely trade the day before a holiday, and are extremely cautious the day after a holiday.

A lot of you overtrade because you trade when you are not sure. You think you have to take every trade that meets a certain specification. We had a gentleman here recently who told us if a trade meets his trading parameters he feels obligated to take it.

Why put such stress and pressure on yourself? Don't trade when you're sick. Don't trade if you don't feel sharp. Don't trade if your gut feeling isn't right. Don't trade if you smell a rat.

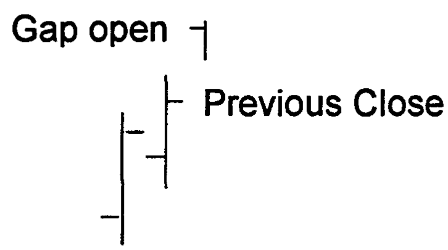
To the devil with the parameters! If the trade doesn't feel right, don't take it.

If you don't feel right, don't trade. If you have any doubts at all about the trade, don't take it. Nobody but you says you have to take a deep breath, close your eyes, and then jump. *All right, I've got my eyes closed. Spin me around. I'm going to pin the tail on the donkey. Hey, was that you who said "Ouch?"*

LACK OF PERSPECTIVE

When you trade, do you look at the daily chart? If not, why not? The daily chart shows you the forest. The intraday chart shows you only the trees. Oh, you don't have time for the daily chart? My, my, that's too bad. Well, you'll just have to trade counter trend. You'll just have to trade right into support that has held for the last eight months. *Hey there, George of the Jungle, WATCH OUT FOR THAT TREE! **!!BLAP!!***

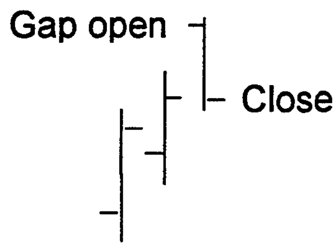
"I don't have to look at daily charts, I'm a daytrader." Fine, but do you at least look at the sixty minute chart? Get perspective! Let us show you something.



On this bar chart, whether it is weekly, daily, or 15 minutes, where are prices most likely to trade next, higher or lower? What is the line of least interference? Well now, we've given away the answer. The overwhelming odds are that prices will trade lower and fill the gap, probably even overlap part of the previous bar's trading range. Prices have a propensity to trade toward yesterday's close. Prices will tend toward the "average" price, which, in the case just shown, will mean that you can "expect" a move downward.

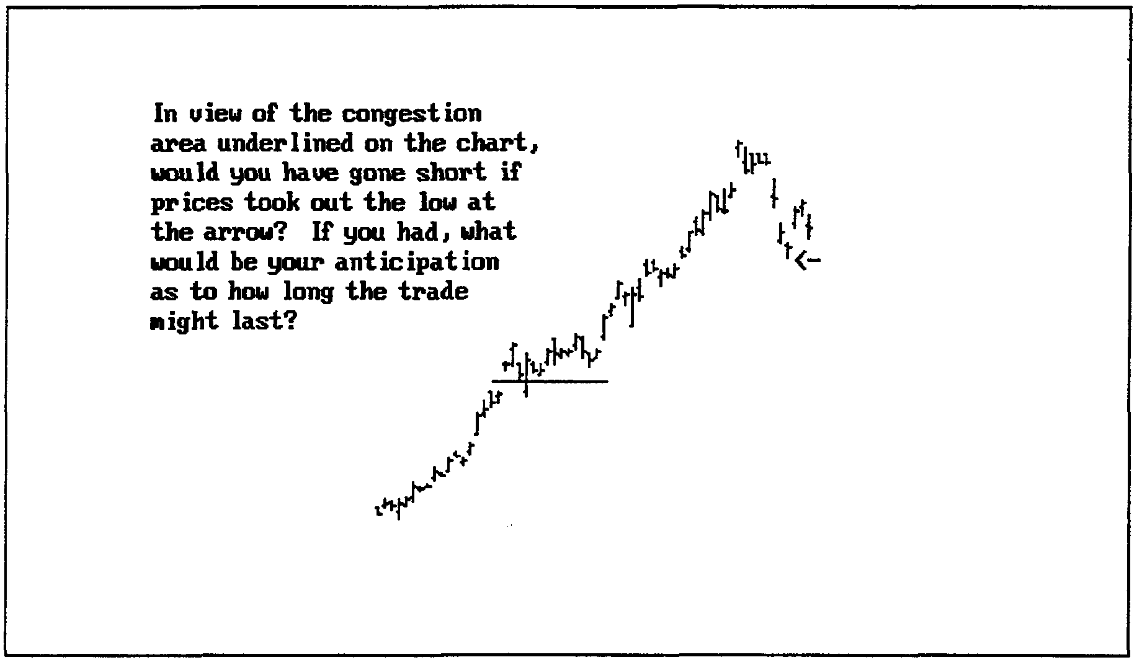
Reality is that ***some*** of the time you will not get it. But, since in trading we make our money based on correct anticipation, you have to view the market in light of the highest probability — in the case on the previous page that probability is for prices to come down and overlap the previous price bar.

Then the chart will look like this:



If you looked at prices in the middle of the week and saw the first picture of prices, you would have to be insane to enter from the long side. The same would be true intraday. If prices haven't yet traded into the area of the greatest propensity of expectation, then you can logically and reasonably expect them to trade there next. If they don't trade there, then you miss a trade. So what? So you missed a trade! Do you have to go to bed with every trade?

All right. Here comes the Slobovian intelligence test! Let me show you another picture.



Don't peek at the next page. Answer both questions. Know, and know that you know, how you would have answered. Know ***why*** you answered as you did.

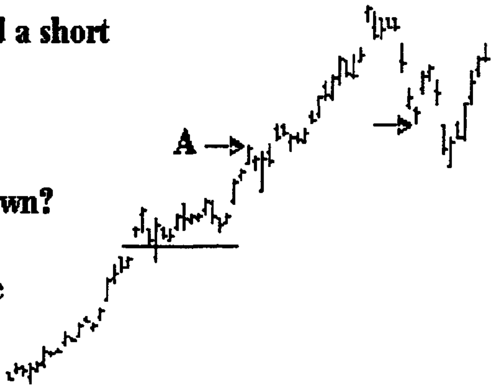
Yes, it would have been OK to short the breakout at the arrow.

You would have expected a short term trade.

How short a term?
How could you have known?

Does it make a difference whether this is a weekly, daily, or intraday chart?

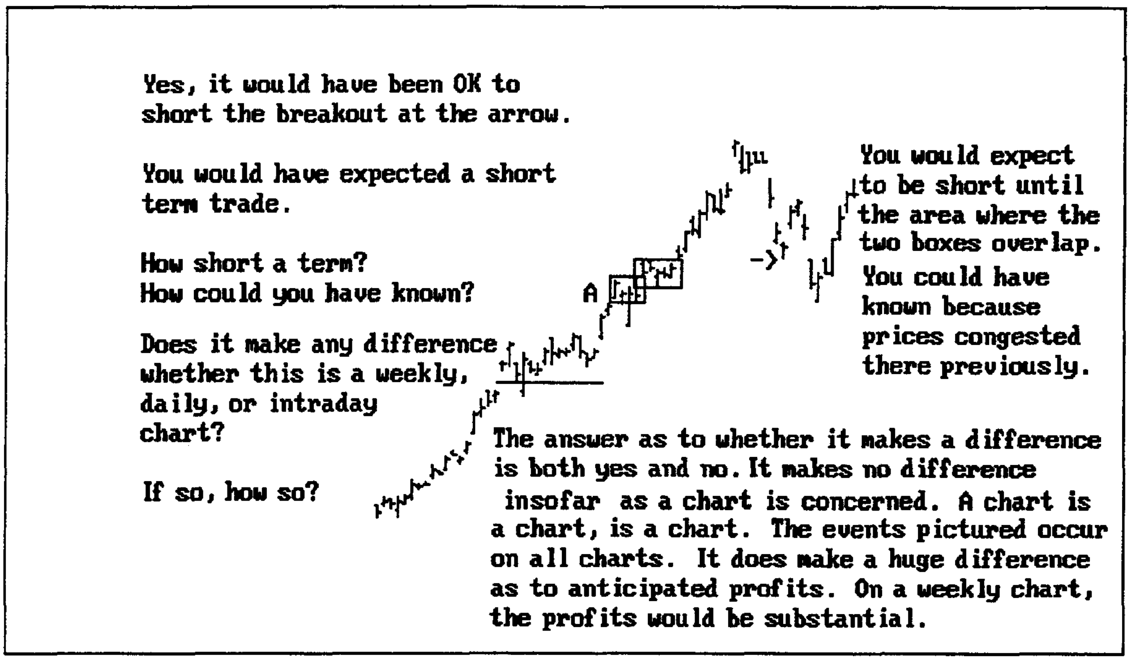
If so, how so?



Prices were already at approximately a one-third retracement of the major leg up from the intermediate congestion at the level at which we drew the line to the highest high. A short trade should have taken into account that there would be some sort of support at the 50% retracement level. Why? Because a lot of technically minded traders think that 50% retracements are magic, and their belief often creates a self-fulfilling prophecy. To anticipate optimizing profits at that level, a profit taking buy order should have been placed at the 50% marker. If the trend would continue, you would anticipate being able to get back in when it cleared the congestion at "A", which it never did. More material about retracements is presented IN ELECTRONIC TRADING 'TNT' I — GORILLA TRADING STUFF and ELECTRONIC TRADING 'TNT' III — TECHNICAL TRADING STUFF.

We're not advocates of trading the 50% "golden ratio" of Fibonacci support and resistance, but please realize that others do trade that way. Even without a knowledge of Fibonacci numbers, a strong clue was evident as to where prices might find support.

Please examine the next figure.



The area where the two boxes overlap is an area of overlapping congestion. It would have been logical to anticipate that support of some kind would materialize there. Therefore, profits should be taken at that point. You would then wait for a reaction and reenter the trade when the retracement was complete and the low of the correction was taken out. That event did not happen.

It makes no difference in the time-frame of the chart as to how these events materialized. It makes no difference as to which equity, either.

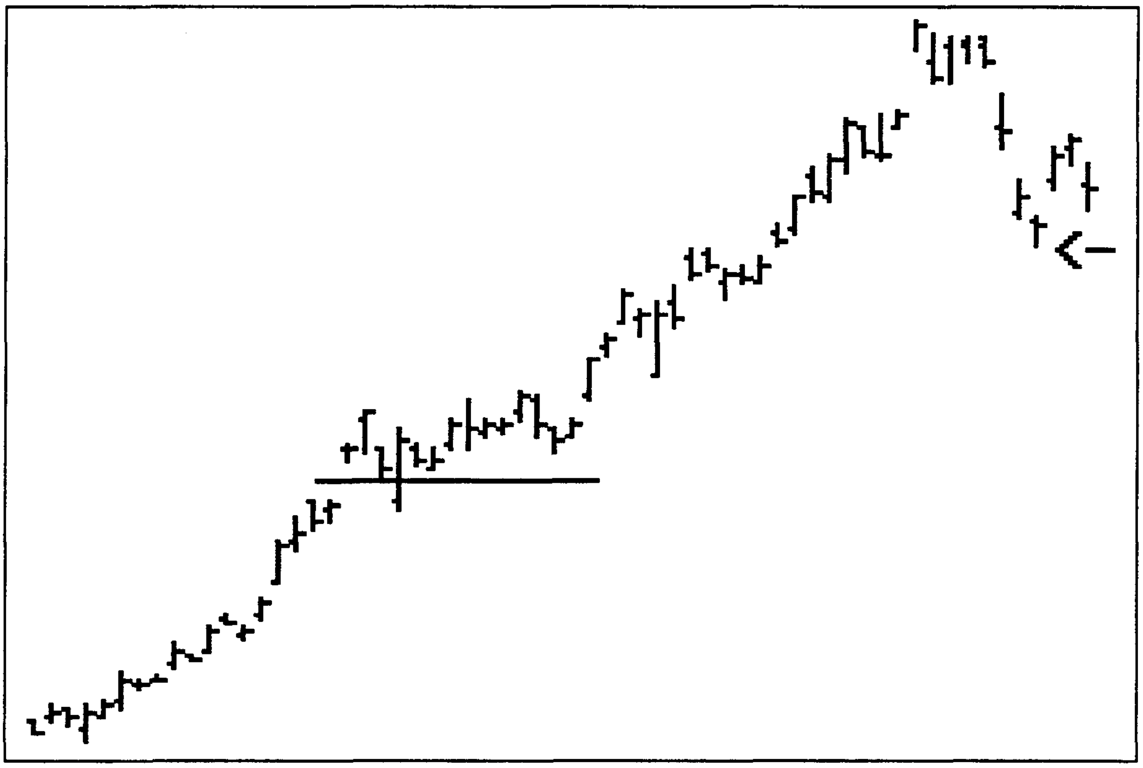
There would be a major difference in magnitude of scale on a weekly, versus a daily, versus a fifteen or five minute chart. A trade such as the short pictured would, on a weekly chart, result in a nice profit. On a daily chart, the profits would have been fair. On a fifteen or five minute chart, the move might not be worth the risk taken.

So look around. Get perspective, get the big picture. Understand and see where prices are in relation to where they have been and to where they might go. Know where major support and resistance exist, and don't trade into them, trade the breakouts from them. Take profits at major support and resistance areas.

FEAR

Virtually on a par with your lack of perspective is your desire to not be left behind. You have a fear of missing out on a profit. That happens only because you refuse to organize and plan your trades. Greed has gotten the better of you. You will rarely miss an opportunity on a planned trade, provided you have acted on your plan.

Let's look at that last trade again.



Your plan is to enter the market if the low at the arrow is taken out. You don't want to be filled on a gap opening, so either you use a stop limit order if possible, or you wait for the open, see where the first trade is, and then enter your own trade.

You plan to take profits at the probable support area, so you will enter a buy order there to lock in profits. You plan to enter a sell order above the high of the breakout price bar, and to move your position to break-even as soon as prices close below break-even. You plan that, if prices don't reach your objective, you will not give back more than fifty percent of the unrealized paper profits that you've already seen. What are the possibilities of this trade, and which one(s), if any, are important?

The only possibility that matters is that the trade develops according to your plan. If it doesn't, then it isn't your trade, and you must exit quickly.

If prices gap past your planned target order, then you don't want to be filled. It's not your trade.

If your order is filled and prices don't reach your objective, then this is not your trade and your tight exit order will be placed. If it happens at break-even, you haven't lost much. If it happens at a lower level, then you have something to show for your risk. If it happens early on, you will take a small loss. It is imperative that you keep your losses small.

If the trade goes according to plan, then you can consider it as mission accomplished.

The important thing is you had a plan, you organized it, and you acted on it. You weren't trading by the seat of your pants. You had an entry point, a selected protective stop-loss point, and an objective. You have controlled your trade and your risk.

Whether you like it or not, you have just acted as a manager: planning, organizing, directing, delegating, and controlling. Is it any wonder that the trade would have worked? Even if you missed the trade, your plan was successful. Pat yourself on the back. You acted as if you were in business. Hooray for you!

If your plan is not foolish, it is impossible for you to simultaneously act like a fool and still be following your plan. It is impossible for you to chase the market and still be within the parameters of the plan. It is impossible for you to miss the trade and still be in accordance with your plan.

So, WHY don't you make money in the market? You don't take the time or effort to plan, your plan is no good, or you don't follow your plan once you initiate it! You're a bozo. You'd get rid of an employee who consistently did that, wouldn't you? *Why you !#*@*! idiot, YOU'RE FIRED!*

YOU STAY IN TOO LONG

You stay in your trades too long. You don't know when to get out. *Take your money and run!* Take your profits and escape while they still exist.

You were in such a hurry to get in, why are you not equally in a hurry to get out? You've got it all wrong. Be slow and careful getting into a trade. Be in a great hurry to get out, especially when you can see that you are wrong.

It's like the young bull and the old bull who were standing atop a hill: The young bull said, as he snorted and pawed the ground, "Man, oh man, look at all those fantastic looking heifers down there. I'm going to race down there and take care of one them right now!" Then the old bull said, "Whoa boy, you've got it all wrong. Let's just walk down there, take our time, and service them all!"

Be slow to get in; be quick to pull out and take your money to the bank.

An additional consideration here is to pull your money out of a trade the minute you feel uneasy or uncomfortable about the trade. Don't wait. If you hesitate, you lose.

YOU EXPECT TOO MUCH FROM A TRADE

You act as though each and every trade owed you something. You feel you need to make a lot on each trade for all the work you've done and the amount of risk you've taken. That is a totally wrong attitude. In fact, it is what is called the "professional syndrome." This is what all too many of you have been taught. It goes something like this:

You study hard, you do the work, you pay your dues, and so now the world owes you a living. You think you have it coming to you.

This is the attitude of most people — from the highly paid professional down to the blue collar worker who belongs to a union. Yes, even you dues-paying, union-belonging traders think you have something owed you for your trading.

Well wise up, Charlie Brown, the markets don't owe you a thing. You're lucky to make any profits in the markets. Remember, most lose in the markets. Have a business-like attitude. Be content with small profits on a steady basis. Then every so often the market will hand you a big profit, a real humdinger.

GREATER FOOL

The markets work on the "greater fool" theory. You think we're kidding? We're not. The market maker or specialist is buying or selling when prices go past the pivot point down on the trading floor. He is liquidating just at or slightly past the breakout that brings in the daytrader sitting in front of a screen.

The entry into the market by the daytraders (the greater fools) drives the market ahead just enough to give the market makers their profit. The specialists in a sense have faded the daytraders by taking the opposite side of the trade, since they are exiting as the daytraders are entering. Prices go against the daytraders, at least for awhile. This is evidenced by a reaction shortly after the daytraders enter the market.

Prices then recover their momentum, and begin to move again in the direction of the initial thrust.

At that point, the daytraders are in the black. If prices have sufficient momentum to drive them to a point that brings in the longer-term trader or investor, the entry by the longer-term trader (the greater fool) gives sufficient thrust to the shares to drive prices to a profitable position for the daytrader. The daytrader then fades the longer-term trader by taking the opposite side of the trade as he is exiting the trade.

Unless the longer-term trader has entered a position in a stock with very strong momentum in the direction of the trade, he is the one who will eat the football.

If the stock has sufficient momentum behind prices to initiate a trend, those longer-term traders who get out quickly will make profits. If the market has sufficient strength to go into an established trend, then all of the trend following intermediate and long-term traders (the new greater fools) will drive prices ahead as they enter their positions, thereby giving the longer-term or investor a profit, provided he has the sense to take it when he sees it.

Eventually somebody has to eat the football. That will turn out to be those traders or investors who did not get out soon enough. That's usually YOU!! Why do you stay in so long?

YOU'RE GREEDY

A part of your staying in too long is your beady, red-eyed greed. Some of you actually drool over anticipated profits. You're so sure that every trade is going your way you don't know how to take profits and get out. Does it never occur to you that the market is going to decide how far it will go in your direction; it's not you who makes that decision? *Why do you think you have to hit a home run on every trade? And by the way, here's a tissue, you need to wipe your chin.*

Why don't you trade one or two round lots to cover your costs, one or two round lots to take some profit out of the trade, and one or two round lots to let run as long as prices will allow? Maybe then the market will hand you a home run.

Any businessperson knows that before he can even think about profits, he has to cover costs. Do you think you can violate this principle of good business practice and still make money in the markets? You have to cover costs before you do anything else. You say you don't really know what your costs are? Well you'd better find out. I'll give you a hint. Some of them are direct costs and some of them are indirect costs.

What are your direct costs? What about your live data terminal, your regular software maintenance fees, your telephone line? What about commissions, exchange fees, and data acquisition costs?

And your indirect costs, what are they? What about utilities, a computer, and trading software you own? What about all the magazines and newsletters to which you subscribe? What about the seminars you attend, the tutoring you've had, and/or the trading schools you've attended?

Here's a biggie, what about all the past losses you've had? Are you just going to write them off? You haven't made a profit until all of the things we've mentioned here, and all the ones we've missed, are covered.

"Well now, I consider those losses and all of my books, subscriptions, and seminars to be just a part of the investment I've made."

Hey, don't give us that line. What professional doesn't open his or her practice with the immediate intention of "getting back" the investment s/he has in the business? Face it friend, you haven't made a dime until you get back your losses and all your educational costs. You can't count a single profit until you do. This is a business, not a tea party.

For some of you, you'll have to trade profitably for a very long time before you can count any true profits. If you don't think about these kinds of costs, then you are living in a fool's paradise. It's OK with us, we'll continue to fade you in the markets. How can we miss when you are so willing to give us your money?

Do you figure costs into your trading plan? If not, what kind of a controller are you? You've got to cover costs. Some of you are willing to write off all those costs, because...

YOU THINK TRADING IS AN INVESTMENT

But you are wrong! Trading is a business, remember? It is not an investment as long as you are the one doing the trading. Now, if you want to give your money to someone else to trade for you, then you are talking about an investment. You will then be investing in that person or persons' ability to manage your money, in the hopes of making a return on your investment.

But if you are the one doing the trading, trading can never be an investment. You may have invested in equipment, your education in trading, various paraphernalia, etc., but that is the extent of your investment, and you must make a return (profit) on your investment. The actual trading ***is*** a business, and for you it has been a losing business. Some of you have lost so much and so often that...

YOU'RE DESPERATE

You act as if every trade were the last trade in world. *Oh my goodness (slobber, slobber), here comes the world's last trade (pant, pant). Here comes my last chance to get rich. I've got to make it big on this one, I've got to make back everything I've ever lost. Hang on, hang on, hang on! C'mon baby, you've got to take me to the moon!*

Calm down! Relax! You don't have to make it all on this trade. Make a little on this one and a little on the next one — and the next, and the next. Some of you are so desperate that you'll do anything to get even in the market. You go to seminars, you buy every book that comes along, you send for magic software, but worst of all,...

YOU LISTEN TO OPINION

Yes, you even call us and ask us for ours. While we're flattered you do, many of you know by now it's best to have no opinion in the market.

You don't know where the market is going or when it's going to get there. Don't flatter yourself with notions that you ***can*** know.

Look! Here's a question for you: Can anyone possibly know which way the next tick will go? C'mon now, answer me. Will the very next tick in the market be up, down, or sideways? You don't know, do you? Well, neither do we. No one can say for certain what the next tick will be!

If you can't tell what the next tick will be, how in the world would you possibly know what the tick after next will be, or the one after that, or the one after that...? Yet, isn't that what the market is? The market is made up of all those ticks — the ticks caused by the buying and selling of all the participants in the market.

All you can have is an opinion of where the next tick will be. But you can't trade on opinion, you have to trade on reality. What you think doesn't mean a thing. What you think is just another opinion.

Don't believe anyone's opinion in the markets. No, not even your own. Learn to trade from the reality of what you see, and that is ***it***. There is nothing else. The sooner you learn that lesson, the better.

Forget the gurus. Forget the prognosticators and their reports. Forget to turn on the business channel. And most of all, forget your broker, or if you're in a trading office, forget the guy screaming out buy xyz, he probably already owns it. Never say, "Prices ought to go up," or "Prices ought to go down." Prices oughtn't to do anything! Trade well defined patterns and formations. Trade them gingerly and with great respect. Trade clear cut signals from your indicators if you must, but have no opinion concerning them. Just trade what you see. Cut off your ears, or buy ear plugs. Don't listen to any kind of opinion, even your own.

Opinion leads to hope. Hope will destroy you in the markets. Hope has its origins in the emotions. You cannot trade emotionally. You have to trade your logical, thought-out-in-advance plan.

If you have no opinion, then you won't have one to change. You will trade what you see, not what you think. Trading what you think is one of the greatest traps into which you can fall. Your plan should allow enough flexibility so that it will accommodate alternative actions.

That way, you won't try to change your plan. One of the biggest mistakes you can make is to deviate from your plan. But some of you do so the first time the plan seems to go awry. That's because...

YOU'RE LOOKING FOR THE HOLY GRAIL

You do this in two ways. You are looking for the perfect technical indicator or set of indicators. You are looking to call turning points in the market. The worst possible situation is that you are a perfectionist looking for these things.

How can anyone in his right mind think that somehow, some mathematically calculated formula is going to make up for being a poor businessperson? It doesn't make sense and it won't work.

We crack up every time we read about some linear-regressed, parabolically displaced, standard-deviated whodaddy that is supposed to tell you when to buy or sell. It seems as though the more complicated and ludicrous someone makes these things, the better it's supposed to work — and the more phony systems they can sell with it. Certainly they can get them written up in some of the newsletters and magazines.

We guess that is what becomes of math majors when they leave college. You can't blame them, what else can you do with a major in math? (Heh, heh, only kidding) We know a guy who majored in theoretical mathematics. We asked, "What in the world do you do with that?" He said, "Not a whole lot. It's theoretical, there is no known application for the stuff. But some day there might be."

Maybe someday elephants will fly. Perhaps that's when he can apply some of his theoretical mathematics. But for fun and money he can always write articles to be devoured by stock aficionados. They will lap it up as though it were some new truth.

At last, maybe this is the oscillator I've been looking for! Zowie, I think this guy's really got something here! Let me see now, you take the square root of the magnitude of the standard deviation and factor that by the determinant of the log of the highest high of the last 4 *days as differentiated from the highest low of the last 6 days.... Oh boy, oh boy, this has got to be the Holy Grail of trading!*

Part and parcel with looking for the Holy Grail of trading is that of being a perfectionist. This is where many of you engineering and accounting people come into the picture. You have a nitty-gritty mind. You want everything perfect down to the last detail.

Boy, have we got news for you! Trading is not like that at all. There is no perfection here, only slop — big slop and little slop, but almost never perfection. Markets are not mathematical, geometrical, symmetrical, or most other kinds of "..ical" with the exception of hyster***ical***. That they are, and more often than one would care to believe. Would you like a market theory to play around with in your mind? Good, we knew you would. Here it is: *Markets consist of a series of hysterical bursts with pauses for recovery in between. The hysterical bursts are real, caused by rumors and news, or false, caused by intentional manipulation by those traders able to move a market.*

A friend of ours majored in history. That's another one of those "what in the world do you do with it?" types of college majors. He became a school teacher. We've tried to tell him there was a lot more money to be made in selling price history to stock traders, but he won't listen.

Hey, pal, what's past is past. You need to be worried about the next five minutes on the chart. What do you care about the price of Microsoft six month ago.

Some of you are lured in by history. "Buy my trading software and not only will I NOT charge you extra for my magic oscillator, but I'll throw in 100 years of stock history." Do you go for that? Great! *Step right over here and we'll sell you this real bona fide quartz-synchronized time machine so you can go back in time and trade those historical charts. That may be the only way you can win in the market. Just think what you can do trading when you know what the outcome will be.*

You forget you are trading what is happening *now!*. You are ***not*** trading *history*.

Here's an amusing thing that happened to a daytrading friend of ours a few years ago when he was trading shares of a certain stock on a 15 minute chart on a huge volume day. An acquaintance called at about 8:35 AM Central time. He said, "Where do you think this stock will close today?" At that point our friend was already long a sizable position. He was still thinking about all those price bars (several weeks worth of price bars on a daily chart) yet to come. Now, how in the world was he expected to know where that company's shares were supposed to close dozens of bars from now? All he wanted to know is "Where is this thing going to go in the next minute or two?!"

One of the biggest sucker traps we've ever seen are the ads placed by people who are trying to convince you that they know how to call market turning points, or that it is even possible to figure them out. How can anyone believe these rip off artists? If they could really do it, would they be telling you? If they were kind and generous wouldn't everyone have found out how to do it by now? If you told 100 people how to call market tops and bottoms, even swearing them to secrecy with a blood oath, do you think it would still be a secret? Could you trust even ten people with a secret like that?

C'mon now, you know better than that! Do you want to continue to be a sap? You do? *Psst, we want tell you about this magic elixir we have. You can rub it on your head while you're trading and it's guaranteed to make you a winning trader while at the same time it will grow hair on balding men, increase your sex drive, and has been know to cure most diseases known to man. If you rub it on a your trading terminal on the first full moon after the seventh month, every stock you buy will go up in price for three full weeks, and if you sprinkle it on your left toe when the Major cycle in Apple Computers is coincident with the minor cycle in IBM...!*

There are some things that cannot be known. Accept that and you will be okay. Don't, and you will end up chasing your tail. You'll be like Ponce DeLeon, searching for the Fountain of Youth and eternal life.

Some handful of people paid $35,000 apiece or so to find out one man's magic turning point secret. *Hah! The secret's out, so now he's selling it for $175!* You know who you are, and what we mean — and You know that we know what you paid. By now you also know that the great secret doesn't work worth a tiddle. Some secret, hey? *You say you have another thirty grand you'd like to drop? Tell you what! For only twenty-nine grand, we'll tell you a* **real** *family secret. It was discovered by a hermit known as Great-uncle Pete. It has to do with predicting precise market turning points using refractory-glass magnification.* Come on down here where no one can hear us. *We want to tell you why we never lose in the markets. We'll show you how to get rich beyond your wildest dreams...*

"Well, if that's true, why are you so willing to reveal your trading secrets in your seminars, tutoring and courses?" Wow! You've got us there! The truth is that there are no trading secrets. A secret is something that only you know. Once you tell it to someone else, it's no longer a secret. If you've ever attended one of our seminars, or have been tutored by us, you have all our "secrets." We may be the original big mouths who want to show everyone else what we do. Most of the truths we trade by are self evident. We're sure we are not the only ones to have discovered them. (To attend one of our explosive 'TNT' seminars, contact information is at the front of this manual.)

Besides, trading is hard work. We have no magic trading potions or formulas. Maybe the truth of the matter is that misery loves company. Yes, that's it. We want you to have to work as hard as we do to make a living trading.

Maybe we want company while we sit around and patiently (frettingly?) wait for the right trade. Now you know our real motivation, it's the same as many of you have. It's...

BOREDOM

Yup, a lot of you trade because you are bored. You are bored half to death with what you do. You're a professional, and that's where the bite comes in.

Lots of professions have boredom built into them in a big way. Daytrading has plenty of it. You sit in front of a boob-tube all day long on some days.

We tutored a pharmacist once. He made good money. He leased the private pharmacy at a rather large and well attended medical building. Wow, did he ever have it made! The doctors in the building phoned all the prescriptions down to him. He never had to discount. He could charge retail-plus on every prescription he filled. But he was bored. Can you imagine having a better than average education and mental acumen and standing there all day pushing little pills into little bottles? Even some assembly line workers have more variety than that.

So he hired another pharmacist to push the pills while he daytraded, probably to keep from going bonkers. Here was this well trained brain wasting away as a pill pusher.

How about you, is this why you trade? After all, how many teeth can you fill before it becomes old hat? How many nose jobs can you do before the next one is just another nose on a face you'll probably never see again after the follow up visits?

How many wills can you write out before it's pretty much the same old thing? Isn't that why your legal aide uses a word processor? It's the same old thing, day in, day out. How many tax returns can you fill out before you're ready to scream? How many...?

That's the trouble with some professions — even the profession of trading can eventually be boring. Instead of trading when you're bored, perhaps you need to study some more, especially in the area of how and when to exit trades. Maybe in your studies you'll discover that...

YOU DON'T KNOW WHAT IT MEANS TO LET PROFITS RUN

You all have heard the expression, "Cut your losses short and let your profits run." But you don't know what it means. The key word here is *profits*. You've been letting your ***trades*** run. Why? Simply because you don't know the meaning of the word "profit."

You're supposed to let your ***profits*** run. You don't have any profits until you've covered costs. You haven't covered costs until you have liquidated one or more round lots that have sufficient gain in them to have covered your costs. When you have done that, then you can let profits run.

Any good business person knows that costs must be covered. That is your first job, if you want to stay alive as a trader.

What was that, you say fewer than 1000 shares is for babies? You say you want to play with the big boys? Great! When you have learned how to let your ***profits*** *run, then you can play with the big boys. But for now, Babe, maybe you'd better cut your teeth on fewer shares. By the way, some of the biggest big boys cut their teeth that way.*

One of the reasons you let your trades run too long is because...

YOU DON'T UNDERSTAND RISK

Once you've covered costs and are trying to let your profits run, you add to your position too soon. Why? Because you don't understand risk. Let's say you've liquidated a round lot to cover costs and now you have $250 per 100 shares profit in your remaining position. Let's also say you were willing to risk $2.50 per share or $250 at the inception of this trade, and you are willing to risk $2.50 per share on any add-on trades. Can you add shares when you see $2.50 per share in profits? You can, but it may be foolish. Why? Because now you are at risk again. If the trade corrects or in any way starts to move against you and takes out your risk price, you may have lost all your unrealized profits plus the costs of the additional shares.

Hand in hand with this lack of understanding risk is the fact you don't understand the odds encompassing the risk. Too many of you trade right into support or resistance. Too many of you, because you have no longer term perspective, end up trading into previous congestion.

If you are shorting a market into its recent low that you didn't see because you refused to look at a longer-term chart, you are at very high risk. The low risk for the trade is to go long. The probabilities are that prices will test that recent low and then bounce. The same is true when you trade into congestion. Prices are most likely to stop there. If you trade right into that congestion, you are going to get whipsawed. You will have placed yourself at great risk.

You are better off to place your entry past the congestion, so that once prices have worked their way through the congestion, your risk is low because the probabilities are high that the trend prior to the congestion will again resume.

YOU DON'T UNDERSTAND ABOUT LOSING

If you can't stand losses, you have an ego problem. You're so vain you can't face reality. Losing is part of the business of trading. You've all heard of successful traders who lose seven out of ten trades and still make money in the markets. How is that done? There is an art to losing. You have to be like the guy who runs away today, but lives to fight another day.

Here's an example. You get long on a breakout of yesterday's high and share prices move up a bit. You, being the careful good loser you are, quickly move your mental stop up to break-even. For different people, break-even means different things, but for this example let's say it means your stop is at the price where you got in. At $15 per side in commissions and costs, you can afford to take twenty hits in a row and still lose only $600.

In Las Vegas, at one of the casinos, there is a sign or a plaque on the wall that tells about a man who made twenty-one straight passes at the craps table.

It has happened only once since the inception of the casino years and years ago. The odds are astronomical against its happening again soon.

As far as costs are concerned, the same is true of your trading. The odds are astronomical that you would ever take twenty-one break-even hits in a row, even if your entry technique was nothing more than the flip of a coin — heads I go long, tails I go short. If you did take twenty-one break-even hits in a row you would still be out only $630 in commissions. That's nothing compared with what most of you regularly lose in the markets. We use the term "break-even" because we have no idea of how much beyond that you might lose.

But let's say you were that thirty percent trader mentioned above. You would have seven losses out of ten trades. Assuming they were all break-even and all in a row, you would be out $210 in commissions. That is a very manageable overhead figure for any trader. It would not be at all difficult to assume that on your remaining three trades you would have made that back plus a profit.

OK? Now you know how it's done. Now you know how a thirty-percent trader can afford, from the standpoint of commissions, to lose seven out of ten break-even trades and still make money. What we've just shown you is worth one hundred times the price of this course at the very least.

Will you get yourself and your big fat ego under control sufficiently to manage risk the way we're showing you? Or, will...

YOU TRY TO REINVENT THE WHEEL

Why, oh why, when someone shows you something that works in the market, do you feel you have to improve on it? *Why do you have to "fix something that ain't broke?"*

We'll tell you why! It's that overstuffed ego of yours. *Yeah, yeah, we know you have a need to be creative.* Well that's what some of you have your career for.

Do creative surgery, come up with a way to make someone beautiful. Figure out a cure for cancer. Figure out how to straighten the teeth of an old man. Come up with a house that doesn't need heating or air conditioning. Breed a one hundred pound chicken.

Oh, you want to be professional trader? Fine. But if you do, don't be the wrong kind of creative with your trading. Don't invent a new oscillator, don't search out a cycle that no one's ever seen before. Don't check out the moon to see if XYZ's shares will go down next July. And for Pete's sake, don't rip off your fellow traders. If you've got to be creative, figure out creative ways to help the other guy.
Write a book, or make a tape — you know, one that tells the way it really is. One you'll be proud of and that people will thank you for creating. *Do we mean* do for others what you would like them to do for you? *Yes, that's exactly what we mean. You can be a good guy and still make plenty of money.*

Isn't it about time you started setting an example of how to do things right? You want to tell everyone else what to do? Start with yourself. ***You*** do it right. ***You*** show you can be an honest trader. ***You*** show you care about other people. Clean up your own act. Then maybe, just maybe, there won't be such a high rate of turnover in the trading business. Maybe people will stick around and trade for a few years instead of a few months. Maybe you'll be a lot better off when there's more liquidity in the markets. *Maybe we should have been preachers...?*

What we're trying to say is that there is no place for ego in your trading. Be humble. Stand in awe of those markets. Use your head when you trade. Consider the other guy to be better than yourself. If the other guy has shown you how to make money in the market, respect that.

Think about it. For the most part, you drive your car without trying to make it better than it is. You accept your appliances for what they are. You don't sit around and try to make your refrigerator colder, or your stove hotter. You accept the light bulb for what it is. You don't dink around with the TV, and you don't tinker with the VCR. So don't mess around with methods, systems, or techniques that work.

If you've got a system that gives fifty percent correct trades, then you're going to do better than the seventy-thirty trader. If you trade as we show at our seminars, you're going to consistently hit sixty-five percent at the least, and close to eighty percent when you get better at it. If you learn to trade really well, you will have winning trades at least eighty percent of the time.

There's another problem many of you have, and it's that...

YOU SHOOT YOUR MOUTH OFF!!

Don't tell your broker about your hot new newsletter. Don't tell your friends about the great trade you're making in ABC company. Don't tell you wife that at last you've figured out the markets. Don't tell anyone anything that would cause you to have to defend your pride. Keep your big mouth shut! You don't need the pressure of having to live up to someone else's expectations, or at least what you think they might expect from you. There is enough pressure in trading that you don't need any from image salvation. Keep your trading to yourself, unless you become qualified to trade for others. Then you will have to show your trading record to others. If you don't mind the feeling of someone looking over your shoulder and you want to be a manager who trades for others, then go for it.

Never show anyone your trading account unless you have to in order to meet regulatory requirements. It should even bother you that your brokerage firm sees it. Never brag about a trade or any exploit in the market.

If you call and ask us, we will tell you which trade we were in today or are still in today. But we won't brag about it. We won't tell you what clever sons-of-a-gun we are, because we're not. We trade our trades when they look right to us and when we feel right about trading them. It all has to be just so, or we don't want them.

You can let a lot of good trades get by you. Because if they don't happen your way, according to your plan, you don't want them.

We're telling you straight out, that's how it is. There's only one way to be when you're trading, and that's truthful and honest. Don't trade any other way. Don't fall into the trap that describes you as that...

YOU'RE LYING AND DISHONEST

Yes, if you've fallen into the trap you are both. You kid yourself about your trades. You hang on to them in the vain hopes that somehow they will prove you right. Some of you even move your stops back to give the trade "more room." That's the tragedy behind your dishonesty, you are dishonest with yourself.

If a trade goes against you, you read into the chart what you want to see instead of what's really there. You lie to yourself. The market has clearly turned. It is now making lower highs and lower lows, and you sit there getting hemorrhoids telling yourself that this is only a correction and that if you hold on long enough the market will go back up. Sure it will. Some day it will go back up, but that could be five years from now.

You're dishonest because you know all these things when it comes to everybody else's trades, but you won't admit them on your own. You tell yourself "This isn't really happening." You tell yourself, "This time I'm going to tough it out." You sit there and lie to yourself until the relentless tide of change engulfs you, and then you are thrown out, a dead duck with a solid loss.

Sometimes the agony is so bad you throw yourself in front of the advancing tide to lessen the blow. That is when the market really punishes you for being a liar and for being unfaithful to your plan.

That is when the market steamrollers over your stop loss number and then turns on a dime and heads back the other way, leaving you shattered, overwhelmed and dismayed. That's when you tell the biggest lie of all. You say, "Never again. Never again. I've had it with this !*#*#! trading." You blame your fill, the market maker, your broker, God, and blind chance. *Tough luck, Buckwheat! We all know it wasn't your fault, it was everyone else's, right?*

If you think this book is not talking about you, you're a liar. If you think that we're talking about the other guy, you're dishonest with yourself. You can find yourself in here dozens of times. *If we think we're not in here with you, then we're dishonest liars too!* We know we're in here! How in the world do you think we could write a book like this if we haven't personally lived through it?

How long are you going to keep kidding yourself? How long will you be a liar when you trade? You'd better drop the habit before you end up like one guy we know of...

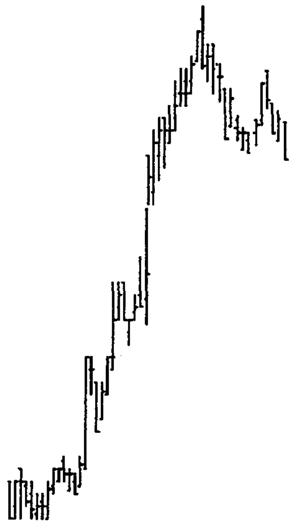
FAST EDDIE GOLD

We'll call him Fast Eddie Gold. That's not his real name (you think we want a lawsuit?)

Old Fast Eddie was a short seller who liked to trade mining stocks, especially those that produced gold. Back in the olden days, Fast Eddie thought that a particular mining company's shares had finished going up. Prices had made a big high, a real big high. Then share prices made a really nice correction, started higher again, but failed and started back down again. At that point, the company's chart looked like this:

This was just what Fast Eddie was looking for. If prices would take out the low at the arrow, he was going to go short. To give the trade plenty of room, Fast Eddie placed his stop above the highest high, risking $4.00 a share on 10,000 shares.

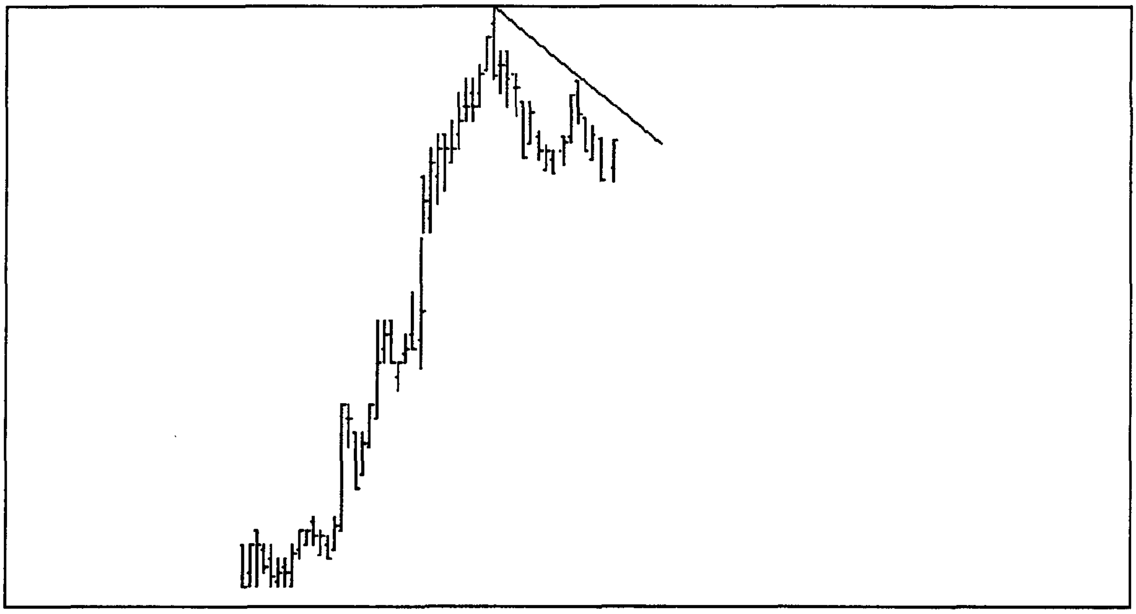
Sure enough, share prices came down and Fast Eddie got his fill. The market looked something like this, and Fast Eddie was already counting his profits. He was one of the eighty percent who were on the right side of the trade that day.



Fast Eddie had a good sleep that night as his position was already $1.10 per share to the good.

The next day, prices opened a little higher, but then went down and tested the previous day's low. Eddie was watching the price action from his screen. He could have moved a stop loss order down enough at that point to cover his transaction costs. About mid-morning, there was a rumor, something about a possible strike at the gold mines in South Africa. Fast Eddie thought to himself, "Shoot, I'm not going to let a bunch of South African miners blow me out of this trade." So, not only did Fast Eddie not cover costs, he also ignored a rumor that was bound to cause some buying by market makers and traders.

"And besides," Eddie said, "this stock is due for a correction." That day prices closed up and the chart looked something like the one that follows:



Eddie drew a trend line on the chart just to reassure himself that the trend was still down. He felt a certain amount of comfort in that trend line.

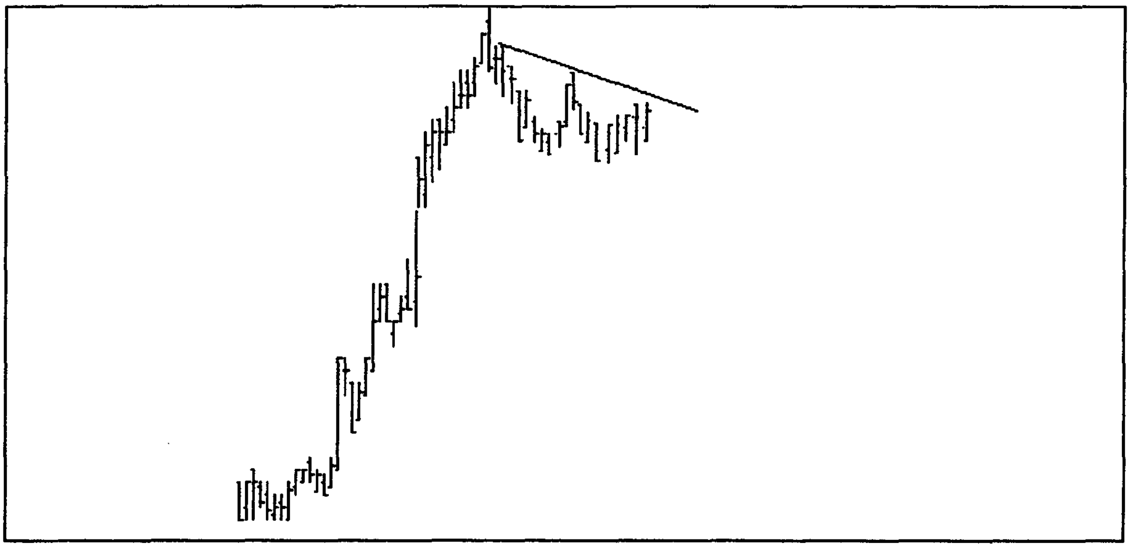
The following day, the price of the shares started to make the anticipated correction. They corrected two more days in a row.

On the fourth day, prices made another higher high and a higher low.

Fast Eddie thought to himself, "I've seen corrections that lasted this long before. Besides, there's not much chance that prices will take out that intermediate high. I mean, share prices are definitely in a down trend."

Just to be sure, Eddie drew another trend line. He was a bit perturbed by the fact that he had to move it. "Oh well," Eddie thought, "that highest high was just an aberration. This new trend line seems to be a pretty accurate reflection of the trend."

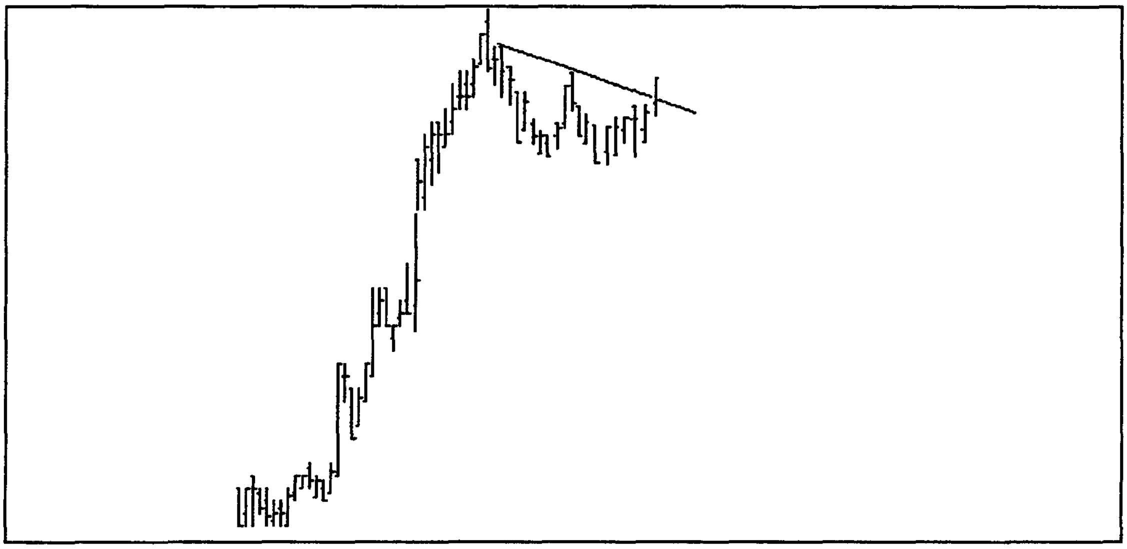
It seemed to Eddie that prices were forming an /\/\, and /\/\'s usually go down. At that point the chart looked like this:



"The next wave will surely be down," said Eddie, "Tomorrow ought to do it."

Eddie comforted himself saying, "Even if I'm wrong and prices take out my trend line, they'll no doubt stop at the resistance from the intermediate high."

The next day the price chart looked like the one below:



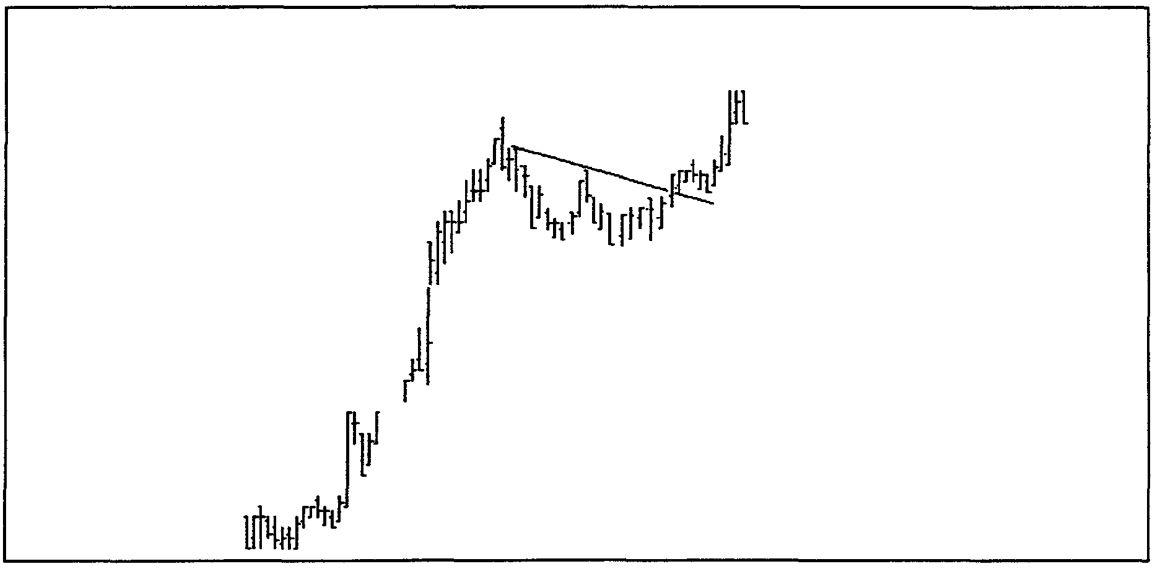
Eddie was getting worried now. He thought to himself, "If I move my stop loss now, I'll be taking too big a hit. Maybe prices will hold here. The market makers are probably just going to run prices up to that intermediate high. Besides, I'm going to exercise discipline, I'm going to sweat this one out if it kills me."

The next few days, Eddie had to do a lot of lying to himself to be able to stay in the trade.

However, the market was relentless in finding and exploiting Eddie's weaknesses. Prices tested the intermediate high, seemed to back off some, and then surged on up to test the major high. All the while, Eddie continued lying to himself and rationalizing the trade in his own mind.

Finally, just before the end, Eddie went down to the lake to get some air. He did a little silent praying that day, and tried to work out a deal with the deity. With tears in his eyes, Eddie swore to never be so proud again. He promised to never trade again if only he could get off the hook this one time. Too bad, that day the deity must have been on vacation, or maybe he was on the other side of Eddie's trade. In any case, Eddie's frantic yearnings remained just that — an unfulfilled wish — an empty hope.

The market ended up looking like this:



Fast Eddie doesn't trade anymore. He's broke. His pride and dishonesty destroyed him. He had ample opportunity to get out with his hide intact. He didn't take it.

Why didn't he move his stop down when the rumors about the gold mines became known to him? That's the least he should have done. He could have moved it down to the intermediate high at the very least. He should have covered his costs, but he didn't. He even missed his opportunity to take some profits on the trade.

Why didn't he move his stop loss when the market made a higher high for the fourth day in a row? That should have told him that he was possibly facing the resumption of the major trend.

Why did Eddie move his trend line? Why didn't he move his stop loss to just above the trend line?

Eddie was so used to lying to himself that he couldn't tell fact from fiction. He was persistently dishonest with his own trading. He was vain and he was, as some of you are....,

STUBBORN

Yes, poor old Eddie was stubborn. That caused him to be inflexible. His stubborn refusal to change his plan in the face of certain destruction was not commensurate with sound management. What Eddie did was not a case of sticking with his plan. Eddie's problem was in his defiant, egotistical attitude, in his absurd refusal to take a loss. He defied reality. He ignored the many signs the market was giving. He violated rule after rule of good trading. Eddie's plan was derived out of stubborn foolishness. All he could see was the money he was going to make. He was blinded by greed and the anticipation of fat profits.

Now ask yourself, are you Fast Eddie Gold? Are you sure about what you are? How can you be sure? Fast Eddie definitely lacked humility. Is that true of you? Is it that,....

YOU LACK HUMILITY

Some of you are not humble enough to admit you are on the wrong side of a trade, or that you made a mistake or overlooked a factor in your planning. In fact, some of you are not humble enough to lower yourself to making a trading plan.

Some of you are not humble enough to admit you don't have what it takes to trade. Your perspective in that area is all wrong. You think it is somehow shameful to admit you don't have the God-given talents to trade successfully.

We do ***not*** all have the same gifts, abilities and talents!

We can't all be concert violinists, does that make us less of a person? Some of us can't play golf worth a diddle, but there's no shame in that. In Zoology class, it becomes all too apparent that some will never be surgeons. It's just not "there" in their hands. Dyslexics may never become architects. Everything could come out mirror image. Each of us lacks a great many skills and abilities, many of which we deeply admire in others. How about you, what talents and propensities do you have, and which do you lack? Does the lack of a talent or ability make you any less of a human being? If you are not cut out for trading, does that make you some sort of sub-human?

Trading successfully takes a certain amount of skill and talent. Not everyone has the proclivity for trading. A successful trader is no better than you are because he trades well and perhaps you can't. There are probably dozens of things you can do that others can't. Some things you can do they've never tried, and many things you can do you do better than they ever could.

Does that make any one of us better or worse than the other? Please, take a hard look at your trading. Look at it and yourself as objectively as you can. Make an evaluation and then, if trading is not something at which you can excel, stop doing it. Otherwise, trading will be nothing more than a terribly expensive frustration. Life has enough problems without going after more of them, especially expensive ones like trading equities. No one is going to think any the worse of you. At least you will have been truthful with yourself.

All right, if you can't admit that you do not have the talent or ability to trade successfully — if doing that is somehow going to destroy your self image, then tell yourself and everyone else you just don't have the time to dedicate to the steep learning curve needed to master trading.

Will you do that, will you admit that perhaps daytrading is not your cup of tea? Or, will...

YOU CONTINUE TO THROW GOOD MONEY AFTER BAD

We could buy a ship and sail around the world on what some of you have spent in a frantic effort to learn how to trade. Yes, some of you have more guts than brains when it comes to throwing away your hard-earned money. You are certainly braver than we. One man we met told us he has lost two and one half million dollars trying to become a trader. We know another gentleman who lost seven hundred thousand dollars last year alone.

In any business venture, you have to have an ultimate stop loss.

Most of you come into this field, and before you know it you have invested thousands of dollars in time, courses, seminars, historical charts, hardware, software, and all manner of things that are supposed to help you make money as a trader.

In addition to that, you lose thousands more trading, in effect learning the hard way.

Without giving it a thought, perhaps without even realizing it, you are being bled to death. Most of you never counted the cost before going into this business. Many of you have never had the nerve to sit down and count the cost since going into this business. You have invested and risked a great deal of money in a most haphazard manner.

When you finally realize how deeply you are in, you are reluctant to lose that investment, so you keep throwing your money at the markets and the parasites who live off your foolishness. You continue to throw good money after bad.

In any business, there has to come a time when you throw in the towel. There has to come a time when you say "For me, this just isn't profitable."

That's when we get back to that old problem of pride. How can you do that and still save face? How can you admit to anyone, including yourself, you've failed? How can you look in the mirror and face yourself?

You're worried about what others will think, and you're not quite sure what to think of yourself. What you're really faced with here is an image problem, and so rather than face it and deal with it, you continue to pour money down a rat hole. No wonder some of you trade so frantically and desperately.

Look! There comes a time when you need to get out. Maybe we can help you there. Here's what you can do. Call us. The way to contact us is at the beginning of this book.

Say, "I've made a decision with regards to daytrading. I'm going to quit. I have my reasons."

Here's what one of us is going to say to you, " My friend, my opinion is you've made a wise decision. Actually, you've made a brilliant decision. You are one of the most prudent people with whom I've ever spoken. I'm really proud to know you. You have a magnificent astuteness about you that is something I really admire. Please keep in touch. I don't want to lose as valuable an asset as a knowledgeable and judicious friend. You are a wiser business person than many I know and have met."

The truth is, we'll sincerely mean every word of it.

If you absolutely need to continue lying to yourself and others, tell everyone you know you finally made that big score, and now you're going to quit while you're ahead.

Whatever you do, you will be money ahead if you do resign from trading, once you find out that this business, at least for you, is a losing proposition.

Every businessperson knows that, even traders do: Cut your losses!
we'll tell you another true story, and then we'll get on with putting you back together.

Chapter 13

WISTFUL WILLIE WHEAT

In order to protect the innocent (us), we'll call this the story of Wistful Willie Wheat. It is a story about the blind leading the blind. It takes place in the commodity markets, in which Joe has spent many years of his life as a trader. It incorporates many of the mistakes traders make — some of which we haven't previously mentioned. One of the main lessons we want to bring out is that some of you trade from ignorance. Though it is not a stock trading story, we are sure you can benefit from the lessons it teaches. Commodity futures trading is not at all unlike trading equities, and daytraders of futures such as the S&P 500 stock index trade under considerably more severe handicaps than do stock daytraders. In this story, some of the terminology is different, so we've placed explanations inside parentheses where appropriate. Probably the main difference is in the amount of margin required. Futures traders quite often put up less than 5% of the total value of the contracts they trade.

Wistful Willie Wheat came from a long line of wheat farmers out in western Kansas. Wistful had sort of broken away from the family farming tradition of hard work and sound farming practices in order to have time to study charts so that he could become a wheat trader.

"I can make a heckuva lot more per bushel in the wheat futures than I can bustin' my hump out there on the farm," said Wistful. "Besides, I'll be following my broker. Mr. Churnem is going to lead the way and I'll be following right along with him trade for trade."

So that year, Wistful sold off part of his inheritance (the family farm), in order to open a hefty margin account with his broker.

He wanted to be right on top of the action, so Wistful bought equipment and software needed for use with a live data feed, and a data base so that he could start watching the charts.

Wistful made daily calls to his friends and relatives in the area so that he would have "inside" information, and could regularly check on the wheat crop — not just his own but that of others in the area. (This is the equivalent of checking out the fundamentals of a stock.)

By late winter, the almost perfect weather seemed to ensure that a bumper crop of Hard Red Winter Wheat would be harvested. The government wheat reserve was full-up to overflowing, and when rumors about a large European wheat purchase turned out to be just that — rumors, the price of wheat started to fall.

That weekend, Wistful drove around western Kansas in order to get a first-hand look. He wasn't going to take any chances. He wanted to be sure of crop conditions when he shorted wheat, which he planned to do at the suggestion of Churnem.

Sure enough, Wistful sold short 20 wheat contracts on Monday morning. (A wheat futures contract is for 5000 bushels of wheat to be delivered at a guaranteed price on a specific date to a specific site.) As he looked out the window at the gentle rain, Wistful contemplated the money he was going to make.

"Why didn't I ever think of this before," he thought. "Even if wheat goes down to $2.00 a bushel, I'll clean up on my short position what I don't make on my crop. Not only that, I can hold over most of my crop until a better price comes along, and take profits on my inventory then," Wistful thought.

Churnem had called Wistful and said that at some point he contemplated adding to his short position.

Wistful wasn't sure how to add to his position, and he wondered if he hadn't ought to have put on a bigger position to begin with.

By Thursday of that week, wheat was nicely down, and Wistful was feeling just great. On Friday, wheat gapped down at the open and, at the suggestion of Churnem, Wistful got filled short with some "add-on" contracts.

Wistful watched wheat intently that day, but after the gap down opening, wheat rallied a bit and then traded sideways the rest of the day. Three weeks later, it was clear that wheat was in a trading range.

Each day, Wistful eagerly watched the news and crop reports that came in on his data feed. He also listened to the farm reports on the radio throughout the day, and he went to the farm association meetings at the Grange Hall. In April, the guest speaker was a gentleman from the weather bureau. His report on long range weather forecasts was bewildering, to say the least.

When the meeting was over, Wistful, along with the other farmers, was confused. "Seems like that weather feller was talking out of both sides of his mouth," was the consensus opinion of most everybody down at the Grange Hall.

Wheat stayed in a trading range for a while longer because wheat was undergoing a period of accumulation by large commercial interests.

Wistful's first set of contracts stayed in the money, but his second set wasn't going anywhere. Wistful told himself, "Be patient."

The almost perfect weather in western Kansas continued, but wheat rallied some on concerns over the unusually dry weather in Texas, Oklahoma, and Missouri. Wistful became fretful as he saw his profitable position go flat.

At this point, Wistful was dead-even in the market. He could have gotten out and covered costs and been OK. Wistful called his broker with the idea of doing just that.

"What do you think, Mr. Churnem, you reckon I ought to get out?", asked Wistful.

"Heck no," said Churnem, "This is the time to add to your position. I'm going to add to mine. Our analyst is pretty sure that this is only a technical correction. We call it a Fibonacci retracement."

"A what?", asked Wistful.

"A Fibonacci retracement," said Churnem. "You got a wheat chart there in front of you, Willie?"

"Yeah," said Wistful.

"Well you see that high we made back there in February?"

"Yup," said Wistful.

"Well, now look over to that low we made in March — right about the day you added to your short."

"Uh-huh."

"Well, the analyst says we can expect at least a fifty percent pull back from that low toward that high before the downtrend continues. Then we can expect an expansion of the down move to go an equal amount more below the lowest low. So, what we're recommending here is that you add to your short just as soon as the fifty percent retracement is hit. It may retrace a tad more than that, but at least you won't miss the move down," said Churnem. "It's almost for sure going to go down, 'cause so far we've only seen the first wave of an Elliott three wave advance!"

"Oh," said Wistful. "Well OK, go ahead and put in my order to sell at that point — whatever you said it was."

Wistful wondered who this Elliott feller was. Maybe he was the analyst that Churnem was referring to.

The weather continued to be very favorable for Winter Wheat out in western Kansas. But in the other states growing that crop, the weather continued to be dry. It was difficult for Wistful to hear all the glowing crop progress reports in his area and relate them in any way to what he was hearing about the very dry weather in the other wheat growing areas.

Wheat prices moved steadily upward, and now Wistful's position was definitely in the red.

Prices climbed to the anticipated fifty percent retracement. Wistful spoke with Churnem at least daily and sometimes more often than that. As planned, they both added to their short positions at that level.

Finally, when wheat prices had retraced to seventy-five percent of the recent move, Wistful could no longer stand the heat. He called Churnem and said, "There's got to be something I can do about all of these losses that's pilin' up."

Churnem said, "Yeah, it sure doesn't look so good now. If I were you, Willie, I'd buy some September wheat to offset your July short. That's what I'm doing. I don't know why I didn't think of that before. That's what you could do, Willie, buy some September wheat and that way, if the market keeps on going up, at least you won't lose any more than the difference in the spread between 'em, and you might even make some profits if September moves up faster than July. Then, if wheat starts down again, you can drop your September long and keep your short in the July."

"You think that's what I ought to do?", asked Wistful.

"Sounds like a winner to me," said Churnem. "That's what I'm doing."

"Well let's do it," said Wistful.

Wistful wondered to himself, "How can that Churnem feller call it a winner when I'm still losin'?"

A few minutes later, the telephone rang. It was Churnem.

"Gosh, Willie," Churnem said, "I went to put on those wheat contracts for you and then I realized you're going to have to come up with some more margin money. Better get down here right away with the money, because the crop report is due out today, and we want to position your September longs before the close. No telling what the market might do at the open tomorrow!"

Wistful was becoming more sorrowful by the minute. He was counting on that extra money for some other things he had in mind. It was all he had left from the sale of a portion of his farm. Wistful was having deep regrets that he'd gotten into this whole mess in the first place, but he was at a loss as to what to do. If he gave up now, not only would he lose big in the markets, but he would lose face with the people he'd bragged to about how he was going to trade futures.

With great reluctance, Wistful drew out the last of his money and took a cashier's check down to Churnem.

"Not to worry," said Churnem reassuringly. "The worst that will happen now is that we've locked in our losses. Just as soon as wheat tops out, which should be any day now, we'll dump our long position and go with our short."

If that was supposed to make Wistful feel any better, it sure hadn't worked. Wistful was especially perturbed by the idea of "locking in his loss." "Shucks," thought Wistful, "I didn't get into this to lose money."

Wheat prices continued a steady march upwards. Every time there was a slight correction, Wistful hoped that at last wheat prices were topping out. But the corrections never lasted more than two or three days, and as often as not, only one day. Wheat was definitely forming a bull market, and the reports of a possible drought in the wheat growing areas were not helping any.

Churnem quit calling Wistful. Wistful quit calling Churnem. Neither one of them particularly wanted to hear from the other. Both of them sort of wanted the whole thing to "go away," Wistful more so than Churnem.

To make matters worse, July wheat steadily widened the spread against September wheat. It seemed that the immediate demand for wheat was such that buyers were willing to pay a premium for the front months, and July wheat became the front month sometime in May. Prices were in backwardation. (In a commodity, normally the closer delivery month [July] would be selling at a lower price than the further out delivery month [September] due to extra storage, insurance, and interest rate costs for carrying the underlying September wheat. Backwardation means someone is willing to pay more to get the commodity right now, and so the closer delivery month, July, was selling at a premium to the September.)

Wistful's locked in loss steadily grew in size. By June, the word drought was everywhere in the news. Wheat, right along with all the other grains, broke loose and prices soared.

Wistful couldn't spend much time watching the charts on his screen, he had to be up and about bringing in his wheat harvest.

This is not a story about a total disaster. Wistful had to deliver wheat at the prices at which he had shorted it back in February, March, and April. But when the July contract expired, his long position in September wheat made him back a good deal of what he had lost.

However, Churnem, who had done the same thing as Wistful, but without a wheat crop to back it up, had really lost his shirt.

The analyst (Elliott?), they say, has since moved on to Chicago.

Chapter 14

LET'S PUT YOU BACK TOGETHER

If you are to succeed in any aspect of life, you must develop character traits that consistently strengthen and keep you on the right side of whatever you're doing.

These traits are not going to be developed all at once, but must continually be strengthened by exercising them.

If you have examined yourself and admitted to some of the human frailties pointed out so far, BUT ARE STILL READING ON DETERMINED TO BECOME A SUCCESSFUL TRADER, then there's hope for you.

There are any number of virtues we could write about in this book to try to help you be a better trader. We have selected those that we think will do you the most good. We have chosen them based upon the insights and knowledge gained from our tutoring and seminar sessions, and from the perceptions we get from your phone calls.

Some of the character traits that are important can be covered in a few sentences — others are so important that we have devoted full chapters to them.

As you read through them, ask yourself which of these attributes would best affect you and your trading.

Little by little, you must acquire proper trading habits and self-discipline if you are to be a successful and happy trader. They are not easy to come by.

We all have good habits and bad habits. Don't just pick out your strengths and glory in them. Rather, select those habits that give you the most trouble — the ones that are causing you to fail, and concentrate on them. Take them one at a time and conquer them.
That brings us to our first point.

RESOURCEFULNESS

You have to be resourceful as you seek to better yourself and, consequently, your trading. There are tons of excellent books that can help you to overcome bad habits. Public libraries are full of books on self improvement and self mastery. Self-determination is often not enough. Just saying "I will be a better trader" is not going to do it for most of you. You will have to define in minute detail what "better" is.

There are all sorts of tricks and gimmicks you can read about or contrive for yourself to help you overcome your weaknesses.

For instance, when some people first start daytrading, they have a lot of trouble pulling the trigger on a trade. They sit there and say to themselves, "Prices are going to drop any second now." Then they sit and watch prices dive just as they thought they would. The only problem is that they never get short. This happened time and time again.

We suppose one solution is take the problem to a "shrink." Even better, you could go to see a shrink that specializes in helping traders.

Here's a little gimmick that can help you to get into a trade if you're having trouble pulling the trigger. It circumvents the hang-up about pulling the trigger on a trade. What you do is to write out a little plan on a piece of paper. Write down on the paper, "If the prices violate today's low, I will go short." Then write the price at which you would go short. The next logical step is to call in an order when the event takes place. With electronic order entry, that translates into simply pushing a button on your trading terminal keyboard.

Perhaps that sounds simplistic. But that was what some traders have needed to do to overcome the problem. By being resourceful you can save yourself a bundle in psychological, seminar, book costs, and fees.

Another problem that some have is that of getting out of long term trades too quickly. You simply can't stand the heat — especially when daytrading.

You get into a trade that should last at least a couple of minutes and very often is worth holding for a few hours or even days. Then you watch the trade on your screen on an intraday basis, and as soon as there is pressure on the trade, you cash it in.

No matter how hard you try, you are unable to overcome the problem. You make regular resolutions to the effect that "Today I will stay in my trade!" You resolve is always in vain.

Now let us tell you about the elaborate and costly solution some have come up with — they simply turn off the screen. That's it!

The next time they are long, and want to stay in the trade, they simply turn off the screen. Every time they look at that blank screen, it reminds them that they are not to look at prices until just before the close of trading.

No matter what your hang-up is, there is a way to solve it, get around it, or replace it with a better habit if you are resourceful.

DILIGENCE

You must be diligent about ridding yourself of hangups. One of the oldest books in the world, the Bible says, "He who trades (deals) with a slack hand becomes poor, but the hand of the diligent makes him rich." [Proverbs 10:4]

Be diligent in mastering self-discipline and self-control. If you are slack in these areas, you will be annihilated in the markets. You have to be diligent in getting down the fundamentals of trading, and your own methodology for how you execute the various aspects of trading. Be diligent in writing out a trading plan. Be diligent in smoothing out the way you enter orders. Be diligent in figuring out ways to stick with your plan. Be diligent in learning how and when to enter and exit trades. Be diligent in learning and understanding trade, risk, and money management. For the most part, our problems begin when our orders are filled.

FLEXIBILITY

You must come to an understanding of the fact that prices are forever adjusting and changing. What works today may not work tomorrow. Therefore, it is incumbent upon you to seek out ways to trade that are not upset or made obsolete by the ever changing markets.

There are some things that are constant in the market, and you need to stick with them.

For instance, the trend will always be the trend while it remains the trend. A 1-2-3 breakout will always be just that, a breakout. A Ross hook is always a Ross Hook, a Ledge is always a Ledge, and congestions are always congestions. No matter what happens in the markets, these will remain constant. 1-2-3's, Ross hooks, Ledges, and congestions (Trading Ranges) are all described in ELECTRONIC TRADING 'TNT' I — GORILLA TRADING STUFF and ELECTRONIC TRADING 'TNT' III — TECHNICAL TRADING STUFF.

But you must realize that these are, in a sense, only relatively constant. A 1-2-3 formation, once it has broken out, is no longer a 1-2-3 formation. Therefore, you have to adapt your trading to take advantage of it before it becomes something else.

How do you take advantage of 1-2-3's? By learning how to get into the market just ahead of the breakout. To do this intraday, you can trade the breakout of the congestion that comes closest to the number 2 point. A way for traders to accomplish this is to trade the breakout of the high or low that is nearest to the high or low of the number 2 point counting on the fact that the number 2 point will probably be tested, and you can make your money and move your stop to break-even. This is information you should already know, but if you need to refresh your memory, please refer TO ELECTRONIC TRADING 'TNT' I — GORILLA TRADING STUFF and ELECTRONIC TRADING 'TNT' III — TECHNICAL TRADING STUFF.

The trend is a trend for only a period of time. Sooner or later, the trend will change. You must be flexible enough to trade the trend while it is trending, and be agile enough to exit the trade when you suspect that the trend is about to end.

How do you take advantage of the trend? Here are a couple of ways: By trading pivot point breakouts, or by curve fitting a moving average to the trend and staying with it until a penetration takes you out. Curve fitting a moving average is discussed IN **ELECTRONIC TRADING 'TNT' III — TECHNICAL TRADING STUFF**.

Learn to read the detail on a chart. That way you will be light years ahead of all the guys who are watching their smoothed indicators.

When there is a choice between using chart detail and the artificial detail of an indicator or moving average, we will choose the chart detail every time.

Chapter 15

KNOWLEDGE

KNOW YOURSELF

You must have knowledge to trade well. You must know what to expect from your trading. Above all, you must know yourself. That is an important part of the knowledge you need to have.

You can find out who you are. Later in this part of the course, we'll be showing you the Life Index. Believe me when we tell you it works. Many have used it to turn their trading from making a living as a trader to making a good deal more than just a living.

A very important concept in trading is to get in touch with your feelings. How do you do that? We'll tell you how others do it, and also let you know that it worked for us too. Here's what you do.

Begin to keep a diary of how you feel just prior to entering a trade, just after entering a trade, just before exiting a trade, and immediately after exiting a trade. In your diary, write out your feelings and your thoughts. You may be absolutely flabbergasted at what you will find out about yourself. Intuitive trading and the diary is discussed in Chapter 30 or this manual.

One of our students diligently kept a diary for several months. Want to know when he did his very best trading? Aha, we thought you might. He found that when he had terrible regrets about what he had just done, that was when his trades turned out to be the very best.

He would study out trades very carefully. He would record his plan. He felt totally ready to enter a trade. As soon as he had placed the order, he got a feeling of immense regret. All of a sudden he would see at least several reasons why he shouldn't have done what he did. Why, oh why had he not seen those reasons before? He would then lambaste himself for being so blind. He would be down on himself. In turn, his chagrin would make him be quick to want out of each trade. He developed a hair trigger, commando style of trading. He would get out as soon as possible, leaving most of the profits lying on the table.

Yet he was steadily and consistently making money on these trades. He came to learn that when he felt remorse and regret, those were usually his very best trades. So he learned to squash his reaction to those feelings. He learned to stay in the trade and to make fifty percent and more of the profits that were available, whereas before, he was taking only fifteen to twenty percent and leaving eighty to eighty-five percent of available profits there for someone else to enjoy. Four years later, he still trades the same way. He learned to be content with his piece of the cake.

If you have trouble pulling the trigger on a trade, if you are a person who just can't spring into action when action is needed, you need to know that about yourself and take measures to circumvent your problem. You must adjust your trading to take into account your inability to pull the trigger.

You need to find out why you are having that problem. Is it fear, is it lack of decisiveness? Are you not sure of yourself, the system you are trading, or the method you are trading? Find out, and then take steps to correct the situation. That is the kind of knowledge you need to have about yourself and what you are doing.

The best way to build confidence in yourself and in the method you trade is to have a detailed plan for your trading such as you will find in a later chapter of this book.

Maintain statistics about your plan. Find out which trades worked best for you. Why are you in the trade? You need to record your reason. What did you see that made you enter? Record what you saw. Draw a picture or print a chart of how the market looked.

Then, keep statistics. How many times did such and such an event or pattern work for you? You need to know, so you can discard the ones that don't work out to your benefit. I don't care if Jack Mack is making a fortune trading heads and shoulders patterns, if heads and shoulder aren't making you money, you need to quit trading them. The same goes for cycles, oscillators, moving averages, waves, or anything else that isn't making money for you in your trading. Leave those things to the ones who do well with them. You need to keep records of what works for you, and then stick with that.

You also need to keep records of those sectors and stocks in which you do your best. Stay with those stocks. Review every day. If you see a pattern of your losing when trading those stocks, stop trading them. However, they may well work for you at a later date, so don't discard them forever. If stocks you are trading are not acting the way they used to, then try some new ones. This also goes for your trading style.

One of the top traders we've ever seen traded an average of 250 times a day. He found most of his trades on one particular ECN, where he thought he had an advantage. He was up about $130,000 for the year when some regulatory changes were made by the SEC and NASDAQ. Unfortunately, he didn't change his trading style. Over the next two months he lost over $80,000, and eventually decided it was the trading firm or software or something in the trading environment. He then went to another trading firm. Guess what? Things didn't get any better. As far as we know he is now somewhere back in India driving an oxcart. **IMPORTANT POINT: WHEN THE MARKET CHANGES, YOU MUST BE WILLING TO CHANGE WHAT YOU ARE DOING. YOU *MUST* CONSTANTLY ADAPT TO MARKET CHANGES. EVEN IF IT MEANS TAKING A STEP BACK TO OBJECTIVELY REVIEW THE SITUATION. THAT MAY EVEN MEAN TAKING TIME AWAY FROM TRADING.**

Is your timing off? Bad timing is one of the biggest problems you can have. You are right about the market, but you are wrong about when to get in.

If you keep records of your actions in relation to your plan, you may find that you are consistently getting in too soon or too late. From your records, you can decide what to do.

Are you too soon? You may have to adjust your stop loss price to a greater distance away. If you are consistently too soon, you may have to give the market more room. Can you afford to do it?

You may find out just the opposite is true when you are consistently too soon. You may have to use very tight stops. That way you will take small hits in the market, but you will have the wherewithal to try again, and again, and perhaps again.

If you take a big hit because you consistently enter too soon, that not only depletes your capital, but it weakens your courage and confidence to try again.

Adjusting your stops is only one way to handle "getting in too soon." Another way is to adjust your plan to allow for additional signals prior to entering a trade. Perhaps you need to add a filter to your "too soon" trading. The additional filter may cause you to enter a bit later.

Are you entering markets too late? You know what we mean! You buy just about the time a market reaches its high, and you sell just about at the low.

Is that you? There are ways to solve that problem. Ask yourself how much filtering you are doing.

Do nineteen different indicators all have to agree before you'll go into a trade? Yes? No wonder you consistently get in late.

Are you late because you're hesitant? If you are consistently late because you hesitate, then you need to find out what causes you to do that and get it fixed. If it turns out to be emotional or psychological, get help.

But there are other ways to handle lateness. You can learn to fade yourself. If you are consistently late, what is wrong with taking opposite side trades? If your records show that you are late eighty percent of the time you go long, and you find that when you do go long the market usually goes down, then why not take advantage of your consistency? Trade opposite of what you would have done. Become your own contrarian.

Yeah, yeah, that's easy for us to say, but impractical for you to do, right? Look, Buster, if some can learn to trade with remorse and regret, then you can learn to trade against yourself and win — you can force yourself to do it.

In real life it may be that way. Some of the greatest public speakers, ones who make gobs of money doing it, consistently experience terrible fear and lack of confidence just before going on. It's the same for many famous entertainers. They learn to live with it. They learn that the fear and trembling works in their favor. It prods them to be the best they can.

How about salesmen? How many great and famous salesmen, and even not so great and famous but very competent salespeople, experience horrible fear and dread each and every day that they go out, especially before they hit that first door?

Great athletes often feel terror before an event.

The point is that if you maintain a trading plan, and keep records and statistics along with that plan, you will be able to detect and discover the reasons that you are losing, and the reasons you are winning. You will find out which trades work best for you. You will find ways to improve the timing of your entry into the markets and you will improve your exit techniques as well.

Do you stay in the market too long? Do you consistently see profits turn into losses when you are in a trade? If this is happening to you, then you need to use profit objectives. Set short term, intermediate term, and long term objectives for your trades. Have them mentally as resting orders in the market contingent upon being filled at your entry price. That way you will have something to show for your efforts. The resting orders will aid in forcing you to exit the market. But then you need to go to work to find out what it is that causes you to stay in too long.

Is greed your problem? You have to find out. Is it that you feel an urgent need to make more from a trade than is realistic? We have found this to be true with many of the people we tutor. They simply have no concept of how much a trade should realistically make for them. Usually their ideas are quite overblown. This seems to arise because they don't know how to figure true profits based on a percentage over cost. That, in turn, is because they don't know how to figure out the true cost of a trade.

When you trade, do you have in the back of your mind the thoughts of past losses? Are you unconsciously trying to make back those losses on this one trade? Dig deep on that one. If it's there, you must ferret it out and stomp on it. Making up past losses is like eating an elephant — you have to do it one bite at a time.

Have you ever seen a baseball slugger go into a batting slump? After awhile in the slump, he'll be swinging for the fences. It's as if hitting a home run would somehow make up for all his past failures to get on base. The harder he tries for the home run, the worse the slump gets. A famous baseball player once wrote that the only way to get out of a slump is to try to just tap out a single, and then another, and then another. Your trading has to be that way, too. Just keep trying to tap out a hit.

Here's another good analogy from baseball: When a team has a big inning, is it made up of all home runs? Of course not. One man may walk, the next man taps out a single and advances the first man. Then the next man hits a single, and a run comes home. The big inning is made up of singles, maybe a double, a sacrifice bunt, another single, etc. Occasionally the whole thing will be capped off by a home run, but not most of the time.

When you are trading, go for a small win, and then another small win. Just try to get to first base. Keep going for small wins and determine not to lose. Then the market will hand you some doubles, triples, and an occasional home run.

If you lack faith in your system or method, then stop trading until you find out why. You cannot successfully trade without that kind of faith.

Without it, you will lack staying power, and you will not have the courage of your convictions. Without courage, you will be a sitting duck for any kind of trouble that might unfold as the trade progresses.

You need to trade from a level of confidence that comes only from a series of successes. Remember, consistency is what you are looking for. Winning days, no matter how small, are what you want. You want winning days. It doesn't make sense to have fourteen winning days in a row and then give it all back and more on the fifteenth day. If you make $20,000 trading in one day, we assure you that you are capable of losing $20,000 in a day.

Many of you do not give the method you are trading an adequate chance to prove itself. The biggest single problem I have seen with that is that you test the method by paper trading, and when you don't get the same results from real trading as you did from paper trading, you almost immediately set aside what you have worked so hard to learn and go off looking for something better. Because of that, you go from one system or method to another, looking and searching, but never finding.

Paper trading is just that, paper trading. The mental stress of real money on the line is truly not the same when paper trading. In fact, if and when you do paper trade, it's better to write down your trades in a trading log rather than letting the computer keep track of them for you. This way you have a record of your trades. Always keep and review that log. At the end of the day, you can print out the charts of the stocks you traded, and see how much money you left on the table. This is also a very good way to see in which stocks you made money and in which you didn't. Tomorrow, trade only those stocks that made you money.

This is part of what we meant when we stated earlier that your expectations are all wrong. You cannot for one moment think that any simulated system or method will produce the same results in real trading as it did during testing. A simulated method or system cannot possibly encompass the myriad of variables that crop up during actual trading.

To make matters worse, most of you do your back-testing and simulations using daily data, and, in some cases, intraday interval data.

The only way you could possibly even approach reality would be to use tick data. Tick data is expensive, but it is the only way to back-test, if you feel that you must back-test. Even then, it is only an approximation of what might have happened to you in the trade. Why? Because it doesn't show you how fast the market really was. Another problem with tick data is that there are plenty of bad ticks to contend with, and yet another is that, with the exception of the electronic system where you are filled at a specific price, there is no indication of the slippage encountered as your orders would have been filled. But even backtesting with the trading system, you would not know if you would have ***been*** filled at all!

A system or method based upon simulated trading is a false lover that will let you down time and time again. You will have no faith in it, and you will not be able to trade it with conviction. The true value of simulated trading is to assist you in working out a plausible way for real trading. Besides learning to hit the right keys, you will benefit by avoiding costly keying errors. The true test of what you've accomplished from paper trading will come when you actually trade in the real market.

KNOW ABOUT TRADING

When we say, "Know about trading," we mean know as much about the market and the way it operates as it is possible for you to know. With electronic trading, know everything you can about how the system works. Know everything that you can find out about trading it, know the rules and regulations governing the exchange and the arena in which you choose to trade. But you must use discretion in selecting the knowledge to which you devote your time and attention.

It is extremely important to know all the 'ins' and 'outs' of the trading system and software you are using. Much money is lost by people not knowing which keys to hit, and by erroneously hitting the wrong keys. They hit "buy" when they mean to sell, and "sell" when they mean to buy. You might think this sounds crazy, especially when your hard earned money on the line, but it happens. And we're willing to bet it will happen to you. **BE VERY CAREFUL WHEN ENTERING ORDERS!** It is also very important to make sure the software vendor, trading systems developer, and your broker all deliver the latest and greatest up-to-date trading manuals.

Be as well informed as you can be. Let's give you an example of the kind of knowledge you may seek to acquire and inculcate into your trading plans and strategies.

One of the most important times to know who is dealing on the floor is the day options expire. The large brokerage firms are heavily into the writing (selling) of options. That is why they try to get the public to buy them — they are the ones selling them.

When a stock is trading near an option strike price on option expiration day, these large brokerage firms will try with all their might to keep the options they have written from expiring in the money.

They will send armies of traders down onto the floor to push the market away from the option's strike price.

This recently happened to someone we know. She wanted to get long a stock at a particular price which happened to be an option strike price. It was the day the options were to expire. She noticed that every time prices broke through the options strike price, the volume would increase and the price of shares would fail to hold above the option strike.

She called her brokerage firm and they checked it out. Her broker said, "Oh yeah, some of the big houses are short a ton of CALLS at that strike price. They aren't about to let the share price close with those options in the money."

She then abandoned any attempts to buy those shares.

Sure enough, the share price, which had poked through the option strike several times that day, closed with the options out of the money. There was a flurry of short selling in the market just ahead of the close. That selling drove the market down well below the strike price. Prices then struggled back to where they finally ended up for the day.

Since the options expired on a Friday, she looked to get long the following Monday. Once the pressure from the option writers was off the market, the share price rallied and rose all day Monday.

This type of price action we call this the snap-back effect. A good time to take a position in this type of trade is just before the close, when prices have been artificially pushed away from a strike price in which the major options writers are holding a short position. Usually, with pressure from the options sellers removed, the price will quickly move to wherever supply and demand dictate.

Don't spend the majority of your time backtesting and simulating systems. Instead, spend the time learning as much as you can about how the market makers and specialists operate.

Don't waste time reading inane articles in magazines. Instead, spend the time learning about the process flow, and the timing for placing orders. Learn the tactics of the market makers so you will recognize their strategies when you see them. Their actions can be seen on a price chart, and the pattern of their strategies can be seen there as well. Learn which market makers have real buy and sell orders and are able to move the market compared with those who are just filling small retail orders. (See Appendix D for a list of Market Makers.)

Instead of reading the book that you are tempted to buy because of the glittering promises the ad copy holds forth, spend the time studying the finest details of the relationships between highs, lows, opens, and closes on your charts.

Yes, there is a lot of knowledge out there, but you must be discreet in learning the things that are important.

If you use oscillators or technical studies in your trading, be diligent to learn and thoroughly understand just exactly what these oscillators and studies are capable of telling you. How are they constructed? What do they measure? When can you count on their being right? When are they wrong? What are their nuances? What does it mean if there is failure to reach a parameter line? What does it mean when they wiggle along in a certain way? What is happening when you see lines crossing one another, or you have penetration by price of the studies you regularly use?

Get knowledge in the things that are important to the way you trade, and the vehicles in which you trade.

Keep a log, a notebook, or a diary, and record what happened when the prices did such and such. Record the way your indicator looked. Record the way it behaved. Record the way the price bars looked. Record where the opens, highs, lows, and closes were situated. Record the finest details and their relationships to each other. This is the kind of knowledge that brings success in your trading.

Wow, that sounds like an awful lot of work. Are you nuts or what? When am I going to find time to keep all those records? I just want to trade! I don't want to become a records clerk!

Well, now, who told you that trading was easy? Trading involves work. Why do you think some of us have lightened up on our trading after all these years of doing it? You'd better believe that trading is hard. It's hard work and it's hard to do. This is just one of the things we meant when we said that so many of you have the wrong perception of trading. Your notion of how to make money trading has been incorrect from the start.

Earlier, we told you why trading is such a fantastic business. We wanted to capture your interest so you would read at least this far. But nothing is perfect. There is a down side to trading, and this is what it is: With most businesses the true purpose for which they exist is to create new value. A lot of people fail to see that. They erroneously believe that the purpose of business is to make profits.

Whereas in most businesses making profits is important, in a trading business that is all there really is. You are never able to create new value, and therefore, it is impossible to rest on your laurels. This is especially true for daytraders. At the end of each day you are out of business. You are flat. You have no position in the market. It's like being put out of a job each and every day. You have created a job shop rather than steady employment. This is even more so if you are selective in your trading, i.e., you don't think you have to take every trade that comes along, or trade all the time. You have no paid vacations, no paid sick leave, and no retirement plan other than what you create and allow for yourself. And as a self-employed person, you tend to drive yourself much harder than would any employer.

So many of you come into the world of trading with the notion that it's going to be like taking candy from a baby. The problem is, you've been hyped! You're the baby who's going to give up the candy.

That's right, you've been suckered in by all the glitter, the fantasy land dreams that this is the place to get rich quick. You know what we mean. All you have to do is look at the ads in Investor's Business Daily, the Wall Street Journal, the Financial Times, or any one of the dozens of publications carrying advertisements that are all going to show you how easy it is to skin a cat in the markets.

"Buy my book. I'll show you how I made a million in the markets!" *Oh, yes. But a million what? A million mistakes? A million new customers (i.e, suckers) who bought the book?*

"Buy my 'Big Buck Maker' book on electronic daytrading."

Uh huh, and find out that 90% of this wonderful work will teach you about the trading system the author provides to his customers and almost nothing about successful trading.

"Take my advisory, my readers are up 89% this year."

Yeah, sure they are. They're up 89% of the night worrying about the advice they've been following from the great guru.

"Call my 900 hotline for riches this year." *My riches, that is*!

Here's an interesting idea for you to ponder. The most money is made in stocks when the stock is trending. Any given stock trends only fifteen percent of the time. Conclusion: a trader should trade only when the stock is trending. ***OR,*** traders should find and trade only those stocks which are in the 15% time period in which they are trending.

So, what is a trader to do with the other eighty-five percent of the time? Keep records and manage — that's what!

Study, pore over your trading diary, your trading plans, your trading statistics. Study the market, entry techniques, exit techniques, trade, risk, and money management. Work out strategies and tactics. Do this until it becomes second nature to you. Then, and only then, will you be able to ease up and relax somewhat from all that studying.

Hard work? You bet! Boring? Sometimes! Tedious? Often! If you trade too much, trading can become old, and quickly.

Why, you're describing a job. Well I'll be! I sure don't want to trade the way you do. Humph, I'd be better off staying in my profession where I've got it knocked!"

Perhaps you are right! Trading can be a job unless you have the proper love for it. Then, it's fun. Then, it's profitable. Maybe you would be better off staying right where you are. Or maybe you could palm off some of the grunt work onto one of your employees. Or maybe you'd better count the cost of a records clerk into your trading overhead.

If you're a longer term trader, who's to stop you from having a clerk (they call them analysts these days) who compiles all the nit-picky information for you, so you can make the trading decisions without having to go through so much of the detail?

If you find that you don't really like trading or making trading decisions, you can always become an investor. Here's how! You can hire a trader to trade for you. When you do that, you are investing in him. I've seen this produce good returns for some investors. I've also seen some major disasters from having done so. It takes a lot of hard work. Usually the traders need to be managed and you can go through a lot of bad traders before you find a few good ones. Once you've developed good traders, you may find that they no longer need you or your money.

When hiring traders to trade for you, it is important to have the right type of agreement in place and to review the security laws in your locality. Learn all the risks involved. If you decide to hire a trader, realize that it is an investment. You will need to weed out the bad traders and keep the good ones as long as you can.

The point is this: The work has to be done. Proper trading is like any other business. It must be run and managed as a business. You need records and statistics to manage a business. If you don't manage your trading business as a business, your business will fail.

Yes, trading is work. It is hard work. The greatest part of it is in the preparation. Trading is eighty-five percent grunt time and fifteen percent fun time.

In actuality, the grunt time doesn't have to be boring, tedious, or distasteful. We're all different. Some enjoy detail work. Some enjoy keeping records. Some love to delve into statistics, self evaluation, designing reports and forms that enable them to keep track of what they are doing. Various parts of management can be fun. The best part is that when you are having fun, it's not work. To paraphrase an old saying, "One man's work is another man's pleasure."

You can be as creative as you care to in your record keeping chores. We have in the past kept a computerized spreadsheet with data gleaned from the Trading Plan we'll be showing you later in the course. It enabled us to make all manner of fancy reports about our trading statistics. Later, we'll be showing you the Life Index. It's fun charting your Life Index to see where you are strong and where you are weak. We also enjoy making bar charts of our corporate trading equity.

In any case, you don't have to work your tail off all your life. Especially the record keeping part. Once you have learned how to trade and understand the markets and what is really going on, trading becomes much easier, more pleasant, and relaxed. It's like any other profession, in the early stages you have to pay your dues. Ask any doctor what it was like being an intern and then a resident. Most of them thought they would die before they ever made it.

Chapter 16

TRADING WISDOM

Knowledge, knowledge, knowledge. Get knowledge. It comes through observation and experimentation. It comes through reading and studying. It comes through your senses. You must have it to win in the markets. But by itself, knowledge is not enough. You must have wisdom to go with that knowledge. How many of you know what wisdom is? How many of you can give us a definition of wisdom right now: Wisdom is ______________________________!??

Well, were you able to tell us? We defined it earlier in this book. Did you already forget?

Wisdom is the right application of knowledge. Knowledge is worthless until it is applied. In order to apply it in the right way, you must have developed a certain amount of self-discipline and character. The very things we've been talking about: Self control, flexibility, patience, resourcefulness, diligence, etc.

We've tried to help you explore the areas of knowledge you need in order to trade well.

You need to know yourself, you need to know the system and the vehicles in which you are trading. You need to know all the mechanics of how to go about trading, and you need to know what is going on when you see market maker movement in the price action on your trading screen. And, if you are not trading a electronic trading system with full electronic execution, you also need to know how the market makers and specialists work down on the trading floor. All of this entails an enormous amount of knowledge. But that entire body of knowledge is meaningless unless you have a proper application of it. The proper application of knowledge is wisdom.

Set up an equation: Wisdom = Proper Application Of Knowledge.

You must, in a right way, consistently apply the knowledge you have to your trading.

That means you must constantly adjust your trading commensurate with the wisdom you gain. As you overcome character deficiencies, you can trade more freely, with fewer constraints upon yourself.

A good example of this is being able to daytrade without stops, as long as you are able to pay attention to the market without interruption. If you know that you have sufficient character to get in and out of the markets when you should, and that you are not gun shy and hesitant to pull the trigger, then you do not need to place protective or objective stops in the market. You can, for the most part, rely on yourself to get yourself in or out. We say, "for the most part." There is always the chance that some bizarre event will prevent you from pushing a key on your computer or calling in your mental stop. You could have a stroke, or a heart attack, and never call in that stop. Or believe it or not, your computer could crash, the Internet could be slow, or the Internet service provider (ISP) could go down. The phone lines in your entire area could go out and you would have no way to extricate yourself. Such obscure events are part of the risk you take when you trade.

If you realize that there are such unusual but very real risks, can act in accordance with them, and are willing to trade without stops in the market, it is Okay. But never leave a trade unattended for even a minute.

If you have wisdom, you will not even go to the bathroom without having set stops in the market. You will never hold a position overnight without stops. If you are diverted by many phone calls during your trading day, you must always have stops in the market.

If you hear something on the news that is almost sure to adversely affect the trade you are in, and fail to get yourself out, then you have not properly applied knowledge to your trading. You have been unwise.

If you see, when you are short, that the current price bar is not currently making or has not already made a new low, and you don't move your stop closer to the price action, then you are not wise.

If you notice that a good many times, just after you enter a trade the market goes against you, and you don't adjust the timing for your entries, then you are unwise.

If you don't pay attention to everything that is happening so you can adjust your trading, then you lack wisdom.

Trading is not stagnant. You must constantly shift and adjust your actions. What works today may not work tomorrow. You have to adjust your trading to the time frame in which you trade, just as the specialist must adjust his trading to what is happening on the trading floor. This is where flexibility comes in. You must learn to be flexible.

If you are using a method or system that you see has problems because everyone else is doing the same thing, then adjust what you are doing. You don't have to throw out the baby with the bath water and run out to purchase and learn a new method or system. Simply make an adjustment to what you are currently doing. You might need to do something as simple as moving your protective stops to an odd ball price — some price where everyone else's isn't. You might alter the time frame — perhaps from a 30 minute chart to a 15 minute chart.

Figure out a way to get in a few ticks before everyone else does. Then their entry into the market will push your trade to a profitable position.

If everyone is using a fourteen bar Relative Strength Index oscillator (RSI), then you use an eleven bar RSI, and beat them to the punch.

That means watching your screen for clues about the situation on the trading floor. Pause often to assess what is going on. Is the market fast? Is the market thin? What orders have you seen being entered on your screen? Where are the order accumulations located on you chart? You can see much of this simply by evaluating the information on your terminal screen.

If you use technicals in your trading, set them differently from the norm. There is no magic in the values for which technical indicators are set. There is no optimum moving average setting, or Stochastic setting, or any other kind of setting. There is no magic simply because an oscillator is set at three, five, nine, or eighteen days. The very word "optimize" makes us shudder when we think about how some of you use these tools.

One setting will give just as valid a signal as another. The trick is in learning how to read and use the technicals at the settings for which you have them. Always, always, always keep your perspective by what you see prices are doing. Always remember that your bloody technicals have smoothed away the very detail that you sometimes need to see. We call them "bloody" because many of you have shed a considerable amount of your financial blood trying to use them.

If you know that oscillators drift and actually go counter trend when a market stabilizes, and you still trade according to what the oscillator tells you, then you have become a fool. There is no wisdom in your trading. And, by the way, all oscillators drift when a market reaches equilibrium, even though the market may be trending wonderfully and may stay that way for minutes, hours, days, weeks, and months on end.

We feel that wisdom in trading is so important, that we have included in the next chapter what we feel is the best of the best in trading wisdom.

Chapter 17

TRADING RULES

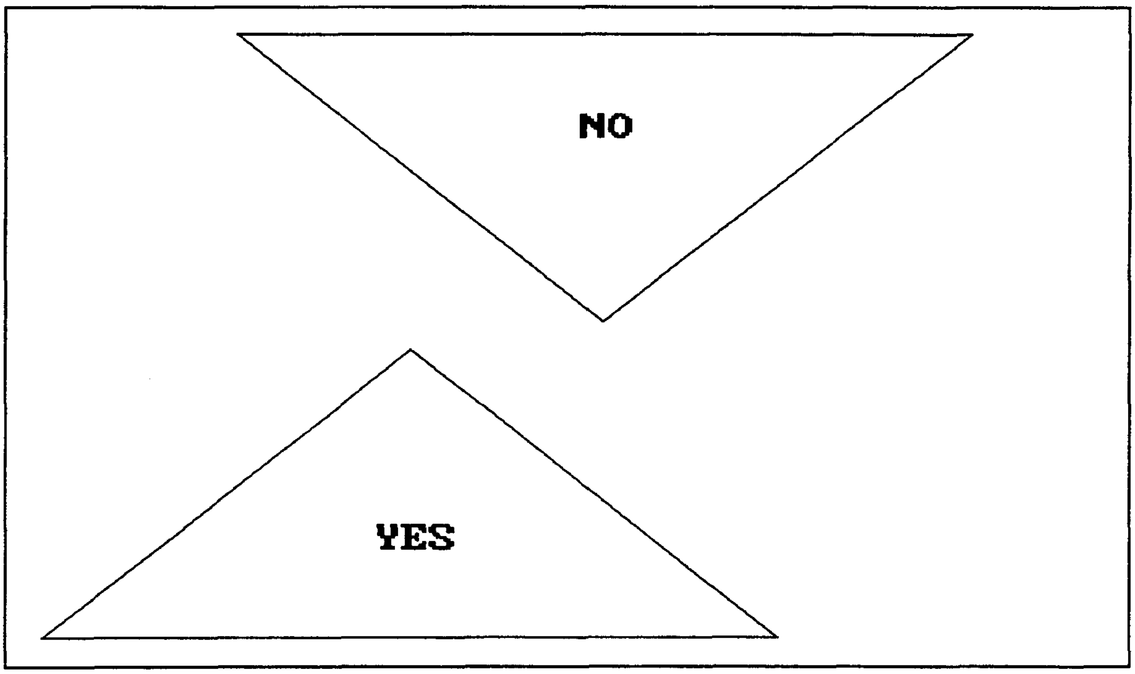
MANAGEMENT

Trade only with money you can afford to lose. Speculative funds should be only money you are willing to lose. Never trade with money that is needed for normal living. You must be able to trade with a minimum of pressure without the fear of losing money you have committed for a specific need. You cannot trade well with 'scared money', it will influence the mental freedom needed for sound trading decisions.

You must be disciplined in your trading. You cannot trade emotionally. You must be hard-nosed and steadfast, and trade from a definite strategy.

PYRAMIDS

Pyramiding may seem a wise move for the experienced, if the price moves relatively straight up. We don't particularly favor it. You have



to decide if you are willing to risk a little, almost sure profit, for a chance at a lot. You may be knocked out of the market, but the one you make it through supposedly will make up for the two or three in which you got knocked out. NEVER, EVER use the inverted pyramid approach of buying a larger position on each upmove based on paper profits in your margin account. One pullback may totally wipe you out.

Adding on to winners is the risking of giving up some of your profits if a market tops or bottoms out early. Actually, "adding" to your position is a misnomer. It's impossible to "add" to a position. If you put on more shares, you are creating an entirely new position. With that new position you are creating all new risk. Even if you "add" to your position at the same price, the fact that you are doing so at a later time or date changes the entire risk structure of the trade.

SEASONALITY

Most years there are seasonal factors which can affect certain sectors of the market. For instance, computer related shares may have a tendency to move up in anticipation of increased sales and profits for the Christmas season. Be very cautious and watch for this sort of action. Earnings reports also fit into the category of seasonal tendencies. These reports don't come out every day. A strong earnings report or the opposite, a weak earnings report, will give a daytrader ample opportunity to take advantage of the rush by the public to get in or out of a stock.

September, October, and November are traditionally weak months for the stock market. Fund managers are eager to lock in year-end profits, and become sellers. There is also a tendency on the part of fund managers to get out of the more speculative stock and into the solid blue chips in order to look good not only at year's end, but for quarterly reports as well.

Be flat through major economic reports. Being flat through major reports is the only safe way to go through them. This is especially true for interest sensitive stocks.

STOPS

Always place a stop at some point, even if it is some distance away, and even if it is a mental stop. It gets you out of losers, and helps you stay with winners. Be sure you execute those stops if they are mental. Don't start to flinch or back away from them just because they are mental stops. You must execute and follow through just as though they were in the market.

Stops are a very useful tool in risk and money management. The general rule, when you want to give the trade some room, is to put your initial catastrophic stop the same distance away as twice the value of an average move for the time interval in which you are trading. An example of this would be if you were position trading shares on a daily chart, place your catastrophic stop at a distance that represents an average of two day's total moves, let's say over a 20 day period. For a daytrader watching a 30 minute chart, your catastrophic stop would be twice the average move that takes place in 60 minutes over a period of 20 price bars.

Closer stops can occasionally be used when you are near a critical chart point. Stops should be brought up to the break-even point as soon as possible, but then be more liberal. If you are not trading with specific price goals, it is best to let your stops take you out of a market. A profit taken too soon is as a loss of profits, but you must learn to be content with a reasonable profit. Get your piece of a move and get out. Profits you fail to take will be taken by someone else, guaranteed.

You should always use stops, even if they are wide. Everyone is wrong sometimes. The difference is not really in how much better are the trades you pick, but how soon you cut your losses.

Make your initial stop closer than your trailing stops. As the market moves in your direction, allow more distance in your stops.

The placement of stops is a big problem. If you use a really tight stop, you may get knocked out on a small correction, and you may not be quick enough to get back in before a market takes off without you. The opposite extreme will see large account drawdowns as you ride out all corrections. When it hits the top, you will still be in the market if you don't use stops. You will have the big profit, but you may not recognize the top and you may give it all back, plus some, when the turn comes. Our job is to find a happy medium between the two extremes. There is no perfect stop that will work at all times. You will have to continually adjust your stops to different types and speeds of markets. You have to adjust them according to where **you** are in the trade.

If you are stopped out, you should then re-evaluate the market, as it is now a brand new position.

TRADING PHILOSOPHY

You should have trades designed to accomplish a specific purpose. You should have trades designed to position yourself to where you can attempt an even better and potentially more profitable trade. We cover this in our EXPLOSIVE TRADING seminar under the topic of "Tick Banking." See the front of this manual for contact information if you are interested in attending one of the 'TNT' seminars.

You should trade totally on what you see. While it may be enjoyable to keep up on the fundamentals, it is only the market's reaction to fundamental news that will affect you. Everything that is known and some things that are not generally known are reflected in the price action.

Don't base your trades on hope. You must isolate your trading from emotion. When you 'hope' the market will go your way, you will often violate basic trading rules.

You want to buy the strong market and sell the weak market, and never the other way around. If you "add," add new risk to a winning position and never to a losing position. You add to a winning position if you want to take a chance on winning more. You add to a losing position only if you want to lose more.

When you are not scalping and want to stay with a trade, trade only trends. There is really not any other kind of situation in which you can make more money.

Always trade from a definite plan and strategy. Decide upon a basic strategy and follow it. Don't let the ups and downs during the day upset your course of action. Stick with your plan. Formulate a basic strategy before the market opens, and then execute your decisions totally apart from the emotion of the current market. Never form an opinion, nor act on that opinion during a trading day. Trade only what you see.

The strongest moving equity is, of course, the one that will make you the most money quickly. This is also the kind of movement that makes most people say "it has already moved so far that I can't get in now". One advantage of getting into the strongest equities is that you don't have to judge which stock is going to be the fast mover — it has already been done for you.

The odds are that a strong bull market will be higher in a month.

You have low odds when you try to pick a bottom. Instead of trying to pick the bottom, use a tight stop.

The best thing you can do when you're right is NOTHING, except trail your stop and let your winner grow.

The trend in a stock comes when the market realizes that either supply or demand is suddenly out of line. This is the only type of situation in which a big profit can be made. When prices are congested, only small profits can be made because when the supply is equal to the demand, the prices move up and down slowly.

The strategy for a congestion is to take quick profits. The strategy in a trend is to add new risk and build your positions. If you want to risk less, use a larger increment between each addition. Although this will result in somewhat less profit than increasing in smaller increments, you will be more likely to ride out the dips.

Although you do raise your average price by pyramiding, you are adding to a situation that has shown you that you are right. You may also end up with a profit on many positions when you had only an initial risk on a few. Nevertheless, be extra careful about adding to a position.

Trade for the big move if you want to make the big money, but first make sure you have covered your costs. Personally, I would rather take regular small profits from a trade.

Take trading breaks. Get away from trading at regular intervals. This will give you a fresh outlook and a more objective view. Market factors will be seen in a better perspective. Trading every day without a break dulls your judgment and lessens your efficiency.

TRADING RULES AND OBSERVATIONS

Make money by sitting on your winners after you have covered costs. This rule goes against human nature, as many rules do. Remember you ***bend*** the rules. There is a saying, "rules are made to be broken," but do this with great care.

All too often we will take that quick small profit on a winner and sit and wait for a different losing trade to come back. The loser will then continue to lose as the one we got out of continues to make profits.

It is impossible to take a $5000 profit if you get out as soon as you have $500. This is why we enter a trade with at least a sufficient number of shares to break our position into thirds. You should drop your losers quickly and add to or sit on your winners. Bring your stops in close if a market just sits; in fact, it is usually better to get out.

Recently one of our students who is now a professional trader called. He said, "I finally understand! If the trade doesn't immediately go my way, I get out. I can absorb lots of small losses and commissions. The good trades take off and go my way immediately, and that's where I make my money!"

It's a bull or bear — don't trade for corrections. Don't decide a bull market is overbought because it has had two huge up days, sell out your long position, and get short to catch the dip.

Up is evidently the direction of least resistance. A bull market can go several days without correcting. A bull market doesn't turn in one day.

Buy strong up markets — not a downtrend or dip. Most people want to buy a dip because this makes them feel they are getting a bargain. Here's what makes sense — you have to get into a strong market by entering on breakouts or just before breakouts of the retracement highs. There are too many bidders trying to buy on any dip. A method to get into running markets is to jump in with a real close stop. You may get your stop hit a couple of times before you are on board, but once you're on board you can raise your stop regularly. You want to be in the strongest market, not the weakest. Another way is to jump in front of an advancing market using a tight stop. Of course, the opposite of the above is true for bear markets.

Don't try to catch the first and last cent. It is impractical to try to catch the first and last cent. You will get burned bottom picking when you try to catch the bottom tick. You have to wait for the market to tip its hand. That's why you study the minute details of a price chart, so you'll know when a market is tipping its hand.

No new high/low means the trend is changing. No new high/low for a certain length of time works well for picking trends. The length of time can vary. It seems that the time has to be long to qualify the bottom of a bear market in a stock, but as short as one week in a strong bull market. Four weeks is probably a good all around average.

Downtrends seem to last forever and have many false breakouts. Bull markets top quickly and Bear markets bottom slowly. A market that gives you a close stop down at new lows may have a 90% chance of making another leg down.

Use money management — especially trailing stops. Always use trailing stops. Always be prepared for the unexpected because it will happen. Protect yourself. Don't keep waiting for your losers to come back.

If you're not a daytrader, try to check market conditions several times a day.

Don't overtrade. You should diversify enough to lessen your risk. All your eggs in one basket is risky.

If you are going to use trend lines, use the 45 degree line off the high/low to determine the trend. The 45 degree line is the boundary between a bull market and a bear market. Use a sharper trend line as the move gains momentum. A bull market has only to break one steep trend line to be in question. A bear market may even break the 45 degree line and still be a downtrend.

It is not a correction when a dip comes after a very sharp run up. It is a new downtrend. Uptrends top quickly, but downtrends last. Bull markets often expend themselves.

Trade opposite a 90% majority opinion. By the time something gets in the news and the majority agrees, the move may be ready to reverse. Avoid following the crowd. If everyone seems to be going in one direction, look for a reason to go in the other direction. When most of the advisory services are going one way, get ready to take a sideline position or to take the opposite position. Consider a market to be overbought when 85% of the analysts are bullish, and oversold when 65% are bearish.

TRENDS

The trend is your friend! Follow it, but with the realization that it is not easy to do. Remember, too, the trend is your friend only 'til it ends.

Most trends go a lot further and last a lot longer than you expect.

When you are trading long term, realize that most trends last from two to six months. Trends are much easier to trade because you may have to have only one right decision. Adding on or using stops is the problem after you are riding a winner. Some few trends last for years, but they will have corrections every few months. The longer the trend, the more money you will make. The problem is in having a wide enough stop to keep you in the trend, but not so wide as to give back too much.

There is a lot to think about and consider in the things we've just written. Try to use wisdom in planning your trades, and to follow the rules in implementing your trading strategies and tactics.

At the end of this manual you will find additional wisdom that can be used in your trading. We didn't want to saturate you with it here, because there is so much to consider. Appendix A will give you more wisdom to ponder. It is a collection of wise sayings as applied to trading. Appendix B is a collection of wise sayings that will give you even more food for thought.

Unfortunately, most readers, in their eagerness to rush out to "make money," will give far too little consideration to the things we've included in this chapter, and the wisdom contained in the two appendices. That is sad, but true.

Chapter 18

PATIENCE

It is said that patience is a virtue. We will agree with that as long as it is patience that is well placed.

Being patient with a trade is not only for long term traders with deep pockets. In their case, it is not as much being patient as it is that they can afford to be right. They put their stop far enough away that it is highly unlikely it will be hit. In the case of scale traders, they actually are incrementally purchasing as the market goes against them.

For most traders, the only patience worth having comes before the trade is entered, not afterward.

You must learn to be patient about the entry to your trades. Be totally impatient with the exit.

When it comes to getting out of a trade, impatience is a virtue.

You must patiently screen and sift every trade before you enter it. Take only those trades that exactly meet your criteria — whatever those criteria are.

Be patient about filtering out all garbage trades.

If you are trading from indicators, take only the most clear cut signals.

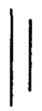
If you trade from chart formations, take only those that are most perfectly formed.

Carefully look to see that you are not trading into support or resistance. Be patient in taking the time to get proper perspective on the markets you trade.

There is a time and place for everything. There is a time to be impatient.

If you are long and a price bar ***fails*** to make a new high, or you are short and a price bar ***fails*** to make a new low, start getting impatient. If you are long and a price bar makes a new high, but also takes out the low of the previous price bar, or you are short and a price bar makes a new low, but also takes out the high of the previous price bar, light a short fuse under your patience.

If you are long or short and you see an inside bar, become impatient. An inside bar has a lower high and a higher low than the bar which preceded it and looks like this:



If you have been careful about planning, you normally won't have to rush your orders. Be careful to hit the right keys when ordering.

Planning is another area in which you need to have patience. Sure, it takes a lot of energy to plan, but you must patiently do it. It takes time to plan properly, and you need to patiently set aside the time to properly plan your trades. Get hold of your plan and stick to it. Be patient in seeing it through to fulfillment.

Chapter 19

PERSEVERANCE

Obviously, not every one can be a star trader. Yet the only way many can ever find out their potential is to persevere.

Some of the greatest trading stars have been people who have had a bulldog approach to trading. They have withstood the enormous financial strain and pressure of being net losers in the markets until they mastered their chosen profession. Along with staggering financial losses, they have stood up to the immense mental and emotional strain of losing, often over long periods of time. It would seem that for most, the only way to the top in trading is to persevere.

When starting out, the key ***is*** to persevere. We have seen too many traders with pent-up emotions about finally getting started. They take a trading class at a brokerage firm or a trading seminar, they paper trade for one or two weeks, they set up an account, and 'boom' they start pushing buttons. That's not the way to do it. The key is to try to stay in the game. Too many times these new traders lose their stop-loss money in less than a month. The ***good*** news is that, if they have a stop loss and adhere to it, the financial pain stops at that point. **[PLEASE SEE OUR CONTACT INFORMATION AT THE FRONT OF THE BOOK IF YOU ARE INTERESTED IN OUR TRADING SEMINARS.]**

Every time you get knocked down, get up and try again. ONLY THIS TIME, TRY TO HAVE LEARNED SOMETHING FROM THE LAST TIME YOU HIT THE FLOOR.

Most people think that the only real measure of success in the market is that of making money. In a way that is unfortunate. We think that someone who sees that trading is not his cup of tea, admits that to himself, and then goes on to other things is successful in the markets as well.

That may sound silly to you, but keep in mind that there are bunches of those kinds of people out there. For example, there are those who have given up trading to become researchers, brokers, provide chart services, write books about trading, offer legal services to traders, give them psychological help, teach courses in trading, offer training for certification, set up advisory services, write computer software, etc.

These people love the art of trading. They may or may not have succeeded as traders, but they have persevered, and thereby have found a niche for themselves in a field in which they enjoy working, and hopefully are able to help other traders.

And although it seem inconceivable at the moment, there are even one or two people in this world who have found fulfillment in fields that have absolutely nothing to do with markets or trading!

Chapter 20

HONESTY AND TRUTH

In the business of trading it is rather easy to fantasize. You picture yourself making the big trade.

You see an indicator that is seemingly miraculous in the way it works, or a chart pattern that "nobody has ever seen before", and you get all excited thinking about the money you can make with this newly discovered magic.

Pipe dreams, walking on clouds, and hitting home runs are traps that are easy to fall into when you trade.

Sometimes it is really hard to be honest and truthful, even with yourself.

When you are in a trade, you tend to see only what you want to see on the chart.

Want to have some fun? The next time you get into a trade, ask a small child what he or she sees on the chart. That is one way to get at the truth.

The sad reality of lying to yourself is that you will soon be broke and out of the markets.

How do you accomplish being truthful and honest with yourself when you are trading?

Listen to this voice of experience:

"I had that problem big-time. Here's what my problem was, and here's how I solved it. Just because I was trained properly and given the right mindset for trading doesn't mean that I could automatically carry out my training and not have bad habits. I still had to overcome my weaknesses and bad character traits.

"I would get into a trade, and subsequently the trade would go against me. When that happened, I would tell myself to give the trade a little more room. As the market continued to move against me, I would fantasize that surely the market would hold at the next logical point, which might have been a high or low, or prior resistance or support.

"Quite often, that is exactly what would happen. The market would move to my logical point, and then back off for a bit, thereby trimming my already sizable paper losses and giving me hope that, 'Surely now, the market will go my way.'

"After awhile, the market would resume its relentless search and destroy mission against me. I would then pick out the next logical point at which the market would surely stop. I would grit my teeth, and determine in my mind to stick with the trade until the trade finally went my way.

"I entertained all sorts of lying and dishonest thoughts. Worst of all, I rationalized them to the point of trading on hope.

"I took some mighty big hits in those days, hits I could hardly afford to take. Those big hits would completely demoralize me. I would be forced to get out of the markets and retreat to lick my wounds. I would go through all sorts of self-flagellation, only to return to the markets and do the same thing all over again.

"What do you do when you realize your problem, face it, determine not to make the same mistake again, and then turn right around and do it one more time?

"Here's how I solved it at first, and how my solution evolved into what I do now.

"I decided to make myself a three bar rule. If the trade didn't go my way by the time I saw three bars on the chart, I would get out. This was a hard and cruel rule to follow, but I stuck with it and began to cut my losses considerably.

"However, I got hit pretty hard at times if the market made a big run against me within the duration of the three bars.

"Although I hated to do it, I had to add another factor to my rule. I had to put an absolute limit on the amount of money I would risk on any trade. This caused me to develop what I call my "catastrophic" stop.

"When I added the catastrophic stop factor to my trading, my losses dropped again, and consequently my wins were greater in relation to my losses.

"Then I noticed that the penetration of a curve fitted, offset moving average made a good protective stop (see ELECTRONIC TRADING 'TNT' III — TECHNICAL TRADING STUFF.) Not only that, but it gave me a real number at which to set my stop. Another good thing was that it was a number that not everyone else would be using.

"Again this helped my dollar win to dollar loss ratio. I was on the right track, and as a byproduct of what I was doing, I was learning to be honest in my trading. I no longer had to lie to myself. I had contrived a mechanism for getting myself out before I got killed.

"Finally, once I began to think honestly and truthfully with myself about what was happening in the market, I came up with the method that I use today.

"I move my stop up, when I'm long, as soon as a price bar fails to make a new high. Conversely, I move my stop down, when I'm short, as soon as a price bar fails to make a new low."

There are many other ways to fantasize and be dishonest with yourself.

What lies are you telling yourself? Are you one who moves the trend line in order to convince yourself that the trend is still going your way? Are you one who keeps lifting his stop in order to give the market more room?

Perhaps you're one who, when the heat really turns up, walks away from the trade in the hopes that the next time you look, everything will be all right.

Whatever it is that you lie to yourself about, you need to confront it and come up with some way to get around it. You need a device or gimmick to cause you to break the bad habit.

Chapter 21

BUILDING CHARACTER

What is character? Can you tell me? You need it to trade. Without it you are a ripe for disaster, and believe me, the market will pick you apart if you don't have it.

Character is what? *Think*, what is character?

We'll tell you what it is — it's the development within yourself of everything that we've been writing about ever since we started putting you back together. Character pertains to your very makeup, the essential fiber of your being. It is your integrity, your honesty, your self-discipline, and, consequently, your self-control.

It has everything to do with your success as a trader.

Character is so important that you have to be persistent and diligent in developing it. There is no room for slop in your trading. The markets have enough slop in them without your adding to the pile.

Our main objective in this book has been to help you build the right character and have the correct mind set to be a successful trader.

We've raked many of you over the coals, but we've been careful to put you back together again. If you were angry or insulted when you read the sections about what you do wrong, then you need to examine your own level of maturity as a trader and as an individual. Hopefully, as you read certain of those sections, you were angry with yourself, not us. All we did was to point out the problems and state that if the shoe fits, wear it. It's up to you to change yourself.

Over the years, we have gone through the steps of self-flagellation needed to make us better (not perfect) traders. We, too, are still growing and learning. We have to do this consistently over the years. "Change", "modify", and "grow" are bywords of sound trading.

Now, we're going to give you a tool that was developed to help build the right kind of character for trading. Feel free to adapt it in any way you want, to conform to your own needs. It's called the Life Index.

THE LIFE INDEX

The Life Index is a tool you can use to help form the habits you want to acquire. It is the organization of a plan that will aid you IN CAPTURING your thoughts and bringing your actions under control. The Life Index is a simple concept that, if applied diligently, will serve as a navigational device to help you stay on course towards becoming a successful trader.

This is a deceptively powerful tool. We have had many students tell us that using the Life Index has had a positive impact on their trading as well as on other aspects of their lives. We strongly urge you to try using it in your life.

You may use the Life Index to monitor your daily life and to chart your progress as you work to stay on course with your plan. Feel free to make as many copies of it as you desire. It's OK to change its categories to fit your own situation. Add, subtract, rename categories as you see fit.

Now let's look at each question so you can understand how to keep score of each day and week, and how to chart your course.

Your answers will, of course, be subjective. Your honesty is crucial.

LIFE INDEX FOR WEEK ENDING ____________

Life Index — Trading		Mon.	Tue.	Wed.	Th.	Fri.
Trading Life:						
Planned trades today?	0-4					
Studied today?	0-4					
Meditated today?	0-5					
Trading goals met today?	0-5					
Business conduct today?	0-4					
Resisted bad habits today?	0-4					
Overcame bad habit today?	+5					
Today's trading life score?	Total					

Life Index — Physical		Mon.	Tue.	Wed.	Th.	Fri.
Physical Life:						
Diet under control today?	0-2					
Exercised today?	0-2					
Proper rest/recreation today?	0-2					
Business or work goals met today?	0-4					
Personal physical goals met today?	0-4					
Overall Physical Life today?	Total					

Life Index — Relational		Mon.	Tue.	Wed.	Th.	Fri.
Relational Life:						
Outgoing - served others today?	0-4					
Incoming - served by others today?	0-4					
Got along with others today?	0-2					
Overall relations today?	Total					

Life Index — Emotional		Mon.	Tue.	Wed.	Th.	Fri.
Emotional Life: (0 - not applicable, ± 1-3)						
Happy or pleasant day?	1-3					
Sad or unpleasant day?	1-3					
Peaceful or calm day?	1-3					
Anxious or Nervous day?	1-3					
Patient-longsuffering day?	1-3					
Frustrating-Impatient day?	1-3					
Overall emotional day?	Total					

LIFE INDEX RECAP FOR WEEK ENDING ___________

Overall Week:		Fri.
High score this week + Low score this week divided by 2 = Average Score this week to plot on bar chart.	Total	
Plot: Last weeks Close = this week's .... This weeks high score = ... This weeks low score = ... This weeks average score = ...	High Open Low Close	

USING THE LIFE INDEX

TRADING LIFE

PLANNED TRADES TODAY? Did you plan your trades today? If not, your score here is 0. Perhaps you meant to but didn't actually get there. Perhaps this was just one of those days.

Did you have a brief mental plan for your trading today? If so, score 1. If you abandoned it before the end, score 0. If you carried out your mental plan, you might want to give yourself a score of 2.

Did you perhaps plan, but not with great vehemence or drive. Score a 2. Be honest!

A score of 3 would be a very excellent planning session, without interruption, where you didn't get drowsy and you really got through with a complete plan for your trading.

A score of 4 should be reserved for those occasional great planning days carried out with great enthusiasm – the ones where you really do get with it and you come out of your planning sky-high and ready to do some serious trading, and then carry out your plan.

It's OK to change your plan. Changing your plan does not affect your score. However, you can't change your plan if you don't have one.

STUDIED TODAY? Well did you or didn't you? Rank your study session from 0-4. Zero means you didn't study and four means you had a real wing-ding session in which you realized a new (for you) truth.

Give yourself a 1 if you really gave your charts a good looking over, or read material about trading. Give yourself a 2 if you noticed a relationship between two or more things on your chart or in the material you read. A three means you learned something new and perhaps recorded it so that you can go back to it in the future.

MEDITATED TODAY? If you studied today, did you meditate on what you discovered? If not, give yourself a 0. Did you at least pause, apart from studying, to contemplate your study material? If so, give yourself a 1. You also get a 1 if you meditated about trading without having studied. If you really and deeply considered and pondered any aspect of your trading, or what you have seen on your charts, or in a book, give yourself a 3.

If, as a result of your deep meditation about your trading related material, a "light" went on, and you got excited or felt any other emotion about your new discovery or realization, give yourself a 4.

You can't meditate about what you studied today unless you actually studied. But if you did meditate at all, perhaps about past observations in trading, and as a result of your meditations you put into effect a new wrinkle in your trading – you took action based upon your meditation, then give yourself a 5.

TRADING GOALS MET TODAY? This one is a little harder. Not everyone really knows what it is to meet his goals. Entering a trade is not it. Scoring a home run is not it. By meeting your trading goals we mean you followed and executed your plan – win or lose.

If no goals were met, or you didn't have any goals, score 0.

Give yourself 1 point for each goal that was met, up to 5. If you met more goals than that, you have too many goals for a single day.

BUSINESS CONDUCT TODAY? How would you rate your overall attitude and businesslike conduct today? How well did you measure up to operating your trading as a business?

If Joe Ross or Mark Cherlin were looking over your shoulder, would they say that you were a good and faithful businessman today?

If you traded like a slob, give yourself a 0. If you at least had a mental stop in the market, give yourself a 1. If you wrote down the amount of true risk you had, score 2. If you diligently recorded all orders, stops, risks, and results, score 3. If you did everything required for a score of 3, and also kept track of your equity position, give yourself a 4.

RESISTED HABITS TODAY? Did you resist your bad trading habits today? Did you resist the temptation to stay in your trade a little longer? Did you resist your human nature? Did you resist the urge to overtrade? Did you resist lifting your stop? Did you start to tell yourself a little white lie and then resist and not do it? Did you resist anger, greed, or sloppiness today? How about your honesty today? Give yourself one point for each urge or temptation that you resisted up to 4. Virtually no one can resist 4 temptations in one day, so be truthful when you score 0-4.

OVERCAME HABITS TODAY? Did you finally overcome one of your bad trading habits today? The score here will be cumulative starting now. You cannot take credit for past overcoming. Overcoming is not something you do often. It can take years to overcome a bad trait. If you find that you have indeed overcome a bad habit or characteristic, you can give yourself 5 points. These 5 points will then become a permanent part of your score. Overcoming is the only way you can permanently raise your score. Should you backslide, then you decrease your cumulative overcoming score by 5 points.

OVERALL TRADING LIFE TODAY? Here you will total your score for the day. This total represents the overall trading aspect of your life for this one day.

However, life is not all trading and markets. We are still human beings. What happens to us physically, mentally, relationally, and emotionally has a definite impact on our trading life. It is often by improving the other aspects of our lives that we are able to improve the trading part of our lives.

PHYSICAL LIFE

DIET UNDER CONTROL TODAY? Did you eat properly today? Did you eat too much? Did you eat too little? Did you eat junk? Were you mindful of your nutritional health today? Was your diet balanced today? Did you eat too fast? Did you eat while you were under stress, angry, or emotionally upset? If you were out of control, score a 0. If you did a pretty good job, score a 1. If you really were in control of your diet, planned it, organized and directed it, and ate to stay fit, score a 2.

EXERCISED TODAY? Labor is not exercise so don't count it. Did you walk, jog, do calisthenics, rebound, dance, participate in a sport, ride a bike, or have an exercise workout today? If not, your score is 0. If you did exercise, score 1. If you had a great workout, score 2. To be fit for trading and the market wars, you need a sound mind in a sound body.

PROPER REST TODAY? Did you get enough sleep? Did you relax? What about recreation? All work and no play is not balanced. You need proper rest to function well. How can you trade if you're sleepy, tired, or irritable? How can you have a proper attitude if you are overworked and overtired? You can't! Score 0 if you failed at rest, relaxation, and recreation. Score 1 if you did a fair job. Score 2 if you really were able to let go.

BUSINESS OR WORK GOALS MET TODAY? Did you get much done at work? Did you have a successful day on the job? Were you efficient? If you got nothing done as far as work and business is concerned, score 0. This is not necessarily bad, maybe you were on vacation. If you are a full time professional trader, score here how profitably you ran your trading business today. Score 4 if this was a really great day on the job. Score anything in between according to the way it went at work today.

PERSONAL GOALS MET TODAY? How was your non-work related life? Is this the day you finally got your house painted? Did you cut a stroke off your golf score today? Did you complete your stamp collection today? Is this the day you lost the last pound of a 10 lb. weight loss program? What did you accomplish today? Score 0-4.

OVERALL PHYSICAL LIFE TODAY? Total your Physical Life score. It represents your overall physical life today.

RELATIONAL LIFE

OUTGOING – HELPED OR SERVED OTHERS TODAY? What went out from you today? Did you have outgoing concern for others? Did you help anyone today? Did you serve anyone today? Did you pray for anyone today? Score 0-4 according to your evaluation of the amount of service performed.

INCOMING – HELPED OR SERVED BY OTHERS? Did others serve you today? Nothing wrong with that, we have to learn to be gracious in allowing others to serve us. Did you thank them for their service? Did someone care for you or show you love today? Score 0-4 according to your evaluation of incoming love today.

GOT ALONG WITH OTHERS TODAY? Did you or did you not? Were you argumentative? Did you cooperate with others? Were you encouraging to others? Were you helpful and supportive? Did you make a new friend, or did you make an enemy? Were you courteous and polite. Were you considerate of another's feelings? What was your attitude towards others today? Score 0-2 according to how well you got along (including with your family).

OVERALL RELATION TO OTHERS TODAY? Total your score for your relational life today.

EMOTIONAL LIFE

In this section, score a zero for any description that doesn't apply. Enter a minus score of 0-3 for each description that does apply but is negative in nature. Enter a plus score of 0-3 for each description that applies and is positive in nature. The descriptions are self-explanatory.

OVERALL EMOTIONAL DAY. Total the score for your overall emotional day. Remember to subtract the negative numbers and add the positive numbers.

CHARTING YOUR LIFE INDEX

You are now ready to chart your life index. You can create a bar chart of your life and manage it just as you would any bar chart. Here's how to go about it.

OVERALL DAY. Sum all the Totals under each of the preceding categories: Trading Life, Physical Life, Relational Life, and Emotional Life. This is your Life Index for today. You can chart it on a piece of graph paper if you like, by placing a dot for each day on a chart which shows days on the horizontal axis and a scale of 5 - 65 (or number of your own choosing — depending upon the items you choose) on the vertical axis. The dots can then be connected to create a daily chart of your life.

If you have a computer with a spreadsheet or trading software, enter your Life Index for today in such a way that you can plot it on a graph.

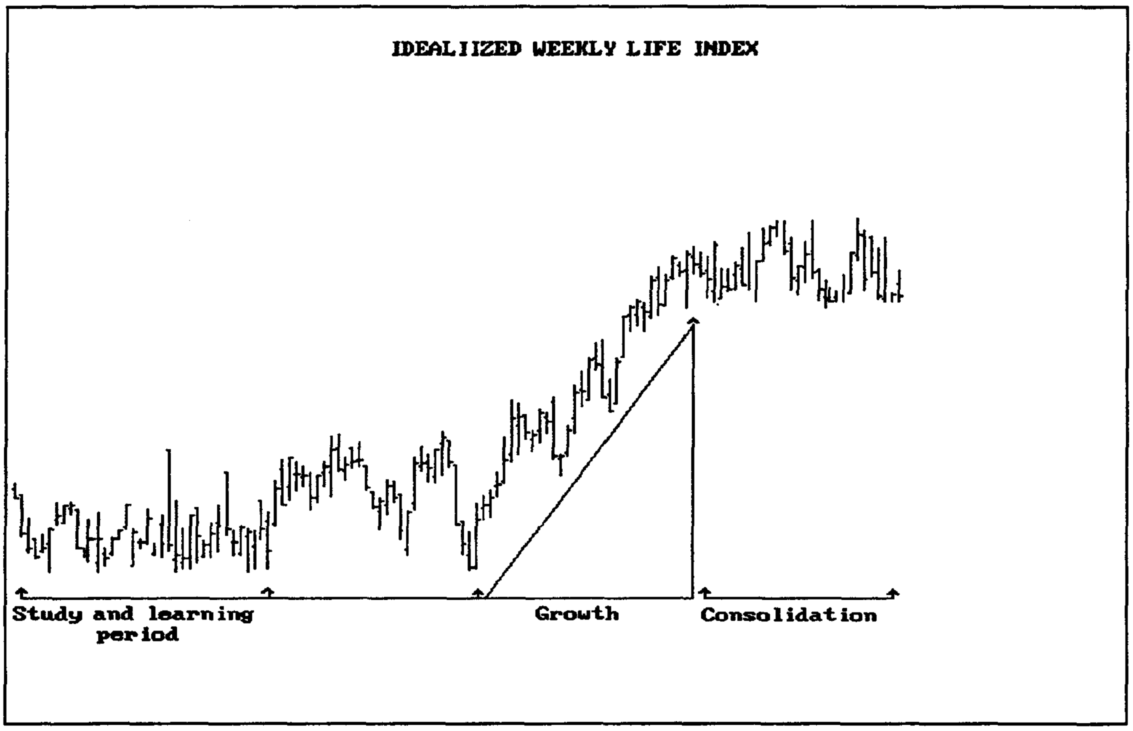
HIGH SCORE THIS WEEK. Enter your highest score for an OVERALL DAY this week.

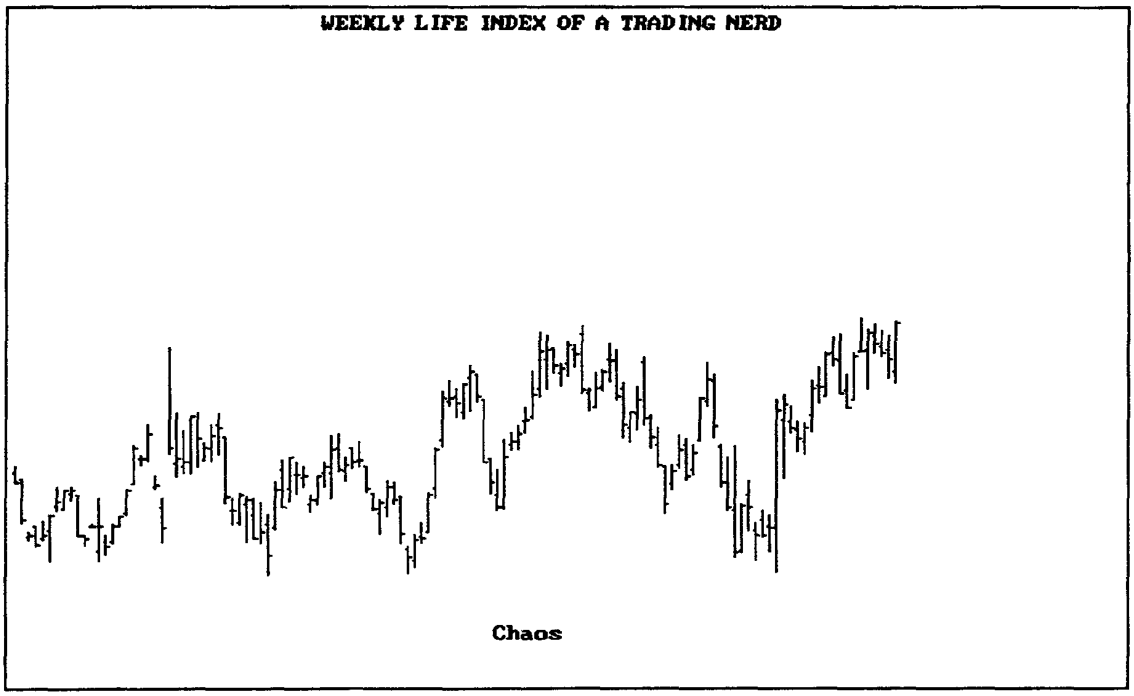
LOW SCORE THIS WEEK. Enter your lowest score for an OVERALL DAY this week.

AVERAGE SCORE THIS WEEK. Add your high score and your low score together. Now divide the total by 2. This is your average score this week. You can chart your score on a piece of graph paper by creating a bar chart. On this chart, the high for each bar is your high score for the week. The low is your low score for the week. The close is your average score for the week. If you start out the next week feeling high, then place your open higher than last week's close. If you start out the next week feeling low (rough weekend), then place your open lower than last week's close.

Once you have your bar chart, you can run all your regular studies to find out how you are doing. If you find yourself in a downtrend, stop trading and take a vacation. If you really want to get on top of your situation, you can plot a daily chart. We can tell you this: the more you think you don't need to keep a life index, the more you are apt to be the person who really needs to be doing it.

You can chart any aspect of your life that you feel is important to your trading. For example, you can chart your spiritual life if you have one. Some chart their sex life. You can chart your financial life. Any or all aspects of your life that impact your trading are possibilities for charting.





Chapter 22

MAKING PROFITS

This course is about making money as a trader.

This part of the course is the result of coming across an amazing piece of information. If you're paying attention you've seen it before: **ON ANY GIVEN TRADE IN THE MARKETS, EIGHTY PERCENT OF THE TRADERS WHO ENTER THE TRADE ENTER IT ON THE CORRECT SIDE. YET OVERALL, SOME EIGHTY-FIVE TO NINETY PERCENT OF TRADERS LOSE MONEY AS A RESULT OF TRADING.**

This simple reality is devastating. Initially we found it hard to believe. The revelation is shocking. You might ask, "How can this be? How can so many be correct in calling a trade and still not be able to lock in profits?"

In the earlier chapters of this volume we delved into the mental and psychological factors that cause people to fail as traders, and we tried to show how to overcome such factors. We tried to take you apart at the seams, and then offered a specific methodology for becoming a better trader by adjusting your individual personality.

We have sampled the writings of others in the field of trading. Without exception, they try in some way to reveal what they have been doing, or what might work in the markets. There are scads of books, articles, manuals, and courses — all of which are an attempt, genuine or not, to teach people how to trade.

However, in all our search for market "goodies", one thing stands out: There have been ***few***, if any, who teach others HOW TO MAKE MONEY <u>TRADING</u> IN THE MARKETS! If such a book, manual, or course exists, we have not personally come across it. If any one knows of one, we'd like to know what it is and where to find it.

Yes, you can find plenty of books on HOW TO INVEST, but try to find one on HOW TO MAKE MONEY TRADING! Even the ones who claim to show you how ***they*** made a fortune in the markets, in the final analysis, never do show ***you*** how to do it.

Some books have such illustrious titles and hold forth such promise that people rush forward to snap them up when they are published. Then follows the sad realization that comes from an unfulfilled expectation. All too many of these books turn into a case of breach of promise.

This is why we decided to teach to others what has been so profitable for us.

In this part of the course we're going to attempt to teach you how to make profits from your trading. Some of it you may have heard from others, but most of it you have never seen before, or at least you have never previously seen it put together in the way we present it here.

We've focused this volume of the course on business concepts because our purpose in it is to teach you what we know about the ***business*** of making money as a trader. We will show you how to make your trading profitable.

It is clear that just teaching others how to trade is not sufficient. Nor is it sufficient to teach you the proper mind set for trading. We also have to teach you how to make money. The three — trading, mind set, and making money — are all parts of a whole. You must be a good trader first and foremost. You must have a proper mind set. You must also be a good businessperson. They all go together — they are inseparable.

We believe that if you learn how to make money from your trading, you can make money in the markets whether or not you follow the methodology shown here. However, the content of this course will surely help. Since eighty percent of the traders are correct when they first enter a trade, it is not important to trade exactly as we do. It is more important that you trade in a way and with a methodology that is the most comfortable for you.

Obviously, for some, cyclical, seasonals oscillator, and moving average signals, etc., are sufficient to make a correct entry into a market. It's what happens after the entry that causes people to lose when they are trading.

Professional traders have contacted us and told us that the material you are about to read has substantially increased the bottom line profits of their trading — they are consistently making more money than they ever have before.

We have been told by some that otherwise losing mechanical systems have become profitable by incorporation of our management concepts.

Please pay close attention to the remainder of this volume. Its contents have been changing people's lives. To have had such a great impact on the lives of others is a great honor.

We're going to tell you something that most traders never learn. Most are long gone before they ever come to the knowledge of the truth we're about to reveal. If you can grasp what we're about to say, this part of the course alone will have been worth multiple thousands of times its price to you.

There are basically only two ways to make money when you are trading:

Taking profits quickly

Taking profits slowly

This must be some sort of joke, right? No, it isn't. And when we get done you will know the difference, and why each method works. You will also have enough information so you can make a choice as to which one to use. For most traders there is only one choice: Taking profits quickly. Since that is the case, we will start with that option.

TAKING PROFITS QUICKLY

Since eighty percent of traders are correct when they enter a trade, then for most this will be the solution.

Stop and think about it. Is it not true that, more often than not, when you enter a trade, the trade doesn't immediately go against you? If this is not true for you, then you need to study further so you will have the techniques needed to make that a true statement.

Once you are in a trade, if you have selected it carefully, you should almost certainly see a profit sometime after entering the trade. If this is not true for you most of the time, then you are not ready for this part of the book and what it has to teach. You need to go back to square one and learn how to select trades as shown in ELECTRONIC TRADING 'TNT' I — GORILLA TRADING STUFF AND ELECTRONIC TRADING 'TNT' III — TECHNICAL TRADING STUFF.

If your immediate costs are reasonable, $.50 per share profit on 200 shares is all you need to cover immediate expenses plus bring home a profit.

Assuming that commissions and exchange fees amount to $20 per side or $40 for the round turn, if you were to make .50 per share on a trade, you would have made more than double your immediate costs. *(Actually, $40, may be far too high a price to pay if you're an active daytrader and need no broker assistance. If you are paying that or more, you need to look closely at the purchasing function of your business. There are many brokers who will let you trade for $15 and less per side, but what you pay also depends on the electronic system you are using. It could be very well worth paying higher commissions to obtain a better electronic trading system.* ***(Please contact the numbers in the front of the book if you would like one of them to call you.)***

You can ask any successful business owner how often he makes multiple times his immediate costs on an item that he sells.

We're not talking about risk here. We're talking about a profit to cost ratio of no less than two-to one.

Let's use the good old widget example.

If a manufacturer can make 1000 widgets at an immediate cost of $.25 each, once they are made, he is immediately at risk for $250.

If he anticipates that he can sell them at $.625 each, then he anticipates making a profit of two-and-a-half to one over his immediate costs, provided that he can liquidate all of them at the anticipated price.

Now it may turn out that, as time passes, he has to liquidate some of them at a lesser price.

If there should suddenly become a scarcity of widgets, he may be able to liquidate some of his stock at $1.25 each, thereby gaining a profit ratio of five to one over immediate costs. In other words, sometimes the market will give the owner some windfall profits. We must have the same approach when trading.

Let's say we want to purchase some high tech shares, and that the shares are priced at $40. We buy 1,000 of them at $40 per share, placing a mental or physical stop loss at $39.50 per share . To keep things simple, we are essentially at risk for $500 (1,000 X $.50). Let's assume our commission per side is $20. $20 is our total immediate cost to do the trade. If we were forced to exit at $39.50, our risk/loss would be $540 ($500 + [$20x2]).

If share prices rise to 40.50, we have an unrealized paper profit of $500, exactly the amount we risked to purchase the shares, and almost equal to our entire risk/loss of $540. The trick is to take that price while we can get it. We liquidate 200 shares to cover our costs, while at the same time taking a small profit of $60.

At the point where we have a profit, it may be wise to eliminate further risk. To do that, we must move our exit point on the remaining shares to break-even — $40. We have a choice here. We can move the stop to $40, the price at which we first entered the market, or we can move the stop to perhaps $40.25 to lock in $220 of profits among all 1,000 shares. In other words, we are willing to discount the price of the remaining 800 shares in order to lock in a profit of $220. Let's see how we arrive at those figures.

If the remaining 800 shares are stopped out at $40.00, then our trade looks like this:

Profit on 200 shares	$100
Immediate costs on 1,000 shares (in)	-20
Immediate costs on 200 shares (out)	-20
800 shares sold at break-even	0
Immediate costs on 800 shares (out)	-20
Profit on trade net of immediate costs	40
Net profit to cost ratio = $40/$60 = .33::1	

If the remaining 800 shares are stopped out at $40.25, then our trade looks like this:

Profit on 200 shares	$100
Immediate costs on 1,000 shares (in)	-20
Immediate costs on 200 shares (out)	-20
Profit on 800 shares	200
Immediate costs on 800 shares (out)	-20
Profit on trade net of immediate costs	240
Net profit to cost ratio $240/$60 = 4::1	

A profit of four-to-one is certainly a respectable profit in any business. By moving our stop to take only .25 out of the market, we can more than triple our profit ratio. Moving that last stop is the equivalent of a merchant's lowering prices to clear out inventory. We were willing to take less, but we recovered all our costs plus a profit on all the merchandise we had to sell. How many business owners that you know make three to one profits over costs?

We know, we know, "What about the losses?" Well, we're going to come to that.

COMMISSIONS

If you're a very active trader, talk to your broker. He will usually give discounts to active traders. By active, we mean, in some cases 50+ trades a day, and in others 100+ trades a day. Trading firms have different discount schedules. Don't be afraid to ask.

Brokers live or die by commissions. Most of the daytrading firms are strictly transaction oriented. We've seen some very active daytraders pay only $12 per side. At 100 trades a day, compared with paying $20 per side, that's a savings of $800 per day, $4,000 a week, $16,000 a month, or $192,000 a year, so don't be bashful. If you are doing the business, try to get your costs down.

Let's remind you again: Electronic trading systems vary as to how they fit the temperament of different types of traders. It may well be worthwhile for you to pay $25 a side and still be getting a great bargain. Surely does represent a *big* change from a few years ago when you called your retail broker, asked him to buy you a thousand shares of IBM, and paid a $350 commission.

The above example will serve to point out the importance of commissions and costs. It is essential to keep immediate costs as low as possible.

Assuming a $15 total immediate cost basis, we have:

If the remaining 800 shares are stopped out at $40.00, the trade looks like this:

Profit on 200 shares	$100
Immediate costs on 1,000 shares (in)	-15
Immediate costs on 200 shares (out)	-15
800 shares sold at breakeven	0
Immediate costs on 800 shares (out)	-15
Profit on trade net of immediate costs	55
Net profit to cost ratio $55/$45 = 1.2::1	

If the remaining 800 shares are stopped out at $40.25, our trade looks like this:

Profit on 200 shares	$100
Immediate costs on 1,000 shares (in)	-15
Immediate costs on 200 shares (out)	-15
Profit on 800 shares	200
Immediate costs on 800 shares (out)	-15
Profit on trade net of immediate costs	255
Net profit to cost ratio $255/$45 = 5.67::1	

Yeah, Yeah, we know, "But what about the losses?" Hey, let's glory in this for awhile. We're going to come to the losses, but not just yet. Remember, if we are daytrading, we may do this numerous times a day."

We mentioned earlier that sometimes the merchant is handed some windfall profits. Well, that happens in trading, too. Sometimes the windfall profits are mediocre and sometimes they are fantastic. Let's explain.

MEDIOCRE WINDFALL PROFITS

When we move our exit point on the remaining shares to break-even, about 40% of the time it will not be hit. That's right! Prices will not correct far enough to take out the break-even stop. In that case, we can follow any number of strategies. Here's one:

As soon as we see another .25 in the trade, we take profits on all remaining shares. Using our previous example, in the first instance, completing all profit taking only .25 higher, the trade looks like this:

Profit on 200 shares	$100
Immediate costs on 1,000 shares (in)	-15
Immediate costs on 200 shares (out)	-15
Profit on remaining 800 shares	600
Immediate costs on 800 shares (out)	-15
Profit on trade net of immediate costs	685
Net profit to cost ratio $655/45 = 14.55::1	

FANTASTIC WINDFALL PROFITS

About twenty percent of the time, even when we move our exit point to a price at which we are protecting fifty percent of our unrealized paper profits, the market will never look back. It will then give us some really fat profits. The market will let us have our home run. We can trail our stop by whatever method we choose, and eventually get out with multiples of what we would normally expect to make on a trade. Those trades will serve to hike our profit to cost ratio to a very high level.

"Wow, boss, it looks like we've got the Holy Grail here!"
Nope! Here comes the bad news! There ***are*** losses to contend with.

"Oh shucks!"

Just as the merchant can't always sell all his widgets at a profit, we can't always sell some or any of our shares at a profit. Sometimes we have to take a loss.

It can happen in a couple of different ways. Sometimes the merchant has to mark down his widgets almost immediately, they just won't sell at the price he wants. In that event, he marks down his price and unloads, hoping to at least make back his costs.

The same thing happens to us when we get into a trade and it doesn't immediately go anywhere. The market may fill our order, move up a few ticks, and then either sit there or even start to go against us. If the market gives us a chance, and if we are quick enough, we can liquidate our position with a small profit.

Those small profits will bring down our beautiful profit to cost ratio, but our trading business will still be profitable. We may have to take only .25 out of the market, or just break even. But we will be alive and well and ready to try again at a later time.

Notice how we're sneaking up on the losses.

LOSSES

Since we don't all trade alike, it's going to be rather difficult to tell you what to expect in the way of losses. We can only relate the way it works for us.

By ***very careful*** trade selection, we enter markets that quickly move our way the majority of the time. We have shown how to select such trades in ELECTRONIC TRADING 'TNT' I — GORILLA TRADING STUFF and ELECTRONIC TRADING 'TNT' III TECHNICAL TRADING STUFF.

Let's say you are a sixty-five percent trader. That's not out of line with the facts. Remember? Eighty percent of the traders are on the correct side of a trade upon entry.

That means you are going to have to lose thirty-five percent of the time. The trick here is to lose as little as possible. As soon as you suspect that anything is wrong with the trade, you must exit. You cannot hesitate, you must get out now!

A good way to do this is to exit as soon as three bars on your chart have not gone anywhere. Another way (a favorite) is, if you're long, get anxious as soon as one completed bar fails to make a higher high or if it fails to make a higher low, and begin your exit if it makes a lower low. When you're short, get anxious as soon as one completed bar fails to make a lower low or if it fails to make a lower high, and begin your exit if it makes a higher high. You miss an awful lot of good trades that way. You will often get out too soon, but you have something to show for your efforts, usually avoiding losses.

If you must take a loss, keep it as small as possible.

Your exit point, once you are in a trade, is at a level where you will not risk more than your comfort level will allow per trade. However, the comfort level of each of us varies.

That is the secret of taking profits quickly. You must refuse to lose. You must have that mind set. *I will not lose, I refuse to lose.* That will cause you to get out quickly before you do lose. You will grab the profits while they are there, before they disappear. You will realize that it is a combination of a series of varying size wins, coupled with not losing, that allows you to take home the profits.

Now some of you are going to say, "I'll do exactly the same thing."

If you think that, or say it to yourself, you are as blind as a bat. There is a lot more to consider about placing stops.

What we have said above about exit points are generalizations. If prices are moving very fast or are very volatile, we may become very cautious. In fact, we may not trade it at all.

You must take into account the volatility of a market when you want to enter it. Since you are trading electronically, you can see for yourself how prices are ticking. Are they ticking minimally? Fine, go ahead and enter the market with your comfortable exit point . It will probably be safe.

Are you a position trader? Then you may need to use a much larger stop. You still need to discover whether you are entering your trade in a fast market. You still need to discover if the market is volatile. You still need to check out the tick size. You still need to look at the bid/ask spread. You still need to check liquidity.

Now that you know it's okay to check market movement and volatility before you enter a trade (look before you leap), you had better take into consideration a couple of other things.

How fast are you at entering orders? Are you fast on your feet? Are you a slow thinking plodder? Have you worked out your trading plan so that you know ahead of time where you will locate your exit points?

The speed at which you are able to enter orders has a lot to do with where you place your stops.

If you are a daytrader and you are a bit hesitant about placing orders, you might need to widen your stop. You may also need wider stops if you are trading from the Internet with a slow turnaround and risk the chance that what you are seeing is not truly concurrent with market action.

Anything that takes time when you are trading should cause you to move your stop further away from the price action.

There are also costs to consider. How much in commissions and fees are you paying? Before you decide on a risk figure, don't forget to add in the cost of commissions.

Do yourself a favor – read and reread this chapter. Get it down cold. If you cannot see how to do this, then you will probably never win in the markets. For most of you, this is the only way you can trade and make money.

Looking back over what we've said, can you see that your mindset has been all wrong? Can you see that your expectations have been all wrong when it comes to risk versus cost? Can you see that you should take profits quickly? Can you see that exit point determination has at least something to do with time and costs?

Yes, you have heard of the big profits to be made in trading. You have heard about making large percentages of profit on your money, but you didn't know how to go about it. Now you know!

You have thought that to make those kinds of profits, you had to make a big score on every trade. The way you have been trading has made that true. You have learned a lot of inane things about where to place your stops, and consequently you have taken big losses. That meant you had to try to hit a bases loaded home run every time you entered a trade. Now you know that it doesn't have to be that way at all. Not when you know "How to Win."

At the beginning of this chapter, we said that there are only two ways to make money trading. Maybe at that point you thought we were crazy. Perhaps now you are not so sure. Well, here is the second way to make money trading. It is not for everyone. There will be only a few of you who can do this, because it requires deeper pockets and lots of patience.

Chapter 23

TAKING PROFITS SLOWLY

We've shown you how to take profits quickly. Now see how to take profits slowly. Believe it or not, it's not a whole lot different from taking them quickly.

First, you have to have the correct perspective. You have to have the right expectations.

To take profits slowly implies holding a position longer than what we've shown under the heading of taking profits quickly. However, as you will soon see, that may be an illusion.

Typically, the long term trader makes a few, at times only one or two, big hits per year.

How is that done? Here's how you do it as a good business person. We suspect it will be a revelation to many of you. You've wanted those big long term profits, but you just haven't known how to go about it. As we said, it's not a whole lot different from taking profits quickly.

Let's say that you have entered a 1,000 share short position at $40.00 per share.

You place a protective stop $.50 above the price action. If you are not daytrading from a terminal, you now instruct your broker to liquidate two hundred of those shares at $39.50 per share. Just because we are making a long term trade is no reason to ignore the basic fact that we must cover costs and pocket something for our efforts.

At a rate of $20.00 per side for commissions, if profits on two hundred shares are taken there, we will have made $100 less costs of $40.00, for a small profit of $60.00 on the two hundred shares.

Our risk before costs on our remaining shares is $1.00 per share. It is comprised of the difference between $40.00 and $39.50 plus the $.50 unrealized paper profits.

Many times our stop will be hit, and we will have nothing to show for our trouble on the remaining shares. Sometimes, when the trade has gone our way for awhile, we will be able to move our stop up to a profitable position and we will get stopped out there. Occasionally, prices will take off and never look back. Our trailing stop may keep us in the trade for days or weeks, depending upon where we decide to keep it. Once, twice, maybe more times a year, we will earn a huge profit on our remaining 800 shares.

In what we said above, we have not taken into consideration adding shares at logical entry points of an established trend. These add-on shares may yield additional profits. However, there is a caution that should be kept in mind: each time we add them we will incur additional risk — risk that could conceivably wipe out existing profits already earned.

Now, it is true that when we entered our order, we were at risk for $500 plus $40.00 in costs. However, if trade selection is correct, the tide of public participation should carry the momentum in the trade forward in the intended direction. Such is the nature of breakouts.

The point is this: If we have correctly selected the trade to take advantage of thrust, our protective stop will rarely be hit. If the trade doesn't go our way quickly, we want out before our protective stop is hit. Or if the trade goes our way a few ticks, and then turns back, we want out. The extent to which we can do this will, of course, depend upon the electronic trading facility we are using.

By now, you should know how to make money trading. We've shown you a simple method for doing that. We've shown you a method that works. It works for us, and it is working for our students.

TOO DEEP POCKETS

When we first thought about presenting this concept, we thought of entitling it "Trading Like a Doctor." The reason we considered that is that the only people we could think of who have deep pockets and lots of patients, are doctors. But then we remembered that most of the doctors we know, while they have lots of patients, don't always have lots of patience. It's the patients who have to have the patience, especially when they go to see doctors.

On second thought, this seems to be true of dentists as well. They have fairly deep pockets and lots of patients who have to have patience when they go to see them.

But, if we entitled this concept as we had originally thought, that would have left out the lawyers we know. Lawyers don't have any patients, they have clients. They usually don't have much in the way of patience either, except when they are suing doctors on behalf of the doctors' patients. Then they patiently await the fat rewards that come from these actions.

It is then that the doctors have to have patience while they await the result of the lawsuit that was brought by the no longer patient patient.

If you are any other kinds of traders with deep pockets, then we hope you have been patient with us as we have plowed through this discourse on patience.

If you are a trader ***without*** deep pockets and have patiently read through this piece of fluff and have lost your patience reading about patients and patience, then for you relief is in sight. There will be something of interest here for you.

Taking profits very slowly is the flip side of taking profits quickly. We know there are some traders, long term traders, who do it. We know that it is done by placing exit points at tremendous distances from the price action, or by not placing them at all.

It takes a lot of money to trade that way. The concept is, if you have deep enough pockets, sooner or later, most of the time, you will be right. These traders can afford that kind of luxury.

They know that if they can hang on long enough they will eventually make back all their paper losses and then take home some big profits.

They can afford to take a position and then ride out all the corrections, staying with the long term trend. Since they can afford this type of position trading, all they need to have, besides a good method and plan, is the patience to wait out the trade until prices move their way. It is difficult to distinguish this type of trading from investing, other than that the mind set and approach is that of a trader. Long term traders are not looking for dividends per se. They are not concerned with a company's financial, marketing, or profit information. They are trading based on what they see on a chart, and perhaps information gleaned from various technical indicators.

This is not to say that these traders are not astute. They have their methods and ways of identifying intermediate and long term trends, and they go in and often make big killings in the market.

They have their own trade, risk, and money management techniques which ensure that they will make money most of the time, and that their wins will far outweigh their losses.

When they are wrong, they lose a bundle. But because they are willing to risk much, they gain much. **WARNING: THIS IS NOT FOR NEW TRADERS TO TRY AND CAN BE A VERY RISKY PROPOSITION.**

DOLLAR AVERAGE TRADING

There is one other deep pocket technique that is supposed to make money for traders. This one is supposed to render it difficult to lose money if you stick with it. It is a way of trading, but it is much more a way of managing risk and money. It has little to do with chart analysis as such.

The proponents of this method do not trade stocks in the sense that trading is presented in this course. What they do is to dollar average down as prices, apart from stock splits, fall within their lowest quartile of the past 5-10 years. The only position they ever take is long. They are never short.

Contrary to the statement of its proponents, it's possible to lose heavily using this method.

There are times when you have so many losing open share positions that there is no profitable way to hold them all and still take advantage of new opportunities.

Trading involves the concept of buying and selling in order to realize unlimited potential profits. With the averaging down method, also known as scale trading, there is a complete denial of the ability to realize unlimited profits. Profits must be taken at fixed intervals along the way or you nullify the entire money management scheme. Proponents of scale trading argue that there is no other practical way to win at trading. That's only because they have never done it.

In essence, dollar average trading is a way to attempt to come out ahead using a variation of one of the oldest gambling system techniques known to man.

Some proponents claim high percentage returns. The method actually turns what would be trading stocks into an investment in equities.

We've talked with some who have used this method. They claim that the return over a period of time is between twenty and thirty percent. They also tell of the nerve grinding patience they have to maintain as they watch share prices go against them for months, even years at a time. All that time, money placed in the market on their earlier entries is tied up, with only dividends as a return, provided a company whose share prices have been hit that hard is still paying dividends. If the company goes out of business, which happens too often, they have to abandon the trade and take their losses.

The system does give them tiny wins here and there that help keep up their courage and enthusiasm. But one heavy loss can wipe out much of the smaller profits they've made.

One man we know scale traded IBM all the way down from $156 to the $47 per share. Finally, he could no longer stand the pain of having to constantly add margin to his account. Of course, soon after he abandoned his position, IBM began to move up. Our acquaintance no longer had sufficient margin to enjoy the rising prices.

That's a scary story, but we believe that if you have the guts, the patience, and the bucks, scale trading is one way to get a return in the markets. Personally, we'd much rather invest in an index fund. That way you let the market do all the work. In the long run, the returns are reasonable, and you don't have to take any margin calls.

The trader who is going to win in the markets must take his profits quickly or slowly, steadily, and in amounts not influenced by greed or the "betting" instinct.

Chapter 24

FLEXIBILITY

The markets are forever changing. They change in ways that are not immediately apparent to most traders, but that are reflective of world-wide economic and political swings as well as rule changes by the exchanges. This is going to be difficult to explain, so stay with us while we make the effort.

The changes with which we are most concerned have to do with changes in the behavior of the insiders.

The insiders, predominately the market makers or specialists are, by necessity, the most nimble of all traders. They adjust their strategies and tactics quickly. Those who don't, quickly fail. Often they end up going upstairs as brokers or in some other capacity, if they stay in the business at all. Read the following paraphrased text from The Soes Bandit's Guide, by Harvey I. Houtkin.

When I first started to utilize electronic trading back in 1988, it was fairly easy to spot trends, enter quickly and exit profitably. Only myself and a few traders represented the entire 'ELECTRONIC TRADING' community, market makers' minimum electronic trading exposure (the amount of shares any individual market maker had to honor) was 5,000 shares. There was no short sale rule or any other restrictive regulations, and competition between electronic traders was virtually nil. Today things have changed and it is generally more difficult to electronically trade now than in 1988.

At the urging of the major market making firms, the NASD has passed numerous discriminatory rules and regulations in an attempt to eliminate the electronic traders from the marketplace....

...Market makers have become much more experienced in dealing with electronic traders. At first market makers very often overreacted to a flurry of buy and sell orders from the electronic traders. Now market makers realize that the actions of electronic traders are overall net neutral to the marketplace; electronic traders buy and sell virtually the same numbers of shares daily and the net activity should not move the markets. This realization has created many more "wiggles and jiggles" in the intraday price movement of electronically traded stocks. For example, when several electronic traders decide to buy APPLE at a certain point in time, several market makers might move up their quotations as they each sold a small quantity of shares.

Other market makers moved their price quotation just because they saw other market makers moving, without even making a print (trade at their quoted level). Market makers have begun to realize that when electronic traders come in to buy shares, it is only a matter of time (usually only a very short period) until they will be offering to sell back those very same shares. Therefore, now we see that several more astute market makers are starting to 'fade the trend' (selling into the electronic buyers) and then downticking the stock, causing traders to panic and sell out. This type of action creates what I call "wiggles and jiggles." Stocks go up (or down) a small amount, stop and reverse — sometimes several times a day. This type of action drives an electronic trader nuts. Because electronic traders must overcome the spread and expenses (commissions), wiggles and jiggles cost them dearly and have the greatest negative influence on profitability.

Since it is almost impossible to know for sure whether a perceived move is "real" and/or the beginning of a significant trend or just a jiggle, the electronic trader must act on his/her best judgment and hope for the best. If you get "jiggled" out, so be it. Persistency and discipline must always be maintained. There will be days when you get wiggled and jiggled like crazy, but that is a reality and a cost of doing business. On balance this reality, if handled with good business sense, can be kept under control and does not deter the successful electronic trader. The overall advantages of electronic trading significantly outweigh the difficulties created by the wiggles and jiggles.

"Headfakes" are a problem similar to wiggles and jiggles. Whereas wiggles and jiggles are created by routine market maker actions that have come about through their increasing experience in dealing with electronic traders, "headfakes" seem to be more deliberate. "Headfakes" are movements by a market maker or market makers (sometimes in concert) designed to create an illusion to induce market participants and the electronic trading community to take an action (i.e.. buy or sell). For example, if a market maker wants to create selling (they are really a buyer), they will try to give the illusion of weakness by having a few of their market making 'friends' initiate a downtick at about the same time. This gives an 'illusion' of weakness and there is a good chance several electronic traders will be induced to sell shares into this staged decline. After the selling is completed these conspiring market makers will quickly reverse the trend and "catch" the electronic traders. Often head faking occurs around lunchtime. Lunch hour headfakes appear to be a game created to amuse market makers during a time of day when very little activity may be occurring in the markets. Of course, market makers vehemently deny that they conspire to fix quotes or spreads, but most observers who follow these markets know better...

Headfakes can be costly, but once again, just as in the wiggles and jiggles scenario, they are part of the business and overall do not have to be a significant negative in your electronic trading career.

To lessen the effects of wiggles, jiggles and headfakes, most electronic traders try to trade only stocks that are very active with a relatively large float and capitalization. "Active large cap" stocks, are much more difficult to wiggle and jiggle. They trade so actively and there is so much institutional interest that it is very difficult for a market maker to move them around or create any false illusions.

The insiders react quickly to trading tactics. They can see where orders are bunched. They are also aware of who is placing the orders and the buying or selling power held by large commercial interests who are actively trading .

When trading is thin, they are often able to run stops in the market. A market can be thin when there are too few traders participating, or when there are too few orders coming across the network. Usually these occur at the same time, but not necessarily so. There can be too few traders participating for some reason or other, but a lot of orders coming in over the network. Usually this is when the only players around are big. Occasionally, the reverse is true. There can be lots of small players in the market, but because they are the only ones there, the volume of shares traded is light.

If a preponderance of traders are taking very quick profits, it can and does cause an adjustment by the insiders.

Actions, strategies, and techniques by daytraders and daily traders will cause the insiders to adjust their trading. This has happened in the past and is still going on.

A couple of examples of this should suffice.

When position traders, in droves, began to trade the crossing of moving averages, the insiders glommed onto that fact and positioned themselves just ahead of the crossover. Their entry into the market made the event a reality. By being positioned ahead of the crossover, when everyone else entered into the market, the insiders were able to liquidate their positions at a profit, thereby fading the position traders. Then, unless the fundamentals of the market sustained the move, the position traders who were last to get out were left holding the bag.

The same thing has happened with the advent of various popular oscillators, indicators, and other technical studies. Knowingly or otherwise, the insiders pick up on the bunching of orders and stops that are caused by the followers of such indicators.

We have personally known insiders who positioned themselves in such a way as to fade Stochastics traders. They kept track of the most popular Stochastic intervals, and automatically took positions ahead of overbought or oversold, knowing that those sheep who blindly follow such technical indicators would be ripe for the shearing.

The same thing is regularly done by fading the signals given by RSI, Percent R, Momentum, and a whole host of other popular studies.

Some insiders are even now beginning to watch the Bollinger bands, to see ways to fade those readings. Others watch Fibonacci numbers so that they can suck in those who trade from those numbers. The magic of the fifty percent rule has been all but ruined as the insiders will as often as not drive prices far beyond the fifty percent or even the sixty-two percent marker.

One way to beat them at that game is to either completely avoid the use of technical indicators, or learn to use the most popular to your advantage much as the insiders do. Another way to do it is to use logical combinations of these indicators that measure the markets from several different aspects, perhaps even from different time frames.

What all of this means is that, while certain market phenomena such as breakouts will always be true, the insiders will often bring about false breakouts. They do this by gunning for order accumulations.

They can see the orders bunched at the breakout point. They are trying to make their profit on the distance that prices travel from the support point to the breakout point. That is how they scalp the market. Sometimes their entry is just enough to drive prices one or two ticks past the breakout point, and then their selling, if no additional buying comes in, causes prices to retreat and move away from the breakout.

This is where flexibility comes into play. We must be flexible in our trading reactions and in our planning to allow for such eventualities. We must be prepared to exit a market quickly if it doesn't almost immediately go our way.

We must realize that markets are living, breathing, dynamic entities. They have changed in the past, are changing right now, and will continue to change in the future. Therefore, our trading methods, techniques, and style must accommodate such changes.

Too many get hung up on technical trading systems and methods. You find out that something works, and you are ecstatic. We've seen some tremendously creative and imaginative concoctions coming out of those wonderful brains that some of you possess. But then you somehow think that what you are doing will continue to work on and on, forever.

Well, it just isn't so. Sooner or later, the markets adjust to virtually every flea-flicking phenomenon that in and of itself, as you are doing it, becomes part and parcel with the market. Your actions are as much a part of the market as are the actions of anyone else.

Remember, when your order is filled in the market, it ***is*** the market.

Chapter 25

MANAGEMENT

In order for any business to function, it must have proper management. Management consists of five functions: Planning, organizing, delegating, directing, and controlling. Some add communicating, but as we see it, communicating is a part of directing, delegating, and controlling. Have you ever thought of your trading in this manner?

PLANNING

You should have a detailed plan of how you are going to trade. The plan should include your entry order, where you will put your protective stop, what your objective is, the strategy for this trade, the tactics for this trade, and any other detail that might be pertinent to this trade.

If this started out as a daytrade, under what circumstances would you allow all or part of your position to be carried overnight? That information needs to be thought out ahead of time and strictly adhered to.

Until you become totally organized in your planning, it's a good idea to write down the details of your plan.

Plan for contingencies. What will you do if your computer crashes or you cannot reach your broker by telephone during the course of a trade? What if your phone is out of order, or worse, his is out of order, or the Internet is out of order ?

ORGANIZING

You need to organize your trades and your trading. What does your organization look like? Do you use a computer to enter your own trades in a daytrading office? Do you trade over the Internet? Do you call in your trades? Does your secretary call in your trades? Does your mate call in your trades?

Who answers the phone when your fill is returned to you? If it is someone other than yourself, what procedures have you organized to ensure that you get the message in a timely manner?

Do you have more than one account? Which account gets this trade? Do you have more than one broker? Your brokers are a part of your trading organization.

If your computer goes down or you lose your Internet connection, can you get out of a trade? If your broker's phone is out, can you get your other broker to give you a courtesy (give up) trade should you need to get out of a trade in a hurry? Have you discussed this possibility with your brokers?

Who receives your trading statements? Can you find them when you need them? Who keeps track of your trades? You do keep some form of a trading log, don't you? Can you find it if you need it?

What about the accounting for your trades? Do you have an accountant? Does that accountant also do your taxes? In either case, accountant(s) are part of your organization.

Even the most private trader has some kind of organization.

DELEGATING

When you signed your new account agreements with your brokerage firm, you delegated to that brokerage firm the authority of placing your orders with the floor. If you also signed a discretionary agreement with a trader or broker, then you have delegated the authority to place some or all of your trades according to their discretion.

If your mate or secretary calls in your trades for you, then you have delegated to that person the authority to call the broker, who in turn has the authority to place the trades with the trading desk on the floor.

You have delegated authority to anyone who performs any service for you in connection with your trading.

You can delegate authority, but you can never delegate responsibility. You, as the supreme authority over your account, are responsible for whatever happens to it. You can't blame anyone else. The buck always stops with you. Therefore, you must be extremely careful as to whom you delegate the authority to do anything at all with your account, your statements, or your record keeping. **YOU AND YOU ALONE ARE ULTIMATELY RESPONSIBLE EVEN IF YOUR COMPUTER CRASHES, YOUR CONNECTION TO THE INTERNET GOES DOWN, OR YOUR TRADING SOFTWARE HAS A PROBLEM. AS WITH ANY TYPE OF TRADING, WITH ELECTRONIC TRADING THE RESPONSIBILITY IS YOURS, ALL YOURS, WHETHER OR NOT THIS SEEMS FAIR.**

DIRECTING

Directing is instructing those to whom you have delegated authority as to how you want things done.

If you tell your secretary to place your fills in your "In" basket, then you have directed your secretary as to what to do with your fills.

If you tell your accountant to hang on to your statements, then you have directed your accountant as to what to do with your statements.

If you tell your broker(s) you don't want to hear any of his dadburned opinions, then you have directed your broker(s) to keep his opinions to himself.

However, the most important aspect of directing is learning to give the proper orders for putting into effect your strategies. This will be covered in greater detail in the next chapter.

CONTROLLING

Controlling is the process of exacting back accountability from those to whom you have delegated authority.

You cannot ever delegate responsibility, even though others talk about doing it. There is no such thing. But you can hold accountable anyone to whom you have delegated authority. They are accountable for their actions.

If your broker forgets to place your order, you can hold the broker accountable for that.

If your broker places an order for which you gave no authority, you can hold the broker accountable for that.

You can hold anyone accountable for failing to carry out the orders that have been directed to that person, as long as you gave that person the authority to carry them out.

When dealing with computers and electronic trading, if an order doesn't go in or cannot be canceled, it presents a situation which you will have to accept. The worst thing you can do is to sit there and continue pressing keys. Be extremely careful! If you enter an order over and over, by pushing the buy or sell key while trading on a live terminal, you could be buying or selling thousands of shares of stock even though you don't mean to do so. Guess what? You will be accountable for them! Interestingly, the odds are that you will lose money on the position. For some strange reason, most errors will go against you.

So far, we have talked about managing primarily as it relates to people. However, there is more to management than that. You also have to manage your trades, your risk, and your money. They are three distinct and different things. We will go into each briefly.

TRADE MANAGEMENT

Managing your trades has to do with the mechanics of trading from the inception of the trade to its culmination.

Have you ever thought about how a trade begins? Did the idea of it begin with a rumor, an opinion, or a tip? Did the trade have its inception from your study of the market? How is it that you conceived this trade? Was it something you saw on a five minute chart, an hourly chart, a daily or weekly chart? Was it because one moving average crossed another (Heaven forbid!). Did prices penetrate a moving average? Did an oscillator become overbought or oversold?

You need to have an organized set of rules for selecting a trade. Then you need to usually stick firmly to that set of rules. Trade selection is a part of trade management. You definitely need a business plan.

Another part of trade management is ordering. Do you thoroughly understand the different types of orders? Do you know when and where to use them? Do you know which exchanges will take which orders? Do you write out each order in advance when possible, so you can review them at the end of the day? These are "must do" items.

Record keeping, especially keeping track of every trade, is also a must, and is part of trade management. You must record the time and date of each order We didn't say your broker must do this, we said you must do it. Some electronic trading software will do this for you, but we still think it's a good idea to do it for yourself.

You should tape record every order you make, as well as writing it down on a work sheet when you use a broker. That way you have as good evidence as anyone of what was said to whom by whom, should you need to contest a fill. You time stamp your taped orders, by mentioning the time as you give the ordering instructions. You might say, "12345, recording YY0601, buying 1,000 shares of ABC, at..." Where 12345 is my account number and YY is the year. Make sure to synchronize your clock with your broker's clock so that there can be no question of the time stamp. That way you have a legal backup recording of you orders.

You must also record the other side of the conversation. Make sure your broker's response is recorded on the tape. Record every call you receive from your broker as well as every call you make to your broker.

Listen to each conversation in order to proof it as soon as possible after the conversation is made.

You must maintain a written record of every open order. If you don't, and think you're going home flat, it could be disastrous. You may be still holding a stock position. If the company for which you are holding the stock comes in with an up or down earnings surprise, or a news announcement adverse to your position, this could be the end of your trading career. If using a broker, you must know if your broker keeps these orders.

At the end of the month, you must always check your written records against the statement you receive from the brokerage firm. Make sure you are flat. Don't rely on the computer. Check your hand written record, and use the computer as a backup. This is extremely important. We can't tell you how many times we've seen traders forget they were in a position and when they find out, they get upset at the trading firm or trading software. The ultimate responsibility is yours. The hard way to learn this lesson is finding out that the equity in your account is $10,000 less that you thought. Fighting your broker about a trade that you forgot was in your account, is futile. If there is any question at all about your account, get it straightened out quickly.

RISK MANAGEMENT

Entire books have been written about risk management. Many of the best are derived from those who write about gambling. While they are very interesting to read, they tend to be oriented towards mechanical systems.

This is all fine if that is the way you trade. If you choose to be a mechanical systems trader, then all they have to say applies to you. In our opinion, trading a system in the stock markets is for the most part no different from using a system to bet the horses, or to play the blackjack table, or even to play the Lotto.

Let's face it, in the U.S.A. we have become a nation of gamblers. Everyone is looking for a way to get rich quick.

We have lost, or are losing, the work ethic. More and more people think that the system owes them something (we wonder where they got that idea?). For some, it is easier and more profitable to be on the dole than it is to work.

All you have to do is to walk into any food store where they sell lottery tickets to see what many of those on welfare are doing with your hard earned tax money.

Far too many of you enter the world of trading with the same mind set. You are looking for easy money, often a way to get rich quick. That is why you lose, lose, lose. You've never figured out that trading is a business or "How to Win Trading."

However, the next best thing to running your trading as a business is to operate it as a gambling system. Systems players can and do make money in the markets. What you are doing there is removing the business acumen from trading.

All you have to do is to find a system that consistently gives a certain percentage of wins over losses, and then build a money management system around the known risk. If this is for you, then you are not a trader, you are a gambler. You should be reading books about gambling, odds, and probabilities.

In that event, our personal opinion is you can do a lot better with the horses than you can do with mechanical trading systems. Joe's nephew, Clark Gary, makes his living at the track, and has done so since he was fifteen. He has written a book with a little help from Joe, called the Track Attack ($89 from Ross Trading). In it he shows a system that can yield as high as eighty-three percent wins. That is better than any mechanical trading system we've ever heard about. Besides, at the track, you don't start out in the hole by having to pay commissions and fees.

In the book, Clark discusses odds and probabilities in a way that makes them usable. His system has worked for decades, and what he shows is totally applicable to trading with any system, even a system for trading stocks.

All you need to know about risk in trading equities has already been shown in this book. The problem has been that you have not really understood what risk is, or what amount of risk you truly have had on any given trade.

You've read that stock traders can make over 100% on their money. That means you have to make big bucks on this trade. Hey, be real! That's a hard thing to do. But those are exactly the kinds of things that go on in your mind. You have these loosely put together notions of what you expect from a trade. Then you rush into the market and take a bath.

As we've said numerous times throughout this book, your expectations are all wrong. Or, since you take so many baths in the market, maybe we should say your expectations are all wet.

One of the most inane things we ever heard was from a very famous investment advisor, who said that unless he could see ten times the margin he was putting up, he wouldn't even enter a trade in the markets.

This guy must have been some kind of magician. We have never entered a trade where we could see we were going to make ten times the margin we put up. Have you ever been able to do it? If you have, please tell us what it is we're missing.

When you see sufficient unrealized profit in a trade, you should lock in at least half of that by moving your stop ahead. That is no guarantee you will get even half, but at least you will have done the right thing.

Do you <u>finally</u> understand risk? Repeat after us: "Apart from slippage, I'm at risk only for the amount of money I'm willing to lose in the markets, that includes any unrealized profits I'm willing to give up. Furthermore, I understand I do not need to make the big score on any one trade, but that the big scores will come to me as a free gift of the market on an occasional basis."

MONEY MANAGEMENT

Essentially what you really need to know about managing money when trading equities is to avoid over-commitment and under-commitment.

Over-commitment can occur in a couple of ways.

When you get a margin call, you have obviously over-committed. The reasons are lack of self-discipline and/or not understanding risk, unless you purposely over committed and know that you are able to cover the margin call the next day.

Most over-commitment derives from greed. You get into too many positions at one time. You are afraid that a trade might get away from you (heaven forbid you should miss a trade).

Sometimes over-commitment comes from putting on too big a position for the amount of money you have in your margin account.

The result of over-commitment is that you are spread too thin. You lose your staying power. You simply do not have enough money to do all of the trades you have done.

This includes having too many orders in the market. We've seen traders with very small accounts who have tried to place ten or twelve orders in the market, in the hopes that some of them would be filled.

There is a flip side to over-commitment, and that is under-commitment. Because you never before have really understood risk, you don't put on enough shares when you enter a trade.

Most of the time, with proper trade selection, the market will go your way and not take out your stop. As soon as you see an acceptable unrealized profit in the trade, go ahead and cash part of your position. That, friend, is good money management. Simultaneously, move the stop on your remaining shares to break-even. Now you have reduced your risk. If you're trading a small account, you should definitely take profits on most of your position early in the trade, and then think pretty hard about taking profits on the entire position until you have built up your account to where you can let a portion ride.

If you can't make it managing your money the way we've just said, then there is something wrong with your trade selection and you need to read ELECTRONIC TRADING 'TNT' I — GORILLA TRADING STUFF so that you can find out how to make proper trade selections.

BUSINESS MANAGEMENT

There are many decisions you must make as a trader which generally have little to do with personal, risk, money, or trade management. We like to lump these together under the category of business management. It has to do with the environment in which you choose to work and the tools with which you work. For instance, what will your trading environment be like? Will you trade in a trading office with other daytraders, from home, over the Internet, or Intranet? This is a business decision. What hardware will you purchase, which software will you use? Will you use a chart service? Will you download data? If so, will it be end-of-day, delayed, or "live?"

Will you maintain a cellular phone as a back up to your regular phone? How many phone lines will you have? There are many more business decisions we could include here: What will your trading library contain (We *mean besides books by Joe Ross and Mark Cherlin*)? Will you subscribe to any trading magazines? Which markets will you trade?

Hopefully by now you get the point. These decisions are a part of management and most likely you as chief trader of your trading organization, will be making most or all of them.

Chapter 26

TECHNICAL ANALYSIS

You are already in possession of one particular piece of knowledge that is germane to the point we want to make, and that is that eighty percent of traders are on the right side of a trade when going in.

Throughout much of this book, we've tried to show you some of the reasons that ninety percent or more of you lose money, even though you enter a trade from the correct side, going in the right direction.

TECHNICAL INDICATORS

In this chapter we want to address the fallacies and weaknesses of technical analysis when done exclusively through the use of indicators. Perhaps we can pull a number of points together so you can see the big picture.

Did you know that some of the market makers and operators actually keep an eye on technical indicators in order to fade the technical trader? It's somewhat like what the gambling houses do with system players. They love them, because they know that eventually they will get all their money — they are willing to fade the system player. There are some traders who operate on the same principle — they love you because they know they are going to take you to the cleaners. The question is, if you have knowledge of that fact, why would you still walk into their trap?

Many traders in the market today are using technical analysis. Most traders in the market today are losing money — over ninety percent of them lose. Knowing that, why would you want to do what the rest of them are doing? Why would you want to follow along with all the rest of the technical analysis sheep who are going to be fleeced?

Knowing that the market makers respond to most of the details in the market, why would you want to trade with technical tools whose purpose is to smooth away the very detail that makes a market what it is?

We know you've been told to use these gimmicks because they smooth out the ripples. We know that you cannot react to every undulation of the market as do the market makers. But you must still be aware of what is going on in the market. You must pay attention to those details.

The only case we can make for consistent and exclusive use of technical indicators is if you have very deep pockets and want to trade long term, or you are a mechanical system player, who, as we've pointed out earlier, could do much better at the track than at trading stocks.

If you want to trade a mechanical system, then you have made trading into gambling. The stock markets are not the best place to operate as a system player, although some claim they do it successfully.

There are correct ways to use technical indicators. But that is a subject that is beyond the scope of this book. IF YOU ARE INTERESTED IN LEARNING MORE ABOUT TECHNICAL ANALYSIS USING INDICATORS, SEE ELECTRONIC TRADING 'TNT' III — TECHNICAL TRADING STUFF.

We have done in depth experimentation with technical indicators and have personally traded that way exclusively many times, and with excellent results. We did it using a method of looking at indicators in a totally different way.

Chapter 27

THE REAL PROBLEM IN THE MARKET

The real problem in the market is ***you***. That's right! ***You*** are the only problem in the market that can be solved, and then, for some people, only with the greatest of personal dedication and effort.

We'll explain what we mean on the following pages. Your realization of what we are going to reveal to you will change your entire approach to markets.

Markets are not a problem to be solved. Yet, most traders and would-be traders try mightily to solve this alleged problem. They strive desperately to come up with a method, technique, or formula that will produce winning trades. They combine everything and anything possible into systems, as though there were some virtue in systematic trading that will overcome what they perceive as the problem of trading markets.

There is nothing wrong with being systematic. There is nothing wrong with developing systems that will win in the markets, even if it only wins in a single market. These are noble pursuits. However, there is not a single system or method that has ever been developed or will ever be developed that can solve the problem that is presented by trading markets.

We can prove that to you, and it will forever change your perception of the markets and enable you to concentrate on the only ***thing*** you can do to become a winner. Whether you do that ***thing*** methodically, systematically, or haphazardly may affect the degree of success you can have, but is of no consequence to the truth we're about to show you.

Picture, if you will, a puppet on strings. Can that puppet maneuver about, reach up and grab the control bar, and manipulate itself? No, it is subject to an environment apart from anything it can control. Such is the situation of the trader.

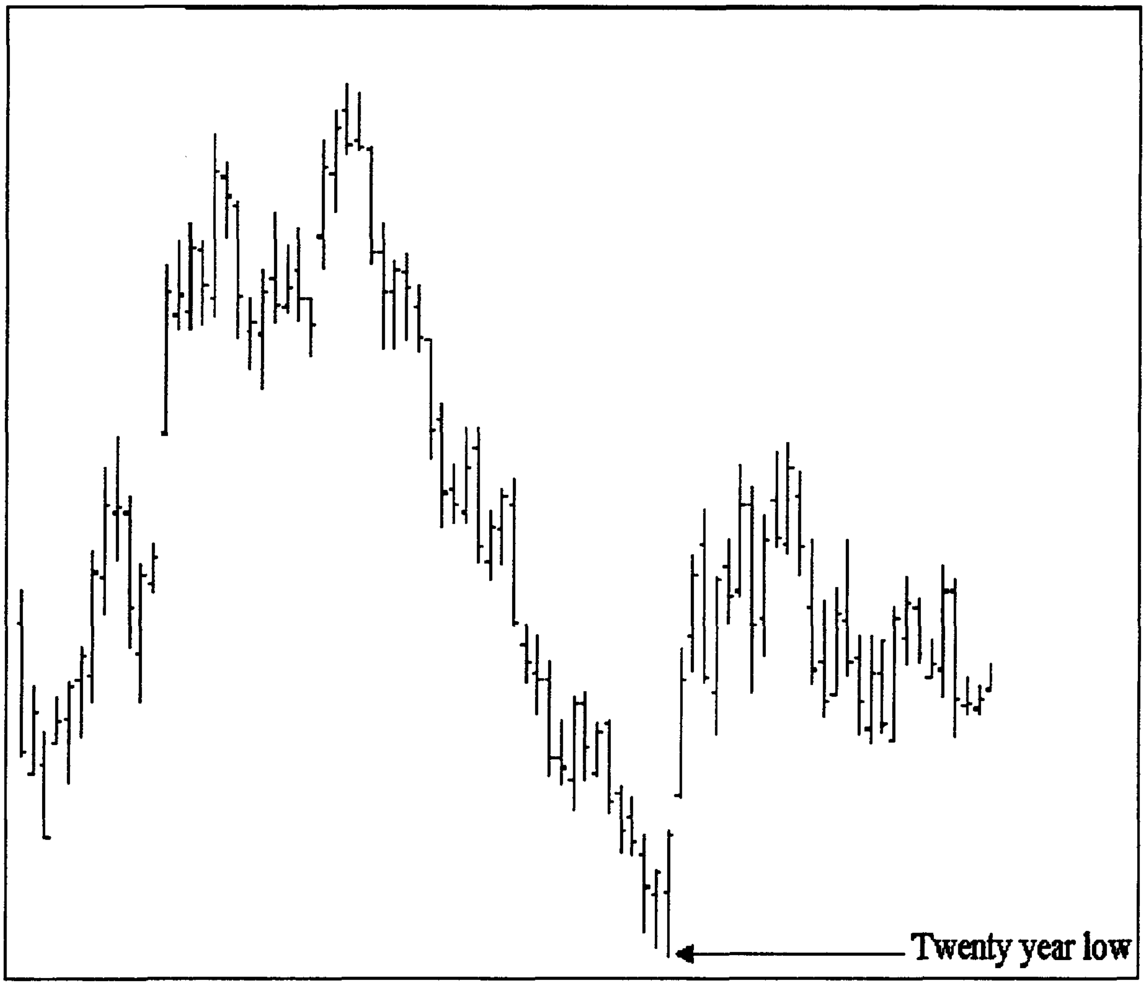
A trader is subject to an environment apart from anything he can control. The trader, by his very action, becomes a part of the market. When he is part of the market, he cannot solve the problem of the market. He ***is*** the market.

The trader's participation in the market makes him part and parcel with the market. Therefore, the trader is his own problem. The market is not a problem when the trader stands aside. It only become a problem when he enters into the market with a trade.

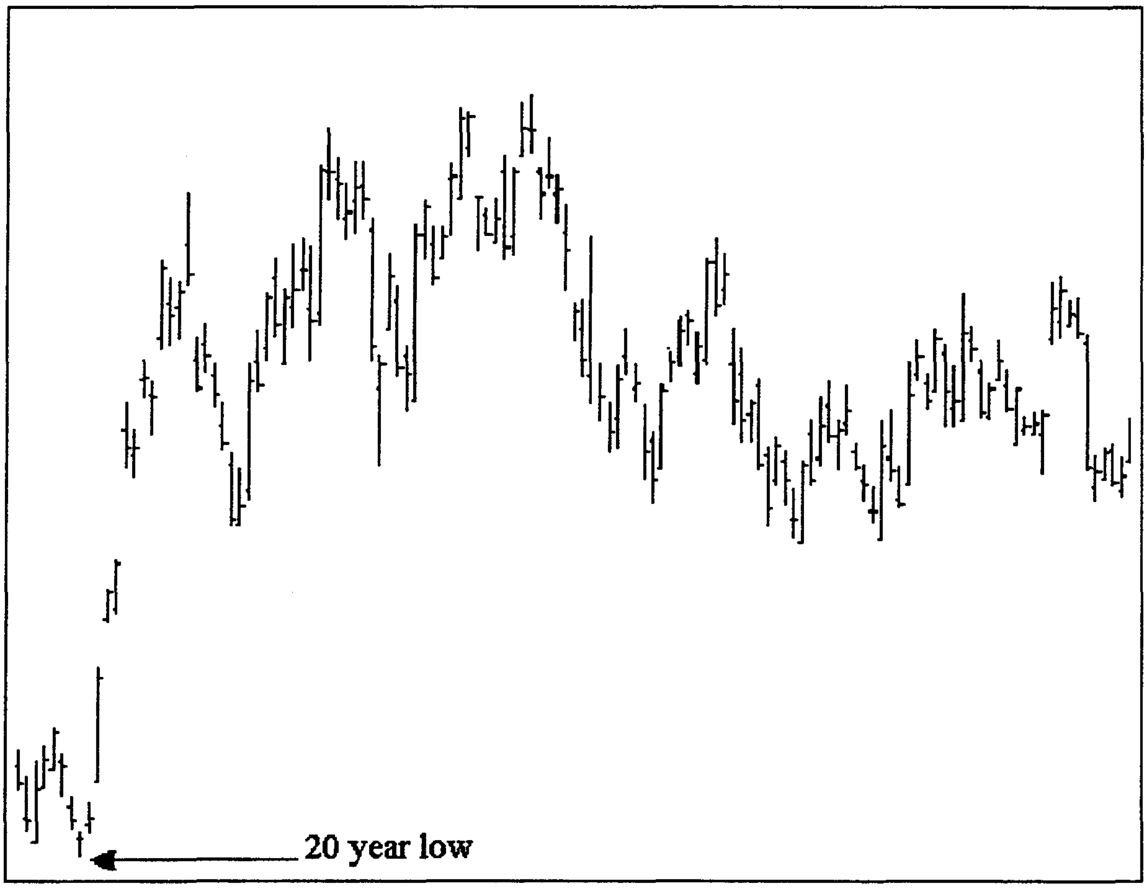
Now when we say "trader," we don't mean someone who is big enough to come into a market and manipulate and maneuver it, and make it move in a desired direction. Such an entity fits our definition of a market mover, not of a trader. The thinner a market is, the more easily it can be manipulated by a market mover.

But normally, when you think of a trader you do not think of a market mover. A trader is an integral part of the market. The trader becomes integrated into the market at the precise moment his order is entered. The trader's order(s) is what makes markets move. His bid/ask causes the market to move towards him. Collectively, the market moves towards a price where most of the orders exist. Let's illustrate this for you with a real event from the experience of someone we know. The monthly chart below shows a 20 year low.

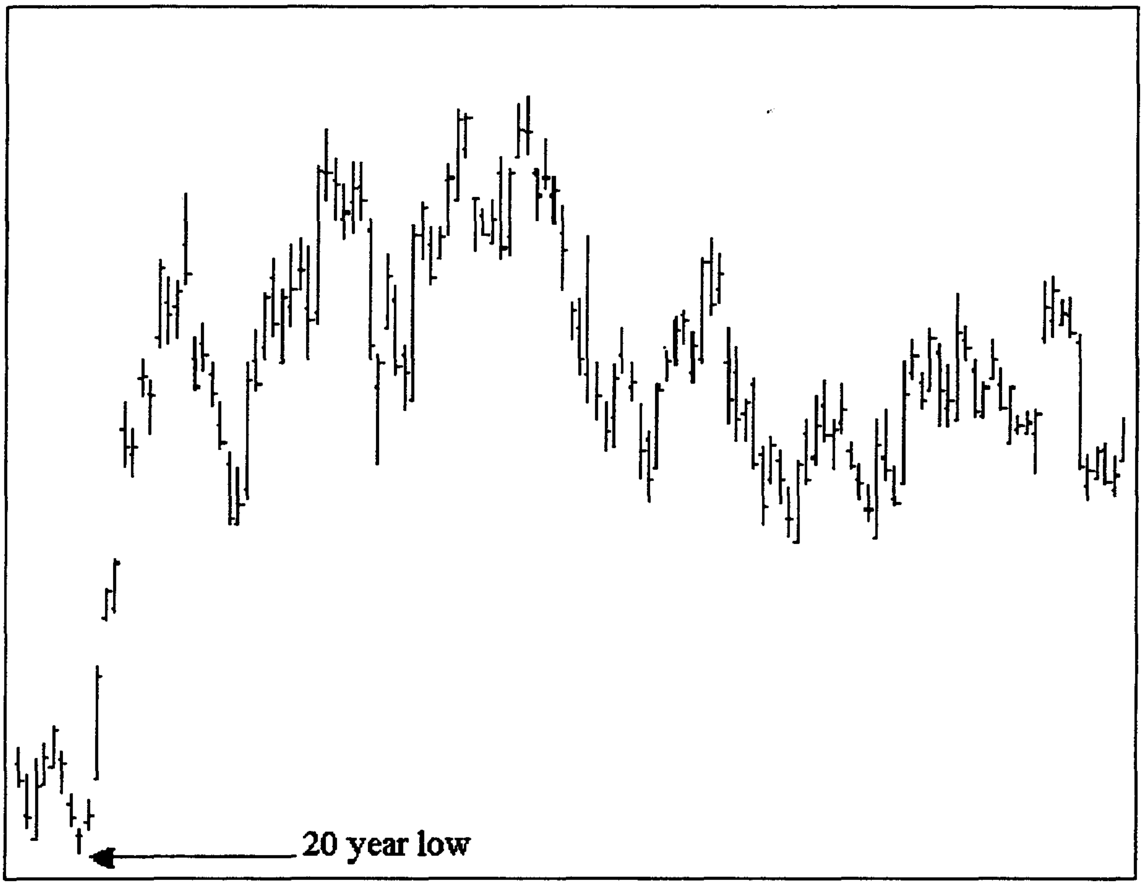
Now, look at the same low on this weekly chart.



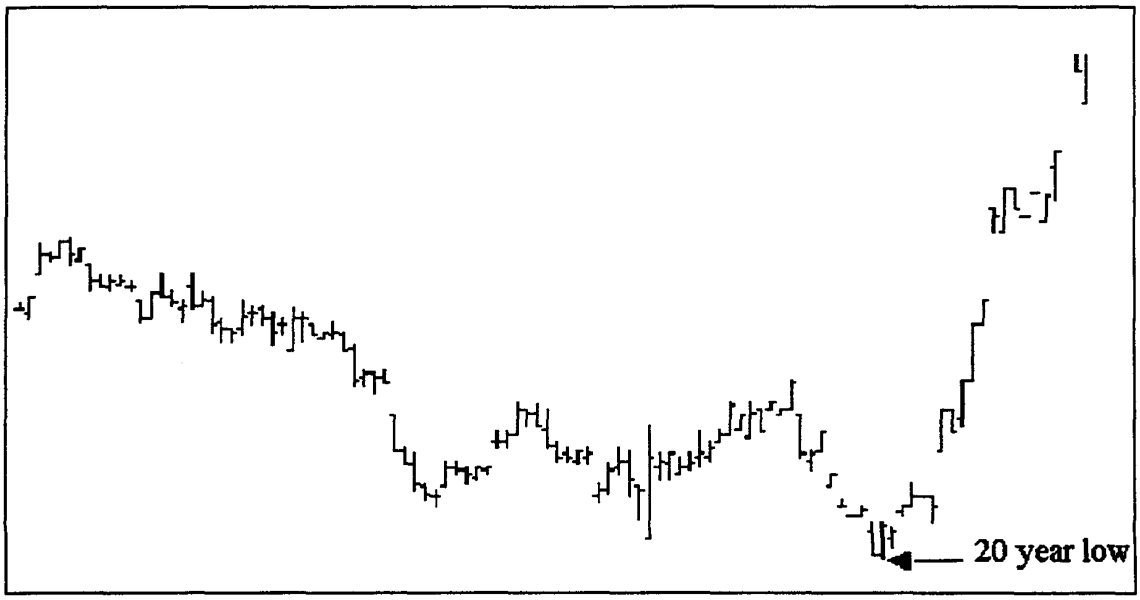
Here it is again on the daily charts.



Here it is again on the daily charts.



One last time, here it is on a 60 minute chart.



We've shown you a twenty year low on monthly, weekly, daily, and hourly charts. Why? Because the person we know is the owner of that low. There may be others who sold short at that low, but his order of significant size certainly helped provide the bait that caused that price to be filled. He may never know if he was the only one with a sell order at that price, but he will always wonder whether or not that low would have ever been made without his order being there.

Yet the trader was properly short the market that day by virtue of the method he was using. That trade came at the end of a series of trades in which he caught the trend most of the way down.

So you see, the problem was the trader, not the market, and not the method. It was he who placed the trade. When his trade went into the market, it made a low that may become the lowest low for many, many years.

The market is not a problem to be solved, yet the approach of most is to treat it as such. More than that, our educational system teaches us that there are certain ways to solve problems. We are taught three methods, but there exists a fourth. The first method is to simply exit the environment in which the problem exists. When you give up the idea of making your fortune as a trader, and cease all trading, you are free of trying to "solve the problem of the markets."

The second method for solving problems is to change the environment. Let's say you are locked in a room with a poisonous beetle, and a spray can of insecticide. Because you are locked in the room, you cannot exit the environment and solve your problem that way. However, you can change the environment. You can grab the insecticide spray can and change the environment by making it poisonous for the beetle.

Now, let's say you grab the insecticide can and find it is out of propellant. There is still a solution for the problem and it is the third method — you can become part of the solution. You can crush the beetle by grabbing the empty can and smashing it. It's a bit messier, but you will have solved the problem.

But markets do not lend themselves to the way we were taught to solve problems. As a trader, you are not big enough to change the environment in the manner that a market mover can. And you are certainly not big enough to "crush" the market with your presence.

If you quit trading, the markets are no longer a problem and you can go your merry way and not be a trader. But, if you didn't want to be a trader, you wouldn't be taking this course. So what can you do?

Learning what we're going to tell you now should be one of the greatest lessons you've ever learned in trading. It may be the single greatest concept that ever materializes as reality in your mind.

When you begin to realize that you can't beat the market, that you can't solve what you might perceive as the single biggest obstacle you've ever had to overcome, you may begin to understand what action you have to take in order to do well as a trader.

Understanding that you can't change the markets should lead you to the only possible solution available. ***You have to change yourself!*** You can't change the environment, You can't change the market, you can't be a part of the solution. All you can change is yourself. You can never be a part of the solution, because you are a part of the problem. You have to change your behavior relative to the market. You have to learn to enter a market and stay with that market as long as possible.

It is similar to being a rodeo cowboy. It is like riding a Brahman bull. Once you get on that bull and they open the gate for that bull to enter the ring, you have to stay on for eight seconds. If you can do that, you may win.

In the markets, you have to stay in long enough to cover costs. If you can do that, you may win. But until you at least cover costs, you have no chance of winning.

Trading becomes a contest of trying to time your entries in such a way that you can get in rhythm with a market for at least a period of time sufficient to cover costs. But then, unlike the Brahman rider, the longer you could stay on, the more points you can make. Every trade, then, starts out as a short term trade. Stay in the market and ride that market long enough to cover costs. After that, whatever the market is willing to give, you gratefully accept. It means that sometimes the ride is only minutes long. At other times the ride can last for months — not because of any great talent or skill of your own, nor because you have managed to tame that market — because you have caught the market rhythm by being in the right place at the right time, and the market has allowed you to go along for the ride when it collectively decided to set out on a longer journey than usual.

That's how your trading life can be. Listen to these words from a professional trader:

"In all the years I've traded I've caught exactly three large moves in the market. I learned to make my living from the everyday trading that takes place. I quit looking for the ***big*** move. Too often, they are few and far between.

"I had to change my behavior so I could run a profitable trading business in the environment of what ***normally*** takes place in the markets.

"With the realization of this great truth, the entire picture changed. The market was no longer something I had to overcome. I had only to overcome myself. The market was not the enemy, the enemy was my lack of discipline. In a comic strip I once read, Pogo said, 'We have seen the enemy, and it's us.' I believe that with all my heart. The market was my friend. It was the environment in which I had chosen to earn my livelihood. All I had to do was to cooperate. I learned to bide my time and wait for my opportunities. I learned to find those situations which suited my temperament, my pocketbook, and my trading style. That's when I did my best. I constantly checked my physical status to make sure I was trading when at my best. I learned to trade when I was right and the market was right. We both had to be right for each other. When we were, the money came. When we weren't, I learned to get out in a hurry. Getting out in a hurry kept my losses small. Staying in as long as possible whenever I could kept my winnings large in proportion to my losses."

The only solution to trading markets is to change yourself. You cannot solve the problem of the markets any more than a puppet can manipulate its own strings. The sooner you realize this truth, the sooner you will succeed as a trader. When you win, it will not be because of some brilliant thing you did. It will not be attributable to your superior mind or intellect, or your great ability as a trader. Instead, it will be because you have learned the greatest lesson any trader could ever learn — you will have learned to discipline yourself. You will have changed your attitude and your behavior relative to the markets. You will have at last become a trader.

Chapter 28

SOME EXCELLENT TRADING RULES

As part of a structured trading approach, it is especially good to have a series of general rules which can be employed as a memory help during the course of trading.

These rules should be simple enough to be easily and quickly read without losing track of what is happening in a busy market. They must be applicable both generally and specifically. The stock market is drowning in worse than useless platitudes like "sell in May and go away." These are fine for bar room lounge lizards, or financial journalists. They will simply not wash as part of a structured trading approach in today's highly volatile and challenging markets. The greatest tragedy of those using such third rate admonitions is that, not only do traders tend to use them to conceal their inadequacies from others, they are (often unwittingly) even deluding themselves.

All traders are separate sovereign individuals and, as such, have significantly different priorities. Therefore, the emphasis of a basic rule program must be aimed squarely at weaknesses shared by most traders in general. Rules highlighting trading strengths are little more than an ego trip. The rules we are presenting here are as much an attempt to emphasize our own inadequacies as they are to alert you to yours. Since they include traits such as stubbornness regarding stops etc., which are widespread failings among traders, we believe they are broadly based enough to be of interest to most of our readers and students.

For the benefit of intraday traders in particular, all rules must be sufficiently brief to be recalled and considered in little more than a split second. The ones that follow are intended not only to be used to retain discipline on a general basis, but also to be useful as a split-second memory assist and confidence booster for very volatile and confidence-shaking days. Placing the emphasis on rapid recall, this list is restricted to 10 rules. Longer-term traders may prefer to have more.

Although the central principles will remain essentially the same regardless of approach, giving consideration to individual trading style is vital in the formulation of the rules themselves. The majority of trades covered within the format below are for a timeframe of less than 3 days, with many of them for daytrading.

HEALTH

Never trade with any form of impairment — from a head cold to an emotional upset.

Anybody endowed with even the vaguest work ethic finds this a really difficult rule to fulfil. It is entirely contrary to conventional business theory. It can be very hard to put into practice. Listen to these words from another professional trader, he knows this from bitter experience:

"Many years ago I was ill with major nerve damage from a lengthy stay in the hospital. For me it was a most debilitating situation. I couldn't walk and could barely talk. The problem was that it was taking so long to recover that eventually I forgot what was like to actually feel healthy. Thankfully, after 18 months, I recovered to the point where I could begin trading, although maximum recovery did not come for a period of 10 years. Unfortunately, during the 18 months a couple of false starts at trading proved rather costly. The most vital point to remember is that any form of upset or illness, even a relatively trivial head cold, can upset the mental equilibrium essential for successful trading. Don't trade when you are upset with a spouse, a child, or your trading business in general. Don't trade when you have a headache, a toothache, or are in any way not up to par."

PARTNERSHIP

Always play a lone hand when trading.

The old adage "Two heads are better than one" is another piece of conventional wisdom utterly unsuited to stock trading. All traders must accept that they are on their own. Relying upon or constantly consulting with another person will serve only to compound the pressure of trading. Trading partnerships are fraught with difficulties and ultimately bound to fail. We've never known one to work, and we've seen numerous attempts. If you are too weak to trade alone, don't trade at all. Educate yourself further, seek psychological help, or some sort of support that will bolster your faith and courage in what you are doing. A partner will not fill the gap of your weaknesses.

ORIENTATION

Look Down, Not Up.

The art of successful trading is frequently not one of actually making profits, but rather one of avoiding losses. We cannot overly emphasize the importance of this rule. While maximizing gains might be at the forefront of our thought process, more important is the need to always restrict losses to the bare minimum.

Remember, not only must risk be restricted, but all traders must review their positions regularly (several times a day, hour, or minute if necessary) to ensure that the total risk of all positions is kept to a practical minimum. Be blazingly quick to get out of a losing trade. Don't hesitate, don't wait. Get out now!! All too often, ***now*** is late enough.

PATIENCE

Learn the art of patience: When in doubt, stay out.

While constantly monitoring the risk of open positions, it is just as vital to continuously assess potential trades in advance. Waiting for a good trade, especially during slow periods, can be utterly excruciating. Those who are ever guilty of "boredom" trades should assess recent losses incurred on such activity whenever they are tempted to indulge in such dangerous trading. You must trade when you are right, the market is right, and the timing is right. All three must be there. Wait for the trade that has your name on it, the one that meets ***all*** your criteria.

LIQUIDITY

Be careful when trading illiquid stocks.

Obviously, only stocks whose trading characteristics match your approach should ever be considered. To reduce losses to a minimum, use actual or mental stops. However, it is utterly pointless attempting to limit losses to any reasonable level if the market itself is lacking in liquidity. This may be due to profound failings in the stock itself, or as a result of market conditions.

LOSSES

Never trade with more money than you can reasonably afford to lose.

Always keep cash in reserve. Just as setting exit points on each individual position is an absolute must, the overall risk of a trader's account must also be borne in mind. Equally, when assessing position size and risk, etc., always ensure that your trading account doesn't include funds which have been ear-marked for another function. Before you start trading, set a limit of drain on your account for a set period. When this level is triggered, get out and stay out of the market for the rest of that month. Equally important, don't increase your size dramatically. If your stop limit is set at the start of a month, don't consider altering the amount of that stop until at least the end of the month in question, no matter how profitable you think that period might be. When you are making money, always place at least some of your profits in a reserve account, just in case you suffer a sudden capital depletion as a result of an unexpected development.

STRATEGY

Remember, there is no Holy Grail.

Traders, in particular unsuccessful traders, spend a disproportionate amount of their trading careers desperately seeking the magic ingredient that will render their trading strategy impregnable. On the other hand, the best traders in our experience are those who are acutely aware of the shortcomings of their trading approach (although that is emphatically not the same as saying they are lax about optimizing their methods). When trading, use whatever approach is good for you.

ADVICE

Ignore free tips and so-called friendly advice.

If your broker could regularly profit from trading, would he be speaking to you? Maybe or maybe not!

Again, mediocre and downright abysmal traders always appear to be those most addicted to idle gossip and chatter. Frankly, we neither know nor care about the latest idle foolishness, or whether or not the financial news station is of the opinion that prices of a certain stock are bound to go up or down. Rumors give brokers a reason to ring up traders.

PERSPECTIVE

The best trades often contradict recent market activity, but don't lose sight of the big picture.

While trend following should always be regarded as a potential source of healthy profits, smart traders are invariably poised to exploit a reversal. While it is always very easy to become wrapped up in the most recent events, remember that the best traders invariably keep events in perspective.

PLANNING AND PROGRESS

Don't let progress pass you by, but do stick to your plan.

Given the many dynamics involved in trading, it is always vital to review all approaches on a regular basis. Equally, there are always new interpretations or methods which can be integrated. However, try to avoid making frequent wide-ranging changes to your approach as it merely zaps morale and is often motivated by only temporary dips in profitability. If you want to survive the ravages of the stock markets in the long term, rule ten is in many ways the most important in this group.

Chapter 29

MINIMIZING LOSSES

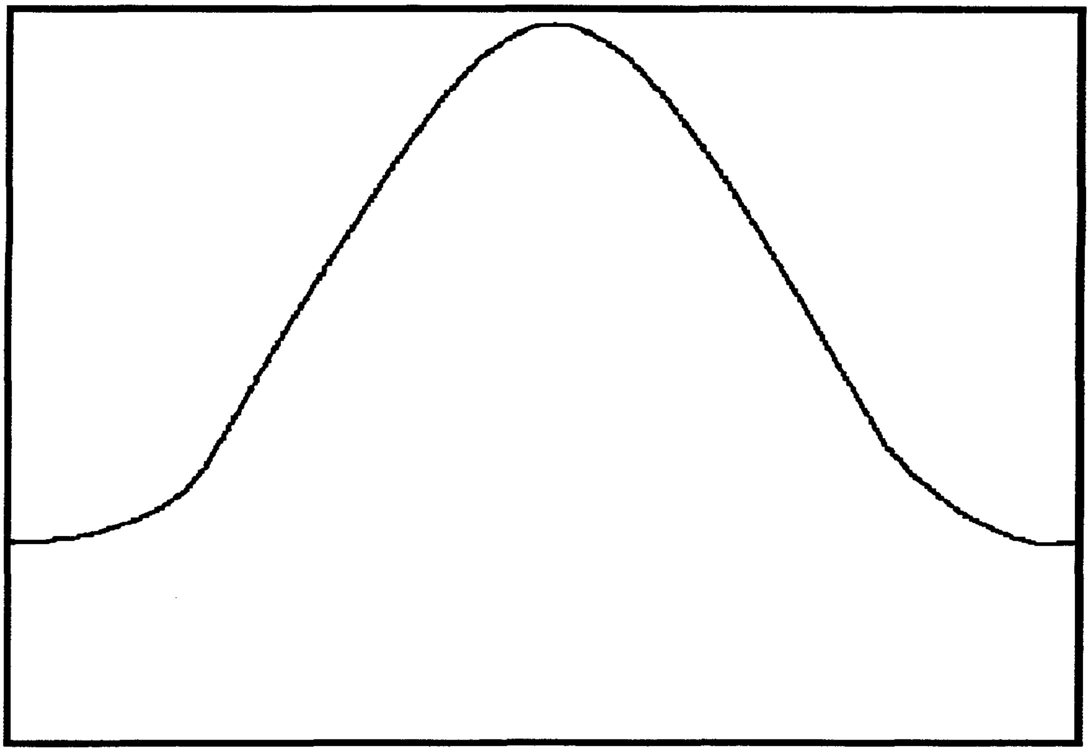
We've all heard the wonderful platitude, maximize profits and keep your losses small.

There is probably not a book on trading or investing that somehow managed to leave out that brilliant piece of advice.

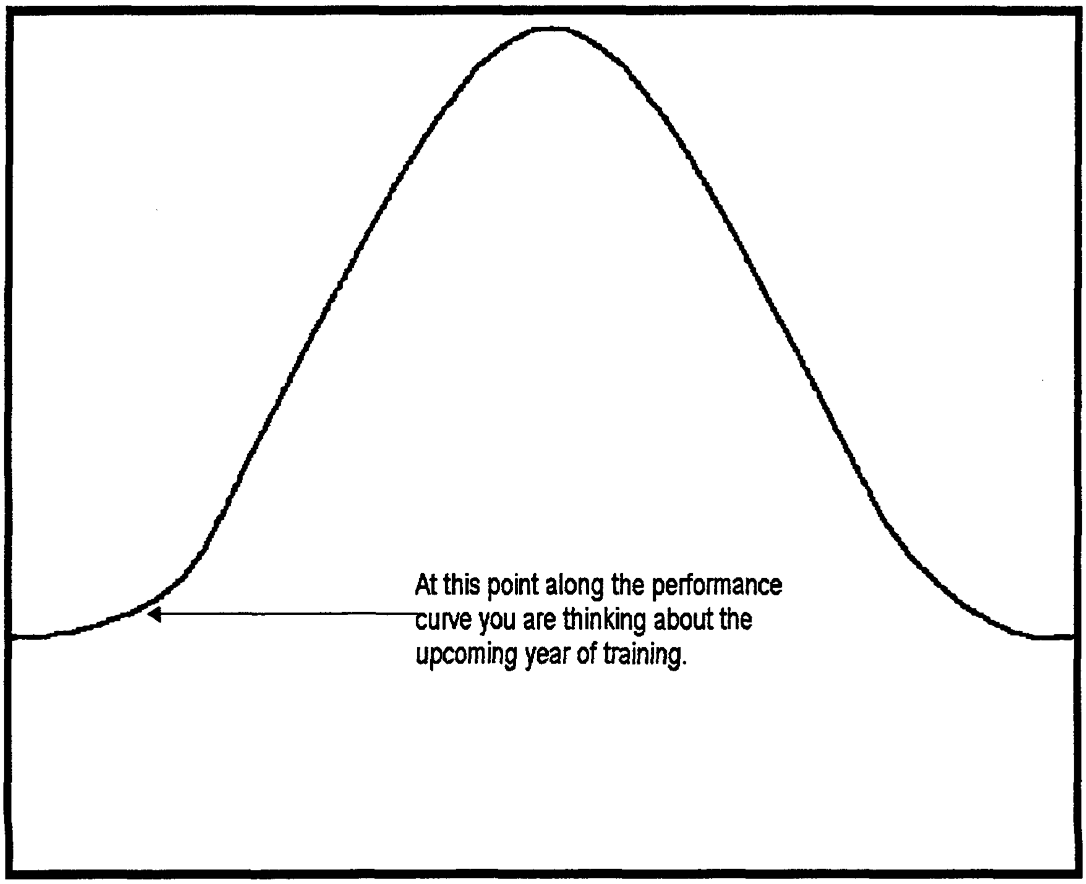
But we have never read a book or attended a seminar in which anyone taught how to implement this marvelous piece of advice.

But now, we are going to explicitly show you how it is done. If you get nothing more out of this course than what we are now going to show you, you will find that you have paid only the tiniest fraction of what it is worth.

You've probably seen something like the figure below before. It is called a bell curve, or a frequency distribution curve.



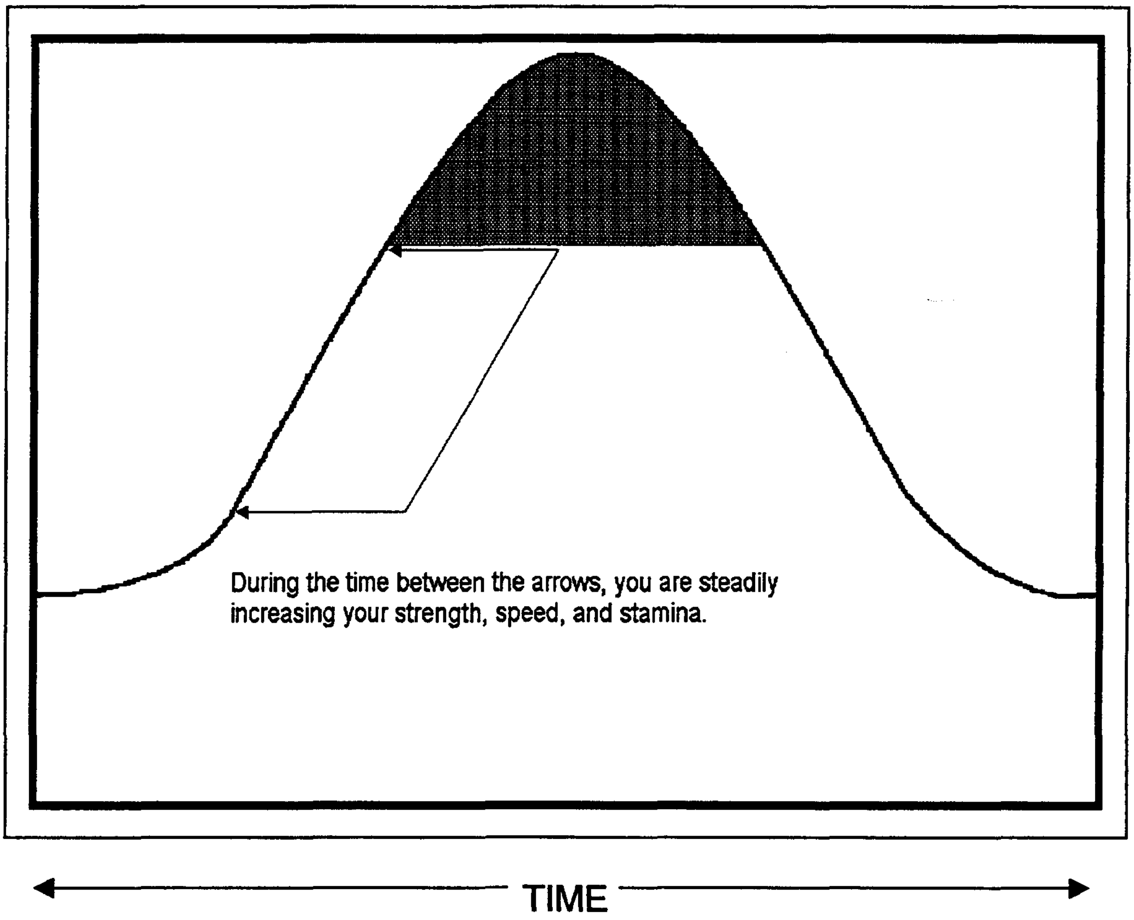
However, for our purposes we are going to call it a performance curve. Please notice:



Visualize yourself in the following situation:

As an Olympic contender, you have been at rest, and are now looking forward to a year of building your health, strength, and stamina for the upcoming Olympic trials. You begin by changing your diet, getting more rest, and increasing your exercise routine.

PERFORMANCE CURVE



During the course of the year, you build your physical prowess as a runner by running a bit further and a bit faster each day. You are also growing in knowledge of both yourself and of the competition.

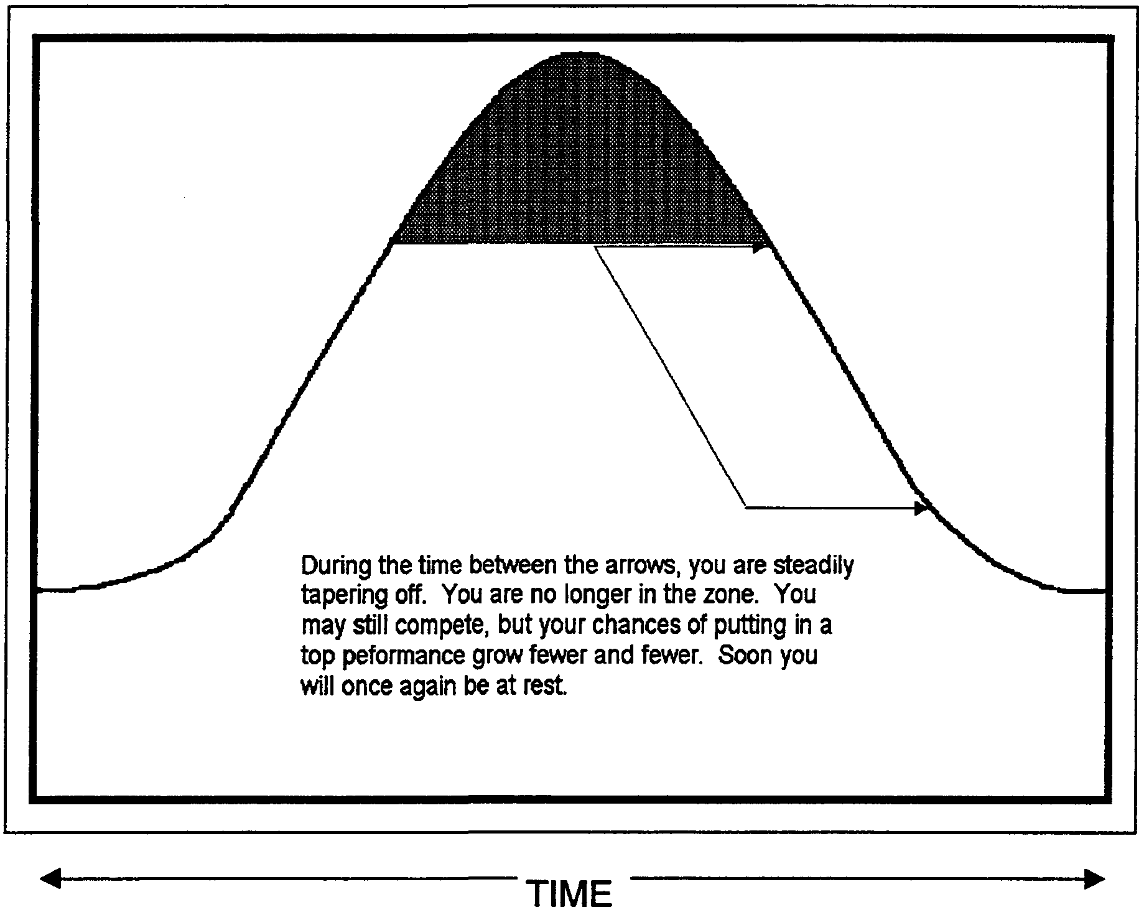
You have heavy workout sessions. You are getting closer and closer to the "zone," that level of performance at which you have a chance of winning every single competition you enter. (Dark area above)

You have strategy sessions in which you learn to take advantage of your physical and mental strengths.

You are working towards your peak performance, but you don't want to reach it until the Olympic finals, so you pace yourself. The "zone" is shown as the gray area above. You want to be entering that area just about the time the Olympic tryouts begin.

The Olympics and your time of top performance is now over. You are no longer in the zone where you are at your physical and mental peak. You begin tapering off to eventually rest for next year's competition.

PERFORMANCE CURVE



The point of this entire fiction is to get you to see that no one can be at their absolute best all of the time. If you sit and trade all the time, you will be trading when you are at your worst as well as when you are at your best.

Of course, for a trader the performance cycle is much shorter. You will have to discover your own. Some people can trade every day. Others can be effective trading only every other day. Some traders are at their best a couple of times a day, if they rest in between.

The Life Index will help you to trade at your best, i.e., when you are physically, mentally, and emotionally ready to trade.

However, there is another tool that you can use. It fits very nicely with the Life Index. We'll call it "charting your equity." Here's how it works!

If you have records of your real trading going back in time about 3 months, you will use those.

If you have paper traded for about 3 months, you can use your paper trading records.

If you have never traded, you can paper trade for 3 months and keep track of your paper trading equity.

What we want to do using manual entry with some charting software or by using a spreadsheet, is to make an Open, High, Low, Close chart of our account balances.

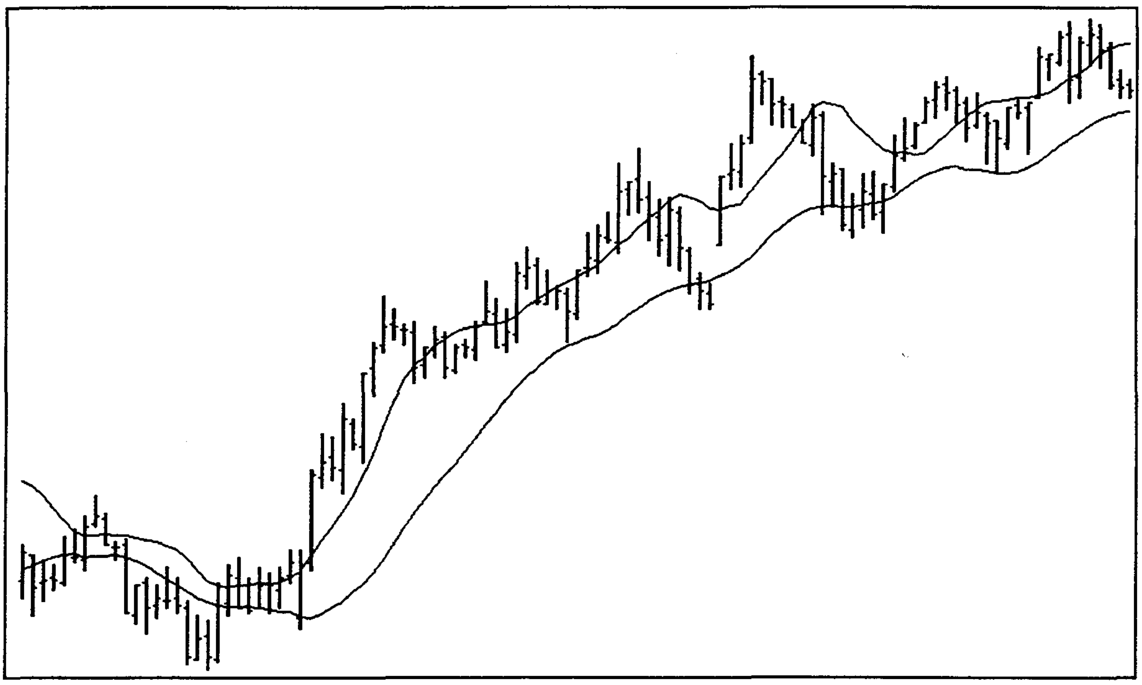
You will create catch-all account, i.e., a fictitious account that includes both real money trades and paper trades. If and when you have sufficient account data, you will begin to use weekly charts. At first, unless you have data going far back in time, you will use daily charts.

You can begin the catch-all account with a $50,000 fictitious balance. As you trade, you will add or subtract the results of your trading to the catch-all account.

The account starts out at $50,000, which is the Open for the first bar on the chart. Your highest balance for the day will be the High of the day, and your lowest balance for the day will be the Low of the day. The balance at the end of the day is your Close.

We will affix two moving averages to the chart, which we will show you how to do in a moment.

Our objective will be to minimize our losses and maximize our gains. Keep that firmly in mind as we go through the exercise. Remember, this is not a real account, but it will serve you well for the remainder of your trading career.



Here is how it can work for you.

When your weekly equity Closes below both moving average lines, you stop all trading. It is time to figure out what is wrong. You must learn that only you can take the blame for a drop in equity. Something is wrong and it is ***always*** you.

What is wrong ***always*** falls into one of two categories:

> **1. YOU HAVE CHANGED (STRAYED) FROM WHAT YOU WERE DOING THAT WAS BRINGING YOU SUCCESS AND PROFITS.**
>
> **2. THE MARKET HAS CHANGED AND YOU HAVE FAILED TO ADAPT TO THE CHANGES.**

In the first instance you have changed. In the second instance, you have failed to change. In either case, there is only one solution: you must change your behavior relative to the markets in which you are trading.

Earlier in this manual we mentioned that there are only four ways in which we are taught to deal with problematic situations:

We can run away from the problem. We see this all the time in modern societies.

We can choose to become part of the solution. This was illustrated earlier in the situation of taking an empty insecticide can and crushing the offending insect.

We can try to change the environment. We learn this method first in life. Even an infant learns that by changing the environment he can solve a problem. When he is uncomfortable for any reason, he cries. This causes noise pollution, thus changing the environment. The crying brings nourishment or a clean change of clothes.

However, there is a fourth way to deal with problematic situations. That way is the least popular because it means changing our behavior. We all love ourselves and do not really want to change. Most of us abhor change when it comes to changing our behavior.

Yet this is the only way that we can deal with markets. We have to adapt and change to market action. Think about it! We cannot run away because if we do, then we are no longer traders. We cannot become part of the solution because we are part of the problem. When our order is in the market, it becomes the market. We cannot change the environment because, in general, most traders are not big enough to move markets. Moving markets is not the job of traders, it is the job of market movers.

That leaves us with only one choice — we must change.

To accomplish that, stop all trading. Go away from markets and news of markets. Don't look at or listen to a financial newscast. Don't read the newspaper. Get completely away from your regular routine. go away if you can, preferably far away. Rest and relax. After five or more days, you may begin to be able to think about the markets and where you have gone astray. More often than not, it is simply a matter of having drifted away from what you were doing that was correct before. Occasionally it turns out that you have stuck to your game plan, but the market has changed and you have failed to change with it.

Markets can change for any number of reasons. New rules and regulations at the exchange can change a market. Government policy can change a market. News can change the market for a stock or even an entire sector, etc.

When you have figured out what it is that you are doing wrong, you then go back to your trading. At that point in time, you are paper trading at full size.

Your wins and losses are placed into the catch-all account, and you chart the fictitious equity until the equity bars are once again above the longer term moving average line. At that point, you begin to once again trade with real money. You trade minimal size during this period until the equity bars move above the shorter term moving average. When that happens, you are once again trading at full size.

The result of this technique is that you will end up trading the greatest size when you are winning. You will trade minimally when you're not at your peak performance level, and for the most part, you will trade away your losing streaks on paper. You will have quite effectively minimized your losses and maximized your profits.

Interestingly, the periods of greatest equity growth will usually come when your Life Index is moving sideways, an indication of stability. Your Life Index tends to move up only after having the pain of losing. The Life Index tends to drift downward when you are winning big. Why? Because that is when you begin to be careless and think you own the world. That is when you do something foolish, careless, or arrogant.

Feel free to change the moving averages as your equity profile changes over time. For instance, if your equity begins to move steeply upward, actually becoming visually parabolic, shorten the moving averages to more closely follow the equity curve. However, it should be a rare occasion, if ever, that you flatten the moving average. To do so will greatly increase the length of your losing periods.

Chapter 30

BECOMING AN INTUITIVE TRADER

TAKING CONTROL OF YOUR EMOTIONS

Here's a story from an experienced trader. Let's listen to the voice of experience:

"After I had been trading about eight years, I had an emotional crisis that almost permanently drove me away from trading.

"It happened this way. I had decided that I wanted to become more intuitive in my trading. I had a definite plan in mind.

KEEPING A DIARY

"I decided to keep a diary of my feelings. I thought to myself, 'If I were more in touch with my feelings, I would become intuitive.'

"Sounds simple, doesn't it? But the truth is that it was difficult. Having grown up according to the culture of a Western civilization I didn't know my own feelings. I was taught to be macho. As a man, I wasn't allowed to show feelings. Most young men will not allow themselves to cry. Men, unlike women, posture with one another — whereas women learn that emoting is quite acceptable. Women speak to each other about their feelings. Men don't. Men speak at a level above their feelings, seeking to be important in the eyes of their peers.

"For the most part, Western men are not in touch with their feelings. I was one of those. I did not know how to separate my feelings from my opinions. But I tried. I wrote down what I thought were my feelings. Eventually, I was able to separate feeling from opinion.

"I recorded my feelings in a diary just before entering a trade, immediately after entry, just prior to getting out, and immediately after exit.

"I then correlated my feelings with whether or not I made a profit from the trade. I did this by making a histogram of which feelings went with which trades.

"I discovered that the best trades came when I was apprehensive about going in; remorseful immediately after entry; anxious to get out; and relieved to be out, win or lose.

"I discovered that when I felt elated about a trade, convinced that it was a sure thing, that was when I had the most losses. This discovery weighed heavily upon me.

"Coincidentally, I had read something stating that negative emotions and stress were the cause of early deaths in many young businessmen. Since I fancied myself to be an up and coming entrepreneur, I read the material with a lump in my throat. Why? Because trading for me was obviously a highly stressful situation.

"At the time, my wife was pregnant and I thought to myself, 'I might never live to see my children grow up.' I had been plagued by fear and remorse throughout my trading career. The feelings were so strong, that I began wondering if I would make it to age 35.

"At that point, I stopped trading and went into the insurance business.

"After about a year selling life insurance, the company I worked for invited all the insurance salesmen in the area to a meeting in which we would be addressed by the 'greatest salesman' in the world — we'll call him Ben.

"The company was thrilled to have Ben representing it, and at the time, 1966, his commissions from life insurance sales were $1.5 million a year. That was a lot of money in those days.

"Since it was our company who was sponsoring the meeting, we had the best seats in the meeting hall. We were seated front and center to hear the great man speak.

"We heard Ben speak, but we saw him for only a moment at the end of an interview. Strange? Yes! This great salesman was unable to address a live audience. We heard him, but Ben was interviewed from behind a screen. All we saw was his silhouette as he was seated at a table being interviewed by one of the company vice-presidents.

"It was explained to us that the Ben was too shy to speak to us directly. When the interview was over, he came out to thunderous applause and took a bow. That was it, that was all we actually saw of him.

"During the interview, Ben told about his tremendous fear of making cold sales calls. Yet Ben wrote life insurance on some of the wealthiest men in the world. He explained that because of his great fear, he had come up with the idea of researching the business situations of rich businessmen. He knew they would have estate problems, and tax problems. His idea was to present them with an insurance solution to their problems. To do that, when he would discover a man he thought he could help, Ben began sending that man a monthly newsletter. The newsletter had Ben's picture on it, and it had helpful hints and tax news items that would be of general interest to a wealthy businessman.

"After a year of sending the businessman his newsletter, Ben would show up at the businessman's office and present his business card to the secretary requesting that she take it in and show it to the businessman. The business card had Ben's picture on it, and it rarely failed to get him an invitation to come in. The businessman must have said to himself, "Well, here's the guy who's been sending me this newsletter for the last year."

"Ben would then go in and shake the man's hand and say something like, 'I know you're busy, but I happened to be in town and just wanted to stop by and say hello. I have a very interesting idea for you, but I have another appointment in a few minutes, and I have to go. Would it be possible to see you about this idea before I leave town?' "

"The result was that Ben would get the appointment, make his presentation, and usually make a multi-million dollar sale for life insurance for tax and estate liquidation purposes.

"There were a lot of lessons in that story, and they had a great effect on my life.

"I noted how Ben studied, researched, and planned his sales campaign. I thought, that's the way trading ought to be done, with study and planning. Let me remind you that this was in the days before live data feeds and daytrading had even entered into the mind of men. However, daytrading does not obviate the need for studying charts and planning out how you will trade.

"I noted how Ben was patient, waiting for just the right situation, waiting for a year for his newsletter to do its work. I thought this is the way traders should be, patient, waiting for just the right situation to occur, the one for which they have planned and prepared.

"But most of all, I realized that Ben had figured out a way to deal with his negative emotions. He still had the fear. He still had the apprehension. But he found a way to live with it, a way to work around it. What drove him to do that? Ben discovered that the rewards were more important to him than the fear. He wasn't about to let fear drive him away from the rewards he could see if he could just succeed.

"The thoughts and realizations Ben had brought to my mind haunted me for weeks. Maybe I could find a way around my own negative emotions.

"The more I thought about it, the more I realized the truth. There were plenty of people who had learned the secret that Ben discovered. Many excellent salesmen learn that you have to overcome fear if you want to succeed. They learn to knock on that first door, the one they dread the most. They fear rejection. But they have learned to look past the fear and focus on the reward.

"I remembered 'little Al' who was our State champion middle-distance runner in high school. Al would come to school on the day of a track and field meet, and he would immediately head for the men's bathroom. He never went to class on that day. Instead he sat and used the toilet facilities all day, until it was time to warm up for his event. When Al ran, you would have thought the devil was chasing him, and I he literally ran on 'empty.' There could not have been much left inside of him other than sheer determination.

"I thought about the many Broadway stars who apparently are so sick before a performance that they vomit before going on stage. But they do go out there, and they perform for whatever the reasons they have or rewards that come their way.

"Athletes, musicians, actors, and performers of all kinds learn that once they overcome the nervousness and fear and get out there and do what they are supposed to do, the rewards are much greater than the discomfort. They learn to focus on the money, the fame, the applause, the medal — perhaps the life style that their efforts bring to them.

"I decided then and there to go back to my trading. I've been doing it ever since."

Chapter 31

WRAP-UP

Our primary objective in this manual has been to teach you how to trade profitably.

In order to do that, we had to teach you to run your trading as a business, with an economic motivation and with sound management.

We have tried to show you ways in this manual, coupled with the methodology of the other volumes of Electronic Trading 'TNT,' that would enable you to trade profitably.

The methodologies shown in this course are by no means the only ways to trade. For many, the ways shown here may not be suitable for your own comfort level and personality. We'll even concede that some of you have managed to trade well using combinations of the very things which are, for the most part, contrary to the ways taught in this course.

We have seen the trading records of those of you who have been willing to show them to us. In some cases, as was said at the beginning of this book, many of you are excellent traders — you just haven't been able to hang onto the profits that were there. Instead, you let them slip through your fingers. All too often, profits have turned into losses.

We've tried to show you that it's OK to take small profits — small profits amass into large profits. It is our greatest hope that you have finally come to see the differences among business, risk, trade, and money management. One of the greatest lessons of this book has been to show you the components of real risk in a trade. We also hope you learned that you need personal management and discipline in order to succeed.

We have included for your use Appendices A and B. They contain a lot of the wisdom which you can use to become a better trader, and are very precious if you will make them part of your thinking. We hope you will read these appendices and deeply ponder the things written there. We have also included Appendices C, D, and E for the furtherance of your education. Appendix C shows you the "Law of Charts," fundamental to your understanding of chart reading. Finally in Appendix D we list for you a number of the current market makers in operation today, and, of course, books we suggest reading.

Don't just rush through the appendices. "Listen" carefully to what is written there. Throughout this book, we've been trying to lead you to a certain way of thinking — trying to show you the right mindset.

We are all "blind" many times in our trading lives. If you don't "listen" carefully to what is included in the Appendices, this whole manual will have turned out to be a case of the "blind" leading the "deaf."

We wish you every success in your implementation of the lessons taught here as well as all the best in your trading. We hope we will see you next in ELECTRONIC TRADING 'TNT' III — TECHNICAL TRADING STUFF.

Joe Ross Mark Cherlin

PS If you've read this far and haven't yet found the free trading strategy offer, it's because you haven't read far enough. Keep reading!

FOR YOU

In this course, consisting of the four manuals that make up the ELECTRONIC TRADING 'TNT' series: GORILLA TRADING STUFF, HOW-TO-WIN TRADING STUFF, TECHNICAL TRADING STUFF, and TIPS-TRICKS AND OTHER TRADING STUFF, we've revealed the way we trade and conduct a trading business. We've shown what we do day in and day out. We've described the tools we use, and how, where, when, and why we use them. We make our living as traders, not as authors.

Unlike most authors who secrete themselves behind a publisher's telephone number and address, we will gladly respond to any phone calls, faxes, E mail, or letters that we receive regarding the material presented in these manuals. For more information about other services, books, and seminars which we offer our readers, please continue reading.

SEMINARS

At times a manual is not enough. Some would like more help than we are able to present in a manual. For this reason, we hold seminars regularly for the purposes of tutoring those who want and can afford the additional help.

If you want to learn to run your trading as a profitable business, you will benefit from the two day seminars we give. We give these seminars almost every month. Enrollment is limited. A prerequisite for taking the seminar is that you must have read both ELECTRONIC TRADING 'TNT' I — GORILLA TRADING STUFF and ELECTRONIC TRADING 'TNT' II — HOW-TO-WIN TRADING STUFF.

At our seminars we attempt to answer any and all questions concerning the material in our books. We then go on to expand the material beyond what is contained in the books.

Once you have taken a seminar, you may attend it again for up to two years. There will be no charge other than what it costs you for travel, lodging and meals. The only requirement is that you let us know well in advance that you will be coming.

At the seminar, you will be shown a great many things that are impossible to get into a book. Here are some of the novel things you will be taught:

HOW TO NEUTRALIZE THE ADVANTAGES THE INSIDERS HAVE OVER YOU.

HOW TO NEUTRALIZE THE ADVANTAGES THE INSIDERS HAVE OVER YOU.

TECHNIQUES FOR GETTING INTO A STOCK AHEAD OF EVERYONE ELSE SO THAT THEIR ENTRY PUSHES ALONG YOUR POSITION.

TECHNIQUES FOR TAKING THE RISK OUT OF A TRADE.

TECHNIQUES FOR BUYING MORE TIME FOR A TRADE WITHOUT GETTING HURT.

HOW TO SAFELY HOLD OVERNIGHT POSITIONS IN VOLATILE STOCKS.

HOW TO FIGURE THE TRUE RISK IN A TRADE.

HOW TO MAKE SIGNIFICANT PROFITS OVER COSTS FROM YOUR TRADING.

And much, much more in the way of tips and tricks to help your trading. To book reservations, contact information is listed at the front of the manual.

Private Training Sessions

We offer three-day private training sessions, one for day traders and one for position traders. These are intensive sessions for a maximum of four persons at $10,000 each. The same sessions are also available on a one-on-one basis for $12,000.

Private Tutoring and Consulting

For those who want one-on-one private tutoring, we are available by appointment only. Fees are:

$400/HOUR BY TELEPHONE

$500/HOUR IN PERSON

$4,000/DAY IN PERSON

$4,000/DAY (plus travel, lodging, meals, and expenses if travel on our part is involved.)

Private tutoring sessions involve any or all of the following: You doing the trading while being coached, offered suggestions, and being helped with proper organization; Answering your particular questions; Custom tailoring of the session time to precisely fit your needs; Anything else with which you might require assistance.

CATALOG

DON'T FORGET TO SEND FOR OUR FREE CATALOG. CONTACT NUMBERS ARE AT THE FRONT OF THIS MANUAL.

Appendix A

A COMPOSITE

This appendix is a composite based in part upon the writings contained in ancient scriptures, as well as those found in modern books on trading. Can ancient writings help anyone to be a better trader? The answer is a resounding YES. How and why this is so you will soon see.

Answer this question: can you as a trader of markets afford to leave any stone unturned in the quest for more trading wisdom and knowledge as you seek to trade consistently better and for greater profits?

You can become a better trader by following any and all insights and wisdom. Certain principles and laws are immutable. In writing this chapter, we have searched for wisdom from any source that can help in achieving success in trading.

It is written that wisdom gives a long, good life, riches, honor, pleasure, and peace of mind. It is also written that wisdom is comprised of two things: Knowing and doing right, and common sense. As stated earlier, wisdom is the right application of knowledge.

Simple, isn't it? These two things — common sense, and knowing and doing what is right — will "fill you with living energy, and be a credit to you. They will keep you safe from defeat and disaster and from stumbling off the trail. With them on guard you can sleep without fear; you need not be afraid of disaster."

"Learn to be wise, develop good judgment and common sense! This point cannot be overemphasized. Cling to wisdom — it will protect you. Love it — it will guard you. Determination to be wise is the first step toward becoming wise! And with your wisdom, develop common sense and good judgment. If you esteem wisdom, it will dignify you.

Hold it fast and it will lead you to great honor; it will place a beautiful crown on your head." *The book of Proverbs.*

THE MARKETS

"Be faithful and honest with yourself in your trading, be diligent and consistent and it will bring you prosperity."

The markets are like the flow of life itself. Not yielding to feelings of kindness or compassion, inexorable, merciless, ruthless, cruel, and implacable. What a formidable challenge they offer to anyone who dares to swim against the tides of their flow.

The markets offer the battleground for the ultimate test of self-control, self-discipline, and wisdom. You cannot consistently win in the markets unless you have mastered your human nature, and the markets constantly force you to examine yourself. Markets expose your every weakness both to yourself and to others who may be watching. If you want to win, you must learn to seek out all the available truth and knowledge about the markets, seek wise counsel, make your own decisions, keep your mouth shut about the decisions you have made, and face the truth of what you really are.

Markets are driven by weaknesses of human nature. Greed, fear, superstition, lust, anger, and vanity. You will be successful to the extent that you are able to overcome these weaknesses.

You will also have success to the extent that you can master wisdom and learn to cooperate with the markets you trade. You must learn to be an active observer. Develop market sense. Watch, be tuned in, and capture the rhythm and the personality of the markets.

You must learn to skillfully use the tools that are available, tools that you choose, tools that can make you a winner. Realize that you are unique, different from anyone else. You have to master the techniques that will make YOU successful. These are not necessarily the techniques that work for others. How you trade will depend upon the sum total of everything you are. Trading shows up every one of your strengths and weaknesses.

Some of you have asked "If you are successful traders, how can you take time away from making money to write a book?" The answer is, if you want to continue to make money in the markets, you must get away from them from time to time. Writing is one way to take your mind completely away from your personal trading, even though you might write about trading. It helps to step back and take a look at what trading is all about.

We are presenting to you a philosophy of trading based upon the inexorable laws of the universe, the wisdom that is found in historical writings, the knowledge and discoveries of traders both past and present, and the successes and failures of own lives as businessmen and traders.

If you as an individual allow a broker or manager to trade your account, you are not a trader, you are a financier, an investor, or both. The primary focus of what we have to say here is for people who trade their own account or the accounts of others. This part of the book is, to a certain extent, written for traders and would-be traders, those who have their wealth, their health, and their financial lives on the firing line.

It seems so simple. All you have to do is to 'go with the flow', 'ride with the tide'. Step into the unrelenting flow of the markets — in the right direction — and let its momentum carry you to your profitable goal, a deceptively simple action, and difficult to do. Only few do it effectively and well. In reality, when you step into the stream of a market, you may be swept off your feet by the undertow. You may slip on a submerged log in the form of an unexpected news item. You may have underestimated the swiftness of the current. You may find yourself caught in the chop of the waves raised by a sudden gust of the winds of emotion and mood that all too often control a market. Though you intend to enter and go downstream, you may find yourself suddenly facing upstream, swimming against the tide, fighting for your financial life, an unwilling salmon clawing and struggling upstream against your wishes, and against the perilous odds which are the rapids and rocks that suddenly appear in any market.

FUNDAMENTAL VERSUS TECHNICAL

"Truth stands the test of time; lies are soon exposed."

Much of what is considered to be fundamental information turns out to be false, erroneous, and incomplete.

Would you want to make all your trades based on the accuracy of news reports? Yet the markets constantly react to what is considered "the news".

The plain truth about trading is that no one can consistently gather fundamental information fast enough and in such quantity and quality as to be able to totally and adequately make trading decisions based upon what is really happening. Even the largest traders cannot sufficiently accomplish such a task, although many try.

To do so you would have to accurately know every worldwide political happening, every whim of global weather, and all financial and managerial information concerning every stock or commodity market in which you are interested. You would have to have data on interest rates, supply, demand, labor, production, corporate planning, politics, plantings, government action, and much more. Yet you must take a certain amount of fundamental data into account when you trade.

Realistically, however inadequate it may be, the major part of your trading decisions will be based upon technical data. Technical data, primarily in the form of price information, will always be affected by the total of all of the known fundamental information. More precisely, price will always be affected by the sum of all of the reactions by human beings to the fundamental information available.

Such a situation is fraught with danger. It eliminates any possibility of a sure thing. Just when every technical indicator looks right, an emotional reaction to world events can send a market careening off in just the opposite direction.

Any government announcement can send stocks and bonds spinning off in just the opposite direction from even the most precisely calculated technical assessment.

In order to have any chance at all of success, you must look at every possible piece of data available in making trading decisions. The more you look at, study and examine, the more you increase the chances of making a correct choice. (This must be balanced against the tendency some have of gathering so much information that they are frozen into inaction because there is always more information.) To which available things can you look? The material that follows contain pearls of wisdom which you may care to examine as you make your trading decisions. You may want to absorb every one of these gems, but wisdom dictates that you will do better to concentrate at first on only those few which best suit your own personal needs. You will have to master every one of them you decide to use. This is a big job. As with moving a mountain by yourself, you have to do it one shovelful at a time.

But before going on to any of these gems, you need to know a fundamental truth as set out in scripture. Whether you believe it or not is up to you. We set it out here for your consideration and review.

PREDICTING THE FUTURE

"If you are gods, tell us what will happen in the days ahead."

The greatest single mistake made by thousands is to believe, or even to hope, that somehow they can predict the future!

Mankind does not have the ability to predict the future on a consistently accurate basis. In a moment, I will show you what the scriptures have to say about this.

Millions of dollars and countless hours are spent by individuals who seek out or who are trying to work up prophetic systems and schemes. They live in the false hope that they can predict the future, that they can come up with THE system that will automatically tell them when to trade.

Yet there is a person quoted in scripture as saying that the ability to predict the future on a consistent basis is the exclusive ability of himself or those to whom he gives the ability to do so. He claims that only he can infallibly foretell the future.

Who is this, quoted as saying, "I am God, and there is none like me, declaring what the end result will be from the very outset"? Is it just some ancient writer with no power to make good his boast, who wrote his challenge to the skeptics?

There is a challenge and a taunt recorded in the biblical book of Isaiah. You can read it for yourself in chapter 46, verses 9 and 10, and again in chapter 41, verses 21 through 23. We quote a part of it here. "Show me what is yet to be, that we may watch how it turns out; yes, let us hear what is coming, that we may be sure that you are gods; come, do something or other that we may marvel at the sight!"

This is the taunt of the one quoted as being God, and who says "predict what is going to happen in the future, and let us watch and see whether you can foretell. Have you the power to bring it about? Are you a god? Do you rule the universe?"

The ability to predict the future is a proof of divinity. If anyone can predict and tell what is going to happen in the future, and then if it actually happens ***in every case***, and ***without a miss***, you'll know that was a real God speaking.

"In every case and without a miss", that sure leaves out a lot of self proclaimed prophets. Do you know anyone who can do that? We don't! Of all the investment and trading gurus around, past or present, we know of none who could even begin to take up the challenge we have just read. Prophecy is clearly not within your power or ours.

Markets can be and are traded seasonally, cyclically, and to a certain extent predictably, based on man's ability to observe and reason from seasonal and cyclical phenomena. Unfortunately, the application of such phenomena has had extremely limited success so far.

SELF CONTROL

"A person without self-control is as defenseless as a city with broken-down walls."

Within human nature reside the weaknesses that can destroy you financially. These weaknesses consist of emotional factors that must be overcome in order to successfully trade in the markets.

What are these emotional factors? Greed, fear, false hope, anger, superstition, lust, and pride, to name a few.

What are the results of these emotions?

A lack of courage, resulting in hesitancy at inappropriate times. Panic, which can cause you to change your mind and your position every few minutes.

"It is safer to meet a bear robbed of her cubs than fools caught in their folly."

Exuberance and untimely over-enthusiasm may lead you to gamble and take unnecessary risks.

"Wealth taken from gambling quickly disappears; wealth from diligent effort and hard work grows."

Greed can cause you to want to get rich quickly and, in so doing, lose everything. There is no 'easy way' in the markets.

"Steady plodding brings prosperity!; hasty speculation brings poverty."

Superstition may result in a totally unrealistic approach to trading. It may subject you to reacting to the half-truths, rumor, and false news reports that constantly bombard the trader.

"Rumors are dainty morsels, too often consumed with great relish."

False hope can lead you to hold a position too long. It can give the illusion of 'the easy way' to success rather than by consistent personal learning and growth.

"Those who work their plan will prosper, but those who chase fantasies lack judgment."

Anger can cause you to try to "get even" with the markets and so lose even more than you already have. The markets are unemotional, unrelenting, and cruel. You have to trade with a hard-nosed attitude, displaying the ability to be unaffected by short term circumstances and temporal market phenomena.

"A fool is quick-tempered; the wise stay cool in the face of insult or adversity."

Pride may cause you to stay with a losing trade too long. It keeps you from admitting your mistakes, especially if you've been foolish enough to tell others about what you have finally decided to do.

"There is one thing worse than a fool, and that is a person who is conceited."

To trade successfully, you must develop an objective temperament. You must learn to trade unemotionally. You have to work at developing and maintaining a trading discipline. Your success is heavily dependent upon objectivity in decision making.

You have to become familiar with just who and what you are, and learn to trade within the boundaries of your own personality and level of existence.

"Be faithful and honest with yourself in your trading, be diligent and consistent and it will bring you prosperity."

You must develop a style and a plan that best fits your personality as a trader, and then lock in on that style and not even attempt to trade any other way. You alone can ascertain how long you can stay with a trade, how much capital can be at risk, how much of a loss you can withstand both financially and emotionally.

"The wise in heart will accept (trading) rules and live by them, but the chattering fool will come to ruin by ignoring these rules."

Ask yourself, "Am I comfortable with this trade? Can I sleep at night?" If not, why not? Will you make the trade anyhow, despite the discomfort? Watch out, you may be gambling. Maybe you need to reassess the situation. Maybe the risk to reward ratio is such that you feel you have to go ahead at any cost. If this is the case, you have only yourself to blame if you are unsuccessful. In reality, this is usually true, you have only yourself to blame. Normally there is no one forcing you to make a trade. You have to assess your personal makeup and circumstances thoroughly to know what you are capable of doing.

"Follow the rules and keep your (financial) life; ignoring them means (financial) ruin."

LEARN THE BASICS

Before everyone there lies a wide and pleasant road that seems right but ends in (financial) death."

One of the best ways to learn how to trade in markets is to first trade on paper without risking any capital. This gives you a chance to test your trading ability and learn new skills. If you are trading a system or on the advice of others, you can check the results that might have occurred, before ever risking a dime.

Even with paper trading, start out trading small and learn how to manage the tools you will need to use. Test your perception, and your consistency. See if you are able to follow a set plan. Make this paper trading as realistic as possible. Write down the orders just as you would have given them to a broker. Keep records of every trade. Be honest with yourself. Better to take the loss on paper than in real money. There is a time and a place for paper trading, but always keep in mind that it is not remotely like the real thing.

Practice making sure, swift and timely trades, as you would have to do with your money on the line.

If you are an experienced trader getting into new markets or testing a new tool or system, then paper trade for awhile to see how well you can do.

When you are finally ready to trade using money, start out small. Trade in small amounts. Trading with your own capital will bring out your true emotions, strengths, and weaknesses as no paper trading can ever do. It will also expose you to real slippage and bad fills, something you can never understand or really compensate for in paper trading.

"It is dangerous and stupid to rush into the unknown."

CAPITAL AND COMMITMENT

"The wise are cautious and avoid danger; fools plunge ahead with great confidence."

HOW MUCH CAN YOU AFFORD TO LOSE?

To make wise trading decisions you need to feel free from financial pressures. If you are speculating with money needed for necessities, you won't be able to make sound decisions. The money you speculate with should be money that you can afford to lose, and are willing to lose.

Don't commingle your "necessity" funds with your "trading" funds. If you make a mistake, you may find that you are wiped out.

COMMITMENT

In the event of a loss, you want to have enough money left to trade later in a more favorable situation.

When you trade with too little capital, you are overtrading.

In long term trading, never enter your entire trading position at one price. It is wiser to enter a position on the installment plan. First test the waters. When you are buying shares of stock, first buy a few shares, and look to see if the market is going in your direction before totally committing the remainder of the funds you have allocated for the trade. What you want is for the market to verify that your initial position was correct before putting on the full position.

LOSSES AND MARGIN CALLS

"Pride goes before destruction and arrogance before a fall."

One of the best television ads I've seen in a long time is for one of the financial publications, in which the gentleman in the commercial says something to the effect that "the stock you are buying today, believing you are right and that you will profit, is being sold to you by someone else who also thinks he's right and that he will be the one to profit."

"The proud end up losers, but the humble become wise."

Obviously when you make a trade, you think you are right. It's what you do when the market goes against you that will, in part, determine how good a trader you really are. You must learn to admit that you are wrong, when you are wrong, and not stubbornly hold on to a losing position. We believe that all of us have done it — even as our loss grows larger — we refuse to take that loss and get out.

This stubbornness derived from pride results in living under false hope. You hope the market will turn around and prove you were right after all. You hope the market will move back again, so that you can save face — even if it's with yourself — and that your loss will not be as large. Reality is, all too often, the market will not return and rescue you.

OPINION

"Don't lean entirely on your own understanding and do not be wise in your own eyes. Seek counsel, but then make your own decisions and you will receive financial good health."

APPENDIX B

GEMS OF WISDOM

Apply these to your trading and your life:

"Only fools refuse to be taught. Wisdom calls out in a loud voice wanting to be heard."

"Wisdom is supreme; so get wisdom. Though it cost you all you have, get understanding."

Joe writes: "The above proverb reflects much of how I feel about the subject of wisdom. For years I have pursued it diligently. I long ago realized that I was a fool — with that realization I began an unrelenting hunt for wisdom in my trading. The quest still goes on, and probably will as long as I live. It is one of the most important things in my life."

The following is a paraphrase of proverbs, taken from various translations of scripture and set into language that makes them more easily understood in light of one of the purposes of this book, which is to bring wisdom into the trading of markets. It is our pleasure to share them with you.

PURPOSE

The purpose of these proverbs is to help you to attain wisdom and discipline; for understanding words of insight; for acquiring a disciplined and prudent life of doing what is right, just, and fair.

They are set forth for giving prudence to the simple-minded, and knowledge and discretion to the beginner. Let those already wise read them and add to their knowledge.

Respecting God is the beginning of knowledge, but fools despise wisdom and discipline.

DON'T BE ENTICED

Read these instructions and don't forget these teachings. If salespeople, promoters, and hustlers try to entice you saying "Invest along with us, we're making the hot trades, we're eating up the markets, we've got the most fantastic system", don't go along with them, don't listen to them, because they will head you straight for danger. Trouble and disaster await all those who want easy wealth and to "get rich quick."

The lips of these financial whores drip honey, and their speech is smoother than oil. Flattery is their stock in trade. But, afterwards, you are left with only the taste of bitter gall as you realize that they have led you down the path to financial ruin and destruction.

Wisdom will save you from the words and enticements of these greedy fiends. Their words are perverse and crooked. They are designed to play on your greed and suck you in. What they have to say is devious and deceptive. They blaze a crooked trail and don't even realize that they themselves are staggering down that same path, ultimately snaring themselves in the same trap in which they have entangled others.

You beginners especially, and you elderly who may have become less nimble minded and astute, run from these crooks. Don't go near them, because they will feast on your wealth, and all your labors will go to enrich them. You will be left groaning, tired and sick to your stomach, having been cheated out of all your wealth, your savings and the fruits of all your labors. Then you will say "Oh, if only I had been wise. If only I had listened."

BENEFITS OF WISDOM

Be faithful and honest with yourself in your trading, be diligent and consistent and it will bring you prosperity.

Anyone willing to be corrected is on the path to success. Those who refuse correction have lost their chance.

WISDOM IN FINANCIAL SITUATIONS

If you have been foolish enough to co-sign someone else's debt, if you have been trapped by what you have said, ensnared by the words of your mouth, then do this to free yourself, since you have fallen into their hands: Go and humble yourself; press your plea with them! Don't even allow yourself to sleep until you free yourself from the mistake you have made.

Follow the rules and keep your financial life intact; ignoring them means financial ruin.

Steady plodding brings prosperity; hasty speculation brings poverty.

Any enterprise is built by wise planning, becomes strong through common sense, and profits wonderfully by keeping abreast of the facts.

Riches can disappear fast — so watch your business interests closely. Know the state of your investments.

Those who work their plan will prosper, but those who chase fantasies lack judgment.

CONCERNING LAZINESS

If you are lazy, learn a lesson from the ants. Learn from their ways and be wise. Because even though they have no one over them to make them work, yet they labor hard all summer gathering food for the winter.

Lazy people won't use the tools at their disposal, but the diligent make good use of everything they find.

The lazy are full of excuses. "I can't go to work" they say. "If I go outside I might meet a lion in the street and be killed."

WISDOM AND FOOLISHNESS CONTRASTED

If you instruct the wise, they will be wiser still and will add to their learning. If you instruct fools, they will ignore you and may even insult you.

The wise in heart will accept rules and live by them, but the chattering fool will come to ruin by ignoring these rules.

The wise store up knowledge, but the fools blurt out everything they know, which only leads to sorrow and trouble.

The earnings of the wise advance their purposes; fools squander their earnings on foolish things.

A fool's pleasure is in doing stupid things; the pleasure of the wise is in being wise.

What fools dread overtakes them; what the wise desire will be granted to them.

When the storm has swept by, the foolish are gone, but the wise are still there standing firm.

The wise are guided by their honesty; fools are destroyed by their dishonesty.

The fool sometimes gets rich for the moment, but the reward of the wise is lasting.

Fools think they need no advice, but the wise listen to others.

A fool is quick tempered; the wise man stays cool in the face of insult or adversity.

The wise ask advice from friends; the foolish plunge ahead and fall.

The wise think ahead; the fool doesn't, and even brags about it.

The wise eat to live, while the fool never gets enough.

The wise look ahead. The fools fool themselves and won't face facts.

The wise are cautious and avoid danger; fools plunge ahead with great confidence.

Simpletons are crowned with folly; the wise are crowned with knowledge.

The wise are praised for their wisdom; fools are despised for their folly.

Fools despise advice; the wise consider each suggestion.

The wise are hungry for the truth, while fools feed on trash.

The wise think before they speak; the foolish pour out their nonsense without even giving it a thought.

A person of few words and settled mind is wise; therefore, even a fool is thought to be wise while remaining silent. It is profitable for fools to keep their mouths shut.

The wise learn by watching ruin overtake the foolish.

The foolish will lose in the end, the wise will end up with the winnings.

The wise save up for the future, but the foolish spend whatever they get.

Wisdom is a fountain of life to those possessing it, but a fool's folly is his burden.

WEALTH AND POVERTY CONTRASTED

The wealth of the rich is their strength, but the poverty of the poor is their curse.

Hard work brings prosperity; playing around brings poverty.

PRIDE AND HUMILITY CONTRASTED

The proud end up losers, but the humble become wise.

Pride leads to arguments; be humble, take advice, and be wise.

Pride goes before destruction and arrogance before a fall.

Pride ends in destruction; humility in honor.

THOUGHT PROVOKERS

Gossips go around spreading rumors, while the trustworthy try to quiet them.

To learn, you must want to be taught. To refuse correction is stupid.

The plans of good people are honestly thought out, but advice from the dishonest is deceitful.

Everyone admires those with good sense, but those with a warped mind are despised.

It is better to get your hands dirty and eat, than to be too proud to work and starve.

Lies will get anyone into trouble, but honesty is its own defense.

The truthful give honest testimony, but a false witness tells lies.

Some people like to make cutting remarks, but the words of the wise soothe and heal.

Truth stands the test of time; lies are soon exposed.

Wealth taken from gambling quickly disappears; wealth from diligent effort and hard work grows.

It is pleasant to see plans develop. That is why fools refuse to give them up even when they are wrong.

If you are looking for advice, stay away from fools.

Before everyone there lies a wide and pleasant road that seems right but ends in death.

Only simpletons believe what they are told! The prudent check to see where they are going.

The quick tempered do foolish things, and despise those who are patient.

Work brings profit; talk brings poverty.

The wise control their temper. They know that anger causes mistakes.

Mockers resent correction; they will not consult the wise.

When you are feeling gloomy, everything seems to go wrong; when you are feeling cheerful, everything seems right.

Plans go wrong with too few counselors; many counselors bring success.

Everyone enjoys giving good advice, and how wonderful it is to be able to say the right thing at the right time.

If you profit from constructive criticism, you will be elected to the wisdom hall of fame. But to reject criticism is to harm yourself and your own best interests.

Wisdom is better than gold and understanding more valuable than silver.

Hunger is good if it makes you work to satisfy it.

A rebuke to those of common sense is more effective than a hundred lashes on the back of a rebel.

It is safer to meet a bear robbed of her cubs than fools caught in their folly.

Fools find no pleasure in understanding, but delight in airing their own opinions.

At times the rich think of their wealth as an impregnable defense, a high wall of safety. What dreamers they are!

Rumors are dainty morsels, too often consumed with great relish.

What a shame – yes how stupid! – to decide before knowing the facts.

The intelligent are always open to new ideas, in fact they look for them.

It is dangerous and stupid to rush into the unknown.

People who love wisdom love their own best interest and will be successful.

Get all the advice that you can and be wise all the rest of your life.
Stop listening to teaching which contradicts what you know is right.

If you won't plow in the cold, you won't eat at the harvest.

The intelligent person sitting as judge will weigh all the evidence carefully, distinguishing the true from the false.

If you love sleep, you will end up in poverty. Stay awake, work hard, and there will be plenty to eat.

"Utterly worthless", say the buyers as they haggle over the price. But afterwards they brag about their bargain.

Good sense is far more valuable than gold or precious jewels.

Don't tell your secrets to a gossip unless you want them broadcast to the entire world.

A fortune can be made from cheating, but there is a curse that goes with it.

The glory of the young is their strength; of the old, their experience.

The man who strays away from common sense will end up dead.

The wise are mightier than the strong. Wisdom is mightier than strength.

Don't go into the battle without wise guidance, there is safety in many counselors.

A person without self-control is as defenseless as a city with broken-down walls.

In the mouth of a fool a proverb becomes as useless as a paralyzed leg.

As dogs return to their vomit, so do fools return to their folly.

There is one thing worse than a fool, and that is a person who is conceited.

Don't brag about your plans for tomorrow — wait and see what happens.

Sensible people watch for problems ahead and prepare to meet them. Simpletons never look, and suffer the consequences.

Ambition and death are alike in this: neither is ever satisfied.

Persons who refuse to admit their mistakes can never be successful. But if they admit them and forsake them, then they get another chance.

Those who want to do right will get a rich reward. But those who want to "get rich quick" will quickly fail.

Trying to "get rich quick" is wrong and leads to poverty.

It is foolish to entirely trust yourself, but those who use God's wisdom are safe.

One of the most beautiful pieces of scripture that any trader can take to heart is found in the eighth chapter of the book of Proverbs. I end this book with quotes from that chapter.

"Can't you hear the voice of wisdom? She is standing at the city gates and at every fork in the road, and at the door of every house. Listen to what she says: 'Listen men!' She calls. 'How foolish and naive you are! Let me give you understanding. Let me show you common sense! Listen to me! For I have important information for you. Everything I say is right and true, for I hate lies and every kind of deception. My advice is wholesome and good. There is nothing of evil in it. My words are plain and clear to anyone with half a mind — if it is only open! My instruction is far more valuable than silver or gold.'

"'I, Wisdom, give good advice and common sense. Because of my strength, governments reign in power. I show the judges who is right and who is wrong. Rulers rule with my help. I love all who love me. Those who search for me shall surely find me. Unending riches, honor, justice and rightness are mine to distribute. My gifts are better than the purest gold or sterling silver! My paths are those of justice and right. Those who love and follow me are indeed wealthy. I fill their treasuries. The Lord formed me in the beginning, before he created anything else. From ages past, I am. I existed before the earth began. I lived before the oceans were created, before the springs bubbled forth their waters onto the earth; before the mountains and the hills were made. Yes, I was born before God made the earth and fields, and high plateaus. I was there when he established the heavens and formed the great springs in the depths of the oceans. I was there when he set the limits of the seas and gave them his instructions not to spread beyond their boundaries. I was there when he made the blueprint for the earth and oceans. I was always at his side like a little child. I was his constant delight, laughing and playing in his presence. And how happy I was with what he created — his wide world and all his family of mankind! And so, listen to me, for how happy are all who follow my instructions.'

"'If you were wise enough to have read this far, we feel you are entitled to send for the trading strategy we promised at the front of this manual. To get it absolutely free, please send a self-addressed stamped envelope to the address shown at the front of the manual. You must include proof of purchase, the name of the manual (so we know which gift to send you), your name, address, telephone number, fax number, and email address if you have one. We know you will be pleasantly surprised.'"

"'Listen to my counsel — don't refuse it — and be wise. Happy is the man who is so anxious to be with me that he watches for me daily at my gates, or waits for me outside my home! For whoever finds me finds life.'"

Appendix C

CHART READING

For your convenience we are including a partial review of material covered in ELECTRONIC TRADING 'TNT' I — GORILLA TRADING STUFF.

What is chart reading? Why is it important? What is meant by chart reading?

Chart reading involves determining the most likely direction in which prices will move based on a pictorial representation of price action. Chart readers believe that everything known about a particular stock is reflected in its share price at the moment you are viewing it on your screen. With proper implementation and interpretation, a bar chart can reveal very powerful price patterns.

The immediate psychology of a market is reflected in the price action. What you see in price patterns would seem to be nothing more than supply and demand in action. Supply and demand and stock valuation are not the only things determining price action. When you are able to accept this as fact, and appreciate the psychology behind the various patterns, you will begin to appreciate why price patterns are worthy of very close inspection and analysis. The only way to gain confidence in the price patterns we will teach you is to see them in action. We will view them when they provide profitable trading signals and when the patterns fail.

It is this concept that makes trading quite different from investing. Investors, unless they are entering orders based on some "hot tip," usually trade based on their own or someone else's investigation of a company's vital statistics. Investing is wisely done based on fundamental information about the condition of a particular company and often its standing in a particular industry or sector. Conversely, trading, especially daytrading, is done mostly based upon technical information. A chart showing a stock's open, high, low, and closing prices, is, in the estimation of many, the best possible way to trade based on technical information. From the point of view of a chart trader, supply and demand are seldom directly related. The same is true of a company's fundamentals. For a chart trader a company's financial statements are not directly related to how we as traders deal with a stock. As traders we base our trading decisions on what we see on a chart. We look at the overall picture before us. We also learn to examine in minute detail the behavior of each price bar as it appears before us. We do this regardless of the time frame in which we trade. We are looking for any clue that might indicate to us what will happen next.

A CHART IS A CHART

To us as traders, ***a chart is a chart, is a chart***. We don't care which company is involved as long as we see good price action and good liquidity.

Years of looking at price charts have revealed to us that there is a "Law of Charts (TLOC)." The law states that anything that can be charted and displayed as a bar chart having both high and low values for the interval represented by each bar will always present itself as one of four definable chart patterns. These are:

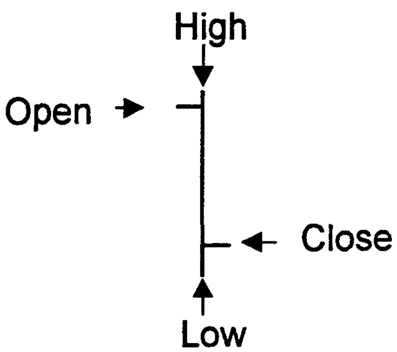
1-2-3 high and low formations

Ledges

Trading Ranges

Ross Hooks

Now let's examine these formations. Learning them is critical to what will be taught throughout this course.



First, notice the picture on the left. We will be discussing bar charts. The picture on the left is a price bar it consists of an Open, a High, a Low, and a Close.

THE LAW OF CHARTS

THROUGHOUT THE REMAINDER OF THIS COURSE WE WILL OFTEN REFER TO THE LAW OF CHARTS AS TLOC. THESE INCLUDE, 1-2-3 HIGHS AND LOWS, LEDGES, TRADING RANGES, AND ROSS HOOKS.

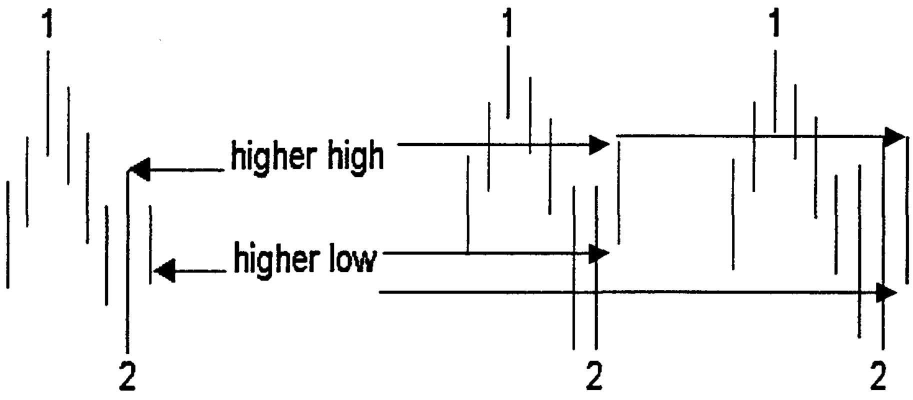
1-2-3 HIGHS AND LOWS

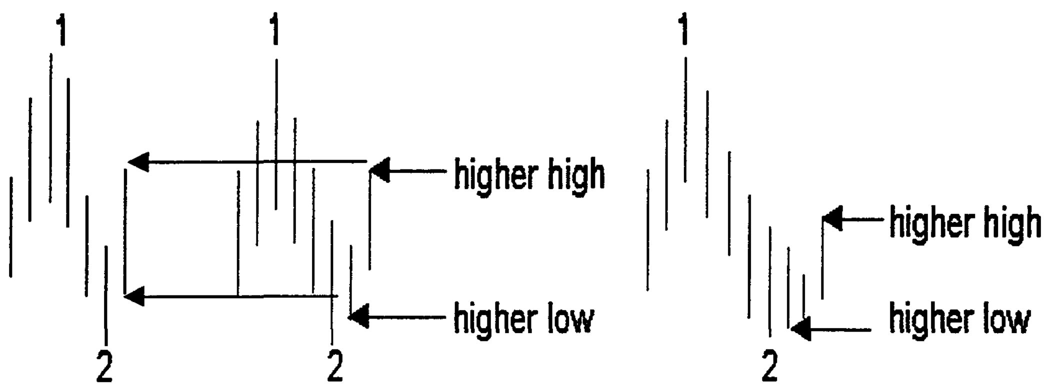
A typical 1-2-3 high is formed at the end of an uptrending market. Typically, prices will make a final high (1), proceed downward to a point where correction begins (2), and then resume a downward movement, thereby creating the pivot (3). There can be more than one bar in the movement from point 1 to point 2, and again from point 2 to point 3. There must be a full correction before points 2 or 3 can be defined.

A number 1 high is created when a previous up-move has ended and prices have begun to move down.

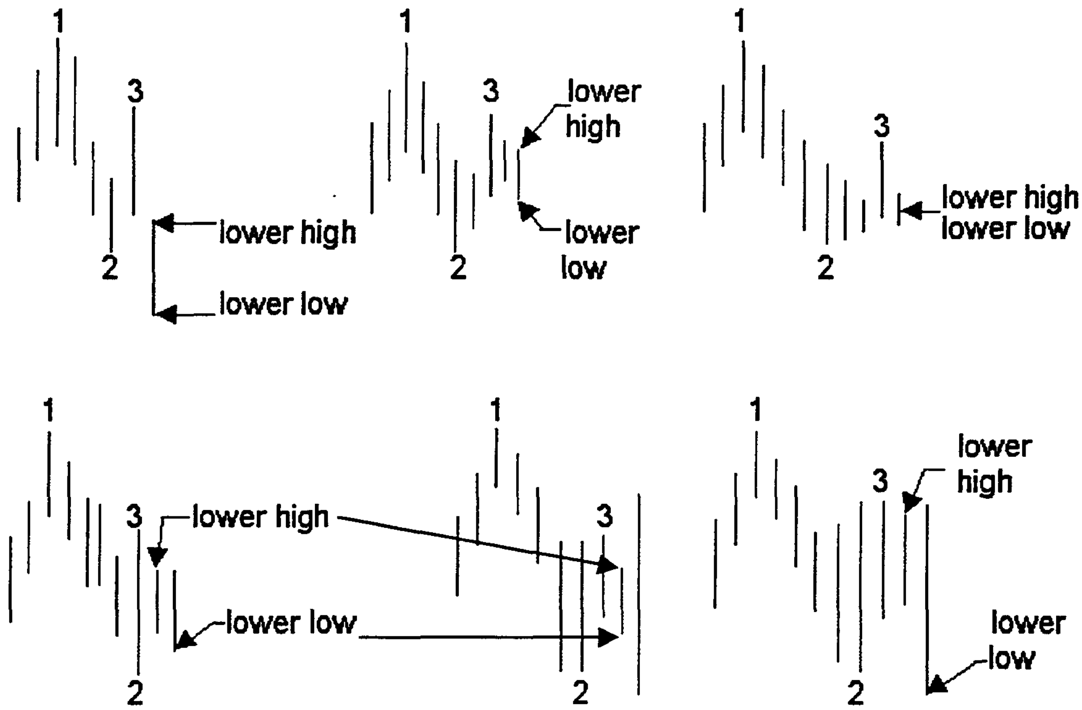
The number 1 point is identified as the last bar to have made a new high in the most recent up-leg of the latest swing.

The number 2 point of a 1-2-3 high is created when a *full* correction takes place. Full correction means that as prices move up from the potential ***number 2 point***, there must be a single bar that makes both a higher high and a higher low than the preceding bar *or* a combination of ***up to three bars*** creating both the higher high and the higher low. The higher high and the higher low may occur in any order. Subsequent to three bars we have congestion. It is possible for both the number 1 and number 2 points to occur on the same bar.





The number 3 point of a 1-2-3 high is created when a full correction takes place. A full correction means that as prices move down from the potential number 3 point, there must be a single bar that makes a lower low and a lower high than the preceding bar, *or* a combination of ***up to three bars*** creating both the lower low and the lower high. It is possible for both the number 2 and number 3 points to occur on the same bar.



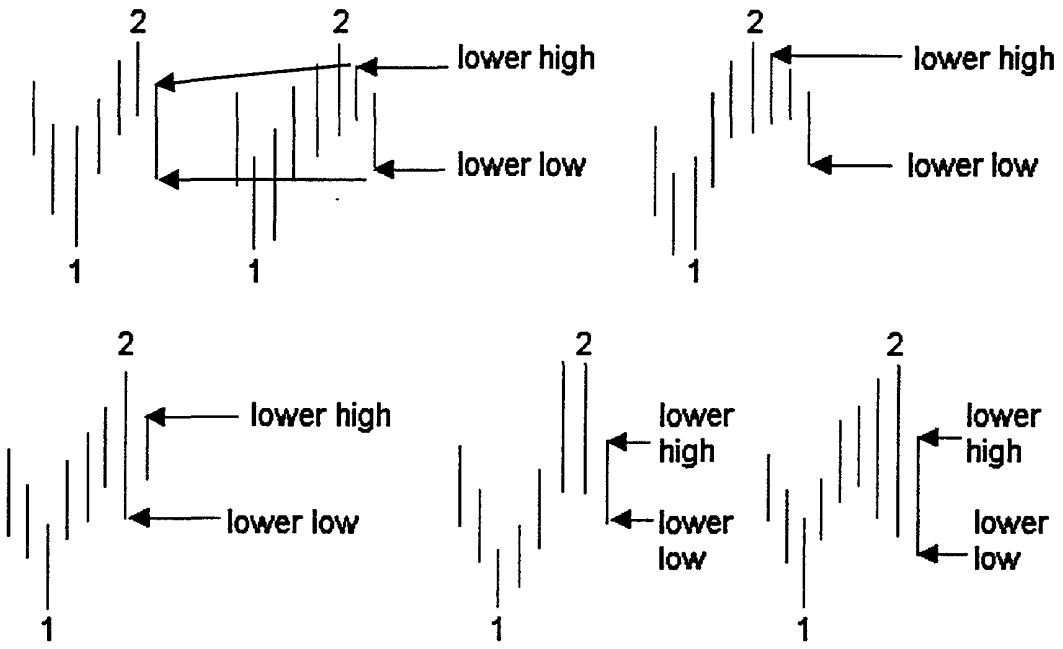
Now, let's look at a 1-2-3 low.

A typical 1-2-3 low is formed at the end of a downtrending market. Typically, prices will make a final low (1), proceed upward to a point where correction begins (2), and then resume an upward movement thereby creating the pivot (3). There can be more than one bar in the movement from point 1 to point 2, and again from point 2 to point 3. There must be a full correction before points 2 or 3 can be defined.

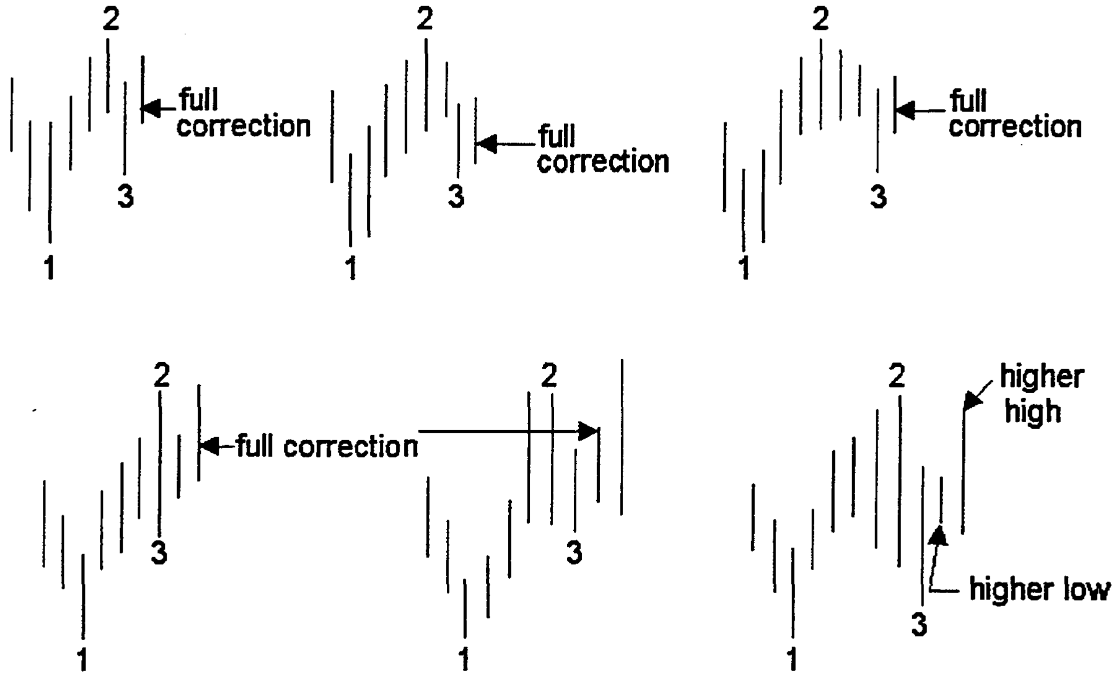
A number 1 low is created when a previous down-move has ended and prices have begun to move up.

The number 1 point is identified as the last bar to have made a new low in the most recent down-leg of the latest swing.

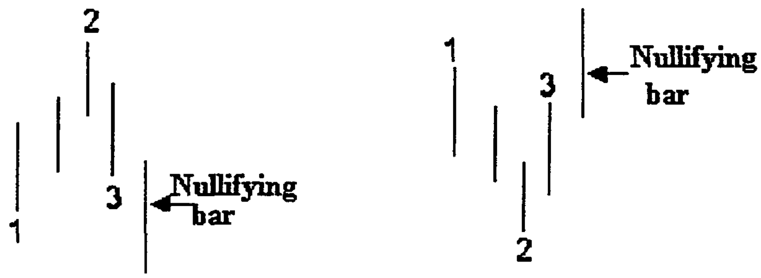
The number 2 point of a 1-2-3 low is created when a *full* correction takes place. Full correction means that as prices move down from the ***potential number 2*** point, there must be a single bar that makes both a lower high and a lower low than the preceding bar, *or* a combination of ***up to three bars*** creating both the lower high and the lower low. The lower high and the lower low may occur in any order. Subsequent to three bars we have congestion. It is possible for both the number 1 and number 2 points to occur on the same bar.



The number 3 point of a 1-2-3 low exists when a full correction takes place. A full correction means that as prices move up from the potential number 3 point, there must be a single bar that makes a higher low and a higher high than the preceding bar, *or* a combination of ***up to three bars*** creating both the higher low and the higher high. It is possible for both the number 2 and number 3 points to occur on the same bar.



The entire 1-2-3 high or low is nullified when any price bar moves prices equal to or beyond the number 1 point.

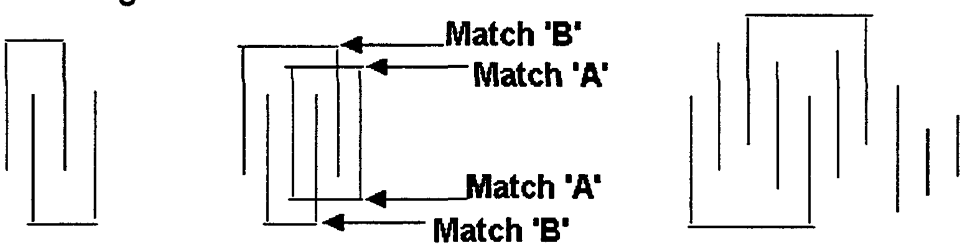


LEDGES

A LEDGE CONSISTS OF A MINIMUM OF FOUR PRICE BARS. IT MUST HAVE TWO MATCHING LOWS AND TWO MATCHING HIGHS. THE MATCHING HIGHS MUST BE SEPARATED BY AT LEAST ONE PRICE BAR AND THE MATCHING LOWS MUST BE SEPARATED BY AT LEAST ONE PRICE BAR.

The matches need not be exact, but should not differ by more than three minimum tick fluctuations. If there are more than two matching highs and two matching lows, then it is optional whether to take an entry signal from either the latest price matches in the series (Match 'A') or those that represent the highest and lowest prices of the series (Match 'B'). [See below]

A LEDGE CANNOT CONTAIN MORE THAN 10 PRICE BARS. A LEDGE MUST EXIST WITHIN A TREND. The market must have trended up to the Ledge or down to the Ledge. The Ledge represents a resting point for prices, therefore you would expect the trend to continue subsequent to a Ledge breakout.



TRADING RANGES

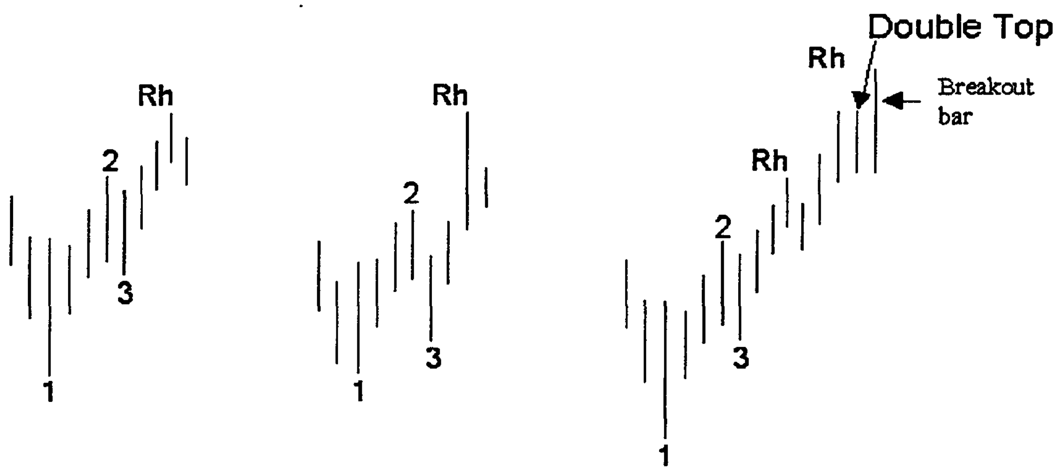
A Trading Range (See below) is similar to a Ledge, but must consist of more than ten price bars. The bars between ten and twenty-one are of little consequence. Usually, between bars 20 and 30, i.e., bars 21-29, there will be a breakout to the high or low of the Trading Range established by those bars prior to the breakout.

ROSS HOOKS

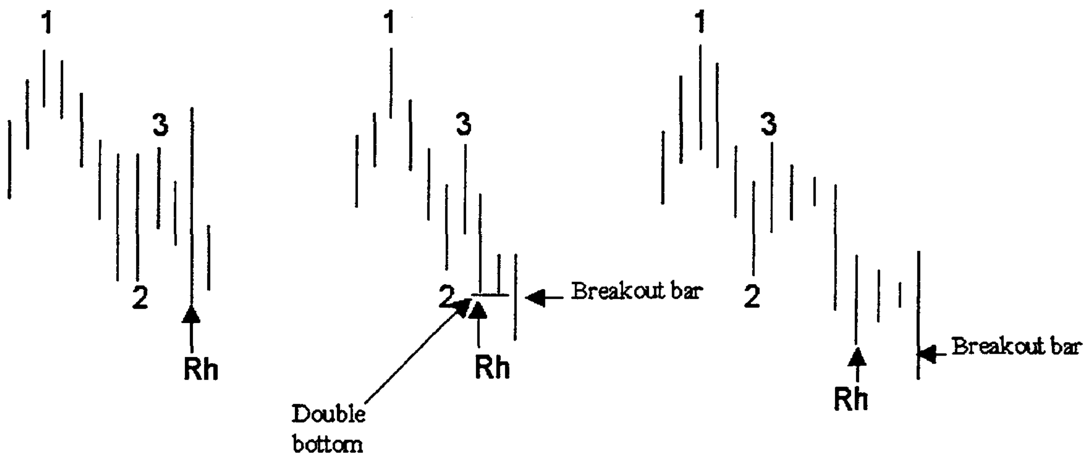
A Ross Hook is created by:

The first correction following the breakout of a 1-2-3 high or low.
The first correction following the breakout of a Ledge.
The first correction following the breakout of a Trading Range.

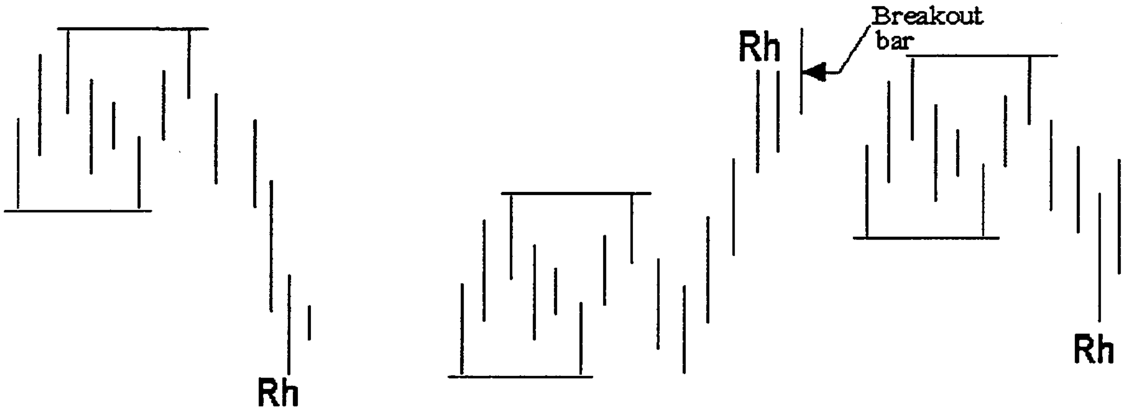
In an uptrending market, after the breakout of a 1-2-3 low, the first instance of the failure of a price bar to make a new high creates a Ross Hook. (A double high/double top also creates a Ross Hook).

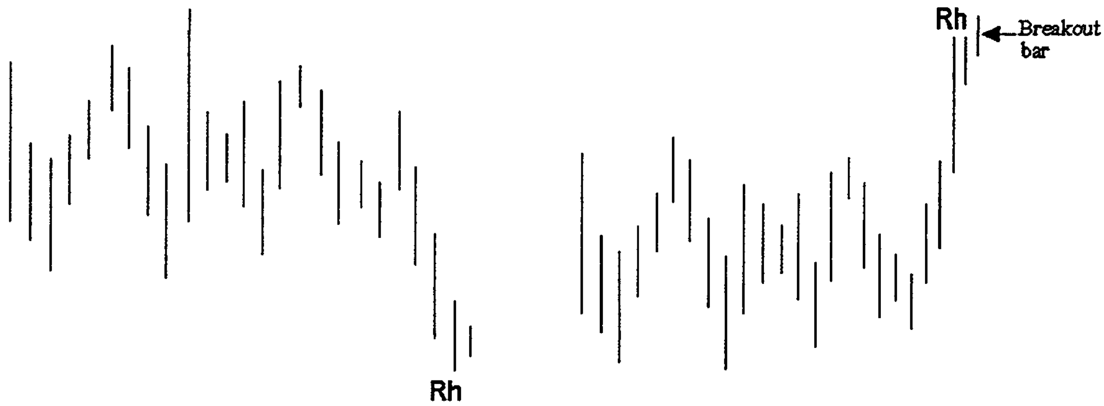


In a downtrending market, after the breakout of a 1-2-3 high, the first instance of the failure of a price bar to make a new low creates a Ross Hook. (A double low/double bottom also equals a Ross Hook).



If prices breakout to the upside of a Ledge or a Trading Range formation, the first instance of the failure by a price bar to make a new high creates a Ross Hook. If prices breakout to the downside of a Ledge or Trading Range formation, the first instance of the failure by a price bar to make a new low creates a Ross Hook (A double high or a double low also creates a Ross Hook).





We've defined the patterns that make up the Law of Charts (TLOC). Study them carefully.

What makes these formations unique is that they can be specifically defined. The ability to formulate a precise definition sets these formations apart from such vague generalities as "head and shoulders," "coils," "flags," "pennants," "megaphones," and other such supposed price patterns that are frequently attached as labels to the action of prices.

When one looks up into the night sky, it takes great imagination to say, "Oh, look! There is a 'bear' up there. By what definition is there a "bear" to be seen in the night sky? It is much the same with many of the so-called formations that various experts claim to see on charts. They lack definition and are seen only through a stretch of the imagination. The terms 1-2-3's, Ledges, Trading Ranges, and Ross Hooks may be names concocted from imagination, but the definition of these formations is precise.

The material on the law of charts should not be used without first studying the Trader's Trick which is presented in <u>ELECTRONIC TRADING 'TNT' I — GORILLA TRADING STUFF</u>.

Appendix D

MARKET MAKERS

ABSB	ALEX BROWN & SONS, INC.
AGIS	AEGIS CAPITAL CORP.
BEST	BEAR STEARNS & CO., INC.
BTSC	BT SECURITIES
CANT	CANTOR FITZGERALD & CO.
CHGO	CHICAGO CORP.
CJDB	J LAWRENCE DEUTSCHE BANK
COST	COASTAL SECURITIES
COWN	COWEN & CO.
DAIN	DAIN BOSWORTH, INC.
DEAN	DEAN WITTER
DLJP	DONALDSON LUFKIN JENRETTE
DOMS	DOMESTIC SECURITIES
EXPO	EXPONENTIAL CAPITAL MKTS.
FACT	FIRST ALBANY CORP.
FAHN	FAHNESTOCK & CO.
FBCO	FIRST BOSTON CORP.
FPKI	FOX-PITT, KELTON, INC.
GRUN	GRUNTAL & CO., INC.
GSCO	GOLDMAN SACHS & CO.
GVRC	GVR CO.
HMQT	HAMBRECHT & QUIST, INC.
HRZG	HERZOG, HEINE, GEDULD, INC.
JEFF	JEFFERIES CO., INC.
JPMS	J.P. MORGAN
KEMP	KEMPER SECURITIES, INC.
LEHM	LEHMAN BROTHERS
MADF	BERNARD MADOFF
MASH	MAYER & SCHWEITZER, INC.
MHMY	M.H. MEYERSON & CO., INC.
MLCO	MERRIL LYNCH
MONT	MONTGOMERY SECURITIES
MSCO	MORGAN STANLEY & CO.

MSWE	MIDWEST STOCK EXCHANGE
NAWE	NASH WEISS & CO.
NEED	NEDDHAM & CO.
NMRA	NOMURA SECURITIES INTL.
OLDE	OLDE DISCOUNT CORP.
OPCO	OPPENHEIMER & CO.
PERT	PERSHING TRADING CO.
PIPR	PIPER JAFFRAY
PRUS	PRUDENTIAL SECURITIES.
PUNK	PUNK ZIEGEL & KNOELL.
PWJC	PAINE WEBBER INC.
RAGN	RAGEN MCKENZIE INC.
RPSC	RAUSCHER PIERCE
RBSF	ROBERTSON STEPHENS & CO.
SALB	SALOMON BROTHERS
SBNY	SANDS BROTHERS & CO., LTD
SELZ	FURMAN SELZ INC.
SHWD	SHERWOOD SECURITIES CORP.
SNDV	SOUNDVIEW FINANCIAL
SWST	SOUTHWEST SECURITIES.
TSCO	TROSTER SINGER CORP.
TUCK	TUCKER ANTHONY, INC.
TVAN	TEEVAN & CO., INC.
UBSS	UBS SECURITIES
WARB	S.G. WARBURG & CO., INC
WEAT	WHEAT FIRST SECURITIES.
WEDB	WEDBRUSH MORGAN SEC.
WEED	WEEDEN & CO. LP
WERT	WORTHEIM,SCHRODER

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