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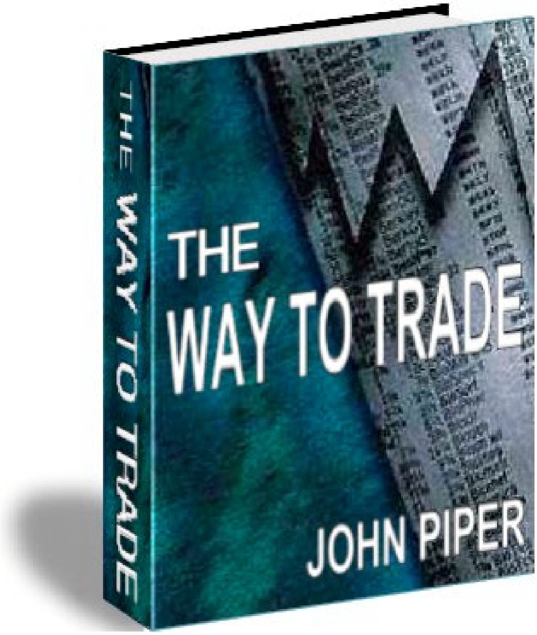

THE
WAY TO TRADE
JOHN PIPER
THE WAY TO TRADE

# THE WAY TO TRADE

Discover your
successful
trading personality

JOHN PIPER

# THE WAY TO TRADE

## About the Author

John Piper has been involved with markets since his early twenties. In the late 1980s he started to trade options full time and did so right through the Crash of 1987 – an experience that stands him in good stead for markets today. For over a decade he has been the editor of *The Technical Trader*, the leading newsletter in the UK for those who trade futures and options markets worldwide. His articles bring a fine edge of analysis to markets and how they work. He trades full time, making consistent profits, and now manages money for selected clients at Berkeley Futures Limited, a firm regulated by the SFA. He lives in Cobham, Surrey and in Massa, Italy.

This book is dedicated to
all those who are struggling with markets, whoever and
wherever they may be.

# CONTENTS

**Why you need this book** xiii
**Foreword** by Dr Alexander Elder xvii
**Introduction** xix
**Acknowledgements** xxi

**Section 1**
**THE UNDERLYING PHILOSOPHY**

**1 An introduction to the Trading Pyramid** 3
The Trading Pyramid 4
Summary 9

**2 The evolution of a trader and the 55 steps** 11
The three stages 12
The 55 steps (a personal journey to success) 15
Summary 19

**3 The human brain** 21
Structure of the brain 22
Trading chaos 26
Summary 26

**4 You – the first level of the pyramid and why** 29
The trading experience 30
Summary 33

**5 Commitment** 35
The nature of the market 35
Market Profile 37
Summary 39

**6 Discipline** 41
Discipline and the Trading Pyramid 42

System parameters 43
Summary 45

**7 Money Management** 47
Using Money Management 48
Position size 49
Monitoring position 50
Summary 51

**8 Risk control** 53
Risk inherent in the vehicle 54
Risk inherent in the market 55
Other forms of risk 55
Summary 57

**9 The three simple rules (or trading secrets)** 59
The trading secrets 60
Following the rules 61
Summary 66

**10 System parameters – the thinking behind system design** 67
Buying options 68
Writing options 68
Futures 68
Designing a system 69
Summary 75

**11 System parameters – simple trading rules and the human brain** 77
Systems 78
The human brain 79
Summary 81

**12 Developing your methodology** 83
Time frame 84
Trading type 84
Analysis type 85
Money Management (MM) 85
Risk control (RC) 87
Entry methodology (EM) 87

Exit methodology (ExM) 87
Interview with an institutional trader 88
Summary 93

**13 Operation** 95
The set-up 96
Problems with operation 97
Summary 99

**14 The whole structure = profit/loss** 101
Summary 103

**15 Stops and acceptance** 105
Are stops necessary? 105
Stop approaches 106
Acceptance 107
Summary 110

**16 A trading coach?** 111
The benefits of working with a coach 111
Adrienne Toghraie 113
First steps 114
Summary 115

**Section 2**
**MARKET TECHNIQUES AND METHODOLOGIES**

**17 Some points of principle** 119
More general points 120
Low risk trading opportunities 122
Trading tips 123
Summary 125

**18 Market Profile and Minus Development** 127
Market Profile 127
Minus Development 130
Value 130
Other concepts 132
TTT article 132
Trading tips with Market Profile 136
Summary 137

**19 Futures and options** 139
Stocks 139
Futures 140
Options 141
Summary 149

**20 Spiky action** 151
Trading Trend 151
Types of spike 152
Summary 153

**21 An options strategy** 155
The options strategy – principle 155
The options strategy – operation 157
Options – the hedging strategy 158
Summary 163

**22 A number of futures strategies** 165
Gas opens – code word: goose 166
Failed breakthroughs – code word: goat 169
Failed re-tests – code word: snake 172
Square congestion – code word: box 172
Key levels – code word: piano 173
Eliott fives – code word: illusion 174
Aborted patterns – code word: platypus 175
Trend following – code word: horse 176
Corrective action 177
Other systemized approaches 178
Summary 179

**23 Systems** 181
Stops 182
One secret to success 183
A few additional comments 183
My own trading 183
My trading rules 184
Risk warning/disclaimer 185

It doesn't end here 186
Summary 187

**24 Trading systems and when to use them** 189
Trading systems 189
How to make a fortune trading futures 191
Summary 193

**25 Market myths** 195
Indicators and market techniques 195
News 196
Zero sum? Don't you believe it! 196
Systems 197
Summary 197

**26 The 10-step approach to futures and options trading** 199
Step 1: Where am I now? 199
Step 2: Where do I want to go? 200
Step 3: Survival (1) 200
Step 4: Survival (2) 201
Step 5: Methodologies 201
Step 6: Theory 202
Step 7: Practice 203
Step 8: Fear 203
Step 9: Running profits 204
Step 10: Expertise 204
The consultancy service 204
Summary 205

**Section 3**
**A CHART TUTORIAL**

**27 Low risk trading opportunities on U.S. and U.K. markets** 209

**Section 4**
**AN OPTIONS TRADING CAMPAIGN**

**28 A war of attrition** 221

**Epilogue** 231

## APPENDICES


1 **Follow-up Services** 239

2 **The Troubled Trader** by Tony Plummer, MSTA 241

3 **Recommended reading** 255

4 **Trading and psychology questionnaire** 257

5 **Is Elliott addictive?** 269

**Index** 275

# WHY YOU NEED THIS BOOK

If you are an individual trader, whether a novice or experienced, you will benefit from reading this book because:

**1** Trading the futures and options markets leads to a greater compounding of wealth than any other method available. Billions have been made in days on many occasions, and will be made again. Nothing else comes close.

**2** It is possible to make money in the markets *consistently*. It is possible to beat the market. The author, John Piper, among many others, has done it. To do the same you need to follow a proven methodology which suits your personality. This book explains how.

**3** This book also sets out a number of proven methodologies, giving you a head start in selecting the one which will work for you.

**4** But it also goes a lot further. John Piper wrote this book because he had never come across a book which deals with the whole issue of trading. There are many books which deal with market analysis, and technical analysis techniques. There are many books which deal with psychology. There are books which deal with money management and all manner of other subjects, some even cover a range of topics. But no other book covers it all, from a successful philosophy of trading, through all the psychology, into the methodologies, the operation thereof, and the end result.

**5** It is rare to find a book which appreciates that it is no good doing it "how I say." We each have to find our own route to success. This book spells out why that is, and how to do it. That is what *The Way to Trade* is all about.

**6** The futures and options markets offer the biggest potential for growth, far more than is offered by stock markets. The people who really make it big do so in these markets. Perhaps more importantly you can make money whether markets go up or down. In coming years this may be important.

Fascinated? You should be, and anyone who is into money, and wants lots more of it should check out this book. Rich or poor, working or retired, there is something for everyone in these pages.

## Why this book is unique

Trading is a life experience, it is not like any other business. As you become a better trader, you become a better person. But as you evolve it is difficult to look back at where you were. I believe this is why there are no other books which cover all the ground. Those traders who do make it often "forget" how they got there, not surprisingly, as a lot of the skills become subconscious.

However, John has always combined his trading with writing about markets. This has given him a fairly unique insight and forced him to express personal matters which other traders just assume. It has also forced him to more carefully examine the precise process involved in becoming a successful trader. It is solely through this process that John Piper "discovered" the Trading Pyramid. This is the first attempt to create a model for trading success and traders will find it immensely useful.

So not only does this book take the trader right through from the beginning to the end result (trading profits, lots of them!) it also provides a framework against which to work.

## There are no right or wrong ways to trade

The only thing that counts is the result. This book sets out a range of parameters within which to build the system that suits you. The beauty of trading is that it becomes an expression of your own personality. Good traders don't do, they simply are. But to become a good trader you have got to find the approach which will work for you. This book, and the follow-up services that are available with it, will help you do just that.

## Follow your own path

But to get there you must follow your own path. It is no good following the trades other people do. Certainly you need help to learn this business, which is what this book is all about. You need a mentor, but you do not need gurus who tell you how to trade. You will only win by trading your way. Indeed Frank Sinatra's big hit "My Way" is an excellent anthem for any trader. Taking that step to do it by yourself is one many traders find the most difficult, but it is essential.

If you don't want to do it your way then you are better off giving your money to another trader, like John Piper, so that he can trade it for you. But make sure you check out the track record and risk profile first.

# FOREWORD

by Dr Alexander Elder
Financial Trading Inc.

Successful trading is based on 3 Ms – Mind, Method, Money.

Mind refers to your trading psychology. You must follow certain psychological rules that lead to winning when faithfully applied and avoid pitfalls that become death traps for most losers.

Method refers to how you find your trades – how you decide what to buy or sell. Each trader needs a method for choosing specific stocks, options, or futures as well as rules for "pulling the trigger" – deciding exactly when to buy and sell.

Money refers to how you manage your trading capital. You may have a brilliant trading system, but if your Money Management is poor, you are guaranteed to lose money. A single unlucky trade can destroy your account if Money Management is not in place.

Trading psychology, trading method, and Money Management – people sometimes ask me which of the three is most important. I answer – imagine sitting on a three-legged stool. It is pretty stable, but try getting comfortable sitting on that stool after taking away any one of its three legs. Now please tell me which of the three legs is most important?

Traders go through three stages of development. When people first approach the markets, they usually focus on the method. Most of them do not survive this stage. They are too inexperienced and do not have anyone who can tell them how to stay out of trouble. No amount of optimized moving averages or fine-tuned trendlines will keep them alive in the markets.

Those who survive that stage acquire a greater sense of confidence. They acquire a method of selecting what to trade and the tools for analyzing markets and deciding when to buy or sell. Some become quite proficient in technical analysis, market indicators and systems, using computers to search on-line databases. Then the smarter survivors start asking themselves: if I am so good, how come I am making so little money? How come my account is up 20 per cent one month, and down 20 per cent or worse the next month? I clearly know something about the markets – why can't I hold on to what I make?

Traders at the second stage tend to grab profits and buy something before their money evaporates in a series of bad trades. Then one day they look in a mirror and realize that the biggest obstacle to winning is the person they see in it. Impulsive and undisciplined trades with no protective stops lead to losses. A trader who survives the second stage comes to recognize that his or her personality, with all its complexes, quirks, and faults is just as much a trading tool as the computer.

Traders who survived that stage become more relaxed, quieter, not jumpy in the markets. They are now in the third stage – focusing on managing money in their trading accounts. Their trading system is in place, they are at peace with themselves, and they spend more and more time thinking how to allocate their trading capital in order to reduce overall risks.

The concept of the 3 M's comes from my book *Trading for a Living* which has become an international bestseller. I met John Piper six years ago and enjoyed watching him grow and mature as a trader and a teacher of traders. It gives me pleasure to see that we share a number of ideas about markets, such as the 2% Rule, the concept of the market as a manifestation of human psychology, buying below value and selling above value, the market as a minus-sum game.

In the book you are about to read John Piper takes you beyond theory in a very useful Chart Tutorial. He invites you to follow him through a series of trades, commenting on his actions along the way. He provides an essential lesson that most beginners never get.

In *The Way to Trade* John Piper mentions that he has been managing money profitably for the past year and I know that he has been trading for many years before that. To get really serious money under management in the US requires a five year audited track record. I wish John success in continuing to make consistent profits and his readers a captivating and profitable journey into the financial markets.

Dr Alexander Elder
*New York – Moscow*

# INTRODUCTION

I have been trading futures and options markets for over a decade. I now manage money and make good consistent profits. So what I have to say about markets has been forged in the fire of market action itself. I have suffered the highs and the lows which all traders experience on the road to success.

This book is unique in that it takes the reader right through the trading process and it also uses a model, the trading pyramid, which explains the process and the inter-relation between the component parts.

The key component for successful trading is the underlying philosophy of trading and this is what so many books and seminars ignore. There is so much written and spoken about analysis but that is such a small part of the game. *Good trading is not a question of doing, it is a question of being.* This book is dedicated to those who want to become good traders. *Analysis and trading technique are useless to those who have not gone through this process.*

Having dealt with the underlying philosophy, we then move onto specific trading techniques and the underlying analysis which builds those techniques. I do not believe that analysis is used correctly by the vast majority of those who risk capital in worldwide markets. Analysis is not for use on markets, it is solely to devise your methodology/approach to the market. You must devise this methodology and then use it. Thus you become an expert in its application and then the money flows your way.

But you must have your own methodology; it is no good being spoon fed something by the currently "hot" guru. This is very unlikely to suit your trading personality. This book tells you how to develop your own methodology and explains the feedback process within the pyramid that will make it work for you.

*Most people lose in the markets for one simple reason – they trade emotionally*. When traders understand the problem they improve by becoming mechanical. This is a big improvement but it is still not enough. To be truly successful you have to become intuitive, and this simply means you become an expert in what you do – something you achieve through experience. It is this path I chart in this book. I think you will enjoy it.

Don't accept anything in this book at face value. It is an essential part of a trader's development to carefully consider all aspects of the market and his individual approach to it. Some of the statements made in this book are deliberately provocative and designed to ferment that process. So don't accept anything, think about it, draw your own conclusions, and thus create your own *useful* beliefs about markets and your methodology. The key word is 'useful'; your beliefs and techniques must prove their usefulness in producing lots of lovely profits.

Finally I must say that there are various lessons in trading which become particularly relevant at particular times during our progress towards success. For this reason you may find that parts of this book do not seem relevant to you the first time you read it. But they may well do so on a subsequent reading. This is a book which may repay frequent readings!

*John Piper*

(Editor's note: *John welcomes comments on this book and contact details appear on page 240*.)

# ACKNOWLEDGEMENTS

Many, many people have gone into the making of this book. Frequently I speak to a consultancy client or discuss a point with an attendee at one of my seminars and gain insight which I have tried to distill into these pages.

I am also grateful to the authors of the many works on markets and trading which I have read. The key works are listed in Appendix 3, but I must single out Tony Plummer whose article "The Troubled Trader" appears in Appendix 2. This article makes it clear why we find trading a tough proposition.

In my own trading career I owe a great deal to Adrienne Toghraie for her help with my psychology, and to Adam Seccombe who is, even now, helping bring in further sums for me to manage.

Thank you to those who took the trouble to read the first draft of this book, especially Dr Alexander Elder who was kind enough to also write the Foreword.

Thank you, also, to the team at Financial Times Pitman Publishing who are responsible for the work you hold in your hands, particularly Richard Stagg, Iain Campbell, Elizabeth Truran and Heather Serjeant.

Thanks also to my family who bore the brunt of the difficult years before I learnt how to make money consistently.

Finally I must thank Karen for all her help with the book, not the least for soothing my troubled brow when I most needed it.

## Section 1

# THE UNDERLYING PHILOSOPHY

## Chapter 1

# AN INTRODUCTION TO THE TRADING PYRAMID

When we enter the trading arena we enter an environment unlike anywhere else. The rules we have lived by in the normal outside world no longer apply and, indeed, will cause us loss. Our very motivation can be our own worst enemy as we seek to extract money from the markets.

To succeed in the markets we need to put in place an entire structure, as we have put in place an entire structure (personality) in the outside world. The Trading Pyramid is just such a structure. But before I begin to explain how it works let me give you two examples of why our normal behavior and motivations are not going to help us in the markets.

Many people enter the markets because they have had a successful career or business life elsewhere. At this point they may feel a little bored with life and seek a new challenge. This is very normal, and the kind of stimulus all of us have felt at one time or another. But think about this for a minute. Such an individual, starting to trade, will probably, like many other traders, trade in a fairly haphazard manner to start with. I term such trading "emotional," because whatever method traders may think they are using, the ultimate decision is more usually an emotional one. I will explain this in more detail later in this book. So the overall rationale can be described as "the person is bored and wants to trade." So what happens the next time boredom sets in? Once able to trade, it is very likely that a person will make the emotional decision to do just that when bored. This timing is unlikely to correspond with a low risk trading opportunity; I will also be talking a lot about those later in this book.

So the first question traders must ask themselves is "Why do I trade?" The answer to that simple question may save you a fortune.

Now to the second example. In this modern world where we all seek gratification as and when we want it, what do we do when we are offered something nice? We take it. In the real world what do we do when something unpleasant comes along? We seek to defer it and hope that time may lessen its impact. What are these tendencies going to do in the market? They are going to mean you take profits too quickly and take losses too slowly. Yes, you will be cutting your profits and running your losses. What works in the real world does *not* work in the market. These are just two of the many reasons why all traders need the Trading Pyramid.

## The Trading Pyramid

The Trading Pyramid is illustrated in Figure 1.1. Each level builds on the next and, indeed, is essential if the next level is going to be put in place. Each trader already has such a structure in place but if trading and losing then the pyramid needs to be re-built along the right lines – lines which are going to be fully explained in this book.

In this chapter my only aim is to introduce the overall concept and in succeeding chapters I will look at each level in detail. The first level is *you.* Obviously if you are not in place, do not exist, then it will not be possible to add further levels. But also *you* determine the overall structure, as you have to build something which suits your overall personality. As such, each individual trader will have a somewhat different structure, although I believe there will always be common features. Because of this, it is vital that traders each plough their own field. I often tell my consultancy clients that one of the major steps they must take is to learn to be disinterested in what I or anyone else says about the market. Because your trading structure is going to be different from mine or from anyone else's you must learn to initiate and manage your own trades, nothing else is going to work. So already we can see how this model becomes useful – it gives us insights into the way trading works.

***You must learn to initiate and manage your own trades, nothing else is going to work.***

The next level is commitment. Trading is a tough business, in my view one of the toughest. And that is only right as it is also the highest


**Fig 1.1 The Trading Pyramid**

paid in the world for the high flyers – so you would expect it to be tough. If you are going to battle your way through then you are going to need to be committed. But even if you get as far as reading this book then you are probably already committed. That means that you have already accepted that it is not going to be easy.

Next comes discipline, a key factor in trading markets. You have to learn about your own emotions and control them. This takes discipline. You need to develop a methodology that gives you an edge, and if you are going to use that you will need the discipline to do so. This brings in another point, because there are some things we can do and some we cannot. We do not need to make it unduly difficult for ourselves, so our methodology should be one to which we are suited, it should also be one in which we become expert. Once these two conditions are in place the ability to exercise discipline and to follow our systems becomes a lot easier, although the discipline itself remains essential. But this is an example of how the various levels of the pyramid inter-relate. Also this illustrates how the structure is organic and evolves as our trading skills and experience grows. Our methodology is, in part, a function of our experiences of different market strategies and our knowledge about ourselves and our own emotions. So as we (*you*) evolve, this creates a feedback loop to our system / methodology which also has an impact on the discipline level, and all other levels.

We have so far looked at the first three levels and these levels may be categorized as the "Personal" levels; they contain what we bring to the party. For the purposes of these three levels, we may never have looked at markets, may never have taken a trade. The next five levels have to do with developing our methodology. There are many books on trading which only deal with system design. Some only deal with analysis techniques – yet this is a tiny part of this game, forming merely part of one of the levels within the pyramid – that level being System Parameters.

Money Management (MM) is the first key feature of any methodology. Without appropriate MM policies nothing is going to work. A system with a 99 per cent success rate (which sadly does not exist other than in the physical sciences, an airplane with that success rate would not be very popular!) would still wipe you out if you risked 100 per cent of your capital on each trade. Similarly risking too little on such a system would produce much less than you might otherwise expect. Getting your risk parameters right is the first step, and this also has to be personalized. Most people fail because they put themselves under too much pressure, this produces excess emotion, and emotional trading is a losing occupation. There are two types of pressure of particular importance. The first is financial pressure; if you risk too much cash then you become "a fugitive from the law of averages", and you will be wiped out, that is guaranteed. The second is psychological pressure, maybe as a subconscious realization of the financial pressure. Both of these must be avoided. Partly this has to do with experience, and partly with your risk parameters for each trade. I think that 1–2 per cent per trade is about right. You can still make lots of money but you need not feel pressurized. One of the "market wizards" said that almost all traders should immediately halve their trading size, that is good advice.

Next we have Risk Control (RC). MM and RC are interlinked. MM is essential, as set out above, but often MM policies include RC. For example using a stop loss point (mental or "in the market") controls risk, but the amount of risk is an MM matter. To be a successful trader you must minimize risk. It is for this reason that we often see sharp moves after a news item, often in the opposite direction to that suggested by the news item itself. This is because the big traders, who got that way by minimizing risk, wait for such risky items as news to be out of the way before taking positions. But what the news actually says is rarely of import – See Chapter 25 on Market Myths. Higher risk times include around news items, overnight and over the weekend, among others. Unexpected news items are something we can do nothing about except minimize risk at all times. We can never eliminate risk and we don't really want to because without the risk there would be no reward. Traders have to be like tightrope walkers. Many people think that tightrope walkers learn to balance, but they don't. Instead they learn to live with imbalance, in the same way a trader must learn to live with risk.

***Traders have to be like tightrope walkers, they learn to live with imbalance, in the same way a trader must learn to live with risk.***

This takes us to the three simple rules, which I often call "trading secrets." You see the best place to hide anything is out in the open where everyone can see it. You see such things all the time but do not realize their value. This is completely true of the three simple rules. You know these well:

1 Cut your losses.
2 Run your profits.
3 Trade selectivity.

These correspond with the three stages which traders go through, although these stages can be described in different ways. The Evolution of a Trader (see Chapter 2) describes these three stages as "greed-orientated," "fear-orientated," and "risk-orientated." These three stages can be linked to the three simple rules. Another way of describing the trading experience can also be linked to three simple rules. This is Emotional to Mechanical to Intuitive, but we are getting a little ahead of ourselves. In my view any methodology which does not follow the three simple rules is not going to be effective. Having said that, some purely mechanical approaches are reputed to do well, but they would perform much better if you get the trade selectivity right (see again Chapter 25). Only now do we get to talk about market analysis, as we must now look at system parameters. But all the key features are already in place, and once they are in place we will have no real difficulty with system parameters because we will better know ourselves, know how we want to trade, know what we need to trade that way (rather than merely buying the software package with the glossiest brochure or the best sales pitch), and be able to do so – and this final stage should not be minimized.

In my opinion the purpose of analysis is generally misunderstood. It is not for market analysis, it is for putting your system in place. You must decide how you want to trade; futures, options, hedging, long term, short term, are all factors which relate to this. You may decide that you want to trade with the trend and hold trades for between three days and three weeks depending on market conditions. You may decide that some form of trend indicator would be useful within your approach. Alternatively you may prefer to observe market action and draw appropriate conclusions from that, as I do. But whichever style you adopt you need to decide what triggers you into a trade and also how to get out. Personally I leave some of this to intuition, but I am far from perfect in this. But the point I am making is that there is some flexibility at this stage and the key thing is that the system/methodology follows the principles laid down in all the stages of the pyramid up to this point, that it is in accord with your trading personality and what you are trying to achieve.

Once this is the case you have your system and it merely comes down to operation. Now the real problems can start. There is a trader in the USA called Joe Ross. Among many other things, he has said **"Trade what you see, not what you think."** This is the key phrase when it comes to operation. So many trades are taken because traders become convinced of what might happen, they imagine the riches which would flow from that big fall, or that big rally. *Wisdom lies in sticking with what you can see.*

Some traders develop blocks on their trading. I will deal with this in Chapter 13 on Operation. But to introduce this topic, some of these problems have to do with complex thought processes which need to be unravelled, some to do with confidence which can be built through practice, and some to do with past experiences which need to be properly dealt with. Sometimes a trading psychologist can be helpful and there is a chapter on this as well (see Chapter 16).

The top of the pyramid is the result: profits or losses. Sadly most make losses, but this is inevitable. It is one of the conundrums of trading that if everyone was perfect no one would make any money because it is a negative sum game (see Chapter 25). But this is not going to happen because people are emotional animals and many do not want to change that. They provide the fodder for the winners. This book is about how to join that select group, I hope you enjoy it.

## SUMMARY

- The rules we live by in every day life do *not* work in the market environment.
- We need to construct a separate trading "personality" to succeed in the markets. This personality must learn much greater control over the emotions.
- The Trading Pyramid provides the necessary framework for this personality. Each of us will seek a different trading personality, making the most of our strengths and minimizing our weaknesses.
- The Trading Pyramid has the following levels:
  - YOU
  - Commitment
  - Discipline
  - Money management
  - Risk control
  - The three simple rules
  - System parameters
  - Your system/methodology
  - Operation
  - Profits/losses
- The structure is organic and each level interrelates with each other level
- Trade what you see, not what you think. (Joe Ross)

## Chapter 2

# THE EVOLUTION OF A TRADER AND THE 55 STEPS

This chapter describes some other ways of looking at the path traders take to success.

For some years I have set out a simple process which all traders seem to encounter on the road to success. This is detailed below and thereafter I expand this in a way which I feel will be useful for those who want to tread this path.

STARTS OFF **"Greed orientated**."

Loses because:

1 Market problems
   a Not a zero sum game, a "very negative" sum game (see Chapter 25)
   b Market psychology – doing the wrong thing at the wrong time
   c The majority is always wrong
   d Market exists on chaos and confusion.

2 Own problems
   a Overtrading
   b No knowledge
   c No discipline
   c No protection against market psychology
   d Random action through uncertainty, broker's advice for example
   e Market views.

RESULT: the **"greed orientated"** trader gets a good kicking and becomes **"fear orientated."**

Loses because:

1 Market problems as above
2 Scared money never wins
3 Own problems
   a Still overtrading – derivatives
   b Fear brings on what it fears
   c Tries to cut losses too tight creating more losses
   d Still no real understanding of what it takes.

RESULT: Traders who persevere “travel through the tunnel” and becomes **“risk orientated.”** This is when they start to make money because they:

1 Develop a methodology which give them an edge
2 Use an effective Money Management system
3 Develop the discipline to follow their methodology
4 Erase “harmful” personality traits.

This sets out the bare bones and you will note that there are three basic stages. As I often say it is curious that many things come in threes in the markets. Major trends can be sub-divided into three, there are three key trading rules, etc. The three key trading rules in fact equate to the three stages through which traders must pass.

## The three stages

The three stages have been labeled “greed orientated,” “fear orientated,” and “risk orientated.” However, these labels are not meant to be too literal, they are merely an attempt to approximate to the three key stages.

### Greed orientated

The first stage is characterized by ignorance and the thought that the markets will provide “easy money.” The actual emotion driving the new trader may not be greed, indeed it is often something else. A successful businessman or professional may be seeking a new challenge. Similar individuals may just be a little bored with their lifestyle and want something to spice it up. Others may be compulsive gamblers. One of the first problems facing a new trader is the very motivation to trade. Most people do most things emotionally. The decision as to which car to buy, which holiday to go on, etc. is usually based on emotional criteria. Just think why you own the car you do, why you married (or did not) the person you did (or did not). It is no surprise we come to the market and continue to make emotional decisions. But these will not work in the market because the market is an emotional animal itself and when the emotion is screaming *sell*, the successful trader is more likely to be buying. If we think about traders who are in the market to relieve boredom it becomes clear that the strongest impulse to trade will come when they are most bored. There is no reason why this emotional point should correspond with a good time to trade the markets. Other traders suffer from self-esteem problems, indeed I think we all do from time to time. If so, an argument with another person can again set the trader up for taking a position, to counterbalance the low self-esteem.

All these problems have to be dealt with before a trader can find success and, in my opinion, the only way in which the trader can "see" himself/herself is by using a fairly mechanical "system" so that he/she knows what he/she should be doing. In this way the trader can begin to see when his/her actions do not correspond to the system and start to question why this should be. It is through this process that we can begin to understand ourselves. I believe that this is a key requirement for trading success.

Because of these and other problems, as outlined above, novice traders lose a sufficient amount of cash to cause pain, many (most?) lose all their cash. The key point is that they become fearful as a result. At the same time they begin to realize the first secret of trading: *cut your losses*. It is this concept which marks the move to fear orientation. Indeed cutting losses can be seen as a reaction to fear.

## Fear orientation

At this point stops are used, but they are generally placed too tight. The trader has realized that trading is not easy and that a lot of hard work is required. Many fall by the wayside around this point. But those who persevere do show the necessary commitment for success. But greater tests may still come and that commitment is not always enough.

Fear orientation is inevitable given the nature of the beast, i.e. the human being. The market is not terrifying, or bad, or difficult. It just is what it is, and it gets on with its own business. It is how we perceive the market and how we act that causes the problems. We must realize that we are responsible for our results, nobody else, least of all the market itself. It is only when we accept responsibility that we can start to win. If our losses are someone else's fault then we are in effect saying that we have no control. If we have no control how can we win?

***The market is not terrifying, or bad, or difficult. It is just what it is, and it gets on with its own business.***

This stage can last a long time as we work out our various problems. Fear is not helpful in the markets because scared money never wins. We cut losers too quickly and we take profits too quickly. Our trading is characterized by nervous, over quick, action.

## Risk orientation

To become risk orientated we must make progress on all fronts. Knowing ourselves, changing as need be, understanding the trading process better, adjusting our trading methodology to suit ourselves, learning to relax when trading; these are a few of the necessary requirements. Most people should immediately at least halve their trading size and that can bring immediate relief/relaxation.

Risk orientation gets its name because you need to understand risk in order to win. Trading is a risk business, when you become risk orientated your orientation is right for the market.

The key trading secret at this point is *letting profits run*. It is at this point that you may start to make consistent profits in the market. Before you reach that stage you should never trade more than the minimum size, i.e. one contract. Why pay more in tuition fees than you need?

Once risk orientated you may learn the final trading secret, *trade selectivity*. Once you have that down pat it can all become less exciting. I make money consistently but I still find myself occasionally taking too many trades. To master trade selectivity you have to become an expert in your chosen approach. The key aspect of your approach is that you filter out a vast amount of market information and just focus on those factors which you need to know. It is a lot easier becoming expert in a narrow field than a wide one. The various sources of market information are so vast that it is not possible to take it all in. Let alone become an expert in it. You must decide what information you want, design your approach and then use it. Become an expert and you will find that you become intuitive, that is when you can select only the best trading positions, the low risk ones. Then it will all go the right way.

***You must decide what information you want, design your approach and then use it.***

## The 55 steps

### (a personal journey to success)

(*A simplified summary of the key steps taken by John Piper to get where he is today.)*

**1** We are intrigued by the market and start to do some preliminary reading and research.

**2** We buy a book or two and perhaps some newsletters.

**3** We find something we quite like and start doing some research using this particular technique.

**4** We dabble a bit in the market, trading every now and then, mainly losing money, but not much, and having the occasional winner.

**5** We generally forget about the losers and congratulate ourselves on our winners. Convincing ourselves that once we learn the techniques better there will be fewer of the former and more, lots more, of the latter.

**6** We keep manual charts, which may become quite large physically, and maybe plot a few indicators manually (this was before computers became quite so available).

**7** We spot an approach to the market we think cannot fail to win!

**8** We start to trade actively.

**9** The results make it clear that it is not as easy as appeared to be the case. There were a few key points we failed to fully appreciate.

**10** We continue to trade. Results are fairly indifferent (to bad) but there are enough profits to keep the interest up.

**11** We continue to expect great results.

**12** Trading volume increases and the amount of money in the market grows.

**13** We continue to read and take newsletters, but our research has only scratched the surface. We still have no real idea what we are involved with.

**14** Our technique scores a major success (the '87 Crash), but our lack of trading skills means that we do not profit from it as we might.

**15** The market begins to instill a little fear but we have yet to learn the first key lesson.

**16** We keep trading in size. We are overtrading and clearly act as a fugitive from the law of averages. It is only a matter of time.

**17** We make a big profit. It is all going well, we start to get overconfident.

**18** We suffer a big loss. Psychological problems start to develop.

**19** We buy a computer and start to monitor many more indicators.

**20** We look at other techniques and other markets.

**21** We get wiped out.

**22** It becomes clear this is not at all as easy as it looks.

**23** We become impossible to live with.

**24** It also becomes clear that the information available (in 1987/88) is not much use to those seeking to make money from trading.

**25** We determine to fill this void and look to create a newsletter telling it how it is.

**26** We work with an analyst in the USA. Note how inappropriate this is for someone who wants to trade. Much better to work with a trader!

**27** We continue to trade, but in a much reduced manner.

**28** We start our newsletter which is an immediate success.

**29** This requires a lot of research plus a lot of self analysis, but it is still not clear that trading is a psychological issue and that the externals (systems/software/computers/ brokers/advisers, etc.) are almost completely irrelevant until the internal is set up right.

**30** We are plagued with fear and have no clear methodology.

**31** It becomes clear that judgmental trading (without a clear methodology) is a dead end.

**32** We start to look for a suitable methodology.

**33** Those available on the market do not seem to be suitable and so we design our own.

**34** We start to trade using a clear methodology. This is not easy but some things start to become obvious.

**35** We find ourselves trading for no good reason (something that was impossible to detect before we had a clear methodology), but then realize that it is due to an argument earlier. Self esteem clearly plays a role.

**36** We realize that the key element in trading is our own mentality.

**Now we can start to make some real progress.**

**37** We improve our systems and start to make some money on a one contract basis.

**38** But we are still fearful and this remains a big problem. We learnt, some time ago, the necessity of cutting losses, we cannot get to the second secret until we deal with the fear.

**39** We keep trading and we continue to do OK, we start to get more confident and the fear starts to dissipate.

**40** We take another big hit.

**41** We feel awful and think we should perhaps give up, should perhaps have given up some years ago when it all went wrong the first time.

**42** We keep trading and determine not to get overconfident again. We reinforce the stress management systems we had to learn in the early days and keep meditating (essential to trading success). We realize the importance of remaining humble and also of being an "empty vessel." If you are full of yourself there is no room to learn anything else.

**43** We meet another trader who becomes a mentor. He introduces a new (to us) technique (Market Profile) which immediately "fits." This is because we now have the right attitude.

**44** We build on our successes. Systems improve, results improve, and our mental attitude improves, fear becomes less of a problem.

**45** We decide to see a trading coach/psychologist (Adrienne Toghraie) and have an initial meeting in Switzerland.

**46** We make a big profit by letting profits run. We have managed to do what every successful trader must. Can we repeat this trick?

**47** We start to move away from fear, and start to become risk orientated.

**48** We realize that mental attitude is all. We see that it is vital to be relaxed, we reduce position size, again!

**49** We spend a few days in the USA working in a group with our trading coach/psychologist.

**50** We begin to make money with consistency.

**51** We get a little overconfident, again! But this time we realize the fact and the damage is limited. But we learn, again, to remain humble.

**52** We start to trade almost subconsciously some of the time. We are becoming expert.

**53** We know there are still many challenges ahead but we are confident that we will deal with them.

**54** Money ceases to be a problem, we truly live in a world of abundance.

**55** We find that our lives improve across the board and that we are achieving in a wide range of areas.

## SUMMARY

- Two different ways of looking at the same journey: the Trader's Evolution and the 55 Steps.
- Greed orientation to fear orientation to risk orientation; greed orientation leads to losses and traders become fearful. They then need to persevere and develop the skills to become risk orientated.
- The 55 Steps (every mistake in the book) depict a stylised journey which John Piper has undergone to get where he is today.

Chapter 3

# THE HUMAN BRAIN

This chapter looks at two brain models which are useful when considering the way traders react to markets and why.

I recently published a series of articles by Tony Plummer entitled "The Troubled Trader" (see Appendix 2). These articles were based on the concept of the "triune" brain. I also read the book *Trading Chaos* by Bill Williams which proposed another "three part" brain model. Both of these models are useful for the consideration of traders because they identify trading problems and trading solutions.

Actually Bill Williams would say that is the wrong way of looking at it. Problems do not require solutions they require transcendence. Personally I would say that these models are essential and they have allowed me to go one step further and produce the Trading Pyramid. Perhaps that is a form of transcendence.

Background reading to this chapter is *The Disciplined Trader* by Mark Douglas, the series of articles by Tony Plummer (see Appendix 2) and *Trading Chaos* by Bill Williams.

First let me explain some of the concepts from the book *Trading Chaos*. Traditional "problem" solving can create a pendulum effect. A simple example is the discipline loop which traders often go through. We acquire the discipline to follow our trading methodology, we start to make good money, we then get over-confident, we start to diverge from the discipline, we start to do badly, we are humbled, we re-learn the discipline once again, we start to do well, we again become over-confident, and so it goes. This pendulum effect is seen in the real world again and again. To succeed we have to go beyond that state, this means we have to transcend that state. Bill Williams calls this "problem solving" process a "Type One Structure," transcendence he calls a "Type Two Structure."

He likens the comparison between these two structures to the difference between Euclidean geometry and the new "Chaos" approach to the world. I have to say I find the links to Chaos Theory in his book somewhat tenuous, but it still includes some excellent material. There is plenty about "fractals" but then they have been around for years.

## Structure of the brain

Getting back to the human brain. Tony Plummer's model is in three parts: the instinctive part, the emotional part, and the thinking part – see Figure 3.1. As we evolved from the primeval swamp, or wherever it was we came from, these parts formed in turn. So the brain stem derives from our reptile heritage and is millions of years old, this provides our instinctive drives. The limbic system derives from our basic mammal heritage and involves emotional input, this too is very ancient. Of more recent development is the "neo-cortex" which involves reflective thought processes and imagination.

The problem is that trading triggers many instinctive and emotional reactions and because these reactions are so deeply buried within the functioning of our brains it is difficult for us to override them. Hence a simple activity, trading, becomes very difficult to do well. In fact this does prompt the thought that by trading we are trying to cram a square peg (ourselves) into a round hole (the trading environment). However true this may be, I would argue that by so doing we learn so much about ourselves that the process (unpleasant though it may be at times) is extremely worthwhile. Money may be the smallest of the gains we make.

I have rather sketched over the "triune" brain as discussed by Tony Plummer because this is fully covered by his article in Appendix 2.

Bill Williams' three part brain is rather different and gives rise to different considerations. He divides the brain into the three parts: the "core," the "left hemisphere" and the "right hemisphere". He doesn't particularly focus on the negative aspects of each part but more on their positive aspects. This falls in line with his Type Two Structure.

To summarize a lot of detailed material (it makes sense to read the book itself) the function of these three parts can be stated as follows. The "idiot" left hemisphere has strictly limited ability but provides the "programing" for the "core" which goes and does what needs to be done. Of the million bits of information available at any one time the "idiot" left hemisphere (which is normally in charge) can handle around 16 bits, the core can handle the lot. Hence what we do well we do subconsciously because the left hemisphere has trained the powerful core to do the job.

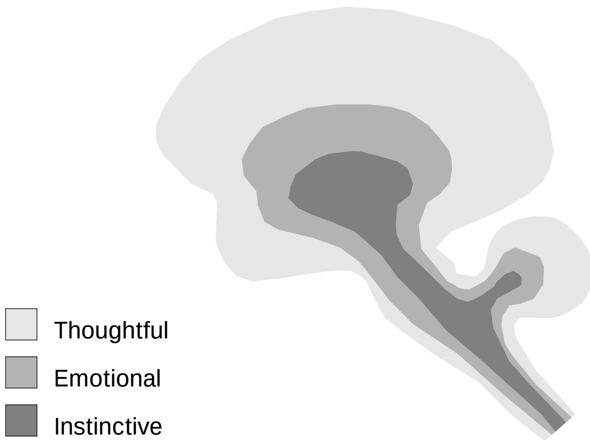



**Fig 3.1 The triune brain**

So the left hemisphere is "in charge" and here rests the ego which is filled with fear – primarily fear that it may become redundant. So it is always worrying, on the basis that if there is something to worry about it is still needed – illusory though this may be.

So what of the right hemisphere? Here we have the home of the 3 I's: **I**nspiration, **I**ntuition, and **I**magination (and perhaps also **I**nsight). Some say the power of the right hemisphere is infinite, that it is a direct link to the "God Force" (call it what you will).

In Bill Williams' model, (which in many ways is a far more appealing concept – thus we may find ourselves believing it more because we believe what we want to believe) there is access to vast resource and we just have to use it by transcending our current state.

The concept of the "triune" brain fits within Bill Williams' model and subdivides, in the main, the core and the left hemisphere, although the third part of the triune brain, incorporates the right hemisphere as well. But the focus of Plummer's writing is on the problems presented by the structure of our brains and not how these problems may be transcended.

Personally I feel that the concept of the triune brain and its problems in trading are self evident. Those who have traded *know* these problems all too well. We do not need to discuss whether or not the concept is right, because we have been there.

We could perhaps say that it is only a model and as such is merely a representation of the true reality. As such perhaps it is merely a useful lie – a concept which we can use but which is not the "truth." Indeed, yes, but then so is everything, including the chair you are sitting on and the book you are holding in your hands. Everything within your mind is only a representation of the truth.

Bill William's three part brain is perhaps a little more complex, but there is plenty of evidence for its existence and its usefulness. When we learn to ride a bicycle we go through the process of trying to ride it with the idiot left hemisphere and falling off. Eventually the core becomes trained and after that it is plain sailing. Actually I managed to fall off my bicycle the other day, but we will ignore that as a red herring. We have all experienced, I expect, driving up the motorway and being unable to remember the last few miles. This is because the core has been doing it all for us. Less common is the experience of the right hemisphere taking control.

Bill Williams explains how we know which part is in control:

> One of the most interesting characteristics of your intrapersonal inhabitants (the three parts of the brain) is that you can always tell in an instant which one is in command. The way the world looks to you at this moment will tell you exactly which one is in charge. If your life at this instant is a struggle, you are concerned about time and language, you dearly want to do the right thing, and/or you aren't having fun, your left hemisphere is definitely in charge. If, on the other hand, life is a series of ups and downs, you feel good physically, and you are having a good time, you are operating from your core. If life is absolutely a bowl of cherries and everything in the world seems to be geared to giving you exactly what you want, you are in the right hemisphere.

An illustration of how these three parts interact in the trading environment described in *Trading Chaos* is reproduced in Figure 3.2. If you trade with *only* the right hemisphere you will have bad management, so you will lose. If you trade with only the core you will be reckless, or with only the left hemisphere you will be scared. If you trade without the left hemisphere you don't have the experience, without the core you don't have confidence, and without the right hemisphere you don't have intuition. It is when all three parts are working in harmony you get what Bill Williams calls "profitunity."

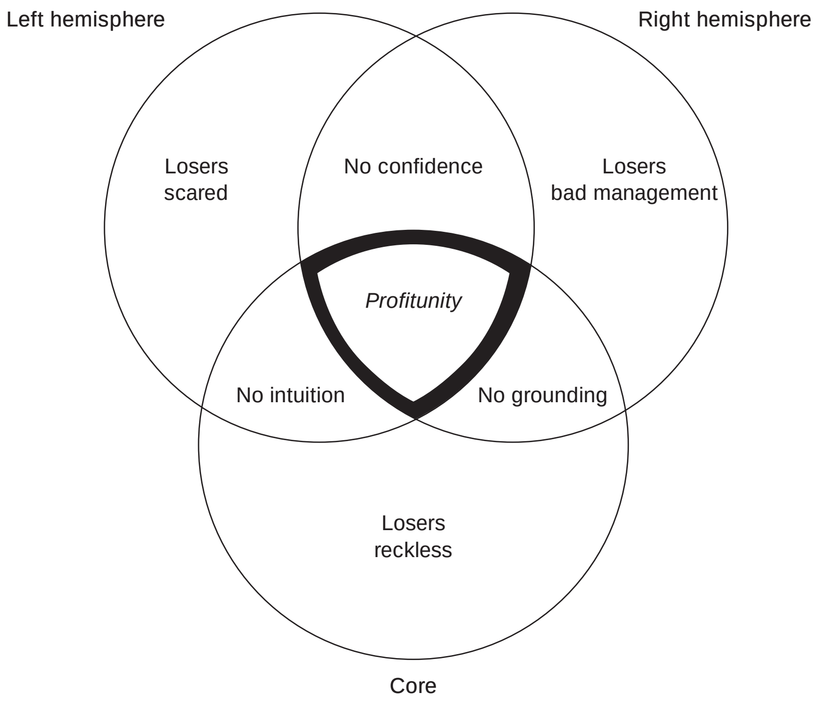



**Fig 3.2 Bill Williams' brain model**

Source: Williams, B (1995) *Trading Chaos*, © John Wiley & Sons, Inc. Reprinted with permission.

## Trading Chaos

The layout of *Trading Chaos* is designed to get you there. The book offers five stages, each including different goals, and different tools to help you attain those goals. The five stages are: novice, advanced beginner, competent, proficient and expert. The goals are respectively; to minimize losses, to make money consistently on a one-contract basis, to maximize your profits, to trade your own belief systems, and to trade your states of mind. Each stage offers better tools to achieve these objectives. In this context tools refers to analysis techniques plus your own inherent abilities.

The book doesn't tell you how to tap the vast potential of your necktop computer but then this has been the goal of all mystics and spiritual gurus through the ages and is perhaps too much to expect. But if you want to see the Holy Grail, look in a mirror!

I have written this chapter because I believe the more we understand about ourselves the easier it will be to find success in the markets. The chapter may seem incomplete but it will be many decades, or even centuries, before we, as human beings, have a full understanding of ourselves, if indeed we ever do. So do not expect precise answers; and they are probably not even desirable. What you need are subtle signposts to steer you in the right direction (possibly such signposts should be aimed at parts of the brain other than the left hemisphere), I hope this one helps.

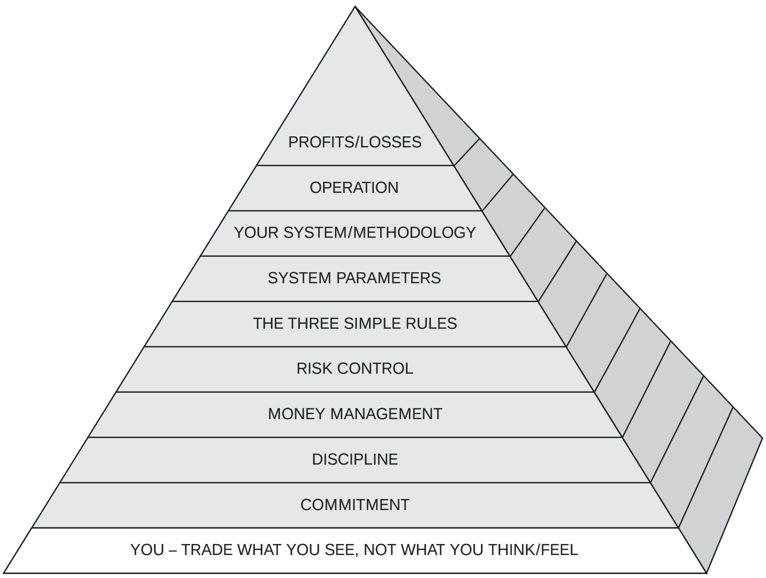
## SUMMARY

- I discuss two models of the human brain.
- The triune brain (see Appendix 2) offers a guide to why we often make a mess of trading.
- The Bill Williams' brain model offers a guide to how we might want our brains to function to optimize performance.
- The triune brain consists of three parts, the Emotional, the Instinctive and the Thoughtful. All three have a vital part to play in our lives but the first two can be very destructive when trading the markets.

- The Bill Williams' model is more physically based, consisting, again, of three parts. In this case the left hemisphere, the right hemisphere and the core. The left hemisphere brings management and learning to the table, the core operational ability, and the right hemisphere, intuition, inspiration and imagination. When all three parts are working in harmony we have "Profitunity," as Bill William puts it.

Chapter 4

# YOU – THE FIRST LEVEL OF THE PYRAMID AND WHY




We lie loudest when we lie to ourselves.

*Eric Hoffer*

There are many fundamental misconceptions about markets and trading. I have a natural talent for analysis. I wish I had more of a natural talent for trading, but I do not. I have got where I have despite my abilities, not because of them. But my analysis has helped a lot, because I now understand markets and how to make money out of them. I now make consistent profits and as each year goes by those profits get bigger.

This book is not verbose, it cuts to the essentials. I might summarize these essentials as follows:

1 You may think that the market exists somewhere out there. **Wrong**. How you think of the market is unique and exists only in your head. To win you have to ensure that your version of the market is "useful" and then make use of it.

2 You may think you see your version of the market clearly. **Wrong**. What you see is shrouded within an emotional whirlwind. The whirlwind may get a lot faster when you have a trading position in place.

***To win you have to ensure that your version of the market is "useful" and then make use of it.***

3 You may think that trading is an easy function involving buying low and selling high. **Wrong**. In fact trading is not difficult, although nor is it easy, but the emotional problems we bring with us to the market mean that few win.

These three statements summarize what you are getting into. In normal walks of life these sort of things either do not happen or we soon learn to stay away. The market is different. It does not do the same things all the time. So one day a particular tactic will work, the next day it won't. Compare this with a normal everyday function like walking down the street. If you walk into a lamp post, you soon learn that you need to walk round them. But in the market-place, the lamp posts keeps moving as you approach them, you can never be sure that you can get round them.

But what you can do is develop the mental discipline so that even when you do bump into them it's OK.

This section is entitled "YOU." This is because you are the essential element behind the way you trade. If you refer to the diagram of the Trading Pyramid at the beginning of this chapter you will see that **you** form the base of the pyramid. This is because you have to develop a style of trading which suits **you**. In no other way is it going to work.

## The trading experience

If you peruse any bookshop with a few books on trading you will soon find that there are masses of people out there seeking to grab some of your hard earned cash so that they can tell you about how **they** trade the markets, although in many cases these authors do not actually trade themselves, but that is another matter. Now it may be that one of these many books is right for you, but which one? Not an easy question to answer. Apart from the analysis technique you should use, you also have to learn trading skills, which ultimately are about 95 per cent of this game. This takes time. Do not expect to be an instant success at trading, you have to learn this business as you do any other. Whilst you do so you have a simple task and this is the first **secret** of trading. Like all great secrets it is well known, because that is the best way to keep something a secret, make everyone think it is not a secret at all. But this is where most novice traders fall down, this is where they knock themselves out of the game. I am not going to repeat this secret now because to do so would be to belittle its importance. This secret, plus the other two are revealed throughout this book. When you hear the secrets you will already "know" them but maybe this time they will have sufficient impact to make a difference. That is all I ask, that what I say helps to make a difference, to improve your trading performance.

***In the trading environment there is no absolute truth.***

To introduce the trading experience we must look inside ourselves. This is where it all takes place. There are a few simple rules but before saying what they are I think it is important to stress three points:

1 In the trading environment there is no absolute truth. We never know what is the "right" thing to do in any one situation and what is "right" for one trader is wrong for another. We therefore have to formulate "useful beliefs" which work for us. This is akin to how scientists work when dealing with quantum mechanics. The building block of all matter, according to current theories (or useful beliefs), is a quark. But this is found to have no mass. How can the building block have no mass? Another word for a useful belief is a useful lie. Anything which is not the truth, the whole truth, and nothing but the truth, can be said to be a lie, although this definition is not widely accepted.
2 Given this fact nothing I say is cast in stone, it is important you discover your own "useful lies" that will form the basis of your trading philosophy.

3 In similar vein it is your personality which should guide you in your search for the right approach. Do not be guided by advertising copy, as many are. Ask the question "What is right for me?" and then go out and find it.

So what are the few simple rules? In my opinion they are as follows:

1 Always limit your losses.
2 Try to ensure that your average gain is at least 2.5 times your average loss.
3 Endeavour to find an approach which gives you an edge.
4 Make sure you are comfortable with your trading approach. This involves self discovery, something many shy away from. But peal away the outer layers and what is inside is often very fine indeed. The outward layers can be a bit yukky.
5 Learn to let profits run.
6 Learn to trade selectively.
7 Learn to control your own self sabotage.

## SUMMARY

- YOU - the first level of the Trading Pyramid because the whole pyramid has to be based on your personality.
- How we each see the market is unique and we need to ensure that our perception is "useful."
- The key trading "secrets" are well known.
- In the trading environment there is no "absolute" truth.
- Nothing in this book is "cast in stone" and you must find your own road to success.
- Don't be led by advertising copy, decide what you need and then go and get it.
- There are seven simple rules to success.

Chapter 5

# COMMITMENT


To many traders the market is a generator of random sequences. In many cases it will drive you round the bend. Commitment is a very necessary quality if you are going to be a winner.

## The nature of the market

Whether the market is such a generator depends on your perception of the market. For example if you choose to trade the market on the basis of a precise algorithm, i.e. a precise formula such as used by stochastics, moving averages, etc., then you are dependent on exactly what the market throws at you. In this sense it is such a generator. If, however, you choose to look at something which has "meaning" then the market will not be solely such a generator. However, most of the chart patterns, etc. that are used are fairly meaningless. This is illustrated by two facts:

1 For something to have meaning it has to be right more than half the time. Strictly, the variance from the 50/50 criterion has to have statistical relevance.
2 Very often, no sooner do we see a "pattern" than it aborts. It was never really there in the first place. It just so happens that the market, in its function as a generator of random sequences, is going to throw out all types of "pattern" but that does not mean that they have any meaning.

I became interested in markets via the Elliott Wave Theory (EWT). This is a good example of what I consider fairly meaningless. The theory is general enough that there are going to be lots of random sequences meeting its criterion. Some of them work, some of them don't. I doubt the ratio is much away from 50 per cent. But I find I am now indoctrinated in EWT, see Appendix 5, so I have learnt to live with it. I now ensure that I only take signals which have something meaningful attached to them – for example, Minus Development from Market Profile (see Chapter 18).

So what does have meaning? In my view the only fact that can be stated about markets is as follows:

**Markets move from extreme to extreme across all time frames.**

Markets are a manifestation of human psychology. They are driven by fear and greed. Peaks are driven by greed, troughs by fear. This is obvious in the very long-term extremes. Fear is often illustrated, literally, with blood in the street. Greed is so endemic nobody recognizes it for what it is. But stand aside and it becomes obvious. Not so obvious in the shorter term moves, but still there. At the extremes the key point is that price is stretched unrealistically. Why is this? Because traders and/or investors are paying too much, selling too cheaply, because it is an *emotional* decision. To win you must put yourself outside that emotion.

Extremes are detectable and I have built an array of tactics for spotting them – see Section 2.

## Market Profile

There is something else we can use, and this is Market Profile developed by Peter Steidlmayer. The concept is simple and built around the bell curve. A bell curve takes chaos and substitutes order. Market Profile is another way of displaying market action. Other ways are:

1 A quote screen.
2 A bar chart.
3 A tick chart.
4 A Point and Figure chart.
5 Candlesticks.
6 All the various indicators.

All of the above (and others, as this is not meant to be exhaustive) display the same thing in a different way. In all cases you lose some information but other information is highlighted. To an extent this is your first decision point. What is the most useful way for you to look at market action? The answer to this critically important question depends on how you are going to trade and what you therefore need to see to do so. Don't put the cart before the horse. Decide what you want and then go and get it. Do not get something because someone sells it to you and then adapt yourself to that, it is the wrong way round. Incidentally, modern software is such that you can often have a number of the above all on the same screen layout. My software will give me all of the above on one layout and it is not expensive. But I don't use them all because I see no need to.

***If it is not obvious why something should work, it probably doesn't!***

Market Profile has a number of key concepts. To my mind the most important is Minus Development (MD). MD is merely a technique which shows determined buying or selling. It is fairly obvious, as are most useful techniques. Indeed I would say that if it is not obvious why something should work, it probably doesn't! MD comes in various shapes and sizes, but I consider the most important to be spike highs or lows. In fact most of my own trading is concerned with just these. The key concept is that MD shows where price is swiftly rejected. You want your stop to be beyond such a point, that way it is relatively secure. If you want total security, you had better get out of the market and call in Securicor. Gaps are also a form of MD but I do not like gaps so much because a market will try to close any gaps. There is a simple reason for this: the aim of any market is to maximize trade. You can prove this by looking at who runs the market and how they get paid. In the case of a futures market it is organized and run by the Exchange itself (LIFFE in the case of FTSE, CME in the case of the S&P), the brokers and the market makers. All of these make more money the more trading there is, so that is the aim of their market. In order to maximize trade a market must trade at all levels because there will be buyers and sellers at each of those levels. Or there may be, so the market has to check and see – if it is efficient. So gaps get closed, at least on markets that are actively traded, like the FTSE futures. Not so much on the FTSE cash, because this is just an index, it is not actually traded. In fact since the introduction of the appalling SETS system the FTSE cash no longer leaves gaps.

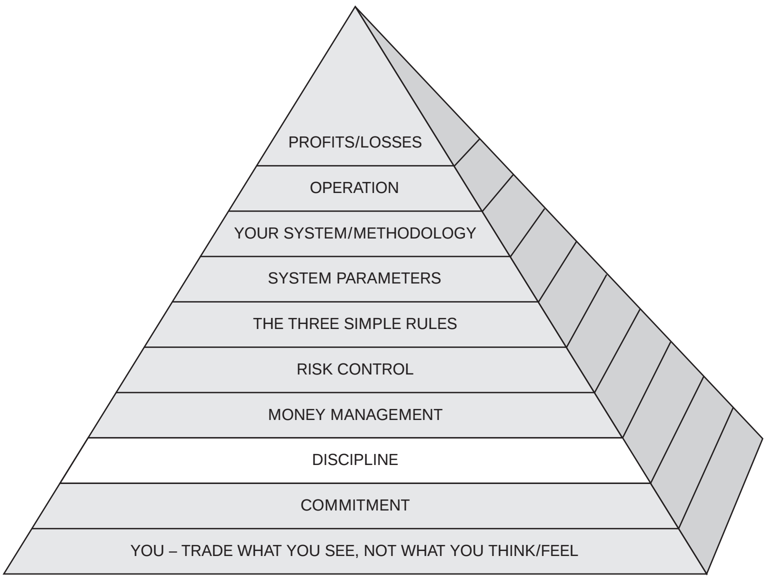
***The aim of any market is to maximize trade.***

## SUMMARY

- The market can be seen as a generator of random sequences, if you follow a precise trading system, that is exactly what it is.
- You have got to have commitment to succeed. The road to success has many pitfalls and those who lack commitment will be easily dissuaded.
- Markets move from extreme to extreme across all time frames. This is the only absolute truth we have about markets.
- Different ways of looking at market action all serve to highlight some information; whilst minimizing or eliminating other elements.
- Market Profile and Minus Development are ways of looking at the market which have some meaning and may, therefore, prove more useful than other techniques.
- The market is designed to generate trade and maximize it. This is a fundamental fact it is always well to remember.

Chapter 6

# DISCIPLINE




The next level of the pyramid is discipline. It is said, and it is true, that without discipline you will be unable to make any progress. The reason is simple and comes in a number of guises. First, without discipline you will be unable to follow your own methodology, you will, in effect, have no methodology. Thus you will be doomed to trade emotionally, and that is not a winning approach. Second, you will not have the self discipline to overcome your own emotions and instincts. So in some ways these two factors overlap, but the second is far more pervasive than simply in operating your methodology.

The big question here is whether you can develop the discipline if you do not have it naturally. I believe that the answer is "yes, you can," but you must have the necessary commitment to do so.

Clearly discipline can be developed, and you only need to look at an army training program for confirmation of this fact. But it is one thing to have a vast and experienced organization bearing down on you and prepared to do whatever it takes to make its point, quite another to do it yourself in the comfort of your own home, with all the distractions that normally involves. Clearly self discipline is going to be a requirement even to start the process.

However, the market itself is going to be helpful, although not as helpful as it might be. Ultimately undisciplined behavior is going to be punished by the market, either by direct losses or by the loss of profits which would otherwise have been available. So private traders who persevere do have external stimuli that help the process. But the market does not help as much as it might because of the principle of random reinforcement. I will mention this again. It is the market's tendency to reward bad behavior from time to time. What works one day may not work the next and this applies to the "best" trading practice. Similarly bad habits do bring rewards from time to time. This crucial fact is one of the reasons that it takes so long to learn how to trade.

## Discipline and the Trading Pyramid

So, let us look at discipline within the context of the Trading Pyramid. We have already discussed how the various levels of the pyramid interact. Now I want to concentrate on how this interaction relates to discipline. There is a great deal of difference between applying discipline to doing something you like, as opposed to something you don't like. For example if you like playing a particular sport, say tennis, then you may find it very easy to be disciplined when taking shots, keeping score, following court etiquette, and the rest. No problem, because you would enjoy the whole thing. But say you had to go fishing and you couldn't stand it. Would you have the same discipline with baiting the hook, casting the line, sitting patiently waiting for a bite, etc.? No, you wouldn't. You would probably be slapdash and sloppy, you would probably fidget, when you need to be still. It is the same with trading. If you find an approach that suits you, it will be much easier to

***If you find an approach that suits you, it will be much easier to follow.***

follow. You will avoid trying to squeeze a square peg (yourself) into a round hole (your market approach). This applies to every level of the pyramid. Your Money Management (MM) system is designed to keep you safe so that you can relax. Much easier to apply discipline in such an environment. Risk Control has a similar function. It is all about making you comfortable and developing the skills to keep your losses under control. Again this makes the trader's situation a lot more comfortable. Moving up to the next level we come to the three simple rules. The logic of these rules is unassailable. However, we have to learn how to use them and this takes time, especially learning to let profits run. After all the skills needed to cut losses are almost exactly the opposite of those required to let profits run. The first requires careful monitoring and quick action (maybe using a stop in the market to do it for you) whereas the latter requires a more relaxed approach to avoid getting out. So one is actively looking to get out, the other is passively not looking to get out. Once you have learnt actively to look to get out, how do you then totally adjust your view to achieve the other? It takes time.

It is easy to see how we can be a lot more relaxed, and therefore more disciplined once we have learnt how to operate these rules. Some readers may feel that linking the words "relaxed" and "disciplined" is something of an oxymoron, or two incompatible concepts. I disagree. In my view relaxation is the essence of "easy" discipline. You do not need to be tense and standing to attention to be disciplined. You just need to be able to do certain things in a certain way. The easier these things are, because you choose what they are, the more experience you have in doing them, clearly the easier they will be to do.

## System parameters

This brings us to your system parameters. It is going to take time to discover these. This is not because there is any particular magic about the parameters themselves, but because you need to know yourself well before you will be able to judge what is going to suit you. There is a feedback loop involved in this process. Once you start to use a more precise methodology that feedback loop can start. Until that point most traders are just spinning their wheels. Once you start to use a methodology you begin to learn a lot about yourself. This is because you start to see when you have difficulties with the methodology. You are forced to stop and ask yourself. "Why did I not take that trade?" and, perhaps more importantly, "Why did I take this trade which has nothing to do with my methodology?" Often you find that you have certain preconceptions which are not useful, that you have impulses to trade that have nothing to do with making money, but have everything to do with various emotions you have not yet learnt to control. At least that was my experience.

***Why did I take this trade which has nothing to do with my methodology?***

It is the feedback from these things you learn about yourself that allows you to modify your methodology. This process, which takes you round the loop many times, eventually allows you to discover something that is truly useful to **you**. It will not necessarily be useful to anyone else. This is why I am always distrustful of those who claim to have market "secrets" they will not disclose. To my mind this shows a misunderstanding of the entire process, although I can see why someone would not want to disclose their entire methodology. The more people who trade "your way" the less likely that way is to be effective. But even this is debatable as any trader who looks at another's methodology is liable to alter it and trade it in their own way. However there is no point in taking any chances in this respect, why take the risk?

## SUMMARY

- Discipline is necessary because without it you will not be able to follow your methodology, or to control your emotions and instincts.
- Developing discipline is a process rather like exercising muscles, but is helped by developing an approach that suits us.
- Random reinforcement is the way in which the market often rewards “bad” behavior and punishes “good behavior”. Rats go mad when treated like this.
- Inter-reactions between discipline and other levels of the Pyramid show the importance of developing all levels of the Pyramid in line with our personalities.

# TRADING RESOURCES

| | |
|---|---|
| Futures - | http://www.the-way-to-trade.com/futures.php |
| E-mini - | http://www.the-way-to-trade.com/e-mini.php |
| Discipline - | http://www.the-way-to-trade.com/discipline.php |
| Online - | http://www.the-way-to-trade.com/online.php |
| Stocks - | http://www.the-way-to-trade.com/stocks.php |
| Commodities - | http://www.the-way-to-trade.com/commodities.php |
| Beginners - | http://www.the-way-to-trade.com/beginners.php |
| Options - | http://www.the-way-to-trade.com/options.php |
| Swing Trading - | http://www.the-way-to-trade.com/swing-trading.php |
| Day Trading - | http://www.the-way-to-trade.com/day-trading.php |

## Lucky Dip:

These are trading resources that we were unaware of at the time of publication so we are unable to name them now, but if you check out each link you'll find they are connected to something you'll find useful in your trading. In fact we will frequently change their destination to the hottest new resources, so please check them regularly.

| | |
|---|---|
| Lucky Dip 1 - | http://www.the-way-to-trade.com/lucky-dip1.php |
| Lucky Dip 2 - | http://www.the-way-to-trade.com/lucky-dip2.php |
| Lucky Dip 3 - | http://www.the-way-to-trade.com/lucky-dip3.php |
| Lucky Dip 4 - | http://www.the-way-to-trade.com/lucky-dip4.php |
| Lucky Dip 5 - | http://www.the-way-to-trade.com/lucky-dip5.php |

This completes the introductory section of The Way To Trade.

In this introductory section you have seen the full text of The Way To Trade up to the end of Chapter 6 on page 45. There are 28 Chapters and 273 pages in total, so you have only seen a fraction of the gems inside.

If you're like me, you like to discover as much as possible about something before you order it.

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Sincerely

Paul Handforth