What is Involved in Peak Performance Trading?
by Van K. Tharp

There is so much involved in developing peak performance, that I recommend that all traders have a **business plan**. We recommend that the business plan cover all of the following areas.

- Your vision.
- Your purpose.
- Your objectives.
- A thorough self-assessment of your strengths and weakness, based upon real trading logs that you collect (if you haven't done so already).
- A thorough assessment of the big picture of the fundamentals.
- A complete understanding of your beliefs about the market.
- Procedures for getting empowering beliefs and mental states behind you.
- A documentation of your research procedure for developing new systems and determining how to analyze their effectiveness.
- Your procedures for developing and maintaining discipline.
- Your budget and cashflow systems.
- Other necessary systems such as marketing, back office record keeping, etc.
- Your worst-case contingency plan.
- System 1 – which is compatible with the big picture.
- System 2 – which is also compatible with the big picture.
- System 3 – which might come into play should the big picture change.

If you have all of those things, then you have a chance of doing well. But this means that your business plan becomes a tool for you to continually use to improve yourself and your trading.

You will notice that at the top of the list I include "vision." One of the keys to real success
in trading is commitment. Before I coach a trader, I look for commitment. Those who are not committed to do what it takes, usually commit financial suicide when they try to be full time traders. Now, I have no idea how to give people commitment. It's more like something they are born with—not something I can coach.

However, I do have some clues to how you can develop it in yourself. The key to doing so is to develop your vision and purpose. Your vision is your dream life. What do you really want to accomplish, be, and have in your life to know that you've done your best? What is your dream life? I'd write this out in detail.

And you also want the purpose behind the dream life. What are the "whys" in your life? This is what gives it the real motivation and commitment. Why do you want the things you want? Write down as many whys as possible. You'll know you have it correct when you are so excited about your dream life that you must do something right now.

What is a Trading System? (Tim Wilcox)

What most people think of as a trading system, I would call a trading strategy. This would consist of eight parts:

1. a market filter
2. set up conditions
3. an entry signal
4. a worst-case stop loss
5. re-entry when it is appropriate
6. profit-taking exits
7. a position sizing algorithm, and
8. you might need multiple systems for different market conditions.

A **market filter** is a way of looking at the market to determine if the market is appropriate for your system. For example, we can have quiet trending markets, volatile trending markets, flat quiet markets, and flat volatile markets. And, of course, the trending markets can either be bullish or bearish. Your system might only work well in one of those market conditions. As a result, you need a filter to determine whether your system has a high probability of working. Should you trade your system or not?

The **set up conditions** amount to your screening criteria. For example, if you trade stocks, there are 7,000+ stocks that you might decide to invest in at any time. As a result, most people employ a series of screening criteria to reduce that number down to 50 stocks or less. Examples of screens might include William O'Neil's CANSLIM criteria[2] or a value screen for stocks with good PERs or a good PEG ratio or a fundamental screen having to do with management and its return on assets. You might also have a technical set up, just prior to entry such as watching the stock to go down for seven straight days.

The **entry signal** would be a unique signal that you'd use on stocks that meet your initial screen to determine when you might enter a position—either long or short. There are all sorts of signals one might use for entry, but it typically involves some sort of move in your direction that occurs after a particular set-up occurs.

The next component of your trading system is your **protective stop**. This is the worst-case loss that you would want to experience and it defined 1R (or your initial risk) for you. Your stop might be some value that will keep you in the stock for a long time (e.g., a 25% drop in the price of the stock) or something that will get you out quickly if the market turns against you (e.g., a 25 cent drop). Protective stops are absolutely essential. Markets don't go up forever and they don't go down forever. You need stops to protect yourself.

The fifth component of a trading system is your **re-entry strategy**. Quite often when you get stopped out of a position, the stock will turn around in the direction that favors your old position. When this happens, you might have a perfect chance for profits that is not covered by your original set-up and entry conditions. As a result, you also need to think about re-entry criteria. When might you want to get back into a closed out position? Under what conditions would this be feasible and what criteria would trigger your re-entry?

The sixth component of a trading system is your **exit strategy**. The exit strategy could be very simple. For example, it might simply be a 25% trailing stop where you adjust the stop to 75% of the closing price whenever a stock makes a new high. The stop is always adjusted up, never down.

However, you may have many possible exits in addition to a trailing stop. For example, a large volatility move (e.g., 1.5 times the average daily volatility) against you in a single day is a good exit. Crossing a significant moving average (e.g., the 50 day) might be a great exit. Technical signals are good exits (e.g., breaking a significant trend line.)

Exits are one of the more critical parts of your system. It is one factor in your trading of which you have total control. And it is your exits that control whether or not you make money in the market or have small losses. You should spend a great deal of time and thought on your exit strategies.

The seventh component of your system is your **position sizing algorithm**. Position sizing is that part of your system that controls how much you trade. It determines how many shares of stock should you buy. A general recommendation would be to continually risk 1% of your portfolio. Thus, if you have a $25,000 portfolio, you wouldn't want to risk more than $250.

Let's say you wanted to buy a stock at $10. You decided to keep a 25% trailing stop, meaning if the stock dropped 25% to $7.50 you would exit your position. Since your stop is your risk per share, you would divide that $2.50 risk into $250 to determine the number of shares to purchase. Since $2.50 goes into $250 100 times, you would purchase 100 shares of stock. Notice that you would be buying $1,000 worth of stock (100 shares @ $10.00 each) or four times your risk of $250. This makes sense since your stop is 25% of the purchase price. Thus, your risk would be 25% of your total investment. If you want to know more about position sizing, I'd suggest that you read review *Trade Your Way to Financial Freedom.*

Finally, depending upon how robust your trading system is, you might need **multiple trading systems** for each type of market. At minimum, you might need one system for trending markets and another system for flat markets.