The Ten Tasks of Top Trading

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Our purpose at Investment Psychology Consulting is to model or duplicate successful trading. Modeling is a science that developed within the last decade. An expert modeler can determine how people perform a task well and teach that skill to others. We have been developing such a model for trading success.

We are in the process of modeling every type of trading (day trading, floor trading, position trading, fund management). We already have most of the essential elements of all of these types of trading. We are simply refining our models and developing training programs to teach top-level trading performance to others.

The first and most important aspect of modeling is task decomposition to determine the different tasks involved in the behavior you want to model. Unfortunately, most traders, even the best ones, don't know what those tasks are. When you ask them, you get responses like:

- "I don't really know. I trade when it feels right. It's mostly gut feel."
- "Well, I get up in the morning, and I do other things until the markets close, and then I turn on my computer and the data comes in via the modem, the computer cranks out an analysis, the orders go out to the brokerage network, and then I do other things. That's effectively what I do broken down into tasks."
- "The formula for what I do is look for X, Y, and Z. When I see that pattern and the market hits my entry point, I get in."

These responses only begin to detail the tasks that are involved in trading.

In an interview in *Technical Analysis of Stocks and Commodities* (April, 1987)[1] I mentioned the importance of knowing the different tasks involved in trading. That interview stimulated Dr. Pruden to start thinking about them. He came up with a model which included seven different tasks.* We've subsequently added three more, and now believe the model to be complete and accurate. *This model is the starting block for understanding successful trading.*

*Dr. Pruden developed the first version of this model and has helped greatly in producing the current form of the model.

The Ten Tasks

The ten stages in the model are illustrated in *Figure 1.* These ten tasks fit the metaphor of a hunter, a predator, or a warrior. For example, in his book, *The Art of War,* Sun Tzu points out that **battles are won before they start.**[2] Think about the implications of that statement. In the case of trading, it means that your mental state and preparation virtually determine whether you will win or lose in a given trade before you even open the position. Perhaps that statement is a little strong, but I believe that your mental state and preparation determine whether you will win on the average. The statement also points out the importance of the first stage of successful trading, a task called **self-analysis.**

1. Daily Self-Analysis. Successful trading is 40% risk control and 60% self-control. In turn, the risk control portion is one half money management and one half market analysis.[2] Thus, market analysis is only about 20% of successful trading. Yet most traders emphasize market analysis while avoiding self-control and de-emphasizing risk control. To become successful, traders need to invert their priorities.

Trading involves human performance, and that performance can be objectively measured in terms of profits and losses. You can't hide from your performance record. Your performance is either profitable, breakeven, or losing. Since *you* are the most important factor in *your* performance, doesn't it make sense to spend time analyzing yourself? The best traders do it subconsciously. You will probably be one step ahead of them if you make a conscious effort to begin each day with self-analysis.

Stressors, or anything that detracts from your performance such as a cold or illness, are going to impact upon your trading. What if your normal performance is breakeven and you have a cold which reduces your performance by 10%? Suddenly, you're going to start losing money. Even if your typical performance is profitable, if some stressor reduces it by 10%, then you might find yourself at breakeven or losing money. As a result, you are better off staying away from trading until you eliminate the stress from your life. Yet if you don't spend some time analyzing yourself prior to trading, then you are likely to trade out of habit. And if you do trade under these circumstances, then you'll wonder why you suddenly start losing.

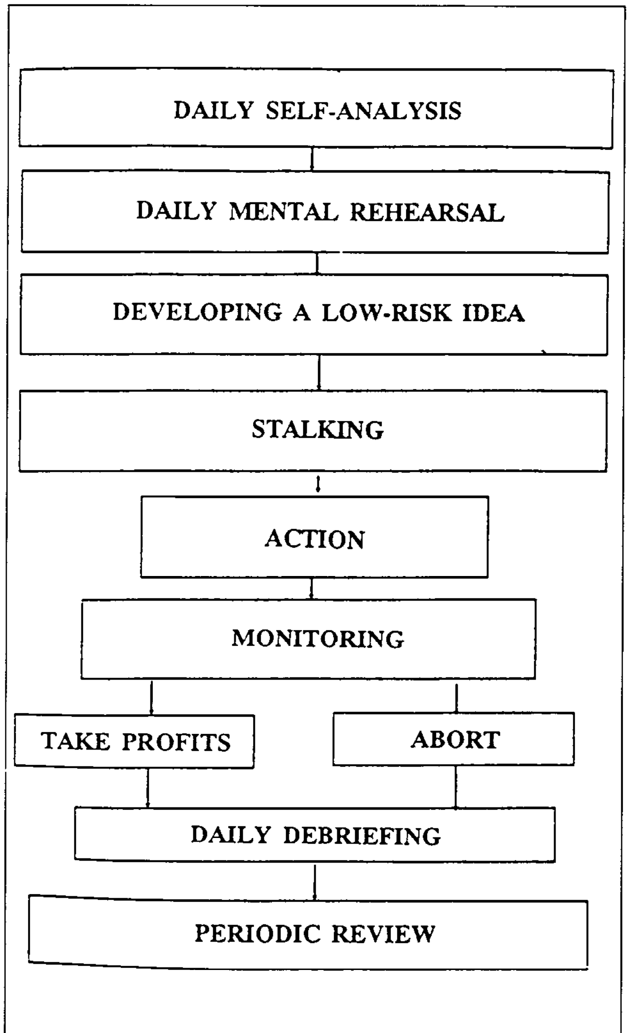

Figure 1 The Ten Tasks of Top Trading©

Numerous people find that their best trades are the hardest trades to take. You generally go against the crowd in the best trades. As a result, when most people believe you are wrong with enough conviction to be in the market, and you're around a lot of them, it's very hard to go against them. As a result, people who trade in a crowd perceive their good trades to be "hard trades." Let's assume that for you the hard trades are the big winners. How do you know if a trade is hard, or whether you are simply not in the mood to trade? You don't. Self-analysis allows you to distinguish between the "hard" trade and those times when you make the trade seem hard.

You might do self-analysis in several ways. The easiest method is to develop a rating scale going from 1 to 8, with 1 being poor and 8 being great. A sample rating scale is illustrated below:

HOW I FEEL TODAY

1	2	3	4	5	6	7	8
POOR							GREAT

At the beginning of each day, spend about 30 seconds meditating. Go inside yourself and determine how you are feeling that particular day. Rate yourself on the scale, with 1 being your worst, 8 being your best, and 4 to 5 being average. For a month or so, compare your trading performance with your morning ratings. You will find that trading may not be worthwhile unless your rating is above a particular level. When you discover what that rating level is, make a rule not to trade unless your self-rating is above it.

An even more effective way to conduct self-analysis is by means of a parts analysis. In essence, I find the belief that we are composed of parts, most of which are in your unconscious mind, to be useful. You might think of your parts as your various roles in life, although they are probably more extensive than that. Each part is formed to carry out some positive intention. For example, you might establish a part to protect you or to increase your security, to help you make money, to have fun, to bring love into your life, to bring excitement into your life, etc. Since most of these parts are unconscious, you are not aware of them. In fact, you probably don't pay attention to any of them. As a result, each part simply finds behaviors to fulfill its intention. Those behaviors are not necessarily in your overall best interest, since the behaviors of one part often will conflict with the behaviors of another. For example, if a part wants your attention, it will produce some signal to get that attention. If you ignore the signal that it gives you, it will produce a more dramatic signal. This process continues until it finally gets your attention. Unfortunately, many traders do not respond to these signals until they become very dramatic such as extreme anxiety or a major loss.

People can learn to determine what parts are active and how to communicate with those parts easily. What happens is that once parts know that you are willing to pay attention to them, then they do not have to produce dramatic signals to get your attention. Self-analysis, using the parts model, amounts to a short dialogue with your parts in the morning. It might simply amount to asking yourself, "Does anybody (i.e., any of your parts) need anything?" while you pay attention to any signals you get. Be sensitive to a range of internal cues. Your parts might communicate by means of a voice, a visual image, or a feeling of some type. Be open to such signals throughout the day.

When you do this process every morning, it only takes 15 seconds to a minute to complete. Furthermore, the parts dialogue method of self-analysis has an advantage over the self-rating method in that if you have a problem, you can deal with it immediately by finding an appropriate way to meet the needs of the part in distress. In contrast, if you just give yourself a poor rating without knowing the source of the problem, then all you can do is not trade.

Self-analysis, when practiced regularly, can make an immense difference in your trading. If you do it, we think you will be amazed at the improvement in your trading results.

2. Daily Mental Rehearsal. One of the most important activities to improving almost any form of human performance is mental rehearsal. Trading is no exception. Remember how important mental rehearsal is for top shooters. The top shooter in the world rehearsed every single shot that might be necessary in a shooting match. The second best shooter believed that rehearsal was important, but he did not rehearse the entire match. Most shooters, in contrast, do not even practice mental rehearsal. Similarly, most traders fail to practice mental rehearsal. How about you?

Top Athletes—from professionals to Olympians—mentally rehearse their performance prior to acting. For example, Billy Casper, one of the best golfers on the PGA Senior Tour, almost never three-putts a green. Casper claims that he learned to putt in almost total darkness and that experience taught him to really concentrate on the internal image of the putt he is attempting to make. Extreme concentration on his internal mental image is what makes him one of the world's best putters.

The rehearsal task allows you to pre-plan how you will carry out any of the trading tasks so that the actual task is automatic. It allows your to anticipate problems and develop appropriate solutions to them. And most importantly, mental rehearsal helps you avoid mistakes. Nevertheless, there are appropriate and non-appropriate ways to do the rehearsal.

One of my clients uses a planning log for his next trading day. One entry he showed me went something like this:

> Tomorrow will be *hell.* I will be tempted to trade—probably from both sides of the market and probably several times. In addition, the market is due for a big swing tomorrow and they will try to grab my stops. It'll be a real test of my mental state control...

His plan anticipates problems, but from the wrong framework. He is actually programming himself for a day of "Hell." Typically, you get what you program yourself to get. Instead, he could have said the following:

> Tomorrow will have some interesting challenges. The market may come close to my stops. That is part of the game of trading. I will stick to my rules and practice mental state control throughout the day.

In this second form of mental rehearsal, he is anticipating the same events. However, the events are **challenges,** not "hell." More importantly, he is rehearsing carrying out his plan and following his rules, despite potential challenges. As a result, his rehearsal will be very effective.

A client in my Super-Trader Program performs his mental rehearsal by listening to a 60 minute tape each day. He has made tapes covering most of the important tasks in this model. Each tape includes a description of the task and the appropriate mental state, as well as music and poetry to help him achieve the correct mental framework for the task.

3. Developing A Low-Risk Idea. The predator must know the location of his prey, the water holes used by his prey, and the habits of his prey. Once he knows that information, the predator can relax until the prey appear. The next stage in the model, as a result, involves **developing a low-risk idea.**

I initially called this task "market analysis." However, one of the best traders in the world told me that market analysis for most traders amounts to building a straw house. They collect data about the markets; they look at different patterns of charts and specific market indicators; and they even make predictions about the future direction of the market and then focus on trying to help those predictions come true. However, they don't consider the probabilities of winning and losing or the amount that might be won or lost. In other words, what most traders do in terms of market analysis has nothing to do with making low-risk trades. Hunters like to build straw houses, but that activity has nothing to do with catching prey. It amounts to spending time and energy on what you think is important, while you avoid the really important issues. Building a straw house has more to do with giving you a false sense of security. Your straw house might indicate where you live and dictate the boundaries of your territory. In that sense, having a straw house is important.

A fundamental principle of modeling is that those elements which are important to a skill will be present in everyone who performs that skill at a top level. In contrast, elements which are present in one person at the top of a skilled area, but not in another, are probably idiosyncracies. Since successful traders analyze the market in different ways, the type of analysis one does is not that important as long as it helps to minimize the risk taken. In addition, since there are countless examples of successful traders training other people in their methodology yet not being able to transfer their success, the methodology per se must not be a critical aspect of that success. What top traders **all** do, on the other hand, is develop a low-risk idea. If your market analysis focuses on developing a low-risk idea, then you are performing a useful task in terms of making money as a trader.

Most traders analyze the market in order to predict prices. Predicting prices has little to do with successful trading. What is important is determining when the risk is overwhelmingly in your favor and then controlling that risk (i.e., through the next five tasks in the model). You have already learned that the development of a written game plan for generating low-risk ideas is a critical task in preparing to become a top trader.

There are several subtasks to **developing a low-risk idea.** The first subtask involves **gathering data** (i.e., recording the high, low, opening and closing prices; the volume; the advance decline ratio in the stock market; sentiment indicators; etc.). It involves transferring information into your charts, your computer, or your tables. Other subtasks involve **creative brainstorming** and **determining the risk behind those ideas.** We are exploring these subtasks in more detail, and we will provide a further update when more information is available.

Most traders gather data and jump to a conclusion at the same time. For example, if you have a bearish bias, then most of your trades will tend to be on the short side—even in a major bull market. When you interpret data you begin to form an opinion which will strongly influence any subsequent operations that you do. Be objective and dispassionate while your are doing the analysis. Complete the entire data gathering phase of market analysis before you brainstorm. Once you have generated a number of ideas, determine the risk behind each idea. Don't jump to conclusions until the entire sequence is complete.

Avoid the opinions of others while you are developing your low-risk idea. The thoughts of others can easily result in your jumping to a conclusion prior to completing your own analysis. In addition, other people are usually wrong, so you do not want to accept the crowd sentiment. The only exception to this rule is if you know someone who accurately signals market turns by his euphoria about the market continuing a move. If you know such a person, then consider using that person's reaction as one of your sentiment indicators.

Document the development of your ideas. This documentation will provide you with valuable information in some of the later tasks that you will need to do, such as your daily debriefing and your periodic review.

Once you have a low-risk idea about how to trade, you must take that idea to the market. Thus, the next task in the model is "stalking" your idea in the market.

4. Stalking. Imagine the following scenario: You have developed an idea that you think has little risk and you want to open a position. You have two choices. You could just jump into the market or you could attempt to find the best possible price by becoming a day-trader. The essence of "stalking" is to find the best possible price for entry. Thus, stalking is another form of risk control.

Think about the predator after its prey. Have you ever watched a young cat chase a bird? It sees the bird and then runs after it. The young cat gives the bird a lot of warning, so it has little chance of catching the bird unless the bird flies right into it. Contrast the young cat with the mature cat. The mature animal stalks the bird. It waits until the bird gets close enough so that the kill is almost certain. At that moment it pounces. The mature cat will expend little energy unless it knows that there is a good chance of success.

Top traders love the hunting metaphor to describe what they do. One of them, for example, claims he is like a cheetah. The cheetah can outrun any animal, but it still stalks its prey. It won't attack until it is right on top of its prey. In addition, the cheetah usually waits for a weak or lame animal to get close. Another top trader told me that he trades like a lion. He watches the herd for weeks until something *other* than his presence causes the herd to panic. When the herd panics, he then chases a weak or lame animal that appears most confused. The difference between an average hunter and a really skilled animal like the swift cheetah or the cunning lion is that the skilled hunter waits until the odds are overwhelmingly in his favor.

Stalking means making sure the odds are even more in your favor by paying attention to the smallest time frame possible for you. This means that you must narrow your focus to find the best possible entry price in the day (e.g., by selling an intraday rally or buying on an intraday decline). Steidlmayer's Market Profile® was designed for this purpose, but other technical signals[3] will give you the same information.

Stalking is difficult for most people because it requires a mental state that is totally different from the mental state required in the next task, the action phase of trading. The mental state for stalking your idea involves a broad focus, a slowly moving time frame, and a strong intensity. These qualities are a distinct contrast to the mental characteristics that most people have when they have developed a low-risk idea about the market. Most traders, after analyzing the market, are energized and ready to act. By doing so, they don't miss an opportunity, but they also increase their risk because they are rehearsing action rather than responding to actual market conditions.

When you are "stalking," you need to get into the flow of the market. Become sensitive to a range of cues! The market is sending you numerous signals if you pay attention to them. Learn how to read and interpret those cues. One of my clients, a long time frame trader who only puts on occasional trades begins the stalking task by paper trading a position in the opposite direction of the one he is planning. This helps him develop "finger-tip" feeling for the market. At the same time, he knows that the best time to get out of his paper trade is also the best time to open his planned position.

5. Action. The action stage only takes an instant. But to perform it correctly, you must be aggressive, bold, and courageous. You just do it. The trader must have quickness, accuracy, and a narrow focus of attention—concentrating on getting the trade off accurately and quickly. He must be quick or he will miss the opportunity. And he must be accurate, or he might find himself with something other than his prey.

The action phase of trading must be strong and intense. A weak response will not get the job done, because it lacks the necessary commitment. Imagine what would happen if a lion or tiger fails to go all-out when it attacks its prey. The answer is obvious. It would go hungry.

Action involves commitment to entering a market position. If the trader has completed the first three tasks, then he knows the consequences of this commitment. He knows he is ready. He knows the maximum loss he is willing to tolerate and the potential profit. He knows that the risk is overwhelmingly in his favor, and as a result, the commitment is easy to make.

When action is appropriate, reflection, second guessing, and delays are inappropriate. You should have reflected on the consequences of your trade in the tasks prior to the action stage. When a trader thinks about consequences at the time of action, he cannot act with abandonment. The action stage is a time for prompt, courageous action.

Similarly, the action stage needs to be very accurate. Both you and your prey are moving rapidly. If you are not extremely accurate, then you are likely to miss. You may even get hurt. Accuracy should not be a problem, however, if it is carefully practiced and rehearsed in advance. For example, write down your order ahead of time. Read it to your broker in a clear firm voice. Have your broker read it back to you after you finish and at the time of confirmation.

The contrast between the requirements for the "stalking" task and the "action" task is so dramatic that many traders cannot make the abrupt shift. They are either energized and prepared to act or they are cautious and wary of any action. As a result, they either take the trade immediately and increase the risk of the situation, or they concentrate on getting the best possible trade and end up getting nothing.

6. Monitoring. Once a trader has a position in the market, he must monitor that position. In a sense, the hunting metaphor breaks down for monitoring. Imagine a tiger attacking a buffalo. Monitoring would occur at the split second the tiger lands on the back of the buffalo. He must instantaneously decide to either make the kill or to abort because the buffalo is bigger and stronger than he is. Fortunately, traders have a longer time frame to make the same decision about the market.

The nature of the monitoring task depends upon the trader's time frame for keeping his position. For a top day-trader, the stages of stalking, monitoring, taking profits, and aborting are somewhat circular. Day-traders may take several positions each day and may do all these tasks together. The constant need to shift mental states between tasks is one reason that so many people lose money day-trading.

A top position trader, in contrast, will wait for exceptional opportunities and then allow them to unfold. As a result, the monitoring process is more relaxed for the position trader. Nevertheless, complacency can destroy even the longest term trader.

Monitoring may consist of two subtasks, especially for the longer-time-frame trader. The first subtask, **detailed monitoring,** is similar to stalking. It involves paying detailed attention to the pulse of the market while getting ready to take action by adding to your position, by aborting, or by taking profits. On the other hand, when the market is moving comfortably in your favor on a long-term time frame, the trader can step back from the market into more of an "overview" position. Thus, the second subtask might be called **overview monitoring.**

Detailed Monitoring. Detailed monitoring begins as soon as one opens a position. If you correctly stalked your position, then the market should move in your favor soon after you open it. If it does not, then you probably do not belong in that position. As a result, a trader needs to pay close attention to the fine details of the market. He should be alert, vigilant, and suspicious.

I frequently recommend that my longer-time-frame clients rate their position three times a day for the first three days according to "how easy it feels." A typical scale might look like the one illustrated below:

Easy **Neutral** **Hard**

↑____↑____↑____↑____↑____↑____↑

"How Easy Does It Feel" Scale

Use a scale similar to this one at the beginning, middle, and end of each of the first three trading days. If the position does not feel "easy" by the end of the three day period, then it probably is a bad trade for you to be holding. On the other hand, if it is easy to hold, then you can probably switch to "overview monitoring." If you trade around other traders and are influenced by their opinions, then a good trade might feel "hard" because you are holding it against the crowd. If this is the case, then reverse the rules given above.

Switch back to detailed monitoring only when action of some sort might soon be necessary or for a periodic check of our position. You might, depending on your time frame for the trade, switch back to detailed monitoring once each day or once every three days.

Overview Monitoring. During overview monitoring, the trader broadens his focus and steps back from the market. He is looking at the forest instead of the detail of the trees. When a trader is in the overview phase of monitoring, he is more detached and objective. He is more patient and calm. His focus is much broader and his time frame is slower.

The worst mistake that one can make during the monitoring phase is to rationalize and distort data according to expectations. The purpose of monitoring the market is to pay attention to market signals. The trader who interprets signals according to his expectations is not performing this task adequately.

During overview monitoring, the trader is simply surveying the conditions. He is comparing market events as they unfold with his plan and his knowledge of what various market events mean. If everything is going according to his plan, then monitoring can remain a detached and relaxed process. Some traders give away big profits simply because they are unable to relax when the markets move in their favor. You don't get rich, as a rule, taking a dollar profit. On the other hand, if events do *not* unfold according to plan, then the trader needs to focus on the details of the trade (i.e. switch to detailed monitoring).

The monitoring stage is a form of risk control. If a trade is good, then it should be easy to hold because it is moving in one's favor. When the market moves in support of your position, the trader can change his stop level to decrease his risk or even lock in a profit. On the other hand, if nothing happens, if the market behaves unexpectedly, or if the trader is uncertain, then he should get out or, at minimum, reduce his exposure to a loss by reducing the size of his position.

7. Abort. The two stages which occur after monitoring are action-like stages much like the task of opening the position. These stages are "abort" or "take profits." One could argue that these stages involve "searching for the right opportunity to act" and "acting." On the other hand, since many traders search for the right opportunity during the detailed monitoring phase, we simply call these "action" stages.

Developing a low-risk idea and marketing your idea allows you to plan risk control. **Planning your risk is not nearly as important as** executing your trades in a manner in which you can **actually control your risk.** In executing trades, the golden rule of trading, "*Cut your losses short and let your profits run,*" comes into play. Controlling risk involves aborting and taking profits under the appropriate conditions.

Most successful traders have one or more of the following three beliefs about aborting a position:

(1) If the market is going against you, then that is the most critical time to get out. You can't afford to lose big. Some traders enter a position with a stop and get out when the stop is hit. However, other traders expect the market to go in their favor as soon as they open the position. If it does not, then they get out. **The issue of when to get out depends upon the maximum amount of loss you are willing to tolerate.** However, if your best trades immediately go in your direction, then when you open a position and the market starts going against you, don't wait for your stop to be hit. If it's going against you, then it's not the trade for you. Get out! Limit your risk.

(2) When the original reason for a trade no longer exists, get out of the market. And when you are uncertain, get out.

> One of my clients, for example, had a problem with uncertainty. He said "I don't know what to do when uncertainty comes up. You haven't described uncertainty in your books and I don't know how to handle it."

I responded, "What percentage of your trades make money?"

"About 40%", he said.

Then I asked, "When you're uncertain, what percentage of those trades make money?" He couldn't remember ever making money when he was uncertain, so I said, "If you're uncertain, just get out." Rather than trying to control your uncertainty, treat it as a valuable signal about what you should do.

(3) When time is against you, you probably should be in a better position, so get out. Many of the people reading this are speculators, as opposed to floor traders or commercial traders. **Your primary advantage to trading is that at any particular time you don't have to be in the market.** Use that advantage! Enter and stay in a position only when it is fully advantageous for you to do so.

Aborting involves a quick, accurate, and very focused mental state. Once you determine, through the monitoring process that it is appropriate to get out of the market, then you must immediately shift mental states to abort properly. If the predator decides that the prey he's selected is inappropriate (i.e., it's too big and strong for him), then he retreats quickly. A quick retreat allows him to survive to hunt again another day.

A quarterback can sense if the play is going to work out as soon as he gets the ball. If he senses that he is in a "busted" play, then he needs to do whatever is necessary to keep from losing ground. He may throw the ball out of bounds just to make sure that he doesn't lose yardage. What's important for him is to have the best possible position when the next opportunity comes. He doesn't want to lose ground.

If you have trouble aborting a position, then look at "pro" and "con" scenarios together. Allow the evidence against your position to unfold and then allow the evidence for your position to unfold and compare the two pictures together in your mind. If the evidence is against your position, them simply call it a **bad trade** and get out.

8. Take Profits. Many traders claim that their game plan emphasizes trade entry but not trade exit. As a result, they argue that they do not make enought profit on each trade. If you have not thought about trade exit prior to opening a position, then you have a problem with your game plan because you have not adequately calculated the risk involved in the position. If you've calculated risk properly, then you should know two elements ahead of time: 1) your changes of being right on that trade and; 2) the size of your potential profit versus your potential loss. If you don't have that information (at least generally), then you still need to work on your game plan.

A properly-designed low-risk game plan will give you optimum profits within your comfort level for trading. Thus, the task of maximizing your profits should simply be one of following your plan. For example, if you have a plan that gives you a 50% return each year and you maintain that record year after year, compounding your profits, then you will be one of the best traders in the world. Some of my clients have designed plans that give them three digit rates of returns each year. As a result, all it takes for any of them to become one of the best is to avoid self-sabotage by becoming too greedy or too fearful. If you concentrate on anything other than maintaining consistency, then I believe your concentration is misplaced.

Top traders have four primary beliefs about taking profits. Taking profits is equivalent to the predator's kill. When the predator acts, he must be quick and decisive. Thus, the first belief is that if market conditions change so that your reason for your trade no longer applies, then take your profits. Avoid being greedy. Just react to the signals provided by the market.

A second belief about taking profits is to do so when the market reaches your objective. Be patient and allow the market to move toward the target. If you set your targets at extreme levels, then you probably don't give up much by taking your profits at those levels. In most cases, market conditions will probably change before your target is reached, so you can get out simply by acting when those occur. If the market hits your target, however, I recommend that you take profits by continuing to move your stop closer to the market price as the target is reached. Wait for the market to take you out. If the market keeps moving rapidly in favor of your position, then you have no reason to take profits.

A third belief about taking profits is that one should do so if market volatility changes dramatically, thus altering the risk parameters of the trade. Volatility typically increases when a market becomes popular and mass hysteria exists. Although a lot of profit potential may exist in that market, the risk is much greater compared to the potential profit. As a result, increasing volatility after you're in the market might be a good reason to take profits.

Bear market moves are often climatic, and that climatic portion of the move may go past your target area. However, if you wait for the climatic portion of the move to end, you might get whipsawed in the opposite direction as soon as the move ends. As a result, the fourth belief is that when such a move occurs, you should take profits immediately.

9. Daily Debriefing. The ninth task in the model is a **daily debriefing.** Most good traders do it, either formally or informally. I think a daily debriefing is essential for consistent, top performance. It provides an important transition period between trading and being out of the market.

The idea behind the daily debriefing is to deterine whether or not you made a mistake during the day. A mistake, however, has nothing to do with losses. **A trading mistake means not following one's trading rules and one's plan of action.** In fact, traders should *pay special attention to mistakes made while making money.* Just because a predator chases its prey through an area filled with quicksand or tar without setting stuck, doesn't mean that it is safe to do so again. The LaBrea Tar Pits in Los Angeles contain the bones of many more predators than prey, because numerous predators made the mistake of going after the other animals caught in the tar.

Look at your written trading rules and the written notes you made when you were developing your low-risk idea. What can you do if you made a mistake by not following your rules?

- First, avoid self-recrimination—telling yourself that you "should have" done this or you "could have" done that. Instead, resolve not to repeat that mistake again.
- Second, replay the trade in your mind. Prior to making that mistake, you reached a choice point. At that choice point, you had a number of options available to you.
- Third, mentally go back in time to that choice point and review your options.
- Fourth, for each possible option, determine what the outcome would be if you had taken it. Be sure that you give yourself at least three good choices and mentally rehearse them. Some generals are known for fighting the strategies of the last war. Those who do usually lose the battle. Always give yourself as many choices as possible, so that you don't get stuck with limited options or a forced choice.
- Fifth, once you've found a least three options with favorable outcomes, mentally rehearse carrying them out in the future when you encounter similar situations. Once you've practiced them in your mind, you will find that selecting one of them is easy when you encounter a similar situation in the future.

When you do follow your rules, pat yourself on the back at the end of your debriefing. If you followed your rules and lost money, then pat yourself on the back twice. You may have lost money this time, but in the long run following your rules will make you money. Mistakes, on the other hand, will not result in long term, consistent profits.

Once you have analyzed your day's trading, summarize it in writing. Write down your mistakes and your new choices for that situation. This written information will be very important when you begin the next task of doing a periodic review of yourself and your game plan for trading.

The daily debriefing shouldn't take more than 5 or 10 minutes, so do it every day. It is one of the most important tasks of the ten part model. Get through it. Then put the trading day behind you, because tomorrow is a new trading day.

10. Periodic Review. The tenth task in the model is a periodic review of what you're doing. Markets change and you change. As a result, you need to be sure that your rules are still appropriate for both you and the markets. In addition, once you develop a sound business plan, I don't recommend that you change your rules on the spur of the moment or without a thorough review. The day you do your periodic review is the time for rule changes. It's also a time to be away from the market. You cannot objectively review *yourself* and *your rules* while you are actively involved in the markets.

How often you need a periodic review depends upon your time frame for trading. If you make several trades (or more) each day, then you need to review your rules every three to four weeks. If you trade three or four times each week, then a periodic review is necessary every three to four months. If you trade several times each month, then a semiannual review is appropriate. Finally, if you trade less than once a month, then an annual review is probably sufficient.

When you do your periodic review, first go through your written debriefing statements. Once that information is fresh in your mind, go through your entire business plan step by step. You need to review your trading diary and determine your strengths and weaknesses. Give yourself a whole day to do a periodic review. It is an important part of maintaining consistency.

The Task of Being Out of the Market

I have saved the most important part of the model until last—taking care of yourself when you are out of the market.

TOP TRADERS WHO *LAST* LEAD WELL BALANCED LIVES

To understand the importance of how you live your life when you are "out of the market," consider the parts model discussed earlier in the self-analysis section. You've created a number of parts with various needs. All of your parts have good intentions. *If you do not take care of your needs when you are*

Attitudes to Become a More Successful Investor

Investment Psychology Guide No. 4: *How to Develop Discipline to Become a More Successful Investor*

Investment Psychology Guide No. 5: *How to Make Sound Decisions to Become a More Successful Investor*

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away from the market, then your parts will act to fulfill those needs while you are in the market. If you don't play or add excitement to your out-of-the-market life, for example, and part of you desires those aspects of life, then you're going to get those needs met while you're in the market. Getting those needs met while you are in the market will not make you money in the long run. I guarantee it. As a result, you must deal with the needs of your parts while you're out of the market.

You might argue that "out of the market" is not a trading task. Yet it is the most important task for trading success. If you ignore important aspects of your life when you are out of the market, you will have trouble ignoring those aspects while you are in the market.

Many people want to be in the market to avoid personal issues. You cannot escape personal problems by trading in the market. What happens, unfortunately, is that the market magnifies those problems. A compulsive gambler is probably the best example of how failure to deal with personal issues can result in market disasters.

One of my clients called me, saying that he couldn't follow my suggestions. He couldn't bring himself to trade most of the time. When he did trade, he did the opposite of what he really wanted to do. He also told me that the material didn't seem to help him in solving his personal problems. In addition, during our conversation he also told me that he only had $5,000 with which to trade commodities and he had been trading for over nine years with no nest egg and never more than $5,000 in his trading account. I recommended that he immediately suspend trading and seek help in solving his personal problems which I believed to be serious. *Traders with serious personal problems cannot trade successfully because they will bring those personal problems to the market.* I also recommended that once he had solved those problems that he continue to stay away from the market until he had enough capital to trade with—in his case, about $50,000. Once he had solved his personal problems and raised enough money to trade effectively, he had a chance to become a good trader. Although my advice would have saved him thousands of dollars and would have given him the opportunity to become a successful trader, I doubt if he took me seriously.

Consistent, top traders keep their lives in balance and that makes trading fun. In addition, they also seem to realize their overall purpose in life. Predators are helpful to the whole system. They weed out the weak members of their prey and in doing so strengthen the herd. As a result, they serve a very useful purpose. Similarly, strong traders serve as predators for weaker traders and weed them out of the market. As a result, they strengthen the markets by their presence. As long as you keep that perspective in mind, then you can continue to have success. Traders who have a lot of initial success tend to lose that perspective. They suddenly believe they are bigger than the markets. As a result, the market teaches them humility by wiping out most, if not all, of their capital.

Many traders will take a lot of money at some time in their trading lives and then give it back. Why? Because they don't keep the overall ecology of the system in mind. They use the markets to prove something to themselves that has nothing to do with trading. What happens to them? They ignore their overall purpose. They increase their trading dramatically or, if they are big enough, they try to corner the market (as the Hunts tried to do with silver) and fail miserably. As a result, they lose everything and are forced out of the market.

Being out of the market means BEING OUT of the market. It's important to exercise, take a vacation, and even take a break during the day. And when you do those things, do not take the market with you. When you start worrying about trades that you might have missed and a thousand other possibilities, you are like a puppet on a string and the market is pulling your strings. If you take the market with you, then those parts of you that wanted the vacation or the break will disrupt your performance during those times in which you need to give your full attention to the market. Remember:

You don't have to catch every move!
There is always another opportunity!

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Investment Psychology Guide No. 3: *How to Control Losing*