



BUILDING A TRADING FOUNDATION

Linda Bradford Raschke

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About Linda



Linda Bradford Raschke is an American trader, investor and hedge fund manager. She became a professional trader in 1981, with memberships on the Pacific Stock Exchange and the Philadelphia Stock Exchange. In 1991, she founded LBRGroup, a CTA (Commodity Trading Advisor), and eventually became a Commodity Pool Operator. After starting several successful hedge funds, both onshore and offshore, she rose to the top of the ranks in hedge fund performance, ranked 17 out of 4500 for best 5-year performance by BarclaysHedge in addition to top rankings in numerous other categories. She retired as a CTA and CPO in 2014, with only one losing year in her career. She continues to trade for herself and enjoys life with Damon, her original SP broker, and her four horses.

She is included in dozens of trading books, including Jack Schwager's New Market Wizards. In the world of professional trading and money management, Linda Raschke stands out from the crowd in three factors: Performance, Longevity, and Consistency.

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Tape Reading

Sometimes it is nice to reexamine a simple concept when there appears to be overwhelming volatility in the markets. Mechanical systems and patterns are helpful and even necessary for the structure they impose in organizing data, but even Richard Dennis in his original course discussed ways to “anticipate” entry signals, exit trades early, and filter out “bad” trades.

Learn to follow the market’s price action and read the signals it gives. This can become a strict discipline in itself and the result will be greater confidence that a trade is or is not working.

Tape Reading:

“TRADING TECHNIQUE IS SIMPLY THE ABILITY, THROUGH STUDY, OBSERVATION, AND EXPERIENCE, TO RECOGNIZE THE SIGNALS IN EACH OF THE SEVERAL PHASES OF MARKET MOVEMENT.”
– GEORGE DOUGLAS TAYLOR

Tape reading long ago referred to the practice of studying an old-fashioned ticker tape and monitoring prices, volume, and fluctuations in order to predict the immediate trend. (It does not mean you have to have the ability to read the prices scrolling across the bottom of the screen on CNBC!) Tape reading is nothing more than monitoring the current price action and asking: Is the price going up or down right now? It has nothing to do with technical analysis and everything to do with keeping an open mind.

Even the most novice observer has the ability to see that prices are moving higher or lower at any particular moment or, for that matter, when prices seem to be going nowhere or sideways. (Markets do not always have to be going somewhere.) It is also fairly easy to watch a price go up and then tell when it stops going up – even if it turns out to be only a momentary pause.

I've known hundreds of professional traders throughout my career. I don't want to disappoint you, but I know of only two individuals who were able to make a steady living for themselves with a mechanical system. (I am not counting the well-capitalized CTA's who are running a money-management program with "OPM" – other people's money.) All those other traders used some type of discretion that invariably involved watching the price action at some moment – even if just to move a stop up or down.

If you can learn to follow the price action, you will be two steps ahead of the game because price is faster than any derivative. You may have heard the saying, "The only truth is the current PRICE." Your job as a trader will become ten times easier once you accept this. This means ignoring news, opinions, and personal biases.

Watching price action can actually be very confusing if you go about it like a ship without her sails up in an ocean squall. You will get tossed back and forth with no sense of direction and no sense of purpose. There are two main tricks to monitoring price action. The first is to watch the price relative to another "reference point." This is why many traders use a "pivot point" – and it works! It is the easiest way to tell if the market is moving closer to or further away from a particular point. This is also why it is often easier to get a "feel" for the market once you put a position on – your "reference" point tends to be your entry price.

Some reference points, such as a swing high or the day's opening price, will have much more significance than those points involving some type of calculation. (Some numbers might have special meaning for those who calculate them, and who am I to argue if they work.) I like to concentrate on pivot points that the whole market can see. To sum up so far, when watching price, we want to know the following: how fast, how far, and in which direction. It takes two points to measure these things. One will always be the current price, the other a pivot point.

* Do not watch price for the sake of watching price. Watch price with the intent to do something or to anticipate a certain response!

Responses:

***“THE STUDY OF RESPONSES ... IS AN
ALMOST UNERRING GUIDE TO THE
TECHNICAL POSITION OF THE MARKET.”
– ROLLO TAPE (RICHARD WYCKOFF), 1910***

The second main trick to monitoring price action is to watch for the market's response to a particular condition ... in other words, anticipating a particular behavior. For example, if the market has been at a very low volatility point and just begins breaking out of its particular trading range, one might anticipate that the price would begin to accelerate in an impulsive manner and not run into immediate resistance. Or, on a directional play, if the price is moving in an impulsive manner in a trending market and then pauses to catch its breath on a mild reaction, one would expect it then to continue on in the direction of the trend. When there is a particular behavior to anticipate, it is easier to watch the price to see if it acts according to one's expectations.

Is the market failing to break on bad news? Is it finding support after a series of advances? Does it run into an invisible overhead wall and sharply back off, implying strong resistance? These are market responses to certain conditions. Tape reading is like playing a tennis game and watching to see how your opponent hits the ball back.

Part of studying price behavior and gaining experience as a trader is gradually learning what actions to anticipate. Then you must learn what the market's most probable response or outcome should be. It will always be easier to anticipate an event or response which happens 70% of the time than to be looking for that which happens only 30% of the time.

However, it can also be a profitable strategy to recognize when a given signal or expected response is failing. Sometimes a failed signal can be more profitable than the normal expected response. For example, a classic failed response might be a scenario wherein price was consolidating in a pattern of higher lows and lower highs – a classic triangle pattern. One would expect a breakout from a chart formation to have some follow-through. However, if price only penetrates the lows by a small amount and then turns upward, picking up volume and momentum as it goes, and comes out the upside, a

very significant reversal has probably occurred and there may be much more price advance to unfold.

One last trick to watching price action is to learn to think in terms of "handles," or levels. Think of the S&P's as reaching for the "3000" handle, or the "low 2300's" as a level. Each ten points is a defined level. Use big round numbers as reference points for levels. It doesn't mean that you are placing orders at those numbers. It is just a simple way of organizing data that professional traders practice subconsciously.

Pivot Points:

An astute trader will always have the previous day's close in his head. He also knows the previous day's high and low (prices he would have liked to have bought and sold but probably didn't). He also knows the opening price, for that tells if the buyers or sellers are in control for the day.

The previous day's high and low and today's open have very strong psychological implications and are the most important "pivot points" to recognize. By concentrating on price action near these points, we can eliminate much of the hard work in tape reading. Many times the market will let us know right away if this is going to be an area of support or resistance.

The previous day's high and low tend to overlap in congestion areas. Look to exit profitable trades immediately at these points in sideways markets. In trending markets, the price will run through these points a bit before pausing. When the market is strongly trending, the opening price becomes the most important.

If we are watching a high, low, or opening price as a pivot point, we are watching to see whether there is any impulsive price action as the market approaches the point or moves further away from it. What is "impulsive action?" I like to call it a "whoosh." The market moves rapidly as if just coming to life for the first time. It is usually a series of ticks in one direction without a tick in the opposite direction. The market is tipping its hand. A sequence like this tends to consolidate or pause a bit before being followed by more impulsive action. This is quite easy to see in a market like the S&P's if you look on a short-term time frame. If we quantify these "whooshes," which we can do in several ways, we will see that the market tends to have continuation moves at least 2/3's of the time. Not bad for arriving at a "positive expectation" simply by following price action.

In conclusion, tape reading is not watching every trade that passes by (a monotonous task) but rather keeping an eye out for unusual impulsive action, unusual volume, or just observing the way the price trades at significant levels. Each price swing has forecasting value as to what the next most immediate move should be. We then follow the price action to see if that move plays out.

Tape reading is at the heart of swing trading. When looking for short-term moves, price-based derivative indicators will be too late to be of value. Ultimately, traders should feel a great sense of freedom when they can rely on simple charts to formulate a game plan or a conceptual roadmap in their heads – and the movement on the tape to tell them their game plan is correct.

Swing Trading: Rules and Philosophy

My style is based on the “Taylor Trading Technique”, a short-term method for trading daily price movements that relies entirely on *odds* and *percentages*. It is a *method* as opposed to a *system*. Very few people can blindly follow a system, though many find it easier to be discretionary in a systematic way.

Because this short-term swing technique generates frequent trades, it is important to know the “correct plays,” to lock in profits, and to seek the “true trend.” *Taking a loss is merely playing for better position.* One trades strictly for *probable* future results, not for what the market might do.

To know the “correct play” is to know whether to buy or sell first, to exit or hold. Trades are based on “objective points,” which are simply the previous day’s high and low. Movement between these two points determines the “true trend.”

When swing trading, adjust your expectations. The lower your expectations, the happier you will be and, ironically, the more money you will probably make! Entries are a piece of cake, but you must also trust yourself to get out

of bad situations and trades. It is important to use tighter stops when trading swings and wider stops when trading trends.

This method teaches you to *anticipate*! Never react! Know what you are going to do *before* the market opens. Always have a plan—but be flexible. “See” your stop (support or resistance) before initiating a trade. Know how to trade out of trouble situations and get off the hook with the smallest possible loss.

Finally, never trade in narrow, dead markets. The swings are too small. Never chase a market. Rather than worry that you’ve missed a move, think instead, “Oh, boy! I’ve got oscillations and volatility back...”

Basic Rules for Swing Traders:

Because of the short-term nature of this technique, swing traders must adhere to some very basic rules, including:

- If the trade moves in your favor, carry it overnight—the odds favor follow-through. Expect to exit the next day around the objective point. An overnight gap presents an excellent opportunity to take profits. Concentrating on only one entry or one exit per day relieves the pressure.
- If your entry is correct, the market should move favorably almost immediately. It may come back to test and/or exceed your entry point a little, but that’s OK.
- Do not carry a losing position overnight. Exit and play for better position the next day.
- A strong close indicates a strong opening the following day.
- If the market doesn’t perform as expected, exit on the first reaction.
- If the market offers you a windfall of big profits, take them to the bank on the close.
- If you are long and the market closes flat, indicating a lower opening the following day, scratch or exit the trade. Play for better position the next day.
- It is *always* OK to scratch a trade!
- Use tight stops when swing trading (wider stops when trading trend).

- The goal always is to minimize risk and create "Freebies."
- When in doubt—get out. You have lost your road map and your game plan!
- Place your orders *at the market*.
- When the trade isn't working, exit on the first reaction.
- *ANTICIPATE!*

"Trading the Swing"

How does one anticipate entry? The following may be indicators of a buy day or a sell day:

Start searching for a *buying day* 2 days after a swing high or, conversely, a *shorting day* 2 days after a swing low. Ideally, the market will move in complete 5-day cycles. (In a strong trend, the market will move 4 days in the primary direction and only 1 in reaction. Thus, one must seek entry 1 day earlier.)

"Check Mark" on the Test

The potential entry is sought opposite, or contrary to, the previous day's close. If looking to buy (sell), one first wants the market to "test" the previous day's low (high), preferably early in the day, and then form a trading pattern that looks like a "*check mark*" (see examples).

This pattern sets up and establishes a "double stop point" or strong support. If entering a market with only a "single stop point" or support formed by today's low only, exit on the same day—the trade is clearly against the trend.

Close vs. Open

The close should indicate the following day's opening. When a market opens opposite what is expected or indicated by the trend, one may first look to "fade" it—but must take profits quickly. Then look to reverse!

Support (Resistance)

Is today's support (resistance) higher or lower than yesterday's?

Swing Measurements

Where is the market relative to the last swing high or low? Look for swings (up or down) of equal length, and for retracements of equal percentage.

Additional Considerations:

No matter what the time frame, always look for supply at previous tops and support at bottoms. Penetrations should then be accompanied by volume and activity.

Expect trends, either up or down, to last for either 2 or 4 weeks.

The following conditions are fairly reliable indicators for the start of one of these trends. (I personally skip the first buy or sell reaction when one occurs because the move ensuing could be quite strong):

- Narrowest range in the last 7 days
- 3 consecutive days with small range
- The point of a wedge
- A breakaway gap
- A rising ADX (14-period) above 32

Practice:

Because a certain amount of confidence in any technique is required to trade it consistently, paper trading can cultivate the faith necessary to recognize and trade pattern repetition. Although the temptation to try too many different styles and patterns always exists, one must strive ultimately to trade in just one consistent manner—or at least to integrate techniques into *your own* unique philosophy.

System Characteristics:

Certain points about trading short-term swings deserve note. Understanding the nature of short-term systems can help you recognize the psychological aspect of trading.

When consistently following a short-term system, you should expect a very high win/loss ratio. Though the objectives with this style of swing trading appear conservative, you will almost always incur "positive slippage".

In all systems, winners are skewed. Even though making steady profits, 3-4 really big trades may actually make the month. It is vitally important to always "lock in" your trades. Don't give back profits when short-term trading.

You may be astonished at just how big some winners may be from catching the swings "just right!"

Decision-Making:

I feel it is important to address this topic. Every time you make a trade, you make a decision. The more decisions you make, the more you increase your self-esteem.

You grow with each decision, yet each decision has a price—you must discard a choice, and you must commit. Conditions are *always* imperfect! You must allow yourself to fail. Allow for human limitations and incorrect choices. Reserve compassion for yourself and your limitations.

There is so much instantaneous information available to all market players today. It is OK to use intuition and to listen to that little voice inside your head, "Does the trade *feel* right?" If in doubt, get out...!

Golden Rules:

Finally, I want to leave you with what I believe are two Golden Rules, applicable to all traders but, of essential importance to short-term swing traders:

- NEVER, ever, average a loss! Sell out if you think you are wrong. Buy back when you believe you are right.
- NEVER, NEVER, NEVER listen to anyone else's opinion! Only YOU know when your trade isn't working.

Notes from a Swing Trader

Extract– 1993 lecture

by Linda Bradford Raschke

Swing trading seeks to take advantage of a very basic price pattern that sets up and can be traded in any market. Though I refer to a two- to three-day trading cycle, principles that I teach work on an intermediate time frame – weekly charts – as well as on five-minute charts.

Whether you trade short-term, from a mechanical system, or a methodology like what I teach, there is one thing I want to impress on you: Be consistent! You can't do a Fibonacci calculation on one trade, try something else the next day, and then jump into a seasonal trade the next. It just doesn't work because trading is just a numbers game, that's all it is, trying to get a little bit of an edge in your favor.

My personal rhythm consists of buying one day and selling the next, or the day after that. I carry a lot of trades overnight. I don't take many on an intraday basis, only the trades which don't work out. The ones that don't work out become intraday trades really fast. The exception, of course, is the S&P market...in which there is plenty of opportunity to day trade.

Money (and Risk) Management:

Scale in and scale out of trades. That's one aspect of money management on which I concentrate. I'm always scaling out of trades. Put yourself in a win/win situation. Take some money off the board; take partial profits. That way you can't lose. If it then goes against you, at least you locked in something. If it goes your way, you still have bullets to play with. Don't get greedy.

Most floor traders tend to make money twenty days of the month. Then in the last two days they get blown out of the water on a big trend day during which other traders are buying breakouts and cleaning up. When swing trading, you truly don't want to fight a trend day – the market is going to tell you quickly if your play is right or wrong. And if you're wrong, don't fight it.

Always go in with a game plan. Anytime market action deviates from my road map, I'm out of there because the market is not doing what I expect it to be doing. If I don't know what it is doing, why am I in there?

Anytime that you're in a trade and you start to have questions like, "Well, what should I do now? Should I get out now? Should I take profits now? Should I stay in a little longer? Should I add to the position?" Anytime you have a question like that, you have no business being in that market. You have lost your edge because you don't have any control or game plan in that market. So, first, before you start swing trading, realize that you never want to put yourself in a position where you're going to be reacting to that market.

I find the best way to control my risk is to watch my equity curve. Every day I calculate how much money I made or lost. I don't care which positions made or lost it or how many winners or losers I had. When my equity curve starts to dip, I know something is wrong – perhaps I am stressed or getting careless.

I also believe in diversification. Something is always working. Don't get married to a position; don't get an opinion on a market. If I get an opinion on a specific market, I have to stop trading it.

Finally, when a market closes against me, the odds suggest that it will go even further against me. So I get out. I can always get back in the next day at a better price. That's my rule. I don't view it as taking a loss – I'm just playing for better position! And it works!

"Reading the Tape":

The most important points to me are the previous day's high and low. That's all I care about. Now some people like to do retracement numbers, some people like to do Fibonacci numbers. Any number is going to work because it focuses your attention on market action relative to another number. You can take any number and ask if the market is getting closer to or further away from it. That's all tape reading really is. Is the price making progress towards or away from that number?

You'll find that intraday cycle tops, cycle bottoms, intraday swings, lows, highs, are important support and resistance levels. Even on five-minute time frames, watch those lows and highs on the swings. If you're on a weekly chart watch the previous highs, watch the previous lows. What you're going to do is just focus in on the price action around that point.

It's either going to be a test, with the market finding support and forming a nice double bottom (a high-percentage trade because you can put in a really tight stop and the market should move in your favor right away), or else it's going to break through (if accompanied by volume and activity, there is no support but there probably is going to be a continuation. Perhaps 90% of my trading tends to be looking at previous lows and previous highs on daily charts.

A lot of people like to look for price divergences using oscillators, or the Elliot Wave fifth wave – which is either a failure top or a last little hook through. It's still the same concept – double top, double bottom, and tests. That's what swing trading really is: Buying retracements, finding out where the market finds support, and getting out.

You just have to define what works for yourself. There is nothing wrong with one time frame or another, or one style of trading or another. But build a road map in your head. It teaches you to anticipate, to have a plan, anticipate, watch it setup.

Overnight Positions:

However, I do believe in holding contracts overnight. For those of you who trade an intraday time frame, if you have a profit in your contract coming into the end of the day, try holding it overnight. The odds are you will win. Sure, one or two times it is going to gap down against you. But who cares? You took it home with a little profit, a little cushion. But the odds are that 70% of the time, you're going to get more money holding it overnight.

How many times have you come in the morning and they're gapping that market open? And you have to sit there and wait till the dust settles, and wait until the first 40 minutes of trading is out of the way. Do you know how nice it is to be able to come in with the market called to open higher – a ball of fire – and you say, "All right, suckers, if you want to pay that much for something, fine, you can have it, on the opening, yours, sold!" And usually the price will back down some after they have finished squeezing everybody who was short, everybody who had to cover on the opening.

Setting Up "The Swing":

Here is what makes a market. You have a number of different players and time frames in these markets. You have institutions, commodity pools and funds, and all that kind of big money.

On the other side are all the locals on the floor. Half of them make their profits off one tick, just trading the market back and forth. The other half usually close their positions out by the end of the day anyway. These guys are just scalping, putting money in their pockets; there are really not that many position traders in the pits.

Because of the activities of all these different market players, a two- to three-day swing pattern sets up. The big guys can't take advantage of it and the little guys don't care; but it creates a perfect niche from which to make a living.

What happens? The big players, the commercials, know the fundamentals, which their analysts have priced into the market. They know where they have to deliver x number of barrels in x number of days – a really long-term game plan. They have really deep pockets.

Those guys are right eventually; they have deeper pockets than anybody. They can sit and buy into one decline after another. Maybe three months later the thing will turn around and they'll sit on it, and then they will start selling out, selling out, and selling out.

When the big guys come in to start accumulating their line, it doesn't mean the price is going to hold there, merely that at some level they start buying. The locals standing in the pit see Merrill Lynch working an order to buy 1000. They know exactly what's going on, where the big guys are, so they'll start coming in and buying a little bit, supporting the market.

All of a sudden the price is holding. Because the price is holding, all the people that shorted it earlier are going to start taking it back. Well, the price stopped going down, so they better start taking it back, which might cause the price to lift a little bit. Then it starts to rally a little bit. It trickles up, then some people feel maybe the price is going to go up, so they start buying.

Just about now, traders looking at charts notice it going up. However, by the time an outside order gets to the pit, everybody else is buying these "breakouts" and the price is already marked up – and all of a sudden outside orders are chasing it.

And sure enough, like moths to a light, everybody has already bought? The locals bought their line, the commercials are only buying at this price down here. Who's left to buy? What happens when there is nobody left to buy?

The price stops going up. It doesn't fall down immediately, but the price stops going up.

When pit traders sense that loss of acceleration, when the order flow starts to slow down, those that bought in the morning when nobody else wanted to buy, who knew that the price held there yesterday – start taking their profits. That puts a little selling pressure on the market and the guys who see weakness in the market come in and start shorting it.

There are always people buying the market and always people selling it. There is constant supply and demand. There is always support and resistance in every time frame, always someone taking profits. Every long is going to have to take a profit or loss, and every short is going to cover at some point. It's like a zero sum game! It's a two-sided market. There's always going to be longs getting trapped and shorts getting squeezed.

The Rhythm of "The Swing":

So I look for a swing low and count that as day one. Day two is going to be the second day up, and day three I'm going to sell and go short – short it and look to cover on a pullback the next day. Then I'm back to day one, looking to buy.

So my rhythm is to "buy," "exit," "sell short," "exit," "buy," "exit". You find that usually there is not enough of a case to stop and reverse. I just sell and take profits. I find that to be the highest percentage. I know that I can lock it in, put it in my pocket. I do 90% of my orders at the market; I want in or I want out, I don't dicker over a tick or two.

Higher Bottoms/Lower Tops:

How does the market "test the water?" Prices decline one day and the locals cover their positions. The market finds support at some point, even if just a little. What I want to do is buy the test of that support, which the market usually gives you.

The market makes a V-bottom only a minority of the time. Most of the time it makes a W-bottom, or multiple tests, sometimes with higher and sometimes with lower bottoms. Tops are very rarely an inverted V; rarely does a market go straight up and straight down. You get a test, or at least a sideways ledge or consolidation.

Don't be too anxious; think about what you want to buy, how much, where. Have a little patience, see what the market is going to do. You can make a living just buying higher bottoms and selling lower tops.

Day Trading S&P Futures

The S&P market is a trading arena unto itself, which can accommodate many different trading styles. Not only does this market display a different daily profile than the other futures markets, but it has a much longer "length of line" (intraday swings), which offers more trading opportunities. Additionally, there is a wealth of information provided by many internal indicators on the equities market that some professionals like to monitor. In this article, I would like to share some observations, pointers, and favorite trading patterns. However, let me also say that the majority of the professional S&P day traders I know tend to specialize in just one pattern or trade just one style. This is definitely a market where overtrading can be a temptation.

Swing Trading Concepts:

The principles of "swing-trading" are nothing more than applying basic technical analysis to the secondary fluctuation which occur in a market. We can apply these principles to all time frames and all markets, but they work particularly well with the S&P's, so a brief summary is first in order.

Swing trading is following the price action and learning to anticipate the market's most probable course of action. We learn to determine the immediate trend by observing whether upswings are greater or lesser than downswings. In a simplified model, we look to enter on retracements in the direction of the trend. An early sign of a trend reversal is a "test" of a most recent extreme price level which usually forms a higher low (or lower high). A trend reversal is confirmed when the upswing leg exceeds the length of the downswing (or vice versa). If a trader enters a position on a "test" looking for a trend reversal, but does not get this confirmation, he should exit the trade or pull his stop up close to his entry price.

There are also periods of market rest, consolidation, or low volatility range contractions. These patterns provide an opportunity for traders who like to trade "volatility breakouts" – a methodology in which one waits for the market to tip its hand with a powerful thrust and then jumps on board in the direction of the movement. This too, can be a form of swing trading, as we

are playing only for the market's next immediate move and not making any longer-term valuation judgments.

When a trader practices the principles of swing trading, he learns to develop a conceptual roadmap in his head. In the S&P market, it is particularly important to learn to think in terms of concepts because there can be so much distracting intraday "noise". Some more examples of concepts are: mid-morning trends tend to carry into 12:00(EDT) +/- 15 minutes. The best average intraday trends tend to last 45 to 90 minutes before having a countertrend reaction. The earlier a trend starts, the earlier it peters out. There is often an opportunity to play off a reversal of the move into 10:00 (EDT) +/- 15 minutes. The markets tend to be more emotional at the beginning of the day when a good move counter to the initial opening swing can occur. If you learn to think in terms of concepts, you can master the markets instead of becoming a slave to the charts.

Time-of-Day Tips:

On average there are only 2-3 great S&P intraday "legs" or swings. Most professionals catch only 3-4 really great trades a week, if that! (Most trades will often be very small wins and losses). So don't be too harsh on yourself if you feel that you are missing the majority of the movement. Overtrading suckers one into seeing only the trees and missing the forest.

Traders tend to be creatures of habit, and thus it is easy to compile market tendency charts. There are several key patterns which have held constant over time. One common pattern might be: the market rallies or sells off into noontime. At this point, a large percentage of the floor traders and brokers in New York go to lunch and a countertrend correction begins. When the late stragglers get back from lunch, the morning direction tries to reassert itself again. If the afternoon rally or selloff starts too soon, it won't be able to sustain itself through the end of the day. It will die out around the bond close. However, if there is an afternoon "shakeout", (usually between 2:00-2:30), then the market can finish in a trend mode into the close.

Do not fade a move into the last hour of the day, for there is no time to exit gracefully if wrong. The odds suggest a better entry price the next day on the probable morning follow through. Moves on Friday tend to end at 3:00, not 4:00, too many traders prefer to flatten out or even up before the weekend.

On many days there occurs what I call the 3 o'clock jiggle. Right around the time the bonds close, there is a great 10-15 minute scalp trade. I believe it

occurs as an emotional reaction to how the bonds go out. The trade usually lasts for no more than 10 to 20 minutes, but is fun to anticipate.

Sometimes a good selling opportunity occurs around 2:00. In fact, it is amazing how many good turning points occur on hourly readings, for example, 10:00, 12:00, and 1:00. I think this is because people are more conscious of time at these moments, creating a slightly sobering effect.

Divergences:

Many clues can be gained by watching the S&P market in relationship to other markets or indexes. There is very often a leading/lagging relationship with the following: the NASDAQ, the Dow Jones Industrial Average, the Transportation Index, the bond market, and even the OEX's. These types of observations are another form of tape reading. How is the market acting? Is it holding together as the bonds are making new lows? What does this tell you? Is the S&P failing to confirm a new afternoon low made by another index? This may be a sign of relative strength.

Divergences with other indicators based on market internals make fabulous trading signals. My favorite one is when the S&P makes a higher high but the "Ticks" fail to make a higher high, indicating a potential non-confirmation or sell divergence. "Ticks" also indicate how much buying or selling power there is... in other words, fuel for the fire. (Technically, the Tick specifies the net number of stocks on the NYSED whose latest change in price was up or down.) If Ticks are minus 500, there is lots of fuel for an upside rally. If Ticks are plus 500, buying power is running out. In general, pay attention to when the Ticks stop going up or down. From here the market may often reverse. I don't necessarily initiate a trade on fading these extremes, but I do use it to take profits on an existing position. It is much easier to sense the loss of momentum in a move when watching the Ticks because there is not nearly as much "noise" as there is in the actual price of the S&P.

The divergence pattern can also be used with the S&P premium level. For example, if the S&P contract makes a new low but the premium level makes a higher low, this indicates relative strength in the underlying cash index.

Another intraday indicator I would like to mention is the Trin (the concentration of volume in advancing and declining stocks.) Trin represents the market's "gas pedal". The absolute value of the Trin is not really as important as the direction it is trending. If the Trin is dropping from 80...76...74...72..., it indicates buying coming into the market. Someone is stepping on the gas pedal. If the Trin holds at a constant level from here,

you can say that there is no selling coming into the market. In other words, there is no deterioration. In general, follow the trend of the Trin. A change in its direction confirms market turning points. (In the first 1/2 hour of trading, the Trin will tend to jump around a lot. Don't pay too much attention to this indicator until the majority of stocks have opened and had a chance to stabilize).

Exits:

Many traders can get good entry points but don't exit very gracefully. In fact, this is a common problem for the very reason that exit signals are never as strong as entry signals. If they were, we would constantly be stopping and reversing – a tiring prospect.

I have always found it psychologically easier to exit too early rather than too late in the S&P's. I get my best prices by selling longs into strength and covering shorts as the market falls – not after it turns. These days I usually pick up the phone and go in "at the market". I am happy to take a profit and don't want it to slip away by worrying about a few extra ticks in a fast market.

Trend Days:

Good trend days occur 2-3 times a month. On these days, the market will open at one end of the range and close at the opposite extreme. Trend days most often occur after 2-3 small range days or a period of dull, listless trading. These are the types of days that systematic volatility breakout traders like to capture. Trend days are usually accompanied by heavy volume, extreme advance/decline ratios, and extreme Trin readings which do not back off much during the day.

Do not get anxious if you missed the morning move or tries unsuccessfully to fight it; trend days tend to have a parabolic move in the afternoon. Again, think of the concept: the market will close much further away from whatever the current price is. Pick up the phone and enter in the direction of the trend. Use the previous hour's opposite extreme price as a protective stop and plan to hold the trade until the end of the day.

Trend days also often occur when there is a big price gap on the opening. It is generally difficult to predict with any statistical accuracy whether or not the market will trend up or down. However, the best entry signal is to buy if the market starts trading higher than the first hour's trading range and sell if it breaks below it. (Aggressive traders like to "cheat" on this parameter and

try and enter a bit earlier). This is also an excellent way to enter breakout traders where the previous day's range has been relatively narrow.

How to Limit Losses:

Any experienced trader can tell you that his greatest losses have been taken on those rare occasions where he substituted stubbornness for a proper stop loss technique. The proper way to trade is to establish where a stop loss will be taken before the trade is made. I recommend risking an initial fixed amount because it simplifies calculations and order entry. (In other words, you don't have to think about it too much!). You can then pull the stop up tighter if the trades does start working in your favor. If a trader waits until he has a loss before making that initial decision, his judgement is almost certain to be warped by such loss.

The best trades will tend to work right away if the trader has correctly anticipated a pullback or spotted a divergence. The market's response should be swift and certain. However, no trader is infallible, and thus a stop loss should be considered to be an invaluable form of insurance – something necessary to running any type of business.

I suggest keeping a daily journal to note your own observations. Also note which types of trades seem to work out best for you. I know one market professional who trades best by waiting for a strong afternoon thrust. He then enters on the first pullback in the direction of the thrust. He claims he loses on balance getting "chopped up" in the morning's cross-currents. However, another good friend can trade only in the morning and only from the short side. He waits for an initial morning surge, places his shorts, and never risks more than 2 points. This professional has consistently made a most enviable living for the past 15 years. The moral of the story is: he knows himself and what style works best for him, and he always has a resting stop loss order in the marketplace.

Paper trading can never substitute the psychological lessons accompanying putting a real trade "in your gut". Don't worry about the exact prices you are getting in or out at, but instead remember to always think in terms of concepts – it is far more important to get the main idea right! Time and practice will then improve upon your execution skills and allow you to build up your confidence level.

Best Wishes for Happy Trading!

Secrets of Top Trading Performance

Trading is a performance-oriented discipline and every great athlete, trader, or performer will occasionally hit performance blocks. Every Olympic contender trained hard physically, but the difference between the ones who made the Olympic team and those who did not was the emphasis put on mental coaching by the winners. Much of a trader's early education is concentrated on strategies and market analysis. But what are the necessary ingredients for peak performance? What are the tools for both mastering the mental side of the game and busting out of the inevitable slumps that can occur along the way?

Key Ingredients to Performing Your Best

1. *Passion.* You must be passionate about what you are doing and having fun. Passion first, then performance.
2. *Confidence.* Top performance comes from having a high degree of confidence. You must have the confidence that you can take control and face adversity. You must also be confident that you will have a favorable outcome over time.
3. *Concentration.* Peak performance comes from exceptional CONCENTRATION. You must concentrate on the process, though, not the outcome. A sprinter who is in the lead is thinking about the wind on their face, how relaxed their arms are, feeling the perfect stride...they are totally in the moment. The person who does NOT have the edge is thinking, "Oh, that runner is pulling ahead of me...I don't know if I have enough wind to catch the leader..." They are tense and tight because they are thinking about the outcome, not the process.
4. *Resiliency.* Great performances come from being able to rebound quickly and forget about mistakes.
5. *Challenge.* Great performance comes from pushing yourself and trying to overcome limitations. Staying in the safe zone becomes a monkey on your back. Challenge yourself to take that hard trade. Manage it. If it does not work out, so what...your risk was limited and you can pat yourself on the back for taking the hard trade in the first place.

6. *See and DO ... don't think!* Great performance comes from turning off the brain and becoming automatic. This is being in the Zone ...in the groove. You can't overanalyze the markets during the trading day.
7. *Relaxation.* When you are relaxed, your reflexes and timing are superior because you are loose.

First – what is the mindset necessary for peak performance? How does one ultimately get in the groove? There is no better feeling than being in the “flow” – especially with trading. That is what many of us live for and what keeps us in the game, because trading can be a very tough business with long hours.

There are several key common ingredients when you are performing your best (see sidebar), no matter what the field.

EXPECT success. It begins initially with your self-talk. Do you get down on yourself when you make a mistake? – Or do you say to yourself – next time I will do better because I have great trade management and am a superior trader! Be your own best motivator and believer in yourself. Positive Self Talk leads to positive BELIEFS. If you believe you can do something, you WILL eventually find a way. When you have a positive belief system that the eventual outcome will be OK, then you are more mentally and physically relaxed. You then have better concentration, which leads to smoother execution, which of course leads to peak performance.

Now, on the flip side of the coin, negative self-talk sows seeds of doubt. This lowers self-confidence, which leads to a negative belief system. This then creates anxiety, which leads to disrupted concentration. Now the trader becomes tense and tentative which in turn leads to poor performance. Talk about a vicious cycle!

Positive Self Talk

What are some concrete tools to break the cycle and bust out of the slump? The number one tool for starters is POSITIVE SELF TALK. We all talk to ourselves in our own head. Be aware of the things you are saying to yourself. The written word is also a powerful tool. Read affirmations and books on positive thinking. Norman Vincent Peale, Napoleon Hill ... Arnold Schwarzenegger's autobiography are a few. Richard Marcinko wrote a book called the Rogue Warrior. He talked about the Will to WIN and the belief that

ANY circumstances could be overcome. This is a great inspirational book for traders.

Next – act like you are already where you want to be. Assume the mannerisms, posture and talk of a top trader. In addition to self-talk and reading written words, develop mental pictures. Visualize what you are going to do with your wealth or how it is that you want to live. Think of the power that money would give you to start any organization you want or to make other people's lives better. Visualize your dream house. Program your subconscious as though you are already there. Dare to dream.

OK – talk, words and pictures...what is next? Look at your environment that you have surrounded yourself with. Your success in trading will also be a product of your environment and I am not just talking about office space. Look at the people you surround yourself with. Do they support your activities? Surround yourself with people who believe in you, who smile, and who are enthusiastic in anything they try or do. The top Olympic athletes had friends and family cheering them on every step of the way.

Be Prepared:

All of the above factors deal with external factors and internal belief systems. Now let's get down to the DOING part! Every trader should be prepared before the markets open because they already did their homework – right?! One of the most impressive points in the Rogue Warrior book was this veteran navy seal's obsession for being totally prepared for Mr. Murphy! There was always a backup plan for everything and this is what kept him alive. Prepare your daily game plan by looking for both new setups and preparing strategies for managing existing positions.

So, assuming that you have done your daily homework as a trader, the next step is to learn how to get into the groove. There is no better tool for this than having routines and rituals. Pre-market rituals help calm the nerves, get you into a rhythm, and also help to turn off the logical part of your brain – the part that wants to overanalyze everything. If you have a chattering monkey sitting behind your ear, routines and rituals are one of the best things to shut that monkey up. Maybe there is an opening sequence of tasks you do before the market opens. Perhaps in the middle of the day you draw swing charts or take periodic readings of the market's action. Maybe you keep a journal and make notes to yourself. At the end of the day, what type of record keeping do you do for your trading activity? What do you do to unwind? Salesmen are taught to do small rituals before cold calling clients. It

controls the anxieties and fears of rejection. Baseball pitchers have a pre-wind up ritual. It calms their minds and puts their body on the autopilot mode. It keeps them involved in the PROCESS and not thinking about the outcome. One of the more common rituals on the trading floors was to wear the same disgusting lucky tie every day. If the mind BELIEVED that the tie was lucky, this was all the traders needed to tip the long term odds in their favor.

Here is another helpful factor: A healthy body keeps a healthy mind. EXERCISE! This gets oxygen to the brain and keeps the blood flowing. How can you expect to be a peak performer when you are eating junk food and going through insulin swings? Or perhaps you drank too much wine the night before or are jittery from drinking too much coffee. How can you concentrate well if you are not getting a full decent night's sleep? Sure, most of these are minor factors but they can all add up to major bumps in your performance. One moment of sloppiness can lead to forgetting to place stops or letting a bad trade go too long. Then when damage is done, your confidence gets chipped away. You must treat your confidence level as something to be protected. Good habits will keep your confidence level high. Once you have good habits, it will allow you to increase your trading size.

If you want to push yourself to the next level in your trading and are wondering how to increase your size, you MUST have a foundation of good habits. If you are running into a mental block in this area, it is your unconscious's way of telling you that either you have not done adequate preparation or you are not satisfied with your money management habits.

Goal Setting:

- *Desire.* The most successful players are the ones who have a *burning desire to win.*
- *Defy Failure!* Don't check out of the game. *Never give up!*
- *Consistency.* *Improve your consistency.* Stay active, stay involved, and keep your feet moving.
- *Patience.* *Be patient.* Do not force a trade that isn't there. Wait for the play to set up.
- *Management.* When you get a good trade, go for it. Manage it. Trail a stop. *Don't be too eager to get out.*
- *Flexibility.* *Be flexible* – if what you are doing isn't working, change what you are doing!
- *Confidence.* When down, get a little rhythm and confidence going. *Don't worry about being too ambitious*

- *Concentration. Stay with your game.* Don't let outside distractions bother you. They take energy and break your concentration.
- *Know Yourself.* Match your particular strengths to the type of market conditions.
- *Clean Up Your Act. Hate making stupid mistakes and unforced errors.* This includes not getting out of a bad trade when you know you are wrong.
- *Stay Positive.* Many players will play their best game when they are coming from behind.

There is one more extremely important thing that contributes to your success and that is GOAL SETTING. When you set your goals, they must be concrete and measurable. You must also break them down into bite size pieces. Perhaps your larger goal is to make 7 digits over the next three years, but how do you get there? Put together a more detailed business plan that is NOT dollar oriented but will help you eventually reach your dollar-oriented goal. Maybe it includes how many trades you should make per week, how much time you should devote each evening to preparation and studying charts, and plans for controlling risk. Both short term and long term goals help achieve peak performance.

You must also have concrete ways to measure those goals. Top athletes know the splits that they run. They know if they are ON or OFF according to how practice goes. They know their unforced error percentage, their personal best, and their competition's stats. The same should apply to you in your trading. Know your weekly win/loss ratios, your trade frequency, and the average amount of profit or loss each month. Only by having something to measure can you tell if you are improving or not and moving closer to your goal!

The battleground isn't the markets but what's within you. The more you talk with other traders, the more you realize that everyone goes through various common experiences. Everyone makes many of the same classic mistakes. But what distinguishes the ones who can ultimately overcome them?

The accompanying comments (see sidebar) were inspired from Brad Gilbert's book, *Winning Ugly*, which was written about tennis. There are many parallels between tennis and trading, both being individual performance disciplines.

And on that last note, remember that ATTITUDE is everything. How you frame out an individual experience or event will affect your success in the long run. Do you see a trading loss or bad drawdown period as a major setback, or do you see it as a learning experience from which you can figure out how to be on the RIGHT side of a trade instead of the wrong side the next time around. Many great traders use periods after drawdowns to go back to the drawing board. Some of the best systems and trading ideas have come after periods of adversity. What incentive is there to learn and improve ourselves when everything is smooth sailing and we are fat and happy? But when times are tough, that is when we can rise to the occasion and prove that we can overcome any obstacle set down in our path. So many great athletes have been able to come from behind when they are down because they have learned how to seize that one opening or opportunity and CONVERT. They latch on to the tiniest shift in momentum and milk it for all it is worth. Latch on to that next winning trade and convert. The first small moral victory is the first step towards reaching the top of Mt. Everest. And if you keep making small steady steps, you will eventually reach the top. Sometimes for a trader, the greatest feeling in the world can be making back those losses, no matter how long it takes, because once you have done that, you realize you can do anything.

Volatility Breakout Systems

Breakout systems can actually be considered another form of swing trading, (which is a style of short term trading designed to capture the next immediate move). In other words, the trader is not concerned with any long term forecast or analysis, only the immediate price action.

Volatility breakout systems are based on the premise that if the market moves a certain percentage from a previous price level, the odds favor some continuation of the move. This continuation might only last one day, or go just a little bit beyond the original entry price, but this is still enough of a profit to play for. A trader must be satisfied with whatever the market is willing to give.

With a breakout system, a trade is always taken in the direction that the market is moving at the time. It is usually entered via a buy or sell stop. The

bit of continuation that we are playing for is based on the principle that momentum tends to precede price. There is also another principle of price behavior that is at work to create trading opportunities. That is, the market tends to alternate between a period of equilibrium (balance between the supply and demand forces) and a state of disequilibrium. This imbalance between supply and demand causes "range expansion", (the market seeking a new level), and this is what causes us to enter a trade.

There are several ways to create short-term volatility breakout systems. I have found that different types of systems based on range expansion test out quite similarly. Therefore, whichever method you choose should be a matter for your own personal preference.

In designing a system, one can choose to place an entry stop off either the opening price or the previous day's closing price. This entry stop can be a function of the previous day's range or a percentage of the previous 2.10-day range, etc. Mechanical exits can range from using a fixed objective level to using a time function such as the next day's open or close. Most of these systems function best when a very wide stop is used.

Another way of trading the breakout mode is by using "channel breakouts" which is simply buying the highest high of the last seven days in the case of a 7-period channel or the highest high of the last 2 days in the case of a 2-period channel breakout. In the case of an inside day breakout pattern where one buys the high or sells the low of the previous bar, a 1-period channel breakout is actually being used for the trigger. The most famous long-term breakout system adapted by Richard Dennis for training the "Turtles" was the 4-week channel breakout originally designed by Richard Donchian. Other breakout systems can be based on chart patterns (i.e., Curtis Arnold's Pattern Probability System), trend line breaks, breakouts above or below a band or envelope of prices, or variations of simple range expansion functions.

Training Benefits for the Novice Trader

Derived from Trading a Volatility Breakout System:

Trading a short-term breakout system can be one of the best exercises to improve your trading.

- First, it teaches you to do things that are hard to do – buying high or selling low in a fast moving market! For most people, this feels quite unnatural!

- Second, it always provides a defined money management stop once a trade is entered. Not adhering to a defined money management stop is the most common cause of failure among traders.
- Third, it teaches a trader the importance of follow-through once a trade is entered, as most breakout systems perform best when the trade is held overnight.
- Last, it provides a great means for traders to improve their execution skills. Most volatility breakout systems are fairly active compared to a long-term trend following system. A trader can gain skill in placing orders in a diverse number of markets. Having a mechanically defined entry point is sometimes just the thing needed to overcome a trader's fear of pulling the trigger. The order is placed ahead of time and the market then automatically pulls the trader into a trade if the stop level is hit.

Even if a person prefers to ultimately enter orders using discretion, trading a mechanical volatility breakout system can still be an invaluable exercise. It should at least increase a trader's awareness of certain types of price behavior in the marketplace, especially if one is conditioned to entering on counter-trend retracement patterns. It can't but help impress upon one the power of a true trend day.

Pros and Cons of Trading a Breakout System:

Like most systems, volatility breakout systems will clean up in volatile or runaway markets but tend to thrash when conditions get choppy or volume dries up. I believe they are still among the most profitable type of system to trade, and I also feel they will continue to be profitable in the long run. They are "durable" and "robust", though they tend to deteriorate when too large of an order is placed (i.e., greater than 50 contracts). However, so that you do not get the impression that there is a Holy Grail of systems, the following considerations should be kept in mind:

Entries can be nerve-racking, especially when the market is in a runaway mode. The best breakouts won't give you retracements to enter on. You are either on board or you are not! If you conceptualize that the best breakouts turn into trend days, and are most likely to close on the high or low for the day, then it is not so difficult to enter. Usually it is best to have a buy/sell stop already resting in the marketplace.

Sometimes a market gaps open outside your initial entry level. These often turn into the best trades. They can also turn into the most aggravating whipsaws. Big gaps test out that one should still take the trade, but they will definitely add more volatility to your bottom line. If your trade gets stopped out and a new signal is given in the opposite direction, this reversing trade usually more than makes up for the first loss.

Whipsaws are a drag but they are also inevitable when trading a breakout system. Many times I have bought the highs and sold the lows. It takes a great deal of "confidence in the numbers" to trade this type of system. System testing should always be done for a minimum of 3 years, preferably 10. Be sure to then examine out of sample data to see how the system performed.

On balance, a volatility breakout system can be traded on most all markets. However, a market might be very profitable one year and yet perform mediocre at best the next. A portfolio of 10 to 12 markets seems to work well. The problem with trying to trade too many markets at once is that it can become quite difficult to keep up with the activity level if your parameters are fairly sensitive. Many times in systems development, people overlook what one person can realistically manage.

Enhancing a Basic Volatility Breakout System:

Adding filters can sometimes create further enhancements. Examples of types of filters include: indicators to determine whether or not a market is in a trending condition, seasonality, days of the week, or degree of volatility contraction already present in the market. Periods of low volatility in the market can be defined by a contraction in true range, a low ADX, or a statistical indicator such as a low historical volatility ratio or a low standard deviation.

A system then might look something like this:

1. Initial volatility condition = true
2. Buy or Sell on a stop based on the current bar's open, plus or minus a percentage of the previous day's range.
3. Initial Risk management stops once a trade is entered.
4. Exit strategy.

Types of variables which can be used in a simple range expansion breakout system:

1. Period – is the breakout based on a function of the previous day or the previous 10-day period, for example?
2. Range – does it use the average range for that period or the largest, smallest, or total range?
3. Percentage – what percentage of the range is used? It is possible, for example, to use 120% of the previous 3-days' total range.
4. Base – is the range function added to the previous day's close or the current day's open. This function may also be added to the high or low of the previous bar or a previous period such as the last 10 days.

As a general rule of thumb, the greater the percentage factor used, the greater the percentage of winning trades will be. However, the overall system may be less profitable because fewer trades are taken.

Once again, an example of an initial condition might be: Enter a trade only on a day following the narrowest range of the last 7 days. Or, take a trade only if the market has made a new 20-day high or low within the last five trading days. Whenever you add a filter to a system, be sure to compare the results to a baseline and examine the difference in activity level.

EXIT STRATEGIES:

1. Time based (2nd day's close, 1st day's opening)
2. First profitable opening (Larry Williams)
3. Target or objective level (1 average true range, previous day's high/low)
4. Trailing stop (displaced moving average, parabolic, 2-day high/low)

RISK:

Controllable Risk – the amount of risk which can be predetermined and defined by a money management stop.

Types of money management stops:

1. fixed dollar amount
2. function of average true range

3. price level (i.e., bar high/low)

Uncontrollable Risk:

1. Overnight exposure (close to open risk). You cannot exit a position when the market is not trading. Thus, you are subject to adverse gaps, which can be exaggerated by news or events.
2. Slippage risk. Fast market conditions or thin, volatile markets often cause a trader to get filled at prices much worse than expected.

In general, the numbers behind most systems are very dependent upon capturing a few good trades. You can't afford to miss the one good trade that can make your month.

Here are some tips for trading this or any other system:

1. Gain confidence by first trading a system on paper.
2. Make sure you can successfully trade a system mechanically before attempting to add any discretion.
3. Track your actual performance against the mechanical system at the end of each day, rating your success by whether you can match the system's performance.
4. Monitor performance over an adequate sample, perhaps 100 trades or a set number of weeks. Do not let a down week or trade deter you.
5. Manage the exits rather than filter the entries. It is impossible to tell in advance which trades will be the good ones. The one entry skipped might be the BIG ONE, and one can't afford to miss it. Managing the exit means two things: The first, learn when it's okay to let that occasional great trade run an extra hour or two before getting out; the second (which really depends on one's skill level), learn to recognize a bit sooner when a trade is not working and exit just before the stop is hit.
All systems display subtle nuances and insights into the market's behavior over time.
6. Keep a notebook of your observations and patterns you notice. In this way you truly "make the system your own".

7. Never be concerned about how many other people are trading systems. If slippage seems excessive, it often suggests a significant breakout from a triangle or period of congestion. Remember: Something had to drive the market far enough to penetrate the breakout point in the first place!

Building a Good Foundation- Lessons from Mister Bill

There are common threads among those who are successful in life and have reached a level of excellence in their chosen field. Success is defined not by monetary standards, but rather by level of happiness, personal fulfillment, and mastery in their discipline. Mr. Bill has achieved this exalted plateau. He is not a trader, but if you substitute the word "trading" for "trainer", Mr. Bill's lessons are the perfect recipe for success in the markets.

Mr. Bill is a personal trainer who has discovered the secrets to health, happiness, and building an awesome physique. Some of his clients are Olympic equestrian riders who have remained loyal to Mr. Bill for many years. And here's why – his philosophy on the importance of building a good foundation has helped his clients bring home Olympic medals! Mr. Bill is in his late 60's, has a body like Jack LaLane's, and a mind like Yoda's. I am going to listen to someone who says that the first thing he does in the morning is to get out of bed with a smile on his face because that is the proper way to greet the day.

Mr. Bill says a good foundation is the key to everything, whether it is bodybuilding or trading the markets. How can you start on the journey towards reaching a level of competency, let alone mastery, if you don't start from a base of solid training principles? In any discipline, if shortcuts are taken, the cracks in the foundation will show up later and inevitably hold you back.

Mr. Bill has many words of wisdom to share with us on building a good foundation. To start, there must be a solid methodology used to build a

foundation, and this methodology must be followed with CONSISTENCY. For example, when working out, it is important to work the muscle groups in a particular order because blood flows from one group to the next. There is a logical rationale for everything, even if results are not seen for a while. A good foundation is built on the basics – core exercises for the major muscle groups. And when applying these basics, proper technique is everything. If you have proper technique in what you do, you will be able to accomplish twice as much in half the time.

This certainly applies to the bottom line in the markets. In your trading, keep a basic core group of patterns or strategies that you trade. They should be built on the elementary principles of price behavior, for this is where there is an edge. Follow your trading program with CONSISTENCY, using proper technique and form when it comes to managing your trades. Proper technique is the equivalent of good habits. Even though a trader may not see immediate results in their P&L from following a methodical approach with good money management, it is the good HABITS that will eventually enable the trader to climb to higher levels by using more leverage. It is the good foundation and habits that give a trader CONFIDENCE that their goals are achievable.

Rituals are the main tools used to achieve consistency. However, rituals are not just a tool, they are a lifestyle! Mr. Bill has rituals for practically everything, starting with how you wake up. Shave first, THEN brush the teeth...the same way every day. Next, one cup of coffee with condensed milk...the one sweet luxury of the day. Mr. Bill has 2 ½ hours of rituals before he starts training his first client at the gym. Check the computer for e-mails, meditate, take morning supplements, (have that cup of coffee) and of course leave plenty of time to get to the gym so as not to feel rushed! In addition to creating a methodical approach to everything, rituals offer the REAL luxury of freeing the mind...from stress, anxieties, and negative thoughts.

Mr. Bill states that record keeping is a critical part of building a good foundation. (Sound familiar for success in the markets?) He keeps track of every exercise, weights, reps, and minutes that go by for each of his clients. He notes every detail, comment or aberration. If a client has a unique problem, he thinks about it at night and lets his mind come up with creative solutions while he sleeps. He is devoted to achieving maximum progress for each of his clients. He is even more meticulous in his personal record keeping, including everything from personal nutrition and exercise to finances.

Think of record keeping as one more type of ritual. It is a tool that will help you to stay focused and gain control over areas that are prone to distractions. It is also the main tool used to monitor performance. Every top athlete keeps detailed records on their physical performance and progress. There is no reason why a trader can't keep detail records on the more abstract business of trading.

Record keeping monitors your progress in reaching towards your GOALS. If your goals are not written down, Mr. Bill says that they are worthless. Once you write something down, that is the first step towards commitment. Writing down your goals firmly implants them in the subconscious and you are less likely to change them. Have you written down your goals for this year? How about starting out with building and maintaining a solid foundation in your trading program!

Mr. Bill suggests learning how to properly SCHEDULE things into your daily routine. Once it is scheduled in, it is part of your routine and quickly becomes integrated into the rituals. Mr. Bill says that if you do not schedule something, such as a regular trip to the gym, it is too easy to talk yourself out of it or procrastinate. So, learn how to schedule time for your record keeping and preparation time necessary for the next day's markets. There should be no discussion with yourself when it comes to doing your necessary preparation for the markets each night. You will welcome making rituals part of your routine when you find that it helps you start the trading day feeling totally prepared and in control, ready to go.

Mr. Bill says that if you CONCENTRATE on the specific muscle you are working and give it your whole attention, it helps it grow faster. Concentration, in addition to a consistent methodology, is a key component of a good foundation. Learn to concentrate specifically on the task at hand. When you are putting on a trade or managing a position, give whatever you are doing your full attention at the time. With practice, it gets easier to eliminate distracting thoughts.

Mr. Bill believes that everything starts with positive thinking! He was not always that way. He used to drink heavily and smoke until one day, 20-years ago, he simply quit and said THAT IS IT! He weighed 135 pounds at the time (and he is a tall man!) Now he exudes more energy than people half his age. This man clearly loves his life! He says his biggest secret is positive thinking. He starts his day by saying "No negative thoughts today." He refuses to entertain one negative thought. If one pops into his mind, he kicks it right out or turns it into something positive. And he claims that there are some days now where not one negative thought pops into his head.

Exercise is one of the easiest areas that you can quickly start to feel good about yourself. As you become fit, you gain strength and confidence. Everything then branches out from there. You will eat healthier as your body feels better. Supplements or vitamins become part of your daily ritual. Alcohol and sugar are less attractive. And you will find yourself making more time at night to get a good sleep, as your muscles need time to rest in order to grow.

This analogy can be applied to the business of trading. When proper homework and preparation has been done at the end of each day, we are in a stronger position coming in at the beginning of the trading day. The first few successful trades give a taste of the satisfaction gained in running a well thought out program, which in turn increases incentive to continue to eliminate all the distractions and wasted time engaging in frivolous activities. Just as the person who engages in a regular exercise program starts to set higher physical goals for themselves, the person who starts to follow a consistent trading program will also set higher goals, such as one day running a successful money management business or striving for continuous new account highs.

Remember Mr. Bill's lessons on the importance of a good foundation as the New Year begins: Stick with the basics, follow a methodology, be consistent, use rituals to achieve consistency, concentrate on your form and technique, write down your goals, keep records of your progress, and above all, practice positive thinking!

The Mental Aspect of Trading

Many traders quickly come to acknowledge that despite being familiar with winning strategies, systems, and money management techniques, trading success is dependent on your psychological state of mind. If you're a trader just starting out, where do you find the initial confidence to pull the trigger? How do you deal with the down times without digging yourself deeper into the hole? If you are in a hole, how do you work your way back out? How do experienced traders push through the ceiling of profitability that caps their initial trading years and make a truly fabulous living?

Trading is a performance-oriented discipline. Stress and mental pressures can affect your ability to function and impact your bottom line. Much of what has been learned about achieving peak performance in both business and sports can be applied to trading. But before looking at some of these factors, let's first examine the ways that trading differs from other businesses.

1. Intellect has nothing to do with your ability as a trader. Success is not a function of how smart you are or how much you have applied yourself academically. This is hard to accept in a society that puts a premium on intellect.
2. There is no customer or client good will built up each day in your business. Customer relationships, traditionally important in American businesses, have little to do with a trader's profitability. Each day is a clean slate.
3. The traditionally 8-5 work ethic doesn't apply in this business! A trader could sit in front of a screen all day waiting for a recognizable pattern to occur and have nothing happen. There is a temptation to take marginal trades just so a trader can feel like he's doing something. There's also the dilemma of putting in constant hours of research, having nothing to show for it, and not getting paid for the work done. Yet if a trader works too hard, he risks burn-out. And what about those months where 19 out of 20 days are profitable, but the trader gives it all back in one or two bad days? How can a trader account for his productivity in these situations?
4. If you were to invest time, energy, and emotion into developing a business venture and backed out at the last minute, it would be considered a failure. However, you should be able to invest time and energy into researching a trading idea, and yet still be able to change your mind at the last minute. Market conditions change, and we cannot be expected to predict all the variables with foresight. Getting out of a bad trade with only a small loss should be considered a big success!

What IS the definition of a successful trader? He should feel good about himself and enjoy playing the game. You can make a few small trades a year as a hobby, generate some very modest profits, and be quite successful because you had fun. There are also

aggressive traders who have had big years, but ultimately blow-out, ruin their health or lead miserable lives from all the stress they put themselves under.

Principles of Peak Performance:

The first principle of peak performance is to put fun and passion first. Get the performance pressures out of your head. Forget about statistics, percentage returns, win/loss ratios, etc. Floor-traders scratch dozens of trades during the course of a day, but all that matters is whether they're up at the end of the month.

Don't think about TRYING to win the game – that goes for any sport or performance-oriented discipline. Stay involved in the process, the technique, the moment, and the proverbial here and now! A trader must concentrate on the present price action of the market. A good analogy is a professional tennis player who focuses only on the point at hand. He'll probably lose half the points he plays, but he doesn't allow himself to worry about whether or not he's down a set. He must have confidence that by concentrating on the techniques he's worked on in practice, the strengths in his game will prevail and he will be able to outlast his opponent.

The second principle of peak performance is confidence in yourself, your methodology, and your ability to succeed. Some people are naturally born confident. Other people are able to translate success from another area in their life. Perhaps they were good in sports, music, or academics growing up. There's also the old-fashioned "hard work" way of getting confidence. Begin by researching and developing different systems or methodologies. Put in the hours of backtesting. Tweak and modify the systems so as to make them your own. Study the charts until you've memorized every significant swing high or low. Self-confidence comes from developing a methodology that YOU believe in.

Concentrate on the technical conditions. Have a clear game plan. Don't listen to CNBC, your broker, or a friend. You must do your own analysis and have confidence in your game plan to be a successful trader.

Analyze the markets when they are closed. Your job during the day is to monitor markets, execute trades and manage positions. Traders should be like fighter pilots – make quick decisions and have quick reflexes. Their plan of attack is already predetermined, yet they must be ready to abort their mission at any stage of the game.

Just as you should put winning out of your mind, so should you put losing out of your mind – quickly. A bad trade doesn't mean you've blown your day. Get rid of the problem quickly and start making the money back. It's like cheating on a diet. You can't undo the damage that's been done. However, it doesn't mean you've blown your whole diet. Get back on track and you'll do fine.

For that matter, the better you are able to eliminate emotions from your day, the better off you will be. A certain amount of detachment adds a healthy dose of objectivity.

Trading is a great business because the markets close at the end of the day (at least some of them). This gives you a zero point from which to begin the next day – a clean slate. Each day is a new day. Forget about how you did the week before. What counts is how you do today!

Sometimes what will happen during the day comes down to knowing yourself. Are you relaxed or distracted? Are you prepared or not? If you can't trade that day, don't! – And don't overanalyze the reasons why or why not. Is psychoanalyzing your childhood going to help your trading? Nonsense!

The third important ingredient for achieving peak performance is attitude. Attitude is how you deal with the inevitable adverse situations that occur in the markets. Attitude is also how you handle the daily grind, the constant 2 steps forward and 2 steps back. Every professional has gone through long flat times. Slumps are inevitable for it's impossible to stay on top of your game 100% of the time. Once you've dug yourself out of a hole, no matter how long it takes, you know that you can do it again. If you've done something once, it is a repeatable act. That knowledge is a powerful weapon and can make you a much stronger trader.

Good trades don't always work out. A good trade is one that has the probabilities in its favor, but that doesn't mean that it will always work out. People who have a background in game theory understand this well. The statistics are only meaningful when looking at a string of numbers. For example, in professional football, not every play is going to gain yardage. What percentage of games do you need to win in order to make the playoffs? It's a number much smaller than most of us are willing to accept in our own win/loss ratios!

Here is an interesting question: should you look at a trade logically or psychologically? In other words, should every trade stand on its own merits? Theoretically, yes, but in real life it doesn't always work that way. A trader is likely to manage a position differently depending on whether the previous trade was a winner or a loser.

How does one know when to take profits on a good trade? You must ask yourself first how greedy do you want to be, or, how much money do you want to make? And also, does your pattern have a "perceived profit" or objective level? Why is it that we hear successful winning traders complain far more about getting out of good trades too soon than not getting out of bad trades soon enough? There's an old expression: "Profits are like eels, they slip away."

Successful traders are very defensive of their capital. They are far more likely to exit a trade that doesn't work right away than to give it the benefit of the doubt. The best trades work right away!

OK. Realistically, every trader has made a stubborn, big losing trade. What do you do if you're really caught in a pickle? The first thing is to offer a "prayer to the Gods". This means, immediately get rid of half your position. Cut down the size. Right off the bat you are taking action instead of freezing up. You are reducing your risk, and you have shifted the psychological balance to a win-win situation. If the market turns around, you still have part of your position on. If it continues against you, your loss will be more manageable. Usually, you will find that you wished you exited the whole position on the first order, but not everyone is able to do this.

At an annual Market Technician's conference, a famous trader was speaking and someone in the audience asked him what he did when he had terrible losing trades. He replied that when his stomach began to hurt, he'd "puke them at the lows along with everyone else." The point is, everyone makes mistakes but sooner or later you're going to have to exit that nasty losing position.

"Feel good" trades help get one back in the game. It's nice to start the day with a winning scalp. It tends to give you more breathing room on the next trade. The day's psychology is shifted in your favor right away. This is also why it's so important to get rid of losing trades the day before so you don't have to deal with them first thing in the morning. This is usually when the choice opportunity is and you want to be ready to take advantage of it.

A small profitable scalp is the easiest trade to make. The whole secret is to get in and get out of the market as quickly as possible. Enter in the direction of the market's last thrust or impulse. The shorter the period of time you are in the marketplace, the easier it is to make a winning trade. Of course, this strategy of making a small scalp is not substantial enough to make a living, but remember the object is to start the day out on the right foot.

If you are following a methodology consistently (key word), and making money, how do you make more money? You must build up the number of units traded without increasing the leverage. In other words, don't try going for the bigger trade, instead, trade more contracts. It just takes a while to build up your account or the amount of capital under management. Proper leverage can be the key to your success and longevity in this business. Most traders who run into trouble have too big a trade on. Size influences your objectivity. Your main object should be to stay in the game.

Most people react differently when they're under pressure. They tend to be more emotional or reactive. They tense up and judgement is often impaired. Many talented athletes can't cut it because they choke when the pressure's on. You could be a brilliant analyst but a lousy trader. Consistency is far more important than brilliance. Just strive for consistency in what you do and let go of the performance expectations.

Master the Game:

The last key to achieving mental mastery over the game is believing that you can actually do it. Everyone is capable of being a successful trader if they truly believe they can be. You must believe in the power of belief. If you're a recluse skeptic or self-doubter, begin by pretending to believe you can make it. Keep telling yourself that you'll make it even if it takes you five years. If a person's will is strong enough, they will always find a way.

If you admit to yourself that you truly don't have the will to win at this game, don't try to trade. It is too easy to lose too much money. Many people think that they'll enjoy trading when they really don't. It's boring at times, lonely during the day, mentally trying, with little structure or security. The markets are not a logical or fair playing ground. But there are numerous inefficiencies and patterns ready to be exploited, and there always will be.

Trading and Betting the Horses

While some people question how easy it is to make a consistent living TRADING, how about making a consistent, comfortable living betting on horse races? Here is a story about Ernest Dahlman – someone who has experienced amazing success at betting on horses for the past 35 years. Some of the principles that have contributed to E.D.'s success are the very same applied by top, professional traders. The following includes excerpts from a June 3, 2001 article titled THE WIZARD OF ODDS, published by the New York Times and written by William Grimes. We recommend that before you read our story you read the original article in its entirety. It is necessary to register first on the NY Times website. They will have the article freely available only until June 10.

This Wizard of Odds, "Ernest Dahlman, may be the world's most successful horse bettor. The reason he's so good is that he doesn't gamble." But, according to the article, "in a busy year, Dahlman might bet as much as \$18 million." Let's look at some of the main principles that contribute to Dahlman's success and see how they are transferable to trading.

1. Dahlman narrows his playing field. He specializes primarily "with races at tracks in New York and California" where he perceives himself to have a larger edge. This way, he can become familiar with the subtle nuances such as local trainers (in whose hands a horse can experience a "religious conversion") and track conditions. A trader will do best to concentrate on a select "stable" of markets and learn their individual personalities, than to jump into markets or individual stocks that have not been thoroughly researched.
2. Dahlman specializes in a very specific type of bet – the exacta, his "bread and butter." A trader will do best if he specializes in just one style or pattern or trading methodology. Know the risk/reward characteristics of your individual technique. Dahlman chooses what would at first glance appear to be a high risk technique, but one which offers good rewards.
3. Dahlman pays more money to minimize his risk. He hedges his bet by creating a box ("twice as expensive as a straight exacta" but

which "lets Dahlman have things both ways"). Successful top traders are far more interested in strategies by which to minimize risk than those that go for the big gains. Stops, protective options, or spread strategies are just some of the ways to minimize risk.

4. Be a "plodder," a nickel and dimer. "On average, (Dahlman) says, he earns 3 or 4 percent on his investment." He never bets serious money on long odds. Stick with the high probability setups. Don't try to hit home runs. "The point is, there's no such thing as a sure thing. Favorites win only a third of the time, an immutable racing statistic. Even successful bettors tear up more tickets than they cash. The trick is to cash enough tickets, at the right odds, to offset the losses and turn a profit. That's where addition and subtraction come in."
5. Know the seasonalities of your game. "'Winter is my favorite time of year,' he said cheerfully. 'It's more predictable. The horses tend to be older, and you know what they're going to do. And out in Northern California it rains, and you get a lot of grass races switched to the main track, resulting in complete mismatches.'" If you are a grain trader, there are distinct times of year when volatility increases. If you trade options, there has historically been a strong tendency for volatility to contract going into the summer – good if you are a short premium player, bad if your game favors a momentum style. Do you do best at the beginning of the year or the end of the year? Know the cycles in both your game and yourself.
6. Do your daily homework. "Most horseplayers love a contentious 12-horse race with the promise of three-figure exactas and monster trifectas. Not Dahlman. 'Anyone who knows anything about gambling will tell you I'm not a great gambler,' he says. 'What I'm good at is arithmetic. I can add and subtract.'" "Like many other professional horseplayers, Dahlman relies in part on the work of others. The Daily Racing Form gives him a compressed description of the last dozen races run by each horse entered in a race. That merits a quick glance. The more serious numbers come from 'the sheet'" ... which analyze and quantify... "a variety of factors, ranging from track resiliency to wind direction to the distance actually traveled by each horse." He considers his detailed record keeping to

be his biggest edge. What type of detailed record keeping do you maintain with your own trading?

7. Specialize, Specialize, Specialize! Who would have ever thought of specializing in Dahlman's "overriding preoccupation, horseshoes? Years ago, Dahlman began noticing something funny about horses equipped with mud calks, cleats that some trainers use for extra traction when rain turns dirt into mud. Dahlman noted that even when rain failed to materialize, a lot of horses seemed to improve several lengths when wearing mud calks for the first time" It's also another "reason he loves Golden Gate Fields, near San Francisco. It rains a lot there, so plenty of mediocre-seeming horses are switching to mud calks for the first time and then sneaking into exactas at good prices. A second reason for loving Golden Gate is that the track posts very detailed shoe information before each race." Find your niche!
8. Believe in your own game and don't listen to anyone else! Although "Dahlman accepts as highly accurate ... the raw speed numbers," he rejects "other assumptions in the sheets." Others dismiss Dahlman's horseshoe theory. It does not matter who thinks your style is right or wrong ... all that matters is that you believe in it yourself and follow it consistently.
9. Keep your losses at the sleeping level. In the best quote from the article, "If I keep my losses at \$7,000, I can sleep easily," Dahlman says. "I can get that back in one race." Your sleeping level may be different from anyone else's.

Here is a person who has managed to keep a balanced life and raise 6 children while still maintaining his passion for the horse racing. As the game changed, from trotters to thoroughbreds, he was able to adapt with the times. We have seen many games come and go in the markets, from equity options arbitrage to the disappearance of SOES traders. We have seen markets change from a momentum environment to a trading-range game. A trader must specialize in one thing yet be ready to recognize when it is time to learn a brand new game. Recognize that Dahlman built up a lifetime of racing knowledge. He relies on that experience to interpret the incredible amount of information he gathers. For newer traders just learning to make their way in this business, recognize that, ultimately, experience is the best teacher. Every day that you trade, you gain experience. Keep the discipline,

keep the faith. To repeat one last quote: "It's an art with just enough science to make it possible for a very tiny percentage of bettors to take money away from the herd of less disciplined bettors."

Trading? or betting the horses?

Putting Together a Business Plan

(Transcript from a LBR Online Trading Room class)

Your business plan is your personal blueprint for trading success. It includes not only your goals, but a detailed plan of how you plan to get there. This plan should go far beyond the details of your trading methodology. It should include structuring not only your trading environment, but your whole life. Your mind and psyche are your main trading assets. How do you plan to protect them throughout the year?

Your business plan should be structured to motivate you to make higher highs in your account equity. This sounds like a given, but you must truly fight to come back from each drawdown. You must have allowances in your plan not to give back more than a minimal percentage of profits. Your trading plan must include all the details such as which markets you will trade, which strategies you will follow, and what type of leverage you will use. Only by having a trading plan will you be able to avoid emotional trading decisions.

I am of the belief that it is never too late to start thinking about working on a business plan for the current year. It is also never too early to think about putting together a business plan for next year. This is because it will take you some time to think about the things that I am going to say, and work on your own program.

Trading is abstract and there are so many questions and decisions to be made that come up during the day. Your goal as a trader is to execute your plan and leave the thinking out of it. A daily plan helps to aid in providing ritual, organization and structure. But before you think about how to construct your daily game plan, you need to first put together a broader annual business plan. In setting up your larger business plan, you will be designing a trading program for yourself. Many of the questions our office receives pertain to what type of trading patterns to follow, what time frames

to trade on, how to place orders, and which markets to trade. Your business plan should address these issues.

When you setup up your program, you should think of yourself as your own best client. Your account is a client. Your goal should ultimately be to design the type of program you could trade several accounts on, or, think if you wanted to add just one client. You would need a very specific type of program to present to that client, and then, assuming they would be monitoring your trading activity every day, you would be more conscientious about following your program. Leverage and money management issues would be addressed in this "program", as would markets traded, drawdowns, types of trades made, etc. I will share with you some of the ways I design my program. Before I do, the business plan includes so much more. It must also include goals and motivational factors, as well as rules, guidelines, and plans to keep you away from trouble areas or spots that you are weakest in.

I find that as a trader caught up in the markets, it is hard to take time off. So it is easy for me to hit the burnout point. I have a tendency to put too many positions on. Taking positions into the last day of the quarter seems to be my Achilles heel and bite into my bottom line. So, I am making a very clear provision in my business plan for 2000 NOT to have big positions on going into the last day of the quarter. If you want to give yourself the liberty to take several weeks as you develop your plan to still break a few rules, think about it as you do it. Think which rules are really going to serve you best. This is why I said it might take some time to mull over a few things.

I will give you the essence of my program and then you will see how easy it is to design your goals around your plan. I have separate accounts, one for scalp trades, and one for position trades. Now it is easy to design different goals for each program. For example, if the SPs are the only market you are trading, one goal could be to include a range of expected activity level in making SP scalps. This could comprise your core program or be designated as supplemental activity. By having a goal to make a certain amount of scalp trades a week, you will challenge yourself a bit.

Will you include position trades, index options or GLOBEX activity in your program? Look at you past trading performance. It is easy to break down if you are more profitable sticking to short term scalps, or how much holding longer-term positions really adds to your bottom line. I like to keep my SP scalping activity separate, so for longer-term positions, I like using the NASDAQ futures or SP options as a separate trading vehicle. For trades made in the domestic futures markets, I try to hold trades anywhere from 2 – 8 days. Occasionally I will day-trade the bonds, but I try to play for

overnight follow-through in most markets. This was my basic program carried over from my CTA program.

So, I essentially have three separate programs: SP scalping, short term swing positions based off classic chart patterns and 2-period Rate of Change pattern recognition, and long-term positions which can also include stocks, options, mutual funds, etc. You need to think about your mix that will work for you and be CLEARLY organized as to how you are going to manage your money. Each account should have a specific level of funding and number of contracts that can be traded in it.

There should also be leverage guidelines and money management rules for each type of trade. Most of the time I do not use my full line. I trade 1 contract per "x" number dollars in my account. Determine a unit size for yourself. As your account grows, you can add another contract. These things should all be spelled out in your business plan.

As for goals, you can structure those two ways. Some people set a dollar amount goal for their trading activity. I have actually avoided doing this in the past, instead choosing to focus on maintaining a certain amount of activity level. I figured if I just did the best job I could each day, the profits would take care of themselves. Sometimes setting a dollar amount can be discouraging during drawdown periods or encourage you to force trades when nothing is going on. This year, I want to have my biggest trading year ever, so that is my goal.

But for some people, a better goal might be to do "x" number of trades on a regular basis, or try for "x" number of SP points per week. This helps to reach the larger goals. I would like to reach half my goal from my day trading account and half from my position account. Now the question has come up, sometimes gains are unevenly distributed. If you set a target for yourself to make 3 SP points per day for each contract you trade, than do you quit when you make these three points? It doesn't quite work that way. When you are hot, you are in synch and should keep trading. If your 3 points come easy to you, than why would you quit on the day? You could very easily have a scratch day the next day...or even a losing day.

But you must have SOME sort of guideline. This will serve as your motivation to make a trade in the first place! You must have some reason to pull the trigger in the first place, because so many times it is too easy to hold back on being aggressive. Set a goal that you can not only reach, but that you can exceed. So again, if you are a newer trader starting out with a small

account, perhaps your goal will be to take 8 SP points out per week. How are you going to achieve that? If you have a smaller amount of capital you do not want to trade on a longer time frame. You need to find 1-2 spots a day where you can go in and try for 2 points.

Now you are breaking your goal down into bite size pieces. How much can you risk on each trade? When I make "short skirt" type trades, I automatically risk no more than three points. If you decide that you can't risk more than 2 points, you are going to have to be very careful on picking your spot. You must be able to see your risk point before you go in. See the market turn and then enter "at the market" or as close to that turn as you can. So, that might be a "program" that you can start out with. Now, what might happen if you start out with your scalping program, is that for a few days, the markets might be dull, choppy. Perhaps you feel like you are behind your goal a bit. But then one day, your 2 point trade turns into a 5 point one...or, you get motivated and make a few more trades and exceed your goal. OK?

Don't put pressure on yourself to make x-amount every day, but you must have a guideline for what you would like to achieve on a monthly basis. Then at the end of the month, you ask yourself, how is your performance standing up to your business plan? If it is falling short, what needs to be adjusted? The biggest things that keep a trader from meeting their plan are: getting sloppy a few times, forgetting to place a stop, or getting stubborn on one trade. These are the things I see. One mistake waiting to bite you in the rear.

But guess what...it is possible to make all these mistakes and yet STILL make money. Astonishingly, the markets can be more forgiving than we think. It just takes a bit of persistence. So, each month, set your goal to do a better job than the month before. All you have to do is work on making fewer mistakes.

OK! On to some more parts of the plan – record keeping and structure. THIS IS AN EQUALLY IMPORTANT PART to your business plan. Here is why. Routines and rituals keep things automatic. Additionally, they help set up the daily Game Plan (which we will get to next). A trader needs to get to the point where picking up the phone is just one more thing he does during the day. At the end of the day, I log all my daily numbers. This might seem a useless endeavor since this data is already listed on my computer and I am merely writing it down on paper. But this ritual brings a certain amount of relief to me because I can shut down making all decisions and do some therapeutic grunt work. I thrive on menial tasks and grunt work because I

do not have to think during this time. It is a ritual that wipes my mind clean of all the good and bad that happened during the day.

I also have sheets where I log each trade, and lately I am becoming more diligent about doing my P&L at the end of each day. I used to do this during the eighties but stopped the last few years. Part of my business plan for this year includes becoming even more involved in record keeping. I am monitoring the amount of slippage on each trade and the average holding time for each type of trade. You see, you must make it into as much of a detailed game as possible to draw yourself into the game, increase the intensity.

The object is not to burn yourself out either – wrong idea. You do not have to focus on every tick, but rather the opposite. Keep your monitoring of the markets a Zen type of thing, meaning stay loose and relaxed. Sometimes the best trades will happen out of the corner of your eye. For example, perhaps you have been watching a market for a few days. You have been doing your nightly homework watching a particular setup unfold. Then, when the market starts to act a certain way that confirms your analysis is correct, you should be all over it.

You can't force the trades, but when you are relaxed you will see them better. The best way to stay relaxed and loose is to be involved in some sort of ritual. Like the tennis player who bounces the ball up and down a few times before he serves, does a dance with his feet and wipes his brow – these are all rituals to keep his serve loose. The same tricks apply with trading. You can doodle and make swing charts on paper during the day, write down periodic readings of the ticks, or note extreme price levels.

I hope you are getting the basic idea so far, because I do not want to elaborate to the point of overkill. But here is one more example. The person I worked for when I first traded on the Philadelphia Exchange had been a physicist. He spent 1 1/2 hours at the exchange before the market opened and would be there for an hour and a half after the close. He was very methodical and organized, writing out tickets and orders in advance. He was quiet and unassuming, and as I found out later, he was also one of the most consistently profitable traders down there. The person who first backed me when I traded in San Francisco taught me to chart the 3/10 oscillator every night using Security Market Research charting service. He also taught me to log the daily trin, tick, breadth figures, etc., in addition to writing out orders for the next day. Both these guys are still trading today.

These are some of the common traits I have noticed among those traders who succeed. They all have daily routines and rituals. You must balance out the abstract conceptualizing process the market requires with some tangible activities.

Your business plan should include making a daily Game Plan for each day's trading. What type of strategy are you going to use for the next day? Is the market due for a consolidation type day, one that starts to form a small trading range? Or is it poised for a breakout, a potential trend day? Is there an opening play for the morning? For example, if there is an early morning sell off, will it setup a buying opportunity? Or should rallies be shorted? Your game plan could include looking to sell a test of the previous high or buy a pullback to the hourly moving average.

At night, it is easy to note where the hourly grain patterns might be in other markets. Write down imaginary orders..."Buy Silver at such and such a price if it retraces to EMA". You will be more likely to make the trade if you follow this practice. Perhaps there is a particular market you have been following with a directional bias. Write down the previous day's high or low and use that as your pivot.

When managing longer-term trades, you will be more likely to stay with them if you write out clear instructions for trailing a stop. Write down your stop level and continue to move it as the market moves in your favor. My favorite way to trail a stop is to use a two-bar channel stop, or to use hourly support and resistance levels. In a downtrend, I will trail it just above the last hourly swing high, but in an uptrend, I will give it more room and trail it beneath the hourly low of two levels ago. Trail your stop not on the last swing low but the one before that one. This is because up-trending markets are more prone to A-B-C type corrections. There is not a perfect way to trail a stop – they all have their flaw. A 2- bar trailing stop works well, on paper, but personally, I hate the give back on any trailing stop and usually look to exit on some sort of buying or selling climax.

Sometimes, trading in another market can be a good diversion to keep you from taking profits too early on a position that is working. You have to let time work FOR you in winning positions.

Game plan – Business plan – overall trading environment structure...just start thinking about the way you really go about things. Get yourself down to a one day at a time type of process. Even if you are a position trader, your job is not to think about too far into the future, it is still to take one day

at a time, even if it is just a monitoring process. The tape is always in the here and the now. Your goal should be to do the best job you can that DAY. Follow your rules and your game plan for that day. If the market moves in ways that were not in your game plan, that is OK. The wrong game plan is always better than no game plan at all. At least if your game plan is wrong, you will know it fairly quickly and that in and of itself has forecasting value.

It is OK to miss a million trades, but it is not OK to miss one that setup on your game plan you have been waiting for. You can also adjust your game plan midday. Perhaps you were looking to sell a rally back to the hourly moving average, but the market blasts on through. It is OK to say, "Because the market failed at that benchmark, it might mean there is a stronger move in the opposite direction". Perhaps then it would signal to switch gears and start looking for the first 5-minute grain buy. You get the idea!

Here is a list of some of the types of things you can include in your annual business plan. This will give you something to work on. Start thinking about putting together a professional program, comprised of bite size pieces.

1. What methodology or patterns are you going to trade? It is OK to have a "library" of setups, but most people do best concentrating on a niche or particular technique.
Learn to do one thing consistently well instead of trying to master too many styles.
2. Which markets are you going to trade? If you trade equities, think about keeping a "stable" of stocks to follow. Don't get caught up in scanning a database of too many issues that you are not familiar with. It invites unfortunate situations where there may be pending issues or reports in the company that you are unaware of. If you have not had much success trading soybeans or silver in the past, why try to continue to trade them in the future?
3. How much capital are you going to put into your trading accounts? Something I have to add here, stay away from looking at percentage returns when evaluating performance statistics, such as percent return or drawdowns, on your personal account. Concentrate instead on dollar amounts. What is your dollar amount tolerance? My stomach turns at a specific dollar amount drawdown. Percentages vary too much according to how much money you keep

in your account. You might have a net worth of 1 mil and keep 100,000 in your trading account and your situation will be entirely different than a person who has 5 mil and keeps 100,000 in trading account. The person with the higher net worth will feel freer to use a different type of leverage. So think in terms of dollar amounts...how much are you willing to draw down to?

4. How do you plan to enter, exit, and manage trades? I like dividing my contract size into two units. Sometimes I go all in and then scale out in halves. Other times I put half on and look to add the other half. Some positions I keep half on as a core and use the other unit as a scalping unit. Whatever style you choose, it should be written down into your plan.
5. What is your plan to manage drawdowns? How will you evaluate when you need to take time off?
6. What are your monthly goals? Are you going to strive to make a certain number of trades each week or perhaps a certain number of SP points? Remember, these are guidelines by which to measure your progress. Some months will be better than other months. The end of the month is a good time to do a periodic review. Most businesses do this on a monthly or quarterly basis.
7. Include a daily routine in your overall business plan. How are you going to evaluate your performance each day? Keep a notebook of the things you do RIGHT. Pat yourself on the back for small moral victories, such as exiting a losing position in a quick fashion. Note the small incremental improvements you make.
8. Create an office environment designed to facilitate performance. Eliminate distractions and outside influences. Reduce glare and get a comfortable chair. Invest in good equipment. Invest in an excellent data feed.
9. Include a provision that will keep you from trading if outside circumstances create an unusual stress, such as health, divorce, or a major move. You might as well just write a check out of your trading account and kiss it goodbye. This is a hard thing to recognize before it is too late. People LOSE money during times of 10 major stresses: death, taxes, divorce, moving, health...you get the point. Trading is a performance-oriented discipline. If you can't

perform well, cancel the show... If a tennis player severely sprains his ankle, he cancels the match. Why do damage to your ratings? Why mar your statistical record with sub-optimal performance?

10. Record Keeping – Rate yourself on your routine and structure and nightly homework. Do you do research or have way of logging results? What type of research is included in your program or plan? My problem is I stack too many projects up on back burner. I need to streamline this area for myself. Or, I get diverted doing research, go off on a tangent late at night and stay up way too late. Then I am not in optimal condition the next day. My business plan includes a bedtime. I promise myself to adhere to it.
11. Rewards! All work, no play makes Jack a dull boy. You must have outside interests or hobbies to get your mind off the markets at the end of the day. You must treat yourself to something you really want. If you spend money on yourself you will eliminate subconscious poverty thoughts. I am serious. Treat yourself like a million bucks and you will be worth it soon. Maybe after a good week you treat yourself to a massage, or buy something you really want. I already have something in mind that I will do for myself if I meet my goals next year. It is something that does not cost too much but that I could never justify spending money on because it might seem frivolous. But the money comes from my trading account so nothing is frivolous!
12. LASTLY, what plans do you have to continually improve yourself? See yourself as a top-notch person, health-wise, performance wise, and attitude wise. How do you keep advancing in life? You know the old saying, if you are not going forward, you are going backward. Educational pursuit such as books and study courses are important, but don't neglect spiritual pursuit, or outside projects...perhaps building your own website, starting your own trading network, writing your own book on all the trials and tribulations of the business, or working with a charity.

All the above subjects are more important to your long-term success in staying in this business than any trading indicators or setups! People do not lose money from entering on bad setups. They lose money from getting

sloppy in their trading and sloppy in their habits and life. They allow emotional trades to creep into their program because they have not done their homework and are not prepared. Your business plan is a contract with yourself. It is a contract to treat yourself as your own best client. Surrounding yourself with guidelines, rules, and an overall structure can be the vehicle that brings you freedom from performance anxiety and gives you the confidence that you can take your trading to the next level.

Time Tested Classic Trading Rules for the Modern Trader to Live By

This is a list of classic trading rules that was given to me while on the trading floor in 1984. A senior trader collected these rules from classic trading literature throughout the twentieth century. They obviously withstand the age-old test of time.

I'm sure most everybody knows these truisms in their hearts, but this list is nicely edited and makes a good read.

1. Plan your trades. Trade your plan.
2. Keep records of your trading results.
3. Keep a positive attitude, no matter how much you lose.
4. Don't take the market home.
5. Continually set higher trading goals.
6. Successful traders buy into bad news and sell into good news.
7. Successful traders are not afraid to buy high and sell low.
8. Successful traders have a well-scheduled planned time for studying the markets.
9. Successful traders isolate themselves from the opinions of others.
10. Continually strive for patience, perseverance, determination, and rational action.
11. Limit your losses – use stops!
12. Never cancel a stop loss order after you have placed it!
13. Place the stop at the time you make your trade.
14. Never get into the market because you are anxious because of waiting.
15. Avoid getting in or out of the market too often.
16. Losses make the trader studious – not profits. Take advantage of every loss to improve your knowledge of market action.

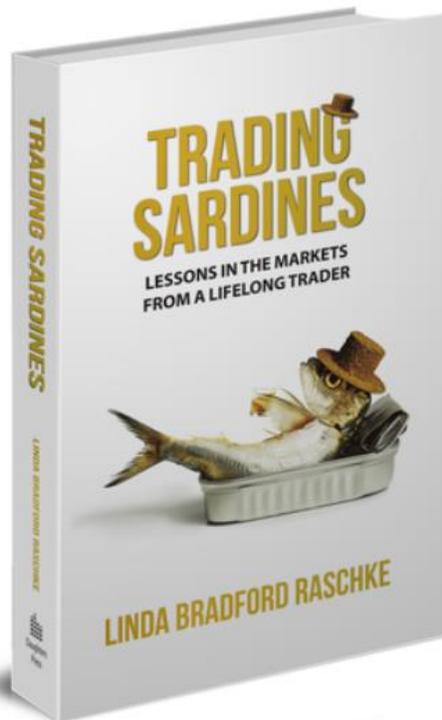
17. The most difficult task in speculation is not prediction but self-control. Successful trading is difficult and frustrating. **You** are the most important element in the equation for success.
18. Always discipline yourself by following a pre-determined set of rules.
19. Remember that a bear market will give back in one month what a bull market has taken three months to build.
20. Don't ever allow a big winning trade to turn into a loser. Stop yourself out if the market moves against you 20% from your peak profit point.
21. You must have a program, you must know your program, and you must follow your program.
22. Expect and accept losses gracefully. Those who brood over losses always miss the next opportunity, which more than likely will be profitable.
23. Split your profits right down the middle and never risk more than 50% of them again in the market.
24. The key to successful trading is knowing yourself and your stress point.
25. The difference between winners and losers isn't so much native ability as it is discipline exercised in avoiding mistakes.
26. In trading as in fencing there are the quick and the dead.
27. Speech may be silver but silence is golden. Traders with the golden touch do not talk about their success.
28. Dream big dreams and think tall. Very few people set goals too high. A man becomes what he thinks about all day long.
29. Accept failure as a step towards victory.
30. Have you taken a loss? Forget it quickly. Have you taken a profit? Forget it even quicker! Don't let ego and greed inhibit clear thinking and hard work.
31. One cannot do anything about yesterday. When one door closes, another door opens. The greater opportunity always lies through the open door.
32. The deepest secret for the trader is to subordinate his will to the will of the market. The market is truth as it reflects all forces that bear upon it. As long as he recognizes this he is safe. When he ignores this, he is lost and doomed.
33. It's much easier to put on a trade than to take it off.
34. If a market doesn't do what you think it should do, get out.

35. Beware of large positions that can control your emotions. Don't be overly aggressive with the market. Treat it gently by allowing your equity to grow steadily rather than in bursts.
36. Never add to a losing position.
37. Beware of trying to pick tops or bottoms.
38. You must believe in yourself and your judgement if you expect to make a living at this game.
39. In a narrow market there is no sense in trying to anticipate what the next big movement is going to be – up or down.
40. A loss never bothers me after I take it. I forget it overnight. But being wrong and not taking the loss – that is what does the damage to the pocket book and to the soul.
41. Never volunteer advice and never brag of your winnings.
42. Of all speculative blunders, there are few greater than selling what shows a profit and keeping what shows a loss.
43. Standing aside is a position.
44. It is better to be more interested in the market's reaction to new information than in the piece of news itself.
45. If you don't know who you are, the markets are an expensive place to find out.
46. In the world of money, which is a world shaped by human behavior, nobody has the foggiest notion of what will happen in the future. Mark that word – Nobody! Thus the successful trader does not base moves on what supposedly will happen but reacts instead to what does happen.
47. Except in unusual circumstances, get in the habit of taking your profit too soon. Don't torment yourself if a trade continues winning without you. Chances are it won't continue long. If it does, console yourself by thinking of all the times when liquidating early reserved gains that you would have otherwise lost.
48. When the ship starts to sink, don't pray – jump!
49. Lose your opinion – not your money.
50. Assimilate into your very bones a set of trading rules that works for you.

If you enjoyed this content, be sure to visit Linda's website and subscribe to get more items like this

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Every once in a while, a book comes along that smashes the mold of the typical Wall Street trading book... ★★★★★



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