

**EMAIL NEWSLETTER No 7**

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## What it Takes to be a Good Trader

I am constantly asked about the **facts of life** with respect to trading. Although many of my readers are hopefully beyond this stage, it may be useful to review the following reply to a recent enquiry. It may also be useful if you are badgered by friends and acquaintances who are asking the same questions. Please pass it on freely and invite them to contact me to add their address to the list for my free email newsletters.

***I would appreciate your opinion on a number of issues about trading. I'm just starting out looking at if trading suits me or not before I commit myself to it.***

You should be aware that trading is a difficult and hazardous business. Somewhere around 9 out of 10 would-be traders fail. The main reason they fail is that they do not have any formal thought-out trading plan, let alone one that is viable. I teach how to design a trading plan in my weekend seminars. It takes two days to go through it, so I could not even approach the subject in an email.

You should also be aware that it takes time to become a good trader. Those who have made it tend to agree that the learning time is five to ten years. I don't think this is unreasonable when you compare it to other professions that require similar knowledge, skills and experience.

***How much understanding of yourself do you need to know, to know if trading suits your personality, temperament, etc.***

Successful trading demands that you have a very clear idea of who you are and what your attitudes, value systems, temperament etc are. No trading plan will work successfully unless it fits you. Indeed, many people come to trading with the idea of avoiding problems in these areas in other occupations, only to find that the market ruthlessly seeks out and exposes these problems.

Trading requires someone who is very comfortable with analytical thinking. They also need to be very flexible and risk averse. The two Market Wizard books by Jack Schwager give a very good picture of the minds of great traders.

***How much knowledge of the market does one need before trading? I know Elder has a study guide to his Trading for a Living - if you pass the study guide are you ready?***

A great deal. You need a thorough knowledge of technical analysis. The two subjects run by the ATAA/SIA E114 Technical Analysis and E171 Specialised Techniques in Technical Analysis are a great introduction. If you start in semester 1 2001, you could get them done in a year. Details are on [www.ataa.com.au](http://www.ataa.com.au)

Then you need to read widely on money management and psychology (mass psychology and psychology of the trader) before you can start to put your trading plan together.

My good friend Alexander Elder has written one of the great books on trading. The study guide will improve your understanding of that text. However, you are not equipped to trade after you have read one book any more than you would be equipped to do brain surgery after reading a book. For some reason, most people take more risk with large amounts of money than with their health or anything else important in their lives.

You need to study for trading as you would for any other profession. You need formal training, to read widely, attend seminars by traders and spend a lot of time thinking through and testing your trading plan, before you go anywhere near the market. If you crave the excitement of trading, take yourself off to a casino. It will be cheaper and less disastrous to your financial health.

If you like Dr Elder's book, take a look at his seminars, which he runs as trading camps on [www.elder.com](http://www.elder.com)

I am an associate of Dr Elder and have taught at his trading camps.

***What software is best? When's the best time to buy that software?***

The best software is that which does what you want for your trading plan. In the learning and development phases the best value in my opinion and experience is Insight Trader. See [www.insighttrading.com.au](http://www.insighttrading.com.au)

If you go the route of discretionary trading, this may be all you ever need. However, if you want to do system testing or use very specialised techniques, you will need to purchase other software later.

I have no pecuniary interest in Insight Trader software and recommend it on the basis of my personal experience only.

***What are the realistic returns one should expect per trade and per annum?***

Without meaning to be offensive or patronising, if you are only at the point of asking this question, you are no where near ready to begin trading. Frankly, you are at the early stage of not knowing what you don't know. Let me sketch in the landscape.

The greatest investor of the last century is Warren Buffett. He has made about 25% compound over 40 years. Some absolutely outstanding traders have beaten this rate for short periods in markets that were very conducive to trading. However, most of the best funds managers fall in the range of 15 to 20% return on assets over all market conditions. In your early years you should work on a lower return than this. It takes time to learn.

Does this rate of return sound low to you? It shouldn't. Think of it this way: Most great companies struggle to exceed 15% compound return on assets over any reasonable period including the full business cycle. If returns much in excess of this were possible by trading the financial markets, the best business brains in the country would shift into trading and arbitrage away the excess returns. The truth is that the returns are not greatly out of line with the best achieved in other businesses.

***How much time is the minimum one needs to spend on trading, for "end of day traders"?***

How long is a piece of string? You are asking the wrong question if you want to succeed at trading. You do not succeed by doing the minimum, but by doing what it takes. In the early years it should consume your life like studying for any other profession. You will do your day job and then study many hours at nights and weekends. You should read voraciously and attend as many seminars as you can.

When you have completed your studies and developed your plan and tested it, you will find it is all consuming as you start to trade. Later, if you are good at it, you may get it down to 2 to 4 hours a day, plus continuing studies. You never stop learning in this game, just like other professions.

## Reader Question - Help Please

After the last Newsletter, I received the following question from a reader:

***Quite regularly there can appear to be large volume bids on stocks before the opening of the ASX. When the opening is upon us, these bids appear to vaporise or at least diminish significantly. Is this some "rigging" of the market to make it look like there is market depth to a stock that otherwise would not have much depth and volume?***

This is not something on which I have any insights. Can any reader assist with this query? I will publish any reply anonymously.

## Scams and Dubious Telephone Calls

I recently received a suggestion from a reader to address the following issue:

***Over the last few years I have been contacted by several overseas "brokerage" houses that always seem to have a good price offering for some new emerging stock and unless I get on board very soon I will miss out. They have confidential information that cannot be revealed "for obvious reasons" that the company profit will certainly take off very soon.***

***Today, I was again contacted, this time by (name deleted) to buy a modest parcel of 5000 shares at U\$5.00 for a share that was currently trading at U\$5.75/U\$5.82. Within 4 or 5 months the price will "see" U\$11 "although I do not have a crystal ball". I have seen the stock offered in an email I received a few days ago when I was out of town. So others appear to "know" of its potential too without the privilege of inside knowledge. It seems to be public knowledge.***

***I have seen some recent email regarding the questionable practices of (name deleted) although they have told me they have been operating for about 23 years. This time the person was in Hong Kong when he phoned me.***

***I have had calls from Hong Kong, Manila, Jakarta, Kuala Lumpur, Brisbane, San Francisco and London over the past 2 or 3 years from various organizations.***

***Back in May, I was given a ticker to check out and I could not find it on the web sites I looked at. Again, I was offered the stock at about 75 cents under the current market price. When I challenged them as to why they were offering it to me and not buying it themselves to make an instant profit, they said they were not allowed to do so by the Securities Commission.***

***I am sure you have had similar calls. So, you may like to do a Newsletter on these overseas "broking" houses and their method of gaining business. For me, I use a local broker as many of the locals now are offering easy US access.***

I need to stress that I have no personal knowledge of the "broker" mentioned and have removed their name in case I inadvertently damage their reputation. My remarks below are general and do not specifically refer to this "broker". My advice concerning these approaches is:

Australia has very comprehensive laws concerning the marketing of any security. Especially shares. If you receive such a call, ask for:

- Whether they are licensed with the Australian Securities and Investments Commission (ASIC) and the reference number for that licence.
- The name of their firm and the person calling
- Their official address as in the records of the ASIC
- Their return telephone number and hours of business
- Ask them to confirm their offer in writing - fax or mail on a letterhead.

If they cannot, or will not answer all these questions or confirm their offer in writing, terminate the call without wasting your time further.

If they do answer the questions and make the offer in writing, telephone the ASIC and verify that they are licensed to make this offer to you. If they are not, the ASIC should be very interested in the information you have and you should encourage them to investigate.

If they pass the ASIC hurdle, you need to decide whether you are trained and competent to evaluate their offer. If you are not, then you should seek the advice of a licensed person who is experienced in and competent to advise on the securities in question. Skilled advice costs money, but it may be a pittance compared to what you stand to lose on a bad "investment".

If you are tempted by any of these offers, remember that you are probably dealing with a skilled salesman who will be trying to tell you what you would like to hear and to evoke in you the emotion called greed. Just ask why someone you do not know would be calling you with such a wonderful opportunity? If it sounds too good to be true, it invariably is.