Van Tharp on Systems & Trading Fundamentals

Van Tharp Institute Free Trading Education Material
(Including excerpts from Van Tharp's home study programs)

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Table of Contents

Systems

What *Is* a Trading System?

By Van K. Tharp, Ph.D.

Traders are constantly asking us “What exactly is a system?” The purpose of this article will be to give you that information as clearly as possible. First, we’ll go through some background information to help you understand what a system is outside of the context of trading. You’ll learn how different people relate to systems according to how they relate to money. The second part of this article will focus on clearly defining what a trading system is. The third part of this article will focus on the broader picture of your system—your trading plan. Finally, we’ll focus on some key elements in system development.

Business Systems

In Robert Kiyosaki’s book, *Cash-Flow Quadrant*, he distinguishes two types of people who work for money and two types of people who have money working for them. In each case, one of the major distinguishing characteristics is how they deal with systems.

First, let’s look at the idea of business systems. McDonald’s, as a major franchise, is basically a large set of systems that one buys. In fact, a person who buys a McDonald’s franchise must go to Hamburger University for about six months (I believe that’s the length of it) to learn the systems for operating the franchise. There are systems for food delivery, preparing food, greeting customers, serving them within a minute, cleanup, etc. And all of these systems can easily be carried out by a manager who has a college degree and employees who might even be high school dropouts. In other words, a system is something that is repeatable, simple enough to be run by a 16 year old who might not be that bright, and works well enough to keep many people returning as customers.

Now, knowing that definition of a system, let’s look at how people in the four cash flow quadrants relate to systems.

The Employee: Employees are basically motivated by security. They have a job and they do their work to get money. Employees basically run the systems. They don’t necessarily know that they are running a system, but that is their function. For example, one employee at McDonald’s will greet customers and take their order. This employee is basically running the “customer-greeting” system.

Most employees do not understand systems. Instead, they just know what their job is. And this is typical of employees who become traders or employees who work as traders. They typically ask questions such as “What stocks should I buy?” “What is the market going to do?” Or “How do I go about doing this?” We see it all the time in the questions we get. For example, a gentleman just called into CNBC, as I’m writing this, and asked the guest, “What direction do you think the market may go with respect to 'the war' and how might one profit from it?" These are typically employee questions. And they amount to saying, "I don't really understand anything, please tell me what to do!" The financial media thrives by answering the questions of the employee investor/trader.

The Self-Employed Person: The self-employed person is basically motivated by control and doing it right. Notice that I have often talked about how these motivations constitute some of the biases that most traders have—the need to be right and the need to control the markets. The self-employed person <u>is</u> the entire system. They are basically running on a treadmill only they don't know it. And the more they work, the more tired they get.

Like the employee, the self-employed are working for money. However, they like it a little better, because they are in charge. They think working harder will make them more money—and to a certain extent it does. But mostly, working harder gets them tired. Nevertheless, they continue to plough forward thinking that they are the only ones who can do it right.

As I said earlier, the self-employed person basically is the system. And quite often they cannot see the system because they are so much a part of it. They are stuck in all the details. In addition, they have a strong tendency to want to "complexify" things. They are always looking for perfectionism and they believe that the perfect system must be complex. They are always asking, "What will make my system perfect?"

A lot of people come into trading from the self-employed mentality—doctors, dentists, and other professionals who had their own small business in which they were basically all of the systems in one. This is all they tend to know and they approach trading the same way. They keep adding complexity "until it works," even though this strategy seldom works. The self-employed person would be likely to have a discretionary system that is constantly being changed.

The Business Owner: A good business owner should be able to walk away from the business for a year and come back to find it running better than before. While this is an ideal type of statement, it has some theoretical truth to it. This should occur because the job of the business owner is to design a group of systems to run the business so well that his employees can do the job by themselves (or at least with a manager in place). In other words, the business owner is someone who designs systems and these are usually simple systems.

The business owner usually does very well in the trading arena if they approach the process the same way that they've run a business before. And, of course, the business owner would usually hire someone to run their trading system, at a much lower wage.

When Tom Basso,[1] who is interviewed in *The New Market Wizards*, did workshops with me, he always described himself as a businessman first and a trader second. Part of Tom's perspective was to look for repetitive tasks that a human being in his organization has to repeat over and over again. When he found such tasks, his job was to develop a program to take that task out of human hands. Routine computer programs are great examples of simple systems.

The Investor: The last person on the quadrant is the investor. The investor is someone who invests in businesses and his/her most important criterion should be, "What is the rate of return of the business?" In other words, this person is continuing to ask, "If I put money in this investment, what kind of return will I get on it?" High return investments (e.g., high returns on equity) are typically good businesses in which to put your money.

Robert Kiyosaki describes this as the quadrant in which money is converted to wealth. Rich people, according to Kiyosaki, derive 70% of their income from investments and 30% or less of their income from wages.

Most traders are probably not investors by this definition. They buy low or sell high, trading stocks. As a result, there is something they must do to generate their money. Investors, in contrast, are people who typically look for places where they can put their money that generate rates of returns of 25% or higher without them doing anything. If you know how to get those types of returns, then you want to hold onto those investments as long as possible. Many high tech stocks were showing earnings growth rates of well over 25%, and when they did, the prices went up dramatically because this is what investors want. The problem with such investments is they are not guaranteed to continue forever. Many of you have probably discovered that in the last few years.

What is a Trading System?

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

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

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

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

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

The next component of your trading system is your **protective stop**. This is the worst-case loss that you would want to experience and it defined 1R (or your initial risk) for you. Your stop might be some value that will keep you in the stock for a long time (e.g., a 25% drop in the price of the stock) or something that will get you out quickly if the market turns against you (e.g., a 25 cent drop). Protective stops are absolutely essential. Markets don't go up forever and they don't go down forever. You need stops to protect yourself. As I said in *Trade Your Way To Financial Freedom*, entering the market without a protective stop is like driving through town ignoring red lights. You might get to your destination eventually, but your chances of doing so successfully and safely are very slim.

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

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

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

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

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

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

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

The Entire Trading System: Your Business Plan for Trading[3]

Remember that I said that what most people consider a trading system, is simply a trading strategy that should be part of an overall business plan. Without the overall business plan, many people would still lose money. Let's look at the overall context in which a trading strategy should be made—your business plan. I have written extensively on this subject, therefore for the purposes of this article, the following is just a brief overview.

Here is a summary of what we consider to be essential for a good trading plan:

1) *The Executive Summary*. This is usually the last section written. It reviews all of the material of the plan and presents it in summary form. It should describe in detail the objective of the plan and then briefly describe, without a lot of detail, how the objectives will be achieved.

2) *A Business Description*. The business description should include the mission of the business, an overview of the business and its history, the products and services you provide (which is growth of capital and risk control as a trader), your operations, operational considerations such as equipment needed and site location, and your organization and management of employees (if any). All of these topics are fairly self-explanatory, but you should take the time to write them out as part of your plan.

3) *An Industry Overview and Competition*. In the industry overview you need to look at the factors influencing the market. For example, Ed Yardeni in his web site lists ten major factors influencing the market. These include a globally competitive economy, a revolution in innovation, wireless access to the Internet, low tech companies having access to high tech tools and changing their businesses as a result, the need to outsource to increase productivity, and many other themes. See www.yardeni.com for more information. In addition, you also need to know who/what your competition is. Who are you

trading against? What are their beliefs? What advantages do they have that you don't? What advantages do you have that they don't?

4) *Self-Knowledge Section*: You need to know your strengths and your weaknesses and list them in this section. You need to know how to capitalize on your strengths and avoid (or overcome) your weaknesses.

5) *Your Trading Plan Itself*. The tactical trading plan should be a part of your trading plan, but it should also include (a) your trading beliefs that form the basis of your plan, (b) any strategic alliances you may have, and (c) what you plan to do in terms of education and coaching.

6) *Your Trading Edges*: I believe your trading plan should also include a listing of all of the trading edges that you have in the market. When you list your edges, you can review them often and be sure that you capitalize upon them. For example, your edges might include a) the fact that you don't have to trade, b) your understanding of R-multiples and position sizing (which give people a huge edge over those who have no idea about these concepts), c) your ability to read a level II screen to get excellent stock trades, d) your sources of information, e) your ability to plan well in advance so that you have a game plan each day, f) your skill in following the ten tasks of trading, g) your knowledge of yourself and your strengths and weaknesses. This is just a sample of the possible edges that you might have over the average trader/investor.

7) *Financial Information*. This section should include three parts. The first part is your budget. How much money do you have? What will the trading process cost you? The second part will be your cash flow statement. Does your plan make sense in terms of cash flow? And finally, the third part will include profit and loss statements. If you have no trading record, you need to make estimates based on historical testing and based on paper trading.

8) *Worst Case Contingency Planning*. Things always happen that you have not accounted for or planned for in your trading plan. How will you deal with these elements? What will you do if any of these things come up? How will you make decisions when these elements come up?

If you want more information, I have *Market Mastery* newsletters that were devoted to business planning.

Developing a System

I am revisiting an interview I did with LTC Ken Long, a systems expert with the U.S. Army. Here's what Ken said about developing a system:

Define Who You Are: "Before you conduct any planning or system design, you must have a thorough understanding of who you are and what your objectives are. Individual investors, private hedge fund managers, public mutual fund managers, and trust managers will have different dynamics, time frames, and risk profiles. This relates to system design in that the final product must fit the circumstances and dynamics of the group or individual. If you jump into system design without considering these basics, you will sow the seeds of future problems."

Objectives: "In trading system design, the problem is to define what you want the system to accomplish. With as many ideas, events, circumstances and adjustments that occur in system development**,** you have to have your objectives crystal clear in your mind. If you don't know where you are going, then any old road will do."

"Objectives give you the basis for making choices and prioritizing actions. This is not to say that objectives are static. In fact, they can change as you discover either unexpected limitations or advantages in your system as it matures. But before you start you must have an initial set of goals and objectives to guide you."

Calibration: "After the system is deployed and operational**,** part of the process of calibrating the system is checking to see if the objectives still fit the person or organization that you have become. That's a very exciting part of system design. I can't tell you how often I've been part of a design team that started with a limited set of objectives and discovered in the "imagineering" phase that by adjusting our sights we were able to accomplish far more for much less. But, you have to start somewhere. If you don't start with objectives, you are spinning your wheels."

I posed this question to Ken: "This section is critical. How will you know if your system is working or not? What are your performance benchmarks? What are your criteria for knowing that your system is not working? How will you make decisions when these criteria are met? Will you scrap everything or just make position sizing adjustments?" All of these questions are critical to developing and operating a good trading system.

How to Make Decisions Within the System

Here's what Ken said about this critical topic:

> "If you don't work out how you will make decisions ahead of time, then you will certainly have to sort it out at the time of the first difficult decision. If you make decisions on the spot, with no guidelines, you have two problems: 1) figuring out what to do and 2) how to do it. And these problems must be faced under great stress and limited time. It's better to calmly sort out the decision making process ahead of time so that the decision mechanism is agreed to before hand."
>
> "In the Army, no plan usually survives the first contact with the enemy, and so our goal in planning is to develop a range of alternatives that can apply to a number of scenarios. Through rehearsal and analysis, we know which strategy works best for a given set of conditions. The goal of strategy development is to provide the decision maker with a menu of choices that are robust enough to cover a wide range of contingencies."
>
> "In general system development then, we look for robust, simple plans that can cover a wide range of conditions. When you preplan like this, you don't try to force the world to adapt to your plan. If you fall in love with a strategy and become emotionally invested in making it work no

matter what the market or the world says, you lose the ability to adapt and learn."

"A real world example for a trading system might be a trader who decides to check his actual trading performance every month against the calculated system expectancy, and determine the statistical significance of the variation. He might decide that any result greater than one or two standard deviations is a signal to stop trading and recalibrate the system or reconfirm the validity of the trading model and its underlying assumptions. If the actual expectancy is close to the predicted expectancy, then the trader knows he's on target. In modern manufacturing systems this concept is called "Statistical Process Control."

"It lets the system controller know when the production machines are drifting out of tolerance and degrading the quality of the output to the point where the line is stopped and the machines are retooled."

I asked Ken about how his advice applies in view of the fact that many trading systems are automated. Here's how he responded:

"It's a general problem of the information age, which provides us with a wide range of automated decision support systems that can compile massive amounts of data, analyze and process it, and present us with decision packages for action based on criteria that we can specify. I use a lot of these. However, the key to making them work is to make sure that you understand the underlying business model and system logic. When you do things automatically by computer, you need to understand what the computer is calculating and filtering. I won't use power tools until I know how they work and I have mastered their use in simulations."

"If you have done all the preparation work that you outlined in your system design workshop,[4] and you have chosen indicators that provide you the right signals for making your trading decisions, then the right thing to do is to rely on the signals to make your decisions. Periodic calibration of the system, however, is still necessary to confirm that you have chosen the correct signals and that your actions are correct. If you have not done that work though, it may be the case that you simply picked up the latest hot indicator and are using it regardless of how appropriate it may be for your trading system. If it fails to work as advertised, you are likely to dump it for the next hot idea that comes along. Then you're not a system's trader, you are only reacting to advertising."

Notes

1. We have two newsletter back issues in which we interviewed Tom Basso for those of you who would like to know more. Call 919-466-0043 for more information.

2. William O'Neil, *How to Make Money In Stocks*. New York : McGraw-Hill, 1987.

3. We have an audio program on business planning for traders that takes you through the development of a business plan.

4. The workshop Ken is referring to is the, *How to Develop a Winning Trading System That Fits You* workshop, which we offer once or twice each year.

Trader Self-Evaluation

By Van K. Tharp, Ph.D.

I believe the most significant work that anyone can do to increase market returns is self- work. Really understanding yourself and how you think can give you an edge that others in the market don't have.

As part of my training, I give a long questionnaire to each trader to do an evaluation of themselves. Some of the feedback that I get is that taking the test is like doing a Ph.D. program! It's that involved.

I consider the ten questions that I give my Super Traders to be the essence of this self-evaluation process—a minimum starting point for this type of work.

We'll start with just one of the points. My advice to spend at least an hour on each question—a day is even better. These questions are meant for you to really dig deep and come up with responses from your core belief structure.

What are seven key psychological areas that you need to work on or are currently working on?

Don't say "none" because that answer really suggests that you are totally unaware of what is going on with you.

We basically live in a society in which we are programmed to feel separate and alone from everyone else, programmed to follow the rules of the games that others invent for us to play. The net result is most people do the exact opposite of what is necessary for success. As you become aware of this, you'll also become aware of all your patterns, beliefs, and emotions that you need to work on or clear out to become more successful as a trader.

Here are some examples that might fit some of you:

- I really have a fear problem that enters into my trading. I want to make trades but I'm afraid to pull the trigger. And that fear seems to come up in other areas too; I guess I'm really afraid of failure.
- I have some internal conflict when it comes to working on myself. On one hand I want to, but on the other hand, I'd rather do other things. Working on myself feels like having a tooth pulled. For some reason, I just don't want to do it.
- I don't have any discipline. Sometimes I just decide to trade. I make almost random trades or take recommendations that I've been given, but just certain select ones appeal to me. And the net result is that those trades never seem to work out. (Note: this is also an incomplete answer. What is the selection process? What happens to those trades? Do you cut losses and let profits run? Are you compelled by some emotion to trade?)
- My mother continually criticizes me. My mother gave me everything when I was growing up, and I'm very grateful to her. But she's always telling me what I do wrong. In fact, it upsets me to be around her. Yet at the same time, I feel

that I must support her. I need to find out why her criticism bothers me so much and what I can do about it.

- I really don't like to be alone. When I do things that are important to trading success, like psychological work, I have to go inside and search and that really disturbs me. Also when I try to meditate, things come up that cause me to be afraid. (And, of course, if you had this response, I'd want you to at least find out what's trying to come up that is causing this).

Those five statements are just examples of what might come up for you. But whatever you find…look thoroughly. What's really going on? What are the emotions you don't want to feel? What are the hidden beliefs? What is the internal conflict where part of you wants certain things and another part wants something else?

What are your key beliefs about the markets?

It is important for you to remember that you can only trade your beliefs about the market. So what are the key beliefs that are guiding you?

To really understand what's guiding your trading, you should list at least fifty beliefs. However, at least ten is a good starting point.

To help you get started, I've listed 12 of my most important beliefs about the market. Some of these are core principles that I teach everyone and some of them are just things that fit me. Also I just came up with these twelve off the top of my head. Like I mentioned, you'll probably need to discover at least fifty beliefs to thoroughly cover the key principles that guide your trading.

1. Cut your losses short and let your profits run!!!!!!!
2. Risk, as it relates to how much you can lose in a trade, is much more important than risk as it related to how much volatility you can have. Both are related though.
3. You must understand the R-multiple distribution of your trading system and the average R it produces (expectancy) and the variability of that distribution (i.e., how volatile it is).
4. You must know the objectives you wish to accomplish. What would you like to accomplish and what can you tolerate in terms of drawdowns? In my case, I'd like to make 10% per month in my trading.
5. To achieve your objectives, you must understand and use position sizing to your advantage.
6. Fill your portfolio with a core position that you might adjust weekly or monthly. However, then find efficient stocks and use leverage with those stocks to achieve peak performance. (Again, remember that these are my beliefs and they might not fit you.)
7. When I have a large down day, thoroughly investigate what happened and how I might have caused it or made any mistakes.
8. Keep a trading diary on every trade.
9. Follow the ten tasks of trading.
10. When I cannot be actively trading, remove all speculative positions.
11. Understand the risk reward of each trade before you enter it. For example, your potential reward should be at least three times your potential risk.

12. Keep stop loss levels with my core positions and actively monitor the market for my speculative positions. (Again, this one is my personal preference.)

I want to caution you again that these 12 beliefs are *my* personal beliefs. Your beliefs might be different. However, certain beliefs are universal for good trading. These include beliefs 1- 4 (knowing your objectives), and 8-11. These are just ideas to get you going.

So be honest with yourself, and start to look at what you truly believe about the markets. You may surprise yourself.

How to Protect Yourself in a Super Bear Market

By Van K. Tharp, Ph.D.

If you've read my book, *Safe Strategies for Financial Freedom*, you should understand that we are still at the early stages of what could be a Super Bear Market. That bear market started in 2000 and will probably end sometime between 2015 and 2020. And while it's difficult to predict what the market will do in a year, we can predict that if you have a long stock position that you just hold, you'll lose much of those assets by the time this bear is finished with you.

How do we know this occurs? Basically in the last 200 years, the market has gone through such cycles, repeatedly. Why should it be different now? Furthermore, the cycles tend to have a huge psychological component. At the end of the last secular bull market in 1999, everyone was playing the stock market. Everyone was a a stock market genius—the waiter at your restaurant, the bartender at the same restaurant, and even the taxicab driver who picked you up.

However, you might be thinking that we already had three rough years in the stock market from 2000-2002, so perhaps the market is now on its way to recovery. No, that's not the case at all. This bear market will be over when everyone is totally afraid of the stock market. Here's what you'll probably see:

1. many mutual funds will close down because they've lost heavily;
2. pension funds will no longer be allowed to invest in the stock market because they consider the risk too great;
3. very few of my clients will be equity investors (i.e., they'll all be into options or futures or Forex.); and
4. most importantly, stocks will be at all time bargain levels.

Blue chip stocks will be paying dividends of 5-6% and have single digit price earnings ratios. When you see that you'll know that the bear market is over.

How Can You Protect Yourself?

In *Safe Strategies for Financial Freedom*, you learned several strategies to protect yourself and even profit on the way down. These included the bear market mutual fund strategy, the shorting stocks strategy and the Graham's Number strategy to use as when prices start to get low.

We've also provided you with a 1-2-3 model, which gives you a general idea what to expect within the next year from the stock market. When it goes to red light mode (which it is in right now), you can expect stocks to fall on the average about 10% per year (but that's an average—it could be worse or it could be much less).

What If You Absolutely Have to Own Stocks?

Let's say you own a lot of your company stock and you need to keep that for some reason. You might be a senior executive and perhaps you feel it wouldn't look good to sell your stock or perhaps you cannot sell it or you'd lose control over the company. Perhaps your stock is expensive, but your basis in your stock is only $1, so you'd have a large tax consequence (this is a very poor excuse for hanging onto a stock but many people use it). You might have any of these, or numerous other reasons, for hanging onto a large holding in some stock. What do you do? You don't want to lose 70-90% of its value.

Mark Cuban was such an individual. He was an Internet entrepreneur, one of the founders of Broadcast.com. Mark, however, was lucky. His company was bought out by Yahoo! near the peak of the Internet bubble for $56 million worth of Yahoo! stock Although I don't know all the details of the transaction, this was probably close to the time that Yahoo! was worth $240 per share, but during the 2000-2002 crash Yahoo! dropped about 95%. When your company is bought out by another company, what you usually get is restricted stock that will not allow you to sell it for a certain period of time. Had Mark Cuban not been very smart, he could have ended with Yahoo! stock that was worth $2-3 million.

But Mark Cuban started employing sophisticated options strategies. He had put and call collars around his stock. And the net results is that he's still a very wealthy man and he still owns his stock. He's also the proud owner of the Dallas Mavericks.

You can do the same thing. For example, if you are convinced that the stock you own is going to start falling big time (e.g., its in a downtrend and we are in red-light mode), then you can create a synthetic short position. The net result is that you stop losing money. And when the stock stops falling, you can unwind your synthetic short (or convert it to something else) and pocket a lot of money. And you'll still own the stock. Wow.

Sophisticated options traders know how to do that and you can too.

What About Gold Stocks?

If we look at the big picture, the United States has a huge debt (over $35 trillion dollars) a huge balance of payments problems (over $50 billion each month), and we are facing a situation in which the elderly could have bankrupt pension plans and bankrupt social security. Read *Safe Strategies for Financial Freedom* to understand this better.

What can we expect? If the situation keeps going, other countries will not want our dollar. Thus, we can expect the dollar to go down in value. In case you don't know, the dollar declined 40% in value against the Europe at the same time the stock market was falling. Thus, even if you didn't have money in the stock market, you still lost 40% of your wealth if its based on dollar denominated assets.

In addition, the best way for a country to handle massive debt is to inflate the value of the currency. The Federal Reserve has basically said that this would be their policy. And we usually consider 2-3% inflation to be acceptable. However, as the debt gets worse we might have to revert to massive inflation that would simply make the debt become worthless. That's certainly one solution.

Anyway, both of these scenarios suggest that you should own gold stocks.

How Do I Do It?

I’d like to caution all of you that 90% of all option trades lose money. Don’t just buy options. You might hear about the extreme leverage and the limited risk in options. That’s true, but most people just don’t have the knowledge to trade options adequately and then end up losing money. And most options workshops that promise fast profits quickly simply show you the potential leverage with buying options or the protection you might get with covered calls. And the latter is especially dangerous in this market because it is equivalent to writing a put option. That means you have limited upside profit, but if the stock drops heavily you’ll lose big.

Instead, what you need to do is to educate yourself about options. You need to learn how to price options without a computer, how to tell what an option is really worth just by looking at it and how to use all sorts of sophisticated strategies to protect your positions.

Procrastination & System Development

By Van K. Tharp, Ph.D.

My research suggests that the problems people have in developing a trading system fall into five different categories.

The first three areas prevent traders from ever starting (or finishing) the development of a trading system. These include computer/technology phobia, procrastination, and being overwhelmed by the whole process. The last two problems tend to prevent the trader from coming up with a workable system. These include perfectionism and judgmental biases in your thinking.
I'd like to focus on procrastination which is big hindrance for many system developers.

So many of us have a hard time getting started—especially when it comes to the task of developing a workable trading system. Yet postponing the task creates even more problems.

What is behind procrastination problems of this sort? Often, a major cause is the fear of failure, especially since the result of completing the task is an opportunity to play a risky game like trading. For example, if you've tried trading without a plan, you know how risky it is and part of you may be so afraid of the consequences of trading that you are having difficulty starting to develop the plan. Or, perhaps you've quit your job to start trading full time, but you're so afraid of the possibility of not trading well that you cannot complete your system.

If you're uncertain of your ability to perform, either based on past experience or a general lack of self-confidence, you'll probably find it difficult to begin. And the greater your time pressure to perform, the more fear you will create.

Sometimes the fear of success will produce the same result. People fear success because it will bring something new. Suppose you become "rich" and, based on your experience, you don't like all the implications of what it means to be "rich." Perhaps your friends will no longer want to be associated with you or perhaps they'll try to take advantage of you when you have more than they do. Or perhaps you think wealthy people are stingy and narrow-minded. You think "I don't want to become stingy."

Another reason you might procrastinate about developing a trading system is lack of interest in that portion of the task. You don't like the idea of playing around with computers, testing numbers, and doing all of the work. Maybe it reminds you too much of school. Lack of interest, like a fast growing weed sending out roots in all directions, can strangle motivation and make it impossible to even start a simple task. All you wanted to do is get about the business of trading. As a result, you just trade, but you have never tested what you are trading. You just prefer to make mistakes the hard way.

Perhaps the work involved in developing a trading system reminds you of someone you do not like. Someone you dislike told you to do it and you feel resentment—or perhaps someone you dislike always used to do things like develop trading systems. You don't want to be like that person, even though you know you have to do the work, so you tend to put it off.

The more you dislike the idea of developing a trading system, or even doing certain parts of the task, the more you will tend to push it away. This means you'll leave the toughest part of the job for that portion of the day when your energy is lowest, and you are likely to make a lot of mistakes.

Lastly, the most important part of developing a trading system is to develop the objectives for the system. Once you have the objectives down, then the task of developing a system really is fairly simple. Getting your objectives down is 50% of the task. Until you have your objectives written down, you have no way of knowing what you want or of knowing when you've got it. How can you even monitor your progress, a major factor in ongoing procrastination, until you know exactly what you want? In contrast, once you know what you want, you can set deadlines for each phase of the project.

How to overcome procrastination.

First, you must realize that procrastination comes from you and take control of the situation. Make a commitment to get the job done. Also concentrate your focus on *starting* the project (or the next phase) rather than *finishing* it.

Next, write down all of your objectives for your trading system. At this point, you should know what you want, the tasks involved in producing it, and standards you will have for knowing when each part of the task is complete. When you know what has to be done next, it's much easier to concentrate on doing it.

Third, divide the task of developing a trading system into steps. Rank the steps in terms of priority and then in terms of your desire to do them. Set deadlines for completing each step and announce those deadlines to the world. If you find that one portion of the job is particularly onerous, then break it into subtasks and give yourself a deadline for each subtask.

Lastly, begin the next step. Concentrate on taking each step and then begin.
Remember that Lao Tse, the great Taoist teacher, once said,

"A journey of a 1000 miles begins with a single footstep."

Trading Fundamentals

Your Beliefs About Trading

By Van K. Tharp, Ph.D.

You do not trade the markets—no one does. Now that might sound surprising to many of you. But what you really trade are your beliefs about the market. Furthermore, your ability to do so is tempered by your beliefs about yourself.

I'd like you to write down your beliefs about yourself. These beliefs will typically start with words like

- I am
- I feel
- I experience myself as

Now if this sort of exercise is new to you, when you first do it, you'll probably write down a bunch of your positive attributes. Furthermore, you'll probably have trouble writing down more than twenty or thirty such beliefs. But you probably have hundreds.

However start your list. Let's say you think for about five minutes and you come up with the following items:

- I am a fairly good trader.
- I feel positive about my potential.
- I like myself.
- I am fairly astute in thinking about the markets.
- I am intelligent.
- I am creative.

You know there are a lot more, but after 15-20 minutes of thought that's all you can come up with. Okay, that's a start. But now I'd like you to continue the exercise each time you make a trade, either opening the position or closing it.

Let's say it's Monday morning and you open positions in the market. After doing so you continue to assess yourself and you notice two things:

- I'm feeling really excited.
- I like fast moving stocks.

Okay you've gained some insight about yourself.

By mid afternoon the market is in a steep decline and three of your stocks are down $500 on the day. Now you start thinking to yourself:

- I feel angry about that position. I just got in and it's going against me.
- I'm not going to let them take advantage of me this time. I'll hang on until it comes back.

Notice that you've just gathered some more insights about yourself. Keep this up until you've written down 100 or more statements that reflect you and your feelings. When you do, you'll have a lot more insight about how you produce your trading results. And you will be starting on your way to becoming a peak performance trader.

Make an Honest Self-Appraisal

By Van K. Tharp, Ph.D.

Think about the last loss you had in your trading. What caused it? Who was responsible for it?

If your response was anything other than yourself (e.g., the market, my broker, bad advice, etc.), then you are not taking responsibility for your results. And the consequences of not taking full responsibility for your results, is that you will repeat mistakes over and over again.

On the other hand, if you are willing to accept total responsibility for your investment results, you begin to understand all of the mistakes that you've made and then you are able to correct them. The market will become your Financial University. Moreover, you will realize that you are the most important factor in your trading or investment success. When you do that, you are way ahead of the crowd.

I once had a call from a gentleman in England who had been working with my Peak Performance home study course. He said, "I've been working through the course for over six months. It's helped me realize a lot about myself, but there is one thing it hasn't done. It hasn't given me a positive expectancy system." The ironic thing about that statement is that I had not even attempted to give a methodology in that particular course. That course is about how to become a peak performance trader/investor not system development.

There are several reasons for focusing on behaviour rather than systems:

1. If you want to be good, you must design something that fits you. That is only possible if you design the methodology.
2. Psychology is far more important than methodology. In fact, psychology is part of methodology. For example, when we attempt to help people develop a reasonable method that works, they resist it strongly because they have so many biases that keep them focused on the wrong aspect of trading—areas that have nothing to do with success. And it is very difficult to show them the correct direction.

The best thing you can do for yourself to increase your income from the market is to determine how you are blocking yourself. This should be done at two levels. Whenever you develop a trading business plan a great deal of that plan should have to do with introspection. Take a look at all of your beliefs. Are they useful beliefs or do they hinder you in some way? What are your strengths and weaknesses? What about you can't you see clearly because you are part of it? You should look at doing this sort of assessment at least once each quarter.

The second self-appraisal you need to make is at the beginning of the day—and perhaps even hourly throughout the day. What's going on in your life? Are you ready to face the markets? How are you feeling? Is there some sort of self-sabotage surfacing in you? For example, are you starting to get too confident? Are you starting to get too greedy? Do you in any way want to override your system? The best traders and investors are constantly doing this sort of self-assessment. If you want to make more money in the market, then perhaps you should start doing the same.

An Interview with Van K. Tharp, Ph.D.

In the unique arena of professional trading coaches and consultants, Trading Psychology Expert, Van K. Tharp stands out as an international leader in the industry.

Most people are not successful when it comes to trading. Why?

I can answer that question on a number of levels. At the most basic level, people must trade by processing information. Unfortunately, we're not very efficient information processors. We have a lot of biases that enter into trading decisions. I've documented 25 of them in my home study program. However, I think most of those biases can be summarized by realizing that trading/investing are very simple processes and we human beings try to make it into something much more complex. Those biases are all about adding complexity to the world.

Is it really that simple?

Consider the trading rules that work: 1) follow the trend; 2) let your profits run; 3) cut your losses short; and 4) manage your money so you can stay in the game. If you design something around following those rules, you'll make a lot of money. But when a great trader says, "That's what I do," the average person responds, "Yes, but tell me what your real secret is." This all about Trading Psychology.

The markets are not random in that we have very large abnormal price moves. On a normal distribution curve, these amount to abnormally large tails. For example, in the past, we have seen a one-day move of 500 points in the Dow Jones and a very short-term move of crude oil from the mid-teens to the $40 level and back to the mid-teens. We might expect those moves by chance, perhaps once in a 1000 years, but not several times in a decade. But we've seen those moves in the last decade. Consequently, what most traders need to do to be successful is to participate in those moves in some way and not lose too much money when we're wrong. Unfortunately, we have all sorts of biases in our thinking which keep us from doing so.

What are some of those biases, Van?

First, we have a bias to understand things such as "Why is the market acting like it is?" Most traders make money with systems that are right less than fifty percent of the time. What makes them money is that they make a lot more, on average, than they lose. Executing a system based on probabilities doesn't require an understanding of how the market works, it requires money management. Nevertheless, people want to treat the world as if they could predict and understand everything. As a result, they tend to seek patterns where none exist and to invent the existence of unjustified, causal relationships. Traders don't want to trade probabilities. Yet trading is a probability and money management game.

Another bias that most people have is called the law of small numbers. This means that we don't need a lot of information in order to find the patterns or causal relationships that produce our understanding—it only takes a few examples. People also have a bias in that we tend to imagine that what we see or expect to see is typical of what can and will occur. Thus, if you observe a pattern in the market, you expect it to occur. If you develop some concept about the market, you will look for data to support that concept in the market, and you will probably find it whether it exists or not.

Add to those another bias called the conservatism bias. This means that once we find a pattern or causal relationship, we tend to ignore contradictory evidence no matter how pervasive it is. There are many more biases. Hopefully, you get the picture. We tend to create a reality that's much more complex than what really works. We try to add complexity rather than employ sound money management.

There is one more important bias, called the ego bias. The ego bias amounts to the fact that most of us make the following statement: "Yes, I understand that most people have these biases, but none of them apply to me."

Are there any biases around money management?

Yes, there are several. The most notable is called the gambler's fallacy. People tend to assume that after a string of losses, a win is much more likely and vice versa. Thus, after a losing streak they are likely to risk a lot because they believe a win is more likely. Or after a winning streak they are likely to bet less because they believe a loss will occur soon. However, in reality a win or loss depends upon the probabilities levels in your type of trading, not what has happened in the past. Professional gamblers know that you bet small during a string of losses and bet big during a winning streak. This is the reason most professional traders use some sort of money management in which they risk a percentage of equity. Your equity increases during a winning streak and decreases during a losing streak.

Most good traders would agree that risking less than 1% of equity in a trade (where 1% is the amount you would lose if your stop loss was hit) is a prudent risk. Risking between 1% and 3% gets into the gun-slinging range. Risking any more than 3% is usually financial suicide, and the average trader commits financial suicide all the time without knowing it.

Your definition of 1% risk is important!

Most people don't understand risk at all—including a lot of professionals. Risk often is equated with the probability of losing. Thus, for some people, futures trading is considered to be risky. Others equate risk with the amount invested or with margin. But that's not it at all. Risk is the amount of money you are willing to lose if you are wrong about the market. When you define risk that way it changes a lot.

Let me give you an example. An equity trader might say, "I risk 10% on each trade." For him, that might mean that if he has $100,000 he wouldn't invest more than 10% in each stock or $10,000. That's not the same thing. According to his definition, he could only buy 50 shares of a $200 stock. But let's say that he bought a stock at $200 and that he would admit to being wrong if his stock dropped to $198 and sell it—that's a $2 stop. If he is willing to risk 10% of equity it means that he could buy 5000 shares of the stock. Those 5000 shares would cost him a million dollars and no brokerage house would allow him to buy that much with a $100,000 account. Risk must be thought of as the percent of equity you are willing to lose on a trade if you are wrong. And when you do it that way, anything over 3% is extremely risky, especially if you have 10 to 15 positions on at one time.

What's really interesting is that once you understand risk and portfolio management, you can design a trading system with almost any level of performance. For example, you can design a system to trade for clients that would make about 30% per year with only 10% drawdowns. On the other hand, if you want to trade your own account and be a little more risky, you can design a system that will produce a triple digit rate of return-as long as you have enough money to do so and are willing to tolerate tremendous drawdowns.

Van, you call yourself a modeler. What is a modeler?

I've had a lot of training in NeuroLinguistic Programming (NLP), and I consider NLP to be the science of modeling. That means if you can find several people who do something well, then you can determine how they do it. You need several people because if you try to model one person you tend to find that person's idiosyncrasies rather than what makes that person a super-performer. For example, I know one "Market Wizard" caliber trader who has actually hired people to model him. However, they've all failed because they were only trying to model one person and that just doesn't work. They'd just find out what he thinks he's doing and that's not it at all. Most of what he thinks is important are his idiosyncrasies.

Anyway, once you get the common tasks that produce excellent behavior, you need to get the ingredients of those tasks. Those ingredients include the beliefs, mental resources, and mental strategies necessary to carry out those tasks. Once you have that, then you can teach the same skill to others and have them perform well. And when you can duplicate success in others, which we have been able to do in most aspects of trading, then you know you have a workable model.

What is a coach for traders?

A coach is someone who takes raw talent and brings out top performance. People sometimes forget that trading is human performance—measurable human performance. Changes in equity reflect the performance of the trader much more than what happens in the market. A good trader can make money in the long run no matter what the market is doing. In contrast, a poor trader is unlikely to make money, regardless of what the market is doing.

A coach is someone who attracts talented people and then teaches them the fundamentals of good performance. At the Yankees spring training camp, Casey Stengle, who coached such baseball greats as Mickey Mantle and Roger Marris, used to hold up a baseball to his entire staff and begin the season with the statement, "This is a baseball." Even the best players need to be reminded of the fundamentals occasionally.

But just what are the fundamentals of trading?

To me, trading fundamentals include the ten tasks of trading. Traders need to be reminded of that and to eliminate any self-sabotage that keeps them from following those tasks. That's what I do and I am very effective at doing it.

Van, what is a low-risk idea?

A low-risk idea is a trading strategy or concept with a long-term positive expectancy for profit, which allows for the worst possible result in the short term. It still allows the trader to remain in the game to obtain the long-term rewards.

Why did you decide to do modeling and coaching with traders, Van?

My mission in life is to teach people how they think and how they can change their lives and this planet by changing their thinking. Traditional occupations do not do that. If I can influence just one more person by creating great models, I'm eager to do so. People need to realize that they can wish upon a star and get their wish. What they really want is happiness. Happiness does not come from wealth or money or achievement. People get happiness from deep down inside of themselves. And they realize they have it by giving it away. I guess that's what I'm about—giving away happiness. I sell financial success, but what I'm attempting to do is give away happiness in the process.

You said there were other levels at which we could talk about why people lose in the markets?

Yes, at another level, people get exactly what they want out of the markets. Most people are afraid of success or failure. As a result, they tend to resist change and continue to follow their natural biases and lose in the markets. When you get rid of the fear, you tend to get rid of the biases.

I guess the classic question is "Can a losing trader transform himself?"

I believe that if one person can do something, then you can model it and teach it to others. And we've developed all sorts of trading models that work. In fact, we've had great success teaching the models to other traders.

Yet transformation is only something that winners do. I've found over the years that most of the people who come to me are above-average traders and investors. In fact, when my clients have tried to talk others into using my service, they don't want it. I can remember one client telling a friend that if my course didn't help him (both his life and his trading) that he (my client) would pay for it. The friend still refused to buy it. Eventually, the friend lost so much money that he no longer trades. Yet he never called me. I hear stories like that all the time. The best way to describe the phenomenon is to say that losers don't want to transform themselves.

What role does discipline play?

Discipline to me means being able to control one's mental state where mental state is like the emotional context that one brings to a task. Every task has some state of mind that's important for optimal performance. For example, in answering these questions I'd describe my state as being relaxed, confident and focused. I just let the answers flow. If I were in any other state, I think it would be a lot harder to come up with the answers.

Well, the same thing holds for trading—there's some optimal state that is necessary for carrying out each of the tasks of trading. Overall, you need a background state of confidence, of knowing that you'll make money in the long run. If you don't have that context, then trading is quite difficult. And, each trading task requires a different sort of state.

Can you give us an example?

The first task of trading, self-analysis, requires that you be introspective, dissociated, objective, curious, and willing to trust messages that come from your unconscious mind. If you don't have a mental state like that, then it's hard to do self-analysis properly. And the same goes for any of the other nine tasks that are important to successful trading.

Can one change their mental state?

Yes. We teach about 15 methods for changing one's state. One that everyone reading this interview can use immediately has to do with what we do with our bodies. Our posture, our breathing, and the muscle tension in our bodies all have a profound affect on our mental state. There's a profound statement credited to the native American Indians: "Before you judge someone, walk a mile in their moccasins." So try it; only imitate their walk rather than actually wear their shoes. Try on four or five different walks.

That also leads to a profound way of changing yourself when you are not in a resourceful state. Change what you are doing with your body. Change your posture! Notice your posture and change it. Notice the muscle tension in your body (especially your face) and change it. And notice your breathing. Sometimes when people panic, for example, they completely stop breathing. That's not very useful, so change your breathing.

What are mental strategies?

Essentially, mental strategies refer to another of the three ingredients of success. It refers to the sequencing of our thoughts—most of which is unconscious. For example, most people make decisions based upon specific details of their mental images. Traders usually have a mental image of a trade that works. If the image is in the correct location and has a sharp figure-to-ground distinction (e.g., the last bar stands out), then people get a strong feeling to act. Now, that's not the same for everyone, but it's the most common pattern. Everything else we do in terms of manipulating the environment or changing our own thinking is just to set up an image like that which causes us to act.

Are there different mental strategies for different types of trading?

Floor traders, for example, tend to be more auditory than off-the-floor traders. That's one reason floor traders have trouble making the transition to an off-the-floor job. Their decisions usually relate to the volume, pitch, and location of the sounds they hear in their mind. When they are off-the-floor and don't have that input, they feel lost. In our courses I usually can suggest some strategy work with them to help them make the transition to being a position trader.

What other kinds of strategies are there?

We have strategies that distinguish confusion from understanding, successful versus unsuccessful decisions to act, what is easy-to-remember from what is hard-to-remember, and even what's "real" from what's made up. People are really amazed when I teach them that!

What's the difference between system development and trading?

System development is different than trading. For a beginner, it's learning how to trade. For a seasoned trader or investor, it is ongoing research. But in either case, it is different from the actual tasks of trading.

I have continually asked top traders how they learned to trade and there are a lot of commonalities. As a result, I have incorporated many aspects of systems development into my work. It started with the material in *How to Develop a Winning Trading System that Fits You* workshops and has evolved into detailed information about position sizing and expectancy. Jack Schwager says in his *New Market Wizards* that the most important characteristic that all market wizards have is that they've adopted a trading system to fit their personality. Well, that's the concept that I've seen work over and over again, and it's what I've built my system development work upon.

What can you share with us about system development?

First, there are a number of trading psychology issues involved in system development. That topic covers a lot of ground. It's too much to cover in this interview, but I've written a newsletter on the topic: Psychological Issues in Trading System Development, Course Update 19.

Second, trading systems tend to have various components. Those components include selecting the market, the entry, the initial stop, the exit, and the money management overlay. Everyone concentrates upon entry, which is the least important component. In fact, technical analysis, which is popular among investors and traders, focuses primarily upon market timing, which implies entry. I've conduced a study in which you can use a coin flip for entry and still make money if you use the other components effectively.

Incidentally, the most important part of the equation is the money management overlay that I've already talked about. Yet, if you bought a software package to develop a trading system, you could not apply any of these money management overlays. Isn't that interesting? All of the software packages give people what they want and thus focus on the least important areas of system development—how to use various indicators for entry.

What about a trading business plan? What role does that play in trading success?

I think the statistics indicate that 90 to 95% of all new businesses fail and the reason they fail is that they do not plan adequately. Most fail because they lack an adequate business plan. Well, trading is just like a business. Traders need more than just a system—they need a business plan. And that business plan should include several systems that generate low-risk trading ideas, a psychological management plan, a money management plan, and a worst case contingency plan.

The psychological management plan has to do with managing oneself. Trading is human performance and the main determiner of the performance is the trader. For example, most people spend all their time analyzing the market and trying to predict what is going on, which has very little to do with successful trading. As a result, I recommend that people develop a full psychological management plan. This involves analyzing themselves regularly and spending time on anything that would improve their own performance. This would include such things as proper diet, regular exercise, regular relaxation or meditation, goals, planning, and avoiding anything that would get one's life out of balance, etc. This kind of mental rehearsal will go a long way toward improving performance.

But perhaps the worst case contingency planning is even more important. It amounts to brainstorming about what could go wrong. That doesn't mean that I'm advocating that one expect disasters, just that one plan for them so that it's easy to weather the storm. Once you've brainstormed what could go wrong, then I recommend that your plan include three or four ways of dealing with each potential disaster.

Once I got a phone call from Tom Basso wondering what I had called about the previous day. He said, "We had a disaster yesterday, and I wasn't able to answer the phone." I said that I hoped everything was okay and Tom responded, "It was a planned disaster." They had planned and run-through dress rehearsal of a disaster in which all of their computers and phone systems were down. Thus, they were assuming that they had to run the office on Tom's home computer and home phone line. Could they do it? What would the problems be? And how would they overcome problems they hadn't predicted? I think every trader should do that kind of planning.

Do you advocate a mechanical approach to trading for most people?

That's generally true. Most people have better things to do with their time than sit around watching a monitor all day, which is usually necessary if your trading is not mechanical. Also a lot of problems tend to develop in discretionary traders that system traders can easily avoid. Consequently, I advocate system trading for most people.

But I also think that discretionary trading can be terrific once someone has had a mental clearing and knows what he or she is doing.

What other component is important to trading and investing?

Belief systems. Beliefs are grounded in the universe. Everything I've said in this interview reflects my beliefs. Beliefs are filters. You see and experience what you expect because your beliefs are filters to reality that allow you to find information and evidence to confirm them. Beliefs are concepts that help you understand things in this universe.

For example, people once believed that the earth was flat and that everything in the universe revolved around the earth. People's lives were shaped by that belief. We then believed in Newtonian physics where everything was mechanical and lawful and most of the universe was thought to be outside of us. And today we've moved into quantum physics in which everything is relative and the observer has an effect on the observation because he is part of it. The laws of physics (which are really just beliefs) shape our concepts, inventions, and progress. Probably at a level beyond all of that (of course, this is a belief) is that once you give up all of your beliefs, you have an experience of the universe as it really is—which tends to be a very profound spiritual experience, the kind that some of my clients have after an emotional clearing.

Beliefs are one of the ingredients of success. They tend to form a hierarchy with spiritual beliefs and self-concept beliefs being the most significant. I've written extensively on this topic in my home study program. Most significantly, I have developed my advanced workshop, *Peak Performance 202*, to maximize a person's understanding of belief systems and how they affect not only our trading and performance, but our daily lives. It's powerful material.

The Flow of the Markets

By Van K. Tharp, Ph.D.

Imagine yourself floating down a river, only you don't know that you are. You do, however, notice that when you move in one direction, with the flow of the river, you move rapidly. When you move in another direction, against the river, you move slowly or not at all. In fact, when you go in that direction, you seem to put out a lot more effort just to stay in place. Your life becomes a struggle. It just seems to push you in another direction. Feeling miserable, you fight against it. But it doesn't help. You still seem to move only in one direction—with the flow of the river.

Most people prefer to struggle against the river. They try everything they can think of to go upstream. All solutions like this—going against the flow—have the same result: frustration. If you were in the river, what could you do to make your life easier? One solution would be to get out of the river. But that would be giving up. There is only one easy solution—to acknowledge or accept that the problem has nothing to do with the river. The river just is. And it moves downstream and nothing you do can change that. When you realize that the problem stems from you, then the solution becomes obvious—just relax and flow with the river.

Buy High, Sell Low?

One of the oldest adages in market psychology is "Don't be afraid to buy high and sell low." Let's analyze what that means. If the market price is high, then the market is moving up. Those who are afraid to buy because the market is too high are fighting the flow of the river. It is possible the river may change direction, but you cannot predict if it will by determining how long it has been flowing in a particular direction. It may continue in the same direction for an unspecified length of time. Then again, if the market price is down, it also indicates the direction of the flow of the river. Those who are afraid to sell, once again, are fighting the flow.

Why do traders resist the flow of the markets? They do so because they play psychological games with the market. The most common game involves not being willing to give up what you perceive to be control, the need to be right, although you have no control over the market flow.

When you are struggling with the market, the struggle becomes all consuming. You don't realize that you are struggling with the market. Instead, you find yourself always looking for some solution to overcome the struggle. The struggle obscures the obvious solution: Letting go.

For example, suppose you have a tendency to be in a perpetual market bear, always expecting the market to go down. For you, every little turn in the market is evidence that the market is turning. As a result, you always go short and consequently, take a beating. You repeat the process, over and over, until the market actually turns down. With each transaction the struggle against the flow of the market intensifies for you.

Even worse is the trader who refuses to accept the inevitability of eventual loss. The market moves against each position the trader takes, but he refuses to go with the flow and refuses to accept the loss, no matter how small. It is an affront to the trader's ego. As a result, he refuses to accept it and the loss becomes larger. The bigger loss is even harder to take and the trader again refuses to accept it. The struggle continues until the loss becomes so overwhelmingly large that the trader has no choice but to take the loss.

The solution to the problem of resisting market flow is to realize that the problem has nothing to do with the market. The problem stems from you, the trader. The market is not going against you personally. The market is simply moving. Whether you go with the flow of the market or struggle against it, the market will continue to flow, taking you with it one way or another. Market flow is bigger than any individual trader. The question is whether you realize how you are creating your struggle against the market. When you push against the market, the market seems to push back. But the market is not the problem.

The trader's struggle with the market is the problem.

Stopy Worrying Yourself Out of Profits

By Van K. Tharp, Ph.D.

Every time Michael thought about entering the market he said to himself "But what if I lose?" Those thoughts often paralyzed him from action or delayed his entry so long that many opportunities simply passed before he would pick up the phone. When Michael did open a position, all he could think about were negative consequences. "My system is wrong at least half the time—what if this is one of those times?" He couldn't sleep because his mind was racing with those “what if” thoughts. Michael suffered from a chronic "dis-ease" of the mind called worry.

Research suggests that both a biological component and a psychological component of stress impair human performance and that it is useful to consider these two components separately. The biological component is the fight-flight response, a primitive reaction that early man developed in order to survive. This physiological arousal causes people to narrow their focus and put more energy into what they are doing. It might help you run faster or fight more aggressively, but it does not help you invest more successfully.

The psychological component of stress is what Michael was doing: worrying. It involves a concern for one’s performance and its consequences. It is the expectation of failure and the negative self-evaluation that accompanies failure. Worry is probably the precursor to the fight-flight reaction. Constant worry or intense worry certainly produces physical stress and, as such a herald, worry might be expected to only have a mild effect on performance. Research, however, shows the converse is true. Though physical stress at its extreme might result in death, worry generally has a much greater effect on human performance than its biological counter. Much of the experimental research on worry has dealt with a common problem of students—their concern about performance on an examination. Students who worry about test performance are likely to do poorly compared with students who are not concerned. The worry has nothing to do with preparation for the examination—it is simply the fear of poor performance. As a result, concerned students spend at least 25% of their conscious thought worrying about their grades on the examination rather than devoting their full effort to talking the examination. Michael, the investor who cannot sleep well because of his concern over possible negative consequences, will perform as poorly as the worrying students. His ability to forecast price movement or select good investment opportunities does not matter. His constant worry about his performance ensures that he will not achieve optimum results.

Worry and Information Capacity

Our senses are constantly bombarded with millions of bits of information. One can only select a small portion of this information for conscious processing. Thus, people have a limited capacity for dealing with information that comes through the senses. You can test this capacity in yourself by reading the following list of numbers, closing your eyes and then recalling as many of them as you can:

78 23 81 59 44 90 37 17 4 91 16 55 98 11 84

Unless you have an elaborate strategy for organizing the numbers into groupings that you can memorize, the basis for most mnemonic techniques, you probably were not able to recall many of them. Fifteen two-digit numbers far exceeds the capacity of most people.

Now imagine what other people will think of you if you don't recall all 15 numbers. Perhaps they'll think you are stupid or getting old or incapacitated. In addition, imagine that you will be fined $1,000 for each number that you miss. You could lose up to $15,000 if you miss them all. And what if the numbers you think you know turn out to be wrong? You really could miss all of them!

Now, keeping all of these thoughts in your mind, try again to recall the numbers. Chances are you missed more of them, if not all of them, on the second attempt. Why? Because worry takes up precious processing capacity. When you worry and take up capacity, little remains to perform more important tasks such as investment decision-making. Worry takes away from your ability to pay attention to what is really going on in the market.

You cannot notice subtle changes in the market or respond to them if you are too preoccupied with your fantasy of "what if." Thus, if you worry about what will happen if you make a mistake, you probably will make that mistake. By concentrating on potential mistakes, you make them happen.

Worry and Perception

All the information obtained through the senses about the world "out there" comes from a set of complex mental operations called perception. These mental processes interpret and attach meaning to the information the senses detect. For example, one might see a set of black markings on a white piece of paper and “perceive” it as a bar chart with a "head-and-shoulders bottom" or some sort of "resistance" or, to a non-technician, just meaningless lines. Perception is a filtering process, which selects information for conscious, processing. It selects information from the billion of bits impinging on our sensory apparatus, so we can cope with the world. The selection process is not random, but an active process that selects information according to one's expectations. What one sees out there depends on what one expects to see. The investor who expects to see a bull market in stocks will tend to perceive information that supports his expectations. He will "see" bullish technical patterns in his charts and ignore any evidence that might contradict the possibility of a bull market. Worry is a form of perception based on negative expectation. People who worry anticipate negative consequences. Most stressful events are stressful because of the way they are perceived. The event is just an event. It is a person's interpretation of the event that makes it stressful. Winners, for example, have learned how to make it "O.K. to lose." Losers, in contrast, become extremely anxious over losses and, as a result, have difficulty "letting go" of them.

A large loss, or even the potential for a large loss, may devastate the worrier. The person who dwells on the more positive aspects of the situation will view the same event as a lesson or even an opportunity. Suppose for example, the price of soybeans drops 20 cents per bushel. Let's look in detail at the reactions of five commodity investors to this same event.

- An old man with a smile on his face had been stopped out of soybeans early in the day. He had a $3,000 loss at the time he was stopped out, but the closing price of the day would have amounted to a much larger loss. He felt good about himself for sticking to his trading plan, so he responded to the news by smiling and telling himself, "Great! You stuck to your system."
- A soybean farmer had sold his crop two months earlier at a much higher price because he was convinced that certain big companies were manipulating the markets down. The 20-cent price drop was, for him, further proof of manipulation. "Damn them," he said to himself as he frowned. He remained in a bad mood the rest of the day.
- An active trader was convinced soybeans were due for a major rally. He had predicted the drop during the day and had used the opportunity to acquire a substantial long position in soybeans. He had a small loss on the day, but he felt a sense of satisfaction because his plan was working well. The only thing he said to himself was, "I'm right."
- A company president phoned his broker in a panic even though he was short in soybeans. He now had a $3,000 profit and he was concerned the market might go against him. His broker had convinced him to enter into the position and now he was afraid that he might lose his profit. "I'll lose again! " he thought as he called his broker to learn if he was still bearish.
- A financial columnist was long in soybeans. He had absorbed the loss because he did not enter a stop with his order. His predominant thought was that he did not stand a chance. If he entered a stop, he was sure it would be picked off by the traders on the floor. If he sold out at a large loss, it would probably be at the low price of the day. If he held onto his position, the market probably would continue to go against him. "Why me?" he thought.

Notice how the same event is a totally different experience for each of these traders. Three traders actually lost money in the market, yet two of them had positive experiences. Two traders made profits, yet both of them were unhappy. Of course, most people are not happy about losses or sad about profits. These examples merely illustrate that profits and losses have nothing to do with experience. People create their own experience by the way they think. Each person experiences life differently because each person's thinking is unique.

People who generally worry a lot will worry a lot about their investments. People who worry about their investments will tend to do so constantly. In any situation that might involve a threat to an individual's self-esteem, worriers show a marked capacity reduction. Self-esteem situations involve a threat of failure, whether it's a failing grade on an examination or performing poorly in the market. In fact, investing may pose a tremendous threat to an individual's self-esteem. The losing investor may not only experience financial hardship, but may also feel that he has failed to prove himself to those he loves or to himself.

How to Deal with Worry

How do you manage worry? If you can discover how you worry, then a simple solution to the problem is to do something else. If the new solution doesn't work, then again do something else. Keep changing your approach until you find something that does work. This does not necessarily mean changing your trading system. If you execute a system poorly, you will execute a new system poorly. "Changing your approach" means to change how you think, how you make decisions, and how you execute your system.

This solution is simple, but most people find it very difficult to accomplish because they are locked into certain patterns. Changing the way you think and perceive the world is not always easy. To change the way you think, you must first discover how you start the worrying process. Being objective about your own thinking is difficult while you are doing it, but much easier later when you can try two techniques to discover how you start worrying. The first exercise is to review a past, painful market experience. It is the quickest way to discover how you worry. You need only recall what happened just before the painful experience. You have no need to replay the experience itself.

Review the experience as if you are watching a movie of yourself. Sit back in a chair and feel yourself in that chair watching yourself on a movie screen. As you watch your movie, determine what started the worry experience. Was it something you saw or read? Was it something you heard or something someone said? Was it a feeling? What happened next? Did you start talking to yourself? Seeing pictures? Did your self-talk and pictures trigger the bad feelings? How did you do it?

When people worry they typically get themselves into a negative feedback loop. They talk to themselves, which produces bad feelings that results in more negative talk followed by more bad feelings and on and on. Others see images, which produce bad feelings that make the images worse, and so on. What kind of loop do you produce?

Once you discover how you start to worry and what kind of negative feedback loop you produce, figure out some ways to change it. Disrupt your loop in some way. If you say negative things to yourself, practice following those phrases with a picture of something pleasant. Try changing the quality of the voice you hear. If you say negative things to yourself, say it in the voice of some well-known cartoon character. Be creative. Do anything that is different until you find something that works for you. If you have trouble discovering how you worry from your past memories, then a second exercise is to keep a worry diary. When you feel anxious or worried about an investment, make a note of it in your diary. Do so at the time you are worrying. Don't put it off. Be sure to include the following information:

- What were you doing when you started to worry?
- What triggered the worry?
- Was it someone's actions?
- A memory?
- A visual image?
- A feeling?

- How did you go about worrying?
- What kind of a loop do you set up for yourself? Is this a new or an old pattern?

Later, when the experience passes, make a note in your diary about what you actually did, and what you could have done instead? Also comment on your original diary entry. After recording your worry diary for several weeks, you can study it objectively. What kind of irrational fears do you have? How does worrying affect you as an investor? Most importantly, you can determine how you trigger an episode of worrying and how you go about worrying.

When you have a good idea how you start to worry, select some changes you can make, such as those just suggested with the past memory technique. Become aware of when you start to worry and immediately select one of your changes. Once you discover how you go about worrying and have selected some alternative behaviors, practice using them. If you do so diligently, then the process will soon become automatic. Imagine yourself in some future situation where you would normally worry and practice some of the alternatives you have selected. Once you can feel at ease in an imaginary situation, you should be able to deal with the real situation. Investors who go through this process frequently comment, "It's just not the same anymore. I don't know what happened, but it's not the same anymore."

This article is taken from the book How to Control Stress To Become A More Successful Investor, *the second volume of Dr. Tharp's five volume course on how to develop peak performance in the markets.*

Personality Type and Trading: (Part 1)

By Van K. Tharp, Ph.D.

The path toward becoming a better trader is usually a path toward wholeness, and no two paths are identical. Each of us has to begin where we are in our own life situation. No matter what your path, you must first determine where you are. What are the patterns in your life that block you in your trading, your relationships, etc.? Those patterns can be available to you right now because they show up in your trading and in every other aspect of your life as well. Unfortunately, in most cases, people are not aware of them. Thus, the transformation journey often begins with a crisis. For it is only when an obvious crisis begins that we wake up to the fact that something is wrong in our lives.

This article, the first in a series, on individual differences or personalities is to help people determine where they are. Jack Schwagger has suggested from his experience interviewing "market wizards" that the most important element of successful trading is having a trading system that fits your personality. As a result, I'm going to base this article on the fact that knowing your personality type is important to finding out where you are in your journey toward wholeness.

The importance of personality traits comes into play because they provide a quick mirror of where we are and the neglected parts of yourself that you must nourish. For example, all of the personality traits that we are going to examine in this series come in pairs. If your personality tends to be extraverted, it simply means that you tend to focus your energy more externally than internally. Wholeness for you may mean moving more toward an internal focus (e.g., determining how you produce your results by your thinking) until you achieve a balance between focusing on the internal and the external.

Understanding Your Personality

If you've taken the Investment Psychology Inventory, you probably received a much more comprehensive personality profile based on the four dimensions of personality developed by Carl Jung. These include introversion/extraversion, intuition/sensing, thinking/feeling, and perceiver/judger. When you evaluate someone along four dimensions, you arrive at 16 personality types instead of four. This is similar to the well-known Myers-Briggs profile.

If you haven't taken the Investment Psychology Inventory, you have two choices. Take the profile and find your personality type and determine your strengths and weaknesses for trading. Or, as a second solution, you can got to the following web site to get a basic Myer-Briggs type test for free: http://www.humanmetrics.com/cgiwin/JTypes2.asp. When you get your type, look it up on www.google.com. The sites you find will tell you a lot about yourself. And in this eight part series, we'll tell you how your type relates to trading.

Three personality types—the ENTJ (known for their ability to develop strategies), the INTJ (known for their scientific reasoning), and the ISTJ (the trustee type person)—combined should constitute about 12% of the population. However, at this time these three groups represent 50.1% of our current sample. The NTs constitute 45.6% of our sample, probably because these people are always attempting to improve themselves.

Given these interesting developments, we can discuss the four Jungian elements of personality, and how they combine to form cognitive processing modes and temperaments. We can also discuss how these modes and temperaments are related to trading success.

Most of us give little thought to how we process and perceive information in order to make sense out of what is happening. Yet dramatic differences occur in how people perceive and interpret what goes on around them. And these differences lead to dramatic contrasts in behavior and personality.

The next step in this series on personality type and trading we will examine the four dimensions of personality developed by Carl Jung and how each of them might influence you as a trader.

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Personality Type and Trading: (Part 2)

By Van K. Tharp, Ph.D.

The next few parts of this series on personality type and trading will examine the four dimensions of personality developed by Carl Jung and how each of them might influence you as a trader:

1) Introversion/Extraversion

2) Sensation/Intuition

3) Thinking/Feeling

4) Judgment/Perception

First we will look at Introversion/Extraversion.

Introversion/Extraversion (I vs. E). Jung believed that human beings have a preferred attitude, being either introverted or extraverted. Although we think of these two terms as describing whether someone is socially oriented or not, that was not Jung's original focus. Instead, the extravert has a focus on the outer, physical world, while the introvert has a focus on the inner, psychological world. However, very few people are purely "introverted" or "extraverted." Instead, they apply an inward directed focus in some situations and an outward directed focus in others. (This will become more understandable later when I discuss cognitive styles and trading.)

An introverted trader, for example, would focus on his own subjective world primarily on concepts and ideas. His inner thoughts would predominate. This type of trader would tend to focus on how they produce their own results. That does not mean that they cannot be very social and likeable. It just means that their attention is directed toward the inner world. Only about 25% of the population is thought to have primarily an introverted focus, but 57.9% of our sample has such a focus. In contrast, 75% of the population is thought to have an extraverted focus, but extraverts only represent about 42.1% of our sample.

Extraverted individuals tend to focus on the outer, physical world—actions, objects and persons. People, things, the environment, their career, the market and their achievement are their primary focus. The extraverted trader, for example, would search for solutions outside of himself to become more successful. Since 75% of all people have an extraverted focus, most traders—especially those with an extraverted focus—tend to be concerned with what system they can develop to become more successful or with how they can change their system to become more successful.

Extraverted people tend to be energized by other people, by a party, or by crowds in the big city. If their extraversion runs to an extreme they may risk losing their own sense of identity. For example, if an extraverted trader loses all his capital, and he has identified himself as a trader, then that loss could result in a total mental collapse.

The internal/external focus has little to do with trading success--at least in our sample. About 7% of the introverts had outstanding trading records as compared with 8% of the extraverts.

Introversion and extraversion both exist in each individual. Most people can move flexibly between both orientations. However, Jung proposed that when the individual is unaware, the non-dominant orientation would tend to emerge from the unconscious.

Personality Type and Trading: (Part 3)

By Van K. Tharp, Ph.D.

We have already learned about Introversion/Extraversion (I vs. E). Continuing with our series, we will explore the other three dimensions:

1. Sensation/Intuition,
2. Thinking/Feeling and
3. Judgment/Perception.

Sensation/Intuition (S vs. N). The two perceptual functions are sensation and intuition. The sensation orientation involves using the five senses—seeing, hearing, touching, tasting and smelling—to convey a concrete reality. It is the function that receives information, from the inner, subjective world and/or the outer, physical world. Sensation is very connected to the present moment. While 75% of the population is thought to be sensation dominant, only 39% of our sample is sensation dominant.

In contrast, intuition is what Jung called "perception by the unconscious mind." The key characteristic of intuition is imagination. It involves "seeing the big picture" and "imagining what is possible." It also involves moving out of the present and encompassing both the past and the future to determine what is possible. Although 25% of the population is thought to be intuition dominant, 61% of our sample is intuition dominant.

The intuition function seems to contribute more to success than any other Jungian function or quality. We had 31 traders in our sample with outstanding trading records. Among this group, 26 of them were intuition dominant, while only five of them were sensation dominant. Thus, awareness of the big picture may be very important to successful trading.

Thinking/Feeling (T vs. F). The two judgmental functions are thinking and feeling. Thinking involves logical thought processes entailing cause-and-effect reasoning. It facilitates cognition and judgment. In this particular style, people are concerned with facts, reality, experience, specifics, and the "here and now." Everything is concrete and sequential. When people make decisions by thinking, they tend to weigh all the pros and cons in a sequential way and then make a decision. However, when trading decisions involve pure "thinking," the trade is usually gone before the decision is made. Interestingly enough, people generally make decisions based upon thinking, but they act based on feelings.

Feeling involves making decisions by means of value judgments. It allows us to determine if a thing is important or not. It involves subjective, personal values. Does the person like or dislike it? What is the impact on a person? Is it strong enough to act upon?

If thinking is highly developed in an individual then feeling would be much less developed and vice versa. And you can probably guess that it takes a lot of "thinking" to develop a trading system, but it takes "feeling" to execute the system. Thus, you must be well-balanced in order to trade well. About 50% of the population tends to be thinking dominant while the other half tends to be feeling dominant. In our sample, 57% was thinking dominant, while 43% was feeling dominant.

Top traders in our sample were much more likely to be thinking dominant (by a 6 to 1 ratio) than feeling dominant. However, thinking dominant traders as a whole were more likely to be losing traders than were feeling dominant traders. My guess is that the top traders show a good balance between thinking and feeling, yet are thinking dominant.

Judgment/Perception (J vs. P). The last dichotomy is very deceptive, in that the names used, judger and perceiver, do not adequately describe the two processes involved. This dichotomy refers to the amount of closure a person needs in handling their affairs. Judgers, the first category, want closure, wanting everything organized and in its place. In contrast, perceivers prefer fluidity by keeping their options open.

The Judger is apt to feel a sense of urgency until a decision is made. They establish deadlines and take them seriously. Judgers tend to believe that work comes before all else—rest or play. Thus, judgers will do all sorts of preparation, maintenance, and cleaning up afterward with respect to their work. About half the population tends to have a bent toward closure and thus be judgers. However, about 72% of our sample showed this type of dominance.

Perceivers tend to be "go with the flow" type people. They resist making a decision, always wanting, and waiting for, more information. Thus, when they finally do make a decision, there is always a sense of uneasiness and restlessness. Perceivers tend to be more playful and easy-going than their counterpart. They want their work to be enjoyable. However, they can also become so caught up in a work project that they totally forget about time and everything else. About half the population is this way. I would expect that people who have trouble making a decision would stay away from trading. And, indeed, only 28% of our sample were perceivers.

These four dichotomies can be used to describe 16 different personality types, as described by Isabel Myers and her mother, Katheryn Briggs. The so-called Myers-Briggs test divides people into 16 different types, ISTJ, ISTP, ESTP, ESTJ, ISFJ, ISFP, ESFP, ESFJ, INFJ, INFP, ENFP, ENFJ, INTJ, INTP, ENTP, and ENTJ. In some ways, I dislike this test because it does tend to put people into psychological boxes. So rather than going into each of the 16 types, we will begin to look at eight cognitive styles and four temperaments. I will describe each type and give you my opinions about how it functions in the process of trading or trading system development.

Personality Type and Trading: (Part 4)

By Van K. Tharp, Ph.D.

The Cognitive Modes

The eight cognitive styles are combinations of what Carl Jung thought of as the four mental functions (sensing, intuiting, thinking, feeling) combined with either an internal (introverted) or external (extraverted) orientation. The relative strength of these eight modes within your personality determines how you process information and make sense out of your life.

Some of these modes of functioning will be very familiar and comfortable. Yet, when I explain other styles, you may wonder how anyone could function that way. These unfamiliar cognitive modes are the ones you have failed to develop because they do not align with the core beliefs you developed about yourself (and your relationship to the world) as a young child. At the end of each description you'll see a rating scale going from one (it's very strange) to seven (it's very comfortable). Think of the number that you believe best describes your comfort level with that mode of functioning.

Most people only develop a few of the eight modes and are unaware of their full potential as human beings. Of course, we all use all eight modes, but the less developed, more rudimentary ones reside only in the unconscious mind. None of these modes showed a strong correlation with trading success, suggesting that each may be important in some way. This week we begin with the first two of the eight modes: Sensation, introverted and extroverted.

Introverted Sensation (IS). IS is the cognitive mode that allows us to be in touch with our bodies. Through IS people are able to sense the rhythms of their bodies. You become aware of how alert you are, how much energy you have, and if any particular part of your body needs attention. For example, the ideal diet for you simply amounts to paying attention to your body. Eat whatever you seem to crave, and then notice what your body's reaction is to that food. If you have reasonable introverted sensation, then you will know your body's response to each food after you've eaten it. Once you know your body's response, then it will teach you exactly what you need to eat to attain the ideal nutrition for your body. Unfortunately, this only works when you have fairly well developed IS.

One of the market wizards, when he first attended our Peak Performance 101 workshop, told me that he was very attuned to stress in his body. He said that whenever it seemed to develop, it always started in his fingertips and then worked its way up his arms and into his body. I suggested that since he was so attuned to the inner sensations of his body, he should simply use the sensations as a signal to back off and relax. Subsequently, he reports that he just does not experience stress any more. This, to me, is IS at its best as utilized by a market wizard.

I believe that IS is critical to the trading task of self analysis. If you tend be lax doing self-analysis, then it may be because you have not developed this particular cognitive mode.

Please record how comfortable you feel with Introverted Sensation. A rating of one means it seems very strange, and you have trouble imagining anyone could do it. Four means you know you do it sometimes, but it is probably just an average skill for you. Seven means it seems very comfortable for you, and it is something you do all the time.

1	2	3	4	5	6	7

If you are weak in IS, start some exercises in which you pay attention to your body. Spend half an hour each day, lying down with your eyes closed. Explore your whole body for feelings and notice what is there that you've missed. Also while you are at your computer or observing the market, notice any tensions or unusual feelings you have in your body. Whatever you notice in either exercise, do something about it. If you're tense, stretch it out or practice relaxing or meditating.

Extraverted Sensation (ES). People who use a finely developed ES find it easy to note details and be in tune with their environment. ES processing connects people to the physical aspects of life—the sights, sounds, touches, aromas, and tastes of the physical world. It allows one to appreciate sexual contact, the beauty of a symphony, or the art in a fine painting. People with a highly developed ES typically have good memories, since they record details accurately and have no difficulty remembering them accurately.

Everyone uses ES, but there is a big difference between discerning the difference between a red and a green traffic light (a basic survival skill) and noticing subtle shades of differences in a family of colors. People with highly developed ES skills can match the exact shade of red and grey in the couch in a room from memory and come home with a paint color that works perfectly. Those with average skills would probably have to take a swatch of the fabric with them, while some of you may have trouble matching the colors even with the swatch in front of you because "all those reds look the same."

ES skills extend to all of the senses. For example, can you identify a wine just by tasting it? Or can you recognize people when they enter the room just by their smell? Or can you recognize someone you haven't been with for years just by hearing their voice?

Good ES skills are essential for anyone who must be accurate with details or concrete facts. It is essential for a craftsman or a CPA. ES skills help us keep our feet on the ground and our mind in the present moment.

You can probably imagine how important ES skills are for any sort of pattern recognition in the market. If you expect to be able to react to certain market conditions, because you've experienced them before, then you need well-developed ES skills. However, ES skills showed a slight negative correlation to trading success.

Once again record how comfortable you feel with this particular mode of interaction.

1	2	3	4	5	6	7

To improve your ES skills, you must ground yourself in the present moment. When you are talking with someone, notice all of the specifics of what they say. Practice repeating what they say back to them, repeating as many details as possible. They'll usually be very flattered that you have listened to them so closely.

Learn to identify the aromas and tastes of various herbs and spices. Memorize different shades of colors until you can verbalize them on sight. Listen to a band play and pick out how different the music is from instrument to instrument. Or look at daily bar charts, bar by bar until you can recognize every market just by looking at a small sample of bar charts and can say, "Oh, that's a chart of soybeans in April 1997."

Next we will cover Intuition, both introverted and extroverted modes.

Personality Type and Trading: (Part 5)

By Van K. Tharp, Ph.D.

The Cognitive Modes Continued

As I pointed out, some of these modes of functioning will be very familiar and comfortable to you, while others may leave you wondering how anyone could function that way. At the end of each description you'll see a rating scale going from one (it's very strange) to seven (it's very comfortable). Think of the number that you believe best describes your comfort level with that mode of functioning.

Most people only develop a few of the eight modes and are unaware of their full potential as human beings. Of course, we all use all eight modes, but the less developed, more rudimentary ones reside only in the unconscious mind. None of these modes showed a strong correlation with trading success, suggesting that each may be important in some way. Previously, we covered the first two of the eight modes: sensation introverted and sensation extroverted. Now, we will cover the two modes of intuition.

Introverted Intuition (IN). According to Jung, IN provides us with a variety of perspectives for viewing life. When this skill is highly developed, a person can use these multiple perspectives almost simultaneously. It allows people to connect with the endless images of the unconscious and to make inductive leaps, revealing creative connections between ideas and symbols. It is one of the required modes of operation for anyone who is involved in developing a theory: philosophers, theoretical physicists, and those few people who are good at developing new ideas about how the market works.

Introverted intuition is especially valuable in allowing problems or situations to be viewed from multiple perspectives. For example, when you are having difficulties in trading, IN will allow you to view it from your own perspective, from a dissociated (watching yourself) perspective, from the perspective of a trader who has the opposite side of a position from you, from the perspective of a hypothetical Super Trader—anything you want. It is a very valuable mode of operation. IN skills showed a slight positive correlation with trading success.

Record how comfortable you feel with this particular mode of interaction.

1	2	3	4	5	6	7

To develop IN skills, I would suggest you practice role playing. For example, relive an argument or discussion from the other person's point of view. Take a perspective that is entirely different from the one you usually hold.

Extraverted Intuition (EN). The EN processing skill helps people see the possibilities in a situation. For example, when you look at a chart pattern and suddenly become aware of something else going on in the market, you are using EN skills. When you think about a particular day in the market and can recall generally what was going on, without remembering any specific details, you are using EN. In other words, when you have an overall impression of something, yet are hard-pressed to give details, then you are using EN. It is this cognitive mode of processing information that gives us our hunches.

People with highly developed EN can easily come up with speculative or imaginative solutions to a problem. They can jump from the present condition to the outcome without considering a step by step process. They are great at brainstorming and continually come up with new ideas. More of our top traders showed EN dominance than any other processing mode.

Once again record how comfortable you feel with this particular mode of interaction.

1	2	3	4	5	6	7

To develop EN skills, I would suggest that you start following your hunches. Practice "guessing" what will happen in the market tomorrow. Imagine at least three scenarios that could dramatically change prices in a particular market tomorrow. Or try an exercise that we use in the Winning Systems Seminar: come up with at least ten new ways that you could represent market behavior (e.g., time versus price).

We have covered a lot of information thus far in this series. We will continue with this topic, picking up with the analysis of the other four remaining modes, thinking and feeling in both introverted and extroverted forms.

Personality Type and Trading: (Part 6)

By Van K. Tharp, Ph.D.

The Cognitive Modes Continued

We have now covered four of the eight cognitive style combinations which Carl Jung categorized as the four mental functions (sensing, intuiting, thinking, feeling) combined with either an internal [introverted] or external [extraverted] orientation. The relative strength of these eight modes within your personality determines how you process information and make sense out of your life.

We have covered sensation introverted and sensation extroverted, and two modes of intuition. And we will continue with thinking and feeling in both introverted and extroverted forms.

Introverted Thinking (IT). IT is a skill that helps people solve problems involving in concepts, ideas, or symbols. IT is the process involved in the logical manipulation of ideas, as in philosophical reasoning or mathematics. If you are good in mathematics, you probably have highly developed IT skills.

This skill is important in hypothesis testing. Thus, you might use EN to come up with a new concept about the market. However, IT skills would be important to test out that hypothesis to determine whether or not it would be profitable.

People for whom IT is highly developed usually begin problem solving with a strong conviction. For example, in developing a new market theory, you would probably begin with a strong conviction that such a theory exists.

Traders who rely strongly on IT also tend to work best by themselves. They can remain highly focused and carry an idea through to completion. These individuals are strongly concerned with expanding their knowledge and understanding of markets (and the world). They want to explain their reasoning and justify their conclusions.

More traders in our sample showed IT dominance than any other cognitive style and this skill was important to the top traders. However, if you exclude the top group, it showed a negative correlation with trading success—probably because IT skills are useless without the ability to develop a useful hypothesis for trading.

Record how comfortable you feel with the IT mode of interaction by picking the most appropriate number below.

1	2	3	4	5	6	7

To develop IT skills, I would suggest that you take a math class (especially higher math) or a course in logic. Or find an area that interests you, such as a particular aspect of the market, and memorize the definitions of the concepts and terms. Once you've done that, compare and contrast the concepts so that you know how they are similar and how they differ.

Extraverted Thinking (ET). When logical problem solving is connected to the external world, it is called extraverted thinking (ET). This mode of thinking allows one to take a problem and break it down into component parts. An extraordinary example of the ET mode is provided by Chuck LeBeau and David Lucas in their book, Computer Analysis of the Futures Market.1 The authors break down the task of system design and development into component parts and then solve each part of the puzzle separately.

The ET mode is also used when one finds a goal to attain and then breaks down the attainment of that goal into distinct, sequential tasks, determined in part by their cause and effect relationships. For example, the task of becoming a proficient trader involves the tasks of self-assessment, self-transformation, system development, system testing, and then following the ten tasks of trading. I also used ET to develop that sequence.

Since personal problems can affect the type of system one uses to trade, I recommend that people do a complete psychological assessment, followed by a psychological clearing, prior to beginning the task of developing a system. Why? Because the system one might develop after clearing out any strong issues will probably be much more profitable than anything developed prior to the clearing. And, of course, one must develop and test a system before one can actually trade.

Generally, people with highly developed ET will determine a series of priorities through logic and reasoning. They will weigh the pros and cons of each possible solution before deciding what to do. ET is usually a methodical, step-by-step process in which each component is carefully considered. People with a strong ET cognitive process will usually have a strong code of conduct or system of rules about how to lead their lives. They tend to be focused and very efficient in getting the job done. Fairly well developed ET is probably essential for good trading if you are starting from the beginning. ET is also a cognitive skill that is highly developed in our top traders.

Record how comfortable you feel with the ET mode of interaction by picking the most appropriate number below.

1	2	3	4	5	6	7

To develop ET skills, I would suggest that you make a list at the end of the day of what you would like to accomplish the next day. Determine the pros and cons of each task and then determine what order the tasks must be accomplished in order to make the most efficient use of your time.

Introverted Feeling (IF). When one uses the IF mode of cognitive processing, one connects with the values and feelings deep within. Your inner values tend to rule your life. They may be personal, abstract (e.g., independence), spiritual, or even mystical. These values tend to strongly connect the person who uses them to what he or she likes and/or dislikes. For example, a person following the IF mode will tend to honor what is within more than what is outside of themselves. Thus, it usually takes IF processing to ignore the crowd and go with a "gut feel" about a trade.

A person for whom IF is highly developed will probably be a very poor systems trader, always preferring to go with internal feelings over external signals. This type of trading would probably only work if the person was so highly trained as to have very accurate internal feelings. In our sample, IF processing showed a negative correlation with trading success and it was seldom dominant among top traders probably because these people are not tuned into what is going on in the market.

Record how comfortable you feel with the IF mode of interaction by picking the most appropriate number below.

1	2	3	4	5	6	7

To develop IF skills, I would suggest that you take on a new project and complete it by only doing what you like to do. Consult only your own inner feelings for whether or not you like it. And thus proceed by only doing what you like to do. Avoid any other reasons for doing the project except to say, "I like it." Do not give in to group pressure and do not change your schedule or what you are doing to accommodate others.

Extraverted Feeling (EF). EF processing helps us connect to other human beings. Through it we are able to share their experiences and recognize their intrinsic value. It is a very important ingredient to developing significant human relationships.

EF processing always brings the "human" factor into the decision-making process. For example, EF dominant people tend to strongly adhere to the standards and values of the group to which they belong. Most institutional traders are selected because they have this quality. However, it probably has a negative correlation with successful trading. EF traders tend to be crowd followers. EF people tend to suppress their own needs and desires in order to promote harmony because relationships tend to be of primary importance for them.

I would expect someone with dominant EF processing to be a poor trader. However, it showed a positive correlation with trading success in our sample. EF processing might be useful if other modes of processing were also highly developed (e.g., ET, IT, EN) because it could help a trader understand what other traders are doing without necessarily influencing how he trades. For example, a trader with highly developed EN skills might come up with some important insights about what is happening in the market. And if those skills are combined with strong ET or IF skills, it could result in excellent trading decisions.

Record how comfortable you feel with the EF mode of interaction by picking the most appropriate number below.

1	2	3	4	5	6	7

To develop EF skills, I would suggest taking on a project in which you continually place the needs and wants of others before your own. Change your plans to accommodate what others want. Take time to "be" with other people and show genuine concern for what is happening in their lives. Also, find ways to give sincere compliments and express your appreciation to others for what they do for you.

LeBeau, C. and Lucas, D. Computer Analysis of the Futures Market. 1992. An excellent book that breaks down the problem of trading system design into component parts and then deals with each problem separately. I highly recommend this book.

Personality Type and Trading: (Part 7)

By Van K. Tharp, Ph.D.

So far in our continuing series on Personality Type and Trading we have covered a lot of ground. We have examined all of the various aspects of the Myers-Briggs personality profile and elements of these profiles related to trading.

In our last leg of the discussion we will begin with the Four Temperaments.

Psychologists David Keirsey and Marilyn Bates believe that an important basis of personality are four key temperaments. Looking from a mythological stand point, these correspond to the characteristics that Zeus told his gods to help man adopt. Dionysus was to teach man joy. Epimetheus was to give man a sense of duty, while Prometheus was to give man science. And, finally, Apollo was to give man the spirit of the gods.

Dionysian Temperament: The Dionysian Temperament occurs in those people for whom sensation (S) and Perception (P) are dominant. These SP people (ISTPs, ESTPs, ISFPs, and ESFPs) comprise about 38% of the population.

SPs tend to gravitate toward trading because they have a strong need for freedom and independence. They don't want obligations or to be tied down in any way. The ideal life is to do what he wants to do when he wants to do it. Action is the key for these people and they tend to be impulsive. Actually, they want to be impulsive because that gives them their free spirit and sense of aliveness.

People with this type of temperament work best in crises and they even will create a crisis just to make things more interesting. You can imagine what happens when this type of behavior is brought into the trading arena.

The Myers-Brigg's personality types for which we have little data include all four SP categories. In fact, although SPs constitute 38% of the population, they only represent about 8.3% of our sample. Why? First, I suspect that SPs do not last long as traders and those that have enough money to last for a while are not that interested in self-knowledge, just the action of being in the market. Thus, SPs will tend to gravitate toward very short-term systems in which the odds are definitely against them, but they are still willing to take their chances because that's where the action is. In fact, the SP probably could not do well with a longer term orientation, because that would just not fit his impulsive nature.

People with SP temperaments are good with tools. Thus, I would expect them to have the potential to work well with computers and thus do fairly well in that aspect of trading.

Record how comfortable you feel with the SP temperament by picking the most appropriate number below.

1	2	3	4	5	6	7

Although I do not recommend that one apply an SP temperament to trading, unless you want to forget about profits and just enjoy the action, the SP temperament is an excellent one to bring to many aspects of living. To develop more of this trait, I would suggest that you practice being much more spontaneous in what you do with your life. For example, pick one day each week in which you do everything just for the fun of doing it.

The Epimethean Temperament: The Epimethean Temperament occurs in people for whom the sensation (S) and judgement (J) qualities dominate. These SJs (ISFJs, ESFJs, ISTJs, and ESTJs) also constitute about 38% of the population. These people are dominated by a sense of duty. They exist primarily to be useful to the social units to which they belong.

Epimetheus was the husband of Pandora, who let all manner of ills escape onto mankind—old age, sickness, insanity, vice, and passion—when she opened her famous box. Yet Epimetheus, although forced to endure the result of his wife's actions, steadfastly stood by her and remained devoted to her.

The SJ personality has a strong need to belong. But he must be the giver, not the receiver. He must earn his belongingness. As a result, I would not expect SJs to be that happy in the lonely world of trading unless they had a major social system for support (i.e., strong family support). However, the SJ might be quite content in an institutional trading situation.

However, the SJ personality is constantly seeking out what he is "supposed to do" to belong. They typically do well in school, because the rules are quite obvious. However, in the trading arena the "supposed to do" rules are not that obvious. In fact, if you ask enough people they will probably give you advice that is the exact opposite of what will produce trading success. Indeed, our sample of SJ traders produced below-average trading results. Nevertheless, the SJ usually has a very strong work ethic, which could help him overcome a lot of difficulties.

The SJ will shine in one of the ten tasks of trading—mental rehearsal. Why? The SJ is likely to envision all sorts of disasters and constantly be trying to figure out how to overcome them. Indeed, his personal motto is usually to be prepared. Unfortunately, much of his idea of being prepared involves following traditions (e.g., the "I go by the book" motto) and this also may not breed success in the marketplace.

Record how comfortable you feel with the SJ temperament by picking the most appropriate number below.

1	2	3	4	5	6	7

To develop SJ skills, develop a total disaster control plan for your trading. Think of anything and everything that could go wrong in your trading. And, if your list does not include at least 100 items, then you need to continue until you have that many. Once you have your list, then come up with three ways to either circumvent each disaster or to overcome it if it does happen.

Personality Type and Trading: (Final, Part 8)

By Van K. Tharp, Ph.D.

This is the final installation in the on-going series on Personality Type and Trading. We have examined all of the various aspects of the Myers-Briggs personality profile and elements of these profiles related to trading.

Psychologists David Keirsey and Marilyn Bates believe that an important basis of personality are four key temperaments. Looking from a mythological stand point, these correspond to the characteristics that Zeus told his gods to help man adopt. Dionysus was to teach man joy. Epimetheus was to give man a sense of duty, while Prometheus was to give man science. And, finally, Apollo was to give man the spirit of the gods. We end this series with the final two.

The Promethean Temperament: The Promethean Temperament comes into being when the qualities of intuition (N) and thinking (T) are dominant. The NT temperament (INTP, ENTP, INTJ, ENTJ) is only found on average in about 2% of the population. As a result, NT people must grow up in an environment full of people who are usually quite different from them. For example, about one family in 16 would have both parents as Ns and only one in a thousand would have both parents as NTs.

The NT personality is looking for power over nature: to be able to predict, control and explain realities. Thus, the NT trader would be one who wants to predict, control and explain the markets, much of which is the antithesis of good trading. However, since his ultimate goal is to be a good/great trader, the issue is simply how to get there. He has a strong drive to continually improve (as opposed to the SPs drive to simply act). As a result, I would generally expect this group to produce more good traders than any other. Our data suggests this to be the case! First, we have a lot of data on the NT personality types. Although they only constitute about 2% of the population, NTs constitute 45.2% of our sample population—a truly amazing statistic. Among our NT traders, about 10% show outstanding trading records—a higher percentage than any of the other temperaments.

The NT is very self-critical. He badgers himself about his own errors. He taxes himself with the resolve to improve. If his pushing is used as a learning process, then he is bound to improve. However, the NT can easily get caught up in the perfectionist trap, which can prevent him from getting anywhere. For example, if the NT's self-criticism is tied into his/her self esteem, then he can become frozen into inaction or into repeating the same task because he is not satisfied with the results. However, I have found that NTs show tremendous improvement when they go through my private consultation program.

The NT is likely to know that recreation is important to his health and overall well-being. However, his play has little spontaneity or fun. Instead, NT play is an exercise in conquest and being the best. He does not allow himself to make any mistakes, logical errors, and yet, paradoxically, requires that he have fun because that's what people are supposed to do when they're playing.

The trader who is an NT will live his work. If markets stay open 24 hours, he is likely to try to follow the market for 24-hours just because the market exists and missing something might be making a mistake. He wants to be the best possible trader, so he will do whatever he can to be successful. He is extremely vulnerable to the "all work, no play" syndrome and this kind of attitude can lead to a very out-of -balance lifestyle.

The NT wants to be the scientific trader. They are drawn to occupations that have a logical understanding, in which they can master some new concept about trading or design some great new trading system. He has an inquiring attitude and deals with others in a straightforward, albeit cold, approach.

The NT generally focuses on the future, trying to figure out what might happen next. And once he masters a challenge, he is very likely to move on to another one. Why? Because his goal is competency in every field. Thus, his goal might be to achieve greatness in trading, but as soon as he receives it or thinks he has it, he is likely to move on to something else.

Record how comfortable you feel with the NT temperament by picking the most appropriate number below.

1	2	3	4	5	6	7

To develop NT skills, spend at least one day a week reading everything you can about the markets. Make a list of 50 ways you can improve your trading and then work diligently to adopt each of those ways.

The Apollonian Temperament. The Apollonian temperament involves a combination of intuition (N) and feeling (F). Apollo was the messenger of the gods and as such provides a direct link between man and the gods. Thus, NFs are involved in a search for self-actualization—a search for "being" and their mission in life. The NF is just trying to be himself, nothing more and nothing less. He is constantly wondering, "How can I be the kind of person I really am?" as he hungers for self-actualization, meaning and a unique identity.

The NF person wants authenticity and integrity. There must be no facade, no mask, no role-playing, no pretense, etc.—just genuine harmony with the inner experiences of the self. The NFs tend to be great persuaders as they form the majority of the world's writers, therapists and clergy. They love to transmit ideas and attitudes to others as they strive toward a vision of perfection.

NFs place a strong role on developing relationships—usually giving much more than he expects in return. And he is always willing to give strongly to it as long as he can get some sort of response in return.

The NF also has an extraordinary ability to appear to others what the other person wants them to be. Thus, they make great actors, as they take on each role completely. And the NF person does not mind that others see him as something other than what he is as they would only communicate who they really are to those with whom they have a very deep relationship.

Approximately 16% of our sample of traders are of the NF temperament. This is quite similar to the one to two percent thought to exist in the population at large. I would expect that NFs would probably enjoy participation in the market as a chance to learn about themselves. Our results tend to suggest that ENFs (whose focus for meaning is directed outward) tend to have above average trading records, whereas INFs (an inward directed focus toward meaning) tend to have below average trading records.

The NF person is future oriented, as is the NT, but his focus is on the possibilities in people in contrast to the NTs focus on possibilities in principles.

Record how comfortable you feel with the NF Temperament by picking the most appropriate number below.

1	2	3	4	5	6	7

To develop NF skills, spend some time thinking about your purpose in life. What is your mission? If you had six months left to live, what would you do with your life? If you had all the money you could possibly spend, how would you live your life? What do you find in common with your three answers? Does it involve trading? Now figure out how you can change your life and your trading to live congruently with your purpose and mission in life.

While the Myers-Briggs is a great tool and among the most well-known and widely used measure of personality traits, there are others. My March 2004 Market Mastery Newsletter featured an article about the Enneagram typology test. This issue also relates the Enneagram personality types to trading and offers area of focus for developing helpful traits. If you don't subscribe you can purchase the single issue for **$19.95.**

What is Involved in Peak Performance Trading?

by Van K. Tharp

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

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

If you have all of those things, then you have a chance of doing well. But this means that your business plan becomes a tool for you to continually use to improve yourself and your trading. All of these topics were covered in some detail in our teleconference on business planning, and you can now get that series on CDs—including some sample plans that I critiqued during the last session.

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

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

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

So get started this week with just this one aspect of developing your business plan for trading or investing...start by writing out your vision.

A Healthy Psychological Profile is Needed for Successful Trading

By Van Tharp

Excerpted from Van Tharp's Peak Performance Home Study Course

Many mental health professionals define an "uncertain" condition as being stressful. Uncertainty occurs because of too much information or because of too little capacity. The very fact that we cannot deal with available information is stressful.

Available trading information far exceeds one's capacity for making basic trading decisions, so one can only attend to some of this data. Limited capacity is a major factor in trading success and in understanding stress.

Three factors are **essential** to **successful trading**:

1. a healthy psychological profile,
2. the ability to make accurate decisions from a large amount of information, and
3. money management and discipline.

A weakness in any of these areas reduces one's capacity for processing information, resulting in stress, poor trading decisions, and losses. Losses, in turn, can produce stress, resulting in more losses. Readers who have taken the Investment Psychology Inventory Profile™ may recall that their test results were split into these three major areas.

A Healthy Psychological Profile

A healthy psychological profile might easily encompass all aspects of trading. However, certain psychological characteristics appear distinct from decision making and money management.

Everyone has a different set of past experiences. As a result of those experiences, one develops certain attitudes toward life. These attitudes may be open or restrictive. Open attitudes produce growth, encompass change readily, orient people toward self-improvement, and produce happiness and success. The successful trader, for example, might describe himself as follows:

I enjoy life to the fullest. I am constantly exploring new ideas, visiting new places, experiencing change, and having fun. I try to get everything I can out of life, and I eagerly look forward to each day.

I am in the best of health because I eat proper foods, get plenty of exercise, and sleep well. I am never overly stressed because I do not feel pressure—only challenge.

Although an open attitude is not essential to trading success, most successful traders are quite open. An open attitude will help a trader in the market because it enhances information processing capacity. Although the successful trader still has a limited capacity, his attitudes toward life keep his capacity at the highest possible level.

The losing trader, by contrast, often has a closed attitude toward life. Part of this closed attitude includes a number of defense mechanisms against winning, such as the fear of success or the fear of failure. Any form of defensiveness results in isolation, building protective walls, and resisting change. Consider the following statements that a losing trader might use to describe himself:

I am really unlucky. Every time I try to trade, something goes wrong. I end up losing. Other people make it impossible for little guys like me to be a winner. Perhaps that is why I am so depressed all the time. Money sure has been my downfall.

Trading is very stressful to me, perhaps because I worry about what will happen all the time. But I also worry about what will happen if I get out of the markets. I'll probably never be able to get ahead in life.

The losing trader has closed himself off from the world. Some information still gets through, but it is all darkly colored by his restrictive attitude. His closed mind severely restricts his capacity for dealing with information, and he feels "stressed."

This is only a brief introduction to this concept. To learn more about the relationship between stress and capacity, and how this relationship affects you as a trader, refer to Chapter V in Volume Two of the Peak Performance Home Study Course for more.

Want to learn more of the above? Get your hands on the following books: