CHAPTER 1

The Market Is What You Think It Is

There Is No Reality, There Is Only Perception

Words are things, and a small drop of ink
Falling like dew upon a thought, produces
That which makes thousands, perhaps millions,
think.

—Lord Byron

GOAL

To understand how the markets really work and why the majority of market participants consistently lose money.

A number of years ago I attended a meeting in Boulder, Colorado, with a newly arrived swami from India. Muktananda proved to be a most interesting fellow. He gave no lectures; he only told stories and wove those stories into an instructional format. Accompanying him was an interpreter, complete with saffron-colored robes, from the University of Colorado. Muktananda maintained that not being fluent in English was a great advantage to becoming a guru in America. He started his lecture with the following story.

There was a student in India who wanted to become enlightened. He left his family in search of an appropriate guru to guide him further on his journey. Stopping at one guru's place of business, he inquired as to this guru's method of becoming enlightened. The guru said, "Becoming enlightened is really quite simple. All you need to do is to go home each night and sit in front of a mirror for 30 minutes asking yourself the same question over and over. That question is: Who am I? Who am I? Who am I?"

The prospective student replied, "Hey, it can't be that simple."

"Oh yes, it is just that simple," replied the guru, "but there are several other gurus on this street."

"Thank you very much," said the student, "I think I will inquire down the way."

[Today we call this action seeking a second opinion.]

So the student approached the next guru with the same question. "How do I become enlightened?"

The second guru replied, "Oh, it is quite difficult and takes much time. Actually, one must join with like-minded others in an ashram and do Sava. Sava *means 'selfless service,' so you work without pay."*

The student was excited; this guru's philosophy was more consistent with his own preconceived view of enlightenment. He always had heard it was difficult. The guru told the student that the only job open at the ashram was cleaning out the cow stalls. If the student were really serious about becoming enlightened, the guru would allow him to shovel all the dung and be responsible for keeping the cow stalls clean. The student accepted the job, feeling confident that he must be on the right path.

After five long years of shoveling cow dung and keeping the stalls clean, the student was becoming discouraged and impatient about enlightenment. He approached the guru and said, "Honored teacher, I have faithfully served you for five years cleaning up the dirtiest part of your ashram. I have never missed a day and have never complained once. Do you think it might be time for me to become enlightened?"

The guru answered, "Why yes, I believe you are now ready. Here is what you do. You go home each night and look at yourself in the mirror for 30 minutes, asking yourself the same question over and over again. That question is: Who am I? Who am I? Who am I?"

The very surprised student said, "Pardon me, honored one, but that is what the other guru down the street told me five years ago."

"Well, he was right," responded the guru.

"Then why have I shoveled cow dung for five years?" asked the student.

"Because you are stupid, that's why," replied the guru.

I think of that story quite often while working with traders. One of the first problems I encounter is convincing traders that making profits in trading is really quite simple—notice, I did not say *easy*. There is a world of difference between a concept's being simple and being easy to carry out.

Looking at yourself in the mirror for 30 minutes each night is a simple concept, but asking yourself the same question over and over again and seeking an honest answer is not easy. As a psychologist I have found that we humans have two innate tendencies: (1) We tend to *overcomplicate* everything we touch and, because of that, (2) we cannot see the obvious.

To most traders and investors, the market is a dangerous and undependable animal. Their mottoes are: "Don't count on it" and "Get it before it gets you." They see the market as a dog-eat-dog world where other traders/investors are the dogs. This is not an accurate picture of the markets.

THE SIMPLICITY OF *ALL* MARKETS

The markets are not mysterious and unfathomable. The primary purpose of any market is to ration, at a reasonable price, existing and future supply to those who want it the most. You trade almost every minute of your life. Profiting in the markets is much easier when you really understand the underlying structure. To keep it as simple as possible, take the Flintstones as an example. You remember Fred Flintstone, a rather rough and outdoors kind of guy, and his more domestic next-door neighbor, Barney? Fred sees himself as a macho he-man who likes to hunt dinosaurs. One day he goes out and kills a big something-a-saurus even though his freezer is already full of dinosaur burgers. Barney does not enjoy hunting and killing but he likes eating dinosaur Whoppers®. Barney prefers to sit around his backyard whittling wood and making clubs. Fred rarely takes time to make his own clubs.

Fred wanders over to Barney's backyard and gets an idea. Why not swap Barney a couple of platters of dinosaur burgers for that new club he is finishing. So he puts this proposition to Barney: "Barney, I'll give you two platters of dinosaur Whoppers for that new club. How 'bout it?" Barney says, "Okay, you got a deal."

Fred and Barney have just created a market. *It is just that simple!* Both Fred and Barney valued what they wanted more than what they had. To Barney the burgers were more important (valuable) than the club he was making, and to Fred the club was more valuable than the burgers.

All Markets are Created When Two or More People Have an Equal Disagreement on Value and an Agreement on Price

When you bought your last car, the car was worth more to you than the money used to pay for it. However, to the person who sold you the car, your money was more valuable than the car. You created a miniature market when you made your deal. We buy bonds when we would rather own the bonds than the money we are paying for the bonds. Our fantasy (trading is a fantasy game; more about this later in the introduction) is that the value of the bonds will go up relative to the dollar. We bought them from some unknown trader who was just as confident that their value was going to go down. We have a real disagreement on current and future value, but we agree on price.

Every market in the world is designed to ration or distribute a limited amount of something (whether it be stocks, agricultural products, currencies, dinosaur clubs, or whatever) to those who want it most. The market does this by finding and defining the *exact price* where, at that moment, there is an *absolute balance between the power of those who want to buy and those who want to sell.*

The stock, commodity, bond, currency, and option markets all find that place of balance very quickly whether they are using open outcry or computer balancing. The markets find this place before you and I can detect any imbalance and before even the traders on the floor become aware of any imbalance. If the preceding scenario is true—and it is—then we can come to some very simple and very important conclusions about information that is distributed through the market and accepted without question.

WE PROMISE YOU THE TRUTH AND SOMETIMES IT IS NOT PRETTY!

You can break the cycle of failure by recognizing the things that cause failure. This book not only shows you *why* most traders lose money; it also introduces you to the latest findings in physics and psychology as they apply to the various markets and to your thinking patterns.

You probably dream about what every other investor/traders desires, which is success in the markets. However, when you trade, you come away with fewer goodies than you had counted on.

Profitunity is here to change all of that. Perhaps the Profitunity approach is the cure that you had dreamed of and prayed for, and wondered why someone has not figured it out. The approach taught here is all you will need to stop forever the endless cycle of trading and losing. This approach can completely change your trading future in a way that may seem extreme. It will do it by eliminating errors in thinking from your game plan and replacing these errors with something that works. Here are some basic fundamental truths that you must understand to become a consistent winner. We call them the five sacred Cows Terminators.

Trading becomes perplexing when you think about all the different stocks and commodities, the electronic retrieval systems, the fast execution of your orders, and the second-by-second monitoring of the markets and still, fewer than 10 traders out of 100 are consistently successful over time. That is simply unacceptable. This 90+ percent failure rate represents the concrete boots that keep you anchored at the bottom of the ocean of money promised by trading gurus. You, most likely, are drowning in a sea of broker or advisor promises.

Now let us clear our minds and expel the old ideas about life and trading as you begin to use your Five Sacred-Cow Terminators. These may appear to be strange at first but will make more sense as you progress. Remember trading does not work for most of those who trade. There must be something better and there is! So we get rid of five common ideas that are promoted as truth but simply do not work and will drag you under in your search for profits. Our first job is to eliminate these Five Sacred Cows from our minds and our trading.

Sacred-Cow Terminator #1: Don't Listen to the Popular Experts

Remember that financial writers know as little as and perhaps even less than you do about the markets. They are paid by the word and not by truth. As stated earlier, if they really understood the markets, they could make many times more money trading than they do writing about trading.

Ask yourself a question: Why do none of these analysts and commentators ever show their personal trading track records? Could it be because they are not personally able to make profits in the markets? If they were good at trading, they probably would be eager to tell you how much profit they are making.

Crazy, huh? If years of platitudes from dead traders who buried their secrets with them, other catch phrases, and hype have led 90+ percent of you to fail, then what you have listened to has aided in your failure. You must decide to do something different or continue to make it worse.

Sacred-Cow Terminator #2: There Is No Such Thing as Bullish/Bearish Consensus

Oh, yes, they tout that on TV and in every financial newspaper and even your broker may share this misinformation with you. However, let us examine if there could be such a thing as bullish and bearish consensus. If the markets are doing their job (and they do it well), their primary job is to make sure there is *no* bearish or bullishness in the markets. Those who tout the bull-bear information get it by surveying a group of traders and asking their opinions about the market. They survey those who are *not* in the market at the moment because those who are in have voted their preference and their vote is already in the markets. If, for example, they report a 75 percent bullish consensus in bonds, all that means is they have not surveyed all the bears. The markets cannot endure even 50.01 percent bullishness before the price rises. Remember that the market's primary job is *to instantly find that exact place where there is an equal disagreement on value and an agreement on price.*

Sacred-Cow Terminator #3: There Is No Such Thing as Oversold/Overbought

If there is no such thing as bullish or bearish consensus, then it logically follows that there cannot be any such thing as an oversold or overbought condition, even though analysts talk about it all day on CNBC-FNN and have an oscillator that supposedly measures it. How can it be measured when the markets are specifically designed to destroy any oversold or overbought situations in microseconds, well before the traders see it on their screens and days before they start talking about it?

Sacred-Cow Terminator #4: Most Money Management Suggestions Are Ineffective

You do not read much about money management without running into someone's ineffective ideas such as "Whenever you buy a bond, immediately put in a $500 stop." Sometimes they say things like "Always use a 25 percent trailing stop" to maximize your profits. Think about this concept for a moment. When you follow that advice, you are trading only your bank account or your wallet, neither of which has one iota to do with the actual market movements. Most of us have had the experience of using a wallet stop, only to see the market turn around and leave us with a much smaller equity than we would have had if we had traded market movement. That kind of protective thinking comes directly from fear, and in the markets, fear never wins in the overall picture. Our only hope for consistent profits is to get in synch with the market and attune our own personal strategy and energy to that of the market.

Sacred-Cow Terminator #5: Common Formulas for Profitable Trading Do Not Work

Let us examine another common misconception among traders. Two often-repeated formulas for successful trading are (1) buy low and sell high and

(2) to make profits you must trade with the trend. Those two statements are absolutely incompatible. If you buy low or sell high, you are standing in the way of the trend, not following it. And if you follow the trend, you are not buying low or selling high. The Profitunity strategy is to know when to use either one of the two approaches. There are times when it is best to trade against the trend and other times when you want to go with the trend. The choice of which strategy to use is determined by the market itself. Mother Market always tells us exactly what we should do. And when we do not, the market will tell us where we went wrong and what we have to do to correct the error and get back into the profit-making mode.

UNDERSTANDING, ATTITUDE, SCIENCE, AND CHAOS

Making use of the Five Sacred-Cow Terminators lets us agree with Mark Twain who supposedly said, "I am less and less interested in what's so and more and more interested in not believing what's not so." As we start eliminating these misconceptions, we can begin to see the market as it really is. Trading becomes a more profitable occupation when it is based on reality rather than on someone else's imagination.

This necessity of understanding what the markets really are and how they work was expressed very eloquently by Warren Buffet, probably the best trader on the planet, when comparing trading the markets to a poker game: "If you are in a poker game for 20 minutes and you don't know who the patsy is—you are the patsy." In our words, if you are in a trade for 20 minutes and you do not know who the paymaster is, you are the paymaster. One purpose of this book is to make you patsyproof and keep you from being a paymaster in the markets you trade.

There *is* risk in the markets. There is risk in day-to-day living. There is enormous risk whenever you drive your car. On some highways, only inches separate your car from the cars speeding in the opposite direction. A swerve of only a few feet could bring a death-dealing head-on collision. Every time you take a short drive, you are literally risking your life. Yet you drive almost daily and remain suave about the danger. The reasons: you have gained *understanding* and *experience*.

As you gain understanding and experience in trading, the markets need be no more dangerous than the route of your Sunday drive. For safe driving, you must have a vehicle you are familiar with, the right tools in case repairs are needed, and the right attitude. This book is all about having the right understanding and the right attitude for using the right tools. We refer to it as "Attitools."

Science is concerned with producing the right understanding and tools for civilizations to prosper and advance in knowledge. Traditional science, which created automobiles, factories, air and space travel, computers, and many other advances, turns out to be impotent in two vital areas: (1) living systems and (2) turbulence. Classical physics can describe every nanosecond since the (assumed) big bang, but it cannot approach any explanation of blood running through the left ventricle of the heart, the turbulence in a white-water river, or the tasseling of corn. If the market is anything, it is living systems (humans) working in turbulence (the markets).

Physics in the 20th century will be remembered for three revolutionary developments: (1) relativity, (2) quantum mechanics, and (3) the science of chaos. Einstein left us with one constant—the speed of light. Quantum mechanics took that away. Now, the science of chaos is changing our entire worldview.

We developed a whole set of mathematics under the crippled logic of our evolving, developing brain. This logic leaves immense areas of our world undiscoverable and indescribable.

Recently a new look at the world, the science of chaos and nonlinear dynamics, has been emerging. Chaos is a particularly unfortunate name because chaos actually refers to a higher and different degree of order. To learn more about the science of chaos and its effect on our actions in the market see Chapter 3 in our first book, the previous edition of *Trading Chaos* (Wiley, 1994), and Chapter 2 in our second book, *New Trading Dimensions* (Wiley, 1998).

In summary we can say the current educational approach to trading is not effective in producing consistent profits for over 9 out of 10 traders. The old approach is simply not producing results in today's market. Throughout this book we will present the latest findings in the science of chaos and nonlinear dynamics and show how they can be used in defining and managing your trading and investing account. The result will be easier trading, less hassle, and more profitable outcomes.

MARKET IDEAS: FACTS OR OPINIONS

Ideas rule the market. However, two kinds of ideas affect the market: *facts* and *opinions*. And each one produces different kinds of effects.

A fact, as defined here, is something that affects every trader/investor on earth, regardless of what they are trading (stocks, commodities, options, bonds, etc.). Actually, there are relatively few facts. It is a fact that you are alive. Other facts include birth, death, gravity, electromagnetism, the earth, or the markets. Facts are things that *are*. They affect everyone whether in the market or not. For all practical purposes, they cannot be changed. You can eliminate facts (like destroying a building) and you can manipulate them (like making cars and airplanes) but you cannot change the facts themselves.

As an example, the dodo bird is no longer here. It is no longer a fact. The record that it was here is a fact, the bird is not. So a fact can be manipulated or eliminated but it cannot be changed.

However, the largest category that affects you and the markets are *opinions*, which is really the same as *beliefs*. Opinions are ideas about facts, and unlike facts they only affect some of the people some of the time. They are, however, very potent, because your opinions about the markets and their movements affect how you trade, what you do, and how you feel about your performance. Opinions are very different from facts in that they can be changed. As your opinions change, so do your experiences and results in the market.

What gets most traders in trouble is that they tend to confuse opinions with facts. They tend to treat their opinions as facts of the markets, instead of ideas about the facts. Typical opinions that some traders call facts are:

- Trading is a struggle.
- Winning is due to luck.
- I am powerless against the floor brokers.
- No one wins consistently.
- The markets are always scheming against me.
- It is a dog-eat-dog market.
- My broker hates me.

Let us extract the facts from these opinions.

- Trading is
- Winning is
- I am
- No one
- The markets are
- It is
- My broker

Those items are facts. Anything you add to them is an opinion. Opinions can be either positive or negative. Whatever they are will govern your experience in the markets. An opinion is like a set of filtered glasses through which you view the markets and trading. They only allow you to see things in a certain way. These glasses block out any incoming information (chaos) that does not agree with your opinions. Instead of reacting to the incoming information, your opinions guide and limit your responses and understanding. If opinions are working for you, that is great. However, if you are not happy with your results and your trading, it means that your glasses need adjusting. There is hope because opinions are not facts. You chose (at some level) the opinions you have and you do not have to keep them if you do not want to.

Where Did Your Opinions Originate?

It all starts at the beginning, your birth. From the first moment out of the womb you started experiencing life and you began to try to understand what was going on around you. You were not just a hunk of squirming flesh. You were much more aware than most people thought. Studies have shown that newborn infants only 60 seconds old were able to make imitations and responses to facial gestures of an adult. As you grow, you continue to try to make sense of this new world so you make choices or decisions about what your experience means. Once you make a tentative decision, you automatically look for confirmation that your decision makes sense, that it is "correct."

Your parents are most helpful in this regard. You watch them, their responses, hear their words, and use that data for making and confirming your decisions. You accept some of their responses and reject others. Some very interesting psychological studies concern children who are called "invulnerables." These are children raised in chaotic, schizophrenic, neurotic environments by psychopathic parents and siblings, and who seem not to be affected by the ideas and behavior of the rest of the family. They are not genetically or otherwise superior to those children who do succumb. They have just made different decisions about life and about themselves. As you grow, you continue to listen to relatives, playmates, and authoritative adults, and continue to make decisions.

Once you have made the decision that your particular interpretation of an experience is correct, you have given birth to an opinion. From that point on, you tend to channel any new incoming information (chaos) into that assumed format. You massage or distort the incoming information in amazingly creative ways so as not to see the actual facts themselves. Most of the decisions you make today about the markets are actually outgrowths of decisions you made about life as a child. They tend to be permanent throughout your life unless you change them.

Let us assume two traders buy the same stock or commodity and it moves drastically against them. One chooses to focus on the idea that it is a tragedy and he always makes the wrong decision and will probably go broke if he continues to trade. He confirms earlier decisions that the world is unpredictable and you have to be very, very careful because it truly is a dog-eat-dog world (market). The second trader tends to review the reasons for getting into the trade and reassesses the facts and indicators, realizing that he is capable of dealing with the markets and plans how not to get caught in the same situation again. The same raw experiences processed through two different sets of filters produce two completely individual sets of guidelines.

You are the source of your experience in the markets because your decisions about life color your thoughts, your imagination, your emotions, and your actions. Your attitude toward the markets is like a magnet for attracting good or bad trades. There is lots of profit in the market and the part that you experience is a result of your opinions about it.

Your Results Reflect Your Opinions about the Markets

For some, it is quite difficult to understand that you are the source of your success in the markets, especially in a society that tends to promote the idea that life is something that happens to you. But successful people are those who have the willingness to accept that they happen to the markets (life), not the other way around.

There is no other way around it. If you are failing in the markets, you are holding opinions that keep you from winning. If you have poor health, you are holding opinions that are keeping you from becoming well. What is in your life reflects what is in your mind. For a full scientific verification of this idea see Lynne McTaggart's new book *The Field—The Quest for the Secret Force of the Universe* (HarperCollins, 2002).

Here is a part of a belief system that was taken from a person we trained who realized that money was an aspect of her life that was just not working. By a process of questioning we found that her basic opinion about money was that

Money is time.

Then, of course the next step was to discover her basic opinion about time, which was

Time is limited.

These two opinions produced the following logical sequence in her biocomputer: Time is limited, and money is time, therefore, money is limited, therefore, no matter how hard I try or how much I learn, I will never have enough money.

Since we only act in accordance with our basic opinions about the markets (life), this lady was continually making choices in the market that would make a profit and follow that with other decisions that created losses. There was no system or approach in the world through which this person would come out a winner. There simply was no winning alternative in her databank. This story does have a happy ending because she was able to change her opinions about time and money, and she became a winner using the same entry and exit strategy that she had used all along that created consistent losing trades.

To show how different opinions can produce the same effect, here is another example. In this case it was a man who held the following three basic assumptions about life:

> *You always get what you deserve.*
> *I am a good person.*
> *Money is bad.*

which led to: I deserve what is good, and therefore, I do not deserve money.

This situation could have been humorous except it was ruining not only his life but also the lives of his wife and children. The same effects would probably have been produced if the second two beliefs were "I am a bad person" and "Money is good."

Remember that apples grow from apple seeds but the seeds do not *cause* the apples. What causes apples is the continuing urge toward fulfillment. And that continuing urge for fulfillment produces successful traders and investors.

SUMMARY

The markets are really quite simple. Quickly and efficiently, they find that point where there is *equal disagreement on value and agreement on price*. We illustrated that concept with the Flintstone market and the trade between Barney and Fred.

Two large problems still face any new trader. First, most traders (90 percent) are using the wrong logic maps. Second, there are no consistent, effective, currently available techniques for precisely aligning one's energy with that of the markets.

In Chapter 2 we examine the new science of chaos and nonlinear dynamics as it applies to trading and investing. We will see how we can use the insights from this newest of all sciences to improve our trading and investing prowess.