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My Story

As a college student I became interested in stocks. My college roommate, several years younger than I, had been brought up with the market, trained intensively and extensively by his father, an accomplished and extremely knowledgeable investor. My friend, John, convinced me to open an account at the local brokerage firm in Champaign, Illinois, our college town. Since John was under age, he could not open a brokerage account on his own, and so we stuck a deal: I would open the account, he would fund it, and he would teach me how to invest in stocks. His knowledge was impressive. We began trading gold mining stocks, John's favorite at the time. The year was 1968.

John was convinced that gold mining stocks were likely to go considerably higher. We bought 100 shares of Wright-Hargreaves Mines (WRT), a small Canadian gold mining firm listed on the American Stock Exchange. As I recall, the stock was trading at about $3 per share. In those days of low inflation, some stocks like WRT traded in sixteenth's of a point. Several times a week we'd venture down to the brokerage firm and, feeling important, we'd sit and watch the ticker tape like seasoned investors, breathlessly anticipating every tick. Even a gain of 3/16 was exciting!

From WRT, we expanded into mobile home stocks, electronics stocks, and the budding computer industry. We had some great successes and we had our share of failures as well. But it was the thrill of the game that was the most exciting aspect of the stock market. I wasn't making much money but I was learning a great deal.

John was and most likely still, a fabulous market technician. Although we parted company many years ago, the market lessons I learned from him will never be forgotten. His technical knowledge was vast and his perspective on market history was truly amazing. He devoured virtually everything he could read about the market.

The one major bit of knowledge I failed to acquire in my early trading days was that the most important market skills I would need, could not be learned from John, or for that matter, from anyone else. John was too busy wrestling with his own inner conflicts to help me with mine. He was too involved in understanding the reasons for his own psychological limitations to give me insight regarding mine. And while we both spent hundreds of hours researching market indicators and trends, we both knew that there was something lurking in the depths of our minds that was much more important than trends or indicators, much more valuable than trading systems or methods; much more dangerous than mere dollar losses, and much more potentially profitable than tips or inside information. Yet, we couldn't express our thoughts and feelings clearly enough to bring them to awareness.

I went off to pursue a career in clinical psychology and John continued his market work. After John graduated, we became roommates again and lived in Chicago with his older brother, who also shared an interest in the markets. Our apartment was crammed with market related materials; charts, graphs, books, reports, and Wall Street Journals. We were our own good work, long on research but short on psychology and self-awareness. We knew that the market work was good, but we weren't always able to follow our own good work. I found myself growing tired of stocks, blaming the market and not myself for my failures. I failed to realize that it was not the market that was wrong, but rather I was wrong. I began to look elsewhere for trading opportunities.

Will Eggs Hit the Moon?

One weekend, while reading *Barron's,* an advertisement for commodity futures trading attracted my attention. The ad, very clever and seductive, depicted a rocket ship on its way to the moon. Inside the rocket was a basket of eggs. A caption on the ad read: "Will Egg Futures Hit the Moon This Year?" The ad was rich in psychological and symbolic messages, so much so that it lured me into requesting more information. Lo and behold, several days later a fast-talking charismatic commodity broker called me. His sales technique was well-polished, but wasted on me, since I had only $1000 to my name.

Being very persistent and high-pressured, as brokers are apt to be, he called time and time again, until at last he had enticed me to open a futures trading account. My last few dollars went his way. I had no unrealistic expectations in spite of the promises. I expected, in fact, to lose what little money I had managed to scrape together.

By now you're probably sure you know the outcome of my story: a small loss, some margin calls, and a bigger loss. But you're wrong, for I was more fortunate—at least initially. Luck was on my side. Within several weeks, my friendly broker (let's call him Joe) phoned to tell me that my $1000 had turned into $3500. My original $1000 was being returned. I owed my good fortune to Joe and his knowledge of the egg futures market. Herein, my story gets even better. Within several months, the original investment grew to over $6000.

As the days passed, the profits swelled. The winners were many and large; the losers few and small. All the while, I knew nothing about the futures market (called the commodity market back then), but each day I received confirmation sheets in the mail—"We have today for your account and risk bought 5 Sep 69 Eggs. . . ." and the profits continued to grow. Winners continued to outnumber losers. The profits were rolling in. Joe and I were very happy. As far as I was concerned, the game was easy.

Joe had taken just a little time to explain to me how the game worked. He told me that the egg market was a weather market; that chickens were very sensitive to hot weather. "The hotter it gets the unhappier chickens get" explained Joe. "Then, when it gets too hot, they die," he added. "And when chickens die, there's fewer eggs. When there's fewer eggs, the price goes up. That, my little buddy, is what we call the law of supply and demand" he concluded.

Finding My Niche

The commodity market was just the right place for me. After all, I grew up in poverty, raised in the slums of Montreal, Canada, by parents who barely spoke English. My parents were concentration camp survivors, who knew well the meaning of persistence and refusal to quit even under the most adverse of conditions. While my parents couldn't provide me with material things, they did instill in me a high degree of motivation. I was quick to recognize an opportunity when I saw one. I witnessed my parents working hard all of their lives, waking at 4:00 AM and working until well after 10:00 PM to earn a meager living. I was determined not to go down the same path.

The commodity game soon pushed my studies in clinical psychology into the background. I visited the local library and checked out several books on the commodity markets. After some hours of study and a little creative thought, I developed a system. It was based on support and resistance. The books made it all look so easy with 20/20 hindsight; buy at support and sell at resistance. That's all there was to it! I gave it dry-run tests on several markets, and soon I was ready for the "acid test."

Buy Them Bellies

After some intensive chart analysis and study of lines on charts, I concluded that the day had come to double my money in pork bellies. I called Joe to place an order just before boarding a commuter train to downtown Chicago. I was on my way to the Merc, the Chicago Mercantile Exchange. I wanted to be there when the market made me rich.

Today, when I think back to that day, I can only wonder how I could have been so naive, so blind-sided, so jaded. I know well enough today, that such excessive self-confidence, the "King-Kong" feeling is a sure sign of trouble. "Joe," I said in a self-assured voice, "buy 15 Feb bellies on the open with a stop loss 10 points from limit down. Place an order to liquidate at limit up OCO." (I was proud to show off my market knowledge in such a professional way.)

Aghast, after regaining his composure he replied, "Jake, you don't want to trade the belly market, stick with eggs, we know the market, if you trade bellies you'll get creamed . . . besides that, you've never even traded before, don't buy 15 right off the bat!" I refused to listen to reason. "Just buy them bellies," I commanded. "But Jake, you don't know the market. You think that just by reading one book and having a system you'll profit. Believe me, it's not that easy, or I would have done it myself. Don't do it . . . You'll be sorry . . . OK, let's buy just a few bellies, not 15; or better yet let's open a second account with some money from this one. Then you can lose it slowly."

But his pleas fell on deaf and overconfident ears. I had allowed a larger percentage gain, none of which came from my own efforts, to get in the way of logic and good sense. "Joe, if you don't buy those bellies, I'll close my account. I know what I'm doing. I have a trading system. I know I can double the money today . . . so just put in those damn orders and I'll be down there in about an hour to watch the fun." He hesitated a bit, then replied: "OK, Jake, but you'll be sorry, very sorry."

I boarded the train from Chicago's northern suburbs to downtown. With a copy of *The Wall Street Journal* in hand and wearing my best pair of blue jeans, I sat and observed all the businessmen in suits. Everyone of them looked alike to me—unhappy, going nowhere in their humdrum jobs, void of excitement and potential. As for me, delusions of grandeur danced in my head. "What a dull life these people must lead," I said to myself as I glanced over the commodity section of the Journal. "No need for me to wear a suit. I'm making money in the market. All I need worry about is how to spend it. . . . What color should my Jaguar be?"

Before long, the train chugged its way into the Canal Street station and I boarded a taxi to the Chicago Mercantile Exchange. As I entered this realm of fast money and fast markets, I felt more at home. This was a game I understood . . . and it had been so easy to learn! I must be a natural at this; a born winner. My anticipation was beyond control. This game was so very easy, once you knew the ropes. It was almost boring, I thought.

I add here parenthetically that I had, by this time, lost every remnant of common sense, good sense, market sense, self sense, and logic. I had clearly entered a fantasy world that was being fed by my own delusional system, by my own wish fulfillment, and by my own mental masturbation. And I can tell you that I have never been back to that place since. The fate that awaited me was a classic case of what learning psychologists call *one trial learning*—an experience whose consequences are so intense, so extreme that the lesson is learned immediately and never forgotten.

It was only a quick elevator ride up to Joe's office and into the "boiler room." My sophistry continued all the way up the elevator. I knew that the market had already opened and half way expected a cheer to well up in the roomful of brokers as I made my grand entrance. But a distinctly different reception awaited me. I looked for Joe's smiling face but I didn't find it. In fact, Joe didn't look so good. "What's up, Joe," I quipped. "Not bellies," he answered as he handed me several order tickets showing where I had bought my bellies and where I had been sold out. In disbelief I looked at the tickets several times. I was out of most of my position at limit down, but I was unable to get filled on several contracts since the market was "locked" at limit down.

This was a new experience for me. I had no idea that a market could stop trading due to a lack of buyers. I was unable to sell my remaining bellies for two more days. Then, finally, when the market started trading again I sold out, glad to be out at the low price for the day. I called Joe for the damage report. The news was brief and devastating, but not unexpected; I had been wiped out on my very first trade!

The End and the Beginning

The story ends here. But it also begins here. For this was the real beginning of my commodity education. How much I made or lost was not the important thing. What was significant was the lesson itself. I was much more fortunate than many stock and commodity traders. For I, at least, had lost back only what I had made. There are countless others who daily lose much more than they can afford. And despite their charts, graphs, inside information, tips, systems, and news, their losses keep rising.

Having no speculative funds left, I fortunately had no choice but to stay out of the market. This was a blessing in disguise. In my thirst for knowledge and in my efforts to intellectualize the loss, I was driven to the writings of Bernard M. Baruch, Jesse Livermore, W. D. Gann, Burton Pugh, Arthur Cutten, and others. The resulting education was not in technique, which is very important, but in self-awareness. My experience did not indicate that my technique itself was at fault, but rather my attitude was at the base of this loss, as it is for virtually every loss. Had I traded only one contract, I might have had many other opportunities to prove the system, but the system did not get a valid test because of my personal shortcomings. By being overconfident, by fantasizing that I was a modern day Jesse Livermore, I became blind to the truth. By ignoring the basics of "know thyself," I became an instant loser. In the sense that we are all subject to emotion, we are all vulnerable to losses.

The painful lesson I had learned only needed to be learned once. It marked the beginning of my career as a serious futures trader and it marked the end of my days as a totally undisciplined trader. Today, more than 22 years after my painful experience, I am still struggling with issues of self-discipline, but the struggle becomes less difficult with each completed trade. The fight against emotion will never end. It will always haunt traders and it will always lurk in the background as a deteriorating influence. The best we can hope for is to limit its negative influences.

Systems and Traders

A trading system is an inanimate scheme that cannot win or lose. A car without a driver is only a shell consisting of metal and mechanical parts. It can go nowhere without a driver. It can only stand in one spot and look attractive. A car with a destructive driver becomes an instrument of death. It can be driven into a brick wall, and despite all its beauty and mechanical perfection, it has served no one well. However, in the hands of an experienced driver, a car can achieve unbelievable feats of speed and performance.

Trading systems are vehicles that must be piloted skillfully through the traffic and carefully through the curves and highways. The advanced computer hardware and software technology of the 1990s has given us powerful tools for finding and testing trading systems, signals, and timing indicators. But the effort is for naught unless the results can be applied in a disciplined and consistent fashion.

What follows in this book is about traders, not systems. Systems have no feelings, no emotions, and no faults. They are what they are. Traders can take good systems and turn them into outstanding results, acceptable results, or deplorable results. A good system in the hands of a fool is a worthless system. A mediocre system in the hands of a skilled practitioner is an excellent system.

Stock and futures trading depends more upon the ability of the trader or investor more than any other single variable. But none of this will do you any good unless you can recognize problems, evaluate potential solutions, and apply those solutions consistently. Not too many years ago, I had the good fortune to spend a few hours privately with W. Clement Stone, a man who, beginning with less than nothing in his childhood, managed to build one of the largest and most wealthy insurance empires in the world. In response to my queries about the secret of his success, Clem responded:

> in order to achieve success you need to see, think, and do . . . you need to let yourself see objectively the opportunities and problems which exist . . . you need to think about solutions or opportunities, but most important of all, you need to take action.

Without action, the possibility of positive change is extremely limited. There are few things in life that take care of themselves. Problems, if left to themselves, will most often go from bad to worse. Trading problems must first be recognized as problems. Potential solutions must then be evaluated, and finally, action must be taken.

The Need to Take Risk

Since the first days of recorded history, the urge or need to speculate has been a driving factor in the development of humankind. Although the cultural growth and technological advancement of civilizations have liberated us from the more crude forms of risk taking, many of us are still risk takers at heart, although we may not be willing to admit to it. In fact, many of us are not consciously aware of how risk-laden our lives really are. Risk is an inherent aspect of life. The primordial roots of what we today term "speculation" are found in prehistoric man's struggle against a multiplicity of foes—animal, human, and climatic.

Since the earliest days of recorded history, the farmer who has set seed in the ground or raised animals on the hoof has been constantly engaged in gambling on nature. Should he plant early? Will there be sufficient moisture to support a crop of corn? Will there be an early frost? Are prices now best for marketing his crop? Will there be demand for my animals? Will weight gains be slowed by extreme weather? Will disease strike my animals? And in more recent years, the producer has been plagued by questions such as: Will government actions adversely affect prices for my products? Will my banker lend me the money to support my operations? Will my bank fail? If they do, will I get my money back? How can international events affect prices? What's the economic outlook?

We often fail to realize the risk and uncertainty in our daily lives. In fact, we are by nature speculative beings. Living as we do in a world of constant change, instability, aggression, and uncertainty, we must be willing to accept the potentially ephemeral nature of our existence. To drive an automobile, fly in a plane, or even walk on the streets, we must be willing to speculate on the outcome of our actions and of those around us. Consider the menace of the drunk driver or the action of terrorists against planes. And with the growing threat of AIDS, even sexual activities have become more dangerous than ever before. Check into a hospital and the statistics show you have a considerable risk of infection, death, mismedication, and/or unnecessary treatment and misdiagnosis.

And some of us consciously seek an even higher degree of risk. Driven by a variety of needs—emotional, physical, and financial—some of us attempt to increase our personal wealth, knowing all the while that we are attempting to do so in a way that could jeopardize what we now possess. For many, the freely accepted challenge of the markets provides a high-risk game of financial life and death. For some, the markets offer a profession, providing steady and above-average income. For the very few, they are a mighty engine which can, with skill, be used to create vast wealth.

What are the motivating factors that drive individuals to speculate? What are the traits that differentiate successful speculators from those destined to failure? Are there, indeed, ways in which speculative performance can be improved? What, if any, are the psychological forces that underlie success or failure in the world of stocks and futures? Can the necessary and appropriate behaviors be learned? Is successful speculation more a product of the speculator than of the system he or she is employing? How can one determine his or her standing in the speculative world?

Inasmuch as my original training and profession were in the area of clinical psychology, it was not difficult for me to recognize the numerous emotional and psychological factors involved in the markets and in the mind of the trader. My experience as a futures trader, combined with my experience as a psychologist helped me recognize the existence of a very close relationship between speculation, success, and emotional stability.

After spending considerable time in the study of human behavior and personality, I was attracted, quite fortuitously, to the futures and stock markets. At first I saw little, if any, relationship between my profession as a clinical psychologist and my market hobby. As the days passed and my losses increased, I reached an awareness that changed not only my life, but my fortunes as well. Once I recognized the close relationship between these two seemingly diverse fields—psychology and trading—the road to personal and financial success was considerably easier to travel and better defined. Until then, I felt like most traders—a small and anxious child attempting to be heard above the loud voices of traders in the pit.

Traders, Investors, and Success

Regardless of education, background, intellectual ability, and effort, there are some individuals who are extremely successful in the markets. On the other hand, there are those who spend virtually every free moment studying the ups and downs of prices only to fail time and time again. I have personally known traders who had little or no understanding of the fundamentals behind price movements, but who, despite this seeming liability, have acquired considerable wealth through trading the markets. I have known traders who similarly had no understanding of the markets and who lost repeatedly. I have always been intrigued by what I perceived as an inverse relationship between intellectual ability and success in the markets. It seemed to me that the less intelligent traders I knew, were more consistently successful than those I knew, who were intellectually and analytically inclined. If this was indeed the case, then I was certainly interested in determining why.

What differentiates losers from winners? The question is not only intriguing, but also very valuable in the lessons it can teach us. Why did legendary speculators such as Livermore, Baruch, and Gann place such great emphasis on personal development, self-control, and emotional stability? Were these qualities the real reasons behind their success? Is it possible to be a market winner without thorough knowledge of the market? Is an education in the self more important than an education in market techniques, systems, or methods? What are the more valuable lessons a trader can learn? How can these lessons be learned and applied in a consistent, money-making fashion?

Invariably, there will be those one-time winners who strike it rich in the markets or in real estate ventures. But such successes by novices are few and far between. Lasting success in the market, or for that matter in any other venture, is most often a function of experience, insight, and self-discipline. While some individuals appear to come by these skills naturally, it is more likely that they acquire them through subtle and direct learning experiences, most of which occur in the formative childhood years. An individual who does not acquire these skills during childhood, is not locked in to a life of failure. The good news is that these skills can be acquired at virtually any time given appropriate learning and understanding.

Much has been said in support of the genetic argument for financial success. There are those who take refuge in deterministic ideas, claiming, for example, that certain ethnic groups or nationalities have a predisposition for success; that they control the markets; that they have inherited the ability to trade effectively, or that they are doomed to failure as a result of their ancestry. While it is true that genetic differences exist, it is also true that learning plays a very important part in the success equation. It is virtually impossible to separate the effects of heredity from those of the environment.

Hence the issue is primarily an academic one. Unfortunately, there are those who use the issue to rationalize their own failures or to explain away the successes of others. Taking solace in such excuses is a waste of effort as well as a psychological mechanism used to avoid dealing with reality. These issues will be discussed in considerable detail later on.

In addition to the abuse of genetic arguments as a rationalization for failure, some skeptics claim that speculation in stocks and/or futures is merely a form of legalized gambling, and this may very well be true in some cases. Although those who know both themselves, as well as the markets, there is virtually no relationship between gambling and speculation in stocks or futures. I will devote considerable attention later in this book to the gambling versus speculation controversy.

The Philosophers' Words

I'd venture to say that few of my readers will be familiar with the works and life of G. I. Gurdjieff or his fellow theosophist philosophers such as Ouspensky, Blavatsky, or C. W. Leadbetter. In fact, the theosophical school of philosophy is unfamiliar to even a vast majority of those with "higher" educations. This is likely so, because the teachings of theosophy are so basic that they threaten the psychological stability of all but the most well-developed minds. Many of the more popular philosophical movements have rejected theosophy for a variety of reasons, all of which are open to debate. Gurdjieff has been criticized as a charlatan and Blavatsky rejected as a fraud. Yet there are staunch supporters of theosophy who are well respected. It is certain that the conflicts will never be resolved.

My studies of Gurdjieff and Ouspensky have helped me discover many truths about myself and about life. I will share some of these with you later on. However, before beginning, I'd like to briefly mention one of the insights I achieved through my readings of Gurdjieff. The system which he proposed for achieving self knowledge was complex and difficult to accomplish. It required years of study, several under the direct supervision of the master himself. Once Gurdjieff was approached by a frustrated and dejected student who complained about the difficult physical and mental tasks which were part of his self-education. "Why must this work be so difficult?" asked the disgruntled student. Upon brief reflection, Gurdjieff replied confidently "so that your future will not be the same as your past". And I give the same answer to those who ask why they must work hard at self understanding in order to achieve lasting and consistent success in the markets. If you are pleased with your results, and if your market performance has been consistent, then you do not need to read any further. If, however, you feel that you can do better; that you are not achieving your full potential as a trader or as an investor; that you are missing some key ingredients in the formula or success; then you must read on.

What I've Seen and What I'm Doing about It

After years of watching traders defeat themselves, and after years of watching myself become my own instruments of destruction, I have learned that we alone are responsible for most of our failures and/or successes. I have been guilty of repetition in telling you that the self is the single most important variable in the equation for success. But by the time you have finished this book I will be guilty of even more repetition. Why? Because it is impossible to drive this point home as fully as necessary without repetition. Self is the most difficult thing to understand; more difficult than understanding the objective sciences and more difficult to understand than mathematics. Self is elusive, ever-changing and worst of all, defensive. Self consists of many selves. No person is always the same self. What prompts a trader to act in a particular way in one situation on a given day, may evoke an entirely different reaction in the same situation on another day. It is this seeming inconsistency which makes self so difficult to understand. In order to objectively evaluate virtually any situation, we must stand away from it and evaluate it with clarity and reasonable objectivity. It is difficult, at times impossible, to stand away from the self and evaluate it objectively.

The chapters that follow are, therefore, intended to provide a road map to the self. The Bible says "know thyself," and in this sense my writings are designed to be a chapter in the trader's bible to self-knowledge. Note that I have set only a modest goal. I seek to write only a chapter in the bible of self knowledge. I do so since I understand well the immense complexity and intricacy which constitutes self knowledge. If you can add to your library of self knowledge my chapter, then you will likely be that much closer to your goal. In knowing where you stand psychologically, you will know how to get where you want to be financially via the most direct and successful route.