

Introduction

Jim Kelvin was a retired cattle rancher from Texas. He had developed an interest in the futures market during the years when he would hedge his livestock at opportune prices. After he sold his ranching business, he began to experiment with a few small trades as a hobby.

Jim read everything he could find on futures trading. He studied all the technical models, read manual after manual on market analysis, attended seminars, and kept point and figure charts. In time, he felt he had a firm grasp on all the factors that make the market tick and began to look at trading as a serious vocation. He wasn't making money, but he thought he was just paying his dues as he learned the intricacies of his trading system.

One morning, Jim got up at 6:00, as he always did, and went to his study to turn on his quote monitors and prepare for the market's open. He picked up the *Wall Street Journal* to see what the bank traders and brokerage analysts were saying about the foreign exchange market. He had been watching the Japanese yen closely, because he felt the recent depth of coverage in the news would surely reveal some good trade opportunities. The U.S. dollar was expected to record new lows because of a slowing U.S. economy and consistently negative trade balances, forcing the yen and other currencies higher. All the foreign exchange related articles on his quote equipment news service were bullish for the yen.

A good friend and fellow trader called and commented on how the currencies should rally that day. Jim then checked the 24-day channel model and the 16- to 32-day moving average crossover model, two longer term technical indicators on which he frequently based his trading—both had been generating buy signals for some time.

Jim glanced over his charts and volume numbers and chewed on the end of a pencil. At the end of every day, he conducted a personal analysis of the market's structure and wrote down possible trades for the following day. Last night he had written "weakening yen—look for opportunity to sell." The yen had been in an upward trend for some time, but in recent weeks volume was drying up. Price was moving higher, but activity was decreasing and there had been no substantial moves to the up side in over a week.

He knew from his ranching days that less volume was significant. When he would auction off his livestock, the price would continue up until the last buyer had bought. When the auction was nearing its end, the bulk of the buyers would have dropped out because they had fulfilled their inventory requirement or the price was too high. When no one was left to buy, the auction was over.

He read his analysis again. Common market sense told him that the up auction in the yen was over. There were no more buyers. But what about all the fundamental and technical indicators?

"All these professionals can't be wrong," Jim said to himself. "I can't sell the yen."

The market was going to open in less than five minutes. Jim stared at his blank monitor for a moment, thinking about what his friend had said. He put his hand on the phone, but did not pick it up.

The yen opened higher, rose a few ticks, and then stalled. The floor traders were acting on the recent bullish sentiment, but the buyers that had driven the yen up for the past month were nowhere to be found. He just sat and watched his terminal. *It's going to break . . . I should sell*, he thought. The flashing green price on his quote screen began to drop as he sank deeper into his chair and indecision tightened its grip.

What happened? Jim Kelvin's decision-making process was jammed by the conflict between his own intuition and popular opinion. "How can the majority be wrong?"

The majority of people who trade futures don't make money. In fact, over 90 percent aren't successful enough to justify being in the market. If you trade with the majority, then you will fare only as well as the average, and the average market participant does not make money!

He was caught, like the goat that starves to death between two piles of hay, in the conflict of multiple sources of information indicating opposite conditions. Jim's common sense and firm understanding of the market's auction process told him the yen was weak and should have been sold, but he let himself become frozen by the power of the majority. All the fundamental

and technical indicators agreed—everyone was predicting the bull trend to continue.

The difference is relatively simple. Jim was basing his opinion on current market information—he was “listening” to the evolving market—while all the other sources were based on information that was history and no longer relevant to what the market was doing *in the present tense*.

What if a baseball catcher waited to see how fast a man stealing second could run or pondered how often he was successful before he threw the ball? There is no way the throw would be in time. A good catcher operates solely in the present tense. He feels when the steal is on and reacts immediately, just as an experienced trader feels the direction of the market and reacts immediately.

Similarly, if a linebacker waited until he could see what the offense was doing or tried to read the play by watching the scoreboard, he would never make the key tackle. He reads the offense by recognizing patterns learned from experience and by trusting his intuition—sensing the play. To wait is to miss the opportunity. If you wait until a market has committed itself in a direction, you are too late.

In *Mind Over Markets*, our goal is to teach you how to read the plays. In more concrete terms, you will learn how to identify the information generated by the market, understand its implications, and act on your knowledge. However, this is not a book about a trading system that works or does not work. The Market Profile is not a black box that dogmatically tells you when to buy and sell commodities. This is a book on learning. This is a book on observing and understanding the market.

Mind Over Markets is organized around the five basic steps in the learning process, roughly corresponding to the five stages of skill acquisition discussed in the book *Mind Over Machine*, by Hubert and Stuart Dreyfus.

To illustrate these stages, imagine a young man named David. He attends a concert at his college given by a well-known contemporary pianist. While listening to Beethoven’s haunting “Moonlight Sonata,” he is moved by the pure emotion expressed in the piece and decides he must learn to play the piano. The next day he arranges for his first lesson.

In the first few weeks, David learns to “recognize objective facts and features relevant to the skill and acquires rules for determining actions based on those facts and features.”¹ In other words, he reaches the first stage of

¹ Hubert Dreyfus and Stuart Dreyfus, *Mind Over Machine* (New York: The Free Press, 1986), pp. 21–36.

learning: *the novice*. He learns that the black ellipse with a stem is a note, and that a note placed on the bottom line of the treble staff is an E. He is shown where the E is on the keyboard and can then press the corresponding key to sound the note.

David can look at a sheet of music, and by reducing it into individual parts, he can find the right keys and play the song. Of course, this is a slow, painstaking process that forces listeners to use their imagination when trying to make out any semblance of melody.

After a month of lessons and regular practice, David becomes an *advanced beginner*. By playing a song over and over, he goes beyond the note-by-note struggle and begins to achieve some continuity of melody. Experience improves his performance. He still sees the song as a series of notes on a page, but begins to feel the flow that allows a recognizable song to emerge. David can play “Amazing Grace” so it actually sounds like “Amazing Grace” and not some array of notes in random rhythm.

As the years go by, David reaches the third level and becomes a *competent* pianist. Most musicians never pass this stage to become proficient or expert. He sees each song as a whole, a certain expression to be performed with a definite goal in mind. He still plays by reading the notes, but he achieves some degree of emotion and purpose in his playing.

An important distinction must be made here. David plays with the emotion of the written expression in the piece (crescendos and fortes, etc.), not with individual interpretation. He performs much like a machine that very accurately converts the musical score into a sonata or concerto.

This level of competency can lead to excellent performances, for most written music is thoroughly marked to show the composer’s emotion. These marks have literal meaning, such as quiet (*pianissimo*), or pronounced and sharp (*staccato*). David plays Bach’s “Prelude in E Minor” flawlessly at a recital and receives a standing ovation for his technical excellence.

However, David is still a person playing an instrument, much like a computer running a complicated flow chart. To advance to the next level, *proficiency*, he must transcend the physical notes on paper (the rules) and become deeply involved in the music.

To reach the fourth level and become proficient, David must learn the actual notes of a piece so well that he no longer has to think of them. The written work becomes a part of his mind, a holistic image, allowing him to interpret the music. This comes from experience—in life as well as hours of practice at the keyboard. The pianist must rely on his intuitive ability to express emotion through the piano, leaving behind the fact that the piece is

in E flat in 6/8 time. Therefore, if David is proficient, he will feel the emotion that Bach created and, drawing on his own emotions and experience, convey that emotion in his playing.

Music that surpasses the competent level goes beyond the auditory aesthetic and involves the listeners. Hearing a proficient musician is often a deeply moving experience, for passionate music arises from the emotion of the performer and strikes similar chords in the listener. This cannot be explained in rational terms, for one cannot teach the expression of true emotion. Only through experience and involvement can proficiency be reached.

The final stage is labeled by Dreyfus and Dreyfus as *expertise*. David has studied piano for many years and knows the instrument inside and out. When he plays, the piano becomes an extension of his body. It is as if the music comes straight from his mind, which in an important way it does. He no longer thinks of individual notes or any rules when his hands are on the keyboard.

An expert musician feels the melody, and the song lives as an expression of his feeling. The mechanical aspects are fully ingrained, leaving the brain to its wonderful powers of creation. Listening to an expert musician is like peering into his thoughts and feeling the weight of his sadness or the exhilaration of his joy. It is a mode of expression that transcends all rules and calculative rationality to become pure expression. Few people reach the expert level in any field.

This example was meant to introduce you to the basic levels of skill acquisition that we will attempt to take you through in learning to trade the futures market successfully. However, learning is a process that requires a great deal of time and effort, and learning to be an expert trader is no exception. The musician spends many hours of rote memorization and practice to develop experience and skill. Successful trading requires the same discipline and hard work.

Many perceive futures trading to be a glamorous, high-profit venture for those with the nerve to trade and that, through the purchase of mechanical systems and computer software, you can bypass the time and dedication it takes to succeed in other professions.

In reality, there are few glamorous professions. Some, like the music industry, reward the best quite impressively. It is easy for the naive music lover to glamorize performers like Burt Bacharach, Frank Sinatra, and Billy Joel. However, if we dig deep behind the sell-out stadium concerts and multiplatinum albums, the music business is not much different than any

other profession. For every Simon and Garfunkel there are literally millions of aspiring young musicians who spend endless hours of dedication and frustration learning and perfecting their profession. Even the established superstars spent uncounted days perfecting each song and their musical ability to achieve recognition.

Because of the difficulty of making it big, many musicians burn out. The process of becoming good enough to succeed brings with it the potential for failure, and the process of becoming an expert trader is just as difficult. The learning in this book goes beyond technical systems into areas of self-understanding that might reveal weakness in your abilities of self and market observation, discipline, and objectivity. Also, much of the information in this book differs from the accepted models of market analysis. Just as you will learn that the best trades fly in the face of the most recent market activity, the information in this book flies in the face of most current opinions and theories on trading and understanding the market.

Futures trading is not a glamorous or profitable experience for most of the people who attempt to trade. Futures trading is a profession, and it takes as much time and dedication to succeed as any other profession. You will start as a beginner, learning the objective basics about the Profile, then proceed through the stages toward the ultimate goal of any professional in any trade—becoming an expert.