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The Mental Game

At first you thought it was going to be easy. You read the hype and hoopla that day trading would bring you the sun, moon, and stars. You opened an online account and jumped into trading with both feet. You scored on the first few trades. It seemed too easy to be true: You bought a stock. It went up. You sold at a profit. What you didn't realize, however, was that in 1999 the market as a whole was up. As the old saying goes, "A rising tide raises all boats." In this case, the market's upward surge brought the majority of stocks with it.

Then came the downturn. The Nasdaq Composite, the highflier that had posted nearly an 86 percent gain in 1999, ended 2000 with a loss of more than 39 percent. The Standard & Poor's 500-stock cash index (S&Ps), the benchmark for individual stock and fund performance, declined 10 percent from the close of 1999 to the close of 2000.

Even on the last trading day of the year—December 29, 2000—the Nasdaq Composite index dropped 63 points or 2.5 percent to 2493. Cisco Systems Inc. (CSCO) and Microsoft Corporation (MSFT) led the way downward, with Cisco trading off $1^{3}/_{8}$ at $38^{3}/_{16}$ and Microsoft down $1^{5}/_{16}$ at $43^{1}/_{4}$. ("U.S. Tech Stocks Fall on Final Trading Day of Year 2000," Reuters, December 29, 2000.)

Blame the "tech wreck," or recession fears, or overzealous activity

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efforts by the Federal Reserve in 1999 to curb a runaway economy. Whatever the reason, the market was down. Period.

As all traders know, you can't ignore the facts. The price on the screen is as immutable as the fingerprints on your own hands. You can't change the price by an act of will any more than you can make time stand still. And the fact was (and is) the much-touted new millennium raised far more questions about the new economy than Wall Street had answers. The suffix ".com" no longer was a license to print money (or raise it from eager venture capitalists). "Flight to quality" meant out of Nasdaq and its dominant tech sector and into household names. Even a surprise rate cut early in 2001 by the Federal Reserve wasn't enough to jump-start the markets and keep them running positively.

As we write in first quarter 2001, the talk is of economic slowdown and the possibility of recession, with all eyes on Mr. Greenspan & Co. to bail us out. Markets and leading stocks continue to struggle. Traders who had ridden on the bulls' coattails are now nose-to-nose with the bear.

In the trading arena, a bear market is what separates the amateurs from the pros. Put another way, welcome to the trader's law of physics: What goes up must come down—often in gyrations and sometimes with ever-increasing volatility and for reasons that may confound you. The result can be panic and confusion. Fearful of losing money, the uninitiated cling to positions that move increasingly into the red—until they face a margin call on a deflated stock or the brokerage house yanks them out of a futures position.

Clearly, they have neglected the cardinal rule of trading: **Always protect against losses. Profits take care of themselves.**

In this book I will address not only the how-to's of technical analysis and trade execution, but, more important, the mental discipline that must be a part of every trade. You can never underestimate the mental side of trading, whether you're placing your first order through a broker or you've been trading successfully for years. Discipline is as much a part of my trading plan today as it was when I first walked onto the floor of the Chicago Mercantile Exchange 20 years ago.

It was a different world then. In 1981, stock index futures had not

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been launched as yet at the Chicago Mercantile Exchange, where I still trade today. I started out as a 22-year-old runner and clerk at the "Merc," an apprentice to Maury Kravitz, a major trader in those days at the exchange. After a few months, I became a broker, filling customer orders in the gold futures pit, a contract that is no longer traded in Chicago. Later, I traded for my own account and filled orders, since dual-trading was allowed at the Merc in those days.

It was a tough learning curve for me just as it was—and is—for every beginning trader. Your expectation is that you'll make money at this, because you want to make money. But don't be discouraged if you don't see any profit the first year. In fact, if you can just cover your cost of trading the first year, you should consider yourself a success. The most important lesson for you, particularly in the first year, is to learn how to take losses—quickly, with a clear head, and without panic. In my first year of trading, I was barely able to cover my costs. I had to take a job at night to support myself. I nearly gave up, I was so discouraged.

What I couldn't see then was that I was gaining a valuable education in the University of the Market that would serve me well over the years. Then, when a lucky out-trade (see Glossary) netted me a windfall of $57,000, I had ample capital for the first time. I headed to the hot new pit at the Merc—the S&P futures pit—and I never left. But I went to that market a wiser trader. I had withstood the test of the market. I had endured losses and kept my head when I made profit.

Today, I trade in the S&P pit on the floor of the Merc for an hour or two a day. Then, I trade or monitor my position at the screen at my Chicago-based trading firm, where I also run an educational and market commentary web site for traders, TeachTrade.com.

I've gone through a lot of change as a trader. But one thing that remains constant is the psychological side of trading. Trading is a mental game. The emotional and psychological aspects of trading can never be overlooked or underestimated. For one thing, there is the motivation of trading. (*Yeah*, you say to yourself, *it's money, right?*) Well, if it were only the money, then most of us would have found something else to do. If you doubt that, consider the failure rate of traders. In equities, those who try day trading last about six months. In futures,

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the average life span is about three months, although trading activity dwindles significantly in the latter two months.

The one thing I know about trading is that it's infectious. Once you've made a couple of trades and turned a profit, it gets into your blood. The most successful traders I've known live and breathe trading and the markets. The money is part of it, to be sure. But a bigger part is the adrenaline rush you get from the market. You can also tell this from the retail side of the trading business with average investors and speculators who trade through a broker. Many times beginning traders who try their hand at this will lose their capital, but they don't close their accounts. They leave a small amount to keep them open, and as soon as they get some more capital to trade, they try again.

Now, before you tell yourself that this won't happen to you, that you'll somehow beat the odds, remember that the success rate among traders is slim. The only way to improve your chances of survival—and there is no guarantee—is with education. That is the purpose of *The Day Trader's Course*.

Whether you trade stocks, futures, or even options, you must have a carefully executed plan. You shouldn't buy because you heard a tip at the health club or on television. Your trades ought to be the result of the execution of your plan. And if your trade goes against you, the next step is a reexamination of that plan to learn what went wrong and what you'll do differently next time.

The foundation of this plan is technical analysis, which will be addressed at length in later chapters. But the quality that must be developed and maintained—first, last, and always—is discipline. More than an analytical mind and the ability to make quick decisions, discipline is an attribute that will keep you in the trading game. Discipline allows you to make the best decisions based on the market conditions (not your ego, your need to make money, or your fear of loss). And discipline will allow you to execute your trades according to plan, including getting stopped out of a trade.

There are highs and lows in trading equivalent to those experienced in a competitive sporting event. When you're trading, it's the ultimate David versus Goliath situation, for it is truly you versus the market. Whether you're a one-lot trader or an institution swinging around

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1,000-contract positions, you are still in competition with the marketplace at large. When you place that trade, you are putting everything on the line—not only the money involved in that trade, but your research and analysis, your decision-making process, and your execution. You will face the ego challenge of knowing that, at least some of the time, you will be wrong.

Each time you trade, you are weighing the success and/or failure of your plan. And if you do have a profitable trade, the challenge then becomes even harder: You must not allow your ego to be clouded by your financial success so that you can't keep a clear sight on your plan. What you savor is not the money that you've made, but rather the fact that you've successfully executed your plan. If you don't think this kind of successful challenge is the primary motivating factor, ask anyone who has launched or built a business. Entrepreneurs will tell you that the payoff was not the money they made, but the fact that they were successful in conceiving, developing, and merchandising an idea. And, as in trading, it all started with a plan.

The first step in drafting that plan begins long before the market opens and you sit down to trade. It begins with your psychological preparedness. You couldn't launch yourself into trading without this kind of conditioning any more than you'd set out for a cross-country run without stretching exercises. When I discuss trading, I use a lot of sports analogies because of the parallels of intensity, physical and mental demands, ego control, risks, and rewards. For traders, this preparation is a daily routine that will be a personal ritual.

For me, that means an hour workout in my home gym or, when the weather is fair, an hour at the golf course chipping balls onto the green. Your choice of preparation may be jogging, meditation, yoga, tai-chi, or whatever. But there must be an activity—I prefer a physical one—that tells your mind, "Okay, it's time to get ready for trading. The rest of my life has to be put aside for now."

You can't trade effectively during times of personal problems, disruptions, or distractions. If something is weighing on your mind—whether it's an illness in the family or even a positive event such as buying a new house or the birth of a child—it can and will affect your trading. If you can't sufficiently clear your mind, you won't be able to

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apply unwavering concentration to your trading. Better just to do your homework for that day, watching the market, studying the charts and indicators, than to put your money on the line. If you decide to trade, reduce your trade size so that you have less at risk. Don't bemoan the big money you could have made; be glad you had the discipline to limit your exposure.

The backbone of mental discipline is to focus on the trade, not the money. This isn't easy for the novice or even the professional trader. In fact, professional traders face a special breed of mental demon, born of their own successes. I've wrestled with these demons on more than one occasion.

The problem comes when you know you can make money, and a good deal of it, by trading. You've had five-figure and six-figure days. So when the money pressure is on, you think you can work your magic in the market. Your focus shifts from making a good trade to making good money. The result is almost always disaster. As we'll discuss in Chapter 5, you have to trade what the market gives you, which will play a large role in your profit potential on any given day.

What occurs is usually something like this: You go into the market saying, "I'm going to make a lot of money today." Or maybe you say, "I *need* to make a lot of money today," either to make up for previous losses, to put a down payment on a bigger house, or to buy that boat/car/vacation property/whatever that you've always wanted.

Complicating this factor is that you know you've had big days in the past. But, if you examine them, those big days were the result of market opportunities that you reaped for large profits. Put another way, you successfully executed a plan that, coupled with market conditions that you analyzed properly, yielded a profit.

But if those market conditions do not exist—if the market is thin in terms of volume or participation, rangebound, or quiet—then you may be forcing trades that won't materialize. You'll trade too big or too frequently and risk too much. Instead of big profits, you may end up with the exact opposite.

Your goal is to develop a positive mental attitude and to have confidence in your ability to make good trades and to move quickly beyond the losing trades.

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Legends, Language, and Lore of Traders

As you trade, you will face your own personal demons. There is greed and its best friend, fear. And of course there is ego. Now, to trade you have to have a sense of confidence and the ability to make a decision, which may be the by-product of a good, healthy ego. But beware of letting your ego become so big that it clouds your judgment and skews your decision making.

Here's a case in point: In the early part of 1987, at the age of 30, I made $4.5 million trading my own money. I was trading with such size that all the order fillers came to me. I was used to trading big, and everybody in the pit knew it—and my ego liked that. The problem was, after the crash of October 1987, liquidity dried up considerably. As a result, I was trading too big for the market. In the end, I made about $100,000—before expenses—trading, and I had huge swings in profitability that year.

That's when I learned a valuable lesson about trading what the market gives you. I couldn't fling around hundreds of contracts just to satisfy my ego or because people in the pit expected that of me. I had to trade what suited both my own plan and the market conditions. After that, my trading was noticeably back on track.

In my career, I've seen so many talented young traders blow it because they lacked the discipline or the ability to take on risk. Either they took on too much risk and lost all their capital in one or a few trades, or they became the proverbial deer in the headlights when it came to risk. The underlying factor was they failed at the mental game of trading. The singular problem was a focus on the money and not on the trade. But admittedly, it's a tough lesson to become unemotional about money.

In my own experience there have been times when I've been up $17,000 and I'd like to make $3,000 more—just to have a nice round profit number of $20,000. So, I keep trading for the extra $3,000—even though the market may have quieted down and there are no longer that many opportunities to trade. When I'm on the floor, that

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absence of volume is palpable. When the market is busy, the S&P pit is packed with people—about 500 of them—all shouting, screaming, waving their arms, and gesturing wildly with their hands. When it's quiet, the noise level and activity are far less. And when it's dead . . . well, I've seen times when traders have tossed a nerf football around the pit they're so bored.

When the market conditions don't warrant—on their own—an objective reason to trade, it's better to quit for the day. Sticking around just to make some more money is not a good motivation. There have been times when, trying to make another $3,000, I lose the $17,000 I had in the first place.

Then there are the days when I'm down, say, $15,000. I'll stay in the pit to make it back, even though I know I should cut my losses, take a break, and regroup. The temptation, even after all these years, is to stay in the pit and keep trading to make it back—even though the market conditions aren't there. The problem is that by focusing on the money and losing sight of the trading conditions I am at a higher risk for further loss. What I'm trying to tell you candidly is that even after 20 years and much success, I still fight these demons. In fact, it's a bigger mistake for an experienced trader to think that he or she won't face them.

The best days happen when a trader is prepared and the market presents opportunities that can be capitalized upon. The more volatility, the more opportunity to make money. Day traders and short-term traders live on volatility. But when ranges are tight, volume is light, and the market is slow, it's not worth the time—or the risk—to trade. The opportunity just isn't there.

One of the signs of experience for a trader is to know when to trade . . . and when to wait. Overtrading, chasing the market, risk and reward out of balance—all of which we'll discuss in later chapters—are pitfalls that await every trader, no matter how experienced. There are simply days—and times—when it's best to sit on the sidelines. You study the market on days like that, keeping your mind in—but your money out. For example, you may find it's better to be on the sidelines the day before a Federal Reserve meeting—and the market

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is anticipating some kind of interest-rate action—and the morning of the day the Fed will make its announcement.

It may not be easy to make yourself sit on the sidelines. If you have a regular day job—with a salary, benefits, and the security that you'll be paid on Friday—it's not so difficult to take a day off. If you're sick or you take a personal day, you may be a little busier when you go back, going through the voice mail and sifting through the e-mail, or maybe putting in another hour or so to make a deadline. But you'll still get paid. When you don't trade, however, you don't have the chance to make money. For beginning traders, the temptation is to be in the market all the time. The more they trade, they tell themselves, the more money they'll make. But, as I outlined earlier, you must be in the market at the most opportune times. Because if the timing is wrong or your mental discipline isn't there, then you're faced with the possibility that the more you trade, the more you'll lose.

That's a harder lesson to grasp than you might think. For one thing, the lure of making money—big money—is very strong in trading. And those who are new to the game usually have the fever; they want to trade. I remember when I was starting out, and over the years I've trained many young traders in the pit. More recently, we've brought some aspiring young screen-traders into B&S Trading (for Borsellino and Sullivan), the day-to-day operation of which is overseen by my partner, Brad Sullivan, one of the most talented traders I've ever had the privilege to work with.

Over the years, I've met countless wanna-be traders. Too many of them end up being a casualty statistic because they underestimate what they're up against. It doesn't matter what your professional background is—you could be a doctor, a lawyer, a nuclear scientist—trading is an entirely different endeavor that requires a unique set of disciplines, techniques, and strategies that must be learned and employed to trade.

Here's an analogy that may prove to be helpful. When I learned to play golf, I was told that this was a "game of misses." No one—not even a pro—hits a perfect shot every time. But the difference between pros and the rest of us is that the pros' misses are slight compared with

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ours. In other words, they don't miss by as much. Trading is the same thing. No one trades perfectly. No one can pick the top and the bottom every time, or identify every move. But the professional traders, thanks to their experience, have fewer "market misses" than the novices. They know how to cut their losses, regroup for the next trade, and execute—without damaging their confidence and second-guessing their abilities in the process.

The other thing that many traders don't fully comprehend is that they are entering a competitive arena dominated by experienced traders, professionals, and institutions. It's like being a fish in a shark tank.

When you start trading, you will have losses. In fact, with the traders that I've sponsored and trained over the years, I never expected them to turn a profit the first year. The best outcome to anticipate for the first year is to cover expenses. We give a similar message on our web site, TeachTrade.com, telling traders not to expect to do more than cover expenses the first year. Expectations higher than this are an invitation to a fall.

Many people who go into trading have an entirely different perspective. They want to make money—lots of it. And they expect to make it tomorrow. Ironically, it's this kind of attitude that undercuts a trader's potential to make money. They're so focused on making money that they can't trade effectively.

Here are some examples that are representative of a lot of wannabes out there.

"Joe" is in the building trades, an occupation he now sees as limiting. He believes he can do more with his life and his intelligence in a different field. He wants to try his hand at full-time trading. He's been dabbling part-time, and he's managed to turn a modest profit. He has $5,000 to start trading, and he's ready to go into this full-time. The only problem for Joe is that once he quits his current day job, he won't have another source of income. He has a wife, who doesn't work outside the home, two small children, and a $1,500 monthly mortgage.

"Jane" is a 22-year-old with the "trading bug." She spent six months working as a clerk for minimum wages to learn the ropes of

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the market. Her family has given her $20,000 to start trading. But instead of keeping her monthly living expenses to a minimum, Jane rents an apartment in downtown Chicago. Her expenses of rent, food, and entertainment are $3,000 a month.

Both Joe and Jane are starting out with tremendous disadvantages by underestimating the learning curve. Their lifestyles and their lack of outside financial cushions demand that they make money their first year of trading. That means, from day one, they are going to focus on the money—and not on making trades. To start out with the premise that you *must* make money is potentially deadly.

To be a trader, you must take a different view of money—or more specifically the money in your account. It's not a profit, and it's not money to be spent. Rather, it's "raw material inventory." You can't trade without this inventory money any more than a paper mill could operate without pulp. If you deplete your inventory to pay your bills and finance your lifestyle, you will seriously hamper your potential as a trader. Moreover, you've increased the probability of becoming a casualty statistic.

Now let's take the case of "Bill," who has been trading on the side for three years. The first year, he gave back as much as he made trading. The second year he did a little better, and the third year he made a good profit. He has $25,000 to trade and a $15,000 nest egg that he vows he won't touch. Further, his wife works outside the home and has an ample salary to meet the family's financial obligations. Bill has reached the point in his life and in his career that he has to make a change. His trading is getting in the way of his day job. With his wife's blessing, Bill is going to quit his job and trade full-time.

Obviously, Bill is starting out against a far different backdrop than are Joe and Jane. He can scratch the first year—meaning no profit and no significant loss after expenses—and still do okay. Without that pressure to make money, Bill has the best likelihood actually to make money, at least compared to Joe and Jane. Put another way, think of the old saying, "Desperate people do desperate things." In trader's lingo, "Desperate traders take on too much risk and almost certainly blow up."

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Legends, Language, and Lore of Traders

Most traders have an innate respect for money. It's our raw material with which we make our living. And, of course, it's what pays our mortgages, feeds our families, and sends our kids to college.

When I have a bad day, I have a ritual that reminds me about the value of money. If I lose a few thousand, I go out and buy something—a new suit for myself, something my wife has had her eye on, or something for the kids. Then I look at that item (or items) I have just purchased. I tally up what I've spent. That brings home, in a tangible way, what money is. When you trade, sometimes you can become disassociated with the value of money. You're trying not to focus on the money, so it may seem like playing with poker chips. But while you don't focus on money, you can't lose respect for it.

I remember one of my early lessons about respect for money, taught to me by my mentor, Maury Kravitz. I was in my mid-20s and I had just had a big day—a six-figure day. Maury and I were out to breakfast.

When the check came, I grabbed it before Maury could. The total was $6. I gave the waitress $20 and told her, "Keep the change."

"Why did you do that?" Maury asked me.

"I had a big day. She works hard. So I figured I'd give her a big tip," I replied.

"Then why didn't you leave her $100? That would have really made her day," Maury said.

I was beginning to see his point. With a $6 bill, a 20 percent tip would have been $1.20! The $14 tip I gave the waitress was generous, but I was in danger of thinking that the money didn't mean anything.

"Just because you had a big day," Maury told me, "doesn't mean you can lose respect for money. Because when you're trading, you can lose money just as fast as you got it."

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Remember: the market, not the money. Think about making good trades, not about making money. Focus on the trading process. If that process is sound, the outcome will be a profit.

What goes on in your mind is a vital part of how you trade. For that reason, let's review what I call my Ten Commandments of Trading. If you follow them more often than not, you'll keep yourself on the path to trader heaven (which is, of course, buying low and selling high). Trader hell is when everything starts out so promising—and then it all blows up.

Commandment 1. *Trade for success, not for money.* Your motivation is the well-executed trade. We all want to do well and reap the financial rewards. But the goal is success itself. In the case of trading, this is the feeling of accomplishment that comes from a well-executed trade, based on technical research.

Commandment 2. *Be disciplined.* As I stated previously, the one quality that traders must possess above all others is discipline. The ability to master your mind, your body, and your emotions is the key to trading. You can have the best technical analysis available, but without discipline, it will be difficult—if not impossible—to execute trades consistently and profitably. Remember this: The disciplined trader—regardless of profit or loss—comes back to trade another day.

Commandment 3. *Know yourself.* Are you the kind of person who can handle risk, or do you break out in a cold sweat at the mere thought of risking something—such as your own capital? If the thought of putting money on the line makes you unable to sleep at night, then a diversified, low-risk stock and fixed income stock portfolio may be all you can handle when it comes to participation in the financial markets. But if you can handle risk in a disciplined fashion, then perhaps trading is for you. Remember, the key here is handling risk with discipline. Over the years, I've talked with countless people who think they would be naturals at trading because they love going to Las Vegas, and they can "really lay it on the line" when they're at the gaming table. If you want to gamble—go to Vegas. If you want to use discretionary capital to make well-executed trades based on technical analysis, then consider trading.

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Commandment 4. *Lose your ego.* The quickest way to end your career as a trader is to let your ego influence your decision making. And the more successful you are as a trader, the bigger the challenge this will be. You need to silence your ego in order to listen to the market, to follow what your technical analysis is indicating and not what you think *should* happen. When you can put yourself aside and bow to the whims of the market, then you will have a greater chance of success. But believing that you are successful because you possess a certain skill—or, more dangerously, to believe that you have mastered the market—is a path to almost certain ruin. At the same time, you cannot be so emotionally fragile that unprofitable trades shatter your confidence. When you trade, put your ego aside. Allow yourself to get out of losing positions quickly, even if that means the humbling experience of having the market prove you wrong. And when you're successful, never let it go to your head. This is often difficult for people who have been high achievers. They have to realize that part of the trading plan is dealing with a loss.

Commandment 5. *Understand that there's no such thing as hoping, wishing, or praying when it comes to the market.* The market goes up when there are more buyers than sellers, and it goes down when the opposite occurs. It doesn't, however, rise because you will it to do so, nor does it fall because you're short and you pray that it will go down. I've seen too many traders, staring panic-stricken at the computer screen, actually beg the market to move one way or another. The reason? They're stuck in a losing position and won't get out because they hope, wish, and pray that the market will turn around and go their way. The reality is on the screen. When the market hits your stop-loss level (the predetermined price at which you'll cut your losses), get out. Even if the market then turns around and rallies in your face, you should congratulate yourself for having discipline. If you have solid money-managment skills, you can have a loss and still keep trading.

Commandment 6. *Let your profits run and cut your losses quickly.* This goes with Commandment 5. Know your risk level, and, when you hit your stop-loss point, exit the trade. As we'll discuss in later chapters on execution, always trade with stops. When you have a

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small loss, get out. Then reevaluate the market and execute a new trade. At the same time, know how to let your profits run, but don't be greedy. If you trade using technical analysis, you'll determine your entry and exit points before you place the trade. Then when the signals are confirmed, you make the trade. When you hit the profit target, get out. You'll never go broke taking a profit. Don't get greedy and hang onto a profitable trade so long that the market turns against you suddenly and then you have a loser.

Commandment 7. *Know when to trade and when to wait.* As we discussed earlier, it is not practical or possible to trade every day, all day. You trade when your analysis, your system, and your strategy say that you have a buy or sell to execute. If the market doesn't have a clear direction, then wait on the sidelines until it does. Meanwhile, keep your mind on the market, but keep your money out of it.

Commandment 8. *Love your losers like you love your winners.* Maybe even more. Losing trades will be your best teachers. When you have a losing trade, it's because of some flaw in your analysis or your judgment. Or perhaps the market simply didn't do what you thought it would. Maybe you're trying to trade breakouts, and the market is rangebound. Or perhaps you were chasing the market, jumping on the uptrend too late when the market had already topped out. When you have a losing trade, something is out of sync with the market. Determine what went wrong—objectively; then adjust your thinking, if necessary, and enter the trade again.

Commandment 9. *After three losing trades in a row, take a break.* If you've just had three losing trades this is not the time to take on more risk, but rather to become extremely disciplined. Sit on the sidelines for a while. Watch the market. Clear your head. Reevaluate your strategy, and then put on another trade.

Consider the story of an S&P trader we profiled on TeachTrade.com who trades out of his home in the Smoky Mountains. On October 12, 1999, the trader recalls, he went long at the opening bell, only to have the market go against him—and keep going against him "until that uncle point was reached yet again, three losers in a row." The losses reached the point, the trader says, that he still doesn't want his wife to

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know! He took a break, drove to a quiet place, and thought about things—his life, his trading. Then he went back to trade the afternoon session, starting small and building back his confidence.

"By the end of the day, I had gotten it all back, and had a few dollars to the plus side," the trader recalls. "That day taught me that all the indicators, systems, books, videos, web sites, and advisers mean nothing unless you, yourself, are willing to apply them—and apply them on every trade, to every setup, to every entry, to every stop placement, and to every exit."

Commandment 10. *Observe the unbreakable rule.* As we all know, you can break a rule and get away with it once in a while. But one of these days, the rules will break you. *If you continually violate these Ten Commandments of Trading, you will eventually pay for it with your profits.* That's the unbreakable rule. If you have trouble with any of these Commandments, come back and read this one. Then read it again.

The goal of these Commandments is to help you keep your head in the game while your money is on the line. Just as the professional athlete—from the golfer to the football player—has rituals and exercises to prepare mentally and physically for the next game, so must traders condition themselves before the bell rings. Certainly, when I began trading there was the physical demand of standing—sometimes from bell to bell—in the trading pit, arms extended over my head until I thought my hands had turned into 100-pound weights. Physical fatigue is a big factor for many floor traders (and why the 40-something veterans like me are gladly trading upstairs at the screens).

But even at the screen, you need full concentration when you're in the market. For someone who has always been physically active—whether it was high school and college football or a workout at the gym today—I believe exercising my body keeps my mind sharp. That's why the first step in preparing to trade is to clear your mind of distractions. If your money is in the market, your brain had better be there, too. You can't be thinking, worrying, daydreaming, or obsessing about anything else.

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Next, have realistic expectations about your physical and mental limitations. Yes, when I was a young trader I stood in the pit from bell to bell, largely because I was filling orders for customers. But it is not realistic for *any* trader to expect to sit in front of a computer from 8 A.M. Central time (a half hour before the market opens) until 4 P.M. (45 minutes after equity index futures close) five days a week. You must take a break. Work smart. Concentrate your trading time during the first 90 to 120 minutes of trading, and then take a break. Regroup your thoughts. Do some more research, and then prepare anew for the final 90 to 120 minutes of trading.

Even when I was in the pit for the entire session in my early days, I saw that the best opportunities (and frankly the busiest times for customer orders) were from the open at 8:30 A.M. Central time until 10 A.M., and then again around 1:30 P.M. until the close. The rest of the time, I usually got chopped up in thin markets that lacked direction.

Know that you will have bad days. (Remember Commandment 8: You've got to love your losers like you love your winners.) You must be able to bounce back psychologically the next day (or the day after that) and look at the market and your trading plan with a fresh perspective. Here's what I mean: It's not constructive to say, "Yesterday I lost a lot of money. If I don't make a lot of money today I'm in trouble." (Or worse still, you could put the blame on "them"—other traders, institutions, arbitrageurs, major central banks, economic cartels, your computer, your software program, your parents, your spouse, your dog, the Fed, solar radiation, or your inner child.)

Just like you might be tempted to brag about your big trades, you have to own up to your bad trades. You can't go through life (or trading) blaming someone else for your mistakes. The better way to do this is to say, "[Expletive deleted], I really made some mistakes yesterday that cost me. But I've learned a few things. I had better start out slow today, make some profits, and then move on." Believe me, the latter is a far better mental attitude for success. You'll have a restless night, but in the morning you will be ready for the market to reopen. Then you'll be back in the game—and ready to fight.

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Sure, when you're going through the loss, it's very painful. But exiting a losing trade provides a tremendous amount of clarity and even relief in some cases. When you're out of that trade—it's over; that's as bad as it's going to get on that trade. It's not the end of the world if you lose money. It's only a problem if you let those losses eat at you and cloud your judgment.

Once your mind is ready to trade, it's time to focus on the market. In fact, your mental preparation and the study of your indicators and technical analysis, which we will address in depth later in the book, go hand in hand.

When I began trading, I would pore over price charts for an hour every morning, committing the prices on the paper to my memory. Today, my technical review time is compressed. For one thing, as a large, independent trader (or "local," as we're called) I am on the front lines of the market every day. I am literally a part of what appears on that chart. In addition, I employ the services of technicians who provide a synopsis of the market and indicators.

As we'll discuss in upcoming chapters, you cannot devise a trading plan—which governs every trade that you make—without first studying previous market patterns. Looking at such things as previous highs and lows, moving averages, and so forth will help you determine the type of market you're in—whether the stock you've been trading is stuck in a range or the futures market is setting up for a trend reversal.

While I focus on the S&P futures, this methodology of trading will work with any market, whether it's a stock, an equity index futures contract, or commodities. Or, as I'm fond of saying, a trader can trade anything that has enough liquidity and volume. If it has a price that moves, a trader can trade it!

One thing to bear in mind as you read this book: My goal is not to give you the holy grail of trading. First of all, there is no holy grail of trading—and if there were, nobody (including me) would sell it to you for a few dollars. Rather, my goal is to give you some guidance and support as you move along the learning curve of trading. These are the lessons that I, with 20 years' experience as a trader, had to master—and there are some that still challenge me. Let the experience of others help you to shorten your learning curve and offer sup-

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port when you face a difficulty. Remember, trading is a discipline that is honed.

But there is no substitute for your own hard work. It's your mental discipline that will determine your readiness to trade. It's your technical analysis and homework in the markets that will help you devise a plan. The good news is, you're not in this alone. The goal of this book—and the mission of my web site, TeachTrade.com—is to provide insights for traders from traders, like me.

And with that, let's begin.