

Introduction

Thomas Edison performed 2,999 experiments before he invented the electric light bulb—a fact reflective of his incredible perseverance in the face of defeat. Edison’s experience is an inspirational model for people from all walks of life but especially for traders who must learn to remain committed to their objectives in spite of repeated failures.

While a few traders are so-called naturals and from the start seem to thrive in the emotionally charged, high-risk activity of trading, most traders must work at learning psychologically sound ways of riding out the highs and lows and especially at learning how to persevere in the face of failure. My first trading book, *Trading to Win*, focuses on psychological strategies for successful trading. *Trading in the Zone* expands on these themes and represents three more years of experience in working with a variety of traders on issues ranging from portfolio size and strategy to traditional coaching issues pertaining to performance, motivation, and recovery from failure.

Having helped a number of traders to perform exceedingly well, I wanted to dig deeper in terms of finding additional ways to help traders achieve even greater levels of excellence. Through the use of risk management statistics, I was able to speed the process of identifying trading behaviors that needed tweaking or modification. By reviewing and

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recreating the positive mind-set of past positive trades on a daily basis, I was able to help other traders bolster their confidence in selecting and staying with specific trades and to mentally and emotionally enter the zone before the day started.

Although the basic principles of *Trading to Win* continue to influence my work with traders, in this book I also focus on ways of staying in the “zone”—that combination of positive mind-set, focused attention, and adherence to trading discipline that allows the best traders to keep on producing outstanding results day after day, year after year.

Over time it soon became apparent that the same principles outlined in *Trading to Win* could be applied to digging deeper for information, because it is the tradability of particular ideas that is important, not just understanding the company. By understanding the subtleties of price action, the nature of the market, macroeconomic factors, and the like, traders could be assisted in making the right choices.

As one fast-rising trader told me, “You can’t rest on your laurels. Yesterday doesn’t give me anything for today. The zone psychologically prepares you to focus. I have the ideas and know-how to do it. For me it is all psychological. It is execution and being focused. Following the discipline helps me to get into the zone. The zone is where you are disciplined and centered, and the trade is working. Once you have the judgment, research, and ideas, it is just confidence and risk-taking. The mental rehearsal gives me more confidence.”

Most traders believe that “getting into the zone” happens when you have “a hot streak.” I believe you can create the zone. The zone is a psychological state. It is when you are focused, disciplined, and fully engaged in the process at hand. Being “in the zone” doesn’t necessarily mean winning. However, trading in the zone will certainly increase your capacity to perform and succeed.

Ultimately, being in the zone is about self-control and focus, the ability to recover and sustain momentum. It means doing all the things you have trained to do so that regardless of your results, you can begin the next day with the same degree of energy and enthusiasm that you had today. Learning to trade in the zone is about shifting your frame of reference, defining a far-reaching objective, and then filling in the pieces in terms of what the objective requires.

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Trading is a complicated process due to the emotions triggered by the incredible volatility and unpredictability of the market and the roller-coaster ups and downs that are daily experienced by traders. There are emotional waves activated by wide swings of success and failure and by the impact these responses have on the way you continue to trade. It is easy to try to find ways of reducing the anxiety and even reducing the euphoria by disengaging from the process.

For the past eight years I have been working with top-notch Wall Street traders unearthing specific psychological issues that interfere with the trading process. These include resistance, fear of failure, defensive behavior, negative self-characterizations, and negative mind-sets that become self-fulfilling prophecies.

It is important to see how these issues keep you from using your talents, distract you from your strategy, and get you to trade too many stocks and sectors. Anxiety may lead to poor selections, picking hot names rather than good names, and hesitating and holding back.

For example, inexperienced traders may get attached to their own ideas or to stocks. They may get out of winning trades to get a quick profit, hold on to losing trades, and lose more money in losing trades than they make in winning trades. When a trade goes against them, it may set off a losing cycle where they can't separate from the trade, clear their thinking, and get back into the flow. This anxiety exacerbates the cycle and leads to more of the same errors. Anxiety leads to a tendency to hold while a stock drops until the trader is devastated and loses confidence. Better traders admit they are confused, fearful, or don't know. They ask for help or reduce the size of their positions until they are in the right mind-set to start winning. They realize the self-fulfilling prophecy that a losing mind-set creates.

To be most successful, traders must recognize the repetitive patterns in their behavior and the situations where there are opportunities to extend themselves, to extend their horizons, or to change their perspectives. Once a trader is out of the negative mind-set, he or she is better able to use information as well as to enter into the zone.

The best traders don't get attached to their stocks. They recognize that there are forces they cannot understand. Like Zen masters, they are able to be in the now and evaluate where they ought to be on

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the basis of where the stock is and where it is going. They don't let their own good or bad feelings or hopes or beliefs color their choices or decisions. They take a loss, clear their heads, center, and focus, and don't try to make it back in that same stock. They continually read the market rather than allowing feelings about the stocks to impinge on their trading. Traders need to contain those natural distortions that interfere with their capacity to see the reality of the market or the tape.

You need to develop a discipline based on understanding the way you personally are trading and playing the game. To trade in the zone, you need to learn the application of intelligence, communication skills, reading, and taking notes on what you are doing. Keep track of your scores, your trades, and ways of improving the elements of your game. The results will multiply dramatically. Face the truth and be honest with yourself. Recognize where you did stupid things or believed too much in your own ability. Recognize when you are not looking objectively at what you are doing.

Play your winning names. Stay with what has been working in the event you want to double up. Avoid stocks that don't move. Make rules that are personal and related to your trading style. Adherence to them will improve the quality of your game. Find a coach, a partner, or someone you trust who will keep you honest and on your game. Consider trading with a team whose joint profit and loss (P&L) can have value in providing a cushion and allowing you to trade bigger-sized positions, with the confidence that the group is behind you. Share fears, doubts, and mistakes so you don't spend too much energy covering them up. Get support from others. You need to be able to share your concerns and ask for help.

Most of this book is based on intensive training sessions with traders where I have focused on trading styles, trading problems, the psychological states to enter into to maximize trading, diversifying risk in personnel, and developing the profitability of selected traders on the team. This book represents an expansion of *Trading to Win* and explores more strategies for winning, more negative trading loops, and more applications to other trading instruments. It also examines more approaches to mastering the self through observation, review of the past, and modifying trading behavior to strengthen performance. The

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focus is on helping traders to do what they think they cannot and to discover new things about their trading.

Trading in the Zone can be read as a sequel to *Trading to Win* or on its own. Although I have sought to further develop some of the principles outlined in my previous book, I have also taken this opportunity to:

- Add a longer-term view to the trading strategies discussed.
- Examine more mistakes that traders can make.
- Review basic trading strategies and examine more complex strategies.
- Demonstrate additional ways to increase a trader's psychological edge.

This book has been written not only to assist the professional trader but also the ordinary amateur trader and day trader as well. Taking into account the increasing use of the Internet for trading, the applications in this book can be of assistance to the home trader who trades once or twice a week as well as the career trader doing it every day.

The relative ease of entry into day trading through Internet access to online brokerages, the easy access to stock market information, and the continuation of the biggest and longest bull market in history have set the stage for a lot of amateurs to get into trading. Amateur traders may get hooked on trading because of a few quick and easy wins, much as people get hooked on gambling. Random wins and losses create an inconsistent pattern of reinforcement that is habit forming. They then begin to focus attention on finding winning stocks rather than on learning the process. They are also likely to eventually lose because they become anxious and unable to behave as flexibly as the successful trader.

If you are a beginner, you need to get into the game by studying what you know and then systematically learning how to trade with fundamental information. Read information on the Internet. Find a mentor. Work as an assistant to a trader. Paper trade. Take courses. Know how to handle risk, loss, and stress. These activities are all parts of the trading experience.

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In my work with professional traders, I have consistently found that the most successful make most of their profit from 3 percent to 10 percent of their trades. Therefore, most of their trades are *not* making profit. Success is not about picking the right stocks. It is really about how well you do once you are in the trade. Good traders stay with winning trades. They keep adding to those positions. If one goes bad, they get out fast.

I am often asked how, as a psychiatrist, I became interested in the psychology of trading. The answer is simple. Psychology, along with trading techniques and money management, is one of the foundations of successful trading because of the emotional and stressful nature of trading itself. Even experienced traders find that their emotional responses can get in the way and interfere with implementation of their money management skills and strategies. My work with traders has focused on these issues.

For example, one trader, Dylan, bought 2,500 shares of a telecom stock and made \$15,000. If he had bought 7,500 shares he would have made more, but he wasn't that sure of the stock. I questioned whether he needed to do more work to increase his conviction and to trade at the level he wanted to trade. He was governed by his fear, held back, and hesitated to do what he needed. He was taking a chance instead of doing the work.

Therefore, my objective is to assist traders to change their behavior so as to increase their profitability. Part of this process is urging traders to be more analytical about themselves and what they are doing. Encouraging traders to participate in the process of discussion often requires cajoling, humor, and emotionality. I must get them to see how stuck they are in their mental and physical positions, encourage them to take bigger risks, and to think the impossible.

I am fundamentally concerned with helping traders to focus on ways of getting out of losing positions and expanding winning ones. As I see it, my principal function is to help teach traders to:

- Make decisions based on data-clear thinking.
- Define entry and exit points.
- Know when to get bigger.

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- Handle uncertainty and cope with emotional responses.
- Avoid trying to win back losses.
- Sustain momentum.
- Recover from breakdowns and break through barriers.

Real profitability comes from maximizing the profit in good trades, which requires preparation and visualization of anticipated moves that will be made in response to events.

The critical function of this book is to teach you how to consciously define a target and then trade in terms of it. By making a conscious commitment and then measuring your performance and tracking your behavior, you can be more in the game.

Most trading overemphasizes current positions. The master trader has a longer-term focus, a goal, and a strategy to reach that goal. Because of this, he or she is able to tolerate the pain of losing. This ability requires learning the meaning of trading with no ego—letting the trade happen and getting out of the way.

It takes time to “reframe” the thinking of the trader so that he is willing to commit to a trading target beyond his current capability or his past performance. It is not simply a matter of following a formula. The process requires engaging him in a dialogue where he is willing (sometimes in the presence of his peers) to verbalize his expanded goal and face his fear of being ridiculed by the group. He must admit to the trading errors he has made that day and face the shame in the presence of others (including perhaps his boss). This process is softened by having others, including his boss, also admit to mistakes and old habits that were difficult to break.

In my work with traders I have learned to discover who a person is and what she needs to work on in her personality by watching her trade or listening to her report of her trading. I am always looking for the point of vulnerability or the stopping point where the most change can occur—the point where the trader stops out of fear or habit and where she has the chance, if shown, to enter into the arena of uncertainty and can trade past her own expectations.

By understanding your emotions, how you approach and enact a trade, and what your thinking is, I can help you achieve your objectives.

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I will not tell you how or what to trade; I will teach you to understand your own anxiety and emotional responses to fluctuations in the market. I am not as concerned with your results as I am with helping you define a strategy consistent with your goal. When you develop such a goal-directed strategy, you will discover you can set and reach bigger objectives.

As one trader expressed it, “There is no better job in the world. I would take this over pro basketball, but you are your own enemy. You are the biggest obstacle to your success. You have to keep working on yourself all the time because your own psychology is ultimately the most limiting factor in the arena of trading.”

In order to teach you how to trade in the zone, I have used many examples of the right and wrong ways of handling certain situations. However, the names of traders and the companies traded have been disguised. My intention is not to explicitly comment about particular individuals or companies, but to help you see the necessity of examining your trades to see what works and what doesn't and to determine what you need to do to stay on target. This book is about raising levels of consciousness and developing the appropriate skills so that you, too, can trade in the zone.