TraderTom

Phantom of the Pits
Abridged Version with Comments

By Tom Hougaard

Phantom of the Pits is an outstanding book, filled with wisdom, buried under 10 feet of chit-chat and irrelevant information.

I have edited the book to its core, stripping out all the noise, and leaving you with a pure read of the greatest insight into the mind of a hugely successful trader.

Enjoy!

Phantom of the Pits

INTRODUCTION

I heard about Phantom of the Pits many years ago. It is an unusual book. It was never published. It is free to download from many websites, including mine.

The original version from 1997 is a 110-page mess. It is not an easy read at all. That is a shame, because it contains great nuggets of wisdom. The problem is that the nuggets are buried under 10 foot of irrelevance.

I wanted an abridged version, and here it is. By all means read the original book, but if you want a shortened version, edited by a trader who knows what is relevant and what is not relevant, then my version is the one to read.

THE ORIGINAL VERSION

The original version of the Phantom of the Pits was published as a “free of charge” book in 1997. It is written by Arthur L Simpson. The book is essentially a conversation between two traders, Arthur, and his anonymous friend The Phantom.

I have contacted Arthur on several occasions to get permission to publish the book. I also contacted Futures Talk for permission. I don’t think they knew what book I was talking about, and Arthur is not responding to my emails.

As I have no commercial interest in the book, I have taken a chance to publish it without permission. Considering the book can be downloaded from numerous websites (some even charge for it), I hope I am not breaking any laws. If I am, email me on hello@tradertom.com

MY VERSION

The original book has pages and pages of information which relates to trading 23 years ago. I am writing this in 2020, and I do not need to worry about “calling my broker” or “acquire accurate data”.

I am sure those were legitimate concerns 23 years ago. Today those problems are no longer an issue. We have lightning fast internet speed. We have accurate data. We have sophisticated trading platforms.

In short, we are a quarter of a century further down the on-line trading road than when the original book was written.

My version has stripped away all the fluff. It will give you a pure read of the book. I have included my own comments in places, where I feel clarification was needed or an example of how this particular wisdom has transformed my own trading.

Whenever I have made a comment to the chapters, I have written it in blue.

I am following the book chronologically, chapter by chapter. Whenever something needs emphasis, I have put it in bold. However, there are chapters that I have not commented on at all. I have only included the material that is relevant to the trading rules.

AN UNPOLISHED DIAMOND

I think this is one of the greatest books on trading ever. There is no technical analysis in the book. There are no trading strategies revealed.

So why is it so good?

It is good because trading is not about strategies. It is about mindset and money management.

This comes from a man who has stared at charts for 20 years. I know in my heart that trading success is not down to an ability to read a chart. Chart reading helps, of course, but you can quickly learn to read a chart.

Making money trading is about operating from a rule-based perspective, which serves to guarantee you are still playing the game many years from now.

There are two sections to the book.

Section one is the formal part of the book. The two traders, ALS and POP, begin to discuss questions from readers. This is where the book loses its momentum. I have not included much from those sections.

Let's get started.

PHANTOM'S GIFT

Most traders think the important element in success is knowledge. In my trading career I have found that correct knowledge and the ability to change behavior are the most important parts of successful trading.

Correct knowledge without behavior modification projects improper execution of an otherwise perfect trading plan.

In three decades of learning correct trading knowledge and behavior modification, I have included in my trading plans two rules that present me with the ability to change my thinking and behavior.

Both rules are required for successful trading. Upon urging from a long-time trading friend, I shall share my insight on these rules.

Essentially you will learn to operate your trading business from the vantage point of two rules. The whole book is about these two rules.

Rule 1 will focus on how to take losses. Consider this before you read on. 90% of people who trade never make money. Maybe the percentage is higher, maybe it is a little lower, but whatever the percentage is, it is very high.

If you want to be a profitable trader, you need to learn what the 90% is doing. Once you have learned this, you need to train yourself into always doing the opposite of what the 90% is doing.

That is simple logic.

Rule 2 will focus on how to increase your position size when you are winning. In a game like trading, where you can expect to be right about 50% of the time, you need to make sure you make much more money when you are right, than you do when you are wrong.

Otherwise, you are merely playing to break even, or worse.

PHANTOM'S INSIGHT

In this chapter, Art Simpson talks about how he met Phantom of the Pits. It is not relevant for trading, but I have included a small part of it. It gives you an idea of the respect Arthur Simpson has for his friend.

It was almost 30 years ago that I had first met him. I didn't see him as a tall man until years later. Over the years he had grown taller than I had imagined possible -- not in height but in his confidence, his manner of thought, his gestures, his speech and all the characteristics you would expect of a hero.

I met him in the pits in Chicago on even ground. We were trading the same futures. I got the best of him that day but just one lesson he taught me by week's end showed that the market is more than a day!

YOUR BOOK

To reiterate the points, I made in "Phantom's Insights," the following chapters in "Phantom's Gift" are based on interviews with one of the most important and best traders I have ever known.

His purpose in agreeing to these interviews is to help those who have the ability and desire to become the best traders they can possibly be. There is no claim to fame, so to speak, but only the honest effort to bring to other traders the insight of a very difficult business of trading for a living.

Art Simpson (ALS):

Phantom, why do we start this book without knowing who you are for others to admire and thank?

Phantom of the Pits (POP):

I remember being on a train after one of my first trading days and thinking about how I had doubled my account in that one day. I looked around and was so proud of what I had done, but not one person on the train knew or would even care if they did know.

At that point **my direction was self-driven in seeking out what was possible in trading.** I know more now than I knew then. The markets have humbled me as a trader more times than I wish to remember. It's always easier for an observer to put their finger on a problem than the one who is wrapped up in the situation.

That is who I am!

It has taken years to understand that being wrong is what trading is all about.

ALS:

To you, what is the most important aspect of trading?

POP:

Behavior modification, without doubt, is the key to trading success -- not only in how we think but also how we act in certain situations. We must adapt to changing situations over which we have no control. We must change the situations over which we do have control.

A LITTLE HISTORY

Every day there was this trader named Cindy who would make her office (*in the trading pit where POP traded*) one tier in front of mine. Each day she would wait until she was sure where the market was headed and position.

It happened that I was strong into taking profits on the 3rd wave of buying or selling. It apparently was her breakout indicator. She would always take my offer below the last trade for selling, and before she carded it she would say, " I hate trading with you because I always lose when I take your trade."

I never forgot that statement she would make. **Losing never stopped her from staying with her plan** as she knew how to lose small and go with her program. I am sure she has made lots of money over the years.

I sort of felt bad when she would say what she said, but it started me thinking about losing. Her mind was set correctly in trading. Funny how little incidents shape our belief in trading -- some good and some bad.

It requires a balanced life to sustain the meanness of the markets. Traders never plan for the bad days, and there are bad days. Either change your behavior or go down in defeat.

ALS:

What must they learn?

POP:

Most important, they must learn that they don't have to make SELF-LEARNED mistakes. They are always better off to learn from OBSERVED MISTAKES.

It can be pretty costly to make mistakes in this business. You cannot really tell someone what to do, but often if you guide him or her, they will be more receptive to making the right decision.

ALS:

How do you differentiate between self-learned mistakes and observed mistakes?

POP:

Let us say you go to an eye doctor, and he asks you if you can see better out of lens A or lens B. You make a choice, and then he goes to the next step by asking you again if you can see better with lens C or D. This continues until you have the best lens criteria for your eyes.

Well, any mistake you make is a self-directed mistake, and it will hurt only you. No one can teach you not to make this self-learned mistake.

Now, if you tell the eye doctor you are blind in your left eye when he says cover your left eye and he then says cover your right eye, then you have an observed mistake. You wouldn't make that mistake, and because you were affected by that mistake, even though it wasn't your mistake, you will remember better.

It is better to learn from a mistake that affects you directly when it is made by someone else. You have to be mistake-aware in trading because there are so many lessons.

ALS:

I see. I mean, it is clear what you mean on mistakes. Learn from others' mistakes, and it is cheaper than learning from your own mistake?

POP:

I think you have it.

The truth is that the BEST LOSER is the long-term winner.

PREPARATION FOR TRADING

I find much of this chapter entirely irrelevant. I have included a few relevant points.

First, we must be prepared! It's a step everyone must go through to get to where traders want to be in trading. To prepare oneself for trading is just as important as any aspect. Without it, a trader does not have the foundation to continue in trading.

Where does a trader start to prepare to be a successful trader? Too many beginning traders -- and established traders as well -- take the easy route and expect the markets to be cut and dry of what is required of them in their trading careers. They will paper trade and have fairly good success.

This in no way prepares them for trading. They must be prepared in every way. That means mentally as well as physically and emotionally. Priorities must be in the proper place including family, friends and environments.

ALS:

We have our office with a chair and a clock. What's next?

POP:

You must establish a routine to set up the environment of each trading day. Allow at least one hour prior to the opening of your market. In this hour you should exercise from 10 to 20 minutes. This really does keep your mind sharper.

The next thing after your shower you should spend one or two minutes giving thanks to your higher power and explain what you are going to do with the funds you earn. Don't be selfish about it. This actually gives your subconscious a reason for being a successful trader.

ALS:

It all seems like a lot of work, and we have not started our learning process yet.

POP:

The most important person in your trading is yourself. Take care of the minor details early, and you will have your routine. It is more of a positive reinforcement of what you are expecting from trading.

RULE NUMBER 1

I am going to express the importance of doing the right thing from the beginning of a trade and at the right time. Many traders -- and most new traders -- aren't even aware the market can do what it did to them today.

I have often said the BIG money is on the surprise side. I should perhaps have said the BIG LOSERS are on the familiar side or the popular side of a trade. I call that the expected side.

I need to ask you a few questions to better present my Rule Number 1. When the walk light comes on, assume there is traffic that will run the red light at each intersection you cross. What do you do now before you cross the intersection?

ALS:

I would double-check and look both ways before crossing.

POP:

Of course, that is the correct answer -- you know what I am after. Now, just because you looked both ways before you crossed and each time you cross you looked both ways and each time there wasn't any traffic that ran the stop light, is there any reason to stop looking each time you cross the intersection? Your answer, of course, is no, you won't stop looking.

I don't want to lose you in this thinking but to point out that it's the same in trading as in crossing an intersection. We need to make our best assumption of what is possible. We must plan for that assumption in trading as long as it is a possibility and not just when it is probable. This is a very important point in understanding Rule Number 1 correctly!

If you were never to look at the intersection until proven wrong for not looking, wouldn't it be too late? It is the same in trading. You must protect yourself from any possibility in trading and not just protect yourself when the probabilities are high.

This will be the surprise side in trading. The surprise side is a possible outcome but not a very high or likely probability like today's grain trade. When someone gives you a gift, you are surprised by it.

Getting that gift was not a high probability. However, you are prepared for that surprise because you say, "Thank You!"

Most traders plan only for the probability side and that, to them, is always what they consider the winning side. This is the biggest mistake you can make in trading. Instead, you must plan for the losing side.

The correct way to control positions is to only hold them once they prove to be correct. Let the market tell you your position is proven correct, but never let the market tell you that your position is wrong. You, as a good trader, must always be in command of knowing and telling yourself when your position is bad.

The market will tell you when your position is a good one to hold. Most traders do the opposite of what is correct by removing positions only when proven wrong. Think about that. Your exposure and risk are much higher if you let the market prove you wrong instead of your actions removing positions systematically unless or until the market proves your position correct.

Let me give you an example before we state the first rule. Today let us say you sold beans just like your plan said to do at $6.30 on the open. If that position did not prove you correct, you must remove it to reduce your risk. You decide what is correct according to your plan.

Let us say you expected hedging to come in early and the price to drop from 5 to 8 cents in the first hour. It didn't even drop 3 cents, so you remove the position. Say you removed it at $6.29. Just because it showed a profit of 1 cent when you got out did not declare it a good position. However, your exit is a better exit than if you made the market tell you the position was wrong.

When you remove the position because the market proved you wrong, it is always a higher loss, and with stops it also is usually with higher slippage. This is not the same as removing the position because the market proved you wrong -- say, buying back at $6.45 on a $6.42 stop.

By making the market prove you correct in order to hold a position is acknowledging that trading is a losers' game and not a winners' game. If you only remove your position because the market proves you wrong, you are acknowledging that trading is a winners' game.

You never want to be in a position that is never proven correct. If you only get out when the market proves you wrong, it is possible to have higher risk due to the longer time period required to prove your position wrong. We will further clarify these thoughts for you further into the book.

Rule Number one:

In a losing game such as trading, we shall start against the majority and assume we are wrong until proven correct! (We do not assume we are correct until proven wrong.)

Positions established must be reduced and removed until or unless the market proves the position correct! (We allow the market to verify correct positions.)

It is important to understand that we are saying the one criterion for removing a position is because it has not been proven correct. We at no time use as criteria for removing a position the fact that the market proved the position incorrect.

There is a big difference here as to how we treat all positions from what most traders use. If the market does not prove the position correct, it is still possible the market has not proven the position wrong. If you wait until the market proves the position wrong, you are wasting time, money and effort in continuing to hope it is correct when it isn't.

How many traders ever hoped it wouldn't be proved wrong instead of hoping it was correct? If you are hoping it is correct, it obviously wasn't ever proven to be correct. Remove the position early if it doesn't prove correct. By waiting until a position is proved wrong, you are asking for more slippage as you will be in the same situation as everyone else getting the same message.

What makes this strategy more comfortable is that you must take action without exception if the market does not prove the position correct. Most traders do it the opposite by doing nothing unless they get stopped out, and then it isn't their decision to get out at all -- it is the market's decision to get you out.

<u>Your thinking should be:</u>

When your position is right, you have to do nothing instead of doing nothing when you are wrong!

I would like to interrupt the book and tell you about my interpretation of rule number 1. Rule number 1 goes to the heart of trading. You must keep your losses small.

However, that requires you are far more proactive in your management of your trades. It will mean having to make decisions based on an unknown variable called “The Future”.

It means learning to accept whatever outcome comes next. The whole premise of Phantom’s approach to trading can be summed up in a few words:

Be in control at all times.

You must never let the market be in control of you. Let me give you an example of what I mean.

I enter a short position in the Dow Jones Index at 29,061. I have a stop loss 75 points away.

After 45 minutes the position is 15 points on the wrong side. I am not stopped out, but the position is not exactly flying in my favour either.

My interpretation of Rule 1 is that I should consider closing the trade. I had expected to be right sooner, but I am not.

What makes closing the trade a mental challenge is that the stop loss has not been breached. I have another 60 points of leeway on the stop loss before I am closed out, so why not give the market a chance to prove me right?

I believe that Phantom is arguing that the best positions are those which are proving to be right immediately. By having a small losing trade open, which is going nowhere, we are draining our attention and our margin on such a position.

Rule no 1 tells me to address my relationship with “hope” and “fear”.

As traders we hope that the position will come good, which is why we do not close the trade. We also fear that if we close the trade before the stop loss is hit, we may witness the position come good after all, and we fear that we will miss out on a good trade.

As you can see, this has nothing to do with technical analysis.

THE REAL PATH TO PROFITS

Can I offer a different vantage point? Can I offer a different thought process to your trading conundrum?

I assume you want to make money. You want to be successful in trading. Only 5% of us are. Hold on to that thought for a moment.

I believe this to be true for all of us who trade:

1. We want to make money trading.
2. We know most people fail.
3. We know even really smart people fail.
4. We know trading success is not just about technical analysis and intelligence.

This doesn't solve the trading challenge, but at least we have the facts in front of us – in plain sight. What if we trained ourselves to always to the opposite of what the 95% are doing?

What are they doing? They are always doing what feels good to do. They drift down the path of least resistance.

I solved this challenge many years ago. I don't have a simple solution for you, BUT I have some simple logic for you.

You want to make money? Then you need to look around. Look at the 90%. Why do the 90% run their losses? Because it is easy to do.

Why do the 90% take their profit so soon? Because it is easy to do.

Why do the 90% bet more when they are losing? Because they are not in control of their emotion. They want their money back.

Why do the 90% bet less when they are winning? Because they are not in control of their emotion. They protect what they have made.

I observed the behaviour of thousands of traders in my career as a broker. It served as a foundation of what I didn't want to become.

Why don't you observe your own trading behaviour right now, and then multiply that by "the masses"? The thing you find hard to do is what everyone else is finding hard to do.

It is hard to do "it". The key word here is "it".

Very few will do "it". Very few are successful in trading.

By logic, do what is hard, and repeat "it" until it becomes second nature, and you are bound to be successful.

You will need to consistently do what the masses cannot do.

What is this "it"?

Well, that is what the whole book is about. "It" is doing the very things that is uncomfortable to do, because most people will not do what is uncomfortable.

As Charlie D says in another extraordinary trading book, "When you are a good trader, everything you do hurts. Everything feels uncomfortable."

Do you want me to give you examples?

I run a live trading channel. I have more than 5000 followers. I trade in front of people so they can see for themselves how it can be done.

I receive hundreds of emails every month asking me the same questions over and over. Here are 2 questions I get asked frequently.

<u>How do you grow your trading size?</u>

I cannot speak for others, but I can catalogue my own journey. I have discussed this in my book on trading psychology. I will keep the description short, and if you want more information, you should visit the "Resource" section of TraderTom.com and download my psychology book.

1. I started trading the size I was comfortable with.
2. I made plans to increase my trading size when I reached an account threshold.
3. I made the changes incremental, so as to not shock my brain.
4. I measured everything I could about my own performance.

In practical terms I traded £10 a point. I aspired to trade £100 a point. I went from £10 to £12. Then I got used to £12. I then went from £12 to £16, and I would get comfortable with £16.

The numbers are irrelevant. You can move at a quicker or slower pace. The important thing to remember is to walk before you sprint. Do not compare yourself to anyone. Perfect your game step by step.

When I got to £100, it felt like child's play. When I got to £100, my goals shifted. Now I wanted to trade £500 a point. Once you have the process under control, you simply go through the repetitive motions. Isn't that the hallmark of success?

Success is not what we do every now and again. It is what we do all the time.

<u>How do you hold on to winners?</u>

The 90% of traders, the losing traders, are great at holding on to losing trades. If they could hold on to winning trades the same way, they would be great traders.

When I am asked this question, I always ask back if they have problems holding on to winning trades under all circumstances or just under certain circumstances.

Without fail people will say they are good at holding on to winning trades when they are trading smaller sizes. However, when they try to scale up, they lose their objectivity.

Someone might be unable to trade calmly when they trade 10 contracts, but if they are trading 1 contract, they are cool as a cucumber. That should tell you something.

It should tell you to trade up to your limit. Only by keeping a vigilant eye on yourself and your emotions will you be able to track the progress. When POP writes about his success on a particular trading day, and then realizing on the train ride home, that no one cared about his success, all his motivation became self-driven.

In case you forgot, here is the passage again:

At that point my direction was self-driven in seeking out what was possible in trading. I know more now than I knew then. The markets have humbled me as a trader more times than I wish to remember. It's always easier for an observer to put their finger on a problem than the one who is wrapped up in the situation.

I think the following extract from the book validates my thinking on this matter.

POP:

Most traders keep their position until it proves to be wrong for them. I say do not keep any position unless it proves to be correct.

ALS:

Yes, but who is to say a position that was not proven correct turns from a bad position to a correct position?

POP:

That is the kind of thinking most traders have. They fear being wrong when they get out and that the market will show them, they should have stayed with the position. If they don't take early losses, it becomes more difficult to take a loss as it gets larger.

However, the market assumption you must make is that big losses will eventually take you out of trading.

My Rule Number 1 is to address the **swiftness** needed in keeping your losses as small and quick as possible. **It won't always prove to be correct, but you will stay in the game this way.**

Most traders don't know what their choices are when it comes to assumptions about what is possible in trading. Keep in mind that traders are usually unaware that trading is a losers' game. **He who loses best will win in the end!**

Why not make a time-proven decision to change your behavior to trade the method that gives you the best long-term outlook?

Trading is not gambling! Treat it as a business where you only want the best merchandise for the shortest possible time in order to have the maximum profit with the least possible chance of failure.

That is what Rule Number 1 does for you.

In trading most of you have a greater chance of being wrong than right! Trade accordingly. . which means expect the limit (being wrong more likely) in your trading. How can you come out ahead? In the short run, you can only with luck. But in the long run, luck tends to even back the other way.

You must trade in the long run!

So, what is a trader to do in a losing game? You must trade in the long run! How can you trade in the long run? Only way I know is that you must keep your losses small and take more small losses than small winners to come out ahead. This often means washing a position for the sake of being able to keep in the game.

The theorem now is to assume your position is wrong until the market proves what you positioned is correct. Keep your losses quick and small. Don't ever let the market tell you you're wrong. Always let the market tell you when your position is correct.

It is your job to know you are wrong and not the market's job.

The other side of the coin is that you will get positions that are correct. You must be bigger at that time. This will require a Rule Number 2, which is designed around adding to winners in an unfavorable game to come out ahead in the long run.

Learn to be wrong, fast.

Best Loser Wins

The value of this chapter is simply immense.

Even before we move on to rule number 2, we get a sense of a trader who has realised that in order to be a great winner, he needed to learn to lose often.

The best loser wins.

It is so simple. If you want to win, you need to learn to lose. I know it may sound like those two things contradict each other. They do not. Once you understand the meaning of "The best loser wins", you also understand why so few experience success in trading.

As I type these words, I have a few trades open. I am short the market. The market is falling hard. I have more money in open profit than I have on my account balance.

However, there is a flip side to that story. About 90 minutes ago the profits were twice as big as they are now. 90 minutes ago, the market looked incredibly weak. Then the market staged a recovery. I am still in profit, but the rally has eaten a lot of my gains.

This scenario would never have happened, had I not dealt with my fears. I would have shorted the market, and I would taken my profit as soon as I sensed that the market was moving against my profitable position.

I learned to deal with a fluctuating profit through repeated exposure. I am going to tell you a story which has nothing to do with trading, but it has everything to do with the lesson I am trying to impart to you.

It was a cold winter day many years ago. The sun was up. It was a clear day. I was walking with my son along the beach. The air could not have been more than a few degrees above freezing.

Suddenly we saw a person in the sea next to us – swimming. The water was calm and crystal clear. We stood and marveled at anyone braving the cold water for so long. As chance would have it, the woman swimming came up on the shore, close to where my son and I stood.

I walked up to her and commented on her incredible resilience. The water must have been no more than about 4-5 degrees. I asked her how she could withstand the cold water for so long. I am not unfamiliar with cold water myself. I have taken cold showers since I was 13. However, a swim is a vastly different matter to a cold shower.

She said “Well, you start in the summer, and then you make sure you swim 2-3 times a week. As it gets colder, your body acclimatises to the cold water. There is no magic to it.”

5 years into my independent trading career I decided to change the way I traded. I started trading the way I knew would make me a long-term winner. I started losing on many more trades. I began to slowly and gradually build up my trading size.

I started with small stakes so that my mind could get used to seeing profits disappear. It was all about training my mind to be wrong a lot, and to appreciate that this way I would often see bigger profits disappear. However, I would be compensated by having very big profits.

Over time my mind has been accustomed to seeing bigger and bigger stake sizes generating bigger and bigger profits. It has been hardened by the repetition of thousands of trades.

We learn from observing our mistakes. Every time you make a mistake, you have an opportunity to learn something. Something did not work out. It exposes you to the part of the world or the part of you that you don't consciously understand.

The exposure to something that isn't working or that you don't understand gives you the possibility to rebuild the structures in your mind that you use to interpret the world.

Our mistakes become opportunities to learn. That is often why it is more important to notice you are wrong than prove you are right. Rule number 2 is about being right.

RULE NUMBER 2

I worked as a broker for 10 years. I saw some 100,000 people execute more than 100,000,000 (one hundred million trades) over those 10 years. I saw thousands and thousands of people destroy their trading accounts by adding to their losing positions.

I saw perhaps a handful of traders add to their winning positions. That is what rule 2 is all about – pressing your winners.

Press your winners correctly without exception. Without Rule 2, you will find that trading still isn't even a 50/50 game.

Without a correct method to press your correct positions, you will never recover much beyond your losses.

You need rule two to ensure you have a larger position when you are correct. You always want a larger position when you get a great move or trending market than when your position is not correct.

As someone who likes to add to winning trades, and is often asked about the best way to do that, I am comforted by the following comment from the Phantom:

Phantom of the Pits:

There certainly will be debate on how you know when to add to a correct position and on how a market can turn a correct position into a wrong position. We will cover those debates later. First, let us get the rules and reasons established. By knowing what is expected in Rules 1 and 2, we can prove the theorem based on good assumptions and experience.

Rule 2 does not mean just because you have a position in your favor that you must now add to that position. "Correctly" in Rule 2 means you must have a qualified plan of adding to your position once a trend has established itself. The proper criteria for adding positions depends on your time frame of expectations in your trade plan.

You might be a day-trader just trading back and forth, a short -term trader, weekly trader, monthly trader or trend trader only. The add criteria will be different for each trade plan.

The important point of Rule 2 is to point out the rule is established so you can make the most gain with the least drawdown expectations. You must also use Rule 1 properly.

Rule 2 is important for it keeps you in a good position as well as impresses upon your own thinking about having a correct position initially. Most traders are conditioned to want to take a profit to prove to themselves that they are right. **Being right does not, in itself, make the most amount of profit.**

Most traders also want to get out before the market turns and takes away any profit they may have. Ordinarily, they will let losses get larger but only let gain get started before getting out. This is just simple human nature when having a market position. Human nature in trading is not often proper trading technique.

Always a good reason for adding to a winner is because traders usually tend to doubt the position unless they reinforce the correctness of that position. Adding to the position correctly best does this.

Correctly adding to a proven position must be done so that a pyramid isn't established that will hurt the trader in a minor reversal. Each add onto an original position should be done in smaller and smaller steps. As an example, if you put six contracts on as your initial position, you should use four contracts for your first add and two contracts for your next add. This gives you twice the original position when all three positions are in place. This is a 3:2:1 ratio in establishing three levels of positioning.

Reviewing Rule 2, it states only that you must add to correct (proven) positions and that it must be done correctly. The rule does not tell you how to add, as this is your requirement in the trade plan you develop. The rule makes no exception on adding to correct positions. The intent of Rule 2 is twofold: Reinforce your correct position both mentally in your thinking and your execution and increasing the size of your position.

Day-traders will have a problem with Rule 2 unless they position properly and understand that their adds must only be made correctly. Day-traders are in for the quick profit so it is hard to have a good add plan. Their best trade is to put all positions on at once -- original and adds -- and use Rule 1 to take them off unless or until proven correct. Believe me, this is the proper probability in a loser's game like trading.

These two rules are to give you the long-term ability to continue to trade with the least amount of drawdown and the best possibility of making the most money in the long run. Huge drawdown is the critical reason some traders go out of the business.

You must start your trade plan with rules created to protect your equity. I am presenting those rules to incorporate into your plan. Experience has proven these rules a necessity in survival and reaching your objective of making the most return with the least amount of risk.

I want the traders to ask themselves two questions:

"Do you put only part of your expected position on from the initial entry?

"Are you planning for adds prior to your initial trade?"

If the answer to either of these questions is no, then you must go back and rethink your trading program.

I have said it before. If you can think it, you can do it. Perhaps the traders aren't thinking it to begin with because it certainly is not expected thinking without the proper planning.

More thought must go into Rule 2 as it is not as self-explanatory as Rule 1. It is true that Rule 2 is what makes my money for me. It does it in the long run and not the short run.

I think one of the of the hidden benefits of using Rule 2 in your trading plan is that it will actually keep you from over-trading from the entry through to the end of the position if used properly.

By incorporating Rule 2 in your game plan from the start, you will be eliminating the desire to be proud when the market moves your way and want to take profits to show that you are right. Traders love to be right.

This is your enemy . . . to love to be right. Your motivation must be to love to do the right thing in trading by either reinforcing correctly your position or removing it should it not prove to be correct.

You see, when you think you are right in the market, this is just the beginning of your trade -- not the time to take your profits to say to the world, "See, I was right!" Let me ask you, "Who really cares if you were right?" So what?

You will become the best trader you can be by being wrong small, **not right small!** Get that in your mind now. You are going to have to press your winners if you really consider yourself to have the ability to make a living or extra income from trading. Otherwise, face the truth that you are only playing to break even.

Who wants to play for a tie? I sure don't!

I remember a trader asking me how I felt about making money in my early days. She wanted to know how much I made. I indicated to her that if I did not make at least a thousand dollars a day, it wasn't even worth trading to me. She said she would be happy with a hundred a day.

I asked her if she added to winners. She said there was no reason to add to winners. I didn't mean to laugh at her but at what she said. I pointed out to her that, if she had three days a week where she made money and two where she lost, she would be in the hole for it would be a 50/50 game if she was never able to add to winners.

My point was that you must make bigger money on your good days and not just the same amount of money you lose on your bad days. You would be better off working for a living rather than trading if that is the case.

I cannot help you with over-trading or being under-margined. You must correct that situation before you can ever expect to be on even ground with the big funds. You must at all times be able to put only a portion of your expected position on at entry and be able to at least double your size somewhere along the route of an expected move.

Rule 1 and rule 2 are designed to keep you in the game for good.

I may be confident on my trade implementation, but rule number 1 will remind me of two things:

1. **Be confident, but be humble enough to admit when you are wrong.**

2. **Put only part of the position on.**

Part 2 of rule 1 is new. It enables me to scale into a trade, and if I am wrong, because the market moves against me immediately, then I will get a loss on half my size.

If I am right, then I will add more to my trade, because I now have some profits from the first entry.

Now, anyone who knows me, knows that this is all fine in theory, but I will be the first to admit that theory and reality don't always go hand in hand.

Therefore, I try to protect as much of my "first entry" profit as I can, by moving my stop loss down. This is much easier said than done, and it is an immense challenge when you are day trading.

If you are swing trading, then time is on your side, and you have more bandwidth in the form of time to put on the second entry.

I am giving you a rule that not only makes you larger when you are right but keeps you smaller when you are wrong from the start of a position. I am also giving you a way to not over-trade. It is up to you to make sure you are properly funded to make this step an important one in your favour.

Never over-trading was one of the criteria of my Rule 2. A lot of thought went into Rules 1 and 2, and it must come out the other side for you to understand before it will work well.

ALS:

Okay, you are telling the readers that using Rule 2 properly will keep them from over-trading because their entire position is never in place until they have added the remainder of their initially expected position only after the market has proven the position correct along the journey of the move they are working with in the trade.

What the traders have failed to see is that to correctly use Rule 2, they never put the entire desired position on until or unless Rule 2 needs to be used along the way. Am I correct so far?

POP:
Yes, you are. What other points am I making?

ALS:
Your Rule 2 is also protection from adding to losers and keeping the initial position smaller until proven correct. Is that right?

POP:
Not exactly. What I want them to understand about that point is that they will only get bigger when their criteria in their trading program tells them it is time to add. They will not add just because the initial position has been proven correct. When they have completed their adding of additional positions, then and only then should they have their entire expected position established.

Traders are over-trading most of the time when they say they can't seem to justify adding to an existing position. Most of the time a trader does not think about the reason for adding because they have their initial position on from the start. This is their maximum risk from the start.

That is never what you want in trading. You must take some risk but never your maximum. That is exactly what they are doing if they cannot plan for added positions along the way.

ALS:

It is so obvious now! It is just like playing chess and seeing after the stalemate that you could have won so easily if you had just thought there could have been a stalemate.

POP:

Yes, the trader is playing for a stalemate if they don't use Rule 2 in some form somewhere along the way in their trading plan. Isn't it simple?

TRADING WITH RULES 1 AND 2

Art Simpson (ALS):

Phantom, your required rules seem pretty simple. Let's use some practical applications in real-time trading.

Phantom of the Pits (POP):

You must research your trade program well enough to be able to not enter at bad entry levels. Even if you make a simple mistake such as chasing markets, Rule 1 will still keep you from excessive drawdown during your trading career.

Today, as an example, I bought the DJIA after a 30-point rise and expected to see another 5-point increase within 30 seconds. After 30 seconds I bailed. I had a loss of 1 point on the trade. The market continued to drop against me, and my loss would have been 30-40 times my commission, even if I had paid top commission at the low point.

Now you can't tell me that it is better to stay in and wait for the market to come back than it is to get out and re-evaluate the situation.

In the end I would have been right, but my mental standing after a simple Rule 1 trade is a lot better and allows me to have sanity about my next move.

What I am going to say next is something usually learned not by observation but by making the assumption itself. **Most of your money from trading is going to come from trades that take off rather quickly from when you put them on.**

That is the reason Rule 2 is so important. Just look at most starting trends and the good runs you have once a market turn. The chop-chop markets aren't going to give you good income.

You can never let your guard down in trading. You must always know what the next step is for you in any situation. You rehearse your criteria of a trade, and it becomes second nature -- just like driving a car becomes a subconscious effort for you when you are proficient at it.

You start out by not knowing what the trade will ever do when you put it on. You can never control what the market will do or how the orders will enter the pits. You cannot tell me when a large fund is going to take a profit or enter a new position. Nor can anyone else tell you for certain.

All you can do is build your criteria or trade plan to take every angle that is important into account. I can give you a plan that will catch every move, but you will catch moves that are the wrong way, too.

You are expecting a big reward and fail to see the big risk that faces you at first. Somewhere along the way you must face the situation for what it is. Trading is a loser's game. **You must learn how to lose. The biggest loser who loses small will continue in the game.**

A trader must know and accept what the market can do along the damage side to equity, to mental peace and to self-esteem. Every day is a big surprise in trading. You must plan for the surprise from the time you put your position in place. The big surprise can sometimes be a friend, but you must be prepared for it.

Why do I say the market is going to give you a surprise? Can you tell me exactly how far a market will move and then retrace before continuing? Or if it will continue?

What you can do is to eliminate your reactions to what the market does to you. You do this by not giving the market the power to control your position or emotions with adverse market moves. You start out expecting the adverse market moves and plan your action based on those outcomes.

When you place a trade, don't ever think this is the only trade to make. There are thousands of trades you can make. You aren't going to miss a move for long if you trade correctly. You aren't going to chase markets if you trade correctly. You must have a plan to enter positions based on each market's criteria.

Behavior modification can take place in many forms, but you need a rule to show you what must be done at all times. Just because you put on a trade that lost money is no reason to feel bad. If you put a position on and lose big money, that is when you can feel very bad.

With Rule 1 you are freeing yourself from having to feel bad. You put the trade on based on the trade plan. The market either confirms and you now have a good position, or it doesn't confirm, and you are not okay with the position and you get out. Simple!

Most of your trades that don't confirm within a logical time frame are usually going to look bad sooner or later. Why not take the sooner?

ALS:
It's beginning to look like it takes more thought to put a trade on than the time you're going to be in it if you're wrong . . . or I mean not proven to be in a correct position!

POP:

The logical step is to have the plan in place for the next step before you put on the trade. I would guess that 95% of the traders put the trade on and then wait for the market to prove they have a bad position. Even if the position is correct, their next step is wondering when to get out. It's human nature to do it their way. It causes a lot of unsuspecting reactions in their lives.

ALS:
I would like to ask you a question that I have wondered over the past couple of decades: When you take a position, do you feel you have taken a good position?

POP:
Never! Do you understand my NO? If a trader thinks at any time, they have a very good trade, they are going to get removed from trading very quickly. I make the best trade on my trade probabilities program, but who is to say my guess is better than someone else's? Never do I know it is a good trade until it proves to be.

To feel you are making a good trade is signing your death warrant in trading.

There is an old saying that the market is never wrong. I don't mean to protest directly, but I think that is not always the case. However, that is what we must trade by in price.

Markets go to extremes, and that is certainly a challenge in always being right. Once we know markets go to extremes, we can put that on our side and exploit the advantage. Very few traders exploit that advantage. You must press your winners with Rule 2.

Oftentimes, you won't understand the importance of pressing the winners, but it makes no difference as to reason when you collect your profits. Who really cares if the market is or isn't always correct? The market price is what we are measuring our equity with and always will.

Don't ever let anyone tell you they have a long-term position on at any time. How do they know? How does anyone know? Only the market can tell you, and it opens every trading day. Don't ask me what I think. It doesn't matter. I can only give you the best odds. It is up to you to believe what the market is telling you.

ALS:
How about Rule 2?

POP:
What can I say other than set up an example. Okay, let us say beans opened today at 85-88 and after the first half hour 85 was still the low but 90 was the high. What would you do if it were 15 higher at 88 and you put on your position yesterday? Would you get out and take your profits, take half your profits or add to the position?

I will tell you what most will do: They will take all of their profits. That is when you know your position was proven correct again from yesterday. What do you think the correct answer is?

You must use Rule 2. You certainly don't reverse pyramid by putting the same or bigger positions on because the market could very well take out the lows quickly, and you will have to salvage what you increased if wrong. Do it in smaller numbers. Your plan must tell you when you know that what you did yesterday is confirmed okay and that you must increase your position somewhere along the line.

Sure, the argument is, "But I am not sure it will keep going up." So what? We never really know that anyway. So, what is different about going with the current certainty?

As long as you have Rule 1, it makes no difference if you are wrong because you have all the doors covered. Don't ever lose sight of Rule 1 when using Rule 2.

Okay, today we pointed out a situation where it was obvious to add. Looking back, it is always obvious. What matters is that after enough lead on your position after you have put some time between the position and an advancing price of a little magnitude, you must be pretty sure it's time to take your profit.

Well, don't take your profit. Add to your position. Then, if it doesn't prove correct, take your remaining profit and expect to re-enter at a different level.

So, what if you lose a few ticks because you put an added position on, and it was wrong! You will get enough lead on adds that you won't ever think twice after you see the runaway markets!

It isn't because I say so but because the market catches traders the wrong way. It is seldom that it's not the case.

Phantom of the Pits is not giving a recipe for when to add to winning trades. We are asked to figure that out ourselves.

I have never come across a trading book that discusses how to add to winning trades. I don’t think this book is the right setting for discussing the question.

I have added to my winning trades for many years. Maybe my observations on the matter can point you in the right direction.

1. I have lost count of all the times where my good and profitable position turned sour because I had added to the trade.

2. I find that adding to a trade is a great antidote to the emotion of wanting to take profit.

3. I add for as long as the position is moving in my favour. This goes against what POP says. He argues you add 2-3 times and you do it in a pyramid format. I add in skyscraper style. It means my positions double up and double up, while POP adds half the original size on his second position.

4. When the market trends, I make a lot.

5. When the markets are range bound, I am often stopped out of my add on positions with a loss.

DAY TRADING

This section clearly gives away that this was written 23 years ago.

POP and ALS traded under different circumstances and restrictions than we do today, in 2020. You have to remember that when this document was written, online trading was in its infancy. Literally.

Today, 23 years later, the trading industry is in a hugely different place. I believe there is value in the chapter, but I felt that singling our paragraphs would lose the context.

Therefore, I have not posted any essential posts from Chapter 8, except this one:

Sometimes your criteria may be that you must be swift to take any possible loss -- especially when a certain Fed chairman speaks.

ALS:

Is there a way to plan for such surprises?

POP:

Yes, there is . . . by not ever over-trading at any time.

CLOUD HOPPING

There are advantages and disadvantages in charting. When you use charts to look back to get signals, you are setting yourself up to believe you can actually be more right than wrong. It is possible, but you must never forget Rule 1, regardless of how accurate your chart indicator shows over the past. Just because it worked nine out of the last ten times does in no way suggest that it will stay 90% accurate.

Protect your positions at all times.

Do your research! Do it again! Learn what different outlook charting can do for your trading plan.

Your trading career should be a long-term expectation on your part. A short time frame is not acceptable in trading. I am not saying that short-term trades are not acceptable but that you must look beyond one day in your trading career. Some of the best traders started out broke! And then they got more broke. Until success!

BEHAVIOR MODIFICATION

ALS:

Where do you start in changing your behavior to proper behavior for successful trading?

POP:

It goes back to history class. Not everyone liked history, but it was a way of understanding prior behavior and events in order to plan for the future. It is the same in trading. **We must understand our present behavior so we can judge what we need to do to make changes in our trading style, if any at all.**

A person will make the same mistake again and again if there is not a properly learned reaction to a particular consequence of an event. We must know the right and wrong reaction before we can make any judgment as to what is correct for the situation.

Most situations are pretty obvious as to what a proper reaction should be. Most traders assume their reaction is proper in the consequence of what the market has done. Some traders are better at knowing the correct behavior than others. The correct behavior is a learned process and not one that is always obvious.

(Traders) They take a big loss and, they will never take that signal to position again or perhaps just won't take it the next time. Now, that is not proper learned behavior. It is learned behavior by instinct due to a consequence of an event.

This is just one of the examples I mean for you to understand when I say behavior modification is one of the most important aspects in becoming successful in trading.

How can a trader expect to be successful unless the trader knows the proper behavior to react to an event, especially unexpected events, which a trader seldom is expecting?

I think that, along with my two rules of trading, a trader must have a good inventory of what behavior they need to survive and succeed in trading. Something that has been missed on my rules up to this point by traders (in the Futures Talk forum) is that the two rules incorporate behavior modification within the rules.

ALS:

Explain how behavior modification is in your first rule!

POP:
Look at what the rule states! In a losing game such as trading, we shall start against the majority and assume we are wrong until proven correct! Positions established

must be reduced and removed until or unless the market proves the position correct. (We do not assume we are correct until proven wrong. We allow the market to verify correct positions, not incorrect positions.)

Rule 1 incorporates behavior modification by expressing the truth that trading is a losing game and that we start against the majority and assume we are wrong until proven correct.

By stating that trading is a losing game, we think differently each time we position. By also stating we shall start against the majority and assume we are wrong until proven correct, we also change our thinking.

We should not trade under false assumptions for if we think most everyone wins in trading, our behavior is going to be based on winning protection rather than losing protection.

In other words, our focus will be on when to take our gains without thought on taking a loss, much less a quick loss.

We need that correct assumption to be able to correctly incorporate the proper behavior when we have positioned. With the proper assumption we can now include the proper behavior.

We are going to concentrate on protecting what we have rather than what we expect to make first. That is behavior modification. This, above all else, is just as important in trading as any plan for entry and exit.

Next, we know from the rule the proper behavior for protecting our positions is to remove them unless the market proves them correct. This is the proper behavior instead of letting the market tell you that you are losing money.

When the market tells you that you're losing money, your reaction to get out is not by instinct because nothing really physical happens to you except that maybe you get a sick feeling in your stomach.

That sick feeling as your body chemistry changes doesn't teach you anything about the proper behavior. It is a fact that you will become braver when your body chemistry changes as that is a protection, which is natural. This is not the behavior you want to learn.

Actually, you never want to get to the point of a market move making you sick. It is destructive, and you won't react properly without learned behavior modification.

Rule 1 is designed to protect you from ever being in a situation of distress. In distress you will make the wrong decision in trading most of the time. There are always exceptions but not at first. Because all traders must start somewhere, why not learn properly as soon as possible?

Again, not to repeat myself but it is necessary to say it is the same in trading. Traders mostly change their behavior by what they are told. Is this the proper behavior modification for traders? The answer, of course, is no, not at all.

A trader must learn from research what the proper behavior modification is in all possible situations. This takes lots of inner soul searching and market data to understand what behavior takes them to the threshold of successful behavior in trading.

You see, behavior modification is your responsibility and no one else's. You cannot dictate behavior to anyone. All I can do is tell you I feel it is not possible to succeed in trading at all without some sort of plan for proper behavior modification. I could never have survived without it.

You see, what the outside basketball coach did was to incorporate his knowledge of why most free throws are missed. It is usually because the ball never clears the rim getting to the basket. He told his students to shoot the ball higher above the rim.

Even though they had not shot a single basket, they were able to improve their behavior through knowledge. They go together, knowledge and behavior modification.

I want to give you a well-known statement, and it is effective in trading, too: "You have to think about it before you can act on it!" I am a believer in the small trader. We just need to point out they must shoot higher above the rim to have better odds.

Behavior modification learned from knowledge is what they must research in their trading careers if they expect to succeed.

ALS:

What is the most important point of this chapter on behavior modification, the point you want traders to remember?

POP:

There are several but the one that is often missed or misunderstood is this: Trading is a losing game, and the best loser is the big winner!

If I were to tell you that your signal to enter a market has the criteria that you must also be swift in protecting that position and correcting that position as quickly as you can, would you be able to reverse your position as many as three or four times.

You would be more agreeable to that prospect by being alert to the possibility of having to reverse your original position. That thinking would make it easier for you to make the needed adjustments to your position.

This is what you must do anytime you enter a position. You must know that the initial entered position is just the beginning of your trade. Rather than taking a position and letting emotion enter the picture, you must understand that position does not justify any emotional modification of your thoughts.

Stop that position before emotion even enters the trade by removing the position. You can re-enter the position correctly again and again until you have no emotional effect from that position. If your position brings emotion into the picture, it is usually wrong or the wrong way.

The market will seldom comply with your position at first, but that in no way says not to trade correctly. A lot of times your entry is at the place where many think the same as you. Don't ever feel bad about this because you're not alone in your thinking. It is that you seldom can all be right at the right time.

The edge you have over everyone else's thinking is that you know you are quicker than the eye. You can remove your positions quickly because you are alert to the idea of knowing you can re-enter immediately quicker than the eye.

A bad or incorrect position is the best opportunity to do the correct thing. You are going to always do the correct thing.

Be swift!

You can stop this emotional feeling of always getting in at the wrong place immediately, and it will soon become second nature to you.

If you find that you feel you are wrong as soon as you enter, remove that position because you are right (in removing that position!) Why do I know this works? I know that some of my best days and trades are when I started out wrong with a position. Learn to understand that an existing wrong position is the best excuse to get a good position.

So, what if you are wrong and wrong and wrong again.

The best part of being wrong is that you are going to do the correct thing by removing that wrong position. Listen to your inner thoughts on being wrong, and when emotion becomes an element, remove the position.

It really works. Emotion has no place in a trade. If emotion is in your trade, it is a wrong position.

ALS:

It seems easy to say but how about executing the idea of getting out when emotion shows its face in your trade?

POP:

You must make it a mechanical thing. It can be done in various ways. Most new traders don't have enough funds to diversify properly so they have several positions, which gives them the opportunity of throwing out the bad and keeping the good with lower overall risk proportionally.

There are other ways of making the removal of emotional positions mechanical such as when you use Rule 1. You are not going to become as emotional when a position proves correct as when it proves wrong.

So, what you need to do is listen to yourself and your emotional distress of knowing that you and not the markets are going to tell yourself that you are wrong in a position. Your emotional distress is telling you to remove the position immediately.

Do that without hesitation, and it becomes mechanical to you. Isn't the purpose of Rule 1 to also listen to yourself and not the market on telling yourself when you are wrong. If you let the market tell you, you have an elevated emotional distress, which now will affect your judgment and decision to remove a bad position properly. Because we don't allow the market to tell us when we are wrong but only when we are right, we must have something tell us when we are wrong.

What do you think that is? There is probably not a better signal to get out than the beginning of elevated emotion in a trade.

I know it take practice and a method of behavior modification, which you must devise to help you work with the implications of emotional elevation when wrong in a trade. You can do it and make it a habit after a little practice. It is no different than if you were to go to a stranger each day and say good day.

After a period of doing it, you would find it second nature.

Keep your loss small and quick; act early while you have the opportunity, otherwise you will allow bigger losses to affect your loss taking and thinking. This is why I call entry the dangerous time of a position. It is your first opportunity to keep losses small.

The first opportunity to keep losses small is your best opportunity. What you do immediately upon entry of a trade determines whether you will be a good loser and the best winner you can be.

We do make the market prove us right rather than wrong, and that is the reverse of common thinking. We do assume we are wrong and in an unfavorable game until proven correct. That is also reverse image. In Rule 2 we do press our winners, and that is the reverse of taking losses or the other side of the coin.

Yes, I guess that by looking in a mirror you could easily understand why others do not see as you do. You really are looking at a reverse image. Sometimes it is important to see things differently than others. I have learned it is better in trading to be different.

You never need to conform to anyone's view but your own in trading. Don't forget that! Use your own ability to improve your behavior in trading.

Who I am is always going to be more important to myself than anyone else in the field of trading. It must be that way in order not to interfere with my duties of success.

It is not a selfish thing; it is just that we must be in control first. You see, **trading must be the most important thing in your life for it to be possible for you to become the trader you know you are capable of being.**

You will take the blame and try to take the claim. But listen to me! You must never be so lost in your trading to think that your success is because of you.

This ends the first part of the book. What now follows – in the book – are comments and questions, which POP and ALS are discussing.

POP:

I want you to go into the next stage of your trading by accepting an assumption. I want you to accept an assumption that you have made 15 trades in a row that have all made money.

ALS:

I thought you said we were going to assume the big drawdown was caused by 15 losing trades in a row. What do you mean now when you say, "Assume you have 15 trades in a row that have made money"?

POP:

Frame of mind is what I am changing for you by asking you to make an assumption that you have 15 winners in a row. The reason I am asking you to do this is because you will be more careful if you have had 15 winners in a row. If you assume you had 15 losers in a row, you will be sort of careless in your thinking by expecting that, surely, you won't have many more losers in a row.

Your frame of mind with 15 winners in a row will put you on the edge of caution. I want you to be on the edge of caution. Or we could call it being alert to quick market changes. You can no longer afford to make a bad trade, and now that puts you at a disadvantage.

There are many more chapters, but they are not for me. There is discussion of a Rule 3, which I found less interesting. It talks about volume and liquidity. You can find the rule discussed on page 79 in the original book.

There was one topic which was discussed vaguely, but I will include it. It has to do with taking profits.

Rule 1 was concerned with protecting your account.

Rule 2 was concerned with making sure you make more on your winning trades than you lose on your losing trades.

I feel something is missing. How do you take profits?

TAKING PROFIT

POP: My trade programs allow me to take profits after three adds upon a third wave of movement. The third wave usually is the strongest, and that is where I get out of the elevator on the 14th floor rather than ride to the 18th floor if it seems to move rather fast.

I know it is going to stop eventually. The only question in traders' minds, I think, is do we get out at the 14th floor on the way up or the way down.

In the following segment ALS and POP are discussing the element of intuition and the use of stop losses.

ALS:

I've known some people who know it all!

POP:

They don't trade long, do they? Having all the answers is still an incomplete process in trading. Often in trading we know the logical answer but don't know the intuition answer. There are situations in trading when we don't want to take the logical answer but the intuition answer. To know which answer to take is the most difficult decision for most traders.

I believe at least 90% of the traders lose money and that close to 80% of traders are logical in their trading and not intuitive. What do you now see about trading? Wouldn't you now look more at the intuition side of trading and do more research on intuition?

Do you remember that many times I say "second nature?" What I mean is intuition when I say that. Intuition can come from known logical reasoning but with the emotional part removed. It is a feeling we have. Sometimes we can't explain the feeling with reasoning or a logical plan.

You don't want to chase the market, but you don't want to miss it either. So your two plans cover all the bases with your input of market characteristics. If each day the market tends to give you a range of, say, 15 points, then you surely must be cautious when the market is already up 15 ticks. But only be cautious for a short period of time.

Don't miss the move and use your "at the market" plan after a period of time. Sort of like a stop and I must say the best use of stops I know.

POP:

I don't know if you can remember my remark about not being able to carry a reputation. My reason for that feeling is that I know what has happened in the past is no guarantee of the future. I also know I change my mind more often than the experts.

It is extremely difficult for expert traders to convey with confidence to their customers that they know what they are doing if they change their minds often. I like the luxury of changing my mind. They don't have that luxury.

I remember one day when I got at least six reversal signals in one day. How do you think a trader you are trying to help would understand your changing direction every time they saw you in a day?

That is another reason I say it is not an impossible road but a lonely one. It is out of necessity. You must have the courage to do what is correct at all times. A good advisor is perhaps good at advice. There is conflict between giving advice and also trading. I

do not accept conflict. Some can but not me. Most new traders are better off without the conflict of advice.

I could tell you what I am doing every trade, and you would not trade the same way. You could never be at my point in time when I execute my trades. We must always have the latitude of changing our positions based on our systems. My rules allow this thought for doing the correct trading.

I certainly don't think the forum participants were wrong in their thinking but only having fun with the way the markets tend to act on their positions at times. They have really hit the nail on the head, and it just takes some understanding as to why it seems to be that the locals are gunning for the stops.

Locals are good at taking the smallest loss possible and going with the flow. It is an advantage over the public traders.

To understand why markets act as a system that tends to prove the most people wrong in any one day is a good start in correcting bad entries when trading. Traders are correct in thinking that the stops will get them out, and then the market will just turn around and go the way they had thought prior to being stopped out.

The fact that it happens is reason enough to devise your trading plan accordingly. This idea is especially useful upon planning entries. I never really liked stops but trading off-floor creates a problem for the public because they certainly need protection from being hurt from extreme moves.

Stops do not protect well in choppy markets. Trading plans can be improved by knowing how stops work and what happens far too often.

We proceed with a trading plan after we feel our behavior and reaction to market conditions is in our total control. As long as we are prepared for any outcome and adapt our behavior to all possibilities, we can start to follow a good system.

CREDITS

The credit for this book goes to Arthur Simpson. I do not know if he is around anymore. I have tried to contact him via email and via Facebook. I have had no luck.

It is rumoured the Phantom is George Lane, but I am only passing on hearsay. I do not know.

What I do know is that trading is a losing game for many people. Well, it is a losing game for most people. There is nothing to be ashamed of, if you haven't made money from trading yet.

This book makes the argument that to be successful we need to turn some basic human qualities, such as hope and fear, on its head.

Good luck on your trading journey

Tom Hougaard