Phantom of the Pits

Knowing his thoughts could be worth thousands of dollars in a single trade. For decades traders have wondered what is so special about perhaps the best trader ever.

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Preface

I've been asked over three decades to present to others just a few of the secrets of trading. I am not one to want my picture front and center. I am not one to want my name a household word. I am not one to face the 5% of those who would cry foul in giving to others what has been given to me. If I can save the grief of some of the trading torture to those who search out the knowledge of trading, then I am in a position to acknowledge my debt.

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.

By trade, I am not a writer nor is Art. We are both traders, but it is my desire to present insight into what is required in successful trading. This project was agreeable to me if we would do it on my terms. We came to an agreement on my terms of how it would be presented and that it would be presented as I wished. Our agreement was that I would remain in my own privacy. I would not give my name but only my approval in writings about my insights of trading. You may call me "Phantom of the Pits."

Your success in trading shall be at your own hand and direction. You shall know me as Phantom, a shadow in your success. That is how I wish it to be.

"Phantom of the Pits"
(As narrated to Art Simpson)

Foreword

When Futures magazine started the "Futures Talk" forum on its website in the middle of 1996, it attracted some good interest initially -- nothing too spectacular but just traders talking to other traders about markets and comparing notes. But beginning in the Spring of 1997, it became increasingly clear that one participant had unusual trading wisdom and insight and experience, although he sometimes wrote in a vague, mystical way that forced other traders to really think to get his point.

His posts became so popular and attracted so many responses and followup questions that separate threads were set up just for his comments. He was willing to share what he knew about trading exclusively on the Futures magazine forum, yet he did not want his identity known under any circumstances and he did not want the money or accolades that he might have gotten from revealing his ideas. Thus was born the "Phantom of the Pits."

From his participation in the forum and the acceptance of his ideas by a growing number of loyal followers came this “book" summarizing some of his thoughts. "Phantom's Gift" is not a print book in the traditional sense but is actually a work in a progress, continually being updated or added to online as a result of interchanges among the Phantom, associate Art Simpson and forum participants. A new chapter may be added to the middle of the book to expound on Rule 1 at any time, for example, so the “book" you see today may not be the same tomorrow.

The book is presented as a conversation between the Phantom and Art Simpson and is "printed" here essentially as it appeared over a period of weeks on the Futures Talk forum, with some comments from other forum participants included. The unique process for writing this "book" means thoughts or ideas may be restated, they may seem a little disorganized in places or they may even appear mysterious at times. Some chapters may be more rambling or personal than will appeal to many traders.

But most traders will find some real nuggets throughout these chapters. Accept the Phantom's gift for what you can glean from it that will make you a better trader. And, better yet, participate in the Futures Talk forum yourself and share your questions and ideas so everyone can learn more about trading.

P.S. We still don't know who the Phantom is.

Chapter 1: Phantom's Insight

It had to happen, I thought to myself as I took a walk to the top of a small hill just behind my home.

There isn't a single trader who wouldn't give half his trade equity to know how the big guru did it! Knowing his thoughts could be worth thousands of dollars in a single trade. For decades traders have wondered what is so special about perhaps the best trader ever.

It was six months ago that we had talked about giving something back. And why shouldn't he give something back? We're talking knowledge, and you can't put a value on knowledge or experience. He had both. We agreed that, to give back, it would have to be without expectations of any recognition or rewards. He came up with a plan just as he always did. We would go on the "Futures Magazine Traders forum" and sneak information onto the forum and see how well the reception would be for the new knowledge.

First, he called me every name he could think of calling me, other than my name, to be listed as the author of the information. I wasn't happy with any of the names until he asked, "How about POP?"

His agreement to give back (knowledge) to other traders was really important to him at this stage of his life. I could hear it in each breath of his voiced words. I could see as his face mirrored the concern in his heart. I could see he was taller than usual that day in the spring.

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!

The name "POP" sounded like a setup for me. He stopped at the top of the hill and looked to the sky as he urged me to agree on always keeping his identity confidential. He said, "I will not accept the credit for my good fortune and do not want recognition for my insights on trading."

He looked me in the eye and said, "From now on, you may call me Phantom Of the Pits!"

Yeah, "POP," I thought to myself.

As you progress from page to page, you'll see the importance of Phantom's insight on trading as I have over the years. Trading is not as we all thought. Few have ever approached is methods in trading. "How do you measure the worth of a man or woman?" I still ask myself after that short walk to the top of the hill. Here is a trader who is the best trader I have ever known and perhaps the best trader in the world. We will measure his worth by his deeds and insights into trading!

Yes, that's how we will size up Phantom of the Pits. Phantom is dedicated to giving knowledge to those who have open minds and a desire to learn. Your part is knowing that, in trading, you can do it, too! It is not an untraveled road . . . only a lonely one!

Chapter 2: 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! I am the observer, and I wish to point out the line in the sand. I don't know who puts the line in the sand, but I clearly see it. Who remembers who points out the line? You may call me Phantom of the Pits from here forward, and we shall remain as the shadow of your writings.

ALS: After more than three decades of trading, why haven't you written a book sooner?

POP: I have, but they have all seemed to become outdated because knowledge is quicker in coming than in writing. I always wanted to have it exact. I have made mistakes, and to give my mistakes to others seemed to be admitting I was wrong often. It has taken years to understand that being wrong is what trading is all about.

ALS: Surely there are those who know you and appreciate what you have accomplished in your trading career. Why don't you accept their recognition?

POP: I have always believed that there are two sides to a coin. In fact, I find there are times when you could argue a third. I won't take credit for what I have accomplished. There are no guarantees, and I have been put on notice a few times. My success is nothing without putting a bucket full of water beside the pump to prime it for the next trader, the other side of the coin. There will always be those who drink the water from the bucket (the third side of the coin). Why shouldn't the thirst of others be fulfilled when it can be done so easily?

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.

ALS: Let's start your writings and insights into successful trading from any background you can give us of your trading! Is there any important point you wish to make about your trading background.

POP: My only point is that I am no different than any of the traders who will read this. How I got started or who I am makes no difference in trading. Let us not dwell in such trivia, which has no significance in how your readers will succeed. What was is and what is was but a breath after the markets close.

ALS: Okay with me if it is okay with you that we get started with our behavior modification for trading!

POP: Okay with me. But a little history on my first access to behavior modification as a child. My brother was on a tour of a blacksmith's shop in his youth and watched the blacksmith take channel lock pliers, hold a horseshoe, hit it with a ball pin hammer a few times to shape it and then put it into a fire to temper the metal. Upon removing the horseshoe from the fire and dipping it into water, a tempering process, he laid it down.

At that point, my brother picked it up and threw it down on the ground. The blacksmith looked at my brother and said, "Hot isn't it, son?"

Well, my brother said, "It don't take me long to look at a horseshoe!" That taught me more about trading than anything else: Trading is not taking long to look at a horseshoe. Don't ever forget that!

ALS: What do we call the next chapter?

POP: It's their (traders') book. Why not ask them?

NOTE: *Phantom has observed and participated in an internet forum sponsored by Futures Magazine in an effort to pay his debt, so to speak. Many sharp traders, as well as beginning traders, frequent the forum. Often in posting replies, Phantom uses a sort of firewall to protect his identity. Some of his remarks get posted through the author's efforts. One remark of interest that other traders made Phantom aware of was how effective knowledge can travel today compared to the late 1960s and early 1970s. It is Phantom's thought that those who have the most toys will not win but those who have the most knowledge and can change their behavior to what is needed will take it home.*

Chapter 3: A Little History

Art Simpson (ALS): Let us get into a little of your background without breaking the rules here. How did you come upon the name of Phantom of the Pits?

Phantom Of the Pits (POP): It all comes from the respect I have been given in the pits. I started pit trading in the early 1970s after some early off-floor introductions to commodity trading.

ALS: Why did you decide to trade on the floor instead of up above (off - floor with quote machine) as most traders do?

POP: I really liked the challenge and excitement of floor trading. The appeal of being in complete control at all times seemed to be a dream of all traders. I certainly felt I could do well on the floor by being in total control. I had a few friends who advised me to buy a membership and get on the floor. It happened so fast.

ALS: We both know you are Phantom at showing up on the floor over the last several years. Can we get into some of your experiences on the floor?

POP: You know we all had so-called offices on the floor in the pits. Each day prior to the market open we would all go stand in our little 3-foot by 3-foot office. Every day there was this trader named Cindy who would make her office one tier in front of mine. I remember her name because her career start was as a math teacher. Her husband was a general manager at the FM radio station I always liked to listen to for easy music. I actually knew more about her than she ever knew.

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.

ALS: She was never afraid to take your trade, even though she felt she lost from it most of the time?

POP: She had convictions. A lot of the other traders would shut up and back off whenever I would make an offer. I was starting to pick up a reputation for being correct, and the traders would start to follow me. It actually would hurt my execution, and that is where I discovered that EXECUTION is critical. If you can't EXECUTE in getting in, you sure can't execute to get out. It wasn't a mental thing but a hindrance in my trading plan.

ALS: So what did you do to overcome this execution problem?

POP: I started to play games with my trades. Actually the funds do it now. It is so artificial but they fall for it. It worked like this: If I had a position and I wanted to take profits, I would pretend I wanted to add to my positions. So I would bid the market instead of offer. I had enough people following me that they, too, would bid the market. Then I would turn and, instead, hit the bid and sell my positions.

ALS: Seems like a good strategy. Did it work most of the time for you?

POP: Well, I felt bad about getting the other traders out of position by using this little game so I decided to just hit the bids when I wanted to get out. If there weren't enough bids at the last price, I would let the market work itself down to a point I was out.

Today the funds must use fades because they must go at the market to position. This is a problem if they don't know the liquidity at the time. In the long run, it won't make much difference as short-term influence isn't what you would think. I also learned to not stake it all on one price. A long-time friend taught me the range strategy. It works for me.

ALS: What did you usually trade at first?

POP: You know the only answer I am going to give you! Anything that moved! By that I mean movement has less risk. You wouldn't think so ordinarily, but in a move you can have a smaller position and make a better return. In a dead market you tend to position too large and then, wham, a news story runs the market and you weren't prepared.

ALS: But don't moving markets chop you around more?

POP: There is integrity about the chop as trends that develop give you a good range to work with if you don't get emotional about it.

ALS: Maybe we should elaborate on that statement in a later chapter. How did the other traders treat you when you first hit the pits?

POP: They would yell at me to take my profits and to step off of first base. I didn't mind their remarks except for one. They would say, "Well, it is only money," and that made me mad as I took it personally when I would throw money away. I started out with such a small amount of money, and I couldn't stand to lose money at first.

I got even with the other traders for that remark. I would watch them, and when their shirts would expand and their ties were too tight and, finally, when their face would turn red, I would yell at them, "TAKE YOUR LOSSES!" It wasn't long before we had an understanding.

I actually was doing them a favor in telling them to take their losses. To this day, I call this out to myself when the market isn’t working my position correctly -- the big start of my behavior modification, I suppose.

ALS: How have your pit friends and your recent friends treated you over your trade life?

POP: You know, I have just really found out recently how loyal my friends can be. If you do something they remember, it is without fail that they will be loyal to you. They respect me more now than at first. That respect is not just out of trading but knowing that true friends look beyond your face into your heart and soul to find you. It is very touching.

ALS: You don't seem to floor trade much anymore. Is there a reason?

POP: You look on the floor and you see it is a young person's game out there. I am not saying that is the route to success now because it is more than youth in this business that makes you a successful trader. I trade upstairs because I understand the markets better at a distance and can trade more markets.

Being on the floor is limiting as a trader. A floor trader is more of a scalper than a position trader is. I like the latitude of being able to set up various criteria for different markets and not depend on my own execution in the pit to position.

ALS: Would you advise other traders to start on the floor?

POP: I am asked for advice often, but I don't like to ever give advice. I only like to give guidance, as all traders must make their own bed. They must make their own efforts to learn. It is their decision as to how they will make their plan on trading. I can help guide them away from bad behavior, but it is their own determination that makes them a success.

ALS: Phantom, can you remember the first advice you ever heard from another trader?

POP: No, I can't ever remember any advice. I don't mean to be ungrateful to all my many friends and colleagues, but I really don’t remember any advice. In fact, that is part of the reason I want to pay a debt to other traders. I don't think anyone ever gives much advice because they feel it is putting them at a disadvantage. Of course, it isn't the case but most traders' behavior is determined early in their lives. That is why I feel behavior modification is critical.

ALS: I can see the critics already starting to line up to point out your big point of trading is behavior modification! Are we going to write an entire book on behavior modification? If so, we will have to give this book away. Not only that but also what credibility does Phantom of the Pits have to anyone?

POP: Nothing would please me more than to give the books away. Or perhaps we could ask Futures Magazine to sponsor it for all the publicity they would receive. Accurate insight is what we are going to give every trader who reads this book. It isn't enough to point out requirements. I want to give them guidelines so they can choose their own destiny.

ALS: Sort of like change your thoughts and you change your destiny, huh?

POP: This is exactly where we want to be. No promises, no requirements, no false hopes and no undue influences. Exactly the way it should be. Traders must make their own millions. I only need to be responsible for keeping them in the game forever.

ALS: Phantom, I don't make my money from writing so how about making it a little easier in writing this book for me? Guide me a little in what you want to convey to the traders in this book.

POP: I have an idea, which presented itself when I viewed some of the other traders' questions on the forum I frequent. They don't know the important questions other than from their own experiences in trading. Eventually they will come upon all of the situations I want to protect them from getting into.

However, I don't want to give specific trading advice or any outdated information like the writings I wrote in the 1970s. So why don't we call upon the traders from the forum to guide us in this book?

ALS: Great idea! I am rather impressed with this one trader and know he will respond. But we don't want to exclude any of the others so I guess we kind of make them Phantom of the Pits, too!

POP: That certainly is okay with me. I like the idea. No loss to throw out is what I enjoy.

ALS: Okay again! You win! You are right!

POP: Funny, I have had years to hear what you just said. I really don't hear that anymore. I mean the "You win and you're right."

Trading is not those statements. A trained trader understands success as "You lose good and you're wrong small." Trading is called coming out on the small losers' side and being rewarded with knowing how good you have been wrong.

It requires a balanced life to sustain the meanness of the markets. Traders never plan for the bad days, and there are bad days. It is when it affects their lives that they must make a new choice. Either change their behavior or go down in defeat.

ALS: There's our subject again. Are we going to get tired of hearing the truth of trading?

POP: Traders have a choice: Either face the truth of trading or look for the nearest exit.

ALS: Have any of your associates over the years given you a difficult time in your trading?

POP: Only through ignorance! I can forgive all that. Those who don't learn are their own enemy.

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.

ALS: Do you ever go into the pits much anymore?

POP: To sharpen my thoughts on a market and to re-enforce the proper behavior, I often do go back. There is always something to learn from it.

ALS: What happens when you walk into the pit?

POP: At the end of the trading day there are those who come up to me a say, "I knew it, I knew you would be selling today. I should have known the market was going down."

ALS: So you move the market?

POP: It seems to be their thought, but it isn't the case at all. You see, if I am selling to take profits, I am aggressive in doing just that. It is that I have a position to get out of, and it so happens there are others doing the same thing. Maybe they have a signal close to mine. It is inaccurate to think anyone moves the markets. If they could, I wouldn't trade! The truth is that the BEST LOSER is the long-term winner.

ALS: One of the traders (on the Futures Talk forum) had some good suggestions on phases of this book. He calls step one "preparation." Let us continue with that suggestion from the forum.

POP: Suits me fine.

Chapter 4: Preparation for Trading

When several traders who use the Futures Magazine Talk forum learned there would be a book by Phantom of the Pits, they made suggestions. We are going to start this chapter with an anecdote from Ulrich Eckardt, a young trader who was born around the time Phantom was learning his first behavior modification about trading.

When Ulrich was in the States as a youngster, his uncle wanted him to paint the staves on his roof. Excited as any child at a young age to earn money, he was eager to start. He grabbed the paint and a brush and decided to hurry onto the roof. His uncle stopped him and gave him his first lesson in trading -- or life, for that matter.

His uncle proceeded to tell him the requirements for completing a job. First, you must be properly prepared. Second, you will do the work and, last, you will do the cleanup. It seems we can follow that train of thought just fine. 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?

POP: 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: Where do you suggest they begin?

POP: Get your office ready! Pick out your office where it is comfortable for you to have quiet time and a proper place to relax.

Trading is going to be an all-out effort if they expect to climb the mountain in front of them.

The first thing is to get a comfortable chair. It must be a proper chair in order to start behavior modification immediately.

ALS (laughing): I really have heard strange things but really? The readers are going to think this is a joke book! A chair?

POP: I'll tell you the reason for the remark about the chair being so important. There is significance in what I am going to tell you about the proper chair. You see, some traders think the market is to position yourself and lean back and wait to get stopped out or take their winnings.

It's not. That is where your chair is going to save you more than it cost you. Don't get one of the lean-back easy chairs as they will be too comfortable. As with the markets, you must be reminded daily that you can never let yourself get too comfortable in your market positions.

Don't get a standard rocker, especially if you have a cat with a long tail, as it moves all over the place. What kind of chair do you think I am talking about?

ALS: I'm supposed to ask the questions! I know your chairs so that is an easy one to answer.

POP: Okay, I'll give you the answer anyway. You want to get what is known as a slider-rocker chair -- one that rocks back and forth over its own base without moving over the floor. Even get yourself an ottoman. The big reasons are as follows:

First, in your trading career you will find that the markets go back and forth without going anywhere a lot of the time. Your slider rocker chair will remind you of this every time you use it. That step is important to drill into your thinking. Your chair will not move around the room but will rock back and forth.

Second, in your trading you will find you do not ever control the market but only your position. Your chair is the same way as you can stop your position wherever you wish. I want you to drill that into your thinking also.

I will repeat what I just said because it is important. You can stop your position wherever YOU want! You wouldn't think of letting the chair oscillate if you didn't want it to. Same in trading. You can stop the market's oscillation any time you wish. Simply stop (remove) your position.

ALS: I knew you had a good reason for the proper chair. Do you really believe this helps?

POP: How much easier can it be? No one has to remind you to stop your chair from rocking back and forth. You will do it without thinking. Your trading position will oftentimes need to be stopped. It must become second nature to automatically do it at times.

This simple symbolic gesture for your office will save you lots of distress in your trading.

ALS: Okay, we are now prepared with an office and a chair. What next?

POP: Next, we want a clock with accurate time -- a battery -operated clock so you don't have to reset it often. The most important part about the clock is to get one that actually talks to you and gives you a reminder of the time by talking. Instead of looking at the clock for time, it will remind you what time it is.

It's another symbolic point to start behavior modification. You see, we remember things well when we associate them with something else. Memory experts will tell you this also. When the time announces itself, you must realize you are required to work with your positions and not let the market work on your positions. You must always act promptly and deliberately within your plan.

The clock can be used to reinforce your thinking and behavior.

ALS: Aren't you making an assumption that traders are going to be free while the markets are open? Doesn't this leave out the poor trader who works two jobs and seldom has time to kiss his wife, let alone trade your way?

POP: So it seems. But, no, I am not making that assumption. My concern in preparing a trader to trade is to make behavior modification immediate from the beginning. The chair is to be used whenever any trading plan is developed and thought is given to what the market possibilities on your position might be. The clock is to be there to remind you of promptness every time it announces.

The office setup is to give the trader the message of importance to be in control of their positions and not delegate it to the markets. Your office is important because you must be in control. Remember, we used to have our small space in the pit and what did we call it?

ALS: Your office.

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.

Last of all, face the north and acknowledge you actually know which way is up. This gives you a better sense of well-being by confirming to yourself that you are in total control. You will need that total control when you follow your trading plan.

ALS: Not everyone can do or would want to do as you suggested!

POP: I know! Some will be at work or on their way to their work, but they can still do those things as they commute. It is important to acknowledge the reason for trading, regardless of your situation or reason. Thirty years ago I would have thought it very strange to take these steps.

ALS: Do you do these things?

POP: Yes, in my own way I do. Every trader, whether beginner or established, should set up a routine to follow as I suggested.

There is more benefit from it than can be seen at first thought.

ALS: It all seems like a lot of work, and we haven't 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.

ALS: Are we ready to start yet?

POP: A couple of more items. You need to acknowledge your reason for trading each day. If you can't afford to buy the chair and the clock, then you should postpone trading until you can, the reason being that you need every aspect of trading in your favor. If you do it all right, there will be better times ahead.

The next thing I suggest is to get a favorite book to read.

The last thing I suggest is to pick out a person you admire most in your life for their accomplishments.

ALS: What would your favorite book be?

POP: I shall tell you of a suggestion from a very brilliant trader. His suggestion is "The Art of Warship" (the U.S. title might be totally different) by Sun Tzu. The book was written about 2,500 years ago and forgotten for a long time. Because it was in Chinese, there are different translations.

The best one is with a word from James Clavell. He based his noble house saga characteristics on that book. The book discusses rules for war in ancient times but can be translated into business -life, private relations and even trading. Sun Tzu's rules have been alive for 2,500 years now and still fit perfectly.

ALS: Why is a book important?

POP: On bad days, instead of coulda-woulda-shoulda, you must expel your feelings of defeat as soon as possible because, if you don't, it will affect your next day's trading. Read that book if just for 10 minutes. Make it a routine.

ALS: I guess I have a few things to learn myself. You said to pick out the one person you admire most. Why? Whom do you admire most?

POP: There is a great deal to be learned from the person you admire most. You will need to understand your ability to become an admired person if only in your own mind. I have changed my most-admired over the years, and now that person is younger than I am.

There are many reasons I admire my choice. I'll give you the most important reasons. She gives and gives of herself each and every day. She is not selfish, and she truly cares about her fellow men, women, children and all life on this planet. I admire that so much. I hold her responsible for showing me the light. She is the only Oprah I know.

ALS: Does she know you feel that way?

POP: No, but it is important to let your most admired person in your life know they are indeed most admired. It goes right to the positive example you need in your trading life. Do it! Let them know, even if there is no time for their acknowledgement. You have done your part at that point. It is good mental food.

ALS: Are we ready to start learning to trade yet?

POP: I would say that for me I am prepared now for the job.

ALS: I guess preparation for trading is a different process than most imagine. I really thought we were going to get into the learning process of how to trade and setting up a program to trade. Are we going to get into the specific ways to trade?

POP: Keep in mind we want to guide and not give specific advice on trading. There are basic requirements that determine a winner from a loser, and that is what I am after in this insight. There are as many ways to trade as there are traders, but the basic fundamentals required are seldom presented to the trader. It is important to present a plan that keeps the trader in the game over their lifetime.

Let us expound on that subject in your book. We can address trading methods in detail in later writings. I have been trying to give some examples on the forum to help traders understand where I am coming from in my rules of Phantom trading.

We will answer some of their specific questions on trading later. I read a short book called "Notes to Myself" several years ago; it was but a self-diary that had been published. It was a small book, but it really had great insight. I like the idea. We can all learn from other people's insight on subjects that we are investigating. It in no way is advice, but we can make up our own minds by knowing those thoughts.

This is more of my purpose in answering your questions for this book. It puts the traders on a one-on-one basis for understanding the complexity of the markets and helps establish a criteria for an overall plan with the most important points at the front of a trade program. More often than not, these simple thoughts are not used or known by most traders. It's sad that everyone feels they have a great fortune hunt in front of them and there isn't a lot of thought required in how trading actually unfolds.

What subject do you want to discuss next?

ALS: It's beginning to be a surprise to me and knowledge learned new again.

Chapter 5: Rule Number 1

When the subject of why it was so important to write this insight, Phantom's remark was always, "Catch me at the right time for that answer." I remember as a child playing out that situation. It was always better to get my Dad to agree to something when the mood was correct. When gathering Phantom's insight on the reasons for this book, it wasn't clear until I caught him at the right time. It was after a big move in the grains in early October 1997.

Art Simpson (ALS): Phantom, I see you agree on the subject today. I need to know just why is this particular time the right time to give your reasons for this book?

Phantom Of the Pits (POP): This day is an example of the reason for this book. The grain market did a total surprise on most traders. Oh, there were those who were fortunate to be on the right side, but most of them took their positions off too soon. I wanted to discuss the shock most traders get on a day like today.

A great number of traders got what we call "killed" today in the grain market. Most all of the new traders are now wondering what they did wrong today. There isn't anything they did right today because they most likely don't know what the right thing is. I don’t mean that all traders are in the dark. I am talking about those who fail to understand what to do and, if they do, don't carry out that requirement.

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.

Today gave us several reasons for a surprise -- harvest pressure is strong and this is a day you expect there to be more selling by the producer than normal. Expecting prices to be pressured by hedging and seasonal influence is the correct way to trade in most minds. You can't argue with probabilities. It is not what the trader does with his trades until the market starts a big move like today's. That's what separates the big winners and big losers. There were more big losers today than big winners.

There are traders who, because of today, can't make their next month's car payment or their house payment now. It just didn’t ever occur to them that what happened today was even a possibility. They were over-positioned, even though they thought they had a good protection plan. They used stops okay, but they forgot to tell the broker to place the order.

Everything they did was based on their thoughts of how much they could take out of the market today. Their trades are designed to lose but not because of the good traders or the way the market works but by their own hand. The worst part is they don't even know it was at their own hands.

It is sad anytime a person's heart gets pulled from their dreams but even worse when they lose money, too. Sometimes they lose a fortune in such a little period of time. It has happened to every trader. It happened to me when I was smarter than the market.

Why does it happen? Mostly because a trader's plan doesn't consider, "What if I am wrong?" Their thoughts are always expecting to be right.

Herein is the key to being a successful trader. I have learned this over and over again in my trading career. I haven't found one trader to tell me what I am going to tell you. The reason for our agreement to give something back is that all of these big losers are doomed from the start unless they are given the knowledge of what the market can do to them. The blame is within their own responsibility and not anyone else's fault.

Six months ago we started our journey in presenting one of the most successful sides to a market strategy. On the Futures Talk forum there have been exceptional traders who have read the information I gave and did not understand the simplicity of what I said. We will have a better exposure of presenting the same information in this writing.

I never want to see a homeless person and always wonder how they became homeless. If traders aren't aware of what the market can do against them as well as for them, they will head in that direction. Many homeless people I have talked with have had bad luck. In most of our lives we will experience an evening out of luck.

In trading, if you have bad luck, you will eventually have to stop trading. To be prepared for that bad luck is a requirement in trading. You will not survive if you do not plan for bad luck. My first steps in trading remove the bad luck altogether.

ALS: I know what you are going after here. Should we put this in red letters and double the size of the print here?

POP: Yes, I think that would be appropriate, but traders must discover for themselves what I am telling them. It will save them from an outcome that they never discover until it is upon them. So let us not over-emphasize the most important point of any trading plan here as we will drill it into their plan until they survive at all costs in trading.

There are those who, in a modified way, do exactly as I suggest but may consider it more money management than a plan for trading positions. Every broker tries to limit a customer's exposure and protects them, but the key word is "limit." Putting a limit on something infers that you actually can put a limit on exposure when having a position established. You really only have a ballpark limit in most cases. It seems to be worse than you thought in looking back.

I shall present two main rules in trading. Both are required to be successful. Every trading plan must start with the understanding of these rules. Before I give the first rule, it is important that what we say is understood correctly. Next, it is important to have this rule become second nature in all of your trades. The second rule I shall state and explain after the first is adapted into behavior modification by the traders reading this.

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.

What kind of limits did I just give you? Are they life-saving limits before you cross the intersection? Yes, they certainly might be, but you will never know that if you follow the restriction each time you cross the intersection. You can't know if it saved your life for you prevented finding out by looking each time.

But what if you don't look and you lost your life. You certainly won't know you should have looked either.

Does the restriction tell you that, if you look, there will never be any traffic running the stop light? No. Does your experience of crossing and looking tell you what the probability of someone running the light will be? You can make an assumption based on your knowledge at this point. What does an assumption do? It actually presents criteria based on proven facts that are a possibility. It in no way gives you a high probability or low probability but the best answer you can present.

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.

How you understand your plan is how you will react to a situation. You must learn that, when you are told not to do something in trading, it is not ever the same thing as saying you must do the opposite.

I often get feedback telling me I told someone to do what I never said. As an example, I will tell you not to sell beans today. Would you tell me I told you to buy beans today? It's not funny because most traders would. This is what I mean by "correctly."

We have covered "assumption" and "correctly" in my terms . . . what I expect you to understand in the first rule and second rule. If you don't have those correct, you will not be able to fully understand and accept the two rules for trading required in all plans.

ALS: Let me get this straight! When you say to not do something, you are never telling me I must do the opposite. Seems simple enough. Thanks for making that point by example.

On your meaning when you say "assume," you are telling me there is a possibility or probability based on some fact of the situation that requires me to acknowledge and always have a plan for the possibility or surprise side in trading. Your meaning of the surprise side of trading is the side that presents the possibility but not the highest probability. Am I correct on this?

POP: It really is quite simple. After our dialog, it will be more clear to the traders as to how to interpret our rules. I don't want any misunderstanding. I say with a high probability that the readers will read our dialog again.

We often don't understand how news stories get out of context, but it can be done pretty easily. Lack of proper assumption is routine by lawyers a lot of the time. They'll ask someone something like, "Who is in the picture?" and when they find out it was the defendant, their next question is, "Were you there when the picture was taken?" In their case, it might be proper for information gathering, but you as a trader must have proper assumptions as you cannot know exactly how a market is going to react each day.

Trading is not a favorable game in most circumstances, and that is what we must use as our assumption in trading. The big mistake made by traders is thinking and expecting trading to be a favorable game.

You have execution costs or slippage when getting in and out of a position as well as commissions as a cost factor to be subtracted from your winnings or added to your losses. The market spends much time in an unpredictable mode. Trends both short - and long-term do exist but not 100% of the time.

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 is 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.

So here is **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 criteria 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.

Your thinking should be: When your position is right, you have to do nothing instead of doing nothing when you are wrong!

I don't mean to repeat and repeat but, in this case, you will better understand the rule the more you read it. It is very critical to your success in trading. Over time it has proven to be the rule which keeps the losses small and keeps a trader swift and fast to take that loss.

A person's thinking when the market proves a trade to be bad is counter to what is productive. By using the rule properly, you are productive and don't have to face the demoralizing effect of the market when you have a proven wrong position. This enables you to continue to trade with the proper frame of mind. You are more objective in your trading this way than letting a negative reinforce your thinking. This way you only let good trading reinforce your thinking and actions.

ALS: Phantom, not everyone is going to agree with your first rule. There will be traders who don't feel this is a good rule for them.

POP: Look at it like you would buy a new car. The dealer says you can drive the car you think you want for a month and we will give you credit toward another car if you don't want to keep it. Okay. After a week you decide you don't want this car because it just isn't right for you. You take it back and the dealer says you only owe $80 for rental.

You don't buy the car and keep it until it proves to be the wrong car for you, which could be months from now. If you did, you would lose more of what you would have to pay for the car.

Most traders keep their position until it proves to be wrong for them. I say don't 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.

Which would you choose? You have an opportunity of a 10% probability of making money in the long run if you take a position until you have lost 10% of your equity or made 10%. Or take the opportunity to have a 90% probability of making money if you only keep a position for three hours unless it has proven to be correct by that time. It is pretty clear which choice you would make.

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.

ALS: I can see the need for much discussion and review of your first rule.

POP: It's critical to have Rule 1 in force by next surprise day. The one thing that teaches most traders to take a small loss is a big loss.

ALS: Yes, but that is expensive behavior modification. My wife, Karen, just gave another parallel example of your Rule Number 1.

She points out that you don't go buy clothes, take them home and wear them until they prove to be wrong for you. Instead, you try them on and make sure they have the proper fit and look before you buy them. I like her thoughts along this line.

POP: You can see in ordinary life you try to spend the least amount of money and have the least amount of waste. Why should you do it differently in trading?

ALS: The answer is surely that in trading human elements take over. Everyone knows them and most likely have come face to face with them. They are fear and greed.

POP: We must remove the emotional element as quickly as possible in trading. If you can do it before you put on a position, you have a good start.

Note: *To give some insight on Phantom's Rule Number 1, several traders have indicated their experience with it as presented on the Futures Talk traders forum. The following is a copy from one such trader, M T*:

I've read Phantom's postings about Rule Number 1. The price action must confirm the position or get out quick. What I have done in trading is to enter a position and have a chart position that is a good spot to exit if the price moves adversely. This would usually either be the previous swing point, which, if violated, would be a signal for a possible new trend and would definitely be the signal for me to exit my position or it would be the first 15-minute high (resistance) and low (support), if it were violated adverse to my position.

So that meant there were times when I entered a position and the price action was flat or slightly adverse but not so adverse as to violate my predetermined chart exit position. I would stay in because there was no violation. I thought this meant I was following Rule Number 1.

I was staying in not because the price action "confirmed" my position but because the price action did not "confirm" my stop-loss chart signal. I was thinking this is what Phantom means. I have to tell you that with this strategy I was keeping my losses small, just by the nature of my plan.

But I was unwittingly violating Phantom's Rule Number 1. I thought I had modified my behavior but, in reality, I was “behaving" incorrectly. It's a very subtle thing, I believe.

Then last night, in a restless sleep thinking about my trading, an inspiration came to me (don't laugh too hard). A lot of my losses had come after I had been in a trade for an hour or longer, where price action was mostly flat but my stop point was never touched. I realized I would have been better off if I had just gotten out in the first 15 minutes. It would have been a loss, but it would not have been as much of a loss as my chart stop point would give me.

Then I realized that is what Phantom means. My position was not confirmed in those first 15 minutes! It wasn't violated according to the nuances of my plan, but it also was NOT confirmed. Get out.

Well, lo and behold, I went back over the last three months of trading and, using the exact entry points (fills) that I used every day, reviewed what would have happened if I had followed this 15-30 minute confirmation rule. Let's just say it made a huge difference.

I know back-testing is not completely reliable, but it was significant.

Anyway, thanks Phantom. I'm still learning. I'm still here trading. Started with only a 5K account, day-trading, and I'm still alive without even following your rules. I'm below breakeven. Let's see if I can change that. I'll keep you filled in. Once again, many thanks. You once asked for Rule Number 1 stories. Well, there is mine.

Note: *The following is an excerpt from a message in the Futures Talk forum that Phantom presented to help understand Rule Number 1.*

Behavior modification is knowing the limits. Let us use basketball shooting as an example. Say you shoot 1,000 times and make an average of less than 50% of your shots. This means you have a better chance of missing than hitting whenever you shoot.

After practice, let us say you are able to hit 55% of your shots. You would expect to say that, now when you shoot, you have a better chance the shot will go in than not.

Same in trading. You must know what the limits are! 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. When you are correct, you must continue to use Rule 1 to keep losses small. It's okay to be wrong small but never okay to be wrong big if you expect to trade in the long run.

Trading is not easy. Most traders just let the market do its thing. The correct way is that you do your thing and control your positioning. You control your positions by using rules that keep you in the game.

Rule 1 is the most important rule in any trade plan. Rule 2 will be the other side of the coin, which must be dealt with if you are expecting to remain in the game in the long run.

Learn to be wrong, fast.

Chapter 6: Rule Number 2

Art Simpson (ALS): Phantom, do you want to continue on Rule 1 or is it time to move on to Rule 2?

Phantom of the Pits (POP): There will be lots more on both rules so let's get to Rule 2 and see the other side of the coin. We will need to get to the qualifier of Rule 2, but we will do that later. We'll state **Rule 2** right now:

Press your winners correctly without exception.

Sounds pretty elementary but correctly is the key. What you hear quoted most of the time is "cut your losses." Cutting you losses is only one side of the coin. 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 isn't correct.

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.

The other good reason is that you must be larger when correct on a position than when your position is wrong.

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.

At all times during the trade it is important that Rule 1 be in your plan. This includes when you are adding to your positions to protect your trade from any major reversals, which often happen.

Your plan for adding positions could be as simple as using each buy signal for longs and each sell signals for shorts. It could be on 45-degree retracements or support lines.

Without exception the rule indicates it is not an arbitrary decision on the trader's part whether to add. Keep in mind this does not exclude the correct method of adding in respect to variables of different trading plans. What is a correct way of adding in one trade plan may not be in another.

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.

ALS: Phantom, what do you say to the traders who are going to ask you, if they must add without exception, why is there any question as to how to add correctly? Doesn't the fact a proven position is correct indicate it is time to add?

POP: Adding can certainly be done this way, but it is not always good for all trade plans. I oftentimes add immediately when my position has been proven correct because I tend to do it in smaller steps and work more long-term trades.

Let us say you are only a day-trader trying to take a little out of the market each day. You will find your adds at the wrong place by adding as soon as your position is proven correct due to the nature of the markets. They give you back and forth action much of the time, especially looking at it as a day-trade.

One correct way for a day-trader is to see that the position is proven correct and then add at a proper retracement. This will not be the case for a trend trader. A trend trader would most likely have at least one add at a breakout or breakaway gap. It all depends on your trade plan. Your method of adding must be validated by your trade plan.

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.

Rule 2 says you must add to your winners without exception. As a day -trader, you are only keeping a position if proven correct or until proven correct. In a sense the market is deciding how large your position will be. The variable can be from all to none in this situation.

Trend traders will get larger when they are correct, but day-traders will start larger and get smaller when they are wrong. Day traders can be large when they are wrong, but trend traders will never be large when they are wrong.

This is due to the nature of a loser's game for day-traders. By reducing your positions when wrong, your exposure is not extreme for a day-trader, provided Rule 1 continues to be followed.

Exposure and risk are also an element of time in a position. That is the edge day-traders expect to work to their advantage. Trend traders are expecting higher probabilities in smoothing out the swings.

ALS: Aren't you changing the rule here for day-traders?

POP: Rule 2 must be used if you expect to make money in the long run. Your validation of how you add is according to your trade plan, and a day-trading plan is certainly going to be geared for the quick profit so why shouldn't you have your biggest position to work with from the start? Right or wrong, you are going to use Rule 1 to protect at all cost.

Criteria will be different for the type of trading you do, and scalping or day-trading has a lower probability of making money than most think. You have to be right when you get in and out and twice the execution cost for each trade. A day -trader takes most positions on a fade of an expected range and on what they consider to be the edge. "Correctly" for day-traders is different than "correctly" for trend traders.

ALS: Wouldn't you say that adding for day-traders isn't always a good rule?

POP: Adding correctly regardless of your time period is useful in making bigger gains in the long run. Day-trading is certainly a shorter run. A day-trader should cheapen the cost of what they have, and to do this you almost certainly have to have your biggest position on first.

I use to watch a very good trader put a big position on and take it off until it proved to be correct. He made good trades and ended up with bigger gains by doing it that way than by adding after being proven right.

What you are missing here is his positions were larger at first, and this really is the Rule 2 in that you still are larger when you are correct than if you had added later this way. The drawback is that you are larger when you are wrong, too, but it's still a protected position if you use Rule 1 properly. It is acceptable but, again, I must remind you that Rule 1 is critical here.

It looks like a modified Rule 2, but as I stated, your trade plan determines your method of adding. It is understood that you want to have a larger position when correct. This is a way to do a trade when you don't have an established trend and the probabilities are lower.

I can't rule out this method. I have used it on short trades. When I feel I am trading an established trend, I have criteria for adding that gives better positioning.

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.

The followup dialog below on Rule 2 took place as a result of feedback from the Futures Talk forum when traders expressed their questions about Rule 2.

Followup to Rule 2

It is clear that the traders are interested in more review of Rule 2. From the posts on the forum, it seems to be a problem of understanding not only why to use Rule 2 but also exactly how they should use the rule.

I asked Phantom to give us more detail on his Rule 2 so it can become more effective for the traders. Phantom feels there are several problems in understanding his Rule 2 from reading the posts of the trader's forum. We will address a few of the problems and also try to explain more on how to use Rule 2..

ALS: Phantom, it looks like your Rule 2 is not a good rule for most of the traders who have given return input on your rule?

POP: By now, you should see why we are spending so much time on just Rules 1 and 2. Rule 1 understanding has been pretty good so far. Rule 2 has been a problem. I could see that coming in the past posts. There is doubt in traders' minds as to the real purpose of Rule 2 and why they should be saddled with a rule that requires them to put a bigger position on than they want to have.

The traders aren't going to like what I am going to tell them here, but I know they want me to be totally honest with them. There are going to be several reasons why a trader does not want to come up with a plan to add to winning positions. I will try to cover some of them.

ALS: Why is it that Rule 2 doesn't seem to work for most of the traders?

POP: One simple fact! That fact is they are putting their entire position on at their entry into a market. This is not Rule 2's intent. A total position is a series of positions until the complete expected position is established. They should only have their entire position established upon getting the move as expected. Rule 2 addresses this expectation.

Keep in mind that I don't blame the traders for their views on my Rule 2. It is not their thinking but their trading situation we must address as a place to start with Rule 2. It is a solid rule and its importance cannot be diminished in trading. Until you see the reward from Rule 2, it is very difficult to understand a bigger position being anything but wrong to you as a trader.

That, of course, is going to be some of your behavior modification (covered in a later chapter). Learning by experience is the only way most traders will be able to accept this rule. It is important to learn this rule by more than just example. It is not a rule you learn by making a mistake. It is a rule you learn by being rewarded for using the rule.

How can we reward the traders for using this rule by example? I don't think we really can. Therefore, we will explain why they are having difficulties and ask them to soul search as to the truth of the problem being within their own situation.

The nature of trading is that more often you see a negative effect from what you have just done. Seldom do you see or remember the good effects from the proper trading as often as the negative. This will leave a plan to add to winners on the back burner when it is time to add unless you fully understand the need for this rule.

The first problem with understanding Rule 2 is that any time a trader cannot or does not incorporate a plan to add to winners, they may be under-funded and unable to margin properly the additional positions in the add. Another aspect of being under-funded may only be that over-trading in the original position is actually a problem from the start.

Any time you plan a trade program, you must consider what size position you are looking to establish. If your position, as mine often is, is that you will have a total of six units upon completion of your position entering, you can have a better idea of what you must fund. You need to be able to fund the position properly from the start.

I believe most traders want to have a certain size position, and that is the position they place from the start. This is not a correct way to allow you to use Rule 1 and definitely Rule 2 properly. When you see an expected move from the start of trading, your thinking is counter to ever adding in the first place.

True, you should be at least twice as big or larger when right than when wrong, but you must work that position into your trading plan. You never risk it all on the initial position being correct or you are defeating the rule. You are trading more like a day-trader if you put it all on at once.

Another reason for problems with Rule 2 is that traders are actually day-trading so they won't have undue risk in their positions.

This will cut their odds of making the goals expected in any kind of move. It is more of a hit-and -run type trading.

This type of trading leaves you vulnerable to the flow of orders into the pit. We can never estimate the exact quantity or direction of order flow for more than a very short period of time except in established moves. Sure, we have our three-phase theory, and it does work to an extent but never good enough for us to know without seeing beforehand just where the price turns are going to be. Looking back, we can always pick the price turns and possible support and resistance.

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.

I knew we would have problems trying to convey Rule 2, and that is part of the reason we have stepped back to wait and see the blank stares. We have those blank stares as I can tell from reading the posts and resistance to Rule 2.

That is okay for it is what can be expected from such a rule. I don't want to get into telling the traders their game plan for actual trades or their trading programs. What I do want to do is to establish that you must consider the favorable side of adding to positions when they are correct.

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.

There are several good aspects to the rule. We have discussed a couple of them previously. The fact that reinforcing a correct position actually keeps you thinking correctly is one of the important reasons for Rule 2. Another aspect is that, of course, you will be with a larger position when you are correct.

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.

Now, I am not laughing at anyone! I meant what I said about my statements of respect for the small trader! They need to know just why and how important it is to press winners before they will ever be able to approach the idea into their trading plans.

It isn't an obvious thought to think that, even before you trade, you must have a plan to be bigger when the market is going your way. The first thought is always what size position to take to reach your goal.

You must understand that you are not the one who will determine your market position size. It is going to be the market and must always be the market. Rule 2 is going to tell you to put a complete plan into effect before taking the initial position.

The light is starting to come on about Rule 2 now. I can see some raised eyebrows in anticipation of what is possible now. Not only is Rule 2 a saver of your drawdown by its proper use, but it is an enforcer in pointing out that you are looking to have a complete position when your expected move allows you to be totally positioned.

I am a little ashamed I did this, but I purposely held back the best part of the rule to see who would come up with the important aspects of Rule 2. Rule 1 was hit bullseye by at least half of those on the forum who thought it out.

Rule 2 may have had a few who understood it but didn't really make a remark on it. I do know one who did hit the nail on the head:

Gerald Mullins. (Perhaps I better get permission to use his name before the book version comes out.) At any rate, there were others, I think, who did not indicate much about Rule 2 who most likely had some good clues.

On adding to winning positions, I could give you my trading plan and my signals and tell you exactly when to add. But that would be doing the same thing as digging out the Mississippi on the west side and changing its course. I would be better off trading for you, and you would be better off giving me your money to trade. I don't want that at all. Don't forget my faith in the small trader.

You shall have to see the prospects of Rule 2 more clearly yourself.

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.

The protection is Rule 1, but the biggest protection is Rule 2! Now I am going to tell you why Rule 2 is the biggest protection of all.

You never suspected what I am going to point out.

You have all heard that you should not add to a loser! Well, Rule 2 takes care of that from the start by keeping you with a smaller entry position in the first place. You never have your entire position until you are getting the move you had expected.

Now, why would I encourage you to have half of your total position at entry? Because it is a losers' game from the start and you knew that from Rule 1. Now, from Rule 2, you find out that, to trade it correctly, you were never really suppose to have your initial position upon your entry of a trade.

Can you tell me that you don't expect the market to fade your trade to a slight point? You really are going to pick a range when you are right, and you are going to be at least half size when you are not proven to be correct. When you take your loss with Rule 1, it is a milder way of slapping your equity from the start.

Are you beginning to see any of the value of Rule 2 yet? We can go into examples but understanding the rule is what we want now. Trading programs will all have different aspects of entry and adding. It is up to you now to understand Rule 2 and try to incorporate it into your plans.

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 favor.

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.

Now, you have the background of Rule 2 and can understand it a little better. Whether we go any further trying to impress this rule upon traders depends upon its acceptance by the traders in whom I have complete faith. They shall continue to live up to my expectations, and I shall continue to be proud of the faith I have in them.

I say it again and I know it for sure: Clothes makes the man, in most cases, if that man lets it change his thinking and feeling to a point of betterment. Knowledge is your new suit.

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?

To want to have a correct position from the start is over-trading when you place an entire position. Traders don't add because they have their position. The big drawdown is that when that original initial position is wrong, their losses are as large as their gains seem to be if they were right. We don't want that.

Keep in mind that trading is always a losing game unless you change the odds. With Rule 1 and more so with Rule 2, you are changing what you can in trading to your advantage. If any position is taken without forethought about adding to it later when it has been a proven correct position, you are in a 50/50 game at best.

ALS: You also said the light should start coming on for the traders. Do you think this is enough to digest or should we continue?

POP: It's time to step back and let them get off the elevator. Let us see how many frowns we still have and if we need to review more on Rule 2. My faith in the small trader is that they are the best majority of one I could ever want in my class. I am willing to stoop down and consider the questions of my little Phantoms. I can do it for a day, and I can do it always?

I am trying to make it possible for them to become the best traders they can be. I know they will grow up faster than they realize.

Good luck to them as we see what their new plans become.

ALS: Any lights coming on? Do we understand CORRECTLY yet?

Chapter 7: 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): In trading, rules are not meant to be broken for your own sake. The rules bring you to a no judgment type approach. You design your trade program and approach to trading by keeping the major choice of positions within your program while keeping the confirmation to the market. Your only job is to follow your trade program while obeying Rules 1 and 2.

The rules take away the need to decide while the market is open what to do during the trade day. You will have a good idea what you expect of yourself at all times rather than guessing what is actually going to take place with your positions. You will either be proven correct with your positions or you simply get out of the positions. You don't stick around to get hurt with exposure if the market is not proving you correct.

Yes, you will have exceptions when the rules don't corporate with you and what the markets are doing. This will be a minimum problem, as the rules will keep you in the trading game for long-term trading. 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.

ALS: I notice a few questions coming up (on the Talk forum) about excessive commissions when using Rule 1 . . .

POP: 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.

Most traders think it is bad for them to be wrong and, when they are, that’s it for the day. Well, being wrong is the best chance to put a correct position on with your next trade as you certainly can trade again. If you keep a trade that never proves to be correct within your program of time element, you will never be able to correct a bad situation but only be able to remove that bad situation.

Your mental well-being is worth a lot in trading. You can trade well when you are thinking well.

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 turns. The chop-chop markets aren't going to give you good income.

While it is true that being in control of your position in the market rather than the market being in control of what you are going to think about your position next simplifies your trading life, it also greatly enhances your ability to make good trades. The main reason is that you know what to expect and have those expectations up front from the entry of your trades.

If you supervise building a house and you have several trades working on the house, you certainly make sure the plumbing that goes in the foundation is being put in correctly before you walk away and let the foundation be completed. Building a position is the same in trading as in most occupations. If the plumbing and foundation on the house are completed correctly, you move to the next step.

Still, at any time the prior work finished could create a problem. Let's say the foundation settles and cracks the sewer pipe. Would you continue on the house? Of course, you wouldn't. Well, no way will you continue with a trade that proved correct but now shows problems.

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.

Along with that plan to never miss a move, I can give you the big drawdown and the rules that will eat you alive if you can't afford the drawdown. In the end you will have what you think is a very small profit for all your time and patience of going along with the plan. But, yes, you will have a profit.

That is not what the usual trader is about. He is not in this game to earn a few extra bucks for his vacation. He is always after a better return than most would consider fair in any other investment. That is another reason for creating Rule 1. 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.

Obviously, the small trader who loses big will quickly go to the sidelines. Sometimes the sidelines are not even there for a few.

Their losses take away their hearts. Believe me, for I have seen them. It is the saddest thing in the world to take away someone’s dream -- more so when they never knew the enemy in the first place.

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.

Rule 1 is the rule that keeps you in control at all times when that position is in place.

Behavior modification can take place in many forms, but you need a rule to show you what must be done at all times. One trader suggested the rubber-band method. Each time you took a big loss or did some bad trading, you would snap the rubber -band on your wrist -- that is, if you remembered to do it. I don't like this method, but it is better than a lot of others.

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! Only a big deal if you don't get out when it isn't confirmed as a good position. No need to ever feel bad. 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: Human nature is as you say. I know you did some research on human nature of traders and non-traders. Perhaps we can talk about some of your data.

POP: I'll tell you what I would prefer to do. It would be better to just suggest some of the experiments and let the readers come to their own conclusions. Let's keep that in the behavior modification tips.

ALS: There were some questions on when to get out of a position. I realize this is out of order here, but I know we need to include Rule 2.

POP: That's okay, as a common question is when do you know when to get out of a position. Actually Rule 2 addresses this very well because it says to press your winners correctly without exception. Rather than getting out of a position with the proper criteria, you will be increasing your position. You only do the adding with correctly proven positions.

The time to get out of a position is not when the market is proving your position to be a correct one. You have the opportunity to be wrong as often as correct, but when you are already proven correct, this is certainly the time to step off of first base.

We have two rules to keep us protected from our lack of certainty and enforcement of certainty. Many trading plans have the trader in a position at all times, the thinking being that the market is either going to go up or go down.

Well, this is just absolutely an idiot's plan. Maybe I shouldn't say it so strongly as I should still have an open mind. I have to put this in the category of thinking a statement that says not to do something actually says to do the opposite of that statement.

Too many times I have watched a fund bid the market so they can sell the market. It's a plan to take advantage of the surprise element in the markets. There was the day when you would only see me on both sides only when I was wrong. I am wrong a lot more lately. That's not bad either!

The readers are surely asking by now: How do we use these two rules?

It's easier to use real-time quotes and markets to prove the points, but because we only have hindsight here, we will do it differently. Let's use the old common day-trading technique, on which I am not going to give you judgment at this time.

You say your plan wants you long if you take out the opening range! Okay, let us say we are trading onions and the price is 1000 ($10). The price goes to 1001 and the opening range was 999-1000. Your plan says "buy" so you buy. You get filled at 1002! Why 1002? Well, execution is getting the position filled! You gave up a slip of 1 tick. Not bad. Most of the time it is small.

We can go into the importance of execution now or continue the trade. Let us continue the nature of the trade and cover the importance of execution later.

Now that you are long at 1002, you are using Rule 1. You assume this is a bad trade until the market proves to you that the trade is good. If the market does not prove this a good trade, you are going to exit the trade. Fine so far!

What criteria in your day-trading plan says you are right? Most say what determines you are wrong. Not us! We only want to know the criteria for being right. Okay, for us our program says, "If in the first half hour the market opens lower than yesterday and moves higher, expect a move above the prior day's high within the first half day of trading."

Our program also says the position is only correct if the market stays in the prior day's top half in the first half hour. Our last criteria for the trade is that it must show a 3-point profit by the close. Now, I ask you, what is your next step?

Your criteria for remaining in this position is only when the requirements of your data indicate to you the position is correct. The other data you would need in the program is yesterday's range, yesterday's high and yesterday's close. Your day-trading program says to use the old rule of opening range breakout. Yesterday's data is critical in knowing when you are correct.

For our example we will use yesterday's high as 997 and yesterday's range as 991-997. It gets interesting here because you are going to decide whether you will exit the position. At the end of 30 minutes the market is at 997. What would you do?

The first criterion of our trade program is in conflict with your day-trading strategy, but you still bought the opening range breakout.

We don't care if the two are in conflict! We only care what causes our position to be correct.

Okay so far. The market has been open a half hour and our price is 997. As you can see, you must know your trade plan before the market opens and what you are required to do. What makes your position correct? You must be in the top half of yesterday's range after the first half hour of trading.

Are you indeed in the top half of the range from yesterday?

I am going to give you the answer indirectly so you can't slip down to find it. We will go to the next step here. At the end of the first half day of trading the price is 996. Are you still in the position? You did take out the prior day's high but you didn't open lower.

Okay we still did it! Stayed in the first half hour. That's right.

Now the first half day price is down to 996 and we bought at 1002 -- still in the top half of yesterday's range. Okay, we are still in the position. Bad entry, though, as our plans conflicted. Should have only taken the position if it opened lower. It didn't. Well, okay, because we are day-traders, we used the opening range breakout. Our entry wasn't the best but so what!

At the end of the day the market is at 992. Are we still in the position? You have the right answer but why? The market had to be at 1005 to keep the position -- it had to show a 3 -point profit on the close.

How would you get out of this position? You would have used a stop close only order after the first half day to sell the position: 1004 stop close only.

The example gives you several interesting situations and perhaps just as many questions about Rule 1. Rule 1 will not protect you from wrong entries! That is your job. You must solve your own conflicts in your trading. Rule 1 did take you out of the trade on the close because you were not proven correct based on the required criteria.

Keep in mind this example is a very different situation than you would expect of your trading program. You can't have a program that says, if the market doesn't go to 980, it looks for the market to go to 1100 sometime. There has to be a time frame on when to expect 1100.

When a market doesn't go up anymore, somewhere it isn't correct to stay in the position, regardless of the expectations. The market must prove and continue to prove. There can be simple or complex strategies in your program, but when the position is not going according to the expectations, it is wrong -- not when it proves your stop price got hit.

Stops? Yes, we did use a stop to get out. We did not use the stop as the criteria for getting out. The stop did not prove us wrong, but the criteria proved us wrong.

I realize that in the example we put conflict, various criteria that was required for the position to be correct and a bad entry. Does this point out more than just Rule 1 to you? Rule 1 will get you out of a position that is not proven correct, but it won't fix a bad entry. Know your plan before the market opens! If you had known your plan in this example prior to opening, you would have never positioned as you did.

ALS: Okay, I see your point. But how can most traders with jobs trade as the example shows?

POP: I can give you other examples, but it all comes down to the criteria for proving a position correct. If you trade by looking in the newspaper each night, your trading plan will be different and your positions must be smaller as you are going to need wider ranges to work with your criteria.

In the example above, you could never have placed the order to buy the opening range breakout; therefore, it would never have been in your plans. You may have had criteria that said to buy yesterday's low plus one tick or two ticks and a time of day order that said, "TOD10:00a.m. sell 993 stop."

The market would have to be in the bottom half after the first half hour to get out as the criteria indicated that, to be correct, the market had to be in in the top half of the range after first half hour.

The other criteria could be met with either OCO (one cancels other) orders or stop limit close only orders. Not all brokers take all orders so your plan must include this possibility of difficulty in trading.

For each tool you lose or don't have in trading, you must reduce your position accordingly to have an effective long-range program. The farther away you are from all the tools you need, the wider road you must have. Reduce the size of your car (position) for the road that isn't wider.

Now that we have your attention, I think it is clear to see how just two simple rules can be exploited. You can't help but understand why trading can be so difficult. You want to be a knowledgeable trader, and you need to take all of the difficulty out of your daily trading when the market is closed.

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. The majority of traders do certainly feel they have a good handle on a trade and are only putting on good trades.

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.

In trading nothing goes right for most traders unless they take total control of positioning and letting the market only prove when a position is correct. I know I am repeating myself, but there is no better way to impress information of this insight upon the readers.

I don't want to see any small traders wiped off the map when it comes to trading, but that is what happens to most of them. They are small and are stopped by the big traders and funds most of the time. If they can understand the urgency of not letting the big traders ruin their plans and hopes, they will do much better.

The first step is what we are pointing out. I know because I have driven the big cars on the small tracks. It is better to drive the small car on the big track, but it just never comes out the same. With a little understanding we shall change that for them.

ALS: I remember an experiment that proved very successful with a group of traders or would-be traders. Do you foresee that situation again?

POP: I have no idea what you are talking about! I wish them well. No, I think an individual is the best minority of one I have ever hoped to reward. Only one at a time in trading is fine with me. It is their dream and my reality. They have to make it happen. If it doesn't, don't blame the messenger. Look in the mirror.

ALS: You and I are traders, not writers. Doesn't it seem strange to you to bring forward your thoughts on trading for others to read?

POP: You may end up a better writer than you think. It's perfect as the best time to learn about trading is when the market is closed. Most traders only learn when the market is open, and what a mistake that can be! It can be costly and emotional. Both are wrong sides of the coin.

ALS: We need some examples of other questions the traders and readers will have on Rule 2. When do we press a winner, and when do we get out of our winners?

POP: I know they would like me to say this is the plan and it is very simple. I can't say that as it takes work, experience and execution at all times.

Most traders -- I don't mean to group them so severely and handicap them -- but it is true most traders look to remove their positions just as soon as they prove them right. They forget what their true purpose in trading really is. It is not only to make as much money as possible but, most important, to make it in the least amount of time. This keeps them from facing the problem of drawdown because they are not trading to face drawdown but only to trade to make money.

I will never forget my mother's words when I was honest with her on a trade one day. She asked how I did the day she visited the exchange. I said I lost a large sum of money. Well, her remark was, "I wouldn't have done that!"

I didn't attend to my business that day and left a trade on. You don't do that. But that is just what traders do everyday. They leave trades on when their mother visits! Believe me, Your mother will visit you every day when you trade! You have to attend to your job of cutting losses.

Just a couple of days ago, I was asked to go out on a nice boat trip for five days. It is costly if you don't attend to your affairs.

There are times you must, above all else, attend to your positions. There are no long-term trades! Only trades that turn into longterm held positions.

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.

Some traders will say they don't really know where to put the trade on price-wise. Yes, you do! The word E-X-E-C-U-T-I-O-N means make sure you guarantee you have that added position.

There are times when execution is the most important aspect of a trade. If you can't get a position on, you sure can't take one off. I know you have heard that statement in the past, but it is with good foundation. You must say "at the market" in those situations.

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.

When a market gaps higher or lower, you are in a position to take the profit-takers position away from them. Do it, but use Rule 1 when you do. That way you will never worry if you are in a correct position or not. Doesn't matter anyway because with your Rule 1, you will do the right thing. It is.never bad to be wrong. Only then can you benefit when you are correct.

Most traders will make a trade and lose a good amount and miss the next trade. Out of step with the market is bad and it gets worse. Don't get out of cadence for long on any one trade. That way you can half step right back in line.

ALS: Phantom, you are acting as if everyone can do what you explained.

POP: Not everyone can do what they must do. Learn what you are capable of doing and stick to those parameters. Use the protection rules in your parameters. Don't modify them or misunderstand them for your own satisfaction. Use them as they were meant to be used. They will hurt you if you don't use them correctly.

ALS: We could use more examples of how to use your rules, but I feel the readers will get a little overwhelmed if we continue to throw examples at them. We could address every situation and eliminate most of the required interpretation by the traders. I don’t think we should do that at this time.

POP: Yes, I totally agree, as the integrity of a subject is not always how well it is presented but how well, in this case, it is impressed upon traders. It is up to the trader to fully comprehend their part of what is required of themselves. They can make mistakes but as long as they use the rules properly, they will stay in the game.

It is a fine line when creating a program to trade markets. I have always suggested they establish their own criteria based on the best knowledge they can find. You start with point-and -figure charting to understand the characteristics of your market. Even if it is someone else's chart, you must see what the market is capable of doing to traders.

I am not saying that there aren't good trading programs but only that the trader must fully understand where the criteria in these programs are establishing the entries and exits. These programs will never have Rules 1 and 2 in them so you will have to incorporate them, which could void the program.

So be careful and express your concern to the program vendor on these matters. Your concern is to keep your drawdown within reason to allow you to trade forever.

So, **Art**, have we covered it yet?

ALS: Never in a thousand books can we cover it completely, but I think we have made our point and you have made your mark on the reader's thinking.

Chapter 8: Day-Trading

"In day-trading when the last trade is made, you expect to be out of your positions. You are letting the clock decide if you win or lose. That, to me, is a restriction.'" Phantom of the Pits

Art Simpson (ALS): Just by the title of this chapter I can see a picture being painted by an artist. All these traders standing with notebooks, bow and arrows, alarms ready to sound and no bids in the pit as quiet sets in.

Phantom of the Pits (POP): Yeah, and I can tell you the artist.

ALS: Who would it be?

POP: Leroy Neiman! I'm impressed with his work. It is something he would paint. I can't help but put him in the class with Oprah, MJ, Don Gibson, LeAnn Rimes and . . .

ALS: . . . and Phantom of the Pits!

POP: Phantom of the Opera maybe but not the Phantom of the Pits! You must remember that no one knows who the Phantom of the Pits is. In fact, I can argue that there will be but this one book! Only this one!

ALS: Now wait a minute. You said it depends on the reception of the traders when we started this project six months ago. Are you backing out?

POP: That is something I want to discuss with you. There is no big profit in writing unless you can really write. I can't and don't want to write except for my own keeping. You can make more money trading than writing.

This brings me to my point of insight in trading. I wouldn't do this insight on my own for it would be a waste of my time. In fact, I am sure this reason is the primary cause of lack of knowledge presented to traders based on experience. Theory is great but not a learned behavior. Behavior is the key.

ALS: Phantom, you forget easily as it was YOU who came to me about giving back by helping other traders. You were as sincere as Michael Jordan is on the court. You don't fool me! I know what your plan is!

POP: Yeah, perhaps, but I know you won't tell anyone unless I let you.

ALS: I am going to tell without your permission right now! You are going to cut your losses, if any, in this project, and you certainly will press your gain, if any, from this insight give-back.

POP: That's good. Wish I had thought of that.

ALS: I would like to know in day-trading if you should use the same rules as in longer term trading. Are there times when you shouldn't use Rule 1 for day-trading or any trading, for that matter?

POP: Never, in trading forward from now. Looking back, you could say there are certainly times when you would have been far better off to forget the rules. But that is looking back and that is not how you trade. You must plan for what will eliminate you from trading in the long run and protect yourself.

ALS: There are going to be lines of traders lined up to tell you why you are wrong!

POP: Let me point some things out here. Many years ago when I first started to use computers and their speed was slow, I had so much to do that I had to get outside help. I had this one program that I could have written but it would have taken too long. I didn't want to write it in assembly language because I needed to see every step work before I could use the program. I contacted newly established programmers and some not so new to help me.

It was sort of an experiment within itself. I narrowed my choice down to about four or five possible candidates. I asked each one of them to solve a problem for me and gave them access to a computer and a basic programming language. The question I asked first was what is the answer to every number from 1 to 100 added up.

Think about how you would solve that problem for a minute before you see the final conclusion to it. One programmer used the computer and came up with the correct answer. It took him all of three minutes plus. One candidate put down his paper and computer and said the answer is 5,050 within 10 seconds.

I asked the individual who only took 10 seconds how he came up with that answer. His remark was, "I don't see or do things the way everyone else does. I take and split the numbers into pairs such as 1 and 99, 2 and 98, 3 and 97. When I am done, I have 49 pairs that make 100 ,with two numbers of 100 and 50 left over. If you multiply the 49 pair times 100 , you get 4,900. Then add the 100 and 50 you get 5,050 as the answer.

Well, that made an impression on me I still remember.

Now, I want you to understand about day-trading the same way. WE DON"T ALL SEE OR DO THINGS THE SAME WAY! We are all after the correct answer. My answer is to keep you in the game for the longest possible time.

ALS: Who gave you the quick answer?

POP: You know very well who it was! I didn't say I wouldn't give you credit in these insights, just that I wouldn't take any. And wipe that big smile off your face.

That impression was a start, but I wasn't done with my experiment. Next, I asked each of them to write me a computer program to give me the correct answer for all numbers added from 1 to 10,000. They were all able to give me a program to do what I asked of them in Basic language. I judged their success on how quick the computer would give the answer and not by looking at the program. I used 1 to 10,000 because I knew it would take longer.

All of the programs came up with the correct answer but at different speeds. Because we were using Basic language, it was slower than I wanted for my particular program, but I was pretty well decided I wanted to understand the program for my own protection. The ranges of speeds were from 48 seconds to 3 minutes for all but one.

The last one took less than a second done in Basic. That surprised me so I took the fastest two programs and called in the programmers. The 48-second program ended up with a loop: N=0, for NN=1 to 10,000, N=N + 1, next NN. Print N.

The time of 48 seconds was still slow as far as what I wanted. The fastest program was: N=N squared + N divided by 2. Print N.

Just as each programmer came up with a different style and program, not everyone was correct for what I wanted. It is the same in trading. The common ground here is that we are all after the ability to not ever having to stop trading, and we are all after the ability to make more than we lose.

You see, there are variables in all of our trading styles. It is just that my Rules 1 and 2 are designed to give you the longest answer when it comes to trading longevity (Rule 1) and the shortest time to get to your goal of return (Rule 2). You need them both.

ALS: You've made a good point!

POP: Let the debate continue for we all benefit from knowledge brought forth with each different situation. The only time I have a closed mind is when there is total lack of understanding of what is required of a trader. That part of a program is not a control from a program but the required execution by the trader.

ALS: Day-trading. Where do we begin?

POP: We'll start with the reason for day-trading by most traders. It is a function of my Rule 1. And it is a function of my Rule 2.

ALS: You mean you are going to take credit for day-trading? I thought you said you didn't want any credit!

POP: It is the traders desire to be able to trade and not worry overnight about their positions, risk and exposure of positions beyond a short period of time while expecting the maximum possible gain in the quickest possible time. Actually, the desire to have Rules 1 and 2 in a short time frame is a perfect prelude to day-trading.

ALS: Okay, we'll buy that. A day-trader often is doing just what your rules imply.

POP: There are advantages in day-trading but not many because restrictions come into play. In day-trading you are more apt to lose than win due to the time limit being a restriction that creates a situation of whoever is ahead at the buzzer wins.

In basketball, when time runs out in the fourth quarter, the game is over. The high score wins. In day-trading, when the last trade is made, you expect to be out of your positions. You are letting the clock decide if you win or lose. That, to me, is a restriction.

I did a study on day -trading and came up with some very interesting findings. The first thing I learned in the study was that you could use the day -traders to your advantage in trading by knowing that they would have to get out by the close.

Second, I learned that day-traders actually do a better job of keeping ranges smaller than do scalpers whose purpose is to fade small moves for quick profits.

Third, I learned that day-trading did afford traders a way of keeping risk smaller and allow them to work larger positions in the short run as opposed to large positions in the long run.

Without going into the next 10 learned points, we will concentrate on the first three. The first three are probably the most important, but they all have merits.

Day-trading is good for some traders, as this is the only way they know to keep risk smaller because of shorter time frames. There are those traders who do not want to put up the margin to carry overnight positions and have the risk (better known as underfunded traders who don't have the money in the first place and should not be trading such size). Whatever the reason for day trading, it is a valid method of expressing my Rule 1. The only exception is that they usually expect their position to be right.

A scalper is quicker to take a loss but tends to let profits run a little less than a day-trader's ability to take losses. In other words, a day -trader tends to lose on a trade more than a scalper makes. This leaves a margin of loss in losing trades. Believe it or not, guess who picks up that extra loss that day-traders make? It is usually the position trader.

So that, to me, is the edge. You must know when you have the edge and just what it is. It is not an exact thing, but I feel it is because day -traders are not as good or don't have the ability to execute as scalpers. A day-trader would do better if execution became a market order on exits -- especially on taking losers.

ALS: You're going to discourage a lot of day-traders.

POP: Not at all, as the day-trader is a more disciplined trader. It you take Rule 1, which is the assumption of being wrong until proven correct, you will have the other side of the coin for most day-traders. They could become better traders if they were to use Rule 1. Day-trader's odds are lower because of their limitations on overnight carries.

Another big drawback is delayed reactions on what the market prices have done. If they use criteria such as opening range breakouts, they will have to be fast at getting the orders into the pits. On that type of trade they are better to take a position on the open and protect it than to take the opening range breakout. But they want the position proven before they take the position and wait until the breakout.

As a day-trader, they would do better if their trades were within criteria, executed and protected by Rule 1 instead of the delayed trade due to the lag in information. They must pick the points almost exact. This is another drawback for them. You put yourself at the mercy of how the orders enter into the pits as a day-trader. It is almost impossible to be exact in your estimate of price. A better situation is to be able to pick a range instead of a price on execution.

Same with exits. This all reduces your potential profit from day-trading.

So what is the answer? A day-trader can do better by averaging, but you never want to average in an established trend. The trend will tease you into bad entry positions if you don't do your research on market characteristics. Countertrends will do the same thing, mainly because there will always be those weak positions that turn into profit-taking. This is a day-trader's nightmare in day trading.

ALS: How can you be so certain on day-trading?

POP: The best traders will take what I have to say, study it, research it and decide how exact it is. They will judge accordingly and make their own trades based on improved judgment of day-trading.

That is what we want them to do. It is too easy to think day-trading is everyone's game and a good one. It is a good one for some but not most. It can be improved by understanding the drawbacks. All trading has drawbacks so it is critical as to how they view their trading probabilities.

ALS: You said day-trading could also be compared with your Rule 2. How so?

POP: A day-trader tends to take bigger positions because they know they will exit quicker than most position traders. This will give less risk long term and affords them a way to over-trade . . . or I guess I should say gives them a way to trader bigger.

In Rule 2, the idea is to be bigger after proven correct, and I suppose that is what the day-trader is thinking in trading bigger as a day -trader. Right or wrong, it is correct in being bigger within correct criteria. The bad side is they tend to be wrong as often as right. This keeps it more of a 50/50 game than an advantage they would have if only being larger on correct moves.

Being larger on correct moves as a day-trader is difficult, at best, due to limitations of the day's range requiring the adds to come quicker after the initial position. Often, day-trading will not allow more than one add, if any add at all. Often, too, the profit side gets taken off sooner, restricting the range even more.

ALS: Is there a better way to day-trade?

POP: You bet there is! Now I have every day-trader's attention. For a price I will be glad to give that information out.

I am just kidding, of course. The answer lies in their research. Look at what causes the most losses in day-trading. Now study your own entry and exit criteria and decide what doesn't work. Look at the other side and assume a day-trading criteria does not work and expect it to be wrong. Next, devise a way of removing positions until they prove correct. There you have the answer.

Can you incorporate it? Not in all situations, such as we said previously. Trends and countertrends tend to do a number on day - traders due to their not caring what a trend does.

Next, set up a criteria for removing your positions. You must not allow the clock to dictate when you get out.

Most important in day-trading, you must never play everyone else's game. Say, for example, you play the opening range breakout.

Everyone does that. You will wash in the long run, even though you just want to day-trade.

You set your criteria differently. Let us say you trade the third move through the opening range. Why? The market tends to be a trading market if you get the third move through. That is what you are, a day-trader. You can now expect the market to be on your terms as a day-trader. You expect it to come back, but what if you are wrong? Well, then you will make your profit instead of being prepared to break even on a swing trade.

As a day-trader without an existing trend, you can also fade the market. Let us say the last 10 days' range averages 8 cents in onions (never heard of them). Your criteria could be the old Fibonacci number of 5. Wait for a 5-cent setback to buy or a 5-cent rally to sell. I am not saying this works in your particular market, but you can study it and establish your criteria in a non-trending market.

I know some day-traders who take the day off until they have had two days in a row of a non-trending market in the same direction. The next day is theirs, as they will wait until it looks like the reversal is about to take place and then counter the two-day move.

Day-trading is a psychology study of the last few days. If you use Rule 1, you stand a better chance of being up in the long run. It is not exact, and as long as that is understood and losses are kept low, it is a possible moneymaker in the long run. If you like the odds, you can be satisfied if you do everything correctly, regardless of the outcome.

A critical point in day-trading is not to just use the prior day's high, low, range and close as inputs to your criteria of signals to use.

Point-and-figure charts are closer to the market as P & F charts don't restrict prices to within a day's range.

Remember, you are staying away from the same methods used by most day-traders in order to get the edge on them, as well as the position traders who most likely only use bar charts.

Last of all, don't just take someone's word on day -trading. Check out your particular market and see the characteristics in action during the day. What you think is a good trade might not even be possible when you try to place the position. Use market orders to make sure you have a position but do it with intelligence. A non-position is a wash.

ALS: Phantom, I have a question and sort of a remark from a successful day-trader. Using a volatility breakout system and using a stop after a series of consecutive losing trades, can you use Rules 1 and 2 correctly?

POP: I can tell you whose idea that is and what course it is in, but I don't want to disclaim or endorse the data. There are some markets in which this is an excellent method for day -trading. Not all markets will be good markets for this method. I am sure traders who use this method know which markets to shy away from by experience.

Yes, you can use Rule 1 correctly, as it is saying that you assume your position is wrong until proven correct and, by taking a position after a series of losses, you are certainly aware that you are going for probabilities of a turnaround. If there is no turnaround, you certainly were expecting to get out. Naturally, the market will have to prove you correct after your entry within your established criteria.

On one of our examples of an onion trade earlier, we used end-of -day criteria as an example of what some would consider the last resort criteria for day-trading. It is the end-of-day criteria to get out. Day -traders tend to be or get out by the close. To watch a market go against you all day and not get out until the close is certainly a challenge in trading criteria, but sometimes your criteria will require this situation to be set up. You just know you will be out on the close if all does not prove out. This alone keeps you from carrying a loser overnight.

On using Rule 2 in your question, would you say the odds of increasing the position after a series of indicator losses allows you a better opportunity to add if the initial position is taken after those losses? Only if the position was to prove to be correct.

The swift would be able to determine if the position had proved itself and at that time adding or removal should take place without the fade to enter. I would agree that, with this plan, if your data feed is quick and your line to the floor is quick, you would certainly be in a position to improve your payout. The part I like in this style is that you are required to do either one of two things at a certain point -- either add or remove.

Keep in mind that Rules 1 and 2 do not negate a successful trading system at any time. They are to keep you from a huge drawdown from which you would never recover. This could be additional protection outside the plan or could be incorporated within the plan itself. I appreciate that question and understand where that trader is in his career. It sounds like proper research for the proper criteria in his style of trading is paying off. It's good to hear when that happens. It proves that trading is not easy but is behavior modification and knowledge.

You can learn from other traders, but you never learn to be them. Just the other day on a business channel I heard the announcer indicate that a particular trader was selling all day, and the question was why they would sell now. One of the answers was correct: He was offsetting his positions.

I remember one day when I bought all day and at the end of the day when the market was down on the close, one trader asked me why I went long all day. He didn't know I had orders twice as large selling after every buy I made.

My point is that you don't know what a trader did; you only know what you have seen him do at the time. You see, my plan was to establish what the market was going to do that day. Every time I bought, I had a broker with my exit double the other way. I would try to offset my new short position and getting out was wrong so we doubled it the other way again. At the end of the day I had a position twice as large as I had intended and the opposite way I intended to go. I only knew that it was the day I had to be swift.

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.

Chapter 9: Options

"An option can get bigger than its original size if all goes well for the trader. It can also melt with predictability." Phantom of the Pits

Options trading presents many more possibilities to vary your trading plan than do just futures, bonds or stocks. There are as many ways to trade a position or scenario as there are ideas, it seems. Phantom uses options for various reasons, as do most traders who understand them.

The purpose of this chapter is to give insight to all traders and not to narrow the insight just to the experts. There is much to be learned about trading options, and good research is needed to become properly prepared in trading them. Keep an open mind as to what the market can present on both sides of the ledger.

Art Simpson (ALS): Phantom, I know you don't see or do as most traders when it comes to options trading. How can we better understand the proper trading of options?

Phantom of the Pits (POP): Most traders know what options are and how they work. I view them as ice cubes, which can either melt or get larger when the water around them also freezes. When water freezes, it will take up more volume than the water did in the original state. An option can get bigger than its original size if all goes well for the trader. It can also melt with predictability.

I like to weigh each of my option positions against a futures contract. By this, I mean that each position or combination of positions has a weight. To impress upon you my view, let us use a balancing scale. You know the kind I mean -- one that has a platform on each side of a balance indicator. Put an ice cube in the glass of water, and I consider the weight of the ice cube as a call that has been purchased. I consider the weight of the water as a put that has been sold.

Regardless of how large the ice cube (long call) or how much water is left (short put), the total weight of that glass will remain the same. The ice cube can become larger when the temperature drops below 32 degrees, and the water becomes reduced liquid.

It is the same with the call and the put. They can and will change size. I call the size of each ice cube the delta and also the amount of water a delta. Any time you add the long call delta and the short put delta at the same strike price you will get 100 in theory, excluding the interest rate factor, volatility and time element.

Using this as a rule of thumb for our understanding, we will assume positive 100% delta in this case. You can consider the opposite as negative

100% delta -- the ice cube as a call sold and the glass of water as a put bought.

On the other side of the balancing scale you will have an equal futures position of some size and bias that will equal the option side and balances the scales. Your glass of water with an ice cube (long call, short put at same strike) is equal to short one contract of the futures you are trading. You will remain balanced and have no risk as long as this position is in place. We call this a conversion. The option side of the scale is the synthetic future. You would be either long or short a synthetic future, which can be offset with an opposite futures contract.

Pretty simple at this point. You start to throw variables in, and it changes dramatically. Each glass is going to be a different size, depending on the strike price. In other words, even though the delta of our initial position will be 100%, regardless of strike price,

the size of the glass will be different. I consider the size of the glass as the value of the water and ice cube added together. It will be different at different strike prices. The delta remains at100%.

You may be getting into this description and even a little ahead of me. If you have had geometry, you can have some good fun with this approach.

We can now think of throwing out the futures contract but still wanting to balance the scale! We put on the other side of the scale the opposite option position, and we still have our balanced position. But guess what? What we have really done is to offset our position, and no position exists on either side of the balanced scale. We can only make money in certain situations, but we must know what we can do to move our position around when required.

Now we get into the ifs. There is no limit to what we can do -- almost no limit, I should say. What we want to do is to come up with a plan to make money in almost any situation. We must also find a way to include Rules 1 and 2.

We discover we can balance the scale by using different strike prices and not just the same strike price. We also can tilt the scale to one side and leave it biased to the long or short side. Pretty simple still.

Now add a balanced scale on each side of the existing balanced scale. You have three balanced scales to work with. You can add four more balanced scales to the last two on each side. You see, you now have the possibility of each of the balanced scales giving you an opportunity to move positions around but still keeping it balanced. It becomes trickier with each set of balanced scales you place in use. You can even add as many balanced scales as you wish, but you are out of control trying to stay balanced. This is what happens to some option positions not well thought out.

I hope I didn't confuse anyone with the balanced scales and ice cubes, but it is critical to understand what each move can do to your overall position. My option model is a combination of balanced scales as data input to the program, which determines what each variable will do to my position. You can make money when you know how to use volatility, time decay and price movement.

The criteria research becomes a little more intense and expanded.

Without getting into specific programs, we'll discuss the fact there are certain option positions that work with my rules. Extensive options understanding is beyond the scope of what I am trying to teach you. I only want to show you how you can incorporate options trading into a good method of trading while using Rules 1 and 2 to protect your drawdown.

ALS: I know you use vectors, weights, volumes and angles as part of your computer program to establish criteria of balance as well as the usual research of option evaluation. I also know you developed your own evaluation of options' worth, which is different from most programs. Is it because you don't want to play someone else's game?

POP: It's like a basketball, which retains the same shape but has a different bounce when the pressure changes. Same with options. I consider an option evaluation in a bull market different than in a bear market. The market just considers the volatility different. It is how you can best work with options.

If I gave you a notice that from now on we would consider bearish options and bullish options and not just change the volatility to fit the price, you could better understand what is expected of your trade instead of guessing the changing volatility every day. This has all been debated before, and we aren't going to change what is believed to be the best method. In fact, sometimes when you are trading with a different view, you are better off.

I am going to explore some option possibilities that use Rule 1 to start. Because we are going to assume we are wrong until proven correct in options also, we will put a fairly protected position on to start. Let us say we have a bull market started as we see from our criteria platform. Okay but we could be wrong so we will not go long an option. We will instead put on a bull spread. A bull spread is buying a lower strike and selling a higher strike price. This leaves Rule 1 in use.

Options experts are going to say we only put a smaller options position on. Yes, that is correct for the purpose of requiring the market to prove us correct. Let us say we bought a 1000 strike when the future was at 990 and we sold a 1010 strike just for an example.

If we had bought a 1000 call outright, we would have paid more for the call than we would by also selling a 1010 strike. We have limited our potential loss at this point to the debit we paid out. Let us say we had a debit of 3. An outright call bought without the bull spread would have cost us, say, 5. We have already started to use Rule 1 by reducing our possible loss to 3. Our maximum loss is 3 at any time.

What can now happen? Three things can happen. One of them isn't going to happen as the price never remains the same very long. So prices are going up or down. What else can happen to our position? We can lose time value as the ice cube melts, and we can lose volatility as the interest in trading falls.

We have used Rule 1 so we are slightly protected from time decay because we don't have as large of a position as we could have with an outright call. We are also slightly protected form falling volatility because we are not with as large a position as we could have had with an outright call.

Okay, but the experts are saying we did all this at the expense of potential profit. Yes, indeed, right again. But isn't Rule 1 to keep our losses as small as we can? Isn't the name of the game to stay in the game forever? Yes, so we need Rule 2 to make our money!

Rule 2 actually works better in options than futures. The main reason is that volatility can increase and decrease. With futures, sure, the market may go limit up or down, but options move that value as expected and then some extra because of what the experts call volatility changes. I call it changes form liquid to solid! Water freezes with higher volume as a solid.

At any time you are not risking more than 3 in our example and you are long a 1000 call and short a 1010 call (bull spread.) Let us say that our criteria for being correct is that the market moves at least 15 points. So at 1005 we accept being correct at this price.

We will make our position larger at this point. How? We have many option possibilities but the best option is to buy a higher strike than where our current position is due to the increase in volatility. We want a delta (position size) that can more than double. A delta of 50, 60, 75 can only go to 100. A lower delta gives us a possible double plus, triple plus, etc. Also we are risking less equity.

Okay, we buy a 1020 strike for example purposes. Let us say we pay 6 for it due to increased volatility. So what do we risk now?

We risk our original 3 but, because of volatility increase and price movement, we have a value of, let us say, 6 on our original bull spread. Okay, because we paid 6 for the 1020 strike we still have only 3 at risk or do we? We have a value of 6 (1000/1010 bull spread value) + 6 (1020 call purchase price) or a value of 12 and have only paid out 3+6 or 9. We show a profit of 3 at this point and can work with our Rule 1 and have no additional risk on our position by using criteria here forward, which protects us from negative drawdown. To do this we remain alert to be swift and use Rule 1 properly. We don't know this position is okay yet. We have also used Rule 2 here by adding.

The values of these moves will depend on time remaining and volatility changes but, for example purposes of using Rules 1 and 2, we won't consider those variables at this time. After two weeks we have a move to say 1030. We are flagged that it is time to reverse. What do we do now?

Now comes the interesting part in options. Most traders want to take their profits. But we are using Rule 2 again here. We must press our position, and the market looks like a reversal. We don't take our profits but decide to set up our payday. We do this by selling another 1010 call. This leaves us with a bull spread and a bear spread with 3 strike prices. In fact, we could call this a butterfly.

We sell the 1010 call at 20 due to increased volatility again. Okay, so what do we have at risk in the trade. We paid 3 for the first bull spread of 1000 long call and short 1010 call plus we paid 6 for the 1020 call. But, wait, we sold the last 1010 call at 20. That means we have -3+(-6)= -9 paid out and +20 received. We are up 11 points. Okay, the experts say you could have had more if we had just offset the positions. Okay, so we're bad! We still have 367% profit so far. That isn't bad, is it?

Two weeks later the market is at option expiration and the price of futures is at 1009. Oh, darn, we forgot our butterfly position!

Well, let us salvage what we can!

What is the butterfly worth now? The answer is 9. Okay, so we offset it and take commission charges or we don't offset it and let it offset by our exercising the 1000 call. In the end, by leaving the butterfly on, we set up a payday provided the market was within 1000-1020 at expiration. We made anywhere from 11 to 21 (depending on where the butterfly is offset) on the trade.We made the 11 from the sale of the 1010 call and anywhere from 0 to 10, depending on where the butterfly is offset. Don't take all your profits but let leverage work for you in options.

Our maximum risk was our original 3 and never more, using Rule 1 correctly in options by having a limited risk. We also added to our position and used Rule 2. But, wait, there is more! Once we put the second short call on to establish the butterfly, we were never going to lose anything because we bought our butterfly by being given 11 to take the total trade of four options over the range of movement. Two options long at 1000 and 1020 strikes and short two options at 1010 strike for a butterfly legged into. In other words, as soon as we neutralized or balanced the scales on each side, we could never lose.

The experts again say, "What if the market had gone to 980 instead of up to 1005 and then 1030?" Well, we would have lost 3. So what kind of ratio did we set up for our trade in options? Risk 3 to gain 20 equals 6.6:1 (slightly less with commission and depending on where the market price established itself at expiration).

ALS: It looks easy. Is that all there is to it?

POP: I don't want anyone to think it is that easy because you must be aware of what is required in exercising options and the effects of increased volatility and decreased volatility. This is a start to give you the desire to learn more about options.

One of the big keys in options is the hidden secret of putting on no-risk or low-risk trades and working the positions into a no-risk trade with the potential of a big payday toward expiration. If you are to trade butterflies, you must learn that the proper time to buy them outright is with a long time out when the liquidity may not always be good to put them on. You can often put them on with bull spreads and then a bear spread. Commission costs are a concern if you are at a full brokerage. You must figure all of the costs to reduce the ratio of payout.

ALS: Do you want to go into some other strategies?

POP: Let us put this on the back burner and see what the traders want?

Chapter 10: Cloud Hopping

"I believe if someone important can have faith and expectations in those around them, it will make a difference in their lives." Phantom of the Pits

"Cloud Hopping" is dedicated to the memory of your and our friend John Denver, who died in his experimental airplane on October 12, 1997. John touched our hearts with his songs, and his touch of kindness reached out to all living things. Our memories are stronger than death as we search the clouds and share past laughs. Far out, our Brother in Mankind.

One of the most-used tools in trading is perhaps the chart. Charts not only show high prices, low prices and current prices but also other data that can be used for derivative information generating. Each trader has their own way of using and interpreting their charts. Some make up their own charts; others buy them from a commercial vendor.

When it comes to their use, Phantom remembers when charts were charted on a big graph in the pits themselves for all to see.

We continue our insight with Phantom on charting.

Art Simpson (ALS): Phantom, sometimes I wonder how organized traders can be with all of the charts around their offices. I always thought the less information you had to research during trading hours, the better you would be able to react to the current market situations. What do you view with your charting?

Phantom of the Pits (POP): First of all, you mean "Cloud Hopping!" On a Sunday afternoon I would go out to the park and do my charting. Let me reach over and turn this old radio on with this funny-looking knob here. This big radio is an old timer, and it takes me back 30 years or so. As I turn it on, you will hear WGN and the Eddie Hubbard show with his theme song, "Poor People of Brooklyn," playing in the background. I think his theme was a spoof on "The Rich People of Paris" but I don't know that for sure.

I doubt that many old timers will be reading what we say here but, just the same, the past is certainly worth a view once in a while.

A look back is good if, for no other reason, just old time's sake.

On my Sunday afternoon charting, this is what I would see with my charts! I would look to the sky and see all of these kites flying.

My chart would show this as volume. All of the kites on the ground, not in the air, and the flying kites would be the open interest.

The clouds in the sky would be my price on the charts. I would chart all of these with a connecting line from all of the clouds in the top part of the chart and volume and open interest on the lower parts of my chart.

As I saw the movement of the clouds in my sky market, I would place another chart point either higher or lower, depending on whether an existing cloud moved higher or a new lower cloud formed. Any time I could get a divergence from the clouds' highs and the open interest of kites and volume of kites, I would get a signal to sell sunshine futures.

My father would ask me what I was doing, as he would always pick up the trash from our picnic when the wind would blow it away.

I would answer him, "Dad, I am CLOUD HOPPING!"

I got pretty good at cloud hopping and sunshine futures as I could predict when it was going to get cloudy again. I think I was all of 13 at the time. That was my first introduction to charting.

I tell you this little insignificant point of my early charts because I have seen just this week examples of the same things in trading signals from traders. It may not make much sense most of the time to most of the people but if it works, who am I to argue. My cloud hopping worked for me!

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.

I think the main advantage I see in charts is that you can plainly see what will be dictated to other traders for them to think at certain points. You will remember I said I don't totally agree the market is always right at all times, but that is what we must trade with or against. How many times have you seen public sentiment be a massive majority of opinion one way or the other? What happens? More times than not the thinking was wrong.

In charting I have to say my strongest signals are when support or resistance is broken and thinking is in the majority against what is happening to that support or resistance.

I don't want to go into specific types of charting and indicators as there are so many of them and so many ways to interpret them. I will try and point out what I think is useful to all traders the most. I could explain each type of indicator and charting process, but that serves no purpose. Each trader must decide his or her own criteria for charting.

My charting is based on knowing what the signals of each type indicate to other trades more so than to myself. I am always looking to find what is the edge to me. I don't care about what the charts indicate if they are not my tools, but because others do use them, I must be aware of those indicators. I need to know what other traders are thinking.

I don't position opposite to my signals ever, but that doesn't mean I don't position opposite to my fellow trader's charts and indicators. My criteria takes into account the other signals, though not directly a signal indicator to me.

There are many trading plans based on various charts and indicators, which can be accurate over a period of time. The biggest problem with the dependable plans is that Rule 1 and 2 are not a part of the plan, and the traders never get to trade in the long run. The trade plan may have what they call money management, but that is always a weak point in the plan. Drawdown eventually demoralizes the traders. In the end all is lost.

ALS: Do you have any specific advice on using charts?

POP: Yes, when you see what most charts give you, it is clear that everyone is looking at the same data to establish a method of being the most accurate.

The key to usefulness of charts, as far as I am concerned, is that you take everyone else's chart with a grain of salt and establish your own charting to be reflective of data not usually known to others. All bar charts show the same things. It is a daily chart of high, low, close, open, volume, open interest and other moving averages or indicators. This is one reason I prefer a chart like a point-and -figure chart. It removes the daily bar graph points as the most important for that day.

Let me ask you what would you think of a chart that takes the same parameters as a standard bar chart but your daily high, low, close and open data had a time frame different than daily? You would laugh. I like that laugh! It tells me I have no competition with the idea.

I will give you an idea and an example here. Let us say you make a chart that starts one hour and fifteen minutes prior to the close of a market. We will justify this by saying that the most important trading data for a day is in that last part of the trading day. We will call this the opening for your next day's chart. One hour and fifteen minutes of today's trading is already on tomorrow's chart.

We will call this tomorrow's support and resistance. We continue to chart tomorrow until one hour and fifteen minutes prior to the close. This closes out our day's trading chart.

Okay, I think you see what I am getting you to think about. Now keep in mind I am not giving you my way of charting but using this as an example of how to change your behavior when it comes to charting. Most traders will never chart this way for several reasons and that, to me, is good. They can't get the data this way as they may only get it out of a newspaper, delayed or through a broker. Other reasons exist that prevent them from getting a different outlook chart.

I feel you need a jump on tomorrow's trading to get the edge. The edge to me is important but not as important as execution. It is just that, with the edge, you can get better execution. You are ahead of the game because you are in front of the day -traders, funds, scalpers and position traders because you are not using their data to follow them. Instead, you are using your data to look beyond their view. By using Rules 1 and 2, you can establish a plan that is a little more remarkable than anyone would think.

You will have to do back-testing and research and most traders can't even come up with that data yet, even today. I guarantee in the future there will be those who look at what I have done lately and say it is time to make the computers earn their keep. You see, the frontier is just now opening! The sharpest trader with the most intuition will win here. I want you to remember where the idea of "Different Outlook Chart" came into play. It started with me when I was 13. It can start with you today.

Do your research! Do it again! Learn what different outlook charting can do for your trading plan. I have given ideas of what my criteria is in trading certain situations so that an understanding of where I am coming from shows up. Vary your data times. Use 15 minutes, half an hour, half day, first hour and other time frames.

I am giving you a gift here and someday it will hit you. Just don't take too long to see what is behind all three doors. I still want to point out that we will see different outlook charts as the years go by, and they will get better and better. There will be a day when they are followed closely enough that they no longer have the same value.

In trading you need to change the odds to your favor. By using Rules 1 and 2, you are moving in the right direction. By using your own mind, you are doing what that computer programmer did many years ago. You are looking at a different view. An artist will view his subject material from all angles. Shouldn't you?

ALS: Aren't you making it a little dangerous by telling traders to go find your own plan and make your own charting system?

POP: I believe I am only making it a little more difficult in showing that trading is complicated when it comes to getting the edge in trading. I don't expect them to take entry and exit signals they devise without using Rule 1 for protection and Rule 2 for enforcement of their new knowledge.

I believe in the small trader! I know what the potential is because I know every trader started out as a small trader. Not one big trader started just big. You must start. There is no better place to start than at the start line. Only then can you say you went the entire course.

I want to impress upon you the importance of my belief in the small trader. I believe if someone important can have faith and expectations in those around them, it will make a difference in their lives. A good mentor knows that their guidance will grow up one day in those who benefit from their convictions of belief.

This story I am going to tell you was told to me by a very brilliant mind. I like the story better the way I like to tell it but will tell it the way it was told to me.

One year a math teacher in the geometry class had more students that usual. Thirty-eight students were just too many to have the time to give one-on-one guidance as required. Not only were there too many students in this particular class but the teacher also had more bad students than usual.

One particular student had never gotten grades above Ds in all his school years. His name was Robbie, short from Robert. Robbie was the class clown and had been his entire life because that is what the other students expected of him. He had no interest in school and would brag he would quit school at the age of 16 in a few short months.

The teacher had three Robert's in his class: Rob, Robbie and Robert. It was pretty easy for the teacher after two weeks to keep the Robert's clear, as the one who went by Robert was the top student in math.

Five weeks into the school year the first PTA meeting was coming up. The teacher told each of the students to have their parents come to the PTA meeting. That night only about a third of the parents showed up. The teacher knew by how well the students were doing just which parents would most likely show up at the meeting. The teacher took three to five minutes with each set of parents to chat and find out a little about them.

The last parents were a little backwards and shy, but the teacher shook their hands and made them feel at ease. The teacher never got an answer when they were asked their name so the answer was never known. The parents asked the teacher, "How is my Robert doing in class?"

The teacher thought and then answered, "I have never had such a good student in my class who takes so much interest and is a delight to have as an example to my other students. Why, your son is a living example of those who will be leaders in our future.

It's just wonderful to know that in our lifetime we will see youngsters like Robert grow up to make us all proud to have known him!"

The parents of Robert stood a little taller and smiled as they left the PTA meeting that night.

Over the next three months going into the end of the first semester the teacher noticed his students doing better than he had expected up to this point. Trying to comprehend how his teaching had improved and what he had done differently, the teacher spent more time trying to improve. At the end of the school year, the teacher was in his own glory as no student had failed -- not even the class clown Robbie. In fact, Robbie had gotten all his assignments done, taken a math scholarship exam and finished with the top score nationwide. He had won a math scholarship as a sophomore. The teacher was really proud to have taught so well.

The last day of class, Robbie waited until everyone had left and then headed to the teacher's desk to talk. Robbie held out his hand and said, "My Mother told me what you said about me! I have never had anyone ever want me in their class before or even cared if I learned. Thank you for giving me insight into my life!"

The teacher began to cry as all the efforts to improve as a teacher reflected back to the PTA meeting at the beginning the year.

You see, the teacher thought that, when the parents asked how Robert was doing, it was Robert's parents and not Robbie's parents. The teacher had made the biggest mistake of his life at that PTA meeting by assuming he was talking about the right Robert. Not only was it the biggest mistake but it also was the best mistake of his life.

Can you imagine a grown adult crying? Isn't it refreshing to know we as adults can learn from youngsters and it's ok for us to cry!

At one time or another in life we see a flash of light in thought looking back and realize what we have just been given.

ALS: Pretty touching. You say you like to tell it differently?

POP: I like to substitute Robbie's name and instead use "a brilliant trader." You must understand that somewhere as a trader the light must come on for you. There will be a point that the biggest mistake of your trading career will be the best mistake you have ever made.

I personally want that student to come to me and say, "Phantom, no one has ever wanted me in their class before or even cared whether I learned about trading. Thank you for giving me insight into correct trading."

I do care and I have only one thing left that I wish to become: A better teacher!

ALS: How do we go on from here? I think your pep talk has caught me by surprise. I don't know what to ask right now.

POP: I'll go over point-and-figure charting next. Go and enjoy a walk to the top of your hill with your wife.

ALS: Okay, I would like to reflect upon what you have just given as insight -- not just for the book but I also want to reflect for my own personal evaluation right now. Thanks.

The next interview:

ALS: On point-and-figure charting one question I see often is what size to make the boxes?

POP: The fact of P & F charting is that the smaller you make the boxes and retrace criteria, the closer you will see the market characteristics and order flow. To learn the nature of trading and each market, at first I suggest the smaller box sizes. Keep in mind for the retrace that it must have some significance beyond a normal bid-and-offer slippage.

Each market can be a percentage of daily expected moves. I would say that, as an example in soybeans, if the daily range is usually 9 cents, I would use a 1 by 3 box -- each box is 1 cent and each significant retrace has to be at least 3 cents. This pretty well says to take 10% of the daily expected move as the box size and 30% of the daily move as the retrace requirement.

As time goes by, you will want to extend the sizes to larger sizes. You may even keep multiple P & F charts to compare. Today computers can do this for you if you are set up for it. It is important to realize that, at one time or another, each trader will try and improve his trading office.

Is it good to improve your data before your success or after your success? The answer is a catch 22 as you will improve your trading as you improve your understanding of how markets work. Most traders do not want to extend the costs at first due to limited funds. What really can you do with your data if it is based on someone else's criteria and information? You can only be a derivative trader of that restriction.

I am not going into how to specifically use P & F charts, but many good books on the subject will be a good library add for you.

Learn the highlights of support lines, resistance lines, three wave recognition and breakouts. You will be able to see what the trade does each day within the market parameters. This is important to see first-hand, and P & F charts are the perfect way to do it.

You are better off if you do your own charting rather than using a computer until you understand and see what important data is available on these type charts. I also suggest that, if you had to use only one chart, it should be a point-and-figure chart.

I don't mean to be weak on giving knowledge on charting, but it is critical that each trader come up with his own thoughts and ideas. For someone to give you their thoughts just limits a trader's horizon of what is possible for them. Do your own homework and decide what your charting shows.

On some of my programs on charting and signal criteria, I narrow it down to inputs of importance. I could have as many as 64 inputs. I can weight each one according to how important they are, or I can have them in one of two states only. Some of my criteria input is qualified by going through several doors first. In other words, if the criteria is met, that input must go through the next set of criteria. It sort of ends up like an eye examination as you expect one total answer in the end.

Charts and criteria are nothing more than the best set of eyeglasses at the end of the examination. You will wear those glasses after your exam. Same in trading, you will use that data after your criteria is set. Why argue with it?

Many traders are always making exceptions. For example, the last time they used their criteria signal they lost money. They won’t make the next trade. The big one! If you lost money last time and aren't happy with the signals, you must go back over your program or criteria and reintroduce the correct data that you expect to be required. If at any time data is excluded that you require, your signals are useless. Get the total picture on your plan and not just the pieces. Have a definite signal and not a maybe signal.

There are times when nothing you do seems to work. When things continue to go bad, I can say to you that you have violated another known fact. Diversity helps reduce risk but only in the long term. In the short run we are talking about luck, both good and bad. Believe me, if bad luck comes first, you are finished if you only depend on luck.

Charts are not an answer alone and have no use if your trades can't be executed promptly. Any time you can't do what is required as a trader to get the position on, you will take the scales the wrong way. Remember, you must be in before you can get a correct move.

ALS:What kinds of charts do pit traders use mostly in trading?

POP: I have seen P & F charts, bar charts with half hour, ten minute, down to 1 minute used. I have also seen several of the new popular volume based price charts as well as different color charts with indications of momentum along with price.

ALS: What type do you use when you are in the pits?

POP: I never use anything but mental graphs when in the pit. The mental charts are more point-and-figure charts. They are really easier as I am looking for the third wave to position against the public on the third wave in my desired direction. It works well for add-on positions and keeps my entry cleaner for protection requirements.

I don't go to the pit often anymore unless it is to be an exceptional day indicated by my signals. I will go to the pits when I have an unusually downward bias indicated, as gravity seems faster to me in those markets that reverse to the downside.

Most of my charts are kept on computers, but that doesn't mean the computer gives me my signals during the day. I like to have them before the day begins. It is more mechanical and not ever emotional that way. That is an important point in trading -- remove those human elements as best as possible. Only then can you truly be objective.

Look at it this way. When it is no longer your money, it is easy to do the right thing. But, when it isn't your money, you can also be careless. Just follow the rules and your signals without exception. If they don't work in the long run, you are not using the correct system or you're not using my two rules first and foremost.

ALS: You are still going to have arguments about your two rules as to whether they work for all traders!

POP: We wouldn't have markets if everyone agreed on a plan. We would have nothing but limit day moves everyday. We really need various ideas and concepts. I just want one that will work over time and keep my drawdown smaller than when I first started.

I must have a rule that allows me my freedom to know, regardless of what happens today, I will be here tomorrow and the next day and next year and next decade if I wish to be.

Don't ever think that no one ever cared whether you learned anything in trading. I do care and I insist you take full responsibility to learn the correct knowledge. That knowledge must be not only criteria for trading but also the correct method of changing your behavior to that which is required to be successful in the long run. 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!

Chapter 11: Behavior Modification

Phantom has indicated it is a combination of knowledge and behavior modification, which he learned over his trading career, that are the important elements in correct trading. We will go into some of the observed behavior modification insights Phantom has seen and used over the years. Phantom liked the approach of a professional on behavior modification but felt it was important to present the unique situations that trading presents to traders. Phantom is not a professional in behavior modification and wanted to make sure that was known before we began any conversation on the subject.

Art Simpson (ALS): Phantom, you and I know that we are on some thin ice when we talk about behavior modification. You are only qualified to give examples of what you have seen and used over your career in and out of the Pits!

Phantom of the Pits (POP): Yes, thank you for being alert on that point. Your point is important, as my methods are unscientific, to say the least.

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.

Animals are easier to study than humans, and I think that perhaps is a good reason for studying animal behavior. Take a simple action-reaction event for any animal and see what results come about.

Let us say your family dog has never known what hot meant. In the old days when stoves burned coal and cobs, my Grandfather would pick up the stove lid to put corn shucks and cobs in the stove to get the fire to flame a bit. This would ignite the other coals better. He would lay the stove lid down on a fire-protected material on the floor-stove board.

Well, because the dog liked warmth, it would come over to lie near the stove. When the dog lay on the stove lid, he let out a yip you could hear on the trading floor. The dog learned behavior modification by instinct. The dog would never lie on a stove lid again. Now, was this correct behavior modification?

ALS: I've heard this one before. The dog never would lie on a cold stove lid either. I suppose it saved the dog from getting burnt again. In the dog's case I would say it was proper learned behavior. It is the same when your brother threw the hot horseshoe on the ground. He would never pick up another horseshoe again.

POP: Yes, but, you see, traders learn that way, too. 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.

ALS: Sort of like the IRS, huh?

POP: (Smiles) I think their behavior modification is going to be changed, but that is another example. I am not sure we even want this example.

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?

ALS: I can see some psychology majors challenging you on your thoughts.

POP: Yes, they are the experts on psychology and not on trading. I am not expert on either subject. I am only an expert on myself.

That is what I trade with today -- expertness of oneself!

I could give you the reasoning behind Rule 2 with the behavior modification incorporated within the rule but let us leave something for the readers to interpret for themselves.

ALS: Okay, let us leave Rule 2 open to interpretation and reasoning for better understanding of one's own expertness, as you put it.

It's really strange how we start with this cheat sheet of an outline and never get to most of the points, and the ones we do, they seem out of order. It goes to show that we really don't have a followed plan in such a widely interpretable field such as trading. I don't think you are stepping on anyone's feet, as you were concerned about earlier in your efforts. How about discussing some examples of observed behavior and behavior modification?

POP: There are so many possibilities, and every trader could come up with better ones than I am going to use here. I will start with the elevator behavior data.

It was my desire to learn how most people thought in certain situations. It was important to compare ordinary people and then traders. I wanted to see if they thought differently and reacted differently to situations such as getting on an elevator -- pretty simple but yet complex enough that we had enough variables to group data. It was not scientific, but it did give me good insight.

Rather than give the exact results, I'll just give the particulars and let readers decide for themselves.

We took an observation at a building away from the trading district at an elevator on the top floor of the elevator ride. We watched those waiting to get on the elevator to see what the behavior would be. We had two criteria: They would try to get on the elevator immediately or, second, they would stand back. This gave us a better-computed programming input by using binary input of one of two states.

The second group we observed was in the trading exchange at the top elevator floor. We assumed most were traders but did not know, without trading jackets, which were off-floor traders. It was important to find out about would-be traders also so we included a third group, which we took to the top floor to observe without their knowing our reason for the tour at that level.

The results were rather surprising. Most of the people would approach the elevator as soon as it arrived on the top floor. They had no thought that there could be anyone getting off the elevator. Some would even get on the elevator before all the people on the elevator got off. This was strange, but most who got on the elevator before those on the elevator got off apparently did not recognize the situation of the elevator being on the top floor and that all who were on the elevator would get off on the top floor.

Others blocked the door when the elevator arrived.

A small minority of people would stand back and anticipate the elevator would not go down before all were off-loaded, new people back on and the door closed. They would wait to get in last, and they were the first to get off on the way down. I won't tell you which group did the best because you will have to decide for yourself how you would react.

This little experiment was important because trading is not so different from the elevator. Markets go up and down and trends take off, stall and fall. And then they do nothing for a period of time. Behavior modification for the elevator riders didn't occur to most of the people. It is the same with trading. Who would teach you this?

Okay, we watched behavior and next we would tell the group of would-be traders they would have to stand back because the elevator would be packed with people getting off. They became so good they didn't even care to anticipate which elevator would be up first. Now, we had our behavior modification, but was it correct behavior modification for the would-be traders? In this case it worked for them because it is what they were told.

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 are most likely seeing my reason for stating that knowledge and behavior modification are required for successful trading. It never is an addressed issue in trading, when a trader opens an account, as to what their behavior might be. They are qualified as being financially fit to trade and understanding the disclosure documents that explain the risks but nothing occurring to the trading public flags them to learn about their behavior in situations.

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.

Behavior modification can take many directions for traders and can be defined differently by experts. All successful plans have some sort of behavior modification built into the plan. I feel the best plans are those that address the proper observation of trading and the proper reaction of trading.

ALS: I have other examples we have jotted on our sheet here. It might be interesting to give the readers ideas for their own research.

POP: I don't really think we could give them ideas greater than their own. But I understand they might be interested in some of mine. If we get to a few, that is fine. We have really made the point of behavior modification to the readers, I feel. That is my concern. We can give them a total book on it, but that is not going to help them search their own souls for their trading.

ALS: I hear what you are trying to say. Are there any people in the field of behavior modification who you regard as impressive?

POP: Yes, there is this one genius whom I have always admired and have felt is the only one who I can honestly say has every point in successful trading covered. If I were to tell you who it is, it would disappoint a lot of deserving people who are pretty close to being exact -- especially when exact is almost impossible to maintain for long.

Changes mean changing behavior in trading constantly. I don't know everyone's trading characteristics and, besides, whom am I to judge. I am but an observer and only an expert at observing my own trading.

I really wish I could give you his name, but it isn't fair. I shall tell that person some day. In fact, I have a diary in which I include the accomplishments of great people, and that person is certainly in it. I am not even in it. I don't think I will ever be.

ALS: I think the readers are interested in your view on how they can imitate or change their behavior to be a successful trader.

POP: You are going to get me into trouble with someone. I'll drive around the outside of the track here with another good story and example.

In a basketball camp about 30 students were trying to improve their shooting. Half were taken outside and told to sit down and practice shooting free throws. The other half stayed in the gym to practice real free throw shooting.

This went on for three days of practice. On the fourth day all were given a chance to shoot 100 free throws. The outside group actually did better, even though they had not actually been able to shoot prior to the fourth day.

This was astonishing to the main coach, and he asked the outside group coach why his group did so well. He remarked, "Most of my boys were shooting at the basket and not above it so I called out their name each day and told them to shoot the ball higher above the rim instead of at the basket. My boys improved on the last day as they never missed a single shot in their own minds."

Now, I am not going to paint a picture of the head coach's face, but you can imagine his mouth hanging open and shaking his head. It didn't make sense that this could even occur to the head coach.

It is the same with trading. You cannot rule out any possibility but must have proper behavior to address any situation once it happens. This takes forethought.

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 it before you can act 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.

It shall happen in the future that the small trader will learn they can move more quickly than a big trader, and that is oftentimes an advantage provided they know how to use it. To make it happen, they have to know the rules -- not my rules specifically but their own interpretation of what is required.

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!

ALS: Thanks again for your insight, Phantom. I know it's meant as a gift and you are not selling anything or trying to show up the experts. Surely you are expecting some kind of reward here?

POP: Every day I am surprised by a reward. Today an editor whom I consider the greatest editor of all times and whom I have had great admiration for over the years humbled me by pointing to others as the reason for success. I cannot say that about myself and that bothers me.

I cannot point to others yet in my life and say that. It is not because I am selfish. It is because, to be a successful trader, we must walk alone in our days and do it alone. I feel it's very sad until you actually can point to others as your reason for success. It says a lot about a person who can expand his or her horizons by including others.

Trading isn't that type of business. It's almost a solo flight at all times. It's you and the markets. I shall look forward to my day that I, too, can say, "any credit for whatever I did belongs to a lot of people." When that day comes, I can walk taller and I can reach the heavens! Until that day I can only pass along my insights of trading.

Chapter 12: A Wink is as Good As a Nod To a Blind Horse

"There are few things in a child's life that allow a child to play as an adult while allowing an adult to play as a child." Phantom of the Pits

Many subjects of interest seem to intrigue Phantom on trading but seldom there is time in a person's life or career when the time to smile and have nothing but fun exists. As a child we all experienced the great fun of a Sunday afternoon filled with surprises and anticipation of newly found fun things. As an adult we often miss the point of a balanced life in most respects and none more than to take the time to be happy, regardless of the current situation.

It seems fitting that Sunday could be one of those days for traders. With electronic trading now and world markets, it is more difficult to have the old days of limited hours of trading through the week and have weekends free.

Still, Phantom wanted to give a smile upon the serious adventures of trading. Today we start with a blank sheet of paper on the so-called cheat sheet so we can convey the thoughts of fun in trading as well as respect the seriousness of the business required.

We never know the road and the turn this project is taking until we come upon it. Fitting, since this is written as Phantom's view as a trader's insight into reality of trading . . . nothing more than his presentation into your thoughts in order to generate your own ideas as to what the possibilities are.

Sometimes a question of how to approach any situation can usually be reduced to a series of qualifications of one of two states before going into the next priority of thought. Phantom indicated that, as we grow older, it seems to be natural to oppose change of any kind. Because change is the one thing we can count on, we must learn to use it to our favor even more so as we grow older or we fail to grow at all. This is true in trading and is usually magnified as change takes place.

Phantom's explanation of how the opposition to change is directed was explained as a percentage of the whole. He indicated that, as a child of maybe 6 or 7, we would judge change based on our new adventures of discovery. Over the next year as a child we would grow much more than the additional year of 12.5% from age 7 to age 8 -- mainly that, in that additional year of growth as a child, we would find change an adventure of new-found knowledge and not put restrictions on ourselves.

As we grow older, say from 49 to 50, we have increased our new -found life knowledge by a smaller percentage of, say, less than 2%. Our new knowledge is now not new frontiers of adventure but more of an uncomfortable reality of unfamiliar situations.

Because 98% of our known knowledge is more comfortable than the 2% of new knowledge, we tend to oppose any change created by the new knowledge for we strive for the simple, comfortable life as we grow older.

We tend to feel that our effectiveness of making changes ourselves is reduced as we grow older because the percentage of the whole of new knowledge is smaller and smaller each year.

Phantom feels when we reach the point of not caring about change any more, we have severely defeated our most powerful thought process of creativity. Creativity can enhance our ability to accomplish great things and make great trades.

One point Phantom felt about the question of change was that it is important to expand the creativity process best by doing the fun or new thing, which gives us a sense of adventure in our lives. To be young again is not a lost thought if we could decide to be young today in our thoughts and our motivation toward being creative again.

But how do we proceed with our creativeness to overcome opposition to change? Phantom is no expert on such a subject, so he feels as long as we could put a fun smile on the reader's face, it would serve to put on notice anyone who failed to come up with their own excellent ideas or their own answer.

Art Simpson (ALS): Phantom, I know that "A wink is as good as a nod to a blind horse" is one of your favorite sayings. Why is that so great a statement to you?

Phantom of the Pits (POP): My Grandpa was one of the last people to have horses for working the fields that I knew. It really wasn't that long ago, but to younger people it seems like long ago. When I was a small child, my Grandpa would take his workhorses to the field to plow. I would get to sit on the big workhorses, as they were very gentle. Being gentle horses had drawbacks, as they also were at times very stubborn. When Grandpa couldn't get them to do what was required, he would say, “A wink is as good as a nod to a blind horse."

Well, that stuck with me whenever I knew I was correct on something and couldn't convince anyone of it.

Trading is full of situations where that phrase is fitting. There are traders who are as stubborn as the horses my Grandpa had for working his fields. Still, we loved those horses until they died. We never gave up on them, and they proved to be great memories of wonderful efforts of a great team of my Grandpa and the horses.

Today if I take interest in any particular trader's view and I see that view as very narrow or perhaps close to an opinion set in cement, I will use the phrase. It is meant only to provoke thought as to all possibilities rather than leaving a narrow and fixed opinion. There are often times when it is obvious to me that the particular trader is wrong in their fixed and narrow view. I am not making a judgment that the view is wrong but that it is too narrowly based or insufficiently thought out. I will use that phrase to provoke the important re-thinking process to search out new knowledge.

ALS: You must be careful with the statement because there are traders who will immediately think they are wrong and go the other way.

POP: Yes, that is a mistake newer traders will make. To verify an order, a broker will say, "Are you sure you want to place this stop?" The trader will doubt his plan at that point and say, "No, let's hold off on that."

I don't mean to be responsible for changing a trader's mind but only to change their horizon of knowledge and thoughts. I especially will see it as an important statement when a dramatic change is starting to flag our indicators.

A common thought is, "What if I miss the move?" So what? Is there no tomorrow? Okay, you put the position on anyway and you are wrong! So what? You expect to be wrong if you are thinking and trading correctly. It is a big problem only if you don't properly protect your trade as required.

My statement is to prepare a trader for looking and being prepared to act on any possibility rather than being convinced beyond doubt.

ALS: You said we would talk and explore fun things that provoke creativity. Let's just start with being a child again and playing games on Sunday.

POP: Okay, you have given me good thoughts when you said to start being a child again. I can remember when just our family would play a game on Sunday called "Pit." I don't think many folks knew of it that many years ago, but I just recently saw a deck published in the 1920s and that brought back memories of a game that has been around for a long time. It was a game based on trading. Now that I think of it, I can take my introduction to trading back even further.

It isn't my intention to sell the game, but I know there will be a run on it now. Perhaps we should talk Futures into licensing its own version for marketing as a courtesy to their readers. The game was an exciting game then and still is today. We would get as many as four decks together and have 32 people at a time yelling and screaming. What fun that was to everyone from 6-year-olds to 80-year-olds.

By expanding the players to four decks, we were being creative. To be creative, it is easy to improve upon anything that inspires your interest. That is what we all need to do to grow, as we grow older.

ALS: Why was the game so much fun?

POP: The game was rather simple and, though not well-publicized, became an adventure of newly found fun for anyone who discovered the game. It was a deck of cards with different commodities on the face of the cards. I remember there were commodities such as hay, rye, wheat, corn, barley, oats and I believe two others. I will leave the two others out to let the readers fill in the blanks as we get them to being a child again. Each commodity had, I believe, eight cards. There was a bell like the one you would see on the counters at motels; you ring it by hitting the top of the bell.

The idea was to deal eight cards to each player, and the first player who had all eight of the same commodity would ring the bell and say they had won. At that point the game was over. Each player who had never played the game before would be shy and say this seems a bit far-fetched. As the game progressed by the rules, the shy player would start screaming the loudest.

Each player could exchange any number of their cards with any other player up to three at a time. If you had five wheat cards and were trying for all eight wheat cards, you could get rid of the other three cards based on the number of other commodity cards you had. For example, if you had two corn cards, you would yell, "Two!" Anyone else who had two cards to trade would trade with you.

You wanted to trade all of your cards away except the ones you were trying to get eight of the same kind.

You wouldn't think much of this game without seeing the action it created. All the players would start screaming at once as they got into the game. I remember we had a visitor come by one day when we were playing, and they thought there could be a war going on when we were playing.

"Pit" is the closest game to true trading emotion and adventure to this day. I haven't played it for decades but still remember the fun it gave us all.

If I were a magazine or broker, I would put my advertisement on the cards and give that game to all of my clients at a discounted price. It's a fun game anyone can play within minutes of hearing the rules, and it takes less than 15 minutes for each game. We found it was the best way to bring strangers into a conversation at a new meeting or reunion.

ALS: You're going to start a run here! I am sure lots of people remember the game and would like to get a game or two.

POP: Okay, I know we have the readers thinking and being creative now. They can improve the game and the cards, as an example of showing them the nature of how being creative will overcome opposition to change.

ALS: Why don't you put your picture on the cards and call them the "Phantom of the Pits" game?

POP: Why didn't I think of that? You see, you are very creative, too! Sure, we could do that and give the game to each person who bought a book. In fact, I know you have two artists working on the trademark now.

I realize we are getting a little away from what the traders want to read. Do you think they will forgive us and understand the importance of the Sunday fun point we are trying to make?

ALS: To use your phrase, "So what?" I know you are going to cover it all eventually and interactively with the traders. How can we deny you the smile on your face as you think back as a child would and enjoy the pleasures of being creative. I know the readers and traders whom you have so much faith in are enjoying this as much as you.

POP: Yes, it is important to me. There are few things in a child's life that allow a child to play as an adult while allowing an adult to play as a child. I don't regret bringing up the game I remember best as a child. "Pit" is a game that will sharpen your awareness of your surroundings and interaction with other people without requiring much of a task on your part. Do you remember the game?

ALS: Yes, and a few others, too, more recently. I remember playing drop the clothespin in the milk bottle with a 101-year-old lady.

Now, how much younger thinking can you get! If a 101-year-old can go back and enjoy the childhood memories, then why wouldn't a trader be able to understand this importance, too?

Phantom, it looks like you're on a roll here. I remember a well-known writer saying that he felt the books with less in them were sometimes better books. We certainly are giving less in this part anyway.

POP: I know whom you are talking about. I don't know whether he would want credit for that statement or not. I think I know what his point was. It was to express that it was important not to overwhelm readers with too much data, which could do more harm than good.

ALS: I think so, too. Could that be the true Phantom of the Pits who said that?

POP: You're not going to get me to admit or narrow the field, but why don't you ask yourself that question? I guess we can narrow the field, can't we? That is pretty clever on your part. By knowing who POP isn't, I guess you do narrow the field some. But why is it important anyway?

ALS: Okay, I'll drop it. I was just trying to think from the reader's point of view in asking. I am just being creative. Can you be more creative in front of a warm open fire on a cool fall day or cold winter day?

POP: Relaxed, maybe, but I think serenity sets in with comfort. That, too, is important in a trader's balanced life. I really see trading as driving a car around the Indy 500 track at 200+ and having to always be alert at every turn.

That is why it is so important to wink at a blind horse sometimes. You don't need to operate at 100% -plus all the time for you lose some sharpness that way. Come down and go a different direction on thoughts. We are kind of doing that now.

One of the ways a trader can be creative is to just pick up the newspaper on a Sunday and ask how a story they read could be expanded for more information. I like to do this, as very few times do we happen to see the followup story of something that is a question for which we want the ending answer. It is easier to research further today with the news updates on the Internet news posts. Oftentimes, we read news on different trading stories, and we must keep in mind that the view is not ours but the writer’s view.

I don't want our discussion to be taken as my views but my effort to provoke traders' views and ideas.

ALS: Yeah, and I know your draft chapters are just a beginning in getting feedback to complete the process of interactive feedback so you can continue and complete each chapter. You have presented ideas, which have generated other ideas, and questions to which you want to respond for the benefit of the readers.

POP: It's part of the reason I wanted a light part in our discussion here before we get into trying to narrow down the needed answers to questions that will or already have been presented. We have many subjects yet to draft before we turn the car around.

ALS: I remember reading an article about motivational speakers recently. Do you see your insights as doing that?

POP: Not at all! Who would want to replace their own intuition of what they see as success with someone else's? It is important to have your own thoughts and ideas. You can't be someone else so why would you want to be totally guided by someone else’s idea on what is best for you? Motivational speakers have a place and it is important to be motivated, but most that follow forget one of the most important truths: You are the one who motivates yourself. It must be you. As in trading, it is you who must make the trades, not someone telling you to make a trade. I see my insights as a guide to knowledge that the trader may not have had otherwise. This always leaves open the interpretation of their own ideas and thoughts. In fact, that is what makes markets. In trading we make assumptions based on known knowledge, and we use theory to prove or disprove our expectations being correct. I am trying to take away the feeling that a trader usually has the advantage when they do not. I am trying to take away the feeling that there is no way to succeed in an unfavorable game.

My insights are not anyone's ideas but experience in my trading career. When I was in junior high school, I and the class were asked to select one of two stories to write. The first one was, "Clothes don't make the man;" the second one was, "Clothes make the man." I chose "Clothes make the man." It was the worst grade I ever got.

The teacher was biased toward clothes don't make the man. Well, I chose the one I felt would be the hardest to prove with theory and assumption. I had good arguments, and I think to this day that I did the best piece of writing in that class. The teacher had her mind made up: Anyone who chose what I chose would be wrong. "A wink is as good as a nod to a blind horse" was what I thought of the teacher's grade.

I have proven that I was right in my lifetime, and I think that story is part of my success. You see, a person must believe something and then proceed to either prove or disprove their theory. My theory proved out over the years. My theory of clothes make the man built my character and my determination that I would someday be able to prove in fact that it was, beyond theory and assumptions, true in my case. Now, that does not mean it would be true in all of the classmates' cases. This is what the teacher missed.

ALS: How did you prove you were right by fact?

POP: My assumption was that how a person feels affects their actions and reactions to situations in their lives. My main point was that someone who had good clothes and was dressed well would have a different feeling about themselves than someone who would be wearing, let's say, just shorts in important situations. The key was "important situations." Can you imagine being at a funeral in just shorts? How would you feel? Wouldn't your actions and reactions be more agreeable with your feelings if you were dressed in good clothes? Of course, they would.

My fact proof came as a parallel to that article. I considered the well-dressed person and the well-knowledgeable trader as a parallel in points of feelings. In the pits trading with good knowledge (well-dressed) I felt more confident in trading. When well dressed in correct situations such as meetings and important events, I felt better confidence and my effectiveness was much higher. True, I am the same man, regardless of how I am dressed, but I am not the same person if I have not prepared my knowledge before I trade.

For the traders, I want to impress in their minds the same parallel. If you trade with lack of proper knowledge and behavior modification in situations the market will present you with, you are only wearing shorts at a funeral. How does that make you feel?

It certainly won't say to you, "Clothes don't make the man!" It will strike you to know that being prepared properly is the same as having the proper clothes for any situation.

ALS: Okay, did you ever want to get back at that teacher?

POP: I don't think I was smart enough to know what getting back at someone even meant as a child. I had lots of stars in my eyes. I still do, for that matter. It is a waste and non-productive of time to have anger or greed or regret or fear.

ALS: How about hope?

POP: Hope and love have a place in my life. Hope must be tied to action and plans. Love is my reflection of what I have given or am willing to give.

Chapter 13: Quicker Than the Eye

"You really are looking at a reverse image. Sometimes it is important to see things differently than others." Phantom of the Pits

Usually a newly placed trade in any particular market is placed with the greatest optimism and with human elements of hope for its correct movement. Perhaps the hope for the correct movement is what keeps new traders mesmerized by the market's inability to comply more times than not. Can it be possible that it is easier for a trader to do the wrong thing, or is it that, when a trader makes a trade, all the other information comes out two minutes later?

We will explore Phantom's insight on why things seem to change rather quickly when a new trade is established. Why does the market seem to know when we have placed a new position? What does it take to expel this type of thinking and reaction to our newly placed position?

At what point do you feel that it is the other traders against you in trading? Why should you feel that someone who is giving objective advice is now your new enemy and on the other side after you have just positioned yourself? Doesn't everyone?

Is it possible to do just the opposite of what we think is correct and come out ahead because we seem to do what we think is right and get slapped too many times? We are talking emotion here, and that is the one element that no one seems to have at the time of researching a position or entry. Once a position is placed, emotion becomes an element we don't like to deal with. We get excited when the position moves our way but become complacent far too often when it totally ignores our hard-earned research for positioning.

Art Simpson (ALS): Phantom, I know you have said you are not an expert on anything except on your own trading. I also realize we are only talking about your insight and that you have said it is important for each trader to grow and develop his or her own ideas from insights they formulate from observation and research.

Sometimes it helps other traders to know other points of view on a subject. We know that everyone has his or her own ideas on what a particular market is going to do. Do you think it is important to view other people's insights as a way of understanding our own behavior?

Phantom of the Pits (POP): I've read good books on the adult-child theory in trading. We start out as the child, and traders often never go beyond that point. Our thinking must become adult in trading, and that is from understanding and knowing what is correct. As a child, we often don't need a reason but just the rule. As an adult, to be effective in trading, it is important to know why and not just the rule.

It is difficult to convey to someone an insight of what happens when a position is placed unless the person you are trying to convey the information to has the same position on and effectively has the same environment.

Just a simple thing as changing a flat tire is a good example of what I mean. If you are not the person who had to change the flat tire, the effect of frustration is not the same. Because of this, you are going to be more removed from the important feelings of such an event. Trading does have the same type of removal from a situation of a particular point of view as changing that tire.

Most trades are placed with good reason and backed with good research. If the trader didn't feel they had a good chance of being successful with that trade, they never would have made that trade. That feeling of better-than-average probabilities is self-defeating because, with that feeling alone, it is possible to miss the big moves by being wrong first.

I view the nature of entering positions a little differently, and I feel that is a key in better trading. It is not natural to feel other than optimistic about a trade. What must be done is that the optimistic view must be projected beyond the initial position.

The most important point of a newly established position is to understand that the initial entry of a trade is only a small part of the expected process of trading your position. Look at it as if you are going to make a series of trades anytime you get a signal. You must have the latitude of knowing and doing what it takes to correctly end up with a position that reaches to your goal. Your goal is the important part and not the trade you have just entered.

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.

ALS: Aren't you going to give us your methods or suggestions for helping with the behavior modification on getting out of bad positions?

POP: If you have to unbutton your top button on your shirt, you had better get out. If the phone ringing irritates you, you had better get out. If you are beyond your reasonable time frame to hold a position that does not prove correct, you had better get out.

We know a broken clock is right twice a day. You could assume that when you don't know the position is correct, you just as well reverse as you still won't know, but you can be sure you will soon know one way or the other. Of course, this isn't a very good assumption so it will actually keep you on your toes more than anything else will.

This can also be a dangerous way to position but, believe it or not, I have seen day -traders position this way to establish a position when the trend is not established. I don't personally recommend it, but I don't advise against it if you do it with good research of non-trending markets. Sometimes your best opportunity comes when you have initially entered a bad trade. The opportunity is that you correct a bad position and profit from that wrong position being corrected. It happens more than not if you are alerted to this thinking.

Be swift is all I can say to impress you to this possibility in markets. The surprise is often the other side of our current position. Just because we have the expected side of a trade does not prevent us from going with the surprise side when we know our position is wrong. In a correctly proven position, we never go against that position, though.

ALS: Do you feel it is easier to put the wrong position on rather than the right position?

POP: Actually, it works out that what we have just done is often not proved correct, but that does not mean putting on the wrong position is easier than the correct position.

There is another element that gives us the feeling that we seem to see the market go against us as soon as we enter. That element is timing. Timing will cheat us more than not. An inexperienced trader will fail to recognize the importance of persistence in our re-positioning after removal of a position. Just because we exited an unproven position in no way says we were wrong. It is our intention to keep the drawdown small and allow us a better entry when we are not proven correct.

Isn't it better to get out if you don't get the expected move? You want to be swift when the market is working for you, and you want to have the least exposure you can have when it isn't working for you. I realize most markets spend lots more time going up than down, and your exposure will be longer in a bull market than a bear. But why diddle in the middle when the market is doing its chop-chop? You use the chop-chop to better position and to cheapen your position.

ALS: Just as soon as a position is placed we seem to hear all the news that does the opposite of confirming our entry. Why?

POP: After we enter a position, we are more open to listening to news that makes us more sensitive to doubt our position. The answer, of course, is to remove our position if the market does not confirm our position. If we see the news is against us, we surely are having doubts about the position, and it hasn't proven correct in the first place. It is just another signal to ourselves that

Rule 1 must be foremost upon a new entry above all else to keep emotion out of our thoughts. That way you can bring on any news and not let it directly affect your thinking.

ALS: Why does it seem the market knows when we have just placed our position?

POP: It is true that it seems to happen to us. I think every trader feels that way at one time or another until they learn to be mature in their understanding of how the markets react to waves of orders.

Price movement makes other traders decide to enter into a position. We tend to take obvious signals and entries, which many others are taking at the same time. Because of that, the market will appear to make a move against us immediately. Every trader will eventually face this impression. That is not a bad circumstance to have happen unless we don't react properly to it. It happens much more than you think when the market turns very close to our entry. To be alert to that possibility is a must in trading at all times. To be able to have a plan to address that situation is critical in survival long term.

To eliminate the feeling of the market knowing when you enter and immediately moving against your position, you must know that the most critical time of a position is immediately upon entering. That is when you must be prepared to be the quickest to protect your position. I always consider the most dangerous time of a position is at entry because you do not have a proven position at that time. Why is the most dangerous time of a position upon entry? My answer is that it is because this is your only opportunity to keep your drawdown small if you aren't proven correct with the position.

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.

ALS: I have often heard traders make the statement they should just do the opposite of what they think and they would trader better. What do you think of that statement?

POP: I also have heard that remark. I know my Dad thought that was a good strategy in my early trading days, too. It does have merits. Don't get this wrong! The merits are that it is good thinking to have a plan for acting upon that thinking. Plan to know that what you do has a good possibility of being wrong and have a plan to do the opposite as soon as you know you don't have a proven position. This works better in non-trending markets.

Let's say you know a big news item is going to come out or you have just been given data from a big report. Your thinking could be that the news is already in the market but you aren't sure. Most traders will trade accordingly and, when wrong, get out and that is that! Well, doing the opposite is the correct thing to do, but you do it because you were the wrong way to begin with after the data. It is important to avail yourself to all sides of a market in certain situations such as reports.

So you must admit the merits are true in a sense of that statement. You can do the opposite of what you think, even though you did something that was wrong at first. Isn't that the same as doing the opposite of what you thought at first? In a roundabout way it is!

ALS: I have another question that just recently became pretty important. On a news channel an interview with a particular expert was like throwing gas on a fire. The traders who were positioned counter to a remark made felt the person making the remark was their enemy for making such a statement. Is this appropriate to have such remarks made, and is it destructive thinking to let it affect a person's trading?

POP: It happens all the time. That is the first assumption you must make for it is true you will be more sensitive to a person's remarks that are counter to your position. And I suppose that is okay to be sensitive as long as you keep emotion out of it. But keeping emotion out of it when you see a big slide or big runaway market is hard and almost impossible to ignore.

The true test of such remarks is what the market does in reaction. I have found over the years that markets do react to such remarks. But here is the key: You will have more than one reaction. You can use those reactions to your advantage if you remain swift in your market moves. In fact, you must be swift, and you must use what the market gives you for your advantage to position for profit.

Here is why you will tend to have more than one reaction. The local traders will see the remark or even a report of data first. Their reaction will be as a professional, and they will position according to their beliefs. At first it won't be in unison but it will pick up a cadence of sorts, and you will see some kind of trend in pricing early. That is usually your first wave of buying or selling.

Next come the orders into the pit from those who have just gotten the news, and you see a further reaction to the news. The third wave of news is the customer (public) who has been told the news and has contacted or been contacted by their brokers. The third wave will usually be the strongest because the willingness to fade the news is less prominent when their orders reach the pit.

This is when you have your thinnest market and when markets make new highs or lows.

After all three waves of orders are filled, you still have your stragglers who take positions upon learning the news. This could take a day and a half to enter the market. The news is seen on TV, heard on radio and read in the newspaper after the market is closed. That is part of my day-and-a-half theory on news items and events. Upon the conclusion of a day and a half of response and reaction to data or a critical news remark, the market usually comes to a plateau of understanding of equilibrium.

The second part of your question is that it is not constructive to become emotional about a news remark, but you should recognize the opportunity of such a remark being a mechanical reaction you can make to capitalize on other people's behavior to emotion from such a remark. This sometimes will take a couple of days to play itself out.

It is important to understand that this can change the continuing trend, countertrend, non-trending or interday trading and void some trader's signals. To be alert to this is crucial in following your protection of your positions. More times than not, you can cheapen your cost of your position by using the knowledge.

You can improve your cost of positions by using the news to properly split half of your profits and re-establish on the waves of orders. Or you can use the news to establish a trading range to have a better position than from putting it on all at once. In other words, you have the opportunity of scale trading due to an expected wider range of activity.

But keep in mind this must all be thought out in your trading plans, and you should be prepared at all times for these events to utilize them in your trading. Most systems do not take this into account. The surprise side is created often by, as you called it, adding fuel on the fire.

Its is sort of like watching someone pile logs up next to the fireplace. With almost certainty you can say with high probability as soon as you gather additional information what is going to happen. If the temperature is very cold, you can say there will be a fire in the fireplace from the knowledge you have gathered.

Well, news stories at critical turns in a market can do the same thing. You see the logs and you are waiting for the temperature to drop. You certainly don't use a squirt gun on the match. You use the warmth to your advantage, even if you don't like fireplaces.

Same in trading. You use the warmth of news items to your advantage, even if you don't like the fact it is against your current position. Change your ideas on events when you gather additional information whether fundamental, technical or tactical (as I call the mix.)

ALS: With a slide of the hand and quicker than the eye, we seem to get back to the same things in successful trading: knowledge gathering and behavior modification. Isn't this most everyone's theme in trading?

POP: You know, I don't really know. I only know what I have learned over my years of trading. If it isn't most experts' themes, I would venture to guess it soon will be. I know there are those who will read this to improve understanding of insight into successful trading. I know they can understand the problems of trading better because of what we are doing. I am not out to disprove any successful method by presenting my views on trading but only to enhance the possibilities.

ALS: I think there will be critics of your views.

POP: Do you really think so? I disagree with you. I am wrong in the markets a lot of the time, but I don't think you are right with that statement. It is like going down one of two roads. Unless you go down both of them, you cannot say you chose to take the wrong one for the better view along the way.

It is the same in trading. I have presented a view along the way. It is just that I have been down both roads, and I can accurately express which road I feel is the better one to take. I am presenting an opportunity to expand horizons of trading within each trader's mind. I am not presenting a limit or restriction to improved thinking on trading systems or criteria.

To be a critic, it is important to look at things from all views. You look in a mirror and you don't even see yourself the way others do. It is reverse image. To be a good critic you must be able to see as others see. You must not rule out the reverse image as a correct view.

ALS: Is that what you consider your rules, reverse image?

POP: Very interesting observation. I suppose you could call Rule 1 a reverse image rule from what others see. It is just the opposite of most people's understanding of what is necessary in trading rules.

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.

Chapter 14: Your Comeback After a Big Drawdown

"You want to establish your position prior to the increase in volatility. This will be your entry of the fourth day when the market breaks above the prior four day's highs." Phantom of the Pits

Art Simpson (ALS): Is it true that you have saved the best until last in your insights? (NOTE: At the time it was written, this was the last chapter of Phantom's Gift. However, due to reader response and questions, the Phantom elaborated on some insights and presented other thoughts in additional chapters.)

Phantom of the Pits (POP): You will see as clearly as anyone can see that what I am going to tell you is the most exact and best information you will ever get in your entire trading career. You can call it the best. If it isn't the best part of any book you ever read, I will send back every thought to the cleaners.

There are great authors, great advisors and great traders in the world of trading. There are great editors, great reporters and great teachers of trading. They all have a reputation. They carry that reputation well. I could never carry a reputation for it would be such a burden I could never survive. Great people have been able to deal with it like my friend John Denver, Don Gibson, Oprah and my brother. They have learned how to carry such heavy baggage in their lives.

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 isn't 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.

Art, you have dropped some hints along the way with the events that have taken place. I can tell you that my faith in the small trader is no whim. As I read your brother's memorial to John Denver (see chapter by Harold Simpson), I realize Harold said it as perfectly as anyone could say the true reason of what this is about. "Was I somehow meant to be here? Was this moment just coincidentally mine for my imagination to make it as I will, or was I supposed to be a part of all this?"

I can figure theorems pretty well from the facts I am given, and I can assure you that you and I have learned a great deal from this project. We have learned more than we started out to give. We have learned more than we could imagine in a lifetime. Do you know the mail and understanding I have received over just the last two weeks (NOTE: from Futures Talk forum participants following John Denver's death)? I know you have seen the response, too.

I have it calculated we could put no less than a 1,024-page book together of those we can thank for not our, but their, insights. It is overwhelming to think that we are alone. But being alone is what trading is about. It is very lonely in the world of trading.

I can tell you that our experience has opened our eyes and unlocked our hearts because of what has happened to us by being a part of the Futures forum. What a step forward it has been to see the speed of thought in our lives today. I believe, because of the faster speed of communications, the markets are quicker today and my rules are even more appropriate.

I don't know why I say my rules anymore for I feel they are supposed to be the small traders' rules now. I don't mind or regret the route it took to give what I have to give. I am not capable of carrying a burden. I have just lately learned what tears are about. I have been told, scolded and directed to a different light in my life. It has all been for a good reason, and I thank my new teachers for all of the effort to let me be in their class.

You must accept my thanks and appreciation for your understanding of my weakness and loneliness of trading. Only a trader can understand that darkness. I thought I was alone but find out there are many lights along the path. Those lights are our newfound friends who have walked the path, strategically placing their brilliance so we can continue our walk.

What a joy to receive the oldest book of Shakespeare form New England. What a lesson to receive guidance from more countries than I have visited. It's important to learn again the zip code of every state in the U.S. It's an important lesson to learn what I would never have imagined 30 years ago of how thought and feelings could transit the world so quickly. This is my shock to new learned knowledge.

Winston Churchill once stated, "This is not the end or the beginning of the end but could very well be the end of the beginning."

We'll accept that. We have started! It gets better. There are more of us now. I no longer shall have to walk around in a majority of one.

It is going to be difficult because there are those who would pull my mask off. But all I can ask is for understanding — understanding of why I do not want or, mostly, why I cannot accept credit for my insights. To answer your brother, Harold, yes, I was meant to be here! As long as I know why I was chosen to be here. Only others can tell me why I am here. I shall listen to them! They will give me joy from their hearts and allow me to bow at their feet in appreciation, for they know more than I of what need brings in my life.

Traders are a macho bunch but look at me, Art! Am I macho and the true image of what a trader looks or acts to be in the world of finance? No, I am just a teddy bear in my own world of big complications. I am a very simple man and a small image of God.

I no longer shall ask Harold's question. I accept the idea that I truly am supposed to be here, and I have the responsibility to respond and give what I can give to satisfy my inner needs or my boss. You and I know it is the readers and the givers on the forums and all walks of life who are the guides in our lives. We have learned behavior modification well and acknowledge that criteria in our lives from here forward.

Just ask and you shall have the answer. But it is in your own thinking that the appropriate ration be dealt. Consider your reasons and you shall change your destiny. It is Phantom's duty to follow and see that you don't stumble for I have already walked the path. I do not lead and I do not follow. I only walk your path in appreciation of knowing you shall grow and be the leader that is expected of you.

I need to show the starving how to take a bushel of rice and, instead of eating it, sowing it instead and learning the magnification of effort in prosperity. The starving are my traders who are my little Phantoms in an overwhelming world of giants. My Phantoms shall become the leaders in the world of traders -- not by my hand but by their own. You see, they are the chosen ones to lead the New World of finance. There are cycles and a new one shall surface. The little Phantoms shall learn the smile of trading in their lives. What more could you ever wish for them!

Art, I hope your wife isn't getting tired of my stepping on her cats. It has been good to share some of the sad times with you both and the traders who have helped us get beyond a period of sadness in our lives. I know some day your hill behind your house will be famous. I expect your brother, Harold, has already renamed it. Take it to heart. It is not your hill. It's only your walk, which is yours. It is the same in trading. It is not our success; it is theirs. Not by forfeiture but by design, the student of a good teacher shall surpass the teacher.

I asked Alfredo if we could use his ideas from a post (to the Futures forum) to convey more of what my intentions are. It surprises me that others seem to pick up on what I am supposed to do more than I do. Look at his posting (below).

Can you forgive me for not sticking to the subject on this chapter?

ALS: I and the readers and traders understand where you are coming from and the importance of what it is to walk alone. I know you are pouring your heart out to us in an effort to show your genuine appreciation of what has been given to you. I know you are humbled again by what others have presented to you. You have always prepared yourself for the possibilities as well as the expected probabilities in your trading. When it comes to being an expert on everything, it just can't happen.

I know what a genius you are and how it sometimes robs you of simple happiness that most people take for granted. To continuously move swiftly into the next step of life is true, as you have stated thus far. Opposition to the unknown is high. You are no different than any other person or trader. It is just that you have been given a different view on life, events and reactions to events that puts you where you are. You have been given a gift, and you are the first one to accept that you do not have a right to accept any credit for what you have been given. It is your time to give back!

So it takes us a little longer to get to our chapter theme? We have only shown what an ordinary person the Phantom really is. You are no different from the inside out than any other trader. You may see the line a little more clearly; as you said, you are the observer and you do see the line in the sand. You have been patient enough to wait for others to see the line in the sand. And they will see the line in the sand. It only needs to be pointed out to them that there really is such a line.

Phantom, I am not saying this because you are my long-time friend but because it has been proven to me. You are the light in the lighthouse for the future, current, expert and novice traders, not just in the U.S. but in the entire world. You are their hero because you dared to be great. And you are great.

Anyone who could teach Christine to sing surely must be worth something (said with a grin) in somebody's life! The fact of you, Phantom, is that you are a very simple man! That is what you have always wanted to be! So be it!

POP: Do I have your wife sew my buttons back on? You have exposed me more than I could ever have shown. I have to put it in the category of committing a random act of kindness! I do appreciate what you are trying to do. Let's just turn the tables a bit here so the readers know more about you now.

You see, I know of your love for music and your first trip to Nashville in the 1960s and your collusion with Floyd Cramer on your song. I know you didn't make much on your first song and that trading has been better to you. Maybe you should go back to your first love, no offense to your only wife ever! After all, what is important in life?

ALS: My brother is the singer and the musical part of our brain sides. It is funny how daring to be great can change our lives. It is the same with traders. You hear! Go ahead and dare to be great! Phantom knows it can be done, and he is giving you the gift.

Somewhere you will know how the thank you will be directed.

I am impressed with the faith you have in the small trader. Just today on CNN I heard an expert say just that same thing about the small trader leading the way. It is true, you know, that the word has been written already. A small trader can and, Phantom, if you are correct, will make a big difference in life. I use faith and not hope in your view.

You know, Phantom, if we keep this up, we are going to have to pay the readers and the other traders to pay attention to us!

POP: We know where we are going so what difference does it make if we can be real people like everyone else. I think that, for the first time in my life, I have an outlook on life, which is a total shock. I can't get enough. I don't care what my positions do tomorrow.

ALS: You never did! I guess that is why you are who you are. If the other traders who read your insights can understand how simple it can be to not care because of your rules and just do it -- DO IT! I mean, as you say, it only matters what you do with your losers that determines your success.

I don't mean to change the subject, but the CD we are listening to now is Floyd's "Losers - Weepers." Do you think that has any significance in this interview?

POP: Yes, Keep emotion out of it. If you do the right thing in trading, never be a weeper. Hey, that is pretty good, don't you think?

ALS: 12:15 a.m. and I have your attention and tomorrow is Friday. I know you have big positions on in the stocks. It is a long drive to Chicago! How do you think you will trade tomorrow?

POP: The same as always. I will sell more corn on the rally and cover when I am wrong. That will be at 9:30 a.m. But, first, I will run the stocks. Lucky I covered on the close today. It has been down and then up. I like it. More opportunity for us tomorrow, don’t you think?

ALS: Why don't you just take tomorrow off?

POP: Okay, I will get out at the open or perhaps we can do it before tomorrow's open with the night trading.

ALS: How far do you think the corn will move if you get out tonight?

POP: You don't even want to know! At least I am on the right side. We could see by going at the market heavy. I can't for I know better. Okay, we'll just have to look for a Saturday and Sunday walk back to the top of the hill.

I notice that song you wrote in the 1960s is now playing on your CD. Are you ever sad you sold it for such a miser of a penny?

ALS: You may not know how much I got for that song. It is the best price anyone could ever get for a song. I have the greatest memories. I don't make many of them anymore. Nor do you, I bet!

POP: I'm pretty simple! My memories are no different than our traders' . . . or our little Phantoms, I mean. I hope Phantoms can grow up faster than children. I don't want to watch from the sidelines. I want to pass the ball once in a while.

ALS: Phantom, we are losing out here. I think this is all going to be cut from the book. Maybe we had better call it a night until we get back on the subject.

POP: Okay, we can cut our losses. We will start over again. I just want you to do one thing for me tonight before I head back. Put this on the Futures forum and let the other traders know I am one of them. I'm no different. I'm just a bigger size!

ALS: Okay, you win again. I will be up until you get home. See you for the true part of our trading after the big DD.

POP: I'm going to take that bushel of rice to starving you now! First, I would like to go to Lake Tahoe for the best chateaubriand. See you beyond!

ALS: We will get to the point soon!

Alfredo's posting

(Note: Alfredo posted the following in relating his view on the parallel of Phantom's rules with his beloved game of chess.)

Author: Alfredo A.

I consider myself a weak amateur of the game of chess. But an amateur (in the sense of lover) nevertheless. There are some fundamentals that even beginning players know they must execute properly in order to stand a chance of at least forcing a draw against a better player, or checkmating a weaker one.

1. The opening is critical. You have to be both aggressive as well as defensive and work your pawns looking 10 or 12 moves down the road. Some games are won during the first five or six moves. (Phantom's Rule 1 ???)

2. Next comes the consolidation. You develop your horses, bishops and towers and protect your king. You are preparing your pieces in such manner as to later permit you to launch a successful attack. You explore the weaknesses demonstrated by your opponent. You try to tire him as much as possible. (Phantom Rule 2 . . . press your winners ???)

3. If possible, the final attacks and checkmate. Against a stronger player, a draw will do. (Phantom Rule 3 -- this one he owes us — when to liquidate and take your profits ???)

Battles are battles, be they on the air, sea, land, chessboard or the PITS. Is this a very futile analogy???

Any chess players out there to correct/improve my reasoning?

Good trading

ALS: Phantom, I think Alfredo has you pegged pretty well! Did you ever play chess?

POP: In my younger days I would pride myself in chess but as I grew older, I never felt I had much time for the game. I should play more chess to relax, but there are so many things to do now.

ALS: We'll cover your chess matches someday but for now let's go to "trading after the big drawdown." Why do want to put this part in?

POP: First, it was a question that one of the forum followers posted, and I want to answer their questions. It is a good question.

Second, most traders wouldn't be reading this if they had never faced a similar situation as a big drawdown.

It can happen in so many ways. I am not going to judge why a trader would have a big drawdown because it has searched each of us out at one time or another. A big drawdown is what will stop you from trading. I am going to approach the reason for the big drawdown as if a trader had 15 losers in a row! I am not going to judge any other reason of character as to why the big drawdown occurred. I want you to also forget the reason for your misfortune from here forward.

ALS: We both know that holding a loser too long is the biggest cause of the big drawdown! Why are you so kind?

POP: Really, this is the best part and to go forward is what we are after here. We don't look back except to learn from what has happened in this case. Another reason I want to approach the drawdown as having a series of losses in a row is because that is an event that happens every once in a while.

We are going to recover, and I shall show you how to recover after the big drawdown. I am pretty intent on not giving you specific trading plans or signals from my programs, but I do need to give you the way to recover.

To do it correctly, I will have to give you a good suggestion to take in your recovery. I want you to research on your own and take the suggestion only after you have understood the suggestion correctly and can approve of what I say to you on your own. In the end it will be you who make the decision to make the trades. Therefore, please verify your data. It leaves some interpretation to you, the trader, in your trading program.

To start, we are going to make sure we have enough funds to continue to trade. If you don't really have enough funds, then you should postpone until a later date. Notice I did not say you had to quit trading! We all quit trading for some reason. It is just that your reason is different at this time. Okay, we proceed now that you are satisfied you have enough money to continue to recover from your past misfortune.

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. We will turn that table from here forward by doing the following suggestions.

First, you must know what your risk to the dollar is going to be on each trade from here forward until you get to a point of recovering from your big drawdown. How many ways can you know your true risk to the dollar on your trades? Actually, with options you can but only if you are a buyer. There are other ways to do this, too, by using butterflies in futures positions and by using three contract months, but this is too advanced for you at this time so we will stick to options.

I don't like to give trading advice, but it is imperative at this point that you understand we are talking about an exception. You do need some advice as to where you can find the correct road. You know what you want, and I am only giving you directions on which road has what you want along the way. I am not going to give you specific advice but a method of turns and directions to get you on the road and headed in the correct direction.

Second, I am going to tell you that you can and will recover after the drawdown if you do not take a side road along the way. You can get to where you are going, but you only have enough gas (money) to get you to that point. Don't take any detours.

Sometimes it is not as much fun to head straight down the road with one purpose in mind. That is your only handicap. You have a good choice to make. Knowing you can do it by following the road correctly is a good choice. Should you decide differently, you are putting the recovery in your own hands.

Take out your chart book and study it. Tell yourself the nature of the market you are studying! Pick only your best eight markets.

Try to diversify to a point that they don't all tend to trend together or that they are all related in their behavior. Pick out the existing trends of the eight markets. Write them down and notice how many are in up trends and how many are in down trends. You'll most likely see that most are not in trends at all. At this point it makes no difference. You are not in a hurry except to make the right trades at the right time.

What you are going to do in your recovery is to put as many aspects of trading in your favor as you can to change the law of probabilities of recovery in your favor. By knowing the trends of your chosen markets, you are to classify them as bullish, bearish or non-trending. Seems simple enough, doesn't it?

Place the bearish and non-trending market charts aside for this day and pick them up again tomorrow to see if any changes have been noticed in behavior. You are going to concentrate on the bullish established trends at this time.

The main reason we need eight of your favorite markets is because we are only making the highest probable trades and we need to diversify. You are also going to put advantages on our side. You have a better chance to predict a bull trend than a bear or tired trend. Or do You? Sometimes a tired or bear trend is easier to see. Bear markets tend to move down quicker than bull markets move up. Or do they? You don't really know, do you?

Okay, do your research and look at the market behavior from today backwards a few years at least. Learn from this research. It won't do you any good for me to tell you since each market can react a little differently. At any rate, I want you to know, not me.

You are going to use options for your recovery because we can limit your exact known loss. Futures tend not to give you an exact known loss when you enter due to the variable factors you have no control over. You also get other benefits from options that you can't get from futures.

The best advantage we are looking for in options is the fact that, in bull markets, options pick up and increase in volatility most of the time. Because of our limited required risk, we can use the bull market's increased volatility tendency to our advantage.

In a bear market options tend to lose volatility. Because you don't want to sell options and have open-ended risk, we rule out the bear markets for your recovery.

Also bull markets tend to spend more time going up than bear markets do going down. Markets, that go up give us more time to increase volatility as open interest builds and interest increases. Bear markets tend to lose traders' interest. Or do they? Do your research!

I am not going to give you a lesson in options as there are experts and software programs on about any aspect of options you could want to learn. If you are interested in learning more during your recovery, by all means do it. You are, however, going to use the best part of options for your recovery. You are going to put increased volatility on your side as a part of your plan.

Now that you have your vehicle for recovery, you need to get a friendly trend working for you with some information in your corner that also has some help from the charts and from research. Isn't it a good assumption that, in bull markets, volume and open interest tend to increase? Isn't it a good assumption that increased volume and open interest increase volatility? Isn't it a good assumption that markets tend to have three major waves of buying in a bull move? Again, please do your research so you have confidence those statements are true and good assumptions.

After looking at all of the charts to determine if any bull market is established, you are ready to make a trade when the parameters are correct. Just what are the correct parameters? First, you must find a bull trend in one of your markets. Next, you must learn which phase it is in. Is it in the first, second or third wave up? How do you tell?

The answer can be several possibilities. You are going to research your own possibilities! You will have to make your own assumptions. When you are convinced a bull trend has started, look for a four-day reversal. At that point you shall call that wave one of buying. Look further and see if you have any other four-day counter trends. If you can point out another, let us call that wave two. And then look for a third. You may have to look backwards in your research to find some examples.

On your current charts, look for a market that is established as a bull market. What you want to find is a possible four-day counter trend starting to develop. We want it to be in the first wave of buying in the established bull market. You could look at the second four-day counter trend development, but we want the most powerful opportunity.

You will want to take a position on the first four-day counter trend in the direction of the bull trend. You can make it one of two ways. You can do it on the breakout of the fourth day's highs when it breaks above the previous four days or you can position when the move is above the high of the established bull move. The best way in your case is the first. You want to establish your position prior to the increase in volatility. This will be your entry of the fourth day when the market breaks above the prior four days' highs.

You have a pretty good idea of what you want to do and how you want to enter your trade. You are looking for a limited risk trade when you have an established bull trend. You are expecting to be wrong but with limited risk by buying calls, you can make the trade. You want to either place a call bull spread or purchase the next higher strike call, depending on your capital available for trading.

You must decide what amount of risk you can afford to take based on your account size at this time. It is your decision. A rule of thumb is 10% of your capital on the trade. If the bull spread costs you $500 and you have $5,000 in your account, we can go along with it. After you put the trade on, you will be looking to get out when it is half value or your position has met the criteria to press, get out or reverse.

You want to trade the option with at least 40-60 days of time remaining. An option with less than 40 days remaining will leave you too little time to participate in a good trend without losing too much time value. You can position an option with time upwards of 120-180 days with little problem, but in a good bull move, the closest contract will be the faster volatility mover. You are after the fast volatility move in this position.

Your trade can benefit from any increased volatility in the established bull market and the fact you have entered at the first phase of a bull market. Your entry point is a critical point in that you are going to see either a continuing of the trend or a failure of the continuation. You have used Rule 1 by limiting your exposure and risk. You have set your limit on your risk, and you are expecting to only lose half of your risk by placing an order to get out of the position once you have lost half of the value of the option. If the option reduces in value by one-half, you surely are not in the trend anymore at that time or you have moved too close to expiration. You move to the next trade!

The other criteria of removal of the position is failure of the four-day counter trend to re-establish the continuation of the existing trend. A failure is confirmed when you have moved below the prior four-day lows during the next trading day. You could have a very fast trade if wrong and a long ride if correct. Be prepared to recognize the failure or the continuation. With your option position, you are protected in the amount of drawdown, but be swift in preserving your funds when not proven to be correct.

You can take the second four-day counter trend to establish an added position by using Rule 2 but only if you were able to properly establish the first four-day counter trend position. Be under the assumption you may be too late on the third to establish positions. The third four-day counter trend can lead to some pretty wild swings if it fails to continue the trend but is still in a trend.

This is the part of the bull trend you will want to think about taking profits. Because you are in a recovery stage, you must decide to take your money on this move rather than trying to force another trade. You make the next trade with the same criteria.

The importance of this type of positioning in your recovery is that you will make a much better return than what you risk when you catch both a bull trend and the increased volatility of the move. You want to make the most amount of money with the least amount of risk. You want as many factors working for you as you can possibly have.

You will be tempted to take the four-day counter trends in a bear market, but you have an additional drawback -- that is, volatility most likely will fall and your expectations are reduced rather quickly on what is possible in the move. Therefore, it is recommended you stay with only bull trending markets and the first four-day counter trend.

You'll find many advantages in this style of trading, but patience is rewarded in the long run by good gains only from waiting with the correct trend. On the other hand, running away from failures of continuation of a trend still leaves you with small losses. This is less fun than most trading done by you over the period when you had the drawdown.

There will be times you won't have positions on -- in fact, many times. But don't let that be your downfall as you are not trading to trade but to recover from the big drawdown. The best benefit from this type of trading is that you will learn a lot about markets and options this way, too.

ALS: Let me review a little here. You are suggesting that, after a big drawdown, traders take at least eight markets, study them and determine which are in established bull trends. Next, you are saying you must see a four-day counter trend to enter an options position. You establish either a bull spread or bull call position in the direction of the original trend when the market takes out the prior four days' high.

For protection you suggested a continuing trend failure is reason to get out on the next day if it goes below the prior four days' low.

Also, if the option loses one-half of its value, it is time to get out. You want at least 40-60 days of time left on the options. Have I left anything out?

POP: Yes, you want the first position on the first four-day counter trend and you want to press on the second four-day counter trend, but you want to use the third to take profits rather than add again. You only add on the second four-day counter trend, and it is best to establish on the first four-day counter trend of a bull move. You are looking for volatility to be your friend in a bull move, and you are expecting to have bigger profits in a bull move than your risk by at least a ratio of four to one.

ALS: Will this work every time?

POP: Of course not, but there are good merits presented here. As I have said before, I really have a lot of faith in the small trader.

The large trader has all of the data to establish the good trades and has the funds to back up big drawdowns. I am not giving advice but presenting a situation that can lead to recovery from adverse market effects on drawdowns. I want the small traders to become the leaders I know they can be. It has to start somewhere, and I think it is going to start from a big drawdown for many of them.

No one is immune from market exposure. To control that exposure, first, we must trade with extra advantages on our side. We are doing that with this type of trading. We are trading with an established trend, and we are adding but only correctly. We also are protecting our position in two ways. Both Rules 1 and 2 come through again.

ALS: I have been meaning to say something about that -- your two rules. As Alfredo mentioned in his chess parallel, he says you owe the readers a third rule of when to liquidate and take profits. What about Rule 3?

POP: I have said on the forum what I feel about taking profits and when to liquidate. I did include it in the recovery. I am a believer in taking profits in the third phase or wave and within three or four days of high-volume days. In most markets I like to take profits within three days in most cases. I hope that gives some answers and makes a few traders alert to functions of profit-taking. I am not going into the detail at this time. I really have given more than I intended to give in this book on profit-taking.

I see as the most important aspect of Phantom trading at this time the understanding of Rules 1 and 2. As far as giving a Rule 3, not yet!

ALS: There are a lot of questions about Rule 2 yet. Most traders are still uncomfortable with it. They have taken to Rule 1 pretty well. We surely can explain Rule 2 a little better.

POP: Maybe we should do a followup on Rule 2. Let's ask what questions are foremost in traders' minds on the forum. If we don't get it into this part of the book, we will do it in a later writing.

ALS: Okay, that sounds good to me. It also sounds like you might have another rule yet.

POP: Time will tell on whether there is to be a Rule 3.

ALS: Are you giving a hint here?

POP: Have you noticed how sometimes things don't get written or interpreted correctly? I don't care about errors about me or my career as I am in the background by my own asking, but I don't like to see data wrong. I shall challenge when the data is wrong that affects a trader's interpretation or their ability to trade correctly. How can I know unless I get feedback. I must get that feedback before I can move on to other points. I don't mean to take so long in Rules 1 and 2, but there is no other way.

ALS: Should we cover some detail into recovery after the big drawdown a little more?

POP: No, let us wait and see the reflections coming back first.

Chapter 15: Is the Market Always Correct?

Everyone knows the market is always considered correct, and there isn't reason to even dispute this belief. Most of our beliefs have been previously written or have been stated for years or decades by experts.

Phantom has hinted his feeling as to how he felt about the market being correct. He made the statement that he didn't always agree. We felt it would be an important insight into trading plans by looking at his view on the subject.

Art Simpson (ALS): Phantom, do you feel the market is always correct?

Phantom of the Pits (POP): NO! NO! NO! Definitely not! Can you tell me who proved that to be a correct statement? Or can anyone tell me who proved it? This statement is the biggest reason traders are buying highs and selling lows.

ALS: They're going to put you away with that kind of statement. They're going to lock you up. You are going to lose all of your credibility unless you can make a good case for your disbelief, Phantom. You are taking on a lot of people.

POP: I guess I appear to be bad with that statement. The experts seldom know or acknowledge that trading is a losing game. A trader expects it to be a winning game. It is the same with the statement that the market is always correct. Whoever thinks it is possible the market could be wrong at times? Why do as many as 92% seem to lose in the markets?

I see the market as a continuing image of liquidity. A liquid market reacts differently to news situations and technical indicators than non-liquid markets. After all, what is the purpose of floor traders in the pits of different markets? It is to provide liquidity.

Liquid markets are the leaders in determining price. Non-liquid markets tend to be sloppy in price determination. We have the reason for different markets and the creation of new markets. It is to provide liquidity and ACCURATE price discovery.

If a news item is bullish or bearish in a non-liquid market, the bid and ask spread is usually wider than in a liquid market. Now, are we to believe a wide spread on bid and asked price is telling us the market is correct? I think not! Sure, you can try to make the same demand and supply argument in the market being correct, but lack of liquidity is an artificial market condition of demand and supply a lot of times. Not having an offer to sell is not the same as not having any product available. Sure, it can have an effect on changing price, but it is an artificial condition.

These artificial market conditions must be utilized in a good trading plan in order to survive. Our plan is to trade as long as you want. To not get caught in artificial market conditions requires criteria. Every trader has been told the market is always correct.

The market is always in a process of moving away from what it currently says about a price. Does that say it is correct? It only says to me, "A market is more than a day!"

ALS: Yes, that is the first lesson you taught me in trading. I didn't even know who you were when I learned that from you. It didn't take me long to respect you and watch you in your trading. I've studied you ever since, and I feel I know you almost as well as you know yourself. I know there are those who study you now. I see by the respect shown toward you since you began this project that loyalty comes from the reflection of traders changing views about trading.

POP: A simple statement about markets being more than a day can change a person's thoughts and lead to a different outcome.

It says the market is changing every day, and what price it shows now is surely not correct all the time and definitely not correct for long.

You often see larger market moves in thin markets. Those who direct a fund know new prices generate new orders. So why wouldn't they place desired positions in the market on thin days in the direction of their indicators? This does happen.

Now, are you telling me the market is correct at the close in thin markets at all times? I am telling you to look at both sides of the coin in thin markets. Why? The thin market move is not often going to hold without some kind of base building or reversal when liquidity comes into a market. The fund positioning in a thin market is going to see a slight advantage on thin days, but it is at their expense in the long run. After they have positioned, the market will tend to retrace.

When funds take profits in a thin market, it hurts their average price fill because the market will move farther than in very liquid markets. So it is a double-sided edge where there is a good side and a bad side. Okay, so it evens out pretty closely. Markets in trends do react differently in thin markets. It is important to have the knowledge of the difference of thin and liquid markets. This never occurs to a trader most of the time because they are using price to generate their positions.

Markets are more than a day! This alone tells you not to believe the markets are always correct! This is a good reason to use Rule 2. Not all of your position will be established until or unless the market proves you correct.

ALS: Isn't this a conflict to make the market prove you correct while not always believing the market is always correct? Doesn't this present an implied conflict in your trading plan?

POP: Isn't this the same conflict most traders use to get out of a position by getting stopped out? Even if the market were thin on the day they got stopped out? This is what traders think of when they say the pit is gunning for their stops. The fact is that, when the markets are thin, a trader's chance is greater of being stopped out of a good position.

Why shouldn't we turn this situation to our favor by using another rule in trading? Yes, there has been a third rule in my trading.

Not everyone will want this rule. In the search for a third rule by our trader's input and their looking for a third rule, they have come close but not exact on Rule 3.. They wanted a rule to tell them where to take profits. This is their desired Rule 3, but they all have agreed they just could not justify a criteria for Rule 3 telling them when to take a profit.

You see, my Rule 3 takes into consideration both sides of the market instead of just taking profits. It also takes into account when to take positions off totally. Sometimes it will be to take profits and other times it will be to offset any position when the market's criteria says to do so.

Rule 3 uses the criteria of the market not always being correct.

ALS: Do you want to state Rule 3 here?

POP: No, I don't! I want the traders' input now that they know they have been on the right track of Rule 3 but not quite getting to the important point in the criteria. I want them to think about it and give us input. We will state Rule 3 shortly. To just state Rule 3 without a lot of thought on their part will make the rule a little less useful to them. We need more information for them so they understand my view on the market being correct.

I have indicated on the Futures Talk forum the importance of several aspects on offsetting positions. There have been those who have asked. I've passed it on lightly. Some who have read my posts to the forum are picking up on it. You'll be surprised at how punctual and accurate their input shall become after knowing they have been correct about a Rule 3 all the time.

We have traders for years and decades saying they see the market reflects all the market conditions by just looking at the last price. They continue to trade based on that fact. They make their trading programs based on that thought about the market always being correct. Why shouldn't I use that to my advantage with a Rule 3? Why shouldn't traders take advantage of that knowledge by modified behavior in their reaction to the current price?

I want to state again, "It just never occurred to most traders the market could be wrong! They think it is only their trading that is wrong all of the time. They continue to lose when they know they are correct. Just how can there be so much conflict in their trading plan. I'm saying the market is not always correct and that liquidity and timing are two elements that keep a market from always being correct.

In making this assumption, wouldn't this help in positioning and exits? It is not complicated, but another rule to keep the advantage of a situation from being unfavorable at all times. My rule looks at the liquidity situation of a market and uses that knowledge for Rule 3.

Let us further explain our position on this thought! To review the statement,"Is the market always correct?" let's start on even ground. Let's say we do not know either way whether the statement is or isn't accurate. Do we say the statement must be always correct or always incorrect to be a legitimate statement?

Why must we say always correct without exception? I start with the assumption that there are times when the market is not correct, and I will show you that side. It is important because I want to point out that you can trade correctly and lose money. Why do you lose money when you are correct? It is because the market is a true reflection of liquidity at any one time when a market is trading and not always based on a fundamental or a technical reason.

I know many experts are going to say that liquidity is really a technical or fundamental aspect of trading, and that helps prove the market is always correct. What about timing in a market? Is a market's timing always correct? Why does the market prove the most people wrong and make more losers than winners? Think about this very carefully. Is the market not as we had all been taught or thought? Let us research that further.

By assuming the market is not always correct, I am going to show you that you can devise a better trading plan by just knowing you must question the correctness of the market being correct.

Most traders use either fundamental or technical reasons for trading. I like to use what I call "tactical" reasons, which include aspects outside of purely technical or fundamental aspects. Let us use examples of how markets can react in situations to better show our point.

Say, for example, a report came out that the orange crop was the smallest in history and the night before the report we had the worst freeze in history in the Florida crop area. Based on fundamentals, the orange juice market should go higher normally. Based on technical indicators, let us say the market shows a bullish trend being established. Before the open, the public knows no other information. At the day's open, the market opens limit down with locked in sellers and offers, which build, and not one trade is made.

Now, the market is open and no trading is taking place and OJ is limit offer two hours into trading. The experts and the reports in the news make the following statement: "Well, we see the market is correct in proving that OJ was overpriced."

How can you say that the market is correct when there are no buyers willing to buy? Any shorts in the markets are not willing to buy back! This does not show the market to be right in my book! It only shows me there is no liquidity in the market at this time.

Say the market closes limit offer. Now, are we to believe that from close to tomorrow's open the market is always correct? And that this situation is correct during the time the market is closed and there is no market? How can the market be correct when there is no trading?

Okay, now we watch the next day's open in OJ, and it opens limit bid with no trading the entire day. No additional news is available except the news reports stating, "The market proved to be correct today in that OJ was under priced."

The only thing the news reports did for the last two days was to declare the current price correct. Let us say, for example, the stock market moved to a point of being halted for half an hour. Is the stock market right because of the halted trading?

While it is true we only have the current price to use to gauge our equity and balance our accounts, other criteria must be used to understand if the market is correct. I am not sure you are beginning to see my point here so we need to use another example.

ALS: When we say "market," are we talking about the price of a contract currently or does "market" mean what is or has happened over time in a market action of a contract?

POP: That is a very good observation, and the question needs to be answered. You hear reports the market moved up today. Is the market correct in moving up? Say it opened lower and closed higher than the low but lower than yesterday. Is this moving up a correct statement? Or what if the market opened on its high and closed on the low but a point higher than yesterday. Is the statement, "The market moved higher," correct? Is the market always correct?

What are the reporters referring to when they say the market? Their definition is "now," I believe. That is what they mean about the market: now. "Correct" can be different, depending on their reference point. Timing can be different, depending on when the observation is made.

I hope you are seeing my point, but let me use an example of how a pit in a thin market might react to various situations to better relate our thoughts on the market not always being correct. Keep in mind the market's price is a function of liquidity.

We will use a small pit in bread futures (no such futures contract). There are10 traders in the bread pit -- two are brokers, five are day -traders and three are position traders. Yesterday March bread closed at 66 cents a loaf. The daily limit on bread futures is 10 cents.

The two brokers have orders on the open, and all are executed at 66 and 67 cents. The position traders in the pit have all kept their existing positions and not traded. The day -traders have positions on the other side of what the brokers orders were.

Because little activity was taking place, the position traders in the pit decide to leave and trade something else. The day -traders don't see any big volume so they offset their positions with each other and the brokers orders when they come into the pit. When the day-traders in the pit have offset their positions, they leave and go to lunch for an extended time. Effectively for this day no change in open interest exists at this point. The only two left in the pit are the two brokers.

All of a sudden someone bought wheat, and it went limit up within 10 minutes. Now the pit brokers in the bread pit get large orders to buy bread futures. The brokers bid and bid and bid and now bread is bid limit up at 76 cents. The locals are eating lunch, and the position traders happen to be short. They all return to the pits as quickly as they can. No one wants to sell so the market closes limit bid.

Is the market always correct and correct now in bread futures? I still only see the market is not liquid. I don't see this as being a market that is correct. Okay, the experts say that, yes, demand and supply have proved the market is correct because demand outstrips supply.

No one wants to sell, but this may not be correct just because the wheat market went up. Traders think this way, though, and that is why I always look to sell the weakest market in a strong up move. It is because of the similar thinking toward the bread market that, when wheat goes limit up, bread should also.

Often, there are correlation's until the positions are or can be filled. At that point the true market takes over when there are now no buyers. There are times the markets are not correct. It happens and those are often times of great opportunity.

You would never think of this side of trading if you only see the market is always correct. The experts are going to tell you this view is more of an interpretation view. I am going to tell you the opportunity of the surprise side is often because of the market not being correct.

There are times I do not consider the market correct. I feel it is useful in questioning the correctness of the market in certain situations. If there are situations where I must question the market for correctness, then there is always a possibility the market is incorrect, and I must be prepared for it.

Some days when we are seeing a topping action and the market makes several moves up and then back down, we are not seeing anything but good liquidity. So can you say the market is correct? With good liquidity, I consider the market correct. With poor liquidity, I do not consider the market always correct but possibly distorted.

Anytime I consider the market distorted, it is my judgment as to whether I consider the market correct, and I do not want to leave it to the market.

ALS: Isn't that just another technical indicator you are using rather than debating the correctness of the market?

POP: If a market moves limit one way or the other and no trade takes place and you have both a gap and lack of liquidity, you can call the gap a technical indicator, but the lack of liquidity is a different flag in addition to a technical indicator. It is impossible to trade without liquidity, and those times are flagged as not fit for trading and a not-correct market.

You could have several days in a row of limit moves without the ability to establish a position. Which day do you want to pick as the one where the market is correct? Would you pick all of them, none of them or any one of them?

Art, let's go back to the traders for input on whether the market is always correct. They now know there is a Rule 3. Let them discover it as best as they can. We shall state Rule 3 soon.

ALS: Okay, we now wait for input! Is the market always correct?

Part II: Is the Market Always Correct?

There are great traders and many great ideas. You usually can tell the great ideas from experience, and in our search for answers we know the input from Alfredo A. is always very worthy indeed. We felt the following post by Alfredo A. (on the Futures Talk forum) important enough to put in this section.

Alfredo A.'s post:

Phantom/Art/et al: Was traveling the past two weeks. Am excited by your concepts and developments of an eventual Rule Three relying heavily on volume/open interest/liquidity. I think you are definitely on the right track.

I personally don't like and shy away from illiquid markets. We have all seen OJ go limit up for three days and then down for four sessions with no liquidity. You can get really hurt because you won't even have a chance to implement Rules 1 and 2. (This is OJ, never mind pork bellies).

I like to watch OBV (on-balance volume) and be wary of major divergences. But a market (OJ) that sometimes trades only 300 lots of the first futures month per session is subject to violent price fluctuations, not to mention eventual attempts at manipulation, resulting in impairment of liquidity.

As for the markets being "correct," I daresay they are never correct, and that that ´s where you have a chance of making some money. The only "correct" market I can imagine is the SPOT market, where someone actually stops and the other side actually tenders the merchandise.

If, on the date of expiration of a gold contract, the last contract tendered is, say, at US$300 per ounce, then that perhaps is as "correct" a price as you can get. But as for futures, the very fact prices fluctuate constantly during one session shows there are differences between traders; for a market to be "correct," there would have to be, by definition, unanimity. I think futures markets, at least in their nuances, are essentially "incorrect." (Ergo, the importance of being proven correct.) But I also guess this "incorrectness" adds to the fun of the game.

But, yes, I myself consider OI and volume very important, both as indicators of liquidity as well as giving us inklings about where prices might be going. It ´s a shame the exchanges can't get OI to us faster as they do with volume, but I suppose that would be an operational impossibility.

Best regards and good trading.

Alfredo A.

Phantom felt Alfredo has lots of great ideas, and when we are fortunate enough to be presented with them, others should read them.

We need another chess piece on the board, and many of you have ideas and feel open interest and volume are very important.

As Alfredo believes, they are important indicators of liquidity and give good feedback about where prices could be heading.

I believe we can trade our pawn in for another more useful piece to improve our trading. Phantom took note of Geoff Hughes' thoughts as they show correct interpretation of the importance of volume and liquidity.

Geoff Hughes' view:

POP, what I THINK you are telling us is that Rule 3 pertains to volume. Volume = Liquidity. If a market rises on low volume, the market is incorrect, and a short order would be the best way to enter a trade. If the market rises on large volume, the market is correct, and a long trade would be the best route. This pattern would be reversed on a market that goes down. Open interest would be another factor in Rule 3. If open interest decreases in an up market, shorts are covering their losses. I think that's right . . . not quite sure . . .

Phantom liked seeing Geoff's excellent interpretation of questioning a market with price and volume. David Palmer had great insight.

David Palmer's post:

Phantom, ALS and all. Thanks for stirring the creative juices on this forum. I'm certainly a better trader for the effort. On the volume/liquidity thought, I remember reading a while back that Phantom had mentioned he looked to take profits within 3 or 4 days of high-volume days, so this must be part of Rule 3.

After reading the last posts, I attempted to build an indicator that would show me current volume relative to recent history. What I came up with was current volume divided by 45-day highest volume minus 45-day lowest volume times 100 to yield a percentage of range. I then averaged the percent volume over 5 days to smooth it and better see a trend.

Then, using Phantom's 1/3 theory, I put alerts at 67% and 33%. Tell me if I get out on a limb here. This could almost be used as a confidence indicator for the price-discovery process. Anything in the upper third of the range could be considered "correct" price discovery, and anything in the lower third would definitely be suspect. Nothing special about the exact numbers used.

This seems to make sense. Any thoughts on this, anyone?

What do you think of David Palmer's ideas? Phantom was impressed and indicated, with good testing, even if the criteria had to be modified slightly, it would be a very useful indicator. We will call it the Palmer indicator after David Palmer. Think this one over and put your thoughts on paper.

Randy Hogan always gives his thoughts plenty of time for accuracy and they are always well thought out. Take a look at his thoughts on Rule 3:

Randy Hogan's post:

Rule 3 thoughts . . . How often are markets thin? Can you tell a thin market as it's trading or does Rule 3 criteria get us away from the effects of making a trade in one?

The comments I've read about offsetting are after a position is taken and the market moves in your favor (near high of day on a long, for instance). If the market doesn't follow through immediately the next day (10 minutes in some markets, 30 minutes in others, etc.), the position is "offset." Is this Rule 3 protection?

Can a thin market or an incorrect one last more than 1 day? Rule 3 criteria changes daily so the market must continue to prove, eliminating the possibility the position was taken and added to in an "incorrect" market.

That was a stab in the dark (with maybe a little light on in the background)!

Thanks . . .

Phantom's thoughts on Randy's ideas were that Rule 3 should do as he asked in getting away from making a trade in illiquid markets. Thin markets certainly can last more than a day. Alfredo had a good example in OJ.

Ulrich always questions both sides of a situation and has good insight. Phantom wanted to post part of his thoughts as being bold enough to agree the market is not always correct, a very big and unpopular stand. Here are a couple of Ulrich's ideas:

Ulrich's ideas:

I stated the market is always correct before. I meant it in the way that your equity runs will always reveal the truth. If you lost, YOU lost. Not the market, the broker, etc. It was you putting on the trade, no one else.

The market itself is wrong most of the time. This is what gives opportunity to trade. If the market were to be right today, why should I trade it? I wouldn't expect a move -- would I? . . .

Ulrich usually hits the nail on the head because he never gives up his search. That is a characteristic that leads to great trades.

Phantom appreciated all the input and didn't want to leave anyone out of the input process as he feels it is very useful. How often do you come face to face when the market is closed to search out ideas that have been around for a long time. Many of those ideas of the past are in need of discovery as to the correctness of them.

I asked Phantom if he would want to expand on the input he received. His comment was that, yes, indeed he would. We shall come up with what will be known not as Rule 3 (his rule) but "THE THIRD RULE," which is their rule.

Thanks for your input and thoughts on improving a knowledge and behavior search beyond Phantom's Rules 1 and 2.

Chapter 16: Rule 3, You Say?

"It's all the traders, you and me, who will be satisfied with Rule 3 at its conclusion." Phantom of the Pits

I've noticed a lot of arrows drawn on pieces of papers, a few triangles and other strange dittos. I thought they might be new flow charts for another one of Phantom's computer programs. It's not unusual to have scribbles that turn into worthless pieces of paper shortly after the markets are closed and are tossed out to the circular file.

These particular scribbles didn't get thrown away, and that made me more interested in them. Because they didn't make any sense to me, I decided to ask Phantom just what they were. He was a bit uneasy about them and didn't want to detail any of them.

I decided to try and figure this out myself. Here is what I saw. In his first set of scribbles, there were arrows and two triangles. The first set contained four arrows. The first arrow pointed to the top of the page, and the second pointed to the right of the first arrow.

The last two arrows pointed from the other two arrows down toward the bottom of the paper, and the last pointed to the left side of the paper. In other words, what we had here was your old ordinary "to turn left, make three right turns."

The next set of arrows had but two arrows. One pointed to the top of the page and the other to the left of the first arrow. In other words, we now had the old "turn left directly" symbol.

To the left of both sets of arrows was a triangle, indicating one of two choices. It still looked like a flow chart for a program to me at this point.

But wait, there it is! I see it at the bottom of the page. In very small letters are the words "rule three." Great, I thought, Phantom is going to give us Rule 3 just like everyone had asked.

Traders on the Futures Talk forum had asked Phantom to give them Rule 3 to tell them when they should take their profits. Their feelings were that the circle must be completed. The traders were beginning to understand Rule 1 in getting into a position and whether to keep the position established. They were also beginning to understand Rule 2 better and what the purpose and advantage of adding to correct positions would do for them.

Could it be that Phantom has had a Rule 3 all the time? Did he just not want to share this rule? I wasn't sure about Rule 3 in his trading career as I thought I knew reasonably well how he traded. How had he kept it from me? Why wouldn't he share his Rule 3 with us? So many questions ran through my mind.

I turned the papers over, and I was a little disappointed in what I saw. Nothing other than a big question mark was on the other side. There was nothing written on the pages except the scribbles and "rule three" at the bottom.

Art Simpson (ALS): Phantom, about Rule 3, what can you tell me so I can pass your insight on to our traders as we had agreed upon when we started this project?

Phantom of the Pits (POP): I am afraid I have let them down, Art! I don't have a Rule 3 as such. What the traders are asking of me is more automatic for me than a rule. When to take profits is not an easy and clear-cut rule.

You see, my rules have been set up to address the nature of trading as a losing game and to keep losses small. This is the most important aspect of trading and to add to correct positions when correct. To have a rule on taking profits is to have a rule that is second nature most of the time.

I can understand the point of view that taking profits must be done correctly also. Though it might be second nature for me, I am learning that important insight on that aspect is just as important to our traders.

We will come up with a Rule 3. Did you notice I said "we?" It's all the traders, you and me who will be satisfied with Rule 3 at its conclusion. It is not clear yet at this time, but we shall do what we discover as correct.

If you take a beaker of dirt and water, what do you get when you stir it up?

ALS: The clear water becomes muddy. Is the rule going to be revolutionary?

POP: Okay. Well, that is what taking profits becomes when it is time to take them. Revolutionary, as you say, and I suppose revolutionary Rule 3 will be the most liked rule of all! There are so many variables that we can't just have a simple rule to take profits. Most profit situations should be within the trade program, but I am sure we can come up with the rule that doesn't interfere with a good trading program. We will work on it.

My Rule 1 takes care of removing the position when not proven correct. And Rule 2 takes care of getting larger when proven correct by adding positions. Back again we go to Rule 1 to protect Rule 2 after adding positions. Rule 1 usually addresses removing a position when it no longer continues to prove correct, even though we have also added positions.

Taking profits is never as cut and dry as removing positions that are never correct for me. It's kind of funny, though, as most traders find it pretty cut and dry in taking profits. It is taking losses that seem muddy to most traders.

The traders on the forum have a legitimate request for Rule 3. I take profits within my programs and never gave it much thought that it would be as important a rule as they have pointed out to us.

I can't give my programs, and it is going to be rather difficult to separate Rule 3 from the programs I use to establish and remove positions. I don't want to let them down either. Taking profits is critical to increasing equity in their account. They are right in wanting the rest of the insights into taking profits.

Outside of a trade program, taking profit criteria is going to be a little modified. Because we have to modify when to take profits this way, we will have to have qualifiers as we did in understanding of Rules 1 and 2.

First, it must be stated that any time you take profits, you must be satisfied this is the correct move. If you look back at any time, you will see that you could have made more money -- not that you would have taken the position off at a better price but just the nature of hindsight.

By using Rule 2 to add to positions, our newly found Rule 3 will be much better and agreeable for our traders to use. We need to establish criteria on the rule before we can actually set the rule into words.

Are we going to define taking profits at the point we remove a position and end up with profits? Or are we going to consider a rule to take profits for use only after a success of having added to our total position? Do we consider Rule 3 for taking profits after one add, two adds or additional adds if required? At what point do we consider our trade totally established?

You can see some of the difficulties in coming up with Rule 3 to take profits unless we set the criteria for the rule from the start.

Removing positions can, at times, be considered taking profits; yet, at other times, removing positions is keeping loss small.

Taking profits must be considered differently than removing positions. We consider removing positions as keeping losses small, even though removing profits at times leaves us with a profit by the nature of the rules working for us.

Art, This is going to be a rule where we must have input from the traders to come up with the wording of Rule 3. This is their rule so we must go back and get their input. It is important that traders understand Rule 3 is with my input also, but it is not a rule I have set into cement over the years. It will include the nature of my profit -taking to the extent of what criteria traders want in the rule. Thought must be given on Rule 3 by all who want the rule to use.

It is not possible to end up with a rule that will cover everyone's input, but we can come up with a rule they will be satisfied with using. We might need to do a lot of computer testing since we are giving a rule they are asking to have. I am not completely comfortable in a Rule 3 if it is different than my way of trading. Because of that feeling, I shall incorporate my own criteria within the rule also.

I must know what the traders want in the rule. Consider all the variables, do your homework and set your criteria so we can work on your rule!

ALS: What about the arrows on your paper on Rule 3?

POP: You see two sets, don't you? We may have three sets after their feedback. Feedback is what we want now before I go into detail on any of my thoughts here.

I can guide some on what we need. Consider both Rules 1 and 2 and do a flow chart of the possibilities of each rule in each step and then point to what Rule 3 is to consider as possibilities for taking profits. Let us know your thoughts by steps if you can. This will help us work the rule criteria better.

ALS: Okay, we will wait for feedback on what criteria our traders need.

Note: Further research and input came from the Futures Talk forum of excellent traders in an attempt to end up with a creditable Rule 3.

ALS: We are beginning to get some ideas from traders on Rule 3 now. Actually, there are some pretty good suggestions. In fact, some of them end up with your arrows.

POP: I'll discuss some of my theory at this point to give some hints, and then we will address the input from the traders.

Consider trading to be nothing but a maze -- by maze, what I mean is a series of rooms to progress through from the entry until you get through all the rooms until you come out the other side. You can go straight ahead or must turn to the left or right. But the object is to get through all the maze and progress from each room until you have ended up through all the rooms and are at the outer side of the maze once again.

In our maze, you must design a system that guarantees you will indeed get to the finish of the maze. You cannot know exactly which way to turn each time, but you know you must make a turn. Trading is the same idea. You don't know which way to turn for sure each time to get to the goal. Your plan can be guess-and-miss, trial-and-error or systematic.

We want a balance of correct procedure each time and a speed that does not create unnecessary moves. Now, the next point is going to make you laugh and question my integrity, but it is an important learning process from observation.

In my younger years at a great university I learned the maze answer by watching a mouse going through a maze. The mouse was released to move around the maze, and we were to learn what the mouse would do. To my surprise, a low-intelligence mouse had a system to get to the other end, and it didn't really take long.

What the mouse did was always turn to the right whenever possible until it had progressed through the entire maze and was out the other end. While this wasn't always the fastest way to get through the maze, it certainly accomplished the object of the study by ending at the other end.

At that time I devised what is a simple method to get to the exit of the maze by just placing my right hand on the right wall and continuing to progress until I could only turn to the right. At that point I would turn to the right. As I continued forward, I would go forward, turn left or turn right (whenever I could), but I would never retrace or reverse my steps. The idea was to guarantee I could get through to the exit of the maze with the least number of steps using a system to prevent repeating my steps.

Isn't that what trading presents to us also? A maze where we never really know which way to turn but must have some kind of system to keep us from retracing our steps and extending the amount of time required to get to our goals.

In trading, you can never really know at each important point what the correct move is until you look backwards. Therefore, you must have a method that is systematic with what your goal is. The goal in trading is to get to the point of the least amount of loss in the journey. In a maze you cannot have the exact path, but you can totally eliminate the unnecessary steps by using a well devised system. In trading, you cannot make the exact moves each time you trade, but you can devise a system that prevents you from unnecessary steps. The unnecessary steps are usually costly losses in trading.

My Rules 1 and 2 give me part of my system in trading by allowing me to eliminate the unnecessary steps after defining what my goal includes. Let us progress forward with a forward arrow upon entry of a position. My next move is either Rule 1 or Rule 2. I either turn to the right or turn to the left.

When I turn to the left, I am removing my position because it was not proven correct or does not continue to prove correct at that point of the trade. If I can turn to the right, I will do it (my right hand on the wall) because this is my Rule 2, adding to a correct position and the current position has been or continues to prove correct. I want to turn to the right whenever I can to get to my goal systematically without unnecessary steps. You see, this is in my maze system as well in my trading system.

Pretty simple and elementary since it was learned from a lowly intelligent rodent. This in no way lowers the value of the knowledge. I sure don't want anyone calling my system the rodent system so please have mercy on me!

Now you can see some of my dilemma in getting to Rule 3. If I must either go straight ahead (continue status quo) or turn left (get out of my position) or turn right (add to my position), I have no room for turning around 180 degrees and taking profits outside of my Rules 1 and 2. That would interfere with my two rules and cause unnecessary steps in reaching my goal properly.

Two points I want to make here. First, I do not mean to imply that I must either use Rule 1 or Rule 2 when I make a decision. If the decision is to use Rule 1, I know I am either correct or must remove my position based on Rule 1. Just because Rule 1 is used and I now have a proven correct position does not mean I must use Rule 2 until the proper criteria is established. That criterion will not necessarily be to add just because the position was proven correct. We may not add until the next buy or sell signal.

In trying to associate Rules 1 and 2 with the maze, don't forget we turn right only when we are able to do so (add to a position).

We turn left (remove our position) when we come to a head-on wall and cannot continue without turning left (removing our position.) A head-on wall in trading is when the position has not proven to be correct. This is not the same as having been proven wrong.

While trying to correlate the maze and our trading rules, don't over-analyze the comparison. I am only presenting it as a background thought in design of your flow charts for trading should you want the simple arrow diagram for your own use.

I am concerned that feedback indicates my insights are a little difficult to understand. Can you imagine if we had 10 or 20 rules? I know I repeat myself often, but it is necessary to continue to reinforce the importance of the rules we have established. I guess I could make a career out of better explaining my thoughts. I think it is better if the traders do more of their own thinking rather than try and imitate my thoughts in coming up with their own plan. Anything can be improved, and I feel each trader has the opportunity to improve their plans by knowing my insights. While mine are not perfect, they work for me. Traders' plans must work for them to be of any use.

I feel like I am leaving something out of my thoughts here, but I am not really holding anything back intentionally. I want to address some of our feedback so far!

ALS: The first one we look at is from M.T. In summary his feedback indicates Rule 3 seems intuitive -- in a sense, that Rule 3 is just an extension of Rules 1 and 2. His thoughts are that taking profit could be at a point of adverse movement back to, say, the last point of adding to the existing position.

POP: I've always liked his thoughts and writings. Because add-on positions are done in smaller parts than the initial position, his thinking can actually be successful if it were considered time to take profits at the adverse movement.

But, for profit-taking sake, all positions would have to be removed to have a profit. Otherwise, it would just be using Rule 1 to assume the last add-on position was not proven correct, but Rule 1 would not be used properly, mainly because using the adverse movement to remove the position was the criteria for removing the position.

I want the last add-on removed if the position's criteria does not prove correct rather than because of an adverse move after entry.

Of course, if there is an adverse move, it certainly wasn't proven correct either so it is still right to remove the position. Don't get me wrong, as sometimes the adverse move takes place immediately and you must remove the position because of it. But you are removing because the position didn't prove correct.

ALS: Yes, M.T. does say he questioned whether his thinking was correct in using a price movement to determine what to do instead of controlling the trade. He also indicated he feels he does better if he just has a stream of consciousness type thinking.

He also indicated that, at the last add, perhaps you would drop all of your established position, and that is more or less what you said, Phantom.

POP: M.T. is to the point of being more comfortable with his trading and being more subconscious in his actions. Believe me, that is how it eventually plays out when you have your plan in effect and the confidence in what you are doing builds. He is certainly showing a good handle on his future in trading.

ALS: M.T. pointed out that indication of change in trend might be the removal point of positions.

POP: In a trading program, that is what causes us to remove our entire position sometimes. Certainly, when we get an early indication of topping, we remove our positions also. In fact, last week we did get our topping indicator in beans. Now that is a good reason to remove your positions. Also, we sometimes get a very quick reverse position indicator after a topping reversal. We did get that last week.

I see you threw up some questioning to that effect last week on the forum in the proper form so as to not preclude other traders' thinking. Our indicators can be wrong at any time, and it is important we don't inflict our suggestions as advice on trading. Never give the crutch to a trader as long as they can walk on their own two legs. They strengthen their legs by walking on them and not using a crutch -- meaning they must make their own best judgment based on their experience and knowledge.

Let's move on to the next feedback, as M.T. is pretty helpful in helping us drive down the road on our journey.

ALS: David Thomas had a followup to M.T., indicating that perhaps Rule 3 could be quite simple. Rule 3 is simply following Rules 1 and 2. D.T. said that, by using both rules in the last part of your positioning, you will use Rule 1 again and never return to Rule 2 for your position is removed by Rule 1.

POP: Yes, that is basically how I end with most of my positions. But there are times when I get a reverse or topping or bottoming signal where I remove my positions without Rule 1. That is where the traders are correct in thinking there should be a Rule 3. The more I think about it, the more I see this as a qualifier rule to remove positions and take a profit at the time. But it could also be a qualifier to remove a position without a profit also at those times.

It is beginning to look like an interesting story here. The making of Rule 3 or the failure of a rule is this point, I see now!

ALS: Steve Waring has some interesting flow-charting. He did a good job with the format on the forum, as the effort to convey the idea with actual arrows is rather difficult. Steve said he can't see any clear answers to profit-taking, just a lot of trade off.

He uses two examples of mechanical profit-taking systems. One system has a target price and one has a retracement of price. As you would expect, each at one time or another has an advantage over the other. They both seem to go against Rules 1 and 2.

He picked up on your "cheapen the price of what you have" trick. As you always indicated, trading is like the ocean when the tide is either coming in or going out. He had good thoughts on how to use Rules 1 and 2. When your program indicates a possible plateau or short -term reversal, offset part of your position, looking to re-enter at a better price and cheapen the price of your position. Steve also indicated his thoughts on positions as being a series of trades. Questions on cheapening your position price arose from some of the holes.

If you re-position in this manner and miss the lower price, do you do it at a higher price? What do you do if the market continues to go against you and it gets to be a cheaper and cheaper place to re-enter (leaving your remaining position losing)? How many attempts do you make to re-enter?

POP: All good questions and the answer to each is along the same lines here. When using Rule 1 to tell you to remove an added position, it is possible you may have held the position for a period of time and you have a good profit. Your trade program may look at the fact that the market is starting to plateau, and you are not seeing your position to continue to prove correct.

By this indicator and using Rule 1, you would remove the position due to the failure to continue to prove correct, even though you have a good profit but have just stalled in the move. In this case you would look to re-enter at a more favorable price on a reaction and have to prove that re-entry with Rule 1 again.

Of course, if the market continues to go against the proven correct position, you would within your trading program expect to be flagged of that situation and use Rule 1 accordingly. You would not make any new attempts unless your trading program indicated to position further. As far as how many attempts to reposition, that is up to your trade criteria and program.

Rules 1 and 2 are not the criteria to position but only the rules to follow within your indicators from your program to have a mechanical system for doing what is required on both sides of the coin.

In asking questions on different aspects of your rules, I think Steve is actually trying to cover all the bases on proper behavior in all situations of the rules. By asking the questions, he is actually devising a probable and possible scenario that is required in addressing validity of the rules' use. As I have said in the past, it is questions of methods and systems that allow a trader to correctly simplify trading when the market is open by obtaining the answer to the best probability of a method or system.

Does Steve see his points in his research as different than I see them? I don't think so at all as I question every aspect before using my two rules to solve any possible conflict in their incorporation of my trading criteria. I think Steve is going to be able to incorporate his trading program without conflict after satisfying his program criteria to what he expects of it.

ALS: We could debate the use of your rules more!

POP: I don't call it debate. I call it improving trading styles for our traders. They ask the right questions, and they trade the right way after incorporating their knowledge. It gets even better after they incorporate their experience, too.

ALS: Steve indicates his feeling on catching a move as being willing to risk open position profits for the reward of the trend reasserting itself at plateaus. We still consider a profit-taking rule as a variable.

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.

The correct answer to that lies in our trading program, using the criteria we have programmed in. Let us say on-balance volume is telling us, above all other indicators, that on our way up we are seeing large volume on any reversal day and more so than on up days, even though our OBV is increasing. This is conflict and perhaps our program will say get out on the 14th floor on the way up and not on the way down. Other times we will have a program that says to stay in as long as the positions continues the move.

ALS: Ronald Adams had another good idea on Rule 3. He felt you should never give back to the market if you can help it -- in other words, keep what you have. He also felt there was really no need for Rule 3.

POP: It has always been easier to make money than to keep it in trading. Ronald has some good points. Giving back is the big problem after having profits. This really leaves us with conflict as to whether there would be a good advantage in having a Rule 3.

I know a very famous system of trading over decades never had a Rule 3 until it was proven to them that they must have a way to keep their profits -- at least around 50% of what they had made in their positions. It changed their profits.

ALS: Rob Klatt climbed on board the bus on the Rule 3 thoughts. He is with the other traders on his thoughts, too.

POP: We can let him drive for a while then.

Maybe we need a Rule 3 completely outside of Rules 1 and 2 to keep more of our profits using probabilities based on research. I am 50/50 on this rule now.

As you see, we are still in conflict as to what is the need or purpose of criteria for Rule 3! Go back to the traders and let us listen some more.

ALS: Okay, let us do that! I think this is excellent improvement material on effective profit-taking. I know you have many more ideas, and with that grin on your face, I know, too, that you have the ending answer within your sight. It has been in your computer's program all along.

Where is Alfredo when we need Alfredo? We are at a stalemate. New game?

Chapter 17: The Third Rule

"Find the positive in taking small losses rather than getting wiped out. Find the positive in the simple rules we have given you to use. Decide what you want to do with the guidance you have been given!" Phantom of the Pits

Art Simpson (ALS): Phantom, you have indicated you used Rule 1 and Rule 2 in your trading career to allow you to change your thinking and your behavior. Why do you now state a third rule?

Phantom of the Pits (POP): The third rule has not been a written rule for me but has been a second-nature type of rule over the years. You know I strongly disagree that the market is always correct. From experience I have concluded that to be the case. I use this assumption on my part to protect profits and eliminate new positions in illiquid markets.

I'd like to point out that the third rule is not my rule, and the credit goes to the traders who have convinced me there certainly is a third rule to be used after Rules 1 and 2. I was very reluctant at first, but I see they are correct in this request. Let us look at everyone's rule here and not my rule.

Almost every trader who read my Rule 1 and 2 felt there is a third rule. They really are sharp and more observant than I am. Even though I have used a third rule more as a rule of thumb, it is indeed a third rule. Our traders thought it should be a rule on when to take profits. It extends beyond that point because our true focal point is to keep loss possibilities as small as possible and retain as much profit as we can. That implies taking profits at the correct time and properly outside of Rules 1 and 2.

Although Rule 1 does address taking the quick loss when the position has not been proven to be correct, we do need Rule 3 to tell us something about our trading plan that is very valuable in trading. That rule tells us when we must question the liquidity in the market and the place that indicator has in our trading plan. I feel it is better to have that in a rule outside of the original trading plan to give us our criteria in illiquid market times for not losing much money.

I also feel the time to take profits is clear within market conditions when we have our extreme volume days. This is usually a turnaround indicator in most cases. But let us get out on those indicators. Why? Because we can re-enter any market as soon as we get another signal from our trading plan. Even if we were to miss part of the move at the expense of being early, we still will be better off in the long run. It is the long run we plan to trade in our careers.

ALS: Do we need to qualify the third rule?

POP: No, we do not. We will state it now! The Third Rule

We shall go against the majority and assume the market is not always correct (those times being when liquidity is poor). At those times we shall question all signals and wait for future signals for positioning.

We shall use the converse of poor liquidity and remove our existing positions when extreme liquidity takes place in two steps and within three days of extreme high volume. Half of our position shall be removed immediately the following day after an extreme high-volume day. The other half of our existing position shall be removed within two additional days. We shall wait for further signals in those cases for future positioning.

The first part of the third rule addresses the situation of thin or illiquid markets. It states that we shall question our trade program signals and wait for further clarification of signals in those thin markets. At illiquid times the market is not a valid indicator for taking positions. Because most signals are generated by price, you can see the importance of the third rule allowing you to have an exception of questioning your signals. Some trade programs address this situation very well. Not many programs use volume and open interest such as moving average indicators in generating signals.

I am not questioning various systems but only saying that with the third rule we must put an illiquid relief valve somewhere in the plan to preserve equity at those times.

The second part of the third rule gives us criteria for taking profits or removing any previously established position. We do know when to take profits. Although we take all the profits and may miss some of the move, we shall await further signals at extreme high-volume days. Additional signals develop quickly after high-volume days, and we want the benefit of that by not being positioned incorrectly prior to additional signals.

Don't forget that a good plan will continue to give you signals based on market conditions. We are using extreme liquidity to our advantage by knowing that huge volume is the prelude of further correction possibility. Many times huge volume days are the very reversal days in bull markets. At any one time there could be an event that causes extreme volume. It usually takes several days to play out when this happens. We also use that to our advantage in the third rule.

When we say we shall take the last half of our position off within two additional days, it is important to note there will be times when we will do it very quickly and not extend to two additional days. The two additional days gives us the outside limit allowed for our rule.

The third rule is a good rule, and it stresses the acknowledgment of trading in the long run and not the short run.

ALS: Many experts are going to argue with your Rule 3, as it will surely interfere with their professional trade programs. Most systems say to trust them over a valid time to allow them to work properly in the long term.

POP: My trading experience has told me to have enough integrity to bail out when I see that everyone starts putting on their parachutes. Why stick around to see who leaves their seat belts on? Trading is a run-run game. There are times you have to run before they run. That way there is less chance the market will out-run you.

Do you think the experts ever buy insurance for their homes, cars and health? Surely the experts have a plan to protect positions at critical times. The third rule just places another double-check in a good trading plan.

Traders must never be complacent when the market is at extreme volume, whether high or low. These times are to be flagged, and I don't know a better way to flag them than to remove existing positions. How much can you lose after removing a position after a market volume extreme? Why not make your plan give you another signal before you re-enter the market?

ALS: Do most traders have the same kind of thinking on this liquidity situation?

POP: We are either at the first floor (bottom) or approaching the 18th floor (top) of the elevator. Few traders watch the floor indicator. They wait to get off. I say just don't wait long! Liquidity is giving us our floor information so we know where to get off the elevator.

I've seen what waiting can do to people. It was back when the Hunt Brothers had too many bean positions in place. They were told they would have to get out. I had just put a position on and within seconds the market was practically all sellers. I lost money that day within 10 seconds and I got out. The volume was extreme, and the market went limit down very quickly. Sure, this was a short time frame and few knew to get out until it was too late, but many situations do flag you that you are looking at a special price level.

We have all heard "when in doubt, get out!" I think a poet made that statement, and it took hold. It makes sense to this day and always will. You don't ever lose when you are out. There are times to be out.

ALS: It looks like the third rule is more of a rule to keep from losing money and to keep from losing profits previously made in the market. How often do you foresee a situation in which market conditions present these criteria of either high or low liquidity? Or should I call it volume?

POP: Yes, you could associate liquidity with volume in most cases. We are talking normal and abnormal market conditions of liquidity, and we measure liquidity by using average daily volume as our reference. But don't forget, we are only talking about extreme conditions of liquidity that are abnormal.

Traders will see the validity of watching for extreme volume days. Their use of the third rule will become second nature. They will see the thin markets better and know what not to do in those situations. The third rule is a good rule!

We would normally expect the conditions to be a possibility at trend-reversal times and at certain events that cause lack of interest in trading a particular market. At times in front of critical reports you could see the situation develop.

ALS: In front of reports what do you usually do with your positions?

POP: From experience I have learned that, if you make a mistake, you pay heavily with being wrong after the report. You have to have a big lead and then it takes it back sometimes. I must consider always cutting back in front of a report unless I am given a big edge. There are times you cannot control your position the next day so why not cut back? Most traders should remove their positions to allow longer views of their trading careers.

I just recently had a new trader ask me about a sugar position, and my guidance was to look at what the market had done the prior four days -- we had three higher lows in a row. The opinion was that sugar would go down. That day it made a contract high.

Rule 1 and Rule 2, with the help of the third rule, allows all traders a long-term outlook in trading.

First, behavior modification must be adapted to the rules to have any expectation of trading long term in a trader's career. Many shall have to face the aspect of human nature to oppose any change. Change is required, and you are the only one who can do it.

Your trading career depends on it. Don't take it lightly.

If you must, rehearse your behavior daily until you have it down correctly. Behavior modification requires positive reinforcement, and trading often is not positive. Find the positive in taking small losses rather than getting wiped out. Find the positive in the simple rules we have given you to use. Decide what you want to do with the guidance you have been given!

Unless you go down the defeat road, you will never have to endure the hardship of knowing you didn't make a good attempt to change your behavior in trading.

I would like to leave you with one last thought: Trading is not as we had all thought. The sooner you learn that what you imagined about trading is far from reality and that you must change your thoughts on that reality, the better trader you shall become.

Good trading to all of you! I shall watch you trade and shall always be your shadow.

Chapter 18: Tie Ribbons on Your Trading

Just when you know you have everything covered to start your trading career or to continue the one you already have started, you find you have a few more questions you would like to have answered. We will get Phantom's view on a few of those important questions yet unanswered. Questions like a few of the following are perhaps in your minds:

- When you spill a soft drink on your mouse pad, why does it always soak in, but good trading methods take forever to soak into our brains?
- What kind of system should I use to trade?
- Should I buy a good system or come up with one of my own?
- How do I trade to not chase the market all the time?
- Why do I always end up with the bad positions but seldom get the good positions and the big moves?

Other than your questions, we should ask Phantom some of the questions he first had and has now in trading. Answers are usually from different views. It helps to get other views for our questions. A good decision is one that can be made from having good choices.

Isn't trading a lot like picking out a Christmas tree? Do we just take the first one we see? Or does that apply only to the first house we buy? How about when we buy a different car: What approach or plan do we have? Do we buy the same car everyone else wants to buy? Or do we make the trade that no one wants?

There isn't really an end to questions we have in our trading careers. We'll try to touch upon some of the most important ones without writing a book about each one. These are Phantom's views and are not in keeping with everyone else's ideas at times.

Art Simpson (ALS): Phantom, since this was your idea after reading the Sunday paper, what questions do you think are important points that should be answered in trading?

Phantom of the Pits (POP): A point I would like to make is that sometimes the most brilliant minds cannot trade correctly. They don't always have all the answers. When they don't have the answers, we are disappointed. Many times the correct answers for someone else does not mean they are the correct answers for us.

It shows that, to be taught by someone else or by being self-taught, there is an important aspect of gathering the correct information. And then the remaining part of learning is the behavior modification after learning correct information. This conclusion has been stated previously.

The point I want to make is that, when we don't know the correct answer, so what? Admit it and use the channel required to find the answer. We can't know all the answers, and we can't be expert at all things. The smartest person doesn't know all the answers.

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.

Does this make trading seem more scary or open more thought in you mind? Many traders don't want to miss a move so they buy regardless of the intuition they may have. Other traders see a market move and refuse to jump on because intuition says they are buying a top. Who is right?

Is the intuitive trader a better trader than the logical one? How do you know? How would you prove it?

Those are questions I had when I began to trade. I found the correct answer for me, but it may not be the answer for others.

I guess you will want my point of view on the logical or intuitive trader answer. I don't expect all of you to agree with what I have found to be my case. There is one word I have dropped on you at times in these writings, and that word is a very important one in the answer to the logical or intuitive trader question.

I'll give you the word and let you use it to give some thought to the question. We'll answer that question as I see it along the way in this part. The word EXECUTION is our key to the answer.

I saw an advertisement pointing out you would never have to worry about buying tops and selling bottoms again. There are times when you can make an exception about any statement, and you need a filter system in your trading program to help clue you in on these times.

There are, of course, times when you should buy tops and sell bottoms. I do it all the time when I expect a market to reverse.

Why? Because I use a method I call the best of a bad position theory -- my theory being a learned one that my best trades are usually after correcting a bad position and getting correct in a market. This happens to me more at tops and bottoms than any other place.

Some of the biggest moves take off from a reversal, and if you miss the entry, it causes you to be hesitant to position as the move gets stronger because you missed the entry. A worse case is when you had a plan and didn't get filled. Why does it happen you got filled when it went against you but a good position never got hit? There are good reasons for that to happen.

I've always said to pick a range and not a price. The exact price cannot be done with consistency. A range is easier to pick and position when you have your signals. Most people think the position of getting out is the most important. You know what? It is important but the most important position is actually the entry. How many times have you put an order in at a price and got the price but not the fill? Many more than you think! It happens to most traders.

By knowing that most traders have put orders in the market and never gotten filled, what does that tell you? Inexperienced or uninformed traders are great market supporters and market resistance builders. Now, just why should I say that? The locals lean on the orders, as it is only natural. It works like this: You want to buy 10 December corn at 268 because that is where the support is. Sure enough, that is support. Tomorrow on the way to 275 you ask yourself why is it you only get filled if it continues to go down.

Do you have any clues? E X E C U T I O N! You must guarantee that you are filled with every signal you get. Any signal you get and you don't get your position is going to be your money position. The market never waits for you. If you trade millions of bushels a day, then you should worry about the extra quarter-cent.

Even so, execution is still the most important step in your positioning. Your plan is the most important part of your trade, but execution is what validates your plan by giving you a position.

When you learn to use Rule 1 properly, you will never worry about or hesitate to take your signal and position with the utmost execution. You will see you must take all signals and make sure the market lets you in. How do you think the best way to enter a position is? The answer is based on how close you are to the market, how accurate and timely your quotes are and how quick your orders to the floor are.

You must guarantee you get all your positions on at all times! I can't stress that enough! The unfortunate thing about that statement is that it is completely true. The unfortunate part of positioning is that most trade programs or systems use price action, and positions are usually taken on strength or weakness. This causes buying tops and selling bottoms at the thinnest part of the trading day at times.

How are you going to make sure you have all your signaled positions in place? I could give you a way or you could come up with a plan of your own. Which would be the best plan? It has to be your plan. It is only my job to tell you what you must do!

You must position according to the market characteristics. Sometimes you will have to buy the high and sell the low. How do you know when to buy the high and sell the low? You must have two plans in place at all times. I would guess most traders have one plan, and when they miss their position, that is it for the day. You must be smarter than those who only support the market with their orders and never get filled. They can never make any money but you can. You see the market order support the orders waiting to get filled but never will be filled until they are wrong. Same thing on the topside! Why would you want to position this way, too?

One of your entry plans will always be a market order. The other order will be an intelligent order based on the nature of market you are trading. We know that each day there is a high and low and a range throughout the day. You seldom buy the low and sell the high so don't even consider it. Your second plan for entering positions will be based on the fact that better liquidity tends to migrate toward the middle of a day's range.

You don't want to chase the market if you can prevent yourself from doing so. This is the reason for your two plans. Your market order plan is your plan to execute upon failure of your first plan -- same as "get me a soda" but if no soda (sometimes they are out), then "get me a glass of water" (lots of water around). This is all pretty elementary to most traders.

What is not elementary is always having two entry plans. Some of your systems will ask you to enter a position on a stop. Okay, it is a market order. Throw out your other plan if the system is that accurate to expect you to enter on a stop. Other systems may ask you to enter on the close. Okay, execution is important and you have no choice but one plan at that point.

I usually know within the last hour of the market what I am going to do. This allows me more time than to just enter on the close.

The reason most entries are poor is because the systems are based on how you get your market prices and information. It can't be a system that gets data that you don't have the possibility of obtaining. That is your big disadvantage.

As an example, if there are 1,000 day -traders in a market, you can almost be certain they have positioned by the last hour of the day. If the market is up, what do you think their position is most likely to be? Same if the market is down. What is their most probable position to be? Long or short?

Okay, you get my thoughts here. The point is that, when they offset, there will be some kind of wave action. You want to use wave action to your advantage when positioning.

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.

How does it work? Today at one hour into the trading session you get a buy signal. Your two entry plans are now valid to be used.

The first one says to buy at the market, but you want to use that one last. Okay, so you hold that one because what you are doing is holding your own stop order to buy. The second plan is to buy as intelligently as your input allows for the particular market you are trading.

You know the signal to buy is going to be based on strength and stops are hit going up when it kicks in. More times than not, you will get several waves of buying, and this can be to your advantage. Sometimes you do just plateau but that is okay, too. Use your second plan for entry and price based on your criteria, but do one thing more! Add "MIT" (market if touched) to that order and add two ticks! It will be the best money you ever threw away. You must guarantee you are in your position but with intelligence. That is exactly what you are going to do.

After a short period of time, if your position is still not filled, you will use your first plan to go at the market to get filled. So be it! You still acknowledge that you guarantee you are filled and in the market at all signals.

Keep in mind if you don't get positioned, you are acting like you only want positions when you are guaranteed wrong immediately.

This is one time the market can give you an emotional letdown if you didn't get positioned. It will always be the time the market takes off without you. Stop! Stop yourself into your entry signal at last resort but absolutely do it if necessary.

Take a survey! How many of you have missed your entry? Don't let it happen again!

Now we have your position established after you have a signal. Good and well so far, but what happens now that the position just isn't acting correctly? You have the old "oughta get out" signal. So what is so important about the bad position, now that it isn't correct?

What is important about a bad position -- one I consider not proven correct -- is that it gives you the greatest opportunity to get a correct position. This happens often at tops and bottoms. It must come from a trade program you develop that allows you to reverse your position at certain times but not all times.

Most of the time a good position, other than the bad position, is being out of that position. Other times the best position is to reverse the prior position. Your trade program should address this.

How do you know when to reverse? We watch effective ranges in bull markets. We expect a bull market to continue to build range during most up days as long as bull markets are strong. When markets are getting into topping action, you often see what is known as a large effective range.

Effective range is nothing more than a broker's dream. The market will go to a level, reverse, go to a level, reverse and so on until you have a very large number of price swings within a small range. Buying gets met with selling and selling gets met with buying which swings the market back and forth many times in compact ranges.

In bear markets your effective range may just go dead and not swing at all for lack of interest. A normal bear market will eventually have bottom-pickers cause upswings even though you are in a bear market. When all interest is lost in trading, you can look for a possible reverse of a bear market.

I find the positions that I reverse are usually the ones I have the intuition of not wanting to place in the first place. It works so well for me because I know my answer to what I disagree with in my positioning. This allows me to take all signals, even when I disagree with them, because I know that my true thoughts will allow me reverse if the first position isn't proven correct.

I saw some posts (on the Futures Talk forum) that the most difficult positions to place are usually correct. That is true in most traders' situations. That is why you must take all your signals and be prepared when you disagree with the signal to have a strong counter-plan due to your intuition. Intuition is your friend as it is your caution flag but not to the extent it takes you out of your plan.

Logical plans are usually what a system is developed around. Intuition is often left out. To me, the intuition side of trading is the surprise side of trading. You must always have your intuition plan along with your expected logical system.

You are starting to get my answer on the logical and intuition trade question. I did not prefer one to the other. They both have their place. What the true answer is to me is in the trading system or program I develop for my trading. Perhaps this is an answer for you also. I must have both covered in my trading plan. There are times the intuition plan comes out ahead, and these are usually at tops and bottoms. Be swift! The intuition part of my program is swift. It prevents large drawdown.

It's not exact but you see you must let intuition be your surprise side plan. How many times have you said, "I just knew it?" That is right! You did know it. Learn to use that intuition and when to use it. I cannot tell you because I am not you. I can only tell you how important it is. I know you have all felt it was important and have learned that it is important.

You know now how to put the good positions on and not just get stuck with the bad positions. EXECUTION when you get your signals is a must!

ALS: I thought you would go into more detail on how to enter with the two plans than you have. Would it help if you did?

POP: The point of execution has been made, and I think reflection of a person's trading is more important at this time. The positions must be entered to have a fairly good chance of having the good positions on as well as the positions that are never correct.

ALS: What kind of trading system should a trader start with for the early part of their careers?

POP: First, it must be one they totally understand. They cannot take a system they are not familiar with and expect to trade it correctly. There will be too many conflicts if the signals and how they are obtained is not fully understood. This can be a problem at times for some systems, which may not properly disclose the criteria on entry and exits of the trades.

The trader should error toward simplicity at all times unless they have a better understanding of a more complex system. With my rules, the system is going to be easier to judge, and simple systems can be just as effective as long as execution is never in doubt. The system they choose will be a tradeoff most of the time. I always want the system with the least drawdown and the maximum gain in the shortest period of time.

ALS: You don't want much, do you?

POP: I don't mean to be cavalier about it, but it's easier with my rules to look toward that goal. You will have to make sure you can use the rules successfully with the particular system you choose.

The other terms of a good system are the liquidity filters but with Rule 3, thanks to our traders, it won't be as critical as without the rule. To confirm the move, of course, the system should have some kind of volatility figured in and open interest.

On suggestions as to whether to purchase a commercial system or design your own, I would say your first purchase of importance is price data whether it is included in your system or outside of it. You need price data and chart data. Without those two elements, you have a very large handicap to overcome.

ALS: I've seen systems where they say "just 10 minutes each day." What about systems where you only need a short amount of time each day?

POP: I don't rule them out! I am saying you need the data to verify the validity of any system. Without it, you cannot be a good judge of any system.

ALS: What about long-term trade suggestions by various individuals or vendors?

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.

Good advisors are often trading funds instead of giving individual advice. Advisors have a harder job than I do. Think about how you explain to more than 80% of traders that they have lost and been wrong in their trading.

I am not saying anything against advisors, for I know the cards are stacked against them. You take the best advisor, and there will always be those who are upset with them for one reason or another. It's the adult-child thing in trading. I admire those who stick to the field and move beyond the difficulties of being leaders in their field.

The same also holds true of systems vendors. They are only as good as their data used for back -testing, and often it is past data being used for future prices. Any one event can change the entire picture. I guess that is why stops are so important in most systems.

I think to not overtrade is more important than a good stop system, but most traders don't have the discipline to trade small enough that stops won't much matter. Everyone is in this game to get rich. Why, it's the farthest thing from my mind. Can you imagine trying to get rich by trading? There is only one way to trade and get rich.

ALS: What way is that?

POP: Trade your program signal, protect it with Rule 1, add with Rule 2 when the program says to add and take profits or offset with Rule 1 or Rule 3 when required. And then do it all over again and again and again until you have the confidence you need. At that point you can think about getting bigger but not until you have complete confidence in your trading.

Trading and Three Accidents

The phone rang in the middle of the night. Not knowing if it was important, I got up to answer it just as everyone else would. The voice at the other end was a familiar one.

"I believe John Denver's biography is going to be the most important biography of this year. If not the most important, surely one of the important. Art, I was just doing some thinking on John Denver's accident. He touched millions of lives as well as yours and mine. I can relate to that accident," Phantom told me.

"You called me in the middle of the night to tell me this?" I asked.

Phantom explained, "I know how our traders can relate to John's accident, too. Of course, there are those people he never touched or who didn't even know who he was. This is so important to me. Maybe it is more important to me than anyone. It is important because I always have had timing as my friend in my trading career.

"Traders will have to face in their trading career what John had to face in his last flight," Phantom continued. "I just don't want our traders to ever have to face that last flight in trading. I have to make them understand one very important point in their trading.

Somewhere along their path they will face an unexpected event that can take them out of trading if they don't prepare for that eventuality in their trading."

Phantom continued to convince me, but I already knew Phantom was expert at timing. When you get a phone call at 2 a.m. in the morning, you can almost know it must be from a friend. Why else would someone call at that hour and awaken you from deep sleep? As I answered the phone, I could see this call from Phantom was not just to me but also to Phantom's trader friends.

"**Art**, I must ask you to address three aircraft accidents! It's John's, the latest one in the article your brother sent you (about a December 1997 accident) and the one I was in. I never could make anything out of the aircraft accident, but it has to do with life and in trading, too. It is important that we warn our traders of needing to be prepared for all possibilities.

"I have searched for some kind of answer from John's accident and my accident in the past. Not until I read about the last accident -- the doctor whose aircraft landed itself after carbon monoxide poisoning in the cockpit

-- did I realized the similarities to trading and how it is important," Phantom continued. "It does have to do with trading, Art! When you wrote about God's rules, you never really understood fully why it was such a difficult time for me. I went through the same process in my aircraft accident as with

John's. We survived and we had altitude to recover and to make a decision. John didn't have that altitude and couldn't make a decision. He had to take what was given. The doctor wasn't even in the decision process because of his condition.

"Three accidents, and they all had different results. The doctor had no choice, and when he lost consciousness because of the carbon monoxide in his aircraft, he still survived because he ran out of gas. John had what appears to be fuel and a fuel valve problem and he lost his life. Our engine failed, and we had time to work the fuel tank valve and get the aircraft on the ground where we wanted because we had altitude. We were able to make a choice of where to land. John didn't have a choice. The doctor's aircraft landed by itself and he survived. These three accidents are all the same accident with different circumstances.

"Can't you see what I am getting at, Art?" Phantom exclaimed. "Trading has the same conditions"

I remembered seeing Phantom's post on the Futures talk forum to Randy about the fuel valve over a month ago and had thought little about it until now. I began to see Phantom's thought on the three aircraft accidents. There are times when the market hasn't given you enough altitude to be able to recover. At other times you have enough altitude on your position to make a good landing choice when the market goes wrong. And there are times when you have no control over where you are going to land or how because it is out of your hands. Yes, it makes sense that Phantom would call at 2 in the morning.

Phantom never pulled rank on anyone and never considered himself better than anyone. He has always been a gentleman and perfect example of what you would expect of a hero. Why should I hesitate to let him impress his thoughts on his friends? He wishes to save as much grief of trading to his trader friends as he can. I cannot question the unconventional thinking about the accidents and trading as my thinking is pretty unconventional at times, too.

We shall convey the insight for you on the three aircraft accidents and allow you to question if you feel it appropriate.

Phantom rarely ever said anything about an aircraft accident in his life, but it always bothered him. In John's accident he was presented with an aircraft accident not easily accepted. Now, out of the blue sky, an accident where there is no logical reason the pilot, a doctor, could have survived but did. Phantom surely has gathered reasoning for all of this. He has been right in his useful insight on events over his trading career. Why not now, too?

Events in life have a lot to do with trading. Could it also be that trading has a lot to do with survival in life?

"Okay, Phantom," I said. " We can start the chapter while it is most importantly on your mind at this early hour. Where would you want to start?"

Phantom indicated he would just tape his thoughts and let me make out of them what seemed to be the message as we had on his insight in this project. I agreed and went back to bed.

You can know that Phantom didn't sleep that night and kept the midnight oil burning. I guess there is a time and place for all thought. We must let it flow and not restrict thought at those times. That point is another Phantom has taught me.

Phantom felt the three airplane accidents reflected clearly similar uncontrollable events in trading just as in the accidents. We'll see just how they compare.

The three accidents Phantom was talking about were John Denver's, the doctor/pilot's and Phantom's accident. The doctor's aircraft landed in Missouri on its own when it ran out of fuel while the doctor was unconscious. The aircraft accident Phantom was involved in was at greater than 5,000 feet altitude when the aircraft engine quit.

In John Denver's accident, two pieces of information about the accident disturbed Phantom. Before the flight took place, John had borrowed a pair of vise grip pliers to turn the fuel selector valve. The fuel selector valve was not in the correct place below his right hand on the floor of the aircraft but over and above the left shoulder behind him. This required him to take his right hand from the flight stick to turn the valve, which was difficult to maneuver.

The most disturbing aspect of John's accident was that his problems occurred at less than 500 feet of altitude. Thought time in the emergency situation didn't exist, as actions had to be second nature. Because John had few hours in the aircraft, second-nature reaction with such little time wouldn't have allowed recovery in time.

The doctor's accident happened when he was overcome by carbon monoxide, which entered the aircraft because of a faulty exhaust system. The aircraft was on autopilot when the doctor lost consciousness from the carbon monoxide. He was flying to Topeka, Kan., from the west and, instead of a 150-mile trip, made more than a 300 -mile trip to the Moberly, Mo., area as the plane ran out of gas. Surprisingly, it landed with the autopilot engaged and the pilot unconscious.

The doctor walked away with only a broken arm. Had the fuel onboard been enough to fly another half-hour, the carbon monoxide level in his blood would have been 50 parts per million rather than the 35 ppm he had. He would never have lived. Had the terrain been different, the aircraft could have crashed instead of landing on its own.

The third aircraft incident occurred to Phantom, and he never wanted to talk of it before. At about 5,500 feet altitude, the aircraft engine stopped. Phantom's explanation of the accident was that it required an immediate decision, and that was where to land.

The altitude gave comfort in allowing a good amount of time for a good decision on where to land.

In two of the three accidents everyone survived. Two aircraft made landings without loss of life. While the two aircraft had control in landing, one pilot wasn't conscious but still survived. In the other airplane accident, in the safest aircraft, John lost his life. The loss of life was in the aircraft that had the lowest altitude and least amount of time for reaction and corrective action.

All three accidents were unexpected, and all had different outcomes because of circumstances beyond control of what the pilot could do. It was these situations and different outcomes that Phantom wanted to discuss as it relates to trading.

Phantom never had any value of learning from the accident he was in as he always wondered what reason or purpose it pointed him to in his life. He always felt other people's thinking of a person who is in an accident is that somehow they are to blame. As I see the way John was treated in the news media when he lost his life, I understand Phantom's view. Others do often look for blame rather than answers.

Phantom has always looked for an answer in his airplane accident. He has found some answers to uncontrollable events in life and in trading. To relate the three aircraft accidents to uncontrollable events in trading, Phantom gave me his explanation.

In our lives and in our trading lives, we come upon a situation sooner or later where we have little or no control. We must at all times plan for that time. When a pilot learns to fly, they are always practicing emergency landings. In trading we must practice those same landings.

Depending on the exact situation, we shall at times end up with entirely different results, even though the situation may repeat itself again and again. We, of course, want the best result, but there are times we don't control the result.

In your first situation as you take a trade, there is a time when it is just as if you took off from an airport and don't have a comfortable altitude. This is the time when the trade has not really been proved to be a correct position yet. At this time an unexpected event can have its worst result in your trading. You have to take what you can get for a landing spot due to the lack of altitude.

The second situation is when a trade becomes a proven correct position. It is similar to being at a higher altitude in an aircraft. If an unexpected event takes place, you have a more comfortable choice and can make a better decision due to the extra lead, which is also similar to picking out a better landing spot. In this situation you are in control of keeping the trade from being a total disaster. You land in a clearing.

The third situation for a trader that parallels these three aircraft accidents is that you are on your way with comfortable altitude and are on autopilot. There are no problems with your position. All of a sudden your trade is taken out of your control. Several events can cause this . . . your phone line goes dead . . . you get delayed on your transportation and can't get communications to your broker . . . your quote machine goes dead . . . a big report comes out and the market locks limit before you can even get an order into the pits.

All of these are the same as losing consciousness due to carbon monoxide in the cockpit as you fly to your destination. Nothing you can do will change the result as the result is going to deal you what it will.

The trades with the best altitude or lead allow you the best opportunity to recover from a bad or unexpected event. A lot of traders expect their trades to show this lead and do nothing when they don't show the lead they need. They allow the market to take them out and prove that they are wrong. To be taken out by the market when proven wrong opens up much more disaster than many traders ever imagine.

At all times you must understand that the surprise and unexpected event will create a worse situation than you are prepared to face. You must practice your emergency landings. You can recover from good positions. You will not recover from bad positions in unexpected situations.

Just as the doctor's airplane landed itself, you will have times when you luck out. After all, a broken arm is much better than a lost life. Traders are in the only profession I know where they are happy when the market gives them back half of their loss. When you get back half of your loss, you have just seen your airplane land itself on autopilot as it ran out of gas.

Phantom indicated the most critical time of a trade is immediately after you have just entered the position. This is the time you must be most sensitive to news and events. How many traders are most comfortable upon entry because they know they are protected by stops? How many surprises are there in trading? How about the time the unemployment report was a surprise and your stop gave you the biggest slippage you ever thought was possible? Listen to Phantom! It happens. Don't let an unproven position set you up for a downfall.

Phantom asked why is it so difficult for traders to understand that bad trades get worse? They get worse until the unexpected takes place. The unexpected is always your downfall in a bad position getting worse. Get a lead on your trades or throw them out.

Phantom wanted you to understand part of his distress in John's accident and death. He wants the best for you. Can you relate to the three accidents and your trading? Make out of it what you can. Phantom intended it as a way to ask his trader friends to be prepared for any possible event in your trading career.

My Order Was Filled . . . Where?

"This shall be the ending post of "Phantom's Gift" but not the end of Phantom's attempt to give to you!" Art Simpson

Phantom has always been anxious to address what the traders questioned in trading. It was with great hesitation that the subjects of order placement and fill prices were finally addressed. He felt more research on his part was necessary. There are so many different situations for traders when they put in orders for their trading.

Some of the questions appeared over the months on the Futures Talk forum. Many traders would get what they felt were bad fills for one reason or another. Phantom knew it was mostly misunderstanding of how a market works in volatile situations. This lack of understanding due to little known knowledge on the subject disturbed him in these situations.

It seems there is a vast opinion by most traders that the brokers are to blame on most of their bad fills. This misunderstanding is a great handicap to traders unless they are aware of what causes bad fills in volatile markets. We shall present some of those situations with the explanation in order to improve order placement by traders.

Little research is done individually by most traders, and Phantom felt this is a big mistake. Phantom has always done his own trace of order placement, execution and reporting of orders to and from brokers in order to know the integrity of his placement. It gives him the ability to know what the edge can or cannot be upon an order placement.

Logging and tracing placed orders early in a trader's career affords the opportunity of knowing just how exact an order must be placed. An order placement for market orders, price orders and stop orders will have different urgency and slippage at various times due to current volatility at execution. Understanding changes in volatility is critical in knowing when and how to place each type of order.

I asked Phantom to give some insight on order placement before we got into particular experiences and results of traders. His insight is based on experience and knowledge of his many orders in his career. Phantom is the only trader I know to have been stopped out limit up and limit down in the same day. It was early in his career, and he takes full blame for not knowing early in his career the situations that can cause such slippage and fills.

Some of the important points on order placement and price fills are seldom talked about or considered. Phantom felt many misconceptions were important to address as well.

Art Simpson (ALS): Can you tell us some of the most important insight you have observed in your trading career on order placement and market prices?

Phantom of the Pits (POP): Let's just start with a normal day and look at an opening, daily range and closing. Regardless of what your order is to be, you will find that there are times during a day that liquidity will be better than at other times. That is really the reason for different ranges each day.

I remember in the early 1970s watching a trader bid the high of the day consistently at each new high. I asked that trader why he would buy the high of the day. His answer was that there would be many highs during a day but at the end of a day only one true high of the day.

If you think about that answer, you'll realize it is true. Each time you buy a high, it is possible that, sooner or later, there will be another new high for the day. To use his method of buying new highs, you would have to be a floor trader to use my rules but it has merits. A reason I say it has merit is because the thin part of markets is at highs and lows. You'll see this if you look back on volume at the end of the day. When the markets are thin, they can be pushed further until liquidity once again enters the markets.

Even though markets are thin at the high and low of a day, during the day there will be many new highs or lows that are not the high or low showing at the end of the day. We can never know for sure which high or low during the day is the true high or low for that day.

I got a kick out of some posts on a forum as one was headlined something to the effect that the locals were gunning for the stops.

There are some misconceptions in that thought. Locals don't gun for stops; it is just how they trade. If you knew the market was thin at highs and lows and were positioned the wrong way, what would you do if you were a floor trader? It is the traders who are wrong who push the stops before the stops are hit. In other words, you don't want to have to buy many ticks higher if you are wrong and approaching the high of the day. That is what the public tends to do by putting their stops above the high for the day.

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.

If I get my signals for what I want to do, often I can see a new high for the day in the last hour of the day. If I have my signals telling me to sell, it oftentimes will say to sell the new high in the last hour, with the requirement of proving that position correct being that the market must spend little time at or above that new high. This is not saying to take a loss on a stop but saying that the new high is a move created by day -traders, locals getting out or bad buying creating the stop run toward the end of the trade day. For the position to be proven correct, the market must prove that the reason for the new high is just as I previously described.

Markets slip through stops on the bottom toward the end of the trading day also because of the day-traders, locals and bad selling that push the stops that build up below the markets. This is natural in trading and is not recognized often enough by traders, especially new traders.

Another big disadvantage of stops, as I see them, is the feeling by traders that they are protected from adverse moves. When the market is liquid, stops work fairly well. Too often, however, when an important report comes out -- the monthly unemployment report, for example -- markets such as bonds and currencies will do the long jump. There is no liquidity sometimes for as much as several support or resistance points. This means huge losses in a matter of minutes until the stop order can be executed.

Keep in mind a stop order is a market order whenever the price is hit. Most traders blame the broker for not getting the stop order filled at the stop price. How can they, if the market has no bid at your sell stop price? How is the broker to fill your order on a stop when every order he has is the same stop order price and there are no traders or orders willing to take the other side? Everyone sees the same chart. Stops are grouped in the same place.

After a big report, the stops are free game for anyone who wants to squeeze as much profit as they can. If I am correct, I know it will often take three waves of effort before I have to worry about the market reversing and taking my profit back. Why shouldn't I bid the lowest price possible after a report my way? If the market didn't fall substantially on a big report, I would be adding to my position until I see the bad selling. The bad selling is the stop selling after a report. Same on bad buying as the bad buying will be the stops buying at the market.

By understanding the drawbacks of stops, you can come up with a better-suited trading plan to protect yourself. Rule 1 does just that. Your criteria must include getting out if you don't want a flip of the coin at times. Big reports are those times.

Another aspect of getting your order filled way out here is when you go at the market on the open. Order fills look bad to some traders just by the way some of the quotes get reported. Some quote machines show the open price as the price that was the night trading open price. The next day the open may not be anywhere close to the night trading open.

Many trade systems signal a position to take after the previous day's close is used as data in the program and position on the open. This alone can skew the opening price by good margins of price difference. If you are buying and you are on one side of the pit, you may get a good fill. However, a large order may bid above your order in another part of the pit. The broker's job is to buy the offer when it is a market order on the open. They don't have time to look for the cheapest price when there are numbers to do.

They take what is offered.

If you wanted to buy a computer and you did, you bought at the offer price. Why didn't you wait six months until the price was half as much? It is because you wanted it now! It is the same in trading. Your market order on the open is saying you want it bought now, not after it went down or went limit up or tomorrow after a selloff.

Just because the opening call was four cents lower and you put a market order in on the opening, are you going to get the low of the day? You might get the high of the day but most likely never the low. You may even be filled five to ten cents higher on the day if news changes quickly enough. Or in orange juice, you might have no sellers at all on the open for several minutes.

Orders are entered poorly more due to lack of understanding of how the market works at certain times in getting orders filled. It is seldom because of a mistake on the order placement by the broker or executing broker that you got filled way over there.

Another misconception of being filled in left field on an order is the thought that the broker is trading for himself. I watch this myself and can attest that what I see has never been beyond providing liquidity by a broker in poor liquidity times. Brokers are position traders. They cannot attend to being day-traders or scalpers. It is their primary job to fill your order first. The brokers I have seen do just that! They fill your order first.

One more aspect of being filled at what looks like huge slippage is the delay in quote prices and the delay in getting your brokerage runner to get the order into the pit in timely manner. They are allowed a certain amount of time to get your orders into the pit as it takes time to go to the desk, take the order to the pit and hand it to the broker who is filling other orders already.

Repeat the process again as the runner looks for your order to report your fill price back to you.

Sometimes you don't know you were filled because the runner can't find the filled order before he has to run another order to the pit. Let me give some insight on this situation. If you must know if your was filled, CANCEL the order! This way the runner must require the broker to pull the order from the deck. If it was indeed filled, it won't be there and the runner will have to look for it. Sometimes new runners don't know to look over in that pile for the filled order. Every runner starts a new career and is not good at it until experience becomes the teacher.

There are times when runners are seeing so much volume that the floor managers will tell them to do the most important aspect of their customer business -- that is, getting the orders into the pits and worrying about the fills later.

Often, confidence of customers and a new trader in the way orders are routed and filled is never above a "1" on a 10-point scale.

You owe it to yourself to see the flow of orders and understand the strict method that must be -- and is -- followed by the commission houses and the brokers. Believe me, integrity is as good as it has ever been.

I remember when beans had gone above $4.44 for the first time in history, and I fed orders to the floor to sell out my longs as they hit $4.44. My fill was at 4.32. I did my research and checked all time and sales and price quotes that day. When I get a bad fill, I know why today and everyday. It has never been because of the broker not being alert. It has always been because I was not in the pit and did not know what was going on for anywhere from two to ten minutes before my order was filled.

Art, I know we want feedback on this so we can address the input from the Futures Talk forum. I never really had my heart into this chapter as it seems so cut and dried for me, but I know it is important to the traders. They must understand their fate when blame is quicker than answers in difficult market times.

ALS: Okay, traders, Phantoms, paper traders, brokers, newcomers and us old folks alike, let us have it! Your questions and observations, please!

Note: *Within a few days after posting the message above, we had some good feedback from R.H. and it seems fitting to put it in this writing.*

R.H.'s comments:

Phantom . . . thanks for another insightful chapter. Unless you've been there or had much experience, you tend to follow the notion that the little guy always gets the short end of the stick. This chapter explains the process of the markets for better understanding.

No specific comments other than paraphrasing my understanding of your words.

On tracing orders, is there other info or stats that one can request other than time and sales and price?

On "gunning for stops" it's my paradigm and others that running the stops creates a quick bounce and, once hit and expanded, the locals offset and is done as a tactic in itself. Your explanation seemed to be that it was not necessarily a concentrated effort to run the stops but rather floor traders positioned wrong, and as they offset near the thin areas, the market pushes through the stops.

On markets proving most people wrong and hitting their stop and heading in the way they had thought, Rule 1 was made for this action. If you position and the market goes against you, Rule 1 offsets the position, allowing for re -entry (in the last hour, in this instance) rather than positioning once with a stop just beyond the daily extreme. So Rule 1 allows us to use these areas to reenter again or enter (e.g., on the 1 1/2-day move) rather than lose the position and see it go our way shortly afterward.

On stops and a big report, any other ways to see the bad buying or selling other than looking at the same chart everyone else looks at?

Thanks again for providing us clarity on the true workings of a market. R.H.

ALS: Phantom, a couple of questions from R.H. we should answer. His question on tracing orders: Is there other info or stats that one can request other than time and sales and price?

POP: The best way to trace an order is to know by name the phone clerk who takes your order and to identify the runner who takes your order into the pit. For me, this is pretty easy to know because I am pretty well known for requesting all the information I need to keep the integrity of my orders going into the pit.

I like to have the information because I like to prove to myself that the myths of what happened to an order are just that -- myths.

Most of the time other traders who put orders into the pit are not aware of what has happened because of fast markets or newly reported information. They only know they got a bad fill.

Well, bad fills all have a good reason. Every time I check to see the reason for my bad fill, I have verified the circumstance that it has indeed been at my own hand that I got a bad fill. I didn't know at the time when I placed my order that I didn't have the timely news or what the liquidity was at the time. How can we always know the situation at all times? We can't!

You see, it is easy to use a crutch in blaming some reason other than a fact that we don't know at the time. It is wasted energy to think our fill was other than with the highest integrity. Even though I could fill all of my own orders, I know I can do a better job giving the order to the professional broker. Now, most traders don't know that.

On tracing orders, most of the time you can get time and sales, but the true event is that your order, if a market order, can be filled anywhere within a time limit of say two minutes. Now, have you ever seen a market move in two minutes? Of course you have! A market can move quite a lot in two minutes.

How do you win the game? If you put enough orders in, you will find it tends to even out. If you put few orders in, you will find you tend to get the short end of the stick as Randy suggested. The short end of the stick is that you will put your orders in just as the market is changing direction and starting to go against you.

You know what the market is going to do, and it has already done it by the time your order reaches the floor and you got the slippage from the market reaction. The quotes you receive are not the same as the bid and offer in the pit when you put the order in. There is always a lag. I can stand in the pit and watch the tape and be behind as much as minutes at times. I bid and offer according to what is going on around me in the pit. The public cannot do that. At times you are better off with resting orders, but execution is always the most important part of order placement if you don't trade large amounts.

Okay, time and sales is it, and the rest of your research is on your shoulders to check your broker, runner and phone clerk. A good commission house will do this for you but not always when the market is open. Do it when the market is closed and keep your own records. I consider it as if I am hiring the people who work my orders both into the pit and in the pit.

ALS: What do you think of R.H.'s ideas on his interpretation of running the stops ideas?

POP: I don't mean to remark lightly, but R.H. has a good handle on the correct interpretation of what I meant. I can't really add anything to his correct ideas.

ALS: Another question for you on stops and a big report: Any other ways to see the bad buying or selling other than looking at the same chart everyone else looks at?

POP: I see the reason for R.H.'s question on the bad buying and selling. In the pits it is pretty easy to see what is going on. Off the floor it is a sense we have to be alerted to in our thinking. We must know the possibilities of why things happen the way they do in markets. People will trade like herds at times and when the herds have finished their positioning, the market takes a breath and the move starts to fade.

It is the lack of followthrough that tells us when we have seen bad order placement. When we are away from the floor, we must be aware of lack of followthrough. It happens at the highs and lows because of momentum trading, which causes the moves to be quick and sometimes causes artificial moves.

My suggestion is to be alert as to how quick a move happens and then to watch for the followthrough in a proper amount of time.

Each market is going to take a little different reaction to such conditions. R.H. has my idea on Rule 1 and the way I trade correct. It is the criteria of followthrough with the combined knowledge of what day-traders have done up to the last hour that I use to help generate a trade during the last hour or two. It is more powerful for me to get the bounce in positioning.

In fact, I have a chapter or two or even a book on the systems I use in trading. Of course, I would not give all of the inputs but enough to help most traders establish a game plan that would match mine.

ALS: Do you want to address any other situations on order fills?

POP: No, I don't as I think it is research that every trader must make on their own, and I cannot give them the results of their ideas of bad fills. They must slay that situation themselves to have the confidence of putting it behind them.

ALS: You've been generous in helping me write "Phantom's Gift." I know the traders do appreciate it and wonder what are the plans from here?

POP: You know I have been rewarded, and as I watch posts of forums, I see the effect this project has had.

Art, I think it is time to see how Robbie does in his trading. We must step back and be the observers again.

ALS: Does this mean this project is completed?

POP: **Art**, you know the project is not completed. I see the CD on your desk, and I see "Phantom's Gift" in red on the cover. I also know we have the best for last. Now, who wouldn't suspect that? We want our traders to make it big. So far, they have had lots of insight to interpret on their own.

You know the respect and expectation I have for the small trader. It shall happen that they are the winners. For how long I don’t know, but they will be the unexpected winners.

The next step is to point out where the pot of gold is. I have a little surprise of a grand trade that is going to happen in the first full week of the new year. Unless you have seen Darrell Jobman's new internet video, you will have to search out the clue yourself. It is somewhere in the internet within your reach. You had better have it two-day delivered and in your hands by Thursday (Jan. 8) unless you want to search clues out yourself.

ALS: I see you can get the tape free with Darrell's book. I haven't seen it. What do you think of it?

POP: First class, just like Darrell!

ALS: Do we go ahead with "Phantom's Gift" on CD with the rest of the story chapters? If so, what will it cost?

POP: Only if our traders want it! Production and distribution will have a cost. It's up to our traders as to what they think it is worth to them. That will be the cost. It has to meet cost of production and distribution. It is all up to our traders!

ALS: What is next?

POP: I am a good observer. I know our traders. Some know me already! It shall get better for the small trader. To keep my mask on makes me pretty obvious, but the small trader has the best advantage this way. Let's keep it that way. Offers are offers, but I want to see my little Phantoms grow up.

ALS: So be it!

Thank you sincerely,

Art & for Phantom

Your Trade Program

"Let's look at some of Phantom's writings and his updated notes as to his ideas on your trading plan." Art Simpson

Phantom indicated it was time to conclude the Futures talk forum part of Phantom's Gift and move to the sidelines to complete the first book of his give-back project. There were a few hesitations on the forum but only because of not knowing the further plans that Phantom intends to complete.

The project has been very successful and well-received, which pleased Phantom and exceeded his projections. Several comments were made to the point of wishing for a never-ending dialog between Phantom and participants on the forum. Phantom felt it was time for him to stand on the sidelines to see the results of his efforts.

Trading is an extremely difficult business, and research is always a demanding part of each trading day. While Phantom needs to complete a few other projects, none are as important to him as the efforts he has given on seeing the small trader compete successfully with the big traders.

There are so many turns and new frontiers in trading, and only a few have been covered up to this point. For a trader to know what is required to stay in the trading game for a long period of time is most important and above other aspects. But without the other aspects, such as a trading plan and a system to generate trades, trading cannot be completed properly.

There are so many trading plans and systems; while one trader may be able to be successful with a system, another trader may have failed to master the same system due to different entry and exit points. It can be a very fine line.

With Phantom's rules, it is a more even call with the same system. This is what Phantom intended to see in presenting his trading rules. To more or less level the playing field and improve the standing somewhat due to the quicker actions required by the rules than actions of the deep pocket traders is an improvement for the small trader.

The small trader cannot survive unless equity is preserved first and foremost in trading. It can be done but must be done with the skill required. This requires following closely the rules and knowing oneself. It is difficult to teach this method without a trader's own experience pointing the need for the rules, which require the trader to run like a coward to survive in the long run.

It isn't too much different from a professional basketball game in that, if you missed your shot, you are running to defend at the other end of the court. You know you will have another chance if you can continue to keep the opposing team (the market) from running up the score on you.

It must be instinct, and practice is required to make it a reaction trained by your practice. Knowing the rules is just not enough. No one tells a good trader to make a trade, as it must be your own thought to properly follow the correct rules. Same at getting out of positions that don't prove to be correct positions.

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.

Phantom wanted to give the important step beyond the critical starting rules to give traders a better outlook in their trading. We include some of his writings over the years of his trading on such things as how to look for an entry and improve the edge upon entry. We shall look at ideas on system entry and trade signals.

All traders feel there is a system that is best. The best system is going to fail at one time or another, and that is why we need Phantom's rules. Bad systems can turn some good trades and be correct at opportune times. Many of these systems have drawbacks.

Many systems assume you will have the funds to cover what the back-testing indicates is required to margin your trades. Phantom has studied these assumptions and has his own ideas as to the difficulty of using back - testing as the criteria of system creation.

Often, system traders fail to see the entire requirement when emotion takes a seat on the team bench. This absolutely will defeat the system. What system is best? Phantom has thoughts on which system you might use to better survive. Which ones are they?

Most of the book has required a couple of readings to interpret a lot of what Phantom has indicated in his insight. It was no accident that his insight prompts your own questions and searching. You are with us so far. That was the most important step.

You are doing your own thinking. From here forward it will be a little easier for you. It is discouraging to have a market take funds away from you and your family. The more soul-searching you do about what the market is waiting to show you, the better your outcome will be in using the rules properly.

Take a break, have a favorite drink or refreshment and get your note pad ready to make your own notes. You are going to draw your trade plan according to your goals. Phantom will have some good suggestions about your trade plan.

Your trade plan will give you your entry signals. Phantom's rules will give you your exits and drawdown protection. What else is there? If you have the rules for protecting your funds in a losing game and you have a good plan for putting on good trades that you exit if not proven good trades, you have it pretty well covered.

It is easier to look greed and fear in the face with the proper frame of mind. You have to be your own motivation expert in your trading. The motivation must be tilted toward the rewards of keeping big losses out of your account -- not just today but every day you trade. You must look at a big loss the same as you would a personal bad habit. It is undesirable to ever have a big loss show on your statement.

Phantom is going to look at your statements. If he sees big losses in your account, you will have to answer to him personally. It is his business when you have a big loss because he is going to see it in your face. Your tie will be too tight, your face red and you will have a miserable day. POP wants better treatment for you in your trading. He cares and you must care each minute your position is against you.

Can you make that good fortune in trading? Only if you lose small and never let turnaround markets take you for a ride. It is your question to answer. Phantom has no one to answer to and nothing to prove to anyone. You must prove to yourself. Let your performance speak for you. It should not take you more than six weeks to know for sure.

You can expect to be on your way not because you made some money but because you don't let much money get away from you.

We have known some big winners, and winning was easy for them. The only thing they forgot or never knew was that, though it isn't difficult to make money, it is difficult to keep it. There is only one way to keep it.

Okay, if it isn't difficult to make money, why don't you understand before you make money that you must keep all money at whatever cost you can create with the word small. The biggest loser I ever saw was a trader who had a few outstanding months of trading in a trending market. You may have heard of the Hunt silver slide. It can happen to anyone who does not respect the reward of a SMALL LOSS! You must see the reward of a small loss. Don't let it be your forgotten advice.

Let's look at some of Phantom's writings and his updated notes as to his ideas on your trading plan.

Art Simpson (ALS): Phantom, I'll transcribe these into our book and have you verify the points that I don't fully understand.

Though I have known you my entire trading career, I still don't know everything about you. When you put thoughts on paper, it seems different for me than when we talked answers back and forth.

I am more like the readers now, as I must read what you wrote instead of what I wrote from your spoken insight. Do you think this will make it easier for the readers by doing it this way?

Phantom of the Pits (POP): You bet, Art! I am exact in my thought when it comes to making a trading plan for our traders. You go ahead and put it in the book.

ALS: Okay, here we go!

POP (from his writings): In every trading plan there must be an element that gives you the edge. It is that edge that can change the outcome of your trading career. In the pits it is the edge the locals get for putting on the trade that is to their advantage that allows them to trade for a longer term than if they had not gotten the edge.

My rules are not the plan, but the rules are a must to have a plan that will work. To me, the rules are the most important part of giving me the confidence I need to know that I can and will survive in my trading. Survival is the most important point of any plan.

If I know I can survive, then my plan can be much easier to design.

While my plan may seem advanced to others, there are only three ways for a market to go. I know you are going to ask, "What is the third?" but, nonetheless, believe me! There is a situation coming up in a few days, and every trader off the trade floor is not thinking the trade. My writing points out a third way the market can move.

I didn't want to put this on the Futures talk forum because I didn't want to confuse new traders with my thoughts on this point. I am not going to ask you to interpret what I am trying to say. I am going to tell you what I mean here.

A good trading plan must have the third way a market can move included in the plan. Is the third way a market can move the surprise side move. No, not exactly!

The third way a market can move is the edge we want in our trade plan. A market that goes with the trend and then breaks support or resistance, which also flags traders to get out or cause them to get stopped out, will turn into your friend. The most powerful signals in a plan are the ones where the market has moved both ways in a trend and are showing reversal to the big buildup of trend-followers. I know of a couple of funds that have been proven winners due to this one input of their plan. Sure, there were other criteria, too.

Oh, you say, but you are the great trend-follower of all time. What is wrong with throwing in the towel early in a trend? I'll tell you what is wrong! Not throwing in the towel early is what is wrong. Big losses are the reward when you have convictions in a trend beyond support or resistance. You got it, the market trips and you must take it. You need not only to take the profit but also to head the other way. You need to make criteria for this situation in your trade program.

In your trade plan we now have two situations that can give you the edge. The first is the surprise side and the second is the third way a market can move. The surprise side is an event that takes place during the day and, unfortunately, seldom allows the public to benefit from entries -- mainly because they are already the other way when it takes place.

The public seldom reverses their position because they seldom get out at the right place in the first place. You must use this knowledge to your advantage and not be caught up in the same situation.

I don't care how bullish or bearish a position you have established appears to be, there is a place in every day when it is going to be right to be out of that position. The odds are you won't hit that place most days. You'll find it seldom happens when expected in trends. That is why you must have that exit planned during every day. You must be prepared within your trade plan to use the exit if needed.

How do we put this into our plan? If you are using point-and-figure charts, you can often see the 45-degree line of support and resistance. A good trend will give you several attempts at the support and resistance lines. After several attempts, a reversal day will break through the line. At that point you will have stops, and the stops can generate more orders coming into the pits. As the price moves through, it will generate more orders to exit.

You don't want to stay around long after the first move through the line. Even if it does reverse back again, you usually will have a good clue that you did the right thing by offsetting as consolidation starts to take place if the line holds.

Some of your biggest trends and moves come from the breaking of support and resistance of a strong established trend. Put these criteria in your trade program. Even if you were to only trade this edge, you would be making the best moves of your program.

Let me qualify this for you a little more. This is the third way a market can move. The market must have moved in the direction of the trend and then broken support or resistance. It is not the same as the surprise side moves. The surprise side move is different in that it can be caused by a reversal of a market after going the way of a report and then failing. The surprise side also can be when opinion is one way and the market has no more traders to reinforce the opinion with positions so the market fades the other way.

You must have a surprise side plan in your trade program at all times also. The surprise side, over years of research for me, has always been the opposite way the market opened in all markets except one. It is up to you to search that one market out. It tells you something about taking a diversified trade plan by spreading your trades over several contracts. If you trade five different futures and see that only one can be the one I expect to be a surprise side in the direction of the open, you have the odds in your favor in your thinking.

I don't want to mislead you on the surprise side. What I mean is that, if the market opens higher and closes higher for the day but lower than the open, it is what I call the surprise side. It is the same on a lower open that closes higher than the open; then it is the surprise side. Go do your research on the open and close but not in respect to higher or lower on the close but in reference to the open only.

The big money is made on the surprise side. Why do you think that is? It is because the professionals are not only getting out before most but also going the other way when the rest of the trade starts getting out on stops.

You should make yourself a data chart and research this knowledge to confirm it before you put it in your trade program knowledge.

First, the market opens and, last, the market closes in reference to the open. This is your data research required for this input.

What do you find over the last six months? What do you find in a trend and when not in a trend? Chart it or data scale the information and use that in your program.

You see, opening prices are good indicators of where the market will close in relation to the open in certain market conditions. It seems to have certain credibility due to the way the market information is reported in newspapers to off-floor traders. Some traders only get the open, high, low and close most of the time.

Opening prices are bad news most of the time. There are times when opens and gaps have high credibility in predicting the close direction. Learn them from your technical research and use them in your trade program.

During a surprise open there is little you can do if you are already the wrong way other than to protect your position. If you are right by mistake on the surprise open, consider yourself lucky but listen to your plan just the same. If your program said to offset after a higher open and you get a surprise higher open, do it and then re-enter your trade when you have met the criteria of your program.

Many times an extreme open will give you support at the opening range as the gap indicates to professional trader an invitation to continue to move in the same direction, as new orders to follow continue to come into the market in waves. You must consider this phenomenon in your trading plan and input it carefully in your program.

It is just as important to not make a mistake about good gaps on the open. Watch them and research what happens with them.

There will be a two-sided market in those situations but only because there are always many traders willing to take a profit. Use that to your advantage, as we have said in the past. These profit-takers are your friends in these situations.

Gaps are certainly a study needed because they are your opening indicators and can change most trading plans immediately.

Use the information you gather on gaps to implement good trading plans with the gaps being a possibility each day.

Getting back to the third way a market can move is not the way many think in picking tops and bottoms. It is not picking tops and bottoms. Third way moves are your acknowledgements of what the market is telling you about the existing trend. It is finding lack of continuance and is going to reverse somewhere along the trend. It is usually after the support or resistance of the trend has been flirted with and broken. Be aware of your support and resistance points in your plan each day.

Always take into consideration the possibility that the third way moves in trends are the most powerful moves in markets. If you have missed the existing trend for some reason, you can always be ready for the third way move out of existing trends. Don't ever force the trade until the resistance or support has been violated, depending on which way the trend established is moving. Hav your points in your daily trading plan.

Most systems will not give you criteria other than expected entry points and exit points. Thus, there must be further establishment of your trading plan. It is good to have a system that you can have confidence in, but you must complete the total trade plan in addition to it.

Seldom is a trade system a complete trade plan but there are some that are. On selection of a system to trade, I feel it is best to have an additional trading plan along with the system. I feel this way mainly because there are times when your system can generate a period of losing trades. You must be able to filter as well as protect with my rules when this happens.

Look for a system that allows you the opportunity to complete a trading plan along with the system. You should be able to find the needed criteria to allow the dual situation in your trading.

Many systems writers say you must follow the system exactly at all times. What happens when an unpredictable event totally changes a market from technical to chaos? How can you continue to follow a system in that event? This is why I like a trading program in addition to the system. And above all else, the rules of survival take priority over all.

So we are saying the best system is one that allows you the best lateral movement in your determination of trading throughout the day. We are also saying that rules of survival are much more important than the system. But without the system, you will have no positions established.

Many call money management the same as we call the survival rules. Don't rule out either explanation of survival. You can only succeed if you trade in the long run. This is not the same as saying long-term trades. Long-run trading allows you the opportunity to be around for good moves in both the present and the future. If you trade just for today, you had better just buy a lottery ticket.

When you select a system, there are drawbacks to each one. Look for a system that back-tests data currently. What I mean by this is that it must be current in the last six months or so. What good is the system if it takes the last 50 years into consideration

but not the current six months that reflect current market conditions best. I like to see a system back-tested in two stages, one for lots of data and one for the last six months of data.

If you design your own system, compare both the long-term and six -month sets of data. If they conflict, you must refine the system somewhat to a better signal generator. If you can't refine it better, then use both sets of signals and throw them out when they conflict. This can be a good filter for you in your trade signals. Who is to say that times don't change in cycles just as do market swings? Use it to your advantage.

More times than not, when you have conflicting signals, you will be better to disregard them. Your powerful moves come when all your signals tend to agree. Don't make the mistake of having too many indicators as the more you have, the wider the road must be and the more difficult it will be for you. You may over-stay the market because you entered too late.

Too many indicators will cause you to enter too late many times. This also leads to staying in beyond the proper time. Most systems will not give you a good intraday reversal signal, as they tend to be more day-to-day signals. You need your trade program to flag you on third way moves in trends at reversals.

Don't be a hero and don't use a system that requires you to be a hero by holding on the extra day. If you do, you will find yourself missing the reversal signals and catching the bounce instead. This will change your outcome and sometimes invalidate your ability for the particular system you choose. This is another good reason you should have a trade plan along with the system chosen.

I have covered the most important aspects of what you should include in your trade plan, but this is no way complete. There are unique inputs from each market you want in your system like seasonal tendency, volume, open interest and other factors that are unique to each futures contract you trade.

Your plan can be generic with minor specifics for each futures. Keep in mind you still need a fairly simple program. The system is what will be complicated. It may include several moving averages or other indicators. Try not to use too many lagging indicators.

You are talking about future and not past. Stay closer to leading and forecasting in your system choice. The reason I say this is because quick and extreme moves take place in trading.

What kind of signals do you want to trade? Mostly you should use a trade plan to keep you from chasing markets. Your system may require you to buy strength and sell weakness or buy the open. I don't like this type of trading anymore. You must have a filter, but keep execution as part of the trade plan. You can have two possibilities set as long as one of them guarantees you do indeed follow your signals. It will only change and moderate your entry places.

A system cannot know what the market is doing after entry. Your trade plan can. That is your edge. It is not second-guessing but intelligence-gathering upon entry. Systems may be giving you a signal again and again. Does this mean to add at every signal?

Your trade plan must address that. I have liked the three add-on points. Use your own ideas.

I hope this helps you with your trade plan. The ideas are unlimited, but you must narrow them down and keep your plan relative simple.

Phantom of the Pits

Phantom's Christmas Gift

Phantom's Journey

Phantom remembers those people he meets along his journey in trading and those he has met since he started giving his insight back. His remarks were that he felt he could serve you much better than he has. Phantom felt that he is the beneficiary of what you have given to him.

The best compliment I can remember Phantom ever getting was when he was at an important meeting. The wine steward had just poured a glass of red wine for the host and, to be polite, Phantom also accepted the gesture. As the wine steward poured Phantom's glass to the brim, the last few drops spilled onto Phantom's white shirt and suit.

The wine steward turned to Phantom and said in a loud voice, "Sir, a lesser man I could have served perfectly!"

Phantom turned to the wine steward and said to him, "It is I who must serve mankind better! I am grateful for your reminder."

Phantom wants to serve you better and is grateful to you for the thought you provoke within his reach. Some of the great traders are often overlooked. Great traders are not just those who have been fortunate enough to make it big in trading but also those who have made great trades in their lives.

It was Phantom's request after seeing a simple kindness of others toward a dad and his son in their loss of a long-time family friend. The family dog had just passed on. To see the pouring of kindness of others toward the man and his son touched Phantom's heart.

It is not just this random act of kindness that touches his heart but powerfulness of wonderful thoughts that can be extended by others. Traders in their time and atmosphere of intense trading are still human in a cold and harsh environment.

Phantom wanted us to write his journey in an effort to balance the scales of trading and living as partners within the soul along the way. Trading at times can reach out and grab your soul with cruel implications, but your living can repair your touch of kindness within your soul. Phantom wants you to see his insight of you.

It is true that much of the human element has nothing to do with trading and that most see no need to study human behavior. Or do they? In researching the lost dog incident, it is clear that around 90% of traders involved tolerate such thought along their trading route, and actually those opposed also contribute.

Phantom starts his insight to your journey. There is something to be learned. Or is there? He starts with his Christmas Gift.

Arthur L. Simpson

Phantom of the Pits (POP)

Along my journey of trading, there have been great traders I shall always remember. To my surprise, it is not the big success stories I remember but the great trades (events) those traders have made in their lives. Often, it is a helping hand in exchange for their precious time; other times it is dedication in their lives toward mankind. The brotherhood shown by those great traders is what my journey has shown most to me.

I want to share some of my insight on you, the great traders in our world. The strongest thing in the world is love. It is stronger than death. What guides us to gather strength even when touched by death? This is just one of my questions in an effort to balance my trading career with the living side of the scales. What I have found out about you continues to give me answers. I want to share that with you.

The wife of a trader conveyed to me one of the great trades made by a person whom I consider a great trader. In our journey, we shall identify that person only if that person wishes us to do so. In this case, the person has not decided to do so at this time.

It was Christmas Eve in 1979 and two men had just finished their work shifts on a United States Navy ship tanker. The ship was anchored in Ulsan, Korea, and unloading fuel a distance from shore. Because the two men didn't get to be home with their loved ones on Christmas Eve, they had plans for the evening. It was 8 p.m. and the two men took a boat launch to get to shore.

Both men were carrying large bags ashore. One of the men questioned whether they should be taking anything ashore for fear of being thought to smuggling. The other man pointed out this was surely the time to take that risk as it was indeed Christmas Eve, and understanding might be easier if an explanation were required of them.

After getting off the boat launch, the two men walked about two miles, and the sacks were really getting heavy by this time. It was a cold winter night in a country foreign to them, but they had a plan and carried on with their heavy sacks.

The two men arrived at a building and entered, as it was unlocked. A lady came and met the two men from the ship and asked them to have a seat. A short time later a group of children came into the room and spoke in Korean. It seemed to be with great excitement that the children were pleased to see the two men. They had seldom seen others and especially these two men.

One man's name was Preston, and the other man was my trader friend. The youngsters were laughing at their broken Korean language. Because the youngsters could not speak English, it was the only chance for communications.

My trader friend, according to his wife, had caught the eye of two children. One was a boy about 10 years old, and the other was a young girl about 6 years old.

The only word the children were trying to convey to the men was the word "Wahn" or "Waan" or "One." The men thought that perhaps they were trying to show they could count in English. The young girl would stare at the two men, and the older boy would not stop talking, as he was very excited to meet Americans on Christmas Eve.

"What is in the sack?" the housemother asked.

The two men said you shall see in time. Let us get the children something to drink. At that point they were given something to drink.

Preston pulled out a sack within a sack, and the children's eyes got wide as they thought it was a trick of sorts. The little girl was questioning with her eyes as the two men pulled out pieces of fried chicken, which was left over from the ship's Christmas dinner that night. The men started eating a piece of chicken in front of the children, whose eyes were sad as they seldom were able to eat as much as they wanted.

The children had never seen or eaten fried chicken in their entire lives. Chicken pieces were being passed around to the youngsters as they learned the tasty smell of the new-found food. The full sacks of food were more than enough for it didn't take long for the children to get full.

The oldest boy motioned to the housemother and asked several questions. It was Christmas Eve and getting late for the children, but they were allowed to stay up late this special night.

The two men had to be back at the ship soon because it was to leave at 3 a.m. as the tide was going out, and it was the only time the ship could leave safely. About midnight the two men left on the launch for the ship. As the two men arrived back at the ship, the crew made ready to depart as their unloading of fuel had been completed.

My trader friend had tears in his eyes as the ship left, and he thought of the starving children and his small participation on Christmas Eve. He had just been presented with a gift for trading his time in this event. He would see many years later it was one of the best TRADES he would ever make.

Fifteen years later in October 1994 my trader friend was once again on a ship, and his wife had just been in a life-threatening event. Being on a ship and away from family presents impossible resolve in helping anyone.

My trader friend searched the ship for a Bible, and for some reason none existed on this ship. The ship made weekly trips from Puerto Rico to New York and was in New York on a Saturday. After the ship had been properly secured to the dock, a man walked on the ship with permission to do so and approached my trader friend.

The man held out his hand and said, "My name is Mr. Wohn. Here is the Bible you wanted!"

Why, my trader friend was astonished as he had not mentioned this to anyone. How could this be? A stranger walks aboard a ship and hands out a Bible after my friend had been looking for one earlier in the week.

Having just finished lunch, my friend asked Mr. Wohn if he would stay for lunch. Mr. Wohn asked, "What is your meal on the ship?"

"Today it is fried chicken," my friend informed him.

Mr. Wohn indicated it was his favorite food, but he had already eaten lunch. At that time Mr. Wohn started to explain just how fired chicken became his favorite food.

"I am in America from Korea," Mr. Wohn said. "I promised God I would give mankind what they are in need of in their lives."

My friend asked him how he had decided to dedicate himself to helping others.

"I was 10 years old and my sister was 6 and the only family I had. We were both orphans and lived in an orphanage in Ulsan, Korea. I first met God in my life on Christmas Eve in 1979. It was a cold Christmas Eve, and it was a sad time in our lives for we never had enough food to eat and we would always be hungry when we went to bed.

"At about 9 or 10 that night, our housemother awakened us and told us to come with her. We went to our lunchroom and sat at one of the tables. It was cold so my sister and I sat nearest to the stove to get warm.

"Two men were in the room, and I thought we would see a magic trick as one of the men pulled a sack out of bag. The men started to eat a piece of food, and it looked strange to us. They gave us some and motioned for us to eat the same way as them.

One man put it up to his mouth and took a bite of the food. So my sister and I did the same. It smelled good and really was wonderful. It was fried chicken. It was the first time we ever ate fried chicken.

"Well, I remember the kindness of the two men to this day, and that is how I decided I would help others.

"On that Christmas Eve, our housemother let us stay up late as this was different from the other nights. I was the oldest in the group of children, and I wanted to know who brought the food for us. I asked our housemother, and she said God and Jesus had brought us the food. My sister looked at the two men and wouldn't take her eyes off of them when she heard the housemother’s explanation of where the food had come from. She had heard of them and wanted to know more. My sister asked how they had gotten to their orphanage, and she was told they had come on a big ship in the water.

"The two men left before we went to bed, and all the children talked about the wonderful food and happiness of that night. Our housemother told us it would soon be Jesus' birthday the next day.

"I was excited the next morning, and my sister was more excited as she wanted to go down to the ocean to see the big ship that God and Jesus had come on to give them food.

"I will never forget the disappointment in my sister's eyes when there was no ship. Can you imagine that? We had just seen God and Jesus in our eyes, but there was no ship there at all. How had they gotten to us?

"I began to lose faith that it was God and Jesus who had brought us food. My sister said yes, it was them and she knew it was and wouldn't change her mind. She was so dear to me and all I had in life. So I let myself have the same faith, and I promised God I would spread the same kindness to man.

"My little sister talked of meeting God and Jesus when she died and of living with them. She would ask me if I would come with her. I would cry at nights because I knew I would soon lose her."

Mr. Wohn told my trader friend of his sister's death when she was eight.

Mr. Wohn indicated that perhaps he had seen God and Jesus that Christmas Eve in 1979. As he walked down the gangway, my trader friend called to him but didn't know what to say. He could only think of that Christmas Eve away from home and loved ones when he had walked a cold night's walk with heavy sacks of food from the ship to an orphanage in a Korean town.

My trader friend yelled to Mr. Wohn, "Mr. Wohn, God uses people to accomplish his wishes at times."

Mr. Wohn yelled back, "Yeah, I know! Would you thank your friend for that Christmas Eve in '79 for me?"

Talking to my trader friend's wife, I have found a deep gift. She says it is one of the most powerful gifts her husband cherishes. To trade a part of his life and to see it come back everyday when he looks at that Bible is the greatest Christmas gift he will ever need.

It was a great trade my friend made in 1979, and to see it come back amplified 15 years later is what I consider a great trade of a great trader. There are great traders among you, and I see this of you, too!

I hope you can see the true meaning of being a great trader. This one Christmas story of a ship's chief cook and an officer is just the beginning of your great future in your trading career. There shall be more along the journey, and I wish to share them with you.

It's all about YOU!

Phantom