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THE VAN THARP INSTITUTE

Van K. Tharp, Ph.D.



# Special Report

# Trading Strategies That Fit the Big Picture


by Van K. Tharp, Ph.D.


*For every dollar added to [America's] GDP, there are now 4 dollars added to indebtedness. This is the worst performance in terms of credit expansion in history and of course in comparison to any other country.*

— Dr. Kurt Richebächer, Economic Lecture, November 2005

When I wrote the first edition of my book, *Trade Your Way to Financial Freedom*, I left out one style of trading that I called mental scenario trading. My experience of it was that it was an art form practiced by some of the best investors and traders. For example, I would describe Market Wizards Bruce Kovner and Jim Rogers with the label "mental scenario traders." And the best way I could describe what they did is to say that they kept up with everything going on in the world and through that knowledge developed great ideas to trade. Jim Rogers has said about mental scenario trading, "How can you invest in American Steel without understanding what is going on in Malaysian palm oil? … it is all part of a big, three-dimensional puzzle that is always changing."[1]

I've never modeled a mental scenario trader, so I haven't talked much about it in my books and courses. But my thoughts about mental scenario trading have evolved. I believe that everyone, at minimum, should keep track of the big picture and trade two or three systems that develop from the patterns that seem to emerge. Here are a few of my beliefs about the big picture. Once again realize these are just my beliefs, my filters for reality.

- I believe we are now in a global economy in which emerging nations are starting to consume great qualities of raw resources.

1. Jack Schwager. *Market Wizards*. New York: NY Institute of Finance, 1987, p 306.

**Special Report**

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- I also believe that United States is in the beginnings of a secular bear market during which such issues as our massive debt and the retirement issues of the baby boomers must play out.
- I believe the U.S. has probably reached its peak as a world power and will decline long-term. I'm just being realistic here because throughout history this happens to every great nation.
- Given that scenario, I believe that the U.S. must endure at minimum a general devaluation of the dollar (best case scenario) and perhaps a fairly strong inflation, which will really erode the purchasing power of the dollar. We could see a DOW of 40,000 with the dollar worth about 5 cents in today's purchasing power. And, just in case you thought I was predicting a great boom in the stock market, that translates to a DOW of 2,000, which is quite low.

These beliefs lead me to want to focus on certain trading ideas:

- Be careful about the U.S. dollar and the U.S. stock market over the long term.
- Expect great trading opportunities in global stock markets over the long term.
- Expect great trading opportunities in gold, oil, and commodities in general over the long term.
- Focus on consumable assets (e.g., timber) over equities (e.g., General Motors). And collectables will probably do very well over the next 10-15 years.

I plan to discuss some of these ideas (and others) in more detail. However, my reason for discussing them is to give you an example of laying out a big picture scenario. My big picture may not be the same as yours, but hopefully, I'll give you some questions and ideas that you might want to focus upon in your own big picture planning. Furthermore, when you do lay out your big picture, you should have a way to measure it and update its progress.

I recommend that all of my clients develop a business plan in which they play out their own long-term scenarios for trading. In that plan you must ask yourself, "What do you think the big picture will be over the next five to twenty years?" And the answer to that question will help you focus on which markets to trade and the type of trading you might want to do.

As I was laying out my version of the big picture for you, it suddenly dawned on me that what I'm suggesting is that everyone does some form of mental scenario thinking as the basis for your trading. At one level, you can focus on the big picture as I just did and come up with markets that you want to concentrate on with some expectation of results you can get. Or, as an alternative, you can drill down into the big picture on a regular basis and become more and more of a mental scenario trader/investor.

You basically have a choice. If you want to be a good trader/investor, then I suggest that you focus broadly on the big picture to get an idea of the types of markets you want to concentrate on and how you might want to trade them. If this is your choice, then you probably need to gather some data weekly (or at least monthly) to refresh your big picture scenario. Doing so will help you know 1) if your beliefs need to be changed or 2) if you were totally wrong about one aspect of the big picture or even all of it.

On the other hand, you might want to gather more and more ideas and information about the big picture to the point that doing so is a part of your daily routine. When you do this, specific trading ideas will develop that you'll want to act upon. And, if this is your style, then in my opinion, you've become a mental scenario trader/investor.

So let's look at where you are in your development as a trader/investor. At this point you should have a list of your beliefs about yourself and the market. Now I'd like to encourage you, at minimum, to think about developing systems that fit with the big picture and to develop some monthly measurements that will help you keep up with changes that might occur in the big picture.

This article reflects my beliefs, which I've found useful in my trading and in helping me to be a top trading coach. I'm going to be talking about the big picture as I see it today in early 2006. *This is just to give you an example of big picture thinking. Your beliefs about the big picture might be totally different. Furthermore, my beliefs in the future might be totally different as new developments unfold.* However, if things change, I have a method of monitoring the market for data that would cause me to think differently about what might be going on in the world. You need that as well. *You'll also need to understand that while some aspects of the big picture imply a crisis, every crisis is also an economic opportunity.*

**The Big Picture As I See It**

When looking at the big picture today, I believe that several primary factors must be considered. First, the debt picture in the United States is absolutely horrific with the total government debt equaling about $125,000 per person in the United States. Second, I believe we're currently in a secular bear market that started in 2000 and could easily last until 2020. That doesn't mean that stock prices will go down, but it does mean that stock valuations, measured by price-to-earnings ratios will go down. Third, we're becoming a global economy with former third world countries like China and India now becoming significant economic players. The fourth key factor in the big picture, as least for Americans, is the impact on the stock market of the large portfolio managers. Right now they support the major stock averages, such as the S&P 500, but when baby boomers start to retire in 2010, there will probably be a net redemption for many years and this will have a negative impact on the major averages. The fifth key factor in the big picture is changes in taxes, policy, regulations, etc. that could change the entire economic picture. The government generally does what it can do to fix problems so that they look good now, and this is usually at the expense of future generations. The final key is that people are very inefficient when it comes to money decisions, but this is good news for you. You can actually become efficient. There are probably other keys that you may want to consider in your mental scenario planning, but these are my major ones.

My reason for reviewing my beliefs about the big picture is simply to give you a starting point. The key issues you come up with could be entirely different.

### Factor 1: The U.S. Debt Situation

In 1983 the United States was the largest creditor nation in the world. Two years later, we became a debtor nation for the first time since 1914. And now, in 2006, we are the largest debtor nation in the history of the world. In 1993, Rep. James Traficant, Jr. (Ohio) made the following comments to the floor of the House of Representatives:

> "Mr. Speaker, we are here now in chapter 11. Members of Congress are official trustees presiding over the greatest reorganization of any Bankrupt entity in world history, the U.S. Government. We are setting forth hopefully, a blueprint for our future. There are some who say it is a coroner's report that will lead to our demise." [2]

I can remember when the U.S. debt hit a trillion dollars in 1980. I kept thinking "How can it get any higher?" Well, it's now much higher and we don't seem that much worse off, so perhaps it can go on forever. But can it? I decided to take a look at a graph of the U.S. debt of the past 100 years shown in Figure 1. It's not a pretty picture.

In 1900 our debt was about 2.1 billion dollars. The debt begins to take off in the sixth decade (i.e., 1950) after the expenses of World War II. It takes off again in the eighth decade after the expenses of Vietnam. But since that time, it's gotten totally out of control and the 11th decade is not a full 10 years. It's priced as of May 12th, 2006. We could easily see our "official" debt at 15 trillion dollars by 2010. Furthermore, this table does not include future entitlements such as social security, which the government includes when it now estimates our total debt at 37 trillion.

We currently have a balance of payments problem to the tune of $750 billion per year, with about $200 billion of that going directly to China. This means that the U.S. is spending about $750 billion more each year with other countries than it is exporting to other countries. Already, foreign countries hold about three trillion in U.S. debt instruments. They seem to be willing to do this because the U.S. consumer supported the growth of the world economy during the 1990s. But it took decades for foreign governments to accumulate three trillion in U.S. debt. With our current balance of payments now at $750 billion per year, it will only take four years to double the commitment that foreigners must hold of our debt. What happens if they decide they don't want

2. United States Congressional Record. March 17, 1993. Vol. #33, page H-1303. Speaker Rep. James Traficant, Jr. (Ohio) addressing the House.

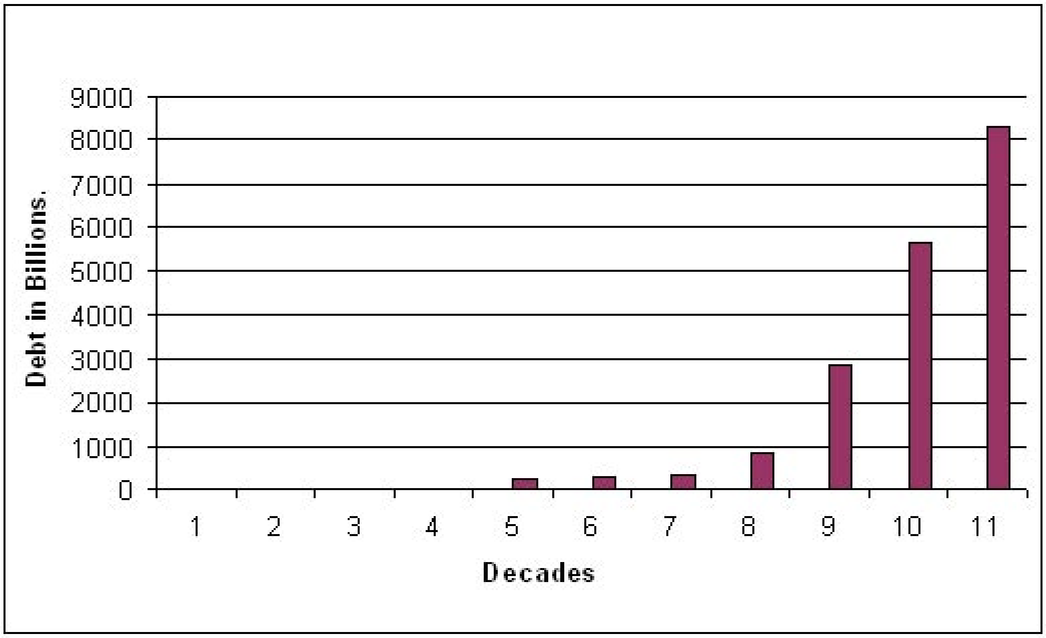


Figure 1: The U.S. Debt During the Last 11 Decades

our debt any more? They are sort of in a catch-22 situation. If they decide they don't want our debt, then the dollar will dramatically shrink in value and the debt they hold will be worth even less. And if the dollar shrinks dramatically, it will be almost impossible for them to sell more of their products to "toy-hungry" U.S. consumers.

**U.S. Corporate Debt.** Furthermore, the debt problem is not just due to the U.S. government. U.S. corporations have taken on massive debt over the years. My friend Steve Sjuggerud in May of 2002, when the NASDAQ was down 70% from its all time high, discovered that the debt of all NASDAQ companies in the U.S. was 2.3 trillion dollars. If we take away the two biggest stocks (Microsoft and Intel), then you have a picture in which the entire NASDAQ was worth two trillion dollars with a debt of 2.3 trillion. That's a little like buying a $200,000 house with a $230,000 mortgage. The NASDAQ decided to stop publishing this data right after Steve first reported it. The bottom line is the debt situation of U.S corporations is not good.

To look at the value of U.S. corporations, we take the current assets (i.e., what the corporation is worth if we liquidated everything within the next year) and subtract from that number its total debt. Why don't you try doing this for about 10 to 15 major U.S. corporations? Try some big household names like General Electric, Boeing, Google, Microsoft, or IBM, plus some stocks you might pick randomly out of the newspaper. For about 70% of them or more, you'll find that this number is negative. What does that mean? U.S. corporations have way too much debt and are in trouble.

**U.S. Consumer Debt.** And now let's look at the U.S. consumer debt, less you think that the U.S. consumer is any different that the U.S. government and U.S. corporations. U.S. consumer debt has reached staggering levels, going well over 2.2 trillion dollars by 2006. This is up from 1.3 trillion dollars in 1998. And if you count mortgages, it amounts to more than 10 trillion dollars. According to John Wasek, who writes for *Bloomberg*, consumer debt has increased over disposable income by an annualized rate of 4.5% throughout the decade of the 2000s.[3] The Federal Reserve showed that personal savings had dropped to a mere 2% of after tax income in the first part of 2003. By 2006, it had reached negative territory for the first time since the Great Depression of the 1930s. This is shown clearly by the graph from the U.S. Bureau of Economic Analysis given in Figure 2.

**The Debt Solutions**

So what's the solution? There are several. **First, we could be logical and politicians could stop spending.** The government could sell of some of its

3. John Wasek commentary. See www.bloomberg.com, January 17, 2006.

assets, such as some of its vast reserves of public land, and we might manage to get out of debt. Do you think that will happen? If you do, then the politicians you know are different from the ones I know. And since Americans themselves are not logical with regard to debt, how can we expect our elected representatives to be logical?

**The second solution is that we could simply default on our debt.** What would happen if we did that? Treasury bills would move from being considered "risk free" to worthless and our treasury bonds also would be worthless. The U.S. dollar would be worthless and our country would be bankrupt. Our country would have no credit because no one would lend to us. Thus, solution two is not a viable solution.

**The third solution is that we could have a massive economic collapse and a big depression.** During such scenarios our money becomes worth much more and things become worth less. If our money was worth more, then our 37 trillion debt might seem like 370 trillion and be impossible to pay without a default. This deflationary scenario is not likely at all. Our current Federal Reserve Governor, Ben Bernanke, made the following remarks to the National Economists Club in November 2002:

> "The second bulwark against deflation in the United States … is the Federal Reserve System itself. The Congress has given the Fed the responsibility of preserving price stability (among other objectives), which most definitely implies avoiding deflation as well as inflation. I am confident that the Fed would take whatever means necessary to prevent significant deflation in the United States and, moreover, that the U.S. central bank, in cooperation with other parts of the government as needed, has sufficient policy instruments to ensure that any deflation that might occur would be both mild and brief."

**And the Fourth Solution is to Inflate the Debt out of Existence.** Bernanke after saying that the Federal Reserve will prevent deflation at all costs, then goes on to say

> "…the U.S. government has a technology, called a printing press (or, today, its electronic equivalent), that allows it to produce as many U.S. dollars as it wishes at essentially no cost. By increasing the number of U.S. dollars in circulation, or

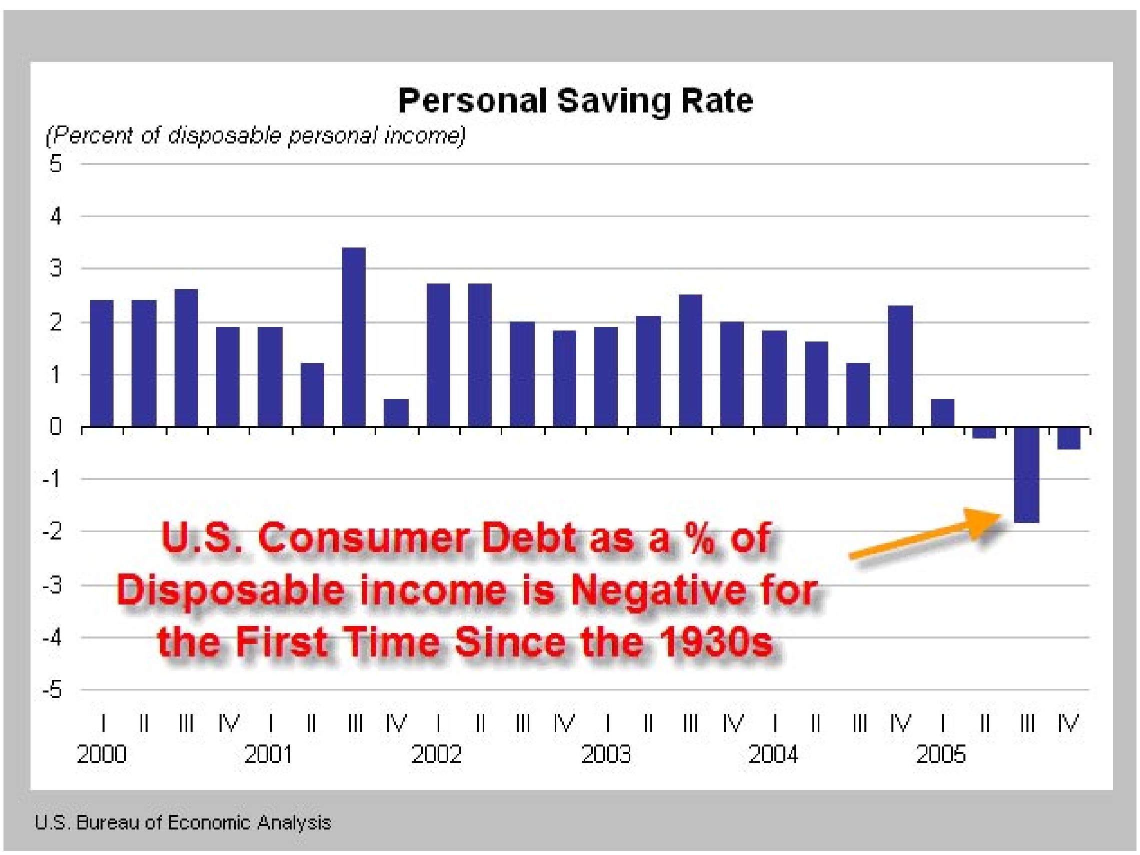


Figure 2: Personal Saving Rate as Percent of Disposable Income

even by credibly threatening to do so, the U.S. government can also reduce the value of a dollar in terms of goods and services, which is equivalent to raising the prices in dollars of those goods and services. We conclude that, under a paper-money system, a determined government can always generate higher spending and hence positive inflation."

Thus, Bernanke points directly to the most logical solution—we'll inflate our debt out of existence. Inflation really means that our money will become worth less and less.

My mother, who would be nearly 100 now if she were alive, could remember going to the movies when they cost five cents. I can remember, as a child, going to double feature movies (i.e., they actually showed two movies for one price) for fifty cents. All night drive-ins were even better, you could get four to six movies for a car full of people for a few dollars. Today you could pay $8 to $10 for a single movie ticket, and movie theatres make most of their money off of concessions, not the price of the ticket. Thus, it could easily cost you $20 per person for a movie, popcorn and a drink. That's inflation.

However, we've seen relatively mild inflation throughout most of America's history. The Federal Reserve actually targets having about 2% inflation. But what if inflation ran 100% per year as it has in some South American and Latin American countries? If it did, our debt would soon be worthless, as would the dollar. But we could always start again with a new currency. Such an inflationary scenario would be the mostly likely solution to the problem of a continually growing American debt. Our debt could be inflated out of existence. And under such circumstances, things would go up in value dramatically.

What would happen to the stock market under such an inflationary scenario? We had a relative high inflation during the 1966-1982 bear market. The stock market basically had a lot of volatility, but was range bound, with the DOW trading between 500 and 1000 for much of the period. During the entire period, stock prices went up a little, but stock valuations went down a lot and people generally lost money. And that could easily happen. By 1982, the price-to-earnings ratio of the major averages was in the single digit range.

**The fifth solution is that the dollar depreciates relative to other currencies.** The solution will make the balance of payments shrink to zero or even become positive, assuming that Americans stop spending as foreign goods become more and more expensive. As a result, it should be considered a possibility. This will generally occur as the U.S. raises interest rates because money moves to where it is treated best. However, high interest rates mean that our debt becomes more and more costly to service. So under that scenario, how would we get rid of the current accumulated debt or even manage it?

**What's Your Personal Assessment of Factor One?**

- Do you believe that government, business, and consumers in the United States can continue to spend at current rates without serious consequences?
- Or even if we stopped deficit spending right now, do you believe that we can get out of the current massive debt without serious economic consequences?
- If your answer to the first two questions is "no," then what do you think the economic consequences will be? Your answer should be part of the planning you do with respect to the big picture.
- If your answer to the first two questions is "yes," then how do you deal with the fact that our gross Federal interest payments are now 14% of the government's expenses (although they cheat on this and credit about half of it to social security)? If the deficit keeps growing, what will happen?

You have just read one of the six trading strategies that fit the big picture by Van K. Tharp. The full article including the five remaining factors can be found in Chapter 6 of the new edition of *Trade Your Way to Financial Freedom.*

# Tips & Tidbits from Van
## An Interview

by Van K. Tharp and Melita Hunt

**You've written a lot about your trading experiences as a young man and your desire to study the trading process because of the mistakes you made. Let's start with a brief overview of how it began.**

I have a Ph.D. in Psychology. I think that gave me enough sense to decide after several episodes of losing money in the markets that the losses might have something to do with me. As a result, in 1982, I began a research project to determine what qualities great traders had (that I lacked).

That same year, the *Investment Psychology Inventory* was born. Over the years more than 5000 people have taken that test. It predicts investment success based upon "where you are now." But, of course, nothing is set in stone. I've seen people who rank in the bottom 10% totally transform themselves.

Initially, about 700 traders had taken the test and they started asking me, "How can I do better?" I didn't know, but I knew how to find out. I became an NLP modeler and started modeling some of the best traders in the world to find out what they did. And over the next five years, I wrote a five volume course on peak performance trading, which has been the cornerstone of our business.

I've been coaching traders for about 25 years. I've modeled all aspects of trading from discipline to system development, position sizing, and even the wealth process. And we teach it all. There are many people that I've coached who have since made millions in the markets.

**When did you start trading stocks and have you ever traded full time?**

My first trade was in 1962. I bought 100 shares of a stock at $8. I watched it go to $20 and then down to zero. And on the way down at $4/share and at $2/share, I bought more. I broke every rule that I teach in that one trade. But there are some people who just say I picked the wrong stock.

Of course, after all of the transformational work I've done, I consider myself to be a good trader. However, I am not a full-time trader. I do manage my company's retirement funds, but I'm a full-time coach for traders and there is a big difference. If I were a full-time trader, that's all I'd be doing.

**Prior to starting on this trading coach journey, what other jobs did you hold?**

I did sleep research for the Navy and then I got into research on compulsive gamblers and sociopaths. Eventually, I was doing drug research with the emphasis on human performance, and I helped to standardize the sobriety test battery for NHTSA (National Highway Traffic and Safety Administration), used by the police nationwide. At the same time, I was working with the Los Angeles police helping them develop tests to detect people driving under the influence of drugs.

I later teamed up with another psychologist, a police sergeant, and a criminologist to create a company called DARTS (Drug Alcohol Recognition Training Seminars) that gave workshops to police all over California. That gave me a flavor of being self-employed, although I still worked for the research company.

**What, if any of this, prepared you for what was to become your vocation?**

None of it, other than knowing how to do research! Most of my work in the trading world came through NLP (Neuro Linguistic Programming). Modeling is what enabled me to work out the nuances behind people's beliefs, mental states and mental strategies, which make them do the things they do.

**So you started to look at trading seriously after you experienced your second big loss, which happened in 1982, exactly twenty years after your first loss. What is one of the first things you did?**

I read every book that I could get my hands on about the psychology of trading because I wanted to learn what the common myths were about trading—especially the psychological ones.

As I said earlier, the *Investment Psychology Inventory* was born in that first year. It is a profile test for traders and investors and is comprised of a series of 176 questions that gives insight into whether someone's personal life interferes with his/her trading success, whether his/her attitude supports his/her trading activity, whether the decisions he/she makes are done without worrying about what others are doing, how disciplined and patient he/she in his/her approach to the markets, and more.

**How did you start testing traders?**

Back then, most guys in the trading world were proclaiming doom and gloom, and a popular commodities newsletter was *The Reaper* by R.E. McMaster. McMaster took my profile and so did all of his clients. When that original bunch of 700 traders took the profile, it really launched my career.

**Did people share openly about their trading back then?**

I think a lot of people shared what they did, and their so-called "secrets," with me because I wasn't a trader. There will always be traders who think that if they have a good method that they should keep it a secret, but I think that over the years, through my teachings, I have pretty much dispelled that there are any "big trading secrets."

**Didn't some of them have proprietary trading systems?**

Back then most people truly believed that a trading system was a bunch of setups and entry indicators; they were therefore less receptive to learning what a trading system really was and how to create one to fit them.

Even today, most people don't understand trading systems, so in that sense they don't really have a system. And if they do, more often than not it's flawed. As I said, in my early days as a coach, most trading systems equated to a set of setup conditions for entry. For example, people thought CANSLIM (William O'Neil's setup conditions) was his trading system rather than just a series of setups—which is just part of the overall system.

**Is that why people lose money?**

Most people never get a reasonable system. If they do get a reasonable system, then they probably don't understand position sizing. And if they don't understand position sizing, then they probably make a lot of mistakes.

Let me explain it this way. Expectancy is the mean R-value of your trading system. Thus, if you have a trading system with an expectancy of 0.75 that gives you 100 trades per year, then you'd make 75R on average per year. That's a reasonable system. If you risked 1% per trade, then you'd probably make 75% per year trading that system…maybe even 100% with compounding.

However, let's say that you make one mistake each week and every mistake you make costs you 2R. That means that over the course of a year you've cost yourself 104R in mistakes. If your system produces an average profit of 75R per year, then the net result is a loss of 29R. I'd say that probably describes what happens with most traders that have a reasonable system.

They continue to make mistakes and don't learn from them, so their profits turn to losses.

**Which brings us back to the psychology of trading. The *Peak Performance Home Study Course* was eventually born from this modeling, correct?**

Exactly, it took me five years and over $200,000 to create that course, but it is timeless information that has helped thousands of traders and I trust that it will continue to do so well after I'm gone. The basic nature of humans is not going to change, so I just identified what mistakes people commonly make in trading. I also researched, studied and modeled what made great traders great, and put it all together in this program.

**Why is the information in home study course so important?**

Simply because it is the original model of what works in the trading process.

**How does your newsletter differ from other trading newsletters?**

I believe what I write about is timeless. People pay hundreds and thousands of dollars to get a trading system, and they will also pay big bucks to get a newsletter that provides them with current information about the markets or specific stocks or investments. All of these things are pretty soon out of date.

As I said, what I write is not obsolete on the week that it comes out; it has no expiration. I write about what is necessary for trading success.

**You have done a number of interviews over the years. Which ones in particular stand out?**

We would be here all day if we spoke about all of the interesting characters that I have interviewed over the years, but there are three that I have interviewed that questioned traditional norms in the trading world or given me insight as to how things work from the inside:

I have most recently interviewed Scott Brown in the article *How Academia Leads Wall Street Astray*. I interviewed Scott because he was well versed in the subject of "Tharp think" before he went to graduate school to get his Ph.D. in finance. In fact, I warned him that he would have to forget many of the ideas that he believed in order to survive in academia. My work is often the antithesis of what they teach in academia; however, Scott has studied both sides of the equation, and his opinions on many of the current theories in finance and how they feed the "Wall Street Machine" are quite charged.

Steven O'Keefe's interview was another that exposed me to a much different perspective on Wall Street. After doing numerous talks throughout Asia, I became more and more interested in the guidelines and rules that dominated institutional investors. Many of the concepts that I teach in the areas of position sizing and risk were not even known about and in some cases couldn't be implemented because of restrictions. This concerned me because of the massive amount of money that flows out of investors' pockets and into these firms on a daily basis. Steve has worked as both an analyst and a portfolio manager, and because he is no longer in the field, he was able to speak freely about his experiences with me and what actually happens behind the scenes.

Chris Weber was another interesting character. He accumulated a net worth of over $10 million from a starting point of $650 that he saved delivering newspapers. He has never had a traditional job and currently resides in a villa in the French Rivera. He has chosen to live a life of enjoyment and invests without being encumbered by the traditional standards of living and working.

**Over the 25 years that you have been a trading coach what would be the most significant changes that you've noticed?**

Years ago there were huge edges that don't exist anymore.

The most significant changes would be:

1. Internet trading, and the speed of transactions nowadays.
2. Cost of trading. When I started it was $65 to get into a trade and $65 to get out of a trade. In fact, when I counted my losses for that year, I had spent the equivalent amount (about $20K) in transaction costs.
3. Market makers becoming electronic as opposed to human beings. This will mean that the markets will become more efficient and less likely to be taken advantage of.

**On the flipside, many things have stayed the same—the fundamentals. What would you say are the main things that stand true for traders today as they did over 20 years ago?**

There are probably a lot more than this, but here's my list:

1. Trading is 100% psychological.
2. Trading is a business and should be treated like one.
3. It is imperative that you find a trading system that fits you.
4. Position sizing is the key to meeting your objectives.
5. This is a new insight that has evolved over the years, but basically, your trading system needs to be designed to get you a high system quality number. This means that the higher the number is, the easier it is to use position sizing.
6. People are programmed to do the wrong things, especially when it comes to money and trading.

**What is the most common but easily corrected fault you see in traders?**

One is the root of everything else: Make the assumption that you totally create your investment results. That way, if you are not meeting your objectives, you will look to yourself as the source of the problem and not the market or your broker.

**So if traders are responsible for their results, how do traders adapt to longer term market shifts?**

I think we're in a secular bear market that will last another 15 years. This doesn't say anything about what the stock market will do. It doesn't even predict prices. Rather a secular bear market means that I expect PE ratios to decline over the next 15 years. Secular bear markets usually end with single digit PE ratios.

Since 2000, we've only had one good up year, 2003. In 2003, the S&P 500 finished up 25%. However, during 2003 the dollar lost 40% versus the Euro and almost every stock market in the world outperformed the U.S. stock market. That is what typically happens in a secular bear market.

However, I think crisis means opportunity. You can go short the market when it goes into a prolonged down periods. Also ETFs now exist that represent most sectors of the market, different commodities, and even most foreign stock markets. However, the most dangerous place to be, in my opinion, is in mutual funds. When I first started trading, there were about 500 mutual funds. Now there are more mutual funds than stocks, so something has to give. And in a prolonged bear market, in which they must remain fully invested, a lot of them will just disappear. My guess is that 75% of them will be out of business by the time the secular bear market is over.

**Finally, tell us about the social side of Van. What else do you like to do outside of the trading world?**

I definitely enjoy poker but that probably still falls into the realm of learning about money, myself and the psychology of it all.

Outside of trading, I have a strong interest in spiritual studies; I am an avid stamp and art collector and a big supporter of the Green Bay Packers (I own some of their stock).

My wife and I enjoy going to theatrical productions and shows. I've always been a big music and dancing fan and will try everything from the ballroom to the disco dance floor—just because I like the beat. My favorite music would definitely be jazz, especially big band and the old Dixieland stuff.

I have a son Robert from my first marriage, he lives in San Diego and although he has been a trader in the past, he now has a successful on-line business and social training business.

I have been married to Kala for 14 years and our niece, Nanthini, from Malaysia lives with us. She is like a daughter and we are putting her through college.

**Do you have any last quotes or words of advice that you would like to add?**

First and foremost, I just want traders to know that it isn't hard to create a system that will generate 80R, which is 80% a year (if you risk 1%). The important part to realize is that every mistake that you make can cost you 2R, and your profits can just slip away. So the ultimate goal is to make as few mistakes as possible.

If you create a good system and do not make mistakes, you can make a decent living trading.

I wish you success on your trading journey.

# Spring Clean Your Trading

## Ten Important Questions to Ask Yourself

By
Van K. Tharp, Ph.D.

In many of our programs, including the Super Trader Program, I give my clients a long questionnaire to do an evaluation of themselves. Some of the feedback that I get is that taking the test is like doing a Ph.D. program. As a result, I won't be quite as hard on you. However, I consider that answering the ten questions that I present below to be a minimum starting point for doing a thorough Spring cleaning of yourself. So read over the questions and plan to spend at least an hour on each question – a day is even better. And then, once you've done that, I'll give you a number of steps that you can take to improve yourself.

### *Question 1:*

What are seven key psychological areas that you need to work on or are currently working on? Don't say none, because that answer really suggests that you are totally unaware of what is going on with you.

We basically live in a society in which we are programmed to feel separate and alone from everyone else, programmed to follow the rules of the games that others invent for us to play. The net result is most people do the exact opposite of what is necessary for success. As you become aware of this, you'll also become aware of all your patterns, beliefs, and emotions that you need to work on or clear to become more successful as a trader.

Here are some examples that might fit some of you:

· I really have a fear problem that enters into my trading. I want to make trades but I'm afraid to pull the trigger. And that fear seems to come up in other areas too, I guess I'm really afraid of failure.

· I have some internal conflict when it comes to working on myself. On one hand, I want to, but on the other hand, I'd rather do other things. Working on myself feels like having a tooth pulled. For some reason, I just don't want to do it.

· I really don't like to be alone. When I do all of the things that are important to trading success, like the psychological cleanup, I have to go inside and search and that really disturbs me. Also when I try to meditate, things come up that I'm afraid of. (And, of course, if you had this response – I'd want you to at least find out what's trying to come up that you are so afraid of).

· I don't have any discipline. Sometimes I just decide to trade. I make almost random trades or take recommendations that I've been given, but just certain select ones that appeal to me. And the net result is that those trades never seem to work out. (Note, this is also an incomplete answer. What is the selection process? What happens to those trades? Do you cut losses and let profits run? Are you compelled by some emotion to trade?).

· My mother continually criticizes me. My mother gave me everything when I was growing up, and I'm very grateful to her. But she's always telling me what I do wrong. In fact, it upsets me to be around her. Yet at the same time, I feel that I must support her. I need to find out why her criticism bothers me so much and what I can do about it.

Those five statements are just examples of what might come up for you. But whatever you find…look thoroughly. What's really going on? What are the emotions you don't want to feel? What are the hidden beliefs? What is the internal conflict where part of you wants certain things and another part wants something else? Who are the parts and what are they trying to do for you?

### *Question 2:*

Do you believe that you are responsible for everything that happens to you? Please explain your answer.

I consider personal responsibility to be the most important trait that a good trader (or a successful person, for that matter) can have. Most people believe that they are victims in life and things are always happening to them. For example, most investors believe that they were victims of the 2000-2002 stock market crash. They believe they were victims of corrupt analysts, corrupt CEOs, corrupt brokers, and a corrupt system. I've even seen billboards saying, "Did you lose over $100,000 in the stock market? We can help you get the money back." And, of course, the billboard is sponsored by an attorney. People who believe that they are victims, of the stock market crash, or of anything else for that matter, tend to repeat the same mistake over and over again. On the other hand, if you ask, "How did I create that?," then you can begin to uncover the mistakes you made.

And, by the way, what happens if another crash is right around the corner? Are you ready for it? Or are you expecting another 10 years of market mania? Can you profit big time on the downside as well as on the upside? Or are you going to repeat the same mistakes all over again?

Now, search your mind for the three worst things that you think ever happened to you. First determine how you were a victim. What happened to cause those events? And now re-answer the question. How were you being to cause the events to happen? What belief caused those events to happen? What did you do to cause those events to happen?

## Question 3:

What is a mental state and what mental states have come up for you repeatedly over the last five years? A mental state is something like fear, anger, jealousy – some emotion that you feel. And the question you should ask yourself is, "What mental states do I repeat over and over again?" If you don't know, then for the next three days, ask yourself once every half hour, "What mental states have I experienced during the last half hour?" If you are not very aware of what your mind is doing, you might find this exercise quite surprising.

Your job in this exercise is to come up with at least five mental states that you repeat over and over again – and even once a month is a repetition. If you can find more than that, great, list them all. And, once you've listed them, ask yourself, "What happened in my life to first cause this emotion to appear?" And to really do this exercise well, get at least five emotions and the root cause of each written down.

## Question 4:

How stressed are you and what causes that stress? Stress refers to the wear and tear on our mind and bodies by the "demands" of life. There are 5 key areas in life where situations and events occur that you might perceive as stressful: 1) Your Personal Life 2) Financial Life 3) Health 4) Job 5) Family Life. So it is important that you periodically evaluate what is going on in your life. Conditions can change dramatically and suddenly and these changes can affect your trading before you know it.

You need to determine how stressed you are and in which particular areas and then create a program for stress reduction if required or if you are not particularly stressed, then what is your program for increasing your stress protection?

Book Two of my Peak Performance Home Study Course is completely devoted to the subject of stress because of the impact that it has on trading. I encourage you to work through the tests and surveys in that book to really ensure that you have your stress under control.

## Question 5:

How do fear and greed affect traders? You can answer this two ways. First, there is detailed information about this topic in the Peak Performance Home Study Course. You can go through that material and summarize it in response to this question. That would probably be a good exercise for you to do.

Next, do a survey of your own trading. How does fear and greed affect you? What typically comes up for you? What happens to you periodically? If you've kept trading journals, then go over your trading journals for the past year or so to look for how fear and greed might have entered into your trading. If you don't have any trading journals, then ask yourself, why not? Your answer may provide some good input to question 6.

## Question 6:

What are your five biggest sources of internal conflict? Some of you may know the answer to this question already, whereas others may have never even considered it before. If you know the answer, just list all of your sources of conflict. You don't have to limit it to five. For each source of conflict, identify the part of you that is involved (see book three of the Peak Performance Course to learn more about parts) and what it's positive intention is for you.

If you cannot think of five sources of internal conflict, then answer the following questions, and you'll probably find lots.

· What's your financial freedom number? If you don't know, why not? If you do know, what steps have you taken to move toward financial freedom? If the answer is none, why not? Do you want financial freedom? And if you don't know anything about financial freedom, then read the first section of *Safe Strategies for Financial Freedom*.

· Have you completed a thorough business plan for your trading yet? Yes, we have a section on that in this newsletter, but the question is, have you done it? If you've been exposed to my materials, you should know that its important. So what's stopped you?

· How many of my educational courses are sitting on the shelf at your office or home unused? You purchased them, so why haven't you started doing the work yet? Or better yet, how many of the home study programs have you gone through that recommended that you take certain actions. You read about what you should do, but you have not done them yet? Why? Why not?

· Let's say you have the Peak Performance Course, our core product. You actually went through it once and it took you several months. (If you have it and have not done anything with it, then go back to the last question). Now, go through it and notice all the exercises you skipped. Why did you skip them? Why not do them now?

· What's been your reaction to doing these questions? Have you just read them over, but not started doing them? Do you plan to do them? When do you plan to start? Why not now?

I can't imagine that answering those questions, won't give you a big start in discovering some of the internal conflict in yourself – at least, for most of you. Anyway, questions such as the ones I presented should give you a big start in determining your sources of internal conflict.

If you'd like more, then make a list of five to ten things you want to be, do, or have. If those things are not in your life now, then what stops you? What's the part of you that wants them and what is it trying to do for you? What's the part of you that stops you and what's it trying to do for you?

## *Question 7:*

What are your key beliefs about the markets? It is important for you to remember that you can only trade your beliefs about the market. So what are the key beliefs that are guiding you?

To really understand what's guiding your trading, you should list at least fifty beliefs. However, I'll accept at least ten as a good starting point. And to help you get started, I've listed twelve of my most important beliefs about the market. Some of these are core principles that I teach everyone and some of them are just things that fit me. Also I just came up with twelve off the top of my head. You'll probably need to discover at least fifty beliefs to thoroughly cover the key principles that guide your trading.

1. Cut your losses short and let your profits run!!!!!!
2. Risk, as it relates to how much you can lose in a trade, is much more important than risk as it related to how much volatility you can have. Both are related though.
3. You must understand the R-multiple distribution of your trading system and the average R it produces (expectancy) and the variability of that distribution (i.e., how volatile it is).
4. You must know the objectives you wish to accomplish. What would you like to accomplish and what can you tolerate in terms of drawdowns? In my case, I'd like to make 10% per month in my trading. I frequently make 5-10% a day, and I'm willing to tolerate drawdowns as much as 10% per day. You might think that's a bit risky, but I will thoroughly investigate my trading performance if I have any losing months and I've only had once since last August.
5. To achieve your objectives, you must understand and use position sizing to your advantage.
6. Fill your portfolio with a core position that you might adjust weekly or monthly. However, then find efficient stocks and use leverage with those stocks to achieve peak performance. (Again, remember that these are my beliefs and they might not fit you.)
7. When I have a large down day, thoroughly investigate what happened and how I might have caused it or made any mistakes.
8. Keep a trading diary on every trade.
9. Follow the ten tasks of trading.
10. When I cannot be actively trading, remove all speculative positions.
11. Understand the risk reward of each trade before you enter it. For example, your potential reward should be at least three times your potential risk.
12. Keep stop loss levels with my core positions and actively monitor the market for my speculative positions. (Again, this one is my personal preference.)

I want to caution you again that these 12 beliefs are my personal beliefs. Your beliefs might be different. However, certain beliefs are universal for good trading. These include beliefs 1-3, the first part of 4 (knowing your objectives), and 8-11. The rest are a bit personal for me, especially my objectives.

## *Question 8.*

What are your key beliefs about yourself and the universe? These form the basis for who you are, so they are important to really understand yourself. Here I recommend you list 10-12 core beliefs about yourself and your universe, but fifty would be much better. And once again, I've listed ten beliefs of mine as examples, to show you what I mean.

1. I create my own results and if I don't get the results I want, then I look to myself as the source of those results.
2. I am a spiritual being who is working on realizing his potential. However, I have many things to work on and it's a never-ending journey as long as I'm in the universe that is governed by time.
3. There are many paths on this journey.
4. It's important to follow my bliss. If it doesn't give me joy, then it's telling me that I'm going in the wrong direction.
5. What I do with my body relates directly to what my mind experiences – this includes what I eat.

6. God is my source and the source for everyone else. This means we all have unlimited potential.

7. Since we are all one, what I give to others is given to myself.

8. My purpose is to help others awaken (i.e., what this article is about). And by doing so, I'll help transform the world.

9. The best way to transform the world (i.e., what I see and perceive) is to transform myself.

10. What I believe is a filter to my reality – it's not REALITY itself. Therefore, I need to periodically assess my beliefs and see if they are useful.

Your beliefs are very personal, and they really are the filters of your experience. So isn't it a good idea to discover them for yourself?

## *Question 9:*

List your top values. I think this is a way of telling you to do the value elicitation exercise in book three of the Peak Performance Course. This is perhaps the most important exercise that you can do in your life, because your values totally shape who you are. So why not take a look at how you are programming yourself. What's important to you?

In addition, you might want to also do a negative value elicitation. For example, some people are more prone to move away from certain values. Their life is motivated by avoidance of what they don't want than by moving toward what they do want. And if this is you, then I'd suggest that you start looking at what drives you on the negative side. This means looking at your negative values. What do you most want to avoid? And since we all have both approach and avoidance tendencies, perhaps it's important for all of you to do both a positive and negative value elicitation exercise. Which probably gives all of you a lot more to do with this exercise.

## *Question 10:*

How much coffee do you consume each day? How much alcohol do you consume each day? How many cigarettes/cigars do you smoke each day? Do you have a problem with drugs – even prescription drugs? How many soft drinks do you consume each day? How much bread or pasta or wheat products do you consume each day? And how about sugar? How much sugar do you consume each day?

**Now that you've done a self-assessment, what's next?**

So what's the next step for you now that you've done a self-assessment? First, take a look at your self-assessment and make a list of the top ten things you need to work on to improve yourself. And once you have your list, prioritize it. What's most important for you? What's the second most important change you need to make and so on?

Now decide upon the best course of action to do the work. Perhaps you have the Peak Performance home study course and you can just look up the techniques you need to make the changes you want. If that's the case, go ahead and do that and then make the changes. If you don't have the Peak Performance Course, then I strongly recommend you get it.

Here are my topic suggestions for helping you through the changes you want:

1. The Peak Performance Course contains many techniques for making change. If you already have it, I'd suggest that you review it for ideas. You'd be surprised what you might find.

2. This solution won't get you specific changes as you want them, but it will change your life if you at least do the first 75 exercises. What I'd suggest that you do is the workbook from *A Course In Miracles*. These consist of 365 exercises that you do – one a day for a year – although few people get through it in a year. The exercises are some of the most sophisticated exercises I've seen. And they will change your life. It took me four years to finish that course, but by the end of it, I was on a totally different path and I had my own business. Incidentally, the exercises have a strong religious tone. However, don't let that put you off. You don't have to believe any of it for it to make a difference – you just have to do the exercises.

3. Another book that's very useful for self-improvement is a book by Leslie Temple Thurston called *Marriage of Spirit*. There are many exercises in this book which are also life changing. Incidentally, the Van Tharp Institute sells both *A Course in Miracles* and *Marriage of Spirit.*

4. My fourth suggestion for improvement is to take the Peak Performance 101 Workshop. This workshop, conducted entirely by me, will help you get through many major roadblocks and you'll return with an entire arsenal of tools to work on yourself. It is our core workshop.

5. One last suggestion would be to do transformational consulting with Dr. Carol Adams, which we offer through the Van Tharp Institute. I completed her program myself and I've found this work to be very useful and I think you will feel the same way.

Most importantly, just start somewhere. Being the best trader you can be means that you will continue to learn about yourself and the business of trading as you evolve.

# Developing a Business Plan

By
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There is so much that you need to remind yourself about peak performance trading that I recommend that you develop a thorough business plan as part of your spring cleaning. And even if you are trading well, I still recommend developing a planning tool. Those who are doing well will just have a little less work to do.

In my opinion, your business plan should cover all of the following areas.

- Your vision.
- Your purpose.
- Your objectives.
- A thorough self-assessment of your strengths and weakness based upon real trading logs that you collect (if you haven't done so already).
- A thorough assessment of the big picture and the fundamentals that might be behind any trend.
- A complete understanding of your beliefs about the market.
- Procedures for getting empowering beliefs and mental states behind you.
- A documentation of your research procedure for developing new systems and determining how to analyze their effectiveness.
- Your procedures for developing and maintaining discipline.
- Your budget and cashflow systems.
- Other necessary systems such as marketing, back office record keeping, etc.
- Your worst case contingency plan.
- System 1 – which is compatible with the big picture.
- System 2 – which is also compatible with the big picture.
- System 3 – which might come into play should the big picture change.

If you have all of those things, then you have a chance of doing well. But this means that your business plan becomes a tool for you to continually use to improve yourself and your trading.

## Vision and Purpose:

One of the keys to real success in trading is commitment. Before I coach a trader, I look for commitment. Those who are not committed to do what it takes, usually commit financial suicide when they try to be full time traders. Now, I have no idea how to give people commitment. It's more like something they are born with – not something I can coach.

The key to commitment is to develop your vision and purpose. Your vision is your dream life. What do you really want to accomplish, be, and have in your life to know that you've done your best? What is your dream life? I'd write this out in detail.

And you also want the purpose behind the dream life. What are the whys in your life? This is what gives it the real motivation and commitment. Why do you want the things you want? Write down as many whys as possible. You'll know you have it when you are so excited about your dream life that you must do something right now.

## Objectives:

Most people don't think too much about their objectives, what kind of returns they want and what kind of drawdowns they are willing to accept. But you cannot develop any sort of trading system (or at least one that you'll be happy trading) without knowing these things. For example, you might decide that you want to make at least 20% and have a peak to trough drawdown of no more than 10%. That's a reasonable objective. But it's totally different from someone who says I want to make as much money as I can and not worry about drawdowns at all. Both would have entirely different objectives.

Different objectives call for different position sizing algorithms in order to achieve those objectives. And there are an unlimited number of possible objectives. Thus, you must give a lot of thought to this and put it into your business plan and stick to it. Once you have objectives, you know where you are going and you have a chance to get there.

## A Thorough Self-Assessment:

You've got to design your business plan around your strengths and weaknesses. If you know your strengths, then you can design your plan around that. If you know your weakness, then you can design a plan that minimizes the impact of those weaknesses and also has ways for you to improve yourself. However, when this information is missing, then the potential for disaster is huge.

I've already suggested this as part of your spring cleaning, so you should know what to ask yourself and what to think about.

Can you develop a system? Are you able to deal with adversity well – like many consecutive losses as one might have in a system? You know yourself much better than I do, so you need to list your strengths.

## Knowing the Big Picture:

In my experience working with traders since 1982, I've seen many major trading fads come and go. I've seen when futures were hot or when currencies were hot or when stocks were hot like in 1999. But all of those trends come and go. And people who find trading methods that work when they are hot, go out of business when the trends disappear. My suggestion instead is that you understand the big picture and have a method that tells you what's going on. You also need various strategies that work as the big picture changes.

For example, in *Safe Strategies for Financial Freedom* we have models that tell you about the stock market, inflation, the dollar, real estate, and many other things you need to know. All you have to do is keep track of the models. When the models shift be ready to change strategies.

For example, the stock market shifted to "yellow-light" mode in April 2002. It shifted back to red light mode at the end of June. Both changes, signaled major changes in strategies. And you need to have the strategies ready and understand why.

One of the biggest reasons people get hurt is that they don't understand when the big picture changes. In fact, they are most likely to get involved in the wrong thing when the big picture changes.

Thus, this simplest way to protect yourself is to have models that reflect the big picture and that don't change too often. But when they do change, you need to be ready to change.

## Market Beliefs:

Again, I've already suggested that you do this as part of your spring cleaning. What are you beliefs about the market? What are your beliefs about yourself?

My point is that you need to list ALL of your critical market beliefs in this section. And don't be afraid to have a 10-50 page document listing your beliefs about the market if you are seasoned.

## Get Empowering Mental States and Beliefs Behind You.

There are certain beliefs you need for success. Volume 3 of the course tells you how to put those beliefs in your favor. Thus, what you need to do in the next section of your business plan is determine what those mental states and beliefs are and how you'll get them to work for you. It's primarily to reinforce this critical aspect of your discipline.

## Know How Each of Your Systems Work:

First, you need to know how your system works, why it works, and how it fits with the big picture. Tom Basso once said that the better you understand your system, the less testing you'll have to do with it. Second, you need to have a systems development procedure like we recommend in the system development workshop. And, third, you need to make sure that you have all of the critical parts of the system covered. These include:

i. Objectives
ii. How System Fits the Big Picture
iii. Entry Set and Conditions
iv. How Initial Risk (1R) is determined
v. How to Take Profits
vi. Position Sizing

Fourth, you need to know how to evaluate the system. We personally recommend that you collect enough R-multiples from your system (at least 50) and work out your expectancy. That will tell you a lot about what to expect with your system.

And, lastly, but most importantly, you need to know when your system is broken. This would occur when you exceeded a certain drawdown, a certain level of losses— measures of this sort that you need to predetermine.

## Personal Discipline

There are three aspects to personal discipline. The first involves doing the ten tasks of trading on a regular basis. These tasks allow you to program yourself at the beginning of the day, and allow you to fix mistakes, and know when you are getting in the way. So if you are doing them on a regular basis, then you are doing a lot. There are four major psychological tasks involved and you need to have checklists in place for each of them. They include:

1) a daily self-analysis;
2) a daily mental rehearsal;
3) a daily debriefing; and
4) periodic review.

Also, include a daily schedule for doing this.

Next, you need a top down approach to discipline. It starts with your vision and purpose. From there you develop three to five different plans that will bring you closer to your dream life. These could be goals, but the goals are usually so big that the often involve major plans. For example, this year my four action areas were 1) to dramatically grow the business (and this one had five sub areas); 2) to develop much greater personal discipline; 3) to develop a stronger spiritual guidance; and 4) to improve my health. As you can see, none of them were simple and each required a separate plan.

The third aspect of discipline is to know the conditions under which you'll avoid trading and get out of the market. Have a list of them and be ready should one occur to make a hasty exit.

For example, if you are going through something that could be psychologically upsetting like a divorce a move, a major illness, a lawsuit or even the birth of a new child – all these things can have a major impact on your trading. You need to be ready for them.

## Budget and Cash Flow Systems:

Every business has many systems and by system I mean something that is automatic that really helps people know what to do when running a business. For example, a fast food restaurant will have systems to help you greet customers and serve them within a minute. They will also have systems for preparing food, for cleaning up, for managing cash flow, for dealing with problems that arise, etc. And your business of trading needs such systems too.

The most important of those systems has to do with your cash flow and budgeting.

What is it going to cost you to run your business? What does equipment cost you every month? What does Internet connectivity cost every month? What do you pay for data? What do you pay for education? How about subscriptions? What else is part of your regular monthly outflow… how about research time or perhaps just your salary?

All of this should give you an idea of what you need to make every month to have a profitable business. What is your hourly wage as a trader? Are you making below minimum wage? What is your salary? This should be answered (or at least well planned) in a very detailed manner in your business plan.

## Customer Relationship System

(Even if Your Customer is Your Spouse).

When trading for others, you will need to get customers – thus, you'll need some sort of marketing of your business. How will you legally let people know about what you can do for them. That should be a complete plan or at least a section of your business plan.

Next, you will need to know how to keep your customers happy. How will you deal with customers who call you on a regular basis with questions about your trading? That can be a real distraction. What will you do on a regular basis to minimize the need for your customers to call you? For example, you might want to have a newsletter going out to them weekly or monthly. How will you report results to them? How will you manage things when your results are poor? And just as importantly, how will you manage things when you do well and your customers get excited and want that performance to continue. These questions should all be answered as part of your planning.

Next is your back office. How will you keep track of your customers? How will you send statements to them? How will you keep track of your performance – especially if you have a lot of individual accounts you are managing? How will you do bookkeeping? How will you manage your data? What if you have errors in your data? What if you have errors in your trade fulfillment? These are just a few of the questions you'll need to answer with respect to your back office. You'll need to plan for this.

## Worst Case Contingency Planning.

The idea behind a worst-case contingency plan is to brainstorm to think of what could happen and approach it as a creative exercise. If you do it from that perspective, there is really nothing negative about it.

The purpose behind it is to prepare yourself for what could go wrong. The market will usually find something that you are not prepared for and give you a great test of your fortitude. When this happens, and you are not prepared, you become stressed and your brain shuts down. Typically, you respond in a very primitive way, but with a lot of energy. For example, you might scream loudly. However, this does you very little good and hurts your account.

First, brainstorm everything that could go wrong. You might find that such problems fall into five broad categories. The first category would be personal emergencies. For example, one of my clients has a personal emergency and left a number of open positions to go deal with the emergency. When he returned, he came back to a financial emergency!

The second category would be disasters with the market that are not expected. Examples of that nature might include the 1987 crash – no one expected the S&P 500 to move 20% in one day, but it did. It might also include events like 9/11 when the stock market closed down for a substantial period of time.

We actually had a training for our old super trader program that was like playing war games and was designed by someone who used to design games for one of the U.S. intelligence agencies. In that training, we had a scenario in which the World Trade Center was blown up. The reaction was: "This is so unrealistic, nothing like this would ever happen." But it did – and within about five years.

The third category should include equipment and data problems. What if something happens to your computer? What if something happens with your software – especially if you don't know its happening? What if something happens to your data? What if you get faulty data and false signals? What if something happens to your phone or your Internet service?

You need backups for all of these sorts of things.

The fourth category might be major things that would cause a major problem in trading if you are not well prepared. These events include:

1) having a baby;
2) going through a divorce or a major breakup with a loved one;
3) moving your office or your home;
4) a personal or family illness;
5) a personal or family death; and
6) anything else that might be a major distraction such as a lawsuit.

These tend to occur over a long period of time and you need to plan how you'll respond to them. Sure, you can just stop trading. But perhaps there is also another way if you work it out and practice it.

The fifth category for this section would be various types of psychological problems that come up. This really fits under discipline, but here is where you plan for it and make sure it doesn't wipe you out.

The last category has to do with your broker. What kind of performance should you expect from your broker. What will you do with errors? Bad fills? A broker who questions your judgment? All of these are items you should consider.

First make a list of everything that occurs to you in each of these categories, plus miscellaneous – anything else. Plan on having at least 100 items or your list is probably too short.

Second, once you've generated your list. Now come up with three ways to deal with each situation. So if you have 100 items on your list, you need 300 solutions.

Third, now determine which solution is the most effective one for each problem and rehearse it thoroughly until it is second nature to you. This is the real value of worst case contingency planning. The more you can rehearse globally, the less you'll have to deal with in a daily mental rehearsal.

Most people prefer to ignore this section of their plan, but it really is the most important.

And sometimes good things can be a disaster. In my company business plan, I once considered that one of the worst things that could happen would be a large order that might take me several months to fill because I didn't have enough stock. People often don't think about how "good news" could be a disaster.

## Develop 3-4 Systems

It's probably good to have at least two good, non-correlated systems that fit the current big picture. If they are non-correlated, then you'll probably continue to make money.

For example, in *Safe Strategies for Financial Freedom*, two non-correlated systems that would work when the market is in red light mode are the bear market mutual fund strategy and Graham's number stocks. When the market's going down, you probably won't make much from your undervalued stocks, but your mutual fund should do well. And when the market rallies, you'll start to make money in your undervalued stocks. Thus, both strategies work well together. In fact, you won't get many undervalued stocks until the market is way down anyway and ready for a rally.

I also recommend 1-3 other systems for when the market changes. For example, if you are an equity trader, you might do efficient stocks.

## Position Sizing and Risk Control

These are the most important aspects of your system. If the system doesn't work, then you should know when to get out to protect your capital. And you should always limit your exposure to make sure you don't lose too much of your capital. These are really fundamental rules of trading well.

And on the other side of the coin, you should know how to step on the gas with position sizing should the position go in your favor. This would favor certain types of scale in position sizing. Thus, you are cutting your losses and letting your profits run through keeping (and adding to) a winning position.

For more information about business planning, I strongly recommend our business planning CD series. And as a bonus, we have some started plans in there that you can review, adapt to your own situation, and use as a template for developing a thorough plan that fits you.