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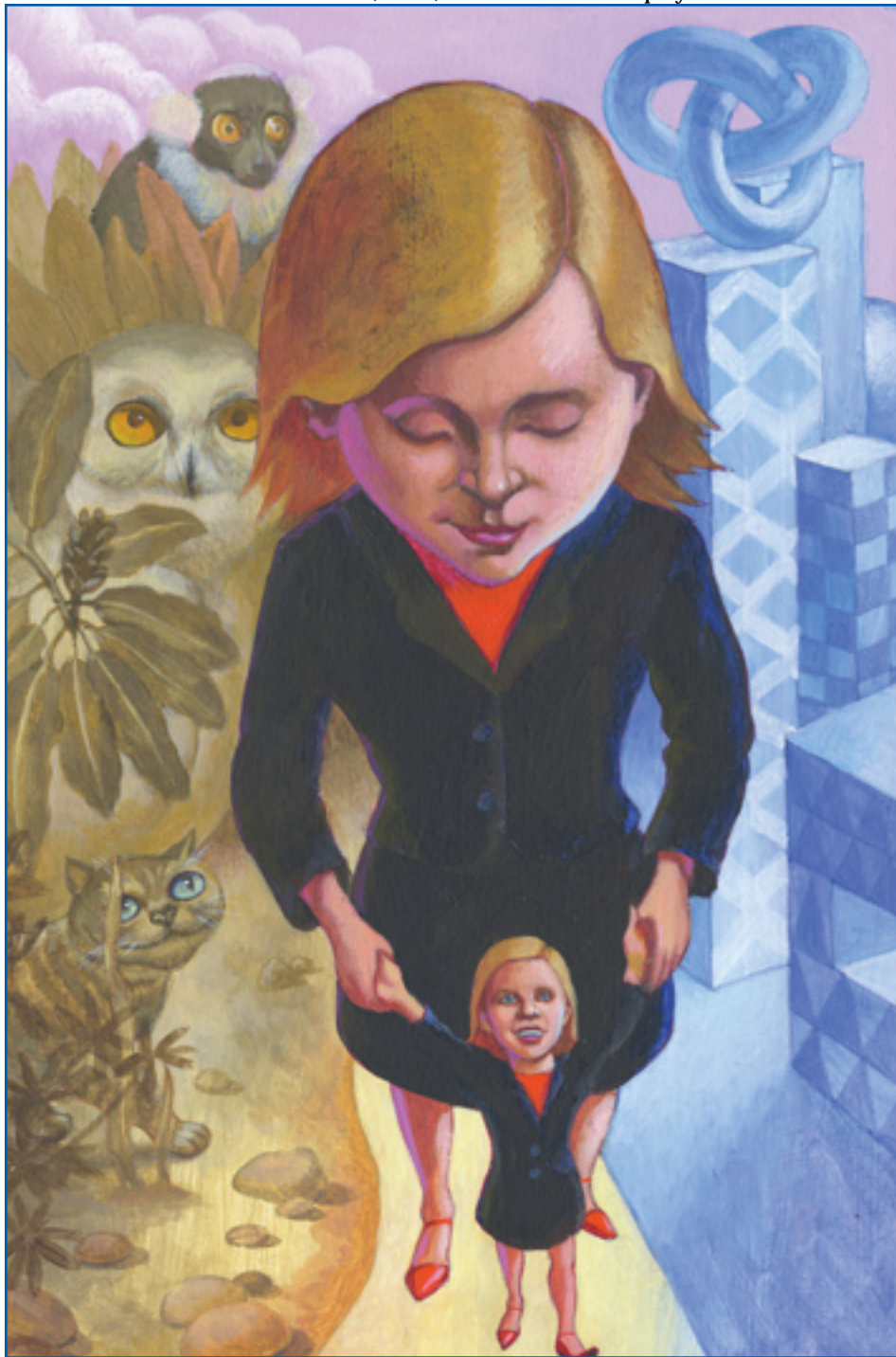
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INGA POSITIVUR

Succeeding As A Trader

Take The First Step

So you want to become a trader? Don't miss the critical first step that can make you the trader you want to be.

by Tom Hamilton

S

urely after reading a few books and taking a course or two you'll be ready to be a profitable trader. Unfortunately, most people entering the profession of trading will give up or go broke within the first year. It's not because they read the wrong

book or used the wrong software; rather, it's that they skipped the first step: Knowing themselves. Professional traders and money managers understand that they have to find and adapt a trading strategy that will work for their own personality before worrying about the details of hardware, software, and indicators.

DISCOVERING YOURSELF

The critical step often missing in the process is the step of self-discovery. You must first understand how you think, how you learn, and what you enjoy. Without this knowledge, the process of researching a successful trading strategy is next to meaningless and you will likely suffer a high degree of failure before you even begin. Trading is one of the few careers where you do not need to demonstrate competency in it. Doctors, lawyers, electricians, and pilots, for example, all have to do so. With trading, however, you'll be going up against someone with more experience and more knowledge than you have, and that's how you gain competence.

So let's start with the first step, an understanding of yourself.

THE RUSH FOR ANSWERS

Traders who look at different portfolio management techniques can quickly become convinced that active technical analysis is the best practice for their portfolio. Active technical management techniques can set them apart and give them a competitive edge. Opportunities are limitless, and so are the options to consider. But how do you manage such a portfolio? Many well-intentioned traders go right to executing tactics and skip any review of strategies. For this article, the definitions of strategy and tactic are:

Strategy: A plan of action toward an objective or goal. A strategy is the study of how different decisions and transactions are linked together, such as long-term planning of a portfolio and investment model objectives.

Tactic: The tools employed in carrying out an immediate objective. A tactic is the conduct of an investment decision. It has short-term significance and is characterized by skill.

Before applying tactical tools to the portfolio, you must first determine strategy. By focusing on the formula for making the trade, you forget about the objective of the portfolio model. An example would be a system that has proven to provide a 45% annual return, with a 5% maximum drawdown. This is very attractive and may be something you should add to your toolbox.

But there's more to it. The system can't be completely automated; it is subjective and requires you to sit in front of a computer monitor during market hours, six and a half hours a day. Still interested? Some traders may be, while others will not. This model may fit your management strategy or personal objectives, or it may not. You may find that it is a failure for you because you can't provide the time or attention it needs, while another trader may be able to and succeed with it. Is it the fault of the system (that is, investment tactic) or just a poor strategy?

A key factor in your strategic thinking must be how you work and operate. An important factor in the success of a trader is how he/she operates within the chosen investment strategy. Having an outstanding system is not in itself a guarantee for success if it cannot be implemented properly.

Now let's investigate how traders can determine strategies for their trading in order to give them the best opportunity for success.

We look for answers or perhaps a special formula that was developed by some well-known trader. We think we can succeed with just a few good systems, but the problem is we are all different; there is no single solution.

The key is to discover which ones are a match for you and your trading style. There are ways to determine which of the many investment theories and approaches would work for you, but you need to take the time to understand yourself first.

FINDING THE PATH TOWARD A STRATEGY

Since we are all unique, we need to find our own paths to define the strategies that we can use to effectively manage a portfolio. The first step in this process is to set aside some time to assess yourself. Two exercises allow you to do so: a personality profile and a left brain/right brain information processing assessment.

Our personalities and preferences are major factors in determining how we behave. They also have an effect on how we approach problem solving. The results of these exercises will give us insight to what type of portfolio strategies we may be most successful with. It is important to think honestly about ourselves, what we like, and what we don't. Jot down notes. Find a quiet time when you won't be disturbed.

One thing for you to consider is how you function in a social activity. Do you prefer to interact one on one, in small or large groups? What activities do you find creative, relaxing,

Before applying tactical tools to the portfolio, you must first determine strategy.



or stimulating? Are you interested in taking on one task at a time or many? What activities do you enjoy or avoid? What classes did you enjoy or dislike in school? Are you happy to work toward a goal with a deadline? Are you organized or messy? All of these, and more, make up your personality.

Personality profile assessment: I recommend taking a personality profile test to help identify characteristics so you can determine compatible investment strategies. This evaluation will ask questions about how you work and what you prefer to do in various settings. One such site to take such a test is www.outofservice.com/bigfive/. It will give you a percentile score in the OCEAN personality model (openness to experience, conscientiousness, extroversion and agreeableness).

The results will give you insight into your creativity, organization, sociability, interaction with others, and nervousness/relaxed states. Responses will be evaluated in the areas of logical/social, reserved/outgoing, and tried & true/new & different. There is no right or wrong answer. You will combine these results with the next exercise and begin to see a pattern.

The next area to review is how you learn things and react to new stimuli. This is a major factor in what makes you different. The left brain/right brain theory explains how your brain functions. Research indicates that the brain is divided into two main hemispheres. Each specializes in different functions and processes information differently. This, in part, defines how you deal with problems. The left part of your brain processes



"The 'I hate Wall Street' is a problem. How come Martha Stewart did time, but bankers and brokers seem to have a kind of sovereign immunity?"

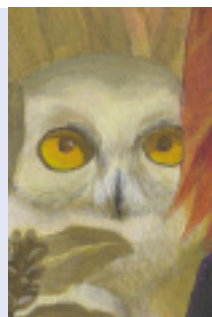
more logic and analysis functions, while the right part of your brain processes more emotion and imagination functions.

Left brain functions

- Uses logic
- Detail oriented
- Facts rule
- Words and language
- Present and past
- Math and science
- Comprehension
- Knowledge
- Acknowledgment
- Order/pattern perception
- Knows object name
- Reality based
- Forms strategies
- Practical
- Safe

Right brain functions

- Uses feeling
- Big picture oriented
- Imagination rules
- Symbols and images
- Present and future
- Philosophy and religion
- “Gets” it (that is, meaning)
- Believes
- Appreciation
- Spatial perception
- Knows object function
- Fantasy based
- Presents possibilities
- Impetuous
- Risk taking



Hank Pruden suggests a number of investment strategies that are in harmony with key personality attributes.

In between — most people: In reality, most people will be in the middle. What is difficult to determine is how each trader should proceed, given that there are so many variables. The most likely result is a hybrid approach, using ideas from both sides. Regardless of where you fall, one thing remains constant: You are always looking for ways to improve.

LEVELS OF SELF-DISCIPLINE

Hank Pruden of Golden Gate University suggests a number of investment strategies that are in harmony with key personality attributes. Here is how self-discipline may apply to a strategy selection (Figure 1).

Left brain/right brain information processing assessment: Typically, each of us tends to have more attributes toward one side or the other. This is what defines us and how we process information.

MATCHING THE STRATEGY

It is important to determine how personalities relate to managing portfolios. Once you have the results of the personality profile and the left brain/right brain evaluation, you will see some similarities emerge. The following are suggestions for interpreting the results of these exercises:

Predominantly right brain — social, outgoing — likes new & different: If your brain processing is biased to the right side and you are extroverted, social, and agreeable, perhaps you should consider using the strategies and tactics that others develop. Of course, you would be responsible for selecting the specific strategies and recognizing when they stop delivering the expected performance. If you fall into this category, then you are probably able to manage the “big picture” of your portfolio.

Predominantly left brain — logical — reserved — appreciates tried & true: If your brain processing is biased to the left side and you tend to be internally focused, practical, calm, and relaxed, then perhaps you should consider working to develop your own strategies and tactics. You will accept that this process is time consuming and will take a significant effort. You can use your talents to create high-performance portfolio strategies, thereby using these features to maintain your trading edge.

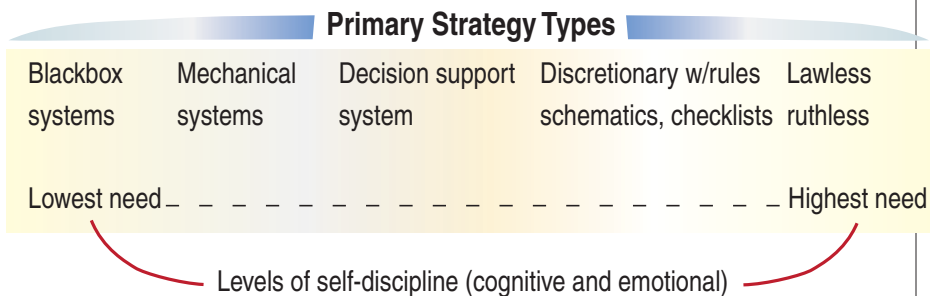


FIGURE 1: PRIMARY STRATEGY TYPES. Here you see the various strategy types based on your level of self-discipline.

Levels of self-discipline (cognitive & emotional): If you have determined you have low self-discipline, you may consider strategies toward the left side of this scale, or a method to compensate for this characteristic. If you have high self-discipline, then you may consider using strategies that are toward the right side of this scale.

Additional factors

- *Risk tolerance:* Your tolerance to risk and your objectives should work together in order to follow the strategy.
- *Types of securities to consider:* Be comfortable with the securities being considered in order to manage the strategy.
- *Timing:* The time basis to operate this strategy (hourly, daily, weekly), and what is required for this commitment.

■ *Picking a strategy:* If the strategy does not coordinate well with your personality, that does not mean you have to abandon it. An alternative to running a strategy yourself is to let someone else do it. This is done all of the time when selecting a mutual fund. We pick a strategy and let the fund manager use his tactics to manage the money.

Your objective is to be aware of who you are and how you process information. Any strategy in conflict with who you are will not succeed. But that doesn't mean you should ignore it. There are methods to deal with personality traits you are in conflict with.

STRATEGIC FACTORS TO CONSIDER

Most traders will find that their personality profile and right brain/left brain evaluations are relatively neutral, with few strong biases. There may be adjustments to consider, but likely nothing major. This section challenges set ideas and stimulates continued investigation.

Four basic investment strategies

Many of the different techniques can be broken down into the following macro strategies:

1 *Momentum — short term*

- Reversion to the mean (trend/countertrend)
- Swing trading (corrections within a trend)
- Pure momentum (increasing/decreasing price movement)

2 *Growth — intermediate term*

- Looking for a trend with basic fundamental & technical management

3 *Value — long term*

- Searching for undiscovered value using business & economic cycles, buying at a discount

4 *Income — interest & business cycle based*

- Interest, dividend, and quality of the underlying security

A typical strategy might be considered like a 30-second elevator speech. It is short in length and covers the major objectives; it establishes intent.

- Who is affected? (What model or client is it applied to?)
- What is evaluated? (What group of securities are considered?)
- When is it evaluated? (How often are reevaluations made?)
- Where is it carried out? (How are resources used and applied?)
- Why do we use this?

Here is an example of a strategy: My junk bond trading strategy is used as part of the income and moderate portfolio (*who*). I consider high-yield mutual funds that have a no or

low redemption fee within 30 days of purchase, that have shown to have above-average performance for these funds over the past five years (*what*). I evaluate current holdings daily, using dividend-adjusted data, with my junk bond trading model (*when, where*). The strategy has typically traded four times a year, with a return of 8.5% and 3.8% drawdown over the past 10 years (*why*). (Note: performance data is for our use and knowledge, not a promise.)

TACTICS AND THEIR APPLICATION

With all of the emphasis on trading tactics, you would be remiss to not cover the human element. Pruden suggests a few key elements in selecting and defining tactics:

- *Direction:* The trend — lines, channels
- *Extent:* Support & resistance, possible price movements (peak to peak), overbought, oversold
- *Momentum:* Rate of change, acceleration/ deceleration
- *Form:* Price movements in waves, advances, and corrections.

The elements of a tactic should include the setup, the trigger, the follow-through, and exit. One human element of the tactic is critical — being able to follow the tactic (trading plan) once it is established. Many traders have a solid, proven plan, but are unable to execute it. This is especially a problem after a series of losses. Here are two ideas to remove self-doubt: training the mind and testing of tactics.

Training the subconscious is one method of controlling or minimizing self-doubt. Active management and trading is about being okay with ambiguity. It is about tolerating confusion but still being in the context of the market. This means you must be engaged — that is, you must stay “in the now” with the market and not predict what it *should* be doing.



IMPORTANCE OF TESTING

While the main reason for testing a tactic is to determine its feasibility, another is to gain confidence in it. Evaluation techniques include out-of-sample testing, statistical analysis to detect overoptimization, and walk-forward testing. These help you find a tactic that could be profitable, but since no one can predict the future, the element of risk will always remain.

Another important reason to test is to have a dataset with which you can compare real-time performance. If the performance criteria in real time varies significantly from the testing reports (past data), that alone is a strong indication that the tactic is broken and should be reevaluated. Comparing current real-time performance to what is expected increases your confidence in the system. It helps to minimize self-doubt when the markets do the unexpected.

Keep a trading journal of what you saw when a position is entered and exited. Do not rely on memory; write down

what you saw and why you took the action. Did you follow your tactical plan? Take a screen capture of the decision environment with all indicators at the hard right edge of the chart — remember, plan the trade, trade the plan.



GAIN EXPERTISE

Expertise is about developing your skills to such proficiency that your actions become nearly automatic. The message is to study, learn, and practice. Practice provides you with experience, and experience will provide confidence. You may need more than 10,000 hours of practice to achieve the highest performance levels. You may need to study and understand 1,000 to 5,000 examples before reaching the point of mastery. It is important that you study and practice the right things and for that you should find a trading coach or mentor.

The benefits of practice are not only high performance, but also self-efficacy. If this sounds like a daunting task, don't be discouraged. This is a level of expertise to strive for and it is a path for continuous improvement.

THE JOURNEY OF SELF-DISCOVERY

There is no users' manual for becoming a successful trader. Each of us must find our own way because we are all different. Start the process of self-awareness. Discover what you like and dislike, what your primary personality traits are, and how you learn and process information. All of this has an effect on your trading performance. With this information you can define a series of strategies that can meet your needs.

The last step is to test the tactics, which will guide your investment decisions every day. While there is no holy grail for trading, there are many possibilities, and the journey to find them begins within.

Tom Hamilton is the owner of Special Risk Capital Management, a Registered Investment Advisor. He is on the board of directors of the National Association of Active Investment Managers and a member of the American Association of Professional Technical Analysts. He can be reached at thamilton@special-risk.net.

SUGGESTED READING

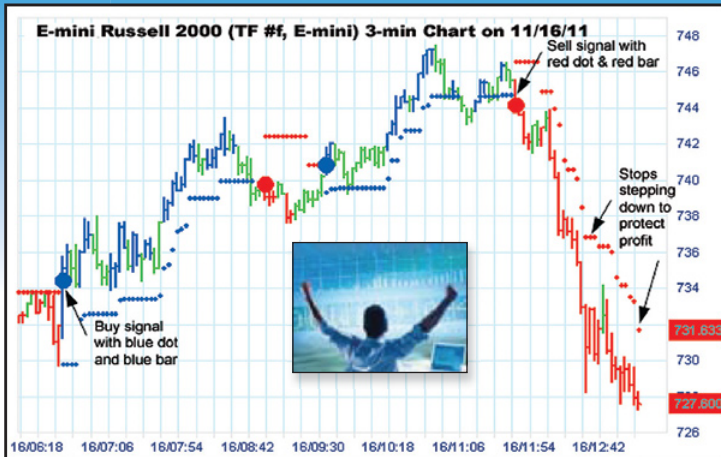
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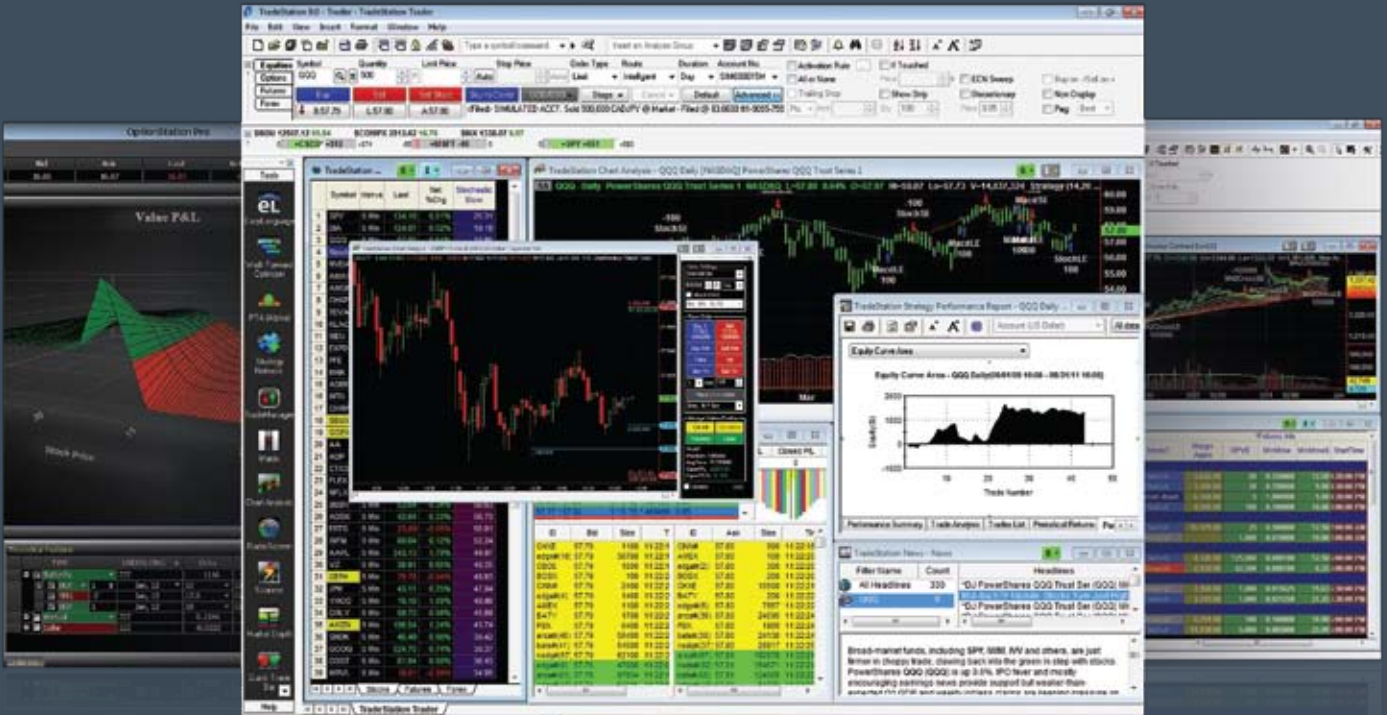


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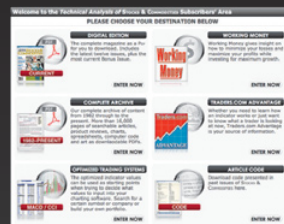
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