<u>The Three Main Pillars of Trading / Investing</u>

Pillar 1: Psychology

I break the psychology pillar down into two parts. The part that gets the most attention, though not enough, is how you feel and act during the actual trading process. The other part that I think is totally ignored is in the preparation phase as you begin your investing career. Let's start with that one first.

The First Step –

Before we even think about what to buy and set up an account, we need to define our goals as specific as possible. Then we'll need to get "real" about "us". How much time do we intend to spend and how in depth do we want to get into the investment process. Do we realistically have that spare time or are we kidding ourselves? Do we really want to study and learn this activity or are we just interested in making "a quick buck"? Is this enjoyable and challenging or would we rather be doing something else? In any case, know this: You'll be competing with others who make their living at trading / investing and have spent years learning it.

In The Trade-

Assuming that we have a proven process that we feel is sound, how do we deal with the feelings of fear, greed and frustration? At times we need to be aggressive and at others just be patient and wait for the proper set up to come into focus. If you need to be right all of or nearly all of the time then maybe this is not what you should be doing, or at best, look into different strategies that may be less profitable but ones that you can easily follow. How do you handle setbacks? Can you be detached from the money side and execute your process without emotion?

Placing a trade is easy and if making money was just that easy . . . everyone would be doing it and it probably wouldn't be very profitable. So the message is start with "you" and self-awareness. Be honest with yourself and select a strategy that you can execute reliably and fits your lifestyle. Be aware that this is not an easy path and there will be times of stress and doubt. Know how to identify those feelings and figure out ahead of time how you're going to deal with them. The psychological factor of trading & investing is an import part of your "edge" in the markets. Don't under estimate its importance.

As with anything else, you can work on this area to improve. Gain awareness of common psychological traps, learn to identify your emotions and manage them.

Pillar 2: Find your "Edge" in the Market and make it a Process

All professionals (especially gamblers) realize that in order to be successful they need an "edge"; something that sets them apart from the crowd. You'll need to find, refine and define a selection process that has a positive "expectancy", that is a methodology that will make you money over the long run. It won't be successful all of the time, but it will yield positive results over time <u>when followed</u>.

There is a saying that goes like this: "There are hundreds of ways to make money on Wall Street, unfortunately there are many thousands of ways to lose money on Wall Street." Finding the right system / process for you can take many paths. You can study and back test ideas, you can purchase a system and you can just buy signals / ideas from others. Another saying: 'Good, Fast, Cheap . . . pick any two". If you don't want to pay for help, expect to spend a lot of time studying the subjects.

Make sure that any process that you consider is going to work well in all market conditions. There are ideas out there that do very well in trending markets, either up or down, but blow out in a market that goes back and forth. Make sure that you know what type of market condition that you're dealing with, otherwise you'll be making the right trade but at the wrong time.

Finding a process that provides you an "Edge" is important. Without it you're just going to lose money. Don't rush the search process and don't give up. It takes time and the results are worth it. Few succeed in finding their "Edge" and burn out.

Pillar 3: Risk Management

Before you buy anything, ask yourself "What has to happen to show me that I was wrong and sell this thing?" Having an exit plan before you enter is a requirement. Now, that can take many forms. You can have a fixed dollar amount to lose. A fixed number of points or percent of the price to lose, or you can use technical indicators. There are many, many techniques out there to review, but this part is critical because you're not going to be right all of the time. And it's important to realize when you're wrong and to take action without hesitation to minimize losses.

You've heard the phrase "Don't put all of your eggs in one basket." And that's basically true for investing. You shouldn't buy just one security for a portfolio and also you shouldn't buy 2, 3 or 5 of the same type of security. For stocks, diversify in the top stocks in the top sectors / industries. If you own Exxon, BP and Mobil you are not diversified. If oil refiners get hit so will likely all three of these at the same time. Likewise avoid similar industries; in this case oil drillers, oil equipment, etc. will get clobbered if the Oil sector gets hit, hopefully you see the point.

Lastly, don't fall in love with any security. If it's not performing sell it and rotate into something else. Review portfolio holdings constantly. And sometimes it's best to be in Cash, especially when the path and opportunities are not clear. When in doubt, stand aside.

I hope that this brief essay has given you some ideas and food for thought. Just don't jump into investing, your strategy should include these three pillars at a minimum. Good luck on your journey.

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