
PEAK PERFORMANCE
TRADING & INVESTING
Sneak Peek
Bruce Bower

About Bruce Bower

Bruce Bower has been interested in the markets since he was a kid. Right out of college, he landed his dream job at a bank as a trader...only to suffer big losses in his first year. Despondent, he resolved never to lose again. He plunged into deep research and discovered the field of "Elite Performance" a decade ago. He quickly recognized its applicability to the professional world of investing and trading.

Bruce is a London-based investor in emerging market equities and growth companies. He is also an active writer about markets, investing, psychology and peak performance. Check out his blog "The How of Trading", www.howoftrading.com, or follow him on Twitter (@HowOfTrading) for the latest updates.

About SMB Capital

SMB is recognized for teaching new and semi-experienced traders how to profitably trade equities. SMB was founded by two well-educated, experienced, and active traders, Mike Bellafiore and Steve Spencer. Together, they have traded for over 30 years. During these years they have learned and utilized different trading styles to become well-rounded, self-directed, consistently profitable traders. A few years ago they realized that the market was harder to navigate than when we began. It was more difficult for a new trader to become profitable without advanced training and mentoring from professional traders. They decided to start a training program and trader mentoring which considered these changes. SMB has created several world class training programs so that new traders are given the best chance to succeed. They provide this on their blog and through online courses.
Read their blog at www.smbtraining.com/blog or follow them on Twitter (@smbcapital)

Introduction

In the fifteen years that I've been investing in the markets, I have constantly been surprised.

For the most part, these surprises have been quite pleasant, interesting, and challenging, such as the market reactions to political events, to monetary policy, and the performance of certain stocks. "Never a dull moment," as they say. There is always something happening in the world that demands more research and exploration. There is always another rock to turn over, and when you do turn it over, you typically find something quite different from what you were expecting. For someone who likes reading and learning and exploring, this is the ideal job. It channels my innate curiosity in a very productive and lucrative direction.

As I discovered, investing is about more than just researching companies and countries. In terms of what I do every day, research constitutes a big part of my routine and it continues to be central to the work that I love. But it's not everything. As I discovered, it takes something else, something unique to become a very successful investor. There's a whole mental and emotional side that I had no idea about before I started putting money to work. As soon as I started taking positions, the emotional rollercoaster began. Fear! Greed! Despair! Euphoria! These ups and downs, and their intensity, were perhaps the biggest surprise of all. And for once, this was a challenge where I couldn't just read and study more to arrive at the answer. Mastering my own mental game quickly emerged as the biggest challenge of them all.

There were some clues along the way. The *Market Wizards* books had interviews with trading psychologists, which got me thinking more about the psychological side. They had all kinds of fascinating suggestions and ideas, which led me to explore a variety of tools and approaches. I learned a lot from my conversations with some of the best traders out there about how they manage the psychological side of the markets.

Since I love the markets so much, I made the commitment to myself to do whatever I had to do to become a successful investor. A lot of that involved upgrading my research process and skills, tweaking my investment decision-making process, and developing my thinking about risk. But getting the psychological side right took considerably more effort—a lot more exploration, a lot more experimentation, and, of course, plenty of emotional ups and downs while I was investing. Moreover, working out the interaction between the analytical and emotional side was quite a headache.

As part of my career journey as a prop trader and portfolio manager, I have made every effort to be the best that I can be. I've read an innumerable amount of books and picked many brains. I learned about new fields that have a lot in common with trading, such as sports, therapy, and other peak performance activities. I met lots of interesting people with a genuine passion for markets and with bountiful wisdom to share. Some of it resonated with what I went through day-to-day. And inevitably, I came across some resources and information that I disagreed with or didn't ring true with the day-to-day life of a portfolio manager.

Eventually, and after many years of trying things out and exploring countless avenues, which includes observing and benefiting from the ideas of others, I arrived at some conclusions of my own about how trading and psychology fit together, about what works for every trader and what is more individual, about self-development, and how to manage the emotional side of investing. These are far from definitive answers. Nevertheless, I included this mix of ideas on my blog, "The How of Trading" (http://howoftrading.com/). Now, this book is a more comprehensive collation of some of my ideas and missives from my blog. So let's keep the discussion going!

Chapter 1: Stating the Problem

"A hard way to make an easy living" —a famous quote about poker

No one who's invested money or traded the markets would describe it as easy.

Guess what? It's not.

The markets are very seductive at first and can easily draw us in. We start trading and investing because we think we can make money—hopefully lots of it, right now. But markets can give us so much more than just money. We find the markets fascinating because it acts much like a puzzle, where the pieces change every day—and sometimes every minute. We love the stimulation, the adrenaline rush that comes with the markets moving constantly. We like the thrill of victory that comes with getting a position right—and we will do anything to avoid the pain that comes from a losing position.

But the markets can be frustrating. Think of the weeks or months where we are working flat out, doing our research and preparation diligently, putting on positions with great attention—and not making any money. Think of all the hard work you put in to have just a decent year, only to see your neighbor bet his entire life savings on a penny stock—and triple his money. That will make you feel really stupid, really fast.

When we are frustrated or want to take our trading up a notch, we seek resources outside of ourselves. We talk to friends or contacts who seem to be more successful than us; we resort to reading blogs or watching stuff on YouTube; we try to soak up the lessons of some great investors of our times, like George Soros or Warren Buffett. For some, this can help; for others, it only leaves them more confused, deepening the despair. Sometimes it seems like the results are kind of random. The resources that help one trader to get better can hurt another.

Everywhere we turn, there is yet more information for a trader, whether or not we are seeking it out. Pundits dispense free advice, which is worth exactly what we pay for it. Seemingly everyone has a “hot” stock tip or a “can’t lose” investment idea, but they never seem to be profitable for us. There are a billion books and seminars offering “guaranteed” trading systems at steep price tags. Trading psychologists with impressive degrees can tell us to “be more disciplined” or “to try to calm your emotions,” but we never seem to figure out how to do that. We could spend the rest of our careers soaking up all of these resources, only to feel more helpless and frustrated, further away from the consistently and large profits that we seek.

It doesn’t make any sense. With unlimited resources readily available at our fingertips—and this includes learning from the greats—then why should we still be struggling? If there is so much advice and so many tools at our disposal, then how could we ever fail to reach our profitability targets? Assuming we have the right work ethic, surely we could quickly achieve the success that we want by tapping into all of these resources. Trading and investing can be a difficult journey, requiring lots of diligent work, exacting a steep emotional toll with no guarantee of success.

If we aren't making the kind of progress we want, then what's wrong with all of the advice and resources circulating out there? Why aren't we able to take all this helpful information and turn it into something useful? What do we always find ourselves having to change our techniques and approaches in our goal to become the best trader possible? Is the problem with us?

Chapter 2: Solving the Problem

"Give a man a fish and you feed him for a day.
"Teach a man to fish and you feed him for a lifetime" —Proverb

Perhaps we need to pose the same questions, but phrased differently. Or perhaps we just need to ask different questions. Instead of coming out and asking "What's wrong with the resources out there?" or "What am I doing wrong?" we should start with what we want. We know that we want consistent and high profitability, so a better question to ask would be "What works to generate consistent and high profitability?"

By asking what works, we are starting to get somewhere. In order to turn around from failure, or to build on existing successes, we need to discover what works and do more of it. We also need to be vigilant to avoid what doesn't work. Just by putting up a simple filter—"Does it work?" —we can start to separate the wheat from the chaff in terms of resources and advice. A lot of stuff, like "hot tips" or pithy sayings, may sound alluring, but it's difficult to demonstrate whether or not they actually work.

After all, how do you verify the stock tip from that tuxedo-clad guy at yesterday's cocktail party? What's the entry point? What's the exit point? Where's the stop loss? What's the methodology? Has it worked in the past? The answer to all of these questions is: we have no idea.

Going deeper, there are actually two different levels to these questions. The first is whether or not something works in general, for all traders. Some actually does. For instance, "Cutting your losses and letting your winners ride" is a truism that works for all traders. Another would be, "Have a tested methodology for getting in and out of positions." A counterexample would be, "keep doubling down on losers" as this almost certainly doesn't work. There are some universal principles or rules of investing and we always want our activity to be in harmony with them. These truths are like gravity. We can either work with these truths or fight them, but I would strongly advise accepting them if we want happy lives! The next question is: “Does it work, for me?” Once you’ve moved past these universal principles of trading, then you want to find something that works for your own unique self: your personality’s strengths and weaknesses, your capital base, and your life circumstances. An investing strategy may suit a particular personality very well but be completely incompatible with another person. This doesn’t invalidate the system, not at all. If it’s consistently profitable, then more power to it! Rather, the fact that it works for one person and not for another just reaffirms the age-old saying: “Different strokes for different folks.” A trained physicist’s long-term, trend-following quantitative trading system would not suit the seat-of-his-pants day trader. This is an important distinction: Things that work for one kind of trader may not necessarily work for another one, and this is not a bad thing! As a matter of fact, one set of advice may completely contradict the other and yet are both are valid, because they are intended for different audiences.

The solutions are pretty straightforward. We need to figure out what works for every trader, no matter how experienced or inexperienced, regardless of capital base or personality. These principles are universal and should be followed no matter what. Then we need to understand how to apply basic truths to develop yourself in your own particular circumstances—and just as importantly, how to know when something is not helpful. So much of the confusion comes from not understanding what advice or rules are applicable for every trader and what is specific to each individual.

In this book, I am going to take you on a journey into a new model for developing and perfecting yourself as a trader. Instead of passing along my “secret and insanely profitable” trading systems like so many hucksters do, I am going to teach you how to think holistically about the markets and your activity in them. Following the old saying, I am not going to give you a fish in order to feed you today; I am going to teach you how to fish so that you can feed yourself for a lifetime.

The focus will be on the “How”—how to approach trading and the markets in general; how to design trading styles that work for you; how to think about risk and position sizing; how to use your strengths and avoid your weaknesses; and how to work on your own psychology so as to achieve peak performance.

The first step will be about the universal, general laws for trading—what I call the Basic Truths. These are true for everyone, and we will discuss what these rules are and why they work. From this, you should have a good understanding of what works in general, for every persona and trading style.

Next, we are going to explore *you*—what makes you tick, what works for you, and what doesn't work for you. It's about how to come up with and perfect a trading style that suits you, with your own strengths and weaknesses, your own skills and talents. This is about building a trading process that will enable you to be consistently profitable by playing to your strengths. We will get into the nitty-gritty of discussing individual systems and to provide concrete examples of how to think about this and what to do. The goal is to teach you how to think on your own, so that you can develop the understanding and mindset necessary to keep working on yourself.

Lastly, we are going to delve deep into the psychological aspects of markets, trading, and taking risk. A lot of the first two parts will be about creating and executing a successful trading plan, with the goal being to "plan the trade and trade the plan." We are going to delve deeply into how to transform your own thinking and emotions so as to access and sustain a peak performance state. At the same time we will work on overcoming any emotional resistance and blocks that you may have—even ones that you may not even be aware of. There are many exciting tools and exercises that we can adapt to our own purposes from other spheres, such as sports psychology or therapy. Psychology and mental states are critical ingredients for being a successful trader. We want every part of our brain to propel us in formulating a trading plan and in executing that plan.

I hope that you will find this to be a refreshing approach to trading and understanding the markets. By focusing on what works and "how" to do it, we can find a blueprint for taking our trading to the next level. It pains me to see many people who go into trading having a lot of the prerequisites for success like drive, curiosity, mathematical skills, and a competitive spirit but end up burning out and failing. I firmly believe that that they could succeed if they had better training and resources that focused on giving them the proper tools for working on their own trading. I want to give new and existing traders advice that works, to focus on the "how" and to give good guidance, so that everyone who wants to succeed has tools that can help them to achieve the profitability that they want and deserve.

Chapter 3: My Story

> *"I've missed more than 9,000 shots in my career. I've lost almost 300 games. 26 times, I've been trusted to take the game winning shot and missed. I've failed over and over and over again in my life. And that is why I succeed."* – Michael Jordan[i]

You may ask, "Why is he writing this book?" or "Who is Bruce to write anything about the markets?" Those are certainly valid questions, ones that any discerning reader would ask.

Let me start with what I am not trying to do. I am not trying to pontificate or to show off. I am not seeking any emotional catharsis by getting my life story on the page.

Rather, what I want to do is something that's more personal. I want to share my journey in the markets and the lessons I've learned. You see, I have failed numerous times—and sometimes in painfully embarrassing ways. I have lost money, sometimes large sums, many times. I have committed many exceedingly stupid errors and mistakes in my time. These mistakes were certainly not fun.

Whenever I have made a mistake in my life, I have always tried to learn whatever I could from the experience. I've tried to make lemonade out of the lemons that I've brought into my life. In my quest to learn more about markets and to finally "crack the code," I have put in a huge amount of study. To overcome my own natural shortcomings and to get better at trading, I have left few stones unturned. I shudder to count how many ideas I've explored and the number of courses I've taken. My former colleagues are no doubt tired of hearing about the latest idea that I've plucked from a book that I read yesterday. I've even gone off into completely different disciplines that are partly related to trading, like psychology, to discover new insights that could be relevant.

Over time, I began to discern some signals amidst all of the noise and to learn stuff that genuinely worked—for any trader. I've even started to have a couple of ideas about what worked. My blog, www.howoftrading.com, was a first attempt to start a dialogue and to share some of what I've learned and developed. Hopefully you'll find something helpful there.

My own journey with the markets started out at the young age of 12. My dad worked with financial markets, working both with commercial loans for big projects and also investing in the markets. One summer, I decided to be useful and work for him. Sitting in the office one day, I found a wonderful book about famous investors. My eye was drawn to the first interviewee—T. Rowe Price. It's a prominent name around Baltimore, where I'm from and where T. Rowe Price Inc. is a major corporation. Naturally, I wondered, "Who is this guy, anyway?" With that I started reading—and became completely absorbed.

Ever since then, I wanted to work with markets. Everything about it seemed so attractive. It just clicked somehow. I can't put my finger on what was so appealing to me—it was everything. First off, you could make gobs of money—and to a kid from a family that had experienced its share of financial ups and downs, this was very attractive. The whole process of investing seemed immensely intellectually challenging and rewarding—like a big puzzle. I got a kick out of reading the business section of the newspaper, learning about companies and the problems they solved, the new products that they brought to market. Plus, when investing, I had to think about a company, the market, the economy, politics, and a roster of other ever-changing variables.

Being around the markets always seemed to result in my learning something—to a bookworm, that was a big plus. Thirdly, the risk part of it added some excitement and unpredictability—it was luck and skill, dull grunt work interspersed with excitement, much like Monopoly. Lastly, it seemed like what poker players called "a hard way to make an easy living"—to someone who had delivered newspapers before dawn for several years and done yard work in Baltimore's steamy summers, sitting in an office also had its appeal. I was sold.

After that, my key choices in life were focused on one goal: to get me into the world of markets. By some miracle, I got a summer internship as an asset manager when I was 18. While I obviously didn't know the first things about markets and was only qualified to make coffee, which I still managed to bungle, I did start to soak up the markets. It was my first step on the ladder.

I thought about the markets when I was applying to colleges. As is common, I applied to several universities, all of which had good economics programs. I wanted to be immersed deep into economics, finance, math, and anything else that I thought I would need on my journey. While I wasn't yet sure how it all fit together, I knew that I wanted to be in the middle of the action—in a good place to learn something and to be well-positioned for the future. That future, of course, was in taking risk in the markets. In one admissions interview, I can distinctly remember telling the interviewer that I was interested in my part-Hungarian heritage, and could see myself working for some place like Citibank in Hungary. As it happened, that goal would be met in the near future.

Fortunately, I was accepted to my dream college, the University of Chicago. The school is well known for its Economics Department and the Booth Business School, both of which are stuffed with Nobel Prize winners. The faculty and resources were top-notch. For any student interested in the field, attending was a no-brainer. In addition, there was the rest of the university, which offered a broad Core Curriculum and tons of flexibility as to which classes you could take. This meant that I could indulge all of my fascinations at the same time, including history and French. Lastly, the school was in a vibrant, big city, which meant there would always be something to do.

However, things turned out differently once I got to campus. Yes, a lot of things worked out well, like the city of Chicago. The economics and social sciences departments had amazing faculty and it was easy to run into them in the hallway. But I discovered that I didn't like the material in my economics classes—it was theoretical, dry and overly mathematical. I wasn't interested in mathematics because it reminded me of an advanced physics class. I wanted to learn more about investing!

There was a good reason why the school was at a remove from actual markets. Remember that the University of Chicago invented the Efficient Market Hypothesis, which asserted that it's almost pointless to try to outdo the market because all available information is already priced in. This thinking clearly influenced the faculty and as a result, being in the markets seemed to be discouraged.

Instead, the main attraction for me turned out to be the library—millions and millions of books on open stacks. While that was useful for classes, especially for my history courses, what it really meant was that I could immerse myself in the finance and securities sections. My friends knew where to find me: in the library, flipping through yet another book on a finance topic, maybe about convertible bonds, perhaps about securities pricing, or a really scintillating title like “Accounting for Securities Analysts.” For me, it was like being a kid in a candy store. There were so many choices and so little time. All of it brought on a big rush. I just loved learning, and every day I could learn something new about the markets. I was so absorbed that my friends began to joke that I was at risk of radiation poisoning, because the Regenstein B Level was right near the squash court where the first controlled nuclear reaction had taken place. As of now, all that time was worth it—and no, I don’t glow in the dark!

In the end, I majored in both history and economics. Fortunately or unfortunately, having a degree in economics helps you get hired into the markets—because of an understanding of basic principles, a certain level of math skills, etc. What I found was that I enjoyed my history classes more—the material, the way it was taught, and so I kept taking classes and ended up majoring in it. My field of interest was 17th and 18th century Europe—a transformative time, when all of the modern political and economic frameworks of “modernity” came into being. These classes involved a lot of intellectual heavy lifting, as we had to consider numerous difficult questions and overlap them with other disciplines. We had to think critically, draw conclusions, and then justify them with a broad array of facts. This is exactly what I had imagined college to be like.

Moreover, the real prize for me was being able to work on the capstone project for a history major, called the BA paper. This was a 40-plus-pages original research paper on a topic of your choice. In one of my history classes on 18th century Europe, I found a topic that overlapped with my love for the markets: the Mississippi and South Sea Bubbles, two concurrent financial bubbles in France and England respectively, in 1719-1720. Having just lived through the NASDAQ bubble and its bursting, these were obvious parallels with the modern day, as these bubbles were no less crazy and dramatic than the NASDQ bubble.

As I plunged into the research, including two months in a musty archive in France, I found stories that drew me in. The markets for stocks and bonds seemed to work the exact same way back then as now—the greed and fear, the over-exuberance, the way that markets functioned. Moreover, some of the stories were almost too good to be true, illustrating everything about the times. Take John Law, the Scottish gambler and rogue, who ended up running and subsequently crashing the entire French financial system; the hunchback in the exchange alley in France who made a fortune providing his hump for signing trade settlements; Isaac Newton, who lost a fortune from bad investments in the South Sea Bubble and proclaimed "I can calculate the motions of heavenly bodies but not the madness of people."[ii]

While I was in school, I was taking more steps to get actively involved in markets. First off, I got a part-time job at a big financial firm in downtown Chicago. They were fixed-income specialists, focused on a narrow but very profitable niche. It was a good chance to learn another side of the markets and to work with professionals in the business. While they probably don't remember me now, I enjoyed the experience tremendously and had a wonderful time and learned a lot from it.

Even more exciting, I began trading with my own money. I started college in September 1999, at the height of the Internet bubble. If you weren't trading at that time, then the mad stories from that era will sound like fairy tales—but they were all too real. Internet IPOs would go up three-fold on the first day of trading, even if the company sounded like a total scam. Top-performing NASDAQ stocks, especially technology-related companies, would double in a month. Money-losing Internet companies would soar if they could announce higher numbers of "eyeballs"—even if it resulted in larger losses. The Nasdaq 100 itself doubled from September 1999 to March 2000. The S&P 500 sported the highest P/E ratio on record. The airwaves and news were filled with talk of a "New Economy." And aggressive day trading was all the rage.

While this may sound like an alternate reality, it was still the universe that we lived in. It was certainly an interesting time to start out trading! I took my savings from a summer job and jumped in with both feet. While I didn't know much, I had one firm conviction—that I would also be a successful day trader. I'm shaking my head now in a mixture of disgust and amusement, but back then, I could see myself jumping in and out of stocks in a matter of minutes and hours and printing money. Nimble and agile, I would monitor the news flow and CNBC and the tape and trade actively, making money every day.

Boy, was I in for a surprise. As it often happens, the markets crushed my hopes in the blink of an eye. While being a day trader sounds fun and glamorous and insanely profitable, it is hard work and takes preparation. I was doing neither and instead committed all of the usual mistakes. After six months, I was down 50% on my capital and hurting. My dreams were shattered. It became clear to me that I didn't know what I was doing. Obviously, I was taking far too much risk. As you can surmise, I didn't have a real strategy behind my entries and exits, which were more or less random. Moreover, I hadn't the foggiest idea of how to right the sinking ship. This was my first encounter with failure.

It took a ton of effort to get back on track with my personal trading. First off, I took a break, which always helps me to clear my head, especially if I need to lick my wounds. I studied up and devised a new plan of attack on how to trade individual stocks with a longer-term view, to play to my research and analytical strengths. I resolved to trade less actively but to have done some research on positions that I got into. I would keep using technicals but as a backup to fundamentals.

I vowed to take much less risk, and to bleed less when I did lose money. After some thrashing around, I managed to get the hang of it. For the first time, I was able to make money consistently in the markets, by catching big gains and cutting my losses early. My research helped me to pick some winners based on more than just chart patterns, as I picked up a few stocks that had been beaten up excessively and rode them higher. Moreover, the markets were favorable in 2002-2003, as the bear market ended and stocks began to explode higher. The currency markets also had nice, tradable trends that I rode. Eventually, these trading results would help me to land what would turn out to be my first big break.

This was the first time I had recovered from failure in trading. I did so by taking a good hard look at my mistakes and correcting them. In retrospect, my mistakes and stumbles were classic rookie mistakes and so they were quit fixable. The answers to those stumbles were easy enough to understand—they were the universal trading principles you could find in any book, from *Reminiscences of a Stock Operator* to the various interviews in *Market Wizards*. The general answer is one that has held the test of time: Have a process that makes sense; cut losses; let winners ride. It was basic stuff, but it worked. Combined with favorable market conditions, that was all that I needed to become profitable and to start feeling confident in my own trading.

Then, in my senior year of college, I hit the jackpot. No, I didn't win the lottery. I did even better—I got the job I wanted in the markets. Let me repeat: *the job*. Naturally, I was looking for any work in the markets where I was able to take risk and put on my own positions. Forget investment banking or mergers and acquisitions or working 100 hours per week—I had no interest in this. What I found and zeroed in on was an even better opportunity. The single most coveted position among my classmates was a unique opportunity at Citibank. Each year, Citi hired one person in the world directly on to the Foreign Exchange and Fixed Income prop-trading desk. At a bank, prop trading was very simple—you manage the bank's proprietary (i.e., its own) capital and try to make money. It was a very straightforward deal—you could trade whatever fixed income or FX instrument you wanted, however you wanted, using Citibank's own capital, while sitting next to the best traders in the bank. It was an unrivalled opportunity to learn. And if you made money, then the job was a potential gold mine.

For me, the attraction of this position was overwhelming. I wanted this job so badly that I was prepared to do anything to get it. As there were a lot of very smart, capable people in the running all around the world, I had to take my preparation to a different level. I ditched school for a few weeks to prepare for the interviews. I read ten years of back issues of *Euromoney* magazine. I learned the names and biographies of everyone I could find from Citibank's FX desk. I traded the FX and fixed income markets in my account to familiarize myself, beginning with the euro versus the dollar. Then I moved further afield, looking at emerging and offbeat markets. In my last year of college, some of my big winners included the South African Rand and government bonds in Iceland. After three months of non-stop work, I knew that I was ready.

After two grueling rounds of interviews in New York and one in London, I got the long-awaited phone call. “You’re hired. Our best trader just moved from New York to London, would you like to go sit next to him?” Jackpot. I said “yes” in a nanosecond. A few months later, I was sitting next to this trader. We’ll nickname this trader Peerless—because he was. Even before I started working, I had heard all the legends about him. Highest grosser on his desk. Biggest moneymaker in the entire department. Best trader at Citibank. “All-around genius.”

Peerless was certainly a phenomenal trader. But more than that, he was an oracle, a veritable fount of trading wisdom. I tried to get as many crumbs as I could from his wisdom table. To this day, almost ten years later, I consider myself extremely fortunate to have worked with him.

Alas, despite all that I was learning about the markets and trading from Peerless and the other guys around me, I wasn’t making money. In fact, I was losing money. A lot, at least by my standards. I lost about 10% of my capital allocation in short order, which is a pretty poor showing. Wait, this wasn’t supposed to happen! This was my unique opportunity to make a gazillion dollars. What was going on? A few things were going wrong.

First of all, while I had made money and possessed some ideas about how to trade the FX and rates markets, I didn’t have a thorough and robust system or methodology. Instead, I was flailing about. I would make a well thought-out, deeply researched trade that I had spent a month preparing, only to follow it up with another position that I’d thought about for five minutes. I was chasing a lot of moves and momentum without any good reasons, just reacting to random data points in the market.

During that time, 2003-2005, a lot of the FX and interest rate markets were very choppy, and what seemed like powerful moves were actually just fluctuations within large trading ranges. If you looked at charts from 2004, you would sort of shrug your shoulders and think “How could anyone have lost money? The markets didn’t do anything!” Of course, I would have been better off sitting on my hands than putting on trades, but in retrospect, I was also trying too hard to make money, so I would take marginal trades.

As such, greed got the better of me—my positions sizes were too big, because I was trying to make a lot of money quickly. I would put on positions where my potential loss, if I got stopped out, was several percent of my capital—so naturally, when just a couple of positions didn't work out, I would take a huge hit to my capital.

The end result was that I lost money. A fairly large amount, actually—about 20% of my allocated capital. That's bad, for sure. But even worse was what I felt like inside. I took it extremely hard. I felt like a failure. A complete, abject, total failure. I couldn't eat properly for months. I couldn't sleep and then had trouble getting out of bed. Imagine preparing for that big chance, and then completely screwing up. Think of Bill Buckner, the Boston Red Sox first baseman who watched the ground ball, and the World Series, go right through his legs in 1986.

This was an absolutely unique opportunity and I had dropped the ball. I had prepared for many years to get a job like this. It offered such an amazing opportunity. The bank was a wonderful environment, full of great mentors, and it had given me access to unlimited resources. I was working hard and doing all of the necessary preparation work. In spite of all that, at a time when I could have and should have been making a fortune, and I ended up losing money. Talk about misery. I had hit rock bottom in my trading journey.

Eventually, I left Citigroup in order to hit the reset button in my life. I got a new job, this time at a hedge fund, dealing with familiar territory of interest rates and currencies but also equities. I had wanted to be in emerging markets, because the boom in those markets was just kicking off. The fund where I ended up was based in Russia, and originally I was supposed to be there for only six months. Not knowing Russian or anyone there, I instead took my "six months" to bury myself in study. I did not and would not let myself feel the sting of failure ever again.

Looking back on it all, it did seem like a pretty harebrained decision. I went to Russia not knowing anyone outside of my employer, not knowing the language, and not knowing the market. Easy pickings, right? Of course it was a risk. I thought about it this way—I would give it two years. If it worked out well, then I would be well on my way career-wise. If it turned out badly, then I would just go to business school at the ripe old age of 25. The firm I joined had a good team and track record, so I figured that it was a great risk/reward from a career standpoint.

As you may have noticed by now, I genuinely enjoy learning. All my life I've always been reading everything I could get my hands on and peppering people with endless questions—about where they're from, their business, what they're studying, etc. I feel most engaged when the learning curve is as steep as possible. Thus, I viewed all of this as a chance to learn as much as possible about Russia and then the new aspects of the market that I was looking at.

Was it a daunting challenge to learn a new language, product set, and adjust to life on the buy side? Yes, of course. But my earlier experiences had left me with an absolutely indomitable will. No matter what happened, I would figure it out. Whatever it took, I would pay the price to become ultra-successful in the markets.

I read everything that I could get my hands on and devoured it. Since I was doing both equities and fixed income, I devoted a huge amount of time to figuring out what worked in these markets, especially equities, since I was new to emerging-market equities. I wanted to find something that worked and built on my previous success when I was in college.

I started thinking a lot about how to borrow an existing system that I had read about and to tweak it to fit different circumstances. For instance, I experimented with several different equity trading/investing styles and looked at how they would fare in the unique climate of the Russian equity market. Would they make money, could they adapt to the unique circumstances of the market, etc.?

One conscious shift in my learning was to go in many different but related directions. Instead of exploring mostly technical books or ones about specific trading styles, I read more about trading in general or fields that had an impact on trading—my favorite subset was trading psychology. What really sparked my interest was the *Market Wizards* series, where the first two books had four interviews with trading coaches/psychologists. While I had heard the platitudes—"Trading is psychological," etc.—I had never thought about how you could blend these two disciplines—trading and psychology—together.

Moreover, the stuff that they were espousing just sounded exotic and fun. Take the interview with Robert Krausz in *New Market Wizards*, where he described how he uses hypnotherapy tools to help traders get over psychological hurdles like the dreaded "freeze." At the same time, he eloquently explains how his work builds or extends on a trader's methodology, as opposed to taking its place. To me, this was a like a roadmap—all of the "psychological' struggles that I was having, like depression or frustration, could only be addressed after I had thoroughly addressed the basics of methodology and strategy. I was intrigued by these related disciplines, like psychology and the study of peak performance, and added them to my study list.

What I've Learned

"You can't connect the dots looking forward. You can only connect them looking backwards." – Steve Jobs[iii]

After a deep immersion, lots of talking to traders all over the world, and years of study, some light started to appear. First of all, I realized something that was surprising: Even in the world of professional money managers, very few actually understood investing well *as a whole*. They could tell you a lot about how they did things and what their particular edge was in the market, but they couldn't differentiate between what worked for them and what worked in general. Strange, but true. A second surprise: most market participants aren't interested in improving. Perhaps it's not that—maybe they are just resistant to change. They think, quite reasonably, "I've found my niche and have a profitable strategy, so why risk messing it up?" Or maybe they are uncertain of how to go about it, and consequently can't decide which direction to go in to improve, grow, and develop.

In the world of markets, there is a huge amount of machismo, due to the fact that it's a competitive and male-dominated industry. In this worldview, striving for improvement would mean its flipside—admitting some kind of weakness, which they are completely loath to do. Whatever the reason, talking about how investing works and how to get better became a journey that I had to walk mostly on my own. It was only later on that I discovered the blogging world and was able to start a dialogue with fellow traders and to communicate with like minds all over the world.

My main frustration as a trader is that too few people in the business seem to be interested in trading or investing at a theoretical, higher level. They rarely understand the concept of a process, why it's there, and how to build one. You'll meet many people, on the buy and sell side, who cling stubbornly to the notion that taking risk is a seat-of-the-pants endeavor that doesn't need intellectualizing. A lot of people don't really understand risk management and while they talk about "trading psychology," the whole concept seems fuzzy and amorphous. For a profession with a lot of extremely intelligent, hard-working and competent people, there is a surprising lack of introspection or of broader understanding. Why is this?

Maybe people are too focused on the tasks directly in front of them and working extremely hard and diligently to look up from their daily monotony and wonder if what they're doing is the "right thing" or not. Among action- and success-oriented traders, they would probably regard this as "navel gazing" and thus a waste of time. "Why bother with that kind of theoretical exercise," the thinking goes, "when I'm busy making money?"

There is a grain of truth to that logic. Obviously, most traders work very hard. The question is whether or not they spend that time doing the right things and in the right way. You could spend 12-plus hours per day researching the markets but if you don't have a consistent way of making decisions, then it's all for naught. If your trading logic is flawed, then each marginal hour of work may worsen your returns, rather than improving them.

I want to address this by giving my view of what trading is, theoretically speaking, of how to go about it, starting with the need to build an investment process and how to build it, and then moving on to various related topics, like how to personalize it, and how to use advanced psychological tools to upgrade one's skills and remove the blocks. It's shaped mostly by my experiences trading various products and markets, augmented by some of my studies in neuro-linguistic programming and other fields of psychology.

As I continued with my explorations, I started to have my first real theories that I could work with. Initially, these theories concerned some of the things that united all traders versus how they were different. In other words, I looked at the universal trading principles employed by all traders instead of ideas that were specific to a person.

Secondly, I started to understand what those basic truths of trading are. Just by reading interviews with great traders, like *Market Wizards*, I started to piece together some of the commonalities between the greats. Thirdly, I started to think about how all of the related disciplines, influences and thinking styles interacted with the markets. And lastly, I had some ideas about how all of the pieces fit together.

Even better, as some things started to click, I could also feel my trading could get much better. My results went from bad, as in my Citibank days, to pretty good in recent years, and I felt much more confident in what I was doing. Moreover, as I integrated what I was learning about trading psychology, I could feel myself becoming calmer, more collected, and able to tackle new challenges. The ideas and techniques that I will present in this book have worked for me, and that is why I want to share them with you.

Maybe my journey is just one of my confidence improving as years of hard work finally paid off, but I'd like to think that there's more to it than that. I've waded through a lot of material out there, for years and years. My early failure and my desire to succeed spurred me on, not only to do better but to learn and understand my craft so thoroughly that I would never experience the same kind of failure again.

While it was not an enjoyable experience, my early losses have spurred me on to a better understanding of how to make money. Hopefully my failure can become your success; my struggles, your learning; my losses, your profits.

Chapter 4: The Solution is a New, Holistic Approach to Trading

> *"For most people, attaining the intellectual clarity and emotional detachment that investing requires is tough*" – Guy Spier[iv]

As we move away from my story and start to talk about investing, here's one question to think about. If you were going to play a game of soccer, you would have to know something about the sport, right?

There is a bare minimum that you would need just to get started. You would want to know the objective of the game, the rules, some basic strategy or tactics. Otherwise you couldn't really play. Furthermore, imagine if you didn't know the game and its rules but had to do a passing drill or practice a defensive formation. It would seem pointless to say the least, and probably very frustrating.

In many ways, that's what a lot of material about the markets seems to be doing. They've completely skipped over the basics and gone right down to the finer details—which are pointless if you don't understand the bigger picture. Rather than talking about the basic rules of the markets and taking risk in the markets, we've gone straight into teaching someone's trading system. Instead of bothering with the core fundamentals, they're teaching you the finer points of the technical analysis patterns of commodities futures or of picking stocks using the same analysis as Warren Buffett. Yes, those sorts of how-to can be helpful in the right context but they're pretty irrelevant when you don't know how trading works in general and don't have the right framework for thinking about it. In fact, it could be quite harmful: You might feel more confident because of your knowledge base but you wouldn't know how to think about the risks that you're taking. What happens if you combine overconfidence and too little skill? You can get yourself in a lot of trouble.

Let's go back to the original example of soccer. Think of Pelé or Lionel Messi or Diego Maradona. All three have been absolute superstars on the international stage, yet their individual playing styles are unique. We know what they have in common—the basic rules and strategies of soccer, similar positions—but their dramatic success came because they went beyond the basics and they developed tactics and techniques that were a unique expression of their own abilities. They built their skills on a common base of knowledge and practice, but went in their own directions.

In the markets, we have our equivalents of these greats—names like George Soros, Warren Buffett, and Bill Gross. We understand that they all have their own styles and strategies, just like the soccer stars. Yet, unlike the soccer stars, we are still trying to learn what it is that they have in common. What are the basic rules and strategies of the game that are universal? What works for everyone and what is more individual or personalized?

Furthermore, we must grasp this whole idea, because two people who try to have a discussion could end up talking past each other. Imagine two very successful hedge fund managers. One is quite focused on the long-term buying and holding of stocks and is willing to sit through a lot of the volatility and be in it for the long-term, like a Seth Klarman. The other is a short-term macro trader, constantly in and out of foreign exchange and interest rate positions in markets all across the world. Obviously, they would say that their strategies have nothing in common, and maybe they would even say that the other's style is reckless or crazy. They could even be right that they have nothing in common—*on the surface*.

Scratching beneath the surface, they actually do have a lot in common. Remember, they're both very successful, in spite of pursuing different strategies across different markets with wildly different return series. But they've probably done a few things exceptionally well: crafted their own methodology, implemented it rigorously, and managed risk well. These are some basic characteristics of nearly all successful investors and traders. For example, I don't remember anyone interviewed in *Market Wizards* who said that the key to their success was "cutting winners and letting losers ride." Of course not—no successful trader would say that.

The contrast is stark: two people whose styles seemingly have nothing in common but underneath it all, they may actually doing a lot that's similar. Naturally, this leads to a lot of questions: What part of their common success is due to what they do similarly, and how much is due to what they do that's unique to themselves? Are there some universal principles that they are following that make them both successful but which we haven't identified? And where do you make the transition from something universal to something personal? What are the rules? What do we have absolutely have to do to be successful? And how does it all work?

It seems like a lot of questions, I know. To get to the bottom of this, we need to figure out what investing is all about. Once we can come up with a broad framework to describe what investing is and is not, then we can explore and work out some of its basic universal principles. After that, we can figure out where it becomes tailored to the individual and where it does not.

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