Emotional Habits of the Successful Investor

"Trading from your strengths makes you a more consistently profitable trader."

How the focus on individual trade *outcomes* sabotages the success that could otherwise be enjoyed if the trader instead focused on the *process* of trading.

INTRODUCTION

Learn To Invest With Silent Partners Of Fear And Greed

It is said that successful investors have an investment plan and they stick to that plan. What this really means is that successful investors know what to do (have a plan) and they know how to do what they know they should do (stick to that plan). To become a lifelong successful investor you must control your emotions and you must stick to your investment plan even when it sometimes gives you losses. Remember, all investors lose money...the successful ones lose less money than they win because they remain disciplined through all the ups and downs of the market.

The author of this book has taught thousands of investors how to invest successfully. But he has realized that most people find learning the system is the easy part. The true measure of success is in the discipline one applies to the markets. This mental toughness is often the hardest part for individual investors to learn.

Written from the perspective of the novice investor, this book will outline and discuss various emotional traps of fear and greed people fall into as they invest; which prevents them from doing what they know they should do. As emotional investing often leads to failure in the market, this entire book is devoted to sharing a new view—the view that you can only be in control of your investments if you learn to be in control of your emotions.

1

Find a System

Most people invest with what I call a "buy; hope, wish and pray" method. What this means is that most people feel a little uncomfortable about the markets. They are intimidated by the markets and don't know exactly what to do. A good example is found in my own life. I can remember being raised in a home that just never had success in the markets. My parents would invest on some tip or another and every time they did they would lose money. As a young boy, I felt that the only people who could be successful in the markets where those who cheated!

This lack of confidence causes people to pay experts for advice and help. By itself this is not a bad thing. In fact, good coaching is key to the success or failure of many endeavors here on earth. But what causes problems with this approach is if the person abdicates personal responsibility to this expert. Remember, no one else will take care of your money like you will. The expert does not really know you or your investing style. Their recommendations can be made for many reasons, not just because it will be in your best interest.

Abdicating control of your investments to an expert can be dangerous even as it is seductive. If you have given your retirement to someone else to manage and you spend little time on it, then you have adopted the buy; hope, wish and pray method of investing. Think about it. How many times has your expert come to you with advice on what to do. If you have not developed your own education about the market you will not really understand why the investment is a good one, nor will you fully understand what the stock is likely to do. In other words you will buy and hope for something good to happen. This is often known as luck!

Do you feel lucky when you invest? Do you feel lucky when stocks you own go up in value? Do you feel unlucky when your stocks go against you? Maybe you have found that as the stocks went up you loved your expert, but as stocks tanked you wanted to blame your expert. Do you do this? If so, you have likely abdicated your personal responsibility of your financial future to your expert (whoever that may be).

Experts come in many forms. They could be your friend, neighbor or family member. Experts can be the "talking heads" on TV telling you what they think the market is going to do. Maybe your expert is your broker or financial advisor. Each of these sources of expertise have one thing in common: they do NOT know what is going to happen tomorrow. In fact, no one knows with absolute certainty what is going to happen tomorrow. All of these experts are guessing or forecasting what they think is going to happen but none of them really know.

If you learn to take control of your financial future by gaining an education about the markets, you will be able to make forecasts about future stock movement and then track your success or failure as a forecaster. What this allows you to do is become a better forecaster over time as your skills improve. This is one way to become financially free; independent and filled with financial confidence.

By depending too heavily on an expert, you never really learn how to make your own forecasts and your financial future is in the hands of someone else. Is this something that inspires confidence? I once spoke with an individual in my office who had lost hundreds of thousands of dollars a few years earlier during the market crash of 2008 because his expert didn't get him out in time.

During that meeting in my office, he related to me how difficult that time was. How filled with fear and hopelessness he'd been. He told me that he was so tired…and that as a retiree, he didn't know how to start over and hated the thought of having to go back to work.

Then he responded to one of our advertisements about learning how to trade for yourself and he started going to class. At the time he came into my office, he simply wanted to express heartfelt joy and appreciation to me for the classes and the instructors he'd learned so much from. From a dark night of hopelessness, he'd become confident in his ability to put his money to work and new that his retirement would be as good as he'd imagined it.

He went from not knowing why his expert did things to knowing why he would do things. And the best thing about doing this for yourself is the ability to learn and become better and better at it. Over time, as you learn increased mental discipline in your approach to the markets and as you develop your skills in various options strategies, your results will improve significantly. Knowledge is power and applied knowledge is powerful. Change your life…learn how to invest for yourself!

Successful investors (like successful athletes) often hire a coach for advice and help and insight, and the better they learn to apply this training, the better they perform. A good system will help you be able to make your own decisions because it gives you a home base from which to approach the markets. This home base is composed of a set of rules that you follow no matter what.

Finding a system requires knowing natural tendencies

Now that you know how important it is to find a good investment system, it is time to discuss how to find the system that is just right for you. The first step to doing this successfully is to sit down and really think about who you are. What is your background? What is your level of expertise in the markets and what would you like it to be? What talents and abilities do you bring to the market?

This self-analysis is critical for you to find the right system for you. Some people have a natural tendency to assume large risk. They love the adrenaline rush that comes with the possibility of huge wins. Others have a natural tendency to avoid risk. Some people are really good at weighing the different options available to them and in making decisions on the fly. Others just want to have a very specific set of rules to follow without having to do a lot of thinking. Some are short term minded and others want to set it and forget it.

During Marine Corps boot camp, our platoon was taken to the rifle range for two weeks to learn how to shoot the M-16A1 rifle. The first week consisted of sitting around in a circle with plastic guns learning proper bone support and breathing techniques and trigger control. Not a single shot was fired. It was only in the second week that we applied our knowledge with actual weapons, firing at actual targets. The best shooters applied their training better than anyone else.

In the investing world we have to know how we are likely to react to a given situation so we can learn to protect ourselves from our own emotions. We need to know what our plans are with the money we invest so we don't get confused by conflicting signals or differing opinions from the experts. By knowing who we are, what our investment goals are, and what our investment time horizon is we are able to make better and more systematic investment choices. It really doesn't matter if you have a number of different investment strategies as long as you don't mix them up.

Some investing systems are more time intensive than others. How much time do you have or want to give to investing? How closely do you want to follow the news and events of the world? How much time do you have to spend in an ongoing effort to learn about the markets by reading books and magazines?

In the sports world athletes are often told to "become one with the ball." There is a lot of truth to this worn out phrase. Good investors know their limitations and operate within those limitations. This is part of the process in finding a successful investing system. To illustrate this point, let's use the example of perhaps the most successful investor of all time, Warren Buffet.

Warren Buffet is a value investor. He finds companies with great fundamentals trading at a discount and he invests in those companies. He often says that he is not buying the stock, he is buying the business. For decades this approach was hugely successful for him (though he has had some failures along the way). During the last part of the 1990s his investing system seemed to stop working. This was during the phenomenon known as the "new economy" where all the technology stocks where just on fire as they just kept setting new high after new high.

During this heady time in the market, many people began to question the abilities of Mr. Buffet. The Oracle of Omaha (as he is known) seemed to have lost his touch because he refused to invest in technology where all the real money was being made. And yet, he stuck to his system. He remained disciplined in the market and he operated within his limits. He stayed out of technology because he did not understand it. And he has consistently had success over decades using this approach.

Knowing who you are will allow you to select the type of investing you are most comfortable with. Using a system that allows you to invest within your natural tendencies allows you to act with power and confidence in the markets even when it seems like the clouds are darkest. Become one with your investing style by knowing what that style is and staying within the limits of that style.

Learn about the market—know what options are available

Ponder your life experience and how this experience might influence the type of trader you are and the type of trading you should do. In these early stages, avoid bringing judgement or bias to your desired investment approach. Learn about different systems and be open to what resonates best with you.

Learn about different investment strategies and time lines. Some investment approaches requires more time in the markets while others don't. Some strategies focus on cash flow, some on gains, some on steady protection. As you spend time with your coach, learn about various methods of investing and choose one to to begin with.

Warren Buffet knew what type of person he was so he did some research and found that Benjamin Graham was a successful investor using the type of system that resonated with him. He then put himself in a position to learn how to invest as Benjamin Graham invested. You may not be able to go work with the individual who personifies your investment style, but you can attend your coaching sessions, practice with a paper trading account and continue to learn.

Over time you may decide to diversify your trading styles. You may decide that for the bulk of your retirement, avoiding losses is more important than gains. While at the same time, you take some of your investments and work to generate cash flow to pay for a lifestyle. You may also want to take a small part of your portfolio to experiment with different investment methods to keep learning about the markets and improving your investment skills.

Develop confidence through small successes

Confidence comes from consistent success. As you begin your investment journey with your classes and instructor, begin trading in a virtual account. The real learning is in the doing. The learning you get from your mentors is best when combined with the learning that comes from actually trading.

Keep a journal of your trades. As you get better with practice, your confidence in the system and in your abilities will increase. Keeping a journal helps you track your progress and helps you improve your trading.

The important thing in this early stage is to carefully apply the things you learn in class. Practice good portfolio and trade management. Practice strict adherence to the rules of your strategy. Practice forecasting entry points and profit targets. Practice setting stops and getting out with small losses.

Remember knowing what to do is only part of the process. Knowing how to do what you know you should do is also a critical and all too often forgotten step. To develop this emotional control, you will need to invest actual money. Only do this after you have experience with your virtual account.

Invest only small amounts of real money initially. Protect against loss. As you trade your real funds, examine your emotional state before the trade, during the trade and after the trade. Track your results over time and write down your emotions with the trade. This focus on the emotional side is not done in books or investor workshops because it is hard to quantify. Yet it is important and you should spend time to measure and improve your emotional reactions to your trading.

Don't try to swing for the fences when you first begin trading. Instead just try to get on base with small, consistent wins by being conservative and careful. Small successes will help you develop confidence in your system so you can trust it when times are bad. This trust will be critical to your investing success as will be shown in later parts of this book.

Small profits will lead to more profits which will lead to a growing confidence and to an improving emotional discipline. Be careful here not to get too caught up in the "golden child" syndrome. This syndrome is where you begin to have enough success that you think you can do no wrong. It's tempting to use past success to forecast future results and to begin to put more and more money at risk on fewer and fewer trades.

Don't be overconfident. And don't be too tough on yourself with your losses. Losses are a natural part of trading. Limiting your losses and letting your profits run develops confidence in your financial future and your investing system. This confidence is necessary to maintain motivation and enthusiasm for investing in all market conditions. It can be so easy to give in or give up during the investment slumps all investors experience.

It's human nature to simply give up on those things we that don't come easy to us. Remember, the best things in life are the most difficult ones. Remember the adage, Do today what others won't do so you can live tomorrow like others can't. You can't become a world class pianist without first being a world class practicer.

Celebrate your success

Celebrating success is a crucial part of the process for all investors but especially for the beginning investor. It's easy to fall into the trap of calling your profitable investments a failure if you get out too early and miss out on additional gains. So if you have profits…remember you did it! Don't pull out the ugly stick and beat yourself with it just because the position continued making money after you got out.

It's so easy to give up on yourself and your financial future when things seem hard. And it's really easy to only see your failures in the market (especially since even success can be seen as a failure). It's easy to let the habits of thinking and being that brought you to this place keep you on the same path that leads to a less than desirable retirement.

Stay positive. Keep a journal. Things are improved only if they are measured. Measure (and remember) your successes and celebrate your growing skills as a trader. Implement something of meaning to you to celebrate your successful trades. Do this on every winning trade. Remember most investors use the buy; hope, wish and pray method or in other words, they depend on luck. Celebrating your successes can help you maintain confidence in your system even when you experience a losing trade.

It can be challenging to stay motivated. Your efforts to make money and the rest of your life will get in the way of your efforts to put your money to work. It can sometimes feel like a joyless grind. When you feel this way, ask yourself this question: Do you think it is possible for Olympic athletes to just wake up one morning and be ready to compete? No, they prepare for years and years far away from the lights, the glory and the applause to have their one shining moment in the sun. What was it within them that propelled them to such a long-term investment of effort, time, money and energy?

All those who achieve greatness in anything have worked hard and invested considerable and consistent effort over time. They didn't achieve greatness just because they decided to roll out of bed one morning deciding to be world class. Thomas Edison has said that invention is 1% inspiration and 99% perspiration. Your success in the markets will be a similar ratio. Celebrating your success helps you maintain your confidence and willingness to continue pressing forward.

Confidence is such a big part of success. Great athletes must maintain their confidence even if they experience a slump. If they lose confidence they begin to play tentatively, they play scared. By maintaining confidence in the face of failure they continue to act with power and play with surety. This allows them to get out of the slump faster. You need to develop this mindset and capability so you too can overcome your slumps as they come.

As an investor the biggest challenge you will likely face is maintaining a deep confidence in your system and in yourself. Being realistic about failure—analyzing it from a third person perspective—will help you constantly be able to learn and grow and adjust your system to make it more successful. And continually reinforcing your successes will help you maintain the confidence you need to keep going.

Remember, most of your work will be done behind closed doors far away from the glory and the music. But if you maintain confidence in yourself by celebrating your successes you will continue to be motivated to keep working to grow your abilities and expand your capacity.

Often in our lives we think about certain objectives we would like to achieve. Perhaps you want to retire early, or perhaps you want to lower your handicap in golf. Whatever your goal, recognize that the realization of that goal is accomplished only through a series of processes over time. It does not happen overnight just because we suddenly decided we wanted to achieve something.

Think back to your last set of New Year Resolutions. How long did you stick with these resolutions? Try to develop a mindset of excitement about the baby steps you take towards your goal. Too often we see the goal we want way out there in the distance and we agonize over all the distance between where we are and were we want to be. Sometimes this agony grows so large that we give up the goal rather than have to think about how far we are away from it.

The mindset you are working to develop is the mindset of other successful investors. These investors are not right all the time but they are right enough that they can continue playing the game and they understand that sticking to a system is a large part of success. Have the confidence you need to continue sticking with the system you choose and to continue to act with power in the market.

Understand loss is part of the game

Probably the hardest thing for investors to learn is the fact that failure is part of the game. No investor is right all the time. Even the most successful investors of our time have losses. If the greatest investors of our time have losses be assured that you will too.

When you experience a loss, adopt the emotional position that failure is part of the game and that it does not reflect on you as a person. People tend to associate their success of failure in life to their success or failure as a person which tends to limit their vision and stop their forward progress.

But how do you develop the ability to separate loss in the markets from your own success or failure as a person? In our minds we understand that losses happen as we invest because we do not have total control of the outcome. But knowing this with your mind is one thing—it is altogether another thing to understand this at the deepest, intuitive level.

Think about it. How many times have you been in a stock that lost money? Was it easy to accept that losses are part of the process and continue following your system? Most of us are so worried about losing money that we can't make money in the market. I mean, most of us cut our profits short and let our losses run. I will come back to this statement later in the book, but for now understand that you need to learn how to take small losses if your forecast was wrong.

Think about your portfolio. How many of us could have done better if we would have eliminated one or two large losses in the past year? Why did you let these losses spiral out of control? What is it that causes us to "let our losses run"? Later in the book we will discuss various mental and emotional traps that people fall into that cause them to hold onto their losses. You need to identify that part of you tempted to hold onto your losing investments because "they will come back." Don't fall into that trap. Take the small loss to protect your investment capital.

Most great individuals in history are also well acquainted with failure. Walt Disney was told he could not draw, Barbara Streisand was told she could not sing and Sylvester Stalone has been told that he couldn't act. And yet each of these people and a host of others somehow knew that they had something to contribute or to offer and they did not let early, initial failure prevent them from doing what they wanted to do.

You will have losses. But if you can approach your investing like a business, these losses can be thought of simply as clients who didn't pay for work you've done. As a business owner, would you keep doing work for people who don't pay you? Of course not! Same with investing. Stop doing work for those trades that don't pay you. Cut your losses short.

Understand that if you are not careful, you will find that your past losses affect your future investments. If we are tentative or if we invest with fear, we will make the wrong decisions. You need to develop the ability to hold the success or failure of your investing at arms length so it does not affect your emotional approach to the market. Don't let past mistakes influence your current investments or you will never really succeed.

No system will work all the time

Similar to the understanding that losses are part of the game is the understanding that even with a proven trading system mistakes will be made or trades will go bad. No system will work all the time. But you can control the amount of loss using stop losses. Stop losses help you get out if the stock moves against you. Once you have gotten out, focus on the next investment opportunity and do not dwell on the recent failure. Sometimes we get so caught up in focusing on our failures that we cannot be successful!

All successful investors have confidence in themselves to make accurate decisions. This does not mean that they will make accurate decisions every time. What it does mean is that successful investors have the ability to act with confidence—or to act with power—following their systems despite losses. They also learn from mistakes they make and are able to carefully improve their market approach because they journal their trades.

Let's be realistic. The reason there are so many approaches to the market is that no single system works every time and there is always somebody out there trying to develop a better one. I call this the "silver bullet" approach. Many people are trying to find the silver bullet, the bullet that never misses AND IT JUST DOESN'T EXIST!

There has never been an investing system in the history of the world that has been right every time. Your system will not be right every time. You will make mistakes implementing it. It will give false signals. But to be successful you will have to have confidence in yourself and in your system even during the bad times.

Even the best traders are not the best traders in every trade. The best traders are measured over time and over many trades and not just from trade to trade. Take the long view of your own results and work to get better, protect against loss and nurture your profits.

As a trader, work to develop the same mental approach to the markets through regardless of a trade's outcome. By learning how to stay "forward focused" you will be able to approach the next investment opportunity with every bit as much confidence and power as the best traders do. This will help you be more successful more of the time because your emotions do not dictate your actions in the market, your logic does.

When losses come, stay confident

It's a given that in sports superstar athletes experience slumps in their usual world class performance. A slump is that time when greater things are expected but lesser things are performed. You will often hear a sports figure talk about the need to "get back to basics." They often talk about the need to maintain their confidence and continue performing until they can break out of the slump.

Slumps are periods of time when people are not as successful as they normally are. Michael Jordan is considered to be the greatest basketball player of all time. But he also experienced slumps where he was not as successful as usual or when others appeared to be more successful. These slumps are a natural part of being human and should not be construed as indicative of a person's real abilities.

If you have been careful to find a system that resonates with you and if you have started by investing carefully to experience a large number of successes, you will be able to stay more confident in the face of failure. This is critical to long-term investing success.

Go back to the greatest sports figures of all time. What did they all have in common? They all had confidence to continue playing despite the occasional slump. Did Babe Ruth hit a home run every time he got to the plate? No! He "failed" a great number of times. In fact he struck out nearly twice as many times as he hit home runs.

There will be times in your investing life when you will strike out. How you handle these failures has a direct correlation to your investing success. Imagine if Babe Ruth had decided to quite baseball after his very first strike out! Obviously Babe Ruth decided to focus on his strengths and was able to understand that strike outs are part of the game. As an investor you too will have to focus on your strengths and understand that bad investments are a part of the game. Don't dwell on the negative realities of life—instead try to stay focused, on task and consumed with learning how to improve and get better.

Imagine how much different the world would be if people decided after the first failure that they were not good at something and decided to leave and do something else. How many authors have had their first books turned down by multiple publishers? How many musicians or artist have not been fully appreciated in their lifetimes let alone after their very first work?

Take some time right now to think about how you react to life. I tend to react to failure by thinking I should just quit and do something else. Sometimes I don't even attempt something because I am worried that I wouldn't be that good anyway, so my fear of failure prevents me from even taking that first step!

Are you afraid of failure? Does this fear of failure make it hard for you to even begin the process? If so, you will need to overcome this part of your personality before you even begin to put money in the market under your own direction. Increase your confidence by understanding that losses are part of success because having a loss means that you are moving and if you continue to move eventually you will learn how to have more and more profits with fewer and fewer losses.

Stick to the system--Avoid "flavor of the month" investing

Flavor of the month investing is my term to describe a fairly common occurrence. How many of you have decided that you wanted to go to the Baskin Robins Ice Cream shop because you are in the mood for some delicious chocolate ice cream. But when you got there you saw so many different types of ice cream and such a variety of toppings that you suddenly couldn't make up your minds about what you wanted?

Sometimes there is such an overwhelming number of choices facing us that we get confused about what we really want. This is especially relevant in the stock market because there are so many ways to play a stock and there are so many different signals often pointing to conflicting forecasts. I have watched so many "experts" get on TV saying this stock was a good deal only to see another "expert" tell me why it is not a good deal. How do I develop the ability to make decisions for myself? How do I develop the ability to take action amidst all this noise? I do it by carefully defining my investment system and then sticking to that system no matter what.

Learning to treat my investing like a business instead of a hobby helps me stick to my system and remain true to my "business plan." Remember that for every person who thinks they should sell the stock, there is another person who thinks they should buy it. In other words, there will always be conflicting viewpoints and differences of opinion. This is the nature of the stock market—a big bazaar where some people are buying and others are selling the same stock every single day. Your job is to chart your own course of trading despite this noise.

I keep repeating the old saw that successful investors are those with a system of investing and who stick with their system. How can you become good at something if each failure leads you to change your system? Imagine Tiger Woods deciding that he was not good at golf anymore because he lost a tournament. If he was like many investors he would try his hand at another sport and with each failure would try yet other sports until he came back around to golf.

How good would Tiger be if he tried to be a golfer one month, a basketball player the next month and a world champion bowler the month after that? Would he ever achieve the level of greatness in any of these sports as he does right now with golf? As an investor you will need to develop the ability to stick to your system. You must have a well-defined system of investing and you must have the discipline to stick with it. Journaling will help you see where you don't stick to your system and help you course correct to improve your results.

I've taught thousands of students from around the world how important it is to develop discipline and to stick to their chosen system. I currently own a business that teaches various trading and investment strategies to students. The best students learn to trust their system and follow it as best they can.

The company often makes the statement that investors are drowning in data but thirsting for information. A proven system helps make sense of all the data now available to the average investor. A good system acts as a filtration device to help you stay focused and on task. The brain uses different systems to make sense of all the data it processes every second of every day. Because of the innate ability to focus, people can make sense of what they see without experiencing sensory overload.

Unfortunately many investors don't fully understand this. They try to develop shortcuts to their system. Just like I did with long division in the fourth grade, people try to find easier ways of getting to the right answer. And since investing, unlike long division, does not always lead to clear cut right or wrong answers it is easier for these investors to justify their actions by pointing to a few wins.

I believe that most people are constantly on the lookout for the best, most accurate trading system that uses the least amount of effort. If it were possible, most people would like to buy a "black box" that tells them exactly what to do in the market. Of course this is a natural human tendency. It is very human to want to try to get the maximum possible gain with the minimum possible effort. Don't fall into this trap. All successful investors know how the markets work and have spent the time learning how to take the available data to make their own decisions.

Making money in the stock market is a very simple process: you buy low and sell high. But what I have seen is that many people begin to get a little confused about exactly how to do this. There are hundreds of different technical indicators used for different investment time frames, strategies and profit targets. All of which are appealing and can easily cause confusion in your approach.

It can also be tempting to change your system with your first loss. Or to change it when you had a 25% win but could have had a 59% win had you held it a few more days…even though your system told you to get out.

So what often happens is that new and inexperienced investors tend to begin with one investment system but quickly move to another and another and another over time. They never get really good at any one system because they are always trying to find the shortcut or grasp the magic system that is never wrong. I know that there are constant advertising pitches out there promising huge returns but don't believe it. Not one person in the world knows with absolute certainty what will happen tomorrow. But if you find and stick with a good system you will be able to develop a better and more accurate forecast for how stocks will move tomorrow and will be able to generate more consistent profits as a result.

Imagine yourself a world class investor. How did you get there? What actions did you have to take to get from where you are now to that level of expertise? Did you find one system and get really good at it, or did you constantly jump from system to system? Just like anything else in life, success comes by remaining consistent and by sticking with what works. Don't ever forget this.

In the Marine Corps we are issued a weapon. The weapon we are issued is the same one over and over and over. Despite the fact that there is no direct ownership (I did not buy my weapon) the Marines recognize the value of the individual being familiar with the weapon. In fact, this was such an important issue that we were constantly told that the weapon is to stay with us at all times during the day and night. It got to be so much a part of me that I felt naked without it.

This level of familiarity leads to greater success. I don't know if this is a true story or not, but I once heard that a concert pianist was asked how he could play the piano so well with such small hands. His response was simply, "What makes you think I play the piano with my hands?" His instrument of choice—the piano—was so much a part of him that it became an extension of his soul just like his other appendages.

You must develop this level of expertise or familiarity if you are to become a successful investor and you cannot develop this level of expertise if you constantly change investment systems. You don't have to master everything in the market to do well, you only have to master a few things but do them consistently.

How money management affects investing emotion

This book is not a book about money management. But money management does affect how you invest and how you emotionally react to the market. So this book will spend some time discussing the importance of money management in controlling your emotions while investing.

There is a book called, "The Richest Man in Babylon" which basically states that in order to achieve financial freedom you have to learn that a part of all you earn is yours to keep. In today's language we would say that successful people or those people with money have learned how to live below their means. It's said that it's not how much money you make…but how much you keep which determines your wealth. The money you save is what you put to work in your trading.

It's difficult to live below our means today. With credit so easily available in the form of credit cards and with so much marketing to buy different products or services it is hard to refrain from spending money we don't have. A recent study found that the average college student carries over $3,000 of credit card debt in addition to their student loans!

This just shows that we do a poor job teaching our children the nature of interest. It has been said that those who really understand interest are paid it while those who don't understand the principle of interest pay it. Living below your means helps you become one of those people who are in a position to compound their investments. Compounding increases your net worth over time which is a powerful motivator to continue saving.

Once you have a history of generating substantial gains in the markets, it becomes easier to avoid buying things as you contemplate how much you lose in opportunity cost by spending that money instead of investing it.

One of the reasons why it is important to live below our means is that by doing so you will always be able to put money into the market. Putting new money in the market makes it easier to keep trading through the losses one inevitably experiences. And any amount you regularly put into the markets (even small amounts) can grow to substantial investments over time as you continue generating consistent returns.

Traditionally one of the most conservative investment strategies is to dollar cost average. Dollar cost averaging is a strategy whereby the investor puts a set amount of money into the market every month. This is a straightforward and easy way to lower the risk of stock ownership over time. Perhaps a specific example will help you understand the power of this strategy. Let's illustrate by saying there are two types of investors putting money in the market. The first one buys a set number of shares every month and the second one buys with a set amount of money every month. Below are three tables:

Spent $9700 one time					**Purchased a set amount of shares per month**					**Spent a set $ amount per month**			
Date	**Price/ Share**	**Shares**	**Cost**		**Date**	**Price/ Share**	**Shares**	**Cost**		**Date**	**Price/ Share**	**Shares**	**Cost**
15-Jan	$35	277.14	$9,700		15-Jan	$35	100	$3,500		15-Jan	$35	69.288	$2,425
15-Feb	$20	0			15-Feb	$20	100	$2,000		15-Feb	$20	121.25	$2,425
15-Mar	$15	0			15-Mar	$15	100	$1,500		15-Mar	$15	161	$2,425
15-Apr	$27	0			15-Apr	$27	100	$2,700		15-Apr	$27	89.815	$2,425
Total		**277.14**	**$9,700**		**Total**		**400**	**$9,700**		**Total**		**441.35**	**$9,700**
Avg. price per share			**$35**		**Avg. price per share**			**$24.25**		**Avg. price per share**			**$21.98**

Now take a close look at the tables above. As you can see, if you were to invest a set amount one time in the market, and if you happened to invest that one amount during a period where the stock was toward the high end of the range, you would be a lot worse off than if you can put a set amount of money into the market every month.

Now take a good look at the numbers where you buy a set amount of shares per month and when you pay a set amount of money per month. When you buy a set amount of shares every month you have a wide swing in the amount of money you spend every month. You also end up buying the same number of shares whether or not the stock is high or low.

Finally you can see that when you spend a set amount of money per month you end up buying more shares when the stock is cheaper and less shares when it is more expensive. This gives you a much better cost basis over time. It also is much easier to invest the same budgeted amount of money every month. Think of it like a bill that comes due every month. Except this is a bill for your retirement!

The emotional side to all this has to do with confidence and perspective. If you can only invest $10,000 and you know you will never put more money into the market, your concentration and your emotional state on any movement in the overall value of that $10,000 will be extreme. Imagine how your emotions will paralyze you if you lose 10% of that investment. It may cause you to get out of the market entirely.

Losing money is never very enjoyable. But consistently adding more money into the markets gives you a confidence to keep going when you experience loss. This is especially true if you dollar cost average. Then volatility works in your favor and your investments grow in profitability as your cost basis reduces over time.

Consistently investing in the market smoothes out the volatility curves and makes it easier for you to stay positive and confident. You will be able to take the long view, have patience and exercise discipline. By putting new money in the markets over time you increase your returns and you develop a better emotional attitude about your investments.

Don't abdicate personal responsibility

To this point we have focused on the value of developing an investment plan to help you remain an unemotional investor through knowledge and education. We have also discussed the importance of sticking to that plan no matter what—of thinking of that plan as home base. The emphasis has been on doing the things you need to do to develop confidence in yourself and your ability to accurately predict market movement.

This confidence is gained through education and through practice. We have talked about the need for setting up and using a virtual account to apply what you learn in class.

We have discussed the importance of knowing what to do and in being able to do what you know you should do. Remember, knowledge is power because it gives you a guideline for how you should act. But you must also be able to act; to apply that knowledge to achieve your desired goal. I was once told that good ideas only cost a dime a dozen because that's all they are worth unless that idea can be acted upon and brought to life.

You have begun a journey to wrest the reins of financial security into your own hands. You will do a far better job it it...once you make it through the initial learning curve. The initial effort required to overcome inertia, learn new concepts, remain consistent in your approach and overcoming the knee-jerk reactions of fear and greed is a barrier. Many people start out with the best intentions along this course... but falter when the going gets tough. It won't be easy for you to work all day and then take the time and expend the energy necessary to learning how to trade. But know that as you gain experience, the process becomes easier and easier.

Peter Lynch once stated that most people spend more time planning their vacation than they do planning for their retirement. Don't let yourself go back to the status quo just because it's hard to overcome habits of thinking and habits of being that want to stop you in your tracks. Push through this initial resistance and you'll find a new world of financial confidence and empowerment.

You may already have accounts with financial planners, advisors, brokers or whatever. In the past, this is all you knew and that's okay. But remember these experts are really just highly trained salesmen. They may helped you make tons of money or they may have lost you tons of money. Like you, they don't know what the markets will do tomorrow. And it may even be worse that this. Remember, they work for their firm....and their firm's best interest may not be yours.

Investing for yourself (however difficult it may initially be) gives you the benefit of being able to learn from mistakes and get better over time. You are the only one with full responsibility for your retirement. You have a duty to provide for your family's financial future. You have the responsibility to make sure that your money is growing to prepare for retirement. You should not abdicate this responsibility to anyone else. Remember, no one worries about your financial future as much as you do.

By taking control of your financial future you also take control of your investing. You will be able to make more informed decisions whether you work with an expert or not. I am not suggesting that you should never work with an expert once you have developed your investment strategies. Quite the contrary. Experts can be great helpers in finding potential investments and in providing additional insights and education. But if you do choose to work with an expert they must work for you.

I have taught thousands of students all over the world and find that many of them have the same things in common. Many of them have experienced great success during the bull market by listening to financial advisors and brokers and by following their advice. But since the bear market started most of these people have become frustrated with their expert who know longer seems to have a handle on the market.

Many of these students come to my class and comment that they don't know why their expert is losing money, but that they can lose the money just as easily as their expert. What they mean is that the education of the course will give them power to make better, more informed decisions in the market. I think that what they really want is the confidence education can bring. To be able to make your investment advisor your partner, you must be confident enough with yourself to make your own decisions after gathering the input from the expert.

The truth is the entire system of preparing for retirement is broken. There is a massive conflict of interest between these so called experts and your needs. They want to spend as little time with you as possible because their money making efforts are to sell more people into their funds. They get paid by assets under management and not for performance. They won't teach you how to maximize your gains. It takes too much time.

I once worked with a financial advisor to help me with my investing. I was pretty young and I did not really know anything about the market. I can remember sitting down with this advisor and being shown a large number of mutual fund choices in which I could invest.

There were international funds, growth funds, income funds, a whole range of choices. I just sat there so confused because I did not really understand the markets and had no idea what fund I should choose. I remember when the planner asked me which fund I wanted to invest in I responded by saying that I did not know—I just wanted to buy the fund that went up in value and that was what I was paying him to tell me.

He quickly responded by telling me that he was not responsible for future market direction because no one can predict the future. Not knowing what else to do I chose the mutual funds that had had the best historical performance. But is this a good idea? No! Usually a great performance leads to a mediocre or even and under performance the following year.

Once the investments where made I started getting my quarterly statements. Every quarter some of the funds would have gained value while others had lost value. Because I did not really involve myself enough to educate myself about the market I never really knew why things were moving up or down. They just sort of magically did what they did.

Can you see how this might be a bad way to invest? I was unable to learn better investing techniques to improve my performance. My money languished in less performing assets and I was not taught how to increase the performance by using options. They didn't tell me I could cash flow my investments via covered calls to help pay for things like cars, homes, vacations, education or whatever. My ignorance helped them keep making money on my funds under management but also kept me from fully maximizing my returns.

Did my investing advisor did not teach me because he did not know or because he did not really care? I will never know, but I do know that no one worries about your future as much as you do. So take control of your future by learning about the markets and by investing in the markets for yourself.

Abdicating your responsibility to some expert is the worst thing you can do but I also know it is the easiest thing to do. I also know that paying others to tell us how to invest often leads to success. But if this thing called investing stays a mystery you will never really be financially free because you will always be dependent on someone else.

Yes you will make mistakes. Yes you will lose money. Yes you will have to grapple with your emotions. But if you trust an expert you will also find that they make mistakes, that they lose money. They will be an easy target to blame, but playing the blame game does not really help you become free does it. Do this for yourself and experience a new world of opportunity open up to you.

Learning how to invest in the markets can have so many other benefits in your life. Think about it. If you learn how to remain calm despite the storm raging in the market, if you learn how to be careful and how to make forecasts, you are also learning things that can help you in other aspects of your life. Developing the proper emotional discipline necessary to be successful in the stock market will also help you be more successful in your interpersonal relationships, your current job, your education or whatever.

So do the research, develop your skills, learn proper emotional discipline, and develop your trading skills. Your entire life will benefit.

Chapter Summary

Before we move to the next chapter, take some time reviewing the concepts discussed in this chapter:

- The first step to develop emotional discipline is to trust a proven investment system. You've chosen a proven system...now follow it carefully.
- Remember that not all trades will win. You will have some losses. Follow the system anyway.
- You may have more than one investment goal and may therefore use more than one system at a time. But consistently apply each system throughout the trade.
- You must be consistently apply the system to have consistent results.
- Each system has its own tradeoffs of time, investment horizon, win/loss ratio.

- No one will make your money grow as fast as you can if you apply your proven system.
- Learning about the markets and investing your own money is the first step to becoming financially free.
- You must have confidence to stick with the program.
- Investing with confidence (and without emotion) brings greater success.
- Putting new money in the markets is like paying a monthly retirement bill.

If you have not already done so, please put this book down and spend some time evaluating your reasons for taking over your own investing. Let's be clear. It's very difficult to shift habits of thinking and of being. Unless you really know your WHY, you will give up short o f the goal of financial freedom.

We all work very hard to make money. And we know inside us that we should be diligent in saving that money. But saving money can be hard because *life.* What you have chosen to do by engaging with us is work a little harder now as you learn to put your money to work.

You don't have to save much money to have a great retirement...as long as you know how to make the money you do save really work hard. Your entire focus as you invest should be on your desired annual return. Warren Buffet guaranteed a 50% annual return on accounts less than a million dollars.

Developing your skills as a trader is the only way to achieve this kind of annual percentage return. Your broker, financial advisor, 401k or lawyer will never be able to achieve such impressive returns. But you can. If you fully embrace this education, make the mental changes you need to make and develop the ability to follow your proven system consciously and with exactness.

2

Avoid "Squinting"

In this chapter we discuss the absolute necessity of maintaining a level head. Too many investors become cheerleaders of the stocks they "want" to invest in or have held profitably for years. They buy (or hold) for emotional reasons and not because they are following their proven system. Squinting is working to see what you want to see to justify your trade even though you know, deep down, that the trade is not within your system.

As I have emphasized before, if you are a buy—hope, wish and pray investor you have become a cheerleader. You must allow the facts to speak for themselves and not try to see only those things you want to see or try to talk yourself into something simply because you allowed an emotion to overcome you.

As an instructor, I have literally spoken to thousands of investors from all over the world and one of the biggest mistakes I have seen them make is squinting hard enough to buy or hold a stock even though their system tells them otherwise. Are you a squinter?

Squinting is the term I use to describe the common phenomenon of seeing what you want to see. We all see our world through the lens of our experience and expectations. When it comes to investing, we must learn to see through the lens of our system and not through the lens of our emotions.

People often label themselves realistic, pessimistic, optimistic, depressed, or whatever to describe their point of view—to describe the outlook they naturally tend to have. I don't point this out to discuss the pros and cons of any outlook or to pass judgment for which world view is the best or most appropriate. Instead the thrust of this book will be to discuss how each of these natural outlooks tends to affect our judgment and our forecasts and how you can take steps to protect yourself from... yourself.

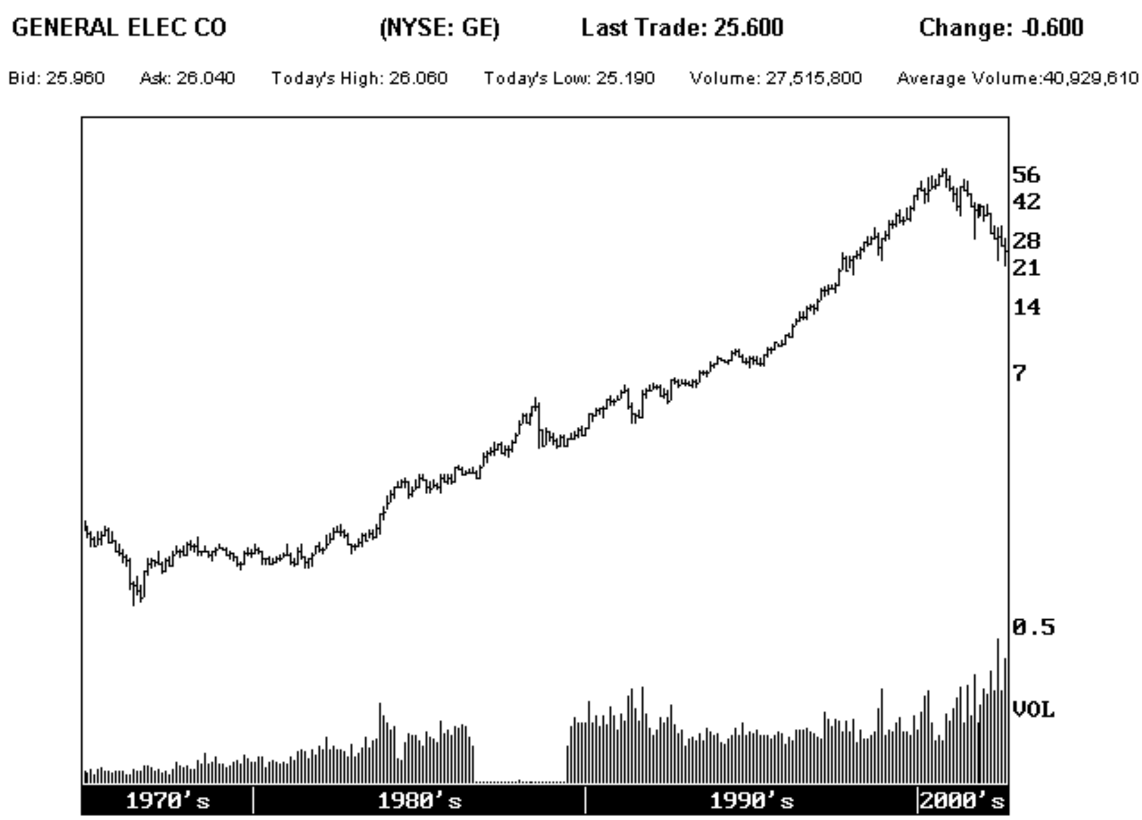
I had a boss once that always talked about "blind sides" that everyone has. This boss believed that every person on earth possessed blind sides they should work to be aware of and guard against. He believed the first step of protection was to determine natural tendencies and then find other people who are willing to help guard against these natural tendencies.

As an investor you will have to understand your own natural tendencies and then embrace a system you can embrace and guard against those blind spots which will seek to pull you out of the system. Chapter 1 was written to help you understand the importance of following a proven system that fits your personality. This chapter will discuss in greater detail the importance of sticking to your system so you can be protected from your weaknesses as a trader.

Let the facts speak for themselves

Most people's biggest weakness in investing is having their emotions of fear and greed blind them to things as they really are. As an investor in control of your own financial future, you must approach the stock market in a more mechanical way. Imagine giving your best friend investment advice. Would you be comprehensive of the risks and the possible rewards in your explanation?

Below is a chart of price movement of GE's stock since the 1970's to the early 2000's. As you look at the chart imagine you have owned GE since the 70s including the past year.



Try to imagine that you bought $10,000 of GE in the 70s. Your investment would now be worth over $280,000! How do you feel about this investment? How do you feel about GE?

I use this example to highlight how easy it is for our emotions to cloud our lens and cause us to hang on to something too long simply because it has treated us well in the past.

GE has dropped nearly 50% from its high reached in 2000. Imagining that you owned GE and that you still own GE, why do you still own it? What is it about GE that has caused you to hold onto the stock despite the heavy losses suffered in the past couple of years?

Over the past 30 years GE has developed a reputation among investors as a high performance and dependable stock holding. This reputation is just like a brand in that it gives GE top of mind awareness in the minds of investors. People know about GE and they trust GE enough to buy the stock because the company has performed so well and because the stock has performed so well. Most investors would think that GE stock is a good, safe investment because, well…because it is GE.

Going back to the question asked earlier, "Why do you still own GE"? What are some reasons you give yourself for still holding on a similar investment? Here are some of the common reasons people give me for still owning a stock like GE:

1. It will come back. (probably the most popular reason)
2. The broker told me to keep hold of it.
3. I didn't know what else to buy.
4. Fear of the markets.
5. I can' sell it now that it's dropped, I have to wait until it gets back to its high. I don't want to lose money in the markets.
6. I didn't spend the time to really watch it that closely.

A lesson to learn is to take what the market gives you. Remember, this is a business. If this "client" no longer pays you…stop doing business with it! But it can be hard to act amidst the emotions and self-doubts that assail us as we trade. This is why it's so important to have a system and to be confident enough in the system to cling to the rules even when your emotions try to sway you a different way.

It's human nature to find patterns in the things we see. It's literally how our brains are wired. As an investor, you may be tempted to "squint" until you see the pattern you want. But this approach won't work over time. Squinting until you see what you want to see is another way to blind yourself to the way things are…and trading requires you to see things as they are, not as you hope, wish and pray for them to be.

We all have blind sides we have to guard against. If we are to become active investors, working to control our own financial future and get our money working harder for us, we have to develop the ability to see things as they really are. I call this learning how to invest like a scientist.

Scientists have developed a very disciplined thinking style. They make a forecast (create a hypothesis) and then they seek to prove or disprove that hypothesis. Scientists create experiments designed to control for a number of variables so they can prove or disprove their theory. Scientists have to be careful not to allow what they want to happen to color their results so their results will be accepted and able to be repeated by their peers.

Investors, truly successful investors, create a forecast for a stock. They then look at the facts through the "lens" of their investment system without being swayed by other considerations or abstractions. This allows them to invest in the same way every time making their success a repeatable process.

Don't try to force your will on a stock

Similar to "Squinting" it's important to take what the markets give you…don't try to force your will on them. Your hope and prays and wishes will not move the markets. Successful investors protect against loss by employing cautious strategies diligently follow their proven system without letting emotions cloud their decision making.

The whole reason you have chosen to embrace the effort and expense required to master the markets in the first place is to put your money to work at ever higher rates of return. Whatever your approach, you expect consistent winners and impressive annual gains. You will be able to increase your annual percentage gains most effectively if you learn to take what the markets give you and follow your system assiduously.

As a new investor I followed a system pretty well and did okay. I made consistent money but not at the speed I wanted to earn it. So I began to adjust my system without really knowing how to define the additional risk I was putting myself into. At one point I decided that I wanted to earn at least 100% return every time I invested in the market.

Now this might seem like an astronomical return—and it is—but with an investment known as an option it's possible to get 100% returns if you forecast accurately and the stock moves a few points in the direction you forecast. But learning options is not the focus of this text—learning how to control your emotions is.

Just take a second right now to think about what I was trying to do. I was saying to myself that I wanted at least 100% returns! Does the market care what kind of return I wanted? Does the market even know that I have invested in that stock? No, of course not. So what was I doing? I was trying to dictate to the market the returns I wanted it to give me.

You have to learn to take what the market gives you. If you day trade, capture profits and roll into new positions with profits you've just made in the previous one. If you invest for the longer term, get out when the signals tell you to even if you end up losing money. Sometimes the best trade is the loss you take getting out quickly when things move against you.

As a teenager I decided to join the Marine Corps. So I attended boot camp at the Marine Corps Recruit Depot (MCRD) in San Diego where they train Marines who hail from west of the Mississippi. A few years later I also attended Officer Candidate School at Quantico, Virginia which is similar to boot camp but much more focused on the leadership aspect.

What I was taught there is that the battleground is a fluid and ever changing environment. As enlisted Marines we were taught to obey every order immediately to the best of our ability. We were taught to respond to the situation at hand keeping the objective firmly in mind. As an officer in training, I was taught to focus on the end result while responding as necessary to the new information streaming in from the battle. We were taught to be adaptable to new information but adaptable in a way that brought us closer to our objective.

Like we had to learn in the Marine Corps, you must also learn to become adaptable if you want to become a successful investor. The difficulty will be to balance the necessity of changing your plans while still being true to your objective or your plan. You have to be able to continually take stock of the situation and develop the ability to act on new information as that information impacts how well stocks in your portfolio still fit your plan. If you simply buy GE because it is GE and if you hold GE because it "will come back;" then you are not taking new information into account and you are not as adaptable as you need to be to remain successful in this market. You're also not following your system.

Why don't we get out when our system tells us to? Maybe ego gets in the way. Maybe fear? Maybe life is allowed to get in the way? Another reason it's difficult avoid the pitfall of forcing our will on a stock is that there are always two sides to a trade. Both buyers and sellers make their case and it's easy to listen and be swayed by this logic if we're not careful.

This is why it's so important to select a proven system to follow. This is why it's so important to journal your efforts and learn to be more strict as you follow the system. This system will give you signs for entry points and also exit points. Trust them and act based on the system and not on your desire to be right or the fear of losing money.

Let me provide a specific example. Look at the chart below. Assume that our investing system told us simply to buy when the trend line was point up and sell when the trend line pointed down. Notice the first half of the chart the trend line was basically pointing up but that during the second half, the trend line is basically pointing down.

It might be easy to give yourself reasons for staying in the stock when it hits 60 and the trend line starts to fall. But your system tells you to get out. So get out. You don't need an angel from heaven to come down and tell you to sell, you need discipline to get out when the stock no longer no longer fits your system.

This system works pretty good *if you follow it*. Your system also works pretty good if you follow it. Follow it! As an aside, this chart is a 5 year chart of GE. Would this knowledge make it harder to sell GE when it no longer fit your system? Would you be tempted to "squint" in late 2000 because you still want to own GE despite the warnings from your system?

Remember, learn to take what the market will give you. Don't try to impose your will, your prayers, your hope or faith onto them. Avoid squinting to see what you want to see. Learn confidence in your system and follow it carefully.

Learn to make quick decisions

There is a motivational sign that declares, "Lead, follow or get out of the way!" Many people who start the journey of investing for themselves have a hard time actually investing. We never have complete knowledge of everything that could possibly affect a stock's price. We have to act with incomplete information. Many people so keenly want to know everything that they literally apply the "ready, aim, aim, aim, aim, aim, aim, aim, aim, aim aim"....and maybe eventually they get to the "fire" part of the equation.

The message is clear, we must be willing to act to get things done. For the purposes of investing, the action must be in the form of understanding your system and applying that system in the markets consistently. That's it. If you want to significantly increase your financial net worth and remove the financial fear so many of us carry, you must be able to take action to buy and sell as you follow your system despite all the noise of talking heads, earnings releases, economic reports, losing investments or company promises.

The hardest thing most investors face is the ability to make quick decisions. A good, clear investment system will help you make faster decisions because it provides a set of lenses from which to view the market. And gives you specific buy and sell rules to follow. But even with a clearly defined and closely adhered to system you will still face situations where you will have a hard time making a quick decision.

Too often investors will sit and stare at a chart for too long. They second guess themselves, their system and the markets. This is especially true after someone has had a losing trade. After every trade regardless of the outcome, apply the "Next" philosophy. Don't let any previous trade affect your future trades.

Knowing what you should do does not help you unless you also know how to act. And in the stock market you often have to learn how to act fast. But at the same time you cannot be too reactive to the market or you will whipsaw in and out of stocks with nothing much to show for it. You never want to be a "ready, fire, aim" investor!

There is a delicate balance that must be kept between adapting to the market and remaining true to your investment system. This is not an easy balance to maintain. If you are long-term you will find that short-term signals or moves will happen that might shake your confidence. You will also never really know if this short-term signal is the first step in a new change in direction. You will find yourself constantly pulled into confusion and inaction.

The guiding principle that must be followed is your system of investing. Great leaders have an ability to make decisions and take responsibility for those decisions. Like you, the great leaders of the world do not know the future. They do not know every possible fact that can be known about a subject. But they are able to take what they do know, decide on a course of action and then motivate others to move along that chosen path.

You have a proven system to follow...so trust that system and follow it. You must not lose your confidence and be whipsawed out too soon. You must not allow yourself to get greedy and buy stuff that you end up wishing you didn't own. You must be able to strike a balance of knowing how much information is enough to take action....and taking that action.

I've worked with thousands of investors and I know how hard it is for most people to take quick, decisive action as they follow their system. Most people second guess themselves, they second guess the system, they second guess the markets. They try to do less work to get the same results. Frankly they lack confidence. And success requires the confidence to trust a system to get in even during slumps and to get out even when your positions become hugely profitable.

Don't get paralyzed

Have you ever heard that saying, "paralysis by analysis"? This type of paralysis comes in two forms. The first is where we feel we can't act because we are getting or seeing conflicting signals. You'll get negative and positive information about a stock's prospects. Which one do you believe?

The second type of paralysis by analysis is where we feel we can't act until we know all the answers. Too often investors worry about getting into a stock because the one thing we don't know will be the thing that drops the value of the stock. So we wait and we wait and we wait until it is too late to get in so we wait some more for the best time. If you find yourself wishing you could know the future movements of that stock then you are likely suffering the paralysis by analysis disease.

How many times have you heard a successful entrepreneur make the comment that if they knew how hard it was going to be before they started, they would never have started! I once watched an interview with Tom Hanks conducted on a show called "Inside the Actors Studio." As you know, Tom Hanks is arguably one of the most successful actors of our time. During this interview he talked about his early days of acting and the process he had to go through.

He described the many times he auditioned for parts and was turned down. He described the months and months of effort he put into acting and in bettering his craft. He talked about how hard it was to "break through" into the business. And then he ended it by encouraging the students in the audience to understand that this effort, this patience, this hard work was simply part of the process of becoming successful at their chosen vocation.

You must also understand that as investors, we must also go through a process. This process is painful, it takes patience, it takes a rock hard center of confidence and stick-to-it-iveness to finally break through into consistent success. But one guarantee is that it will not happen if you become paralyzed at some point and stop moving.

Most times investors are able to start out with all the right intentions and they begin by doing all the right things. They might even be successful for a while. But at some point (it happens to everybody) they'll experience a loss. It is how people react at this point that causes them to experience success or failure over time.

Remember, you cannot experience success every time—this is impossible. But your success over a period of time is directly related to your ability to act. You are constantly being bombarded with information about the companies in which you invest. News articles, often both positive and negative, come out. Stock charts change and give different signals. The industry group the stock is in goes through a natural down cycle.

This information is valuable and contribute to the signals your system will give you for buying or selling. But if you can't act until you know everything then you will never be successful. Learn how to act on minimum amounts of information as you follow your system.

Probably the best way to avoid paralysis is by keeping yourself centered in your system. Make this system your home base—a place of safety from the swirling storms of information raging against you. If necessary stop watching news programs about the market or how the geopolitical uncertainty will affect the market. Just put put on the blinders and avoid anything that is outside of your chosen system.

Learn to see the whole picture

Seeing the whole picture means that you see everything your investing systems says you should see and not try to see everything that might affect the stock. This might include such things as earnings, revenue growth, industry group strength, chart patterns or whatever. I have seen many investors who are just learning to use a system forget to look at some key aspect from their system and end up with bad trades because of it. To help you learn how to automatically see the whole picture, it might help to develop a simple checklist of items your system suggests. Then journal how well you followed the entry and exit points following your system.

Different world views are called paradigms and these paradigms influence what we see and what we don't see. Paradigms are lenses through which the brain processes the information it receives from the world. When we view the world through one type of lens, we cannot see solutions that lay outside of this paradigm.

As an investor you will need to understand the lens through which you see the world. You should clarify your world view and write down your paradigm so you know where your blind sides might be. The most important part of any journey is knowing where you start. Once you know where you're starting this journey, you'll be able to protect yourself from in-grained, self-sabotaging tendencies as you evolve your blind sides into strengths.

Understanding where your lens prevents you from seeing things clearly helps you take conscious steps to protect yourself from blindness. Seeing the whole investing picture helps you follow your system more closely despite emotional swings which will try to pull you away from it.

Most people want to control the outcomes of their lives. They want to see their goal and every step it takes to achieve it. This very control gives people a sense of safety and security. It's a mechanism designed to protect us from pain.

Many new investors automatically apply this need to control outcomes to their investing. They desire to control their investments....and yet there is no control of the markets. We can't dictate the direction or the magnitude of a move. All we can do is anticipate it and react to it. This creates a high level of uncertainty and fear which could lead to selective blindness where we focus so much on the market that we literally can't see the signals our system gives us.

The result of selective blindness is investment loss. And these losses could cause us to second guess ourselves and our proven system and rethink our original desire to take control of our financial future through education and application. Don't let this happen!

There is a tendency for many people to rationalize behavior and poor outcomes. Maybe we play the blame game or maybe we hide from ourselves. Rationalizations lead to poorly conceived changes to our investing system and a focus on profits or losses and not on the system.

Stop grasping at straws looking for excuses. Focus instead on the actions necessary *right now* to protect investment capital (cut losses short) or to grow investing capital (let profits run).

Learning how to see the whole picture means learning to do away with any rationalizations. It means learning to overcome the tendency we all have to justify our behavior. Remember, with investing nobody needs to know what you are doing. You do not have to worry about failing in front of thousands of friends or family. The biggest struggle most people have is to see and then act on the opportunities the markets present. Learning to open your awareness to all the elements of your system is critical to your trading success.

One mistake people sometimes make is to think that seeing the whole picture means knowing everything that can be known about the stock and to be completely plugged into the news, stories, "experts" and entertainment of the financial news markets. These things will not help you make good investment decisions. They are in effect "noise" designed to confuse you and paralyze you. Like we discussed in the previous chapter, all of this programming is biased to either the buy or sell side. With the system you've chosen, you don't need any of these things to make sound investment decisions. Stop confusing (and paralyzing) yourself and stop consuming this material.

Don't allow yourself to only see what you want to see. Use a matrix or some other reminder to ensure that you approach every trade in the same way.

Understand that the more you know how and why things work, the more confidence you will have as an investor and this confidence is something that translates directly to your level of success. Remember, it is not how you deal with success that determines your ultimate level of success, but how you deal with failure. Learn to see the whole picture so you can invest with more confidence and so you can have more confidence to help you "keep on keepin' on" despite the occasional roadblock of failure.

Learning to see the whole picture also entails a continued effort to learn about how the stock market works and a willingness to spend consistent effort every day getting better at following your system. Remember, this effort will reward you with more consistent returns over time and more success in your investing. It is hard to take control of your investing instead of paying someone else to do it for you. But only as you do take ownership, will you find true financial success in the markets.

Don't panic in the short run

If you are not careful you will begin to develop something called "deer in the headlights" syndrome. Deer often freeze at the exact worse time as the car speeds towards them. Don't allow yourself to freeze from panic or greed or mania. Don't make emotional decisions. Remain logical and unemotional and keep following your system. Stay the course you've chosen.

These three words are so simple to say, "stay the course." Isn't it interesting that the hardest things in life are often described by the simplest of words. As we have discussed, the individual investor has little if any control over the market. This lack of control often leads to fear if the stock begins to move in the wrong direction.

Movement in the wrong direction often causes the individual investor to panic, or do the wrong thing at the exact wrong time. I was once told that I needed to learn how not to be ruled by fear. The person who told me this is a serial entrepreneur meaning he lives and loves to start new businesses. This person, one of my closest friends and greatest mentors, was able to see that I suffered from a malady that afflicts most people in the world today. I was ruled by fear.

Are you ruled by fear? Be honest with yourself. Part of seeing the whole picture is painful honesty when required. I love to read investing books and one of my favorite authors is Peter Lynch. He has written a few investment books to help each of us become better investors. I love his writing style, his ability to take something as scary and intimidating as the stock market and make it easy for me to learn and understand.

But more even than this is his ability to renew my trust in the markets. I believe we all go through periods of time where we no longer trust the markets or where we feel so beat up by the market that we want to just throw in the towel. Reading books like the ones written by Peter Lynch are a way to keep things in perspective. To remember that successful investors are measured over a lifetime of investing, not on one or two plays.

One of the central themes of many of the investment books written by Peter Lynch is the idea that investors in general are still scared by the great depression. In his book, "Learn to Earn" Peter Lynch writes, "No event in American history has worried more people over a longer stretch of time than the Crash of 1929. People who weren't even born in 1929 were worried about it. The children of people who weren't born in 1929 have worried about it as well."

He also describes the Crash of 1929 as "the most pernicious collective phobia on record, and it has kept millions of people from buying stocks and making a profit they could have used. The idea still lurks in the back of many brains that the stock market is headed for another crash that will wipe out everybody's life savings, and the suckers who put in their money will be roaming the streets..."

Peter Lynch then spends the next couple of pages describing the systems and changes to the system that have helped to prevent another Great Depression. Among these reasons are a larger, more powerful government, deposit insurance, a stronger Fed who knows to pump money into the market during economic slowdowns, and the millions of people on pensions and social security.

He finally states, "if you buy the argument that we're not likely to suffer a relapse into depression, then you can be a little more relaxed about drops in the stock market. As long as the economy is alive and kicking, companies can make money. If companies are making money their stocks won't go to zero. The majority will survive until the next period of prosperity, when stock prices will come back."

I have included all this here because I think Mr. Lynch does a masterful job describing the deep-rooted and perhaps unconscious fear we all have that our investments will head to zero any time stocks head lower. As an investor you must learn to stay the course. It has helped me remain confident despite falling stock values by reading books written by successful investors. You may not understand everything they say, but you can remember to stay confident.

Don't panic. Don't follow the crowd. Have a system and stick to that system. Stay the course. It has been said that most retail investors tend to make wrong decisions.

Why is that? Because they have forgotten to stay the course. In fact, this phenomenon is so common that there are actually contrarian indicators that have been designed to measure what the regular investor is doing so the professionals can do the opposite.

A story that I heard somewhere serves to illustrate this point. The story depicts an interview between a hard-bitten reporter and the very successful investor Sir John Templeton. This reporter decided that while he was interviewing such a famous investor he should try to find out the secret to success in the market. You know, the reporter wanted what we all want: that magic, silver bullet that never misses, the perfect investing system that always made money. He wanted the easy solution to success. He wanted access to the crystal ball Mr. Templeton used to be successful.

The response to the reporter's question was a little unusual and caused some consternation in the mind of the reporter. You see, when the reporter asked Mr. Templeton for the secret to his success, the reply was that Mr. Templeton was successful in the stock market because he had learned how to help people. "Help people?" What does that mean?

The reporter did not know what to make of this answer. So John Templeton decided to expand on his answer and he told the reporter that when stocks went up Sir John Templeton helped people by selling them stock. And when stocks went down he helped them again by buying their stock from them. In this way he was able to buy low and sell high.

So, have you learned how to help people? Have you learned how to buy more stock when the stock is heading lower? Have you learned to sell your stock when it is going higher? Hopefully this book will help you learn how to act in the correct manner despite the emotional spell a strong move the stock might try to cast over you.

Panic is the same thing as fear and you must learn to overcome your fear of the markets and of short-term market down moves as you become a successful investor. But this is hard because we never know if this down move is the beginning of a long series of down moves that drops the stock to zero. So balance is once again required. You must invest for specific reasons and you must decide to get out only if the reasons why you invested changed.

Several high profile companies have announced outright fraud in their bookkeeping while declaring bankruptcy. Enron is an especially egregious example of this because their CEO, Jeff Skilling declared in late 2000 that their stock, then at $90 a share could easily reach $126. Then in late 2001 he and Kenneth Lay also tried to convince their employees to buy more Enron stock in their retirement plans and to tell their family to buy Enron stock because it was cheap now, so far below its high of $90.

Incidents like these and many others only perpetuate this lurking fear most of us have that somehow, someway we are going to get cheated and lose our money in the markets. But when you feel this way, try to remember the words of Peter Lynch and take comfort in the fact that while the few failures of businesses are often spectacular flameouts, the vast majority of investments will do very well over time.

Working to hold on to this perspective will help you learn to avoid panic which helps you be able to act with decisiveness according to your investment system and not react to the wrong signals occurring in the short-term. Panic often causes you to stop using your mind to make rational decisions because you are too busy using your feelings to make emotional (and wrong) decisions. Remember that "fear is the mind killer." (from Dune)

Opportunities will always come again

One of the things that will help you most as you become an investor controlling your own investments is a sense of perspective. You must remember that each day is a new day. Each new day brings new opportunities for profit. If you miss a play today, it's okay, tomorrow another one will come.

You don't have to spend time beating yourself up for not getting into a great play. Instead spend your time and energy looking for new opportunities. Learn to focus your energy in positive ways finding new plays or new investments. Don't waste your energy remorsefully thinking about the money you might have made had you invested in something you were watching because this just makes it harder to act today.

Businesses often invest in new ideas or new marketing plans only to find later that they were wrong. In the accounting world they call these investments "sunk costs" meaning costs or investments made in the past that did not bring the desired return. These costs are written off and not allowed to continue draining the company's coffers. Remember the "Next!" attitude. If you miss a trade, don't let that miss blind you to the next trade on the horizon.

As investors we might have some sunk costs in our portfolios in the form of investments that did not pan out or lead to the desired return. You might even be tempted to allow these past investment to affect your future investing. Have you ever held onto a stock because you did not want to sell at a loss? If so, you are allowing a "sunk cost" to affect future investments. An old adage on Wall Street is that we must "live to trade another day." Sometimes retreat is the better part of valor. When you get into a stock that unexpectedly heads lower, learn to cut your losses quickly.

It takes a 100% return to recover from a 50% loss. And it takes a 300% return to recover from a 75% loss. Protect your investment capital.

By cutting losses quickly you will still have money to invest in the next opportunity that comes along. Don't be so afraid of losing money in the market that you forget to make money. The other old adage is that it takes money to make money. If you get into a stock and it moves the other way; and you decide to stay in that stock, you might have to wait for years before you get your money back out. Try to keep in mind that there will always be another stock, another play. Of course, this is only helpful if you have money to invest with! Learn to preserve your capital cut cutting your losses short.

The idea that each day is a new day is just my way of reminding you to learn how to let go of mistakes made in the past so these mistakes do not affect how you approach the market in the future. Develop a strong mental approach to the investing game by thinking of each investment on its own merits without being colored by something negative that happened in the past.

Up to this point I have focused almost exclusively on negative actions taken in the past leading to negative results today. I have warned you about allowing these mistakes to affect future investments and have helped you understand this through the mantra; each day is a new day. But what about positive results?

When you make a profitable investment in the market, or when the market as a whole is moving strongly up the general emotion is one of euphoria. Experiencing positive results gives us greater confidence and it motivates us to try again. But if you allow yourself to dwell too much on your success, you will forget to do all the little things you did to become successful in the first place.

Curt Schilling was a pitcher for the Arizona Diamondbacks. His team won the World Series in 2001 in large part because of the pitching of Curt Schilling and his teammate Randy Johnson. I bring this up because after winning the world series Curt Schilling promised he would come back the next year just as sharp as he was during the World Series. He started the next season so strong that there was quite a discussion going on in the world of sports over whether or not he would become baseball's first 30 game winning pitcher. He stayed focused on the little things he had to do to stay on the top of his game despite winning the World Series title.

As investors we all have times where we make great investment decisions and see sweet results in our portfolios. If you allow this delicious euphoria to lead to cockiness in the market you will find that you will begin to take short cuts. It has been said that men tend to want to prove themselves right. We don't like to ask for directions for example because we know we can get where we are going (even if we can't!)

I don't know much about that, but I do know that if you are not careful success will be just as debilitating to your portfolio as failure. If you are not careful you will allow success to “go to your head” where you will begin to think of yourself as the golden child who can do no wrong. You will begin to think that you can walk on water.

If you ever start feeling this way, I suggest that you take a break from the markets. Remember, success is measured over a lifetime. Success is wonderful but if this success causes you to approach the market or make new investments outside of your investment system you will likely suffer a big loss. So take any success or failure with a grain of salt—don't let it become symbolic to your success or failure as a person—and remember that each day is a new day for you to prove yourself. Every investment must be evaluated on its own merits and not as a continuation of what went before.

Remain unemotional—overcome your fear and greed

We have spoken in great detail about fear. You must remain unemotional as you invest so you can more fully follow your system. Fear is a pervasive and sometimes hard to identify emotion that colors much of what we see. Greed also affects how we react to the stimuli of new market information. If you allow these emotions to control your investing, you will find that your investments control you.

I was raised as the oldest of eight children. As you can imagine in a family of this size we experienced some degree of sibling rivalry. My mom is not college educated but still is extremely wise. I can remember going to her on more than one occasion where I told her that one of my brothers “made me so mad.” And she would always respond that I couldn't change others, I could only change myself.

In my mind this lesson thunders from the past. “YOU CAN'T CHANGE OTHERS, YOU CAN ONLY CHANGE YOURSELF.” How many times do we want to blame others for the choices we make? We say things like “you make me so angry” or “you cause me so much pain” or “I'm so happy when I'm with you.” We use these terms so often I think we often forget that we are ultimately the ones responsible for how we act and what we think and feel.

Stimulus from outside of ourselves often causes an emotional reaction within ourselves. This is most clearly seen in our interpersonal relationships but it can be seen in anything where there is pressure or need to succeed. You might find yourself feeling hugely successful due to a raise or a promotion or you might find yourself feeling like a failure because of a “right sizing.”

Yes, this happens. Yes our emotional state is often “determined” by outside events beyond our control. We often think of ourselves in terms of what we do or how successful we are at what we do. But you must learn to define yourself by other criteria so you don't put yourself under too much pressure to succeed. If you put yourself under too much pressure in the stock market you are likely to make mistakes leading to negative outcomes and more pressure. This becomes a self reinforcing negative cycle that you must avoid.

Last night I was watching the first regular season game between two NBA teams. One of the announcers asked the other how the regular season differed compared to the preseason. The response was telling, "Pressure." Preseason games don't really matter so there is not as much pressure. But regular season games matter because the outcome is measured and leads directly to the ability to compete for the championship.

Pressure can cause people to act differently than they normally would. You see someone making all their shots in the pre-game warm up but miss every one during the actual game. You hear the term, "Choke under pressure" to describe this common event. Investing brings intense pressure because we are investing in opportunities where we don't have all the information, where we have no control and we can actually lose our investment.

Just like I learned that I can't control or change others, you must learn that you can't control or change the stock market. Don't allow yourself to get too cocky when you succeed and don't allow yourself to feel like a failure if one of your investments goes the wrong way. Stick to the safe harbor of your investment system and continue to have faith in the long-term efficacy of this system.

There is no one way to relieve the pressure you feel when investing for yourself. Some people just need to get away from everything for a while, to get a new perspective on the situation. Others need a good friend to confide in. Still others brag about their accomplishments to total strangers. Whatever it is you need to do to relieve pressure, do it. You must maintain an emotional equilibrium in your investing so you do not become controlled by your investments.

Ostrich investing is very, very bad

One of the examples I use in my class to illustrate the common phenomenon of emotions affecting investing style is the ostrich. Ostriches are said to bury their head in the sand whenever something dangerous comes around. In children's literature we are told that the ostrich buries its head in the sand to hide from its enemies. It thinks that if it can't see the problem the problem won't be able to see it and will simply go away.

Analyze how frequently you look at your portfolio. Most people have a tendency to review their accounts a lot more when they have significant profits and a lot less when they have losses. Have you fallen into this trap?

Hiding from your investments by not looking at your accounts and hoping the problems (losses) will just go away is not the answer a successful investor finds. Successful investors approach the markets the exact same way regardless of whether they are profitable or not. Don't be like the ostrich and try to hide from your problems hoping they'll just go away.

Can you see how emotions can lead us into traps as we try to invest? Having a system is so key to success in any endeavor in life. But knowing how to follow that system through thick and thin is even more imperative. Good ideas are only worth a "penny for your thoughts" but implementation of good ideas is worth much more. Remember this lesson—problems don't go away simply because you avoid them. They only go away if you face them head on and deal with them.

Invest like a scientist

A consistent approach to the market makes for consistent results from the market. Your system gives you a repeatable approach. It helps you remain consistent as you trade.

Consistency is so critical to success in life. You cannot achieve the pinnacle of success in anything in life unless you first develop the ability to be consistent. If you consistently practice then you'll have more consistent performances. Consistency is a necessary ingredient to eventual success.

I think the lack of consistency is one of the biggest challenges we face in life. How many times have you set a New Year's Resolution only to find that a few weeks later you had gone back to your old method or fallen back into old habits? Have you ever punished a child for doing something because you were in a bad mood only to allow that activity when you were in a good mood?

Have you ever decided to begin an exercise program only to stop after a little while? What causes us to act this way? I don't know the full answer to this question, but I do know that you must be consistent in your approach to the market if you ever hope to achieve consistent results from the market.

Now think about your investing. How consistent are you in your approach to the market? How consistent are your results?   Too many of us approach the markets with a shotgun…sending a scattershot of little pellets hoping something will succeed. We send out lots of bullets hoping that at least one of them will hit the target. Greater success can come if we learn how to focus. We called this "one shot one kill" in the Marine Corps.

Warren Buffet is famous for saying, "diversification is protection against ignorance. It makes little sense if you know what you are doing."

I often tell people that they must learn how to invest in the stock market like scientists conducting experiments. Scientists have a set process they follow as they set about proving or disproving hypotheses. This is called the scientific method these are the steps of the scientific method:

1. Observation: Be observant of things in the world.
2. Question: Ask a simple and concrete question that can be answered by an experiment.
3. Hypothesis: A testable and tentative answer to the question.
4. Prediction: A forecast of the likely outcome.
5. Testing: Controlled experiments to find the actual answer to the question.

All these steps add up to a repeatable process. In other words, if the experiment has been done correctly the outcome will be the same every time the experiment is run regardless of the person conducting the experiment.

As investors we must also learn to think more like a scientist. We must learn to separate fact from emotion so we can see things as they really are and not just as we want them to be. Here are the scientific steps an investor should live by. Remember, these can only be followed within the safe boundary your chosen trading system.

1. Observation: Have a watchlist and know what is happening in the markets.
2. Question: Think about how news can affect your company and other companies in its industry or in its circle of influence.
3. Hypothesis: Forecast what the stock is likely to do.
4. Testing: Carefully track how accurate your forecasts were, continue watching.
5. Buy and sell stocks only when your system says you should.
6. Repetition: Repeat steps 1-6 throughout your life.

As can be seen, good investors learn to think very similarly to scientists. You must remain unemotional about the outcome. You must not try to force your will on a stock. You must work to make your forecasts as accurate as possible through ongoing education and experience. And you must do everything in such a way that you are able to repeat the process time after time.

A sound investment system will help give you the steps you must follow. But it will not force you to follow those steps. To follow the system you must learn to discipline yourself and keep your emotions in check.

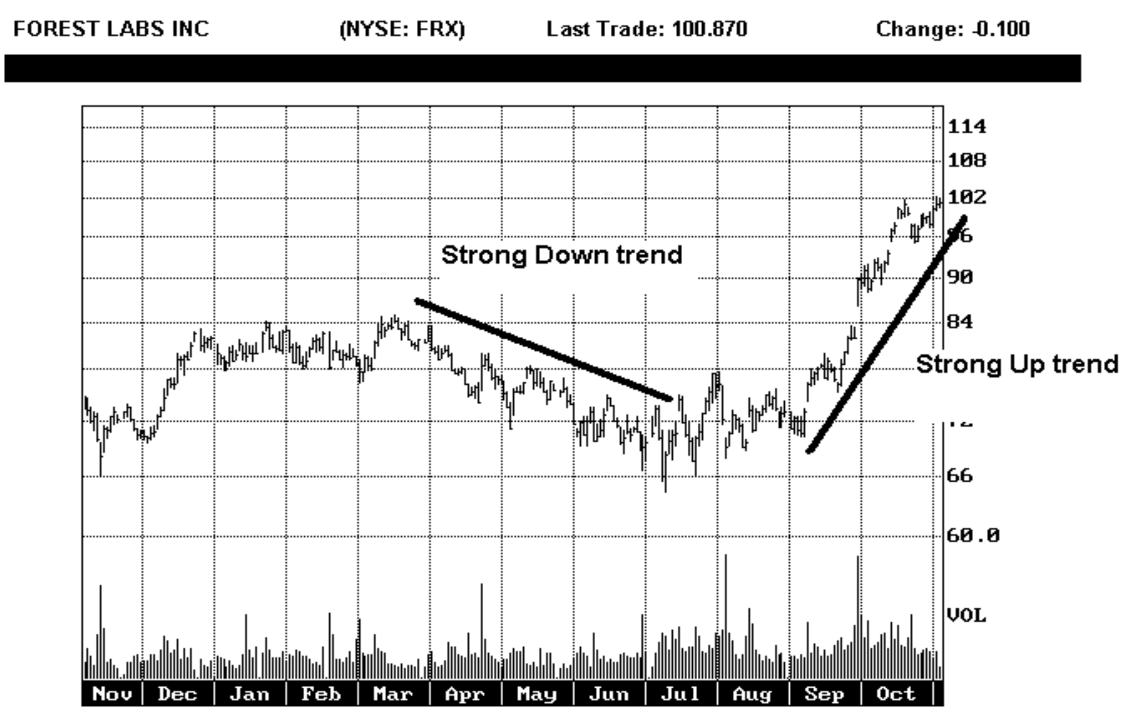
3

Know Why You Buy

As a teacher I like to emphasize to my students how necessary it is for them to know why they are buying a particular investment. I tell them that if they know why they are buying a stock they will know how and when to get out of it. Knowing why you buy helps you know when to get out. As investors we have so many different and conflicting signals and emotions or experts telling us what to do that it becomes easy to get confused.

Your investment system tells you to buy, but your emotions tell you to wait. What do you do? You have to trust your system and you have to be able to act despite your emotions. Once you own an investment your emotions will continue to factor into your decisions because the stock will continue to move up and down. The stock you buy a stock at $24.50 will move up and down in value every day.

The real trick is knowing when to sell based on changes to the stock's internal or external environment. To explain more clearly what I mean, take a look at the chart of Forest Labs, Inc. below:



As you can see, the stock has had a strong up trend for the past couple of months preceded by a fairly obvious down trend that last from April to July or so. What I mean by a "trend" is that the stock basically moved in the same direction over a period of time. So from September to October this stock moved from about $70 to about $102. But even during this unusually strong period of directional movement the stock still had days when it went down or closed lower than the price the day before.

Now if you had purchased this stock when it first started moving up around $70 you would have had a great run. But would you have held it the entire time? It is easy for me to write that you invested $70 a share and it is even easier for you to read that a $70 per share investment was made. But try to think about putting a sizable number of dollars at risk on a stock like Forest Labs, Inc.

Now take a closer look at the chart. The first move in the stock took it from about $70 to about $80 before it started dropping lower the third week of September. If you owned the stock at $70 would you be worried that this move down was the beginning of a large move down? Would you make the choice to sell your stock to protect your profits? If you are like most investors you tend to "cut your profits short and let your losses run." This means that the vast majority of people reading this book will have a tendency to get out too early at the first sign the stock might be heading lower.

But if you know why you decided to buy this stock in the first place you might have the courage to stick with the stock until your system gives you a sell signal. This sell signal might be in the form of technical analysis or it might be a slowing of earnings or revenue growth or it might be something else. But it will be something your system tells you to look for. And you must wait for that sell signal before you get out. Don't be a retail investor taking too little profit on your good decisions and your accurate forecasts!

Because we don't know the future or what the future holds, it is easy to get panicked in the present. Especially if we are inexperienced in the stock market. Like I have said before, sometimes we get so worried about losing money that we can't make any money. Let me suggest that following a system will be the best thing you could do to both for getting in and for getting out of a stock.

Learn to think like a business person

I like to use the term "think like a business person" to describe the ability to see things without emotion. Most people tend to want or seek after security. We like to work at stable jobs because we get a stable paycheck. We take comfort in the boundaries created by jobs and often associate our self worth with our jobs. How many of you are asked what you do for a living when you first meet someone?

I think many of us are like Robert Kiyosaki. In his books he describes how his real father taught him to get a good education and work for a large and stable company. But Mr. Kiyosaki was lucky enough to have a rich dad mentor who showed him how to build wealth like a business person would build wealth. If you have not read these books I recommend them to you.

I have had the good fortune to be raised by parents that taught me how to work hard for my money. I had parents who loved me and wanted the best for me. They thought that the best thing for me would be to get a good education and then go to work for a large, stable company making a secure paycheck. Like Robert Kiyosaki, I had parents who urged me to gain marketable skills so I could be employed more securely at a bigger company.

So I praise my parents for helping learn how to work hard for my money. But I wish they could have also taught me that financial freedom comes when we start making our money work for us. Approaching the markets like an entrepreneur means approaching them like Robert Kiyosaki learned from his rich dad.

This means you understand what the risks are and you are able to live with the risk. Business people also find the "leverage points" in their investments and spend their time focused in these areas to achieve big gains. Business people must be focused on the task at hand without getting distracted by other things. Finally business people must also live with a fluctuating income stream.

As investors we must learn to understand the risks of any investment. We must learn to live with the insecurity of an uncertain return. We must be able to find the leverage points necessary to make our investment system work and not be distracted by the noise of biased opinions. We must learn to focus and we must learn to live with a fluctuating return.

We do not have control over the markets. We cannot dictate to the market our return. If we are careful and if we strictly follow our proven system, our money will grow but it will not grow in a strait line. Sometimes it will go up and sometimes it will go down. The actual return is what happens over time as you capture and protect your profits. And hopefully you get better and better at this business and see your return percentages grow accordingly.

I often ask the students in my class to raise their hands if they own their own business. In most cases about half the class actually raises their hands. I then ask them to keep their hands raised if every customer they have ever done work for has paid them in full. For the vast majority of business owners across the world there are some customers for whom they have done work without getting paid.

Now think about that for a second. Business people are used to doing work for certain customers expecting to be paid but not actually being paid. Like business people, investors will also enter into a trade expecting to be paid (the move is profitable) but then not get paid when the investment turns sour and loses.

But business people have learned something important that we must also learn....if a customer refuses to pay you, stop doing work for that customer! If an investment does not do what you expect it to do, get out of it and move on to something else! Remember that though some customers don't pay, the vast majority do and businesses will survive. Be cautious in your selection of your "customers" in the stock market and you will be handsomely rewarded.

Another thing to remember about successful business people is that they are able to size up the risk/reward of each opportunity and they are able to move toward the reward despite the possible risks. Investors must also learn to do this. I once heard a man tell me that as an employee he had been so busy earning a living that he could not make any money. Be careful as investors that you don't become so busy obsessing over unimportant things that you can't make any real money.

Stay focused on those things that matter

One of my all time favorite people told me that to be successful in life required the ability to focus on the "thick of thick things" and avoid the "thick of thin things." Think about that for a minute. What he taught me was that some things are urgent and important and some things are nothing more than rabbit trails leading to dead ends. To be successful in life we must learn to find the leverage points (thick of thick things) and apply our efforts in these areas.

If we want to become successful investors we must also be able to focus on these leverage points. Let me put it another way to further explain. Think about how you currently invest in the stock market. Are you taking a scattershot approach with a little bit of frantic effort scattered about? I call this the shotgun approach, meaning that the investor pulls the trigger without much effort on their part and hope for something good to happen.

A better approach to the market is to be more focused. In the Marine Corps we called this the one shot, one kill method. In the Marines we were taught to know what we were shooting at so we could be assured of the kill. As investors you must also learn this skill. We must learn to be selective in our investments. We must abide by our system and not get distracted by the noise out there telling us to buy this or buy that.

Remember, the people you see on TV or in the news talking about the stock market have their own agendas. There are those who want to pump up a stock so they can dump the shares and those who want to crater a stock so they can profit from a short. Stay focused on what your system tells you and stop listening to all this noise which causes you to second guess your system and yourself at every opportunity.

Don't be shaken by the normal ups and downs of the market. Have a plan and focus on that plan. If necessary for you to keep your peace of mind, don't let anyone else know what you are doing so you don't have to spend time developing excuses for what happened. Learn to move on after failure with the idea that you will never make the same mistake again.

Also learn to leverage yourself. We only have so much time and energy in a day. You can't expect great results from the market unless you are also willing to approach the market consistently. Expect consistent results *from* the market only if you bring a consistent approach *to* the market. Stay focused and avoid the scattershot method of investing.

You've chosen a proven investment method. This system will tell you what types of stocks to look for, when to buy them and when to sell them. Successful investors believe this system and follow it carefully. Being focused means knowing where your efforts can provide the best possible return right now.

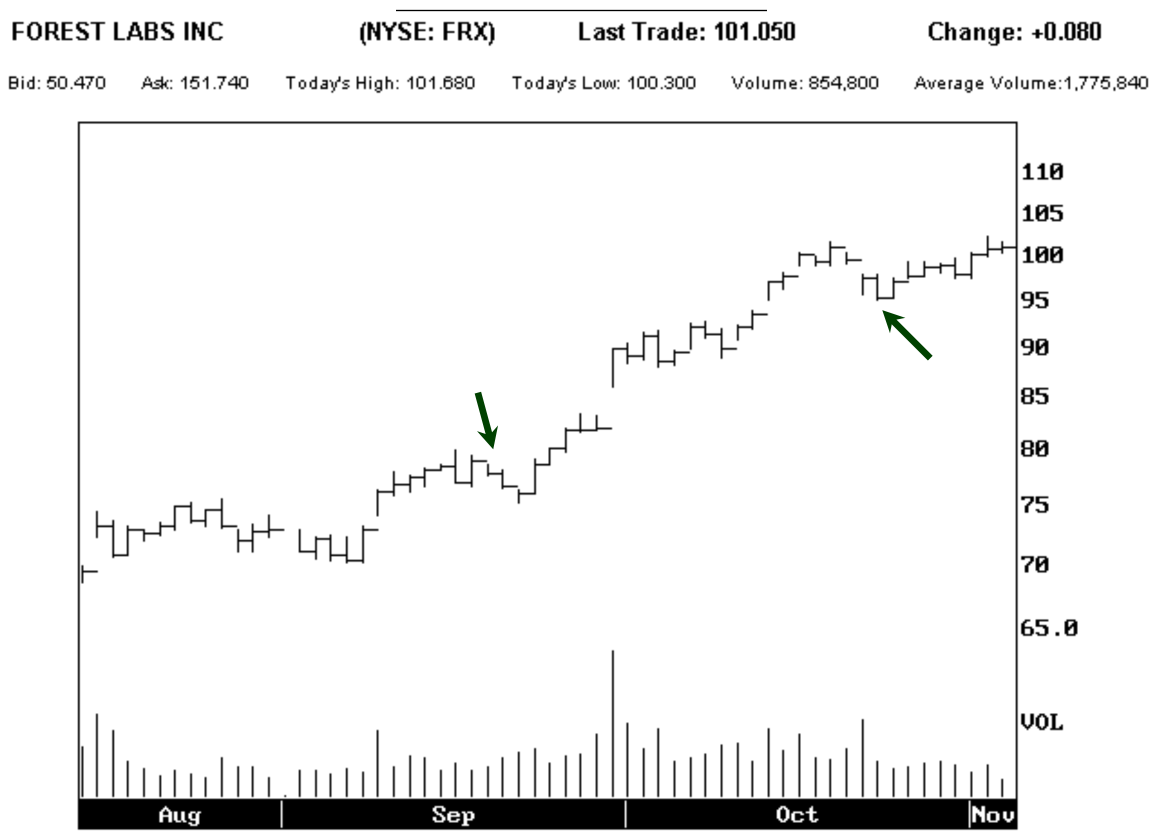
This area of effort might be in prospecting as you look to find new investments or upgrade current investments. It might mean education as you learn more about the stock market and the different investing vehicles you can use to increase your returns. Your effort might be most needed in examining current holdings to be sure they still fall within your system. And maybe you need to spend some time in self-analysis as you tally your journaled results and learn from your recent trading history.

All of these endeavors are worthy and appropriate. But if you try to do them all at the same time, you will find that none of them get done very well. Focusing means to limit your effort to one thing at a time until that thing is accomplished. Learning how to focus your energy in the markets mean that you learn to concentrate on those things your investing system tells you to do without spending too much time worrying about things that can't be helped.

You can't change how the news will affect the stock market. But you can dictate how much time and effort you spend trying to figure this stuff out. Make sure you maintain balance in your life by not allowing your investments to consume all of your time and mental focus. Do enough to get the job done, don't worry about everything else.

Don't get too caught up in day to day movement

Earlier in this chapter I showed you a picture of Forest Labs, Inc. (FRX). Let's go back to that picture now but only show the most recent two months or so to make it easier to explain what I mean by not getting too caught up in the day-to-day movement of the stock. Here is the chart:



As you can see, over the past three months the stock has run from about $70 to about $101. This is a move of over 44% in only three months! This is a HUGE move in the markets. But by looking at this chart you can see that the stock did NOT go up every day. There were days the stock actually fell in value. For example you can see that from middle of September the stock fell for three days in a row. You can also see the same thing at the middle to end of October.

If you allowed yourself to be a "nervous Nellie" you might have chosen to get out of the stock because of the fear that these downward movements were the beginning of a long set of downward moves sure to erase your equity. Don't allow this fear to shake your confidence or get you out too soon.

Your system will tell you when to get out and it will tell you when to stay in. Trust your system. Have confidence in your own expertise and don't allow fear to make your decisions for you. Remember there is a whole industry on Wall Street just working to measure fear and greed so the professionals can profit. You must learn to have confidence in your abilities to think like investment experts so you will have the confidence to stay in until your system tells you to get out.

Remember to breathe

I like to remind students that it is important to breathe as they learn how to take control of their own financial future. This is not a sprint but a marathon. The first few trades are scary because it's new and you're not that confident in the system or in your ability to follow the system yet.. I was once told that it is always hardest to pull the trigger on the very first trade and it is. You must learn to simply act robotically.

I believe it is human nature to get so emotionally involved in something that we almost forget to breathe. Have you ever felt this way? I often tell my children to calm down, to relax, to take it easy. I do this in various ways but one of them has always been to tell them to breathe.

Each trade that you place will try to dominate your thoughts and your emotions. Each trade you make will get under your skin. If the trade is successful you will feel elated, excited and on top of the world. If it is not successful you will feel saddened, perhaps depressed and you will feel like a failure.

Whenever you have either one of these emotions creep into your investing you must remember to breathe. Maybe you should take a break from the markets for a while and do something else. Perhaps you should get involved in a hobby or something else to take your mind off what is going on in the market. Whatever it is you do to relax you must do it if you find yourself beginning to panic or beginning to obsess over the markets. Learn to relax.

One of the traits all world-class athletes have in common is the ability to relax. They have learned to depend on muscle memory so they don't think too hard when performing. If athletes think too hard they often fail because their minds plays tricks. Remember my story about learning how to shoot a weapon in the Marines.

We were taught very specific methods of relaxing our bodies with our weapons still aimed on target so we could be more accurate shooters. We were told that if we tried to "muscle" the weapon on target we would not be as successful because our muscles would get tired and our bullets would go off target. To be successful in the world of investing you must also learn to relax. To depend on your "bone support" (your investing system) and not try to muscle your results through sheer will power. Remember—the market does not get swayed one way or another simply because you hope, wish or pray!

Success and failure are part of the process—they are not personal

Like we have talked about throughout this chapter, some customers will pay you and some will not. The successful business people have learned how to screen their customers so they do more and more work for those that do pay and less and less work for those that don't pay. This means successful business people *stay in business!*

How successful would any company be if that company stopped doing work for every customer the first time one customer did not pay them? As an investor you will also have customers (trades) that do not pay you. You will make trades that lose money for you. Every investor who has ever lived, no matter how successful, has lost money on some of their investments.

You must also realize that losses are part of the game. To be successful you must realize that both success and failure are part of this game. For every success you have you must learn to stay humble and for every failure you experience you must learn to stay confident.

Most market experts advise investors to use something known as diversification when investing. Diversification is simply investing some money in many different companies in a number of different industries. We are told that this is a good way to protect our nest egg because as one stock is moving down, others in the portfolio are moving up. Your investment system should include some diversity because market diversification is an important part of the process of developing emotional stability while investing in the market. Diversification will help you maintain emotional equilibrium when some of your stocks fall because others are rising making it easier to maintain confidence in your approach and in your system. However, remember the quote by Warren Buffet. Don't diversify too much or you will never beat the market.

By buying different stocks in different industries you will find that when one of your investments is going down (losing you money!) another of your investments is going up; helping to take the pain of loss away. If all of your money was invested in one stock and that stock had a down day would you feel the pressure of that loss? What if you had money invested in two stocks and one went down today and the other went up? Would you feel the same kind of pressure?

You must have multiple investments to help keep things less emotional. Even in business it is important to insure that no one customer represents too high a proportion of the overall business. If this is allowed to happen that customer will begin to exercise too much power and could cause a tremendous loss of profits. It is the same with investing. The best investors practice good portfolio management so no one "customer" could bankrupt the business.

In the beginning diversification will be a critical aspect to your investment plan as you learn how to control your emotions and have trust in your system. As you gain experience and as you become more confident and expert, you will not need to diversify as much. This means you can focus more money on better opportunities. In fact, Warren Buffet believes that investors are typically too diversified so they don't have enough money left to buy great companies that come along. He has said, “Diversification is protection against ignorance, but if you don’t feel ignorant, the need for it goes down dramatically.”

The market does not know you.

The last word of advice of knowing why you buy is simply that the market does not know you. The market does not care if you buy or sell stock. And despite appearances to the contrary the market does not have a personal vendetta against you. So the market isn’t trying to hurt you when you experience a loss and it’s not doing you a favor when you have profits.

So only buy when your system says to and only sell when your system tells you to. Don’t look at the profits or loss. Look at the system. And then, as you journal and honestly review your trades, make careful adjustments to your system to try to improve it.

Sometimes it is hard for humans to fail in front of others. Sometimes the thought of failure in front of peers prevents us from actually doing something. We don’t like to be made fun of and we don’t like the idea of looking foolish.

One of the nice things about the market is that it does not know you! What this means is that you can fail spectacularly in the markets and no one will need to know about it. This anonymity is a powerful thing as we try to become experts in the markets. We can allow ourselves to take chances. We can invest without fear of belittlement from colleagues and friends or family members.

You can decide to only share your successes if you want. So don’t be timid. Don’t allow yourself to act with fear in the markets because of some imagined audience just waiting to laugh at your mistakes. Instead, act with power and confidence. This will help you be more successful more often. Remember, you don’t have to right every time to be a successful trader—just be right in letting your profits run and cutting your losses short!

4

Read The Chart Like a Pro

Up to this point we have spent our time discussing the importance of having a system and in following that system as you invest. We have discussed the importance of remaining unemotional and refraining from allowing your investments to control you. You must remain in control through confidence in your system and through strict discipline in following your system.

While this book is not a book about a specific system in the market it is important to understand some technical analysis to better understand how emotions are so often affected in subtle ways by stock movement. Chart reading is that process of using past stock price movement to predict future price movement. We are looking at the past to predict the future. This process is called technical analysis.

There are literally hundreds of technical indicators all of which have been developed to give a trader an edge. These indicators can be applied to any time frame. What makes this all confusing to new investors is that indictors will give conflicting signals if used improperly. And any indictor will give conflicting signals when used on different time frames. For example, a 1 year chart may show a sell signal while a 5 year chart may show a buy signal even when looking at the same indicator.

There are no hard and fast "if, then" rules that say if the stock chart looks like this, then resulting move will be that. This type of certainty doesn't exist. This is why so many mutual funds are so quick to say, "Past accomplishments do not indicate future results."

Whatever system you've chosen will have an approach for chart reading. Use only the indicators and time frames suggested by your system.

Some chart reading basics

With chart reading, it is important for you to remember an earlier lesson—take what the market gives you and avoid squinting until you see what you want to see. Please remember that these indicators from your investing system are the only tools you should use for chart reading even if another indicator gives you a conflicting signal.

Use the technical indicators and chart time frames suggested by your system and only look at them. Don't get into a trade because of your system and get out of it using a signal which is not part of your program. Of the hundreds of technical analysis signals, we'll show only 3 simple indicators on a day chart to show how your emotions can be swayed by these signals. Don't overcomplicate things as you look at charts to determine entry and exit points, targets and stop losses using the technical indicators your system recommends.

The three simple charting techniques to be described in this book are, (1) Trends, (2) Support & Resistance, and (3) Volume. The first element of technical analysis we will discuss is something known as the trend.

Trend using the Moving Average

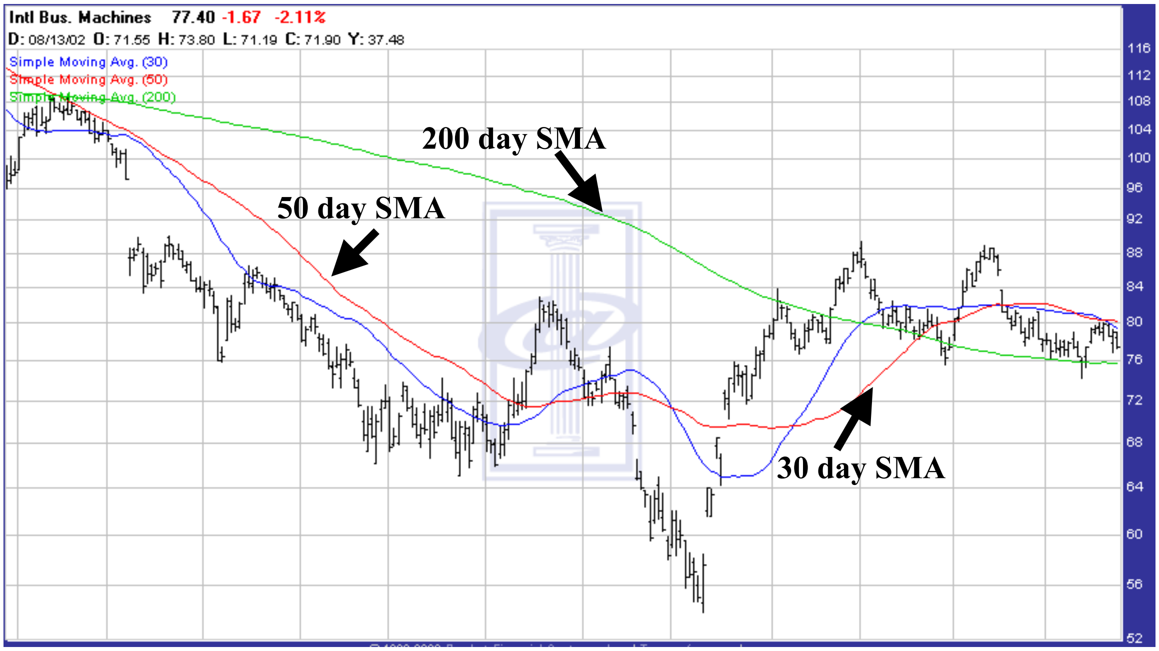
A common statement on Wall Street is "the trend is your friend." The term "a trend" is used to describe the general direction the stock is moving at any point in time. The trend does not describe the direction the stock will be moving every day, just the overall direction the stock will move over many days. In fact you could say that stocks tend to follow their trend…until they don't! Trends can be seen on individual stock charts as well as on broad market indices like the Dow Jones Industrials or the NASDAQ.

Trend lines are used by every technical trader. Trend lines can be drawn on any chart time frame though we'll show examples on a year chart showing daily price action. Trends can be horizontal and they can be diagonal (either upward or downward trending). You can draw trend lines on the chart or moving averages can be used to determine the trend. We'll show a 30 day moving average on a year chart for the purposes of this book.

A 30-day moving average (a standard term on Wall Street) is created by taking the most recent 30 days' closing prices, adding up all these prices and then dividing by 30 to get an average closing price for the stock over the past 30 days. This number is then plotted on the chart. The next day the 1st day drops off and the 31st day is added. We still take an average closing price of the past (most recent) 30 days, determine the average and plot the point. Then this process is repeated every day with each new number plotted on the graph until all the points create a line—a 30-day moving average line. This line smoothes out the volatility of daily price swings in the stock, making it easier to forecast a stock's general direction over time.

Your system will give you the length of time desired for the moving average. We'll show 30 day (shorter term), 50 day (intermediate term) and 200 day (long-term) moving averages on each chart example below.

For our examples we will use a combination of all three so you can see the effect longer time frames have on a moving average. Each of these charts will be one year charts for easier reading. The first chart to be shown will be IBM. I'll use the letters "SMA" instead of the full, "simple moving average." A 30 SMA means a 30-day moving average.



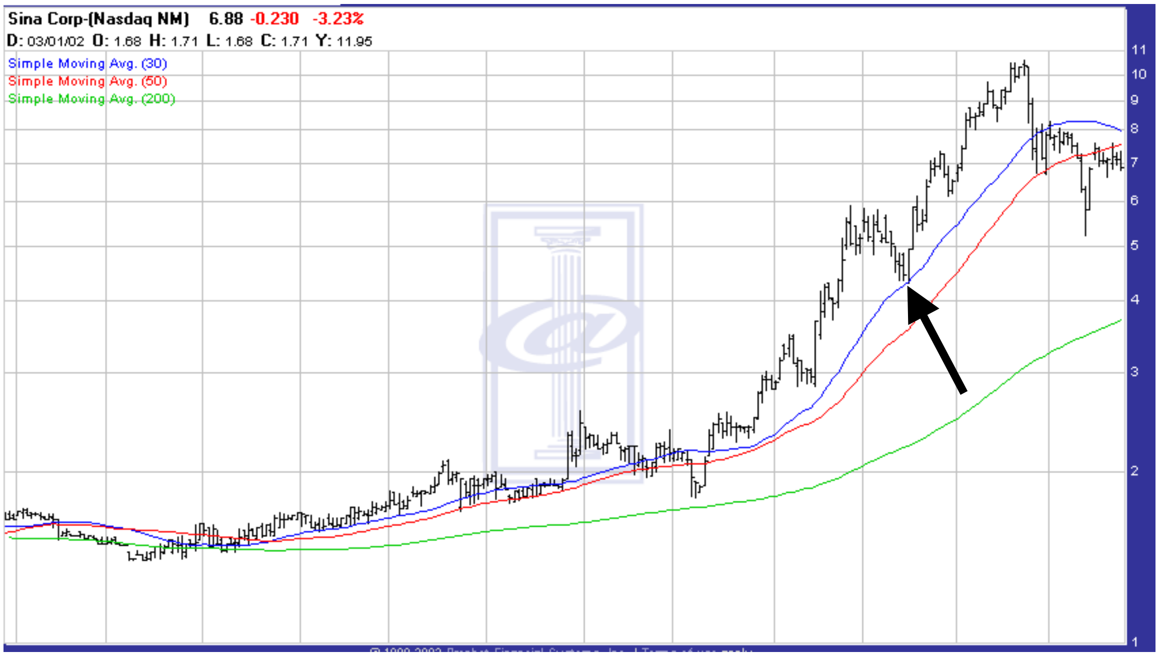
As you can see, the 30 sma follows the movement of the stock more closely than the 50 sma while the 200 sma moves the slowest of all. This chart shows an example of how volatility in the stock can and does affect the shorter moving averages more quickly and more violently than the longer moving average. Notice how the stock makes a huge move to the downside at about the midpoint of the chart. Notice also that the 30 sma was affected most by this volatility in the stock while the 200 sma hardly moves at all. The shorter the time frame of the moving average the more closely it will follow the actual price movement of the stock.

Notice also that the 30 sma and the 50 sma are both bullish (heading up) even as the 200 sma continues heading down. This is a conflicting signal which can be confusing and paralyzing. If your system says only use 200 sma, then don't use any other indicator to avoid confusion.

Here is a chart of Sina Corp. As you can see, this stock has been in a strong uptrend for the past year. But the stock hasn't gone up every day. There are periods of rest or "dips" where the stock drifts lower. But all three moving averages continue a smooth upward trajectory.

Now look at the last month of the chart. The stock has dropped from just under $11 to around $7. Notice the blue moving average (the shortest 30 sma) has begun trending down while the other two are still trending up. If your system is to buy the stock when the 30 sma is pointing up and sell when it points down…you should sell the stock. But if you look at other data points outside of your system (the 50 and

200 sma), you could confuse yourself and end up doing nothing. Stick with your system and don't let anything else confuse you!



As these two charts show, the moving average is used to help the investor smooth out the daily price fluctuations to show a smoother line. The idea is that the trend is your friend. If your system is to follow the 30 sma, then you need to get in that stock only when the 30 sma is trending up and get out of it only when it is trending down.

Even with this very simple system, two things should immediately be clear. Moving averages are a lagging indicator. All thee of these trends moves slower than the stock does. Which leads to the second thing. This system will not get you in at the bottom and it will not get you out at the top. I think most people will conceptually be okay with this…until they invest their own money and aren't buying the stock at the lowest price nor getting out at the highest price.

Usually what happens in practice is fear and greed begin to pull people out of a system even as simple as this one. They start to try to anticipate the lows or highs. Maybe they shorten their 30 sma to a 14 sma or even shorter to try to capture more of the move. Or maybe they get out at the first sign of a drop and miss the rest of the move. Look at the chart where the stock prices comes down to touch the blue, 30 day sma line. It could be very easy to get out during this drop and miss the rest of the significant move from $5 to $11.

One of the biggest mistakes rookie investors make is that they allow their emotions of fear to control their investment decisions as the stock begins to come down from a peak. Sometimes this fear causes people to become paralyzed and unable to make any move. Other times this fear causes people to sell too soon. Take another look at the Sina chart. You will see an arrow pointing to a Bounce up off the 30-day moving average. In this case the trend was decidedly upward moving, though the stock itself was dropping from $6 to around $4.50. This $1.50 drop represented a 25% drop!

Imagine your portfolio losing 25% of its value over the course of a couple of weeks. How fearful would you be? In my experience a drop such as this one would lead to one of two different investor responses. The first one is to panic and sell quickly before it can fall any lower. The second one is to panic and then try to forget about it. In both cases the investor was wrong. What would you do?

If a professional trader used a 30 day sma as their only data point, they'd trust it. They wouldn't get caught up in stock price movement (not part of their system), they'd not get caught up in other moving averages (not part of their system), they'd not worry about getting in at the exact high or low (not part of their system). All they'd care about was following their system with exactness.

Have you ever been so caught up on not losing money that it feels like you'll never be able to make money? Learning to follow a proven system with exactness will help you begin making money. Just don't get distracted by other data points or signals.

Support & Resistance

The next technical analysis tool we will discuss is something known as support and resistance. Support and resistance can be drawn in many ways but we will only discuss two of them. The first method is to draw a horizontal line along the tops or bottoms of the stock movement over the course of some period of time. We will use one year charts in our examples. The second method is to simply use the moving average as the support and resistance line.

As you will see from the examples below, horizontal trends often form channels or boxes of definite trading ranges. This pattern is something that you will begin to notice on almost every chart.

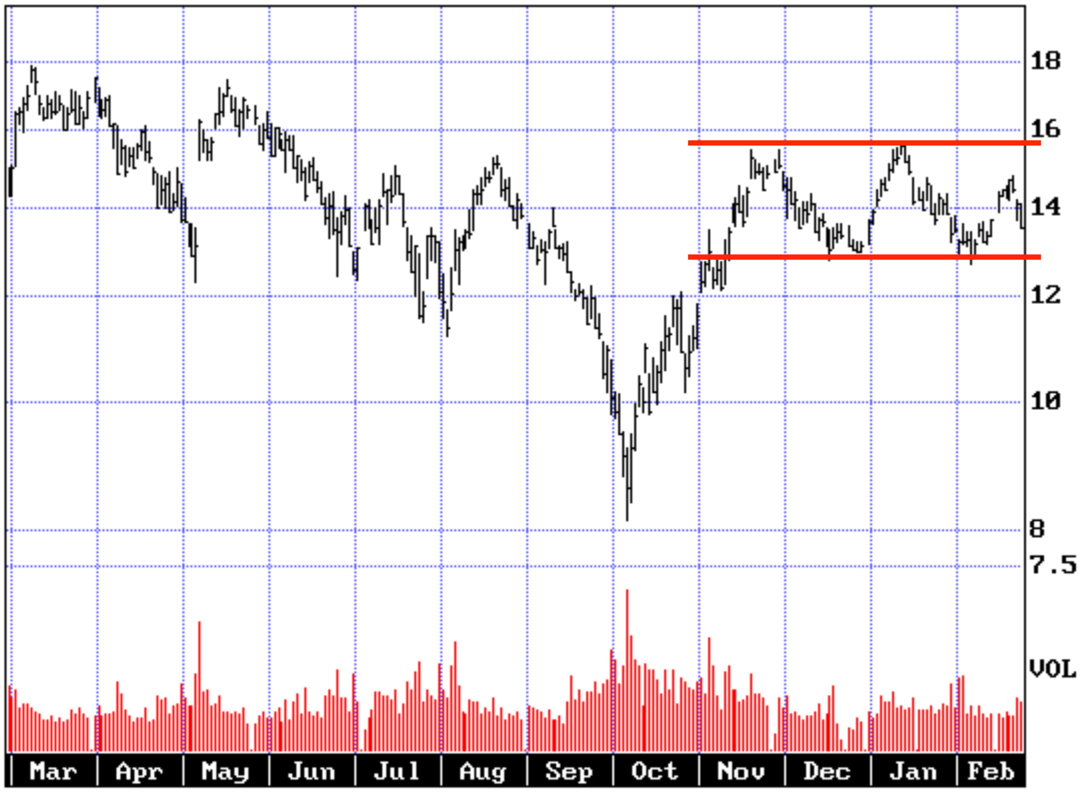
Below is a chart of Tenet Healthcare (THC) during a period of time. I have added horizontal trend lines. This particular chart is an extreme example of how well trend lines can work. As you can see, the trend lines are drawn along the tops and bottoms of the previous stock movement. I will include three additional charts with trend lines as well so you can get a feel for support and resistance.

As can be seen in the THC chart, the stock tends to stay in a very tight trading range. At least over this year the stock rarely moved out of the boxes as drawn on the chart. Below are some charts. Once again the stock tends to bounce up and down in a definite horizontal trend between two fairly obvious points.

Look at these charts with the idea that the only criteria for your system is to define clear support and resistance patterns and trade between the high and low points.


31.0
30.0
29.0
28.0
27.0
26.0
25.0
24.0
23.0
22.0
21.5
VOL
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
Jan
Feb


6.3
4.9
4.2
3.5
2.8
2.1
1.4
0.7
0.5
VOL
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
Jan
Feb



Moving averages are also support and resistance lines. If the moving average is downward trending and the stock is below it, the moving average will act as resistance pushing the stock back down when it comes up to or near it. On the other hand an upward trending moving average will act as support for the stock and push it back up when the stock drops down to it.

In theory, it seems easy to identify support and resistance lines and simple to trade them. But look at these charts again paying special attention to the price move from the top to the bottom of the chart. Would it be easy for you to get in at the bottom support line after the stock has dropped from its highs?

Your emotions might cause you to think this is the time the stock will drop to zero. You may second guess your system. Or you may end up paralyzed on the sidelines never able to get in. Even in a system as simple as this, it's very possible for your emotions of fear and greed to play tricks on you.

The key to success in the stock market is disciplining your emotions enough to trust the system you have and follow that system exactly.

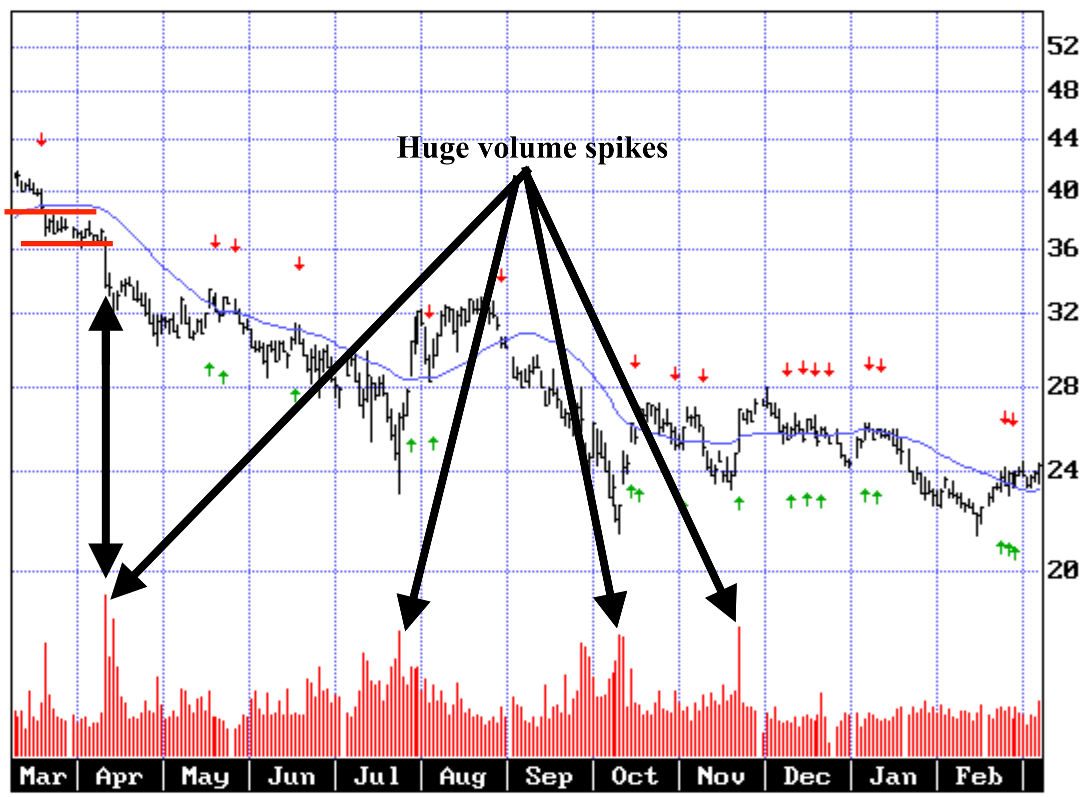
This whole book is written from the stand point of helping you understand and process the real and challenging ingrained emotional responses you may have to shift for you to become a successful, lifelong investor. While not always easy to make these changes to emotional responses, the reward is well worth the effort.

Volume

Volume is the last technical analysis indicator we'll discuss in this book. Like moving averages and support and resistance, volume is a basic but widely used tool that investors use to confirm a move in the stock. Volume by itself would not be a good indicator to provide buy or sell signals but it can confirm a move and also confuse you about a move.

Volume shows up as the vertical lines at the bottom of the chart just above the names of the months as below. The higher the vertical volume bar the more interest in the stock that day. Very high volume bars compared to the rest of the volume are called spikes. Some charting packages will also chart a line through the volume bars showing average volume.

Take a look at the chart below to see examples of huge volume spikes. Spikes often (though not always) indicate interest in pushing a stock in a new direction.

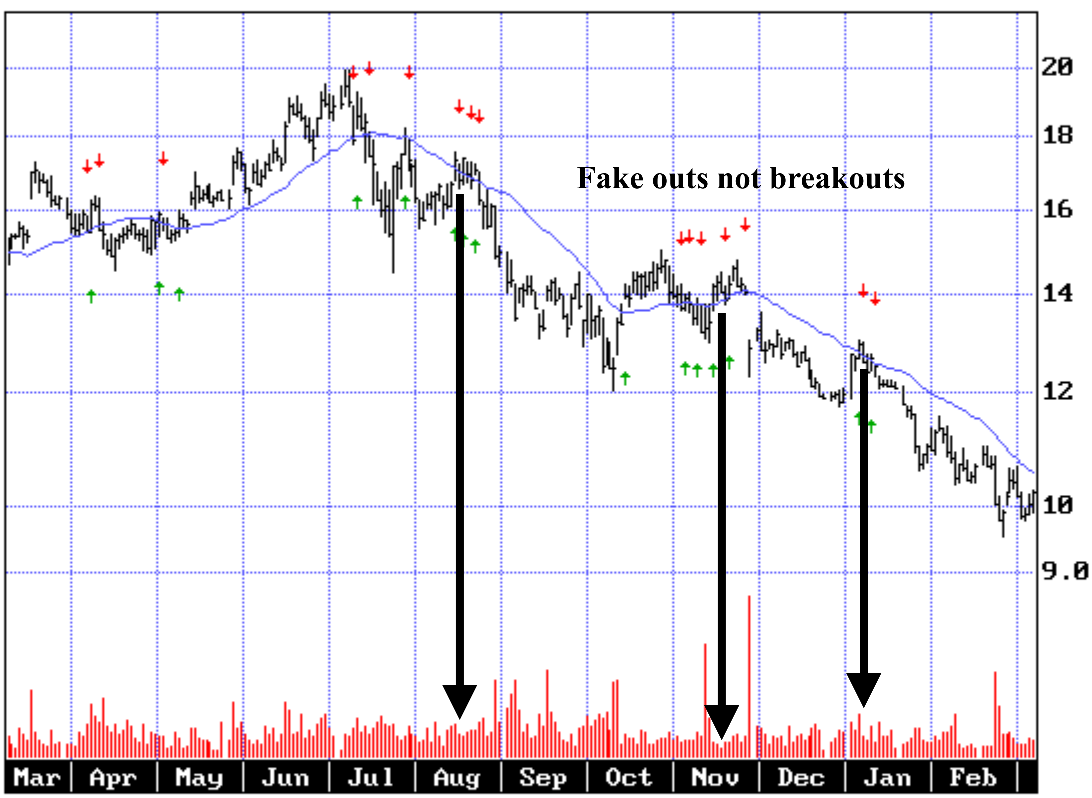


As you can see, in the early part of April this stock was in a flat trend. We can't see the support and resistance lines (they happened too far in the past) but we can see the moving average pointing in a flat direction. But by mid April, the stock took a decidedly downward move on extremely high volume. This is an indication that the stock had changed direction.

The volume spike as the stock broke through a support line is a great indicator that the stock is starting a new, downward trend. Yet it might be easy to give yourself other data points to "squint" until you do what you wanted to do anyway and stop following your system.

While changes in the direction of a stock are pretty obvious in hindsight they are difficult to identify in the moment. One of the techniques you can use to help you spot the breakout from the fake out is volume. If a stock breaks above a resistance point on very little volume, that stock will most likely turn and continue following its former trend.

Below is a chart that shows a stock breaking out of a resistance point in August, November, and January on weak volume. As you can see, in each case the stock actually fell back down and continued its former direction because there was no interest in the breakout and not enough buyers to create a breakout to a new, up-trending direction. In other words, each of these moves above the resistance point (the moving average) was a fake out and not a breakout and lack of volume was an indication of that.



Take a look at the movement in the first part of January. The stock quickly went from $12 to $13 or so. This quick movement to the upside might have made an inexperienced investor believe that they must hurry and get in before they miss any further move up.

A more consistently successful investor would have patiently waited for their system to give them a signal for entry and exit points. If the system was to buy on volume spikes in an uptrend, then the successful investor would not have gotten in despite the volume spikes and run up in stock price because the trend was still negative.

Patience before the trade, and in the trade

We've shown some basic chart reading and technical analysis in an effort to show you how easy it is to allow fear and greed to affect how exactly you follow your chosen system. Controlling emotions is often the single hardest aspect of investing for the individual trader. It takes effort to control emotional reactions in the market but this effort will likely pay dividends over time in other aspects of your life.

We've taught the need to learn how to trust your system so that it can protect you from yourself. Your system is "home base" where you can center yourself when things start getting crazy. In the sports world this is referred to as "getting back to basics."

A big mistake most people make when drifting from their system is to anticipate the move and get in early. Greed causes this mistake as we try to get in closer to the bottom. Another mistake that's easy to make is getting in early before all the indicators in your system line up.

But sometimes the best trades are the ones you don't take. Your system will keep you out of bad trades. However, it's easy to lose patience as you wait for your system to give you the entry and exit signals. Have you ever felt so afraid of missing out of profits that you bought or sold before or contrary to your system? Why do investors get afraid? Why do you get afraid?

I believe that for many of us getting into the market is a scary thing because we don't feel in control and we don't feel like we fully understand why things move the way they move. But we get into the market anyway because we know how important it is to put our money to work at ever higher rates of return. We know that if we do well as traders, our retirement will be what we want it to be.

It's important to learn patience in your trading. Patience before you get into the trade waiting for your system to give the appropriate buy signals (do not anticipate the move) and patience in the trade waiting for your system to give you the appropriate sell signals.

This patience will keep you out of bad trades and keep you in trades longer, letting your profits run. Remind yourself that there will always be another opportunity. Don't jump the gun today just because you feel like you might be missing out on opportunity.

There is an old saw on Wall Street that it is better to be out of the market wishing your were in than to be in the market wishing you were out. We have already discussed the need to take what the market gives you without trying to force your will on the market. The next few sections will discuss ways we can exercise patience before and in the trade.

Learn how to wait for the right opportunity

The right opportunity happens when your system gives you an obvious signal. It's nice to be making money in the markets and you may feel pressure to catch up your retirement by not missing any opportunity. But the best way is to patiently wait until you have the obvious opportunity and the obvious entry point based on the requirements of your system.

Learning how to wait for the right opportunity can be challenging. Think about your investing life. Have you been able to wait for the stock you wanted to buy, or did you buy it as soon as you identified it as a stock you wanted to own? What caused you to want to own it? Did this stock pass through your system or did it come from a hot tip?

I believe that most people have a natural human tendency to want to experience immediate gratification. What I mean by this is that most of us want to make a sacrifice of time, talent or money and experience immediate rewards from this effort. Or in the investing world, when people want to invest, they want to get into something immediately. But *right now* may not be the best time to invest.

Keep in mind the market will always give you a second chance so you don't have to jump in to something just because you happened to see it the day you did some investigation and you don't have to buy something the day someone gives you a hot tip. You should make the time to put the stock through its paces. Does it pass muster by meeting all the elements of your system? If it does you should buy it, but only buy it after you know for sure. Following your system to get into the opportunity makes it easier to follow your system to get out of it too.

The right opportunity can be both a buy or a sell signal. Just like greed may get us in too soon, fear (or greed) could get us out too soon (or too late) if we don't have the patience to wait for our system's clear sell signal.

Just like we showed in the trend line section, sometimes stocks dip lower even in an uptrend. Don't get out too soon and miss out on the rest of the move. Don't allow panic or greed to shape your trading or affect your results. Invest by focusing only on your system and don't allow yourself to second guess the system or your ability to follow it.

Be patient before the trade. Learn patience in the trade. Don't let the market dictate to you how to act or what to do. You should stay centered in your own "peaceful place" known as your system and don't get pulled out of it.

Wait for the obvious trades, don't try to play every play

In addition to patience before the trade, not in the trade, it's crucial to learn how to play just the obvious trades. Too often we feel an emotional need to be in the market so we search and we seek and we squint until we see what we want to see. You must avoid this trap. You must learn that yes, there is always something moving on Wall Street. Yes, there is always some pundit on TV talking about this or that move in that or the other stock.   Yes, there will always be something pulling you into the market. But you must resist these tugs and invest only when you see the right opportunity.

Too often the rookie investor wants to try to capture every possible move in a stock. But the best scenario is to wait until you can capture the obvious moves. Remember, successful lifelong investing begins with limiting your losses. If you try to capture every move you will experience more losses and feel less confident. If you exercise discipline and get in only when your system tells you to get in you will be right more often than you are wrong and you will develop more confidence.

Maintain perspective

Investing for yourself is a lonely and sometimes challenging business. This is true because we never really have control of the outcome of our investment. Since we can't predict the future with absolute certainty there will always be some risk or some fear as we put our money in the market.

If it happens that you go through a string of unsuccessful trades—fall into a slump—how will you approach your next trade? Will failure in this area cause you to pull back and quit taking risks? Will failure in your investing cause you to get angry at others in your life?

It's easy to lose perspective in our trading and in life. Losing trades is part of the package. No investor wins on every trade. Sometimes the system gave us a bad trade. Other times we don't follow our system and get into bad trades.

The most talented people in the world are not the best all the time. They have bad days, they experience slumps, they struggle with self confidence. As an investor, you'll also experience bad days, slumps and struggles with self-confidence. This means that when you experience any of these things in your trading, you're in great company! Learning how to keep perspective is a great way to keep going anyway.

Remember, no system is right 100% of the time. That's why it's important to set stop losses to protect yourself. And when you have a losing trade, maintain perspective and keep investing so you can continue making returns in the market. Look at Warren Buffet. Over the past few years of the 1990s and early 2000s, he appeared to have lost his mojo because he wasn't part of the tech bubble. But he hung with his system and is once again considered a genius.

Remember in the markets that your account will be up and down each day but the goal is to have a general uptrend in the account value. When our account shows less value today than it had yesterday its so easy to begin to panic and to get worried and fearful and start making trading mistakes. Maintaining perspective will help you look at the general trend of your account and not the day to day swings in value.

Stay the course with confidence and power

Developing confidence in your system helps you act with power in the market. Acting with power is a way of approaching a thing with confidence and inner peace. It's a way of staying centered and focused on the execution of your trading strategy and proven system regardless of the emotional swings fear and greed may try to impose on you.

A confident investor trusts their system and keeps going despite losing trades. They use losses as a way to learn and get better, not as an excuse to throw in the towel. Confidence is so key to success. Cultivate confidence in your system and in your ability to follow your system.

Attitude is such a key component to success in all aspects of life. The most successful people have developed an attitude of confidence which allows them to be more aggressive. They don't let past failure affect their future performance. They know failure is part of the game so they don't get tentative. They don't expect failure. They expect success. Develop this attitude.

It might be easy to get scared out of your trades too quickly, or to be scared out of the next trade. Learning to act with power and trade with confidence is a way to stay on course through the blinding squalls you might have to sail through in this sea called investing. You will be tempted to get in too soon, to invest too speculatively, to get out too soon or to not get in at all if you lose confidence.

So learn to stay the course. Learn to be confident (in your system and yourself) despite failure. Learn to act with power. Learn to live in the moment and not let prior account activity (gains and losses) affect your current attitude as you approach the market. And as you learn these things you will become a much more successful investor.

It may take some time to get past the habitual emotional responses that so easily lead to failure in the markets. It may take effort to change habits of thinking so that your mind opens up to opportunity in the face of failure. It may take some time to permanently put away your "ugly stick" and learn from bad trades instead of being stopped by them.

Whatever it might take to learn the proper emotional "bone support" to be successful in the markets is worth the price in the long run. A few percentage points of compounding a year has a massive impact on your retirement over time. And great traders with smaller accounts can do far better than this. Imagine if you could generate a Warren Buffet guaranteed 50% a year on your trading. How would that affect your life? How would that affect your financial future? How would that affect your financial confidence?

5

Keep It Simple

This chapter will discuss the need to keep it simple. It's easy to get sucked into additional signals outside of those your system tells you to use. If we process too much information or try to look at too many things outside of our system, we will get conflicting signals which will confuse us. And confused people do nothing. You don't want to fall under the spell of "paralysis by analysis."

It is a relatively simple thing to get sidetracked in our trading. I have a close friend who describes these sidetracks as "rabbit trails" leading us away from our proven system into unproven regions which often lead to losses. In investing these rabbit trails are anything that pull you away from your system, make you confused, or cause you to second guess or pause before taking action.

An investing system is the blueprint that you should follow despite the many voices both internal and external that push you to do things differently. A blueprint is used by a builder to keep the building process organized and efficient. A blueprint spells out in advance to all the sub-contractors exactly what they will doing and how the owner wants the house to look.

But one of the dangers of building a house is that during the building process the owner will begin to see some things they would like done differently. They will have an urge to move this or add that or change the other. If the home owner gives into these feelings a price will be paid in increased time and money that must be spent to adapt the blueprint to the changes.

Your investing system should be a blueprint that you follow religiously. Remember that to invest with power you must invest with focus and invest with confidence. You must not allow your focus to dissipate down the rabbit trail. Or your confidence to erode through unnecessary losses. Focus on the thick of thick things and avoid those things that don't really matter.

Stephen R. Covey describes four quadrants for how we can organize our time and our efforts to be more effective. These four quadrants include the quadrants of urgent/unimportant and urgent/important. The urgent/unimportant quadrant is filled with activities that we feel are urgent and must be accomplished but if done don't lead us anywhere.

Successful investors don't let themselves get pulled down rabbit trails. Perhaps you find that you are "addicted" to certain financial news stations—that you can't seem to get enough news about the markets. Perhaps you allow yourself to be constantly inundated with up-to-the-minute news announcements because you are so worried about missing out of the one thing that will help you get in before anyone else.

There is no way to know everything in this market. And there is no way to know for sure which direction the stock will move tomorrow. We can be in control of our investments but we can't control the outcome...only react to the now; limiting our losses and letting our profits run.

Keeping it simple means just doing exactly what your system tells you to do when it tells you to do it. Act on what it tells you even if there are lots of reasons you can give yourself to do the opposite or do nothing at all.

I have spoken with students who admit that they have been so consumed with watching the markets that they literally don't move from their chair all day long. In fact, these people have told me that tif hey could make arrangements to use the bathroom right at their desk they would just so they wouldn't have to stop watching the computer screen and playing in the market. They became this obsessed in part because of their fear of losing out on potential movement coupled with the fear of losing money in their investments on some market move that happened while they "took care of business."

This is too complicated and consuming for most people. Don't become a person who allows themselves to be led down one rabbit trail after another until they are completely lost. Keep things simple. Stick to your system and shut everything else out. Literally. Put blinders on and focus exclusively on your system.

In the software world, programs often experience "feature creep," meaning they continue to add more and more features which fewer and fewer people actually use. This feature creep adds to the size and complexity of the program leading directly to increased bugginess and susceptibility to viruses.

Learn to keep it simple. This isn't to say you don't want to adapt your system over time to new market conditions...but you want to do so carefully and logically and by making changes to one element of your system at a time to exactly measure the results. Don't add too much complexity or you'll end up with conflicting signals. Don't allow feature creep in to your system.

Think of your investment system as a boundary of sorts that allows you to get on with the rest of your life. By developing a system and by following that system you will draw very clear lines of how much time you will need to spend and still approach the market consistently. Remember, a consistent approach to the market creates consistent results from the market.

You don't have to let your entire life be overtaken with your investment system. If this has happened, you are probably not following a system at all but using what I call the shotgun approach to investing. The shotgun approach is where an investor spends an inordinate amount of time zig-zagging from idea to idea hoping that enormous but scattered effort will lead to consistent results. It just doesn't happen.

Keep your investment system simple to avoid unnecessary stress in your investing caused by a vague need to be constantly aware of everything in the markets. If you are not careful this vague need to know will grow like a cancer into a debilitating need to spend as much free time as possible plugged into the market. Don't go down this rabbit trail. Know what you need to do and do just these things. Keep in mind that no one knows everything and yet there are still wildly successful investors in the market. Be one of these successful investors.

Stay focused on your system- Don't become a 'jack of all trades'

It is not necessary for you to be an expert in every type of trading system or philosophy. Each type of investment strategy has its risk/reward ratio and its own time constraints. All investors should know what their risk/reward ratio is and should know how much time they can put into their investing. How much risk can you live with for the promised reward? Each investor should then pick a system that matches their risk/reward level with the amount of time they can use working this system.

Once you've chosen your system, stay focused on it and don't let any other system or ways of doing things confuse you. Don't get sidetracked by the "next big thing" that comes along or by the popular fad or investing philosophy of the day. Stick to your knitting, stay with what works and don't get pulled into anything else.

Before the actual investment of hard-earned cash, human nature tends to focus on the upside potential while minimizing the downside risk. This innate optimism is actually quite helpful as we live our lives. But this same optimism can lead to what I call, "flavor of the month investing." This is the process of selecting your system only to quickly change it for another strategy that seems to have better results. Remember, you don't need to catch every trade…just the obvious ones that your system will serve up to you on a silver platter. But if you spend time trying to find the next big thing, you'll have less time to work your system and you'll miss out on these moves.

The temptation to change systems often comes as a result of a loss. Like I have repeatedly stated in the book, not every system works every time. It will be tempting to leave a system if it doesn't work even one time. It will be tempting to switch systems in your pursuit of the "silver bullet" or the system that never misses.

If you find that you always seem to be chasing stocks, then you are probably investing in the markets using a variety of strategies that are actively switched around in an effort to milk every penny from every play. This is a losing strategy.

When I first started investing, I played only stocks. Then after a few months I decided that I wanted to do covered calls. Covered calls is a strategy safe enough it can be done inside an IRA. A covered call obligates me to sell my stock at the agreed upon price within the specified timeframe in exchange for being paid a premium.

The goal of this strategy is more about generating consistent cash flow and less about appreciation or depreciation in the underlying asset. As I started doing covered calls I was highly successful. I made a set 8% a month on average. Great right?! Then one day I saw that the stock I had sold the call against had risen more than 20%. It hit me that if I had not sold the call, the stock I owned would be worth more than I received for the covered call I sold.

Notice the progression. I started with a great system consistently making me 8% a month. But then my eyes shifted to money I missed out on because I had capped my return to 8% a month. My emotions pulled me out of my system of steady cash flow and into a different system hoping for returns from appreciation. I had allowed a "failure" in the market to affect how exactly I followed my system. All this happened very quickly and without much thought. It's partly why I decided to write this book. To help others avoid the emotional mistakes I'd made.

Is it a "system" to shift direction mid stream? Or change approaches on the fly? Or is this a manifestation of the "buy; hope, wish and pray" system so many investors fall into?

There is a bewildering amount of information available for consumption and almost as many ways to trade on that information. Your success will depend on trusting your system enough to follow it exactly without drifting into different strategies or second guesses.

The entire purpose of this book is to help you learn the emotional habits necessary to actually follow your system despite the sneaky way fear and greed will cause you to rationalize other choices and actions. Most people will learn their chosen system relatively quickly but will struggle with the momentum of emotional habits and patterned responses which will lead to loss if allowed freedom.

Successful investing is comprised of two things. First is to learn the mechanics of the system. Second is to follow the system exactly. This takes effort and discipline and mental toughness to push through the initial resistance you'll feel. Don't be one of those who starts this path only to stop before full success is achieved.

It is a natural human tendency to start following a system of investing only to second guess that system and abandon it too quickly. It's hard to stick with the investing system you start with. Why?

Well how many times have you gone to an ice cream store knowing exactly what you wanted to order but when you got there you couldn't make up your mind? We often know what we want…until we are actually faced with the several possibilities now presented to us. It's like our mind "glitches" and struggles to remember the initial flavor that drew us to the ice cream store in the first place. We knew what we wanted before we got to the store but now that the choices are right there in front of us we suddenly can't make up our minds.

The investing world is very similar to this ice cream store example. Our system tells us which stock to buy and sell and exactly when to buy or sell them. But in the heat of the moment we struggle to make a decision. And we end up paralyzed, on the sidelines and unprofitable.

Let's explain this glitch in a different way. Let's just say that you decide you are a conservative fundamental investor. So you do your research and you decide to buy ABC company because that company has the best fundamentals and also appears to be undervalued. So you contact your broker to make the trade.

Think of the emotion of the trade. Are you nervous? Are you worried? Are your palms sweating, your heart palpitating or your guts twisting? Or are you calm and steady. Do you KNOW this is the right investment or are you a little nervous in your ability to pick good stocks? Are you confident?

What if your broker begins to ask questions about why this stock. Maybe he points out the negative technicals. Maybe he shares his fears about the economy. Or maybe you catch something negative on the news or online somewhere.

Suddenly it's like you're back in the ice cream shop with new information flooding your brain and making it easier for you to "glitch" by not following your proven system. How do you feel? Do you think you might be pulled out of this investment even though your system told you to get in? Or worse, will you be pushed into another investment you hadn't previously considered and which is not one your system gave you?

Can you see how easy it is to get pulled from the flavor you had contemplated with delight when you are suddenly given much more information or more choices?

Once the trade is actually made, how are your emotions affected? Now, try to project that investment out six months. Let's just say that during the past six months the stock dropped a little bit from say $40 to $37. Now how do you feel about this trade now. Are the words of your broker beginning to affect the way you think about this investment? Your system told you to get into the stock but now the conflicting messages you are being sent by current stock movement, broker appeal, and general market dynamics might cause you to lose faith. Don't let this happen!

I have seen inexperienced investors change their system mid stream or try to find a shortcut to make following the system easier. This ability to stick with a system even in the face of apparent failure is a critical part of the makeup of any successful self-directed investor.

Developing the right mental approach to the markets is a process. You can't make a leap from emotional to unemotional investor overnight. Having an investment system and learning to stick to this system is critical to your investing success. Most people understand that having a system is a very important first step to successfully investing in the stock market. There are examples all around us of successful investors who stand by their system without trying to second guess themselves or try to straddle the fence between two investments.

But there are other people who start with one system but find themselves unable to follow that system with exactness. One of the biggest mistakes individual investors make is that what I call strategy creep. They choose a strategy for how they will approach the market but then, right at the last second, some new information comes into the equation and the investor's mind glitches. The investor ends up breaking their investing system's rules and making a mistake.

Many unsuccessful investors start with a system but quickly adapt or change it once they experience a loss. They let the natural human emotion of wanting full control of the outcome push them into new systems or strategies. Another way of describing this is to say that these investors are on the "return treadmill." Or they are constantly on the lookout for larger returns so they move from system to system and never get good at any of them. They try to be a jack of all trading systems and end up being a master of none.

Let me suggest that you work to forget about all the other stuff out there in the marketplace once you have chosen your system. Try to remember that there is always a buyer and a seller and the news you see, the signals you receive and the emotions you feel might be coming from the other side of your trade. It can be hard to stay so single-minded. But if you try to limit the time you spend on your investments strictly to the time you need to work your system, you'll be less tempted to get confused by conflicting data points.

If you get caught on this treadmill of always looking for the "magic" system which only finds stocks which go up in value, you will be standing on a shifting surface trying to hit a moving target. Investors are those who have a concrete method of stock selection and who persevere even in the face of failure. Think of the system as home base—the one place you are safe. You may decide to adjust the system in some way, but you know exactly what you are changing and exactly how to get back to home base if the change does not work as expected. In this way you are constantly in control of your investing.

Think of this dedication to your system as one part of the process of learning how to invest successfully. To really become good at anything in life requires that we follow a process and work that process over time, pushing through walls of resistance. To become a pilot requires a dedication to the process of learning how to fly and embracing the time, effort and focus learning to fly requires. Just because I decide I want to fly a plane does not mean I can just hop into the plane and begin flying it without any prior preparation.

Investing for yourself is just like anything else. To really master the intricacies of investing so that you become a successful self-directed investor requires more than simply making the decision to trade. You must first say to yourself that you are committed to doing what it takes to become a successful investor. Then you must determine the best system for you to use. And then you must be willing to pay the price to learning and finally successfully implement this system.

Let me tell a short story from my personal life which illustrates this point. Not long ago my daughter and I were once again going the rounds over how important it is to practice the piano. In the middle of this discussion I suddenly had an epiphany where I realized that it is not important to practice the piano today if you don't want to play the piano later in life. In fact, the only reason practicing the piano today is important is because you want to become a person who can play the piano "in the future."

In this conversation I asked her if she wanted to be able to play the piano at some future point in her life. She told me that yes, she did want to be able to play it. Once I knew that she did want to play the piano at some point (she had committed to the goal) I tried to help her understand that this goal for the future requires some potentially unpleasant effort today. This "unpleasant effort" involves those things about learning how to play the piano that she does not like to do. In her case, these are things like playing scales, practicing for the allotted time, playing songs she does not like and learning music theory.

To help her understand, I used the example of a garden. Every spring I plant a garden of tomatoes and cucumbers. I do this work in the spring because I like the idea of harvesting home grown tomatoes and cucumbers in the late summer and fall. We all know that for me to harvest sometime in the future, I need to plant today.

But planting alone is not enough. Planting and harvesting are a process. I go through the expense and effort of planting as the first step of the process. Then I have to nurture these plants by watering them, fertilizing them, and weeding the garden around them. I don't find any of these things pleasant, but I am willing to put forth the effort because these things lead me directly to the goal of harvesting delicious tomatoes and cucumbers at some point later that summer.

So just because the goal is something you want does not mean that every step necessary to achieve this goal is something you want to do. Think of a goal as a destination. To get there first requires the decision or desire for the goal. Next, a clear path of how to achieve that goal must be mapped. Finally, every step required to achieve that goal must be taken. Each step may or may not be pleasant, but if the end goal is something you really want, you will deal with the unpleasantness and still move towards your goal.

It is the same in the investing world. We all have a goal in our minds for what we want our money to accomplish. Perhaps you really want to have your money grow so you can enjoy a comfortable lifestyle in retirement. Perhaps you are trying to generate huge cash flow in the market so you can enjoy a comfortable lifestyle now. It doesn't matter what your goal is, what matters is that you have one and that you recognize that achieving that goal is critically important to you. Achieving that goal must become so important to you that you are willing to put in all the effort necessary every day far away from all the music and the lights to achieve this goal.

And to be honest, this is probably the biggest challenge you will ever face in investing. To set a goal and to meet that goal by doing the little things day in and day out that are required to accomplish that goal. Like I have said throughout this book, consistency breeds consistent results. If you approach the markets consistently—day in and day out—you will find that you achieve consistent results from the market.

One other challenge that I should mention here regarding consistency is found in the sports world. In the sports world an individual or a team will occasionally take off on a long winning streak. These winning streaks are difficult to maintain because of the unique pressures we put on ourselves to keep winning.

You will sometimes have a long series of successes in the markets and this is wonderful. But these streaks might cause you to put so much pressure on yourself that you end up losing just to stop the streak! Just try to play every day the same. Try to think only of the next "game" or investment in the market and forget about all the other stuff swirling around. Don't psych yourself out.

The final thought for this chapter is this: Don't complicate the system trying to avoid loss. Loss is a part of the deal. Stay focused on your system and your results over time before you try to twist your system into a pretzel just to try to avoid loss.

Don't worry so much about failure that you become defensive in the markets while developing a complicated procedure for how to avoid losses. Losses and risk are an unavoidable part of the market. Be willing to take chances, trust your simple system and stick to the basics. And above all, be willing to take action when your system says to get in or to get out.

6

Leave the Ugly Stick in your Pocket

This chapter will just spend a little time talking about the things you can do to begin overcoming the emotions that cause you to make mistakes in the market. Keep in mind that emotional investors make poor investors. To really be successful you will have to discipline yourself and keep playing according to your system despite what your emotions are telling you to do.

The vast majority of investors in the market are people who invest part-time after a hard day's work on their main job. These investors might just be people participating in a company sponsored 401k or some other retirement plan. It might be people who are trying to build wealth through the stock market. The vast majority of people investing in the markets do not consider themselves proficient investors and therefore lack confidence in their ability to select performing trades.

I believe this lack of confidence in their investing ability causes them to be intimidated and unsure about what to do or where to go for guidance. A result of this trepidation is an over reaction to the various news articles, conflicting technical indicators or hype that come out on a company. As we have mentioned before, retail investors (the inexperienced ones) tend to cut their profits short and let their losses run. This general tendency is a direct result of the emotions of the individual investor.

One thing you can do to overcome this tendency is to work to maintain your confidence. One way you can do this is to leave your ugly stick in your pocket. What is an ugly stick? An ugly stick is the tendency to beat ourselves up for not being perfect. It seems that at every opportunity people will chastise themselves for some perceived weakness or inferiority.

I think this has something to do with how we are raised and educated in our younger years. We never get points for effort, only for accuracy. I remember one time in my tenth grade English class we were asked to write a paper on Leonardo Davinci's life. I chose to write my paper using mirror writing, meaning I wrote the entire two page paper in backwards cursive similar to the way Leonardo wrote in his journals.

Did I get an A because I sought to exceed the teacher's expectations? No! I received an F on that assignment because I made it more difficult for the instructor to grade my paper. This event has stuck with me through the years and has grown in importance as I have pondered its meaning. At first I was devastated. I mean, an F? I had never had one of those before!

So I spent the next few years working very diligently to stay within the normal boundaries and to not make any "mistakes." I was taught by this experience not to take risks. While this experience is an isolated event, it does illustrate what I want you to understand: Our parents tell us "no" to protect us from mistakes that might hurt us. Our overwhelmed teachers wanted us to all perform within narrow parameters. We don't get points for effort, only accuracy.

We are taught that people who do things differently do things wrong. The end result is that as adults we have a poor ability to learn from our mistakes. We tend to beat ourselves up and to refrain from taking risks. I have been a major user of the ugly stick. I still pull that tool out of my pocket every now and then to beat myself with it!

One of the stories that I like to use in my classes is that told of Thomas Edison—the famous American inventor. He spent thousands of man hours trying new things in his attempt to find the best materials for use in his electric light bulb. As he described it, he tried hundreds of different combinations until one finally worked.

But despite the failure and enormous expenditure of effort and focus which didn't lead to immediate success, he never allowed himself to quit because of the difficulty in finding the right combination. In fact, his approach is a lesson that we can all learn from. He believed that each failure just showed another combination that did not work. Too often we identify our failures (or losses in the market) as some failing in us which seduces us to quit trying because "we are not good enough."

Nothing could be further from the truth. But too frequently, we allow our failures to dictate our future. If you allow your losses in the market to dictate your future actions in the market you will pay a heavy price in lost opportunity.

So improving your ability to deal with loss will be one way for you to increase your emotional control. Don't get discouraged by mistakes. Try to adopt Thomas Edison's approach by saying after each loss that you have learned something new to help you in the future. Each loss is not a loss per se, but rather an educational premium that you pay to develop and hone your talents and your skills.

This is much easier said than done. It is very hard to think rationally after a mistake. In fact, we often don't want to think of that mistake at all. We want to forget about it because the very thought of how much money was lost causes us pain and we try to avoid pain as humans. Or if we think about it, we think about it in a way to maximize the self-inflicted pain of our ugly stick.

So avoid this need to internalize a loss in the market as a failure in yourself. Learn to develop a scientific approach to your process. Learn to analyze your behavior and your motivations and your results as if you were a scientist looking at an interesting, but not personal experiment. It may not be easy to develop such a mindset. But if you try to remember that losses in the markets are normal and expected, it might be easier. Also, avoid playing the blame game with the loss. Learn from it. Move on.

When mistakes are made, don't get discouraged. Instead try to be positive—tell yourself that you have just learned something new. I know that a mistake in investing is the same as a loss in your financial well-being and that can cut right to the heart of a person. Seeing an account lose value can be very depressing. It can be traumatizing. It can be paralyzing. But it can also be empowering because you just cut your losses short!

This is why you must try to remember that each loss is not a loss, but an investment in your investing education. This positive attitude will help you make better decisions when you have a loss. Sometimes we are so afraid of losing money (of admitting mistakes; even to ourselves) that we can't make money. Instead we hang on to that investment, sometimes buying more shares of that company for the long term. Sometimes your best trade is the one where you took a small loss and saved your investing capital for the next, better trade.

I suggest that you quit paralyzing yourself through a constant and repetitious beating with the ugly stick and instead spend your energy concentrating on what you can do to make things better. And perhaps the best thing will be to get out of a bad investment quickly before it devastates your portfolio. Remember one or two bad losses in the stock market can really wipe out a portfolio so work to avoid these losses by admitting defeat quickly and getting out rapidly if the stock moves against you.

A study was once done to compare the different investing outcomes between men and women. What was found was that female investors tended to be better investors. The statisticians were amazed and explained this result by saying that women tend to be more ready to admit failure and to take steps to both learn from that failure and to prevent more such failures. Men don't like to admit mistakes or be proven wrong; so they tend to stay in the market too long. Men *will* be right, which causes problems for them in their trading.

So, in a nutshell you must remember that when you make an investment in a stock and that stock falls, YOU are not the failure. Don't take losses in the market personal. Don't let your ego keep you in too long. You are a business doing work for a client that has chosen not to pay you. Analyze that client relationship to find anything you can that will help you avoid future clients like that one and then move on.

Remember that even the best players in the game have bad days. It is how you deal with failure that determines how successful you will ultimately be in the stock market. You should never fall in love with a stock you own. Instead remember to treat this as a business. If a stock performs well for you then that stock is a great customer and keep doing business with it. But don't get too confident or dependent on this great customer. Be humble and be thankful, but also be watchful. If the stock starts to move against you and your system says to sell, pull the trigger! You should only own stocks while they treat you well. As soon as they stop treating you well, pull the plug!

Avoid the "ostrich" mentality

I like to tell the students in my class that they need to avoid the ostrich mentality that most investors adopt. The ostrich mentality is where you constantly look at your portfolio when it's doing well and avoid looking at it when it's not doing so well.

It is human nature to spend more time with those things that make us feel good and avoid those things that make us feel bad. When your portfolio goes up it feels good to look at it and imagine your wealthy future. When the markets move against you, it's harder to be as excited.

Your approach to the market should be consistent. Remember, you should be focused on executing your system with exactness more than on the results. If you have selected a proven system (and you have), then trust the results will come as you learn what you need to learn to remain consistent in your application of your system. Don't fall into the trap of looking at your investments only when they are profitable.

Active management of your portfolio is how you consistently apply your strategy for consistently positive results. Active management does not mean active trading (though it could). It means constant vigilance and attention as you learn the emotional habits required to implement your system successfully on every trade (both the winners and the losers).

My advice to you is not to bury your head in the sand whenever you experience a loss. I understand that there will be times when the going gets tough…but that is the time when you should get going. Don't try to hide from or ignore the pain of a loss. Instead look at that mistake as a learning experience and be excited that you have found a new thing NOT to do in the markets!

The nice thing about investing nowadays is that it can be totally anonymous. You can do all of your trading online without talking to a single person. You don't have to win or lose in front of an audience. It might be easier for you to make decisions and execute your trading system if you know you don't have to do it in front of others. You don't have to share your successes or your failures with anyone meaning nobody has to know if you suffer a loss or make a mistake.

Get better by continuing to hone your skills

Kaizen is the idea that businesses should strive for constant small improvements. Apple has embraced the idea of small, iterative improvements to their products year by year until all of a sudden, no one else can compete with them. Nobody starts out as an MVP or champion. Everyone starts out the same…nervous, uncomfortable and inexperienced. But over time, as we consistently play the game, we get more comfortable, less nervous and more experienced. And if we keep mastery of ourselves, we eventually become MVP traders.

Initially it won't feel comfortable to make your own investment decisions. You'll be nervous to take control of your own financial future and you may be worried that you can't do it. But as you push through this initial wall of resistance, you'll develop skills and learn to to this like a champion. You'll get much better results than your advisor or broker would ever get for you. Just start and practice "kaizen" to make small improvements over time which add up to big advancements in your approach.

I once interviewed a candidate for a job position who told me that he had over 10 years of experience in that job. Later as I spoke with colleagues about this person the question was asked whether this job applicant had 10 years of experience or 1 year of experience repeated 10 times. As an investor you must learn to stretch yourself, to become more capable and more knowledgeable so your capacity increases.

Increasing your capacity will give you 10 years of experience instead of one year repeated 10 times. It takes effort to implement your strategy with exactness, but it must be done. It's tempting to expend the minimum possible effort for the maximum possible gain (or the gain we "can live with"). It's tempting to allow any immediate loss to impact future gains because we stop our efforts to control our own financial destiny.

When things get tough, try to remember that investing is a journey and not a destination. You will always be on this journey called investing. This is exciting! These adventures in investing are just that—adventures. Attack this adventure with passion, courage and discipline. It will give you a bigger rush (and a bigger retirement) than scaling Mt. Everest - I promise.

I suggest that you decide to keep learning about the markets. Perhaps you should set a goal to read one investing book a month or a quarter or something. By reading these books, you will do two things. First, you will train your instincts. Second you will learn is a confidence to keep going. I have been through many peaks and valleys in my investing—many that have threatened to scare me away from the markets. But reading about investing or successful investors helps m get re-energized and find the passion and confidence re-awaken, helping me to stay in and keep playing.

This time spent in additional educational pursuits will lead to big payoffs. Remember that more accurate forecasts and better investment decisions will drop profits right to the bottom line as your account grows dramatically. It is not a waste in time or money to get additional information and understanding about the markets.

The Ugly Stick on winning trades? No!

One final thought about the ugly stick and how easy it is to pull it out of our pocket to whack ourselves with. To illustrate this, I want you to imagine you have just come out of a winning trade. That over the past two months, your investment gained 100%. How do you feel?

Now, imagine that the day after you close your trade for a 100% gain, the stock suddenly moves and you could have made 150% had you held it one day longer. What's running through your head? Are you excited about your 100% gain like you were yesterday? Or are you pulling the ugly stick out of your pocket as a failure because you missed out on 50%?

For reasons previously discussed it's natural for us to feel failure even when we're right. This need to beat ourselves up seems so universal and so constant that it must be part of the human condition. Guard against this natural human tendency. Let your wins stand on their own and don't look back at how much you could have made had you just done this or that.

Remember, it's not really about the wins or losses. It's about how effectively you implement your system. The only thing you should focus on is how well you implement the system to get into a trade and to get out of the trades (win or lose). Leave the ugly stick in your pocket…or better yet, through it away!

7

Stay the Course, Maintain Discipline

The final chapter of this book will talk about some specific things you can do to develop emotional discipline. Throughout this book we have discussed different strategies to overcome emotions and we have outlined the different emotional traps investors tend to fall into. While it is not easy to become less emotional when you win or lose money, learning to focus only on how well you implemented your system is critical to your long-term success in the market.

Becoming a little less emotional every day will help you over the long-term as you become a more active and more confident manager of your own portfolio. This chapter will simply add some common sense ideas to help you help yourself in your pursuit of increasing returns and safer investments.

One of the best ways to begin controlling your emotions in the market is to begin to watch stocks you don't yet own but which fall within your system. Now, don't discount me out of hand. Think about human nature. Is it not human nature to begin to feel comfortable with things that we have long interaction or contact with?

How many of you have stayed in a bad investment because you did not know what else to buy? As I have told thousands of students, sometimes the unknown pain is much scarier than the known pain. We sometimes don't get out of bad stocks because we are worried that by selling the loser at a loss we have less to invest with and that the new stock we buy might treat us worse.

Have you ever felt this way? I know that as an investor I have stayed in bad investments too long because I did not know what else to buy. The devil I knew was still better than the unknown. Isn't this a horrible reason for staying in a stock? I believe as you become more familiar with different stocks you will have the ability to get out of losing trades quicker because you'll want to put your money into these other trades.

So develop a watch list of stocks and keep track of them every bit as carefully as you keep track of your actual investments. You should only put stocks into this watch list if they meet your investment system's criteria and they should only stay in this watch list as long as they meet the criteria. If things change and the stock no longer passes muster you should get it out of your watch list portfolio and replace it with something else.

Another reason to keep a list of potential investments is that a diverse list of possible investments can help you maintain a better feel for the overall markets. Having a list of stocks you watch but don't own will help keep your head in the game. In today's market the Dow Jones Industrial Average (DJIA) is often used as a gauge of the overall market health and strength.

But the DJIA is only a listing of some 30 of the largest companies in America so it's not a good indicator of what the overall markets are going to do. "False facing" is a term used to describe the affect of the DJIA.

False facing is a term used in the grocery business to describe stacking the cans nice and neat from the front of the shelf to the back. This makes it easier for the customer to grab the can even though it's harder to see if the shelves are fully stocked. In much the same way, the DJIA can sometimes put a false face on the market. The DJIA might be up but this only means that the stock prices of some of the largest companies in America increased that day. Thousands of other stocks could have fallen. This effect was actually clearly seen towards the last part of the bull market of the late 1990s. The indices were actually still rising while thousands of companies share prices were falling.

If you have a portfolio of stocks you own, you might be looking at as many as 25 stocks on a daily basis. While it is important to watch these stocks on a daily basis, I believe it is just as important to your emotional well-being to watch an additional 25 to 50 stocks. Putting these stocks in a watch-list portfolio will help you avoid tunnel vision by forcing you to look at stocks in different industry groups and sectors. This broadening of your vision will help you have a better feel for the overall market.

Having a watch list will help you understand the overall market better. But even more importantly it will give you a list of stocks that you become comfortable with. And as you get more comfortable, you will find it easier to get out of your losers and get into another stock doing better.

Too many of my students thought they were diversified in early 2000 because they had stocks in computer manufacturers, chip makers, internet companies, and other technology based companies. These investors did not have a watch list of stocks in other sectors and ended up holding on too long, losing large percentages of their portfolio in part because they didn't have anything else they knew or were comfortable with to get into.

If they had maintained the discipline of watching stocks they did not yet own, of building a pool of stocks they could get more comfortable with, they might have been able to survive the so called "tech wreck" by getting into stocks moving up as their actual holdings began to move down.

Be Focused

Another suggestion is to be focused. Don't waste time looking at things that aren't part of your investment system. All this will do is confuse you and paralyze you. You should spend your time looking for the obvious play in the finite number of stocks in your portfolio and your watch list instead of looking for every play. I always tell my students to just play the obvious play, not every play. You should too. You don't have to be in the market if your system is telling you to stay out. If your portfolio of stocks you own says you should get out—get out!

If you can't find new opportunities in your watch list of stocks—that list of stocks that you have painstakingly tracked over the weeks, months, and years—then you should simply stay out of the market. Don't waste time trying to find the one or two stocks moving up in a down market. Simply stay out of the market if necessary. Don't try to force your will on the market just because you want to get in. Remember, staying out is a valid strategy that protects your investment capital until it makes sense to get back into stocks.

The other thing I think investors spend way too much time and energy on is in trying to find the "perfect play" in the markets. If you are spending your time trying to find the stocks at the perfect time you are likely to miss most of the moves the markets will give you. If you buy a stock and put pressure on yourself to have a profit within a small number of days you are likely suffering the malady of looking for the perfect play.

Instead of trying to find the perfect play focus on following your system with exactness. Keep your eyes on how well you followed your rules and less on your gains or losses. Find the right kind of company whose fundamentals or charts fit your system and then buy and sell that stock at appropriate times.

Stay the course—maintain discipline!

Perhaps the hardest thing in life is to stay the course. How many times have you made the decision to start exercising, lose weight, quit smoking or get healthier only to break after a few short days or weeks? It is natural to get discouraged at the seemingly slow progress we make towards our goals. But we mustn't get discouraged. We must instead realize that the work and effort we put into our investing and investing research is part of the process of becoming a successful investor. All things of value in life take time, energy and commitment.

Be committed to your retirement lifestyle by investing both time and money now to prepare for that lifestyle. Another reason many people become discouraged is failure. I know many investors who are scared to get back into the markets because they are afraid of failure. In fact, studies have been done to show that the average investor tends to get in towards the market highs because their greed finally overcomes their fear. This emotional trap is seductive. Don't give into it. Stay focused on your system and applying it carefully and exactly.

These emotional investors who get in at the high often end up holding all the way down to nearly the lows before their fear is so great that they get out right before the markets turn up. These investors allow the emotions of fear and greed to affect when they get into and out of the market. But fear and greed get it wrong nearly every time! Don't get discouraged with failure. Don't let fear keep you out.

Remember that we all have an ugly stick that we use to beat ourselves up with. Instead of using this ugly stick, try to throw it away. Work to remain upbeat, positive and confident. Try to keep in mind the heroes of your life who continued to struggle in the face of initial obstacles. These heroes only became heroes because they overcame their own doubts, fears and worries; and reached for their goal with real grit.

You have a goal. The goal is financial freedom to live your life as you would like without money worries or concerns. The market has historically been the best place to put your money to work at the highest rates of return, but to make money successfully over a lifetime requires discipline and confidence.

There are basically two different kinds of people in the world -those who are internally motivated, forcing themselves to stretch and grow, and those who are externally motivated, who must be pushed by others or by circumstance to learn new things. Make your goal so real and your commitment to that goal so pervasive that you become internally motivated. This will help you do the little things your system requires you to do on a regular basis.

Now that you have started overcoming the negative emotions within yourself, you must also contend with the negative commentary coming from others. You will have people in your life who will second guess you, belittle you, and generally do things to take away your confidence. Even the talking heads on the TV will sometimes take away from your confidence because they will take the exact opposite position you have on a stock, making you a little unsure of your decision.

It might be easier as you begin this journey of learning the emotional habits of the successful investor to imagine yourself a toddler. Toddlers just learning to walk are easily knocked off their feet by little things, including their own inexperience of walking. But each time these toddlers fall down, they get up and keep trying. They have a goal (or maybe a burning need) to walk and they don't let the bullies, the lack of experience or the ugly stick stop them from learning how.

The biggest danger to you as you begin this journey is that you'll forget the lesson of the toddler. You'll get knocked off your feet so many times that you'll be tempted to give up and stop trying. Don't let the bullies of skeptical friends or family, brokers, talking heads, your own losses or headlines push you down to keep you down. Find the burning desire of a toddler to walk and allow this burning desire to propel you back on your feet and walking towards your financial goals!

There are so many conflicting signals to confuse and paralyze you. Don't "fall down" by listening to these signals (even your own emotional ones) and stopping your forward momentum. Focus on and follow your system carefully and don't let the noise out there swing you away from your rules of success.

Remember the mantra, "control your investments, don't be controlled by them." If you allow your investments to control you then you will not succeed in the market. What do I mean by having your investments control you? If a stock you bought goes down and you panic and get out, then you have allowed yourself to be controlled by your investments. On the other hand, if you wake up and see that the markets are having a really good day and your greed causes you to get in despite what your system is saying, then you are being controlled by your investments.

If you allow outside opinion to sway you as you make investment decisions, then you are not in control of your investments. You must remain confident in your system, remain confident in yourself. As you do this you will find that successfully controlling your investments will help you in other aspects of your life. You will begin to think differently because you'll stop the self sabotaging habits of thinking and of being that have limited you in your pursuit of success.

Conclusion

Being in control of your life is a worthy goal and something that everyone can achieve. Learning how to discipline yourself as you approach the markets will help you gain control of your emotions at work, at home and at play.

I guess the last thing I can leave with you as a word of encouragement is that every great journey begins one step at a time. You should never put pressure on yourself to walk this journey faster than you have strength. In fact it is unnatural to think that you could begin a trip, take one step and arrive at the destination without taking all the other steps between the beginning and the end.

You cannot be an expert overnight. As you know, it is impossible to become great at anything regardless of talent level without practicing, without working that talent, without making sacrifices in the moment to develop that talent over time.

I hope that each of you will apply the lessons you have learned in this book to take control of your life and your lifestyle. Only you can take control of your investing. Only you can take control of yourself. And only you can decide what investment system will be the best one for you to follow. Get started now. Good luck!