

Market Mastery

Putting Peak Performance to Work for You



A Conversation with Van K. Tharp

By
Van K. Tharp, Ph.D.

Part I: What Builds Consistency Into Your Trading Performance

I've done a number of good interviews, including the original interview in *Market Wizards*; an Interview in *Stocks and Commodities Magazine*; several interviews in various foreign magazines; an interview in *Active Trader*; an interview that I did with myself in the early 1990's that appeared in our Course Update Newsletter, and many I have forgotten.

I believe that there are a number of new developments that I'd like to share with you. These include:

Factors That Build Consistency Into Your Trading Performance.

Factors Involved In System Testing and Development.

The *You* Factor: Consciousness, Discipline, and Inner Work.

Financial Freedom and the SafePaths™ branch of the Van Tharp Institute.

I suspect that it will take several issues of *Market Mastery* to completely cover these issues. Many of these questions were generated by you, but some were self-generated just to convey a point I wanted to make.

I want to start out with a question that appeared on our on-line forum.

How do we know that what you do works? What percentage of the traders that you work with are successful? How long does that success last?

First, let me give an Ed Seykota type answer to that question. Your question appears to come from several assumptions. The first assumption is that there is a magic pill that you swallow and then have success for the rest of your life.

I'm sorry, but to the best of my knowledge such a pill does not

exist. It has never existed. If you find such a pill tell me about it. Life is a dynamic process. Success often amounts to simply staying in the NOW at a high level of consciousness. And I'll go into this topic in much more depth at a later time. However, the bottom line is that **most people cannot attain a high enough level of consciousness to go with the flow – no matter what you teach them. Others may be able to get into a flow consciousness momentarily, but they cannot consistently stay in the NOW.**

I personally believe that if you could get into a flow state and stay there, then you could probably trade well

consistently. But most people cannot even get there. Those who do get there cannot stay there. As a result, most people either cannot be good traders or they must do a lot of work to get there. This amounts to **personal psychological work and lots of discipline work.**

What is the other assumption people make when they ask this question?

The question also stems from feelings about, "Does it work and will it always work?" Feel what it's like to be skeptical that anything will ever work. Imagine that it won't.

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Market Mastery

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Live with those feelings and accept them until they just disappear. I'd suggest that you continue to process those feelings until you see what's left underneath.

Can you explain that a little bit more?

People always bring their psychological issues to the table in everything they do. It's in the assumptions they make (i.e., beliefs) and in the feelings they are going through when they ask the question. When a question comes from suppressed feelings or erroneous assumptions, then those are the issues keeping you from trading well. Those are the primary issues that need to be addressed. We'll discuss this in much greater detail in Part III of these conversations.

Okay, but how is the research is done? How do you know the model works?

To do modeling, you must find a group of good traders and determine what they do in common. When you have the common tasks, you must then determine the necessary beliefs and mental states necessary to carry out those tasks. That, by the way, is why the beliefs and mental states of the person asking the question of me are so important – do they have anything to do with good trading?

Okay, so for the trading process, that might be the ten-task model that you present so well in the Peak Performance 101 workshop. But, how do you know that it works.

One of the keys is to get feedback from people who use the model. What kind of results are they getting? In the short term, we have had excellent success. We get numerous reports of great success from people

who take the Peak Performance Course, the Peak Performance Workshops (101 and 202), or who get the material through personal consulting with me.

Can you give a good example?

I did a two day consulting session with a trader who worked for one of the world's largest hedge funds run by a market wizard. When we finished, he seemed happy with the results and I asked him to stay in touch. However, I never heard a word from him.

Two or three years later, I was working with another client in London. He said that he called me because of a referral from that original client. I said, "Great, how is he doing?" And the response was, "After he worked with you, his performance was so good that he took over the London office of the fund. He's now managing over a billion dollars."

That's really interesting, because he personally told me nothing. However, a referral is usually worth a lot of words. But sometimes that's all the feedback I get. And, word-of-mouth referral is one of our major sources of new clients!

Yes, but people are interested in long-term results. What about that?

Other than examples like I just gave you, I have no idea. First, our business is to help people. We are not an accounting company and we don't have the resources to track our clients. Some people would cooperate. Some wouldn't tell us the truth. Thus, the only way to really track results would be to demand account statement from our clients before and after introducing our model. Our compliance rate would probably be 5% even if we

had the resources to actually track this material.

So, What do you think the long-term results might be?

My guess is that many of the people who achieved excellent success in the short run eventually go out of business as traders. The trading model is just one of the many factors involved in success. It only takes a shortfall in one or two areas to cause havoc with someone's account. Such things as:

- 1) They might stop following the ten tasks of trading;
- 2) They might risk too much;
- 3) They might stop trading at the wrong time;
- 4) Some psychological disaster might occur for which they were not prepared;
- 5) They might start risking too much or start blowing stops; or
- 6) Any number of things might happen. Good trading is a very complex process.

In fact, the original model was derived by modeling a number of good traders. However, many of them did not succeed forever. Frequently, they had a huge edge which lasted for a limited time period. When the edge goes away, they stop being successful. That's why we are recommending all sorts of procedures to keep that from happening to you.

I don't know too many traders who've been successful forever. In fact, that's one reason why are now stressing the importance of financial freedom. But that's still another topic.

So what are a few of the factors involved in success that need to be covered?

Success requires consistent a) inner work and/or b) discipline. Most people do that for a while but at some point it stops. For example, I coached someone for three years. He went from having \$10,000 to running a \$50 million fund during that time. Then he stopped the coaching and spent his profits doing research. Two years later he concluded that "trend following didn't work anymore" and he gave back all of his investors' money¹.

Does that mean that what I was doing with him didn't work? I doubt it, because it sure worked well while we were doing it together. Does that mean that it requires consistent coaching or does that mean that markets change and we must adapt? Your guess is as good as mine – I don't know.

Okay, what's another significant factor?

Psychological variables are the most important factors. Events can happen that would devastated almost anyone and unless people have a consistent pattern of working on themselves -- things fall apart. For example, one of the best day traders I worked with was making 200% a year on a \$500,000 account while working through our programs. However, he stopped working with me and then he put a lot of money with a certain hedge fund manager and lost it all. His trading was never the same. Does that mean that what we were doing didn't work? I suspect that what he was doing didn't stop working at all, he just stopped working at it and on himself.

And how about changing markets as a condition?

Markets change and systems stop working. One of the "New Market

Wizards" that I know very well went from \$50 million to a half billion under management trading currencies. He was getting excellent results. Several years later, with adoption of the Euro, currencies were not a good place in which to invest. Soon he was back to \$50 million under management. Does that mean that what he was doing didn't work? No, it just means that the markets changed and he couldn't produce the return people wanted in currencies.

Look what happened to stock traders in 2000. People were making lots of money. But if they didn't know the big picture... if they didn't understand that secular bull markets are followed by secular bear markets, then they could have been hurt big time. And, by the way, this will probably happen for a lot of people in real estate within the next five to ten years.

So what typically happens to people that causes less successful results?

People do the Peak Performance Course, develop a business plan with several systems, and then follow it with consistent discipline and they report superb results. Later on they complain that their trading isn't working. My first question is, "Are you doing the the tasks of trading?" Have you done a daily debriefing lately? Have you done self-analysis? Have you done a periodic review? The answer is always "No." Does that mean that the Peak Performance Course is not effective? You could argue that if your logic is that I need something to fix my trading and it should work forever. But that's the magic pill that doesn't exist. Instead, something else is involved.

It's a little like Tiger Woods' situa-

¹ What he was doing was the Market Profile, which in my opinion, has nothing to do with trend following.

tion. He hasn't won a Major since he stopped working with Butch Harmon two years ago. He says its just normal and that he's close. Does that mean that Butch Harmon's coaching didn't work? The fact is that Tiger hasn't won a major since he stopped working with Butch. And while he was working with Butch he used to dominate the Majors. He used to often win by five strokes or more.

But couldn't that be just one of those things that happen? After all, most golfers don't win a major every year and even Jack Nicklaus lost 12 majors in a row at this stage in his career.

What you notice about Tiger are the inconsistencies in his game now. They didn't used to be there. I talked with one of the best golf coaches in the game and he said that Tiger is definitely inconsistent in his swing and that didn't happen when Butch was with him at every tournament.

And what does this have to do with trading again?

Peak performance trading requires consistency in a number of different areas. And you typically need someone to remind you of those things. Someone to stay on top of you – or at least someone to call or run through with a checklist when something is out of sorts.

So what else is involved in peak performance trading?

Well, there is so much that I recommend that all traders have a business plan. We recommend that the business plan cover all of the following areas.

- Your **vision**.
- Your **purpose**.

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

If you have all of those things, then you have a chance of doing well. But this means that your business plan becomes a tool for you to continually use to improve yourself and your trading. All of these topics were covered in some detail in our teleconference on business planning – and you can now get that series

on CDs – including some sample plans that I critiqued during the last session.

Okay, but let's go over each of those points briefly, so we are all talking at the same level. Let's start out with the vision. Why did you include that?

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

However, I do have some clues to how you can develop it in yourself. The key to doing so is to develop your vision and purpose. **Your vision is your dream life. What do you really want to accomplish,** be, and have in your life to know that you've done your best? What is your dream life? I'd write this out in detail.

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

What about those who are not committed?

That's one reason we've formed the SafePaths™ division of the Van Tharp Institute. I believe that everyone can commit to obtaining financial freedom. But we'll talk about that more as this series continues.

Does that dream life and purpose give people the commitment to do what it takes to be a good trader?

Everyone has some sort of purpose for their existence. You'll know you have found yours when you find what brings you continual joy. Some people never get in touch with it, but you can find it through a simple exercise like this one. And when you've found it, if you link your purpose to trading, then chances are you'll have the commitment to do whatever it takes to be a successful trader.

Why do you insist on objectives in the trading business plan? And how is this different from one's vision and purpose?

Your objectives have to do with the returns and drawdowns in your account. Most people don't think too much about these things, but you cannot develop any sort of system without knowing these things. For example, you might decide that you want to make at least 50% and have a peak-to-trough drawdown of no more than 20%. That's a reasonable objective. But it's totally different from someone who says I want to make as much money as I can and not worry about drawdowns at all. Both have entirely different objectives.

Furthermore, we can show with our simulation software, *Know Your System™*, that different objectives call for different position sizing algorithms in order to achieve those objectives. And we can show that there are an unlimited number of possible objectives. Thus, you must give a lot of thought to this and put it into your business plan and stick to it. One you have objectives, you

know where you are going and you have a chance to get there.

Why is a thorough self-assessment necessary?

Let me give you two answers to that – a philosophical answer and a logical one.

First the philosophical answer. In the interesting book, *Conversations with God, God²* (and you don't have to believe that God was really talking to see the importance of the point) says that our real purpose in life is to discover who we really are. Wow, most of us answer that question by just saying what are name is and what sort of job we have. And, if our purpose in life is to decide who we are, then perhaps we should give it a little more thought than just our name and occupation.

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

What do you recommend that one include here?

Well, just off the top of my head, you might ask yourself, "What major conflicts to I regularly confront in my life?" "What are the consistent negative emotions that I see out there?" "What beliefs to I have that conflict with my potential success?" "What bad habits do I have?" "What secrets do you have that you must keep from someone or everyone?"

Since most people blame what happens to them on people or things outside of themselves, they tend not to become aware of the major elements going on within them. They just seem to repeat the same mistakes over and over again. However, if you start to answer some of these questions, you'll really begin to open yourself up to who you really are.

How about your strengths?

Well, here you might list your good habits, your strong traits and characteristics, and what you are good at doing. For example, are you good at math and computers, which might be necessary for the research you'll need to do. If not, how are you going to overcome that? Learn it or hire someone!

Are you a disciplined and organized person? That's very useful. And it's also useful to know if you are not. Can you focus on a project and get it done? Can you do research and develop a system? Are you able to deal with adversity well – like many consecutive losses as one might have in a system? You know yourself much better than I do, so you need to list your strengths.

You mentioned that these should be based upon real trading logs, but you didn't say anything about that in your elaboration statements here. Please clarify.

In my opinion, logs or journals are one of the best ways to really get to know yourself. If you keep track of every trade – all the reasons for entry, exit, and any emotions or beliefs that come up – then you'll start to see patterns emerging. In my opinion, for someone who hasn't done a

Continued on next page

2 You don't have to believe in God or what God says to get a lot out of these book. Just take it in with an open mind.

lot of inner work, that's a great way to start. Once the patterns arise, it'll be pretty clear that it's you. And then you can begin to do the real work.

But don't ask me about that yet – let's finish this section first.

Obviously, you took the words out of my mouth. Okay, so next you have a section about knowing the big picture. Can you elaborate on that?

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

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

For example, the stock market shifted to "yellow-light" mode in April 2003. 2003 was a pretty good up year. It shifted back to red light mode at the end of June 2004. Both, signaled major changes in strategies. And you need to have the strategies ready and understand why.

One of the biggest reasons people get hurt is that they don't understand when the big picture changes. In

fact, they are most likely to get involved in the wrong thing when the big picture changes.

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

You suggest including a whole section on your beliefs about the markets. What's this all about?

This is somewhat obvious, because you can never trade the markets directly. You can only trade your belief about the markets.

For example, right now I believe we are in a Secular Bear Market, meaning that I expect the market to go down over the next 15 years or so. However, I do expect some rallies, lasting a year or more, to occur. Nevertheless, when we got a red light signal on the market, it strongly steered me toward looking for a bear entry signal and getting out of anything risky.

The 1-2-3 model, developed by my friend Steve Sjuggerud, is another such belief. Steve claims there are three critical market factors. Is the market overvalued? Are the Feds in the way? Is the market acting badly? When the answer to two of the three questions is "Yes," then you can expect the market to generally go down about 10% over the next year. We got that red light signal when the Federal Reserve raised interest rates.

So is that an example of two beliefs – we're in a secular bear market and when the 1-2-3 model is in red light mode the market goes down?

Yes, although each sentence in the

above three paragraphs could represent one or more beliefs. But those were the critical market beliefs in what I said. Anyway, my point was that my current outlook is strongly shaped by my beliefs.

They are quite organized. I know to look for signals to use my bear market mutual fund strategy when the market moves into red light mode. And I have a lot of beliefs about that.

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

Now what do you mean by getting your empowering mental states and beliefs behind you?

There are certain mental states that are most appropriate for the trading tasks you will be doing. The Peak Performance Course (in volume four) tells you how to get yourself in those states.

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

The next section seems like it might be a whole book – how you will research new, appropriate research techniques? Can you say a little about that?

There are several things that you need to keep track of here. First, you need to know how your system works, why it works, and how it fits

with the big picture. Tom Basso once said that the better you understand your system, the less testing you'll have to do with it.

Second, you need to have a systems development procedure. That's been detailed in our Systems Workshop and an earlier version of it is in the systems tapes that we sell.

Third you need to make sure that you have all of the critical parts of the system covered. These include:

- i. Objectives (see section 2)
- ii. How System Fits the Big Picture
- iii. Entry Set and Conditions
- iv. How Initial Risk (1R) is determined
- v. How to Take Profits
- vi. Position Sizing
- vii. *Know Your System*TM Report

Fourth, you need to know how to evaluate the system. We personally recommend that you collect enough R-multiples from your system (at least 50) and then get a *Know Your System* report from us. That will tell you a lot about what to expect with your system.

And, lastly, but most importantly, you need to know when your system is broken. This would occur when you exceeded a certain drawdown, a certain number of losses, that sort of thing that you need to predetermine. Again, the *Know Your System* report can help you a lot with this.

Can you elaborate on that a little more?

Well, there are six types of markets

- 1) up volatile;

- 2) up quiet;
- 3) flat volatile;
- 4) flat quiet;
- 5) down volatile and
- 6) down quiet.

You need to know how your system will/should perform in each of those markets. Thus, whenever you do a periodic review of your system (which should be at least every six months) you must decide what kind of markets occurred during the period and if your system performed appropriately, given the types of markets. If it did, then nothing's broken. If it didn't, then you need to know exactly what went wrong.

The next section involves one's discipline procedures. What do you think people should do here.

There are three aspects to that. The first aspect involves the ten tasks of trading. These basically keep you on track. As I mentioned earlier, when my clients call me and say that things are not working, I tend to ask, "Are you following the ten tasks?" And the answer is always, "No."

Thus, you've got to follow the ten tasks regularly. And this takes in a lot of information. It allows you to program yourself at the beginning of the day. It allows you to fix mistakes. So if you are doing that on a regular basis, then you are doing a lot. There are four major psychological tasks involved and you need to have checklists in place for each of them. They include: 1) a daily self-analysis; 2) a daily mental rehearsal; 3) a daily debriefing; and 4) a periodic review. Also, include a daily schedule with this.

What is the second aspect of discipline?

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

However, the plans each involve three things. What's the overall goal I'm trying to accomplish? What's the purpose (i.e., driving force) behind it? And what action steps to I need to get there?

Can you give us an example?

You need to think, "What are the key outcomes (together with the purpose and action steps) that you want to accomplish within the next year, next month, next week. It's much more significant to list an outcome with its purpose than it is to list something to do. As an example, an outcome might be to thoroughly test a trading system. The purpose might be to know that it will give you satisfactory results and to gain the confidence to trade it. And then you might have a dozen or so action steps that are involved in doing that—each of which might be separate outcomes—(outcome-purpose-action).

How does that work to give you more discipline?

Most people make to-do lists each day (if they do anything). At the end of the day, you probably find that

you haven't completed too many of your to do lists. However, if you list outcomes instead (with actions necessary to get the outcomes), then you are going to find that you are much more motivated to get things done. We did a teleconference on psychology this year (available in CDs now) in which this is explained in detail.

It's quite remarkable how effective it can be in helping you get things done and that's what discipline is all about.

What's the third aspect of discipline that you advocate?

I think it's to know the conditions under which you'll avoid trading and get out of the market. Have a list of them and be ready should one occur to make a hasty exit. For example, if you are going through something that could be psychologically upsetting like a divorce and nasty move or a major illness or a lawsuit or even the birth of a new child – all these things can have a major impact on your trading. You need to be ready for them.

I'd like to cover the topic of discipline versus psychological clearing work in much more detail. But I think that's another entire interview. Thus, in the next issue we'll finish up the various parts of business planning and then get into personal psychology in much more detail.

However, I plan to use this interview series to help my clients. If you don't have a business plan, I'd suggest that you get the Business Planning CD series and start developing one right now.



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