Developing a personal trading style

The Wyckoff method of trading

Part 14

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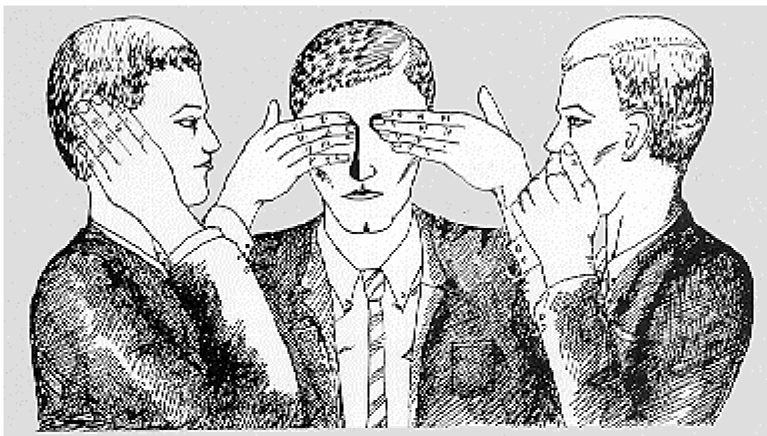

"A stock market operator must be as hard-boiled as a five-minute egg; cold-blooded as a fish; deaf to all gossip; blind to news, and dumb as a door knob when it comes to discussing the market with others."

—Richard D. Wyckoff

Trading the stock market with the Wyckoff Method is as much a test of personality and personal perseverance as it is a test of analytic education. Wyckoff was strictly a loner when it came to studying and trading the stock market. He believed the best way, the only way, his students would become profitable technical analysts was to rely on their own intelligence and to develop an inner fortitude against inevitable mistakes.

To his way of thinking, mastering the technical aspects of his method was only half the battle of working the stock market. Controlling emotional fervor and keeping a clear head when actually applying the technical know-how in a not-so-perfect market was the other half. Traders or investors wouldn't be able to do that, he felt, if they were continually looking for advice from others or if their technical reasoning was poisoned with rumors and news reports.

Brokerage houses, especially, were his bane. He warned against eavesdropping on the gossip, taking quick looks at the ticker or listening to unsolicited recommendations from brokers. "Be self-reliant," he advised. "Never ask your broker or anyone else what they think of the market. Make it a rule that your broker only quotes prices when you specifically ask for them. Make it a rule that the broker does nothing more than take the order and confirm its execution. Form your own opinion and try to make it so accurate that you gain confidence in yourself."

Wyckoff was quite intent on his students developing their own judgment, self-reliance, courage, prudence, pliability and patience. "We can train you to develop good judgment," he said, "but you must train yourself to act upon your decisions and to carry them to a successful conclusion." Success, he said, requires that "you operate with no emotions whatever. Be as indifferent, hard-boiled and level-headed in opening and closing actual commitments as you would if they were merely paper trades. You'll be surprised to find how greatly (complete emotional control) strengthens your judgment."

As a start, he recommended that each student "make a searching analysis of your own mental processes. Study your psychological shortcomings To know them is to beat them. "Above all, he admonished against wasting time regretting losses or lost opportunities. "The only value of a mistake is the lesson it may teach; the only thought you will give to your errors will be studying the reasons for them."

Wyckoff was a firm believer in "playing a lone hand" and drawing conclusions without the consultation of "experts" because every person views the market from a slightly different vantage point. One expert may interpret price and volume movements from an investor's standpoint and another from a day-to-day trading outlook. The trader who is dependent on another person's opinions will not only fail to understand the market, he felt, but could very well be thrown off a proper course by offhand and conflicting opinions.

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Realistically, though, Wyckoff did acknowledge the existence and lure of advisory services even in the 1930s. It went against his grain, but he said, "If you must use an advisory service, check up on their recommendations. . .and don't hesitate to disagree."

He was a prudent market player, too. He believed that staying out of the market was as much a strategic move as being in it. "Never get the idea you must be in the market all the time," he counseled. "In fact, plan to be completely liquid at intervals to prevent yourself from going stale, and to keep a fresh, clear perspective."

He taught several clear signals that warn to pull out of the market. The first is a technical warning—the situation in which the trader's analysis gives unclear, confused signals. The other two are emotional warnings—relying on "instinct" rather than research and a growing or chronic indecisiveness about executing trades.

His advice was to never go into a stock because you *think* it may do well and never make a commitment until you've thoroughly studied its position, background and present behavior.

If at any time, you find yourself powerless to move because you haven't the nerve to trade, he advised making trades on paper until confidence returns. Better still, he said, "take a vacation from the market. Do nothing for some days or weeks. When you return to it, you will find your judgment improved."

He especially advocated stringent measures "whenever you find hope or fear warping judgment. Close out all positions at the market price regardless of profit or loss. Stay out of the market for a few days, a week or longer until these two emotions that cause so many failures subside."

Wyckoff's experience led him to the conclusion that being in the market at all times is not the key to profits. Being in the market when there is a clear, unconfused technical signal and the trader's judgment is not swayed by emotion was his rule for success.

The first emotional juggernaut traders or investors must deal with is the matter of risking capital. Working the stock market requires the courage to lose money, but risking more than you can afford to lose will warp judgment. Equally destructive and ill-fated, as Wyckoff points out, is an obsession with amassing a fortune overnight.

"Just one more thing Mr. Arnheim - sign where it says "Government by consent of the Governed."

For both these reasons, Wyckoff counseled his students to first venture a fraction of their capital—say $1,000 out of a total $10,000 trading fund—in a series of trades in small amounts of stock. Learn to play the game professionally instead to trying to make an instant killing, he told them. Don't allow actual or potential success in the early stages lure you into trading too large a proportion of capital. And, he reiterated, until you can be calm and collected with the amount of capital at risk, continue to practice on paper and hone your skills for the real campaign

Flexibility is another essential skill Wyckoff felt anyone in the stock market should develop. "Don 't get fixed on a certain amount of profit you hope to make on any commitment. The charts will indicate the possibilities. . .but the market situation can change in 24 hours."

Once you've made up your mind the market is topping out, he added, don't be in a hurry to climb back into a stock out of which you have just taken a substantial profit. "Let the other guy gamble for the last eighth of a point," he advised.

In Wyckoff's mind, patience equals greater profits. This is the patience to wait for opportunities to develop and to wait for clear signals from the charts. "Don't be in a hurry to get into the market simply because you have surplus cash," he advised.

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"Wait until you see a real opportunity. One good commitment a year will make profits of many times the interest you could earn on your money for a few months outside the market. . .but one hasty trade can set you back an entire year's interest plus the shock to your confidence."

Wyckoff believed in committing capital to the market when stocks were ready to make their swiftest and furthest moves. The patience to wait for these situations, however, didn't demand 100% certainty before taking action. "By that time," he said, "your move will have started and the opportunity slipped away. Don't run after the move that has escaped— your judgment will be biased by your first error and chances are you won't act with a clear mind. Look around for the next opportunity."

He also cautioned against mixing technical methods. If a trade is made based on ticker tape indications, close the trade on that basis. If a chart is the basis for taking a position, the chart should be the reason for finishing out the position. Don't confuse the techniques of short-swing trading with intermediate-trend trading. And don't, he warned, drop by the broker's office at lunch to see how the market's behaving. It will be just one paragraph, not the whole story that your analysis will show.

Wyckoff, likewise, believed in one trading method—his method. He saw no reason to clutter it up with other ideas and theories (especially the Dow Theory). "Our instruction is practical, founded on principles employed by real operators and not beautiful theories. It is complete in itself, it covers all requirements in all phases of the market. It has been tested in all kinds of markets for more than 25 years and the underlying principles are as old as the market itself."

