Black Swan Capital
Currency Snapshot

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Keeping It Simple

(The following is a rebroadcast of this morning's Currency Currents.)

I don't know about you, but I know I get tangled too often into trading ruts. And most of the time it's all mental. Let me give you a recent example.

"The dollar is due for a correction," is what I have been telling myself for the last couple of weeks. And the last couple of weeks I have fought the trend, even though I believe in the longer term trend.

"The market is an easy game to play. It is just that we are hell-bent upon making it so complicated. That's what makes it so difficult for us to win," Edward Toppel writes, in his gem of a book, Zen in the Markets.

Guilty as charged I am. Oscillators, retracements, waves, time counts, trend lines, blah, blah, blah…into infinitum head at times, making it harder than it is. Maybe it is just a simple as Toppel says.
Here are the rules:

1. Buy low, sell high.
2. Let profits run, cut losses quickly.
3. Add to a winning position, not a loser.
4. Go with the trend.

Bingo! Unequivocal! Easy to understand! The problem is that we break the rules on a consistent basis; at least I know I do.

Instead going with the trend, I look to make a short-term trade against the trend because I think I know more than the market. Often I believe I can tell when a profit should be taken and cut winners short. In general, I do a good job with rule #3 and the second half of rule #2—cut losses quickly. How about you?

It is important that you describe your mistakes and weaknesses in the "I" term. Because in the end, even though currencies are a zero-sum game, we are in competition with ourselves here. The market does not personalize. Dealers don't personalize when they gun a stop when trading is thin; after all they have to eat and educate their kids too. No, it is part and parcel to the process—it is the market. But I know the rules; therefore there is only one person to blame for breaking them.

Toppel cuts to the chase. Once we understand we are in competition with ourselves, the culprit is easy to spot. He refers to it as the "Big E," for ego. Because the Big E gets in the way and thinks its right, it robs us of the ability to do the right thing. And this goes to what Jesse Livermore tried to tell us many moons ago, "Trading isn't about *being* right, but *doing* right."

Trading guru psychologist Mark Douglas put it this way, "You don't have to know what's going to happen in order to make money in the market." Now, that may sound odd to many. But the reality is that trading is nothing more than a probability bet. No more and no less. And if we can think of it in those terms, I think it helps remover the Big E from the equation. For as Mark Douglas says, you don't take an ego hit when you pick heads, and tails comes up on a coin flip; you know it is all about probabilities. Trading should be considered the same. But, that is easier said than done; I know that too well.

Big E is wedged between how we should and how we do think of trading. "Really, ego has a life of its own within all of us. Its hold is more powerful than a plutonium bomb," writes Toppel. True that!

Toppel talks about how to change Big E's hold. He writes about the idea of "egoless sight"—seeing things for what they are and not for what our ego would like them to be. Mark Douglas says that we have to ingrain deep and permanent within our psyche that "anything can happen" in the market at any time.

How many of us have nailed all the economic stuff in advance, predicted all the news, reports, etc. and have lost money on the trade? Guilty again as charged your honor. This is why I always do my best to use words like maybe/could/should/seems etc. The reality is that we never know—NEVER—EVER!!!! And when we start thinking we do know, our trading accounts pay the price, at least mine does.

It's why at times I realize this morning missive can be a lot more detrimental than good for you as a trader. In *Currency Currents* we apply standard Aristotelian logic. We give reasons and rationales. We jump to conclusions. But I want to issue this warning label: Always keep in mind when reading our stuff, and anyone else's for that matter, it is simply an alternative scenario. That's it. Maybe it proves right. Maybe wrong. But a scenario only it is.

We try to view it that way. And we always try to build an alternative competing scenario with as much plausibility as possible and hold both thoughts in our head at the same time. Granted, one is favored enough over the other for us to take a position. But, we do our best not to fall in love with either side of our story (and fail at this sometimes too). When we do fall in love with our story, it proves Big E is once again taking control. And that goes to the problem lately, we have fallen in love with the idea that the "dollar has to correct in order to consolidate recent gains." The fact is, it doesn't have to correct—it can blow-off and keep going—anything can happen.

Let's look at some of the ideas many have fallen in love with:

1) Gold will rise to $2,000. Gold will fall to $300.
2) Oil will rise to $200. Oil will fall to $60.
3) The dollar index will fall to 40. The dollar index will rise to 125.

When you look at these in stark isolation, without the Aristotle stuff, it looks really silly. These are nothing more than a whole bunch of guesses. Some seemingly more "reasoned and elegant" than others, but guesses based on varying degrees of bias nonetheless.

"If the market were logical, we'd all be winners," Toppel quips. "So let's give up applying a system of expected outcomes to that phenomenon that has eluded the best minds sifting through a multitude of data for their analyses."

So do we give it all up and just throw darts? Maybe, if that works for you. Easier and stress free it can be, assuming no one wonders in front of your dartboard. But the reality is the best we can do is "stay in the now moment" as the Eastern-psycho babblers like to say. Each trader has to define what a "now moment" is. For some it may be 5-mintues, for others it may be a week.

In one of the interviews in Market Wizards by Jack Schwager, a Wizard said that every day he wakes up he considers any positions he has on as new positions. All new risk/reward criteria because it IS a new day—it is the now moment.

"The noise is your ego's voice. Stop listening and turn to the only expert worth following—the market. Don't make it difficult and obscure this simple truth. Forget your voice, and listen to the clear message and direct call given off by the market. Just feel, follow, and put full faith in your ability to blend with the leader, not attempt to lead the market," adds Toppel. Again, easier said than done; I realize. But, there are ways to help achieve this.

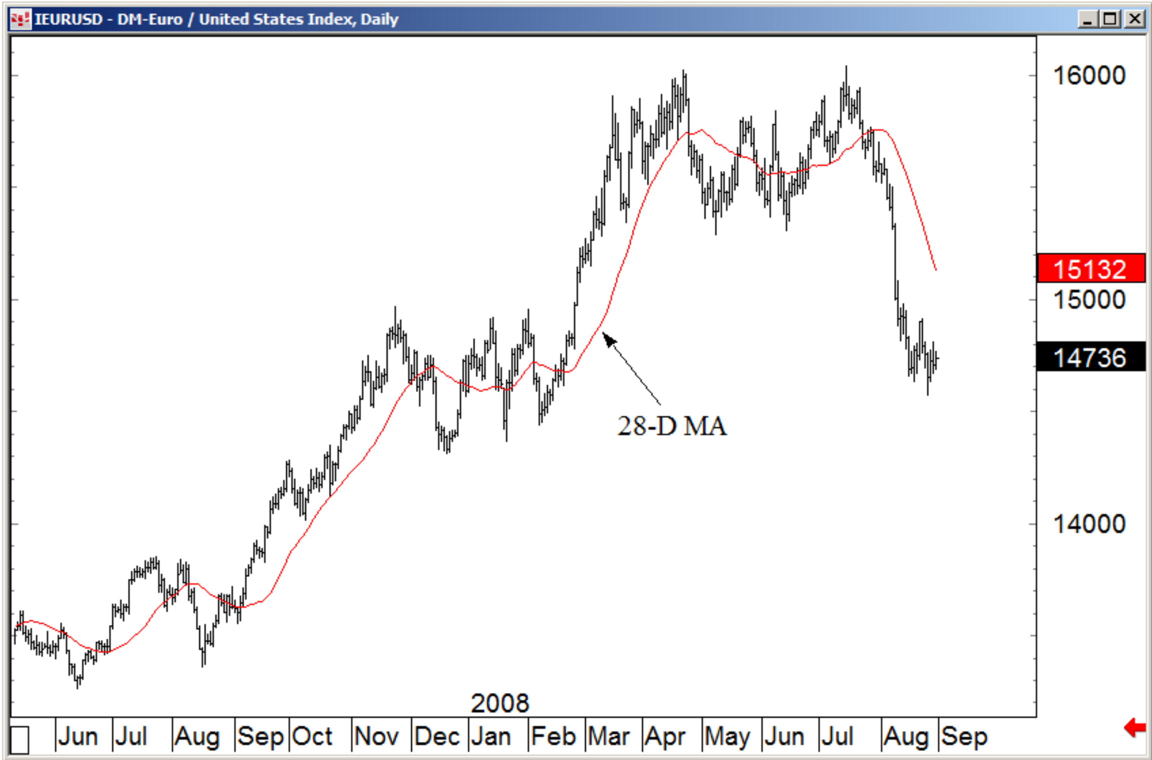
Don't trade against the trend.

Whatever the trend is, you must assume it will continue.

You will know when it reverses because prices will change.

Granted, the shorter term time frame you use to trade, the more difficult this simple but powerful way to think becomes. But for others who don't try to predict every twist and turn, and for those who shouldn't try (guilty again your honor), you can keep it simple.

Below is a chart of the euro against the US$ (EURUSD) daily: The red line is the 28-day moving average. Let's say we simply bought EURUSD when it went above the average and sold it when it went below. In the period below, from June 2007 thru Sep 2008, this simple system of staying with the trend looks like it would have made us a decent amount of money, even accounting for the inevitable whipsaws.



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I wonder how many market players forecasted the break of the 28-day moving average near 1.5750 would have led to a beeline move down to 1.4630? Proof again that you never know—anything can happen.

So, keep it simple. And do your best to keep Mr. E on ice.

Have a great weekend.

Regards,

Jack Crooks
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