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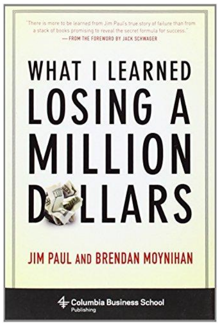

YOUR KINDLE NOTES FOR:

What I Learned Losing A Million Dollars (English Edition)

by Brendan Moynihan

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39 Highlights

Highlight (Yellow) | Location 55

> The truth is that trading, both successful and unsuccessful, is more about psychology than tactics. As Jim Paul ultimately learns through a very expensive lesson taught by the market, successful trading is not about discovering a great strategy for making money but rather a matter of learning how to lose.

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> Personalizing successes sets people up for disastrous failure. They begin to treat the successes totally as a personal reflection of their abilities rather than the result of capitalizing on a good opportunity, being at the right place at the right time, or even being just plain lucky. They think their mere involvement in an undertaking guarantees success.

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> parables the lessons can be applied to a great many other situations. These lessons will help you whether you are in the markets or in business. The two areas have more in common than one might suppose. Warren Buffettt, the richest man in America, is quoted on the cover of Forbes's 1993 edition of the "400 Richest People in America": "I am a better investor because I am a businessman, and I'm a better businessman because I'm an investor." If the elements of success can be transferred between the markets and business, the elements of failure can too.

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> People lose money in the markets either because of errors in their analysis or because of psychological factors that prevent the application of the analysis. Most of the losses are due to the latter. All analytical methods have some validity and make allowances for the times when they won't work. But psychological factors can keep you in a losing position and also cause you to abandon one method for another when the first one produces a losing position.

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> When I was a kid, my father told me there are two kinds of people in the world: smart people and wise people. Smart people learn from their mistakes and wise people learn from somebody else's mistakes.

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> The big difference is: gambling creates risk while investing/speculating assumes and manages risk that already exists.

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> Betting and gambling are suitable for discrete events but not for continuous processes. If you introduce the behavioral characteristics of betting or gambling into a continuous process, you are leaving yourself open to enormous losses. In betting and gambling games, you wager and wait to see if you are right or to experience some excitement, respectively. Any resulting monetary losses are real, but they are also passive because the discrete event ends all by itself. On the other hand, a position in the market is a continuous process that doesn't end until you make it end. If you "wager and wait" in the market, you can lose a lot of money.

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> The first psychological fallacy is the tendency to overvalue wagers involving a low probability of a high gain and to undervalue wagers involving a relatively high probability of low gain.

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> The second is a tendency to interpret the probability of successive independent events as additive rather than multiplicative.

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> The third is the belief that after a run of successes, a failure is mathematically inevitable, and vice versa.

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> Fourth is the perception that the psychological probability of the occurrence of an event exceeds the mathematical probability if the event is favorable and vice versa.

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> Fifth is people's tendency to overestimate the frequency of the occurrence of infrequent events and to underestimate that of comparatively frequent ones after observing a series of randomly generated events of different kinds with an interest in the frequency with which each kind of event occurs. Thus, they remember the "streaks"

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> Sixth is people's tendency to confuse the occurrence of "unusual" events with the occurrence of low-probability events.

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> For example, if I bought my famous takeover stock (which you will hear about in the next chapter) at twenty-six dollars and placed a sell stop below the market at twenty-three dollars with an upside objective of thirty-six dollars, my risk-reward ratio would be three to ten. Risk three dollars to make ten dollars. It is clear that I don’t understand probability. Couching my rationalizations in arithmetic terms does not automatically lend credibility to my position.

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> Are you motivated by the prophet motive or the profit motive? To answer, you have to figure out which type of participant you are: bettor, gambler, investor, trader, or speculator. You do this by examining the characteristics and behaviors you are exhibiting, not the activity,

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> Emotions are neither good nor bad; they simply are. They cannot be avoided. But emotionalism (i.e., decision making based on emotions) is bad, can be controlled, and should be avoided.

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> The basic distinction between the individual and the crowd is that the individual acts after reasoning, deliberation, and analysis; a crowd acts on feeling, emotion, and impulses. An individual will think out his opinions whereas a crowd is swayed by emotional viewpoints rather than by reasoning. In the crowd, emotional and thoughtless opinions spread widely via imitation and contagion.

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> Speculating is the application of intellectual examination and systematic analysis to the problem of the uncertain future.

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> Broadly speaking, the decision-making process is as follows: (1) Decide what type of participant you’re going to be, (2) select a method of analysis, (3) develop rules, (4) establish controls, and (5) formulate a plan. Depending on what your goals or objectives are on the continuum of conservative to aggressive, you will decide whether you are an investor or speculator, which in turn will help you decide what markets to participate in, what method of analysis you’ll use, what rules you’ll develop, what controls you’ll have, and how you will implement these things with a plan. We already know that no single analytical method will be successful for everyone. Instead, you are likely to find some type of method that is compatible with your tolerance for exposure. You will fill in the specifics based on your research and your tolerance for exposure.

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Anytime someone says he can’t get out because he’s losing too much, he has personalized the market; he just doesn’t want to lose face by realizing the loss. To make matters worse, since most stock players pay for their stock in full, they are very prone to extending their original time horizon.

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“The Colonel’s secret blend of eleven herbs and spices.” Well, Colonel Sanders could have safely told anyone the names of his eleven herbs and spices (i.e., the ingredients). As long as he didn’t tell anyone the secret blend of his eleven herbs and spices (i.e., the measurements and the mixing instructions), he didn’t have to worry about anybody stealing business from him.

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Price-limit orders that were entered to initiate new positions yet remain unfilled are trades we wish had been made. However, “profitable trades” that are missed actually cost zero while poor controls (pick the stop later) or no controls (no stop) will sooner or later cost you a lot of money. Having picked your exit-loss criteria before entering the position, presumably you choose an amount of loss you could tolerate. After that, leave your exit order alone, change a trailing stop to lock in more profit if you’re following a technical method of analysis, or monitor for any change in the fundamentals that you previously determined would cause you to exit the position if you’re following a fundamental method. If you wait until after the position is established to choose your exit point or begin moving the stop to allow more room for losses or alter the fundamental factors you monitor in your decision making, then you (1) internalize the loss because you don’t want to lose face, (2) bet or gamble on the position because you want to be right, and (3) make crowd trades because you’re making emotional decisions. As a result, you will lose considerably more money than you can afford.

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When someone asks, “Why is the market up?” does he really want to know why? No. If he is long he wants to hear the reason so he can reinforce his view that he is right, feel even better about it, and pat himself on the back. If he isn’t long, he’s probably short and wants to know why the market thinks the market is up, so that he can argue with it and convince himself that he is right and the market is wrong. He wants to say, “Oh, that’s the reason? Well, that’s the stupidest reason I ever heard.” He wants to justify his position of being the “wrong” way in the market by asking “why” so he can say, “That’s a stupid reason.”

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Just before Kluge bought the Ponderosa steakhouse chain in 1988 he met with some skeptical bankers who asked. “Don’t you think this is the wrong business to be in?” Everyone in the country was talking about health food at the time, and steak wasn’t on the list of food that was good for you. Kluge began pounding his fist on the table. “The people want steak,” he shouted.

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> So you can be right and lose money. But which is more important? Remember, there are two kinds of reward in the world: recognition and money. Are you being motivated by the prophet motive or the profit motive? In the markets and in business don’t concern yourself with being right. Instead, follow your plan and watch the money.

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> Preoccupation with being right means you’re betting, which personalizes the market and is the root of losses due to psychological factors. Concern yourself with whether you have done your homework to define a set of conditions under which you will enter and exit the market and whether you carry out that plan.

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> Have you ever said to yourself, “No way! Is the market really down that far?” That’s denial. Have you ever gotten mad at the market? Called it a name? Gotten angry at friends or family because of a position? That’s anger. Ever begged the market or God to get you back to breakeven so you could get out? That’s bargaining. Has a market loss ever changed your sleep or diet patterns? That’s depression. Ever have a firm liquidate one of your positions? That’s acceptance. Unless you have a plan, your potential loss is unknown and you can count on suffering through the Five Stages, losing more money as you go through each of the stages.

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> Having a plan requires thinking, which only an individual can do—not a crowd. A crowd cannot think any more than it can eat or drink. There is no such thing as a group brain.

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> As my mom used to say, “Weak is he who allows his actions to be controlled by his emotions, and strong is he who forces his actions to control his emotions.” If you’re not consciously doing the latter, then you’re unconsciously doing the former, which is precisely Le Bon’s description of the conscious personality of an individual vanishing when he enters the crowd. This last section has been a detailed

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> Philosopher-novelist Ayn Rand was asked one time in a radio interview whether she thought gun-control laws violated the Second Amendment right to bear arms. “I don’t know,” she responded, “I haven’t thought about it.” And she said it in a manner as though it was the most natural thing in the world not to have an answer or opinion. Now here is one of the towering geniuses of the twentieth century and the architect of an entire philosophical system saying, “I don’t know.” Contrast her approach to that of most people who have prepackaged intellectual positions, views, opinions, and answers on almost every topic, gathered from television, newspapers, newsletters, and conversations.

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> Remember, participating in the markets is not about egos and being right or wrong (i.e., opinions and betting), and it’s not about entertainment (i.e., excitement and gambling). Participating in the markets is about making money; it’s about decision making implemented by a plan. And if implemented properly, it’s actually quite boring waiting for your buy/sell criteria to materialize. The minute it starts getting exciting, you are gambling.

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> LBJ did not have an exit strategy, much less an entire plan formed after objective decision making. In fact, according to one of his aides, “it was Johnson’s custom to reach a decision inwardly and then make it appear the decision was the result of consultation and debate.”25 That was inductive decision making. Instead of starting with a blank slate, analyzing the situation, and arriving at a decision deductively, he inductively took a position and then searched for evidence to support that original position.

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> It’s not wise to violate the rules until you know how to observe them. —T. S. ELIOT

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> The market is no place for “making the wrong move at the right time.” Any deviation from your plan triggers the potential for losses due to psychological factors. It cannot be emphasized enough how important it is for you to stick to your plan. If you get nothing else from this book except the acknowledgment that you need a plan, then at least you’ll know when you’re deviating.

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> look at the story of Roy Raymond, who started the highly successful chain of seductive and elegant lingerie stores, Victoria’s Secret. In 1982, he sold the business to The Limited for $2 million. Says a friend of Mr. Raymond’s, “Roy had that feeling that he was bulletproof and that whatever he touched would turn to gold.”3 His next endeavor was an upscale children’s clothing store which plunged him into bankruptcy proceedings.

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> The ego drive of a salesperson may also explain why salespeople have a reputation for being lousy traders. How so? A salesperson’s goal is to make the sale; to be right by countering objections and negative feedback from the prospect. But the Speculator’s goal is to make money, not to be right or counter the negative feedback from the market. A salesman’s ego gratification from being right is precisely what the entrepreneur, Speculator, and manager must avoid.

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> Managers and corporate executives can become too attached to a project and personalize it, and they are susceptible to the losses due to psychological factors just like Speculators are when they personalize market positions.

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> However, there is a common denominator among this group: rather than just taking risks, as is commonly assumed, they excel at judging, minimizing, and controlling risks. Craig McCaw understood this; did Steve Jobs? Over a period of eight years, NeXT has “consumed $250 million without producing a successful product or sustained profitability.”17 What is the exit point? The original capital infusion from Ross Perot and Cannon, Inc., was $125 million. Was it known then that the loss might go to $250 million? If so, fine. But if not, what’s to keep it from going to $350 million? Managers of all businesses must be able to take losses.

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> The formula for failure is not lack of knowledge, brains, skill, or hard work, and it’s not lack of luck; it’s personalizing losses, especially if preceded by a string of wins or profits. It’s refusing to acknowledge and accept the reality of a loss when it starts to occur because to do so would reflect negatively on you.