Chapter 9

EXPERIENCE

Throughout our course on futures trading, we have tried to point out to you that there is a great difference between having an investor attitude and being a trader. There are also many similarities. In one sense, a trader is someone who invests in his own trading ability. Therefore, in that sense trading is investing. Trading and investing are interrelated. You come to realize this through experience.

For the most part, the trading approach comes from a much shorter-term mindset than the mindset of an investor. It can also be much more based on technical information than on fundamental information. But here again we find a dilemma. What exactly is technical information? What exactly is fundamental information? Where do the two overlap, or do they? Are they interrelated? Sure they are. But again, it is through experience that you learn about and develop an appreciation for these concepts.

TECHNICAL VS FUNDAMENTAL??

As futures traders, we get to hear some pretty weird things, and also as writers, and teachers in the business of educating people about futures trading . One of the strangest things we get to hear is when people try to separate trading into either technical or fundamental. Why, oh why, does everything have to be put into a box? Would someone please explain how to separate one from the other? Is it possible, or is there some middle ground that cannot be classified as either technical or fundamental?

For example, how do you classify trading from news stories? Surely you would not call news stories *fundamental* information, would you? A friend of ours tells about a time in January when he heard a commentator on CNBC explain that the price of coffee had gone up because of a freeze in Brazil. The only thing wrong with the story was that January is the middle of summer in that country. Was the news worthy of the name fundamentals?

What about seasonal trades? Are they technical or fundamental? Certainly they are not based upon hard facts. Who knows if tomorrow will bring a season like the last? Who knows that the weather will be the same this summer as it was the last?

They say enter on rumor, exit on fact. Is that technical or fundamental? Or is it just plain good old common sense?

This chapter is about experience, but here's the catch: You must survive as a trader long enough to gain experience. Experience will show you that trading cannot be placed into a box. Experience will bring you to the realization that some of the best trades you will ever make come from experience, gut feelings, and good old common sense. Experience will demonstrate to you that many great trades are derived by paying attention and learning to be an opportunist. Experience will bring you to the point where you will take a smattering of what others may call "fundamentals" along with a pinch of what some call "technical analysis," and combine them with a spoonful of know-how to succeed in making your living in the markets.

FUNDAMENTALS

Our understanding is that fundamentals deal with known facts and published or unpublished information about the underlying commodity or instrument you wish to trade. Because statistics lie, governments knowingly lie with statistics, or at times do so unwittingly, those who can afford it and also have a need, spend tons of money doing their own research in order to come up with their own body of fundamental knowledge. This includes gathering information and statistics on anything imaginable that might affect the underlying. They research production, marketing, crop conditions, financial conditions, etc.; everything they can find out about the underlying. They may even make in-person visits to farms, mines, or financial institutions for discussions about the underlying. They then combine this knowledge with what they find believable as handed down by various reporting agencies.

Even with live data, it is not economic to compete with these behemoths with regard to the amount of fundamental knowledge they can afford and are able to gather.

TECHNICALS

Technical analysis in its purest form assumes that everything known about the markets that affect the markets can be seen on a price chart. We believe that to be true. But that's where reality and the kind of technical analysis we see today part company. What we mean is, in general what do technical indicators show you that you can't normally see with your two eyes via pure chart reading and analysis? Admittedly there are a few things. We have never denied that an indicator like Bollinger Bands can show you the location of 2 standard deviations. We cannot visually know where that amount of deviation from price would be without the bands. But most technical indicators wipe away the very things we do want to see. They take your focus away from what is truly happening to price.

By smoothing, they purport to remove "noise." But it is the noise that we, as traders, and especially as day traders, most want to see. The noise is what tells us the reality of what is going on.

REALITIES

Fundamentals, in the purest sense, are beyond what the individual trader can deal with. Most individual traders simply don't have the time to conduct the required research. But that doesn't mean they cannot use this information should the happen to stumble across it. Technicals in the purest sense are fine, but the way they have been bastardized into virtually meaningless indicators makes no sense. The ultimate foolishness of technical indicators is that of rendering them as mechanical trading systems. Employing mechanical systems represents the height of the undisciplined mind. It is tantamount to conceding that because you do not have the discipline to exercise self-control, you will undergo the harsh discipline enforced on you by an uncaring, unfeeling machine. While you try to escape from self-disciplined trading, mechanical systems force an even more horrible discipline upon you in that you now have to sit and grit your teeth due to the pain brought on yourself because of the mechanical aspect of the system. Mechanical trading is not without discipline, rather it places the discipline onto the wrong part of the trade. Instead of placing the emphasis on planning, organizing, directing, and controlling the trade, it gets the trader in via a mechanical signal and then forces him to suffer through the trade in order to exercise discipline — quite often a discipline he does not understand based upon a system he does not understand, and that may have been derived entirely outside the realm of reality.

The realities of the market are many. Markets are affected by a lot of things that are not measurable by either fundamental or technical analysis. In addition to seasonality, news, rumor, weather, and common sense observation, one has to take into account the market conditions at the time at which a trade is to be entered. Is the market fast? Is the market thin? Is the tick size abnormal? Are market makers moving the market? Is it options expiration day? Is it the day before a holiday? Is an important dignitary going to make a speech? Has the market gone into a state of hysteria, or even euphoria? Are you going to buy or are you going to sell? It is the summation, organization, and perception of these and even other criteria that constitute the realities of trading.

REALITY TRADING

We are convinced that the best way to trade should be termed "Reality Trading™." In fact, we are so convinced that we have trade marked the name for future use. Reality Trading views the market as an entire entity, a living, throbbing reality that includes fundamentals, technicals, and realities such as news, rumors, seasonal tendencies, common sense observations, and market conditions.

Let's look at a possible trade that is based upon realities. Let's say that this is a trade that has been good most years in the last 15 years. Let's say that the trade is to buy March wheat between September and December of the current year.

First we look to see if March wheat futures are behaving normally. What does the March wheat futures chart need to look like if this trade is going to work?

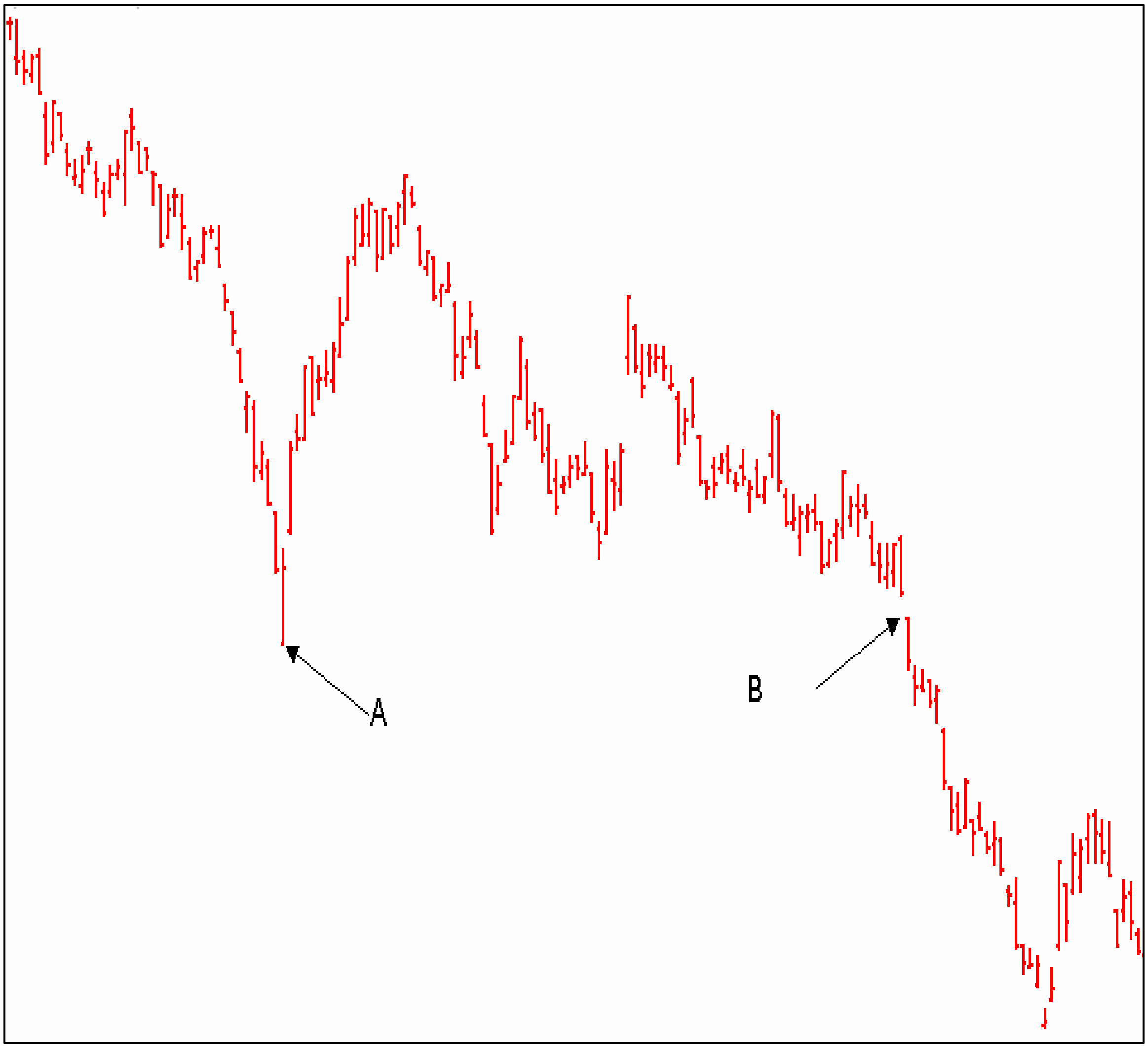
We begin watching March wheat futures in the first week of September, for possible entry between that time and the last week in November. We're not particularly interested in what the March wheat futures look like prior to September, but according to past seasonal patterns, they should not end September in a down trend. The normal pattern for wheat futures at that time of year is that wheat prices begin to rise or at the very least remain flat. Falling prices would indicate an over supply of wheat. The rising or flatness may have begun earlier, or it may begin later, but not by the end of September. The main thing we don't want to see is wheat prices falling after September. If wheat prices are falling in the time period mentioned above, then we do not have a normal year for these futures and we want to avoid this trade. No one knows for sure what weather conditions will be between the first week in September and the time the that wheat inventory figures are known. No one knows if exports will be up, down, or flat compared with the previous year. It is the seasonal anticipation that should prop up the price of the wheat futures.

Obviously, this same sort of technique could be applied to any purchasable commodity that can be expected to experience increased activity seasonally.

So, lets look at a wheat chart. We want to select the best the best possible time to enter. Experience has shown that the two best times are as follows:

- An announcement by the government between September and October that it export sales of wheat have increased materially – a buying situation

- A report showing a greater than expected inventory of wheat in September through November – a selling short situation.



At “A” we see announcements coming from government reports that demand for wheat for export is great. It is the middle of September. People rush in to purchase wheat futures. However, from the look of this chart, overall demand for wheat was not very good. Actually, the year shown was poor for wheat most of the time.

Later, beyond the time frame in which we are interested, at “B” we see that the government crop report for January was really bad for wheat. There was simply too much of it. Wheat prices began to plunge. What stopped the plunge? Anticipation of planting problems due to unusually cold weather.