Van K. Tharp, Ph.D.

Market Mastery

Putting Peak Performance to Work for You

An Interview with John Mauldin
By
Van K. Tharp, Ph.D.

John Mauldin writes a free weekly email on the economy that is sent out to at least a million readers. I think John's letter is an excellent letter for people to keep up with the big picture. I've been reading it for some time. (Information on how you can join John's email is at the end of the interview.) I originally asked John to contribute to our book, Safe Strategies for Financial Freedom. *Unfortunately, once the book was written, McGraw Hill asked us to cut the book by 100 pages and John's chapter (because of its complexity) was one of three large chapters that had to go. However, the chapter was full of valuable information about hedge funds, and I want my readers to know more about John's insights into that world of top traders. As a result, I asked John if he would like to do an interview for* Market Mastery*, covering much of the same material. Happily, John agreed.*

The best investors and traders tend to gravitate toward managing hedge funds. They do so for several reasons: First, they get paid more for their great performance (they usually charge fees of 1%-2% plus 20% or more of the profits they generate. But wouldn't you pay that for someone who could consistently make you 20-30% after their fees? Of course, you would.) Business Week (July 14, 2003) ran a piece on the compensation of the highest paid hedge fund managers. Their yearly compensation of the top five ranged from $225 million to over $600 million per year in annual salary. In addition, much of the money in their respective funds probably belongs to those managers.

In fact, if you want to make a seven figure salary in the trading arena, running a hedge fund is probably the best way to go. In this month's interview, John will give us numerous insights into the world of hedge funds.

See interview on page two

Psychological Clearing Versus Discipline: Which is More Important For A Trader

By
Van K. Tharp, Ph.D.

Had you asked me this question (about clearing versus discipline) two months ago, my answer would have been clearly in favor of psychological clearing. That means that I believed that traders needed to clear out their psychological blocks and as they did so, they became more and more able to see the markets as they really are.

So How Does This Work?

Perhaps the best way of illustrating what I mean is through an article I wrote on self-sabotage in Market Mastery (a two-part series, June-July 2002), describing a trader who could not "pull the trigger." Following is a brief sequence of events from the work with that trader, each area having a more powerful effect on him.

The trader first came to me because he had trouble pulling the trigger on trades that he knew would make money. However, when we went deeper into what was going on, I discovered that he had mastered none of the fundamentals of trading. He didn't have a business plan,

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John, with the high fees that hedge fund charge, what's the appeal?

Well, there are funds that average 12% a year for ten years with 95% positive months; others that have less statistical risk than long term government bond funds and average 10% a year; and still other funds that have little or no correlation to the stock market, but just keep on making their investors smile like it was 1999. And some funds have even averaged 30% or more in returns for a substantial period of time.

That sounds great. You'd think that most people would just want to jump into those funds.

The problem is that most people can't. These funds exist, but they are private funds. They do not advertise. In fact, they cannot advertise. They limit the number of investors who can join them. These funds have high minimum investments and often are closed to new investors. There may be risks that are not apparent in the track record. They often have lock-up periods of one year or more. But savvy investors are finding them and flocking to them in an effort to keep their investment portfolios moving upward.

Why are most people excluded from the world of hedge funds?

U.S.based hedge funds are limited to high net worth investors, typically with at least $1,000,000 or more net worth. If you are a member of that club, you should be investigating these funds as a potential way to create the type of passive income – income that is steady and requires very little work.

Is there some value to the average person who doesn't qualify knowing about hedge funds?

Yes, there are two key reasons to want this information. First, many of the strategies employed by hedge funds are ideas with which informed investors should be familiar. Using them will make you a better investor. Secondly, chances are, soon you will be able to invest in such funds. I recently testified before Congress, suggesting they loosen the restrictions which keep average investors from having the same choices as the rich. There was a great deal of interest, and several key congressmen openly spoke in favor of such a proposal.

There are now a few mutual funds which are de facto hedge funds. There will soon be many more. This category of funds is going to increase. Further, investors willing to look beyond our shores will soon find certain styles of hedge funds available to them on foreign stock exchanges.

The benefits that hedge funds offer to rich investors should also be offered to the middle class, within a proper regulatory structure. The current two-class structure limits the investment choices of average Americans and makes the pursuit of affordable retirement more difficult than it should be. The rich have a considerable advantage in growing assets for retirement in that they simply have more assets to begin with. They should not also have an advantage in better investment choices.

Let's talk about some of the restrictions on hedge funds and why that exists. Why is the average citizen prohibited from investing? Is it like a club for the wealthy? The average investor can go into Enron and World Com, why not a hedge fund?

Many articles portray hedge funds as secretive, unregulated investments, but let's look at the reasons hedge funds behave this way. Many investment strategies employed by hedge funds are restricted and/or prohibited by the Securities Act of 1933 and the Investment Companies Act 1940. While you as an individual can execute these strategies in your private portfolios, they cannot be done within a mutual fund or regulated public fund. As a result, the hedge fund manager will structure his fund to avoid registration under these acts.

The two key things that exempt a manager from registration under those acts are 1) they cannot advertise to the public; and 2) they can only accept accredited investors. An accredited investor is an individual with $1,000,000 in net worth or with $200,000 in personal income ($300,000 if combined with a spouse) over two consecutive years with no reason to doubt that that income level will continue. In addition to the income numbers, the securities laws also limit the number of investors the fund can have to avoid registration. The number of investors is limited to 99 or 499 depending upon the net worth of the investors.

The trade-off for managers who operate under these limitations is that they have full use of leverage, derivatives, and short selling. These investment tools are not available to most mutual fund managers, and even when they are, they are greatly restricted in how they are used.

It still seems a little strange that they prevent the general public from

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investing in these funds. As I said, you can invest in Enron. In fact, the mutual funds tell you that you can and should buy and hold a mutual fund, even during a primary bear market when the 20 year real rate of return might be zero or negative.

Oddly, you have the right in your personal accounts to execute any of these strategies no matter what your net worth. But the laws passed by congress, forbid you to hire someone to do them for you in a fund unless you are wealthy. In theory, it should be no different than hiring a mutual fund manager to purchase your stocks and bonds.

Specifically, why should 95% of Americans, simply because they have less than $1,000,000, be precluded from the same choices as the rich? Why do we assume those with less than $1,000,000 to be sophisticated enough to understand the risks in stocks (which have lost trillions of investor dollars since 2000), stock options (the vast majority of which expire worthless), futures (where 95 % of retail investors lose money), mutual funds (80% of which underperform the market) and a whole host of very high risk investments, yet are deemed to be incapable of understanding the risks in hedge funds?

I agree, but obviously, there are some risks with hedge funds, including fraud. I have certainly heard of that and even had bad experiences myself.

In recent times hedge funds have made numerous headlines, starting in 1998 with Long-Term Capital Management, the early twenty-first century bear market and recent articles about investigations by the SEC and NASD. Because of the war stories, that might stick out in investor's minds. However, if you do a proper due diligence, fraud is very unlikely.

But there are many risks?

Well, there are a number of risks with hedge funds, and you should consider those risks, including the fact that leveraging and other speculative practices may increase the risk of investment loss and that these funds may be illiquid (making it hard to sell at a good price when you want to do so). Other risks include the fact that they are not subject to the same regulatory risk as mutual funds, so the risk of fraud such as you mentioned is more likely. In addition, these funds charge high fees and can hide their investments from you, so that only the manager knows what he or she is really putting into the funds. And, of course, past performance is not indicative of future results.

Although hedge funds have practically become an everyday word, there are many misconceptions about them, beginning with the idea that hedge funds are a new phenomenon.

John, give us a short history of hedge funds.

The first hedge fund was formed by Alfred Jones in 1952. He had the novel idea that by having a fund which could be long stocks he thought would go up in value and short stocks he thought relatively over-valued, that he could produce better risk adjusted returns for his clients. He also decided to keep a percentage of the profits he made for his clients. Due to limitations imposed by Federal securities laws, the only available legal vehicle for him at that time was a private limited partnership. Thus he was forced to not advertise or publicly solicit investors. This became the pattern from which future hedge funds were cut.

Other than a few larger than life names, like George Soros and Julian Robertson, or the occasional problem, hedge funds toiled in public obscurity until 1998. Today, there are an estimated 6,000 hedge funds managing $600 billion and growing rapidly.

Why does the large growth exist?

The most significant reason for the growth of the hedge fund industry is investment returns. Simply put, if high net worth investors and institutions could get the same returns as hedge funds by simply investing in stocks, bonds or mutual funds, why would they choose hedge funds which have higher fees, are hard to find and evaluate, and need more scrutiny? The demonstrably observable higher risk-adjusted returns in hedge funds make the effort worth it.

So what's the typical business model for a hedge fund?

Hedge funds should be thought of as an asset class or a business model rather than as another way to invest in bonds, equities or derivatives. They are typically structured as limited partnerships. The manager is the general partner and the investors are the limited partners. Quite often, the manager puts a significant portion of his own net worth into the fund, which helps align his interests with the other investors. (Ask your mutual fund manager if he has 50% of his portfolio in his fund.)

Aside from investing in investments that are prohibited by mutual funds, there is one other major difference between hedge funds and mutual funds – the pursuit of absolute returns. Absolute returns means that the manager is trying to produce positive returns no matter what the rest of the markets are doing.

You'd think every professional manager would want to do that!

Yes, but the mutual fund industry has it all figured out – they just seek relative returns. Relative return models judge the managers performance relative to a benchmark, like the S&P 500 or the Lehman Brothers Bond Index. The manager does not care if his fund is down 15% if the benchmark is down 18%, because the manager's directive is to outperform the index whether it is up or down.

In addition to the manager putting a substantial amount of his own money at risk in the fund, there is one other aspect of hedge funds which align the managers and investors interest in achieving absolute returns. That factor is the fee structure – managers get paid well for

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absolute returns. The most typical fee structure is a 1% management fee and 20% of profits, but some funds charge 3% and 35% or more of profits.

How do they measure profits?

The measurement of profits typically uses what is referred to as a "high watermark." The fund can only collect a percent of profits of the gains above the old watermark. Thus, if the fund has a negative return it must make that back up before collecting 20% of the gains. Other funds may also have a hurdle rate, which means they must yield an agreed rate of return before the management gets incentive fees. The hurdle rate would typically be based upon some bond or money market index.

So how does that work. Give me an example.

If the fund falls from $100 to $90 in the first year, the manager will only get the 1% management fee. He will not collect the 20% until the fund gets back above $100. So if the fund goes back up to $95 on the second year, the mangers still just collects the 1% fee, but no 20% profits fee. However, if the fund gets to $105 by the end of the third year, then the manger will collect the 1% fee and the 20% on the $5 profit. And now the high watermark fee is $105. That's how it works. And if the manager had a hurdle rate of say 6% per year, he would still collect nothing because the profit must be above 6% before he collects anything.

As you can see, the incentive is for the manager to perform consistently with absolute returns, so they can collect the 20% fee. So for the smaller start up funds the 1% and 20% is not as lucrative for the manager as some might suggest. Of course, they all hope to manage much larger funds, and thus a new fund is formed somewhere almost every day.

So would that explain why some fund managers fold?

Since many hedge funds start with limited capital, if they don't perform well the first 1-2 years, they shut down — they simply cannot afford to continue. The reason is pure business economics. A 1% management fee on $10 million in capital is only $100,000. From that relatively small sum, the manager must cover any operating costs such as payroll, rent, data feeds, and equipment costs.

Other hurdles, of course, include the investment minimums that some funds have for new investors.

Historically, hedge fund minimum investments have been quite high, running from $250,000 up to $1,000,000 or more. The incentive for the manager is to try to attract as much money from individual investors as possible, because they are limited in the number of investors they can let into the fund.

Some strategies only work well with large amounts of capital, like a Global Macro where the manager might want $500 million under management at a minimum. Others can only take a limited amount of capital, like Micro-Cap strategy where the manager might want a maximum of $30-$50 million in the fund.

That could be a lot of risk in one manager for a particular individual. Are there any better options?

Some hedge funds just invest in other hedge funds. And these tend to have much lower minimums. In general the minimum is in the $25,000 to $250,000 level, but new products are coming into the market which could go as low as $5,000. Keep in mind, of course, that even though the minimum is low the investor currently has to meet the appropriate net worth requirements. *Fund of hedge funds add additional management fees and/or incentive fees, which can vary considerably.* The benefit is the ability to diversify into multiple managers at a lower cost, because the one investment gets spread across multiple underlying managers.

Okay, so as we've stated, there are a lot of hurdles to overcome. Let's get into the real advantages of hedge funds, which as I've gathered are that you tend to get the best managers who have an incentive to produce great absolute returns.

Look at how hedge funds have done vis-à-vis the stock market and certain mutual funds. There are many different hedge fund strategies which basically involve stock market strategies. I will

Table 1 Market Neutral Hedge Funds versus the S&P 500

Fund	Volatility	1 Year	3 Year	5 year	10 year
Equity Market Neutral Index	3.14%	5.85%	8.06%	10.39%	10.69%
S&P 500	16.34%	-15.17%	-14.59%	-3.47%	7.75%

Table 2 Market Neutral Hedge Funds Versus Popular Mutual Fund

Fund	Volatility	1 Year	3 Year	5 year	10 year
Equity Market Neutral Index	3.14%	5.85%	8.06%	10.39%	10.69%
Sample Large Popular mutual fund	17.13%	-14.26%	-14.13%	-2.10%	7.52%

(Volatility is based on monthly returns over 9 years annualized.)

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use one of the more well-known hedge fund strategies: equity market neutral[1]. This style of long-short equity fund tries to eliminate the fluctuations of the market by precisely balancing long and short positions in stocks to avoid any market directional speculation.

First, let's compare the market neutral hedge fund index with the S&P 500 (dividends included), as many investors use an S&P 500 index mutual fund as their benchmark for the market. This is shown in Table 1.

The typical S&P index fund had volatility[2] of over five times the market neutral index. High net worth investors have watched their overall returns drop in the last few years, but are still comfortably in the black each and every year with this strategy. I am at a loss as to a reason why average investors should not be allowed to invest in such a fund strategy.

Let's compare hedge funds to one of the largest and most popular of mutual funds. This is shown in Table 2.

Investors were well served by this mutual fund during the large secular bull market of 1982-2000. This fund seriously out-performed not only the market neutral index in the recent bull market, but also most hedge fund indexes. It rose 598% from March of 1990 until March of 2000. Since that time, investors in that fund have seen their assets lose over 42%. The annual volatility of this fund was over five times that of the average market neutral hedge fund.

The management of this fund is one of the best available anywhere. However, they are limited to a long only stock market strategy. They live by the bull and die by the bear.

I should mention at this point that John runs a fund of funds Hedge fund. By law, he is prohibited from mentioning fund names, so that's why the tables don't give the specific names.

Yes, unfortunately, that's the set of rules under which I operate.

Okay, John, so let's look at a few more examples.

Let's now look at one of the largest and most popular of technology mutual funds, which invested in a highly concentrated portfolio of technology stocks. See Table 3. The management for the fund told investors it was their stock analysis which enabled them to give investors very high returns. This fund was up 679% from March of 1990 until March of 2000. Since then, through mid-2003, it had dropped 67%, cutting its return by two-thirds and costing average investors over ten billion dollars of net worth. Volatility was almost 8 times that of the market neutral index. This fund is by no means the worst performing technology fund. At its peak, it had over $25 billion, much of it from small investors. Which fund would they choose today if they had access to the market neutral funds available to the rich?

Okay, you've given a few examples. How about comparing all mutual funds with all hedge funds? What's the overall comparison.

Okay, let's look at the entire range of equity mutual funds[3] vs. the entire range of hedge funds. We asked Morningstar to give us an index of all equity mutual funds, and took the Tremont index of all hedge funds. This is shown in Table 4.

So this implies that you'll get double digit returns over the long run?

No, you will not walk into the hedge fund world and easily get consistent double digit rates of returns, with most months being profitable. Some hedge funds are very volatile and extremely risky, as are some mutual funds and stocks and futures. Some hedge funds are fairly stable and boring, as are bonds. Lumping all hedge funds styles into the same category can be very misleading.

But just as voters get to choose the type of congressional representative they want, so too should investors be able to choose the type of funds and risk they or their advisors find suitable.

Table 3 Market Neutral Hedge Funds Versus Best Technology Fund

Fund	Volatility	1 Year	3 Year	5 year	10 year
Equity Market Neutral Index	3.14%	5.85%	8.06%	10.39%	10.69%
Sample Technology Fund	24.98%	-8.05%	-27.63%	-3.96%	3.46%

1 This will be represented by the CSFB/Tremont Equity Market Neutral Index. (There are indexes and hedge fund investment styles with better returns and with poorer returns, so it is possible to create either more or less favorable comparisons. But I believe this hedge fund investment technique or style is typical and representative. An exhaustive comparison could take hundreds of pages, but would, in my opinion, produce the same overall impression.)

2 Volatility here is defined as standard deviation. Standard deviation quantifies the dispersion or scattering of returns around the average return for a given period. The higher the standard deviation, the more volatile the investment. Hedge fund investors typically seek lower standard deviations and steady performance. For this statement we use monthly returns over the entire period to produce an annual volatility.

3 This is an average of all US diversified equity funds that fit within the 9 Morningstar style boxes, which include growth, value, blend, small cap, mid cap and large cap. It excludes any hybrid funds that include bonds and sector funds.

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Table 4 All Hedge Funds versus All Mu tual Funds

Fund	Volatility	1 Year	3 Year	5 year	10 year
CSFB/Tremont Hedge Fund Index	8.79%	4.98%	6.02%	5.84%	11.27%
Morningstar US Div Return	5.69%	-7.39%	-4.50%	-0.81%	1.03%

Okay, so let's get into some of the strategies that hedge funds use. I guess the original reason they were called "hedge funds" is because they were market neutral, having an equal number of long and short positions.

Hedge funds were so-named because they tend to hedge their risk. For example, a hedge fund might buy undervalued stocks, while at the same time shorting overvalued stocks. The long and short positions would "hedge" each other and the manager would profit through buying and selling the appropriate stocks

So what kinds of hedge funds are there?

There are basically three types of hedge funds — market neutral which attempt to profit without the direction of the market coming into play; event funds which take into account some particular known event such as doing arbitrage on a merger or taking over distressed assets; and lastly, directional funds which include global macro funds and managed futures funds.

Okay, so let's talk about the market neutral funds in this issue and save the other kinds of funds in for the next issue. Tell me about market neutral funds.

Well, there are three kinds — convertible arbitrage, bond arbitrage and long/short equity. Do you want to talk about each of them in detail?

Yes, Tell me about convertible arbitrage funds?

When something is convertible into something else, you can usually do so at a fairly fixed price. And arbitragers make profits when such price relationships get out of line. Hedge funds that do this are called convertible arbitrage funds. This class is one of my personal favorites, because it has been the source of steady returns for many hedge fund investors. There are significant variations among many of these funds, with significantly different levels of risk. Do not assume they are all alike, even if the returns appear similar.

And I assume there are many different kinds?

Convertibles can come in the form of bonds, preferred stock or warrants, but for our discussion we will concentrate on one of them, the convertible bond. Convertible bonds allow the holder to convert the bond for a fixed number of shares of stock in the underlying company, at a specific conversion price. The bond can be viewed as a bond combined with a call option, so the hedge fund manager buys the bond and shorts (i.e., sells without owning) the stock.

So give me an example of how it works.

Let's say ABC company wants to issue a convertible bond with an 8% interest rate. Hedge fund Y will buy the bond and immediately short the stock. They don't care if the stock goes up. They simply want the 8%. If the stock goes up, they lose on their short position, but the convertible bond is more valuable. If the stock goes down, their short position increases in value even as the bond becomes less valuable.

But let's look at what might happen. Hedge Fund Y invested $1,000,000 in the convertible offering. There is not a one-to-one relationship between the bond and the stock, but typically you might see the hedge fund short 80% of the value of the bond. That means they get back $800,000 in cash from selling the stock short. They are getting $80,000 in interest payments from the bond, plus whatever they earn on the $800,000. At 2%, they would be getting $96,000 in interest or a 9.6% return on their original investment. Leverage this up a few times, and you can see where convertible arbitrage can produce some excellent returns.

And is it that easy?

If only it were that easy! The manager is betting on the stock falling more than the bond in a down market, or the bond rising more than the stock in an up market. Since the bond is convertible into shares, once the conversion price has been passed the bonds should go up in tandem with the shares. The problem is that option and bond prices are non-linear, meaning that they will not move one-to-one with the underlying stock when the stock price is close to the conversion price. Therein lies the problem and the opportunity for a skilled convertible arbitrage manager. The manager will analyze credit quality, equity valuation and option pricing models to try and find a bond they feel is priced wrong, or to properly hedge the risk of a convertible bond already in his portfolio.

Interestingly enough, I know day traders who do strategies similar to this on a minute by minute basis. Typically, when one company is buying another for stock, the two stocks should stay in alignment, because they are convertible in terms of the buyout agreement. However, market pressures get these things out of alignment and the day traders play the arbitrage when they get out of alignment.

Yes, it's the same thing, but on a much longer time frame for most hedge funds.

Let's do one more example of convertibles – let's say bond funds.

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Fixed-income arbitrage is similar to convertible arbitrage. Instead of buying a bond and selling the stock short, however, the manager buys a bond and sells a similar bond or interest rate future short. The manager is trying to exploit small pricing inefficiencies in the bond market. Since the inefficiencies are small the manager will employ a large amount of leverage to "juice" the returns of this low volatility and low return strategy. If they did not leverage up the fund, the return would not be great enough to justify the investment.

Note: Some fixed income hedge funds are very stable, steady funds. Some are highly risky. It all depends upon how they hedge. To see if a manager understands the meaning of the word hedge, as a quick rule of thumb, I often look to see how a fund performed in the summer of 1998, when interest rates were extremely volatile. Remember, however, to ask if they are using the same hedge strategies today. (Past performance is not indicative of future results.)

We'll continue this interview with John Mauldin in next month's *Market Mastery*, when we'll discuss other types of hedge funds — which will either give you some idea of what you might want to look for with hedge funds or ideas you might want to consider with your own trading. It's fascinating material.

Key Ideas

- Hedge funds are an excellent way of earning higher returns than stocks with less risk than the stock market over the long run, regardless of what happens to stocks
- There are a wide variety of hedge fund styles out there, with varying levels of risk. So make sure you do plenty of due diligence before making a hedge fund investment.

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If you answer yes to any of these questions the Van Tharp's Peak Performance home study program is for you.

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4. Learn self-confidence — the one trait that is most essential if you are to follow your game plan for making money. Dr. Tharp's course will teach you techniques to overcome fear and nervousness and bring out the big winner in you.

5. Make a habit of keeping an investment/trading diary. This will put you in control and you will gain insight into how to get more profits. You'll gain a perspective on what you've been doing and why. Put yourself in charge of your future.

6. People do not trade the markets. They trade their beliefs about the markets. Learn about the six levels of belief and how those beliefs influence your investing and trading. Be able to adopt beliefs that will help you become more effective. And most importantly, learn the beliefs that only the best investors and traders have and adopt them for yourself.

7. Learn how to avoid the school of hard knocks. Save thousands of dollars that you might have lost in the markets by doing it right to begin with instead of making lots of costly mistakes.

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he didn't understand R-multiples or expectancy; and he didn't know about position sizing. But as we progressed, I learned that the problem was not his lack of knowledge.

On the next level, I discovered that he'd had some pretty severe trading losses which had generated some fear. But was that the source of the problem? No.

Underneath that, I discovered that he'd gone bankrupt about ten years ago in his real estate business. He was concerned that if he was successful, people would take it away from him. But was that the source of the problem? No, it went even deeper.

My client was very close to his best friend. However, about a year before his real estate empire fell apart, his best friend died in an accident. My client blamed himself and also felt very alone, which was the reason his real estate empire began to collapse. But even though we were now close, this was still not the source of the problem.

The source of the problem was a deep seated loneliness that this person had had for most of his life. This resulted in a very strong attachment to his best friend. And then the best friend's death brought about a lack of attention to detail to his business. This caused the bankruptcy, which caused some paranoid behavior, which then caused my client's inability to be able to pay attention to the fundamentals of trading success. As a result, my client experienced severe trading losses which led him to consult with me for not being able to pull the trigger.

You can see from this story why I've always believed that psychological clearing was so important to trading well. Or at least, why I thought good traders who didn't deal with such issues would eventually implode.

Discipline: The Other Side of the Coin

I defined discipline in the Peak Performance Course as being able to control your mental state. I now view it with a slightly broader perspective. It really means being able to program your beliefs, mental state, and mental strategy on a daily basis so that you do the things necessary for success.

Some traders just seem to have this ability down. They constantly work on programming themselves and it works. The result is extreme discipline in carrying out what is necessary for trading success. These are the people who develop great business plans. These are the people who do the ten tasks of trading on a daily basis. And discipline, when carried out regularly, seems to be strong enough to overcome deep psychological issues (as long as the discipline is done on a regular basis).

I now believe that discipline is slightly more important than psychological clearing and I'd like to illustrate three examples that lead me to that conclusions.

Example One: One of the best day traders that I met didn't spend much time with me on his psychological issues, although he did extensive consulting with me. Instead, we always worked on refining his business plan, his strategies, and most importantly his discipline. He was someone that I could always count on to regularly do the ten tasks of trading, plus much more. He gave me one of the most complete business plans I had seen and his reward was a return of 200% plus, while working perhaps six months of the year on his day-trading.

I always felt this trader could have done some more clearing work, but his discipline was strong enough that any psychological hang-ups he had didn't seem to get in the way. Instead, he was an outstanding performer.

Example Two: One of the "Market Wizards," when I first met him, struck me as neurotic, with perhaps a lot of psychological problems. I spent four days at his offices, but never got the chance to socialize with him over a meal, which struck me as very unusual. However, this trader has consistently produced 20% returns or higher on huge sums of money. At the time I met him, his hedge fund was worth over $5 billion dollars and he was totally in charge of trading 20% of it. And in order to obtain his high rates of returns, he had developed a schedule that was so rigid that my guess is that even a pleasant conversation with family members had to be fit into the schedule. Why? It was part of his discipline routine. Being the best was so important to him that he had scheduled a routine (discipline) that would drive most people crazy. However, he continued to produce great return rates, so I can only assume that the discipline was critical to his success.

Example Three: The "Market Wizard" described in example two has several trading departments, each controlling a billion dollars or so. I've had the privilege of doing clearing work with the chief trader of two of those departments. Each one came in for two days and then started doing an incredible job of trading. However, in each case the trader was already highly disciplined (perhaps influenced by his boss) and the clearing work simply put him back on track.

Conclusion: Discipline is super critical to trading well. It can cover a multitude of sins, including some major psychological issues. Disciplined traders may implode, but when they do a simple clearing session, takes care of it.

A trader in my Ultimate Trader program meets my qualification of being super disciplined. He has a very rigid day routine which includes the ten tasks of trading and programming himself to have the appropriate beliefs, mental states, and mental strategies to carry out his business plan. I will be interviewing him as part of the psychology teleconference series. It will be available on cd following the series. His ideas about discipline could have a significant impact on your bottom line.

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