

BIRGER
SCHÄFERMEIER

The Art of Successful Trading

How to Become
a Master Trader!



FBV

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FOREWORD

The quest for the key to financial freedom through trading - successful investing and top performance - leads most people to embark on a long, expensive and frequently endless odyssey. Dozens of trading strategies are tried out, widely varying indicators are tested, gurus are consulted and research reports are carefully studied. Naturally, this aimless wandering also includes the search for the holy grail, for “the” method or for “the” trading system that promises reliable and long-term gains.

Only a very small number of traders realize their goal of generating top performance continuously. Many drop out along the way. Maybe they run out of funds, maybe they lose interest or the belief that it will ever be possible to achieve this goal. Studies show that only around 5 percent of all futures traders achieve long-term success.

Why is it that there are so few winners in this game of games? Is successful trading a question of talent, perhaps? Is it maybe just the luck of the draw if, year after year, someone earns millions by trading on the capital markets of this world? Or could it really be the case that these chosen ones have discovered a secret trading system that turns them into super traders?

It’s nothing of the kind. Experienced traders and investors know that neither talent, nor luck nor the trading system is the key to financial freedom, to top performance.

The sole determinant of a trader’s success is the priceless ability to implement INTERNAL CONTROL and to manage risks.

Internal control is the equivalent of checking the status, which is also known as discipline. This is the key to infinite profits. Discipline is not the ability to follow rules. Discipline means more.

Discipline is the ability to put yourself, at any time, in an optimal productive mood for tackling the task at hand. Here's an example: Each of us knows the traffic regulations but we frequently break these rules. Why? Because we just happen to be tired, not concentrating, angry, aggressive, nervous or in some other unproductive mood. It's the same with trading. We know exactly which rules lead us to success. However, frequently, we're not in a position, or in a mood to follow these rules. We're anxious, greedy, impatient, nervous and, thus, not in an optimal state for the task ahead of us. Anxious traders, for example, will take profits too quickly when they're trading.

Those who are in a position to put themselves in any desired mood, at any time, will always be able to create the ideal conditions for tackling the task at hand. It's only when we're in the right mood that we can also achieve the best possible output when solving a problem.

Imagine that you have to hold a speech in front of important people. What would be better: holding this speech in a nervous mood or with confidence? The answer is obvious.

For each task that has to be tackled there are productive and unproductive moods. The art is to put yourself in the optimal productive state before you tackle each task. With trading there are various tasks that have to be accomplished during the different phases. In this book, I'm going to show you which tasks you have to accomplish when you're trading and how you can put yourself in an optimal productive mood for every second of your trading.

Up to now, many traders have assumed that they don't have control over their moods and that their state of mind is, thus, determined by external events or randomly. In the following chapters you'll learn that precisely the opposite is the case. It's we ourselves who have control over our moods.

For example, a trader is in a bad mood and aggressive because he's had to take the sixth loss in a row. After so many setbacks you can't blame him for not being in a good mood. Nonetheless, it will be clear to everyone that the trading outcome will suffer considerably as a result of this aggressive state. Instead of being aggressive and bad tempered the trader could also put himself in a confident, relaxed state. The impact on his trading behavior and trading outcome would be huge.

An aggressive trader will tend to fight the market constantly. He'll increase his risk and only profits will be able to appease him in his anger. By contrast, those who are confident will be able to continue trading in accordance with their trading rules.

In order to understand how we can control our moods and our state, first of all, I'm going to talk about how moods come about. In my seminars, I keep on meeting people who, initially, wonder what all of this has to do with trading.

I'm going to show you that in trading there are various problems that need to be solved. You have to develop a trading idea (a low risk idea), you have to complete a mental ability test and you have to monitor your trade as well as many other things.

Each of these tasks requires a different mood. The better you can put yourself into a state that you determine, the better will be the outcome of the problem that needs to be solved. If you solve all problems in an optimal state then you'll easily achieve your objective of excellent trading.

People fail at trading because they attach great importance to external control. With external controls it's a matter of tackling problems such as the question of when is the best time to open a position, or what is the best trading system, or the best method of analysis.

In this book, I'm going to show you that external control doesn't help us in our trading. External control is an illusion, to a large extent, and can even hinder us in trading.

However, there is one issue that we can and have to control externally. This issue, which no trader can get around, is risk control. Besides internal control, it's the only factor that will make you a successful trader. The words "risk control" are the best definition of trading. If I'm asked what it is that I do in my job, I usually reply that I manage risk.

In order to be able to control risk we have to know what possibilities and instruments are available for this. Here, it's not just a matter of stops but, instead also, for example, money management functions. Money management is a crucial factor in trading. Money management doesn't mean "where

do I set my stop?” but, instead, how much money should I risk with this position, hence, what size should the position be?

Despite having a successful strategy you can still ruin your account if you don't practice any, or the wrong sort of money management. In my seminars, I let the participants trade in a simulation with a predetermined trading system. Here, the entry into and exit from a position are determined by the system. The traders only have to decide how much money they want to allocate to the position. Do they buy 100 shares, 1,000 shares or some other number? After some of the simulations we compare the account balances. Every participant has a different account balance. Some have halved their accounts, others have doubled then, although all of them applied the same trading strategy. The only difference between their approaches was through money management.

There are typical human behaviors that result in us increasing our risk when we're making losses. Humans have a natural affinity for risk with regard to losses and are risk-averse with regard to profits. In keeping with the old adage that a bird in the hand is worth two in the bush, we're too mean when it comes to profits. However, we also say: “Hope springs eternal”, so that we're frequently too generous if we have to accept losses. In this book, I explain which human instincts encourage this behavior and how you can protect yourself from them.

When it comes to trading, we always have to bear in mind that human nature and human instincts are frequently of no help to us in trading but, instead, hinder us. In short, this book is about two things, therefore: self-control and risk control.

Self-control means mastering the right way of communicating with your own subconscious, the ability to know what you want, how you can achieve this and how to put yourself into an optimal state for this. First off, you'll be thinking that this is no easy task. However, it's a task that many successful traders before you have already mastered. This book will help you to achieve trading excellence.

Risk control is the ability to develop money management strategies and to implement low risk ideas, which will enable you, day by day, month by month and year by year, to generate outperformance and to earn multi-digit

returns. In this book, I show you my strategies that have helped not only me, but also many other investment professionals and super traders, to achieve absolute success in trading. You're going to learn what distinguishes a low risk idea and how you can develop these yourself.

Birger Schäfermeier

1.

CHAPTER 1

What traders really want and how they achieve it. Find out the purpose behind your goals and decide what you want specifically.

1.1 Find out what you want

Bunker Hunt, a Texan oil millionaire, was once asked how can you attain success.

He said that there was a simple answer to that. “First, you decide what you want specifically; and second, you decide you’re willing to pay the price to make it happen, and then you pay that price. Success is that simple.”

Most people are unsuccessful because they’ve already omitted the first step to success. They simply don’t know what they want. The same can be said of many traders. When I ask, “What do you want to achieve with your trading?” time and again, I get the reply: “Quite a bit. Earn lots and lots of money.” Most of the time, I then say to these individuals that they should imagine that they’re now going to get a lot of money from me, let’s say Euros 1,000.000, however, only on condition that they have to spend all of it again. For this they have one minute to write a list of all the things that they would buy. The only rule here is that they’re not allowed to invest the money, nor are they allowed to buy real estate with it, thus, it has to be spent entirely on consumption. I hand over a slip of paper and a pen to them and most of them start to write avidly: a luxury car, Armani suits, a gold watch, expensive electronic devices, a luxury trip and so on. Hardly anyone manages to spend the million. After the first three or four wishes the writing frenzy grinds to a halt. What else would I need, what do I want and what for?

The traders quickly realize that “a lot of money” is a very unspecific goal that doesn’t help them because they don’t know what they want to do with the money. However, in order to be successful you have to decide what you want specifically. Money is a product that is generated in trading but it’s not your real goal.

That’s why I ask the traders another question. They should imagine that they have as much money as they could wish for. What would they do with it? Would they buy a house with it, or a sports car, all the same? If they want to buy a house, then why exactly a house? Maybe so that they never have to pay rent again? Why are they concerned about paying rent? Do they feel more secure if they own a house that has been paid off? If they want to buy themselves a sports car, I ask them why it has to be a sports car precisely and not an antique car. Maybe because fast driving is fun, or because the car provides them with a young and successful image?

I try to find out what the traders really want. And actually, it’s not goods that they’re after but, instead, values such as security, recognition, fun, independence and freedom. These values determine our actions. Nobody wants a sports car because it can get him or her from A to B. In fact, behind this wish is a yearning for a feeling. The goal is to achieve the experience of this feeling. Behind every goal there’s a purpose, which needs to be identified.

If you don’t know exactly what you want, then it will also be impossible for you to attain your goal. Or, would you set out on a journey without a destination? Without knowing it, the probability of you landing up at the destination that you wanted to reach is very low. It would be a lucky coincidence. However, we don’t trade in the hope of a lucky coincidence but, instead, in order to achieve a very specific goal. Yet, frequently, we haven’t figured this out.

Already as a little boy, I had the goal of becoming a millionaire, at the latest, by the age of 30. I achieved this goal much earlier. I made my first million at the age of 22, while I was still studying. Although, I didn’t have a clue as to why I wanted to be a millionaire and I certainly didn’t know what I wanted to do with the money. So, I left the money in my account and continued to trade. I was a millionaire but the feeling of happiness at having achieved my goal only lasted for a few days. After that I was somehow dissatisfied even though I had so much money in my account.

This dissatisfaction grew stronger day by day and, at that time, I didn't know why. I was now a millionaire and I had achieved my supposed goal. However, as the money was still in my trading account and I didn't indulge myself with anything at all really (why should I, I wanted the money for money's sake and had no idea what I wanted to use it for, or how I wanted to feel), after a few days already, the money had no significance for me anymore. It was only a number.

I was living in my student house share, in a small room with a coal stove and an unheated bathroom. The million was just a number in my account. The money didn't provoke any feelings in me and that's why it was meaningless for me. I didn't appreciate it because what else could this million give me? In my subconscious, like anyone else, I was striving for particular values. Among other things, I eagerly wanted to have a feeling of fun and excitement. If you act in a very disciplined way, then fun and excitement are the last things that you'll feel. That's exactly what it was like as I arduously made the first million. But I wanted to have fun.

Now, what's the best way of generating fun and excitement with a million when you're not aware of this yearning and the subconscious has taken over command? It's really simple - aged 22, you call up your banker and buy a short term DAX option for an amount that is ten times this man's annual salary. Every one-point change in the market now means multiples of Marks 10,000. Your account begins a roller coaster ride. In the space of minutes you earn or lose amounts that are the equivalent of the price of a luxury sports car.

I was now having my fun and the excitement that I had wished for. However, this wasn't good for my account. Within just three months the entire million was gambled away and I was back to where I'd started - with zero!

It was only much later that I learned why I had lost the hard-earned money again so quickly. I didn't know what my goal was; I hadn't decided what I wanted specifically. It wasn't until I became aware of this that I was also in a position to earn money continuously and to use the profits that I generated to achieve my goals.

You can be certain that you will never achieve lasting success as a trader if you don't really know why you're trading, what goal you're pursuing and

why you want to achieve this goal at all costs. Knowledge of your goal is crucial information in order not to let your journey turn into an odyssey.

1.2 Ask yourself what values do you strive for in your life

Trading will determine a large part of your life. It's only when your value concept is reflected in your vocation as a trader that you'll be in a state in which you'll be able to achieve top performance in the long term.

As a trader you have to decide what feeling and what values you strive for. This will be different for each person and changes over the course of life. When I was in my early 20s, I wasn't interested in values such as security. What I wanted was fun, recognition and excitement. Ten years later - when I'd started my family - security was a very important feeling for me, which I wanted to experience in order to be contented. As you can imagine, you'll display completely different behavior if you're striving for security, or for recognition and excitement. Those who strive for security as the ultimate goal will buy a house, those who strive for recognition and excitement will prefer a sports car.

Of course, we always strive for several values. Nevertheless, there is one value that dominates our actions, one value - if we had to choose - that we would prefer over all the others. You can find this out really easily by writing down all the values that are important for you, one below the other, in a list. Next, search for priorities among the values that you would like for your life. You do this by comparing two values in your list in terms of which one is more important for you. The best way is to imagine that in your life you could only achieve one of these values. Which one would you then give up in favor of the other?

Your list could include values such as: harmony, success, health, honesty and security. Now, ask yourself what's more important for you: harmony or success? Let's assume that the answer is success then, after that, compare success with health. If health is more important, then compare this value with honesty. If health is more important to you than honesty and also security, then you've found the value that is at the top of your scale of values.

In order to find out the further sequence, you should now do the same again, as described above, with the remaining values.

As soon as you have compiled your scale of values, for each value you should ask yourself the question how will you be able to tell that you have attained this value. What would your life be like if it was completely in accordance with the desired value? What would your environment have to be like? What would be the course of events of a so-called perfect day?

This exercise is very time-consuming and can take several days, but it helps you to identify your personal goal. And that's necessary in order to be able to achieve it at all. Remember the Texan oil millionaire: "First, find out what you want."

It's only when you know what your personal goal is that you can prepare a plan of how trading can help you to achieve this goal. In the course of this, you could also come to the conclusion that trading won't help you much to achieve your goal. In that case, you should think very carefully about whether or not you do, indeed, want to continue risking your money, your time and your nerves in the markets, every day, if this doesn't enable you to enhance your wellbeing. In that case, trading isn't your vocation.

In order to trade successfully you have to know what you want. When you know your goal it'll be easier for you to achieve this goal. Your brain, the consciousness and the subconscious, will now know what you want. We know from psychology that with the help of our brain we can achieve almost anything that we want. But it's only when we realize what we want that we can undertake the necessary steps in order to achieve it, too. To trade successfully is a big challenge for each of us, which we can only solve successfully if we know why we trade and what goals we're pursuing in this way. Knowing your own goal is one of the most important things that you have to find out in order to be successful. However, as most traders have never explicitly asked themselves this question, they're unsuccessful, or at best average, but never excellent. Super traders know which goals they want to realize with their trading. Because they know this, trading is their vocation.

1.3 Condition yourself for success!

Only those who reward themselves directly for good performance will be in a position to repeat this performance.

You can only be successful in the long term if you're willing to use the money that you earn with trading for your personal goals. What's the point of having money in your trading account if you don't put it toward your goals? It's important to reward yourself continually so that your brain knows why it's making all that effort.

We know about this stimulus from psychology under the keyword "conditioning".

If fun is among your preferred values, thus, if the goal of fun is right at the top of your list then, after a successful trade, you should indulge yourself by having some fun. Withdraw a part of your profits from your trading account and experience an amazing day when you treat yourself to everything that you enjoy. Splurge some of the profits. You'll notice that you'll earn the money again more quickly and more easily because by rewarding yourself you learn that you can achieve your goals by trading. Your brain needs feedback that it's done everything correctly.

After I'd lost my first million again, I vowed to myself not to make the same mistake the second time around. I realized what I actually wanted, namely, fun. So, from time to time, I would go and withdraw a larger amount from my account, even though I still had a long way to go before I reached the million again, and I would spend the money within one day. For example, I flew to Sylt for a day [an island in northern Germany], hired a luxury suite and enjoyed the day.

The experience reinforced my conviction that by trading I was doing the right thing. Most of the time, I earned back the money that I'd spent on my fun within a few days already. I developed a completely different attitude to money and to trading and I learned that "realizing your own goals" doesn't mean spending all your life working toward a goal but, instead, enjoying your life and that means realizing some of your goals immediately.

By realizing your goals already while trading you condition your brain for success. Conditioning is nothing other than action and reward. Our brain functions in accordance with this simple principle. Once it has learned how it can get its reward, thus, once the conditioning has taken place, then, through action it can help itself to obtain a reward over and over again.

That's why you should learn to program your brain for success. That's the only way that you can be successful in the long term. Otherwise, you'll share the same fate of many traders who earned a lot of money once, but then lost it again and were never able to earn a lot of money once more. Star traders earn money continuously because they have conditioned themselves for success.

In practical terms, this means that even if you're dreaming of owning a sailing yacht and, for this reason, you keep on accumulating more money in your account, it's better to withdraw money intermittently and, for example, to charter a yacht for a week. In this way you reward yourself and condition your brain.

Most traders think: Why should I withdraw money from my trading account? The less money I have in my account, the higher my returns have to be in order to achieve my goal.

Mathematically speaking that's right, but in terms of psychology it's wrong. An important element of successful trading is rewarding yourself even for small successes. My experience and that of many traders has shown that continuous rewards enable you to reach your target faster.

So, firmly resolve to condition your brain for success. For this, you have to know what you want and set interim goals that can be achieved quickly. Every time that you achieve an interim goal you should reward yourself. Be sure that the interim goals are not too difficult to achieve. It's absolutely fine to reward yourself already after the first successful day, or the first successful week.