
Winning the Day Trading Game

*Lessons and Techniques from
a Lifetime of Trading*

THOMAS L. BUSBY



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Table of Contents

[John Wiley & Sons](#)

[Title Page](#)

[Copyright Page](#)

[Acknowledgments](#)

[Introduction](#)

[CHAPTER 1 - The Crucible Black Monday](#)

[FROM PORK BELLIES TO PAN AM](#)
[THE AFTERMATH](#)

[CHAPTER 2 - Time Is Central](#)

[IN THE MARKETS, JUST LIKE FISHING, PATIENCE PAYS](#)
[CAREFULLY SELECT TRADING OPPORTUNITIES](#)
[CERTAIN MARKET MOVEMENTS CORRELATE TO THE TIME](#)
[OF DAY](#)
[USE A 24-HOUR TRADING CLOCK](#)
[THE TIME OF YEAR IS ALSO IMPORTANT](#)
[REVIEW](#)

[CHAPTER 3 - Trading Is a Numbers Game](#)

[USING KEY NUMBERS IS NOT NEW](#)
[WHAT ARE KEY NUMBERS AND HOW ARE THEY](#)
[ESTABLISHED](#)
[HOW I USE KEY NUMBERS TO ANALYZE THE MARKET](#)
[HISTORICAL KEY NUMBERS](#)
[HISTORICAL KEY NUMBERS ON THE S&P FUTURES](#)
[HOW I USE KEY NUMBERS TO TRADE](#)

REVIEW

CHAPTER 4 - Read the Tape

SOMETIMES, THERE IS TOO MUCH OF A GOOD THING
TRADING IS AN ART
GET THE BIG PICTURE
KEEP A TREND LINE OF YOUR TRADING VEHICLES
NOTE KEY NUMBERS
CHECK MAJOR INDICATORS
MY INDICATORS
THE SIGNIFICANCE OF TIME
TRUST THE NUMBERS
REVIEW

CHAPTER 5 - There's No Crying in Trading

DON'T GET GREEDY
FEAR IS A NEGATIVE FACTOR
ARROGANCE CAN ALSO BE COSTLY
TECHNIQUES TO TAME YOUR EMOTIONS
REVIEW

CHAPTER 6 - Riding the Rail

REVIEW

CHAPTER 7 - Worry about Risk, the Rewards Will Come

TRADING IS A BUSINESS
MANAGE YOUR ACCOUNT BALANCE
MANAGE EVERY TRADE
USE PROTECTIVE STOPS
FOLLOW THE TWO-MINUTE RULE
GREEN CIRCLE COUNTRY

REVIEW

CHAPTER 8 - Respect the News

BREAKING NEWS CAN RUIN YOUR DAY
A DAILY MARKET MOVER: SCHEDULED ECONOMIC
REPORTS
THE BIG IDEA: KNOW WHEN IMPORTANT REPORTS ARE
BEING ISSUED
REVIEW

CHAPTER 9 - Getting Down to Brass Tacks

TRADING FUTURE INDEXES
TRADING MUTUAL FUNDS
TRADING STOCKS
TIME AND QUANTITY
TRADING BOND FUTURES
TRADING OIL OPTIONS
TRADING GOLD FUTURES
REVIEW

CHAPTER 10 - Preparation Pays

PREPARATION PAYS IN EVERY PROFESSION
DON'T GET COMPLACENT, KEEP LEARNING
DON'T JUST READ BOOKS, READ THE MARKET
HAVE A PLAN AND EXECUTE IT
KEEP A TRADING DIARY
REVISIT THE DIARY OFTEN
REVIEW

CHAPTER 11 - A Study in Contrast

THE WEEK BEGINS

LET THE NUMBERS LEAD THE WAY
COUNTING MY CASH OR MOURNING MY LOSS
REVIEW

CHAPTER 12 - Recap the Essentials

BEGIN WITH TIME
INTEGRATE NUMBERS WITH TIME
READING THE TAPE IS THE SKILL OF MARKET ANALYSIS—
LEARN IT
GOOD TRADING REQUIRES EMOTIONAL BALANCE
ESTABLISH STRATEGIC OBJECTIVES AND BE TACTICAL
TRADING IS A BUSINESS THAT REQUIRES GOOD MONEY
MANAGEMENT
NEWS CAN DESTROY THE PERFECT STRATEGY
A WINNING TRADER HAS TO GET THE RIGHT EQUIPMENT
ALWAYS PREPARE, EVALUATE, AND IMPROVE

CHAPTER 13 - An Afterthought for Consideration The Doctrine of Genius

APPENDIX A - Glossary
APPENDIX B - Getting Started
APPENDIX C - Order Types
APPENDIX D - Suggested Reading
APPENDIX E - Helpful Websites
Index

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THOMAS L. BUSBY



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Published by John Wiley & Sons, Inc., Hoboken, New Jersey.
Published simultaneously in Canada.

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Library of Congress Cataloging-in-Publication Data Busby, Thomas L.,
1951-

Winning the day trading game : lessons and techniques from a lifetime of trading / Thomas L. Busby. p. cm.—(Wiley trading series)

ISBN-13: 978-0-471-73823-7 (cloth) ISBN-10: 0-471-73823-9 (cloth)

1. Day trading (Securities) 2. Electronic trading of securities. I. Title. II. Series.

HG4515.95.B87 2005
332.63'228—dc22
2005016420

ISBN-10 0-471-73823-9

Acknowledgments

I would be remiss if I did not thank and acknowledge the people who helped me to write this book. First, I want to thank Paula, my wife of more than 20 years and my two sons, Winston and Morgan. I thank them not because they wrote the book but because they lived it. They know first hand what the life of a trader is like—they have ridden the rocky road with me and experienced the ups and the downs. I thank them for the chance to do the job I love. Their patience and understanding cannot be measured.

I also thank my Dad, Melvin. His guidance and instruction taught me the lessons that have been my guiding light throughout the years. They illuminated my path. Dad, I thank you.

Also, I want to thank Patsy Dow, my cousin, one of my students, and the wordsmith of this book. Patsy took my trading method and techniques and mixed them with my personal stories and experiences. She accurately transported them from my mind onto these pages. I appreciate her hard work and dedication to the task.

Thanks also to Jeanette Sims, the COO of DTI and my right hand. Jeanette spent many long hours proofing and editing these pages and adding her ideas to the mix. Geof Smith, our Chief Instructor at DTI created all of the artwork and graphics that enhance and explain the information presented. Thanks to a long-time friend and student, Christopher Castroviejo, who was instrumental in helping me with my facts, dates, and the overall structure of the content. Thank you to all of the DTI Students who have enhanced my education in the markets over the years. Thanks to all of you.

There is one other person who had a tremendous impact on my trading and that is Dr. Bobby Gene Smith. Over the years, he had such great faith in me and he was infinitely patient. He died a few years ago, but his influence in my life and the lives he touched was great.

Finally, a special thanks to Kevin Commins and all of the folks at John Wiley & Sons for allowing me the opportunity to publish this book.

Introduction

Trading is risky business that involves a great deal of discretion and skill. Accurate market analysis, correct execution, emotional control, discipline, consistency, and good money management are some of the skills that are required to trade successfully. In addition, there are times when any method, even when executed correctly, will result in a loss.

A great deal of effort has been made to insure that the information presented in this book is correct and accurate. However, we are all human and mistakes can always be made. The information and techniques presented have been helpful to me. However, I cannot and do not guarantee or assure you that they will work for you. I hope that you will find some of the ideas useful. In fact, I hope that your trading will be both more enjoyable and more profitable as a result of the information and ideas presented.

Before you trade, be sure that you can afford to lose the money that you are risking. Always limit your risk first and worry about taking profits second. I make money with this method, but past results are never a guarantee of future results.

Enjoy the book and trade with care.

CHAPTER 1

The Crucible *Black Monday*

October 19, 1987. When the sun rose on that Monday morning, I felt financially secure. I had a great job, a beautiful house, nice cars, money in the bank, and a belief that the future would bring me greater and greater riches. By the time the sun set that evening, I was broke!

During the course of the day, the Dow Jones Industrial Average dropped more than 500 points. The Dow lost approximately 22 percent of its total value in a single day. One trillion dollars of financial assets vanished as quickly as a tiny puff of smoke in a strong wind. And, of course, the Dow was not alone. The Nasdaq also fell, losing more than ten percent of its value.

The United States financial markets underwent a free fall and there seemed to be no stopping, or even bracing, the fall. Furthermore, the decline was not limited to the United States. Major markets around the globe took a nosedive. It was as though a flame on Wall Street quickly got out of control and spread around the world faster than a fire in a parched, dense thicket. Close to home, the Canadian market reeled from historical losses and dropped over 20 percent before the disaster ended. The international scene was not any better: by the week's end, the average stock value on the London Financial Times Stock Exchange had declined by over 20 percent; Asian markets also tumbled. On October 20, the Nikkei experienced the biggest loss in its history. The market in Singapore was down significantly for the week. After experiencing a huge decline on October 20, the Hang

Seng closed for days. In the wake of the crash, the Australian market suffered a record double-digit loss. Some exchanges and indices closed for a few days in the hope that the break or timeout would serve to calm jittery nerves. The reality of a global economy became all too real.

What caused the crash? Theories were cheap. Everybody had one. Program traders, soaring federal debt, high bond yields, market overvaluation—these were only a few of the speculated causes. In reality, all of these factors probably played a role. I didn't know the cause, and I really didn't care.

To me, the debate was strictly academic. What was real was that I, and some of my clients and dearest friends, had lost a lot of money. I had lost not only my wealth, but my self-confidence as well. I was broke and my faith in my trading ability was undermined. I grieved for my clients and for myself.

Even in the depths of my despair, there was no time for pity or resignation. I had a wife and two small children depending on me. It was time to be tested. Failure was not an option.

FROM PORK BELLIES TO PAN AM

At the time of the crash, I had been a trader for almost a decade. My experiences with the stock market began in 1978 when I was stationed in Spain with the U.S. Air Force. One of my fellow officers was trading pork bellies. He often talked to me about his experiences and the money he was making. He made it all sound very exciting and easy. I knew absolutely nothing about trading pork bellies or anything else, but I wanted a piece of the action. I did not have a clue as to how to begin, and the only brokerage firm I had ever

heard of was Merrill Lynch. (This was back in the days when their major television advertisement was the bull in the china shop.) I truly thought that Merrill Lynch was the only brokerage firm in existence.

I was stationed at Torrejon Air Force Base in Madrid and the brokerage house was in the city's central business district. I had to use the subway, which I usually avoided because I found it so difficult. My Spanish was poor and my southern accent added a slow twang to the few Spanish words that I knew. Then, as now, I couldn't roll my tongue. In an effort to communicate, I gestured profusely. This small-town boy found downtown Madrid daunting. As I searched for the brokerage office, I just kept asking directions and gesturing. It was southern Spanish spoken with hand signals.

When I finally arrived at the office, I opened an equities account with the intention of trading pork bellies. I was so ignorant and naive that I didn't understand that pork bellies were a commodity and, therefore, couldn't be traded via a stock account. If you want to know the truth, I am not sure I even knew that pork bellies were commodities and equities were stocks. At any rate, I am sure that I did not have a clear view of the significant distinctions between the two.

Nevertheless, I opened an account. The military published *The Stars and Stripes*, a paper to boost the spirits of service people abroad and to help them stay in touch with events at home. I began following the financial information and paid close attention to the stock quotes, even though the quotes were about three days old. That was the extent of my market research. After reading *The Stars and Stripes* for a number of days, and considering the information presented, I decided to purchase my first stock. I bought 100 shares of Pan Am and another 100 shares of Eastern Airlines. I eagerly awaited every issue of *The Stars and Stripes* so that I could

follow the fluctuating price of my holdings. It was exciting to be a stockholder and I enjoyed talking about my new portfolio.

Unfortunately, in the long run, my investments did not work out and both companies filed for bankruptcy. I had no stops; it was an all or nothing mentality. When both of my stock picks eventually went belly up, I lost everything from my first venture. However, I was not easily dissuaded. One loss did not make me a quitter. I enjoyed investing and I continued to study the markets looking for other stocks to purchase and other investment opportunities. Trading was the closest profession to sports that I had ever tried and I quickly gravitated to it. I had no idea that I would eventually become a professional trader. I just enjoyed the markets.

My Avocation Becomes My Vocation

After getting out of the military and returning to the United States, I settled in Oklahoma City and started attending law school. Trading for a living was not part of my life plan; in fact, I never even considered it. I intended to be a lawyer. I enrolled in law school while also continuing to invest in a small trading account. My trading was a hobby from which I hoped to eventually make a few bucks. My broker, Henry, and I soon developed a friendship and he introduced me to stock options in oil companies. At that time, oil was king in Oklahoma City. Henry taught me his trading strategy for options. It was a very easy three-step plan that he called the Bigger Fool Theory. The essence of the theory was simple: Buy a stock at a high price and there is always someone (a bigger fool) who will buy it from you at an even higher price.

Here is how the system worked. A stock price would rise one day, we bought it on the second day, and we sold it on the following day. I began regularly watching the market.

Just as the strategy dictated, if an oil stock went up one day, I bought it on the second day, and then I sold it on the third day. Believe it or not, I successfully executed this strategy over and over again. Oklahoma City was booming and oil prices seemed to go up every day. The Bigger Fool Theory was working like a charm for me and my account was growing. I seemed to have a knack with options as evidenced by my profits. I didn't know that the odds of trading options to the long side were like playing the lottery.

One day I was surprised to receive an invitation to come to the local brokerage house and meet the boss. From the time I entered the door until the time I left the office, I was treated like royalty. I soon learned that the office manager was aware of my successful options trading. Everyone seemed to be impressed and they offered me a position. I was still attending law school and planned to finish my studies. I was not sure I wanted to be a broker or work in the financial field. I intended to be a lawyer. I communicated my feelings to them. However, the firm offered me a chance to achieve both objectives: accept the position with them and attend law school at night. I could be a broker in the Oklahoma City office and my studies would not be interrupted. It was an offer I could not refuse. I took the deal. From that day forward, my life would never be the same. I began the journey to becoming a trader. I started to educate myself about the stock market. I wanted to learn all of Wall Street's secrets.

Soon I received training in New York; not long thereafter I obtained my brokerage license and I returned to Oklahoma City where I honed my skills. I did well and gained the confidence of my clients and the management team at Merrill. I was dedicated to profitably managing my clients' portfolios and assisting them with their financial wealth management. I liked the industry and saw the potential to

succeed and achieve my personal goals. Trading was both a passion and a profession for me. I loved it.

In 1982, the S&P Futures opened for trading. It was a watershed day for me. On that first day, I made the best and the worst single trade of my career. I bought the S&P at the open for a price of approximately 118.70. With the S&P currently trading at 1220.00, the trade would be worth \$275,000.00 today! And that is just for one contract! That was my best trade ever because I have been buying it and selling it ever since. However, I also sold the S&P; that was my worst trade because if I had kept it, my investment would have yielded me incredible profits.

So, from the very beginning, I traded the futures indices. After studying futures, I added to my credentials by receiving a license to trade them. I quickly fell in love with this new market. As a beginning broker, I became concerned about the limitations of a one-way trading strategy. That is, if you buy stocks, you can only make a profit if the stock prices rise. But stocks move both ways. They go up and they go down. Therefore, the strategy that I had been taught was flawed. I knew I needed a strategy that worked in both bull and bear markets. Futures offered me the flexibility and the versatility that I needed. A stock trader with the best bull strategy in the world cannot profit from a bear market. Futures are not so restrictive. A good futures trader can make just as much money in a bearish market (maybe even more) than in a bull market. Trading opportunities are doubled. The trick is, of course, to correctly read the market and trade on the right side of it. That is where experience and education pay off.

I worked long hours and after four hard years, I was reaping the benefits. Within a short time I moved on and accepted a position with another established firm where I

became a vice-president. I was one of the biggest producers in the office and, in fact, in the region.

Options became my obsession. You might say that I never met an option that I wouldn't sell. Just before the crash in 1987, I had assisted one of my largest clients in making over a million dollars in the options market. That is a million dollars of profit in one month! I was one of the biggest retail options traders in the United States. I thought I was one of the chosen. Walking on water didn't seem like that hard of a task. Then, came October 19, 1987, the day the floor evaporated beneath my feet.

My Mistake

I lost a lot of money on Black Monday. Let me tell you what happened. On Thursday, October 15, I was holding two contrary market positions. I was long 1000 S&P 100 puts and I was also short 1000 S&P 100 puts. My short position was offset by my long position and vice versa. There was no problem because the offsetting positions were my insurance against calamity. I was protected regardless of where the market traveled.

My problem surfaced on Friday the 16, just before the crash; my long positions expired but my short positions did not. They did not expire for another month; I was holding naked options. In other words, I had sold 1000 options that I did not own; I had guaranteed a buyer that I would deliver the options if the strike price was hit. On Black Monday the strike price was hit and I had to produce. Because I did not own the options, I was forced to buy them at a preset, high market price, even though the market was dropping like a ton of bricks.

If I had been able to hold onto my long puts for one more week, I would have made millions of dollars. But, the market did not wait for me. I was a day late and a thousand puts short. On Black Monday, with the market falling out of bed, all I could do was wring my hands and suffer. As the day progressed, I was literally throwing up in the trash can. That day, I experienced anguish that I never want to feel again.

THE AFTERMATH

I wish that I could say that on Tuesday, October 20, all was well for me, but that was not the case. I went to the office as usual, but the atmosphere in the office was far from usual. Our office was in turmoil. Throughout the financial industry there was total panic. Clients wanted to be assured that things were not so bad, but we could not offer that assurance. No one knew what that day or even the next day or week would bring. Everyone was asking questions. How much had been lost? Were we solvent? Were the markets going to continue to fall? Was the nation going to experience another depression like the one suffered in 1929?

Some analysts compared Black Monday of 1987 with Black Monday of 1929. Did the crash of 1929 cause the Great Depression? Was the world going to experience years of financial suffering? It depended on whom you read. Some writers predicted the worst while others framed the crash as nothing more than a correction. At any rate, a heavy sense of apprehension hovered over the financial industry. For a time, a sense of doom and dread engulfed the nation and the world.

Computer systems lacked the sophistication of the systems of today. So much information had been thrown at

them so quickly that these titans of technology were not able to keep up and process the data. Over 600 million shares had traded hands on Black Monday alone. How bad was it? No one seemed to know. Wall Street firms feared the extent of their exposure. We were in quicksand and did not know what to do or where to begin to make sense of it. I remember selling some IBM shares and not knowing for days what my price was. It was clearly not the 2-second fill that we are accustomed to today.

The markets closed for a couple of days to evaluate the situation and to try to settle accounts. When the actual losses were calculated, it was an ugly sight. Those who refer to 1987 as a market correction always amuse me. Instantly, I know that they lack credibility. Black Monday was not a correction; it was a crash. On Monday, October 19, 1987, Wall Street experienced its greatest single-day loss to date. The loss dwarfed that of Black Monday in 1929. In 1929, the loss was only a little over 12 percent, but in 1987, the loss was over 22 percent. It was almost double. A correction? I don't think so. I, like many, many others, lost everything. I had to start over.

The financial loss that I suffered was catastrophic. However, believe it or not, that was not my biggest problem. My biggest problem was my loss of self confidence. I questioned my experience and my ability to trade. How could I not have seen what was coming? How did I let this happen to me? Was I to blame for the suffering of my family, my clients, and me? Should I have done things differently? What should and could I do now?

Over the next few weeks and months, I had to undergo a lot of soul searching. I questioned the basis and the rationale of the financial institutions that had been my source of livelihood for years. And, I questioned whether or

not I had foolishly selected a profession in which years of work and labor could vanish in a single day.

Survive and Persist

As I thought about my plight, I remembered the struggles I had when I tried out for my high school football team. My nemesis was a big brute named Danny. At every practice, I had to face Danny. When we collided, my bones rattled and my brains shook. He must have weighed well over 200 pounds and he was as solid as a slab of granite. I was a freshman in high school hoping to make the team, and Danny, a soon to be all-state lineman, had made it his goal in life to peel my face, one layer at a time. Day after day, Danny tackled me—violently exhibiting his superior gridiron skills. When I saw that mountain coming at me, I had one thought: survive the blow. I braced for the impact. After I survived, I had another thought: flee. Quit. Forget about playing football. It is just too hard, and I don't need the hassle. Danny was deadly.

I tried to convince my Dad to see it my way. I told him that I should quit. I explained to him how hard it was. I told him how big this other guy was and how humiliated I felt to be pulverized by him day after day. I promised to study more, work harder, be a better human being, but Dad would have none of it. "Don't start something that you're not going to finish. You wanted to join the football team. You went out for it and now you are going to finish it. You will not be a quitter." So day after day I faced the mountain.

When tryouts ended, no one was more surprised than I was that I had made the team. I was not an all-star and I took my turn warming the bench, but I was on the team. Persistence had paid off and I wore the team uniform with pride.

On October 20, 1987, and for many, many days thereafter, I felt like that young high school freshman who was being battered by that mountain of a lineman. The air had been knocked out of me. I had to fight to survive. I wanted to quit trading, but I needed the money. I was a victim of the crash of 1987. That is the way I viewed myself. The market had victimized me. It had behaved in an irrational and inexplicable manner and it did so intentionally to hurt me. It was personal. Rationally, I knew that was not true, but I wanted to blame someone or something. I felt sorry for myself. I was literally drowning in self-pity.

Additionally, I was also having a lot of conflicts with my employer. They approached my clients as numbers and I considered my clients as friends. The office environment had become very unpleasant and stressful. I had to make a change. I needed to move on. I decided that I should leave my position and find employment elsewhere, but where? I had to have a new position that gave me the ability to provide for my family. What type of position should I seek? Should I stay in the financial field or practice law, or business, or something else? One thing was sure, I had to make a living somehow. My life was flipping upside down and I seemed to have no center or direction. It is difficult to relate the depth of despair that I felt.

I had not been raised with money. My father was a civil servant who made a modest income and provided for me sufficiently, but there were few frills. Dad had a well-deserved reputation for being thrifty and he usually pinched a penny until it squeaked. Growing up, if you didn't need to turn on a light, you left it off. If you turned it on, you turned it off when you left the room. Wastefulness was a sin and you didn't waste food, clothes, utilities, gas, money, or anything else. Sears or J. C. Penney was a fine place to shop, and eating out or going on a vacation was an extravagance. Dad saved as much as he could; he saved a little from every

paycheck. He managed his finances well and always prepared for that inevitable rainy day. Now it seemed that he had managed far better than I had. I was totally unprepared for the rain that pelted down on me. I was a Bozo and I felt it to my core. I asked myself over and over again: How could this be happening to me?

As an adult, I had become accustomed to living well. I bought what I wanted, at least most of the time. My family lived in a beautiful home. We drove new cars. My children attended private school. My wife had furs and jewelry and other trappings of the financially comfortable. Then, overnight, my family and I had to give up the luxuries we enjoyed and settle for far, far less. It was psychologically very difficult.

Once you have had money and lose it, it is painful. It is not just giving up the big house and other such stuff. I'm not so spoiled that I can't drive an older model car. But, it is the psychological effect of failure. I felt like the world's biggest fool. I had spent time and money educating myself. I had a law degree, a degree in business, training in the military, and a good upbringing that stressed good money management. Yet, here I was in the worst financial situation of my life. How did I let it happen? I just kept asking myself that question over and over again. My self-confidence was just south of zero!

Just like on that football field when I had come face-to-face with that big lineman, my first thought was for survival. I liquidated everything I could. The house, the cars, the investment portfolio—just about anything marketable was sold. Still, there was not nearly enough money. I started going into debt and relying heavily on credit cards. I worked hard to appear to be okay, and that just added to the pressure. It is exhausting to try to look like all is well when you know that your sky is falling. I was probably technically

bankrupt, but I never declared bankruptcy. Declaring bankruptcy was simply not an option. I never really considered it. I continued to struggle and hoped to find a way out of the deep pit where I found myself. I was not a quitter.

I always was an optimist, happy with my life and my achievements. I had believed that good guys always win and that my future would just get better and better. Now, the man in the mirror was a confirmed pessimist. He expected the worst, and he was getting it.

Oklahoma City had weathered the Penn Square Banking Crisis and the oil crash. Yet, now there were few opportunities in the city for me. I decided to leave the west and head south. I returned to my hometown of Mobile, Alabama. I went to work for E. F. Hutton and received enough money to get on my feet. The bulk of that money was eventually lost by investing in a company recommended by an associate. Once again, my ignorance cost me. I did not do enough analysis and I put all of my eggs in one basket.

As luck would have it, during this period of time in the brokerage community, consolidation and mergers were very common. Unfortunately, E. F. Hutton was soon to be no more. That particular opportunity was gone and I basically started looking for any viable opportunity to earn a few bucks.

By day, I continued to trade the S&P Futures. I traded very small positions and lost money far more often than I made it. My outlook on life was so dark and dismal that I expected my trading to fail and it did. As I look back, I realize that my attitude was a tremendous detriment to my trading. I tried to improve. I studied technical analysis as well as various charting techniques, wave theories, and patterns. I read every trading book I could find. I desperately wanted to

make money in the markets because I knew there were millions to be made, but nothing seemed to work for me. From 1987 until 1992, I worked incredibly hard but had nothing to show for it. Now, I realize that it is not about working hard; it is about working smart.

I looked for other financial opportunities and by night I worked with a group of men to manage some funds for a local tribe of Native Americans. We experienced some small success, but that was not the answer. We put together some capital and actually opened a casino in Biloxi, Mississippi, but that, too, was not the panacea. Every day of my life had become a fight for my survival. I call these years my dark years.

Trading is a very psychological game. If you are under too much stress or if you are too fearful and pessimistic, you cannot trade successfully. That point was driven home to me on a daily basis as I lost on trade after trade after trade. After every loss, I considered quitting, but every time I remembered my Dad admonishing me to stick it out. "If you can't finish it, don't start it."

Everyday I had to tell myself again that I was not a quitter. Things would get better. I just did not know how or when. Trading is a journey: You learn as you go and I was doing a lot of learning.

The Metamorphosis Begins

Sometimes you experience an event that has a profound effect on you. You can't explain why, but it just does. You may have had similar experiences that didn't even faze you, but for some reason, this time it's different. The experience speaks to you in a unique and dramatic way and it impacts your life.

If you have ever tried to quit smoking or lose weight you probably know what I mean. You were well aware that you were fat. You knew rationally that you needed to lose weight because those pounds were adversely affecting your health. You even knew how to get rid of those excess pounds. Proper nutrition was not foreign to you and you could recite dozens of diets by heart. But you just could not lose weight or stick to any diet. In fact, you probably got fatter every time you tried to reduce the number on the scale because you were not buying into the need or the way to change.

Then one day you heard or saw something that you had heard or seen dozens of times before. And for some unknown reason, you finally got it. You began eating a balanced diet, living a healthy lifestyle, and losing weight. On that particular day you were ready for the message you received and you took it seriously and changed.

In 1992, I had a far more significant life-altering experience. I didn't shed a few pounds; I shed five years of misery.

The Sermon

My wife Paula, our two sons, and I went to the Sunday service as usual. George Mathison may have been the minister of a small Methodist church, but his ministerial skills were far from small. He was well versed in the scriptures, extremely articulate, and very personable. When he spoke, you felt as though he was speaking to you individually. George could preach one heck of a good sermon.

On this particular day, I was anticipating going through the motions of worship; singing a few well-known hymns, listening to some good words of encouragement, and

leaving for another tough week ahead. Things started off as planned. The music was good and George began the sermon. However, when I heard his voice, things changed quickly. This message was not just good, it was great, and it was tailor made for me. George was talking about forgiveness and allowing God to share life's burdens with you. He was talking about forgiving yourself and giving your burdens to someone far stronger than you will ever be. I was encouraged. Could I allow myself the freedom to give my load to God and let God help me gain a new freedom from the baggage I was carrying?

The weight had been so heavy for so long. Not one day had passed since 1987 that I had not revisited my mistakes. I had carried the guilt of that experience like a load of heavy metal welded to my being. I trudged through every day because my burden was so heavy. Could I put that burden down? Could I forgive myself and be free? I listened more intently.

George was urging me to forgive myself for my sins and my mistakes. "If God can forgive you, surely you can forgive yourself." I was so hungry for this message. I wanted to quit calling myself a Bozo and move on with my life. I had tried, but I had been unable to do it. Now, there was hope. I leaned forward in the pew, not wanting to miss a word.

I don't remember exactly what he said, but I remember the essence of it. Or, at least the kernels of wisdom that I took from it: Life is full of problems that are often so great that they overwhelm us. We want to solve them alone and we want to solve all of them instantly. But we can't. No one can deal with all of the problems of life without help. Sometimes our load is too heavy; but if we share our difficulties with God and allow him to help us, he will. We can give our burdens to God and free ourselves from the guilt and the pain that we are suffering.

I had not sinned in 1987, but I had made mistakes. I wanted to hear more. George continued: First, give the baggage of the past to God. Then, deal with life's problems from this day forward one at a time. All a human being can do is the best he or she can do. No one can climb a mountain with one step, or cross an ocean with one row of a paddle. No one can find a solution to every one of life's problems in one fell swoop—and neither can you. Let God forgive you for your shortcomings and forgive yourself. Then take life one day at a time and do the very best that you can do on that day. Some days you will do well and some days you won't do so well. Just focus on doing the very best that you can. Solve the problems you can solve and handle the situations that you can handle that day. That is all that you can do. No human being is expected to do more than that.

This advice may seem simplistic, but from my point of view, it was not. I knew that I needed to set myself free and then to take one problem at a time, one day at a time, and one trade at a time. I did it. I put that burden down. I gave it to God and I felt a sense of freedom that I had not felt in years.

Then George's message concluded with a suggestion. At the end of every day, after you have done the best that you can do, reset yourself. Think of your day as a message on a tape recorder. Visualize yourself as having a reset button in your head. At the end of the day, reset the button. The day is over. You cannot change it. Take everything positive from it that you can, and move on. Begin the next day with a clean slate and with a determination that in the course of the new day, you will again do your best.

I'm sure that the message was more eloquently presented. It must have been persuasive because that experience changed me. It altered the way I have conducted myself from that day until this one. I started doing things