



Wiley Trading

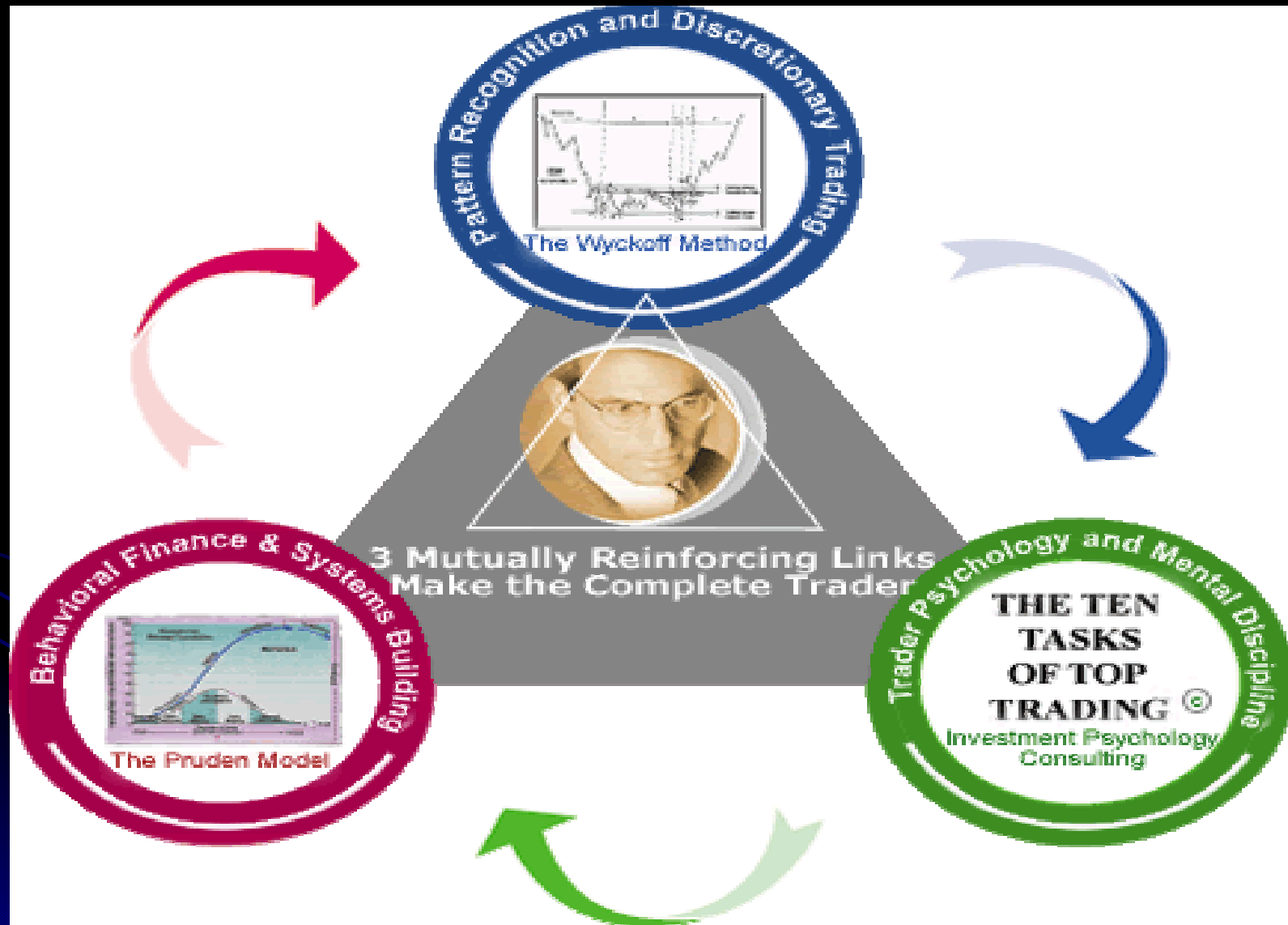
The Three Skills *of* Top Trading

Behavioral Systems Building,
Pattern Recognition, and
Mental State Management

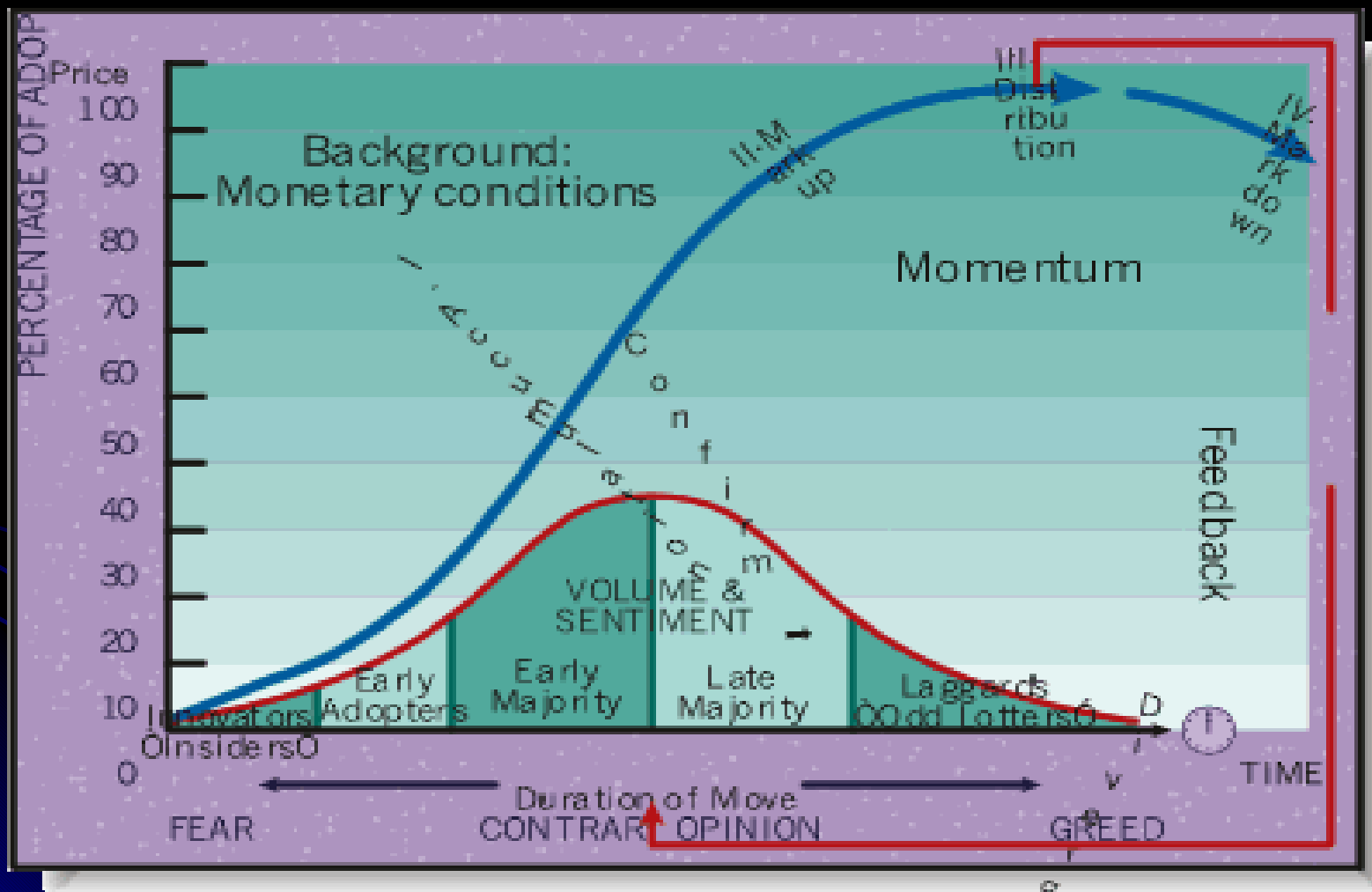
HANK PRUDEN

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3-in-1 TRADER MODEL



THE PRUDEN MODEL



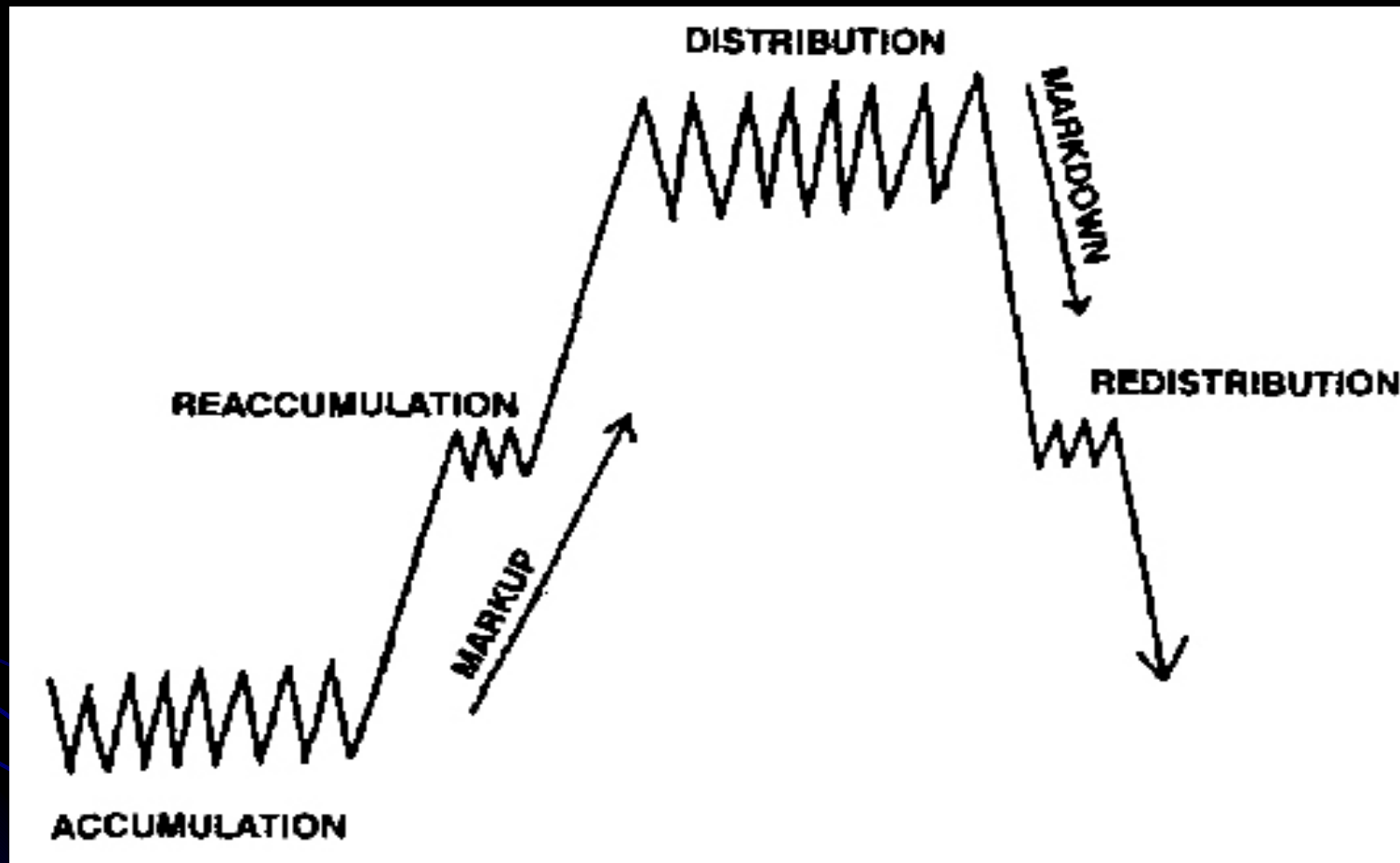
THREE DEEP AT EVERY POSITION

INDICATORS			
Three deep at every position Four elements: Price, volume, time, and sentiment Three levels of analysis, or three units of analysis for every element			
Element	Unit	Indicators*	Weighting
			<u>Bullish—Bearish</u> +4 +2 +1 -1 -2 -4
Price	Momentum Extent Form		
Volume	Total Upside/Downside On-balanced		
Time	Cycle Duration Season		
Sentiment	News Opinion Speculation		

*Indicators chosen by the analyst. Depending on the time frame used and the market studied, each technician can systematically select an array of specific technical indicators to represent each element of the model.

FIGURE 4: THREE DEEP AT EVERY POSITION. This form shows each element broken down into three levels or units of analysis. Entries under “Indicators” and “Weighting” depend on the market and time frame being analyzed.

WYCKOFF THEORY



Accumulation: The establishment of an investment or speculative position by professional interests in anticipation of an advance in price.

Markup: A sustained upward price movement.

Distribution: The elimination of a long investment or speculative position.

Markdown: A sustained downward price movement.

WYCKOFF LAWS AND TESTS

1. The Law of Supply and Demand – states that when demand is greater than supply, prices will rise, and when supply is greater than demand, prices will fall.

Here the analyst studies the relationship between supply vs. demand using price and volume over time as found on a barchart.

2. The Law of Effort vs. Results – divergencies and disharmonies between volume and price often presage a change in the direction of the price trend. The Wyckoff

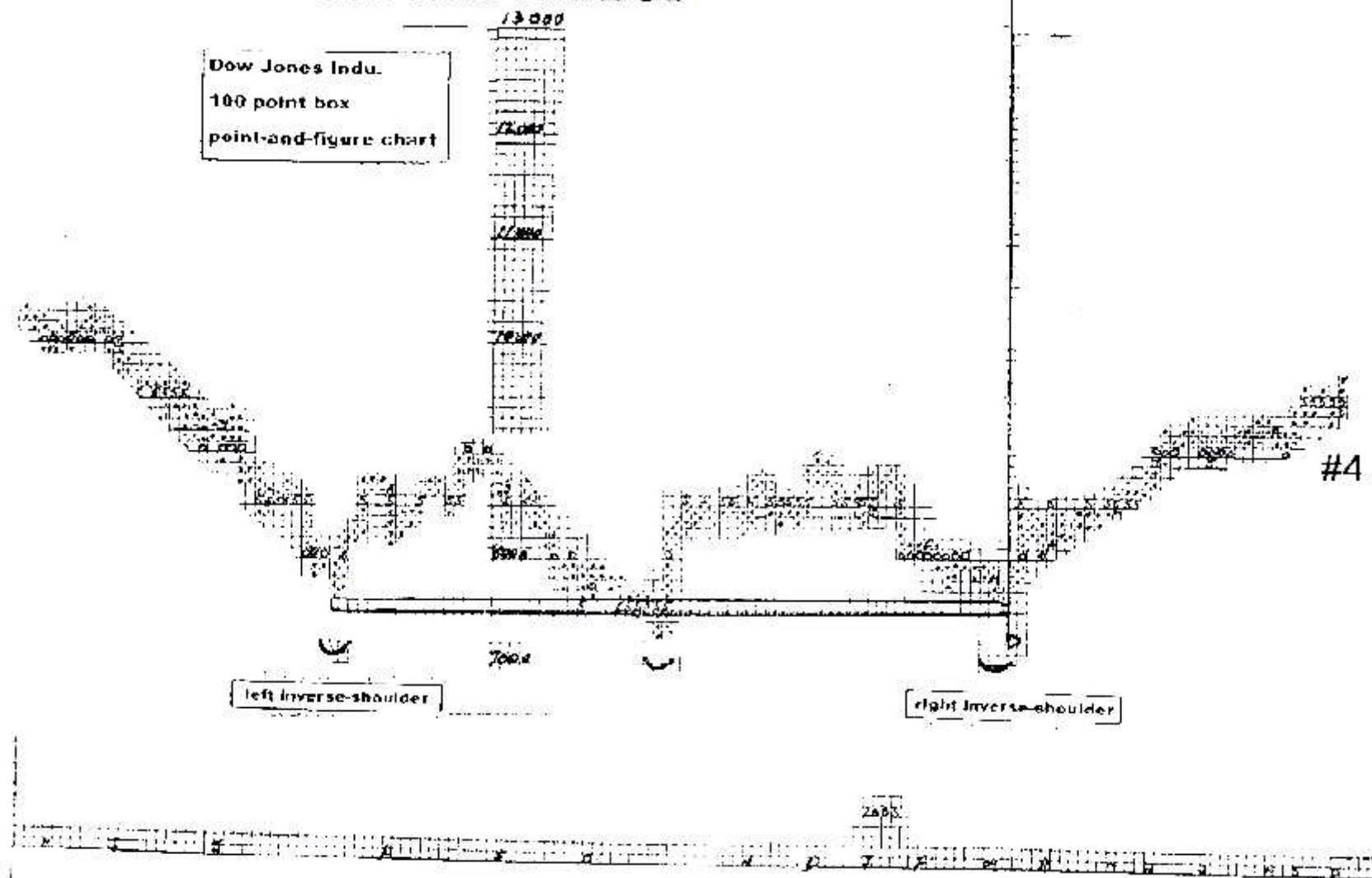
“Optimism vs. Pessimism” index is an on-balanced-volume type indicator helpful for identifying accumulation vs. distribution and gauging effort.

3. The Law of Cause and Effect – postulates that in order to have an effect on you must first have a cause, and that effect will be in proportion to the cause. This law’s operation can be seen working as the force of accumulation or distribution within a trading range works itself out in the subsequent move out of that trading range. Point and figure chart counts can be used to measure this cause and project the extent of its effect.

WYCKOFF LAWS: LAW OF EFFORT vs. RESULT LAW OF SUPPLY AND DEMAND



. LAW OF CAUSE AND EFFECT



THE NINE CLASSIC BUYING TESTS

TABLE #2

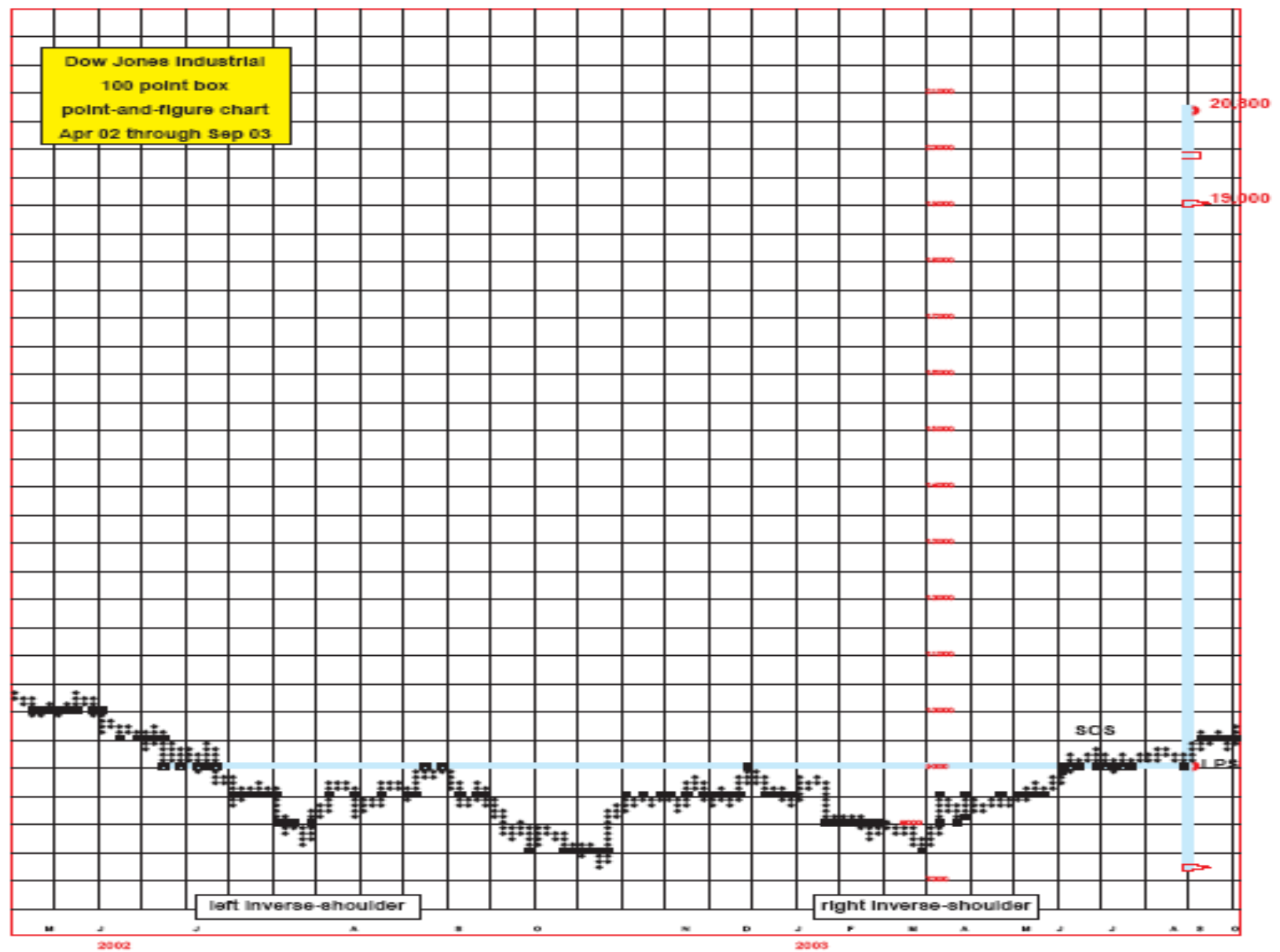
Wyckoff Buying Tests: Nine Classic Tests for Accumulation

Nine Buying Tests (applied to an average or a stock after a decline)*

Indication:	Determined From:
1) Downside price objective accomplished	Figure Chart
2) Preliminary support, selling climax, secondary test	Vertical and Figure
3) Activity bullish (volume increases on rallies and decreases on reactions)	Vertical
4) Downward stride broken (i.e., supply line penetrated)	Vertical or Figure
5) Higher supports (daily low)	Vertical or Figure
6) Higher tops (daily high prices rising)	Vertical or Figure
7) Stock stronger than the market (i.e., stock more responsive on rallies and more resistant to reactions than the market index)	Vertical Chart
8) Base forming (horizontal price line)	Figure Chart
9) Estimated upside profit potential is at least three times the loss if protective stop is hit	Figure Chart for Profit Objective

* Adapted with modifications from Jack K. Hutson, Editor, *Charting the Market: The Wyckoff Method* (Technical Analysis, Inc., Seattle, Washington, 1986), page 87.





Trader Psychology and Mental Discipline

Richard D. Wyckoff observed many years ago that the mastery of a sound technical analysis methodology was only one half of the game of speculation in the securities and commodities markets. The other half of the game was the control of one's own emotions and the mastery of certain mental qualities or mental discipline. Wyckoff argued that "rigid self-control is half the battle. . . . You must operate with no emotions whatsoever . . . until you can learn to trade and invest without hope or fear you will not meet with all the success you should."

Wyckoff went on to cite the injunctions of a famed nineteenth-century cotton speculator, Dickson G. Watts, who said that "the qualities essential to the equipment of a speculator are judgment, self-reliance, courage, prudence and pliability. To these could be added another quality, patience." Wyckoff concluded: "If you do not possess courage, self-reliance, patience, prudence and pliability, cultivate those qualities. . . . You must train yourself . . . make a searching analysis of your own mental process."¹

Although this need for mental discipline in traders was recognized over 100 years ago, the serious study of trader psychology and concepts and techniques for understanding and enhancing the trader's mental discipline did not become popular until the late twentieth century. In his June 1994 article "Mind Games" in *Futures* magazine, David Nusbaum wrote: "Many traders are turning to psychological 'coaches,' eager to find an edge on the unknown they can control—their own behavior." He went on to report that:

This trend—of course—started in California. The study of the psychology of trading began in 1988 for the Zim's group, an informal

collection of money managers, retail and institutional brokers and independent traders named for a small hamburger chain in San Francisco where they first held meetings.

Psychology was the focus, says Zim's member Hank Pruden, also editor of the Market Technicians Association Journal, because following a mechanistic program is all right for beginners, "but not if you wish to be a world champion. . . . There are other elements involved, including the ability to trust your intuition to perceive things differently." In other words, using your head.²

Nusbaum's article profiled several popular "trader's coaches" and their techniques. Notable among them were Mark Douglas, author of *The Disciplined Trader: Developing Winning Attitudes* (Upper Saddle River, NJ: Prentice Hall Press, 1990); Charles Faulkner of Mental Edge Trading Associates, Chicago; and Dr. Van K. Tharp of the Van Tharp Institute in Raleigh, North Carolina, who at the time of publication had written five books on trading psychology.

Starting in 1988, I collaborated with Tharp on a study of trader psychology and mental discipline. Our collaboration culminated in the creation of "The Ten Tasks of Top Trading," which led to an article that was ultimately published in the *MTA (Market Technicians Association) Journal*, Winter 1992-1993.

I was inspired to create the "Seven Tasks of Top Trading" after reading John Sweeny's article entitled "Van K. Tharp, Ph.D.: Trader's Psychologist" in the April 1987 issue of *Technical Analysis of Stocks & Commodities (TASC)* magazine. In the article, Tharp was quoted as saying that, based on his training, experience, and six years of research and testing, he was convinced that "Everything is psychological in terms of investing. So it's really understanding those psychological variables that are most important for winning and losing. . . . For example, each system typically has a number of discrete trading steps that one must follow and each step is associated with some distinct psychological state. If you follow the steps but you don't have the right psychological state associated with it, you're going to be in trouble."³

That interview in *TASC* prompted me to start thinking about the possible task steps and corresponding mental states. I came up with a model composed of seven different tasks and the mental state appropriate for each task. Table 8.1 is the original model that I created to share with Tharp and the members of the Zim's group.

I called the model "Know How by Hobbes." *Know How: Guided Programs for Inventing Your Own Best Future* (San Rafael, CA: FuturePace, Inc., 1986), by Leslie Cameron-Bander, David Gordon, and Michael Lebeau, is a Neuro-linguistic Programming book, and Hobbes is the

Putting it all together: Ten Principles for a Trader to Live By

The Ten Principles

1. Be your own boss: Create a "sealed room" for yourself and commit yourself to "only one client."
2. Leapfrog your competitors: Gain the winning edge by acquiring high-concept and high-touch talents for the twenty-first century.
3. Learn the Wyckoff method of technical analysis and master the Wyck-off art of speculation.
4. Become the complete trader: Play the role of the Composite Man.
5. Always be disciplined: Follow through your trades with the Ten Tasks of Top Trading.
6. Build your trading systems on the solid, scientific foundations of behavioral finance.
7. Use decision support systems to help set up your market timing.
8. Test your trading system and train yourself to use it via the action sequence method for active learning.
9. Adopt a planning and control process.
10. Integrate the Three Skills of Top Trading and make them an inseparable part of yourself.

Praise for The Three Skills of Top Trading

"Professor Pruden's new book, *The Three Skills of Top Trading*, is unquestionably the best book on a specific trading method and the necessary attributes for trading that I have read. His logic, understanding of human foibles, and use of the Wyckoff method of trading are broadly referenced, readable, understandable, and entertaining."

— Charles D. Kirkpatrick, II, CMT, coauthor of
*Technical Analysis: The Complete Resource for Financial Market
Technicians*, Editor of the *Journal of Technical Analysis*,
and board member of the Market Technicians Association

"At long last, someone has taken the time and effort to bring the work and insight of Wyckoff to wider public attention—and Hank Pruden has done so masterfully, with great clarity and eloquence. Hank has taken the best of Wyckoff's work, combining it with the essential aspects of trader discipline and psychology, to provide a highly readable and particularly useful guide to trading. MUST READING!"

— Jacob Bernstein, www.trade-futures.com

"Hank Pruden puts all of the elements needed for successful trading into one volume. This book not only belongs on every trader's shelf but should be close enough for continuous reference."

— Martin J. Pring, President, www.Pring.com

"Dr. Pruden has brought together his lifetime of work in developing a modern approach to analyzing and trading the markets built upon classic market analysis from the early part of the twentieth century and topped off with modern-day tenets of behavioral finance and mental state management."

— Thom Hartle, Director of Marketing for
CQG, Inc. (www.cqg.com)

"I usually consider a book to be well worth reading if it gives me one paradigm shift. I believe that this book will give the average investor a lot more than just one."

— Van K. Tharp, PhD, President, Van Tharp Institute