10 Differences between Masters of Wall Street & Retail Investors

How to trade like the 10% of Master Traders that profit 90% of the time?

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First Edition

Introduction

I have being a trader for more than 12 years.

At the age of 16, I begin my trading career with commodities before investing in stocks, financial indexes and Forex. Like most amateurs, I gave my fair share of "school fees" to the market. I'm fortunate to witness the major up and downs of the financial market, starting from 1995 Stock Bull run to 1997 financial crisis, 1998 Bull run of the NASDAQ, 2000 crash of the NASDAQ, 11th September 2001, 2003 SARS, 2005 Bull Run of the Asia Stock markets.

It has been statistically proven that 90% of the people who trades lose money in the Stock market. Yet everyday, thousands of traders from different parts of the world would rush into the market to pit their wits, knowledge and capital, hoping feverishly to make big bucks.

Although billions are made and lost during major market upheaval, Wall Street Masters manage to prosper while retail investors lost their fortune.

How is the Wall Street Masters managed to make profits CONSISTENTLY? What differentiates the Wall Street Masters from the Retail Crowd? Is there a common denominator, characteristic, habits that sets the Masters apart from the rest?

I studied numerous "advanced" trading techniques but none is able to generate consistent profits over a period of time. Instead of searching for the "HOLY GRAIL", I came to realize if we can CONSISTENLY avoid common mistakes of the Retail Crowd and internalize the successful habits of the Wall Street Masters; we would be getting CONSISTENT results like the pro.

It has taken me more than 5 years of interviewing financial gurus and reviewing intensively over 200 graduates trading records to summarize 10 major differences between the “Gurus” and the “Wannabes”. I’m not surprised if you are already practicing certain good trading habits written in this book. In order to achieve financial freedom, it is now your job to remove yourself from the herd and move towards the Greats.

And do me a favor; email me your ideas, comments and complaints. I want to know what you think.

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Notice

TABLE OF CONTENTS **Page**

1. Preservation of Capital is Always Top Priority

All Masters set their top priority to preserve their capital, which is the cornerstone of his investment strategy. Without capital, one can never make money from the market. It is logical. Retail Investors, on the other hand, believes in making a lot of money in a single trade i.e. they will dump all their trading capital in a single trade. As such, when the market turns against them, they will be totally wiped out!

Capital Preservation, in simple terms, involves money management. This is especially more important when you are trading in the high volatility futures market, where you need to take note of your Initial Margin and Maintenance Margin.

Initial Margin (IM)

IM is the minimum amount of trading capital that the Futures Exchange requires before you can initial a single trade. Calculation for IM is as using Hang Seng Index (HSI) as an example:

Assuming HSI is currently trading at 20,000 points and the value of 1 HSI point is SGD10, you will have to pay 20,000 x 10 = **SGD200,000** in order to purchase 1 HSI. This is obviously beyond the means of most retail investors. In order to make it affordable to retailers, the Exchange will normally take 5% of the actual value of 1 HSI as the minimum trading requirement, which is the IM for that market.

Total Value of 1 HSI	= 20,000 x SGD10 = SGD 200,000
Therefore, IM	= 5% of Total Value = 0.05 x SGD 200,000 = **SGD 10,000**

This implies that you must have SGD 10,000 before you can buy or sell 1 HSI. However, depending on the volatility of the market, the Exchange has the right to increase the percentage so as to deter the retail crowds for entering the market.

Maintenance Margin (MM)

MM is the minimum amount of remaining trading capital after you enter the trade. MM is usually 70% of IM, which varies between Brokering Firms.

Taking the example of HSI,

MM = 70% of IM
= 0.7 x SGD 10,000
= SGD 7,000

Let's assume you have a trading capital of only SGD 10,000 and have entered to buy or sell HSI. The moment the market turns against you and you loses more than SGD 3,000, your broker will call you to let you know that you are in margin call i.e. you have to top up your account in order to carry on trading. Most brokering firms will allow you to top up within 3 days. If you didn't top up by the end of 3 days, the broker has every RIGHT to close out your position at any price he wants without seeking your consent!

Master Traders will NEVER allow themselves to be in Margin Call. Assuming trading capital of SGD 100,000, one is able to purchase 10 contracts of HSI (Trading capital / IM = 10). Master Traders may only enter the maximum of 8 contracts instead of 10.

2. Passionately Avoid Risk

Masters constantly seek to lower their trading risk. Warren Buffett, 3rd richest man in the world, is well known for making sure that risk is kept to the minimum by doing strictly investing in industry that he can understand. That's one of the reason why he stay away from technology stock no matter how attractive the potential upside may be, simply because he doesn't understand the nature of the industry. Yes, Warren Buffett may seen to be potentially miss out a sizable profit but by minimizing his risk, he is confident of generating profits consistently.

Despite having lost their fortune in trading, most retail investors usually allow emotions to affect their trading decision. They have the mindset that big profit can only be made by taking big risks, which is absolute wrong.

How do Masters reduce their risk?

1) Master Traders will never trade based on their feeling but uses their preferred trading indicators (e.g. Moving Average, Elliott Wave, Bollinger Band, etc) to decide when to enter the market.

Although the indicators may differ, Master Traders will never allow their emotion to affect them. Even if the market is rallying up, Master Traders will not be affected by greed and enter trade unless their indicators say so. Similarly, they understand that there will be a bit of volatility in the market and will only exit their position if their indicators say so. In fact, trading is so systematic that they can write a software program to calculate the entry point and exit strategy!

2) Master Traders ONLY enter trade when they are ABSOLUTELY certain of making profits.

Master Traders enter into a trade ONLY when ALL their indicators are in synch. They are obsessed with finding every possible means to stack their odds in their favor.

3) Master Traders only trades when they are in the right emotional state.

If Master Traders are not feeling well, confused, fearful, arrogant, basically all negative emotions, they will rather not trade since the emotions will likely affect their trading decisions. Why take the risk? It is always good to have the money by my side instead of passing it over to the market.

4) Master Traders resist the temptation to trade everyday

Statistics have shown that Master Traders generally trade less than 1 times a week, which comes as a surprise to most Retail crowd. By trading less, they are able to make better judgment on the financial market as a whole, thereby increasing the odds of success.

5) Master Traders do not hesitate to cut their position the moment the market turns against them.

The reason why Master Traders are able to make CONSISTENT profit is simply they respect the market. There is no 100% certainty in a market. As much as they are able to stack the odds in their favor, Master Traders know that if the market prices are the most accurate indicators. By taking small losses, Master Traders are able to keep their trading capital way above their MM. Through the process of taking small losses and maximizing their profits, Master Traders are able to amass HUGE wealth CONSISTENTLY while Retail Investor remain clueless why they are still playing the “zero sum game”.

3. Develop Your Own Unique Investment Philosophy

Master Traders develop their unique investment philosophy that fits their personality, abilities, knowledge and trading objectives. No two highly successful investors have the same investment philosophy. Some traders like to take positional trades in stable blue chip counter while others may like the fast paced, high volatility futures market, doing only intraday trading. Some prefer to trade in the day while others likes to trade at night. To them, Trading is no longer an uncertainty or a gamble but a financial tool for success.

On the other hand, Retail Investors are constantly searching for the “Holy Grail” – the single trading technique that will guarantee them 100% profit every time they trade. As the trading technique may not fit their character, confusion and frustration will set in and eventually lead to unnecessary losses.

There’s no simple solution. You have to trade and update your trading journals consistently for at least 6 months in order to know your trading habits, likes and dislikes. For example, you may want to trade Asian markets in the daytime and US markets in the nighttime concurrently for a start. At the end of 6 months, you will realize normally when do you make profit i.e. Do I usually make money in the morning or afternoon? Which day in a week do I consistently make a lot of profit? Why and how do I lose money?

For example, I have 1 student who consistently makes money in the morning but loses her profit in the afternoon. After reviewing her trading journals and speaking to her one to one, I realize that she has to take care of her kids in the afternoon and are not able to concentrate on trading. Her sense of guilt for not taking good care of her kids causes her to make poor trading decisions, thereby leading to her loses. As such, I shared with her only to trade in the morning when her kids are not bothering her. She now spends quality time with her kids while enjoying a steady stream of income trading futures in the morning!

4. Develop your own, personal system for selecting, buying and selling investments

Other than having his own investment philosophy, Master Trader develops, test and refine their personal system for selecting, buying and selling investments. They usually select the market that can amplify his effort into wealth and therefore doesn't trade many products.

Most Retail Investors fall into the trap of changing their system frequently whenever they find that their system doesn't give them their expected success ratio.

So, the question then is "How do you know which is your investment philosophy"

For a start, you may ask yourself the following questions:

1) How much of a risk taker am I? How much risk am I comfortable of taking?

Financial Planners have a systematic process of assessing your risk ratio by looking at your monthly income, age, future financial needs, and investment objective. One golden rule: If you can't eat or sleep in the night consistently whenever you enter into a trade, you are likely to be risk averse or have no faith in your trading system

2) How comfortable am I to have an open position for weeks? How much margin do I have?

Knowing this will determine whether positional trading or intraday trading is more suitable for you. Positional trade in Futures Market never works well for traders with low margin cos normal market movement (e.g. Nikkei Futures market has a trading range of about 200 to 300 points, which translate to about SGD 2,000 per

contract winnings or losses within a day) will wipe out their trading capital within a matter of days.

3) Are you comfortable with high volatility? Do you enjoy looking at fast price movement on the screen for hours at end?

Those traders who prefer significant price movement will find it difficult to trade in commodities market such as oil or gold where it takes days for the market to reach your profit point. On the other hand, less risk adverse traders may prefer not to stare on the screen everyday lest they get emotionally worked up for nothing. As such, trading in Oil or Gold futures may be suitable for them.

How would you know it doesn't work well? Have you tested out in other markets? Maybe there is certain big news in the market that causes the market to be extremely euphoric or bearish? You need to give the trading technique time to see if it is consistently giving you the profits.

Some Retail Investors may go for numerous financial trading seminars. Due to their excessive exposure, they may "mix and match" different trading techniques together unconsciously, causing great confusion as to when to enter and exit the market.

Frankly, there is no quick solution to this question. You have to experience the system for at least 3 months to see if you are comfortable with it.

The bottom line is this: When you can trade without emotions and have that inner confidence of making money consistently without having sleepless night, most likely the trading technique may be suitable to you. Do note that trading system, like any other system, is subjected to review and changes since our situation changes.

5. Buy as much as You can if You are Right

Master Traders do not believe in diversification. Since they only trade when all the indicators are aligned, they will always buy the qualified investment as much as they can without compromising on his margin. Should there be 2 markets having all the indicators aligned, they will decide which investment is the better choice and select them rather than buying both concurrently. Another advantage of putting in a big position is savings on the brokerage.

Retail Investors are uncomfortable to take a huge position on any investment even if he knows that it is a sure win trade. The lack of conviction resulted in mediocre profits, which are not enough to offset his earlier losses. Instead of taking 1 huge position, many would prefer to diversify, thinking that it will be a safer alternative e.g. buying a few contracts in every Asian market instead of hammering hard on the sure win market. Assuming Nikkei is the sure win market, if NK fell, there is a high likelihood that the rest of the Asian markets will falls as well.

Allow me to share with you one of the classic Wall Street Folklore…

When Stanley Druckenmiller shorted the dollar against the mark and the market is moving in his favor, George Soros asked him, “How big a position do you have?”

“One billion dollars,” Druckenmiller answered comfortably.

“You call that a position?” Soros boomed “Double it!”

Druckenmiller increased the position to 2 billion and profited greatly from this single transaction.

6. Focus on After–Tax Return

Master Traders hate to pay taxes and other transaction costs. They will try their best to arrange their affairs legally so as to minimize their taxes. Paying unnecessary brokerages consistently will only lead to wealth depletion. As such Master Traders do not trade regularly but when they do, the huge position will guarantee cheaper brokerage and extraordinary profits concurrently.

Retail Investors overlook or neglects the burden that taxes and transaction costs place on long term investment. Most Retail traders enter multiple positions in the market to seek thrill and excitement without realizing that their effort is draining their profits.

Understanding the tax structure of your country

Different countries have different tax laws on profits made in Financial markets. Generally, most countries will place a tax on capital gains. In his book “Rich Dad Poor Dad”, Robert Kiyosaki engages full fledge accountant to advise him on tax matters. While most of us may not have the finance to do so, having a sound understanding of the tax structure will help to significantly lower down your tax payable.

Reducing Brokerage fees

Many brokering firms offer a electronic platform, which charges a lower commission as compared to calling up a trading test or individual broker. Most Retail Traders take for granted that the brokerage is fixed and didn’t bother to find out more. If your trading volume per transaction is high (e.g. buying and selling 20 to 30 contracts at a go instead of 1 to 2 contracts), most brokering firms would be glad to negotiate a better deal to maintain your loyalty to them.

7. Only Invest in What You Understand

Master Traders only invest in financial tools or markets that they can understand. This is especially important with the advent of varied financial derivatives. Without a clear understanding, you may lose a lot of money without knowing why. Be as Master rather than Jack of all things.

Retail Investors, on the other hand, do not realize that they are in the position to take advantage of profitable opportunities exist. For example, options trading and futures trading have gained popularity in recent years, especially in Asian countries. A growing number of institutional players have started to invest in these financial derivatives rather than the stock market to take advantage of the leverage. Instead of purchasing the stock and locking up the trading capital, options and futures trading allow investors to use significantly less capital to control the same amount of stock while gaining more profits concurrently.

However, financial derivatives do have their risk. There is an expiry date for options, warrants and futures. As such, if the Retail Investors are not aware, their potential risk is tremendous.

The good news are there are many websites that provides basic financial info for the general public e.g. www.shareinvestors.com, www.cnnmoney.com, etc. In addition, plenty of financial forums are available to answer your most pertinent questions.

Remember: Knowledge is POWER. Better understanding of the market, the financial instruments and the financial tools available would greatly reduce your risk in trading but be careful of free tips from analyst, who may be manipulating you to buy or sell a particular counter. Hence, developing your financial wisdom is critical to your success as a trader.

8. Refuse to Enter Trade that does not Meet Your Criteria

Although this point is mentioned earlier on in Chapter 2, having the discipline not to trade if the conditions do not meet your criteria is so important that I decided to reiterate this point again. Whether you made it big in Trading depends on the trades that you enter.

Master Traders always refuses to make investments that do not meet his criteria. They can effortlessly say no to everything else. Most Retail Investors lose money because they succumb to their greed. They lose even more money when they refuse to take small loses due to ego.

Everyone knows the importance of following the system. Every single financial gurus advocate following the system as the key factor in trading success. So why is it that 90% of traders still loses money for not following their trading system that was taught?

It happens to us all. Whenever the indicators are not congruent, the system tells us not to trade since it is not 100% sure win. But when we saw the market moves in our expected direction by a HUGE margin, the fear of LOSS seeps in so much so that we will enter trades regardless of the system especially when it happens a couple of time.

The reverse is also true. When our system told us to cut our losses, the very moment we do so, the market shot in our expected direction. Instead of potentially making a big profit, we take a small loss. And when this happens a couple of times, we started to rationalize and deviate from the system. No wonder, 90% of Traders lose money!

In my humble opinion, Trading is simple but not easy. Trading techniques are relatively straight forward i.e. if it passes this point you buy/sell, if indicator cross,

you enter trade, etc. But why is it not easy? Cos you need to stick with the system without fail for every trade.

Wouldn't it be easier and less frustrating if we did not enter in these "uncertain" trades in the first place?

World Greatest Stock Trader, Jesse Livermore once said that one should never break his own rules. He only loses whenever he broke them.

9. Do Your Own Research

Despite their high net worth, Master Traders industriously hunt for new investment opportunities that meet his criteria. It is not uncommon for them to work for 18 hours per day. To them, Trading is like a consuming passion. All Master Traders believe in their own research and take “hot tips” with a pinch of salt. They do not blindly follow and seek to verify whether the hot tips carry actual value or not.

Retail Investors consistently seek the “Holy Grail” by following the ‘hot tip of the month’ provided by some “experts” or his broker. As they rarely make a deep study of any investment before buying, it is of no surprise that their trading money will deplete in matter of days.

How do Master Traders build their Financial Wisdom?

1) Subscribe to e-Letters, Financial journals, magazines, newspaper etc

It is interesting to see how institutional players manipulate the market through these mediums. Most analyst will seek to explain why the market rally or plunge. E.g. Because Oil prices have drop slightly therefore the US market rally upwards. This doesn’t make sense when Oil prices have move up substantially before doing a minor correction.

2) Attend financial seminars especially those that were organized by speakers they come to respect.

It is always important to never stop learning from the best. They may have a important trading philosophy that can boost your profit significantly in a long term

3) Review the financial market daily (i.e. commodities, spot, currency markets) trying to understand the reason for the market movement

Financial markets do not exist by itself but inter-related with the whole world. What happens in Asian market will impact Euro and US markets e.g. Dow plunges more than 400 points on 27th Feb 2007 because Shanghai index plunge by 3%. By reviewing the financial market and comparing it with the analyst report, we will be able to understand how the world economy is functioning and therefore made better informed decision.

4) Network with other Master Traders

Other Master Traders have expertise in different markets and different tools. Networking with like-minded individuals reinforces basic trading philosophy as well as providing an avenue for individuals to leverage on each other strength and expertise, thereby generating greater profits as a group.

10. Have Infinite Patience

Master Traders have the patience wait indefinitely for the investment opportunity that fits their trading rules. If they know that something is brewing and there is an opportunity to make money but patient is required, they will wait. During the ERM crisis, George Soros shorted 10 Billion of the Pound against the Bank of England, in 1992. But he started planning it since 1988!

Most Retail Investors fear of missing money making opportunity. As a result, they felt that they have trading at all times. Such Scarcity mind set made for them the perfect prey for the bull and bear trap that are set up by the market manipulators.

I know… I know…

It is easier said than done. I'm pretty sure that I'm not the first person who told you this. Here's my suggestion to build patience:

1) Do not stare at the screen for long hours at all times.

Watching price fluctuations will only lure you to trade.

2) Write down 10 incidents of not having patience and thereby missing out the valuable trade.

The more incidents you can think of, the better it is. Writing down the incidents makes your losses seems bigger instead of talking about it.

3) Remind yourself the losses that you made trying to trade everyday instead of waiting for the Golden OPPORTUNITY.

Associate IMMENSE PAIN of losing money due to trading everyday and not having patience e.g. Not able to buy a air ticket for your parents, Missing out a luxurious spa holiday, etc

4) Associate IMMENSE PLEASURE for having the patience.

Think of all the good things (e.g. Material needs, Security, Self-Confidence) with the money made. Visualize the happy faces on your spouses, the exquisite taste and sweet aroma of fine dinning, the sound of your friends tapping on your shoulders for having the discipline to be patient.

5) Write down your trading system on a cardboard and stick it beside your computer screen.

Made sure you read out your trading rules out loud everyday before you trade.

Thanks for reading, and I hope you have enjoyed this material.

If you have any questions or comments, or there's something that I need to explain better or correct, please email me at

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Enjoy!