

The Van Tharp Institute

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### Tharp's Thoughts Weekly Newsletter

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#### Workshop Special

Van Tharp's Signature Workshop for Traders and Investors

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## [Peak Performance 101](#)

March 11-13, 2006  
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***"Tharp's disciples swear by the results." -- Forbes Magazine***

You'll leave this investment "Boot Camp" knowing, for the first time in your life, why some people consistently make profits over and over again, while other investors and traders are erratic and unsuccessful.

More importantly, you'll be able to overcome self-sabotage and develop rock-solid discipline in your performance in the markets.

#### Quote of the Week

Abraham Lincoln's Birthday is February 12th

"Am I not destroying my enemies when I make friends of them?"

Abraham Lincoln

[Learn More...](#)[Register Now](#)**Feature****The Characteristics of Experts**

By Michael Covell

**Are You an Expert?**

Michael J. Mauboussin, Legg Mason Capital Management, outlines in a recent whitepaper the "Characteristics of Experts":

*"Given that experts exist in diverse domains, psychologists wondered whether they have much in common. The answer: a resounding yes. Research on expert performance reveals seven robust and universal characteristics:*

- 1. Experts excel in their own domains, but not outside their domain. Expertise is domain specific.*
- 2. Experts perceive patterns in their domain.*
- 3. Experts solve problems much faster than novices. Lightning chess, where players only have a few seconds to decide a move, illustrates this point well.*
- 4. Experts have superior short and long-term memory. When tested, experts appear to have recall capacity that exceeds the limits of short-term memory.*
- 5. Experts represent problems at a deeper level than novices...experts sort by principle-based categories, while novices sort more literally, reflecting the problem's surface features.*
- 6. Experts spend a lot of time solving problems qualitatively.*

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7. *Experts have a strong sense of their own fallibility. Experts tend to be more aware of their errors, why they fail, and when they need to check their answers."*

I have been fond of Mauboussin's logic for years. He nails it head on most all of the time. How many people really ponder his views on "expertise" in terms of their trading? I say not many. For example, I came across a "risk capacity" survey online from a financial planning firm. Here is one of the questions with the answer choices:

*How would you rate your knowledge about investing in general and more specifically, the relationship between risk, return, and time?*

- A. *significantly below average*
- B. *below average*
- C. *average*
- D. *above average*
- E. *expert*

The right answer is not the point here. If the great traders, the experts, are living Mauboussin's seven points, how does it help to pose the question above? Isn't the question above just an over-simplification to make people feel good? Doesn't it let them avoid the heavy lifting needed for real trading excellence? The firm that poses the above question also makes these assertions on their website:

1. It is virtually impossible to beat a market over time through active investing.
2. Indexing is backed by Nobel laureates who have provided unbiased, rigorous, empirical research, most notably the Modern Portfolio Theory.
3. Stock pickers are analogous to gamblers who rely on feelings and emotions when making bets.
4. Time pickers or market timers move

### Did You Know...

Van Tharp is featured among Jack Schwager's original Market Wizards.

The Market Wizards books are cited by top traders as essential reading.

Here's a direct link to Amazon if you want to learn more about it. [Market Wizards](#)

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money in and out of different investments in an attempt to profit from short-term cyclical events, which is a futile endeavor.

5. Manager picking is not a reliable practice because the past performance of money managers does not predict their future performance. Star money managers fall from their stature sooner or later, since their stellar performance is attributed to Lady Luck rather than skill.

Whoever wrote the above 5 points has not read [Market Wizards](#), [Fortune's Formula](#) or [Trend Following](#).

Whoever wrote those 5 points doesn't believe "expertise" is possible.

But it is possible. There are many trading experts or Market Wizards who have been whipping the market for decades. Consider one of the great trend followers, David Harding of Winton Capital, who was recently asked: 'Because recent performance has been good, does that necessarily mean that future performance will be bad?' His answer:

"Au contraire. There is a danger of people over extrapolating recent good performance into the future and being too optimistic about what we're going to achieve. But, equally, there is no evidence of mean reversion, in the sense that whenever we have a good period that's inevitably followed by a bad period or that when we have a bad period that's followed by a good period. It's a biased coin tossing exercise. It's like tossing coins. Luckily we strongly believe our coin will land profit side up, rather than loss side up, 60 percent of the time. But there is no forecasting the future of our returns from our recent performance. However much your feelings tell you something, your gut tells you something, the gut is very misleading in this context."

David has that "expertise" Mauboussin speaks to. In my conversation with David he stressed that he can always tell a client how much risk he is taking, but he can never tell you how much he will make. He is

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Dr. Van Tharp's Trading  
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and investors.

clearly focused on his own fallibility.

Are you focused on your own fallibility?

About the Author: [Michael W. Covel](#) is the founder and President of [Trend Following](#). A researcher of the most successful Trend Following investment managers, he has been in the alternative investments industry consulting on Trend Following to individual traders, hedge funds and banks for ten years. His best selling book, [Trend Following: How Great Traders Make Millions in Up or Down Markets, New Expanded Edition](#) (Prentice Hall, November 2005) is a complete and concise guide to trend following.

Mr. Covel is also Managing Editor at [TurtleTrader.com](#), the leading Trend Following news and commentary resource since 1996. TurtleTrader, one of the largest & strongest trading community on the web with over 7.5 million unique visitors since its inception, also functions as a resource center for the Trend Following Educational Course.

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## Trading Tip

### Trading Tip

#### Passive vs. Active Investing

by D. R. Barton, Jr.

Some interesting new research is hitting the publication circuit and challenging the notion of how Americans are investing. The new report gives some compelling evidence that U.S. based investments are

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really much more skewed to the passive investing style than previously thought.

Passive investing, in this context, is the same as index investing. The most popular and well known passive investing tools are mutual funds that mimic the performance of the S&P 500 Index. These are vehicles that track many different indexes (the NASDAQ and Dow, to name two) and would still be considered passive investing vehicles.

The reason these are considered passive is because investors tend to buy the index-based funds and hold them for long periods of time, hoping to earn the same return as the broader market over time.

There are clear advantages to the passive investing strategy:

- Someone else manages the “basket of stocks” that track the market’s performance, meaning that minimal time is required.
- You have no single stock risk (the risk of bad news that could move a stock’s price substantially in a single day).
- You are tracking an asset class with a history of long-term appreciation.

And, of course, there are disadvantages:

- The performance of the fund will almost always be less than the true index because management fees are subtracted.
- The broad markets are actually quite volatile when compared to the returns generated.

As one measure of the amount of money being invested, research by the Financial Research Corporation (as reported in *The Economist*) showed that 13.8% of mutual fund dollars invested go into passive funds, and that this number is at its all time high.

Next week we’ll dig into some new research that

suggests passive investing actually accounts for a much larger percentage of the overall volume on Wall Street.

Until then –

Great Trading!

D. R. Barton, Jr. is the Chief Operating Officer and Risk Manager for the Directional Research and Trading hedge fund group. D. R. has been actively involved in trading, researching, and teaching in the markets since 1986. D. R. has taught extensively in many investment areas including intra-day trading, swing trading, and cutting edge risk management techniques.

His writing credits include co-authoring *Safe Strategies for Financial Freedom* and co-creator and contributing author on *Financial Freedom Through Electronic Day Trading*.

### Listening In...

#### From Van Tharp's Mastermind Forum

Inside and Outside

Author: TrendTrading

When people come up with names like "supertrader" aren't they talking about the external?

Isn't trading entirely personal? The guys that talk about others are not concentrating on their "internals"...

Reply To This Message

Re: Inside and Outside  
Author: PMK

My belief is that we are all just newbies (and always will be), but some are just more 'new' than others :-). If I ever imply I am an 'expert' trader please just shoot me before my trading account blows up.  
Paul

Reply To This Message

Re: Inside and Outside  
Author: TrendTrading

The point is that for me to place my orders when have to, I need to have a silent, calm, uninterested, detached dialogue with the "executor" in me, who in some way or another, and very minimally, entertains little comments with the "trading system designer" in me.

If that conversation becomes significant my trading is in trouble, for various reasons. One of them being that the "executor" is unable to execute because the "designer" points out something new, and the "undisciplined" [part of] me is willing to try it out with real money and one of the two take place:

- 1) An order which has no reason to be is executed and
- 2) the REAL opportunity goes (one right after the other)

Then the "concerned" in me is hurt ... and in no time - 2 to 3 days we have this:

- 1) bring back the cigarettes
- 2) stop attending karate classes
- 3) test out more "ideas"

And, the REAL opportunities just go.

Man - I'll tell you this - "to BE" is difficult. It's a constant effort, more so in the beginning than in the end.

I traded a trend down and pyramided the thing 8 times risking only 2.5% of my account every time and updating the stop to the previous entry, to cash in the whole thing as soon as it reverted more than x amount.

Two weeks latter it did and the trend retraced the whole trend up of 3 months. That fast and didn't look back at all.

Problems started when I attempted to pick the bottom - suing 1 min charts, momentum, etc, all stuff I do not use in my method. So I paid the price - 5% for that. And it wasn't fun.

Anyway, am now back to the karate classes, the rational diet, the proteins and vitamins and nothing to do with Philip Morris.

We go get all we deserve. I got fed up fast!  
Tough stuff trading! The less opinion you have and the less need you have to engage with it emotionally, the better it is.

A friend! (Bund Trader)

Reply To This Message

Re: Inside and Outside  
Author: Van

I have a supertrader program, but it generally refers to the changes I expect from them during two years of coaching.

Editors Note: As Always...read the complete and unedited thread at the link below. Look for the title above, Inside and Outside, to read many more posts on this topic.

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[Does Your System Still Work in Changing Markets?](#)

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