Phantom’s Gift

Abridged by Daniel WANG (王丹) | PaddingtonMacro@SPECTRUM CAPITAL LLC.
PC: www.paddintonmacro.com ; Mobile: http://m.paddingtonmacro.com

Table of Contents

Phantom's Insights

Being wrong is what trading is all about. BEST LOSER is the long-term WINNER.

Correct knowledge and the ability to change behavior are the most important parts of successful trading.

Behavior modification, without doubt, is the key to trading success:

- not only in how we think but also how we ACT in certain situations
- must ADAPT to changing situations over which we have no control, must CHANGE the situations over which we do have control

Don't have to make SELF-LEARNED mistakes (costly), always better to learn from OBSERVED mistakes (others').

2 important rules:

- Rule 1: focus on how to take losses
- Rule 2: focus on how to increase position size when you're winning

Preparation for Trading

Required to work with your positions and DON'T let the market work on your positions. MUST always act promptly and deliberately within your plan. BE IN CONTROL of positions and NOT DELEGATE them to the markets.

- Mentally as well as physically and emotionally Prepared.
- Must establish a ROUTINE to set up the environment of each trading day, allow at least 1 hour prior to the opening.
    - should *exercise from 10~20 minutes*, keeping mind sharper
    - should spend 1 or 2 minutes *giving thanks to your higher power* and explain what you are going to do with the funds earned, DON'T be selfish (subconscious reason for being a successful trader)
- Take care of minor details early, and will have a routine. It's more of a POSITIVE REINFORCEMENT of what you're expecting from trading

---

Rule 1: It's about being WRONG

Rule 1 addresses the SWIFTNESS needed in keeping your losses as small and quick as possible. It won't always prove to be correct, but you will stay in the game this way.

Rule 1 is designed to protect you from ever being in a situation of distress. In distress you will make the wrong decision in trading most of the time.

BIG money is on the surprise side, BIG LOSERS are on the familiar side or the popular side of the trade (expected side). *All of these big losers are doomed from the start* unless they're given the knowledge of what the market can do to them.

We NEED to make our best assumption of what is POSSIBLE. We MUST plan for that assumption in trading AS LONG AS it's a POSSIBILITY and NOT JUST WHEN it's PROBABLE.

Biggest Mistake in trading: plan only for the probability side and that is always what considered as the winning trade. Instead, MUST plan for the losing side.

Trading is not a favorable game in most circumstances, and that's what we MUST use as our assumption in trading. *The big MISTAKE made by traders is thinking and expecting trading to be a favorable game.* The market spends much time in an UNPREDICTABLE mode.

The correct way to control positions is to only hold them once they prove to be correct.

- Let the market tell you your position is proven correct, but never let the market tell you that your position is wrong.
- Your exposure and risk are much higher if you let the market prove you wrong instead of your actions removing positions systematically unless or until the market proves your position correct.

In a losing game such as trading, we shall start against the majority and assume we're wrong until proven correct! We don't assume we are correct until proven wrong!

- Positions established MUST be reduced and removed until or unless the market proves the position correct!
  We allow the market to verify correct positions, don't let the market tell you that you're losing money.
  You decide/define what is correct as proved by the market according to your plan!
  Most traders do it the opposite by doing nothing unless they get stopped out, and then it is NOT THEIR DECISION to get out at all - it's the MARKET'S DECISION to GET YOU OUT.
- Your thinking should be: when you position is right, you have to do nothing instead of doing nothing when you're wrong.
  Daniel's note: here, "when you're not proven right" = "when you're wrong".
  You're more objective in your trading this way than letting a negative reinforce your thinking. This way only let good trading reinforce your thinking and actions.
- It is YOUR JOB to know you are wrong and NOT the MARKET'S JOB.
  Most traders just let the market do its thing. The CORRECT way is that YOU DO YOUR THING and CONTROL your

positioning.

Rule 2: It's about being RIGHT

It's not a rule learn by making a mistake, it's a rule learn by being rewarded for using the rule. Press your winners CORRECTLY without exception.

The intent of Rule 2 is twofold:

- Reinforce your correct position both mentally in your thinking and your execution.
- Increasing the size of your position.
  Hidden benefits: it will actually keep you from over-trading from the entry through to the end of the position if used properly.

Must have a QUALIFIED PLAN of adding to your position once a trend has established itself. The proper criteria for adding positions depends on time frame of expectations of your trade plan. What's a correct way of adding in one trade plan may not be in another. Being right doesn't in itself make the most amount of profit.

A total position is a series of positions until the complete expected position is established. SHOULD ONLY have entire position established upon getting the move as expected.

Always a good reason for adding to a winner: traders usually tend to doubt the position unless they reinforce the correctness of that position. Adding to the position CORRECTLY best does this.

Each add onto an original position should be done in smaller and smaller steps so that a pyramid isn't established that will hurt the trader in a minor reversal. You MUST at ALL TIMES be able to put only a portion of your expected position on at entry and be able to AT LEAST DOUBLE your size somewhere along the route of an expected move.

Daniel's Note: Phantom's method is 3:2:1 ratio in establishing 3 levels of positioning, doubling the initial position.

Suggestions to day-trading (there're restrictions for day trading because TIME is not Friend here):

- add when the position is proven correct and then add at a proper retracement
- only put all positions on at once

The market is deciding how large your position will be in this day-trading case.

Trend traders will get larger when they're correct, but day-traders will start larger and get smaller when they are wrong. Day-traders can be large when they're wrong, but trend traders will never be large when they are wrong. This is due to the nature of loser's game for day-traders. By reducing your positions when wrong, your exposure is not extreme for a day-trader, provided Rule 1 continues to be followed. Exposures and risk are also an element of time in a position. That's the edge day-traders expect to work to their advantage. Trend traders are expecting higher probabilities in smoothing out the swings. Adding CORRECTLY regardless of your time period is useful in making bigger gains in the long-run. Day-trading is certainly a shorter-run. *A day-trader should cheapen the cost of what they have, and to do this, you almost certainly have to have your biggest position on first.*

At ALL TIMES during the trade, it's important that Rule 1 be in your plan. This INCLUDES when you're adding to your positions to protect your trade from any major reversals, which often happen.

"To love to be right" is your enemy. Your motivation MUST be to love to do the RIGHT THING in trading by either REINFORCING correctly your position or REMOVING it should it not prove to be correct.

When you think you're right in the market, it's JUST the BEGINNING of your trade, NOT the time to take your profits.

You MUST have a plan to be bigger when the market is going your way. You MUST understand that YOU are NOT the one who will determine your market position size. It is going to be the MARKET and MUST ALWAYS BE the MARKET.

Trading with Rule 1 and Rule 2

Rules are not meant to be broken for your own sake. The rules bring you to a no judgment-type approach. You will either be proven correct with your positions or you simply get out of the positions. *You don't stick around to get hurt with exposures if the market is not proving you correct.*

We let the market prove us right rather than wrong, and that's the reverse of common thinking. We do assume we are wrong and in an unfavorable game until proven correct, and that's also reverse image. We do press winners, and that is the reverse of taking losses. You really are looking at a reverse image.

Most of your money from trading is going to come from trades that take off rather quickly from when you put them on. Just LOOK at most starting trends and the good runs you have once the market turns. The chop-chop markets aren't going to give you good income.

You can NEVER let your guard down in trading. You MUST always know what the next step is for you in any situation! You REHEARSE your criteria of a trade, and it becomes SECOND NATURE.

You start out by not knowing what the trade will ever do when you put it on. Trading is a loser's game. You must learn how to lose. The biggest loser who loses small will continue in the game.

What you can do is to eliminate your reactions to what the market does to you. You do this by not giving the market the power to control your position or emotions with adverse market moves. You start out expecting the adverse market moves and plan your action based on those outcomes.

When you place a trade, don't ever think this is the only trade to make. There are thousands of trades you can make. You are not going to miss a move for long if you trade correctly. You are not going to chase markets if you trade correctly.

The true purpose in trading really is NOT ONLY to make AS MUCH MONEY AS POSSIBLE, but most important, to make it the LEAST AMOUNT OF TIME.

There are NO long-term trades! ONLY trades that turn into long-term held positions!

Behavior modification can take place in many forms, but you need a rule to show you what must be done at all times. The logic step is to have the plan in place for the next step before you put on the trade.

As long as you have Rule 1, it makes no difference if you're wrong. DON'T ever lose sight of Rule 1 when using Rule 2 .

Daniel's note: adding to winners, then market doesn't continue to prove right, then get out ASAP as Rule 1 with some profits ideally or even without profit.

Most traders will make a trade and lose a good amount and miss the next trade. Out of step with the market is bad and it gets worse.

Daniel's note: it's also about OPPORTUNITY COST, which is easily forgotten by most traders!

Behavior Modification

Behavior modification is one of the most important aspects in becoming successful in trading.

Behavior modification requires positive reinforcement and trading often is not positive. Find the positive in taking small losses rather than getting wiped out. The sooner you learn that what you imagined about trading is far from reality and that you MUST change your thoughts on that REALITY, the better trade you shall become.

We MUST understand our present behavior so we can judge what we need to do to make changes in our trading style, if any at all.

A person will make the same mistake again and again if there's not a properly learned reaction to a particular consequence of an event.

We MUST know the right and wrong reaction before we can make any judgment as to what is correct for the situation.

The correct behavior is a learned process and not one that's always obvious. The above 2 rules incorporate behavior modification within the rules.

Our behavior is going to be based on losing protection rather than winning protection. Our focus will be on when to take our gains, without thought on taking a loss, much less a quick loss. We are going to concentrate on protecting what we have rather than what we expect to make!

When the market tells you that you're losing money, your reaction to get out is NOT by INSTINCT because NOTHING REALLY PHYSICAL happens to you except that maybe you get a SICK FEELING. The sick feeling as your body chemistry changes DOES NOT teach you anything about the proper behavior and this is NOT the behavior you want to learn.

Daniel's note: so DON'T let the market to shake you out, you get out pro-actively. When the market tells you that you're wrong, it's ALREADY TOO LATE. When market doesn't prove you're right, you should get out!

A trader must learn from research what the proper behavior modification is in all possible situations. This takes lots of inner soul searching and market data to understand what behavior takes them to the threshold of successful behavior in trading.

It's not possible to succeed in trading at all without some sort of plan for proper behavior modification. All successful plans have some sort of behavior modification built into the plan. The best plans are those that address the proper observation of trading and the proper reaction of trading.

Your can't rule out any possibility but must have proper behavior to address any situation once it happens.

You HAVE TO think about it before you can act on it! Behavior modification learned from knowledge is what they must research in their trading careers if they expect to succeed.

To be a successful trader, we MUST walk alone in our days and do it alone. It's almost a solo fight at all times. It's you and the markets.

When we reach the point of not caring about change any more, we have SEVERELY DEFEATED our powerful thought process of creativity. Creativity can enhance our ability to accomplish great things and make great trades. Hope MUST be tied to action and plans. Love is the reflection of what have been or willing to be given.

Most trades are placed with good reason and backed with good research. If the trader didn't feel they had a good chance of being successful, they never would have made that trade. That feeling of BETTER-THAN-AVERAGE PROBABILITIES is SELF-DEFEATING, because, with that feeling alone, it's possible to MISS the BIG MOVES by being wrong first.

Daniel's note: Opportunity Cost is too high, if not pro-actively getting out before market's call of a failure trade.

You MUST know that the initial entered position is just the beginning of your trade. It's only a small part of the expected process of trading your position. Your GOAL is the important part and NOT the TRADE you have just entered.

You MUST understand that position doesn't justify any emotional modification of your thoughts. Stop that position before emotion even enters the trade by removing the position. You can re-enter the position correctly again and again until you have no emotional effect from that position. If your position brings emotion into picture, it's usually wrong or the wrong way! Emotion has no place in a trade. If emotion is in your trade, it's a wrong position!

We don't allow the market to tell us when we are wrong but only when we are right, we MUST have something to tell us when we are wrong. There is probably not a better signal to get out than the beginning of elevated emotion in a trade. It takes practice and a method of behavior modification must be devised to help you work with the implications of emotional elevation when wrong in a trade. After a period of doing it, you would find it second nature.

If you have unbutton your top button on your shirt, you had better get out. If the phone ringing irritates you, you had better get out. If you are beyond reasonable time frame to hold a position that does not prove correct, you had better get out.

The most critical time of a position is immediately upon entering. That's when you must be prepared to be the quickest to protect your position. The most dangerous time of a position is at entry because you do not have a proven position at that time. This is your only opportunity to keep your losses small if you aren't proven correct with the position. The first opportunity to keep losses small is your best opportunity. What you do immediately upon entry of a trade determines whether you will be a good loser and the best winner you can be.

Be swift! The surprise is often the other side of our current position. Just because we have the expected side of a trade does not prevent us from going with the surprise side when we know our position is wrong. In a correctly proven position, we never go against that position, though.

Timing will cheat us more than not. An inexperienced trader will fail to recognize the importance of persistence in our re-positioning after removal of a position. Just because we exited an unproven position in NO WAY says we were wrong. It's our INTENTION to KEEP DRAWDOWN SMALL and ALLOW us a BETTER ENTRY when we are not proven correct. It's better to get out if you don't get the expected move. You want to be SWIFT when the market is working for you, and you want to have the least exposure you can have when it isn't working for you.

Rule 3: Taking Profits (so called...)

Rule 1 and Rule 2 have been set up to address the nature of trading as a losing game and to keep losses small. This is the most important aspect of trading and to add to correct positions when correct.

Rule 1 takes care of removing the position when not proven correct, usually addresses removing a position when it no longer continues to prove correct, even though we have also added positions.

Rule 2 takes care of getting larger when proven correct by adding positions.

In trading, you can NEVER REALLY know at each important point what the correct move is until you look backwards. Therefore, you MUST have a method that is SYSTEMATIC with what your GOAL is. The goal in trading is to get to the point of the least amount of loss in the journey. Rule 1 and Rule 2 allows to eliminate the unnecessary steps after defining what the goal includes. *Daniel's note: "least amount of loss" = "least amount of loss and time".*

Dilemma of Taking Profits with Rule 1 and Rule 2: In trading, either go straight ahead (continue status quo) or turn left (get out of positions - Rule 1), or turn right (add to positions - Rule 2), there's no room for turning 180 degrees and taking profits outside of the Rule 1 and Rule 2. That would interfere with Rule 1 and Rule 2 and cause unnecessary steps in reaching the goal properly.

Daniel's note: if following Rule 1 and Rule 2, maybe Taking Profits is not a necessary step, just an extension of Rule 1 on profitable positions not continued to be proven correct.

Rule 3: We shall go against the majority and in times of poor liquidity, we shall question all signals and wait for future signals for positioning.

We shall use the converse of poor liquidity and remove our existing positions when EXTREME liquidity takes place in 2 steps and within 3 days of extreme high volume.

- Half of our position shall be removed immediately the following day after an extreme high-volume day.
- The other half of our existing position shall be removed within 2 addition days. We shall wait for further signals in those cases for future positioning.

Daniel's note: poor liquidity includes limiting up/down situations, when the market is "NOT CORRECT" as there are no transactions, market's price discovery function is not valid; the last half of the position off within 2 additional days, here the "2 additional days" gives the outside limit allowed for Rule 3, there will be times when need to do it very quickly and not extend to 2 additional days.

The 3rd rule is a good rule but not a very strict hard rule, and it stresses the acknowledgement of trading in the long run and not the short run.

Traders must never be complacent when the market is at EXTREME volume, whether HIGH or LOW. These times are to be FLAGGED, and there's no better way to flat them than to REMOVE existing positions.

When in doubt, get out. You don't ever lose when you are out. There're times to be out.

Trading Plan

In every trading plan, there MUST be an element that gives you the **EDGE**. **SURVIVAL** is the MOST IMPORTANT point of ANY plan.

A trading plan MUST include below market situations:

- Market Moves（Conditions)
  - Trend
    - bull
    - bear
  - Consolidation
    - after bull
    - after bear
  - Reversals in a trend (Phantom's 3rd way the market can move)

    It's not picking tops and bottoms. 3rd way of moves are your ACKNOWLEDGEMENTS of what the market is telling you about the existing trend. It's finding lack of continuance and is going to reverse somewhere along the trend.

    It's usually after the support or resistance of the trend has been flirted with and broken; 3rd way of moves in trends are the most powerful moves in markets.

    A market that goes with the trend and then breaks support or resistance, which also flags traders to get out or cause them to get stopped out, will turn into your friend. The most powerful signals in a trading plan are the ones where the market has moved both ways in a trend and are showing reversal to the big buildup of trend-followers.

    If you have missed the existing trend for some reason, you can always be ready for the 3rd way of move out of existing trends.
- Market surprises (OPEN is the reference point)
  - market opens higher, close higher, but lower than the open
  - market opens lower, close lower, but higher than the open

  The surprise side is an event that takes place during the day and, unfortunately, seldom allows the public to benefit from entries - mainly because they are already the other way when it takes place. The public seldom reverses their position because they seldom get out at the right place in the first place. It can be caused by a reversal of a market after going the way of a report and then failing. It can be when opinion is one way and the market has no more traders to reinforce the opinion with positions so the market fades the other way.

  You MUST use this knowledge to your ADVANTAGE and NOT be CAUGHT UP in the same situation as the public.

There's a place in every day when it's going to be right to be out of your position. The odds are you won't hit that place most days. You MUST have exit planned during every day, must be PREPARED within your trade plan to use the exit IF NEEDED.

Some of your biggest trends and moves come from the breaking of support and resistance of a strong established trend.

More times than not, when you have conflicting signals, you will be better to disregard them. Powerful moves come when all your signals tend to agree. Don't make the mistakes of having too many indicators. Try not to use too many lagging indicators, you're trading the future not the past.

About: Recovery from big drawdowns

A big drawdown is what will stop you from trading.

Don't look back except learn from what has happened. Having series of losses in a row is an event happens every once in a while. You can and will recover after the drawdown if you do not take a side road along the way (don't take detours).

Drawdown: Good thing is brining the edge of caution, being alert to quick market changes. You can no longer afford to make a bad trade, and now that puts you at a disadvantage.

An option example to trade established bull trend:

Reason to use option:

1. limit exact known loss
2. take advantage of increased volatility as well as price trend

Recovery Steps:

- pick 8 familiar markets, study the nature of the markets, try to diversify the bets
- pick existing trends of the 8 markets, classify:
    - down trends
    - up trends
    - no trends
- take up-trend as trading example (allocate 10% capital on each bet)

  Establish Position in Phase 1
    - find the bull trends
    - identify the phase of it (first wave, second wave or third wave?)
    - establish position when the 1st wave's counter-trend breakout (higher than the counter-trend's high)
- exit plan
    - Rule 1: market doesn't prove the trade's correctness

      or
    - losing half of the option's value
- adding plan

  Press Position in Phase 2
    - 2nd wave's counter-trend breakout is confirmed
- take profit

  within 3 or 4 periods' time of high volume in the 3rd wave

Summary:

No one is immune from market exposure. To control that exposure:

1. MUST trade with extra ADVANTAGES on our side
2. Trading with ESTABLISHED TREND
3. ADDING but ONLY CORRECTLY
4. PROTECTING position with RULE 1 and RULE 2

About: Day trading

In day trading, when the last trade is made, you expect to be out of your positions. You are letting the clock decide if you win or lose. That is a restriction.

Daniel's note: Should solve the problem, you should decide your position, not time/not market!

Being larger on correct moves as a day-trader is difficult, at best, due to limitations of the day's range requiring the adds to come quicker after the initial position. Check out your particular market and see the characteristics in action during the day.

The answer: study the entry and exit criteria and decide what doesn't work. Look at the other side and assume a day-trading criteria does not work and expect it to be wrong. Next, devise a way of removing positions until they prove correct. Set-up a criteria for removing your positions. You MUST NOT allow the clock to dictate when you get out.

About: Making use of news remarks

The true test of news remarks is what the market does in reaction. Markets do react to such remarks, but more than one reaction. You can use those reactions to your ADVANTAGE if you REMAIN SWIFT in your market moves. In fact, you MUST be SWIFT, and you MUST use what the market gives you for your ADVANTAGE to position for profits.

It's not constructive to become emotional about a news remark, but you should recognize the opportunity of such a remark being a mechanical reaction you can make to capitalize on other people's behavior to emotion from such a remark. This sometimes will take a couple of days to play itself out.

This MUST ALL BE THOUGHT OF in your TRADING PLANs, and you SHOULD be prepared at ALL TIMES for these events to utilize them in your trading.

About: In front of report releases

You pay heavily with being wrong after the report. MUST consider ALWAYS cutting back in front of a report unless given a big edge. Traders should remove their positions to allow longer views of their trading careers.

Notes

If you do not use proper rules in your trading, you will LOSE everything you had hoped to gain.

Trading must be the most important thing in your life for it to be possible for your to become the trader you know you are capable of being. You MUST never be SO LOST in your trading to think that your success is because of you.

Always look to sell the weakest market. Daniel's note: sell the weakest in the correlated basket.

Market is a continuing image of liquidity. The market is a true reflection of liquidity at any one time. Liquid markets are the leaders in determining price. Non-liquid markets tend to be sloppy in price determination.

A market is more than a day: market is changing everyday.

You MUST have the courage to do what is CORRECT at ALL TIMES.

Daniel's note: It doesn't mean Money/Profit in trading, taking small losses are correct.

Inexperienced or uninformed traders are great market supporters and market resistance builders. You must be smarter than those who only support or resist the market with their orders and never get filled. EXECUTION is still the MOST IMPORTANT step in your positioning. Your PLAN is the MOST IMPORTANT part of your trade, but EXECUTION is what validates your PLAN by giving you a position.

One of your entry plans will always be a market order.

The other order will be an intelligent order based on the nature of the market you're trading.

What's important about a bad position (not proven correct) is that it gives you the GREATEST OPPORTUNITY to get a CORRECT position. This happens often at TOPS or BOTTOMS. *Daniel's note: when trading trends.*

It MUST come from a trade program you develop that allows you to REVERSE your position at CERTAIN TIMES but NOT ALL TIMES. Most of the time a GOOD position, other than bad position, is being out of that position. Other times, the BEST position is to REVERSE the prior position.

The market will go to a level, reverse, and so on until you have a very large number of price swings within a small range. Buying gets met with selling and selling gets met with buying, which swings the market back and forth many times in compact ranges.

Daniel's note: Trend to Consolidation

At ALL TIMES you MUST understand that the surprise and unexpected event will create a worse situation than you are prepared to face. You MUST practice your emergency landings. You CAN recover from good positions. You WILL NOT recover from bad positions in UNEXPECTED situations.

Just because it worked 9 out of the last 10 times does in NO WAY suggest that it will stay 90% accurate. PROTECT YOUR POSITIONS at ALL TIMES.

There will be a point that the BIGGEST mistake of your trading career will be the BEST mistake you have ever made.

When the markets are thin *(Daniel's note: "thin" means "low volume" or "low liquidity")*, they can be pushed further until liquidity once again enters the markets.

We can never know for sure which high or low during the day is the true high or low for that day.

The more soul-searching you do about what the market is waiting to show you, the better your outcome will be in using the rules properly.

The motivation MUST be tilted toward the REWARDS of keeping big losses out of your account, not just today but every day you trade.
You MUST look at a big loss as the same as you would a personal bad habit.
It is undesirable to ever have a big loss show on your statement.
RESPECT the reward of a SMALL LOSS!

Great traders are not just those who have been fortunate enough to make it big in trading but also those who have made great trades in their LIVES.