

Building a Foundation for Active Management

Taking the First Steps

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Abstract

The author begins by establishing the need for Active Management in a manner that contrasts it with traditional methods of money management, most notably portfolio rebalancing using the principles of Modern Portfolio Theory. An argument is made that what may have worked in the 1960's through 90's to obtain reasonable returns with controlled risk, does not work now, nor will it likely in the future. The description of Active Management is purposefully kept broad due to the wide variety of strategies that can be successfully employed within this methodology. The question of what strategy to utilize is addressed in the second part of the paper.

The error that many portfolio managers make is to quickly look for immediate, tactical solutions in an Active Management practice; a search for the Holy Grail. Active Management does not have a single methodology to follow as other portfolio management techniques do. Each individual manager must determine for oneself and the client what strategies to effectively employ. The freedom to select a broad array of strategies is not without significant, and at times, hidden problems. Not all strategies can be used by every individual advisor successfully.

Another argument is made that while a strategy may work and be effective for one manager, the same strategy may not be appropriate for another, thus leading to mediocrity or failure.

A solution is proposed that the first step toward successful Active Management should be self awareness. How an advisor learns, what his preferences and personality traits are, will have a significant bearing on how successful he is in managing client funds with a selected strategy.

The author contends that not every strategy is “right” for every advisor, thus the tactics used to obtain superior performance should be tailored to the advisor and/or organization.

The author proposes several exercises to assist the reader in understanding where his personal strengths and preferences lie. Further, suggestions are made as to what approaches should be considered that match these strengths. The contention is that systematic approaches of finding the best methods for managing money begin with knowing about one’s self, then defining strategies that are compatible, and finally selecting the tactics to carry out the strategy. A section of this paper is dedicated to managers who find themselves in balance with their current strategies, and takes a broad view of tactics to consider for implementing the strategies. A study of how people obtain expertise in any field of endeavor is reviewed, and how a manager gets better once a knowledge base is secured.

In order to derive the most value from this paper, the author urges the reader to actively participate by taking the on-line evaluations. In this manner the proposed solution steps become more meaningful and relevant to the reader, and a greater understanding of the principles is achieved.

The author’s objective is to support the concept of Active Management, then assist the reader with exercises in self awareness, in an effort to identify strategies before tactics. This is done for

the purpose of selecting client portfolio strategies that are compatible with the advisor, and hence can be successfully implemented on a consistent basis. Continuous improvement is the final topic covered.

Review of Portfolio Management Methodologies

It is said that the longest journey begins with the first step. Anyone attempting to manage money would agree that becoming successful at portfolio management is indeed a long journey. Becoming skillful at one of the newer forms of management, Active Management, is even more difficult because of the magnitude of information and misinformation available. The objective of this paper is to take a step back and propose to the reader a logical, well thought-out approach in determining what strategies he/she should consider applying to their advisory practice and only after that, consider the tactics to accomplish them.

Everyone wants to be a winner, especially in the field of investments. More than at any time in history, our current and future well-being is linked to our financial decisions. With the advent of the many retirement plans (401k, 403b, traditional and Roth IRA's, annuities, etc.) our quality of life during retirement may well be held in balance by our ability to obtain above average returns with below average risk. As investment professionals, our current and future incomes will also be a function of our ability to deliver portfolio performance to our clients. With so much riding on our investment decisions, it is a natural tendency to jump in and find the best solutions to clients' needs, and just get it done. Many advisors fail to perform well and others just do okay, having a constant flow of clients in and out. Finding the best solutions to managing client portfolios must be very difficult, a well guarded secret, or maybe we are going about our quest in the wrong manner. Before the journey to find these answers begins, we must first understand what Active Management is, and what it is not. We begin by looking at some well-known approaches to portfolio management, and observing some of their short comings.

Buy and Hold

No one knows when or how this approach to investing started, but we can guess that it is based in fundamental human nature. It may have had some merit in the ever growing American economy after the Second World War, when demand, labor, materials and the entrepreneurial spirit thrived. A good example of the success of Buy and Hold was the group of stocks known as the “Nifty Fifty” of the late 1960’s / early 70’s ¹⁾. These were the “can’t go wrong - one decision” growth stocks that you could buy and forget. Here are a few examples:

	<u>1972 P/E Ratio</u>	<u>Status – 2010</u>
Polaroid Corp.	90.7	bankrupt
MGIC Investments	83.3	issues private mortgage insurance, significant losses
Avon Products	65.4	struggling; has gone through many reorganizations
Emery Air Freight	62.1	bankrupt
Digital Equipment	60.0	once the leader in mini-computers, now a shell
Burroughs Corp.	48.8	merged to form Unisys, minimal market share
Xerox	48.8	struggling; limited to document handling products
Eastman Kodak	48.2	affected by digital pictures, now a shell

The list also includes J.C. Penney, Sears, Kresge, First National City (Citibank), and ITT.

The conclusion to be made is that securities cannot be held for extended periods of time without being reevaluated ²⁾. Technology changes, economies change, consumer tastes change, it is hard to stay on top for very long. There were some companies on the list (McDonald’s, Texas Instruments, Eli Lilly, American Express) that continued to do well, but none of them have gone through the economic cycles without a significant reduction in value. The growth stocks’ extremely high price/earnings (P/E) ratios are noted by Ed Esterling, “P/E’s cannot be sustained on a broad basis much above the low to mid-20s because of limits on the real growth

rate of the economy and the market's requirement that equities be priced to return more than bonds.”³⁾

We can conclude that high P/E ratios are an indication of stock over evaluation likely caused by investor euphoria in the economic cycle. Economic cycles do tend to repeat, thus a “Buy and Hold” philosophy is destined to suffer significant value draw downs. Nobody gives the investor “extra points” for suffering a 50% drawdown in value before recovering from it.

If the purchase and long term holding of the highest potential growth stocks over market cycles is not the answer, then the stock market itself cannot be any better.

Portfolio Re-Balancing - Modern Portfolio Theory (MPT)

The idea to diversify a portfolio's holdings into broad sectors was developed to provide continually strong returns with lower risks in just about any type of market. Modern Portfolio Theory (MPT) was developed by Harry Markowitz, from the University of Chicago, in 1952; he later won a Nobel Prize in Economics with the Capital Asset Pricing Model. According to Wikipedia, Modern portfolio Theory “is a theory of investment which tries to maximize return and minimize risk by carefully choosing different assets.”⁴⁾ The idea is to diversify risk away by investing in asset classes that typically have a low correlation to each other. In that manner, when one or two classes are down in performance, one or two are likely up and the others are in between. The mathematical model describes the “Efficient Frontier” which plots Expected Return vs. Risk. By using performance data from many previous years, one is supposed to model this risk/reward ratio, and then adjust the investment portfolio to approach the optimal value.

The theory requires the investment manager to re-balance the portfolio holdings on a regular basis to maintain the desired performance and exposure. The manager must sell assets that have made a significant profit and buy additional assets that have lost value, in essence, sell the winners and buy more of the losers. This process is done on a regular time basis, regardless of market conditions. Many proponents of MPT will point to “no one can time the markets”, since they do not have to. In practice, MPT, once set up, can be run in an almost a cookbook manner. There are a number of books and software available to provide the guidance to accomplish just that. While the theory may help reduce risk, its returns in practice are usually less impressive than in theory. The reason is that the returns do not follow the theoretical Gaussian distribution, and that correlations between asset classes can vary substantially during an economic crisis. We can look no farther than the severe economic recession of 2008-09, when stocks worldwide declined, bond values declined, and most commodities declined in near unison. Suddenly, nearly everything was correlated, a disaster for a fully invested, “balanced” portfolio. Another simplified technique to portfolio management, which is espoused to managers and investors alike as being the long term answer to portfolio management, is Dollar Cost Averaging.

Dollar Cost Averaging

Dollar Cost Averaging is the practice of investing a fixed dollar amount in a group of securities on a regular, fixed time basis. The idea is that you will buy more shares when the price is low and less when the price is high. It is especially popular with portfolio plans that have a regular input of funds, such as a 401k and other retirement plans. In many ways, the technique of Dollar Cost Averaging is a cousin to Modern Portfolio Theory portfolio re-balancing, in that, no thought is given to the current price trend of the securities to be purchased,

and the assumption is that price will always recover. As noted in the Buy and Hold technique, assuming that the price of a security will recover in a timely manner is a very big assumption, and it breaks a common investment rule to never add to a losing position. It is but another example of a simplified investment technique that works reasonably well in a long term, generally up trending market.

Buy and Hold, Portfolio Rebalancing (MPT), and Dollar Cost Averaging are very risky and doubtful in today's economy because they require full investment all of the time. If these techniques cannot deliver on the objective of above average returns with below average risk, the attention must turn to a more contemporary approach, Active Management.

Active Management

We will start by giving Active Management a broad definition, the reason will be clear shortly. Active Management is: "The periodic review of securities to select and hold positions that offer the best risk/reward benefits, based on the portfolio's strategic objectives".

Successful active managers can review a security on a 5 minute basis or a quarterly basis, though most are somewhere in between. They evaluate international and domestic stocks, mutual funds, commodities, bonds, etc. The key is a regular, periodic review of all candidates within consideration, and making the required purchase or sale to maintain the objectives of superior risk / reward, in keeping with their strategy. Objectives will vary primarily on the needs and wants of the client. A laddered Treasury bond portfolio will require a different review technique than a fast moving leveraged commodity portfolio. Different clients have different needs, and this is where the active manager's skill is important. While there is no cookbook,

there is guidance. A short review of recent stock market behavior is all that one needs to be convinced that Active Management of a portfolio is necessary.

Look at the five recent, most significant market corrections of the S&P 500 Index, and the time it took to recover (break even) from those losses. The period covered is from 1968 through (February) 2010, 42 years, a typical long term retirement time frame, ranked in order of losses.

Rank	Drawdown /Loss	Drawdown Length	Peak Date	Valley Date	Recovery Time
1	-56.78 %	17 mo.	Oct-07	Mar-09	TBD, > 12mo
2	-49.15	31	Mar-00	Oct-02	55 mo.
3	-48.20	21	Jan-73	Oct-74	69
4	-36.66	18	Nov-68	May-70	40
5	-33.51	4	Aug-87	Dec-87	23

The point to be made is that these are major losses and they take a significant amount of time to return to a breakeven level. In hindsight, being patient and riding out the storm is not a strategy to grow a portfolio. Many clients do not understanding that a 100% return is necessary to recover from a 50% loss, not to mention the time that is lost in the recovery and not in the growth of the portfolio. Many papers and books have been written explaining the benefits of taking an active approach to managing client portfolios. One of the better texts to explain the need for Active Management, and to place it in a global economic perspective, is a book by Mr. Ed Esterling, “Unexpected Returns”³⁾. Mr. Esterling devotes chapter 10 to the idea that we must learn to row, and not just sail. He describes “sailing” as an investor hoisting the portfolio sails to run with the prevailing wind of the economy. While there may be nothing wrong in the concept, those that propose it make the assumption that the next 50 years of economic growth will be comparable to the last 50 years. This could be fatal, since the world in the 50’s was

recovering from the Second World War. Consumer demand was very high, technology bloomed, labor was plentiful and so were natural resources in the Western World countries. That balance may be slowly shifting in the future. “Rowing” is defined as the manager’s ability to detect and focus on specific sectors and companies that are growing profitably and adjusting to market changes. Likely, these are the same companies that are flexible enough to adapt to new technologies and opportunities on a worldwide basis, and not just on a single country or industry. As such, “Buy and Hold” and “Portfolio Rebalancing – MPT” will suffer significant losses, with sectors and companies that may never recover. Active Management is nimble, focused and not married to any single investment theme, so it adapts to changing markets and economic cycles.

To the unfamiliar, Active Management, being multi-functional and multi-disciplined enough to adapt to the ever changing markets, must have a series of complex theories and formulas to apply, in order to achieve the goal of above average returns with below average risk. Like the many portfolio theories that preceded it, Active Management must have the techniques well documented and explained. In theory, all a manager needs to do is to study these techniques to have a successful Active Management practice.

Search for Active Management Solutions

The Rush for Answers

Investment advisors who look at different portfolio management techniques can quickly become convinced that Active Management is best for their practice, especially if they are independent. Active Management techniques can set them apart and give them a competitive edge, making for many happy clients. Opportunities are now limitless, and so are the possible options to consider. “How do I run successful active management portfolios, what is the answer, what is the formula?” Many well intentioned advisors go right to executing tactics and completely skip any thought or review of strategies.

For the purpose of this paper, the definitions of Strategy and Tactic follow:

Strategy: A plan of action, highly important to an intended objective or goal.

A strategy is the study of how different decisions and transactions are linked together, such as long term planning of a portfolio and investment model objectives.

Tactic: The tools employed relating to carrying out a limited or immediate objective.

A tactic is the conduct of a single investment decision. It has short term significance, and is characterized by ingenuity and skill.

Before applying the tactical tools to the portfolio, we must first determine the strategy for the portfolio. By being so focused on the special formula for making the trade, we forget about the objective of the portfolio model, and hence the client. An example of this would be a system that has proven to provide a 45% annual return, with a 5% maximum drawdown. This is pretty good, maybe something we should add to our toolbox, but wait, there's more to it. The system can't be completely automated; it is somewhat subjective and requires you to sit behind a computer

monitor during market hours, 6 ½ hours a day. Still interested? Some advisors may be, while others definitely not. This is a proven model, but it may or may not fit our management strategy or our personal objectives. We may purchase this system and find that it is a failure because we can't provide it the time or attention it needs, while another advisor may have it and be very successful. Is it the "fault" of the system (investment tactic) or just a poor strategy to implement it? Clearly a key factor in our strategic thinking must be how we work and operate. The contention is that an important factor in the success of an advisor is how he operates within the chosen investment strategy. Having an outstanding system is not in itself a guarantee for future success, if it can't be implemented properly. Let's take a big step back and investigate how advisors can determine strategies for their practice, in order to give them the best opportunity for future success.

We look for answers, perhaps a special formula that was developed by a famous deceased guru. All we need is just a few really good systems, and we're successful active managers. The problem is we are all different. There is no single solution, there are many. The key is to discover which ones are a match to the advisor and their operational style. There are ways to determine which of the many investment theories and approaches we are compatible with, by taking the time to be aware of ourselves first.

Finding the Path Toward a Strategy

Since we are all different, we will need to find our own individual path(s) toward defining the strategies that we can use to effectively manage a portfolio. The first step in this process of self awareness is to set aside some time when you are free to assess yourself. This is not a task to

dread or rush through, but a time to pause and reflect. What follows are two exercises: a Personality Profile and a Left Brain/Right Brain Information Processing Assessment.

Our personality and preferences are major factors in determining how we function and behave. They also have an effect on our professional approaches to problem solving and business organization. The results of these exercises will be combined to give insight as to what type of portfolio strategies we may be most compatible with and comfortable running. It is important to think honestly about ourselves, what we like and what we don't like. Get in the right mood, calm and introspective, jot notes down on a pad of paper. Find a quiet time when you won't be disturbed, this is all about you and no one else.

Some areas for you to consider are how you function in a social activity with people. What characteristics of people do you admire? Do you prefer to interact one on one, in small or large groups? Also consider individual activities and what satisfaction you derive from them. What activities do you find creative, relaxing or stimulative? Are you interested in one task at a time or fascinated with many? What activities do you enjoy or avoid; consider what classes you enjoyed or disliked in college or high school? Are you happy to work toward a goal with a deadline? Are you organized or messy? All of these, and more, are part of your unique personality.

- Personality Profile Assessment:

The author recommends taking a Personality Profile test that will help in the identification of characteristics, so you can determine a group of compatible investment strategies. This first evaluation will ask questions about how you work and what you prefer to do in various settings. The scoring is immediate. One such site is: <http://www.outofservice.com/bigfive> ⁵⁾. It will give you a percentile score in the OCEAN personality model (Openness to experience, Conscientiousness, Extroversion and Agreeableness). The results give you additional insight as to your level of creativity, organization, sociability, interaction with others, and nervousness / relaxed states. Responses will be evaluated on in the areas of Logical-Social, Reserved-Outgoing and Tried & True-New & Different. There are no right or wrong answers, only more information about how you function and work. You will combine these results with the next exercise and begin to see a pattern. The pattern is the manner in which you think, learn and prefer to act, and respond to situations.

The next area to review is how we learn new things, and react to new stimuli. This is a major factor in what makes us different. The left brain / right brain theory explains how our brain functions, in short, how we are “wired”. Research indicates that the brain is divided into two main hemispheres. Each specializes in different functions and processes information differently. This, in part, defines how we deal with problems. The left brain processes more logic and analysis functions, while the right brain processes more emotion and imagination functions.

Left Brain Functions

uses logic
detail oriented
facts rule
words and language
present and past
math and science
can comprehend
knowing
acknowledges
order/pattern perception
knows object name
reality based
forms strategies
practical
safe

Right Brain Functions

uses feeling
big picture oriented
imagination rules
symbols and images
present and future
philosophy and religion
can “get it” (i.e. meaning)
believes
appreciates
spatial perception
knows object function
fantasy based
presents possibilities
impetuous
risk taking ⁶⁾

- Left Brain/Right Brain Information Processing Assessment:

Each of us tends to have more attributes towards one side or the other, and that is typical.

This is what defines each of us and how we process information. It is suggested that the reader explore this concept further by taking a quick on-line evaluation to assist in learning more about personal preferences in processing and acting on information. Here is one suggestion:

<http://www.testcafe.com/lbrb/?affil=> ⁷⁾.

Matching the Strategy to the Advisor

How personalities relate to managing portfolios is the important thing. At this point the reader has the results of the Personality Profile and the Left Brain/Right Brain Evaluation. After a careful review, some threads or similarities begin to show themselves; note these. The author

does not make any claim of expertise in the field of psychology. The following are suggestions for interpreting the results of the previous exercises. What is important is being truthful in the response and analysis, in an effort to match the strategy to the person executing it.

Predominately Right Brain – Social, Out Going – Likes New & Different:

If an advisor's brain processing is heavily biased to the Right Side and their Personality is biased towards Extroverted, Social and Agreeable, perhaps using the strategies and tactics developed by others should be considered. Using a Black Box or purely Mechanical System would be an example of this type of strategy and tactics for a portfolio. The advisor maintains the responsibility of selecting these strategies, and knows when they stop delivering the intended performance. He must learn how to perform this critical function. These advisors are more able to use their talents to focus on client services, and to manage "the big picture" of their practice.

Predominately Left Brain – Logical – Reserved – Appreciates Tried & True:

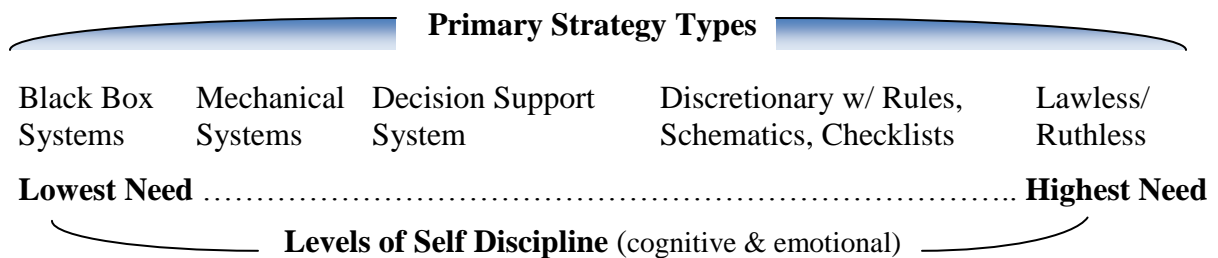
If an advisor's brain processing is heavily biased to the Left Side and their Personality is biased towards being Internally Focused, Disorganized, Calm & Relaxed, then perhaps he could consider working to develop his own strategies and tactics. He will accept the responsibility that this process is time consuming and will take a significant effort. These advisors will use their talents to create unique, high performance portfolio strategies, thereby using these features to keep and gain clients.

In Between – Most People:

In reality, most people will not be toward the extremes of all of the evaluations; that is to be expected. What is difficult to determine is exactly how each advisor should proceed, there are many variables. The most likely result is a hybrid approach, which is the incorporation of ideas from both sides. The objective here is to provide the tools and the ideas for interested advisors to begin asking the questions. This may explain why a certain investment approach does not work for them, while others appear to be very successful with it. Regardless of where the advisor falls within the evaluations, one thing remains constant; the advisor is always observant and looking for ways to improve.

Levels of Self Discipline

Professor Hank Pruden in his book “The Three Skills of Top Trading, Behavioral Systems Building, Pattern Recognition, and Mental State Management” suggests a number of investment strategies that are in harmony with these key personality attributes ⁸⁾. We next investigate the area of Self-Discipline, and how that personality trait may apply to a strategy selection.



If advisors with low self discipline are to be effective, they may consider strategies toward the left side of this scale, or consider a method to compensate for the characteristic. Advisors with high self discipline may be most effective using strategies that are toward the right side of this scale.

Additional Factors

- **Risk Tolerance:** the advisor's tolerance to risk and the objectives of the client should be harmonious in order to follow the strategy and to allow it to work.
- **Types of Securities to Consider:** understand and be comfortable with the securities being considered in order to manage the strategy.
- **Timing:** the time basis to operate this strategy (hourly, daily, weekly), and what is required for this commitment.

If the strategy does not match well with our personal traits, it does not have to be abandoned.

An alternative to running a strategy yourself is to let someone else do it. This is done subtly all of the time when selecting a mutual fund. We indirectly pick a strategy and let the fund manager use his tactics to manage the money. Here are some alternatives to consider:

- "Jobbing Out" the money; managing another manager.
- Buying Signals; subscribing to a service and following the directions.
- Subscription Service; using suggested securities as candidates for your analysis.
- Hired Help; using a partner or hiring help with complementary traits and strategies.
- Hybrid Approach; using a purchased strategy and tactics for some funds, while managing the remainder with your own select strategy.
- Education; challenging your deficiencies, changing and applying new techniques.
- Mentoring; finding a mentor to provide guidance.

Our objective is to be aware of who we are, and how we process information. Any investment strategy that is in conflict with who we are won't be successful. There are methods to deal with personality traits that we find a conflict with, we should consider these methods and not ignore them.

How We Invest: Strategic Factors to Consider

Most advisors will find that their Personality Profile and Right/Left Brain Evaluations are rather neutral, with few strong biases. There may be adjustments to consider, but likely nothing major. What can be offered to them are ideas to contemplate on various investment time frames. This section is intended to challenge set ideas and stimulate continued investigation.

Four Basic Investment Strategies

Again we step back and consider that many of the different management techniques can be broken down into the following macro strategies:

1. Momentum – *short term*
 - Reversion to the Mean (*trend / counter trend*)
 - Swing Trading (*corrections within a trend*)
 - Pure Momentum (*increasing / decreasing price movement*)
2. Growth – *intermediate term*
 - Looking for a trend with basic fundamental & technical management.
3. Value – *long term*
 - Searching for undiscovered value using business & economic cycles, buying at a discount.
4. Income – *interest & business cycle based*
 - Interest, dividend and quality of the underlying security.

A typical strategy might be considered like a 30-second elevator speech. It is short in length and covers the major objectives; it establishes intent.

- Who is affected? (what model or what client is it applied to)
- What is evaluated? (what group of securities are considered as candidates)
- When, the time basis. (how often are re-evaluations made)
- Where is it carried out? (resources used and applied)
- Why do we use this? (the objectives expressed in general terms)
- How? (No, that's a tactic)

Here is an example of a strategy:

“My junk bond trading strategy is used as part of the Income and Moderate models (*Who*). I consider High Yield mutual funds that have a no or low redemption fee within 30 days of purchase, that have shown to have above average performance for these funds over the past 5 years (*What*). I evaluate current holdings daily, using dividend adjusted data, with my Junk Bond trading model (*When, Where*). The strategy has typically traded 4 times a year, with a return of 8.5% and 3.8% drawdown over the past 10 years (*Why*).” (Note: performance data is for our use and knowledge, not a client promise!)

This strategy example is something that is compatible with our client model(s) for risk and objectives, compatible with our personal traits, and we can feel comfortable in operating it. It is easy to explain the concept and its objectives.

Thoughts on Tactics and Their Application

With all of the emphasis on trading tactics, the “How To” part of money management, one would be remiss to not cover the human element of this area. Professor Pruden suggests a few key elements in selecting and defining tactics. ⁸⁾

Direction - *The Trend: Lines, Channels.*

Extent - *Support & Resistance, possible price movements (peak to peak), over bought, over sold.*

Momentum- *Rate of Change, Acceleration / Deceleration.*

Form- *Price movements in waves, Advances and Corrections.*

The elements of a tactic should include: the Set-up, the Trigger, the Follow-thru, and the Exit.

One human element of the tactic is critical: Being able to follow the tactic (trading plan) once it is established. Many a manager has had a solid, proven plan, but was unable to execute it

(“pull the trigger”). This is especially a problem after a series of losses. Here are two ideas to remove self doubt: training the mind and thorough testing of tactics.

Training the subconscious is one method of controlling or minimizing self doubt. A reference is made to a mind training CD (item C under “Other Resources”), as well as a course sold by Dr. Van Tharp, and others, which go into detailed analysis and training. Active Management and Trading is about being okay with ambiguity. It is about tolerating confusion, but still being in the context of the market. This requires the manager to be engaged. To stay “in the now” with the market, and to not predict what it should be doing, can be a difficult task.

While the main reason for testing a tactic is to prove it out, the other is to gain confidence. Evaluation techniques to employ include out of sample testing, statistical analysis to detect over optimization, and walk forward testing. These help the advisor find a tactic that could be profitable in the future, but since no one knows the future, there will always remain the element of risk. Another important reason to test is to have a data set that the advisor can compare the real time performance with. If the performance criteria in real time vary significantly from the testing reports (past data), that alone is a strong indication that the tactic is broken and should be completely re-evaluated. There is no sense in doing research if you are not going to follow it. Constantly comparing current real time performance to that which is expected increases the confidence of the advisor, confirming that things are in fact working as planned. This helps to minimize the self doubt when the markets suddenly do the unexpected.

Keeping a trading journal of what you saw when a position is entered and exited, is an idea that is strongly recommended. Do not rely on memory; write down what you saw, and why you

took the action. Did you follow your tactical plan? Capture the decision environment at the hard right edge of the chart, do a screen dump of the chart. “Plan The Trade and Trade The Plan.”

How to Gain Expertise

Techniques for gaining expertise can be found in the book “The Cambridge Handbook of Expertise and Expert Performance”⁹⁾. This amazing text is a collection of studies from many authors who have investigated expert performance in nearly every area of competition; sports, music, chess, medicine, finance and various specialties. What they found were the common characteristics that nearly every super performer had, these can also be applied to money management. Expertise is not only talent, but is brought about by implicit learning. It is about developing your procedural memory to such a level of proficiency, that your actions become nearly automatic. In short, practice does make perfect. The message is to study, learn, and practice. Practice provides you with experience, and experience will provide confidence. The handbook estimates that over 10,000 hours of practice is necessary for most people to achieve the highest performance levels. For investing, somewhere between 1,000 and 5,000 examples may be necessary to study and understand before reaching mastery. It is important that you study and practice the right things, and for that it is highly recommended that you obtain a coach or mentor. The benefits of practice are not only high performance, but also self efficacy. At that point you will have enough confidence in your own opinion and skills, that you will have no need for the opinion of others. (Note: this is not about being “cocky”, but about mastery of a skill set through immersion.) If this sounds like a daunting task, don’t be discouraged. This is a level of expertise to strive for, and a path for continuous improvement. There are many benefits to gather along the way.

Conclusion

The goal of this paper is not to lay out a recipe to follow and find the ideal set of investment portfolio strategies, and then suggest a couple of good tactics to employ. There is no cookbook for being a successful Active Manager. Each person has to find his or her own way, because we are all different. The objective is to start the process of self awareness. What we like and dislike, what are our primary personality traits, and how we learn and process information do have an effect on our investment performance. With information about ourselves, the advisor can define a series of strategies that can be effectively executed, and meet the needs of the client. The last step is to find and test the tactic, those sets of rules, which will guide our investment decisions every day. Before we find answers, we must first ask the questions. Hopefully, this paper has motivated the reader to ask those questions.

Richard Wyckoff talked at length about the Composite Operator in the market, the omniscient, all seeing - all knowing person, who knew what to do and when to do it. The first step toward being that Composite Operator is to know thy self. While there is no Holy Grail, there are many “graillettes”, and the journey to find them begins inside.

Wishing you Good Trading and Happy Clients.

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- 7) Brain Type Test (on-line with scoring), <http://www.testcafe.com/lbrb/?affil> (website).
- 8) “The Three Skills of Top Trading, Behavioral Systems Building, Pattern Recognition,
and Mental State Management”, by Hank Pruden, 2007, John Wiley & Sons.
- 9) “The Cambridge handbook of Expertise and Expert Performance”,
edited by K. Anders Ericsson & others, 2006, Cambridge University Press.

Additional Resources

- A. “The Disciplined Trader: Developing Winning Attitudes”, by Mark Douglas, 1990,
New York Institute of Finance.
- B. “The Inner Game of Trading, Modeling the Psychology of the Top Performing Traders”,
by Robert Koppel and Howard Abel, 1994, Probus Publishing Company.
- C. “Trading Mind Software”, developed by Jake Bernstein, 2009,
Subconscious Training Corporation, (mind conditioning course on compact disc).
- D. Materials & Course Work for additional study:
 - Dr. Van Tharp - <http://www.iitm.com>
 - Adrienne Toghraie - <http://www.tradingontarget.com>
 - Ruth Roosevelt - <http://www.ruthroosevelt.com>
 - Dr. Brett Steenbarger - <http://www.brettsteenbarger.com>
 - StockBee (subscription, short term stock trading) - <http://www.stockbee.biz>