

The Story Behind Best Loser Wins

I am happy I wrote Best Loser Wins, but I regret deeply that this chapter was not included in the book. If there ever is a second edition, it will be included.

I wrote Best Loser Wins because I wanted to tell a story about trading that I felt was missing from the trading world. My name is Tom Hougaard. I am a professional trader, meaning that I make my living from trading. I mostly day-trade, using high stakes – as compared to an average retail trader.

With high stakes comes additional emotional pressure, something that I have gradually gotten my mind accustomed to. It wasn't always like this, and what you are about to read is the story behind the story. It all started two decades ago.

I placed my first trade 22 years ago. The Dow Jones Index had just reached an all-time high, and I went short. That short position would have been brilliant if it had been placed 3 months later. Instead, it turned into a margin call. Back in those days, your account could go into negative, and quite significantly so.

I deposited more money and I doubled up on my short position. Over the next week I watched the market like a mother watches her new-born baby. When the market fell, even temporarily, I was excited. When it rallied, I was in despair.

Eventually I could not stand the emotional pain anymore. I closed my open positions, and I mourned the loss with pitiful and pointless negative self-talk. The loss was significant. I was working for JP Morgan Chase at the time, in a non-trading related job, but I was earning good money. My trading loss equated to 2 months salary. I felt the pain.

Fast forward to the 14th of July 2022 – some two decades later. It is 3 minutes into the European trading session, and I short the FTSE 100 index. I run a Telegram channel that has 15,000 followers, and they receive my trade alerts within a nano-second of the trades being placed. I tell them I have just shorted the UK index at 7,155 with a stake size of £300 a point.

193 seconds later (everything is time-stamped to the second in Telegram), they receive another message, this time saying that I have shorted the FTSE once more (added to my winning trade), now at 7143.2. Then 4 minutes later they receive another message that states that I had shorted the FTSE for a third time, now at 7138.6.

By the time the market is 15 minutes into the European trading session I have shorted the FTSE 100 index 6 times, with a total stake size of £1,800 a point risk. Every short trade has been added at lower and lower prices, thus not violating a golden rule of mine never to add to a losing trade.

The next 20 minutes is a test of my resolve and patience. The German Dax index stages a come-back and it pulls the FTSE higher as well. The FTSE did start weak, as did the DAX index, but the next 4 bars, on my 5min chart, were relative bullish. Overall though the chart context was bearish. My stop loss on my entire position is 7,160. The FTSE went as high as 7,156. Then it began to fall - heavily.

As it fell, I added again and again, according to my plan. Over the course of the next 75 minutes, the FTSE fell from 7,156 to 7082. My open profit was more than £130,000. My followers in Telegram is sending me high-five emoticons and cheerful comments. It is a far cry from the trader I was two decades earlier.

What happened in those two decades? How did I transform myself from a trader who knew everything there was to know about technical analysis, but still didn't make money, to a high-stake trader, who boldly engages with the market with high stakes?

Was it because I found a new hidden truth about technical analysis? The answer is a resounding "no". You are not a losing trader because you don't know enough about technical analysis or money management. If you want to trade or you already trade, then realise this: The house (the broker/the market) always wins. If you play long enough, and you never change the stake size, the house will win, unless when that perfect hand comes along, and you bet big, you take the house.

That "perfect hand" – that opportunity comes along every single day, many times a day, but unlike say a game of poker, where you know you have a good hand, in trading, a good trade only reveals itself slowly and gradually. And while you are never guaranteed a good hand in poker, you can be guaranteed that the market will give you good setups every day, if you have the right mindset.

How do you go from being a losing trader, who thinks he knows what he is doing, who knows a lot about technical analysis, who has read all the "bibles" of technical analysis, who says he has a system, to being a high-stake trader, who adds to winning trades, who sticks to the plan, who is not knocked off course because the market is moving against you? How do you transform yourself from a losing trader to a winning trader?

There is a saying that practise makes perfect. This is not true. If you practise the wrong thing, all you do is cementing the bad traits. You make the bad behaviour permanent. Practice does not make perfect. Practise makes permanent.

The Will to Act

As traders we should ask ourselves a question: "How do I bridge the gap between what I am achieving now and what I know I have the abilities to achieve?" One thing is to have the knowledge. Another thing is to have the will to act. Knowledge is nothing without the will to act.

Think about the obesity crisis that is ravaging western societies, is that happening because there are not enough slimming books or weight loss systems? Hardly. Every day new weight loss methods make their appearance, promising you to shed weight quickly and effortlessly. Does that remind you of something? In the context of trading, it should remind you of all the YouTube adverts you see of smart good-looking people promising you to turn you into profitable traders, if only you buy their course or the book or their secret system.

My journey from those first Dow trades 22 years ago to where I am today is not so much a story about me and my abilities – or the lack of - but the typical behaviour of mankind. You see, I worked as a broker for 10 years, and I got to observe "you" trading – well the metaphorical you. After I left JP Morgan Chase to start trading for myself, I only lasted 18 months before I ran out of money. Now I had to look for a job.

I had cultivated a good relationship with a broker in London, so I moved to London, and I got a job as a broker. I reasoned that if I couldn't make money trading, then at least I could make money whilst watching other people trade. It wasn't what I wanted, but it was a step in the right direction.

Over the course of the next 10 years, I worked for a broker called City Index. It was a magical time to be working in London. The bear market from 2000 to 2002 was followed by a relentless bull market that lasted almost 6 years.

I spent my days watching the markets, trading my own account, and observing and dealing with client's orders and trades. I was thirsty for knowledge and sitting on a trading desk observing clients trade was my idea of heaven.

Brokers Business Model

City Index was a thriving CFD brokerage. They had many very active clients, trading everything from stock indices to individual stocks. Every day they would log into the trading platform and trade. And here is where it gets interesting.

Brokers obviously have to make money, so how do they do that? Well, the answer might not sit well with you, but you are going to get the honest answer anyway. To say that the broker wants you to lose is not actually true, so what is the truth?

As a broker, when you are sat at the trading desk, you have certain risk parameters that you have to abide by. So, for example, if all your clients are betting on the Nasdaq to rise, the broker will lose money, if the Nasdaq does in fact rise.

Most CFD brokers will have some risk tolerance parameters that limits the amount of exposure they want. So, if all their clients all bet in the same direction on a particular instrument, then the broker will immediately go out and hedge their exposure with their own prime broker. Yes, there is such a thing called a Prime Broker, which are brokers that act as brokers to smaller brokers.

What the risk parameter limit is will vary for each broker. Needless to say, every broker on planet earth has a complicated relationship with their clients. On one hand, they want their clients to win, because a winning client is a client that keeps trading. On the other hand, brokers often generate their profits from the money that the clients lose. I say "often". I am not saying "all the time". Let me elaborate.

New ESMA Rules Uncover Truth

The new ESMA rules in 2018 made it obligatory for brokers to post the percentage of their clients losing. If you look at the front page of any brokers website, you will see what that percentage is, and you will quickly realise that most brokers will have a 75% losing ratio, meaning that 75% of their client's accounts are net losers over the last 3 months.

Now before you start demonising the brokers, just pause for a second, because this article is not an attack on the brokers. The problem lies not with the broker you trade with (although you do need to make sure you trade with a broker that has tight Bid Ask spreads – otherwise you are sabotaging your own best effort*). The problem lies with you.

*You may want to read my article called "The Broker Report", which is an in-depth analysis of more than 150 brokers globally.

Over my 10 years of working on a trading floor at one of the biggest CFD brokers in the world, I came to realise that human beings make awful traders. There were so few people amongst the City Index client base that made money, that you quickly came to know them by name. Whenever their name came up on the position monitor, which hung above all the trading desks, you paid attention. They tended to trade big, and they tended to not trade often.

Of course, there was also some lucky traders, but they didn't stay lucky for long. These "flash-in-the-pan" traders, who were riding a lucky streak quickly burned to the ground. In fact, more often than not the occasional big winners would lose all their money again and more.

Over the 10 years on the trading floor, I observed people from all walks of life execute tens of millions of trades. There was the typical "you" – armed with textbooks on technical analysis, doing their best to make money trading. There were famous professors of economics, there were famous lawyers and eye surgeons throwing money after the market, perhaps for excitement, perhaps because they thought they were smart people, so beating the market should be easy. But they never won permanently. Ever.

In 2009 I had had enough of working in London. My timing was perfect. I was made redundant as City Index and many other brokers suffered big losses as a result of the financial crisis. I took my redundancy money and I started trading for myself. I felt more ready than I ever had before.

And yet somehow, in spite of having traded professionally for an organisation for nearly 10 years, in spite of having read hundreds of trading books, and delivered courses and speeches about technical analysis, I fell right back into my old behaviours from 10 years earlier.

At first, I dismissed it as an unlucky streak, adjusting to a new environment. I reviewed, and I persisted, and my performance picked up again. However, as part of my self-audit process, I noticed how often I gave a disproportionate amount of my profits back to the market. I also noticed that my winning trades were much more frequent than my losing trades, but my losing trades lost me more.

For example, I could have 7 trades, each making me £1000, and 3 trades losing me £1750. While I was still profitable, it concerned me that so few trades lost me so much. Perhaps more importantly, whenever the market gave me an opportunity to make big money, I never held on to that opportunity.

Navy Seal

I had only traded for myself for a few months after my redundancy, when I realised that I was not going to make the money I thought I would. I looked back over the last 10 weeks of trading, and I realised that while I was marginally profitable, I was fundamentally doing something wrong. I was not seeing the results I knew I was capable of achieving.

It was the summer of 2009, and I decided to stop trading. I reasoned that perhaps some time away from the markets, after 12 years of intense screen watching for 12 hours or more a day, was needed.

During my time away from the market I went walking in the mountains in Spain. I walked the Camino Santiago, a religious pilgrim journey that snakes its way along dusty roads in Northern Spain. I stayed in cheap hostels at night, together with other ramblers. One day whilst walking I got talking to a gentleman from America. He was a movie producer from Hollywood.

We talked about movies, about script writers, about actors, and this gentleman knew them all. It was hilarious to hear about what goes on behind the scenes in La La Land. He had taken his 10 favourite movies with him on his walk, and at night he would sit in the hostels and savour his and other's work. He invited me and others to join in these impromptu movie nights.

What was fascinating about these screenings was that he would talk over the movie and explain settings and unique features that the casual viewer would never be treated to. He would also explain where some of the movie lines came from.

One evening we watched Batman Begins. There was a fight scene that particularly spoke to me. I felt the actors were addressing me when they said "Training is nothing. The will is everything – the will to act."

The following morning, I must have seemed quiet to the Hollywood producer, and he asked me what was on my mind. I explained that I was a struggling trader, who didn't seem to be able to "connect the dots".

I had acquired an immense amount of knowledge of the markets and of technical analysis, and I continued to do so, but no matter how much knowledge I acquired, no matter how many books I read, I never seemed to get measurably closer to my goal of making consistent profits trading.

For a while he didn't say anything. I was surprised because normally his mouth would not stand still, but when you walk the pilgrim route you quickly learn that people walk this spiritual path for all sorts of reasons. Perhaps my new friend just needed some quiet time.

That night we watched another movie. This time it was a less serious movie called Ocean's 11. There is a scene early on in the movie where Rusty (Brad Pitt) asks Danny (George Clooney) "Why do it?"

His reply made me pay attention:

"Because the house always wins. If you play long enough, if you never change the stakes, the house takes you. Unless when that perfect hand comes along you bet big and then you take the house." Once again, I descended into deep thought, wondering how it applied to me. I felt it applied to my trading, but I couldn't figure out how.

The next day as we set out, it was an unusually cold morning for a Spanish summer. My Hollywood friend and I walked briskly through the morning dew to keep warm, as the sun peaked over the horizon, warming our faces.

"There is a good chance I will never see you again, so if you don't mind, I want to tell you something that I think will help you. Since I am not active anymore, I can talk about my time in the US Army. I went through the selection process, and I became a Navy SEAL."

"What you have to understand is that the movie quotes you picked up on over the last two days is only half the story. Training is important, and the will to act on the training is obviously paramount. However, our minds are not naturally gravitating towards taking risk. So, if you want to be a risk-taker in life, you need to introduce risk into your life slowly and gradually."

"Once you begin to become accustomed to taking risk, your appetite for more risk will grow. Now there is a big difference between sitting in a casino, throwing a \$10 chip on a number at a roulette wheel and being engaged in active warfare. If you don't mind, I want to tell you how you can bridge that gap between what you are achieving now and what you want to achieve."

The key is not to train less. You still have to train. However, you need to review your performance, and then you need to replay it in your mind, over and over to how you want it to be. Your actual outcome and your desired outcome are currently not aligned. You need to spend specific scheduled and focused time on imagining your desired outcome. You can't control the enemy, but you can practise your response, so it becomes automated.

By doing so, you will de-sensitise your mind to the normal impulses that a normal mind will react to. You will not have the same degree of hesitation as you used to have. You will not feel the same degree of trepidation. Most importantly, you will not encounter the same fear stimuli that a normal brain will because you will have trained the normal fear response out of your mind. “

We spoke about the practicality of mind training. I was astounded to learn about the level of preparation that an elite soldier goes through, and how rigorous the training is. Specifically, he told me about some common misconceptions about the selection process.

“When I went through the selection process, there was an All-Star athlete in the group. We all thought he would sail through the intensive training program. I looked at some of the scrawny Iowa farmer boys, and I thought “not a chance in hell they would make it.

12 weeks later – and the All-Star athlete had given up a long time ago, but the scrawny farmer boy with the spaghetti arms was still there. Everyone thinks that it is all about “brawn”, but actually the real battle is in the mind. It is the mind that runs the body. These farmer boys might not have been the perfect bodily specimen, but their minds were impervious to quitting.”

New Beginning

I didn't trade much for the rest of 2009. I studied – myself. I plotted my old trades on charts. I imagined better outcomes. I spent focused training hours on imagining, on visualising. The focus of my work became on “me” rather than on the markets and the charts.

When I started trading again, the effect was immediately noticeable. My trade selection process was markedly improved. My patience was significantly improved. However, the most important improvement was found in two areas.

1/ my winners were held longer, and I added more to them.

2/ my losers were cut without remorse.

As I see it, my training had subjected me to so much “imaginative losing” that when it came to the real thing, taking a loss was no longer associated with pain. It just became a natural part of the process of trading.

I want to make something very clear to you though. The process didn't improve my ratio of winning trades to losing trades. In fact, oddly enough, it worsened it slightly. I used to have a hit rate of around 70%. I was a prolific scalper and a short-term trader, and I was (and I am) VERY good at it.

But what good does it do you to have a 70% hit-rate, if you lose more on the 30% of trades you lose on. So, while my hit-rate went down to around 60%, my profitability went through the roof, and with it my enjoyment of trading.

And that is where the story could have ended.

But it didn't!

Technical Analysis or Behaviour Analysis

Then something happened, that proved to be a turning point in my life. I was invited to give a talk for a broker called ETX Capital. The CEO at the time was a real gentleman called Andrew Edwards.

I was to give a talk to some of their bigger clients about technical analysis, and I arrived at their office bright and early. Andrew Edwards invited me into his office for a friendly chat, and as we chatted away, I noticed some A4 pages on his notice boards. They looked like charts, but they were not charting financial products.

I asked him what the charts were showing. He told me they were charting client behaviour. He told me that virtually every broker in the world had begun to profile their clients, segmenting them into categories, such as "age", "sex", "income", "account deposit" to name a few. It was done to better understand the profile of the client, and how they were likely to act.

I didn't want to be controversial, so I kept my mouth shut, but I knew this profiling was done to segment clients into categories, essentially labelling them as either "likely to make a profit" or "unlikely to make a profit".

On the flight home that night I was evaluating my talk. Had I made a difference to them? I had given a thorough talk about technical analysis that day, but I wondered how many of those attendees would actually go on to perform better as a result of it. I couldn't take my mind off the charts that I had seen in the CEO's office. Is technical analysis utterly useless without training in behaviour modification tools?

I began to realise the reason why so few of the clients I had observed during my 10 years on the trading floor had made consistent profits. It wasn't because they didn't understand the financial markets. It was because they didn't understand what made them act how they did. It reinforced to me the training I had put myself through after my pilgrim walk in Spain. I had trained my mind to recognise both patterns on a chart and patterns of my behaviour.

As chance would have it, I received a phone call the following week, again from ETX Capital. The event had been a huge success, and they wanted me to repeat the course in my own home-country Denmark. ETX Capital had opened a branch in Copenhagen, and they asked me if I was interested in becoming their in-house instructor.

Why Are Danes Better Traders?

I began teaching their Danish client base on a regular basis. I changed my focus from pure technical analysis to a mix between technical analysis and emotional management. I taught the Danish clients how to handle emotional setbacks.

I gave long talks on how our emotional responses could be trained, very much like how elite soldiers are trained to handle stressful combat situations, over and over, until their sensory auto-response (how they were likely to respond without training) was no longer in control. Instead, they began to act in a way that only very few people act naturally.

The training was focused on doing the very thing that didn't come natural to them. It was done by creating an awareness of how they were likely to respond to stresses (trading losses) and how they could create circuit breakers in their mind, in order to facilitate the appropriate response.

These "after work" training courses became sought after for traders in Denmark. I ran them every month for years, and they were always packed. People wanted to know how to trade well, but they also wanted to know how to get rid of their bad trading traits.

2 years later I was sitting in Andrew Edwards office once again. I had been invited to the annual Christmas party of ETX Capital, and he invited me into his office. He wanted to share some news with me.

He pointed to an A4 page on his notice board. He said, "Do you see that chart there? Do you see the ones next to it? Do you see how different they are?"

"Yes", I said. "What is it"? One chart showed a steady rising curve, while the other charts resembled a heart monitor, oscillating around a mid-point, but with all of them sloping downwards.

"That is the Danish ETX Capital client's profitability curve vs. every other client we have", he said

He went on to explain that they had looked at every possible explanation why the Danish clients were so different to all the other clients globally. They traded more selectively. Their longevity was more than 15 months (and counting) vs the average 3-month life span of a typical client.

Their stake size was 400% bigger than the average global client. In every shape and form the Danish client matrix was different than all the other clients the brokerage serviced, he told me.

He went on: "Then we looked at the WHY. Why were the Danish client different? Why are this country's clients so much better than the average global client?"

They have the same charts, the same indicators, the same news flow, the same instruments, the same Bid Ask prices. It is the same personal demographic as well. Then we considered that people from Scandinavia are wealthier than the rest of the world. We looked at our Swedish and Norwegian clients, and their profile didn't fit the Danish profile. Clients from Sweden and Norway fit the global profile, but not the Danish profile."

"The only differentiating factor we could find between the Danish clients and the rest of the world clients is the fact that you travel to Denmark once a month and give talks all over the country about trading. I don't know what you are telling them, but please continue. You should write a book about it."

And that night I began writing. It took me 8 years. Why did the Danish traders make more money than the average global client did? They learned to lose better, and they learned to lose without clouding and diminishing their sense of self-worth.

Best Loser Wins is not a book about technical analysis. You are not going to succeed in trading by learning more and more strategies. A good trader, a profitable trader, is, surprisingly to most people, the person who handles losing best. That mindset is one we can acquire, and that is what Best Loser Wins is all about – acquiring the right mindset to trade profitably.

Best Loser Wins has an official launch date of the 16th of August 2022, but the audio book has already been released – with an American accent. I didn't have the time to record it myself. I know some countries have already released the physical book.

Thank you.

Tom Hougaard

www.TraderTom.com