

PREFACE

Books can generally be categorized into one of three groups: education, entertainment, or reference. Education books teach us; entertainment books amuse us; and reference books inform us. This book combines education with entertainment to make it easier to recall the lessons by remembering the story. In that sense, this book is a parable: a simple story illustrating important lessons. From the story of the little boy who cried wolf to the story of the emperor's new clothes, parables have been used to convey lessons that apply to many aspects of life. Similarly, in this book the story is about a commodities trader, but its lessons apply to stock-market and bond-market investors, as well as all types of business people: entrepreneurs, managers, and CEOs.

The moral of the story you are about to read is: Success can be built upon repeated failures when the failures *aren't* taken personally; likewise, failure can be built upon repeated successes when the successes *are* taken personally. Thomas Edison failed roughly 10,000 times before finding the right filament to make an electric light bulb. The day his Menlo Park laboratory burned to the ground a reporter asked him what he was going to do. Edison responded, "Start rebuilding tomorrow." In part, Edison succeeded because he didn't take failures or losses personally. On the other hand, consider Henry Ford, who worked with and greatly admired Edison. Ford started in 1905 with

nothing and in fifteen years had built the largest and most profitable manufacturing firm on the planet. Yet a few years later, this seemingly impregnable business empire was in shambles and would go on to lose money almost every year for the next two decades. Ford was known to stick uncompromisingly to his opinions; is it possible his company lost so much money because he took the successes personally and came to think he could do no wrong?

Personalizing successes sets people up for disastrous failure. They begin to treat the successes totally as a personal reflection of their abilities rather than the result of capitalizing on a good opportunity, being at the right place at the right time, or even being just plain lucky. They think their mere involvement in an undertaking guarantees success.

This phenomenon has been called many things: hubris, overconfidence, arrogance. But the way in which successes become personalized and the processes that precipitate the subsequent failure have never been clearly spelled out. That is what we have set out to do. This book is a case study of the classic tale of countless entrepreneurs: the risk taker who sees an opportunity, the idea that clicks, the intoxicating growth, the errors, and the collapse. Our case is that of a trader, but as with all case studies and parables the lessons can be applied to a great many other situations. These lessons will help you whether you are in the markets or in business. The two areas have more in common than one might suppose. Warren Buffett, the richest man in America, is quoted on the cover of *Forbes's* 1993 edition of the "400 Richest People in America": "I am a better investor because I am a businessman, and I'm a better businessman because I'm an investor." If the elements of success can be transferred between the markets and business, the elements of failure can too.

We could study a hypothetical series of successes to demonstrate how success becomes personalized and then how a loss follows, but you are more likely to remember and learn the lessons if they are presented in anecdotes about a real person and a really big loss. How big? The collapse of a fifteen-year career and the loss of over one million dollars in a mere seventy-five days.

WHY A BOOK ON LOSING?

Almost without exception, anyone who has participated in markets has made some money. Apparently people have at least some knowledge about making money in the markets. However, since most people have lost more money than they have made, it is equally apparent that they lack knowledge about not losing money. When they do lose, they buy books and attend seminars in search of a new method of how to make money since that last method was “obviously defective.” They are like racing fans making the same losing bet on an instant replay. Investors’ bookshelves are filled with Horatio Alger stories of rags-to-riches millionaires. Sometimes these books are read solely for entertainment, but more often than not they are read in an attempt to learn the secret of how the millionaires made their fortunes, particularly when those millions were made by trading in the markets. Most of these books are of the “how-to” genre, from James Brisbin’s 1881 classic *The Beef Bonanza: How to Get Rich on the Plains* to modern-day versions of how to get rich in the market: *How to win in the market . . .*, *How to use what you already know to make . . .*, *How to apply the winning strategies . . .*, *How to make a million dollars in the market before breakfast*. We’ve all read them, but if the “how-to” books were that beneficial, we’d all be rich.

A review of the investment and trading literature reveals very little written about losing money. When something has been written on this topic, it’s usually a sensationalistic, unauthorized tell-all biography or tabloid-like exposé that panders to people who delight in the misfortune of others. Personality-journalism books are definitely read for entertainment, not as an attempt to learn from the subject’s mistakes. Losing has received only superficial coverage in most books on the markets; they raise the subject, stress its importance, and then leave it dangling.

What I Learned Losing a Million Dollars is a light treatise on the psychology of losing and is intended for investors, speculators, traders, brokers, and money managers who have either lost money or would like to protect against losing what they’ve made. Most discussions of

the psychological aspects of the markets focus on behavioral psychology or psychoanalysis (i.e., sublimation, regression, suppression, anger, self-punishment). This isn't to say such books aren't instructive; it's just that most people find it hard to digest and apply the information presented in those books. Other books use hypothetical character sketches to make their points while others simply compile a list of old saws about losses. This book, on the other hand, entertains and educates you on the psychology of market losses in layman's terms, anecdotally, through the story of a trader who actually lost over a million dollars in the market.

The first part of the book is Jim Paul's personal odyssey of an unbroken string of successes that took him from dirt-poor country boy to jet-setting millionaire and member of the Executive Committee at the Chicago Mercantile Exchange before a devastating \$1.6 million loss brought him crashing down. One of the premises of this book is that the rise sets up the fall; the winning sets up the losing. You can't really be set up for disaster without having it preceded by success. If you go into a situation in a neutral position, having neither successes nor failures beforehand, you acknowledge that your odds are maybe fifty-fifty; you may have a winner, you may have loser. But if you start from scratch and have a run of successes, you are setting yourself up for the coming failure because the successes lead to a variety of psychological distortions. This is particularly true if you have unknowingly broken the rules of the game and won anyway. Once that happens to you, you think that you are somehow special and exempt from following the rules.

The seeds of Jim's disaster were sown with his first job at the age of nine. His exposure to the outside world, money, and material things was the foundation for his career's sharp and quick ascent as well as its ultimate collapse. Repeated attempts to make the money back by speculating in the markets ended in failure and left Jim disillusioned. He set out on a quest to find out how the pros made money in the markets so he could follow their example. When you're sick you want to consult the best doctors; when you're in trouble you want the best lawyers; so Jim read all about the techniques of the

professionals to learn their secret of making money. But this search left him even more disillusioned since he discovered that the masters made money not only in widely varying ways but also in ways that contradicted each other. What one market pro advocated, another ardently opposed. It finally occurred to him that studying losses, losing, and how not to lose was more important than studying how to make money.

The second part of the book presents the lessons Jim learned from his losing experience. Namely, there are as many ways to make money in the markets as there are people participating in the markets, but there are relatively few ways to lose money in the markets. People lose money in the markets either because of errors in their analysis or because of psychological factors that prevent the application of the analysis. Most of the losses are due to the latter. All analytical methods have some validity and make allowances for the times when they won't work. But psychological factors can keep you in a losing position and also cause you to abandon one method for another when the first one produces a losing position.

The third part of the book shows you how to avoid the losses due to psychological factors. Trading and investment mistakes are well known and easily understood but difficult to correct. What you need is not a long litany of complex psychological theories but a simple framework to help you understand, accept, and thereby avoid catastrophic losses. This book will help you recognize, identify, and avoid the pitfalls of investing, trading, and speculating.

So, why a book on losing? Because, there are as many ways to make money in the markets as there are participants but relatively few ways to lose, and despite all the books on how to make money in the markets, most of us aren't rich!

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**WHAT I LEARNED
LOSING A
MILLION DOLLARS**

