

THE PLAYBOOK

AN INSIDE LOOK AT HOW TO THINK
LIKE A PROFESSIONAL TRADER

MIKE BELLAFIORE

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The PlayBook

An Inside Look at How to Think Like a Professional Trader

Mike Bellafiore

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To my dad, who teaches me the most valuable lesson: work ethic

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About the Author

Mike Bellafiore is the co-founder of SMB Capital, a proprietary trading firm in New York City; SMBU, their education arm; and SMB Systems Trading, their algorithmic trading division. He is the author of “the trading classic” *One Good Trade*. His firm has regularly appeared on CNBC, Bloomberg TV, CNN Money, Fox Business, the BBC, and in the *Wall Street Journal* and the street.com. SMB’s trader training program was highlighted on the TV documentary *Wall Street Warriors*. An international lecturer, Mr. Bellafiore has built trader training programs globally for hedge funds, prop trading desks, and retail traders, working with some of the world’s largest traders. He lives on the Upper West Side, with his wife and newborn son.

Introduction

Weaknesses don't matter if you find solutions.

—Ray Dalio

The PlayBook will help you become a better, bigger, more profitable, increasingly efficient, well-rounded, calmer, happier, and grateful trader. This book teaches you how to make more of the trades that make the most sense to you, with larger size, holding them for the real move, so that you boost your trading P&L. It will gift you with the tools to realize what I argue should be your ultimate goal: becoming *your best trader* (YBT). The PlayBook is the derivative of something good coming from personal hardship (mine, as it turns out). Let me tell you how it all happened and how the PlayBook can transform your trading performance.

I was in my hotel room in Phoenix, Arizona, preparing to talk to the Scottsdale–Phoenix meet-up group when my BlackBerry vibrated. It was my mom.

“Michael, I am so sorry to tell you this. Your father has had a stroke. It's not good. I don't know what to do.”

“Here, please talk to your father,” continued my mom.

She put my dad on the phone. Well, more accurately a man's voice came to the phone. It could have been my dad, but it was hard to tell. The man on other end of this phone clearly had had a stroke. “Hello” was “Hawoooooh” and with great strain from the speaker. The man gave the phone back to my mom.

“Mom, let me check when I can get out there and call you back.”

“Okay, thank God. Thank you, Michael.”

I hung up the phone, went to Kayak.com, and punched in an airline search for from Phoenix to Tampa. My hands felt frozen from the shock. I could arrive very early the next morning if I left in the next hour, or in the early afternoon with the first flight out the next day. I thought: Seriously, you can't get from Phoenix to Tampa in a few hours. Driving would take forever, the same with a bus, and there were no trains.

Guilt for my inadequacy to immediately be in Tampa persecuted my mind and body. In 46 minutes I had a commitment to give a lecture to a group important to me to support and for which I'd flown across the country. But my family needed me. I needed to be in Tampa for them urgently. Should I bolt to the airport, cancel my presentation, and land in Tampa early morning the next day? Should I do the talk and head out on the first flight the next morning? I called my wife. I called my sister. I called my mom. This was my prisoner's dilemma. We decided on the first flight out the next morning. I hated this decision.

I arrived at the venue for the Scottsdale–Phoenix meet-up, which to me appeared like a quintessential location shoot for those political town hall meetings. *And now running for the Scottsdale city council, please help me welcome candidate Mike Bellafiore.* What was I doing here? None of this was helping my mom or dad. I was physically present while my mind was observing the absurdity of my presence.

So I went and did it: I stood on my feet for three hours talking to a room full of mostly retired investors. I had painstakingly prepared a talk on short-term trading setups, but after one look around

the room of this friendly senior citizen crowd, I scrapped my prepared remarks to engage this demographic. I got lost in our talk for a few hours, with appreciative attendees coming together as a community, a trading community. They were admirably in attendance to learn more about the markets, meet some new people who invested like them, and perhaps spend a night away from mindless reality TV. There cannot be enough great meet-ups for investors/traders across the United States. People like me have an obligation to support them. Such communities make our markets better for the plain reason that a well-educated trader class manifests a better market.

I gave that audience everything I had, answered every last question, and shook each hand with a smile such that no one detected my personal hardship. *Just like my dad would have done.* Engrained in my memory is a snapshot of my dad on his hands and knees, paint, dirt, and muck smothering his work blue polo, improving a family property for one of his tenants. This is work ethic. You do things as well as you can because what else is there?

At 9 p.m., I walked out of the hall exhausted, on-the-road famished, and about to face one of the most difficult years of my life. I drove my rented mid-size back to my resort hotel, asked for a 3:30 a.m. wakeup call, and passed out soberly, still in my suit and shoes.

BAA-RING!!!!

BAA-RING!!!!

My next conscious moment was the phone in my room ringing as I awoke feeling as if a 300-pound lineman had just sacked me. The early hour brought me that sleep-deprived physical pain, stomach discomfort, and uncomfortable head pressure. Somehow I got on a plane, with my bags, and touched down in Tampa.

I called my mom.

“Hi, Mom. I’m here.”

“Oh, Michael, thank God you’re here. Your father is at Morton Plant Hospital. Do you know where it is?”

“I’ll find it.”

I walked into my dad’s hospital room, my mother sitting across from him, pale and trying to force an unworried smile. When her first-born son entered a room, my mother usually stood and made me feel like there was nothing else more important than me. She tried this now-impossible task while living her life-changing moment. I looked to the right at my dad, smiled, but inside was *astonished*. He couldn’t talk. He couldn’t move. He couldn’t lift his hand. “Michael” was “Mikahhhhh.” The strongest person I have ever known was now as fragile as a newborn.

This was so much worse than my mother had explained. I made happy small talk, unsure when to stop the farce. After this absurd hospital custom, my mom grabbed my arm and pulled me into a private room a few doors down the hall.

“Mom, people make full recoveries from strokes. Let’s not assume anything. When can we get him rehabbing?”

Okay, at this point (or well before, and if so, thank you for your patience), you might be wondering why I’m sharing this personal story with you, an account that has yet to say a single thing about trading. As it happens, this drama is pertinent, as you are about to see. And if ever there is a person who can inspire you to improve everyday as a trader, or serve as an allegory for the path of the new, developing, or underperforming trader, it is a recovering stroke victim. Further, an event like this helps traders place their work in the proper context. No one has ever lost a loved one in a losing trade. More to the point, the PlayBook might never have been born without this calamity.

Fast-forward (and bypassing medical bureaucratic details too numerous to recount), we finally freed my dad out of the hospital and into a 24-hour rehab center, where he (and I to a lesser extent) would live for the next 2 weeks. I write often on the SMBU blog that trading is an exercise in getting better everyday. A stroke victim personifies the ultimate real-life, all-consequences example of a struggle to get better each day. Your brain has been injured. New connections in your brain circuitry to control walking, speaking, and thinking must be remade. Harder still, you must do all of this in the autumn of your life, when you're supposed to be slowing down and enjoying the rewards you worked your whole life to reap.

Building your PlayBook is a similar test. As a trader, you must make connections in your trading brain for the setups that make the most sense to you. Then you can execute these plays as automatically as you breathe, walk, and talk. But before, each trade is a struggle of indecision and uncertainty. More about this soon.

I called Steve Spencer, now one of the most recognized U.S. equities traders in the world, the best man at my wedding, and my partner at SMB. "My dad has had a stroke. I am going to be here for a while." "Okay, stay as long as you need."

I didn't wonder for even a moment whether I would help my dad in his rehab. There were only moments when I questioned whether I needed to do more. My dad had given me so much. We ate dinner together every night during my childhood. I cannot recall a game he ever missed. He never declined a throwing session, which led to me becoming a college athlete. College. Law school. Now I would be there to help him.

Day one of rehab was one of the better days of my life, during the worst period of my life. I love the science of performance enhancement and saw it all-day, in real-time, inches from me. We went to speech therapy, physical therapy, and occupational therapy. Dad couldn't do much, and everything was so difficult. Picking up a sandbag during occupational therapy was impossible. I had to lift his back to get him into a bridge position during physical therapy. He still really couldn't talk. In a light moment, we got into trouble during speech therapy for not following one of the rules. Threats were made at us, and angrily. We laughed and laughed and laughed some more about potentially getting kicked out of the rehab home. As if there is anything really bad that can happen to you after having a massive stroke or seeing your hero after he has had one.

By the end of the day, Dad improved. He had the infrastructure to make progress, like a new trader must. And he was determined with every breath and thought to get better. Mom used to say she never met anyone as determined and focused as my dad. The rehab center was seeing that. He worked.

I returned home that first day to our Clearwater Beach family condo, which overlooks the Gulf of Mexico at one end and Tampa Bay on the other. My mom, obviously anxious and eager to hear my report, sprung up from her reclining chair upon my arrival. "Mom, he is going to make a substantial recovery."

"Oh, Michael, that is such wonderful news."

For the next ten days, I woke early, grabbed a few protein bars, and headed over to the rehab center to spend the day with my dad. I had in my head that the more he moved and thought, the better he would get. Sort of like the more screen time you get as a newb, the more you improve. During rest breaks, I asked him to punch my hand. By day three, he could. I would move my hand up and down, and he would slap at it. You could sense his brain struggle to figure out how to get his arms to hit my hand.

It was also hard to miss how my dad outworked the others in rehab (and by a large margin). Many did enough not to get in trouble, literally stopping their reps when the staff stopped looking. My dad did extra reps.

After every rehab set where I noticed progress, I praised him. We built from the positives. I would tap his stomach and say, “Good set” or “Good work, Dad.” The trading coach in me knew that to sustain his motivation I had to encourage the effort and not the result. I knew that act of touching would help reduce his stress and communicate we were in this together. Before I headed home after day five, I pulled his chair right up to mine, waited for his eyes to meet mine, smiled, and said unwaveringly, “You are going to make a substantial recovery. People can make remarkable recoveries from strokes. Keep working. You are going to get better.” I could have been talking to one of my traders.

I sensed he wanted to get better *for me*. Of course, he wanted to improve for himself, but he also wanted to get better for me. I wanted (no, needed!) him to get better, and he read that. I see this behavior in my traders with whom I am close. They do not want to disappoint *me*. Coaches who love their players will see them do almost anything not to disappoint them. Love is a powerful motivator.

During speech therapy, my dad earned the nickname “Friendly Frank” because he gabbed with everyone in the facility. Friendly Frank grasped that he needed to talk as much as he could to expedite his speech progress. So he talked to everyone. He was working to get better and enjoying himself with his latest challenge.

There were periods of frustration to overcome. On one particular day, my dad got discouraged at a lack of staff attentiveness. He directed unkind comments at their competence and performance. He was acting like a trader on tilt. I had to keep him focused on his task. When Dad started complaining about bad service, I refocused him on the only thing that was important: our day of improvement. I told him to count to ten when he got mad, and to take deep breaths between each number. All that mattered was that he play as much as he could with his rubber bands and speech exercises and jabbing drills we had created to speed his recovery. I could have been talking to one of my favorite traders moaning about *high-frequency traders* (HFTs). In trading, we say, “One Good Trade and then One Good Trade and then One Good Trade.” (I hear there is a pretty good trading book by this title.)

My wife flew down for Christmas. I hadn’t seen her for a few weeks at that point, which was just two months after our wedding. She got a kick out of seeing my dad working so hard, stopping to talk with everyone, and answering every question asked to the rehabbers during group therapy.

“Frank, don’t raise your hand. You can’t answer every question.”

“Why not?”

She laughed. My dad and I laughed. We all laughed again together. He had a point. Why not?

On day ten, my dad stood, placed his right hand on a handrail, and walked 40 yards up the rehab hall and then back. Wow! He was going to walk again! I couldn’t wait to go home and tell my mom.

The prior four nights my mom had been very ill. She had a history of stomach issues and couldn’t keep anything down. She wasn’t sleeping. Her back was terminally screwed up, and she was in constant pain. I found her pacing our condo in the middle of the night trying to relieve her back pain. Doctors say one of the mistakes a family makes is not looking after the spouse of the stroke victim (in this case, my mom).

Before my wife and I left the rehab center that day, my dad asked me to go check on my mom. Even selfless, he was first worried about her and her health. As hard as life had been after taking that call about my dad from my mom, it was now about to get worse.

My wife and I grabbed some dinner at the mall in Tampa and then headed back to the condo. I opened the door and found my mom face down on our kitchen floor.

I sprinted right to her, turned her over, and found a huge welt above her left eye, which had absorbed her fall. I called 911. "My mom is unconscious. Send an ambulance."

"Okay, sir. Where are you?"

I answered.

"Is she breathing?"

"How do I tell?" And on it went.

"Clasp your hands together and push against her chest. I will help you with the tempo." And the gu was going, "And push and push and push and push." My mom was covered in sweat and obviously dead, and here I was, in my opinion, just hurting her body.

"Mom, please wake up. Mom, please wake up."

Seemingly hours later, really approximately 15 minutes, the paramedics and police arrived. Like some *CSI* episode, the paramedics took over and applied machines and technology to my mom. In cases like this, the police look around. They ask you questions. You show them your license. They are doing their job, and their presence is comforting, but you cannot help but think, "Does anything else matter but that my mom is obviously dead? How in the world am I going to tell this to my dad?"

We followed the paramedics to the nearest hospital. Well, we started to, but then got lost. We eventually arrived, and then waited in the waiting room (never has a room been so aptly named). It was bizarre: I was certain my mother had passed, but we were waiting around as if she had an ankle sprain and were anticipating X-ray results. I called my sister.

"We're at the hospital. Mom had an accident."

Now, you wait, and you know what they are going to come and say. They hand you a plastic bag of your mom's possessions. Strange thoughts drift about like, "God, is that a ginormous diamond necklace she wore!" They escorted us from the waiting room into an exam room and told us the doctor would come with news. News? The doctor is going to come and tell us that my mother is dead.

Some young, sweet Indian doctor and kind-eyed nurse entered the room. *Well, this can't be good.* The nurse was obviously there to help us with the grieving. If it were good, there would be no nurse. This must be protocol.

"I am so sorry to tell you that your mother has passed away. You can go and see her now." I entered the room and felt more grief than one should possibly have to bear. And I felt an awful and strange protective guilt for the trauma to which I had just exposed my wife. How could I have missed not paying more attention to my mother?

My sister flew down on the next day, Christmas, with my then one-year-old niece Kate. My little sister had ordered me not to tell my dad until she arrived. Mom always said, "Never awake anyone with bad news. It can wait until the morning." It's funny the things you never question said by your mom.

We found my dad. I wasted little time. "Dad, we lost mom last night." My heart broke looking at my dad's face as he absorbed this news. We brought in Kate to play on Poppa's lap, desperate for some way to distract.

Over the next several days, we flew my dad back to Long Island, buried my mom, moved my dad into a rehab center in our hometown, and kept moving.

During all of this, the markets don't close, the competition in the trader education space doesn't

discontinue business, trading systems need tweaking, and my traders require coaching and direction. Deals have to be negotiated, calls returned, and problems solved. But I wasn't able to work. I had lost my mom, and my dad needed my help. I was emotionally unavailable.

Later, at a conference in Singapore, I proclaimed that starting SMB was the stupidest, most arrogant, naive thing I had ever done. Starting a firm like I did, essentially from my Upper West Side apartment and with no outside funding, was overly-ambitious. I cannot help but think the years of my mom telling me I could do or be whatever I wanted led me to start SMB. Now that unconditional voice of confidence was silently resting. Meanwhile, the strongest person I had ever known was broken and years away from a significant recovery.

As if things were not bad enough, they were about to get worse.

The Perfect Storm

A perfect storm of events compiled to stop and reverse SMB's forward progress. As a firm or business, particularly in the money business, you never want to be backtracking; after all, the firm's very existence depends on forward momentum. Running a prop firm is very expensive. Specifically, even a flat month in P&L can cost 200k plus after fees, expenses, staff, and rent. From profitable to broke can come fast. Add to this strain 1) some of our profitable traders left, 2) the industry as a whole was struggling, 3) a large legal bill was ahead, 4) new regulation increased costs, and we were headed in the wrong direction. All of this came when I wanted to be elsewhere, with my dad and family.

I always love how people think running a business is so easy, particularly a trading firm. Respectfully, it isn't. And your individual trading business will not be easy for you to run either. We will be upfront about not having all the answers, mistakes made, the need for timeouts during personal struggles, and the necessity to persevere as a trader or firm. Solutions must be found, you must uncover a way to subsist and even reinvent yourself. This is true even for the best traders and firms. This is the life we have chosen. As it so happened, *The PlayBook* was the key for how we weathered this storm.

A great clash lay ahead, one that would have been daunting even if I were at full strength. But I wasn't. My mental state held us back. For example, SMB was sucked into a contentious negotiation with our third-party provider. We leased space and routed our trades through this third party. I had to excuse myself from these meetings because the idea of fighting over a nickel on tickets just wasn't in me. Nor was I in the proper state of mind for the day-to-day grind of running a prop-trading desk, educational arm, and our new systems-trading division. When you have just experienced trauma, stress can trigger a return to a state of trauma, which is unhealthy.

Ciao Bella

That perfect storm? First, some of our consistently profitable traders left. At that time, the career path for our traders was this: become a consistently profitable trader and then get bigger. How 2007! Other firms (poachers from the League of Lesser Firms) learned of the success of many of our home-grown traders. These firms started offering our built-from-scratch guys race-to-the-bottom trading deals that we could not match. It would be hard to find objective traders who would not acknowledge that we offered the best training and infrastructure for the beginning trader. Most of our competitors even admit this. The problem was we were not offering enough value to those who we had trained to become consistently profitable heading into their year three or four with us. SMB thought loyalty and our present value would keep the traders we built for their entire career. We were mistaken.

Here's where we were wrong. If a firm is only going to offer the chance to get bigger after traders are consistently profitable, these traders might forget or undervalue the firm's contribution to their

success. At that point, you can be viewed as just a buying-power provider, for which some profitable traders do not want to share much of their profits. In 2009, traders were seeing their profits shrink from the historic trading opportunity of 2008, so some sought ways to keep more of their take. Poaching firms were desperate to fill their emptying seats and so pitched our traders. In fact, one firm kept a file of all the bad things they could say about SMB and literally handed our guys this information. It was mainly printouts of trader forum nonsense, home of the anonymous failed trader and made-up testimonials. I have heard from reliable sources that this firm is responsible for many of the negative quotes in these forums about competing firms. This mistakes playing tackle, being a tough businessman, with being unethical. Some of our guys wanted to find a way to get closer to their 2008 levels and fell for this sell of greener pastures.

SMB had a math problem. You see a prop firm takes losses on underperforming or new traders so that one day those better traders will have a new crop of traders around them offering fresh ideas, new strategies, and lower transactions costs. You are only as good as the stocks you trade. Sixty extra pairs of well-trained eyes calling out trading opportunities helps you as an experienced trader. Then these new traders develop strategies that you have not considered, which you might add to your trading quiver. Further, when these new traders get good, transaction costs decrease for the firm, which can be spread to all traders. When the older, profitable traders squeeze the firm for minimal profits, the firm cannot support the lesser traders' losses.

Simply put, our profitable traders asked for deals that we could not meet within our prop trading model. They got upset that we weren't matching the race-to-the-bottom deals that poacher arcades were offering them, so they left. After a few guys leave, others find other reasons to leave. A firm can become like a downtrending stock that needs a catalyst for it to change direction. Arcades offer a seat and computer but do not offer downside risk, draws, or value-added trading tools and services to traders. It's cheaper to trade at an arcade. I don't have a problem with another firm talking to our traders that approach them. I am even okay with another firm approaching a trader who came to us as experienced. I have a problem with that firm approaching traders I built from scratch and selling them on a better world of slightly lower transactions costs. One trader left to save maybe \$500 a month. That is about the cost of parking in NYC. Seriously, that is the business you are in?

Pitch them on added value, specifically technology, more downside, better education, and so on. Show them how you can significantly increase their P&L. That is fair game as far as I am concerned. Also, show some decency. Don't come after the guys I spent ten hours a day with for three years. Playing the lowest cost provider game with rates now so cheap actually harms better firms like mine who invest in their traders. Without firms like SMB, there will be no new blood of future star traders. Also, it sells a false premise that lower transaction costs will improve your P&L. Unfortunately, too many trade to their P&L regardless of transaction costs, meaning that once you know your costs you factor that into all of your trades. Your overall results stay the same. This is just trader psychology.

Perhaps the reason for leaving was our limited career path. Perhaps it was the tougher market of 2009 forcing traders to look elsewhere. Perhaps after three years of our coaching it was time for a new voice for some of them. With our past model of "get good and get bigger," perhaps our desk was more like a college basketball program where, after four years, seniors graduate or turn pro and you have to develop a whole new set of players. Perhaps those traders should have been more loyal.

Whatever the reasons, winners get to write history. You cannot keep losing consistently profitable traders and then claim you were right. That is a world of failure. All that said, I am proud that most of those traders were grateful for the trading education they received from our firm, how much they learned, and our indisputable contribution to their trading success. Some now are seven-figure traders. Many gross more than \$250,000 each trading year. A few are even running their own firms. A bunch

manage money for others. A half-dozen even work at places like Bridgewater, the second-largest hedge fund in the world. One thing was crystal clear from the loss of traders in 2009–2010: We need to get better and offer more.

In full disclosure, I was deeply hurt by this trader exodus. Intellectually I am aware that I am not supposed to take such things personally, that business is business. That is beyond my capacity. Guys train are more like friends and family to me. I spend too much time with them, worry too much about their progress, and get to know them too well not to miss them when they leave. This even applies to traders who don't succeed; it's a horrible feeling that haunts me for weeks when a guy fails. What's worse is when new recruits come in and don't see some of those great traders you helped develop. That is tremendously disappointing.

And there was more.

The Intraday Trading Contraction

Adding to my strife, the intraday trading industry as a whole was struggling. This was not indigenous to intraday trading; in fact, it is more accurate to note that the equity trading world was hurting. So difficult was this period that intraday trading godfather Steven Schoenfeld penned an infamous letter to his traders putting them on notice that many would soon be fired if their performance did not improve. The biggest, baddest, and richest intraday trading firm on the Street was cutting costs. Also, there was the “day trading is dead” blog of the week. These were exaggerations. Day trading (a term I refuse to recognize; it's called *intraday trading*) was contracting, times were tough, but it was not dead. When I first started, we were taught the trading principle that not all years on the Street are wildly profitable. I did not hide any of this on my blog penning numerous posts on this subject.

In one of these “day trading is dead” blogs of the week, I lost a friend who runs an established finance website. From my perspective, SMB was very helpful to this site when it first launched, earning it credibility on the Street. His site posted a sensational, irresponsible blog post titled “Day Trading Is Dead.” The industry was down enough; this post that would be read by many didn't need to exaggerate. I knew the author of this piece, who had spent like three minutes in the field of intraday trading, and also knew that the title had been changed by my former friend for the purpose of driving traffic. I called respectfully lobbying the website to rechange the headline to its original title. He did, but that was the last we spoke.

Firms were shrinking as traders were being washed out. HFTs were seen as ruling the day. Allocators were pulling funding of the bigger intraday traders as their appetite to back discretionary traders waned. It was a tough time for the intraday trader and firm.

And then came the worst moment of my trading career.

The Government

Steve was calling. I answered.

“Hey, how are things?”

“I have some bad news. We just received a subpoena from the SEC to be a witness to an investigation.”

Adding to all this, SMB was about to absorb a major legal spend complying with an SEC witness subpoena. Remember our third-party partners with whom I couldn't bear to argue? They were being investigated by the SEC. We were issued a subpoena to be a witness to their investigation and provide documentation that related to them.

And the hits just keep on coming.

My dad had a stroke, my mom had passed, we lost some of our better traders, equity trading was suffering, and now we had to provide hundreds of pages of documents and pay a top lawyer god know how much because someone else was potentially in trouble with the SEC?

WTF!

There is something about getting documents from the government, any documents; no matter how innocuous they might be, it just scares the heck out of you. Add to this that at this time penalizing the Street, anyone on the Street, was political treasure. We immediately wondered if we were doing something the SEC had decided to use its enforcement power to correct. And if they did, how far would they go? This may seem odd, but the rules for trading firms at times are not clear, even after review from your lawyers. And you cannot just call up the SEC and get their guidance on activities. They tell you when you are wrong only after you act, not before. You could be doing something improper without your counsel or you knowing it. Regulators can decide you were doing something incorrect without you being able to foresee it. That is just the way it is. It is a weird game of moving regulatory target practice, even for the good guys on the Street.

As a firm, you do the best you can so that the government never even wants to ask a question as to whether you are or were doing something improper. Firms in our space had been shut down by the SEC, with partners banned from the business. To clarify: Those firms were doing some very shady stuff that was clearly illegal. Was the subpoena as a witness just a ruse to start investigating us next? While most likely not, at this time our sole focus was not to end up on the front page of the *Wall Street Journal* and live to play another day.

More perverse during this whole fiasco, I felt like a guilty person. I racked my brain thinking, reviewing, wondering if we had done something wrong. I am a lawyer, so is Steve, and our business model is regularly scrubbed by attorneys. None of us could think of anything. The whole reason I started SMB was to give new, developing, and underperforming traders their best chance of succeeding. Check the thousands of blogs we have shared for free in the blogosphere. See *One Good Trade* and the hundreds of webinar hours released to the trading community. And here I was worried about having done something improper and having to expend money and time and stress to contain this matter?

WTF!

Imagine sitting down with your newlywed wife and telling her that news.

WTF!

We spent five days finding the best attorney. We spent the next six months paying him and his firm and providing all the documents requested by the SEC. We shared hundreds and hundreds of pages of documents through our lawyers. Our e-mails, contracts, and trader results were delivered. Again, I feel like a villain, while desperately trying to find something we could have done untoward. We were paranoid, part responsible business owners playing outstanding defense.

As it turned out, we were, in fact, not next to be investigated. We really were only a witness. And that third party in the end had done nothing improper. It turned out this third party was one of many being scrubbed by the SEC simultaneously. But this was huge money, brain, and time drain that required daily attention during a period when we were not at our best. The result of this industry-wide investigation was most prop firms moving to regulated entities, registering their traders, and dealing with the added cost of this regulation.

Just Doing Their Job

The SEC and other Wall Street regulators have a difficult job. Wall Street is a dangerous, powerful place with a few dishonest players. It's often the case that "good guys" are in fact the crooks; so how can governmental lawyers know whom to trust? Jon Corzine, a U.S. senator, governor of New Jersey, and former head of Goldman Sachs, blew up his futures firm, MF Global, including customer money totaling \$1.6 billion, with absurd trading risk. Long Term Capital Management, whose traders were once known by the phrase "the smartest guys in the room" blew up \$4.6 billion following the Russian financial crisis, which required intervention by the Federal Reserve. The head of JPMorganChase, who used to possess the best reputation on the Street, testified to Congress that a "London Whale" trading loss would be in the vicinity of \$2 billion. It turned out to be more than \$6.2 billion. Recently, major banks, most notably Barclays, have been fined and charged with fixing interest rates. And let's not forget Bernie Madoff.

And then we have the mortgage-backed securities fiasco, which was perhaps the heart of the 2008 financial collapse. Our prestigious banks took outsized risks with mortgage-backed securities, and then tax payers had to bail them out. Some journalists, however, have argued that it wasn't so much that the banks took outsized risks. It's that they engaged in outright fraud. As *Rolling Stone* reporter Matt Taibbi has noted about the 650-page bipartisan report titled *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse*, the document compiled "a mountain of evidence" against Goldman Sachs. Evidence of "gross, bald-faced fraud delivered up in such quantities as to almost serve as a kind of sarcastic challenge to the...Justice Department." Consider this morsel. Goldman's CFO, David Viniar wrote, in an internal memo, of the urgency to reduce the bank's giant bet on mortgages. "Let's be aggressive distributing things because there will be very good opportunities as the markets [go] into what is likely to be even greater distress, and we want to be in a position to take advantage of them." Taibbi's translation: "Let's find as many suckers as we can as fast as we can, because we'll only make more money as more and more shit hits the fan."

Clearly, there are many leaders in finance who do things that are unconscionable such that it brings a pox on all of us. So, the government has to investigate fully, even a matter as small as ours. The sins of others are a regulatory tax on all of us.

Okay, so this was not the best of days for our firm. SMB was not very good. On the Street, like in golf, we learn to play the ball where it lies. We needed a solution. We knew improvement would take time, at least two years. We needed to invest in our strength, building new and developing traders, with new and better techniques and wait. We went all in on our core competency, building profitable traders from scratch.

The PlayBook Becomes Our Solution

Some traders on our desk still needed my help during our rebuilding phase at SMB. But I needed a time out. I had learned enough not to trade in this psychological condition, so they wouldn't receive my tick-by-tick, real-time trading instruction. With me on the desk, actively trading, a new trader learns the best stocks to trade, the setups that are worth risk in real-time, strategies for various trading patterns, how to read the tape at expert level, how to get big and hold, and much more. Real-time coaching is the most effective way of working with a new, developing, or underperforming trader. Mentoring and reviewing a trader's work after the close or a lull in the trading action is effective but not as beneficial as real-time coaching. (I find it disappointing when trading education firms don't know the difference between mentoring and coaching.) This is true of any sport. Going to the office on most days was not possible, as I was still helping my dad rehab, so face-to-face, one-on-one coaching sessions with our traders also were not an option. I faced a quandary: How could I contribute to the firm in this psychological state—and from Long Island?

The answer was The PlayBook. I needed a way to show our traders I still cared about their progress, though as this absentee coach. You cannot teach or coach anyone if students/players do not know you care. Reviewing their PlayBook trades and providing detailed feedback showed them that I did. I required a way to rebuild the desk without being on the desk.

Also, I coveted a way to get our core of developing traders bigger in their best setups. They suffered from what I call and outline inside this book *Trader Wuss Syndrome*, afraid to “man up” in their better risk/reward opportunities. Further, I craved a way for our traders to transition into more intraday swing trading, what we call Trades2Hold, from the momentum trading that worked so well in 2007 and 2008. HFTs had gamed that strategy out of the market, save for the very best momentum traders. Moreover, I needed a way to get them to hold their trades longer for the real move. In addition, because we had a solid core of young traders, I wanted them to learn more from each other.

The PlayBook was their framework to talk most specifically about trading setups with this strong core. The act of talking about your trading with fellow traders is a very powerful progress tool. I needed to get our firm back on track and our traders improving—and I had to do it all from a distance. And so out of this crisis the SMB Playbook was born. It was our solution.

The Truth about Trading

People often ask me to autograph *One Good Trade*, which I do with gratitude. I receive appreciative e-mails daily about how my work has helped traders, which makes my day. When I was in Singapore I literally couldn't pass through the lobby of my hotel without someone recognizing me and asking to take a picture. Perhaps the large billboards of Jim Rogers and me presenting at a big conference was the cause. SMB recently had to shop for a new trading space in NYC for a *joint venture* (JV) with a larger firm. Apparently, very few traders missed *Wall Street Warriors*, and some of our other appearances, as they easily recognized Steve and me when we walked onto a trading desk looking to sublease space. I have been introduced as a “trading expert” to multiple packed-house lectures. If you Google my name, you can find some pretty nice things said about my writing and the contribution my firm has made to the trading community. All of this makes me very uncomfortable in the sense that some might think that I, and people like me, have mastered the trading game. I haven't. I never will. This is impossible.

What you can learn from me, my firm, and *The PlayBook*, and the reason I have shared so openly about the personal events described earlier, is the truth about trading. These truths often escape what call The Financial Media Entertainment Complex and leave many new traders misinformed. You mu

get better every day. Even if you do become a great trader, you'll sometimes face personal struggles and need a timeout. ~~When you become a successful trader, this is not the end. There is no trader destination. Trades will stop working, and you will have to find new ones that do work. Seven-figure traders can walk around in a frustrated daze desperately searching for a return to just a profitable month. Trading is a sport of survival, reinvention, and perseverance, even for the successful trader. That is why I shared the earlier personal anecdotes. That is why it is so important for each trader to develop his or her own PlayBook. This is what I hope you learn from this book.~~

Yes, You Can!

Even though trading is so very challenging, you *can* do it! The market doesn't care where you went to school, who your father is or isn't, what country club you belong to, your past stardom as a college athlete, or your IQ. But the right path to success does matter. The daily rehearsal, practice, thinking, trade talking, and review are crucial. You must embrace the mindset to improve every day, build from your strengths, and develop your PlayBook. That's why, and I hope you agree, that this is an important book for your trading development.

Martin Seligman teaches us in his wonderful book *Learned Optimism* that we should absorb difficult events, such as mine described earlier, and learn to look beyond the hardship to recognize those moments in our life that appear catastrophic and to embrace them as opportunities to open our minds for the good that could follow next. And I found the good. I found The PlayBook.

Rogue Traderette, a terrific blog run by an Aussie woman, notes the difference between optimism the common glass-is-half-full kind to what she considers to be real optimism:

Real optimism is the ability to attribute the good stuff to "that's how life is" and the bad stuff to "that's how things are [at] this moment, but not forever."

We did make it through the storm. We did find a solution, which perhaps you can learn from. We are stronger than ever. Tomorrow can be better than yesterday. Our traders improved, our work developing traders was recognized, and we built a new and stronger office with everything new, developing, underperforming, or even experienced traders need to excel.

Developing your Playbook will be a personal journey of trader rehearsal. Your goal should be to improve to become a *Consistently Profitable Trader* (CPT) and then a YBT. Focus unrelentingly on what setups make the most sense to you. Your storms will come, but you can persevere and find your path to becoming a stronger trader.

What's Inside

Here's how the PlayBook works: After each trading session, I ask the players on our desk (and now you?) to archive a trading setup that made the most sense to them during that day. They archive this play in a template form, which we share: the SMB PlayBook. This exercise brands their winning trades in their trading brain, synthesizes the most important market patterns for them to study, and helps them internalize their best trading setups so that they trade them instinctively in real-time. There is no real-time deep thought and hesitation for their A+ trades. They spot a favorite trading pattern, they execute (*and* with size). The best traders know when they are right and get bigger. They spend their energy searching for more of their favorite setups and focus on where they can add size responsibly. In this book, you will learn how to get bigger in your best trades so that you improve your trading performance.

In this book, most chapters are divided into three sections: an introduction to a pro trader; their PlayBook trade; and a review of this trade with the trader, our desk, and me. We begin most chapters

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