Market Wizards

Interviews with Top Traders

Jack D. Schwager

Part I FUTURES AND CURRENCIES

Michael Marcus: Blighting Never Strikes Twice

1. Start as a commodity research analyst, then a floor trader, then work for Commodities Corporation. He attributes his success to Ed Seykota, who taught him how to cut losses, as well as the importance of riding winners. Ed is a trend follower, who utilized classic trading principles. Ed said, "The trend is down, and I'm going to stay short until the trend changes." He learned patience from him in the way he followed the trend.
2. Plywood price case: it was theoretically frozen at $110 per 1000 square feet. One day, the futures price was trading 20 cents over the legal ceiling. So I started calling around to see what was going to happen, but nobody seemed to know. I used the following reasoning: if they let it trade over $110 today, they might let it trade anywhere. So I bought one contract. Ultimately, plywood went to $200. The futures market functioned as a supply of last resort to users who couldn't get supplies elsewhere. Basically, it created a two-tiered market, a sort of legal black market.
3. Things leaned from the floor: you develop an almost subconscious sense of the market on the floor. You learn to gauge price movement by the intensity of the voices in the ring. I learned the importance of intraday chart points, such as earlier daily highs. At key intraday chart points, I could take much larger positions than I could afford to hold, and if it doesn't work immediately, I would get out quickly. My trading in those days was a bit like being a surfer. I later used that surfing technique as a desk trader. Although that approach worked real well then, I don't think it would work as well in today's markets.
4. The best trades are the ones in which you have <u>all three things going for you: fundamentals, technicals, and market tone</u>. First, the fundamentals should suggest that there is an imbalance of supply and demand, which could result in a major move. Second, the chart must show that the market is moving in the direction that the fundamental suggest. Third, when news comes out, the market should act in a way that reflects the right psychological tone. For example, <u>a bull market should shrug off bearish news and respond vigorously to bullish news</u>. If you can restrict your activity to only those types of trades, you have to make money, in any market, under any circumstances. All my profits come from the trades that met the criteria. The other trades broke even and kept me amused. The thing that saved me was that <u>when a trade met all my criteria, I would enter five to six times the position size I was doing on the other trades</u>.
5. I believe that <u>the era of trend following is over</u> until and unless there is a particular imbalance in a market that overrides everything else. Another exception would be if we were to enter a major inflationary or deflationary environment. One reason we don't have many good trends anymore is that the central banks are preventing currency moves from getting out of hand by taking the other side the trend.
6. I try to avoid the currencies, because I feel it is a totally political situation; you have to determine what the central banks are going to do. During late 1978, the dollar was getting battered, falling to new lows every day. One day, we noticed

that the dollar got mysteriously strong. There was an intense price movement that couldn't be explained by any known information. We just bailed out of our long currency positions like crazy. That weekend, President Carter announced a dollar support program. That situation illustrates one of the principles we believed in – namely, that the big players, including the governments, would always tip their hand. If we saw a surprise price move against us that we didn't understand, we often got out and looked for the reason later. I believe the European central banks are notified about major changes we are going to make, and they often act ahead of US policy announcements. Consequently, the price move shows up in Europe first, even if it is because of something we initiate.

7. One of my rules was to get out when the volatility and the momentum became absolutely insane. One way I had of measuring that was with limit days. In those days, we used to have a lot of situations when a market would go limit-up for a number of consecutive days. On the third straight limit-up day, I would begin to be very, very cautious. I would almost always get out on the fourth limit-up day. And if I had somehow survived with any part of my position that long, I had a mandatory rule to get out on the fifth limit-up day. I just forced myself out of the market on that kind of volatility.
8. I think to be in the upper echelon of successful traders requires an innate skill, a gift. But to be a competent trader and make money is a skill you can learn.
9. Advice for beginners: always bet less than 5% of your money on any one idea. If you take a long position in two different related grain markets, that is still one idea. Always use stops. If you become unsure about a position, and you don't know what to do, just get out. While you are in, you can't think. When you get out, then you can think clearly again. Perhaps the most important rule is to hold on to your winners and cut your losers.
10. E.g., when we were in a very inflationary period and all the commodity markets were trading in lockstep fashion. On one particularly powerful day, almost all the markets went limit-up. On that day, cotton opened limit-up, fell back, and finished only marginally higher for the day. You absolutely want to put down a bet when a market acts terribly relative to everything else. When the news is wonderful and a market can't go up, then you want to be sure to be short.
11. Gut feel is very important. Being a successful trader also takes courage; the courage to try, the courage to fail, the courage to succeed, and the courage to keep on going when the going gets tough.
12. If trading is your life, it is a tortuous kind of excitement. But if you are keeping your life in balance, then it is fun. All the successful traders have a balanced life; they have fun outside of trading.
13. On success: I am very open-minded. I am willing to take in information that is difficult to accept emotionally, but which I still recognize to be true. I look for confirmation from the chart, the fundamentals, and the market action. I don't trade the Dow Stocks. I prefer the little ones, because they are not dominated by the big professional traders who are like sharks eating each other. Commitment to an exit point on every trade.

Bruce Kovner: the World Trader.

1. Harvard graduate >> Professor in political science at Harvard and UPenn >> Trader in the interbank currency and futures markets. << influenced by Michael Marcus, who told him that "you have to be willing to make mistakes regularly; there is nothing wrong with it."
2. One of the primary anomalies Kovner discovered was related to the price spread between different futures contracts. Given the prevailing phase of the business cycle, interest rate theory predicted that the nearby contract (say, March) should trade at a higher price than the next contract (say, June). Although the nearest two contracts did indeed tend to reflect this relationship, Kovner found that the price difference between more forward contracts often started trading at near-zero levels. His first trade involved buying a forward interest rate contract and selling a more forward contract.
3. To this day, when something happens to disturb my emotional equilibrium and my sense of what the world is like, I close out all positions related to that event. The first rule of trading is that don't get caught in a situation in which you can lose a great deal of money for reasons you don't understand.
4. on own success: I have the ability to imagine configurations of the world different from today and really believe it can happen. Second, I stay rational and disciplined under pressure.
5. Successful trainees are strong, independent, and contrary in the extreme. They are able to take positions others are unwilling to take. They are disciplined enough to take the right size positions. A greedy trader always blows out.
6. I almost always trade on a market view; I use technical analysis a great deal and it is terrific, but I can't hold a position unless I understand why the market should move. Every position I take has a fundamental reason behind it. But I would add that technical analysis can often clarify the fundamental picture. Technical analysis is like a thermometer. If you are a responsible participant in the market, you always want to know where the market is – whether it is hot and excitable, or cold and stagnant. You want to know everything you can about the market to give you an edge. Technical analysis reflects the vote of the entire marketplace and therefore, does pick up unusual behavior. It is very important for me to study the details of price action to see if I can observe something about how everybody is voting. Studying the charts is absolutely crucial and alerts me to existing disequilibria and potential changes.
7. On trend-following system. The only thing that will save those technical systems is a period of high inflation, when simple trend-following methodologies will work again. However, if we have stable, moderate rates of inflation, the technical trading systems will kill each other off.
8. I sometimes put on a trade because "I've seen this pattern before, and it is often a forerunner of a market advance." I usually go with breakouts. Tight congestions in which a breakout occurs for reasons that nobody understands are usually good risk/reward trades.
9. – (Jack) How about breakouts that occur because there is a story in the WSJ that day? – that would be much less relevant. If corn is in a tight consolidation and then breaks out the day the WSJ carries a story about a potential shortage of corn,

the odds of the price move being sustained are much smaller. If everybody believes there is no reason for corn to break out, and it suddenly does, the chances that there is an important underlying cause are much greater.

10. – (Jack) It sounds like you are saying that the less explanation there is for a price move occurring, the better it looks. – I do think that. The more a price pattern is observed by speculators, the more prone you are to have false signals. The more a market is the product of nonspeculative activity, the greater the significance of technical breakouts.
11. Whenever I enter a position, I have a predetermined stop. That is the only way I can sleep. I know where I'm getting out before I get in. the position size is determined by the stop, and the stop is determined on the technical basis. I always place my stop beyond some technical barrier. Place your stops at a point that, if reached, will reasonably indicate that the trade is wrong, not at a point determined primarily by the maximum dollar amount you are will to lose per contract.
12. – What eventually tells you that you are wrong on a major position trade? – First, a loss of money itself slows me down, so I reduce my positions. Second, in the change in the technical picture will give me second thoughts.
13. – On emotional control. On any given day, I could lose millions of dollars. If you personalize these losses, you can't trade. I never had a lot of difficulty with the process of losing money, as long as losses were the outcome of sound trading techniques. But as a day-in, day-out process, taking losses does not bother me.
14. Bear markets have different characteristics than bull markets. The principal characteristics of a bear market is very sharp down movements followed by quick retracements. I would always sell too late and then get stopped out in what subsequently proved to be part of a wide-swinging congestion pattern. In a bear market, you have to use sharp countertrend rallier to enter positions. I had too many correlated trades in 1981 when I lost about 16%.
15. From that point on, I paid strict attention to the correlations of all my positions. I measured my total risk in the market every day.
16. I assume that the price for a market on any given day is the correct price, then I try to figure out what changes are occurring that will alter that price. One of the jobs of a good trader is to imagine alternative scenarios. I try to form many different mental pictures of what eh world should be like and wait for one of them to be confirmed. We create a scenario for every currency at least once a week. We define the range we expect for each currency and what we will do if it breaks out of these ranges.
17. Forgetting trading for a minute, one of the reasons I am in this business is that I find the analysis of worldwide political and economic events extraordinarily fascinating. For me, market analysis is like a tremendous multidimensional chess board.
18. On risks – I try not to risk more than 1% of my portfolio on any single trade. I study the correlation of my trades to reduce my exposure. In all my trading, if I am long something, I like to be short something else.
19. On different markets – the stock market has far more short-term countertrends. After the market has gone up, it always wants to come down. The commodity

market are driven by supply and demand for physical goods; if there is a true shortage, prices will tend to keep trending higher.

20. Advice: a. risk management is the most important thing to be well understood. B. undertrade, undertrade, undertrade. Whatever you think your position ought to be, cut it at least in half. C. don’t personalize the market. A common mistake is to think of the market as a personal nemesis. The market, of course, is totally impersonal; it doesn’t care whether you make money or not. D. if you don’t work very hard, it is extremely unlikely that you will be a good trader.
21. Regardless of the approach used, once a strategy is selected, the trader should stick to his game plan and avoid impulsive trading decisions.

Richard Dennis: A Legend Retires

1. Started as a runner on the exchange floor >> borrowed $1600 from family, bought a seat on the Mid America Exchange and run $400 to approach $200 million.
2. – (Jack) Do you know traders for whom early success proved to be their undoing? For many traders, it doesn’t matter so much whether their first big trade is successful or not, but whether their first big profit is on the long or short side. Those people tend to perennial bulls or bears, and that is very bad. Both sides have to be equally OK.
3. – Most dramatic emotional trading experience. One day, I made a particularly bad trade and lost about $300. I then compounded the error by reversing my original position and losing again. To top things off, I then reversed back to my original position and lost a third time. By the end of the day, I had lost $1,000, or 1/3 of my entire capitalization. Since then, I have learned that when you have a destabilizing loss, get out, go home, take a nap, do something, but put a little time between that and your next decision. Looking back, I realized that if I had had a trading rule about losses, I wouldn’t have had that traumatic experience. I learned to avoid trying to catch up or double up to recoup losses. I also learned that a certain amount of loss will affect your judgment, so you have to put some time between that loss and the next trade.
4. I always say that you could publish trading rules in the newspaper and no one would follow them. The key is consistency and discipline. Almost anybody can make up a list of rules that are 80% as good as what we taught our people. What they couldn’t do is give them the confidence to stick to those rules even when things are going bad.
5. Most traders who do a trade that works will not think: why did it work? What did I do here that I might be able to do in another market, at another time? There is not a lot of reflection on the process of trading. In contrast, I think I always have been analytical about trading, even before I ever researched a mechanical system. On the opposite extreme, you have the academic types who research before they have ever traded. They lack the seat-of-the-pants knowledge necessary to develop good trading systems. Mercifully, I did the trading first. Therefore, the research we do is more applicable to the real world.
6. You should expect the unexpected in this business; expect the extreme. Don’t think in terms of boundaries that limit what the market might do. There were

plenty of guys who went short soybeans at $4 in 1973, because just like sugar at 4 cents couldn't go any lower, beans at $4 couldn't go any higher. Well, not only did they go higher, they went to a high of $12.97 in a matter of four or five months.

7. – (Jack) When you hold a major position, at what point do you know you are wrong? - If you have a loss on a trade after a week or two, you are clearly wrong. Even when you are around breakeven, but a significant amount of time has passed, you are probably wrong there too. – (Jack) do you define your maximum risk point when you get into a trade? <u>You should always have a worst case point. The only choice should be to get out quicker</u>.
8. <u>On trading strategy. The market being in a trend is the main thing that eventually gets us in a trade.</u> Whatever method you use to enter trades, the most critical thing is that if there is a major trend, your approach should assure that you get in that trend. If a market goes up when it should go up, I might buy earlier. If it goes down when it should go up, I will wait until the trend is better defined.
9. – On different markets. <u>My research on individual stocks shows that price fluctuations are closer to random than they are in commodities. Demonstrably, commodities are trending and, arguably, stocks are random.</u>
10. – Does your solution to false breakouts involve being far more short-term oriented, so that you can respond more quickly to those situations? – The secret is being as short term or as long term as you can stand, depending on your trading style. <u>It is the intermediate term that picks up the vast majority of trend followers. The best strategy is to avoid the middle like the plague.</u>
11. <u>Trading decisions should be made as unemotionally as possible.</u> It is a little bit like playing golf: You can throw your clubs around after making a bad shot, but while you are making the next shot you should keep your head down and your eye on the ball.
12. Advice: <u>trade small</u> because that's when you are as bad as you are ever going to be. <u>Learn from your mistakes.</u> Don't be misled by the day-to-day fluctuations in your equity. Focus on whether what you are doing is right, not on the random nature of any single trade's outcome.

Paul Tudor Jones: The Art of Aggressive Trading

1. Started as a floor clerk for 6 months >> work for Eli Tullis – "the toughest son of a bitch" he ever knew.
2. Tullis taught me about <u>moving volume. When you are trading size, you have to get out when the market lets you out, not when you want to get out.</u> He taught me that if you want to move a large position, you don't wait until the market is in new high or low ground because very little volume may trade there if it is a turning point. He instilled in me the idea that, <u>to some extent, to be a good trader, you have to be contrarian.</u>
3. Dramatic trade: lost 60-70% of equity in a single trade in 1979 cotton market. I was determined to come back and fight. I decided that I was going to become very disciplined and businesslike about my trading. Now I spend my day trying to

make myself as happy and relaxed as I can be. If I have positions going against me, I get right out; if they are going for me, I keep them.

4. I become quicker and more defensive. I am always thinking about losing money as opposed to making money. I have a mental stop. If it hits that number, I am out no matter what.
5. My goal is to finish each day with more than I started. Tomorrow morning I will not walk in and say, "I am short the S&P from 264 and it closed at 257 yesterday; therefore, I can stand a rally." I always think of it in terms of being short from the previous night's close. Risk control is the most important thing in trading.
6. Trading rules: don't ever average losers. Decrease your trading volume when you are trading poorly; increase your volume when you are trading well. Never trade in situations where you don't have control. For example, I don't risk significant amounts of money in front of key reports, since that is gambling, not trading.
7. ALWAYS THINK OF YOUR ENTRY POINT AS LAST NIGHT'S CLOSE.
8. Don't be a hero. Don't have an ego. Always question yourself and your ability. Don't ever feel that you are very good. The second you do, you are dead. If you make a good trade, don't think it is because you have some uncanny foresight. Always maintain your sense of confidence, but keep it in check.
9. I am more scared now that I was at any point since I began trading, because I recognize how ephemeral success can be in this business. I know that to be successful, I have to be frightened. My biggest hits have always come after I have had a great period and I started to think that I knew something.
10. I believe the very best money is to be made at the market turns. Markets trend only about 15% of the time; the rest of the time they move sideways. I attribute a lot of my success to the Elliott Wave approach.
11. One of my strengths is that I view anything that has happened up to the present point in time as history. I really don't care about the mistake I made three seconds ago in the market. What I care about is what I am going to do from the next moment on. I try to avoid any emotional attachment to a market.
12. I never apologize to anybody, because I don't get paid unless I win. 85% of my net worth is invested in my own funds, primarily because I believe that is the safest place in the world for it.
13. We have a very good trading system. The basic premise of the system is that markets move sharply when they move. If there is a sudden range expansion in a market that has been trading narrowly, human nature is to try to fade that price move. When you get a range expansion, the market is sending you a very loud, clear signal that the market is getting ready to move in the direction of that expansion.
14. I always believe that prices move first and fundamentals come second. When I trade, I don't just use a price stop, I also use a time stop. If I think a market should break, and it doesn't, I will often get out even if I am not losing any money.
15. Advice: don't focus on making money; focus on protecting what you have.
16. Trading gives you an incredibly intense feeling of what life is all about. Emotionally, you live on the extremes.

Gary Bielfeldt: Yes, They do Trade T-Bonds in Peoria

1. I always try to lean primarily on fundamental analysis. However, since it was very difficult to know all the fundamentals. I thought it was important to have something to fall back in case my fundamental analysis was wrong – technical analysis. I use my own trend-following system primarily as a backup to tell me when to get out of a position.
2. On trend-following systems. – The best thing anyone can do when starting out is to learn how a trend system works. Trading a trend system for a while will teach a new trader the principle of letting profits run and cutting losses shot. I think to be viable, a trend-following system has to be medium to longer term. The more sensitive systems just generate too much commission. I would advise anyone who develops a system to combine it with their own judgment. In other words, they should trade half the money on a system and the other half using their own judgment, just in case the system isn't working.
3. Key factors in fundamentally evaluating the T-bond market. – the economy is the single most important factor. Four other elements are inflation expectations, the dollar, the trade balance, and the budget deficit.
4. – On elements of good trading. The most important thing is to have a method for staying with your winners and getting ride of your losers.
5. You need to develop a plan of your strategies for various contingencies. That way, you won't get swayed by every news item that hits the market and causes prices to move up or down.
6. Traits of a successful trader: a. discipline. b. patience. If you have a good trade on, you have to be able to stay with it. c. courage to go into the market, and courage comes from adequate capitalization. d. willingness to lose. e. strong desire to win.
7. On Success: most people will judge success by how well they do in their field. A trader would probably judge success by whether he wins or loses in the market.
8. On analogy between trading and poker: my father taught me the concept of play the percentage hands. You should play the good hands and drop out of the poor hands, forfeiting the ante. If you apply the same principles of poker strategy to trading, it increases your odds of winning significantly. I have always tried to keep the concept of patience in mind by waiting for the right trade, just like you wait for the percentage hand in poker.

Ed Seykota: Everybody Gets What They Want

1. EE from MIT>> developed the first large-scale commercial computerized trend-following trading system. I used an exponential averaging method because it was easier to calculate and computational errors tended to disappear over time.
2. My style is basically trend following, with some special pattern recognition and money management algorithms. The key to long-term survival and prosperity has a lot to do with the money management techniques incorporated into the technical system. In order of importance to me are: a. the long-term trends, b. the current chart pattern, and c. picking a good spot to buy or sell.

3. Over time, I have become more mechanical, since (1) I have become more trusting of trend trading, and (2) my mechanical programs have factored in more and more "tricks of the trade."
4. The profitability of trading systems seems to move in cycles.
5. Fundamentals that you read about are typically useless as the market has already discounted the price, and I call them "funny-mentals." However, if you catch on early, before others believe, then you might have valuable "surprise-a-mentals"
6. If I were buying, my point would be above the market. I try to identify a point at which I expect the market momentum to be strong in the direction of the trade, so as to reduce my probable risk. I don't try to pick a bottom or top.
7. If I am bullish, I neither buy on a reaction, nor wait for strength; I am already in. I turn bullish at the instant my buy stop is hit, and stay bullish until my sell stop is hit. Being bullish and not being long is illogical.
8. Dramatic trade: pride is a great banana peel, as are hope, fear, and greed. My biggest slip-ups occurred shortly after I got emotionally involved with positions.
9. Elements of good trading: cutting losses, cutting losses and cutting losses. I set protective stops at the same time I enter a trade. I intend to risk below 5% on a trade, allowing for poor executions.
10. On success: my success comes from my love of the markets. I am not a casual trader. It is my life. I have a passion for trading. It is not merely a hobby or even a career choice for me. There is no question that this is what I am supposed to do with my life.
11. Trading rules: a. cut losses; b. ride winners; c. keep bets small; d. follow the rules without question; e. know when to break the rules.
12. Advice for an average trader: he should find a superior trader to do his trading for him, and then go find something he really loves to do.
13. The markets are the same now as they were five to ten years ago because they keep changing – just like they did then. Trading becomes more difficult because it is harder to move large positions without moving the market. It becomes easier because you have more access to competent people to support you.
14. Good traders have a special talent for trading just as good musicians and good athletes have talents for their fields. Great traders are ones who are absorbed the talent. They don't have the talent – the talent has them.
15. My personal life is integrated with my trading life.
16. – (Jack) I notice there is no quote machine on your desk. – Having a quote machine is like having a slot machine on your desk – you end up feeding it all day long. I get my price data after the close each day.
17. – (Jack) How would you rate the relative importance between psychology and market analysis to successful trading? – Psychology motivates the quality of analysis and puts it to use. Psychology is the driver and analysis is the road map. The winning traders have usually been winning at whatever field they are in for years.
18. On traits to identify the winning trader personality: a. he loves to trade; and b. he loves to win.
19. On success: I don't judge success. I celebrate it. I think success has to do with finding and following one's calling regardless of financial gain.

20. EVERYBODY GETS WHAT THEY WANT OUT OF THE MARKET.

Larry Hite: Respecting Risk

1. actor and screenwriter >> rock promoter >> broker >>trader
2. I have noticed that everyone who has ever told me that the markets are efficient is poor. He argued that if I could develop a winning system on a computer, so could others, and we would all cancel each other out. – (Jack) What is wrong with that argument? – because people develop systems and people will make mistakes. Some will alter their system or jump from system to system as each one has a losing period. Others will be unable to resist second-guessing the trading signals. People don't change. Because of it, if you use sufficiently rigorous methods to avoid hindsight, you can test a system and see how it would have done in the past and get a fairly good idea of how that system will perform in the future. That is our edge.
3. When I was a broker, my boss taught me that if you don't call you client when he is losing money, someone else will.
4. The very first rule we live by at Mint is: Never risk more than 1% of total equity on any trade. Secondly, we always follow the trends and we never deviate from our methods. In fact, we have a written agreement that none of us can ever countermand our system. Thirdly, diversify in two ways. A. we trade more markets worldwide than any other money manager. B. we use lots of different systems ranging from short term to long term. Fourth, track volatility. When the volatility of a market becomes so great that it adversely skews the expected return/risk ratio, we will stop trading that market.
5. –(Jack) How many days of past data do you use to determine your volatility filter? Anywhere from ten to 100 days.
6. Over-rated indicators: Overbought/oversold indicators.
7. Valuable indicators: if a market doesn't respond to important news in the way that it should, it is telling you something very important. Secondly, when a market makes a historic high, it is telling you something. No matter how many people tell you why the market shouldn't be that high, or why nothing has changed, the mere fact that the price is at a new high tells you something has changed.
8. If you traded across the board, controlled your risk, and went with the trend, it just had to work. I could see it absolutely clearly.
9. Two basic rules: (1) if you don't bet, you can't win. (2) If you lose all your chips, you can't bet.
10. His system never trades counter to the market trend. There are no exceptions, and he always follows the system. Volatility is continually tracked in each market in order to generate signals to liquidate or temporarily suspend trading in those markets where the risk/reward ratio exceeds well-defined limits.

Part II MOSTLY STOCKS

Michael Steinhardt: The Concept of Variant Perception

1. Graduate from Wharton at the age of 19 in 1960 >> Research Assistant on Wall Street>> financial journalist and a research analyst >> founded own investment firm in 1967.
2. Investment style: Concept number one is variant perception. I try to develop perceptions that I believe are at variance with the general market view. I will play those variant perceptions until I feel they are no longer so. To make money in the markets, you have to be willing to get in the way of danger. I have always tended to short stocks that were favorites and backed by a great deal of institutional enthusiasm. Generally speaking, I have tended to short too early and, therefore, have usually started off with losses in my short positions. If I short a stock and it goes up a lot, it may skew my exposure a bit, but as long as my variant perception is unchanged, I'll stay short. If I'm wrong, I'm wrong.
3. Investment style: nothing that is so distinctive. I don't use stop-loss orders or such. I don't use any rules about buying on weakness or strength. I don't look at breakouts or breakdowns. I don't use charts.
4. There is a very important difference between being a theoretical contrarian and dealing with it in practical terms. In order to win as a contrarian, you need the right timing and you have to put on a position in the appropriate size. If you do it too small, it's not meaningful; if you do it too big, you can get wiped out if your timing is slightly off. The process requires courage, commitment, and an understanding of your own psychology.
5. Advice: Recognize that this is a very competitive business, and that when you decide to buy or sell a stock, you are competing with people who have devoted a good portion of their lives to this same endeavor.
6. Elements of good trading: The balance between confidence and humility is best learned through extensive experience and mistakes. There should be a respect for the person on the other side of the trade. Always ask yourself: Why does he want to sell? What does he know that I don't? Finally, you have to be intellectually honest with yourself and others. In my judgment, all traders are seekers of truth.
7. From the author: Steinhardt's filters are a combination of a keen sense of fundamentals and market timing. One trait I have noticed among a number of the great traders is their willingness and ability to take on a particularly large position when they perceive a major trading opportunity. Conviction is probably an important quality for any trader, but it is essential to the contrarian trader. Steinhardt has repeatedly demonstrated amazing resolve in maintaining large positions during difficult times, as long as he was convinced he was still right.

William O'Neil: The Art of Stock Selection

1. "Great opportunities occur every year in America. Get yourself prepared and go for it. You will find that little acorns can grow into giant oaks. Anything is

possible with persistence and hard work. It can be done, and you own determination to succeed is the most important element."

2. Born in Oklahoma during the Great Depression years and raised in Texas. Began his career as a stockbroker in 1958 >> bought a seat on NYSE and formed William O'Neil and Co. in 1964, an institutional research brokerage firm.
3. CANSLIM model:

- C: current earnings per share -> quarterly earnings per share should be up at least 20-50% year to year.
- A: annual earnings per share -> The prior five-year average annual compounded earnings growth rate of outstanding performing stocks at their early emerging stage was 24%.
- N: something new. It can be a new product, a change in the industry, or new management. We found that 95% of the greatest winners had something new that fell within these categories. The "new" also refers to a new high price for the stock. We find that 98% of investors are unwilling to buy a stock at a new high. Yet, it is one of the great paradoxes of the stock market that what seems too high usually goes higher and what seems too low usually goes lower.
- S: shares outstanding. 95% of the stocks that performed best had less than 25 million shares of capitalization during the period when they had their best performance.
- L: leader or laggard. 500 best performing stocks during 1953-1985 had an average relative strength of 87 before their major price increase actually began. I tend to restrict purchases to companies with relative strength ranks above 80.
- I: institutional sponsorship. Leading stocks usually have institutional backing. However, although some institutional sponsorship is desired, excessive sponsorship is not, because it would be a source of large selling if anything went wrong with the company or the market in general. This is why the most widely owned institutional stocks can be poor performers.
- M: market. 3 out of 4 stocks will go in the same direction as a significant move in the market averages. That is why you need learn how to interpret price and volume on a daily basis for signs that the market has topped.

4. On relative strength: - (Jack): might a relative strength of 99 indicate that the stock is overextended and vulnerable to a sharp correction? – (Bill): you have to look at a chart to make that determination. The key point is not how high the relative strength is, but rather how far the stock is extended beyond its most recent price base. You buy stocks that have a high relative strength if they are just beginning to emerge from a sound base-building period. However, I would generally not buy a stock with a high relative strength that is already more than 10% beyond its prior price base.
5. – (Jack) How do you tell the difference between a market top and a normal bull market correction? – First, the average moves up to a new high, but does so on low volume. This tells you that the demand for stocks is poor at that point and that the rally is vulnerable. Second, volume surges for several day, but there is very little, if any, upside price process as measured by market closes. In this latter case, there may not be a pickup in volume when the market initially tops, since the distribution has taken place on the way up. Another way to determine the

direction of the general market is to focus on how the leading stocks are performing. If the stocks that have been leading the bull market start breaking down, that is a major sign the market has topped. Another important factor to watch is the FED discount rate. Usually, after the FED raises the rate two or three times, the market runs into trouble. The daily advance/decline line is sometimes a useful indicator to watch for signs of a market top.

6. A stock should never be sold short because its price looks too high. The idea is not to sell short at the top, but at the right time. Short selling of individual stocks should only be considered after the general market shows signs of a top. The best chart pattern to short is one in which a stock breaks out on the upside of its third or fourth base and then fails. Before you sell any stock short, you should decide the price at which you will cover that short position if a loss occurs.
7. I make it a rule never to lose more than a maximum of 7% on any stock I buy. Letting losses run is the most serious mistake made by most investors. If you aren't willing to cut your losses short, then you probably should not buy stocks.
8. – (Jack) When to liquidate a winning stock position? – you should hold a stock as long as it is performing properly. You have to realize that you will never sell the exact top. Therefore, it is ridiculous to kick yourself when a stock goes higher after you sell. The goal is to make substantial profits on your stocks and not be upset if the price continues to advance after you get out.
9. On P/E ratio. To say that a stock s undervalued because it is selling at low P/E ratio is nonsense. We found there was a very low correlation between the P/E ratio and the best-performing stocks. The average P/E ratio for the best-performing stocks at their early emerging stage was 20, compared to an average P/E ratio of 15 for DJ during the period of 1953-1985. At the end of their expansion phase, these stocks had an average P/E ratio of approximately 45. This means that if, in the past, you were not willing to buy stocks with above-average P/Es, you automatically eliminated most of the best performing securities. A common mistake a lot of investors make is to buy a stock solely because the P/E ratio looks cheap. There is usually a very good reason why a P/E ratio is low. Another common mistake is selling stocks with high P/E ratios.
10. There is no correlation between dividends and a stock's performance.
11. Diversification is a hedge for ignorance. I think you are much better off owning a few stocks and knowing a great deal about them. For an investor with $5000, one or two; $10,000, three or four; $25,000, four or five.
12. Only about 5 to 10% of investors understand charts. Investors would be foolish not to use charts.
13. The volume is a measure of supply and demand. When a stock is beginning to move into new high ground, volume should increase by at least 50% over the average volume in recent months. High volume at a key point is an extraordinarily valuable tip-off that a stock is ready to move. When prices enter a consolidation after an advance, volume should dry up very substantially. In other words, there should be very little selling coming into the market. During the consolidation, declining volume is generally constructive.

14. On Random walk theory: it is not efficient because there are too many poorly conceived opinions; it is not random because strong investor emotions can create trends.

David Ryan: Stock Investment as a Treasure Hunt

1. Three times U.S. Investing Champions, worked for O'Neil.
2. Every time I buy a stock, I write down the reasons why I bought it. Doing this helps cement in my mind the characteristics of a winning stock. Maybe even more important, it helps me learn from my mistakes. Learning from my trader's diary: not buying overextended stocks, using O'Neil's criteria for stock selection, and being as disciplined as possible. The more disciplined you can get, the better you are going to do in the market.
3. Procedure for selecting stocks:

- I start out by going through the stock charts and writing down the stocks with strong technical action. I avoid stocks under $10. I probably go through about 4000 charts very week.
- Then, I look at the five-year earnings growth record and the last two quarters of earnings relative to the previous year's levels. The quarterly comparisons show you if there is any deceleration in the earnings growth rate. For example, a 30% growth rate over the last 5 years may look very impressive, but if in the last two quarters earnings were only up 10% and 15%, it warns you that the strong growth period may be over.
- The relative strength is very important. It should be at least above 80, and preferably above 90.
- I generally rule out stocks that are overextended from their base. Very often the stocks with the highest relative strength continue to outperform the market for months and months. I would rather go with a relative strength of 99 than 95. However, once the relative strength starts falling off, I usually get out of the stock.
- I usually want the industry group to be in the top 50.
- I am looking for stocks with less than 30 million shares and preferably only 5 to 10 million shares. Stocks with more than 30 million shares are more mature; they have already split a few times. It is a case of supply of demand: because you have more supply, it takes a lot more money to move those stocks.
- To cut down from 70 stocks to 7: I pick those stocks that have all the characteristics plus a great-looking base pattern. A lot of the stocks I buy have already doubled and tripled before I buy them.
- To sum up, I am looking for the strongest stocks in the market, in terms of both earnings and the technical picture.

4. I would probably place relative strength first, then EPS. Many times the relative strength takes off before that big earnings report comes out.
5. I only have about 50/50 of winners. I cut the losers very quickly. I make my money on the few stocks a year that double and triple in price. The profits in those trades easily make up for all the small losers. I usually hold my big winners for

about 6 to 12 months, stocks that aren't that strong about 3 months, and my losers less than 2 weeks.

6. Volume: if the volume doubles one day and the stock moves to a new high, it is telling you a lot of people are interested in the stock and buying it. If the stock moves to new high ground, but the volume is only up 10%, I would be wary. When a stock that has been moving up starts consolidating, you want to see volume dry up. You should see a downtrend in volume. Then when volume starts picking up again, it usually means the stock is ready to blast off.

- (Jack) so, in the consolidation phase, decreasing volume is good. If you continue to see very high volume, do you start thinking potential top? – yes, because that shows that a lot of people are getting out of the stock. You want an increase in volume when the stock breaks out, but you want a decrease in volume as the stock consolidates.

7. If a stock reenters its base, I have a rule to cut at least 50% of the position. Stocks should be at a profit the first day you buy them. In fact, having a profit on the first day is one of the best indicators that you are going to make money on the trade.
8. Different from O'Neil: I learned that most of our greatest winning recommendations started off with prices under 30 times earnings. O'Neil says the P/E is not important. I think it is, in that your success ratio is a lot higher on lower P/E ratio stocks. Lower P/E -> I really mean ratios between even and up to 2 times the S&P 500 P/E.
9. On success: I am doing something that I love to do and find fascinating. I think if you love what you are doing, you are going to be a lot more successful.
10. Advice: learn from your mistakes. That is the only way to become a successful trader.

Marty Schwartz: Champion Trader

1. Spent a decade losing money on trading as a securities analyst before he found his stride as a successful trader.
2. Even now, I still put in about 12 hours a day. I feel uncomfortable not doing the work. I calculate a lot of mathematical ratios and oscillators, and I post my own charts. My attitude is that I always want to be better prepared than someone I'm competing against. The way I prepare myself is by doing my work each night.
3. The rigorous Marine training gave me the confidence to believe that I could perform at levels beyond my previous expectations. Just as Amherst had strengthened my mind, the Marines strengthened my body. The two experiences convince me that I could do almost anything if I worked hard enough and provided the groundwork for my successful trading.
4. I lost my job in the bear market and was out of work for four months. That was a very interesting period, because I believe you learn the most through adversity.
5. When the market gets good news and goes down, it means the market is very weak; when it gets bad news and goes up, it means the market is healthy.
6. – (Jack) when did you turn from a loser to a winner? – When I was able to separate my ego needs from making money. I used fundamentals for nine years and got rich as a technician.

7. One of the most suicidal things you can do in trading is to keep adding to a losing position. The most important thing is to keep enough powder to make your comeback. Whenever there is a really rough period, I try to play defense, defense, defense. I believe in protecting what you have.
8. I have always had my biggest setbacks after my biggest victories. I was careless. So, after a strong run of profits, I try to play smaller rather than larger.
9. I always check my charts and the moving averages prior to taking a position. Is the price above or below the moving average? That works better than any tool I have. I try not to go against the moving averages; it is self-destructive. Has a stock held above its most recent low, when the market has penetrated its most recent low? If so, that stock is much healthier than the market. Those are the types of divergences I always look for.
10. Before taking a position, always know the amount you are willing to lose. Know your 'uncle point' and honor it. I have a pain threshold, and if I reach that point, I must get out. I always take my losses quickly. That is probably the key to my success.
11. I have several bank accounts and a few safe deposit boxes with gold and cash. I'm extremely well diversified.
12. If you're ever very nervous about a position overnight, and especially over a weekend, and you're able to get out at a much better price than you thought possible when the market trades, you're usually better off staying with the position. When your worst fears aren't realized, you probably should increase your position.
13. Advice: Think that you might become more successful than you ever dreamt, because that's what happened to me. The most important thing is not letting your losses get out of hand. Also, don't increase your position size until you have doubled or tripled your capital. Most people make the mistake of increasing their bets as soon as they start making money. That is a quick way to get wiped out.

Part III A LITTLE BIT OF EVERYTHING

James R. Rogers, Jr.: Buying Value and Selling Hysteria

1. Started with $600 in 1968 >> formed the Quantum Fund with George Soros in 1973 >> "retired in 1980.
2. I short hysteria. Just about every time you go against panic, you will be right if you can stick it out.
3. – (Jack) Why were you expecting a financial collapse (Oct 1987)? – It was the atmosphere. Money was flooding the world. Every stock market in the world was at an all-time high. You had all these stories of young guys, three years out of school, making half a million dollars a year. That is not reality. Whenever you see that in a market, you are near a top. So, I went into the summer positioned for a collapse.
4. I knew that market is going to go higher than I think it can and lower than I think it will. I had a tendency to think that if I knew something, everybody knew it.

What I now know is that they don't know what I know. Most people don't have the foresight to look six months, one year, or two years out. The Memorex experience taught me that anything can happen in the stock market, because there are a lot of people in the market who don't understand what is going on.

5. You would have had a great bull market in gold in the 1970s, no matter what. Even if inflation was at zero percent, you still would have had a big bull market in gold during the 1970s, because of supply and demand.
6. I have made very few mistakes. I learned quickly not to do anything unless you know what you are doing.
7. I guarantee that the Japanese stock market is going to have a major collapse – possibly within the next year or two (this statement was in 1988)
8. About loss: if there was going to be a major fundamental change forever, the first loss is the best loss. But if fundamentally you are basically correct, then you do nothing but sit there and let the market hysteria wash around you.
9. It should be written down as an axiom that you always invest against the central banks. When the central banks try to prop up a currency, go the other way.
10. Never, ever, follow conventional wisdom in the market.
11. Look for hysteria to see if you shouldn't go the opposite way, but don't go the opposite way until you have fully examined the situation. Don't do anything until you know what you are doing.
12. I have no boundaries. I am totally flexible. I am open to everything, and I pursue everything. I haven't met a rich technician. But, I look at charts every weeks. I use them for knowledge, to see what is going on. I learn a lot about what is going on in the world by looking at charts.
13. Rogers' investment approach

- Buy value: if you buy value, you will not lose much even if your timing is wrong.
- Wait for a catalyst. Wait in bottoming markets until there is a catalyst to change the market direction.
- Sell hysteria
- By very selective
- Be flexible. Biases against certain markets or types of trades limit your field of opportunity.
- Never follow conventional wisdom.
- Know when to hold and when to liquidate a losing position.

Mark Weinstein: High-Percentage Trader

1. Real estate broker >> trader.
2. In those (old) days, commodities seemed to follow chart patterns a lot better than they do now. Very few people knew anything about technical analysis then, so the markets were much more orderly. I got a break by learning as much as I could about technical analysis at a time when it was working pretty well.
3. Weinstein employs his own custom-designed state-of-the-art computer systems to monitor constantly technical indicators designed to measure changes in market momentum. Rather than use the standard values for these indicators, he uses his own values, which he frequently adjusts for changing market conditions. He

combines this intensive real-time analysis with comprehensive chart analysis incorporate a variety of methodologies, including cycles, Fibonacci retracements, and Elliott Wave analysis. Finally, add to this one last essential ingredient: an uncanny sense of market timing. Only when nearly everything lines up right and he feels the timing is virtually perfect does he put on a trade.

4. There are times during the day when I am sure that the S&P is going up, but I don't try to pick the bottom, and I am out before it tops. I just take the mid-range where the momentum is greatest. That, to me, is trading like a sparrow eats.
5. I use all forms of technical analysis, but interpret them through gut feel. I am always looking for a market that is losing momentum, and then go the other way.
6. In contrast to the commodity markets, the stock market very rarely gives you the opportunity to enjoy a meaningful trend. Because when institutions and specialists sell out, they don't sell out at one price level, they scale out as the market goes up. Similarly, when they buy, they scale in as the market goes down. This leads to choppier price action and is the reason why many good commodity traders that I know lose every time they go into the stock market.
7. – (Jack) But you win consistently in the stock market, as well. What are you doing differently? I don't try to figure out where the market is going before the action; I let the market tell me where it is going. Also there is such a variety of technical input in the stock market, that you will almost always get a signal before the market is about to do something.
8. Stocks have their own personalities. For example, IBM and GM will usually rally before a major bottom and fail to rally before a major market top. And I have never seen a real good rally without the utilities leading the market. The utilities go up when interest rates are expected to come up, and when interest rates come down, portfolio managers jump into stocks.
9. On the public's biggest misconception about the markets: people always expect the market to react to news. For example, when JFK was assassinated, the market initially broke very sharply, but then quickly rebounded to new highs. They failed to realize is that a market that is fundamentally and technically poised to move higher is not going to reverse direction because of a news item – even a dramatic one. People are always saying that the market is down because of profit taking. The fact is, the market goes down not only on profit taking, but on a lot of loss taking as well.
10. Trading rules:

- Always do your homework.
- Don't be arrogant. The best traders are the most humble.
- Don't trade until an opportunity presents itself.
- Your strategy has to be flexible enough to change when the environment changes. The mistake most people make is they keep the same strategy all the time.

11. Advice: you have to learn how to lose; it is more important than learning how to win. If you think you are always going to be a winner, when you lose, you will develop feelings of hostility and end up blaming the market instead of trying to learn why you lost. Limit losses quickly..

Part IV THE VIEW FROM THE FLOOR

Brian Gelber: Broker Turned Trader

1. Now, I know the characteristics of various institutions. Let's take CitiBank. Back then, I was buying because they were buying. Now, if Citi was buying, I might conclude that they were just reallocating their assets or changing the duration of their portfolio. Today, I have little regard for the views of portfolio managers, because their outlook tends to cover a much longer time perspective than mine. I didn't understand that back then.
2. – (Jack) Was your trading success a matter of being able to read the tape? Yes, I was attentive and had good instincts.
3. The reason I have been so consistent is that I'm a great listener. I probably talk to about 25 traders each day. Most traders don't listen to your opinion; they only want to tell you their opinion.
4. – (Jack). What other things are important to your trading success? The realization that when you don't care, you do well, and when you try too hard, you don't do well.
5. – (Jack) Do you use trading systems? No, we are "discretionary traders." We only use technical indicators and systems as trading tools. One particularly interesting system we have developed is based on quirks related to volatility. Our belief is that volatility offers clues to trend direction.
6. Most traders who fail have large egos and can't admit that they are wrong. Also, some traders fail because they are too worried about losing. When you start being afraid to lose, you are finished.
7. I usually don't trade that big early in the year. I like to make money gradually at first and then play with the money I have made.
8. Never add to a loser. Don't overtrade and beg for tips.

Tom Baldwin: The Fearless Pit Trader

1. The largest individual trader in the T-bond pit.
2. I worked hard. I stood there six hours a day, all day, every day. You have to have a total disregard for money. You can't trade for money. Average traders trade too much. They don't pick their spots selectively enough. They end up forcing the trade rather than waiting patiently. Patience is an important trait many people don't have.
3. I probably average 4-tick profits on big positions. I try to make my holding time short to minimize risk. I evolved from a pure scalper to a combination of scalper and speculator.
4. I use charts – bar charts covering the past six months. I look for key points such as the high and low for the week, the halfway back point, and consolidation areas. Also, whenever any important fundamental numbers come out, I use them.

Tony Saliba: "One-lot" Triumphs

1. Clerk (half year) >> got 50K from another trader >> trader
2. After losing most of 50K, I became a spread scalper trying to make a quarter or an eighth of a point on a trade. I stuck strictly to my goal of trying to average $300 a day and it was working. This period taught me to be regimented and disciplined. <u>To this day, I live by the credo of hard work, homework, and discipline.</u>
3. I consider myself a matrix trader. I trade everything on the screen as it interrelates to everything else. My basic strategy, however, was buying butterflies. Long the wings. You risk is limited, and if the market does not move widely, time decay works in your favor. I put on the butterfly in the front month, where time is working for me, and the explosion position in the mid- or back –month. Then I complement that with scalping to help pay for the time decay in the explosion position.
4. <u>I was a millionaire before I was 25. I had decided to retire when I was 30. On my 30th birthday, I walked off the floor and said good-bye to everybody and that was it. My retirement last for 4 months. I missed the markets and the excitement</u>.
5. <u>There is a high correlation between the action on a Friday and the follow-through on the next Monday</u> – at least on the opening.
6. I am always hedged and I'm always prepared.
7. <u>Elements of good trading: clear thinking, ability to stay focused, and extreme discipline. Discipline is number one: take a theory and stick with it.</u> But you also have to be open-minded enough to switch tracks if you feel that your theory has been proven wrong. You have to be able to say, "My method worked for this type of market, but we are not in that type of market anymore." Always respect the marketplace. Do your homework. Recap the day. What do I want to happen tomorrow? What happens if the opposite occurs? What happens if nothing happens? Think through all the "what-ifs." <u>Anticipate and plan, rather than react</u>.
8. <u>On success: I used to judge success as being the best in your field. In my industry, it would have to be dollar-wise. Now, I think it is more quality of life</u>.
9. – (Jack) What makes you different? I think I can do anything, and I'm not afraid of hard work.

Part V THE PSYCHOLOGY OF TRADING

Dr. Van K. Tharp: The Psychology of Trading

1. Three major clusters important to investment success: <u>psychological factor, the management and discipline factor, and the decision-making factor</u>.
2. Psychological factor has five areas<u>: well-rounded personal life, a positive attitude, the motivation to make money, lack of conflict, and responsibility for results</u>.
3. Decision-making<u>: a solid knowledge of technical factors in the market, an aptitude for making sound decisions without common biases, and the ability to think independently</u>.
4. Management discipline: <u>risk control and ability to be patient</u>.

5. I believe that anyone can win if they are committed to do so. I am convinced that it is difficult to make money day trading or trading in a short time frame, so I am skeptical about anyone who wants me to help them day trade successfully.
6. What typically happens is that when people approach the markets, they bring their personal problems with them.
7. First problem: How to deal with risk? Two primary rules to successful speculative trading are: cut your losses short and let your profits run. If you think of trading as a game and that a mistake is not following the rules of the game, then it becomes much easier to follow these two rules. You should review your rules at the beginning of the day and review your trading at the end of the day.
8. Second problem: How to deal with stress. Stress takes two forms: worry and the biological fight/flight response. If your mind is preoccupied with worry, that worry takes up most of the decision space, and you don't have enough capacity left to perform effectively. A common decision that people make under stress is not to decide. They also tend to be crowd followers. Crowd followers don't have to make decisions, but crowd following is a sure way to lose money in the markets.
9. Winners typically differ from losers in their attitude about losses. Most people become anxious about losses, yet successful speculators have learned that an essential ingredient to winning is to make it OK to lose. Most investors must change their beliefs about losses to become successful.
10. The third problem is dealing with conflict. For instance, someone might have a part to make money, a part to protect him from failure, a part to make him feel good about himself, a part which looks after the welfare of the family, etc. now once you establish these parts, you usually allow them to operate subconsciously.
11. Another problem is that many people allow their emotions to control their trading. An easy method that people can adopt right away is simply to control posture, breathing, and muscle tension.
12. The last major problem is making decisions. The solution is to adopt a trading system that gives you signals to act. But most people with a trading system continue to apply their normal method of making decisions to the signals given to them by their trading system.
13. Top traders that I've worked with began their careers with an extensive study of the markets. They developed and refined models of how to trade. They mentally rehearsed what they wanted to do extensively until they had the belief that they would win.