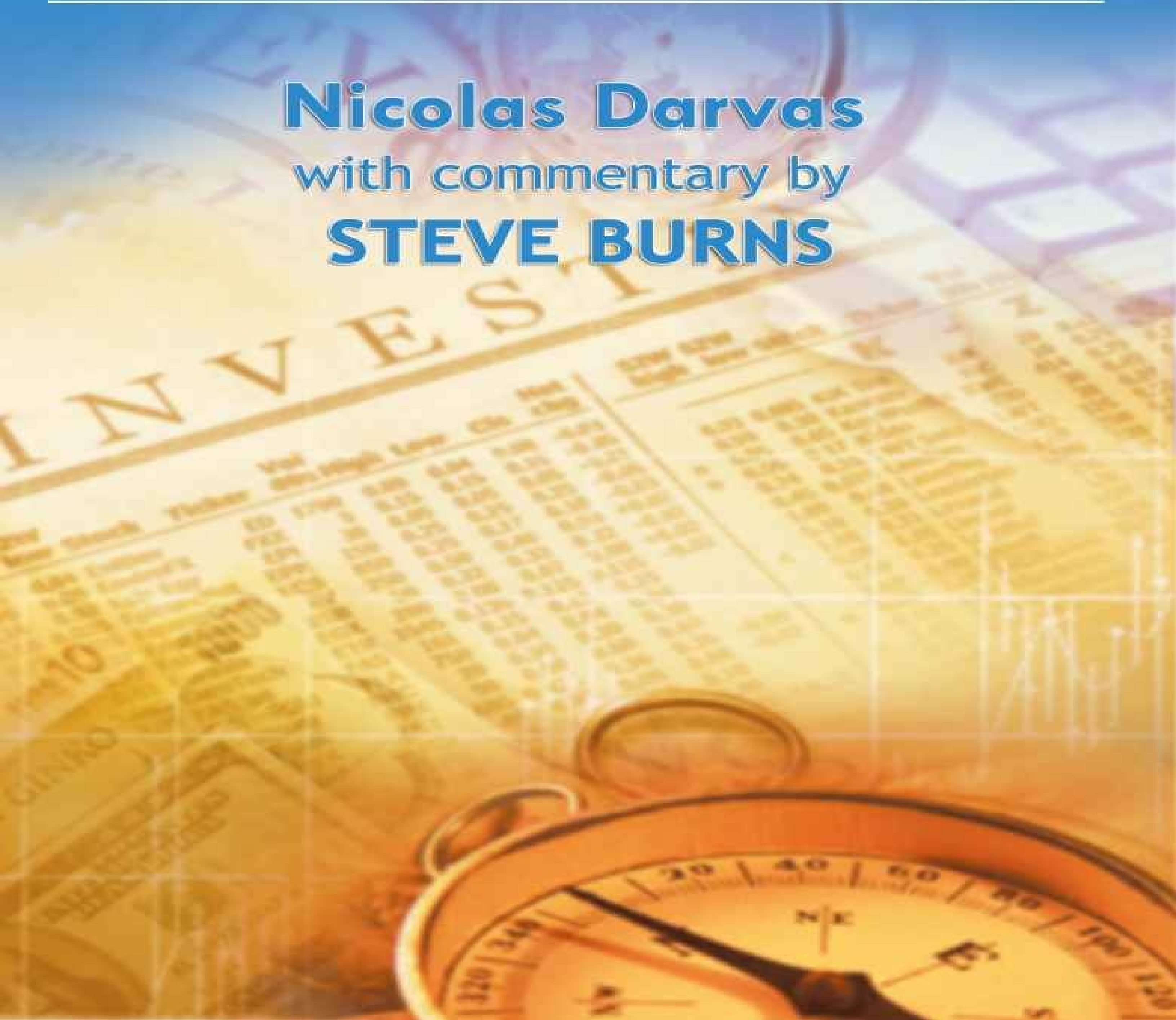
How I Made $2,000,000 in the Stock Market

NOW REVISED & UPDATED FOR THE 21st CENTURY

Nicolas Darvas
with commentary by
STEVE BURNS



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Foreword

Trading is a skill. Like any skill, it is not something people are born with. While any individual may be born with emotional or physical characteristics that favor proficiency at a particular skill, such proficiency is ultimately only obtained through learning and practice. No one is born a good trader.

It is actually quite natural to mistakenly convince ourselves that successful traders were simply born that way. Without an understanding of the years of research and hard work that are required to become a skilled trader, the need to study the work of the masters may elude us. Some wonderful strategy guides have been written based upon the careers of the all-time greats: Jesse Livermore, Nicolas Darvas and William O'Neil to name a few. However, as new traders entering the market for the first time, we have a tendency to conclude that we too were born to trade, rendering a study of these strategy guides unnecessary.

There are several influences that may lead us to the overlyconfident conclusion that we were born a good trader. Numbers are perhaps the biggest influence. The sheer number of traders, over 100 million by some estimates, lends credence to the argument: "If millions of people around the world are trading stocks, surely a good number of them must be profitable." It is inconceivable that the majority could lose; therefore it seems plausible that trading itself is not very difficult.

The truth is that the vast majority does lose, and most individual traders lose everything, usually within their first year. Some studies suggest that the number of traders who immediately wipe out their accounts could be as high as 95%. That is a sobering figure, for even if we surpass the performance of the average trader, we are likely to fail. Furthermore, some of the best traders in history, including Nicolas

Darvas, initially suffered losses that nearly destroyed them. If we somehow manage to become as skilled as Darvas, the possibility of failure is still not out of the question. Trading is not as simple as it appears.

If we are fortunate enough, we discover the inherent difficulty in trading before we go the way of the 95%. We then realize that we must learn to trade just as we learn any skill. The moment we come to this realization, the value of a strategy guide becomes clear. Of the many strategies available, the Darvas method is one of the simplest, and like many traders, we may find it to be the best way to start learning our new skill.

But, there is a problem. We live in the 21st century, where modern technology would seem to make the stock market a different place than it once was. Modern conveniences including the Internet, mobile devices, live video broadcasts of financial networks such as CNBC, and sophisticated electronic trading platforms are common today. The wisdom of Darvas tends to have limited appeal to us when we are rookies, as we discover that he received his stock quotes from a weekly magazine and executed trades via telegram.

While the Darvas technique appears promising, we may be reluctant to implement it without verification that it still works in modern times. Here, Steve Burns provides that verification. It is true that technology has changed, but the behavior of the stock market itself is practically the same in the 21st century as it was many decades ago when Darvas made his millions. Burns has been using the principles originally developed by Darvas for many years now, and his returns would make almost any trader envious. As a colleague and fellow trader, I have personally observed Steve Burns repeatedly reap huge gains while incurring small losses. He has truly mastered the Darvas technique.

Now he has compiled an updated strategy guide for anyone wishing to learn how to profit using the methods of Darvas. Burns uses his experience to gain insight into the mind of Darvas and then offer explanations as to why the methods are so consistently reliable. Already the author of several books about trading, Steve Burns currently presents us with this - A trading book that not only details how he himself successfully executes Darvas-style trades nowadays, but also answers the question: “How would Nicolas Darvas trade if he were here in the 21st century?” Darvas became a skilled trader through trial and error. Burns developed his own skills from the teachings of Darvas. Now it is our turn to learn from them both, and equip ourselves with the skills necessary to survive where almost everyone else fails.

Christopher Ebert @optionscientist

Introduction

Have you ever heard of a trader by the name of Nicolas Darvas? Who is that? In Just 18 Months, he turned $25,000 into over $2 Million. He traded stocks over 40 years ago and his principles for successful trading apply to the stock market up to the modern day. His book “How I Made $2,000,000 in the Stock Market” is recommended reading by master trader William J. O’Neil founder of Investor’s Business Daily.

I consider Nicolas Darvas to be one of the first modern day trend traders to explain is system publicly. While his first book “How I made $2,000,000” is a great true life trading story, I believe within it is embedded the principles that can make those that trade successful his they follow Darvas’ lead.

In this 21st century publication of his famous title I will be making commentary explaining the Darvas System as it applies to risk management, trading psychology, and his trend trading method. So a trader is not left with the issue of fishing these out for themselves amid the great story.

Who am I to take on this task? In using the Darvas System and principles I was able to build accounts worth over $250,000 from 2003-2007 and then take them all to cash and avoid losses during the market crash and ensuing Great Recession of 2008. Much like my favorite trading author Nicolas Darvas did in his own time.

In the morning of September 3, 1958, the following cable arrived at the Gloucester hotel in the Crown Colony of Hong Kong.

"BOUGHT 3000 THIOKOL 49⅞"

This purchase represented one part of a chain of purchases that were to net $2,000,000 in eighteen months. And this is the story of the events that led up to it…

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Chapter 1 Canadian Period

It was November 1952. I was playing in Manhattan's "Latin Quarter" in New York when my agent telephoned. He had received an offer for me and my dancing partner, Julia, to appear in a Toronto nightclub. This was owned by twin brothers, Al and Harry Smith, who made me a very unusual proposition. They offered to pay me in stock instead of money. I have had some strange experiences in show business, but this was a new one.

I made further inquiries and found they were prepared to give me 6,000 shares in a company called BRILUND. This was a Canadian mining firm in which they were interested. The stock at that time was quoted at 50 cents a share.

I knew stocks went up and down—that was about all I did know—so I asked the Smith brothers if they would give me the following guarantee: if the stock went below 50 cents, they would make up the difference. They agreed to do this for a period of six months.

It so happened that I could not keep that Toronto date. I felt badly about letting the brothers down, so I offered to buy the stock as a gesture. I sent them a check for $3,000 and received 6,000 shares of BRILUND stock.

I thought no more about it until one day, two months later, I idly glanced at the stock's price in the paper. I shot upright in my chair. My 50-cent BRILUND stock was quoted at $1.90. I sold it at once and made a profit of close to $8,000.

At first I could not believe it. It was like magic to me. I felt like the man who went to the races for the first time and with beginner's luck backed every winner. Cashing his winnings he simply inquired: "How long has this been going on?"

I decided I had been missing a good thing all my life. I made up my mind to go into the stock market. I have never gone back on this decision, but little did I know what problems I would encounter in this unknown jungle.

I knew absolutely nothing about the stock market. I was not even aware, for instance, that there was one in New York. All I had heard about were Canadian stocks, particularly mining shares. As they had been very good to me, obviously the smart thing to do was to stay with them.

But how do I start? How to find what stocks to buy? You could not pick them out with a pin. You must have information. That was my major problem: how to obtain it. I now realize that this is, in fact, impossible for the ordinary man, but then I thought I had only to ask enough people to learn the great secret. I thought if I asked often enough I would get acquainted with people in the know. I asked everybody I met if they had any stock market information. Working in nightclubs I meet rich people. Rich people must know.

So I asked them. The question was always on my lips: "Do you know a good stock?" Oddly enough, everybody did seem to know one. It was surprising. Apparently I was the only man in America who did not have his own first-hand stock market information. I listened eagerly to what they had to say and religiously followed their tips. Whatever I was told to buy, I bought. It took me a long time to discover that this is one method that never works.

I was the perfect pattern of the optimistic, clueless small operator who plunges repeatedly in and out of the market. I bought stock in companies whose names I could not pronounce. What they did and where they came from, I had no idea. Someone told someone who told me. There could have been no more slaphappy, ignorant buyer than I was. All I knew was what the last headwaiter in the last nightclub I had performed in had told me was good.

Early in 1953 I was performing in Toronto. Because of my first extraordinary $8,000 break with BRILUND, Canada was the land of financial milk and honey as far as I was concerned, so I decided this was a good place to go looking for a "hot tip." I asked several people if they knew a good, reliable broker, and eventually I was recommended to one.

I must admit I was startled and disappointed when I found his office. It was a tiny, dingy, prison-like room full of books, with strange scrawls on the walls. Later I found out that these are called "charts." There did not seem much smell of success or efficiency. Sitting at a rolltop desk was a busy little man poring over statistics and books. When I asked him if he knew a good stock he reacted at once.

He smiled and pulled out of his pocket a dividend check bearing the name of a famous gold company, KERR-ADDISON.

He stood up and said: "My friend, take a good look at that. That dividend check is worth five times what my father paid for the original stock. That is the sort of stock everyone looks for."

A dividend five times the price of the original stock! This excited me as it would any man. The dividend was 80 cents so his father must have paid only 16 cents for the stock. It looked beautiful to me. I did not realize he had probably been holding his father's stock for thirty-five years.

The little man described to me how he had been looking for that kind of stock for years. In view of his father's success he felt the answer must be in gold mines. He confided to me that he had at last found it. It was called EASTERN MALARTIC. Working with his production figures, estimates and financial information, he reckoned that these gold mines were capable of twice their present gold production; therefore five dollars invested in their stock would soon be worth ten dollars.

On this piece of erudite information I immediately bought 1,000 shares of EASTERN MALARTIC at $2.90. As I watched anxiously, it went to $2.70 then to $2.60. Within weeks it was down to $2.41, and I hastily sold my stock. I decided this painstaking, statistically-minded broker did not have the answer to making a fortune.

Yet the whole thing continued to fascinate me. I went on following any tip but I seldom made money. If I did, it was immediately offset by my losses.

I was such a novice that I did not even understand about broker's commission and transfer taxes. For instance, I bought KAYRAND MINES in January 1953. It was a 10-cent stock, and I bought 10,000 shares.

I watched the market like a cat and when next day KAYRAND went to 11 cents per share, I called my broker and told him to sell. By my reckoning I had made $100 in 24 hours, and I thought I was being smart by taking a quick small profit.

When I talked to my broker again he said: "Why did you decide to take a loss?"—"A loss?" I had made a hundred dollars!

He gently explained to me that the broker's commission for buying 10,000 shares was $50, and for reselling the shares next day it was another $50. In addition, there were transfer taxes on the sale.

KAYRAND was just one of the many strange stocks I owned at that time. Others included MOGUL MINES, CONSOLIDATED SUDBURY BASIN MINES, QUEBEC SMELTING, REXSPAR, JAYE EXPLORATION. I made money on none of them.

Yet I spent a happy year on this Canadian buying and selling. I felt I was the successful businessman- the big stock market operator. I jumped in and out of the market like a grasshopper. I was delighted if I made two points. I often owned 25 to 30 stocks at one time, all in small parcels.

For some of them I acquired a special liking. This came about for different reasons. Sometimes it was because a good friend of mine gave them to me, other times, because I had started by making money with them. This led me to prefer these stocks to others, and before I knew what I was doing I had started to keep "pets."

I thought of them as something belonging to me, like members of my family. I praised their virtues day and night. I talked about them as one talks about his children. It did not bother me that no one else could see any special virtue in my pet stocks to distinguish them from any other stocks. This state of mind lasted until I realized that my pet stocks were causing me my heaviest losses.

In a few months my record of transactions looked like the trading record of a small-scale stock exchange. I felt I was doing all right. I appeared to be ahead. If I had carefully studied my statements I would not have felt quite so happy. I would have realized that, like a horseplayer, I was buoyed up and excited by small gains, and overlooked my losses. I completely ignored the fact that I was holding a lot of stock that was standing well below the price I had paid for it and looked like staying there.

It was a period of wild, foolish gambling with no effort to find the reasons for my operations. I followed "hunches." I went by god-sent names, rumors of uranium-finds, oil strikes and anything anyone told me. When there were constant losses an occasional small gain gave me hope, like the carrot before the donkey's nose.

Then one day, after I had been buying and selling for about seven months, I decided to go over my books. When I added up the values of the bad stocks I was holding I found I had lost almost $3,000.

It was on that day that I began to suspect there was something wrong with my moneymaking scheme. A ghost at the back of my mind began to whisper to me that, in fact, I had no idea what I was doing.

Yet I was still ahead. I consoled myself that I had not touched the $3,000 I had originally paid for BRILUND, and I had about $5,000 of my profit from that transaction besides. But, if I continued like this, how much longer would I keep it?

Here is just one page from my profit-and-loss accounting. It tells the whole sad story of defeat in microcosm.
OLD SMOKY GAS & OILS Bought at 19 cents; Sold at 10 cents
KAYRAND MINES
Bought at 12 cents; Sold at 8 cents

REXSPAR
Bought at $1.30; Sold at $1.10 QUEBEC SMELTING & REFINING Bought at 22 cents; Sold at 14 cents

Obsessed by my carrot-before-the-nose gains, I had not noticed I was losing an average of a hundred dollars a week.

It was my first stock market dilemma. The market had several much more serious dilemmas in store for me in the next six years but this one was in some ways the worst. On my decision at this point depended whether I would continue to operate in the market.

I decided to stay and have another try.

The next problem was what to do. There must be a different way. Could I improve my approach? It had been proved to me that it was wrong to listen to nightclub customers, headwaiters, stage-hands. They were amateurs like me, however confidently they offered their tips, they did not know any more than I did.

I gazed at page after page of my brokerage statements, which said: Bought 90 cents, sold 82 ... Bought 65 cents, sold 48...

Who could help me to discover the secrets of the stock market? I had started to read Canadian financial publications as well as Canadian stock tables. I had begun increasingly to glance at advisory newssheets, which gave tips about stocks listed on the Toronto Stock Exchange.

I had already decided that if I were to go on, I would need professional help, so I subscribed to some advisory services, which gave financial information. After all, I reasoned, these were the experts. I would follow their professional advice and quit buying stock on the odd tip from a stranger or an amateur stock-fancier like myself. If I followed their skilled, sensible teaching, I must succeed.

There were financial advisory services that offered a trial subscription of four copies of their information-sheets for one dollar. You could have these as a goodwill taste before you began seriously to buy their valuable service.

I put down a dozen or so dollars for trial subscriptions and eagerly read the sheets they sent me.

In New York, there are reputable financial services, but the Canadian sheets that I bought were strictly for the sucker trade. How was I to know this? These financial advice sheets delighted and excited me. They made stock market speculation sound so urgent and easy.

They would come out with huge headlines saying: “Buy this stock now before it is too late!” “Buy to the full extent of your resources!”
“If your broker advises you against it, get rid of your broker!”
“This stock will give you a profit of 100% or more!”

This, of course, seemed like real, red-hot information. This was much more authentic than the odd tip picked up in a restaurant.

I read these promotion sheets eagerly. They were always filled with much unselfishness and brotherly love. One of them said:

“For the first time in the history of Canadian finance the little fellow will have the fantastic opportunity of getting in on the ground floor of a brilliant new development”.

“The plutocrats of Wall Street have been trying to acquire all the stock in our company, but in clear defiance of the evil traditions we are only interested in the participation of investors of moderate means. People like you...”

But this was me! They understood my position exactly. I was the typical little fellow to be pitied for the way he was pushed around by the Wall Street plutocrats. I should only have been pitied for my stupidity.

I would rush to the telephone to buy the stock they recommended. It invariably went down. I could not understand this but I was not the slightest bit worried. They must know what they were talking about. The next stock must go up. It seldom did.

I did not know it but I was already coming up against one of the great pitfalls of the small operator—the almost insoluble problem of when to enter the market. These sudden drops immediately after he has invested his money are one of the most mystifying phenomena facing the amateur. It took me years to realize that when these financial tipsters advise the small operator to buy a stock, those professionals who have bought the stock much earlier on inside information are selling.

Simultaneously with the withdrawal of the inside-track money, the small sucker money is coming in. They are not firstest with the mostest, but lastest with the leastest. They are far too late, and their money is always too small to support the stock at its false high point once the professionals are out.

I know this now, but at that time I had no idea why stocks behaved like that. I thought it was just bad luck that they dropped after I bought them. When I look back I know that I was all set at this period to lose everything I had.

When I did invest $100 I almost always lost $20 or $30 at once. But a few stocks did go up and I was comparatively happy.

Even when I had to go to New York I continued to telephone my orders to brokers in Toronto.

I did that because I did not even know you could transact Canadian stock exchange business through a New York broker. The Toronto brokers would telephone tips and I always bought the stock they or the Canadian financial advisory services suggested. Like all small hit-and-miss operators, I put down my losses to bad luck. I knew—I was certain—that one day I would have good luck. I was not wrong all the time—in some ways it would have been better if I had been. Once in a while I made a few dollars. It was always a complete accident.

Here is an example. The Canadian stock tables had become obsessive reading with me. One day when I was looking through them I saw a stock called CALDER BOUSQUET. I still do not know what it was or what the company produces. But it was such a pretty name. I liked the sound of it, so I bought 5,000 shares at 18 cents, for a total of $900.

Then I had to fly to Madrid on a dancing engagement. One month later when I came back I opened the paper and looked for the name. It had gone up to 36 cents. That was double the price I had paid. I sold it—and made $900. It was just blind luck.

It was doubly blind luck because not only had it gone up for no good reason but had I had not been dancing in Spain I would certainly have sold the stock when it rose to 22 cents. I could not get Canadian stock quotations while I was in Spain so I was saved from selling too soon by being in blissful ignorance concerning the stock’s movements.

This was a strange, mad period, but it only seems so in retrospect. At that time I felt I was really beginning to be a big-time operator. I was proud of myself because I was working on tips of a more educated nature than my previous headwaiter and dressing-room information. My Canadian brokers called me, my financial services advised me, and if I did get a tip I felt I was getting it from the source. I cultivated more and more the society of prosperous businessmen in cocktail lounges who told me about oil companies which were going to strike it rich. They whispered where there was uranium in Alaska; they confided about sensational developments in Quebec. All these were guaranteed to make a great fortune in the future if you could only get into the stocks now. I did, but they did not make me any money.

By the end of 1953, when I returned to New York, my $11,000 was down to $5,800. Once again I had to reconsider my position. The businessmen’s tips did not produce the Eldorado they promised. The advisory services did not provide the information, which enables you to make money in the stock market. Their stocks tended much more to go down than up. I could not get quotes for some of my Canadian stocks in the New York newspapers, yet stock quotations fascinated me so much that I began to read the financial columns in papers like The New York Times, the New York Herald Tribune, and The Wall Street Journal. I did not buy any of the stocks that the New York exchanges quoted, but I still remember the impact of the beautiful names of some of the stocks and the appeal of some of the mysterious phrases like “over the counter.”

The more I read, the more I became interested in the New York market. I decided to sell all my Canadian stock except for OLD SMOKY GAS & OILS—and I kept this one because the man who gave me the stock in the first place advised me that fantastic developments were expected. As usual, no fantastic developments took place, and after five months in New York I gave up the unequal struggle. I sold my last Canadian stock, which I had bought for 19 cents, for 10 cents. In the meantime I had begun to wonder if the bigger jungle nearer home, the New York Stock Exchange, would not be easier to assail. I called a friend of mine, a New York theatrical agent, Eddie Elkort, and asked him if he knew a New York broker. He gave me the name of a man whom I will call Lou Keller.

Chapter 1 Insights by Steve Burns

“I made up my mind to go into the stock market. I have never gone back on

this decision, but little did I know what problems I would encounter in this unknown jungle."

–Nicolas Darvas

Perseverance is the first requirement for success in the stock market. You must make up your mind to not quit at the same time that you begin. You must be willing to spend years if necessary to win in trading. Part of the process is not only developing a system and method that matches your personality and risk tolerance but also trading the right system at the right time in the right market environment. Many modern day Darvas style traders became millionaires in the market leading up to the March 2000 internet bubble. However, before they made it big they lost entire accounts and had to start over. They didn't quit.

Nicolas Darvas received his first stock in November 1952 he did not start his big winning streak until 1958, he put in six years of study and trial and error not to mention some large losses of his hard earned money. You have to make the commitment to stick with your trading through the ups and downs if you want to be successful.

"As they had been very good to me, obviously the smart thing to do was to stay with them." –Nicolas Darvas

"Sometimes it was because they were given to me by a good friend of mine; other times, because I had started by making money with them. This led me to prefer these stocks more than others, and before I knew what I was doing I had started to keep pets". –Nicolas Darvas

When trading stocks just date them don't marry them. Just because you made some money in a particular stock does not mean you will again in the future. Do not let your emotions get you attached to a particular stock. Only trade the price action. How do you know if it is still a good stock? You are making money in it. Don't keep stocks in your portfolio when they are no longer winners. If you need a pet get a dog.

"Whatever I was told to buy, I bought. It took me a long time to discover that this is one method that never works.
–Nicolas Darvas

A successful trader does not trade stock tips they trade systems and methods. A stock should only be traded because it meets your entry criteria, if it is in an uptrend or breaking out. Stock tips do not work because the tipster does not give you an exit price or how much to risk in the trade. You will also never hear how you will know if the tip was wrong. Their absolute confidence in their pick should also be a red flag. The stock market is a complicated mechanism and anything can happen. Successful traders are not overly confident in any one trade and are willing to change their mind when proven wrong.

“I must admit I was startled and disappointed when I found his office (broker). It was a tiny, dingy, prison-like room full of books.” –Nicolas Darvas

The old joke is that they are called “brokers” because they are more broke than you are. Unlike Darvas, in the 21st century we are privileged to have online discount brokers that only charge between $4.95-$14.00 a trade. There are even trade-per-share brokers that charge $1 for a 100 share trade. Darvas was charged around $50 for his trades. There is absolutely no reason to use a full service broker today.

Full service brokers are not traders; they are sales people who make money when you trade through the commissions you pay to them. Avoid them like the plague, educate yourself and get a good online broker.

“I seldom made money. If I did, it was immediately offset by my losses.” – Nicolas Darvas

Most traders when they start out do what is called “churning” their account. They trade and trade, they go in and out of shares over and over and when they are done their account if where it started at if they are lucky. This is very frustrating; traders need to see their capital grow steadily.

The mistake that Darvas made at first by over active trading and new traders can avoid is to let winners run as far as they will and cut losses short. This is one advantage that a trader can have in the market: their winners are big and their losers are small, this will make you successful in the long run.

“I was buoyed up and excited by small gains, and overlooked my losses.” – Nicolas Darvas

When you are quick to go tell your friends and family you made some money in trading but never tell about your losses, you are not a trader, you are a gambler and the same emotions and hopeful thinking that drive gamblers in affecting you.

You should not be emotionally moved by your trades, each trade should just be one trade in a string of many and you do not know how your week or month will finish with your profits. It is exhausting to be emotionally moved by every trade. Small gains are nothing to get excited about, and losses are something to learn from not ignore. Darvas had to learn these things.

“A ghost at the back of my mind began to whisper to me that, in fact, I had no idea what I was doing.” –Nicolas Darvas

If an inner voice is telling you that “You do not know what you are doing” then you probably don’t. If you do not have a written trading plan for what you will trade, how much you will trade, and when to take your entries and exits, then you should be nervous like Darvas was when he was a new trader. If you make detailed plans when the market is closed and know exactly what you will do when it is open then you will get a feeling of confidence not doubt.

“I was saved from selling too soon by being in blissful ignorance concerning the stock’s movements.” -Nicolas Darvas

Darvas accidently learned the power of letting profits run while away in Europe and away from his broker and quotes. We have to let winning trades run because we need the profits to pay for all the small losses. You will never get to hold that amazing stock that goes up 300% in a bull market if you sell it when it is up 20% and never get back in.

“I had already decided that if I were to go on, I would need professional help, so I subscribed to some advisory services.” -Nicolas Darvas

“The advisory services did not provide the information, which enables you to make money in the stock market.”
–Nicolas Darvas

Why do the vast majority of people write newsletters? Because 95% of them can’t trade so they make money writing newsletters and preying on new traders looking for a short cut. Just like only 10% of traders make consistent money in the markets I suspect the same percentage for newsletter writers.

Avoid anything pushing penny stocks; these are illiquid and very difficult to get in and out of. There are a few great newsletters out there but they are rare. A few real traders run newsletters and advisory services as an extension of their trading business. Some of these are good when written by real traders. I do have one recommendation for a modern day Darvas Trader newsletter in the appendix. I also think Investor's Business Daily is an excellent tool for traders.

Any advisory service, magazine, newspaper, or newsletter you subscribe to must have entries and exits for each trade along with position sizing recommendations. The recommendations must match your trading method, and they should be teachers not dictators. Very few are useful and measure up, choose carefully.

Chapter 2 Entering Wall Street

I called Lou Keller. I told him who I was and what I wanted. Next day he sent me some papers to sign, and advised me that as soon as I returned them with a deposit I would have an account with his brokerage firm. When I received his notice something happened to me. Suddenly I began to feel that I was becoming part of the financial scene. I cannot describe Wall Street because I have never been there physically, but even its name had an almost mystical attraction for me.

Here everything was going to be serious and different. I now considered my Canadian induction period as pure crazy gambling that I would never repeat.

As I studied the long gray columns of stock market quotations in the New York papers, I felt I was about to enter a new and successful period in my life. This was not like the wildcat Canadian market with its quick tip-offs on gold strikes and uranium fields. This was responsible business, the street of bank presidents and great industrial combines, and I prepared to enter it with proper reverence.

I intended to make a much more cautious and mature approach to the stock market. I added up my assets to see what I had to work with. I had started in the Canadian market with $11,000—my original BRILULND investment of $3,000 and profit of $8,000. This had been reduced by $5,200 in the fourteen months of my Canadian operations. All I had left of the BRILUND money was $5,800.

This did not seem like enough money with which to approach Wall Street, so I decided to add to it. From the savings of my show business activities I raised my stake to $10,000. It was a good round figure, and I deposited this sum with the broker.

Then one day I decided to start trading. I rang Lou Keller and nonchalantly, trying to be the old financial hand, simply asked him what was good.

I realize now this inquiry was more suitable for a butcher, but Mr. Keller was equal to it. He suggested several “safe stocks.” He also gave me the fundamental reasons why these stocks were “safe.” While I did not understand, I listened intently to such explanations as dividend increase, stock-splits and improved earnings. Now this to me was the highest professional advice. This man earned his living on Wall Street, so obviously he knew. Besides, he only “suggested.” He emphasized that the decision was “up to me.” This made me feel important and in command.

When one or two of the stocks he gave me rose a few points almost immediately, I had no doubt of the excellence of the information I was receiving and my natural ability as a stock market operator to act on it. What I did not know was that I was practically smack in the middle of the biggest bull market the world had ever seen and it was quite difficult, unless you were extremely unlucky, not to show a little paper profit from time to time.

Here are three typical consecutive deals I concluded in the early part of 1954—deals which convinced me I was a natural in Wall Street. In this table as in all the following tables in this book, I have included commissions and taxes.

200 COLUMBIA PICTURES Bought at 20 ($4,050.00) Sold at 22⅞ ($4,513.42)

200 NORTH AMERICAN AVIATION Bought at 24¼ ($4,904.26) Sold at 26⅞ ($5,309.89)

Profit $ 405.63

100 KIMBERLY-CLARK
Bought at 53½ ($5,390.35) Sold at 59 ($5,854.68)

Profit $ 464.33
Total Profit $1,333.38

You will note that each of these transactions netted me just over $400. It was not a large sum, but three profits in a row amounting to $1,333.38 in just a few weeks made me feel that these were smooth, simple operations and I was in control.

The feeling that I was operating with a profit in Wall Street, allied to a natural awe of the place, made me feel foolishly happy. I felt I was losing my Canadian amateur status and becoming a member of an inner circle. I did not realize my method had not improved—that I was simply using more pompous words to cover it. For instance, I no longer considered the broker's advice as tips, but as "information". As far as I was concerned, I had given up listening to tips and instead was receiving authentic news based on valid economic evidence.

The boat sailed happily along. Here are some of my transactions during April and May 1954:

Bought Sold NATIONAL CONTAINER 11 12 ⅜ TRI-CONTINENTAL WARRANTS 5⅛ 6 ALLIS-CHALMERS 50¾ 54⅞ BUCYRUS-ERIE 24¾ 26¾ GENERAL DYNAMICS 43½ 47¼ MESTA MACHINE 32 34 UNIVERSAL PICTURES 19⅝ 22¾

Profits, profits, profits. My confidence was at its height. This was clearly not Canada. Here everything I touched turned to gold. By the end of May, my $10,000 had grown to $14,600.

Occasional setbacks did not bother me. I regarded them as slight, inevitable delays in the upward climb towards prosperity. Besides, whenever a trade was successful I praised myself yet when I lost- I blamed it on the broker.

I continued to trade constantly. I telephoned my broker sometimes twenty times a day. If I did not conduct at least one transaction a day I did not feel I was fulfilling my role in the market. If I saw a new stock I wanted to have it. I reached out for fresh stocks like a child for new toys.

These transactions in which I was involved in Wall Street around July 1954 will show the energy I expended for very small returns:

200 AMERICAN BROADCASTING-PARAMOUNT

Bought100 at 16⅞ ($1,709.38)

100 at 17½ ($1,772.50)
Sold at 17⅞ ($3,523.06)

100 NEW YORK CENTRAL Bought at 21½ ($2,175.75) Sold at 22½ ($2,213.70) Profit $37.95

100 GENERAL REFRACTORIES Bought at 24¾ ($2,502.38) Sold at 24¾ ($2,442.97)

Loss $59.41

100 AMERICAN AIRLINES Bought at 14¾ ($1,494.75) Sold at 15 ($1,476.92)

Loss $17.83

Total Profit $79.13
Total Loss $77.24
My net profit on these transactions was $1.89. The only

person who was happy was my broker. According to the New York Stock Exchange rules, his commission on these ten transactions amounted to $236.65. Incidentally, my $1.89 profit did not include the price of my telephone calls.

In spite of this, only one thing really bothered me. Half the words my broker used concerning the stock market I did not understand. I did not like to show my ignorance, so I decided to read up on the subject. In addition to the financial columns in the New York daily papers, I began to read books about the stock market so I could talk on his level.

Slowly I became acquainted with a series of new words and was always trying to use them. I was fascinated by words like earnings, dividends, capitalization. I learned that “pershare earnings” means “the company’s net profit divided by the number of shares outstanding” and that “listed securities” are “those stocks that are quoted on the New York and American Stock Exchanges.”

I labored over definitions of stocks, bonds, assets, profits, yields. There was plenty to read, because there are hundreds of books published about the stock market. More has been written about the stock market, for instance, than about many cultural subjects.

At this time I studied books like:
R. C. Effinger: ABC of Investing
Dice & Eiteman: The Stock Market
B. E. Schultz The Securities Market And How It Works Leo Barnes: Your Investments
H. M. Gartley: Profit In The Stock Market
Curtis Dahl: Consistent Profits In The Stock Market E. J. Mann: You Can Make Money In The Stock Market

Now, I am certain that the serious Wall Street analyst who prepared this glossy booklet had nothing but the highest intentions, but I must record in the interest of the truth that by the end of 1956, this stock was down to 5¾.

About that time I heard a saying which has been passed from mouth to mouth for generations in Wall Street, but to me was new: “You cannot go broke taking a profit.” I was much impressed by this and I was burning to put it into operation. This is how I did it.

One of the market leaders early in February 1955 was KAISER ALUMINUM. On my broker’s recommendation I bought 100 shares at 63⅜, paying $6,378.84 for the stock. It went up steadily, and at 75 I sold it. I received $7,453.29, which gave me a profit of $1,074.45 in less than one month.

Hoping for another quick profit, I switched into 100 BOEING at 83. I paid $8,343.30 for these shares. The stock almost immediately began to drop. Four days later I sold at 79⅞ for $7,940.05. My loss on the BOEING transaction was $403.25.

Trying to make up for the loss, I then bought MAGMA COPPER in the first week of April. It was selling at 89¾. I paid $9,018.98 for 100 shares. No sooner did I buy, than it started to drop. Two weeks later I sold it at 80.5 for $8,002.18. This gave me a loss of $1,016.80. By this time KAISER ALUMINUM, which I had jumped out of in the first week of March, had moved up to 82. An advisory service was recommending it, so I switched back to it, buying 100 shares at that price. I paid $8,243.20.

Five minutes later it started to slide. Not wanting to risk a further loss, I sold at 81¾ and received $8,127.59. This meant that for five minutes of trading I lost $115.61, including commissions.

On the first KAISER deal I had made a profit of $1,074.45. The losses sustained by jumping in and out of the other stocks were $1,535.66. So the whole circular transaction, which began with KAISER and ended with KAISER, gave me a net loss of $461.21.

If I had stuck with KAISER from my original purchase at 63⅜ until my ultimate sale at 81¾, I would have had a profit of $1,748.75 instead of the loss of $461.21.

Here is another case. From November 1954 to March 1955 I was constantly jumping in and out of a stock called RAYONIER, which in an eight-month period went from approximately 50 to 100. These were my transactions in RAYNOIER, 100 shares at a time:

November-December 1954
Bought at: 53 ($5,340.30)
Sold at:58¼ ($5,779.99)

Profit: $ 439.69 **February-March 1955**
Bought at: 63⅞ ($6,428.89) Sold at:71⅝ ($7,116.13)

Profit: $ 687.24

March 1955
Bought at: 72 ($7,242.20) Sold at:74 ($7,353.39)

Profit: $111.19
Total Profit $1,238.12

The profit I made on this series of trades amounted to $1,238.12. Then the old loss pattern repeated itself. In April 1955 I switched into MANATI SUGAR. I bought 1,000 shares at 8%, paying $8,508.80. Immediately afterwards it started a downward slide and I sold out at the varying prices of 7¾, 7⅝ and 7½. I received a total of $7,465.70, giving me a loss of $1,043.10. This left me with a net profit of $195.02 on the combined RAYONIER-MANATI operation.

However, if I had held my original November purchase of RAYONIER without constantly trying to take a profit, and sold it in April at 80, I would have had a profit of $2,612.48 instead of $195.02.

What did all this mean? I did not appreciate it at the time, but it was a classic refutation of: "You cannot go broke taking a profit." Of course you can.

Another stock market saying that began to fascinate me was "Buy Cheap, Sell Dear." This sounded even better. But where could I buy something cheap? As I searched for a bargain, I discovered the over-the-counter market, the market of unlisted securities. I knew from my books that in order to get its stock listed and traded on the stock exchanges a company has to observe very stringent financial regulations. I had read that this did not apply to over-the-counter stocks.

This market, therefore, seemed to me the perfect place to find a bargain. I naively believed that because these stocks were not listed, few people knew about them and I could buy them cheap. I hurriedly subscribed to a monthly booklet called Over-the-Counter Securities Review and started hunting.

I searched eagerly among the thousands and thousands of names for the bargains that seemed to be offered. I bought stocks like PACIFIC AIRMOTIVE, COLLINS RADIO, GULF SULPHUR, DOMAN HELICOPTER, KENNAMETAL, TEKOIL CORPORATION and some of the more obscure ones. What I did not know was that when I came to offer them for sale, some of these stocks stuck to my fingers like tar. I found it very difficult getting rid of them—and rarely at anything like the price I paid for them. Why? Because there was no rigid price discipline as there is for the listed securities; there were no specialists—professionals to assure a continuous and orderly market. There were no reports where one could see at what price a transaction took place. There were only the "Bid" and "Ask" prices. These, I discovered, were often very far apart. When I wanted to sell at 42, which was the quoted "Ask" price, I only found a buyer at 38, the quoted "Bid" price. I sometimes ended up at 40 but that was by no means certain.

When I stumbled into the over-the-counter market, all this was unknown to me. Fortunately, I quickly came to realize that this is a specialized field and is only lucrative for experts who really know something about the affairs of a particular company. I decided to give it up, and returned my attention to listed securities.

All this time, I never once questioned the truth of any Wall Street rumors. I had no way of knowing that they are just as ill-founded and dangerous as rumors in the Canadian or other markets.

What I believed to be solid information, piped straight from Wall Street, had the most sensational lure for me. Here are two typical cases that show the sort of information I gobbled up and acted upon.

One day a strong rumor floated into the market that BALDWIN-LIMA-HAMILTON, a firm of railroad equipment manufacturers, had received an order to construct an atomic train. Wall Street acted on this at once. The stock shot up from 12 to over 20. By the time I heard this startling information, the stock had risen to what later turned out to be its peak.

Another time my broker called me and said, "STERLING PRECISION will go to 40 before the end of the year." The stock was quoted at 8. He gave me the reason: "The company is buying up many more small prosperous companies and will grow into a giant in no time." He added that this was first-hand information.

To me that was sufficient. Why not? A Wall Street broker, who I thought could not possibly be wrong, had favored me with this authentic news. I could not give my buying order quickly enough. I decided, in view of the source of my information, to plunge big on this one, I bought 1,000 STERLING PRECISION at 7⅛ paying $8,023.10. I sat back happily to watch it rocket toward 40. Far from rocketing to 40, it began to waver. Slowly it slid downwards. When it looked as though it would fall below 7, something had obviously gone wrong, so I sold the stock at 7⅛ for $6,967.45. This piece of news showed me a loss of $1,055.65 in a few days. The stock subsequently touched a low of 4⅞.

But these losses were more than offset by the great pride I felt in being part of Wall Street, and I constantly searched for new approaches. One day, reading The Wall Street Journal, I saw a column reporting stock transactions by officers and directors of listed companies. When I looked into this further I found out that, to prevent manipulations, the Securities and Exchange Commission required that officers and directors report whenever they bought or sold stocks of their own company. Now, that was something! Here was a way for me to know what the real "insiders" were doing. All I had to do was to follow them. If they were buying, I would buy. If they were selling, I would sell.

I tried this approach, but it did not work. By the time I found out about the insiders' transactions, it was always too late. Besides, I always found that insiders were human, too. Like other investors they often bought too late or sold too soon. I made another discovery. They might know all about their company but they did not know about the attitude of the market in which their stock was sold.

Through these and other experiences, however, certain conclusions began to emerge. As a baby repeatedly hearing the same words starts to learn them, so did I slowly start, through my trading experiences, to discern the outlines of some rules that I could apply.

They were:

1. I should not follow advisory services. They are not infallible, either in Canada or on Wall Street.
2. I should be cautious with brokers' advice. They can be wrong.
3. I should ignore Wall Street sayings, no matter how ancient and revered.

4. I should not trade "over the counter"—only in listed stocks where there is always a buyer when I want to sell. 5. I should not listen to rumors, no matter how well founded they may appear.
6. The fundamental approach worked better for me than gambling. I should study it.

I wrote out these rules for myself and decided to act accordingly. I went over my brokerage statements and it was then that I discovered a transaction that gave me a seventh rule and led to the events that immediately followed. I discovered that I owned a stock and did not know it.

The stock was VIRGINIAN RAILWAY and I had bought 100 shares in August 1954 at 29¾ for $3,004.88. I had bought it and forgotten it, simply because I was too busy on the telephone jumping in and out of dozens of stocks—sometimes making as little as 75 cents; other times frantically calling up about a sliding stock, trying to sell it before it dropped any lower.

VIRGINIAN RAILWAY had never given me a moment's anxiety, so I left it alone. It was like a good child that sat playing quietly in the corner while I worried and fretted about the behavior of a dozen bad children. Now that I saw its name— after having held it for eleven months—I hardly recognized it. It had been so quiet it had gone completely out of my mind. I rushed to my stock tables. It was standing at 43½. This forgotten, calm, dividend-paying stock had been slowly rising. I sold it and received $4,308.56. Without any effort on my part, or even any anxiety, it had made me $1,303.68. It also made me dimly aware of what was to become my rule number

7. I should rather hold on to one rising stock for a longer period than juggle with a dozen stocks for a short period at a time.
But which stock will rise? How to find it by myself?

I decided to have a look at VIRGINIAN RAILWAY. What had caused its steady rise while other stocks were jumping about? I asked my broker for information. He told me that the company paid a good dividend and had a fine earnings record. Its financial position was excellent. Now I knew the reason for the steady rise. It was a fundamental reason. This convinced me of the tightness of my fundamental approach.

I made up my mind to refine this approach. I read, studied, analyzed. I set out to find the ideal stock.

I thought that if I really studied the company reports I could find out all about a stock and decide whether it was a good investment. I began to learn all about balance sheets and income accounts. Words like “assets,” “liabilities,” “capitalization,” and “write-offs” became commonplace in my vocabulary.

For months I puzzled over these problems. Night after night, for hours after my daily dealings, I pored over the statements of hundreds of companies. I compared their assets, their liabilities, their profit margins, their price-earnings ratios.

I thumbed through lists like:
• Stocks with top quality rating
• Stocks the experts like
• Stocks selling below book value
• Stocks with strong cash position
• Stocks that have never cut their dividend

Time and again, however, I was confronted with the same problem. When things looked perfect on paper, when balance sheets seemed right, the prospects bright, the stock market never acted accordingly.

For instance, when I carefully compared the financial position of some dozen textile companies and after much study decided that the balance sheets clearly indicated that AMERICAN VISCOSE and STEVENS were the best choices, it was very puzzling to me why another stock called TEXTRON advanced in price while my two selections did not. I found this pattern repeatedly in other industry groups.

Baffled and a little disconcerted, I wondered whether it would not be wiser to adopt the judgment of a higher authority about the merits of a company. I asked my broker whether there was such an authority. He recommended a widely used, serious, very reliable monthly service, which gives the vital data on several thousand stocks—the nature of their business, their price ranges for at least twenty years, their dividend payments, their financial structure and their per-share annual earnings. It also rates each stock according to relative degrees of safety and value. It fascinated me to see how this was done.

High Grade stocks whose dividend payments are considered relatively sure are rated:

AAA—Safest
AA—Safe
A—Sound

Investment Merit stocks that usually pay dividends:

BBB—Best of group
BB—Good
B—Fair

Lesser Grade stocks, paying dividends but future not sure: CCC—Best of group
CC—Fair dividend prospects
C—Slight dividend prospects

Lowest Grade stocks:
DDD—No dividend prospects
DD—Slight apparent value
D—No apparent value

I studied all these ratings very carefully. It seemed so very simple. There was no longer any need for me to analyze balance sheets and income accounts. It was all spelled out for me here, I had only to compare: A is better than B, C is better than D.

I was absorbed and happy with this new approach. To me it had the charm of cold science. No longer was I the plaything of frantic, worrying rumor. I was becoming the cool, detached financier.

I was sure I was laying the foundation of my fortune. I now felt competent and confident. I listened to no one, I asked no one for advice. I decided everything I had done before was as slaphappy as my Canadian gambling period. I felt all I now needed to achieve success was to set up my own comparison tables. This I did, spending many grave and serious hours at the task.

Chapter 2 Insights by Steve Burns

“What I did not know was that I was practically smack in the middle of the biggest bull market the world had ever seen and it was quite difficult, unless you were extremely

**unlucky, not to show a little paper profit from time to time”.
–Nicolas Darvas**

Bull markets are like tides that raise all ships while bear markets are like storms that wreck all ships. What Darvas realized later was that you did not have to be a genius to make money in a bull market; all you had to do was to be long stock almost any stock.

In today’s stock market in flows both into an out of mutual funds is a leading driver for the market’s trend. If people are moving their retirement money from cash equivalents to stock mutual funds this provides money managers with more capital to put to work buying stocks. If people are fearful and sell their mutual funds and move into bonds or cash equivalents in their retirement accounts this causes money managers to have to sell some stock holdings to redeem the mutual fund shares back to their customers. The velocity and the amount of money flowing into and out of stock mutual funds in retirement accounts is one of the main determinants of the trend of the market. If you own stocks during an influx of money into the market you will likely win regardless of your skills as an investor or trader. However do not be deceived, only a long term trading plan allows you to keep those profits.

“Whenever a trade was successful I praised myself; when I lost, I blamed it on the broker”. –Nicolas Darvas

Taking responsibility for your trading results is one of the most important things you can do. You must have a plan to use a methodology and then follow that method with discipline and focus. If you are a Darvas style trader and you follow his momentum style of investing and you lose, whose fault is it? It is no one's; the market simply was not conducive to that style in that stock at that time. You simply try again and follow the system.

Many traders fall into the trap of blaming 'them'. 'They' ran the stock up then dumped it on me; 'they' caused the reversal by selling into the strength. Each trader and investor is responsible for their own decisions. If you took your entry point based on your method and it took off for an amazing return you cannot praise yourself for the win, you did not cause it. You can only praise yourself for having the discipline to take the entry and for doing the homework of knowing how to trade for profits over the long term.

"I continued to trade constantly. I telephoned my broker sometimes twenty times a day. If I did not conduct at least one transaction a day I did not feel I was fulfilling my role in the market. If I saw a new stock I wanted to have it. I reached out for fresh stocks like a child for new toys".
–Nicolas Darvas

The biggest mistake that new traders make is that they think activity equals success. The opposite is the case in my experience. The less I trade the more money I make. I am not looking for $1 scalps in trades I want to catch the $50 or $100 dollar moves in the high priced stocks that I trade. Thanks to Darvas I have done that many times while day traders are working so hard and playing for pennies.

As a Darvas style trader and investor you should ONLY buy the very best stocks in the market. You want to be in the stock of a company where the earnings are flowing because of world changing innovation that is not easily copied or competed with. Do not waste your time buying junk stocks or trying to watch 100 stocks at one time. Instead I would advise watching the best ten and buying the top 3 to 5 when the time is right. I think Darvas would agree.

"I tried this approach, but it did not work. By the time I found out about the insiders' transactions, it was always too late. Besides, I always found that insiders were human, too. Like other investors they often bought too late or sold too soon. I made another discovery. They might know all about

their company but they did not know about the attitude of the market in which their stock was sold". –Nicolas Darvas

The problem with watching insiders buying and selling the stock of their own company is that they sell many times just because they need the money available to them with company sponsored stock options or they want to diversify their total holdings. Who wants 75% of their net worth in one stock? Other times they are selling because they have been in their companies stock for years and already have huge profits based on their original cost.

Insider buying is not as good an indicator as you would think because most do not understand how the market really works and many times the future earnings are already priced into the stock itself. Insiders have no way of knowing how the market will react to news or an earnings or sales announcement. Most news is expected and priced into a stock before the announcement even happens.

Also trading on insider information not available to the public is illegal. So the company insiders are highly unlikely to be buying on information that is not available to the public because they could go to prison. Trade the chart not the insider's opinions.

Nicolas Darvas writing is in bold with my comments below: 1. I should not follow advisory services. They are not infallible, either in Canada or on Wall Street.

The vast majority of advisory services are worse than useless; they are dangerous if they do not set risk parameters for their subscribers. The vast majority of stock newsletters are written by people that make money on the letters not trading.

I would strongly advise you to only take advice from services that use credible methods to provide you with stocks to watch. The methods that I recommend are trend following, CAN SLIM stocks, and the Darvas method. Also you need to know the newsletter writers trading performance and search the web for successful subscribers.

Generally going off of newsletter writer's personal opinions or their fundamental reasoning for a stock to go up is the most dangerous of all.

2. I should be cautious with brokers' advice. They can be wrong.

Trade a historically proven system or method and never trade off of a brokers or anyone else's advice. Each one of your trades has to make sense to you and fit inside or your own trading plan. Single trades are meaningless unless completed inside a well thought out long term plan for success.

3. I should ignore Wall Street sayings, no matter how ancient and revered. About that time I heard a saying which has been passed from mouth to mouth for generations in Wall Street, but to me was new: "You cannot go broke taking a profit." I was much impressed by this and I was burning to put it into operation. Another stock market saying that began to fascinate me was "Buy Cheap, Sell Dear." This sounded even better.

Darvas learned that you can go broke taking a profit. If you cut your winners short by taking $100 profits five times and let your losers run and then lose $500 five times you are down $2000 after ten trades. That is a great formula for going broke over the long term. In trading and investing you have to let your winners run and cut your losses short.

The problem with the plan to buy a stock cheap and then sell it when it goes back up higher is that many junk stocks are low for a reason and they never go back up. Stock prices generally follow earnings expectations, as real earnings drop the stock drops with those earnings. If there is no turn around in those earnings the stock continues to fall. Historically stocks that are at or near all time highs tend to go higher, stocks at or near all time lows tend to go lower. This is due to the flow of capital into the stock market chasing earnings.

4. I should not trade "over the counter"—only in listed stocks where there is always a buyer when I want to sell. What I did not know was that when I came to offer them for sale, some of these stocks stuck to my fingers like tar.

If you have not already learned this lesson the hard way then please take Darvas' advice and NEVER trade penny stocks or over the counter stocks only listed on the pink sheets. Keep your trading limited to stocks listed on the major exchanges and trade healthy volume of over 500,000 shares a day. There is little regulation or standards in the over the counter market and it is very dangerous to buy stocks that could literally have no buyers when you are ready to sell. There are scams set up by boiler room operations fishing to find buyers to unload their stock on to. Avoid this altogether and trade in the light of the major exchanges where liquidity and real companies are the norm.

5. I should not listen to rumors, no matter how well founded they may appear.

Nicolas Darvas did not trade rumors, he traded price action. The problem is that if someone really does have a fact that is not available to the public then they are breaking a law and if your trading on that information it could also cause you to go to jail if caught. So even if it is true it is not worth the risk. But, rumors are false the vast majority of the time so really they add no value to your trading. Avoid them.

6. The fundamental approach worked better for me than gambling. I should study it.

Real companies with real earnings and innovative products are the ones that go up in value. Some junk stocks may rise for awhile based on perceived game changing information but they usually sink back to the prices they came from. Speculative stocks that are believed to eventually make money and change the world are usually the first wave of an industry where most do not make it. A company's fundamentals and future growth in sales and earnings do play a huge part in the current and rising valuation and price of its stock.

7. I should rather hold on to one rising stock for a longer period than juggle with a dozen stocks for a short period at a time.

You will do much better in your trading to focus on a very limited amount of the best stocks in the market and buy them when they are at their strongest and breaking out of key resistance points. Generally focusing on trading and investing in only a few stocks that you know extremely well and believe in will lead to better results than juggling 12, 50, or 100 stocks at one time. I would limit your watch list to only the best ten in the current market then only trade up to five at any one time in your personal account. Watching their price action closely each day and really getting to know how they behave when trending, how volatile they can be, or how they act leading up into and after earnings.

Chapter 3 My First Crisis

From my reading I knew that stocks—like herds, indeed— form groups according to the industry they represent and that stocks belonging to the same industry have the tendency to move together in the market, either up or down.

It seemed only logical to me that I should try to find through fundamental analysis:

a. The strongest industry group;
b. The strongest company within that industry group.

Then I should buy the stock of that company and hold on to it, for such an ideal stock must rise.

I started studying the personality of a stock in relation to its industry group. When I read the quotations of GENERAL MOTORS I automatically looked at those of CHRYLSER, STUDEBAKER and AMERICAN MOTORS. If I looked at KAISER ALUMINUM, my eye automatically glanced afterwards at REYNOLDS METALS, ALCOA, and ALUMINUM LTD. Instead of reading the stock tables in A…B…C order, I always read them in industry groups.

Whenever a stock started to behave better than the market generally I immediately looked at the behavior of its brothers—stocks of the same industry group. If I found that its brothers also behaved well, I looked for the head of the family—the stock that was acting best, the leader. I figured if I could not make money with the leader, I would certainly not make money with the others.

How delighted and important I felt doing all this! This serious, scientific approach made me feel like a soon-graduating expert in finance. Besides, I felt this was more than mere theory. I was going to put all this into practice and make a lot of money.

I started by compiling earnings of whole industry groups like oils, motors, aircraft, steel. I compared their past earnings with their present earnings. Then I compared these earnings with the earnings of other industry groups. I carefully evaluated their profit margins, their price-earnings ratios and their capitalizations.

Finally, after a tremendous amount of sifting and concentrating, I decided that the steel industry was the vehicle, which would make me rich.

Having made this decision, I then examined the industry in the minutest detail. Once again I delved into my rating service.

I was determined to play safe, so I figured the stock to buy should be in the "A" range and should pay a high dividend. But I received a surprise. As I went into this I discovered that “A” ratings were extremely rare and were almost always for preferred stocks. They were relatively stable price-wise and rarely rose spectacularly. Obviously these were not for me.

I decided to have a look at the “B” range. Here the stocks looked fine and they were numerous. I selected the five best known of them and started to compare them with each other. I did this with the utmost thoroughness. I set up my comparison table like this:

Company

Bethlehem BB 142⅜ 7.9
Steel
Inland BB 79⅜ 8.3
Steel
U. S. Steel BB 54⅜ 8.4

Jones & B 41½ 5.4
Laughlin
Republic B 47¼ 8.5
Steel

Earnings-per-share Estimated 1955 EarnDiviings dend

1952 1953 1954
8.80 13.39 13.18 18.00 7.25
4.85 6.90 7.92 9.50 4.25
2.27 3.78 3.23 6.50 2.15 2.91 4.77 3.80 7.75 2.25

3.61 4.63 3.55 5.50 2.50

As I looked at my table I began to feel a wave of excitement. My table, like a pointer on a scale, clearly pointed to one stock: JONES & LAUGHLIN. I could not imagine why no one had noticed it before. Everything about it was perfect.

- It belonged to a strong industry group.
- It had a strong B rating.
- It paid almost 6% dividend.
- Its price-earnings ratio was better than that of any other stock in the group.

A tremendous enthusiasm came over me. This undoubtedly was the golden key. I felt fortune within my grasp like a ripe apple. This was the stock to make me wealthy. This was a gilt-edge scientific certainty, a newer and greater BRILUND. It was sure to jump 20 to 30 points any moment.

I had only one great worry. That was to buy a large amount of it, quickly, before others discovered it. I was so sure of my judgment, based on my detailed study that I decided to raise money from every possible source.

I had some property in Las Vegas, bought out of many years of work as a dancer. I mortgaged it. I had an insurance policy. I took a loan on it. I had a long-term contract with the “Latin Quarter” in New York. I asked for an advance.

I did not hesitate for a moment. I had no doubts. According to my most scientific and careful researches, nothing could go wrong.

The 23rd of September, 1955,1 bought 1,000 shares of JONES & LAUGHLIN at 52¼ on margin, which at that time was 70%. The cost was $52,652.30 and I had to deposit $36,856.61 in cash. To raise this amount I had put up all my possessions as a guarantee.

All this I had done with the greatest confidence. Now there was nothing to do but sit back and wait until I would begin to reap the harvest of my foolproof theory.

On September 26th the lightning struck. JONES & LAUGHLIN began to drop.

I could not believe it. How could it be? This was the new BRILUND. This was going to make my fortune. It was no gamble; it was a completely detached operation, based on infallible statistics. Still the stock continued to drop.

I saw it fall and yet I refused to face reality. I was paralyzed. I simply did not know what to do. Should I sell? How could I? In my projection, based on my exhaustive studies, JONES & LAUGHLIN was worth at least $75 per share. It was just a temporary setback, I said to myself. There is no reason for the drop. It is a good sound stock; it will come back. I must hold on. And I held on and I held on.

As the days went by I became afraid to look at the quotations. I trembled when I telephoned my broker. I was scared when I opened my newspaper.

When after a three-point drop the stock rose a half-point, my hopes started to rise with it. This is the start of recovery, I said. My fears temporarily calmed. But the following day the stock resumed its downward slide. On October 10th, when it hit 44, blind panic set in. How much further would it drop? What should I do? My paralysis turned to terror. Every point the stock dropped meant another $1,000 loss to me. This was too much for my nerves. I decided to sell, and my account was credited with $43,583.12. My net loss was $9,069.18.

I was crushed, finished, destroyed. All my smug ideas about myself as the scientific Wall Street operator crumbled. I felt as though a great bear had shambled up to me and mauled me just when I was preparing to shoot it. Where was the science? What was the use of research? What had happened to my statistics?

It would be difficult for anyone to conceive the shattering effects of the blow. If I had been a wild gambler, I could have expected such a position. But I had done my best not to be one. I had labored long and hard. I had done everything possible to avoid a mistake. I had researched, analyzed, compared. I had based my decision on the most trustworthy, fundamental information. And yet, the only result was that I was wrecked to the tune of $9,000.

Black despair filled me when I realized I would probably lose my Las Vegas property. The horror of bankruptcy stared me in the face. All my confidence built up by a benevolent bull market and by my first quick success with BRILUND, deserted me. Everything had been proved wrong. Gambling, tips, information, research, investigation, whatever method I tried to be successful in the stock market, had not worked out. I was desperate. I did not know what to do. I felt I could not go on.

Yet I had to go on. I must save my property. I must find a way to recoup my losses.

For hours every day I studied the stock tables, feverishly searching for some solution. Like a condemned man in a cell, I watched all the active stocks to see if they offered any escape.

Finally my eye noticed something. It was a stock I had never heard of, called TEXAS GULF PRODUCING. It appeared to be rising. I knew nothing about its fundamentals and had heard no rumors about it. All I knew was that it was rising steadily, day after day. Would it be my salvation? I did not know, but I had to try. Much more in despair than in hope, as a last wild attempt to recoup my losses, I gave an order to buy 1,000 shares at prices ranging between 57⅛ and 37½. The total cost was $37,586.26.

I held my breath as I anxiously watched its continued rise. When it hit 40, I had a compelling temptation to sell. But I hung on. For the first time in my stock-market career I refused to take a quick profit. I dared not—I had that $9,000 loss to make up.

I telephoned my broker every hour, sometimes every fifteen minutes. I literally lived with my stock. I followed its every movement, every fluctuation. I was watching it the way an anxious parent watches over his newborn child.

For five weeks I held it, tensely watching it all the time.

Then one day, when it was standing at 43¼, I decided not to stretch my luck any further. I sold it and received $42,840.43. I had not got my $9,000 back, but I had recovered more than half of it. When I sold TEXAS GULF PRODUCING I felt as if I had just passed the crisis in a long, critical illness. I was exhausted, empty, spent. And yet, something began to shine through. It came in the form of a question.

I asked myself what was the value of examining company reports, studying the industry outlook, the ratings and the price-earnings ratios? The stock that saved me from disaster was one about which I knew nothing. I picked it for one reason only— it seemed to be rising.

Was this the answer? It could be.

So the unfortunate experience with JONES & LAUGHLIN had its significance. It was not wasted. It led me toward the glimmering of my theory.

Chapter 3 Insights by Steve Burns

"Stocks—like herds, indeed—form groups according to the industry they represent and that stocks belonging to the same industry have the tendency to move together in the market, either up or down". –Nicolas Darvas

Part of a stock's price action is based on the industry it is in and whether that industry is in or out of favor with the market. In the late nineties any stock in the internet industry was a winner, not because of the fundamentals of the stock but based on the future expectations that the internet would change the world and the companies that were already there when it happened would benefit greatly.

If the worst industry group in the market is gold miners because gold is currently at a low price compared to its historical average price and the expectations are that gold will stay low then it makes no difference how good a company's fundamentals are, it is slow money and investment capital will look elsewhere for a better return on investment.

"Whenever a stock started to behave better than the market generally I immediately looked at the behavior of its brothers—stocks of the same industry group. If I found that its brothers also behaved well, I looked for the head of the family—the stock that was acting best, the leader. I figured if I could not make money with the leader, I would certainly not make money with the others". –Nicolas Darvas

When a stock goes up when the rest of the market is down this is what we call relative strength. It is also relative strength if the S&P 500 rallies 1% but a stock is up 5%. A stock that is showing positive price action in relation to what the rest of the market is doing is always one to watch.

When you see a stock that is green in a sea of red the next step is to see what industry it is in and how the other stocks are doing in the same industry. If you decide that the group is performing well and you want to invest in that industry then you want to locate the strongest stock in that group, the leader, the best up trending chart with the highest percentage of earnings and sales growth over the past 3 years. Trade the leader not the followers of the group.

Investors.com and Investor's Business Daily divides stocks for you into 197 industry groups this makes it very simple to view the stocks group quickly and conveniently.

"I did not hesitate for a moment. I had no doubts. According to my most scientific and careful researches, nothing could go wrong". –Nicolas Darvas

Confidence in your trading method and system is needed. However, complete faith and confidence in any one trade can be deadly to your account. Over confidence in a particular investment or trade leads to not having an exit strategy, stop loss, or trailing stop. Why would you? You KNOW it is going to be a winner, you can't lose. Yes, you can. The certainty that you have that you are going to win is a bad sign in itself. The best trades are usually the hardest to take, whether buying at a bounce off support or buying at a break out to all time highs. Also there are no sure things in trading you enter each trade based on your planned entry signal, ANYTHING can happen, never become too sure of any trade. Some of the best traders in the world are only right 50% of the time.

Marry your trading plan, method, and system but only date your stocks and any single trade.

"I said to myself. There is no reason for the drop. It is a good sound stock; it will come back. I must hold on. And I held on and I held on". –Nicolas Darvas

That is a perfect example of what most traders think before they have the biggest losses of their trading careers. And if they are not managing risk through position sizing it could be the fatal blow that ends their trading careers. The price is the truth regardless of the fundamentals or your own personal opinions about what the price should be and why. The market does not care about your opinions. Each price that is established on the ticker is a real agreement between a buyer and a seller not an opinion; they made a transaction that both thought was fair. That price is reality.

Before you buy any stock for a trade or an investment always have a set price that you will know you were wrong and that you will sell at regardless of your opinion at that time. You can also have a time stop to sell if it does not move by a certain time or a volatility stop if your stock starts moving much more than its average true range which will increase the risk more than you had anticipated.

Before you buy a stock always know the most money you are willing to lose and have a set stop loss point if you are wrong.

"As the days went by I became afraid to look at the quotations. I trembled when I telephoned my broker. I was scared when I opened my newspaper". –Nicolas Darvas

The biggest reason to manage your risk and position sizing carefully is not just for the sake of your capital but for the sake of your emotional and mental well being. How you manage your emotional capital while trading will determine how long you are able to trade. Mental and emotional frustration causes many new traders to quit trading before they really even get started. Never let any single trade affect your emotional and mental well being, trade at a size that you are comfortable with. I make a big effort to never risk more than 1% of my total trading capital when I enter a trade by proper position sizing and stop placement. This makes any single trade just one trade in a string of the next one hundred.

"When after a three-point drop the stock raised a halfpoint, my hopes

started to rise with it. This is the start of recovery, I said. My fears temporarily calmed". –Nicolas Darvas

When you are trading on hope instead of a well planned system then you are in trouble, get out of the trade. The reason that Darvas made so much money is that he traded in the direction of the trend. Contrary to popular belief the more a stock moves in one direction the better the odds are that it will continue to move in that direction. If a stock is down five days in a row the odds are in favor of it being down on the sixth day also. This is due to supply and demand and a stocks trend tells you if there is demand for the stock.

When you start hoping that a stock goes up in price against all odds it is time to get out.

"This was too much for my nerves. I decided to sell, and my account was credited with $43,583.12. My net loss was $9,069.18." –Nicolas Darvas

Your first loss is your best loss. If Darvas would have only risked $500 on this trade he would have either had a very tight stop or had to have reduced his position size of his shares to give it more room to move. You should never take a 17% loss on your account in any one trade; a few losses in a row will end your trading quickly. The key to your winning in trading is to have small losses and big wins that is how it works for winning traders.

"For hours every day I studied the stock tables, feverishly searching for some solution". –Nicolas Darvas

One of the most beneficial things that you can do as a trader or investor is study charts of the biggest winning stocks of all time. With any stock that you want to trade you need to first look back at the stock's chart over the last year with the 5 day exponential average, and also the 10, 50, and 200 day simple moving averages. If you study these charts you will begin to see patterns of support and resistance both around the moving averages and specific price points called Darvas boxes, many times round numbers and all time highs are pivot points for these boxes. This is one of the most beneficial things you can do is see how a stock actually trades. Charts are maps that show where a stocks buyers and sellers have been in the past and where they may still be waiting.

"It appeared to be rising. I knew nothing about its fundamentals and had heard no rumors about it. All I knew was that it was rising steadily, day

after day”. –Nicolas Darvas

Half of the puzzle in finding a winning stock is simple buying stocks that are going up day after day with the key moving averages or a price point acting as support during the rise. It sounds simple but so many traders are drawn to cheap stocks like a moth to a flame. They get routinely burnt by those cheap junk stocks also. Many times if you find the stock with the best up trending chart and highest price it is usually also the company with the best earnings and sales growth. Why? Capital flowing to the place where earnings are growing.

“For the first time in my stock-market career I refused to take a quick profit.” -–Nicolas Darvas

If you want to win in the stock market the most important thing you have to do is “Let your winners run” Why? Because you need a few really big winners to pay for all you small losses and still make a profit. The Darvas method is all about finding the very strongest stocks in the entire stock market that are in huge demand and buying them at key price break out levels above resistance. This is the formula for explosive moves that you will miss if you take your money off the table too early in the move.

Cutting your losers short and letting your winners run is one of the key formulas to winning with the Darvas method.

THE TECHNICIAN Chapter 4 Developing the Box Theory

After my frightening experience with JONES & LAUGHLIN, and my more fortunate experience with TEXAS GULF PRODUCING, I sat down to assess my position. By now I had been scared and beaten by the market enough to appreciate that I should not regard the stock market as a mysterious machine from which, if I were lucky, fortunes could be extracted like the jackpot in a slot machine. I realized that although there is an element of chance in every field in life, I could not base my operations on luck. I could be lucky once, maybe twice —but not constantly.

No, this was not for me. I must rely on knowledge. I must learn how to operate in the market. Could I win at bridge without knowing the rules? Or in a chess game without knowing how to answer my opponent’s moves? In the same way, how could I expect to succeed in the market without learning how to trade? I was playing for money, and the game in the market was against the keenest experts. I could not play against them and expect to win without learning the fundamentals of the game.

And so I started. First I examined my past experiences. On one hand, using the fundamental approach, I was wrong. On the other hand, using the technical approach, I was right. Obviously the best method was to try to repeat the successful approach I had used with TEXAS GULF PRODUCING.

It was not easy. I sat with my stock tables for hours each evening, trying to find another stock like it. Then one day I noticed a stock called M & M WOOD WORKING. None of the financial information services could tell me anything much about it. My broker had never heard of it. Yet I remained obstinately interested because its daily action reminded me of TEXAS GULF PRODUCING. I started to watch it carefully.

In December 1955 the stock rose from about 15 to 23⅝ at the year-end. After a five-week lull, its trading volume increased and its price resumed its advance. I decided to buy 500 shares at 26⅝. It continued to rise and I held on, watching its movement intently. It kept moving upward and its volume of trading was consistently high. When it reached 33,1 sold it and took a profit of $2,866.62.

I was happy and excited—not so much because of the money but simply because I had bought M & M WOOD WORKING, as I had bought TEXAS GULF PRODUCING, purely on the basis of its action in the market. I knew nothing about it nor could I find out very much. Yet I assumed from its continuing rise and high volume that some people knew a lot more about it than I did.

This proved to be correct. After I had sold it, I found out from the newspaper that the steady rise had been due to a merger, which was being secretly negotiated. It was eventually revealed that another company planned to take over M & M WOOD WORKING for $35 a share, and this offer was accepted. This also meant that although I was in complete ignorance about the behind-the-scene deal, I had only sold out 2 points under the high. I was fascinated to realize that my buying, based purely on the stock's behavior, enabled me to profit from a proposed merger without knowing anything about it. I was an insider without actually being one.

This experience did more than anything to convince me that the purely technical approach to the market was sound. It meant that if I studied price action and volume, discarding all other factors, I could get positive results.

I now began to try to work from this point of view. I concentrated on a close study of price and volume and tried to ignore all rumors, tips or fundamental information. I decided not to concern myself with the reasons behind a rise. I figured that if some fundamental change for the better takes place in the life of a company, this soon shows up in the rising price and volume of its stock, because many people are anxious to buy it. If I could train my eyes to spot this upward change in its early stages, as in the case of M & M WOOD WORKING, I could participate in the stock’s rise without knowing the reason for it.

The problem was: How to detect this change? After much thinking I found one criterion—that was to compare stocks with people.

This is how I began to work it out: If a tempestuous beauty were to jump on a table and do a wild dance, no one would be particularly astonished. That is the sort of characteristic behavior people have come to expect from her. But if a dignified matron were suddenly to do the same, this would be unusual and people would immediately say, “There is something strange here— something has happened.”

In the same way, I decided that if a usually inactive stock suddenly became active I would consider this unusual, and if it also advanced in price I would buy it. I would assume that somewhere behind the out-of-the-ordinary movement there was a group who had some good information. By buying the stock I would become their silent partner.

I tried this approach. Sometimes I was successful, sometimes not. What I did not realize was that my eyes were not sufficiently trained yet, and exactly when I started to feel confident I could operate on my theory, I was in for a rude awakening.

In May 1956 I noticed a stock called PITTSBURGH METALLURGICAL, which at that time was quoted at 67. It was a fast-moving, dynamic stock and I thought it would continue to move up rapidly. When I saw its increased activity, I bought 200 shares for a total cost of $13,483.40.

I was so sure of my judgment that I threw all caution overboard and when the stock—contrary to my expectation— began to weaken, I thought this was just a small reaction. I was sure that after the slight drop it was set for another big upward move. The move was there all right—but it was in the wrong direction. Ten days later PITTSBURGH METALLURGICAL stood at 57¾. I sold it. My loss was $2,023.32.

Something was obviously wrong. Everything clearly pointed to the stock as the best in the market at that time and still, no sooner had I bought it, than it dropped. And what was more disillusioning, no sooner did I sell it than it started to move up.

Trying to find an explanation, I examined the stock's previous movements and discovered that I had bought it at the top of an 18-point rise. This was as much as the stock could contain for the time being. Almost at the very point that I put money in it, it started to drift downward. It was evident that I had bought the right stock at the wrong time.

Looking back I could see this very clearly. I could see exactly why the stock had performed the way it did—afterwards. The question, however, was: How to judge a movement at the time it happens?

It was a simple, straightforward problem, but it was complex in its enormity. I already knew that book systems did not help, balance sheets were useless and the information was suspect and wrong.

Clutching at a straw, I decided to make an extensive study of individual stock movements. How do they act? What are the characteristics of their behavior? Is there any pattern in their fluctuations?
I read books, I examined stock tables and I inspected hundreds of charts. As I studied them I began to learn things about stock movements which I had not seen before. I started to realize that stock movements were not completely haphazard. Stocks did not fly like balloons in any direction. As if attracted by a magnet, they had a defined upward or downward trend, which, once established, tended to continue. Within this trend stocks moved in a series of frames, or what I began to call "boxes". They would oscillate fairly consistently between a low and a high point. The area, which enclosed this up-and-down movement, represented the box or frame. These boxes began to exist very clearly for me.

This was the beginning of my box theory, which was to lead to a fortune.

This is how I applied my theory: When the boxes of a stock in which I was interested stood, like a pyramid, on top of each other, and my stock was in the highest box, I started to watch it. It could bounce between the top and the bottom of the box and I was perfectly satisfied. Once I had decided on the dimensions of the box, the stock could do what it liked, but only within that frame. In fact, if it did not bounce up and down inside that box I was worried.

No bouncing, no movement, meant it was not a lively stock. And if it were not a lively stock I was not interested in it because that meant it would probably not rise dynamically.

Take a stock, which was within the 45/50 box. It could bounce between those figures as often as it liked and I would still consider buying it. If, however, it fell to 44½, I eliminated it as a possibility.

Why? Because anything below 45 meant it was falling back into a lower box and this was all wrong—I wanted it only if it was moving into a higher box.

I found that a stock sometimes stayed for weeks in one box. I did not care how long it stayed in its box as long as it did and did not fall below the lower frame figure.

I observed, for instance, that when a stock was in the 45/50 box it might read like this:
45 - 47 - 49 - 50 - 45 - 47

This meant that, after reaching a high at 50, it could react to a low at 45 then close every day at 46 or 47 and I was quite happy. It was still within its box. But, of course, the movement I was constantly watching for was an upward thrust toward the next box. If this occurred I bought the stock.

I did not find any fixed rule as to how this takes place. It just has to be observed and instantly acted upon. Some volatile, eager stocks moved into another box within hours. Others took days. If the stock acted right, it started to push from its 45/50 box into another, upper box.

Then its movement began to read something like this: 48 - 52 - 50 - 55 - 51 - 50 - 53 - 52
It was now quite clearly establishing itself in its next box—

the 50/55 box.

Do not misunderstand me on this. These are only examples. What I had to decide was the range of the box. This, of course, varied with different stocks. For instance, some stocks moved in a very small frame, perhaps not more than 10% each way. Other wide-swinging stocks moved in a frame between 15% and 20%. The task was to define the frame exactly and be sure the stock did not move decisively below the lower edge of the box. If it did, I sold it at once, because it was not acting right.

While it stayed within its box, I considered a reaction from 55 to 50 as quite normal. It did not mean to me that the stock was going to fall back- just the contrary.

Before a dancer leaps into the air he goes into a crouch to set himself for the spring. I found it was the same with stocks. They usually did not suddenly shoot up from 50 to 70. In other words, I considered that a stock in upward trend that reacted to 45 after reaching 50 was like a dancer crouching, ready for the spring-up.

Later when I had more experience I also learned that this 45 position in a stock after a 50 high point has another important benefit. It shakes out the weak and frightened stockholders who mistake this reaction for a drop, and enables the stock to advance more rapidly.

I came to see that when a stock was on a definite upward trend there was a feeling of proportion about its advance. If it was on its way, rising from, let us say, 50 to 70 but occasionally dropping back- that was all part of the right rhythm.

It might have gone like this:
50 - 52 - 57 - 58 - 60 - 55 - 52 – 56
That meant it was in the 52/60 box.
After this, on an upward swing, it might have gone: 58 - 61 - 66 - 70 - 66 - 63 - 66

This meant it was well inside the 63/70 box. I also considered that it was still edging towards higher spheres.

The major problem still remained; what was the right time to buy into it? Logically, it was the moment when it entered a new higher box. This seemed quite simple, until the case of LOUISIANA LAND & EXPLORATION proved it was not.

For weeks I watched the behavior of this stock and saw it form its pyramiding boxes. When the upper frame of its last box was 59¾, I felt I had assessed it correctly. I told the broker to telephone me when it reached 61, which I considered the door of its new box. He did, but I was not in my hotel room when the call came. It took him two hours to reach me. By the time he did, the stock was quoted at 63. I was disappointed. I felt I had been deprived of a great opportunity.

I was angry at the way it had passed me at 61 and when it went to 63 in such a short time I was certain I had missed a very good thing. Good reason deserted me in my excitement. I would have paid any price for this stock in my enthusiasm. I just had to get into a stock, which I thought was going up to a fabulous price.

Up it went—63½—64½—65. I was right. I had judged it correctly and I had missed it! I could not wait any longer. I bought 100 shares at 65—at the top of its new box—because I had missed it at the bottom.

Although I was improving in my selection and method, I was still somewhat of a baby in the mechanics of Wall Street, so I placed my problem before the broker. We discussed the 61-point telephone call, which had unfortunately missed me. He told me I should have put in an automatic “on stop” buy order. This meant the stock would have been bought when it rose to 61. He suggested that whenever I made a decision about a stock I should put in a buy order at a named figure. Then the stock would be bought for me without further consultation if the market reached this figure. This I agreed to do.

My problem of buying automatically at what I thought was the right time was settled.

By this time my box theory and its form of application were firmly planted in my mind and on three consecutive occasions I used it successfully.

I bought ALLEGHENY LUDLUM STEEL when it appeared to me to be going into the 45/50 box.
I bought 200 shares at 45¾ and sold them three weeks later at 51.
I also bought 300 shares of DRESSER INDUSTRIES when it seemed to be entering the 84/92 box.

I bought at 84, but as it did not seem to be making the right progress through the box, I sold at 86½.
Then I bought 300 shares of COOPER-BESSEMER at the bottom edge of the 40/45 box at 40¾ and sold at 45½. My profit on these three transactions was $2,442.36.

This gave me a great deal of confidence, but then I received a slap in the face, which proved to me that I needed more than a theory alone. In August I bought 500 shares of NORTH AMERICAN AVIATION at 94⅜ because I was sure it was about to establish itself in a new box over 100. It did not. Almost immediately it turned around and started to fall back. I could have sold it when it gave up a point. I could have done the same when it lost another point. But I decided against it and stubbornly held on. My pride did not let me act. The prestige of my theory was at stake. I just kept saying this stock cannot go down any further. I did not know what I learned later, that there is no such thing as cannot in the market. Any stock can do anything. By the end of the next week, the profit from my three previous operations was gone. I was back where I had started.

This experience, as I see it, was an important turning point of my stock-market career. It was at this point that I finally realized that:

1. There is no sure thing in the market—I was bound to be wrong half of the time.
2. I must accept this fact and readjust myself accordingly—my pride and ego would have to be subdued. 3. I must become an impartial diagnostician, who does not identify himself with any theory or stock. 4. I cannot merely take chances. First, I have to reduce my risks as far as humanly possible.

The first step I took in that direction was to adopt what I called my quick-loss weapon. I already knew that I would be wrong half of the time. Why not accept my mistakes realistically and sell immediately at a small loss? If I bought a stock at 25, why not at the same time order the stock to be sold if it returned below 24?

I decided to give "on-stop" orders to buy at a certain figure with an automatic "stop-loss" order on them in case the stock went down. This way, I figured, I would never sleep with a loss. If any of my stocks went below the price I thought they should, I would not own them when I went to bed that night. I knew that many times I would be "stopped out" for the sake of a point just to see my stock climb up immediately after. But I realized that this was not so important as stopping the big losses. Besides, I could always buy back the stock by paying a higher price.

Then I took the second equally important step.

I knew that being right half of the time was not the answer to success. I began to understand how I could break even and still go broke. If I invested about $10,000 and I operated in a medium-priced stock, each operation would cost me approximately $125 in commission every time I bought a stock, and another $125 every time I sold it.

There was only one answer to this danger: My profits had to be bigger than my losses.

I had learned from experience that my most difficult problem was to discipline myself not to sell a rising stock too quickly. I always sold too quickly because I am a coward. Whenever I bought a stock at 25 and it rose to 30, I became so worried it might go back that I sold it. I knew the right thing to do but I invariably did the opposite.

I decided that since I could not train myself not to get scared every time, it was better to adopt another method. This was to hold on to a rising stock but, at the same time, keep raising my stop-loss order parallel with its rise. I would keep it at such a distance that a meaningless swing in the price would not touch it off. If, however, the stock really turned around and began to drop, I would be sold out immediately. This way the market would never be able to get more than a fraction of my profits away.

And how to determine when to take profits?

I realized that I would not be able to sell at the top. Anyone who claims he can consistently do this is lying. If I sold while the stock was rising, it would be a pure guess, because I could not know how far an advance might carry. This would be no cleverer a guess than anticipating that “My Fair Lady” would end its run after 200 performances. You could also guess it would go off after 300 or 400 performances. Why did it not go off at any of these figures? Because the producer would be a fool to close the show when he sees the theater full every night. It is only when he starts to notice empty seats that he considers closing the show.

I carried the Broadway comparison through to the problem of selling. I would be a fool to sell a stock as long as it keeps advancing. When to sell then? Why, when the boxes started to go into reverse! When the pyramids started to tumble downwards, that was the time to close the show and sell out. My trailing stop-loss, which I moved up behind the rising price of the stock, should take care of this automatically.

Having made these decisions, I then sat back and re-defined my objectives in the stock market:

1. Right stocks
2. Right timing
3. Small losses
4. Big profits

I examined my weapons:

1. Price and volume
2. Box theory
3. Automatic buy-order
4. Stop-loss sell-order

As to my basic strategy, I decided I would always do this: I would just jog along with an upward trend, trailing my stoploss insurance behind me. As the trend continued, I would buy more. When the trend reversed? I would run like a thief.

I realized that there were a great many snags. There was bound to be a lot of guesswork in the operation. My estimate that I would be right half of the time could be optimistic. But at last I saw my problem more clearly than ever. I knew that I had to adopt a cold, unemotional attitude toward stocks; that I must not fall in love with them when they rose and I must not get angry when they fell; that there are no such animals as good or bad stocks. There are only rising and falling stocks—and I should hold the rising ones and sell those that fall.

I knew that to do this I had to achieve something much more difficult than anything before. I had to bring my emotions—fear, hope and greed—under complete control. I had no doubt that this would require a great amount of self-discipline, but I felt like a man who knew a room could be lit up and was fumbling for the switches.

Chapter 4 Insights by Steve Burns

“I could not base my operations on luck.” –Nicolas Darvas

In the stock market luck does not make you money. Trading with luck is nothing but gambling and how many gamblers do you see walk out of casinos with money? In true gambling the odds are not in your favor. Good traders are not gamblers; they have systems that actually put the odds in their favor based on the probabilities that a stock will continue within the trend that it is already on. Good traders have proven methods that allow them to trade with the odds in their favor so they act more like the casino than the gambler.

“It was not easy. I sat with my stock tables for hours each evening, trying to find another stock like it.” –Nicolas Darvas

Good traders are always looking for another stock like their biggest winners. The identification of Darvas type stocks is one of the most important things that you can do as a stock trader. Many people also now call the kind of stocks that Darvas traded Monster stocks. These stocks can usually be found by the strength of their charts and their defined support levels on the chart during massive up trends.

“I assumed from its continuing rise and high volume that some people knew a lot more about it than I did.”– Nicolas Darvas

The price action in a stock tells its story. Increasing prices day after day shows increasing demand and the reluctance of holders to turn it loose. Stagnant prices show a lack of interest either way up or down. Trading ranges will show where there are buyers willing to step in and also where people are waiting to sell a stock. A stock that has increasing volume and is rising every day, day after day is telling you that many people want the stock and are accumulating it at higher and higher prices because of what they know about its future potential. You do not have to know why there is buying pressure there you just have to get on board and see how far it will take you.

“I was fascinated to realize that my buying, based purely on the stock’s behavior, enabled me to profit from a proposed merger without knowing anything about it. I was an insider without actually being one.”

“If I studied price action and volume, discarding all other factors, I could get positive results.” –Nicolas Darvas

The art of technical analysis is reading a chart of a stock's price action to determine the underlying dynamics of the supply and demand action of the actual shares. This is done with no consideration of the value of the underlying company of the stock. It is like watching the speed of a race horse on a track and looking for his actual behavior and if he won races. Fundamental analysis would be more concerned about his pedigree, his diet, training program, and how much he was 'worth'.

Once you find the right trend on a chart it is possible to trade the stock very profitably without knowing anything about the company itself. Of course these two can be combined but always remember price is the truth.

"I now began to try to work from this point of view. I concentrated on a close study of price and volume and tried to ignore all rumors, tips or fundamental information. I decided not to concern myself with the reasons behind a rise. I figured that if some fundamental change for the better takes place in the life of a company, this soon shows up in the rising price and volume of its stock, because many people are anxious to buy it." –Nicolas Darvas

A key to successful trading is to block out all the 'noise' that does not help you make money. In the 21st century Nicolas Darvas would not be glued to CNBC all day he would be focused on charts in the off hours not tick by tick movements while the market was open. Darvas believed that the charts told the story of what was really going on with the fundamentals because traders and investors were pricing in the perceived value of the company with each new bid and ask price on the tape.

"In the same way, I decided that if a usually inactive stock suddenly became active I would consider this unusual, and if it also advanced in price I would buy it. I would assume that somewhere behind the out-of-the-ordinary movement there was a group who had some good information. By buying the stock I would become their silent partner." –Nicolas Darvas

Do you want to be the silent partner with big mutual funds as they build large positions in stocks based on their research department's fundamental analysis? Do you want to be on the side of early buyers that foresee a takeover bid in a smaller company? You can do all these things by piggy backing unusual volume entering a stock causing its price to increase dramatically. The tape doesn't lie, giants can’t hide their foot prints very well when they are eager to build positions.

“It was evident that I had bought the right stock at the wrong time.”– Nicolas Darvas

There are two elements of successful Darvas trading, first you have to find the right stock with the potential to continue to trend up in price, and then you have to buy it at the right time. Buying it too early could cause you to sit with it as dead money with it going sideways for a long period of time. Or you buy it after it has run too far, too fast and catch the top, or buy on a pull back that is really the end of the trend. To be successful as a Darvas trader you have to buy it ideally on the initial break out of a consolidated Darvas price range box. Do not buy it before the break out and do not buy it at the end of a huge run up. Also understand that what few break outs happen during bear markets usually fail.

“I decided to make an extensive study of individual stock movements. How do they act? What are the characteristics of their behavior? Is there any pattern in their fluctuations?” –Nicolas Darvas

Study the chart of any stock for the past year before you buy it. Look at price levels to get an understanding of support and resistance at specific levels. On your chart you can insert some key moving averages, the 5 day exponential moving average or the 10 day simple moving average is are excellent starting points to see which one provided the support and resistance in trending price moves, try both and go with the one that had the most reactions with price levels over the past year. Volatility and professional money manager interest plays a big part with which moving average is meaningful for an individual stock. How did the price react at these levels? Where did it find support? At what levels did the price bounce? The answers to these questions will tell you how to trade the stock.

“I read books, I examined stock tables, I inspected hundreds of charts. As I studied them I began to learn things about stock movements which I had not seen before. I started to realize that stock movements were not completely haphazard. Stocks did not fly like balloons in any direction. As if attracted by a magnet, they had a defined upward or downward trend, which, once established, tended to continue. Within this trend stocks moved in a series of frames, or what I began to call “boxes”. They would oscillate fairly consistently between a low and a high point. The area, which enclosed

this up-and-down movement, represented the box or frame. These boxes began to exist very clearly for me." –Nicolas Darvas

Read the most useful books on trading, like Darvas did. See Appendix C in the back of this book.
Using the IBD 50 as your watch list is a short cut to finding Darvas Stocks.

The majority of stocks move in trends depending on the growing or falling earnings expectations of the underlying company. Contrary to academic belief stocks do not move randomly, they move based on the perceptions of the buyers and sellers of the stock. Stocks tend to trend in one direction until acted on by an opposing force of earnings reports or game changing news. The price levels of support and resistance have meaning because those levels are watched by the traders and investors waiting to get in or out of a trade at those prices.

"This is how I applied my theory: When the boxes of a stock in which I was interested stood, like a pyramid, on top of each other, and my stock was in the highest box, I started to watch it. It could bounce between the top and the bottom of the box and I was perfectly satisfied. Once I had decided on the dimensions of the box, the stock could do what it liked, but only within that frame. In fact, if it did not bounce up and down inside that box I was worried." –Nicolas Darvas

Losing the price support at the bottom of a Darvas box is bearish, breaking out above the resistance price at the top of a box is bullish.

"No bouncing, no movement, meant it was not a lively stock. And if it were not a lively stock I was not interested in it because that meant it would probably not rise dynamically." –Nicolas Darvas

Stay away from dead stocks. You want to be in stocks that are moving in one direction over several weeks or months. Your stock must have the potential of huge earnings growth so the price can increase to fit those expectations.

"Some stocks moved in a very small frame, perhaps not more than 10% each way. Other wide-swinging stocks moved in a frame between 15% and 20%. The task was to define the frame exactly and be sure the stock did not move decisively below the lower edge of the box. If it did, I sold it at once, because it was not acting right." –Nicolas Darvas

You have to understand the volatility of your stock so you know how big of a position size you can take and how big the price box is. Some $100 stocks might have a $10 price box range and others have only a $5 price box range meaning that one is twice as volatile as the other one.

"Before a dancer leaps into the air he goes into a crouch to set himself for the spring. I found it was the same with stocks. They usually did not suddenly shoot up from 50 to 70. In other words, I considered that a stock in upward trend that reacted to 45 after reaching 50 was like a dancer crouching, ready for the spring-up".

"Later when I had more experience I also learned that this 45 position in a stock after a 50 high point has another important benefit. It shakes out the weak and frightened stockholders who mistake this reaction for a drop, and enables the stock to advance more rapidly." –Nicolas Darvas

It is dangerous for a stock to just go straight up without some range bound trading inside price boxes. This is needed to allow the traders and investors that want to sell to go ahead and sell so the unencumbered buying can continue once the sellers at the current level are removed as holders of the stock.

"The major problem still remained; what was the right time to buy into it? Logically, it was the moment when it entered a new higher box." –Nicolas Darvas

While Darvas was a momentum trader and wanted to buy at the confirmation of a break above the price box as his buy point, modern traders can also buy with a bounce off the bottom support of the price box for a better risk/reward trade.

"He told me I should have put in an automatic "on stop" buy order. This meant the stock would have been bought when it rose to 61. He suggested that whenever I made a decision about a stock I should put in a buy order at a named figure. Then the stock would be bought for me without further consultation if the market reached this figure. This I agreed to do." –Nicolas Darvas

This will be hard for most traders to do. Plan to buy a stock at a higher price. Many successful traders buy into price strength and sell into weakness. You do not have to be at your computer when a Darvas stock breaks into to all time highs you can enter a 'buy stop' order where it is automatically bought on a break out to new highs during the trading day.

"I just kept saying this stock cannot go down any further. I did not know what I learned later, that there is no such thing as cannot in the market. Any stock can do anything. By the end of the next week, the profit from my three previous operations was gone. I was back where I had started."– Nicolas Darvas

Very few people understand that the in the market literally anything can happen. A stock at 52 week lows can eventually go to zero. The hottest stock in the market can go on from a 52 week high to double and then top out months before the company's fundamental sales and profits finally top out. Nothing is guaranteed.

1. There is no sure thing in the market—I was bound to be wrong half of the time.

This is an amazing observation by Darvas for his time period. Even in the modern day, the majority of the best traders in the world have about a 50% win rate or less in their trading.

2. I must accept this fact and readjust myself accordingly—my pride and ego would have to be subdued.

Your goal as a trader is not to be right every time, it is to lose small when you are wrong and win big when you are right. Your goal is to make money not prove anything to anyone.

3. I must become an impartial diagnostician, who does not identify himself with any theory or stock.

Trade the actual price action, not your personal opinions about the market and where it 'should' be going. Do not get too wrapped up in any one stock, it is only good if it keeps making you money.

4. I cannot merely take chances. First, I have to reduce my risks as far as humanly possible.
The key to successful trading is to make the most money possible while risking as little as possible in the process. Big risks for little profits are very dangerous and prone to blowing up accounts eventually.

"The first step I took in that direction was to adopt what I called my quick-loss weapon. I already knew that I would be wrong half of the time. Why not accept my mistakes realistically and sell immediately at a small loss? If I bought a stock at 25, why not at the same time order the stock to be sold if it returned below 24?" –Nicolas Darvas

Darvas knew like many other great traders that the best trades are ones that show you an immediate profit. If you have to start fighting with a trade at the very beginning then the odds are it will not be a winner. Darvas believed in buying in at a perfect pivot point to higher prices and if the stock failed to stay above that level then selling it quickly for a small loss if it pulled back below his buy point.

"I knew that many times I would be "stopped out" for the sake of a point just to see my stock climb up immediately after. But I realized that this was not so important as stopping the big losses. Besides, I could always buy back the stock—by paying a higher price."

Taking small losses quickly prevents you from ever having to take a huge loss slowly. Be great at taking small losses and you will have the odds of being a great trader on your side. What if the stock reverses and goes higher? No big deal, just buy it back.

"Each operation would cost me approximately $125 in commission every time I bought a stock, and another $125 every time I sold it."

We have a huge advantage in our modern times to be able to use discount brokerages for much cheaper round trips of $8, $10, $14, or $20 as the total price to both buy and sell a stock. Shop around and be sure you get the cheapest rate along with great trade execution. There is absolutely no reason to ever pay more than $20 round trip for any trade. (That is $10 per trade, which I feel is too expensive) Also look into pay per share brokers like Interactive Brokers if your position sizing will be only a few hundred shares per trade. (See Appendix D for best current rates at time of publication)

"There was only one answer to this danger: My profits had to be bigger than my losses." –Nicolas Darvas This is truly the secret to successful trading; all your wins are simply bigger than all your losses.

"I had learned from experience that my most difficult problem was to discipline myself not to sell a rising stock too quickly. I always sold too

quickly because I am a coward. Whenever I bought a stock at 25 and it rose to 30, I became so worried it might go back that I sold it. I knew the right thing to do but I invariably did the opposite."

"I decided that since I could not train myself not to get scared every time, it was better to adopt another method. This was to hold on to a rising stock but, at the same time, keep raising my stop-loss order parallel with its rise. I would keep it at such a distance that a meaningless swing in the price would not touch it off. If, however, the stock really turned around and began to drop, I would be sold out immediately. This way the market would never be able to get more than a fraction of my profits away."

"I realized that I would not be able to sell at the top. Anyone who claims he can consistently do this is lying. If I sold while the stock was rising, it would be a pure guess, because I could not know how far an advance might carry." –Nicolas Darvas

A big mistake that many traders and investors make is selling a Darvas stock very early in its run and missing an additional 50, 100, even 150 points of a price move because they tried to judge a logical place to exit. You have to let the stock's price action tell you when to exit the stock. The key to making the really big returns is to get on board a Darvas stock and to ride it as far as it will possibly go and not sell it until it has truly reversed course and is heading lower.

"When to sell then? Why, when the boxes started to go into reverse!" –Nicolas Darvas

You have to have an exit strategy in every trade to lock in profits on your winners so you do not hold them as they become losers. Price levels of previous support were a good place for Darvas to sell and lock in profits. For modern traders that will likely be moving averages.

"My trailing stop-loss, which I moved up behind the rising price of the stock, should take care of this automatically." –Nicolas Darvas

Darvas did not exit based on his opinion, he continuously moved a stop loss up to the point where he would be stopped out if price boxes starting reversing so he would be taken out with profits still intact.

Chapter 5 Cables Round the World

Almost at the same time that I started to operate with my new principles in mind, I signed up to make a two-year tour of the world with my dancing act. Immediately, I was faced with many problems. How, for instance, could I continue to trade while I was at the other side of the world? And instantly and very vividly there came before my mind the occasion when my broker missed me on the telephone. If this could happen in New York, how was I to overcome such a difficulty when I was thousands of miles away? I discussed the matter with him and we decided that we could remain in touch with each other through cables.

We also decided upon one tool—this was Barron's, a weekly financial publication, which we arranged to have airmailed to me as soon as it was published. This would show me any stocks, which might be moving up. At the same time a daily telegram would quote the stocks I owned. Even in such remote places as Kashmir and Nepal, where I performed during the tour, the daily telegram duly arrived. It contained the Wall Street closing prices of my stocks.

To save time and money, I had instituted a special code with my broker in New York. My cables consisted only of a string of letters denoting the stocks, each followed by a series of apparently meaningless numbers. They looked something like this:

"B 32½ L 57 U 89½ A 120¼ F 132¼"

It only took me a few days to discover that these quotations were insufficient for me to properly follow the movements of my stocks. I was unable to construct my boxes without knowing the upper and lower limits of their moves. I called New York and asked my broker to add to each closing price the full details of the stock's daily price fluctuations. This consisted of the highest and lowest price of the stock for that day. Now my telegrams started to look like this:

"B 32½ (34½-32⅜) L 57 (58⅝-57) U 89½ (91½-89) A 120¼ (121/2-120¼) F 132¼ (134⅞-132¼)."

I did not ask for volume quotes, as I feared that too many figures might overcrowd my cables. My selections were highvolume stocks anyway and I thought that if the volume contracted, I would notice it in Barron's a few days later.

As my broker and I both knew which stocks we were quoting, we only used the first letter of the name of each stock I owned. But because these were not the normal stock-market abbreviations which are known all over the world, these constant mysterious letter-figure cables upset and bothered postoffice employees almost everywhere. Before they handed my first cables to me, I had to give them a detailed explanation of what they contained.

They obviously thought I must be a secret agent. I was constantly confronted with this suspicion, especially in the Far East. It was perhaps worst in Japan. The telegraph officials there were more suspicious than anywhere else, as the Japanese bureaucrats do not appear to have completely shed their pre-war spy mania. Whenever I went to a new town such as Kyoto, Nagoya or Osaka, the cable officials would look at me with the gravest doubts.

I had always to go into long explanations. As I did not speak Japanese, this was often a complicated operation. Oddly enough, however, they seemed quite happy as soon as I signed a paper telling them exactly what my cables contained. It might not have been the truth, but that did not seem to have occurred to them. On the other hand, without this paper bearing my signature, they would refuse to send my cables.

It took me a long time to change their minds. I spent six months in Japan before I finally became a well-known figure in the cable offices of most of the major cities. They even began cheerfully to accept my cables without a special signature. The word had gone around among the Japanese that I was a mad, but apparently harmless, European who kept sending and receiving telegrams containing financial gibberish.

During my tour of the world my journeys ranged from Hong Kong to Istanbul, Rangoon, Manila, Singapore, Stockholm, Formosa, Calcutta, Japan and many other places. Naturally I often ran into other difficulties trying to receive or send my cables.

One major problem was that while I was traveling I had to be careful that cables did not miss me. So when I was on the move they were duplicated or even triplicated. It was quite common for the same cable to leave Wall Street addressed Pan-Am Flight 2 Hong Kong Airport, repeated Tokyo Airport, repeated Nikkatsu Hotel Tokyo. This arrangement enabled me, if I missed it in flight, to pick it up immediately after landing.

My difficulties in operating in Wall Street from Vientiane in Laos, for instance, were tremendous. The first of them was that there was no telephone system there at all. The only local telephone was between the American military mission and the American Embassy, which, of course, was of no use to me.

If I wanted to send or collect any messages I had to take a rickshaw to the post office, which was open just eight hours a day and always closed bang on the minute.

Since there was a difference of twelve hours between local and New York time, the post office was shut from opening to closing time on Wall Street. I was under constant tension, worrying whether important news from the stock market was being held up.

One day when I went to the post office, I found a telegram awaiting me, which had been forwarded from Saigon to Hong Kong and then sent on from Hong Kong to Vientiane. I opened it apprehensively, thinking that the delay certainly must spell disaster. But luckily it contained no information I felt compelled to act upon.

But Laos was only one of the places where I ran into difficulties. In Katmandu, the capital of Nepal in the Himalayas, there was no telegraph service at all. The only telegraph office was in the Indian Embassy and all communications by cable from the outside world came through there.

The Embassy officials obviously considered it beneath their dignity to bother about private cables addressed to ordinary people. When a telegram arrived for me they would not deliver it, and I had to constantly telephone the Embassy to see if there were any messages. Sometimes I had to call ten times before they told me to come and collect my cables. Moreover, they were handwritten and often illegible.

The basic mechanics of my operations were these: Barron’s, published in Boston on Mondays, usually reached me if I was in Australia or India, or any part of the world not too remote, by Thursday. This, of course, meant that I was four days behind the Wall Street movements. However, when I saw in Barron’s a stock that behaved according to my theories; I sent a telegram to my broker asking him to bring me up to date on the stock’s movements from Monday to Thursday, for example:

"CABLE THIS WEEK'S RANGE AND CLOSE CHRYSLER."
If the stock, for instance, was, in my opinion, behaving well in the 60/65 box, I would wait to see if the four-day quotations from New York still showed this. If the quotations cabled to me showed it was still in this box, I decided to watch it. I would then ask my broker to quote it daily so I could see if it was pressing toward a higher box. If I was satisfied with what I saw, I cabled to New York my on stop buy order, which my broker was instructed to consider good-till-cancelled unless otherwise specified. This was always coupled with an automatic stop-loss order in case the stock dropped after I bought it. A typical cable looked like this:

"BUY 200 CHRYSLER 67 ON STOP 65 STOPLOSS."

If, on the other hand, my broker's cable showed it had moved out of the **60/65** box. Since I had noticed it in Barron's, I forgot about it. It was too late for me to act. I had to wait for another opportunity.

Naturally, I was forced to narrow down my operations to a few stocks. The reason was purely financial. If I spent more than $12 to $15 a day on cables requesting stock quotations, the operation would become uneconomic unless I made enormous profits.

In the beginning, I was terribly afraid. Not that being in New York had helped me in the past, but to be able to communicate with Wall Street by telephone had given me a false feeling of security. This I missed for a while. It was only later, as I gradually gained experience in trading through cables, that I came to see the advantages of it. No phone calls, no confusion, no contradictory rumors—these factors combined gave me a much more detached view.

As I only handled five to eight stocks at a time, I automatically separated them from the confusing, jungle-like movement of the hundreds of stocks, which surrounded them. I was influenced by nothing but the price of my stocks.

I could not hear what people said, but I could see what they did. It was like a poker game in which I could not hear the betting, but I could see all the cards.

I did not know it at the time, but later, as I became more experienced in the market, I realized how invaluable this was to me. Of course, the poker players would try to mislead me with words, and they would not show me their cards. But if I did not listen to their words, and constantly watched their cards, I could guess what they were doing.

At first I tried to practice on paper without investing any money. But I soon discovered that working on paper was quite different from actual investing. It was like playing cards without any dollars in the pot. It had as much savor and excitement as bridge at an old ladies' home.

Everything seemed very easy on paper with no money at stake. But as soon as I had $ 10,000 invested in a stock the picture became quite different. With no money involved I could easily control my feelings, but as soon as I put dollars into a stock my emotions came floating quickly up to the surface.

As my cables continued to arrive day after day, I slowly became accustomed to this new type of operation and started to feel more and more confident. Only one particular fact bothered me. Sometimes some of my stocks made inexplicable moves, which had no relation to their previous behavior.

This baffled me, and it was while I was looking for an explanation that I made a momentous discovery. I realized I was on my own. I was certain I could learn nothing more from books. No one could guide me. I was completely alone with my daily telegrams and my weekly issues of Barron's. They were my only contact with Wall Street, many thousands of miles away. If I wanted an explanation, I could only turn to them.

So I plunged avidly into Barron's. I turned its pages until they turned to shreds before I finally discovered this: the inexplicable moves in my stocks usually coincided with some violent move in the general market. As I only received the quotes of my own stocks, I was completely disregarding the possible influence of the general market on them. This was no better than trying to direct a battle by only looking at one section of the battlefield.

This was a very important discovery for me and I immediately acted on it. I asked my broker to add to the end of my cables the closing price of the Dow-Jones Industrial Average. This I thought would give me a clear enough picture of how the general market behaved.

My telegrams now read like this:
"B 32½ (34½-32⅜) L 57 (58⅝-57) U 89½ (91½-89) A 120¼ (121½-120¼) F 132¼ (134⅞-132¼) 482.31"

When I received the first cables with this added information, I was like a child with a new toy. I thought I had discovered a completely new formula. As I tried to relate the Dow-Jones Industrial Average to the movements of my own stocks, I reasoned that if the Average was going up, so would my stocks.

Soon after, I found out that this was not true. To try to fit the market into a rigid pattern was a mistake. It seemed quite impossible to do it. Each stock behaved differently. There was no such thing as a mechanical pattern. I was wrong many times before I banished the average to its proper place. It was some time before I discovered that the Dow-Jones Company publishes an average. It simply mirrors the day-to-day behavior of 30 selected stocks. Other stocks are influenced by it but do not mechanically follow its pattern. I also began to appreciate that the Dow-Jones Company is not a fortunetelling organization. It does not attempt to tell you when individual stocks will rise or fall.

Gradually, I began to understand that I could not apply mechanical standards to the relationship between the Average and individual stocks. Judging this relationship was much more like an art. In some ways it was like painting. An artist puts colors on a canvas obeying certain principles, but it would be impossible for him to explain how he does it. In the same way I found that the relationship between the Average and my individual stocks were confined within certain principles, but they could not be measured exactly. From then on, I made up my mind to keep watching the Dow-Jones Industrial Average, but only in order to determine whether I was in a strong or a weak market. This I did because I realized that a general market cycle influences almost every stock. The main cycles like a bear or a bull market usually creep into the majority of them.

Now that I was armed with a finishing touch to my theory, I felt much stronger. I felt as though I was beginning to touch some of the light switches, which would illuminate the room.

I discovered I could form an opinion on the stocks from the telegrams in front of me. They became like X-rays to me. To the uninitiated, an X-ray picture is meaningless. But to a physician, it often contains all the information he wants to know. He relates its findings to the nature and duration of the illness, the age of the patient, etc., and only then does he draw his conclusions.

Looking at my telegrams, I did something similar. I compared the prices of my stocks first with each other, then with the Dow-Jones Average, and after I weighed their trading range, I evaluated whether I should buy, sell or hold.

I did this automatically without deeper analysis. I could not fully explain this to myself until I realized that I was now reading and no longer spelling out the alphabet. I was doing what an educated adult does—I could absorb the printed page at a glance and draw rapid conclusions from it, instead of painfully putting the letters together like a child.

Simultaneously, I tried to train my emotions. I worked it this way: Whenever I bought a stock, I wrote down my reason for doing so. I did the same when I sold it. Whenever a trade ended with a loss, I wrote down the reason I thought caused it. Then I tried not to repeat the same mistake. This is how one of my tables looked:

Bought Sold **BLAND CREEK COAL** 46 43½ **JOY MANUFACTURING** 62 60⅛ **EASTERN GAS & FUEL** 27¾ 25⅛

ALCOA 118 116.5 **COOPER-BESSEMER**
55⅜ 54

Cause of Error Bought too late Stop-loss too close

Overlooked weak general market Bought on decline Wrong timing

These cause-of-error tables helped me immeasurably. As I drew them up one after the other I was learning something from each trading. I started to see that stocks have characters just like people. This is not so illogical, because they faithfully reflect the character of the people who buy and sell them.

Like human beings, stocks behave differently. Some of them are calm, slow, conservative. Others are jumpy, nervous, tense. Some of them I found easy to predict. They were consistent in their moves, logical in their behavior. They were like dependable friends.

And some of them I could not handle. Each time I bought them they did me an injury. There was something almost human in their behavior. They did not seem to want me. They reminded me of a man to whom you try to be friendly but who thinks you have insulted him and so he slaps you. I began to take the view that if these stocks slapped me twice I would refuse to touch them anymore. I would just shake off the blow and go away to buy something I could handle better. This does not mean, of course, that other people with a different temperament from mine were not able to get on well with them—just as some people get along with one set of people better than they do with others.

The experience I gained through my cause-of-error tables became one of the most important of all my qualifications. I now realized I could never have learned it from books. I began to see that it is like driving a car. The driver can be taught how to use the accelerator, the steering wheel and the brakes, but he still has to develop his own feeling for driving. No one can tell him how to judge whether he is too close to the car in front of him or when he should slow down. This he can only learn through experience.

As I flew around the world and operated in Wall Street by cables, I slowly came to see that though I was becoming a diagnostician I could not be a prophet. When I examined a stock and found it strong, all I could say was: It is healthy now, today, at this hour. I could not guarantee it would not catch a cold tomorrow. My educated guesses, no matter how cautious they were, many times turned out to be wrong. But this did not upset me any more. After all, I thought, who was I to say what a stock should or should not do?

Even my mistakes did not make me unhappy. If I was right- this was of course better. If I was wrong—I was sold out. This happened automatically as something apart from me. I was no longer proud if the stock went up, nor did I feel wounded if it fell. I knew now that the word "value" cannot be used in relation to stocks. The value of a stock is its quoted price. This in turn is entirely dependent on supply and demand. I finally learned that there is no such thing as a $50 stock. If a $50 stock went to $49—it was now a $49 stock. Being thousands of miles away from Wall Street, I succeeded in disassociating myself emotionally from every stock I held.

I also decided not to be influenced by the tax problem. Many people hold on to stocks for six months to obtain longterm capital gain. This I considered dangerous. I might lose money by holding on to a falling stock just for tax reasons.

I decided I would trade in the market by doing the right thing first—follow what a stock's behavior commands and care about taxes later. As if stocks were made to confirm my new attitude, I handled them successfully for quite a while. I bought with bold confidence when I thought I was right and coldly, without hurt ego, I took my limited losses when I thought I was proven wrong.

One of my most successful operations was in COOPER BESSEMER. I bought three times into this stock, each time 200 shares. Two operations ended with a loss, but the third made me a sizable profit. Here are the details of these purchases:

November 1956
Bought at 46 ($9276.00)
Sold at 45⅛ ($8941.09)

December 1956
Bought at 55⅜ ($11,156.08)
Sold at 54 ($10,710.38)

January-April 1957
Bought at 57 ($11,481.40)
Sold at 70¾ ($14,056.95)

A few other stocks, like DRESSER INDUSTRIES and REYNOLDS METALS, behaved equally well and gave me satisfactory profits.

But then, in the summer of 1957, when I was in Singapore, a most staggering series of events developed.

I brought BALTIMORE & OHIO RAILROAD at 56¼. I thought it was in the 56/61 box and it would advance. But it started reaching down, and I sold it at 55.

Then I tried DOBECKMUN. I judged it was in a 44/49 box, so I brought it at 45. It began to sag and I sold it at 41. I brought DAYSTROM at 44 because I thought it was rising into the 45/50 box. I sold out at 42¼.

I brought FOSTER WHEELER at 61¾. I thought it was in the 60/80 box. When it turned slowly against me, I sold out just below 60 frame at 59½.

AEROQUIP was the last one. I had brought it at prices ranging from 23¼ to 27⅝. I watched it climb towards 30 and waited for the 31/35 box to evolve. It did not happen that way. I was stopped out of AEROQUIP at 27½.

Finally, on August 26, 1957, I found myself without a single stock. My automatic stop-loss had sold me out of everything. In two months every one of my stocks had slowly turned around, and one by one had sagged through the bottom of their boxes. And one by one, even if it was only a question of half a point, they were sold.

I did not like it, but there was nothing I could do. According to my theory, I just had to sit back and wait patiently until one or more of the stocks I had been stopped out of, or any other stocks I was watching, went towards a new higher box.

Eager and anxious, I watched from the sidelines with not a dollar invested, while prices continued to drop.
But no opportunity seemed to appear. What I did not know was that we were at the end of one phase of the great bull market. It was several months before this became evident and it was declared a bear market. Half the Wall Street analysts still discuss it. They say it was merely an intermediate reaction—a temporary halt in the rising market. They all agree, however, that prices collapsed.

Of course all these opinions are expressed by hindsight— when it is too late. The advice to get out of the market was not available when one needed it.

I recall the case of Hitler when he decided to invade Stalingrad. To him it was just another Russian town to be conquered and occupied. Nobody knew while the battle of Stalingrad was being fought that it was the turning point in the war. For a very long time, few people realized it.

Even when the German armies were halfway back, it was still talked about as strategic withdrawal. It was, in fact, the end of Hitler. The Nazi war bull market ended the day Hitler attacked Stalingrad.

In the same way, I realized that it was impossible for me to assess great historical turning points in the market when they began to happen. What fascinated me, as Wall Street prices continued to fall, was the gradual realization that my system of ducking out quickly with my stop-losses made such an assessment unnecessary.

I made the joyful discovery that my method had worked much better than I had dreamed. It had automatically released me well before the bad times came. The market had changed—but I was already out of it.

The most important aspect to me was that I had absolutely no hint whatsoever that the market would slide. How could I have had any information? I was too far away all the time. I had listened to no predictions, studied no fundamentals and heard no rumors. I had simply gotten out on the basis of the behavior of my stocks.

Later when I studied the stocks I had sold automatically, I found that they subsequently slid down very low indeed in the recession period.
Look at the following table:

1957 1958 1986

I sold at Lowest Highest price price BALTIMORE & OHIO 55 22⅝ 45¼ DAYSTROM 42¼ 30 39¾ FOSTER WHEELER 59½ 25⅛ 39⅛ AEROQUIP 27½ 16⅞ 25¾ ALLIED CONTROL 48¼ 33½ 46½ DRESSER INDUSTRIES 54½ 33 46⅝ JOY MANUFACTURING 68 38 54½ ALLEGHENY LUDLUM 56½ 30⅛ 49⅜

When I looked at this table, I thought this: If my stoplosses had not taken me out of the market I could have lost about 50% of my investment. I would have been like a man in a cage, locked in with my holdings and missing my opportunity to make a fortune. The only way I could have escaped would have been by smashing out, taking a 50% loss, possibly ruining myself, and gravely impairing my confidence for future deals.

I could, of course, have bought these stocks and “put them away.” This is a classic solution among people who call themselves conservative investors. But by now I regarded them as pure gamblers. How can they be non-gamblers when they stay with a stock even if it continues to drop? A non-gambler must get out when his stocks fall. They stay in with the gambler’s eternal hope of the turn of a lucky card.

I thought of the people who paid 250 for NEW YORK CENTRAL in 1929. If they were still holding it today it was worth about 27. Yet they would be indignant if you called them gamblers!

It was in this mood of non-gambling that I received my monthly statement in the first week of September 1957, and I began to check up on my accounts. I found I had made up the money I had lost on JONES & LAUGHLIN and my original capital of $37,000 was almost intact. Many of my operations had been moderately successful, but commissions and taxes had taken a great deal.

When I went into the accounts more closely I found I had the unenviable distinction of coming out of the greatest bull market in history with a lot of experience, a great amount of knowledge, much more confidence—and a net loss of $889.

Chapter 5 Insights by Steve Burns

“I discussed the matter with him and we decided that we could remain in touch with each other through cables.”
–Nicolas Darvas

The interesting thing about trading in the 21st century is that now we can all have a smart phone in our pocket with real time quotes available to us in most places throughout the world. The problem is that this may hinder more than help the emotional trader who gets emotionally whipped around by every trade and lives through the win and loss of dollars as a stock fluctuates through the day.

Nicolas Darvas was able to emotionally remove himself completely from the daily gyrations of the market by simply not even watching it. His stop losses would take him out if there was a wild sell off in his stock. In doing this he conserved much of the emotional capital that modern traders spend so freely by watching each tick of the stock and living the wins and losses in real time. The money is not in the watching of a stock all day long; money is made by riding the stock as it goes in one direction for a sustained period of time.

“We also decided upon one tool—this was Barron’s, a weekly financial publication, which we arranged to have airmailed to me as soon as it was published. This would show me any stocks, which might be moving up. At the same time a daily telegram would quote the stocks I owned.” –Nicolas Darvas

Darvas was wise to use the Barron’s weekly periodical in his time period. But today we are fortunate to have a much better tool for spotting Darvas’ type of stocks. The Investor’s Business Daily’s IBD Monday Special would be a dream come true for Nicolas Darvas. In the Monday edition of this weekday paper you get the proprietary ranking system of O’Neil and Company to show you the top 50 stocks in the market based on relative strength, earnings strength, and other top metrics that find the very best stocks for you in the market and rank them from 1 to 50. This is the place I have found all my biggest winners. The best stocks generally show up in the top 15 but there are gems all throughout the 50. This is a great way to save yourself a lot of time and trouble.

"I called New York and asked my broker to add to each closing price the full details of the stock's daily price fluctuations. This consisted of the highest and lowest price of the stock for that day." –Nicolas Darvas

Darvas did not trade off only the end of day prices; he wanted to know the complete day's price range. He needed to know all the prices that people were buying and selling a stock for throughout the day so he could construct his boxes of support and resistance. His questions were:

At what price were buyers stepping in to buy the stocks? At what price would sellers step in and start selling?

His pivot point was when one of the two stopped stepping in and a stock made a new higher high or a short term lower low versus the established short term box.

Today we can use Japanese Candlestick Charts for a very clear visual representation of what Darvas was looking at. This is what I prefer to use in my Darvas trades. They really tell the story of support and resistance very visually,

"I cabled to New York my on stop buy order, which my broker was instructed to consider good-till-cancelled unless otherwise specified. This was always coupled with an automatic stop-loss order in case the stock dropped after I bought it." –Nicolas Darvas

While full service brokers offer this service, you will have to see if your specific broker will allow you to enter a layered buy stop order that has linked to it an automatic stop loss to put in place on the stock at the same time. Most discount brokers do not offer this service so it will require some type of alert sent to you when your buy is triggered so you can manually enter the stop loss. I would still stick with your discount broker and find a way to be alerted on a buy: through a text or e-mail. Full service brokers are just too expensive to use in this day and time and will severely eat up your profits.

"I was forced to narrow down my operations to a few stocks. The reason was purely financial. If I spent more than $12 to $15 a day on cables

requesting stock quotations, the operation would become uneconomic unless I made enormous profits." –Nicolas Darvas

Darvas found it was financially viable to only follow 5-8 stocks due to expenses for his cables. While this means that with no cable expenses a modern day Darvas trader could possibly follow all of the IBD 50 closely along with the top 10 stocks in the S&P 500 for earnings and sales growth as an example this still may be too much noise and not enough focus. While your watch list could be 60 stocks be sure to really focus in on the very best candidates. In my experience a Darvas style trader only needs a handful of stocks to do very well in a bull market up trend. For example if you traded AOL online and Cisco exclusively through the internet bubble you would have done very well. Likewise trading Apple and Google through 2006 and 2007 should have lead to some great results. Focus on only the very best stocks; ten should be more than plenty to actually trade, the ones with the best earnings expectations, the best price up trends, best innovators, and the companies that are changing the world.

"I came to see the advantages of it. No phone calls, no confusion, no contradictory rumors—these factors combined gave me a much more detached view." –Nicolas Darvas

If you want to get really confused in your trading watch CNBC, watch every tick of every stock. Listen to rumors on message boards. Get the opinion about your positions from everyone you know. This is the path to failure in trading. The path to success lies in the focus on where capital is flowing, what the charts are saying, buying the best stocks in up trends and holding them until you are stopped out of your position. Darvas was able to trade when he was left alone in peace and quiet with price action alone.

"As I only handled five to eight stocks at a time, I automatically separated them from the confusing, jungle-like movement of the hundreds of stocks, which surrounded them. I was influenced by nothing but the price of my stocks." –Nicolas Darvas

Trading a handful of the best stocks based on price action alone is one of the simplest principles of stock market success, nobody telling you to sell your winners prematurely. No talking heads on CNBC talking about a bubble, just you and your stocks and their prices.

“At first I tried to practice on paper without investing any money. But I soon discovered that working on paper was quite different from actual investing. It was like playing cards without any dollars in the pot. It had as much savor and excitement as bridge at an old ladies’ home.” – Nicolas Darvas

While paper trading or trading on simulated accounts is good practice to learn the basic dynamics of the stock market it will not properly prepare the new trader for the reality of their hard earned money put at risk.

“Everything seemed very easy on paper with no money at stake. But as soon as I had $10,000 invested in a stock the picture became quite different. With no money involved I could easily control my feelings, but as soon as I put dollars into a stock my emotions came floating quickly up to the surface.” – Nicolas Darvas

There is a wide chasm between practicing to trade and putting real capital on the line. Few new traders realize how trading with real money will start to affect their emotions and egos. The bigger the account the more stress and strain is put on the new trader’s nervous system. Learning to manage the mind and emotions is just as big a part of trading as the method used and the management of risk.

“I realized I was on my own. I was certain I could learn nothing more from books. No one could guide me. I was completely alone.” –Nicolas Darvas

While reading trading books is a great education for a new trader there comes a time when you have read enough books and more learning and growth can only come from actually trading. In fact many of the lessons in trading books cannot even be understood until you have felt the pain of losses, the ego being threatened from a string of losses, and a draw down in trading capital to test your faith in your method and yourself as a trader.

“I finally discovered this: the inexplicable moves in my stocks usually coincided with some violent move in the general market.” –Nicolas Darvas

Darvas discovered that the biggest determinant in whether his stock went up or down was not the fundamental value of the company but whether the market was in an uptrend or a down trend, a bull market or a bear market. Why is this? Stocks are either in favor or out of favor as an investment class. Capital is either moving into stocks and causing the general market to move up or flowing to other assets and causing it to trend down. The overall trend of the market which I measure with the S&P 500 Exchange Traded Fund (Ticker Symbol SPY) is the primary determinant of whether your Darvas Stock will go up or down.

“I asked my broker to add to the end of my cables the closing price of the Dow-Jones Industrial Average. This I thought would give me a clear enough picture of how the general market behaved.” –Nicolas Darvas

This was a great addition to the Darvas Method it is very important to always look at the major indexes to see the tone and trend of the market. The trend of the modern day stock market is best measured with the Dow Jones Industrial Average, NASDAQ, and the S&P 500 index used together to get a full picture..

“I made up my mind to keep watching the Dow-Jones Industrial Average, but only in order to determine whether I was in a strong or a weak market. This I did because I realized that a general market cycle influences almost every stock. The main cycles like a bear or a bull market usually creep into the majority of them.” –Nicolas Darvas

It is very true, today we have the luxury of tracking the major averages with exchange traded funds that can be used to create charts with the daily ranges on them. Also we can use the 50 day and 200 day simple moving averages to gauge the trend very quickly and easily. This will be discussed in later chapters.

Index ETFs:
Dow Jones Industrial Average: Ticker DIA
S&P 500 Index: Ticker SPY
NASDAQ 100: QQQ

“I discovered I could form an opinion on the stocks from the telegrams in front of me. They became like X-rays to me. To the uninitiated, an X-ray picture is meaningless. But to a physician, it often contains all the information he wants to know. He relates its findings to the nature and duration of the illness, the age of the patient, etc., and only then does he draw his conclusions.” –Nicolas Darvas

Price action in a stock tells the technical analyst many things about the buyers and sellers of the stock. Modern day candlestick charts really act as x-rays telling the trader and investor what is going on inside the price action. A chart shows where support and resistance lies for specific price levels. It shows the current trend of the stock price which is really nothing more than investors and traders causing up trends by adding more and more capital into the stock or down trends by consistently removing capital from a stock by selling off shares regularly. The battle for price trend is always between the current bid and ask price and whether the buyer wants in more than the seller wants out.

"Simultaneously, I tried to train my emotions. I worked it this way: Whenever I bought a stock, I wrote down my reason for doing so. I did the same when I sold it. Whenever a trade ended with a loss, I wrote down the reason I thought caused it. Then I tried not to repeat the same mistake." – Nicolas Darvas

Mr. Darvas even recommended a trading journal; this is a common recommendation from modern day trading authors. Just like in school when you are trading you are a student of not only the market action but also a student of yourself. Each trade is an opportunity to learn about market action and about your ego and your own emotions of greed and fear. How will you learn if you do not take notes and identify patterns?

"Like human beings, stocks behave differently. Some of them are calm, slow and conservative. Others are jumpy, nervous and tense. Some of them I found easy to predict. They were consistent in their moves, logical in their behavior. They were like dependable friends." –Nicolas Darvas

Some stocks will be too volatile for a trader some will be to slow and unrewarding. Some traders thrive on the profit potential of small cap growth stocks that can run 10% up or down in a day and others like the slow and steady calm and trudging along big cap growth stocks that go up 1% a day for 10 straight days.

"And some of them I could not handle. Each time I bought them they did me an injury. There was something almost human in their behavior. They did not seem to want me." –Nicolas Darvas

I have also traded stocks that were just so odd in behavior that after a few losses I just had to find a stock that was more conducive to profits. Do not get in a battle with a stock if you lose a few times in a row just find a better stock with steadier price action.

"I began to take the view that if these stocks slapped me twice I would

refuse to touch them anymore." –Nicolas Darvas

That is a good idea, the majority of the time, if your first two trades in a new stock are both losers the odds are good that the third attempt will also lose, keep looking for a better stock with stronger trending price action.

"I now realized I could never have learned it from books. I began to see that it is like driving a car. The driver can be taught how to use the accelerator, the steering wheel and the brakes, but he still has to develop his own feeling for driving. No one can tell him how to judge whether he is too close to the car in front of him or when he should slow down. This he can only learn through experience." –Nicolas Darvas

The Darvas trading system cannot be made 100% mechanical because many aspects of the system are an art. They require a 'feel' for the price action in a stock. Boxes are partly an opinion on whether it is in a small 5 day price box or a bigger 10 day price box. Position size at times is a judgment of risk based on volatility measured by the average true range. In my Darvas style trading my primary watch list is discretionary in a lot of ways even though I understand how I quantify a stock as a world changer others may disagree. What I try to do is after picking my primary watch list off the IBD 50 and then getting an entry off the Darvas parameters I make my exit as mechanical as possible based on a breach of the Darvas box or key moving average support that I am seeing on the chart. This way even if I make a mistake the price action of the stock will take me out before any major damage can be done to my capital.

"I slowly came to see that though I was becoming a diagnostician I could not be a prophet. When I examined a stock and found it strong, all I could say was: It is healthy now, today, at this hour. I could not guarantee it would not catch a cold tomorrow. My educated guesses, no matter how cautious they were, many times turned out to be wrong. But this did not upset me any more. After all, I thought, who was I to say what a stock should or should not do?" –Nicolas Darvas

To be a success in trading it is necessary to separate yourself from your trading outcomes. A winning trade should not make you overly happy or excited and a losing trade should not make you sad or depressed. If you start riding an emotional rollercoaster through your wins and losses you will burn yourself out very quickly. In all likelihood 50% of your trades will be losers in the long term so you really need to pace your emotions carefully.

Whether you are winning or losing you must realize that: “This too shall pass.” The best you can do is follow the Darvas Method and let the market determine whether you win or lose.

“Even my mistakes did not make me unhappy. If I was right, so much the better. If I was wrong—I was sold out. This happened automatically as something apart from me. I was no longer proud if the stock went up, nor did I feel wounded if it fell. I knew now that the word “value” cannot be used in relation to stocks. The value of a stock is its quoted price. This in turn is entirely dependent on supply and demand. I finally learned that there is no such thing as a $50 stock. If a $50 stock went to $49—it was now a $49 stock. Being thousands of miles away from Wall Street, I succeeded in disassociating myself emotionally from every stock I held.” –Nicolas Darvas

If you ever hear someone debating about the real value of a stock just remember the fact is that it is currently worth exactly what you can get someone to buy it from you for in the market. Price is always truth not opinions.

“I also decided not to be influenced by the tax problem. Many people hold on to stocks for six months to obtain long-term capital gain. This I considered dangerous. I might lose money by holding on to a falling stock just for tax reasons.”

“I decided I would trade in the market by doing the right thing first—follow what a stock’s behavior commands and care about taxes later.” –Nicolas Darvas

Tax implications should never affect your trading decisions, instead focus on maximizing your gains and be glad if you have to pay taxes as opposed to losing money in trading. Always trade to make money not to avoid taxes. Trading is difficult enough without adding in yet another variable.

“I bought with bold confidence when I thought I was right and coldly, without hurt ego, I took my limited losses when I thought I was proven wrong.” –Nicolas Darvas

This is how the winning trader thinks. He is just operating a business, it is nothing personal.

“Then I tried DOBECKMUN. I judged it was in a 44/49 box, so I brought it at 45. It began to sag and I sold it at 41.” –Nicolas Darvas

This quote shows that Darvas was not against buying off support in one of his boxes. I have done this with success in up trending markets- the key is not to buy at the very bottom because support could be lost but to wait for the bounce off support to get in. In the market of the 21st century the 50 day moving average acts as a big support to most Darvas type stocks during market corrections and provides another place that Darvas stocks can be bought off support during an overall market uptrend.

“I found myself without a single stock. My automatic stop-loss had sold me out of everything.” –Nicolas Darvas

If you take nothing but this one principle away from this book it will be money well spent. When you buy a stock you must have a price where you will exit. Plan your exit when you enter. Honor your exit, do not hope or wish- just get out. The first exit is always the best exit. Taking your stop losses when they are hit will prevent you from having to stress over a growing loss and waste precious time and emotional capital as your stock plummets. If you cut all losses when they are small then you will not have to cut them later when they are huge.

“I watched from the sidelines with not a dollar invested, while prices continued to drop.” –Nicolas Darvas

While being in stocks at the right time will make you money being in cash at the right time will save you from losing money. In the stock market it is not enough to simply make money you must keep your profits over the long term. The best way to keep your profits is by knowing when to stop buying stocks, start selling what you do hold, and simply go to cash until you get new buy signals. Going to cash in my main two accounts in 2008 and sitting out the financial panic allowed me to keep ALL of my bull market profits from 2003-2007.

“Of course all these opinions are expressed by hindsight—when it is too late. The advice to get out of the market was not available when one needed it.” –Nicolas Darvas

Analysts do not downgrade stocks most times until they have fallen 25%-50%. Good news does not come out about the economy getting better usually until 6 months after the stock market has bottomed and rebounded. The thing that makes the Darvas system such a great trading method is that you are not predicting the future you are following price action and letting it be your guide and your guru, not listening to stock analysts or talking heads on television.

"The most important aspect to me was that I had absolutely no hint whatsoever that the market would slide. How could I have had any information? I was too far away all the time. I had listened to no predictions, studied no fundamentals, and heard no rumors. I had simply gotten out on the basis of the behavior of my stocks." –Nicolas Darvas

This statement from Darvas explains perfectly how to trade a trend without predicting anything. He did not have to predict the future; his exits were based on the actual stocks price movement. Since sellers were exiting quickly and buyers were paying lower prices as they were taking on more stock this triggered Darvas to join the sellers and exit. Lower prices show clearly the reversal of supply and demand Darvas systems had him follow this trend automatically.

"If my stop-losses had not taken me out of the market I could have lost about 50% of my investment." –Nicolas Darvas

During many bear markets leaders of the last bull market get crushed by falling prices, many get cut in half or worse before the bear market is over. The Darvas system takes you out at a much smaller single digit loss than you would experience than if you had no exit plan and just starting hoping it will come back. Many fallen leaders never come back in the next bull cycle the market just moves on to the newest fastest growing and innovative company stock that is becoming a market leader. Always take the initial 5% loss of price on a losing stock trade so you can avoid ever having to take a 50% loss later.

"When I went into the accounts more closely I found I had the unenviable distinction of coming out of the greatest bull market in history with a lot of experience, a great amount of knowledge, much more confidence—and a net loss of $889." –Nicolas Darvas

This is what I call paying you tuition in the markets. You will have some beginner's luck and make some money. Then you will lose money either in one big trade or a string of losers. If you are lucky you will trade for a year spend countless hours on homework and watching markets just to break even. This is all part of the learning process do not get discouraged and quit if trading is what you want to really do, to make money in the stock market you have to pay your dues first and get a hands on education.

THE TECHNO-FUNDAMENTALIST Chapter 6 During the Baby-Bear Market

After a few weeks of being without a single share I decided to take a closer clinical look at the situation. To understand it clearly I made a comparison between the two markets.

The bull market I saw as a sunny summer camp filled with powerful athletes. But I had to remember that some stocks were stronger than others. The bear market? The summer camp had changed to a hospital. The great majority of stocks were sick—but some were sicker than others.

When the break came almost all of the stocks had been hurt or fractured. It was now a question of estimating how sick the stocks were and how long their sickness would last.

I reasoned that if a stock has fallen from 100 to 40, it will almost certainly not climb up to the same high again for a long, long time. It was like an athlete with a badly injured leg who would need a long period of recuperation before he could run and jump again as before. There was no doubt in my mind now that I could not make money by buying a stock and then trying to cheer it on. JONES & LAUGHLIN had convinced me of that. I could remember how I almost felt myself willing and pushing that stock upwards. It was a very human feeling, but it had no effect upon its market any more than spectators have on a horse race. If one horse is going to win, it will win, even if thousands of onlookers are cheering for another one.

It was the same now. I knew that if I bought a stock and turned out to be wrong, all the cheering and pushing in the world would not alter the price half a point. And there was no telling how far the market might fall. I did not like the trend, but I knew it was no use trying to fight it. The situation reminded me of George Bernard Shaw's remark at the opening night of one of his plays. After the curtain fell everyone cheered and clapped except one man who booed. G.B.S. approached him and said: “Don't you like my play?”

The man replied, “No, I don't.” Whereupon Shaw said: “Neither do I, but what can the two of us do against all that crowd?”

So I accepted everything for what it was—not what I wanted it to be. I just stayed on the sidelines and waited for better times to come.

I firmly refused to trade—so emphatically that my broker wrote to me and asked the reason. I tried to explain it by making a joke: “This is a market for the birds. I see no reason why I should be in a bird-market.” The period that followed I spent like a runner limbering up for the race. Week after week, while I did not have any stock and the market was in a steady downtrend, I followed the quotations in Barron’s. I tried to detect those stocks that resisted the decline. I reasoned that if they could swim against the stream, they were the ones that would advance most rapidly when the current changed.

After awhile, when the first initial break in the market wore off, my opportunity came. Certain stocks began to resist the downward trend. They still fell, but while the majority dropped easily, following the mood of the general market, these stocks gave ground grudgingly. I could almost feel their reluctance.

On closer examination, I found the majority of these were companies whose earning trends pointed sharply upward. The conclusion was obvious: capital was flowing into these stocks, even in a bad market. This capital was following earning improvements as a dog follows a scent. This discovery opened my eyes to a completely new perspective.

I saw that it is true that stocks are the slaves of earning power. Consequently, I decided that while there may be many reasons behind any stock movement, I would look only for one: improving earning power or anticipation of it. To do that, I would marry my technical approach to the fundamental one. I would select stocks on their technical action in the market, but I would only buy them when I could give improving earning power as my fundamental reason for doing so.

This was how I arrived at my techno-fundamentalist theory, which I am still using today.
As to the practical application, I decided to take a 20-year view. That did not mean I wanted to hold a stock for 20 years. Nothing was more contrary to my intentions. But I looked out for those stocks, which were tied up with the future and where I could expect that revolutionary new products would sharply

improve the company's earnings.

Certain industries were obvious at once, like electronics, missiles and rocket fuels. They were rapidly expanding, infant industries and, unless something unforeseen happened, their expansion should soon be reflected in the market. From my research into the history of the stock market, I knew that the basic principles governing stocks-of-the-future have always held good in Wall Street. In the years before automobiles, the smart operators went into railroads because they knew these would supersede the covered wagon and the stagecoach. A generation or so later, the shrewd investors moved out of railroads into automobiles. Forward-looking, expanding companies like GENERAL MOTORS and CHRYSLER were comparatively small firms then. But they represented the future. People who bought into them at that time and stayed with them during their expansion period made a lot of money. Now these are well-established stocks. They are not for the forward-looking speculator.

It is the same today, I reasoned. On the general theory of the buoyant future, stocks, which promise dynamic future development, should behave better than others. A sound stock, which is in tune with the jet age, might be worth 20 times as much in 20 years.
I knew that in this kind of stock there were definite fashions just as there are in women's clothes, and if I wanted to be successful it was important to search for fashionable stocks.

Women's fashions alter, and so do fashions in stocks. Women will raise or lower their hemlines one or two inches roughly every two or three years- the same with stocks. While the fashion persists, the forward-looking investors get in and stay in. Then slowly the fashion fades and they are out. They are putting their money into a new-style stock. I knew I must watch eagerly for these fashion changes, or I might be left still holding a long-skirt stock when the new stocks were showing their knees. I might also miss, unless I was very alert, something sensationally new like the big-bosom era.

This is not so fanciful as it may seem. Take a mythical product like an automobile, which can also fly. Everybody is rushing for that company's stock. Yet in a converted stable in Oregon two men are working on an invention, which will far outclass the flying car.

Once that is ready for the market, and a company has been formed to handle it, the original flying car will be superseded. Its stock will start to slide. It will become old-fashioned.

This is an over-simplification and does not solve the problem: How to buy into this year's fashion? I could only do it by carefully watching the market for signs. If the fashion seemed to be moving away from the long skirt, there must be some other about-to-be-fashionable stock ready to take its place. What I had to do was to find stocks that would be hoisted up because they stirred people's imagination for the future.

On the basis of this thinking, I carefully watched stockmarket quotations in this general bracket of expanding stocks in tune with the jet age. I was not interested in the company's individual products, whether it was metals for rockets, solid fuel, or advanced electronic equipment. In fact, I did not want to know what they made—that information might only inhibit me. I did not care what the company's products were, any more than I was influenced by the fact that the board chairman had a beautiful wife. But I did want to know whether the company belonged to a new vigorous infant industry and whether it behaved in the market according to my requirements.

This, of course, was directly against the advice of many financial writers with conservative backgrounds who have been pounding into investors for generations that they must study company reports and balance sheets, find out all they can about a stock's background, in order to make a wise investment.

I decided that was not for me. All a company report and balance sheet can tell you is the past and the present. They cannot tell the future. And it was for this I had to project my plans. I also humbly realized that that was only my attitude. I was looking for capital gain. A widow looking for dividend income had to think otherwise.

As I flew around the world, I was constantly searching for stocks that would climb into the stratosphere because of the vision of their future. This attitude was a preparation for what I suppose you could call high-territory trading. I looked for stocks that I thought could make new highs and I decided to give them my full attention when they had climbed on to the launching pad and were preparing to rocket up. Now these stocks would be more expensive than ever before and so they would look too dear to the uninitiated. But they could become dearer. I made up my mind to buy high and sell higher.

Using my hard-bought training, I diligently attempted to find these expensive-but-cheap, high-velocity stocks. I searched constantly for them because I felt sure that they would move up at the first sign of a better market.

I carefully watched a dozen stocks, which seemed to be in this category, checking their quotations every week, analyzing their behavior for any sign of a hardening.

I closely observed their price action, and I was on the alert for any unusual activity as well. I had not forgotten the importance of volume.

I also prepared myself to operate in higher-priced stocks. This was because of the brokerage commissions. When I examined the rates I discovered that it was cheaper to invest $10,000 in a $100 stock than in a $10 stock. Here is why:

Let us suppose I wanted to invest my $10,000 in one stock. I could do it in several ways. For instance I could buy:

1000 shares of $10 stock
or
500 shares of $20 stock
or
100 shares of $100 stock
The New York Stock Exchange commission rates were: PRICE OF STOCK COMMISSION PER 100 SHARES

$1 $6
$5 $10
$10 $15
$20 $25
$30 $30
$40 $35
$50 $40
$100 $45

To invest my $10,000 would cost me (buying plus selling):

In the case of the $10 stock…..$300.
In the case of the $20 stock…..$250.
In the case of the $100 stock…..$90.

If my buying point was correct, the broker's commission was not important. It came off my profit. But, if my timing was wrong and I was stopped out—that was another matter. Then the two commissions, one for buying and one for selling, had to be added to my loss. So as you see, my mistakes would be much less costly if I bought higher-priced stocks.

As I watched the market continually sinking, I knew that it could not sink forever. Sooner or later stocks would begin to move upwards. They always had. Bear markets were always followed by bull markets. The educated art was to watch for the first signs, be sure they were real, and buy in before everyone else noticed and the prices began to rise too high.

My mind went back to the battle of Waterloo. At this famous battle Rothschild had an agent who, as soon as victory was certain, set off for London and informed Rothschild. Rothschild started buying every British government share he could before anyone else heard the news. When they did, of course, the shares rocketed and Rothschild sold at a huge profit. The principle remains the same in Wall Street today. Communications are much quicker but the ancient art remains the same—to get in faster than the other fellow.

That was the position for which I had now trained myself for five years. I knew I had learned an enormous amount. My Canadian period taught me not to gamble; my fundamentalist period taught me about industry groups and their earning trends; my technical period taught me how to interpret price-action and the technical position of stocks—and now I reinforced myself by piecing them all together. It was like the solution of an intriguing jigsaw puzzle where finally all the pieces fall beautifully into place. I was certain this method would prove successful in the future. I felt calm and confident waiting for the market-tide to turn.

After a few months, what I was waiting for began to happen. Reading Barron's, I noticed that, while the averages were still showing a decline as they had for several months, a few stocks were beginning to peep up, almost as unnoticeable as primrose buds on a winter's day. It was still a question whether these tender shoots would survive or be killed by frost. But when I noticed this slow awakening, I began to sense the end of this baby-bear market—at least for certain stocks.

I did suspect one thing, however—and that was that the leaders in the previous market would probably not lead again. I felt sure they had fulfilled their place in history and they would not—for the time being—reach the same dizzy heights that had brought so much money to the investors who had followed them.

I had to find new ones. Later this was proved right because hidden away in the market quotes during this period were some stocks which were apparently of not much interest to anybody. At that time—November 1957—they were certainly of no interest to me. I had hardly heard of them.

They were:

UNIVERSAL PRODUCTS quoted at 20
THIOKOL CHEMICAL quoted at 64
TEXAS INSTRUMENTS quoted at 23
ZENITH RADIO quoted at 116
FAIRCHILD CAMERA quoted at 19

These stocks were not dead. They were only sleeping the promising sleep of the unborn. One day soon they were destined to wake up. They were going to leap into a new leadership of the market. They were going to make me $2,000,000.

Chapter 6 Insights by Steve Burns

The bull market I saw as a sunny summer camp filled with powerful athletes. But I had to remember that some stocks were stronger than others. The bear market? The summer camp had changed to a hospital. The great majority of

stocks were sick—but some were sicker than others. –Nicolas Darvas

This is an excellent analogy to describe the huge difference between a bull market and a bear market. Almost every stock goes down in a bear market regardless of the company's fundamentals. Many new traders make the mistake of buying in bear markets to get what is perceived as great prices but this does not put the odds in your favor. The odds are in your favor when you buy the best stocks that are making higher prices not buying stocks that are making lower prices.

When the break came almost all of the stocks had been hurt or fractured. It was now a question of estimating how sick the stocks were and how long

their sickness would last. –Nicolas Darvas

Bear markets are a time to either sell stocks short very carefully or like Darvas to just stay in cash and study chart action and look for the stocks that hold up the best.

I reasoned that if a stock has fallen from 100 to 40, it will almost certainly not climb up to the same high again for a long, long time. –Nicolas Darvas

The mistakes that new traders make is judging a stock as a great deal in relation to its all time high is that they do not do the math. While a stock that has fallen from 100 to 40 has gone down ‘only’ 60%, to get back to 100 from 40 it must go back up 150%, this is highly improbable because it also has to overcome all the people that bought it from $40 to $100 that will be waiting to get out when it gets back to their breakeven point by selling it into any price strength. Also that old high was likely made during a bull market peak and the company was likely getting credit at the time with the expectations of earnings growth reflected in that all time high. Very few stocks ever come back after falling so far and so hard in price.

There was no doubt in my mind now that I could not make money by buying a stock and then trying to cheer it on. –Nicolas Darvas

Let’s not waste our mental and emotional energy cheering on our stock. Unfortunately the market does not care who we are or about our opinions.

I did not like the trend, but I knew it was no use trying to fight it. –Nicolas Darvas

A good way to lose money is to ignore that the market is going down day after day and just plunge in and buy stocks anyway. While to new traders it is very counterintuitive it is absolutely essential to buy stocks when they are going up and look strong. It is like betting on a strong racehorse that is running well not a sicklier one because you think it has better odds of improvement. So I accepted everything for what it was—not what I wanted it to be.

Another thing a trader has to overcome is their bias. If you want to win in the market you have to really look at what the stock market is actually doing not what your opinion is about what it should be doing. The market has a way of doing whatever causes the most people to lose the most money. This happens because at the height of bullishness or bearishness is usually when all the buyers that can buy have bought or all the sellers that can sell have already sold. Money is made by following the flow of capital until it stops, not predicting but only trading based on what is actually happening.

I tried to detect those stocks that resisted the decline. I reasoned that if they could swim against the stream, they were the ones that would advance most rapidly when the current changed. –Nicolas Darvas

During bear markets we want to watch stocks that are forming nice price bases with support and resistance and maybe even holding up at the 50 day or 200 day moving average. In less severe bear markets it is also very beneficial if the stock is within striking distance of all time high prices or at least 52 week highs. 20% from all time highs would be good so there is not a large amount of over head selling pressure to have to overcome on a break out.

On closer examination, I found the majority of these were companies whose earning trends pointed sharply upward. The conclusion was obvious: capital was flowing into these stocks, even in a bad market. –Nicolas Darvas

In the stock market the smart money chases earnings and earnings expectations not speculative stocks that can have their price popped relatively easily with some breaking news about the company. During each bull market uptrend it is very profitable to find and trade the leaders that are actually producing the most earnings growth quarter after quarter not the stocks that are just pure speculation and many times have no earnings.

I decided that while there may be many reasons behind any stock movement, I would look only for one: improving earning power or anticipation of it. To do that, I would marry my technical approach to the fundamental one. I would select stocks on their technical action in the market, but I would only buy them when I could give improving earning power as my fundamental reason for doing so.–Nicolas Darvas

Earnings growth and earnings expectations can show you what to buy but the charts have to show you when to buy it.

But I looked out for those stocks, which were tied up with the future and where I could expect that revolutionary new products would sharply improve the company's earnings. –Nicolas Darvas

The best Darvas stocks are the ones that change an industry or even the world and grow quarter after quarter. Whether it is a company that first puts the world online or first makes the chips for all the computers that are being bought, whether they change internet search or revolutionize cell phones, the key is that they are changing the world and this will cause large amounts of cash flow and earnings into the company as a reward. When capital flows into the company and earnings grow then the stock price also increases to reflect this perceived value. Nicolas Darvas wanted to be along for the ride up but get out at the right time and avoid the ride down.

What I had to do was to find stocks that would be hoisted up because they stirred people's imagination for the future. –Nicolas Darvas

The best stock runs in history are not caused by either fundamental valuations or technical patterns. The best runs are because a company captures the imaginations of investors and traders. The company's earnings and growth give the appearance that it will grow to the sky. It seems like it can do no wrong and can't be beat. It gets to the point where many come into the market just to be able to buy the stock. It goes up every day for a month. Slowly all the critics of the stock saying it is a 'bubble' even give up. This is the stock that Darvas wanted to be in and actually found many times.

All a company report and balance sheet can tell you is the past and the present. They cannot tell the future. – Nicolas Darvas

A company's financial reports only show you its assets, debt, and cash flow not how investors are valuing it. A stocks price action on a chart shows exactly what investors and traders are doing at specific price levels, whether they are buying or selling.

I looked for stocks that I thought could make new highs and I decided to give them my full attention when they had climbed on to the launching pad and were preparing to rocket up. Now these stocks would be more expensive than ever before and so they would look too dear to the uninitiated. But they could become dearer. I made up my mind to buy high and sell higher. –Nicolas Darvas

Surprisingly, this is how many of the greatest traders in history made their most money: buying high and selling higher. Once a stock has been in a price box for a long time, the longer the price base the more powerful the trend may become. When the high of that range is broken through what this break out is saying is that no holder is willing to sell below the highest price. Once a break out occurs you will know if it is a true new price level for the stock if it finds support at this old all time high at the point of the break out. Why is this? Because the traders that missed the break out will buy the stock when it pulls back to the point that they missed it the first time; which is the all time high break out level.

Chapter 7 The Theory Starts to Work

While most Wall Street stocks drifted or dropped, I continued my dancing tour of the world. In November 1957 I was appearing at the “Arc En Ciel” in Saigon when I noticed in Barron’s a stock unknown to me called LORILLARD.

I did not know then that they were the manufacturers of a particular brand of filter-tip cigarettes and the filter-tip craze was about to sweep America, causing their production to leap up astronomically. Out in Saigon, all I knew was that LORILLARD began to emerge from the swamp of sinking stocks like a beacon. In spite of the bad market, it rose from 17 until, in the first week of October; it established itself in the narrow box 24/27. Its volume, for that week, was 126,700 shares- this sharply contrasted with its usual 10,000 shares earlier in the year.

The steady rise in price and the high volume indicated to me that there was a tremendous interest in this stock. As for its fundamentals, I was satisfied as soon as I found out about the wide acceptance of their “Kent” and “Old Gold” cigarettes. I decided that if it showed signs of going above 27 I would buy it.

I asked my broker to cable me daily quotes. It soon became clear from these quotes that certain knowledgeable people were trying to get into this stock in spite of the general state of the market. Few people at that time had the faintest indication that LORILLARD was to make Wall Street history, that it was to shoot up to a most astounding high in a relatively short time, watched by the amazed and gasping financial community.

We were at the depth of the baby-bear market and the atmosphere was rather gloomy. But, as if unperturbed by the general pessimism, LORILLARD was happily jumping up and down in its little cage.

By mid-November 1957 it became even more independent and it began to push upward toward what I estimated would be a 27/32 box. This isolated strength in the face of general weakness was very impressive to me. I felt I had sufficient proof of its strength, and I decided to become a bull in a bear market. I sent the following cable from Bangkok:

“BUY 200 LORILLARD 27½ ON STOP WITH 26 STOPLOSS”

As you see, although I felt quite secure in my judgment with my merged technical and fundamental viewpoints, I did not for one moment consider abandoning my chief defensive weapon—the stop-loss order. No matter how well built your house is, you would not think of forgetting to insure it against fire.

Within a few days, I received confirmation that I had bought 200 LORILLARD at 27½. I was well satisfied with my purchase, and braced myself for a big rise.

This came, but not the way I had assessed it. My first experience was disheartening. On Tuesday, November 26th, the stock dropped back exactly to my stop-loss of 26 and I was sold out. To add insult to injury, seconds after I was stopped out, it started to rise and closed at 26¾.

However, the reaction was so short and the rise that followed so firm, that I decided to go back into it. That same week I bought back my shares at 28¾. Again I fixed my stoploss at 26.

But this time, LORILLARD’s behavior was perfect. As the days went by, I was satisfied to see that the quotations never came close to my stop-loss. This was a firm indication that I was on the right track, and that my theory applied to this stock.

I happened to be right. In December 1957, LORILLARD rose over 30 and made a new 31/35 box. My experiences with similar stock movements in the past told me that it was being accumulated. I felt I had the right stock. Now it was a question of getting into it with more money at the right time.

I carefully watched my daily quotes. I looked for the right moment as a fighter looks for an opening to land his blow. Towards the end of January, after a false move, the big surgethrough which I had been expecting occurred, LORILLARD started to move decisively out of its box.

This seemed to be the ideal moment. Everything was encouraging—the technical action, the fundamentals, the pattern. Also, the New York Stock Exchange had just lowered its margin requirements from 70% to 50%. This meant that my limited capital now had much more purchasing power. Every $1,000 could buy $2,000 worth of stock. This was important to me, because I needed my funds for another stock I was watching at that time.

I was flying from Bangkok to Japan. It was from there I sent out my cables to add a further 400 shares to my holdings. These were bought for me at 35 and 36½.

In the weeks that followed, the stock's behavior continued to be exemplary. It was exciting to watch my theory being vindicated in practice. While I was traveling around the world dancing, LORILLARD was steadily dancing about in its box. It would do this for a short time and then, with an impeccable, almost predictable thrust, move into the box above, LORILLARD boxes began piling on top of each other like a beautifully constructed pyramid. I watched them fascinated. I had never seen a stock behave so perfectly as this. It was acting as though my theory had been built around it.

On February 17, 1958, LORILLARD bounced up to 44⅜. I was feeling very pleased with myself and the stock when, two days later, I received a cable in Tokyo which frightened me. In one single day my stock had dropped to a low of 36¾ and closed at 37¾.

I was baffled. This move was completely unexpected. I did not know how to explain it. I rapidly cabled New York and raised my stop-loss to 36, less than 2 points below the day's closing price. I felt if it dropped there, I would be sold out and still make a nice profit on my first purchase.

As I was in Tokyo, I could not know the Wall Street rumors which had driven the stock down that day. All I knew was that it acted badly. Later I found out there had been a report saying that filter-tips were not so efficacious against lung cancer as they were claimed to be and this had panicked a lot of people out of the stock.

Fortunately, the setback was very short, and my stop-loss was not touched off. This convinced me of the stock's power and I decided to buy an additional 400 shares. I paid 38⅝.

Almost immediately we left this price behind. The quotes came in: 39¾-40¼-42.

I was very happy. I felt as if I had become a partner in an immense new development. Everything looked as if I had planned it.

It was at this time that I received from my broker three weeks' issues of a well-known advisory service. Week after week this service strongly urged its subscribers to sell LORILLARD short. The third recommendation read like this:

"Lorillard was obviously under distribution around 44 last week after we told you to start it on the short side." This amazed me, but I had long ago become so disillusioned with advisory services that I did not pay attention to it.

Instead I started to recommend LORILLARD to any American tourist who mentioned stock market to me. I was genuinely trying to be helpful. My enthusiasm is best illustrated by what happened one day in the Erawan Hotel in Bangkok. One afternoon at lunch I was introduced to the president of one of the largest American shipping companies. During our conversation he mentioned that his holdings in the stock market amounted to $3,000,000. They were broken up in the following way:

$2,500,000 worth of STANDARD OIL (NEW JERSEY) $500,000 worth of LORILLARD

"What do you think about it?" he asked. What did I think of it? He could not have asked a better man.
I immediately told him to sell all his holdings in JERSEY STANDARD and switch his funds into LORILLARD. That was what I would have done.A year later I met him at a party in New York, LORILLARD was then above 80. "What's your latest stock market advice?" he asked me.

"Advice?" I said. I was astonished. "Wasn't that $3,000,000 worth of advice I gave you in Bangkok enough?" "It would have been," he said. "If I had followed it." In the third week of March 1958, LORILLARD entered on an even more definite upward-thrust. It jumped 4 1/8 points in one week, its volume increased to an astounding 316,600 and it established itself decisively in the 50/54 box.

In the second week of April LORILLARD left its new box. It pushed through to a new high of 55¼ but immediately dropped back to its former 50/54 box. As I did not contemplate a further purchase this did not upset me unduly. However, I cautiously raised my stop-loss to 49.

I also wavered for a moment, on the verge of selling, but I decided against it. By now I had trained myself to be patient and, although I could have taken an easy $20 per share profit on my earliest purchase, I sat back determined not to take too quick a profit.

My cost figures for LORILLARD were:
200 shares at 28¼ $5,808.76
200 shares at 35 $7,065.00
200 shares at 36½ $7,366.50
400 shares at 38⅜ $15,587.24
TOTAL 1000 shares $35,827.50

I carried the last three purchases on 50% margin. This enabled me to keep the rest of my capital for a further investment, which turned out to be a stock called DINERS' CLUB. I first became interested in this stock at the turn of the year, while I still battled with LORILLARD.

DINERS' CLUB had just split 2-for-l, and in the last week of January 1958 its weekly volume swelled to 23,400, which I considered unusually high for this stock.

As an advance in price accompanied this increase in volume, I decided to check the stock's fundamentals. They were reassuring. The company was a near-monopoly in an expanding field. The credit-card system, of which it was one of the pioneers, was firmly established. The company's earnings were in a definite upward trend. With these factors in mind, I bought 500 shares at 24½. My stop-loss was 21 ⅝.

Now the question was which direction the stock would take. My first LORILLARD purchase had already shown me a profit, and I reasoned that if it came to the worst, I would lose it on DINERS' CLUB. But I did not. A few days after my purchase, the stock began to advance.

According to my theory, I immediately bought another 500 shares—at 26 1/8. On both buys, I took advantage of the new 50% margin.

The pattern evolved perfectly—first a 28/30, then a 32/36 box. The last penetration was accompanied by a volume of 52,600 shares for the week. This was higher than any other week's volume in the newly-split stock's history.

As I saw my profits piling up, I did not for a moment forget to trail my stop-loss insurance behind the rise. First I raised it to 27, then to 31.

In the fourth week of March the stock penetrated a new 36½/40 box and seemed to establish itself there. I summed up my position in DINERS' CLUB. I had bought:

500 shares at 24½ $12,353.15
500 shares at 26⅛ $13,167.65
Total 1,000 shares $25,520.80

I already had a profit of more than $10,000. Still, according to my theory, I had to hold on. The stock behaved as if it would go even higher. Every indication pointed to that.

But suddenly, unexpectedly, my cables began to read differently. It was difficult to understand why, but I began to feel uncomfortable. The stock seemed to have lost its will to rise. It looked as though its last pyramid would hesitate on the brink of going into reverse. It almost seemed ready to tumble. So as not to get caught in any collapse, I decided to raise my stop-loss to the unusually narrow margin of 36⅜.

In the fourth week of April, the event against which I had insured myself occurred. DINERS' CLUB broke through the lower limit of its box and I was sold out. I received $35,848.85. I had made an overall profit of $10,328.05.

For the first time—as I sat in my room in the Imperial Hotel in Tokyo with the cable in my hand, which said I had made $10,000 profit—I felt all my study and worry over the past few years had been worth it. I was beginning to come out on top.

Six weeks later I received news, which in some ways made me feel more elated than the $10,000, because it completely confirmed the technical side of my approach. It was officially announced that American Express had decided to launch a rival to DINERS' CLUB. This had been the reason for the hesitation of the stock near the 36 mark. Some people had known this before the announcement and were selling out. Without knowing about it, I was their partner.

Being in the Far East, I could not possibly know of any rival organization being set up. Yet the technical side of my system based on the price action had warned me to get out.

During all the time that I spent with LORILLARD and DINERS’ CLUB, I never neglected to follow the quotations of other stocks in Barron’s. This began to show me that there was a great interest springing up in a stock called E. L. BRUCE, a small Memphis firm. The stock was quoted on the American Stock Exchange. On closer examination, I learned that the company made hardwood flooring. This most certainly did not fit my fundamental requirements, but the technical pattern was so compelling that I could not take my eyes off it. What amazed me was the movement of E. L. BRUCE on Wall Street. It usually traded below 5,000 shares a week. Then it suddenly woke up and started to move. In the second week of April 1958, its volume rose to an astonishing 19,100 shares. Thereafter the weekly volume climbed to 41,500—54,200— 76,500 shares, with the price jumping 5 to 8 points weekly without any sign of downward reaction.

BRUCE went from 18 in February to 50 at the beginning of May. Only then came its first reaction, which carried it back to 43½. I could not be sure, of course, but this reaction seemed to me only a temporary halt, a refueling. I felt it would continue to rise. I tried to find a fundamental reason, but I could not. Still, the volume was there, the price action was there, the rhythm of the advance was there.

I began to feel like a man sitting in a darkened theatre, waiting for the curtain to go up on a thriller. As I flew from Tokyo to Calcutta, I puzzled over the BRUCE quotations every hour of the way. It had a wider, freer range than most stocks, and I could not place a definite frame around it. Flying over the Indian Ocean, I made up my mind to make an exception. Fundamentals or no fundamentals, if it went over 50, I would buy it, and I would buy a lot of it.

But I needed money. My DINERS’ CLUB sale had released some of my funds, but that was not enough. I could have used my savings, but after the JONES & LAUGHLIN disaster I had decided never again to risk more money than I could afford to lose without ruining myself. Consequently I have never again added to my market funds from my showbusiness income.

The only possible thing to do was to take a close look at my old friend LORILLARD. Was it still behaving well?

It was not. Its penetrations were not decisive; its reactions were deeper. I decided to take my money out of LORILLARD and be ready to invest it in BRUCE. I sold my 1,000 shares the second week in May for an average price of 57⅜. The total price on the sale was $56,880.45. My profit on the deal was $21,052.95.

This, with the $10,000 I had made from DINERS' CLUB, meant that in five months I had nearly doubled my capital. I felt pleased and proud and ready, like a giant-killer, to deal with a powerful and erratic stock like BRUCE.

I made special preparation for this fight. I had concluded after the LORILLARD deal that my system was working so well that I did not want to entrust it into the hands of one firm. I felt if anyone were to follow my operations, this might make it difficult for me. I called New York and opened accounts with two other brokerage firms.

In the third week of May 1958, I cabled New York to buy 500 BRUCE at 50¾ with my automatic on-stop buy order. I put in a stop-loss of 48.

In the following days the stock acted so beautifully that I decided to take full advantage of the existing 50% margin conditions. When I saw that my stop-loss was not touched off I proceeded with further purchases, each of which was protected by stop-losses between 47 and 48. I figured that, should I be stopped out, I would only lose my DINERS' CLUB profit.

These are the details of my purchases:
500 shares at 50¾ $25,510.95

500 shares at 51⅛ $25,698.90
500 shares at 51¾ $26,012.20
500 shares at 52¾ $26,513.45
500 shares at 53⅝ $26,952.05
TOTAL 2500 shares $130,687.55

My timing was right. E. L. BRUCE really began to climb as if drawn upwards by a magnet. As I watched it, I became amazed at the way it soared. It was spectacular.

I just sat in Calcutta gazing at my daily quotes. Soon they told me the stock had surged over 60. After a slight hesitation, it suddenly broke out again. By June 13th, it had advanced to 77.

It was obvious even in faraway India that something fantastic was happening on the American Stock Exchange. I had to fight a hard battle with myself not to phone New York and find out what was going on. No, I said to myself as I felt like calling my brokers, that will only mean rumors and you may do something silly.

No man's resolution and patience were more severely tested than mine as I sat in the Grand Hotel at Calcutta, wondering what Wall Street was doing.

A few days later my nail-gnawing impatience was changed to terror by a call from New York. It was one of my brokers, and he nearly stopped my heartbeat. He said: "They have suspended trading in BRUCE on the American Stock Exchange." I nearly dropped the phone as I listened. I was terrified. Stopped trading in BRUCE stock! I had over $60,000, my entire capital, invested in it. Did this mean I had lost my money? It was with some difficulty that I was able to concentrate enough to listen. It was minutes before I recovered enough to hear what he had to say.

With my emotions running amok, it took me a long time to understand that far from being broke. I now could sell BRUCE for $100 a share in the over-the-counter market. I was completely confused. $100 a share! What was this?

I was trembling while he told me the story over the telephone from New York to Calcutta.

Certain traders on Wall Street, basing their views on a purely fundamental approach, had decided that BRUCE's book value and earnings indicated that the stock's price should not be more than $30 a share. Therefore, they had started to sell the stock short between 45 and 50, confident they would be able to fulfill their bargains by buying it back at a price much nearer 30.

They made a grave mistake, because there was one factor they did not know about. A New York manufacturer named Edward Gilbert was trying to oust the Bruce family from control of the company. He and his associates were trying to obtain a majority of the 314,600 shares outstanding which the Bruce family owned. It was this move that had rocketed the price. The volume was terrific, and more than 275,000 Bruce shares were traded during a period of ten weeks.

The short-sellers who had so misjudged the market jostled each other to push the stock to dizzy heights in their frantic efforts to buy it. They were caught with their pants down by the mysterious upward surge of the stock and they could not buy the shares at any price to fulfill their obligations.

Finally, as it was impossible to assure an orderly market because of the frenzied dealings, the American Stock Exchange suspended trading. But this made no difference to the desperate short sellers. They still had to deliver the stock. Now they were willing to pay anything over-the-counter for BRUCE.

I listened in a daze to all this. My broker asked me whether, since the over-the-counter price per share was now 100, I would instruct him to sell at this price.

I thought back to my daily cables, and how they had begun to paint an amazing picture of BRUCE to me. I remembered the ordeal I had undergone as I steeled myself not to telephone to find out what was happening because this would come under the heading of "rumors" which I had sworn never to listen to again. I recalled how I held on while my daily quotes revealed to me BRUCE's sensational upward progress, and I did not know what to do.

Should I still hold on? I was faced with a very hard decision. I was offered a big, tempting profit. As I listened to my broker, I felt strongly urged to sell the stock. After all, selling at 100 meant I would make a fortune.

I thought hard while I listened. Then I made one of the most momentous decisions of my life. I said: "No, I will not sell at 100. I have no reason to sell an advancing stock. I will hold onto it."

I did. It was a big decision and a difficult one, but it proved exactly right. Several times within the next few weeks I received urgent telephone calls reporting higher and higher offers for my shares from brokers in various parts of the United States. I gradually sold out the stock on the over-the-counter market in blocks of 100 and 200 shares—for an average price of 171.

This was my first really big killing in the market. I made $295,305.45 profit on this operation.

This was a tremendous event for me. I was so happy I did not know which way to turn. I told my story to everyone who cared to listen. I showed my telegrams to them. The only reaction was: "Who gave you the tip?" I tried to explain that no one had given me a tip, that I had done it all by myself and that I was so happy and excited exactly for that reason.

Nobody believed me. I am sure that every one of my friends in Calcutta still believes today that Mr. Gilbert himself had taken me into his confidence.

Chapter 7 Insights by Steve Burns

"I did not know then that they were the manufacturers of a particular brand of filter-tip cigarettes and the filter-tip craze was about to sweep America, causing their production to leap up astronomically. Out in Saigon, all I knew

was that LORILLARD began to emerge from the swamp of sinking stocks like a beacon. In spite of the bad market." – Nicolas Darvas

This statement captures two principles:

#1. You can find great stocks by looking at their price strength even in a weak market, higher highs and increasing volume is a big clue.

#2. Companies that are changing the world through innovative new products will tend to have stocks that rocket higher if the earnings expectations are large enough.

"This isolated strength in the face of general weakness was very impressive to me. I felt I had sufficient proof of its strength, and I decided to become a bull in a bear market."
–Nicolas Darvas

This actually shows that Nicolas Darvas would buy great performing stocks even in a market correction. But the key here is that he was not bottom fishing and buying a stock that was falling day after day he was sticking to his method of buying strength. He was buying stocks that were rising in a bear market. If you have a watch list in a bear market and you have a stock on it that is green day after day that is one to watch. A green ticker symbol in a sea of red may be a Darvas type stock.

"I did not for one moment consider abandoning my chief defensive weapon —the stop-loss order. No matter how well built your house is, you would not think of forgetting to insure it against fire." –Nicolas Darvas

It is dangerous to get over confident in a bull market and to stop setting stop loss points. Never stop planning on where you will get out of a trade before you get in. If you use mental stops instead of hard stops like Darvas never let the stop be triggered and not take it. If your stock hits your stop and you start hoping instead of exiting it will could cost you dearly.

“However, the reaction was so short and the rise that followed so firm, that I decided to go back into it. That same week I bought back my shares at 28¾. Again I fixed my stop-loss at 26.” –Nicolas Darvas

Here is another key teaching that great traders follow. Do not be afraid to be stopped out of a trade but then turn around and go back in when it starts acting right. Many cannot do this because it makes them feel stupid, but it is smart to change your opinion to match the price action, it is stupid to stubbornly hold on to opinions when the market has proven you wrong.

“My experiences with similar stock movements in the past told me that it was being accumulated. I felt I had the right stock. Now it was a question of getting into it with more money at the right time.” –Nicolas Darvas

Here is the key to what makes a stock go up in price. It is not opinions, beliefs, fundamental valuations, or a rumor. Stocks rise because money managers and investors are accumulating shares over a long period of time. The price rises because the people that want to buy the stock are willing to pay more to get in than the people that own the stock are willing to take to get out. The big money managers’ accumulation of a stock is what drives stocks higher for a sustained period of time.

“Also, the New York Stock Exchange had just lowered its margin requirements from 70% to 50%. This meant that my limited capital now had much more purchasing power. Every $1,000 could buy $2,000 worth of stock. This was important to me, because I needed my funds for another stock I was watching at that time.” –Nicolas Darvas

Since Darvas used tight stops he was not afraid to use margin to enable him to purchase large stakes in multiple stocks at the same time. He was a believer in leverage and this is one factor that enabled him to make such amazing results. If you want to trade like Darvas then you will need to open a margin account with your broker, this will give you double the buying power if you qualify. But be aware that this can also lead to you losing twice the money when you are wrong and have leveraged positions. Another option is to open a stock options account where you can use options to trade the Darvas method with greatly reduced risk and no need to use margin but be able to use leverage with minimal risk. These were not available to Darvas in his time and there is no telling what he would have done with these instruments and that kind of leverage for a minimum fee.

“Fortunately, the setback was very short, and my stoploss was not touched off. This convinced me of the stock’s power and I decided to buy an additional 400 shares. I paid 38⅝.” –Nicolas Darvas

Darvas was a master of adding to winners on each leg up. Adding to winners enables you to maximum your returns and multiply your profits when you are in the right stock in an uptrend. Of course never do the opposite and add to a loser trying to get a better cost basis that is a formula for disaster. Add to winners if you want to win, add to losers if you want to lose. Add to your winning trades on strength not weakness.

“By now I had trained myself to be patient and, although I could have taken an easy $20 per share profit on my earliest purchase, I sat back determined not to take too quick a profit.” –Nicolas Darvas

If you take your profit after a stock has moved $20 a share then you will never get the $50 and $75 moves. In bigger priced stocks in the $400-$600 range it is possible to get a $100 or $200 move in prices at the beginning of a bull market. If you take small profits you will not get a chance to take large profits. Let your winners run as far as they will go until they reverse and stop you out.

“I carried the last three purchases on 50% margin. This enabled me to keep the rest of my capital for a further investment, which turned out to be a stock called DINERS’ CLUB.” –Nicolas Darvas

One thing margin or stock options will enable you to do is get in the top two stocks at the same time in a uptrend. This can really amplify your returns if you could have taken sizeable positions in both Cisco and America Online during the internet bubble, if you could hold both Apple and Google in 2006 & 2007, if you could have held both Apple and Price line in the first quarter of 2012. (This is what I did with in the money call options). When it is hard to choose, you can choose both.

“As this increase in volume was accompanied by an advance in price, I

decided to check the stock's fundamentals. They were reassuring. The company was a near-monopoly in an expanding field. The credit-card system, of which it was one of the pioneers, was firmly established. The company's earnings were in a definite upward trend." –Nicolas Darvas

Darvas primarily found the best price strength first, and then would see if the fundamentals gave validation for its move based on current earnings and earnings expectations. This ensured that he was not just playing a pure speculation that could crash or a run based on known rumors that could crash when the known rumors were found to be false. He wanted price action to match the company's earnings expectations.

"My first LORILLARD purchase had already shown me a profit, and I reasoned that if it came to the worst, I would lose it on DINERS' CLUB." – Nicolas Darvas

A secret of many of the best traders is to go into every trade assuming it is a loser. This helps the trader mentally deal with the loss before it happens and take the stop. It also helps keep your opinion neutral and not start hoping that it will come back if it hits your stop. Thinking this way is not negative because you cannot control what the market does so you have to be prepared to take a loss every time you enter a trade.

"As I saw my profits piling up, I did not for a moment forget to trail my stop-loss insurance behind the rise." – Nicolas Darvas

If you want to keep the big profits you have accumulated in an uptrend then you must trail your stop loss so when it reverses you can lock in your profits and not give them back. The sad thing is many investors and traders that are good at holding for big profits are also bad at knowing when to exit and keep those same profits. Never let a winner turn into a loser: trail a stop loss up with the rise in price.

"DINERS' CLUB broke through the lower limit of its box and I was sold out. I received $35,848.85. I had made an overall profit of $10,328.05." – Nicolas Darvas

When the run is over your stop loss will tell you when to exit with great profits still in place.

“I felt all my study and worry over the past few years had been worth it. I was beginning to come out on top.”
–Nicolas Darvas

If you do the homework and don’t give up one day you will be able to take large profits out of the market when the right opportunities arise. But you have to decide to read the books, build an initial trading account, maybe do seminars, and use coaches or mentors, but do not quit during the learning process.

“Some people had known this before the announcement and were selling out. Without knowing about it, I was their partner.” –Nicolas Darvas

The interesting thing about trading price action is that you will unwittingly be on the same side as smart money, mutual funds, and insiders driving a price up because “Somebody knows something” all you need to know is that many people want in a stock for some reason so you will join them.

“During all the time that I spent with LORILLARD and DINERS’ CLUB, I never neglected to follow the quotations of other stocks in Barron’s” –Nicolas Darvas

Always keep going through the IBD 50 even if you already have full positions in your favorite stocks. You have to be ready to move positions when leadership moves or be ready to grab the best winners coming out of a correction or bear market. Never stop searching for that next big winner.

“This most certainly did not fit my fundamental requirements, but the technical pattern was so compelling that I could not take my eyes off it. I made up my mind to make an exception. Fundamentals or no fundamentals, if it went over 50, I would buy it, and I would buy a lot of it.”
–Nicolas Darvas

Darvas would turn into a 100% trend follower at times with no regard to fundamentals. If he found a very unique stock rocketing higher day after day he would get on board knowing that something was causing this. So in the Darvas method you can take some speculative plays at the right times, but these trades should have some defined price support areas or price boxes, stay away from the ones that are wildly volatile.

“I had decided never again to risk more money than I could afford to lose

without ruining myself." –Nicolas Darvas

The key to the risk of ruin is to always have tight stops and trade with money you can afford to lose, never mortgage your house or use loans in your trading account. Do not trade with your entire net worth just with money that is set aside for speculation.

"Was it still behaving well? It was not. Its penetrations were not decisive; its reactions were deeper. I decided to take my money out of LORILLARD and be ready to invest it in BRUCE." –Nicolas Darvas

When a stock stops 'behaving' you can sell the stock and move your capital to one with better price action. If your Darvas stock quits making higher highs, becomes more volatile, and is unable to break the top of a box for weeks consider selling it for a new stock that is performing well with an uptrend in price.

"No, I said to myself as I felt like calling my brokers, that will only mean rumors and you may do something silly." –Nicolas Darvas

The problem with listening to CNBC, talking to a broker, or chatting with your trading buddies is that you could be influenced to do something stupid and break your system. I trade my best when I trade from price charts alone.

"They made a grave mistake, because there was one factor they did not know about. A New York manufacturer named Edward Gilbert was trying to oust the Bruce family from control of the company." –Nicolas Darvas

It is very dangerous to short an up trending Darvas stock in a bull market. Oddly enough that is something many bad traders like to do. They are usually right eventually and the stock falls but generally they have lost all their money fighting the uptrend. There is usually one thing that they do not understand and that is that world changing stocks get awarded very high prices and as long as it is at all time highs people tend to hold on to the stock and it can go to absurdly high price levels defying all fundamental valuations. If you want to play the short side and attempt to short a fallen leader the best time to do this is when it loses its 50 day moving average, if professionals are not stepping up to buy at this level then it could plunge to the 200 day, and this can happen quickly. Using in the money put options instead of shorting the stock helps manage risk by defining it with the price of the option contract and not having an open ended risk of it going up to infinity while you are short.

“No, I will not sell at 100. I have no reason to sell an advancing stock. I will hold onto it.” –Nicolas Darvas

If you want to trade like Darvas you can’t have price targets, you have to let a winner run until it stops. You have to resist the urge to sell a winner and take the profits off the table. You will be surprised how stressful it is to watch a stock rocket so high and then not sell it. Paper profits lying on the table are very stressful but leave them there until the stock really reverses and takes out an old support.

“I tried to explain that no one had given me a tip, that I had done it all by myself and that I was so happy and excited exactly for that reason.” –Nicolas Darvas

You will know you are trading like Darvas when you grab a huge 50% run or maybe 100 points in a stock and everyone wants to know your secret. How did you do it? What told you to buy it? They are never satisfied with the answer of you bought it based on price strength and earnings expectations and held it until it stopped going up. They always think there is some magic formula that you used; it can’t be that ‘easy’.

Chapter 8 My First Half-Million

The overwhelming success of my handling of E. L. BRUCE should have made me more eager and less cautious. Yet, somehow it made me more cautious. I had made over $325,000 in nine months’ investment, and I was determined not to lose it by a wrong move. So many operators have made big money in nine months and lost it in nine weeks. I decided this would not happen to me. The first step I took was to withdraw half of my profits from the market. With my remaining capital I eyed the market warily, watching for possible new well-behaved stocks. Often after a coup, I had very little success for a month or two afterwards.

I cautiously bought 500 shares of MOLYBDENUM. I bought it at 27, paying $13,606.25. Almost immediately, I was stopped out at 26½, so that I got back $13,123.78.

I had a go at HAVEG INDUSTRIES. I bought 500 shares at 31⅜, paying

$15,860.95. It turned around and looked as if it was going to slip under 30, so I sold out at 30½ for $15,056.94.

Then, as I saw nothing interesting, I ventured back to LORILLARD. This stock, which had once stood out in the bear market like a tree in a desert, had now become a rather weary, slow-moving elderly gentleman. But I suppose I had a sentimental attachment towards it because it had done so well for me the first time. For a long time I could not leave it alone. It became my American “pet.” This was an utterly wrong attitude but I could not seem to help it.

Three times I bought into it, because I thought it was climbing towards a higher box. Three times I sold out because the new box did not materialize.
This is how the LORILLARD operation looked:

1,000 shares
Bought at 70.5 (70,960.50)
Sold at 67⅞ ($67,369.74)

Loss $3,590.76 500 shares
Bought at 69⅛ ($34,792.05)
Sold at 67¾ ($33,622.42)

Loss $1,169.63 1,000 shares
Bought at 67¾ ($68,207.80)
Sold at 67 ($66,495.66)

Loss $1,712.14

That did it. The third loss finally broke my sentimental attachment and I did not buy in again. I realized that as LORILLARD now moved at a very leisurely pace, it was obviously no longer a stock for me.

After I withdrew from LORILLARD, I sat back and assessed my overall position.

It looked like this:
Profits Losses
LORILLARD $23,052.95 $6,472.53
DINERS’ CLUB $10,328.05
E. L. BRUCE $295,305.45

MOLYBDENUM $482.47
HAVEG INDUSTRIES $804.01 _________ ____________ $326,686.45 $7,759.01

My overall profit was $318,927.44.
During the time I was getting in and out of LORILLARD, I was continuously looking for stocks that would fit my theory. One very important factor that urged me to deeper search was that the general market started to get stronger. As I felt this strength becoming pronounced, I wanted to take full advantage of it by getting into a promising stock as early as possible.

Among the stocks that caught my eye was a little, unknown company called UNIVERSAL PRODUCTS. It was quoted around 35, running up and down between 35⅞ and 33½. I found out it was an electronics company and therefore I felt it qualified as far as my techno-fundamentalist theory was concerned.

In July 1958, when I was still in Calcutta, I asked New York for daily quotes. The story they told me was very promising. However, my recent LORILLARD losses reminded me that I could be wrong several times in a row and I wanted to act very cautiously. I thought I could get a better feel of the stock's movement if I actually owned some of it, so I decided to make a pilot buy. I sent out the following cable:

"BUY 300 UNIVERSAL PRODUCTS 35¼ OR BETTER" Next day, when I received the advice that 300 shares of universal products had been bought for me at 35¼, I wired: "ENTER STOPLOSS 32½"

Now there was nothing to do but sit back, watch and wait for the next move. At this period, I was flying back and forth across India rather frequently. But cable quotes on UNIVERSAL PRODUCTS followed me everywhere. In the third week of August 1958, I was in Srinagar in Kashmir, when I noticed that the stock was beginning to firm up. I cabled:

"BUY 1200 UNIVERSAL PRODUCTS 36½ ON STOP 33 STOPLOSS"
When I returned to the Imperial Hotel in New Delhi I received the notice:
"BOUGHT 1200 U 36½ ON STOP U 36¾ (37⅞ - 35⅜) ETC"
This meant I had bought my stock at 36½ and it closed at 36¾. While it

did not decisively pull away from my buying price, it closed above it. Now the question was: Will my stock continue to advance or will it return to its former box?

I was quite excited. Although I had already fixed the limit of my possible eventual loss, now it was a question of whether my judgment was right or wrong. I could hardly wait for next day's cable. When it finally arrived, it showed that UNIVERSAL PRODUCTS had closed at 38⅛. Its range for the day was 38¾-37½. This meant I was right—at least for the time being.

In the next few days the stock continued to advance, and when I was in Karachi I bought another 1,500 shares at 40. Shortly thereafter, UNIVERSAL PRODUCTS changed its name to UNIVERSAL CONTROLS and split 2-for-l. It continued to act well but after my last purchase I decided that I had as much UNIVERSAL CONTROLS as I cared to carry.

This was my exact position: (The prices in this table, and all following tables, are average.)

Pilot buy of 300 at 35¼ $10,644.93
1,200 at 36½ $44,083.56
1,500 at 40 $60,585.00
TOTAL 3,000 shares $115,313.49

This gave me 6,000 shares of the newly split stock. Now I sat back and held on while the stock started to skyrocket.

At the beginning of December, when I saw that UNIVERSAL CONTROLS was behaving correctly, I recommended the stock to my secretary. I told him to buy it at 31¾. I said: "If it goes below 30 take a loss and sell it, otherwise hold it for a big rise. If you have to take a loss I will cover it."

It so happened that his father was an old-fashioned, pure fundamentalist and when he heard what I had suggested, he told his son not to be such a fool. His argument was: What was the point of buying a stock if it might go down? He reckoned you should only buy stock that was sure to rise—as if anyone could be sure. He also said he wanted to examine the books of the company to see if it was in good condition.

My secretary took his father's advice. He did not invest any money, but waited while the old man was carefully examining the books. While he was engrossed in this task the stock went up to 50.

Simultaneously with UNIVERSAL CONTROLS, I was watching another stock whose action was fascinating to me. It was THIOKOL CHEMICAL.

It first attracted my attention in February 1958, when I was in Tokyo. It had just split 2-for-l and was the object of heavy trading before it quieted down into a 39/47 box. It stayed calmly in this area for several months.

As I regularly checked it in Barron’s, this area of tranquility looked like a pond on a summer’s day. But somehow I had the feeling it was a calm that precedes the storm.

In March I cabled New York:
“QUOTE THIOKOL”

The quotes duly arrived but, except for a few weeks of short-lived flurry in April, nothing noteworthy happened. After a few weeks I sent the following cable from Hong Kong:

“STOP THIOKOL QUOTES START QUOTING AGAIN IF RISES OVER 45”
I reasoned that if it reached again toward the upper frame of its box that would be the moment to watch it again. It was in the first week of August that THIOKOL quotes started to reappear in my telegrams. Above 45 it looked as though it was flexing its muscles for an upward jump. I decided for a pilot buy, and cabled:

“BUY 200 THIOKOL 47¼”
The order was executed at this price for a cost of $9,535.26. After that it took three weeks for THIOKOL to find its

true dynamics. At the end of August I felt the moment had come. I cabled New York:
“BUY 1300 THIOKOL 49½ ON STOP”
The purchase was executed at 49⅞ on September 2, 1958. The cost was $65,408.72.
With my 1,500 shares I saw the stock rapidly rising over 50 and trading in the range of 52-56.

A week later I receives notice from THIOKOL had decided to issue stock-rights. These were given as bonuses to the holders of the stock at the rate of one right per share. In turn, with 12 of these rights you could buy one share of THIOKOL at the special price of $42. As the stock was quoted over 50, this was cheap indeed—if you wanted to exercise your stockrights. If not, you could sell them on the American Stock Exchange where they were listed and traded for a limited period.

However, there was another important feature about these rights that made them very interesting. According to stock exchange rules, if the rights were being used to purchase the company's stock you could take advantage of what they called a "special subscription account." When you deposited your rights in this account, the broker was permitted to lend you up to 75% of the current market value of the stock. In addition, there was no commission charge on the purchase.

I jumped on this eagerly. Here was a unique opportunity for me to buy a great deal of stock on credit. I decided to plunge into this with all my free cash. I made a quick rough accounting of my position. Here is how I stood:

Original Investment $36,000
Total Profits (after deducting loses) 319,000
________ Total Capital $355,000 Cash Withdrawn 160,000 _________ Free for Investment $195,000 Purchases Now Held
3,000 UNIVERSAL PRODUCTS $115,300 1,500 THIOKOL 75,000 ________ $190,300 70% cash under margin rules $133,000 _________ Free for further investment $62,000

But now a curious situation developed. As I tried to make my arrangement with New York, I discovered that—in spite of the regulation permitting a 75% loan—there was wide disagreement among brokers concerning the amount that I could borrow from them in a special subscription account. While one broker was only willing to lend 75% of the purchase price of the stock, another was willing to advance a full 75% of the market value of the stock. THIOKOL being quoted around 55, the latter proposition was an extraordinarily attractive credit situation. I proceeded to take advantage of it.

I bought 36,000 rights at an average price of l 5/16 for which I paid $49,410. They entitled me to buy 3,000 THIOKOL at $42 per share. These cost me $126,000, but under the rightssubscription I only had to add another $6,000 cash. The rest of the money was loaned to me by one of my brokers.

This arrangement looked so favorable that I made up my mind to take further advantage of these unique credit conditions.

I figured out that by selling my original lot of 1,500 THIOKOL shares I could buy twice as much back under the special subscription rules.

I sold my stock at an average price of 53½. This gave me a new buying power of $57,000. With this I bought a second block of 36,000 rights. Just as in the previous operation, I converted them into a second block of 3,000 shares of THIOKOL stock.

The operation looked like this:
a) Sold 1,500 shares THIOKOL stock
b) Bought 36,000 THIOKOL rights, and with these c) Bought 3,000 shares THIOKOL stock
My total cost for 6,000 shares was $350,820.

In the second week of December, THIOKOL shifted from the American to the New York Stock Exchange. It immediately moved up 8 points and the following week it was touching the 100 mark. As it continued its upward move, my broker must have become nervous, because I received a telegram, which said:

“YOUR THIOKOL PROFITS NOW $250,000”

This came to me while I was staying at the Georges V Hotel in Paris. I suddenly realized I had been so busy watching the quotes that I had almost forgotten about the paper profits piling up. Added to my profits in BRUCE, I now had a profit of over half-a-million dollars! This was much more money in fact than I ever thought I would own. It would make me a rich man for life.

The realization that I had all this money came to me with startling suddenness. Every fiber in my being seemed to be saying, “Sell, Sell.” It was the biggest temptation in the world.

What should I do? Would the stock rise still higher—or should I take my profit and get out? Perhaps it wouldn’t rise any higher—there might be a fallback. It was a terrible dilemma, the old one of “when to sell” much magnified because of the large amount of money at stake. If I did the right thing here, it would change my whole life. If I did the wrong thing, I would regret it forever.

I felt very alone. No one on earth could give me any advice on what to do in this situation. I decided to go out and have a few drinks by myself and consider the situation. Before I went out, I sat down at my dressing table and wrote on a little card, “Remember BRUCE!” I thought this would remind me of what I had learned in the past.

As I wandered around Paris, I kept fingering this little card in my pocket. Every time I felt like sending a cable to my brokers telling them to sell THIOKOL, I pulled out this card, looked at it and hesitated.

Finally, I decided not to sell. It was the best example of my new market technique and it was anything but easy to do. By the time I arrived back at my hotel I was exhausted. I must have looked more like a man about to commit suicide than one who had just made himself a small fortune.

But I was proved right. THIOKOL continued to rise and by making that decision in Paris, I was able to hold on and make much more money out of the stock.

A few weeks later, in January 1959, I returned to New York. When I landed at Idlewild Airport, I was holding 6,000 THIOKOL and 6,000 UNIVERSAL CONTROLS. They were both doing very well indeed. THIOKOL was standing on the 100 mark and UNIVERSAL CONTROLS had risen to 45.

In New York, my first appointment was to see my brokers and discuss my “Wall Street dealings with them. They told me that, according to their books, my investments had made me well over half a million dollars.

I felt elated, confident and successful. I booked myself a room at the Plaza Hotel and decided that during my stay I would continue my stock-market dealings from close quarters.

How little did I know I was preparing to make a complete fool of myself? Within the next few weeks I was to bring myself within whistling distance of ruin.

Chapter 8 Insights by Steve Burns

“The overwhelming success of my handling of E. L. BRUCE should have made me more eager and less cautious. Yet, somehow it made me more cautious. I had made over $325,000 in nine months’ investment, and I was determined not to lose it by a wrong move. So many operators have made

big money in nine months and lost it in nine weeks. I decided this would not happen to me." –Nicolas Darvas

Great traders are always cautious and understand that it is possible to give back all their trading profits with a string of bad trading losses if they do not control their risk. No one can predict the future no matter how great a trader they are so over confidence is very dangerous in trading regardless of skills and trading record. We have to always be focused first and foremost on keeping the money we have made.

"As so often after a coup, I had very little success for a month or two immediately afterwards." –Nicolas Darvas

The Darvas method implemented correctly will get you huge returns at certain stages of a bull market up trend. Your winning can last for a quarter or sometimes even a year with the right stocks in the right economic environment. However when you are stopped out and you do not get a signal to re-enter a trade, then leaders all start to break down it is a time to be cautious with buying any stocks. A strong up trend is generally followed by corrections, down trends, or bear markets. The Darvas method does not win all the time in every month; it works in up trending markets. So if you have blockbuster wins for 3 or 4 months straight you can expect to have a losing streak eventually.

"This stock, which had once stood out in the bear market like a tree in a desert, had now become a rather weary, slow-moving elderly gentleman." – Nicolas Darvas

Stocks have different seasons and leaders become laggards regardless of the fundamentals of the company, at some point the stock has ran as far as it can go, profit taking sets in and the stock has to overcome all the over head resistance from past buyers waiting to get out. The Darvas system works best with stocks pushing at all time highs in a bull market look for these new leaders after a market correction. Do not just go habitually back to a favorite stock that made you money in the past its run is likely over unless it shows the best price strength.

"One very important factor that urged me to deeper search was that the general market started to get stronger. As I felt this strength becoming pronounced, I wanted to take full advantage of it by getting into a

promising stock as early as possible." –Nicolas Darvas

The big money is made at the very beginning of a new bull market. It is crucial that you take the first few leading stocks that show break outs above old resistance levels, these will be your biggest winners in a bull cycle. This is also the time to use maximum leverage and add to your winners as paper profits build. Do not wait for a pull back at the very beginning of the new trend, there may not be one, get on board, and take the buy signals when they occur.

"I thought I could get a better feel of the stock's movement if I actually owned some of it, so I decided to make a pilot buy." –Nicolas Darvas

Nothing focuses the mind like buying in even a few shares of a stock. There is a huge difference between watching a stock on a watch list and owning even a few shares, you go from watching from the stands as a spectator to being in the game. If you want to really increase your focus on a stock buy a tiny position (5-10 shares) and you will be amazed at the focus on the price action that you will suddenly gain.

"This meant I was right—at least for the time being."
–Nicolas Darvas

A common characteristic of rich traders is that they hold their opinion loosely. They realize that they could be wrong on any trade at any time and even at times will instantly flip and reverse a position that they believed in just a few hours ago due to an unexpected reversal or event.

"I decided that I had as much UNIVERSAL CONTROLS as I cared to carry." –Nicolas Darvas

At this point in his trading Darvas was carrying about one third of his entire account on this one stock. This to many observers looks completely reckless and like he is not managing risk. But the reader must look deeply at how Darvas built positions like this:

1. He only bought the very strongest stocks at a break out from a previous trading range. This put the odds in his favor with a good entry point.

2. He added more stock only after he had paper profits in his initial holdings.
3. He had hard stops entered so that if the stock reversed he had limited losses

and would be put automatically in cash. 4. Darvas was long primarily when the market itself was in an uptrend.
5. He focused on trading only a few stocks so he knew their movements and volatility very well.

“I told him to buy it at 31¾. I said: “If it goes below 30 take a loss and sell it, otherwise hold it for a big rise. If you have to take a loss I will cover it.” –Nicolas Darvas

Here is something you will almost never hear with a hot stock tip, where to sell it if the tipster is wrong. Any trading advice that is over confident with no instructions on where to get out if the trade does not go in the intended direction or how and when to lock in profits is 100% worthless. Trade your own method and leave tips for waiters and waitresses

“I jumped on this eagerly. Here was a unique opportunity for me to buy a great deal of stock on credit. I decided to plunge into this with all my free cash.” –Nicolas Darvas

Much like Jesse Livermore and even George Soros when Darvas was very confident in the price action and could get a deal with the odds hugely in his favor he would plunge in aggressively. I believe in this situation these special stock rights were working much like in the money call options do for modern day traders. So I believe Darvas saw the risk/reward potential in this trade and just couldn’t help himself from being a pig and loading up.

“I figured out that by selling my original lot of 1,500 THIOKOL shares I could buy twice as much back under the special subscription rules.” –Nicolas Darvas

I believe Darvas’ action here with selling his stock in favor of the leverage that the rights provided gives us a clue that Darvas would have likely been an option trader instead of a stock trader because of the upside potential of options with the limited downside provided in these contracts. This was an interesting scenario to see how he traded it.

“Every fiber in my being seemed to be saying, “Sell, Sell.” It was the biggest temptation in the world.” –Nicolas Darvas

Surprisingly this is one of the most difficult things for traders to do: let their profits run in a strong trend. But on the flip side traders have no trouble letting a loser run because they do not want to take a sure loss they prefer to have a chance for it to come back than to go ahead and take the loss. However traders get nervous with profits and are scared that the market will take them back so they are in a hurry to lock them in. So they end up with big losses and small wins. Darvas' method is built on the premise of big wins and small losses, aggressiveness in up trends and sitting out down trends. If you sell your winners when they are small you will not have any big winners. If you sell your losers when they are small you won't have any big losers.

Chapter 9 My Second Crisis

The half-million-dollar news gave me enormous confidence. I had a very clear conception of how I had done it and I was also convinced I could repeat the feat again. I had no doubt that I had mastered my art. Working with my cables, I had developed a sort of sixth sense. I could "feel" my stocks. This was no different from the feeling that a musical expert develops. His ear will detect a flat note, which is inaudible to the ordinary listener.

I could almost tell what stocks would do. If after an eightpoint advance a stock dropped back four points, I did not become alarmed. I expected it to do just that. If a stock started to firm up, I could often predict the day its advance would start. It was a mysterious, unexplainable instinct, but there was no question in my mind that I possessed it. This filled me with a tremendous sense of power.

It is therefore not the slightest bit surprising that I slowly started to imagine I was a Napoleon of finance. I felt I was about to march along a glittering road. I was not aware of any perils. I did not know that along the way a dangerous giant lay in wait. After all, I reasoned to myself rather smugly, how many people could do what I had done?

I decided to really get down to business. If I could make half a million, what was to stop me from making two, three or even five million? Although the margin requirement had recently been raised to 90 per cent, I was convinced that by using the $160,000 I had set aside from my BRUCE profits, I could lay the basis of a new fortune. I intended to start serious day-to-day dealings on the spot—dealings that would make my previous buying and selling seem like very small potatoes.

The truth was that as my pocket had strengthened, my head had weakened. I became over-confident, and that is the most dangerous state of mind anyone can develop in the stock market. It was not long before I received the bitter lesson the market always hands out to those who think they can carelessly master it.

After a few days in New York, I decided to establish closer contact with the market. Possessing what I thought was a foolproof system; I believed that if I moved nearer to the market, nothing could stop me from making a fortune each day. As the scene of my future triumphs, I chose the uptown office of one of my brokers.

I was fascinated by my first visit to the office. The boardroom was large, with chairs placed in front of an ever-moving little machine, the stock-ticker. The atmosphere was exciting, filled with electricity. The people in the room, like hangers-on in Monte Carlo, were nervous, exalted. There was an air of action, bustle, and noise. Tickers ticking, typewriters pounding, telegraph machines clacking, clerks busily rushing around. From every direction I heard sentences like: “GOODYEAR doesn’t look good to me.” “I am getting out of ANACONDA.” “The market is ripe for a reaction.”

On the first day I was quite unperturbed by this taut, electric atmosphere. With my success behind me I felt I was above the anxieties, hopes and fears of these tense people. But this did not last long. As I began trading day to day from the boardroom, I gradually abandoned my detachment and started to join them. I opened my ears to the confusing combination of facts, opinions and gossip. I read the market letters. I also started to answer questions like, “What do you think of the market?” or “What do you know that’s cheap?” All this had a deadly effect on me.

In a few days of trading, I threw overboard everything I had learned over the past six years. I did everything I had trained myself not to do. I talked to brokers. I listened to rumors. I was never off the ticker.

It was as if the “get-rich-quick” demon had gotten hold of me. I completely lost the clear perspective I had so carefully built up through my cables. Step by step I led myself along a path where I began to lose my skill.

The first thing that deserted me was my sixth sense. I did not “feel” anything. All I could see was a jungle of stocks running up and down without rhyme or reason. Then my independence went. I gradually abandoned my system and adopted the attitude of the others. The first thing I knew, I was following the crowd. My reason forsook me and emotion took over completely.

It is easier to understand how difficult it was for me to cling to my system if I explain it this way: Yell “fire” in a crowded theatre and what happens? People rush for the exit, killing, injuring each other. A drowning man will struggle, grasp his would-be rescuer and perhaps pull him under too. They are unreasonable, wrong attitudes, yet instinct will dictate them.

As I followed the crowd I also started to act like this. Instead of being a lone wolf, I became a confused, excited lamb milling around with others, waiting to be clipped. It was impossible for me to say “no” when everybody around me was saying “yes”. I got scared when they got scared. I became hopeful when they were hopeful.

Nothing like this, not even in my first novice years, had ever happened to me. I lost all my skill and control. Everything I touched went wrong.

I behaved like a complete amateur. The careful system I had built up collapsed around me. Every transaction ended in disaster. I put in dozens of contradictory orders. I bought stocks at 55. They went back to 51. I hung on. Stop-loss? That was the first thing I threw away. Patience? Judgment? I had none. Boxes? I forgot about them.

As the days went by the vicious circle of my operations started to look like this:
I BOUGHT AT THE TOP
As Soon as I bought
The stock started to drop
I Became frightened
AND SOLD AT THE BOTTOM
As soon as I sold
The stock started to rise
I became greedy
AND BOUGHT AT THE TOP

I developed a tremendous frustration. Instead of blaming my own stupidity, I invented different reasons for my failures. I started to believe in “They.” “They” were selling me dear. “They” were buying stock from me cheap. I could not, of course, tell anyone who “They” were—but that did not stop me from believing in them.

Fighting “Them”—these grey ghosts at the back of the mind—made me reckless. I became stubborn. Even though stocks went on beating me, each time they hit me I just wiped off the blood and came back for more. I kept telling myself that I was more than half-a-million dollars ahead of the market and therefore this could not possibly be happening to me. How wrong I was!

It was a period of complete disaster. I lost $100,000 in a few weeks. A detailed list of my trading at this time reads like a lunatic’s chronicle. I can still hardly believe it. Now I know that it was caused by egotism leading to vanity leading to over-confidence, which in turn led to disaster. It was not the market that beat me. It was my own unreasoning instincts and uncontrolled emotions.

I bought stocks and sold them a few hours later. I knew that if I bought and sold the same day, I was permitted to operate with as little as 25 % margin in my account. Instead of profiting from this, I succeeded in losing several thousand dollars each time. This is how I assured myself of disaster:

2,500 HAVEG INDUSTRIES Bought at 70 ($176,150.00) Sold at 63½ ($157,891.34)

Loss $18, 258.66

1,000 ROME CABLE
Bought at 37 ($37,375.00) Sold at 31 ($30,724.48)

Loss $6,650.52

1,000 GENERAL TIME
Bought at 47¾ ($48,178.80) Sold at 44¾ ($44, 434.32)

Loss $3,744.48

500 ADDRESSOGRAPH-MULTIGRAPH Bought at 134½ ($62,507.25)
Sold at 116½ ($58,053.90)

Loss $4,453.35

1,000 REICHHOLD CHEMICALS Bought at 63½ ($63,953.50)
Sold at 61½ ($61,158.37)

Loss $2,795.13

2,000 BRUNSWICK-BALKE-COLLENDER Bought at 55½ ($111,891.00)
Sold at 53½ ($106,443.46)

2,000 RAYTHEON
Bought at 60½ ($121,901.00) Sold at 57¾ ($114,823.69)

Loss $7,077.31

2,000 NATIONAL RESEARCH Bought at 24½ ($49,625.00) Sold at 22 ($43,501.52)

Loss $6,123.48

4,000 AMERICAN METALS-CLIMAX Bought at 32⅞ ($132,917.60)
Sold at 31⅝ ($125,430.37)

Loss $7,487.13

3,000 AMERICAN MOTORS Bought at 41¼ ($124,938.90) Sold at 40 ($119,094.50)

Loss $5,844.30

2,000 MOLYBDENUM
Bought at 49½ ($99,875.00) Sold at 47½ ($94,352.50)

Loss $5,522.50

2,000 SHARON STEEL
Bought at 48¼ ($97,362.60) Sold at 43¼ ($85,877.27)

Loss $11,485.33

1,000 WARNER LAMBERT Bought at 98½ ($98,988.50) Sold at 95½ ($95,127.09)

1,000 LUKENS STEEL Bought at 88 ($88,478.00) Sold at 81 ($80,640.48)

Loss $7,837.52
TOTAL LOSS $96,588.66
Do you wonder, after this melancholy table, why I shuddered whenever I looked at stocks?

The plain fact was that I was reading too much, trying to do too much. That is why I rapidly reached the stage where I could read the figures on the stock market quotations but they no longer told me anything. Not long afterwards came an even worse phase. Haunted by never-ending losses, terrified by the confusion, racked by rumors, I got so I could not even see the figures. My coordination broke down. I used to pore all day over columns of figures, which my eyes scanned, but I could not assimilate. My mind had become blurred. This last phase really frightened me. I felt like a drunk who loses touch with reality and cannot understand why.

At the end of a few disastrous weeks, I sat down soberly to examine the reasons why this should have happened to me. Why should I have the touch in Hong Kong, Calcutta, Saigon and Stockholm, and lose it when I was within half a mile of Wall Street? What was the difference?

There was no easy solution to the problem and for a long time I was baffled. Then one day, as I sat in the Plaza Hotel afraid to make a telephone call, I suddenly realized something. When I was abroad, I visited no boardrooms, talked to no one, received no telephone calls and watched no ticker.

The solution was whispering to me but at first I could not credit it. It was so surprising, so simple and yet so extraordinary that I could hardly believe it. It was: My ears were my enemy.
It dawned on me like a revelation that when I was traveling abroad I had been able to assess the market, or rather the few stocks in which I was interested, calmly, neutrally, without interruption or rumor, completely without emotion and ego.

I had operated simply on the basis of my daily telegram, which gave me my perspective. It showed me the way my stocks were behaving. There were no other influences, because I did not see or hear anything else.

In New York it was nothing like that. There were interruptions, rumors, panics, contradictory information, all floating into my ear. As a result of this my emotions became involved with the stocks—and the cold, clinical approach had gone.

I decided there was only one answer. I must try to find myself. I must go away at once, a long way from New York, before I would lose all my money.

There was only one thing, which saved me from complete ruin during this period. And that was that UNIVERSAL CONTROLS and THIOKOL were behaving well and I left them alone. I now realize I only did this because I was too busy to bother about them? I was trading in other stocks, which were losing me money.

I reviewed the situation and got rid of every stock except for these two. Then I took a plane for Paris. Before I left, however, I made a very important decision. I gave instructions to my brokers that they must never telephone me or give me any information of any sort on any pretext whatsoever. The only communication I wanted from them and from Wall Street was my usual daily telegram.

I wandered around Paris in a daze, my head still spinning with blurred, meaningless columns of stock market quotations. My daily telegrams arrived—and they did not make much sense to me. I had completely lost my touch. I felt like a man who has had a terrible accident and feels he will never be well again. I was thoroughly demoralized.

Then just when I thought my condition was permanent something happened. I had been in Paris about two weeks when one day I picked up my daily telegram in the Hotel Georges V. As I scanned it dispiritedly somehow the figures seemed less dim. At first I could not believe it. I felt myself gazing at them as though I had never seen them before. I was afraid I was only imagining things.

I impatiently waited for the next day's cable. When I received it, there was no doubt: the figures were clearer and more familiar. As though a veil was being lifted, once again images started to form before my eyes, giving me some view of the stock's future.

In the days that followed my telegrams became clearer and clearer; I started reading the quotes like my old self. Once more I could see that some of the stocks were stronger, others weaker. Simultaneously my "feeling" started to return. Gradually, like an invalid, I began to regain my confidence. I recovered enough courage to try to approach the market again.

But I had learned my lesson. I decided to make it a permanent rule that I must never visit a brokerage office again. Also my brokers must be prohibited from picking up the telephone and calling me. I must only have stock quotations by cable—and nothing else.

Even if I returned to the New York hotel, the scene of my disastrous dealings, which is within a short taxi ride of Wall Street, my instructions would be unyielding. I must place Wall Street thousands of miles away from me. Every day my brokers must send me a telegram just as if I were in Hong Kong, Karachi or Stockholm.

Also, my brokers must never quote any stock to me, except the ones I asked for. They must not tell me about any new stock because that would immediately come into the rumor class. I would pick new stocks myself, as I had always done, by reading my weekly financial paper. When I saw one that interested me and seemed to be preparing for a rise, I would ask for quotations. I would only ask for one new quotation at a time. Then, as I did before, I would study it carefully before deciding if it was worth going into.

Like a man who has survived a plane crash and knows he must fly again immediately or lose his nerve, I knew only one way of making this method foolproof. I booked myself on a plane back to New York.

Chapter 9 Insights by Steve Burns

“The half-million-dollar news gave me enormous confidence. I had a very clear conception of how I had done it and I was also convinced I could repeat the feat again. I had no doubt that I had mastered my art.” –Nicolas Darvas

The most dangerous thing that you can do as a trader is become arrogant. Arrogance makes you trade too big, take entries that are not optimal, chase trends and lose with late entries. Winning traders know that the market is the boss; it tells the trader what to do based on the price action. The moment the trader thinks that they are more clever than the market action itself they are setting themselves up to take losses, usually big losses. Everyone is always a student of the market no one is ever its master.

“I could often predict the day its advance would start. It was a mysterious, unexplainable instinct, but there was no question in my mind that I possessed it. This filled me with a tremendous sense of power.” –Nicolas Darvas

It is possible to get a ‘feel’ for the market, all this really means is that you have seen patterns in market action before and you know what it looks like. However Darvas did his best trading when it was quantified, when he planned where to get in and out and followed his plan before the market opened.

“I intended to start serious day-to-day dealings on the spot—dealings that would make my previous buying and selling seem like very small potatoes.” –Nicolas Darvas

Many traders underestimate the psychological impact of dramatically increasing position sizing and trading with a much bigger account in a short period of time. If you want to be successful in trading it is much better to start smaller and ease up in account size gradually over years. I also believe it is beneficial for stress management to lower your percent of capital at risk. If you start out with $10,000 for trading and risk 2% per trade you would stop out with a $200 loss. But I would suggest that when you get to $40,000 instead of risking 2% or $800 per trade, lower your risk to only 1% of capital or $400. When and if you get closer to a $100,000 account only risk ½% of capital per trade or $500. This will keep you in the game and prevent you from the mental pain of losing 20% to 25% of your account when a losing streak starts. This should limit your draw downs from equity peaks to hopefully no more than 10%.

“The truth was that as my pocket had strengthened, my head had weakened. I became over-confident, and that is the most dangerous state of mind anyone can develop in the stock market. It was not long before I received the bitter lesson the market always hands out to those who think they can carelessly master it.” –Nicolas Darvas

What is the lesson? That nobody can ‘predict’ what will happen in the stock market. Why? Because that would mean that someone would be able to read the minds of all the millions of market participants, that person would be able to see all breaking news before it happens that might affect the market and even know how the market will respond to that news. This all knowing trader would also have to be able to anticipate every political move before it was made. Predictions do not work, no one masters the market. What does work? Reading what is actually happening through price action and trading reality as it unfolds, following trends, buying supports, selling resistance, managing risk as you trade and staying humble after your big wins along with maintaining confidence in your discipline.

"With my success behind me I felt I was above the anxieties, hopes and fears of these tense people. But this did not last long. As I began trading day to day from the boardroom, I gradually abandoned my detachment and started to join them. I opened my ears to the confusing combination of facts, opinions and gossip. All this had a deadly effect on me." –Nicolas Darvas

True Darvas traders trade quietly with the price action. You want to respond to what the price action is saying and what is actually happening not on a news flash, a rumor, or worst of all let other traders fear and greed leak into your own trading plans. The weakest part of any trading method is the trader. The weakest part of the trader is their emotions. To improve your trading improve your emotional control and management. To overcome your emotions, strengthen your faith in yourself and system along with the discipline in your trading.

"In a few days of trading, I threw overboard everything I had learned over the past six years. I did everything I had trained myself not to do. I talked to brokers. I listened to rumors. I was never off the ticker." –Nicolas Darvas

Traders are constantly living with the danger of a loss of discipline. The dangers are to go off the trading plan and trade too big, too much, enter too late, stop a loss too soon or not take a stop loss when hit. It is important to never think you are bigger than your trading plan or the market will reduce your accounts to prove it to you. Even if you are Nicolas Darvas you can't beat the market you can only take what it gives you.

"It was as if the "get-rich-quick" demon had gotten hold of me. I completely lost the clear perspective I had so carefully built up through my cables. Step by step I led myself along a path where I began to lose my skill."
–Nicolas Darvas

The demon of greed can not only take down a trader but can take down a major investment bank, a hedge fund, or even a rich trader. When greed is your primary driver in your trading then profits become your #1 goal and focus.

Greed causes you to think about profits instead of risk and where your stop loss should be, it causes you to start to blindly look at price targets while ignoring the down side risk. You start renaming trend reversals as 'short term corrections' you start saying your losses 'will come back', you stay focused on your price target and you are sure the stock will make it there. You begin to search for anyone who will confirm your belief that the stock will rally and you will make all your losses back along with profits. This is the road to destruction, risk management ALWAYS comes before thinking about profits or their will be no profits to think about.

"I gradually abandoned my system and adopted the attitude of the others. The first thing I knew, I was following the crowd. My reason forsook me and emotion took over completely." –Nicolas Darvas

Your emotions will cause you to be fearful and sell too early, to be greedy and buy too late. They will cause you to 'feel' instead of follow, to 'believe' your own opinions more than the market action. Chart patterns will be blurred through the filter of your own emotions and will begin to be meaningless as you are driven by the fear of losing money and the greed of making money over what the market is actually saying to you.

"I hung on. Stop-loss? That was the first thing I threw away. Patience? Judgment? I had none. Boxes? I forgot about them." –Nicolas Darvas

Here are all the classic ways bad traders still lose money all the way up to our modern times. Instead of stopping losses when they are hit they instead start hoping. As the losses get bigger they become long term investors and vow to sell when it gets back to even tying up their capital in a losing trade instead of moving it to where they could have a better chance to make some money. Luckily for Darvas he did not have much patience for losing trades and did cut them before they got out of control.

Bad traders also jump too quickly on trades without waiting for a trend to emerge or before they really find the right stock or confirmation of a trend starting. He lost his ability to judge what a good trade was and what a bad trade was and just started taking trades with little edge in them. The blur and noise from the brokerage office even made Darvas forget the keys to his system of price support and resistance based on his price boxes, he started trading on opinions. He forgot what made him successful and made all his mistakes all over again due to over confidence and listening to all the noise instead of his trading plan and system.

“I developed a tremendous frustration. Instead of blaming my own stupidity, I invented different reasons for my failures. I started to believe in “They.” “They” were selling me dear. “They” were buying stock from me cheap. I could not, of course, tell anyone who “They” were—but that did not stop me from believing in them.” –Nicolas Darvas

Bad traders do not take responsibility for their trades. They become convinced that there is an imaginary, ever present ‘they’ that just set them up and will take their money. While what happens in the overall market appears that way it is really just a function of it fooling the majority of the people most of the time due to it being counter intuitive. Maximum bullishness usually happens after the market has run out of buyers, maximum bearishness happens when the market has ran out of sellers. This is what many new traders and bad traders perceive as ‘they’, the ‘they’ is simply the majority of participants making decisions. The bad trader feels like it is a conspiracy because they are making bad decisions in their trading.

“A detailed list of my trading at this time reads like a lunatic’s chronicle. I can still hardly believe it. Now I know that it was caused by egotism leading to vanity leading to over-confidence, which in turn led to disaster. It was not the market that beat me. It was my own unreasoning instincts and uncontrolled emotions.” –Nicolas Darvas

To be a successful trader you must first control yourself so you can make the right decisions in your trading. Egotism leads to believing you somehow have an advantage just based of who you are, you do not, and you must have an edge that puts the odds in your favor in the long term. Over confidence leads to bad trading that is usually also big trades. The market cannot beat you if you go with the trend, manage risk, and trade a robust system with confidence. You are your biggest enemy in trading.

“I bought stocks and sold them a few hours later.” – Nicolas Darvas

Very few traders can become profitable day trading. It is the hardest time frame to trade because the smaller the time frame the more random the price action is. The big money is in being on the right side of the big moves not sweating and stressing all day to catch the movements of a few dollars only to give them back. Darvas made his fortune from betting on the best stocks in the market and being in them on historic runs not day-trading. All my six figure profits were made and kept on a time frame of weeks or months not sitting in front of the computer all day getting caught up in every tick that can become draining and actually hurt your performance. Remember this one thing; the big money is in being on the right side of the big moves. .

“My ears were my enemy.” –Nicolas Darvas

In trading the best traders also have the best filters. They know who is important to listen to and who is not. They know what is important to look at and what is not. In trading you have to ignore the noise of talking heads on financial news networks, and the fear and greed of other traders. You also have to know what indicators are worthless and what the most important part of any trading method truly is: THE CHART. The chart contains everything you need, the expected earnings are being priced in, you can see where the buyers and sellers are located in the stock and if the majority is getting in or out of the stock based on price trend. Listen to rich traders that have proven themselves in the market with a track record also listen to the charts. Tune out the meaningless noise and focus on what makes the money. Price is reality words are just opinions.

“When I was traveling abroad I had been able to assess the market, or rather the few stocks in which I was interested, calmly, neutrally, without interruption or rumor, completely without emotion and ego.” –Nicolas Darvas

This is the way to trade, quietly looking at price action for patterns of accumulation and distribution. Focusing on the few really great winners will keep you in tune with what to do when they hit your buy signals and stops. Looking at price action without the noise of rumors and speculations keeps the mind clear. Doing this when the markets are closed without money at stake keeps your emotions and ego out of the game and lets you mind keep the leadership in your trading decisions.

“I reviewed the situation and got rid of every stock except for these two.” –Nicolas Darvas

There is usually a time in most traders’ careers when they have to sell everything they have except their big winners and start all over. Usually a lack of discipline has them taking too many new trades and putting on too much risk or getting greedy or afraid to miss a winner. Always remember you only need a few great stocks during every market uptrend cycle to do very well. Only trade the very best performers in price action leave the other stocks alone.

“In the days that followed my telegrams became clearer and clearer; I started reading the quotes like my old self. Once more I could see that some of the stocks were stronger, others weaker.” –Nicolas Darvas

Many things can cause you to be unable to read price action correctly.

1. Trading too big causing your emotions to overtake you.
2. Looking at too many stocks on your watch list.
3. Letting greed alter the way you look at charts.
4. Seeing what you want to see instead of what is there.
5. Letting people’s opinions influence what you see.

It is important to have concrete rules for price action that you have written down so you do not drift away from what is really happening in a stock to what you want to happen. Stay sharp and neutral to outcomes.

Chapter 10 Two Million Dollars

When I came back to New York in the third week of February 1959, I had completely recovered from the shock of my mad period, and I began to invest in the market again.

I could still feel the bruises of my own foolishness but I was like a man who feels stronger and better after a bad experience. I had learned my last lesson. I knew now that I had to keep rigidly to the system I had carved out for myself. I had learned that if I deviated from it even once, I would be in trouble. My whole financial structure was immediately in danger—it could crash like a house of cards.

My first move in New York was to erect an iron fence around myself to ensure that I did not repeat any of my previous errors.

I first decided to spread out my deals among six brokers. This way my operations would not be followed. To guard myself against any possible interference from them, I put up my barrier. It is a way of protection I am still using today.

This is how I worked it out. I asked my brokers to send out their telegrams after Wall Street closing time, so they would reach me at 6 p.m. This is about the time I get up—the result of performing in nightclubs for many years. Meanwhile, during the day, the telephone operator is instructed not to let any calls through.

In this way everything happens in Wall Street while I am in bed. I am sleeping while they are working, and they cannot reach me nor worry me. My delegate, the stop-loss order, represents me in case something unforeseen happens.

At 7 p.m. I start to work studying my daily telegram and deciding what my future dealings will be. Before I do this, I buy a copy of an afternoon paper that contains Wall Street closing prices. I tear out the pages giving the day's quotations and throw the rest of the financial section away. I do not wish to read any financial stories or commentaries, however well informed. They might lead me astray. Then, with my telegram and my page out of the newspaper, I settle down to work while Wall Street sleeps.

During the weeks I spent repairing my injured confidence, the two stocks I did not sell continued to rise. UNIVERSAL CONTROLS almost uninterruptedly advanced until it stood around 60. This was more than a 40% rise since my last New York visit. THIOKOL behaved equally well and now was pushing over 110.

This was very promising indeed. I decided I had no reason whatsoever to touch them. Armed by my bitter experience and well entrenched behind my new strong fence, I began to move into the market with cautious confidence.

These were some of my successful operations:

l,000 GENERAL TIRE & RUBBER Bought at 56 ($56,446.00) Sold at 69½ ($69,151.01)

Profit $12,705.01

1,000 CENCO INSTRUMENTS Bought at 19½ ($19,775.00) Sold at 23½ ($23, 247.63)

Profit $3,472.63

500 AMERICAN PHOTOCOPY Bought at 71½ ($35,980.75) Sold at 79½ ($39,570.92)

Profit $3,590.17 1,000 UNION OIL OF CALIF Bought at 46 ($46,420.00) Sold at 50 ($49,669.00)

Profit $3,249.00

500 POLAROID
Bought at 121 ($60,755.50) Sold at 127 ($63,299.08)

Profit $2,543.58

500 BRUNSWICK-BALKE-COLLENDER Bought at 71¼ ($35,855.65)
Sold at 77 ($38,322.08)

Profit $2,466.43

500 BELL & HOWELL
Bought at 93 ($46,741.50)
Sold at 99¼ ($49,436.81)

Profit $2,695.31

This being the stock market, not all my deals were successful. A number of stocks I bought did not behave as I had predicted.

These are some of my transactions ending with a loss:

1,000 CENCO INSTRUMENTS Bought at 23 ($23,300.00) Sold at 22 ($21,755.76)

Loss $1,544.24

500 REICHHOLD CHEMICALS Bought at 65 ($32,727.50) Sold at 65¾ ($31,703.17)

Loss $1,024.33 1,000 FANSTEEL
Bought at 63½ ($63,953.50) Sold at 62 ($61,657.96)

Loss $2,295.54

500 PHILADELPHIA & READING
Bought at 131 ($65,760.50)
Sold at 129¾ ($64,672.79)

Loss $1,087.71

These two tables confirm my method completely. You will notice that in each case I was successful in taking larger profits than losses in proportion to the amounts invested. Remember that all these operations were entirely done by telegram from New York to New York. I had never seen or spoken to my brokers even once. Many times during the day's trading when some of my holdings began to flutter and fail like dying birds, they must have itched to pick up a telephone and alert me. They must have felt I was the biggest fool in the world to forbid them to do it. But my rule was rigid. I heard the news—good or bad—every day at 6 p.m. when my telegrams arrived. Then I began to act.

During the few weeks I spent trading like this in New York, signs of trouble started to show up in UNIVERSAL CONTROLS. It began to lose its steady upward marching progress. Its activity and price advance became wild—too wild.

This spelled trouble and trouble surely came. After an advance from 66 in the first week of March, the stock rose within three weeks to 102. It was at this point that it switched its momentum and began to go in the other direction. I did not like the look of this drop at all. It fell as if in an air pocket and there seemed no sign of a rise. I had little doubt that the holiday was over. If I were not careful I might get caught in a nosedive, so I brought up my stop-loss within two points of the day's closing price. I was sold out of UNIVERSAL CONTROLS next morning at varying prices between $86 and $89. This was more than 12 points from the high. I was well content with this. There was no reason why I should be unhappy. I had had a good long ride and my total selling price was $524,669.97. This gave me a profit of $409,356.48.

I now had a very large capital to invest. I took a careful look at the market, looking as usual for an actively traded, high-priced stock. Another problem arose at this point which made a suitable stock more difficult to find. With this amount of money to spend I must be careful not to allow my own buying unduly to influence the market.

After some search I alighted on a stock, which fulfilled all these difficult requirements. It was TEXAS INSTRUMENTS.

I bought my first 2,000 shares at an average price of 94⅜ in the second week of April and another 1,500 at 97⅞.
As the stock continued to act well, I added to my holdings 2,000 shares.

The average price of this last purchase was 101 %. This, as you realize, involved big money, more than half a million dollars in fact. The details of my TEXAS INSTRUMENTS purchases looked like this:

2,000 shares at 94⅜ $189,718.80
1,500 shares at 97⅞ $147,544.35
2,000 shares at 101⅞ $204,733.80
Total 5,500 shares $541,996.95

Now that the capital I had taken out of UNIVERSAL CONTROLS was reinvested, I devoted my attention once again to THIOKOL.

THIOKOL and I were now partners of long standing and had, like all old-time partners, a special relationship. I had always allowed THIOKOL a greater leeway than other stocks—partly because I really “felt” this stock, and also because I had the great advantage afforded by the special subscription account.

It would have been foolish to give up such a unique credit arrangement, so I always kept my trailing stop-loss far behind its rise. This I would do with no other stock, but in the case of THIOKOL it saved me twice from being sold out. The second time was when it had a very bad reaction in the first week of April. This reaction came on the heels of the announcement of a 3-for-l split. It was so severe that I thought we would have to part, but I decided to let my stop-loss decide.

This was not touched off, and the sinking spell was quickly followed by a vigorous rise. However, I was not the only one who liked THIOKOL. The newly split stock was met by a hectic public response which shot it up to 72 in the first week of May.

The response was too good. It led to this amazing situation: Its activity for the

week was an incredible volume of 549,400 shares.
Its advance for the week was 13¼ points.
The trading volume represented an aggregate value of $40,000,000.
The price difference for the week was $7,000,000.

It looked as if every trader on the New York Stock Exchange had done nothing else all week but rush in and out of THIOKOL.

Of course, it could not last. The governors of the New York Stock Exchange decided to suspend all stop orders. The effect of this was that the majority of traders left the stock alone. They would not buy and sell a stock where they could not protect themselves. It also meant that I was automatically out of the stock myself. They had taken my most powerful tool away, and I could not work without it.

I sold my THIOKOL holdings, at an average price of 68. This gave me, under the 3-for-l split, over $200 for each of my original 6,000 shares. I had paid a total of $350,820. For my 18,000 split shares I received $1,212,851.52. My profit was $862,031.52.

The prospect of putting a million dollars back into the market posed an enormous problem. I would have to be doubly careful. This was too much money to switch into another stock easily. It was such a big sum that my buy was bound to influence the market.

I also had to face the fact that my stop-loss would be no longer practical, because no trader or specialist would absorb such a large quantity of stock in a matter of seconds.

There was only one thing to do: I decided to divide my funds into two parts. Once I had made up my mind to do this, selection was comparatively easy. I had only to decide among four stocks:

ZENITH RADIO, LITTON INDUSTRIES, FAIRCHILD CAMERA and BECKMAN INSTRUMENTS.

I had watched all of these for a long time. They were all suitable as far as my techno-fundamentalist theories were concerned. Now all that remained was to see which two of them I should choose. There was only one way to do this—to let their strength in the market be the judge.

Using the technique I had employed so successfully with UNVIVERSAL CONTROLS and THIOKOL, I made a pilot buy into all four of them on May 13, 1959:

500 shares ZENITH RADIO at 104 ($52,247)
500 shares BECKMAN INSTRUMENTS at 66 ($33,228)
500 shares FAIRCHILD CAMERA at 128 ($64,259)
500 shares LITTON INDUSTRIES at 112 ($56,251) On each of these stocks I put a stop-loss order of 10 per cent below buying price.

I was fully aware that these stop-losses were vague and too mechanical. It was a deliberate, if clumsy, method. I purposely used this system because I knew sooner or later it would eliminate those of the four that were weakest.

On May 18th I was stopped out of BECKMAN INSTRUMENTS at 60, and on May 19th I decided to sell LITTON INDUSTRIES, which was acting worse than the others, at 106¼. Now I adjusted my stop-losses on the remaining stocks.

It was the fourth week of May when I proceeded to switch more than $1,000,000 into the two stronger stocks. These were my total purchases:

ZENITH RADIO

500 shares at 104 $52,247.00
1,500 shares at 99¼ $150,359.70
1,000 shares at 104 $104,494.00
1,000 shares at105¼ $105,745.30
1,500 shares at 107½ $161,996.25
Total 5,500 shares $574,842.25

FAIRCHILD CAMERA

500 shares at 128 $64,259.00
1000 shares at 123¼ $123,763.30
1000 shares at 125 $125,515.00
1000 shares at 126¼ $126,766.30
1000 shares at 127 $127,517.00 **Total 4,500 shares $567,820.60**

Discounting my short-term tradings, my funds were switched from stock to stock in the following way:

March-April 1959
Sold UNIVERSAL CONTROLS $ 524,670 Bought TEXAS INSTRUMENTS $ 541,997 **May 1959**
Sold THIOKOL CHEMICAL $1,212,850 Bought ZENITH RADIO $ 574,842 Bought FAIRCHILD CAMERA $ 567,821

Total received $1,737,520
Margin debt 274,600 $1,462,920
Available cash from previous operations 274,600 Available for reinvestment $1,532,920
Total reinvested (at 90% margin) $1,684,660

At that time I had six brokers. I closed my account with three of them. Then I sat back and watched the stocks I held. There was nothing else for me to do while TEXAS INSTRUMENTS, ZENITH RADIO and FAIRCHILD CAMERA went to work for me.

During June the telegrams continued to flash between Wall Street and the Plaza Hotel. They were meaningless to the Western Union operators but they were full of meaning for me. For instance, on June 9th I received the following telegram:

"Z 122½ (124-116¾) T 119¼ (121½-117¼) F 125 (126-121)" The following day's telegram read:
The following day's telegram read:

126½)"

They were boring, meaningless hieroglyphics to the operator but they meant a lot to me. They told me that the value of my holdings had appreciated $100,000 in that one single day!

It began to be a strange life. I sat in the Plaza every evening, reading my telegram and filing it. There was nothing further I could do. I felt elated and restless, but powerless. I was like a scientist who, after years of work and research, has successfully launched a rocket to the moon, and now as he tracks it climbing higher and higher he has a tremendous sense of achievement and also a strange letdown feeling of inactivity. Like him, I was now on the sidelines just keeping vigil while my stocks continued to climb steadily like wellmade missiles.

Then one day early in July I received an offer to appear in the “Sporting Club” in Monte Carlo. I accepted it gladly. Sitting still was beginning to hold a slight boredom after all my nerve-wracking problems and panics of the past.

Before making arrangements to leave New York I asked my brokers to meet me. I went through my accounts with each of them. I found that if I were to sell out before flying to Europe I could realize my stocks for over $2,250,000.

What was my feeling at this news? Elation? Excitement that I was now more than twice a millionaire? Not exactly. I was happy, but not excited. I had been much more excited when I made my first $10,000 out of DINERS’ CLUB. This time I felt rather like a runner who has trained strenuously and has suffered many defeats, and now trots to victory.

I was also faced with the same dilemma I had known before: Should I sell? Should I get out altogether?

The answer this time was easy. It was the old tried and trusted answer: I did not have any reason to sell a rising stock. I would just continue to jog along with the trend, trailing my stop-loss behind me. As the trend increased, I would buy more. If the trend was reversed I would, as ever- flee like a disturbed burglar.

I put new stop-losses on all my stocks so that if they dropped while I was on my way to Europe I would be sold out and my two million would remain intact.

I felt content and assured as I rode up Fifth Avenue in a taxi after leaving my brokers.

I walked into the lobby of the Plaza Hotel, automatically bought an evening paper, tore out the Wall Street closing prices, threw the rest of the newspaper away, picked up my 6 P.M. telegram and went up in the elevator.

In my room I opened the telegram, spread out the sheet of newspaper, and sat back with a happy sigh. Not only because I had made two million dollars, but because I was doing what I liked best.

I was working while Wall Street slept.

Chapter 10 Insights by Steve Burns

"I knew now that I had to keep rigidly to the system I had carved out for myself. I had learned that if I deviated from it even once, I would be in trouble."-Nicolas Darvas

Your discipline to stick with a winning system will determine your success in trading over the long term. Your ego and emotions are terrible traders they cannot beat the market in the long term only a systematic approach with an edge can do that. The ability to follow your own method will prove vital in your trading journey.

"I asked my brokers to send out their telegrams after Wall Street closing time."-Nicolas Darvas

A pure Darvas system trader has the advantage of not needing to watch the live market. It is possible to trade with buy stops and stop losses alone if your broker provides this service. The key principle here is not to get caught up in the intraday fluctuations of stock prices but look at the longer term price action and trend.

"Meanwhile, during the day, the telephone operator is instructed not to let any calls through."--Nicolas Darvas

Another key characteristic of the Darvas system is that you do not sell until your stop loss or trailing stop is hit. You do not get out of a winning trade until the price where you believe you are wrong is touched, and then you are out to avoid any bigger losses.

"My delegate, the stop-loss order, represents me in case something unforeseen happens." -Nicolas Darvas

Your stop loss order is your ever present risk manager. It takes you out quickly with no need for decisions, emotions, or ego to be involved.

"I buy a copy of an afternoon paper that contains Wall Street closing prices. I tear out the pages giving the day's quotations and throw the rest of the financial section away. I do not wish to read any financial stories or commentaries, however well-informed. They might lead me astray."
--Nicolas Darvas

I have found myself doing the same thing, taking out the IBD 50 section from the Investor's Business Daily paper and not reading the news section. Price and trend is all that I am really concerned about. If I do watch news or go online I am only searching for facts that will lead me to a chart. The chart is what I trade off of not news or opinions. Darvas wanted his mind completely clear as he traded price action.

"Then, with my telegram and my page out of the newspaper, I settle down to work while Wall Street sleeps."
-Nicolas Darvas

The work of the Darvas method is in the study of price action. Where are people buying to support the price? Where are people selling and taking profits? What stocks have stable price boxes that are getting higher and higher consistently? That is where Nicolas Darvas spent his time, not day trading all day trying to scalp a dollar or 50 cents while watching the ticker tape. Darvas was looking for a stock with the capability to go up $50 or $100 a share, and many times he found them after careful observation.

"I decided I had no reason whatever to touch them."Nicolas Darvas

Do not sell a stock until you have a reason to sell it. If you are making money every day holding the stock then there is no reason to sell. Let your winners run. The main reason why the Darvas method is a winning system is that your upside profitability is unlimited and can be huge while your down side risk is small. Do not set a target on your stocks allow them to run as far as they will go. The right stock in the right market conditions can run farther than you could suspect based on fundamentals are preconceived price targets.

"This being the stock market, not all my deals were successful. A number of stocks I bought did not behave as I had predicted."-Nicolas Darvas

Many new traders do not understand that NO SYSTEM is anywhere near 100% accurate. The best traders in the world only have between a 40%-50% win rate and many of them have less than 40% wins. There are even studies that conclude that winning percentage is least important variable that determines if a trader is profitable or not. What determines profitability on the traders P&L is the size of the wins versus the size of the losses at the bottom line. One huge win can pay for many losses if the losses are kept small. If you choose to trade the Darvas method you will have losers it is not a predictive system it simply puts the odds of a trend in your favor by following price action.

“You will notice that in each case I was successful in taking larger profits than losses in proportion to the amounts invested.”-Nicolas Darvas

Nicolas Darvas understood what made his system a winner. It is the same principle that will make you a winner. Enter trades that break out of price boxes, if it retraces back under the break out sell for a small loss if it keeps going up let it run with a trailing stop under logical past price support. This should result in big winners and small losers if the market itself is in an uptrend this is a winning system.

“I took a careful look at the market, looking as usual for an actively traded, high-priced stock.”-Nicolas Darvas

While Darvas poured through Barron’s weekly searching for stocks that were rising on increasing volume we are spoiled with investors.com’s “Stocks on the move” and Investor’s Business Daily’s IBD 50. The other tools available for locating hot stocks with these two sources are also very helpful for hunting Darvas stocks.

“It was so severe that I thought we would have to part, but I decided to let my stop-loss decide.” -Nicolas Darvas

Do not sell hot stocks because of your opinion allow your predefined stop take you out of a trade. A little volatility should not be troubling as long as the price support holds. Do not step in to sell a winner let your stops take you out based on facts if you want to trade like Nicolas Darvas.

“Now all that remained was to see which two of them I should choose. There was only one way to do this—to let their strength in the market be the judge.” -Nicolas Darvas

Let the markets pick stocks for you, after you narrow your search down to, say 10. Then you want to pick the ones that go up the most consistently. You want the stocks that have the best price strength consistency with well defined support and resistance in a price range. You want companies that are unique and have an innovation that is hard for competitors to compete with. A true Darvas stock is a world changer it does not matter if it is a birth control pill, rocket fuel, filter cigarettes, the first credit card, smart phone, iPad, or energy drink. You just want a stock with a stable price base over weeks and a break out to new all time highs.

“Using the technique I had employed so successfully with UNVIVERSAL CONTROLS and THIOKOL, I made a pilot buy into all four of them.” - Nicolas Darvas

Here is a winning strategy: you have four great potential Darvas stocks during the beginning of a bull market on your watch list and all look very strong and promising. So you take equal smaller positions than usual in all four as they break out of bases into new all time highs. You allow the winners to run, but when you are either stopped out of the other two or three or they fail to climb in price you then sell the losers and buy more of the winning stocks. This technique lets the market choose the winners and losers when you have four equally strong candidates that are even as far as you can tell. If you are very fortunate all four will be winners in a baby bull market and you will have to choose the two that are going up the slowest to sell.

“The answer this time was easy. It was the old tried and trusted answer: I did not have any reason to sell a rising stock. I would just continue to jog along with the trend, trailing my stop-loss behind me. As the trend increased, I would buy more. If the trend reversed? I would, as ever, flee like a disturbed burglar.” –Nicolas Darvas

This is the Darvas method principles:

• In an up trending market buy a rising growth stock as it breaks out of an established price range to all time highs and let it run as far as it will go. Do not use a price target to tell you when to sell, only sell when the stock finally reverses and stops you out by losing short term support.

• When you are winning with a rising trending stock add more shares early in the move as your profits build and it continues to make higher highs.

• Always have your stop in place and ready to lock in your profits and get out of your Darvas stock while it is still near all time highs but loses short term support levels.

The Darvas Principles in a Nutshell

Go long only in a market that is in an uptrend.

This rule opposes the old buy and hold advice by telling you instead of just holding that when a down trend begins get in cash instead of giving back profits and losing money. My market filter says that when the SPY ETF is above the 50 day simple moving average it is an up trending market if it falls below the 50 day it is possibly the beginning of a down trend until it is retaken. If there is a reversal and bounce near the 200 day simple moving average then that is a signal that it is safe to start taking small long positions again. Coming out of a bear market my uptrend signal is a close above the 200 day that holds for multiple days. This is a time of opportunity to look for the best Darvas stocks. I do not have opinions I allow the market to tell me what trend it may be in, I personally let these two long term key moving averages act as break out buy points for me. Above the 50 day I am generally looking to be long, below the 50 day I am waiting for the 50 day to be retaken to confirm strength or the 200 day to serve as support to confirm the down trend is over. For much of the price areas between the 50 day and 200 day I am in cash or take small short positions. Below the 200 day I am also looking to be in cash or taking small short positions. This is not just my index filter but my rules for many individual stocks as well.

Only trade the Monster stocks.

Do not waste your time with slow growth big cap stocks or little junk stocks others think are a bargain at $2 a share. All stocks are priced accordingly to the current perceived value. If you want to trade like Nicolas Davas then your watch list needs to be the IBD 50, these are the best performing stocks both in earnings growth and price action. The very best stocks do not hide under rocks; many of the best performers in history were household names. Google, Apple, America Online, Cisco, Intel, Hanson Naturals, Taser, and Research in Motion, etc.

Buy the best stocks to make the most money. You want to buy stocks that are changing an industry or even the world through new products, innovation, a new service, advanced technology, or by using a system or method in their business that gives them a huge advantage over their competition.

You can only get 50 to 100 point up trends in stocks that could grow earnings by 20% to 50% over the next year. Triple digit earnings and sales growth companies are the most ideal this can give you doubles and triples in price and you only need one to make your year. The Darvas system is for massive growth companies not run of the mill slow moving companies. Remember this in your search; GROWTH is what you are searching for.

Enter stocks at high probability moments.

It is not only crucial to know what to buy but when to buy it. Like Darvas my favorite place to buy is at a break to all time highs but I will also enter Darvas stocks at high probability moments when the sellers of the stock have been overcome and it either breaks to new highs or it breaks above key resistance levels or finds support at key moving averages, I have found these areas to also be high probability entry points when I do not have the luxury of a raging bull market to buy all time highs. However the type of stock is the same as Darvas used.

Here are my key entry points for Darvas stocks:
1. At a break out to new all time highs in price.
2. Price bouncing at the bottom of a well defined Darvas price box.
3. The Darvas stock bounces off the 50 day moving average.
4. The Darvas stock breaks out above the 50 day.
5. The Darvas stock bounces off the 200 day.
6. The Darvas stock breaks back above the 200 day coming out of a bear market.
7. I will buy a Darvas stock during an uptrend as it finds support at the 5 day ema or the 10 day sma depending on that charts specific action showing support levels.

Let the winner run.

Do not limit the Darvas stocks upside potential, the right stock in the right market can make a run that is beyond anyone's ability to predict, measure, or set a target on. As long as it continues to go up let it. It only takes a few of these stocks running up 25%-50% to make your whole trading year profitable. Set no limits on profits and only sell and get out once the trend reverses below near term support of the moving average you are using as a tracker and support level. Many will find it more difficult to let winners run with all the paper profits on the table than when they let losers run hoping to get back to even. Humans are programmed to take the sure thing but fight any loss. You must train yourself to let the winners run and end the losses quickly.

If you are wrong get out quickly.

Keeping losses small is one of the biggest keys that separate winning traders from losing traders. If you risk only 1% of your capital per trade and then lose ten times in a row and only be down 10% you have a huge advantage over the trader that risks 10% of their capital per trade and loses half their account after five losing trades. Always know where you will get out when you get into a trade. Set your position size so the 1% of your capital will take you out at a logical loss of support when possible. For example: if you are trading with $50,000 you could buy 100 shares of a stock when it breaks above the 50 day and if it falls back $5 under the 50 day you will be stopped out. Do not neglect the stop loss and trailing stop element of this system it may be the most important part.

Do not waste your emotional and mental capital watching every tick of your stock.

Darvas was not a day trader; he was not glued to the screens. Many day traders lose because they just get burnt out going through the market fluctuations all day long. Losing money and making money minute by minute. In the Darvas system you can set in buy stops, limit orders, stop losses or even use stock options for built in stops and go about your day. Or you can check in at the market at the open and close and see what is going on or just trade at the end of the trading day. You can check in every hour if that is what you want to do and it makes you more comfortable. But the thing not do is just get all wrapped up in every price fluctuation all day and exhaust yourself. The money is in the big moves focus on them not the penny and dollar price ticks. Conserve your mental and emotional capital.

Always do your homework

Darvas was always looking for the next big winning stocks. He stayed on the lookout for higher highs, increasing volume, and Darvas boxes building on top of each other. No matter if you are in cash or not, or if the market is in a bear stage never stop looking for the stocks that have the potential to run when things turn around. You have to always be ready to start buying when the time is right. Maintain a watch list and watch it!

Pyramiding

Never, ever, ever, add to a losing trade. This can end your trading career very quickly and burn through much of your mental and emotional capital as you stay in pain as it goes against you hour after hour, day after day. On the other hand add to winners early in the move for maximum profits. If your Darvas stock breaks to a new all time high out of a sound base at $90 then runs to $100 in a week and closes above $100 then you may consider adding at that round number because it is probable that it could act as support. The key is to add to winning trades early not late in the move.

How I Trade Like Nicolas Darvas

Even after I have read over 250 books on trading and I come back to read this classic by Nicolas Darvas I am still amazed at how he was able to learn and implement all the principles of successful trading on his own. He was then able to capture these lessons in his book and imbed them into a fun and exciting narrative. I wrote this book to bring out more clearly the principles he was explaining that the new trader may not fully understand on a first reading of this book.

The question remains, "Is this a valid method or just hype?" Did Mr. Darvas just get lucky during one of the greatest bull markets of all time or was he truly a talented trader? I would like to say he was not only a trader but one of the most talented for his ability to find monster stocks and then ride them for everything they were worth. He also had the ability to leverage his account and stay with these winners. This is a skill that is very difficult to master if you do not have faith in your system.

But riding the winners is not enough, most people that do that are just buy and holders, they never sell. They tend to ride the stocks back down. Nicolas Darvas understood the importance of the trailing stop and took his profits off the table only after the stock really reversed and started making lower lows through near term support levels. Many investors that do have the ability to ride a winner into the clouds make the mistake of falling in love with the stock and never sell it, their profits just eventually melt away.

I believe Nicolas Darvas was the total package as a trader. He had the discipline, the focus, he let the prices and volume dictate his trades, and he created a system with a huge edge.

Nicolas Darvas' principles have enabled me to average double digit returns for a decade. I have been able to build accounts to six figures and then side step bear markets and even the complete financial panic of 2008. I owe a lot to this little book.

Here is how I used the Nicolas Darvas method to return 51.7% on my trading account in the 1st quarter of 2012.

At the beginning of 2012 I started buying Apple stock options as the stock broke above $392 on its way to all time highs of $420 then to rocket up to $644. When I bought this stock I personally believed it had the potential to go to $500 with its earnings growth and success with the iPad. The iPad was truly a game changer and the competition was having trouble producing a tablet that could compete while Apple was doing all it could to keep up with demand for its new product. So my first buy was at the close of the day when the stock broke above the 50 day moving average. Unlike Darvas I did not have to put $39,200 on the table to control 100 shares I simply bought a January $390 call option for $1,550. This also limited my risk, not only did I only have $1,550 at risk in the trade but with my first trade being at the money it would only move up or down half as fast thanks to a .50 delta. So my downside was tiny and my upside was unlimited. It would move more dollar for dollar with the stock as it got deeper in the money. (If you need to understand more of how stock options work my book “Show Me Your Options” is a great place to start).

Okay, I am in a historical monster stock, it has broken above the key 50 day moving average, so now how would Darvas know if he was right or wrong if he had access to instant charts online? I think the best update to the Darvas system is to replace his price boxes with shorter term moving averages. In our modern times traders key off these moving averages more than the price levels. There are times when a monster stock gets so far away from a key moving average that Darvas boxes do come into play but the 5 day exponential moving average and the 10 day simple moving average are the two that I have found to be most meaningful and appear to be followed by many for buy and sell decisions.

In my Apple trade I had to allow it to run as far as it would go, so initially the 50 day simple moving average would be my stop but I would let the 5 day ema be my end of day stop if a trend began and it extended away from the 50 day after entry. If Apple was going to close below the 5 day ema I would sell my option and be out of the trade at the end of that day. The support of the 5 day ema would be my guide. I would not need a stop loss order at the 5 day ema because my option contract had a built in stop with a limited down side due to only the price of the contract being at stake. Based on the average daily range of the stock and my .50 delta along with the price of my option contract versus the size of the capital I was using in my trading account I was actually only risking 1% of my capital, this was an excellent risk versus reward trade. This is called an asymmetric trade, a built in limited downside but an unlimited potential upside.

As you can see from the chart the stock went on the be up 15 days in a row before settling in at around $423 and stalling at all time highs before earnings. I was barely stopped out once and sold my first stock option for $3,235 a 108.7% return on capital at risk. I bought a 2nd one for a strike at $420 for $1,125 and sold it for $1,475 a few days later on my 2nd stop out. I then waited for a close above the 5 day ema to get back in. Price action got choppy and uncertain before earnings. So I waited patiently from the sidelines seeing how the earnings announcement would play out ready to make a move.

I did not hold any call options through the earnings announcement; I believe the risk is not worth the reward, even for a monster stock. I liken holding growth stocks long or short through earnings to betting on red or black on the roulette wheel in Las Vegas the odds are not on the trader’s side it is more of a 50/50 bet and many times the downside is possibly much worse than the upside potential due to great earnings already being priced in. The earnings were great and the stock gapped up to $454 but closed at $446. At this point it was far above the 5 day ema and this was what I took to be a new Darvas box. I would be long on a break above $454. I waited as it bounced around in this price box for 4 days but on day five it broke it and closed at $456.48. I was in with an in the money call option at $450 to capture the move, for $1,025 I controlled 100 shares. (Many times you will get very cheap call options using the Darvas system because call options do not price in parabolic moves very well to the upside like put options do to the downside, this gives the Darvas option trader a huge advantage in risk versus reward). For two days it stumbled but held above the 5 day ema and stayed in the Darvas box but then on the third day it closed at $459.68 and started a run for the next eight days that would take it to $526, I was along for the ride. It was a great trend before losing the 5 day ema in wild volatility on the ninth day after I entered. I was finally stopped out.

During the price run up I had to roll my $450 strike call option from February to March and I sold it for $6,530 for a 537% return on capital at risk. After the volatility was over and the 5 day ema was retaken I went deeper in the money with new call options at $480 strikes. There was another run to $549 before a shake out. I re-entered at $540 and was not shaken out again until the reaction and profit taking at $600. I was finally stopped out again at $625 as the stock rolled over and my next buys at rallies over the 5 day ema failed. I was mostly on the sidelines by April as the stock fell all the way back to $555 and then $530.

How much did I make using the Darvas strategy on this one stock?

In the first quarter of 2012 using the capital in a $40,000 trading account I made $14,690 on my Apple trades alone with 11 wins 3 losses. This was only one of many stocks I was trading in this account. I finished the first quarter (Which is only 3 months long) with a 51.7% return on total account capital with all trades counted in that period. And this was with little risk to total capital, only three trades exceeded my 1% risk of total capital per trade rule out of all of my trades and two of those only slightly went over and the big loss is on the table below, the big whip saw the week before Apple earnings.

Expiration Strike Bought Sold P&L **AAPL** January $390 $1,550 $3,235 $1,685 **AAPL** January $410 $1,125 $1,475 $350 **AAPL** January $415 $1,140 $1,225 $85 **AAPL** February $450 $1,025 $6,530 $5,505 **AAPL** February $480 $2,445 $3,305 $860 **AAPL** February $480 $2,880 $2,280 ($600) **AAPL** March $490 $2,395 $5,570 $3,175 **AAPL** March $510 $2,165 $2,700 $535 **AAPL** April $520 $3,465 $7,670 $4,205 **AAPL** April $560 $3,830 $4,400 $570 **AAPL** April $580 $3,695 $3,040 ($655) **AAPL** March $575 $3,065 $3,675 $610

(WKY)

AAPL March $595 $2,055 $420.00 ($1,635) (WKY)
TOTAL $14,690 profit

This is how I used the Darvas system to take advantage of the Apple run up. This was a very risk controlled trading method. It is the way I trade, it could have been used even more aggressively with larger position sizes for much greater returns using stock options for more aggressive traders who do not mind bigger draw downs. I also traded Price Line in the first quarter as it broke out of its Darvas box after earnings. Chipotle Mexican Grill was also the 3rd stock on my primary watch list but I stayed so leveraged in Apple and Priceline that I never was able to take on the risk of Chipotle Mexican Grill because the options were very illiquid with an expensive bid/ask spread. I would have had to purchase the stock of CMG due to the bid/ask spreads for the option chains.

For others wanting to use my method based on the Darvas method you can use either the 5 day ema which will prevent larger draw downs by getting you out of a reversal early or the 10 day sma which will keep your trading activity down but lead to bigger draw downs, in my experience both are valid systems in the right stocks in an up trending market. Looking at these moving averages on a chart of the stock should give you a picture of which level is the most actively used support by other market participants.

You have to choose your rules, risk management, and position sizing before you start trading. You have to have the discipline to follow your plan. If you start trying to predict instead of follow the chart then this simply will not work, it works by going with the flow not trying to predict what will happen next.

Before you start trading this method you have to have faith that it will work, if you do it half heartedly just hoping it might work than it is highly likely you will quit with your first few losses. Also the Darvas system only works on stocks with huge earnings growth expectations or that are heavily speculated on for the potential of huge earnings this method is not for sluggish big caps or little single digit junk stocks with huge overhead resistance from past buyers who lost money and are waiting to get out even.

You also want to keep the sell discipline. Lock in profits when price closes below the key moving average you are using, if you start holding and hoping you could see your profits vanish, especially if you over leverage your position size. Apple went down 100 points after I exited my position at $625. Price line went down 150 points after I exited that stock. Lock in your profits when you get your signal.

You will see from the following charts that the market runs in cycles, up trending accumulation, down trending distribution, and also uncertain volatility. The Darvas system works in up trending accumulation search for stocks that behave and maintain support at key short term moving averages when the market as a whole is trending higher. Nicolas Darvas stayed on the sidelines during down trends and sloppy markets where he could not define price boxes.

Charts 2012


AAPL (Apple, Inc.) Nasdaq GS
©StockCharts.com
5-Jul-2012
Open 600.56 High 614.34 Low 599.65 Close 610.15 Volume 16.2M Chg +10.74 (+1.79%)
RSI(14) 66.79
AAPL (Daily) 610.15
MA(50) 573.91
MA(200) 489.58
EMA(5) 595.29
Volume 16,169,117
MACD(12,26,9) 6.151, 3.096, 3.055
12 19 2012 9 17 23 Feb 6 13 21 Mar 12 19 26 Apr 9 16 23 May 7 14 21 Jun 11 18 25 Jul

Charts 2012


CMG (Chipotle Mexican Grill Inc.) NYSE
©StockCharts.com
5-Jul-2012
Open 379.00 High 386.69 Low 379.00 Close 382.99 Volume 406.9K Chg +2.62 (+0.69%)
RSI(14) 39.70
CMG (Daily) 382.99
MA(50) 403.99
MA(200) 369.70
MA(10) 394.83
Volume 406,880
MACD(12,26,9) -6.112, -3.045, -3.067

Charts 2012

Interview With Time Magazine INTERVIEW WITH TIME MAGAZINE

It was May 1959—six-and-a-half years after I had been offered the Canadian stock called BRILUND by the Smith brothers. It looked as though the wheel had turned full circle because, like then, I was again appearing at the “Latin Quarter” in New York.

Somehow my stock-market dealings had got talked about in Wall Street. The news of my success had leaked out and gradually spread.

One day, to my surprise, I received a telephone call from the Business Section of Time. They said they had heard something about my success in the market and asked if they could send a reporter to see me.

Next day he came and I gave him all the facts about how I had made my fortune. I let him see my accounts, my statements, my cables. He examined them carefully and left saying that he was very impressed with my story.

A day later he came back and told me the business experts on the staff were highly skeptical. They said the story could not be true.

This really did not surprise me, so again I took him over the facts and figures. He studied them for several hours, and when he finally went away he seemed to be convinced that they were accurate.

But this, I was to discover, was only the preliminary skirmish. The next morning he called to ask if we could meet for lunch. Half an hour before lunch, he telephoned again and said he was bringing along a senior editor, who wanted to check on the story himself.

They arrived for lunch at one o’clock. Once again I went

through all the financial details. The senior editor was so interested that he left his food untouched on the table.

At four o’clock, after he had heard the whole story, he ate a sandwich. At five o’clock he left with the reporter. He had made no comment, but he was obviously impressed. I have never seen a man so interested.

At six o’clock that evening came another phone call. This time it was a Wall Street expert of Time. He said the Managing Editor would not allow the story to be printed until three members of the Time staff would vouch collectively that they had seen me and checked all the facts. He also, to my great surprise, insisted on seeing my dancing act. The Managing Editor not only doubted my success in the stock market, but he apparently did not think I could dance either!

At seven o’clock the expert arrived. At first he shook his head incredulously about everything I told him and all the evidence I produced concerning my stock-market operations. He seemed determined to disbelieve everything.

When Julia and I appeared on stage he seemed to be impressed by our dancing—so at least that was something! I had been undergoing this cross-examination for three days and I was becoming slightly unnerved by it. As a result I did not feel at the top of my form and towards the end of the act, when I had a strenuous lift to perform, I tore one of my right arm muscles badly. I was just able to finish the act.

It was with a painfully aching arm that I sat down with the Wall Street expert to continue the meticulous financial cross-examination.

It went on and on—for hours. All the time he came back to one question: Why did I talk so freely about my stock transactions?

I replied that it was because I was proud of what I had been able to do. I felt that I had nothing to hide.

It was after midnight, but during all these hours my inquisitor refused to have even one drink. He admitted, quite frankly, that he wanted to keep his mind clear to detect any flaws in my system or records.

Then at two in the morning, he threw down his ballpoint. “Let’s have a drink,” he said. His last skeptical doubt had been swept away. He was convinced. He lifted his glass and toasted my success in the market.

He left at four o’clock in the morning, but before he did he was asking me for advice. I gave it to him. I told him to buy a certain stock, but only if it rose to 39¾. He was also to put a stop-loss on it of 38½. I hope he did not disregard this advice and buy at a lower figure because it never reached 39¾. It fell suddenly to 22!

The following week the article appeared in Time, which of course has a highly influential readership, especially in financial circles. The result was that I became accepted by most— but not all—of the financial pundits as a highly successful, if unorthodox, stock-market investor. Hence this book.

The other result was that I had a badly torn muscle. A doctor told me that I might have to stop performing the act altogether. He was doubtful if I would ever be able to lift my partner again.

Two weeks later I was on the stage doing the act as usual. I have done it ever since—proving, perhaps, that medical experts can sometimes be as wrong as the experts on Wall Street.

Appendix

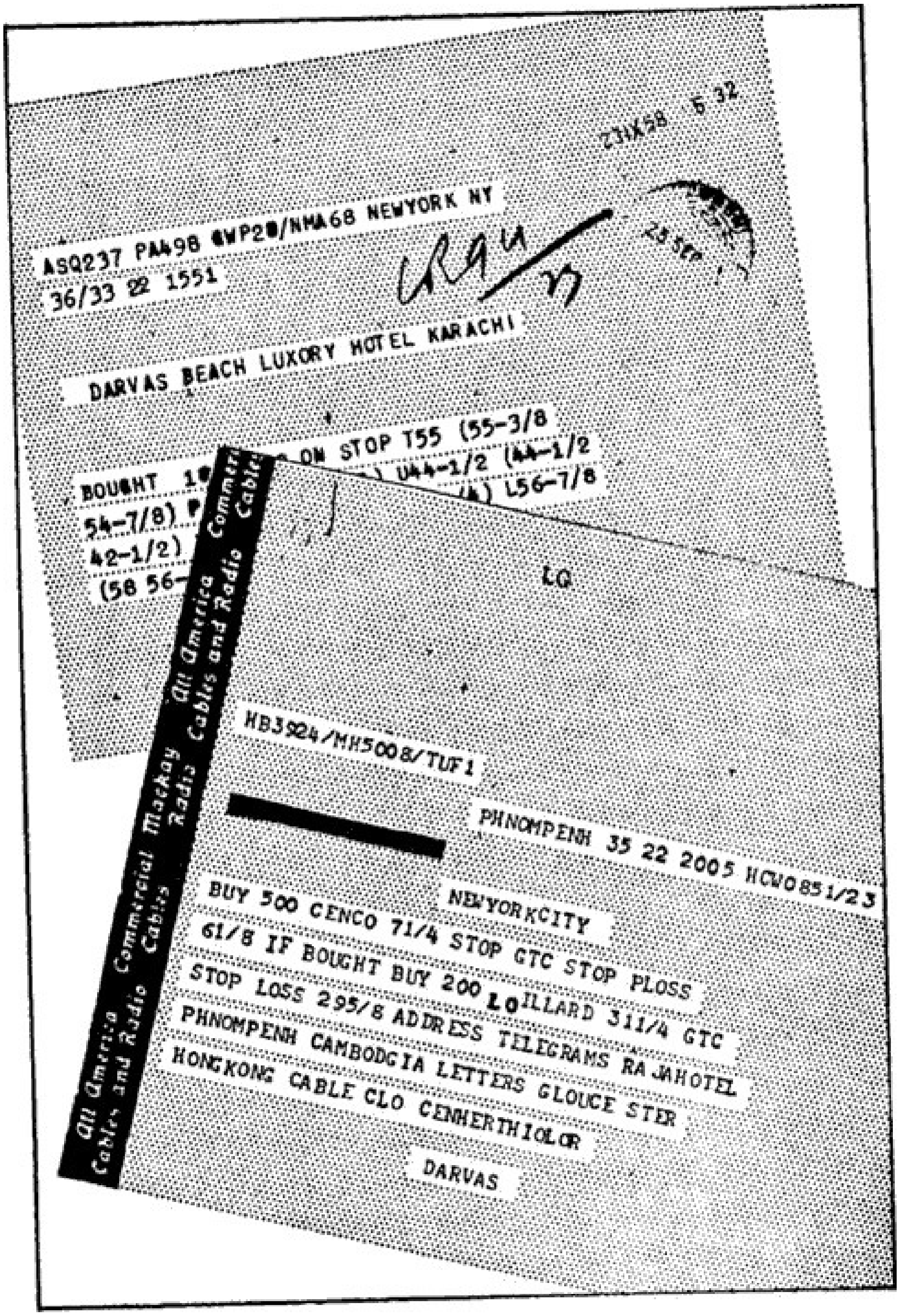
His two-year dancing tour of the world forced Darvas to rely exclusively on cablegrams as a means of communication between himself and Wall Street. Despite the many inconveniences that were involved, this turned out to be an important element in the combination of investment techniques that led to his eventual success in the stock market.

The following are reproductions of actual cables that show just how he was able to transact his stock-market operations from any part of the world. They include typical examples of the various phases of these transactions.

Once Darvas had instructed his broker as to which stocks he wanted quoted, only the initial letters of the names were necessary. It was the code-like nature of these messages that led to frequent difficulties with cable-office employees.

The upper cable is one he received in Karachi, Pakistan, notifying him that his broker had executed an on-stop purchase order. At the same time, the day's closing, high and low prices were listed for the other stocks in which Darvas was interested at the time—THIOKOL CHEMICAL, POLAROID, UNIVERSAL CONTROLS and LITTON INDUSTRIES.

When Darvas placed a buy order, he usually gave the full name of the stock. In the lower cable, from Indochina, he transmitted a "good-till-cancelled" on-stop order for 500 shares of CENCO INSTRUMENTS at 7¼ and 200 LORILLARD at 31¼. In both cases he automatically included stoplosses (6⅛ and 29⅝ respectively), as was his practice. In addition, he brought his broker up to date on his next change of address, and requested the day's closing prices of CENCO, HERTZ, THIOKOL and LORILLARD.



ASQ237 PA498 VP20/NMA68 NEWYORK NY
36/33 22 1551

DARVAS BEACH LUXORY HOTEL KARACHI

BOUGHT 1... ON STOP T55 (55-3/8
54-7/8) P... U44-1/2 (44-1/2
42-1/2) ... L56-7/8
(58 56-...

All America Cables and Radio
Commercial Mackay Radio
All America Cables and Radio
Commercial Cables

LG

HB3924/MH5008/TUF1

[redacted]

PHNOMPENH 35 22 2005 HCW0851/23

NEWYORKCITY

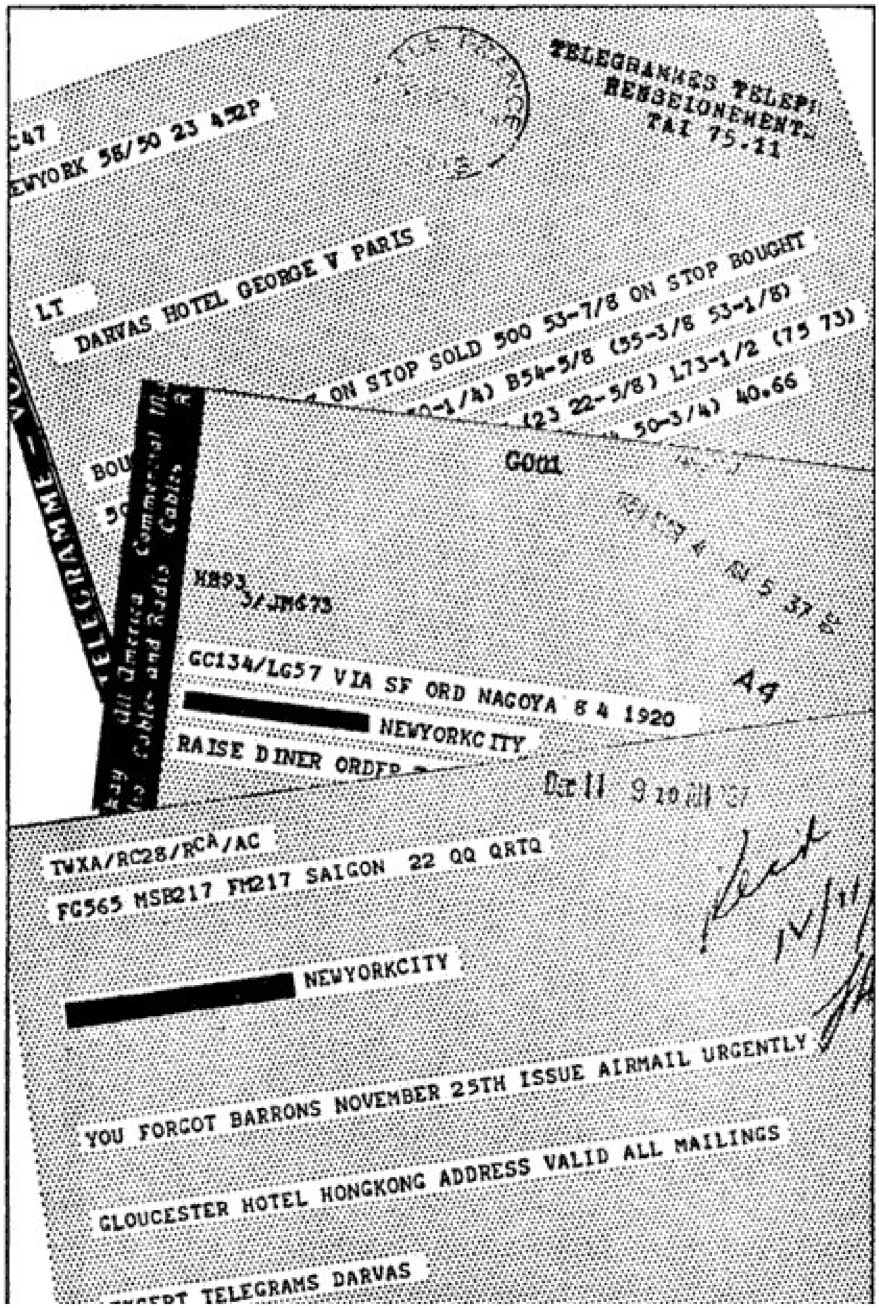
BUY 500 CENCO 71/4 STOP GTC STOP PLOSS
61/8 IF BOUGHT BUY 200 LOILLARD 311/4 GTC
STOP LOSS 295/8 ADDRESS TELEGRAMS RAJAHOTEL
PHNOMPENH CAMBODGIA LETTERS GLOUCESTER
HONGKONG CABLE CLO CENHERTHIOLOR

DARVAS

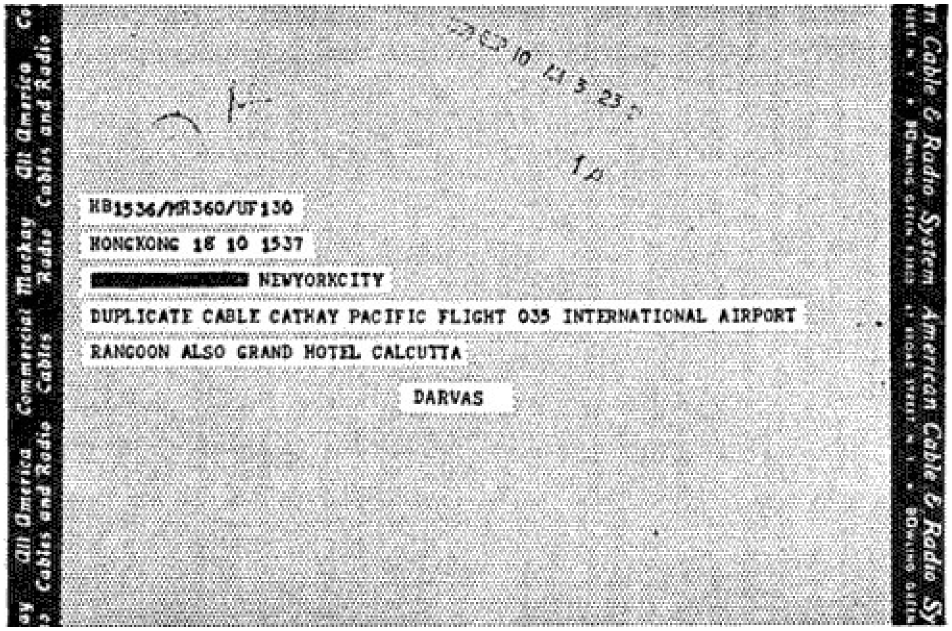
With his automatic stop-loss accompanying every buy order, Darvas was frequently in and out of a stock in one day. In the top cable, received in Paris, he was informed that 500 shares of a stock had been bought and later sold as the price dropped to his stop-loss point of 53⅞. Another purchase was confirmed, and the day's quotations supplied for BOEING, LITTON INDUSTRIES, and several other stocks. The final figure represents the Dow-Jones Industrial Average for that day in abbreviated form.

Darvas was constantly changing or canceling orders on the basis of his daily quotes. In the center cable, from Nagoya, Japan, he instructed his broker to raise the quantity of a previous DINERS' CLUB order. He later cancelled this particular order altogether.

Aside from the daily wires, Darvas' only contact with Wall Street was Barron's, which was airmailed to him every week as soon as it was published. The bottom cable, from Saigon in Indochina, reflects his complete dependence on regular receipt of this publication.



Darvas was always fearful that a vitally important cable calling for immediate action might miss him in transit. This problem was solved when he realized he could instruct his broken to send copies of a cable to both the airport at which he would be changing planes and the hotel at which he was to arrive.

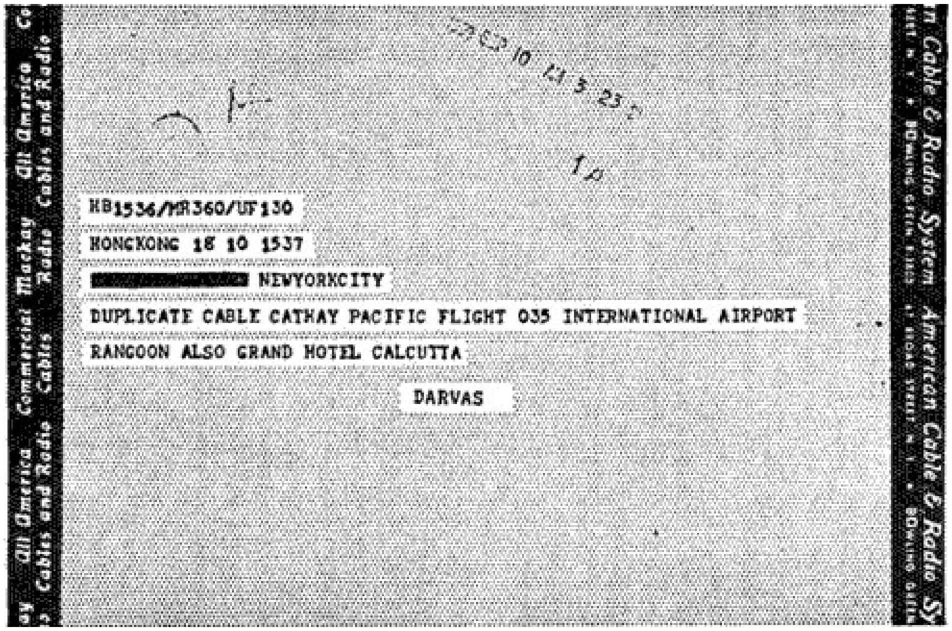


HB1536/MR360/UF130
HONGKONG 18 10 1537
[redacted] NEWYORKCITY
DUPLICATE CABLE CATHAY PACIFIC FLIGHT 035 INTERNATIONAL AIRPORT
RANGOON ALSO GRAND HOTEL CALCUTTA
DARVAS

An on-stop buy order cannot always be executed at one price for the entire number of shares. According to the market, the purchase is made in hundred lots at varying prices starting at or above the specified buy price.

According to this cable received at Kathmandu, Nepal, Darvas' order for 500 PARMELEE TRANSPORTATION had been filled at two prices: 400 shares at 33½ and 100 at 33¾. The stock had closed at 34⅛ and its range for the day was 34½-32⅝.

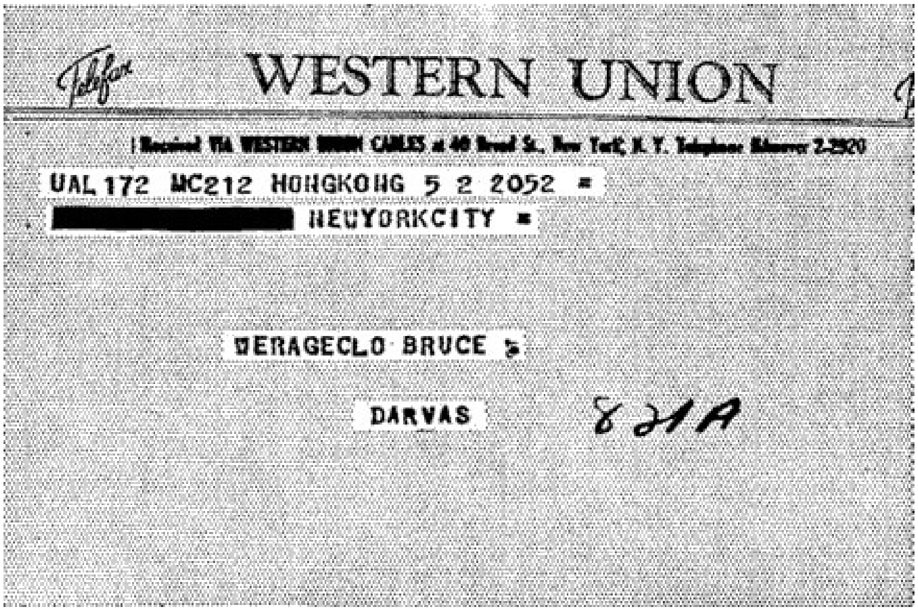
Darvas says that this cable is unusually intelligible compared to many of the handwritten messages he had to call for at the Indian Embassy, which had the only telegraphic link with the outside world. The day's quotes are clear enough for PARMELEE, THIOKOL, UNIVERSAL CONTROLS, FAIRCHILD CAMERA and LITTON INDUSTRIES. As for the last stock, Darvas cannot identify it now, although he must have known at the time what it was supposed to be.



HB1536/MR360/UF130
HONGKONG 18 10 1537
[redacted] NEWYORKCITY
DUPLICATE CABLE CATHAY PACIFIC FLIGHT 035 INTERNATIONAL AIRPORT
RANGOON ALSO GRAND HOTEL CALCUTTA
DARVAS

Darvas first became interested in a particular stock on the basis of its movement as recorded in Barron’s. Since this publication took several days to reach him, he needed to be brought up to date by cable concerning the most recent activity of the stock.

It was in Hong Kong that he first noticed the unusual amount of trading in the stock of a small company, and from there he sent this cable requesting “this week’s range and closing price of E. L. BRUCE”. Little did he suspect then that his pinpointing of this stock on purely technical grounds was to result in a profit of almost $300,000.



WESTERN UNION

UAL172 WC212 HONGKONG 5 2 2052 =

[redacted] NEWYORKCITY =

WERAGECLO BRUCE 5

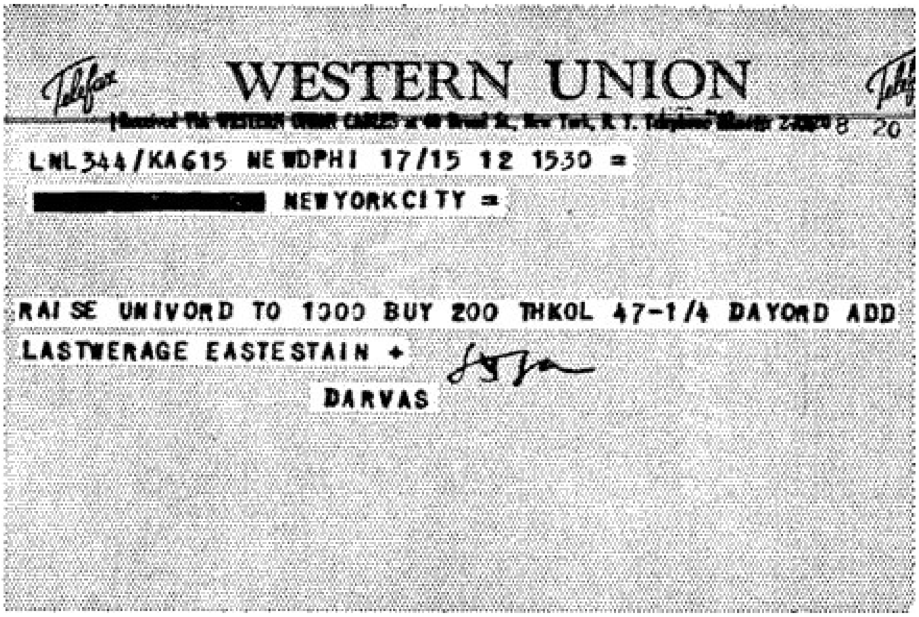
DARVAS 8 21A

Once the daily quotes on a stock showed Darvas that it was following the pattern his theory called for, he would generally make a small pilot buy. It was only when he actually owned shares that he could really get the “feel” of the stock’s movements. Since his broker had blanket instructions to handle all of Darvas’ on-stop orders on a good-till-cancelled basis, he often specifically placed a “day order” for a pilot buy.

These few words from New Delhi, ordering 200 shares of THIOKOL CHEMICAL at 47¼, were to be worth almost a million dollars. This pilot buy led to the eventual sale of Darvas’ holdings in this one stock alone for over $1,000,000.

In this cable, Darvas also took the opportunity to raise the quantity of a UNIVERSAL PRODUCTS order, only to cancel it shortly afterwards because he felt the time wasn’t ripe. Within the next four weeks he actually did purchase 3,000 shares of this stock.

The last request calls for the previous week’s range of EASTERN STAINLESS STEEL.



WESTERN UNION

LNL344/KA615 NEWDPHI 17/15 12 1530 =

[redacted] NEWYORKCITY =

RAISE UNIVORD TO 1300 BUY 200 THKOL 47-1/4 DAYORD ADD LASTWERAGE EASTESTAIN +

DARVAS

After his pilot buy into a stock, if the price pattern he was looking for continued consistently, Darvas followed through with additional purchases.

In this cable from Kobe, Japan, he sent the third of his orders to buy another 200 shares of LORILLARD. Darvas' purchases into this stock formed the cornerstone of the pyramid of investments that was to grow to over $2,000,000 in the following eighteen months.

2/3/58

FEB 3

#66

RCA/TWXC9 2J FB4372
JR XT2797
KT1275/GK609 VIA SF KOBE 27 2 1844

[redacted] NEWYORKCITY

BUY 200 LORILLARD 36-1/2 CONTINUE LAST WEEKS CABLES ALL WEEK
STOP NEW CABLE ADDRESS KYOTO HOTEL KYOTO JAPAN STOP MAILING ADDRESS
REMAINS NIKKATSU

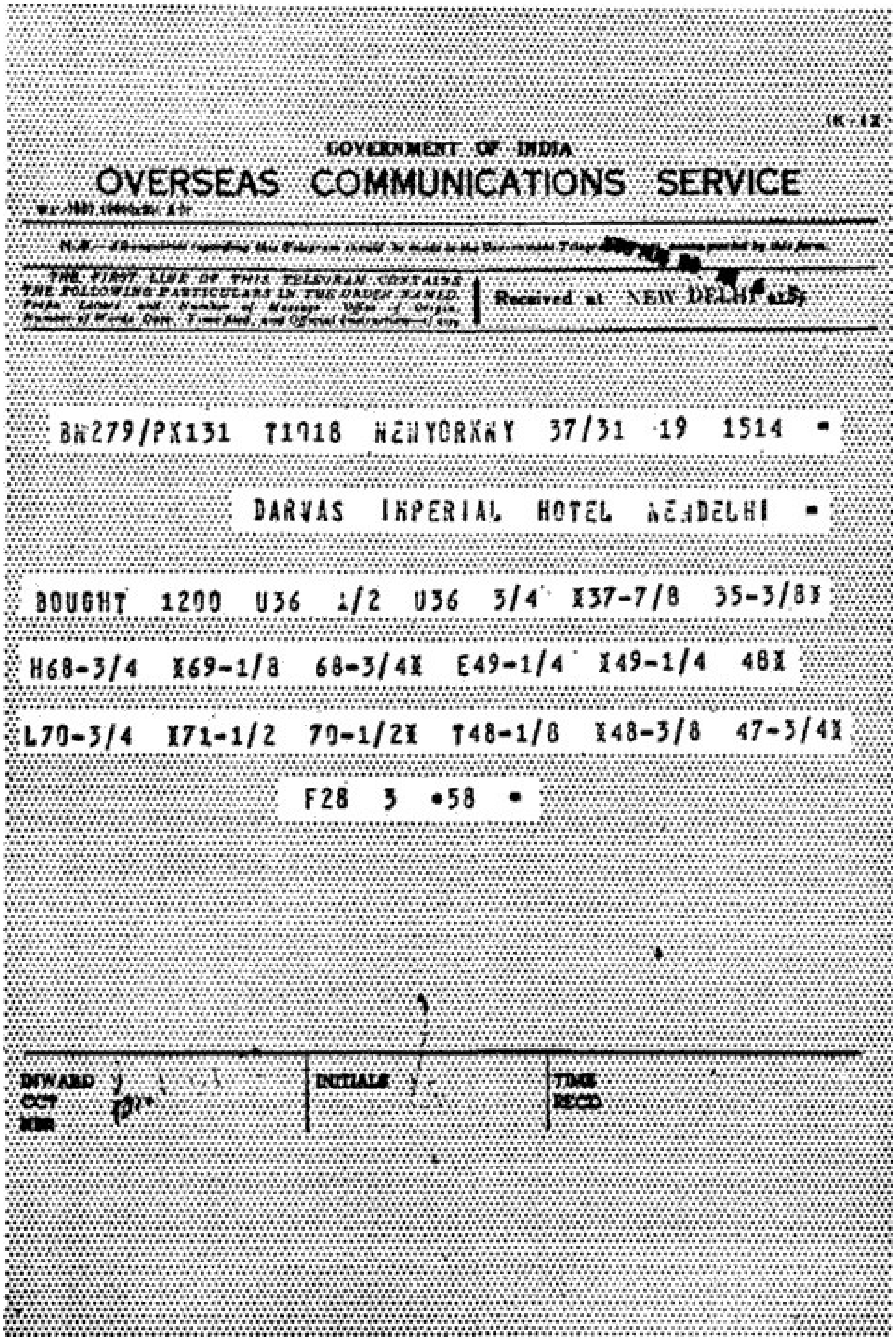
DARVAS

END
SENT 920AM EST ,
REC OK THNX

As his capital grew, so did the amount Darvas invested in any one stock once he was sure of it. After a pilot buy of 300 shares of UNIVERSAL PRODUCTS at 35¼, Darvas was well enough satisfied with the continuing movement of this littleknown stock to make a second purchase of 1,200 shares.

This cable notified him that his on-stop order had been filled at the designated price of 36½, and gave him the day's range and close for UNIVERSAL.

Also quoted were HUMBLE OIL, EASTERN STAINLESS STEEL, LITTON INDUSTRIES, THIOKOL and FAIRCHILD CAMERA. For the last stock, only the "28" applies. The 3.58 stands for the Dow-Jones Average of 503.58.



GOVERNMENT OF INDIA

OVERSEAS COMMUNICATIONS SERVICE

Received at NEW DELHI

BN279/PX131 T1918 NEWYORKNY 37/31 19 1514 =

DARVAS IMPERIAL HOTEL NEWDELHI =

BOUGHT 1200 U36 1/2 U36 3/4 X37-7/8 35-3/8X

H68-3/4 X69-1/8 68-3/4X E49-1/4 X49-1/4 48X

L70-3/4 X71-1/2 70-1/2X T48-1/8 X48-3/8 47-3/4X

F28 3 .58 =

INWARD CCT NBR | INITIALS | TIME RECD

After Darvas had invested in a stock, he was always careful to trail his stop-loss behind the rise. The relationship between the price and his stop-loss point was a very flexible one, since it depended on many variable factors.

He was in Hong Kong at the beginning of April 1958 when he became uncomfortable about the behavior of DINERS' CLUB, which until then had been rising steadily.

With this cable he established the very close stop-loss that was to take him out of DINERS' CLUB at a substantial profit just when this stock took a sudden and drastic turn for the worse.

Charts

In the following pages the AMERICAN RESEARCH COUNCIL presents a series of specially prepared charts of weekly prices and volume for the major stocks that netted Nicolas Darvas $2,000,000. While this amount was accumulated by Darvas in a little over 18 months, we have included the record for a full three-year period—1957 through 1959— to show the history of each stock's movements before and after, as well as during, the time that Darvas held it.

In addition, explanatory notes by our editors highlight the reasoning behind Darvas' choice of each stock, the timing of his buys, and his use of the trailing stop-loss—based on his techno-fundamentalist theory as explained in the text of the book.

The charts are arranged in the order in which the stocks are discussed in the book so that the reader may more easily follow the sequence of Darvas' transactions as they occurred.

LORILLARD

Darvas asked for daily quotes on this stock after observing the sudden rise in volume at (A) when it "began to emerge from the swamp of sinking stocks like a beacon."

He bought his first 200 shares of LORILLARD at 27½(B) with the very narrow stop-loss of 26. A few days later a sudden drop (C) touched off this stop-loss and he was sold out.

The immediate rise which followed convinced Darvas that his first assessment was correct, and he bought his 200 shares again at 28¾ (D).

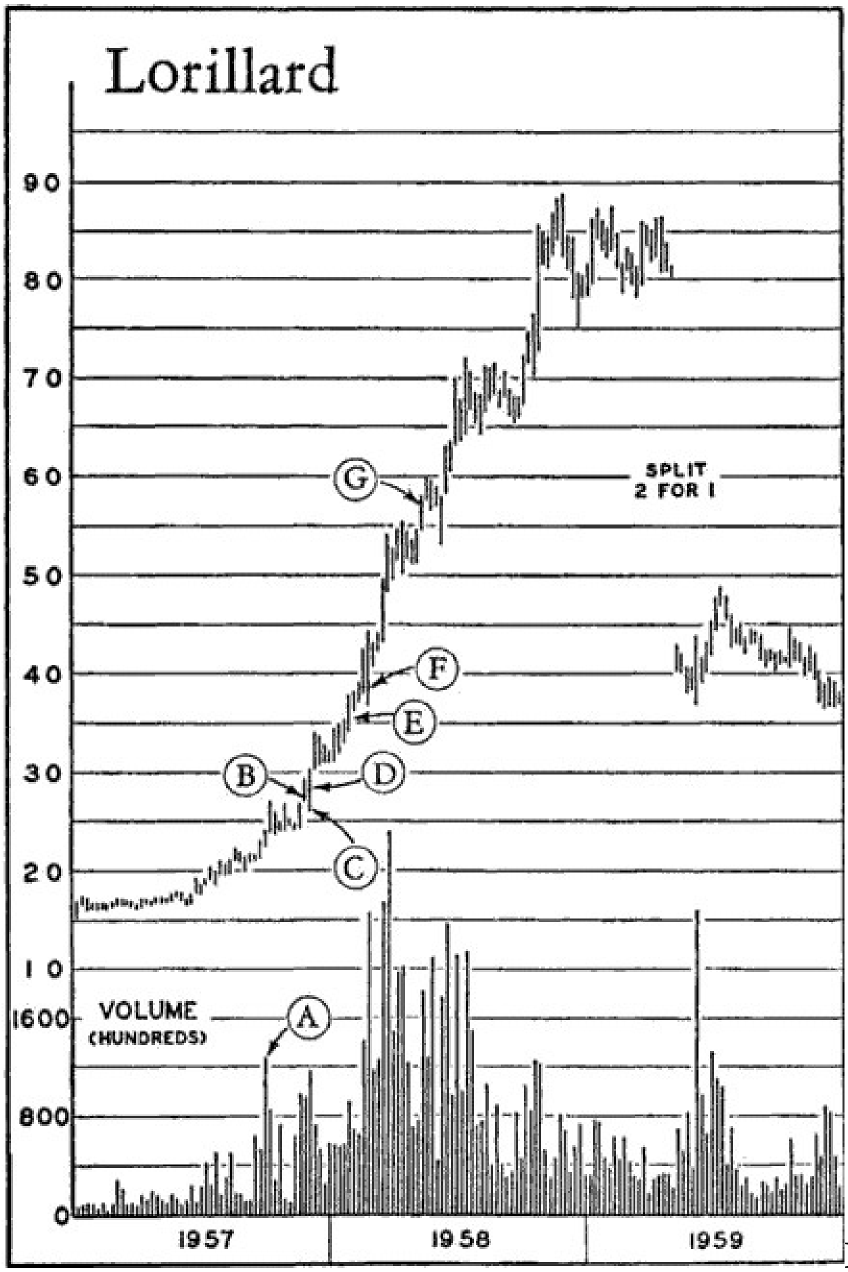
As the “boxes” piled up, Darvas bought another 400 shares at 35 and 36½ (E). The stock rose rapidly to a new high of 44⅜.

A sudden drop to a low of 36¾ on February 18th scared him into raising his stop-loss to 36. This was not touched off, and the stock picked up momentum immediately, so he purchased a final lot of 400 shares at 38⅝ (F).

As LORILLARD continued its sensational rise in price and volume, Darvas was strongly tempted to sell for a quick profit. But he adhered to one of the basic principles of his theory— “There is no reason to sell a rising stock”—and trailed his stop-loss at a safe distance behind the rise.

Except for the possibility that, with a very close stop-loss, he might have been sold out in June when there was a sudden drop to 53⅜, Darvas might easily have continued with LORILLARD on its phenomenal rise into the 80’s at the end of the year.

However, in May he became extremely interested in the movements of another stock for which he would need all the capital he could get. It was for this reason that he sold his 1,000 shares of LORILLARD early in May at 57⅜ (G) for a substantial profit of $21,000. He was now ready to invest in E. L. BRUCE.



DINERS’ CLUB

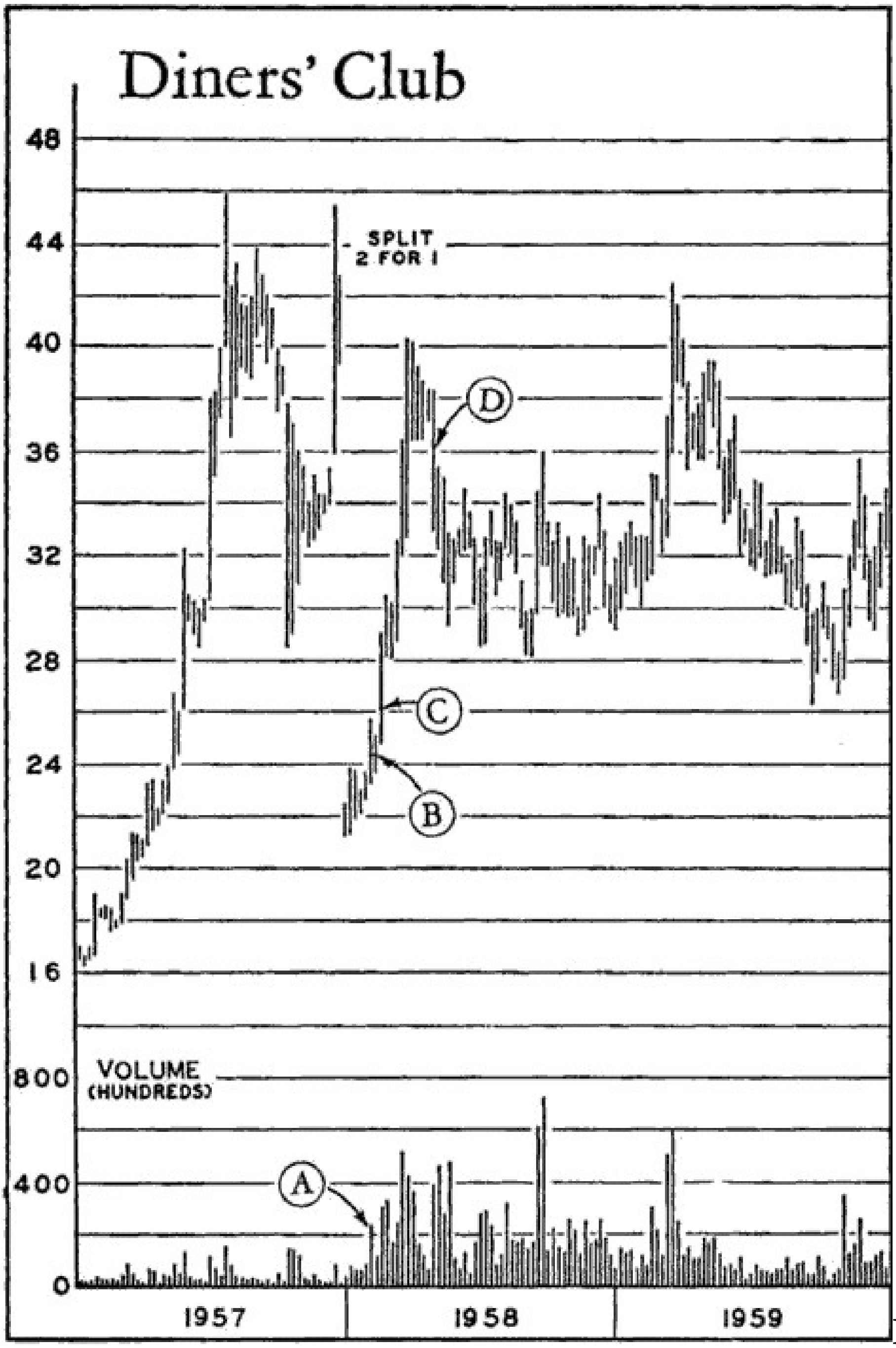
Although this stock had shown a rising price pattern in the first half of 1957, this rise was not marked by an accompanying increase in volume. It was only at (A), when after a 2-for-l split there was a sudden sharp jump in volume, that Darvas became seriously interested in DINERS’ CLUB. He found that the company was a pioneer in a new field with a definite upward trend in earning power.

Satisfied on this “fundamental” point, he bought 500 shares at 24½ (B). As the stock continued to advance, he followed through with another 500 at 26⅛ within a few days (C). He watched complacently as the pattern of pyramiding “boxes” developed, accompanied by a tremendous rise in trading volume. As the price rose, so did his stop-loss—to 27, then to 31.

After reaching a new high of 40½, the stock suddenly seemed to Darvas to have "lost its will to rise. It looked as if its last pyramid would hesitate on the brink of going into reverse. It almost seemed ready to tumble." Fearing collapse, Darvas moved up his stop-loss to 36⅜.

In the fourth week of April, "the event against which I had insured myself occurred." DINERS' CLUB took a dive and Darvas was sold out at (D), with a profit of over $10,000.

He had acted on purely technical grounds, completely unaware at the time that American Express was about to enter the credit-card field in direct competition with DINERS' CLUB. It was the successful timing of this operation that fully confirmed for him the correctness of the technical side of his approach.



E. L. BRUCE

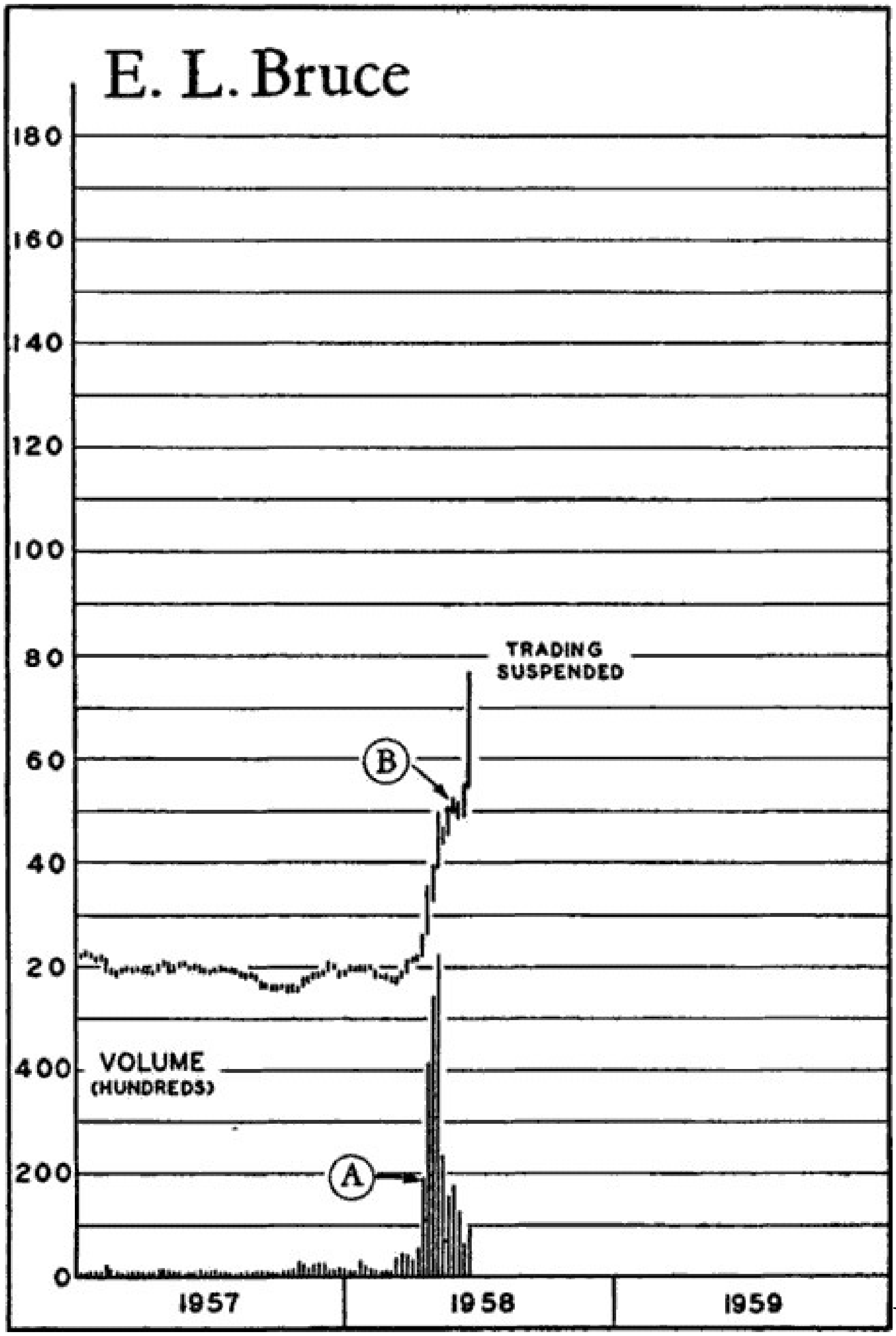
At the time that he had all his funds invested in LORILLARD and DINERS' CLUB, Darvas suddenly noticed (A) "a great interest springing up in a stock called E. L. BRUCE, a small Memphis firm". While it did not meet his qualifications as to fundamentals, "the technical pattern was so compelling that I could not take my eyes off it".

A phenomenal rise from 18 to 50 was followed by a reaction to 43½, but to

Darvas' trained eye this seemed "only a temporary halt, a refueling". Despite the lack of a fundamental reason, he determined to buy as much as he could if it went over 50. Fully confident that the "rhythm of the advance was there", he sold out LORILLARD in order to have all his funds available for immediate investment in BRUCE. Within a period of three weeks at the end of March, he bought a total of 2,500 shares at an average price of 52 (B).

His timing, as the chart shows, turned out to be perfect. BRUCE "began to climb as if drawn upwards by a magnet . . . It was spectacular". By the time the price reached 77 "it was obvious even in faraway India that something fantastic was happening on the American Stock Exchange".

The situation was indeed fantastic. Short-sellers operating on a "value" basis were desperately trying to cover their positions. Trading was suspended on the Exchange, but Darvas was offered $100 per share over-the-counter. It was then that he made "one of the most momentous decisions of my life". He refused to sell this "advancing stock". A few weeks later he received prices averaging 171 for a profit of $295,000.



UNIVERSAL CONTROLS

"A little, unknown company called UNIVERSAL PRODUCTS" caught Darvas' eye in July 1958, after a sudden enormous spurt in volume (A) was accompanied by a price rise from below 30 into a 32-36 range.

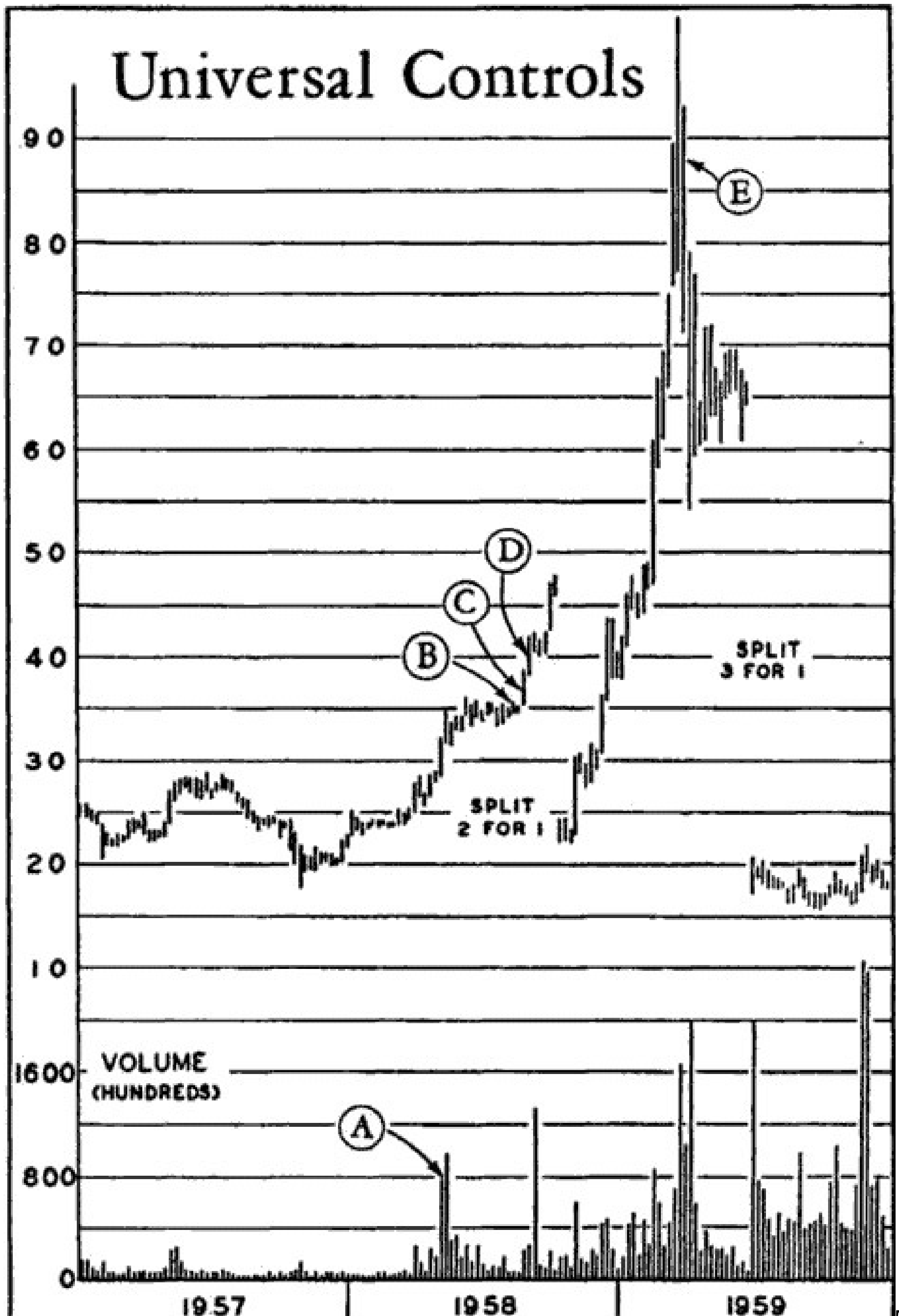
In the beginning of August he made a cautious pilot buy of 300 shares at 35¼ (B). Two weeks later, as the stock began to "firm up", he purchased 1,200 shares at 36½ (C). Up it went, and days later he acquired 1,500 more at 40 (D).

Shortly afterwards, the company's name was changed to UNIVERSAL CONTROLS and the stock was split 2-for-l, so that he now had 6,000 shares.

In January 1959 Darvas landed in New York and embarked on a series of operations that came near to ruining him. Fortunately, UNIVERSAL CONTROLS performed beautifully during this period and gave him not a moment's concern.

But in March something began to happen to UNIVERSAL that "spelled trouble and trouble surely came". After a wild 3-week rocketing from 66to 102, "it switched its momentum and began to go in the other direction. I did not like the look of this drop at all. It fell as if in an air-pocket and there seemed no sign of a rise."

Darvas performed exactly as he had done with DINERS' CLUB in a similar situation. He raised his stop-loss to just below the last closing price and was sold out (E). His prices, ranging from 86¼ to 89¾, were more than 12 points below the high but he was "well content with this. There was no reason why I should be unhappy. I had had a good long ride and ... a profit of $409,000."



THIOKOL CHEMICAL

In Tokyo early in 1958, Darvas noticed sudden heavy trading in this stock following a 2-for-l split (A). It remained quiet for some months afterwards, but to Darvas this “tranquility” had the feeling of “a calm that precedes the storm”.

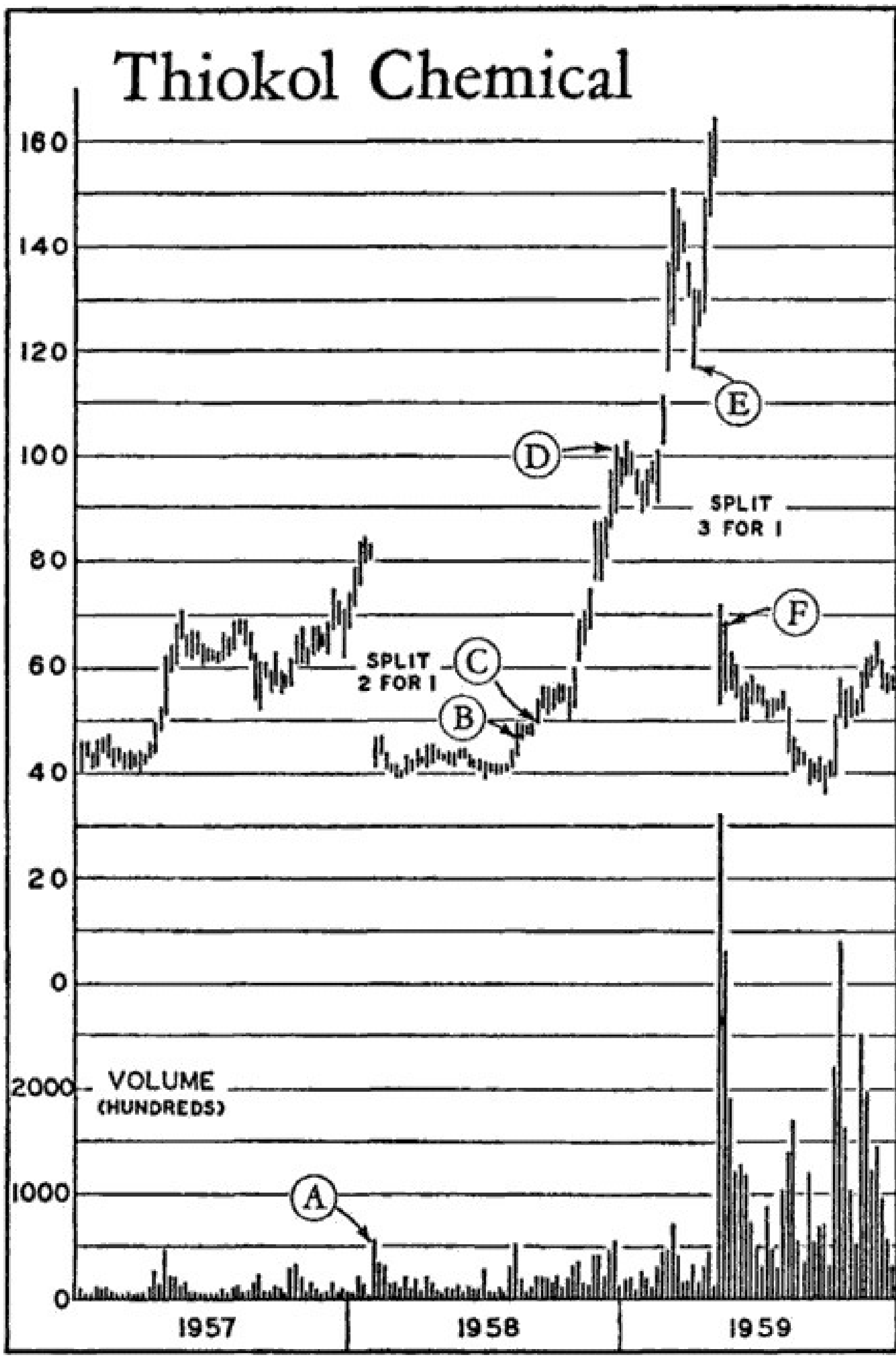
Soon after Darvas started getting daily quotes, THIOKOL “looked as though it was flexing its muscles for an upward jump” from 45, and he made a pilot buy of 200 shares at 47¼ (B). For four weeks the stock kept pushing toward 50, and at (C), just as Darvas felt it was ready to break through, he bought 1,300 shares at 49⅞.

On the heels of this purchase came THIOKOL's issuance of stock rights. In an inspired series of transactions, which are fully explained in the text, Darvas took maximum advantage of the tremendous credit that is available when rights are exercised. Through the purchase of 72,000 rights (and the sale of his first 1,500 shares at 53½), he acquired 6,000 shares of THIOKOL stock at the subscription price of $42 per share (when the quoted price was in the middle 50's). His cash outlay was only $111,000 towards the total purchase price of $3 50,000.

Three months later (D) his broker wired him that he had a profit of $250,000 on his THIOKOL investment. As he walked, tormented with temptation, through the streets of Paris, "every fiber in my being seemed to be saying 'sell, sell' "— but he held on to the stock.

Of course, Darvas never for a moment forgot to move his stop-loss up as the stock rose, but with THIOKOL he allowed a greater leeway of movement so as not to risk being stopped out on a short-lived reaction such as did occur at (E). The rise which followed, and which continued after the 3-for-l split at the beginning of May, culminated in a high-point of 72 accompanied by such hectic trading that the N. Y. Stock Exchange suspended the use of all automatic on-stop and stop-loss buy and sell orders for this stock. For Darvas this meant: "They had taken my most powerful tool away, and I could not work without it".

He sold his 18,000 split shares at an average price of 68 (F), for a total profit of $862,000. The momentous decision in Paris - "You have no reason to sell a rising stock" - had paid off.



TEXAS INSTRUMENTS

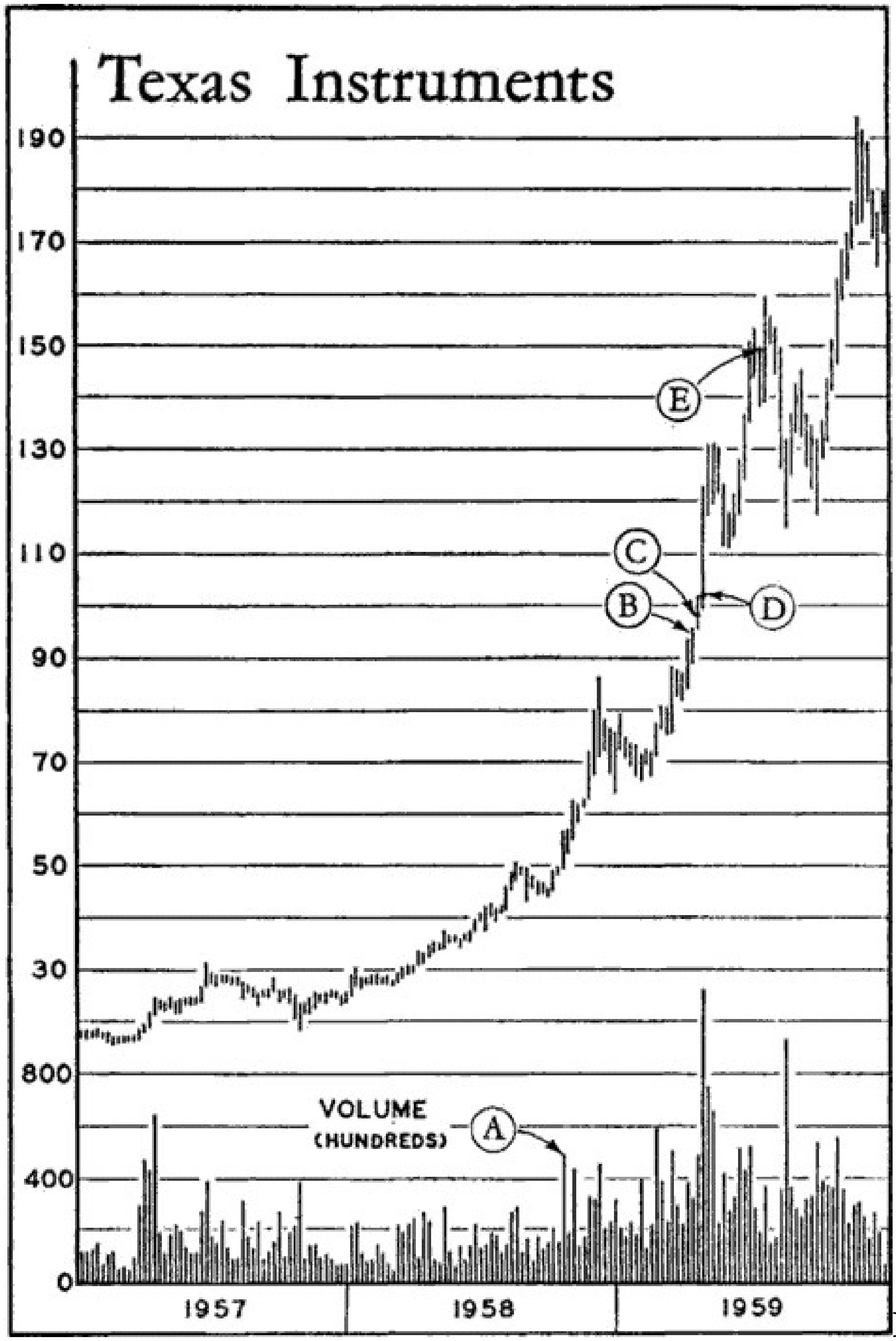
After his sale of UNIVERSAL CONTROLS, Darvas "took a careful look at the market…for an actively traded, highpriced stock" in which to invest over a half-million dollars. With such a large sum involved, he had also to allow for the possibility that his buying might affect the market.

Except for some slightly erratic behavior at the end of 1958, TEXAS

INSTRUMENTS had been moving steadily upward for over a year, and the velocity of its advance had increased coincidentally with a marked rise in volume (A) in October.

Darvas bought 2,000 shares the second week in April (B) at an average price of 94⅜. The following week, "as the stock continued to act well", he acquired 1,500 more at 97⅞ (C). Within a few days he made a final purchase of 2,000 shares at an average of 101⅞ (D).

On July 6th, TEXAS INSTRUMENTS closed at 149½ (E), and it is at this point that Darvas takes off for Monte Carlo at the end of Chapter 10, with a new set of adjusted stop-losses waiting somewhere below the closing prices of his more than $2,250,000 worth of holdings.



FAIRCHILD CAMERA

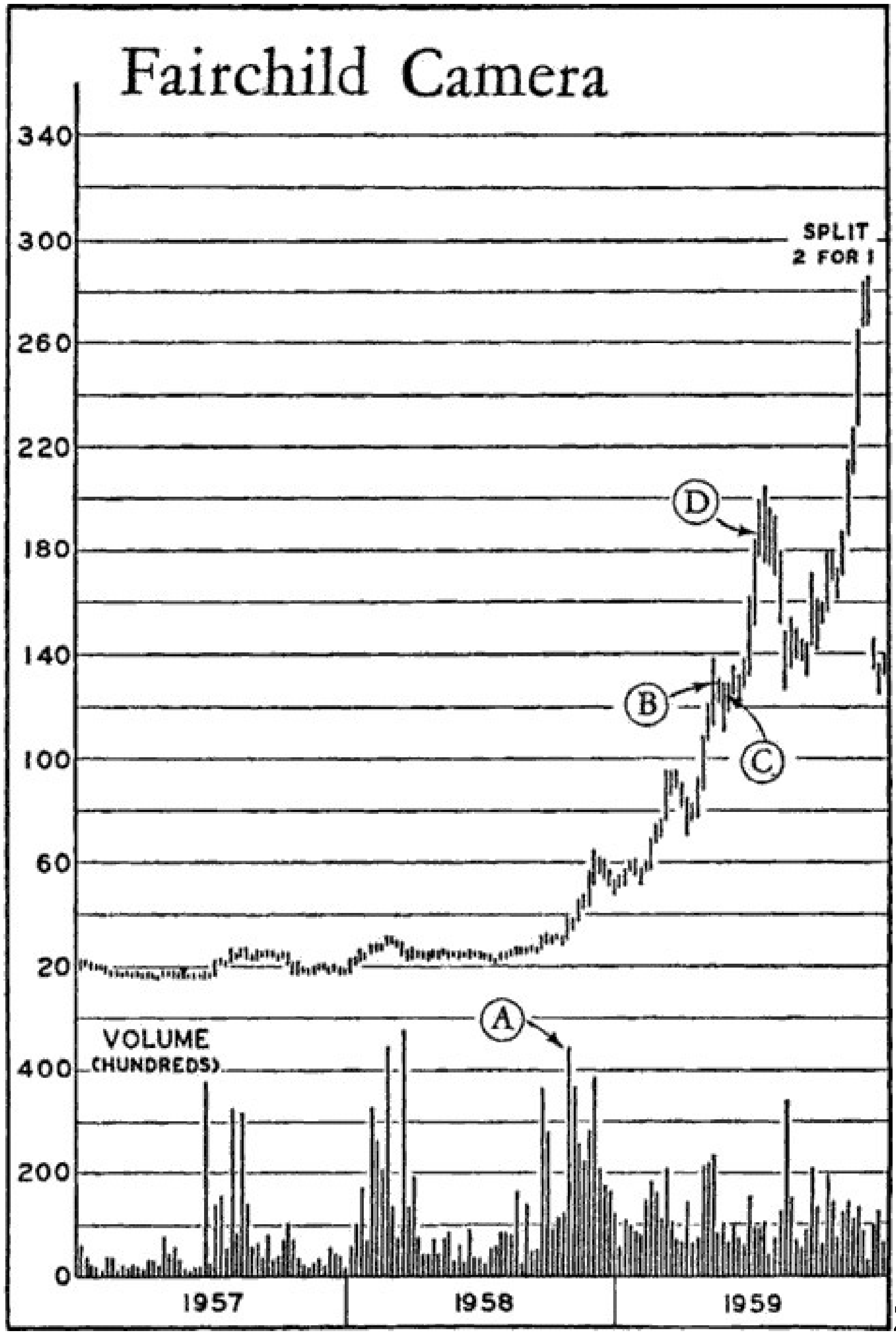
The sale of THIOKOL left Darvas with an investment capital of over $1,000,000. Having decided to divide this into two parts, he narrowed his choice to four stocks, which he had been watching for a long time and which were "all suitable as far as my techno-fundamentalist theory was concerned".

One of the stocks that survived a test buy to determine the relative market strength of the four was FAIRCHILD CAMERA.

FAIRCHILD had been very stable in price throughout 1957 and most of 1958 despite two periods of tremendous increases in trading volume. But at the end of 1958 a new jump in volume (A) was complemented by a rapid and almost continuous rise in the price of the stock, at which point it became interesting to Darvas.

He made his pilot buy of 500 shares at 128 (B), when the stock had established itself in a 110/140 box. Having removed the arbitrary 10% stop-loss, which was too close with respect to the lower limit of the box, he was unaffected by the low of 110¼ which occurred two weeks later. On the contrary, as the stock re-established its upward momentum almost immediately, he bought 4,000 additional shares at (C) for prices ranging from 123¼ to 127.

With his holdings of 4,500 shares of FAIRCHILD CAMERA along with ZENITH RADIO and TEXAS INSTRUMENTS, Darvas was now in a position to sit “on the sidelines just keeping vigil while my stocks continued to climb steadily like well-made missiles”. As of the end of this book, FAIRCHILD CAMERA closed at 185 (D).



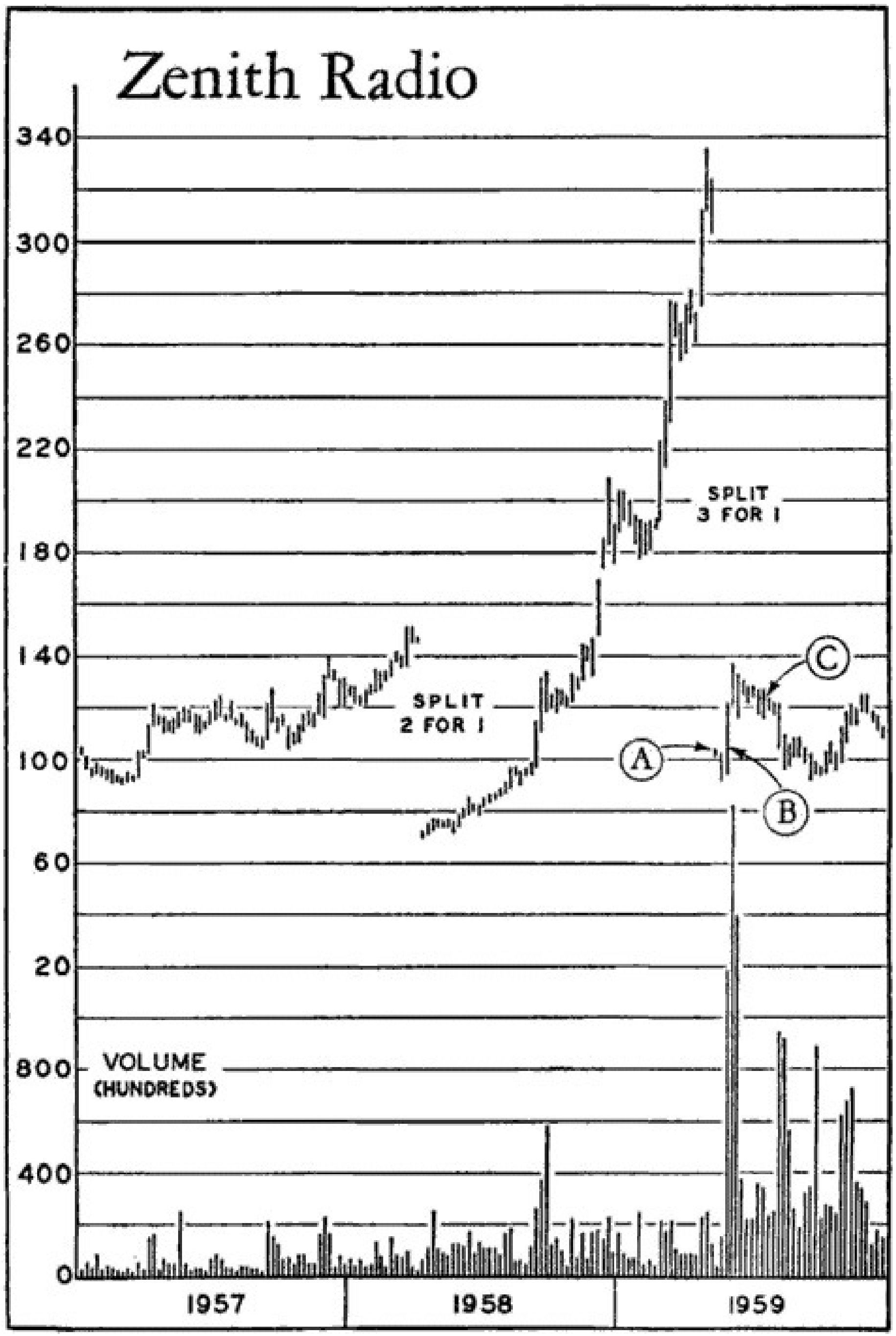
ZENITH RADIO

This is the second of the stocks into which Darvas switched the capital that THIOKOL had built for him, and it is quite different from FAIRCHILD in its pattern prior to the time of this investment. Peak trading in ZENITH at the end of September 1958 was accompanied by an explosive price advance for this already volatile stock.

Darvas made his pilot buy at 104 (A) on a “when-issued” basis just after announcement of a 3-for-l split. As with FAIRCHILD, he dropped the arbitrary 10% stop-loss, which he had set up to eliminate the weakest of the four stocks, he was interested in. Had he kept it there, he would have been sold out the following week when ZENITH dropped to 93. However, as the price immediately started an upward move, he proceeded as planned and bought 5,000 shares at prices ranging from 99¾to 107½ (B).

ZENITH moved along nicely after that, and it is worth noting that though its progress was unspectacular compared to its pre-split rise, the “little” difference between his average buy price of 104 and the closing price of 124 (C) on July 6th, when the book ends, represented a profit for Darvas of more than $ 100,000.

When they were writing up these charts, our editors pointed out to Darvas that his purchase of ZENITH so late in its rise looked anticlimactic. He agreed and said, “By hindsight it seems to have been late in its rise—at the time it looked to me like the beginning of a new rise. After all, I only expect to be right half the time.”



2012 Appendix Appendix A

Best sites for free charts: www.stockcharts.com www.freestockcharts.com www.investors.com

Appendix B

Recommended Sources to help use the Darvas method Investor's Business Daily's IBD 50
Darvas Pro Newsletter
www.DarvasTrader.com
www.investors.com

Appendix C

Book Recommendations to trade like Darvas
"How I made Money using the Nicolas Darvas System" By Steve Burns
"New Trader, Rich Trader" by Steve Burns
Nicolas Darvas' Books by BN Publishing :
"How I made $2,000,000 in the Stock Market"
"Wall Street: The Other Las Vegas"
"You Can Still make it in the Market"
"The Darvas System for Over the Counter Profits" "How to Make Money in Stocks" by Willaim J. O'Neil

Appendix D

For current commission prices and reviews for all discount brokers go to:
http://www.brokerage-review.com/

About the Author

Steve Burns has been an active trader for over 13 years. He is the author of New Trader, Rich Trader, Show Me Your Options and How I Made Money Using the Nicolas Darvas System published by BN Publishing (available at all major internet retailers). He ranks in the top 350 of all reviewers on Amazon.com, he is also one of the sites top reviewers for books about trading. He has been featured as a top Darvas System trader on DarvasTrader.com and interviewed on the Miss Trade YouTube channel. He has also been a contributor to ZenTrader.ca and Business Insider. He lives in Nashville, TN with his wife, Marianne, and they have five children, Nicole, Michael, Janna, Kelli, and Joseph and one granddaughter Alyssa.

From 2003-2007 he returned an average annual gain of 22.95% and went to a cash position on January 4th, 2008 keeping all of his bull market returns through the Great Financial Panic. His trading beat the S&P 500 six straight years and had a cumulative 209.5% return over an eight year period.

The Author trades accounts worth over a quarter of a million dollars.

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