Updated Text

for

UNKNOWN MARKET WIZARDS

This Updated Text PDF is only for purchasers of the audiobook edition of *Unknown Market Wizards* on or after November 7, 2023.

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UNKNOWN MARKET WIZARDS

The best traders you've never heard of

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Harriman House

PREFACE TO THE REVISED EDITION

I am doing something with this volume I have never done before in any *Market Wizards* book: revisiting the traders years later for an update.

I conducted the original interviews for *Unknown Market Wizards* in 2019. The years since then have been remarkably eventful, witnessing a worldwide pandemic, extraordinary government stimulative actions, a transition from low inflation to the highest inflation in 40 years, and two bear markets. The assumption that readers would be curious about how the traders interviewed navigated the turbulent markets of this interim period provided the catalyst for my decision to conduct follow-up interviews for this revised edition.

How have the traders fared in the intervening years since the original interviews? As demonstrated by the accompanying table, which summarizes the annual returns and worst drawdown experienced by the traders during the past four years, they have continued to generate superior performance. All but two of the traders had average annual returns greater than 20%, with some far exceeding this level. The only two traders below this average return level maintained strong return/risk performance. Their more moderate returns simply resulted from their choosing to run low-exposure portfolios.

They could have doubled their exposure levels—and, by implication, returns—and still had low maximum drawdown levels.

Two statistics that require further explanation are Camillo's 2022 return and the surveyed period maximum drawdown. These numbers, which seem to imply that Camillo witnessed a devasting surrender of previous profits, are misleading. These figures miss that, in 2022, Camillo recognized the market environment was unfavorable to his strategy and drastically reduced his trading size (an action discussed in the update to his chapter), thereby greatly mitigating his dollar losses. As a result, despite the huge percentage decline in 2022, he only surrendered about 13% of the profits of the prior three years, and the period since our original interview represented the best performance of his career. There is a valuable lesson here: reducing your exposure when your trading is out of sync with the markets is critical to long-term success.

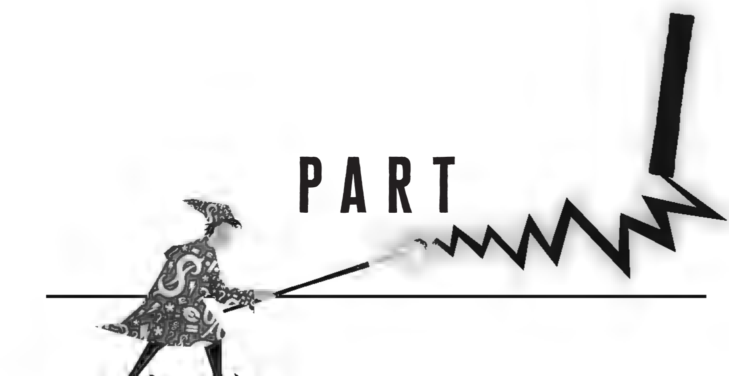
Readers may note that Jeffrey Neumann is missing from the accompanying table. This omitted entry reflects Neumann's reluctance to have his performance numbers made public, which, in some sense, is ironic since the last few years were the best of his entire career (a fact I was able to verify) and arguably the best of any trader surveyed in this volume.

	Annual Return (%)*				Average Annual Compounded Return	Average Annual Arithmetic Return	Maximum Drawdown (%)**
	2019	2020	2021	2022	2019–2022	2019–2022	2019–2022
Brandt	37.1	39.4	50.2	52.9	44.7	44.9	−7.0
Shapiro	9.9	18.4	17.3	15.1	15.1	15.2	−3.6
Bargh	166.2	80.0	52.4	119.0	100.0	104.4	−9.7
Sall	121.4	48.6	101.7	273.5	123.1	136.3	−31.0
Dhaliwal	466.0	80.0	50.4	17.2	105.9	153.4	−16.2
Netto	4.4	5.6	53.4	26.9	21.0	22.6	−10.5
Camillo	28.2	356.5	8.4	−52.9	31.5	85.1	−67.1
Parker	15.6	53.7	19.8	−0.4	20.7	22.2	−18.9
Kean	34.1	54.6	23.8	−6.8	24.4	26.4	−16.4
Krejčí	15.0	14.5	9.6	6.9	11.4	11.5	−7.0

* All returns are gross (i.e., returns exclude management and incentive fee deductions in cases where return figures are based on managed accounts). Annual returns include compounding of monthly returns except for accounts traded at constant fixed notional level for the entire year.

** Largest percentage decline from prior equity peak based on month-end data.

Note: The data in this table has not been audited, and insofar as any of the traders included might manage assets other than their own, this data should not be relied upon for any investment decisions.



PART I

FUTURES TRADERS

PETER BRANDT

Strong Opinions, Weakly Held

THREE YEARS LATER

Since our interview several years ago, have there been changes in the way you trade?

I've always been quick to close losing trades, but ever since our interview I have become uber-obsessed with risk management. I have done this in two ways: by reducing my maximum risk per trade to 50 to 60 basis points, and by bleeding off risk as quickly as possible. I've become more aggressive in advancing protective stops on at least half of my position. Stops are often moved the same day of the trade, with the idea of having a breakeven trade on half the position within a few days.

You reference becoming even more extreme in your risk management since our interview. Is this timing coincidental, or was it somehow related to the interview?

If you talk about your trading for an entire day like I did with you, a bit of self-discovery takes place in the process of talking. At some point afterward—I don't remember exactly when—I analyzed my trades going way back. In line with the Pareto principle, I found that almost all my profits came from 15% of my trades. So that means my goal as a trader must be to make sure the other 85% of my trades come as close as possible to a net zero performance, thereby allowing the 15% to put in the bottom line.

But there is a trade-off. If you tighten your risk control to further limit the loss in losing trades, you will also change the percentage of meaningful winning trades. As a result of tighter stops, you would turn some of those winners into losers.

That's true, but I did look at whether there was something behaviorally different about the 15% trades versus the other 85%, and there was.

What was that difference?

The significant winning trades worked immediately. For example, last year, I had 17 trades that contributed to almost my entire bottom line. Fourteen of those 17 trades never had a losing close. The other three had a closing loss for only one or two days. Sure, some of the trades that were stopped out eventually did work. But the 17 significant winners were behaviorally different. They broke out and went. I never had to grind through a losing period with them.

Any other changes in your trading?

One new thing I have started doing—and I have no idea how it's going to work out—is adding a third tranche on those trades that are also triggered by weekly chart patterns. If a trade that is triggered on the daily chart isn't also clear on the weekly chart, then I'll have just two tranches—one tranche that I trade with tighter stops than the other. I give more leeway to the third tranche, which is triggered by the weekly chart, than the other two tranches that characterize my normal trading process.

I am attracted to the idea of using weekly charts to signal trades because I had committed to my wife and kids that I would be done with trading in 2025, the 50-year anniversary of when I first went to the Chicago Board of Trade. But I still want to trade. So my thinking is that if I could switch to trading just on weekly charts, I could continue trading without it interfering with anything else. Rather than suddenly switch from daily to weekly charts in 2025, I am starting to experiment with the idea now to give myself a couple of years to see if I can make trading on weekly charts work—and I am not sure I can.

If I am stepping back my trading activity from daily to weekly, I wouldn't expect a rate of return anywhere near what I average now. But I'd be OK if I could make only 10%–15% a year, not that I ever have a return target because I think that is stupid.

Stupid because you don't know what opportunities the market will provide?

Exactly. As a trader, your goals should be process-oriented, not return-oriented.

I noticed you have built up a large Twitter following. Which of your tweets has gotten the biggest response?

Some of my largest responses have been to tweets with single-sentence trading advice. Some examples: "Don't carry a position over the weekend if it shows a loss on the Friday close." "Don't risk more than 1% of your capital on any trade."

In one of your tweets, you refer to a market being in a "chair-and-ottoman" pattern. Was that a spoof, or were you being serious?

No, it's not a spoof. I first saw the pattern in a sugar chart years ago. I thought to myself, "What the heck is that?" Edwards and Magee, and Schabacker, had nothing to say about that pattern. So, I made up the name myself.

What is a recent example of the chair-and-ottoman pattern?

A recent example was a chair-and-ottoman bottom in gold. The chair was formed between September 28 and October 21 [2022]. The ottoman formed between October 21 and November 4 when gold broke out on the upside of the pattern, which is when I went long. I was bullish on gold anyway.

Why was that?

The bearish sentiment in gold was very high. The Commitment of Traders report showed that at the gold low in late September 2022, commercials had their smallest short position since May 2019, while speculators had their smallest long position since May 2019. Also, there had been large liquidation of long positions in gold ETFs, such as GLD. Retail investors just didn't want to be long gold anymore.

If you could only trade one market, which market would it be?

Eurodollars,* if we're not at a zero interest-rate policy with the Fed. I've always loved the Eurodollar market.

Do you like that market so much because it trends better than most?

It has wonderful trends, and once it starts moving, it tends to continue to move in that direction. I like soybean oil for the same reason. The Japanese yen also sometimes trends very well.

Any mistakes you have made since our last interview that might be instructive?

Yes, there's one that comes to mind that I made very recently. Last week, I bought the five-year T-notes. It was a good buy, meaning I bought the five-year T-notes for a good reason. Then a couple of days later, the Fed came out with a statement that caused the market to turn volatile, and it spooked me. In response, I jammed my stop. I have legitimate rules for moving stops, but this was not one of those cases. I moved my stop up for emotional reasons, not based on any rule I could identify. It was a totally unnecessary action because I had already tightened my stop the first day I was in the trade.

It is much harder dealing with a winning trade than a losing trade. For me, the recipe for handling a losing trade is simple. I don't want to be in it. If it's digging into my pocket, I don't want it to dig any further. But in a winning trade that is not near my target, I sometimes may get spooked out of the trade for some reason.

I was upset by the fact that I reacted emotionally, not by the outcome of the trade. When I look back and say to myself, "What a stupid move," it has nothing to do with whether the trade was profitable. I can make a stupid move and have a profitable trade come out of it, or I could do everything right and end up with a loss. I have more emotional and intellectual satisfaction over a trade that had a loss for which I did things right than over a trade that I accidentally made money out of by being stupid.

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* The Eurodollar futures contract will be replaced with the similar SOFR futures contract in April 2023.

Although I may get upset when I do something wrong, I also recognize that, as a trader, you have to be able to forgive yourself. If you can't, you're in trouble because a mistake can then impact your next trade, which can then affect the trade after that, and so on.

JASON SHAPIRO

The Contrarian

THREE YEARS LATER

Did your methodology catch the 2022 bear market?

Speculators got super long in November 2021. So, I was looking to get short. Then, I specifically remember one of my favorite fades on CNBC, who had been a bear forever—he had been bearish all the way up from the March 2020 bottom—saying, "The Russell has broken out, and I want to get long this breakout." That was the exact top! I am not exaggerating. The market reversed the very next day.

I was surprised to see you start writing a weekly market letter and, more recently, doing YouTube videos. What prompted you to take this more public profile and do this extra work?

After *Unknown Market Wizards* came out, every day, I received multiple requests from people asking me to mentor them. I like the idea of mentoring people, but I don't have the time to do it. I told them there was no way I could mentor hundreds of people. One of them replied, "If there are that many interested people, why don't we start a centralized web page?" He offered to take care of all the mechanics if I wrote the content. I thought that sounded like a good idea. I write a market letter every weekend and have been doing it for 20 years.

Do you mean you were writing a weekly letter just for yourself all those years?

It started as something I would write for myself every weekend to crystallize what I was looking for in the markets. When I worked at a hedge fund, my letter went out to some portfolio managers who seemed to like it. Then when I ran my hedge fund, I sent it out to some clients.

Was your analysis similar to what you do now for the newsletter?

It was exactly what I do now. So, I figured that if this guy was willing to set up a web page and all I had to do was give him the weekly letter that I was writing anyway, I might as well try it and see what happens.

I assume your partner handles the business end as well?

Yes, he does everything except write the content. We split the subscription revenue 50/50. Just for the record, my half goes to a local charity. So I'm not making any money personally off of this thing.

I watched some of your recent videos. I noticed you thought this bear market was different from past bear markets. Do you want to expound on that thought?

I believe that we are in for a very long bear market. Probably the most important statistic is that we had more money flow into the stock market during 2021 than in the 20 prior years combined. So, you had massive amounts of retail money flow into the market. And to me, this is not money that will earn a positive return over time. I get it. People have been conditioned that buying on market weakness is what you do. They didn't do it in 2002 when they should have. They didn't do it in 2008 when they should have. And now, they have learned their lesson. The market rebounded in those past years because retail investors didn't buy. The market is not going to rebound this time because they are buying.

The government printing money and using it to buy its debt is just one giant Ponzi scheme. There is a limit to everything, including the amount of money the government can print. I don't know what the limit is, but the market will tell us.

Is there a historical analog to the current situation?

I would say the closest analog is Japan 1989 forward. The Japanese stock market peaked in 1989, and here we are over 30 years later, and the Japanese equity index still hasn't recovered to the 1989 high.

Does your long-term bearish view affect the way you trade the markets now?

No, because I am not a fundamental macro trader. I trade a process. That is what I do. What I have sold to my investors is a non-correlated return stream. That is what my process produces, which is why they have given me money. That commitment keeps me disciplined in following my process.

When the S&P goes from a high of over 4300 in mid-August to a low near 3500 six weeks later, and I am not short, even though I am Mr. Bear, does that piss me off? No, it doesn't. The trade didn't fit my process. I won't catch every swing, but I will catch the bear move somewhere. I know that because I believe in my approach and am disciplined in my process. But I won't chase a trade because I am bearish on the stock market, and the market is going down, and I'm not in it.

You have some strong opinions about day trading. Can you explain your view?

I see it all the time; people want to day trade. I think it's the worst type of trading you can do. I have known hundreds of people who tried to be day traders; out of all of them, I know only one who is still doing it. The shorter the time frame, the more random the market. Why would you want to operate in the most random time period?

When you did your video on day trading, did you get pushback from people saying that they were day traders and profitable?

Of course. I got comments like, "You don't know how to day trade." "Stick to talking about what you know." "I made a ton of money day trading." I know lots of people who made money day trading—for a while. In the end, though, they're not trading anymore. Lots of people started day trading after Covid. They would buy a bunch of stocks in the morning, the market would go up, and then they would sell at the end of the day. That worked great in a bull market. They never had to sell at a loss because if a stock went against them, all they had to do was hold, and it always came back. But then the market stopped going up, and rather than sell, they just held, which is what they had learned to do. Now, they are sitting on stocks that are down 70% or 80%. Suddenly they are not day trading anymore; they are "investing."

What advice do you give traders?

The three most important things to succeed in trading are patience—the ability to wait for the right trade rather than feeling you have to trade all the time—discipline, and risk management. I recently heard a great quote by Caroline Ellison [the CEO of Alameda Research, the trading firm affiliated with the FTX crypto exchange and allegedly instrumental in its spectacular collapse]. She said, "stop losses are a horrible risk management tool." [Shapiro laughs loudly.] I love it!

RICHARD BARGH

The Importance of Mindset

THREE YEARS LATER

With the advent of Covid and, more recently, the re-emergence of inflation, we've had some eventful markets since our original interview. How has your trading fared during the past three years?

I was up around 50% in both 2020 and 2021. This year [2022], I had an amazing start. I was up about 100% through May, and then everything unraveled. I'm still trying to figure out what went wrong. I think part of the problem was that because there was so much going on, I spent more time than usual at my desk and not enough time away from it. During the first half of the year, I was forced to take time off from trading because I was attempting to pass my motorcycle test, which I kept failing. I failed four times before I finally passed. Training to pass the test forced me to take lots of breaks from trading.

When you say, "everything unraveled," what kind of results are we talking about? Did you give back a significant portion of your profits earlier in the year?

No, I'm up about 10% since May.

I was confused by your negative tone. You have a triple-digit year going. Most traders would be thrilled by that.

It may sound silly to say that I've had a bad time when I'm up 10%, but I measure my performance relative to the opportunity set. There's been just as much opportunity in the second half of the year as there was in the first half. I set high standards for myself. I'm aiming for consistency in my performance.

It sounds like you have a distorted image of your performance. You had a spectacular early part of the year, and you are still net positive for the remainder of the year. You are being way too hard on yourself.

If you're a long-only equity trader, you will be down this year. But I'm an event trader, and the events have been bountiful this year. I'm disappointed with the way the year ended. If this were a more stable year without many events to trade, then maybe I would feel differently. But this has been a year with a lot of opportunity, and to succeed as a trader, you have to capitalize sufficiently when the opportunities are there.

Over the last few years, have there been any trades that were major contributors to your performance?

Not really, almost all my winning trades have been under 10%.

So, unlike the earlier years in your career when you had quite a significant number of giant winning trades, your performance in recent years has been more a consequence of a lot of moderate gains.

I keep reminding myself that I don't need to knock it out of the park on every trade. In some ways, it's better to make just a little bit on a trade.

Does that mean you are trading a smaller position size relative to your account size than you were in your earlier years?

Absolutely, and as a result, my drawdowns are also smaller. My last significant drawdown was 7% in March 2020. I wanted to reduce my volatility because I felt like a lot of my drawdowns were, in some sense, self-sabotage. Sometimes, I would get too confident, take too large of a position at the wrong moment, and then take a big loss. Then I would feel underconfident for the next series of trades, which would have been quite profitable. I'm quite proud that I have avoided repeating those situations.

Was the March 2020 drawdown primarily due to a single event?

It was. In response to Covid, the Fed announced a quantitative easing program on a Sunday, and I wanted to go long on the news. Buying the open after a weekend event is always risky because the market will usually discount the event on the open. But I was banking on additional upside momentum after the open because many people were still quite unsure of the market. Also, the Fed announcement came only a few hours before the

Sunday evening market open, so I thought the information might not have gotten through to enough market players to be fully discounted on the open. My strategy was to buy the S&P on the open with a tight stop. This trade occurred in the final week of the March contract before expiration, when most open contracts are rolled into the subsequent June contract. I was aware of the approaching expiration but thought there would still be sufficient volume in the March contract so that it didn't make a difference which contract I bought. I went long the March contract on the higher open. It immediately reversed, locking limit down, and I couldn't get out. I liquidated as soon as trading resumed, but by that time, I had a 6% or 7% loss on the trade.

Was it just the March contract that stopped trading?

That is the frustrating part. Trading wasn't suspended in the June contract. If I had been in the June contract instead of the March contract, I would have lost only about 1% on the trade.

When we initially spoke, you were in a transition incorporating technically oriented trades that you held longer than your event trades, which you entered and exited on the same day. Have you continued in that vein?

It's still a work in progress.

How have the technically based trades done?

Let me check. They were: 19% in 2019, 18% in 2020, flat in 2021, and 14% in 2022.

It sounds like it is still a minor component of your trading.

I guess you could call it minor in terms of P&L, but it's major in terms of its psychological impact. In event trading, you can go through periods where nothing is happening, which can be quite boring. During such times, it's nice to have another strategy to keep me busy.

Does having this technical strategy to keep you busy help prevent you from taking suboptimal trades when event trading opportunities are sparse?

Maybe a little bit, but I have worked hard over the years to become more disciplined and wean out those suboptimal trades. I'm much more comfortable with knowing what my edge is in event-driven trading, and

I'm good at not trading when I don't think there is an edge. I'm still trying to work out what my edge is on the technical side. The main benefit I have received from technical trading is that it has gotten me used to riding winners over weeks, and even months, which I never did before.

At times, I try to combine my event and technical trading. For example, earlier this year [2022], I was bearish the S&P and looking for a place to sell. The S&P rallied a bit, and it looked like it was at a good spot to sell on the chart. At the same time, there was a slightly hawkish statement by Lael Brainard, the Fed vice chair. By itself, this event was not sufficient to take a trade. But given the technical setup, I used the statement as a trigger for the trade. I went short with a stop at the day's high. I risked only about 13 basis points on the trade. I held that trade and ended up making over 600 basis points. So, it was a nearly 50-to-1 trade.

It sounds like you take much smaller positions on your technical trades than on your event trades.

Yes, purposely so, because I'm not anywhere near as comfortable with my edge in technical trades as I am in my event trades.

By what factor does the size of your event trades exceed the size of your technical trades?

I risk ½% on my technical trades. The risk on my event trades is far more variable, ranging from ¼% to 5%, depending on my conviction on the trade.

On the technical side, is there any pattern or event you particularly like?

My favorite trades are when markets move from periods of low volatility to high volatility. If you're in a low volatility regime, then the distance to your stop can be much smaller, and your lot size much larger, relative to a higher volatility regime. So, if the market moves from low volatility to high volatility, it provides a highly asymmetric risk/reward ratio—the potential gain far exceeds the required risk because of the increasing volatility. If the market is super volatile, then your stop will be about as wide as your target, and your risk will be about the same as your profit. The perfect environment for me is when the markets are quiet, and traders switch off because they are bored by the lack of volatility, but then there's an increase in volatility. The volatility increase could be triggered by prices moving out of a consolidation area or an event that shakes things up, such as Covid or Russia invading Ukraine.

Anything else that is particularly important on the technical side?

You always want to be aligned with the dominant trend.

AMRIT SALL

The Unicorn Sniper

THREE YEARS LATER

The last time we spoke, you were planning to take time off from trading with the birth of your son.

Yes, I decided to take some time out to spend with my newborn son, Reuben, and reassess what I wanted to do with my career. That break lasted for about three months, and then I got the itch to get back to trading as a lot was going on.

Did that period of reassessment lead to any changes?

I built a team around me, mostly because I thought the markets would be attractive for event trading for the foreseeable future. We were getting a combination of both fiscal and monetary stimulus. If there was ever a time when there was going to be inflation, it's when you send money straight into people's bank accounts. It felt like only the beginning of a favorable environment for the sort of trades I was good at. So, I decided to take on a very smart trader I had previously worked with—his name is Ray—as a full-time analyst, and I also hired a more junior researcher. I was looking at how I might be able to scale some of the strategies I already used. Now, I can sometimes run positions into events, whereas before, I mainly reacted to events. We also did a deep dive into using options in trades, whereas previously, I had just traded futures.

Has your methodology changed to hold positions longer instead of being almost totally focused on the events themselves with an exit on the same day?

I will now hold some positions longer, for weeks and even months.

Was the inflation wave you saw coming the catalyst for that change?

It was. The central banks at that point were still easing, even though inflation was picking up. It just screamed policy excess. You knew that inflation would likely not be transitory, which would create havoc. Then, the central banks would have to pull back easing and overdo it the other way, which would probably crash the economy or trigger a credit event, forcing a potential policy pivot. My support team and I developed proprietary leading indicators and pricing models for certain asset classes. It's all coming together now so that I can hold positions for more extended time frames based on the most probable outcome indicated by my models. I use events to get short-term leverage on my positions if those events validate my long-term view. If the event trade runs counter to my longer-term position, I will use the event trade to hedge or overhedge my exposure.

Does that imply that you keep your longer-term position even in the face of an adverse event?

It would depend on the event catalyst. If I think it was just a short-term catalyst, then I'll trade the event and keep the longer-term trade on. But if the catalyst was a fundamental shift, then I'd liquidate, and possibly even reverse, the position.

Was there a specific trade opportunity that enticed you back into the market when you were taking a break following the birth of your son?

It was a simple information arbitrage trade in June 2020. Covid news was moving the markets then, so you could trade headlines. Florida reported their Covid cases daily, and their announcements were moving the market. We figured out that you could get that information before it was reported by the newswire services by retrieving data directly from the Florida website. It was market-moving information in the public domain, and I got it two or three minutes before Bloomberg reported it. That information edge allowed me to put on a leveraged position and sit with it for a few minutes until it hit the screens. That type of opportunity doesn't happen very often. But, because the whole situation was new, you could do this type of trade then.

What would be an example of another similar trade?

Ray had set up screen scrapes and alerts on the SEC website because there were rumors that Elon Musk would buy Bitcoin with Tesla money. One day, when I was out of the office, I got a call from Ray. He said, "Tesla bought Bitcoin. It's in their filing, and it's not on the wires yet." Although I already had a long-term Bitcoin position based on my macro analysis, I could have greatly increased my leverage on Bitcoin on this news, but I didn't place the trade because I was not at my desk.

Why couldn't you place the trade on your cell phone?

I need to be at my desk to trade. I'm not comfortable placing trades on the phone. The news hit the market only a few minutes later, and Bitcoin repriced miles higher within a few minutes.

How long did it take to get back to your desk?

About 40 minutes. By then, the primary opportunity was gone. It could have been a big trade. I reconsidered the situation. I felt like the market still had further to go but in a move that would play out over days, not minutes. We had done a lot of work on all markets on price distributions after events. So, I had some idea of what type of price response to expect from different event triggers. It was a time of peak FOMO bullishness in the crypto markets because of all the unprecedented monetary easing. The news that Tesla bought Bitcoin seemed like an event that would set the trend for a while. So, I put on the trade in smaller size and made 10%–15% over the next week.

Is there any trade that is particularly noteworthy since our original interview?

One trade that comes to mind was a short in the BTP [the Italian government bond futures contract]. BTP yields had moved up above 4% for the first time since 2014. The ECB announced an emergency meeting, which doesn't happen very often. The market was expecting the ECB would take actions to cap yields, and the BTP quickly shot up from 114 to 117.5. This move up was an easy trade, but I missed it because I was on my way into the office.

I thought that unless the ECB announced actual policy measures at the meeting, the move was overdone. When the meeting outcome was reported, it seemed apparent that the ECB hadn't agreed to any concrete policy action and instead just issued a wishy-washy statement to calm the markets. I immediately went short. The second I did, the market took off again. I asked Ray, "Have I missed something?" Ray had read the transcript and confirmed they hadn't taken any action.

I was heavily short with a position that was a mile offside. But I was still sure I was right on the trade. Because I was in a calm state, I was able to stay rational, and I didn't get out. Then, at the point of maximum pain, the market cracked and kept moving lower and lower. I had a really good day. But the line between success and failure on that trade was so thin that if I weren't in a calm state of mind, I definitely would have stopped myself out at the top and had a big down day.

This trade was a perfect illustration of the importance of mindset in trading. Event trading is different from other trading strategies; it's almost like playing a professional sport. You have to be so present in that moment. There is so much information coming at you, so many variables you don't control, and yet you have to be in this state of equanimity where time slows down. You're as calm as you can be. If you're in a fight-or-flight state, you won't be able to make the best rational decision.

How large was your open loss on that trade at its worst point?

It was about 10% of my equity.

Do any other major trades come to mind since our interview a few years ago?

There was one last month following the release of the U.S. November [2022] CPI report. The report showed a 0.2 drop in the year-over-year core CPI year and a 0.2 drop in the year-over-year headline CPI, at a time when many were still expecting a higher inflation print. So, the report was a complete shock. Based on work we had done looking at price moves after different categories of events, I felt there was a high probability that the CPI report would result in a maximum price move. However, because of the market's increased volatility, I had to give up three times as much as usual to get into the trade.

What was the trade you did?

I went long Euro Stoxx 50 futures because the S&P is subject to volatility-based trading halts, which makes it inappropriate for my type of event trading.

What exactly do you mean when you say, "give up three times as much as usual to get into the trade"?

Because of the market's increased volatility, the difference between the market price at the time of the data release and the price where my buy order would get executed was much wider than normal. Most traders would be unwilling to give up as much as was needed to get into the trade. But I was willing to do it because I felt the probability of success was high.

So, this was a trade where you went long as soon as you saw the reported number.

Yes, it was the purest form of event trading: You wait for the catalyst and then go with it. It is a difficult trade to do because the market responds to the reported number almost instantaneously. Nine out of ten times, by the time you can get filled in the trade, the new information has been fully discounted. But sometimes, the profit opportunity is still there.

Why did you have such a high conviction on this trade?

My pre-trade analysis indicated that the same higher volatility that made it necessary to give up more to get into the trade would result in a bigger price move and a larger payout on the trade as well. It was also a time when I was running hot. As a trader, you need to be aware when the market conditions are aligned with your running hot. That's where the magic happens. That's where you get paid to take risk.

You can only take on a lot of leverage when you have a very high conviction on the timing, and events offer that opportunity. If a catalyst is good enough to make it very likely that you will get an anticipated market move at that moment, you can use maximum leverage. Whereas if you have a three-month or a six-month view, you can't take remotely the same leverage because the timing is uncertain.

How big of a day was that CPI trade?

It was about 40% profit day. After this large win, though, I quickly fell into a big drawdown—big for me, that is, about 10%. My more significant drawdowns often follow big winning periods. Sometimes, it's the result of misguided overconfidence, and the market will quickly humble you. Other times, it's because the tide has turned; you stop running hot, and valid trades lead to a series of back-to-back losses. Over the years, I've tried to limit any leakage, but it's impossible to eliminate entirely. Drawdowns can be frustrating and, if left unchecked, can trigger a self-reinforcing spiral that leads to poor decision-making, compounding the situation and affecting your most valuable asset: your emotional capital.

My feelings about drawdowns are drastically different now than when I first began trading. Now, I accept that being in a drawdown is the natural state of a trader. You spend most of your time underwater just like a shark; you're an apex predictor coming up occasionally for a big meal. It's very difficult to succeed at event-based trading if you adopt a hunter-gatherer mentality, trying to find small, consistent wins to keep you alive.

This perspective on drawdowns allows me to be in the right mindset when the unicorn trade arrives. In the past, I may have had low confidence and been timid in my approach coming out of a drawdown. But now, just like the shark, I'm always ready for the next big meal. An apex predator knows nothing else; timidness is not part of its nature.

This drawdown was fairly recent. Was there any unicorn trade since then that allowed you to recover?

There was. I entered the drawdown after the CPI trade on November 10 [2022]. I exited the drawdown on the ECB rate announcement on December 15. The ECB surprised markets with a notable hawkish shift. At the rate announcement, a lot of information is published all at once, which often leads to volatility on the release. I quickly noticed that the ECB language regarding rate hikes, which included such terms as "significantly further" and "sufficiently restrictive," signaled a marked change from its previous month's statement. The ECB was telling the market that rates were too low and much more work was needed to bring inflation back down to its target. Also, inflation projections were very high.

I sold the German 10-year Bund and the Euro Stoxx 50, taking maximum risk. There was some initial volatility to sit through as the market tried to digest all the information that poured out on the announcement. Both markets went the wrong way initially. But I knew it was a hawkish shift, and I could handle the downside risk of the trade. I expected that, soon enough, the market would reconnect to the fundamentals and reverse lower. The Bund started moving lower soon afterward, but the Euro Stoxx 50 took some time. I was patient, and eventually, the Euro Stoxx turned down as well. It's difficult when a leveraged position instantly goes offside, but certain events come with added volatility risk, which you need to incorporate into how you manage a trade.

The ECB press conference was due to begin 30 minutes after the rate announcement. Based on all the information I had, I felt the only possible outcome would be further hawkish rhetoric from Christine Lagarde [President of the European Central Bank]. The Bund had rebounded off its low on profit-taking going into the press conference. I decided to double down on my short position and hold it into the press conference rather than trying to hit hawkish rhetoric later. I expected other traders would be waiting for the press conference to act, leading to a lot of volatility on every word Lagarde spoke. So, I wanted to be positioned ahead of that. This secondary trade worked out great. As expected, the market sold off into the press conference, and I was pre-positioned for all the hawkish rhetoric to come, and insulated from any short-term volatility against my position.

There was a final trade that represented good risk/reward for me. At the press conference, Lagarde said, *"Our staff projections that embed and incorporate the market expectations of our terminal rate, do not certainly allow a return to the 2% inflation target that we have in a timely manner. So more needs to be done, and as a result, new market expectations will, hopefully, be embedded in future staff projections."* She was telling us the implied market rate was too low and needed to be higher. It was the type of news headline that I knew would accelerate the market downmove. I was still short the Bund and it had already sold off a lot. So, I went short the Schatz [German 2-year note].

I took partial profits when the various markets approached the maximum price moves I expected for a day like that. I scaled out of more of the position in the ensuing few days. I still hold a portion of my Euro Stoxx 50 short position because our research suggests further downside in the stock market. If my target is reached on that final partial position, the total return for the trades I implemented on the ECB announcement day would be over 100%.

DALJIT DHALIWAL

Know Your Edge

THREE YEARS LATER

I understand you started managing money this year. How has that gone?

It has gone well, but it has also been a learning experience. I discovered a difference in how I managed risk versus an institutional investor's view of risk. I never looked at my NAV [net asset value] because it included open profits. I never considered open profits as my money until I closed the trade and took money off the table. I didn't care too much if there was a big downside variance in my open P&L because my risk was always fixed. I had my stops in place, and I knew my worst case in getting out. I always thought of risk control in terms of adverse price movement from my entry level, not the surrender of open gains.

There was a Fed meeting in May 2022. I thought the Eurodollars were oversold and that the market had already more than priced in any potential hikes by the Fed. I was long Eurodollars in size going into that meeting. The market took the Fed comments as being hawkish, whereas I thought they were dovish. I was up quite a bit on the trade by that time, and I didn't want to get out. The market moved lower, and by the next morning, my NAV was down over 3%. My risk protocol says I should get out once I am down more than 2%, which institutional money defines as a decline from peak equity. As I explained, I never looked at it that way when trading my own money. So, I wanted to stay long Eurodollars. It was a tough call, but I got out at a price that proved to be near the day's low. Then, throughout May and into June, Eurodollars rallied to my original target. It would have been my most profitable trade of the year. That was a frustrating experience for me.

So, you only got out of the trade because you were managing money?

Yes. I felt obligated to adhere to the risk guidelines I had told the investor.

Is the fact that your daily loss could be due to a surrender of open profits something you didn't think about when you told the investor your protocol?

Yes, that's right.

Did that episode prompt you to change anything in the way in which you communicate to investors?

Yes, I spoke to the investing firm, and they were more than happy for me to take the additional variance as long as I was OK with it. But before having that conversation, I wanted to stick to our risk guidelines, especially in a year when the markets have been so volatile. Otherwise, things are going OK, although 2022 has probably been my worst year ever.

Are you down for the year?

I'm still up about 18%.

I think in 2022 in particular, many traders would be happy with your "worst year." True to form, you have had some double-digit winning months since our last interview. Any trades that were instrumental to these big winning months?

Coming into January 2021, Covid was still raging in the U.S. We got some news from Johnson & Johnson about their vaccine. Although the headline data wasn't great, more importantly, the data around deaths was very encouraging. The vaccines were never about stopping people from getting Covid; they were about preventing people from dying, which many people still didn't understand. The equity markets had a negative reaction to the news. I thought people were overestimating the lingering effects of Covid and were way too bearish about the outlook. I went long S&P futures and short T-note futures, anticipating a pickup in growth and inflation. February 2021 was my best month that year.

Any mistakes you have learned from during the past few years?

My biggest frustration this year has been going for home runs and being unable to sustain the trades because my size was too large, and my stops were too tight. The lesson here is that I need to size my trades to account for their potential duration and volatility. I also need to trade more around my positions and take profits off the table when I get them, which is what I've been doing for the last few months.

By taking profits off the table, do you mean taking partial profits?

Yes.

Is the implication that if you took some initial profits out of a position, you'd have more staying power for the rest of the position?

Yes, exactly.

JOHN NETTO

Monday Is My Favorite Day

THREE YEARS LATER

Any trades that were particularly noteworthy during the last few years?

The big trade for me was crypto in 2021, which provided one of the best trading opportunities I've seen in the last 15 years. It was a special trending market you don't get many times in your career. You could ride that wave until you were done riding it. You could buy every pullback until crypto unraveled in November 2021.

How long have you been trading crypto?

I started trading crypto futures to make up a material part of my trading in 2020.

What made you so bullish on crypto at the time?

There was an institutional allocation shift taking place. Crypto was becoming more mainstream, and there was an underallocation to it. Also, I had seen this type of market froth before. As long as you had zero interest rates and an influx of liquidity, bellwether crypto coins like Bitcoin and Ethereum, which are traded as futures, would be beneficiaries. If you understood the fundamental asset allocation that was taking place and the risk-on environment that was lifting all boats, you could step in and buy the dips. I knew it was a game of musical chairs and that, at some point, the music would stop—but in the meantime, you could trade it. It was going to work until it didn't. When it stopped working, I got stopped out.

You were buying the market on pullbacks. Did you then get out on rallies?

Yes, absolutely. I only held the trade for a few days, sometimes as little as 12 to 24 hours. Oftentimes, I would even get up every few hours at night to check the market.

How did you time your trades?

There's an intuitive feel you develop after decades of doing this. At some point, you get a sense that the sellers have exhausted themselves, and the low is probably in. I'm going to buy here. I'm going to set my stop here and my target here. It wasn't much more complicated than that.

How did you know when the game was over?

You never know anything.

OK, how did you know the game was probably over?

The Fed made a dramatic shift in November 2021 when they went from saying that inflation is transitory to acknowledging inflation is a big problem. That was a major sea change, and in the weeks afterward, the dips weren't bouncing as they had before. I wish I could tell you I stopped buying the dips at the highs, but I still made some losing attempts from the long side after that point. By the beginning of 2022, it was clear that the trade wasn't working anymore, and I haven't bought Bitcoin since then.

Were there any other trading themes that were important in recent years?

Yes, trading on CPI release days. For context, two years ago, on a day when the CPI price index was released, the one-day S&P straddle would trade at 20 to 25 points. The CPI simply didn't move the market. During the second half of 2022, the same straddle would trade around 70–75 points on days when the CPI was released. If the one-day straddle in a market is three times the price it was two years ago, and you have an automated way to get into that market, you can probably do pretty well because the market is going to be very responsive to that CPI number.

Are you anticipating what the CPI will be, or are you responding to the number after it is released?

I create both bullish and bearish scenarios around what the CPI could be.

Which markets were you trading on that CPI release?

All of them: currencies, fixed income, equity indexes, and precious metals.

How are you determining what CPI levels translate to what market levels?

I'm aware of what the general market expectations are. You need to understand what the narrative is: which result hurts the market, and which result helps the market; what number will give you a protracted rally, and what number will give you a big selloff.

So, you create scenarios for each possible level of the CPI reported, and then your software automatically executes the trade when the number is released.

Yes, exactly.

PART II

STOCK TRADERS

JEFFREY NEUMANN

Penny Wise, Dollar Wise

THREE YEARS LATER

So, you've had quite a ride in the last few years.

It was wild.

The last time we spoke, I believe you had quintupled your career winnings from what they were at the time of our original interview.

Actually, it was more than that.

That's incredible. What were some of the trades behind these phenomenal gains?

I watch the news for a living. It all began when I saw the initial reports of a coronavirus outbreak in China. I went to a CVS to buy some masks and couldn't find any. When I asked for them, the clerk laughed at me and said, "We don't have any, and we're not going to get any." Then I went to a Walgreens, and they said, "We might have them in a few months, but you can keep checking every day." I had traded through swine flu and bird flu and was familiar with the type of market plays these situations provided. I went home and bought a large stake in Alpha Pro Tech (symbol: APT), a small-cap mask maker. I smashed it. The stock went ballistic, shooting up from $4 to $40 in 10 days. That trade started it all.

The next big play came when my son wanted to deliver a package to the neighbors using a drone. There was only one pure-play, publicly traded drone company, a small cap trading at around 50 cents. I bought it, and in about 10 days, it went to $5.

I never traded the dot-com bubble, but I felt like this was my dot-com moment. Robin Hood and free trading, everyone being home, stimulus checks, and WallStreetBets building its swagger all coincided, and it was game on. I couldn't have made more trades in a day. I was working 10-hour days, building on a 20-year skill set in a once-in-a-generation moment. Every day, it felt like I was a step ahead of everyone else, and I was. I monitored my volume scanner to focus on the right sectors.

Is looking for volume surges one of the main elements in your trading approach?

It is. I have a customized scanner at the bottom of my screen where I can select my tickers and my volume size requirements. There has to be a large enough volume increase in a stock on my scanner to trigger a signal. I sit there all day and watch the order flow to see which sector is getting lit up and then join in.

Were you then getting some of your trade ideas from WallStreetBets?

[WallStreetBets is a forum on Reddit (a "subreddit") whose participants focus on trading-related posts. It became famous when its members piled into stocks cited as heavily shorted, such as GameStop, sparking soaring prices and historic short squeezes.]

I used this neat Reddit crawling tool, which indicated the frequency of specific stock posts on WallStreetBets. Of course, Tesla was frequently number one, and GameStop was number one for a while. I focused on stocks that went on the top-25 list. If a stock went from 25 to the top 10, the price would go parabolic. So, I was watching the trends of the stocks on this list, checking it every minute. The power that group of people had on the market was ridiculous; they could move any stock they wanted for any reason. Although I did very well on these trades, I missed the biggest one. I had a ton of GameStop at $10 but sold it at $11. And then, it went to $500. I never traded it again. I don't know why I sold it so early, but I reacted by unleashing on every other stock that was moving on WallStreetBets. Of course, none of them had the success of GameStop, but many had 5× to 10× moves.

How did you know when to bail out of these trades, as they were stocks that were being pushed far beyond any fundamentally justified price levels by speculative buying?

Getting out is by far the worst aspect of my trading. I consider myself a poor seller of stocks. I take large positions, and when a stock has doubled or tripled, and the risk/reward has changed, I start scaling out of my position. Once I start selling a position, I just can't stop.

What other trades were responsible for your big gains?

I did well with Covid, but SPACs were career-changing for me.

[A SPAC, an abbreviation for a special purpose acquisition company, is a public company that raises capital for the express purpose of acquiring a target private company, which is not identified, and taking it public. The original investors in a SPAC receive shares, typically priced at $10, and warrants. Once a deal with an acquisition target is announced, these investors have the option of withdrawing their investment and receiving their money back.]

It was a once-in-a-generation moment. You could buy a company with almost zero risk because you could opt to get your money back at nearly the same price. I noticed a pattern where there would be a huge volume spike, usually in the last two minutes of the day, and the next day these companies would announce who they were partnering with. After the announcement, the stock would go up to $20 or even $30. And, if it was a poor partner, maybe only $15. So your upside was 2X or more, and your downside was a few cents per share. And SPACs had virtually unlimited liquidity at just over $10, so you could size up to any level you wanted. I had massive positions in lots of these SPACs. There were several months when virtually every day one of these SPAC positions was hitting, and I was making $3 million, or $5 million, or $7 million on a single trade. There were two profit opportunity days in SPACs: the day they announced a partner and the day when the ticker symbol changed, usually a couple of months later.

Would you sell your position on these days?

Yeah, I would sell on the initial pop after the partner was announced, and if I got back in on a subsequent dip, I would sell on the symbol change. If I liked the stock, I might hold part of the position longer.

The economic structure of SPACs, though, is a bad deal for investors. [A critical negative aspect is that the 20% promotion fee typically given to the SPAC founder effectively dilutes the value of the shares investors receive.]

I agree. I haven't played SPACs for a long time. It was just a moment in time that will live with me forever. I will always be looking for another zero-risk, unlimited-gain opportunity.

What major trading theme came after SPACs?

Cryptocurrencies were having insane run-ups, just like small caps had a year earlier. At one point, my crypto trading was actually larger than my equity trading.

As we speak, cryptocurrencies are down 80% or more, depending on the currency. How do you know when the game is over?

Do you remember those trendlines we talked about in our original interview? When Elon Musk came out and said Tesla would no longer accept Bitcoin for car purchases because of the negative environmental impact of Bitcoin mining, it coincided perfectly with the breaking of that trendline. I had been all in on crypto, and here was this significant warning sign. That is when I cut back my crypto exposure in a big way. Again, when I start selling something, I don't stop.

I remember from our original interview that you never go short. Yet, in the past few years, we've had two bear markets: the Covid bear market and the more prolonged bear market this year [2022]. How do you avoid getting hurt in such adverse market environments?

Well, the Covid bear market only lasted for about a month. I saw the news and could see where things were going. So, I liquidated everything and just played golf every day.

When did you begin trading again? What told you that the bear market was over?

It was the price action in the stocks that offered solutions to the problems Covid created. When the vaccine makers started acting super strong, it clicked that I had to get into stocks that could help deal with Covid. I bought vaccine makers, mask and thermal camera manufacturers, and drone delivery companies.

How about the 2022 bear market, which has lasted much longer and may still not be over? How did you avoid significant losses during this period?

Well, I am down this year, which doesn't surprise me. After the previous incredible two years, I would expect to be down at some point. That said, I am down only a couple of percent.

Were you trading more lightly in 2022?

I probably made as many trades on an average day in 2020 as in the entire first half year of 2022.

Was there a reason for your drastically reduced trading activity?

I earned it. I took time off to spend with my family and travel.

Was it just that, or was it because you perceived market conditions were less favorable?

I had done so well for so long. My friends who were newbies weren't texting me anymore. They were losing. I wasn't making any money. It was just a perfect time to walk away. I took a break until August of this year [2022] when lithium prices broke out to multiyear highs and went parabolic. This price action got me super motivated. I am incredibly bullish on lithium equities for the next few years and think it's going to be the price move of my career. There is a once-in-a-lifetime demand/supply imbalance that is starting, which has allowed the price of lithium to defy gravity. We are seeing a massive increase in EV penetration globally. This year, China is expecting 100% year-over-year growth in EV sales. Next year, they are expecting 100% growth again. US EV sales are running about 60% higher than last year, and the trend is strengthening. Lithium prices have increased tremendously, while lithium equity prices have not increased that much. So, I think there is a massive opportunity in lithium equities traded on

American exchanges. It is such a small sector that when these stocks go into play, I believe they will go far beyond what anyone could fathom.

You have had this idea for a long time. What has changed?

The change is the rise in lithium prices. A year ago, lithium prices were already high at $20,000 a ton. They recently went to $85,000. My playbook is to be heavily long lithium miners for the next three years, then roll the proceeds into solid-state battery companies, and then several years later roll my investment into recyclers, riding what I anticipate will be a giant electrification trend. I feel in my bones that this will be the biggest trade of my life, and I am all in.

CHRIS CAMILLO

Neither

THREE YEARS LATER

How is it going?

I'm trying to survive. It's been a wild, wild year.

Has 2022 been your toughest year?

Oh, by far. Nothing has come even remotely close. As you might remember, my methodology involves identifying change, whether it is consumer behavior, cultural shifts, or trending products, and recognizing that change early. For this methodology to work, you need a stable market. You don't want macroeconomic factors to become more important than the company-specific information you are trading on. This year is my worst nightmare. The market is being driven by macro events, which are far outside my area of expertise. This is the year for me to be trading less. I've been trying hard not to do a lot this year.

What kind of macro events are you referring to?

Supply chain issues that might prevent companies from being able to produce enough product even if they have excess demand. Also, inflation, which can increase a company's labor and input costs and negatively impact its earnings even if revenues are up. I could be right about a company having abnormal demand for its product that the market can't see, but what I might not see is that the company's inability to manufacture sufficient product that quarter could negate my entire thesis. There is a situation where I did my job and have an edge, but I don't see things that are more important than the edge I have, and my trade doesn't work.

Can you give me an example?

ON Holding [symbol: ONON], which makes running shoes, reported earnings today [November 16, 2022]. I anticipated that they would have the biggest sales quarter in the company's history and were likely to raise sales guidance. Typically, when I expect a company to crush the quarter and increase sales guidance, I would place a very large bet. The bet I placed on that company before today's earnings release was probably less than 5% of the position I usually would have had. The company did great on revenues and raised the revenue estimate for the next quarter. But due to the impact of inflation on product cost and their inability to produce as much product as they wanted because of supply issues, they missed earnings. I knew there was a real risk of that happening, so I placed a small bet. What has been critical for me this year is understanding I don't know what I don't know.

What I do requires that information will be correlated to investors' perception of a company's value. When that ceases to be the case, it doesn't matter how good my information is. It doesn't matter how early I can detect change because that change impacting customer demand is not the essential thing that is happening to that company. The most important thing for that company might be that they can't make enough of their product or that the cost of their product has gone up quicker than their ability to raise retail prices.

You have to come to terms with the fact that the thing you do well might not matter at a given time. That is something a lot of traders have trouble accepting. They always want to believe that they can do something better than anyone else in any environment.

You responded correctly to a challenging environment by drastically cutting your trading size. Given that, are there any trades that had a significant negative impact on your equity this past year?

If there is one thing that I wish I had done differently this year, it is how I managed my position in Amazon. Amazon was a multiyear trade. As you know, most of my trades last weeks or months, not years. Amazon was a super-cycle trade that the market never appreciated until one day it woke up and realized that cloud computing is everything. I had millions of profits in that trade, and I decided I wouldn't exit the position because I didn't want to take the tax hit. Amazon is down 55% or 60% this year, and this legacy position is the most significant negative contributor to my account this year. I obviously would have been better off taking the 23% tax hit.

So, if it weren't for the tax consideration, you would have been out of the position.

Oh, of course.

Well, then, there is another way of looking at it. Maybe the tax consideration also kept you in for a good part of the advance before Amazon reached its high. You probably would have gotten out well before the ultimate high.

That's fair. You're right.

What was your trading experience during the Covid bear market?

It was exhilarating. I felt that everything I had ever done had prepared me for what happened in 2020. It was the biggest year of my life. I made over $20 million in profits on an account that started the year near $7 million. It all started with Covid, or the coronavirus, which was what it was called then. The second I got the first word of the coronavirus in China, I started translating Chinese blogs and newspapers into English. It didn't take long for me to see that something big was happening. I was so confused because it seemed inevitable that this virus brewing in China would become a global pandemic. It was clear to anyone who understood how viruses work that this outcome was unavoidable. And I thought that the degree to which the coronavirus did damage almost didn't matter because the threat of it alone would be catastrophic for global markets. I was looking at what appeared to be the most severe global threat in my life. It was a train that couldn't be stopped. I could not understand why global markets weren't reacting to it.

How did you first learn of the coronavirus?

It was a story you could find that no one was talking about. But it was not hard to find the story. I don't remember where I saw it first, but it was probably some headline. And as you know, when I see something, I don't just go on with my day. Everything I see, I stop and ask myself, "Is this meaningful?

Can it significantly impact public markets in any way?" If it does, then I have to start my research process. So that is what I did. I quickly concluded that the coronavirus was an unstoppable threat to world financial markets.

Did the fact that the markets weren't reacting give you any pause?

I was stunned, absolutely stunned. I had 100% conviction, not 99%. What's crazy is that it is usually difficult for me to feel strongly about something that is apparent. I was thinking, "How on earth could people not see something this large?" It's quite easy to understand how I can see something that is trending on TikTok in a demographic that is far removed from Wall Street and know that my competition on Wall Street doesn't see it. But to see something big and obvious and then have the entire financial community brush it off was wild to me, and it still is to this day.

Can you explain this behavior?

I could explain it this way: It is difficult for people to wrap their heads around extreme anomalies or believe in them until they are right in front of their faces. I believe if there was news that a large asteroid was going to hit the earth—I'm not talking about an end-of-the-world situation, but big enough to cause catastrophic destruction—there would be a good time window to trade on it. I think people would be unable to accept that truth without time to process it.

We experienced a similar situation in 2008. Some people saw the impending financial crisis as clear as day, but the market was unwilling to believe it until it couldn't be ignored. That historical precedent assured me that the market could ignore something big and obvious. But unlike in 2008, when a financial asset—securitized mortgages—triggered the crisis, financial institutions had no control over the situation with Covid.

What trades did you take to benefit from the impending pandemic you anticipated?

I had a straightforward trading strategy: I went leveraged short on the market as a whole, as well as travel and casino stocks. The reason why I picked those sectors is obvious. If you have a pandemic, the thing that should get hit the hardest is travel. And what other sector would have to close down completely? The answer is casinos. If you're in the middle of a pandemic, you can't fly to Vegas to sit at a card table next to somebody. So, I went short the market and a combination of airline, cruise, and casino stocks.

When you say "leveraged short," do you mean options?

Yes, as my primary short position, I bought weekly puts in the stock indexes and the stocks I wanted to be short. I got my ass kicked for 2½ weeks. I bought weekly options because I wanted to maximize my position. At the time, I had about $7 million in my account. Each week that passed with nothing happening, I lost a couple of hundred thousand dollars as the options expired worthless. I bought the weekly options again and again. I couldn't stop. But I was getting nervous, wondering how much longer I could keep taking these significant weekly losses. Then—I will never forget this—I watched CNBC on the day there was the first crack in the market, a decline of about 3%. I watched the commentators talking about how huge of a buying opportunity that 3% break was. I almost fell to the floor. I was thinking, "You bastards! How do you not see what is going on?"

Why were you angry? Did you think the CNBC commentators' recommendations would affect the market?

No, I don't believe they have any impact, but I thought their comments might represent how people were thinking. And if everyone felt this way, it would push the market collapse that I was looking for out another couple of weeks. I didn't want to go through another two weeks of bleeding money on my short-term puts. I didn't want to have to keep losing six figures a week.

Given these weeks of bleeding money, with the prospect of more of the same, did your confidence waver?

No, I knew the pandemic was coming and that it couldn't be stopped. Let me tell you a story that illustrates my frame of mind.

Every few months, we have a dads dinner where a bunch of dads of the kids that are all friends go out to dinner at this neighborhood steakhouse. We were having one of these dinners right around this time. About midway through dinner, someone mentions this China coronavirus thing and asks if it's real. I just let it out and said, "You guys are going to think I'm crazy, but let me tell you what's about to happen. In the next few weeks, we will all learn that the world is going to shut down. I have no idea what that means, but I would assume there's going to be chaos, and we're going to run out of all sorts of stuff. I've prepared for it by buying a freezer and stocking up on everything we might need." I must have been very convincing because three of these dads went out the next day and bought freezers at our local Home Depot. Then, about two weeks later, I received messages from each of them thanking me and saying they couldn't believe I told them exactly what would happen weeks earlier.

It was a bittersweet moment for me because I was distraught over the pandemic being real and the devastation it caused, but at the same time, I felt so vindicated as an investor. I wasn't insane. It was the biggest trade in my life.

After the market finally cracked, did you replenish your weekly options when they expired?

Yes, I kept taking those profits and buying puts again and again. I was seeing people processing something that I had already processed weeks earlier. Every day, more influential people said the pandemic was real and the market would react further. I was probably sleeping only two or three hours a night. I knew this was the moment I had waited for my entire life. I want to be very clear: I mean as a trader. I never hope for bad things to happen, but as a trader, I knew this was my moment to do what I do.

The Covid bear market didn't last long, and the market reversed abruptly, eventually setting new highs by a wide margin. When did you abandon your bearish stance?

During that market drop, something way more important was happening that I knew would become an even bigger trade for me. I recognized that a handful of companies were positioned to not just benefit from the virus but benefit hugely. And those companies were being sold off along with the rest of the market, which blew my mind. The potential impact of the virus on these companies was so obvious that if you asked a 13-year-old on the street whether one of these companies would benefit or be harmed by a global pandemic where everybody had to stay home, they could give you the correct answer. I'm talking about companies like Peloton when people can't go to gyms, Shopify when every retailer in the world now needs a significant e-commerce presence, and Amazon when everyone had to order everything online. This is not complicated stuff. It is just really, really obvious.

What about the vaccine companies?

I didn't mess with the vaccine companies. You didn't know whether they would be successful. The vaccine companies required some degree of speculation and being right about something. The companies I was looking to buy were 100% shots. There was no question. There was no debate. There was no discussion to be had. The only question was when, not if, the market would see this.

When did you decide to go long these companies?

The market was in panic mode. I wasn't going to invest in these companies while the market was in freefall. I was prepared to go all in on these long trades in a way that I had never done before, but I was not going to flip from my short positions to long positions until after the market had made a turn. I knew precisely what stocks I was going to trade. I was mentally prepared, so no research had to be done. Exactly two days after the market bottomed, I exited all my short positions and went leveraged long.

How did you know this two-day rebound was the beginning of a major reversal instead of a minor blip correction in a continuing bear market?

I didn't care about the market as a whole so much as the fact that the rebound would start to change the thinking about where the opportunities were right then. I knew that even if the market saw some renewed selling, the *what's next* mentality of Wall Street would come into play. There was an inevitability in these trades. You could not debate the fact Amazon, Peloton, and Shopify were not just going to be strong, but were going to see the very best months in their histories. There was also a new reality with the advent of government stimulus. We went from the world is falling apart to the government is going to save us. So, I went all in on what I would call the stay-at-home trades. Then I had the great outdoor trades investing in bicycle, boat, and RV companies.

Everything I do hinges upon changes in consumer behavior, and we have never seen a time of change in consumer behavior that comes close to what we saw in 2020. The world's consumers changed everything about their lives.

They changed the way they shopped. They changed the way they traveled. Knowing what I do, I should have had the best year of my trading career, and I did. I turned my account of less than $7 million at the start of the year into nearly $30 million by year-end.

I had 30 monster trades, and every one of them was the most obvious trade in the world. What are people doing? They are stuck at home, so they are shopping online, which has obvious implications for Amazon and Shopify, which we talked about. Home entertainment becomes crucial, which is great for Netflix. Although people are no longer flying or staying in hotels, they can rent an Airbnb with their family members. They can drive to their destination, but not everyone owns a car, so rental cars became huge. There was a small company in Canada that owned Schwinn bicycles. Has there ever been a time in history when more people wanted to bicycle? That company went up 10×. Every kid is doing school from home. They all need a printer and, even more importantly, printer cartridges, so Hewlett-Packard had some of their best quarters ever. Suddenly, people need a good computer camera because the whole world is on Zoom. Could you even write a better script for Logitech?

How did you know when to abandon the ship?

It was the same methodology I told you about in our original interview. I invest early before people see the consumer trend I identify and exit when we reach information parity. It isn't always black-and-white. It's not like nobody knew about this yesterday, and everybody knows about it today. Over time, more and more people start to notice what is happening and write comments on web boards and Twitter. "Hey, I noticed that web cameras are sold out everywhere. Could this be a positive sign for Logitech?" When I start seeing regular people talking about the idea, analysts writing about it, and companies crushing earnings, I know we are at information parity, and I exit.

Has there been any significant change in your methodology since our original interview?

Yes, the emergence of TikTok was a game-changer for me. There are over a billion people on TikTok from every walk of life, and they are making videos about every single facet of life. In the comment section of those videos, thousands of people talk about what they are doing, what they are feeling, and what they are buying. TikTok allows me to read shifts in consumer culture and behavior in real time. TikTok is a platform where people share what they're excited about. I have never been more enthusiastic as an observational investor. I think the next five years will be the best years of my trading career, excluding 2020, which we talked about earlier.

Were you able to adapt your software to search TikTok?

No.

Then how do you do a search on an app with a billion users?

Easily. There is a search bar in TikTok, and you can search for any keyword or combination of keywords that you want, the same way that I used to do this on Twitter. You can then see the difference in videos made about that subject two months ago, six months ago, or a year ago compared with the videos made about it this week or this month.

Can you give me an example of a trade that was influenced by TikTok?

One of my best trades this year [2022] was Crocs (symbol: CROX). Crocs bought a company called Hey Dudes, which makes an ugly, lightweight, extraordinarily comfortable, cheap slip-on shoe that started trending in Middle America. Wall Street thought that Hey Dudes was a joke and that the acquisition was a desperate move by Crocs to buy revenue growth. I knew that Hey Dudes was one of the hottest companies in the entire shoe world when Crocs acquired them. I had been following this privately held company for years, wishing I could invest in it. The Wall Street analysts that cover this sector are out of touch. They have no sense of reading consumer culture. They don't have a clue what's happening in the real world. The problem with Hey Dudes was that they had inadequate distribution and limited ability to expand their store locations. So, although their numbers were decent, I knew that given the proper distribution and increased stores, their sales could explode. The Crocs team knew this as well because they're savvy. I went all in on Crocs after the stock had fallen from a high above $180 to under $50. The stock is now back over $100 only four months later.

Yes, but what does TikTok have to do with this trade?

If I have a trading thesis that I originate by visiting the mall or some other experience in my life, it could easily be biased and therefore wrong. TikTok, with its billion participants, provides a place where I can test and validate my thesis. TikTok is how I assessed the love people had for Hey Dudes shoes. I could see the videos with people who were obsessed with the brand. I could read 500 comments with a typical post reading, "OMG, I got my husband a pair of Hey Dudes for his birthday, and now he has eight pairs." It was almost like a cult following. Wall Street doesn't see cultural shifts happening in Middle America. They're looking at what happened two or three months ago. I'm looking at what's happening today, and TikTok is my tool.

How do you gauge whether the number of videos or comments you see for a product is meaningful? For example, in our original interview, you mentioned that the conversational volume for *Stranger Things* stayed high far longer than for any prior hit show. You had a benchmark. What is your benchmark in TikTok? How do you know if the videos and comments you see for a product are exceptional in number or enthusiasm?

Great question because that's all that matters. You have two benchmarks. One benchmark is the volume of videos relative to the past. What's great about TikTok is that you can search the videos by timeline. So you can see whether the video view counts, likes, and comment counts are growing substantially over time. A second benchmark is to use comparisons with similar companies and to see how their counts have changed from the past. But when you spend enough time on TikTok, you get a sense of what's meaningful and what's not. A lot of this analysis is qualitative, not quantitative. Immersing myself in the conversation allows me to gain a deeper understanding of the tone and sincerity of the speakers, which is often the deciding factor in assessing the validity of the trade thesis.

Are you using TikTok more than Twitter now?

One hundred times more.

Any other examples of trade ideas that came from TikTok?

Another one of my big wins was lululemon. The company moved to expand into younger demographics, and no one knew whether it would work. They came up with a new product called the lululemon crossbody bag, which was sort of a fanny pack that you wore as a shoulder bag rather than around the waist. It became one of the most popular products of 2022. Through TikTok, I identified early on that the product was going viral. Although the sales of the crossbody bag alone were not meaningful enough to move the needle for lululemon, the attention it brought to the brand through web traffic and foot traffic in their stores increased the sales of their other merchandise, and they had one of their strongest quarters ever. Whereas Wall Street had to wait to see this sales trend play out in the numbers to believe it, as an observation investor watching TikTok videos, I was able to surface and verify this development early on.

There has never been a better platform than TikTok for uncovering things early and deciphering the world's thoughts and behavior in real time. It's everything I ever wished for as a social arb investor. My only question is: How long do I have before other people catch on? You would think that people would catch on quickly, but I know from experience that I have a pretty long runway—definitely years, not months.

There has been talk that Congress might ban TikTok. What would you do if this happens?

As an observational investor, my success is rooted in my capacity to immediately recognize shifts in consumer behavior and culture, and I have become heavily dependent on TikTok to obtain real-time insights. I am not worried about Congress banning TikTok, as the transition from social graph-based platforms such as Facebook and Instagram to content-driven social networks like TikTok will most likely continue through the emergence of new platforms. The golden age of social intelligence is not going away anytime soon.

Why do you call your YouTube channel *Dumb Money*?

"Dumb money" is how Wall Street refers to ordinary people like me. I didn't graduate from an Ivy League school. I didn't work for a financial firm. So, I would be considered an outsider. I'm dumb money.

What prompted you to start the YouTube channel?

Part of my life mission is to pull as many people as I can into the investor class. Turning ordinary people into investors is the only way to solve the wealth gap. If we are going to depend on the education system to get people excited about investing, it's just not going to happen. It's going to be YouTubers. It's going to be TikTokers. It's going to be people like me sharing their success and sharing their knowledge with the world. That's why I do *Dumb Money*.

How many subscribers do you have to your YouTube channel?

Not that many. We have two YouTube channels: *Dumb Money* and *Dumb Money Live*. We have near 200,000 subscribers combined. It's not a business for me. We don't sell anything. We don't even have any ads. Thousands of subscribers, though, are doing the same thing I do. They're on TikTok. They're looking for ideas the same way I do.

Have you gotten ideas from your audience?

Sixty percent of the trades I do were either surfaced by or vetted by people in the *Dumb Money* community who are now using my investing style.

So, even though you started this endeavor to help people, it has come back to benefit you as well.

Absolutely! If I have a trade idea, I'll present it and say that I need help vetting it. I'll then have people around the country walking into stores and talking to clerks. I now have over 100 people doing this stuff and other research, which probably makes me more powerful than the best hedge fund on Wall Street. It's wild. When we were invested in Peloton, I had one guy in my community fly his single-engine plane to one of their warehouses to talk to a worker on the dock to see how things were going.

I used to feel isolated in the type of trading I do. I'm not a technical trader. I'm not a fundamental trader. So, when I went to investor conferences, there was nobody like me, and nobody was talking about the things that I wanted to talk about. Now, for the first time, I have people that do things the way I do them.

Having had such a successful run, do you have any goals?

One of the things I'm most proud of was starting a foundation to help kids with leukemia and autism, which has been a primary goal in my life. If I didn't do it after a year like 2020, I would never do it. So, I decided to take $5 million of my gains and start the Camillo Foundation. Through my trading, I hope to grow that foundation to be substantially larger than it is today.

Any final words?

I've never been more excited about the future than I am right now. I also believe there has never been a better time for an ordinary person to be an investor. I don't care if you're a dentist, janitor, or homemaker. Pay attention to videos and comments on platforms like TikTok. You can beat the professionals by learning how to identify the change happening around you.

MARSTEN PARKER

Don't Quit Your Day Job

THREE YEARS LATER

Has anything changed significantly for you since our original interview?

The Covid lockdown allowed me to work hard on my backtesting software to get it to the point where I felt like I could market it.

What is the software called?

RealTest. The description of the product is on my website, mhptrading.com.

How many users are there?

I'm up to about 200 users. Many of the users I have are from Australia. There's a lot of interest in systematic trading in Australia. I think that is because the U.S. markets are open when they are asleep.

Is there anything about your software that differentiates it from other system testing software?

What makes it unique is that it lets you define any number of trading strategies and combine them into one system. So, it supports the kind of trading I like to do, which is strategy diversification.

Is it designed just for equity systems, or does it also support futures?

RealTest supports futures as well. In fact, it includes the original Turtle system, as defined in Curtis Faith's book.

[The Turtles were two groups of traders trained by Richard Dennis and his partner William Eckhardt. The Turtle name originated on a trip Richard Dennis took to Asia. At one point, he visited a turtle farm where turtles were raised in huge vats. In Dennis's mind, the image of growing thousands of squirming turtles in a huge vat was a perfect analogy for training traders. The name stuck. Dennis and Eckhardt taught the Turtles a trend-following system based on price breakouts to new highs and lows. Curtis Faith, one of the Turtles, wrote a book, *Way of the Turtle*, in which he detailed the Turtle system rules.]

I'm curious. What does the performance of the Turtle system look like over the years?

It's not bad, and like any futures trend-following system, it has been great this year [2022].

I believe there was a long period beginning in 2011 and lasting through 2018 when trend-following systems of this type performed poorly.

Yes, that was the era of the "Fed put" [the belief that the Federal Reserve would step in with accommodative monetary policy to support U.S. equity markets whenever they came under severe pressure]. This era was detrimental for trend-following systems and a time when buying the dips in stock prices was the optimal strategy. The problem with these futures trend-following strategies is they have big drawdowns. I've never tried trading that approach, but some of my users were interested, so I put it in there. The software comes with a library of about 50 sample systems, including ones similar to the ones I trade but not precisely the same.

Is your software designed to work with any specific price data?

It works best with Norgate data, an Australian company with the best daily data for equities. Their data includes all the delisted symbols and the historical index constituency. If you're building a system that trades the stocks in the S&P 500, and you run a backtest using the current components of the index, your results will be badly distorted by survivorship bias. To test the system correctly, you need to run your simulation based on the stocks that were part of the index on every past date, not the stock list based on the current components of the index. RealTest uses Norgate's index constituency data to include the correct index components for each past date.

I see. Without that type of data adjustment, your test will miss the worst-performing stocks in the index, which are the stocks that have fallen out of the index.

That's right. With Norgate data, your test will include stocks like Enron and WorldCom, which went bankrupt and are no longer in the index. Even more importantly, it will exclude recent high-fliers like Tesla before they became part of the index, which I would call a "look ahead bias."

Any change in the strategies you trade?

I've added two mean-reversion strategies that don't hold positions overnight. They fade a big move during the day, then exit on the close. One of these strategies takes only longs and the other only shorts. They have done quite well and have helped smooth out my results.

Do you deliberately trade an equal number of long and short strategies?

Yes. I currently trade three long and three short strategies, which roughly balance each other. This balance between shorts and longs is the main reason my results are relatively smooth over time.

Any other changes in your trading system?

Another change is that I reduced my position size from 10% per position to 5%. This reduced position size was partly in response to the increased market volatility and partly because I changed my system to allow two strategies to hold the same stock (only one of them overnight).

Another innovation, which was influenced by the short squeezes in meme stocks, was to prohibit shorts in any stock in which margins were raised to 50% or higher. It was not a rule I backtested because I don't have the historical margin data. It was just a risk management rule that kept me out of many losing trades. If I notice I'm losing money faster than usual, I tend to look at what's going on so I can make changes that I think will help stop the bleeding. The margin rule was one of these cases.

MICHAEL KEAN

Complementary Strategies

THREE YEARS LATER

I noticed that in February–March 2020, when we had the Covid bear market, you got away without much damage. How did you sidestep that selling wave?

I remember a Friday night when Trump held a press conference admitting Covid was an issue. The market had been in freefall, but it had a big rally on that day, gaining about 5%. As the market was soaring, I bought enough puts to hedge my entire long position.

Were you waiting for a bounce to hedge?

I was. That weekend the Fed had an emergency meeting, and I was upset because I had just spent a lot of money insuring my portfolio, and now the Fed was going to bail everything out. But what actually happened was the market had one of its largest one-day declines on the Monday. I covered my entire put position and made about 4% that day, while the market was down about 8% to 10%.

Why did you cover your hedge so quickly?

My thesis was that the world would go into a lockdown within a few weeks, and the market would bottom when it did.

I saw April 2020 was one of your best months ever. You apparently caught the bull market that followed the Covid crash very early. What told you that first upmove was the beginning of a sustained recovery instead of just a bear market bounce?

I was fairly bullish as the market crashed in March because I thought the Fed and the government would throw everything they could at keeping the system going, and that is exactly what they eventually did. I was buying in March as the market was falling. For a week or two, I was losing money along with everyone else. But the big gain I made on my put hedge earlier in the month enabled me to be more aggressive, and I progressively added to my longs through March. So, I was already heavily long by the time the market bottomed in late March.

How did your net long position at that market bottom compare with your normal net long position?

I was about 80% net long, which is above the top end of my usual range of 40%–70%.

This year [2022], the market is down over 20% year-to-date, but you are down only about 6%. How did you keep your losses so contained?

During the first half year, I did as poorly as the market, but I have done much better since then. There were several reasons for the better performance. I took some profits on the summer rally. I also had a takeover stock that was a big winner, and my long biotech portfolio did well despite the market weakness.

Are there any trades that stand out since our original interview?

The technology stocks I bought during the March 2020 crash were a major contributor to the 54% gain I had that year. An out-of-the-money call option position on JD.com, a stock we discussed in our last interview, was a huge winner.

PAVEL KREJČÍ

The Bellhop Who Beat the Pros

THREE YEARS LATER

I remember you live in a small village, and I'm just curious, do people know you were in the book?

No, not here. I think people here don't even know what I do and would have no idea what I am talking about if I told them. But I got so many contacts through the internet. The book changed my life.

How did it change your life?

For 15 years, I worked alone at home and didn't speak about trading with anybody. After the book came out, I connected with people from the U.S., China, France, and all over the world. Most of these people asked me to help them trade, which was very difficult because I spent so much time answering questions that it interfered with my trading. But some of these contacts developed into friendships and some into business or potential business.

By "business," do you mean managing money?

Yes.

Two things are different about managing money and trading your own account. First, you have to trade much larger, and second, you're managing other people's money. Did you find those changes to be difficult?

Yes, it is difficult to take a larger position on every trade. It takes some time. It's not something that can be done immediately.

Difficult mentally? Because I think, given the liquidity of the stocks you trade, you could do any size you want.

Yes, mentally. It's not a liquidity problem because the stocks I trade are very liquid.

Although your losses have remained very well contained, with maximum drawdowns each year in single digits, your return levels have been lower, averaging only a little over 10% during the past three years since our original interview. Was there a reason for your lower returns?

I didn't trade for almost half the year in 2021. I had Covid and was hospitalized. I'm very happy I survived, but it was a difficult period. Also, my daughter was born two years ago. The responsibility of having a kid changed me mentally. It made me more cautious about taking risks.

Were the lower returns then due to these personal factors and not because the markets were more challenging?

The markets were also less favorable for my strategy. My strategy does not work as well when the markets are extremely volatile.

Is that because if there are wide market swings that can dominate the stock-specific influences you trade on?

Exactly. There are periods when the volatility of all stocks is more influential than individual stock earnings reports, which is what I trade on.

Were there any trades that were particularly memorable during the past few years?

Like always, my trades are very boring. I didn't have any huge winners or losers. My losses are restrained because I only hold positions for the day, which also limits my profits.

Did you change anything in your trading over the last few years?

During the past year, I have started to trade stocks from the short side to make it possible to find more opportunities. Before that, I only took long positions.

Is the strategy different for shorts than for longs?

It is analogous in that shorts are also placed after earnings reports. Also, similar to longs, I place the trade at the opening and liquidate it the same day. There are differences, though. I don't search for strong stocks. Instead, I search for weak stocks with poor earnings and disappointing guidance for the next quarter or year.

That implies that if you are going short, the stock is already gapping lower. Basically, you are selling weakness, anticipating more weakness.

Yes, the stocks I sell are usually down 7% or more on the open. I am just going with the trend.

How does the success of the short positions compare with the long positions?

There have been far fewer short position trades, but the success rate has been even better than for longs. Maybe that is because I am more selective in shorting stocks. I found a method that seems to work well. So shorting is something that I want to focus more on. Another benefit of trading the short side, which is relevant now that I am managing money, is that the liquidity on the open is higher when stocks are down after an earnings report than when they are up.

Why didn't you trade the short side before?

When I started trading, I also traded from the short side until 2009, when shorts stopped working because of the massive uptrend. I stopped taking short trades because they kept losing money. I said, "OK, I don't know how to short. I just have to accept it."

Are you using a different system to trade shorts now than you did in your early years as a trader?

Yes, back then, I was using a very simple system. I developed the system I use now to trade shorts based on what I learned from trading from the long side.

Did you research the short-selling method you're using now going back in time?

Yes, I always test anything I will trade going back at least 10 years. I discovered that my shorting method worked well even when markets were in uptrends, which gave me the confidence to add this shorting strategy to my trading.

What percent of your trades are shorts now?

A little less than 30%.

Are you entering your trades with a limit, or do you go in at the market?

I use a limit order on the open because that is when the liquidity is best.

Does that mean that you no longer execute trades before the open, as you sometimes did at the time of our original interview?

Yes.

Is that because now that you're managing money, you're much more conscious about liquidity?

Yes, and also because I use the opening price when I do a backtest. So, I can test how something would have worked if I entered on the open. I don't know how the results would have differed if I entered during the pre-opening.

What is the most important lesson you've learned in trading?

How not to lose money.

How do you not lose money?

I always play defense; I don't play offense. I don't think it is something that you can learn from a book or seminar. It must come with experience.

What are the things that you do to not lose money?

Well, the most important thing is to have an exit strategy. I always know the price where I will get out.

NOT A MARKET WIZARD CHAPTER

Jack Schwager Interviewed

A*uthor's Note:* After several decades of writing *Market Wizards* books, my son, Zachary, thought readers would be interested in hearing my story and suggested including a bonus chapter in which he would interview me. I was both reluctant and unsure about the idea of my being the interview subject, since it was a suggestion that, by definition, was impossible for me to assess objectively. I therefore bounced the concept off my editor, Craig Pearce, who was particularly enthusiastic. So here is the chapter. I want to make clear that I am a chronicler of Market Wizards and not a Market Wizard myself, nor have I ever claimed to be. And it is in that vein that this chapter should be read.

INTRODUCTION BY ZACHARY SCHWAGER

Sometimes we pick up a book that changes our lives. Occasionally, there is a much rarer moment. We pick up a book that changes our perspective on life.

I can always spot these people because they take a deep breath when they learn my dad is Jack Schwager, the author of *Market Wizards*. They almost always double check to make sure I'm not joking. Then, when the comfort sets in, they share their story. As with each Market Wizard, their story is unique, but there is one thing they have in common. This book created a defining moment in their lives. Sometimes they will show me their copy so that I can get it signed. The copies are always worn with love, pages folded, highlights all over, and sometimes the pages have waves from being carried in the rain or handed down from person to person.

In pursuit of creating something timeless, there is a bit of irony, since we are trying to duplicate truths or concepts that have already stood the test of time. Consequently, emulation itself is rarely timeless because it is a replication.

My dad would never describe himself as a trendsetter, and my mom certainly wouldn't. While my dad embarked on the journey of putting this book together, he had a sense of conviction – even though he had no idea how the book would be formatted, who he would encounter, and most importantly, how many readers he would reach. He knew this book would be special in the least arrogant manner.

All my life, I have never understood how someone could be so driven by purpose in pursuit of an uncertain and unproven outcome. You may have seen my father in person, at the office, or on television. At first glance you see a highly articulate man in a suit possessing a unique perspective, to which he is the sole expert. I think most of my family members would struggle to imagine my dad wearing anything other than a flannel shirt and comfortable hiking shoes. In most cases, my dad would prefer to be prepared for a pleasant walk than a business meeting. His humility, quietness, and inquisitive nature mask his success. His immediate circle would never guess he is the best-selling author of one of Wall Street's most-read books.

My dad visited my house earlier this week. I recognized him as the same dad I've known all my life. A colorful plaid shirt, REI hiking pants, and comfortable Merrell slip-ons. We were walking to the Boca Raton Synagogue to hear Yossi Cohen, the former head of Mossad, give a talk. It was my duty to lend my dad a yarmulke and explain that this congregation was Orthodox. While my dad could tell you the best places to purchase a bagel, he would have difficulty finding a yarmulke if you gave him an entire afternoon. After a nice and short walk to the synagogue, my dad shared something that had recently interested him. In particular, he had just watched a Netflix documentary about chimpanzees that he found enthralling.

I tell this story because Yossi answered many questions during the talk with responses that were long and complicated and addressed multiple highstakes variables, but one question he answered with a single word. The host asked Yossi, when he was recruited into Mossad at the very young age of 22, did he ever think in his wildest dreams that someday he would run Mossad. His single word response was, "Yes."

As I reflect, I believe this was my dad's level of conviction when writing *Market Wizards*. No arrogance was present—just a simple gut feeling that it is absolutely something he should, can, and must do. I think most of us feel a sense of imposter syndrome or false bravado as we face new challenges, but a select few, such as Yossi and my dad, choose their destiny and then follow it.

I will close with one more story, since it is the #1 question I get from my dad's readers: Have you ever met any of the Wizards?

Interestingly, I am the only child out of three who can answer yes, and it is probably the most interesting story of my life.

During my senior year of high school, I knocked on my dad's office door. This was rare, because my dad was always head down, working, and we were careful not to disturb him. He worked in our house on Martha's Vineyard, on the very bottom floor. We were one of the few families who lived on the island year-round. Having a place of natural beauty near his work allowed my dad to combine his two passions – work and exercising. I explained that I was just thinking, "I am about to head to college, and we have never really taken a trip together before. Would you like to join me?"

"Yes, of course," was his answer.

Several weeks later, he told me he had a standing invitation from one of the people he interviewed, John Bender, who had retired from trading and had purchased 5000 acres of Costa Rican rainforest to conserve.

Our flight landed in San Jose, Costa Rica. It was late at night, and we were eating dinner. It was my first time having hearts of palm, and it was one of those dishes that was so good you wish you could have just one more bite. We drove into the rainforest the next day. For over four hours, the drive was almost entirely on dirt roads. The road was only wide enough for one car, and there were no guardrails. There were no other vehicles along the way, perhaps because your chances of reaching your destination were limited. In addition to being worn, the roads were extremely bumpy. From my passenger side window, I could only see a steep drop of a thousand feet or more, but I couldn't see any of the road because it was so narrow.

Two men armed with automatic rifles ushered our car into a gate at the end of our drive to nowhere. After that, we reached a clearing. This property is unlike anything you have ever seen; it is literally out of a fairy tale, and it is essentially beyond description. There were two small single-floor homes, and then perched at the very peak was a massive cement, open-walled, multi-level home. It looked more like the Guggenheim Museum than a residence.

During the construction of the main home, John and his wife Ann were residing in one of the temporary small homes. We were graciously welcomed by John with an ear-to-ear smile. He was a big man, wearing a partially open button down that was dripping with sweat. He had on green cargo pants, big brown boots, and a long machete to complete the ensemble. I am not sure what I was expecting on this trip, or from meeting my first Wizard, but this certainly was not it. At the same time, I was surrounded by such a magical environment that the whole thing felt like a dream.

We put our stuff down and went on a hike with John. Looking back, I'm not sure what any of us were thinking. As we marched confidently into the preserved and untouched Costa Rican rainforest, we were over four hours away from any possible help. The two of us enthusiastically followed John as if he were an expert in the wilderness and not a brilliant biophysicist and options trader. Since there was no trail, we just walked forward eagerly, equal parts explorers and prey. John was excited to have our company and to share his passion for his nature preserve with us. He was so proud of how he had invested his earnings in caring for these 5000 acres.

Double-backing the way we came had worked. We were rewarded when John took us to the main house, which at the time was still in the final stages of construction. There were several identical enormous circular granite floors, each with wraparound decks. There were no walls or windows separating the interior from the rainforest. It was a once-in-a-lifetime experience to look out from the top of the structure. It was at the highest point of the jungle, and you could see all the way to the ocean.

After dinner, Ann helped me upload my photos on her computer. Having recently purchased a Fujifilm 3.2 megapixel camera, I was very proud of it. As John spoke during dinner, he mostly talked about quantum physics, and specifically about the topic of entanglement.

Towards the end of the day, the sun was setting over the ridge. We all sat down on a planted overlook where John had a small farm setup. The clearing provided the perfect view of what seemed like a hand-selected sunset for the occasion. It was during this conversation that John became most passionate about trading—well, specifically about one trader. As a matter of fact, John was enraged by this trader, and he had reported him several times to the authorities with no result. The serenity of hundreds of miles around him did not lessen his distress. Having a beer with the guys and hearing them talk about the world of trading, which I had no understanding of at the time, made me feel privileged.

Nearly seven years later, I would hear that trader's name again, and I will never forget it, because it was all over the news. It was announced that Bernie Madoff had been arrested. I couldn't believe what I was hearing. I vividly recalled the time I had been just a kid watching a sunset, excited to drink an Imperial Beer, and listening to John recount how he was doing everything in his power to expose Madoff's fraud.

In a tragic circumstance, John died two years after Madoff's arrest, in that same beautiful home, disturbingly from a single gunshot wound to the head. The circumstances remain shrouded in mystery. I can only say that John and Ann were the best hosts we could have ever asked for. In the same way that *Market Wizards* changed the world for so many readers, John and Ann had changed my life for the better in ways that I will never be able to thank them for.

My last writing for my dad's books was the epilogue to *Hedge Fund Market Wizards*. There's no other way to end the introduction to this chapter than what I said there:

A couple of months ago, I was out for happy hour with a few associates. One of them asked me, "Do you feel that because of your dad you have a lot to live up to as a trader?" to which I replied, "It would be far easier to be as successful as my dad in trading than to be as successful as he is on a human level. My dad is one of the kindest, humblest, and most generous people I have ever come across. I would much rather be as great a person as he is than be as successful as he is."

Do you remember coming to America?

I was four years old at the time. I don't recall the voyage, but I remember that after we arrived in America, our entire family lived in a single room for about half a year (a residence provided by the HIAS, a refugee aid organization).

Do you have any memories of what that experience was like?

I remember how happy I was to leave. My father got a job as a busboy and was able to rent an apartment in East New York, which is in Brooklyn. It was a small tenement apartment, but it seemed terrific compared to where we had been living.

Did you ever talk to your parents about how they survived the Holocaust?

Yes, but one of my greatest regrets is that I didn't have more extensive conversations with them about their years in Europe during World War II. Here's what I know.

My mother lived in Belgium in the early war years. She was in the hospital giving birth to my half-brother when the Germans did their sweeps rounding up Jews. Her husband was arrested and later killed. So, she and my brother would not have survived if she had not given birth then. My mother had a close friend whose boyfriend worked for the Belgian police. My mother obtained false papers through that connection. She got by for a while with false documents, but that was only a short-term solution. Eventually, she fled to Switzerland. I wish I could tell you how she managed that feat with an infant, but I just don't know. When she crossed the Swiss border, she was arrested and placed in a refugee camp, where she remained until the end of the war.

As for my father, he escaped from a labor camp with his brother. I wish I remembered how they escaped, but I guess I was told the story when I was young and don't recall more detail. I also know that my father, who was German, was living in Germany near the end of the war, passing as a gentile. Two weeks before the end of the war, he was walking his German Shepard and was stopped by two Gestapo officers. They initially argued with each other, one insisting that my father was not Jewish and should be left alone, but the other officer prevailed, and they arrested him. Fortunately, it was near the end of the war, and he was freed shortly afterward, but that is another detail I don't remember.

Actually, that is something I remember from interviewing your mother for an essay I did on the Holocaust in grade school, and I will never forget it. Your father was in a transport with other Jews on a truck on the way to a camp. Americans stopped the truck, and that's how your father was liberated.

When you went to college, did you know what you wanted to do for the rest of your life?

In high school, I liked math and thought I wanted to major in it in college. There was a calculus class for seniors, but it conflicted with another class I needed as a requirement. I tried speaking to the principal to resolve the conflict, but it didn't help. I remember feeling very frustrated because I knew not being able to take that class would be an impediment to my goal, and I couldn't do anything about it. I tried teaching myself calculus but had trouble fully grasping it. I still started as a math major in college, but by my sophomore year, I realized I wasn't good enough at it. I always believed that in choosing a career, it has to be something you like but also something you are good at. Math fulfilled the first requirement but not the second.

Fortunately, as a freshman, I also took courses in microeconomics and macroeconomics, both taught by the same professor. The introductory year of economics was conducted in this large lecture hall with hundreds of students, which was not ideal, but the instructor was excellent. I liked economics, and by my sophomore year, I switched my major.

Did you have any idea of what type of job you wanted to pursue with an economics degree?

No, I just figured economics would have a lot of practical applications.

Why did you decide to go to graduate school?

There wasn't any decision involved. It was just a natural given that I would go for an advanced degree after college. It was like you get up; you brush your teeth. You graduate college; you go to graduate school.

Was that true of your group of friends as well?

It was. They all went on to advanced degrees, including biomedical science, nephrology, gastroenterology, psychology, and math. You wouldn't stop at college. It wasn't a consideration. That was true of every friend that I had. It was also my natural inclination.

How did you choose which graduate schools to apply to?

I applied to about a dozen universities with well-regarded economics programs, about half of which I considered reach schools, including Stanford, MIT, Chicago, and Brown. I received several acceptances, the best one being from Brown, an offer that also included a scholarship, making it even more attractive. All my other reach schools were rejections. One side note: Many years later, I received a small royalty check from the University of Chicago because a section of one of my books was being used in one of their courses. I have to admit I got a kick out of my book being used in a university that rejected me.

My attendance at Brown, however, was almost prevented. My senior year in college coincided with the first lottery held for the Vietnam draft. Now, I have to provide some background context here. In my early years of college, I was pro-government, a stance that was primarily a reaction to the SDS (Students for a Democratic Society), a radical anti-war group. I hated their tactics of shutting down colleges as a protest against the war. However, I was always a close follower of the news and political events. My views changed as I discovered the government was guilty of lying about crucial aspects of the war. I thought the war was a monumental mistake and not worth risking my life for. I just got to the point where my attitude was, "A curse on both their houses." At that point, I was antiwar. I knew I didn't want to risk my life for a war I believed was a colossal blunder and waste.

At the time of the first draft lottery, it was estimated that if your birthday had a number in the mid-200s or higher, you had a good chance of not being drafted. I remember listening to the lottery live, with each draw, hoping that my birthday would not be chosen. My birthday ended up being number 64, which was a guaranteed ticket to Vietnam.

Weren't you excluded from the draft as a student?

At the time, there was student deferment for college but not graduate school.

What did you do?

National Guard and reserve units were not being sent overseas at that time. My plan was to immediately enlist in one of those. I started calling various units in Brooklyn, looking for one that had openings. The one I found was a national guard unit in Bedford–Stuyvesant. The next morning, I enlisted and was sworn in. Five months later, in May 1970, I was sent to Fort Polk, Louisiana for basic and advanced training. It was the most miserable weather I had ever experienced. It was over 90 degrees and humid when I arrived, and it only got worse from there. When we went on long marches with full packs, and they halted the unit, you could see the uniforms in front of you turn from light green to dark green from perspiration.

It was May of your senior year. Didn't your army training conflict with your starting graduate school?

It did. That's why I said before that I was almost prevented from attending graduate school. My scheduled army training extended well beyond the start date for graduate school. I communicated with Brown about my situation, trying to get some special exemption to allow me to start midterm, but that was impossible. If I couldn't be there for the start of the school year, I would miss that year. I also believe I would have lost my scholarship and possibly any guarantee of being accepted for the following year.

What did you do?

There was a national guard Inspector General on the base. I went to see him to explain my predicament and plead to get a dispensation for early release so that I could make the start date for graduate school. I figured it was a long shot, but I had no other option and nothing to lose. Amazingly, he agreed and gave me the official papers I needed for an early release from active duty. And this event led to one of those memories that absolutely stays with you forever. After I met with the Inspector General, I hitched a ride in a jeep back to my unit. They had the radio playing, and one of the songs that came on was Bob Dylan's, "I Shall be Released." It was exhilarating. Every time I hear that song, I think of that experience.

Did you have a particular career in mind when you went to Brown?

I intended to go for a Ph.D. initially, which would have allowed for the possibility of being a professor, but I didn't have any specific job in mind. I did have an area of particular interest, though. In my senior year at Brooklyn College, I took a course in econometrics. As a project for the course, I built a simple econometric model of the U.S. economy. I liked the challenge of creating a model that tried to predict key variables in the U.S. economy and the anticipation of waiting for the computer results to see how well the model forecasts performed. Back then, you had to type your program on IBM punch cards and then submit the program—a stack of cards—to the computer department to be run overnight on the school's IBM 360—a huge mainframe computer that was the size of a small room. If there was any error, like one missing comma, the program wouldn't run, and you would have to find the error and resubmit the program. It took many tries before a program ran successfully, but it was a great feeling when it did.

So, by the time I graduated college, I wanted to focus on macroeconomics and econometrics. I had taken very few macroeconomic courses in college, and I thought I could get a broad grounding in macroeconomics in graduate school. My macroeconomics professor at Brown was this genius who had earned an undergraduate degree in physics and then decided to switch to economics and earned a Ph.D. in economics. He went on to become a famous economist. In the yearlong course at Brown, he basically taught his Ph.D. thesis. So, instead of getting this broad background in macroeconomics, I got this intense, in-depth focus on one small area. If I already had a sound grounding in macroeconomics, perhaps I could have appreciated what he was teaching, but as it was, it was disappointing.

The year I was admitted to Brown, the incoming graduate class in economics was larger than normal. Schools calculate the number of acceptances they issue based on an estimate of the percentage of those students that will decline and go elsewhere. Apparently, the year I entered Brown, the number of students that accepted their invitation was higher than anticipated. There were rumors that scholarships would be cut at the end of the year. Those rumors ended up being true. The number of scholarships was cut sharply, and my grades were not good enough to retain mine. I could have continued without a scholarship, but I decided to stop at the M.A. level, get a job, and presumably return to school to get a Ph.D. after several years of work. As it turned out, I fell into a successful career and never pursued any further education.

What happened after you graduated with an M.A. from Brown?

I sent my resume to several employment agencies and waited for interview calls. Almost nothing happened. The only job interview I recall getting was for a labor economist position at a shockingly low salary. So, I placed a short position-wanted ad in the *New York Times,* which read: M.A. Economics, Brown University, seeking analytical position. I got about 15 responses to that ad, but only one turned out to be a legitimate job interview.

What were the others?

Well, I followed up on one. The caller said he saw my ad and thought I might be a good fit for their company.

“What exactly is the position?” I asked.

He gave me some vague response.

“Is this a sales position?” I asked.

“We have sales positions but have a managerial position in mind for you. We’re having a company meeting on Tuesday night, and we would like you to come in.”

I expected a conference room meeting where several company members would interview me. Driving to the meeting, I noticed the location seemed odd. It was just off a particularly ugly section of the New Jersey Turnpike. As I pulled up to the address, I discovered it was a hotel, which seemed even odder. I walked in and saw signs with arrows pointing to the company event. I was met by a glib guy with a big smile, wearing a flashy suit. He ushered me into a large meeting room with seats set up for hundreds of people. In the front, there were displays with a variety of cleaning products.

I was shocked and was ready to leave, but he implored me to stay. The event began with a film about the company narrated by a recognized actor—Sebastian Cabot, if I remember correctly—in a move that was obviously intended to lend credibility to the company. The film told the story of the invention of the product. There was a dramatization of a chemist who had an accident falling off a ladder. While lying in the hospital bed, he thought about how he could make his wife's life easier, leading to the invention of the company's original cleaning product. This inspiring film was followed by a talk by a used-car-sales-type speaker who told us how he made hundreds of thousands of dollars in his spare time, showing a slide of the fancy sports car he had just bought with his profits.

So, this was a multilevel marketing pitch.

Yes, it was a pyramid selling scheme, although I knew nothing about this type of operation at the time. They wanted you to invest thousands of dollars to buy their product line, and then you could recruit other people to sell the products and get a cut of their commissions.

After this experience, I recognized and rejected all the other similar calls. But, as I said, there was one legitimate job interview offer call. It was from Irwin Shisko, the Commodity Research Director for Reynolds Securities. He wanted to interview me for a commodity analyst job.

How did the interview go?

I only remember one question, because my answer was embarrassingly awful. Shisko asked me rather legitimately if I knew anything about commodities.

Back in those days, universities had few, if any, investment courses, let alone a course on commodity markets. I was totally ignorant. "Not really," I answered. "Something like gold?" I said, in a tone that was somewhere between a hesitant answer and a question.

But, even though I knew nothing, I must have said something in that interview that at least intrigued him because I was invited to participate in the next stage of the interview process. At the time, Shisko wrote a weekly column for *Barron's*, which I believe was called "Commodities Corner." He asked each candidate interviewing for the job to write a column on a specific commodity, which he would use as a source of material for his column. I was assigned the copper market.

Of course, I knew nothing about the copper market. This was way before the internet, so you had to go to the library to do any serious research. I spent a week at the Grand Army Plaza library, which is Brooklyn's version of the New York Public Library in Manhattan, reading anything I could find on the copper market, which included years' worth of various periodicals, ranging from annual to daily. At the end of the week, I wrote a four-page article and submitted it. I got the job.

I later found out from a broker in the office who became a close friend of mine that there were four candidates for the job, including me, and that Shisko had passed around the four articles to all the brokers in the office, asking for their feedback. Everyone said, "Pick this guy," referring to my article. So, I wrote my way into my first job, which was the beginning of a long career. Many years later, I found a copy of that article while cleaning out papers in my office. I was surprised. It was actually fairly decent. You couldn't tell it was written by a complete novice.

What was the office like?

There was a large main office in which all the brokers sat facing a huge commodity quote board. The quote board was constantly clicking and clacking as the commodity prices changed. It was a very active atmosphere, primarily because of the dominance of the quote board, but also because of all the broker phone calls happening in the same space. My office, which I shared with Shisko, was on the side, separated from the main office space by a glass partition. From my desk, I could see both the board and the brokers.

What was your reaction on the first day on the job?

I was intrigued. Serendipitously, that first day also proved pivotal in laying the seeds for the first *Market Wizards* book and, by implication, the entire series. The commodity research department consisted of the director, Irwin Shisko, and two analysts—one in the New York office and the other in the Chicago office. I was hired to replace the New York analyst who was leaving to become a trader. That analyst was Michael Marcus, who would later be the subject of the first trader chapter in the first *Market Wizards* book. Michael was also the contact for other traders in the first *Market Wizards* book.

When I arrived, Michael was cleaning out his desk. We chatted a bit. Thanks to that initial meeting, Michael and I maintained contact. For the next few years, while he remained in New York, we got together for lunch every few weeks.

What was your job?

I was assigned four commodity markets: cotton, sugar, hogs, and cattle. My main job was to write weekly commentaries and special reports on these markets. These reports were mailed out to clients, and many brokers used the reports for marketing and trade generation. About two weeks into the job, I got a call from the *Los Angeles Times* asking me for a comment on the sugar market, which I provided. I thought it was ironic that I was being quoted by a newspaper as a market expert when I had all of two weeks' experience.

Covering the markets and seeing the price board in front of you all day, did you want to trade yourself?

I did. I think that is a natural inclination. Reynolds, however, had a company policy against analysts trading. I spoke to Michael, and he told me how he traded when he had my job. He had an account at another brokerage, and whenever he wanted to place an order, he would call his broker and use code words—something like "sunny" might mean buy, and "rainy" might mean sell. Michael put me in touch with his broker, and I opened an account for

$3,000 in my brother's name. It was his account, technically, but it was my money, and I placed all the trades.

Were you using the same type of code language method to place trades as Michael did?

No, I wasn't comfortable making the call from my office. When I wanted to place a trade I would take the elevator down to the lobby to use the pay phones to make the call.

How did you monitor your trades?

They were staring me in the face all day long. I could see the commodity quote board from my desk.

Did you have a method for trading?

Fundamental analysis. It was as simple, or simplistic, as: The market should go higher because my analysis indicates prices are too low; the market should go lower because my analysis indicates prices are too high. I thought I knew what I was doing, but I didn't.

There were high commissions at this time, right?

Yes, they were something like $60 or $70 per contract.

Did you know how long you would hold a trade?

No, I didn't. I didn't know anything about risk management at the time. I also didn't know technical analysis.

How did the account do?

I made money; I lost money. But ultimately, I lost. There was one trade in which I was dead wrong, and I blew out the account.

Do you remember the trade that wiped you out?

Oh, sure. It was a trade in the cotton market, one of the markets I covered. Incidentally, that trade provides a stark contrast between a great trader and someone like me who didn't know anything about trading. One of the things I did as a cotton analyst was to review the cotton market for every post-WWII year. I discovered that in almost every year, the determinant of the cotton price was the government loan program, which as a nonrecourse loan, acted as a price support. Effectively, the market declined to the area of the loan price and stayed there. There were only a handful of years when the market traded freely based on supply and demand. I knew there wasn't enough data to draw a statistically meaningful conclusion, but it was all the relevant data that was available.

One of those past years was a shortage year, in which the season-ending carryover supply was very similar to the then-current year. I took an unwarranted leap of faith, assuming the prices in the two years would be roughly similar. Since in the past bullish year prices failed somewhere around the mid-30 cent region, once cotton prices reached that level, I thought they should top out.

I remember discussing the cotton market with Michael at one of our lunches. I said, "Well, cotton is up to the same high where prices failed in the past similar bull market." He said, "No, cotton prices are going much higher." Michael didn't do any of the analysis I did, but he had the uncanny ability to look at a market with 50 different factors and latch onto the one factor that was most important. That year was the first year China was a significant buyer of U.S. cotton, and Michael understood that one factor would dominate everything else.

I went short in the low-30s, attempting to pick a top, and the market kept moving steadily higher. Somewhere in the mid-to-high-30s, my account was wiped out. I was extremely fortunate that I didn't have much risk capital. Otherwise, my loss could have been many times worse. Cotton ultimately ended up going to a high of 99 cents! Michael, of course, made a fortune on that trade.

Do you remember how you felt during that trade?

I know I would have seen the quote board cotton prices clicking steadily higher all day. I'm sure it was a painful experience.

Was the money in your commodity account all the money you had, or did you have a separate savings account? Did you have to worry about having enough money to pay the rent?

I definitely had a savings account. I was always conservative, which is a good thing because I didn't know about risk management and would have lost all the money I had.

OK. So now you're back to being a research assistant. You have no trading account. What happens next?

I was earning only $10,000 a year, which was a low salary even back then. I remember that I was making less than the department secretary. So, after two years, I asked for a raise. The head of the commodity department met with me and offered to give me a 20% raise, which sounds good percentage-wise, but still left me at a relatively low salary. I decided to see what else was out there. I went to an executive recruiter. Within a week, I had an interview that led to a job offer for a director of commodity research for Hornblower Weeks at more than triple my salary at Reynolds.

Do you know why you got the job?

I supplied them with samples of my reports. I also had started writing articles for an industry magazine called *Commodities*, which gave me some name recognition. So, once again, my writing was instrumental in propelling my career.

What happened to your trading after you blew out your first account?

Over the next few years, I tried trading again two or three times, starting with a few thousand dollars. I don't remember any details, but the end result was the same as for my first account.

By the way, even though I was clueless about successful trading, I was doing something right at the time: I was only risking a small amount each time I started trading, and if I lost my starting stake, I stopped trading. Even though I knew nothing about risk management in those early years, this small-starting-stake approach provided a strong risk control. It is the only element of my early trading that became a lifelong rule: Whenever I start trading, I always risk a small amount, and if I lose that small amount, then I'll stop and come back at a later time.

I believe the recommendation to use this approach is good advice, especially for novice traders, because it creates an asymmetric payoff: If the trading attempt fails (the account wipes out), the loss will be relatively small. But if it succeeds, the account can grow to multiples of the initial starting equity. Although they achieve it differently, creating asymmetric payoffs is a critical element in the success of many of the Market Wizards I have interviewed.

When did you start experiencing success in trading, and what changed?

As a research director, I supervised a staff of analysts. I noticed that the only analyst who was significantly more right than wrong was the technical analyst, Stephen Chronowitz. Steve and I shared a large office, and we became close friends. At the time, I was still totally oriented toward fundamental analysis. Perhaps because of my academic background in economics, I had an inherent bias against technical analysis. I thought it was mumbo jumbo. But seeing that technical analysis worked for Steve, I reconsidered my prejudgment.

Through my conversations with Steve, I understood that there was a rationale why technical analysis embedded real information: Market prices—the core input of technical analysis— reflected all the known fundamentals and the actions of all market participants. In effect, prices were the net result of all market information and everybody's actions. So, there was a logical reason why technical analysis might work. I finally said to Steve, "OK, show me what you are doing." Steve taught me the basics of chart analysis.

Did you start using chart analysis, and how did that impact your trading?

Yes, as I gained experience applying chart analysis, my opinion of the technique changed 180 degrees from my original skepticism. I also discovered that technical analysis was compatible with risk management, whereas the reverse was true for fundamental analysis. If, for example, I think cotton prices are overpriced at 33 cents, then if the fundamentals don't change, cotton would be a better short at 38 cents and an even better short at 43 cents. So, with fundamental analysis, the more the market goes against you, the better the implied trade opportunity. It virtually implies you should add to a losing position. With technical analysis, if the market moves against you, by definition, the original rationale for the trade is contradicted.

So, it is difficult to combine risk management with fundamental analysis, but quite natural to do so with technical analysis.

Once I switched from trading based on fundamental analysis to technical analysis, I went from consistently losing to becoming net profitable. When I started using technical analysis, I also started using risk management, and that made all the difference.

One of the trades I remember best in my whole life was a losing trade. It was early on in my using the combination of technical analysis and risk management. The Deutsche mark had witnessed a large slide and then settled into a sideways range for four or five months. I interpreted this price action as the market forming a base. I went long in the trading range and placed a stop 15 ticks below the low of the range. For weeks thereafter, the market continued to move sideways within the range. Then it broke below the range and stopped me out. I was initially disappointed. But then, in the ensuing days and weeks, the market continued to head straight south, and the great thing was that I was not in the trade. I think it is one of my best trades because I took only a small loss despite being dead wrong on the market.

My takeaway is that your best trades can be losing ones because they allow you to have the capital to place winning ones.

There was a time when I was obsessed with trading. I would look at charts all day, then come home and look at charts all night. In a way, it was a good obsession because I enjoyed it, but at the same time, it was also an unhealthy one because it took so much time. I'm curious, how did you find time to trade and do your director of research job?

It was never an issue because trading was always a sideline. First, I only traded periodically. And, even when I was trading, I would review the charts in the evening to decide on trades; I wasn't trading intraday.

Why did you trade only periodically?

As I mentioned before, my modus operandi was always to start trading with a small amount of money—the definition of "small" increasing over time. That way, when I lost, I only lost a small amount while retaining the opportunity each time to substantially multiply my initial risk capital. If I lost my starting stake, I would stop trading for months or sometimes even years. Even when I multiplied my starting stake substantially, once I hit a significant drawdown, I usually stopped trading. I would resume trading when I had a genuine desire to do so and when I had sufficient time. Because of this approach, there were many periods when I wasn't trading at all. I was OK with that because I never considered trading a vocation, only a hobby to be indulged when I wanted to do it and had enough time—which often was not the case.

Also, I realized that I didn't have any particular skill in trading. On the contrary, some of my natural traits, such as impatience, make me poorly attuned to being a trader. I managed to be net profitable in trading only because of what I knew, not because I am a good trader. Bottom line: Although I started thinking I wanted to be a trader, I realized I didn't have the requisite talent to do it well.

Do you believe only people with innate skill and the right personality can be successful traders?

To some extent that's true. Anybody can become better at trading through knowledge and by incorporating key principles like risk management and learning the right things to do and not to do. But to achieve outstanding success as a trader requires some innate ability. Not everyone can be a sports star or a great musician. You need some inborn talent. Why should trading be any different?

What is the story behind writing your first book?

More than 40 years ago, in the early 1980s, an industry acquaintance, Perry Kaufman, was putting together a book called *The Handbook of Futures Markets*, an enormous anthology of articles on the futures markets. I think he wrote one or more chapters on trading systems, which was his specialty, but for the bulk of the book, he recruited different experts in the industry to write a chapter on a specific topic. He asked me to write a chapter on fundamental analysis, and I agreed.

I started working on it, and at some point, I had 80 pages and wasn't remotely near finished. I realized that my topic, fundamental analysis, was far too broad to be covered in a chapter. I also thought it would be crazy to write such an extensive exposition for someone else's book. I figured I had unintentionally started writing my own book. I thought I perhaps had one-third of such a book already done, so I might as well finish the task. I was wildly over-optimistic. As it turned out, I only had about one-tenth of what would be my first book done.

Perry's request was the initial catalyst for writing my first book, but there was also another motivation. At that time, I didn't think there was a good, comprehensive book on futures market analysis and trading. I thought I could write one that was better than anything else that was available. So, I took a sabbatical to finish the book I had inadvertently started.

I called Perry and told him that what I had written so far was too lengthy to be offered as a chapter in his book. I told him I had decided to write my own book and could offer him one of the chapters in that book as a chapter in his. He understood and was fine with the substitution. I then took a sabbatical to work on the book called *A Complete Guide to the Futures Markets*.

Did you think you would make enough on the book to justify giving up a year's salary?

I never thought about it in monetary terms. If I had been motivated by money, I would have avoided including an extensive section on regression analysis, which would have both significantly reduced the time needed to complete the book and increased sales. I believe there is an inverse correlation between the number of equations in a book and sales. It was more about the objective of writing the best book on the subject and establishing a reputation.

How did the book do?

A 750-page book on market analysis will never be a best-seller, but it did reasonably well for a professional book. In fact, the book's positive reception was the catalyst for the first *Market Wizards* book.

How so?

An editor for another publisher invited me to lunch. He told me he was impressed by my first book and pitched me the idea of writing a series of books, each covering a single futures market or market group.

I told him I had no desire to do another professional book. "If I write another book, I want it to reach a much larger audience," I said.

“Do you have anything specific in mind?” he asked.

I told him about my idea for *Market Wizards*.

“Great,” he said. “Do that.”

How did you get the idea for *Market Wizards*, and why didn’t you do the book before this lunch meeting?

I don’t remember when I first came up with the idea for *Market Wizards*. I knew some great traders, and I thought the book would be a fun project and a good excuse to pick their brains. I didn’t pursue the idea because being a research director was more than a full-time job. I knew it would mean working crazy hours to do both. I needed the extra push. I wrote the book on nights and weekends, frequently working through the entire night.

Was it easier to succeed in trading in the 1970s and 1980s, when the traders in the first *Market Wizards* were active, than now?

Logically, it would seem that’s true because there were far fewer professional traders then. There was a lot less competition. Now you have trading firms with a hundred Ph.D. quants, and well over 20,000 hedge funds globally. However, some of the traders in *Unknown Market Wizards* have performance records that are among the best of any traders I have ever encountered. Even though there’s a lot more competition now, apparently, the opportunity to excel in trading is still there.

In sports, anyone who excels is going to have exceptional physical capabilities. But I assume an analogous assumption does not hold in trading. That is, great traders don’t necessarily have extremely high IQs. Is that right?

Yes, to an extent, I believe that’s true. Having a very high IQ is not a prerequisite, or perhaps even correlated, to being a great trader. Some of the Market Wizards I interviewed, such as Ed Thorpe or David Shaw, to name only two, were obviously brilliant. I assume most of the people I interviewed had above-average IQs. But I am sure many traders I interviewed didn’t have *exceptional* IQs.

And is the converse also true—that is, many people with super high IQs might be terrible traders?

Yes, I believe so. As long as they are subject to the same emotional pitfalls that are natural to most people, they would not be good traders.

The *Market Wizards* books are unique in their interview format. I can't think of any other books I have read or that have had prominent success and have remained widely read for such a long time that had this format.

I didn't know the structure when I started working on the first *Market Wizards* book. When you work on a book, ultimately, the structure defines itself. What seemed to work well for each trader chapter was a main interview section sandwiched between a narrative beginning and a conclusion. And in turn, these trader chapters were sandwiched between prose chapters at the beginning and end of the book.

Oddly enough, I don't typically like reading interview-format articles because they're often too pat, too predictable, and dull. I didn't choose this format because I liked it; I chose it because it worked. It's important that the interviews contain narratives. If you go through the *Market Wizards* books, you'll see many lengthy answers that are essentially narratives. Chunks in many chapters are stories, which is how many people like to learn. In my interviews, I'm always trying to drag stories out of people—stories that are engaging and usually, but not always, related to trading. In editing the interviews, which is 90% of the work, I am cognizant of three goals: staying true to the traders' comments, relaying trading insights, and creating a chapter that is a good read. I believe the last of these goals helps me overcome the limitations of the interview format.

You wrote the first *Market Wizards* book pre-internet. How did you find the people to include in the book?

I knew some of the traders in the first book personally. I already mentioned how I met Michael Marcus. Michael, when he was managing money for Commodities Corp, hired Bruce Kovner, and through Michael, I met Bruce.

Michael was also the source for Ed Seykota. Michael kept a very low profile and was reluctant to do the interview. A mutual acquaintance helped convince Michael to agree to participate. I flew out to his home in Malibu, and we spent the entire day in a wide-ranging conversation, initially sitting in his living room, then walking on the beach, and continuing through a dinner cooked by his personal chef. After dinner, Michael pushed back his chair and said, "This has been a cathartic experience. I'm glad I agreed to do it. You should interview Ed Seykota."

"Who is Ed Seykota?" I asked.

"Ed is the best trader I know," Michael answered.

If you are doing a book on great traders, and someone who turned a $30,000 account into $80 million tells you about the best trader he knows, you're obviously interested. Michael got Ed on the phone and told him about what I was doing. I spoke to Ed, and he agreed to do the interview. I canceled my scheduled flight back to New York and flew to Lake Tahoe instead to interview Ed Seykota.

Other traders in the book were well-known. For example, Richard Dennis was already a legend, having turned a starting stake of less than $1,000 into $200 million. Jim Rogers had co-founded the Quantum Fund with George Soros, a firm he had left to manage his own money. Although still early in his career, Paul Tudor Jones had established a reputation as a star futures trader. Larry Hite had founded Mint Investment, one of the largest futures funds at the time. Michael Steinhardt had a 20-year-plus record as one of the best-performing hedge funds. Marty Schwartz was a solitary trader who would normally have been entirely unknown, but he kept entering these public trading contests and consistently scoring incredible returns.

Then, there were traders I found by making inquiries. For example, I kept hearing the firm BLH mentioned as one of the major buyers or sellers in the bond futures market. When I asked industry sources who BLH was, I discovered it was a single trader in Peoria. That certainly got my interest.

When did you realize the traders you were interviewing had different methodologies?

I realized that every trader was different in the first *Market Wizards* book, and that observation remained true in every subsequent book. To quote myself, "There are a million ways to make money in the markets. The irony is that they are all very difficult to find."

How does a trader decide which methodology is best for them?

That is essentially a matter of self-discovery to determine which approach resonates and feels most comfortable. And it will be different for everyone. The right approach has to be something that fits your personality. A good example is Jason Shapiro in *Unknown Market Wizards*. Jason enjoys arguing unpopular opinions. By his description, if he goes to a party where most of the guests are liberal, he will argue the conservative side, and if most of the guests are conservative, he will argue the liberal side. So, what kind of trading approach does he end up adopting? He is a contrarian trader—a strategy that fits him like a glove. As another example, Ed Thorp, a brilliant mathematician, used his mathematical skills to uncover and exploit various market inefficiencies.

Reflecting on all the traders you have interviewed, how much of trading success do you think is due to being right on trade selection versus having the proper risk management?

I definitely come down on the side that risk management is more important than anything else. Most people, especially novice traders, think that trading success is all about trade entry and that risk management is an add-on, if they even consider it all. Successful traders, however, understand that risk management is the key because to win, you have to be able to stay in the game. And if you don't have effective risk management, no matter how skilled you are at picking trades, sooner or later, there will be a trade where you are dead wrong, and it can wipe out your account.

At what point did you know that the first *Market Wizards* book would be successful?

Early on. The *Wall Street Journal* printed a favorable review right after the book came out, and the book immediately sold out. Unfortunately, the publisher took a couple of months to get the book back in stock, which was very frustrating.

Why do you think the book continues to sell more than 30 years after you wrote it, despite all the changes that have taken place since then?

Markets are driven by human emotions, which don't change. They were the same 100 years ago, and they'll be the same 100 years from now. That means there are certain aspects of markets and the right and wrong things to do in trading that are timeless. That is why a book like *Reminiscences of a Stock Operator*, which I read 65 years after it was written, still resonated with me. Many of the trading-related passages in the book still seemed entirely fresh and pertinent, even though it was written in a different financial era. When writing *Market Wizards*, I had an objective of writing a book on trading that, like *Reminiscences,* would capture basic truths about trading that would remain relevant 50 or 75 years later. That is not to say I had an expectation of achieving this, but it was my goal.

When I think of my career, the book that stands out as timeless is Dale Carnegie's *How to Win Friends and Influence People*, published around 1936. It is just as relevant today as it was then because the core of who people are has not changed. Now, there are many new ways to communicate with people, but the fundamental idea that if you want to be interesting, then be interested in somebody has not changed. The elements that make someone successful at trading or anything else—having the right mindset and ethos, not being emotional—don't change because intrinsic human characteristics don't change. I think *Market Wizards* is more a book about human psychology than a trading book.

I have said the same thing myself.

What three quotes stand out to you in all the books you have written and among all the people you interviewed? And I'll tell you there is one quote from your books that I probably think of at least once a week.

I'm curious, what is the quote?

I don't want to give it away now because I want to hear your response first.

At the top of the list, I would place Bruce Kovner's quote: "Know where you will get out before you get in." If I were restricted to one sentence in offering advice on trading, that would be it. This quote is so important because it captures 90% of risk management in a simple prescription. By establishing the exit point on a trade before you place the trade, and adhering to it by, say, using a stop-loss order, you limit the loss to a predefined level (barring a price gap beyond your stop level). The advice is also wise because you determine where you will get out when you still have complete objectivity—before entering the trade. Once you are in a trade, you lose that objectivity.

A provocative quote that rings in my mind is Ed Seykota's observation: "Everybody gets what they want out of the market." Initially, I found this statement hard to accept. Surely, many people who lose in the markets don't want to lose. Then I had an experience that gave me insight into the truth in Ed's assertion. I relate the entire story in the first chapter of *The New Market Wizards*, and I won't go through it all here. But here is a brief description.

I was extremely busy with my job as Director of Futures Research and writing a book. I didn't want to trade because I knew it would create even greater time stress. One day, I saw a trade that I felt strongly about. At first, I resisted the temptation to start trading again, but then I placed the order. Sure enough, the trade worked. Subsequent trades were net profitable. At one point, my net profits were sufficient to pay for a car that I was in the market for. I considered cashing in my account and using the proceeds to pay for the car but then thought, "How could I give up the opportunity to grow my account substantially more?" Soon after, I made a series of extremely stupid mistakes that violated my trading rules. My profits evaporated, and as my account neared breakeven, I stopped trading.

Several months later, Ed Seykota and I were both speakers at a conference in San Francisco. That evening, I related the whole story to Ed. He asked why I didn't stop trading and buy the car with the profits if I was under such time pressure. I explained my rationale. Ed replied, "In other words, the only way you could stop trading was by losing. Is that right?" There it was. I had wanted not to be trading, and that is what I got.

Another time Seykota's quote resonated with me had nothing to do with trading. It concerns your sister Samantha. In her freshman year in college, she was good enough to earn the spot as the starting goalie on the ice hockey team. But she disliked the pressure of being a goalie. She also wasn't happy about the enormous time commitment required to be on a college sports team. In her sophomore year, she didn't do as well and ended up giving up college hockey at the end of that season. Ostensibly, she seemed to be trying as hard, but the results were not the same. I remember sitting in the stands at one of her games that year and thinking of Seykota's line: "Everybody gets what they want." At a deeper level, she didn't want to play anymore, and that is what she got.

So, Seykota's quote applies more broadly in life; it's not just about trading. Often, people experience a disappointing result, but there may be hidden reasons that are more compelling and drove that outcome.

That's two. What about a third quote?

I like Jim Rogers's quote: "I just wait until there is money lying in the corner, and all I have to do is go over there and pick it up. I do nothing in the meantime." It is such a colorful way of describing the quality of patience to wait for the right trade—a critical trait in successful trading.

What is the quote you think about often?

Anybody who's ever worked for me would know exactly what I'm going to say because I bring it up all the time. It's the same line you mentioned: "Everybody gets what they want." It's become an ethos of the way that I live life. It's almost like a law of the universe. If I'm speaking to a large company, and I think they'll never be interested in our product, and I don't belong in the same room as these people, then that is the outcome I will get. If, instead, I believe that our product can help them and that there is every reason I will be successful, that is the outcome I will get.

Three hours north of where we are having this conversation, in Orlando, there's Disney World, which is built on swampland. Can you think of a worse place for crowds of people to have a positive outdoor experience than a swamp? There are more mosquitos in swamps than anywhere else. Any rational person would have said it was a crazy idea to build a huge theme park on swampland. But the chief engineer [William "Joe" Potter] knew what he wanted, and he made it happen by designing Disney World so that any water in the park is always moving. Even the buildings are designed to not allow still water to collect anywhere. That is a classic example of someone getting what they wanted. Everyone would have said the project was impossible, but the answer was as simple as just moving water.

So, in everything I do, I ask, "Am I putting myself in a position to get what I want, or am I the blocker in the situation?"

What has been your favorite thing about the *Market Wizards* journey?

There is a sense of satisfaction in having written books that appealed to so many people worldwide. Over the years, I've received many emails and phone calls from readers expressing gratitude for the positive impact the books have had on their trading and their lives. It is humbling to know that my books have changed people's lives. Also, the books allowed me to speak at numerous events and travel to many different countries.

Something that deeply impacted me was the inscription you wrote in one of your books and gave to me before I left for college. It was the most perfect advice that anyone could receive.

I don't remember. What did I write?

I have it framed on my wall right here:

Follow your talent.

Choose what interests you.

Don't settle for less than your best.

Be honest.

Believe in what you can achieve.

That is a good summary of my philosophy.

That inscription summarizes everything we talked about today. "Follow your talent" goes back to what you said about everyone having their own particular skill. It also relates to why you switched majors and why you focused on writing instead of trading.

"Choose what interests you" reminds me of your description of Shapiro, the contrarian trader, who pursues a trading style that reflects who he is.

Your copper article perfectly exemplifies "Don't settle for less than your best." If you did anything less than your best, you might never have gotten your first job and the entire career that followed.

"Be honest" is a core principle if you want to have long-standing relationships. It also relates to trading because you must be honest with yourself.

"Believe in what you can achieve" ties into getting what you want. If you don't have that belief, you won't achieve your goal because you're the barrier to getting what you want.

Honesty is something that I got from my father; he was absolutely honest.

I have a visceral memory of when the importance of honesty hit me. I was probably about nine or ten, and we lived in Goldens Bridge. You were driving me home. I don't know if you remember, but there was this old mansion with colonial pillars on a large plot of land, which was a real outlier in the neighborhood. It was situated right at a road fork we always passed on the way home. You asked me whether I had eaten a pack of cookies, and I lied and said I did not. You pulled the car over at that fork, turned to me, and said, "Zachary, if you do anything in life, you have to be honest. That's the most important thing." That moment just stayed with me.