Millionaire Traders

HOW EVERYDAY PEOPLE ARE BEATING WALL STREET AT ITS OWN GAME

KATHY LIEN
BORIS SCHLOSSBERG

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PREFACE

How many times have you heard the often-quoted statistic that 90 percent of all traders fail? Yet everyday, millions of ordinary people around the world wake up, turn on their computer, and try to make a living by trading the financial markets electronically. As in every profession, there are successes and failures. The same statistic of failure exists in the restaurant business, especially in our hometown, New York City. New restaurants spring up on a near daily basis, some are successful, most fail, but the possibility of hitting it big never deters people from trying.

We have found 12 people who have hit it big trading for themselves. These are not hedge fund managers or employees of big money center banks, but regular people who started with as little as $1,000 and turned their small initial stakes into a six- to seven-figure fortunes. These people come from all walks of life, live all over the world and trade a variety of electronic markets. Some of the traders focus on equities, others on futures or foreign exchange. Each has a very different style of trading, some that are even in direct conflict with each other, highlighting the fact that there are many paths to success in the financial markets. However, all of these traders practice discipline, stick with their strategy, and always cut their losses. None of our interviewees were successful from the start. Several have blown up at least one trading account. But instead of walking away from the markets, they learned from their early failures and used that experience to improve and ultimately succeed. We convinced them to share their stories and tell us how they got started, their best and worst trades, their number one rule of trading, and the many lessons that they have learned through their experience. We hope these stories inspire you to believe that success is possible and that everyday people can beat Wall Street at its own game.

Kathy and Boris
New York
September 2007

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CHAPTER 1

THE ART OF TRADING

> It ain't about how hard you hit, it's about how hard you can get hit and keep moving forward. That's how winning is done!
>
> —Rocky Balboa

Trading is a battle between you and the market. The traders we interviewed for this book have offered a wealth of insight into the art of trading. We have distilled their most important ideas into this short summary highlighting one unique idea from each trader that can help you succeed in your battle with the markets.

1. IF THE NEWS IS GOOD BUT THE STOCK PLUMMETS, BUY THE CRASH

Buying crashes is not for the faint of heart. For many traders, the experience is akin to jumping out of a plane without a parachute. Yet Dana Allen has made his living doing just that. How does he profit from other trader's losses? By looking for tell-tale signs of divergence. Technical divergence setups where price makes a new high but momentum indicators do not is one of the bread-and-butter routines of many successful traders. However, Dana Allen takes the idea one step further by trading fundamental divergence. He likes to buy stocks that sell off on good news speculating that the initial reaction is often simply due to short-term profit taking. Once the sellers are done, Dana likes to scoop in and buy value at a cheap price and then quickly resell it higher once demand reappears. By making sure that he only buys quality companies with good news, Dana has the fundamental support for his trades and more often than not is able to bank gains in the process.

2. KNOW YOURSELF, KNOW YOUR TRADE

In trading, knowing yourself is more important than any particular trading strategy that you may choose. Your personality needs to be in sync with your methodology, otherwise you will not be able to follow the rules of the setup. Knowing your strengths as well as your limitations is rule one of becoming a successful trader. As Rob Booker points out in his interview:

> I am a 50- to 100-pip-a-week trader. Meaning I have pretty much decided that that's about the limits of my human capacity and over 50 to 100, I start getting a little bit crazy. I become a little bit less disciplined and a little bit more euphoric to put it mildly. So, I have not generally done a lot to increase that pip target over time, even though systems that I build might produce bigger gains.

If you have a short attention span and seek instant gratification, long-term swing trading strategies will not work well for you, no matter how robust they may be because you will not have the patience to successfully see them through. Conversely, forcing oneself to become a scalper is sheer suicide for a trader who may be much more analytically, rather than instinctually, inclined. Therefore, it is imperative that you know what type of trader you are and trade within your comfort zone. There are many ways to succeed in trading but they must be aligned with your personality.

3. REVENGE IS NEVER SWEET

The most dangerous time for any trader occurs right after a major loss. The instinct for *revenge trading* (the desire to get it all back at once) can be far more damaging than the initial loss, leading many traders to make impulsive, irrational decisions that often lead to complete destruction of the account. Therefore, traders would do well to heed Chuck Hays' advice, which could save them from needless ruin:

> Revenge trades are the most costly trades. If you have a bad trade and you try to make it all back at one time, you're going to lose more money. I think I learned from experience that the best thing to do is to try and get back and get even a little bit at a time. It's a whole lot easier to make a half point on a 100 contracts than it is to make 10 points on 10 contracts. I just try to focus on making good trades, do the same thing over and over again . . . and string together some singles.

By chipping away at his losses, Chuck focuses on reestablishing control over his trading by assuming less and less risk until he has slowly recovered his losses. This strategy stands in sharp contrast to what many novice traders do, which is to create even more risk by trying to hit homeruns after a large loss, and shows why Chuck is one of the premier traders in the game.

4. TRIPLE YOUR DEMO TWICE BEFORE TRADING FOR REAL

This insight from Hoosain Harneker is perhaps the most practical piece of advice from any of our super star traders. Nobody can master a professional skill right away. Doctors practice on cadavers, lawyers spend countless hours in moot court, and mechanics toil for months in classroom garages. Practice does not guarantee success but lack of practice almost always ensures failure. In foreign exchange, which is Hoosain's market of choice, every dealer offers a practice platform allowing traders to experiment with virtual money rather than real capital. In other financial markets plenty of software tools exist to allow the trader to "paper" trade in realistic market environments. For example, our other interviewee, Paul

Willette, who was already a successful equity trader, spent three months paper trading his account when he decided to make a switch to electronic stock index futures.

What makes Hoosain's advice even more valuable—albeit much harder to follow—is that one has to achieve substantial success on the demo before moving to a live account. By mandating that you triple the demo, Hoosain requires that your trading methodology has a discernable edge that should serve you well in the real market. While his rules of trade are difficult, they are well worth following because they instill the discipline necessary to succeed in the real market.

5. DON'T LOSE YOUR COOL—ALWAYS USE A STOP

Although this rule is practiced by every professional trader to control risk, Franki Law, the Forex (FX) trader from Hong Kong, offers additional insight into why it is so valuable. In his interview, he states:

> There are many people who will go long a currency pair and keep injecting money into their accounts if they get margin calls to buy at even lower prices in hopes that a rally will help them to recover their entire account. For example, if you are long 10 lots, and the price falls, you add 20, if it falls again, you add 30 etc. Although the ability to recover quickly may seem extremely attractive, it is very dangerous and it is something I will rarely use. The reason is because I feel that if I keep on posting money into my account to meet a margin call and adding into a losing position, I am essentially at the whim of the market. I can only hope that the trade moves in my desired direction, but I am essentially stripped of my decision making power. Perhaps the price movement would have called for a short, but since I am buried so deep in the long position, I can only let the market take me where it wants to. So what would I do if I got a margin call? I would close my position and wait for the next clear opportunity or setup to get into the market because it avoids letting the market dictate my profits and losses and allows me to be the decision maker once again—I get to choose when to get into the market, what product, and what size and this control is very important to me.

If you do not use a stop, you are at the mercy of the market and lose all control over your trade. Since trading at its core is ultimately an exercise in control over the chaotic and often unpredictable markets, a stop is a must for any long-term trading success

6. PROTECT YOUR CAPITAL—PROTECT YOURSELF

This is perhaps the most basic but often the most overlooked aspect of trading. According to Indi Jones:

> Clint Eastwood would be a great commodity trader because he told the Million Dollar Baby that rule number one in boxing is to protect yourself. And I think the same is true in trading. If you want to trade, your capital is everything. So, if you want to be a great trader, you have got to protect that capital. No capital, no trading, no life and its the same whether you want to be a Million Dollar Baby in boxing or a Million Dollar Baby in commodity trading, I think it's the same thing—protect your capital.

The market will forgive many things including bad, even stupid trades, but it will not forgive the loss of capital. Once all of your capital is gone there is no opportunity to recover. That's why capital preservation is always the foremost concern of every trader we interview.

7. AVERAGING DOWN IS FOR LOSERS, BUT AVERAGING IN CAN BE THE DIFFERENCE BETWEEN SUCCESS AND FAILURE

Most traders will tell you that averaging down into a trade is a mug's game. However averaging in is a strategy employed by a number of our interview subjects to a great success. What's the difference? Intent. Traders who average into the positions expect to be initially wrong on price and size their trades accordingly. Roland Campbell is one such trader:

> That to me is absolutely the key to my success. I average in on every trade I make and I average out whenever I exit. I have a tendency where, as soon as I buy a currency, it will dip 10 pips.

> Before I would get upset, but now I love it because I feel like I can get in at a better price, so I hope it dips another 10 pips. I know the price I want, so I will average into that price.

Roland allows himself about four average ins before he calls it quits. "If it goes much further than four average downs, I have to start considering whether this is the right trade to be in," he notes, "but nine times out of ten that strategy works for me." Roland always knows his "uncle point" and unlike novice traders who are never willing to pull the plug on a bad idea, Roland will always stop himself out when a trade goes bad. However, in the majority of the cases, he will succeed in turning a profit on most of his scale in strategies, showing once again that all rules of trading can be broken as long as they are done so for a good reason.

8. TOPS OR BOTTOMS ARE ONLY EVIDENT IN HINDSIGHT

There is an old trading adage that goes like this, "They don't ring a bell at the top." While tops and bottoms may seem obvious in retrospect, in the heat of the battle they are rarely clear. That is why Tyrone Ball's point is so valuable. He said, "I came to understand that you can't pick the top and the bottoms of your trades, you just got to be willing to take money while it's still in your favor and cut your losers small. I mean it sounds too simple, but most can't do that." Market profits can be very elusive. Like ice cubes in your hand. Therefore, banking at least some profits when you get them is a cornerstone to most of our traders' success.

9. TURN HAPPENS ONLY ONCE BUT TREND IS CONTINUOUS

For anyone who is a fade trader trying constantly to pick tops or bottoms, Ashkan Balour's deceptively simple observation should provide a moment of pause. He states, "Basically I am continuation trader. When the trend is going in that direction, I don't see any point in trying to find the turn. It will tell you when it's reversed. If you look at any chart pattern where the market's reversed, you'll see a daily reversal. Reversal only happens once, but the continuations happen all the time until the moment the reversal is hit." In a sense, Ashkan argues rather persuasively that the higher probability trades occur with the trend since, like in physics, price will stay in motion until it is counteracted by a stronger opposing force. Until such time comes, Ashkan believes, it is much more productive to trade in the direction of the major trend.

10. THE LAST 25 PERCENT OF THE POSITION CAN MAKE A DISPROPORTIONATE CONTRIBUTION TO YOUR OVERALL PROFIT

Everyone wants to be able to let their profits run, but in real life financial instruments rarely follow a smooth straight path to riches. Instead prices often retrace the majority and sometimes all of their gains leaving many inexperienced traders empty handed. Paul Willette, however, has come up with a method to harvest some profits right away while ensuring that he can still benefit from an occasional extension run in his favor. What's noteworthy about his insight is that even leaving a small proportion of his original position on could contribute significant profits to his overall account.

How does this work? Let's assume that we trade like Paul does with a position of 20 contracts. The stop on the position is 1.00 ER (a mini-Russell 2000 stock index future) point. At +1.00 points in his favor, Paul would sell five contracts and move the stop to breakeven. At +2.00 points he would sell another five contracts. At +3.00 points he may sell an additional 5 contracts. At +5.00 he may sell two more contracts and at +7.00 he may finally sell the last three remaining contracts. In total the trade would have netted +61 points, but note that fully 31 of those points—or more than 50 percent—came from the last five contracts or just 25 percent of the original amount of the trade.

Paul teaches us that we do not need to make money on more than a small portion of our position in order for the whole trade to be substantially profitable.

11. MAKE YOUR MONEY WORK FOR YOU

In a rush for capital appreciation, many traders often overlook the immense power of compound interest. Marcelino Livian is not such a man. Instead, much like the largest money center banks and the savviest hedge funds in the world, Marcelino always looks to get paid while holding a position. This is the reason he trades FX exclusively on the side of the carry, letting the positive interest rate differential between the currencies work to improve his average entry price while he waits for his trades to become profitable. While his method may be far less glamorous than the swashbuckling style of the scalpers it is no less profitable and should be taken just as seriously.

12. BEAT COMPUTERS AT THEIR OWN GAME BY USING PROBATIVE ORDERS

Almost 70 percent of trading on Nasdaq is now done through automated order-entry programs. Many traders have bemoaned the onset of computerized trading robots as the end of face-to-face markets, but Steve Ickow has not only adjusted but prospered under the new regime by probing out the logic behind the software algorithms. Steve says, "A high percentage of Nasdaq volume is now composed of black box trading. So a lot of times I will test price just to see where the market is. Let's say I am long and I start bidding up and bids come with me then I know I am good. Let's say I offer and now no one joins me, no one is an aggressive seller. That's how I get information on the stock by constantly bidding and offering." Whether you are a machine or a human being, when it comes to financial markets ultimately you are either a buyer or a seller. By constantly probing the logic of the machines, Steve Ickow is able to figure out their true intentions and turn that information into profitable trades.

CHAPTER 2

THE MAN WHO BUYS CRASHES

DANA "DAN" ALLEN

Ever since he was a little boy Dana "Dan" Allen was fascinated with trading. He started reading the *Wall Street Journal* at 9 and opened his own commodity trading account by the time he was 21. Dana's trading career has been characterized by one overarching theme—the uncanny ability to buy a dollar's worth of value for a nickel. Be it commodities, stocks, or options, Dana has succeeded in finding deep value in whatever instrument he traded, often increasing his initial investment tenfold. The man who buys crashes, Dana Allen, thrives on making bids when most other market participants are running for the exits. Although his trading style is not for the faint of heart and can be seemingly chaotic, Dana has managed to face the risks and walk away with returns that most retail traders can only dream about. We had a chance to interview Dana from his home in Nevada.

■ ■ ■

Q: Were you always fascinated with trading? Did you read the *Wall Street Journal* when you were in high school?

A: Oh younger than that, I started reading it when I was eight or nine years old. I'd look at the commodities section and at the charts and I always thought, gee, you know, I can make money in this. Of course, I was too young. But when I was 21, I think right on my birthday, I started trading commodities. So I guess at that point I had to be the youngest commodity trader in the United States at that time.

Q: When you say you started trading commodities, were you trading retail?

A: Yeah, I was. It was back in the very bad commission days. I was still in college and I was trading mostly copper because I was a geology student.

Q: What were the commissions like at that time?

A: Oh outrageous [laughter]. Yeah, it was so bad; I think it was $50 to $100 a side or something like that. It was terrible.

Q: And how much was each point worth?

A: It was $250 per penny.

Q: So copper had to basically move a penny for you to overcome the commission costs, right?

A: That's right, it had to be a fairly big move. Back then my broker had to pay $600 a month for a five-minute delayed quote fee which provided as much information as anyone can get free now. These days, everything is so much better. The information is free, and it's faster. The commissions are 1 percent of what they used to be. I can do options and the commission is a dollar fifty to both buy and sell where it used to be like 50 bucks each. In many ways it's never been better than it is today to trade.

Q: Did anybody in your family trade stocks?

A: Yes, my father did as an investor. But he was a business man, not a trader. I started off doing it myself and then, like most people, I started with the minimum account size of $3,000 [laughter]. And sure enough you always have to blow up when you have such a tiny account.

Q: How long did it take you to blow up?

A: Oh I think six months. That's pretty good when you trade commodities on 3,000 bucks [laughter].

Q: That is pretty good. That's very impressive. You really held out. You treaded water for a long time there. The reason for the question about family was because one of the interesting things that we're finding is that a portion of the traders we're interviewing came from families with strong interest in trading. We were wondering if that had a big impact on you or just a marginal one. Did you and dad talk stocks when you were younger or was this really your own personal pursuit?

A: It was mainly me reading the *Wall Street Journal* and when he would talk to his friends I would pay attention.

Q: So after you blew up the account in college what happened then?

A: Well, for a while I didn't do all that good, I'd refill the account, blow it up again, but later when I started a company in 1988 or

1989, and I played the options on copper, I turned $2,000 into $40,000 in about six months.

Q: How did you find time to trade while you were doing a start up?

A: Long hours [laughter]. Plus I actually used the money to help the company.

Q: So you used your trading profits to help capitalize your startup?

A: That's right.

Q: That's true entrepreneurial spirit. So you ran $2,000 to $40,000. Did you catch a big trend? What happened in the copper market?

A: It went up a lot. It went from about 57 to 85 and of course now, you know copper finally has had its day in the sun. I was very happy with the move because I was buying 70-cent options when copper was at 50 cents and they had a December expiration. I think I bought them in May—it went up a lot. [*Authors' note:* Dana was buying the right to purchase copper at 70 cents a ton when it was only trading at 50 cents/ton. This is a highly speculative strategy that assumes a very large price move over a short period of time]

Q: Was it a one-shot deal where basically you bought options in May and then they just matured into a very fat profit?

A: That's right. I sold some on the way up, but I made a very, very good profit, 2,000 percent or so.

Q: Most people typically get out early, what made you hold on to the trade?

A: Technical analysis. I was following a chart on it and it still looked healthy and so I held on to it until it started losing momentum.

Q: Were you following the daily chart?

A: Yes. Now I use much finer stuff. But back then I think that was the only thing available [laughter].

Q: Was this trade something fundamentally researched or was it frankly just luck that you caught a really nice move and then managed to hold on to it? What made you go long copper at that point?

A: Well, I thought it was undervalued, and then I watched the chart and it dipped down, looked like it washed out, lost its downward momentum, premiums on options became very small, and so I thought quite bit about it and got lucky. I've done that a couple times. I bought Boeing at the market turn in 1982. I bought 25 calls when it was 16 and it went to 28. That was my entire stake in the market [laughter]. I had very little money at that time, but I made another nice killing on that trade. The stock was selling four times the earnings, and it went up to about 28 before the November expiry. Now that I know a lot more about options, I wouldn't have played them that way.

Q: You made a nice punt. Were they trading for teeny (one-sixteenth of a dollar)? They must have been very cheap.

A: I think it was three-eighths or maybe less, maybe an eighth, somewhere in that range definitely under a half. Actually, I think my percentage on the trade was 3,000 percent. But I've also been wrong. One time that I was very wrong on the market was in 1998. I read some articles which made a very good case that S&P was way overvalued, so I started buying S&P 500 put options and I lost a lot of money [laughter]. I quit fighting the tape The next time, actually, I nailed it pretty good, which was in late 1999 The market was just absolutely insane and I was in on the run. At the same point, I was involved with the dotcom startup and we were being offered just outrageous valuations. So, I actually thought it was going to crash in March or April 2000. I felt that way since January, and I wasn't alone. I think in *Forbes* magazine, [Bob] Metcalf of 3Com and [Gordon] Moore of Moore's Law wrote articles about why they thought the dotcom boom was going to crash. If I had it to do over again, I could probably come up with some options techniques, to take advantage of the crash. But back then I didn't feel like shorting stocks because you never know how far it could run. Also, the option premiums were outrageous then. Now I think I would have done *put backspread* and things like that or selling credit spreads, which are good ways to play a runaway market. [*Authors' note: Put backspreads* involve selling put options that are close to being in the money and then using the premium collected to purchase twice or three times as many of far out of the money put options. The strategy works if there is a sharp move down, breaks even if the underlying instrument rallies, and loses money if the instrument declines only slightly.]

Q: At that time you didn't do anything because the premiums were just fat right?

A : I didn't do much in terms of shorting, so that was a missed opportunity. I could have made a lot of money, and I did make some. But in retrospect, I could have a done a lot better because I really felt that what happened was going to happen.

Q: Basically, all the way through 2000 you're very much involved in startups and were just doing recreational trading.

A: Yes, you can say that. It was not full time. In 1998 and 1999, I had two years where I made 50 percent pretty much back to back, and it wasn't actually all that high tech. I was personally in high tech myself. In '98 and '99, valuations were so high. I was buying value stocks and avoiding all the overpriced stuff, and at that point that wasn't the best thing to do.

Q: At what time did you say to yourself I'm going to do this as a full-time trader?

A: 2002 was the time when I really buckled down and saw some very interesting automated trading models and found TradeStation. Actually made a lot of money off their stock too. So it was basically September of 2002 when I really started applying systems and doing it as a full-time job.

Q: Did you develop your own systems or did you buy other systems and modify them?

A: I was trading my own systems, but using TradeStation software to do it because you can actually back test the system.

Q: Why did automated trading attract you? Do you have an engineering mindset?

A: Yes I managed software development. Plus a lot of people say you can never have a completely automated system that will work. But we all know one of the greatest enemies of trading is emotion. People have a tendency to sell at the worst possible moment. I'm no different, but if you back test something, I think it's just natural for you to do a better job.

Q: So currently most of your trading is systems driven?

A: It is, but I don't have it fully automated yet, and I'm working on that now. I can get into positions automatically. I have one system that is very hectic—basically a crash buying system and so you don't know what stock you're going to be in. Using a list of over 200 stocks, it buys the worst crashes. It can go into many different stocks all at the same time on bad market days [laughter]. So I have to manage the positions. The system does work, but you feel like you're losing money until you add it all up at the end day and you end up positive.

Q: Is it kind of like trying to crash land a plane?

A: Yeah, and so I definitely wanted to get that automated.

Q: We're curious about the crash-based system. Clearly the system searches the market using whatever algorithm you have programmed and puts you in a position. We guess that's done automatically. It simply buys at whatever trigger you have. But once you are in position, you are managing the exits manually, is that correct?

A: That is correct, and while you're watching one, another one might be dropping another 2 to 3 percent on you before you look back over on that screen. So I don't enjoy it [laughter]. Clearly it would be better automated. The other thing is you automate the exits—you can back test them. I have basic rules on how to get out, just haven't been able to get them into the computer. I think that with back testing I will find a better way of getting out of position than by watching each stock individually. Wealthlab is what I use now, their back testing is superb.

Q: The system clearly sounds like it buys dips; does it also sell rallies?

A: My back testing indicates that it doesn't work as well on the short side. When they rip up, they continue to go up, so my back testing indicates that it is two or three times better to buy crashes. You're not buying something that's been going down for a week. I'm talking about interday crashes. It's more of an extreme interday crash and then picking up hints that the crash is coming to an end. That's proprietary, of course.

Q: Bottom line: You're primary a long-side trader in stocks because you found that bias to be much more profitable?

A: Yes, you have to know yourself, and I do have a long bias. I tend to buy stocks in oversold conditions, and I am not as good at shorting. That's another reason for automated systems. If I can find something that works very well on back testing on the short side, I'll be very happy to do it, but emotionally in my brain, I have a long bias.

Q: When you are in the midst of holding six, seven, eight positions, do you have either a mental or an automatic hard stop that serves as your risk control? For example, is it a 5 percent move down from your entry price, or is everything discretionary at that point?

A: It tends more toward the discretionary side, but there's also a time stop. I don't want to be in the trade overnight.

Q: So, for example, if at the end of the day you're still negative on the position do you time stop yourself? Will you get out on the close?

A: Yes. I don't want to be in too long. I'll give you a valuable piece of advice: The most dangerous stocks are biotech. So I avoid biotech because they can just go down and down and down.

Q: Because it's very hard to gauge value in those stocks, right? They don't have any assets except whether the drugs either work or don't.

A: Exactly—they are very emotional stocks.

Q: Generally, you're either going to stop yourself out on time or you're going to hopefully have a net positive move before the end the day and take profits?

A: That is correct.

Q: And the system is a day trading system, so you always try to stay flat overnight?

A: Yes, probably 90 percent of the time, but sometimes the crash occurs late in day. Those I hold.

Q: Do you find day trading to be more of a function of your own psychology namely that it helps you sleep at night, or do you believe that there is actually an edge? In other words, according to your back tests is it better to day trade?

A: Yes. I'm just looking for that intraday bounce. I'm not looking to pick up a position.