Learning from Traders that Made It

I recently did a set of articles for MoneyShow.com on 'rogue traders', professional traders that had failed miserably. Some were institutional traders, meaning they were professionals trading a firm's money and some were professional traders from the Chicago Futures Exchanges trading their own personal capital. But both groups shared the same fatal trait: they were unable to recognize and overcome their own personal weaknesses as traders. I received a great deal of e-mails from many of you-some of you were shocked at how often professional traders 'blew up' and some of you found the articles very inspirational. With the recent news of the french trader that lost billions of dollars and the CBOT grain trader that lost nearly US$150 million in one day trading wheat futures, some of you found the articles insightful and interesting and a good look 'inside' what happens in the professional world of trading. We're not invulnerable, we don't control the markets and in fact, we face the same problems, have the same fears and suffer the same difficulties individual traders face.

One e-mail I got in response to these articles gave me pause. One of you wrote me and after telling me how much you enjoyed the articles, you asked an interesting question: 'ok, how do I become a successful professional trader, if the professional traders in your recent articles failed so miserably?' While speaking and being a panelist at the recent New York Traders Expo, I gave the question from this e-mail a good deal of thought. I've been trying to decide the best way to answer the question. Should I write a 'recipe for success' that aspiring beginning traders can follow? Should I make a top ten 'do's and don'ts' list for those of you that want to make it as professional traders? Should I write about how I began my 35-year professional career and what I think helped shaped me and pushed me over the top as a professional trader? All of these were intriguing ideas, but none seemed to answer the question in the e-mail. So I decided to pick out three traders that I personally trained. These three traders are now successful professional traders. They are each very different and yet, they share some common traits. And despite the odds stacked against them, they became successful traders and are now professional successful traders. Stories about professional traders that failed help everyone understand the difficulties all of us face each day as traders. Maybe the stories behind these three traders will help all of you better understand what it takes to make it as a successful professional trader.

Trader 1: Talent Isn't Enough

When I first began running the cash foreign exchange desk at a large US bank, I had already been a successful professional trader for more than ten years. In my new position, I had two new responsibilities: I had to evaluate new trading talent, and I had to train younger traders and help them become successful professional traders. We did hire a few senior traders with experience, but in general, we liked to 'grow our own', because we were starting with a clean slate, free of bad habits and misconceptions. There was one limiting factor that really tied my hands: the bank I worked for [and most US trading institutions at that time] had become enamored with supporting MBA programs and so when we hired people to start as 'new' traders or interns, they either had to come from one of the MBA programs our bank worked with or they had to become accepted into one of the two local MBA programs we supported and take classes while they interned as new traders. I found this limited the talent pool-I saw little if any correlation between MBA school candidates and trading success. I felt and still feel that the character traits inside a person are what make them a success, not the letters on their diplomas. But when you work for a firm, you live by their rules. Their rules limited me to interviewing MBA candidates from a handful of schools and that's what I did.

Here's how the system worked: each Spring our bank would send a handful of recruiters out to the six MBA programs we supported. We attracted a great deal of interest from students at these schools that wanted to become professional traders and 'make seven figure bonuses!' Then all of the various trading departments inside the bank would interview each of the candidates and afterwards, we would get together on a Friday afternoon and have the equivalent of a talent draft. Each of us would have a list of candidates we liked and we'd bargain and dicker until we had secured our quota of talent to train for the next year. If we didn't fill our quota, we were always free to go back to a candidate that made our 'honorable mention' list and interview them again. If we liked them the second time around, we were free to offer them one of our intern spots. And if we fired one of our interns early in the year, we were free to revisit the same talent pool and try to replace them with a quality candidate.

Early one summer, one of my interns quit to return home and join their family business. I was left with a spot to fill, so I spoke with the recruiters to make a short list of candidates to interview. To my surprise, one of the candidates that had originally made my 'wish list' was on the list of available candidates to interview. I asked to interview this gentleman and the bank arranged for him to spend an afternoon interviewing with me.

When Mark came through my office door that afternoon, I suddenly remembered the details of his circumstances: he had been in a joint degree program at one of the schools we recruited from and was also a prized student athlete; in fact, his University won its Division Title two years in a row and he was the division's Player of the Year runner up his last year in school. Although I had bid on him at our talent draft, he had chosen to enter the NBA draft that year and indeed was drafted by an NBA team. In fact the Chicago Bulls had drafted him! He was right in the middle of summer camp with the Bulls and had taken the afternoon off to speak with me about potentially entering our trader intern program. This opened a fascinating line of questioning for me.

Mark was a six-foot six-inch guard and while he had not gone very high in the first round of the NBA draft, he had realized his childhood dream of being drafted by an NBA team and signing an NBA contract. Why would he be interested in interviewing for a trader intern spot? I didn't work my way gracefully to this subject—I went right to the heart of the matter: now that your childhood dream was in your grasp, why would you be willing to give it up to try to learn to be a trader?

Mark looked me in the eyes and was honest and forthcoming. He had been drafted into the NBA, signed a contract and was now playing summer basketball for a NBA franchise with one of the best players in the league, Michael Jordan. It was everything he had ever dreamed of, all there in front of him. And now he was in his third week of summer camp, playing against other professional players. He had more talent than 99.99 percent of all the college basketball players in the world. He should be ecstatic and enthusiastic and enjoying the beginnings of his professional basketball career.

Instead, every trip down the court, it became more and more obvious to him that although he was a star player in college, he was not going to be a star player in the NBA. It hadn't taken him long to measure his abilities against the other players in camp and he had come to a quick and startling decision. He might sit on an NBA bench for a year or two, but he was never going to be more than a bench warmer. The talent level of his competition was too high and his weaknesses were too many to overcome. No matter how much he practiced, no matter how much he wanted to improve, he'd never be able to compete in the NBA at the level he had always dreamed of.

He paused and then he told me that once he realized that he would never be a starter, he knew it was time to move on, time to find out what he *could* do at a professional level for the rest of his life that would make him happy and successful. And when the bank called him and told him that I was interested in interviewing him again, it felt right. He wanted to talk to me about the possibilities of learning to be a professional trader.

I was honestly speechless. I can only imagine just how many thousands of hours this young man must have spent shooting free throws in different gyms over the years, how many thousands of hours he must have spent playing pick up basketball games from grade school all the way through college, how many thousands of hours of structured practices he must have gone through to hone his considerable basketball skills and how many games he must have played in from grade school through college—all with the goal of becoming an NBA player. And now, he was considering walking away to start over! After silently running all these thoughts through my head I looked Mark in the eyes and repeated them to him.

He barely waited for me to finish before responding: sitting on the bench for a year or two wasn't good enough. It wasn't why he had spent all those hours practicing and playing. He wanted to be a successful professional basketball player. And to him, that meant starting on an NBA team and playing significant minutes each night. It was now clear to him that even with all the time and energy he had put in over all those years, added to his significant physical size and talent, he was going to fail at meeting his goal. Then he said the words that cemented my interest in hiring him as an intern: 'once I recognized it wasn't going to happen, it was time to move on. The quicker I get out of this situation and take the emotional loss, the quicker I can move on and start down the road to my new profession. I think I can be a good trader, a successful professional trader. I want you to give me a chance.'

I didn't ask him about his NBA contract. I told him what his starting salary would be and explained how he would be evaluated. Because he was a late entry into our intern program, he'd have to catch up with the other interns, which meant he'd actually have to sit next to me. He'd have to be there when I got to the bank in the morning and stay until I left [I typically arrived at the bank at 5 a.m. and left after 5 p.m. each day]. He'd be responsible for recording all my trades and checking and re-checking all my trades throughout the day. Most nights, he'd have to stay after I left, finishing balancing my various accounts. And while he spent the majority of his time assisting me, he'd have to learn what he had to learn about trading. He'd be fighting an uphill battle and his physical talents would not be any help in this arena—only performance counted in trading.

Mark's response was firm and immediate: if I'd give him a chance, he was ready to start right away. He didn't care about the money, he knew the work would be hard and the hours long. He just wanted a chance to get started on his new career. Then he asked if I would give him the chance, a chance to learn to be a successful trader.

I reached over, picked up my phone and called Human Resources. I told them I was coming upstairs with a new hire and then took Mark to see them. He started two weeks later. Most people think athletes are dumb. Most people think athletes get through college because they are offered easier classes and given special tutoring. I don't know how most colleges treat their student athletes because when I went to college at the University of Chicago, we didn't have organized sports and so there were no athletes there on scholarships. But I can tell you this about Mark: he was a hard worker. He gave up one dream and started working on another and on day one of his new job, he was there when I walked in the door at 5 a.m. and he was ready to learn.

I'd be lying to you if I wrote that it was easy for Mark to learn how to be a successful trader. Like any skill, some people take to it easily and others have to work harder to find their own way, their own style. Mark had to work hard to find a style that worked for him, but he did one thing that really helped him succeed: he asked lots of questions. And if he asked a question and he still didn't understand after you explained something to him, he'd just keep asking until he finally did understand it.

The day-to-day trading intern grunt work didn't always come easy to Mark either. He was generally the last of the interns to finish balancing the trading accounts he was responsible for. There were many evenings his first year as my assistant that I left while he was still checking out trades and balancing accounts and then waited for him to call me to tell me that he had finished and was finally heading home. But he never cut corners-if it took an extra two hours to get the accounts balanced, he stayed the extra two hours, if it took three hours, he spent three hours. He did what he had to do so we were prepared to trade the next day from day one. He learned on day one that attention to detail was very important to me-and since he was my assistant, it became very important to him.

At some point in a trading intern's career, they have learned enough and shown enough promise to get a small amount of capital to trade on their own during the day-or the bank has learned enough about them to tell them they just aren't going to make it as a trader. I remember calling Mark into my office just about 18 months after I had hired him. I could tell he was nervous: he was hoping I was going to tell him he had earned his own trading limit but he was worried that I was going to tell him he was not going to make it as a trader. When I told him he had worked hard and earned a small limit in the Scandinavian currencies, he let out a big sigh and then a grin lit up his face. I reminded him that even though he now had a trading limit and was expected to make money for the bank trading, he was still my assistant and he'd still be checking my trades and balancing my accounts. 'No problem, Tim,' was all he said. Then he thanked me for the chance to learn and went back out to the trading desk to start checking out the day's trades.

Mark began trading the currencies given him-the 'Skandies' as we called them-and his first six or eight months as an actual trader were difficult. He had to split his attention between following what he was trading and maintaining my records while I made hundreds of trades in a day. And his currencies were much less liquid and moved much less than the major currencies the senior traders on the desk took positions in. But after a period of settling in, he began to put together a set of winning months and at the end of that year, he earned a nice bonus-some for being my assistant and some because he had exceeded his profit budget for the year in his currencies.

Mark continued to develop as a trader that was known for his hard work and his attention to detail. He was not the most talented young trader on the trading desk, but he was a very promising one. By the middle of the next year, I replaced him as my assistant with a new intern and gave him his first major cash currency, the Swiss franc. Trading a major currency was a two edged sword: the major currencies had many more trading opportunities but the bank expected you to make much more money per year. To the bank, each seat at the trading desk had a price on it, and as you moved up the food chain, the rate of return on the seat you sat in went up. While a minor currency might have a net expectation of one million dollars profit per year, the trader trading the smallest major currency, the Swiss franc, was expected to make three million dollars net per year for the bank to earn a bonus.

Mark approached his new assignment the same way he had approached his first day as a trading intern: he was the first trader at the trading desk in the morning, he asked questions constantly of all the senior traders, he kept detailed notes of his trades and ideas and he never left until his accounts were checked out and balanced perfectly. After a few rocky months of settling in, Mark began to consistently make money in the Swiss francs. And he earned a very nice bonus at the end of that year.

The following February, I called Mark into my office. The current senior trader that traded the Japanese yen had decided to take the bank's offer to move to our Hong Kong branch. That left a hole in my trading line up. I could go to a 'head hunter' and recruit a senior trader from another bank, or I could promote someone from within our own ranks. I told Mark that the yen would be a difficult currency for him: the bank expected the yen trader to make at least five million dollars net per year and there were many very good yen traders in the US cash FX market at that time. If he wanted this seat, he'd be competing with the first string players-and the price of failure might be high. If he failed to meet or exceed the bank's expectations, he might get the chance to trade a lesser currency-or he might get the chance to resign, depending on how his year went. We didn't discuss the upside possibilities, because both of us knew that if he made it as a yen trader, he'd have shown he had become a senior trader at a major US bank and besides earning a substantial bonus at the end of the year, he could walk away and work for any bank as a currency trader.

After laying out the possible pitfalls of the opportunity, I told Mark I had a decision to make: should I hire an outsider or did he want me to give him the chance? Mark didn't even hesitate. He just smiled and said, 'I'm ready, Tim. Give me the ball. I'm not gonna fail you.' I shook my head and then smiled back at him and told him to take a nice two-week vacation on me, out East to see his fiance' before making the decision. He told me he'd be glad to take the two-week vacation if I was paying but he wanted the chance and he'd made up his mind.

Mark came back from that vacation and slid right into the yen trader's position. This time, there was no settling in period. He made money from the first day and he made money every month that year. He wasn't the top moneymaker on my cash FX desk, but he was the third highest moneymaker and now that the year was over, he was going to get a very nice bonus.

On bonus day, I called Mark into my office and gave him his check. Traders generally opened their checks right in front of me and then gave me some positive or negative feedback, depending on what they were expecting to find in their envelope. Mark didn't open his; he folded his envelope in half and put it in his shirt pocket. Then he asked me if I had a minute to talk.

He told me his fiance had just graduated from law school at the top of her class and she immediately got an offer to join a top Atlanta law firm as a partner.

Let me point out Mark's hard work and dedication again right here: while he was in Chicago learning to be a trader, his fiance was finishing undergraduate and law school out east; at best, they saw each other four or five times a year. But none of us on the desk ever heard him talk about it or complain about it. He just did what he had to do until they were both out of school.

I asked Mark what impact the offer had on him and he went right to the point: he told me her offer contained a very large signing bonus, as well as a very large salary. The couple would have no problem living on her salary alone if she took the job. But there were no banks with major currency trading desks in Atlanta. If she took the job and they got married, he'd have to move to Atlanta. If he wanted to keep trading at a major bank, he'd have to ask her to look at other job offers. I still wasn't sure what Mark wanted from me.

And then he looked me in the eyes and asked the question he had on his mind: he wanted to know if I thought he was a good enough trader to trade his own money, away from any bank's trading desk. And he didn't want to be a trader that was 'just good enough to get by'. He had a taste of being a senior trader on a major bank's currency desk. He didn't want to go sit on the bench at home and pretend to be a trader while his wife made lots of money as a lawyer. Did I think he could make it on his own?

I asked him to tell me what his intuitions told him, since they were so right about his professional basketball career and about trying to make it as a trader. He said his heart told him he was ready. He'd make it on the first team. But he needed to know what I thought. He looked right at me then, waiting for my thoughts.

I told him, 'Mark, I think I'm going to need to interview yen traders tomorrow. And by the way, I accept your two-week resignation. The two weeks are on me. Go give your fiance a great big hug and go find a nice place in Atlanta. I'm sure you'll do great on your own.'

I came around the desk to shake his hand but before I could hold out my hand, he gave me a huge hug and then whispered, 'thanks, Tim.'

Mark is still a successful professional trader in Atlanta. He trades his own money and every once in a great while, I see him when I go through Atlanta and we talk about basketball and trading.

Trader Two: Letting It All Go

I did some research in 2003 and 2004 because I was curious how successful professional traders making a living trading as floor traders were once they began to make the transition to 'off floor' traders that sit in an office and trade while watching charts. With the help of the Chicago Exchanges and the four largest clearing firms of floor trading 'locals', I found a fascinating correlation: professional traders leaving the floor and starting fresh as off floor screen traders had about the same success [or failure] rate as the general public. According to the NFA, well over 90 percent of the people that open $10,0000 accounts lose all of the money in their account within three months-and professional floor traders moving to off floor trading had the same success: 90 percent of them were failing!

Once the research was finished, I decided to see if I could put together a seminar or class to help professional floor traders successfully make the transition. I began teaching weekly seminars at the Chicago Mercantile Exchange and the Chicago Board of Trade and also offered these professional traders one on one mentoring, which allowed me to monitor their progress on a trade-by-trade basis. Well over 300 professional traders took the seminars in 2005 and 2006 and signed up for the mentoring, giving me a huge number of professional traders to watch and observe. And the access to their trades, once they learned my trading methodology, was a great research tool that has allowed me to improve my own teaching and trading methods.

As I was preparing to teach the very first Market Maps Seminar at the CME, I decided to keep notes on each of the traders that attended the seminars and if I noticed any particular character traits, I noted them down for my records. For example, one trader in an early seminar told me three times in front of the other attendees that 'stops are for losers' and no matter how I approached the subject of the importance of always using stop loss orders, he scowled and repeated his statement. I diligently noted this and sadly, within three months he had lost all the money in his seven figure trading account. But this article is about traders that 'made it.' Let's look at another:

Andy was a veteran floor trader with more than twenty years experience. He attended my first Market Maps Seminar held at the CME. While we waited for all the participants to sit down and get ready, I was asking people how things were going on the floor. Most of the responses were guarded-most traders said things like 'things were slower now that electronic trading had become so dominant, the flow was not what it used to be, the spreads and ranges had narrowed so it was harder to make a good living'.

But Andy laid it right out on the line: 'Tim, I've been doing this for more than twenty years and the last two or three years have been hell! I hate it! I can't make money like I used to and I can't go on like this. I'm ready to make the change. I'm never going back to the floor. I'm really looking forward to this.'

After the seminar, I spoke with several of the owners of the clearing firm that had sponsored the seminar at the CME. I asked each of them which attendee they thought would make it, based on what they knew about them and what they had seen today. After they made their picks, I chose Andy.

Why did I choose Andy? Andy was ready to let his old methods go, clear his head and start over again. In my opinion, he was ready to pay the price to learn how to trade all over again. I knew it wouldn't be easy for him-it's never easy for anyone to start over again-but I felt he had made an internal commitment to clean the slate and start over. And that can be half the battle.

The most common mistake I see professional floor traders make when they start trading off floor is their instinct to aggressively enter a trade they see-in other words, they tend to enter *before* the trade entry set up plays out, because they think they are seeing a valid entry before the rest of the market sees it. On the floor of the exchanges, that can give them an edge, since they are making many trades a day and trying to make small profits per contract per trade. But off floor, this anticipation can be deadly. Traders just learning often find themselves entering many trades they thought had valid set ups but in reality, were only fulfilling some of the trade entry qualities. I call these 'look alike' setups and generally, they have a lower probability of success and can be very frustrating.

Andy's first obstacle was overcoming anticipating trade setups. Some market professionals teach that they always come into a day with a bias and then they only trade from that side. I teach exactly the opposite: let the market show you where it is going and then look for a high probability trade setup that you can recognize over and over. After writing up a trade plan that details all your thoughts and orders, execute the plan.

I specifically make all my students keep trade plans and capture before and after images of each of their trades because it makes it much easier to do post trade analysis of losing and profitable trades. But more important, it makes traders plan out their trade from beginning to end, before entering the trade, and in so doing, it makes them analyze each step of the trade. This tends to eliminate anticipating trades. Once Andy began religiously filling out his trade plan, he seldom anticipated trades-instead, he let the trade entry come to the area he had diagrammed in his trade entry plan.

Was it easy for Andy to stop anticipating trades? No, it isn't easy for any floor trader to break this habit and it wasn't easy for Andy to break it, either. But I tried a curious method with Andy and his trading partner: they would call me and ask me about a trade entry they were eyeing. I would pull up the chart they were looking at and to my eyes, I could see that they 'almost' had a trade set up, but not all of the requirements for the high probability trade setup had been met. Then I would explain what parts of the setups were missing and what they'd need to see to make this setup meet the classic criteria for that specific setup.

I generally find that when floor traders 'cheat' on their entries by being extra aggressive, they get 'hit by the train,' meaning price runs through their entry order and immediately fills their stop loss order [thankfully, Andy religiously used stop loss orders from day one]. After four or five days of getting phone calls from Andy and then looking over his aggressive entry ideas, I began watching the potential trades unfold and I would invariably see that when Andy was using aggressive trade entries, he got 'hit by the train' many more times than he made money. So I called him and explained why I did not like these types of aggressive entries and also explained why they led to being 'hit by the train' and what that term meant.

Another week went by and after about the fourth time Andy called about an aggressive trade entry, I simply made a 'choo-choo' sound into the phone and hung up. Then I monitored the trade from my screen. Once it looked like Andy had been stopped out, I called him back and asked if he had taken the trade. The answer came back, 'yes, I took the aggressive entry.' I asked if he had gotten stopped out, already knowing he had been stopped out. The answer came back, 'yes, I got hit by the train'.

But after about a week of him calling to show me aggressive trade entries he was going to make and me making a "choo-choo' sound and hanging up-and then making him admit over the phone he had taken the aggressive entry and had been hit by the train-the calls stopped coming. And the aggressive trade entries began to disappear from Andy's trading. Soon we invited Andy to be a trader in the proprietary trading room. To this day in the proprietary trading room, when we talk about trades and one of us recognizes it's an aggressive entry, not a classic entry, we simply make the train sound and wait for the setup to either fulfill all of the requirements or we pass on the trade. It's interesting how a few losses preceded by the sound of a train whistle cured Andy's aggressive trade entry problem.

Andy became profitable on a month-by-month basis very quickly. He studied the materials hard and I think the only problem he had came when I brought in a person to help me research multi-dimensional Action Reaction Lines, or 'Diamonds', as we began to call them. Andy and the rest of the proprietary trading room watched as we researched and developed this new methodology. And despite my warnings to the traders in the room that we were still doing the gritty research on these new trading tools, I began to notice bits and pieces of these new techniques bleed into Andy's trading. This led to further improvising in Andy's trading methodology. And the improvising began to degrade Andy's profitability and win/loss ratio.

When I asked Andy why he was using these 'new entry methods,' he told me he and his trading partner had noticed that a particular entry 'worked really well'. Andy told me the last ten had all been winners. I asked for statistics on a minimum of one hundred trades. He admitted he didn't have them. I asked him for trade entry sheets and before and after images on the ten trades he had mentioned. He admitted again that he didn't have them. They were doing so well, they weren't bothering to keep trading sheets all the time now, especially on the new entry methods they were using.

I went home and thought about it. Then I came in the next morning and explained exactly what was going on: humans are visual in nature. They see patterns, and often the patterns are not there. Humans also tend to have selective memory: we remember what we want to remember, so if we are 'watching' a trade entry technique we like, we tend to remember the winners and tend to forget about the entries that would have been losers; that's why doing statistical analysis on a larger number of trades is so very important.

I pulled out a quarter and asked Andy what the odds were of me flipping heads. He answered fifty percent. I asked him the odds of me flipping tails. Fifty percent, he answered. Then I asked him if he would like to bet all the money in his pocket against all the money in my pocket that I could toss ten heads in a row within an hour. He gave me a grin and said, 'you ain't gonna flip ten heads in a row.' 'We have a bet then', I asked? 'Sure', he laughed.

About ten minutes into flipping the quarter, I was up to eight heads in a row and Andy's face was turning a nice shade of pale white. I asked him if he wanted me to keep flipping or did he want to forget the bet and talk about what was happening. We agreed to talk instead of bet. Even when watching something as simple as flipping a coin, you may see ten favorable outcomes-winning trades-in a row; this is called a positive run. If you flip a coin long enough, you'll see lots of long positive and negative runs, because the coin doesn't have a memory-it doesn't know, care or remember that it just came up heads. Similarly, if we want to really know if a trade entry works, we have to do serious long-term record keeping of actual observed trade entries and their outcomes. A hundred trade entries was a small start, a thousand or more trade entries and outcomes start to show the real truth about that particular entry method. As traders, we have to take out the selective memory and pattern illusions; only doing statistics on a lot of trade entries and exits can do that. Before you start using a new trade entry technique or a new trading tool, you have to put in the work to verify that what you think you see really is what is happening over a large number of trades.

I told Andy that if he continued down this road of improvising, he'd eventually turn right back into the trader he was when he walked off the floor. I could see the bad memories of Andy's last few years on the floor reflected in his eyes.

He told me he was going to take a week off and study all the materials from the Market Maps Seminar, as well as my book and all his trades and notes. And then he was going to come back in and start in again on the right path.

When he came in a week later, Andy was much more thoughtful about each and every trade. He was much more vocal when the group was discussing potential trade entry setups. He soon became the voice of reason in the room, the trader that was the first to point out when a trade looked like a tried and true set up but was missing a crucial part of the set up. Andy had finally let go of his floor trading habits and became a systematic discretionary trader-which means he looks for certain trade setups he knows he can trade, he fills out a trade sheet on these setups as they occur and then he executes the trade.

Does he have losing trades? Of course he does-we all do! But he knows in advance what his winning and losing percentage should be and what his risk reward ratio should be. And if his monthly numbers vary much from his expectations, he goes over his trades for that month with a fine-toothed comb to pinpoint what went wrong. Sometimes he can fix it himself and sometimes, he sits down with me and we tune up his trading. Andy has made it as a 'off floor' trader.

Trader Three: Profits Don't Come Because We Need Them

I have been running a free forum on the net since 1997, the Median Line forum. I started it to show people what a fulltime professional trader does, day in and out, and just how wrong most people's ideas of what makes a trader successful are. These days, I have a mailing list and a forum, with well over 4,000 members between the two that range from hedge fund managers to people that have never traded but wandered onto the forum to see what it would take to be a successful trader.

About seven years ago, a person named Mary from Europe joined my forum. For most of the first year, she 'lurked', meaning she read the forums but never asked a question on it or answered a question on it. Then one day, she e-mailed me privately and asked me if she could send me a chart and asked me questions via e-mail privately because she was embarrassed to ask on the forum. I told her I was always glad to help people via e-mail and she soon started sending me a few e-mails a week with a chart and some questions attached to each.

The most important thing I noticed about her charts and questions were that they were all related to longer-term trades with very large stop loss orders and very large profit targets. I wrote her back one day and mentioned my observation and she answered me several days later: she was now a single mother with two little children and although she had some money in the bank, she wanted to 'make big trades' so she could stay home with her little ones. She said 'making little trades' wouldn't make enough money for her needs—she needed 'big trades'.

I told her two things: first, you can't start out with the premise that you 'need to make money' or you will simply fail. The market doesn't care about your needs. The market pays those that have a sound strategy with a winning expectation that are able to execute it over and over. Second, making lots of money isn't a matter of making 'big trades.' First you must find your style and your tools. Then you must learn solid money management and couple it with your trading style and tools. Then you must risk an appropriate amount of your available capital on each trade or you will go broke before you learn to trade. I stressed that many successful professional traders risk relatively small amounts on small trades but do it consistently and frequently and that can add up to a great deal of money at the end of each month or year.

As an example, I told her about a senior trader named Bib that had worked for me at a bank in the early 1990's. It was early November and he was having a wonderful year. One day, he told us all over breakfast that he had been out house shopping with his wife yesterday afternoon and she had found a house she fell in love with. The only problem was, he'd need a huge bonus to buy the house. As a manager, the bells went off in my head and though I didn't say a thing, I filed the information away.

Sure enough, I was watching him trade the next day and he was taking larger than normal positions and taking trades he normally would have passed on. I watched for a while until he had closed out a position with a sizeable loss and then asked him to come see me in my office. When he came in and sat down, I asked him about the positions he had been taking earlier in the morning.

He told me he was having a great year and he needed to really 'kill em' the rest of the year so he could 'buy that house my wife found'. He figured since he was already having a great year, he could take more risk than he usually did—both by trading larger than he normally traded and by taking trades he liked but normally wouldn't have taken because the stops were too big. He felt he had a cushion to work with and was going to 'take a big swing' to try to finish the year off with a bang.

I scratched my head and told him he had made a great deal of money for the bank—in fact, he was the top earner on my trading desk so far for the year. Then I reminded him that he had never made this much money trading in one year in his entire career. Finally I asked him if he had had this record profitable year because he had been taking larger positions or taking trades with larger than normal stops. He answered that he had just traded the way he always had, but now things were different: there was just over a month left to trade in the year and he needed to make sure he got a huge bonus!

I warned him to be careful about changing his trading style and size just because he wanted something. He was having a record year because of his trading style and because he was selective about the trades he took. He listened, but I could see in his eyes he was only thinking about making more money so he could be sure he could get that house his wife wanted.

I had a quandary: he hadn't violated any of trading desk rules. He wasn't even having a bad month. But I sensed that his focus had shifted dramatically and in my experience as a manager and as a trader, this generally led to problems. I decided to go see my boss, Dave, the head of Capital Markets.

Dave listened intently and when I got to the part about the wife falling in love with a very expensive house, he groaned. Then he stopped me and asked, 'how much bonus will he need to be able to buy the house?' I told him. Then he asked how much he was up net for the year. I told him that and what I guessed his bonus would be if he stopped trading today. He'd be close to having enough—in fact, if the bank also had a good earnings year, he might have made enough already to qualify for a large enough bonus to buy the house.

But if he continued to trade larger and less selectively and began to lose a fair amount of money, he wouldn't make it. I didn't know what to do.

Dave told me that this was when traders were most likely to 'blow up', when they 'needed' the market to give them money. They generally threw away the good trading practices they worked so hard to perfect—even though these good trading practices had made them so much money in the past. He suggested I watch him carefully for the next couple of days and if he started on a losing streak of any magnitude, I should bring him up to speak with him before he did too much damage.

The next two days were not kind to Bob and we went to visit Dave mid-morning on the second day. I explained the situation to Dave while Bob listened, as if this was the first time Dave and I were discussing it. Dave listened and then asked Bob a few questions about his trading style and how he had changed it in the past week. After hearing him out, Dave asked Bob just how large a bonus he'd need to buy the house his wife was looking at. When Bob told him, Dave asked Bob if it were possible, would Bob buy the house immediately. Of course, Bob told him. Dave picked up the phone, called the mortgage department and told them he was coming downstairs to see the department head. Then he took Bob with him and I went back down to the trading floor.

About two hours later, Bob came back. He was a little pale. I asked him if everything was ok and he told me that Dave was in my office and wanted to see me. I went into my office and Dave shut the door. Dave asked if I really felt Bob was on the verge of starting a large losing streak. I told him my instincts told me Bob was in real danger as a trader. Dave told me he agreed with my assessment and then told me he was going to offer a solution to Bob, if I was also willing to accept it: the bank would write a contract with Bob, issuing Bob the mortgage on the new house at current rates. Against this new mortgage, Bob would place his bonus to be paid at the end of the year. I asked Dave how we were going to manage Bob's trading the rest of the year, to insure he didn't lose a substantial amount of the money he had already made.

Dave smiled and told me that Bob was now officially on vacation for the rest of the year. He hadn't told Bob yet what he was going to offer him; he had simply taken him to the mortgage department to be certain Bob's credit was adequate if he could manage the down payment. But Bob knew something was up, since Dave had walked him through the mortgage area and process.

Here's what we offered Bob: we gave Bob the rest of the year off. He was having a record-trading year and might earn enough for the down payment on the house his wife loved. If he stopped now, the bank would have a great deal of net profits that were no longer at risk. In the contract, we specified that if his bonus fell short, Bob would owe the balance against future bonuses. We also gave Bob two tickets to the Caribbean, where he and his wife usually went at the end of every trading year.

I called Bob in and with Dave listening, made him the offer. He was speechless for quite some time and then asked me if I didn't believe he could continue to make money the rest of the year. I told him I felt he had been put in a dangerous situation, which also put the bank's profits in a dangerous situation. It was not a matter of me believing or not believing—it was a matter of risk management. Dave had simply come up with a way to manage the bank's risk *and* reward a senior trader that was having a career year.

Bob learned a valuable lesson that day: the market gives you what the market gives you. If he had been working for a different bank, they might have let him continue trading for the rest of the year and he might have learned the same lesson by giving up a great deal of the money he had worked so hard to make all year—and not get the house [making his wife extremely angry].

Then I told Mary about the single best trader I knew. He was worth nearly US$1 billion dollars, had made all the money trading and didn't make it taking heavily leveraged positions. Instead, he had a high probability trading entry he looked for and he took it over and over again. Since he always practiced good money management, he regularly made money—in fact, he regularly made a great deal of money. When he traded, he called it 'slicing sausage', because his style was to take bits out of the market here and there and at the end of the month, he'd have a nice pile of money [or sausage] in front of him. I also told her I called my trading style 'making donuts', because to me, it was methodical work taking money out of the market each day.

I suggested Mary concentrate on finding a trading tool that fit her personality and then learn it inside and out. Then she should master the concepts of solid money management. Once she did this, she should couple high probability trade entries with solid money management and only take trades with good risk reward ratios. If she could do these things over and over, she'd be a successful trader and the market would eventually reward her with a living.

After sharing e-mails back and forth for several months, Mary began timidly asking questions on the forum when she didn't understand someone's post about a winning or losing trade. Soon she was asking detailed questions about the trading techniques other people were showing on the forum. And within a year, she was posting her own winning trades. Before my very eyes [well, my 'internet' eyes], I watched a person that had never traded before blossom into a very talented trader. Mary is still single. She makes a very nice living trading from her home. She was able to watch her little ones grow up at home and now they are doing well in school while she trades at home all day. She is a frequent contributor—she believes as I do that you get back 1000 percent what you give, so she generously shares her time and thoughts and ideas with other traders, whether they are new traders or old professional traders like me!

There are many success stories in the markets. But they always come down to hard work, overcoming your own weaknesses and taking what the market gives you. Throw in some solid money management and you generally have a recipe for success.

I wish you all good trading!

Best,
Timothy Morge

www.medianline.com
www.marketgeometry.com

Timothy Morge
President
MarketGeometrics, and Blackthorne Capital, Inc.
1870 Diamond Creek Lane
Aurora, IL 60504-3441
630/236-3441
Fax: 630/236-3448
Web sites: www.marketgeometry.com or www.medianline.com