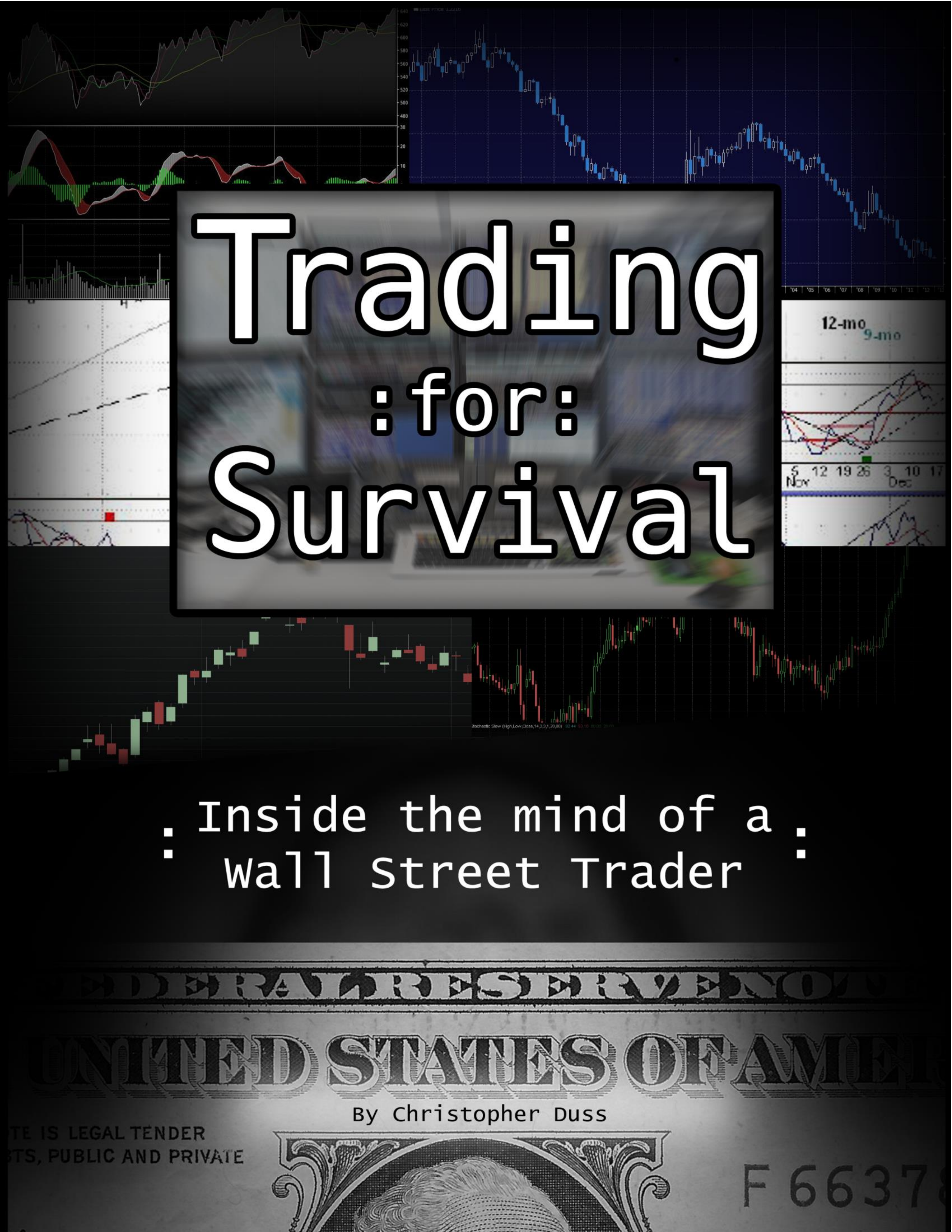


Trading :for: Survival

: Inside the mind of a Wall Street Trader :

By Christopher Duss

For my one and only Cy, who with the patience of a master investor stood by me as I plowed through this book with the swiftness of our pet tortoise.

Written mostly in 2012, published March 2016.

Cover art by Joe Smith (www.soundcloud.com/jwswiss)

Thanks to Joe Smith for extensively editing the text. Thanks to all friends, family, and former colleagues who took the time to read and provide feedback.

See more of my work at www.bluebeltlife.com and www.youtube.com/bluebeltvideo

Note on devices: the e-book version on Amazon contains images and links with colors that will be clearer and easier to read on color displays. I have done my best to explain images in the text so that grayscale readers can also be used. This book is optimized for the Fire HDX and Kindle Voyage. Images will appear small and must be zoomed in on in the Fire HDX 8.9 and Android tablets and phones. Some slightly annoying automatic tabbing appears in older Kindle versions, iPhones and iPads. Please post any feedback on the Amazon page for this book or on my website and I will do my best to address it.

About this preview: included here is a chapter or part of a chapter from each of the main sections of the book. It should give a taste of what the book seeks to accomplish – to inform, entertain, and provoke thought on the market. If it piques your interest, check out the full version on Amazon!

CONTENTS

The Power of the Market

The market is the most powerful man-made object, thing, concept, in the universe. In society, power flows through *attention*. Think about celebrities. As long as they have the attention of the public, they have power – the power to create something, act a certain way, even to control a part of the “attendee’s” life. The more attention they receive, the more power they accrue, and the moment people forget about them, they cease to wield that power.

So why, of all things, is the market the most powerful creation of the human world? Why not one of the religions, the atomic bomb, or the United States? Maybe it is because of the Internet. 20 years ago the market wasn’t nearly as powerful as it is now, simply because fewer people had access to it. Now everyone is talking about it, trading in it, looking to it to solve life’s worries. As emerging economies gain traction and cheap internet access, millions of new entrants are coming to view it as the key to their dreams. It is definitely a bull market in the market right now, and all bull markets end. Excessive attention on a certain object, concept, or person tends to spoil it, to attach too much value to it. This always ends badly, both for the object of attention and those who attend to it. We are seeing signs that the bull market is ending. Some of the great traders of the last generation have hung up their hats – the smart money is cashing out.

Fundamentally, one could argue that the market has ceased to be a true market in the last few years. Machines have largely taken over the price discovery process, resulting in “flash crashes” from time to time. Policy makers now have greater control than ever over the general price direction. The power to conjure trillions of dollars into existence with a single keystroke has inadvertently led to there being no value for “investors”, the market’s original participants. Everyone must be a speculator or close up shop until a market blows up, creating fleeting investment opportunities. Luckily, as the last decade shows, it usually isn’t long before something does blow up. In a world that necessitates speculation in the market, it is mandatory to await these opportunities and profit from them. This means 1) not being on the wrong side of the crowded trades, and 2) being prepared to enter trades *after* the crowd has exited en masse. Someday, probably several years from now, the investors’ market will return, and people won’t have to keep one eye on a screen five days a week. The process that takes us there will be enormously damaging to the majority of market participants. Hopefully the words in these pages will help the reader not only to avoid becoming a casualty of the market, but also to profit from it through this period of turmoil.

Traders Are the Modern Day Hunters

You can extend this analogy to almost anything, but I believe traders are the true hunters of today's world.

Back in the day, hunting was a dangerous but necessary activity. It pitted man versus nature in a struggle to survive. Man had to show proper respect for nature, or nature would destroy him. Over the ages, through invention and adaptation, man has "triumphed" over nature. He no longer has to hunt to eat. He still *can* hunt to eat; it's just a bit easier to overcome nature with a shotgun than with some bits of carved wood and chipped rocks.

Today he can trade. In fact, most of us have to whether we want to or not. The modern financial system has made everyone into a trader because every monetary decision we make is a trade that can gain or lose value. Buying an ETF, investing in a stock, or deciding not to do either and instead hording cash in a savings account – it's all trading. Fortunately, we do not all have to be day traders, and that is a good thing. It's not as glamorous as it sounds.

Trading is a zero-sum game – every dollar I gain is lost by someone else. Actually, as Alexander Elder aptly states, it is a negative-sum game because there are transaction costs in trading. Trading involves hunting for money from other traders – it involves overcoming the minds of other humans. Trading pits man against human nature. In order to trade successfully we must have a thorough understanding of human psychology. Failing to do so will destroy us just as a failure to understand the various beasts of the forest would doom our caveman ancestors. Of course, probabilities are central to both hunting and trading. You don't guarantee survival by understanding nature, but you tip the scales in your favor.

This is the concept of *edge*, which in trading describes any advantage you can gain over human nature. Survival and success in trading are dependent upon edge. Edge can come in many different forms, and one of the best ones is an understanding of human emotion and the human decision-making process. Liken this to the ancient hunter's knowledge of weather patterns, terrain, and animal tracking. The best edge is inside information, but most traders do not have access to this. In fact, because a select few traders at any given time do have access to inside information, and they usually wield a great deal of capital as a proportion of the market, you could say that the odds are truly stacked against the average trader. Therefore, we must summon all of our knowledge and prowess just to bring the odds to even, and then we must pay our broker! We never really left the jungle after all.

The hunter received knowledge of nature, and of the various tools with which he could subdue it, from older hunters and from personal practice. Both are also essential in trading. Books are an excellent start on the path to trading knowledge. A personal mentor is also ideal. After those bases are covered, personal experience in trading is more essential than anything else. During the hunt, the hunter learned what worked for him out of the many tactics and strategies available. In the same way, the trader must develop his own strategy and set of tactics through trial and error.

Now let's delve further into some more debatable aspects of the analogy, suspend disbelief for a moment if you will. I will make the statement that there is no more dangerous profession than trading. Nature can crush you physically, but the market can crush you financially and psychologically. Trading as a profession is unique in that you can both make and lose money, *and* both are stressful.

There is no stress-free condition in the world of the trader. You need to respect the dangers involved and act accordingly by developing an edge and exercising appropriate caution. You are trading against other human beings, the herd, if you will. In order to beat the herd, you cannot be one of them. You have to be a student of the herd, an onlooker from the outside.

The herd moves as one, gets excited as one, and panics as one. Most of the time the herd is asleep. Large market moves awaken the herd, after which they always trade in the prevailing direction of the market. An example is gold. Gold rose nine consecutive years (2001-2010), reaching a price 300% higher than where it started before the public became widely aware of gold as an investment vehicle. The average Joe, sitting at home on his PC, started to buy gold aggressively. Gold climbed for another year, for the herd is indeed a powerful force. It has since, however, dropped sharply from those highs.

As soon as the herd becomes involved in a trade, the easy money is gone. Prices are likely to drop below the herd's entry point soon after. As Elder points out, it is often advantageous to join the herd, because they can result in some truly large and predictable market moves. The balancing act of the hunter trader is to avoid being trampled by the herd if he goes against them, or being run off a cliff if he decides to run with them. Crucially, this involves knowing where the herd's money is. This information is available for many core markets, and traders should avoid markets for which they cannot obtain or ascertain good information on what the herd is doing.

Since the hunter thrives by maintaining an outside view of the herd, it is essential that he not live his life like those in the herd. This is an important and overlooked facet of the world of trading. The typical trader's life is a solitary one. What interaction he has with the herd is often pragmatic in nature. He can enjoy these interactions, of course, but he cannot lose his edge to them. There are sacrifices involved in every profession, and this is probably the key sacrifice in the life of a trader. For those who want to follow the path of trading, it should not feel like much of a sacrifice at all.

In what specific ways can a trader live life separately from the herd? First, he can manage his routines. Herd members are people of habit. They get up at a specific time, get to work at the same time every day, and then follow the same general routine day in and day out, week in and week out, year in and year out. Repetition breeds skill, and they become good at living within this routine. Further, the routine serves as a protection against the outside world, and they feel safe within its confines. Compare this to the hunter of old, who got his meat by studying and mastering the routines of his prey, while maintaining none of his own. In today's market, the herd is easy prey for a master student of human routine.

As Red said in *Shawshank Redemption*, "Prison life consists of routine, and then more routine." Prisoners don't make money in the markets. Study your own routines, and work to curtail them. This can be as simple as changing the order in which you brush your teeth and floss, which room you sleep in at night, what time you sleep and wake. Flip around your hours of operation, the progress of your day. This will add not only adeptness to your trading, but to your life. The routine of daily life, however, is not to be confused with the "rites of trading". Repetitive procedures such as chart preparation, analytical studies, and processing various news sources, are key to building trading skill. They are your weapons in the market, and with them perfection and attention to detail is the key. In other words, perfect your rites of trading, but reject other daily routines. The goal is to be cognizant of changes around you and in the market, and you gain this agility by constantly challenging your status quo.

Speaking of that, the herd loves the status quo. They prove this constantly in their tolerance of rulers who undermine their freedoms in exchange for maintaining a sense of constancy. To separate yourself from this will be difficult if you adhere to rigid or widely held viewpoints. Challenge the status quo and embrace change. Most people aren't interested in real change, or at least they don't want to cause it. If they do, they can't blame others when things go astray. This mindset is so prevalent that it must have served us well over the thousands of years of our evolution. But just like thick back hair, what worked for our ancestors may work against us today. Embrace and accept change; preside over it if you can, because markets change constantly and if you fail to react you are going to be "out some smokes".

The herd is weak, lazy, timid, and fearful. The hunter of old would have lasted about 3 minutes in the jungle or savannah with these traits. Make yourself strong, disciplined, bold, and courageous. Physical fitness is an overlooked part of trading. As they say, sound body, sound mind. Remove the clutter from your life. You need to be sound on every level if you want to go head to head with giants, sharks, and fat cats wielding inside information, political connections, and immense influence. The odds to overcome are serious. As for the other attributes, you get the point – set yourself apart.

The Pizza and a Pasta Method

The “pizza and a pasta method” (p&p) is the crowning achievement of my technical analysis career to date. The name comes from a dear friend from my days in Tokyo, an English gentleman and proud native of Stoke, whose cup of tea this sort of topic was not. He called over one day, as he did on so many occasions, looking for something to spice up the slow Tokyo hours. I told him I was doing peak-trough analysis of US treasury yields. Oh so intrigued, he asked what it was called, to which I said “not sure, haven’t given it a name, what do you reckon?” To which he immediately replied, “pizza and a pasta”, and then hung up. Surprised he hadn’t simply said “sausages”, I decided the name was pretty good and a lot better than peak-trough trend analysis, so I continue to call it that.

The p&p method is a simple trend definition method that works on all time scales. It could even be done by hand for weekly and monthly trend definitions, but why not use computers if they are available. There are two graphs involved, one which plots price points over shorter time increments, and one which plots them over longer increments. We are going to use the first, more detailed chart to determine *when* the major peaks and troughs occur, and the second chart to plot *where* they occur. The frequency of price points in each chart could be anything, but for illustration let’s use daily and weekly. The daily chart is going to include a simple daily line chart of the security, as well as a popular trend-following filter. A moving average is one example of such a filter, but I prefer to use a forward-adjusted graph of the security. This allows you to see if the current price is higher or lower than it was a certain period of time ago, which is actually an example of a popular trend-following method, the 4-week rule. The 4-week rule dictates that you trade long when the price is above that of 4 weeks ago, and short when it is below. Because of its widespread use, and the resulting position shifts that take place at intersections, we can locate “major” corrections in a security’s price by tracking when the current price intersects with that of 4 weeks ago. While this actually tells us both when and where the major correction occurs, we are going to mark the major peaks and troughs on the weekly chart. Here is the p&p system for 10y US treasury yields, weekly trend:

Pizza and a pasta method, US 10y yields weekly trend (Source: Bloomberg L.P.)

Starting from the top left, as the current price (white) drops below the price from 4 weeks ago (orange), the price peak *before* that intersection becomes a “p” in the bottom chart. Then, as the current price rises back above the adjusted price, the trough before that intersection becomes a “t” in the bottom chart. In general, the local price maximum before a decline in the current price *below* the adjusted price translates to a “p” in the bottom chart, and the local price minimum before an increase above the adjusted price translates to a “t” in the bottom chart. You will note that I do not count some short-lived intersections in the top chart – in March/April 2010 and again in June-August 2010. There is some subjectivity in choosing intersections, but a general rule is that the price must continue moving past the intersection for a week to be counted.

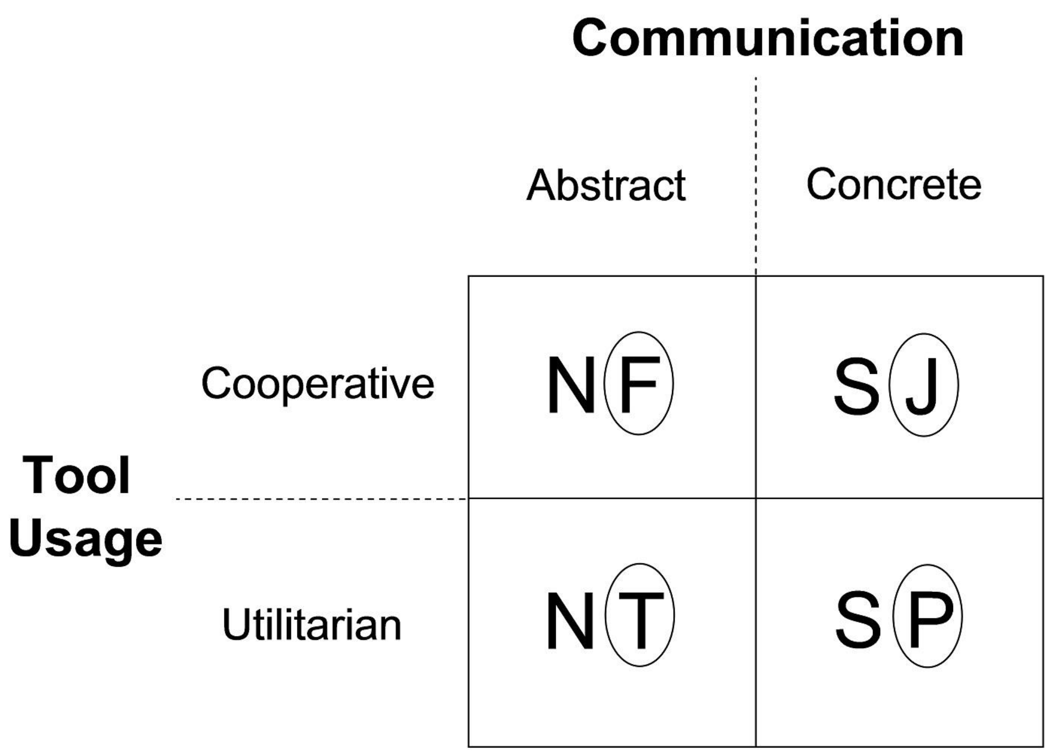
This system pinpoints major psychological peaks and troughs, which we can use to define the trend. When the price (or yield) falls below a major trough, we say it is in a falling trend, and when it rises above a major peak we say it is in a rising trend. In the above, yields begin in a weekly rising trend, change to a falling trend in May 2010 as yields fall below the first “t”, and continue in a falling trend until November. At that point, they rise above the third “p”, marking a change to a rising trend. Moving to the far right of the chart, yields begin a falling trend as they move below the fifth “t”, and that falling trend will continue until they rise back above the last “p” (2.40), or a new lower “p” forms and yields rise above it.

I use this trend-definition technique on all time scales, from hourly trading (30-minute top chart and 2-hour bottom) to monthly (weekly top and monthly bottom), and I view weekly and monthly trends for a variety of major markets to get a broad view of what is going on. I use p&p to define the trend, and then use corrections in the opposite direction to initiate trend-following trades (see “Trend Lines” for more on how I do this). After using the technique for a while, I find I rarely need the top chart, especially in short-term trading, as most major points are clear from an eyeball examination. As long as you take note of the major corrections, you need only use the top chart as a confirmation, if at all.

Character Types and Trading

Here is my opportunity to expound upon my interest in Myers-Briggs character typing. Take the test at the following address to get your own type and follow along: http://www.humanmetrics.com/cgi-win/jtypes2.asp (or search the internet for Myers-Briggs test). Required reading on the subject is *Please Understand Me II* by David Keirsey, in which he describes the four main character types and sixteen sub-types. While the jury is still out on whether or not the classification system is an intellectualized version of astrology (which also has 4 central types and a slew of literature), I have found it useful in my experience and enjoyable as a conversation piece. The major purpose of the typing is to understand how and why people act in particular situations. Keirsey delves into the major life situations of mating, parenting, working, and leading. Let's add to this our crucial niche, trading.

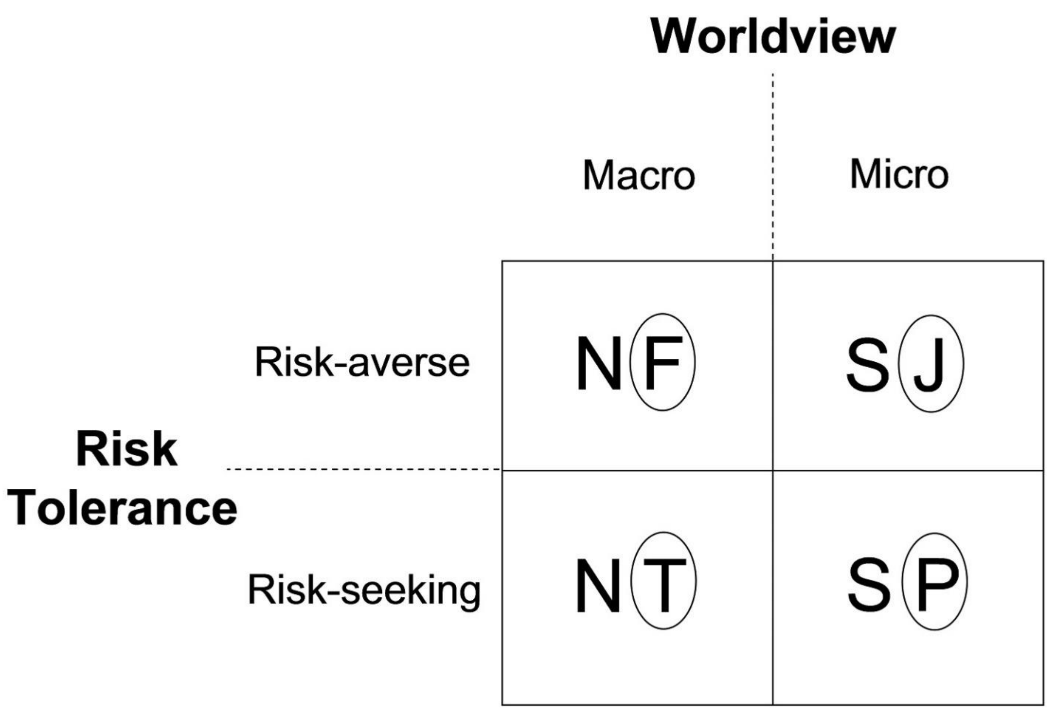
Just for a quick review, here is Keirsey's personality grid:



Keirsey's personality grid; N = i**N**tuitive, S = **S**ensory, T = **T**hinking, F = **F**eeling, J = **J**udging, P = **P**erceiving; defining characteristic circled

The typing uses four categories to define a personality. Each category has two options, resulting in 2^4, or 16 different personality types. Myers and Briggs found that those 16 sub-types could be grouped into four core types, as depicted in the image above. As you can see, only six of the eight traits are definitive of the core type. The other two traits are: I, Introverted, which broadly means that time spent alone *energizes* the person; and E, Extroverted, which means that time spent with *others* energizes the person. Any of the four core types can be either introverted or extroverted. As for the defining characteristics, N, or iNtuitive, means a person sees the world in an abstract way – i.e. not a collection of details and concrete facts, but a chaos of ideas and hidden meanings. This is reflected in the person's communication, which dwells on ideas rather than people/places/things. S, or Sensory, is the inverse of N, and means a person sees the world in a concrete way – as a collection of details that can be perceived by the 5 physical senses. The resulting communication style is one that remarks on the physical world, centering on people/places/things. T, Thinking, means that emotions do not factor largely into a person's judgments. F, Feeling, means they do. Keirsey expands on this distinction by saying that T means Tough-minded, while F means Friendly. Finally, for the above grid's purposes, there is J, Judging, which means the person tends to see a single "correct" option out of the existing options, and P, Perceiving, which means the person considers a range of options as potentially correct. Keirsey goes on to say that Js are scheduling types, while Ps are probing. I will go into more detail on the core combinations below.

As my addition to the body of literature on this subject, here is my conversion of the above grid to the niche of trading:



Keirsey's personality grid converted to trading

The impact of Extroversion/Introversion on trading acumen is minimal, and I know good traders in both camps. Introverts may be slightly more drawn to trading, as the main relationship a trader has in his occupation is with his computer screens, which in my experience are not particularly social. The extroverts tend to be drawn to more managerial or sales roles, while the traders are happy to sit at their screens and speak to no one for hours at a time. I've personally spent the better part of my adult life doing just that!

To read the breakdown of the four major personality types and their suggested roles in the markets, please see the e-book version available on Amazon.

2x2

This is a guarantee system that means 2 million dollars by 2 years, meaning you get 2 million a year, for 2 years guaranteed. These and other variations (1x2, 3x1, etc.) were a product of the finance bubble that peaked with the housing bubble in 2007. They still exist but back then they were being handed out like cookies on Christmas. This is a source of bitterness for any trader my age and slightly older, since we missed the peak by about 2 years.

Algo

Short for algorithmic trading program, this is a type of computer program linked to an electronic exchange that takes a variety of short-term factors such as recent trading range and order levels/sizes in the system as inputs, and executes buy and sell orders based on the program's output. High frequency trading systems (HFT) are a type of algo.

Basis point

As Bloomberg likes to say repeatedly, even though its only readers are traders, "a basis point is one hundredth of a percentage point." They are referred to as bp's (pronounced "bips"). The foreign exchange equivalent is "pip", which is a hundredth of a big figure (see below) of a currency pair.

Bear

1. n. a person who expects a particular market to go lower.
2. adj. that which exhibits signs of falling prices, e.g. bear market, bear trend.
3. also the adjective form, bearish, e.g. "I'm bearish of the Euro, as in it's worth approximately 0." or "The price action in stocks looks a bit bearish, I wonder if we will finally sell off."

Benchmark

1. a major market to which an investment fund or advisory service will compare its performance. For example, the S&P 500 is the benchmark index for many equity-only and multi-market mutual and hedge funds.
2. in the treasury market, the main maturities for which a government or institution issues debt. For US treasuries, this is the 2y, 3y, 5y, 7y, 10y, and 30y. Each of the "on-the-run" issues for these maturities is known as the benchmark, and all other issues can be quoted as a yield spread to these benchmarks.

Bid

1. n. the lower price in a market for a particular traded instrument. The bid is the price at which a market maker will buy the security. The offer is the price at which the market maker will sell.
2. v. to put a bid on a traded instrument. "Please bid 5mm 10y" = "Give me the price at which you will buy 5mm 10y bonds"
3. adj. used to describe when a market is strong/trading higher. "Good god this market is bid. Real glad I sold the low earlier!"

Bid/offer

1. n. the two components of any market for a tradable security or product (see individual definitions for "bid" and "offer")
2. n. a general term describing liquidity conditions (pronounced bid offer). "What is the bid/offer like in Asia time?" (the answer is "great!")

Big figure

The major trading unit of a currency pair. For example, in USD/JPY 1 yen is a big figure, while for EUR/USD .01 dollars is. It denotes about a 1% move in the pair. Trader1: “Holy hell you see the Euro, just dropped a big fig!” Trader2: “Well the euro is worth approximately zero so that shouldn’t surprise anyone.”

Blackberry

aka “crackberry”, the standard weapon of choice for traders and i-bankers for shooting e-mails over a martini at the bar after work. Extra points from the cougar in the corner if you sport a Hermes holster.

Bloomberg

1. n. aka “bberg”, what every self-respecting trader that works for a too-big-to-fail institution uses as his main source for price data, news, and contact with his finance peers. It’s sleek, it’s sexy – it’s the industry standard.
2. v. to send someone a bberg message, as in “Yo bberg me with the concert details when you get a chance.”

*a sampling of awesome bberg functions: MSG <GO> (check messages), TOP <GO> (top world news), USGG10YR Index <GO> (US 10y yields), TYA Cmdty <GO> (10y treasury future, front contract), DINE YOSHINOYA <GO> (review of ultra-high-brow Japanese restaurant, Yoshinoya)

Bond

1. n. a type of security where an investor loans an entity (government, corporation, municipality, etc.) money, the “face amount”, in return for regular fixed cash flows, coupons, calculated as a percentage of the face amount, and the return of the full face amount at the end of the investment, the maturity. Bonds are quoted in the market as a price, but this price corresponds to a yield, which is what the investment will return annually. As prices rise, yields go down, and vice versa.
2. short maturity bonds (1m-1y) are known as bills, while medium maturity (2y-10y) are known as “notes”, and longer than that is known as “bonds”, long bonds, or el bondo.

Bond market

The coolest and most “macro” market of them all. It responds to broad economic changes the fastest, and dwarfs in size the world’s commodity and equity markets. Usually refers to the treasury, or government bond market, as opposed to corporate bonds.

Bond trader

The pinnacle of the trading hierarchy. “Fkn bond trader, I do what I want.”

Broker

1. n. a facilitator of transactions in the market. The middleman, essentially, who links up a buyer and a seller and earns a commission for doing so.
2. what all traders wish they could be but would most likely suck at doing due to differences in the personality requirements between the professions.
3. kind of like a cross between a cold call salesperson and a porn star. In the daytime they man the phones – smooth talking and fast operating are the keys. At night they have to get it up whether they want to or not over dinner and drinks with their clients.