The True Nature of A Long-Term Trend

By W. Clay Allen CFA

The stock of AKAM has exhibited a strong up trending move over the past year. The stock gained over 85% during that time. Some PhDs in math and statistics deny the existence of long-term trends in stock prices. Only a sophisticated statistician could develop a proof that the trend of AKAM could not exist.

It is interesting to delve into the nature of this trend and examine it in more detail. The simple statistics that I use indicate that about 52% of the trading days were up and 48% of the trading days were down. This is very close to flipping a fair coin and the academic would say that this proves the randomness of the daily percent changes in price and that’s all there is to it!

The histogram for AKAM in this example shows the frequency of the days with various percent price changes. The histogram shows the characteristic bell shaped curve of a normal distribution. The closeness of the distribution to the normal shaped curve is also cited as evidence that the distribution is random and completely unpredictable.

The fact that the percent price changes might be random does not require a zero average change and this example showed an average daily percent change of +0.346%. The up days gained 2.51% on average and the down days showed a decline of -2.02%. This imbalance of the magnitude of the up days being greater than the down days persisted for the full 251 days in this example and resulted in the total gain of almost 85%, considerably above the move recorded by the market.

Another simple statistic that is useful to describe this trend is called skewness. Skewness is a measure of the degree to which the tails of the distribution extend out away from the mean of the distribution in either direction. A distribution with low skewness is symmetrical about the mean. The statistics for the trend of AKAM showed a strong degree of skewness to the right or positive side of the distribution. In fact, the estimate of the degree of skewness for this distribution showed that the skewness was 9.6 standard deviations to the right. This is an incredible amount of skewness.

The long-term point & figure chart of the relative performance of AKAM shows a very persistent upward movement during the past year. The p&f chart is constructed to remove the influence of noise from the data and shows the performance of the stock relative to the S&P 500.

It is not profitable to argue whether the trend existed or not because the trend is clearly evident. Most academics would grant the existence of the trend but would argue that because it is random, you couldn’t predict it. If you are using long-term p&f charts to measure the trend, you don’t need to predict it. You need to measure it to make sure that it is still moving in the desired direction. Measuring the trend of a stock allows the investor to participate in stocks with strong up trends for as long as that trend persists. Prediction of the trend is not even part of the problem of deciding whether to continue to participate in that stock or not.

From the Executive’s Desk

At this point in the year, the MTA is gearing up for several Spring events:

- The test window for the Spring CMT Exam is April 26th to May 5th. Sign-ups for all levels have been brisk. Call the MTA as soon as possible to “lock-in” your registration and test date for the upcoming examination. By the time you receive this newsletter the CMT Level 3 registration will have closed, however the Level 1 and Level 2 registration period ends on April 20th. Don’t wait! If you have any questions or concerns in regards to the CMT Exam, feel free to contact Marie Penza at our MTA Office. For those of you that are already registered for an exam, best of luck.

- We are pleased to report that over 100 MTA Members and Affiliates have signed up for our CMT preparatory classes, CMT Institute (CMTi), at various levels. We are pleased with this level of effort by the test participants and we are confident that this will result in continuation of high examination performance.

- The MTA Annual Education Seminar is planned to take place from May 18th-19th in New York City. This event is shaping up to be one of our best seminars ever. Speakers have now been confirmed and the topics for discussion defined. To read more about the Seminar, please see the discussion in this Newsletter, go on-line at www.mta.org, or call Tim Licitra of our Headquarter Staff. Don’t miss this event!

Sincerely,

Tom Silveri
MTA Executive Director

From the Editor’s Desk

In recent months, this newsletter has included articles about volunteering and highlighted the benefits you’ll see from being involved. Michael Kahn, Fred Meissner and Larry Berman have written about how much they enjoyed being involved in the MTA. These three talented individuals would have doubtlessly succeeded in this business even without the MTA. But, I certainly would not have been able to attain my career goals without the MTA.

A month after I joined the MTA, nearly ten years ago, Michael Kahn, then-editor of Technically Speaking, allowed me to prepare one page summaries of the New York MTA meetings. Each month, I forced myself to learn enough about the speaker’s area of expertise to write a concise review, making me a better technician. I would not have passed my CMT tests without this exposure to all aspects of technical analysis. Another benefit of this writing came when the newsletter arrived in my mailbox each month, and I analyzed each of Michael’s helpful edits. If you’re reading this, Michael, thanks for making me a better writer.

Eventually, I became your editor, and that has allowed me to call and email many of you to see if you can submit something. If I haven’t gotten to you yet, please feel free to send me your articles at any time.

I have also had the opportunity to serve on the Nominating Committee and the Journal Committee. Committee work requires a small amount of time and a great deal of interaction with fellow members. In other words, I’ve enjoyed talking to the best and brightest in the field and learned an incredible amount by listening to their decades of accumulated wisdom.

I firmly believe that experience is the best teacher. I have just found that sometimes it’s less expensive to learn from someone else’s experience. My involvement in the MTA has allowed me to learn from the experience of true giants in the field of technical analysis. I urge you to look at what you can do within our organization. The MTA will be stronger with your help, and you’ll grow as a technician through your work alongside fellow volunteers.

Sincerely,

Mike Carr, CMT
Editor, Technically Speaking
MTA Annual Education Seminar 2007

New York City, May 18-19

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5:00 - 6:00PM: Cocktails and MTA Reception Sponsored by Fidelity

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In Depth
Part II: Ralph Acampaora

By Molly McLaughlin Schilling

This is Part II of an interview with Ralph Acampaora at Knight Trading in Jersey City, New Jersey. This section of the interview will focus on historic detail relative to Technical Analysis and its development, as well as the development of the MTA.

Ralph and I have come back to his office after touring this stunning “virtual” stock exchange at Knight Trading. Ralph’s office is spacious and warm, and surprisingly low-tech—a large mahogany desk with pictures of family members, and a wall-to-wall bookshelf filled with books about TA history and theory. Light is pouring through a large bank of windows as we sit down at a big circular conference table to continue the interview.

Molly Schilling [MS]: When you say that your CEO here at Knight Trading has “connected the dots” by his insight into the need for Technical Analysis based research reports to explain and elaborate electronic platform performance for clients, are you implying that there are not many other organizations out there that have made this commitment.

Ralph Acampaora [RA]: No, not yet… not like this.

RA: It dates back to the acceptance of Technical Analysis. The MTA convinced the SEC, the NASD, and the New York Stock Exchange to accept Technical Analysis as real research—and that was a monumental task. We’re in the game now. Up to this point Technical Analysis has lacked a kind of cachet, until recently. Now we have the certification and the legitimacy, it’s done!

Trading on the floors of the stock exchanges, in the commodity pits have traditionally been organized around people who knew each other, traded together, and broadly speaking operated out of a gut feeling for what they were doing— that’s all changing, because these floors are going electronic. The MTA (hopefully—I’m working on it) is going to help teach these traders to look at charts now, and stand in front of computers.

RA: But no one’s ever done that before. I’ll give you the history of that. I’ve been fighting that battle for 40 years now. Now, listen to this - December 1977, I went to Springfield, Massachusetts on behalf of the Market Technicians Association and I gave a gentleman by

the name of John Magee our annual award, I think he was the third or fourth recipient. We all know who John Magee is; he wrote the famous book, in 1948 his book was published, it’s very important to remember the date. The Bible on Technical Analysis comes out in 1948.

When I met Mr. Magee, he was visibly upset. And I said – what’s the problem, Mr. Magee? And he said – they never understood the laws of supply and demand. And I said – Who? He said – the Securities and Exchange Commission. The SEC, in 1949, I believe it was, had him up on fraud charges in New York City, because he had put out a book recommending stock purchases and sales on stocks that weren’t fundamental. And they couldn’t prosecute him because he wasn’t regulated, he wasn’t part of a brokerage company.

The SEC came out in 1949 with a rule that all research on Wall Street, and here’s the quote, “... has to be rooted in sound fundamental principles.” Magee didn’t have an MTA at the time to speak for him, didn’t have one. So from that date forward the whole establishment says – research is all fundamental. And as a consequence the universities started to teach their students all these fundamental things, it was the law of the land – you had to do the fundamentals. And about 10-15 years after that, I think it was the University of Virginia started thinking about creating the CFA – I don’t know if it was the University of Virginia, but it was down in Charlottesville, that’s where it germinated.

And great professors like Benjamin Graham, Warren Buffett’s idol, got big play in the ‘50s or ‘60s. So all of this fundamental analysis and credibility it had established became a very big part of Wall Street research. Now, real fundamental research departments started to develop in the late ‘60s where you had an analyst who followed an industry. And they would go to analyst meetings and they would write reports, very formalized, and it had to be rooted in sound fundamental principles.

So, with the establishment saying – we’ve got to go this way – and they didn’t bring Technical Analysis along, I think part of the problem was that the academics and the practitioners looked down on Technical Analysis because it wasn’t rooted in sound fundamental principles—that was part of the problem.

MS: What’s the hesitation?

RA: It’s wonderful.

RA: It’s an amazing story.

MS: And getting educated… is that largely an MTA endeavor?

RA: Let me tell you a story about education, I told you about the NYMEX, they have about 900 traders—who will be out of business in a year if they don’t learn how to do things electronically. I think a large percentage of these people will get their CMT, and will become active members of the MTA. That’s why the MTA will grow. Do I see potential new jobs out there? Absolutely.

RA: That’s an amazing story.

RA: It’s wonderful.

RA: That’s an amazing story.

MS: And getting educated… is that largely an MTA endeavor?

RA: Let me tell you another thing, these traders at Knight—they’re equity traders, not commodity traders. They have an organization called the STA, the Security Traders Association. Guess what? I’m on the Board of the STA. They have 6,000 members in the United States and Canada, and they’re all

continued on page 5
involved in learning Technical Analysis now, because they know that their life is going to be much, much different, and because a lot of their firms are saying – well, I don’t need that many traders anymore. These traders are beginning to realize that they need to differentiate themselves, distinguish themselves. A CMT is the way to do that.

So, the STA recently created the STA University, because they want these guys to raise the bar. The STA University has partnered with the CBOE and it has a module of classes, basic and advanced classes, for options trading. I just created a module, Basic Technical Analysis for Traders, that they dial up and sit in a room for three or four hours and watch, and learn. I’m going to have the MTA do “Part II” of that. So, traders will have a total exposure to technical analysis sitting right in front of their computers. And by the way, it’s geared towards one thing, passing the CMT.

MS: The New York Institute of Finance…are you still teaching there?
RA: Yep. Every Monday night, for 37 years. See, people don’t understand about the New York Institute of Finance and what it means to the MTA. The New York Institute of Finance used to be part of the New York Stock Exchange. The New York Stock Exchange many, many years ago used to train brokers. And then one day, I think it was in the early ’50s, the New York Stock Exchange turned around, along with Merrill Lynch and the other big houses, and said – hey, we’re out of the education business.

The educational entity of the NYSE spun-out and became its own entity, the New York Institute of Finance. So in actuality it still teaches, but not under the umbrella of the NYSE. It teaches the Street. Now, I got involved in 1965, ‘66, ‘67 – and that’s where I met Alan Shaw who was my Technical Analysis teacher. The school was probably the only place in the country, the only place on the East Coast that has always taught Technical Analysis during the last 50 years.

I started teaching in 1970. Guess when the MTA started? In 1970. It was incorporated in ’73, but it started in 1970. In 1975 the school had just moved, and I was looking at the floor plans and was kidding around with the president of the school, and I took an eraser and started to redraw a few lines…and he said, what are you doing? I said – that’s a closet, why don’t you just move the wall over and it will allow enough room for a library? And that was the birth of the MTA library.

The New York Institute of Finance has been generous to technical analysts from the very, very beginnings of the MTA. They not only taught the subject, they gave us a home that was our home base for years. The New York Institute of Finance -- everybody in the MTA should know about it, we have a very special relationship.

MS: Where is it located now?
RA: The facility was in the World Trade Center, and unfortunately...so after the collapse, they moved to midtown. Now, they also have a nice location in lower Manhattan, right in the Wall Street area.

MS: What inspired you, originally, to take up Technical Analysis?
RA: You’re talking to the luckiest man in the world. When I was young, I was involved in an automobile accident and I wound up in a hospital, to make a very long story short. And I was in the hospital where my father’s very good friend would visit me every day. I was very sick - I was in a belly cast for three months - and I didn’t know what I was going to do. I had to leave school, and that left me not knowing what to do with myself. This kind man would bring lots of reading material, and as he finished reading, he would toss the magazines on the bed. I was like an inverted turtle, I couldn’t move, so I just layed down and started reading. Forbes, Fortune Magazine, and The Wall Street Journal. As I got better, I keep on reading these magazines, and one day, I said to him, “Mr. Downey, this is very interesting.” He said, “This is what ‘research’ is about.”

Now, this was in the mid-’60s and research departments in the markets were just beginning to grow. In those days when you were a chemical analyst you were a real chemist, they took people from industry. So it was very difficult for me to become an analyst. Anyway, I started going around the Street and I was lucky, one of the firms hired me. And half my day was posting for career jobs, and the other half of the day was filling out multiples.

And then they sent me to the New York Institute of Finance. I took a lot of classes, and one of them was with Alan Shaw and it was in Technical Analysis -- the best. And he hired me from the class. And all of a sudden things just snowballed; it was love at first sight.

MS: You loved it.
RA: Yes. I had a passion for it. You love it or hate it, that’s all.

MS: I guess that’s true.
RA: There’s no in between -- it’s a passion, you either have it or you don’t.

MS: Ralph, this is terrific…Thanks for a wonderful interview.

Molly Schilling is an independent trader and freelance writer.
How They Do It

By Matthew Caruso, CMT

This month, we feature an interview with legendary trader Larry Williams on how he views trading in the real world. MTA member Matt Caruso, CMT, recently had a chance to speak with Larry by phone.

Larry Williams has been trading futures and commodities for well over 40 years. He is among the most highly regarded and well known short term traders in the world. No other trader is as accomplished as Larry Williams. He has taught thousands to correctly trade the markets, won many trading championships, and has been the only futures trader in the world to repeatedly trade $1 million of his own money live at seminars around the globe.

Larry began following the markets in 1962 after his interest was sparked by the Kennedy market crash, when President Kennedy forced a roll back in steel prices. The crash was front page news everywhere. People lost millions but Larry was more taken by the fact that if you had been “short” the market, you would have made millions. Larry began to understand that he could make a $100 day trading the markets, whether the market was going up or down, and he was smitten. To a 20 year old college kid, $100 bought a lot of beer and pizza. Larry Williams graduated from the University of Oregon in 1964 with a bachelors in Journalism, thus his passion for writing.

By 1965 Larry was actively trading the markets and began writing newsletters as well. In 1966 Larry developed his famous timing tool, Williams %R. In 1970 Larry’s first investment book, The Secret of Selecting Stocks, was published, followed shortly by, Sure Thing Commodity Trading, How Seasonal Factors Influence Commodity Prices.

In between trading, researching and developing trading tools, teaching, and writing, Larry managed to run twice for the U.S. Senate as well as 65 marathons. He holds a higher degree in archæology and has manned several expeditions. Larry’s long list of best-selling books includes 1982’s How to Prosper in the Coming Good Years, which accurately forecasted the largest bull market and surge in economic growth in American history. He is a past board member of the National Futures Association and the recipient of numerous awards. On October 6, 2002 the mayor of San Diego declared that day as Larry Williams’ Day.

Matt Caruso [MC]: Good afternoon, Mr. Williams. What is your professional job description?

Larry Williams [LW]: I just call myself a trader and author.

MC: When you apply technical analysis are you a top-down or a bottom-up analyst? Do you look first at the long term charts going from monthly to weekly to daily or do you look first at the intraday charts, then daily to weekly etc...?

LW: I actually first look at weekly and then go to daily charts but as you know I look more at fundamentals than I do to the technical side. I don’t look at the technical view at all to find a trade. I think that’s fundamental selection. After that, I’ll go to daily charts and what we call technical analysis to look for entries.

MC: Once you have the desired setup for a trade, what specific techniques would you use to enter it?

LW: I’ve found is that the market is really hard, and there is no one entry technique that works all the time. Therefore, I have a repertoire of entry techniques, maybe 6 or 7 entry techniques, and hopefully one of those will appear when the market is ready to move, but I may still miss a trade. Usually one of those techniques is there but you just don’t know, the markets don’t always top and bottom the same way.

MC: Do you have a certain way to exit your trade or a certain technique or a tool that you use?

LW: Exits are a little different. First, as soon as I’m in a trade I have a stop because I don’t want to get tagged on the markets too much. Then I usually have, but not always, a target that the price should go to. I have a trailing stop, and lastly, I may have an opposite signal.

MC: What kind of money management do you use and how important do you feel it is in trading?

LW: I’ve written about this for years - when I make more money I have larger contract sizes. But, the important part of it is in the beginning and it is how much risk the trader wants to take. I don’t think that we all have the same emotions but that there are extremes in the marketplace, therefore you need to identify your own comfort level and yours might be different than mine. I’m 65 years old so I may have less risk or maybe more risk - I don’t care about the future but you may have to because you’re young. You need to figure out how much risk you can handle and then use that as a percentage of your bankroll, that calculation will tell you how many contracts to trade.

MC: Do you have certain guidelines or a certain percentage of your bankroll that you will not exceed?

LW: It depends on what your objective is - generally most of us should be around 5% risk. If you’re going to try and win a trading...

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How They Do It
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championship or impress the world you’ll have to be higher than that, maybe 15%, or even 20%. At that point you’re definitely at a high risk and you had better be right in your trades or you’ll be blown out.

MC: Are there any areas of technical analysis that you prefer the most, such as oscillators, trendlines or investor sentiment?

LW: I don’t think it matters if you use %R, stochastic oscillator, or the CCI index because they all say the same thing as long as the time frame is the same (figure 1). I wouldn’t say that a 3-day oscillator would say the same thing as a 20-day oscillator. They all measure time so there’s no great magic to this oscillator versus that oscillator and I think that people get carried away with oscillators and indicators and numbers and what not. These are indicators and they’re not a precise tool so I think that’s really important to keep that in mind.

I think that trendlines can be really helpful and I think there’s a place for moving averages but again it’s very judgmental. It isn’t just that you cross above a moving average that makes it a buy signal; you have to understand how the market reacts towards that buy signal. But, the most compelling thing that I find in the marketplace technically is trend. I know price causes trend, but I also think trend causes price and that if a market is in a big down trend prices just keep going down.

Markets always exhibit a reversion to the mean and that’s really what all oscillators are based on. But what you need to realize is that reversion to the mean has to be placed in the context of whether prices are in an uptrend or downtrend. Typical reversion to the mean is homeostasis, which means it’s flat and the data goes up and down. In the market we have trend, so in a downtrend your reversion to the mean is different than if you’re in an uptrend. So you need to place everything within context of the major long term trend.

MC: Are there any ways that you define trend for yourself or do you do so subjectively?

LW: You can probably define trend just by looking at a chart, but of course once you add your oscillators, indicators, and lines, we can’t see the trend anymore because we have all these indicators. A child can tell you in a heart beat what the trend of the market is but because we’re technicians and we have all these indicators on our charts we just get confused. I keep it really simple by using some moving averages along with a couple other trend indicators. It’s not a real complex operation and you’re not always going to be right anyway.

MC: I know that from studying some of your work that you have your own sentiment tool which is called the Larry Williams sentiment indicator. Do you find this to be a useful tool?

LW: Yes I find it very useful. That indicator measures about 100 advisors, newsletters, brokerage firms and websites once a week to determine what percentage of these people are bullish or bearish on commodities and stocks. I think I’m the only one who does it on individual stocks and it was first introduced in a book I did for Bloomberg about 6 years ago. It’s really done well out of sample. By and large you want to fade the crowd and when everybody gets bullish you have to be very careful about being long.

MC: Are there any parts of technical analysis that you don’t agree with or find particularly useful?

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Figure 1 – Crude Oil showing similarity between %R, Stochastics and CCI (Chart by TradeNavigator; www.genesisft.com) continued on page 8
MC: So basically it’s just follow the trend and try to enter at the best point possible.

LW: You got it!

MC: I know that you mechanically test your work. Do you also conduct subjective analysis or are all of your tools back tested?

LW: I’ve been doing this since 1962 so at some point I just know and I don’t have to put it in a computer to tell me if it’s right or wrong. Some of these tools I’ve used for many years and so I know the pitfalls, the upside and the downside to them. But I continue to do back testing of systems and things that I actually trade in the market. As a short term trader I have a lot of patterns that I follow that are very mechanical and I’m certain that a lot of you people know them, and I just follow those patterns. On a longer term basis I look for a setup market and I look for entry and I look for exits, that’s basically what I do.

MC: After reading your book The Secrets of the Commitment of Traders Report, I understand that the position of commercial traders, the seasonality, and trend of a security are all important factors. Would you like to explain these tools?

LW: Yes, but first let me interject here - a great change that has taken place since that book was written and that is that we now have these basket commodity funds where they buy a bunch of commodities and hold them with the belief that the commodity will go higher. Jim Rogers started the whole idea I guess, but these index traders now account for about 25% of the market volume. When you’re looking at anything that has to do with COT (commitment of traders) positions, and I don’t know the answer yet because we haven’t had the data long enough, it’s not the same old game anymore since you have a huge number of perpetual longs, these index funds, and we’ve got to figure out what to do with these guys. Like I said, I don’t have the answer to that yet because I only have sixteen months of data with it.

The question remains, “How do we still use the data?” I think that what people need to understand, the biggest misnomer is just because the commercials are long doesn’t mean the market is going to rally. You have to understand that they don’t speculate in the market, they’re using the market to facilitate their business. They’re not taking positions in the market like you or I as speculators, they’re hedging their business by pre-selling their production, so you need to understand that their function in the marketplace is not the same as ours. They’ve been selling a lot in the grains now and it looks like the grains should come down - the reality is that a lot of guys are selling forward production because at these price levels they can produce a lot of crop; it’s priced to make money so they’ll sell it. It doesn’t mean they’re short the market - they just sold their future production. We really need to put their commercial position into phase with the trend of the market as well.

MC: So you would basically wait for a trend reversal before acting on the commercial short position.

LW: Yes, that’s really critical. They’re heavily short, but that doesn’t mean sell today - it means I want to focus in on that market. The ideal thing would be a big smack on the market and then some technical rally back where you look to take your position.

MC: This is very interesting. Do you plan on releasing an updated version of your COT report to include these new developments in the market?

LW: We don’t have enough data yet but I’m doing something for my subscribers in March about what I think we need to do. I think we need to create a true COT index so that it’ll ferret out all these index traders, option people and other data in there. We need to have a true COT index, a true open interest index, and a true large speculator index.

MC: So until these adjustments are made, do you still feel that there is still a lot of value in the numbers we get from the CFTC?

LW: Oh yeah! I also look at just the net position of the commercials. I put it into an index and I also look at their net position versus open interest. A classic example would be open interest is really peeling off in the marketplace. If you just look at the open interest you don’t know what that means. However, if you go inside that report and see the commercial long position is declining and the large speculator position is increasing rapidly we know that there are a lot of large trader longs coming in and they tend to be buyers of highs. So that would be a bearish scenario since open interest is down and without the large traders, open interest would be way down. If, on the other hand, you have open interest coming down and commercials are increasing their longs, that is very bullish because the only player in the markets on the long is the commercials. That’s how I like to look at the commercials in regards to open interest.

MC: In what priority would you rank the commercials in regards to the trend and seasonality?

LW: I put seasonality way down at the bottom of the list. I was the first to write a book about seasonality back in 1973 and that started this whole industry of seasonal tendency people. Seasonality is indicative and that’s all, it’s not mandatory. I like to start by looking at the commercial position; I look at the buys and sells and then put that in phase with the trend of the market. I would then like to see the trade backed by the seasonality. If I have one trade backed by seasonality and one that isn’t, I’ll take the one that is backed by it.

MC: I know you have many intermediate term tools to help you pinpoint your trade setups. What has led you to evolve from an intermediate term trader who holds his position for several weeks, to a short term trader who holds his position for several days?

LW: I guess it would be my fascination with the market. Now that I’m in Australia I’ve reverted back to the old style because here the bonds open at 12:20 A.M. and I just can’t handle going to work at 12:20 in the morning and getting off at 8:00 in the morning. So I’ve gone back to finding a trade, emailing my orders to my broker, going to sleep and waking up in the morning to see what the damages were. As everybody knows I made a lot of money trading the short term stuff for the contest and everything. I think eventually I learned how to trade on a short term basis, and it took a lot of time to figure that out. Once I found that out, I thought it was enjoyable and there’s a lot of action, but I don’t think it’s for everybody and I think it’s a very hard way to trade.

MC: You are very well know for winning the Robbins World Cup of Trading, where you turned $10,000 to over $1,000,000 in a one year period. Did technical analysis play a large role in winning,
How They Do It

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or were your trades based more on fundamental indicators?

LW: Both. They were mostly short term trades, but they were based on the fact that markets were in uptrends and the commercials were long or short that market. On top of that I use a lot of patterns and something called a volatility breakout which is a common word now but not when I stumbled upon the whole idea back in 1982 - nobody was using anything like that and now everybody is unfortunately. It was a new approach to the market and it helped a lot. Also I was very focused, all I did that year was trade and I had some decent result. However, it was a combination of fundamentals and technicals, but really about patterns in the market place, almost all of those trades were pattern trades.

MC: You often mention that you have a lot of patterns, such as your “oops” pattern, and you are well known for developing the %R indicator. What thought process helps you to develop these indicators?

LW: I think a lot of it is looking at charts. The idea behind the patterns is that I look for patterns that look very bullish and then I’ll use that as a sell pattern. A bar closing right at its high looks very bullish so I figure if it takes out that bars low or does something that’s abnormal, then I use that as my sell. I’m looking for psychological failure of what everybody sees on their chart such as buying on a trendline or whatever it is.

MC: That is very interesting. In essence it’s a form of contrary opinion in that you’re taking the opposite view of the crowd.

LW: Yes. If the chart pattern looks really bullish I think “great,” and it might be. But if that puppy fails you have a great short.

MC: You use investor sentiment as a tool in trading. Do your own sentiment and emotions affect your trading? If so how do you overcome it?

LW: Well, of course. I think the easiest way to overcome it is by not making big bets. If you make big bets you become very emotional and that is what the public does, they bet more than their emotions can handle. I think the best formula for a technician is from Einstein, E=MC2 because what that tells us is that E is your emotion equal to your money multiplied by the square of the number of contracts your trading. Everybody bets too big and then they get emotional, and a lot of your emotions can be controlled by your bet size. You still can become emotional with the markets, but every time I put a trade I know where my stop is and where my risk is. I’ve already accepted that I can lose that amount of money on the trade and it’s done, what else can I do?

The interesting thing about that is if you look at all the great athletes, they can always come back. That means you need to have the energy and the stamina as well as the skills. In trading the only way you can come back is if you have money left - the most important thing for a trader is to have money left. If you bet big, you’ll lose big, and then you can’t come back.

MC: Have you had a terrible investment decision? If so, how did you learn from it?

LW: Absolutely, I’ve had many horrible trades in my life and I’m sure I’ll have some more in the future. I’m still learning this business. I was long propane and it locked limit for 17 days against me before I could get out of it. That taught me never to trade thin markets. I bought cattle one time and lost a few million dollars in one month because I thought it was fundamentally low priced and it obviously wasn’t because it kept going lower. So yes, I’ve had some horrible trades.

MC: Has there been anyone who has influenced the way you apply technical analysis or the way to trade? If so, how did he or she influence you?

LW: There were two people who helped me a great deal. First, there was a guy named Bill Meehan who taught me the fundamental aspect of the market. Bill was an old Chicago Board of Trade guy who taught me about the COT report and a little about money management - maybe I didn’t absorb all the lessons then. I then learned a great deal about money management from Ralph Vince who is the most brilliant guy of them all when it comes to money management. Pertaining to technical analysis, my good buddy Tom DeMark is someone I learned a lot from. Tom is a very creative guy and we made some systems together and did a lot of work together. He may have learned a little bit, I don’t know, but I’m certain I learned a lot more from him about looking at the markets, and patterns. Tom’s work is great and everyone should read it. Henry Wheeler Chase’s work is very good as well. He’s not around anymore but I learned a lot from him.

MC: Do you have a favorite book that you feel everyone should read?

LW: I think the best book on the market ever written is one called Zurich Axioms by Max Gunther. It is not going to tell you to buy wheat tomorrow; it isn’t that kind of book. To me it really explains what it is to be a speculator. It really gets into how to think as a speculator, what to look out for and what to look for. It is so well written, just a really great book.

MC: Do you have any advice for traders or technicians entering the business?

LW: Don’t believe for a minute that technicians are going to be the be-all end-all of the market. What most of these technicians claim about how well you can do in the market is total hog wash or I’m too stupid to make it happen, I don’t know which. There’s no panacea, this is hard work and you have to think about it. All of these tools are subjective, mine as well. They don’t work a lot of the time and you’re going to be wrong. To win big, bet small and just because you have a buy signal doesn’t mean the market is going to go up so you better have stop protection. Do not believe much of what people tell you, you better double check it yourself.

MC: You mentioned quite frequently that you also use fundamental analysis. Are there any specific tools that you use for certain markets?

LW: When I’m tracking the stock market there are. I want to look at a lot of things in the stock market to select my stocks. Some of my work is based on return on equity, dividends, cash flow ratio, and things of that nature. For commodities I have a technique to tell if a commodity is under or overvalued and it is a really great tool.

MC: Do you find different markets such as currencies, commodities and stocks trade differently from one another?

LW: I find recently, because we’ve gone into electronic sessions, that they don’t trade much at all and then there’s explosive trading. The electronic sessions have changed a lot and we don’t have the same kind of markets as before. It used to be the markets closed in Chicago at 3:00 P.M. and then open the next morning. We had gaps and all sorts of things we don’t have now because we have seamless trading, the market closes and reopens a few minutes later. I think electronic trading changed many things.

MC: There’s always something changing.

LW: Yes and that’s why these are all tools and to say you have the be-all, end-all now and forever is not the way it is. Money is never easy to make. You have to be smarter than the other guy and you need to think your way through to make money in the market. You can’t just have some little thing to follow and do all the work for you.

MC: What are you focusing on now going forward?

LW: Just trading really. I have a couple of changes in %R that I think revolutionizes it or any oscillator. That’s been an exciting thing for me. I have a new way of looking at accumulation-distribution in the market place. In my stock market work I think I’ve come across a better way of evaluating stocks - I created a formula that combines a bunch of different evaluation tools such as p/e etc… but on a weighted fashion. I might give forward p/e a weight of 3 and price/sales a weight of 4, in order to get a mechanical approach to stock selection. Those are the big things I’ve been working on I guess. Also I trade and I’ve been pretty busy trading and figuring out what to do myself.

MC: You mentioned that you use mechanical

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systems in your trading approach. Do you always take the signal of the system or at times do you intervene?

LW: I'll intervene.

MC: Do you have any final comments on how technical analysis helps you in your trading that we haven't covered?

LW: I think technical analysis can be of real value, but I think you have to understand that it is analysis, it's not perfect. Basically technical analysis has to do with price and that's a very short term phenomenon. Therefore, to me, the help of technical analysis is for entry technique but I don't think it helps much at all for the selection of what market to get into. To me, it's all about entering and that's just my experience, it's not to say that someone else hasn't figured out another way. My experience is all about entry technique, that's what I use technical analysis for.

MC: Thanks, Larry, it's been very educational.

Matthew Caruso, CMT is an independent trader, analyst and writer. He is a member of the Market Technicians Association and of the Canadian Society of Technical Analysts where he is the Regional Director for the Montreal Chapter.

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