THE MIND OF A TRADER

LESSONS IN TRADING STRATEGY FROM THE WORLD'S LEADING TRADERS

ALPESH B. PATEL

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Bill Lipschutz

'IT'S ALL ABOUT DOLLARS'

TRADING TOPICS

- Sources of funds and their effect on performance
- The advantages of being a 'private' trader
- Insane focus
- The Salomon trader
- Cutting back on luck
- Mentors
- Fear and anxiety
- Networking and pyramid information
- Structuring trades

Bill Lipschutz was Managing Director and Global Head of Foreign Exchange at Salomon Brothers at the end of the 1980s. If ever there was a right time and a right place for a trader, that was it - then and there. Jack Schwager, in *The New Market Wizards* (1992), described Bill Lipschutz as 'Salomon Brothers' largest and most successful currency trader'. That's not surprising when you consider that a *single* Lipschutz trade might be measured in billions of dollars, and the resulting profits in tens of millions of dollars. Schwager estimated Bill's trading alone accounted for more than half a billion dollars profit for Salomon in the eight years he was there. That's the equivalent of $250,000 profit each and every trading day for eight years.

I interviewed Bill Lipschutz twice in London. The first interview was conducted by the side of the open air roof swimming pool of the Berkeley Hotel, overlooking Green Park and Knightsbridge. The second interview took place in Surrey at the home of Mark Slater, one-time Head Currency Trader at Salomon Brothers in London. On both occasions the splendor of the surroundings meant I had to focus extra hard on my interviewee.

Working at Salomon

After earning an undergraduate degree in architectural design and completing an MBA, both from Cornell University, Bill Lipschutz joined Salomon in 1982 at the age of twenty-eight. He trained in equities and equity options and was then recruited into foreign exchange where he pioneered the development of both over-the-counter and exchange-traded currency options. The forex market is the deepest, most liquid market in the world, with daily transactions valued at over $2 trillion.

'I have to say, Salomon Brothers was certainly unique in the market place in the 1980s. It certainly was unique in foreign exchange. The way John Gutfreund [pronounced 'Goodfriend'. He gained particular notoriety from Michael Lewis's *Liar's Poker* (1990)] and Tom Strauss ran that company really gave all the traders at the firm: the ability to run with the ball. Although I am sure that if I had messed up at some point in time, I would have been unceremoniously out on my butt, nevertheless that opportunity, that forum, did not really exist at very many institutions. Other firms simply didn't allS)W people to take positions or risks taken at Salomon. One learnt a p rsonal responsibility and a trading maturity very quickly at the firm. No one ever said "here's your position limit, you have to cut your position".

'If someone lost a certain amount, all of a sudden their desk was empty. But it was an environment where you were always allowed to push the envelope. As long as you reached that next level successfully, you could try to push it again. That was something quite extraordinary and not something I fully appreciated at the time. In retrospect it was a really unique organization, but also with a really unique bunch of guys at the top.

'In the years I was at Salomon, performance in the company was not really measured in the same way as in asset management. The latter tends to be based on percentage return, which in itself is misleading because of additions and growth in capital. When trading a market sector for a company like Salomon there is not necessarily any actual capital dedicated to that sector. In foreign exchange most business between major market-making and trading institutions is conducted on a credit basis. There is no margin required, and therefore no dedicated capital is needed. When I was a trader at Salomon we traded out of a subsidiary which was capitalized at a million dollars. Whatever we made in a year went upstream io the parent. So, who knows what the returns were. But we had $150 billion in credit lines.'

On his own

Bill left Salomon in 1990 to form his own company, Rowayton, named after a town in southern Connecticut.

'Rowayton Capital Management started in 1991 as a vehicle to manage our own capital, which was not huge at the time. I started it with two colleagues, Bill Strack and Ron Furlong who had been at Salomon Brothers with me. We did start it with a view to ultimately managing outside capital, but we were not really sure if many of the elements of success would hold up after making the move from a big company environment to a small "on our own" environment.

'So we traded for a while, and then, at the very end of 1993, we started to raise a little outside money. My wife, Lynnelle Jones, who had been at Goldman Sachs for nine years as an institutional salesperson, not in FX but in fixed income securities, was largely responsible for the money raising. We raised about $150 milli n in about 18 months. That was a substantial amount coming from flat. While FX is the only thing that we traded, we developed three programs which all trade FX, but with different combinations of risk/reward objectives and different instruments. For instance, we have one product that trades no options; it is really just spot foreign exchange, mostly day trading and we don't take any overnight positions. We also have a middle kind of a product where we're using certain combinations of options. We don't do too much writing, ratio spreading or anything like that. We do a lot of intra-Europe currency spreads. Then we have a very aggressive program where we are doing a lot of "naked" writing; we are doing a lot of ratio spreads, a lot of very low delta stuff, things like that. We were able to use those programs in combination to develop other products across a broad spectrum of risk/reward objectives.

'Rowayton, as a company, closed down in late 1995, for a variety of reasons, and we currently operate a company also with an odd name, Hathersage Capital Management, which is a town in Yorkshire. Hathersage is a new company and does a number of similar things to what Rowayton did on a trading level, but we feel it is much better organized than Rowayton was on an administrative level.'

Trading with other people's money

It is often not realized that the source of trading funds can affect one's trading style and performance. As Bill Lipschutz explains, this fact is something even the most experienced traders do not appreciate until they experience it.

'I was unaware that there were these differences. Seven years ago, I had a na'ive view that it does not matter whether a trader is trading Salomon Brothers' proprietary capital or trading from capital raised from ten high net worth individuals or from capital from a single source. I assumed it was all the same. The goal to my mind was to try to extract the maximum profit from the market. I didn't realize it then, but different sources will definitely imply different trading strategies. The source of capital will invariably force different trading motivations on the trader. It is not simply a question of saying, "oh, I have some capital. It doesn't matter what the source is. I will go out and do my best and at the end of the day try to make some money." It is not like that. There are many, many different strengths that come from being a corporate entity, whereas dealing for high net worth individuals you do live and die by your monthly numbers.

'The whole money-management game is a difficult game. It has not only to do with how well you perform, but what kinds of results investors are looking for in their portfolios. Absolute performance can be misleading. I can say to you, "we were up 600 per cent" over five years in our most aggressive program, and you might say, "wow 600 per cent". But that does not necessarily mean that much in and of itself, without knowing how well other currency-only managers performed and how much risk was being taken. For example, say a guy is managing $200 million, and $120 million of it is a fund that he runs with a very specific mandate. If he made 600 per cent over four years in that particular fund, he may have people pulling money out from that particular fund, because that was not the kind of variance they were expecting. The dynamics of the game are complex and often counter-intuitive.

'Look at the very different approach of George Soros, when he used to trade, and Peter Lynch. Soros was usually highly leveraged and purely and simply trying to make a lot of money. Peter Lynch, in managing the Magellan Fund, was first and foremost concerned about the preservation of capital. He was in a big bull market, he was a big stock-picker, he made a lot of money, but believe me, if the Magellan Fund is ever starting to be down at all you would have massive redemptions and you would ultimately have no fund. So the people who invest with George Soros understand they may be down 20-30 per cent in that part of their portfolio. I don't think you have any people whose whole investment portfolio is in the Quantum Fund; they are going to be diversified. The motivation of the investors is very different. Investors choose a style of managment they are comfortable with. Ultimately, the preferences of a trading manager's investors can influence the trader's trading style.

As Bill Lipschutz explains, one way the source of funding can affect your trading style is through the motivation of the lender and the terms on which the funds were granted. We all, as traders, seek more capital with which to trade. Sooner or later, after a degree of success, we decide to seek out new sources of funds, whether as a loan, which then does not require us to be regulated, or as an investment by the lender. Whatever the source of money, you must be aware that since it can affect your trading style it may also affect your trading performance. The worse time to have a deterioration in your trading performance is when the money is not your own. So before you seek new funds think hard about how it is likely to affect your trading.

Your own money

The source of trading capital can vary widely. The most obvious source is one's own capital. So, how does Bill Lipschutz trade with his own money?

'For money I have committed to speculation, as distinct from investment, one would say I have a very high risk tolerance. In essence, if I were to lose all the money I have for speculation, that would be okay. I certainly do not expect to lose it all, but I would be prepared for that outcome. Now, I would make other investments, owning my own home, that is one investment, owning a stock portfolio, that's a certain kind of investment. With the money I speculate with, I am expecting a much higher return, but I am also expecting a lot more volatility, a lot more variance. There is a significant risk of ruin, of losing it all.'

With his own funds, Bill Lipschutz is answerable to himself only and can trade as he sees fit. As he goes on to explain, with other people's money, the degree of freedom is much reduced.

Other people's money

'But, when you are entrusted with client money, it is a different business. The client says to you, "I know you can be a speculative trader. I am comfortable with that and I am willing to lose 20 per cent." I have spoken at length with clients, and we try to talk with our clients and really understand what they want. We want then to understand completely what we can and cannot do. If a guy looks me in the eye and says, "I can be down 20 per cent, no problem", I know he really means 5 per cent, because if you call him in three days and say "you know what, you're down 18 per cent, I just wanna know how you feel, so we can discuss what to do from here", he's going to forget he ever said he was comfortable with a 20 per cent loss.

Because they are not traders, they don't understand ahead of time how they are going to deal with a large drawdown. When you are charged with other people's money you have to help them and not let them get into something they are not emotionally ready for yet. You can't just go out there and wildly speculate with other people's money.

'It's often said that if you, as fund manager, buy IBM stock, and IBM goes down 25 per cent, nobody is going to fire you for that, because everybody owns IBM stock – it is the prudent thing to do. But if you go out and you buy a fly-by-night internet company and its stock goes up 80 per cent and then falls and the company goes bankrupt, then you are going to get fired. They'll pull the money from you and you will have trouble raising more money.

It's not just what kind of returns you can make, there are many other elements that motivate people in the investment decisions that they make. It goes right down to the trader level. Why did you not put that trade on at a bigger level because you knew it had an extremely good probability of going up? Well, because sometimes being wrong, even if there is a 5 per cent chance of that happening, is a whole lot worse than being right, even if there is a 95 per cent chance of that. It's the old "gee, if I make 25 per cent for these guys, they'll be really happy, and they'll think I am a great trader and I'll earn big fees". But you know what, if I lose 5 per cent for these guys, they're going to pull that money out and I am going to be close to being out of business.' So the leverage decision for the trader in this case is far more complex than merely contemplating the probability of the trade succeeding or failing. Usually, There is an entire set of issues that the trader must consider, in addition to determining the probability of the trade succeeding or failing solely on a profit basis.

'You can't just go out there and wildly speculate with other people's money.'

Therefore, trading with other people's money becomes far more complicated than with one's own money. You have to consider both the likely outcome of the trade and the likely reaction of the investor to a positive and a negative trading outcome. The decisions you can make are restricted by the likely responses of your client. That in turn could impinge upon your trading performance. There can be slightly greater freedom and less pressure when trading for a firm, as Bill goes on to explain.

Playing with the company's capital

'When you manage money for individuals you have to focus on preservation of capital. When you are trading for a company, they are looking to make money. They also understand losses better. With a company it has a lot more to do with whether, as a corporation, they want to be in the business of foreign exchange, or not. It has a lot less to do with the individual traders' performances being a determinant. So if, for example, a company takes a $20 million dollar hit, they may decide to terminate the trader, but it is unlikely they will get out of foreign exchange. So, the market sector will almost never be to blame.'

Given all the constraints in trading with other people's money, the question arises, 'why not borrow from a bank as a secured loan which is repaid irrespective of performance?' Unfortunately, practical difficulties can often rule out this source of funds.

'First of all, if an investment bank, or some sort of corporate entity, was going to entrust the trading and speculation of their products with an individual, they would probably want that individual in-house. It is not so much that they are averse to that individual managing other people'-s mo'ney. The downside is so great politically to whoever oversees or okays that loan, that it's a job loser. If you give money to, say, Alpesh's company, and you drop a few million, then the first thing everyone is going to say is "who the hell gave that gq.y that money". And the next thing you know, you are fired. Whereas, if they give the money to a department in their company, then the company has made a decision, year after year, as to the business they want to be in. And if they lose money, year after year, they are not going to lose their job for that decision.'

Ultimately, one has to consider the various sources of funds available and the disbenefits of each, and weigh this up with having more capital with which to trade. Is it worth it if you have to pay for your borrowed funds with the hen that lays the golden eggs? In other words, what is the point of having extra funds if you cannot trade profitably with them?

So, before taking on new funds, ask yourself the following questions:

1. What does the lender say he or she expects?
2. What does he or she *really* expect?
3. Have I traded successfully in the past in the manner required by the lender's expectations?
4. Can I deliver what the lender *really* expects?
5. What are the consequences for me if I fail to deliver?
6. How much control does the lender want?
7. How frequently is the lender going to inquire about the performance?
8. What type of personality has the lender? Is he or she likely to pester and aggravate?
9. Can some ground rules be set?

The advantages of not being a trading Goliath

Most traders of course do not work for the leading investment banks. Most traders are private individuals who toil in whatever spare time they have to make a few accurate trades. These 'Davids', compared to the investment bank 'Goliaths', lack the same infrastructure, the support staff, the research capabilities, the state-of-the-art information and analysis software and hardware, and they lack the benefits of being surrounded by highly experienced colleagues. But the Davids do have a few advantages over the Goliaths. To trade successfully and defeat Goliath at effectively his own game, these few advantages must be 'driven home' and capitalized upon.

Advantage 1: The ability to sit on your hands

Uncomfortable, yet profitable. That is the consequence of sitting on your hands. As Bill explains, the private trader has definite benefits over his full-time investment bank counterpart in not having someone looking over his shoulder.

'When you work for a big company you don't see many traders saying, "oh man, I don't really have a good idea about the market, gee I'll read the newspapers today", because your boss is walking by, saying, "How come you're not trading?" The fact of the matter is, if most traders would learn how to sit on their hands SO per cent of the time, they would make a lot more money.

'Let's say you take one position each day over a period of 250 trading days in a year. You know what it's going to come down to? It's going to come down to five trades, three of which are going to be horribly wrong and you are going to lose a fortune, two of which are going to be amazingly right and you are going to make a fortune. And in between, the other 245 times are not going to matter - you'll make a little and lose a little. They will be all those times when you should probably be sitting on your hands, and you'll be scrambling to get out even, or you are not paying attention and losing a large amount when there was a low probability of profiting on the trade to begin with. It all really comes down to a few decisions.

'You really need to understand the benefit of "being out of the market" if there is nothing to do, if there is no hig probability trade. The whole game of trading is to continuously work for an edge. Continually take the high probability bets. Take those all the time, and by definition you will come out ahead, as long as your risk of ruin is low enough so that you do not get blown out with any one or two or three bad bets, a bad streak. So if you have someone at a big company looking over your shoulder and saying, "how come you're reading the paper, shouldn't you have a position?" the real answer is "no". But most trading management is not too much into that.'

'If most traders would learn how to sit on their hands 50 per cent of the time, they would make a lot more money.'

Advantage 2: Decision-making control

On your own, with your own funds, you are the 'trigger man'. It all depends on you and you alone. Similarly, if you do not work on the trading floor, but instead have individual investors, you could have some freedom.

'Individual investors are not going to call you every day, because they don't really want to know what your positions are, whether you are long, short or out of the market. Now you, Alpesh, you are the sole decision-maker at every level: what to commit, when to commit, if to commit. I am smiling because just like you I was in university for a long time, I traded on my own – you, me, probably every other trader you are going to interview – we were all up 480 per cent at some point and the funny thing is, of course, you are looking at a universe of all successful people. If you weren't up 480, or 200 or 80 per cent or whatever it was when you were on your own, you would never have made it.'

The point Bill is making is that you ought to be having exceptional returns, probably better than your professional colleague at a bank, if you are in total trading control. If you can't do it on your own, it's unlikely to be better when you have someone looking over your shoulder. This is a point with which Kaveh Alamouti, Head of Derivatives and Arbitrage at Tokai Bank, also agreed when I spoke to him about the sizable returns my trading was producing, compared to some of the 'star' traders in investment banks. I reflected that unfortunately the stars had a 'little bit' more capital at their disposal than I!

Advantage 3: Information is profit

The greater availability of information to the private investors than ever before has meant that, rather than being at a disadvantage to their professional colleagues, they are on almost level terms with them. So, strictly, this is neither an advantage nor a disadvantage any longer.

'In 1997 information is available instantaneously far more than any of us can absorb. No one has information first. A guy sitting in his living room in Kansas watching TV can see information as fast as a trader on a trading desk now. Ten years ago, because I was at Salomon, because I had this kind of technology, I had an edge over a lot of people. I was one of the first handful of traders in New York to have a Telerate and Reuters machine in my home. And now it's commonplace.

'I wanted it at home because I knew other traders would get into work and they would have to call colleagues in London and ask them how things had looked overnight. And it occurred to me that you were going to get a second-hand interpretation doing things that way. So when I had the Telerate at home, I could come to work and know what the markets were doing. Today, almost everyone has access to that kind of information and the edge of many traders is gone.'

Do not let information availability become a disbenefit. Although you may be able to obtain information as quickly as a professional trader, they have the resources to manage it. The information problem up until the 1990s has been one of availability, cost and promptness. In the 1990s and beyond the information problem is not really about those things, it is about information management. Do not just sit back in complacency because you have the same information at the same time as Salomon Brothers. Remember you have to manage all the information available to you, otherwise it will be under-utilized.

Advantage 4: Flexibility and agility

As most people know, big things take longer to change and adapt than small things. Those are the laws of inertia and momentum. A similar law applies in trading, to the advantage of the trading 'Davids'.

'As a 'little guy' you can very quickly re-orient what your firm is doing. Many small firms will trade many different markets. If, for example, a certain market is currently yielding certain opportunities or going through structural change, big firms are much slower to realize these opportunities. For big firms there are generally many more decisions which are not related to the issue at hand that have to do with re- orienting a department. That is the nature of big organizations.'

It is important as a trader to monitor industry-wide changes, in the same way the CEO of Coca-Cola would monitor changes in the nature of the soft-drinks market. You ought then to be better placed to change product, or market if what you are trading should prove to be unprofitable, perhaps because of regulatory or other structural changes. It is an advantage which you may only utilize but once in your trading career, but it is worth bearing in mind.

Advantage 5: The pressure to perform

Small traders with their destinies in their own hands may often have less pressure exerted on them than others. However, this is not necessarily an absolute .benefit.

'As far as professional traders versus the individual traders are concerned, the individual trader, does not have the same kind of pressure of someone looking over his shoulder and saying, "you ought to do this or that". But then again there is no one to force a discipline and say, "you have to cut your losses, this is too big or this is too little". Now that is probably a bad thing. You will not have, as an individual, a superior who has a dispassionate view on your positions, who can advise. A small trader who has never worked in a big firm and learnt the discipline of the big firm has trouble with discipline. He will say, "I know this is a great trade, I am going to stay with it", whereas in a big firm you often have a dispassionate superior who will say, "It does not matter. It is too big. You have got too much of a loss. You have to be out of it."'

Consequently, if you are an individual private trader, you must ensure that you recognize what beneficial outside influences (such as an imposed trading discipline) are not being placed on you, and then ensure you impose them on yourself.

Insane focus

Have you ever wondered what drives a man who has everything? Why do the richest men in the world get up and go to work each morning? Is it greed? Is it unquenchable ambition? Is it megalomania? The answer to these questions has a great relevance to trading excellence and explains why great achievers, and great traders, become great in the first place.

'If a trader is motivated by the money, then it is the wrong reason. A truly successful trader has got to be involved and into the trading, the money is the side issue. Although I am not the first to say it, I do subscribe to it. The principal motivation is not the trappings of success. It's usually the by-product - simply stated 'the game's the thing'.

Far more important than motivation is focus. I think people, really underestimate how critical focus is to success, particularly extraordinary success. Yes, it is fun. Yes, you hear traders say "I would do this for no money. I am just so into it." When you have been around as long as I have, you find people, probably yourself included, who spend inordinate amounts of time reading about or investigating phenomena to no apparent goal except that they are so fascinated by it. We observe individuals who stay up deep into the night for days trying to work out some mathematical problem, or the like.

'That's a kind of almost insane focus you must have to achieve trading excellence. You are not thinking "if I do this I will be able to buy a Porsche, or because if I do this I am going to be famous". It is something that comes from within. It's just that quest to solve the problem. That kind of focus is extremely difficult to maintain for the years and years that comprise a trading career.'

Insane focus is very difficult to comprehend unless you have experienced it yourself. It is an intensity of concentration, such that nothing else exists or matters beyond your tunnel vision. While this type of focus comes from deep within your psychological make-up, it manifests itself as extreme hard work and is different from insight or education.

'If you meet a trader who is very, very successful, and he truly, honestly, believes it is because he is smarter and faster and more insightful and more aggressive than all of his peers, question him. One thing that is common among all successful traders - whether they are formally educated or carry PhDs, they are all insightful, and hard-working.

'If a trader is motivated by the money, then it is the wrong reason.'

'Think back to school, people who did well in school were usually one of two types. They were either very hard-working, organized, efficient, did all the homework, all the problems set, re-read all the chapters many more times than any normal person would, and they did very well. Or they were people, and there were fewer of these, that were just so bright and so brilliant that maybe they didn't read all of the stuff, they just had real insight. You very seldom see very bright, insightful people who are also really hard-working, with a real work ethic. You look among the top traders - they are both. They are very smart, insightful and very hard working, and very organized. They may appear to be scatterbrained, but they are not.'

Not only does Bill Lipschutz possess insane focus, he was fortunate enough to have mentors and role models who possessed it as well.

I came to know a British gentleman by the name of Mike Simpson who ran a trading desk for a market-making bank that I did a great deal of business with, and who later worked with me at Salomon. He had been in the market for 10 or 15 years before I met him. This is a guy from whom I really learned the 'nuts and bolts' of foreign exchange. Not so much options theory, but he had been in the market for a long time and really understood how foreign exchange worked, how market-making worked, how the flows worked, what caused the market to see and focus on certain things and not on other things. We became best friends over the phone over a period of three years. We both had similar backgrounds, we were both only-children and were very much about focus and hard work. He would be in his office in Tokyo by Sam his time and he would stay in his office until 9 or 10pm and then go home and get his four hours sleep. He did this for the 10 years I knew him. Of course he had been doing that for years before I knew him.'

Brilliance, intelligence, education and the desire to make money will probably lead to success. But to be a phenomenon, talent and industry are key. If you are looking for a secret to trading success, there it is.

'You have got to be really smart and you have to be willing to work really hard. You see plenty of really bright people who don't make it as long-term successful traders because they are not willing to put in the time. You can't be driven by this desire to make money. Money is a by-product. You really have to be into the whole game of it.'

'You can't be driven by this desire to make money.'

When they call you 'crazy' you know you are on the right track

Insane focus is something seen in others by the very few. It is comprehended by fewer still and ultimately possessed by the fewest of all. For this reason, many times those with the capability to achieve this level of focus are pilloried by those who do not understand it. The onlookers see success and they see an industrious individual, and yet they will refuse to make the connection between the two, for fear that there is a connection. The onlookers comfort themselves with their Freudian defence mechanism: 'I don't want that success anyway, it's not worth it, and anyway you don't really have to work hard to achieve it'.

'I think people in our own industry do not understand the importance of this type of focus. You will always get people who will look at a trader and think, "God, he's up at 5.30am every morning, always working at the weekends. He has no life. I'm outta here. I'm taking my vacation. I'm going to Switzerland for three weeks." Now I am not saying people should not take vacations, but the thing is, the very best traders don't take a lot of time off. They don't want to.

Bill Lipschutz's comments remind me of the woman who said to the great violinist, Fritz Kreisler, 'I'd give my life to play as beautifully as you!' 'Madam', Kreisler replied, 'I have.' Bill goes on to explain the possible causes of this focus and drive.

'All the people you meet for this book are going to be highly motivated. Sometimes it's for deep-seated reasons: they may come from a lower economic background and there is an internal struggle, sometimes people come from situations where their fathers were highly successful and that is a psychological motivator. Ultimately, it is whatever drives an individual. Motivation is very difficult to put your finger on. The upshot of all that is the focus, that looks really odd to everyone else. People think, "what is it with that guy? He's always working. He's always doing this or that."

'I think that one thing that helped me a lot in my career was that I never stopped thinking about the market that I was involved in, about how it worked, and trying to figure out where exchange rates were going. It was not a question of saying, "gosh I am giving up time out with my friends, or I am giving up weekends here, or I am giving up sleep". I didn't think of it that way. I just wanted to trade.

The price of phenomenal success is not one many are prepared to pay. For others, a lack of talent means they do not have the currency with which to pay the price in any event. For those with insane focus, there is virtually no price to pay - they love what they are doing.

De-focus: there is more to life than trading

Of course even the most focused tend to be healthy, normal individuals. As such they do realize that their focus ought at times to be shifted to other things, such as their families. At that point, good trading requires good time and life management skills.

Inevitably you become more de-focused because other thin s become more important in an individual's life. You get married, have a family, where children become important to you, and you want to spend time with them. So you are not focused on the game of beating the market and your focus changes: "It's Saturday afternoon, I really ought to think about putting in those shrubs around the house or play catch with Bill, Jr." Those are the kinds of things you do instead of sitting down when the market's closed and thinking about a problem that you know you won't have a chance to think about on Monday morning.

'When you're hiring young people right out of school, they may be eager but may not necessarily have the ability to focus. That is the period in a person's life when a lot of other things are going on, for instance if they're single then they have got all that dating thing to worry about, or if they're married and maybe just having some kids then they've got that whole thing to worry about. I am not saying that you don't hire single people or people with kids; I am saying that you're looking for mature individuals who have the ability to focus on their job and handle all the other things that are going on in their lives.

'One of the things about trading is that you have got to have the ability to prioritize information extremely quickly. What's important, what's going to affect the market the bottom-line way? You have to be very, very organ- ized and prioritize so many bits of your life, to enable you to focus. Only by properly organizing his time, can a trader find those periods of time to de-focus - time taken to recharge the batteries. This combination of having the insight and a work ethic, I don't think it is intelligence particularly, it's a kind of brilliance. It is a very rare combination. I think you see it in all the successful traders.'

Child-like fascination

Much of the insane focus Bill Lipschutz discusses comes from a child-like fascination with the markets. It is having the inquiring mind, seeking to probe, prod and poke at the mysterious 'toy' that is the markets.

'The money game, or the Wall Street or City game attracts a lot of young people who are very aggressive, who want a big house and a fancy car, expensive suits, and that's fine. I would not say that that is a bad motivation or a motivation that does not exist, but as a principal motivation to success in trading I don't think it works. I think that the most important thing is the almost child-like fascination with the way the game of trading unfolds both against your fellow traders and against this unfathomable market-place, with all the nuances, all the changes - an amoebae-like amorphous thing.

'Most of the top traders have a child-like fascination with the game. Whether it's the psychological elements of the game, the technical elements of the game, whether it's the nameless, faceless aspect of a market, or them as single individuals against the market, or beating their brains against everyone else's. Long-term traders have a depth of fascination with the most arcane things. For example, talk to top fixed-income traders. They will understand and muse upon nuances of delivery details or requirements that would not even occur to you.'

It is this child-like fascination with the markets that can often lead to unforeseen beneficial side-effects, as Bill goes on to explain.

'When I was involved in trading currency options in Philadelphia, I understood the settlement, notification and delivery method so well. For example, in those days there was no automatic exercise of options. You had to notify the OCC [Options Clearing Corporation] by 5 pm on the Friday evening prior to expiration. Virtually all of those trading PHLX currency options took the Friday cut off as an absolute. However since options contracts did not legally expire until noon Saturday, exceptions could be made, which actually allowed dealers to have a window of opportunity to 10am Saturday. Well, to the extent that there might be a news item that came out in foreign exchange on Friday evening or Saturday morning, that was an advantage. Likewise, you would normally notify through your clearer on Monday morning as to what you were exercised or assigned on. But in fact the OCC made it available at 1pm on Sunday afternoon after it was allocated by lottery. So I used to go down on Sunday afternoon, once a month, because they only had delivery once a month, down to the OCC and get our runs out. I would therefore have knowledge of my positions with certainty 20 hours before anyone else knew their positions and before Tokyo opened up. I simply don't think anyone else had taken the time or had the interest to discover this information.

'So you will find an absolutely intense child-like fascination with every detail of what they are doing. They can't know more about it. It is an end in itself. They don't do it because they think, "this will make me a better trader". They want to know more because they just can't help themselves.'

The Salomon's trader: self-confident egotist?

When Bill Lipschutz worked for Salomon they were *the* investment bank. Virtually every financial superlative had been used to describe that bank in the latter half of the 1980s. It bred great traders. One of the key traits Salomon sought in its traders was an ego to withstand losses and the courage to overcome the ego and admit being wrong.

'The other big thing is that you have to find individuals who have a curious blend of ego. You clearly need to have people who have a very strong self-confidence, who have a very strong ego. In some cases you'll find individuals who manifest that as a kind of arrogance which can rub people up the wrong way at times. Sometimes that arrogance can be very important because, after all, you are going to be a loser more often than you're right. The whole idea about trading is that if you are waiting to be right 80 per cent of the time, you will never make it as a trader. You will be lucky if you are right 20 per cent of the time. You have got to figure out how to make money by

> ***'If you are waiting to be right 80 per cent of the time, you will never make it as a trader.'***

being right 20 per cent of the time. It is the old 20/80 thing. [i.e. the theory that in most endeavors it is 20 per cent effort that produces 80 per cent of the results and 80 per cent of the effort that produces the remaining 20 per cent of the results]. And if you have to have that arrogance or courage, then that's alright.'

'However, it is not courageous to say, "I am going to make this one big bet even though everyone else says I am wrong". That is the home-run scenario and that is not what we are talking about. We are talking about the courage and self-confidence and ego not just to go against the crowd but to be wrong, a lot. You will find a lot of young people who cannot accept being wrong.

'It is always easier to look at a market with no positions and a clean slate and work out where it is going to go. The most difficult thing is when you have a bet on and it's the wrong bet. First of all you have to get yourself to admit it is the wrong bet and end it. That is a big psychological leap for everybody. I mean some can do it very easily, but they have to get to that point. So, not only do you have to say "I was wrong", but then you have to go the other way. That is very difficult, so courage is very, very important.'

> ***'It is always easier to look at a market with no positions and a clean slate and work out where it is going to go.'***

So, there are no absolute traits, each is counterbalanced by another complementary characteristic. For instance, the ego to overcome losses with confidence is tempered by self-analysis.

'Self-analysis and self re-evaluation has to be part of that big ego. You have to find people who are very strong emotionally and have stamina. All these things are, of course, interrelated. The ability to focus is largely rooted in stamina. You just have to have a lot of stamina.

Home-grown

As part of a Salomon's team, those hired by Bill had to have the potential to work in a team and possess all the traits needed for that. Of course leading traders are cultivated as well as born.

'At Salomon Brothers most of the people we were hiring were at that time what we called "home-grown". So you are really taking young people right out of university usually with at least an MBA and they were going to develop over a number of years. I think in a lot of ways in the industry now that has become a luxury. Now it's much more common, and also I believe at Salomon, to hire people away from other institutions who have had some degree of success.

'I think that is unfortunate. The loyalty that a person, and ultimately a group of people that work very closely together, develop for an institution and for each other is a very important part of the dynamic. Obviously trading is stressful; we are all human beings. To have colleagues who you can absolutely depend on, not only to watch a position, but for ideas, for enthusiasm, for energy, is very important. So this ability to have a solid team is greatly enhanced if a group of people are not always worried about the next biggest deal down the road.

'What I always used to look for were all the academic things that are a baseline minimum of course. You are always looking for someone who is bright, quick, sharp, and trained in certain mathematical disciplines. But that is a given. But it was always the balance between an individual's intensity and willingness to be accepting of a like level of intensity in each and everyone of his or her colleagues that formed the basis of a hiring decision. Ultimately, in large firms, the ability to work as part of a team and respect the integrity of that team, no matter how outsized an individual's contribution might be, will be the determinant of an individual's success.

A believer in luck

What is and is not luck?

Bill Lipschutz believes luck has an important role to play in trading. Luck is generally understood to be that cause which leads to a favorable outcome that was outside the control of the individual who benefited. Imagine a pedestrian crossing a busy road. He has no control over the cars on the road. He may or may not get hit. If he crosses the road with his eyes dosed, he extends the sphere in which luck has to operate in order to ensure a safe passage. With his eyes closed, he would need even more luck than with his eyes open to avoid being hit. By keeping his eyes open when crossing the road he has more control over the activity he is undertaking and needs less luck to accomplish the task of crossing the road successfully. By keeping his eyes open when crossing the road the pedestrian does not ensure *for certain* that he will not be hit, but he does stack the probabilities in his favor. Stacking the probabilities in your favor is the same as reducing the sphere in which luck has to operate and is achieved by exerting as much control over events that you can control.

Since an essential part of luck is a lack of control, Bill Lipschutz tries to control as much as possible - in other words he stacks the probabilities in his favor.

'I happen to believe that a very large component of trading success is luck. Now that is not something you want to state prominently in a marketing brochure. If you did, an investor is likely to respond "well hang on, here is a guy who is telling me that it's all luck". That's not what I mean. It's not the "rolling the dice" type of luck. People who are successful traders are not gamblers. The key to being a successful trader is continuing to stack the probabilities in your favor. The more successful and the more consistent you can be in stacking those probabilities, the more you will have long-term success. There are many intangibles which a trader cannot control. What he can control is his ability to make an intelligent analysis and to place intelligent bets. By intelligent, I mean skewing the odds of a profitable outcome.

'Always look to stack the odds.'

Clearly, a part of luck is putting yourself in a position where you can be lucky. You have to put yourself in a situation where you are the kind of person who seeks out the advice of others. You have to be the kind of person who is more willing to be flexible, to sit down and try to understand new ideas. Then you are going to put yourself in a position, more often than not, where you are going to be lucky. That is another version of "always look to stack the odds".

So, by luck Bill Lipschutz means that first you ensure the odds are in your favor - you try to arrange things over which you have influence so the element of luck is reduced. Secondly, since you cannot entirely eradicate the operation of luck, you are lucky or unlucky depending on whether the outcome indicated by the probabilities actually occurs. For instance, you may bet that on a dice roll either 1, 2, 3, 4 or 5 will show. Probability theory says you should win the bet. However, as Bill explains, it will be down to luck whether or not a 6 comes up.

Realizing you are being lucky

As well as stacking the odds in your favor so that you are more likely to have a favorable outcome, you have to realize when your 'luck is in', in order to capitalize upon it.

'So as a loose analogy, sometimes you are going to be involved in trades that are going to be dead right - you are going to make your money. But you are not going to realize that it could have been a much bigger thing than you initially thought and you will get out too early. Then you are going to miss the bulk of the move. "Let your profits run and cut your losses short" is all about maximizing those few winners that you have. A trader cannot 'know' how a trade will turn out. Usually there is an element of luck involved in either staying with a position that ultimately proves to be a hugely profitable trade or in exiting very early from one that ultimately becomes a loser'.

Therefore, while it may be difficult to know whether or not your luck is 'in', you can maximize your opportunities by ensuring the probabilities are stacked in your favor.

Other aspects of luck

To be lucky as a trader not only involves luck in trading outcomes, but also other aspects of the trading environment as well, as Bill explains.

'There are so many other elements to luck. You have to be at the right place at the right time. For instance, if you are in a company, the way the company politics work enables you to take advantage of opportunities.

'If you join a trading firm, who knows where you will end up? You may end up trading j:unk-bonds in the late 1980s, that is an area that is hot, or you may end up in a dead-end area like Muni bonds in the late 1980s - that's luck. You may know people in the industry who teach you things which may have taken years to discover, and you can see further on their shoulders. That too is luck. So I think luck is always an important variable in a trader's career equation.'

Fear and anxiety

Great traders must not let self-confidence make them numb to a loss. They need to feel the pain of a loss yet not let anxiety become fear.

A professional athlete before a top game more often than not will say, "If you're not nervous there is something wrong". One has to have self-doubts. Maybe some are less likely than others to admit them to others or to themselves. Others are more self-reflective. Most traders are highly self-reflective. They are continually revaluating their own performance, their approach to the game. This process is indicative of a sensibility common to the best traders - it reflects both a never-ending search for improvement and an ever-present fear of failure.

'No matter how much success you have had and no matter how good you are, you have butterflies in your stomach before the big game. It is the same with the trader. You have to learn to separate fear from healthy anxiety. You certainly can't trade with fear. You can't fear to pull the trigger.

'When you go through a losing streak all the self-doubts come out and you do get very reluctant to pull the trigger. There is nothing you can do that is right. Just every single thing you do is wrong. That is something you just have to learn to control. You really have to learn how to control that fear. You have to feel the pain of a bad trade, or a wrong trade. If you don't, and are numb to it, then it's over. So you have to know what it's like to feel pain, but you can't be afraid of it.'

At some point every trader slips from having healthy anxiety to unhealthy fear. How you overcome that and return to normal trading is very much a personal thing. It is a matter of character.

'With the fear thing, overcoming that was more a personal thing because I did not know how others were dealing with it. I think a lot of that comes from inside, whatever that combination of psychological factors are that drive individuals. You discover whether or not you have it at three o'clock in the morning, when all the lights are out and all you have got is the blue, green Reuters screen glowing at you, and the position is getting worse and worse and there is no one to call or discuss it with, no one to tell you what to do.

'That is when you really discover whether you have it or not, whether you can conquer the fear and get through it and get to the analysis. You have to decide whether you can take it any more, or whether you *want* to take it any more. That is when you come of age. A lot of it is physical. Sometimes you just want to get sick. That is a very personal thing. The ability and willingness to look into yourself and force a basic character change is pretty rare. You reach down inside and you either come up with the goods or you don't. That does not necessarily mean you make money on the trade of course. It is the ability to deal with it.'

'You have to know what it's like to feel pain, but you can't be afraid of it.'

Bill Lipschutz's experiences in overcoming fear reminds me of the quote from the movie *Wall Street:* "A man looks into the abyss and sees nothing but darkness. That is when he discovers his character." As Heraclitus said: "Character is destiny." Sheer force of will can overcome any personal difficulty.

Networking: profiting from pyramid information

As I commented above, information management has become more of a problem for the modern trader than information availability. That being so, it can be of great value to tap into material other people have read and digested and obtain a view from them, especially if they are likely to have a different perspective from your own. This kind of 'pyramid information' flow can permit coverage of a wider scope of information than one individual alone could ever hope to analyze. The benefit of pyramid information is not that it saves you work - there is no substitute to your own analysis - but rather, you can cover a wider quantity of material. Moreover, pyramid information allows you to get a 'second opinion' on your own analysis, thereby providing you with a safety net.

'One of the things that is very difficult in the market is that once you have a piece of information or once you assign a high probability to an outcome, you then have to make a determination as to how the market will react to that. That is not always so easy without other traders' input. So you develop a fairly robust network where, particularly in foreign exchange, different people in different countries will have different perspectives and you can tap into that. Talking over the phone taught me a lot about how different people would take the same news item and interpret it differently. Collectively these varying interpretations and the varying actions that these traders take - or do not take - based upon them, result in market action. It is critical to assess how a market with interpret and react to information prior to evaluating any position or potential position of your own.

'Having in-depth conversations is part of the ebb and flow of market information and market perception, market buzz and market feel. All that comes, in my opinion, from personal networking and personal touch and feel. If you talk to a guy, you can hear it in his voice whether he has got a bad position. I am a great believer in personal conversation - usually it happens on the phone. For instance, you call a guy who regularly carries big positions on the dollar and if you have seen a big move downwards in the dollar overnight, he can talk to you about anything in the world he wants to, but you can hear it in his voice whether he was long or short. You can also tell if he's still got the position or not.

'The other thing is that there are so many countries where the nuances of their economic and political systems and policies within those systems are very difficult for someone outside that system to understand. So, for example, if Kohl's government tries to push some sort of political initiative through, it is very important to understand what that is likely to mean for Germany, politically and economically in 2, 4, 6 or 12 months, if it is that big an event, and how that may impact the currency. By speaking regularly with a knowledgeable contact in Germany, you may be better able to assess that impact and to assess it more rapidly, than the overall market.'

Networking: what's on the market's mind?

'Another useful thing is if you get the same kind of information from several people who don't talk to each other, then that's something that's on the market's mind. If several people start saying, "German Bundesbank Reserve requirements", then you may have a look at that because several independent sources have brought up the same issue. Usually, where there is smoke there is fire.'

Of course not everyone has the privilege of being able to develop a network through the Salomon name. But even if you work alone from home, you can develop a network through the internet, and through different trading newspapers and magazines.

However, be cautious not to fall into the trap of following everyone else's analysis over your own. You have to evaluate their analysis, not just automatically fall subject to it. You cannot allow someone else's analysis to replace your own. Remember too that the analysis you receive from others is 'secondary' or 'hearsay' and therefore has to be treated with care, caution and less weight than your own analysis from a more primary source. If you are not confident in your abilities to make proper evaluations of such information, then stay well clear.

·Using analysis that you will not be using

'I have always been a discretionary trader with my analysis based on fundamentals. I am really looking to see what kind of macro-economic and political events could take place, are taking place and have taken place that could impact the currency. Now I am not a technical analyst or chartist. I don't believe in it. I don't want to take anything away from them. Some of them apparently are highly successful so they must have figured something out. Whatever kind of a trader you are, you have to be aware of perceptions in the market place, that can influence the participants' behavior. If a lot of people are charting and they think that a certain level is a key level for whatever reason - lunar, astrological, who the hell knows - then you have to be aware of it. Because it is going to cause acertain number of market participants to react and you have to be aware of it. You have to understand how that is going to affect your position. So there really is no such thing as saying that this is smart, this dumb, this is the right way or this is the wrong way. Markets move when a certain number of market participants have a certain perception. So to that extent I try to be aware of technical levels and try to factor that in.'

Therefore Bill Lipschutz's message is that whatever your views on technical analysis, you ought at least to be aware of it, because the bottom-line is all about making dollars. As General Patton said: 'I have studied the enemy all my life. I have read the memoirs of his generals and his leaders. I have even read his philosophers and listened to his music. I have studied in detail the account of every damned one of his battles. I know exactly how he will react under any given set of circumstances. And he hasn't the slightest idea of when I'm going to whip the hell out of him.'

'There is only one basic trading rule that everything feeds back to, that is, "it's all about dollars". You can think you're right, but if you didn't make any money then, guess what, you were wrong. Again it goes back to "dumb dollar, smart dollar". You could be the biggest idiot in the world but if at the end of the trade there are dollars in the bottom-line, then you were brilliant.'

Although Bill Lipschutz does not use technical analysis, it nevertheless has its uses for him. First, it gives him an indication of what other market participants are thinking. Secondly, it can be useful in determining market entry and exit.

'You will be aware that some traders use technical analysis as a kind of an overlay to look at entry and exit points. The problem with fundamental analysis is that it is very broad based and it is very difficult to sharpen your pencil and say, "do I buy it here or there". You have to be aware of all these technical techniques, such as momentum, because a lot of market participants use them and so they can affect the market.'

Structuring trades

Encapsulating the idea

After traders have formed a view on likely future price changes they have to encapsulate that idea into a trade. The simplest form of trade would be to buy the underlying asset where the expectation is of a price rise. However, depending on one's view, more complicated strategies can give rise to more optimal results.

'You could have the dead right idea and lose money.'

'The next step is structuring the trade. There are a million ways to structure the trade and the devil is in the detail. You could have the dead right idea and lose money. If your timing is slightly off, you could lose. You have to structure your trade in a manner that increases your probability, your upside, and decreases your downside. And that is all the game really is, a constant series of these kinds of trading decisions.'

'For example, there are a lot of ways to be long the yen. You can buy the yen, buy calls or sell puts. If you want to be long the yen and yen volatility is very low, then buying calls is going to be very attractive. If volatility is very high, then maybe selling puts is very attractive. But if the volatility is extremely high, then selling puts may not be the best thing - maybe just buying the underlying asset may be the best thing. So the manner in which you express the trade idea should be with an eye to getting the other elements of the trade on your side, stacking the odds in your favor.

'For example, if you are buying an out-of-the-money call spread and the leg of the spread that you buy is say, 2 per cent out-of-the-money and the leg of the spread that you sell is 5 per cent out-of-the-money, then if you turn out to be right about the trade and the leg that you bought is now at-the-money, then the volatilities will change relative to at-the-moneys. In other words, when you first buy that spread, both legs will be trading higher implied volatilities than at-the-money. But one leg becomes at-the-money, and you realize you have lost some money because the at-the-money will now trade at at-the-money volatility. So that too is a dynamic to be aware of, especially if you go into ratio spreads, because if you are right on direction you may want to buy one of the legs back and that short leg is likely to hold its value.'

However, remember that it does not follow that the more complex the trade, the more money you will make.

'Gil Leiendecker, my boss for many years at Salomon Brothers, used to say, there is smart money and dumb money. But at the end of the day a dollar is a dollar is a dollar. What he is trying to say is it doesn't really matter how you make the money. A lot of young traders, for example, lose money in, say, IBM. They then want to go back into IBM and make their money in that stock. That's irrelevant. You don't have to force yourself to trade in IBM just because you lost it in IBM. The market has no idea. The bank account doesn't know where the dollar came from. Gil used to say to me, "couldn't we just buy or sell the dollar and take our profit. Why do we have to do options and all these complicated things." What he meant was, "smart money, dumb money". Sometimes you can step back and say "buy it" and if it goes back you can say "sell it, thank you".'

'There is smart money and dumb money. But at the end of the day a dollar is a dollar is a dollar.'

Evaluating the upsides and downsides

Structuring a trade to capture the upside also involves ensuring there are downside protections.

'Of course when you first put on a trade you do have target levels, levels at which you think you are wrong. The price levels of those targets should be determined as a result of your trade idea analysis. The size should be determined as a result of your absolute dollar loss constraints. For example, let's assume that the current price level of dollar yen is 125 yen per dollar. Let's further assume that your analysis of the latest round of trade negotiations between Japan and the United States leads you to believe that the yen may weaken to 130, but due to technical considerations should not strengthen beyond 122.50. Further analysis of the pricing of yen options leads you to determine that the optimal trade structure will be to simply sell the yen against the dollar in the spot market. How large should the position be? The answer lies in the asset size of the account you are doing the trade for and its loss limit. If you are only prepared to take a three percent loss on a ten million dollar account, then it follows that you should buy $15,000,000 against the yen. If you are wrong on the trade, you loss will be $300,000 and if your anaylsis was correct and you sell the position at 130, your profit with be £600,000.'

'This looks quite simple, but the above description is a static analysis in a highly dynamic situation. There is always new information coming in. You must continually re-evaluate your position in the light of the new information - including any new price level itself - and adjust your target levels accordingly. Of course that can be very dangerous in terms of when you think you are right and it keeps on going against you and you keep adjusting downwards. But that is not what I am talking about. You have to correctly interpret the new information. Above all you must not lose sight of your absolute dollar constraints.

Therefore the use of targets and their re-evaluation in the light of new information is a key aspect of trade structure. One way to protect yourself against the downside is to ensure there is a multiple upside to downside.

'With a trade you always look at a multiple upside to downside. But how much greater? A good rule of thumb for a short-term trade - 48 hour or less - is a ratio of three to one. For the longer-term trades, especially when multiple leg option structures are involved and some capital may have to be employed, I look for a profit to loss ratio of at least five to one.'

Options are sometimes used by traders as insurance against an adverse move. For example, if particular traders are expecting an upward move in prices, they may buy calls. However, to protect themselves against an adverse downward move they may also buy some puts or sell different strike or series calls.

'Just know what you are prepared to lose.'

'I have always felt that using options as an insurance policy is probably not appropriate for the professional trader. It may be appropriate in market sectors where there is not much liquidity or if price movements are often discontinuous. However, as neither is the case in foreign exchange, a professional trader who is 'close to the market' at all times that he is carrying an open position will be able to cut the position and get out if it goes against him. Only in the infrequent case of a professional who carries extremely large positions which alter these price characteristics of the market would I favour the use of options as insurance.'

As well as downside protection in any particular trade one also needs downside protection against a losing run.

'I think risk is asymmetrical. To achieve successful longevity, you have to focus on your losses, or drawdowns, or whatever you call them. It's very simple. Just know what you are prepared to lose. It doesn't matter how big, little, right or wrong your position is. You have to know what you are prepared to lose. I don't mean mentally prepared; I mean mathematically what can be lost when you enter a trade. You must not put yourself out of business. You have to be back. You have to be there tomorrow, the next day and the day after. If you manage the downside, the upside will take care of itself.'

All this focus on the downside begs the question 'when does one close a position?'

'There are two reasons for closing a position, I think. One is if the scenario, or a variation of the scenario that you were expecting to occur, clearly was not going to occur. An easy example would be if you expected a certain policy if this person from the left wing of the political spectrum were to win the close-run election, and he does not win. The second reason is, correct scenario or not, you have reached your pre-trade drawdown limit. End of discussion; you must exit the position.'

Mentors: the Salomon experience

There is more to what makes a great trading mind than merely how it takes losses and handles risk and profits. There are a fascinating and unique set of experiences which mold that mind in the first place. Bill related a couple of those formative and informative experiences.

'In my case, there were some early influences on me in my professional career. Several senior people who had been in the markets took me under their wings and taught me a lot. My first boss at Salomon's, GH Leiendecker, was Global Head of Foreign Exchange for about seven years before myself. He had a way about him. His background was not foreign exchange, but in fixed income, but it was always Gil's personal code of conduct and leadership ability which distinguished him from others.

'I learnt mostly about integrity in the markets from him. How you act and how you treat your colleagues. After all, you are focused, driven, high-strung, you are tired, you are pushing your stamina to the limit. People say and do things which they regret later. Gil taught all of us in his department a lot about how one deals with adversaries in the market and colleagues in the market'.

'Gil had great phrases like, "there are a lot of gray areas in the market, especially OTC [over-the-counter, as opposed to traded on an exchange]". Grey areas in the sense that people make mistakes sometimes. Do you hold the guy to a deal? Gil would always say

'Think about whether you would want your mother to read about it in the *New York Times* tomorrow, and if the answer is no, then don't do it".

'Gil had a million of these sayings. I remember I went through a period where I became very demanding of myself and ultimately of those around me. However not everyone was as driven or as focused as I would have liked them to be. For instance, if it's a Friday night and it's this guy's anniversary and you want to be there until 10pm and you expect him to be there, then you get angry that he is not. Gil would say to me, "remember something Bill, people come in, and you can yell and you can scream, and you can expect them to give more than they're willing to give, but at the end of the day people just want to have a nice day. A nice day to you, Bill Lipschutz, means a certain thing. A nice day to a guy who's a clerk (not that that's a lesser thing) or another trader next to you means something different. You have got to figure out what is a nice day for each person." Anyway, he taught me a lot about how to interact in a human fashion with people in a marketplace. That is something that is generally overlooked today in the 'care and feeding' of young traders. That really helped me a lot in my career.

'Another fellow that I learnt a lot from, was a great senior trader who at the time was in New York with Marine Midland Bank. He was Tony Bustamante. He would take me to lunch once a month, which was a big thing because you tended not to leave your desk during the day and because Tony was such a renowned market figure. We mostly discussed things like forwards, the emergence of options as an FX instrument and, of course, the general direction of the dollar. He was a real mentor. So in my case I was very lucky to have had a lot of mentors on a lot of different things, not just about "this is how you buy them and this is how you sell them". They were mentors on the more human aspects of how you survive in this business. For me personally that has really been part of the success.'

The quality and availability of mentors is out of your control. Therefore you have to fall back on luck. These aspects of trading success always seem to be neglected and forgotten.

'That's why luck plays such a big role. All these things coming together. It's quite amazing actually. When you meet someone who is good for you, your whole life goes down a different path and it's like a tree whose branches make contorted shapes as the tree grows. You could never pick that contorted route you are ultimately going to take. It's funny some of the things I remember - just comments that people made that they probably don't even remember.'

Most of us can probably relate to the sentiments expressed by Bill Lipschutz. There will have been individuals in our lives who have set us on different paths from those we would otherwise have taken. For myself, I recall a phrase once stated by my politics tutor, Dr Nigel Bowles, at Oxford. He told me that '90 per cent of students at Oxford, let alone less august institutions, are dull, boring, dare-nothing, take-no-risks, play-it-safe types. The majority of the remainder achieve first-class degrees.' That one comment, which he has probably forgotten ever saying to me, has remained with me for years. Like the types of statement Bill mentions, it is 'life-path altering'. And so it is with trading too that we should, if at all possible, find mentors and place ourselves in a position where our outlook and perspectives can be altered for the better and forever.

TRADING TACTICS

- How will the source of funds affect your trading?
- As a private trader make full use of your advantages: the ability to sit on your hands; decision-making autonomy; information availability; flexibility; less pressure to perform.
- Do you have insane focus - the child-like fascination with the markets - which others think is crazy?
- Ego has to be tempered with self-analysis.
- Can you withstand being wrong 80 per cent of the time and still make a profit?
- Reduce the sphere in which you need luck to operate by stacking the odds in your favor through controlling as much as you can.
- What's on the market's mind?
- Even if there are types of analysis you do not believe in, be aware that if it's popular it will affect prices.
- Trades need to be structured to optimally utilize your view of the market. Give equal thought to formulating your idea and to the structure of the trade.
- However, the trade need not be complex to be optimal.
- Trades with multiple up to downsides will ensure long-run profitability.