Lessons From The Trader Wizard

by Bill Cara

SAMPLE CHAPTER:

Part 1: WHAT IS THE MARKET? WHAT IS TRADING?

Markets are not free, they are driven by forces related to interest rates, economic activity, commodity and forex prices, and by vested interests. After the writing of the original "Lessons" in 2007, the parties I call vested interests or Interventionists have expanded somewhat.

The most powerful of these groups include central bankers and finance ministers, persons elected or appointed to government, plus well-organized networks with names like Council on Foreign Relations, Royal Institute of International Affairs, Trilateral Commission, Bilderberg Group, Club of Rome, Business Round Table, and United Nations and their friends in the media. Whoever they are, all seem to have an interest in globalization, which I now see as a control strategy, and in public-private partnerships, which to me are clearly tactics to invade the public purse.

Given that intervention is now rampant, the loser is the free capital market, which was founded as a simple price discovery mechanism between buyers and sellers who were interested in finding value "underlying" the securities being traded. Interventionists do not seek value. They are interested in the power to control prices, which effectively means the power to control the market.

Trading success comes to those who don't focus on the parties operating in a backroom to manipulate prices (whomever they are), or the stories they publish to help them meet their objectives, just be thankful they do enough to create price volatility.

Rule number 1, 2, 10 and everything in between is, "We trade prices, not stories."

Although some people will tell you it's not true, prices do occur in trends and cycles. Regardless of why it happens, prices in the market are never random.

Have you ever heard of the Random Walk Theory? Perhaps you were taught that at school? Well, I have never met a successful veteran trader who suffers from credulity syndrome, believing in Random Walk! Randomness occurs in a vacuum but we don't live or trade in a vacuum.

*All italicized text chapter openings in this book are taken from the author's commentary in his blog: CaraCommunity.com.

1. Getting your head around capital markets and your place in them

During your trading journey, you will eventually come to see you are not investing in products or companies. You are trading prices, and your motivation is to increase your financial wealth and lower your risk. You will look at trading as a process, a journey that has a right road and a wrong one. Armed with a few skills, some experience and a bit of determination, you can make it on your own, and you should make every possible effort to do it on your own. It is, after all, your capital. — from Bill's blog

What is the market?

As complex as it might seem, the market is merely a case of "people acting like people" — with all their fears, enthusiasms, prejudices, stupidity and wisdom. Together, we create prices.

We are the market.

Trading in securities and contracts is not investing. All of us invest in assets like homes and cars and personal computers and, just like Warren Buffett and Bill Gates, some of us even buy companies. 99% of the rest of us in the market trade securities, which are the prices of stocks and bonds, options, futures, commodities and "Forex", in what is called the capital market.

A security is a financial instrument that has real value evidenced by "underlying" equity or debt. A commodity or financial future includes all products and forward contracts linked to those products that trade on an exchange. These can be physical goods, foreign currencies, financial instruments and market indexes, trading either at spot (cash) or forward prices.

In the case of commodities and futures, there is no equity, debt, or physical value. Instead, there is time value. When you trade time contracts, you engage in a zero-sum activity, which simply means that no new wealth is generated. The impact of futures trading, of course, helps establish a cash or spot price that reflects the sum of knowledge of the "underlying" security, including projected price trends.

There is no principal value at the end of the contract. The expression "zero-sum" means that winners equal losers. Everybody pays transaction costs, including charges not fully disclosed in a net price.

While a capital market is one that involves only debt or equity securities, I refer to all matters relating to securities, currencies, futures and commodities as involving the capital markets. Let's not get stuck on semantics.

In this book, I'm not here to tell you that trading in any type of security is best or that trading securities is better or worse than trading time-based contracts. Trading is about the process of finding a price that differs from the underlying value. I am here to tell you about the trading process and how you can become successful at it.

In the market, we trade prices and most traders never thought about it in those terms.

We all bring a different set of values, personalities and resources to the market. With a conservative leaning you will tend to see danger in markets. If you are an enterprising sort, you will often see the lack of creativity of traditionalists. If you are speculative, you will soon see that most traders are predictably inactive and wonder why.

In this book I give what I believe is sufficient information covering a wide enough range of topics in capital markets to help you become a successful trader. This information is based on my professional experience.

Precious little information on capital markets is qualified, independent and/or objective. You will soon find that you can trust the information here.

There are no absolutes in the market. Here, you will see the markets as I see them.

There are aspects of Wall Street that I don't care for — I have been there and done that. Based on many years' experience, there are people, tricks and concepts I don't trust and neither should you.

The road ahead

If you follow my market-proven guidelines, use common sense, set realistic goals and exercise self-discipline, you will find that trading in the capital markets is a journey anybody can make with considerable success.

Is the road a difficult one? Well, sophisticated art and science are definitely involved, but nothing people with a secondary school education can't handle.

There is much content here. However, if you decide to become a student of the market — which is to say you intend to remain open-minded, always learning, always trying to get better — you will in time acquire a life skill, a skill you can pass along to family and friends.

Ultimately, your success will appear to have come naturally, because the capital markets are nothing more than a personification of human nature. You just have to find the natural rhythm.

Is seeking financial success via trading your end goal? Without a destination you'll never get there. You will probably measure your success in money terms. Never forget that money alone is never as important as peace of mind, which is merely another way of referring to happiness.

Along with monetary capital the market also contains what I call social capital, which I'll also discuss in this book. Enjoy the journey!

I have a simple rule: whether you happen to be conservative, aggressive or speculative, the first rule to trading is: if any trade causes you or your family to worry, do not make it.

The market is chock-full of opportunity, but trading is mostly about avoiding aggravation and risk. If there is a single truth, that's it.

There may be mystique to financial markets, but trading has always been a business of common sense, intuition, faith, courage, knowledge, patience, and luck. Trading is not rocket science, it is life itself. The capital market is just space we occupy for a moment. Attaining success should not be a mystery.

If you're just starting out in a career in finance or making important life decisions about your financial affairs, it's not going to be easy. Wall Street lays serious obstacles in your path. Trading is a long journey where everybody needs some help along the way.

Why take my lead?

I qualify as an expert in many aspects of the capital markets. I have managed major broker-dealers as well as smaller ones. I have built them from scratch — in fact, I did that a couple of times, one full-service and one electronic. I've also worked in research, retail sales, institutional sales and corporate finance.

I've worked onshore and offshore. The firms I've worked for include names you know and a few you won't. I very much enjoyed my time as a professional money manager and a builder of automated decision systems.

I have served as an expert witness for securities commissions and governments, participated in a government task force to reorganize securities markets and appeared before Senate Banking Committee hearings. In the Far East I gave speeches side-by-side with Canada's Trade Commissioner. For many years I have been publishing investment articles in magazines and the Internet and hosted a variety of seminars.

I worked hard to earn two professional accounting designations (CA and CMA) as well as an MBA. By working 24/7 and attending night school, I accomplished all three goals in just one year. I was even awarded the Wall Street Journal Student Achievement Medal.

Although I valued highly my upbringing and my formal education, I saw it as part of a process making me the independent person I wanted to be. I wanted to put myself out into the world as "me" and not somebody's perception of me.

Holding the designations Chartered Accountant and Registered Industrial Accountant (now Certified Management Accountant) along with a B.A. (Hon. Bus.) and an M.B.A., my calling card looked like alphabet soup.

I stayed in that second career for eight years, built a business, did some writing (won a National Business Press Association Award) and eventually grew bored. In 4Q 1980, I decided I had the needed experience to venture into the securities industry, which I knew was dominated by my peer group who had been raised in a "silver spoon" environment. A year into my third career, despite a grueling "Bear market" and a crash in gold, I knew this was where I would spend the rest of my life. I decided I no longer wanted to be branded CA and CMA. While working at the firm of Dominion Securities Investment Management in Toronto, I made a change. I called the two professional accounting institutes that had bestowed their status on me and told them I was mailing back my papers. I then dropped all the fancy letters that followed my name.

Nobody brands me. I am what I am. Some people refer to me as eccentric; I call it independent. Other than my immediate family, I owe nobody. No mortgage debt, no credit card debt, no car loan — no financial obligation of any kind. I am beholden to no one, including those two accounting institutes that were demanding I pay "professional fees" for the rest of my life.

Actually, I do have a debt — to society for giving me my independence.

Within five and a half years of joining the securities industry, I founded and built out the penthouse floor of the Toronto Stock Exchange Tower for Canada's largest full-service independent broker- dealer. I built their Eastern Canada operations from scratch. Twenty-five years later, I'm called the Trader Wizard and I presently run Cara Trading Advisors (Bahamas) Ltd.

Along with giving back to others where I can, I take from life only what I believe is fair and honest. Despite the criticism, I continue to speak out on behalf of the interests of owners and managers of capital against an industry and groups of Interventionists all too willing to exploit them.

Let the journey begin!

Stop listening and talking; start reading and thinking, then doing

Every person has a responsibility to look after their own affairs and not rely on others — in particular Wall Street or any form of government — to work in their interest. That's not to say a person ought to do their own trading, as it isn't practical in many cases. People may need to put their capital under the management of a professional. If that must be the case, it is still a decision that requires knowledge, planning, execution, and subsequent oversight.

A trader is the owner or manager of capital. That is a buy-side role. Job number one is to stop listening to the sell-side or to people who may mislead you. Job number two is to read, discuss and think. Then act. Traders are actors, not part of the audience.

From direct experience, I believe that deceit in financial institutions is commonplace and could easily be discovered by legitimate independent audit. I believe the deceit that exists on the sell- side is not often discovered, unless the wrongdoers are literally caught doing wrong, because they are all part of the financial services network I call "Humungous Bank and Broker" ("HB&B").

Call it "HB&B", the Club, the Firm, the Sell-side — but don't call it a place that works for you ahead of its own interests. In the eyes of "HB&B", you are either their customer or their employee. To those (not me) who refer to the market as a casino, they are the owner-operator and the gaming commission combined. You play by their rules or you don't play. That's a fact.

It's also my belief that the governments of the United States and Western Europe and every important financial agency of government are controlled by "HB&B" and the opaque networks that control these banks either directly or indirectly.

"HB&B" and the government are in the business of credit and I contend they own every person who has a debt. People in debt are not independent and they know it. Burdened by debt, people are clearly disadvantaged, and as traders often taken advantage of as in the case of "MF Global" at the end of October 2011. Complain loudly enough and there may be token examinations by one or more government committees or agencies. Occasionally, fines are levied on "HB&B" criminals to keep up appearances, but none of them apparently are going to be convicted of a crime, nor do they even have to admit to it. They pay fines amounting to a luxury tax, which they immediately pass through to the customers or shareholders.

Having risen to the penthouse in the "HB&B" structure, I think I've earned the right to say that the "HB&B" controls our markets and runs them in its own interests and those of its controllers. It really is a closed society. The rest of us have been treated unfairly. That has always weighed heavily on me, and I have always spoken out for social equity. Although they are not well organized, the Occupy Movement that started in 2011 is doing the same.

During my time as an insider with "HB&B", I experienced human nature at its worst: 99% pure greed and gluttony. I discovered it's not very different from what was portrayed in the movies Wall Street and Boiler Room. Self-interest rules. However, I'm not at all sour today because my time in the "HB&B" was an education. It helped me to see the market as a place of fear, greed and ignorance, which I can exploit. It took me a long time to realize that with knowledge and skill, I could become an independent Trader Wizard.

I have always spoken out about "HB&B" (including at the highest level of government and in public forums), opining that Joe Public would be best served if governments forced the financial services industry to eliminate their conflicts of interest and to act in a completely transparent manner.

Take, for instance, a broker-dealer. If brokers were separate from dealers, you wouldn't be giving your order to an organization that shows your order to their principal trading desk, which then trades in their interest and against your order.

If you think this sell-side, government-dominated market is not fundamentally sick, then ask yourself a couple of questions: Has "HB&B" ever shown you their principal trading orders? These firms control the US Federal Reserve Bank. Has the "Fed" ever shown you its principal trading orders or who, in fact, are the people or organizations that pressure "The Fed" to make the decisions they do?

These companies demand to know your wealth and your trading instructions so they can trade against you. It's a flat-out conflict of interest. Only now are the majority of you understanding this.

Their "we-are-fair-and-transparent" charade will continue until the capital markets implode in a "financial armageddon", collapsing under the weight of debt and misguided credit. My friend Michael Panzner has published a book (2007) by that title. I hope you read it.

Too busy cutting down trees, people fail to see what's happening to the forest. Panzner, however, is one of the few people I know who can deal with day-to-day Wall Street action as a topflight institutional salesperson and yet possess a big-picture perspective — a picture he painted in *Financial Armageddon* that has already come to life and one that should terrify us.

Since I wrote the original *Lessons*, we have seen the bankruptcies of some of the largest financial companies in the world, and a failure of many once solid countries to pay their debts on time, plus personal bankruptcy and homelessness of millions of Americans and Europeans as unemployment soared. I forewarned of these events in the blog, once opining when US national unemployment was about 5% that it would soon go to almost 9%, failing to see at the time the rate would far exceed 10%.

Must this multi-trillion-dollar house of cards that we call the capital market collapse? If so, can society still protect itself? Time, Panzner says, is running out.

I am more concerned about what happens before the financial system ultimately collapses. Until the financial services industry and government restructure to a point where the owners of capital have equal opportunities for wealth enhancement, there will be a continuous transfer of wealth from the middle class to the "HB&B" and the governments and their controllers.

Our job as traders is to build and retain wealth, not to give it to others.

Here's a case in point: At the peak of the equity prices in 2000, the sell-side was advising 97.5% Strong Buy, Buy or Hold positions in stocks. When the market started to look shaky, Wall Street circulated a story of mythic proportions hoping independent traders would take their eyes off the ball. The sell-side was telling us "public day traders" had caused a bubble in the market. "Blame day traders for the catastrophe that was unfolding," Wall Street said.

It wasn't true. All day traders — including the thousands of day traders working on the "HB&B"'s principal trading desks — hold open positions for hours, minutes or sometimes a second or two.

Central bankers and commercial bankers had feared that when 1999 ended, computers would crash, throwing the banking system into worldwide chaos. To avoid a liquidity crisis, excessive money printing took place around the world.

Money printing is done by credit expansion, which happens when banks lend money that has been extended to them by central banks that do it by expanding their own balance sheets. If done too quickly, the process creates an imbalance between global debt and equity. What results, then, is an inflated asset price, often called a bubble because the price will burst at some point.

Independent commentators and analysts who warned of a looming collapse of market prices were ridiculed. This happened in the late-1990s, and the Price-to-Earnings ratio of the "S&P 500" index zoomed from a long-term average of about 15 to about 45. The many critics, for example, who decried buying General Electric (GE) at 50 times earnings (its normalized "PE ratio" is in the 13-to-19 range) immediately encountered unjustified personal attacks on their character and judgment.

It's not enough for the financial services industry to admit they failed us. They knew precisely what they were doing when they sold you their top-rated GE at up to 60 and later bought it back from you under 25 when valuations returned to long-term norms. The extent of the over-bought market in 1999 and resultant 2000-02 crash would never have happened but for a steady stream of characters from Wall Street "advising" the public how good a deal was GE with a 50 PE.

The 1999-2000 bubble, which was attributed to insane valuations placed on Internet companies, and the 2006-2007 bubble, which was real estate related, were nothing more than opportunities for "HB&B" to transfer trillions of dollars of wealth from the general public to a relatively few market insiders, many of whom earned multimillion-dollar bonuses for their efforts. This self- serving conduct was despicable and ought to be the basis of huge class action lawsuits or else the process of "fleecing the lambs" will happen repeatedly.

We are told that "HB&B" is in place to serve us, but I know better. I know that if you are well down the pecking order (which starts with "HB&B" executives and then travels down through their families, friends, biggest clients, church and charities and so on) and you listen to these "HB&Bs", you'll be sorry.

Here's how the public was sucked in:

The sell-siders are storytellers. In 1999 and 2000, even the Madison Avenue storytellers — the advertising kids — got into the game. Right up to the market crash in mid-year 2000, they were producing television commercials for online discount brokers with stories of truck drivers using their stock market winnings to buy tropical islands. The public was sucked right into a bubble and paid a substantial cost.

All seems fine on Wall Street until a "Bull market" ends. Then harsh reality sets in for the buy-side.

Oh yes, there are investigations. When Wall Street helped its biggest clients participate in a front-running scam against mutual funds owned by "Mom & Pop", the SEC regulator called this crooked practice "market timing"! Do you believe that?

Market timing exists for a legitimate reason. There are always pullbacks in equity markets because, ultimately, market price and real value must match up. Effective market timing is crucial to your success.

Whether the “Bear market” landing is short and hard, like it was in 1987, or lengthy but no less painful, like 2000-02, or the one in 2008-2009, the buy-side customer always pays. Does “HB&B” care? Their principal traders need the volatility of cycles to make a profit and know they will soon recover from the low volume challenges of Bear cycles. They anticipate that you will soon get entranced by their latest stories and forget the past.

The sell-side wants to start afresh with the next “Bull market” in hopes of showing a baseline performance from “Bear market” lows. This trickery makes them appear smart and competent. Interestingly, they are neither. The public soon forgets the passing of a “Bear market”, something Wall Street and shareholder-owned corporations count on.

There is one person who should be responsible for your assets — you. If you hand over the management responsibility to “HB&B”, you are putting yourself into an institution in many ways.

The Trader Wizard and my friends at BillCara.com will try helping you down the path to independence — to a realistic understanding of the market — and teach you what is required to become a successful trader. That process is complete once you understand who you are and why and how you’re intending to go forward in search of financial freedom.

The market is about average people like you and me on a lifelong journey. Every journey needs a map, a plan and a starting point. Decisions have to be made and I am here to show you the way.

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