Michael Covel

MICHAEL COVEL *teaches beginners to seasoned pros how to generate profits with straightforward and repeatable rules. He is best known for popularizing the counterintuitive and controversial trading strategy, trend following.*

An avowed entrepreneur, Michael is the author of five books including the international bestseller, Trend Following, *and his investigative narrative,* TurtleTrader. *Fascinated by secretive traders that have quietly generated spectacular returns for seven decades, those going against the investment orthodoxy of buy and hope, he has uncovered astonishing insights about the right way to think, develop, and execute trend following systems.*

Michael's perspectives have garnered international acclaim and have earned him invitations with a host of organizations: China Asset Management, GIC Private Limited (a Singapore sovereign wealth fund), BM&F Bovespa, the Managed Funds Association, Bank of China Investment Management, the Market Technicians Association, and multiple hedge funds and mutual funds. He also has the distinction of having interviewed five Nobel Prize winners in economics, including Daniel Kahneman and Harry Markowitz, and he has been featured in major media outlets, *including the* Wall Street Journal*, Bloomberg, CCTV,* The Straits Times*, and Fox Business.*

Michael posts on Twitter, publishes a blog, and records his podcast weekly. His consulting clients are across hedge funds, sovereign wealth funds, institutional investors, and individual traders in more than 70 countries. He splits his time between the United States and Asia.

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“THE TRUTH OF TREND FOLLOWING IS ITS PHILOSOPHICAL UNDERPINNINGS ARE RELEVANT NOT ONLY TO TRADING, BUT TO LIFE IN GENERAL.”

Ten Tenets of a Trend Follower

1. PRICE IS THE PARAMOUNT TRADING SIGNAL.

In an increasingly uncertain and downright unfriendly world, it is extremely efficient and effective to base decision making on the single, simple, reliable truth of price. The 24/7 never-ending fundamental data barrage, such as price-earnings ratios, crop reports, and economic studies, plays right into the tendency to make trading more complicated than it need be. Yet by factoring in every possible fundamental piece of data, which is impossible, you still would not know how much and when to buy, or how much and when to sell. The truth of price always wins if the debate is grounded in reason. Price is the only fact.

Market prices, traded prices, are the unequivocal objective data reflecting the sum total of all views. Accepting that truth allows you to compare and study prices, measuring their movements, even if you don't know a damn thing about fundamentals. You could absolutely look at individual price histories or charts, without knowing which market is which, and trade them successfully. That is not what they teach at Harvard or Wharton, but it is the foundation of making millions as a trend following trader.

The concept of price as the paramount trading signal is too simple for Wall Street to accept. This confusion or misinformation is seen across the mainstream press where they always emphasize the wrong numbers.

2. EMBRACE SPECULATION.

Speculation is unavoidable. It is all there is for making choices about market prices. Learning how best to speculate using prices is not only a worthy endeavor – it is a survival-of-the-fittest concept that traces back to the earliest literature of Wall Street.

You have to want to get ahead and be rich – the critics' condemnation, the player hating, the rank jealousy be damned. Speculation is not only honorable – it is life. Profit-seeking speculation is the absolute driving force of markets and without it there is only disintegration.

3. KEEP DOWN YOUR LOSSES, LET YOUR PROFITS TAKE CARE OF THEMSELVES.

In *How to Win and How to Lose* (1883) we see arguably the first trend-based market player arrive:

"The shrewdest operator ever known on the London Stock Board was David Ricardo (1772–1823) who amassed an enormous fortune. In advice to a friend he sums up as the true secret of his success, the rule, every word of which is golden. 'Keep down your losses – never let them get away from you. Let your profits take care of themselves.'"

That precept is huge. Timeless. It does not come naturally. Intense study, practice, is the rock solid foundation.

If cutting losses and letting profits run is the trend following mantra, it is because harsh reality dictates you can't play the game if you run out of money. No money, no honey!

A good example of not letting profits run can be seen in trading strategies that take profits off the table before the trend is over. For example, one broker told me one of his strategies was to ride a stock up for a 30 percent gain and then exit. That was his strategy. Let it go up 30 percent and get out. Sounds reasonable. However, a strategy that uses profit targets is problematic at a root level. It goes square against the math of getting rich, which is always without question to let your profits run. If you can't predict the end or top of a trend, don't get out early and risk leaving profits on the table – you will need the biggest winners after all to pay for the smaller losers.

4. BUY HIGHER HIGHS AND SELL SHORT LOWER LOWS.

Understanding how a trend follower implements their philosophy is well-illustrated in Ed Seykota's sugar story.

He had been buying sugar – thousands of sugar futures contracts. And every day, the market was closing limit up. Every day, the market was going nonstop higher and higher. Seykota kept buying more and more sugar each day limit up.

An outside broker was watching all of Seykota's action. And one day the broker called him after the market close, and since he had extra contracts of sugar that were not balanced out, he said to Seykota, "I bet you want to buy these other 5,000 contracts of "sugar."

Seykota replied, "Sold."

After the market closes limit up for days in a row, Seykota says, "Sure, I'll buy more sugar contracts at the absolute top of the market."

Everybody instinctively wants to buy sugar on the dip or on the retracement. Let it come down lower they pine. "I want a bargain" is their thinking – even if the bargain never appears. Trend following works by doing the opposite: It buys higher highs and sells short lower lows.

5. Do not personalize your trading decisions.

By not personalizing your trading decisions, your emotional indecision has the chance to decrease.

Your approach becomes more objective, more rational. You have enough confidence in your own decision making that you never seek out investment recommendations. You're content to wait patiently for the right opportunity. And you're never too proud to buy a stock making new highs, even all-time highs.

For you, investing opportunities are market breakouts. Conversely, when wrong, you exit immediately, no questions asked. You view loss as an opportunity to learn, move on, and save money to play another day. Obsessing on the past is pointless. You approach trading as a business, making note of what you buy or sell and why in the same matter-of-fact way you balance your checkbook.

6. DO NOT PREDICT – REACT.

Predictive technical analysis rightly deserves poignant criticism. Consider a recent Red Alert example from HSBC: "The Head & Shoulders Top with the neckline acting as resistance comes on top of a potentially bearish Elliot Wave irregular flat pattern and the fact that the index is now backing off from the old 2015 highs. A close below 17,992 would be very bearish. Pressure would ease above 18,449."

Good luck with that.

But there is a second type of technical analysis that neither predicts or forecasts. This type is based on reacting to price action, as trend trader Martin Estlander notes: "We identify market trends, we do not predict them. Our models are kept reactive at all times."

Instead of trying to predict market direction (an impossible chore), trend following reacts to movements whenever they occur. This enables a focus on the actual price risk, while avoiding becoming emotionally connected with direction, duration, and fundamental expectations.

This price analysis never allows entry at the exact bottom of a trend or an exit at the exact top. And you won't necessarily trade every day or week. Instead, trend following waits patiently for the right conditions. There is no forcing an opportunity not there.

Don't try to guess how far a trend will extend. You can't. You will never know how high or how low any market might go. Peter Borish, former second-in-command with Paul Tudor Jones, lays bare the trader's only concern: "Price makes news, not the other way around. A market is going to go where a market is going to go."

7. FORGET DISCRETION.

Successfully making fortunes isn't about excitement. It's about winning.

Decisions made at the discretion of the trader can be changed or second-guessed nonstop. These discretionary gut-trading decisions will be colored by personal bias. I have yet to see a multi-decade track record produced by gut trading. It's 100 percent fantasy. Many imagine the process is like a fighter pilot strapped into the cockpit armed with an instinctive feel, or even an innate gift. It's not that.

Now, a trader's initial choice to launch a trading system is discretionary. You must make discretionary decisions such as choosing a system, selecting your portfolio, and determining a risk percentage (some would argue even these aspects can be made systematically too). However, after you've decided on the system-orientation basics, you can systematize these discretionary decisions and make them mechanical.

8. FORGET SEXY.

Since trend following has nothing to do with high-frequency trading, short-term trading, cutting-edge technologies or Wall Street hocus pocus nonsense, its appeal is universally lost during extraordinary delusions unleashed inside the madness of crowds – that is, until bubbles pop. Trend following is not sexy until after the masses get poached and bleed out.

Nonetheless, if you look at how much money trend following has made before, during, and after assorted market bubbles, it becomes far more relevant to the bottom line of astute market players.

Markets of course are built by design to go up, down, and sideways. They trend or chop. They flow or don't. They are consistent, then they surprise. No one accurately can forecast a trend's beginning or end until it becomes a matter of record. However, if your trading strategy is designed to adapt, you can take advantage of changes.

9. CHANGE IS LIFE.

Like sunrise, sunset you can always expect a new trend following obituary, oblivious to the data, and rooted in purposeful ignorance, will be written every few years by an agenda-driven press, EMT defenders, and player haters despite the incredible amounts of money made by trend following practitioners.

Perplexed at Wall Street's lack of acceptance, one trend follower – John W. Henry – sees the danger in trying to be right:

"How can someone buy high and short low and be successful for two decades unless the underlying nature of markets is to trend? On the other hand, I've seen year-after-year, brilliant men buying low and selling high for a while successfully and then going broke because they thought they understood why a certain investment instrument had to perform in accordance with their personal logic."

Trend following is much more than one trend following track record alone – this strategy has performed consistently for more than a century across an untold number of traders. And the reasons to explain why markets have tended to trend more often than not include investors' behavioral biases, market frictions, hedging demands, and never-ending market interventions launched by central banks and governments.

10. AS IN TRADING, SO IN LIFE.

The truth of trend following is its philosophical underpinnings are relevant not only to trading, but to life in general, from business to personal relationships. The old-pro trend followers were clear with me, in their words and actions: Trend following works best when pursued with the right mindset and unbridled passion.

Successful trend followers don't trade with grim resolve or with the intention to impress. They are playing a game to win and enjoying every moment of it. Like other high-level performers – think professional athletes and world-class musicians – they understand how critical it is to maintain a winning attitude for success.