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The Truth About The Turtles

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By TradingMarkets Research

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Art Collins: Discuss how you became a trend following advocate.

Michael Covel: Going back a ways, even before Richard Donchian, some very bright people started to realize that the whole notion of having all the fundamental data in the world didn't address the most pertinent questions. You still have to decide, when exactly do you enter, when do you exit, how much do you bet, and what will your total portfolio consist of. Those kinds of questions don't get answered just by having all the fundamental facts in the world. Many trend followers tended to arrive at their understanding independently of each other. They were scientific in their approach and they knew they had to come up with a method that would answer those kinds of questions.

Interestingly, after my book came out, I found myself giving advice to otherwise sophisticated people who don't "get" trend following. I sat down the other day with a very large hedge fund that was closing in on a billion dollars with just a small select group of principals. They were more comfortable making an allocation to a fundamental trader trading one market alone. They just couldn't wrap their arms around the idea of trend following being a skill set that works across all markets. I'm getting that kind of response.

Art Collins: These are valid arguments regarding the downside of fundamentals, but why do you advocate trend following in particular instead of some other technical approach?

Michael Covel: Tell me another technical strategy where you can find over a dozen traders with similar trading methods and (profitable) records, month by month, over 20 plus years. There has been a group of trend following traders with consistently good performance results over a very long period of time. You can look at that data. That was the nexus of my book-how could I write it if I didn't have (corroborating) data? It would have just been my opinions.

There are all kinds of books out there telling you to try other approaches-try Elliot Wave, try this, try that. There was no data behind it. I've followed people who are trend followers not only by their own admission, but their performance data bears them out. Some people in the last few years have tried to sell themselves as not being trend followers, but the performance data clearly shows they are.

Art Collins: So you're a trend following advocate, which explains the theme of your website. Why did you name it after the Turtles?

Michael Covel: The Turtle story in Market Wizards (by Jack Schwager) was an introduction. My first response, like a lot of people was "Wow!" Then I asked myself, "How do you figure this out?" The dozen or so (participants) were given knowledge and then they all became Golden Children. They were given the so-called "Secret To Success".

We didn't have any great thought process behind the name we chose for the site. It was more like "Let's go ahead and break down the mythology of the Turtles." Once the site was named, you could, in hindsight, have said it would have been more clarifying to name the site "Tend Following." On the other hand, going with TurtleTrader.com really did help break down the mythology and get people to understand there are no secrets.

I can't recall off the top of my head if (Schwager) espoused that they were trend followers. If he went even that far in the book, it was disguised somehow. Maybe he didn't even know. Whatever was behind it, the Turtles did come across as something very mysterious, their technique was unknown, and for that reason, they got a great PR run until we helped break it all down.

Art Collins: They still seem publicity-shy for the most part, which is strange considering Dennis, by his own admission, has moved away from Turtle methodology.

Michael Covel: It was a different time and place, but I think the whole legend probably helped many Turtles raise money for a long period of time.

Art Collins: So from a PR standpoint, it was better that they not talk?

Michael Covel: Yeah. They were the mysterious Turtles who produced these fantastic returns. I don't really think the Turtle legend applies so much today, and in fact, I might argue that the air of mystery that some of them thought worked so well early on might have in the long run hurt them. There was a period of time in the late 80s, early 90s where the mysteries of markets were more acceptable. Today, people just want to know, "Ok, come on. Tell me what's going on. Let's talk."

Art Collins: Part of the Turtle silence resulted from their proprietary agreement with Dennis and Eckhardt. Purportedly, (a onetime Turtle) got cut for that very violation.

Michael Covel: I can't speak to him, but any allocator worth his salt could have run their correlation studies during the late 80s-early 90s against other trend followers and they all knew what was going on. It might not have been publicized, there might not ever have been an article written about it, but what the Turtles were doing was only a mystery to the general public. People putting money into Turtle funds certainly knew they were trend followers. The performance data was there for everybody to see. **Art Collins**: Do you have any relationship with any of the ex-Turtles? **Michael Covel**: I've met with several of them over the years. If it wasn't for the TurtleTrader.com website, some of the mystique and lore of the Turtle probably would have been long forgotten. But by no means is the TurtleTrader.com website strictly about the Turtles. The site is much more about trend following and aspects that go with it from psychology to risk management, etc. I find in talking to people around the world that they use us for a location to find information about systematic trading-prospects, theory, behavioral sciences, and so on. The site was obviously inspired by the Turtle experiment, but as the site is approaching ten years of being online, there's no doubt that a significant other amount of new information has solidified its popularity.

Keep in mind though, not all of the Turtles have been successful. I found Richard Dennis' recent comment interesting, (April 05 issue of Stocks and Commodities) that it didn't make a difference who (his students) were as long as they were under his control following his systems. That was the most interesting comment in the interview.

Art Collins: I was trying to get at the reason for the screening process. That is a big part of Turtle lore-that the mentors were looking for people with certain skill such as game-playing aptitude. On the other hand, the methodology was supposedly 100 percent mechanical which meant anyone with a willingness to follow the systems could do so, making screening irrelevant. What's your take on that?

Michael Covel: I could theorize, but we'll probably never really know. With the evidence available, I think they knew to some degree that some of the folks they were hiring were extremely bright and others weren't. Perhaps that's what they were going for.

Art Collins: So they were deliberately going for some sort of trader cross-section?

Michael Covel: Given the diametrically different results of how some of these folks turned out, it makes sense. I think you've also got to consider Dennis' point about when they were under his control verses later on. I think he was also trying to prove something about ambition and the passion to become an entrepreneur. What people forget is, if you're selected to be a Turtle under Rich Dennis and he gives you a system and he gives you money, and he says, "go do it," what's the risk for you? When you have to become Jerry Parker or Paul Rabar (two that turned out great on their own) and go out and start a business, hire people, and worry about paying the bills, that's where the risk is. Some of those guys like Parker and Rabar got that part of it and some of them didn't. That could be a differentiating element.

Art Collins: So maybe part of the Dennis/Eckhardt debate was "can people be trained well enough to become independent trading entrepreneurs?"

Michael Covel: Well, there were five years between the time he hired these folks and the time they went out on their own in 1988 or so. Do you think he was thinking that far ahead? I don't know. But again, Paul Rabar is approaching a billion dollars under management. Jerry Parker is (in the billions). Then others are either out of the game entirely, or if they are in the game, aren't doing much beyond tooting their Turtle horn.

It's the entrepreneurial thing. I can only go by what Rich himself said, but it dovetails with my theory. He turned on the lights for them. He supplied the brokers, the money and the system. When that stopped and they were faced with "oh my gosh, do I want to do this on my own? Can I do it on my own?" It brings in a whole slew of other factors such as how do really you make something happen in life?

Art Collins: I talked to (one Turtle) for about 45 minutes the other day. (A Turtle who was cut from the program early on-purportedly for divulging proprietary information). His major dispute with the Dennis interview was in terms of what was being taught. He said Dennis wasn't actually imparting 100 percent mechanical methodologies, but rather, he was conveying how to look at, think about, and approach markets as Richard Dennis did. In other words, there was discretion.

Michael Covel: You know, that doesn't make any sense to me. If you want to be quantitative about it, you can look at the month by month track records of the publicly money managed funds of Turtles since the late 1980s. I've seen those results. I've also heard quotes from the Turtles over the years that say "oh, we're all trading different, we're all different," yet the correlation studies all come in very high.

People want to create this air of mystery around the technique (of trend-following). The hard part is waking up every day and doing it--being Jerry Parker, pulling the trigger. You could even run correlation studies of Turtles versus other trend followers and there's a real commonality. It's not like there's a magic secret sauce.

I discussed this in my book in the chapter on correlation. One of the Turtles was quoted in the early 1990s as saying "95 percent of what I'm doing is the system Rich gave me." A few years later he said, "Now we're all doing something different." I don't buy it. The correlation studies say they're all doing basically the same thing. There are a lot of bright and successful people in this field, and yet no one has come out and disputed that.

Art Collins: Would you expect the Turtles to evolve as time went on? Were they taught to move forward as well as to obediently follow an existing program?

Michael Covel: That's an interesting point, but how do you evolve a trend-following system? A trend-following system from the ground up is all about adapting and responding to change. I'll give you a good example. I had a conversation over the weekend with a trend-follower in Chicago. He had $300 million under management. I told him about how fundamental guys always want to know how trend followers are tweaking their systems. There is also a certain cross-section of trend-followers who say they're always making tweaks to the system. Then there's another group who says "we've been doing the same thing for 20 years. We don't change the system." I told the trend follower in Chicago that I thought the guys who were talking about tweaks were doing so to a large extent just to appeal to investors. Investors want to feel like there's some new magic being done-some new magic secret sauce. He agreed.

Art Collins: But there are always variables within systems. Is it valid to change them according to how the markets drift over time?

Michael Covel: That kind of stuff may change, but it's small potatoes in relation to the big picture. If you're working with an entry trigger and you're using a volatility based money management system, whether you decide to tweak a parameter or value here or there doesn't amount to much from a big picture standpoint. That's the kind of thing die-hard traders may argue in chat forums-"oh you switched from a 20 to a 25 day trigger. New system!" I don't really buy any of that.

I've sat down with over ten trend-following traders in the last 120 days who are managing on average anywhere from $200 million to $3 billion. So this feedback is more than just me pontificating. I've seen the commonalities in my research.

Art Collins: Are you personally into market research? Do you program?

Michael Covel: I work closely with two programmers, but as you understand, once you start writing, it can take over your life. When I use the phrase Â'research', I'm really talking at this very minute more about research for a second book-getting out and meeting with really good traders face to face at their offices.

Art Collins: Is that your primary selling card-that you've had access to some of the greatest minds in the business?

Michael Covel: You're one of the first people I've talked to about my second book. A great number of people have been energized by the first book. For a lot of traders and hedge fund managers, this style of thinking is very different. Let's face it, you can still flip on CNBC any day of the week, and you're not going to hear anything that remotely sounds like trend following.

Art Collins: You might be answering in part what I was going to ask you about how much effectiveness has gone out of trend following since the days of the Turtles. Maybe we don't have the same markets we had in the 70s, but if we still have a positive expectancy, maybe it's because that CNBC-hedge fund mentality out there continues to be so prevalent.

Michael Covel: As we talk now in 05, trend followers by and large are in the middle of drawdowns. Some of them are pretty large by any historical standards. It's been a rough stretch even for some of the guys I covered in my book. We'll just have to see how it plays out. One of the things that has changed in the last two years is the money under management in Trend Following funds which has at least doubled and maybe tripled. Is that having an effect or are we just dealing with one of those choppy periods? I talked to a trader last week, and he said, "You know, this has happened to me about ten times before in my career. I start feeling the end is near and then all of a sudden it all turns around and trend followers make thirty percent in a month and they end up being something like 25 percent up on the year."

Art Collins: Although the wide swings you're routinely forced to endure are a big drawback of trend following, wouldn't you say?

Michael Covel: I did a radio interview with Bloomberg (recently) and got asked a similar question. I said that if you'd been long the Nasdaq since January of 2000, you're still in the middle of a 60 percent drawdown five years later. I can't think of any bigger swing than that. I think all trading is risky. It's all about having knowledge and understanding what your strategy is and where you're trying to get with it.

To some degree, I have a complaint with the CFTC (Commodity Futures Trading Commission) there, because the CFTC forces trend followers to wear their worst drawdowns like the Scarlet Letter. They force a lot of risk disclosures, and that's all fine except that nobody else has to do that. A lot of these other trading approaches kind of get a cakewalk in terms of scrutiny. It makes investors feel like trend followers or CTAs (Commodity Trading Advisors) or futures market traders are more "risky", but I get back to my Nasdaq -60 percent drawdown five years later (investing in equities). If that's not risky, I don't know what is.

Art Collins: What should someone devising trend following systems be shooting for, besides the obvious answer of potential for making money?

Michael Covel: That depends on the person. Some of the folks I've been talking to shoot for lower return and lower risk. Others go balls to the wall and try to make as much money as possible shooting for absolute returns.

Art Collins: Let's ask it this way: considering the issue of large drawdowns and givebacks, is there a prudent or optimal approach to skinning the trend following cat?

Michael Covel: Do you skin it or just accept it as reality?

Art Collins: Isn't part of the research process to mitigate those problems?

Michael Covel: I don't know. I look at John W. Henry or Bill Dunn. They've both had careers spanning over 25 years and they've had extensive drawdowns and corresponding recoveries to new equity highs on a regular basis. Those are two of the best. If they can't figure out how to eliminate drawdowns, I can't imagine the new guy just getting into the business fresh out of school being able to do it. I don't think I'd be able to do it.

Small losses are part of the game. Many small losses added up equal a drawdown. The home run trends then come along to offset the losses. That's how it works. Are we thinking about skinning something that is not skin-able, or do we just have to live with it-is it just the nature of the beast?

Art Collins: The other issue is, people like John W. Henry and Bill Dunn have enough money that the drawdowns might not seem as devastating as normal.

Michael Covel: Yes, but both had those big drawdowns even when they started. I think Bill Dunn was once lost -52 percent of his equity within the first two years of launching his firm Â- and then recovered quickly to make new equity highs.

Art Collins: So you're saying it's all relative. Is there any methodology you advocate for ensuring you're staying within acceptable risk parameters?

Michael Covel: From everything I've seen, the more you risk, the greater your chance for reward and the greater the chance for a steeper drawdown. It's the risk quotient. There's a great trend follower in London name David Harding who says "Look, I'm a risk manager and I can tell you precisely what we're going to risk every day. But I can't tell you what we're going to make." That's tough for people to wrap their arms around sometimes. But that is reality. "Do you want to accept reality?" is the question for all of us.

About the Interviewer:

Michael W. Covel is the founder and President of Trend FollowingÂÂ™. A researcher of the most successful Trend Following investment managers, he has been in the alternative investments industry consulting on Trend Following to individual traders, hedge funds and banks for ten years. His best selling book, Trend Following: How Great Traders Make Millions in Up or Down Markets (Prentice Hall, May, 2004) is a complete and concise guide to trend following. It includes interviews with great trend followers who have won millions if not billions in the market. The trading world has embraced *the book with endorsements from Van K. Tharp, John Mauldin, Ed Seykota and many more. Trend Following is now in its fifth printing, and is currently available in a Japanese translation with Chinese, German, French, Korean and Russian translations soon to follow. Teaching and sharing unique insights about Trend Following trading and alternative investments has earned Mr. Covel respect as a rational and logical voice in uncertain times. Mr. Covel also writes for numerous industry publications including Your Trading Edge, Stocks, Futures and Options Magazine and International Petroleum Finance and is consistently quoted and interviewed by a variety of financial publications.*

Mr. Covel is also Managing Editor at TurtleTrader.comÂ®, the leading Trend Following news and commentary resource since 1996. Thousands of visitors from more than 70 countries as well as hundreds of trading professionals engaged in years of debate and interchange making the site the rich archive of trading information, data and opinion that it continues to be today. TurtleTrader, one of the largest & strongest trading community on the web with over 7.5 million unique visitors since its inception, also functions as a resource center for the Trend Following Educational Course.

Art Collins is the author of the book Market Beaters among others. He has been successfully developing and trading commodity systems since 1986. Shortly after implementing his first programs. Art exchanged his managerial position in an automobile dealership for his true passion. He became a full-time floor member of the Chicago Board of Trade.

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