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# William Eckhardt: Doing by learning

By Ginger Szala

*If there were no William Eckhardt, there might not be any "turtles," the highly successful proteges of trading legend Richard J. Dennis. It was Eckhardt's skepticism that trading could be taught that led him and high school friend Dennis to develop the unique program to train traders.*

*Dennis, in fact, had to talk his friend into taking a sabbatical from earning a University of Chicago doctorate degree in mathematics to trade on the MidAmerica Commodity Exchange floor. Eckhardt never looked back.*

*A combination of mechanical and discretionary trading techniques has given Eckhardt only one losing year (-7.4%) in the last five. His best year in that period was 1987 when he had a 234% return. His worst drawdown was in May-June 1987, a 30% loss, followed by a 44% gain. In late November, he was up slightly for 1991.*

## **Futures: Describe your system and some of its important technical indicators.**

Eckhardt: We developed all our systems exclusively in-house... so there aren't any sort of publicly recognizable indicators I could mention. We definitely use non-linear systems and non-linear indicators. Linear indicators, such as filters with moving averages, have been mined dry. Our systems are based more on pattern recognition than on statistical indicators per se.

## **Do you trade all markets the same, or do you optimize?**

I optimize over the joint historical data of all markets, but I don't optimize individually for each market.

## **Is the discretionary part of your trading whether or not to take the signal from your system?**

Most times when I intervene, it's based on a judgment that the system is underestimating risk. Hence, since I believe risk is greater, I will decrease positions.

## **Why would you think risk is greater than the system would estimate?**

A sudden jump in a key market. (The 120-point drop in the Dow Jones Industrial Average Nov. 15) was a situation where the volatility seemed to increase in a matter of a few hours. Any system is going to be a little slow in assessing that change of volatility. So it's easy to (be) in a situation where the position represents more risk than originally intended. That would be a good spot to cut back.

## **How do you make your discretionary decisions?**

I've been a professional trader since 1974. I've seen a lot of markets. I have some ideas about how markets should behave, especially vis-a-vis each other. For the most part, my systems only look unidimensionally at a market. So, as a manager, I'm more interested in patterns that exist between markets and applying my judgment in that way.

## **How do you manage your risk?**

I use modern statistical decision theory and modern utility theory... Utility theory is a mathematical formulation of the idea that each dollar you make is marginally less valuable than what you have and that each dollar you

lose in a drawdown is marginally worth more (with) each successive dollar. It's based on the theory of marginal gain or marginal utility, but utility theory per se is a precise statistical mathematical formulation of this.

## **You had an incredible late 1987.**

One thing that helped was some discretion the day of the (stock market) crash. I was short S&Ps (Standard & Poor's 500 Index), but I was also heavily short Eurodollars. At the end of the day, the S&Ps were down about 8,000 points and the Eurodollars were down about five. Of course, to my system, which is looking at each market individually, it's short the Eurodollars and they're lower — a positive thing. But from my spreader's mentality from being in the pit, it seemed the Euros should have been down 30 or 40 (points) just in sympathy. That seemed to me to be a weak performance, and I covered my short Euros. They opened 300 points higher, so it was really the best trade in my life.

## **Have the markets changed?**

The preponderance of managers using mechanical systems has made it more difficult to profit systematically.

## **How have you adjusted your system?**

I try to avoid trading anywhere near where I feel (other trend followers) are going to trade. I am still a trend follower, but... I don't simply go for the highest optimized values on my system. I go for the values that are high, but that also involves being rather different than what I feel the other trend followers are doing.

## **Do you follow Elliott wave or Gann approaches?**

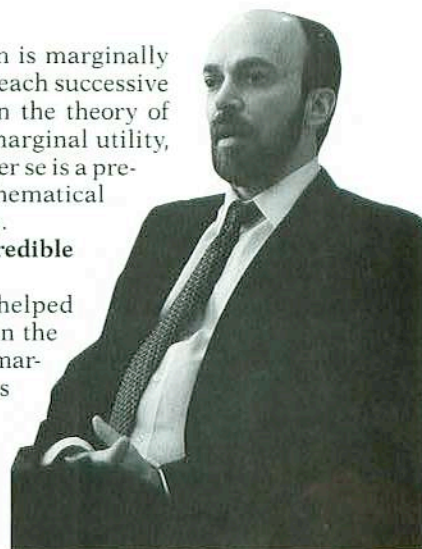
No, I'm fairly convinced that's Rorschach: One can see whatever one wants in it. Perhaps a trader with a lot of insight and a lot of instinct will see the right things, but I believe the (methods are) practically worthless.

## **What's the most important aspect of successful traders?**

You have to be willing to do things that are contrary to your deepest and abiding impulses... Generally, one can learn what one needs to know. It's hard to bring yourself to do what you know you should do.

## **I thought you believed traders were born, not made.**

That was (my) initial view, but after the turtle experience, I was forced to think otherwise... (Trading is) certainly much more learnable than I would have thought. □



*As mechanical systems proliferate, William Eckhardt tries to find niches where other trend followers are absent.*

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Past performance is no guarantee of future performance. Expectations of profits must always be weighted against the risk of losses.



# Managed money: Capitalizing on the trends of 1990

By Ginger Szala

For the Chinese, 1990 was the Year of the Horse; for the managed money industry, it was the year of the trend follower. Unlike many years in the last decade, markets across the board were trending, and almost every month was a winner for the trend-following approach.

The result was that average performance for public futures funds was up more than 18%, the third best year since 1980 (funds rose an average of 34.5% in 1987 and 26.6% in 1980), according to unit value figures provided by *Managed Account Reports*.

It also was a year when managers with at least a decade — or two — in the industry were among the leaders of the pack: Paul Tudor Jones of the Tudor Group, John Henry of John W. Henry & Co., Jack Alban of PRAGMA Inc. and Robert Everson of Visioneering Research and Development.

Other leaders for the year had trained under a trading legend: Richard J. Dennis. Four of the top 10 traders with more than \$10 million under management tracked by Barclay Trading Group were Dennis proteges (see table and profiles).

Perhaps it is this success that has helped the managed money segment of the derivative industry make its mark. Everyone wants a piece of the action. In the United States, pension funds are placing money with commodity trading advisors (CTAs) and banks are setting up their own commodity pool operators (CPOs) as

managers venture into interbank and other markets beyond futures.

## Riding volatility

Although these were all trends that started before 1990, interest in managed money increased in a year when volatility jumped due to the threat — and reality — of war. The results were overwhelmingly positive: Of some 200 public futures funds, 86% ended the year with a gain.

Perhaps part of the growth was due to interest in non-U.S. derivative markets, where volumes escalated to account for almost half the world share. A number of trading advisors from Europe, Australia and even the Far East jumped into the spotlight.

In Europe, Banque Indosuez, Credit Lyonnais and Credit Agricole, the largest bank in France, launched their own funds. In the United Kingdom, tax laws were relaxed for unit trusts to trade futures, and new regulations were drawn — for possible passage this spring — to allow the speculative version of a futures fund to be sold to local investors.

In Japan, a clash took place between the Ministry of Finance (MOF) and the Ministry of International Trade and Industry (MITI) over the regulatory oversight of futures funds. Despite this turf battle, Nikko, Orix Corp., Sumitomo Corp. and Diamond Lease Co. all developed futures funds.

Alliances sprouted: Commodities Corp. joined with Orix to develop

funds and train traders in Japan. Nikko hired Dean Witter Futures and Currency Management as a trading manager for its first offshore fund, the first fund approved by the MOF.

This non-U.S. growth may force smaller managers to regroup, says Robert "Bucky" Isaacson, a leader in the managed money industry and a member of the National Futures Association board of directors. CTAs may have to be better capitalized and have more complete research than in days gone by, especially if the trader wants to enter non-U.S. markets.

This particularly applies to traders wanting to trade the foreign exchange interbank market, where the more money under management, the better the execution price.

Also, smaller traders might get lost as wire houses dominate the money-raising field and lean toward established traders for funds and pools.

Although wire houses may raise the money, a new level of management has evolved in the industry, the so-called managers of managers. This niche group, originally founded by Commodities Corp. and Kenmar, focuses on selecting and managing traders. This service has grown into a major business and may soon be required by regulation to provide its own track record to show how well it has done picking traders for a fund.

For the U.S. industry, this type of regulation is growing in complexity

*continued*

## Top performers for 1990

(Minimum three-year performance history)

### Commodity trading advisor

#### More than \$10 million under management

	1990 return	Sharpe ratio/ Sterling ratio* (Last three years)	Compound annual return (Last three years)
1. Hawksbill Capital Management	253%	0.71/2.22	59%
2. EMC Capital Management	177%	1.07/2.67	80%
3. Rabar Market Research	122%	1.39/2.5	67%
4. PRAGMA Inc. (BETA program)	109%	0.81/2.03	63%
5. Visioneering Research & Development (V-100 program)	98%	0.36/0.88	36%
6. John W. Henry & Co. (Financial and metals program)	85%	0.58/1.13	37%
7. Golden Mountain Trading	75%	1.38/2.27	45%
8. Tudor Investment Corp.	75%	1.53/2.28	48%
9. John W. Henry & Co. (Diversified program)	68%	0.27/0.74	22%
10. John W. Henry & Co. (Original program)	67%	-0.21/0.2	-1%

#### Less than \$10 million under management

	1990 return	Sharpe ratio/ Sterling ratio* (Last three years)	Compound annual return (Last three years)
1. Ron Schneider	132%	0.68/1.54	44%
2. Quicksilver Trading Inc.	103%	0.78/1.52	53%
3. David A. Creecy	101%	0.39/0.94	30%
4. Speculation Ltd.	96%	0.36/1.04	27%
5. Hill Financial Group	96%	0.5/1.12	27%
6. Salem Abraham	89%	1.11/2.71	76%
7. LaRocca Capital Management	76%	-0.12/0.13	-4%
8. New England Futures Inc.	73%	0.42/1	20%
9. Dean Witter Managed Futures Program	69%	0.48/0.9	26%
10. Lawless Commodities Inc.	58%	0.79/1.54	43%

\*Sharpe ratio measures positive and negative deviation; Sterling ratio measures negative volatility. The higher the ratios, the better the performance.

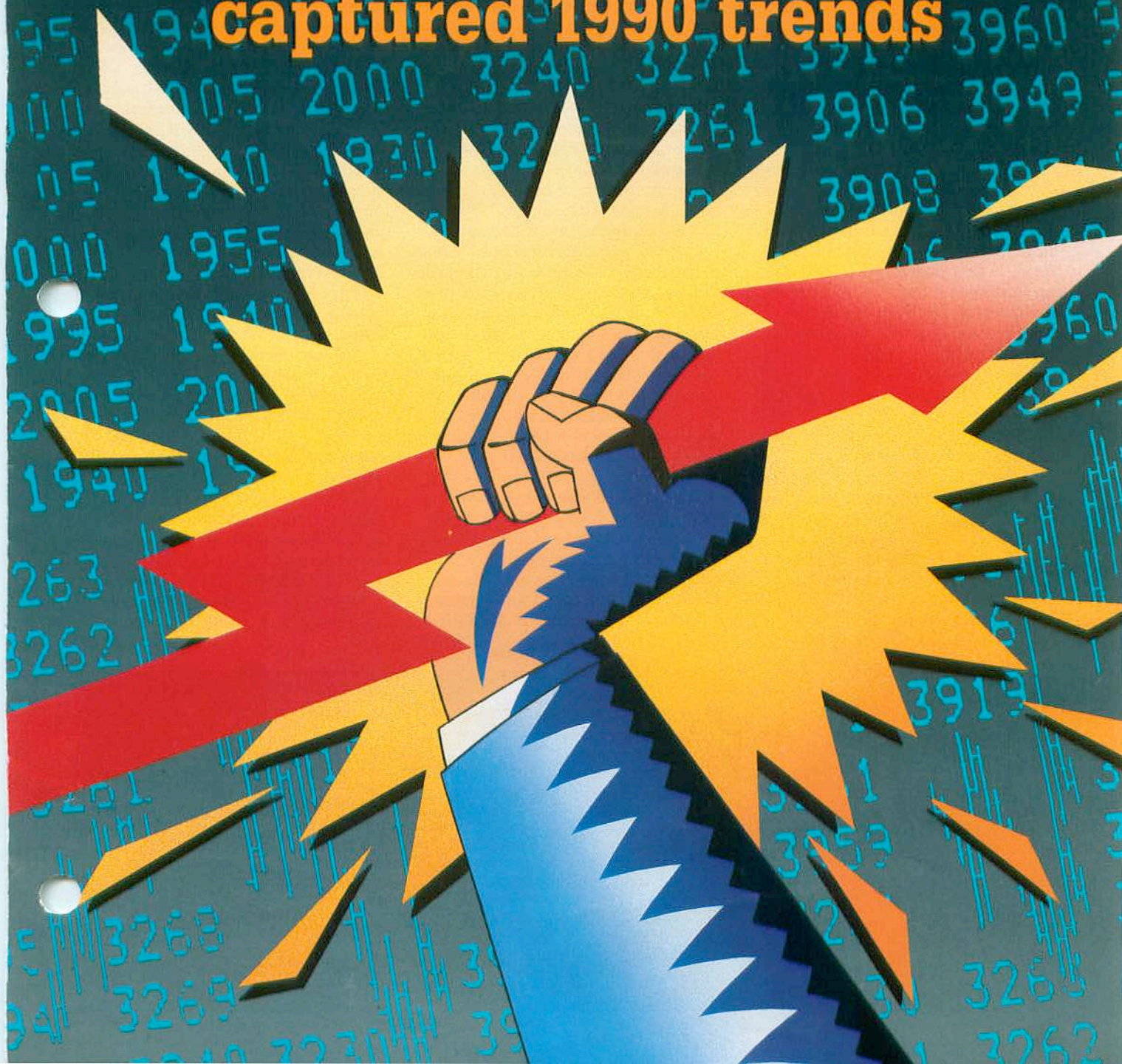


MARCH 1991

# Futures

The magazine of commodities & options

**How money managers  
captured 1990 trends**





and cost. Managed money should be glad if it can just limit regulation to the status quo, Isaacson says. The issues that caused squabbles a decade ago are still argued at every meeting: state securities laws, overlapping disclosure requirements by multiple regulators, speculative limits...

New issues have been raised, too. California recently adopted a law requiring any companies taking part in commission and transaction business

to register with the state and pay a fee of \$350. After some lobbying by industry associations, the California Department of Corporations exempted those managers who only provide advice and do not take part in the transactional business.

Because of the Federal Bureau of Investigation sting operation in Chicago's trading pits, all U.S. traders, on or off the floor, may have to pass an ethics course, much like commodities

brokers must pass a Series 3 test.

The bottom line seems to be that managed money is no longer a cottage industry — and shouldn't expect to be treated as one. □

Past performance of the investment managers listed herein is not an indication of the future success of their programs, and there is no assurance that the trends identified in this article will continue in the future. Futures trading, which is speculative and involves substantial risks and charges, is only appropriate for the risk capital portion of a portfolio.

## Rabar adds fundamental ingredient

A background in music and medicine doesn't necessarily add up to a career in trading commodities. However, for Paul Rabar, this combination of talents provides an insight into how he trades.

Rabar, head of Rabar Market Research in White Plains, New York, is one former Richard J. Dennis protégé who doesn't rely solely on technical trend following. He adds fundamental judgment to the equation.

The technique must work. Since he began trading in 1985 for Dennis, his *worst* year was a 15% gain in 1989. Otherwise, he has had annual returns of 67% or higher, including a 122% return in 1990.

Rabar isn't without his drawdowns. However, his largest loss in the last three years of managing client money was just over 18% during a three-month period in 1989. That was followed by 14 positive months out of the next 16.

"It's important to realize that Richard Dennis didn't quite give us the Holy Grail," he says. "As he put it himself, we probably tend to do things a little bit more efficiently than some other trend followers. There's no single magic element to our trading."

### New twists to old recipe

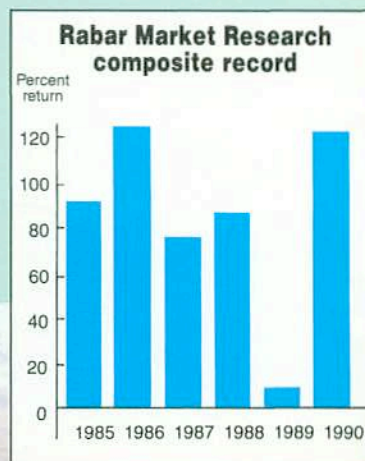
Rabar has added two new dimensions to his Dennis teachings. One is a refinement in money management that adjusts leverage to individual accounts according to client aggressiveness. The other more dramatic addition is his attention to fundamentals, which was never a part of the Dennis doctrine.

"I'll look at fundamentals to identify potential large moves," he says. "I'll also consider fundamentals as part of the common-sense approach to managing risk. For example, I may lighten up positions before a government report that one could reasonably expect to produce volatility in the market."

However, he warns the degree of discretion must be limited and must never supersede the system.

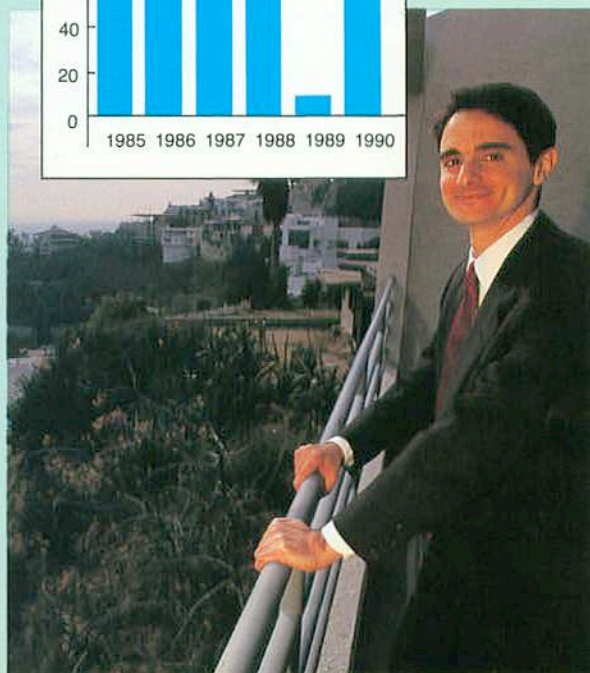
"There are tremendous benefits to a mechanical system, specifically discipline," Rabar says. "There also are advantages to purely discretionary trading, (such as making) use of more information and information that's harder to quantify than one can with mechanical or computer trading. My goal is to attempt to combine the advantages of both approaches. I attempt to use discretion but to do so always within quantitatively defined limits."

Although fundamentals have steeped into his trading



**Largest drawdown since 1988: 18.4% (June-August 1989)**

**Money under management on Dec. 31, 1990: \$65 million**



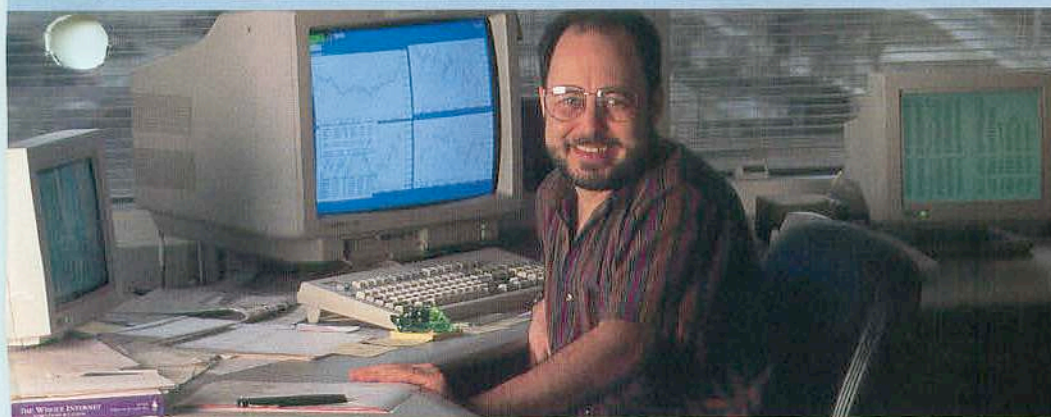
methodology, technical trading still is the basis of Rabar's mind set.

"Despite the fact this is the 20th century, man is still extremely susceptible to superstitions...and it's a constant struggle to resist them," he says.

"Whatever you use should be applied in some quantitative, rigorous fashion. You should use science to determine what works and quantify it," Rabar maintains. "I'm still surprised today at how I can expect so strongly that a trading methodology will be profitable but, after running it through a simulation, I discover that it's a loser." □

3.5.1 3.5.1





Murry H. Sill

## Seidler's returns fuel comeback

By Jack Reerink

Former turtle Howard Seidler, 37, was rolling high in 1990 when he had nearly \$75 million under management, collected in less than three years. But January 1991 came, and Seidler suffered his first big drawdown of 10.9%, ending the year down 19.5%. Eighteen months later, Saxon Investments' equity dropped to \$3.3 million.

"There was a basic mismatch of expectations," Seidler explains. "People thought we were low volatility traders and we hadn't made a serious attempt to dissuade them from that notion...(People said): 'It must be nice, now that the pressure is off.' But that's not true. The money going out the door made it harder to concentrate on trading."

Seidler had his "housekeeping in order" by mid-1992, moving trading from his home to an office in Coral Springs, Fla., and now manages about \$7 million in two diversified programs. He came back with a vengeance: His diversified program was up 68.3% last year, while his aggressive fund (which uses about 35% of equity for margin) posted a 142% return.

With a father trading commodities and stocks, Seidler became interested in futures at an early age. In high school he set up a \$1,000 account with money earned shoveling snow around his suburban New York home. He lasted 11 months, trading corn and potatoes, "things you could trade on a shoestring."

He earned degrees in chemical engineering and management science from the Massachusetts Institute of Technology. After three years with a consulting firm, Seidler was selected for Richard Dennis' turtle program.

"One of the favorite things Rich used to say was: 'Do the right thing,'" Seidler says. "It basically means: You

have methodologies that you've researched and traded with, and what you need to do is follow those methodologies through thick and thin."

After the bad year, Seidler stuck with his basic trading methods, but improved his systems and allowed for more volatility in his returns. "Rather than being overly concerned about risk, I started again to focus on trading. I gave myself breathing room and that enabled me to catch upside."

Seidler, described in his 1991 disclosure document as "discretionary," started to further computerize his trading, and now calls himself "well over 90% systematic." "It may be possible to trade for myself 50% mechanical, 50% discretion, but that's not the right way for me to trade for clients," he says. "Because of psychological reasons, but also because by being mechanical it's easier to quantify the risk side, the volatility."

He improved and added trading systems — now seven intermediate — to long-term trend-following systems, which primarily work on (price) breakout patterns. His average holding period went up to 30 days from 20. Seidler says he changed his entry and exit parameters, trying to steer away from "congested areas," where everybody jumps on the bandwagon or liquidates. But how to identify such areas?

"It's a combination of playing around in the research area as well as a sort of hands-on experience," he says. "You see the bid/offer gets wider, how much skid you get on stops and how hard it is to get filled on a limit order."

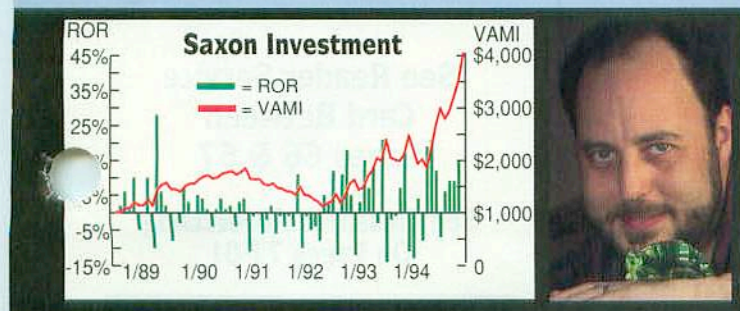
Seidler occasionally uses discretion in fast markets. "The market might trade right up to a point where the system would initiate a trade and then fall apart," he says. "At my discretion I can either buy at a better price or wait till the market recovers and shows some strength."

Seidler's systems use "home-cooked varieties" of simple indicators such as **Donchian's four-week breakout rule** (buy if the market goes through the four-week high, sell if it dips through the low), but employ a shorter time frame for exiting the trade. He pegs his initial stops against a measure of a market's 15-day historic volatility expressed in dollars. For raising stops, he looks at volatility and price breakouts measured against a given number of days.

He gradually builds up a position when the market goes his way, but also takes partial profits. For example, Seidler caught the coffee move April 28, when the market made a new high at around 85¢. He took profits at \$1.30 June 20, at \$1.90 July 8, and liquidated the position July 25 at \$2.10, after coffee had reached its annual high of \$2.74.

His systems suffer one strange drawback: a winter, or rather, January depression. In five of six years, Seidler posted an average 9.8% drawdown that month (he made a tiny 0.2% in January 1990).

"We're on course this January [with a loss of about 10%]," Seidler jokes. "Unfortunately, we haven't been able to prove in a statistically solid way that we shouldn't trade that month. But the evidence is mounting." **FM**





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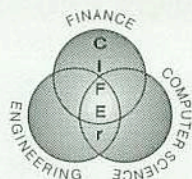
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## Futures' top and bottom 10 public funds of 1999

	Fund	Advisor(s)	Dec. return	vami	1999 return
TOP	MSDW Spectrum Strategic Fund	Irish Capital Management Blenheim; Willowbridge	7.33%	15.53	34.46%
	GNI Technical Fund*	GNI Ltd.	5.70%	27.62	34.40%
	Equilibrium Fund Can.	Di Tomasso Group	-8.23%	11.93	32.70%
	GNI Diversified Fund Ltd.*	GNI Ltd.	1.83%	20.63	32.58%
	Northfield International*	Northfield Trading	0.52%	21.33	19.03%
	Morgan Stanley Tangible Asset Fund L.P.	Morgan Stanley Commodities Mgmt. Inc.	2.70%	7.61	15.83%
	Winchester Futures, Olympia Star Series*	Multiple managers	5.24%	301	13.58%
	Green Way Ltd. Class A USD*	Multiple managers	2.43%	25732	13.39%
	Green Way Investment Ltd. (Ecu)*	Multiple managers	2.27%	1849	11.65%
	Admiral Fund Inc.	Dunn Capital; Crow; Coquest	-5.38%	5359	11.32%
BOTTOM	Tactical Futures Fund II	Tactical; David Druz**	-18.77%	8406	-39.10%
	Tactical Commodity Fund	Tactical; David Druz**	-18.38%	23833	-38.05%
	Tactical Highly Aggressive Commodity Fund Ltd.	Tactical; David Druz**	-17.06%	28.34	-37.45%
	LPS Portfolio International AA (Ord) Shares*	London Portfolio Services	-1.26%	10.2	-33.07%
	Sjö Global Fund Ltd. (B)*	Sjö Inc.	-5.09%	1640	-26.79%
	Mint Limited-Ord.*	Mint Investment Mgmt.	9.67%	37.33	-23.00%
	Mint Ltd. Income*	Mint Investment Mgmt.	9.67%	11	-22.97%
	PB International Futures Fund B	John W. Henry	-3.19%	11.84	-21.74%
	World Monitor Trust A	Eagle Trading Systems	-3.75%	77	-21.43%
	Shearson Select Advisors	John W. Henry	-2.85%	2216	-21.05%

\* Non-U.S. fund \*\* Tactical ceased trading these funds in October 1999

## KEN JAKUBZAK

### KMJ: Ready for anything

The discipline to abandon the familiar for something more efficient, many say, is the only way to succeed in today's unpredictable markets. In 1994, Ken Jakubzak, president of KMJ Capital in Crystal Lake, Ill., recognized that the long-term trend-following system he first began to develop with Craig Soderquist in 1980 was no longer effective.

Jakubzak needed a system that got in and out of the market at the optimal time, giving him the ability to take profits quickly. He says the short- to medium-term strategy he adopted is more effective in his currency and financial programs.

"A strategy in an investment program has to be comfortable for the trader," Jakubzak says. "If you're not comfortable, then it's not going to work for you."

While similar to the financial program, Jakubzak describes KMJ's currency program as "an integrated technical and discretionary system...a trend-following system of buying strength and selling weakness. I look at pattern recognition — trends, contratrends and key reversals — in terms of price breakouts."

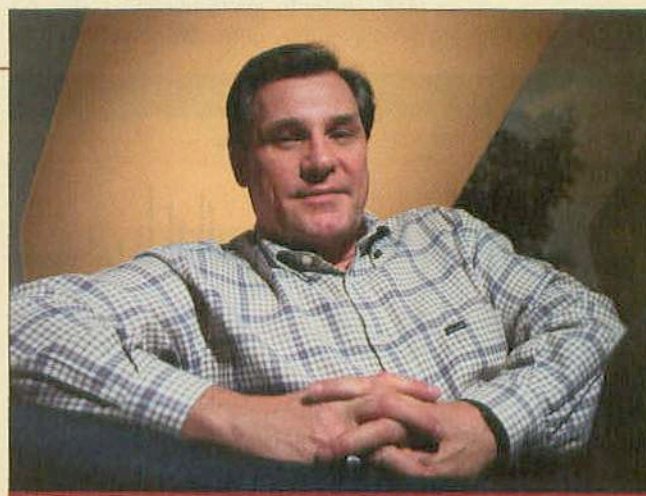
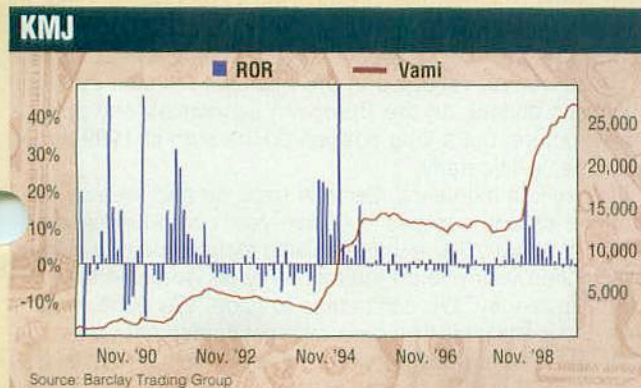


PHOTO BY MICHAEL A. MARCOTTE

Jakubzak also studies macroeconomics, including the G-7.

Once a trade signal is generated, position size is adjusted based on time price, volatility and the risk/reward factor. The signal is reinforced by discretionary overlays, but he takes on a trade only if both the technical and discretionary elements are positive. With a 60.73% return in 1999 for the currency program, and a 52.28% return for the financial program, everything seems positive for KMJ.

Jakubzak credits much of his success to his late friend, Soderquist. "We always felt there was enough for everybody," he explains. "Everybody should have a piece of the pie because there's a lot of pie out there." While he no longer follows the long-term system outlined 20 years ago, he says he simply expanded on the basics of that initial program.

Jakubzak says his ability to adapt to the market resulted in his spectacular 1999. "Markets just don't go on to infinity," he says. "They go to a certain level where supply and demand meet, and then they correct themselves. It's easy for me to adjust to these situations. I can put a stop in to protect profit, or put a stop in for a new trade and reduce the risk of loss."

FM



## NEIL BERMAN

### Leaving his options open

Nearly 20 years ago, Neil Berman, president of Bernex Capital Management in Miami, was buying stocks and selling covered calls and puts. Looking for a change, Berman decided to start selling out-of-the-money options on stock index futures in the late 1980s because he could take on a position in the underlying if his short options were assigned.

Today, Berman's trading philosophy is based on his number one maxim: Try not to lose any money. While he certainly is setting no precedent with that goal, Berman says too many traders focus on making money rather than not losing money. But, he continues, if your main goal is to avoid losing money, making money only is the next logical step.

"The rest really improves on that initial goal," Berman says. "As long as I can sell options every month, I can hold the principle and keep taking in income."

Berman also serves as president of the Miami-based law firm, Berman, Wolfe & Rennert. He says the difference between practicing law and trading professionally is, as a lawyer, there are so many ways to make mistakes. But, he says, the markets are simple — they generally go either up or

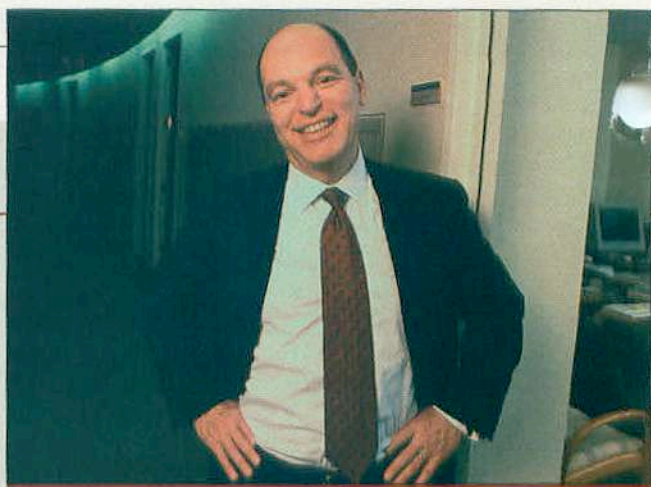


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down. And although there are periods of extreme valuation, Berman says he rarely sees fluctuations much more than 30%.

"On a monthly basis, it's about 3% to 4%," he says. "That's an extreme fluctuation, on average."

Based on this calculation, Berman sells calls and puts at 4% to 5% out-of-the-market. And if the market breaks against him, he will roll diagonally in the direction of the move.

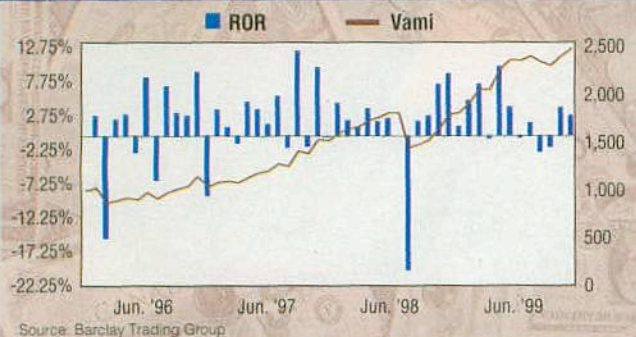
"Let's say the S&P is trading at 1417 and that this was the start of an options cycle," he says. "It goes down 70 points, so we'd sell the 1350 puts." If, by the end of the February cycle, the S&P was lower than 1350, Berman would be assigned the options. "I'll either be long the futures or I'm going to have to bail out of those options. From where will I get the money to buy back my 1350 puts that are in trouble? By selling the March."

Berman could pay off the cost of closing the February puts selling the March at 1350, plus time premium, or he could try to break even by going down to the 1320 puts. "Sooner or later the market will stop dropping. In the meantime, I've made all the money from the calls the first time around, and the next month I'm going to be selling the calls as well." Based on that philosophy, he can constantly roll from one month to the next.

Despite the success he has enjoyed with his options strategy (a 1999 return of 37.99%), Berman is aware of the negative public perception options endure. He says many people will tell you they've lost money buying options. "But you've got to step back and realize that, while they're saying they lost money in options, they're also saying they bought options. Who's making all the money they lost? It's the guy selling them."

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### Bernex



### Red Oak (continued)

► demand balances in the commodities.

"We try to elevate our analysis above the 'noise' of the marketplace in the short-term sense," Gerstein says. He often will hold individual positions for extended periods of time, sometimes as long as three years. "Our job here is to make money, not to have activity."

Gerstein believes his advantage over other traders begins with the fact that Red Oak's commissions-to-equity ratio runs roughly 1.5% per year while some of the competition will have ratios as high as 6% annually. He will look at the cost of carrying a position when making decisions, and also harbors a strong bias to holding positions where, if the underlying cash price remains firm, the futures has a positive rate of return.

"When we look at the composition of our positions, we like to have a positive imputed rate of return," Gerstein says. "It's very comforting to go to sleep at night and know that, if nothing happens overnight, when you wake up in the morning someone's put money in your pocket."

Gerstein says the fact that he follows a fundamental approach, as opposed to a systematic, trend-following one, is the main reason Red Oak enjoyed a 1999 return of 77.40%, adding that his major fundamental positions last year were reasonably correct. Red Oak saw success by being long the Nikkei and industrial commodities, a decision spurred by the economic recovery that Gerstein saw in Asia but was not yet reflected in the markets. He also holds an optimistic outlook on the European economies and political infrastructure, but a long position on the euro in 1999 turned out to be "a little early."

Throughout the years, Gerstein says, he and Weaver have attained steady success — a five-year compound average return of about 20% — by remaining focused on one primary goal: "Keep your eye on the ball. Why do we come to work? To make money. We don't come to trade. We don't come to relieve our anxieties," he says. "We get paid to earn a reasonable rate of return on people's money, which we have done consistently for a long period of time."

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