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Tom Shanks: Former turtle' winning race the hard way

Tom Shanks studies the crude oil chart on a screen in his office at his home overlooking the Sonoma Valley in Santa Rosa, Calif. It's late October, and Saddam Hussein's dreams have caused market upheavals.

Momentum is falling and Shanks -- out of energy due to volatility -- says he wants to sell crude. His discipline says no. Shanks and his former teacher, Richard J. Dennis, never found evidence that momentum was a valid indicator. "One thing Richard always taught us was do the hard thing," he says. He steps back from the trade.

Shanks, a former Dennis "turtle," researcher, blackjack player and American College of Switzerland graduate, heads Hawksbill Capital Management. Hawksbill is a type of sea turtle. But unlike a real turtle, Shanks is fast: In a business growing more risk adverse, Shanks is willing to pull the trigger.

"I'm somewhat aggressive, but not out of line," he says. "I'm less risk adverse than a lot of people. It also reflects a very high confidence in what we're doing."

Maybe that's why he'll leverage up to 70% margin to equity.

"But we won't get in a position like that without substantial profits," he says. "And I certainly wouldn't take on a large position if I was even on the year. I'd be a lot more conservative."

In a year when most former Dennis proteges are posting stellar numbers, Shanks tops the list -- a 260% return through November. He manages $ 40 million.

"The best thing I got (from Dennis & Co.), aside from, obviously, the systems and psychology, was their sense of the importance of statistics and how careful one had to be in drawing conclusions from research, how easily one could be led astray from drawing conclusions from research," Shanks says.

The Dennis structure is deeply ingrained in Shanks' trading. He traded under Dennis 3 1/2 years, ending in 1988. The last several months ended with a 47% drawdown -- but only after two years of 100%-plus returns.

Shanks resumed trading in late 1988. His first full year of managing money, 1989, ended with a 55% return. But it was a roller coaster ride. He was up some 40%, only to have a 55% drawdown over four months. He rallied the last two months with returns over 110%.

This year has been kinder. The largest monthly drawdown -- almost 11% -- was in May.

"Nothing has changed significantly (between 1989 and 1990), it's just basically the markets," especially for trend followers, he explains. "You have to expect drawdowns, and sometimes you have to expect drawdowns from standing starts. This might be the second year out of five that I didn't get stuck with 20%-30% (drop) right out of the shoot. It happens, and you get more conservative . . . you wait until the markets come around, because they will. I'm absolutely confident they will. There's a lot of talk that the trend follower is dead ...but I don't believe it."

He says his system is 95% Dennis' system and the rest his "own flair."

"I'm a long way from someone who follows the system mechanically," he says, "but by far, the structure of what I do is based on Richard's systems, and certainly, philosophically, everything I do in terms of trading is based on what I learned from Richard."

Some of those lessons on risk control include trading in proportion to the bankroll and diversification (he trades 24 commodities).

He's closemouthed about other Dennis risk management lessons (a sort of turtlesque oath) but says they have a set amount they will risk on any position.

"We know from the outset exactly where we're going to get out in the worst case," he says. "Frequently when a position takes off, you build in substantial profits, to the extent that you put those profits to risk. Your stops don't move up as fast as your profits do. As your profits grow, the risk of giving them back grows too."

Why not take them faster?

"I've seen over and over again in research that if you try to take profits too quickly, it just kills you. It upsets your system expectation," he says. "It's the natural thing to do. Richard taught us that the inclinations that come naturally are almost always wrong."

For example, the adage of cut your losses and let your profits run is counterintuitive, he says.

"I still to this day don't do the hard thing nearly as much as I should," he adds. "It's too hard."

PHOTO : Former Richard Dennis follower **Tom Shanks** says a key lesson is to do the hard thing.

GRAPHIC: Portrait; **Tom Shanks.** (portrait)

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