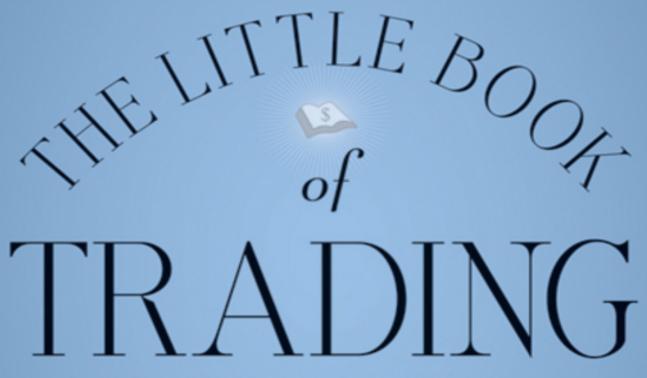
"The Little Book of Trading reveals the secrets of trend following insiders, giving you the freedom to trade all markets: interest rates, copper, currencies, stocks—you name it! Covel encourages you to take that TV blaring CNBC and throw it right out the window. Charts cut the noise."

-Addison Wiggin

bestselling author of The Demise of the Dollar; Executive Publisher, Agora Financial, LLC



Trend Following Strategy for Big Winnings

MICHAEL W. COVEL

bestselling author of Trend Following and The Complete TurtleTrader

FOREWORD BY CULLEN O. ROCHE

Founder and CEO, Orsus Investments, LLC

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<u>Author Disclaimer</u> <u>Acknowledgments</u>

More Praise for

The Little Book of Trading

"I strongly feel that you have to have three things present to be a successful investor/ trader: 1) you have to have mental discipline and control, 2) you have to carefully control risk and deal with various forms of portfolio management, and 3) you have to have a buy/sell strategy. In *The Little Book of Trading*, Michael W. Covel does an excellent job addressing what makes trend following such a successful strategy over time in most markets."

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TRADING

Trend Following Strategy for Big Winnings

MICHAEL W. COVEL



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Capitalists and financiers—Case studies. 2. Investments.
 Investment analysis. I. Title.

HG4521.C815 2011 332.64—dc23 2011021445 This book is dedicated to my grandparents: Wesley Albert Kavaliauskas, Anna Lenore Margis, John Brooke Pruden, Jr., and Mary Margaret Wright

Introduction

A Wake-up Call

Ben Stein famously said, "If you didn't lose a lot of money during the Panic of 2008, you were probably doing something wrong." I heard those words and wanted to scream. His view could not be any farther from the truth. People made fortunes in 2008 with solid moneymaking strategies. The winners were not doing anything wrong, they just happened to have had the vision to prepare for the unexpected and when the big surprises unfolded—they cleaned up.

Investors have been conditioned for decades to believe that they cannot beat the market. They've been told to buy index funds and mutual funds, listen to CNBC, and trust the government. I have news for you. That does not work. We have all seen one market crash after another for the last decade. But the powers that be keep telling us that the old investing ways are the only way. Deep in our gut we know it's not true. Even if we don't know who the winners are, there are winners in the market, especially in the middle of a crash.

I am going to introduce you to a way of thinking, to a way of making money that is entirely different from what you have been taught. It varies vastly from what you have heard from the brokerage firms, the media, and the government.

First of all, you can leave *fundamental analysis* at the door. A lot of people are taught that fundamental analysis—knowing a company's financial statement backwards and forwards in order to know where to invest, and crunching numbers until you're blue in the face—is the cornerstone of investing. Well, you do not need to know how great the

demand will be for the next Apple iPad. You do not need to know how far gold will go up, or down, or why. The only variable to understand, so you can make money, is to know which way the market is trending, and if you are on board, up or down, you go in that direction.

This book is all about trend following trading. Maybe you've never heard of it. Trend following is real simple. Pretend you have no idea which way a market will go or for how long. Trend followers simply say that if Apple is trading at 300, and it starts to go higher, they will buy Apple. Why would you do this? If Apple is going up you want to be on board. Period. No one knows how high or low Apple may go, but if it goes from 300 to 400 you don't want to miss out—even if 300 feels like too high a price to buy in at. Buying low or cheap is not the goal.

The greatest thing about trend following is that you do not have to know anything about oil. You don't have to know supply and demand for next week or next year. Trend followers don't care. If the market is going up—you buy. After you buy, if it goes the other way and you start to lose money—you get out. How do you know to get out? Trend followers abide by certain universal and timeless rules that go way back. One major rule is accepting when you are wrong in the market and getting out. You need to be willing to lose a small amount of money if the trend does not go your way. The key to keeping that loss as small as possible is admitting defeat. This is how you preserve capital.

Let me break it down. Let's look at Apple again. Assume it is at 300. It goes to 310 and you buy. You hope it will go to 400, but you don't know if it will. So when you buy Apple at 300 you say to yourself, "I am only willing to lose 5 percent of my money" (just an example to bring you in). If you have \$100,000 and invest all of it in Apple, then you are willing to lose \$5,000 while hoping the trend will go to 400. If Apple starts to go down and you lose \$5,000, you get out. That's