

"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

THE LITTLE BOOK

of
TRADING

*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

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.”

—Tom Basso, Former President and Founder of Trendstat
Capital Management and author of *Panic-Proof Investing:
Lessons in Profitable Investing from a Market Wizard*

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—Addison Wiggin, Bestselling author of
The Demise of the Dollar; Executive Publisher,
Agora Financial, LLC

“If you're in search of the big returns, buy and hold style indexing isn't going to cut it. In *The Little Book of Trading*, Covel profiles the managers that not only survived the GFC, they made fortunes on it.”

—Mebane T. Faber, Founder and Chief Investment Officer,
Cambria Investment Management

“In today's global financial climate, where both stocks and bonds always sit at potentially very dangerous turning points, successful wealth management intent on 'real, not relative' returns requires a tactical trend following posture to asset

classes. This may be best achieved with the inclusion of a healthy allocation of managed futures. Covell nails it.”

—Arthur T. Doglione, Founder and President,
Alpha Fiduciary, Inc., Phoenix, AZ

“In *The Little Book of Trading*, Michael Covell has collected many gems of wisdom from some of the great traders of our time. After reading this book and icing together all of the commonalities therein, you'll begin to understand what it takes to be successful in the markets. Ignore these key truths and, one day, you'll watch your account disappear.”

—Van K. Tharp, PhD, President, The Van Tharp Institute

“Michael Covell is an expert in the field of trend following. His *Little Book of Trading* is an inside look at why top professional traders and fund managers are hugely successful. Highly recommended.”

—Mark Melin, author, *High Performance Managed Futures*
(Wiley, 2010); Editor, Opalesque Futures Intelligence

“Michael Covell's unique insight into trading is invaluable. Both novice and experienced traders can benefit from Michael's thorough knowledge of markets around the globe. *The Little Book of Trading* is a must-read for serious investors.”

—Louis G. Navellier, Chairman and founder,
Navellier & Associates, Inc.

“Imagine being in the circle of trust of some of the greatest traders of all time, knowing what made them successful and having them share heartfelt advice. Through the eyes of Michael Covell in *The Little Book of Trading*, you will truly feel this experience.”

—Murray A. Ruggiero Jr., Contributing Editor, *Futures Magazine*;
VP, Research and Development, TradersStudio Inc.

THE LITTLE BOOK

OF
TRADING

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In the *Little Book Big Profits* series, the brightest icons in the financial world write on topics that range from tried-and-true investment strategies to tomorrow's new trends. Each book offers a unique perspective on investing, allowing the reader to pick and choose from the very best in investment advice today.

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THE LITTLE BOOK

OF
TRADING

*Trend Following Strategy
for Big Winnings*

MICHAEL W. COVEL



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*This book is dedicated to my grandparents:
Wesley Albert Kavaliauskas, Anna Lenore Margis,
John Brooke Pruden, Jr., and Mary Margaret Wright.*

Contents

Introduction: A Wake-Up Call	xiii
Foreword	xxiii
<i>Cole Wilcox</i>	
Foreword	xxxiii
<i>Cullen O. Roche</i>	
Chapter One	
Stick to Your Knitting	1
<i>Gary Davis, Jack Forrest, and Rick Slaughter</i>	
Chapter Two	
Someone's Gotta Lose for You to Win	21
<i>David Druz</i>	

Chapter Three

No Guts, No Glory 37

Paul Mulvaney

Chapter Four

In a Land Far, Far Away from Wall Street 53

Kevin Bruce

Chapter Five

Think Like a Poker Player and Play the Odds 65

Larry Hite

Chapter Six

Stand Up, Dust Yourself Off,
and Keep Going 83

David Harding

Chapter Seven

Throw Away the Fundamentals and Stick
to Your Charts 103

Bernard Drury

Chapter Eight

Study Hard and Get an A+ 117

Justin Vandergrift

Chapter Nine

You Can't Know Everything 131

Eric Crittenden and Cole Wilcox

Chapter Ten

Make It Work Across All Markets 147

Michael Clarke

Chapter Eleven

Stay in the Moment of Right Now 163

Charles Faulkner

Chapter Twelve

Sing the Whipsaw Song 181

Appendix A: Getting Technical: What is

Capitalism Distribution? 187

Appendix B: Fund Performance Data	193
Glossary of Key Terms	201
Author Disclaimer	207
Acknowledgments	209

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 past 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 it. That is trend following in a nutshell. If it doesn't go down, and you don't lose \$5,000, you stay along for the ride for as long as it goes.

Another wrinkle to trend following? Not only can you make money when markets go up, you can make money when markets go down. You can go "short" when the trend is down, profiting for as long as markets remain in that direction. This means you can make the same amount of money when Google goes from 600 to 700 as when it goes from 700 to 600.

It's not just stocks. Trend followers apply their "know nothing about a market" to currencies, commodities, bonds, gold, oil—you name it. You do not have to know the name of the market to trade it. Trend traders only care which way the market price is moving so they can get on the train. Or think of yourself as a stowaway on a cruise ship to the islands. Why do you care how the ship gets there? You are already on board. Let someone else worry about the particulars of navigating the ship. Do the top traders really think and act like this? You bet.

Not only did trend following traders make money in 2008, but they've been making it big for decades. Why have most people not heard of this great alternate trading strategy that makes money in bull and bear markets?

Why are people not familiar with this moneymaking strategy that performs well during chaos?

One answer: mutual funds.

We have become a world seduced by the idea that you can buy and hold a mutual fund for a lifetime, rewarding you with a huge nest egg when retirement sets in. The vast majority of investors have been sold that pipe dream by the mutual funds themselves. And, they hire serious lobbyists in Washington, D.C. Do you really believe mutual funds are a good idea after a decade of no returns, while simultaneously the owners of mutual funds have made billions?

Let's not dwell there, though, since this book doesn't waste much time on bashing the competition. This book is about showing and proving that there *is* a way you can still take your legitimate shot at making the big money. I am going to introduce you to the strategy of trading trends the best way I know how: through the insights of some of the most successful trend following traders alive. Why should you care about these traders?

For one, they are real people performing real trades. They are not CNBC talking heads. They are not academics. They are not politicians. They do not make predictions. They do not make outlandish claims. They simply make money. How do you know for sure they make

money? How do you know they are real? Their audited track records are on file with the United States government (and in Appendix B).

Still asking why this is all relevant to you and your account? I have been teaching, writing, and researching this subject since 1996. The number one reason people fail to adopt trend following trading, or fail to understand it, comes down to education—more specifically, the lack of it.

I have learned that when you expose people to the subject of trend following, introducing readers and students to real winning traders furthers the learning curve by leaps and bounds. Not the shiny PR bios, but real behind-the-scenes life stories and strategies. If you can go behind the curtain of the greats and even a few newer traders, if you can relate to their upbringing and values, if you can relate to their struggles, you are going to be in a much better position to grasp and utilize trend following strategies for your own account. Better yet, by allowing yourself to *feel* their lives, you will also begin to see that they all have much in common with all of us.

~ ~ ~

**Trading is mental. Doubt me? Want to
go some other direction instead? You
will be broke in no time.**

Bottom line: I go looking for answers where most people can't or don't know how to go. Digging for trend following trading lessons is my lifeblood.

Plenty of people write books telling you that they know what will happen tomorrow. Do you really want to bet on the words of people who say they know what will happen tomorrow? Doesn't that just feel like a roll of the dice at the craps tables?

Exactly. It is nonsense.

However, I do not want you to take my word. I am going to take you on a trading journey. This journey will have you meeting and learning from 14 traders, all with a similar point of view and trend trading philosophy. These men have literally pulled in billions of profit from the market for decades. They are true trading winners who have shared with me their lessons to money-making success. In turn, I am sharing their wisdom with you.

What are the most common threads among these men and their successes? They were all self-starters not born with silver spoons. They did not start with inheritances (but you could have). They figured out how to win, when everyone said they'd lose. They never quit. As diverse as their stories are, they all make up an inspirational foundation you can use to start making a fortune over the course of your lifetime.

Last, and this is important, the lessons that you will learn in this book, the lessons that I will pass along to you, the lessons that these top traders will pass along to you, are rare. These men do not offer extensive insights to the general public. They have trusted me to present the moneymaking story of trend following, and their paths to it, accurately.

I am going to keep the details of the traders' successes out of the chapters to a great extent, and let their trading wisdom shine. But please be aware that these traders are the best of the breed. Many of these men started with nothing and turned nothing into gold. Consider a few details about some of the trading teachers you'll meet:

- **Gary Davis, Jack Forrest, and Rick Slaughter** run Sunrise Capital Partners. Their continuous trend following track record extends for 30-plus years.
- **David Harding**, through his firm Winton Capital, has a continuous track record for 20-plus years. Harding has generated a fortune of nearly \$1 billion.
- **David Druz** saw his trading account dip to \$1,500 30 years ago. Today, his continuous

track record since 1981 has allowed Druz to make millions, trading comfortably from his office in Hawaii.

- **Kevin Bruce**, who started with \$5,000, amassed a fortune of \$100 million trading trends over 20-plus years.
- **Paul Mulvaney**, who has a 10-year track record as a trend following trader, gained over 40 percent in the month of October 2008. Yes, the craziest month of the past 30 years, and he killed it.

This is not a complete list. It is a taste to let you see that you are learning from top winners, not anonymous Internet chat room characters pushing the typical news of the day. Carefully explore the chapters to come. I promise you will be surprised and intrigued at the lessons within.

New Edition Note: As the reprint of *The Little Book of Trading* was underway, Cole Wilcox of Longboard Asset Management (Chapter 9) volunteered to contribute a second Foreword. His trend following comments and stories add a valuable new perspective. Ignore his wisdom at your profit peril!

Foreword



Cole Wilcox

TREND FOLLOWING, IN SIMPLEST TERMS, IS ABOUT INVESTING in positions that work, liquidating what doesn't, and managing your risk to survive over the long term and ultimately to thrive. If that sounds like what every investor *ought* to be doing, you're right. But in practice, it's as different from conventional behaviors as anything you can imagine. Trend following really isn't following the crowd. It actually goes against the trading patterns practiced by the majority of the market. And therein lies the opportunity.

Where are the above-average returns, and what is the most sensible, reliable way to access them? These are