TRADER'S STORY

Nick Radge fell into trading by accident, but now he wouldn't have things any other way.

YTE: How did you get into trading?

Nick Radge: By accident! I was an average student at high school and didn't go to university. When I left school my goal was to work in an office building, wear a suit and carry a briefcase. A psychologist would have enjoyed that one. I guess I failed miserably – today I work from a home office and rarely wear shoes.

When I left school a family friend offered me a clerical job at Potter Partners which, back in 1985, was one of Australia's blue-chip stock broking firms. It ticked all the boxes for me – office building, suit and I could carry a briefcase, even if it was empty. One day I strolled through the private client advisory section and an advisor was drawing on chart paper. It caught my attention so I asked what he was doing. He was plotting a 5 day and 10 day moving average crossover system on the Share Price Index futures. I could see the trends and it just looked so easy; buy when the blue line crossed up over the red and sell on the reverse. That day I went down to Penfolds Stationery, picked up coloured markers and chart paper and started plotting. Within a week I approached the office manager, a wily old guy who had seen it all, and asked him if I could start trading the SPI. From memory there was a wry smile and an amused shake of the head. I was 19 years old, earning $12,000 a year and wanting to punt on a futures contract which, back then, was $100 a tick. He allowed me to proceed so long as he signed the ticket before I called the order down to the floor. That was the full extent of my trading knowledge - a blue and red line. No risk management, no position sizing, nothing.

I was fascinated by trading and spent as much time on it as I could even though I was pushing paper as a career. In my lunch hour I would watch the ASX and SFE trading floors from the gallery. I flicked through various trading books in the library. I loved the excitement of it all – and everyone was wearing a suit!

In hindsight I was quite lucky to learn to trade back then. Today there is too much information and empty promises being made. New traders suffer from information overload.

What do you trade, for example, shares, indexes or currencies, and why?

I left Potter Partners after a year and started working for a large commodity broker on the floor of the Sydney Futures Exchange and then moved onto global dealing desks in Sydney, London and Singapore. So for the first 17 years I mainly traded global commodities. I was heavily influenced by The Turtles and Curtis Arnold who were all trading futures so that's where I focused. I did do some minor equities trading but it was peripheral. In 2001 I realised that managing money in equities was a lot easier than in commodities and leverage was becoming more accessible with margin lending and CFDs so I made the switch. I was lucky enough to be able to convert some of my strategies across to equities with ease. Although I still follow various commodity markets, today I only trade equities across three portfolios both in Australia and in the US. Everything I do today is 100% systematic and the US trading is fully automated.

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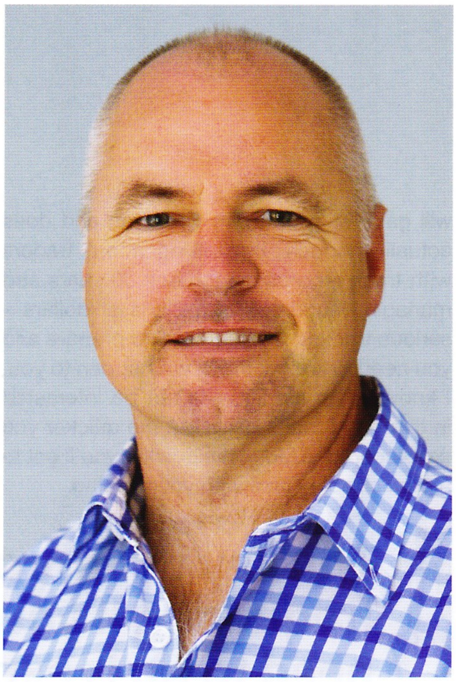
I find trading various strategies helps smooth the equity curve. For example I mainly trade the ASX Small Ordinaries which have basically been going sideways for a few years. That would be frustrating if it were my only exposure, but the US portfolio is going very strongly and helps diversify. Both strategies have long-term positive expectancies, but they can go through drawdowns and flat periods on occasion so blending strategies helps get through the tough times.

What were some of the mistakes you made when you started out?

Where to start! I think my biggest regret was diverging from my strategies and tossing discipline out the window. I become impatient or tried to keep up with other people, which usually ended in disaster. One of my largest single losses came from a tip from a well trusted friend. He knew nothing about trading or the markets yet he was getting lucky on some small caps so I just had to get involved. It was nothing more than a greedy punt so I deserved exactly what I got. It's human nature to think there is something better just around the corner so one tends to wander off course and try different things. I call this the Beginners Cycle and it is the key reason why so many people feel compelled to accumulate trading books, attend high priced seminars or buy expensive software. Obviously today with so much on offer from all sorts of vendors, it becomes even more difficult to stay on track. I think it's important to understand how and why profitability occurs, specifically knowing you have a positive expectancy. Once you have that light-bulb moment you can remove all other noise and distractions and just get on with the job of trading.



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What are some of your golden rules?

Continual research has always been a core part of my life. I have spent 27 years doing this and a significant part of that has been researching trading ideas and concepts. Back in the early '90s I spent two hours a day, seven days a week for 18 months researching a strategy. I didn't place a single trade until I had learned everything I could and it really paid off. It seems these days most people just want to get trading without doing any work or gaining any insights as to why their method will or won't work.

The three core traits I stand by are: Find something that works; 2. Validate it; 3. Do it.

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Most people miss #2 and therefore spend their lives going from #1 to #3 and back again. Correct trading is not gambling. Those that suggest it is simply do not grasp what is required to become successful. Successful trading is pure mathematics. From there it becomes a mind game.

What's the number one thing traders can do to improve their performance?

I guess we need to look at this from two angles: new traders, and established traders. Let me discuss new traders first.

Obviously there are the old adages, such as have a plan, but these will not make you successful. They will get you started but you need to move beyond these quantitative traits and start considering the qualitative requirements.

For example, most new traders assume successful trading is about making money every day, every week, every month and every year, yet nothing is further from the truth. There are many great traders, past and present, who lose constantly. It's a hard pill to swallow but they have losing trades, losing days, losing weeks, losing months and yes, losing years. Warren Buffet has had a -35% year. Every great trader I have studied has had a difficult period to overcome. But what makes them different from the amateur trader is that they accept this as part of the journey. They don't blink. They don't change strategy at the first bump in the road. A professional trader understands why they make money, which is by having an edge, and the only way they can fail is to stop creating that edge or stop what they're doing. So when things get tough, and they will, they push through. An amateur on the other hand will change strategy, buy a new book, attend another seminar or buy some new software in the hope that they'll become a more profitable trader. This is the Beginners Cycle.

Obviously having a strategy with a positive expectancy is the starting point, but plenty of people have access to positive expectancy strategies yet still fail. They fail because they can't trade the strategy, or can't commit to it long enough for it to do what it's designed to do. In 2008 as the GFC started taking hold we were having a bumper year. In the first three months of the year we made great returns but then went into drawdown for a month or so – around 11%. I received a call from a client saying he couldn't take the pain. He stopped trading whilst we finished 2008 with a +174% gain and the client sat on the fence and missed out. The point was that he should never have been in that position where the pain became too great that he had to stop. His risk was too high for his own comfort level. The key factor is not the return but the ability to stay with the strategy so that the longer term results can be achieved. There is no point having a strategy that makes 100% returns when you need to endure so much pain that you can't sleep or function properly. Drawdown is one example. Spinning the wheels is the same. Placing trades and making no headway. Imagine placing new trades every day, every week, every month and having a losing year. Well, it happens and it happens to all great traders. The average retail trader struggles with a single losing month so the thought of having a losing year is simply not even on the radar.

These issues are qualitative in nature. They can't be taught. They need to be experienced and no weekend warrior course will prepare you for these (actually – you won't be told these things because it doesn't bode well for ticket sales). But if you study the long term track records of the world's best, and they are freely available, then you will gain an insight into what can and does actually happen. I'm talking about traders with track records going back 30 years and managing hundreds of millions of dollars – serious traders. So you need to prepare and you need to accept that it will happen to you. I know some readers will not be interested in this - and that's okay, but the quicker you can accept the facts, the quicker you'll get to a comfortable place with your trading.

a year. By reducing the hold time to three days and doubling the number of trades, the strategy becomes profitable in 83% of all months up from 63% and drawdown is reduced from 18% to approximately 13%. A by-product is a decline in exposure to the market, specifically we're only spending 15% of our capital to generate the returns. This may not seem important, but it allows other strategies to be used.

its wonders. Initially it's not about making millions each year. There is no secret and it's not something that you need to pay $25,000 for. It's about taking control, building your wealth slowly but surely and doing it safely.

Let me use a golfing analogy. I played in a pro-am many years ago – three amateurs play a round with a professional. The pro I teamed up with shot 5 under par and was truly spectacular to watch. But here's the thing – he travels around NSW and Victoria playing in these penny dreadful pro-am's looking to win $500 to $2000 prize money. He didn't win with his spectacular score that day and he spends half the time sleeping in his car. Okay, he calls himself a Pro Golfer and maybe one day he'll get to the point of making a decent income from it, but what if it doesn't work out?

When it comes to trading, keep your day job and career. You simply don't need the undue stress and financial pressures that come from relying on trading for an income. I have seen first-hand what it does to people and there are some very unpleasant, extremely sad stories. I know a lot of professional traders and most spend hours glued to their screens – some even trade through the night. I can't think of anything more brain numbing than watching numbers tick over on a screen and doing so on your own. It's not glamorous and it can become addictive. What is also generally not known is that many full-time traders also operate other businesses – they do so because they're driven and have good business acumen. They also do so as

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The quantitative aspects of trading are easy and can be taught. But the qualitative side comes from experience and visceral learning. (You can find a 60 minute talk on this exact topic on Nick's YouTube Channel - "What Makes a Successful Trader").

For an experienced trader I think the key to improving performance is increasing trade frequency. If you have a mathematical edge then all you need to do is exploit that as often as possible. Think like the house at a Casino. The big Las Vegas Casino's have a small mathematical edge so their business is actually making people play the game so they can exploit that edge. They entice the crowd with big shows, free alcohol, discounted food and 24-hour access. In fact some casinos have replaced croupiers with computers for the simple reason that croupiers are too slow at dealing the cards and exchanging chips and money. A computer is quicker meaning more hands can be played in the same period and the edge exploited that little faster.

Increasing trade frequency can be done in a number of ways; lowering ones timeframe or expanding opportunity by trading more markets or strategies. The other benefit of increasing trade frequency is generating consistency and coming out of drawdowns a lot quicker. This is simply because your edge gets exploited more. We have a short term US strategy that has an average hold time of 7 days and does about 300 trades

So a strategy that does 700 trades a year with a small edge will tend to be a lot more consistent than one that does 50 trades a year with a larger edge. This is based on the simple premise that it exploits its edge a lot more. There is a reason why James Packer and the Las Vegas casinos have all that money…

Do you think the everyday person on the street has a chance (can they become successful traders)?

I absolutely believe that anyone can trade and make money, but I also strongly suggest that any aspirations of doing it for a living should be thrown out the window.

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The goal should be to grow your wealth over the longer term - beat the market, beat the fund managers and stay away from financial planners and full service stock brokers. In my opinion the easiest way to make this work is to follow trends. Pick up a book such as Unholy Grails, understand how and why trend trading creates a positive mathematical edge then put some of the strategies to work. Take a long term approach and allow compounding to work

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a hedge knowing that sometimes they could get in trouble financially. It's not good enough to turn a profit. You have living expenses to cover as well, families to support, etc.

Instead, allow the power of compounding to work your capital and focus on your career. The right strategy can take only minutes a day to implement. Then as you build your capital and get more comfortable expand into other strategies to become more consistent.

Have you traded for a company? What are the differences between trading for a company and trading for yourself?

I have only managed my own money and that of clients. I have never traded for a company or prop shop, although I have been approached by various prop companies over the years. I have a number of friends that trade for prop shops – some do extremely well and others just get by with earning a wage. Pure prop trading at banks these days is quite rare. Most bank 'traders' tend to be price makers rather than speculative positions takers. Any jobs in that area are tightly held and rarely offered to outsiders. I would say that in both cases there is significant stress - a bank or prop trader is still required to make a budget, either monthly or yearly, and if they fall out of sync with the market for any sustained period of time they can find themselves out of a job. One prop shop has new intakes all of the time but only 1% to 2% get accepted into the job. Trading limits are very small to start with and take time to grow. Traders with solid track records can eventually get up to an 80% profit split, but even so the pressure remains to stay consistent.

Finally, what's trading all about? To ask in another way, what's core to a trader's success?

Good question. I think successful traders look at it more as a passion than as a financial need. It's the passion that keeps them interested and enables them to disconnect from the financial side. Constantly looking at your account balance creates too much pressure and forces errors. Most successful traders are process driven – they've done it a long time and they grew up in the industry or close by. They have their routines and it is not a 'sexy' career like you see in the ads. To me it's been a lifelong passion and interest. Psychologically it's very challenging – like a big puzzle. I enjoy the research side and then putting those ideas to work and seeing the results unfold. Sometimes it takes time to see the desired outcome materialize, but even then you need to keep working at it and not rest on your laurels. I can't think of anything better to do but I know there is more to life than trading and it's important to keep a balance and not become obsessed.

Nick Radge *is a professional trader, educator and author who has been trading since 1985. You can find out more at thechartist.com.au*