From *Trading Chicago Style: Secrets of Today's Top Traders*, by Neal Weintraub.

Interview With C.V.
"Why You Don't Need Real Time Quotes"

C.V. is a real trader. We agreed not to use his real name. He does not want the publicity nor frankly does he need it. He makes his living trading. I have three years of his trades. All are real time trades. I first talked with C.V. when he lived in Washington D.C. I saw his account statements and tried to urge him to trade a fund. Today he lives in upstate New York overlooking a quiet lake in an historical home (circa: 1830) that he and his wife are renovating. You will not find C.V. on any news group. Want to really meet a trader who trades from home and makes a living at it? Here is a rare opportunity.

Neal: When did you first get interested in trading?
C.V.: At about the age of 28. I recall reading an article on futures trading in the Wall Street Journal; in fact there were a series of articles about a number of financial professions. At the time I was a young lawyer with a wife and two children to support. So I knew that was not the time, but it was something I always wanted to do.

Neal: So you are in reality a full time futures trader?
C.V.: Yes.

Neal: You must get some interesting reactions from people here in Washington?
C.V.: It's not a common profession. Most people consider it extremely risky. When I told friends and colleagues I was retiring from my law practice to become a futures trader, many were aghast.

Neal: What I find so fascinating, is that we are conducting an interview, while you have fifty Deutchemark positions on. Each tick represents about $600.00.
C.V.: My trades are long term trends. I don't follow the markets tick by tick.

Neal: As I look around your office I don't see a television with 24-hour news. I don't even see a price screen.
C.V.: I basically use the Internet to get price quotes.

Neal: Many of the quotes are delayed ten minutes or more.
C.V.: True, but when I need a real time quote, such as right after a major report I can get it through a dial-up service.

Neal: You must have a lot of confidence in your trading system.
C.V.: Yes, I do.

Neal: What is the basis of your system?
C.V.: I use a breakout system as the basis for my trading, but the key to the system is based on money management.

Neal: What is the actual name of the software?
C.V.: I use a software program called Trading Recipes. It allows me to write my own systems and to test an entire portfolio of commodities and futures rather than one at a time. It also allows me to determine how much risk I should run by testing the relationship between trade size, return and drawdown.

Neal: You don't hear too much about Trading Recipes.
C.V.: That's because they don't do a whole lot of promotion and Bob Spear, the guy who developed it, now trades a multimillion-dollar commodity fund.

Neal: You are one of the few traders that have allowed me to analyze your statements for the past three years and I can tell the readers that you have averaged about 30-40 percent a year.
C.V.: That's about right. I consider myself very fortunate.

Neal: Recently, you did a presentation for an investment group. As you know I modified it and called it tickle me.
C.V.: Yes, I recall that.

Neal: I think our readers would benefit from this simple system.
C.V.: Recently I prepared a report on a simple intermediate term breakout system for my local trading group. The focus of the report was the importance of risk management in following a trading plan, but the system itself based on historical testing appeared to be tradable. The report is reproduced below.

Risk V. Return

- Trading offers exceptional returns as well as a high degree of risk.
- Concentrate on managing the risk. The returns will take care of themselves.
- All technical analysis is based on a study of market history. The study should have a high degree of replicability in real time.
- To assure historical studies can be replicated, trade liquid primary markets. You need at least six or seven for diversification. The ten markets in my portfolio are ED, TY, US, DM, JY, CD, CL, NG, C, and CT.
- Trade a simple system with the same parameters for all markets. This protects against where a system works well on historical data and fails in real time.

Managing Risk

- Management of risk is achieved through proper sizing of each new position in terms of the system's risk profile and the risk-reward preference of the trader.
- The most important formula in trading is the Kelly formula. Kelly allows you to evaluate the amount of risk a system can absorb.

```
WP = Winning percentage
W/L = Avg Win/Avg Loss
Kelly = ((WP * W/L) - (1 - WP)) / W/L
Example: 50 -50 coin toss, win = 2, loss = 1
Kelly = ((.50*2) - (1-.50))/2=.25
```

Return is maximized by risking 25% of equity on each coin toss.
In comparing two systems with the same number of trades, the system with a higher Kelly can always produce a greater return at the same level of risk.

The Test 48 System

- I tested a 48-day breakout system with a 12 day trailing stop. Pinnacle Data Corp. continuous linked contracts were used for the period 1/10/91 to 6/30/96. I used my ten market portfolio and allowed $60 for commissions and slippage. Testing was performed with Trading Recipes Software.
- The test 48 system code consists of an entry stop and an exit stop.

```
Col1=Min[Low,12,] ; Col2=Max[High,12,1]
Col3=Max[High,48,1] ; Col4=Min[Low,48,1]
Trade entry:Buystop=Col3; Sellstop=Col4
Trade exit:Sellstop=Col1; Buystop=Col2
```

Test 48 and Kelly

- The system was run on an equalized risk basis to determine Kelly. Equalized risk means that a fixed dollar amount of risk is allocated to each new position so that for example a corn position will have the same initial dollar risk as a T-Bond position.
- Risk can be measured in different ways. I used the greater of margin and new risk, which is the difference between entry price and stop.

W&L	W%	W/L	Kelly
115 –159	42%	2.68	20.3%

Test Procedures and Results

- The test procedure was designed to establish the risk - reward profile for the system. I started with risk per trade (determined as set forth above) of 2% of equity, roughly 10% of Kelly. This was increased in steps to determine effects on return and drawdown. Risk was evaluated up to the turning point in the risk-reward curve, as shown in the following table. No new trade was taken if the existing risk in the portfolio (the difference between closing price of positions and stops) exceeded 50% of equity.

Test 48 Update

- The original test 48 runs were on 1/1/91 to 6/30/96 Pinnacle continuous contracts for C, CT, DM, CD, ED, TY, US, CL, JY and NG. Long and short entries are on 48-day highs and lows, and exit stops are trailing twelve-day lows and highs. $60 a contract is provided for commissions and slippage.
- A full year of out-of-sample data is now available. Test 48 was run with 6/30/97 data using the original parameters. The out-of-sample period shows a somewhat enhanced winning percentage and a lower average win to average loss ratio, resulting in a slightly lower Kelly. The risk-reward curves were calculated for the entire 1/91 to 6/97 period.

Basic Data:

	W&L	W%	W/L	KELLY
1/91 to 6/96	15 - 159	42.0%	2.68	20.3%
7/96 to 6/97	33 - 29	53.2%	1.38	19.4%

Risk-Reward Profiles:

	1/91 to 6/97		1/91 to 6/96	
Risk %EQ	**CAR**	**Drawdown**	**CAR**	**Drawdown**
2%	23.1%	16.5%	22.3%	15.2%
2.5%	29.7%	20.8%	29.7%	19.8%
3%	36%	25.1%	36.4%	23.8%
4%	48.2%	32.6%	51.1%	31.1%
5%	60.2%	39.5%	64.7%	39.0%
7.5%	91.3%	45.9%	100%	45.5%
10%	99.5%	60.2%	103.7%	52.6%
12.5%	126.3%	65.6%	90.2%	57.9%
15%	121.8%	73.0%	84.4%	62.5%

Neal: Could you explain the above table?

C.V.: The table shows the relationship between risk per trade which is a function of the number of contracts and stop, return (CAR, or compound annual return) and drawdown. Up to a point, increasing risk increases return, while also increasing drawdown.

When risk is increased past the system's ability to absorb it, return decreases while drawdown increases.

Neal: In reality, how much does this system make?
C.V.: The system traded on a conservative basis would probably produce a return in the 15% range.

Neal: You do use some common sense trading concepts, like trading into a report, etc.
C.V.: I've learned from experience that it is hard to quantify the effect of major reports in historical testing. Therefore I do not use an entry order on a big report day until after the report is out.

Neal: What is your definition of a trend up and trend down?
C.V.: A good simple definition of a trend is 12 consecutive closes above (or below) the trailing close from 24 days ago. The trend is then in effect and stays in effect until the close is below (or above) the trailing 24 day close.

Neal: Where are your real time quotes?
C.V.: As I mentioned, I don't use a tick by tick trading system.

Neal: In previous discussions, you talked about the book Market Wizards. Is there one particular chapter you found significant?
C.V.: The book was extremely interesting. The chapter on Ed Seykota I found of great interest. Seykota basically says, stick with the trend. There is no deep mystery about trading futures.

Neal: Where is your television? I mean where is CNBC and all that information technology?
C.V.: The markets are a better source of information on what is going to happen in the markets than any news media.

Neal: Would it be fair to describe your trading environment as Spartan? You have no quote monitor and no television.
C.V.: I would prefer the term focus. As I mentioned, I use the internet for my quotes. I find quote.com, which displays bar charts in any time frame from one minute to one month, to be very valuable. I rarely look at commodity news. Price already reflects what comes out in the news. One computer is dedicated to the internet, the other to historical testing and daily updates on my system.

Neal: What seminars do you attend?
CV.: I have not attended any seminars, although I have read a number of books on trading. Early on I decided I would develop my own systems. I started with simple analysis in my Quattro Pro spreadsheet which I still use.

Neal: In your estimate why do so many traders end up being net losers for the year?

C.V.: I saw a detailed study of approximately 100 traders. The information was supplied by their brokers. Only 5% of the traders were profitable. The principal reason for losses was that traders closed out their winning trades early and let their losses run. This is of course the reverse of the old maxim "cut your losses and let your profits run." Apart from this most traders have very little knowledge of money management.

Neal: So you don't believe in day trading?

C.V.: I think it's very hard to day trade. There is a lot of random movement within the day timeframe. There is a premium on speed, and its very hard to compete with the floor traders while sitting at a quote monitor.

Neal: Could you comment on Tom's interview on money management and system trading.

C.V.: It's a very sophisticated approach to money management. I think that many traders would find it difficult to sort out their trades to the extent Tom envisions. I use one basic breakout system with three variations; fast, medium and slow, by which I mean, a breakout range from 40 to 60 day highs and lows.

Neal: What have been the most important influences on your trading style?

C.V.: I mentioned the Seykota interview in Market Wizards. Another important influence was Ralph Vince, who has written three books on portfolio management and trade sizing. Vince's concept of sizing a trade, which he calls optimal F, is extremely aggressive. F is the proportion of equity you risk on each trade. Referring to the Test 48 studies, optimal F would be the peak of the curve for return, which coincides with extremely large drawdowns. However it is important to understand fully the concept of trade size - the only factor in trading which you have complete control of. I have learned a great deal from Vince's discussion of the relationship between risk and portfolio return. The risk-reward curve for any trader should in my opinion be based on the trader's tolerance of drawdown. I find I have a smaller tolerance for drawdown in percentage terms now that I am trading a larger account.

Neal: Anyone else?

C.V.: The software Bob Spear wrote, Trading Recipes, has played a crucial role in my becoming a professional trader. The ability to test an entire portfolio and see how my system worked on an historical basis gave me a great deal of confidence. Risk management is actually something you can program, as I've illustrated in the Test 48 paper. There is another important aspect to portfolio testing: it has some built in protection against curve fitting. I use the same systems to trade all the futures in my portfolio. I know that my systems aren't the best systems for T-bonds, or corn, or Deutchemarks, but because the systems have been tested against a ten future portfolio, I believe they are more robust. For example, T-Bonds have been in a long term uptrend for the last five years. If they were to go into a long term downtrend, a system based on just T-Bond data for the last five years might not be effective. My portfolio includes several futures such as crude oil and the yen which have had a pronounced downward trend over the last several years.

Neal: Have you ever used any of the more popular software, such as TradeStation or Metastock?

C.V.: No, I started using Quattro Pro. I felt it was better to learn the basics writing in fairly simple spreadsheet language. After a few years it became clear that I needed software to handle a portfolio.

Neal: What sort of correlation do you find between your historical testing and real time trading?

C.V.: I have found that invariably the return is lower, and drawdowns higher in real time. If historical testing shows a maximum drawdown of 20%, I expect to have a higher drawdown. The rule of thumb I use is that tested drawdown represents only 4 -5 standard deviations, and in real time you will quickly get to six standard deviations, so a 20% historical test drawdown could easily be 25 -30% in real time. The same principle works In reverse with historically tested return.

Neal: In 1997 you had an eight-month drawdown. How did you react to that?

C.V.: No trader likes a prolonged drawdown , but they are an inescapable problem with long term trend following systems. My historical testing had shown a longer drawdown of 9 -10 months, so I was mentally prepared for it.

Neal: Have you ever had a market make a limit move against your position?

C.V.: Yes and it's not a pleasant experience. Last summer I had a short position in corn. The market opened limit up on Monday morning through my stop. I am suspicious of Monday morning gap openings up, and I thought there was a good possibility that this was a move designed to shake out the shorts. I checked prices on my real time dial-up service every 10 minutes. My position was in the September contract. After about 20 minutes the December contract came off limit. At that point I knew I could lock in a straddle by buying December, but it seemed reasonable to wait for September to come off limit which it ultimately did. It came down a couple of pennies and held. When it started back up again, I got out of my position. The whole process seemed to take most of the trading day, but as I review my trading log, I see that I had completely liquidated my position within one and a half hours of the market open.

Neal: Do you have any advice for someone contemplating a career in trading?

C.V.: As is true in any profession, the best way to start is right out of college. Go to Chicago and learn about trading from the bottom up. Becoming a futures trader in mid life is more complicated because of financial obligations. You should cover any and all financial obligations with non trading funds. And what's very important is to take the time to learn and identify and trade trends. For the off the floor trader this is the most efficient method of trading. Don't try to day trade the S&P's. Do not buy a system; you are better off developing your own. Do not try to pick tops and bottoms. Finally, learn the basics of risk management. Remember, the size of your trade is totally within your control. Keep your risk small. A good rule of thumb is to limit risk to 2-3% of trading equity.

Neal: A number of people I have spoken to have stated they started trading futures because they did not have enough money to trade stocks. Surely you must have some advice for someone who has these ideas.

C.V.: If someone only has $5,000 available for trading, I do not think that person should be trading commodities. Using the risk per trade rule of thumb of 2%-3% of trading capital means that $100-150 would be risked per trade. Most people will risk more than that, and their trading capital will be depleted. If that person has a burning ambition to trade commodities, he or she should go to Chicago and get an entry level job in the business.

Neal: Do you always follow your system?

C.V.: Whenever I am in a trade I always follow my systems' exit signals. In fact if my system says get out tomorrow on the opening, I will many times get out during the night session. I allow a limited amount of discretion in taking a trade. As I mentioned, I will not put an order in to initiate a trade before a big report. Sometimes I wait for confirmation before entering a trade. For example if one of my systems is giving a signal to buy T-Bonds, but I have no other buy signal for T-Bonds or T-Notes, I'll wait for a second system to kick in before taking the trade. I will never take a trade which is not based on a tested system.

Neal: I noticed you failed to take a short position in corn this summer. Isn't that contrary to your system?

C.V.: For my breakout systems, avoiding a short corn position in the summer is statistically preferable. This would be true even adding 1998 to the database. The reason is that my trailing 12 day stop gets hammered by the "shake-the-shorts" rallies, such as the limit move I disclosed. My systems would have a positive 98 return which would not offset the prior years losses. To trade short corn in the summer requires a different type of stop strategy.

Neal: Even though you're a system trader, I noticed that in a recent trade you exited a position early before your trailing twelve-day stop was hit. Could you elaborate?

C.V.: I have found a trailing twelve-day high/low stop to be very effective trading intermediate length trends, which typically end with a consolidation period. Several years ago I realized that under special circumstances such as a blowout top the twelve-day stop left too much money on the table, or resulted in excessive volatility in my account. I therefore developed an analysis of circumstances where a combination of increasing (or decreasing) price plus increasing volatility made it likely that an extreme top (or bottom) was forming. Historical testing showed that it was possible to identify such circumstances often enough to make it worthwhile to incorporate an exit strategy based on the analysis into my systems. The objective is not to pick an exact top or bottom, but to exit prior to the excessive volatility that often accompanies market extremes.

Neal: Thanks Cy, for taking the time to do this interview.

Neal: If you look at the various steps in trading, order entry, money management, trade exit and choosing the correct market, how would you rank them in terms of performance?

C.V.: Choosing the markets to be traded is crucial. You must trade liquid markets to trade successfully. Such markets exhibit consistency over time. They are also less risky. An illiquid market such as orange juice can have limit moves for three or four days in a row. The only highly liquid market I do not trade is the S&P. There are two reasons for this: First I consider the stock market itself a vehicle for long term investment measured in years rather than speculation measured in months. Second, the S&P does not trade like any other liquid futures market. I find more correlation between the trading characteristics of Corn and T-bonds than between T-bonds and the S&P. Of course when I started trading the S&P margin was around $12000. Since I consider margin the minimum risk on a trade that meant that I should not trade the S&P, using a 3% risk criteria per trade, until I had approximately $400000 in my account. The e-mini S&P contract has reduced risk per contract to more manageable proportions. Even so, with a current margin requirement of approximately $3300 you would need over $100000 in your account to trade one e-mini contract.
Once the markets have been selected, there are three parameters to be considered: trade entry, trade exit, and risk management. Trading literature focuses to a large extent on trade entry. Pick up any issue of

Stocks and Commodities and you will find at least one article on trade entry. Invariably trade entry is predicated on getting aboard a trend at an early stage. My opinion is that trade entry contributes about 20% to trading success. Whether you enter a trend on a breakout or a moving average crossover or a more exotic approach is not important. What is important is to trade with the trend. When the train is moving you should be on board.

Neal: How would you rate Exit?
C.V.: I would weight trade exit strategy's contribution to success at 30%. The most crucial time in a trade is the two week period following entry. If the trade is going your way, you don't have to worry. If the trade moves against you, however, you must face the question: where do you get out. Many traders do not like to take a loss, but losses are part of trading. The important point is to minimize the loss. Referring to the Kelly formula I described above, the ratio of average win to average loss is just as important as the winning percentage. I have found the concept of maximum adverse excursion developed by John Sweeney to be very useful. He has written about it in Stocks and Commodities as well as in several books. In essence he says test how far a trade can move against you before it becomes a loser.
Trade entry and exit together account for 50% of trading success. The other 50% - the single most important factor - is risk management. There's an old saying in trading -If you don't control your risk they'll carry you out. Many traders starting out emphasize trade entry and to a limited extent trade exit, but do not devote sufficient attention to risk management. I should not be unduly critical of beginning traders when it comes to risk management. The recent experience of Long Term Capital Management, in which a $4 billion hedge fund incurred a 90+% drawdown, suggests that even the most sophisticated traders may not utilize appropriate risk management techniques.

Neal: Why are you so big on risk management?
C.V.: The ability to control risk is critical to staying the course. As we've discussed, 1997 was a difficult year for me with an extended drawdown. By controlling risk, my equity was preserved to capitalize on winning trades. I can't predict when a good trend trade will come along, but I do know from historical testing that I need to preserve my capital until it does.

Neal: Where do you come up with new trading ideas?
C.V.: When I first started trading I read a great many books to gain an understanding of the markets. Now that I've been trading for a while I find that I frequently generate ideas. Perhaps one in ten will offer a measurable improvement to my existing systems, and of these only a fraction will wind up being incorporated into a system. The markets are not

static. They evolve over time and my trading systems have likewise evolved in an effort to keep pace.

Neal: Why not consider day trading when you see simple trading opportunities?

C.V.: I believe day trading is very difficult for the off-the-floor trader. I have tested some ideas but have found it difficult to achieve the same degree of profitability inherent in intermediate to long term trend systems. The problem with day trading is that the maximum profit is limited by the day time-frame, and the risk - the amount that must be allowed for a stop - is quite large in relation to the realizable profit. This means that the Kelly ratio I discussed above is relatively low. Let me illustrate: T-bonds have an average daily range of about 28 ticks. Suppose you find through testing that if T-bonds rise 12 or more ticks from the open and then come back through the open within three hours, they have a tendency to close below the open. On average, you can expect at most 16 ticks potential profit by placing a sell stop at the open (28 tick range minus 12 tick advance over open). In reality your potential profit will be 10-12 ticks unless you can pick the exact bottom for the day. To gain this much you must risk the random intra-day movement of the bond market, which I estimate at 6-8 ticks. On every trade you have to pay the bid-asked spread of 1 tick on entry and exit, plus brokerage commissions of half a tick. The profit potential is reduced by 2 1/2 ticks to 7 1/2 - 9 1/2 ticks, while the loss is increased to 8 1/2 - 10 1/2 ticks. The average win to average loss ratio is likely to be less than one. Referring again to Kelly, you're going to have to have a very high percentage of winners to overcome the average win/loss handicap. Using the "Test 48" Kelly of .2 as a benchmark, you would need 60% winners with a win/loss ratio of 1 to match it. With a win/loss ratio of .8, you need 65% winners to get a .2 Kelly. If you can develop winning percentages this high, your rewards will be far greater in intermediate to long term trend trading.

Neal: What happens if markets stay in a trading range? You might not be able to trade trends. Do you have a backup plan for non-trending markets?

C.V.: I initially selected the markets I trade by looking at historical weekly charts. Most of the markets I trade have at least one, and often two, tradable trends each year. They have continued to exhibit these characteristics during the period I have traded. While the possibility exists that one or more of the markets will go into an extended trading range, I have as yet seen no signs of this.

Neal: Speaking of Day Trading I thought you might enjoy Mark Brown's response to a new trader asking about Day -Trading the S&P.

C.V. Sure.

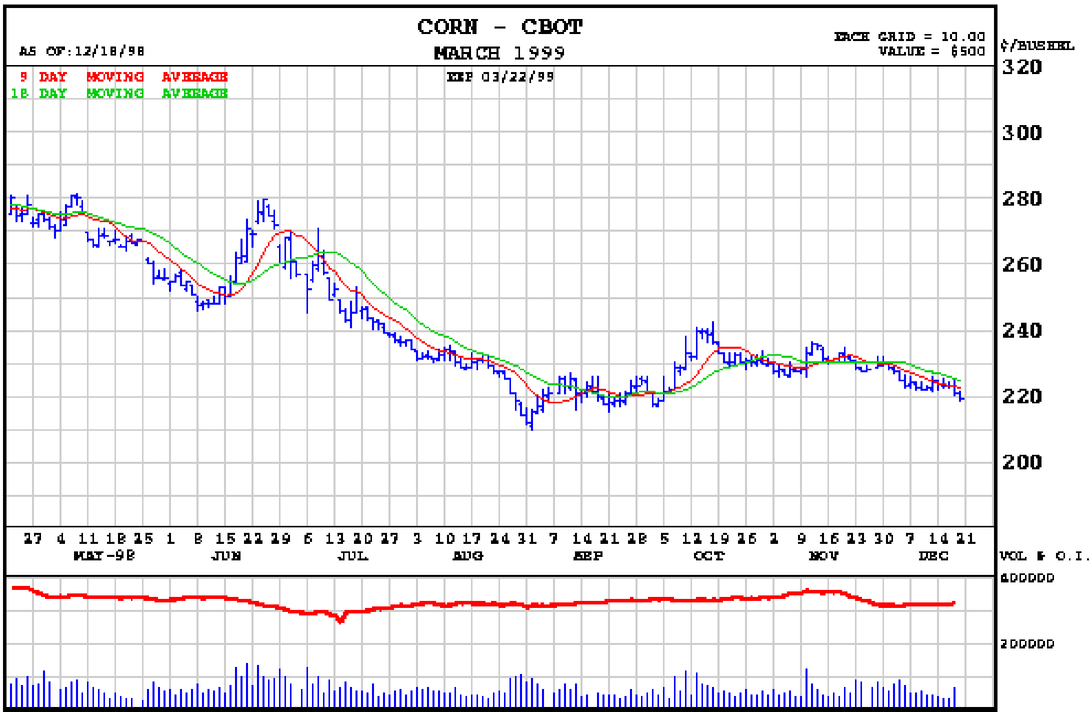
Neal: In the E mail, Mark stated the following: You actually have a better chance to win a lottery, than to become a long term year

after year daytrader of any commodity. When you throw in the idea of doing this on the S&P your odds go from winning the lottery once in a while to winning the lottery every week for 10 years straight. I suggest that you limit yourself to a specific amount of money to lose. Now take the rest of the money and give it to a trustee that will not allow you to have it once you blow the account. Now these are Mark's comments not mine. But I cannot help see how they mirror your sentiments.
Thanks for the interview, CV

Neal's Comments: The above interview CV is one of the more important interviews of this book. CV understands that Trading Chicago Style is understanding how the pit works and that patience, money management, and a plan are the same elements we use in Chicago. It is merely the time frame that is different.
You will note that there are a few interviews where there are no e-mail addresses or Web pages for further information. This interview is one of them. CV continues to trade the markets and quite frankly that is all he wishes to do.

Neal Weintraub's comments
The following charts are an example of the type of contracts C.V. trades. Note the tendency of contracts to develop strong trends without huge spike.

In both of the above markets, C.V. pulled out significant profits.


CORN - CBOT
MARCH 1999
AS OF:12/18/98
EACH GRID = 10.00
VALUE = $500
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9 DAY MOVING AVERAGE
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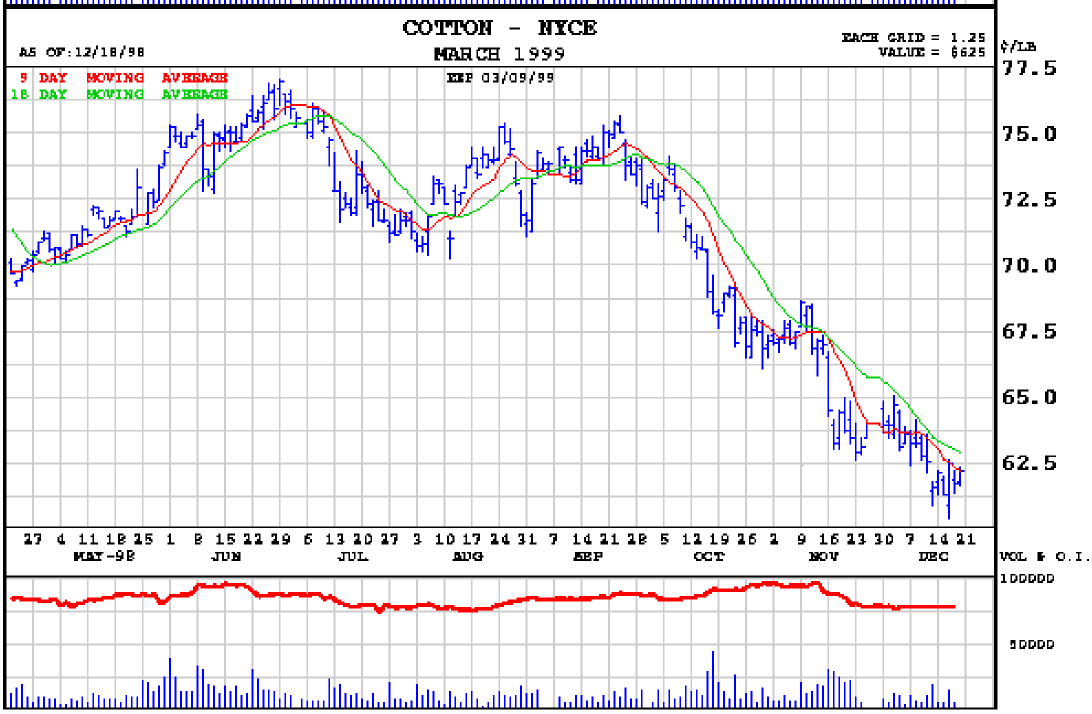
COTTON - NYCE
MARCH 1999
AS OF:12/18/98
EACH GRID = 1.25
VALUE = $625
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18 DAY MOVING AVERAGE
EXP 03/09/99
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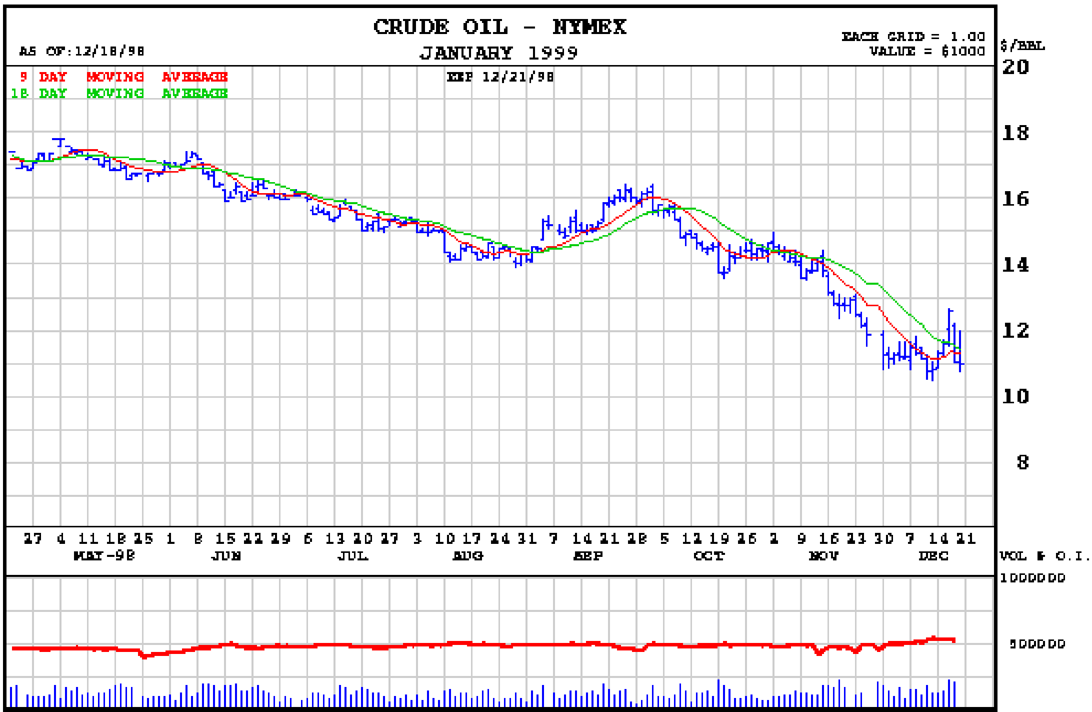
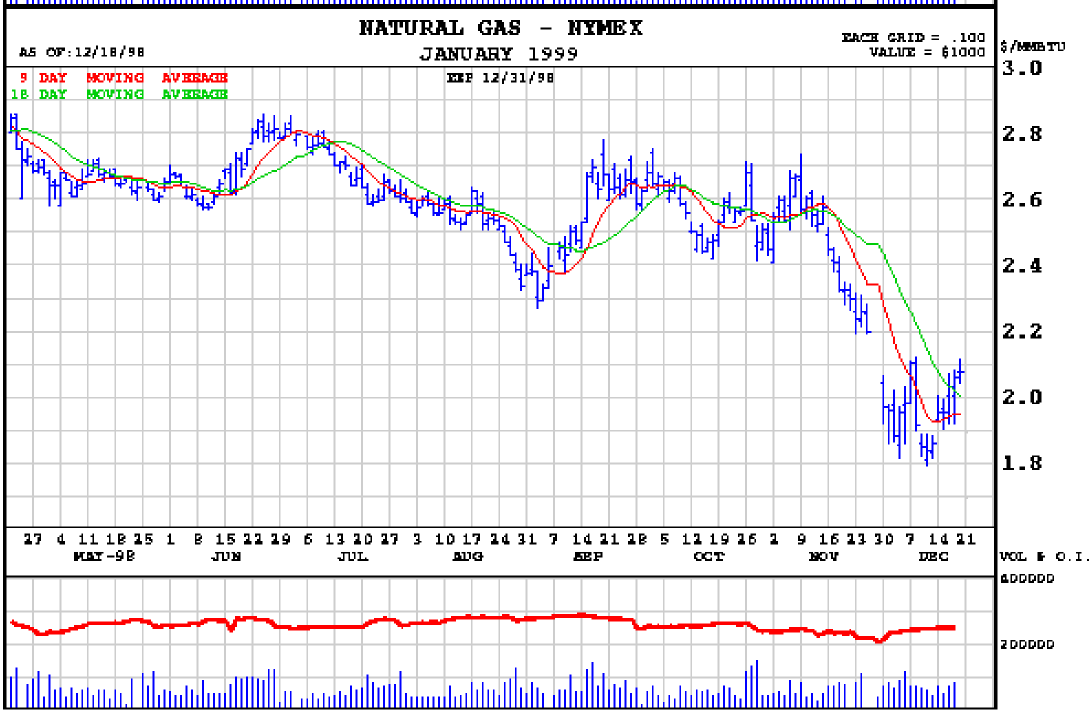
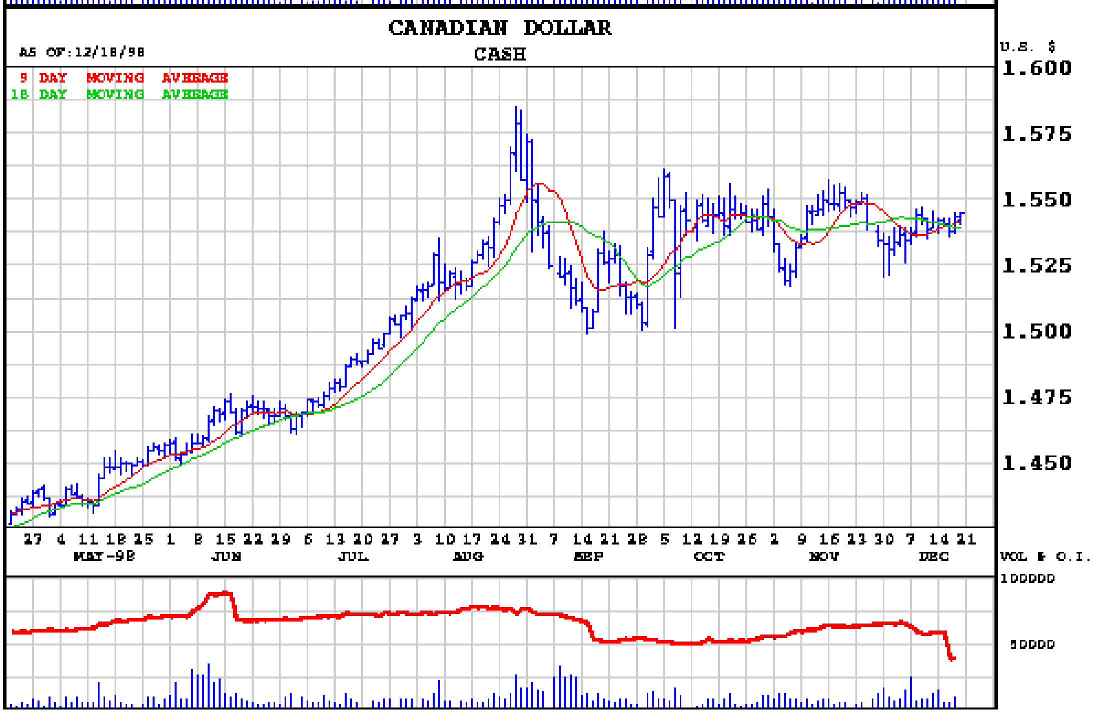


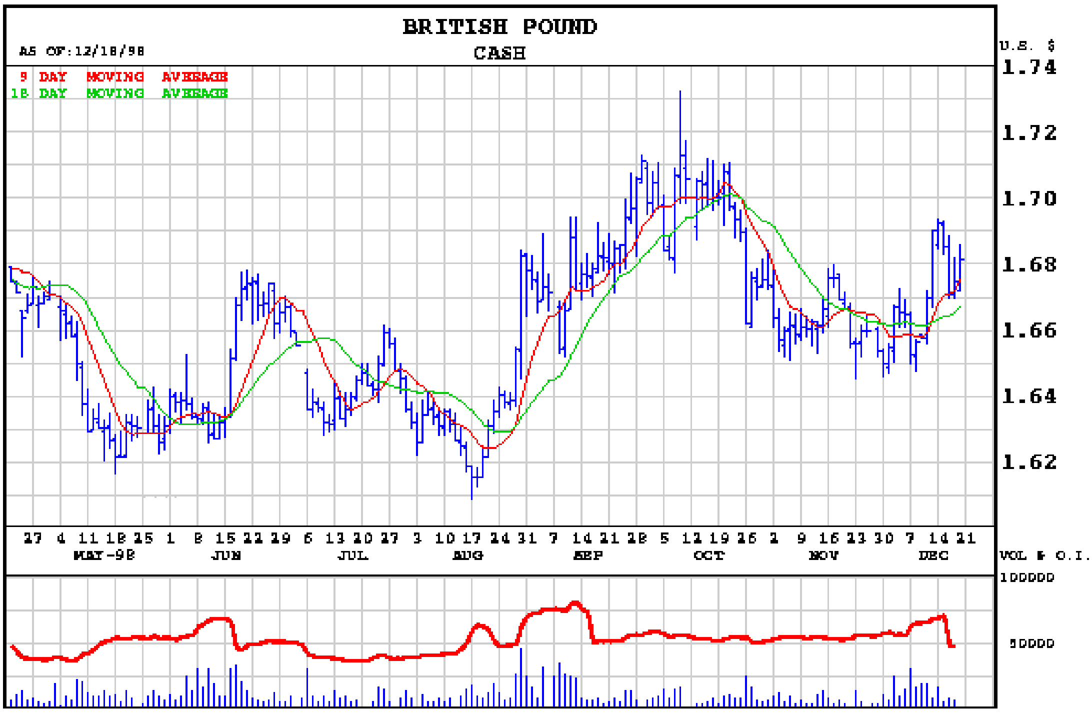


While New York markets tend to cause Chicago traders to shy away, crude oil and natural gas are strong trend leaders. The objective is to wait for the trend.

Once currencies break out of a trading range they have a tendency to run quite a while in one direction.



With a break out system, patience is the operational word. When you trade breakout, you must be patient.



Here is an example of why C.V. does <u>not</u> trade the British Pound. Only one or two good trades.