Jack D. Schwager – Unknown Market Wizards

As most of you know Jack is world-famous for his best-selling series of interviews with the greatest traders and hedge fund managers of the last three decades: Market Wizards (1989), The New Market Wizards (1992), Stock Market Wizards (2001), Hedge Fund Market Wizards (2012). My personal favorite has until now been The New Market Wizards, which made me a much better investor/trader when I first read it in the early 90s. Last year Jack added the Unknown Market Wizards (2020) to this Hall of Fame of interviews. He has written several other books, among which I would like to highlight The Little Book of Market Wizards (2014) and A Complete Guide to The Futures Market (2017). The Little Book, with selected lessons from the greatest traders, is probably most valuable of all, considering the ratio of lessons learned to time to read.

On a sunny February morning Jack kindly took some time off for an interview before his XC skiing in the fantastic Winter Park Resort, Colorado. Below, we will get to learn more about Jack and his thoughts after meeting all these great traders. We will also get some input on how the market wizards performed after being interviewed by Jack, that there is a wizard for any type of trader/investor to learn from and who the greatest trader that Jack has ever met is. (Spoiler: He is in the Unknown Market Wizards). Finally, Jack shares his top 10 trading/investing books with us.

Investingbythebooks: Let us start with your take on fundamental analysis (FA)?

Jack D. Schwager: I started out as a fundamental analyst, as an economic graduate, but what me made change my mind and focus more on technical analysis was that risk management and fundamental analysis are not compatible. Quite the opposite, it fights proper risk management. If fundamental analysis suggests you should buy a stock at 100, and if facts do not change, the implication is that you should buy more and more, as it declines. I also have concluded that fundamental analysis does not work as a timing tool. The only way fundamentals are useful for timing is: i) if there is totally new information (M&A, new medicine approved etc.) that can start a new positive trend. ii) otherwise, it is best used as a contrarian indicator. Fundamental analysis is useful for suggesting the probable direction of broader trends, not for timing trades. If you have a more technical approach then risk management and the analysis are compatible with each other, since you can define ahead of time at what price the analysis would be wrong, which you cannot do with fundamental analysis.

IBTB: But you have interviewed some very good fundamental investors/traders?

JS: Yes, but they are willing to absorb a significant interim drawdown if they are sufficiently confident in a trade. Jim Rogers from my first book is one example. Another example from the equity market is Martin Taylor (from an interview in Hedge Fund Wizards in 2012). He started an emerging market focused fund in 2002 with USD 20mn in seed money and had an excellent track record. When I did the interview with him in 2012, he was closing his funds, which had USD 7bn in assets, because he didn't want investors pressuring him to keep monthly losses below some specific percentage. He subsequently started a new fund with his own money and some selected investors.

At the time of the interview, Taylor was in a drawdown in the high teens—a drawdown that was almost totally due to his largest holding: Apple. However, he emphasized that Apple was his highest conviction trade. He explained that the financial markets were just extrapolating recent quarterly results and were totally missing the potential of its huge expansion into China. He was totally convinced that his thesis was going to be proven right. In the six months after our interview, the stock doubled. Of course, fundamental traders, such as Rogers and Taylor, achieve some risk management through diversification, but they generally, do not have rules to liquidate a position if it has a certain percentage loss. In contrast, many technical traders, such as Peter Brandt, have a very different perspective. For them, the most important thing is not to lose much on any trade.

IBTB: Ok, I hear you, but please give us an example who is the best wizard combining the best of both TA & FA?

JS: One good example is Bruce Kovner from the first book, Market Wizards. His forte was to look at the world economy and form a view of macro and its implications for various markets. But he would also use charts to pick his entry points as well as for risk management. He was the first one I interviewed that told me that he always decided where he would exit a position before he got in. He blended fundamental analysis with risk management, using technical analysis for the latter.

IBTB: When I told some friends that I was going to interview you everyone wanted to know, how did the market wizards do post the interview?

JS I have not kept track in detail, some just because they were private. I think most have done ok. Some were already old when I did the interview and retired only a few years later (like Michael Steinhard). Others went on gathering more assets, which meant a degradation of performance. For example, Bruce Kovner had a decade of near 90% CAGR before I interviewed him. He then went on and started Caxton, raising tens of billions of dollars. He still did very well, but not 90% p.a. Performance will degrade when assets under management increases. In fact, the ability to manage huge sums of money while still delivering superior performance is itself a Market Wizard achievement. The best example of this attribute is Ray Dalio (interviewed in Hedge Fund Market Wizards) who had the distinction of successfully managing the world's largest hedge fund.

IBTB: Please elaborate on the discretionary vs the systematic trader?

JS: Of the all the wizards in my book, roughly speaking 90% were discretionary traders and 10% were systematic traders. The former intrinsically adapt, while the latter also need to do it, and if not, they could have problem. Ed Thorpe (from Hedge Fund Market Wizards) was a systematic trader who adapted and continually found inefficiencies in the market.

One great example of a discretionary trader that had to adapt is Amrit Sall who is featured in the Unknown Market Wizards. He is a trader that trades on events, but as technology progressed, programs were developed that recognized words before he could trade. So, he needed to adapt his approach to this changed reality.

It's difficult for the same systems to continue to work over a long period of time. Therefore, systematic traders also need to adapt. A great example from the new book is Marsten Parker, a systematic trader. As a systematic trader you want to keep the same system, but at some point, it could blow up, Marsten would have gone broke if he didn't change the systems he was trading multiple times. He now has a 20+ years track record.

IBTB: I am sure there is a market wizard for everyone, Jack, so please give us some help.

- <u>What book/interviews to read if you are a fundamental/long only/value investor/trader?</u>
    - **JS:** Hedge Fund Market Wizards, 2012 with Joel Greenblatt, Martin Taylor, and Kevin Daly.
    - Just briefly on Kevin Daly, he was very open, and very specific, and has continued to do well. He was always mostly long only, with a very modest short exposure. Despite launching his fund in Q499, just before the bear market, he was up 900% when I interviewed him in 2012 versus the general market being flat.
- <u>What book/interviews to read if you are a Technical analyst?</u>

  - **JS:** Unknown Market Wizards: Peter Brandt. Very detailed on the use of charts, and he has a great book that I recommend.
  - For trend following traders, I would recommend the interviews with William Eckhardt (New Market Wizards) and Richard Dennis (Market Wizards). Dennis and Eckhardt incidentally trained the famous "turtle traders," who are featured in a chapter in New Market Wizards. Readers interested in a more detailed narrative on this subject should read Michael Covel's excellent The Complete Turtle Trader.
- What book/interviews to read if you want to learn about long/short?
  - **JS:** Most of the interviews are in this category, and they tend to be more global macro-oriented, less equity. The latter tends to be longer biased. For example, Stanley Druckenmiller (featured in New Market Wizards) is long/short, but his shorts are mostly futures and FX.
  - Market Wizards– I have two good examples, Bruce Kovner, and Michael Marcus.
- What book/interviews to read if you are a Quant/systematic investor?
  - **JS:** HFMW Ed Thorp. Very instructive to see how he adapts to the market.
  - Unknown Market Wizards: Marsten Parker who has a very solid 20+ years track record, with many lessons on the critical importance of adapting.
  - William Eckhardt in New Market Wizards offers lots of sound advice about system trading.
- What book/interviews to read if you want to improve your risk management?
  - **JS:** Every Market Wizards book is relevant here. Probably 80% of all the chapters in each of the books will have some significant comments about risk management, which is key for every trader.
  - The one exception being Jimmy Balodimas, from HFMW, who did not employ any specific risk management that I could discern. He breaks all the rules. For example, he trades against strong trends without stop loss orders. The key takeaway for me was that he found a trading edge that worked with his personality. He is the kind of person who always wants to be contrarian, which works for him since he is a good scalper (taking small profits all the time).
- What book/interviews to read if you want to better handle your emotions?
  - **JS:** Of all the books, in the new book, Unknown Market Wizards, the topic of emotions and trading and achieving the proper mindset for successful investing comes up multiple times in very major ways.
- What book/interviews to read if you have little/no experience but want to learn from some of the best, to find your edge?
  - **JS:** Unknown Market Wizards. One interview stands out, Jeffrey Neumann. He is the most amazing trader I have met. He had crazy expectations coming out from college with a goal of making 1 MUSD in his first year, and he started with 3000 USD in 2002. When I met him, he was up to 50 MUSD, but last I heard from him he was up to 250 MUSD.

IBTB: There are eleven Unknown Market Wizards interviewed in the book, let us give our readers some short comments on my favorites in the book, *Peter Brandt, Richard Bargh, Amritt Sall, John Netto, Jeffrey Neumann and Chris Camillo*.

JS: *Peter Brandt*: Peter is the epitome of risk management, and his edge is just that, risk management. His view on charts is that they do not have any great predictive power in general, but at certain points in time, there is an asymmetric trade to be done. Each position always risks a fraction of 1% of the total equity. He has strong views, but weakly held, i.e., as soon as a trade does not work, he is out. Charts are just used to identify points for his risk system. His goal is never to lose much on any given trade and make a lot when he is right.

Richard Bargh. Richard is the most introspective trader I have ever met. He not only keeps a diary of his trades, the details of the reasoning with regards to the buying/selling etc, but also a lot of details about his feelings and how his mental state was at the time of the trade. Every day & weekend he follows up in a spreadsheet and makes a review of everything. During his evaluations of his past performance, he concluded that fundamental analysis works best for him together with the previous mentioned monitoring of emotions.

Amrit Sall, Amrit does exceptional preparations ahead of big trade events, setting out exactly what to do before the event happens. Once the event happens, he can take a very large position when his analysis indicates such action. He is then in the moment for the trade totally; his world ends at the screen. Regardless of how the trade develops, he knows what he will do immediately. For example, if the market deviates from his expectations in a negative way, he will be out within a minute.

John Netto. John is unique since he uses his own emotions as a guideline. He evaluates them as a contrarian indicator. That is why he says emotions are useful and he has even built them into his trading method. He has built an elaborate software program and like Amrit prepares ahead of big events. Ahead of these he has established a fundamental bias, and then he uses technical analysis for timing, with that fundamental bias in mind and constant monitoring of his emotions.

Chris Camillo. Chris is the closest to a (very) modern Peter Lynch of the market wizards. He looks for unusual high levels of mentions of key words and word combinations to anticipate trends that will impact companies. He will hold a position until he believes the anticipated trend is recognized by the market (for example just before earnings or just after). He does not care about technical or fundamental analysis, nor risk management. He even does not care about the price level itself, as long as the change in social media is positive, he stays long. He has written a book with a very "Peter Lynch" kind of subtitle, "How I beat the pros at investing by reading tabloids and connecting at Facebook".

Jeffrey Neuman: Jeffrey is another trader who tries to catch very nascent trends. He is a person that very naturally picks up new things. He is always looking for new trends and doing a lot on the ground research to learn more about the product in every possible way. In that way he also is a modern Peter Lynch, but without the fundamental valuation part. He uses charts for timing with tight risk control and is willing to attempt a trade multiple times if he is stopped out and still believes in the trade. His track record is among the best of all market wizards I have ever interviewed, and in terms of cumulative percent return, he is probably the most impressive of them all.

IBTB: Jack, thanks for the interview. Much appreciated and happy skiing today!

On a final note, I must mention that the best chapter in the book is Jack's conclusions, 46 Market Wizard Lessons, which is a summary of general lessons learned by the 11 wizards in Unknown Market Wizards. Read, and reread.

As a final treat, Jack shared his 10 favorite investing books. Enjoy.

Bo Börtemark, February 2021,
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THE TOP 10 INVESTING BOOKS, BY JACK D. SCHWAGER

Reminiscences of a Stock Operator

Edwin Lefevre

Diary of a Professional Commodity Trader: Lessons from 21 Weeks of Real Trading

Peter L. Brandt

Fooled by Randomness: The Hidden Role of Chance in Life and in the Markets

Nassim Nicholas Taleb

Fortune's Formula: The Untold Story of the Scientific Betting System That Beat the Casinos

William Poundstone

The Quants: How a New Breed of Math Whizzes Conquered Wall Street and Nearly Destroyed It

Scott Patterson

More Money Than God: Hedge Funds and the Making of a New Elite

Sebastian Mallaby

Option Volatility and Pricing: Advanced Trading Strategies and Techniques

Sheldon Natenberg

When Genius Failed: The Rise and Fall of Long-Term Capital Management

Roger Lowenstein

What I Learned Losing a Million Dollars

Jim Paul

The Man Who Solved the Market: How Jim Simons Launched the Quant Revolution

Gregory Zuckerman