# On Jesse Livermore And His Legacy

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I am choosing to write a short biography of Jesse Livermore and his trading philosophies. Livermore was a great trader and speculator – always willing to learn, study and open to new ideas. He was also an eccentric man, unparalleled in his dedication to always gaining an advantage over all other traders and investors. So why Livermore? Is it because of the glamour of discussing such a man? No. Why not Gann? Or Buffet? Was there some type of "secret recipe" for his successes in both the stock and the commodities market?

Definitely not. I am choosing to discuss Livermore because I believe that the legacy left by Livermore is a very important and instructive legacy for the novice, the amateur, and even the professional trader. His teachings all throughout his books and biographies were all about basic trading philosophies such as trend-following, buying and holding in a bull market, industry analyses, following the leaders, identifying pivot points, and of course, risk management. All this did not come easily. It took Livermore literally years to nearly perfect his system and methods, and it requires intensive studying and effort in order to execute and to stay disciplined. This is what Livermore has emphasized all throughout his writings – that the stock market is not for the lazy nor the uninitiated. If one really wants to succeed in making money in the stock market over the long haul, then one will need to put in the necessary time and effort – not only in the studying of the stock market, but in the studying of one's own psychology and tolerances as well.

A more subtle but if not more important question for professional traders to ask is: If Livermore was so great, why did he ultimately lose his fortune again during the Great Depression and why was he not able to make a "comeback" again? This and the fact that Livermore had periodically suffered from depression throughout his life finally led to his suicide in 1940. What went wrong? Traders would often cite his lack of risk management, but I think it goes deeper than that. Perhaps he was getting older and lost his drive, but I believe there is a more important underlying theme and lesson to all this. I will discuss this in later paragraphs.

Early on, Jesse Livermore learned that in order to succeed in life, one needs to put in a great deal of time and effort to an endeavor that one enjoys doing. Of course, it didn't hurt that Livermore also had a great genius with crunching numbers and a great discipline for keeping records. It also didn't hurt in that Livermore was always willing to learn and was always receptive to new ideas. As a young lad, he chose the stock and commodities market as a way to keep score and to make his fortune, and this is what he did until the day that he died.

Livermore was a self-made man. He ran away from home at the age of only 14 and subsequently went to work as a quotation boy in Boston. He quickly learned the art of "reading the tape" and from here, he proceeded to trade in the bucket shops – and was so successful that he was practically banned from trading in all the major bucket shops in Boston. From the bucket shops, he relocated to New York and started trading on the Big Board in the office of E. F. Hutton. This was in the year 1897. By that time, Livermore had already gained a reputation as the "Boy Plunger" in all the bucket shops in Boston. He was only 20 years old.

Trading "legitimately" on the NYSE taught Jesse Livermore his first major lesson in how to consistently make money in the stock market. How? Within six months of opening his account in a legitimate brokerage firm, he had lost all his money – all $2,500 of it – approximately the equivalent of $60,000 in today's dollars. The average person will most probably swear off stock market speculation forever if he was to lose his entire fortune in the endeavor, but not so for Livermore. Of course, he was depressed. Any emotional being would be depressed on losing his entire fortune. But this unfortunate development only motivated Livermore to study his mistakes more carefully. He was able to beat the game in the bucket shops, so why not on the Big Board?

There are many lessons to be learned here. Let's start with the first lesson. Please note that I am not going to list them in any particular order. Each trader/speculator has to deal with their own trading flaws – some lessons may be more applicable than others to one trader but the same lessons may not apply to another type of trader – especially so if he has conquered them.

**Lesson One**: Livermore had no prior trading experience except for his trading experience in the bucket shops. His first mistake was his belief that he could directly apply his prior system of trading to trading in actual stocks on the New York Stock Exchange as well.

What were the differences? Why couldn't he directly apply his system of trading in the bucket shops to trading on the NYSE as well? Livermore studied the differences intently – major money and his future career were at stake here. He learned several things about the art of speculation. Among them were:

1. The greatest amount of money is made following the major trends – not in the day-to-day fluctuations of a stock or in a particular commodity. This fact was later compounded by his experience during the 1901 bull market. He had always been able to call significant bottoms in the stock market and had always be able to initiate long positions at the most opportune time. And yet, he would always sell his long positions after only making 10% or 20% hoping he will be able to get back in at lower prices. This usually does not happen. He eventually learned that in order to make money in the stock market, one will need to adopt a buy and hold strategy in a bull market and only sell when the bull market is on its last legs.

2. Livermore had a significant execution disadvantage by taking his actual business to the NYSE. Not only does he have go pay a high commission (compared to virtually none in the bucket shops although he got a severe handicap when he did trade there), there was also a significant delay between the time he places his order to when the order was actually executed. This disadvantage is severely magnified when one traded as often as Livermore did in his early days as a trader on the NYSE. Livermore was handed down the ultimate lesson in the art of execution during the final day of the Northern Pacific Corner on May 9, 1901. Livermore had anticipated a huge downside move in the morning and a subsequent one-day upside reversal. He was right, of course, but he ultimately lost his entire stake of $50,000 that day. Because of the huge volume during that day, the tape was nearly two hours behind; his brokers (who were very able) did place an order to short U.S. Steel and Santa Fe in the morning, but those orders did not get executed until two hours later. By then, both Steel and Santa Fe had already fallen by over two dozen points. When Livermore ultimately covered, he did so at levels that were two dozen points higher. This one-day plunder cost him his entire stake which it took him a long time to build up.

3. While his tape-reading skills were still important, they were not as important as studying the fundamentals of each company and the credit conditions of the stock market and the economy. His first successful "raid" on the stock market based on his sound, fundamental studies occurred during the Panic of 1907. As credit conditions tightened and as a number of businesses and Wall Street brokerages went bankrupt during the summer, Livermore could sense that something was wrong – despite the hopes of the public as evident in the still-rising stock market. Sooner or later, Livermore concluded, there will be a huge break of epic proportions. Livermore continued to establish his short positions, and by October, the decline of the stock market started accelerating with the collapse of the Knickerbocker Trust in New York City and Westinghouse Electric. J.P. Morgan eventually stepped in to avert the collapse of the banking system and the New York Stock Exchange, but only after Livermore managed to make more than one million

dollars by shorting the most popular stocks (and covering on a plea from J.P. Morgan himself) in the stock market.

There are many lessons to be learned here by professional and amateur investors alike. While I have always maintained that the majority of traders and investors in the stock market usually under-perform the stock market, it is doubly true that virtually all traders who focus on the short-term eventually lose their capital. The successful daytraders are a rare breed – and the successful ones can only expect to obtain a return of 10% to 12% a year, at best. The amateur trader who expects a first-year 100% return by daytrading stocks just does not have a chance.

A more subtle lesson to be learned is the idea of evolution – evolving one's style to not only fit one's personality, but evolve to the point so that it will fit the market's personality as well. What made Livermore so successful during the first thirty years of the 20th century was this: Not only was he multi-talented in the traditional sense (his skills in analyzing long-term trends and fundamentals were as good as his skills in tape-reading and in daytrading), he was also multi-talented in the sense that he was able to evolve with the market very successfully. He had always been flexible in either trading the long side or short side – and he was also able to sit out in a market that was devoid of activity as well.

**Lesson Two**: Do not depend your analysis solely on "insider information." Livermore learned this lesson the hard way – twice in all. The first lesson was moderately costly; the second lesson was to cost him his entire fortune:

1. Livermore had always been skeptical about the dependability on "insider information." After all, why would top management tell outsiders that he was selling shares in his own company because he thinks business will be bad going forward (these were the days before insider-trading was made illegal)? Telling outsiders would only add more selling pressure to the stock, and vice-versa. The legendary trader, Bernard Baruch, had always maintained that insider information was useless, and that a person was doing him a favor if he would keep the insider information to himself and not reveal it to him. Livermore got his first real lesson sometime after he closed out his profitable short position in Union Pacific right before the 1906 San Francisco Earthquake. After three days of tape-watching, he concluded that the shares of Union Pacific were being accumulated. He started to accumulate shares in Union Pacific as well – only to be stopped by Ed Hutton, the great New York financier and owner of the E.F. Hutton brokerage house, and a personal friend. Hutton told Livermore that he had inside information and that the insiders have set up a pool and were dumping shares to him at a furious rate. Sooner or later, Union Pacific is going to tank. Despite his own beliefs and the reinforcements of all those beliefs from years of tape-watching, Livermore liquidated his 5,000 shares of Union Pacific at $162 – making only $10,000 in the process. The next day, the company announced a 10% dividend and the shares shot up by an additional ten points. The opportunity cost? $50,000 in additional profits which would be equivalent to over one million dollars today. Livermore did not get upset or emotional, but after this incident, he swore that he will never listen to insider information again and that he will only trust his tape-watching skills and instincts from now on.

2. The second lesson that was handed down to Livermore did not strictly involve insider information, although it was pretty darn close to it. It also taught Livermore a little about himself – his gullibility and his succumbing to another man's sale skills even though he practically knew all the facts of a product (in this case, it was the cotton industry). Let me clarify. This happened soon after the Panic of 1907 – when Livermore was trading successfully at a peak level and soon after he made a small fortune by nearly cornering the cotton market. Some weeks before, a man named Percy Thomas (who was also know as the "Cotton King") had gone bankrupt in trying to corner the Cotton market, and hearing Livermore's exploits, Thomas would seek him out and ask Livermore to be his partner. Livermore refused to be Thomas'

partner since he had always played a lone hand. However, Thomas was a man of knowledge (particularly in the cotton market, of course – where he supposedly had "spies" that would report crop conditions and the like to him as soon as they could) and a great charmer, and Livermore was soon put under his spell. Prior to Livermore meeting Thomas, Livermore was short cotton. After a month of listening to Thomas and falling under his spell, Livermore covered his short position and went long. This was the beginning of Livermore's downfall. With his judgment clouded, Livermore continued to average down on his long position even as Cotton fell. He even sold out his profitable wheat position in order to maintain his margin requirements in cotton and to even buy more cotton on the way down. After realizing what had happened, Livermore soon sold out – with a stake of only $300,000 left – 10% of what he had only some months ago. Livermore sold his apartment and his yacht and tried to recoup his losses in the stock market. By this time, however, his emotions were running wild and his trading skills were shot. Soon thereafter, Livermore was broke once again – not only losing his remaining stake of $300,000 – but now, he was in debt to the tune of over one million dollars. Livermore would ultimately establish himself once again, but this lesson further reinforced his beliefs that he should always play a lone hand, and that he should never tell anyone what he was doing or ask otherwise.

**Lesson Three**: The need to continuously evolve in the stock market. This was initially discussed in lesson one, but I believe this theme is important enough to warrant its own bullet point (no pun intended). In fact, this is probably the most important lesson that could be taught from Jesse Livermore's experience. The most popular rules such as "cutting your losses" and "don't put all your eggs in one basket" have often been cited, but what if one wants to be able to make money in the stock market over the long run? To this I say: "One needs to continuously evolve in the stock market to survive and to flourish." This is definitely applicable to everyday life and one's career (if one is not a trader or investor) as well.

Jesse Livermore has been able to successfully trade the stock and commodity markets over a period of more than thirty years not only because of his intelligence, cool-headedness, trading skills, and his far-sightedness. He was able to do this successfully for such a long period of time primarily because he was able to evolve. He adopted a more long-term, buy-and-hold-like strategy when he shifted his trading from the bucket shops to the New York Stock Exchange. He was also eager to learn something new everyday. He was also flexible – whether on the long or short side or just being in cash. He figured out when there were opportunities in the stock market, and figured out what strategy to adopt and when there were not. He also made friends with very successful people – whether they were businesspeople or great financiers.

This is actually the heart of this commentary: the need to continuously evolve. In his ground-breaking work "Common Stocks and Uncommon Profits," originally published in 1958, Philip A Fisher remarked that times have changed and that the way to make the most money over the long-run is to find great stocks and hold them for the long-run through thick and thin. The old way of speculating and making money by catching the inflection points of boom and bust cycles was gone with the advent of the Federal Reserve and the maturing of the SEC and the new regulations. I believe Jesse Livermore failed to see that. By the end of 1929, he had successfully maneuvered his way out of the Great Crash with a cash horde of over $100 million – becoming of the richest men in America. When Franklin Roosevelt came into office in 1932 – taking his "brain-trust" with him – and with the creation of the SEC in 1934, the stock and commodity markets adopted a different character – a character which Livermore had never seen in his entire life and a character which America had never seen before either. There is no documented history of the trades that Livermore during that time – all we knew is that he went bankrupt for the final time in his life during the 1930s and was never able to successfully make a comeback. Some say he lost his fortune going long sugar futures before FDR put a ceiling on the sugar price. Some say he lost his fortune going long after the crash and didn't get out in time – thinking that the 1929 "dip" would be one of the many similar busts that America had endured during the 19th century and the early parts of the 20th century before the creation of the Federal Reserve.

The message is clear, however. The character of the market changed in a big way, and Livermore was not flexible enough to go along for the ride – despite the fact that he had successfully evolved his strategies and trading styles many times before in the past.

This is not unsimilar to the period immediately before the technology bubble burst in the spring of 2000. At the time, I stated that the technical indicators that were so successful in the late 1990s would not work anymore – primarily because that we were entering a secular bear market. Few believed me at the time. They continued to use their oversold technical indicators, buying technology stocks during the many dips along the way. They failed to evolve. Warren Buffett had mentioned in the past that only when the tide turns would it be obvious to see who was swimming naked.

The idea of evolution in the stock market continues to hold true today. In fact, with the advent of globalization and information technology, it is now even more imperative to evolve since trends can change much more quickly. Information is now instantaneous. Investors will need to be more nimble. Whereas Philip Fisher emphasized that timing was not too essential in the purchase of stocks in 1958, this has all changed today. Witness the meteoric rise and fall of Taser – all in a short time span of 12 months! Also witness the huge amount of cash that has been sitting on the balance sheet of Warren Buffett's Berkshire Hathaway over the last 24 months. Yes, the company has grown bigger, but as a percentage of total net worth, the amount of cash that Warren Buffett is currently holding is unprecedented. Ten years ago, Buffett would have been able to find opportunities to put this cash to work. Buffett had always been a great timer in the stock market (he had always had the great ability to evolve), and I believe he will be putting all his cash to work once he finds the best time to buy equities, bonds or whole companies. In a weird way, Livermore's trading/timing strategies may have been revived. The point is: Today, the timing of the stock market and individual stocks is all the more essential. And MarketThoughts.com is here to help. While the analyses of individual stocks and industries continues to be important today (and sites such as the Motley Fool does a good job of it), we also believe that the ability to time the stock market on at least the intermediate-term basis (and the ability to adapt to a different style of trading and to recognize which asset class to buy) is going to become more essential down the road. Through our twice-a-week commentaries and our DJIA Timing System, we will seek to complement our analyses of businesses, individual stocks and industries, with our proprietary technical indicators and our timing skills in the stock market.

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