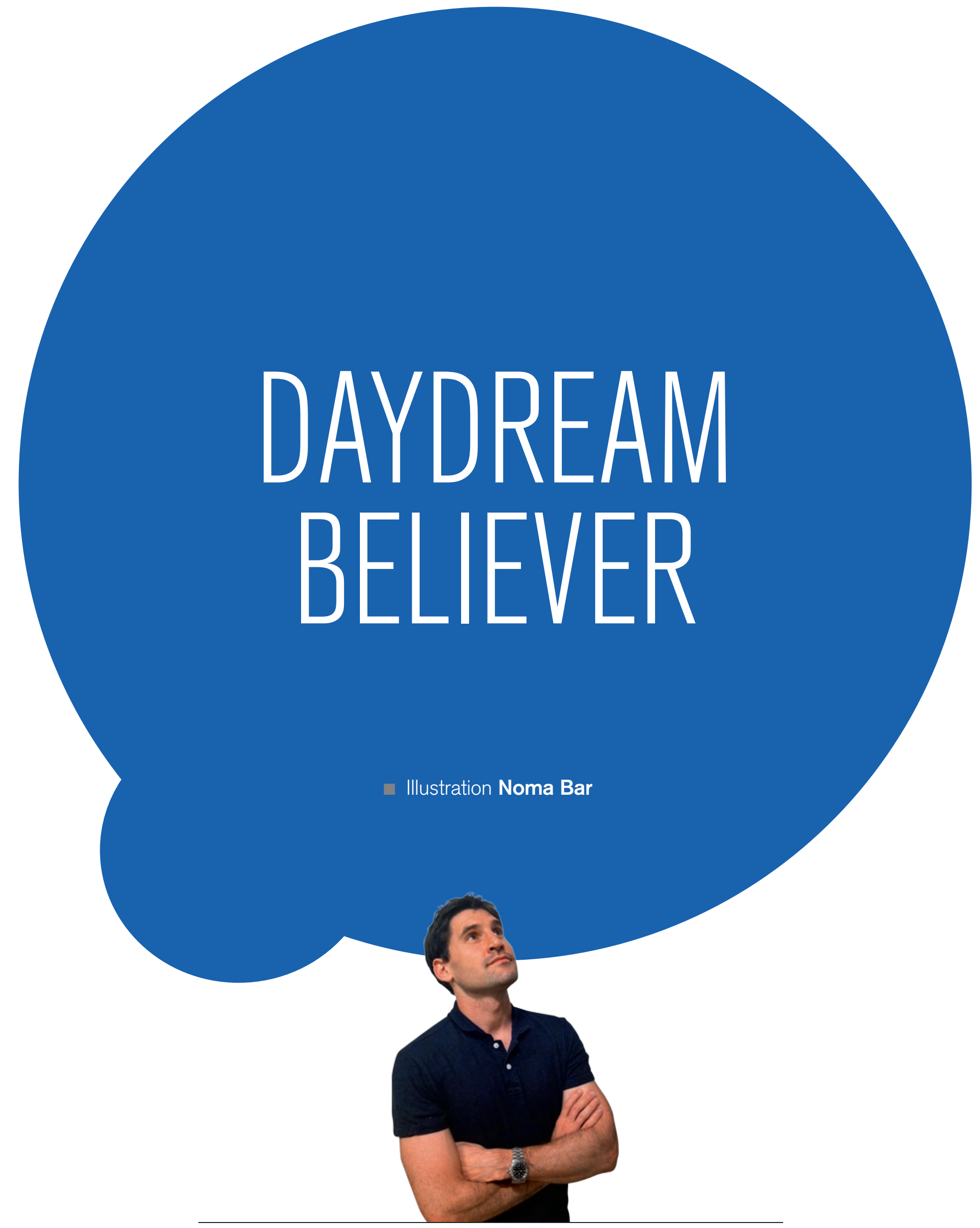
DAYDREAM BELIEVER

■ Illustration **Noma Bar**



Always fancied yourself as someone who could beat the financial markets, if only you bothered to give it a go? So did **Jonathan Shapiro**. As he discovered, the reality of trading options in your pyjamas … bites.

The dream of the day trader is as seen on TV. Middle-aged and self-satisfied, he sits at an outdoor café sipping latte, his manicured fingers sliding calmly across an iPad. He has the smugness of a man liberated from the rat race by his ability to anticipate the moves of the market.

Well that's the dream. The reality is different. For a start, it doesn't always take place during the day. In my case, the times I was clutching an iPhone soaked in palm sweat tended to be between 3am and 4am. I was not staring at passers-by from a café but at the ceiling in disbelief, rationalising that the thousands of dollars evaporating on my options trades were better spent on "the learning experience" than a station wagon for the new baby.

Day trading is difficult, at times stressful and if done successfully, mostly tedious. Liberating? Not if your financial, emotional and even physical well-being becomes a function of the schizophrenia of global markets. But the lure of the day-trader life is strong. Deep in our psyche we are drawn to the intellectual challenge of proving we are smarter than our fellow man. And what better way than by beating the mass collective of financial markets.

My shot came last August when I signed up to be part of the Incubating Joeys Experiment, a homage to the famed Turtles experiment conducted by two traders from Chicago in the early 1980s. Back in Chicago, the "prince of the pit" Richard Dennis argued with fellow trader Bill Eckhardt that anyone could be taught how to beat the market. To settle the debate Dennis recruited a group of "turtles" that he trained into market-beaters. The Joeys was an Australian version of this experiment, thought up by an ambitious and successful Melbourne trader by the name of Kevin Saunders.

Forty-three-year-old Saunders is living proof that it is possible to propel oneself into a financial markets career through self-teaching. A full-time professional with $30 million under management in his Tribelet Capital fund, Saunders is not your typical alpha trader. He studied jazz guitar at the Western Australian Conservatorium of Music and for a while made his living playing the Perth pub circuit and recording for bands. An inheritance got him into the game and a $10,000 trading course helped him change career. Saunders rode the tech bubble up and then down, wiping out 60 per cent of his profit. The course had not prepared him for a bear market, but the losses made him determined to right his wrongs. He gained a Financial Services Institute of Australasia diploma and did a stint as an educator but says these did nothing to help him make money. Hard time plus trial and error, he says, are what turned him from a novice into a backable trader.

Saunders came up with the experiment through his involvement with RAPA, an online trader ranking system created by confessed trading geek, Michael Berman. A South African emigrant, Berman had teamed up with two Ukrainian mathematics professors to devise a system that allowed them to rank traders based not just on how much money they made but also on how much risk they took making it. By their score Saunders was one of the best in the business. So when Saunders approached Berman to help him recruit Joeys, Berman was more than happy to oblige.

While Saunders enjoyed sharing some of the insights he had spent years acquiring, his motivation for the experiment went beyond the theoretical. He was tired of flying solo and reasoned that if he could duplicate himself he could spread the intense workload of managing his fund.

Ten "Joeys" signed up to spend an hour and a half every day until the end of the year learning to trade the financial markets. Among the group were a Melbourne grocer, the daughter of a futures trader, a successful US tech entrepreneur and me. As a finance journalist I'd become accustomed to watching every beat of the market. I'd met some of the world's smartest investors and consumed the highest-quality investment research daily. Would this give me an edge? I'd soon find out.

Saunders was a little on the eccentric side. He liked a good "zero hedge" conspiracy about who was really pulling the strings in the financial markets (Goldman Sachs, of course). But it was clear that while his demeanour was laid-back, he was meticulous, organised and considered. We discovered there is no other way to be if you want to beat the financial markets. Trading is not for mavericks but for the paranoid. To survive, you have to be disciplined in your approach, protect your capital and manage your risk – obsessively.

Kevin Saunders, Tribelet Capital chief and Joeys trading coach, loves a good conspiracy theory.

The four months of training covered much ground, from the basics of options to the nature of markets and the practicalities of steering the software that allowed us to test and trade. We decided to focus our trading on the US options and futures markets and stick to the most widely traded of these.

Options are different from shares or currencies that simply go up and down. They are the right to buy or sell something at a certain point in time, which adds the considerations of time and volatility, the latter being the extent to which prices move around. For that reason they can be wickedly complex. Greek terms used to describe these hidden dimensions, like theta, vega and gamma, add to the intimidation. The advantage with options is that a particular trade has a defined beginning and end date, the latter being when the option expires. That's also the disadvantage; a successful options trade requires precise prediction of the timing of price movements.

Some traders swear by options as an overlooked risk management tool, but many well-known investors openly revile them. "They're like heroin: they feel so good at first, but then they slowly decay you away," says one investor I ask. Whatever their destructive powers, the more we understood options, the more we understood the hidden science of the markets. The hours of training and practice trading taught me more about markets than I'd grasped in years of writing from the sidelines. And making money seemed possible; during the first month of simulated trading I posted decent returns.

There were Eureka moments, one being the undeniable role of luck. During one session we simulated a trading strategy clearly in our favour, akin to more than doubling your money for correctly calling a coin toss. But when we analysed the results we saw it could take many iterations to become profitable. A smart trader can look really dumb for a long time, and a dumb one smart. The latter may survive longer and attract more capital than the former purely out of luck.

We also spent considerable time understanding the "non-normal" nature of financial markets, and why that mattered. Most patterns in nature are statistically "normal"; there may be freakishly hot 40 degree October days or the odd 2.2 metre human, but most days and people are neither. But financial markets display "fat tails", the equivalent of the 120-degree days and six-metre humans that don't exist in nature. Impossible to predict, fat-tail events can – in an instant – wipe out profits accumulated over a month, a year, a lifetime.

We were required to keep a daily log, recording whether we thought the market would go up or down on any given day. The point was to show how futile it is to try to predict daily moves but also to enforce consistency of process. I missed too many days, a clear sign that I lacked the discipline required.

I worried whether the quest to become a trader was a noble one. One long night I joined an Australian hedge fund manager who'd spent his career in London working for some of the most illustrious names in the industry. I told him about my little trading adventure, thinking he'd be impressed. He spat out his wine in disgust. Why would someone forgo the power and influence of writing for the frivolity of trading options, he asked. The intellectual challenge of taking on the markets is attractive, but his reaction led me to ponder whether there was any greater utility to society. Was trading the market an enormous waste of mental resources?

My portfolio performance

Christmas came and with it, time for the Joeys to be released into the wild. In January I went live, putting $12,000 into my new Interactive Brokers account ready to be deployed.

It's a tenet of quantum mechanics that a particle behaves differently when observed. Well, a trader is an entirely different beast when practice money becomes real life savings.

The financial markets began the year in an orderly fashion. The way I decided to trade meant that if markets were calm I'd make money – but if they turned I would get caught out. That the markets could switch from a benign to chaotic state was something that was drummed into us, and we were prepared.

But I lost my mind. My first trade, which bet that the S&P500 would stay in a wide range over seven days, looked a certain winner after two days. But the markets turned angry, and as they tumbled I could either accept my losses or adjust my trade to make money from a cascading market. I opted for the latter but the instant I did that, the stock market turned and rallied, accentuating my losses. When the same situation played out a week later, I decided not to follow my planned strategy and allowed the market to fall a little further, expecting it to repeat its recovery. It was a textbook error; the market that day plunged the most it had in two years. I'd only stood to make a $200 profit from the trade but was staring at a loss of more than $1000. I had displayed every one of the behavioural biases we'd been trained to avoid.

By the end of the month I'd gathered my wits and punted that the market would trade within a certain range. We were trained to consider adjusting our bets if they were sure winners and I contemplated a trade that would make large profits if the market continued to rise. But after deliberating too long, I sat on my hands. The next day, the market surged. The $2000 I missed out on would have restored my account to parity. The trade that got away caused me more anguish than larger losses.

Looking back, my January mistakes were many and varied – and easily avoided with experience. The plan was to ease into trading and risk little more than a few hundred dollars, yet somehow I'd lost more than $2000. If I'd traded by the book – sticking to my limits and taking chances once a trade was a guaranteed profit – I would have made good money. But even after those large losses in January, if I'd not been too gun-shy, February, March and April would have brought more success.

On a warm March morning I met fellow Joey Alan Clement at a Sydney café. It turned out he had quite a bit of trading experience. After losing his high-paying job in IT at Deutsche Bank in the wake of the 2000 tech-wreck, he'd bought books, studied techniques and devoted himself to trading.

As we sipped lattes in the sun we dissected the dream. Saunders had shown us that we were living in a world where the little guy had as much chance of beating the market as the big fishes. The markets were largely democratised. Affordable software, low-cost brokerage platforms and free market information had eroded the advantages of the professional.

But that didn't make it easy. Beating the market in your pyjamas is like a full-time job, only harder, riskier and more stressful. It takes tedious planning, discipline and perseverance. Clement had survived as a trader for more than a decade and looked relaxed leaning back in his cafe chair. Was it really as easy as it looked? "For the first three or four years, I had serious doubts it would all work out," he said.

There and then the daydream died. I had learnt enough to know what it took to be a good trader. And I wasn't one. ■

JOSH ROBENSTONE