

Lessons from a SuperTrader: Intuition

Is there a link between intuition and success at speculation? If so can action based on intuition be part of the repertoire of a successful trader? In an industry where so many place their trust in mechanical trading systems based on analysis via mathematical algorithms, would an example of consummate trading based on intuition be appealing and informative? Can a case for discretionary trading based on intuition be justified?

The Oxford dictionary defines intuition thus: “immediate apprehension by the mind without reasoning; immediate insight.” So a decision based on intuition will be difficult to explain at the time and will be justified as events unfold. Because intuition requires making a decision determined only on a small and probably non quantifiable information base, it doesn’t imply impulsiveness or recklessness. Indeed because successful speculation relies upon the fact that the trader is in front of the crowd and of necessity acts well before all the information is available, intuitive decision making and action should be ideally suited to successful speculation.

As a coach concerned with the development of the trader’s mental edge, I have worked with a few traders who are almost completely intuitive. While not reliant on technical or fundamental analysis as most are, they trade successfully. However the best example of intuitive trading that I know about is in Chapter 6 of “Reminiscences of a Stock Operator” (Traders Press). This related to an amazing trading episode by Larry Livingstone, the alias for Jesse Livermore, the renowned SuperTrader. I want to outline the episode in some detail.

Anatomy of an intuitive trade

Although the bull market was “strong and active”, Livermore was having a “nice rest” at the seaside and completely out of stocks. Livermore claimed the most exciting thing he had to do was to watch the seagulls as he promenaded on the boardwalk. He did call in at the broker’s local office each day just to keep in touch. Looking at the board one morning Union Pacific stood out. “I got the feeling I ought to sell it. I can’t tell you more. I just felt like selling it. I asked myself why I should feel like that, and I couldn’t find any reason for going short U P.”

Knowing his hunches to sell short in the past have proven fruitful he sold 1000 U P shares then and there. Despite his broker’s and friend’s attempts to talk him out of the position he sold another 1000 and then another 1000 even though the stock advanced a little. His urge was strong and the action satisfied his feeling on that day. “I remember on previous occasions when I had the same urge to sell and didn’t do it I always had reasons to regret it.”

The next day the stock went up initially and then retreated to break even for the first 3000 shares so towards the close he sold another 2000 U P shares. Having accumulated a serious short position of 5000 shares, he suspended his holiday and went to New York to be on hand at his broker’s office there.

The next day the catastrophic San Francisco earthquake occurred. However the market didn’t break immediately. It went down a little so Livermore sold another 5000 U P, doubling his short position. On the following day as the import of the earthquake hit home the market broke, so again he implemented “the only play possible” and doubled the short position to 20,000.

Being right and seizing “a heaven sent opportunity” he sold some more. Although the number of extra shares wasn’t specified, he “didn’t get carried away” so the next day he closed his position and “cleaned up”. As a result of the trade he made \$250,000, a grand sum in 1906. Livermore explains “I was much less concerned with the mystery of the hunch than the fact that I got a quarter of a million out of it.”

Observations about the trade

The fact that Livermore was holidaying at that time could have been a subliminal cue that the bull market was becoming exhausted. Regardless of this, the release of the intuition about U P was associated with a relaxed, calm state within Livermore. He was on holiday and was not distracted by a plethora of trading or personal preoccupations. Furthermore he remained in this state of centeredness for the duration of the trading episode. He went to New York only to increase his sense of control, not through anxiety.

It seems from the account in Chapter 6 that for Livermore the occurrence of hunches pertained only to identifying short positions. Furthermore the occurrence was not frequent. But he knew not to ignore the information when it did arise. He had always regretted not following his intuitive leads. Experience showed that he simply had to act on the information revealed. In other words Livermore had faith in his intuitive ability and trusted his intuitions for a positive outcome because they had always been very well rewarded in the past. His experience has shown that ignoring his intuition was not an option.

The method used to implement the intuitive lead to sell U P on this occasion is informative from a trade management perspective as well. Based on his intuition he put his toe in the water first. In essence, as the position worked out and confirmed the “feeling” he rapidly escalated his trading stake. Or put in another way he did not go into a big or maximum position initially but relied on the feedback the market gave him. For instance his initial position was short only 1000, less than 5% of his final position of more than 20,000 U P shares sold. On the first day his intuition was still strong so he increased stepwise to 3000. So each addition confirmed his internal “feeling” and encouraged him to proceed with confidence.

Remember it was a bull market whereby the expectation of a successful short position wasn't high. His friend as well as his broker thought he was being impulsive and reckless. Presumably if his small initial test position did not confirm his intuition he would not advance the stake and probably close it out. However he added the next day because initial position was not losing.

Now it is abundantly clear that the hunch to short sell U P could not predict the San Francisco earthquake. Livermore does not make this claim. But the earthquake was a first rate indication that the position already set up might be an ideal opportunity for a huge short position so he doubled and redoubled over the next 2 days as the market digested and came to terms with the news. In fact over 75% of his total short position was established after the earthquake news broke. To do this he remained present and focused without succumbing to the temptation for ego gratification and complacency.

What Livermore had done was to patiently exploit an outlier to the full. Now I do hope I am not confusing you with the term outlier. An outlier is the rare occurrence of an event well outside the normal data range. Statisticians ignore outliers because their effect on the norm is miniscule. But a trader knows that an outlier gives the opportunity for exceptional returns. A trader of Livermore's experience and ability knows that a negative outlier in a bull market is usually short lived before it begins to be absorbed. That's why he made his breathtaking profits: he unhesitatingly took the profit when it was there without being overawed. How much would US\$250,000 in 1906 be worth in 2005?

Lessons

This story shows that intuition is legitimate and potentially lucrative tool of the trader, especially if it can detect impending outliers. Of course you can dismiss this assertion by saying that Livermore's behaviour was freakish. But the essence of intuition is available to every trader and indeed every human being.

Livermore has the explanation: "friends say it isn't a hunch but the subconscious mind, the creative mind, at work. This is the mind that makes artists do things without knowing how they came to do them. Perhaps with me it was the cumulative effect of a lot of little things individually significant and collectively powerful."

Intuition is not a wild hunch or a feeling 'in the gut'. Furthermore intuition is not an excuse to allow anxiety to make suggestions into the conscious mind which will give relief from the stresses of trading. Intuition is one's creativity operating on the data at hand in the present moment. It selects the tiny but critically meaningful bits which are then interpreted as very significant information to be acted upon. Of course an intuitive lead does not mean that you can do away with patient and disciplined risk management.

Intuition is rational yet uses capacities of the human intellect that are not nurtured by education systems or developed within individuals. Yet every human being has the capacity to be creative and to apply this creativity in changing systems like markets. It seems that there is a myth abroad that the only way to gauge a market is through left brained quantitative analysis. Unfortunately most approach markets using only analytical intelligence which ignores or quashes their intuitive, creative capacity. A huge asset available for the trader is wasted. Is this why most potential traders never achieve the success they are wanting?

I am not arguing that you throw the analytical baby out with the bathwater. But I am suggesting that intuition has an important role to play in your decision making matrix a trader. Intuition enables opportunities to be discerned that other forms of analysis can't. It enables the trader to interact with and gain feedback from his or her market actions in a very personal way. It is an important tool, when associated with sound risk management, which should not be overlooked.

How can your intuitive capacity be resurrected as a useful tool? Certainly there are strategies to increase your intuitive capacity. It is a feature of the trader being 'in the zone'. This requires a calm, relaxed, centered, yet alert state. But it takes more: the deliberate and purposeful effort to encourage whole brain thinking and to trust and implement the conclusions in a measured way. The structures I use to engender this in traders come under the banner of psychosynthesis which enhances the super-conscious, creative mind for the benefit of superior trading outcomes.

You can be reunited with your intuitive capacity, integrate it within your trading style, and as such develop your unique potential for SuperTrader success along the lines of Jesse Livermore.