Stock Market Perspective: The Wisdom of Jesse Livermore

He was a legendary trader who lived in the early part of the last century.[1] A classic book published in 1923, *Reminiscences of a Stock Operator* by Edwin Lefevre, is dedicated to him. Although it is supposedly a fictional first-person narrative by Larry Livingstone, there is little doubt that it is a biography of Livermore who almost surely had a large role in its writing. Livermore made and lost several fortunes, and I have the feeling that the "game" was much more interesting to him than his trading results. The book has been reprinted often, and is currently available from many book sellers and even as a download to e-book readers such as Amazon's Kindle. If you are interested in doing your own trading or investing, it is recommended reading.

Although parts are dated, there is a lot that is still quite relevant. To some extent it shows that while markets and the way they are traded change, essential human nature does not. Or as the French say: «*plus ça change, plus c'est la même chose*» I will show a few of the many sage nuggets in the book (in italics) and add some comments.

Markets and how they are traded change, but humans don't. Much of the wisdom from a century ago is still valid.

▶*If you buy on Smith's tip, you must sell on Smith's tip.* Acting on anyone's tip likely is not a good idea. This maxim is a good reason why you should not pay attention to shouters like Cramer or the more reasoned pundits who appear on shows like *Nightly Business Report*. Even if the stocks they recommend are worthwhile, when do you decide to sell them? You can't count on being told in a timely manner or at all that they should be sold. In a similar vein, I am often asked at social gatherings (and on group bike rides) what stocks I like or what I think the market will do. I try to avoid answering and go on to explain that if I tell them my current positions, I can't promise that I will or will have a chance to tell them when I change my holdings.

▶*But if after a long steady rise a stock turns and gradually begins to go down, with only occasionally small rallies, it is obvious that the line of least resistance has changed from upward to downward. Such being the case why should anyone ask for explanations? There are probably very good reasons why it should go down...* I think this also applies to the market as a whole. In other words, "the trend is your friend," so follow it and don't worry about what is driving it. You don't need to know.

▶*The speculator's deadly enemies are: Ignorance, greed, fear, and hope. All the statute books in the world and all the rule books on all the Exchanges of the earth cannot eliminate these from the human animal.* By speculator he really means trader or even investor. The influences of emotions and how to ameliorate their effects have been the subject of many recent books and articles.

▶*A speculator must concern himself with making money out of the market and not with insisting that the tape must agree with him. Never argue with it or ask for reasons or explanations.* Another saying with this concept is "being right and making money are not the same thing." Or as I like to say, I want the market to tell me what to do rather than tell the market what it should do.

▶*Among the hazards of speculation the happening of the unexpected – I might even say of the unexpectable – ranks high.* More recently, Nasim Taleb has popularized the term "Black Swan"[2] for such events. In investing,

[1] I am still not used to that being the 20th Century.

[2] Because Europeans had only seen white ones, they believed all swans were that color. When they first got to Australia, they found the quite unexpected black ones.

these are extreme market movements that are theoretically highly improbable, but happen too frequently for the theory to be completely accurate. Since these market surprises are just that, the only way to prepare for them is to have a portfolio design and risk control measures designed to avoid severe and highly consequential drawdowns. There are various investment tactics and market instruments for this purpose.

▶*He will risk half his fortune in the stock market with less reflection that he devotes to the selection of a medium-priced automobile.* And we might add a large-screen HD TV or a smart phone to the list. I don’t know why this behavior is all too common. Perhaps it is due to the fear that even after a lot of time, effort, and study, one can still lose money in the stock market while the payoff from researching consumer goods is quite likely to be favorable. That may also explain why the demand for “Smith’s tips” never seems to diminish as it is avoids a lot of work and if it goes wrong, someone else can be blamed.