Bradley, Foster & Sargent, Inc.
Quarterly Market Commentary

October 2015

The Saga of the Legendary Trader, Jesse Livermore: A Cautionary Tale

> After spending many years in Wall Street and after making and losing millions of dollars, I want to tell you this: *It never was my thinking that made the big money for me. It always was my sitting. Got that? My sitting tight!* It is no trick at all to be right on the market. You always find lots of early bulls in bull markets and early bears in bear markets.... Men who can be both right and sit tight are uncommon. I found it one of the hardest things to learn. But it is only after a stock operator has firmly grasped this that he can make big money.
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> *Reminiscences of a Stock Operator*, Edwin Lefèvre, 1923

A new book chronicling the life and trading methodology of Jesse Livermore was published recently. It was written by Tom Rubython and titled: *Jesse Livermore, Boy Plunger – The Man Who Sold America Short in 1929.* Over the past century, much printer's ink has been spilled on the story of this legendary stock market speculator and "operator." And with good reason! During the first third of the 20th century, Livermore acquired a well-deserved reputation as one of the most skilled speculators in America. Newspapers wrote endless stories about his financial successes and his debacles as well. They also feasted on his flashy personal life. In 1923, Edwin Lefèvre wrote his now famous book, *Reminiscences of a Stock Operator,* which was a thinly disguised biography of Livermore and his exploits in the financial markets. With Livermore's coup in the Crash of 1929, when his short positions in the stock market earned him over $100 million, Livermore assumed legendary status. The public followed his private life with ever more fascination – especially as his personal life in the 1930s turned into shambles, ending tragically, when he took his own life in 1940.

So then, why relate his story here? The purpose of this investment commentary is not only to recount the amazing rags-to-riches-to-rags story of the great speculator, Jesse Livermore, but also to explore his groundbreaking speculative trading methods, which are still used by traders today. Paul Tudor Jones, currently one of the most successful U.S. hedge fund managers with assets under management of over $14 billion, hands a copy of *Reminiscences of a Stock Operator* to every new employee at his firm. In 2015, volatility returned to the U.S. stock market. While speculators can utilize market volatility to enhance their returns dramatically, market volatility, exacerbated by leverage, can also wipe out a fortune and destroy a life, as shown in the rollercoaster life of Livermore. Another key aim of this commentary is to highlight the difference between investment and speculation.

Youth (1877-1901)

Jesse Livermore was born in the small farming town of Shrewsbury, Massachusetts, which was part of Acton – about 25 miles from Boston. Jesse was the son of Hiram and Laura Livermore. Hiram, a poor dirt farmer, was so unsuccessful at his trade that he and his wife and their three children were forced to move in with his parents. But Jesse was different from his father. From an early age, it was clear to all that Jesse was gifted with strong intelligence. He was especially good with numbers and at the top of his class in mathematics. His math teacher reported that by the time he was ten, he was already more clever than his teachers in most subjects. But, according to Tom Rubython, the author of *Jesse Livermore, Boy Plunger,* Jesse's father saw him as just another mouth to feed and removed him from school at the age of fourteen. He told Jesse that it was time for him to help out the family as a farmhand. His mother, however, understanding that Jesse was not cut out for farming, gave him $6, which she had been saving for months, and sent him off to a house in Boston where she had arranged for him to stay while he looked for a job.

A Board Boy at Paine Webber in Boston

In 1891, Jesse quickly found a job in Boston as a board boy at Paine Webber at $5 a week – a fortune for the young Livermore. It was his job, along with a half dozen other board boys, to take the wire ticker tape feeds with prices from the New York Stock Exchange and post them on chalk boards, which customers used to trade stocks. It soon became clear that Livermore had a photographic memory for numbers, and he became popular with customers and staff alike. He began to read the newspapers and found that with his facility with numbers and familiarity with prices and trends, he could correctly predict the short-term upward and downward prices of stocks about 70% of the time. He began a daily diary of stock prices and trends – what now might be called moving averages. After two years, at the age of sixteen, he decided it was time to make his first trade with the $200 that he had saved up. With so little capital, no brokerage house would let him open an account so he had to turn to the bucket shops.

A Genius at Trading in the Bucket Shops

Bucket shops were the late 19th century equivalent of horse race betting and established primarily for amateur investors and speculators, who lacked the capital to trade stocks. They were made possible by the telegraph and ticker tape machines. The bucket shops did not buy or sell stocks for clients but took bets from them on whether the prices of shares would rise or fall. Depending on circumstances, margin of 1-10% was required. For example, if Union Pacific was trading at $100 per share, a client would go long or short on the shares by putting up one to ten dollars in capital (depending on the bucket shop's margin requirement). If the next price from the ticker tape was $101, the client could close the bet (trade) with a $1 gain. Of course, if the stock dropped to $99, the client would have a loss of $1, and if the stock dropped as much as the margin placed, then the trade would automatically be stopped out with the client having lost the principal put up for the trade.

Key Events in the Life of Jesse Livermore

1877	Born in Shrewsbury, Massachusetts
1891	At 14, got his first job as board boy at Paine Webber in Boston
1894	Left Paine Webber to speculate exclusively in bucket shops
1898	Made $25,000 in Boston bucket shops – nicknamed the “Boy Plunger”
1900	Moved to New York after Boston bucket shops barred him from premises
1900	Made and lost $50,000, not thoroughly understanding stock market trading
1901	Back to the bucket shops in St. Louis (where they didn’t recognize him)
1902	Returned to NYC and accumulated knowledge about trading stocks
1906	Shorted Union Pacific; S.F. Earthquake occurred, handing him large profit
1906	Accumulated $100,000 over 4 years, started living extravagantly
1907	During Panic of 1907, made $3 million by first going short and then long
1908	Speculated in cotton futures, lost entire capital, ended $1 million in debt
1914	New York Stock Exchange closed for 6 months due to World War I
1915	Declared bankruptcy, pledging to pay back all his creditors eventually
1915	A friend gave him a trading stake of 500 shares in Bethlehem Steel
1917	Within two years, accumulated capital of $8 million
1923	Increased his net worth to $20 million
1923	Bought huge estate on Long Island, 300 foot yacht; winters in Palm Beach
1929	During Crash of 1929, made $100 million by shorting the market
1934	Lost his entire net worth through poor speculation
1934	Declared personal bankruptcy for second time
1940	Took his life with a pistol in the cloakroom of Sherry-Netherland hotel

For his first trade, Livermore pooled some money with a friend and bet $5 on five shares of Chicago, Burlington and Quincy Railroad. Two days later, they cashed out with a profit of $3.12. Once he saw how the game was played, Livermore learned all he could about bucket shops. Soon his bucket shop earnings were much larger than his salary at Paine Webber. Although he felt tremendous loyalty to Jack Hemmings, the branch manager who was his mentor at Paine Webber, he left his job there, after consulting with his mother and giving her almost half of his savings of $500. During the next four years, Livermore speculated in Boston's 15 bucket shops, accumulating approximately $25,000 before he took losses of around half of that amount. His routine was always the same. He would consult his trading records (what would now be called charts) from the evening before, and in the morning, he would enter the bucket shop, check the board to make sure the price was where it was the night before, hand the clerk the cash, and take his time-stamped chit. He went short as frequently as he went long. Then he waited for the right moment to cash out. If the price went the wrong way, he usually cut his losses quickly. And the beauty of the game was, you could never lose more than the margin you put up – a maximum of 10%. The bucket shops were not used to seeing their capital go out the door frequently to one gambler, and in due course, a bucket shop told him that they would not do business with him. Livermore was shocked, but the same thing began to happen all over Boston. By then, he had acquired the nickname the "Boy Plunger," for he was still under 18, and he made big bets. Finally he was banned from all the bucket shops in Boston. It was time for him to start trading stocks.

One of the Best Known Speculators in America (1901-1907)

When Livermore arrived in New York City, he was already a genius at reading the tape and discerning trends in the prices of individual stocks and the market itself. But there were big differences between gambling in bucket shops and trading stocks on the NYSE. In the 1901 bull market, Livermore first prospered, making some great trades, and then lost everything. Rather than borrowing from brokers, he took a trip to St. Louis, where no one knew him. Several days of successful trading in the bucket shops there replenished his capital. Then his identity was discovered, and he was banned from the bucket shops there, too. He returned to New York resolved to master the art of speculating in stocks. With a great deal of study and hard work, he slowly built his capital and learned how Wall Street worked. By 1906, he had accumulated over $100,000 in capital, which was a great deal of money then, and began to live in luxury.

Union Pacific and the San Francisco Earthquake

One day while on vacation in Palm Beach, Livermore shorted 5,000 shares of Union Pacific. He did not make this trade based on fundamentals or the market's trend but rather on instinct – his sixth sense. Within several days, he had an unrealized loss of over $12,500, and he took the train back to New York to watch his investment more closely. The next morning, the 1906 San Francisco earthquake struck with great devastation. At first the stock market barely reacted. The next day, Livermore sold another 5,000 shares. Again the market shrugged it off. Livermore asked his broker, Ed Hutton, for more credit and got it, selling another 10,000 shares short. Two days after the earthquake, the market broke on April 20th, and Livermore covered his position, netting a gain of $250,000. Based on a hunch, followed up by decisive action, Livermore had more than tripled his net worth to $350,000.

The Panic of 1907

In September and October of 1907, Livermore became more and more bearish, and foreseeing a potential financial collapse, he sold a greater and greater number of shares short. There is not space or time to recount the story of this financial crisis in any detail, but suffice it to say that the Panic of 1907 was potentially as dangerous to America as was the Panic of 2007-2009. Only in this case, there was no Federal Reserve Bank to bail out the country's financial institutions. That was up to the banker, J. Pierpont Morgan. Morgan assembled a team of the top New York bankers at his personal residence to devise a plan to rescue the banks, which were experiencing runs, and the broker firms, whose lines of credit had been called by the banks. At the most delicate point of the negotiations, J.P. Morgan sent a lieutenant to ask Livermore to help save the country and stop selling stocks short. Livermore acquiesced and not only covered all his shorts but also went long on the market. In doing so, he made $3 million and shed the nickname of "Boy Plunger." He was now acknowledged as one of the most famous speculators in America. And J.P. Morgan's rescue plan was successful. America was spared a devastating depression.

Spoiled by Success (1908-1915)

The next eight years were a dark period in Livermore's life. One of his great character flaws was that he could not tolerate success. His fame and good looks made him a magnet for women, whom he chased for the rest of his life. He loved fishing off the coast of Florida and gambling at Bradley's in Palm Beach with the rich and famous. In 1907, he bought two yachts – the Anita, which was 200 feet long, and the Venetia, which was 300 feet long. He kept the Venetia on Lake Michigan, living on it when he was in Chicago, trading at the Chicago Board of Trade. During this period, Livermore began to trade in commodities. Coming under the influence of the wealthy cotton trader, Teddy Price, in 1908, Livermore lost most of his fortune by ignoring some of his own most important trading rules. Rather than selling out of his losing cotton position and letting his winning wheat position run, he did the opposite. He sold his winners and doubled down on his losing cotton positions. When his positions were closed, Livermore had lost 90% of his $5 million in capital. By 1910, he had lost most of his remaining capital by speculating in stocks, when it would have been better to sit in cash. The period of 1910 until early 1915 was one of the worst periods in his life. Nothing worked out for him. By early 1915, he was deeply in debt, and he declared personal bankruptcy. Before doing so, he went to all his creditors and promised to ultimately pay them back in full, but he told them he needed to get free of the debts so he could focus on trading successfully again.

$8 Million in Trading Profits (1915-1917)

With World War I underway in Europe, the U.S. was the industrial base for the Allies and its economy was in good shape. Livermore was able to persuade a broker friend to stake him with 500 shares of any stock that Livermore chose. Livermore knew that he had just one chance and that his future depended on picking the right stock. He chose Bethlehem Steel – just as it neared $100 a share. At the end of the following day, the share price was $145, and Livermore had a small stake with which to trade (using margin of only 10%). By the end of 1915, Livermore had accumulated nearly $145,000 in capital. Trading aggressively in 1916, he was first long on the market. Then he shorted 10,000 shares in twelve stocks. He was right on the direction of the market and ended the year with capital of $3 million. By the end of the following year, according to author Tom Rubython, Livermore was worth $8 million.

A Biography of Livermore is Written (1923)

By 1923, Livermore's net worth had grown to $20 million – an immense sum then. He was living in great luxury. He bought Evermore, an enormous estate in Great Neck, Long Island, and had a staff of 30 to look after himself, his wife and his two young sons. The newspaper gossip columns reported frequently on his affairs with beautiful girls who starred in the Ziegfeld Follies. He established his own personal trading room in midtown Manhattan with a staff of over 60 research analysts, statisticians, board boys and operations staff. He had 80 telephone lines and over 60 direct telegraph machines. By now, he was generally recognized as one of the leading financial men in the nation. That year, Livermore was approached by Edwin Lefèvre, who wished to write his biography. Livermore declined – especially as he did not want to reveal his trading rules. Lefèvre then proposed writing a fictionalized biography of Livermore, to which he agreed. Thus was born the classic trading book, *Reminiscences of a Stock Operator*. Although it did not receive a strong reception when it was first published in 1923, it has never gone out of print, and over 500,000 copies have been sold. Almost every bull market since then has seen a new publication of the book, as speculators, traders and modern day hedge fund managers seek to pyramid modest capital into great fortunes, as Livermore did.

Livermore Makes $100 Million in the Stock Market Crash of 1929

By early 1929, the great bull market of the 1920s appeared to Livermore to be running out of steam. In March, he went short on the stock market and covered 24 hours later, reaping profits of $8 million in one day. This replenished his capital which had been shrinking over the previous two years, as many of his short trades had been unprofitable. As the bull market continued during the summer, Livermore and his staff made plans to short the market again. He jawboned his brokers into granting him margin of only 5% in some cases – leverage of 20 to 1. He borrowed against his houses and real estate properties to increase his capital. He picked out stocks that he thought had little chance of going much higher – RCA, National City Bank, Lehman, and many utility and railroad companies. By early October, 1929, he had taken short positions totaling $450 million in over 100 companies, diversifying far more than he normally did because of the size of his bet against the market. On October 28, 1929, known as Black Monday, the Dow Jones fell 12.8%. Livermore did not cover his shorts but sold more shares worth another $50 million. The next day, the market fell 11.7%, and during the day, Livermore bought back everything he had shorted. His profits for the week were reportedly $66 million. When added to his other gains earlier in the year, his total gains in 1929 exceeded $100 million. When he met his wife Tuesday evening, October 29th, she started to console him, and he replied, "No darling, I have just had my best ever trading day – we are fabulously rich and can do whatever we like." He was 52 years old and one of the ten richest men in the world.

Things Fall Apart (1930-1940)

Unfortunately, both Livermore and his wife, Dorothy, did do whatever they liked, and it destroyed them. Both of them had affairs. Dorothy became an alcoholic. Their family life fell apart, and they divorced in 1933. Amazingly, Livermore squandered his entire fortune through extravagant living and terrible stock speculation. He was repeatedly on the wrong side of the market in the 1930s. He was forced to sell his estate, Evermore, and his yachts. And he looked 10 years older than he was. In 1934, he declared personal bankruptcy for the second time. Fortunately, he had set up a small trust in earlier years which provided him with a meager income. He married again – this time to a wealthy woman whose previous four husbands had committed suicide, a foreshadowing that is hard to ignore. He made repeated speculative forays into the stock market in the late 1930s but to no avail. Finally, sad and depressed, he shot himself in the cloak room of the Sherry-Netherland hotel in New York in November, 1940.

Speculating in Securities

The dictionary defines speculation as "engaging in risky business transactions on the chance of quick or considerable profit." The great speculator, Bernard Baruch, in his excellent memoir, *My Own Story*, writes, "I have defined a speculator as a man who observes the future and acts before it occurs." Speculation typically involves a willingness both to buy and short stocks, using the maximum debt (margin) possible. It is very risky, involving pyramiding positions, and can often lead to the complete loss of principal. Below is a short list of Livermore's rules for speculation or short-term trading:

Jesse Livermore's Basic Trading Rules

- Don't trade all the time. It is often best to be 100% in cash.
- Take both long and short positions in the market.
- "It doesn't pay to start wrong in anything."
- Utilize significant leverage (margin).
- Always sell what shows you a loss and keep what shows you a profit.
- Take your losses quickly.
- Never average down. Never.
- Build a position in a security with multiple trades over time, with each trade at a higher price (when going long).
- Trade primarily in the leading issues of the day.
- Don't diversify too much. Focus on a dozen or fewer securities.
- Learn to sit tight and be patient. Don't try to catch every fluctuation, as the big money is made in major market moves.
- Pay attention to industries, as stocks in the same sector tend to move together.
- Stocks are never too high to buy nor too low to sell.
- Don't pay much attention to P/E ratios, i.e., fundamental valuations.

Summary

Investing in stocks is very different than speculating in stocks. Investing in stocks involves the commitment of money in order to create appreciation of capital and growth of income over the longer term. Speculation in stocks primarily involves the goal of quick and large profits through methods which involve the significant risk of losing much or all of one's capital. Rather than focusing on speculating in the short term, investors know that the U.S. stock market over the long term has produced remarkable results. *The S&P 500 since 1926 has produced an average annual return of approximately 10%. The Dow Jones in the 20th century showed an increase of 17,320%.* Thus, investors tend to invest in stocks for the long haul rather than holding cash for much of the time and then making quick forays in the market based on short-term calculations.

There are many approaches to investing in stocks, but they all have much in common. For example, unlike Jesse Livermore who made almost all of his money (before he lost it) shorting the market, investors rarely, if ever, short stocks. It is an extremely risky practice with the potential of unlimited loss. Furthermore, the long-term trend of stock prices in the U.S. has been up – an average annual return of approximately 10% as mentioned in the paragraph above – so that shorting goes against the long-term trend. Speculators tend to seek the greatest leverage that they can, using margin and other derivatives. This also is very risky and can lead to the total loss of capital, as happened repeatedly to Jesse Livermore. Most speculators tend to pay close attention to trends and technical analysis (charts) but give less attention to fundamentals and valuation. In contrast, investors pay a great deal of attention to a company's business model, financial statements, and market valuation as they seek the long-term appreciation of shares of companies. They are also willing, on occasion, to buy stocks at lower prices than their original purchase, if the fundamentals justify it. Speculators tend to diversify less than investors. Most investors believe that it is impossible to predict the future course of the market over the short term, thus rarely trying to time the market. On the other hand, speculators, by definition, are making bets on future fluctuations of individual securities or the market over the short term.

In closing, it is important to note that many professional investors in the stock market do, in fact, utilize a number of Jesse Livermore's trading rules. For example, it is a good practice to sell your losers quickly and let your winners run, or as famed Fidelity mutual fund manager Peter Lynch wrote, "water your flowers and pull out your weeds." It is also generally a sound idea to build positions over time rather than buying all at once. Many investors also agree with Livermore that "it doesn't pay to start anything wrong." Generally, when an investor buys a stock that goes down and then holds it, the temptation is great to sell it once it gets back to breakeven, thus generating no profit from the trade. Finally, Livermore's advice of learning patience is critical for long-term success in the stock market. At Bradley, Foster & Sargent, we are investors, not speculators. And since our inception over 21 years ago, we have demonstrated that investing in quality stocks for the long haul, with careful attention to risk, has protected our clients' capital in times of economic adversity and increased it in times of prosperity. Jesse Livermore's life was a cautionary tale indeed.