Teachings From Commodities Corporation

Tod des Spartacus. Zeichnung von Hermann Vogel.

Above is a 19th century depiction of the killing of Spartacus; the famous Thracian slave turned champion gladiator, then rebel leader of the Third Servile War (slave rebellions) against the Roman Empire in 73-71 BC.

Spartacus is said to have been a fighter unparalleled in skill and a commander unmatched in war. He used these skills to nearly topple the Roman Empire before finally falling in battle against the armies of Crassius.

He undoubtedly learned much of his expertise while in servitude to the House of Vatia; where he trained at the Ludi Gladiatorium "Gladiator School" of Batiatus in Capua. The Ludi of Batiatus in Capua is one of the most famous gladiator schools outside of Rome due to the exceptional fighting talent that was trained within its walls — Spartacus being just one of the many champions it produced.

While reading about Spartacus and the Ludi of Capua in Barry Straus' book *The Spartacus Wars* this week, I got to thinking about the importance one's environment plays in his/her success.

Spartacus was, I'm sure, a naturally gifted fighter and leader. But without his time spent training with other equally skilled warriors at the Ludi of Capua; I doubt he would have ever became the slave who almost brought down a global empire.

The Ludi experience was essential to his greatness. That's where he was exposed to a variety of deadly fighting styles, was passed wisdom from seasoned gladiators, and most importantly, driven to excellence by fellow comrades who were all keenly focused on the same goal.

It's the whole "iron sharpens iron, so one sharpens another" idea.

Well obviously as I was thinking about this I started thinking what the trading equivalent would be to Spartacus' Ludi.

And the immediate answer, without a doubt, would have to be Commodity Corp (or CC as it used to be called).

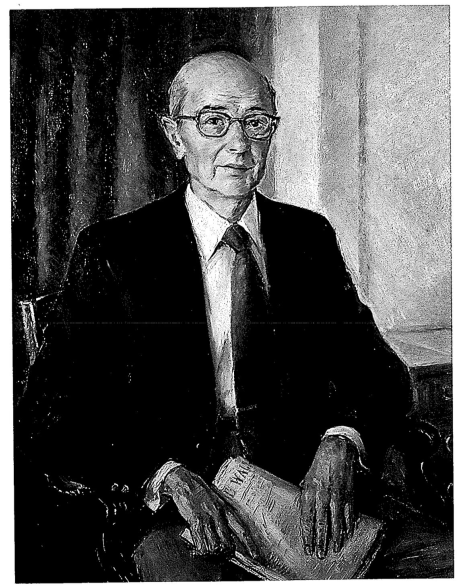
For those of you not familiar with CC, I suggest you read this Fortune article from 1981 and then pick up a copy of Mallaby's book *More Money Than God*; which does a good job detailing the story of this unique outfit, as well as that of many other early pioneers in the hedge fund industry.

CC was a trading operation founded by Helmut Weymar and Amos Hostetter during 1977 in Princeton, N.J. The firm was established to raise money which it would then use to trade in the commodities market and hopefully profit.

In many ways CC was one of the very first hedge funds. It's story is so impressive not just because of the unbelievable returns the fund produced (which were astronomical) but even more so because of the long list of legendary traders who came out of it. The CC alumni list reads like a 20th century trader hall of fame inductee roll. Some of the names include:

- Ed Seykota
- Michael Marcus
- Bruce Kovner
- Paul Tudor Jones
- Jack Schwager

- ➢ Peter L. Brandt
- ➢ Craig Witt
- ➢ Louis Bacon



Anyways, I was going down the rabbit hole of the internet in search of CC related things of interest — something I do when markets are as boring as they've been lately (more on that below) — and I came across some pretty cool finds.

The first one is a short (43 page) internal booklet prepared by another trader named Morry Markovitz at CC that summarizes Hostetter's teachings and approach to trading. The booklet is titled *Amos Hostetter; A Successful Speculators Approach to Commodities Trading.* You can find the pdf link here.

I don't know how I'd never come across this before but it's great. The booklet is jampacked with timeless trading wisdom from one of the greats. Paul Samuelson, Nobel Prize winning economist and early backer of CC said Hostetter was "the most remarkable investor I know, he made money in commodities 50 years straight." That's tall praise coming from a man who was also one of the first investors in a young Buffett.

I suggest you read the booklet in full, but I'm going to share with you one of my favorite takeaways from the piece, which is fantastic in it's simplicity and truth. If you were to follow this advice on every trade I guarantee you would see a significant amount of improvement.

To follow are the pdf images of Hostetter's section on questions to ask before entering and exiting a trade:

SOME OBSERVATIONS ON TRADING IN COMMODITY FUTURES

One might assume that profitable commodity trading is a function of being right something over half the time. Starting with a correct idea is, of course, an important first step, but the next one is the more difficult; namely, converting this idea into a credit on the brokerage statement. This is where most failures occur. It is a source of amazement to me how many traders start with a correct idea, and end up with no profit, even though the move occurs just as expected. They are, of course, violating some basic trading rules, which are rather generally known, but not properly applied.

To force the application of sound trading principles to a commodity position, I have prepared a questionnaire to be answered before taking a position and before closing it out once the position is taken.

Questions to Answer Before Taking a Commodity Position

1. Do you think that a major trend has either started or is about to start in the commodity in question?

2. Is the contemplated trade in the direction of this trend?

3. Do you think that the move will be a substantial one (at least 10% of current price) and run for a considerable period of time (3 to 9 months)?

4. Have you selected an actual or approximate stop loss point where you would be willing to admit you are wrong and take your loss?

(At this point summarize your ideas as follows: I believe that ______________________ (commodity and contract month) now selling at ____________ (current price) will advance/decline to __________ in __________ months. Meanwhile, I will stop my position at __________. Now proceed with the questionaire.)

5. Is the potential move that you visualize at least twice the loss you will take if stopped out?

6. Is the loss that you will take if stopped out (on the number of contracts being considered) less than 25% of the equity in the commodity account?

If the ansẃer to all these questions is yes, then make the trade. One negative answer kills it.

Questions to Answer Before Closing a Commodity Position
(Assuming the stop order has not been executed)

1. Does the position show a loss?

2. Has it reached the price objective which you expected when the trade was initiated?

3. Have you held it for the period of time stated above?

4. Are you convinced that the major trend has changed since your forecast?

If all answers are "no", you must hold your position; if the answer to any one question is "yes", you may close the trade, but you are not compelled to do so.

Now for a few comments on the rationale behind these questions. If you are after excitement, jump in and out as often as you wish. But, I am assuming your motive is profit. If so, you should play only when major trends exist and only in the direction of the trend. Never go short to catch a dip in a bull market or buy for a rally in a bear market. Never trade in a "trading market". Leave a market strictly alone until you feel there is a trend going - then play the trend and, what is very hard to do, stay with it! Don't grab a quick profit. Once a position moves in your favor, sit stubbornly until you think the entire trend has run its course. Don't form opinions as to intermediate moves. In fact, don't even watch it too closely. Just hold on. If the 4 point profit shrinks to a 2 point profit, don't panic. Save your fears and panic for the position that started off with a 2 cent loss. On that one, jump out as quickly as you'd like - the sooner the better.

Commodities are fast moving markets with low margins. Hence, you must decide in advance at what point you will limit you loss and stick to your decision. Also this "exposure" on any given trade should not exceed one quarter of the equity in your account. Should a loss equal as much as one half of your equity, it is obvious that two losses in a row will put you out of business.

On closing out a trade, you will note that our rules say you "may" act under certain conditions. For instance, your price objective may be reached but not your time objectives. If you wish to hold

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longer well and good. A position that is going with you tends to keep going with you and your initial estimate of the move may have been conservative. A loss by overstaying a market is not one of the common mistakes. In fact, holding a profitable position a little longer will win far more often that it will lose. The big risk is closing a good position too soon. Hence, the close-out questions are geared to locking you into a position for a substantial profit or until proved wrong.

ABHostetter
4-15-66

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Now here's the second trading nugget I found in the far-nether regions of the dark web. This one written by an unknown. I don't think he ever gives his name, but apparently he worked at a broker that filled orders for traders at CC and may have even worked at CC itself for a time.

This one is a 10 page document titled *Commodity Corporation: The Michael Marcus Tape.* It's apparently a compilation of some of Marcus' trading notes along with the author's commentary; including some of his stories about working with Marcus. The PDF link is here.

For those of you not familiar with Marcus, he was profiled in Schwager's original *Hedge Fund Market Wizards.* He's a legendary commodities trader who is said to have turned his initial $30,000 investment into over $80 million in under 20 years — not bad. And he also got his start at CC and is part of the most famous mentor/trader lineage which started with Hostetter, who trained Seykota ,who taught Marcus, and who then taught Kovner. Talk about having a Ludi advantage — that's just unfair. And who knows, Hostetter could've trained under Livermore for all we know.

Again, read the entire document. It's short and well worth your time. Here's some of my favorite takeaways from the piece (bolding is mine):
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> *Comm. Corp was essentially a trading university where traders learned to trade and perfect their skills. In the course of their employment the traders were asked to prepare their trading philosophy which was archived. Commodities Corporation also made traders do write-ups when they lost money or "got knocked out-of-the-box."* ***" These "knocked out-of-the box" papers focused on how they failed and how they were going to correct their problems.*** *All of these were archived and available to read or watch. In my opinion, these were an invaluable resource for all traders to learn from. I just wish they were now available on a web-site. I will discuss some of these in a later post.*

I think the "knocked out-of-the box" papers are a great idea and "hot damn!" what I'd give to be able to go through those.

Somebody has to know where those docs are and side note: it's really strange that a more indepth book hasn't been written about CC yet. I have Schwager's number — I used to call him under the guise that I was writing an interview style book and wanted to know how to give a proper interview, but I'd just end up pestering him for trading tips and stories (he was cool about it) — I might give him a ring soon and ask him if he knows where these are or if they still exist. If so, they'd be a goldmine.

> ***Trading has two types of capital that must be managed – financial capital and mental capital.*** *In this case, losing a lot or being unsure of your system drains you of your mental capital. You don't want to do that. Losing either your financial or mental capital will knock you out of business. So protect both equally well.*

So true. Both are equally important and you have to protect one to protect the other. And finally:

> *Comm. Corp. taught me to* ***see the signal, like the signal, follow the signal.*** *If you follow your system /methodology then over time your edge will kick-in and you'll end up ahead.*

"See the signal, like the signal, follow the signal" was an oft used phrase amongst traders at CC, as well as "ride your winners and sell your losers" which was coined by Hostetter. Simple and yet powerfully true. There's also some great stuff in there on adding at "danger points", something we refer to as inflection points and a good discussion on the importance of developing market feel. Take 10 minutes and read it.

Lastly, here's a document (for econ wonks) that summarizes and advances Weymar's original PhD dissertation on forecasting cocoa prices (the theory was the primary reason for CC being created). Here's the link. I used to have Weymar's original dissertation, but I seemed to have misplaced it — but this is close enough.