DEEP ALPHA: THE JOURNEY

Deep Alpha is the code name for a female trader (still notable in the male-dominated trading world) with multiple decades of experience in markets.

DA is remarkable not just for her performance, but the depth and range of her journey. She began as a commercial hedging liaison at the Board of Trade, then moved on to financial futures and day trading.

*As a floor trader in the grain pits, she rode thousands of contracts limit-up (for days on end) in the great North American drought of 1988. As a hedge fund manager, employing primarily short-term strategies, she booked an incredible **280% annual return** for her investors (that's two-hundred-eighty, not a typo) in 2010.*

Over the course of this interview, she'll talk about how she did it. And her biggest encore is yet to come…

Having transitioned from floor trader to day trader to hedge fund manager, DA is now spreading her wings in the discreet world of family office management — hence the code name for this interview — where capital allocation runs into the hundreds of millions to billions.

In addition to all the above, DA is a close and dear friend of many years. So without further ado…

FROM FLOOR TRADER TO FAMILY OFFICE MANAGER

JACK: Why don't we start at the beginning. How did you get involved in trading?

DEEP ALPHA: Trading was not on my radar in college. I started out studying psychology. I had always been fascinated by human behavior.

But I was disappointed with psychology. It was taught, back then, with an emphasis on dysfunctional traits — slapping on labels with all kinds of scary names. I decided to shift to an area that explored perception, consciousness, and how we know what we know.
I went into a major that was built around general semantics — studying how we think through language — and general systems theory, which helps you think about how systems are organized. How the cells in the body organize themselves… how bees organize themselves… how humans organize themselves in thinking and in groups, and so on.

That combination was very interesting. And then I had the good fortune of spending a summer at a Buddhist school in Colorado, the Naropa Institute. This school was known mainly for cultural arts and poetry. But, the summer I attended, a group of neuroscientists got together at the Naropa Institute to share ideas. They decided to turn those ideas into a course, to study things like the circularity of the mind, how consciousness is created, and so on.

This was at the forefront of the whole biology of cognition. I did not want to be a neuroscientist, but I did want to study this area. Unfortunately, back then, there were not any masters programs that focused on this, as it was just emerging. I came away fascinated by 1) meditation and how it quiets the mind, and 2) learning how the brain affects how we think, how through language we think about things in duality, and linearity, and so on. All important areas of study that have helped my trading.

Economics, on the other hand, held no interest for me in college. I actually dropped economics. I just thought it was so dry…

JACK: Ha! Same here. I took a macroeconomics class at Macquarie University in Australia (part of my studies abroad), and walked out in less than two weeks. The concept of "rational economic man" was so offensive to my trading sensibilities, even back then, I couldn't stand it. So I dumped the class and read "General Economic Theory" on my own instead.

DEEP ALPHA: Yes! Rational economic man — that was the driest stuff, and it just didn't make sense to me. I hadn't started reading the Wall Street Journal or anything yet, but it seemed wrong.

So I'm getting ready to graduate from college, and I'm kind of depressed, because there isn't a master's program or a clear path in terms of all the things I'm interested in.

At this point, a major change is about to occur. When people say a book can change your life, this sure did apply to me…

JACK: Small world once again. The book that changed my career path forever – also in college – was "The Investment Biker" by Jim Rogers. Sorry to keep interrupting… what was yours?

DEEP ALPHA: A friend had given me this book, *The Merchants of Grain*. It rocked my world, as it was so different than anything I had read up to that time. It was a history of the grain trade, dating back to the early 19th century, and a glimpse into the world of the secretive families that controlled it. This is the Cargills, Continental Grain, Louis Dreyfus..

JACK: Who wrote *The Merchants of Grain*?

DEEP ALPHA: The author was Dan Morgan. I found the narrative about early commerce to be romantic and intriguing, full of drama and power. I fell in love with the history and, in the process , I learned how they started to use futures (called commodities back then) and hedging, and thought "Wow — this is really, really interesting."

At that point I literally just got on a plane and went to Chicago. That's where the commercials were… Continental Grain and Cargill and Dreyfus… and of course the Board of Trade was there.

So I go to Chicago, and go right down to the Board of Trade for the first time, similar to the way Peter Brandt did. But my reaction was a little different than his. I said to myself: "This is, by far, the coolest human lab I've ever seen!"

JACK: You saw it as a sort of giant psychological experiment.

DEEP ALPHA: Exactly, a full-on human laboratory. I thought it would be great to demystify the chaos, figure out how they were communicating, how the system works… but in the background my whole goal was to learn about the commercials, how they do what they do.

I started out as a runner with Conti –

JACK: Conti Commodities?

DEEP ALPHA: Yes, owned by Continental Grain. After a month or two of being a runner, they put me on the phones. When they realized I was good at communicating, taking orders and so forth, they put me with the top right-hand man of Michel Fribourg, who ran all the Japanese business and just put up some huge numbers.

I took orders from this guy — his name was Miles, since passed away — and Miles would give me these orders and I would run them in as fast as I can. We had a great relationship, and because of that my name got around Continental Grain.

At this point, one of Continental Grain's top producers needed a new assistant…

JACK: And what year was that?

DEEP ALPHA: It was 1980. I went through three different interviews with this top producer, Dave Milligan. A lot of people wanted the job, and I got it. That was one of the best experiences of my life. He had all commercial accounts, plus two huge speculators — very nice men from the Midwest.

We had accounts like Pioneer Corn, the largest corn seed company at the time, do all their hedging through us. A big Canadian company, who did vegetable oil and soybean processing, did all their hedging through us. Then we had a ton of farmers with big positions… and I helped build the business.

The bond futures were beginning to build volume, and I pursued clients that needed to hedge interest rate exposure, branching out from grains. We created a nice balance of agriculture and financial hedging.

Within another year from that point, Dave made me partner. He knew he was sick — he had the same blood clot disease that Nixon had — and I think he wanted someone he trusted to take over the business. We had worked together three years, and in the fourth year he passed away suddenly.

With Dave gone, I inherited this huge business. And my goal at this time, by the way, was to get my membership and trade on the floor.

JACK: You're not on the floor yet.

DEEP ALPHA: I'm not on the floor. I'm in an office at the Board of Trade. And all of a sudden, this succession happens overnight.

JACK: What is your role at that point? You have large commercial clients and speculator clients who give you orders… and you then give them to brokers on the floor?

DEEP ALPHA: Exactly. And I had a great relationship with all the top brokers on the floor, because I was feeding them such big business. Which is key to when I actually go down on the floor, because I already know everyone and they treat me well.

With Dave gone, all these other brokers were circling and going after my clients. At the same time, Conti had a huge trader in Texas that blew up. Michel Fribourg doesn't want all this speculating business, he's getting sick of it. So he sells Conti Commodities to Refco, right when I'm in the process of handling all these clients for myself now.

JACK: Did you go with Refco?

DEEP ALPHA: We were taken over by Refco, but we weren't staying. Within a week I went to a small boutique firm. It was two men, long-term Board of Trade guys, who wanted to start a research and hedging company — primarily grains — and have great research, which they did.

I was with them for another year or two, with an assistant at this point. I had taken all of Dave Milligan's clients with me, and didn't lose one. That was a real coup, with Refco and so many other brokers circling. But there were some things I wasn't happy with there, and I was still trying to build the financial side of the business…

JACK: This is still the early 80's.

DEEP ALPHA: Still early 80's, maybe 1985. By 1986 I'm getting antsy, and really wanting to be on the floor. This was also a time when commissions are starting to fall aggressively. We had clients doing huge, huge numbers, and we were still charging hefty commissions.

JACK: Nothing at all like today.

DEEP ALPHA: It was amazing how much brokers could charge back then. But, it was becoming very competitive. I started shopping around at other firms, and my focus was still "start trading, get on the floor." I had hired an assistant and trained her well — she was good at taking orders and so on — and that freed me up to buy a seat on the Board of Trade and start going down to the floor.

JACK: This was still 1986?

DEEP ALPHA: 1987 now. And the clients love it, because now I'm talking with all the commercial brokers, giving them great information — but my goal is still to really just trade for myself. So I hired yet another person — a broker — to help manage the client business, so I could focus on trading from the floor.
I did well my first year on the floor, and the broker did well with the clients too. He wanted to take over, and I was focused on the floor, so I started phasing out of the client side.

I would do some strategic things, but more on a weekly and monthly basis — the hedging programs — and by 1988 I was basically trading full-time on the floor.

BIG POSITIONS ON

JACK: 1988 was the year of the epic drought.

DEEP ALPHA: Yes, and it was quite devastating. Thousands of lives were lost, due to extreme heat levels. Crops were decimated. Corn alone lost 45% of its crop. Farmers were wiped out and literally "lost the farm." And, it was costly. Up until Katrina, it was the most expensive natural disaster in history.

JACK: And you were in the grain pits of course…

DEEP ALPHA: I was in the grain pits. It was an unreal experience. My first real bull market. You know, I started my career at the end of the 1970s commodity bull market. Or, you could say I started at the beginning of a devastating secular bear market. Good timing!

Interest rates were spiking, production increasing… I had always wished I could have experienced those wild markets, you know, when gold, silver, soybeans, crude oil, you name it were all flying to the upside. In retrospect, however, learning the craft at that particular time helped me develop key practices that kept me in the game.

JACK: What kind of things did you learn?

DEEP ALPHA: Capital preservation was critical, as it was tough to make it back. I learned that the hard way, as most of us do. I learned to trade with a healthy degree of fear, and a deep respect for how the market can just crush you. I also saw that it was not a right / wrong game. My job as a trader became clear – to manage risk well in markets that were going against me.

JACK: That "not a right / wrong game" concept sounds related to your early interests.

DEEP ALPHA: Yes, it is non-Aristotelian logic. People tend to think in terms of duality, and this is limiting.

If you ask most people what they think is the most important part of trading, they will typically say, "being right." Wrong! It is about how a trader manages their risk — especially on the wrong side of the market. There is so much I learned about ego and emotional management.

JACK: Did you study other traders on the floor?

DEEP ALPHA: Constantly. I observed, asked a ton of questions and took it all in. Up until 1988 I had been a fundamental trader. I talked all the time to other traders with a strong background in fundamental analysis and commercial knowledge.

I was always asking, "How do you know that?," "Where did you hear that?," and "What are the big boys doing?" Oh, and I was always asking what they read to keep up on markets, what books they would recommend. I spent most of my afternoons in the CBOT library, a treasure trove of market literature.

JACK: What were you trading in the summer of '88?

DEEP ALPHA: Up until 1987, I had mostly traded spreads in the grain markets. I learned these well, as the commercials were always involved in spread relationships. I would trade the inter-commodity spreads, such as long corn / short wheat. Also intra-commodity spreads, where you go long one month against another in the same market.
Then there was the crush spread — long or short soybeans and short or long the products (soybean oil and meal).

Many times, spread relationships will give you a heads up as to the outright direction of the market.

JACK: So, spread trading was how you learned to trade.

DEEP ALPHA: Yes, and another fact I should mention: I didn't have to put up margin when I was with Conti.

JACK: No margin! You could have really gone crazy.

DEEP ALPHA: I think they were watching, and size would have been a game changer, so I stayed low key. I can't say that about later years, but that's a whole other story… there were a number of leverage gifts going on back then that don't exist today.

JACK: Such as…

DEEP ALPHA: One of the things a lot of people don't know is that, in the 1970s, there were a lot of small local firms who knew each other. It was definitely a club.

At the time it was easy for these local traders, who had memberships on the floor, to make a lot of money very quickly. A lot of them DID go crazy, and would go belly up, and be out of trading for a while. And the local firms would back them, and let them make it back, because they had their seat as collateral.

That was kind of the thing, helping each other out. A guy would go belly up, get new backing, and boom — he's making millions again and back in the game.

When I came to the floor in the 1980s, there was a little bit of that still left. I went with a local firm, because I had a membership, and they gave me an incredible amount of leeway. They did it for two reasons: I was doing a ton of business, because I still had all my clients — the commercials and two huge speculators — and I was trading successfully on my own.

JACK: Right into the drought. Were you trading size then?

DEEP ALPHA: Yes. Those positions were huge for me, and I think they might have been huge for anybody. And it was just limit-up, limit-up, day after day. It was unbelievable.

JACK: How many contracts are we talking here? Thousands?

DEEP ALPHA: More than I would ever dream of doing today.

JACK: How do you deal with the emotion behind that? Riding huge open profits in multiple markets, limit-up day after day?

DEEP ALPHA: You live and breathe weather and pray it never rains on Lasalle Street. And my sleep patterns were awful. I never had a decent night's sleep during this time. But other traders react differently, which leads to a funny story.

There was a famous floor trader, nicknamed "Ricky the Rocket," who was a big player. He always had huge positions on. And his equity swings were volatile. Millions up, millions down and notorious for the swings.

Back then I would have breakfast every morning with three or four competent traders – lots of floor trading experience and deep knowledge of the cash market — to strategize and talk about what's going on in grains. One day, after one of these limit-up days had closed, we're all at Sign of the Trader, the restaurant at the Board of Trade. We're having drinks, talking, and Ricky the Rocket sits down.

I'm kind of freaking out at this point. I'm not sure if I can take much more stress –

JACK: Because of the size?

DEEP ALPHA: Because of the size, the daily swings, and the amount of money I'm making. It is weird to make more in a few weeks than my father ever made in a year.

Now, don't get me wrong. I am loving it and the adrenaline rush is unlike anything else. I just knew I had to be careful. Adrenaline is highly addictive, and trading can quickly turn from treating it as a business to a rush where you just need more to feed the beast.

Anyway, I'm starting to quietly panic inside. Something doesn't feel right .

So I turn to Ricky, knowing he also had boatloads, packets on, and I say: "How do you do it? How do you sleep at night when you have these big positions on?"

And Ricky looks at me and says: "I CAN'T sleep at night unless I have big positions on."

JACK: That's a unique point of view. He must have been wired differently.

DEEP ALPHA: It was true for him, it really was.

JACK: What happened next?

DEEP ALPHA: The very next day I'm taking a cab down to the Board of Trade. The heat is just sizzling, I know it's going to be another hot day in the fields… And the cab driver says to me, "How about those soybeans." He wants to know what I think, knowing I'm going down to the CBOT.

I think to myself, "This is not good." So I went in and methodically liquidated every position.

JACK: Every position??

DEEP ALPHA: Every position, still at limit-up. We're talking wheat, beans, corn, soybean meal, soybean oil, spreads… out of everything by the end of the day. Then I called my best girlfriend — we were both single at the time — who was in advertising.

She knew what was going on, and I told her: "I just liquidated everything, and I made a fortune. If you can take two weeks off, I'll pay for everything and we're going to Europe. I have to remove myself from this place, or I'll probably get back in and give it all back. I have to physically remove myself from Chicago."

I don't think she even blinked. She says, "Book it, Danno!" and hangs up. Next thing you know we're on a plane… I didn't even call in until the third or fourth day. Pouring rain, limit-down.

JACK: Beautiful. What happened to Ricky the Rocket? Did he come out ok?

DEEP ALPHA: I think he came out ok. He gave back a ton, but didn't go belly up. He wound up buying a firm — getting into the commission business and all that — and his later claim to fame was a currency trade. He put on a huge currency trade, made multi-millions, then left the Board of Trade and went out West.

JACK: He went through all of his stress reserves and became a gentleman farmer.

DEEP ALPHA: Exactly — at some point he couldn't take it anymore, and bought a ranch in Montana. I love it though: "I can't sleep if I don't have big positions on!"

EMBRACING MARKET PROFILE

JACK: To pick up where we left off: You liquidated all your positions on the Rockefeller-style cab driver tip, then high-tailed it to Europe. Before we cover what happened next, what was it like being a female in this testosterone-filled world of trading?

DEEP ALPHA: It was quite interesting. I was all business when on the floor, and only had one small incident with a chauvinist attitude. It was when I was first on the floor as a runner and, at that time, we were allowed to stand in the pit. So I would try to observe as much as I could by watching the brokers and the commercial activity.

One cocky trader said to me, "so you think you can be a girl turned trader?" Without blinking, and looking straight ahead, I replied, "we have an actor about to be President (Reagan), so I guess anything is possible." The other guys cracked up, and it was that kind of humor and demeanor which helped me. I also had the good fortune of growing up with a strong father and brothers, who were all good athletes and competitive.

Another factor in my favor — there were a few women that were already members, and that paved the way.

JACK: You were never intimidated?

DEEP ALPHA: No, they knew I was serious and, in time, I was not afraid to trade size. As long as you are managing yourself well, avoid carrying an attitude, and show a strong desire to win, respect follows.

JACK: What about the stories you hear about the intense physicality of the pits? Guys who look like linebackers pushing and shoving each other.

DEEP ALPHA: As I mentioned earlier, I did a lot of spread trading, so I was not standing in the pit where guys were at each other's throats. I was towards the back, and I would also use the brokers I know to fill orders for me. I had a good working relationship with the large floor brokers, as they filled my orders when I was upstairs doing hedging for companies and farmers.

JACK: You were never in there throwing elbows or screaming at people.

DEEP ALPHA: No, that was not my style. Scalping for small increments was not my focus. I also never intended to stay permanently on the floor. I wanted to experience it firsthand and then head back upstairs. Markets were evolving and changing, and I was becoming more interested in expanding my knowledge.

JACK: You wanted a bigger view than just the pit.

DEEP ALPHA: It was an exciting time. The early 1980s had ushered in profound changes lead by computerization, global trading, and the growth of computerized trading systems. The information age and technology were exploding. Currency futures, interest rates, stock indices and metals seemed fascinating, and I wanted to study and trade these instruments. The idea of trading a more global approach was appealing. Soybeans, corn and wheat were a good training ground, but I wanted more.

JACK: How did you approach this next phase of your trading?

DEEP ALPHA: I should share with you that, after the grain trade in '88, I started to make all of the classic mistakes. Not using stops, over-trading… it was humbling and frustrating, and I realized I did not yet have a methodology I could use consistently across markets. I naively thought I could somehow transfer what skills I had learned in grains over to financials, and you can imagine the lessons.

The bond market in particular was challenging, and the S&Ps were brutal. But, I never traded these in any big way in the beginning, so I just had a lot of up and down in my equity. Flat-lined for a while. I laugh now at how little I knew. And I thank my lucky stars I did not burn out or give up.

JACK: What kept you in the game?

DEEP ALPHA: I took three important steps that altered my relationship to the markets, all critical to my survival.

First, I realized my emotional package needed rebooting. Mark Douglas had come out with his first book, "The Disciplined Trader," and I devoured it. I called him and hired him as a coach. He really helped me identify my weaknesses and work on my consistency.

He also had me confront my issues around money. While I was hungry to make it and become a good trader, there was a lingering conversation going on in my subconscious.

JACK: How did you figure that out?

DEEP ALPHA: Through a series of questions, and then, bingo — I remember the "ah-ha" moment.

We were talking about my upbringing, how money was discussed in the home, that kind of thing. I remember telling Mark how upset I was when my mother first came to visit me at the CBOT. I was so proud of my workplace, showing off the exchange and touring the trading floor. She seemed like she enjoyed it, but was also a bit distracted.

Well, that night she phoned my father to tell him all about her day, and she was describing the beautiful, huge statue on top of the Board of Trade. My mother said, "and there on top of the building is Ceres, the goddess of greed." My heart sank. The goddess of grain became the goddess of greed.

JACK: Wow, that is some filter.

DEEP ALPHA: Exactly. In her mind, the idea of people just standing on the trading floor to make money for themselves was too selfish. At some level, I had to deal with that and let it go.

JACK: Mark Douglas helped you with all of that, including self-defeating behaviors in your trading?

DEEP ALPHA: He did, and he was just what I needed then. Around that same time, it was dawning on me that I still knew so little about the stock market and economics in general.

JACK: How did you teach yourself about finance?

DEEP ALPHA: I sought out a teacher. I was fortunate enough to know an amazingly bright and successful stock investor whom I paid to help me learn. He certainly didn't need the money, but I think he got a kick out of having a student and took it seriously.

Homework was in order, and I had a long list of books to read, from "The History of Interest Rates" by Sidney Homer to "The Road to Serfdom" by F.A. Hayek. He had graduated number one in his class at Wharton, and was scholarly and strict. I had to subscribe to a number of newsletters (some of which I still get today), and he would give me pop quizzes on the markets.

He wanted to make sure I was grasping the implications of monetary and fiscal policy as it relates to the market. He was not a trader, he was an investor, and an intense student of the markets. That time with him was invaluable to me.

JACK: Sounds like you had a crash course in economics. What was the third factor that helped you?

DEEP ALPHA: I knew my understanding of technical analysis was shallow. Sure, I used moving averages, Bollinger Bands and drew my trend lines, but I had never embraced a technical method that felt truly comfortable. I had experimented with some systems — such as a neural network program that was useless — and a volatility breakout system, which was actually good. But, I wanted something I could use on a number of markets that I could understand. That was when I discovered Market Profile.

I had been hearing a lot about the success of Peter Steidlmayer, another Board of Trade member from the soybean pit. He was trading and teaching his own methodology, called Market Profile, which is very different from traditional technical analysis..

JACK: In what way is it different?

DEEP ALPHA: Most people look at and study bar charts with indicators that overlay the charts. Bar charts are basically linear – you have an open, high, low and close. They show an inflexible horizontal axis with no variance.

In other words, during a given day, each time slot goes forward without reflecting the extent of market activity at different prices. Steidlmayer set out to change this by introducing more complete data that exhibits the vertical price bar alongside a horizontal bar.

JACK: What does that look like?

DEEP ALPHA: The data creates a beautiful graph, where you can see the auction process more clearly. Think of Market Profile as a structure that uses the components of time, price and volume. These are combined and displayed in a horizontal and vertical distribution — much like a statistical bell curve which, with understanding, reveals pricing patterns and value.

JACK: How did Steidlmayer come up with this?

DEEP ALPHA: In his book he talks about how he took a statistics course at Berkley in 1958, where he was introduced to the concept of a bell curve. He then went on to study Graham and Dodd, and began to see that, in any market, the relationship between price and value usually represents opportunity.

He set out to combine the concepts of price and value, and Market Profile was the result.

JACK: If he created a new way to look at market data, how did he gather the data and use it?

DEEP ALPHA: Steidlmayer was a director at the Board of Trade. In conjunction with the exchange they created something called the Liquidity Data Bank (LDB). In a simplistic sense, the data lets you see how much actual trading is occurring at each price. Up to that point, there was no way to create these Market Profile charts. With the LDB, you could now feel like you were stepping into the auction process and visually see value being built.

JACK: So the liquidity bank was a real-time data collection project?

DEEP ALPHA: That's exactly it. Collecting the data in this form, so it could be represented on a chart. And not a linear chart, but a three-dimensional chart, with so much more information than just "high, low and close."

JACK: Was this being taught in a formal classroom?

DEEP ALPHA: Yes, and the classes were conducted after market hours at the Board of Trade. Market Profile intuitively made sense to me, though it took time, dedication and practice to feel competent at understanding and recognizing the patterns.

JACK: How many Market Profile patterns are there? How many do you use in your trading?

DEEP ALPHA: There are a finite number of patterns that continuously repeat. These help me to assess whether a market is in balance or out of balance. And then there are different strategies to adapt to the various patterns that keep reoccurring.

It's kind of a dance, where the steps are the same but the music changes. Again, the basic tenet of Market Profile is that prices tend to follow a bell-curve distribution during any given day. How the market develops this curve provides clues as to the type of day shaping up. As the market auctions throughout the day, the shape of the bell curve helps to determine potential high probability trades.

JACK: How do you determine a high probability trade setup?

DEEP ALPHA: The Market Profile charts allow you to see what's called "the point of control," or the area with the highest market activity. This is dynamic — in real time — and is always changing with new market activity. As a result, a trader can see in real time if the market is accepting or rejecting critical areas.

JACK: Do you use this for short-term trades only, or longer term trading too?

DEEP ALPHA: It is a great day trading tool. I also use it for swing trading. My longer term trades are usually more fundamental, though I will use all of my tools to help execute and manage the trade.

When Market Profile was first made available to other traders, you could only view each individual day's activity. As the technology evolved, you could merge two days, ten days, thirty days and more. So it has become useful for many time frames. It provides a visual three-dimensional display and, to me, it's like poetry in motion.

JACK: Do you switch back and forth between time frames?

DEEP ALPHA: Yes — it is useful to look at the big picture, and then go to smaller time frames to get an overall feel. For example, if I am swing trading, and I see in a bigger time frame that we keep rejecting what was once a major value area, then that is a good heads up the market is probably going lower. Of course, there are other indicators and information I will use, but Market Profile gives a good indication of the tone.

JACK: So you will use Market Profile on a macro level to look at, say, bonds for instance?

DEEP ALPHA: Absolutely. And when it aligns with some of the classic signals, it's just –

JACK: Like double or triple confirmation something powerful is happening.

DEEP ALPHA: Exactly. And I still follow fundamentals, what I see going on… when I get a sense of what I think is happening, and it all gels with Market Profile and some of the classic technicals, that's when you really get aggressive. But my way of trading is not to put on a big package in the beginning — instead I will add, and then I'll keep adding.

LONG-TERM TRANSITION

JACK: When you add to a position, do you have any general rules about not letting it go past breakeven?

DEEP ALPHA: I may take a small risk, but generally I'll take the original position and do breakeven on that. Then I'll take the new one and do breakeven on that also.

JACK: Is that the same process with swing trades that are X days and so on?

DEEP ALPHA: Yes, very similar.

JACK: If you were going to add to a swing trade, what kind of time frame would you use to make your decision? Does Market Profile have, say, 60 minute and 30 minute windows like regular charts do, or…?

DEEP ALPHA: Yes. It has everything — tick charts, all the minutes, daily, weekly, monthly etcetera. So as it's moving in the direction I anticipate, as the profile confirms it has run out of speed at this important level, and it continues to develop and accept this new value — say we're short for example — as long as that keeps happening, I will continue to add.

JACK: Can you describe an example of a swing trade where you saw a great opportunity to add — either a trade that actually happened or an idealized example.

DEEP ALPHA: Let's take bonds for example. This is a position I was looking to possibly hold for a long time. We had been in a bull market for so long and many technical indicators were showing the trend to be looking tired.

JACK: What is your definition of a long-term position?

DEEP ALPHA: Months and months. You have to look at everything in context. In this example I'm fading a trend that's been going on for a long time — for years. Interest rates have been going down, bonds going up. So I'm looking to initiate a short position in bonds, with the idea that this could turn into a very long-term trade.

JACK: You are probing the market for what could be the entry point on a potentially huge position.

DEEP ALPHA: Exactly. This is critical — to combine the possibility of a long-term trade, with the intention of making it a good swing trade. I think I'm at a good level now, where I got in, and this is when things get tricky. The market starts falling while you are short, and then it has one of those huge breaks. You're still in, and you're wondering "Should I take the profits, or should I get out of some… maybe it will bounce and give me a better entry…" I go through that just like any trader does.

On this particular bond trade, I added to the initial position when it broke about 20 ticks… then managed the stops for both…

JACK: So you're adding to the position at +20 ticks when you're hoping to build it into a position trade? Is that just really fine tuning your initial entry, or…?

DEEP ALPHA: Yes. The other thing I should tell you is that I was stopped out six times in the previous two weeks trying to get short. I didn't risk much, because I know I'm probing what I think is the end of a trend.

JACK: What is your typical planned risk in basis points for a trade like this? Like when you say you tried six times, are you risking half a percent per try? A quarter percent?

DEEP ALPHA: Less than a quarter percent. Very, very small.

JACK: So what happened with this trade?

DEEP ALPHA: It had a fast and furious break until mid-March. Negative fundamentals were getting loud ;

China GDP numbers were slowing, the Eurozone disaster was unfolding, growth in the US was losing steam, and just general dreary news on the recovery front. So, I got out.

JACK: Talk about how you came to be a hedge fund manager.

DEEP ALPHA: A few individuals had given me money to trade the ES (mini S&P). They each gave me a million — which was too much really, I didn't need that much — but I managed that for them for about two years. I stopped when my parents became ill and I just needed some time off. I enjoyed it, though, and may look to do it again. I would probably structure it differently the second time around.

I also think it's great what you guys are doing, in terms of helping people who want to manage money seriously. There are a lot of legalities and things that I don't feel I had enough comfort with. I didn't want to deal with all that, I just wanted to trade.

JACK: In your experience, what were some of the ups and downs of being a hedge fund manager? I know you had some very interesting clients.

DEEP ALPHA: I did. My clients were all heavy hitters in their own right. Fortunately they left me alone, most of the time, and once a month I would talk to each of them. Four out of the five always wanted me to increase the leverage, but I was comfortable with the returns and did not want to push it, at least not then.

JACK: Pushing because they weren't satisfied with 280 percent returns?

DEEP ALPHA: It was always, "If she can do this, why doesn't she do this?" Human beings always want to squeeze more.

I educated them on what I was doing before I started trading the money. I did a skype session, and then decided to do a webinar with all of them, showing them what I do and how I do it, so that they would understand the logic. I told them my risk parameters, that I would never go beyond X, and so on.

It was a great experience. I would like it to take it to a new level eventually.

JACK: Let's talk a little bit about the world of family office management, the institutional realm of investing. You've made these transitions — from grain trading, to swing and position trading, to financial markets and day trading, and then from hedge fund management to family office management. How did that come about?

DEEP ALPHA: My husband had sold a business in 2000. His dream was to buy a big boat and sail, go to the Bahamas and just sail around the world. I didn't want to do it. But I did. I committed to one year to go to the Bahamas. I had sailed a lot with him — we used to sail up in Maine every summer — but I get antsy on a boat. It's a lot of time, and sailboats are slow.

We ended up sailing to the Bahamas, and I still loved the markets so I had to stay in touch. The technology they have today, Wi-Fi, wasn't available back then. Nowadays it's really easy to trade from a boat — but back then it wasn't.

So I would take the dinghy from this island where all these people lived in their boats — it's like a community, down at the end of the Exuma chain in the Bahamas — I would literally take my laptop, in the dinghy, trying to protect it from the saltwater… walk half a mile to the telecom building… wait for one of the two places where you could plug in… and then I would download all these articles and just go back to the boat and read them. That was my thing.

And sometimes I would put positions on — stocks, not futures — and I mostly disengaged from the futures markets that winter, and was really missing it.

When we came back, his family asked me to start managing their capital. Up to this point they had a lot of real estate, globally, but were missing out on other opportunities.

I started attending family office conferences put on by Institutional Investor, and another group called Opal, just really getting into that whole world.

I also started attending the endowment conferences, meeting the people who run money for the top universities like Yale and Harvard. Of course I was interested in their portfolio management and other issues they deal with.

JACK: Did any events or time periods really stand out?

DEEP ALPHA: Probably the most interesting time was a conference in June of 2008, in Boston.

JACK: That was right before the financial hurricane. Two or three months before Lehman and everything.

DEEP ALPHA: Yes and it felt like most people were still in denial of what could happen. It was already getting bad. Then we all met a year later –

JACK: It must have been like a war zone, or a post-disaster cleanup.

DEEP ALPHA: it was unbelievable. And of course with investors like Harvard, so much of that endowment money they use for the college – they were cutting back on all kinds of things. It was wild.

What was truly interesting, though, was getting introduced to a lot of deals that I never would have heard about outside these circles. Emerging market infrastructure, things like that.

JACK: Where $50 million is table stakes just to get a look at the term sheet.

DEEP ALPHA: Exactly. Getting into portfolio allocation was also very educational. How capital is balanced and managed. There were many questions, such as how global do we want to go… how risky do we want to go… timing for certain moves, whether to be aggressive or wait another year… My thinking at the time was to be patient, to sit back and mostly stay in cash.

JACK: What are some of your thoughts and mental adjustments around the subject of liquidity? What I mean is that, as traders we cut our teeth in extremely liquid assets. Paul Tudor Jones, who came up in the futures pits, talks about the beauty of being able to go to cash instantly. Whereas this world, the family office world, is so much about illiquid assets – private equity, infrastructure, deals and so forth – how did you make that mental transition?

DEEP ALPHA: That was the biggest challenge for me, because I really am so used to saying "Okay let's liquidate." It was scary… to me this adjustment felt like a huge challenge to my relationship to time and risk.

My initial reaction was "Really? It's tied up for HOW long?"

JACK: Exactly – that's why I haven't even bought a house yet. I'm still a renter 100% by choice. My feeling is "My god, you want me to own this thing for 10 years?" And of course the opportunity hasn't been compelling.

DEEP ALPHA: Right. In terms of the adjustment, I did it by stepping into things on a smaller scale, and working on ideas I believed in, like investing directly into gold mines… some infrastructure deals… but again, starting small. I got my feet wet first, to get comfortable with the whole process.

I have more respect now for people with a long-term time horizon, but it still goes against my grain.

GLOBAL OPPORTUNITIES

JACK: Let's say you have a sum that is far too large to trade liquid markets with. For example, say you had to allocate $800 million dollars. How would you approach that? What would you do with a chunk of change that big? Because to a significant degree, keeping it in cash is a risk too.

DEEP ALPHA: One of the things I've done, in the past two-three years, is find some of the best minds I can hire to help me. For example, I have an advisor just for biotech… an advisor for trends in cybersecurity… emerging markets etc… they aren't someone I talk to every day, but they are people I stay in touch with and source.

JACK: To find best-in-class opportunities?

DEEP ALPHA: Exactly. If I had $800 million to run, I would scale up this process. Keep finding the best of the best, just a lot of homework, and then hiring people to help you do due diligence on all the decisions you make.

JACK: How would you think about allocation in terms of different strategies? For example, "this amount of capital goes for trading liquid markets… this amount of capital goes for large-scale macro opportunities… this amount goes towards real estate, or long-term venture capital," and so on. How do you even think about slicing that pie up?

DEEP ALPHA: Really great question. When I was first attending these conferences, and listening to how huge endowments and big family offices do this, we would have private breakfasts without the brokers and go over the allocation decisions. From a trading perspective, I was always amazed how vanilla these portfolios were.

JACK: You mean like the standard 60/40 mix of stocks and bonds, stuff like that? GE and Coca Cola?

DEEP ALPHA: Yes, though I see that changing now, especially since 2008. I'm starting to hear more "No, I don't think that's quite right." And it was never my approach to do it that way. My approach is to deal with the question from a macro perspective, isolate the areas I think will see growth, and put more money into those areas. That is how I do it.

JACK: One of the things that amazes me about conventional wisdom and typical portfolio allocation, is the way that so much money was thrown at stuff that had a lot of embedded risk, but not a lot of upside return. Just middle-of-the-road investments with no great potential, but a non-negligible chance of disaster.

If you buy General Electric, for example, maybe you'll make 3 to 5 percent compound returns over X years and so on… but on the downside, maybe GE Capital blows up and you take a huge haircut. The reward to risk seems all out of whack. What always made more sense to me, was what Taleb sort of described as the risk barbell strategy: Put some capital into a class of opportunities that are more aggressive and speculative, but that give you that major upside, and then other holdings that are absolutely safe, with as much risk stripped out as possible.

I find it fascinating how that whole world was forced into violent change post-2008, being aware of just how much embedded risk the old ways carried. What are some of the vibes and psychological observations you're picking up from wealthy families and managers in this post-2008 world? Are they scared? Excited? Pensive?

DEEP ALPHA: Again a great question. The initial feeling was a strong urge to just “play it safe.” The managers have boards they have to talk to, and the families just want to preserve capital and still have a legacy.

JACK: Major risk aversion.

DEEP ALPHA: Yes, major risk aversion. That was the name of the game. That and cutting costs, reducing fees on deals they were doing… very much preventative, “How do we set ourselves up to never be in this position again.”

JACK: And what are some of the answers to that? In terms of avoiding a repeat of 2008? Cut down on illiquid asset classes, or…?

DEEP ALPHA: The whole alpha vs beta question was tossed around a lot. And there was sincere acknowledgement among most of them that the Yale endowment model had run into serious trouble.

JACK: People didn’t realize that Yale did well because they discovered the inherent mispricing of illiquid asset classes 10 or 15 years ago, and now, with everyone piling in, those illiquid assets no longer saw a discount and may even have been pushed up to a premium thanks to all the copycats. Classic game theory, all the extra alpha being milked out.

DEEP ALPHA: Exactly. I think even after 2008 they were still just getting their head around it: “Oh, we were late to the game.” And “to look good, we had to go out on the risk curve at the worst time.”

JACK: Getting closer to return-free risk as they reached for yield.

DEEP ALPHA: Right. It was a balance of feeling that hangover after getting burned, but still being in business and still having a need to perform. Like you said, they can’t just go into money markets – and now they have to play catch-up with their losses.

So it’s a cautious dance, on the lines of “Okay, what can we figure out what’s not so risky but gives a workable return, so we can make at least 3 or 4 percent.” Then let’s take some of the portfolio and do some different things.

Believe it or not, there is more talk about esoteric investment ideas now. These are smart people who realize they made some bad mistakes. But they are also very aware of how the globe is changing.. how demand patterns are shifting… they still don’t want to miss out on the next wave, and they are convinced that next wave is coming.

So I would say for sure they have to become much more “macro.” They are asking questions that they never asked before, about the big macro picture and what is going on.

JACK: The need to leave the United States for instance – to go global in the search for opportunities that combine acceptable returns with low risk.

DEEP ALPHA: Yes.

JACK: What does this look like in practice? Financing the construction for rental income properties in Egypt? Buying Turkish bonds when it looks like inflation has peaked? That kind of thing? More awareness of what is happening?

DEEP ALPHA: Absolutely. And seeking out money managers with expertise in particular areas. Not just the broker that says “some into these ETFs” and so on… a lot more specialization, and expertise in that specialized area, on a global scale.

JACK: Would you then say this point in time is a real opportunity for emerging hedge fund managers? And by emerging I mean up and coming, not necessarily focused on emerging markets.

DEEP ALPHA: I think so.

NEW HORIZONS

JACK: If an up and coming hedge fund manager wanted to break into family office circles and get a meaningful allocation of capital, what advice would you give? What kind of approach would be recommended, what kind of pitch, and so on?

DEEP ALPHA: First, I would say be aware of some changes in the Family Office world. The shifts have been occurring for some years, but since 2008 they have accelerated.

For one thing, there has been a migration from single family office structures to multi-family structures to help reduce costs. For another thing, family offices (like so many) are scarred from financial crisis losses and the lack of transparency post-disaster.

They are more savvy now, and some of the larger offices are plucking top-notch investment talent from hedge funds and private equity firms. That is the bigger scale.

But, whatever size a manager is dealing with, most Family Offices want to know immediately about your fee structure and how you manage risk. They want scenarios. They don't want big surprises.

JACK: It keeps getting back to risk control.

DEEP ALPHA: Yes. In your interview with Peter Brandt, I was very impressed with the way he thoroughly goes over risk management: How he reviews trading performance, what he could have done differently, breaking it down and so forth.

That deep focus on risk management is what I would be asking for. Very specific parameters, broken down, laying out exactly what would happen under various scenarios. That and the profile of the sandbox the manager is playing in. What are the opportunities, how crowded is the space, is it saturated yet… how long has he been there, does he have people there… with emerging markets especially, having people there is key. Knowing the local markets, the local color and flavor of what's happening.

Depth of expertise and depth of risk management – those are the two big ones. Then I want them to be aware enough to answer all my detailed questions.

JACK: What is your opinion on some of the major hedge fund players out there today? Och Ziff, Moore, Paulson… just the big humongous players. How do you view the big giant funds out there?

DEEP ALPHA: This may be a personal bias, but it just isn't my style to go with asset managers that large. I would much rather hand pick some boutique, smaller shops –

JACK: You'd rather trust in your ability to find up-and-comer managers who can deliver real returns.

DEEP ALPHA: That's me. And as I mentioned, since the big meltdown, fee structures are being questioned. Negotiating is much more common. Fees were just accepted before, but now it's no longer the case.

JACK: The standard "2 and 20" is becoming "1 and 15" and so on?

DEEP ALPHA: It's changing, absolutely. The fees are getting smaller.

JACK: Is there a place in this universe for aggressive risk-return type funds? Where there is still a risk management process, obviously, but the target might be 40 to 80 percent annual returns with acceptance of a larger drawdown.

DEEP ALPHA: I can tell you that family offices don't look at that. Endowments wouldn't look at that. I personally would look at it though…

JACK: They are more in the neighborhood of, say, 10-15 percent annualized and single-digit drawdowns.

DEEP ALPHA: Right.

JACK: Another question relating to allocation: In your own trading, how do you think about allocating capital to various time frames: Day trading positions, swing positions, long-term investments… how do you break that out?

DEEP ALPHA: I wish I had a scientific answer…

JACK: Just a general feel for how you approach it.

DEEP ALPHA: My short answer would be "Opportunistically." Day trading is kind of a staple. Bread and butter.

JACK: By opportunistic, you mean that you see something and on the spot say "Hey this could be a good swing trade," or "Hey this could evolve into a long-term position trade."

DEEP ALPHA: Yes. And I would say the swing trades are much more frequent than the long-term trades. I can and have sat with gold for 10 years…but not in the futures market. I never would be able to hold it like that.

JACK: What is going to happen in your own trading as you get more and more involved from a family office perspective? The very definition of long-term capital allocation – deep digging, vetting the managers, finding the gems – how will you balance that with the demands of short-term trading? Just do a lot of delegating?

DEEP ALPHA: There will definitely be delegating, especially with the next move I'm contemplating to a much bigger family office structure.

JACK: So your expertise is also shifting to becoming an evaluator of other traders, of other managers.

DEEP ALPHA: Exactly. I'm looking forward to that. I've been doing that on a small scale, but it's going to start happening on a much larger scale.

JACK: Part of your ongoing evolution.

DEEP ALPHA: Yes. The reality is, I enjoy interviewing others and learning what they know and how they implement their strategies. Time for changes…

JACK: Put short-term trading on the shelf and possibly come back to it later…

DEEP ALPHA: Yes, putting it on the shelf while I see how I like a far deeper commitment to the family office world. Will I still be swing trading and doing things of that nature? Maybe upon occasion. You certainly don't want a conflict of interest when you are responsible for very large sums.

I need to focus my energies on becoming an experienced long-term investor – again, an evolution that I'm ready for. I am looking forward to traveling, meeting with managers, and talking with competent people.

JACK: How do you think about risk from an investment perspective? We're talking just your investment portfolio, where everything in it has a minimum time horizon of twelve months, or a longer term 5 years, perpetual cash generation or whatever – how do you think about risk allocation to this pool of capital that you have? I mean, would you go on an individual investment basis? 5% of capital into this idea and whatnot? How would you mentally approach this?

DEEP ALPHA: Let me get back to you in deeper detail on that. This is an area I'm growing in and formulating right now.

JACK: I've always been curious about this. It's the question of how value investors manage risk. Most of what they do is, "When you buy something make sure it can't go to zero." It's strange in a sense that deep value still has serious embedded volatility risks. But as Buffett says, Volatility is not risk; you think about risk in terms of permanent loss of capital.

If you're going to be a real deep value player, I guess you have to be willing to sit back and have these years where you are down 20% or whatnot… the whole question is very interesting to me, because value becomes more poignant the larger your capital base becomes.

DEEP ALPHA: Certainly. It's going to be a learning process, no question.

JACK: What makes sense to me is: If you're talking about a longer term pool of capital, you have to establish a series of outlier cases and then work off of those. You have to say, "If we're going to invest this capital with a 5, 10, 15 year time horizon, we're going to have to endure drawdowns of X percent or more." And even that is going to be fuzzy because, if you're doing off-exchange type stuff, there aren't going to be regular mark-to-market values. It's very interesting, the complexities involved here.

DEEP ALPHA: Agree, and I will be diving headfirst into that.

JACK: What would you say is the ballpark capacity level for, say, daytrading vehicles like the e-minis and bonds, or swing-trading — say you've developed a great short to intermediate term system for trading equities and futures — what would you say is the upper limit for that type of strategy? 50 million? 100 million? At what point does the base get too large?

DEEP ALPHA: I would say $100 million… there are enough liquid assets and places to play for that to be a reasonable ceiling.

JACK: That makes sense to me too. So then here is another question, more of a personal one: Given that your short-term strategies give you the possibility to run as much as $100 million — the bulk of which could become your own money after a while — why choose to go into the longer term arena? It could be a great decision, of course, I'm just curious about your motivation. Are you just passionate about new vistas and new horizons, or…?

DEEP ALPHA: For me, one of my goals is to open up my time horizons. As human beings we are like monkey brains: We get trained in something, and then we keep going there and going there, and I want to open up my time horizon to get past that. And this is going to do it. This will also open up a whole range of opportunities to dig deep into risk management… all kinds of alternative investments… areas that I am very fascinated by.

JACK: Do you think it could actually be less stress, to run larger amounts of capital on a family office timeframe?

DEEP ALPHA: I think so, for me personally. Again I wasn't trained classically — it's just been boots on the ground training, off we go. This whole concept of an enormous portfolio, and the world as your playground — I want to see how this goes, and what I'll be learning from it. And if it works, the access to people and ideas I'll have will be huge. I've had good access so far, but it will be even bigger. It will just give me this leap to learn –

JACK: It sounds like a new adventure.

DEEP ALPHA: Yes. And like we were talking at dinner the other night — Mongolia. So many interesting places in the world…

JACK: Right, any economy that is growing 50% per year is likely to be intensely interesting. And it is such a wild time. I've said before there is as much exciting change going on now as there has been in the past 100 years. We've got industrial revolutions, global power shifts, breakthrough technologies on the cusp — craziness.

DEEP ALPHA: So much fun. I think too that giving up trading is an empty nest syndrome for me, so I really have to fill it up with something big.

JACK: And you are only partially walking away from trading because there is a new horizon of things that are even more interesting, at such a great time.

DEEP ALPHA: It's a time of incredible opportunity and change. And of course, learning…