Foreword

"No good decision was ever made in a swivel chair."
—General George S. Patton, Jr.

Larry Hite

When I started trading in the commodity futures markets over 35 years ago, the industry didn't even have a name. Today, the business has grown to the point where there are a myriad of ways to describe the funds that operate and their many styles of investing. The particular discipline of trading that I practiced, even before the nomenclature existed, is now plainly and aptly termed "trend following." In fact, while I have seen many strategies come and go, most of the other managers that I have known to survive and thrive over the past few decades in global futures markets are also trend followers. For having made my living as a trend follower, I've yet to come across a more compelling study, so clearly distilled, than has been offered by Michael Covel in *Trend Following*.

I first met Michael when he was working on this book. I was a little hesitant at first about sharing some of the rather simple secrets of my trade. And, I didn't make it easy on Michael. I started interviewing *him* on his investments and how he managed his risk. He quickly made me realize that he not only understood trend following, but that he embraced it much like me. We delved into the roots of trend following and my investment strategies to explore why they work rather than just accepting the results. In reading

A large fraction of traffic accidents are of the type "driver looked but failed to see". Here, drivers collide with pedestrians in plain view, with cars directly in front of them, and even run into trains. That's right—run into trains, not the other way around. In such cases, information from the world is entering the driver's eyes. But at some point along the way this information is lost, causing the driver to lose connection with reality. They are looking but they are not seeing.

Ronald A. Rensink

It's important to have a plan, remain disciplined in executing that plan and pay attention to what is actually happening rather than what you expect to happen. We try to be as objective as possible in our analyses...It's not always easy for people who are involved every day to stay with a plan when misfortune occurs for a time. You always encounter the unexpected and this can push discipline right out of the way in the name of prudence. But prudence almost always dictates staying with the approach that has made you successful. I see that as one of my primary roles. I often encourage everyone during difficult days to remain patient. I don't blame people for the unexpected.

John W. Henry
CME Magazine, Premier Issue

Trend Following, I now see how well he was able to translate his knowledge, and the perspectives of many of my colleagues, to paper.

Back in the 1970s, most of the guys I knew traded individual markets. The ones who traded wheat did not talk to the guys who traded sugar. And, the guys who invested stocks did not care to talk to either one, because commodities were for "speculators" and not "investors." Further, the bond crowd thought the stock guys were cowboys. Each group had developed their own superiority complexes and fundamentally believed that only industry experts, like them, could understand the subtle dynamics of their markets. I guess that's part of the reason that no one cared much for trend followers like me—I viewed every market the same way and each represented nothing more than a trade to me. Today, for all the different facets, I believe everyone has come to speak the same language. It's the language of risk.

In my early days, there was only one guy I knew who seemed to have a winning track record year after year. This fellow's name was Jack Boyd. Jack was also the only guy I knew who traded lots of different markets. If you followed any *one* of Jack's trades, you never really knew how you were going to do. But, if you were like me and actually counted *all* of his trades, you would have made about twenty percent a year. So, that got me more than a little curious about the idea of trading futures markets "across the board." Although each individual market seemed risky, when you put them together, they tended to balance each other out and you were left with a nice return with less volatility.

I could always see, after I got to Wall Street, how, for all the confusion, markets were driven by people and their emotions. That was what all of these markets had in common—people—and people just don't change. So, I set out to understand similarities in the way that markets moved. When I added up Jack's trades, only a few very big trades made him all the money. For each of these big winners, I was there when "experts" told Jack that these markets couldn't go any higher. But, they did. Then when I looked at Jack's losses, they tended to be relatively small. While it took me many years to put it all together—remember, there were no books like this back then—these seemingly small observations became the foundation for me of two important, intertwined investment themes: Trend following and risk management. Jack was not so much a trend follower, but he did practice the first rule of trend following: Cut your losers and let your winners run.

Most of the guys that I knew who lost a lot of money actually tended to be more right than wrong. They just lost a lot on a few big losers. I believe that people put too much of a premium on being right. In some ways, it's one of the drawbacks for people who went to the best schools and always got straight A's—they are too used to always being right. It gets back to people and emotions. Everyone is happy to take lots of little winners—it makes them feel good. When their trades go against them, on the other hand, they hold on because they don't want to accept being wrong. Many times, these trades come back and they are able to capture their small profit. To me, that kind of trading is a little bit like picking up nickels in front of a steamroller.

A prudent investor's best safeguard against risk is not retreat, but diversification. [And] true diversification is difficult to achieve by [simply] spreading an investment among different stocks (or different equity managers), or even by mixing stocks and bonds, because the two are not complementary.

David Harding
Winton Capital

Thankfully, the markets don't care about me or you or where we went to school. They don't care if you're short or tall. I was never very good in school and I wasn't a good athlete either. With my background, the way I saw it, I never had any problem with the idea that I could be wrong. So, I have always built in an assumption of wrongness to anything that I do. We now kindly refer to this practice as risk management, but I just wanted to answer the question: "What's the worst thing that could happen to me?" I never wanted to do anything that could kill me. Knowing that I was not likely to be right that often, I had to trade in a way that would make me a lot of money when I was right and not lose me a lot of money when I was wrong. If that wasn't enough, it also had to be simple enough for me to understand.

After many years of searching and learning things the hard way, I evolved my own version of trend following. The idea made sense and I had some good examples to follow. Still, I wanted to prove to myself that it worked without betting real money. I had to test what would have happened had I traded that way in the past. These were the early days of computers and we even had to "borrow" time on university computers to test and prove our theories. It was a painstaking task, but it gave me the comfort that I needed. Now, in reading *Trend Following*, the do-it-yourselfers might argue that having a book that illustrates these same basic principles takes some of the fun out of it.

Actually, Michael, like any good trend follower, has not focused solely on the endpoint. He gives you a deep understanding of the most important part: The path. Unlike so many other books that have been written about investing, *Trend Following* goes beyond the results to explore the journey of this outstanding group of traders.

For my staff at Hite Capital, Michael's *Trend Following* is required reading. For my daughters at home, it has finally settled the question I seemed never to have been able to clearly answer myself, "Daddy, what do you do for a living?" This book captures and conveys what so many traders have taken careers and large losses to learn. And lucky for all of us, you don't have to be Phi Beta Kappa to understand it.

We no longer live in that world of wheat guys, sugar guys and stock guys. Trend following trading is an important force in every market and should be a part of any diverse investment portfolio. For me, the discipline of trend following goes beyond trading and money management. Trend following is a way of thinking that can be employed in many parts of life as we all tend to continue to do the things that work for us and stop doing those activities that don't.

The way I see it, you have two choices—you can do what I did and work for thirty-plus years, cobbling together scraps of information, seeking to create a money-making strategy, or you can spend a few days reading Michael's book and skip that three-decade learning curve.

[Trend following firm] Aspect Capital is aptly named. Its group of physics-trained leaders took it from the aspect ratio of plane design, that is, the wider the wing span, the more stable the plane. As such, Aspect trades not only futures of its early roots but European equities, bonds and currencies in various forms, covering a so-called wider wing span. The London-based hedge fund was the brainchild of Martin Lueck, Eugene Lambert and Anthony Todd. Founded in 1997, the principals were involved in the development of AHL (now owned by Man) with a track record stretching back to 1983. Aspect's disciplined approach has successfully generated returns from both longs and shorts in difficult markets environments.

Futures Magazine and Aspect Capital

About Larry Hite

Larry founded Mint Investments in 1983. By 1990, Mint Investments had become the largest Commodity Trading Advisor in the world in terms of assets under management. Mint's achievements won Larry Hite and his team industry wide acclaim, and in 1990, Jack Schwager dedicated an entire chapter of his bestselling book, Market Wizards, to Larry's trading and risk management philosophy.

Throughout the 1990's, Larry served as a director at the New York offices of Man Financial as well as managing Mint Investments, the billion-dollar hedge fund company he founded. In 2000, Larry formed Hite Capital Management, LLC. He was joined in this endeavor by former members of the original Mint team, headed by Dr. Alex Greyserman, who continues to serve as the Chief Investment Officer at Hite Capital.

Throughout his career, Larry has been an active participant in numerous philanthropic organizations. He founded his own charitable enterprise, The Hite Foundation, where he continues to act as Chairman. Additionally, he serves as Chairman of the Development Committee for the Institute of International Education's Scholar Rescue Fund, an organization whose goal is to provide safe haven for academics and professionals who are at risk throughout the world.