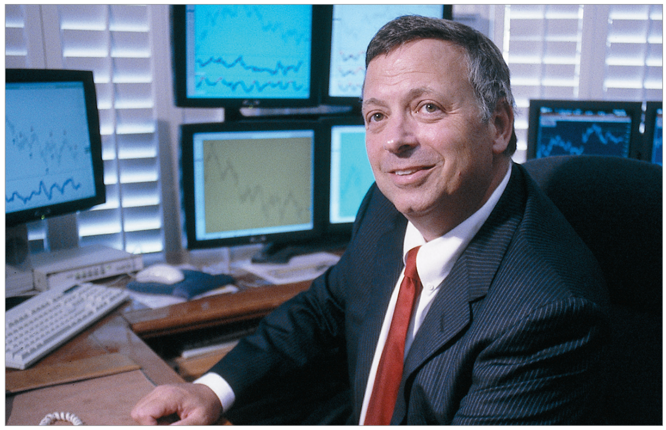
Tom DeMark

It might seem like a different trading world than it was in 1970, but for Tom DeMark, the game remains the same — price exhaustion.

BY MARK ETZKORN



There are still about two hours left in the trading day and Tom DeMark is recounting the latest success of the basketball program at his high school alma mater, St. Catherine's high school in Racine, Wis., which won its 11th state championship in March to go along with 19 conference championships since 1933.

DeMark played on a St. Catherine's team that took second in state his junior year in 1964, and he's obviously proud of his alma mater's continued success, despite its small size — enrollment is only around 350.

However brief, the discussion is a rare break for DeMark, who maintains an obsessive focus on the markets, even after 36 years and success that he admits exceeded his earliest expectations. Even before he published the three popular books (which he says he wrote because he was tired of other people passing off his work as their own) that made him more of a household name among retail traders, DeMark had a successful career as an institutional trading advisor and analyst, with clients ranging from IBM and Union Carbide to Paul Tudor Jones and, currently, Steve Cohen of SAC Capital.

DeMark has also become increasingly well known because several software platforms and analysis networks, including Bloomberg, CQG, and Thompson Financial have incorporated the indicators he's developed over the years. (Reuters is a future possibility.) His latest project is Bloomberg's "Cursor Commentary" service, an interpretation and expert commentary feature users will be able to access by passing their cursors over his indicators.

DeMark has not slackened his pace, perhaps because — like many people who excel in their fields — he appears to love what he's doing; it's not just a job or a means to an end. I reminded DeMark that, at a presentation nearly a dozen years earlier, he had mentioned he might not be doing this that much longer.

So, after 36 years, does he think he'll ever retire?

"No," he says, laughing. "I retired when I first went to work in this business after finishing law school and graduate business school. This is a vocation/avocation for me. Most of the people I know in business end up trading the markets when they retire, anyway, so I have a head start on them.

"But," he adds, "I've really been doing this for the equivalent of around 90 years because it's been seven hours a week, 20 hours a day."

He laughs again. "I have no life — maybe that should be the headline for the interview."

FOT: *How many hours do you put in these days?*

TD: On the average day I might get up at 3 a.m. and go until 9 at night. I follow the Far East markets, then the European markets, then the U.S. market, and then get ready to do it all again the next day.

FOT: *Why do you need to watch the markets all the time?*

TD: I've been working on the Cursor Commentary service for a couple of years, and since it has worldwide market application, I've been monitoring and researching foreign markets. My full-time job of consulting (*for SAC*) requires that I prepare for and follow the U.S. markets.

FOT: *Are there indicators or systems you've developed that have fallen by the wayside — things you don't use any longer because they don't work or you've developed something better?*

TD: Not really. The original TD Sequential, TD Combo, and a several other indicators — TD lines, TD relative and absolute retracements, and TD trend factor — are the cornerstone indicators that have been around more than 30 years.

Also, they were all developed pre-computer — I created them manually, using a calculator and examining charts with a magnifying glass.

FOT: *Are these tools still valid today, as far as you're concerned?*

TD: Oh, yeah. Sequential and Combo — the two key indicators — have never really been changed from their original designs. There have been a few adaptations —

FOT: *— you have variations of these tools you don't necessarily make public, right?*

TD: Yes, and it mostly has to do with how aggressively the different versions of the indicators are applied. Everything is there, in terms of the indicators that are available on the analysis platforms, but it would require some manipulation to get the ideal settings. That's exclusively for SAC.

But the original Sequential and Combo signals are still viable, which might be surprising, considering they were created in the mid-70s and first applied to currency futures, the Ginnie Mae and municipal bond contracts at the Chicago Board of Trade, and T-bills at the Merc. This was even before the S&P futures were launched in 1982, and before the first charting service, ComTrend, that offered one-minute charts. When one-minute charts became available, it surprised everyone that Sequential and Combo were applicable to that lowest common denominator.

FOT: *Was that a goal of your work?*

TD: Yes, universal application over all time periods — one-minute charts, daily charts, weekly charts, monthly charts. That's different from the work of many other people, who seem to optimize or customize things for different markets or time periods.

FOT: *Do you really think all markets are created equal, though, in terms of using your indicators? I mean, would you feel comfortable applying Sequential to intraday rice future prices, or cheddar cheese?*

TD: Yes, in fact, the indicators often work better on thinly traded markets and more-distant futures expiration months.

FOT: *Did computers reveal additional things about your tools that you hadn't been aware of before?*

TD: Definitely. There have been some things, like TDST, which are the resistance and support levels that are formed from Sequential and Combo price setups. Those levels didn't become evident until charts were available on computer screens and the interaction of price activity and the indicator became apparent.

And the nice thing is that now you see and learn things on one-minute charts instead of having to look at a daily chart on a piece of paper — you can see prices as they unfold and these numbers (*from the indicators*) appearing and disappearing, so you can draw conclusions from that. It's an educational opportunity.

FOT: *But what about things that just stopped working?*

TD: Well, nothing really comes to mind. Obviously, I've created these indicators and I'm not going to abandon them — they're like children. And most of the things I've developed have been programmed and are on different trading platforms now.

FOT: *But there must have been dead ends in your initial research and analysis, or things that took a long time to develop. Sequential, for example, doesn't seem like something that could have emerged fully formed, right out of the box.*

TD: The indicators often evolved piecemeal and their components required research and testing to develop. Much of the work, despite that trial-and-error approach, was in retrospect a result of inspiration more than anything else.

FOT: *Are you still creating new tools?*

TD: I've done things that aren't for public consumption, including a number of proprietary indicators for SAC.

FOT: *What's the unifying principle in your work?*

TD: I think 95 percent of it is price exhaustion, which is the antithesis of what almost everyone else does in the industry. The overwhelming majority of CTAs (*commodity trading advisors*) are trend followers, for example.

> Ninety-nine percent of the people in trading are not creative and they're not willing to rely upon themselves to make decisions.

FOT: *Did you ever explore trend-following techniques?*

TD: I initially worked for a large fund (NNIS) that grew rapidly from a couple hundred million dollars in 1970 to many billions of dollars. Out of necessity we had to buy weakness and sell strength, so I never thought of the market in any other context. After a bottom was made, it was impossible to accumulate any size, and when a market topped, it was impossible to sell after the peak. So my goal was always to anticipate tops and bottoms.

FOT: *How precisely are you trying to pick tops and bottoms? That's one of the unattainable "holy grails" of trading, isn't it? Don't such approaches run the risk of being too early, just as trend-following techniques are often too late?*

TD: Most of the time markets are in trading ranges and price exhaustion techniques are easily applied. The times when markets are trending can prove to be vexing, but a market often provides clues to trending by recording steep moves where price bars fail to overlap.

FOT: *Do you think about things any differently than when you started — that is, about the principles of price action or the*

continued on p. 38

"Turtle" trader publishes book

In his new book, *Way of the Turtle* (2007, McGraw-Hill), Curtis Faith recounts his experiences with the now-legendary "Turtles" — an experimental group assembled by traders Richard Dennis and Bill Eckhardt in the 80s to settle an argument whether trading skills were inherent or could be taught to anyone. Many of the traders in the program went on to start successful trading operations of their own.

Only 19 when he was selected to be part of the experiment, Faith was the youngest Turtle, and he also turned out to be one of the most successful, racking up profits in excess of $30 million in four or so years of trading.

In his book Faith, now 43, dissects the Turtle trading approach, some of his experiences in the program, as well as broader trading concepts and philosophical ideas he believes are important to successful trading and life in general.

In this preview of a full-length interview that will appear in the June issue of *Active Trader* magazine (available in May), Faith talks about his decision to write a book about his life as a Turtle after all these years, and some of the things he discovered about himself and the basis of good trading.

Why did you write the book, and why now?

I don't think I could have written a good book at the time, or shortly after the Turtle experience, mainly because I don't think I had a very mature understanding of the reasons for my success. I wasn't old enough to really understand how I was different from other people.

As a young trader in my early 20s I didn't understand the extent to which the way I thought about things was different from the way most people do.

Over the years, I've come to appreciate that the things that are easy for me aren't for a lot of people. And through the process of trying to teach people over the years, I've seen what consistently stands in their way of success.

Invariably, it comes down to just a few things — essentially, psychological barriers people put in place themselves. They don't have the ability to place enough confidence in their own thinking — especially when it comes to simple ideas. People have this need to create complexity, and they believe trading must be more complicated than it really is. When you try to teach them something that's relatively simple and say, "Yes, you can make a lot of money with this," they don't believe it.

Do you think your youth was one of the things that made you different in the Turtle experiment — that you had fewer biases or preconceptions?

I was asked that question before, and my answer was essentially, yes. But looking back, I don't think that was the major factor.

See the June 2007 issue of Active Trader magazine (www.activetradermag.com) for the in-depth interview with Curtis Faith and a review of his new book.

ways markets work?

TD: Obviously, there are a lot of things that have changed but, of course, the more things change the more they stay the same. I still approach the markets from the perspective of buying weakness and selling strength.

By the way, I don't call myself a technician — I'm a market timer. I've always believed fundamentals drive the market. I studied for it, but I never got my CFA (*financial analyst certification*) because I never considered myself a true fundamentalist. And conversely, I was one of the first members of the Market Technician's Association outside of New York City, but I never got the CMT (*certified market technician*) designation because I don't consider myself a technician. I'm some sort of hybrid of the two. I have mathematical justification for my indicators, which has made institutions more amenable to using my work.

Fundamentals drive the longer-term movement of the markets, but shorter-term you have to time your entries, and you do it with psychology and market-timing tools — ideally, with price-exhaustion tools.

FOT: *What are the flaws in the tools you see most people use?*

TD: The things that are in the public domain? By and large, they're all trend-following techniques, and they all pretty much have the same basis.

Take oscillators, for identifying overbought and oversold readings, for example. An oscillator works well in a trading-range market, but not when it evolves into a trending market. One of the things I've done with some of my overbought-oversold indicators is to make time as a factor: If there's a period of time when the market remains overbought or oversold, the indicator becomes severely overbought or oversold; duration becomes a factor and, as a result, the amount of time the market is overbought or oversold tells you [whether it's a justifiable signal]. Then you have to wait for the market to relieve that extreme condition by moving the oscillator back to neutral and recording a mild overbought or oversold reading.

Also, everybody talks about moving averages, and they have their ideal average or series of moving averages. But if a market is trending, *any* moving average will work. And if a market is moving sideways, *any* oscillator will work. It's those times when the market is moving from one to the other that you have to deal with. I've also addressed this with the severe overbought-oversold readings based upon duration — specifically, if the market remains overbought or oversold continuously for an extended period of consecutive price bars, it typically indicates a trend is in force and it would behoove you to respect this trend.

FOT: *Have any people you worked with influenced you?*

TD: There are several people who have been influential, not in the sense that they directed me one way or the other in my ideas, but by being models in terms of their dedication to — or really, obsession with — the markets.

Larry Williams, I think was an inspiration to just about everybody in the 70s. Larry also has something I don't have, which is the ability to pursue other interests — politics, exploring — besides trading.

Joe Granville was a model for a lot of people. He is very bright, and he called the market exceptionally well in the late 70s and early 80s. Both of these people have great work ethics.

But there are plenty of charlatans in the business — people who take credit for other people's work.

Related reading

Click here for more information about some of the indicators in this article.

Tom DeMark's books:

- *The New Science of Technical Analysis* (John Wiley & Sons, 1994)
- *New Market Timing Techniques* (John Wiley & Sons, 1997)
- *DeMark on Day Trading Options* (McGraw-Hill, 1999)

The following list include an article cowritten by Tom DeMark, plus an in-depth interview and analysis of a trading system based on one of his trading techniques.

"Absolute price projections," by Tom DeMark and Rocke DeMark (July 2004).
TD Absolute Retracement, the market-timing approach outlined in this article, is a mechanical technique for calculating price retracements and extensions that avoids the subjectivity and ambiguity of conventional technical approaches.

"Active Trader Interview — Tom DeMark: Objectively speaking"
by Mark Etzkorn (November 2001).

"DeMarking trend exhaustion zones," by Lindsay Glass (July 2002).
This article shows how to use different DeMark indicators — TD Sequential and TD Combo — to identify trend-exhaustion zones.

"Trading System Lab: DeMark variation," by Thomas Stridsman (September 2001).
This system is based on a pattern called "TD Carrie," described by Tom DeMark in his book *New Market Timing Techniques*.

Tom DeMark Four-Article Set: The four articles listed above, in a single PDF file and sold at a discount through the *Active Trader* store.

You can purchase and download past articles at www.activetradermag.com/purchase_articles.htm.

FOT: *On that topic, what's the worst part of the business for you?*

TD: Ninety-nine percent of the people in the business are followers. They're not creative and they're not willing to rely upon themselves to make decisions, so they rely upon other people. When the decision is right they take credit for it, and when it's wrong they point fingers at other people.

And out of that one percent who do make their own decisions and create their own tools, 99 percent of them are going to be wrong, so you've got about one-tenth of one percent that are going to be right.

The market is [full of lemmings]: everyone feeding off one another, following the media, and following a trend.

But floor traders — the specialists, when they were still influential in the market — always operated against the trend.

For more of our conversation with Tom DeMark and specific details about his indicators, see the July 2006 issue of Active Trader *magazine, available in June.*