

Meet Jesse Livermore

Jesse Livermore was perhaps the best stock trader who ever lived. During his lifetime, he was a legend of Wall Street. He was “The Boy Plunger,” “The Wolf of Wall Street,” “The Great Bear of Wall Street.” When he was alive, he was as famous as Warren Buffett is today, although they had entirely different trading techniques.

He was a quiet and secretive man, given to keeping his own counsel. After losing several fortunes by listening to tips and the advice of men he thought were smarter than he was, he closed his offices near Wall Street at 111 Broadway, moved up to the Heckscher Building at 780 Fifth Avenue, and set up a palatial suite of offices. On one of his many trips to Europe, he had found a manor house in England with a huge paneled library. He bought the library, including books, paneling, and furniture. He had it disassembled in England and reconstructed in New York.

The library was highly secure, with a private keyed elevator. It occupied the entire penthouse floor. When visitors exited the elevator, they found themselves in front of a big metal door that opened onto a small anteroom where Harry Dache would be waiting. Dache was a six-foot-six, former merchant mariner. He was Livermore’s bodyguard, chauffeur, confidante, and tutor of languages and life to his two sons. Once past Harry, visitors entered a suite of palatial offices, including one large room in which six men worked in silence on a walkway in front of a chalkboard, posting stock prices.

Once the market opened no one was allowed to talk. Livermore demanded silence for perfect concentration, so so that he could focus on the market and the price, time, and volume signals of the stocks he was inter-

ested in. With the ticker tape clicking, the chalkboard men posting the prices, and direct phone lines to the various stock exchange floors, the steady stream of current information never ceased after the opening bell. Livermore considered himself a student of the stock market all his life, and he loved it.

Livermore was born on July 26, 1877, in Shrewsbury, Massachusetts. His parents were New England farmers trying to scratch out a living from the rockstrewn fields. As a youth, Livermore was slight and sickly, which resulted in a lot of reading and solitude. He was a boy with a quick mind and good imagination, as well as a natural aptitude for numbers.

In a short while, he decided that his boyhood dreams and the adventures he had read about could not be realized in the unyielding New England countryside. At the age of fourteen, he was pulled from school by his father and sent to work in the fields. This only strengthened his belief that success rested in using his brain, not his body. He soon entered into a conspiracy with his mother, who supplied him with \$5, and he formulated an escape plan. One afternoon, he simply slipped out of the farmhouse to the main road to Boston, hailed a wagon, and rode into the city. By chance, the wagon stopped in front of a Paine Webber brokerage office, and he wandered inside.

It was love at first sight for Livermore. He was enthralled with the brokers' office, city life, adventure, unbridled youth, and freedom. Paine Webber needed a chalkboard boy to post the stock prices for the customers, and he jumped at the opportunity. As far as Livermore was concerned, fate had extended a hand, and he grabbed it. Within hours of leaving the farm, he had a job, and with his meager funds he rented a room and became his own man before he was fifteen.

His mathematical brain set to work immediately as the quotes were yelled out by the customers from the ticker tape spitting out an endless stream. Soon, Livermore would challenge the crowd to yell out the quotes faster. With his brain in high gear and his concentration focused, he could write the numbers down on the board faster than the crowd could yell them. He felt alive with the challenge.

But Livermore was not just writing down numbers, he was in sync with them, in harmony, and soon he began to see recurring patterns and cycling trends. He kept a notebook, and during his breaks he would copy down these numbers to see if he could recognize the patterns.

He was also sensitive to the crowd. As the numbers changed and as the stocks moved up and down, so too did the mood of the crowd. They saw a stock's volume increase, and the excitement level increased. He could almost feel their heartbeats accelerate. He saw their eyes light up as their trading increased. It did not take him long to figure out that as they saw opportunities to make money their personalities changed. All of a

sudden, there was an excitement in the air as the price climbed. But this excitement often died as the stock price rolled over and fell—the crowd became quiet, often sullen, and sometimes despondent.

Livermore was eventually able to define these emotions as greed and fear, the two dominant emotions that, he understood, drove market action. He noticed how the traders all talked among themselves, buoying their confidence, reassuring themselves; he also noticed how often they were wrong.

One day, the office manager told him something that he was to wrestle with for the early part of his life. “Hey, Kid, see how these guys all talk among themselves, figuring stuff out about why this happens and why that happens? You see how often they are wrong? Well, I’ll tell you something that could help you: It isn’t what these guys say to each other that counts—it’s only what the goddamn tape says that counts!”

At first, Livermore did not get it. But then one day the light went off in his brain: “Don’t concern yourself with *why* things are happening, only observe *what* is happening. The reasons why will be eventually revealed to you—by then it will be too late to make money—the move will be over!”

Livermore was a good-looking, easygoing kid, with a quick smile and a calm demeanor. His keen intelligence and natural curiosity were obvious to those who knew him. Blond with a perfect set of white teeth, he stood five feet eleven inches tall. He always wanted to be six feet, and later in his life he owned 30 pairs of elevator shoes that raised him the extra inch he wanted. He always found ways to get what he wanted—it was a life pattern for him.

Livermore soon felt that he was receiving more than a university education, a specialty education in stock market trading. He made a series of observations in his diary that later helped make him millions. But he never was motivated only by money. Rather, he was motivated by curiosity, excellence, and a desire to be the best—the best stock trader who ever lived. He knew that the money would come. The money was the reward. Livermore made two observations at his young age:

1. The majority of traders and investors lost money on a consistent basis.
2. The majority of traders had no intelligent and consistent plan to trade the market. In effect they were gambling. Playing tips. Playing hunches. Playing the favorites of the moment. Playing all kinds of tips—tips from analysts, friends, insiders.

In other words, as far as Livermore was concerned, what he saw other traders doing was simply random-action stock picking—deadly and dangerous. The same is just as true in today’s trading environment.

It was then that he decided to spend his life developing his methods, his strategy, and his stock-picking system. He did this in secret, for his own use. He was insatiable in his quest for knowledge. One of the clients in the brokerage house was a professor who, one day, gave him a book on the laws of physics, with the comment, "Maybe there is something in here that you can apply to the market."

There was. The professor had underlined. "A body in motion tends to stay in motion until a force or obstacle stops or changes that motion." Livermore thought long and hard about this, and agreed that *momentum* was a key factor in the behavior of stocks in both directions—*up* or *down*.

He kept his trading diary in secret. He was secretive and quiet by nature, feeling no desire to share his thoughts with others. He was like this all his life. He believed idle chatter was a waste of time and that all that really counted was action. And to him that was what the stock market was, pure action—every minute was dynamic and true: pure to itself and its own rules.

One day his boss caught him making entries into his secret diary. "Hey, Kid, you trading in your head making *pretend bets*? Useless waste of time, Kid. You gotta lay your money on the line in this game. Then you'll see that everything changes for you because your emotions take over, not your intellect. Don't waste your time with that pretend stuff."

Livermore discovered that his boss was correct. The minute the money goes on the line, everything changes. Even his physiology changed. His blood pressure increased, sweat appeared on his brow, he could feel his heart beat increase—the trade loomed as the largest thought in his mind. Yes indeed, his boss was correct, but Livermore liked the rush; it made him feel very alive.

When he was 15, six months after he had started at Paine Webber, he made his first trade. One of the other boys came to him and suggested they go across the street to the bucket shop.

Livermore agreed. He had some confidence in the recurring patterns he had noted in his diaries, and he had developed some trading methods in his mind and tested them on paper. He decided it was time to make his first real trade.

A bucket shop was a place where one could play the market on 10 percent margin. Its atmosphere was more like an offtrack betting parlor than a broker's office. The stock ticker spewed out the trades as they happened on the exchange, and the prices were recorded on the chalkboard. The rules were simple: Put up your 10 percent in cash, place a bet by buying a stock and receive a printed receipt for your purchase. Then sit back and watch the action. As soon as you lost 10 percent of the value of the stock, the house swooped in and took your money. Conversely, if the stock went up you could cash in your ticket at will. The house won almost

all of the time. It was usually a sucker play—with the customers being the suckers. They were simply bad stock pickers.

The bucket shop kept the money. It was never used to buy the stock. The actual purchase of the stock was *booked* by the bucket shop, as bookies still do. Together, Livermore and his friend scraped together \$10 to buy steel. Checking the calculations in his diaries, Livermore saw a good opportunity, and they placed their order. Within seconds, steel rose, and they closed out their trade with a profit of over \$3 on a \$10 play—Livermore was hooked. He had made in seconds what it usually took him a week to earn at his job.

Soon, Livermore quit his job and was playing the bucket shops. In a year, he amassed profits of over \$1000. He returned triumphant to his parents' farmhouse and gave his mother back the \$5 she had given him and \$300 more, as a present. The visit showed them that at the age of 16 he had already become a successful stock market trader. His dumbfounded father accepted the money.

Livermore returned to Boston and continued his trading. As he did, he carefully recorded all his trades, studying them for patterns and trying to improve his methods. As time went by, he became so successful that he eventually was banned from every bucket shop in America.

Unable to play in the bucket shops, Livermore traveled to New York City. At 20 years of age, he arrived in New York with \$2500 in his pocket. His stake had been as high as \$10,000, but he had suffered reversals like everyone else. His philosophy, all his life, was simple: "Learn from your mistakes, analyze them. The trick is not to repeat your mistakes," which meant to Livermore you had to first understand your mistakes—find out what went wrong with the trade, and don't repeat the same mistake again.

Livermore considered his days trading the bucket shops as his education, his college days, his apprenticeship. He had already established some early rules. But could he follow them?

The first two trading rules Livermore had listed in his secret diaries: "Basic Rule:—Before pulling the trigger on a trade place as many factors in your favor as possible." Livermore felt that success was achieved when *all* the basic factors were in his favor, and he concluded that the more factors he could think of the more successful he would be.

The next rule was this: "No trader can or should play the market all the time. There will be many times when you should be out of the market, sitting in cash waiting patiently for the perfect trade."

So, armed with \$2500 and his experience in the bucket shops, Livermore entered the action on Wall Street. He befriended E. F. Hutton and opened an account at his brokerage firm.

He began trading and almost immediately went broke. Then he had to figure out why.

He went to his friend and mentor E. F. Hutton for help.

Excerpt from *Jesse Livermore—World's Greatest Stock Trader* by Richard Smitten (John Wiley & Sons, 2001).

“Ed, I can’t beat Wall Street right now. I’m going back to the bucket shops. I need a stake, then I’ll be back.”

“I don’t get it.” Hutton said. “You can beat the bucket shops, but you can’t beat Wall Street. Why’s that?”

“First off, when I buy or sell a stock in a bucket shop I do it off the tape; when I do it with your firm it’s ancient history by the time my order hits the floor. If I buy it at say, 105 and the order gets filled at 107 or 108, I’ve lost the comfort margin and most of my play. In the bucket shop if I buy it off the tape I immediately get the 105. The same is true when I want to sell short, especially on an active stock where the trading is heavy. In the bucket shop I put my sell order in at say, 110, and it gets filled at 110, but here it might get filled at 108. So I’m getting it from both sides.”

“But we give you better margin than the bucket shops.” Hutton said.

“And that Ed, is what really killed me. With the extra margin from you I could stay with a losing stock longer, not like the bucket shop where a 10 percent move wiped me out. See, the point is that I wanted the stock to, let’s say, go up and it goes down. Holding on to it longer is bad for a trader like me because I was betting it would go up. I can afford to lose the 10 percent but I can’t afford a 25 percent loss on margin—I have to make too much back to get my money back.

“So, all you could ever lose in the bucket shops was the 10 percent because they would sell you out.”

“Yes, and it turns out that was a blessing—all I ever want to lose in any one stock is ten percent.” Livermore said. “Now, will you lend me the money?”

“One more question.” Hutton smiled. He liked this boy—he was a force to be reckoned with, a mental force. “Why do you think you can come back here next time and win, beat the market?”

“Because I will have a new trading system by then. I consider this part of my education.”

“How much did you come here with, Jesse?”

“Twenty-five hundred dollars.”

“And you leave with a borrowed thousand dollars.” Hutton said, reaching into his wallet and extracting the thousand in cash, handing it to Livermore. “Hell, for 3500 dollars you could have gone to Harvard.”

“I’ll make a lot more money with my education here than I ever would have, going to Harvard.” Livermore said, smiling, as he took the money.

“Somehow, I believe you, Jesse.”

“I’ll pay this back.” Livermore said, pocketing the money.

“I know you will. Just remember when you come back—do your trading here—we like your business.”

“Yes sir, that I will.” Livermore said.

Ed Hutton watched him leave. There was no question in his mind that he would see him again.

Jesse Livermore made and lost fortunes a number of times. He lived in opulence, maintaining several palatial homes complete with staff, including a permanent barber. He owned a yacht, and he and his wife kept his and her Rolls Royces. He even had a private railcar, which transported him to Chicago and the grain pits at the Board of Trade, although he never appeared on the floor of any exchange.

Livermore went bankrupt four different times; each time, he paid back every cent to his creditors when he got back on his feet. His skill in trading the market and the resulting incredible lifestyle did not, however, insulate him from tragic events, culminating in his suicide in New York's Sherry Netherlands Hotel in 1940.

Jesse Livermore was, and still is, considered by many Wall Street traders as The Greatest Trader Who Ever Lived. But The Greatest Trader Who Ever Lived knew that happiness was elusive and had nothing to do with wealth.

