Chapter 1

A Brief Look Back at the Good Old Days of Oil Trading

An old cliché says: "To know where you're going, you have to know where you've been." The oil markets have become broken, but they weren't always. In the first 20 or so years of my career as a trader, the oil markets worked much better—at least for consumers and the economy at large; it provided much steadier and generally much, much cheaper prices. Describing how things used to work will quickly show you why.

In my earliest days, from 1983 until about 2000, it was very difficult surviving as a day trader in oil. Statistically, only 15% of those who tried to be floor traders during this time period were able to survive for more than five years. Why was that? Well, simply put, it was about volume and volatility. Nobody outside of the oil companies and our small band of traders cared much at all about oil. So our days were an endless string of small volumes and small ranges. After all, if nothing much moves, how can you make money? It's tough, believe me. We'd wait for something to happen and take advantage of the spurts of interest and motion. In those days, the trick was surviving long enough to see the good days ahead.

In the second part of my career, the world began to see oil as a financial opportunity, although they first struggled with how best to capture it. These were the golden days for us on the floor—from about 2000 until around 2006. Enormous daily volumes and movement began to come into our oil markets, and we finally began to live the dream that most people imagine when they think of oil traders. Opportunities, both to win and lose, arrived practically daily. Floor traders had their best years ever.

The final stage of my career began in 2006, when markets began shifting to electronic venues, and OTC markets began to really swell. But it was a confusing time for the career oil trader on the floor. Volatility, which was normally the lifeblood for profits, had never been greater. Volumes were astronomical and growing daily. And yet, there were no profits to be had. On the contrary, our honed skills seemed to be working against us, and the rules that we had learned were turned upside down by the financial market forces that now completely dominate price. But the story of energy futures trading on a tiny New York commodity exchange begins in 1979, and there, on the floor of the New York Mercantile Exchange is where I appeared, as a fresh-faced participant soon after, in 1982.

Who Grows Up Wanting to Be an Oil Trader?

Going through high school, I had little idea what I would do for a career. I had certainly never heard of commodities. I was ignorant of what that word even meant. *"Commodities? You mean like pork bellies?"* Why pork bellies always comes to mind when anyone mentions commodities (even today) is a cruel joke to anyone in the industry. But that's what I thought of whenever I heard talk of commodities on the news.

Meanwhile, my father ran a small hospital on the south shore of Long Island, NY, and he was keenly aware of the advantages to being an MD. *"You don't know what you want to do? You're good at the sciences—be a doctor,"* he told me.

Good enough. I headed off to college to undertake pre-med courses, with a couple thousand other smart kids whose fathers also thought that was a pretty good major—if you didn't have a better idea.

However, I quickly found out the work required to actually *become* a doctor wasn't so much fun. I was good at school, good at taking tests and retaining information, and I was a decent writer. But I hated the long classes and the arcane material—organic chemistry being a particularly difficult course to bear. I was far more of an instant gratification kind of guy, never happy working at something for weeks and months at a time for a grand result.

Besides being impatient for success and a bit lazy, something else began to take hold of my interest and thwarted my father's (and my) plans of me becoming a doctor. I fell in love with the horse races. I started going to Belmont Park almost as soon as I could drive and could legally bet. I loved that feeling of vindication and validation—of having taken the raw information of the arcane numbers and symbols in the daily racing form, and converting those to relative odds and a betting strategy. That process had just enough math, just enough analysis, and just enough exposure to real risk to create the perfect cocktail for me.

I knew I was pitting myself against the rest of the betting population in every race, that I was in silent competition with them. To continually make money at the track according to this system, the foolproof plan to follow was simply to be smarter than the rest of the betting public. I wasn't a genius, and I didn't come up with any grand new theories of assessing the abilities of horse flesh that gave me any kind of significant edge over the rest of the betting public. Like most other players, I wasn't a long-term winner at the track. But that didn't stop my passion. And 'a good score' (a nice payoff on a race) would go a long way to bringing me back again and again looking for that fantastic, validating feeling.

I remember my first $500 wager on Slew o' Gold, a four-year-old horse running against three-year-old contenders and winners of that year's Triple Crown races. At almost three-to-one odds, Slew o' Gold was clearly being overlooked, but Slew had been racing beautifully in other handicaps and stakes races. To me, he seemed to have only gotten stronger since his own Triple Crown campaign a year earlier.

That horse, on that day, represented to me an incredible and rare, maybe once-in-a-lifetime money-making opportunity, and I summoned the courage to put down more money than I really could afford to lose at the time, right on his nose. The feeling of elation and superiority I felt when Slew bounded across the finish line an easy two lengths in front has never been matched since, although I have continued to search and hoped to find equally validating money-making opportunities every day of my life. But there's something particularly special about the horses that even a good stock buy or a value sale of a long-term spread can't match.

I retained my love of the ponies deep into my trading career. It should come as no surprise that I was met on the floor by many others who had spent plenty of time at the track in their youths, and retained an interest. My early boss whom I clerked for, Mike Milano, was one. Another was Harry Bienenfeld, a legendary platinum trader who left the metals pit to take advantage of the exploding oil markets and ended up standing next to me for much of my career in the gasoline pit. I would see Harry at the old Roosevelt Raceway trotters track in the evenings after the markets closed, when I was still a clerk and only aspiring to become a trader. Another horse junkie from the floor was Joel Bush, a wonderful man who worked for various independent brokerage houses and represented his love of the track by his badge "HORS" (in those days, there were no five-letter badges). Some even owned horses, like Sandy Goldfarb, who had established his own very successful brokerage operation as well as a pretty well-known stable of horses over the years. And Leon Mayer, the godfather of the gasoline pit, who used to stop me when he saw me leaving the trading floor for the track. He'd reach into his pocket, draw out 4 crisp $100 bills, and tell me with his thick Yiddish accent, "*DANO, in the 3rd, 5th, and 7th race, give me the 1, 5, and 7 exacta box for $20. And the rest is for you!*"

But before finding myself among my own kind on the floor of the exchange, where gambling on the races was considered a useful skill and to be admired, I fought the tendency to waste my days at the local off-track betting (OTB) during my college days at the State University of New York at StonyBrook. In one particularly bad semester of procrastination and self-destruction, I spent most of my days trying to find the best-quality $18,000 claimer running in the fourth race at Aqueduct instead of trying to figure out the annealing point of phenols—a much more appropriate use of my energies then. Through a massive rationalization, I had managed to convince myself through much of that semester that I could make up all of the work I was missing until two weeks before final exams, when I had to admit that maybe I was in a bit of a fix. I needed to petition the academic board at the University to remove the semester of NRs (Never Reported) from my records for extreme circumstances. And I was on academic probation for three semesters after that, forced to submit every test score from every class to the committee to prove I was staying on the straight and narrow.

I never went back to the OTB during classes after that, doing well for the rest of my college career, but I had sunk any chance I might have had of going on to medical school. I wasn't sorry. Even now, I can't imagine how I would have been able to stand an additional four years of brutal graduate work followed by another four years of residency to complete a medical degree and finally be in a position to make some money. Whether I had sabotaged myself or not, it was clear how much I hated school. And it would soon become clear how much my passion for betting on horses would have in common with my ultimate career in trading oil.

The Family Tree of Brokers

After the OTB semester, however, not only did my grades improve. I was lucky to fall in with a group of guys who shared much in common with me: Jewish, with European parents, and a familiar upbringing. One was Mark Burnett, whom I met, in a great coincidence of serendipity: we both owned beat-up 1973 red Toyota Corollas, and he mistook his car for mine one day. We hit it off right away and became great friends and suite-mates.

During the time at college with Mark, I kept on hearing of the "neat" job his cousin had as a broker for heating oil in New York. And I kept in touch when Mark joined his cousin on the floor of the exchange, working as a broker after his graduation. After graduation, I had no thoughts of commodities initially; instead, I thought of using my facility in German, gained through school study and a summer spent in Frankfurt working for an import/export firm. In New York, I scoured the papers for jobs that would allow me to continue to use my language skills and give me some continuing international contact, since I had always enjoyed travelling overseas. But all the opportunities I encountered on graduating amounted to little more than secretarial and bookkeeping roles, and instead of being questioned in interviews about my world view or fluency in German, I was constantly being asked how many words a minute I could type.

After a few months of this, entirely frustrated, my father again had a bright idea.

"*Why don't you go see what Mark's doing?*" he suggested, not knowing the first thing about commodities either. "*It sounds fast, and you don't have a lot of patience anyway.....you might like it.*"

I went down to the floor. Mark introduced me to Drew Stein, who was working the phones at a small independent oil company brokerage, where Mark and his cousin were filling orders in the young heating oil pit. Drew knew everyone on the floor and helped me run around, looking for a start-up position I could fill. He had a good relationship with many of the locals and particularly one, Howard Hazelcorn, who had become frustrated with his daily position clerk and was looking for an excuse to fire him. I became the perfect excuse. Inside of a week, I started for Howie and his partner, Mike Milano, at a starting salary of $160 a week. Thanks to Mark and Drew, I was in the commodities business.

Over the course of my many years on the floor, I found out that my story of how I came to be on the floor was similar to so many others. It was almost impossible to get started on the floor of *any* exchange (not only ours) without the help of someone already there. I never heard a story of anyone who answered an ad or got a call from an employment agency for a position as a phone clerk or a runner or a broker's assistant. It seemed that everyone on the floor got there through the help of a relative or a friend. Like six degrees of separation, you could trace an almost incestuous family tree of members and brokers, all giving the leg up to someone else on the floor. It was a very, very closed group.

First Impressions of the Trading Floor

I don't literally remember the first day I walked onto the trading floor of the New York Mercantile Exchange at 4 World Trade Center (4WTC) sometime in 1982. But I do recall the first few months of my life there. Back then, the trading floor was shared by four separate exchanges at the same time: the Commodity Exchange (COMEX); The Cotton Exchange; The Coffee, Sugar, and Cocoa Exchange (CSCE then, ultimately renamed the New York Board of Trade, or NYBOT); and my NYMEX. This quartile arrangement placed the NYMEX at the furthest corner of the room. Our exchange had 816 memberships, or seats, that were allocated. (Each of the other three exchanges had a similar number of seats available.) You needed a seat to transact trades and each seat was in constant use. The support staff for each member either taking care of orders or trading his own accounts (or a little of both) was probably a little more than two other people: brokers required much more help than independent (or local) traders. Add to that population the exchange employees necessary to register trades, work the trade entry room, and administer to exchange business, and you were looking at quite a crowd on this shared, 20,000-square-foot trading floor. We had an intimate (if not ridiculously crowded) condition in which we worked, at least when I first started out on the floor in 1982, as a fresh-faced 22-year-old college graduate.

Even as I remember it now, the scene was incredible. I clearly recall attending my first baseball game, at the tender age of five, because of the impression those vast green fields and living crowds had on me. At age 22, the space carved out for the four New York commodity exchanges were nearly as impressive to me. Pricing boards, with hundreds of unfathomable numbers, ratcheted constantly on all four tall walls, which led up to the amazing 40-foot ceiling. These boards would be considered antiques today, but when I first arrived in 1982, they were a major upgrade from the handwritten chalk boards that had been in use in the previous exchange location at 15 Harrison Street (where NYMEX had moved from, into its new digs as part of the Commodity Exchange Center, in 1979). And they literally ratcheted, making a loud clicking noise when the prices changed. Represented in orange and green numbers, you could easily tell which were the most current (or last print) prices from the older traded prices.

Members of each exchange were easily recognizable from other workers and exchange employees. Each one of them wore a badge—a colored identification card that contained a trader number on top of the badge, which was assigned by the exchange, and a (usually) three- or four-letter handle underneath the trader number, which traders were allowed to choose for themselves. Each exchange had its own unique color that referred to the membership badges that were associated with it: green for COMEX, light blue for the CSCE, orange for the Cotton Exchange, and yellow for NYMEX members.

A membership entitled a trader access to all of the products each exchange had exclusive control over. A few traders owned memberships in more than one exchange, and that was represented with badges cut into two or three of the exchange colors. But I *never* saw four colors on one badge, which represented membership in all four exchanges. Why not? Because only a vaunted few traders purchased licenses to enter and trade in *every* product offered on that combined exchange floor: therefore, they received special badges: the Gold badge. I gave these trading monsters wide berth and spoke of them in hushed tones—as if the ownership of four memberships assigned some great success and reverence to the person wearing the badge. To a 22-year-old who knew nothing of commodities, it was pretty impressive to me.

As you walked back into the NYMEX corner, three trading centers or pits were evident: The first ring you came in contact with was the Potato Pit. Trading in Maine potatoes was a holdback from the earliest days of the exchange, when the NYMEX was first known as "the Butter and Eggs exchange." Its agricultural roots had all but disappeared, except for this last representation into the 1980s, with the potato contract. There was good reason that potatoes had survived to see the new exchange address at 4WTC. It had been the engine which had all but supported the exchange for many years, when other commodity exchanges floundered and disappeared. In many ways, the NYMEX really owed its life to this old and quaint marketplace.

But when I got to the exchange in 1982, although the potato contract had a few more tricks and turns to play out before it was delisted in 1987, it held little interest for me or other young traders breaking into the commodity markets. The traders who populated the Potato Pit were the remaining old-timers from Harrison Street, mostly over 60 years old. And in those days, on the floor of the rapidly growing commodities game, 60 years old was considered beyond ancient. The median age outside of the Potato Pit at NYMEX couldn't have been much more than 25.

The guys who didn't exclusively trade their own accounts in the Potato Pit were often the owners of the small independent brokerages that tended to the potato orders coming in from farmers and end users. It was a tight-knit group that few independent traders wanted to try to invade, mostly because it was a quiet, steady, and ultimately not-very-sexy market.

One of the first traders I met on the NYMEX floor was a 50-ish local trader in the Potato Pit. He never ventured outside of it, and he couldn't have been happier. With some patience, he often glowed to me how he could find a "couple of good trades" a day in the quiescent "spuds," often netting him $200 or *even* $300 in a day. "*Shhh.......don't tell anybody*," he would say, literally guilty about the great world he was a daily part of. "*What a wonderful business!*" he would crow. "*I can't believe I can do this for a living, as opposed to really working!*" Many of us over the years shared his disbelief and some of the guilt, but as a young man on the exchanges, I had no idea what he was talking about. And I wanted much more. As excited as this potato trader was about his small market, everyone else knew that the really great prospects on the fast expanding NYMEX were not going to be with the quickly unwinding and dying potato contracts.

One of the more likely sources of a future living was to the right of the small Potato Pit, the Platinum Ring. The platinum and palladium pit contained the most active NYMEX contracts at the time, populated by traders who wanted access to the only metals markets that NYMEX controlled. Metals were the most lucrative markets available to traders in New York in those days and had dwarfed trade in every other New York commodity market in the early 1980s. The huge bull market in metals and the Hunt Brothers' attempts to corner the silver market (which culminated in the "Silver Thursday" market collapse on March 27, 1980) were still a fresh memory. (If you're not familiar with this episode, the Appendix offers a summary.) Roiling from that fortune-making market move were still being felt when I entered the floor in 1982, and many thought that the next great bull market would be repeated in metals at any moment, so they wanted access. In hindsight, their expectations were misplaced. Although platinum touched over $1,000 an ounce in early 1980, it would be late 2008 before we saw that milestone price again.

Compared to the Potato Pit, however, Platinum was a powerhouse: it had as many as 100 or more traders wrapped around a very tight circle toward the right edge of our quad. Compared to the enormous COMEX Gold and COMEX Silver contracts, however, Platinum was a very weak sister indeed, and Palladium was even more miniscule. Still, the desire for exposure to metals during the 1980s was so strong that Platinum offered NYMEX members a very good trading opportunity and housed some of the most expert and successful NYMEX traders.

The upstart pit of the NYMEX offerings was the newly created #2 Heating Oil contract, begun in 1978, where all the young and fresh guns were heading to make their fortunes. Getting commercial interest from oil producers and users was the major hurdle to the initial success of energy contracts at our exchange—no one knew if any oil participants, let alone the largest oil companies, would even bother with the tiny financial opportunities offered by the NYMEX, a blip on their radars. But little by little, commercial participants began to use the contracts and get more and more involved, spurring a gasoline contract to be listed to flank the heating oil in 1981, and finally inspiring what would become the flagship contract—West Texas Intermediate Crude Oil Futures—in 1983. Before the better part of a year of clerking had passed, I took my opportunity to become a trader by completing the exchange's training course, borrowing $25,000 from my father to open a trading account and signing a lease for six months for a seat with which to trade, at the cheap price of $400 dollars a month. In 1983, I walked into the New York Leaded Gasoline pit for the first time as a member of the NYMEX and as a bona fide oil trader.

How the Trading Floor Worked

Anyone who has seen the movie *Trading Places,* with Eddie Murphy and Dan Aykroyd, has some idea of what the trading floor looked like back in the old days of trading oil. Believe it or not, that scene was filmed on location, in 1983, at the NYMEX where I worked for 25 years, at the now-destroyed 4 World Trade Center building. I remember that traders were given the opportunity, for 50 bucks, to come back down to the floor on a Saturday to appear as extras in that film. Very few brokers accepted that offer, however—a reflection of the big money we were making, the exhaustion we all felt by the end of the week, and the horrible prospect of coming back down to the floor on a weekend. In fact, most of the people in that scene were clerks who borrowed trading badges from their bosses in order to briefly appear. Although that scene is probably the best known representation of a commodity trading floor captured for the general public, it is an entirely false one.

The sounds and rhythm of a trading floor in full flight is singularly unique and impossible to recreate with fake orders and symbols. Unfathomable to neophytes and outsiders, every sound adds a layer of information to those engaged in trade on the floor. To us, the noises of the floor were anything but chaotic. It was a perfect symphony of sounds, where every order bid on and countered with offers was an added note on that musical staff. Floor traders quickly get used to the rhythm and music of the noise on the floor, instantly subtracting the useless information and internalizing the important sounds. Many of the traders on the floor became adept at taking these waves of sound and turning them into trading decisions. On most days, I was one of these types of traders.

So there I was, standing shoulder to shoulder with another 120 sweaty, smelly traders, elbowing my way toward the center of the ring, so that I could be seen and heard by the crowd when I needed to be. These guys were my friends and my enemies. But everyone knows that once the bell rings, relationships will instantly change.

Everyone is alone in this crowded space, known primarily by the letters on the badge they wore. Traders sometimes referred to another broker by combining his first name with the badge symbol—*"you hear* *what happened to Johnny DEVO?,"*—but more often, the badge itself sufficed to name you, especially if it easily rolled off the tongue—"*Hey Freddo*!" (FRDO) or "*What the f*** are YOU lookin' at, DUBS?*"

I was one of these. DANO was my badge, named by my first employer down there when I was a lowly clerk. It was a reference to the 1970s TV show *Hawaii Five-O*, which shows just how old my boss was. But it stuck well enough that I used it when I entered the ring in 1983. I liked a single, recognizable name, like Cher, but far less famous (or successful).

I spent most of my career in the unleaded gasoline pit, a small sideshow to the larger and much more crowded crude oil and natural gas pits. But we had our cast of characters. Everything that was listed for trade in unleaded gas could be quoted and traded in that pit, and we listed 24 consecutive months as well as listing December quotes as far out as six or seven years. But 90% or more of the trading was done in the first four or five months listed, and probably two-thirds of that was confined to the first two months on the board. It's where a lot of the open interest was (contracts that weren't closed out by the end of the trading day) and where the most liquidity could be found.

The bottom line was always liquidity: it gave you easy access in and out of the market at prices that you could trust, at least relatively. Liquidity is a scalper's prerequisite: he provides some, but he needs it even more.

There are basically two types of trading a floor trader could apply himself toward in order to make a living: outright or spread trading. Let's take a look at each type.

Outright Traders

Outright trading was simple enough: you bought a contract and attempted to sell it at a higher price, or alternatively, you sold it to try and buy it cheaper. Your holdings could last as little as a few seconds or as much as a few months. Most floor traders preferred a large number of very short maturity trades to a few very long holds. As compared to the retail community, our commissions as floor brokers were insignificant and allowed us the great luxury of churning volume just as much as we pleased. You just never wanted to get into too many long-term trades. *Trade—don't become an investor*: This was one of the many maxims of the floor that we lived by. If you started playing the game like a retail customer, you were, in essence, voluntarily giving away the advantage you had in wearing the yellow badge.

Many traders on the floor were purely outright traders, and they tended to be the most colorful and explosive: they made big noises in the pits, waved the most, screamed the loudest, took on the biggest risks. They were the cowboys looking to intimidate the market and other traders around them to make moves in their favor. If you were making a movie, these are the guys you would want to keep the cameras on and highlight. Almost daily, their accounts swelled and contracted by huge amounts.

I considered them romantic figures, and I wanted to be like them, but I never had the courage they did. And I knew it, which was almost certainly a good thing. Yet, once in a while, I would take on that persona in the pit, trying to drive my measly 40 or 50 lot position to great heights (the true outright monster would own a couple of hundred at least).

"Quarter bid!" I'd scream.

Translation: I am willing to pay 25/100ths of a cent of the currently traded handle, on a so-far undisclosed number of contracts, on the spot month of the product we are currently engaged in, my fellow gentlemen.

"Quarter bid!!" I'd repeat, even more loudly, as if I'd buy 1,000 lots if they came in for offer. Most likely, I'd have choked to have to buy another 10. But I continue with the ploy, increasing the bid and, hopefully, the upward pressure on the market........

"Half bid!" … … "HALF BID!!!!"

"How many, DANO!?!" (Some either annoyed, hateful, or currently short local would scream at me.)

"Hit me and see … … … … HALF BID!!"

"A THOUSAND at even!"

Translation: You—DANO—you, I am reasonably sure, are a bulls**t bidder, trying to bull up your position on nothing but hot air. I know it; you know it; and to prove it, I have just offered 1,000 contracts at the next handle up that I am daring you to buy. This is a trade that, if we complete it, will certainly ruin the day and almost surely the year of both of us; neither of us is capable of working a thousand lot position favorably, even a winning one. The bottom line is: I don't want to sell just as much as you don't want to buy the contracts you are currently bidding for. Now prove me wrong, you bulls**ter…

Luckily, in this scenario, I can keep my manhood without committing the year to a stupid macho trick just by standing my ground and not taking this bait:

"Half bid!"

Translation: Of course, you're right—I am bulling my position. BUT, I also believe the market is going up and to a certain degree, YOU DO TOO, because you decided to call me out above the market as opposed to just hitting my bid and testing me immediately. Therefore, you have as small a pair as I do.

This type of posturing from outright traders went on all day in the pits, mostly to little effect. Markets will always go where they need to go, and position plays from outright trading locals serve to do little more than stir the pot and make the outcomes percolate a little faster…….perhaps. But traders are, of course, egotists: they need to believe they are right.

Part of the beauty of open outcry as a trade system is that it allows individuals open forums to declare their opinions on the markets in bids and offers and reinforce for themselves the value of those opinions. So much for the pure outright trader. The real ones, as opposed to the playing ones like me, would take those thousand-lot offers and risk their year in a macho fit of frenzy. They'd carry thousand-lot positions across several trading days, sometimes several trading weeks—probing, pushing, adding, and subtracting to positions and waiting for the big move to validate their incredible appetites for risk. In no way, shape, or form did I play on the same playground as they did—not the same universe.

Spread Traders

The other major way to make a living on the floor was through *spread trading*. Although the concept is simple, the application can get a lot more complex. Also, note that spread trading is unique to derivatives; a parallel concept does not exist in equities. Because of this, it is overwhelmingly popular with traders of commodities.

If you wanna trade oil, cowboy, you'll have to learn about *spreads*. Most people who think about trading oil think about just buying or selling it and waiting for a change in the price. But oil traders don't. Even oil traders who *only* buy or sell oil and wait for a change in the price—who are the outright traders I just described—have a keen interest and knowledge of spreads.

Why? Because spreads and how they function are one of the most obvious and telling difference between commodities—particularly oil—and other capital markets. If you want success in commodities, you simply can't ignore the spreads.

What are spreads? They are the price difference of two or more traded issues. For oil, they are normally the difference between two different trading months on the curve of prices.

The greatest oil traders I ever saw were dedicated spread traders. They could figure out dislocations between the various months of a contract (or even figure dislocations between other related contracts) and find the advantage in them faster than most other guys, including me, who had to rely on simpler trades to make money.

In general, the really good spread traders were the more wonky guys, guys with Ivy League degrees who were really fast with numbers. Although they tended to shy away from the super-fast and more exciting risk of outright positions (i.e., simply being long or short and betting on the direction of the market), they were hardly risk averse. Even relatively calm spreads that moved slowly could become very big risk trades, depending, of course, on just how many you had on and just how easily you could get into and out of a position. One of the most often heard jokes of trading was when a trader told you he had just hedged his outright position by putting on a spread, "and you know that there's no risk in spreads, right?" Absolutely right, no risk at all. Ha, ha. The truth is that spread trading only *reduced* the risks and most often the speed of your exposure. But that exposure could become quite dangerous too, if not quite as bad as a simple directional trade.

Two of the best floor spread traders I saw were as different in their approaches as could be. It just happened that both were named Rob.

Rob no. 1 was much more of a swashbuckling trader, even if he was a spreader. He had all sorts of positions, running over all three of our major oil markets (crude oil, heating oil, and gasoline), both outright and in spreads. The risks he took on his positions were overwhelming, but I never saw him put any position on, not one, without thought of the spread quotes in each of the three markets. He was convinced of the value he was getting, whether long or short, and he was far more willing to bank on that value in even very esoteric relationships. I'd see him run into my gas market and talk about—actually *effuse* over—his latest trade:

"*The ocks in heating oil came in 75 bid, so I hit those out and hit the 2–1–1 crack bid at 12.45—all while the crude July/ock was still offered at a dollar forty! Against the Aprils, I KNOW I have at least 15 points in them—what dummies!*"

Translation: A broker had an order to buy October heating oil contracts at what Rob figured was a pretty pricey premium. How did he figure this? He had found an esoteric crack spread that priced the heating oil directly against crude oil at a $12.45 differential. In essence, Rob was taking the heating oil sale he was making and rolling that sale into a crude sale instead.

Why did he want to do that? He also knew about a July/October crude spread quote at a differential of $1.40, and he was able to roll that October crude oil sale into a July sale, which had a rock-solid profit attached of 15¢, based on a near-month spread relating to April, which was far closer to the front of the curve, a lot more liquid, and the prices therefore more reliable. Simple? Of course not.

Moreover, to put a topper on it, this one complicated trade gets more complicated still. In Rob's quick explanation of the trade, he forgot to mention a gasoline position in October that he had coincidentally initiated, implied by the mention of "a 2–1–1 crack." Besides dealing with the relationship of heating oil to crude, that crack had also introduced a trade of a gasoline relationship to crude as well. This piece of this fairly complex puzzle didn't seem to bother Rob at all, as he didn't even bother to mention it. Still, Rob felt sure that his trade was a solid guaranteed winner—how could that broker, or the buyer on the other end of that order for the original October heating oil contracts, not see how much he was overpaying? What dummies!

Rob no. 2 was a different kind of spread trader. A Penn graduate, Rob had started out in the heating oil pit, trading that market exclusively. Slowly but surely, Rob's grasp of the spread values set him apart from many of the other local traders, even though he was flanked by a group of very smart guys. But Rob always seemed to have a better understanding of the curve in heating oil as a continuous whole, instead of just a group of spreads moving up and down. Rob traded crack spreads of heating oil contracts against crude oil contracts, but he also began to put on other, much more difficult spreads to assess and maintain—with contracts very far out along the curve. As you move further out in time, the relative values of prices become much more difficult to see: after all, how does anyone know what will happen in a year and a half?

That didn't seem to bother Rob. He made quotes anywhere in the curve, even going out to the maximum limit, which was 18 months forward at that time. Rob had so much success in making markets in these illiquid and obtuse months that other locals began to follow him and use his quotes for themselves, believing in Rob's ability to see where the value was in markets seemingly so difficult to know.

Rob finally had had enough of the traders in the pit using his hard work to find value in the deep back months of heating oil, although he was always publicly pretty generous with his ideas. But Rob had found a different game in which to put his great spread trading ability to work—in the heating oil swaps market.

When the over-the-counter (OTC) markets first began, and oil trading began moving outside of the pits of the NYMEX, crude oil was the most obvious place for it to start. The European Brent crude benchmark was the first newly created market outside of the regulated NYMEX exchange that gained traction. Slowly but surely, however, OTC markets emerged to satisfy a wealth of new hedging (and betting!) interests, and eventually, they came to the heating oil pit. A host of new heating oil products were designed to allow both producers and end users to fix their prices for heating oil far, far into the future. These products could take the form of forwards (a futures-like contract, but they had a specific physical exchange of real product), or they could be strips (a combination of delivery dates to hedge a six-month or full-year period).

Both types of OTC contracts needed market makers to become liquid enough to trade and provide steady access to customers. These markets were housed almost exclusively at the trading desks of Goldman Sachs and Morgan Stanley, and their traders were most eager to be able to make those markets and the profits from trading them.

But in the early start-up days of heating oil swaps, even the traders from Goldman and Morgan weren't quite as astute in back-month spread trading as Rob was. For a few years at the start of this new market, Rob was a consistent market maker for heating oil swaps, in direct daily contact with the Goldman and Morgan Stanley desks. Even with his great skill, Rob, as a single trader, just didn't have the capital to make liquid markets himself in these esoteric contracts. As those markets began trading, the Goldman boys got quite a good and free education at the feet of Rob, whose quotes were equivalent to a fine watchmaker disassembling his works in front of you to see how he did it. Rob's gift of the bargain, of course, was in the huge pile of money he was raking in: essentially, he was able to be the bank at a proprietary desk, without having to work for them.

After a time, Goldman figured out the spread markets and stopped needing Rob for those quotes. But for a few years, one local spread trader at NYMEX held court on the entire OTC market in heating oil, and he made quite a good living at it. Rob was one of the few spread trading geniuses I met during my time on the floor.

However, few traders on the floor were smart enough to do esoteric spread trading. You needed not only huge capital to retain the various outside-month and weird spread positions that were left over from such varied trading; you also needed a fantastic memory of where a few dozen quotes in each market were going at almost every moment in the day, a super quick mind for arithmetic, and even faster conviction that the calculations you were making were correct. For all that work, you'd get a less risky trade with a much better-than-average chance of making some pretty good money. But I for one was never up to that challenge—though I admired the ability of the truly great spread traders.

The Trading Mistake that Almost Ended My Career

I was never an excellent trader, but I was steady. But there were plenty of guys who lived big, both in the ring and outside of it. These were the guys people think of when they imagine commodity traders and even more specifically, oil traders. These guys bet big, held huge positions, and watched their accounts move by five figures every day, with not uncommon equity swings of the legendary six-figure day. These guys were swashbucklers, they swaggered in and out of the pits, and they were admired and respected by all the other traders on the floor. They cut a wide path, and they lived their power when the markets were closed and when they were open.

I once saw one of these guys, Neil from the crude pit, walk into my local swanky big money jewelry store (where I was getting a new battery for my watch). Neil was dressed precisely as he came to the pits: designer jeans, untucked polo shirt, and a three-day beard, in the style of Antonio Banderas or George Clooney. He was quite a sight among the fancy Chanel- and D+G-clad group from the North Shore of Long Island, but the statement was clear: *"F*** it, I've got the money to do whatever I want."*

I stood by the repair counter, and Neil never noticed or recognized me. (In fairness, I was an unleaded gas trader and did very small volume in comparison to him; he ran with a different tribe of trader.) But I watched as he told the saleswoman that he needed a "knockaround" watch for a deep-sea fishing trip he was planning. He tried on a couple of Rolexes. He couldn't decide between two models, and after a minute decided to take them both. I imagine those watches carried a retail price of $8,000 to $12,000 each, maybe more, and this luxury shop on the miracle mile in Manhasset, New York wasn't in the habit of discounting much. Neil plunked down his American Express Platinum card, turned around, and walked out with both watches. He couldn't have been in the store more than 10 minutes, tops. Another big swinging dick in the Natural Gas pit was a guy named Simon. Every year, Simon took a group of guys who stood near him and were his pals down to the Kentucky Derby. He chartered a big jet, complete with stewardesses and a full bar, and he and about 20 of his crew headed down for a weekend of revelry. I was never lucky enough to be included on one of these trips, but the damage that these guys did to their health (and some of their marriages) during these weekends was the stuff of legends. For Simon, this yearly event was part celebration, part pay-off, and part just because I can. And he could: the $100,000 that Simon parted with every year to create this bacchanalia was a small price, compared to the daily swings his account saw in the natural gas pit. And, of course, Simon depended on the guys he treated annually to keep rolling those swings in his favor. Did Simon see that obscene yearly expense as an investment with a positive return? Lots of us on the floor did, and we whispered about it every year in April when the Derby approached. But we mostly groused because we were just jealous that we didn't get invited. I know I was—a bit.

Simon and Neil were two of a handful of maybe two or three dozen traders who were the most fearless among us, who took on huge positions, who made big and sometimes lost big.

I was not one of these guys. For me, a big losing day could destroy my year—or worse.

It was on one such day in January 1991 that I made a simple mistake and ran into a freight train.

It was a crazy moment for oil. Iraq had invaded Kuwait to kick off Gulf War I on August 2, 1990, pushing prices from $21 a barrel to over $28, in just a few days. I know this sounds tame considering the movement of oil in 2008, but in those days, this represented a historic and quick run. As an aside, the history of oil prices prior to the Iraqi invasion caused much suspicion on the floor: oil prices had been languishing in the mid-teens for most of the year, but managed to rally almost 25% in July 1990, right before the invasion. For most of us on the floor, we were convinced that various inside Middle East trading shops had taken advantage of some inside information to capitalize on Saddam's not entirely secret plan.

For me, it was a time to be careful because the new volatility of an invasion into Kuwaiti oil fields brought great opportunities for trading, but also lots of new chances to get caught and lose a bundle. Those months between the Iraqi invasion in August and the U.S.-led coalition strikes of Desert Storm in January of 1991 gave us a market that we had never seen before (and would not see again for another 12 years).

Through August 1990, the initial surprise of the invasion gave way after a few days to a selloff, but when the question of whether the enormous Saudi oilfields would be the next target for Saddam was left unanswered, the market really started to move higher. Then-president George H.W. Bush's famous "this aggression will not stand" speech on September 11, 1990, to the joint session of Congress signaled clearly that not only would the United States use its military to defend interests and the ruling sheiks in Saudi Arabia, but that he was issuing an ultimatum to Saddam that Kuwaiti occupation would not continue to be tolerated.

However, throughout the fall and winter of 1990, it wasn't clear when or if Saddam was going to back down from American threats and withdraw voluntarily, or even if he was crazy enough to continue his push into Saudi Arabia, where American and other coalition forces stood waiting. Oil prices pushed higher, to over $34 in September—an almost unbelievable level to us on the floor, because oil had been closer to half that, at $16 only three months earlier. Talk of $40 a barrel oil dominated trading conversations. The latest strike price in the options pit—for forty bucks—was receiving a lot of volume. It was the big bet that winter, figuring out just when a counterstrike would come, or whether it would be necessary at all.

The rest of the fall and winter of 1990 was a great time for trading. We saw volatility and opportunity we never could have imagined before. It was our first real experience at fast markets, the kind that the metals markets had seen in the 1980s. Whether a spread or outright trader, we all watched the ticker for fresh news flashes that would bring avalanches of buying or selling. Every perceived comment from Bush and Saddam and every new deployment of troops from United States or other coalition force brought a quick new move in the market. Even with this volatility, oil prices were signaling that Saddam would eventually have to give up on his dreams of conquest: oil had retreated from an almost $40 high in October 1990 to trade in a violent but lower range of $26 to $30 at the start of 1991.

On one Friday in January of 1991, the bell rang, signaling the last two minutes of trading for the day—the close. I spotted a huge amount of selling entering from the left side of the pit, and with barely two minutes left in the trading day, I sold a 30-lot piece to a broker standing close to me, more than a normal shot for me, but not outrageous. Two other brokers were selling their lungs out on the other side of the pit and I had, at least theoretically, a 50-point profit on the sales I had just made in seconds.

I jumped and yelled and waved my arms and tried to get the attention of either of the two brokers—it seemed like they had hundreds of lots for sale and couldn't find a buyer. But I was a buyer and couldn't get their attention. I was frustrated, screaming and cursing and jumping around like a madman. Finally, with less than 20 seconds to go in the session, I figured my only chance was to physically get to them. I started to bully my way through the circle around the pit, elbowing and squeezing through traders and brokers, all screaming and sweating like me.

I reached the first selling broker and screamed "*buy 'em*!" in his face, but he said he was out—finished with his selling. Just as I reached the second broker, the bell rang, but he also claimed to be long finished, cleaned out of all the selling he had. Once his sales had evaporated, the market had quickly returned to where I had sold my 30 lots. My expected profit was certainly gone, but worse, I was holding a short position going into the weekend.

I felt sick. I was stuck.

I scrambled around to see if any selling at any price, in any market, was available. I managed to get seven crude lots to partially offset my shorts in gasoline, and I went home and waited to see the outcome of a long weekend with my 23-contract short position.

I actually slept well that weekend and wasn't that worried: it was the kind of anti-intuitive position that tended to work out. No one wanted to be short in that market, with all the crazy things happening then in the Gulf; therefore, from a trading standpoint, that's precisely what you needed to be to make money. The market was going to come in lower on Monday, I convinced myself; it would all be OK.

I was wrong.

Monday morning greeted me with very bad news: UN Secretary General Javier Perez De Cuellar had abandoned his attempts with Saddam to find a diplomatic solution to the Gulf crisis, saying "only God knows" if a war was imminent. With the end of diplomatic talks came a fresh statement from Saddam, convincing the world that either this was one crazy bastard or he had a real death wish. Not only was he in no way going to retreat from Kuwait, but he gave every indication that he was preparing a fresh invasion, spoiling for a fight in Saudi Arabia with the American coalition, as the self-proclaimed leader of Arabs worldwide.

The world took him seriously, at least for the moment. Crude oil reacted with a $5 spike in price, setting a record then for the largest opening spike ever in crude oil, as war seemed now unavoidable.

I reacted to this news in a daze. I had caught a double whammy: not only had I walked in that morning stuck on a position (which, for me, was incredibly rare), but I had caught the worst possible news and was in line for the biggest single price spike in the history of crude oil. And I was on the wrong side.

There was nothing to be done. I watched the market open, saw my life slipping away, and covered my position. As if to add insult to injury, gasoline opened up much stronger than crude, because it was perceived that the refined products would be in even greater demand than crude if war were to break out. Even my seven hedges were big losers, but still nothing compared to the 23 naked shorts I had carried in that day.

I gave my trading pad to my clerk and went home. Silently, I walked into my apartment, where my wife was sitting with our seven-month-old son. I stepped into the bedroom and shut the door. I calculated my loss: $131,000, give or take a thousand or two. I was finished.

I sat on the edge of the bed and cried.

■ ■ ■

Of course, I wasn't finished, although it felt that way at the time.

The next day was busy with recriminating thoughts of how I could have managed my risk better, of how God might be punishing me for some unknown transgression against my fellow man that week, and just wondering how the hell I could be so damn unlucky. I mean, 23 contracts overnight was a couple more than I tended to carry when I went home with an outright position, but for many of the traders I knew, it was a piddling nothing. That such a tiny exposure could lead to a $133,000 loss was inconceivable to me. And yet, here I was.

Oh well, they say you never make it big until you go broke at least twice. This felt bad enough, along with another very poor year in 1989, to count as making the quota.

I really didn't have many choices. I knew well enough that the only way out of this hole was to trade my way out of it. So I set on the task of recapitalization, otherwise known as begging for dough.

The clearinghouse was by far the best candidate. I was hardly the first trader who had blown up—a euphemism for taking a big loss. The thing to avoid was being blown out—a similar euphemism for a big loss, but one that resulted in the end of a trading career. The difference between the two was usually the amount of the loss—and the politics of the clearinghouse relationship. Their reticence to take on fresh clients and the strange bipolar arm's-length/best-buddy relationships they maintained with their current clients is best grasped by understanding a little about leverage in the futures game. So bear with me as I interrupt my story about my career-threatening hit to explain how I thought I could survive it.

How the Clearinghouse System Works

So much has been written recently in regard to the banks and their wide—until 2008—use of borrowing to supercharge their incredible trading and profits. The key word of leverage was used to describe this borrowing power, but borrowing is not unique to the banks. Indeed, when you take out a mortgage on a house with a 10% down payment, you've employed a quite nifty 10 times leverage. Of course, banks are much better equipped than we are at convincing various governments, investors, and other banks about the quality of the assets that they are being loaned money on, which is why we have heard tales of mortgages, student loans, car loans, and commercial real estate portfolios being run at upwards of 40 times debt to equity—very heady leverage indeed.

But this is all child's play compared to the oil markets.

The traditional clearinghouse system makes it possible to have practically unlimited leverage, at least for futures participants. The clearinghouse system, as it operated then, is the most democratic, self-regulating, and marvelous system of monitoring the participants inside the commodity markets. It is the reason that commodity defaults have been so rare—and the few that have happened have been resolved internally and without outside help required.

The mechanics are simple: every clearinghouse is directly responsible for every market participant that clears through it. Therefore, every trade that a clearinghouse customer does is, to some degree, the clearinghouse's trade: the clearinghouse is ultimately liable to make good on every trade that comes through the house. And when a clearinghouse gets permission from an exchange (the NYMEX or any other exchange) to clear its products and become clearing members, it becomes part of an even larger network of houses committed to ensuring that no default takes place. It becomes partners, to a certain degree, with every other clearinghouse, ultimately sharing responsibility as a whole for every participant in the pool.

The clearinghouse system does not entirely prevent the rare rogue futures trader from often taking on far more risk than he should. But it does put a level of mutual responsibility for all the participants in the system that just doesn't exist in other, less-regulated markets. In my early days at the exchange trading oil, such lax margin requirements lent us incredible leverage in our overnight trading and practically unlimited leverage in our day trading.

That kind of leverage, combined with the outsized volatility that the oil markets were experiencing as I was having my blow up, made the clearinghouses far more guarded with their absolutely necessary and golden guarantee that every trader needed. Exchange margin requirements have changed often during the years and continue to fluctuate up and down, depending on the current barrel price and recent volatility, but I recall per-contract margins of crude oil in the late 1980s at $750 a lot overnight. Even with $20-a-barrel crude in those days, that represented more than 26 times leverage for even the smallest trader with very limited capital resources. And these margin requirements were actually requested of the *clearinghouse*, not of the trader—it was the clearinghouse's total positions of all of its customers that elicited exchange margin deposits, deposits that were more than likely overnight borrowing of the clearinghouse itself using its access to bank or repo rates.

Moreover, for intraday trading, which consumed most of the day traders' efforts (including mine), margin wasn't ever an issue at all. Unless you were a clerk of a local reporting to the clearinghouse during the day as positions accumulated (a practice I imagine went on, but I never actually saw), any local on the floor with a badge and an account could in theory establish any position during the day they wanted—no matter how large or risky. In those first days of wild activity for oil, some of those local intraday positions were getting frisky in a hurry. Toward the end of my days on the floor, margins increased astronomically—today, the exchange exacts margins of $4,000 for an outright lot of crude, $400 for a spread.

With the amount I normally maintained in my account, I shouldn't, in theory at least, have been allowed to accumulate many more than 12 lots either long or short during the day—a laughable restriction, even for me as a small guy. Clearinghouses had gotten used to carrying this risk on individual accounts for the most part—until the market really started to swing wildly. It was impossible to measure and monitor individual positions during the day, and it was entirely up to the trader to keep them in check and not go overboard—a system that worked out incredibly well over the years. Although there were many traders who managed to get overemotional and overextended, most of these outcomes were well controlled by the clearinghouses that accepted their trades.

Those kinds of good results only happened with a lot of work from those houses that dealt with local traders and their consistently honest relationships: most clearinghouses had their own special methods of monitoring and reining in their most swashbuckling traders. At Pioneer (where I cleared), Neil Citrone ran the clearinghouse and kept tabs on his stable of locals in between hours of trading in the pit himself: he would sit in his office and talk to rogue guys, exhorting them to lighten up on positions that were in danger of falling off the desk with a thud. Geldermann, another clearinghouse, had a guy we used to call the enforcer: Harry Marshall, an ex-marine who had served in Korea, still an imposing figure while pushing 60, would stand by the triple doors into the main trading floor, the only way in or out, looking for the locals who had entirely overstepped their limits on margin and positions. I'm not sure Harry had any other job in the company besides this one, designed obviously to intimidate guys 30 years his junior into liquidating accumulated positions or adding cash to their accounts or both simultaneously. Mark Fisher, the owner of the largest clearinghouse of locals at NYMEX, the self-named MBF, would in a case of an extreme margin miscreant in his ranks appear on to the floor himself wearing his badge. Mark, who had started as a brilliant trader but had moved into his office to trade and run the huge clearinghouse years before, was a rare sight on the floor, but when he appeared, we knew someone in his house was in trouble. He'd walk straight into the pit where the offensive position had been initiated and begin liquidating the position himself. Of course, whatever he traded for you was yours—if he needed to come downstairs, you didn't complain about the prices for the trades he executed on your behalf.

The hierarchy of risk assumption was simple: of course, the trader's accounts were the first to be at risk on all his positions. But then the clearinghouse would be on the hook. Finally, if the clearinghouse was unable to make good on losses from rogue clients, other clearing members were brought in to clean up the mess. If this still wasn't enough, talk would run to default, threatening the integrity of the exchange itself. Defaults killed exchanges, and without exchanges, there was no business for anyone; therefore, this democratization of risk made a lot of sense for everyone.

Let me explain with a couple of stories:

One enormous gasoline trader we all knew, named Jeff, had huge spread positions almost all the time, often creating large positions in less-than-liquid back months and creating obtuse relationships between commodities. His risk profile from this style of trading was very bad, although everyone in the ring admired his courage. For his clearinghouse, he was a double-edged sword as a customer: although he generated massive commissions, he also always carried positions that required added margin loans and ran constant risks of blow ups. That often frightened clearing officers because the clearinghouse has to guarantee all the trades of every client it carries. If something goes terribly wrong with a trade, the clearinghouse ultimately must stand behind the trader and bankroll the losses.

An old trading joke has a desperate trader putting 5,000 long contracts on at the end of a trading day, before a clearinghouse could possibly monitor and stop any one individual from initiating such a massively risky trade. The trader then runs out of the building and heads to JFK airport to hop the next flight to Rio (or some other fantasy South American paradise). If the market comes in higher the next day, he calls from Rio and has the position unwound, returning home at his leisure to collect his money and retire in style.

And if the market goes the other way? He doesn't call.

That's an old and long-running fantasy story, and we never heard of anyone actually blatantly running out on their positions, at least not *that* way to a South American hideaway. But it points to the responsibility of the clearinghouse in the trading process. In many ways, the clearinghouse was a partner of every trader on its books. It would measure the value of a client by risk as well as success. The clearinghouse had to view him not only in terms of the commissions he generated, but also by the *agita* he could generate with his risky positions.

With Jeff, we often heard of his jump from one clearinghouse to another, as the margin managers grew tired of monitoring and managing his positions and would ask him to find a new home. As if it were playing a vicious game of musical chairs, one of the clearinghouses was left holding his account when Jeff blew up—for almost a million dollars.

An old saying goes: "owe the bank a thousand dollars, and the bank owns you. Owe the bank a million dollars, and you own the bank."

The clearinghouse had no choice with Jeff. As collateral, it took his seat (which was then worth far less than a million dollars), and it continued to bankroll him in the ring. That was the only chance it had of getting any of its money back. Jeff became an indentured servant to the clearinghouse for much of the rest of his career on the floor.

The shared responsibility of the clearinghouse system didn't always work flawlessly, however—and once I can recall when it ended tragically. In all my years at the exchange, I can recall only one example where other clearing members were needed to help fix another's problems—with Mocatta gold. One partner in the firm had made enormous sales of metals options, adding to call sales as the price rose, waiting for a respite. One particular spike day forced covering of the entire position, outstripping the firm's capital by a great deal—they lost everything first, while other houses were forced to pony up small amounts to make up the difference.

One of the partners of that firm was John Chadonic, who ran the floor operations. John was a terrific guy, living on the upper west side with his two kids, and he had come from nothing. He wasn't a trader, but a decent operations guy who had forgone much of the bonus money due him through the years—as many in the firm had—to continue building up equity. In his mid-50s at that time, John was looking at a nice cashout on his 25-plus years of work within another five years when the disaster struck, destroying his entire life and career on the trading whims of one of his partners. The way John told it, the most senior men still managed to get equity out of the firm before it folded, while he and other junior partners watched their life savings disappear, practically overnight.

For a few weeks after the event, we still saw John, smoking incessantly and playing pinochle with us at lunchtime while he tried to figure out how or why he'd want to create a second career after all this. He didn't need to worry long. We heard of John's death a few months after that, most of us convinced that the incredible disappointment and frustration of a life's work gone south had been too much for him to bear—but we never asked, and his family kept the specifics of John's death to themselves, as they had every right to do. We mourned John, a good guy who was just another part of the commodity system. That system, like it or not, linked us all together. You had a responsibility to be responsible in your trading—not just to yourself and your own family, but to everyone else tied into the system—which was everyone.

The $50,000 Loan that Saved My Ass

Running a clearinghouse was a serious risk and a tough job because every client represented a risk/reward equation for the house and the system at large. I knew that, but I also knew that my situation was nowhere like Mocatta's or even anything as bad as Jeff's. My deficit was piddling in comparison, and I had something else far more important going for me. I was a steady trader, most of the time. I had never given the clearinghouse much to worry about: this loss I had just taken was as close to a one-time fluke as it got for me and my particular style. It wouldn't happen again, and everyone who knew me knew it. I wasn't a big money maker for the clearinghouse, but I was a good client—$20,000 to $40,000 a year in commissions generated, with very low risk attached.

I went confidently to Geldermann, Inc., my clearinghouse where I had started trading and had given them my exclusive business for the last nine years, and I asked for a $50,000 loan to get back into the ring and back to work.

They turned me down flat.

They claimed that the big guys in Chicago had stopped extending loans to traders. (Geldermann was, like many of the big futures clearinghouses, based in Chicago, with most of the big futures markets.) The two chief managers of the New York office, Stanley and Fred, who had taken my money and laughed and smiled with me for years, now shook their heads and feigned sorrow at being unable to help me out. These two f★★★ing guys who spent their days using high-powered binoculars to check out the skirts walking through the WTC plaza (high summer temperatures and a stiff breeze made for the best sightings, they advised me)—now were ready to see me blown out and on the street. F★★★ them. No, really, really f★★★ them.

No—really—F#%& THEM.

I moved on to the next logical clearinghouse. Although Geldermann had been my home, it was a pretty large house, based in Chicago, with lots of commercial clients and lots of bureaucracy. Surely, I thought, I'd do better with a New York-based clearinghouse that specialized in locals and had few if any commercial customers.

So I went next to a clearinghouse that catered exclusively to locals where most of their traders were Jewish, like me. I found the owner of the house, an orthodox Jew named Schlomo, on the floor. I made my case: I would guarantee my seat as collateral, I was a steady trader, a family guy, and had been around more than a few years. . . .

He also turned me down flat. The new market volatility caused by the impending Gulf War had made all the clearinghouses very leery of added risk: They were trying to get used to the larger risk and equity swings from their current crop of traders, and they didn't have much appetite for new traders at the moment. I was scared, wondering whether in this new environment I would be able to find a new home.

But I needed a new home, and quick: the trading was good, and it represented my only chance to claw back to even.

I had only a few more places to try. I walked across the street to the office of another New York clearinghouse that only worked with locals: Pioneer Futures.

Pioneer Futures was a clearinghouse born out of an interesting partnership between two very dynamic and different guys: Russell Rosenthal and Vincent (Vinnie) Viola. Both were stellar traders. Both had cut their teeth in the gasoline pits (where I was trading), and both had made massive money. Both were far more talented traders than I ever was, but they both stood near me in the pits, and they knew me and my style.

After forming the clearinghouse, Russell continued for many years to concentrate on his trading, moving to foreign and OTC markets as well as the NYMEX markets. Vinnie, on the other hand, managed the Pioneer office and would ultimately buy out his partner Russell, but was engaged in other far-reaching business as well. Vinny had made brilliant investments in Houston banks when the oil market was particularly depressed, for pennies on the dollar. He was reaping the benefits of those investments when I visited him in his office on that January day.

I walked in looking beaten, and without much hope, I simply said, "*Vinnie, I'm stuck.*"

Vinnie held a law degree and was a West Point graduate, reaching the rank of Major in the Army reserves. He was fit and chiseled and handsome. (Vinnie would also rise to become Chairman of the NYMEX in 2001 and later start one of the first and most powerful algorithmic trading groups, foreseeing and taking advantage of the electronic revolution in futures trading far sooner than almost everyone else.) His response to me that day still amazes me:

"*Whatever you need, you got it.*"

"*I think $40,000 will get me going again.*" I said. "*I'll sign over my seat to you.*"

"*No need to do that, Dan,*" he said. "*I know you. I've stood next to you and seen you trade. I'll put 60 grand in an account; I know you'll get it back to me when you can.*"

I looked him straight in the eye and began to cry. I was saved.

The rest of the story is pretty interesting. Two days later, in the early morning on Thursday, January 17th, American troops crossed the border from Saudi Arabia into Kuwait, thus initiating "Operation Desert Storm." Overnight, markets touched $43 a barrel for oil briefly, but by the time the morning came, the war was essentially over, as Saddam's troops surrendered in droves.

The market opened $9 lower and went down from there, ending up more than $12 lower for the day. My positions from three days earlier, if I had held them, would have made a greater than $200,000 profit. But I neither would have had them nor held them. I was not that kind of trader.

But the lesson was clear—timing *is* everything.

The leftover volatility of the quick war during the following months of 1991 allowed me to make back a lot of the money I had lost, while still supporting my family. I managed to get my accounts back to even and pay back Pioneer by the end of the year.

I never forgot Vinnie's generosity and confidence in me. Despite countless minor squabbles with Pioneer over the years and offers to move to other clearinghouses offering discounted commissions, I remained loyal to that house for the remaining 15 years of my on-floor trading career. I also proved to be a good investment for Vinnie, but I always gave him credit and my undying gratitude: at that moment in my life, he was the only one willing to take the chance on me. Of the people in my life who emerged at key moments and helped me to succeed, I always remember Vinnie as high on my list.

I never had another blow up incident during my career on the floor, although like most traders, I would have particularly bad days amounting to small five-figure losses once or twice a year. That was just the nature of the beast. Luckily, I missed another confluence of bad events that could threaten me, and I managed to slowly increase my risk appetite while maintaining my conservative trading style. And I slowly increased my yearly take. In other words, I was doing OK as a trader, and although the risk represented a daily stress, I liked it.

But fantastic change in the oil markets began to take place as the calendar brought a new millennium. They brought me significantly better trading profits and ultimately delivered the windfall of my NYMEX membership, which increased in value over my career more than 200-fold. What can possibly cause an asset to balloon in value like this?

Most obviously to me, oil changed—not the oil you'd find being pumped out of the ground in Texas or Saudi Arabia or Nigeria—but *financial* oil, the only kind I dealt with, and it changed in three distinct ways. First, it changed from a tool that participants used to help efficiently run their oil-related businesses into a complex capital market resembling stocks and bonds—what I call the assetization of oil. Next, the financial engineers, investment banks, fund managers, and traders took full advantage of this change to game the system and derive obscene oil profits on the backs of the consuming public. Finally, helping these new players gain their edge was a huge influx of new technology, allowing full and unrestricted access to these once-closed and shielded markets. The results of all three of these changes resulted in an energy price that is overwhelmingly unstable, fundamentally too high, and for the sake of our larger economy, unsustainable.

Part I explains those changes.