Friday, June 24, 2022

am

FX

Brent Donnelly

bdonnelly@spectramarkets.com
(212) 398-6230

A personal favorite from my Web3 Bubble Cringe Scrapbook

Current Views

Short USDJPY @ 136.11
Stop loss 137.15
Take profit 133.15

How to succeed as a sell side trader

3,200 words, 14-minute read

I did a "Fireside Chat"[1] for a group of young Citibank FX traders this week[2] and it got me thinking about my early days as a market maker and how everyone mostly learns all the same lessons, mostly the hard way. There is a lot of relearning of the same mistakes over and over because 1: much of new trader training is by osmosis (they don't give you a "New Trader Handbook" when you start… though they probably should!) … and 2: kid's gotta touch the stove to understand what "hot" means.

Here is some advice for young Roosters strapping into the trading cockpit for the first time. There is useful information in here for all traders, not just people on the sell side. This is kind of a sequel to my piece: Day One Advice for New Hedge Fund PMs.

1. **Study as many other traders as possible, but don't copy them**. Every individual needs to adopt a personal trading style that matches their personality, interests, strengths, and weaknesses. I have never once seen a new analyst come in and copy a senior trader and become successful. Good traders gradually create their own style by amalgamating nuggets and tidbits and setups and tactics from watching other traders, reading books, and thinking of their own ideas. Find a trader you respect and spend an hour asking them about their process. Take the good, throw out the bad. Observe, take notes, and ask questions.

   As Bruce Lee said:

   > *Research your own experience.*
   > *Absorb what is useful, reject what is useless…*
   > *… and add what is essentially your own.*

   Find traders with different styles and pay attention to what they are doing. Incorporate methods and tactics that make sense to you and discard those that do not. If you see traders making tons of money on news headlines but you always sucked at video games and you like to ruminate over a long thought process before taking action… Don't trade headlines.

   Nobody has a trading style when they start. Try one on. If it fits, keep it, but still try some others. If one doesn't fit, try another one. Experiment. Make a list of all the different ways you see that people make money. This will also serve you well in the future when the awesome trading style you adopted that made money for seven straight months suddenly stops working.

   Good market makers can make money on client flow and spread, market direction, news, techs, sentiment extremes, flow patterns, time of day patterns, cross market correlation, lead-lag trading, bid/offer bounce, etc. Don't pick one style and be like "I'm a breakout trader". That will work in some regimes and not in others. Specializing in a market is good but specializing in a style is less good.

2. **Work towards becoming the go-to expert in the market you trade.** It doesn't take that long to become expert in a specific market. You can do it in two years. Get to know every aspect of your market as deeply as possible.

   For example, you should know the following about any market you trade:

[1] There was no actual fire.
[2] The new Citibank trading floor is super nice and futuristic. Just don't stare too long at those blue ceiling lights.

a. Macro drivers
   - What are the cyclical and structural global variables that drive your market?
   - What is the narrative in global macro and how does that feed through to your product?

b. Idiosyncratic drivers
   - What are the endogenous drivers of your market? What flows, stories, and intermarket variables drive your particular product?

c. Microstructure
   - Current and historical volatility and vol of vol. What does a quiet market look like? What does a crazy market look like? Where are we right now on that continuum?
   - Liquidity and volatility by time zone and time of day
   - Time zone bias. Does Asia tend to sell, and NY tends to buy (for example)? Or is it random?
   - Upcoming economic events and catalysts
   - Most important clients trading in each time zone

d. Execution
   - What footprint /slippage can a client expect for x, y, and z size?
   - What execution strategies are most appropriate in different regimes? In fast markets, your execution strategy is different than in quiet markets, for example. At 9am you might use a different strategy than 3pm.
   - How to best manage client expectations? (overcommunicate)

e. The players
   - Who else trades this product at my bank? How can I get to know them better? Ask to travel to foreign branches to meet your colleagues in other centers. It's an excellent use of the bank's money.
   - What other banks are good in my market? Who are my main competitors? Why are they good? What makes them good? Can I emulate that?
   - Which clients are most important? Hedge funds, real money, corporates, and central banks all play varying roles in different markets. Which ones matter in your market?

Excellent bank traders are world class experts in the market they trade and become reliable sources of information for clients. In "Appendix A: Steps toward becoming an expert in your currency" you can read a list of ideas for currency traders who want to become expert. You can make a similar list for whatever market you trade.

3. **Understand and embrace the fact that your number one edge is the seat.** With some notable exceptions, most bank seats have positive embedded franchise value. One of the big advantages of being a risk taker at a bank and not a prop shop or hedge fund, is the franchise annuity that supports your risk taking, pads the downside, and makes you valuable even when you are not making money. Before you rush to take a lot of directional risk, make sure you have done everything you can to master the basics of professional execution, client service, and flow monetization.

   Execution is a skill. Try different approaches. Watch how others execute. Experiment with limit orders, market orders, TWAPs, VWAPs and so on. When you place a level one order, to algos front-run you immediately? How can you manage that? Etc. Risk taking is sexy but servicing the franchise pays the bills and keeps you employed. Bank trading jobs have a lower ceiling than pure trading jobs, but they also have a higher floor. If you are a good market maker who keeps the clients happy, you have a lot of runway and time to learn how to trade. Master everything related to servicing clients first. That's the most important part of most market making roles. Once your solid on the basics of market making and keeping clients happy, you work towards becoming a real risk taker.

   Be proud of your seat and proud of your franchise. Act like a business owner. Your seat and your franchise are your business, and you are there to build it. Sure, sometimes a juicy trade from sales is just free money dropping into your book and you might feel like you don't deserve that P&L or it's "funny money." You deserve that money because you earned the seat.

   Something to remember for the future: Don't trade down to a smaller seat because you think you will get paid on alpha generation. Banks generally do a poor job of normalizing P&L vs. franchise value. You always want the best franchise and the best seat. You will get paid more by making $10 million in a seat that is worth $20 million than you will by making $5 million in a seat that's worth $1 million.

4. **Trade your own view.** If you trade someone else's idea, you will inevitably do everything wrong. You will stop out at the wrong levels because your conviction will not be high when the trade goes against you. Also, if you are trading someone else's view, you might not know when their view changes. Frequently you will hear someone moaning about someone else's idea they followed and then have insult added to injury as they find out the original trader exited long ago or even flipped her position. Successful traders do their own work and come to their own conclusions.

   I remember a particular moment when I was in my 20s and my boss was a loud, legendary fellow who was much-loved by everyone in trading and sales (Hi, Ed!). He always had a strong view, and his view was constantly broadcast at full volume. It was very hard to be short when he was a raging bull because you would look stupid if wrong. He never got on people for trading a view opposite to his, but it was intimidating to do so. You will know you have moved to the next level of trading when you are perfectly happy to be short when your boss is mega long.

   By the way, if your manager doesn't like you trading a different view than the "house view," that is unfortunate. A healthy risk-taking environment respects individual traders' risk taking and if management wants to have a view, they should put that view on themselves. The worst type of management is the MD that sends an email saying something like "Given the events transpiring in Europe, it behooves us to be short EUR. Interpret that as you see fit." If a good manager is bullish and he sees everyone on the desk is short, he'll go long in the management book and let the traders trade.

5. **If you make a mistake, own it.** As a manager, the one thing that made me instantly turn on a junior was any sort of sketchy, dishonest, or questionable behavior. If you make a mistake, don't hide it. Own it. Cover whatever risk or market exposure at a loss and move on. If you were supposed to sell 50 and you bought 50… Sell 100 right away. Don't sit there saying *"well… I'm bullish anyway, I'll just slip these out slowly over the next coupla hours and the bossman is at lunch anyway so prolly no one will even know…"*

   A young trader doing even the most slightly gray area stuff is a massive red flag. Don't.

6. **Learn the systems and pay attention to the details.** This is a weak spot for me because I don't like boring stuff. Operational errors, out trades, fat fingers, dupes, and other general sloppiness is unprofessional. In every organization, there is "the person that knows all the stuff". At Spectra, it's Doug. Instead of just guessing how to fill in that weird tab on page two of the booking system, I ask him how to do it. Figure out who that person is at your bank and learn from them.

   Go into the menus in your trading systems and check out all the features and functions. You might be surprised to learn there is a function in there that not one person on the desk has ever used or even knows about. Most bank systems have no user manual so don't just assume what you have been shown is all there is to know. Institutional knowledge and memory are weaker than you would think because there is very little documentation or training for bank systems.

7. **Gradually figure out what your edge is**. Developing a defined edge is a key to success in trading. Edge in trading is too long of a topic for this note; it's covered in detail in my book, Alpha Trader. But there is another type of edge to think about: What is your edge in the world of finance? What makes you different from everyone else? Every single one of your peers is super smart and probably top 2% of their high school and college class. How will you outperform them?

   Over the past 20 years, Wall Street hiring has narrowed to focus almost exclusively on elite schools and quantitative factors like GPA. As such, quantitative skill and book smarts on their own are not differentiators, they are the bare minimum. What gives you an edge over your peers? Creativity, street smarts, communication skills, writing ability, sophisticated Python skill, and EQ, are a few examples of unique differentiators. One of the traders I talked to while brainstorming this piece said: "U just need to find ur edge … whether its big picture macro or being epic on flow and spreads … or drinking with sales..."

   :] It's funny cuz it's true.

8. **Be humble.** No matter how well you are doing, markets are constantly changing and the second you become overconfident, you will get punched in the mouth. To succeed as a sell side trader, you must have an unshakable belief in yourself, but not be arrogant or overconfident… That is a tricky needle to thread!

9. **Learn the metagame.** What does your bank care about most? What does your boss care about most? If your boss is a long-time trader trying to 4X the risk profile of the desk, that is a completely different metagame than if you report to an ex-salesperson who runs both sales and trading and only cares about building the client franchise. You should make an effort to match your priorities to the priorities of management and the firm.

   What gets people paid in your bank? Is it just P&L? Or is it more about client interaction, content creation, and other facets of the role? Sell side trader roles are about much more than just P&L. This is important because if all you focus on is P&L and all management focuses on is quality of market commentary and trader/client interaction… At bonus time there will be a big disconnect and your expectations will be crushed by reality.

10. **Collect data.** The more detailed information you can capture on your trading and P&L, the faster you can learn. Track P&L by client, by time of day, flows vs. views (alpha vs. beta), and so on.

11. **No cheering until after you square up.** There is an interesting psychological phenomenon I have observed throughout the years which I call The Cheer Hedge. Early in my career as a trading desk manager, I noticed that any time one of my traders yelled or pumped his fist in celebration, or cheered in any way for a profitable position, the trade turned against him almost immediately. This pattern was so persistent that after a while, whenever someone on the desk cheered or celebrated a winning position, I took the opposite position in my management book. The contrary positions always made money.

    I started noticing this effect in early 2004 and I'm writing this 18 years later—the effect still happens all the time. Extreme exuberance is a very important tell. When someone screams "AMERICA!" on a trading floor as the dollar rips higher after strong US data… That is always the intraday high!

    I have been pumping short USDJPY and it came off hard yesterday. At one point, a coworker blasted a bunch of chats with "@brentdonnelly nice call short USDJPY!". Here is the chart:

    The reason this happens is that cheering and yelling happen only at emotional extremes. Price extremes and emotional extremes tend to coincide. When someone around you cheers, most likely 1) she feels invincible as her position is well in the money with strong momentum and 2) others around the world are probably feeling the same euphoria. So, keep this in mind: When someone around you cheers in celebration of a winning position—go the other way. And if you feel yourself wanting to cheer or sing… Take note of that emotion and quickly ask yourself what it might mean.

I am not being funny or exaggerating when I say that I truly believe that a trader cheering for a position that's moved aggressively their way is the most reliable trading indicator I have ever seen. And this has been true for almost 20 years. The hit rate is close to 100%.

12. **Don't hold onto flow just because it's out of the money.** When a client trades with you and the market goes immediately against you, you will tend to anchor on the rate you got hit. If you got filled in at 55, you think "Man, if I can just get out of these at 55, I'll be happy." The market does not care what rate you traded at! Use market logic, not anchoring, to determine how and when to hedge the flow. If you're bullish and short… That's bad. Don't convince yourself it's fine and sit there bullish and short all day. Make rational trading and hedging decisions based on your best unbiased forecast of where the market is going. Not based on where a client transacted.

13. **Pick one time horizon.** Trading is extremely difficult and if you mix up your time horizons, it becomes impossible. Your time horizon should match the product you are trading and its liquidity and volatility profile. Spot FX traders generally should not be putting on 6-month views because there is exactly 0% probability that a spot FX trader has an edge on that time horizon. In contrast, with a good understanding of narrative, flows, positioning, and so on, a spot FX trader can easily have an edge on a 1-day or 3-day time horizon.

14. **Pull the trigger.** Good trading takes courage. When you have a strong view, have the courage to take meaningful risk within well-defined, rule-based risk parameters.

"Everything you've ever wanted is sitting on the other side of fear."

.. George Addair

15. **Don't be contrarian and don't follow the herd. Think for yourself.** In trending markets, the herd is correct, and you want to be on board. At the turning points, the herd is wrong, and you make money with contrarian views. You need to be able to toggle between going with and going against the crowd at the appropriate times. Reflexive contrarianism is a terrible way to trade. But you also can't just do what everyone else is doing.

16. **Be nice and be a team player.** One thing that blows my mind as years go by is the number of random connections and actions from long ago in the past that echo forward through my life. People remember how you treated them and how you behaved, even 10 or 20 years later. All your actions accumulate in the long run. Be nice to the person that cleans the floors in your office. Treat the PAs, salespeople and brokers the same way you treat the trading MDs. If nobody wants to work the holiday; put your hand up.

    An excellent reputation accrues enormous value over time.

    The trader with a good P&L and a bad attitude is the first one tossed when things go south. If you are a positive force on the desk and you have a tough year or two, you'll get a pass. The best hedge against a bad run of trading (even the best traders have bad runs) is to add value in as many ways as possible, above and beyond the P&L.

One trader I talked to boiled it down to five words: **Know your market. Know yourself.** That's a great summary!

Ok that's it! I hope you found this useful. Appendix B is: "21 Ways to Succeed in Trading and 13 Ways to Fail."

Feel free to forward this to anyone you like. I never mind the occasional forward, it is only auto-forwarding that is frowned upon since this is a paid product. Thanks Mark, Nick, Pete, and Sam… For your time and ideas—some of which got CTRL-V'd directly into this .docx. Much appreciated.

Enjoy your weekend, everyone!

good luck ⇅ be nimble

<u>**APPENDIX A: Steps toward becoming an expert in your currency**</u>

- Read everything on the central bank's website
- Read all the central bank speeches
- Watch the currency all day and chart the market profile manually on graph paper to get a feel for the texture and price action
- Always be completely on top of what strategists and technical analysts are saying about your currencies by reading Reuters, Bloomberg and other articles
- Have a list of all major support and resistance levels on hand for any currency you are trading
- Make a list of what drives your currencies and learn as much as you can about those correlated markets, especially interest rates and commodities
- Read the press of the country you are trading, for example:
  - Canada: The Financial Post and The Globe and Mail
  - Australia: AFR
  - UK: FT, Telegraph and The Guardian
- List the central bankers and outline some bullet points on their recent views/comments. This allows you to interpret headlines quickly. You will instantly know if a central banker's comments are news or just repeats of comments they made in the past. For the major central bankers, you should know his or her:
  - Interest rate view (dove/hawk)
  - Currency view
  - Most recent comments
- Make a list of the strong and weak parts of the economy
  - Jobs
  - Manufacturing
  - Trade/import/export
  - Housing
  - Inflation (how does it relate to official target? Do you understand the central bank's target? Do they target core or headline, etc.)?
- Understand what is priced into interest rate markets
- Learn as much as possible about what moves the drivers of your currency. For example, if you trade a commodity currency
  - What are the main commodities that matter?
  - What is the major narrative for those commodities right now?
  - What is the supply/demand dynamic?
- Look for academic papers about your market. There is a surprisingly huge body of academic work on financial markets of all shapes and sizes. If you Google, for example, "time of day behavior of foreign exchange markets" you will find some cool stuff. Even if you don't directly apply the info, you will learn different ways of analyzing markets and get different viewpoints. Also, look in the bibliography of the paper for many, many more papers. It's a fun rabbit hole.

APPENDIX B: 21 WAYS TO SUCCEED AT TRADING AND 13 WAYS TO FAIL

from Alpha Trader

Excellent traders:

1. Adapt.
2. Are rational.
3. Are self-aware.
4. Do not blow up.
5. Study metacognition.
6. Don't mind being wrong.
7. Can clearly describe their edge.
8. Understand process vs. outcome.
9. Use the tight/aggressive approach.
10. Are experts in the markets they trade.
11. Are creative and independent thinkers.
12. Understand variance and the metagame.
13. Love trading more than they love money.
14. Fall down, get back up, and keep running.
15. Work hard, even when they don't feel like it.
16. Have the discipline to both make a plan *and stick to it*.
17. Recognize biased thinking (in themselves and others).
18. Employ a rigorous and systematic risk management process.
19. Have an unshakable belief in themselves but are not overconfident.
20. Are intelligent problem solvers with above-average quantitative skill.
21. Have the courage to put on high conviction trades in maximum appropriate size.

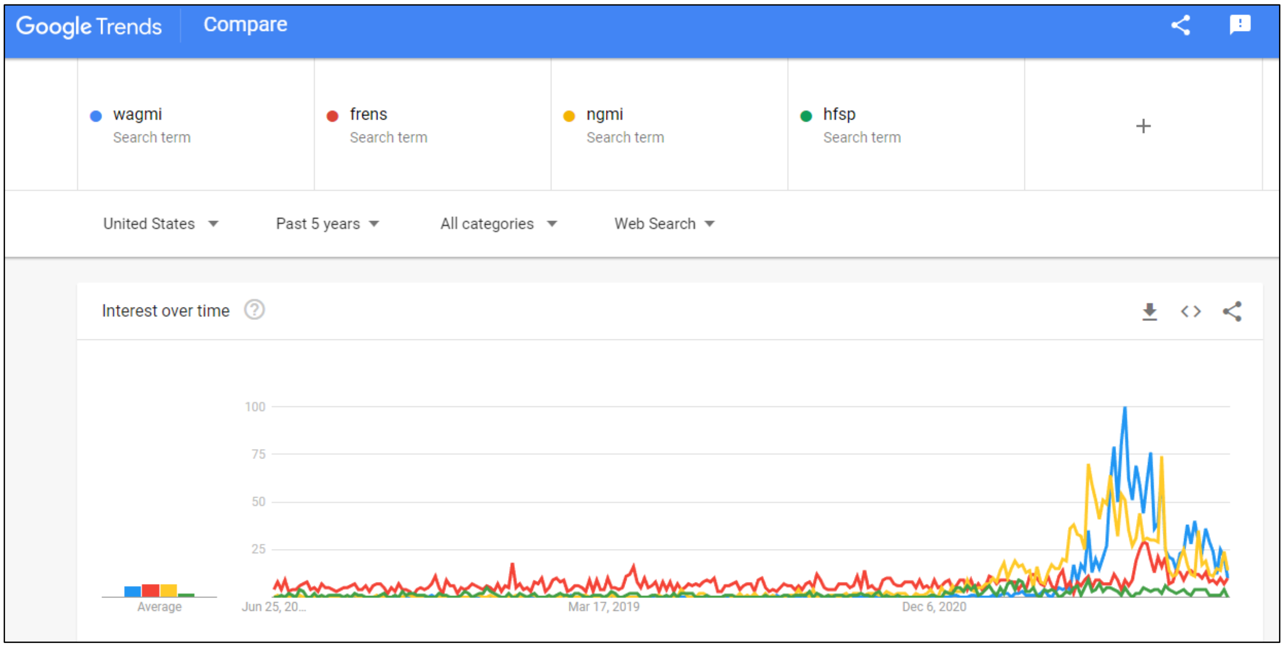
Losing traders:

1. Overtrade.
2. Have no edge.
3. Hate to be wrong.
4. Are overconfident.
5. Can't pull the trigger.
6. Rely too much on simple indicators.
7. Think much more about trade ideas than risk management.
8. Always trade the same position size.
9. Are impulsive and undisciplined.
10. Rely on System 1 thinking.
11. Don't read much.
12. Lie to themselves.
13. Gamble.

#

The 20-word recipe for trading success

Come in each day with a positive attitude. Do the work. Focus. Behave rationally. Go home. Do it again tomorrow.


Google Trends
Compare
wagmi
Search term
frens
Search term
ngmi
Search term
hfsp
Search term
United States
Past 5 years
All categories
Web Search
Interest over time
100
75
50
25
Average
Jun 25, 20...
Mar 17, 2019
Dec 6, 2020

Click here to subscribe to am/FX

Markets and Trading Commentary Disclaimer

This material has been provided by Spectra Markets, LLC ("Spectra Markets"). This material is confidential and therefore intended for your sole use. You may not reproduce, distribute, or transmit this material or any portion thereof to anyone without prior written permission from Spectra Markets.

This material is solely for informational and discussion purposes only. Spectra Markets is not a registered investment advisor or commodity trading advisor. This material should not be viewed as a current or past recommendation or an offer to sell or the solicitation to enter into a particular position or adopt a particular investment strategy. Spectra Markets does not provide, and has not provided, any investment advice or personal recommendation to you in relation to any transaction described in this material. Accordingly, Spectra Markets is under no obligation to, and shall not, determine the suitability for you of any transaction described in this material.

To be clear: Your individual circumstances have not been assessed. You must determine, on your own behalf or through independent professional advice, the merits, terms, conditions, risks, and consequences of any transactions described in this material. Securities described in this material may not be eligible for sale in all jurisdictions or to certain categories of investors. This material may also contain information regarding derivatives and other complex financial products. Do not invest in such products unless you fully understand and are willing to assume the risks associated with such products. Neither Spectra Markets nor any of its directors, officers, employees, representatives, or agents, accept any liability whatsoever for any direct, indirect, or consequential losses (in contract, tort or otherwise) arising from the use of this material or reliance on information contained herein, to the fullest extent allowed by law.

The opinions expressed in this material represent the current, good faith views of the author at the time of publication. Any information contained in this material is not and should not be regarded as investment research or derivatives research as determined by the U.S. Securities and Exchange Commission ("SEC"), the U.S. Commodity Futures Trading Commission ("CFTC"), the Financial Industry Regulatory Authority ("FINRA"), the National Futures Association ("NFA") or any other relevant regulatory body. The author is currently employed at a trading desk. The opinions may not be objective or independent of the interests of the author. Additionally, the author may have consulted with various trading desks while preparing this material and a trading desk may have accumulated positions in the financial instruments or related derivatives products that are the subject of this material.

Spectra Markets does not guarantee the accuracy, adequacy or completeness of the information presented in this material. Past performance and simulation data do not necessarily indicate future performance. Predictions, opinions, and other information contained in this material are subject to change continually and without notice of any kind and may no longer be true after the date indicated. Any forward-looking statements speak only as of the date they are made, and Spectra Markets assumes no duty to and does not undertake to update forward-looking statements. Forward-looking statements are subject to numerous assumptions, risks, and uncertainties, which change over time. Actual results could differ materially from those anticipated in forward-looking statements. The value of any investment may also fluctuate as a result of market changes.
Spectra Markets is affiliated with Spectra FX Solutions LLC, an introducing broker that is registered with the NFA; Spectra FX Solutions LLP, which is a registered entity with the U.K.'s Financial Conduct Authority; and SpectrAxe, LLC, a swap execution facility that is currently in the process of registering with the CFTC. The disclosures for Spectra FX Solutions LLC and Spectra FX Solutions LLP related to the separate businesses of Spectra FX can be found at http://www.spectrafx.com/.