The Art of the Trade
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What I Learned (and Lost) Trading the Chicago Futures Markets

Jason Alan Jankovský
We do not see things as they are; we see things as we are.

—Anaïs Nin
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Read Me First

This is my second book for John Wiley & Sons. It was originally published under the title *Dancing with Lions* by Trader X. Although it was received well by readers, it was not considered a mainstream book by the trading community. It was only after my first book for Wiley, *Trading Rules That Work: The 28 Essential Lessons Every Trader Must Master*, had established itself as a good seller that my editor Kevin Commins approached me with the idea of writing another book. I told him I already had written another book years ago, which had been published with a different publisher. The book had initially sold well, but it was now out of print. I told him that I thought this book could reach a new and wider audience with a new publisher. Kevin read it and felt it had good insights. However, it was, in his words, “a little rough.” He suggested that I update it and let him see what Wiley thought. The result is *The Art of the Trade*.

As my career has grown and changed, I have had to let go of many of the original points of view that I held as a young trader. *Dancing with Lions* was published at a time in my trading career when both the industry and I were going through changes that eventually would alter things significantly. In the case of the markets, technology has given
birth to fully online market access, global market opportunity, and a
host of innovative new trading products; something that had never hap-
pended before. During this time we also saw the tragedy of 9/11 and the
inevitable financial repercussions that a seminal world event like that
can create. The markets went on to recover more quickly than I could.
In my case, I was knocked-flat for years.

My trading suffered dramatically during the months after 9/11. It
would be unfair to the reader to suggest that all markets can be traded
by all traders at all points in time. My emotional and mental state was
devastated by 9/11; I was not capable of a strong market presence. The
demons I thought I had exorcised to achieve the level of success that
I once had had come back in greater force and numbers. I lost every-
thing and eventually quit the business for a period of time. My think-
ing was so convoluted that I honestly felt that I would never achieve
my goals as a trader or even as a person. I went through the hell
I describe in the first chapter for a second time. I laugh about it now,
but when someone asks me now about the experience I usually reply,
“I went from being Trader X to being Waiter X. . . .” Yes, I actually
waited tables for a few months. I was serving drinks to people I could
have bought and sold a few months earlier. It was humiliating.

I think it is important for readers to know that now more than
ever, I sincerely believe that trading is more an art form than a science.
As an artist, there will be times when we are at our best, times when
maybe we are just getting by, and times we are under extreme adver-
sity. As I mention throughout this book, a lot of what we perceive to
be our unique adversity is sometimes self-created. If we are self-aware
enough, we can see this relationship. If we are committed to our suc-
cess enough, we can learn to stop creating adversity for ourselves as
well as resolve the adversities that we have created. Indeed, some of the
best art ever created has come from an artist who has struggled through
extreme personal tragedy and pain, only to find his or her divine spark
of excellence that now expresses itself on the canvas, in stone, or on the
manuscript page. In my opinion, trading is no different and could be
considered an equal expression for this spark of excellence. Some peo-
ple are familiar with Vincent Van Gogh’s issues; try learning about the
life of Galileo or Jackson Pollack if you want to see how far adversity
can take you. Those men amaze me with their tenacity and skill. They
would have made great traders.
In my case, I experienced a deeper and more purifying kind of adversity, and part of what made those years good for me (in the end) was the final acceptance that no matter the circumstances that I find myself in, it is always my response to them that either moves me forward or moves me back. Sometimes people get beat down so hard that they just lie there and quit. I came very close to that point for the second time in my life. I remember the day and the hour. I remember the climb back in the darkness. Before you pass judgment, you might be there too one day. . . .

I couldn’t control the events that happened to me any more than you could. Some group of fanatics (without using a harsher word) chose to do something horrifying and affect millions of people negatively; and we all suffered to some degree. The fact that in my case it meant the potential to lose large sums of money, lose opportunity, and almost lose my sanity (again) had nothing to do with the actual events that transpired. That remained my choice in the end; even if I didn’t see that at first or was unwilling to accept it at first. Making the conscious choice to pick up and start over was entirely mine and even though I discuss this in the book, I know that truth at a deeper and much more complete level than ever before. The trader I am today is a different trader than I was then. To the outside observer that relationship may not be fully apparent, but inside me I know the difference. I think that in my years since the catastrophe I am better equipped. I have not recovered to the level I was prior to 9/11 and I don’t even need to. No matter what happens for me going forward, 100 percent of it will be mine and all of it is exactly what it should be.

Regardless, what you read from here forward was written at a different time in my life. Some of the material has been edited and amended to reflect the changes. Wherever I think it is important, I note that for you. While you are reading, I hope that you take time to reflect back on your own previous trading past and ask yourself some hard questions. Perhaps, in addition to the insights I share or the unique point of view I hold, you will personally be able to use the past years of your trading career in a new way. Much of what I found in the markets has not changed in spite of my personal experience during the last several years; mostly what has changed is my level of self-awareness and self-acceptance. No matter what happens in the markets, my trading account balance is my responsibility and no one else’s. Sometimes
that means I am positioned on the wrong side of a world event; sometimes that means I did something stupid to myself. But in all cases, the responsibility lies with me and it can never be lip service. I must own that level of responsibility.

Lastly, before we get started, in fairness to the reader, most of what you see here is as close to the original text as my new publisher would allow. Much of my more colorful language has been edited to a “PG” level, but most of the content is as I wrote it for the first edition. My intention was to preserve the original purpose of the book without a lot of change. I say that because, if you are one of the traders who sincerely want to get as far as you can go, some things won’t change while others things get better/worse. The trading environment evolves just like you do. For example, in today’s electronic marketplace, the risk of your account balance being affected due to a brokerage house internal issue (as described in Chapter 4) is a lot smaller. On the other hand, the regulators are another issue (as described in Chapter 6). In my opinion, I think that they have gotten worse during the last few years. I think the U.S. markets will lose market share and skilled people as the regulators overregulate, increase costs, and waste time and resources.

Anyway, rather than take up space with a whole new book, let me let you get to reading *The Art of the Trade*. I hope you find value in my experience and wish you the best in your trading.

JASON ALAN JANKOVSKY
Formerly “Trader X”
*Chicago, Illinois*
*Spring 2008*
Foreword to the First Edition

It is the author's intention to write this book only as a journal of his personal experience through being in the business of futures and options trading and how he discovered the true nature of reality as he sees it. Therefore, he could exploit the apparent function of the markets by discovering their real function, as well as how to exploit everything else. He did not intend to write a how-to book. He has made this narrative as brief as possible and that holds at least two real benefits for readers. First, because the author believes he has nothing new to add to the business of trading per se, the reader will not have his (or her) valuable time wasted looking for something that really does not exist. Second, the author will force the reader to wonder what he is really getting at by a consistent reference to the fact that the author knows what some overriding principle or reality related to the markets is and the reader does not. The reader will then form only one of two conclusions: Either (1) the author is nuts and this book was a waste of time, or (2) the author is on to something. The reader will then really start the process of getting what the markets actually represent for him.
Trader X receives two benefits from this hypothesis as well. First, if the reader believes this book was a total waste of time, Trader X knows that particular reader will probably remain enough of a losing trader to provide a constant flow of money that becomes available to him and those that fall into the second group, although he knows that will continue anyway. Second, Trader X can draw new distinctions about the nature of reality from those traders who read this, and believe he is on to something, should he meet them personally without them knowing it was he who wrote this book. He believes their thinking would be influenced somehow by meeting a “famous trader” and, therefore, they would never really share the true nature of what they see, but something else of little value. Because a very large group of traders who could be potential readers live and work side-by-side with him, Trader X believes he would lose these benefits. He would become a direct target of criticism or congratulation that would influence his trading because they could “find” him and, therefore, influence his clients to whom he feels a high degree of personal responsibility. The author believes this could only lead to losses. Trader X believes this would be the case if only one copy was sold and he only met one individual. Since he cannot predict what would happen “positively” or “negatively” in either case, he decided not to take that risk, or reduce it as much as possible, especially if the book sold well within the industry. This is why the book is anonymous.

The author assumes the reader will already have a basic knowledge about the trading business. For those who know little about the markets, or are not in this industry, outlined next are some of the basics he refers to.

The Arena

The futures and options exchanges are a central meeting place for the purpose of trading in some necessary element that affects everyone. This includes consumable commodities such as corn, crude oil, orange juice, and the like. It also includes financial instruments such as Treasury bonds, currencies, stock indexes, and so on. Exchanges do not set prices; they provide a place for price competition from all participants who choose
to trade. Those who do not trade receive a benefit intangibly by keeping prices as fair to them in their daily life as possible. Membership to the exchange is not a requirement to trade through the exchange. This provides a way for anyone to exploit price competition for their personal benefit or to earn profit from some perceived opportunity. There are two kinds of market participants who are in direct competition with each other. It is this competition that will create prices or cause them to move.

One participant is the **speculator** and the other is the **hedger**. The speculator is attempting to take advantage of price movement solely for personal profit. He (or she) is taking the risk of price action, either for or against him. The hedger is attempting to take advantage of price movement for the purpose of reducing his production costs or to improve his profit margin when he markets his final product. He is transferring his risk to the speculator and assumes little or no risk of price action against him. Should prices move in a direction that further reduces his beginning cost of business (or further improves his profit margin), he cannot take advantage of that from the point he transferred his risk to the speculator. The hedgers benefit from the markets is a “known” permanent cost of business. The speculators benefit from the markets is an attempt to profit.

A futures contract is a standardized agreement between two parties to either **make** or **take** delivery of a specified amount of a particular something at a specified future point in time. This agreement can be created or liquidated at any time prior to that date. As long as any market is “open” for trading this agreement can be created or liquidated for any length of time either side wishes to participate. This time frame can be months or years and also as short as just a minute or two. Any individual, whether a speculator or a hedger, is obligated for the total value of that futures contract for the time he holds it. On a specified date he must either pay for it completely if he is a buyer in the market, or actually produce the product traded to the buyer if he has been a seller in the market. That is called **taking** or **making** delivery. Until that point the exchange requires a financial commitment bond to secure this relationship and to protect both parties against default from this contractual agreement. This is called **margin**. The exchange typically requires that each party wishing to enter into this agreement from either side deposit 2 percent to 5 percent of the face value of the contract. In some cases, the hedger does not have to make this commitment. He only needs to
prove to the exchange that he actually owns or controls the product to be traded in sufficient quantity. In either case, this can be in cash or something that is considered liquid enough to be converted into cash within a reasonable time frame. Once this has been done, you may trade. When you choose to participate as either party to the transaction, you are opening or taking a position. Because of the relationship between entering the agreement, and not having to fully accept financial obligation until a future date, a futures contract is considered a leveraged instrument for the period of time leading up to the delivery date. Typically, about 98 percent of all futures contracts are liquidated before that time. This is called closing a position. The time between opening a position and closing the position is called holding a position.

If you open a position in a futures contract by buying the price currently being traded, you are going long. If you open a position in a futures contract by selling the price currently being traded you are going short. When you do either, it is called an execution. To close any futures position, you must make another execution. If you are holding a long, and you wish to close your position, you must execute by selling into the market at the price currently being traded at that time. If you are holding a short, you must execute by buying the price currently being traded at that time. You will be assigned the difference between the two prices executed against the margin in your account as it relates to the full value of the position.

In other words, if you buy one futures contract of corn for $2.75 per bushel and sell it for $2.77 per bushel you would have a profit of 2 cents per bushel. The corn contract size at the Chicago Board of Trade (CBOT) is 5,000 bushels. Therefore, you would have a profit equal to $100 (2 cents × 5,000 = $100). If the opposite has occurred you would have lost $100. The amount of cash in your margin account would have gone up (or down) by $100 if you would have bought and sold corn for a gain (or loss) of 2 cents a bushel, aside from any fees.

If you complete a transaction as described, you will have either a profit or a loss against your margin at that point until you decide to execute another transaction or close your relationship with the exchange and ask for payment to be made to you. If you went long by beginning this process on the buy side, and you closed your position with a sell execution higher than your buy execution, you would have a profit. If the opposite occurred, you would have a loss. If you
went short by beginning this process on the sell side, and you closed your position with a buy execution lower than your sell execution, you would have a profit. If the opposite occurred, you would have a loss. Because you may begin this process in either fashion, you can attempt to profit as prices are rising or falling. The hedger is not obligated to both sides of this process unless he chooses to. He may close his position by making or taking delivery, depending on which side of the market he is hedging from.

Hedgers use both sides of the market depending on their business needs. For example, if you make candy bars you might want to buy sugar ahead of time if sugar is at an important low price relative to your cost of production. If you grow cocoa and sell it to candy bar makers, you might want to sell cocoa in the market ahead of time if cocoa is at a higher price than you normally could get from a candy bar maker. In either case, the buying or selling hedger is not obligated to liquidate his transaction. He may make or take delivery.

The entire process must occur under the authority of the exchange. This is the clearing corporation, which must ensure that both parties to the transactions have been assigned their positions and that sufficient margins for every transaction are available and on deposit with the exchange. This is done to make absolutely certain that those who have traded for profits receive them and that those who have traded for losses will pay them.

An option on futures is slightly different. It is the right but not the obligation to enter the futures contract until a specified date. If you choose to exercise this right you are now in the futures contract itself and subject to the obligations as described above. There are two parties to an options transaction as well; the grantor, or writer, and the owner, or buyer. The grantor is obligating himself to take the other side of a futures contract, which he will provide to the owner at a specified price called the strike price. He is under this obligation until the specified date called the expiration date. The owner of the option may exercise his option, or sell it to someone else, at any time prior to the expiration date. The grantor may also close his position at any time prior to the expiration date by buying it back from anyone who owns the option, or another grantor, prior to the expiration date. This is called offsetting. The grantor does not have to own any futures contracts at any price when he writes an option, but will be assigned his obligation if
the option is ever exercised against him. This is called *uncovered option writing*. If the grantor enters a futures contract at the time he writes an option, or at any time prior to it being exercised, this is called *covered option writing*. The price paid for any option is called a *premium*. The grantor keeps the premium paid by the owner if the option is exercised, or a portion of the premium if he offsets it prior to expiration.

There are two kinds of options. A *call* is the right to buy futures at the strike price specified. A *put* is the right to sell futures at the strike price specified. If you *write a call*, you are giving someone else the right to go long. If you *write a put*, you are giving someone else the right to go short. Approximately 98 percent of all options written are offset or expire with no value that can be exploited from further price action in futures. If they do have some value, this is called an *in-the-money* option. An option can go “in” or “out” of the money any time prior to expiration. If the owner of an option does not liquidate or exercise an in-the-money option at the time of expiration the exchange will do it for him. Conversely, an option that has not gone in the money is called *out of the money*. At the time of expiration, all out-of-the-money options, whether calls or puts, are worthless. The grantor will keep 100 percent of the premium, or the portion that he had before that date. The owner of the option receives nothing.

Whether you are participating in futures, options, or both, the relationship both parties function under is a *zero-sum transaction*. This means that all the participants who hope to profit will be paid those profits from the other participants who have losses. The money paid to a winning transaction is paid from the money in the losing transaction. This also means that anyone who executes any position will be at risk that price action could move for him or against him at anytime. It is not possible to participate in futures, options, or both without accepting this risk. All the infinite possible combinations of futures and options and the price action between the two are an attempt by every participant to take as little of this risk as possible while attempting to maximize the potential for profits. In any case, *the losers will always have to pay the winners*. The clearing corporation will deduct the money from the losing positions and deposit the exact same money to the holders of the winning positions.

*Ghostwriter X*³

*Fall 1998*
Introduction

Every trader has a story. This is my story. When I sat down to put my story on paper, I asked myself some hard questions. After giving some deep thought to those questions, I came to some conclusions. First, as far as the markets themselves are concerned, I really have nothing new to say. It is my belief that everything that could be written (or said) about the markets has already been done. All of it. I think the people who write books about the markets basically do a tremendous disservice to the true student of trading by simply reiterating what has been said already. Or worse yet, publish a lot of worthless psychobabble. They make it harder to uncover the real truth.

I didn’t want to write a book that would slow down anyone’s quest to become the best trader he or she could become. Nor is it my intention to “teach” anything. I tried that. Most people who teach trading, with few exceptions, never walked the road I did. Not even close. In fact, there is at least one person who I think should be in jail for what he sells the public under the guise of a “trading course.” After what I’ve been through, I would never, as God is my witness, attempt to cheapen the price of admission to this business and sell it to Joe Public for $195 knowing full well that his equity is cannon-fodder for men like me. It’s