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# Trade Like Jesse Livermore

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**RICHARD SMITTEN**



John Wiley & Sons, Inc.



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# Contents

<b>Preface</b>	<b>vii</b>
<b>Acknowledgments</b>	<b>xiii</b>
<b>CHAPTER 1 Meet Jesse Livermore</b>	<b>1</b>
<b>CHAPTER 2 Timing is Everything</b>	<b>9</b>
<b>CHAPTER 3 Livermore Trading Discoveries</b>	<b>29</b>
<b>CHAPTER 4 Livermore Pattern Recognition Timing Keys: Pivotal Point Trading</b>	<b>47</b>
<b>CHAPTER 5 Perfecting Money Management</b>	<b>77</b>
<b>CHAPTER 6 Emotional Control</b>	<b>97</b>
<b>CHAPTER 7 How Livermore Prepared for His Day</b>	<b>115</b>
<b>CHAPTER 8 General Livermore Issues</b>	<b>127</b>
<b>CHAPTER 9 Livermore Quotes—Trading Truths</b>	<b>143</b>
<b>CHAPTER 10 Summary of Livermore Trading Rules</b>	<b>157</b>
<b>CHAPTER 11 Livermore Secret Market Key</b>	<b>169</b>
<b>About the Author</b>	<b>211</b>
<b>Index</b>	<b>213</b>





# Preface

**T***rade Like Jesse Livermore* explains the complete Livermore Trading System, developed by Jesse Livermore over his legendary 45-year career trading the stock market. This book explores the technical aspects of the Livermore Trading System, including Timing, Money Management, and a way to achieve Emotional Control. It deals with the details and secrets of the stock trading system that brought about Livermore's amazing and unbridled success on Wall Street.

The information in this book comes as a result of over two years of deep research and many personal interviews with the remaining Livermore heirs. In 2001, I wrote the only complete biography of Jesse Livermore: *Jesse Livermore—World's Greatest Stock Trader*, published by John Wiley & Sons., Inc. This is a very personal memoir about the famous trader and covers every aspect of his life from the time he ran away from home in 1891 until he shot himself in 1940.

For that book, I was able to interview Paul Livermore, Jesse's son, who was a recluse and had never spoken to anyone about his father. Paul provided insights into his father's trading and his methods that had never been disclosed. Paul was 77 at the time and died shortly after these interviews.

I also interviewed Patricia Livermore, Livermore's daughter-in-law, married to Jesse Livermore Jr. She provided not only several personal anecdotes, but also some information about how Livermore prepared for his day of trading and how he prepared his mind to trade in the massive positions he often took.

Livermore made four separate fortunes and caught the crash of 1907 on the short side: He made over \$3 million in a single day. In the Market Crash of 1929, he made over \$100 million.

Livermore was not a fundamentalist in his trading approach—he was a true technical trader. He believed that the technical trading of stocks, recurring numerical and chart patterns are nothing more than the graphic reflection of such human emotional behavior as greed, fear, ignorance, and hope. Livermore knew how to recognize these recurring patterns and

made several fortunes as a result of this knowledge. “Wall Street never changes,” he said, “because human beings never change.”

Through trading and market observation, Jesse Livermore found that stocks and stock markets move in cycles within a series of repetitive patterns. He then developed a set of unique tools, using mathematical formulas and equations that allowed him to identify and interpret the movement in stocks with uncanny reliability. His amazing trading record over the 45 years of his career made him one of the most famous traders to ever work on Wall Street. He is still regarded by many professional traders as the greatest trader who ever lived.

Livermore worked in total secrecy in a highly secure New York City penthouse at 780 Fifth Avenue, the Heckscher Building. He once wrote, “On October 5, 1923, in order to practice my new techniques and theories, I moved my offices to Fifth Avenue. I designed the offices very carefully. I wanted to be away from the Wall Street atmosphere, out of earshot of any tips. I also wanted to gain more secrecy in my operations and more security, so that no one could know my trades. Sometimes I used over fifty brokers to keep my trades secret.”

It was here in these offices that Livermore applied his interpretive skills with the technical tools available to him at the time: board boys recording market movement on a chalkboard; telephone lines connected directly to the exchanges in New York, Chicago, London, and Paris; and a number of ticker tapes spitting out the most current stock and commodity quotes. He proved his trading system over and over again by taking advantage of the accurate price movements predicted by his trading system.

Under the pseudonym Larry Livingston, Jesse Livermore was the real protagonist in another best-selling book: *Reminiscences of a Stock Operator*, published in 1923 (also currently published by John Wiley & Sons). That book explained what he did, like cornering entire commodity markets such as cotton and coffee, and making \$3 million in a single day by going short in the crash of 1907, but that book did not explain how he did it.

This book explains Livermore’s trading methods, techniques, and technical formulas. It reveals the Jesse Livermore Trading System in complete detail. All of these trading methods can be applied to today’s trading techniques, using personal computers and the Internet.

The book explains a number of aspects of Livermore’s technical trading systems, such as:

- Recognizing and profiting from Pivotal Point Trading
- Continuation Pivotal Points and how to recognize them
- One- and three- day reversal signals—how to identify them and profit

- Tandem Trading—looking at two stocks, the stock and the sister stock
- Industry Group action and how it must be analyzed and understood before trading
- Top Down Trading techniques
- The importance of volume activity in trading a stock
- Stocks breaking out to new highs and what that can mean for a trader
- Break-outs from a consolidating base
- Trading only in the leading stocks in each group
- The dimension of time, an important element in trading the Livermore system
- The complete Livermore Money Management system

The Livermore Trading System can be applied to any trading time frame from 10 seconds to 10 years, and it can be used by the long-term trader as well as the day trader.

Like an athlete preparing for a contest, Livermore considered it very important to prepare himself both psychologically and physically for a day of trading. These techniques are disclosed in this book.

[NOTE: As a result of his Jesse Livermore research, Smitten currently is putting together a fully automated software program that allows the trader to trade like Jesse Livermore. This software program is the main asset of a company that was taken public and started trading on the Nasdaq Bulletin Board on April 1, 2003, under the symbol SMKT-Stock Market Solutions. This highly technical software program has led to an even deeper study of Livermore's trading methods and formulas. Much of this detailed technical material is included in this book.]

## **LIVERMORE TRADING SYSTEM— STRUCTURE OF THE BOOK**

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The Livermore system has three main headings: Timing, Money Management, and Emotional Control.

### **Timing—When to Pull the Trigger**

Chapter 4 explores the technical tools Livermore used to determine when to pull the trigger and actually initiate the trade. This includes graphic studies using charts, tables, and examples of Pivotal Points, as well as how to recognize Continuation Pivotal Points and one- and three-day stock reversal patterns. The importance of high-volume breakouts are

explained. Stocks breaking out to new highs are also demonstrated and explored in detail. All these factors are necessary to fully understand the Livermore Trading System.

### **The Livermore Money Management System**

This is a system used by Livermore that explains to the trader “when to hold ’em and when to fold ’em.” The five rules of Livermore’s money management are explained in full detail in Chapter 5.

Rule 1—Use a unique probe system.

Rule 2—Never lose more than 10 percent on any trade.

Rule 3—Always keep a cash reserve.

Rule 4—Don’t sell just because you have a profit; you need a reason to buy and to sell.

Rule 5—After experiencing a windfall profit put half the profit in the bank.

### **Emotional Control**

Chapter 6 discusses how to keep your emotions under control and follow the Livermore Trading System. Livermore believed emotional control to be perhaps the most difficult thing for a trader to master. Often, a successful trader has the biggest battles within himself, in following his own rules. Livermore’s rules for emotional control are explained in detail in this book. A quick summary follows:

- Learn from your mistakes: Keep notes and analyze every trade.
- Preparation: Livermore had a daily regime, almost a trading ritual.
- His Special Office Arrangement: Keep strict office rules such as no talking after opening bell.
- Masterminding the media: Be suspicious of the news media—read between the lines.
- Cut losses/control emotions: A TRADER MUST LEARN AND PRACTICE EMOTIONAL CONTROL.
- Let the winners ride: Don’t dump a winning trade.
- Follow your own rules.
- Beware of stock tips: Never take stock tips under any circumstances.

Livermore finally concluded—perhaps his most important observation—that emotional control is every trader’s major challenge and is often the most important element in successful trading. He went so far as to take college courses in psychology to try and better understand the hu-

man mind. He considered faulty emotional control as his major trading flaw. He said to his sons, *"I only lost money when I did not follow my own rules."*

The book explains the importance of discipline in following the trading rules. It outlines how Livermore traded and how the reader can do so as well.

Each chapter of this book deals with one or more of Jesse Livermore's trading theories, methods, and techniques. In some cases, they have been updated to take advantage of the advanced technology that is currently available to today's technical traders. The book includes a large number of charts, graphs, and tables. It is designed for the trader who wants to become a master trader, like its subject.

Richard Smitten



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**I**would like to thank my friend and partner Dennis Kranyak for all his hard work in helping me prepare this book. Dennis hand-built all the charts in the book and indexed, for the first time, all the famous Livermore quotes in Chapter 9.

Dennis has been with me on the Jesse Livermore journey for more than five years while we studied all the Livermore methods, trading techniques, and secret formulas. He has always kept it fun and interesting, and I am always astounded by his facile and brilliant mind.

Thanks, Dennis.

RICHARD SMITTEN





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# **Trade Like Jesse Livermore**

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## CHAPTER 1

# Meet Jesse Livermore

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

"How much did you come here with, Jesse?"

"Twenty-five hundred dollars."

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

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

"Somehow, I believe you, Jesse."

"I'll pay this back." Livermore said, pocketing the money.