Lessons From A Trading Great: Amos Hostetter

Amos Hostetter cofounded Commodities Corporation (otherwise known as CC) along with Helmut Weymar back in 1969. CC is the trading shop that produced more legendary trading talent than the Yankees have All-Stars. Alumni include: Bruce Kovner, Michael Marcus, Paul Tudor Jones, Ed Seykota and more…

Hostetter was considered the wise sage and mentor of the group. He's credited with imbuing many of these trading greats with the wisdom and knowledge they used to achieve their grand heights.

Upon his untimely death in a car accident in 1977, the directors of CC commissioned one of their traders, Morris Markovitz, to gather and record Hostetter's timeless philosophy on markets and trading. The goal was to ensure future CC traders could benefit from his invaluable teachings. The resulting work was an internal booklet titled *Amos Hostetter; A Successful Speculator's Approach to Commodities Trading.*

Hostetter's trading philosophy could be boiled down to the following (in Hostetter's own words):

1. *Try to acquire every bit of fundamental information available. Read extensively.*
2. Simultaneously, post daily charts on commodities and develop a feel for trends.
3. Follow the fundamentals in your trading but only if and as long as the charts do not cast a negative vote.

He regarded money management as the first priority for any serious market speculator. From Markovitz (emphasis mine):

> ***Sound money management is crucial to successful trading.*** *The best market analysis won't get a trader to the bottom line – consistent profits – unless he has a sound money-management policy. This is an area where Mr. Hostetter excelled.*
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> *Sometimes it is hard to draw a sharp line between trading principles and money-management principles. If I were to paraphrase a famous saying, I think it would provide an accurate summary of one of Mr. Hostetter's most important trading and money-management principles:* ***the market, to be commanded, must be obeyed.*** *As a trader, Mr. Hostetter was aware of his own fallibility. He tried to protect himself from errors by the trading rules he used and by trying to anticipate areas of potential surprise. This alone, however, was not enough. If the market moved against him for a reason he did not understand, he would often exit without waiting for a trading rule to take him out: as a money manager, he knew he could not afford the luxury of a prolonged argument with the market.*

> *Perhaps his most important money-management principles was "**Take care of your losses and the profits will take care of themselves**." This means that a trader should place strong emphasis on keeping his losses small, because two or three large losses in succession would be a crippling blow.*

His risk management principle of "taking care of your losses" is similar to Howard Marks of Oaktree Capital: "if we avoid the losers, the winners will take care of themselves." This truth is the single most important law of speculation. It sounds glib, but cutting your losses and letting your winners run is the most common thread amongst all great traders. If I could travel back in time 15 years, I'd go back and beat this fact into my thick skull… and I'd be much richer today for it.

Hostetter used a multi-pronged approach to assessing markets and potential trades. It's from him that [Michael Marcus]() likely developed the "Marcus-Trifecta" to gauge markets — looking at "technicals, fundamentals, and market tone". Here's an overview of his approach to fundamentals:

> *Mr. Hostetter's fundamental approach was, to use his own phrase, "broad brush." This means that he would look at the overall balance sheet and the statistics that applied to the commodity in which a trade was contemplated. Then, certain basic questions would be asked:*
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> > *— Will production exceed consumption this season (a stocks build-up)? If so, then the initial premise would be bearish.*
> >
> > *— Will consumption exceed production (a stocks draw-down)? If so, then the initial premise would be bullish.*
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> *The initial premise would then be refined by other considerations. For example: weather could destroy the current production estimate for an agricultural commodity; a change in general economic conditions could destroy the demand or consumption estimate; the high price of meat could increase demand for potatoes.; the low price of corn could increase demand for soybean meal; and so forth. The last two items are intended to illustrate the flexibility, or creativity, of Mr. Hostetter's thinking, and represent the personal style he brought to commodity analysis. **He held facts in the highest regard, yet he remained constantly alert to the principle that the facts can and do change.***
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> *The key phrase is flexibility of thinking, which is the opposite of stubbornness. Mr. Hostetter knew that, whatever his fundamental analysis might show today, there was a good chance it would show something different by the time the last day of the season had arrived… In brief, **Mr. Hostetter would never wed himself to a precise position on the outlook for the future; he had often enough experienced the phenomenon of a significant price change before the reasons behind it became general knowledge.** He kept himself prepared for surprises, in both directions, in advance. If one does a little "dreaming" about the [possibilities]() on both sides, then he is in possession of possible explanations for surprises, and will be less hesitant to act if and when they come.*

Maintaining an open-mind and staying aware of your biases is critical. Markets serve ample helpings of humble pie to those who arrogantly wed themselves to a "market prediction".

Hostetter took a nuanced approach to using technicals, similar to how we utilize price action in our trade analysis at Macro Ops. Markovitz writes:

> *Mr. Hostetter definitely did not accept the clear-cut dichotomy between fundamental and technical trading. Both methods can be used successfully, but he blended the two. It is my impression that Mr. Hostetter would have agreed with the following statement:*
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> > *The pure fundamentalist concerns himself with production, consumption, stocks, and other basic economic data, viewing these as the causes and price as the effect, while the pure technician regards price as its own cause. In fact, to draw a sharp line of choice between these two approaches is not the best policy.* ***Price itself should also be regarded as a fundamental. It can play the role of cause or effect or both under different circumstances.***
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> *The market's own behavior can, in a real sense, be classified as a fundamental variable. The method of analysis, however, is completely different. The technical aspect of Mr. Hostetter's trading consists primarily of:*
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> 1. *Trend following*
> 2. *Support and resistance areas*
> 3. *Pattern recognition*
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> *These are listed in order of their importance, although any one of them may be the dominant influence at a given time.*

Within this technical framework Hostetter employed a number of useful heuristics to help him read the tape:

> *Many of the techniques Mr. Hostetter used depended on a time factor. In general, as with congestion areas, most patterns accrue more significance if they take more time to form, and* ***a trader should be aware of time as well as price when considering any technical pattern.*** *For example, a bear market that has persisted for a year is unlikely to form its bottom in a week, nor is a two-month bull market likely to take a year to form a top. A trader should keep in mind the duration of recent major moves and expect commensurate time periods for the formation of the current pattern.* ***(Patience is an important virtue – hastiness rarely pays).***

I find Hostetter's thoughts on the "time factor" useful in analyzing where price may be headed. Markets tend to follow a certain symmetry over long periods of time. Some technical heuristics Hostetter used are:

- *He would become seriously concerned if a bull market was unable to make a new high for thirty days (the same is true for a bear market that hadn't made new lows for thirty days).*
- *A poor price response to bullish news is itself an ill omen for long*

positions, especially if other cautionary signs are present (e.g., the bull market is old, the vigor has shown some signs of waning, prices are near a fundamental objective, etc.)
- *The most important timing issue is patience. One should wait for his opportunity, wait until everything lines up according to his expectations.* ***It is far better to miss an opportunity here or there than to jump in too early without a clear plan.*** *Too much patience is rarely the problem for any trader.*
- *A trader should do his fundamental homework, keep his eye on the charts, and patiently observe. Once he is able to form a definite fundamental opinion, he should wait for confirming market action before proceeding.*

Practicing the necessary patience to win is one of the hardest aspects of speculation. Fear is man's strongest emotion and is behind one of a trader's most common foibles – the fear of missing out (FOMO). Success comes to those who realize that Pareto's Law dominates the distribution of returns. Only a handful of trades a year will account for the majority of profits. It pays to sit and wait patiently for those fat pitches to come along.

Lastly, here's a list of maxims and trading do's and don'ts as recorded by Hostetter in his own words.

GENERAL PRINCIPLES AND MARKET MAXIMS

- A very general and important rule is: ***take care of your losses and your profits will take care of themselves.*** This is both a trading maxim and a money-management tool. A trader needs big winners to pay for his losses and he won't capture these big wins unless he stays with the trend all the way.
- **There is never any objection to taking a loss.** There must always be a good reason before you can permit yourself to close out a profit.
- ***When in doubt, get out.*** Don't gamble. Be sure, however, that your doubt is based on something real (fundamentals, market action, etc.), and not simply on your own nervousness about the price level. If it is only the price level that is making you nervous, then either stick with the winner or at worst use a more sensitive stop-loss point. Give the major trend all the chance you can to increase your profits.
- ***All major trends take a long time to work themselves out.*** There are times when the best approach is just to sit and do nothing, letting the power of the underlying trend work for you while others argue about the day-to-day news. Be patient.
- ***Surprising price response to news is one of the most reliable price forecasters.*** Bullish response to bear news, or vice-versa, means that the price had already discounted the news and the next move will probably go the other way. Actually, this is only one example of a wider principle: When a market doesn't do what it "should", then it will probably do what it "shouldn't", *and fairly soon*. (Note that false breakouts, up or down, are also subsumed under this more general principle. When new lows are achieved in a long-term bear market, for example, the market ' 'should" follow through with weakness—after all, it is a bear market. If, instead, it rallies quickly, this provides some evidence against the bear market premise).

THE DANGERS IN TRADING CAUSED BY HUMAN NATURE

1. Fear – fearful of profit and one acts too soon.
2. Hope – hope for a change [in the] forces against one.
3. Lack of confidence in one's own judgment.
4. Never cease to do your own thinking.
5. A man must not swear eternal allegiance to either the bear or bull side. His concern lies in being right.
6. Laziness prevents a trader from keeping posted to the minute.
7. The individual fails to stick to facts.
8. People believe what it pleases them to believe.

DON'TS

1. Don't sacrifice your position for fluctuations.
2. Don't expect the market to end in a blaze of glory. Look out for warnings.
3. Don't expect the tape to be a lecturer. It's enough to see that something is wrong.
4. Never try to sell at the top. It isn't wise. Sell after a reaction if there is no rally.
5. Don't imagine that a [market] that has once sold at 150 must be cheap at 130.
6. Don't buck the market trend.
7. Don't look for breaks. Look out for warnings.
8. Don't try to make an average from a losing game.
9. Never keep goods that show a loss and sell those that show a profit. Get out with the least loss and sit tight for greater profits.

SUGGESTIONS

1. Experience must teach. Follow it invariably.
2. Observation gives the best tips of all. Observe [market] behavior and experience shows how to profit.
3. Buying on a rising market is the comfortable way. The point is not so much to buy as cheap as possible or go short at top prices, but to buy and sell at the right time.
4. Remember [a market is] never too high for you to begin buying or too low to begin selling. Let your tape reading show you when to begin. After the initial transaction don't make a second unless the first shows a profit.
5. There is a great deal in starting right in every enterprise.
6. When something happens on which you did not count when your plans were made, it behooves you to utilize the opportunity.
7. In a bear market it is always wise to cover if complete demoralization develops suddenly.
8. Stick to facts only and govern your actions accordingly.
9. What is abnormal is seldom a desirable factor in a trader's calculations. If a [market] doesn't act right, don't touch it.

To get more wisdom from trading greats like Hostetter, click here.

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