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Shell Shock

A famous 1980s trading experiment spawned legions of disciples known as “turtles,” including some highly successful commodities managers. but that’s only half the story. the author of the new book the complete turtle trader digs deep into the mythology to uncover the real story behind a wall street legend.

by Michael Covel

FITTINGLY, IT STARTED with a BET.

Self-made Chicago commodities trader Richard Dennis, a large man worth an estimated $200 million by the time he was 39, strongly believed that great traders could be taught. Quirky, brash, disheveled, but passionate about trading, Dennis was the flip side of his stoic partner, a sinewy Vladimir Lenin look-alike named William Eckhardt, who wholeheartedly disagreed with him. Talented traders were born with an innate gift for market reading and risk-taking, he reasoned. Possibly inspired by the 1983 movie Trading Places, the two men decided to settle their dispute once and for all.

What followed in 1983 and ’84 — an ambitious nature-versus-nurture experiment in which some two dozen mostly ordinary folks from across the country were recruited to study futures trading the Dennis way — gave birth to trading lore: the story of the Turtles. The now-famous moniker was chosen by Dennis, who just prior to the experiment had visited a turtle-breeding farm in Singapore. But when he bestowed it on his group, no one could have predicted the course of the average-Joes-turned-market-moguls saga, which would capture the trading world’s imagination and demonstrate how anyone with a healthy sense of self-determination (and a clearly defined, repeatable performance edge) could become a successful trader. Several Turtles, first made famous in Jack D. Schwager’s Market Wizards and several high-profile magazine and newspaper articles, made astounding fortunes. The most respected Turtle, Jerry Parker of Chesapeake Capital, has carved out a spot alongside some of the best CTAs of all time. The group has directly or indirectly spawned dozens of talented offspring, such as Salem Abraham, a college student who, after a chance meeting with Parker, panned every nugget of trend-following gold he could from public sources — and with no experience carved out a fortune of several million dollars by the early 1990s.

Over the years, however, the Turtle legend has been misconstrued and exploited. Parker’s former partner, Russell Sands, an original Turtle, wound up embracing the allure of “selling secrets,” forgoing (for the most part) actual trading and becoming instead, in essence, a marketer. Curtis Faith, whose recent book, Way of the Turtle, leverages off his alleged status as the most successful Dennis disciple, supposedly made $31.5 million in four years. If that’s true, though, he would have made that money for Dennis. Furthermore, Faith, who “retired” at age 24, wound up running an online company selling Dennis’s secrets (you too can trend-follow like a Turtle for just $29.95!) and at one point was rumored to have gone belly-up. Faith even commented on his money woes a few years ago in an online posting: “I have had several periods in the last several years where I was very, very low on cash, but that’s not the same thing as being broke.” He did silently back a small fund a few years ago; it was recently investigated by the CFTC and is now shuttered.

“It was like a two-week seminar on how to fly a plane,” first-generation Turtle Elizabeth Cheval once said.

With the benefit of nearly 25 years of hindsight, the Turtle story, while laden with misconceptions and untruths, tension, drama and even high comedy, is in fact an inspiring tale, a testament to the best of what trading is about: guts, control of one’s destiny and the headlong pursuit of profits. Dennis and the Turtles have influenced countless traders. None other than Paul Tudor Jones was originally inspired to trade after reading an article (one that preceded the Turtles) about Dennis. “The jury is in,” says Tom Willis, a veteran Chicago-based commodities trader and a friend of Dennis’s. “The Turtles show that this kind of knowledge can be implanted, that you don’t need a sixth sense.”

And it all started with a bet.

WHEN TRADING PLACES hit theaters in the summer of 1983 — six months before the formal start of the Dennis experiment — most moviegoers were drawn to the antics of rising star Eddie Murphy. But the film resonated with traders immediately. When Mortimer Duke (Don Ameche) said of Louis Winthorpe III (Dan Aykroyd), “With his genes, you could put him anywhere and he’d come out on top... breeding... same as in racehorses...it’s in the blood,” Dennis might or might not have been listening. He has flatly denied that the film was his inspiration, but another Turtle, Mike Shannon, disagrees: “You bet your ass it had a role — it absolutely did.” While Jamie Lee Curtis was heating up the movie, Wall Street, too, was beginning to sizzle. The stock market was at the start of a bull run that would last another five years. Dennis’s firm, C&D Commodities, budgeted $15,000 for classified ads to run in the Wall Street Journal, Barron’s and the New York Times seeking trainees during the late fall of 1983: “Richard J. Dennis of C&D Commodities is accepting applications for the position of Commodity Futures Trader to expand his established group of traders. Mr. Dennis and his associates will train a small group of applicants in his proprietary trading concepts... Prior experience in trading will be considered but is not necessary.” More than 1,000 people answered the ad. One hopeful sent in two coconuts with a note saying: “If you have the balls to hire me, I’ve got the nuts.”

Those selected (not all were ad respondents; some knew Dennis previously) were a diverse flock, ranging from mild-mannered academics to an accountant to a recent high-school graduate. The exercise was something of a financial forerunner to MTV’s The Real World. There were blue-collar types (a bartender, a doorman). There were women, a Jehovah’s Witness and a blackjack player from Eastern Europe. “You had people who didn’t have a college degree,” recalls Turtle Erle Keefer. “And others had doctorates.” For all that diversity, though, a thread did emerge: The trainees all seemed to enjoy playing games of chance and thinking in terms of odds. In other words, Dennis was, in his own way, stacking the deck.

“I didn’t have a résumé at the time, so I wrote a letter that explained that I spent more time playing chess than attending law school,” recalls Turtle Jeff Gordon.

The first class, comprising a dozen lucky people, assembled in January 1984. They were put up (on Dennis’s dime) at the Union League Club in downtown Chicago. Like a modern-day Willy Wonka, Dennis was going to throw open the doors of his factory. The training would last two weeks. There would be no buying and holding, or even buying low and selling high. The Turtles were about to learn the antithesis of what collegiate finance departments teach.

The Turtles worked in spartan surroundings, seated two by two, with six-foot-tall dividers between their cubicles. The office was furnished with metal desks and chairs and a bookcase holding trading tomes no one ever touched. The dress code was anything-goes. Students showed up in the summer in cutoffs and T-shirts. The informal, no-frills environment was typical of the way Dennis (long a proponent of marijuana legalization) ran his business and his life. Since the rules the Turtles learned dictated that they trade only when the market gave certain signals, they enjoyed a considerable amount of downtime. A ping-pong table was carted in to help kill the hours. Dennis had woven a rich tapestry of characters. Among the most colorful was Anthony Bruck, a wiry and rather fashionable Chicago socialite and artist with a doctorate in linguistics. In his skin-tight black clothes, he reminded his new colleagues of Andy Warhol. There was Jiri Svoboda, a professional blackjack player who had emigrated to America from Czechoslovakia. He spent much of his free time honing his skills in Las Vegas. A card shark was a natural for the program, of course, but most others were coming in cold. Mike Carr, a game designer for the company that made Dungeons & Dragons, had never traded. Yet the Turtle camp did include a securities-industry professional, Mike Shannon, a struggling commodities broker (and former drug dealer) who fudged his résumé to get an interview. Even when Dennis learned that Shannon was testifying for the FBI as an expert witness in a drug trial, he kept him around.

The class consisted of the Turtles learning rules (see “Spilling the Secret Sauce,”) — rules based on observable, empirical, measurable evidence and subject to laws of reasoning. Each time they made a trade,

Turtles had to ask themselves several core questions:

One: What is the state of the market? Or, to put it another way, at what price is the market trading? If XYZ company is trading at $10 per share today, that's the state of that market.

Two: What is the market's volatility? Eckhardt taught the Turtles that they had to know, on a daily basis, how much any market went up and down.

Three: What is the equity being traded? Turtles had to know how much money they had at all times, because every rule they learned was adapted to the size of their account at any given time.

Four: What is the system or the trading orientation? They were taught precise rules that dictated when to buy or sell any market, at any time, based on price movement alone.

Five: What is the risk aversion of the trader or client? Risk management was the most important concept the Turtles would be taught.

Bear in mind that Dennis — considered at the time one of the greatest traders in Chicago, if not the world — was an iconoclast. He reminded his pupils that he had traded soybeans for five years before he ever actually saw a soybean. He consistently poked fun at fundamental research, chiding those who would track weather patterns.

"If it's raining, all that means to me is I need an umbrella," he once joked. "You don't get any profit from fundamental analysis. You get profit from buying and selling. Why bother with appearances when you can go right to the reality of price?" The money, for Dennis, was simply a means of keeping score. "Trading is a little bit like hitting a ball," he would say. "If you're thinking what your batting average should be, you're not concentrating on the right thing when you hit the ball. Dollars are the batting average of the trader."

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IN ADDITION TO his outsize physical proportions, Dennis was an eccentric dresser. Bradley Rotter, one of his first investors, remembers: "I was at his house for a Fourth of July tennis party, and Richard couldn't be found. At the end of the party he came out of his house wearing a white tennis shirt, shorts and black dress shoes."

Hanging on Dennis's every word, the Turtles saw quickly that his system was making him huge amounts of money from big trends. They had taken a leap of faith; now they had the psychological assurance as well. Keefer recalls thinking to himself: I know this works. "It was in my gut," he says. But it wasn't long before the experiment hit choppy seas. After the initial two-week training was complete, the Turtles were given accounts (some say $1 million each; others say amounts varied) and thrown into the soup. Collegial bonding soon gave way to competition. Dennis subjectively began to give different amounts of capital to different traders. To this day, the Turtles have no idea why he did this, but some speculate that he simply played favorites. Meanwhile, a few Turtles, such as Faith and Sands — the former a computer-programming prodigy, the latter a U.S. backgammon champion — had difficulty sticking with the systems they were taught.

Some Turtles now say they saw Faith modify the rules to the extent that his position sizes and exit-and-entry rules reached well beyond Dennis's parameters. Additionally, Faith was trading up to 20 times the equity base of some other Turtles. Trading more money, he likely made more money. "The standing joke was that there were parameters, and then there were Curtis parameters," Turtle Jim DiMaria says.

By 1988, when the Turtle program was discontinued, Faith appeared to have lost all the money he had made; a big 1987 silver trade, evidently, had cost him millions. He has written about this unfortunate trade on the industry-gossip site EliteTrader.com, but the subject does not come up in his book. To this day, the exact amount Faith made or lost for Dennis is a matter of debate among some Turtles, though Faith stands by the figures in his book. Sands quit the program altogether. He thought there "had to be something more to it" — although he would go on to teach Turtle secrets to others.

Trading different account sizes, the Turtles were soon bringing in a wide range of returns. Some were earning millions, some were earning tens of thousands — and they were all in the same room, sitting side by side. To this day, DiMaria insists that certain Turtles got the short end of the stick. Svoboda, he says, was "an absolute genius and probably had the potential to be the best trader of all," but he feels that he himself got slighted. "At the end of the first year, I was one of the top performers, if not the top performer," DiMaria says. "My bonus was, like, $10,000, when other people were getting $600,000."

Many Turtles thought Dennis was just merely guessing who among them had the makings of a great trader. Some saw Dennis allocating money in a "losing game" fashion — they were unable to understand why he wasn't using a much more rigid method to determine his trading allocations.

While most of the Turtles were killing time waiting for markets to move, though, a group of four (Paul Rabar,

Tom Shanks, Keefer and Svoboda) built a systems-testing platform. It took them a year to complete. The results of their research project shook the program to its core. The quartet determined that Dennis had all the Turtles assuming far too much risk. They had been trading according to Dennis and Eckhardt's rules — and were, in the aggregate, making millions — but the research team found a serious design flaw in the system. Dennis's immediate response was to cut back the Turtles' leverage by 50 percent. The students, it seemed, were now educating the teacher.

"That took guts," says trading icon Larry Hite. "Dennis admitted his mistake and immediately changed course. Just like cutting losses, he made the right move, ego be damned." But the course he was on was about to take a turn for the worse. IT CAME WITHOUT WARNING. In April 1988, Dennis pulled the plug on his entire operation. His two funds with Michael Milken's Drexel Burnham Lambert closed down with big losses. People inside Dennis's office were livid. So were his clients. No one could figure out what had happened. Being cast out into the cold came as a shock to the Turtles. "All of a sudden, it's over," DiMaria remembers. "That's how fast it was. They came in Monday morning and said, 'Friday, we're done.' I was like, 'Uh-oh, better get a job.' "

By this point, though, thanks to stories published in the Wall Street Journal and Fortune, the Turtle legend had been born — and the Turtles themselves scrambled to stake a claim to it. Jerry Parker was the clear leader out of the gate. He was the first Turtle who figured out the importance of using less leverage to appeal to investors, saying at the time: "The bigger the trade, the greater the returns and the greater the drawdowns. It's a double-edged sword." With that in mind, Parker raised the most money to trade as a Turtle and has since amassed what is reportedly a fortune measured in the billions. Parker declined repeated interview requests. Dennis, after enduring some down periods in 1983, 1988 and 2000, is trading once again. Word on the Street is that in 2006, he enjoyed one of the best runs of his career. But he'll always be known for his Turtles. His experiment proved, after all, that regular people — and not just born trading savants — could learn to trade and make millions. And though it remains unclear whether Eckhardt really made good on his famous bet with Dennis, the Turtles — for the most part, anyway — certainly did.

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Spilling the Secret Sauce

Global macro trader Mike Martin tells you everything you always wanted to know about the Dennis System

RICHARD DENNIS bet his partner, Bill Eckhardt, that he could teach a simple futures-trading model to a bunch of unskilled trainees and turn them into profit-making machines. The system he taught them is pretty straightforward, so here goes — at no additional charge.

Once the pair of trading vets had their pupils in place, they issued them a set of system rules. There were actually two systems: The first was a shorter-term 20-day breakout system; the second, a longer-term 55-day system. Traders could choose either one, but they had to stick to the one they selected. The Turtle rules made up a "breakout system" — that is, buying and selling into new prices above and below previously defined highs and lows. This was not groundbreaking then, nor is it groundbreaking now. The late Richard Donchian, widely considered the father of trend following, devised several rules like this as well; his were based upon five- and 20-day moving averages. The Turtle rules are a simple set of entries and exits that traded approximately two dozen commodities. Position sizes were adjusted for volatility as measured by the commodity's Average True Range (ATR), a measure developed by J. Welles Wilder and published in his seminal 1978 tome New Concepts in Technical Trading Systems. The Turtle Rules consist, then, of a trend-following system of entries, exits and risk management. The model was built to catch the middle (or the meat) of the move — not the beginning or the end. Fundamental analysis was not a component of the system. And although Turtle trading results were volatile, the group was still managing risk. The rules, essentially, are a risk-management system.

In order to enter a position, trainees were taught to buy one tick beyond the highest price of the last 20 days for any commodity. So if the last high for the December S&P was 1517.50, the Turtle entry would be 1517.60, entered as a buy stop. Once that order was filled, the Turtles would place a protective sell-stop order one ATR below the fill price in order to manage their risk.

The same could be said for short selling. If the 20-day low for November soybeans was 9136, the Turtles entered sell stops below the market at 9134 to enter short. Once filled, they would enter a protective buy stop above the market two ATRs above their fill price on the short sale.

Since each commodity contract is standardized, the Turtles “normalized” their trades into so-called “N units” by dividing a fixed percentage of their assets by the product of the commodity’s ATR and that same commodity’s contract size. This key feature afforded the Turtles the liberty to be indifferent between the commodities they traded, since each represented a fixed risk to the portfolio. For example, one unit of gold might be 12 contracts and one unit of CBOT soybeans might be 18, given their respective volatility as measured by their ATRs. Eckhardt calculated the ATR and the units per commodity and gave the Turtles the list on Friday for the following week’s trading.

The ATR played an immeasurable role in the trading system. At the same time, it provided the input used to calculate position sizes, as well as the distance between the fill price and the protective stop order. The relationship between the ATR and the N unit is inverse: The higher the volatility as measured by ATR, the smaller the number of contracts per N unit of risk. Turtles were taught to add to profitable trades, not truncate them by selling for quick but small gains. They were also instructed to buy an additional unit at a price equal to half an ATR above or below their previous fill price, up to a total of four units (the initial trade, plus three additional units). Protective stops were placed two N units below the entries. The system was not heavy on indicators; the sole “indicator” was price. Then again, many indicators that are prominent today did not exist in 1984.

The system is genius in its simplicity. A certain mathematical elegance can be found in its use of ATR for entries, exits and position sizes. If this sounds more like how one would describe a poem than a trading system, well, there is a similarity between the two: What you get out of each is up to you.

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