Reminiscences Of A Stock Operator – A Book Review from a Macro perspective

There are likely only a few investors – undoubtedly hiding under some rock – who have not read *Reminiscences Of A Stock Operator*. In the financial milieu, the book is revered as a religious text, its quotations are frequently cited as the industry's collective holy scripture. It recounts the early career exploits of Jesse Lauriston Livermore, the infamous Boston stock speculator from the early twentieth century.

It may be strange to find a review of the *Reminiscences* penned by a geopolitical strategist. After all, Livermore began as a technical trader, reading the "ticker tape" for buy and sell signals. While he later adopted more holistic, macro trading strategies based on what he calls "basic conditions" – and that transformation makes up the climax of the book – there certainly are no insights in his prose about incorporating political analysis into one's asset allocation.

Nonetheless, I am an unequivocal fan of the book. For one, his description of trading strategies during the 1907 Panic is one of the most riveting narratives of market exploits in print. Livermore recounts how he shorted Union Pacific stock based on a pure hunch a mere two days before the April 18 San Francisco earthquake. The initial decision to short sell may have been a gut call based on the nosebleed altitude that share prices had attained at the time, but Livermore doubled down on selling the market on an assumption that the earthquake would combine with other global factors to reduce liquidity in the market.

This timing was epically wrong. Livermore lost all his money as the market rallied hard in late summer (this part probably sounds familiar to the bears of 2020!). However, he loaded up on leverage and waited patiently for the opportune time to re-test the bearish thesis, which occurred when several large railroad companies diluted their equity in order to raise funds. For Livermore, this was a signal that liquidity was getting tight, a signal to make his "big plunge."

Reminiscences is a book about the maturation of an investor, from a mere chart reader to a macro-strategist. Livermore repeatedly talks about the "basic conditions" of the market, which dominate his trading style. The basic conditions boil down to determining whether one is operating in a bull or a bear market. Why? Well… "obviously the thing to do was to be bullish in a bull market and bearish in a bear market." However, the failure of the book is that Livermore never actually explains how he ascertains whether it is a bull or bear market, but rather spends an inordinate amount of time focusing on trading tactics once one has made the strategic call.

The 1906-1907 episode, however, contains clues to his approach and what the "basic conditions" really are. Fundamentally, Livermore is talking about *liquidity*. He explains,

I studied the situation in 1906 and I thought that the ***money outlook*** *was particularly serious … It was good hard cash that went up in cannon smoke in the* ***Boer War****, and the millions spent for feeding nonproducing soldiers in South Africa meant no help from British investors as in the past. Also, the earthquake and the fire in* ***San Francisco and other disasters touched everybody*** *… I figured that nothing could stave off one peach of a smash. [Emphasis here is mine.]*

What impacted *global* liquidity are two events, one the unforeseen disaster of the San Francisco earthquake and the other a geopolitical event, the 1899-1902 Boer War. According to Livermore, the United Kingdom had to pay for its South African adventure that had pitted it against Boer settlers in the far flung corner of the African continent. As such, there would be no help from U.K. investors to finance the recovery in the U.S. from the earthquake given that they had already lent money to the U.K. government to fund its imperial adventures (early twentieth century financial repression!). Other than an off-hand remark about the First World War – which Livermore cites as a paradigm shifting event – the Boer War is the only time geopolitics plays a role in the book. And yet, it is a key role in Livermore's most famous exploit.

The 1906-1907 episode illustrates precisely how geopolitical events affect the market. The shock of the San Francisco earthquake dissipated quickly with no impact. Livermore lost all his money. His frustration in the book reminds me of countless questions I receive from investors who state with certainty that geopolitical events do not affect the market. They truly do not. My own empirical work – summarized in *Geopolitical Alpha* – shows that wars and terrorist attacks almost *never* impact the market (and by "almost" I mean that *only* the 1973 Yom Kippur War had a discernable market impact in over 70 years of history).

When I first joined the sell-side – at the Montreal-based BCA Research (which published a first version of this book review) – many of my colleagues and clients thought that I would focus my research on geopolitical *events*. Black Swan events like the Russian annexation of Crimea or the rise of the Islamic State. And yes, while I do have a view on such events, my conclusion is rarely profound. *Events* are fleeting, particularly if the basic conditions of a market are already set. A bearish event in a bullish market, for example, is an opportunity to buy on the dip. And even a once-in-a-100-years pandemic can set the stage for a once-in-a-100-years bull market, if the political trends overwhelm the idiosyncratic event.

Which is why I have focused throughout my career on geopolitical trends, not events. It is the trends that will impact the "basic conditions" of the market. What Livermore realized in 1906 was that the earthquake alone, in isolation, was no reason to short the market. But when put into the global macro context, which is fundamentally driven by geopolitics and politics – such as the Boer War – events can matter.

Finally, a nod is in order to the book's final chapter, which contains perhaps the best critique of the media and the press from an investor's perspective. Livermore's approach to reading the newspapers is much like my own. He ignores the editorializing and the "expert opinions" and focuses on the facts. While this seems like an obvious advice, it is surprising to us how often investors forget it.

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