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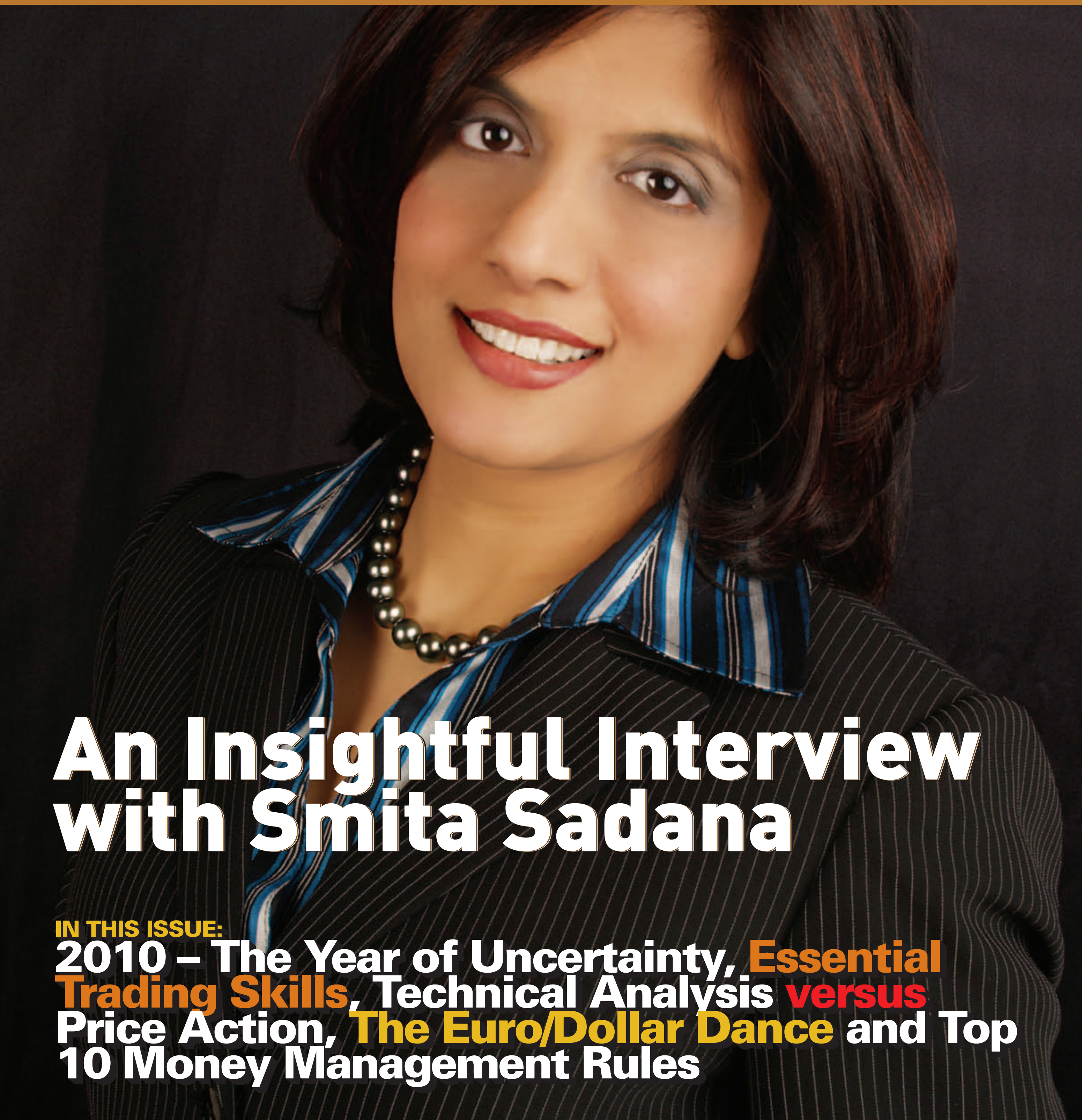

An Insightful Interview with Smita Sadana

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INTERVIEW

An Insightful Interview with Smita Sadana

In the movie, Crouching Tiger, Hidden Dragon, actress Michelle Yeoh plays a master warrior of ancient martial arts. At the end of the film, she confronts her protégé and instructs her with the ultimate secret to success – to remain true to herself. Professional trader, Smita Sadana offers us the same sage wisdom for investing and trading.

Smita Sadana has delivered a 43% compounded annual gain over the last 11 years. During that period, the S&P 500 index has remained virtually unchanged. Her accomplishments make her one of the greatest individual traders – and possibly the best female trader – on Wall Street. My interview with her was like living through a passage from Jack Schwager's classic trading book, *Market Wizards*. She enlightened me on dealing with emotions, risk management and the art of discipline.

Smita is a Wall Street professional who is praised for both her skill and her character. In 2004, her father was tragically murdered over a petty sum of money. As a testament to her admirable nature, she used this event to re-evaluate her life and dedicate new energy to helping others through financial education. Her firm, TraderVantage, perpetuates her mission.

I wish I could say successful women on Wall Street are equal in number to the successful men. However, if Smita has anything to do with this issue, there will be an unprecedented amount of women following in her footsteps soon enough.

DAMIEN HOFFMAN: SMITA, WHEN DID YOU FALL IN LOVE WITH THE MARKETS AND DECIDE TO DIVE IN?

SMITA: My interest in the markets started as a hobby in 1995. I had just finished my double masters in economics. The stock market was a new American passion. I remember thinking, "How tough can buying low and selling high be? I have the education. I can do it really well." The first year, I managed to finish about 20% down – which is bad [laughing], but worse compared to the fact the S&P500 went up 30% that year!

My active investing netted me a very bad blow. But I wanted to do it right or not at all. So, I started reading and researching. I came across what turned out to be one of my favorite quotations by Paul Tudor Jones, "Why not make your life a pursuit of happiness rather than pain?" I thought about that quite a bit and said, "I am going to give myself one year. If I can turn this around, I am going to do it. Otherwise, I am going to quit." I would have quit had I not started making progress. But the early success at that time was the beginning of my attachment to the market.

DAMIEN: CAN YOU SHARE SOME OF THOSE EARLY SUCCESSES WHEN THE LIGHT BULB WENT ON AND YOU KNEW YOU COULD BE A PROFITABLE TRADER?

SMITA: It was the mid '90s. Everything was going up. The financial media was just getting started. There was a lot to learn. I was simply fascinated with the way markets moved. I was enamored by them.

The path to where I am today has been absolutely incredible. We have been through two of the historically worst bear markets in a single decade. As a result, I have learned an unbelievable amount about the market in a very short time. Under normal market conditions, that amount of learning would have probably taken several decades. But the market action from the mid-1990s to 2009 has been unprecedented.

Actually, I am very fortunate and grateful because in the mid-1990s the markets were quite forgiving of trading mistakes – as most bull markets are. However, if for example, I were to start trading today, I would want to be much more knowledgeable and empowered by trading education.

> "I believe strong emotions are a necessary ingredient for success – people who are successful use their emotions to stay passionate. The trouble begins when emotions, instead of being the driving force behind the act of trading, become the driving force behind every trade. You have to stay passionate about trading, not every single trade!"

DAMIEN: SO, WOULD YOU SAY IT IS HARDER TO EARN A LIVING AS A TRADER TODAY?

SMITA: Absolutely, Damien. The markets have changed. It is like the Gladiator movie where the gladiators must be prepared to know what is coming. We are no longer in the time when things just go up in a straight line and it does not matter what you are trading. Actually, piling into one thing might have been okay then, but it is definitely not okay now because the markets are changing on a dime. What once happened over the course of a year can now happen in days.

I remember in December 2008, we were having 4% moves in volatility per day! That is something that had not happened in 70 plus years. The markets have become and will remain difficult to navigate. We are bombarded with a steady onslaught of information, the markets are much more volatile, and our emotions have become more chaotic.

The money management and trading business is tough to begin with. But when you add these heightened variables, this makes our profession quite a challenge. Of course, overcoming challenges is rewarding. However, the new environment means we must be better prepared.

DAMIEN: HOW HAVE YOU SUCCEEDED TO DATE?

SMITA: Well, at the end of 2008, I had been fortunate to achieve a 43% compounded annual return for the past 11 years. Given that I do not take excessive risk, let's just say I think I am allergic to large drawdowns [laughs]. So these returns are decent risk-adjusted returns. I do not rely on leverage. Given the state of the markets in this time period, I feel immensely grateful – blessed. That is another reason I feel compelled to pass on what I have learned from the markets.

I am always looking for things to improve. The market actually teaches you a lot of life lessons. The companies that succeed are the ones that change with the times. Traders that succeed are the ones who are willing to be flexible on the path they follow to their goals. People who are happy are the ones who do not fight inevitable change – instead, they embrace and adapt to it [laughs].

DAMIEN: CAN YOU GIVE ME SOME EXAMPLES OF HOW YOUR PERSPECTIVES HAVE EVOLVED SINCE THE CRASH IN 2008?

SMITA: In September 2008, I realized this was not an ordinary bear market. I had traded through the other bear market at the beginning of the decade, so knew I would depend on my number one trading principal – capital preservation. I became more engaged in the thesis, "Defense is the best offense." I was going into the bear market with my account at all-time highs and I am generally a risk-averse person who does not want to take too many chances – especially in 2008, I wanted to hold on to my gains.

I once took a lot of drawdowns in my account – sometimes 20% or 30%. However, I would go on to make new highs because we were in bull markets. Over time, I have realized I cannot do that anymore – especially as my account size grows. The drawdowns can have too much of an effect on my psyche. So, as I said earlier, you have to adapt and change to the new circumstances. I never intended to make this change, but I have had to tame my trading somewhat. I now use smaller positions. I have parked some assets in cash. I no longer trade my entire portfolio, which I have always done. Basically, I've learned to win by playing good defense.

DAMIEN: ALTHOUGH I AM A RISK TAKER, I WOULD ALSO SAY MY LEGAL TRAINING HAS MADE ME SOMEWHAT RISK AVERSE. WHEN I FIRST STARTED TRADING, THIS WAS A KEY OBSTACLE FOR ME. HOW DO YOU COUNTER-BALANCE YOUR RISK AVERSION TO STILL SUCCEED AS A TRADER?

SMITA: Very good question. I like to think about this topic like driving. What is the basic aim of driving? The basic aim is to reach your destination. If you are driving in good weather and the road is clear, you can drive at the speed limit – which, by the way, I drive this way in real life too because I am risk averse [laughing]. But if there is sleet, rain and fog in front of you, you must drive safely and securely to reach your destination.

To some extent, trading has changed forever. On the other hand, money management rules will never change. I think this is where most people mess up. The problem is usually not in the analysis or whether you are a technical or fundamental trader. The problem begins when traders do not formulate or follow money management rules. For example, they may not honor their stop-losses, position sizes or diversification. They may not care about drawdowns. They may continue doubling-down on a trade because they believe something is a great investment and fall in love with their own thesis. Proper trading is a very difficult balance to strike because you must be engaged with a stock or company enough to have a position, but you must also look over your own shoulder to protect yourself. As I say often, trading for a living is a dream come true, but with independence comes great responsibility.

Chairman Mao Xian famously said, "Good trading is 10% methodology and 90% psychology." Consequently, I think that trading is a pendulum between ecstasy and agony. You want to use emotions as the driving force behind the act of trading, not behind the decision making for the trade. Emotions are a necessary ingredient for success. Have you ever met a successful person who was not passionate about her work?

DAMIEN: NO.

SMITA: I believe strong emotions are a necessary ingredient for success – people who are successful use their emotions to stay passionate. The trouble begins when emotions, instead of being the driving force behind the act of trading, become the driving force behind every trade. You have to stay passionate about trading, not every single trade!

For example, one of the things that really changed my trading was when I started to pay more attention to my total portfolio rather than obsess about every individual stock. I keep meticulous records of my daily trading. I write where my account is versus the S&P500. So if you asked me where my account was at the end of 2007, I could tell you exactly. The one way to know where you are going is to see where your account is going, not where every individual stock is going. Everything you own on an individual level is necessarily built into your account summary.

I think traders make the mistake of saying, "This XYZ stock lost me a lot of money. I need to make all this money back from this one stock's loss." Once you start viewing your trading as an aggregate of many different individual trades, your trading will reflect less emotional activity and more improvement. You will focus more on growing your account with less care for which stock or set of stocks gets you there. This has contributed to a more balanced approach to the markets, since the account as a whole is devoid of wild swings that incite wild emotions.

DAMIEN: GIVEN THESE VOLATILE TIMES, DO YOU HAVE ANY ADDITIONAL ADVICE FOR TRADERS TO HELP KEEP OUR EMOTIONS IN CHECK?

SMITA: Use a check list before you make a trading decision. My checklist has a few basic rules:

1. Trade small in times of extreme volatility.
2. Recognize levels that the markets can go to and wait for validation before further capital commitment.
3. Have reasonable expectations. Do not let irrational exuberance take over.
4. Always remember why you trade.

Additionally, hope is not a trading strategy. Beware of the tendency to trade on hope and the desire to recoup trading losses immediately. Traders need to base their trading decisions more on thoughtful strategy and evidence than hope.

Also, I do not think it is an act of courage to try to trade from both sides of the market when volatility is intense. Of course, I trade both the trend and countertrend – but that is for regular markets. Since September 2008, I have not taken many countertrend trades, I have parked a nice amount of assets in cash, and I have not been trading as frequently. I know a lot of services say make the most of this volatility, but a few mistakes or slight breach of discipline can create havoc.

So, within the context of the market environment, I chose stocks with a certain set of fundamentals that I like. Then, I use technical analysis to facilitate the timing for entry and exit. If the set ups do not act well, money management rules prevent a small rolling stone from becoming an avalanche.

Another important rule is never argue with the markets. Respect the market and believe that the market is always right! I wince when I read about "the need to tame the market beast." In my humble opinion, the only way to beat the market is to tame the beast within! Trading is not simply about returns or beating the markets. You also have to address all the traits in your personality that affect your trading. After that, you must employ your strengths while managing your weaknesses.

Looking at the big picture, if it is muddy, cloudy and dangerous in the markets, how much do you want to expose to the elements? You let the markets tell you. Once the environment clears up, you can get back in and happy days are here again.

"Actually, I am very fortunate and grateful because in the mid-1990s the markets were quite forgiving of trading mistakes – as most bull markets are."

DAMIEN: WHAT SIGNALS ARE YOU LOOKING FOR TO KNOW WHETHER CLEAR AND SUNNY SKIES ARE HERE AGAIN IN THE MARKETS?

SMITA: I conducted a deep study of how bear markets have ended in the past 100 years. The results are summarized in Minyanville's Bull Market Timer. I use these signals to show the way as the market turns. I have also been writing about this in Minyanville's *Buzz & Banter.* Again, so long as you trade with very strong money management rules, you can venture out.

For example, I have a money management rule I never break: I do not hold a stock during its earnings announcement. I prefer to sell prior to earnings and repurchase if I like what I hear and see. As Donald Rumsfeld says, "We are trying to reduce the unknown, unknown factor." Basically, there is a known unknown and then an unknown, unknown.

"My active investing netted me a very bad blow. But I wanted to do it right or not at all. So, I started reading and researching. I came across what turned out to be one of my favorite quotations by Paul Tudor Jones, "Why not make your life a pursuit of happiness rather than pain?" I thought about that quite a bit and said, "I am going to give myself one year. If I can turn this around, I am going to do it. Otherwise, I am going to quit."

For example, we know the known unknowns – we know we cannot know where a certain stock is headed or how earnings will be on the known date for earnings. So, we can take care of the known aspect of the stock trading. What we cannot do is control the unknown unknowns. For example, if a biotech company says a certain drug had adverse consequences, we cannot control that. So, to reduce the risk in these situations, we can avoid trading biotech companies or holding stocks during earnings announcements.

DAMIEN: Seems like a major factor here is discipline. You are known for having extraordinary discipline as a trader. Discipline is a rare and challenging skill to maintain. Where did you learn to be disciplined?

SMITA: While I have naturally tried to be disciplined throughout my life, I recognize trading requires a degree of discipline that most other habits do not. Think of trading as a war – we deal with a constant flow of information and we must manage our reactions, expectations and emotions.

We must be constantly aware of what is happening and cannot let our guard down. If we get hurt, we must rely on resilience to bounce back as if nothing's happened. Such action, day in and day out over the course of many years, is very difficult.

As I said earlier, a slight breach of discipline in trading can unleash financial havoc. I wonder if the Trading Gods know about these rules since minor infractions do not go unpunished! I have also constantly used disciplinary techniques from behavioral economics, psychology and personal trading experiences. As a side point, I majored in psychology and economics while getting my Bachelor's degree.

Discipline is incredibly important because as I said earlier, nobody is looking over your shoulder. There is no agency with which you can launch a complaint, "The stock was not meant to go down … it came out with great earnings!" You can only react as an individual – which means discipline is your only protection.

Also, I do not engage in a relentless pursuit of perfection when it comes to trading discipline. We all know perfection does not work in trading! I think consistent discipline can be maintained so long as lapses in discipline are minor, trading mistakes are not compounded by staying with them and the trader's ability is not seriously impacted.

In reality, trading has taught me more about discipline rather than the other way around. At times, you walk. At times, you run. Sometimes, you sit by the side of the road. But at no point can you lose sight of your destination. As Edmund Hillary said, "It is not the mountain we conquer, but ourselves." I find myself rigorously doing things to hone my discipline so my trading can be positively impacted. If you want to succeed at trading, first dust off those New Year Resolutions and see them through Dec 31st!

DAMIEN: You have mentioned risk and money management many times. In my humble opinion, I think these are the Holy Grail to successful investing and trading. Can you share more about your strategy in this important area?

SMITA: I would be happy to. All risk management stems from a thorough self-analysis of the investor's personality, then customizing the appropriate trading techniques. Some of the questions I asked myself were:

- What are my goals from trading? Are my expectations realistic?
- How much time can I devote to this pursuit of profitability?
- Do I consider myself to be emotionally resilient?
- Can I let go of painful and upsetting situations or do I tend to re-live them over and over again?
- What kind of markets am I more comfortable trading in? Range bound or trending?
- Am I more comfortable trading several stock positions or indexes?
- How do I divide risk within those stock positions? What is my optimal position size?
- Are those positions adjusted for stock volatility?
- Do I feel comfortable in short-selling?
- What is the time horizon for my trades?
- What kinds of stop losses do I feel more comfortable implementing?
- Does my discipline require hard or mental stops?
- Does trading provide me with a high? (Real trading can be actually quite boring)
- Can I use the same trading set-ups over and over again and not fall asleep at the wheel?

I already discussed capital preservation, but it is paramount to my trading. Neither genius nor size can necessarily survive anomalies. Look at the spectacular collapse of Long Term Capital Management or even Amaranth Advisors. They went from being up 22% to down 36% in one trade in 2007!

I have also realized the undoing of the biggest and most successful traders has been their actions after a losing streak. My trading rules enforce a mandatory shut down after such a losing streak. This is due to the fear of being what Malcolm Gladwell calls "Mind-Blind." Poor account action leads to poor risk-assessment of event probability. Traders bet more aggressively if they have endured a losing streak, as many a recreational gambler will attest.

On *Buzz & Banter*, I often discuss the interplay between emotions, risk and technical analysis because emotions are the real cause behind the run-in with risk.

DAMIEN: In relation to emotions, when you look at the tape and charts, what signals do you look for to determine market psychology?

SMITA: I look at hundreds of charts a day, including indices, market sectors, key stocks, as well as market statistics. These paint a picture of the collective emotions of the traders and investors in the market. While one data point is insufficient to draw conclusions, when combined with recent history as well as historical precedent over the last several decades, you can start to draw reasonable conclusions about the sentiment and how the market is likely to react to this state of sentiment.

While all market conditions are different, investor and trader psychology tend to stay the same – oscillating between greed and fear. This is played out in the chart patterns that one can learn to interpret over time. Of course, it is not possible to divine what will happen in the future. The skill is all about gaining an edge in the probability assessment.

DAMIEN: Please tell our readers about your company, Trader-Vantage, and what you specialize in?

SMITA: Over many years, I have been approached by people wanting to learn about different aspects of trading. I think there are three kinds of people in the financial education area. First, those who offer shortcuts and ways to alleged "instant riches." Second, those who belong to the financial media but who have little personal market experience. And, third, those who offer their own expensive trading programs.

I belong to none of these categories. As a trader, I firmly believe that trading is a complex pursuit that requires managing stock and market analysis, money management techniques, market sentiment indicators and individual psychology.

Early in my career, I used some of the stock advisory services. I realized once I got a list of stocks, I would conduct my own due diligence and buy what I felt like. I did not make much money nor did I learn anything about the methodology behind the trades.

So, TraderVantage is my way of sharing some of the knowledge and insights that comes from spending tens of thousands of hours with the tape and proprietary trading patterns that have enabled my personal success. I sincerely believe that the markets are not going to be easy to navigate for many years.

So I hope these resources help individuals improve their trading and investing skills. I try to provide that via our Personal Trading Mentorship program. We have also been consulting with Hedge Funds looking to improve their trading methodology, both via fundamental and technical analysis.

"To some extent, trading has changed forever. On the other hand, money management rules will never change. I think this is where most people mess up."

DAMIEN: I spoke with Todd Harrison, CEO of Minyanville, and he had nothing but great things to say about you. Specifically, he said you "embody everything Minyanville is and hopes to be." What personal philosophy has led your peers to praise your character as well as your skills?

SMITA: Todd has a way with words. I am deeply humbled and honored at the same time. People are driven by different things in their lives. When you come across those who are on the same path, there are synergies. That is where Todd and Minyanville come in. It is really not about me Damien, I guess I stand for 'responsible investing' – the only way investing works over a long time – which is Minyanville's main message. My personal philosophy has always dictated that in order to make a big difference over time, I have got to make small differences every day just like the 'long term' is made up of many short terms.

So, over the years I have been concerned and troubled to see people lose their wealth, health and relationships because they were never taught basic things about managing money. Our education system teaches us a lot, with a goal to earn money via a successful career. But there is very little education on how to handle money, how to stay away from or minimize debt, how to increase savings, or how invest wisely to grow real wealth over time.

In 2004, I went through a terrible personal tragedy during which I questioned the basic premise of my self-chosen profession. My father was a victim of a robbery. He was killed for a petty sum of money. This totally turned my world upside down.

Do not get me wrong. I love trading, the markets, and the constant challenges they bring. But I started wondering, "What is the social value of a good trader?" My sisters, one is a doctor and the other an engineer, both had jobs with social impact. I wondered how my profession could make a real difference in people's lives.

I decided to channel that feeling of restlessness into a mission of helping people more responsibly manage their money. I wanted to influence how people think about money. I wanted to help people use the power of financial education to achieve their dreams rather than haphazard buying and selling what the popular financial media highlighted as the story du jour. I started educating at many levels. I appeared at school sessions in front of kids. I mentored individual traders and investors.

There are no coincidences. When you really want to do something, you will find a way. When I came in contact with Todd and Minyanville, I realized our "mission" was similar. And here was a guy who had given up an illustrious career to do great things for others. An act of courage, I must say.

Minyanville is a great community where people meet without hidden agendas. We work to help and learn from each other towards a common goal. I am fortunate to be a contributing member of the Minyanville community.

DAMIEN: Who influenced you most on your journey & how?

SMITA: I have been very fortunate to have many mentors on my life's journey. My parents always believed that women can do anything – and my mom especially was one of those women. She got her Doctorate in the 1960s when women were still not as active in the workforce.

So, when I realized that my husband (Sumit Sadana) was very interested in the markets, trading with its glass-ceiling was a natural challenge that attracted me to this profession. I actually discussed and debated a lot of my ideas with him and still continue to do so today. I rely on him for his excellent fundamental analysis and backtesting interesting new strategies with me – not just opening jars! I got many lucrative job offers along the way, but they paled in comparison to the challenge the markets offered.

In the mid 1990s, one of first turning points in my trading career came when I started learning about technical analysis through Don Worden's Telechart. Since then, I have read numerous books on technical analysis and absorbed and adapted many different trading philosophies. I am also an ardent student of psychology and believe the real heroes are people who have succeeded despite set backs in life. In that context, I am interested in collecting quotes from great people – this interest was a legacy I got from my mother. The wisdom from these real heroes helps me in my personal growth.

DAMIEN: You first reached out to me as a response to an interview I did highlighting professional women traders. Can you explain your feelings and experiences with women in high finance?

SMITA: Well, Damien, you had touched upon what I am very passionate about. Money management has been dominated by men since they were the ones who traditionally earned money. Many women were precluded from entering this field because of the notion that managing money is all about number crunching and complicated formulas. But the times are changing. After all, this profession is a relatively recent phenomenon. Trading as a profession is a product of the mid-1990s due to the advent of the internet, easy access to brokers and ubiquitous financial information.

I have also noticed a relatively recent phenomenon where women are tired of not being actively engaged in financial matters. I call it the "Mad

"Another important rule is never argue with the markets. Respect the market and believe that the market is always right! In my humble opinion, the only way to beat the market is to tame the beast within! Trading is not simply about returns or beating the markets. You also have to address all the traits in your personality that affect your trading. After that, you must employ your strengths while managing your weaknesses."

Money Phenomenon." Women have started taking steps toward educating themselves about financial matters, commensurate with their earnings power and life expectancy. That remains the next frontier.

So, while success in this profession offers a sense of personal accomplishment, I recognize and respect the fact the market does not really care who is trading on the other side of the screen. Age, gender, even experience does not matter as much as adherence to discipline.

And who knows … maybe my foray in trading will also encourage men to try out the Latin dance class at my gym. For now, only a few brave souls venture in [laughs].

DAMIEN: I'm excited to watch you pioneer for girls such as my new daughter!

SMITA: Thank you!

DAMIEN: Most traders spend a tremendous amount of time consumed by their job. However, I read you are active in the performing arts. Can you tell us about this additional passion of yours?

SMITA: I used to be very active in theatre among many other activities. That was during my university days. I actually won the top national level competitions in India. Now, my interaction with theatre is only an occasional interaction from the other side of the stage – as a member of the audience!

However, that experience has also influenced my trading tremendously. Rehearsals put your through a grueling regimen of patience and discipline. You learn to read emotions since you have to reproduce them. Lastly, the live performance prepares you for dealing with troublesome issues in real time!

Ah … I really miss that time, but I guess I should be content with watching live drama in the markets everyday [laughing].

DAMIEN: Smita, you are quite an interesting person and I have greatly enjoyed getting to know you better. I look forward to staying in touch as my daughter looks for great role models!

SMITA: Thank you, Damien. I look forward to that too. It was a pleasure to do this interview with you. **TTJ**

"I have also realized the undoing of the biggest and most successful traders has been their actions after a losing streak. My trading rules enforce a mandatory shut down after such a losing streak."

Damien Hoffman, Esq. decided to launch a financial website and exclusive subscription-based newsletter after achieving a 63% return versus a -48% return for the S&P over a nearly two year timeframe as a co-founder of popular stock blog SmartGuyStocks (member of the Forbes Business and Finance Blog Network, and certified by Seeking Alpha). He is currently Editor-in-Chief of Wall St. Cheat Sheet and trades full-time. After graduating early with honors from Duke University, he raised private equity with friends during the late Nineties to launch a successful start-up and went on to work for a boutique sports investment bank, Inner Circle LLP, where he worked on the sale of the NBA franchise New Jersey Nets to Brooklyn real estate development firm Forest City Ratner Companies (NYSE: FCE-A). Mr. Hoffman also graduated with honors from the University of Miami School of Law as a Dean's Merit Scholar.

He clerked at the Florida Supreme Court for the Honorable Justice Kenneth Bell and Central Staff. In 2006 at Harvard Law School he gave a guest lecture entitled, "Business and Law in the New Independent Music Industry."

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