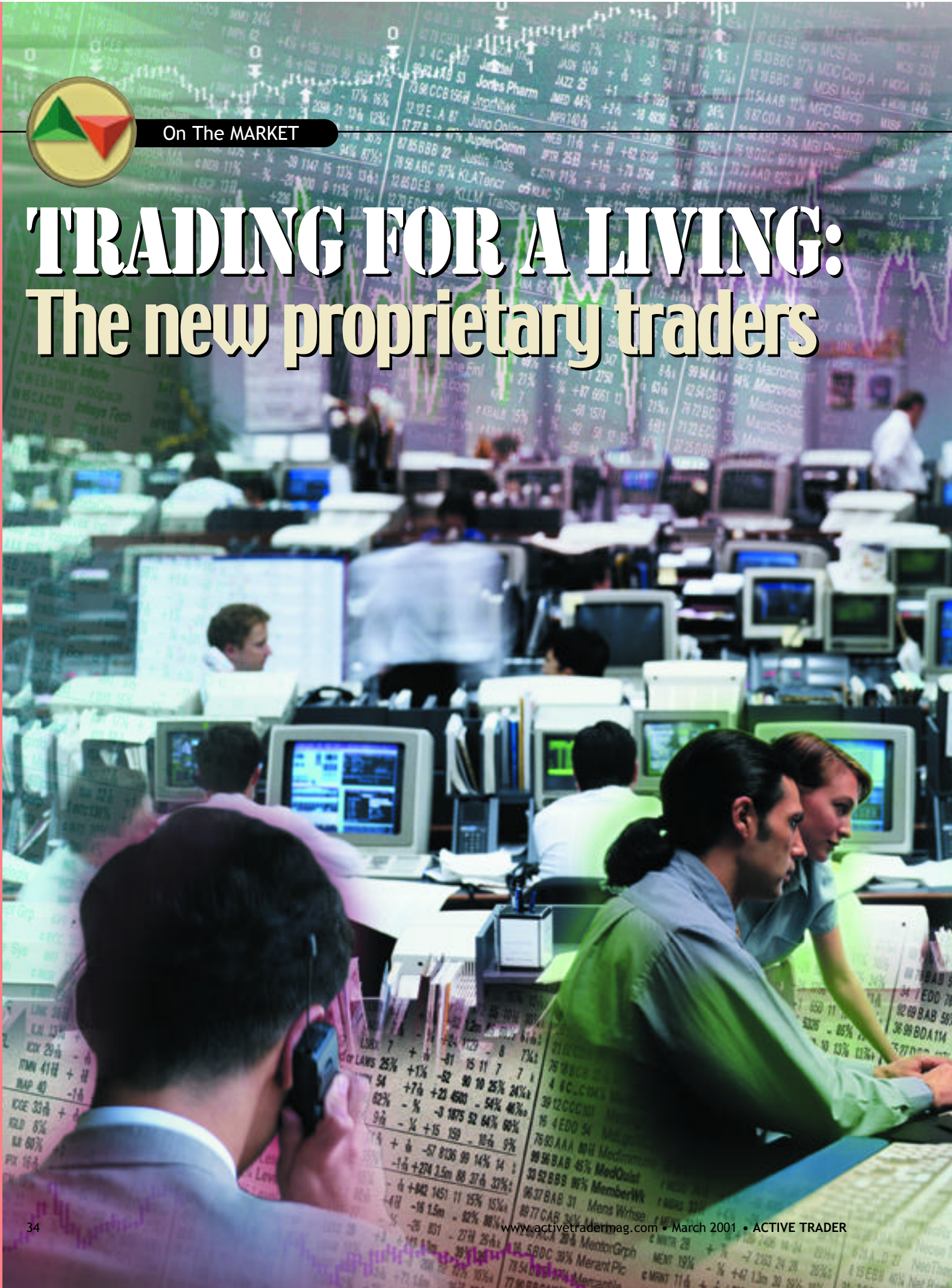




On The MARKET

# TRADING FOR A LIVING: The new proprietary traders





Trading firms across the country are giving individuals access to big trading accounts and cutting-edge technology as proprietary traders. Is this arm of the trading biz for you? Do you have what it takes?

BY KIARA ASHANTI

**T**he volatility and unpredictability in the stock market have triggered fear in some traders and frustration for many others. The latter group is frustrated because they never got a chance to trade. High-risk

is the firm's responsibility, not yours.

Sound easy? Well, you cannot simply show up at a proprietary trading firm on Monday and start trading millions by Friday. First, proprietary trading firms are looking for people with certain skills and characteristics. Second, before they

## Proprietary trading firms require candidates to go through intensive training programs before giving them access to trading funds.

conditions kept them on the sidelines.

"I wanted to trade," says trader John Reese. "But I quickly discovered that I did not have the capital to do it properly."

Reese's predicament is a common one. The old adage, "It takes money to make money," is still a big part of the trading business. While industry professionals generally agree that a day trader should have at least \$50,000 in initial capital, the number of would-be traders who have that kind of cash at their disposal is relatively small. Reese, however, solved his problem by putting another old concept to work — Other People's Money (OPM). In the trading world, OPM often takes the form of proprietary trading.

In its simplest form, proprietary trading is any situation in which you trade a firm's capital, either as an employee or independent agent. The "firm" can be a brokerage house, limited partnership or even an individual. Essentially, the firm puts up the capital and you do the trading. The profits are split between you and the firm. If there is no profit, the loss

risk any of their money on you, they will expect you to commit to training (including taking and passing various industry exams), extend oversight when you begin trading and place various restrictions on what you can do as a trader (what kind of stocks you can trade, how much you can trade, etc.). In other words, it will most likely be a few weeks or months before you start trading — if you make it through the training. And after that, there's no guarantee of success.

Why do firms engage in proprietary trading? Usually, the people who run these firms have trading principles or strategies they feel they can teach to qualified individuals, who in turn do the "heavy lifting" of trading and pass some of the profits on to the firm. The firms essentially get labor on a commission basis. Alternately, a firm may have capital and wish to put it to work by assembling a team of traders with proven skills who may not otherwise have access to large amounts of capital, and benefit

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from their experience and talent. Or, it can be a mixture of the two approaches.

Just as technology has allowed the retail trader to compete with the big boys, a similar democratization is occurring in the field of proprietary trading. Many day-trading firms have branched out from their retail operations and started proprietary divisions because they feel the trading skills of some of their clients are an untapped profit resource.

## At Broadway Trading, the trading style or system a trader adopts is of less importance than adhering to the house rules regarding risk.

The opportunities the firms offer to potential proprietary traders vary. There's the possibility of making a good living, but there are risks — as there are in any other kind of trading. And not everyone has what it takes or, at least, what these firms are looking for.

For some traders, it's a good fit and a good opportunity; for others, it's a dead end — something they're ill-suited for, whether because of restrictions on their trading or nervousness about trading money other than their own.

Three firms with proprietary arms are Broadway Trading, All-Tech Trading and BKWD Traders, which operates out of Blackwood Trading. They offer a glimpse into what you can expect if you're interested in pursuing proprietary trading.

### Help wanted: traders with passion

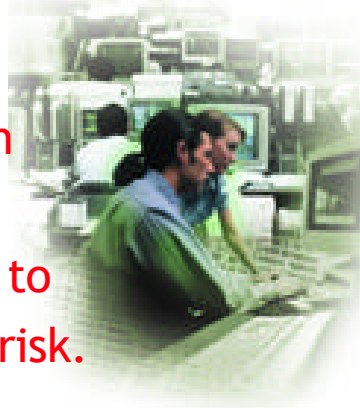
Broadway's proprietary program is housed under a separate division called JGM Securities, which has offices in New York, Miami and Boca Raton, Fla. JGM will not automatically disqualify applicants who do not have securities or trading experience, even if those applicants don't have college degrees. JGM is looking for people with the right "intangibles."

"We are looking for people who have a passion for trading," says Joe Goldberg, manager of the Boca Raton office.

Ronnie Davidovic, branch manager of

the Miami office, concurs. "The biggest thing we look for is a passion for the market," he says. "Having a college degree becomes an issue only because we need people who have a high likelihood of passing the Series 7 licensing exam. A degree at least shows a track record of being able to hunker down and study for something difficult, and succeed."

All-Tech trading, based in Montvale, N.J., has a similar attitude.



"A college degree is good," says Joe Conti, director of All-Tech's proprietary trading program. "But not having one won't necessarily keep you from getting the position."

Translation: If you demonstrate the hunger to trade, you might have the opportunity to work as a proprietary trader. All-Tech would also consider sponsoring individuals who currently hold securities licenses, if qualified. But getting your foot in the door is only the start. Once hired, you can expect intensive training. Firms who will be risking their own money will obviously expect a commitment to learning and the long haul.

"This isn't a get-rich-quick scheme," Goldberg says. "This is a career. If all a person wants to do is trade, then they will do whatever it takes to succeed at this. That's the type of person we want. That's the type of person who will pass the exams, and that's the person who will succeed at trading."

Laurence Bag, managing partner of Blackwood and manager of the BKWD hedge fund, puts it another way. "In our interviews we try and get a sense of whether or not someone is there to learn a skill, or because of the hype."

Bright Trading, perhaps the largest proprietary trading firm outside Wall Street (with 35 offices nationwide — its main office is in Las Vegas), is a bit more formal in its recruiting. Bright actively recruits

local colleges in Nevada and offers internships to some students, typically those with a B average or better. Still, Bright also considers the aforementioned intangibles when hiring potential traders.

Don Bright, CEO of Bright Trading, says their traders do not fit a single profile. They come from all walks of life.

"We have MDs, attorneys, college interns and graduates from the Ivy League," he says.

The one trait many seem to share, though, is they have not fallen for the trap-pings of 'how-to-trade' groups and seminars. "In a nutshell, we want people who are independent thinkers, and understand this is a career, not a hobby," Bright says.

According to Bright, another trait successful traders tend to have is skill at games, like cards or video. "We have found that those who like games and know gaming theory actually make good traders."

BKWD Traders have a more uniform "type" of trader they tend to hire. Most of their traders are from the Ivy League, and tend to be young, between 22 and 24 years old.

"The ability to process information quickly is a key trait for this type of position," says Ben Weinger, a partner at Blackwood Trading. "Because of the rigorous programs Ivy League schools have, [their graduates] tend to be good at processing information this way."

Weinger also believes inexperienced people are usually better candidates. "New people are preferable because you can train them in good habits from the very beginning," he says.

This view seems to mesh well with Bright's view that some professionals from more traditional areas of the financial arena have a hard time making the transition to active proprietary trading.

"Retail stockbrokers seem to make the hardest transition," says Bright.

One reason is that stockbrokers, who are more salesmen than stock pickers or traders, are generally taught very little trading theory. "One 25-plus-year Merrill Lynch veteran told us he learned more about trading in five days [with us] than he did at Merrill," Bright adds.

### Making the grade and getting started

Regardless of your trading experience or background, proprietary firms will require you to pass state and federal

licensing exams.

Typically this includes the Series 7 and Series 63 exams (which are the federal and state stockbroker exams, respectively), but some firms require that you pass others as well. These might include the Series 62 (Corporate Securities Representative), the Series 55 (Equity Trader Examination, which is required of individuals who trade equity or convertible debt securities on a principal or agency basis) and the Series 24 (Limited Representative, required of individuals responsible for the management or supervision of a member's investment banking or securities business).

While some firms will provide free training and pay for the cost of the exams, some will not. Test fees are not cheap. The Series 7 exam, for example, costs \$200; if you don't pass the first time, you'll have to pay for the exam again.

On the other side of the coin, proprietary traders often receive benefits just as they would at other companies. Many traders are classified as employees, and thus are entitled to health benefits and 401(k) plans. Broadway Trading even offers a program for traders who struggle at first to make a profit. For some traders, employee status is one of the draws of the profession. For others — especially those who put being their own boss at the top of their list of job requirements — it's a drawback.

"We expect you to lose money at first," Davidovic says. "There is a learning curve you have to get past. We don't want our traders worrying about how they are going to eat."

Broadway's draw is \$1,600 a month while in training and \$2,000 a month after a trader has passed all the necessary exams.

Of course, and this cannot be stressed enough, firms are looking for a return on their investment. Again, they are looking for people who are truly dedicated to trading, not just temporarily but as a career.

"I am not interested in people just looking for a job," Goldberg says.

### **How much is this going to cost?**

While it is true that proprietary traders are not trading their own money, in some instances there are start-up costs involved. All-Tech requires a \$5,000 deposit, but it will not deduct that amount from any losses a proprietary

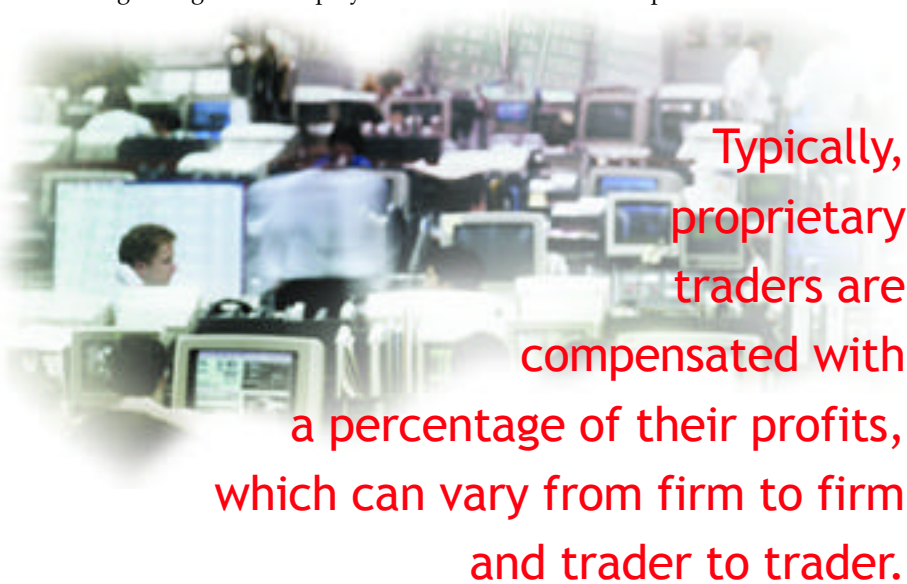
trader might incur.

"[The \$5,000] is a good faith deposit," Conti says. "It shows us you are real, and that you are not some gun-slinging trader moving from proprietary firm to proprietary firm. But it is your money; we do not deduct any costs from it."

Bright requires a \$25,000 deposit, which will make the trader a member of the Bright LLC (Limited Liability Corporation), which is quite different from being an agent or employee. For

training program is that it will not allow you to progress to the next level until you understand and pass your current level. It's very effective," Conti says. Nonetheless, All-Tech prefers traders to train in the main office.

Broadway has a completely different system, one that relies more on personal mentoring than a classroom teaching style. After learning the basics of Level II, each new trader is paired with a senior trader. It is up to the senior trader to



one thing, members of an LLC have certain tax advantages. Also, unlike employees, members cannot be "fired." The deposit Bright requires can be waived under certain circumstances, such as when you are entering the firm under an internship program. Other firms, such as Broadway Trading, require no deposit.

### **In training**

Proprietary trading firms require candidates to go through extensive training programs, although the approaches differ from firm to firm. All-Tech puts you through four weeks of intensive, full-time classroom training, which includes training on their Attain order-routing system, education on trading rules and reading Nasdaq Level II screens and finally, simulated trading. The training is done at their home office in Montvale and is full-time. The firm offers an Internet-based training program for people who do not live close to All-Tech's home office.

"The great thing about the Internet

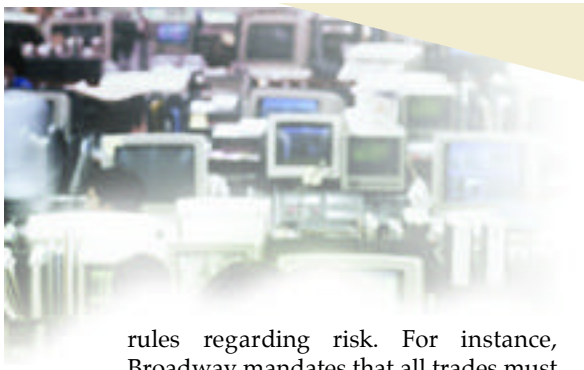
coach, teach and monitor a new trader. Typically, the new trader spends the first few weeks watching the senior trader; new traders are then able to learn and mirror the styles of their mentors.

"The thing I like about the training is that it is very dynamic," says Torin Regin, a trader in the Boca Raton office. "The mentors all care about your success. There is excellent support."

This support and training is key for Regin, who has an MBA and likely could obtain a position with a higher salary and more security. But he prefers to look to the future. "I want to be able to control my own destiny," he says.

Under the Broadway system, no one trading approach is emphasized. Some senior traders are momentum players; others are swing traders. Traders stay with their assigned mentors until they are steadily profitable, and occasionally mentors are rotated so traders can learn different styles. However, the trading style or system a trader adopts is of less importance than adhering to the house

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rules regarding risk. For instance, Broadway mandates that all trades must be exited by the end of the day.

Bright Trading's approach is unique as well. While nearly all direct-access trading firms focus on learning how to read Level II screens and spot momentum moves for quick scalps, Don Bright takes a dim view of this trading style.

"Level II-based trading is just hype. What you think a market maker is going to do is meaningless," he says.

Bright's approach is to teach traders how to "read the tape" and trade like professional floor traders. At its essence, this means reading the actual executions on a dedicated ticker on each stock, next to the quote screen. This allows the traders to base his or her trading decisions on what is actually happening, rather than what *appears* to be happening. Bright believes this is much more accurate in terms of reading the direction of the market.

### Risky business

As with any professional level of trading, risk management is the key. Discipline is enforced by the trading firm. Broadway has a software program that prevents traders from trading stocks that cost too much, or keeps them from purchasing more than a pre-determined number of shares. If a trader were limited to 100-share lots and tried to buy 200 shares, or add an additional 100 to a current trade, the system would not allow it.

All-Tech has "lockouts" as well. The parameters include: no more than ½-point loss in a trade, only two or three open positions at one time; and a \$300 maximum loss in a day. These restrictions not only keep a company from losing too much money on a particular trade, they keep the trader in the game long-term.

"It can really damage your psyche if you lose \$1,000 or more in a day," Conti says. "But \$200 to \$300 is not that much to recover from. Mentally, a trader can come back from that quite easily."

Some risk management parameters cannot be enforced via software, but are nonetheless carefully monitored. These include things such as trading stocks with spreads lower than ⅓, volume at 300,000 or more and good price support,

items that are of primary importance to BKWD Traders.

### It's money that matters

Broadway starts their traders with \$100,000 accounts. All-Tech, on the other hand, does not begin with a specific account size, just with a position-size amount — 300 shares. Traders can trade any stock — regardless of price — as long as their position size doesn't exceed this limit. Bright Trading has a similar system, allowing their traders to buy up to 300 shares. BKWD Traders, however, start their traders off a bit slower — with 100 share lots.

Regardless, the key is that proprietary traders do not have to worry about buying power. Even the best trader in the world would have difficulty being successful if he or she only had \$10,000. All the firms interviewed for this story have traders trading accounts in excess of \$500,000. Bright has some in excess of \$1 million. This type of leverage gives proprietary traders the potential to make tremendous amounts of money.

### What's in it for me?

Typically, proprietary traders are compensated with a percentage of their profits. Broadway has a sliding scale, and traders can keep as much as 70 percent of the profits. All-Tech's payout is slightly lower — somewhere between 50 to 60 percent. But these earnings are all earnings — the companies do not keep anything in reserve.

BKWD has a sophisticated payout scheme that is based on a matrix-type scale. The components include not only the amount of profit for the month, but a trader's "efficiency." Essentially, a trader who makes a \$1,000 a day on 10 trades vs. one who makes that much on 40 trades will have a better payout at the end of the month.

This is much different from the way many Wall Street firms "pay" proprietary traders. At Goldman Sachs, for example, a trader may produce \$200,000 in profits and be entitled to 40 percent, or \$80,000. However, the trader only gets \$40,000, and the rest stays in reserve for future losses.

At Bright, a trader gets to keep 100 percent of the profits past \$15,000. These profits are kept in an account, and 75 percent of that account is available to the trader at any time. The other 25 percent

is retained as a cushion, and will be given to you at the end of the year if there are no outstanding taxes or debts.

Earnings as a trader vary greatly. Don Bright says some traders can make six figures within two years. One trader in Broadway's Miami branch was up \$27,000 for the month of November and had been trading only a few months.

Of course, there are also those who, for one reason or another, do not make any money.

"I lost money every day during my first month trading," says Darren Langer, a trader at BKWD. One reason Langer believes some traders do not make money in the beginning (and beyond) is they cannot take the mental exertion.

"This is not a job for lazy people," he says. "You have to constantly monitor your screens, and be ready to take advantage of an opportunity. It can be draining."

Another downfall of many traders is they get cocky.

"Many times, a trader will have a good day, or a string of good days, and will lose his humility," Bag says. "Well, as soon as you get cocky, the market will humble you, because you cannot beat it. Even with my trading now, I try to maintain that humility and not get into trades that are outside my level."

Impatience is another recipe for disaster, according to Regin.

"So many people want to make the money quickly," he says. "They have no patience." Langer echoes this sentiment. "Unfortunately, because the upside is potentially unlimited, people — new traders especially — try to do too much, too fast."

Not surprisingly, the biggest reason some traders succeed and others fail is discipline — or lack thereof. Yet many traders still have a hard time getting a handle on what this buzzword really means in practical terms. Langer offers a simple definition.

"It is all about getting a set of rules and sticking to them no matter what," he says. "If you do that, you should be fine"

The dream of being a successful trader is alluring. The reality is something different, especially in the realm of proprietary trading. The job is not easy, and it is not something that can be attempted half-heartedly. Nonetheless, for those with the necessary dedication and acumen, it represents a legitimate alternative for career-oriented traders. 🕒