

10 Essential Books for Active Traders

By Michael Sincere

(This article first appeared in the July 2006 newsletter for Fidelity Investments)

A list of highly respected titles that one author believes should reside on the bookshelf of today's informed active trader

Image of a trader reading a book on trading. Trading books have flooded the marketplace during the past 15 years, as new technology has made online securities trading a widespread enterprise for many individuals. Investors routinely trade directly from their homes, workplaces and even on the move with the latest wireless handset capabilities. Amid this burgeoning era of online securities trading, demand for information and education has exploded, a likely result of the growing recognition among novice and emerging traders that securing profits in ever-changing markets can require considerable due diligence. That's why Fidelity Active Trader eNews asked author and trader Michael Sincere to compile a list of "must-have" trading books. To produce his list of recommendations, Sincere spoke with several trading professionals.

Even if you consider yourself a sophisticated trader, you probably recognize that reading an insightful book on trading can be a great way to sharpen your skills. But with bookstore shelves brimming with trading tomes, how do you separate the informative and valuable from the vacuous and dull?

While any top-10 reading list is subjective, there are some titles that were consistently mentioned during my recent informal survey of professional traders and money managers. The following list of books appeared to have made a huge difference in the lives — and net worth — of many folks who make a living on Wall Street. This list is by no means comprehensive, but it's a good start for those interested in reading what savvy traders consider to be "the classics."

1. Reminiscences of a Stock Operator, by Edwin Lefèvre

As a young adult in the 1920s, Edward C. Johnson 2d developed a growing interest in the equity markets while watching his father act as trustee for several family trusts. His fascination with the markets increased after reading *Reminiscences of a Stock Operator*, which draws on inspiration from the life of legendary trader and speculator Jesse Livermore. Several years later, in 1943, Johnson became president and director of a small, Boston-based mutual fund, now called Fidelity Fund, which was the first investment fund managed by Fidelity Management & Research Company (1946) — today one of the world's largest and most-respected global research and investment firms.

Although written more than 80 years ago, *Reminiscences* is repeatedly mentioned by traders as one of the best educational tools for trading. It reads like a trader's diary, but many traders believe the lessons included in the book are still relevant today.

"This book remains one of my all-time favorites because every time I immerse myself in its pages, I am reminded of old lessons — plus, I always seem to learn something new," says Toni Turner, best-selling author of *A Beginner's Guide to Short-term Trading* and her latest, *Short-Term Trading in the New Stock Market*. "In

today's markets, where educational materials become outdated quickly, it's a gratifying experience to read and reread Jesse Livermore's pithy yet enduring advice." Turner says one of her favorite lines from the book is the following: "A speculator must concern himself with making money out of the market and not with insisting that the tape must agree with him."

John Carter, president of Trade the Markets, Inc. and author of *Mastering the Trade*, agrees. "This book is great because it's so timeless. While the book is based on trading that took place in the 1920s, it applies equally well to today's markets. It really shows that markets are all the same because they have one common element that hasn't changed with time — human nature. Once a person understands how to trade 'human nature,' then, and only then, can they consistently make a living speculating in the markets."

2. Trading for a Living, by Dr. Alexander Elder

Dr. Elder, a trader and psychiatrist, was one of the first traders to recognize the importance of the emotional aspects of trading. He pointed out that a superb trading system with a poor psychological profile often leads to an unprofitable portfolio.

"Elder focused on giving first-time traders their own trading plan so that you not only knew where to start, but you also had a good formula for managing risk," says Deron Wagner, president of Morpheus Trading Group. "It was the first book I read after I got into trading and it helped me get my feet wet." Wagner says that the sections of the book that deal with psychology and risk management are "must reads."

On a personal note: Every time I discuss trading with Dr. Elder, I gain additional insight about what really goes on behind the scenes in the stock market. And that's the essence of his book: It reflects his knowledge and understanding of what makes markets move up or down. Elder followed his first best-selling book with another, *Come Into My Trading Room*.

3. Market Wizards and The New Market Wizards, by Jack D. Schwager

These two complementary books are often mentioned as classics primarily because of the author's probing question-and-answer techniques. In these books, Schwager delves into the minds of some of the country's most successful traders to unlock the wisdom behind their profitable trading techniques.

Author Turner says the Schwager books are her favorites. "From these financial superstars, we discover not only terrific insight into the workings of the financial markets machine, we learn that along with their victories, these traders have experienced losses that were, at times, devastating. Yet, they emerged stronger and with renewed conviction that they could succeed in one of the world's most challenging arenas. These two books remain timeless, compelling, and always present me with new nuggets of wisdom."

4. How to Make Money in Stocks, by William J. O'Neil

William O'Neil, publisher of the popular financial newspaper *Investor's Business Daily*, was one of the first investors to clearly explain how to select profitable stocks using both fundamental and technical analysis. In his best-selling book *How to Make Money in Stocks*, originally published in 1988, he introduced traders and investors to his rule-based, common-sense trading approach — CAN SLIM.™ The acronym CAN SLIM stands for: Current quarterly earnings per share, Annual earnings per share, New products, Shares outstanding, Leaders, Institutional sponsorship, and Market direction.

"What's so great about this book is that O'Neil takes the best strategies and combines them into one technique, CAN SLIM," says Morpheus Trading Group's Wagner. "He also gives specific rules that you can use when entering a position. Most important, he tries to keep you from buying stocks that will fall apart, and he does that by teaching you how to find quality stocks by combining fundamental and technical analysis." Wagner adds that 80%-90% of the stocks that he buys are based on a modified version of O'Neil's system.

During a previous interview I had with O'Neil, he explained how he first used CAN SLIM to turn a small amount of money into a fortune. With his profits, he started his financial newspaper based on the successful theories included in his book.

5. The Intelligent Investor, by Benjamin Graham

This best-selling book, originally published in 1949, is often referred to as the definitive work of fundamental analysis. College professor Benjamin Graham is considered by many to be the world's greatest investment advisor of the 20th century because he introduced a generation of investors to a strategy called "value investing." From an early age, Graham learned the importance of thoroughly researching a company and determining whether its stock price was a good value.

Graham's book can be useful to both investors and traders, according to several professionals in both camps. Consider what independent trader Howard Kornstein says: "Traders should read and study this book. Although *The Intelligent Investor* was written more than 50 years ago, it is not outdated. The fundamentals of the securities marketplace have not changed. If you're going to take a long position, it benefits you to choose a company that is fundamentally stable. By reading this book, you learn to identify companies that are fundamentally sound and in position for a possible trade. Anyone who trades a company that is not fundamentally stable is likely to execute a trade that could result in a significant loss." Kornstein said he chooses trades using a combination of charts and fundamental valuation.

Although the original version of this book was found to be a difficult read for some novice traders or investors, the terminology of the latest version is markedly improved. Another highly respected Graham book — *Security Analysis* (originally published in 1934 with co-author David Dodd) — is considered a dietary staple for those considering a career in portfolio management.

6. One Up on Wall Street, by Peter Lynch (with John Rothchild)

Portfolio manager Peter Lynch led Fidelity Magellan Fund to a 28-fold per share gain from May 1977 to May 1990, and is recognized as the most successful mutual fund manager of this generation. When he wrote *One Up on Wall Street*, in 1989, an increasingly larger percentage of the U.S. population was investing in the equity market, but many newcomers had little knowledge about how to buy and sell stocks.

"My objective in writing the book was to communicate many of the basic investing principles I adopted over the years," Lynch points out. "I felt it might help those people willing to put in the time and do the research work necessary to become a better investor."

One of Lynch's key messages was to understand the companies issuing their stock. With his friendly writing style, he explained in his book that investors could identify profitable companies based on their own experience and observations. For example, a person who worked in a shopping mall during his or her career might have an edge in the retail sector, just by watching which stores were busy and which products were big sellers. The person working at the mall could have seen a lot of good ideas just by observing consumers and talking with them. This kind of company observation helped generate several good stock ideas for Lynch in his term running Fidelity Magellan, and he would follow up on those ideas with rigorous fundamental research.

"For new investors, Lynch teaches you how to use what you already know to make money in the market," wrote author and former portfolio manager Joshua Kennon, who included Lynch's book in his own top-10 list on About.com.

Another important lesson Lynch sought to pass along to readers was that investing was serious business. He pointed out that many people spent more hours researching a new television set purchase than investing \$20,000 in a stock based simply on a tip they heard from a neighbor.

7. Stock Trader's Almanac, by Jeffrey A. Hirsch and Yale Hirsch

The Stock Trader's Almanac is a reference book that many traders believe is a requirement for any serious trader. This almanac includes several graphs, historical charts, market data, forecasts, economic announcements, and a calendar of events, among other information. Although not 100 percent accurate in its recommendations, the book will give insight on historical market events and performance, and provide forecasts as to when the authors believe similar scenarios could occur in the future. In addition, the almanac will help identify specific trends that take place on a yearly or cyclical basis. For example, the book notes that the market tends to have higher trading volume during the first three weeks of a new calendar year. The authors also assess the probability of whether or not a similar trend could take place the following year.

8. Technical Analysis of Stock Trends, by D. Edwards and John Magee

Many traders who use technical analysis mentioned the Edwards and Magee book as “the bible of technical analysis.” The book claims to be “the first to produce a methodology for interpreting and profiting from the predictable behavior of investors and markets.” What traders feel strongly about is that this book shows them how to use technical analysis to make money trading regardless of market conditions. It thoroughly explains all of the key technical trading concepts, including chart patterns, relative strength, candlesticks, oscillators, momentum and volume, moving averages, and other indicators. In addition, the authors explain how to spot trends through the use of these technical indicators.

Professional trader Kornstein explains why he feels the Edwards and Magee book is so essential. “Basically, technical analysis is graphing the changes in price, time, and volume, and the mathematical derivatives that are formulated from this data,” he says. “The concepts taught in this book are as useful today as they were fifty or sixty years ago.”

For a less-intensive understanding of technical analysis, Kornstein recommends Martin J. Pring's book *Technical Analysis Explained*. Pring covers the technical indicators of the markets by explaining the concepts in simple, easy-to-understand language.

9. Technical Analysis of the Financial Markets, by John J. Murphy

Technical Analysis of the Financial Markets guides you from the first application of Dow Theory and the basics of charting through the latest computer technology and most advanced analysis systems. Written by StockCharts.com's John Murphy, a former director of Merrill Lynch's technical analysis futures division, this book includes 400 charts that clarify key points of the following: candlestick charting, point-and-figure charting, oscillators, Elliot Wave Theory, Fibonacci, and other technical indicators.

Gail M. Dudack, chief investment strategist for Warburg Dillon Read, provided the following testimonial to Murphy's book: “No one in this generation had contributed more to technical analysis than John Murphy. Through his series of books, he has opened the door to many and raised the standard for all who use technical analysis. His books should be required reading for everyone in the securities business and are never more than a step away from my desk.”

10. The Essays of Warren Buffett: Lessons for Corporate America, by Warren E. Buffett and Lawrence A. Cunningham

This book is a collection of annual report letters by legendary investor Warren E. Buffett to shareholders of Berkshire Hathaway, Inc., the holding company for which he serves as chairman and CEO. Buffett is widely regarded as one of the most successful investors of the 20th century. Reading this collection of shareholder letters, carefully arranged and edited by Lawrence A. Cunningham, is like taking a course from Buffett himself, as you learn the thoughts and theories behind his investing practices.

In his shareholder essays, you won't find Buffett commenting much about the stocks he owns, but he loves to

discuss the basic principles behind his investments. Many of his principles are derived from his study at Columbia University, where he learned — and later worked — under the tutelage of professor Benjamin Graham (*The Intelligent Investor, Security Analysis*).

Buffet's folksy writing style has made his letters among the most widely read financial documents on Wall Street each year. In his company's 1989 report, Buffett wrote:

"We hope to buy more businesses that are similar to the ones we have, and we can use some help. If you have a business that fits the following criteria, call me or, preferably, write. Here's what we're looking for:

- (1) Large purchases (at least \$10 million of after-tax earnings),*
- (2) demonstrated consistent earning power (future projections are of little interest to us, nor are "turnaround" situations),*
- (3) businesses earning good returns on equity while employing little or no debt,*
- (4) management in place (we can't supply it),*
- (5) simple businesses (if there's lots of technology, we won't understand it),*
- (6) an offering price (we don't want to waste our time or that of the seller by talking, even preliminarily, about a transaction when price is unknown).*

"We will not engage in unfriendly takeovers. We can promise complete confidentiality and a very fast answer — customarily within five minutes — as to whether we're interested. We prefer to buy for cash, but will consider issuing stock when we receive as much in intrinsic business value as we give."

Buffett is not immune to owning up to poor investing results, either. Witness this commentary from 1999's annual report letter:

"Even Inspector Clouseau could find last year's guilty party: your Chairman. My performance reminds me of the quarterback whose report card showed four Fs and a D but who nonetheless had an understanding coach. 'Son,' he drawled, 'I think you're spending too much time on that one subject.' My 'one subject' is capital allocation, and my grade for 1999 most assuredly is a D. What most hurt us during the year was the inferior performance of Berkshire's equity portfolio — and responsibility for that portfolio, leaving aside the small piece of it run by Lou Simpson of GEICO, is entirely mine."

Also Worth a Look

The following are titles that many traders and investors also believe are worthy of consideration:

- You Can Be a Stock Market Genius* (Joel Greenblatt)
- The Little Book That Beats the Market* (Greenblatt)
- Security Analysis* (Benjamin Graham)
- Technical Analysis Explained* (Martin J. Pring)
- Winning on Wall Street* (Martin Zweig)
- Options as a Strategic Investment* (Lawrence G. McMillan)
- Tools and Tactics for the Master Day Trader* (Oliver Velez and Greg Capra)
- Beating the Street* (Peter Lynch, with John Rothchild)
- Confessions of a Street Addict* (James J. Cramer)
- How I Made \$2,000,000 in the Stock Market* (Nicolas Darvas)
- The Disciplined Trader: Developing Winning Attitudes* (Mark Douglas)

The Master Swing Trader (Alan S. Farley)
The Stock Market Course (George A. Fontanills)
Buffett: The Making of an American Capitalist (Roger Lowenstein)
The Warren Buffett Way (Robert G. Hagstrom; foreword by Peter Lynch)
Trading to Win (Ari Kiev M.D.)
High Probability Trading (Marcel Link)
When Genius Failed (Lowenstein)
Extraordinary Popular Delusions and the Madness of Crowds (Charles Mackay)
Japanese Candlestick Charting Techniques (Steve Nison)
Mastering the Trade (John F. Carter)
Trade Your Way to Financial Freedom (Van K. Tharp)
Secrets for Profiting in Bull and Bear Markets (Stan Weinstein)
A Beginner's Guide to Short-Term Trading (Toni Turner)

(Views and opinions are those of Michael Sincere and others quoted in this article, and do not represent the views of Fidelity. The information is intended for educational purposes, only to provide perspective on different trading concepts. The information is not to recommend or to promote any book, trading strategy or approach. There is no guarantee that using this information will result in profitable trades.)