



Special Report: Trade Like a Global Macro Pro

This report is part I of our 'Integrated Macro Analysis' series: 3-D Structures and General Conditions.

Legendary poker player David “Chip” Reese, who routinely earned several million dollars a year as a regular in the Bellagio’s “Big Game” before his untimely death at age 56, once said this:

“[Poker is] a very simple game; a five-year-old can learn it. But it’s also highly mathematical. If you never play someone on the next level, you don’t even know that level exists. **It’s almost another dimension.**”

As with so many things, what’s true in poker is true in trading. And the beautiful thing is, there are always new levels to explore. Great traders, like great poker players, are thus on a constant path of exploration, evolution and growth.

So with that in mind – and writing as a fellow traveler here – this piece will try to comprehensively answer a question posed on the elite trader message boards: **“How does your macro analysis affect your actual trading?”**

A great question, albeit a broad one. So consider this the first installment of a broad answer.

Thinking in 3-D

To begin, it feels necessary to digress for a moment and touch on another topic – the importance of viewing one’s portfolio as a *three-dimensional structure* in which all positions are related.

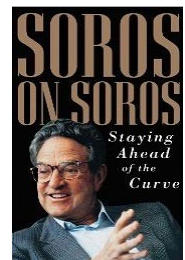
This concept will be important for making sense of what follows.

It is also important because, in truth, all of a trader’s positions really are related, whether that fact is recognized and accounted for or not.

As Bruce Kovner has noted, some of the most serious errors in trading stem from excessive correlation. (And cash is a position too by the way – oftentimes a perfectly justifiable one.)

The master and pioneer of this style is George Soros. From [Soros on Soros](#), his most clarifying work:

“It is a rather unusual structure, because we use leverage. We position the fund to take advantage of larger trends – and then, within those larger trends we also pick stocks and stock groups. So we operate on many different levels. I think it is easiest if you think of a normal portfolio as something flat or two-dimensional, as its name implies. **Our portfolio is more like a building. It has a structure; it has leverage.** Using our equity capital as the base, we construct a three-dimensional structure that is supported by the collateral value of the underlying securities. I am not sure whether I am making myself clear. Let’s say we use our money to buy stocks. We pay 50 percent in cash and we borrow the other 50 percent. Against bonds we can borrow a lot more. For \$1,000 we can buy at least \$50,000 worth of long-term bonds. We may also sell stocks or bonds short: we borrow the securities and sell them without owning them in the hope of buying them back later cheaper. Or we take positions – long or short – in currencies or index futures. **The various positions reinforce each other to create this three dimensional structure of risks and profit opportunities.**”





Soros is also considered a pioneer in his willingness to truly “go anywhere,” versus the far more restricted mandates of most funds and trading styles today. Again from [Soros on Soros](#):

“There is no fund exactly like ours. There is now a family of funds called hedge funds. But the name “hedge fund” really covers a wide variety of operations. I think it would be a mistake to put all hedge funds into the same basket. First of all, there are many hedge funds that don’t use macro investing techniques or use them differently from the way we do. And there are many hedge funds that use only macro instruments and don’t have exposure to particular stocks. **With our three-dimensional approach, we make decisions on different levels. There is a macro decision, a certain posture that the fund adopts. Within that macro posture, there are decisions about stocks to buy or sell and which instruments to use.** Generally speaking, if we can implement a macro decision with a macro instrument, we prefer to do that rather than to do it through more specific investments.”

So now we have hopefully achieved the first step of clarification.

Instead of seeing a trading portfolio as a sort of accidental hodge podge of unrelated positions, we are looking at the whole thing as a **deliberately crafted structure**... that structure being architected within the context of an ever shifting and evolving comprehensive macro point of view.

Fundamentals, Technicals, and Market Tone

So far, so good. But what about the actual trades? Where do those come from?

Again let us first address the question obliquely, rather than plowing into it head on. Before we talk about where trading ideas originate, let’s clarify the kind of trades we want exposure to – the specific nature of the trades we are looking for.

As usual, the old masters say it best. Here is Michael Marcus, via his original [Market Wizards](#) interview, describing in general terms the characteristics of a great trade:

“The best trades are the ones in which you have all three things going for you: **fundamentals, technicals, and market tone**. First, the fundamentals should suggest that there is an imbalance of supply and demand, which could result in a major move. Second, the chart must show that the market is moving in the direction that the fundamentals suggest. Third, when news comes out, the market should act in a way that reflects the right psychological tone. For example, a bull market should shrug off bearish news and respond vigorously to bullish news.”

In an interview from January 2000, Paul Tudor Jones (aka “the Michael Jordan of trading”) expressed the same idea in a different way:

“You pick an instrument and there’s a whole variety of benchmarks, things that you look at when trading a particular instrument whether it’s a stock or a commodity or a bond. There’s a **fundamental information set** that you acquire with regard to each particular asset class and then you overlay a whole host of technical indicators and that’s how you make a decision. It doesn’t make any difference whether it’s pork bellies or Yahoo. At the end of the day, it’s all the same. You need to understand **what factors you need to have at your disposal** to develop a core competency to make a legitimate investment decision in that particular asset class.”

Okay. So if we recognize that “fundamentals, technicals, and market tone (i.e. sentiment)” are the key drivers of a strong trade, where does “macro” or “top down” analysis come into play?

It comes in via the fact that *top down factors are a critical subset of fundamentals and sentiment*.

In other words, **a stock, a bond, a currency or what have you should NOT be analyzed in a vacuum, because nothing trades in a vacuum!** The surrounding environment always plays a role.



For example, consider these questions:

- Is risk appetite waxing or waning?
- Are credit flows expanding or contracting?
- Is the general backdrop sunny with blue skies and a refreshing breeze...
- Or dark and brooding with thunder rumbling and a full-force gale on the way?

The only reason long-only investors had been able to *ignore* the critical nature of top down inputs for so long was because, for the better part of a quarter century, persistently rising markets were a side benefit of the expanding leverage and debt supercycle.

But a smooth sea never made for a skilled mariner, and those days are over now...

Sizing Up General Conditions

What's more, before the palindrome (Soros) was even born, the importance of top down / macro analysis as a fundamental input was hammered home by another trading legend: **Jesse Livermore**.

Jesse Livermore was arguably the original global macro guy. He traded everything from long / short equities to wheat and cotton and coffee, and did it all on razor thin margins, and no doubt would have traded currencies too had the world not been on the gold standard at the time.

In [Reminiscences of a Stock Operator](#), the pseudonymous account of Livermore's trading life and times, the importance of top down / macro analysis – what's referred to as “general conditions” – is touched on time and time again:

~ ...like the physician who keeps up with the advances of science, the wise trader **never ceases to study general conditions**, to keep track of developments everywhere that are likely to affect or influence the course of the various markets.

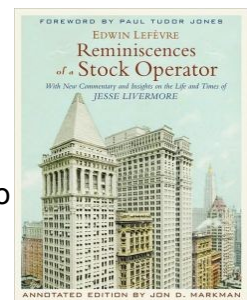
~ I still had much to learn but I knew what to do. No more floundering, no more half-right methods. Tape reading was an important part of the game; so was beginning at the right time; so was sticking to your position. But my greatest discovery was that **a man must study general conditions**, to size them so as to be able to anticipate probabilities.

~ But I can tell you after the market began to go my way I felt for the first time in my life that I had allies — **the strongest and truest in the world: underlying conditions**. They were helping me with all their might. Perhaps they were a trifle slow at times in bringing up the reserves, but they were dependable, provided I did not get too impatient.

~ From then on I **began to think of basic conditions** instead of individual stocks. I promoted myself to a higher grade in the hard school of speculation. It was a long and difficult step to take.

~ Without faith in his own judgment no man can go very far in this game. That is about all I have learned — **to study general conditions**, to take a position and stick with it.

~ Disregarding the big swing and trying to jump in and out was fatal to me. Nobody can catch all the fluctuations. In a bull market your game is to buy and hold until you believe that the bull market is near its end. To do this you must **study general conditions** and not tips or special factors affecting individual stocks.





~ But not even a world war can keep the stock market from being a bull market when conditions are bullish, or a bear market when conditions are bearish. And all a man needs to know to make money is to **appraise conditions**.



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This report is Part I of our *Integrated Macro Analysis* series. Use the links to check out parts II and III below, or visit [MercenaryTrader.com](#) for more trading and market commentary.

Integrated Macro Analysis: [The Market Tower](#)

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