MELISSINOS TRADING

THE EUPATRID GLOBAL TRENDS STORY

HOW MICHAEL MELISSINOS USED VALUABLE LESSONS HE LEARNED AT BEAR STEARS AND DURING THE FINANCIAL CRISIS TO CREATE THE EUPATRID GLOBAL TRENDS STRATEGY.

On Sunday night March 16, 2008, J.P. Morgan purchased Bear Stearns for $2 a share. After 94 years in business, Bear was gone.

I was a year out of college working at Bear as a junior analyst watching the buyout announcement from my New York City apartment. Bear traded at all-time highs of ~$170/share only 12 months earlier. I didn't know what this meant for my future at Bear, but I knew if there was ever a time to strike out on my own now was the time.

I was always independent and competitive. After my baseball career ended, a void grew. I had the urge to get back on the playing field and compete. Before Bear, I worked as public accountant. That didn't last long. It wasn't in my blood. From a young age, I had an interest in investing. The more I learned, the more I learned how important character and discipline were to long-term success. This appealed to me. I knew how important it was in sports, so it made sense that it was crucial in investing as well.

When I first learned about trend following in mid-2007, it felt like a calling. The core philosophy resonated with me. It was deeper than an investing strategy. It was a way of life. It was the complete opposite to fundamental investing, which seemed to be the widely practiced strategy on Wall Street.

The basic principles of trend following are quite simple, intuitive and have a lot in common with other successful businesses:

1) Trade with the trends
2) Ride winners
3) Cut losses quickly
4) Manage risk
5) Stick to the system through the inevitable ups and downs

These principles might appear simple on paper, but they require strong character and discipline to produce long-term success. Trend following is about going with the flow. Not arguing with the markets but aligning with and riding their trends. Taking unpopular and uncomfortable positions at times, maybe even most of the time. Not predicting the future, but adapting to the now. Living to fight another day. Prioritizing long-term discipline over short-term results.

In 2007, I was casually learning the basics of trend following but I needed proof it actually worked. I needed to not only see historical performance, but track it in real time. At Bear, I was watching the markets a lot and getting a feel for them. In tracking a few trend following funds' monthly performance, I started learning how they were making and losing money.

In 2008, I had a few a-ha moments. In March, when Bear collapsed, I realized the importance of respecting the trend and managing risk. Bear's stock was clearly trending down for a long time before the bottom fell out. Seeing my colleagues lose everything was traumatic and scared me to death. No way was that going to happen to me. Trend following principles could've saved employees a fortune.

Then, during the summer, oil was soaring to new all-time highs. I recall conversations in financial media about how the move didn't make any sense. On Bear's trading desk too. It shouldn't have been happening. To trend followers, moves don't have to make sense. The move, itself, is all that matters. I appreciated just how simple, but psychologically difficult it was to invest this way.

In the fall, when Lehman collapsed, trend followers killed it. The trends already in place for many months received a boost in September and October. That's when it all clicked for me. Stick with the trends. Manage risk. Stick with the trends.

Manage risk. Trend following was my future.

"Why aren't these firms being interviewed on TV each week? Everyone on Wall Street is losing money, but trend followers are winning. Is anyone even aware of this? Does anyone care to figure out how they are doing it? Am I the only one? Why is everyone OK with losing?.

I remember the frenzy on the trading floor. Standing at my desk watching people was surreal. Panic had set in. Everyone walked around like they were racing to find the bathroom. Faces stricken with fear and anxiety. Dejected and exhausted. People were losing tons of money and feared for their jobs. It was a wake-up call - a realization that this could be me one day. I didn't want that. I wanted to prepare for situations like this and win."

In late 2008, I knew I was going out on my own. I needed to do a lot of work - to build a strategy, test it and fund it. I summoned the help of a few programmer friends to help me build a backtesting platform. Eventually, I learned how to code and took over the research effort. Early on, I conducted tests by hand to better understand what it was like to trade a trend following strategy. Looking over performance summaries wasn't enough. I wanted to simulate living it day after day. It was then I realized what made trend following so difficult to adopt and practice.

THE ANTI-FUNDAMENTAL INVESTING APPROACH

The fundamental investing approach is the most popular on Wall Street. It relies on logic and reason with a keen preference of understanding things. Fundamentalists dislike volatile markets and are suspicious of unexplainable price moves. They abide by the mantra "buy low, sell high" trying to capitalize on short-term price swings by buying bottoms and selling tops. They believe prices irrationally high or low will eventually revert to the mean.

Trend followers, like Melissinos Trading, don't need to understand why a market is moving in order to take a position and make money. All it needs to do is ride trends with proper risk control. We love volatility. Unexplainable moves without the support of fundamentals often produce the biggest winners. We don't buy low, sell high but the exact opposite. We buy the breakouts and ride the momentum for as long as it goes no questions asked. Markets can divert away from the mean in a big way and for a long time. This happens quite often, providing us with significant opportunities.

The first major problem with the fundamental approach is missing out on large trends. If the market does not get low enough to qualify as a good buying opportunity, fundamentalists refuse to buy and often miss out on a major bull run. Trend following strategies, by design, have no problem buying expensive markets and do not miss out on major moves.

The second problem is managing risk. Sometimes when you buy low, the market falls below your entry price and keeps going down. Many fundamentals view this, a losing investment, as a positive because the investment becomes more valuable as it falls. They still believe the price should be higher, so the lower it goes the more valuable it becomes. This risky approach can quickly become an endeavor of buying lower and lower just to get back to even. Often, this results in fundamentalists taking massive losses and eventually bailing out because they just can't take it anymore. As trend followers, we keep our losses small by cutting them quickly and moving on to the next opportunity.

Buying and holding forever doesn't always work. Stocks, and other markets like gold, routinely experience declines of 50% or more that take many years to get back to new highs.

Fundamental investors love putting a large chunk of their portfolio into their best idea(s) and hold on no matter what. “Inflation is coming, so it makes sense to invest 20% of my portfolio into gold and silver.” What if inflation doesn’t trend up for 5-10 years and precious metals take heavy losses? That one stubborn investment can inflict serious harm on a portfolio, not to mention the opportunity cost of missing out on other trends in the meantime.

Melissinos Trading doesn’t make bold calls and stick with them no matter what. We make many small bets and watch what works and what doesn’t. Whatever works, we keep. Whatever doesn’t, we get rid of. We don’t invest our ego and reputation in our positions. A major advantage of trend following is being open to trends in many different areas like stocks, bonds, commodities and currencies. So what if gold doesn’t provide us with a good trend for 5-10 years? We’re monitoring many other markets and stocks that can.

Fundamentalists, often highly intelligent, love making predictions. They invest a lot of time and reputation into their investment picks. Because of this, they have a hard time admitting they’re wrong and cutting losses. Their emotional attachment interferes with their ability to manage risk. If a fundamentalist makes a few accurate predictions in a row, s/he can develop overconfidence and decide to double up on their next idea. A couple of overconfident investments can eventually put the fundamentalist out of business.

We believe ego has no place in the markets. Imposing our will on the markets can be fatal, a lesson we’re not willing to act out with real money. Research tells us that markets are unpredictable and that the best opportunities are often scary and hard to pull the trigger on. The markets are hard enough to navigate without our mental and emotional baggage. We do our best to check our egos at the door and objectively obey the principles of trend following.

CONSTRUCTING THE EGT STRATEGY

Eupatrid Global Trends (EGT) combines portfolio selection, entry and exit timing techniques as well as risk management into one system. Its objective is to produce attractive absolute and risk-adjusted returns by capitalizing on long-term trends in a globally diversified portfolio of stocks, bonds, currencies, crypto and commodities.

At Melissinos Trading, all of these issues must be addressed before a strategy can be declared complete.

1) How to select which markets and stocks to trade.
2) How much risk to take.
3) When to enter a position.
4) When to exit a position.
5) How to measure trends.
6) How to remain disciplined through the inevitable ups and downs.

In order to improve the odds of achieving our objective, we must adhere to the core philosophy of trend following. *Mentioned on Page 1.*

Trading with the trends. To survive at sea, we must position our sails with the natural elements - the tides and wind. Fighting them increases the risk of capsize and death. In the markets, fighting the trend has the same effect. To survive and profit, we must align with trends. No market is too high for EGT to buy or too low for it to sell. Wherever it goes, we go with it.

To focus solely on the trend means disregarding financial media, not surveilling it daily for news that might affect our positions. The media does a great job of stirring up our emotions and telling stories about the markets - why they’re moving, where they’re headed, what this famous fund manager thinks will happen next. If we allow the media to influence our investing decisions, we run the risk of selling out when a “negative” item hits the wires only to watch it make new highs in the future.

Riding winners. EGT buys high and rising prices. It waits for a market to rise before buying it and then rides the position as long as the trend persists. Through research, we’ve learned that the big money is made by holding on to winners because markets tend to move a lot further than we think. If we do not ride winners, we cannot generate large profits.

Cutting losses. Markets go up and down. We don’t know where they’re going next. We don’t know if the next trade will work out or not, so we need an exit strategy. Protecting capital is priority one. If we don’t take small losses, we wind up with big ones.

Managing risk. If we bet too heavily, one or two losing investments can inflict major damage on our portfolio. If we risk too little, we risk missing out on major opportunities.

EGT utilizes specific position sizing rules for each investment, specifically how much to increase or decrease risk depending on market conditions (e.g. volatility, trend strength and correlation). In general, EGT scales up positions in favorable market conditions and scales back in unfavorable conditions.

Sticking to the system. All the research in the world means nothing if we don't execute with precision. All too often, investors allow short-term performance to influence their judgement. This happens to managers as well. They get greedy in winning streaks and fearful in losing streaks. Business and personal pressures inhibit the manager to stick with it when it matters most. We implement controls to ensure that we follow our system each day, especially during newsy and volatile markets.

When I find myself having trouble with confidence and other feelings that might interfere with my discipline, I consult my friends at the *Trading Tribe*. We get together and work through through my issues, so I can remain the disciplined path.

Adhering to strict investing rules typically presents psychological challenges. In order to follow them, we must believe in them to our core. We must understand why and how they work. Copying someone else's approach doesn't work. Eventually, the process breaks down. Frustration, impatience, greed, despair and all the others can weigh heavily on our psyche. We must focus on doing the work, the process. Allowing short-term performance to influence our discipline is one main reason why so many struggle in this game.

OBSERVATIONS FROM RESEARCH

Investing is a tough business. Hell, life is tough. As I've researched and learned, I've had to say goodbye to previously held beliefs and tactics. Going down the path of honestly observing data, I've discovered that widely used mantras and held beliefs simply don't hold up in the long run.

The ever-popular "buy low, sell high" doesn't work as well as the opposite. "Buy stocks on sale" is a fantastic way to buy good companies with seductive stories that wind up becoming major drags on a portfolio performance. "No one goes broke taking a profit" is precisely how people go broke. By cutting their profits too short, they cannot generate any meaningful gains when they win. In life and in the markets, staying alive to capitalize on a few big winners is the way to win.

As a trend follower, mindset and expectations naturally deviate from the crowd. You must find peace in that. Not many people view the world like you, but you have to go with the data. You find comfort in buying high and selling low and not putting all of you capital into your highest conviction ideas. You must not allow yourself to develop "high conviction ideas". Whatever works, keep. Whatever loses, throw away. Taking lots of small losses is frustrating but a necessary skill for survival. You have to prepare for long periods of inaction then be ready to act when trends materialize. Trend following is about patience, persistence and discipline.

Sound long-term investing strategies don't make you feel good most of the time. This is something I've had to learn to accept, even come to enjoy, because alternative is perilous.

Strategies that survive over the long run incur the most volatility because they're not exactly fit for any specific market environment. This was a hard lesson to accept early on in my career. Executing a solid long-term trend following strategy means I'll have to incur long periods of underperformance. That's tough for a competitive person to swallow. When you conduct sound research, you notice that lengthy periods of losses are quite common.

Forgoing the need to be right and feel smart is crucial to being a good trend follower. Many trend following strategies produce ~40-45% winning trades. Fundamentalists have a hard time accepting losing trades, but trend followers do not. I wonder how many people are emotionally capable of taking many small losses for very long. It's a barrier to entry I think. The psychological anguish that accompanies taking many losses in a row is too much to bear for many people, especially smart people. I knew this was an edge. If I could wait out the losing periods, I could win.

When big trends develop, the urge to take profits increases. Seeing a big open profit is akin to seeing a big slice of apple pie while you're on a diet. You just want to grab it and enjoy it. Good trend followers resist this urge and simply stay with the trend. Early on, I realized that possessing a limited imagination would inhibit my ability to hold the most irrational and unbelievable trends. One must to be able to imagine a stock achieving a trillion dollar market cap. To see Crude Oil at $10/barrel or Gold at $10,000/oz or the Euro at 60 cents versus the U.S. Dollar. A lost decade of two for global stock markets cannot be out of the realm either. It can happen. It has happened. Anything can happen in the markets.

All markets experience periods of trends and consolidation. No market remains in one state over time. When you diversify across many different asset classes, positioning with both up and downtrends, you improve your odds of long-term success. You remove your dependence on one or two markets providing all the profit. Some years, we might hit it big in stocks and metals. In others, agricultural commodities and international bonds provide the most profit. Year to year, we never know what's going provide the opportunity. We must be open to anything and take what the markets provide.

I knew going down the trend following path meant I wouldn't have many supporters, at least from a philosophical point of view. Who wants to only look at prices and not consider fundamentals? To not cash in open profits, but let them run and possibly give it all back? To cut losses for months on end waiting for big trend to arrive? To make money on only 40% of the trades? Who wants to follow strict rules and not change things, especially during painful losing periods? No one. It's an unpopular and uncomfortable way of investing and living life.

I thought trend following would be a hard sell, but that historical performance would do the heavy lifting. I thought performance mattered more than anything. Wrong. That was another lesson I learned. Trying to convince everyone trend following is wonderful and the best thing since sliced bread is wrong. The trick was to find people who were already trend followers. The best trend following investors are those who live and breathe it on a daily basis in all areas of their lives.

STABILITY AND VOLATILITY

Melissinos Trading began trading at the tail-end of a very volatile and trendy period for many different markets (2007-2011). During this period, stock markets fell over 50%, yields collapsed to near all-time lows, both commodities and currencies experienced boom and bust patterns. EGT, sadly not up and running yet, missed a lot of these trends, but caught some decent moves in the first half of 2011. Markets then calmed down over the next couple years and, to no surprise, EGT's performance suffered.

My biggest regret is not launching Melissinos Trading sooner. My plan was ready in 2010, but my nerves weren't. I was scared that I'd mess up and look stupid. I wanted to be absolutely positively certain I was ready. Sadly, I got this reassurance in the second half of 2010 when several commodity trends kicked up.

At the time, I was paper-trading the strategy I was going to launch with. Suffice to say, it crushed it and made a ton of money. This infuriated me because had I acted sooner, I could've made my early investors real money. I learned a great lesson and a lot about myself from that mistake.

Volatility ramped up again in mid-2014 lasting through early-2015 when oil collapsed and the U.S. Dollar exploded higher. EGT profited handsomely from these trends, returning a little over 38% for the year. Following this quick but explosive stretch, markets quieted down again and whipsaws returned with a vengeance. From 2015-2018, equities was the only asset class producing consistent trends. Because EGT diversifies thoroughly, the gains in equities weren't enough to off-set the losses suffered in commodities, bonds and currencies. A very painful period for EGT and trend followers alike.

During losing periods, it's hard to maintain confidence. Many investors, outside of the diehards, lose faith at some point. During EGT's losing periods, in 2012 and again from 2015-18, some investors grew restless. It didn't help that stock markets were soaring at the time. Some lost sight of the long-term benefits of holding EGT in their portfolio and wanted to load up on stocks. I did everything I could to reinforce the benefits of trend following as well as the dangers of chasing returns, but to no avail some people decided to leave. I failed them because I could've culled them from the start. These people never should've invested in the first place.

In order to learn more about my prospects and clients, I began asking them tough questions. I wanted to see if they were just upset with recent performance or if they simply weren't compatible with trend following. Many of them only knew the fundamental or indexing approach. Trend following was anti-fundamentals. It did the opposite of almost everything it stood for. If they liked indexing then they must love trend following because it improves upon the indexing approach. In most cases, people were just unhappy with performance and wanted to run to a recent winner. That's life as a manager.

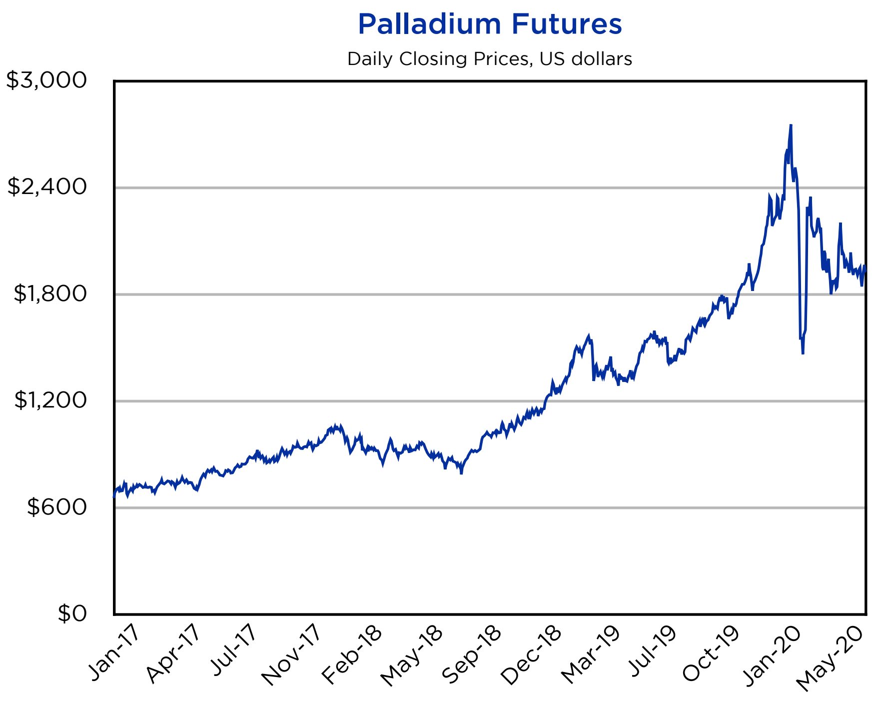
I wanted to illustrate how trend following could help them eliminate one the biggest investor mistakes of all — not getting back in. Once fundamental investors get scared out of a position, they often don't get back in and miss the big move. I asked each one if they got back into stocks after the Financial Crisis. If so, when? Did they let the pain of the Crisis derail their decision-making?

Many didn't get back in quickly enough. I used real-life examples as entry points to teach the benefits of trend following and the importance of sticking with EGT for the long run.

This is still a challenge today. I believe it always will be. I continue to share what I do, why I do it and pound the table on the long-term benefits of holding EGT in any portfolio. Investors need help maintaining their discipline. Performance and mundaneness grinds them down sometimes. My relationship with investors is akin to a personal trainer helping their client get fit. Many folks just cannot do it on their own. Many know what to do, but can't maintain the discipline required each day. It's my job to tell them the truth, connect with them and help them stick with me during the inevitable ups and downs.

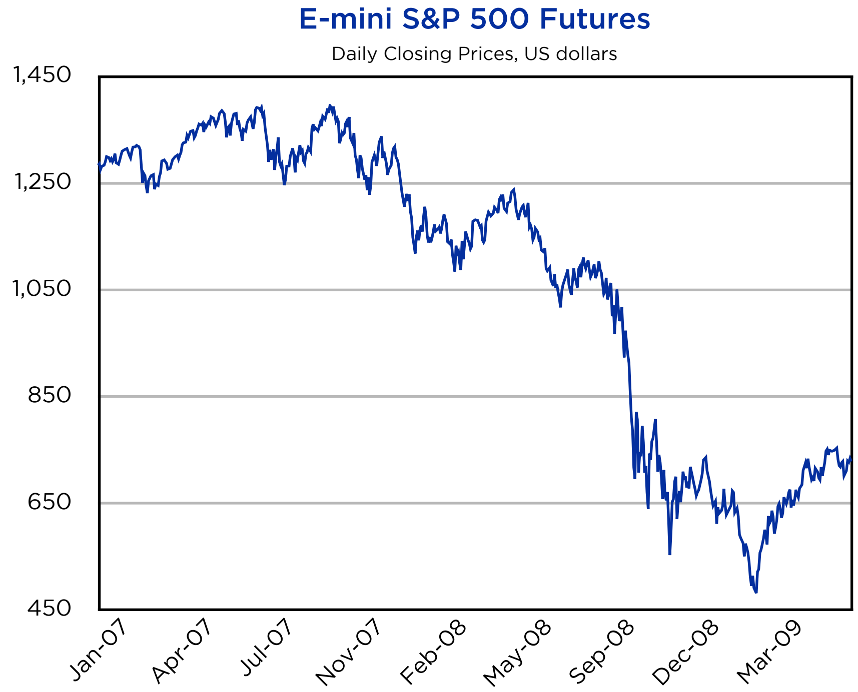
ROOTING FOR BUBBLES

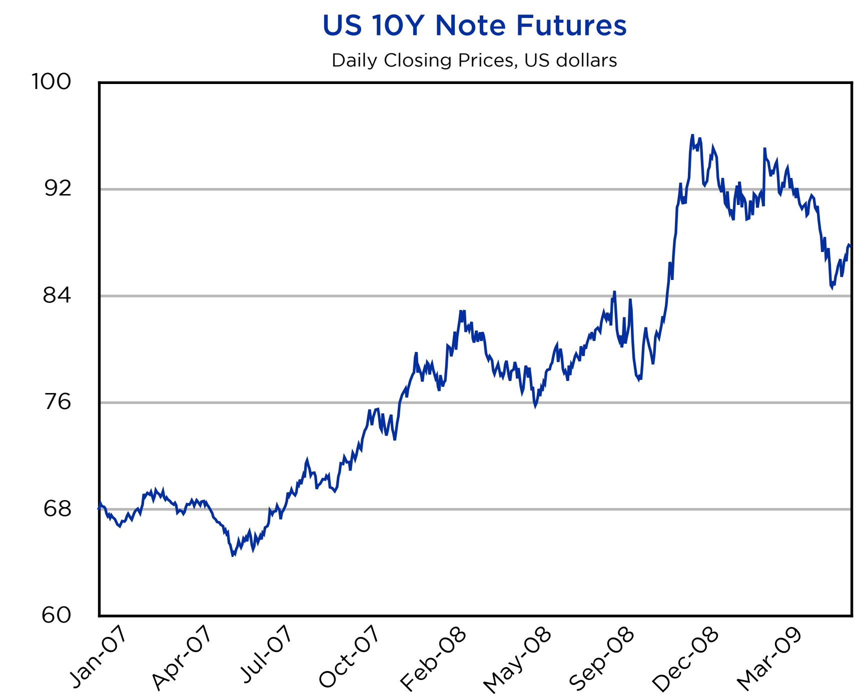
Bubbles are our friends. What is a bubble other than simply a massive trend? All we care about at Melissinos Trading is putting ourselves in a position to find and capture these massive trends. We don't care if the fundamentals justify them or not. When bubbles form, like most recently in Palladium (2019-20), we know exactly what to do. We prepare for them every single day. At the time of our initial entry, we could not have known a major trend would develop. For a while, it began like every other position we take. It broke out to the upside, we bet a small fraction of our capital and moved our trailing stops up as it climbed higher. Focusing only on the trend and following our system allowed us to hold on during several nasty reversals and book a sizable profit.

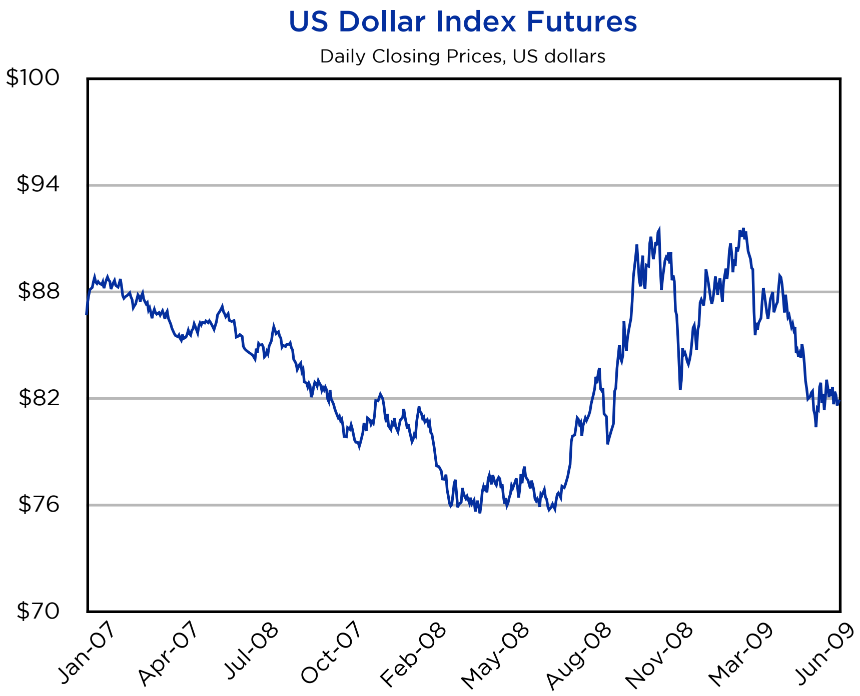


On the flip-side, crashes often present opportunity for EGT. A crash typically puts the exclamation point on a broader long-term trend already in motion. However, some markets crash from the highs, forming an upside down V shape, like the one we saw in stocks and several other markets in February-March 2020. This pattern isn't too kind to EGT or other long-term strategies. In these scenarios, market correlation tends to increase significantly, so we wind up losing a lot of money in many positions all at once.

We weren't operating in 2008, but many other trend followers were and made a killing. There were plenty of trends to ride, both up and down, in a wide array of markets. A few examples:







The Bear Stearns collapse scarred me. Walking into work one day to find out that my stock, and large portion of my savings, was wiped out? No thanks. That wasn't going to happen to me. I wanted to go to bed every night managing my risk by not betting too much on any one trade, having stops in place and respecting the trend.

"Here's where what has to occur in order for us to get in. Here's what has to occur in order for us to get out. We have a preset small percentage of our portfolio at risk in this position. We know how much we stand to lose if this trade doesn't work out."

When you follow long-term trends, surprise events usually occur in your favor. If a black swan swoops in out of nowhere and reverses many trends, like COVID-19 did in 2020, you rely on your systematized position sizing and exit techniques to stay safe. We're always thinking and preparing for what can kill us and take all of our money. We must maintain wild imaginations and respect the trend especially when we don't understand what's going on.

EARLY INVESTORS

When I launched Melissinos Trading in January 2011, the Financial Crisis was still fresh in the minds of many investors. The stock market had rebounded a bit, but the financial and emotional scars of the Crisis ran deep. Many were reluctant to dive back into the stock market. They wanted to invest in something that could protect their capital in a Crisis and diversify their long-only stock market portfolios. EGT presented a good fit.

After the Crisis, everyone understood the importance of protecting capital by diversifying, respecting the trend and cutting losses quickly. Fortunately, these were some of the core pillars of EGT's approach. Investors needed a way to grow their capital, but without investing in reckless approaches such as index funds and fundamental strategies. EGT provided a solution to grow capital, but in a more protective manner. Many investors were happy to take listen and take a chance.

Regardless of how promising an investing strategy sounds, many investors want to see results. Consistent short-term returns is what motivates most investors. I had to do my best to find investors who cared more about long-term discipline instead of short-term results. Naturally, this culled a lot of people out since, I believe, short-term consistency is a deep-rooted human desire. I had to explain how EGT returns would likely be lumpy, where there'd be long periods of sub-par returns and short periods of spectacular profits. As Tom Petty says, "The waiting is the hardest part." In my experience, he's dead on.

I prepared a model for working with investors. The model represented the ideal relationship. Every investor receives the paper and must sign it before committing funds to EGT. To have a look, please click here - *How We Work With Investors*.

In January 2011, my father, two uncles and I contributed a total of $300,000 to the EGT strategy. I steadily signed on new investors over the years as EGT produced solid returns. As AUM grew, I tried to improve the strategy by including more markets, entry/exit and risk management techniques. I like to keep the operation small and work with diehard trend following investors. They live and breathe the principles, not just in the investing arena but in their day-to-day life. Today, Melissinos Trading manages $5 million for over 30 investors.

A fund of funds investor took interest in EGT's performance in spring of 2011. At its peak in the summer, EGT was up around +25% YTD. There were many strong trends - gold at all-time highs, government bonds and the U.S. Dollar soared after the U.S. debt was downgraded. The investor wanted to invest immediately, but I told them to wait because I thought markets would likely to come back down to earth at some point soon. Surprisingly, they took my advice. I stayed in touch and, around a year later, told them to put some money to work. Over that time, the EGT fell about 12%. I was thinking about the long-term, doing the right thing and trying to build trust.

Of course I could've gotten it wrong and watched performance climb higher, but I was going with the data and the odds. In the summer of 2011, it suggested that new investors should hold tight for a while.

I continue to preach the importance of prioritizing long-term discipline instead of short-term returns. In 2014, EGT had a banner year making just over 38%. Naturally, this attracted many new investors. All of the sudden, people who never invested in trend following before, "got it" and fell in love with it. A few of them loved the principles and embraced them 100%. Many others, I believe, were simply chasing EGT's returns. Looking back, I wasn't strict enough in telling new investors to hold off for a while. I regret this. Several investors, who have since withdrawn their money, got in around the equity curve top.

The only way to maximize the odds of long-term success for each investor is making sure they come aboard for the right reasons. This took time for me to learn how to ask better questions and root out the undisciplined performance-chasers. I didn't want those people, no matter how much money they wanted to invest. I believe every investor has an influence on me. If I become selfish and take on any investor who shows interest, then the fund will wind up with lots of unfit investors. Me, not wanting to displease them, will be more likely to abandon my discipline when it matters most. This is a recipe for disaster. This isn't fair to the investors who are in for the right reasons. Ultimately, we'll underperform and carry more stress day-to-day.

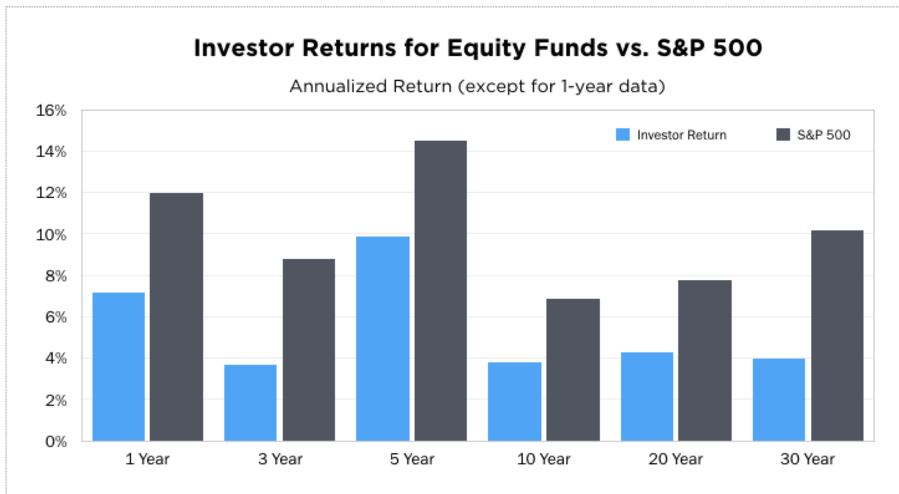
Die-hard investors who love trend following will be able to stick with it through thick and thin. Those who chase returns will always find a reason to withdraw their capital during losing streaks. This is a major challenge of investment management. One that I hope to conquer during my career.

A STOIC MANNER

The markets are both dangerous and opportunistic. They're confusing, frustrating and unpredictable. Melissinos Trading takes the stance that it's better to be adaptive than rigid; to diversify instead of betting it all on one or two ideas; to react rather than predict. The only prediction we make is that markets will continue producing trends over time. We believe the best way to play the markets is employing a systematic approach that diversifies and rides trends while managing risk.

A good strategy, alone, isn't enough. Confidence and discipline are equally as important. Many mistakes occur when confidence wanes. No strategy works all of the time. It routinely experiences losing periods, so confidence to continue to pull the trigger is of extreme importance. A good strategy can becomes poor without discipline. Researching ideas, testing them and working on our mental game help improve EGT and maintain our discipline.

If having a good strategy alone was enough, many more people would achieve better returns. The strategy most people all know and love, the S&P 500 index fund (yes, it is a strategy), has returned ~10% per year over the past 30 years. What has the average investor returned? About 4%. The underperformance is consistent over both short and long-term timeframes. I hope this illustration shows just how important discipline is. A good manager-client relationship can facilitate this. This is one of our major areas of focus at Melissinos Trading.



Source: dalbar.com

We do our best to keep a level head and remember that there will be times of stress and extreme volatility. That's simply the nature of the markets. When the extreme happens to us, we're already prepared. We try to imagine the crazy. We know what to do when crazy happens. We can observe and act logically without emotions arresting our decision-making abilities.

We strive to execute in a stoic manner, the ideal way an investor would want to behave in order to have long-term success.