TRANSCRIPT

Interview with Glenn Neely
Elliottt Wave Forecaster & NEoWave Trading Advisor

Capital preservation:
The “secret” ingredient to successful trading

For successful long-term trading, Glenn Neely reveals trading strategies to let profits run – and essential capital preservation strategies to cut losses short.

Introduction: Welcome to Glenn Neely’s Quarterly Interview Series. He is the founder of NEoWave, Incorporated, which provides money managers and traders worldwide with detailed market strategies to enhance their trading results. Now, here is your host, Brandon Clay.

Brandon Clay: Hello, again, and welcome to our program. I am your host, Brandon Clay, and with us today is the founder of NEoWave, Glenn Neely. Glenn is an internationally regarded money manager, trading advisor, and Elliott Wave expert. He has devoted over 35 years advancing trading strategies and Wave forecasting. Today, we’re here to discuss capital preservation – the secret ingredient to successful trading. Glenn Neely, it’s a pleasure to chat with you today.

Glenn Neely: Hi, Brandon. How’s it going?

Brandon: It’s going well. Thanks so much for making the time, and let’s just dig right in. So this capital preservation bit, we’ll get to that in just a minute. Let’s talk about just the whole, you know, maybe trading strategy basics: letting winners run and cutting losses short. Can you explain why each of those parts is so important to trading well?

Glenn Neely: Well, the only way you survive in this game long-term is to make sure you don’t lose too much money when your strategy turns out to be wrong. If too much money is lost, it’s very hard to make it back. So if you lose, let’s say, 50% of your capital on a trade because you’re really hard-headed, and you’re sure it’s going to happen, and you don’t want to use stocks, and the market keeps going against you, then you have to have 100% winner to gain back the 50% loss, so it gets more and more difficult. The more you lose, the harder it is to make it back.

So, that's why it's really critical to have points in the market, we say, "Well, if it hits THIS point, I'm going to give up. I'm going to get out. I'll just accept that I'm probably wrong. I won't justify it, or make excuses, or think of other reasons why I might be right." What most people don't understand when it comes to any kind of forecasting process is that they want their mind to be right more than they want their pocketbook to grow, because it's an ego thing. So, especially if you're just talking to friends and announcing to everyone what you believe, then you don't want to be wrong, and you want to save face, so you'll hang on and hang on and hope you're right, because you don't want to be wrong. Whereas, the loss of the money is probably less damaging than the hit to their ego.

And so that's the reason why most people go through that process, and one strategy to avoid it is: don't tell anybody what you think is going to happen, then you can't embarrass yourself, and it makes it much easier to get out or do what you need to do.

Brandon: So, the cutting losses, you kind of went through the psychology of what might happen if a loss maybe starts small and then starts growing, and growing, and growing. It's really about the ego. Have you seen this around trading?

Glenn Neely: Oh, yeah, yeah, of course. In the younger days, you think markets are just going to do what you think they're going to do, and you don't realize that it's not just an absolute game. It's more of a probability game. Even if the Wave structure looks good or even if you think you have all the bases covered technically, there's always something that can happen that just messes it all up, or something you didn't consider, you know, an international event. Something can go wrong. So, yeah, of course. I mean it happens to everyone.

Brandon: Sure. So capital preservation, we talked about that in the title here, "Cutting Losses Short." How would you define capital preservation?

Glenn Neely: The way that I actually do it for the fund that I manage and for myself, when I take a trade, my general goal is to risk about 1%. So, if you, say, have $100,000, it doesn't matter how much you spend to get into the position. None of those details matter about the actual position, holding the position, or leverage, or any of that stuff. What you want to make sure is that when your stop gets hit, that the actual dollars lost amounts to 1%, maybe 2% of all the capital you have.

And this is so you can try again, and you want to be able to try again sometimes 5 or 10 times. If you get in a really bad streak, you could be wrong 5 times in a row, maybe 10 times in a row. So, if you're wrong 10 times in a row and you lost 1%, that's only 10%. It's a very survivable situation, and you can recover. You know, if you're risking 10% each time and you're wrong 10 times in a row, well, then you're pretty much gone. So it's critical to keep your risk level low.

Another way to look at it if you were trading stocks instead of futures, you're going to say, again, if you have $100,000, you spend $10,000 on the stock position. Let's assume it's just a naked, raw, unleveraged stock position. So if you spend 10% of your capital in that

position, well, then you'd want to risk 10% of that position which gets you to your 1% loss. So that means you can get in at $100 in the stock, and you spend 10% of your money to buy it, well, then you can let it drop to $90 or $10 against you, and that loss will then amount to 1% of total capital, you know, because 10% of 10% is 1%. And that gives you plenty of room. You know, if you're off by $10 in a $100 stock, it's a pretty big error, so that's the point where you would give up.

If you're trading in futures, you have to be much more careful, because they're highly leveraged, sometimes 10 to 1, so you need to pay much more attention to the actual entry point, the exit point, and what is the total capital loss there. In the futures, you're not really putting up the full amount, you're putting up margin and sort of a promise to pay. You just need to be more careful about how much do you have in your account, and what is the loss going to be on this particular trade and make sure that's around 1% or 2%. And if you do that religiously, you can be wrong quite a few times, and still survive, and then eventually, when you do get into a good trade, that's when it becomes very important not to get out too quickly, because you need to make up for the times that you were wrong. So that's when you need to let your profit run, and let it go as long as it has to go until your stop. It can be done in lots of different ways.

You can have a 1% trailing stop, 2% trailing stops, some might have to be a lot bigger than that. But you want always your core loss, in real terms, to be 1% or 2%, and I really personally think 1% is the safer bet unless your capital is too low. If you're trading only with $10,000, it gets very difficult to risk only 1%. When you move up to about $100,000 or more, then it gets fairly easy to do.

Brandon: Perfect. Yeah, you touched on quite a few areas there. The important point, though, because not everybody's going to be a futures trader that's listening to this episode. Is that depending on the thing that you're trading, the instrument, that's what's going to determine how you implement this general rule that you really have to implement regardless of what you trade.

Glenn Neely: Right. It's absolutely crucial. If you don't do it, I guarantee at some point, you're going to lose a lot of money.

Brandon: Yeah. So then it goes into the next question. This isn't just a part of a conservative trading strategy. This sounds like it's a part of every good long-term, as you said, trading strategy.

Glenn Neely: Right. It's essential. A friend of mine is a very wealthy guy, but he's doing stuff that I know in the long-term will probably be catastrophic, even though he's doing really well short-term, and it's using "Las Vegas-style" trading strategies where, you know, if you take a loss, then you might double up on the next trade. You take a loss, and then you double up on that until you eventually win. Markets aren't quite the same as Vegas. It's not a 50/50 shot every time you get in. The loss isn't just what you put up. You can lose a lot more money than you put up, especially when trading futures. So you might get in and then you keep adding as the market goes against you. In this case, you know, he'll take 1 position, say, at about 100, and 2 positions at 90, and 3, 4 positions at 80, and so forth. So

he's just compounding the loss. And if that recovery doesn't happen, the loss will be catastrophic.

This is a little side note. You shouldn't play those kinds of games with the markets, because for things like the Crash of '87 or the Flash Crash of - I think it was - 2011 are what I call the hyper-crash even though people don't call it that at all. Hyper-crash of August 2015 where the market closed one day on Friday, at one price, and Monday morning, it opened up $1100 lower in the Dow, that was really technically a one-second difference between the close and the open, but it was a whole weekend between so people don't think of it in those terms. But I consider it a hyper-crash because it was instantaneous, right? And those kinds of things could just, you know, not only wipe out your account but, in the futures markets, they have a right to take your house. They could take your bank accounts. They could take everything. Yeah, because you sign contracts that you have to make up for whatever's lost.

Brandon: Important for everybody to know. "Buyer beware," right?

Glenn Neely: Exactly. It's sort of a "buyer beware," but more like "trader beware," right?

Brandon: Exactly. So, yeah, I mean great lead into this. What happens when traders and investors don't concentrate on preserving their capital, if they don't make that a core part of how they do business in the markets?

Glenn Neely: Yeah, we should really definitely talk about this, because this is all psychology. Most people, when they get involved in markets, they're only focused on the "pot at the end of the rainbow" – the big win, the huge return. They're not focused on how much they're losing. It's like being in Las Vegas again. You're on a slot machine, and you might have $1000 in $1 coins, and you just keep putting it in, pull the arm up, put it in, pull the arm up, not paying attention to the fact you're losing $1 every time because it seems so small. But you do it over, and over, and over, and over, eventually you've lost $1,000, right?

So, they're not focusing on the total risk. They're focused just on that little, tiny $1 at a time. They're hoping and praying to make a million dollars. So, when it comes to trading, a lot of people get in, thinking they're going to make, you know, 5, 10 times their money, or make a million dollars or hundreds of thousands of dollars in trade, and not paying any attention to what they might lose, and so they may not use stops. And all of a sudden, the market's going against them, and they keep thinking, "Oh, I'll just hang on. I'm going to make a lot of money," and it keeps going down. And the losses just keep growing, and growing. So, again, in that case, it's not an ego thing, but, you know, it's a *fantasy*. They're focused on the fantasy, hoping their lives are going to change by a particular trade instead of focusing on, "What happens if I'm wrong?"

So, the focus should always be on "What's the downside?" not "What's the upside?" You know, you could take 10 trades in a row, and if you really were careful about managing your risk and let's say the market moved in your favor a little bit, you maybe raise your stock to break even, you can break even 10 times in a row, and then that one trade that makes money means that you've made money, or you can lose, you know, 1% 5 times in a row.

And then when you have a good trade, you might make 10%, so you've made money. It's not an issue of how many times you're wrong. It's an issue of how much you make when you're right compared to how much you lose when you're wrong.

Brandon: Excellent. So then we talked about what happens when you don't concentrate on preserving your capital. If a trader, a good trader, or a long-term trader who's thinking ahead decides, "I'm not going to focus on this fantasy, this 'pot of gold at the end of the rainbow' here. I'm going to focus on NOT losing and preserving my capital," what happens when somebody actually does that?

Glenn Neely: It makes all the difference in the world, because you're going to be right occasionally. And sometimes, if you're lucky, it might be 50/50, maybe a little bit more. But most people are probably wrong more than 50% of the time. But if your primary focus is just not losing money, then eventually, you know, one out of two, one out of three, one out of four, one out of five times, you're going to be right. And then when you're right, that profit's going to really make a difference especially if you didn't lose money the other times that you were wrong or you lost very little. So that is a much better strategy than getting in and hoping you're going to make a lot of money, and you're not paying attention to the fact the market's moving against you, and you end up losing 20%, 30%, 40%.

And then what do you do? Well, what most people do is then they risk even more money the next time to make up for the money they lost the first time. And so it becomes this horrible, circular process that they just keep risking more and more and losing faster and faster.

Brandon: Yeah, and that's the opposite of trying to preserve your capital! Let's say you lose 20%, and you go, "Okay, that's okay. I lost 20%. But if I bet 20%, then I'll go back to break even," or I guess it'd be 40% at that point.

Glenn Neely: And then if you double up on your position size, then you can make it back twice as fast.

Brandon: Which is true if it works out, but it doesn't always work out that way, does it?

Glenn Neely: Right. It's not like black and red on roulette. It's not almost 50/50. It's way less than that. So, you know, the probability should be precisely correct about what you think is going to happen or not too high. So you need to be very careful about protecting against being wrong.

Brandon: Yeah, and it goes back to your 1% rule, right?

Glenn Neely: Exactly, right. They can be wrong five times in a row, and then one good trade, and you make it all back plus more.

Brandon: So, of course, you teach at NEoWave which is a version of Elliott Wave. But going to just strictly Elliott Wave type of trading – overall, most Elliott Wave practitioners, do they normally account for capital preservation in the way that they look at the markets?

Glenn Neely: Well, I would say probably not because with Wave theory … it took me over 20 years to figure this out. But with Wave theory, it gives you this built-in sort of false belief system that you always know what's going to happen, and it takes a long time to realize there's only certain times when you can know and certain times when you can't know. And that's a lot about what NEoWave is about. NEoWave adds additional levels of sophistication, and rules, and details that make it more scientific so that you're not assuming you know when you don't know. Traditional or what I call orthodox Elliott Wave leaves a lot open to the imagination, a lot open to interpretation. But it gives the illusion that you know what's going to happen. And very frequently you'll be wrong.

What it generally boils down to is, in the middle of trends, you're likely to be wrong a great deal about what's going to happen. The beginning and end is when you're likely to be very right, but then no one believes you. So it's in the middle where everyone wants an opinion because they personally are uncomfortable and don't know, and then you're likely to be wrong at that time, because Wave theory is very flexible in the middle of a trend.

And then at the beginning and the end of a trend is when you're almost certain to be right, and nobody believes you because they all are positioned in the opposite way or the news is completely contrary to what you're thinking, such as the January 2008 timeframe. It was, I think, the 20th of January 2008 when I released a long-term forecast where the stock market is saying that the bull market was over in 2007, and that we were getting ready for the biggest, fastest market decline in history, except for the 1929 crash, and that we were going to go through the biggest market decline since that period, breaking below the 2009 lows. And that was going to be the fastest thing, the largest thing we've ever seen in our lifetime. But nobody believed me!

At the beginning of a trend, Wave theory is very clear. It's clear because everybody's doing the wrong thing. You know, Wave structure becomes clear as everyone backs themselves into a corner, and they're all buying or they're all selling, and so the pattern finishes, and there's only one thing that can happen that's going to have to go contrary to what the majority is believing, because everyone's bought, then no one left who's interested to buy, so the only way it can go is the other direction.

So when everyone bought the stock market, and everyone was buying houses, and it was just a mania in 2006, 2007, it took me a lot of personal self-talk to avoid buying a house in the 2006-2007 timeframe, because I knew when that whole mania was over, it was going to get a lot better a lot later, where buying would be a much better deal. But everyone else that I knew, every friend, every person practically I knew was buying houses, flipping houses. I knew one person who'd never bought a house in his life, and he bought five houses in one day! So that's the kind of insanity that makes it clear that a trend is coming to an end.

Now, this is a little side note. This is very important for long-term trading. The only completely reliable way to know that a bull market is over or a bear market is over that I've ever seen in my lifetime, which doesn't require looking at charts or anything, is to wait until you start hearing in the media and especially in non-financial publications, you start hearing

about the stock market regularly, and you start hearing people predicting a market doubling, or tripling, or dropping in half. So if you're at the end of a bull market, you're going to start to hear common statements like, "I think the Dow is going to double in another five or eight years." Typically, a person will linearly extrapolate whatever has happened, and they push that into the future.

So if you remember the high in 2000, the forecasts at that time were starting to get more insane than I'd ever seen in my lifetime. The Dow was, I think, around 10,000 give or take, and I was hearing predictions, you know, 20,000, 30,000, 50,000. I was in Los Angeles about to appear on a financial news show. And me and the anchor were just talking in the back before we went live, and he handed me this book. And the name of the book was called *Dow 100,000.* And I mean, the minute I saw it, I go, "Oh, well, that's it. I mean this is like the end of the biggest bull market of all time." Anybody that's saying the market's going to go up 10 times – 1,000% higher than it is now and that was an official nationally published and advertised publication – that was it. I knew that was it. And this was around February 2000, and that turned out to be the peak of the stock market for, what, the next 15 years approximately. I knew that was it. I knew it was the end of a huge bull market.

And then we got a similar situation in 2007 where the market was in a double or a triple. And at the low in 2000, we were hearing the opposite where the market was going to drop in half, maybe even drop 75% more. That is the only reliable thing that I know. In 35 years of studying the market, and experience, that if you start hearing it commonly expressed, "the market's going to double or triple," you're at a major, major top. And if it's going to drop in half or, you know, 75% lower, then you're at a major, major bottom. But it has to be not just one person on the internet saying it in Kalamazoo. It has to be national television, preferably even non-financial news, and you want to hear about the stock market on local television, in local newspapers. Then you know you're at the end.

Brandon: So basically when the major mainstream media sources, not financial news, say *Time* magazine, maybe CNN.

Glenn Neely: Right. If it's on the cover of *Time* magazine, that's the end of it!

Brandon: That's the end! Huge takeaway there.

Glenn Neely: Exactly. So in this case, unfortunately, the stock market isn't quite to that point yet, so I think there's a chance we might go through a short-term mini mania in the U.S. stock market to finally get the public just overly invested, overly involved, speculative. We need to hear more about it on local news, and hear more about the "spectacular bull market." It's not quite happening yet, so we're not quite there.

Brandon: Yeah. So for the sake of anybody listening depending on when they're listening to this, we're recording this in late May 2017. The content's intended to be helpful, really, whenever you listen to it, but we will see what happens, right?

Glenn Neely: Yeah, exactly.

Brandon: So, going back to the capital preservation topic, you mentioned at the very beginning of the question on whether Elliott Wave normally accounts for capital preservation. Well, let's dig with the NEoWave briefly, and that is, does NEoWave – your version of Elliott Wave – incorporate the concept of capital preservation?

Glenn Neely: No, capital preservation is a totally different subject from Wave analysis or forecasting. They need to be considered as separate phenomenon, separate concepts, and they need to be employed simultaneously or as part of the same process to be successful. So you might do your analysis, and you say, "Well, I need to get in." And once you decide that something's worth trading, or entering, or investing in long-term or short-term, then capital preservation stuff comes in second. So you say, "Well, I need to get in here, and instead of buying, you know, 1000 shares of stock, if I'm going to have a 10-point stop, maybe I need to have just 100 shares of stock," so that you can keep your risk at that 1% or 2% amount.

So you first decide what you want to trade, you know, or invest in, and then you need to decide where you're going to get in, and you need to decide where is your stock going to be to maintain your risk at 1% or 2%, and which, of course, incorporates how big is your position going to be if you're trading stocks for futures or anything. So those are the steps, but it all has to be considered as a whole, but in phases.

You first have to decide if you're going to trade something, and then when you're going to trade it, and where you're going to get in, and then where you're going to put your stop. And where you put your stop is where the capital preservation part comes in. And if the stop is too close, then you might be able to take a larger position. If it's too far away, you take a smaller position. But that would be the step you would take after you decide that something looks interesting, then you worry about the capital preservation process.

Brandon: Perfect. Thanks for separating those concepts. And then if, as you did that, of course you're saying that capital preservation is an idea that doesn't have to be necessarily used with NEoWave or with Elliott Wave, and this is true of really any trading strategy.

Glenn Neely: Yeah. Right, I would think that, first, capital preservation is more important than anything else, so it doesn't matter what technique or system you're using. It doesn't matter how accurate it is. It doesn't matter how accurate you think it is. It doesn't matter how much back-testing you do. **The most crucial thing is capital preservation.** So from the start, you should always set out. "I'm only going to risk 1%, maybe 2%, and that's it." So with situations that look really good, you might go to 2%, but typically, if it's just an average setup, you go with 1%, and that should be the foundation of any process, any trading technique you use. It doesn't really matter what trading technique you use. The capital preservation part is more critical.

Brandon: Perfect. So, I've got one other question I wanted to go through related to your subscribers. So, you have your NEoWave analysis. Let's say that your charts are pointing in certain directions, and you like the buys, you like the sells. You give your subscribers specific ideas. You incorporate that capital preservation concept into each of those picks, I would assume. How often?

Glenn Neely: I usually, very often than not, every single time that I remember to say it, depending how fast the market's moving, but usually, I'll say, you know, risk one-half percent, because we take trades in levels. This is another way to control risk. Instead of being all or nothing where I'm going to get into, say, the Gold market at $1200, all or nothing, frequently it's better to phase in and phase out of a position.

So for my service, we have trades on three different levels: monthly, weekly, daily. So we might take an initial position on a monthly basis, and we risk a half percent. We might take another position on a daily, risk a half percent. And another on a weekly, risk a half percent. So a total risk might be one and a half percent, but we might not be in all three positions. Maybe we're only in one. Maybe we're only in two. So, the better it looks, the bigger the position, the bigger the risk.

Typically, long-term trends obviously start on a big chart, and they work their way down, and you get to points of acceleration as you get closer and closer to the short-term charts agreeing with the longer-term charts. So if you see a big upturn on a monthly basis, it may take a long time to start the upturn. But then when it starts looking good on our monthly chart, weekly charts will start moving faster. And then you might jump in on a weekly position at that point. And then when the weekly charts get well-positioned, then you might have acceleration on the daily basis. So you jump in on a daily chart with an even closer stop.

So, that's the way that we scale in to position, and then you also would typically scale up. A chart that's entered on a daily timeframe will have an entry or an exit a lot sooner than the chart on a weekly or monthly basis. So we might scale out of a daily position and continue to hold a weekly, then scale out of a weekly and continue to hold a monthly. And you're moving up stops, and moving up or changing targets as you go.

Brandon: So it can get kind of complicated. I assume that all of your subscribers are well-versed in this, because you're giving them updates on a daily and weekly basis, right?

Glenn Neely: Right. Yeah, I mean I have a lot of customers who've been with me 10, 20, 30 years, and a vast majority of my customers are professional traders or extremely experienced personal, wealthy investors. So I have a pretty sophisticated clientele.

Brandon: And I would assume that if somebody wants to join, it is something that you can learn as a subscriber. It's not rocket science.

Glenn Neely: Yeah. I'm NOT like a lot of services that sort of talks for 10 pages and give all kinds of reasons for this and that, and you get positives and the negatives. And sort of in the end, you're left to decide what to do, and you don't really know when you're supposed to get in or how long you're supposed to stay in. It's just all this nebulous stuff, right?

Brandon: Right.

Glenn Neely: Generally, you can tell the experience level, and the sophistication, and you

might say success level of a person providing market information based on how quick and short the information is. The more precise and detailed, and short and sweet, the more they know what they're doing. If it goes on for 10 pages, then they're trying to convince themselves they know what they're doing.

With my services, it's usually just one paragraph or less, and you just say, "Buy here. Here's your stop. We're going to sell here, and risk a half percent." And that's it.

Brandon: Glenn, this discussion on capital preservation has been tremendously helpful to myself and to anybody who's listening. I really appreciate your thoughts. If anybody wants to reach out to you, what's the best way they can connect with you?

Glenn Neely: The best way is to go to my website: www.NEoWave.com.

Brandon: Perfect. Thanks again for your time.

NEoWave, Incorporated is a financial publishing firm and provides trading and forecasting services. All opinion is intended for informational purposes only. NEoWave is not an investment advisor or a registered securities broker or dealer. Nothing provided constitutes a recommendation or solicitation for the purchase or sale of securities. Past results are no guarantee of future performance. For more information, check out www.NEoWave.com/terms.asp.