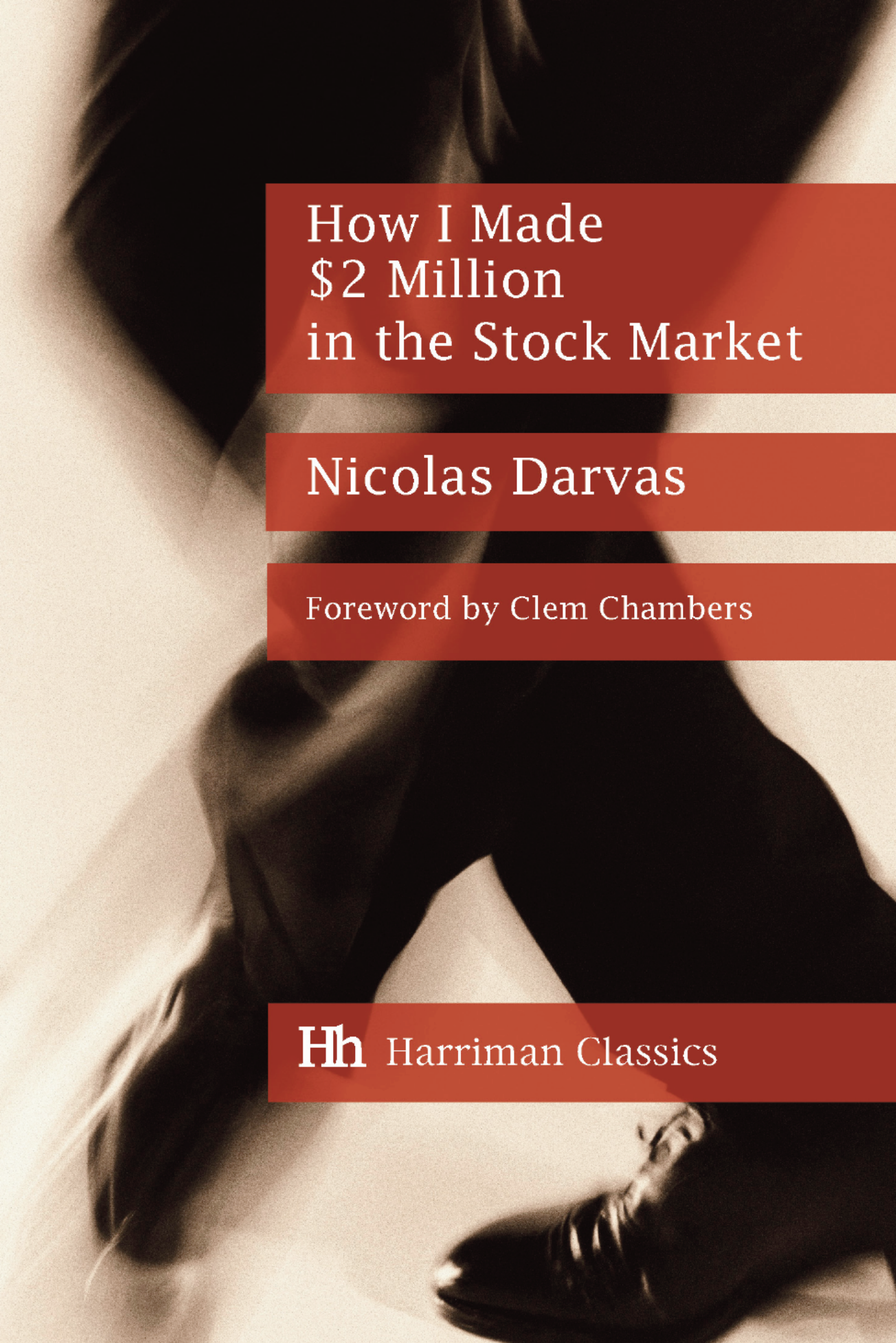

How I Made $2 Million in the Stock Market

Nicolas Darvas

Foreword by Clem Chambers

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How I Made $2 Million in the Stock Market

By Nicolas Darvas

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Foreword

Of the many books written about trading, few are worth the paper they are written on. *How I Made $2m In The Stock Market* is different, it is one of the few gems worth reading over and over.

Like other great books on investing and trading, it has withstood the passing years of rallies and crashes and is as useful today as it was in the nifty fifties.

Darvas was no trading pro or theoretician; he developed his method using his own money in a primitive trading environment almost unimaginable today in our world of complex tools and voluminous data. In fact the general naiveté of the book underscores the robustness of his method.

Most so called trading rules can't and don't work because it would mean that the participants of the trading world could all make huge profits and take their gains from the market. In such an environment the system would be drained of cash and it would implode. It is this obvious insight that underlines the fact that trading is not a science but an art.

While the Darvas system is simple, it still requires judgement, yet it is still clear how to apply its rules.

Most trading rules appear to work because they rely on 'observer bias' – a trick of the mind that highlights the system working, while hiding when the system fails. Support and resistance is a classic example, where only the support or resistance that works is recalled, while the many others are overlooked.

The Darvas system, however, works without much subjectivity and its application can be seen today in current scenarios in the same way as when he wrote the book.

Darvas was a dancer, travelling the world putting on ballroom exhibitions, meanwhile awaiting telegrams that kept him posted about the progress of his positions in New York. There was no need for him to have the up to the minute news or price, not that they were available in those days.

That in itself is an important lesson. Medium term trading is more likely to be profitable than short term day trading. This is confirmed today by spread betting companies who say that their best winners take medium term positions. The medium term investment stance is not only benign, but also convenient, in that most readers will have a job and watching the markets is not conducive to keeping one.

The starting point for Darvas was to look for insider trading. He did this by watching out for sudden increases in trading volume, which he took to be a strong sign that something was afoot with the company. After taking a position he would then see if a rise confirmed this suspicion and then increase his position.

The key stock behaviour he watched for occurred when the stock had finished a rally and began to trade sideways. This sideways trading pattern then formed a range he called a box, the edges of which determined whether he would sell or buy. Breaking out of the box upwards would trigger a buy and conversely breaking down would trigger a sell.

This simplicity of the system was its strength. But of course it has flaws.

No system can be foolproof, but making losses while making bigger profits is not a flaw, simply a reflection that a system is effectively blind to the realities behind the market move, but has an ability to be more right than wrong guessing its direction.

The flaw to the Darvas system is that it relies on overall market conditions.

Darvas was operating in a boom market, much like the dotcom boom of the 90s, and many of the charts illustrating the book look exactly like the booming technology companies of that recent bubble. Darvas would have made many more millions with his system in the dotcom boom environment.

The system requires a market with explosive upside which triggers startling rallies and it would be of little use in quiet markets which rarely produce massive share price spikes like the ones he enjoyed.

However, to say that the system is not a method for all seasons is no real loss, it is very good for the sort of share that can go up two, three, five, even ten-fold, it's just a matter of finding the right arena or waiting for the right time to come by. It always does.

Happily these days – unlike for Darvas who did not reproduce his success in the 60s – there is always something in the market that is the next Big Thing and as such his system is of practical use in these hot sectors. The volatile world of currencies, commodities and wide ranging stock sectors generally ensures that the Darvas method can be brought to bear on a selection of instruments at one time.

The recent commodity rally is a fine example, as was the net gambling stock boom of 2005. The next sexy sector is bound to rear its head soon and when the stocks in that group begin to shoot up, the Darvas system will be just as useful today as it was in the fifties.

For most investors getting out with a profit is the hardest thing, because the share has probably beaten all expectations and seems capable of anything. The emotionally attached investor is loath to betray this profitable allegiance and is then caught by the slump. The system in this book gives an investor a simple way to set his stop losses and get out with his handsome profit and this alone is a priceless tool.

The Darvas boxes are, in reality, equilibrium points that mark the short term end point of a revaluation of a share. These points rarely hold and are revised either upwards or downwards. His method takes advantage of this and gives the investor a simple way of balancing greed and fear. In the modern world however, stop losses can be dangerous and while Darvas picked round numbers for his stop losses, you would do well to set them a safe distance from the obvious levels other traders may seek to exploit.

How I Made $2m In The Stock Market is a rare book and as such is a precious one. Few people know of it and few people use this technique for riding exploding stocks and for getting out of them near the very top of their runs. As such, until the day this system is popular it is likely to be a very useful and profitable one.

Clem Chambers,
Managing Director, ADVFN

Author's Introduction

I was standing in one of those modernistic telephone booths at Kennedy International Airport. A few feet away stood Charlie Stein with a beautiful girl.

Charlie is president of the Lord Hardwick Corporation. He always has a beautiful girl at his side. And he seems to take special delight in introducing me to the girls and praising me in such a way that it somehow makes *him* more important because he knows me!

There are usually no dividends for me in this upmanship, but today was no usual day. For, unseen by all of us, was another beautiful girl. She was invisible, and she stood nearby. Call her Lady Luck or call her Dame Circumstance.

Thus, for the first time, Charlie's use of me proved useful to me. For it prompted the reissue of this book.

While I was trying to reach my girlfriend in Paris on the phone and deciding that she was probably out cheating on me – Charlie proceeded with his usual build-up of Nicolas Darvas. He kept repeating my name and, as always, he was loud. A stranger in the next phone booth stepped out and said to him, "Is that fellow really Darvas? I studied his book like a chemistry text and – would you believe it – I've already made more than one hundred thousand dollars with what I applied from what he wrote!"

I stepped out of the booth, and the stranger turned to me. "Why the hell is *How I Made* . . . out of print?"

He didn't wait for my answer. "I bought more than a dozen copies," he continued, "but now I can't seem to get another at any price. My only remaining copy is constantly being borrowed. Then I have to beg my friends to return it. They eventually do. But by now the book is in shambles."

The stranger held out his hand. "I want to thank you," he said. "I've got to catch a plane or I'd buy you a dinner or some drinks. I want to tell you something. You might have made two million in the stock market, but you wouldn't make two cents in the publishing business!"

With that he grabbed my hand, did a swivel turn, and was racing toward a departure gate.

Then it hit me. I *was* dumb. Here, a decade later, I was still receiving a steady flow of mail in response to my book. Again and again, readers asked for clarification of certain points. Most of the questions were along the same lines. And the book was out of print!

Time has a way with it. And time had proved out my approach to stock market speculation. My book had become a classic that was, in some cases, bringing as much as $20 a copy in the "out of print" book market.

Had I been extraordinarily lucky? Had I been caught in the momentum of a runaway bull market in which even a fool could do no wrong? Or was my approach so sound that it would work in almost any market?

The fact is that *How I Made . . .* has withstood the careful scrutiny of time.

I went from the airport to the Park Avenue South office of Lyle Stuart. He had published my second book, *Wall Street: The Other Las Vegas*. He was a fellow with guts and one willing to take a gamble. But when I mentioned the possibility of putting *How I Made...* back in print, he assured me that that was no gamble at all. After a brief discussion, we decided that we would publish the original book without changing a word. The book was a classic. There was no point in updating it. An estimated one million people had read it. And it had had such an impact that it forced one exchange, the American, to alter its rules on stop-loss orders. The "powers that be" were so upset about the book that they managed to persuade the attorney general of New York State to make some wild charges against it – charges which he later quietly withdrew. (He shouted the charges, but he barely whispered the withdrawal!)

Yes, we would leave the book exactly as it was first published. But we would add some of the many questions that have come in from readers, and I would answer them. You will find this addition at the back of the book.

Obviously I am replying only to the questions most frequently asked. But here I want to tell you about one letter that contained no questions at all. Rather, it was a reprimand.

A reader of the book pointed out, with pages of data, that I had "missed the gold mine." He insisted that, had I hired two full-time assistants and applied my system over a two-year period, I could have had a return of 3,000 times my original investment ($36,000) – or $100,000,000 instead of a mere $2,250,000 in 18 months.

The fault, said this reader, is that I failed to take advantage of high velocity movements and of margin. I failed too, he said, to reinvest my profits.

This, of course, is all hindsight. With the letter were detailed charts proving the case. Could I have made 140 times my capital in the 18 months? 200 times? 1,000 times?

Perhaps. But I have never been unhappy with what I did accomplish. I built a fortune with serenity by avoiding premature selling yet making an exodus from most of my stocks with the use of a single tool: the trailing stop-loss.

I have discovered no loss-free Nirvana. But I have been able to limit my losses, without compromise, to less than 10 percent wherever possible. Profits are a function of time, and so good reasons have to exist to keep a profitless purchase longer than three weeks.

My stop-loss method had two effects. It got me out of the wrong stock and onto the right one. And it did it quickly. My method obviously wouldn't work for everyone. It worked for me. And, by studying what I did, I hope you find this book helpful and profitable for you.

Nicolas Darvas

Paris
February, 1971

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In the morning of September 3, 1958, the following cable arrived at the Gloucester Hotel in the Crown Colony of Hong Kong:

"BOUGHT 1300 THIOKOL 49⅞ . . ."

This purchase represented one part of a chain of purchases that were to net $2,000,000 in eighteen months.

And this is the story of the events that led up to it . . .

The Gambler

Chapter one

Canadian Period

It was November 1952. I was playing in Manhattan's "Latin Quarter" in New York when my agent telephoned. He had received an offer for me and my dancing partner, Julia, to appear in a Toronto nightclub. This was owned by twin brothers, Al and Harry Smith, who made me a very unusual proposition. They offered to pay me in stock instead of money. I have had some strange experiences in show business, but this was a new one.

I made further inquiries and found they were prepared to give me 6,000 shares in a company called BRILUND. This was a Canadian mining firm in which they were interested. The stock at that time was quoted at 50 cents a share.

I knew stocks went up and down – that was about all I did know – so I asked the Smith brothers if they would give me the following guarantee: if the stock went below 50 cents they would make up the difference. They agreed to do this for a period of six months.

It so happened that I could not keep that Toronto date. I felt badly about letting the brothers down, so I offered to buy the stock as a gesture. I sent them a check for $3,000 and received 6,000 shares of BRILUND stock.

I thought no more about it until one day, two months later, I idly glanced at the stock's price in the paper. I shot upright in my chair. My 50-cent BRILUND stock was quoted at $1.90. I sold it at once and made a profit of close to $8,000.

At first I could not believe it. It was like magic to me. I felt like the man who went to the races for the first time and with beginner's luck backed every winner. Cashing his winnings he simply inquired: "How long has this been going on?"

I decided I had been missing a good thing all my life. I made up my mind to go into the stock market. I have never gone back on this decision, but little did I know what problems I would encounter in this unknown jungle.

I knew absolutely nothing about the stock market. I was not even aware, for instance, that there was one in New York. All I had heard about were Canadian stocks, particularly mining shares. As they had been very good to me, obviously the smart thing to do was to stay with them.

But how to start? How to find what stocks to buy? You could not pick them out with a pin. You must have information. That was my major problem: how to obtain it. I now realize that this is, in fact, impossible for the ordinary man, but then I thought I had only to ask enough people to learn the great secret. I thought if I asked often enough I would get acquainted with people in the know. I asked everybody I met if they had any stock market information. Working in nightclubs I meet rich people. Rich people must know.

So I asked them. The question was always on my lips: “Do you know a good stock?” Oddly enough, everybody did seem to know one. It was surprising. Apparently I was the only man in America who did not have his own first-hand stock market information. I listened eagerly to what they had to say and religiously followed their tips. Whatever I was told to buy, I bought. It took me a long time to discover that this is one method that *never* works.

I was the perfect pattern of the optimistic, clueless small operator who plunges repeatedly in and out of the market. I bought stock in companies whose names I could not pronounce. What they did and where they came from, I had no idea. Someone told someone who told me. There could have been no more slap-happy, ignorant buyer than I was. All I knew was what the last head-waiter in the last nightclub I had performed in had told me was good.

Early in 1953 I was performing in Toronto. Because of my first extraordinary $8,000 break with BRILUND, Canada was the land of financial milk and honey as far as I was concerned, so I decided this was a good place to go looking for a “hot tip.” I asked several people if they knew a good, reliable broker, and eventually I was recommended to one.

I must admit I was startled and disappointed when I found his office. It was a tiny, dingy, prison-like room full of books, with strange scrawls on the walls. Later I found out that these are called "charts." There did not seem much smell of success or efficiency. Sitting at a rolltop desk was a busy little man poring over statistics and books. When I asked him if he knew a good stock he reacted at once.

He smiled and pulled out of his pocket a dividend check bearing the name of a famous gold company, KERR-ADDISON.

He stood up and said: "My friend, take a good look at that. That dividend check is worth five times what my father paid for the original stock. That is the sort of stock everyone looks for."

A dividend five times the price of the original stock! This excited me as it would any man. The dividend was 80 cents so his father must have paid only 16 cents for the stock. It looked beautiful to me. I did not realize he had probably been holding his father's stock for thirty-five years.

The little man described to me how he had been looking for that kind of stock for years. In view of his father's success he felt the answer must be in gold mines. He confided to me that be had at last found it. It was called EASTERN MALARTIC. Working with is production figures, estimates and financial information, he reckoned that these gold mines were capable of twice their present gold production, therefore five dollars invested in their stock would soon be worth ten dollars.

On this piece of erudite information I immediately bought 1,000 shares of EASTERN MALARTIC at 290 cents. As I watched anxiously, it went to 270 cents, then to 260. Within weeks it was down to 241 cents, and I hastily sold my stock. I decided this painstaking, statistically-minded broker did not have the answer to making a fortune.

Yet the whole thing continued to fascinate me. I went on following any tip but I seldom made money. If I did, it was immediately offset by my losses.

I was such a novice that I did not even understand about broker's commission and transfer taxes. For instance, I bought KAYRAND MINES in January 1953. It was 10-cent stock, and I bought 10,000 shares.

I watched the market like a cat and when next day KAYRAND went to 11 cents per share, I called my broker and told him to sell. By my reckoning I had made $100 in 24 hours, and I thought I was being smart by taking a quick small profit.

When I talked to my broker again he said: "Why did you decide to take a loss?"-''A loss?" I had made a hundred dollars! He gently explained to me that the broker's commission for buying 10,000 shares was $50, and for reselling the shares next day it was another $50. In addition, there were transfer taxes on the sale.

KAYRAND was just one of the many strange stocks I owned at that time. Others included MOGUL MINES, CONSOLIDATED SUDBURY BASIN MINES, QUEBEC SMELTING, REXSPAR, JAYE EXPLORATION. I made money on none of them.

Yet I spent a happy year on this Canadian buying and selling. I felt I was the successful businessman, the big stock market operator. I jumped in and out of the market like a grasshopper. I was delighted if I made two points. I often owned 25 to 30 stocks at one time, all in small parcels.

For some of them I acquired a special liking. This came about for different reasons. Sometimes it was because they were given to me by a good friend of mine – other times, because I had started by making money with them. This led me to prefer these stocks more than others, and before I knew what I was doing I had started to keep "pets."

I thought of them as something belonging to me, like members of my family. I praised their virtues day and night. I talked about them as one talks about his children. It did not bother me that no one else could see any special virtue in my pet stocks to distinguish them from my other stocks. This state of mind lasted until I realized that my pet stocks were causing me my heaviest losses.

In a few months my record of transactions looked like the trading record of a small-scale stock exchange. I felt I was doing all right. I appeared to be ahead. If I had carefully studied my statements I would not have felt quite so happy. I would have realized that, like a horse player, I was buoyed up and excited by small gains, and overlooked my losses. I completely ignored the fact that I was holding a lot of stock which was standing well below the price I had paid for it and looked like staying there.

It was a period of wild, foolish gambling with no effort to find the reasons for my operations. I followed “hunches.” I went by god-sent names, rumors of uranium-finds, oil strikes, anything anyone told me. When there were constant losses an occasional small gain gave me hope, like the carrot before the donkey’s nose.

Then one day, after I had been buying and selling for about seven months, I decided to go over my books. When I added up the values of the bad stocks I was holding I found I had lost almost $3,000.

It was on that day that I began to suspect there was something wrong with my money-making scheme. A ghost at the back of my mind began to whisper to me that, in fact, I had no idea what I was doing.

Yet I was still ahead. I consoled myself that I had not touched the $3,000 I had originally paid for BRILUND, and I had about $5,000 of my profit from that transaction besides. But, if I continued like this, how much longer would I keep it?

Here is just one page from my profit-and-loss accounting. It tells the whole sad story of defeat in microcosm.

OLD SMOKY GAS & OILS

Bought at 19 cents
Sold at 10 cents

KAYRAND MINES

Bought at 12 cents
Sold at 8 cents

REXSPAR

Bought at 130 cents
Sold at 110 cents

QUEBEC SMELTING & REFINING

Bought at 22 cents
Sold at 14 cents

Obsessed by my carrot-before-the-nose gains, I had not noticed I was losing an average of a hundred dollars a week.

It was my first stock market dilemma. The market had several much more serious dilemmas in store for me in the next six years but this one was in some ways the worst. On my decision at this point depended whether I would continue to operate in the market.

I decided to stay and have another try.

The next problem was what to do. There must be a different way. Could I improve my approach? It had been proved to me that it was wrong to listen to nightclub customers, head-waiters, stage-hands. They were only amateurs like myself and, however confidently they offered their tips, they did not know any more than I did.

I gazed at page after page of my brokerage statements which said: Bought 90 cents, sold 82 . . . Bought 65 cents, sold 48 . . .

Who could help me to discover the secrets of the stock market? I had started to read Canadian financial publications as well as Canadian stock tables. I had begun increasingly to glance at advisory news sheets which gave tips about stocks listed on the Toronto Stock Exchange.

I had already decided that if I were to go on, I would need professional help, so I subscribed to some advisory services which gave financial information. After all, I reasoned, these were the experts. I would follow their professional advice and quit buying stock on the odd tip from a stranger or an amateur stockfancier like myself. If I followed their skilled, sensible teaching, I must succeed.

There were financial advisory services that offered a trial subscription of four copies of their information-sheets for one dollar. You could have these as a goodwill taste before you began seriously to buy their valuable service.

I put down a dozen or so dollars for trial subscriptions and eagerly read the sheets they sent me.

In New York, there are reputable financial services, but the Canadian sheets that I bought were strictly for the sucker trade. How was I to know this? These financial advice sheets delighted and excited me. They made stock market speculation sound so urgent and easy.

They would come out with huge headlines saying:

> "Buy this stock now before it is too late!"
>
> "Buy to the full extent of your resources!"
>
> "If your broker advises you against it, get rid of your broker!"
>
> "This stock will give you a profit of 100% or more!"

This, of course, seemed like real, red-hot information. This was much more authentic than the odd tip picked up in a restaurant.

I read these promotion sheets eagerly. They were always filled with much unselfishness and brotherly love. One of them said:

> "For the first time in the history of Canadian finance the little fellow will have the fantastic opportunity of getting in on the ground floor of a brilliant new development."
>
> "The plutocrats of Wall Street have been trying to acquire all the stock in our company, but in clear defiance of the

> evil traditions we are only interested in the participation of investors of moderate means. People like you. . . ."

But this was me! They understood my position exactly. I was the typical little fellow to be pitied for the way he was pushed around by the Wall Street plutocrats. I should only have been pitied for my stupidity.

I would rush to the telephone to buy the stock they recommended. It invariably went down. I could not understand this but I was not the slightest bit worried. They *must* know what they were talking about. The next stock must go up. It seldom did.

I did not know it but I was already coming up against one of the great pitfalls of the small operator-the almost insoluble problem of *when* to enter the market. These sudden drops immediately after he has invested his money are one of the most mystifying phenomena facing the amateur. It took me years to realize that when these financial tipsters advise the small operator to buy a stock, those professionals who have bought the stock much earlier on inside information are selling.

Simultaneously with the withdrawal of the inside-track money, the small sucker money is coming in. They are not firstest with the mostest, but lastest with the leastest. They are far too late, and their money is always too small to support the stock at its false high point once the professionals are out.

I know this now, but at that time I had no idea why stocks behaved like that. I thought it was just bad luck that they dropped after I bought them. When I look back I know that I was all set at this period to lose everything I had.

When I did invest $100 I almost always lost $20 or $30 at once. But a few stocks did go up and I was comparatively happy.

Even when I had to go to New York I continued to telephone my orders to brokers in Toronto.

I did that because I did not even know you could transact Canadian stock exchange business through a New York broker. The Toronto brokers would telephone tips and I always bought the stock they or the Canadian financial advisory services suggested. Like all small hit-and-miss operators, I put down my losses to bad luck. I knew – I was certain-that one day I would have good luck. I was not wrong all the time – in some ways it would have been better if I had been. Once in a while I made a few dollars. It was always a complete accident.

Here is an example. The Canadian stock tables had become obsessive reading with me. One day when I was looking through them I saw a stock called CALDER BOUSQUET. I still do not know what it was or what the company produces. But it was such a pretty name. I liked the sound of it, so I bought 5,000 shares at 18 cents, for a total of $900.

Then I had to fly to Madrid on a dancing engagement. One month later when I came back I opened the paper and looked for the name. It had gone up to 36 cents. That was double the price I had paid. I sold it – and made $900. It was just blind luck.

It was doubly blind luck because not only had it gone up for no good reason but if I had not been dancing in Spain I would certainly have sold the stock when it rose to 22 cents. I could not get Canadian stock quotations while I was in Spain so I was saved from selling too soon by being in blissful ignorance concerning the stock's movements.

This was a strange, mad period, but it only seems so in retrospect. At that time I felt I was really beginning to be a big-time operator. I was proud of myself because I was working on tips of a more educated nature than my previous head-waiter, dressing-room information. My Canadian brokers called me, my financial services advised me, and if I did get a tip I felt I was getting it from the source. I cultivated more and more the society of prosperous businessmen in cocktail lounges who told me about oil companies which were going to strike it rich. They whispered where there was uranium in Alaska; they confided about sensational developments in Quebec. All these were guaranteed to make a great fortune in the future if you could only get into the stocks now. I did, but they did not make me any money.

By the end of 1953, when I returned to New York, my $11,000 was down to $5,800. Once again I had to reconsider my position. The businessmen's tips did not produce the Eldorado they promised. The advisory services did not provide the information which enables you to make money in the stock market. Their stocks tended much more to go down than up. I could not get quotes for some of my Canadian stocks in the New York newspapers, yet stock quotations fascinated me so much that I began to read the financial columns in papers like *The New York Times*, the *New York Herald Tribune*, and *The Wall Street Journal*. I did not buy any of the stocks that the New York exchanges quoted, but I still remember the impact of the beautiful names of some of the stocks and the appeal of some of the mysterious phrases like "over the counter."

The more I read, the more I became interested in the New York market. I decided to sell all my Canadian stock except for OLD SMOKY GAS & OILS – and I kept this one because the man who gave me the stock in the first place advised me that fantastic developments were expected. As usual, no fantastic developments took place, and after five months in New York I gave up the unequal struggle. I sold my last Canadian stock, which I had bought for 19 cents, for 10 cents. In the meantime I had begun to wonder if the bigger jungle nearer home, the New York Stock Exchange, would not be easier to assail. I called a friend of mine, a New York theatrical agent, Eddie Elkort, and asked him if he knew a New York broker. He gave me the name of a man whom I will call Lou Keller.