An American Hedge Fund

How I Made $2 Million as a Stock Operator

& Created a Hedge Fund

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(***t***) Denotes that the detail chart of this trade can be found at **www.timothysykes.com**

Chapter 6: Once in a Lifetime

This was the play I'd been waiting for. In early 2000, Illinois Superconductor (ISCO, now ISO)(***t***) announced a revolutionary technology that promised to greatly expand the range of cell phone towers. This was back in the early days of cell phones, so fuzzy connections were commonplace and extremely annoying. The description of ISCO's breakthrough product was detailed and scientific, making the company's prospects very attractive. Their stock price quickly surged from the $1 range in January to the low teens by mid-February. Due to the stock's propensity to gap higher, I had played ISCO a few times, but the daily trading volume had always been too low to ever really interest me.

One Friday morning in late February, ISCO issued a press release stating that over the weekend, their revolutionary technology would be featured on a national news program. The stock's trading volume exploded. The press release even managed to get *me* excited. I figured the publicity would be great, even if the product turned out to be a dud. The stock price had already climbed 25% for the day and nearly 100% for the week, but I knew the hype machine would work overtime during the weekend and the stock would be a perfect gap-up candidate for Monday morning.

At this point, I was already living in a dream world, so why not push my luck? I put nearly three-quarters of my net worth at the time into this play, buying 10,000 shares for about $17 each before the market close. It was a bold bet to say the least. If for some

reason the news program dropped the piece or, worse, featured ISCO in a negative light, the stock would surely gap lower and I could lose anywhere from $50,000 to $100,000. It was an educated guess that the story would have a positive spin. The stock price rose into the market close, and I thought about taking risk-free profits of $5,000. Luckily, my greed overpowered my conservatism. My ego wouldn't let me sell for anything less than $20 per share, or $30,000 in profits.

I spent the weekend doing as much research as possible, happily discovering that the message boards were abuzz with anticipation. Everyone seemed to be thinking this company was the next Microsoft, and I knew such thinking would surely draw many buyers for me to sell into on Monday morning. Judging by this play's buzz, I wasn't the only one who'd made a large bet that the stock price would increase in the coming week.

I counted down the hours, minutes and seconds until it was time for the news program to air. When it finally aired, the show hyped ISCO's product perfectly, claiming they would single-handedly revolutionize the cell phone industry. I couldn't contain my enthusiasm. I stormed out of my dorm and ran around the quad screaming like a madman. When it came to trading, everyone already knew I was crazy, so they probably figured I had finally lost a bunch of money. In anticipation of the market open on Monday morning, I didn't sleep a wink Sunday night.

On Monday morning, when the prices began updating to account for the pre-market orders beginning at 8 a.m., I must have clicked my browser's refresh button at least a thousand times. Sure enough, ISCO was moving gradually higher by an average of an eighth of a point every few minutes. By 8:30 a.m., the pre-market stock price was $22

per share and I desperately wanted to sell, but I couldn't. Neither of my online discount brokerages allowed pre-market trading on OTCBB-listed companies. There was no doubt that this would be my biggest score ever. The only question was how fast could I sell my shares and convert my paper gains into real profits? Up until this time, my largest gain on any one trade had been $30,000. At ISCO's $22-per-share pre-market quote, this would be a $50,000 gain, my greatest victory yet. I wanted out quickly, so I called Suretrade to see if I could somehow be allowed to sell my shares before the market open.

While I was put on hold by Suretrade, ISCO's stock price just kept climbing. By 9 a.m., it had hit $24 per share, a potential gain of $70,000 for me. I finally got a Suretrade representative on the phone and hurriedly explained my situation. He was only a junior employee, so he had to check with his superiors to see if there was anything that could be done. Every second that ticked by seemed like an eternity. I sped up the pace of refreshing my quote screen.

By 9:15 a.m., the stock price had risen to $26 per share, and all I wanted to do was get out. I saw a few trades somehow sneak through as the trading volume showed a few hundred shares traded. Oh, how I wished those shares had been mine!

As I expected, my Suretrade representative returned to tell me that I'd have to wait until the market open to sell. Before he even finished his explanation, I angrily hung up the phone and called my other broker, E*Trade. Their representative told me right away that I had no chance at selling during pre-market hours, so I gave up and turned my attention to the still climbing pre-market stock price. I was getting ready to submit sell orders for all my different accounts, but I needed to be sure to enter them after 9:30 a.m. because if they were placed even one second before that time, they'd be rejected as pre-

market orders. I called several people and checked a few websites to verify that my clocks were accurate. I couldn't risk a potential trade rejection, since I'd then be forced to reload all my separate orders, and that would waste at least 30 seconds of perfectly good market action in which to sell my shares.

I timed it perfectly and successfully placed five sell orders within 10 seconds of the market open. The stock price was still climbing at 9:30 a.m. as ISCO was now trading at $27 per share—a $100,000 profit for me. I sat very still in my bathrobe, completely paralyzed, as if any movement might influence how quickly my orders would get filled. I repeatedly refreshed the open order buttons on my two trade platforms, but none of my orders seemed to be executing. The trading volume on ISCO had already surpassed 500,000 shares, but my tiny orders were being ignored.

By 9:37 a.m., the trading volume had surpassed the 1-million-share mark and I still hadn't sold any shares! By 9:40 a.m., I was back on the phone with Suretrade to see why my orders hadn't been executed. Just as a representative picked up, my Suretrade orders got executed. Without explaining, I immediately hung up and began calculating my gains. Suddenly, my E*Trade orders got executed, too.

All told, I sold my 10,000 shares at an average of $29.37 per share, a gain of $123,100. After commissions, my gain was $123,000 on the nose. The slowness of my order executions had actually helped me earn an extra $10,000. If I'd had the patience to wait another 15 minutes, I would've earned another $40,000.

After double-checking my accounts to make sure that I had indeed sold all my shares, I remained paralyzed in my chair for nearly 20 minutes. I repeatedly replayed the

events of the previous few minutes in my head. My daily gain was more money than many well-educated people made in a year, and I was only a college freshman. I'd taken a great risk, and it'd paid off handsomely. I knew I wanted to celebrate that great moment, but the gain had occurred on the one day I had a morning class. The celebration would have to wait.

ISCO continued to climb that Monday and into Tuesday before peaking at $49.45. Their stock price then fell back to $15 that Wednesday and never saw double digits again because the company's revolutionary technology didn't take off. ISCO, now ISO, currently trades at 17¢ per share on the AMEX. Never underestimate the value of hype during a mania.

After this incredible triumph, I went straight to class, but I didn't hear a single word the professor said. I counted down the seconds until class was over so I could return to my dorm and tell everyone about my latest triumph.

I ran as fast as I could to beat my roommate back to the dorm, but he was already there, sitting innocently at his computer. He must've seen the crazy look in my eyes when he nervously asked how much I had made that day. I couldn't pretend that I hadn't made much this time around, so I blurted out, "$123,000!" His eyes became larger than I'd ever thought possible and I told him the whole story.

I decided that I wanted to do something extreme to celebrate this moment. An idea came to me right away. I told him to go round up the entire dorm because I wanted to take everyone out to a lavish dinner in downtown Boston. We eventually scrounged together three dozen or so freshmen who hopped onto a bus to make the journey. We

dined at a fancy restaurant and had a grand ole time. The bill wasn't very high, coming in under $800. After all, other than one flask that somebody had snuck in, there was no alcohol involved, since we were all under 21!

This major trade lifted me to an entirely new plateau of confidence. I was now worth a little under $500,000 and had gained just over $350,000 in less than two months. In early 2000, I was earning approximately $175,000 per month, or almost $6,000 per day or about $250 per hour. If I kept up this pace, I would earn $2.1 million that year. This was all excluding taxes, which I didn't even want to think about. After all, these tremendous short-term trading profits elevated me to the much-dreaded 35% tax bracket, and my being a Connecticut resident added another 4%. Just a few weeks earlier, I'd already taken some money out of my accounts to pay taxes, but my parents now made me withdraw $70,000 more for tax purposes. I was shocked by the speed with which I had made so much money, but it didn't stop me from continuing to trade aggressively. It was during the next few weeks that I would enjoy the single best run of my entire trading career.

Trading during the last week of February and the first two weeks of March 2000 can only be described as surreal. The market's mania went into overdrive and finally reached what would be its pinnacle. This three-week period seemed to fly by as the trades came faster than ever on the greatest trading volume I'd ever seen. One week before, the daily trading volumes on my target stocks had reached only 10 million shares, but now were reaching the 30-, 40- and sometimes even the 50-million-share marks. I could

hardly believe my eyes, but I took advantage of this circus nonetheless. The combination of my newfound wealth, supreme confidence, phenomenal liquidity and the unbelievable volatility in the OTCBB marketplace allowed me to take even larger positions of 20,000 to 30,000 shares, which, as always, I divided among my five accounts.

During this period, I traded more than 70 different plays, almost all of them following the same gap-up strategy. Stock prices now gapped higher by 50¢, 75¢ and sometimes even $1 per share. Multiply those price gains by my average position of 25,000 shares, and you'll be able to understand how I made over $350,000 during those three weeks alone. Yes, that averages out to $116,667 per week, $23,333 per trading day, $3,589 per trading hour or $60 per trading minute! To add to the absurdity of these gains, I didn't even have many losses during this stretch. My greatest trading losses never exceeded a few thousand dollars, while my largest gains cleared $50,000 apiece. The best part of this streak was that the plays didn't warrant much research because these were mostly the same stocks I'd been playing for the previous few months. This was their final run-up during the mania, and each one seemingly wanted to go out with a bang. I was completely in sync with this market environment, and my trading had never been better.

The hype-fueled marketplace peaked in mid-March 2000, and although it made a valiant effort to reach new highs later in the month, the breakout failed and the market's gradual descent began. I cannot pinpoint the exact date on which I stopped making $23,333 per trading day, but as the market declined further, there were far fewer gap-up plays because nobody wanted to risk any potential gap-downs.

After all, these trading opportunities relied on the strength of the overall market for their existence. I'd always bought before the market close and sold near the market open the next day, but now the pattern mutated. Now I couldn't buy at the same time because other traders had already bought in anticipation of the end-of-the-day run-up. Stocks began surging with 10 minutes of trading before the market close, and then a few days later, they would surge with 30 minutes to go. A few days more and I needed to buy as early as one hour before the market close to avoid the inevitable run-up. The pattern's mutation was forcing me to buy earlier to beat the crowd, but the crowd wasn't dumb, so it gradually began buying earlier, too.

By the end of March 2000, we were all buying so early before the market close and selling so quickly at the market open the next day that the best time to take solid gains now was before the market close. The marketplace matured to make holding positions overnight an unprofitable strategy. Stock prices began gapping lower in the mornings because the tremendous number of incoming sell orders outweighed the incoming buy orders. This market inefficiency collapsed under the weight of too many traders playing the same game.

I'm sure the strategy's collapse was due in part to the popularity of my message board, which had now grown to over 9,000 members. I'd already closed my newsletter because too many people were asking me for advice. I stopped checking other boards because nearly every single post was fluff, hype or spam. Since starting to make the big bucks, I'd stopped posting on my own board, but I couldn't help checking in from time to time. The fluff had now overwhelmed my board, too. There was so much money to be

made in this little niche that amateurs of all kinds had become the most active members. Other traders took charge of the board, and, unlike me, they didn't seem to mind the madness surrounding them.

One day, I'd had enough, and in frustration, I deleted the entire group. I would've allowed it to implode on its own, but I didn't want the newer traders to be able to look at the older posts and copy my successful trading strategies. I doubted anybody from the new bunch would even have the brains to do that, but why chance it? Thousands of traders now played this little niche, and their presence overloaded my beloved, consistently profitable gap-up strategy. If I hadn't created the group, would this pattern have lasted another week? Maybe it would've lasted another two weeks? Or maybe even another month? Who knows, but I'd clearly let too many people know about all this easy money. The pattern was so profitable near its end that one extra week would be the equivalent of over $100,000 in profits. The creation of my board inadvertently hurt my chances to make further gains. I learned that if I wanted to make money trading, I was never to never to tell anybody about my trading strategies again.

A trader's ability to adapt to changing market conditions is the key to successful trading. Once I saw my profits fall, I adjusted to the new environment and took smaller positions. I even managed to make a few thousand dollars in the final few days before my strategy imploded. Of course, I lost those profits and more rather quickly when I pushed my luck a little too much at the very end, but overall, I managed to hold onto the vast majority of my gains. By the beginning of April 2000, I had made over $720,000 for the year and there was $840,000 sitting in cash—before taxes—in my five accounts.

As impressive as these figures were, I knew I'd have to hand over a great deal of my newfound wealth to the IRS. My accountant made sure to tell my parents to make me pay my quarterly taxes on time, and I ended up writing a rather large check to the IRS. I was practically in tears as I scribbled out the check that exceeded $300,000, or 40% of all my gains from the previous 15 months. Yes, it had been barely more than a year since I was worth a little over $10,000 and now I had 50 times that amount, even after taxes. Life was sweet, and it was about to get even sweeter as I watched the vast majority of the other nouveau riche lose the greater part of their wealth over the next few months.

While many praised my foresight, they mistook my incredible luck for incredible intelligence. I didn't know the crash was coming. The price action in my target stocks simply didn't offer any trading opportunities, so I was forced to sit on the sidelines. Still, I congratulated myself and began imagining what my life would be like if I could pull in $700,000 annually. I couldn't stop talking about the beauty of my short holding periods, thinking I'd be able to trade profitably in any market environment whatsoever.

Of course, I was in for a rude awakening as the market's fall sapped the potential for any great trading opportunities for the foreseeable future. The volatility and liquidity in the microcap marketplace disappeared almost entirely.

I knew my gap-up strategy was over for the time being, so I began looking for new strategies from which to profit. I looked at commodities, currencies and options, but they all seemed very foreign to me. After a few weeks of research, I concluded I wouldn't be able to compete effectively in those marketplaces. After all, they were home to some of the richest and best-informed speculators on the planet, who frequently indulged in

great leverage. Considering the competition, I didn't see any way I could make the kind of consistent trading profits to which I'd become accustomed. I preferred playing in a smaller, more inefficient arena, so I returned to searching through my favorite OTCBB-listed companies for new patterns and opportunities.

Regrettably, there were no longer any plays that seemed the least bit interesting in the niche I loved so dearly. The trading volume had dried up with amazing speed, so I wouldn't even be able to trade with any size if anything interesting did eventually materialize. The volatility in this marketplace now seemed to pertain exclusively to the downside, especially since many articles were now published that detailed so-called pump-and-dump schemes.

I'd heard about pump-and-dumps before, but I'd never really looked into them in detail. Now that I had a good deal of time on my hands, I decided to do some digging. What I discovered shocked me to my core.

Apparently, the majority of the OTCBB-listed companies I played had been involved in several variations of manipulative schemes. I knew the business fundamentals on many of my target stocks had been less than stellar, especially since the Federal Bureau of Investigation had raided the offices of several of my plays, but I had no idea as to the extent of the price manipulation that went on behind the scenes. Financial publications and SEC filings enlightened me as to the incredible dealings of these manipulators, and I devoured each article in astonishment.

Stock promoters, marketing firms and sometimes company executives themselves received, owned or bought hundreds of thousands and sometimes millions of shares of

these tiny companies and then, using all sorts of methods, proceeded to pump their stock prices higher. These newly published articles detailed how pumpers used message board posts, press releases, e-mail and fax spam and boiler rooms to promote the stocks in which they had positions. They'd send out tens of thousands and sometimes even hundreds of thousands of e-mails, faxes and direct mailings to unsuspecting people, billing the stocks in which they had positions as incredible investment opportunities. The SEC had gone after several promoters who exaggerated or lied in their claims; one of them was just a teenager like me. He'd posted thousands of messages on various message boards by using dozens of fake aliases, convincing others to buy his stocks through spirited debates among his many different profiles. As impressive as his scheme was, I couldn't help feel somewhat proud of myself for never having crossed that line. For once, my inherent scrappiness was subdued by pride. Such tactics helped pull off the manipulation schemes of these stock promoters, but *boiler rooms* enjoyed the greatest success.

Boiler rooms were shady brokerage houses that existed solely to pump the owners' stocks. The "brokers" at these boiler rooms often earned incredible commissions, cold-calling people from all walks of life in the hopes of convincing them to buy the stocks they were promoting. They frequently called people who had little industry knowledge but big dreams of making money in the stock market. It wasn't very difficult to convince people to buy shares in their stocks because the boiler rooms knew that people wanted to participate in the market's rise even if it meant risking their financial

security. So, the boiler rooms would offer people “sure things,” claiming that their picks involved little to no risk.

Brokers frequently called their targets around dinnertime to have the greatest chances of finding somebody at home to take their phone call. If the brokers were successful in their pitches and the targets wanted to buy the stock immediately, a buy order would be placed before the market open the next day. Hence, the pileup of pre-market orders and nearly the entire reason for the gap-up plays that had made so much money for me. While I’m sure that many people were still skeptical after they first received a boiler room phone call, some eventually consented because they must’ve seen the stocks mentioned consistently increasing in price. The boiler rooms would keep calling back every few days to say “I told you so” until the target was persuaded to want to buy the stock. It was like taking candy from a baby as the boiler rooms preyed upon the greed of so many unfortunate investors.

The boiler rooms’ target stocks were manipulated higher because the success of their operation depended on sucking in new customers daily. It was usually only a few weeks after customers had bought the stock that the rug was pulled out from under them. Once the boiler rooms stopped promoting their target stock, the demand and subsequently the stock price collapsed. After all, boiler rooms needed to manipulate a stock only until they could liquidate their position before moving on to their next play and prey. It was a vicious cycle as the stocks they promoted surged from a few cents to many dollars per share before eventually falling back down again. The boiler rooms’ customers were left holding the bag, losing most of what they invested nearly every time. Apparently, my

perfectly uptrending stocks were perfect for a reason; they were being manipulated to appear that way.

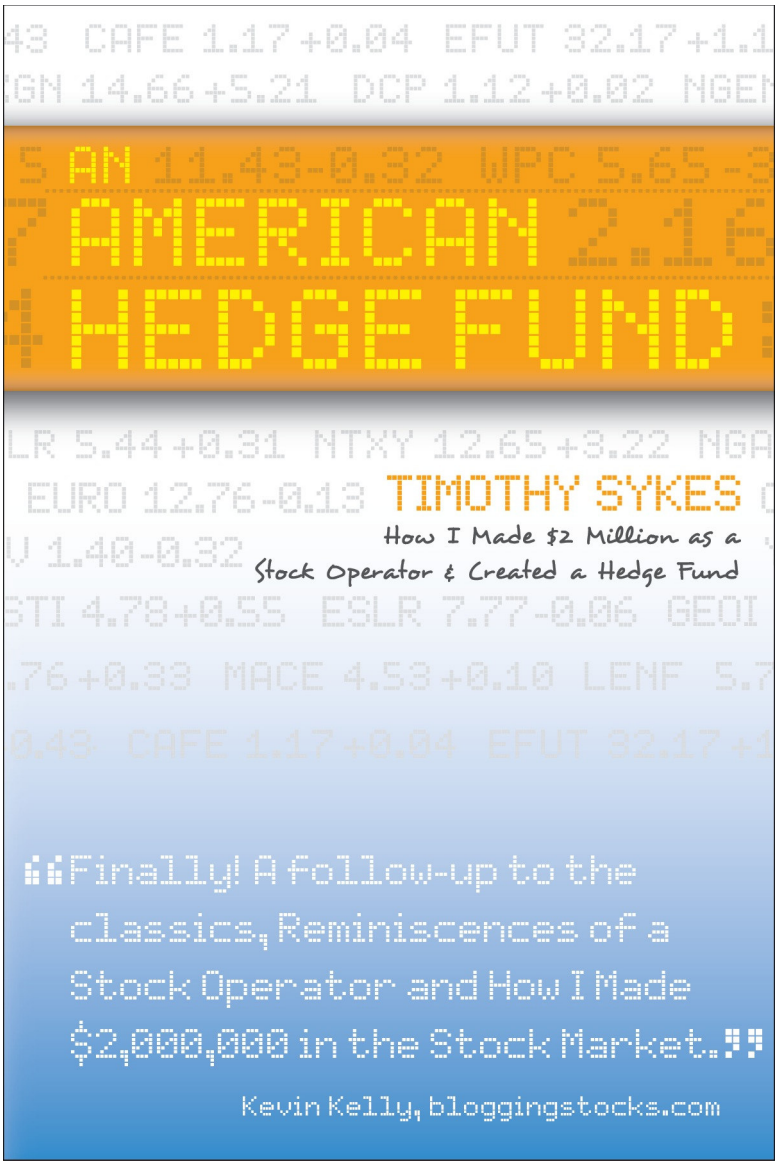
After reading through all the sordid details, I was in shock. I'd known about stock manipulation, but I hadn't imagined its being indirectly responsible for my incredible gains. I could live with promoters, hype-filled press releases and message board fluff because they were all easy to spot, but boiler rooms represented an entirely different level of manipulation. Their presence was nearly impossible to track. There simply wasn't any way to tell who was doing all the buying unless I'd known somebody working for the boiler rooms themselves. This brought me back to the many sleepless nights I'd spent wondering who was behind all the mysterious buying power of my target stocks. I now had my answer and it wasn't pretty.

Since many of the boiler rooms were linked to organized crime, did my newfound wealth place me on an organized crime watch list? Was I now on the SEC's watch list? I hadn't been in cahoots with the nefarious side of the marketplace, but could I prove my innocence in a court of law? Would anybody believe I could make all that money based on my pattern recognition abilities alone? I suddenly grew concerned.

After a few days, my fears subsided and reason kicked in. I was simply a speculator who took advantage of price patterns. Boiler rooms were just one example of the many catalysts that created patterns in the stock market. Inevitably, other catalysts would emerge and I could profit from their influence, too. As long as there was enough volatility and liquidity in the marketplace, I'd be golden. Unfortunately, once the bubble burst, those two variables disappeared altogether and there didn't appear to be any other

opportunities for easy gains for the time being. I was almost sad to see these criminals get busted. I felt bad for the boiler rooms' many victims, but the victims' losses were their own fault: a direct result of greed, ignorance and laziness.

Now I knew it was time for me to leave this marketplace and seek opportunities elsewhere. I sadly closed down three of my five online discount brokerage accounts and said good-bye to the niche that had given me so much.



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