

Talks with a trading legend

Andrew: Hi there, and welcome to the Better Trader Academy podcast. I'm your host, Andrew Swanscott, and today we're joined by trading legend, Mr. Bob Pardo. Welcome, Bob. How are you?

Bob: I'm great. How about you, Andrew?

Andrew: Yeah. I'm doing really well. Now, it's really great to have you here. I'm excited for what we're going to talk about today. But first, I just want to start off by sharing that the last time we did a recording, I don't recall if it was for a podcast or for part of your course, you had a dog barking in the background. Your dog got pretty excited at the time. Must have really enjoyed what we were talking about, but I don't hear the dog today. Is the dog doing okay?

Bob: He's doing really well. We got him a summer cut for the hot weather, and when we first got him, as you know, he was a rescue, and he was highly reactive with other male dogs. It turns out he's a ladies' man. He loves any female dog. But in terms of bigger males, he can get a little hysterical, so we've been working with him for over a year. We got a guy called Your Dog's Guru who's actually a great dog whisperer, and he taught me how to actually get that under control, and he now is peacefully coexisting with our two neighbors who have new large male dogs, so I'm very pleased with that 'cause he's calmer now, and he barks a lot less.

Andrew: Yeah. Well, that's a good thing. It sounds like you've got it under control now, so we'll see if he keeps behaving himself through our chat today.

Bob: Hopefully.

Andrew: Yeah. So, I just wanted to start today by talking about some of your achievements because over your, I think, almost 40-year career now, you've achieved so much personally and for your fund, Pardo Capital, so I just want to mention a few here so that people know what we're talking about. Now, I know you're a very humble man, so I hope this doesn't embarrass you too much, but I just want to share a few of the

facts that really impressed upon me. So, you had a program called XT99, and BarclayHedge placed this XT99 program in the top four CTA money managers over 10 years with a 900-plus return, which is not too shabby. And then in 2008 you were crowned Futures Magazine's Trader of the Year, which is pretty cool, an amazing 143% return. And you also placed number two in the top 20 CTA list according to Barclay Managed Funds.

Bob: Yes.

Andrew: Now, people will also know you as the inventor of Walk Forward Analysis. Now, I don't know how we can even measure the impact that that has had on the trading community, but I think it's probably fair to say it's been used, perhaps, by thousands of traders around the world. Back in the day, you were a pioneer with algorithmic trading, testing with software, you published a book, Evaluation and Optimization of Trading Strategies, you're a consultant for Goldman Sachs. I mean, there's so much more I could highlight there, but I don't want to embarrass you too much.

Bob: Thanks.

Andrew: But you've had a pretty incredible career in the industry so far. Has there been any particular achievement or highlight that really stands out to you that really makes you the most proud?

Bob: Well, you know, I'm actually proud of a lot of that stuff, but I think, like we were talking before, I realized... This may sound strange to a lot of people nowadays, but when I first started doing software, you had to actually convince somebody that this trading strategy could actually make money, if it was actually mechanical. They used to call it mechanical trading systems in those days, and you wouldn't believe the arguments... Let's call them debates. We would have some awfully heated debates about this, and no matter what I showed people, they would say, "I don't believe it." So, the fact that now the pendulum has swung the opposite way, namely people think that you can't make money unless you have an algorithm. I'm actually pretty pleased about that.

And I guess the thing, one of the things about that that I also like is that it actually... I know a lot of people who bought my software, and who bought the book, and so forth really... Some people actually did

the work, and some people got the rewards, and so I am also pleased that I was actually able to bring software that was powerful to the small investor, 'cause that used to be the domain of the institutions, so we kind of broke that glass ceiling, and I'm pleased for that.

But I guess, above all things, and this may strike you as being odd, but I guess the fact that having been successful at this in a very, shall we say, difficult atmosphere that finance actually is, and trading, and how competitive it is, I'm glad that I didn't get soured by it, and I'm glad that it didn't dampen my spirit, and I'm glad that it actually wound up being actually a great spur to my personal development. So, I guess I'm glad that in the end I was able to do what I did with trading, and with software, and so forth but retain myself and retain my integrity.

Andrew: Yeah. It's funny that you've... Well, not funny. But you've done consulting for a wide range of clients, so you've done a lot of work in the institutional world, and also, you've worked with retail traders, so you've got a wide spread of the spectrum there. What do you see in the institutional world that perhaps you don't see so much in retail traders?

Bob: Well, I think there's a lot of things that is different in the institutional world versus the retail trader, the one of which is, you know, especially... People on the floor used to always talk about having their edge, and boy did they ever have an edge. But they talked about having their edge, and I remember I had a client who was a floor trader, who had worked a strategy for some length of time, and he really... It stopped working, and he would refer to it, he says, "I lost my edge," and he actually didn't let me help as much as I probably could have 'cause he wasn't really a consulting client. He was more like a software client. And he really fell into hard times.

But the thing about the institutions is, they know they have an edge, they're always looking for new edges, and they always work their edge very, very hard, and frequently, like with the prop trading firms and market makers, the edge is an edge that only money can buy 'cause the data connections are very expensive, the computers, you have to be as fast as possible. It's all very expensive, and so they really, they utilize their money in the most efficient ways possible to get the fastest trading method possible so they can actually keep their edge. And one of the other things that I've seen them do is that, you

know, when the European markets first came into the futures arena back in the '90s, I had a trader friend/client who basically started trading all this stuff, and I said, "Why do you trade this stuff?" He said, "Because it's very inefficient."

And what that really meant, what I saw when I started building strategies to test some of these markets, was that they really traded great. They traded really well technically. So, one of the things they also, one of the things they do, is they keep on pursuing their edge in terms of being able to find markets that are inefficient. They also pursue the edge in terms of being able to get into markets the ordinary trader can't get into. I mean, like, Bridgewater traded these enormous... They trade spreads on things that would not be really accessible except for somebody who has a lot of money.

So, I guess the point is, they tend to really use their money to their advantage doing things that the average person can't. But I think, also, in the end, the one thing... I still think a lot of people, you know, when they first get involved with trading, they think that they know, they hear stories, they read the Market Wizard books, they know that people may have made buckets full of money trading, but they think, "Wouldn't that be great?" and they go at it, but maybe they really don't believe they can really do it. And oftentimes what they really don't do is they really are not prepared. You know, the... Trust me, the institutions know their risk to the penny, and I mean to the penny, and they're always...

Now, granted, all institutions are not equal, and I'm not going to make them sound like they're all infallible 'cause, boy, that's not the truth, but the thing is, the good ones, really, they're very, very well prepared, and they really know how to behave under all kinds of scenarios. And I think one thing they also do that the average individual doesn't do is... I mean, I know one of the prop trading firms that I deal with got very heavy into crypto, and I was really surprised because the owner is really a real... You call him a... kind of like a progressive, more traditional kind of guy. But, I mean, they were into it in every way. They were making markets there, they were trading it, they were mining, they were doing everything, and I think they made a bundle. So, that's my point. I mean, the crypto, whether or not it's here in five years, in 20 years, and in a hundred years, who knows?

There's a lot of things you can say about that, but the money that he made in the meantime spends, so...

So, those are kind of the big things that I see, the big differences, but I think maybe the most important one is, they know it works, they know how to make money, and they just pursue their edge relentlessly.

Andrew: Yeah. I think there's a lot of insights you just shared about the institutional world that retail traders can kind of apply to their own trading. Now, you shared an interesting story with me, just before we started recording this chat, about a client that you've been working with recently. Do you mind sharing a little bit of that with the audience?

Bob: Sure. No, I... A guy approached me and said he thought he had a curve-fitting problem, and this is a very sophisticated, very industrious, very hard-working, very honest, and very, very nice man, and actually very sophisticated in artificial intelligence. And it turns out he did have a curve-fitting problem, and he had a curve fitting problem because you can so easily curve-fit something in TradeStation with the generic search algorithms, and because of the way it works, you really can't... If you run through 75,000 combinations in 10 dimensions, it's pretty hard to get a feel what that really looks like. So, I basically had to sort it all out for him, and I modified the strategy and improved it, and then I designed a rational approach to optimization because he has... Well, he made a lot of the beginner mistakes, but he's a quick study, so I know he's going to figure it out very quickly after I explained it all to him.

Andrew: Yeah. I think that's a good point you make there is that even sophisticated people can get caught up in curve-fitting, sometimes, and not even realize it, so... It can be a very fine line at times that we tread as traders when we're building strategies not to over-fit things.

Bob: For sure. Let me add... There's something else. I came across a paper about a month ago that really stunned me, because what it really said was that most people in the finance industry actually do over-fit their strategies, and one reason why a lot of them fail is because they have over-fit strategies and they don't know, and that's because you have a situation... It's a subtle point. It's something that, with the way I do things, it would never really... It wouldn't happen to us because by

accident I've actually built into our processes the way not to do that and have that problem. But, I mean, people can run 50,000 combinations and get a hundred of them that look good, and they think, "Okay, I got something." And apparently, it's done. Apparently, people do it.

I had a guy tell me, who actually works with a lot of CTAs, he said, "You wouldn't believe the stuff I see come across my desk." I mean, people who just basically did an optimization, and they just don't have any way of knowing whether or not that thing is actually sound or not. So, I mean, it's surprising to me 'cause I tell some people a few things how to avoid that in the book, and of course the course really goes through this painfully carefully. 'Cause I always say to people, it's very hard to fool yourself with a walk forward analysis, but you can still, so we built in more mechanisms that we talk about in the course that even minimize the possibility of fooling yourself with even in that little possible incident of walk forward analysis.

Andrew: Yeah. One of the quotes that you said that always sticks with me... I don't remember the exact wording, but it was something like, you can even have a successful or a profitable walk forward purely by chance.

Bob: Yes.

Andrew: Which I thought is very interesting.

Bob: Scary, isn't it?

Andrew: It is scary, yeah. And in the course, you do go around, you do share a technique or techniques you can use to kind of get around that. But, just firstly, the book. Now, your book, Evaluation and Optimization of Trading Strategies is kind of a little bit like the bible of systematic trading. It was originally published in the early '90s, 1990s, I think.

Bob: Yes.

Andrew: And then revised in 2008. Now, that's a good 10 years ago. How have your trading insights changed since the book has been released?

Bob: Well, you know, a lot has changed since then, not the least of which is the fact that people are building higher frequency strategies now that trade thousands of times, so that's a big factor, and learning how to deal with that is a consideration. The fact that these markets have become increasingly more efficient and therefore tougher to trade... I

mean, ironically, it turns out that, you know, we have four stock indices in our portfolio, and the S&P used to walk on water for us, and we still do very well with it, but it's ironic to me that all the other stock indices do better than the S&P. And it's not an accident that that's the case because the S&P is probably the most heavily-traded stock index to begin with, and secondly and more significantly, it's very... it's used in hedging.

So, as the markets become tougher... And markets become tougher when they become more efficient, and they become more efficient when you have more and more very smart people trading them. So, as these markets become more efficient, you don't have to be a genius to be able to make money at them, but you do have to be good, and that really means that you really have to, more than anything else... And I remember Larry Hite said this once years and years ago, he said, "I don't care if you give me a strategy that's more profitable... that's less profitable than another one, as long as it's robust." And in the end, that's what really matters. You need to have a strategy which is robust, and you need to have ... I personally believe you really need to have as many strategies as possible 'cause even good strategies will actually, they'll have bad patches.

Now, if you're trading high-frequency, those bad patches can be very, very brief, but if you're trading at the pace most people trade, with daily bars and so forth, the bad patches can last for a while. So, I think it's just important to really... The markets are becoming tougher, and they're not going to get easier. They're just going to get tougher, so being able to be sure that you can actually create uncorrelated strategies is very, very important. Being able to be sure that you actually have a strategy which is actually robust is very, very important. Having a strategy, you know when it's time to put it on ice for a while, that's extremely important. And these are some of the things that we... These are a lot of the nuances that we really dealt with, we really deal with in detail in the course. That's not in the book, and it's never going to be in a book.

Andrew:

Yeah. So, I should just clarify, we've mentioned the course a few times. Perhaps people aren't aware that you've built a course called the [Building Robust Strategies Masterclass](#) which is really, it takes people from start to end on how to build robust strategies, and they get to see your process and all the new insights that you've gained

over the years, and they also get to see over your shoulders. You built some strategies and look at what you're looking for, and those kind of things. It's a really valuable course. One of the main objections we get from people is that they think that they can learn everything from your book. Now, not to discount your book. It's a very good book, but as you mentioned, it was published 10 years ago, and things change. I kind of look at it like the book is the entrée and the course is the main meal, right, so what do you say to people who have this type of opinion or attitude that they can learn everything from the book?

Bob:

Well, I... think that the first thing is that there's a lot of stuff in the course that's not in the book and is not going to be in the book. I also point out that some of the material... I certainly point out the things that are really important when you're going through this process, and this is something, you know, that kind of hands-on touch, that I think is really invaluable. But in the end, it really kind of comes down to, I mean, there are some people who could just read a book, swallow a book, know it backwards and forwards, and start practicing it just like that. I mean, in my experience, I don't think there's that many of them that would... there are that many of them.

I know some people have read the book, you know, 10 times, and implemented it, and really studied it very carefully, but the question is, how fast do you want to get to where you want to go? Read the book, and if you're very intelligent, and you're very diligent, and you're very thorough and meticulous, you can probably piece together a lot of things that would be very valuable, don't get me wrong, but in the end, you're never really going to know exactly how it is that it's done because I don't really tell people exactly how it is that it's done in the book.

And there's also the issue that there are a lot of little nuances and a lot of little techniques that aren't in the book that are very valuable and get you there a lot quicker, so the question is, you want to read the book four times over, maybe, a month or two, or three, and then try to start figuring it out, or do you want to look at the course and study it closely for a week or two, then start putting the stuff into practice immediately? You know, if you can afford the course, I don't think you can afford to not... If you really want to trade algorithmically, unless you know everything that's in the course, I

don't think anybody can really afford to not study it. You have to know how the process is done.

So, I think that's kind of... It's a much... It's more thorough. It gives a lot of the nuances that are not given in the book. There's information that's in the course that's not in the book. And it's much easier to assimilate the information. That's probably... I mean, there's a lot of pictures, a lot of graphics, a lot of summaries, a lot of the slides and so forth are very salient, so you just get there a lot faster, and you get there with... you know, in fact, that it's what I do, 'cause I'm telling you what it is that I do, so I think those are probably, like, the... And I think that those are kind of like the big points, I think. Make sense?

Andrew: Yeah, yeah. I think that that speed thing is a really good point. How fast do you want to get to where you want to go? I mean, you've been in the industry for nearly 40 years, maybe over 40 years now. You know, you've spent a lot of time working this stuff out, so from my point of view, I'm like, yeah, I want to piggyback off your 40 years of experience and accelerate my own growth.

Bob: You know, I think it's foolish to me... What I've always made a practice of in my life is I've always tried to find the guy who was best at what it was that he did, and then figure out what it was that he did, and then see if I could then go from there. 'Cause anybody can beat a guy who's the... the guy who's just the average not-so-good-at-it. Well, what's the big deal about that? But if you find the best guy and learn what he's doing, that's what I've always actually done in my life.

Andrew: Yeah. So, I know that you're an avid reader because you've mentioned some really great books to me in the past, and speaking of working with you, you seem to always be looking to improve yourself and your trading even though you've reached such a high level of success, and you also just mentioned then that you like to seek out the best people at what they do. So, this whole improvement thing seems to be a really big factor in your success. Other than the points you've already mentioned, what else do you do to try and improve yourself and your trading?

Bob: Well, to some extent, one of the things that I've found, and it's not true in all cases, but one of the things that I have found is, if you are very centered, and very calm, and very relaxed, and very focused, you'll trade better, you'll do your research better, everything you do

will be more efficient. So, with me there's always been, personal growth has always been a lifelong pursuit for me. And one of the things about personal growth is, if you actually grow... Sometimes you don't. But if you actually grow, you're going to see things differently when you come out on the other side. So, to some extent, as you grow, you're always... I mean, I just always see...

You know, I'm not a young man anymore, but I just think, like, I can't ever imagine retiring because it would be boring. 'Cause there's too many things to do, and there's too many things... I'm looking at a lot of this stuff with fresh eyes frequently, and with fresh eyes, you see things you wouldn't see with tired eyes, so that's part of it, and I constantly see the fact that... I kind of know any better than some people do just exactly how good some of the best institutions actually are, and I also know from my own experience that the results that I've achieved in performance are really pretty good. But people have this idea that there's some upper limit to how much money you can make in the markets, and I don't think... It's like saying... Nobody really knows what the upper limit is, so the point is, I personally feel that if I'm making...

Renaissance is averaging about 25, 26% annualized rate of return with a pretty low drawdown, but I know from looking at it, I know that there's so many ways that could be improved. I just don't ever stop trying to... 'Cause from my point of view, you know, I pioneered this number called Perfect Profit, which is the money you would make if you bought every valley at its price... at the valley price, and you sold every peak at its price, and the amount of money that's in the five-year period for the S&P contract on 30-minute bars are something like, you know, \$15 million. It's just ridiculous amounts of money. So, I don't... Seeing what is possible, what's there, you multiply that by how many stacks, how many markets... I mean, why is it impossible to make 100% a day? I don't know. I wouldn't say it. It sounds pretty outrageous. I don't know that it's possible 'cause I know I'm not doing it now, but I also don't think that you should think it's not possible. Because with all the markets that exist, and all the opportunities, and all the timeframes, the markets are giving you the possibility of making thousands of percent a day. You just tap into the flow, that's all.

Andrew: Yeah.

Bob: So, I look at this... To me it's like a puzzle, and I just don't... I'm just kind of relentless. I just never quit, and it's too interesting, so I'm always looking for ways to improve simply because I know what has been achieved so far is great, and I'm happy for it, but I know there's much, much more is possible.

Andrew: Yeah. That's quite inspirational. Yeah. That was great. Thanks, Bob. Now, I just want to ask one more question before we start finishing up. I'm kind of stealing this question from a show I saw on TV a little while ago. I thought, that's pretty cool. So, the question is, if you could go back in time to Bob the trader in the early years and give him one piece of advice, what would it be?

Bob: Believe.

Andrew: Believe?

Bob: Believe. Believe when you have something, believe in yourself, believe in your ability to do these things, believe in what the numbers tell you, do your work very, very hard, and believe, and just really go with it, and run with it. A lot of people started trading in the '70s when it was actually, compared to how it is now, god, it was like picking fish out of a barrel. It was actually pretty easy like that in the '80s also. So, a lot of people made buckets of, made lots and lots of money in the '70s, and the '80s, and the '90s. The floor guys who were making money on the floor, when the floor evaporated, the good ones became prop trading firms, so I think it's just a matter that you just... If you've got something really, really great, run with it, and don't ever look back.

Andrew: Yup. Great advice. Thanks, Bob. So, if people want to learn more from you, obviously we've mentioned the course, if people want to find out more details about that, they can go to buildingrobuststrategiesmasterclass.com. We'll also have a link for that on the show notes page if you're not in a place where you can get to that website now. As we mentioned, the course there's so much more than in the book. You get to watch over Bob's shoulder as he builds some strategies, and also, we do quarterly coaching calls, so if you joined us in the [Masterclass](#), you get access to, or the opportunity to ask Bob your own personal trading questions in those quarterly coaching calls, which is invaluable.

And I think it's really interesting to see, as you go through the course, to see, Bob, how you're thinking and what you're looking at, and you also share some tips and techniques that aren't covered in the book as well, which we've kind of already talked about before. And then also, another opportunity for people is, you do private consulting, right? Do you want to share a little bit about that?

Bob: Yeah. I mean, I basically, when I take on a consulting project for somebody, I can do anything... Almost anything that we do for our stuff I can do for somebody else's stuff, and since I've kind of done it all, at the risk of sounding immodest, it's kind of like a real smorgasbord of what could be done, so I could help somebody learn how to build a strategy, we can code off somebody's strategy for them, we can improve their strategy, we can design a strategy for them, just about anything you might imagine. Now, I have people, very sophisticated people, who do very, very well, saying, "I know what it is that I know. I don't know what it is you know, and what I don't know scares me."

So, people oftentimes want to just kind of have somebody who's very expert tell them, "Yes, you're doing the best you can. You can't do any better than you're doing." And then say, "But maybe I can help you do a little bit better." So, it's pretty much, if somebody has a particular need, I'll just deal with that. It can be very open-ended. I'm working with a guy now who I'm just going to... Basically, he wants to learn how to build strategies the way I do, and build them, so I'm going to kind of make him into a... I told him I would show him how to do all that stuff, so we're going to go from beginning to end through that process, so it's very open-ended. It's client-driven.

Andrew: Yeah. Sure. I'll have a link for that on the show notes page as well, so if people are interested in some private consulting with Bob, that'll be easy to find. Just head on over to the show notes page there. Alright, Bob, well, thanks a lot for chatting today. It really was great talking to you, and you shared a lot of valuable insights. Thanks for that.

Bob: My pleasure. It's always enjoyable when we have these conversations, Andrew. I think we spur each other.

Andrew: Yeah. And I'm sure a lot of people are going to get value off what you've shared today as well, so thanks again, and I wish you all the best.

Bob: Take care. Thanks. You, too. Bye.

Andrew: Thanks.