“If a trading strategy is so great, why sell it on Collective2? Why not just trade it yourself and make a zillion dollars?”

I’m presented with this question a lot.

Actually, “presented” isn’t quite the right word.

The question is not usually “presented” to me.

It is *flung* -- the same way dog feces are flung at the old guy’s house the night before Halloween.

When a *friend* asks the question -- or even a family member, god forbid -- her face has *that look* -- the one a high-school debater wears when she is about to deliver a *coup de grâce* to a hapless foe.

I suppose in this age of Twitter wars and angry Facebook rants, I shouldn’t be surprised when a stranger comes up to me at party and basically suggests I’m a fraud, or that my life’s work is a scam.

But I’m not; and it’s not; and here is why.

“The poor man’s hedge fund”

First, some background. Collective2 is the website I started 17 years ago. Think of it as a “poor man’s hedge fund.” (Actually, not so poor; many of the investors who use the site are wealthy and sophisticated by most people’s standards.)

The idea of the site is simple. If you are a good trader, you submit your trades in real time to Collective2 (or simply connect your broker account to us). Then other people can “follow” your trades in *their* brokerage accounts. Through the magic of software, the trades happen automatically. Followers pay you a flat monthly fee to follow your trades in their accounts.

Collective2 presents the performance, in real-time, of thousands of these trading strategies.[1]

In other words, Collective2 is a marketplace where trading talent can be bought or sold. Collective2 acts as a trusted third-party which verifies the performance data of strategies on its platform.

“Why would a good trader offer his strategy on Collective2?”

That’s the question, isn’t it?

If you create a good trading strategy, why let other people use it for a modest amount of money each month (typically, strategy creators ask for between $100 and $200 per month), rather than keeping it all to yourself?

Actually, there are several reasons.

Leverage and risk

First, let me point out the obvious. If you’re going to be snarky and accusatory about Collective2, you might as well set your sights a bit higher.

The same question can be asked of virtually **the entire financial industry**. Why do top-tier hedge funds accept investor money? If the guys at Two Sigma are so smart (and they *are*), why don’t they just trade their own money from an unmarked building in Soho? Why go through the hassle of raising capital from investors?

Or more broadly, why have mutual funds? Why run a bond fund? If Bill Gross is such a genius (and he *is*), why does he bother accepting investor money, and suffering the indignity of

[1] We label these results as “hypothetical” because (among other reasons) there is no single broker account that looks exactly like the results posted on our site. Even if a trading strategy is followed by live investors in real-life broker accounts, or is driven by the strategy manager’s own live broker account, everyone following a strategy can have different results, based on factors such as individual broker used (we work with many), when investors start or stop trading, how large or small they make their trades, whether they use stop losses, etc. And, finally, in many cases, strategies on Collective2 are not followed by real life broker accounts at all -- this is particularly true for newer strategies that have not yet gained subscribers -- and so results presented in these cases are based purely on simulated real-time prices, and these simulations have many inherent limitations. So, you know, *caveat emptor*.

annoying questions, or unfortunate P.R.? Why not trade his own private capital from his house in Laguna Beach, and when people ask him what he does for a living, he can just say, "I'm a beach bum. I don't do anything."

The answer is: *leverage* (people want more of it) and *risk* (people want less of it).

Even Masters of the Universe don't have *infinite* cash sitting around. After all, many Hedge Fund Titans live in New York City: there are co-ops to buy, kids to private-school, restaurants to patronize. If you are a managing director at a top-tier hedge fund, and you have a million dollars in the bank, ready to invest, which would you prefer: to earn 20% on your money? Or 30%?

Letting other people invest alongside you, and making money *on their money*, is a form of leverage. (For those not fluent in finance: leverage means using borrowed money to make more money.) Leverage isn't always a good thing, of course (you can lose more, too) -- but if you have high confidence in your trading ability, using leverage can be a wise decision.

So it can be too in the world of Collective2. No one offering a strategy on C2 is a Hedge Fund Titan -- not yet, anyway -- and so we're not talking about the same orders of magnitude. But listen, if you are a competent trader, and you have $100,000 sitting in your brokerage account, ready to trade, which would you prefer: to earn 20% on your money? Or 30%?

The mechanism through which leverage is achieved is different on Collective2: no one is allowed to collect "management fees" or "performance fees"; that is not permitted under U.S. regulations. Rather, your customers subscribe to your trading information, and pay a flat monthly fee to receive your buy/sell signals, win or lose.

But the effect is the same. Imagine you are a good trader, and you think that, *without* Collective2, you can earn 20% each year on your $200,000 trading nest egg. Now imagine that putting your strategy on Collective2 lets you earn an extra $5,000 each month in subscription fees from your followers. That's the equivalent of another 30% on your capital. Sure, there's no guarantee you will earn that, but if you build a good track record on Collective2, you can earn that much, and more. (As I write this, a popular strategy strategy developer on C2 is earning more than $15,000 each month from subscriber fees.)

So, just like a Hedge Fund Titan -- or just like a mutual fund manager -- you can gain “leverage” on your own dollars by opening your strategy to the public.

Reducing Risk

Allowing outside investors to trade alongside you, and pay you a fee, also reduces your risk. Let’s be honest about that. A typical hedge fund charges “2-and-20” -- which means they charge an investor a fee of 2% of the money invested with them, plus 20% of the investor’s profits. That 2% is charged no matter what -- whether the fund wins or loses. It’s called a “management fee,” and in theory it’s meant to cover fixed expenses that happen every month at a hedge fund, no matter what: you know, rent, administrative assistants, legal and accounting, blow.

But money is fungible, and what you pay with one set of dollars is something you don’t have to pay with another set of dollars. One way to think of that 2% management fee is as a risk-reduction cushion. If trading doesn’t work so well in one month, you still get your 2%. When you’re managing a billion dollars, that’s a nice chunk of change.

Now, listen, if you stink up the place six months in a row, most investors will flee and take their 2% management fee with them. But you’ll get a bit of leeway -- more so if you have a long and distinguished track record behind you. That leeway reduces your risk. That’s what you gain by offering your strategy to other people, instead of just trading it alone.

And again, the same incentives that exist in the hedge-fund world exist on Collective2. You sell your strategy for, say, $150 dollars each month. Get 20 subscribers, and that’s gross revenue of $3,000 each month, which comes in regardless of whether you win or lose in any given month. Just as in the hedge-fund world, your subscribers won’t stick around if you lose money, month after month. (And just as in the hedge fund world, you’ll be given a longer leash if your track record is more substantial.)

So, in addition to increasing leverage, putting your trading strategy on Collective2 reduces your personal risk by some small, but non-trivial, amount.

Building your career

So far, I've discussed the *financial* reasons why a legitimate, talented trading-strategy creator would put his or her trading strategy on Collective2. But there's another reason, which is not related to money, but, rather, to career development.

Finance is a hard industry to break into. We've all read about the glamorous life of hedge fund managers, but how exactly does one go about getting a job at a hedge fund? You don't fill out an application online, and - truthfully - unless you go to a top five American university, you won't see the face of a recruiter at your annual career fair.

I've already written about how stupid hedge-fund hiring practices are. But indignation won't change the world. The fact is, it's ridiculously hard to get a job at a hedge fund, and in finance in general, and probably always will be.

But there's one thing "finance people" respect, and that's money. Prove you can make it for them, and it doesn't matter one bit whether you went to Harvard or Pomona State. Money talks.

Collective2 lets you build a public, verifiable track record. It's out there, for everyone to see. Remember: on Collective2, your can't claim in March that you *woulda, coulda, shoulda* bought Apple stock back in January. You have to make your buy or sell calls at the time they occur. Collective2 will publish your results. No matter what. Your track record is your track record.

Running a public track record, with other people's money at stake, is a different beast that sitting alone in your room, wanking your own tiny brokerage account. The pressure makes some people crack. I've seen it happen at Collective2: a strategy manager is trading well, starts acquiring his first few paying subscribers, and then… he loses his mind. He just can't take the pressure of having to perform *publicly*.

On the other hand, some people love performing in public -- whether the performance is musical, or written… or financial.

So that's the non-pecuniary reason that you can find good trading strategies on Collective2. Some people share their strategies with the public for reasons *other* than money: they are building their career, buffing their resume, trying to break into the business.

For all these reasons, there is always a possibility of finding a good trading strategy on Collective2. Nothing is guaranteed, of course. You can lose money as well as win. But if you're looking for an alternative to the same old same old, come on over.