Volume I Issue X

Fade-Self… One Trader's Commentary

Strategy 30 September 2005

"Art is a Fad"
- Anonymous

Art, like trading, is a perception of value. There is no more appropriate answer with regards to the value of a market or a piece of artwork- than the last traded price. You can never be right or wrong about your decision to buy either a painting or a market- you can simply be less liquid.

Trading is the translation of the abstract into the intelligible. Quite a feat. Imagine watching Jackson Pollock frantically whisping his paint hither and thither- and you're job is to predict where his next gyration lands. The best you would likely be able to do is use a few simple rules to quickly ESTIMATE the probabilities of where the paint might land. Perhaps the quadrant he's standing in, the location of the paint can, and the least painted quadrant of the canvas. This is just an example- but imagine how silly it would be to add to these three variables- the time of day, what he had for breakfast, and the amount of rainfall for the month to date in upstate New York state. Now obviously I'm exaggerating a bit- but the bottom line is that there are THOUSANDS of technical and fundamental indicators that COULD show from time to time some predictive capability. But you must decide how much of this is happenstance and how much has direct relevance to the trader. Don't try to keep improving a system because it doesn't give you the results you're looking for every time- because like Pollack, markets have no absolute certainty before there is absolute certainty. You can't be sure where the paint will land until it hits the canvas.

So, in trading, keep it simple. Because at the end of the day- trading and art are about perception- not perfection.

Equities- "Melancholy and Mystery of the Street"

Melancholy and Mystery of a Street – Giorgio de Chirico 1914

A mysterious pall has fallen over the stock market. Well, not so much a pall as much as a cloud of smoke over a refinery. The stock market has paused its recent ascent and is waiting with bated breath to go higher. There really isn't much of a trend here. However, I would like to make a BOLD prediction. Please recall the last time I made a bold prediction for the equities on July 14th I wrote, "I'm looking for S&P 1250, Dow 10900, Nas 1650, and Russell 710 by Halloween. Please, write those figures down, as well as my phone number- and if they don't make it by then call me and chastise me for my brazenness." Well, the S&P and Nas made it. The Russell moved as high as 691 and the Dow was the laggard missing my objective by 190 points. We could still make it all the way back up, but I think a pullback is a creeping probability.

I think we will see a solid pullback in the S&P to 1170 in the next month. That would be 60 points- which is worth $15,000 on one contract. There is no guarantees in trading- but it's likely that in the next few weeks the bears will be back and Goldilocks will be looking for a new condo.

Treasuries- "The Persistence of Memory"

The Persistence of Memory- Salvador Dali 1931

Ahh, the persistence of memory. In trading- sometimes the market will take your perspective and drub it in the short term. Let's say that two years ago you got short the bonds- with the idea being that interest rates are bound to go higher. It was quite a logical premise for a trade. Well, in the short term the market probably moved against you. If you had the capital to sustain the move you rode it and stuck to your guns. Beyond that, if you thought bonds were a good short at 105.00- they were the trade of the century at 110.00- so you added to your position. You may have even done the same thing at 115.00. By this time you'd be behind in the game to such an extent that now you'd be betting on rates skyrocketing just to make back your initial losses. It's also probably likely that you finally threw in the towel when the bonds hit 123.00 about a year ago- writing off the experience to irration. However, that is THE one job of the markets- to shake out weak hands. The more concrete and fundamental the perspective- the harder the market is going to make it for you to make money off of that idea. Meaning- short bonds? Better have deep pockets. The more popular the artist- the more money it takes to acquire. Want to own a Picasso. Better have deep pockets.

The reason I bring this up is because I think its just about time to short bonds. I'm short the short end of the curve – and in the next week or two I think bond rates will begin creeping higher.   Following is a chart of the Dec. Ten-Year Note- I'm selling it. I think you'll see 110.00 soon and over the next 3 months you'll see 102.00. Each point is $1000. Each tick is $31.25.

Metals- “Bird in Space”


Bird in Space- Constantin Brancusi 1928

This is what the gold chart looks like the last two weeks. That’s the type of market you want to be on the right side of. I’m excited about gold right now for the first time in more than a year (exclamation point.) Reiteration is a useful motivational tool- this is what is wrote two weeks ago- “Bullish gold. I’m not a gold bug, per say. Nor am I going to be calling you pitching $600 December Gold calls for $100 bucks a piece (w/ a $70 Commission per call.) That’s what California and Florida brokerage houses are for (But that’s another rant completely.) But I am bullish gold- last trade in the December contract was $453.20- your risk here would be back to $436.80. Your reward could be new 18-Year highs- above $490 before New Year’s (!)”

Now, if you read the newsletter regularly you know that I’ve been telling hold off on gold and silver for the good part of the last year. There just haven’t been the proper risk/reward profiles. Throughout the summer I’ve been advising clients to wait for the trade with the best risk/reward. Risk is these terms is not only capital risk- but something that I call anomaly risk. This is a function of time in the market- over the life of a trader the longer he’s in the market in unhedged positions- the more risk he has of being involved in an anomaly move- a move that exposes the trader to losses much greater than anticipated. Think 9/11 or Black Friday- or for metals traders the two times in the last two years when silver sold off 80 cents in one day.

The high of the move since that newsletter (until today) was $476.30 which occurred on September 22nd. That’s a $23/oz move in gold in one week. That’s $2300 worth of reward in just 5 trading days. This is an important aspect of trading that even many CTA’s lose sight of. You shouldn’t be in any market all the time. Because the largest positions in any market have to move in and out sometimes- this creates waves- in both directions.

The key is to strike when the market is going to give you the most bang for your risk/reward buck. To put this trade in perspective consider how long it took 22 trading days to get from $425.00 to $450.00. 4 times the trading duration- 4 times the anomaly risk. Remember, futures is less about reward and more about risk control. Following is a chart for December gold.

Energies "Snake Charming"

The Snake Charmer- Henri Rousseau 1907

No matter what supply and demand might suggest momentarily for the energy markets- they continue steadfastly. I'd say there is now an 85% chance we will see $72 Crude before the end of November. Natural Gas could hit $20- that would be a 400% increase in just over 1 year. Now how are you going to tell me that commodities aren't hot? Hey, this isn't the wild west anymore- futures contracts are the future of investing. What am I saying- futures are the present of investing- did you know that 15% of Harvard University's 17 billion dollar endowment fund has been allocated to managed futures. Yes, futures are risky- but that tells you something about the asset as investment tool when in the right hands- don't you think?

Currencies- "Autumn Rhythm"

Autumn Rhythm- Jackson Pollock 1950

For you premium sellers out there I recommended on July 27th that you *"Try selling 124 Calls and 118 Puts in the October Euro- you could take in approximately $1600 per spread."* That spread is currently worth a total of 11 ticks- that's $136. It's time to take profits- with just 9 days to go before October option expiration. I also think its take to take a shot at being short the Dec. British Pound and Euro. I'm short from 177.49 in the Pound (+$912) and 121.00 in the Euro (+$450.) I also sold November 120 Puts in the Euro against the position and took in 101 ticks ($1262.50.) In the currencies we're also long the Canadian from 82.11.

We've been in that trade for nearly 2 months. Long term trend following and covered option writing is in my opinion the best way to trade futures in a manner that can provide significantly above average returns in a manner that keeps returns very smooth. The key to managing money is to grow it a manner that lulls the client to sleep. Because when you don't have to think about an investment- you feel better about the results. Less stress = more reward. Wouldn't you agree. Gains should come in a manner that isn't too exciting. If you want excitement- go to Vegas. If you want an investment that you can feel confident in- trade our strategies.

Fade-Self (fād-sĕlf') ***verb.***
1. In trading- to take objective conscious action that is directly in opposition to the trader's gut instinct.