Volume I Issue XII

Fade-Self… One Trader's Commentary

Strategy ***13 October 2005***

"Destination: Profitability"

"Before he sets out, the traveler must possess fixed interests and facilities to be served by travel."
- George Santayana

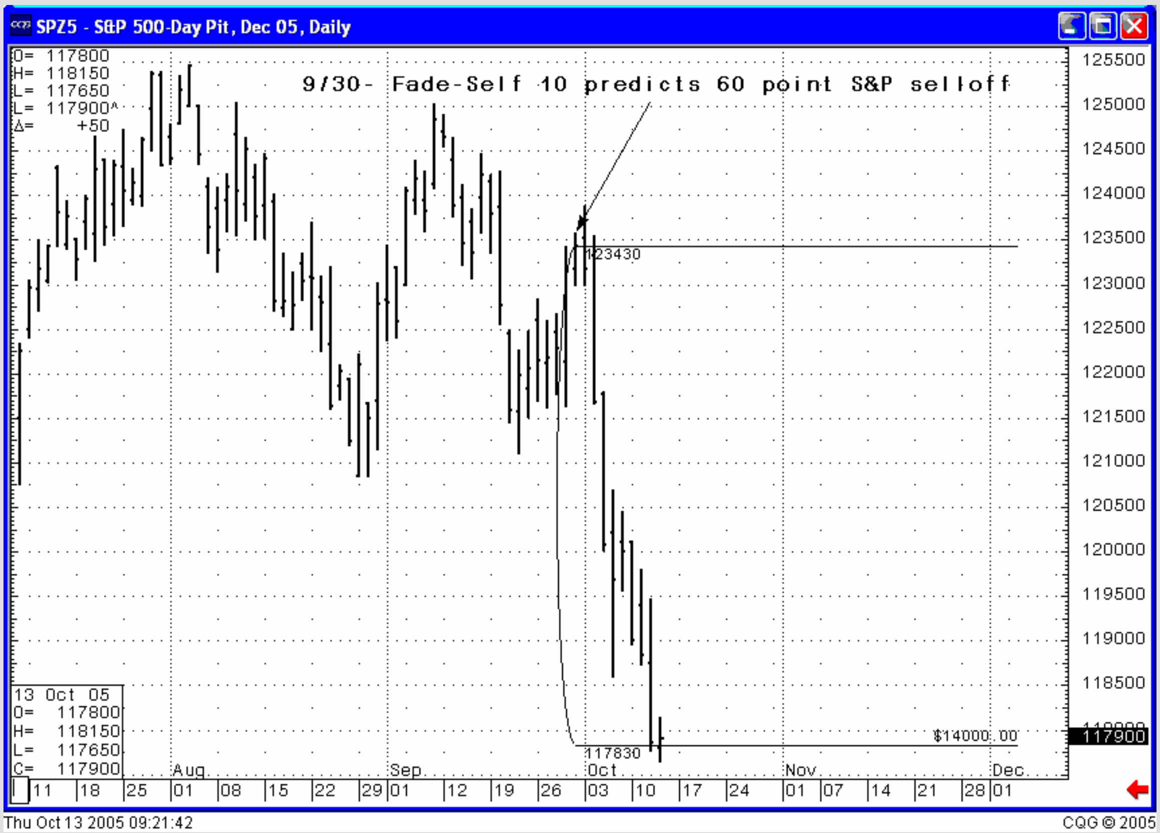
"Two roads diverged in a wood, and I – I took the one less traveled by, and that has made all the difference." *- Robert Frost*

It's the time of year in Chicago when we bid adieux to the three months its worth living here and embrace the nine months its worth working here. It's rainy, sloppy, and gloomy today as I look out over the city from my view at the Board of Trade in this lovely metropolis. It's the kind of day that makes you want to just pack up and take a week somewhere more exotic and luxurious than the windy city. As I think of traveling, I can directly relate it at its most fundamental level (That is leaving your predictable, comfortable environment in favor of the unknown and risky) – to trading. The first quote, by Santayana, illustrates the idea that a trader must have a system or gameplan before he hitches up his britches and makes his way into the market. The second speaks more to the design of the system itself- and for me personally speaks to the idea that is even more fundamental- that is that in trading when you separate yourself from the crowd you have a better chance of reaching your ultimate destination- profitability.

Make no mistake- every time you get into a new trade- its like you're in a foreign country all by yourself (and you're wearing your wallet on your sleeve.) The only defense you have is preparation. The market allows you to design your own itinerary that includes direction, duration, and contingent decisions. You can choose the which general direction you plan trading the market, for how long you'll be on the path, and what to do if things go wrong. The only question is- how well will you arm yourself before entering the fray. It's my opinion that most people just freak out when they are exposed to risk and react with an undue amount of emotion- honestly they're better off staying at the hotel. And most do! I think it makes much more sense to spend you're time doing your homework- trying to find a good tour guide- who knows the language, culture and intricacies of the market you intend to visit. As usual, I volunteer myself for the task.

Equities- "Aspen Extreme"

Speaking of slopes! (Exclamation indicates excitement) Speaking of slopes- have you seen today's S&P 500 chart? (not to mention the Nasty Nas) I hate to say it- but have you looked at your mutual fund returns? Stop throwing away those statements- I implore you to open up the envelope and consider seriously whether you should open your mind up to an investment that has a chance to outperform (especially if the stock market is likely to underperform for the next few years.) This should instill a sense of urgency to consider your alternatives. If that doesn't- the following chart of the S&P 500 should.



Again I think it's important to reiterate my current position- as I voiced so vehemently just 14 days ago when I wrote- "I think we will see a solid pullback in the S&P to 1170 in the next month. That would be 60 points." At that point that was a pretty bold prediction, before the day is done it could be a forgone conclusion- the last trade as of this writing (1:25 CST 10/12/05) was 1178. And falling….Remember that prediction for a dreary October…

Might be a good time to look into tickets to Aspen- 12 inches of fresh powder yesterday…You could spend the 52 points you should have made in the last two weeks in the S&P ($13,000 on 1 S&P contract.)

Treasuries- "Shanghai Surprise"

Does anyone in the T-Bond boat have a sinking feeling? Like there's nobody bailing the water out? Like maybe the Chinese aren't picking up U.S. debt to the same extent that they have been the last few years? Well, they haven't been- they've been buying GOLD! See- the Asian central banks started buying bonds three/four years ago for the same reason a credit card company is in business, because eventually consumptive people extend themselves beyond their means. What happens to a consumer when they spend beyond what they earn? They rack up bills, and interest, and more bills, and more interest. And the credit card company racks up a whole lot of leverage. The scenario has two endings- one the consumer works hard, improves their lot in life and makes enough money to pay back their debts, or two – well bankruptcy. Do you see the parallels? The U.S. is the consumer with infinite wants and finite means- China is the credit card company loaning the money. So, either the U.S. spends its way out of the Nasdaq bubble burst (and the Chinese make a killing on their currency exposure as the dollar rebounds) or we have a prolonged economic downturn (read DE-flation- 90's Japan?) on our hands and the Chinese have a significantly relevant economic advantage.

I've written in the last two issues that you should be short December 10-Year notes. As a long term trade- I think the short side is the correct one. If you're long- at least sell 112 March 06 calls on the position to cushion yourself. If we do get any type of rally- I'd look to exit your longs. Rates will go higher very quickly- they may not stay there- but watch out in the short term.

Metals- "Buenos Aires- Good Air, Rare Air"

The metals are certainly at historically rare levels. Gold recently made new 18-year highs and silver isn't far behind. Last week I urged you to buy silver at $7.59. I said there was a 90% chance it would hit $8.03 in the next 6 weeks. Well, three days later it hit $7.955 and although its pulled back to $7.79- you're still up 20 cents. Each cent is worth $50. Now, one idea I mentioned earlier was that a good trader takes the road less traveled. The trading equivalent of this is to buy when everyone is saying "its too high" or "I've missed the move." That's when the market is going to REALLY accelerate because it's the markets job to draw in the weak hands at the highs and to knock them out on the lows. What follows is the evolution of a poor trade-

1. Market is in consolidation – "It's going to break out so I'll buy it now."
2. Market continues to consolidate "It's going to break out so I'll buy more."
3. Market moves lower in a range "It's really cheap here- I'll average in more."
4. Market plummets very quickly "It's still going higher but I'm on margin call because I've got three contracts instead of the one that I should have."
5. Market rallies very quickly "Damnit- its my brokers fault for giving me a margin call at the bottom of the move."
6. Market breaks out to the upside "Damnit- the market is making the move I KNEW was coming- but I can't buy all the way up here when I sold out all the way down there!"
7. Market moves even higher "It's made its move- I'll just have to wait for it to come back (or worse- I'm so smart I'm going to SELL the market here to make my money back.)

8. Market accelerates much higher "#!*!%@!!*"
9. Market makes new contract highs "Ugh, I can't take it anymore- I was right about this move and I've lost money- I HAVE TO BUY HERE!"
10. Market pulls back and the consolidates "Here we go again- somehow this feels like #1 on that "Evolution of a Poor Trade" list that Fade-Self guy wrote."

Get the point? I hope not. I hope you never have to go through that. It ain't pretty. But that's the reality for the majority of amateur traders. Don't try this at home.

Energies- "The World- Dubai"

Have you heard of "The World" in Dubai, U.A.E.? It's currently under construction and consists of between 250 to 300 smaller private artificial islands divided into four categories - private homes, estate homes, dream resorts, and community islands. The man-made islands are set out to look like a map of the world. Talk about a fascinating destination. Talk about an expensive destination. The hovel of this island is going for about $10 Million USD. A certain valuable commodity probably paid for more than a few of those posh estates. I'm not saying my investment advice is going to get you a second home. But last week I did say, "Crude will also be taking a bit of a breather in the next week- as we will likely pullback to at least $60.50. That would be another $2500 per contract. I think that will present another solid buying opportunity." The low on Monday was $60.35 and the last trade today was $64.15. Hey, I'm not making this stuff up. If you've gotten this far- I encourage you to check back issues to make sure. Because as entertaining as it is to READ about winning trades- I assure its much more satisfying to actually make money. Here is a 60 minute chart for Nov. Crude.

Currencies- "Hong Kong"

No matter what currency you've got in your pocket- this is the most expensive city in the world. Having said that - it may behoove you to be carrying dollars for the next few weeks. These are my current open positions in the currencies- (Short Euro from 121.00 with a Nov. 120 put written, Short Yen from 88.65 and 88.02 with a Nov 88.50 put written, Short Pound from 177.49 with a Nov.175 put written, and actually long the Canadian from 82.00 with a Nov. 85 call written.) November currency options expire the first Friday in November. Right now all of the options positions are at least half a point in the money (except the Euro)- which means that simply by owning the position I'm making between $22 and $35 dollars per option per day for the next three weeks. 23 Days x $29 x 5 options = $3,335. That's 3.3% per 100K over the next month if the dollar simply stays where it's at or strengthens.

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