

Fade-Self... One Trader's Commentary

Strategy

20 July 2005

“Buy The Rumor, Buy The News, Buy The Conjecture”

***“I pray you bear me henceforth from the noise and rumour of the field,
where I may think the remnant of my thoughts in peace”***

-William Shakespeare

Charts sometimes fool the chartist into thinking that there is resistance at the top of the screen and support at the bottom of the screen. The screen acts as a psychological floor and ceiling to the viewer. So, to deal with this fact I would suggest that any trader imagines that they are trading a market that can be viewed six screens up and six screens down- above and below the actual trading screen. Markets actually tend to accelerate in velocity when they are making new contract highs and lows- this fact is only magnified by leverage.

Equities- A Midsummer Nights Rally

I expect this rally to be much like Shakespeare's best comedy- lighthearted and carefree.. As I am writing this Intel earnings are coming out and the Nas is tumbling. I don't care. News is for the masses. The trend is very strong in the S&P, Russ, and especially the Nas right now. The stronger the trend- the more virulent the washouts. But hey, if you're trading 2 contracts with a 100K account- then even a 50 point pullback in the Nas is only a 2% drop in the account. That's like buying Microsoft at \$50 and having it pullback to \$49. No big deal.

I think you could see the Nas pullback as low as 1567.00 in the next week, the S&P to 1215, the Dow to 10550, and the Russ to 660.00. I would sell puts or buy contracts if we hit these levels. Why buy stocks? I'd rather not come up with some fundamental mumbo-jumbo that will be true for a day and then false for a day and then true again. Why a market moves is a question of perspective and focus. Obviously the same jobs number two months apart can cause two different market reactions. Even when you take into consideration the market's expectation of the statistic- there is still the possibility (in my opinion probability) that exceeding expectations can result in a rally one month and a sell off the next. (Ex. A strong number in an economic environment that is perceived as being weak is good news, whereas a strong number in an environment that is inflationary is bad news. So why bother???) Just bet on the American consumer, BUY!

Treasuries- At a Pace That is Likely to be....Measure for Measure

Shakespeare's greatest conundrum was his play Measure for Measure. It dealt with issues of justice versus mercy and many of its themes are still widely debated today. I think that in the future Greenspan will likely be measured by the conundrum that is his pace in removing policy accommodation. On the 20th Greenspan will be making his last testimony to congress. As we begin to consider who his replacement might be, we must also consider what that individual is inheriting. Are significantly higher rates really just around the corner? I think not. Are we really at risk of the Asian central banks dumping our bonds? Not a chance. Will the relationship between the Fed and the market be markedly different? Bet on it. I expect continued weakness in the bonds and notes. I would expect to see a 35 basis point retracement in March Eurodollars at some point in the next month or so. That could mean a monster rally in the bonds. However, my number on the downside is still 113 and change in the Sep. 30-Year.

Another hot topic right now is real estate. It seems that everyone I know in Chicago is a real estate broker now. The greater fool hypothesis is certainly being put to the test. That might be a good new bubble gauge- not the price of the asset- but the number of brokers flocking in to sell the asset. Sort of a derivative market. You make an analysis of who these brokers are, what their expectations and backgrounds are, and most importantly- what they're giving up to jump into the real estate fray. Just an idea. As for a real estate bubble- I give it two years. From what I can tell- there is still probably 3 or 4 greater fools out there. So, at 6 months per fool- an intelligent buyer has little to worry about till 2007. Buy, buy, buy.

Metals- Much Ado About Nothing

Copper just keeps grinding higher- I'd continue to be long and to consider writing calls 5 cents out of the money in the front month- which is now September. I think we are likely to see a pullback to \$1.48 or so in the next month, but mark my word Copper will trade above \$1.75 this year. From here that would be a \$60,000 move on 10 contracts. Gold and Silver on the other hand- I don't have much interest. Nor do many of the hedge funds right now. The upside on Silver is 725 and Gold could move as high as 430. I'd be inclined to sell these rallies or to sell calls at those levels. They will both be much lower in the next month. Sometimes the possible reward just isn't worth the inherent risk. That's how I feel about Gold and Silver right now.

Energies- The Crude Merchant of Venice Tells All

I know, I know, if you would have shorted crude last week- you'd be up \$4000 on one contract. Well, I still say- DON'T SHORT CRUDE. I like Crude- call me "The Crude Merchant of the North Loop." I'd wait to get long again until we see some strength, but I just don't have any interest in getting short. Leave the short profits to the gamblers and the floor traders.

I've been trading a lot of natural gas the last few months. Mostly selling strangles and trading delta neutral around the position. Its unbelievable how much time decay there is in these options with 35-45 days to expiry. Today I sold September \$7.00 calls and \$8.00 puts with 38 days until expiration- and I took in \$3850 per spread. The last trade today in the Sep. natural was \$7.54. So, there is zero intrinsic value in the spread, the delta is about zero- but you make \$100 per day (including weekends and holidays) just to hold the position. On one spread you're looking at 3% per month on 100K. There is risk. Let me reiterate THERE IS A LOT OF RISK!! However, on a 100K account if you just did one spread (looking for 3% per month) natural gas would have to go from \$7.50 to \$5.50 or to \$9.50 for you to lose 20% of the account. So, that's like buying MSFT at \$50 and having it go to \$40 before ditching it. Don't get me wrong- it's not a limited risk play- but if you know what you're doing (Or know someone who does (author points to self)) it is manageable risk.

Execution is really the key to trading energies. They are so extremely volatile that you must have a reliable platform or broker. Just for your edification- and I apologize to those of you who know the business- but let me explain how your order actually gets done at most big brokerage houses.

- 1. You decide to buy September Crude at \$58.05.**
- 2. You either call your broker or place the trade online (10 seconds)**
- 3. If you call your broker- he/she either calls the energy desk in NY
Or he/she places the trade online (5-15 seconds)**
- 4. If the broker calls the floor they place the order with a desk clerk
Or if the trade is placed online a ticket prints up at the trading desk
(5 seconds)**
- 5. Once the broker places the trade with the clerk or the clerk tears off the
Ticket- the order is then run into the pit to the filling broker by the runner
(15 seconds)**
- 6. When the filling broker finally receives the ticket they execute the order
with another filling broker or a local trader (a trader who trades for their
own account) (10 seconds)**

7. Now that your ticket is filled some time will pass before the filling broker hands the filled ticket off to the runner. (10-60 seconds- as much as 5 min)
8. The runner runs the ticket back to the trading desk. (15 seconds)
9. The ticket is then punched into the computer or the broker is called with the fill. (30 seconds to 15 minutes depending on how many tickets)

So, from the time you decide to place your trade to when you receive your fill you can expect between 1 minute 40 seconds and 21 minutes elapse depending on how busy the market is. Now, if you only trade 1 contract at a time and you only trade once in a while- this probably isn't a big issue. However, if you are looking to trade 10, 20, or 50 contracts a day- you simply cannot afford that type of unpredictable environment.

There is an alternative. If you work through my trading desk and you're willing to put up 100K there is a way to cut the whole operation down to 30 seconds. I can just give you the phone number to the floor. Better than that- I can give you the phone number of a guy with a headset that stands back to back with one of our filling brokers. So, you decide to trade- you call the floor- you tell the broker your order and you hear it filled. 30 seconds- max. Anyone who has traded through a big retail brokerage house before has been forced to wait 15 minutes for your fill- and it cost you money. The alternative is out there and it's the way institutional traders trade, but if you're willing to step it up a little bit I can get you to that level of efficiency.

Currencies- As You Like Them

Dollar bulls and dollar bears will both be equally rewarded in the next few months of currency trade- I think. You'll see fierce rallies- followed by fierce declines. The best thing to do would be to sell strangles- just as I explained earlier in the natural gas. This strategy would be most applicable to the Euro, Swiss, and Aussie. The Yen is the weakest of the major currencies. The Canadian and the Peso are the strongest. In the next weak look for more dollar weakness than dollar strength. The Canadian should near 83.00 and the Euro is likely to exceed 123.50. Rallies however will be short lived- so take what you can get or use it as an opportunity to sell calls in the Euro and Swiss. The bottom line is – bet on volatility.

Fade-Self (fād-sēlf) *verb*.

1. In trading- to take objective conscious action that is directly in opposition to the trader's gut instinct.

Past performance is not necessarily indicative of future results. The risk of loss exists in futures trading. The information in the enclosed Report (the "information") is not an advertisement for any security or investment and should not be interpreted as such. The information is not intended for use by citizens of the USA or legal entities registered in the USA. Nothing contained in the information is or should be interpreted as being intended for an undetermined audience.

The report is based on information which is deemed reliable, however FCStone makes no representation that this information is accurate or comprehensive and it should not be relied upon as such.