

Fade-Self... One Trader's Commentary

Strategy

27 July 2005

“To Trade or Not to Trade (or go to Vegas)”

“Humor is the only test of gravity, and gravity of humor; for a subject which will not bear raillery is suspicious, and a jest which will not bear serious examination is false wit..” – Aristotle

You know what has really been on my mind lately...Trading- and what a joke it is. For 98% of people trading IS gambling. Not because of the tool itself- but because of the way the gambler uses the tool. Is a poker table sitting unused in a rec room gambling? No, it's just a table. It has many other practical uses. When the GAMBLER sits down to it- only then can gambling take place. The reason I bring up this point is because for most retail futures traders it would make more sense for them to take their investment dollars and plan a trip to Vegas. If you're serious about making money- find a professional. Just think about it....Six days, seven nights at the Wynn's new place (\$3000) A few luxurious dinners; perhaps Le Cirque or Renoir (\$1000). Check out a show (\$200). Play some hold 'em (\$2000), craps (\$1000), and bet on some games or races (\$2000)...And if you're flying stylishly (\$1000). Ok, so all in you're looking at about \$10,000- for a week you'll never forget (better make it 15- after all it IS Vegas.) Trust me, call your travel agent and schedule it. Because, unless you really know what you're doing- you'll lose that next year trading futures.

Why would I tell you to do this? It's simple- if you lose the money in Vegas it's a glorious tale you tell your buddies. If you lose it in the market- it's a prohibitive story you tell everyone you know whenever the subject of commodities comes up. It makes futures, the investment tool, look bad. It makes me look bad for trading them. So, take the vacation and leave the gambling in Vegas. If you want to trade futures- call me.

Equities- The Indices and the Odyssey

Two issues ago I said, “**I’m looking for S&P 1250, Dow 10900, Nas 1650, and Russell 710 by Halloween.**” That’s still where I’m at- we’re chugging along. I’ve sold some near the money calls against my positions to take some synthetic profit- as I often do when I expect to be in a trade for a long time. Specifically, I’ve sold September 1250 Calls for 11.50 a piece. The delta on my overall position is still ~.70. The last trade in the indices are 1239.00, 10646, 1619.00, and 675.20. So, we’re grinding along- which is bullish- but the market is likely to pull back considerably in the next week or so. By “considerably” I mean ~2%. Likely to do most of it in just a day or so.

It’s not a terribly exciting environment for stocks. If we were climbing a wall of worry- at least we’d have the worry to worry about. Instead, we’ve got a stable low-inflation environment with a seemingly accommodating Fed for more than the near future. I’d be aggressively buying dips this week.

Treasuries- The World is not Flat- But the Yield Curve Is

It is my hypothesis that if you walked along the yield curve as far as you could- eventually you would fall off the end of it. I might be wrong. Heck, maybe its round (or inverted). Philosophers have always had a hard time with this sort of thing. Did you know that the Eurodollar market (3-Month Interest rate- not the currency) is currently pricing in three 25 basis point rate hikes by the Fed by December.....after that 50 basis points from December this year and December 2009. Sounds pretty boring. Well, deflation is boring. It’s got nowhere near the personality its cousin’s inflation or stagflation.

However, in trading where there is certainty there is opportunity. There is bound to be an inflationary scare at some point between now and then. Markets tend to exaggerate. I can recall three times in the last two years when the nearby Eurodollar contracts have moved 25 basis points in 15 minutes. That’s only \$625 per contract, but on a contract whose margin is \$945 that’s roughly equivalent to a \$3.18 move in Crude relative to its margin. This could easily occur if the Fed raised rates by 50 basis points at once. An anomaly CPI number or jobs number could also trigger a cascade downward in the futures (upward in rates.) The thing I like the most about the Eurodollar trade is the trend- its been slowly grinding lower (rates higher) for the past few months. The flatness of the overall curve (2 year to 10 year) suggests however that inflation in not a worry. The certainty shown in the 2-10 spread doesn’t jive with the trend in the Eurodollars- that’s where the opportunity is. Another more simplified (and fixed risk) way to take advantage of this type of scenario would be to buy Eurodollar puts with December 2006 expiration. So, you could profit if rates go up- or if the market perceives them going up.

Metals-The Bronze Age

Well, how about the copper age. And it's a long one. I've been long copper now for what seems like months. Its been grinding slowly higher day by day- making new 5 year highs yesterday at \$1.66. I don't see any reason for it to stop- I'm selling 170 September calls against the position just for good measure. I would prepare for a pullback to 157.00 in the September contract in the next week or two.

Prices have been supported by three main factors. Labor unrest in Arizona and Texas at ASARCO plants has added to worries that copper production won't meet Chinese demand. Strikes in Zambia and Chile have also factored into the higher prices.

For the gold and silver bugs out there- please be patient. We could still see \$400 before we see \$450. Last trade in August Gold was \$425.50. I think we are still in for an inflationary scare at some point in the next three months- but it probably won't happen before Labor Day. I'd be liquidating any long positions above 435.30.

Silver really doesn't interest me either. I'd be taking short positions if September silver hits 7.30. You could sell calls, buy puts, or perhaps sell futures with a stop above 742. I don't sell on strength- and I'd prefer that you wouldn't either.

I would expect Silver to outpace gold because of its industrial uses, but both should be rangebound for the rest of the summer. So again, be patient. Sometimes the best trade is no trade.

Energies- Bullish Crude Since the Age of Antiquity

It's still not time to get short energies. When they do finally move- you'll likely see crude pullback at least \$10- probably to the \$52.00 level in the next month. Last weeks supply numbers all reinforced the idea that there is plenty of energy out there. Be it natural gas or crude distillates- there is plenty of energy. The problem is getting that energy to where is most needed. That's what is causing consistently higher prices. I don't think there is a trade here either. If we breakout above \$62 or below \$55- then I'd consider taking a position. Until then- there is no need to subject yourself to the \$2500 trading ranges. As an aside- don't try to daytrade Crude. Its traded in the pit and the NYMEX guys are really cutthroat- you can depend on losing 10 to 30 cents in slippage. If you're daytrading you're probably looking to make 60 or 70 cents per trade. So, you're going to end up losing between 15-40% of you're trade the locals. Don't even bother. Either position trade or trade the electronic mini-crude contract. Its half the value- and there is no slippage. It should gain even more popularity in the next year. Oh, and did I mention its 60% cheaper to trade. Just a thought.

Currencies- No Clever Title

The Chinese 2% revaluation upwards of the Yuan has interrupted the dollars ascent. I'm not interested in taking long positions in any of the major currencies besides the Peso- which has been on a steady ascent for the last 6 months. The Fed recently reasserted a hawkish stance on interest rates- which implies dollar strength. I think there will be more dollar related trades in a few weeks. Until then I think you could sell premium in the Euro or Swiss with good success. Try selling 124 Calls and 118 Puts in the October Euro- you could take in approximately \$1600 per spread.

The order of strength against the dollar goes: Peso, Canadian, Swiss, Euro, Pound, and Yen. So, the best trade would be to Buy Peso, Sell Yen.

Fade-Self (fād-sɛlf) *verb*.

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

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