Volume I Issue VI

Fade-Self… One Trader's Commentary

Strategy **18 August 2005**

"Like Clockwork"

"You sit at the board and suddenly your heart leaps. Your hand trembles to pick up the piece and move it. But what chess teaches you is that you must sit there calmly and think about whether it's really a good idea and whether there are other, better ideas." – Stanley Kubrick

Trading ain't chess. A lot of traders liken one to the other, but trading ain't chess. Lets examine the brilliant Mr. Kubrick's quote and relate it to trading. First, when you sit in front of the screen if your heart leaps- you've already failed. Trading shouldn't be exciting- because where there is excitement there is emotion. If trading causes you to feel positive or negative emotions it means that you personally have something at stake (besides your capital)- mainly your human ego. Ego is the main cause of trading losses. Next, your hand trembles. Nervous? About what? Risk most likely- that's where position sizing comes into play. It's why my positions are so small that the market could go limit against me and I wouldn't sweat it. Now, many traders feel that trading teaches them to sit, think, analyze, and examine hundreds of different indicators and fundamental information in an undying search for the perfect trade. Give up. I found the holy grail of trading…ready for it…The Holy Grail is that there is no Holy Grail. Just develop an intelligent system, that manages risk, position sizes wisely, and apply it consistently for a year. If you don't make money- do the opposite for the next year. Consistency- not perfection- is the key to trading.

Ok, so now that we've established some theoreticals regarding our trading- you're probably asking- "Specifically- how do I design a system that I can trade consistently?" Well, I'd be more than happy to help. Because to me- trading isn't the system- it's the trader. I may teach you my trading system- but I probably can't teach you how to master your emotions well enough to trade it with any success. If I did- you certainly wouldn't need me.

Equities- "2005 A Stock Odyessy"

Last week we did get our rally to 1245.00 in the S&P and rolled our 1240.00 calls down, but yesterday's massive sell-off stopped us out and left us just above breakeven after buying the 1230.00 calls back for next to nothing. So, overall in the last month we made about .4% on the stock trade. Its better than nothing. Long term trading is about percentages. I'm shooting for 25-30% annually after commissions and fees, so to me .4% is 1.6% of the work I have to do for the year. I like thinking of it in those terms. Every percent counts. I'm currently flat the stocks and will be on the sideline until the following occurs: S&P 1185.00, NAS 1567.00, Dow 10482, Russ 632. At that point I will wait to see if the market bounces. If it doesn't I may be shorting the stocks.

Just as an aside- in the July 14th issue of Fade Self I recommended the trade du mois. I suggested that you buy the Russ2K and sell the Dow. Many casual futures traders or market watchers might assume that there wasn't much profit potential in an intra-market spread in equities. However, at its peak on August 2 when the Russell was at 690 and the Dow was at 10683 (assuming you entered the trade at the close of business on July 14th) you would have been up $2500 on a Mini-Russell and down just $140 on the short Mini-Dow- netting $2360 on the trade. Even if you didn't pick the top- you still should have gotten at least half that on the trade. The lesson here is stock market spreads can be very lucrative.

Treasuries- "Dr. Strangespan or How I Stopped Worrying and Learned to Love Inflation"

Last week I said, "Last week I said, ***"The low of the move in the bonds has been 114.14. Once we hit 114 I would move towards delta neutrality by selling puts against short positions. I think a bond rally will coincide with the broad based currency rally versus the dollar that I've been calling for."*** Check your charts. Bonds bottomed just under 114.00 and have since rebounded above 114 half." Well, now they're above 116.00. I would expect a pullback to 114.31 or so, but look for a huge spike in the bonds (to 118.00+) over the next month and a half. I think the idea that Crude Oil above $60.00 is serving as a synthetic rate hike will cause people to momentarily believe that rates will stay very low. However, fears of inflation will inevitably return to the market. Fears of inflation are good thing right now because they will keep the Fed in the game and keep stock expectations realistic. So, for now bet on more flattening. The next bet, which is probably about 4 months off, is a steepening and a shift up (but that's another story.)

Metals- "Full Metal Jacket"

Well, when I began writing this segment of the letter Sep. Copper was trading above 171.00- and while I did get some at the money calls sold in the upper half of the range- I would have liked to have been on the sidelines today. Copper dropped 5.75 cents today- ouch. I was stopped out of my newest positions and bought back my September 170 Calls. I thought it might be helpful to use this ugly day to illustrate how beneficial employing a covered call strategy can be in trading futures. So, following is a trade by trade summary of my copper trade:

July 6th – Buy 1 Sep. Copper 151.30
July 27th – Buy 1 Sep. Copper 162.65
August 8th- Sell 1 Sep. Copper 166 Call @ $2.90 ($725)
Ausust 15th – Sell 1 Sep. Copper 170 Call @ $3.20 ($800)
August 15th- Buy 1 Sep. Copper 170.55
August 16th- Sell 1 Oct. Copper 170 Call @ $4.20 ($1050)
August 17th- Sell 1 Sep. Copper 166.00 - offset
August 17th- Buy 1 Sep 170 Call @ $1.00 ($250)- offset

So, even with Sep. Copper closing today at 165.70 the following are the net profits on each position:

July 6th Long +$3675
July 27th Long +$762
August 15th Long -$1137 (Position Closed)
August 8th Short Sep.166 Call +$62
August 15th Short Sep. 170 Call +$550 (Position Closed)
August 16th Short Oct. 170 Call +$250

Current Net Position +$4162 (4.16%)- The calls reduced the amount lost on the futures position today by $2300. That's what I mean by smoothing returns. That's why I feel that selling premium is such a necessity.

As for Gold and Silver- I still have no position. I'm now watching December Gold rather than September because the liquidity has shifted there. Getting closer to buying gold- it was down $6.00 today to $445.2, but I think you will see $437.0 in the next week. Silver isn't attractive. The downside is probably still $6.60, last trade was $6.96. Hopefully you're still short the contract from $7.32 with a $6.90 put written- if you are I'd hold that position for the next week or so.

Energies- “Cover Your Eyes Wide Shut”

In the previous issue I said, ***“My response to making that much money so quickly was to write Sept. $66 calls against the positions (bringing in $600-700 each.) These options effectively cap profits at $3,800- but only for the next 8 days- as they expire the 18th of August.”*** Well, on the 11th when the velocity exceeded 6% (my magic number) I rolled the calls down the $64.50 in the Sep. What this meant was that I would lock in $2600 as long as Crude closed above $64.50 at expiration of the contract. This morning at $65.80 I sold the contracts and bought back the calls because I felt like there was a small possibility that Crude might actually drop below $64.50 and I had essentially no reward because the option capped my futures profits with essentially nil time decay left as option expiration was today. The play worked as Crude did drop nearly $3.00 today and I saved nearly $1300 as we closed at $63.20. Hopefully, that all made sense- if it didn’t you may want someone to manage your futures trading for you….Did I mention I know a good guy?..... I’m looking for Crude to drop another dollar but to rebound over the next few weeks.

Currencies- “Lolita”

The Euro is tempting here, but you’ll have to wait a bit longer. Remember, “The quicker the pullback in an uptrending market- the more bullish it is.” If the Euro proceeds to trade down to 121.70 buy it with both hands. Lower rates mean a weaker dollar and that’s what we’re going to see in the next few months. Going back to last week (again) I said, ***“Any profits on the table in the currencies at this point should be hedged tomorrow (Thursday).”*** **Did you do it?** Hope so, because the high on Thursday the 11th was 124.69 in the Euro. Friday the 12th we closed at 124.58, Monday the 15th closed at 123.85, Tuesday the 16th at 123.74, and Wednesday the 17th at 122.78- 200 points off the highs (that’s $2500.) I think its another 100 points in the next few days. I’ll probably be selling puts if we hit 121.70 by Friday.

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