

Fade-Self... One Trader's Commentary

Strategy

15 September 2005

*"Why pay a dollar for a bookmark? Why not use the dollar for a bookmark?"
- Steven Spielberg*

Learning to trade successfully is an endeavor that shouldn't be attempted directly. All of the tools and characteristics of a successful trader can be learned with much less risk (monetary or otherwise) through pursuits periphery to trading or outside of the activity completely. I have a friend who once was a broker and decided to give up his book, put his money where his mouth WAS, and take a shot at trading his own account. He'd spent his time as a retail broker trying to figure out how to trade. He'd been around the markets since he got out of college, spent thousands of dollars on books, and was a true student of the market. (Whatever that means.) The only problem was that he had always viewed trading as being complicated and difficult. He did however believe that he could CONQUER this challenging task and earn a fortune trading if he could just figure out the one way to trade that would allow him to win every trade. When he finally found a systematic method for trading he believed in- he backtested it endlessly. He had found his Trading Holy Grail. So he quit his job to trade for a living.

He soon realized what so many of his former clients had- paper trading isn't the same as real trading. Trading to him became "if I would have." "If I would have followed the system and take this trade I would have made \$XXX." It got so bad that I couldn't talk to him about trading anymore. He wasn't trading- he was gambling. His system could be right 80% of the time, but if he was only taking half the trades- he was only going to be right 40% of the time and that's not enough to make money after commissions and slippage. So trading then simply becomes discipline- not decision making. His decision making for selecting winning trades WAS above average, however his discipline in implementing the trading system was lacking. He couldn't understand that he needed 2 systems. One system for trade selection and another for actually placing the trade. This is why I always say that a trader must realize there are really 2 markets. The first is the actual market begins with the screen and ends at the traders eyes.

The second market begins just after the trader makes their evaluation and ends when he/she places the order to make a trade. Now tell me, which market do you think is more complex and difficult? A market that you can observe and make black/white determinations about OR a market that you are so submerged in that you may not be able to make distinctions between what is fact and what is scewed by emotion. Emotion makes everything more complex and difficult- wouldn't you agree?

Equities- "Catch Me If You Can"

The stocks are on another march towards new highs. The last trade in the December S&P 500 was 1238.50. You'll see the market pullback to as low as 1220.00, but I see stocks rallying into October- making new highs. Just a reminder- in the July 14th issue of Fade Self we wrote, "I'm looking for S&P 1250, Dow 10900, Nas 1650, and Russell 710 by Halloween." Looking back that was a pretty aggressive prediction for me to make, but I'm glad I did today with the stocks making the gains that they have. Especially when you take into consideration the timing of the Kristina catastrophe- the stock market could have easily sold off through the end of summer instead of making the considerable rallies that it has.

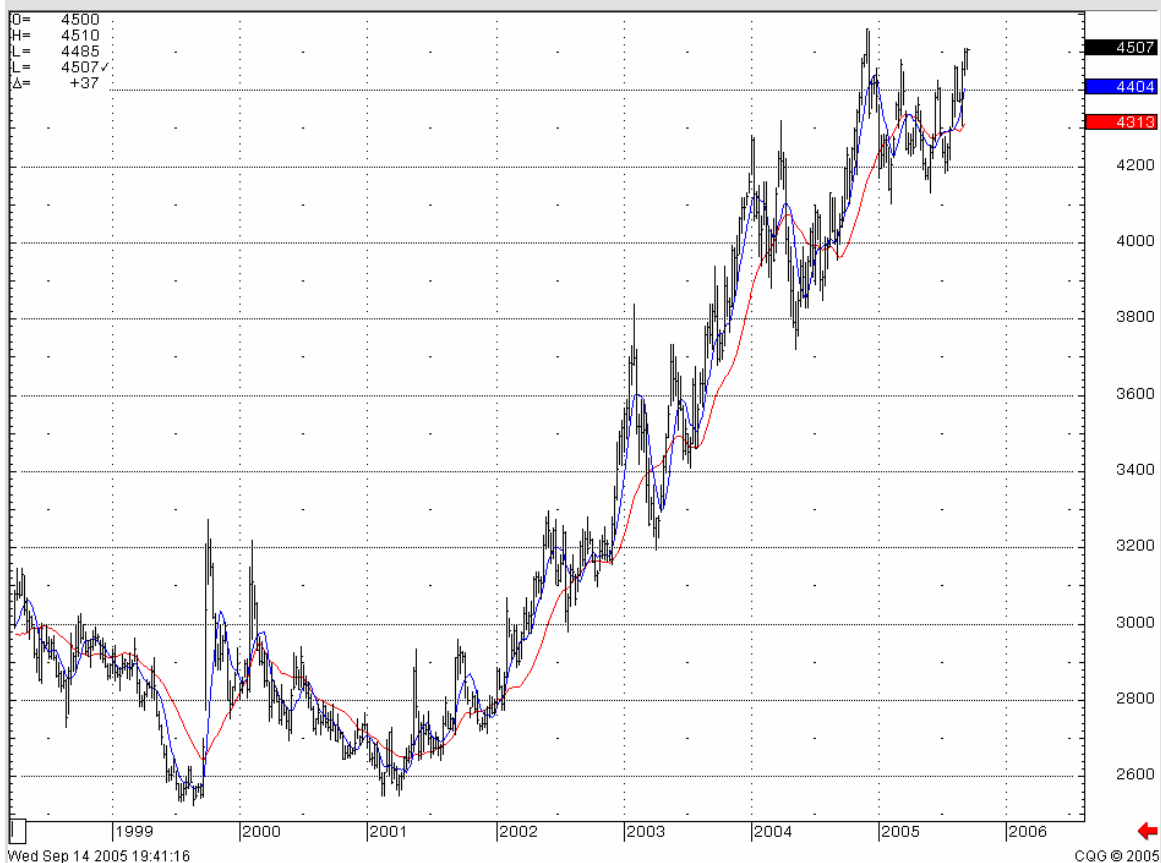
Treasuries- "The Off-Color Purple"

There hasn't been a lot of focus on the treasuries the last few weeks. My 118.16 objective was exceeded last week. It will take a bit longer for the December 30-Year to make new contract highs and move beyond 119. In the meantime look for a quick drop to the 115 level. 116.10 was last. I could dress up why the market would drop \$1500 per contract and tell you about the Fed rate hikes, or China selling bonds, or rumors of Fed rate hikes or China selling bonds....but I won't- lets just say that there will be more sellers than buyers and leave it at that. Everything else is fundamental which means that first its conjecture and later...its hindsight. I always advise against trading through your rear view. It's like trying to pick tops and bottoms- and you know what they say about investors that try to pick market bottoms....

Metals- "Raiders of the Lost Ark"

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 (!)

Yeah, so that "Lost Ark" reference. As you've probably noticed I try to make witty connections between the theme of the letter and the title of the commodity subsection. I guess I already have- you know Lost Arks, treasures, that relates to Gold and Silver right? The bottom line is metals have become a bit of a Lost Ark. The energies have been so popular the last year and a half- investors have forgotten the old commodity standby GOLD! Want to see a bullish chart?



Energies “T. Boone Pickens and the Temple of Doom”

Crude's not done yet. Mr. Pickens is right about that. Will it go straight to \$90- no not likely. The last trade was \$64.40 and I'd say there's a 90% probability that October Crude will reach back up to \$69.20 before November. Katrina worries brought just about all the longs who had been on the sidelines into the fray. And when everyone's on one side of the boat watching the fish- a lot of people are usually going to get wet. A seven dollar sell-off is a good sized splash. Unleaded Gas could drop another 30 cents before the energies drop. I'd look for October Unleaded to drop to \$1.66 in the next week. After this period of volatility I think we will see energies range bound for a few months. Look for Crude to trade between \$59.00 and \$69.00 at least until November. It would be a good time to sell strangles.

Currencies- “The Money Pit”

Currencies are still bottoming. The Canadian has been the only currency that has consistently moved higher over the past few months. 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.” The current value of the spread is \$600. If you understand shorting options you know that you want options to decay. That spread has decayed to the tune of \$1000 per spread in 7 weeks. One spread would have cost about \$2400 in margin- a 100K account would have been able to handle two spreads- that amounts to 2% appreciation in the account over a 7 week period. On an annualized basis you're looking at 15%- on time decay. Not even attempting to call the direction of the market. That's why I believe that selling covered option positions is such an integral part of trading futures. It tips the odds in your favor- so that you don't even need to be right the direction 55% of the time to make money. That's as long as you can cut your losses. By no means is this an out and out guarantee that you will make money trading futures.

Fade-Self (fād-sĕlf) *verb.*

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

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