

## Fade-Self... One Trader's Commentary

Strategy

17 November 2005

"I ♥ NY"

"In dress, habits, manners, provincialism, routine and narrowness, he acquired that charming insolence, that irritating completeness, that sophisticated crassness, that overbalanced poise that makes the **Manhattan** gentleman so delightfully small in his greatness."

- O. Henry

"There are two million interesting people in **New York** and only seventy-eight in Los Angeles"

- Neil Simon

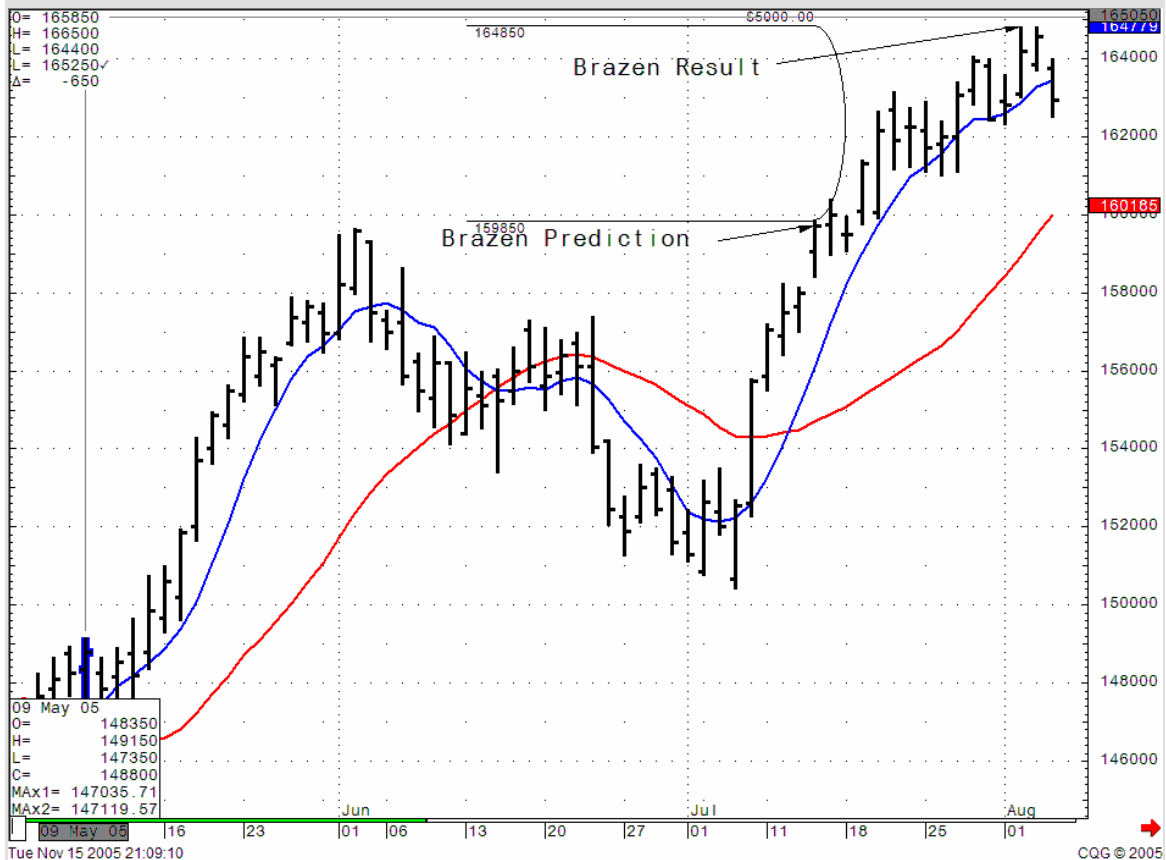
***It's this time of year that Chicago's summer becomes a distant memory and the weather turns perfidious. It's not that I mind Chicago, but there are only two seasons here. Summer and Slush. Fall is just a cold wind. Winter is snow alternately falling and turning to wet sludge. Spring is, well who remembers spring on a nasty, cold, wet day like today. New York. Cliché as it is, I do love New York. I'm jealous of no person. No person, but the New Yorker. It's almost as if the city itself cuts you wide open-exposing who you are at your base and like an open wound causes you to confront it with your utmost attention. The pace doesn't make other cities feel slow, instead other cities just feel like vacation from intellectuality once you've left the island. The markets are like that. They are a true test of life and when you're not in them life moves awfully slowly. The markets force you to prove your mental meddle- just like New York. It's an amazing island and this episode of my little market letter is a tribute to it.***

## Equities- "Heading North- to the Guggenheim"

The Museum of Non-Objective Painting. Of course, that was Solomon Guggenheim's original name for his museum. Cubism, Surrealism, Abstract Expressionism- all could remind one of the S&P, Nas, or Russell charts the last few months. In all of its haphazard madness, there is structure, there is meaning. I don't trade on meaning, I trade on momentum. I don't look at a painting and tell you how much I think its worth- I look at the receipt and tell you how much you just paid for it. Where should the stock market be? I don't know and I don't care. The S&P IS at 1232.00, the Nas IS at 1652.00, the Russell IS at 656.90. I've made my two grand predictions for the year in the stock market. I've shown my grandiloquence plenty this year with these two predictions:

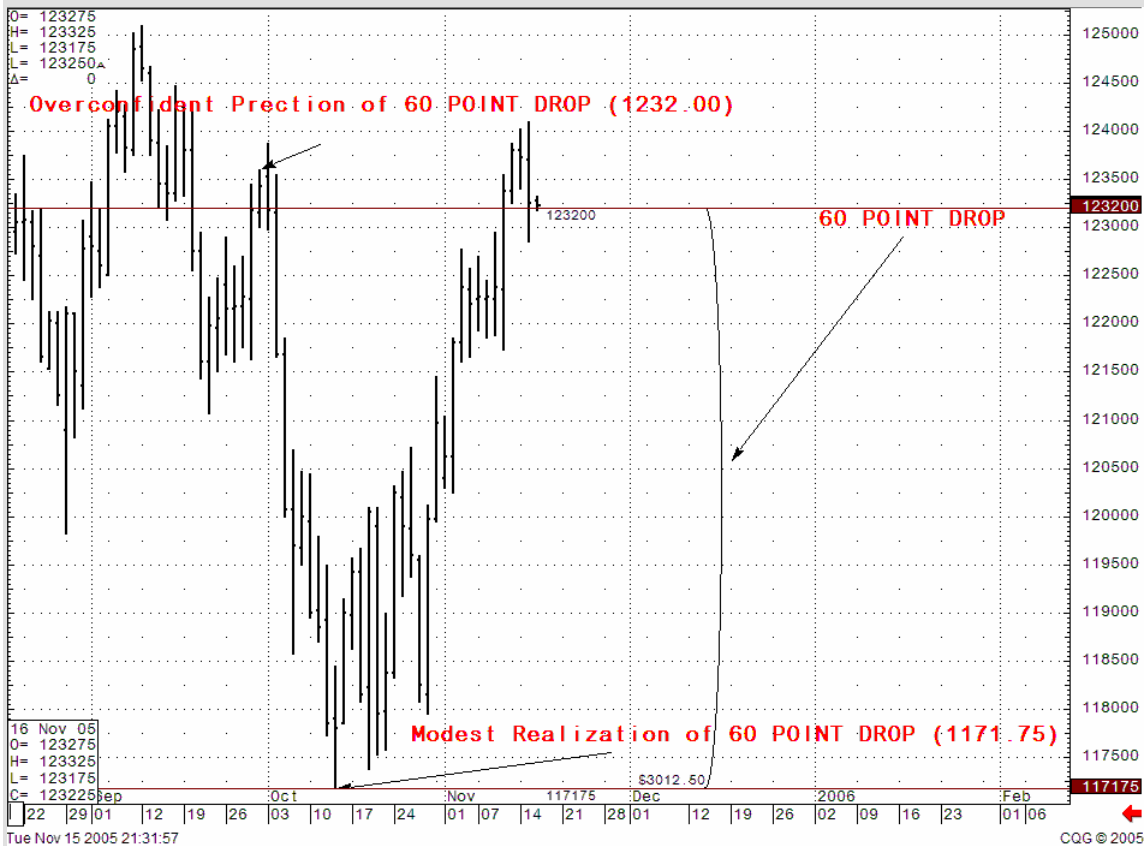
**7/14/05- "I'm looking for S&P 1250, Nas 1650...by Halloween. Please, write those figures down, as well as my phone number (866-802-9684)- and if they don't make it by then call me and chastise me for my brazenness."**

Well my fortitude in decision-making happened to pay off in this instance. (It certainly doesn't always) The chart developed like so:



**9/30/05 "I would like to make a BOLD PREDICTION. I think we will see a solid pullback in the S&P to 1170 in the next month. That would be 60 points- which is worth \$15,000 on one contract. There is no guarantees in trading- but it's likely that in the next few weeks the bears will be back and Goldilocks will be looking for a new condo."**

My success must have really gotten to my head for me to be so confident in the development of such an unlikely scenario. Nonetheless, here's the chart- read carefully.



## **Treasuries- "Heading South- to the Mercer"**

Now, I haven't stayed at the Mercer Hotel quite yet. This luxurious little lodge is located at the corner of Prince and Mercer in the heart of Soho. "Understated, classy, sophistication." Is what a college buddy, who happens to trade Crude, had to say about the Mercer. Speaking of understated, classy, and sophisticated- it's about time we had a little talk about gentleman Ben (Bernanke that is.) He doesn't have a whole lot to do with the theme of this letter, but he did spend the Fall of 1993 as a visiting econ. Prof at NYU. He's a Harvard guy, an MIT guy, AND a Princeton guy. Now he's a Fed guy. A dollar guy. In BEN we trust. It wasn't a surprise that he was appointed to head up the Fed- the Fed doesn't DO surprises. They've been telegraphing this since Kerry Collins was telegraphing passes for the NY Giants. (Whew, that was an awkward analogy.)

It's good to have him though. I think that he will increase visibility and continue on the legacy of consistency bestowed upon him by Volcker and Greenspan. I think Dr. Ben will have it a bit easier than Uncle Al did. Back in '87 the Fed was a bit more secretive and much less adept at letting cats out of bags. The day Reagan announced Greenspan's appointment the US treasury market saw its largest one-day drop in 5 YEARS. At the time the bond market thought it was a political appointment- three Presidential administrations later it has shown to have been anything but. To a large extent the liquidation of treasuries over the past few months has been in anticipation- not of Bernanke- but of the possibility that the Fed's accommodative stance on rates has....WORKED! What did most Americans do after the dot com bubble burst? They grieved there (paper) losses. Then they looked around and said, "Gee, if I lost all this money, everyone else must be in a pickle too. I had better not spend. I had better not borrow. I had better make more rational decisions than I did in 1999." That my friends is called overcompensation. After investors lose money- they become more wary and risk averse (for a period) than they were beforehand. The consumers went into hibernation and were likely to stay there for the next 25 years (as they did from 1929-1954.) But the Fed had an idea- give money away. No literally. Real negative rates mean that whomever is making an overnight loan is actually giving money away to the loan taker. That was the proposition with Fed Funds target rate at 1% and annual inflation being greater than 1%. The Japanese have been doing the same thing since their bubble burst in 1989- but the difference is that it takes a lot less to incentivize a New Yorker to consume that marginal Big Mac than it does to convince the Tokyoite to have one more Toro. (Yes, I know incentivize is not a word, and yes I do realize that a Big Mac is cheap and Toro is very expensive- thank you proofreader.) The Fed had a fire sale on money. US consumers couldn't resist and actually spent themselves out of what could have been a depression. DE-pression. We could have seen negative real growth, not for quarters, but YEARS. Thank you Alan. Thank you Ben.

I've been quoting Ben Bernanke since February 2003. I think that the speech that best represents his outlook on central banking was his 2/3/03 "Constrained Discretion" speech at NYU. There he stated:

***"The approach to monetary policy that I call constrained discretion can be defined by two simple and parsimonious principles.***

***First, through its words and (especially) its actions, the central bank must establish a strong commitment to keeping inflation low and stable.***

***Second, subject to the condition that inflation be kept low and stable, and to the extent possible given our uncertainties about the structure of the economy and the effects of policy, monetary policy should strive to limit cyclical swings in resource utilization."***

Ok, so is this a case of Fed speak in that it says magnitudes or because it says nothing at all? The answer is actually that it says magnitudes. This will be the fundamental difference between the Greenspan years and the Bernanke years. "Constrained discretion" is different from Greenspan's "discretion." That is my opinion. Bernanke's discretion will be constrained by a yet to be introduced inflation target, me thinks.

Bernanke also introduced this idea on 10/2/03 in Chester, PA:

***"First, the stock price multiplier of monetary policy is between 3 and 6--in other words, an unexpected change in the federal funds rate of 25 basis points leads, on average, to a movement of stock prices in the opposite direction of between 3/4 percentage point and 1-1/2 percentage points. Second, the main reason that unanticipated changes in monetary policy affect stock prices is that they affect the risk premium on stocks. In particular, a surprise tightening of policy raises the risk premium, lowering current stock prices, and a surprise easing lowers the risk premium, raising current stock prices."***

This is an important idea and one that in October 2003 had an immense bearing on bond market expectations for the future of monetary policy. (i.e. What does measured rate mean?) Well, measured MEANT 25 basis point every time- and should you have read the above in October 2003 and understood the importance of Bernanke's statements- you would have realized that. Well, that's enough about Ben. If you read my letters consistently you will realize that Fed speeches have no bearing on my trading- there more like comic books to me. Fun to read, yes. Useful in trading futures, no.

Back to the header of the section- "Heading South." If bonds were in Brooklyn in August there at about Mid-Town right now. I think we'll get to Battery Park by the time Bernanke takes over. I think you'll see a short respite over the next two weeks, but the downtrend will remain intact.

### **Metals- "A Walk in Central Park"**

Have you been watching SILVER and GOLD lately? Not to mention copper. But specifically, and I like to get specific- silver- and I'm going to milk this one for all its worth. This might be my best call since that 60 point S&P call last month. Ok, are you ready for this because I'm not making it up.

On October 6<sup>th</sup> I wrote to YOU, ***"There is a 90% chance that December Silver will trade \$8.03/oz in the next 6 weeks. Write it down. (or buy a contract, sell a put, buy silver coins, call your monex dealer, or go up in your attic and raid it for family heirlooms to pawn.) Just pay attention to what I'm saying. I mean come on- have I ever lead you astray? Silver has consolidated long enough- now its showing strength in the face of a dollar rally- time to get aggressive."*** That was Thursday, October 6<sup>th</sup>. Today is Thursday, November 17<sup>th</sup>. Do me a favor and pull out a calendar. Start on the 6<sup>th</sup> and count the weeks between that day and today. It's exactly six. Last trade in December silver? ***\$8.10/oz.***

Gold has been a walk in the park too. Right? I'm sure you're long gold stocks, right? Gold is a nice, steady, comfortable asset. This is the Merrill Lynch of commodities. A good solid **brand name** that you can trust. You pick up the Wall Street Journal and start reading that the trusted text- and the commodity that you check first GOLD. Here's a chart that should help you to trust my judgment more.



Happy you bought gold?

### **Energies- "Getting Battered in Battery Park"**

Funny how markets work. I was just thinking this morning of kind of an abstract idea. Imagine that you live in a world with no fundamental information. That it just doesn't exist. No Hurricane Katrina, no T. Boone Pickens making grand predictions, no Goldman reports being misconstrued, etc...For those of you that follow black gold closely – you understand the references. Imagine that you were trading Crude unaware of any outside factors. You'd have to depend only on price action. And if I could only depend on price movement I would buy when prices were increasing and sell when they were decreasing. AKA momentum trading. I don't attempt to pick market tops and bottoms- why bother. Why try to

be a hero? Think about what a hero is. It's someone who takes a lot of risk to help others. You have to think that eventually Superman runs into a situation where the risk bites him. Have you ever tried to beat a train across the tracks? I haven't. I'm not a daredevil.

A daredevil would buy Crude here. He would have bought crude at \$65 bucks too. I didn't. I'm still not interested in selling it here either. Just hold off for now- there's no rule that says you have to trade energies at all times- right?

### **Currencies- "A New Year, A New Dollar (Times Square)"**

I wouldn't pop the Dom just yet. There is still a myriad of problems with buying the dollar. Its like the beginning of a roller coaster that slowly and mechanically lifts you up the slope. You know that feeling. The feeling of anticipation. You know you can expect a controlled and safe ride. You know what's coming once you get to the pinnacle. So, while you're long the dollar (as I am) be a little wary that at some point the slow grind will end and you'll get what you should have expected all the time- dollar weakness- in a big way. I'm talking about a BIG move- perhaps as high as 130.00 in the EU/USD. I know, I know just told you to sell it aggressively on October 6<sup>th</sup> when I wrote, " **I'm currently short the Euro and Pound with November puts written against. It's possible you could see 115.00 in the Euro before the NEW YEAR!**" Rather than boast about what a great trade that WOULD have been, I just tell you that my clients DID make money. We shorted the Euro at 121.00 on September 23. We've been short ever since. In the meantime we've sold puts on the position as well. We sold the October 120's (went off worthless- which is a good thing when you're short premium), the November 119's, and the December 119.50's. Don't forget about the Yen or the Aussie dollar either.

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**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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