

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

Strategy

2 December 2005

### “ 'Tis the Season ”

“The year that is drawing towards its close, has been filled with the blessings of fruitful fields and healthful skies. To these bounties, which are so constantly enjoyed that we are prone to forget the source from which they come, others have been added, which are of so extraordinary a nature, that they cannot fail to penetrate and soften even the heart which is habitually insensible to the ever watchful providence of Almighty God.”

- Abraham Lincoln's Proclamation of Thanksgiving 10/3/1863

“Too many have dispensed with generosity in order to practice charity.”

- Albert Camus

**History credits Abraham Lincoln as the man that bestowed upon the country a uniform day of Thanksgiving. In actuality it was his Secretary of State, William H. Seward, that suggested the idea to him and actually penned the official proclamation. Seward was a man ahead of his time as he was one our country's first and most undeterred abolitionists to hold high office (as governor of New York.) He was already the most important anti-slavery advocate 15 years before Abraham Lincoln- a truly astounding fact considering that 99% of Americans don't even know his name. The reason I bring them up has to do with Thanksgiving and Charity. Thanksgiving is about being grateful for what one has, however the idea doesn't permeate into the minds of American's as much as it should. Giving thanks in my mind should translate directly into giving to others. And doing so in a manner that doesn't involve receiving anything in return. It's my opinion that we should- commend those who give admirably, admire those who give anonymously. To give while receiving no attention, or name on a building, or future favor shows a lack of personal ego. A life lesson we all ought to learn. For a trader, a lesson ought not to be left unlearned. Without ego in life you'll be magnanimous, without ego in trading you'll survive.**

## **Equities- “Nearing Ozone Levels”**

Speaking of the ozone, a good place to start (although I personally am not that green) would be *Save The Earth Foundation- [www.savetheearth.org](http://www.savetheearth.org)*. Stocks have been doing their share to make sure you have a few extra discretionary dollars to contribute this holiday season. I've really been thinking a lot lately about launching a stock hedge fund. My basic strategy would be to buy various stocks- chosen mostly and random- and hold them. I'd call it the “Buy & Hold” strategy. Now, I'm sharing this idea with just you guys- so don't go and tell everyone you know about my brilliant little strategy. Just think....Buy stocks- do nothing- make money. This must be what those guys that invented the wheel and sliced bread felt like.....Ok, ok...I'm being a bit facetious. I might be oversimplifying things a little bit. Seriously though, stocks are HOT. The U.S. economy has bird flu- but who cares. Just buy and hold gang.

I'm currently long from 668.20 in the Dec. Russell and 1686.00 in the Nas with calls 1710 calls written for 12.00 and 1260.00 S&P calls written as a proxy for the Russell long. (Russell 2K options haven't reached a level of liquidity that I'm comfortable with quite yet.) How much further could we go? Who knows? Just buy the highs and close your eyes. (and place a stop) When I see new contract highs- I just buy them and don't ask questions. You know what they say- “Buy high and sell EVEN HIGHER.” Remember though, when a market makes new contract highs- the attention paid by the public and thus the volatility- increases.

Be careful. Use stops. Sell premium. Or open up a managed account with United Trading Asset Management and I'll just do it for you. You can just watch for the monthly account statements. I certainly can't guarantee that you'll make money every month. Trading is a risky business. One thing that sets our fund apart from most CTA programs is our commission rate. Most funds make their money from charging you between \$35-50 per round turn. Considering their cost is between \$5-10 per contract- that's a heft \$30-40 in the fund managers pocket every time you trade. On top of that he'll charge you a 2-4% management fee and take 20-40% of the profits (if he makes a profit after all the fees). Now you tell me- where does his incentive reside. Well, I'll tell you. (Good question by the way) His incentive is to trade as much as possible (at \$30-40 a turn) and break you even (and collect that 2-4% annually.) And as long as you keep the account open- he makes a pretty good living. When you leave- he replaces you with someone else who hasn't seen through his pitch yet.

### **Here's our pitch:**

**\$10 commission rate (to cover our costs with our clearing firm.) 0-2% Management fee (depending the size of your initial account) As for the incentive fee- hey I'll be frank- that's where MY incentive resides. How does 20% sound? Remember, we only receive an incentive- if YOU make money.**

## **Treasuries- “Moving Average Red Cross”**

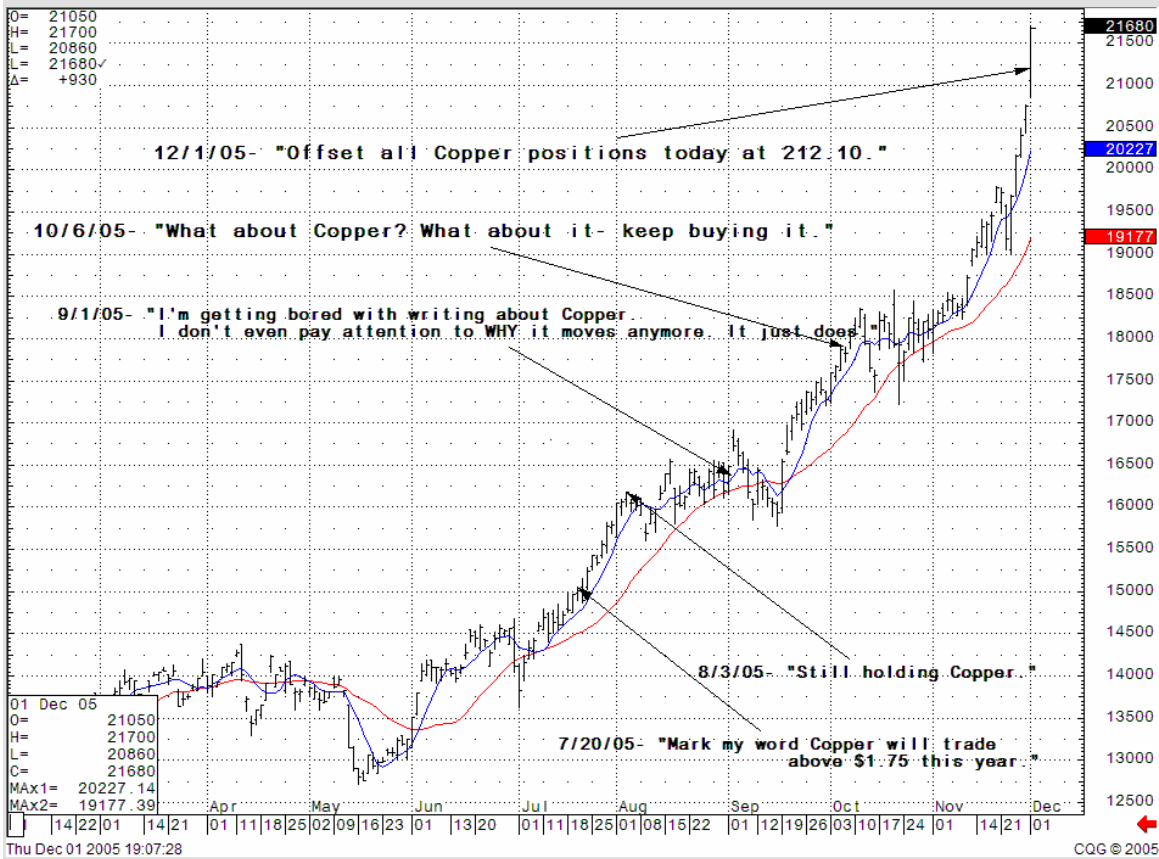
Donate your time, money, or blood. An historically great cause. [www.RedCross.org](http://www.RedCross.org). As far as the treasuries go, trading them right now would likely make you the wrong kind of donor- one who makes contributions to the futures market. I think that we will likely see a pretty good retracement to the upside in the 30-Year Bond over the next two months. I'm predicting 115.17 in the March contract- that's a 3 handle move- by the end of January. You'll see bond rates drop considerably as the markets become more comfortable with Ben Bernanke and realize that he won't be removing the punch bowl from the wild party that is the US economy- any time soon. William McChesney Martin, the legendary Fed Chair that coined the “punch bowl” analogy would be astounded by the phenomenal adeptness that present day monetary policy gurus have chaperoned. It's common knowledge for most investors that Ben Bernanke owes Alan Greenspan a great debt of gratitude.

However, many people forget the man who is truly responsible for the fundamental changes in not only the structure of the US economy, but the changes in the psychological structure of society behind them. That man of course is, my personal hero, the honorable Paul Volcker. It may be another 20 years before we really understand inflation as a psychological phenomena, rather than just an economic statistic. Inflation is an emotion. You can quantify it- but you can quantify consumer confidence too- what a joke. Statistics are useless in unto themselves, they are only useful as a means to an end. In that respect- there must be a human being to interpret them. Making the connection? An investor, who is a human being with emotions is attempting to evaluate an economic indicator that is comprised of emotions. Inflation is basically a second level derivative of an emotion. That's why I am a technician- fundamentals are the other guys problem. Volcker changed the way the markets react to inflation. The manner in which he curtailed it in 1980-81- showed the markets who was boss. So, instead of seeing inflation and reacting by buying assets- the market participants now see inflation and assume that something will be done to curtail it. So, the net effect is that inflation no longer feeds rapidly upon itself- in actuality when it rears its ugly head- because of the esteem now held in the Federal Reserve- the assumption is that it WILL be dealt with. That prevents it from breeding uncontrollably like it did in the 1970's. The difference now is that hedge funds are major players in asset markets. 25 years ago asset prices were skyrocketing without the presence of the major organized speculators that are currently moving the majority of the commodities markets. It means that the ascent and decline will be a bit more orderly than 25 years ago- and probably more sustainable. What it doesn't mean is that inflation is running rampant. Speaking of markets running rampant- lets talk about metals for a page or two....

## **Metals- "\$500 Gold- is it a dream?"**

I Have a Dream Foundation- Contact: 212-293-5480 or [www.ihad.org](http://www.ihad.org). This foundation helps kids get a college education. There's no more valuable commodity. Even at \$500/oz gold isn't even close. It sure does glitter though, don't it? Gold has gotten quite a bit of attention the last few days and that means that you'll probably see the public get harangued before New Years. Nonetheless, its been an enjoyable ride. I'm short January \$490 and \$500 calls against my positions. I'm comfortable with the chunk of change I've taken from the metals markets in the last two months. Copper is even more interesting than gold right now. The rumor is that a major Chinese trader has a \$300 Million short position in the December contract- and has disappeared. This is rogue trader material. Obviously my newsletter **got** lost in translation. A good trader **got** in an ill advised trade. An ill advised trade **got** worse. A worse trade likely **got** covered up. A Chinese trader **got** nervous, **got** panicked, and finally **got** lost. But his firm, supposedly with ties to the Chinese government (wait I guess in a communist country THEY ALL HAVE TIES) his firm is stuck with a massive short position.

When the market knows your position- watch out! Just ask Long-Term Capital Management. Now, their positions were in relatively less liquid and more sophisticated assets, but the idea is the same. If other participants believe that you are stuck in a huge losing trade that you would have a hard time covering- they will gang up on you and SQUEEEZE. That's what is happening in copper in the December contract. The market knows that the Chinese have a massive short position that they cannot afford to take to expiration. If they do, they will have an obligation to deliver the physical copper. Unfortunately, they don't have that kind of copper, it doesn't exactly grow on trees you know. So, that means that everyone who trades copper is buying with the thought that if they keep buying eventually the shorts will capitulate. IF the rumor is true- which it looks like it is today (COPPER UP 6.20 POINTS - \$1550 per contract)- the Chinese will have to buy back at some point between now and expiration in three weeks. By the end of the day I'm going to offset and get on the sidelines in the December contract as liquidity is also drying up there. You could see copper sell off 15 cents in a day- any day. This is a case where no amount of reward can compensate for the potential risk in the market. Besides, there are plenty of other markets to trade where there is less attention being paid. On the next page is a chart showing the copper trade. Check it out and you'll understand why I'm happy to exit this market – at least until December ends.



## Energies- "Give Locally"

There are plenty of ways to get out and give more than just your cash. Take a Saturday and go expend some energy at your local Boys and Girls Club. Check out [www.bgca.org](http://www.bgca.org) for a local branch. As far as energy goes, I haven't been expending much in trading them. Still waiting for an opportunity to get short. Crude is currently trading at \$58.60 up \$1.15 today. We could retrace to as high as \$62.00, but ultimately I think we'll move as low as \$53.05. I don't have to trade energies- so I wont.

## **Currencies- “Donate in Any Denomination”**

The downward trend in the Euro/USD is really waning. The velocity on the daily Euro chart is .3%- that's microscopic. Remember 2-4% velocity is what we're looking for. That's a nice grinding market. It doesn't draw very much attention to itself- its an inconspicuous trend. Strong enough to maintain itself and attract new followers, but not too strong to the point were the trend is unsustainable. Having said that, I still think the Euro will trade as low as 115.00, but the risk/reward profile has eroded considerably. My strategy is to manage the delta of the position based on the velocity. So, a velocity of .3% suggests a very low delta- meaning that on long dollar positions I've sold deep in the money calls. Whenever you're looking for a trend change in the currencies- watch the weakest versus the strongest. The weakest has been the Yen, while the strongest has been the Peso. (or perhaps the Canada) It's time to buy the Peso and its not yet time to quit being short the Yen. That tells me that it's a good idea to stay away from everything questionable. Pound, Franc, Canada, Aussie. All no trades. If you've been reading this letter for a while you can remember when, back on July 27<sup>th</sup> I said, "The best trade would be to Buy Peso, Sell Yen." Lets just say that you did actually take my advice that day. You would have called your broker, told him that you want to Buy 1 December Globex Mexican Peso- at the market. Also, Sell 1 December Globex Japanese Yen- at the market. You'd have been filled around .9045 in the Yen and 9.160 in the Peso. Each tick is worth \$12.50 in the Yen and \$5 a tick in the Peso. The current value of the Yen is .8318. A move from .9045¥ to .8318¥ is worth \$9087. The current value in the Peso 9.505. A move from 9.160 to 9.505 is worth \$1725. That's a total on 1 contract in each currency of \$10,813. That's the best currency spread you could have done in the futures market over that time.

Do you want to know more about currencies? Ok...Lets pick one at random...how about the Swiss Franc. I don't talk about it very often- nor do I trade it very much. This is mostly because its correlation to the Euro is so high. Its velocity right now is -.5% or nearly nil. Much like the Euro- I'd be short, but with very little exposure. When I say very little I mean between  $\frac{1}{2}$  and  $\frac{1}{4}$  of a contract exposure per \$100,000. You could do this by selling a contract and selling a Dec. 78.00 put with a delta of about .77.

I hope you won't limit yourself to the charities listed above. Here are some other worthwhile sites to spend a few minutes visiting. My goal is to get you there and let your sense of humanity do the rest.

Disabled American Veterans (DAV) Charitable Service- [www.dav.org/cst](http://www.dav.org/cst)

ACCION Chicago- [www.accionchicago.org](http://www.accionchicago.org)

Meals on Wheels- [www.mealsonwheels.org](http://www.mealsonwheels.org)

Natural Resources Defense Council- [www.NRDC.org](http://www.NRDC.org)

Abraham Joshua Heschel School- [www.Heschel.org](http://www.Heschel.org)

Action Against Hunger USA- [www.actionagainsthunger.org](http://www.actionagainsthunger.org)

Child Aid- [www.child-aid.org](http://www.child-aid.org)

**Fade-Self** (fād-sēlf) *verb*.

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

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