Volume I Issue XVII

Fade-Self… One Trader's Commentary

Strategy 8 December 2005

"Commoditas Flourit"

"Audentis fortuna iuvat"
(Fortune favors the bold)

- Pliny the Elder 79CE

Derivatives are hot. We've gone from Pork Bellies and Orange Juice to Euribor and Bund, Bobl, Schatz. Those were the times when caveat emptor was stamped across the industry in BIG RED LETTERS. Well, I guess not that much has changed. 95% of "do it yourself futures traders" are still losing money. They believe that you can "do your homework" by watching CNBC and scanning the Wall Street Journal twice a week. You can't. You need to understand technical analysis or find someone to trade for you that does. The reason fundamentals work in stocks is because you have time on your side. If you're correct, you can afford to hold a stock (unleveraged) until things work out for you. It's called a buy and hold strategy. Well, you can do that in futures. And it doesn't matter if you're correct or not- all that matters is whether the market is with you or against you. Think of the stock market as an Olympic size swimming pool. If you jump in and start swimming (assuming you know how to swim) eventually you'll get to the other end of the pool. Now, think of the derivatives markets as the Amazon River. If the waters are calm- you've got a chance- but its not going to be easy. If the waters are tumultuous- you'd better be swimming down stream if you don't want to drown instantly. The river is going to do with your ideas of "correctness" what it wants. By the time you're "right", you're "shark food." The only thing you can control is when you jump in, your level of preparedness, and whether you bring a flotation device with you (this means USE A STOP to keep you AFLOAT). Aren't analogies fun? Moving on….Oh by the way, United Trading Asset Management was up 7.5% for November. Now, this was certainly an anomaly month- I don't expect (nor want) to return that much again…but copper had other ideas. Please, it's important to remember that we shoot for 2-3% per month…any more than that and you're taking too much risk. Only risk capital should be used to trade in any futures investment. There is unlimited risk in trading futures. Do not try it yourelf. (RED LETTERS SIGNAL CAUTION!)

Equities- "Ne Plus Ultra?"

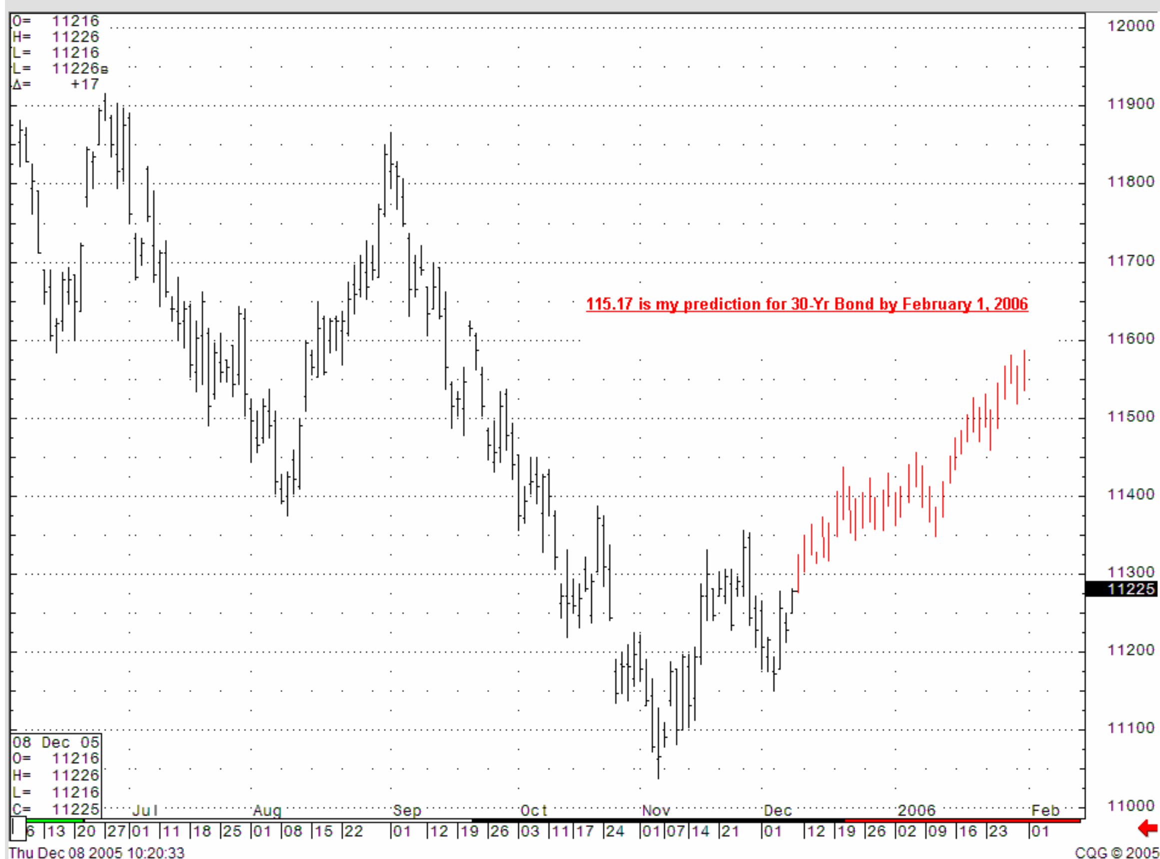
Is this the pinnacle? I'm writing this Tuesday morning and stocks are FLYING! The S&P 500 just made NEW FOUR YEAR HIGHS! Same for the Nasdaq and Russell 2000. We entered the NAS at 1686.00 and the Russell at 668.20. The last trades are 1717.00 and 692.80, respectively. But wait- I have another prediction. You'll see a pullback to the 1253.30 level in the S&P very soon. I'm not saying that I will absolutely guarantee that you will see a pullback to that level in the S&P in the next two weeks. I'm not saying that. But, if I were to say that (which I wouldn't because there are no guarantees in trading) I would tell you to be a buyer at that level. This is certainly not a fantastic nor a grandiose prediction. I could be wrong. If you're long stocks, sell some at the money or in the money calls against them. I would use the January expiry because there are about 6 weeks until they go off. When writing options its best to enter positions between 28-42 days until they go off. This is when the rate of decay is the highest. If it's a covered call, then basically you are being paid for the potential opportunity cost of the futures contract going beyond the strike price of the option. (Going "In the money") So, you want to be rewarded as handsomely as possible for this opportunity cost. This occurs between 28 and 42 days to expiration.

I think world equities are actually going to lead over the next few months. I'm extremely bullish Europe- France, UK, and Russia in particular. I see the dollar weakening in 2006 and thus suggesting continuing low inflation and interest rates. Coupled with China's continued strength you'll see an asset vacuum sweep over the world towards our Red brothers (is Red politically correct anymore?) with a Johnny Appleseed like stimulus planting the seeds of inflation for a later date. Eventually, China's glut of growth will produce real asset inflation globally. As of yesterday, however, because of the unprecedented growth of productivity in the US in the last 10 years inflation is a having a helluva time making headway in the most basic (but most important) measure of inflation that my buddies (I'm counting John Maynard Keynes as a buddy) and I look at. That being- wage unit labor cost. The incremental cost for an employer to incentitize his/her employee to work (also known as get them to stop surfing the internet or instant messenger and do something that is going to make the company $$.) Historically unprecedented technology growth over the past 10 years means that Employees can get a whole lot more accomplished while expending the same amount of effort as they did in the 1980's. This means less stress on each individual which means a happier work environment (which actually leads to more getting accomplished.)

It's what George Soros loved to call a virtuous cycle. So, that means inflation (which begins when more cost is allocated per unit to stimulate the same capital equipment to increase performance) is actually being deterred in our current economic environment. Am I saying that we should be afraid then of DEFLATION instead of INFLATION?? Yes, that's what I'm saying.. Basically, INFLATION IS THE OPPOSITE OF PRODUCTIVTY. That's just my way to bottom line the idea. It's the meat and potatoes of understanding the cost of meat and potatoes. Here's a chart of the Meat & Potatoes 500 Index.

Treasuries- “Caveat Emptor”

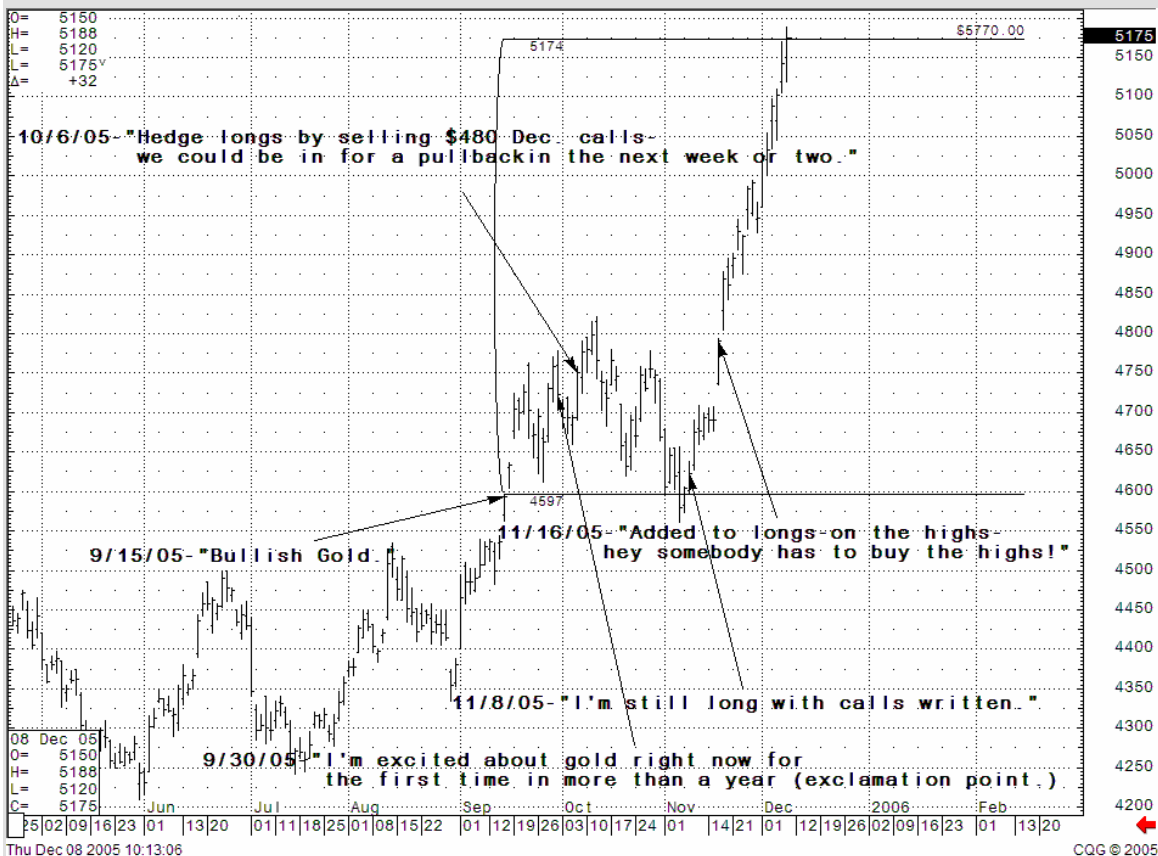
U.S. treasury bond buyers beware! We will likely see a spike down in interest rates and a spike up in prices, but it isn’t likely to last long. A big spike up in prices and down in long term rates. I think that over the next two months you’ll see a continuation of the 30-year’s burgeoning upward trend. Ultimately this “Punch Bowl” trade will probably bring the bonds as high as 115.17 (maybe as high as 117.00.) Here is a chart with my projections for bonds- at the end of January I will put it next to the actual bond chart and we’ll make a visual comparison of my prediction and what actually transpires.



My prediction for the price action over the next seven weeks is in RED.

Metals- "Mirabile Dictu Gold $510/oz"

I wrote the title for the metals section yesterday (Tuesday) when gold was at $510. Just 15 minutes ago it breached the **$520 level**. The velocity in gold right now is 3.96%- that's about the peak of the level that I consider tenable. I think the only thing that had held gold back the last few months (until the breakout above $450) was that the US dollar was strong. Gold is priced in dollars. Thus, if the dollar is RALLYING (like it was versus the EU, SF, JY, BP for most of the year) it takes LESS of the very same US DOLLARS to buy the same nugget of gold. So, the price of gold drops. When you see gold actually moving higher in price when the dollar is worth more- it means that gold itself is becoming a more attractive investment. (Keep in mind if gold is moving up when the dollar is moving down- gold isn't necessarily becoming a more attractive investment- it's a de facto price move- not so much a factor of value as it is due instead to simple accounting.) Oh, by the way "mirabile dictu" means literally- it's wonderful to tell you. I'm very happy to report that the metals are soaring! Whew. Moves like these are why we trade commodities. Occasionally, the markets trend…If you would have just bought 1 contract at $453.20 on September 15th when I wrote to you, **"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 (!)."** If, if, if…..one contract over the last two and a half months moved up $61/oz. That's nearly 15%. If, if,if…..you'd be up $6100 per contract! Now, whenever I state that you could make money or especially when I look backwards at profits it's important to consider risk. The inherent risk of trading futures. Futures are not a limited loss proposition- you should only trade capital you can afford to lose. Why would I say this? Because I want to be honest with you about the investment. This isn't a disclaimer buried in small print at the end of a document. This is me **YELLING AT YOU! FUTURES IS RISKY! DON'T TRY THIS AT HOME!** Why would I say that to you…because I have confident that if you learn to trade properly and respect the investment tool…you can be profitable. I'm confident in my abilities and I think you should be too. Here is a gold chart that shows my opinions at different junctures in this developing trade. P.S. It's now Wednesday at 2pm and the stocks have been dropping all day…I'm hustling to get this newsletter out so you can see my S&P prediction on page 2 before it actually occurs….



Energies- "Does anyone know the word for Energies in Latin?"

I think we could be in for a massive rally in the energies in the next month. We're currently trading around $59.50 in the January contract. I'm looking for as much as a $6 rally in the next month. The overall trend is still neutral to bearish (velocity is -.05%.) I think you'll see a rapid move higher which will likely leave a couple gaps on the chart between $.30-$.50 in size. These gaps and the rapidity of the move will likely signal to me that when we hit $65.20 – I still wont be that interested in being long. Look for heating oil and natural gas to lead the way on this quick move. Its 4 degrees out in Chicago today, with a windchill of -15 degrees. Brrrr. Remember though buy the weather rumor- sell the fact. By the time this cold has been around for a week and its being called a "cold snap" it will be time to sell the energies.

Currencies- "The Dollar – Non Liquet"

The dollar- I don't know. The currencies are still. The vol is low. There are no trades. I'm long the Peso, but that's a tiny position. The trend there is actually very strong, however and maybe we'll make a percent or two in the trade over the next month. Besides that I still continue to be short the Yen on a covered basis. The velocity is just -1.2%. That suggests a delta on the position of between -.75 and -1.0%. I'll be looking to get long the Canadian again in the next two weeks. We're not quite ready to jump in yet- but that could change any day. The last trade in the Canada is 86.41. If we break 87.00 that would be a bad sign for the US Dollar. Since the Canada tends to lead the rest of the major currency contracts, I'd be wary about being short the Euro if the Canada begins to move to the upside. While I wouldn't be surprised to see the Euro hit 115.00 in the next month- I am not holding my breath. Currencies are not trending very much right now, so they aren't holding much of my attention. Maybe next week.

Traditional Commodities- "Pax Sinica"

Peace and prosperity in China. We will no doubt look back- twenty years from now and view 2005 as the beginning of Pax Sinica. China is a consumptive monster. If it can be eaten, welded, burned, or invested in- they're buying! Honestly, in the next twenty years as a country (albeit 5 times our size) their consumers are going to make us look like a country of penny pinchers and coupon clippers. There's 500 Million people in China who've never even seen a McDonalds! Can you believe it??!? I've decided to add traditional commodities to Fade-Self, not because I care about the weather, growing patterns, or global dietary trends, but instead because they are a measure of global consumption patters. I don't look at corn and think about "crops"- I look at corn and think about how many new Lianhua supermarkets are going to open in Shanghai next year. Why don't I care about weather and crops- because hedge funds don't care about weather and crops. If we grow it they will buy it. It doesn't matter how much. Hedge funds know that and they've promised their investors one thing- as long as China is buying- we're buying. Well, to me that makes sense. The commodities that I'm interested in are only the most liquid. These include: Corn, Wheat, Soybeans, Bean Oil, Sugar, Cocoa, and Coffee. These markets are 50-100 times more liquid that markets such as Pork Bellies, Oats, or Wood Pulp. They're 1000 times more liquid than Milk, Tiger-Shrimp, or Appalachian coal. Traditional commodities are what the major derivitieve exchanges were built upon and as long as people eat- they will be an important part of speculating on global economics (by way of consumption patterns.)

The key to trading traditional commodities is trading small. A common theme with me. I've been trading sugar quite a bit this year. March sugar's current price is 13.39 cents. This commodity has nearly doubled in the past year. The margin on one contract is currently $700. A one cent move would make or lose you $1120 per contract. We entered at 12.44 just last week. The key here is that it's very tempting to buy 5 or even 10 contracts because the margin is so inexpensive. However, relative volatility is extremely important. A move like we've seen in sugar in the last week would be equivalent to a $7.18 move in crude oil. That's some serious price action. The margin on crude is $4,725. That means that to trade sugar and crude on a parallel basis you'd need to buy roughly seven sugar contracts for one crude. If you'd have done that in sugar you'd have been exposed to a market that could make that $7.18 crude move. That's too much risk for one week in my opinion. What's an appropriate amount of risk? I'd say buy 1 contract, wait and if it goes in your favor sell an at the money call against it. So, now you're looking at 1/7th of a crude futures contract in risk. For a market such as sugar where hedge funds can suck up liquidity like a sponge when they move, that's an appropriate level. One sugar contract per 50K is about right. So, to lose 2% of your account on a sugar trade- it would have to make a 4 cent move. Sugar would have to give back all the gains its made in the last 8 MONTHS! That's not very likely. The largest one-day move I've seen in sugar was about 0.8 cents or about a fifth of that. Lesson number one in trading futures trade small- with no ego. Give yourself a ridiculous amount of space on every trade.

Currently I'm short Corn, Wheat, Soybean Oil and long Sugar. The corn trade has been one of my longest- we entered on the short side back in early September and its still grinding lower. I've sold at the money puts on all my positions for the March expiry. The same is true for wheat. The sugar I've got in the money (13.00 Cent) calls written. The soybean oil position is the only without short option hedge against as we just entered it yesterday.

This is a major trend. Remember each full cent is worth $1120 in Sugar. When a market is making a major move like this- all bets are off. Don't fade this trend- Sugar could go to 20 cents!

As an aside, if you enjoy reading the newsletter and would like to actively participate in these tremendous moves I encourage you to go to our website at www.UnitedTradingServices.com and examine United Trading Asset Management's disclosure document. This is the prospectus for the investment. The minimum investment is $100,000 USD, however it can be traded with $50,000 to test us out.

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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