Volume I Issue XVIII

Fade-Self… One Trader's Commentary

Strategy 15 December 2005

"The Art of Pugilism"

"Every action is seen to fall into one of three main categories, guarding, hitting, or moving. Here, then, are the elements of combat, whether in war or pugilism."

-B. H. Liddell Hart

"I'm scared every time I go into the ring, but it's how you handle it. What you have to do is plant your feet, bite down on your mouthpiece and say, 'Let's go.'"

-Mike Tyson

I was recently watching the movie "Cinderella Man" starring Russell Crowe. It reminded me of trading and allowed me to ponder the analogy. (Y'all know how much I love trading analogies, right?) Mr. Hart's quote illustrates so appropriately three important facets of trading. So does Mr. Tyson's. One of the quotes comments on the observable outward facets, the other on the unobservable psychology. Hart, a military historian and strategist, describes the method of boxing in a manner that can be understood and even learned. Tyson describes the will of boxing – the unlearnable, unteachable capacity to do, to accomplish something in the face of defeat- and in the face of risk. Strategy is important because you'll need to know what to do to be successful trading. Discipline and will are important in order to actually accomplish success. You must be half strategist and half fighter. Muhammad Ali- the greatest- knew about both. Every word he spoke set up the strategy for his fights. My favorite quote of his is, "My way of joking is to tell the truth." Trading is simple. Just like humor. Or boxing. If you know what result you want- all you need is a plan and an execution of that plan. There are a thousand strategies, but only one way for you to execute. The strategies are observable and public knowledge, the execution is personal and is different for everyone. This issue is dedicated to great fighters (pugilists for the purists.) These champions chose their strategies, but more importantly- executed them.

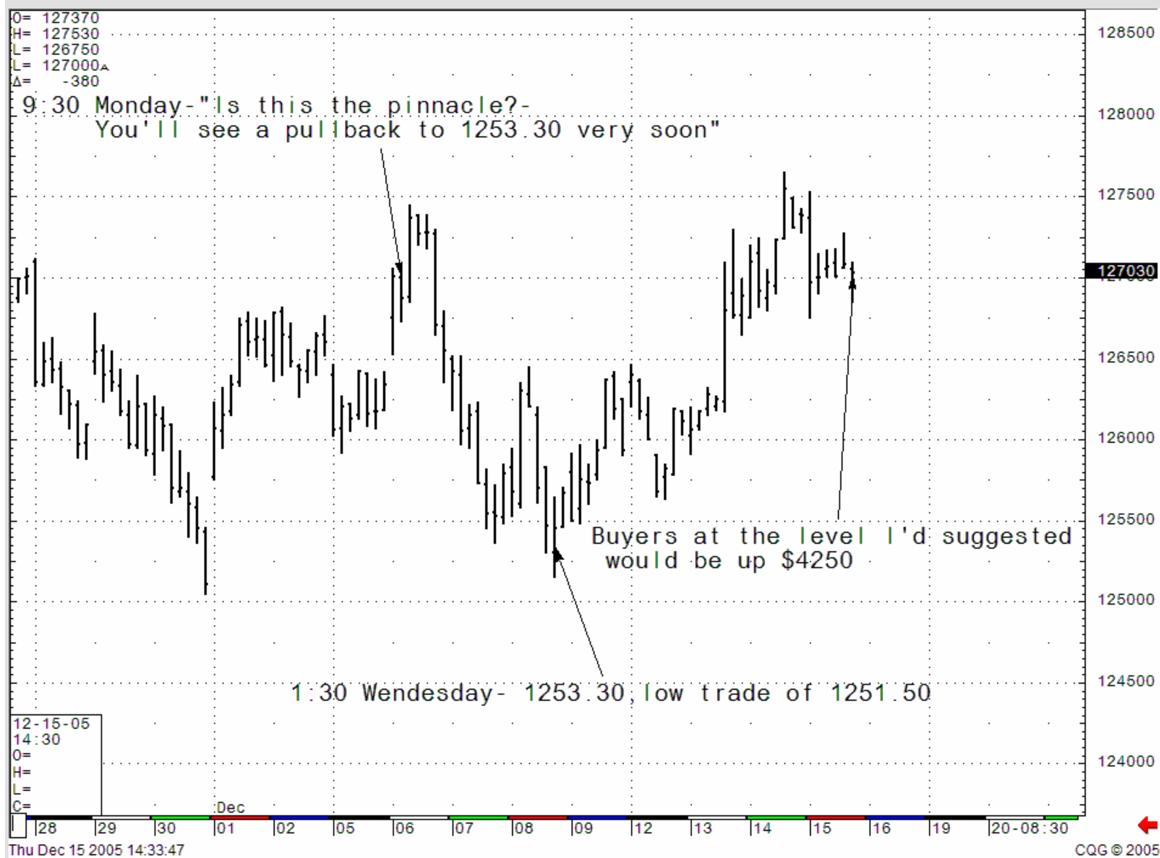
Equities- "Float Like a Butterfly, Sting Like a Bee"

That's precisely been the strategy of the equities market this year. A lot of footwork, dancing around, hype, and trash talking….and we're just about where we were 12 months ago. Ok, well you've seen some dollar appreciation- actually quite a bit. Enough to warrant being long the stock market. Here's the lesson to take from the 2005 stock market, trust me it will be a useful lesson next year.

Currency appreciation. Why are foreign investors happy with their U.S. equities portfolios this year despite historically sub-par returns? Currency appreciation. Think of it this way. You had a ticket to the "Thrilla in Manila" when Ali fought Frazier for the third and final time in October of 1975. Sure you had some fun with the trash talking and the crowd and the weather- but you didn't make any money from it. Well, if you kept your ticket stub you did. Think of currency appreciation as your souvenir return, the return you make just for buying your ticket to watch the magnificent show that was the US stock market 2005. Even with inflation (beer, peanuts, pretzel, and a foam finger) dragging your returns down by 2%. Even a breakeven mutual fund would have appreciated 8.5% on the rise of the dollar alone.

So, take a look at your mutual funds returns last year. What did you return? Five, ten, maybe fifteen percent at best? Now, just imagine that the dollar had DE-preciated 8.5%. Subtract that from your returns. Now ask yourself- what do you think about US equities in 2006? No Greenspan, no accommodative money, no Chinese infusion of buying in the bond market, no significant job growth, NO SOUVENIR RETURN! What have you got? Not a lot, so what. Just look to your bond portfolio for returns. That's not going to be easy in this extremely low inflation environment (yes I'm sticking to my opinion that deflation is still more likely than real inflation. It could be a rocky road ahead and historically (Crash of 1929 & Nikkei Crash of 1990) it has been. It's not straightforward to see from your stock market returns over the last four years, but we've actually been in a bear market in terms of real return relative to foreign investments. No matter what type of stock returns you saw in 2002, 2003 or 2004- they were bolstered by a total of 30% (~10% annually) by a heavily depreciating dollar. In 2005, when you finally saw dollar appreciation- you're faced with a breakeven stock market.

As for my predictions. Think of me as a dirigible – harnessing the power of hot air. Last week when the stocks were on their highs I was eyeing a downside objective. The velocity of the market was waning (~1.2%) and there was a massive gap below the market at 1251.50. In the section called "Ne Plus Ultra" (Is this the pinnacle?) I wrote, **"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…be a buyer at that level."** Following is a chart of the December S&P 500.



Treasuries- "Bare-knuckle Brawlers"

John L. Sullivan, the first heavyweight champ would have been right at home in the bond pits- especially over the last month where we've seen some serious choppiness ahead of today's (Dec. 13) fed announcement. This is one market that is going to get even choppier. Uncertainty breeds sideways markets. The

reason for this is obvious, however many times its hard to realize when you're in a trade. Conflicting opinions lead to a more balanced ratio of buys versus sells over time. This means that a market is more likely to consolidate because buyers are finding sellers and vice versa- at prices they both feel are fair. This is what will cause the market to trade sideways with low volatility. However, the second factor, which I call the "weak hands" factor, is derived from the idea that even if there were a breakout from the consolidation- the buyer (or seller) could easily be tested. Let's take an example using the 30-Year bonds. Ok, so we're trading in a range between 110.00 and 112.00. We've seen mostly low volatility rangebound trading for the last two months due to the uncertainty regarding the Fed verbiage maneuvering in the coming weeks- as well as the transition from Alan Greenspan to Ben Bernanke. Further accommodation would mean lower rates (relative to current expectations) which would mean higher prices (relative to current prices.) That's bull case #1. Transfer of power risk from Greenspan to Bernanke is another reason to buy bonds- because people are nervous that the wrong step by Bernanke could lead to the US stock market tanking- and a return to 1982-83 (read recession.) This would cause people to buy US bonds as a safeguard against below average equity returns. BUT WAIT! Its also bear case #1- Bernanke could continue accommodative monetary policy TOO LONG! This would mean INFLATION!! Higher long term rates- and lower bond prices. And just for kicks lets throw in the scenario that Bernanke makes the right moves and slowly heads off inflation by raising rates consistently over the next year- well that means a shift up in the interest rate curve and a drop in bond prices. Following all this? If not, don't worry its just basic armchair economics- if you really want to learn it just go to your local library and check about 5-10 books. It's irrelevant really- the point is- nobody knows whats going to happen and even if they did- it would be hard to tell which direction the bonds would actually go. So, as people are refining their ideas, reading their latest issue of The Economist, watching the Cosmo Cramer indicator on CNBC, listening to Ben Bernanke's speeches on NPR, and bouncing Fed Speak theories off their buddies on the golf course……..THE MARKET IS GOING SIDEWAYS!! No trend. Just chop. Now, what happens when one idea finally catches on…Cosmo Cramer (formerly of the more respectable and better dressed- Kudlow & Cramer) is blabbing about Ben Bernanke's lack of political savvy and how its going to cause the Fed to lose some of the independence that Greenspan worked so hard…blah…blah…Taylor rule, Paul Volcker…blah…while he is purporting that bonds will drop because Ben Bernanke will make a misstep- guess what- the bonds start to breakout of their 110-112 range to the DOWNSIDE.. Now, the first factor has been

illustrated- lots of noise and very little potential for profits. Now let's say you jump on the Cosmo Cramer bandwagon trade and sell bonds. We break out to 109.15 and you're making some money. Because there is not much of a trend and because there are so many different views in the market- ALL of the BULLISH views will gang up on your one major bearish view because 109.15 makes 110-112 look like chopped liver- it's a bargain to be buying 109.15- for all of the bull cases…so they all come rushing in to buy and they run it up to 111.00 and your stop is at 110.29- you're stopped out. Back to the drawing board.

Enough of my ranting. Let's see some results. I've always like the saying that, "The proof is in the pudding." I'm not promising you that I'll show you solid returns. On the contrary- I simply equipping you with as much information about my trades and trading style to make you make the decision that you trust in my abilities and prognosticating. I don't know what it will take for you to become convinced that this is exactly the type of investing that you're looking for. I'll just let the charts speak for me. Here is a chart detailing my views on bonds.

Metals- "No-Mas"

The famous line spoken by Roberto Duran in his 1980 rematch with the legendary Sugar Ray Leonard. After beating Leonard earlier that year, Duran in the seventh round signaled to the referee that he could fight, "No-Mas." No-more. The bout was called and Duran thus lost the world welterweight title. It's about time for me to say, "No-Mas" with regard to the metals. I can't take the gold move anymore. It's wearing me out, it's a little unreal. Don't get me wrong, I enjoy being right the market- but the move in the metals the last month has been ridiculous. You could have broken even all year long trading commodities and if you'd been long just one contract each of gold, silver, and copper on a one hundred thousand dollar account and offset your positions Monday morning- you'd have returned 23%.

The main problem with trading futures is that winners and losers are magnified. Therefore, if you pick a stock correctly and it makes a 10% move- you feel pretty good. You might mention it to your buddies at the club, at a cocktail party, hell maybe even at the grain elevator. At the end of the day however, you know you're still human. If you make 20% on a stock you'll start giving strangers stock tips, publishing e-mail newsletters (with clever titles- ((well clever to you anyway)), you might actually tell your wife about the trade. The bottom line is – making money on a trade is an ego boost. Making money quickly is a drug. Make four or five successful trades in a row and now you're running percentages while your shaving in the morning and during your morning commute. 20% a month, times 12 months, that's 240%. On 100K that's 240,000 by next December. Now you think to yourself, "If I can just do that same trade each month the following year- I'll have **XXX%**." Ok, so I'm exaggerating a bit, but trading does that to people- I've seen it before. Commodities only magnifies the risk and the potential reward. I had a client once that opened an account with 100K (keep in mind this is a cautionary tale)- he wanted to trade the Euro. So, overnight the first night he put in a bid below the market for 20 contracts – I think the price was 108.55 or so. Well, this was during the beginning of the Iraq war in 2003 and it just so happened that we drifted down overnight- he was filled on 20 contracts and before I arrived in the office the next morning the Euro was up nearly 200 points (there was rumors a major Al-Quida operative had been caught). Well, needless to say my client was ecstatic. His account had gone from 100,000 to 150,000 overnight! I could hear his jittery excitement when I called him to report the boon.

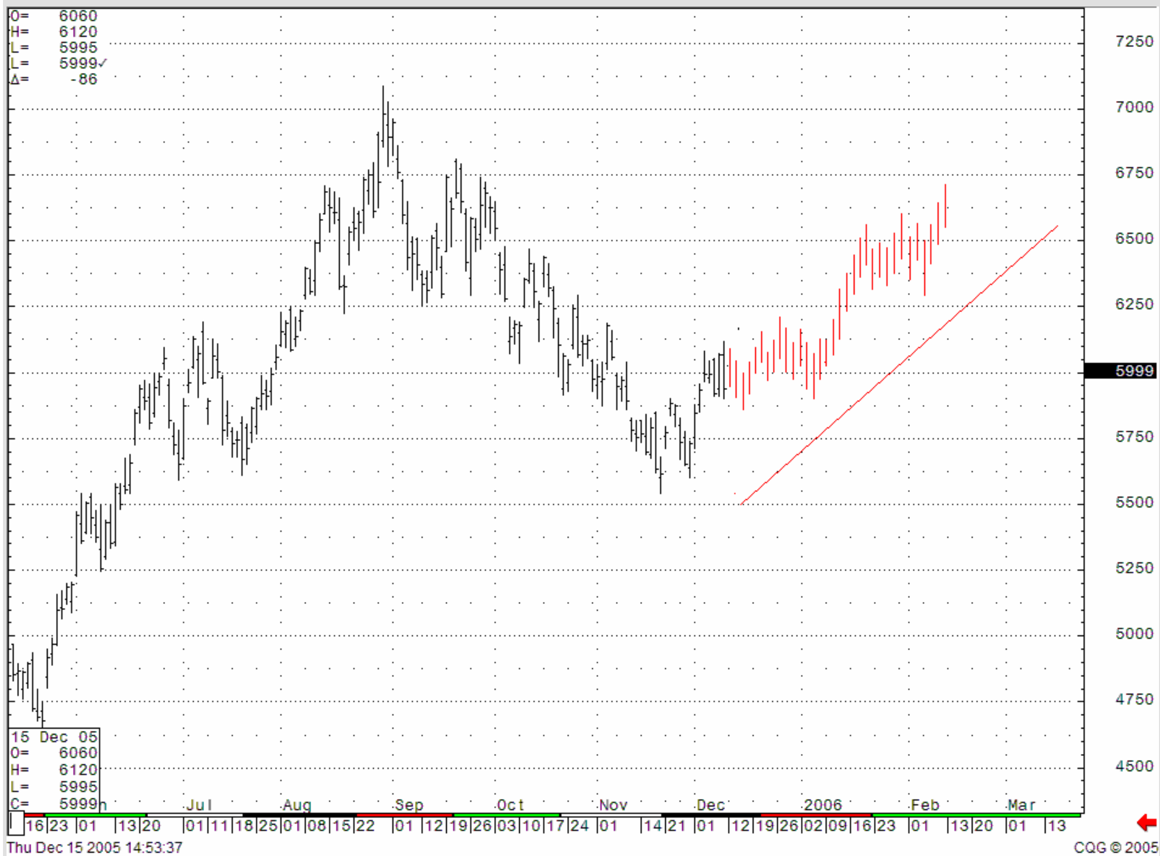
In his mind- he'd already started running percentages…by the end of the week he'd wired in another 450,000 and expected to take the account to 5 million by the end of the year. Realistic expectatons folks. The power of compounding gets in your head though. It makes you think- what is 50% of 100,000? $50,000. Ok, so if I do that every year for the next 10 years. Get out your scientific calculators- $100,000 x (1.50 $\wedge^{10}$) = $5,766,503. **I'm not saying that you could make these types of returns- as a matter of fact there is no active fund on Earth that's done this the last 10 years**- but this is the way that many people psych the themselves up in order to take action. It's not an intelligent way to think about trading. It's a good way to get you prepared to take a risk, because you just focus on the positive aspect- and compound it.

The moral of the story is that he overtraded. I did my best to slow him down, but with him trading online in the middle of the night- it was tough. I once came in on a Tuesday morning and he was already 650 by 700. That means he'd bought a total of 650 contracts and sold a total of 700- IN THE OVERNIGHT MARKET! This was back when the Globex Euro had spreads as wide as 5-7 ticks. The bottom line was- he didn't make $5 million dollars. So, please keep that cautionary tale in mind. I encourage all my clients to start trading with an amount of money that they are absolutely comfortable with. (Providing it meets our minimums) If you want to invest $500,000- I encourage you to start with $100,000 and add as you become more and more confident in the actual results in your account. I'd rather have $100,000 of low worry dollars- than $500,000 before you're totally confident.

As for the metals, it's Thursday morning and since I began writing the letter (I write it in spurts) the metals have plummeted! We gave back some of the wondrous profits that we racked up, but with the deep in the money calls that we're written- we'll still clear nearly 4% on the gold position alone. That's whopping. I hope I don't see those type of results on a trade again- it's TOO MUCH. Anyone who attempts to convince you that anything more than 35% annually is attainable in a low risk environment is – well to be polite lets just say misinformed. Intelligent investors are happy with 15-20%. I know, I know I'm sure you've made that much in a day on a particular stock that you can recall. Maybe you made that in minutes. That's not the point. Could you make that exact same trade thousands of times over and over for the next 30 years- now that's very unlikely. Trust me on this one- Harvard's endowment fund- which manages over $20 Billion dollars- shoots for 15% per year in their managed accounts. I'm currently hedged in the gold and silver- just making money on time decay until expiration in the 22nd. It's been a great month and I don't have a greedy bone in my body.

Energies- "Kid Dynamite"

Before his troubles with the law and the whole episode with his behavior in the ring- Mike Tyson was known for his lights out uppercuts. Fast and in a flurry from his waist through his opponents chin is how they came. I think you're going to see Crude do the same to its bearish opponents over the next three weeks. Shorts are going to be down for the count- for a while. Last trade in the January contract $60.11- my prediction is still $65.20 in the near future and then $70.00 before spring. Following is a chart with my predictions for January Crude highlighted.



Currencies- "The Nicknameless Brit"

Lennox Lewis, of course. Lewis restored honor to the European heavyweight ranks. The British Pound is doing the same thing for European currencies right now. The dollar has been pretty weak, especially against the Pound and the Yen. The weakness in the dollar is partially due to the end of the repatriation binge that occurred because of the change in the tax code that will make it less favorable for multinational firms to report profits next year. The Asian central banks are rumored to be buying Gold instead of U.S. treasury securities- just another reason the dollar will begin to lose strength significantly over the next two months. My prediction in the Euro for the end of March is 125.06 and I'll boldface it for effect- **125.06**. That would be a solid $60,000 move on 10 contracts. Now, if you know my trading style you know that I'm not suggesting you trade 10 contracts with any less than a $1,000,000 account. If you should be so fortunate- I would certainly suggest a 10 contract purchase- at the market. Be sure to use a stop- I suggest no more than 2% risk on the account. Here are my predictions for the rest of the currencies by February 1.

	Current Price	February 1	$ Value of Move
Swiss Franc	**78.11**	**82.05**	**$4925**
British Pound	**176.76**	**183.07**	**$4259**
Japanese Yen	**86.72**	**90.55**	**$4787**
Canadian Dollar	**86.61**	**91.24**	**$4630**

I think that rates will cease to rise significantly in the US in 2006. Bernanke and the rest of the Fed will tread very carefully now that policy is widely viewed as being "neutral" (this assumption is based on the fact that the word accommodative was dropped from the Dec. 13 Fed statement.) That fact in itself could lead to a 10% depreciation in the dollar in the next year. In fact, I fully expect the Euro to top 140.00 by the summer of 2007. It seems far off and even a bit silly to predict- especially considering our current downtrend, but based on my understanding of inflation, deflation, and productivity- I think it's a very likely scenario.

Traditional Commodities- "Eric 'Butterbean' Esch"

Have you ever reached for an analogy before? I mean really reached? Well, here goes….Did you know that you can actually trade butter futures? There's two, maybe three guys who trade in the butter pit, the market trade for about 5 minutes, and as a gag they still write the prices on a chalkboard. It isn't what you would consider a liquid commodity market. Markets like oats, porkbellies, ethanol, and the sort fall in the same category. Like "Butterbean", nobody really takes them seriously. However, the grains that are traded at the CBOT here at 141 West Jackson Boulevard- are the real deal. They are extremely liquid and are still very legitimate markets to trade.

I really can't say too much about the grains except report that Sugar is still strong- nearing 14 cents. Wheat not quite as week as we've seen 15 cent rally in the last week that's caused me to cut my positions back considerably. Corn looks ready to make a move to $2.28 in the March contract, but I'm still very bearish soybean oil. The fun really begins in the spring in Chicago when grains really start to move. Until then- they are really a boring asset. However, if you've been short they've been a lucrative one.

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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