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# Ask Slim

## By Steven Miller

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### Dear Slim,

I have been thinking about trading as a full-time source of income. I currently trade part time — mostly E-Minis. I have been reading a lot regarding trader psychology and find it fascinating. Personally, I feel I have the discipline that is needed to keep focused. Since I am considering trading full-time at home, are there any suggestions that you can give regarding adapting to this new environment?  
-Eric M., via e-mail

### Dear Eric,

It is certainly a big decision to make trading a full-time career. The choice to trade from home should also be given a great deal of thought. I made this step over a year ago, after 19 years of trading in an office.

For most people, trading at home will take a big adjustment. Can you set boundaries? Do you have a spouse or children at home? Trading online takes a huge amount of focus. Distractions can keep a trader from “feeling” the information coming off the screens. There must be an agreement with your loved ones at home. When trading, you cannot be disturbed. The telephone on your desk is dedicated to your business, and the house phone is answered by others or goes to voice mail.

Prepare a space in your home that is your trading area. If possible, I use two computers, one on DSL and one on cable modem. Then you’ll have a redundancy in case one goes down. For E-mini traders, two monitors should be sufficient, one for trading and one for monitoring the markets and charting. Stock traders may need several monitors to get enough space to watch a large enough trading universe. Have a good chair to avoid back problems.

What about the feeling of isolation? Many traders who work in “trading rooms” prefer the interaction with other traders. They like to hear traders calling out, “there’s buyers in such and such stock.” The challenge at home is the feeling of aloneness that can put some people into a coma. CNBC on in the background helps, along with keeping you in touch with the news. Keep yourself alert. Avoid high-carb lunches. Drink a lot of cold water and take walks around the room.

Finally, it’s important to develop a good work ethic. Getting to the computer a minute before the bell just won’t cut it. Give yourself plenty of time every morning to get centered and in touch with pre-opening events. I hope these tips help you as you venture into trading “home alone.”

### Dear Slim,

Is there a website or book that you can recommend that gives advice on tax consequences of stock trading? I am researching how my profits and losses are handled by Uncle Sam. All suggestions are appreciated.  
-Alex P., Atlanta, GA

### Dear Alex,

There are several good websites that offer comprehensive answers to tax issues for stock traders. Many sites are just there to sell their services, books or other products. Read through a few of them for

better understanding of the laws, as the language differs on each site. The following is a list of free sites.

***<http://taxes.yahoo.com>***

A very good site with many tools and valuable information related to taxes. Use the search tool and type in the words “day trader taxes.” Follow the link that says “more tax tips for day traders.” Then click on the link that says “taxes on day trading.” This area has the important information needed for decisions on handling trading income and losses.

***<http://www.smartmoney.com>***

A very good site for financial information. Getting to the page on traders’ tax issues takes some navigation. Here’s the long link that will take you right there: <http://www.smartmoney.com/tax/capital/index.cfm?story=moredaytrading>. After you’ve read this section, follow the link that says “taxes on day trading.” This is similar to the Yahoo section, with great tips on taxes for very active traders.

***<http://www.thestreet.com>***

Jim Cramer’s site, another wealth of information. Use the same searching procedure. Tip: after you have done your search, click on the link that says “sort by relevance.” That will save you from scrolling through the hundreds of stories that will be found in your search.

***<http://www.daytradertax.com>***

Owned by Mann & Co, CPAs, they give minimal information and are basically selling their products and services. If you are looking for a company that offers tax planning and tax preparation for day traders, it’s worth checking with them, at least for comparison purposes.

I am not a tax expert, so I urge you to discuss your tax issues with a professional. The most important issues to consider are: 1) Are you a trader? If you decide to make this election with the IRS, your trading income is handled differently on your tax return. This election allows some expenses that are subject to being handled as itemized deductions with limits, to be handled as business deductions without limits. Also, as an active trader, you have mountain of paper that shows your stock sales. As a trader, there is a specific way to list your sales and cost of purchases. 2) Do you choose to take the mark to the market election? This will eliminate the limit of \$3,000 for capital losses in a given year. So if you have a losing year, you can deduct all the losses from profits in the following year. It also exempts a trader from the wash sale rule, which prevents an investor from selling a stock at a loss and buying it back within 30 days.

There are downsides to making these elections. If you choose to consider yourself as a trader, you are doing so for next year. Your 2002 taxes will be handled just as they were the year before. Also there is additional risk of a tax audit. You may have to prove you are a “trader.” The IRS has specific criteria,

of which the guidelines can be found in the websites listed above. If you choose the mark to the market status, you are giving up any long-term capital gains. But as a short-term trader, this shouldn’t be a big concern.

There is a huge range of costs that tax specialists charge for service to traders. I was amazed to find an accountant at H&R Block Premium Service that was well-versed in traders’ issued and handled my tax filings at a fraction of the cost I used to pay for the so-called experts. Make some calls and shop around for fees and levels of expertise. It can save you thousands of dollars and the nightmare of dealing with these complex issues incorrectly.

**Dear Slim,**

Could you please recommend a few web sites for receiving listed stock option quotes? -James J., via e-mail

**Dear James,**

There are many websites where listed options can be found. Unless you subscribe, nearly every site has a 15-20 minute delay. Some of the best sites are only available if you open an account with the firm. For me, as a professional trader, I want to see the whole montage of puts and calls, real time. Also, I want option study tools and at least the front and second month visible without changing the page. The following is a short list of some of the best stock-option websites.

***<http://www.wallstreetcity.com>***

It’s a decent site with quite a few resources. They offer a 30-day free trial. Option pages are puts or calls, with several months of viewing. There are no Greeks, so advanced option studies are not available (Deltas, Gammas, etc).

***<http://www.quote.com>***

This is the Lycos Finance site. Subscriptions are relatively inexpensive, depending on your needs. Option montage is quite adequate for an inactive trader, viewing of puts and calls, but only one month at a time. There are no Greeks here either.

***<http://www.PreferredTrade.com>***

This is a stock and option trading website that offers full-service trading for professionals. A 30-day trial is available for \$49. Their option software offers full Greeks and scans. There are also position and risk management tools. Overall, it’s a very good site. Option commissions are competitive, but stock trading is expensive if you trade over 2,000 shares.

***<http://www.ThinkorSwim.com>***

This site was designed by options professionals for options professionals. It is user-friendly and does everything an option trader could possibly want. There is no demo, so you’ll have to open an account to see for yourself. Their trading platform will blow you away. Prices are on the high side for smaller options traders because of a ticket charge. Once you exceed 50 lots, the

commissions are very competitive. They also offer stock trading, but that is not what this site was designed for. If you're an active option trader, try this one out.

**Dear Slim,**

I have invested in mutual funds for about seven years. The last three years I have done very poorly. In fact, I am barely even for the whole period. My father-in-law has invested in a couple of hedge funds, one of which has done very well during this period. Please explain what a hedge fund is and how I can invest in this type of fund? -David D., Princeton, NJ

**Dear David,**

A hedge fund is a private investment partnership formed to achieve above-average returns through active management. These funds are exempt from many of the regulations that govern regular mutual funds, allowing the fund manager to use relatively aggressive trading models. Laws restrict participation to 100 limited partners, who supply most of the trading funds. The general partner handles running the hedge fund and the trading. Most hedge funds set their minimum investment quite high, ranging from \$100,000 to more than \$1 million. Thus investors tend to come from institutions or are wealthy individuals.

Strategies may be all long stock, all short stock, long-short stock, market neutral, convertibles, stock hedged with options, stock hedged with indexes, event-driven, program trading or even all options. There are multi-strategy funds and even "funds of hedge funds." This great variance of strategies

tends to bring returns that are all over the map. Do not expect to get a close correlation with the market indexes. Returns can be anywhere from huge losses to returns of well over 100 percent per year, with no regard to market conditions.

The fund manager is compensated through a management fee, usually one to two percent and an incentive fee, usually 10 to 30 percent of positive return. If a fund manager has a negative return for a period, he must bring the fund back above the last high-water mark for which he received incentive compensation, before he can get paid again.

There are several good websites that an investor can search through massive lists of hedge funds. Hedgeworld.com is a great site. Like most of the sites, it requires that you fill out a questionnaire to determine if you are a "qualified" investor (net worth of \$1 million or annual income of more than \$200,000 individually or \$300,000 jointly with spouse for last two years). Only then can you enter these sites.

For my readers' information, I am in the initial stages of forming my own hedge fund. The model will be long-short stock and will be very actively traded. It is the model I believe offers the greatest potential returns with the most controlled risk. Private placement laws are very strict and allow only a very low-key selling effort. Offering memoranda may be sent only to people with whom the general partner has a pre-existing relationship and who meet sophisticated investor requirements of an accredited investor.

