

# ASK SLIM

I'll share a quick history of my trading career and let you decide. I've been a trader for 31 years. My trading career began in 1974, at 24 years of age, on the Chicago Board Options Exchange (CBOE). Over the 17 years I was a member of the CBOE, I traded in nearly every pit on that floor. Much of that time was spent in the chaotic OEX pit. Over the years I was a member of the Chicago Mercantile Exchange (CME) and the Chicago Board of Trade (CBOT). I have traded "off the floor" since 1984.

In this column, I will answer your questions on the technical and psychological aspects of trading and trading methodologies. Oh, and the next question would be, why the name "Slim?" My badge on the CBOE was "SLM" (Steven L. Miller). Other traders gave me that nickname on my first day of trading, back in 1974. So, ask Slim!



Dear Slim,

*I'm thinking very seriously about investing in stocks and futures, and I need some advice on education and on how to start. First, I think I need to upgrade my computer to at least two gigabytes of memory, at least 120 GB of hard drive, a 21" LCD monitor and DSL Internet service. Is this correct? Next, what brokerage firm would you suggest I begin to trade with? Next, what company should I go with for charts and technical and fundamental analysis? Thanks for your advice.*

*—James M., via e-mail*

Dear James,

Oh boy! James, have you got your priorities upside down! Your question is full of "tells." You should think a bit harder about this endeavor before moving forward, as it appears you are just beginning to learn about the markets. There are many important questions to consider outside of computer hardware, execution firms and information sources before putting real money on the line.

Here is the short list: Why are you investing? Is this to increase your returns or to speculate? Are you trading as a hobby, or do you want a career in trading? How much money will be involved, and what percent of your overall net worth does it represent? How much can you lose without it affecting your lifestyle? Have you defined your risk management and discipline rules? You talk about technical and fundamental analysis. If you are an active trader, with a short holding period, the technical aspects of the markets will make more sense. If you are an investor with a longer holding period, you may lean more to the fundamental side. So you need to define your methodology and trading style to have a clue about which tools to use to make your trade selections. Then you have to define loss limits and trade objectives. It goes on and on.

Summing it up, venture into the markets as you might with your next relationship. It's about your approach, not the size of your hard drive.

Dear Slim,

*What is the easiest (and least expensive) way for me to access daily and monthly MACD for stock indexes, individual stocks, and currency and bond futures?*

*—Tom T., via e-mail*

Dear Tom,

The least expensive way to get MACD is for free. There are many vendors that give this and many other charting tools away just so you will visit their sites. Here are a couple of good choices. For stock charts, go to [www.stockcharts.com](http://www.stockcharts.com). For futures charts, go to [www.futuresource.com](http://www.futuresource.com). Of course, these are all delayed or end-of-day charts. If you wish to have live, up-to-the minute charts, you will have to upgrade and pay the fees.

Hi Slim,

*I have been learning as much as I can about options, as I believe, eventually, I will better control my losses and leverage my gains versus equities.*

*I need to know where to concentrate my efforts. Should I be looking at options of high-priced stocks, say over 50, or options of low-priced stocks, say below 25?*

*Low-priced stocks usually have higher volatility, yet options of high-priced stocks move in larger increments. I am interested in getting more bang for my buck but not at the expense of increasing my risk. It's confusing.*

*—Al K., via e-mail*

Dear Al,

There is no short answer to any question regarding the complexities of options trading. Your desire to get more play for your money says you are a directional trader, meaning you buy puts or calls depending on your opinion of the underlying stock. Accordingly, the price of the stock is not as important as your trade selection. What you must be concerned with is that the stock is in a phase when it is on the move versus in a range or consolidating. Otherwise, you may get

into a position that just depreciates without ever having a chance at profitability.

Generally, stocks that are "in play" have higher implied volatility (higher premiums). That's because they have a higher beta (volatility relative to the market). You can partially alleviate the higher tariff in these stocks by buying in-the-money options, which have lower premiums than out-of-the-money options. You will get less leverage this way. However, this shouldn't matter as you are cognizant of controlling your risk/reward situation. This also will improve your risk management because it is harder for in-the-money options to hit stop-loss points because of the lesser rate of option decay (theta). Given that your style is speculative, you'll want all the help you can get.

*Dear Slim,*

*What are the rules for taxation on forex trading? They do seem ambiguous.*

*—Carl H., via e-mail*

Dear Carl,

This issue of taxation of forex trading can be a bit confusing. For companies that may make or lose money from fluctuations in the forex

market, as a function of their normal course of business, forex trades fall under Internal Revenue Code (IRC) 988. This section says that earnings will be treated the same as interest income meaning earnings are taxed based on the company's overall tax rate. Because forex traders also are subject to market fluctuations, their profits also fall under 988.

However, as with other futures on regulated exchanges, forex trades also fall under (IRC) 1256, which allows profit to be split 60/40. That means that 60 percent of profits are taxed at the current 15-percent rate for long-term capital gains, and 40 percent are taxed as ordinary income. The effective rate is then around 24 percent.

Forex traders actually have a choice under which code they will be taxed. Certainly you would want your profits to be taxed under IRC 1256, the 60/40 split. The catch here is that in order to be taxed under 1256, the trader must "opt out" of 988. This has to be done "internally," documented in your own records prior to when you make the trade. Really, there is little reason to choose IRC 988 unless you have a loss. And how would you know that in advance anyway?

These comments, of course, are my interpretations of the tax code. You must consult with your tax professional for advice on forex trading and all tax issues, and you'll find a lot of information in this particular issue of SFO as well. ■

This Article was printed in the February 2006 issue of SFO Magazine.



SEND ME YOUR  
QUESTIONS!  
AskSlim@sfomag.com or  
Ask Slim  
**SFO** magazine  
3812 Cedar Heights Drive  
Cedar Falls, IA 50613

**SFO** Stocks Futures & Options

Provided by permission of SFO Magazine. Originally published February 2006.  
© 2005 Wasendorf & Associates, Inc. • 3812 Cedar Heights Drive • Cedar Falls, IA 50613