
Ask Slim

By Steven Miller



Provided by permission of SFO Magazine March 2003
© 2003 Wasendorf & Associates, Inc. • 3812 Cedar Heights Drive • Cedar Falls, IA 50613

Dear Slim:

I thoroughly enjoy the articles in SFO, particularly those regarding trader psychology. I've been receiving the magazine since Day One and remember your article in the Premier Issue entitled "The Fear Factor," about psychological sabotage. As a trader, I understand the importance of keeping a cool head, keeping a trading journal and monitoring my reactions to fear and greed. I have a very close associate who has just started trading part-time, and his trading seems to be very emotionally charged. I remember going through those emotions when I was a novice, but I was wondering when or if there is a point that a person should consider the fact that trading might not be for them? Obviously, adjusting to the emotional ups and downs of trading takes time, and I have referred my friend to many SFO articles on trader psychology for advice. On the other hand, I have heard of people that simply don't find their niche when it comes to the markets. Do you have any opinions of possible telltale signs that someone is beyond taking psychological advice and probably isn't cut out for the markets?

—Brendan E., via e-mail

Dear Brendan,

I have seen people from all walks of life endeavor to be traders. Many of these traders have had dynamic personalities and stormed into the business. Some of them have been so meek and socially inept that one would never guess that they were successful traders. Every trader I have known has gone through periods of difficulty, and they ask themselves the same question you asked about your friend, "Is trading really for me?"

Very few traders begin their careers making money out of the gate. Turnaround times can be anywhere from six months to 18 months for full-time traders. Your friend just started trading part-time. That might be the first drawback. Part-time traders, who earn their living elsewhere, usually are not attuned to the pulse of the market. That could make the learning period very frustrating, which might be what you are observing.

Learning to trade comes from hands-on experience. One may read many books and attend classes and trading seminars and spend long periods of time paper trading. However, trading with real money, and making the same mistake enough times, is the only way to really learn to trade profitably. Thus, to learn to trade you must start out losing money. That makes trading wrought with emotional triggers. As a person moves through the early stages of a trading career, there are constant threats to their identity. Even veterans (like me) are often challenged to look deeply at who they are as a person, outside of being a trader, when a slump hits.

Very often, when a trader asks me to coach them, they come to me in an "emotionally charged" state. Our work is to find the source of these emotions and arm the trader with a heightened awareness. Then this person can use the energy of the emotions in a positive way. Trading differs from most vocations in that emotion is always involved. Profitability comes from acting with confidence. The root emotion of confidence is joy. When joy is the prominent emotional charge, we feel good about ourselves and about our environment. When in that paradigm, our filters allow us to "feel"

the market and act aggressively and confidently. At that point, the money often rolls in.

Brendan, your friend has had a calling to the markets. It sounds like it's way too early for him to have found his niche or trading style. Yes, the emotional aspect of his trading, that you have observed, will probably need to be dealt with. The challenge is to get an individual to hear the need. I suggest you continue, in a caring and delicate fashion, to suggest that the effects of the emotions are impairment to success. Sources for help are other experienced traders, books and articles on the physiological aspects of trading, personal growth groups and trading coaches. For further information, see Brett N. Steenbarger's article entitled, "Expose Yourself: A Powerful Technique for Breaking Emotional Patterns in Trading" in the October 2002 issue of SFO. The interview with him in this issue should be eye-opening as well.

Dear Slim:

There are a number of books on the market on seasonal trading, and it seems to make sense for commodities, but less for stock index products. Are there, in fact, any seasonality factors on the financial futures side of the market?

—Nicholas S., via e-mail

Dear Nicholas,

It is true, there is not much written on seasonality of financial markets. That's mostly because these markets haven't offered much historical consistency for this subject. What there is might fill a few pages rather than a whole book.

In the '70s and '80s, we saw some regularity in the stock market, with a leaning towards strength early in the year and a weaker market in the fall. The years 1978, 1979 and 1987 all saw crashes in October. However, when the secular bull market really got its legs in the '90s, the pattern changed, with the periods of measurable weakness in the stock market coming in the spring and summer months. Since the bear market began in early 2000, there has been no consistency in the timing of the few short-lived rallies.

There have been studies that do attempt to define stock cycles based on seasonality. One study shows that if you bought stocks near some low point in the fall and sold them near the peak of a rally in the spring, over the years, you would do markedly better than those investors that bought and held the entire period. A similar study entitled, "Winter Blues; A SAD Stock Market Cycle," credited to a UBC professor, Dr. Maurice Levi, discusses a link between Seasonal Affective Disorder (SAD) and improving stock market returns. This study says the short, dark days of winter bring on a depressive disorder (winter blues) that makes people less likely to take risk. They contend that the best returns come by investing near year's end as the "turn of the year effect," coinciding with the end of tax-loss selling, brings a more favorable sentiment to investors.

The best resource I know of covering market seasonality is the Stock Traders' Almanac, by Yale Hirsch. It's available at Amazon.com for \$21.

Dear Slim,

I am delving into the world of technical analysis and am beginning to study different chart patterns (flags, pennants, triangles, etc.). While reading an article, I ran across something called a "diamond" pattern. The article didn't go into much detail, basically stating that they are rarely formed. Could you please expand on this type of pattern? Why is it rarely used? Is it something I should spend time on researching? As a beginner in this field of study, I just want to make sure that I'm looking into all avenues that may benefit my trading.

—Alex P., via e-mail

Dear Alex,

A diamond pattern is a chart pattern that is quite rare. It is actually made up of a broadening triangle or megaphone followed by another triangle. Occasionally, on charts of shorter periods, a diamond will act as a continuation pattern. However, most of the diamonds take a long time to form and are a sign of a major top. To get the measurement (objective) of a diamond pattern, calculate the height of the diamond, around the midpoint, and measure that same distance from the breakout or breakdown point.

A great example of this chart pattern occurred on the monthly chart of the Dow Jones Industrial Average. As shown on the chart below, a very large diamond formed making up most of 1999 and 2000. The height of the pattern was nearly 2000 points, suggesting a downside objective below 8400. Well, we all know that objective was more than fulfilled. However, if you traded bearishly based on this pattern, you had to wait about five months to get paid. Most chart patterns are more useful than the diamond.



Dear Slim:

What, in particular, are trading arcades? I understand the concept of sharing office space and resources, but what are the advantages of such a set-up besides the issue of cost? Is this something that mostly professional traders do? Or are there arcades for retail or part-time investors?

—Jessica L., Albany, NY

Dear Jessica,

Stock trading arcades are facilities that are set up for multiple traders. Beyond sharing expenses, other considerations are educational services, camaraderie with other traders, commission rates and margin benefits.

Time in the classroom will be well spent for beginners and experienced traders alike. Even for seasoned floor traders making the transition to electronic execution, educational services are very important. Trading from “upstairs” is an entirely different paradigm than floor trading or investing. The only “edge” is finding momentum and adding to positions when you sense you have caught a good trade. Much of the classroom time is spent learning tools to identify momentum through chart-pattern recognition, tape reading and order flow. Emphasis is strongly on day trading.

Some people are more comfortable interacting with other traders than sitting alone in an office or at home where there may be many distractions. And watching a large universe of stocks is quite difficult. With other traders in the room, there is often a lot of market chatter which helps a trader stay focused on which stocks are in play at the moment.

Commission rates, for small traders, are very low. Rates have fallen below a penny a share. So if you trade units of less than 1500 shares, you’ll do better in the trading arcade than if you paid a ticket charge with a super-low-priced discount broker. However, if you trade actively in larger size, commissions can get quite costly and will be a factor in overall profitability.

What might be the biggest benefit of trading in an arcade is the hugely favorable margins. Normally, investors only get 2:1 margin. If you are a “pattern day trader” (NASD’s rule 2520 amendment) and you have \$25,000 trading capital, you can get 4:1. However, trading in an arcade gives you access to a huge pool of funds. Most companies give you at least 10:1 and some go as high as 30:1 on your money. It’s a huge advantage!

The most common arrangement between the owner of a trading room and the trader is a partnership where the trader gets 100 percent of the profits and losses. The owner makes their share on the commissions. The trader is usually required to get licensed (Series 7) and to bring in his own funds (\$25,000 or more). Then you pay around \$500/month for desk space, data feed, direct access and computers. Active traders get a monthly commission rebate, which may cover all or most of this charge. There are a few companies around who do not require traders to bring in any of their own money, and they only pay out a small share of the trading profits.

Based on these arrangements, arcades are used mostly by professional traders. In fact, inactive traders have shared that owners of these facilities have pressured them to pick up their activity. So generally, the cost structure and setup of these rooms is not for the retail or occasional investor. For more information on trading arcades see David Silverman’s article titled, “Direct Access Takes on a New Meaning in This Electronic Age,” in the November 2002 issue of SFO.

