

# 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!



*Steve,*

*I have a question about shorting stocks and the NASD Uniform Practice Code 11830. Can you tell me why there are some stocks that trade a large number of shares on a daily basis but can't be shorted? I thought it was my brokerage firm, but they stated that some stocks can't be shorted because of the NASD regulation. Why is this?*

*-Ben, via e-mail*

Dear Ben,

When a short sale is executed, the buyer is entitled to receive the shares. Of course, the seller doesn't have the shares, which is where the term "short" originated. Thus, the seller must borrow the stock to meet this obligation of delivery. Often when a stock has an unusually high level of short selling, it becomes tight or "hard to borrow." So the SEC had to design a rule to deal with this situation.

In 1993, the SEC added UPC 11830, requiring short sales on NASDAQ stocks be delivered no later than ten business days after the settlement date of the trade or the member must cover the short sale for cash delivery. The rule also states that stocks that have an aggregate short position in excess of 10,000 shares that equals or exceeds one-half of one percent of the total outstanding shares of the stock, be restricted. Note that this has nothing to do with average daily volume. If a stock becomes restricted, the member may be required to close existing short trades. The NASDAQ compiles the restricted list daily, and you most likely will not be able to short these stocks.

*Dear Slim,*

*Does the wash rule affect people who day trade? Can I get around the wash rule if I'm a day trader buying and selling the QQQQs?*

*-L.H. from Jersey, via e-mail*

Dear L.H.,

The "wash-sale" rule says you cannot claim a loss on the sale of a security if you replace it with like securities (including options) within a 30-day period before and after the sale.

The rule also affects people who day trade, unless they make the "mark-to-market" election with the IRS. Making this election means you are primarily in the business of trading, and you may have to prove it. If you make this election, there will be other changes besides the exemption from the wash-sale rule. All of your trading becomes ordinary income, and all your security holdings are treated as if they are all closed out at the end of the year. Hence, there will be no capital gains or losses. Also, you can't change your mind. So once you say you are a professional day trader, you keep the label. Exchange traded funds (ETFs), like QQQQs, are like any other security and subject to the same wash-sale rule.

*Dear Slim,*

*You recently mentioned in your weekly newsletter that the VIX at 12.96 is "worrisome." I am not a seasoned trader, but I have come to understand that the VIX can be looked at as a relative measure of market complacency. I was told last year by an ex-market maker that when the VIX was below 20, it represented a complacent market.*

*From observing the VIX daily for the last two years, I have noticed that the stock market does not sustain a rally for very long when the VIX is under about 14.50. Now it has stayed under 14 for many weeks, and the stock market has rallied even further. What does it mean when record-low VIX levels have been blown through to new record lows?*

*Do low VIX numbers mean anything anymore? Readings this low should be a concern, with any bad news causing a fast and hard sell off, trapping the complacent stock market bulls. Do you use extreme VIX levels in your trading?*

*-Mike, via e-mail*

Dear Mike,

The VIX is a Chicago Board Options Exchange index that measures the volatility of the stock market. Essentially, the index is a measure of "implied volatility" on the OEX options. When option prices are high, the expectation of big price moves is high and vice versa. Historically, when the market was in a rising mode and investors felt confident, there was little reason to aggressively buy put options as protection. As demand for puts waned, option premiums fell overall, lowering implied volatility, and with it, the VIX. For many years, a reading of 20 on the VIX meant that stock market buyers were very complacent, and that often brought steep declines. In market panics, the VIX got over 50 as put buyers were willing to pay nearly any price to cover shorts or buy stock market insurance.

In 2004, something changed, as you noted Mike, with the VIX falling to well below 12. Throughout my career, I have seen several well-followed market indicators fail. For instance, short-interest readings used to be a great indicator of market sentiment. However, listed options ruined that, offering strategies that brought soaring levels of short interest without affecting the market. Dividend yield is another stock market measurement that went awry as companies stopped raising dividends and reinvested funds in themselves and other companies.

Thus, due to unique circumstances, the parameters of these indicators changed, at least for a while. I think the big change came for the VIX when futures and options were listed on this index. Traders knew that the VIX rallied (volatility increased) each time it got to 20.

So traders kept buying it as it fell at a time when the stock market traded in its narrowest range in a decade. Traders just kept getting caught and the index kept falling.

I do look at the VIX in my overall analysis. However, it's just a part of the big picture. As stated in my January predictions, I believe 2005 will bring sharp stock market declines. When the selling hits the markets, the VIX will explode upward again as investors move back into put-buying mode. Will the VIX again trade over 50 or will the futures and options make it tamer? That will soon be seen.

*Dear Slim,*

*I cannot find a broker to trade the OEX that does not want \$50,000 to open an account. Do you have any ideas?*

*-Danny M., via e-mail*

Dear Danny,

You must be planning to sell naked OEX options. Nearly every broker will open your option account with much less than \$50,000 if you use strategies that have limited risk. Some brokers will open an account with as little as \$2,000. Margins on buying options outright are essentially 100 percent of the risk. If you are buying one \$5 put or call, your margin is \$500. Margins on one-to-one spreads are similar. Naked strategies, however, carry much higher margins that can be as much as 20 percent of the value of the underlying index. So be clear on how you plan to trade. If you do want to sell naked index options, put up the big dough, and plan on taking the heat from the stock market. **SFO**



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 March 2005.  
© 2005 Wasendorf & Associates, Inc. • 3812 Cedar Heights Drive • Cedar Falls, IA 50613