

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,

In the August 2006 issue of SFO, in a question about the homebuilding stocks, you said you thought this group would "recover 30 percent to 50 percent." For most of these stocks, your prediction came true. There have been improving statistics on housing starts and permits, prompting analysts to declare the worst is over for real estate. What do you think about this group now? What do you think about real estate on the whole?

—Ed K, via email

Dear Ed,

Yes, Ed, the homebuilding stocks have had bounces over the past five months. Most of these stocks have had recoveries towards the low end of my expectations. These rallies came from quite an oversold condition, as there had been relentless selling in homebuilders from July of '05 through July of '06. Buyers were also attracted into this group by the Federal Open Market Committee's (FOMC) end to 17 straight interest rate increases and what appeared to be a coming rate cut.

Conditions have changed, however, in the past couple of months. It had appeared that economic growth was slowing, hence the belief in a rate cut. Now, since the price of crude oil has plunged and the economy has apparently firmed, the Fed Fund market has priced out any rate cut for 2007. Based on current market conditions, we are just as likely this year to see interest rate increases as cuts.

While short-term rates have moved up, long-term rates have remained relatively low. So the difficulty in real estate has come more from the supply/demand situation than from two years of interest rate increases. Inventories of unsold homes remain a huge overhang on the single family home and condo market. In some coastal areas of the country, prices have fallen sharply, yet turnover continues to be low. With speculative buying out of the housing market, these inventories remain a problem.

Another problem is that homebuilding companies are taking big hits on write downs on inventory and deposits, and options on land holdings they accumulated during the bubble. These losses total around \$2 billion so far and there is sure to be more to come. This is essentially writing a subdued future earnings story, as these companies gear down to operate in a much slower housing environment.

What's really interesting is that the Real Estate Investment Trust (REIT) market has fared much better, as commercial real estate has held together. I believe there is a big correction coming for the REITs this year, coinciding with a correction in the overall market. In the meantime, I expect to see homebuilding stocks struggle to make further gains and eventually break to or below last year's lows.

Dear Slim,

What makes the crucial difference between successful, profitable professional traders and unsuccessful traders? Can an individual trader emulate the professional trader and be profitable and successful also? What are the ingredients needed?

—Kurt F, via email

Dear Kurt,

I have seen people with vast differences in personalities and backgrounds do very well as traders. I don't believe there is a single "crucial difference" between successful and unsuccessful traders.

Trading is very complex. I equate it to a golf swing. There are many elements that need to be in balance just to get that tiny head on the end of the club to hit that little ball. Then you need to learn how to get the ball to land where you want it to go, without hitting the trees, water or sand (expletives omitted). It is quite a challenge and takes years of hard work.

In my workshop and coaching programs, I focus on "The Five Essential Building Blocks to Successful Trading." These are the areas I believe need to be in balance for success in trading:

1. Define a healthy "role" for trading in your life. Often traders struggle because their motivation for trading is about solving problems in their lives. "I need to make money to pay for my child's college or to leave the job I hate." It should be about staying within your own "trading map," making trades because they fit within your method and are determined by your analysis.
2. Build "emotional fitness." Our emotions may prevent us from maximizing trades or cause us to stay too long with a loser. Much of what drives us as traders is not related to trading. You need to discover these roadblocks and the emotions they trigger.
3. Your choice of markets, trading style and method should be in balance with your personality and financial conditions. If you are risk averse and have a \$5,000 trading account, it will be hard to be successful trading volatile markets like eMini NASDAQ or crude oil.
4. Discipline! This is the most overused and misunderstood word in trading. It goes well beyond just keeping your losses small. It encompasses your learning and research, mental preparedness each day, physical condition, trading environment and more. It's hard to do this alone.

It helps to have a support system; people you trust with whom you can share ideas and who will hold you accountable. Do you have the discipline to move to a high level of commitment in these areas and execute within your prescribed method and plan?

5. Build a winning formula. You need reasonable goals and the math has to work. So many traders need or expect to have huge returns. It's not possible to make 25 percent or even 5 percent on each trade. If you place a proper expectation on each trade or day or month, depending on your perspective, you will likely handle the positions properly, raising your "batting average" and your overall success.

If I were to identify one area that seems to give traders the most trouble, it is emotional fitness. Traders that are the most easily triggered when a trade goes against them tend to struggle with small profits and big losses. Success comes when they identify the source of these emotions (usually fear or shame from something in their past) and begin to execute without allowing these reactions to contaminate their trading.

Dear Slim:

Is GLD (ETF for gold), which is ostensibly backed by possession of the physical commodity, inherently less risky (i.e., carries no company-specific operational risk) than a top notch gold mining company like GOLD?
--Dick C, via email

Dear Dick,

For clarity, "GLD" is a streetTRACKS investment trust which was formed to track the price of physical gold.

From March to May 2007 GLD moved up from 54 to 72, a 33 percent gain. Coincidentally, GOLD (Randgold resources Ltd, ADR) rallied from 15.50 to 26.50, a 70 percent gain. This comparison is reflective of many other significant moves in the precious metal. It gives GOLD, apparently, a "beta" of 2 vs. the physical commodity, which means it is twice as volatile. This is mainly because gold companies are leveraged to the price of the metal.

Based on the "cost of mining," plus overhead, it costs somewhere around \$300 an ounce to get gold out of the ground (varying widely per company). So if physical gold fell 33 percent in value to around \$400 an ounce, where it was in early '05, earnings for some gold companies would nearly disappear. Alternatively, a \$200 rally in gold (23 percent), might double the earnings of some mining companies. This study makes GOLD, and other gold stocks, a more risky (volatile) trade than equivalent investments in GLD or gold futures.

Dear Slim,

I am a currency trader; therefore I watch the economic reports: PPI, Housing Starts, Personal Income, spending data, Core CPI, etc., all of which affect some currency pairs. Is there a site where I can see the reports at the time they are reported rather than five to 30 minutes later?
--Steve R, Bloomfield Hills, Michigan, via email

Dear Steve,

To my knowledge, there are no websites that post economic data fast enough to use in trading. The biggest problem is that the reaction to economic reports is often instantaneous, which makes it hard for many traders to decipher the news and react in time.

There are many ways you can get economic reports the instant they are released. The easiest is on CNBC, which reports most of these data live. (At times, however, they run a commercial while economic news is breaking—frustrating!). Most vendors of quotes and charts offer subscription news services that allow you to see economic reports the moment they are released. Two of the best known are the Dow Jones News service and Bloomberg.

An interesting subscription website is "Trade The News", which offers several products including "futures squawk," live bid/ask from the S&P500 and NAS pits and an online audio service that reports news 24 hours a day. Go to www.tradethenews.com. This could be just what you were looking for, Steve. ■

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SEND ME YOUR
QUESTIONS!
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