

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!



Hi Slim,

I immensely enjoy your articles in SFO. I've been investing for more than ten years and started covered-call writing on the QQQs last year. I have since gone to individual stocks. My goal is to generate three percent on a \$150,000 portfolio, but I have been running into some problems. I have done 12 trades: six winners and six losers. The big problem I have is that I have had sizable losses on the negative trades.

Here are some examples: 1) I bought 600 RMBS (Rambus, Inc.) at \$35.57, sold the 30, 35 and 40 calls. I bought the calls back for a profit of \$2,260. However, the stock closed at \$27.59 for a \$2,528 loss. 2) I bought 500 shares of RHEO (OccuLogix, Inc.) at \$12.18, but the stock nosedived and went to \$3.61 after a drug wasn't approved. I ended up with a \$3,390 loser. 3) I bought 100 shares of DESC (Distributed Energy Systems Corp.) at \$12.26, sold ten options at \$0.85, and then the stock plunged at \$6.41 after bad earnings. This trade is current.

These are just the biggies. I have some smaller losses. I am down about four percent year to date. I am having a better month and will turn a profit if things hold up. Things are gapping down at the open and there is no time to react. By market open I'm finding myself down before the day starts.

These are my rules: 1) Don't take positions within ten days of an earnings announcement; 2) check message boards for something I've missed; 3) EMA must be above 50 and 200 day; 4) minimum of three different industries; 5) no positions taken before 11am; and 6) positions will not be more than ten percent of portfolio.

Hopefully, you can give me some guidance.

—Lawrence L., via email

Dear Lawrence,

There is an incongruity between your intention and your action. You start out with a rather modest wish: a return of three percent a year. If this is really all you want, you can achieve this return, and more, by putting your money in a bank CD, now yielding more than 4.3 percent to 4.9 percent, taking little or no risk. If you do wish to participate in a covered option writing strategy, it would be better to approach it with a higher expectation of returns, along with the associated risks.

Here are some ideas that you should consider because, as the market has proven to you, covered option writing has risk. Choose stocks that you really want to be long, based on your analysis, not just because the option premiums look juicy. High implied volatility means higher risk. Be conscious of advantageous entry points, based on your technical studies. Also, you must establish risk parameters and stop points, just as if the position were naked. It is obvious, Lawrence, you did not have this discipline. Your losses, when stocks declined, were quite large, sabotaging your strategy.

It is important to diversify your positions. Any single, covered-write position should have a maximum commitment of 15-20 percent of your overall portfolio. So a covered-writing program should have at least five positions and up to as many as you can handle. Also, avoid overloading in any industry group, with two positions, at most, in any sector.

A covered options-writing program works best in stable or rising markets. That's why you have been doing better, recently. This bull market is quite mature, however, so this year brings a significant downside risk. Remember you can also short a stock and write a put. This works well after a big upside move in stocks that are overvalued or overbought technically. As part of your portfolio, it will also help filter out some of the downside risk if a bear market hits. Shorting a stock, however, has unlimited upside risk. As with any trade, one must diligently stick to stop-loss rules.

Dear Slim,

I am relatively new to trading. I struggle to find the best trades, often finding myself in trouble soon after entering. Can you help me with some ideas or rules about finding and entering trades?

—Ronald R., Chicago, via email

Dear Ronald,

Here are my top three rules for establishing trades:

1. Trades should be high probability. It means you have done the technical work necessary to have identified the trend of the commodity or security and a low-risk entry point. It may mean entering in a counter-trend move. This

lowers the chance of being wrong initially, which would risk triggering an emotional response to the trade.

2. Trade size, for the initial entry, should be one-third to one-half of the maximum allowed position, based on your risk parameters. This gives you the opportunity, if the trade is entered a bit early, to average down. Yes, I believe in adding to a losing position, once, as long as the analysis remains the same. Again, this helps keep emotion out of the trade. It also allows you to use wider stops, which help prevent market "noise" from taking you out of a good trade. If the trade is correct immediately, then you can add to the position one or two times, maximizing winners.

3. When you enter a trade, both the target and stop-loss points should be identified. Creating an expectation for the trade will help with the tendency to get out of good trades too soon. The stop-loss will keep you from staying too long when the trade goes bad. Keep reviewing your analysis. If things have changed, you may be able to exit before the stop is hit, reducing the size of your average loss.

These three rules will help keep you out of trouble when you enter a trade and will increase your overall profitability.

Dear Slim,

Ultimately, I would like to trade the markets professionally. How would I find and contact a professional trader in my area? I currently

trade the equities market with options, but my scope is narrow, and I could learn a lot as an apprentice or simply as an observer. Your input would be greatly appreciated.

–Damon S., via email

Dear Damon,

This question is presented to me often. In the heyday of the trading pits, there were often jobs available as clerks or assistants, where one could gain experience in the markets. However, online trading hurt the pits, reducing the number of jobs. Sole proprietors, who trade off-the-floor, tend to work alone. Thus, the opportunity to apprentice with an experienced trader is very rare.

There are a couple of ways you can gain experience in the markets with seasoned traders. One is to join a "prop shop". These are proprietary firms that offer online trading using their execution platforms. You pay them a nominal monthly fee, and you get a decent commission rate and excellent margins. You usually have to put up \$10K to \$25K of your own money. Make sure you find one that offers ongoing classes and assistance. Some of them will just leave you on your own, and then you're back where you started.

Another choice is to get a job as a "junior trader" or "assistant trader" with a large financial firm or a hedge fund. You can find these opportunities, mostly in New York or California, at www.hotjobs.com. Use the keyword "trader." ■

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

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