
Ask Slim

By Steven Miller



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

Dear Slim:

Can you suggest any useful daily online newsletters for an up-and-coming stock index trader? Instead of diverting my attention to news broadcasts or sorting through lengthy newspaper articles, I would rather have something quick I can reference for important facts and tidbits. Is there an online newsletter that offers both potential strategies and news items all in one package?

—Manuel V., via e-mail

Dear Manuel,

I could use all the space allotted to this entire column to list the websites or online newsletters that offer strategies, news items and other useful tools for traders. It is truly amazing how much information is available on the Internet, gratis.

The following is a short list of my favorite sites for technical analysis, news and a vast number of other tools.

Prophet.net: This is an amazing site for technical analysis of stocks, futures and stock indexes. It offers an incredible amount of free resources, including “java” charts, news, streaming quotes, option chains, watch lists and research. There are three very modestly priced premium services that offer just about everything a trader could want. Try the free seven-day trial!

Stockcharts.com: This site is a great source of free study tools for stock traders. Most indexes and ETFs are available also. They offer scans on literally every well-known type of charting method. Imagine no longer needing to go through countless charts each morning to find your favorite signals. It’s all done here for you. Additionally, they have a great tool called “market carpet,” which allows you to compare up to 500 stocks on a single page by price performance or any number of tools. It essentially shows the “heat” in the market at a colorful glance. And all this is free. Their premium service offers expanded resources, but they will seem likely overkill to anyone but very active traders.

Ceoexpress.com: So you want news? Here is the list of every news source you can think of and just about any other business tool you might need. Careful, you could get lost here for days.

It is extremely unlikely you will need to go much further than these three resources for market information. There are countless sites that offer strategies or specific trade recommendations for a fee. If you desire help identifying trading opportunities, I suggest you do a search on Google. Look for sites that are in your area of interest and offer reasonable trial periods. I make no recommendations in this area.

Dear Slim:

Over the past year I’ve attended a number of trading expositions and have talked to vendors who extol their particular trading systems. I have a difficult time sorting out one from the other, and I am somewhat skeptical of trading performance. I have to believe that there is a huge difference between trading profits in the real world and performance of simulated trades using data from the past. If a trading system is so good, why would the developer not purely make money with it and leave the public out?

—Martin M., via e-mail

Dear Martin,

I have received a number of letters similar to yours in which traders voice skepticism around services that offer trading systems. All ask the same question; if the system is so good, why don't they just use it themselves and not trouble themselves with the very tough sell of offering it to traders?

You make a very valid point. There is a "huge difference" between simulated trading performance and that of executing trades in the real live markets. The answer to your question lies within that statement. I remember some years back when a group was creating a neural network that was supposed to be able to analyze the past markets and actually learn to "think," therefore finding trades based on real-market situations. The group contacted me because they were looking for a trader who could execute trades for them once the computer threw them out.

These were some smart men – not only because they had all this brainpower, but because they were aware that the execution of a trading system would be done much more efficiently by someone with expertise in the markets. My point, of course, is that there are system developers and system marketers, and there are traders. It is very unlikely that anyone who has the personality to sit for hours and write computer programs has much of what it takes to endure the battles of the markets; and vice-versa. These are two very different personality types.

Finding the right system for you will take some time and money. Most of these trading systems are quite costly. It is likely that developers have spent extended periods of time and big dollars bringing them to market. If you are interested in using someone else's system, be prepared to pay for it. As I mention in another question in this article, pick a few that look interesting to you and take them for trial periods. Then you can do your own testing. Remember though, when you buy a system, you get trading ideas. Turning them to cash is still up to you.

Dear Slim:

My question relates to short selling. Let's say for example, that JPM looks temporarily overbought and I decide to short 1,000 shares in my trading account. Several days go by and an analyst upgrades the stock on national TV and the stock starts to move up. As I believe this upmove is temporary, I do not want to close out my previous short position, but I do want to take advantage of this short-term opportunity.

As such, I buy 1,000 shares of JPM in my long account and several minutes later, I sell the 1,000 shares I purchased minutes ago for a very profitable quick trade.

My broker tells me that I cannot sell the 1,000 shares I just bought long without first closing out my short position, claiming it would violate the NASD Rule 3350. I argue, saying that I still want to keep my short position open as I believe the stock will ultimately fall, and selling the 1,000 shares I purchased

just minutes ago would simply bring my account back to its original short position of 1,000 shares of JPM.

I have called many brokerage houses, and some say I certainly can engage in the above, while others say no. I have even called the NASD and, believe it or not, some representatives there said I could do it while others claim I cannot.

Can you offer any assistance on this matter, as I can't seem to get a definitive answer from even the entity that wrote the rule?
—Pierre B., New Rochelle, NY

Dear Pierre,

Your question is excellent and turned out to be quite challenging. I have read both NASD's rule 3350, the primary "short sale" section, which your broker implied would be violated by selling your long stock, and NASD rule 3370, which defines "long" sales (www.nasd.com). In my judgment, neither of these sections directly addresses your situation. I took a guess that clarity might come from the SEC. So I went to their site (www.sec.gov) only to discover I needed a 40-hour class to learn how to find anything there!

The next step was to call the investor services department at the SEC, where they didn't know the answer either. They were extremely courteous and suggested they ask a legal expert out of the regulatory division to call me. Amazingly, by 5 p.m. that afternoon, the call came, and I had the clarification I needed to answer your question.

I can see why you are getting mixed and perplexing answers from all sources. I'll save you from the tedious ramblings from the NASD. Below is the aforementioned SEC rule 3b-3, which is shorter, yet contains much of the same language as the NASD rules:

SEC Rule 3b-3 – Definition of "Short Sale"

The term "short sale" means any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller. A person shall be deemed to own a security if:

- he or his agent has the title to it; or
- he has purchased, or has entered into an unconditional contract, binding on both parties thereto, to purchase it but has not yet received it; or
- he owns a security convertible into or exchangeable for it and has tendered such security for conversion or exchange; or
- he has an option to purchase or acquire it and has exercised such option; or
- he has rights or warrants to subscribe to it and has exercised such rights or warrants: provided, however, that a person shall be deemed to own securities only to the extent that he has a net long position in such securities.

So reading through this, you might think there is nothing there that prevents me from selling my long stock. Well, what the SEC says, I'm sure coinciding with the NASD, is that the positions must be aggregated. Though your position is long and short in separate accounts, it is considered "flat" (offsetting). Thus, you don't meet any of the criteria described above in the NASD or SEC definitions to make a long sale. You simply don't have any long stock to sell. Were your broker to allow you to make a long sale in this situation, you (and he) would be in violation of the "short sale" (uptick) rule. If someone did let you get that sale off, you would be subject to margin requirements on the new sale of the stock.

The short sale rule was put in place way back in 1934 – after the market had already suffered a decline of more than 80 percent – to prevent stock manipulators from getting into exactly the position you are in now (on a much bigger scale, of course) and, then, using the long side to drive the stock down.

Your position is essentially a "short against the box." This is an old term that comes from a situation where long-term

holders of securities had taken delivery of stock certificates on their investments and kept them in a bank safety-deposit box. When the stock rose to a point that they wished to sell, they would short stock against the position to lock in gains and avoid the tax liability. The IRS took care of that several years ago, making the trade much more difficult and complicated. Investors that do get into a short against the box situation almost always liquidate in two ways. Either they cover the short at some point, leaving them with their original long stock, or they simply meet their obligation and deliver their long stock to neutralize the position. Notice, there is no long sale here.

The easy answer for you, once your order to sell the stock was refused, was to direct your broker to use your long stock to offset the short position through delivery of the shares and then issue a new order to short the stock again. This would have avoided any violations and additional margin requirements. Then you would have been right back where you wanted be, short. I guess the shortest distance between two points is not always a straight line, at least, not where the regulators are concerned.

