

# 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,*

*Over many years (and a lot of pain), I developed an option trading system, which by now consistently generates income. This allows me to trade rather large option positions - hundreds of index options contracts. I strictly follow my risk management rules, but I have concerns about possible scenarios that are beyond my control. For example, given the current wartime environment, I am wondering what happens to expiring options if, due to some event, an option exchange will be closed on expiration day?*

*Thank you,*

*-Michael, via e-mail*

Dear Michael,

Your example almost happened for September option expiration in 2001. In the aftermath of the terrible events of 9/11/01, the markets were shut down for four days, reopening on Monday 9/18. Option expiration day was Friday 9/21, and there was speculation as to what accommodations would be made, if any, if the option exchanges had not open by that date.

An option is a contract to buy or sell a security at a specific price by a specific date. The key word here is "contract." Were the options exchanges to extend the expiration date, due to some catastrophe, they essentially would be violating the terms of the contract and nullifying the significance of exchange-listed options. After all, extending the date only favors one side of the trade, the buyer. Thus, it's illogical to think that the exchanges would make this alteration to the original agreement.

Were the markets to shut down on expiration day due to some terrible event, holders of long equity options would be forced to make very difficult decisions. They would have to guess where the underlying stocks would open once the stock market were to reopen. It might mean exercising options (puts) that are quite a distance out of the money by the end of expiration day, or choosing not to exercise call options that are in the money. That, of course, would be taking a huge risk that the underlying security doesn't fall as much as feared. It would be quite a dilemma.

Index options are a bit different, in that they settle to the opening price on the following day and then settle to cash. So there would be no guesswork here, as you would know the final price of the index on expiration once the market reopened.

And yes, in this time of war and madness, the risks are certainly very high. We can only hope that the powers of goodness prevail.

*Dear Slim,*

*Enjoy your column every month in SFO. In the September issue, you answered a question about stop-losses, and you made the statement concerning entry for option trades on countertrend moves, rather than on breakouts or breakdowns. Could you explain a countertrend move, and expand on how you would use it?*

*Thank you,*

*-Debra L., via e-mail*

Dear Debra,

A countertrend move is a retracement or consolidation - where a security gives back part of its recent advance or decline - before continuing with the trend. When looking for key chart points at which a security may find support or resistance, traders often look at Fibonacci retracements. The levels most often watched are located at 38 percent, 50 percent and 62 percent of the previous move. Most charting services offer a tool to plot these points.

Please refer to the daily candlestick chart of Boeing (BA) below. The stock was in a steep decline until mid-April of 2004. After a short bottoming process with the chart forming a small inverted head and shoulders, BA rallied in a stair-stepped pattern through June.

During this great rally, there were two corrections, each lasting nearly three weeks, with the stock giving back about half of the previous rally. If you entered a bullish option strategy late in the first two up thrusts, there is a good chance the minor corrections,

along with option decay, would have taken you out of the position with a loss. However, if you entered the position on the breakouts following each countertrend move, noted by the gaps above each trendline and the Parabolic SARs buy signals (dotted blue line), you would have had a very good entry and a profitable trade.

In the September issue of *SFO*, the discussion was about managing risk in options trading using stop-loss orders. The BA example also highlights how a good entry on a trade can put you in the right mindset to maximize gains. Many of my best trades come when I patiently wait for a chart to put me in a trade and then add to the position when the trend is confirmed.



SOURCE: Prophet.net

Dear Slim,

I'd like to point out an uncharacteristic mistake that you made in your September 2004 *SFO* magazine column.

In the first question, dealing with an iron condor, you constructed an example where you sold MXIM August 50 puts and 55 calls, while buying the 45 puts and 60 calls. The net credit was \$2.00. In your third paragraph, you write, "To make the two points, or \$200 for each spread, MXIM would have to close at August expiration between 48 and 57." Surely, you now recognize that this is incorrect. To keep the \$2.00 credit, the sold options have to both expire worthless. This happens when MXIM closes between the two strikes of the sold options – in this case, between 50 and 55. Clearly, you got confused and listed the two break-even points of the spread, namely 48 (50-2) and 57 (55+2).

Perhaps you will print a correction of the analysis in your next column. Sincerely yours,

–Donald S., via e-mail

Dear Donald,

Oh Boy! You caught me. You are correct. I gave the break-even points, not the range of maximum profitability. To make the entire credit on an iron condor, "the sold options have to both expire worthless." What was I thinking? Despite my mistake, the iron condor is still an excellent strategy for option traders wishing to trade with limited risk.

Thank you for pointing out the error and my need to double my daily dose of ginkgo biloba. *SFO*



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QUESTIONS!  
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