
Ask Slim

By Steven Miller



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Dear Slim:

I am new to futures and options trading and am totally intrigued by it. The only problem is that I do not feel I have the mental energy to master the skills necessary to trade successfully. Given that attitude, am I smart not to get involved or am I being unduly cautious? I have a broker who has managed to fumble his way through most of the \$7,500 I gave him last October. He was successful in two of five options he bought and has lost most of his trades with the mini Dow Jones contract, notwithstanding the fact that he claims to have a software system that he developed, which is the best thing since sliced bread. I would like to know how to wade through all of the information that is incoming each day. How do you discern the truth? How do you recognize false or inflated claims? Honestly, right now, I wish I could put my hands on a system that would be a consistent net winner. Is there one out there? Is there a way to learn to trade like when I was taking courses when I was back in college? I need direction.

—George M., via e-mail

Dear George,

I hear your frustration. I don't believe one can be "unduly cautious" when it comes to deciding how to handle investments. You have given discretionary authority to a broker who made grandiose claims, only to suffer the loss of your precious capital. It seems that has brought you to a place of wanting to learn about trading, despite your acknowledgment that you do not have the "mental energy" necessary to do so. Trading is not learned out of textbooks. The "art" of trading is learned through a long and often arduous period of experiencing the markets, hands-on. Your needs will be better served by expending your energies towards finding a place for your funds that offers a reasonable probability of success.

Despite the difficulties you experienced in your last round, I suggest you stay on track with your notion of choosing a professional to handle your money. Avoid those making claims of systems with "huge returns" or track records based on simulations. Hire the trader, not the trading system. Try calling commodity brokerage houses and asking for CTAs (commodity trading advisors) that have at least a few years experience. Then ask for track records and references. You will want to see that clients are staying with this trader long term and that they can vouch for his reliability. If the broker is not cooperative, you'll have a "red flag."

Another approach is to invest in a commodity pool. CPOs (commodity pool operators) must publish their track records in their risk-disclosure documents. Also, you will be able to evaluate the trader's style and the history of drawdowns and returns. Then you'll get a better sense as to whether this investment vehicle is a good fit for your personality. One downside is that many pools have large minimum investments. It might take some work to find one that will take investors under 50 or 100 thousand dollars. Remember, for either of these choices, past performance is not necessarily indicative of future results.

Dear Slim:

I have recently become involved in an electronic trading environment and am continuously fascinated by all of the programs,

charting software, systems, etc. As a younger, fresher face to the market I find all of these tools necessary to keep up with the Joneses' in the trading arena. I was curious if you could shed some light on the early days of trading. How was charting done? Would the time spent creating a chart warrant its use? How long would it take for a fill to be returned? Even the daily operations of the pits have come so far. I think that we newcomers have it much easier than those who have come before us. Also, I believe that with new advances comes a need to be educated on how all of this information operates and to understand that it can, indeed, be helpful. One last thing, when does beginner's luck evolve into skill? —Taylor B., via e-mail

Dear Taylor,

I can unhappily report that I have been involved in the markets long enough to know the answers to your questions on the "early days" of trading. From the mid-'70s to the late-'80s, I kept hand-written charts on my favorite 80 or so stocks and indexes. (See the picture of me, circa 1980, at age 30, studying my chart book). I remember all too clearly taking the weekly high-low-close statistics out of the Sunday New York Times and plotting them on my weekly-bar charts with a pencil and a ruler. It took hours. That's how it was done by most traders. Was that ever cumbersome!

Regarding your question on "fills" (reported execution of an order), from well before the turn of the century (the other one) until the electronic age began, orders were written on paper and hand-delivered by runners to the commodity pits and the specialist posts on the floors of the commodity exchanges and New York Stock Exchange. The floor broker or specialist then executed the order and handed it back to the runner for delivery to the brokers' booths on the perimeter of the floor. Then the fill was called up to the broker who then had to call the customer with the report. The whole process could take ten minutes or hours, depending on the market – an eternity by today's standards.

Regarding your statement that "newcomers have it easier than those who have come before us," I believe short-term traders have it much tougher today than before the birth of electronic trading. In this environment, with tens of thousands of traders with their fingers on their keyboards and news dispersed in seconds, the markets are extraordinarily efficient. Also, stocks now trade with just a few pennies between the bid and ask. And in the options markets, since the crash of '87, implied volatilities are much higher, greatly increasing capital requirements. Thus, edges in the markets are available to only the savviest of traders.

And "when does 'beginners luck' evolve into skill?" Never!

Dear Slim:

Can you please explain what a trend channel is and how it relates to trend lines? Do you personally employ them in your technical analysis methods? Could you also recommend a book for beginners on the basic principles of technical analysis?

—Sam D., via e-mail

Dear Sam,

A "trend channel" is created when the price of stock or futures trades between a trendline and a line that parallels the trendline. It can be formed in a rising or falling pattern. Note on the daily chart of Abbott Laboratories below that the stock was rising from mid-March to mid-June. Each time the stock rose to the top of the channel, it had a reactionary move to the bottom of the channel, forming the rising trendline. In early July, the stock finally broke below the trendline. Then it touched the trendline from below for a few days, which became resistance, before it broke down. Notice how this formed the right shoulder of a head-and-shoulders pattern, an ominous sign. This type of chart can be a great tool, especially for a swing trader looking for buy and sell points and trend changes. I use trend channels along with the many other chart patterns in my trading arsenal.



As I've mentioned in this column before, my favorite book on the basics of technical analysis is *Technical Analysis of the Financial Markets*, by John J. Murphy, \$57.90 at

sfomag.com. Another good book, somewhat more advanced, is *Technical Analysis Explained*, by Martin J. Pring, \$52.20 at sfomag.com.

Dear Slim:

Can you please briefly explain what level of trader can use intermediate-term swing trading? I have heard from others that it is not for the novice. —Marilyn C., via e-mail

Dear Marilyn,

Swing trading is a technical method that takes advantage of the fluctuations that occur in a stock or commodity over periods as short as a day and as long as several weeks. Traders that use this style have trade objectives that fall between those of day traders, who are looking for nearly immediate gratification, and those of longer-term investors. Because a swing trader will hold positions until the trade objective is met, stopped out or some other criteria that demands the trade be closed, this style does carry greater risk and uses more capital than day trading. Swing trading is fine for traders of any level of experience. The key, of course, is that discipline is followed and all risk parameters are honored.

Two books on swing trading are, *The Master Swing Trader*, by Alan S. Farley, available at sfomag.com for \$52.20 and *Dave Landry on Swing Trading*, available at sfomag.com and many financial booksellers for \$117.50.

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