
Ask Slim

By Steven Miller



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Dear Slim:

I have seen numerous trading seminars advertised promising “great trading results,” with price tags upwards of \$500. My impression is that if the organizers of these seminars were able to generate the results they promise, they would not have to sponsor seminars. In general, what kinds of workshops are most helpful to a beginning futures trader with stock options background? I currently like the idea of working online. Are there any seminars you can recommend, and do you have any guidelines on cost ranges?

— Bill S., Albuquerque, NM

Dear Bill:

I disagree with your premise that if “organizers of trading seminars were able to generate the results they promise, they would not have to sponsor seminars.” There may be a vast difference between a person that has the ability or desire to teach a specific trading strategy and a person that has the ability and personality to execute in the markets.

Workshops that are offered for significant sums of money are often sharing specific trading methods that might have taken years to develop. They come with no guarantee of success. Mostly, these workshops are not meant for beginning traders.

For people interested in learning futures trading, nearly every brokerage house offers some kind of educational program, as do many of the exchanges. Many of them are offered at no cost. I suggest taking any of these courses and then consider beginning a period of simulated trading. Best Direct offers a great simulated trading program. Once you have learned the language of the markets and have a sense of how to execute trades, you may consider some of the more advanced trading programs.

You mention you have an options background. For those interested in learning any level of option trading, I recommend looking into courses offered by Tony Saliba (www.salibaoptions.com). Tony has vast experience in options and offers very affordable courses, beginning at around \$200.

Dear Slim:

Many of us here in the UK are watching the development of single stock futures with interest. We can trade here in the UK on similar universal stock futures on LIFFE. But we note that LIFFE spreads are wide on many shares. The size of the spread will be of interest to day traders and the short-term hold trader. What sort of spread could we expect on these futures contracts? — Neil, UK

Dear Neil:

In any market, the size of the spread, the differential between the bid and the ask price, is a function of several factors. Liquidity, the level of interest in a specific market, is the main factor. Liquidity may come from retail customers, institutional fund managers, professional traders or arbitrageurs.

Retail customers, those who normally trade 100 or 200 share units of stock, will be drawn to universal stock futures and single stock futures for several reasons. SSF futures margins will be lower at 20 percent, versus the 50 percent margin needed to hold the actual

stock. Shorting will be easier; with no uptick rule, no need to find shares to borrow, and no short stock costs. And commissions will be lower than the discounted levels of \$15 to \$20 per side for the equity.

Fund managers will use these markets mostly to hedge positions they wish to continue holding, but are wary of risk for short periods. Most managers of large funds are mandated to hold only long stocks and may not use futures as hedges, so this source of liquidity will mostly come from hedge fund managers who may be either long or short in the market. Commissions may be a negative factor to these managers, as they are accustomed to paying very small execution fees.

Professional traders or day traders have offered huge liquidity to the stock markets over the last decade. They often make 100 or more trades a day. Few of these traders pay over one cent a share. For most, the cost of trading the equity is the same for 100 shares as it is for 5,000 shares, from \$5 to \$15 per trade. Also, margins are a negligible factor, with the majority getting day trading margins of 25 percent or lower. Thus, this kind of trader may have less of an incentive to trade.

Arbitrageurs usually trade in very large size. This will be the greatest determining factor to liquidity - spread differentials - in these markets. They will look hard at execution costs in determining if there is an opportunity. Arbitrageurs will buy in one market and sell in another if there are a few cents to be made. That may be very hard to find when the round-turn costs of trading SSFs against the underlying stock may be 6 to 8 cents a share plus any slippage. So you can see their markets may be at least 10 cents wide, even in active stocks.

As illustrated, the greatest appeal will be to smaller investors or short-term retail traders. With everything factored in, I judge you can see that spreads may be wider in single stock futures than we're accustomed to seeing in any of the underlying equities.

Dear Slim:

My particular trading interest is stock index futures, and I've found the e-Mini S&P contract that the Merc began offering for trading several years ago to be extremely liquid. Why does the Dow futures contract not measure up volume-wise to the e-Mini? It would seem that the brand name alone would propel it to much higher levels of interest. By the way, I do know that the S&P is the benchmark for most institutional portfolio managers, but it has to be more than that.

—Paul L., Los Angeles, CA

Dear Paul:

I vividly remember the period leading up to the opening of the Dow Jones futures pit on the Chicago Board of Trade. There was much hoopla, as the major firms built and heavily staffed booths surrounding the pit. Soon after, as volume subsided from the initial burst, it became apparent that interest was far below expectations. As volume failed to grow, clearing firms offered very low seat leases and low capital requirements for

floor traders, and that attracted some under-capitalized traders early in their trading careers. When a sizeable order hit the pit, these traders backed off. Soon it became apparent to program and institutional traders that the DJ pit was not deep enough to handle their trades.

Now, trading levels of DJ futures remain far below that of S&Ps. In fact, much of the volume in the Dow pit comes from a trade where traders buy or sell the Dow futures and spread against the S&Ps.

Despite the fact that the Dow Jones is a great "brand name," the CBT perhaps came too late to the game. The S&P futures pit had over a decade head start and had established an extremely well-capitalized, deep market. E-mini S&Ps continued the success, as smaller traders were drawn to this successful marketplace. E-mini S&P futures trading has now grown, in dollar terms, to equal that of the trading in the full contract.

I do know, however, that the CBT is making an effort to actively promote the Mini Dow and to make it feasible for traders and individual to use. They might be able to make it happen as long as there is growing volume and open interest, and it seems that volatile markets of late have given the Dow complex a bit of a boost.

Dear Slim:

Do you think stock splits offer good trading opportunities? How would you trade them? Would you wait for the setup and trade like any other technical situation or are there other factors to be considered?

I enjoy your articles in SFO magazine, by the way.

—Fred M., Jacksonville, FL

Dear Fred:

During the 1990s, the NASDAQ and S&P 500 rallied to extraordinary levels. Corporate CEOs found their stocks to be valuable currencies. Using stock swaps, without any cash changing hands, they gobbled up other companies, attempting to find new sources for growth and further shore up their stock values. As these "pyramids" raised in price, in some cases to levels exceeding \$300 a share, small investors found them unaffordable. Thus, to keep the inflow of investor capital, companies split their stocks, some several times. Into the year 2000, stock splits were a daily event.

Many traders created trading strategies around the prospect of a stock split. Stocks tended to rise around the time corporate boards met, anticipating the announcement of a stock split. Stocks jumped, though often temporarily, on a surprise announcement of a split. And stocks often rose on the day before a split as traders anticipated buyers coming into the market to take advantage of the more affordable price. After the split, however, the elevated price and the increased number of shares often created supply, which capped the stock, offering a shorting opportunity for traders.

In the last half of 2000, the world changed for the stock market and for traders who made a living off of stock splits. Many stocks had fallen large percentages well before the date of the split. As stocks fell from lofty levels, stock splits occurred less often. Today, as the stock market suffers its worst decline in a generation, stock splits are a rare event. In July of 2000, there were 53 stock splits. This month there will be 16. Next month, so far, only one split has been announced (First Virginia Bank-FVB). In fact, AT&T, in an attempt to create a greater sense of respectability to institutional investors, has just announced a 1-for-5 reverse stock split for later in the year.

Now, in this post-bubble market, companies whose shares have risen against the crushing supply of stock either are safe-

haven companies, trading at high valuations, or are companies offering extraordinarily positive growth situations. Most of the companies splitting this month are financial companies or specialty retailers. Most have doubled or tripled over the last six months. Nearly every stock that has already split this month is lower than it was on the ex-date. So it appears trading strategies remain much the same as they have always been. Stocks that are especially strong with good long-term growth prospects tend to split. They rise as prospects of a split near and consolidate after the split. However, for the foreseeable future, I expect few opportunities of this nature.

