

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,

China recently bid for U.S. oil company, Unocal. Chinese companies also bought out Maytag and IBM's PC division. There's been a lot of uproar over the Unocal news. How will this deal affect the markets?

—Dan H., San Francisco, via e-mail

Dear Dan,

For clarity, Chinese state-owned oil company CNOOC announced it was making a hostile bid of \$18.5 billion for Unocal (UCL). Unocal already had agreed to be taken over by Chevron for \$16.6 billion. The news brought warnings of threats to national security as lawmakers suggested that China could use Unocal's drilling technology to mask weapons tests. Others warned that China was trying to "corner the world oil market." The news, coincidentally, came as Alan Greenspan expressed his fears of "protectionism," telling Congress that "anti-China tariffs could undercut U.S. living standards."

When investors got wind of the Unocal news, stocks sold off heavily, with the Dow Jones Industrial Average plunging a total of 325 points on June 23 and 24. Concurrently, that week the price of light crude oil touched \$60 a barrel for the first time, as China's actions highlighted the strong world demand for energy.

Here is my take. The Unocal news was a huge wake-up call for investors. The U.S. has spent the past decade frivolously debasing its currency. Energy policies and a period of extremely easy money have had us shipping an ever-increasing number of dollars overseas. This year alone our trade deficit is set to exceed \$700 billion – money that's held in foreign hands. China on its own, as reported in *Barron's*, holds \$691 billion of foreign reserves. Now China finds itself with a booming economy and a growing need for energy and refining capacity. With world interest rates very low, making bond-market investments less appealing, and fears of renewed dollar weakness, it makes sense that China would try to spend the cash on the real assets necessary to meet their needs.

Now, the U.S. is between the ultimate rock and the hard place. It wants China to revalue the yuan to help with our deficit, as it would make their goods less competitive. It also will make them less competitive with other Asian countries and slow their economy. Instead of getting our house in order, we ask China to burn down theirs. So they have resisted. If we impose punitive tariffs against China to force them to revalue their currency, it could start a trade war. If they retaliate, it will make their goods more expensive, and because we already spend significantly more with them than they do with us, our deficit with them will grow. Furthermore, a trade war could bust the Chinese economy and bring an already teetering world economy into a severe recession.

Our other choice is to step aside and let China do what they will with their hoard of dollars. That is the free-world way. However, it threatens to drain us of our already short supplies of energy, which could in itself bring a recession as oil prices soar, and could possibly ignite a round of huge inflation as foreign holders scramble to spend U.S. dollars on real assets. That would send interest rates through the roof.

So the U.S. is in a lose-lose situation. Participants in the stock market saw this malaise in late June and headed for the exits. The \$18.6 billion that China would spend on Unocal is a mere pittance compared with the amount of dollars they hold. If they can't buy Unocal, they can go after another oil company, and who knows what else? This will continue to stir congressional protectionist actions and roil the markets. Thus, the U.S. is about to pay the price for years of very poor discipline as foreign countries gain a greater foothold in the U.S. and world energy markets. And the truth is, we gave it to them.

[Editor's note: Update – On July 21, the People's Bank of China dumped its dollar peg in favor of one tied to a basket of leading world currencies, a move which surprised many. It was earlier than expected. Be sure to see Kira Brecht's story on the yuan in this issue.]

Dear Slim,

I have been successfully trading stocks for some time and now am trading the E-mini Dow futures and breaking even. Breakouts didn't seem to work. So I now enter when the market

bounces off trendlines, with the same flat results. Instead of breaking out, the market reverses, and instead of bouncing, it breaks down. How do you tell what will happen?

—Andrew D., via e-mail

Dear Andrew,

When a trading method doesn't work, you change methods, and if it still doesn't work, something else must be wrong.

Commonly, when traders shift from trading equities to futures, they are challenged by the increase in volatility. The mini-sized Dow contract can be very choppy, which can easily get a trader off track. Take your trading size down to the smallest unit. It will reduce the emotional factors that might be affecting your transition to futures trading. Once you find your rhythm again, your analysis, magically, will seem much clearer. If you increase your trading units slowly, you won't let the market put you back in a funk.

Dear Slim,

How as a retail trader in the futures and futures options markets may I buy on the bid and sell on the ask? I primarily trade on the CBOT and the CME.

—Adisa, via e-mail

Dear Adisa,

In essence, you want to trade like the "locals." Some of these pit traders own \$1 million-plus seats or pay thousands of dollars a month in lease fees for the right to trade on the bid and ask ("get the edge"). You can try to place your buys on the bid and your sells on the ask prices. Occasionally, if your floor broker is able to participate in an order that hits the floor, you might get filled. However, if you were filled, it would have been more likely that the market moved, providing the illusion you were given a favorable execution.

Your best chance of hitting bids and offers is in the high-volume markets with very narrow ranges between the bid and ask, like ten-year note options on the CBOT. S&P 500 options on the CME can be frustrating to trade, as this market is quite wide, and trading without giving the locals their prices is nearly impossible. I use index options on OEX on the CBOE, where the odds of better fills are greatly increased. **SFO**

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SEND ME YOUR
QUESTIONS!
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SFO Stocks Futures & Options

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