

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,

I would like to know the (real) difference between money flow and the money flow index. All of the answers I have read have made me more confused than ever. Please explain in detail.
—Al, via email

Dear Al,

I'll see if I can make my explanation clearer than others you have read. Over the years, market technicians have explored ways to measure if a trend in a specific market would continue or falter. The famous stock market technician, Joe Granville, was one of the first to develop such an index, which he called "on balance volume." Simply, the volume on up days is added to the previous total and the volume on down days is subtracted. The running total is plotted on a chart. A rising line suggests buyers are continuing to support the security.

A similar way to measure the strength of the buyers in a market is money flow. This is determined by taking the average price in a period (bar on a chart) and multiplying it by the volume. If the price was up in that period, then it is positive money flow. If it is down, then it is negative money flow. Then, for the previous 14 periods, the positive money flows are added together and divided by the total of the negative money flows. This gives you the "money flow index," oscillating on a 0-100 scale. More than 80 percent is considered overbought and less than 20 percent is considered oversold.

Marc Chaikin developed a more complex way to measure buying and selling pressure in a market, which he called the "accumulation/distribution index." The twist he puts on the data is that he disregards whether the chart was up or down for the period. Instead, he looks at how far the chart closed into the top half of the period (positive money flow) or into the bottom half (negative), and again multiplies it by volume. The cumulative total forms the index. It is then plotted on a chart and used for confirmation on the price action of the security.

Remember that these tools are subjective and far from infallible. You still must use a combination of technical indicators and strict discipline to increase your odds of overall profitability. Was this enough detail?

Dear Slim,

I am an avid reader of your column; I find it very informative and educational. In the July 2006 issue of SFO, you mentioned volume charts. Could you describe how to construct volume charts, i.e. how many contracts per candle for future markets? Also, what is the advantage of volume charts over regular time-based charts?

—Ashenja, via email

Dear Ashenja,

You don't have control over the volume on the charts. The market determines volume, based on actual trading. Your computer program should be able to display the volume in any specific period you wish to see — though it does sound like you intend to plot the charts manually. I haven't done that since 1990.

There is great value in using volume information along with your bar, candlestick, line, or point and figure charts. Volume often confirms the reliability of a chart pattern. Sharply increased volume coinciding with a breakout or breakdown means there is strong subscribership, suggesting that there is momentum and the trend should continue.

My favorite chart patterns, accompanied by high volume, are break-away gaps, cup and handle, and island reversals. As I mentioned in the July issue of SFO, I especially like candle-volume charts. They look like candlestick charts, except the bars get wider as volume increases. So you see a lot of information in one chart.

Dear Slim,

I read the rule book on the S&P E-Minis. It states that trading on the futures market may be halted if underlying equity trading is halted. If trading on the 497th-weighted stock in the S&P 500 is halted, does all trading on the S&P futures really stop? What are the rules and what really happens?

—J.W. Masters, Greensboro, NC

Dear J.W.,

Go to the Chicago Mercantile Exchange website (<http://rulebook.cme.com>, chapter 35602.I). The rule to which you are referring talks about a trading halt in the entire equity market. This could be caused by anything from technical problems to extreme weather. The rules also state that the S&P futures market begins trading again, following a halt, when 50 percent of the underlying stocks reopen. The S&P futures market does not close when a single or even several underlying stocks are halted.

Dear Slim,
I am interested in purchasing silver in coin or bar form. What is the outlook for this pure silver product? Why does silver seem to track gold proportionately?
—John, via email

Dear John,
Though silver and gold are both considered precious metals, these commodities actually do trade quite differently. Silver has a multitude of commercial uses. Hence, it is quite economically sensitive. This metal is an excellent heat conductor and is used in switch contacts and rear defrosters. It is also a great electrical conductor and is used in computers and most appliances. Of course, it is also used in jewelry, fine tableware and photographic film. It has not been used in coinage since 1966. Gold is also an excellent electrical conductor. Because of its high price, it has mostly high-end commercial uses, like in jet engines or electron microscopes. Historically, because of its luster and value, gold has mostly been used for jewelry, coins and as a “store of wealth.”

The gold/silver ratio has swung widely over the past 30 years. In 1980 the Hunt Brothers tried to corner the silver market and drove the metal up to \$50/ounce. With gold moving upwards of \$850/ounce, the gold/silver ratio fell to 17 (gold price 17 times silver). When the Hunts had to sell their silver position to meet margin calls, the ratio quickly moved to over 40. In 1990 as the use of photographic film gave way to digital photography, the gold/silver ratio soared to over 100. In the past few years, gold has doubled in price due to geopolitical issues and loss of confidence in the U.S. dollar. However, silver has more than kept pace due to strong world-wide economic growth. That’s moved the gold/silver ratio from over 80 to around 56; thus, silver continues to gain strength relative to gold.

With the economies of India and China growing strongly, demand for silver will most likely stay strong. That should make silver an excellent investment, in any form, for years to come. This is a time of high volatility in metals, however. Choose your entry points wisely. ■

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SEND ME YOUR
QUESTIONS!
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