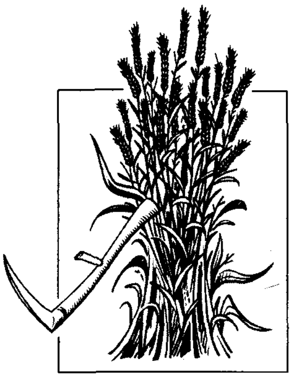
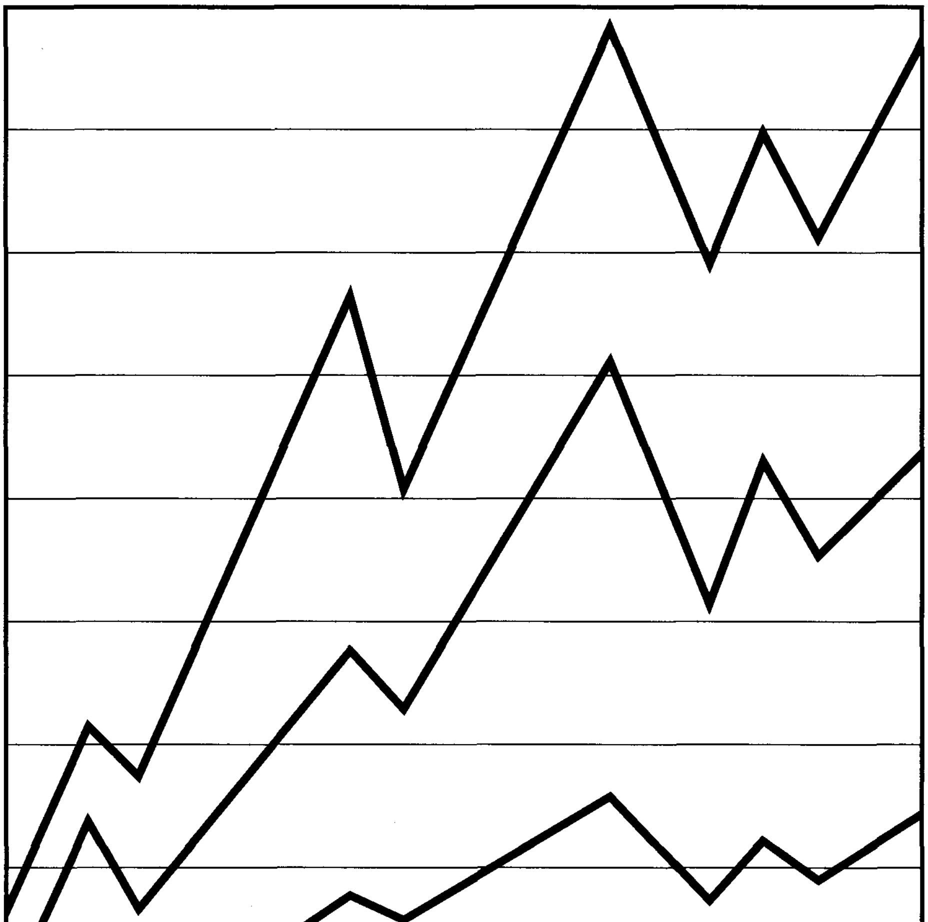


Trader's Notebook 2

by R. E. McMaster, Jr.



TRADER'S NOTEBOOK
#2

by

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ACKNOWLEDGMENTS

A tip of the hat is appropriate to Commodity Research Bureau, Inc. (One Liberty Plaza, New York, N.Y. 10006) and to Commodity Perspective (327 South La Salle St., Chicago, Ill. 60604) whose excellent charts appear throughout this work. Their charts are a vital part of any successful trader's analytical tools.

A special thank you goes to the fine folks at Publisher's Management Corporation (2320 West Peoria Avenue, #122C, Phoenix, Arizona 85029), who not only put this book together, but who also provided me with the support necessary to make THE REAPER a reality.

FOREWORD

It is indeed ironic that in an arena such as the commodities markets, where success is heavily dependent upon objectivity in decision making, that there is so much froth. The half-truths, mysticism, witchcraft, jealously guarded "Holy Grails," and rampant subjectivity that pervades the markets is a tribute to the omnipresent ruling emotion of man. Emotion, money, and security are all linked in the same harness, and are sparked by the pursuit of the illusion of "any easy way," if not "THE easy way."

It is hoped that this work will shed a ray of reality on this fascinating market arena, and in so doing, convince a few that the road to meaningful success is marked by persistent learning and personal growth.

CONTENTS

PART I
PSYCHOLOGICAL SECTION

THE ETHICS OF WINNING

Why do so few win in the markets? Over the years, this question keeps rising to the surface. This writer reflects on the question from time to time. . . . The recent cruise in the Caribbean provided an opportunity to again ponder this age-old dilemma.

There seems to be *two* basic *moral reasons* why the markets are so difficult. First of all, the markets violate the essence of what true free market capitalistic enterprise is all about. In a true free market situation, *both parties benefit* by the transaction. The buyer achieves his desires; the seller reaches his goals. There is a mutual benefit.

In the markets, the only consistent winners are the brokerage firms which, in the case of the commodity markets, may earn better than 50% of a client's account balance in any calendar year. But beyond that, in the case of the zero sum game, for every winner there is a loser. There is no mutual benefit in the commodities market. Therefore, when there is a guaranteed win/lose situation, the moral essence of true capitalism is absent.

Secondly, this editor has become convinced that one who is successful in the markets could have (and usually has) been successful in other areas of life. In other words, he has learned what is necessary *through work* to be successful. Trading the markets to earn a living is not the "sweat of the brow," "curse of the earth" means of earning a living. The markets, by and large, do not contribute to the welfare of mankind in the sense that the discovery of the Salk vaccine or the contributions of Henry Ford did. Therefore, if one is to be successful in these markets, one must do something to compensate for this lack of "work." The necessary compensating factors are (1) One must beat one's self, conquer one's weaknesses before one can become successful. (2) One must integrate the technical and psychological facets of the market. Usually, an individual only enjoys expertise in one area, not both. It goes against the natural bent of man to be inclined toward both areas. No wonder the markets are difficult. The compensating personal qualities necessary to balance the lack of "sweat of the brow" work are achieved by only a few.

NOTES

PAYING ONE'S DUES

I have never known a man who was consistently successful in *any* field who had not paid the price and been battered around a bit in the process. As the old saying goes, "Good judgment comes from experience, and experience comes from bad judgment." It seems that the road to success is paved by the cobblestones of failure.

The road to success in the commodity markets is particularly difficult for at least two reasons: 1) In the commodity markets, for every winner there is a loser. In other words, commodity trading is a carnivorous activity. (This is not the case in most business dealings where both parties benefit from a transaction.) 2) The commodity markets uniquely require one to deal with one's self prior to dealing with the markets. In most other professions, one can have numerous personality flaws, plus numerous character flaws, and still be successful in the occupation. Not so in the commodity markets where the emotion of money rips into one's makeup and warps the ability to perceive the markets accurately and objectively.

Your editor pays his dues in the markets every day, and hopes he will continue to do so. Failure to do so is failure to learn, and a trap door to losses and failure. Paying one's dues, sacrifice, testing in life seems to be the necessary road to edification. Each of us has our own snakes to kill in the market, our own hills to climb. One man's heaven *is* another man's hell.

While I seldom get personal in this publication, I think it might be helpful just to share with you some of the testing that I have been through which, in my opinion, has been helpful in preparing me to meet the market. Your editor has been: 1. Shot at, 2. Poisoned, 3. Paralyzed, 4. Totaled out in car wrecks, 5. Flipped on motorcycles, and 6. Through Air Force land and water survival schools. Also, I 1. Had my jet engine blow up during my first solo in a supersonic aircraft, 2. Lost my instrumentation at night at 35,000 feet, 3. Had my Saberliner windscreen shatter at 37,000 feet, 4. Have seen the whites of the eyes of an oncoming (head-on) Southern Airlines pilot and, 5. Have been attacked by copperheads, water moccasins and rattlesnakes. I have 1. Watched my one-year-old daughter go through major kidney surgery, 2. Watched my five-year-old son three times in an oxygen tent in a hospital wondering whether each breath would be his last and 3. Observed a $35,000 open profit in cotton turn into a $17,500 loss in less than 15 minutes. Yours truly has had good brokers and bad brokers, honest brokers and dishonest brokers, but undoubtedly more than my share of greedy brokers. (Not now, thank God.) Each of you should give thanks if you work with a gentleman/lady with whom you are comfortable.

Paying one's dues does not just mean personal testing, however. Your editor estimates that he has spent more time studying the commodity markets than he spent studying during 4 years of college, 2 years of Master's studies, and his entire Air Force training all put together. It was worth it all. All of it was worth it. The markets are the greatest objective teachers this writer has found on earth. They weed out all unreality, all hope that is not based upon fact or probabilistic evidence. The worth of this type of understanding, of seeing life objectively and unemotionally, of understanding the flow of optimism and pessimism, is immeasurable. And yet, there is so much left to learn. The personal stance of continued growth — once the pain is broken through — is the most exhilarating experience of all.

Is there a way to painlessly pay one's dues, to minimize the emotional and financial losses which are incurred while trading commodities? Yes, most definitely. But, it requires humility. One must take the posture of a student. Be willing to learn. Learning requires listening. Listening requires excluding one's own thoughts. Therefore, all learning is based in humility. Undoubtedly, learning from the experience of others and applying it appropriately is by far the easiest way one can pay one's dues.

Men talk about having "arrived." This writer hopes he never feels that he has "arrived." To learn and continually grow is the most important thing in this man's life. I just share some of my learning experiences with you in THE REAPER. By so doing, I grow, you grow, we both grow, and hopefully, we both profit.

NOTES

A TIME TO REAP, A TIME TO SOW

At the risk of being simplistic, there is a time to reap, and there is a time to sow. With this burst of wisdom, many farmers will fall off their tractors laughing. What could be more obvious? Year-in and year-out primary producers put their grain in the ground, wait for the seasons to change, then harvest it. They reap what they sow. Easy does it, right?

The application of this principle, "A time to reap and a time to sow," may not be quite so apparent to the commodity speculator. Most speculators don't know the difference between a pinto bean and a soybean. Dirt under the fingernails is some kind of disease. Just what is meant by "A time to reap, a time to sow?"

A professional speculator must learn the rules of the game. He must pay his dues. He must learn a technical and/or fundamental system. He must effectively integrate and utilize correct money management techniques. He must have the discipline to carry out his trading plan and money management techniques. Doing all this requires time. It requires careful study. This is the sowing process. After enough seeds have been sown, the speculator may eventually reap some profits. The law of cause and effect is in operation.

When one is sowing, studying, or learning about the markets it is not a time when one should be trading too heavily. New techniques and procedures take time to be understood and implemented into one's trading strategy. New inputs should be tested on the market, paper-traded for approximately six months, before they are used in one's actual trading.

What is also important in understanding this principle is that when one is reaping, one should not concentrate on sowing. Many successful traders have destroyed a perfectly good trading system which was bearing fruit by trying to add new techniques to it.

When one is "in tune" with the market and is reaping profits, it is not the time for additional study. That's right, there is a time *not* to learn. When one is earning profits, reap! REAP! Do not sow! It will only interfere with one's harmony with the market. It is next to impossible to learn and trade simultaneously. So, when one is earning profits, do not learn! It's not the right time! *Losses* will occur soon enough. *Then* will be the time to learn. There is a time to reap, and there is a time to sow.

NOTES

THE OLD MAN AND THE MARKET

It was a lazy late Montana summer day — no wind, ebbing sunshine, and a foaming blue Flathead River. It could have been the middle of winter for all I cared. I was out running, as I often do when I am attempting to cope with a loss. The thief this time had been the copper market.

As I jogged along the country road, out of the corner of my eye I caught a glimpse of an old man rocking rhythmically on his front porch, motioning me over, no less. Somewhat curious, but somewhat aggravated by his intrusion into my sacred penance, I jogged over. As I arrived at his steps, he smiled slyly and gently commanded, "Sit down, Mac." I obeyed, wondering how he knew my name.

"How are the markets?" he asked. I swiveled like a machine-gunner ready for combat. Only his soft, penetrating eyes prevented my verbal barrage. "Bad," I confessed, thinking back. "Took a loss in copper, I reckon," stated he, not missing a rocking beat. "Yes," I squirmed. How in the H__ did he know that? "Are you a REAPER subscriber?" "You bet," he replied knowingly. I relaxed, and it was quiet. Then, he gently pursued. "You were forcing the trade, Mac. Any time you try to force something, struggle too hard to make it work, count on it resulting in failure. It's true in the market, in business, with your wife, or your children. When you fight too hard to make something happen, when it doesn't flow smoothly, count on it going bad. You're just young and impetuous like most Americans. You haven't been seasoned by time like me." He chuckled. I chuckled.

He continued, "You see all that dust out there on the road? Every day the cars and horses kick it up. And every evening the grand old sweeper, the 'Dark' comes and whisks it away. Every day that damn dust clogs me up, and I can't breathe. So I stay inside. And every day, the 'Dark' settles the dust, and I come out here to enjoy the triumph. You know, the markets are like that." He paused. A twinkle filled his eye. "You win part of the time. You lose part of the time. And, after awhile, you develop some judgment, and you learn to stay away from the markets when the odds are that you will lose. Just like the way I stay off the porch until the dust settles each evening. I know when I can enjoy it out here. That knowledge came with patience, naturally, and with judgment over time."

"Any problems with any subscribers?" he queried. "Yes," I stated bluntly, offering no further comment. "Only a *handful* of greedy, demanding and impatient ones, no doubt," he stated as though it was the gospel. "Why, yes," I remarked in amazement. "A few want to eat up all of your time . . . are never satisfied." "That's right," said I. "They . . ." He interrupted, "Forget them! You don't write for them anyway. You write for the mature trader, the whole man, the man who has the common sense to know that the commodities markets don't take place in a vacuum, the man who knows that excellent trading opportunities don't come every day or week. The investors you write for realize that the key to their success lies in their understanding of themselves and their relationship to the market. The others — the greedy, the overbearing, the impatient — they will all be gone in no time. The market will wipe them out, and when that happens, they'll drop your service like one of grandma's hot potatoes. Just don't let them pull you down to their level and destroy you in the process."

"I've been to investment conferences. I've observed your clientele. They are a topnotch bunch. And they'll stick with you. They're on your same path, the learning path. As you've so often stated, 'Making money comes from doing things right.' It is a result of correct thinking and then action. Your core of subscribers know and appreciate this. Just *you* remember it!"

For the first time that day I noticed the sun, setting as it was, and what a wonderful evening was settling in. Funny, I don't remember what else was said that day on the old man's front porch. And I don't jog by there anymore. Don't get me wrong. The old man helped me immensely. It is just that I want to save that treasured route for a time when I again need to tap his reservoir of wisdom.

NOTES

PEAK PERFORMANCE

Just what does it take to perform at one's peak? Certainly, commodity trading demands peak performance. The February 1978 PSYCHOLOGY TODAY listed the factors that produce peak performance. A trader can use these to evaluate his trading or other endeavors in life.

1. Clear focus — "A person performing at his best concentrates solely on himself, the other object or person involved, and the relationship between them. 'Normally, a person has a number of things in fuzzy focus — perhaps a nagging headache, a nearby conversation, another person's expectations — in addition to the one thing with which he is apparently engaged. Each awareness, though blurred, has a claim and demands response. In contrast, the peak performance is marked by full focus on one subject.' "

2. Spontaneity — "Although peak performance is purposeful, it does not result from trying hard. Neither 'Inner restraints nor outer limitations interfere. Behavior occurs effortlessly, spontaneously. The experience itself seems to compel the person's behavior.' "

3. Feelings of strength and vitality — "This awareness 'grows from the mobilization of the whole being. . . . If the expression of the whole being is in words, the person is lucid and articulate; if it is in lifting an object, he is strong; if it is in running, he is fast; for his whole being' is speaking, lifting or running."

Three quick comments regarding the above and trading commodities.

Clear focus — One cannot trade commodities and be distracted, particularly if one is a short-term or intermediate-term trader.

Spontaneity — The best trades are those that flow together naturally over a period of time.

Feelings of strength and vitality — Don't trade when under stress, or when ill. It can only lead to poor judgment and losses.

NOTES

THINKING IN TERMS OF TIME

One of the most damaging human traits, which seemingly afflicts the overwhelming majority of mankind, is the trait of impatience. Good things take time. It takes time to learn the wisdom of ages past to become wise. It takes time to become an authority in one's field. It takes time to become at home in the markets. And, taking time requires perseverance, dedication, sacrifice, and painful growth through error. No wonder so many fall by the wayside. The price of time is high. Average ability with dogged determination and persistence, over time, will outperform the geniuses, the "flash in the pans" every time.

PRESS ON so the old saying goes. Nothing succeeds like persistence — persistence within the confines of the primary trend. Love of work enters in here too. The psychological makeup of man almost necessitates that he is to love his work if he is to succeed, truly succeed, not only financially, but in terms of human relationships, and mental and physical health as well. Small wonder America is miserable. The horror of spending two thirds of one's waking time in pursuits which one views as sheer drudgery is catatonic suicide.

Thoughts like "Be still and know," "Quiet the mind" — these thoughts have to do with taking time to reflect, to ponder, to enjoy, to let the creative impulses from the subconscious rise to the surface.

Having a long-term patient perspective on time presupposes a lack of greed and fear. Greed is desiring too much, too quickly, a state of being dissatisfied, and impatient. It usually results in ruin.

Fear usually focuses on the "now" in the markets. "I don't want to lose any of my profits." Again, a short-term perspective on time is present.

A gentleman in El Paso Texas, whose opinion I value very highly, stated that in every case he had ever known, one of three things had led to a man's downfall — pride, impatience, or greed. And, of course, they interrelate. Interesting. Together they spell PIG. (Pride, Impatience, Greed)

It is difficult to stay with a position in the market. It tests one's patience, greed and fear. Yet, we know the big money in the markets is made by staying in over the long haul. Talk about going contrary to the crowd. Sticking with a position is perhaps the rarest occurrence of all!

How can one stick? It can be done by setting a price objective and exiting the market once the objective is hit. This approach lacks flexibility, however, and one may not exit a trade in time or, one may miss a great part of a move.

Another way to stick with a trade is to wait until the market gives a clear-cut sell signal. This imposed discipline works quite well.

A third perspective is that of TIME, of staying glued to the weekly and monthly charts and computing how long the move is likely to last. This broad perspective can prevent emotional whipsaw, which leads to irrational decisions. Whenever a trader, in the short run, starts to watch market swings in terms of how much each swing means to him in terms of dollars, he has lost the battle. The secret of this commodity game is to play the game correctly. Then, the money will take care of itself. Money gravitates to those who do things correctly. And a correct perspective on time is a great aid to profitable trading.

NOTES

MARKET LETTERS AND RAINDROPS

Market letters are like raindrops. There is a new one falling out of the postal service's sky every day or so. How do you tell a good raindrop (market letter) from a Big Drip? . . . It is quite difficult. Most are professionally written. (Track records and endorsements help.)

If one thing stands out, it is the fact that advisors who are the most successful year-in and year-out are the most *flexible.* They are much like a captain of a ship. They are constantly making small adjustments in order to reach their destination. If necessary, they make large corrections. But in any case, they correct quickly, without regret or hesitation.

There is an old saying in the markets: "It's OK to be wrong, if you're not wrong for long." Chisel that adage in stone! It is 100% correct, even more so today because the markets are rapidly changing trend. Life has become a gigantic seesaw. Perhaps, whipsaw is a better way of putting it. Fast-breaking news events, erratic weather, an inflationary environment, an integrated and yet unstable world — all add to the volatility. Stay loose, stay quick, stay flexible. This advisor never apologizes for changing his mind. It is necessary for survival and profits.

NOTES

SETTING GOALS

Americans tend to do better when they set goals. When starting out in an enterprise, when there is no clear-cut objective, most folks tend to flounder around. Why should it be any different in trading? Answer: It usually isn't.

Setting goals and objectives sharpens the perspective, releases creativity, hinders laziness, and most importantly, gives man purpose. In commodity trading, one could set a monetary objective. For example, a trader could say, "My goal for 1978 is to double my trading account from $10,000 to $20,000." Once that goal is reached the trader should take that $10,000 profit out of the market, bring it home, play with it, or spend it. Only then will the money be *real.*

Another way to set a goal is to think of "winnings" in terms of what they will buy. For example, a trader could say, "My goal for 1978 is to earn enough profits in my $10,000 commodity account to buy a new 4-wheel drive pickup." Here too, the orientation is positive and directional. The word POSITIVE is an excellent word. It stimulates the subconscious mind which lifts men to never dreamed of heights. Setting goals in commodity trading is positive. It increases the probability of profits.

One caveat: One cannot push the market. Patience must reign supreme. Therefore, give objectives and goals adequate TIME to be achieved. We cannot bully the market.

NOTES

THOUGHTS ON GREED

The March 10th REAPER's "Trader's Notebook" quoted a short section from Brad Steiger's A ROADMAP OF TIME. At the Hawaii Investment and Economic Conference, an astute subscriber asked me how I "squared" Steiger's comments with my own philosophy. He was referring to the last paragraph of the "Notebook" which is as follows:

"When trading, thoughts of women, love, home, are positively poisonous; and they will cause losses. The successful trader keeps thoughts in mental compartments where they cannot hurt him; and after a time, they wither. The successful trader gets to be a true miser. Unless fear and greed are rampant in his soul, he will never be successful at winning other men's money."

It is quite interesting that this particular section of the "Notebook" would be brought to my attention, for Steiger's words have been nagging and haunting me since I presented his piece. Some personal reflections will (I hope) clarify your own thinking in this area.

First of all, Steiger's words put me in tremendous conflict because I think he is essentially correct. When one is trading, one MUST exclude thoughts of all else from one's mind. If one does not, one will most probably lose. At least two years ago, I made it a policy to never trade if there was the least little thing bothering me. As a result, I found myself, and still find myself, out of the market a great deal, missing good moves, because I am distracted, or otherwise preoccupied. Sometimes, it seems as if one must literally sell one's soul to the market if one is to *maximize* profits. Problems at home with sick children, other business ventures, lack of sleep, too much work, and temporary dislocations from routine operation can drive one crazy when one is trying to *trade* the markets.

One of the mixed blessings of the market is that it teaches one to keep thoughts in mental compartments where they cannot be of harm. The blessing side of this picture is that one learns, and must learn if one is to survive — to see life, situations, and circumstances objectively. One must flow in harmony with the market if one is to succeed, and the market is coldly objective, COLDLY OBJECTIVE! One literally bleeds out all the hang-ups, prejudices, subjectivity, and EMOTION as the price to be paid in order to succeed. A huge amount of scar tissue is built up, shielding one's emotion from one's perspective of reality. And it hurts. It is contrary to human nature, and sometimes, one wonders if it is worth the price. Why? Because as Steiger puts it, "they wither." One literally dies inside. One subscriber said to me in Hawaii, "The reason I like your writings is because they conform to the Chinese adage which states that a wise man has died many times." Now, I had never heard that before. And I consider myself always a *student in search of* wisdom, knowledge, and understanding — first and foremost, which is in and of itself a hindrance to maximum success in the markets. But, I can say this. I identify with that statement — about dying inside. There are times, in my painful history, as I am sure there are in yours, when I felt that the "pain" could not become any worse. But I recovered. However, when one is in the market as a critical part of life, the dying process continues. Stated differently, the change is constant and relentless. The market seems to demand total *submission* and *humility,* which are at least two of the qualities we all share in common after we take our last breath.

One can and does become able to turn one's emotions on and off like a stop watch, particularly when the human emotion of HOPE dies. Then one can see things as they are, accept things as they come, coldly, in an inhuman way. Now, I know all this is harsh, but it is important, and I know so from bouncing these thoughts off of several of you.

Back to the blessing. By isolating one's emotion, one has enhanced capacity to let them loose, to appreciate the important things in life to an enhanced extent if one is so inclined. The emotion is subordinated to the intellect, which means it is controlled. After all, is not the emotion the appreciator of the soul, which gives it a responsive and feminine quality? The danger and trap into which many old successful traders fall is the one where the heart is hardened for all time, and true inhumanity sets in, which brings us to Steiger's last point.

I know what Steiger is stating when he says, "Unless fear and greed are rampant in his soul, he will never be successful at winning other men's money." Men like this are the most successful in the markets, and in other fields as well. Steiger is referring to an all-consuming greed, a total, personal, mental, and emotional involvement with making money to the exclusion of all else. Please do not confuse this type of greed with the game-winning desire of the typical emotional investor. The type of greed Steiger is talking about is a killer's game, the type you find among the most professional of poker players. You know the type. It seems nothing can move them, and, in reality, little or nothing can.

In conclusion, what we have looked at here are the requirements (a better phrase might be total commitment) if one is to *maximize* profits. The price of selling one's soul comes high in exchange for the greatest of financial rewards in the speculative markets where there is a loser for every winner. Remember, too, that what has been discussed here is *not true* for the most part in free enterprise, where the essence of good business is where both parties to a transaction benefit and profit, hopefully for the good of society.

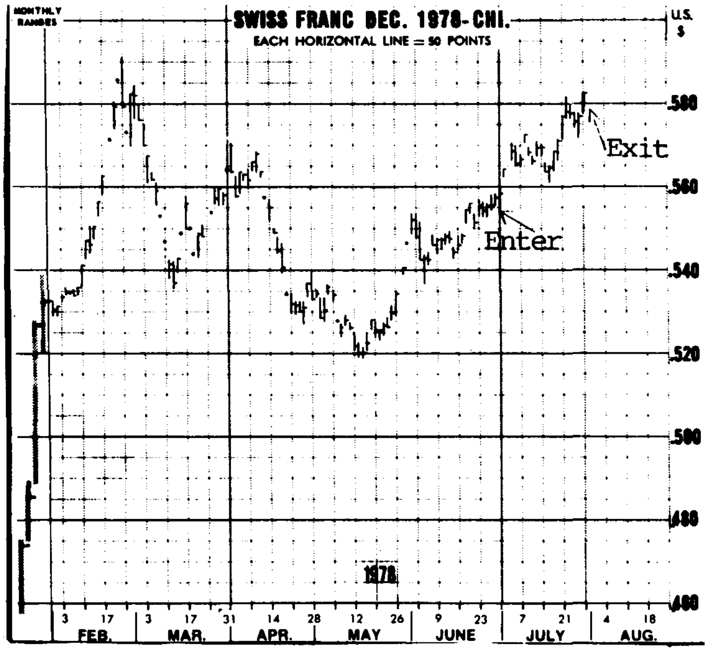
My personal conclusion? I'll trade off the total commitment to the markets for some of the "BEST THINGS IN LIFE ARE FREE" items. Now, I know that means, that all things being equal, I shall not be as successful as I know I can be financially, unless I'm lucky. Or, unless the work I've done with the weather is correct, in which case, the protein complexes in the next 6 years will make us fabulously wealthy.

NOTES

THE CASH IN THE CRADLE

A client called just the other day.
He rang the consulting line in the usual way.
He had planes to catch and bills to pay.
But he wanted to make some bread while he was away.
Now, he'd just taken quite a profit.
And as we talked, I knew
The market was about to take its due
From him.
The market would take its due.

CHORUS
For the cash in the cradle
Is not a silver spoon.
It wasn't put there
By the man in the moon.
It took hard work to make the market pay
So why give it back today, my friend,
Those bucks can go a long, long way.



One of the most *common mistakes* made by old and new traders alike is *jumping right back into the market just after taking a big profit!* The usual result of such an action is an *immediate loss.* In the above trader's case, he had (in line with REAPER comments) bought December Swiss Francs at .555 and sold them at .580 for a profit of $3,125.00 per contract. (See Chart).

The trade had lasted five weeks. Now, he was anxious to get back into the market, any market, as soon as possible, and make more money. Go, go, go! Do we have here a touch of greed? . . .

It is exhilarating to take a profit, better than sex some say. The King Kong feeling takes hold. It is natural to want more of the same. It is *so* great! Emotion is not only *in* control, it is *out of* control. The lessons of patience and careful planning, of watchng and waiting which brought the profits in the first place, are forgotten. The trap is set by the market and the trader is headed its way. The very natural progression of up and down is under way, just like with the rise and fall of markets, so we witness the rise and fall of equity.

It is not so very hard to break the cycle. All it takes is one's *recognition of* one's *vulnerability* after a nice profit. With this awareness, one can compensate. I have found it best, after taking a profit, to force myself to *sit on the sidelines for at least three days,* and usually longer if I am thinking of re-entering the same market. When I am strongest (richest), then am I weakest (poorest), if you will allow a distortion of this old proverb. The market (all the other minds in the market) wants *your* money and *my* money. And they want as much of it as fast as they can get it. Therefore, it is better to calm down for awhile after a healthy win. Enjoy it, relax and then in a cool manner, reassess the opportunities.

Trading opportunities are like buses. One comes along every 15 minutes or so. Self-control, discipline, patience and good judgment are the keys to beating the up and down equity cycles. Utilization of such aspects of character is *essential* for long-term profits and is the hallmark of a true professional.

NOTES

PETER'S PRINCIPLE

Peter is a mathematical and statistical wizard. Since 1972, he has made his living as a professional speculator in the stock option market. (He has also computerized the horses.) His first exposure to the commodity markets came in 1972 when he developed a "regression analysis computerized formula" which worked theoretically on ten years' data. Discouraged by its short-term performance in 1972, Peter quit trading commodities only to observe, from the sidelines, the bull markets of 1973 and 1974. In late 1977, he returned to the commodity markets and tested his formula on the 1973–1974 markets. To his dismay, his paper profits showed a "twenty-five times increase in capital." Peter's Principle — Stay with the markets in good times and bad. They will pay off eventually. . . .

MONEY VS. MONEY

At lunch one day, Peter commented, "There is a real difference in trading commodites that distinguishes it from the other speculative markets. In commodity trading, you really have to *want* to make money in order to *make money!* Most traders play the markets for the excitement or ego satisfaction that comes with being correct. Eventually they will lose because they do not want to make money in an all-consuming way."

Peter's words have been food for thought for this analyst. The commodity markets are a zero-sum game. For every winner, there is a loser. Therefore, the commodity markets are carnivorous. If one plans on surviving in such a competitive environment one must necessarily pull together all one's mental resources — calculative, rational and creative — in almost an evangelical way in order to profit. Stated differently, commodity trading requires dedication, a maximum utilization of the conscious and subconscious mind, and a correct blending of the mathematical/logical with the psychological.

This desire should *not* be confused with the *emotional* desire for money, or considerations of the value *of money.* At first blush, this seems somewhat contradictory. How can one have an intense desire to make money and at the same time isolate the emotion that flows naturally with the soulful desire for money? Candidly, it is quite difficult. And few are able to distinguish this fine line. It is one reason why few succeed in commodities.

By analogy, a professional baseball player who loves the game will generate great enthusiasm for his sport. He will bring to the game an intense desire for team success, and collective and individual improvement. By having an immense desire to play the game correctly, he will most probably increase his personal earnings as well. His increase in pay should result naturally as a by-product of doing things correctly.

By contrast, if every time this baseball player was at bat he thought of how much money a home run would mean to him, his performance would probably be diminished. His concentration would be diverted from his primary task — hitting the ball. Over time, such a player would probably fail or not reach his maximum potential as a professional ball player. Accordingly, his earning ability would suffer.

The successful commodity trader must have an intense desire to play the game correctly! The game is making money. But playing the game correctly and making money *must be separated* from the *greedy desire* to make money, the *fear* of losing money and the *emotionalism* wrapped up with how money will be spent. The desire for money as a source of security must also be isolated.

Few speculators have been able to recognize and define this difficult problem. Even fewer are able to cope with it in the markets. However, dealing with this problem successfully is one of the keys to commodity trading success.

NOTES

ISOLATING ONE'S EMOTIONS

From consulting line conversations, it has become evident that the first and foremost battle to be fought in the commodity markets is till the *battle with oneself.* Here are some techniques that I utilize that have proven to be invaluable.

1. The amount of money that one is willing to lose should be predetermined. Make a contract with yourself before you even think about approaching the market and carve it in concrete. You will be willing to risk "X" amount, LOSE IT ALL IF THE BREAKS DON'T GO YOUR WAY, and never give it a second thought. For example, let's say you have a $10,000 account. Make a firm, unemotional decision to write off $5,000 as risk capital, and to never again give that money a second thought. NEVER! IT IS YOUR STAKE, WIN OR LOSE, and that is that! Make the commitment!

2. Have a firm plan before you enter a trade. Decide ahead of time EXACTLY: (a) What the trading objective is, and (b) Where the protective stop will be placed in case the trade doesn't work out. This approach will keep you *out* of emotional trades, and only *in* trades which are previously, unemotionally thought out. By placing the protective stop at the time of the trade, and mentally agreeing to the potential loss ahead of time, one can more easily stick with the battle plan and not become emotionally whipsawed.

3. Finally, one must never think of the trade in terms of money. Think in terms of playing the trade correctly. Money and emotion are too closely tied together. When one starts to think of the money, one can count on his emotion distorting his judgment. Money does not come to those who seek money. Money comes as a by-product of doing things correctly. If one does one's job correctly in the market, or otherwise, money will come, given a reasonable amount of Divine providence. By concentrating on doing things right, one will be miles removed from the pack of traders who are fighting the waves of greed and fear.

NOTES

SURVIVAL

You've got to know when to hold 'em,
Know when to fold 'em,
Know when to walk away, and know when to run.
You never count your money when you're sittin' at the table.
There'll be plenty of time for countin',
When the dealing's done.

From THE GAMBLER
. . . A Song By Kenny Rogers

Notice that the above song makes it clear that, in three out of four cases, a gambler's position is *defensive!* Defense insures survival. Only in one case out of four does he "hold 'em." The other three he "folds 'em," "walks away," or "runs."

The whole idea is to trade (speculate/gamble) when the odds are in one's favor. With the exceptional minds, the devious minds, the manipulators, explosive fundamentals, and the leverage factor in the markets, one *must* trade defensively. Trading commodities is like operating as a guerrilla fighter. One must hit when the odds are in one's favor, then run. One is attempting to survive first and profit secondly. By playing the probabilities over a period of time, one will succeed.

The negative aspect of this approach is that one may miss a really big move. But the confident trader is unruffled by such an occurrence. He realizes that "moves" in commodity markets are like buses in the night. There is another one rumbling by every fifteen minutes or so.

Ninety-five percent of the prospectors who attempt to strike it rich in the commodity markets end up dead broke. Realizing this, the successful trader neither plunges, goes for broke, nor plans on catching all the big moves. He is content to take a sure profit here and there, to survive with an above average return year-end and year-out. Why? He knows he is among the elite 5% who profit from these most challenging of markets.

NOTES

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SPARE AMMUNITION

I grew up on a ranch in South Texas where deer hunting was a way of life. That's right, I gave Bambi fits! One morning I was sitting on a deer stand near the pipeline waiting for my "trophy" to appear. About 9:00 a.m. four does drifted in from the west. At 9:15 a.m. a buck strutted in from the north. I had my chance! The first shot was low and splattered the sand beneath him. He bolted. I emptied my trusty 30-30 as he darted for safety through the woods. He was the winner. I had missed on all four shots.

Not to be beaten easily, I began stalking that fine eight-point buck. The problem was, and I knew it, I had only one cartridge remaining. You see, I had forgotten to carry any spare ammunition with me. As luck would have it, I crawled over the top of a rise and spotted my buck. Unfortunately, he spotted me at the same time. He jumped. I shot. I missed. He stopped, turned and looked at me. I sat there in stunned silence. I was out of ammunition. Here was my buck, giving me the best opportunity of the day to provide venison for camp and I was out of ammo! If I hadn't known better, I would have sworn that he laughed at me before he raised his white tail and went bounding off into the brush.

The worst was yet to come. I had to face my father. I remember relating the story to him with an ever-growing lump in my throat and increasingly moist eyes. I remember his unemotional and firm statement, "You got what you deserved." He was right.

That lesson of many years ago is branded in my memory. I apply it now to my commodity trading. Here's how.

I always plan on trading multiple contracts. For example, if I plan on trading five contracts of soybeans I will put on only two positions at my initial buy point. By so doing, I have three positions in reserve, spare ammunition if you will. I find I am seldom exactly correct positioning in the market. Usually, I am *within* the allowed buying or selling range. Therefore, if my positions improve substantially, I will add the third and the fourth positions. If the market moves against me, and in the case of a long position, reacts down to just above my protective stop, I will add on my third and fourth position during the reaction. It seems that I always have one or two positions (spare ammunition) in reserve. It seems I never put on my entire originally planned line.

What I have done by entering the market this way is implement a money management technique. Utilizing the "spare ammunition" method, I never plunge. Secondly, I assume I will never enter the market perfectly. By having several positions in reserve I can "average-in" my original line over a more optimum range. Granted, this approach will not make me rich overnight. Only plungers get rich overnight. But then again, most plungers don't last very long. The law of averages catches up with them. What I want to do is get rich slowly, and in the process, protect myself against my own overenthusiasm, which, if it leads to plunging at the wrong time, would result in financial disaster.

NOTES

MONEY MANAGEMENT

Much has been written about money management as the *second* critical ingredient to commodity success. There are *three,* of course. The *first* is a profitable trading plan and the *third* is the courage to execute the plan and money management techniques.

What is money management? First of all, it is a DEFENSIVE strategy. It assumes error in the trading plan, executions and judgment. It hopefully prevents one from putting all of one's eggs in one basket which could result in not only losing one's eggs and basket, but one's shirt as well.

There are many sophisticated mathematical formulas available that one can use to evaluate the risk in a trade. Practically, however, the commodity traders who are willing to go to such trouble are few and far between. What follows is a "quick and dirty" on money management which should be of practical benefit.

1. Trade only commodities which are liquid, have large open interest, and have worldwide appeal. These commodities are less subject to manipulation, and the executions (fills) tend to be near (or at) one's "target" price. Trade only the most active months of these commodities. Specifically, trade Wheat, Corn, Soybeans, Soybean Meal, Soybean Oil, Silver, Ginnie Maes, Live Cattle, Live Hogs, Gold, Treasury Bills, Copper, Sugar, and Cotton. *Avoid* Coffee, Cocoa, Orange Juice, Potatoes, Oats, Broilers, Plywood, Lumber, Pork Bellies, Feeder Cattle, and Currencies, as well as the other "exotic" commodities. Few pit brokers, market manipulation (at least in *some* cases historically), poor fills, lots of limit moves, and thinness of markets are all unnecessary risks and exposures to loss of capital.

2. Spread the risk around. Trade a basket of commodities. For example, one's portfolio might include, Wheat, Soybean Meal, Silver, Ginnie Maes, Live Cattle, Copper, and Cotton. It is unlikely that one will be wrong in *all* of these commodities at the *same time.* Their *fundamentals* are too different.

3. Look for the maximum risk/reward opportunities which come 2–4 times a year per commodity. It makes sense to risk $500 in order to make $2000. It is questionable to risk $500 in order to make $300.

4. Use protective stops. Have them in the market. Most folks do not enjoy the discipline necessary for mental stops. Besides, if there is a dramatic event that occurs that adversely affects the market, and the stop *is* in the market, one can often be stopped out with minimal loss. Such *is not* the case when a mental stop is used.

5. Risk no more than 5% of one's total account equity on any one trade. In other words, in a $10,000 account, risk no more than $500 per trade. "Back into" the number of contracts that one decides to trade. For example, let's say a trader has a $10,000 account and is only willing to risk $500 on each trade. He decides to buy December Silver on a stop at 560. When filled, his protective stop he has determined should be best placed at 555. How many contracts can he buy? Two. Why? Because the dollar difference between 560 and 555 is $250, and since this trader has predetermined that he can only lose $500 per trade, he can only buy two contracts. Let's itemize the steps: A. Determine entry point. B. Determine logical point to put stop loss. C. Compute the total dollar difference between entry point and stop loss point. D. Divide this dollar amount into the amount of money to be risked on each trade. The answer is the number of contracts which can be traded.

Does it ever make sense to risk $500 in order to make $500? Maybe it does. If one judges the probability to be, let's say 80%, of having prices move $500 in one's favor, and 20% of being stopped out, then the trade may make sense. Why? Because the adjusted risk/reward probability is 4:1, or $400 to $100. (.8 x $500 = $400, as compared to .2 x $500 = $100). One had just better be sure that the trade *objectively* deserves the revised probability estimates.

NOTES

MONEY MANAGEMENT — AN ENHANCED PERSPECTIVE

Correct money management is critical to successful commodity trading. It is as important as is a successful trading system and the discipline to implement it.

A helpful rule of thumb for trading commodities is to never risk more than 5% of one's capital on any one trade. In other words, if one has a $25,000 account and makes the decision to trade soybeans, one can only risk 5% of the $25,000, or $1,250 on the trade. In a $35,000 account, one could risk $1,750, a $50,000 account $2,500, and a $60,000 account $3,000 per trade.

There is a problem, however, with this technique. What if the account size has *increased* from $25,000 to $35,000, to $50,000, to $60,000? This increase in account equity can be put on a rising trend line. But trend lines, whether they be in the soybean market, or in one's equity, are eventually broken. And, it's normally not correct to buy a market, or increase one's line, after a significant advance. The same is true for account equities.

I have written many times that, after a series of substantial wins, one is best served by taking a vacation. Why? Because reactions normally occur in one's account equity (losses take place!).

Market writers, who have been around for awhile, start to carefully follow the work of their competent contemporaries who have been *wrong* for an extended period of time. They know that they are *due* for some accuracy. On the other hand, market writers who have been *successful* for an extended period of time usually enter a "cold period." (The way I guard against this personally is by taking a vacation or making *few* recommendations after a "hot streak.")

Back to our original 5% of account equity which is at risk on any one trade. If one's account is rising, as in the above case, from $25,000 to $60,000, the risk per trade increases from $1,250 to $3,000. Herein lies the problem with the 5% rule — increased dollar risk! If one has been successful in pyramiding one's profits from $25,000 to $60,000, one is then probably due to suffer some loss in equity due to poor trades. This means larger losses ($3,000 rather than $1,250), and, therefore, steep drops in equity. Money is lost faster than it was made.

Let's look at this from the perspective of probability theory. If we are flipping a "fair" coin, the probability is .5 that a head will turn up and .5 that a tail will appear. However, if we flip the coin four times, the probability of a head turning up four times in a row is $.5 x .5 x .5 x .5 = .0625$, or 6.25%. In this example, one would bet less money on a head appearing after the coin had been flipped twice, and even less money if a head had appeared three times in a row prior to the fourth flip.

Though the increase in account equity is *not* an exact analogy to coin flipping, the point should be clear. After one's account equity has increased, probability theory *implies* that one should either *reduce* the dollar risk that one takes on every trade, or *keep it constant.* I have found it best to keep the dollar risk *constant.* If a client has a $25,000 account and determines that he wants to risk 5% of his account equity on each trade ($1,250), this is the amount that will be at risk regardless of how much the account increases during the year. If our $25,000 account, with the commensurate $1,250 risk per trade, increases to $100,000, the dollar amount risk per trade remains $1,250. For more study, read Raiffa's DECISION ANALYSIS.

NOTES

THE LAST RITES OF A COMMODITY TRADER

Here lies a former commodity trader. His demise was slow and lingering. It was not planned that way; it just happened. ... In his early days our commodity trader had great hopes, was enthusiastic, and exhibited sudden, short spasmodic bursts of systems' studying, money management, discipline and trading. But he had many other interests. Our trader was very active on the golf course and the handball court. He took little time to learn about the markets. This was particularly sad in light of the fact that his many friends and associates were searching for the very opportunity which he understood and held secretly in the palm of his hand.

He was consistently *in*consistent, causing his friends to look askance at his commodity trading. Some, fortunately, who had seen the opportunity presented by our commodity trader while he was still alive, during some of his active and profitable periods, sought out those more consistent in the business and became successful traders.

Our trader's "trading health" began to fail rapidly when he stopped his regular charting. As usual, this was reflected almost immediately on his end-of-month statements from his brokerage firm.

Previously a loving and friendly man, detectable changes soon appeared in his personality. He became critical, negative, and impatient...blaming circumstances, people, and brokers — just about everything in general — for his condition. He often became ill-tempered when he received a bad fill. He kept no records and became very unprofessional in dealing with his broker. He lost sight of his responsibilities and hadn't the faintest idea of what was involved, financially and physically, in living up to his responsibility as a trader. Small things soon began to upset him greatly! *Any* change seemed to irritate him. A small loss all but shattered his faith; missing a move would cause him to fly into a rage. He swore at everything from pork bellies to cocoa. Once he suffered an almost fatal heart attack due to an unexpected price increase. His abundant and latent abilities, which gave him an inherent advantage over many of the other traders, lay dormant. He refused to accept the fact that his increasingly poor *attitude* was the controlling factor in his failing financial health. Friends could not revive his will to financially survive in the markets. Refusing all prescriptions, such as self-improvement and motivational books, technical systems, money management techniques, and, most of all, discipline, he continued to plunge head-long down the path of failure. His friends, family, and fellow traders watched helplessly. His condition worsened until, at least, he traded aimlessly, being already dead and not knowing it.

He is survived by his lovely wife and children, who will never experience the joys of financial security and the exhilaration of victory.

NOTES

COURAGE

One can be the greatest fundamentalist in the world. One can be the most accurate technician who has ever lived. But if one is short on guts, short on courage, one will fail in trading commodities. One must put one's money where one's mind is. That cold hard after-tax cash must be put on the line!

It is difficult to take a position against the crowd. It is uncomfortable. It is painful to go into the market when unknowns still exist concerning the trade. Yet, we know that when everything is known, then the market will go the other way, for no longer does any "real risk" exist.

It takes courage to assume risk. It is contrary to the nature of man. Man seeks security. Maslow, in his hierarchy of needs, placed man's need for security just after the fulfillment of his biological needs. Therefore, courage takes discipline too. It is not natural.

Have we ever thought of courage in terms of entrepreneurs and salaried personnel? Let's explore it a minute. Most folks are security-conscious, particularly in our day and age. (Social security, retirement plans, pensions and insurance are a multibillion-dollar-a-year industry.) And since most folks are security-conscious, they will take the supposedly "secure" position, the salaried position, rather than risk becoming an entrepreneur (which takes courage). However, if one stops to think a minute, there are no salaried positions without the assumption of risk (courage) on the part of the entrepreneur. Therefore, the so-called security on the part of the salaried persons, particularly government workers, is based upon the risk assumed by someone else. In other words, the typical job holder is more susceptible to loss of income and security than is the entrepreneur because he is subordinate to the entrepreneur and therefore *expendable.* The salaried person departs before the boss (owner) goes.

By the very nature of being conditioned to being told what to do, the job holder is less creative and has less courage to meet new difficulties simply because he has no experience out in the world on his own. One must pause and reflect on the fact that we have become a nation of corporations where everyone, it seems, works for someone. Perhaps this is a partial explanation of why the West is failing. We have lost the creative and courageous avant-garde remnant.

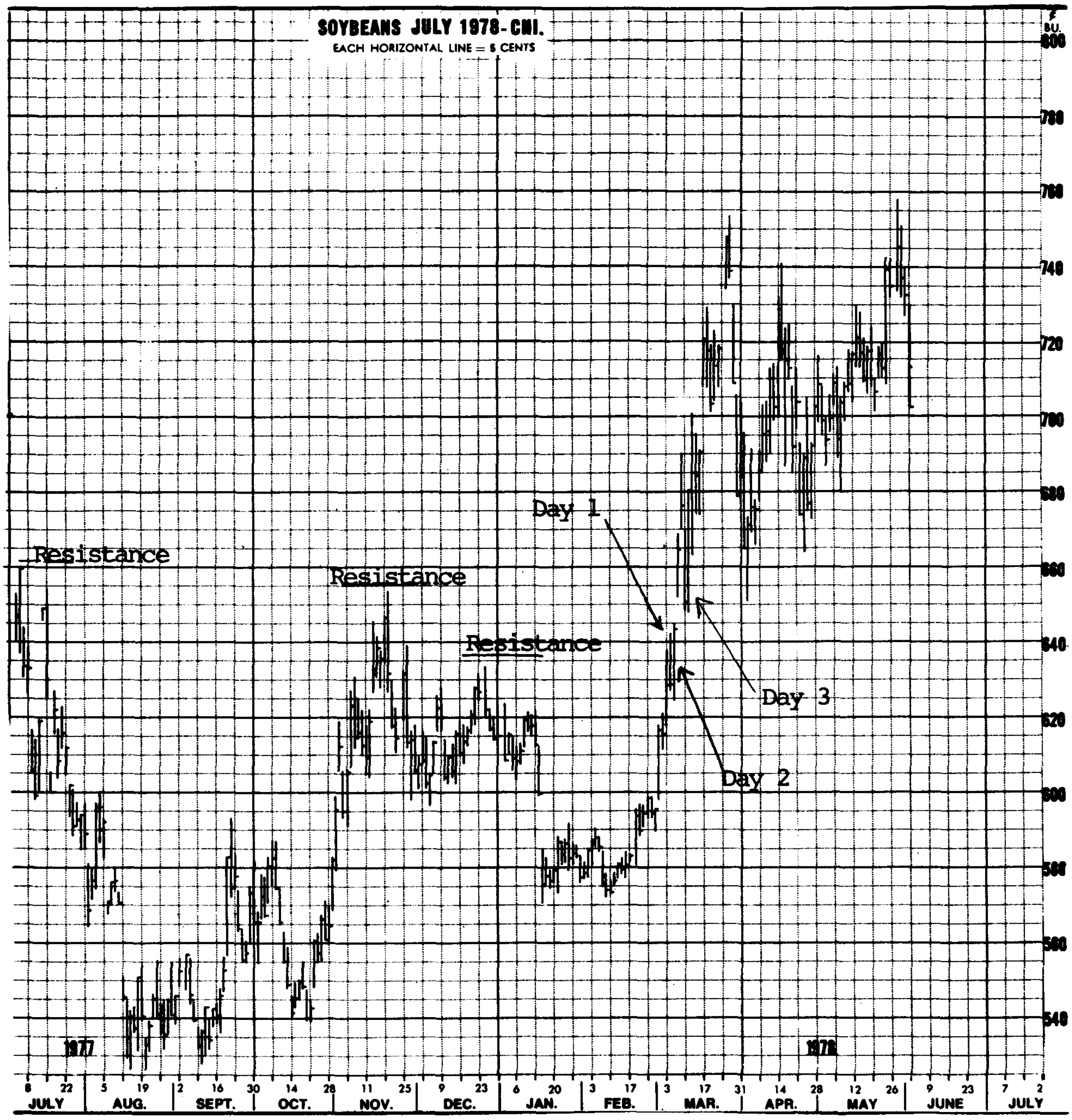
Back to the commodity market. We must strike when the opportunity presents itself. He who hesitates, particularly in the commodities markets, is lost. The markets just move too fast. Lack of courage in taking a position when one KNOWS where the market is headed is just as bad as taking a loss. In business terminology, it is called opportunity loss.

A quick example. In March 1978, when soybeans were moving up, on Day 1, Beans reacted down from the pressure of three previous resistance levels and closed on its low. (See chart.) The next day, Day 2, when the market went lower than the previous day, but reversed intraday and closed near its high of the day, a clearcut buy signal was issued. The breakout was there for all to see. The strength of the vertical rise which began in February and cut easily through the 600–620 resistance level would not be denied. Prices were headed higher. One only needed the *courage* to buy on close on Day 2 with a stop below the low of the day. One only needed the *courage* to buy the correct number of contracts consistent with one's money management program to make fast money in soybeans. One only needed the *courage* to add to one's position on Day 3, the first correction after the breakout. Such weakness in the face of a powerful trend is almost certainly temporary.

COURAGE, the instinct of a mountain man, is necessary for the commodity trader. In my living room I have a painting of a mountain man snuggled up to a campfire in the midst of a storm. His rifle is on his lap. He is courageous. He is ready.

Finally, one needs to recall the difference between courage and recklessness in trading, and in life. What is the difference? Courage is well-thought-out, has meaningful direction, is based in knowledge, has purpose. Recklessness is flippant, is thoughtless, and can be based in egotistical pride. As such, recklessness is a ruinous road in commodity trading.

NOTES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NOTES

BUY ON FEAR, SELL ON GLEE

The above is "R.E.'s adage." It is a prostitution of the old market saw, "Buy on rumor, sell on news." While it is usually correct to "Buy on rumor and sell on news," it is also important to attempt to gauge the psychology of the market. One should trade contrary to one's emotion and the emotion of the crowd. "Buy on fear, sell on glee."

When the markets are going up day-in and day-out with only minor corrections, when profits are piling up and one sleeps well at night, when one stops thinking about the position — Sell!

When one begins telling his neighbor about how much money he is making in the commodity markets, when one thinks about buying that second house with all the profits, when one looks to pyramid one's profits so that retirement can come next year — Sell!

When the public is long up to their earlobes, when all the brokerage firms are recommending a commodity, when the CBS Evening News discusses how commodity prices are soaring — Sell!...

One of the greatest warning signals a trader can have that a market move is about to terminate is when there is *rampant euphoria,* when it seems as if there is no end to the price rise. Then is the time to, "Sell on Glee."

These market tops can be characterized by *heavy volume,* unrestrained trading, wide swinging or negligible price movement. Distribution is taking place.

The market may just run out of steam as the chart approaches the vertical. For several hours in the morning there may appear to be *no volume* whatsoever. Then the market falls of its own weight. There are no more buyers. The vacuum is filled by sellers and bulls taking profits. "Sell on Glee."

"Buy on Fear." When the margin calls are being churned out right and left, when the CBS Evening News is reporting what a shellacking the traders are taking in the pits, when one *knows* the bulls are bailing out of their longs to beat the band because it hurts too much — Buy!

When it seems as though there is no bottom to the market, when the primary producers feel as though they are looking bankruptcy in the face, when the good old commercials feel that they can take their time and buy their requirements any time because prices are going lower — Buy, Buy!

A market bottoms when there are no more sellers, *not* when there are abundant buyers.

A market bottom *can be* a very sleepy affair. Few are interested in it one way or the other. It seems to be taking a nap. Ho hum...is the norm. Psst! It is a good time to establish positions.

Another good time to buy a market is when the trading is fast and furious, and yet, prices refuse to *decline.* Accumulation is taking place. Buy. "Buy on Fear."

In order to "Buy on fear and sell on glee," one must have a clear perspective of the overall environment of the market. Buying on fear makes sense near seasonal lows, and/or in an oversold condition in a new uptrend.

Selling on glee is prudent at seasonal highs, and/or in an overbought condition in a new bear market.

These principals can be readily adapted and applied to any business or life situation. For example, look at the condition of the general public presently. In the early 1950's there was little debt in this country. Now everyone is in debt. One could say now is the time to apply the principle of "Selling on Glee." Avoid debt and leverage.

In the late 1940's and early 1950's, real estate was a "ho hum" market. It was the time to "Buy on Fear." Today the general public believes that it is "the only sure thing." This application of the "Sell on Glee" principle is to liquidate all but the *necessary* real estate. A massive readjustment may be in the wings.

NOTES

HABITS

Mike Newlin, guard for the NBA Houston Rockets, is a long-time friend and client. In addition to his athletic skills, Mike is quite a scholar, literally of "Rhodes Scholarship" caliber. In Houston this year, Mike and I were discussing his reputation as possibly the most aggressive guard in the NBA. He and I chuckled about how the opposition considers him to be "a mean dude." (He is truly mild-mannered off the court.)

When I asked Mike why he "put out" so consistently, he replied that it had become a *habit.* He wisely noted that habits by their nature are consistent. If one has a habit of "extra effort," then "extra effort" will become the norm. He observed that since he only lived once, he wanted to do everything he attempted the best he could. ...

OLD MEN

As a "*young* man," Mike takes the perspective of an "*old* man." What does this mean? It means that as a "young man" he imagines himself to be an "old man." He then looks back on his present situation with more objectivity and less emotion than occurs during "real time." As an "old man" he can ask himself purposefully, "What is the right action in this situation? What is the correct response?"

"Becoming an old man" is a useful technique for commodity traders. If one has the ability to mentally place oneself in the future and then look back upon one's present position in the market, one can gain a perspective which is usually more sound than that made during the emotion of the market. ....

CHALLENGING YOUR DISCIPLINE

Another of Newlin's favorite techniques is to "never challenge my discipline." Mike has observed that in order for him to hustle consistently throughout a basketball game, he must be in top shape. That requires "running" during the off season. Mike admits that he hates to run. If he tried to do it every morning by himself he would fail. But he commented, "I never challenge my discipline. I make something that is unpleasant for me, such as running, enjoyable. I always run with a companion, usually a girl friend. It becomes ecstasy rather than agony."

The principle of never challenging one's discipline has application to commodity traders. It is mentally and emotionally exhaustive to trade commodities. The old "saws" about there being "strength in numbers," "the whole is greater than the sum of its parts," and "division and specialization of labor" apply to commodity trading. Since man is a gregarious beast, human companionship is mutually supportive. Analyze and trade the markets with a friend, a business associate, or a relative. The arduous mental and emotional struggle becomes amazingly lessened. The exhilaration during a "win" is enhanced. The depression of a loss is eased. The greedy, paranoid, and suspicious traders aren't the consistent or the big winners in the market.

The principal also applies to civilizations. Civilizations which are enshrouded by the "team spirit" attitude will be happier, stronger, and more productive. They are applying the concept of synergy — the "one plus one equals three" — the whole *is* greater than the sum of its parts. It is important to observe that such an attitude is absent in our society presently.

Inflation sets class against class, individual against individual. Everyone attempts to benefit at the expense of his neighbor. Everyone assumes that his neighbor is benefitting at this expense. This posture of conflict is the logical result of the welfare redistribution system, the terminal stages of which are marked by severe inflation. An angry, selfish and lonely population, where every individual maximizes selfishness, can't help but result in a weak and exhausted population. It is hard work to constantly be at battle with one's neighbors. It is *negative,* which further deteriorates the soul. It is dangerous as well. In an exhausted civilization, where each individual focuses upon his own needs, one finds not only the short-run perspective, but also disregard for the environmental threats. In the case of a nation, neglecting the environmental threats can result in military defeat — the defeat of a nation. Alienated and tired people have difficulty recognizing their enemy. They also lack the spirit of cooperation and the energy necessary to combat the foe.

NOTES

REVERSE ENERGY/GUILT AND BLAME

After thoroughly analyzing the Soybean market on the weekend of September 29, 1978 this analyst concluded that the probabilities favored a sharp reaction. Now probabilities, by their very nature, are likelihoods. That means they only work a certain percentage of the time. They are subject to error. Once this is recognized, it can be appreciated. When high probabilities are violated it usually means the market has the "bit" in its mouth and intends to runs strongly the other way. For example, on the weekend of September 29th, indices analysis projected a reaction, as did the oscillator, momentum/oscillator indications, bullish consensus figures, point strength analysis, range analysis, and swing analysis. The probability of a reaction based on these indicators was better than 75%. Stated differently, 75% of the time these indicators, over the past few years, would have correctly called a reaction.

So what happens when the indicators fail? Usually it is a curse, which can be turned into a blessing. When the market fails to follow through on indications, which project with 75% accuracy a reaction, one should expect it to explode the other way. This is, in fact, historically the case. Tracing the trading history of these indicators over the past four-and-one-half years, I have found that when they fail collectively, one is better off reversing one's position 75% of the time. In other words, when the indicators are wrong, 75% of the time one can make a profit by immediately reversing one's position.

I now call this phenomena "reverse energy." When these indicators are calling for a severe reaction and they are dead wrong, it means that the market is violating all the "energy" which should lead to a reaction. This market "energy," which is unable to be fulfilled on the downside (for example), *reverses* and adds momentum to the upside explosion some 75% of the time. Therefore, a short-term loss can be turned into a healthy profit by reversing positions.

There are character flaws which keep traders from doing this. Pride and rigidity head the list. Close behind are guilt and blame. By this is meant, traders want to point the finger of guilt at the indicators or the analyst and proclaim, "You are *guilty* of error. You are to *blame* for the loss." Well, let's belly right up to the bar and admit hands down, "You're right. ... But, so what? Assigning guilt or placing blame is a nonproductive activity. It doesn't help us make money. It *diverts* our primary focus from our reason for trading the markets to make money!

I have never seen a trader who was quick to place blame and assign guilt who was also able to reverse his position and profit from a mistake. Additionally, very few traders who are quick to point the "finger" make money trading commodities. The reason why is quite simple. They are more interested in being right or wrong than in making money. This is a personality/character flaw. Possessing it leads one down the road of losses. For after all, as has been stated before, the market just doesn't give a damn about what we think. It doesn't assign guilt or point fingers. It does what it has to do and we change and flow with it and profit, or we fight it and lose.

Incidentally, on September 29th, November Soybeans closed at 652. Two weeks later, on October 13th, they closed at 687, a gain of 35¢ in just two weeks. Reversing one's position *was* the correct strategy.

NOTES

DOWN AT THE OLD BROKER'S OFFICE

Nearly every book ever written about the "correct" way to trade commodities advises one to stay away from the broker's office. The broker's office is too loud, too emotional, too confusing, and will lead to overtrading, or so the story goes.

On a recent trip to San Francisco I decided to run my emotions through the gauntlet and watch the market from the office of a brokerage firm. I had three positions "on" in the market. It had been over three years since I had done this, so I felt it would be interesting to see what effect the passing time had on "being too close to the market."

The setup was classic — Quotron machine all to myself, squawk box tuned in and turned up loud so all the floor gossip was available: Everything was in place for a "heavy" emotional day. And for added spice, the public was heavily invested in the markets (grains and meats), so volatility was assured.

First observation — I lost my sense of TIME! With all the chatter coming over the squawk box and the constantly changing prices, 30 minutes seemed like 3 hours. So much happened so fast. I was snowed with information, simply overwhelmed! With 30 minutes seeming like 3 hours, it is no small wonder that I lost my perspective and therefore felt the urge to TRADE, which in reality meant OVERTRADE!

Next, my long-term, well-thought-out plan escaped me. I was wrapped up in the emotion of the moment. I did not recognize this until I found myself mentally thinking of each "tick" in terms of dollars. This meant I was on the verge of becoming a "dead duck." With the game plan gone, emotion had become king. I was almost unable to muster the courage to stick with the original game plan, particularly when the action became exceptionally hot and heavy.

With a ticker, one has a record of every trade. One can walk away from it, return, and still see what has transpired. On the other hand, the Quotron machine is like a TV set. It tends to hypnotize. One stays glued to the market.

But, lest this sound as though there are no positive aspects to being around a brokerage house, I need to note *two real advantages*. When one is trying to enter or exit the market, pick one's "spot," so to speak, the Quotron is an invaluable aid to precise timing. Additionally, when one wants to know the nature of the buying or selling (locals, commission houses, commercials) the squawk box is very helpful.

Stated simply, the battle one faces by being around the brokerage firm during market hours is a battle with one's emotions. And my judgment is that only a few traders are possessed of the temperament necessary to withstand the onslaught of information that is continuous day-in and day-out. It is almost impossible to keep in mind any concept of trend; one becomes wrapped up with TODAY! If the market is undergoing liquidation, worry can be overtaken by panic! If one's battle plan is to buy dips, it can become too difficult because it "hurts" too much. The risk of mental error is multiplied.

Make no mistake about it. It is fun to be where the action is, and the brokerage office is where the action is. However, just as one is ill-advised to make important financial decisions while riding a roller coaster, one is likewise ill-advised to try to logically trade commodities where the breathing is hot and heavy, as it is in the offices of most brokerage firms.

NOTES

CHOOSING A COMMODITY FIRM AND BROKER

Commodity traders who have "been around the track" have some definite criteria established for choosing a commodity firm and a commodity broker.

When considering which commodity firm to deal with, check out the following items:

1. Is the firm a reputable firm? Ask your attorney, CPA, or a professional investor. Be sure and obtain a copy of the firm's financial statement. Have your CPA look it over. We are living in an age when firms are merging and/or closing down right and left. Check out the firm's capitalization.

There are some small specialty houses whose fine reputation is well deserved. If you are considering one of these, be sure to confirm the longevity of the firm.

2. What is the firm's commission structure? There is no reason to pay exorbitant rates. Commissions in commodities, particularly for short-term or intermediate traders, can exceed the total equity of the account on a yearly basis. For example, it is considered normal for a short-term trader in a $10,000 account to pay $6,000 a year in commission. So, shop around. Rates closest to exchange minimums are a must. If you have a large account, negotiate the commission structure. Every year the number of contracts for negotiated rates becomes lower, by law. Be tough. It is your money. Along the same line insist on minimum margins. It is your job to manage your money.

3. Insist on the privilege of depositing your excess funds ($10,000 or more) in Treasury Bills. Treasury Bills serve as original margin for commodity positions on most exchanges. In other words, you can have your cake and eat it too. Example. You have a $25,000 account. Have your broker buy 2–$10,000 90-day T-Bills for your account at the Monday auction. (That way you will avoid a fee for the transaction.) You now earn interest on that $20,000 while using the T-Bills as margin requirement for your commodity positions. While you make money in your commodity trade, you also earn interest on your T-Bills. You win twice. Keep some "fluctuation money." In this example, $5,000 is ample to cover losses and price swings against you. You don't want to liquidate a T-Bill unnecessarily.

If you don't earn interest on your money the commodity firm will. Commodity firms just love large "free credit balances."

4. Check who the firm "clears" through. You will want to be sure the clearing house is financially solvent and stable.

5. How does the firm operate? Are commodities just a necessary evil in their business, with the focus primarily on stocks and bonds? Or, is the commodity business important to the firm? You'll find your best brokers and management where there is a priority on the commodity end of things.

6. Does the firm use a "hot line" to the floor or just a wire service? I prefer a "hot line." If a market is really moving, and you want out, a "hot line" direct to the floor can sometimes save you hundreds of dollars. It is faster. Timing is everything in commodities.

COMMODITY BROKERS

Traders who have survived the commodity markets tend to come to the same conclusions. Use the broker just for executing orders and gathering information, not for advice or recommendations. A laundry list of what to expect from your broker follows:

1. Immediate and correct execution of orders. Stay on the line with the broker when he/she puts the order in. Then you know you have received timely service, and the order has been placed correctly. Be sure the broker "time stamps" the order. This establishes your priority. Ask for the bid and offer when the order is put in. Then you know exactly where the market is relative to your order. If the broker makes a mistake (either your broker or the floor broker) he/she pays. It is not your loss. Don't stand for it.

2. Don't have a broker with too many customers, or a few really big customers. You're not as important then. And you want to be important to your broker. Your money is on the line.

3. Expect the broker to keep you informed on the dates for all upcoming crop reports and the like. You probably will not want to enter the grain market prior to a big USDA crop report, for example. Insist he/she call you if there is some phenomenal news that hits the market, such as the buying of 10,000 contracts of December Gold by one party or an outbreak of war, or Russian buying of grain. Make it the broker's responsibility to read the tape and keep you informed on the very important or unusual news items.

4. Let your broker gather pit information for you. What side of the market are the commercials on? Has there been any commercial business today? What side of the market are the locals on? You may be considering taking a position on close, and since locals "cover" their positions prior to the close, you may get an idea of which way to expect the market to move in the closing minutes from knowing which side of the market the locals are on.

5. If you are thinking about taking a position, but you're just not ready to place an order, give the broker a price, and have him/her call you when/if the market reaches your price. For example. "Mr. Broker, please call me when November Soybeans hit 830." You can then ascertain if your broker is alert and really interested in your

business. Also, you don't have to suffer the unnecessary emotional strain of following the market too closely! When the broker calls, you know how long it took the market to hit your price.

6. You will not want a broker who trades his own account. If he/she does, you *know* who has priority. Your broker should not be a "giver of recommendations." The last thing you need is an ego conflict with your broker. The markets are intense enough. You must be personally compatible with your broker, work well together in a strict business sense. Insist on your broker being closed mouth about your trades, and trading method. It is your business, no one else's. It is often helpful, in this regard, to drop down to the broker's office unexpectedly to observe him/her in action under fire. You don't want your broker to be an office manager. Office managers are typically loaded with extra, distracting responsibilities.

7. The broker should be an expert on exchange hours, margin requirements, commission structure, minimum ticks, limit moves, etc. — the technicalities of the business. He/she should be a professional. Let the broker be responsible for, and tend to, the details. Your job is to trade and make money. The broker is there to *SERVICE* your account. He/she should *earn* the commission.

If you follow the above suggestions, your trading should be much smoother and hopefully more profitable.

NOTES

PART II
TECHNICAL SECTION

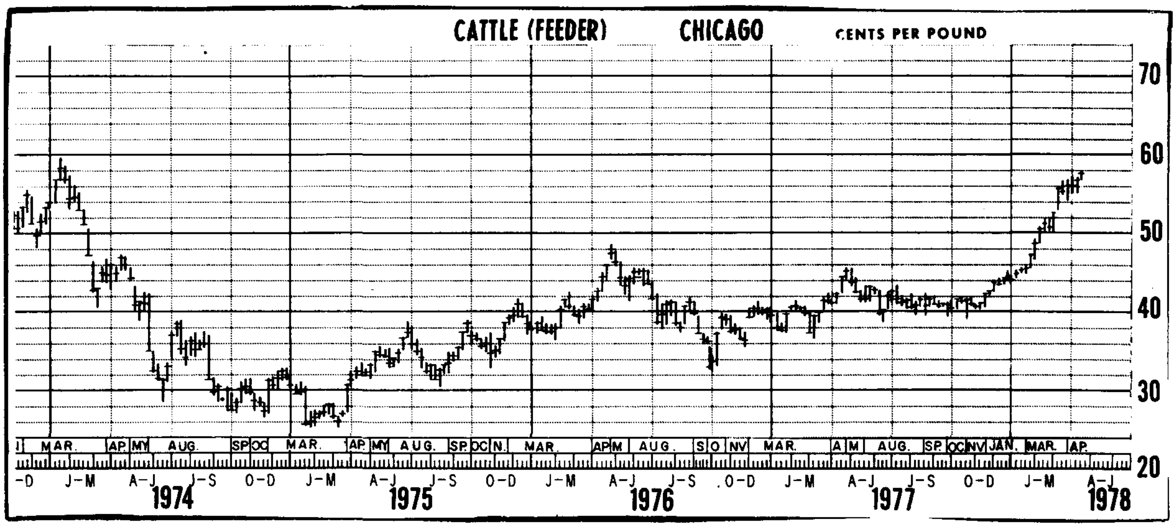
WEEKLY FUTURES CHARTS

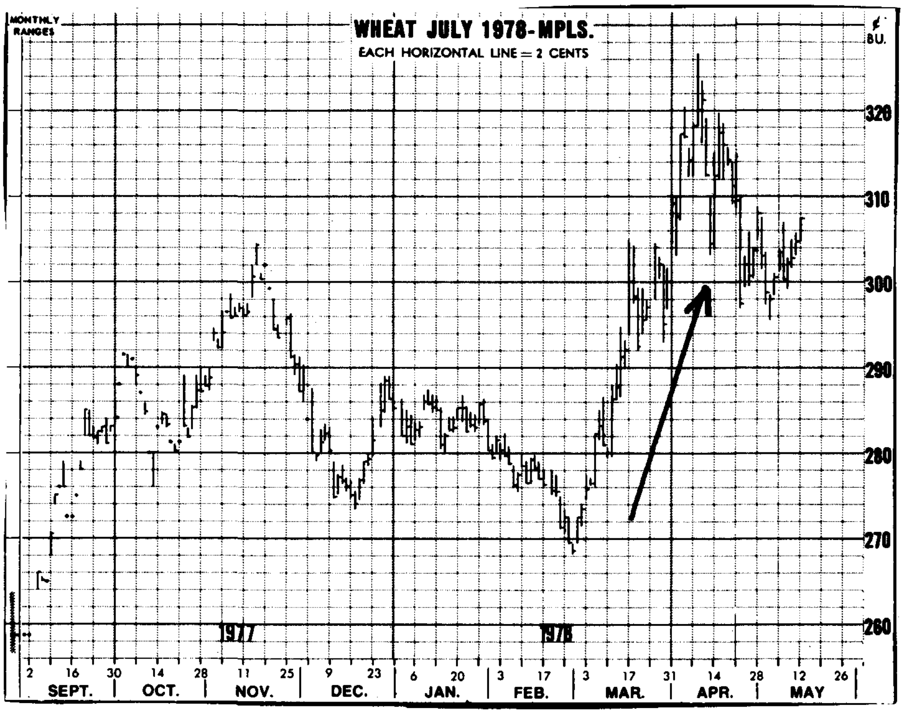
One of the most useful chart services in aiding a commodity trader to maintain his perspective on where commodity prices are, have been, and are going, are the "Weekly Futures" charts published by Commodity Chart Service, One Liberty Plaza, NY, NY 10006. These charts give the weekly high, low and close of the nearest futures contract. As such, the variations between contract months are, in effect, "washed out," and one can see the ongoing equivalent of a continuous contract in a specific commodity. These charts are particularly helpful when one is analyzing the "cash" sensitive markets such as cattle and hogs, where the variations between various contract months are often substantial. (See cattle chart.)

These charts are useful for traditional bar chart analysis-trendlines, head and shoulders formation, triangles, etc. They aid in locating points of historical support and resistance. The oscillator, which was discussed in an earlier REAPER, can be applied to these weekly charts as well.

The tendency of most traders is to look at daily charts and then make a decision to enter a market. Their decision is based on close inspection of market action. However, it is strongly recommended that an overview be taken of these weekly charts as well to insure that there is harmony between the daily perspective and the weekly long-term perspective before a trade is entered. Two quick examples are appropriate.

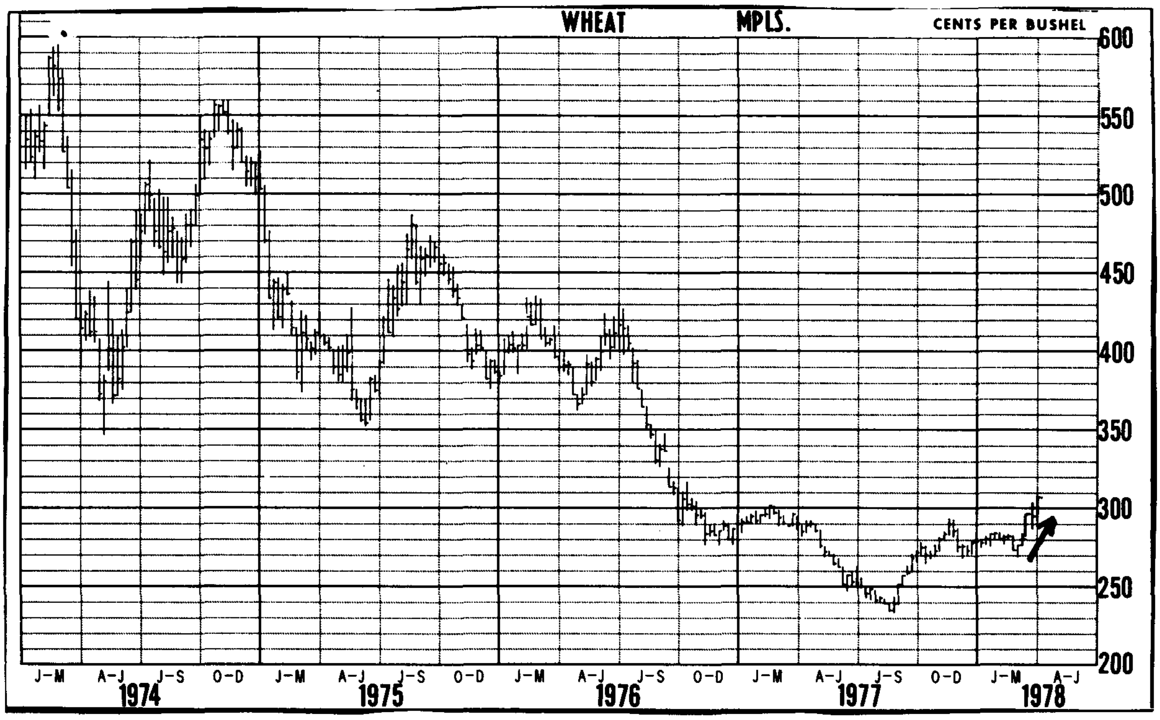
If one views a near-term daily wheat chart (See July

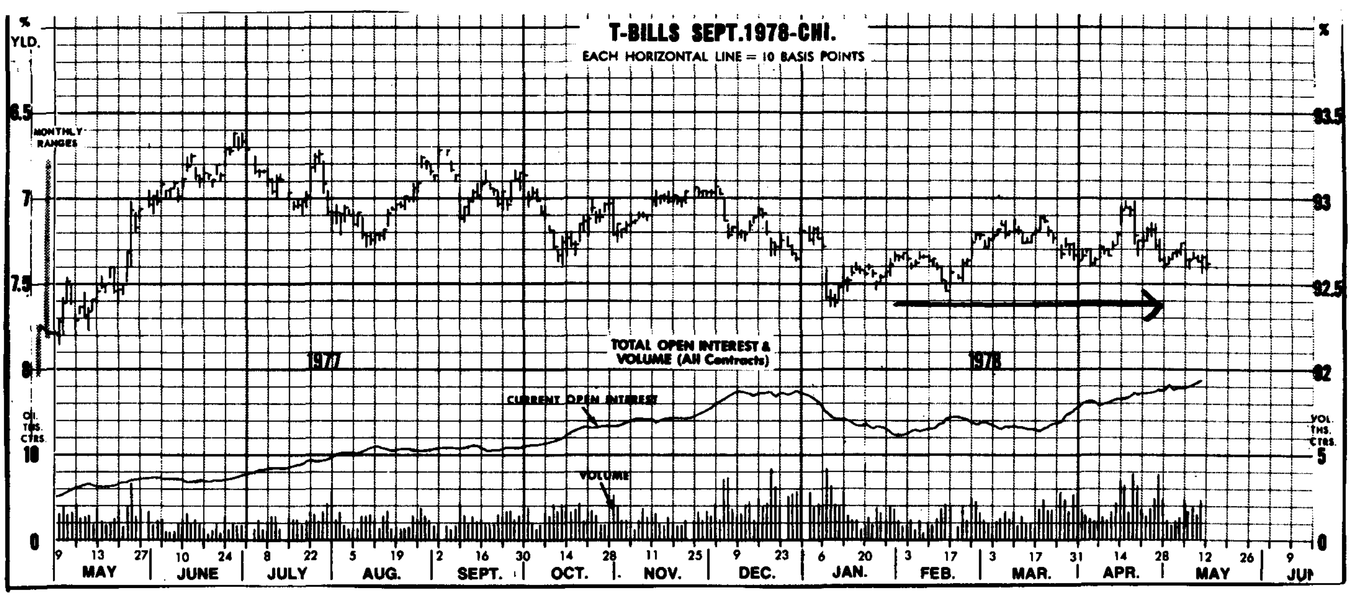


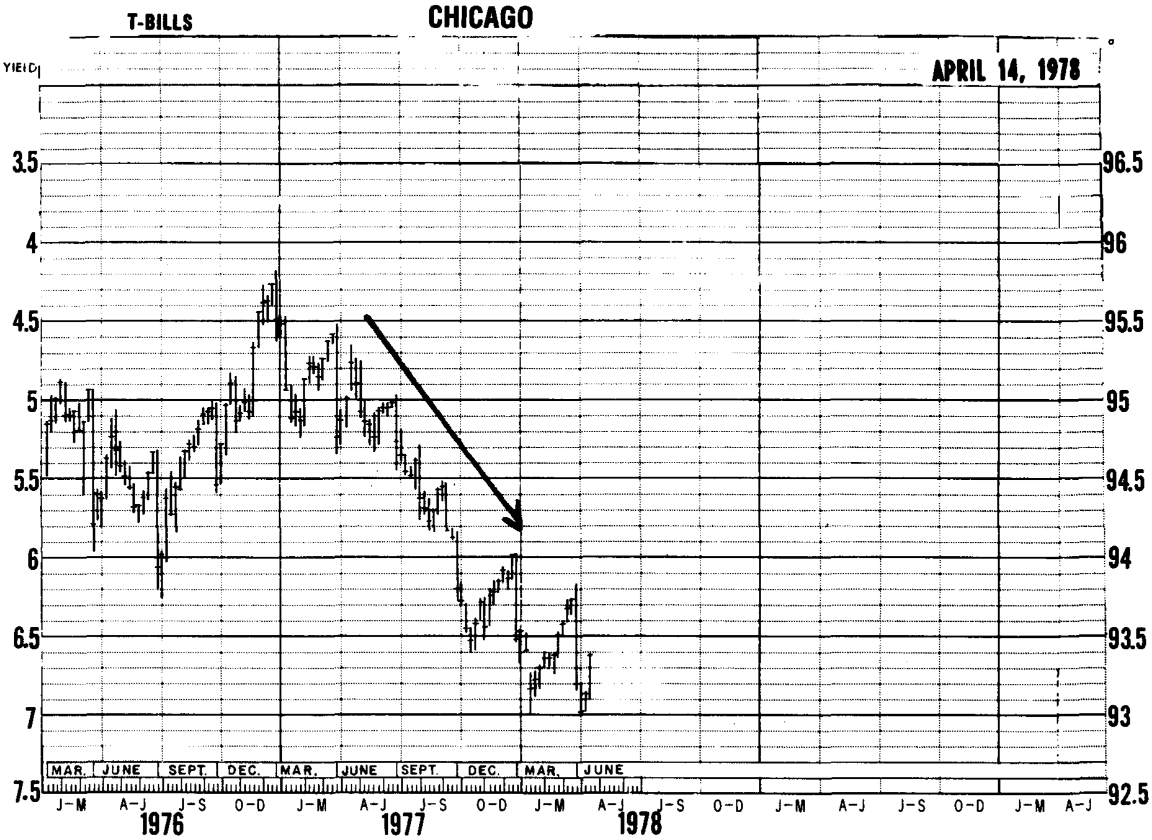


Wheat), it appears the market is presently extremely overbought, that there has been a V bottom with a near vertical rise. However, by looking at the Weekly Futures, one can tell that there is a nice base being built under wheat which should support, eventually, a substantial move to the upside.

Next, if one looks at the chart on Sept. T-Bills, they appear to be in an extended trading range. However, the Weekly Futures charts show that T-Bills have been in a definite downtrend since March 1977. This contrast can help a trader evaluate the market thoroughly, and should lead to better trading decisions.







Finally, it is helpful to keep weekly charts of the contract month that one is following to compare against the Weekly Futures charts. When the two are in consonance, in addition to the daily charts, there is usually increased reliability. For example, if there is a trendline break in the Weekly Futures charts, the weekly charts of the contract month that is being followed, and the daily charts, then there is a greater degree of reliability that can be assigned to that trendline break.

NOTES

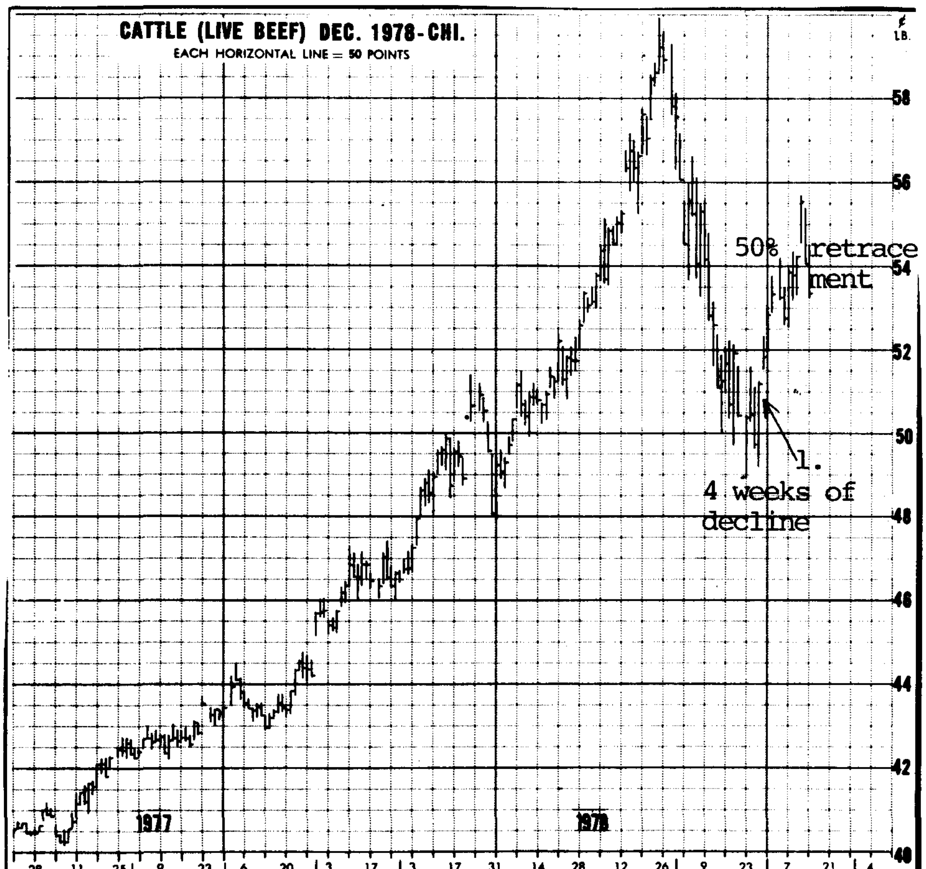
I've tried to beef up this article a bit so that it will be something you can really sink your teeth into. No one should roast their analyst for a hefty slice of technical analysis.

The mid-week tape message on Wednesday, June 28th, gave a buy recommendation in December Cattle, when the market reversed to the upside and closed on its high of 51.22. (See December Cattle chart Day 1.)

Now, the August Cattle had been in a 7-month bull market, which is well-cured as bull markets go. And, all the while, there had *not* been a significant correction, a "no, no" for a healthy bull. What followed was compensation — 5 weeks of decline in the August contract.

Normally, one can expect no more than a three-week decline if the bull is to continue to challenge the bearish matadors. Five weeks of decline was overdoing it quite a bit on the downside, and not only was the oscillator screaming, "Oversold," but the crowd had stopped shouting "Ole," the bearish matadors had so punctured the bull with their rapiers. The time for the bull to stagger to its feet was past due!

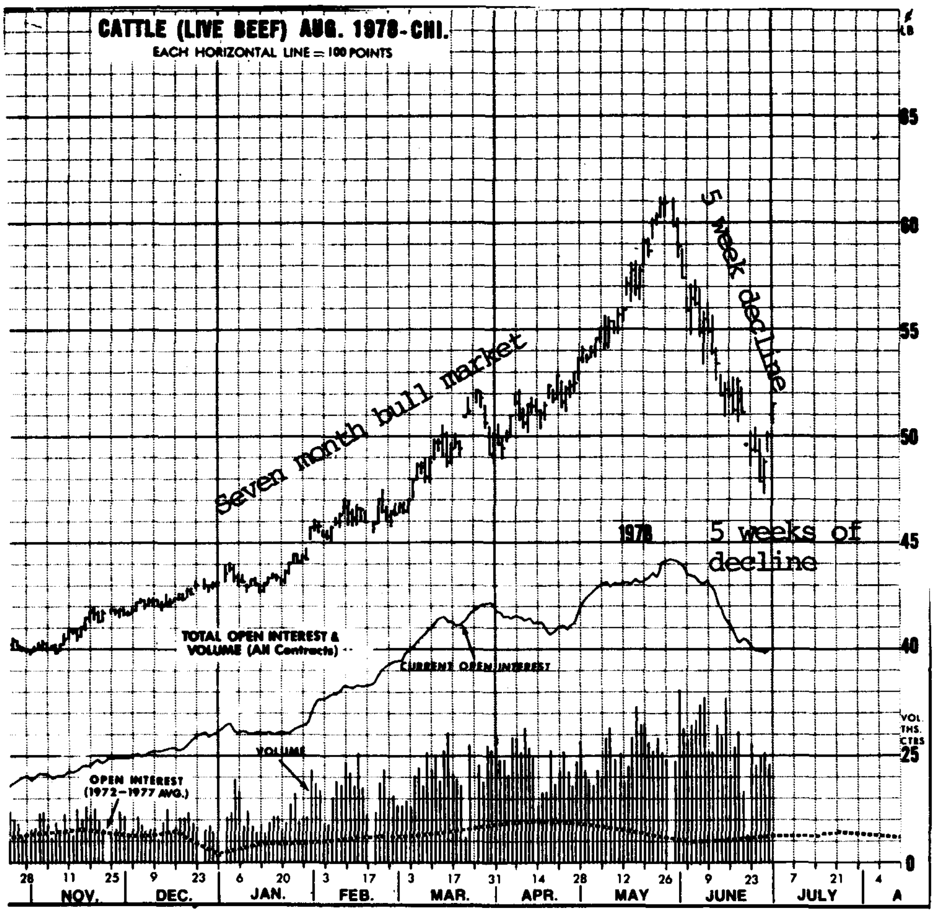
August Cattle, being the "cash" contract, was subject

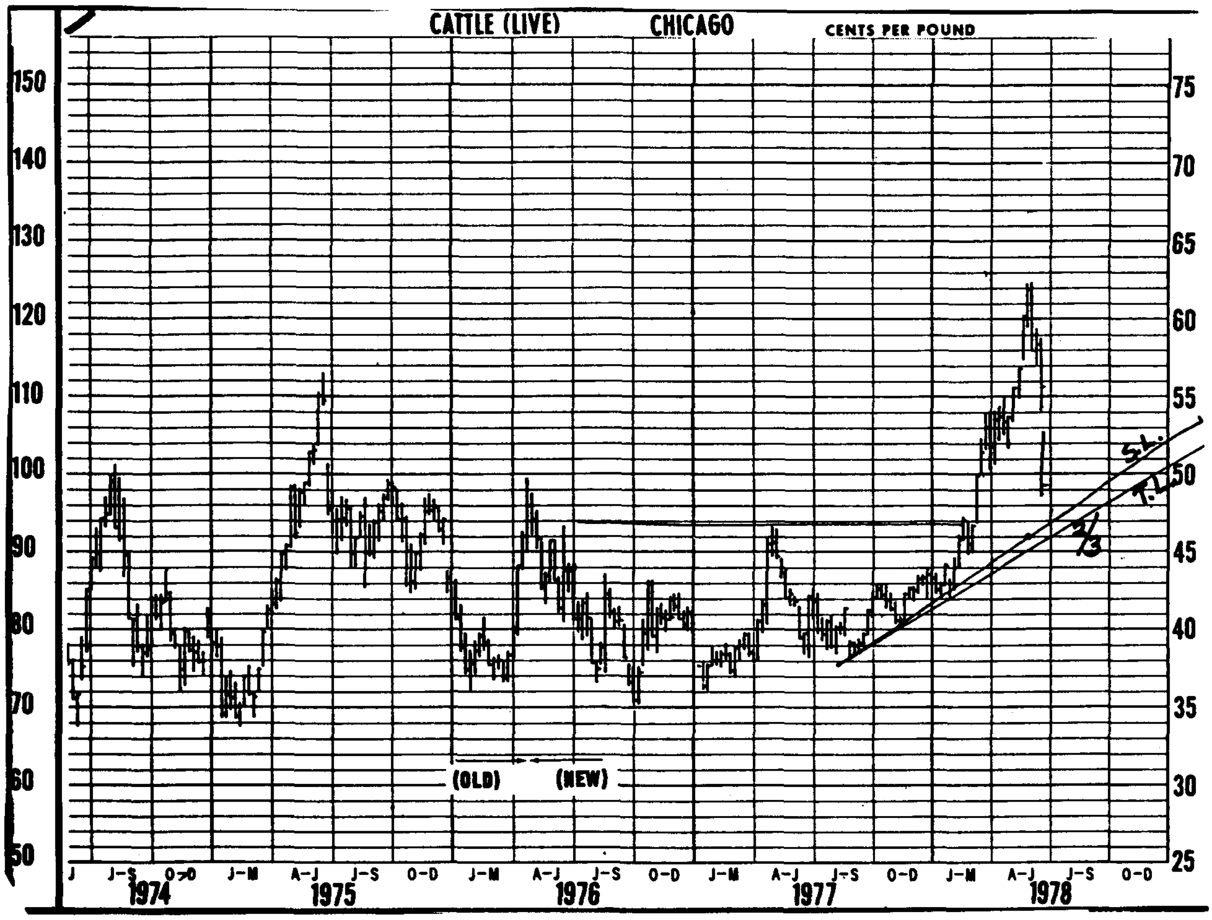


to support as indicated by the weekly continuation charts. A two-thirds retracement point was just above 45¢, and both the speedline (S.L.) and the trendline (T.L.) called for support between 46–47¢. Therefore, with this weekly support, on top of the oversold five weeks of decline, cattle were due some recovery.

So why buy December Cattle? While the bearish matadors were tormenting the August Cattle, the December Cattle were recovering. Notice that December Cattle did *not* break to a new fifth week low, and therefore *did not confirm* the break in the August Cattle. Also, on Wednesday, June 28th, the reversal day (Day 1.), when the December Cattle were unable to "Run" the stops below 49¢, and instead reversed to the upside, it was time for the bearish matadors to scramble. The bull had risen!

After such a severe break, a normal 50% recovery to almost the 54¢ level was to be expected (which occurred), thereby providing the trader with a trading opportunity of 3¢ profit, against 1¢ risk, a reasonable opportunity to round up some profits.

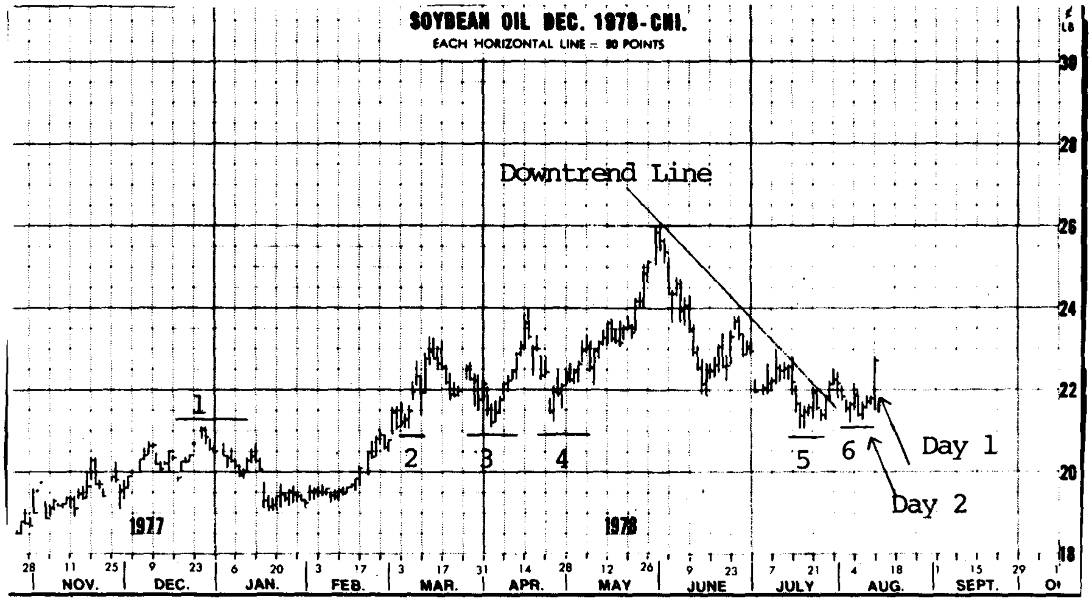

CATTLE (LIVE BEEF) AUG. 1978-CHI.
EACH HORIZONTAL LINE = 100 POINTS
Seven month bull market
5 week decline
5 weeks of decline
1978
TOTAL OPEN INTEREST & VOLUME (All Contracts)
CURRENT OPEN INTEREST
VOLUME
OPEN INTEREST (1972-1977 AVG.)
NOV.
DEC.
JAN.
FEB.
MAR.
APR.
MAY
JUNE
JULY
A

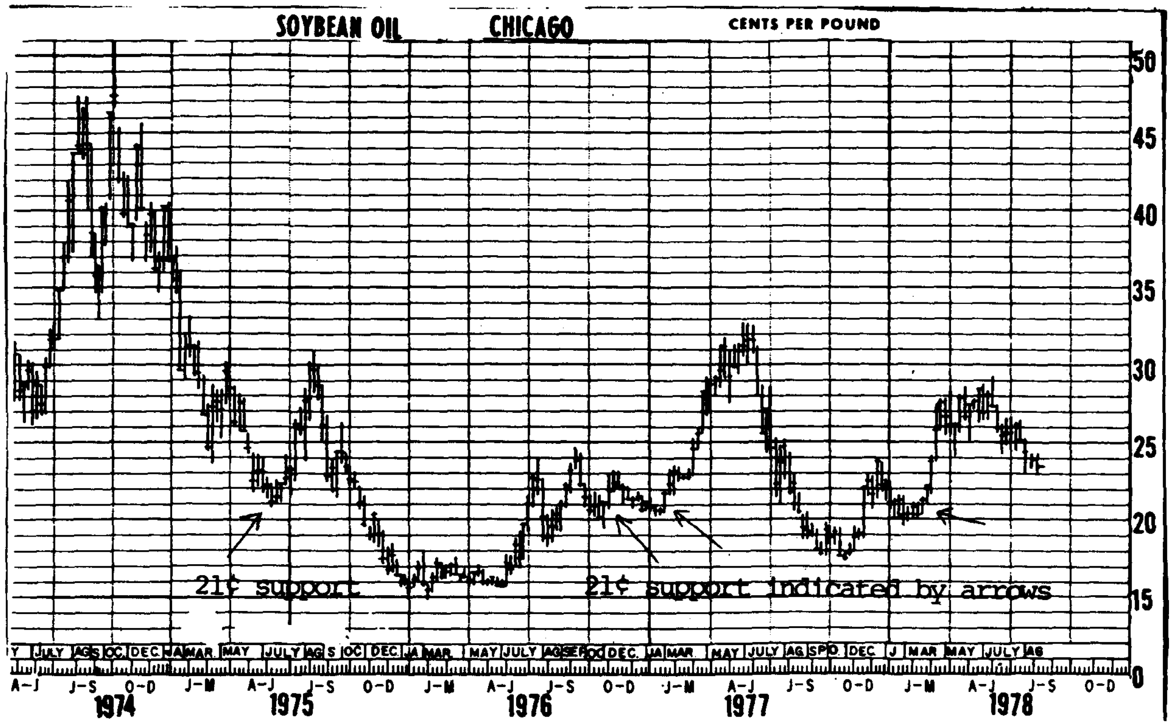

CATTLE (LIVE) CHICAGO
CENTS PER POUND
(OLD)
(NEW)
S.L.
T.L.
2/3
1974
1975
1976
1977
1978

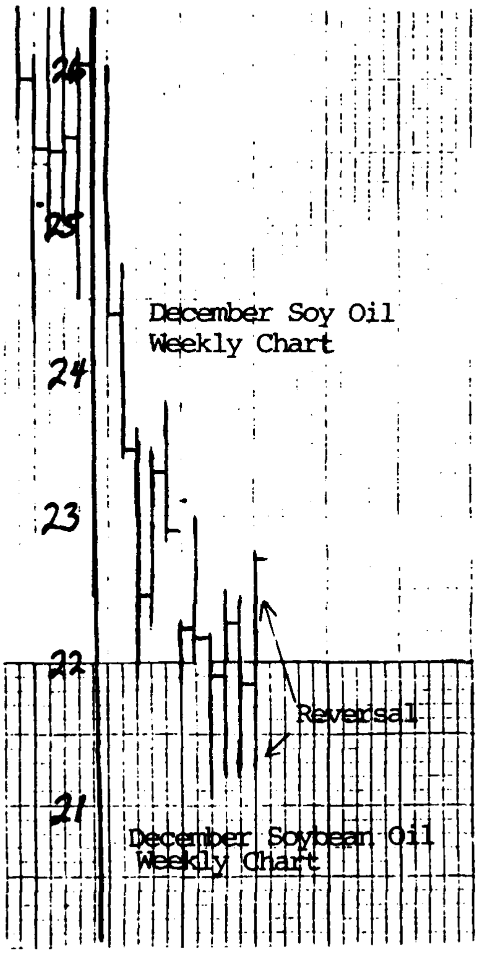
THE SOYBEAN OIL TRADE

The week of August 7th, REAPER subscribers bought December Soybean Oil, either during the week, or when it closed above 22.5 on Friday, August 11th (See Chart Day 1). What were the market clues which indicated a potential reversal in trend?

1. The downtrend line had been broken.
2. Soybean oil found support where it had formed 5 previous bottoms or tops.
3. The 6th bottom was higher.
4. The trading volume was light. There was little interest in the pit over the past 4 weeks.
5. The 21¢ level was a level of historical support (See Chart).
6. The momentum and oscillator indicators had turned bullish as had moving averages and point and figure (Not Shown).



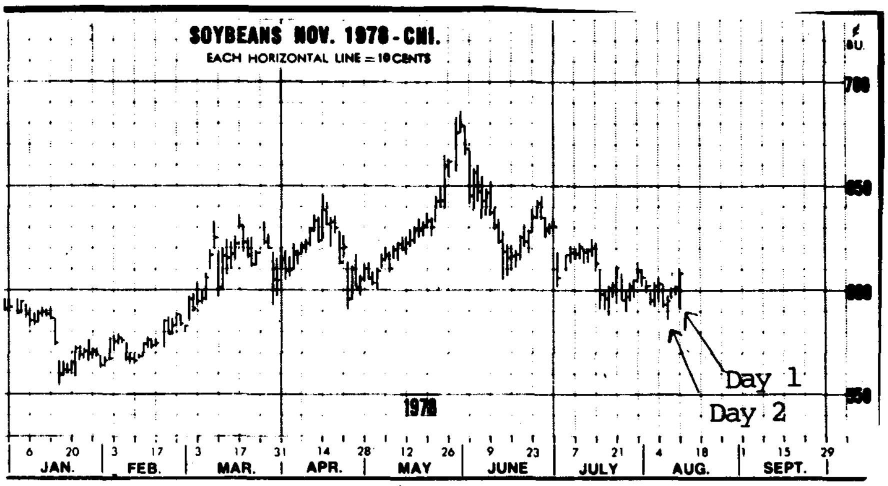


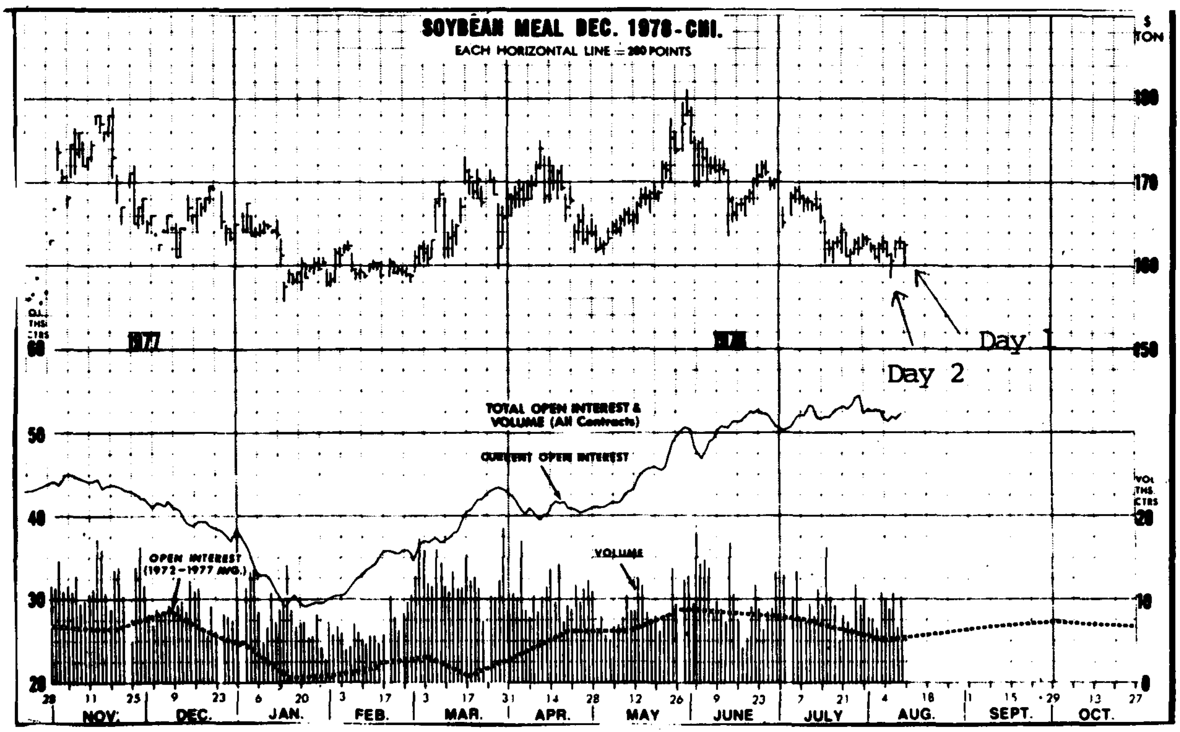


7. The weekly chart revealed a reversal.

8. The fellow members of the soybean complex (November Soybeans and December Soybean Meal) broke to new recent lows on Tuesday, August 8th (See Charts, Day 2) while the Soybean Oil did not break to new recent lows, indicating its strength.

9. On Friday, August 11th, following the crop report on Thursday (which was extremely bearish for corn), Soybean Oil, Soybeans, and Soybean Meal opened near their lows of the day (Day 1) and then rallied the remainder of the day on excellent volume and range, supported by commercial buying. The safest play was to enter the market on close Friday, or when December Soybean Oil rallied above the previous day's (Thursday's) high.



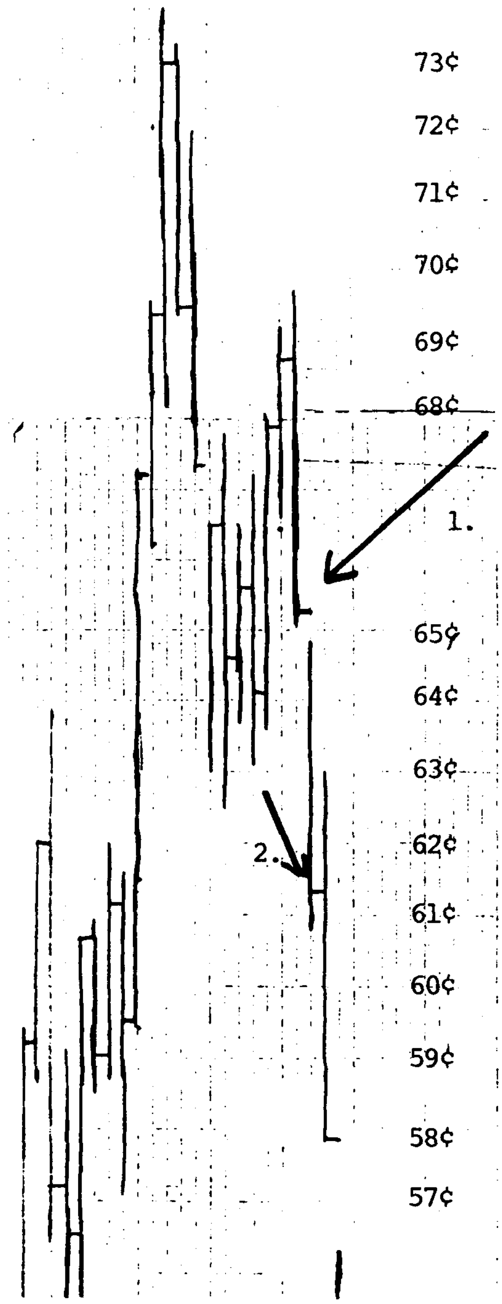


TAKING A CHUNK OUT OF THE MIDDLE

One of the most consistently profitable ways of trading commodities is to "take a chunk out of the middle." Granted, it is not as glamorous as attempting to pick tops and bottoms. However, the rate of survival among traders who take their share of profits in the middle of a move is far greater than the so-called heroes who are reaching for peaks and searching for valleys. . . . The key is momentum.

February Pork Bellies

Weekly Chart



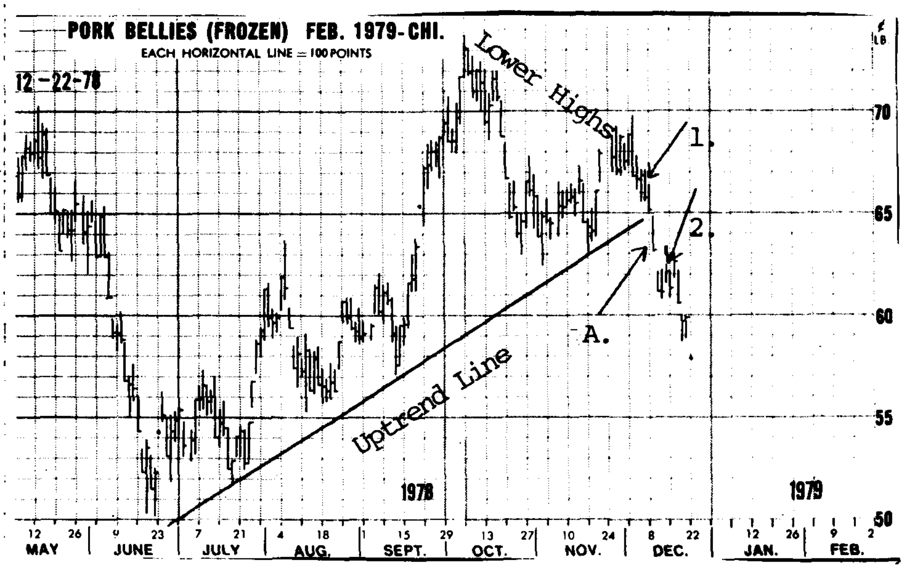
How many times during a football game have we observed a pickup in momentum? We knew, we just *knew* a team was going to score, and then score some more! How about during a basketball game, when a club picks up steam and starts scoring bucket after bucket. We just know that this momentum will continue for at least a little while longer, that the lead will be extended. This same observation can be made of commodity price action. It was recently true in the Pork complex.

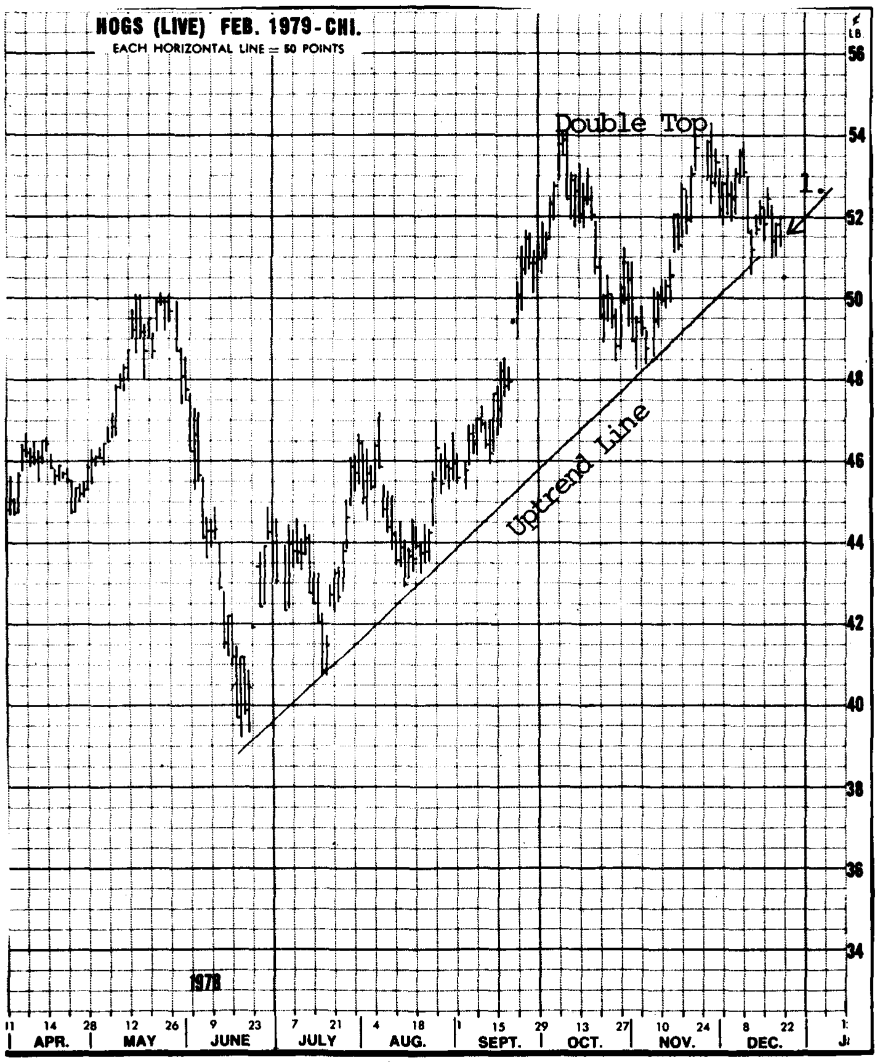
February Pork Bellies rallied for 5 months (a mature bull market), from June through October of 1978. From there, prices broke sharply and moved into consolidation for the remainder of October and November. Toward the end of November, a small rally ensued. Classic bearish action was evident. Prices had moved to a peak, broken sharply, moved into consolidation, attempted to rally, failed, and then broke sharply again. The second break (the uptrend line was violated — Day A.) was the place to go short. A move was almost guaranteed from 65¢ to 60¢.

The weekly charts revealed a downside reversal. Notice week #1 and week #2 on the daily charts. Compare with week #1 and week #2 on the Pork Bellie weekly charts. The *daily* charts clearly show a bearish formation and an uptrend line break. The *weekly* charts reveal the overwhelming weakness of the market during week #1, followed by a gap-down low close week #2, which confirmed the weakness. (A gap-down on the weekly charts with a wide range and low close is overwhelmingly bearish. Gaps on weekly charts are rare.)

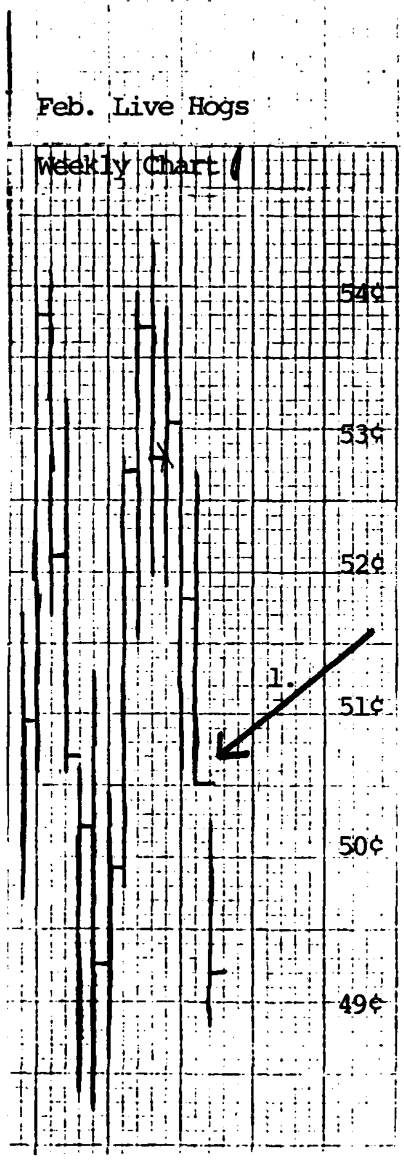
All in all, a 5¢ profit in the Pork Bellie market ($1,800.00) is not all that bad, particularly when one does not have to undertake the risk of top or bottom picking. One is only "taking a chunk out of the middle."

The February Hogs also reveal the potential for "taking a chunk out of the middle." Prices here moved up from





Commodity Research Bureau, Inc.



June through October, a 5-month bull market. Then they broke sharply, rallied back to form a double top at 54¢, then broke down again. Notice on the *daily* charts the break of the uptrend line corresponding to week #1 on the *weekly* charts. The wide range with the low close at the bottom of the weekly range forecast lower prices. Here too, one could have profited by "taking a chunk out of the middle," anticipating lower prices fueled by accelerating bearish momentum.

NOTES

It might be helpful to go back and examine the July Cotton rise from 60¢ to 69¢. If one could have caught this entire 9¢ move (a very unlikely prospect), one would have realized $4,500 per contract profit. . . . The purpose here is to show how clearly this cotton up move was a classic bull move. Let's look at the evidence point by point:

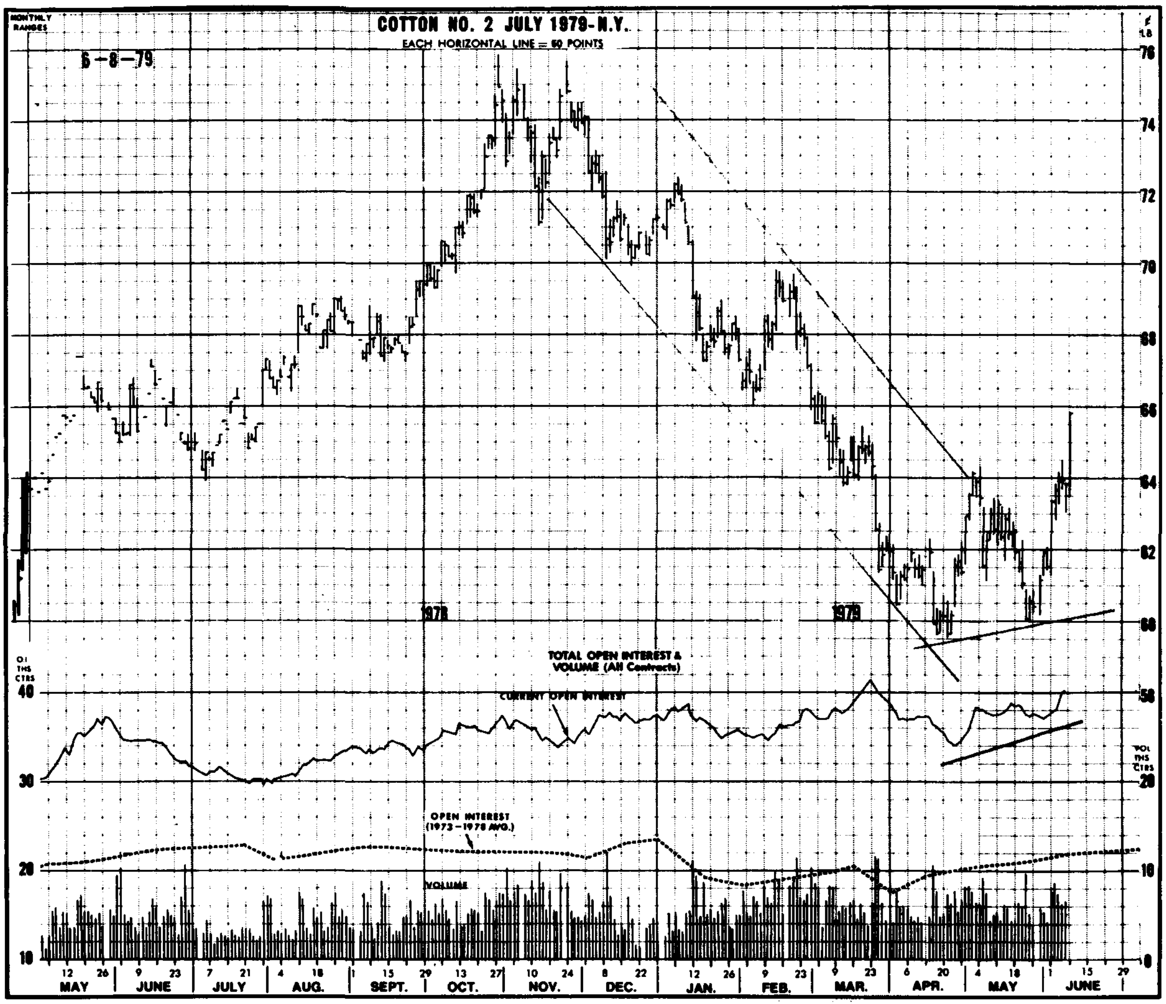
1. On the Cotton "2" weekly continuation chart, we observed that from the latter part of 1978 through the early part of 1979, cotton was confined in a clearly defined down channel. At 63¢, cotton broke out of its channel upside. This breakout projected a move to the 70¢ resistance area.

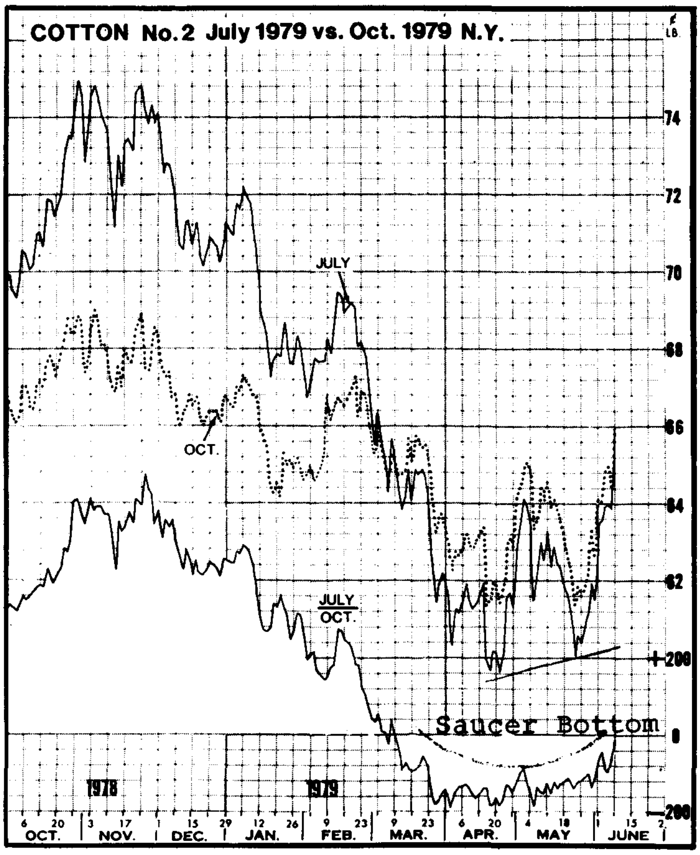
2. Observing the Cotton "2" July 1979 vs. October 1979 N.Y. chart, we notice that, beginning in March 1979, the spread between the July and October contract formed a saucer bottom. This often precedes a bull move.

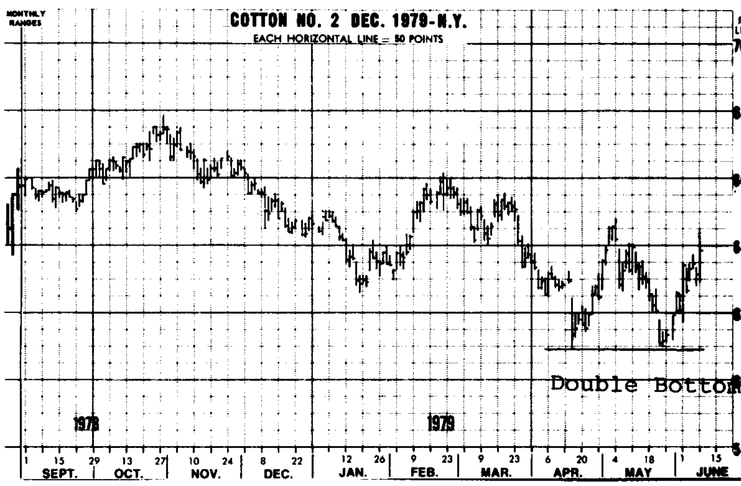
3. On the daily chart of July cotton No. 2, we see, beginning in December 1978, that cotton was confined in a down channel. It formed a quasi-double bottom in April and late May of 1979 (the second bottom was a slightly higher bottom), and then, on increasing open interest, rallied to above the 64¢ high. The close above 64¢ gave an all-clear buy signal for a test to the 68¢–70¢ resistance zone.

4. The action in the July contract was confirmed by the December contract which also formed a double bottom. An almost assured "chunk out of the middle" from 64¢ to 68¢ in the July contract, or from 64¢ to 66¢ in the December contract, made this trade low risk.

I did not take this trade personally. Why? Because fundamentally and psychologically I was expecting lower prices. *I was not listening to the market.* I paid the price by way of opportunity loss.


COTTON NO. 2 JULY 1979-N.Y.
EACH HORIZONTAL LINE = 50 POINTS
6-8-79
TOTAL OPEN INTEREST & VOLUME (All Contracts)
CURRENT OPEN INTEREST
OPEN INTEREST (1973-1978 AVG.)
VOLUME
1978
1979


COTTON No.2 July 1979 vs. Oct. 1979 N.Y.
JULY
OCT.
JULY/OCT.
Saucer Bottom
1978
1979


COTTON NO. 2 DEC. 1979-N.Y.
EACH HORIZONTAL LINE = 50 POINTS
Double Bottom
1978
1979

There are basically two trading patterns within which most traders fit. There are those who attempt to pick tops and bottoms (*guess*). There are those who wait for a clearly *identified* top or bottom.

Those who guess correctly make money by catching most of the moves. These cherry pickin' trades are fantastic ego trips. However, the *guessing* approach has some problems. The market only makes major or intermediate tops or bottoms a small percentage of the time. Therefore, the *guesser* has the odds against him to begin with. The *guessing* approach works best when one is scaling in positions during minor reactions against the major trend.

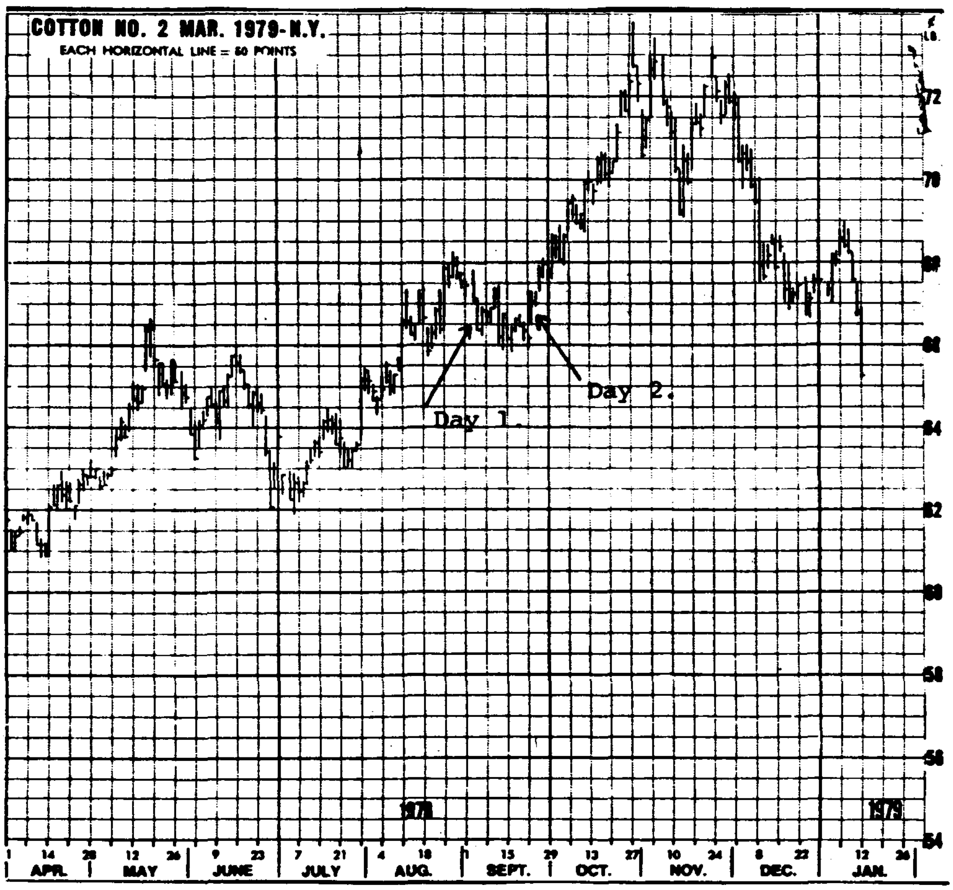
Wht about those traders who attempt to *identify* a top or bottom, and then catch part of a move? Obviously, once a bottom or top is confirmed, the very fact that it has already been formed means the *identifying* trader will only catch a moderate percentage of the move. However, he has two things in his favor: 1) He is riding with the trend. 2) He has something to hang his hat on by way of a stop loss. His losses tend to remain small.

Which trading approach is best? Candidly, I have made money both ways. I have found that the *guessing* approach makes a great deal more money faster, but at the same time, is subject to greater losses. The *identifying* approach is a steadier and more consistent approach, and the evidence, over time, is that it is the most *profitable.* Perhaps this can best be understood by drawing an analogy to the weather.

During cold weather, when the temperature is dropping, one can attempt to pick the day and the temperature which will be the low before the warming trend begins. This is quite difficult. However, if one waits until the coldest day has passed and the warming trend has begun, one can more easily ride (predict) a small continuation of that warming trend and be accurate (profit).

Let's take a commodity example. Let's say one decided to buy March Cotton. If one was *guessing* (picking) the bottom, one could have purchased cotton on Day 1. This was not correct, however, as the following day was a lower low. Additionally, one would have had to sit through nearly three weeks of congestion prior to the continuation of the up move. Furthermore, the market formed four slightly lower lows before it ultimately broke out. Question: How many traders who *guessed* that the bottom was Day 2 would have been able to hold onto the position through four more bottoms?

The trader who waited for a clearly *identified* bottom would have purchased on Day 2, the breakout day. While he ultimately purchased at a higher price than the *guesser* (bottom picker), he didn't have to sweat out the congestion. He was in tune with the primary trend and had immediate profits.



CASH, BASIS AND SPREAD CLUES

Cash prices, basis and spread indications (the difference between different contract months) can often give important clues to upcoming market direction.

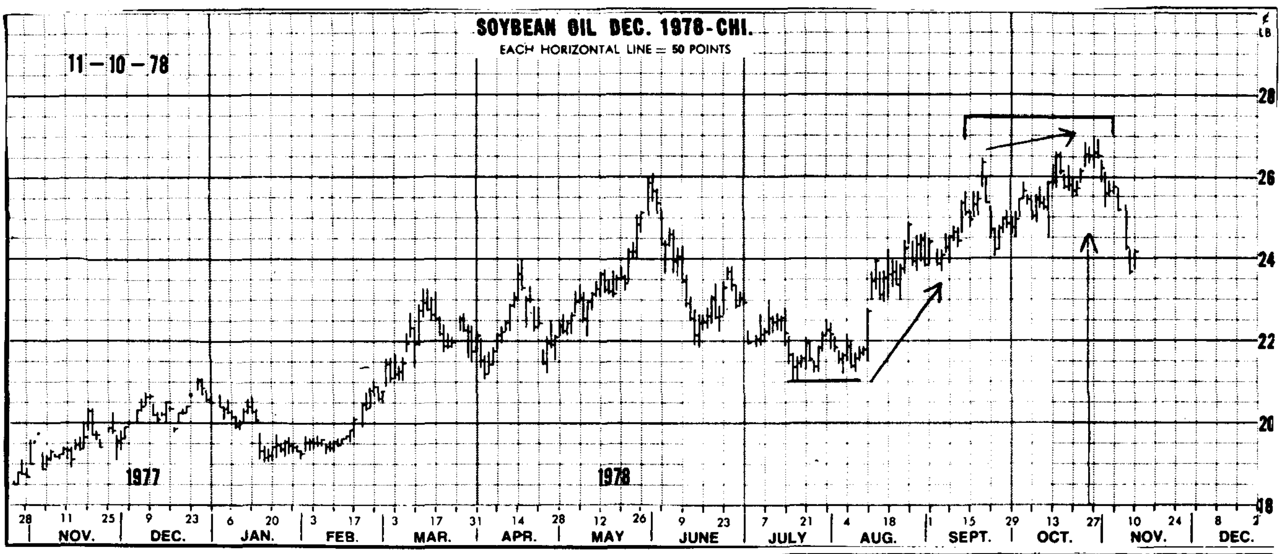
December Soybean Oil formed its bottom in July and August of 1978. From there, it rallied to a high of approximately 27¢ the end of October, 1978. At that point, prices broke sharply and registered a 3¢ loss ($1,800 per contract) in just two weeks. Were there any clues to signal the top of this market?

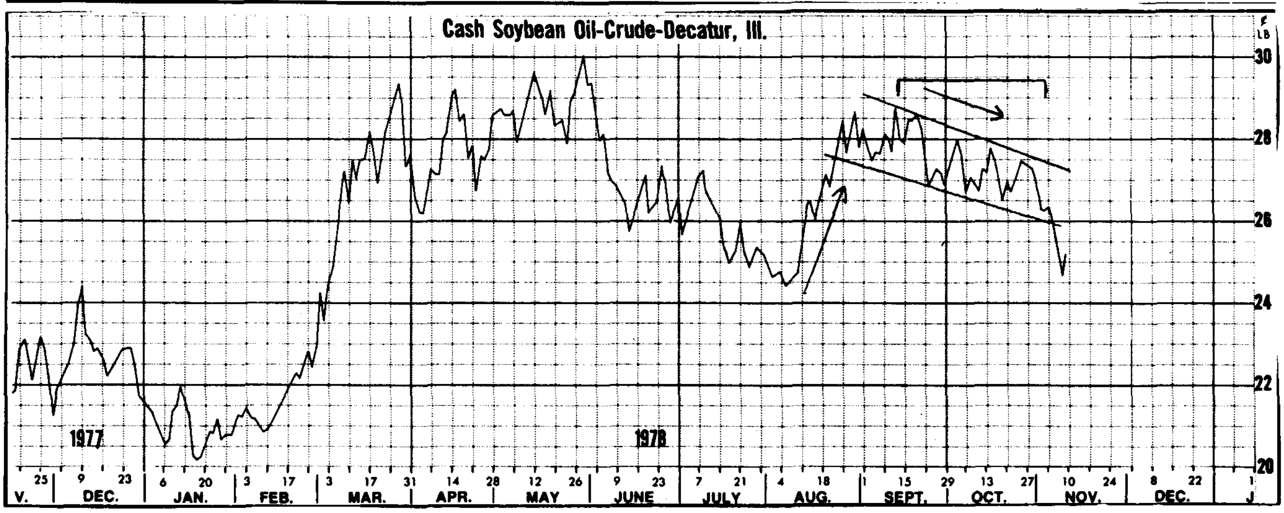
As you may recall, THE REAPER, during this era, was recommending only Soybean Meal and Soybean positions. The reason we shied away from the Oil was due to the troublesome advance warnings from the *cash charts, basis plottings* and *spread indications.*

Notice the *Cash* soybean oil chart. Commodity Research Bureau, Inc., One Liberty Plaza, New York, NY 10006. Prior to the weekend of September 15th, Cash Soybean Oil prices peaked. Then, they began working lower in a downward channel of lower highs and lower lows through the end of October. At the end of October, cash prices broke sharply *with* the futures market.

From mid-September through the end of October, the sequence of lower highs and lower lows in *cash* prices did give the commodity trader a warning to be alert for a potential change of trend in the futures contracts. Notice that during the same time period, from mid-September to the end of October, the December Soybean Oil prices moved *higher.* This conflict with cash could not continue for long. The sequence of higher highs and higher lows and therefore higher prices in the December Soybean Oil contract was contrary to the trend of *lower* prices in Cash Oil. Since cash prices had confirmed the futures market (December Oil) uptrend from the August lows, one should have suspected that the drift to lower prices in the Cash Oil *preceded* a drop by the futures markets.

Notice from the Spread Scope Chart (P.O. Box 41211, Los Angeles, CA 90041, $185.00 per year) that Basis peaked simultaneously with Cash Oil prices. Basis is sim-



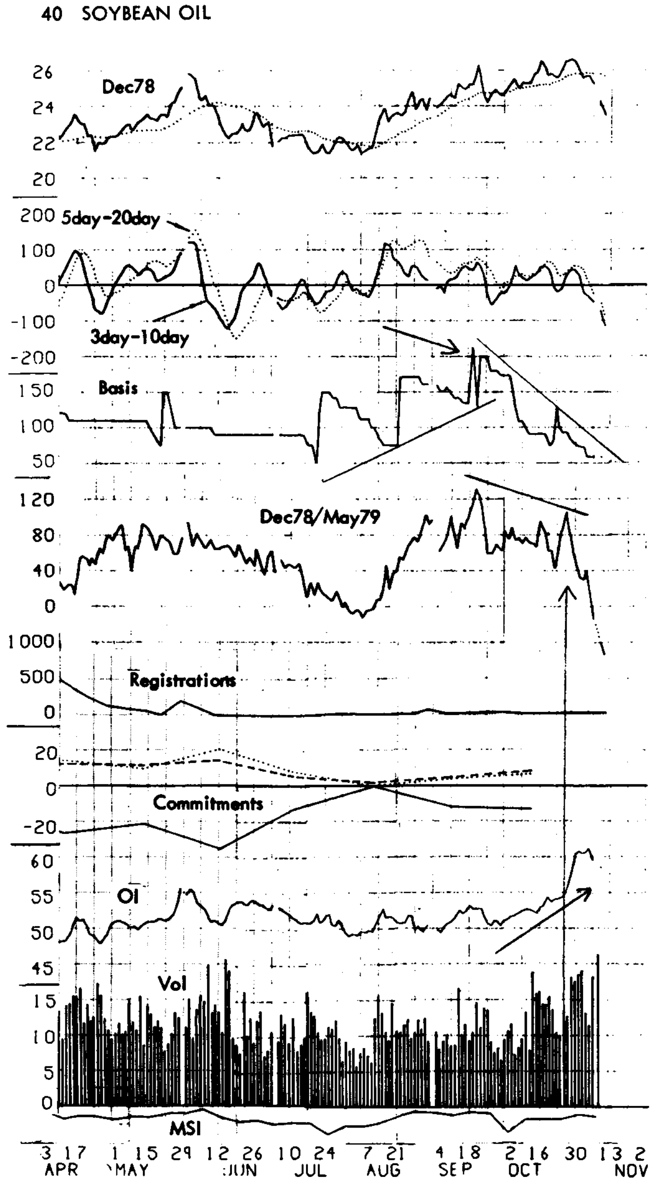


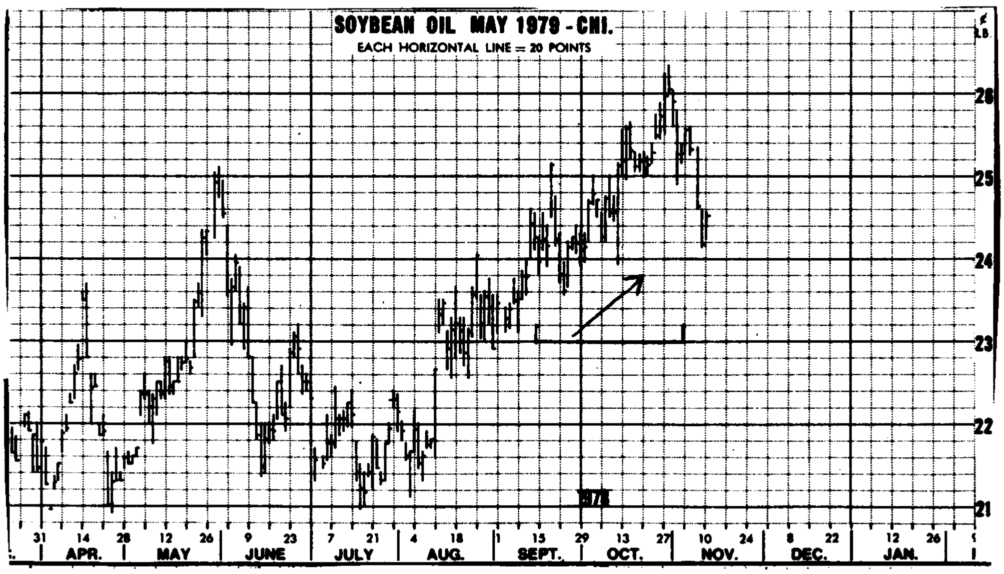
ply the difference between a specific futures contract and a specific local cash price. Therefore, the downtrend in the Basis chart was simply another way of looking at the Futures versus Cash Oil relationship.

Another sign that one could have expected pressure on the December Soybean Oil contract came from the spread relationship between December, 1978 Soybean Oil and May, 1979 Soybean Oil. Observe on the Spread Scope Chart that the spread relationship between December 78/May 79 Oil peaked in mid-September. From that point, it worked its way lower. This indicated a lack of enthusiasm on the part of "users" to continue to bid up the nearby contract to a "premium" over the deferred contract. This deterioration in "premium" was also a warning that Soybean Oil could be approaching a futures market peak. The contraction of the spread was in conflict with the uptrend in Oil Futures' prices.

During the same time frame (mid-September through the end of October) there was a substantial increase in open interest (See OI on the spread chart). One should have suspected that commercials were hedging their position. (This could be confirmed from the Commitment of Traders which is issued by the government.) Even if one did not have access to the Commitment of Traders Report, one should have suspected commercial hedging from the action of Cash Oil prices and the spread deterioration.

No technical indicators work 100% of the time. This is true for cash charts, basis charts and spread relationships. But the Dallas Cowboys don't win every football game either. Nevertheless, they are consistent winners year-in and year-out. The same is true for these technical indicators. Commodities which can be readily stored, such as Soybean Oil, show high probability relationships between cash prices, basis and spread relationships, and price action in the futures market.





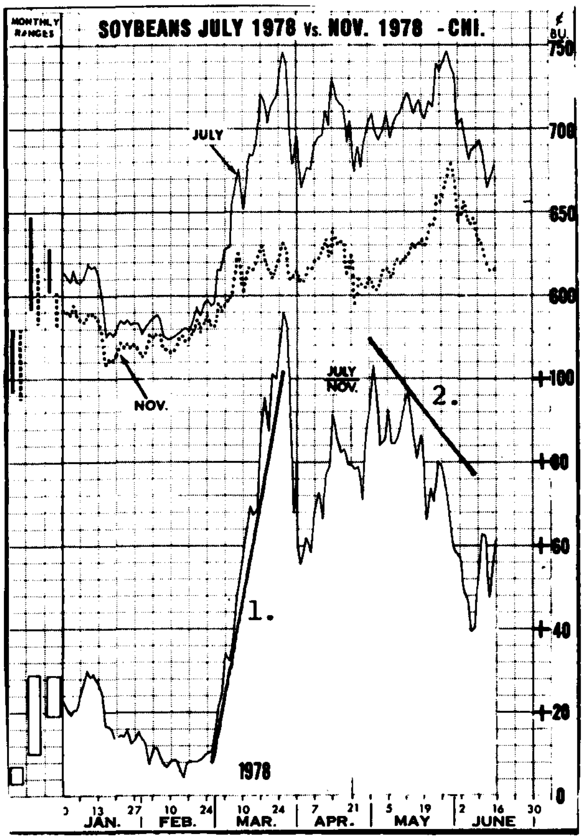
As you may recall, the REAPER went long July Soybeans and short November Soybeans on a spread when the premium to July went positive back in March 1978. We picked up over $2,000 per spread. The bull market then was a "typical" "premium to the nearby months" bull market. (Period 1.)

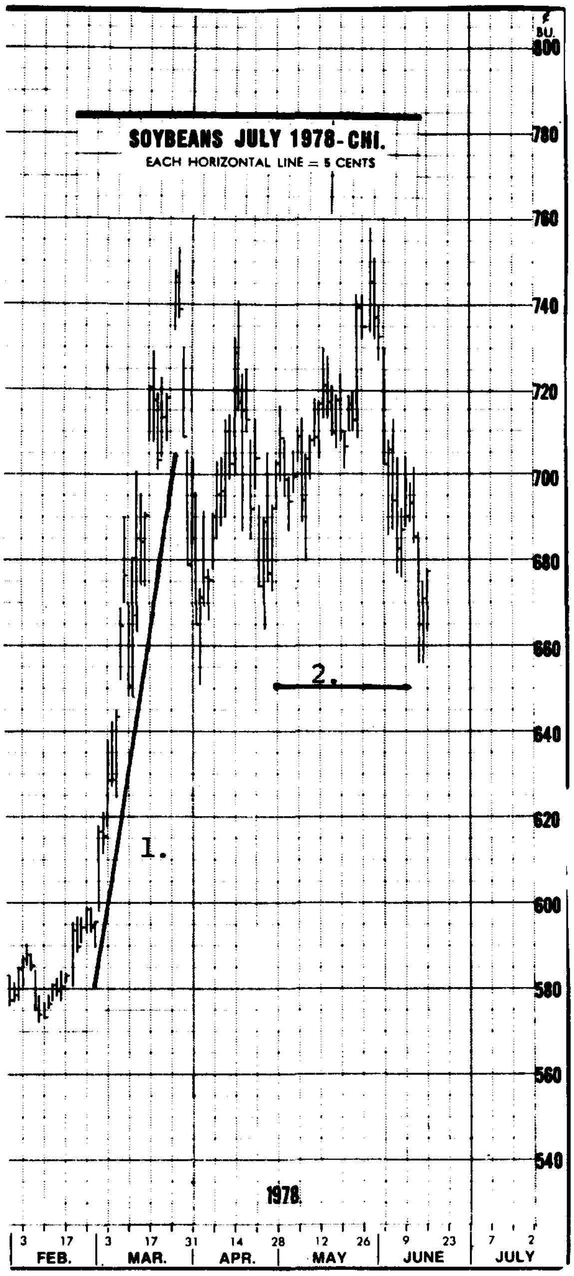
The character of the market changed in late April and early May of 1978. The Soybean market became a "weather" market with wet conditions hampering the planting of the new crop. Therefore, the new crop (November) took over the lead in the bull market (due to weather) and the old crop (July) took a back seat (Period 2.).

Period 2, the "weather" bull market which began in May, is the main focus of our attention here. Notice that as the threat of weather to the new crop November Soybeans took its psychological grip on the market, the spread narrowed (decreased). Why? With the threat of the weather hanging over only the new crop November Beans, they would naturally increase in price faster than the old crop July Beans which were already in storage. Therefore, with November increasing in price faster than July, the spread should and did narrow. (The bull market was a "supply problem" bull market, not a "demand" bull market.)

However, when weather ceased to be a problem, as it did in early July 1978, the spread continued to narrow. Why? Because then there was little demand for July Beans, but the weather threat could again rise to the surface in November Beans. The July Beans were going into liquidation.

As Jim Sibbet pointed out, (Let's Talk Silver and Gold, 68 So. Lake Ave., Pasadena, CA. 91101), "July Beans are selling above the cash, so until the cash basis gets to zero no one can profitably take delivery of July Beans. Even if that should happen, there is still no good market



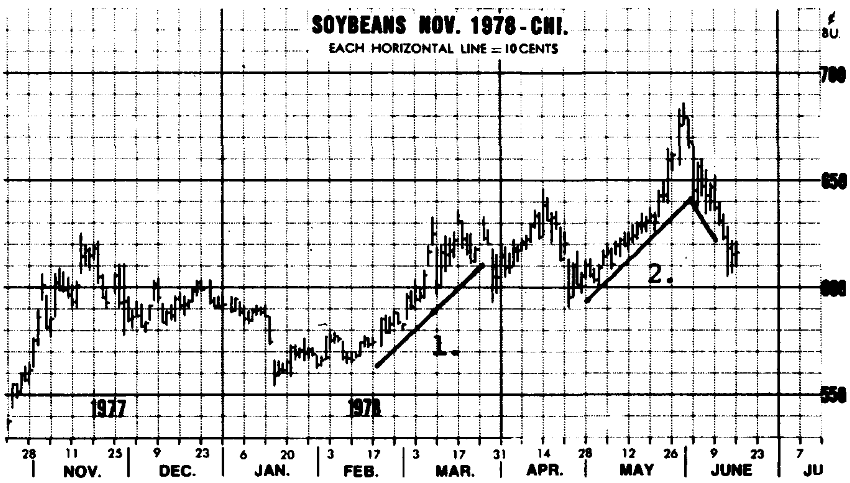


for them. Soybeans (even export) must be ultimately consumed by the crushers. No crusher is going to pay any fancy premium for July Beans over November because all he has to do is wait a couple of months for the new crop. The crushers are very adept futures hedgers. They also have their own elevators. At this time of year they normally have two months' supply of Beans stored in their own elevators. This is why they will not pay any premium for July Beans."

Do you get the drift? Whether November Beans go up in a bull market due to weather considerations (my analysis) or down in a bear market due to pull of the liquidating July Beans (Sibbet's analysis), the spread narrows. It is as near to a sure thing as you will find in commodities. If November Beans rise in price, the spread narrows. If November Beans decline in price, the spread narrows. Therefore, we gave the long November, short July, spread recommendation which was profitable.

Spreads have another use in analysis which not one commodity trader out of 100 understands. Watching spread relationships between different months of the same commodity can give a trader excellent clues as to the bullishness or bearishness of the market, the relative strength of the particular contract months, and a clue to approaching short-term tops and bottoms. For example, if July Soybeans are in a bull market and have gone to a premium over November, and the market is advancing, watch for sluggishness in the spread. In other words, when prices continue rising and the spread then becomes steady or declines and fails to match its advancing rate of change, become cautious. A near term top may be approaching. A healthy "demand" bull market which is "marked" by a premium to the nearby, should maintain and increase the premium as the market advances. On declining reactions in a bull market, the spread will often bottom before prices bottom.

In a bear market, if prices rally and the spread changes little, such as we saw in the case of the July/November Bean rally the week of June 19th, then one can assume, with relative certainty, that prices will again retest the lows, and that the rally is simply a technical correction. Also, on the breaks in the bear market, the spread will many times find bottom before prices and thus give a clue to a coming corrective rally.



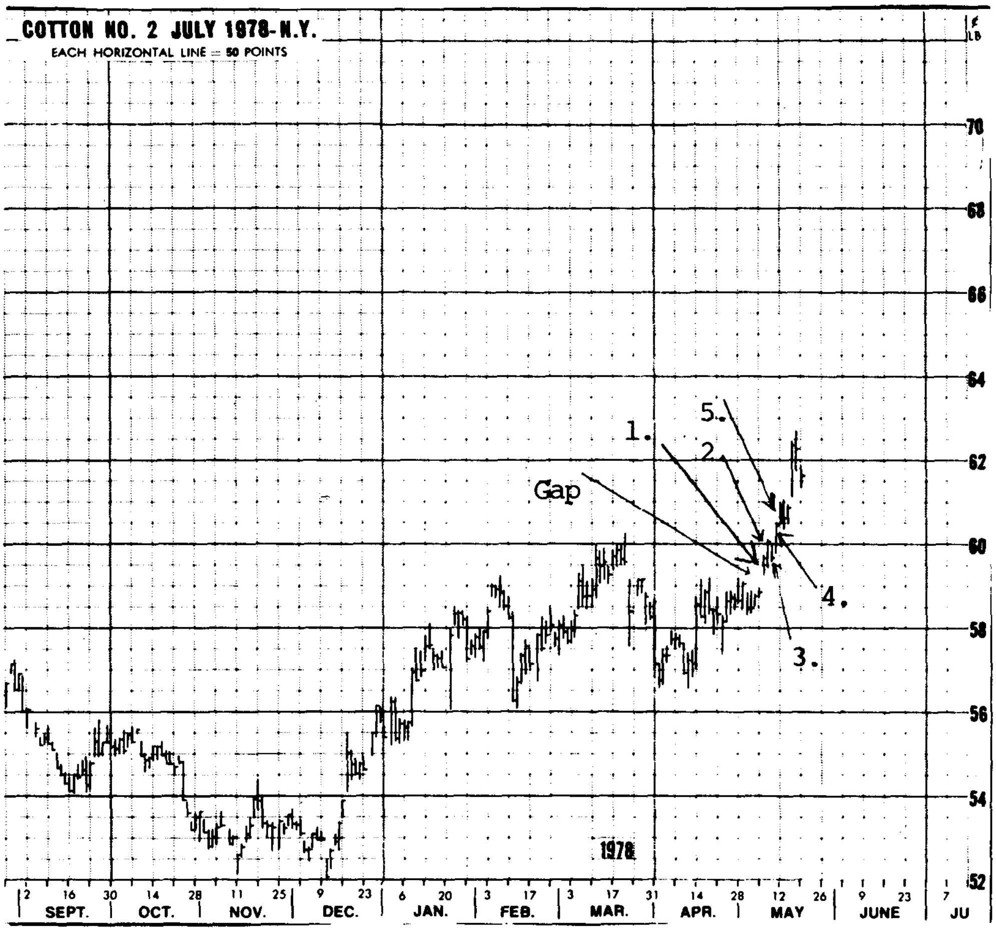
NOTES

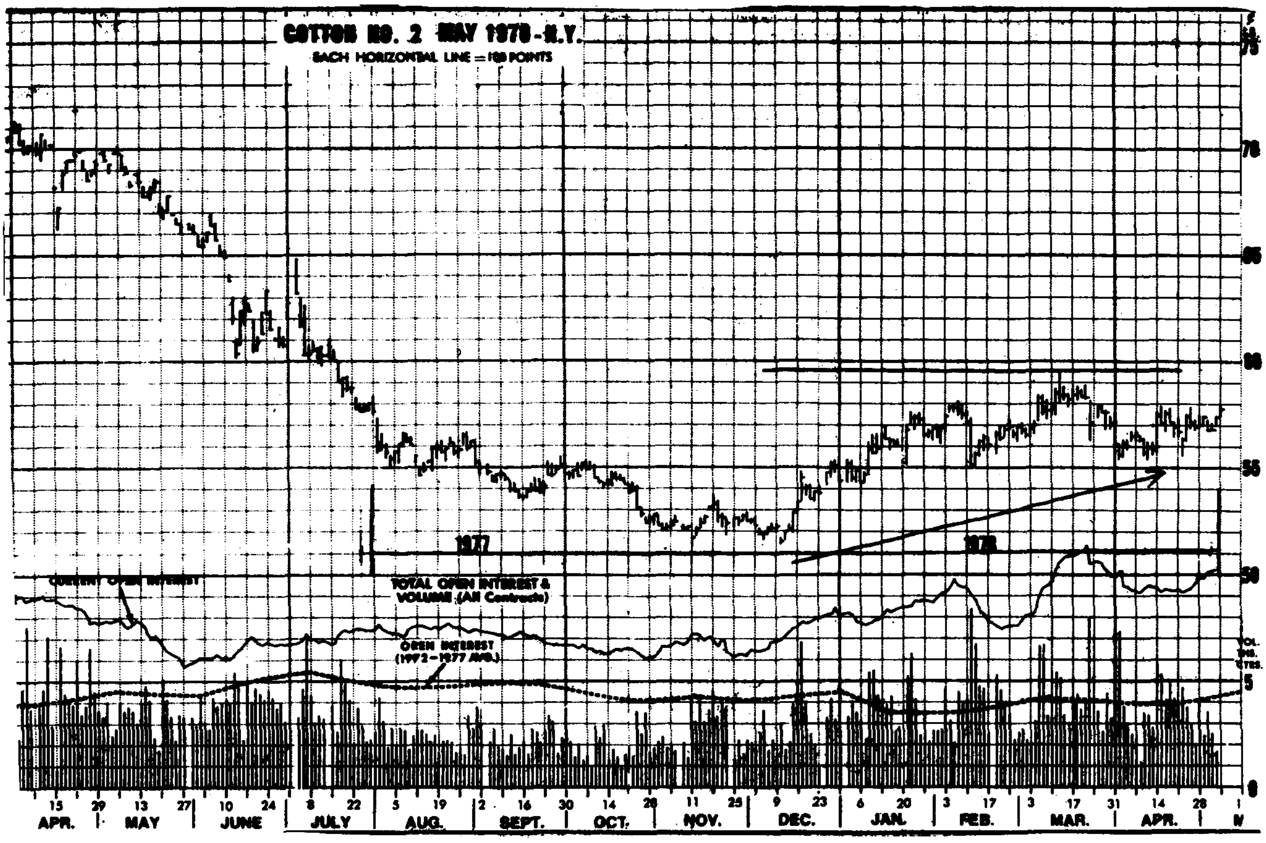
On Monday the 8th of May (Day 1), Cotton broke out to the upside on the December contract. The breakout to new contract highs gave a buy signal to breakout traders. Many bought that day. However, on the July Cotton contract, the May 8th breakout (Day 1) was not to new highs, but instead into the 60¢ resistance area. Therefore, many traders did not buy until Day 2 when the July contract closed at new highs (above 60¢), Day 3 — the first day of the reaction, or Day 4 — the day of the renewed uptrend, or even Day 5 when the close confirmed a buy on the weekly charts. (The weekly charts showed increased strength by way of the weekly breakaway gap, a very unusual occurrence.)

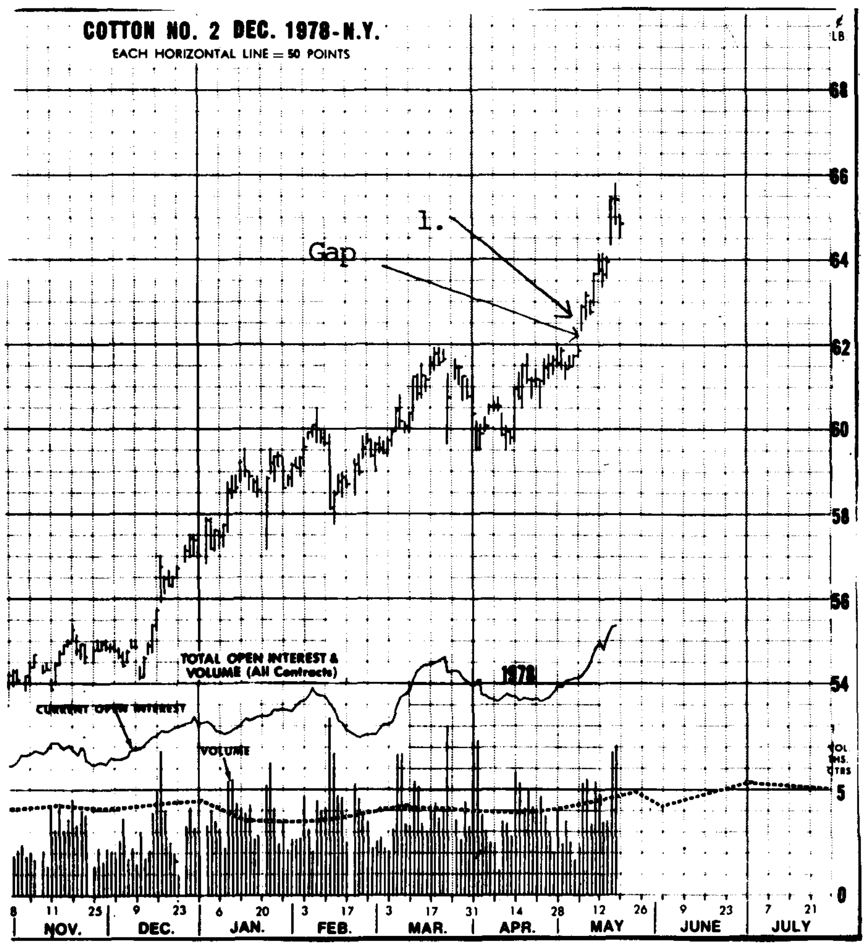
There were other good reasons to buy cotton. The high contrary opinion of 78% the previous week, coupled with a relatively high contrary opinion of 75% the breakout week, was simply shrugged off by the market, often a prelude to a runaway market. The weekly continuation chart projected a run to 63¢, 65¢, and 67–68¢, basis July. The oscillator's overbought condition was also ignored by the market, also often a prelude to a runaway market. Basis indications were extremely positive (See chart), and from viewing the May contract chart, it was obvious that a big base had been building under cotton for 9 months.

However, many traders, commission house types, refused to buy on Day 4 or 5. Why? Dollar risk was too great! The logical placement for stops was 61.5¢ on the December contract, more than $1,000 from the market. Why take a high dollar risk trade? In this case, with such strong evidence in favor of the trade, it made sense, IN THE CASE OF MULTIPLE CONTRACT TRADERS, to buy the first contract on Day 4 or 5.

Let's say, for purposes of discussion, that a trader who normally trades 3 contracts of cotton, bought one on Day 5, the highest day of the week. If the market runs up from Day 5, fine, he is in on the move and making money. However, if the market reacts, he can then put on his second and third contracts where he normally should have bought his first and second contracts. Stated differently, this three-contract trader would normally buy three contracts right off the bat. In this case, having bought his first contract late, he would only buy contract #1 on Day 5, and then if prices moved up, he stayed with the single con-




COTTON NO. 2 MAY 1978 - N.Y.
EACH HORIZONTAL LINE = 100 POINTS
1977
1978
TOTAL OPEN INTEREST & VOLUME (All Contracts)
CURRENT OPEN INTEREST
OPEN INTEREST (1972-1977 AVG.)
APR. MAY JUNE JULY AUG. SEPT. OCT. NOV. DEC. JAN. FEB. MAR. APR.


COTTON NO. 2 DEC. 1978 - N.Y.
EACH HORIZONTAL LINE = 50 POINTS
1.
Gap
TOTAL OPEN INTEREST & VOLUME (All Contracts)
1978
CURRENT OPEN INTEREST
VOLUME
NOV. DEC. JAN. FEB. MAR. APR. MAY JUNE JULY

tract, the idea being that since he was late, and dollar risk was high, he would offset the risk with fewer contracts, in this case, one.

However, if the market *reacted* to the point where he normally would have purchased contracts, then he will buy there, averaging down, to his intended original number of purchases — three.

To clarify, let's say the trader bought at 64¢ on Day 5 (December Cotton). The market reacts to 63¢. There, he buys another. The market reacts to 62.5¢. There he buys his third contract — the point where he should have purchased three contracts originally.

Normally, this is poor trading technique. However, in a strong breakout situation, when the odds overwhelmingly favor the retest of the high, and one is only averaging down to the extent of the original number of contracts one intended to trade, then this breakout trading technique is worthy of consideration.

NOTES

RUNAWAY BULL MARKETS

Runaway bull markets usually only occur after an extensive base has been built (6–9 months). The market breaks out upside on good volume, wide range and increasing open interest. This strong technical bull signal is confirmed by *emerging* fundamentals. In a runaway bull market, high bullish consensus figures (80%–100%) can be thrown to the wind.

Runaway bull markets only occur 15% to 22% of the time. They take all the energy which should have been dissipated through reactions and consolidations. They reverse this energy into dramatic upthrusts.

There is only one way to trade a runaway bull market: Buy the first or second day *of* a reaction, *or* the first higher high or higher close *after* a reaction. Place all protective stops just below the low of the latest reaction. The July wheat chart shows this technique nicely.

The big question is: "How does one know when a runaway bull market is about to kick into gear?" Answer: One doesn't know. So, what does one do? One either resigns oneself to play the swings and then hope like heck that one can identify the runaway bull market when it emerges. *Or,* one can sit and wait and enter every potential runaway market, hoping that it is the elusive runaway bull. Remember, runaway bull markets only occur 15–22% of the time. Therefore, in a highly leveraged environment like the commodity market, one can go broke *quickly* trying to catch the big move, *unless* one is lucky and patient.

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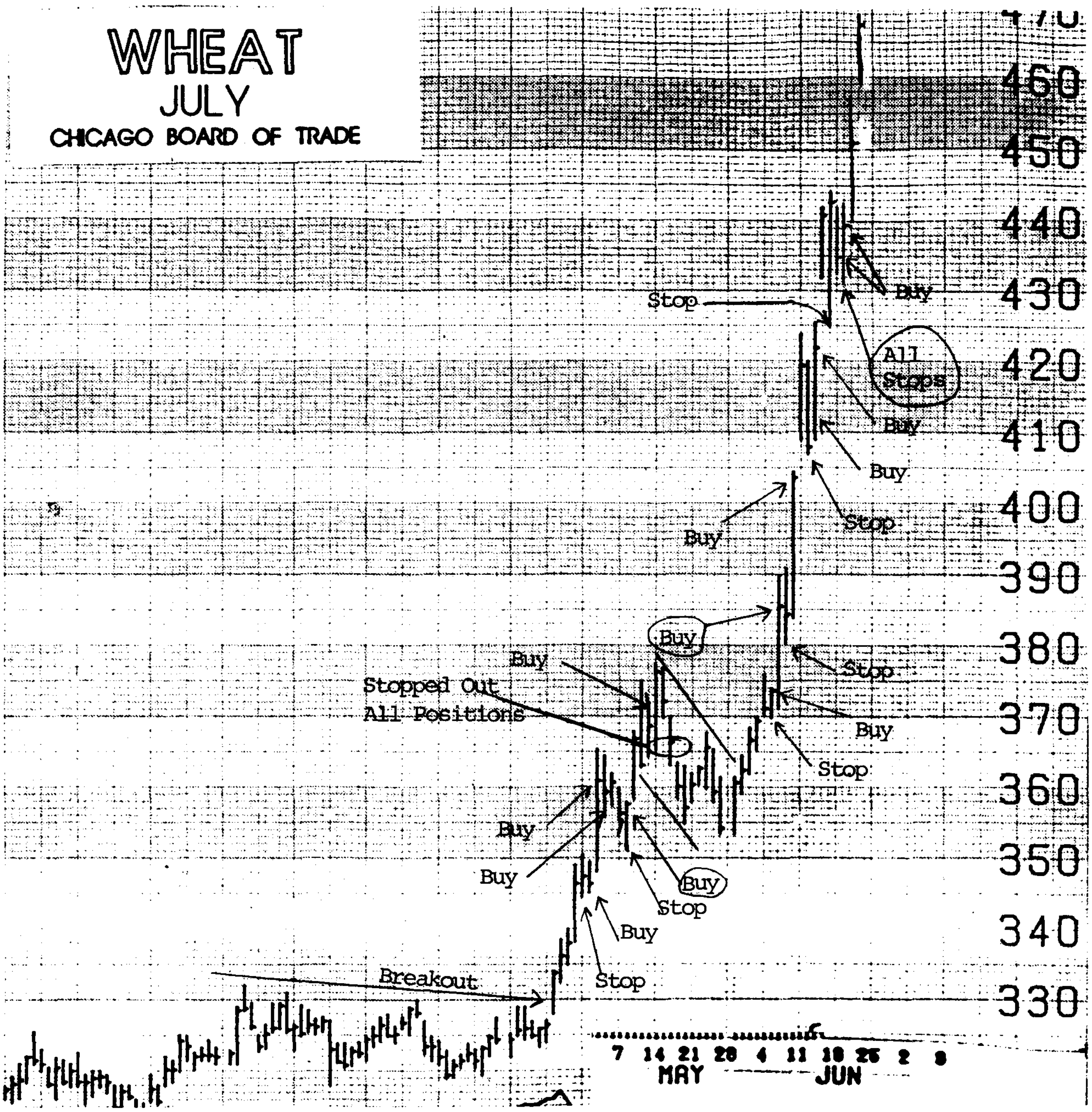


EGGS AND POTATOES, PLEASE

One of the classical technical trading strategies is to "buy the breakout" from a trading range. After a market has been oscillating within a small range for an extended period of time, prices will eventually move either up or down and exceed the limits of the trading range. This "breaking of the boundaries" of the trading range is known as the "breakout." The reason why traders "buy the breakout" is that for the first time, in many weeks or months, prices are forecasting a *directional* move. Surely it would seem, after a considerable period of consolidation, the first major move out of the confines of the consolidation would point to the future market direction. And, more times than not, this is the case. It is what should be expected.

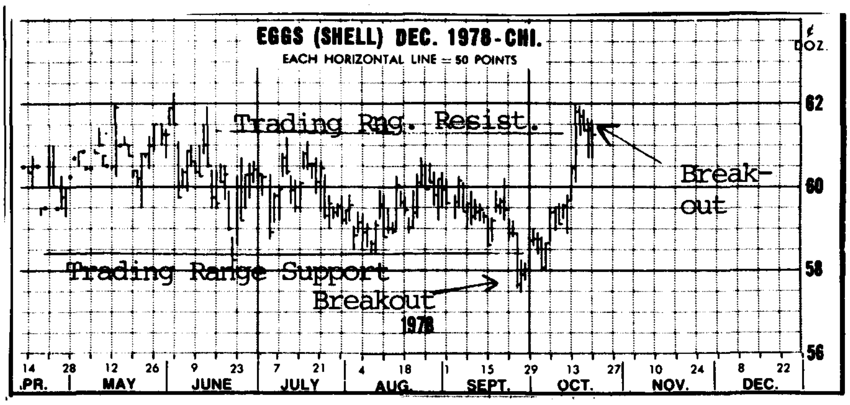
Notice the May Maine Potato chart. During the latter part of August, prices had exceeded the downtrend line and broken through the overhead resistance. Many "breakout" traders would have bought on Friday, August 25, when prices closed at 8.0. The expected market action was for prices to then move higher. Notice in this case, however, that prices returned to within the confines of the trading range. Then in October, prices "broke out" *below* the lower boundary of the trading range. The wide range, heavy volume, low close breakout to the downside on Tuesday, October 10th, signaled the next major market direction.

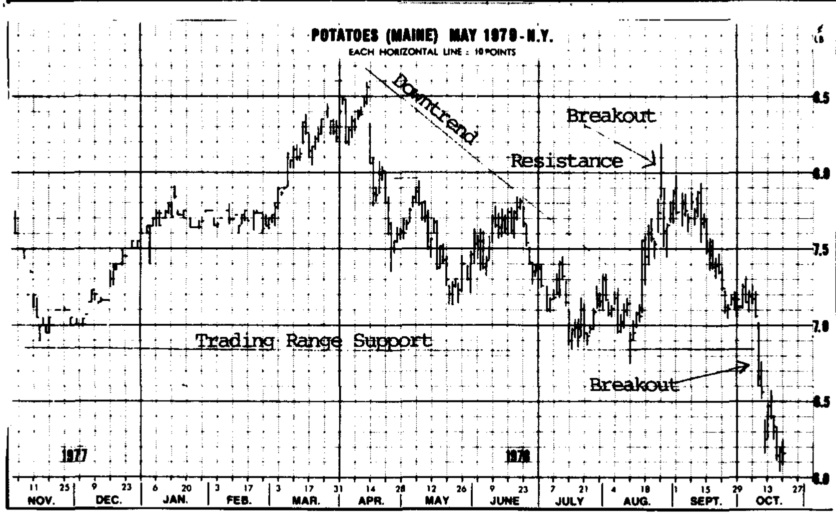
What is most important here is, what should have occurred did not occur! The upside breakout in Potatoes should have been followed by a bull market. Probabilities *favored* a bull market. The fact that prices returned to the trading range, and then broke out to the downside increased substantially the probability (better than 80%) that the *trend* now had *definitely turned down.*

Here's the bottom line. When a market "breaks out" of a trading range in one direction, fails, and then "breaks out" of the trading range in the other direction, *go with the second breakout.* It is seldom a false "breakout."

A second easy example of this technique took place in the December Egg market. The last week of September, December Eggs "broke out" below the trading range support and by so doing forecast lower prices. Notice that immediately thereafter prices reversed and the Egg market broke the trading range resistance to the upside. The "breakout" to the downside was a false breakout. The fact that prices rose dramatically through six months of resistance and "broke out" to the upside forecast higher prices for Eggs. Buying the upside "breakout" in the Egg market was therefore a very safe trade.

One final point. The safest initial placement of protective stops following the "breakout" is on the other side of the trading range. In the December Egg market, if one had bought the upside "breakout," the safest protective stop initially was 58¢ close only. In the May Maine Potato market, if one had sold the "breakout" below 7.0¢, the safest protection stop was 8.0 initially.



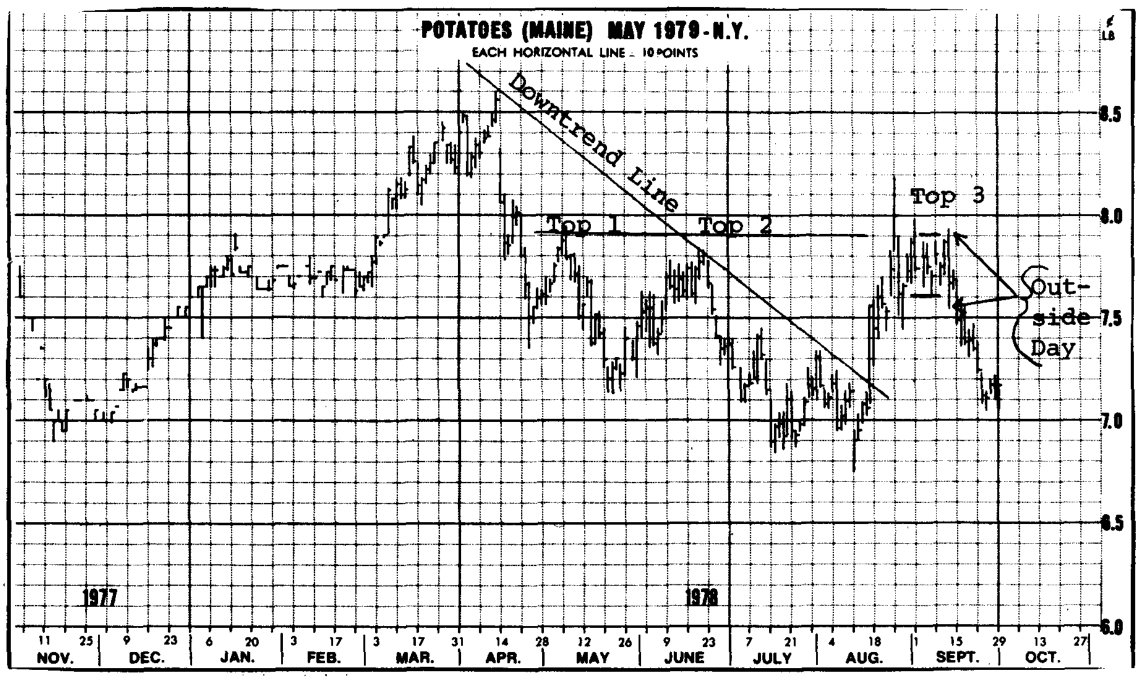


In late August and early September, it looked like we had witnessed an early seasonal low in potatoes. The five-month downtrend line had been broken to the upside on good volume. The May Potato contract had closed above the April and June highs (Labeled Top 1 and Top 2). The three weeks of congestion that followed in late August and early September were rightfully considered consolidation after the explosion off of the bottom. A logical projection was for the market to move higher following consolidation.

(In congestion, the market worked off the short-term overbought indications and allowed the moving averages time to turn up in a construction manner.)

The key to the emerging fact that the market *was not* going to move higher, but instead was going to break down, came on the outside day at the end of the congestion period. (See chart and day marked Outside Day where both the high and low is identified.) This outside day "wiped the slate clean," so to speak, for the previous three weeks of congestion. During the outside day, the market took out the *highs* of the past few weeks. It also took out the *lows* of the past few weeks. The *close* in the lower half of the range hinted that the next move would be lower. However, the correct treatment of the outside day was to wait and see which way the market moved next. If it went up and exceeded the high of the outside day, the trend would clearly be up. If prices dropped below the low of the outside day, then the trend would have decisively turned down.

Notice that following the outside day, an inside day occurred. This is often the case. The break below the low of the inside day, followed by the break below the low of the outside day, issued a high probability warning that the uptrend had terminated and that a test of the congestion area of 7.0 through 7.2 would most likely occur.



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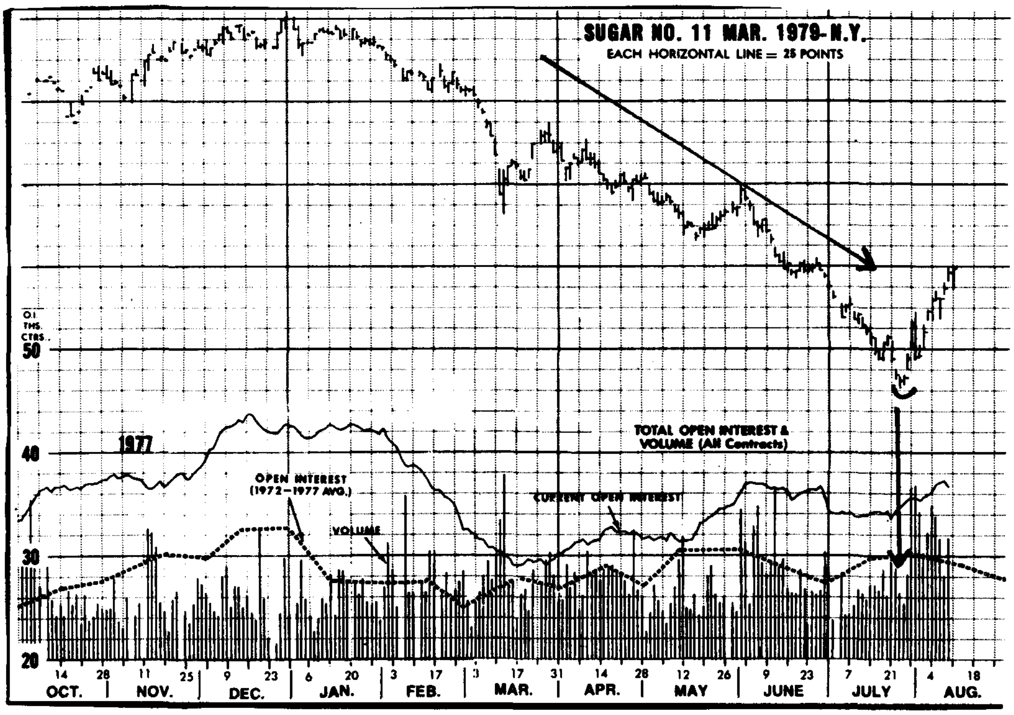
VOLUME AT BOTTOMS

Sugar had experienced an extensive downtrend since January 1978. It had been a leisurely bear market with no significant rallies indicating that, at minimum, when sugar formed a strong intermediate bottom, it would explode off at that bottom and thereby balance the complacency of the bears with bullish price action. Notice that when sugar formed its bottom the week of July 24th, the volume was next to nothing. (Undoubtedly, most of the floor traders and floor brokers were in the coffee shop most of those three days.)

Indications that this bottom was a significant bottom were verified by the wide range and heavy volume days which followed. In the sugar market, and most other markets, when a market is oversold, and has several low volume days *followed* by a high volume reversal, expect a minimum of congestion and most probably a V-bottom. A major change of trend could also be in the making.



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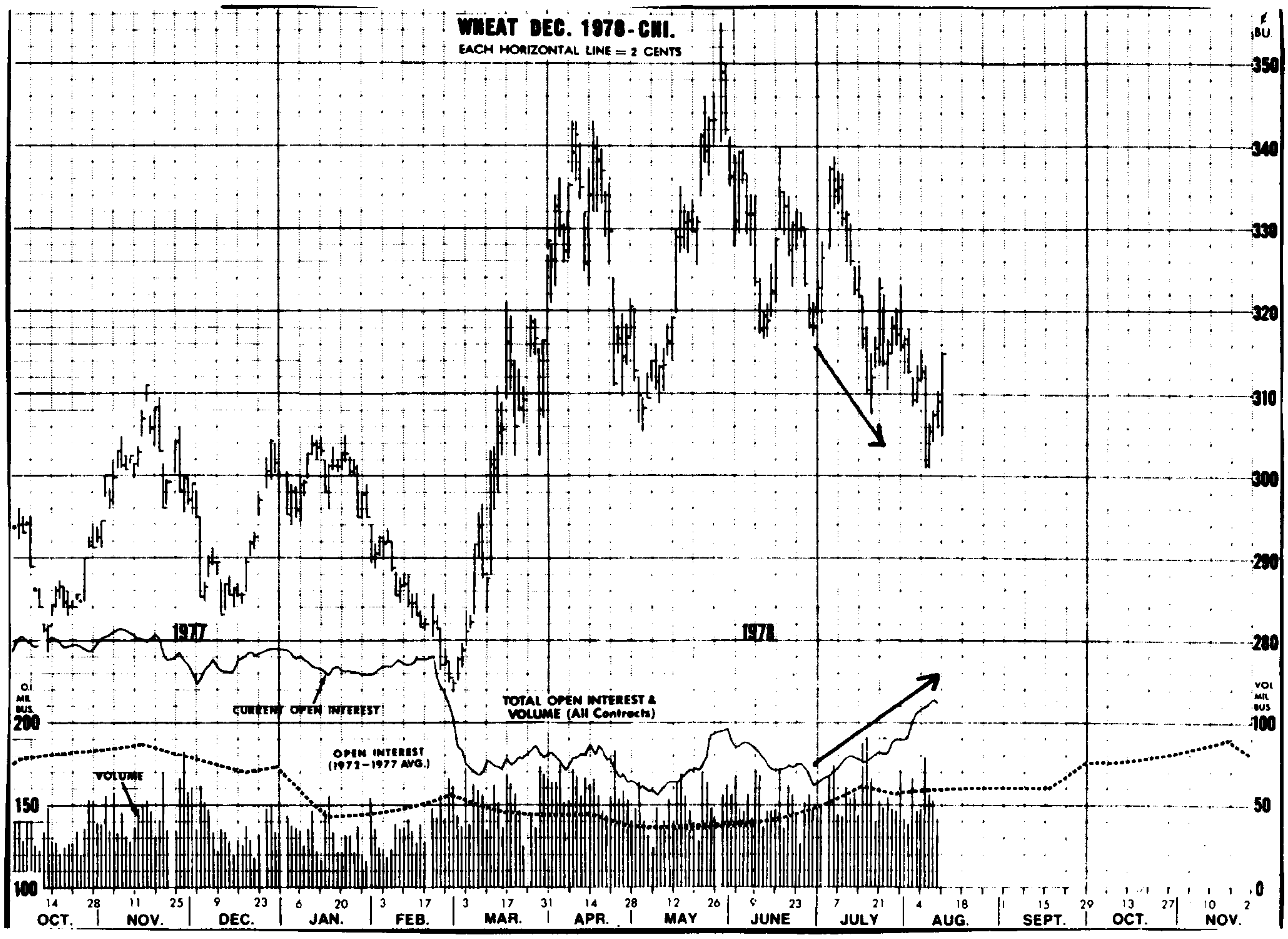
OPEN INTEREST CLUES IN WHEAT

Wheat declined in price during the month of July while open interest increased. Often in bear markets, when prices decline, open interest will also decline, indicative of bears taking profits and disillusioned bulls covering at a loss. Why was open interest increasing during July, in wheat? With the public short as indicated by bullish consensus figures at 42%, 34%, 40%, 27%, and 40%, one suspected that the market was in strong hands. Buying was either being done by well-margined accounts and/or commercial interests buying for foreign purchasers.

Additionally, with the seasonal low due for wheat between June and September, logic dictated that these were long-term safe purchases. Finally on Friday, August 11th, wheat broke out to the upside and reversed its downtrend.

The weekly continuation chart gives a much clearer picture of the price action in wheat from March – July. It shows a congestion area in a bull trend after the initial moveup from a head and shoulders bottom.



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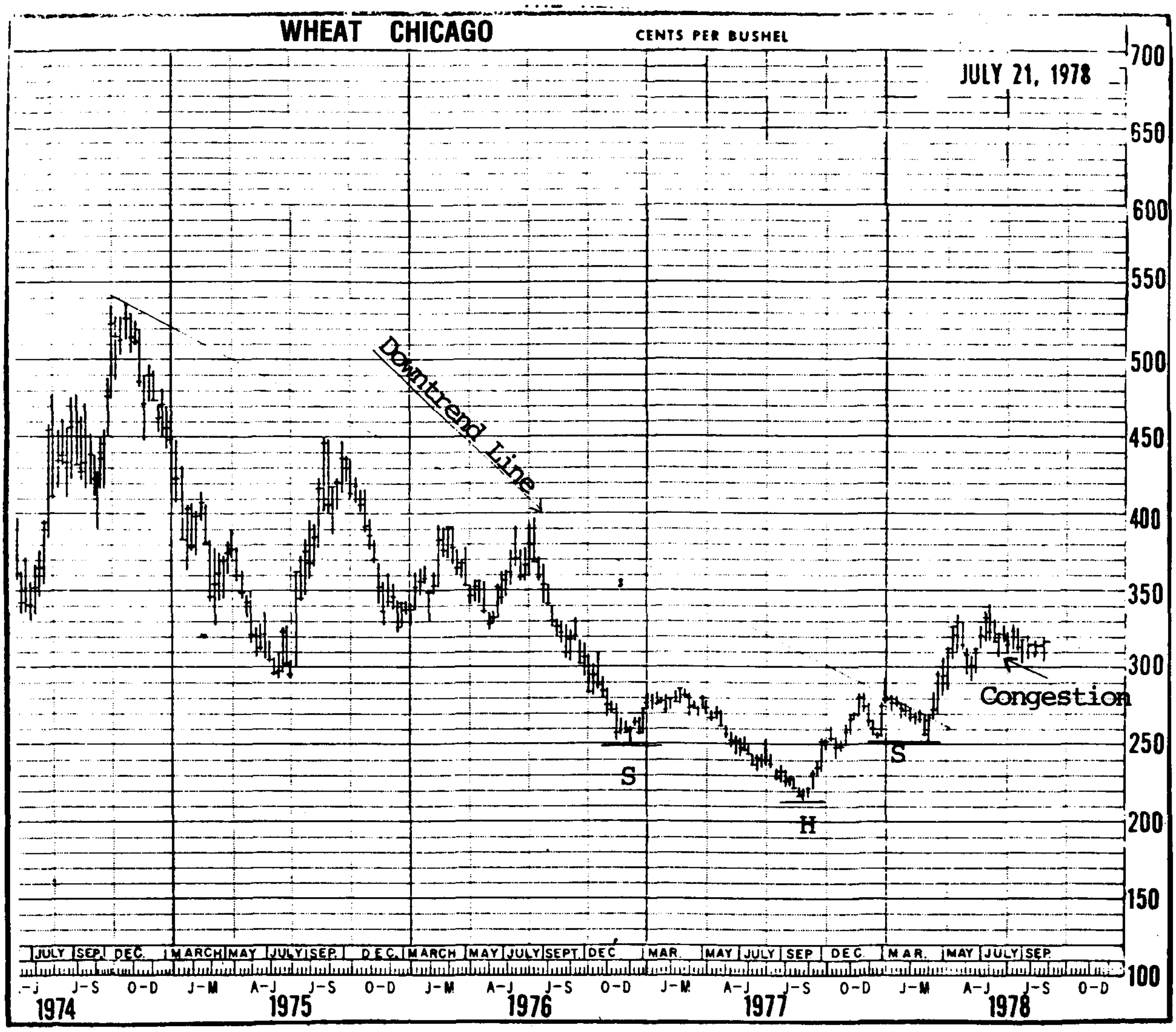
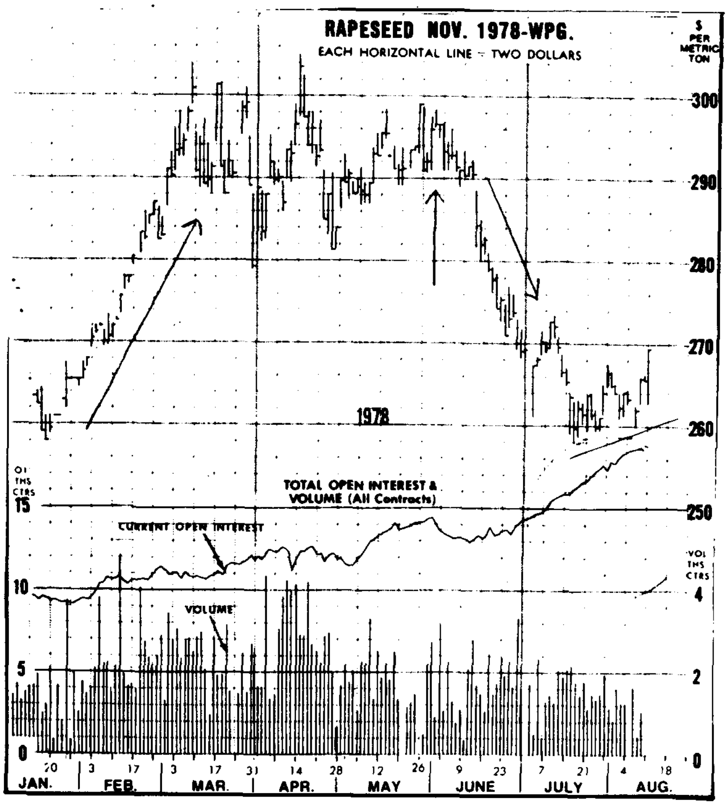

WHEAT CHICAGO
CENTS PER BUSHEL
JULY 21, 1978
700
650
600
550
500
450
400
350
300
250
200
150
100
Downtrend Line
Congestion
S
H
S
JULY SEP. DEC. MARCH MAY JULY SEP. DEC. MARCH MAY JULY SEPT. DEC. MAR. MAY JULY SEP DEC. MAR. MAY JULY SEP.
J-S O-D J-M A-J J-S O-D J-M A-J J-S O-D J-M A-J J-S O-D J-M A-J J-S O-D
1974
1975
1976
1977
1978

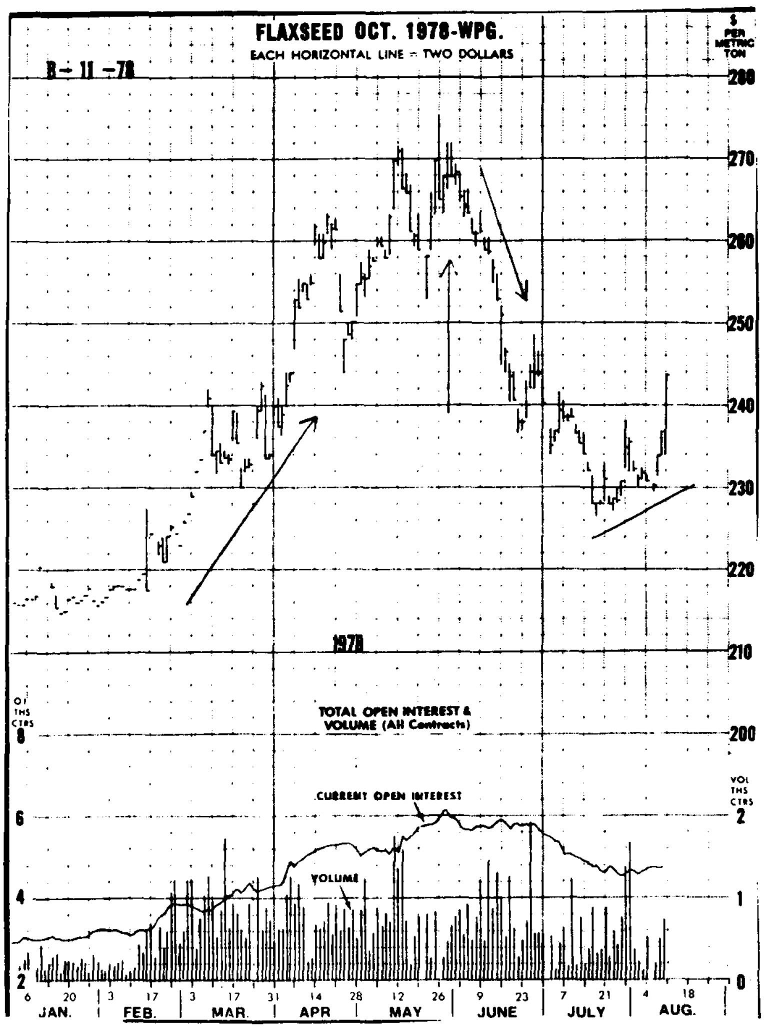
NOTES

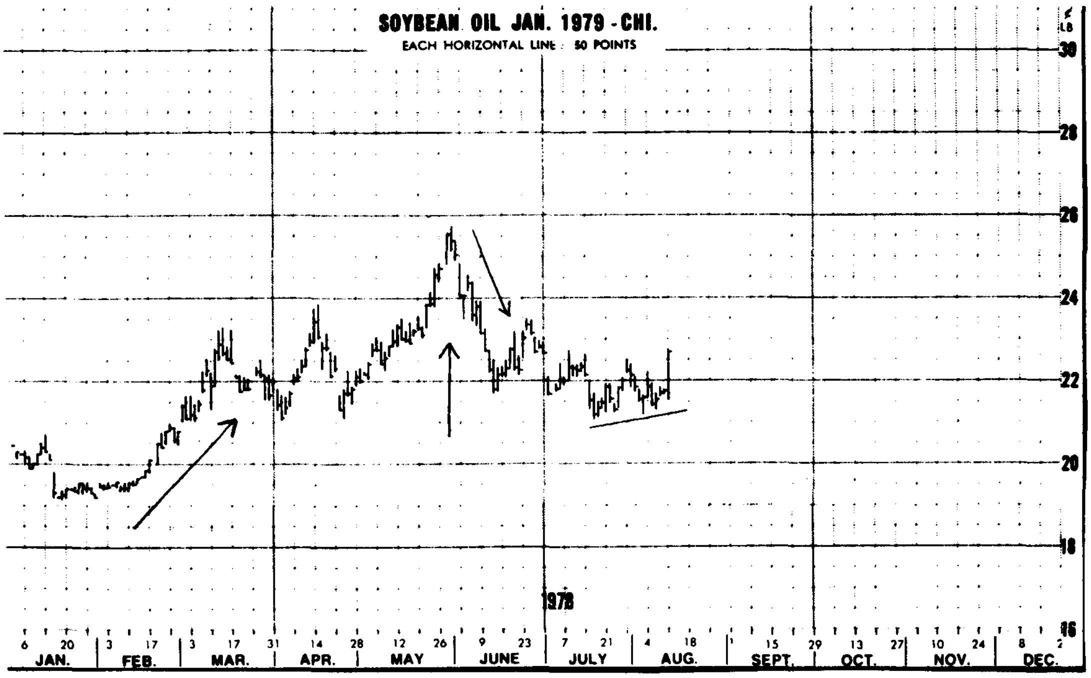
When trading Soybean Oil, it is prudent to follow the charts of Rapeseed and Flaxseed also. (They are traded on the Winnipeg exchange.) Notice that when Soybean Oil advanced in price during February and March of 1978, so did Rapeseed and Flaxseed. Notice that when Soybean Oil made its peak the week of May 29th, the peak had already been forecast by lower tops in both Rapeseed and Flaxseed. Therefore, a change of trend was forecast in the Soybean Oil by the Rapeseed and Flaxseed chart patterns.

Soybean Oil, Flaxseed, and Rapeseed all declined in unison during the month of June. Notice that the reactions in the downtrends are also similar.

A tip-off to the change in trend from down to up in Soybean Oil during mid-August was given by observing the Rapeseed and Flaxseed charts. Notice that both Rapeseed and Flaxseed made significantly higher bottoms than did the Soybean Oil. Secondly, Rapeseed's increase in open interest had to be construed as being bullish. When open interest increases, it means that there are an increasing number of buyers as well as an increasing number of sellers in the market. Bullish consensus numbers indicated that the public was short this market. Therefore, stronghanded buyers and commercials must have been in the Rapeseed market on the long side.






SOYBEAN OIL JAN. 1979 - CHI.
EACH HORIZONTAL LINE : 50 POINTS
30
28
26
24
22
20
18
16
1978
JAN.
FEB.
MAR.
APR.
MAY
JUNE
JULY
AUG.
SEPT.
OCT.
NOV.
DEC.

NOTES

MARKETS AND THE NEWS

By the time April, 1979 rolled around, the July contract of Chicago Wheat had been building a base for approximately 9 months. Wheat, languishing in a trading range, had chopped speculators to bits. The volume had dropped off considerably, and commission house interest was nil. Then, all of a sudden, like a "bolt out of the blue," on Tuesday, April 24, 1979, July Chicago Wheat broke out on the upside of the trading range (330) on heavy volume, with a wide range, and closed above 333. Technically, it was a signal to go long, as was precisely called by THE REAPER of April 20, 1979. Traders asked the question, "Why is the wheat market rallying?" Brokers had no answers.

Some two weeks later and some 30¢ higher, the "newsy" traders had a reason to go long. The Friday, May 4, 1979 issue of THE WALL STREET JOURNAL, Commodity Page declared: "A wave of wet, cold weather from the Dakotas to the Soviet Ukraine is delaying planting and threatening to reduce the world's spring wheat crop.

"For the past several weeks, fields in the U.S., Canada, Western Europe, and the Soviet Union have been too soggy for farmers to plow and the soil has been too cold to allow seeds to germinate. The delay could cause farmers to switch to other crops or result in lower yields on late-planted acres."

THE WALL STREET JOURNAL went on to list other sound reasons, supported by professional analysts' comments, why a trader should buy wheat. The article made it clear that the *fundamentals* for spring wheat were quite bullish. The only problem was, the news came two weeks and 30¢ too late.

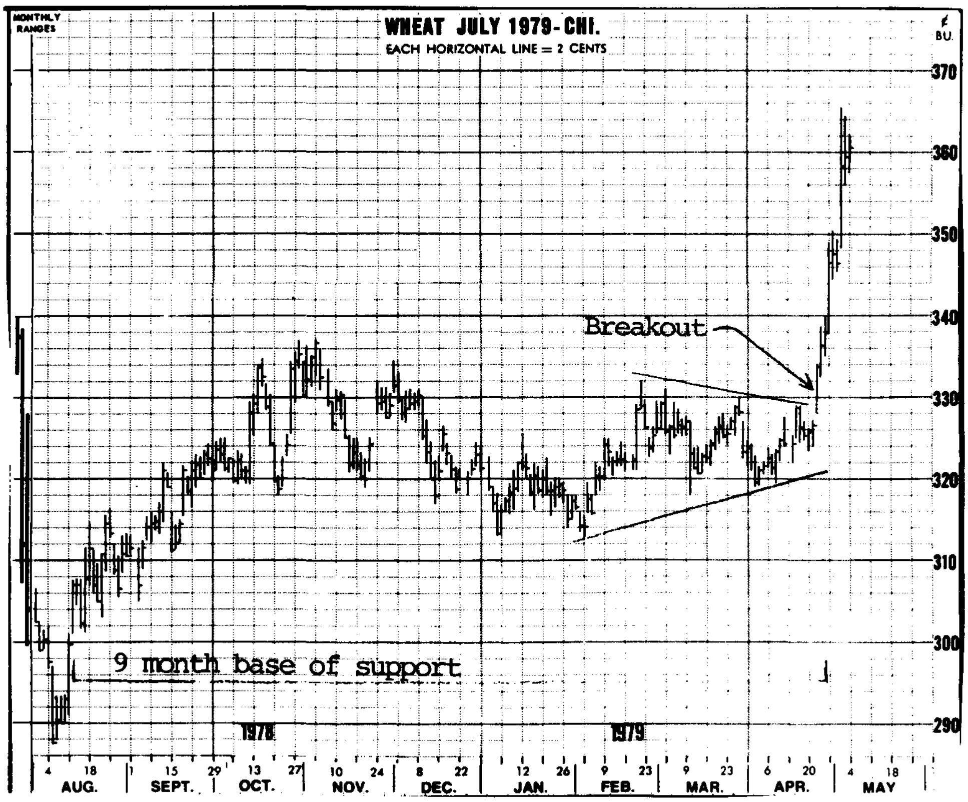
The old market adage, "Buy on rumor, sell on news," has application here. After the news, wheat reacted.

One should be cautious, hesitant to buy a market that is rallying WITH the news. Probabilities favor that the market has discounted the news, that is to say, the market has already moved to the price level which is justified by the news. . . .

In the case of this wheat market, a vacuum of sellers existed prior to April 24th. (There were no more sellers in the market.) This was verified by the low volume. The heavy base of support provided a springboard, and thus momentum, for the upside breakout. The risk on long positions was, therefore, minimal. This was a classic bull move, triggered by technical action and rumor. . . .

The rumor vs. news conflict all boils down to the trader's assumption of risk, his fear, and his degree of comfort operating in an environment of uncertainty. When the news is out in a market, there is apparently little risk, less fear of the unknown, and definitely less uncertainty. The problem is, profits are realized by the *assumption* of risk by speculating on unknowns in an uncertain environment.

We can see this principle readily in other financial investments: A 6% return on money deposited in a bank is virtually risk-free. The reward is commensurately low. Speculation in a gold mining venture, however, is high



risk, and the rewards are proportionately higher. The less risk, the less the reward. The greater the risk, the greater the *potential* reward. Given that reality, it is *very high risk* to *buy* rallying markets *with bullish news,* and equally *risky* to *sell* declining markets *with bearish news.*

Given the unsophisticated nature of the speculative public during such a newsy move, coupled with the above logic, the question must be asked, "Is it ever wise to buy markets that move with the news?" Yes. Here is the exception to the general rule: A market that is "dead in the water," quiet with little activity is subject to surprise news, a totally unexpected happening. If the news can be seen to have dramatic, *long-term effects,* then it can be expected that the market will take some time to digest the news thoroughly, at least several weeks of price action. Riding this "horse" out of the gate is relatively low risk.

When is the most *dangerous* time to buy a rising market with bullish news? During a mature bull market of 6 months or more, when the news is most bullish.

NOTES

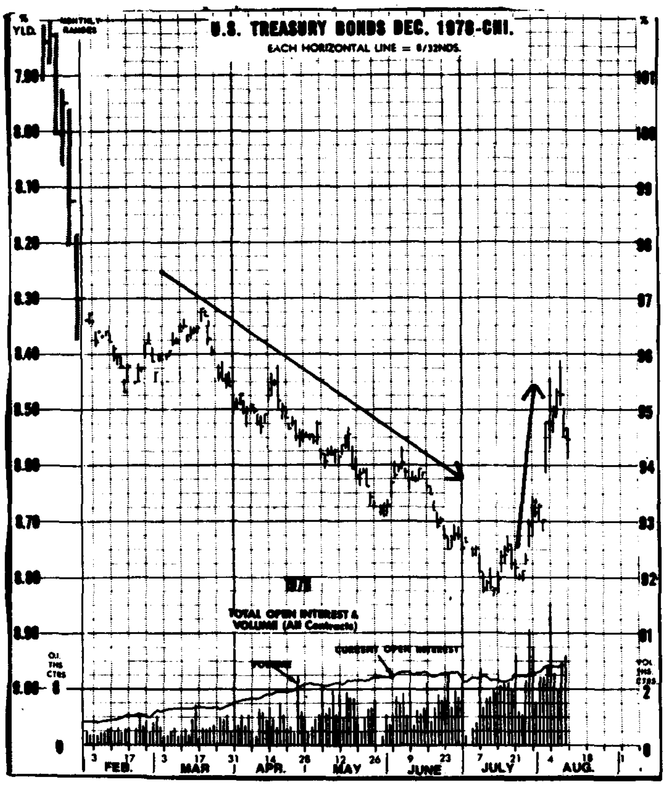
NONCORRECTING BULL AND BEAR MARKETS

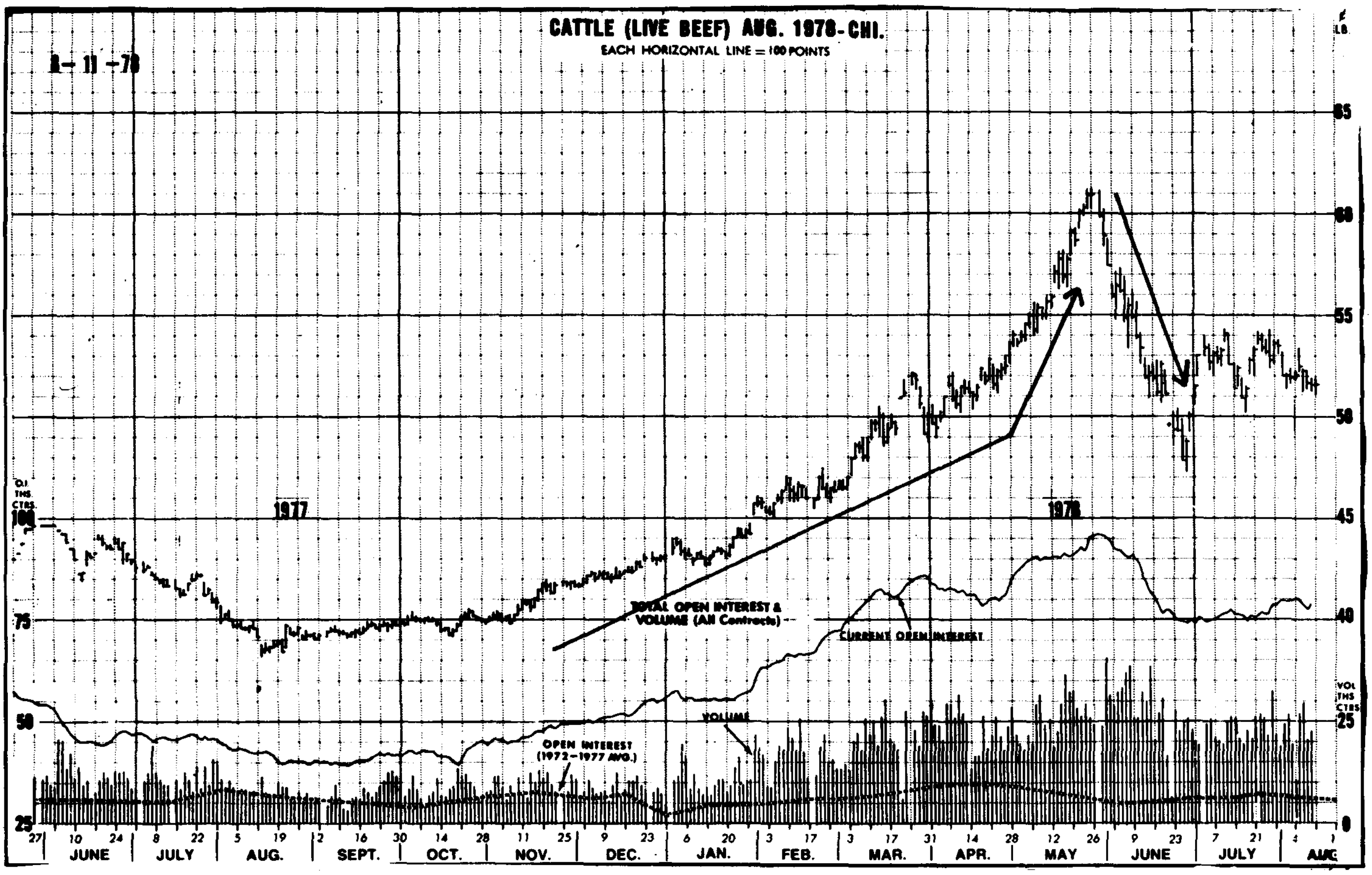
Markets are always seeking balance; They attempt to adjust for rabid optimism or desperate pessimism. That is why a bull market and a bear market often have Elliot Wave (ABC) corrections. Ths type of correction washes out the weak holders. It also provides the stability for the market to either work higher or lower, as the case may be.

Whenever a market drifts leisurely lower on low volume without significant contrary opinion rallies or ABC corrections (as was the case in the U.S. T-Bond market), expect (eventually) (potentially) an explosion off of some intermediate low. The market is storing up energy. Price action has failed to correct the overbearishness over a significant period of time.

In the cattle bull market, from November through May 1978, there were no significant corrections. The natural tendency of the market is to return to balance, to even out the risk between the elated bulls and the shattered bears. A severe, bull-shattering correction, a breaktaking drop of prices from an intermediate high, occurred during June.

Keeping in mind the concept of balance is critical for the commodity trader. When a trade goes one's way for too long, it is time to be on the alert for a reversal.



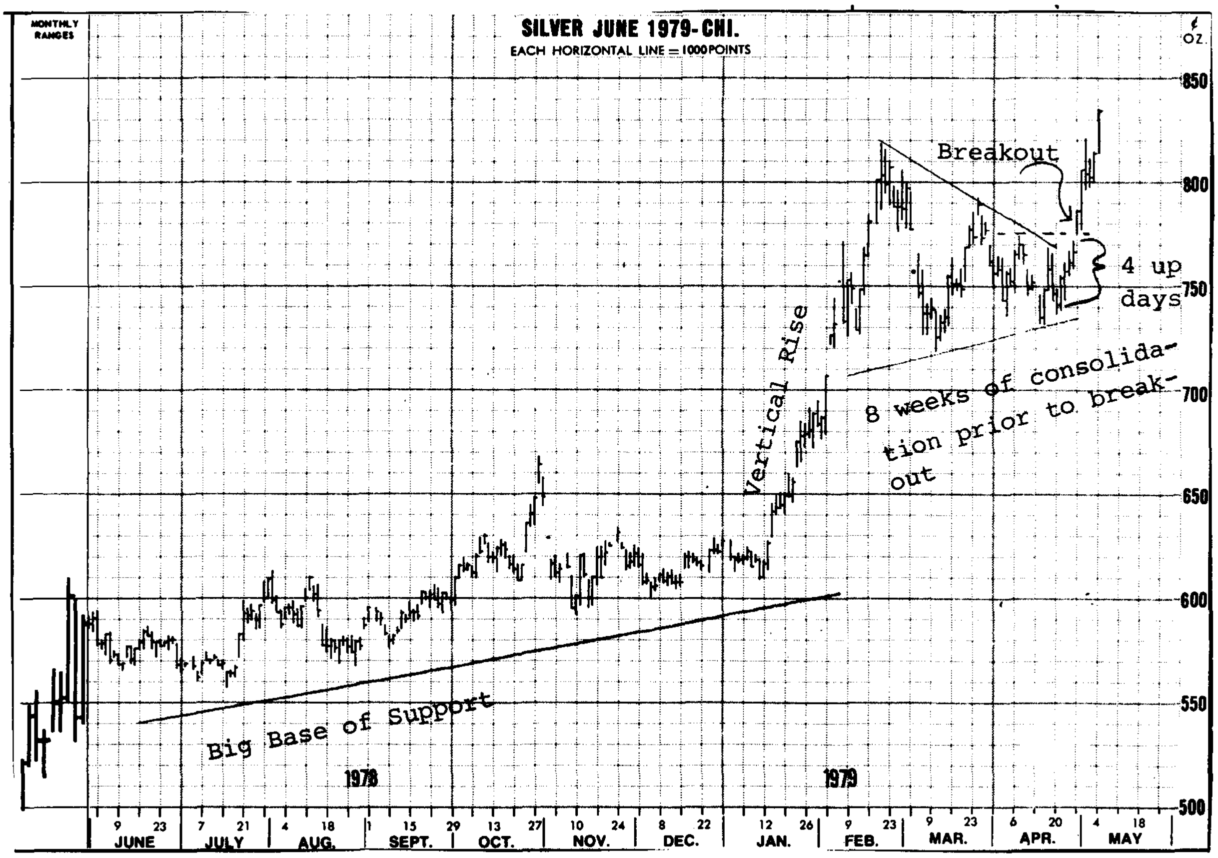


THE SILVER STREAK

On April 23, 1979, silver began an advance to new contract highs after 8 weeks of consolidation. The primary tipoff that the next move would be up was the fact that the 8-week consolidation had followed a near-vertical rise from a multi-year base. The first consolidation after such a breakout and rise is seldom the ultimate top. (78% of the time this first consolidation is followed by higher prices.)

What was also interesting in the silver move was that by market close Thursday, April 26th, silver had advanced 4 days in a row without making a lower high or a lower low. This was in violation of the laws of probabilities, which favored no more than a 3-day advance prior to a reaction. The nature of the advance had led one to expect a reaction. The daily ranges decreased, as did volume. Additionally, silver had advanced into the 770–780 resistance zone, from which level a sell-off was logically to be expected. Silver did not respond, however, according to expectations. Instead, it gapped up Friday and closed on its high at 783. This violation of probability theory indicated incredible underlying strength and justified a long position, which was recommended in the REAPER.

The bottom line is: When a market doesn't do what is expected of it (in this case, silver should have reacted), expect a powerful move in the opposite direction of the expected move.



NOTES

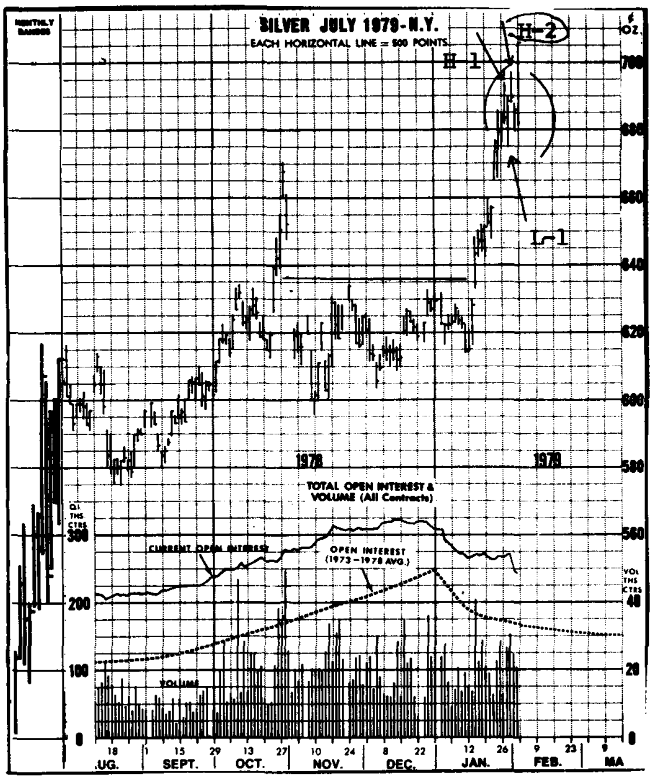
HIGH — LOW — HIGH

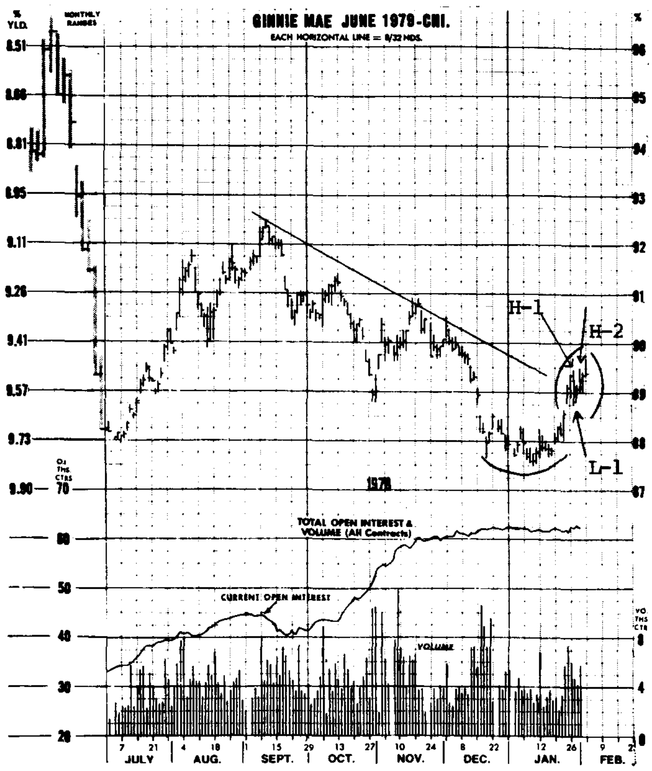
When a new bull market "breaks out" upside, or an old bear market begins a stout "rally in a bear market," the normal sequence of price action is from ascending low to high, low to high, low to high, etc. In this situation a continuation pattern, which occasionally appears, is worth watching for. The pattern consists of a high, followed by a reaction low a day or two later, then another high just barely *above or below* the previous high. This only slightly higher or lower high suggests that a reaction may be in the offing. The market will then usually break down and attempt to test the recent low. If it fails to break the low, one can buy with relatively low risk: (a) The first day the market makes a higher high, or (b) The day it exceeds the previous significant high.

An example of this pattern is visible on the July Silver chart. Silver made a high (H-1). It reversed down and made a low the next day (L-1). The following day it rallied and made a high (H-2) just slightly higher than H-1. It then attempted to test the low (L-1). (Probabilities favored a testing of L-1 at price level 675.) When silver was unable to break below 675 (L-1), and reversed above the previous day's high and/or H-2, a buy signal was issued. Protective stops could have been safely placed below L-1, or the reversal day low (the day silver closed at 706).

The same situation existed in the June Ginnie Mae contract. A small saucer bottom and a strong bear market rally occurred. A high was formed at H-1, a low at L-1 the next day, a slightly higher high at H-2 (it could have been a slightly lower high). Then the market attempted to test the low at L-1.

The day following H-2, the market broke to a lower low. It then reversed and closed near its high. This reversal signaled, at minimum, a move above the highest high of the rally (H-2), and possibly even higher prices.





NOTES

A LID ON COPPER?

On Wednesday, May 24th, copper made a key reversal to the downside in the opinion of many analysts. True, on Day 1, copper did make a higher high than the previous day, reversed down and made a lower low than the previous day, and closed on its low. True, also, is the fact that copper reversed at the level where it had encountered resistance twice before (A & B). Why then, was it not logical to expect copper to again drop off in price, particularly when a key reversal was in evidence?

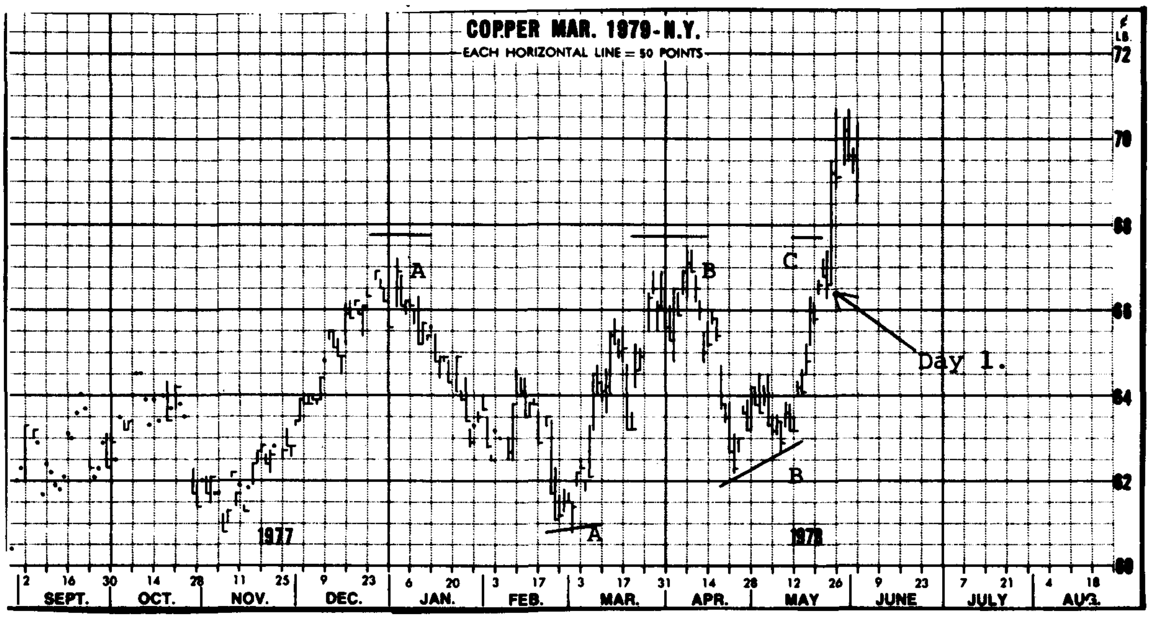
First of all, as can be clearly seen on the Cash Copper Scrap Chart, copper was moving up out of a 10-month base. Therefore, the third assault on the highs could have been anticipated to be successful under the "third time is a charm rule."

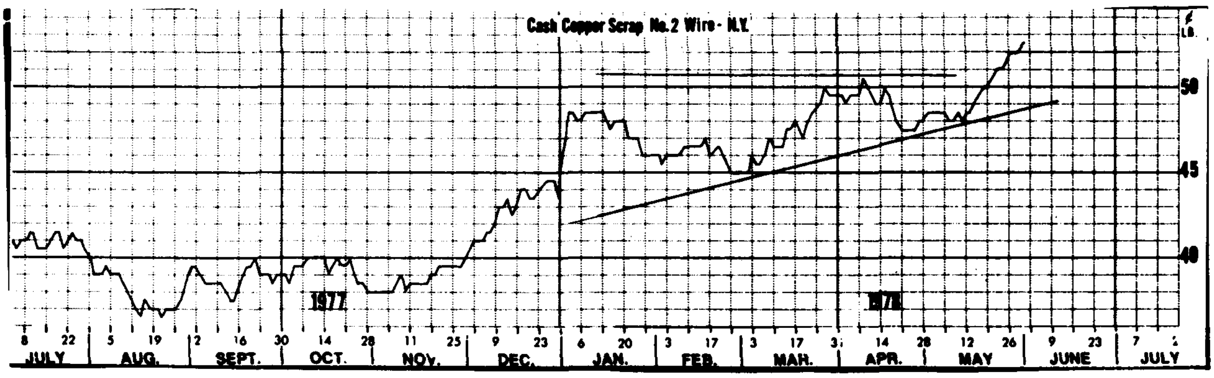
Secondly, copper had made a higher level of support, moving up from the higher base of support, Support B. A higher support zone usually supports higher prices.

Thirdly, March copper had zipped right up through the resistance at 65¢ and 66¢ without looking back. Such a vertical ascent through such resistance is rare.

Finally, the fact that copper prices had risen vertically the entire previous week without a hint of a correction entitled it to some adjustment, which took place at the level of previous highs. But to analyze the price action of May 24th as a significant key reversal, worthy of a short sale, is to be myopic in one's analysis.

One late note. The vertical driveup during the week of May 15th signaled a breakout on the weekly chart with a breakaway gap. (Weekly chart not shown.) Such strength is usually a forerunner of higher prices.





GANN APPLIED (PART 1)

Editor's Note: Phyllis Kahn is a broker with Maduff & Sons, Inc. in Los Angeles, CA (213-655-4025). She and I have done technical research together from time to time. She wrote the following article for THE REAPER.

"A February 'Trader's Notebook,' 'Guess or Identify,' was akin to a statement that Gann repeats throughout his courses, "Don't Guess — KNOW!" Using the tools that Gann provided it IS possible to sell tops and buy bottoms as low risk trades — but you must *KNOW.* And the KNOWING isn't easy. You need the entire history of the commodity: yearly, monthly, weekly, daily, and then you must process all the information, following the unique methods prescribed by Mr. Gann.

"Permit me to take you step by step through a recent example of a top which could have been sold with reasonable risk because you 'knew.' It occurred last October in the most vicious of all markets (when you're wrong) — Pork Bellies. As you know, the Gann Method looks at time alone, price alone, and the merging of price and time. So we start with time.

"We're looking at the February Bellie contract in continuation from the beginning of trading in 1961. Analyzing the monthly cycles for October 1978 we are:

36 months (3 years) from the extreme High in February Bellies which occurred on Oct. 3, 1975 at price 104.10, 104 months from the February '69 high. This means that the extreme high price of 104 was 'squared' with time! According to Gann, 'Time for a reversal of trend.' Also, 52 months from the June 1974 extreme low, 24 months from October '76 High, 18 months from April '77 High.

Note that these cycle numbers have a harmonic relationship . . . 104 is twice 52, 36 twice 18. The 36-month and 18-month cycles in Pork Bellies are especially powerful for a change in trend.

"Now for a look at the weekly cycles. The 1st week in October '78 was *288* weeks from the March 30, 1973, major low. 288 is two complete cycles of 144 — the time period of Gann's Master Price and Time Calculator. The 2nd week in October was 144 weeks from the January '76 high which itself was 145 weeks from the March 30, 1973 low. The last major low in bellies was June 1978 — 143 weeks from the all-time high in October '75!

"On the daily chart the contract high was made on April 7, 1978 so that October 7 was 26 weeks or 180 days from that high. Fifty percent in time or price from any important high or low, Gann considers very important for a change in trend.

"Things are looking promising, but we need to 'know' more. Now, we look 'generally' at the month of October to see what precedence there is for a top or bottom to occur. Here's what we find:

1) October 12, 1973 Peak at 7300 — 3 weeks down for a drop of 13¢!
2) October 25, 1974 Peak at 7300 — 4 weeks down for a drop of 16¢!
3) October 3, 1975 Peak Extreme high 104.1 — 5 weeks down for a drop of 56¢!
4) October 15, 1976 Peak at 5500 — 2 weeks down for a drop of 10¢!
5) October 7, 1977 Major bottom 4580!

Now, it's really beginning to look interesting. We have two 'Anniversary' dates — Oct. 3 and 7. Gann tells us always to look for a change of Trend each year at the anniversary date of important previous extreme highs and lows.

"Up to this point, all of the analyses have been devoted to Time. Next we must find a price which will provide the low risk trade to 'sell the top.' And find it we do! Our October 'history' told us that highs were made at *7300* in October of 1973 and 1974. The February '78 contract high was *7397,* and the then current February '79 high was *7300* (not exactly a surprise).

"On our monthly chart we find that the midpoint, or 50% retracement of the bear cycle from 104.10 high to low 4350, is *7380,* a very strong resistance number and an ideal place to sell February bellies when it reaches that price level again. Midway through the trading session on *October 6, 1978,* February bellies reached limit up 7370 and closed at that price. It was not difficult to sell against the 7380, 7397, and two previous highs of 7300. This indeed was a low risk trade which became the 1978 Season's high in Pork Bellies. Mr. Gann was right — you don't have to guess when you KNOW!"

NOTES

GANN APPLIED (PART 2)

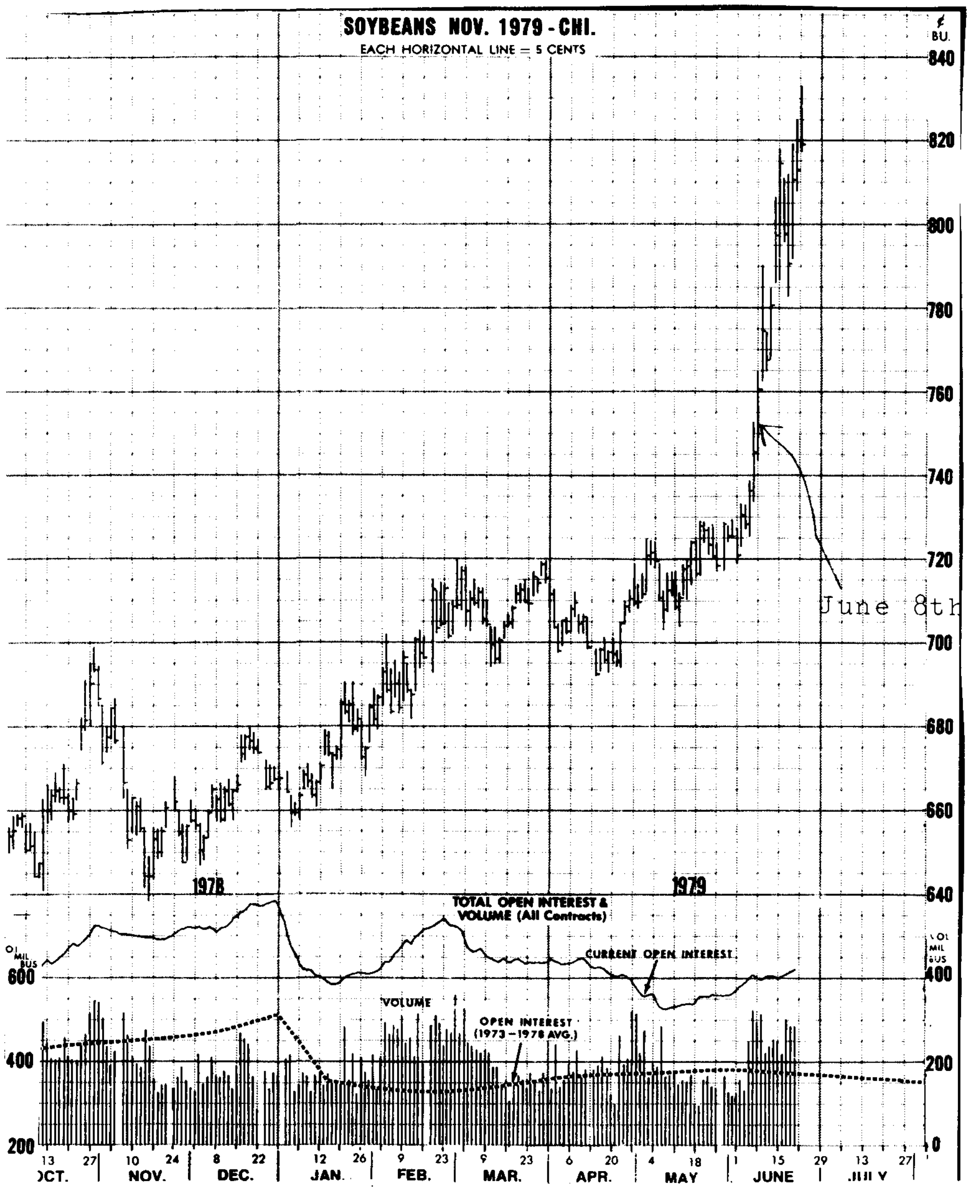
"Now that we've looked at a Market Past, perhaps we should gaze at a Market Future using the Same Gann methods. Some skeptics might say that it's too easy to look backward with 20/20 hindsight.

"I believe we have a Gann classic taking form this year in Soybeans. An analysis of monthly cycles in July Soybeans indicates a major turning point is due in June 1979. Here is a portion of the Time study: In June, 1979 we will be:

1) 34 months from the August '76 low,
2) 55 months from the November '74 low,
3) 89 months from the January '72 low,
4) 119 months from the July '69 low (1 month short of 10-Year cycle).

"These Fibonacci time cycles merging on one month are very potent for a major change in trend. In addition we will be:

1) 12 months from the June '78 high,
2) 35 months from the July '76 high (one month short of 36),
3) 72 months from the Extreme High of June '73 (This is one-half of the Master Time and Price Calculator 'Square of 144'),
4) 156 months from the June '66 high (13 years, a very important Gann time cycle AND another Fibonacci number),
5) 377 months from the extreme high in January '48. This cycle is dynamite because the price of the 1966



high was 377. This means that June 1979 'squares' the 1966 high in price and time. To quote Gann: 'an important time for change in trend.'

"An interesting note is that 377 is also a Fibonacci number, so there's a possibility that price itself, at that time, could be a multiple of 377.

"Zeroing in on which week in June, June 8th will be:

1) 72 weeks from the January 20 '78 low (again one-half of 144), plus 72 months and 72 weeks coming together,

2) 90 weeks from the September 16 '77 low,

3) 181 weeks from December 19 '75 major low (one-half of 360, very potent for a change in trend).

These weekly cycles are the most important numbers as viewed by the Gann method.

"Let's take a look at the June 'history' as we did the October history in Pork Bellies to see what the chart reveals:

1) June 15 '66 — Extreme high,
2) June 5 '73 — Extreme high,
3) June 7 '74 — Low,
4) June 3 '75 — Low,
5) June 6 '77 — High,
6) June 2 '78 — High.

"There is ample evidence for a major turning point to occur in the month of June! Five anniversary dates between June 3rd and June 8th. One of the big questions now, of course, is, will June be a top or bottom?

"As we move closer to June it will be easy to know whether we are making top or bottom because we will have all our price methods, which will generate a particular price, being reached simultaneously with the time frame. When all this comes together, one of our lowest risk trades of the year will be to sell the top (or buy the bottom) of Soybeans. It will happen through 'KNOWING,' not guessing!"

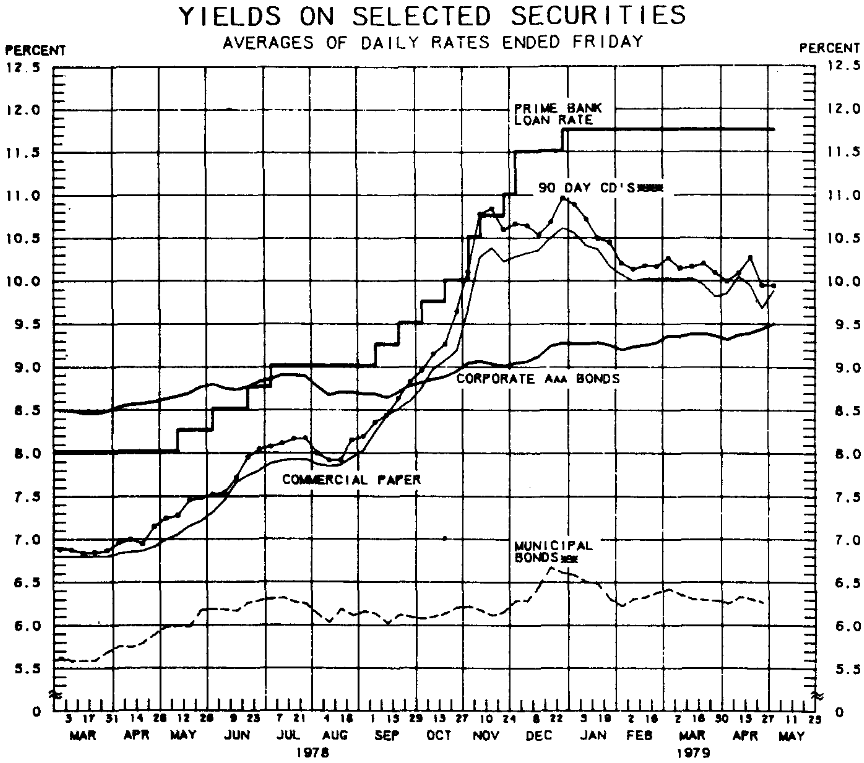
(For additional information on W. D. Gann's trading methods write: Lambert-Gann Publishing Co., Box O, Pomeroy, WA 99347.)

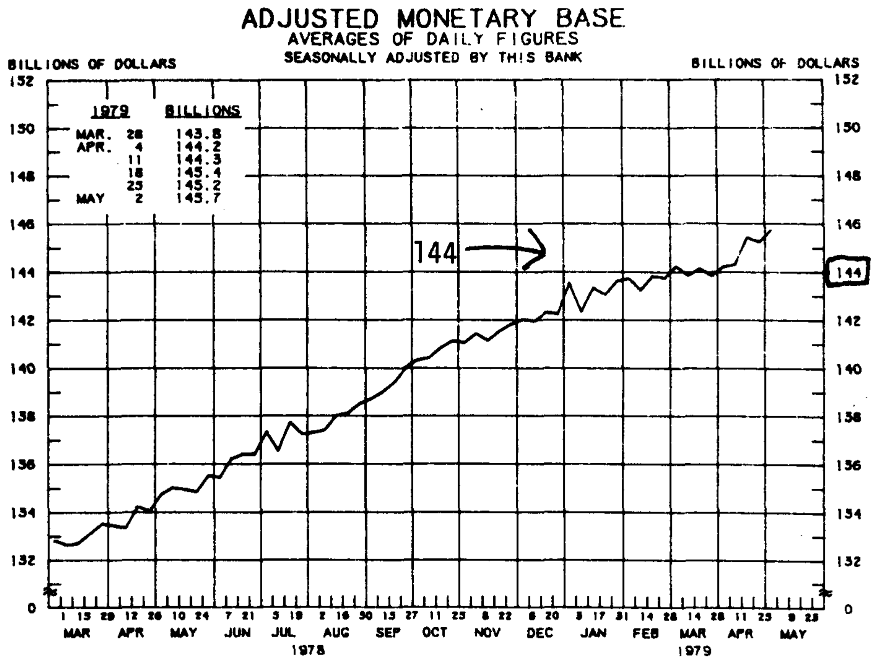
NOTES

NATURAL RESISTANCE NUMBERS BY PHYLLIS KAHN

"In the work of W. D. Gann there are certain numbers which he considered to be 'Natural' Resistance numbers whether they occurred in price, time, volume, sales or *any* regularly measured statistical tabulation. Knowledge of these numbers should be a must for anyone who is a serious trader in either stock or commodities.

"Gann ranked the numbers in the order of their importance with *360,* the number of degrees in a circle, as the most important number. Then he divided the circle in half so that *180* became the second most important. He divided the circle again by four — *90,* by eight — *45,* then by three, to get *120* and *240.* There are several other





numbers that should be included. *144,* the square of 12 and a natural Fibonacci number, plus all the even numbers of *100, 200, 300,* etc. There are others, but just looking at these numbers as they occur in both market and nonmarket data, it is often astonishing to see how dynamic they are.

"I read many newsletters including a bulletin from the Federal Reserve Bank of St. Louis which publishers related weekly statistics on interest rates, the different components of money supply, etc. In this data I consistently see Gann's natural resistance numbers holding back advances or acting as support. The enclosed charts of the 'Adjusted Monetary Base' stalling at *144* is one example. Look at the Money Stock (MI). It went up nonstop from *345* (Billion). As soon as it hit *362* (Billion) it stalled and turned down for the next five months.

"In Richard Russell's excellent *Dow Theory Letters,* he keeps a momentum index of London Gold that has intrigued me since 1974. His momentum index always tops out at one of Gann's natural resistance numbers. Last October 1978, his gold index reached *121* at the top of the gold market when London gold itself hit *240!* Note: In 1974 the same index topped at the very peak in London Gold at — *180,* Gann's second most important number. In 1972 and 1973, London Gold had one peak at *180* with support at *90.* Many analysts are forecasting *360* for London Gold. They, obviously, know the 'Natural' numbers.

"The number *180* is so powerful that anyone keeping statistics of any kind: Sales figures, traffic accidents, hospital admittances, or just about anything that is rising up to *180* can expect a correction in the figures from that level. Conversely, any figures falling from higher levels will always find support around *180.*

"IBM stock is a classic. Every number mentioned in the second paragraph of this article is a support or resistance number in IBM, including the historic high — *366.*

"In futures, the 'naturals' show up in every commodity as contract highs and lows. The historic high in Cocoa is *240.* Lumber futures had three contract highs (different years) and two contract lows at the *180* level including this year's current May and July '79 contract lows at *181.6* and *182.* After corn futures peaked in 1973 at *4.00* (even 100's), corn fell until 1977 when it bottomed at — *180!* Looking at our current futures is eye-popping: (As of May 11, 1979)

1) A major high in May '79 Wheat — *361,*
2) The contract low in Sept '79 IMM Gold — *181,*
3) The contract low Dec '79 Soybean Meal — *180,*
4) The contract low in Sept '79 Coffee — *90,*
5) The contract low Dec '79 Cocoa — *121.50*
6) The contract low Jan '80 Orange Juice — *89.50.* The contract high Jan '80 Orange Juice — *118* (Orange Juice is trading between two strong numbers *90* and *120*).
7) The contract high July '79 corn — *288* (Twice *144*).

As you can plainly see, knowing Gann's 'Naturals' can pay off handsomely in the market year after year after year."

NOTES

NATURAL NUMBERS

The late and great W.D. Gann was a believer in the law of natural numbers. He looked at natural numbers as being levels of natural support or resistance. For example, 100, 125, 150, 175, and 200 are natural levels of price resistance or support. Notice on the March Wheat chart how many times support and resistance were evident at 325, a level of natural resistance/support. Also, notice that the 350 level was a level of natural resistance at which price the market formed three tops (Top 1, Top 2, and Top 3). The rising wedge at Top 3 forecast a possible break in prices, a confirmation of the 350 resistance level.

Gann was also a great believer in natural retracements. If you read his book, *How to Make Profits in Commodities,* it seems that *every* number is a significant retracement number. Gann understood and integrated retracements with the natural cycles for each commodity. That was why he was able to be so precise. He may be the only analyst in the history of the markets who had a comprehensive understanding of the laws of geometry and algebra, price movement, specific cycles of each commodity, and how they all integrate. He knew logically that there is no such thing as a random price movement, and that the concept of a random variable is erroneous.

For those of us who are less gifted, retracements can be computed from highs to lows. Notice in the Wheat chart, a 55% retracement is noted from Top 1. For practical purposes, a good rule of thumb for any technical analyst is to utilize the 50% retracement rule. Markets will normally retrace from highs to lows, or from lows to highs, approximately 50% of the previous move. For practical purposes, utilizing between 45% and 62% is appropriate. Additionally, retracements of approximately one-third are indicative of incredible strength, in bull markets, or weakness in bear markets. Likewise, retracements of two-thirds might indicate that a change in trend is imminent.

Any close above the triple top at 350 should result (and did result) in at least another 15¢ price rise. Breakouts above triple tops are seldom false signals. They usually provide a profitable intermediate swing.

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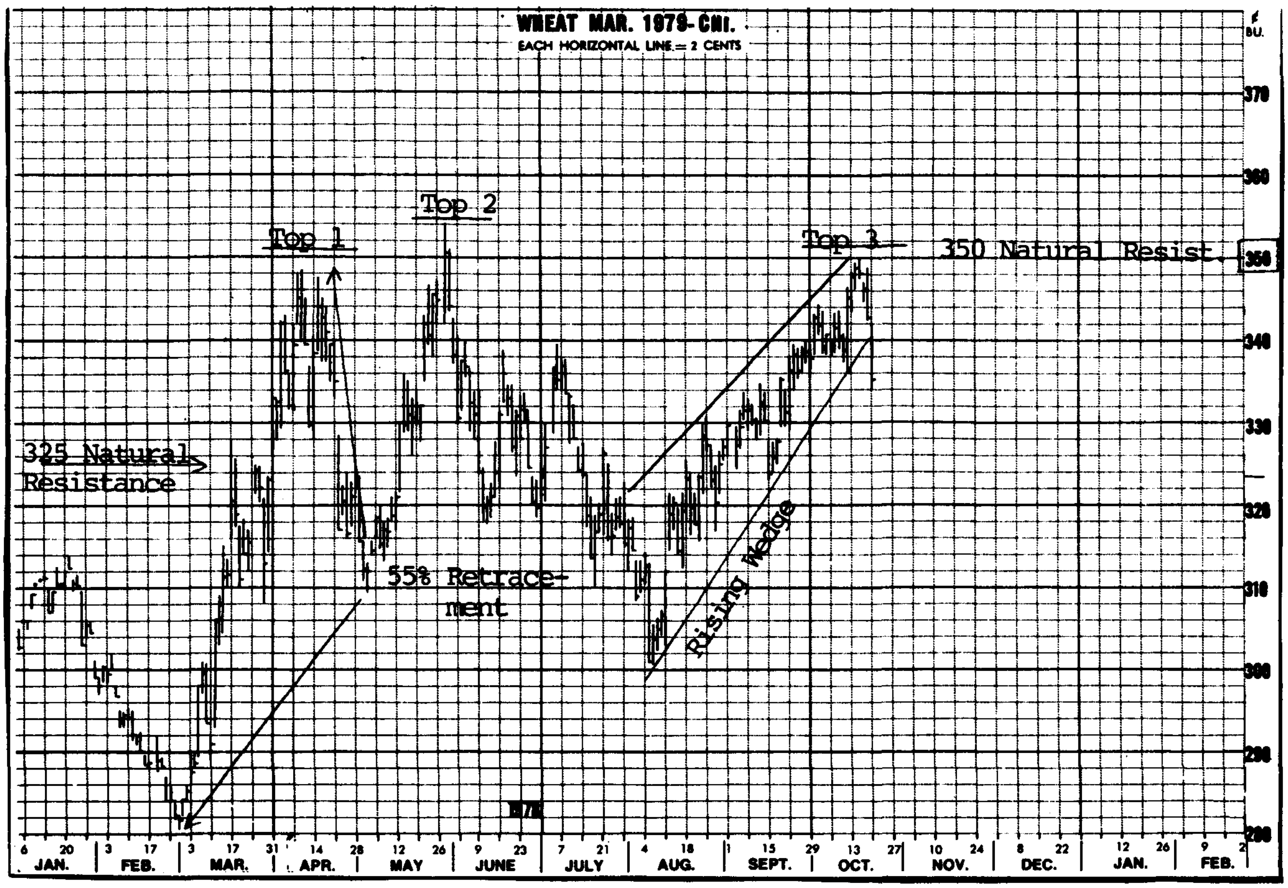
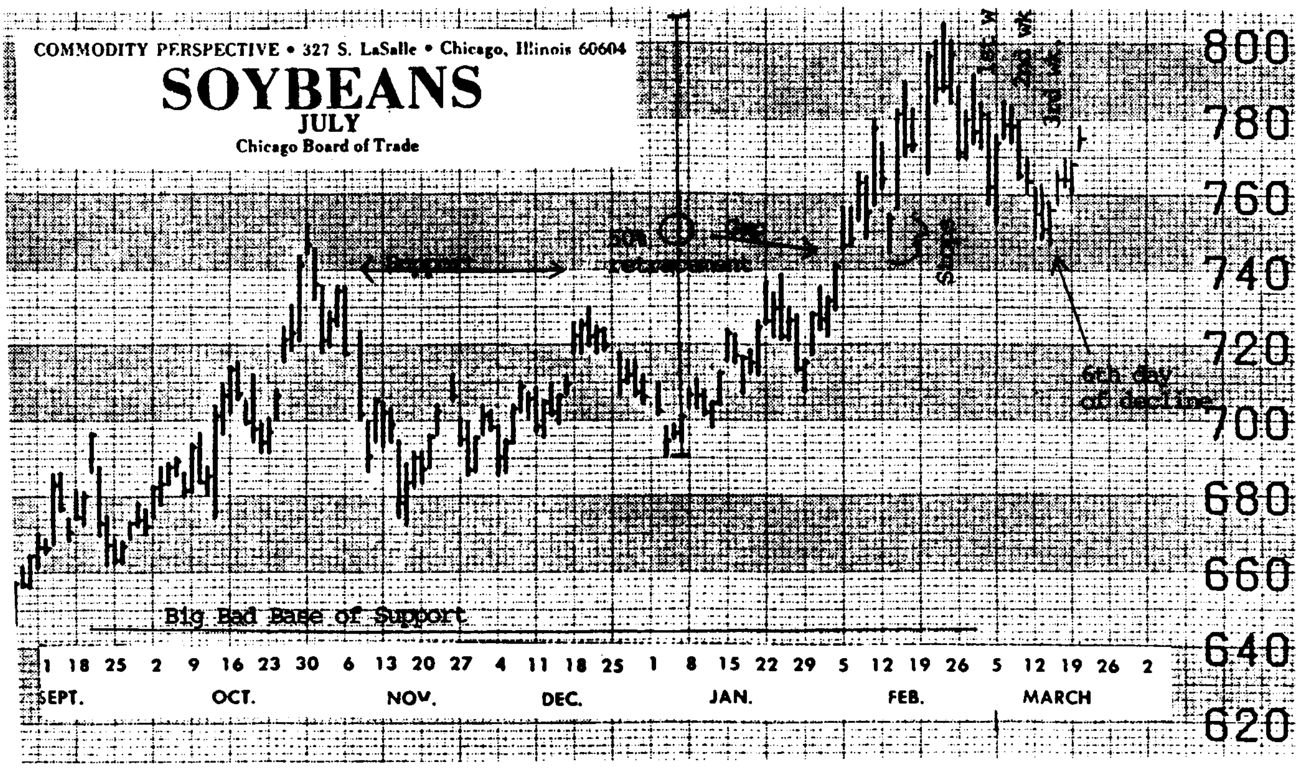
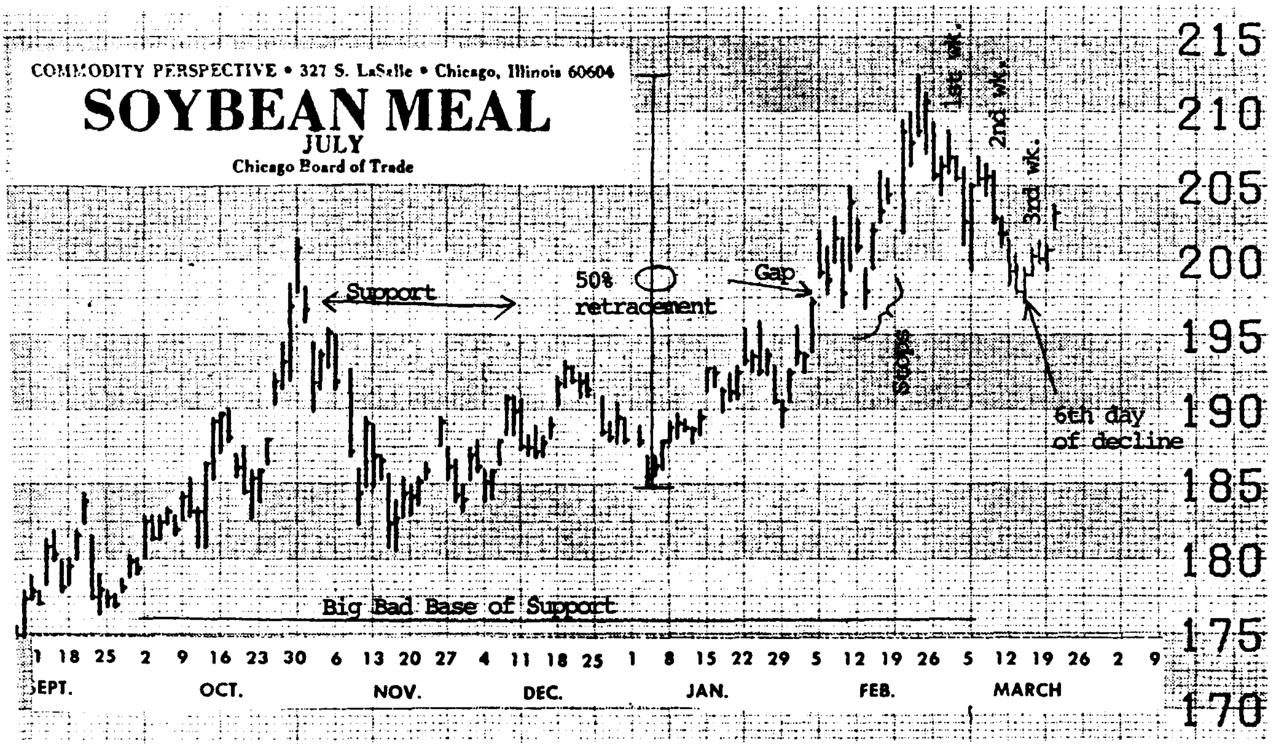


A SCALPER'S OPPORTUNITY

The recent action in the soybean complex gave us a classic scalper's opportunity. July soybean and July soybean meal prices were dropping. As the soybean and soybean meal markets were declining into heavily established bases, one had many reasons to expect a corrective rally. Specifically: (1)The week of March 5th, soybeans and soybean meal declined for the third week in a row. Markets seldom fall more than 3 weeks prior to a corrective rally. One should have suspected that a bottom was at hand. (2)On this third week of the decline, soybean and soybean meal prices fell 6 days in a row (made lower highs and lower lows). This is way out of line with probabilities. The market should have only declined 3 days in a row prior to a corrective rally. Thus, probabilities heavily favored the bulls. (3)Soybeans and soybean meal were declining into a 7-month-old base. Therefore, a trader knew there was heavy support beneath the market to fuel a corrective rally. (4)In July soybeans, a number of "stops" were placed below 752 and the "natural number" 750 level. Long-time followers of the soybean market know that the locals, given the opportunity, will "run the stops" below critical support levels before reversing the market. This, in fact, occurred. The same was true for the soybean meal. Traders ran the stops below 200 and 199, only to reverse the market to the upside. (5)Great strength could have been anticipated in the July soybeans around the 740–750 level because of the breakaway gap which occurred there in early February. This "support" situation existed at approximately the 197 level in July soybean meal. In both cases, the markets returned to the "gap filling" area prior to the rally.

For all the above reasons, sophisticated traders bought the 5th and 6th days of declines in soybeans and soybean meal in anticipation for a quick scalp to the upside.

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NOTES

CLOSE ONLY STOPS

Some exchanges will not take "close only stops" on commodity positions. I have consistently recommended utilizing "close only stops." For those exchanges which do not accept "close only stops," I suggest the following: Put a stop in the market during the last five–ten minutes of trading. If the market hits that price during the last five–ten minutes, you will have basically executed a "close only stop."

For example, if you are long March Soybeans with a 560 "close only stop," you could not "officially" enter that 560 "close only stop." They don't accept "close only stops" at the Chicago Board of Trade. However, you could tell your broker, "Between five and ten minutes before Soybeans close, enter a sell stop on March Soybeans at 560." By so doing, your protective stop will be out of the market *until the last few minutes of trading* and will suffice as a "close only stop."

Don't take any flack from your broker on this matter. He is paid to provide you with service. All brokers should be "can do."

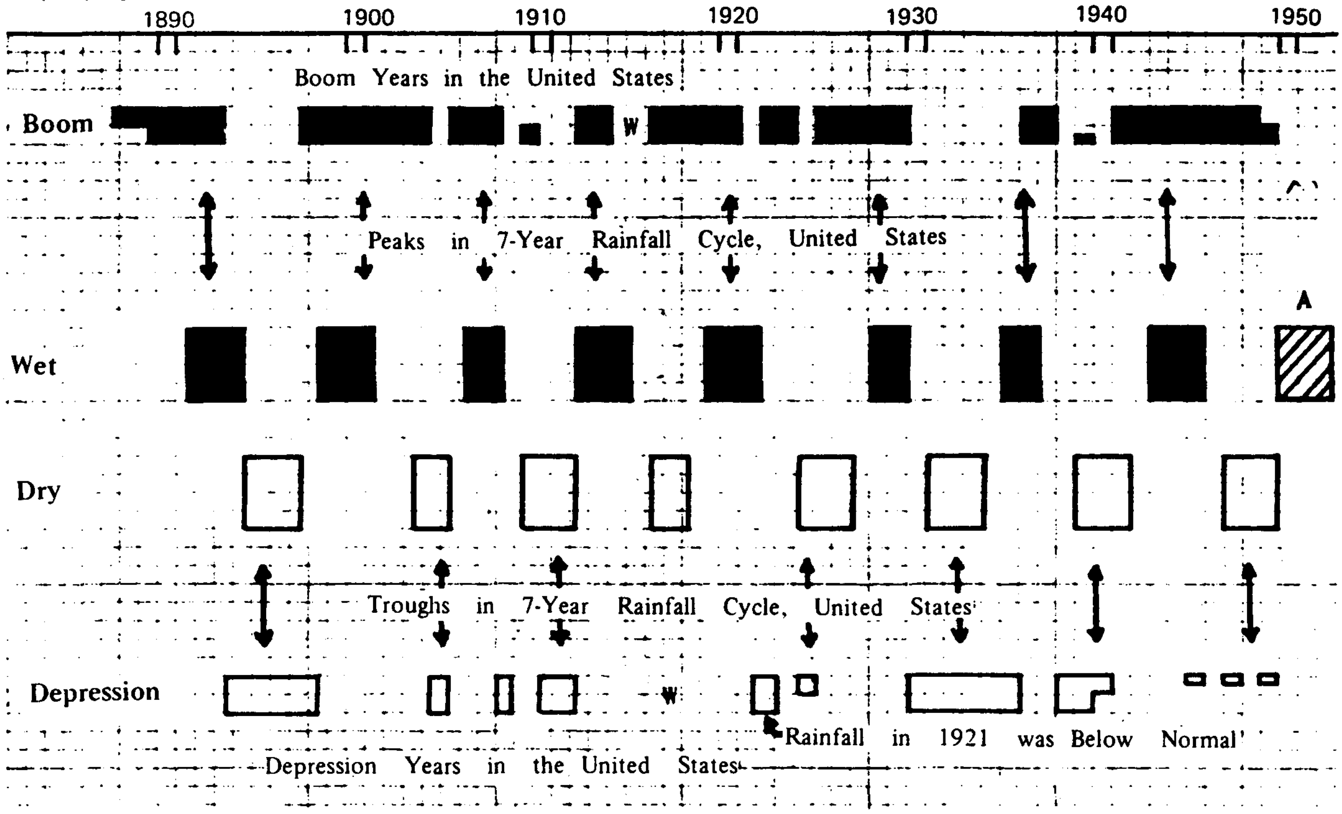
NOTES

THE SOURCE OF CYCLES

From time to time I have referred to the work accomplished by the Foundation for the Study of Cycles, 900 West Valley Rd., Suite 502, Wayne, Pennsylvania 19087-1821. Membership in the Foundation costs $75 for individuals, $105 International and $125 Corporate. Their publication, CYCLES, is well worth the modest membership fee.

Cyclical articles which *broaden* one's perspective and enhance one's overview, such as "The 7-Year Rainfall Cycle in the United States in Relation to Boom and Depression Years," are constantly appearing in CYCLES. Notice from the graph that booms tend to coincide with wet years, and depressions correspond with dry years. Climate does affect economics. We are expecting cold, dry conditions in the 1980's. We should expect an accompanying depression.

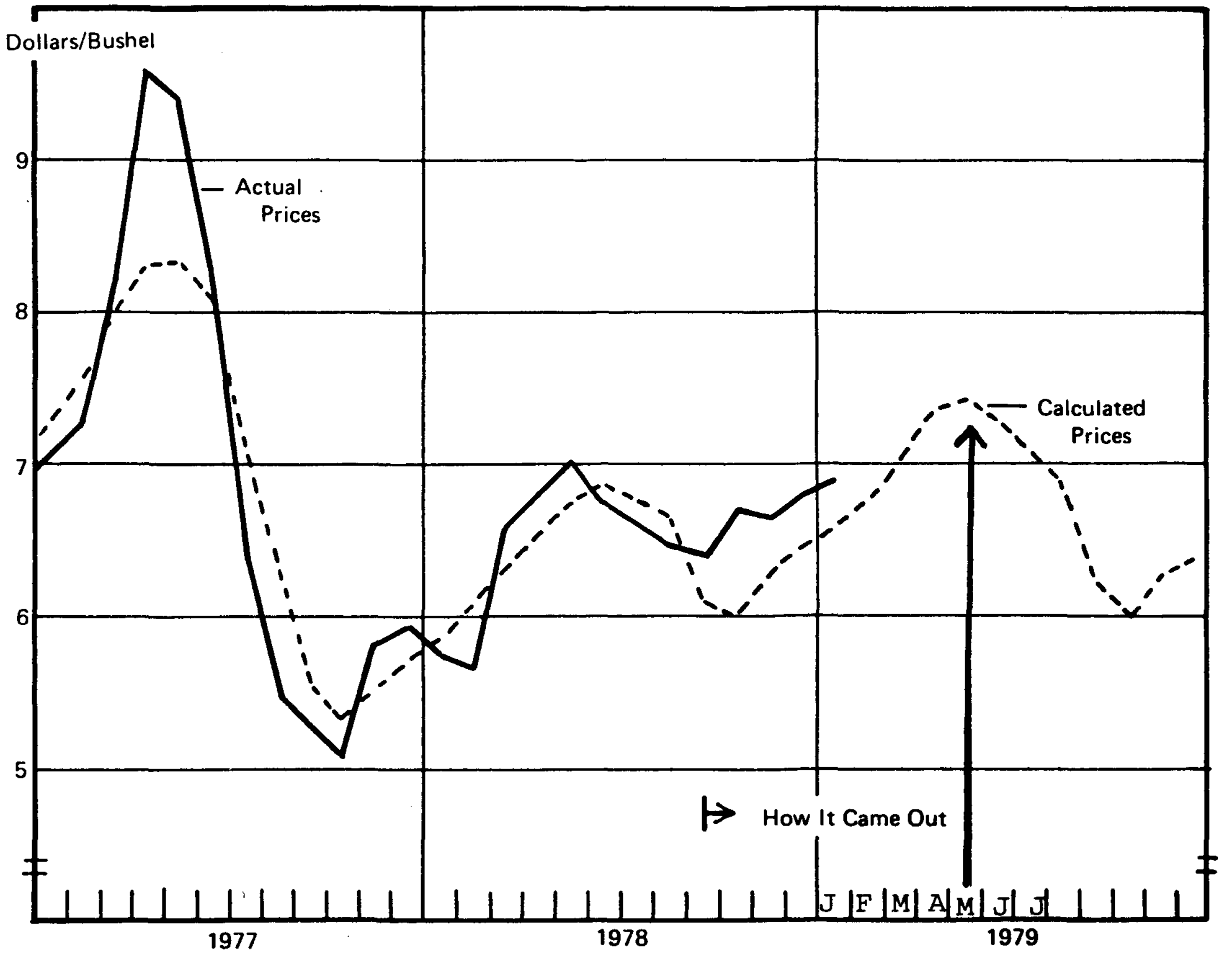
CYCLES includes *specific* timely articles written by such sparkling analysts as Gertrude Shirk. The soybean graph is one example. Notice how closely actual soybean prices have followed the cyclical projections computed by the Foundation. It is also interesting to observe that the Foundation for the Study of Cycles was predicting a downturn in soybean prices toward the end of May, 1979. As you know, this confirmed my own work which projected a soybean peak in the month of *June*. The jury is still out on these projections, as cycles may shrink or expand somewhat. In any case, the rainfall cycle and the soybean graph should stimulate the interest of true students of the market, those who are tuned to their own growth cycle.



The 7-Year Rainfall Cycle in the United States in Relation to Boom and Depression Years

Soybean Prices

The calculated line for soybean prices includes a trend, the the seasonal cycle, the 24.75-month cycle and the 39.29-month cycles. It was first published in Vol. 29, No. 7, 1978.



Actual Calculated Soybean Prices, 1977 through 1979

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