Your Future In Futures!

Dr. Scott Brown

Your Future in Futures!

A Road-map to Creating Your Fortune from Scratch…

Lightning Fast!

By Dr. Scott Brown

IMPORTANT NOTE:

This course should be read after "*Your Future In Forex!*"

This is part two of a two part series.

About the Author: Dr. Scott Brown holds a Ph.D. in finance from the University of South Carolina and an MBA from Thunderbird, The American Graduate School of International Management in Phoenix, Arizona, ranked #1 by the U.S. News and World Report. His doctoral dissertation in futures trading attracted the interest and sponsorship of the Chicago Board of Trade. He is a 15 year veteran of the futures, Forex, and options markets. In addition to leading up the Trade Mentors team Dr. Brown is a professor of finance at the University of Puerto Rico's Graduate School of Business where he teaches doctoral and MBA investments, corporate finance, asset pricing, financial theory, and derivative trading classes. Scott is the author of the highly recognized top selling Trade Mentors core curriculum "*Doc Brown's Futures, Forex, and Options Autopilot*" at **TradeMentors.com** He is also the creator of the best selling, most advanced, stock investing course available to the public, "*Investment U's How To Build Your Million-Dollar Portfolio From Scratch!*" at InvestmentU.com.

Take Notes Here

1. I need to download Track 'n Trade LIVE Futures from http://www.trackntrade.com

2. I should also enroll in http://www.tradementors.com

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Chapter 1: The Best Business on Earth !

Highlights from This Chapter

- Kick your boss to the curb.
- How futures markets work.
- So much profit potential!

Imagine a business with low start up fees, no bosses, and no employees. This business can be operated out of your home office or on a laptop with a satellite uplink from anywhere in the world only a few hours a day 5 days a week. And what if this business had the potential to make you a millionaire or billionaire?

That's what I call a perfect business!

And you only get this combination of ease and opportunity from trading the **futures markets.** Here's the gist of this trillion dollar opportunity.

Ever think about all the stuff you buy every day? Whatever it is from savings rates, plastics or bread somebody has to grow it, pump it, dig it up, or finance it before it becomes a consumer product. All those primary producers have to deal with the risk of price fluctuations, currency exchange rate changes, or interest rate movements before they sell their commodities to manufacturers or lend out their money to corporations.

Think of farmer Joe growing **soybeans** in Kansas — called "*beans*" in trader slang.

He knows that he has a certain cost per bushel to grow the grain he sells. If it costs him $3.00 per bushel he must sell it for at least that much in the market. As I write this in the winter of 2010 beans are selling for $9.61 a bushel.

That means that the farmer has a built in profit of $6.61. In the winter Joe has not yet planted. I guarantee you farmer Joe is scratching his head thinking of some way to lock in potential earnings when he harvests next fall.

Futures markets help Joe lock in his producer profits. Here's how.

He can open a futures trading account at a good brokerage like Gecko Financial Services (http://www.geckofs.com/) and sell his entire harvest in advance. This is done through futures contracts.

All industries sell raw goods in **standardized lots**. In oil it goes by the barrel, in lumber by the foot, and in grains by the bushel. A standardized lot in grains is 5,000 bushels to a futures contract since that's how much will fit into a rail car.

So every time farmer Joe sells a futures contract he's guaranteed to receive $48,050 selling grain that will cost him $15,000 to produce.[1] That's a profit of $33,050 for each contract.

This is called **hedging** since Farmer Joe is "*hedging his business gamble*" of planting soybeans.

There's another side of the coin. The manufacturer who needs to buy soybeans next fall is worried that soybean

[1] $9.61/bushel x 5,000 bushels = $48,050; and $3.00/bushel x 5,000 bushels = $15,000

prices might skyrocket. So he'll buy a futures contract to hedge.

--- Unsolicited TradeMentors.com Testimonial ---

"Hello Dr. Brown, Doug here in Japan. The Telesiminar was great. For me here is why. In the beginning of the course you said that you only wanted us/your students to take about 3 or so trades a year and I didn't really understand. I didn't know what position trading was till you explained it on the call, then you showed us from a chart how to do it and I thought WOW that is pretty simply. Sure, you might have to wait a while but in the long run your patience will, Damn can't think of the word. Anyway, you went on to say that if you are patient and wait you will hit the big one in time. Following your risk management strategy that you explained is

paramount. Of course the Bulls and Bears is just a given at this point for me. Bread and butter baby."

--- Unsolicited TradeMentors.com Testimonial ---

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The Secret to the Best Business in the World

Futures markets are organized on exchanges to help producers and manufacturers hedge. The biggest by far is the **Chicago Mercantile Exchange** merged into the **Chicago Board of Trade** as the **CME Group**. These exchanges have organized delivery months going out in the future.

Futures traders use shorthand for the **delivery month**.

Here it is…

Month	Code	Month	Code
January	F	July	N
February	G	August	Q
March	H	September	U
April	J	October	V
May	K	November	X
June	M	December	Z

And each futures commodity or financial asset has a symbol. The symbol for corn is **C**. You don't have to memorize this just file it in the back of your memory somewhere. What is important to know is that these exchanges are set up to let anybody who wants to

speculate on the future level of raw material prices to get in the middle.

The golden rule is **buy low and sell high**!

If a speculator thinks the bean market is going up she'll buy the contract the farmer is selling. This is called going **long the market**. If another speculator thinks the bean market is going to tank he'll sell the futures contract the manufacturer buys.

This is called going **short the market**.

These markets serve their function because for every futures contract there's a **buyer** and a **seller**. If you make a killing on a futures contract that means somebody on the other side of the trade took a beating.

For every winner there's a mirror image loser where loss exactly offsets gain. For that reason you'll hear futures trading called a **zero sum game**.

Futures Margin Keeps Everybody Playing Straight

So what happens if a buyer or seller in a losing trade decides not to pay up a loss when the delivery month comes due? The futures exchanges makes everybody put down a special deposit called "*futures margin*." This is really a performance bond to keep everybody playing fair.

Remember how I showed you in the example above that the total value of a soybean contract would be $48,050? The futures exchanges require anybody trading beans to put down a $3,712 deposit. And the exchanges change these amounts from time to time to reflect market conditions.

This is called **initial margin**.

Once the trade is placed the market can fluctuate down to where you have $2,750 in your account. This is called **maintenance margin** also called **variation margin**. If your account balance drops below the maintenance margin level you'll get a **margin call**.

You should never get a margin call because you'll be using **stop-loss orders** I'll explain later. Don't answer margin calls by sending money in to keep the position open…**answering margin calls** is a bad idea!

You did something seriously wrong if you get a margin call. Close the position, rethink your trading, and then fund the account again.

Futures exchanges also make everybody sign agreements to be **personally liable for any and all losses**. That's why I

take my job so seriously of teaching you the right way to trade these markets. Do what I tell you to do and you'll have the best shot at owning the best business in the world.

Your Profits and Losses Fluctuate By Point Value

Most people who trade futures started as stock investors. Figuring out your profits over there is easy.

If the stock goes up a dollar you profit a dollar per share!

It's different in the futures markets because pricing is based on **industry standard sales lots**. People get confused with this so let's clear it up right now.

The soybean contract gives you control over the purchase or sale of 5,000 bushels. That means that for every one cent change in the futures price your account will increase or decrease fifty dollars.[2]

We call this **point value**. We say that the soybean market is priced at $50 per point. Every futures market has its own point value depending on what is bought or sold. Point value allows you to calculate your trading profits and audit your **profit and loss statement** you'll receive nightly from your futures brokerage.

Point value is dollars per barrel in crude oil futures, cents per bushel in grain futures, and interest per dollar in bond futures.

[2] 1¢ x 5,000 = $50

Don't worry about memorizing all the point values — just understand the concept. In fact, the only trading platform I personally endorse gives you the margins, delivery months, and point values with a simple click of your computer mouse. I intentionally don't accept sales commissions from this software company so that I can give my unbiased and honest word that this is the best futures trading platform in the world for individuals like us…

http://www.trackntrade.com/

This is how the futures market works in a nutshell. These are the same markets that made burnt out Ohio meat packer **Tom Baldwin** so wealthy he "*collects*" Frank Loyd Wright houses! He was described by the Wall Street Journal as the only futures trader who can singlehandedly move the Treasury bond market.

And he started right where you are today!

Chapter 1 Quiz:

1. If you buy a corn contract for delivery in 2011 with the notation CH11 what is the delivery month?
    a. January
    b. March
    c. May
    d. October

2. If the price for corn increases 4 cents a bushel what is your profit or loss if you are long the market?
    a. $100 gain
    b. $100 loss
    c. $200 gain
    d. $200 loss

3. Maintenance margin is always higher than initial margin.
    a. True
    b. False

Chapter 2: What Markets Should I Trade?

Highlights from This Chapter

- There are only 21 markets that are meaningful to you.
- Determining which groups you can trade.
- You need master only a few markets.

A big advantage of futures trading over stock trading is the fact that you only have to watch a handful of contracts to be successful. There are over 15,000 stocks traded in the U.S. alone. The worldwide futures market is slight in comparison where all futures contracts total just a few hundred.

And of these few hundred futures contracts but 21 are worth your attention. If you're going to become a

successful futures trader you have to first decide which markets are best for your bankroll.

The futures markets fall into two major categories. First there are physical raw materials for production of everything we consume in our modern economy; grains, meats, metals, fuel for energy, and agricultural products called "*softs*" that don't fit the meat or grain category. These are **commodity futures**.

The second group deals with financial assets needed to fuel the engines of growth in our world economy. These **financial futures** include bonds, stock market indices, and currencies.

Here's the handful of markets you can safely trade (Exchange: Symbol) …

The 21 Worthwhile Futures Markets Start With Grains!

The **grains** futures markets put bread on your table, tortillas around your tacos, and vegetarian meats in your diet. Just a handful of contracts here are worth looking at. Soybeans (CME Group: S), wheat (CME Group: W), and corn (CME Group: C) make up the 3 contracts with sufficient liquidity to trade.

The rest, especially oats, are illiquid. Illiquid means that there isn't enough activity among traders to develop a strong market in terms of trading volume and open interest. Open interest is the number of contracts sellers have opened with counterparty buyers. Trading volume is simply the number of futures contracts changing hands every day.

In the **meats** there are only 3 commodity markets worth watching; pork bellies (CME Group: PB), lean hogs (CME Group: LH), and feeder cattle (CME Group: FC). The hog and pork belly markets are where you can place your bets on price changes of pork chops and bacon in your local supermarket. The feeder cattle futures contract is one of the best examples of what economists call a "*perfectly competitive market*" where forces of supply and demand interact in equilibrium to determine price.

The 3 most important metal markets are copper (COMEX: HG), gold (COMEX: GC) and silver (COMEX: SI). These are the only markets you need monitor to know what metal prices are doing. Copper is an industrial metal used in wiring homes and has a vital link to the worldwide housing market. Both precious metals gold and silver used to be

linked to currencies but that ended in 1972. Today speculation is the major force in the precious metals markets making them highly volatile and unpredictable in the short run.

Perishable and semi-perishable food stuffs are called **softs**. There are but 5 markets worth trading in this group with sufficient volume and open interest; orange juice (ICE Futures: OJ), cocoa (ICE Futures: CC), sugar #11 (ICE Futures: SB), coffee (ICE Futures: KC), and cotton #2 (ICE Futures: CT).

There are just 2 **energy** contracts that are worth your while; light crude oil (NYMEX: GCL) and natural gas (NYMEX: NG). All other futures contracts in this commodity group are derivatives of light crude oil or simply to illiquid to trade.

Financial Asset Futures Put the "C" In Capitalism

In the **financials** you need focus on just 2 contracts to see the entire picture; the 30 year U.S. T-bond, in trader slang called the long bond (CME Group: US), and the Eurodollar contract (CME Group: ED). With the long bond you're betting on interest rate changes in the United States. The Eurodollar contract, on the other hand, allows you to speculate on changes in overseas interest rates.

Towards the end of the last century folks figured out that it would be nice to have futures contracts on stock **indices** to help portfolio managers hedge their bets in the stock market. There are just 2 contracts in this market worth watching; the S&P 500 (CME Group: SP), and the NASDAQ (CME Group: ND).

There are only 3 **currency** contracts worth paying attention to; the euro FX (CME Group: EC), Japanese yen (CME Group: JY), and British pound (CME Group: BP). That's because these are the three most heavily traded currencies.

--- Unsolicited TradeMentors.com Testimonial ---

"Just wanted to say thank you for doing the Trade Mentors course. I listened to the open calls. It was kind of intimidating to hear the conversations going on between the experts. It was nice to hear all your thoughts and ideas about everything. I am very new to this and am excited to learn all I can. I feel like I really don't know much, but I am starting to put up on some things like when your analyzing the charts.

Thanks again and I hope I can hear the next open call." Barry D., California

--- Unsolicited TradeMentors.com Testimonial ---

A secret Forex trading advantage to these markets is that currency futures offer option contracts that can help you. Forex is another way to invest that's closely related to futures trading but the contract sizes and margins are different.

In Forex you can speculate on the same price movements on much less margin than in the currency futures. You can also get a guarantee that your Forex account won't go negative.

How to Decide Which Futures Contracts You Can Trade!

Traders generally fail because they start out undercapitalized — they initially fund their account with to little mullah to safely trade.

Let me explain…

There's a hard and fast rule to futures trading. Limit your losses to no more than 45% of the initial margin of any futures contract you trade. After that you must decide to trade a prudent money management rule.

If you risk just 5% of your portfolio you'll give yourself 20 tries to beat the market. Some "*gurus*" say to risk no more than 2% (I don't agree with the 2% rule but you'll see this in places like Jack Schwager's "*Market Wizards*" book).

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With a 2% rule you're giving yourself 50 chances to beat the market. But hey, if you need 50 tries to beat the market, your trading is pretty crappy!

With this information you can determine which markets you can safely trade by figuring in the margin for each of the 21 most viable futures markets. You can also trade **mini-contracts** for a lot less margin than the full sized contract. So in the table below I've added information wherever a mini version of a futures contract is traded.

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How Much Money Do I Need To Trade Futures?					
Market	**Mini Market**	**Initial Margin**	**45% Max Risk**	**Capital Needed (5%)**	**Capital Needed (2%)**
	Mini Corn	$ 297	$ 134	**$ 2,673**	$ 6,683
	Mini Wheat	$ 472	$ 212	**$ 4,248**	$ 10,620
	Mini Soybeans	$ 742	$ 334	**$ 6,678**	$ 16,695
Eurodollar		$ 1,282	$ 577	**$ 11,538**	$ 28,845
Feeder Cattle		$ 1,350	$ 608	**$ 12,150**	$ 30,375
Lean Hogs		$ 1,418	$ 638	**$ 12,762**	$ 31,905
Corn		$ 1,485	$ 668	**$ 13,365**	$ 33,413
Pork Bellies		$ 1,620	$ 729	**$ 14,580**	$ 36,450
Orange Juice		$ 1,680	$ 756	**$ 15,120**	$ 37,800
	Mini Natural Gas	$ 1,688	$ 760	**$ 15,192**	$ 37,980
Cotton		$ 2,100	$ 945	**$ 18,900**	$ 47,250
Wheat		$ 2,362	$ 1,063	**$ 21,258**	$ 53,145
Cocoa		$ 2,520	$ 1,134	**$ 22,680**	$ 56,700
Sugar		$ 2,520	$ 1,134	**$ 22,680**	$ 56,700
	Mini Crude	$ 2,700	$ 1,215	**$ 24,300**	$ 60,750
British Pound		$ 2,700	$ 1,215	**$ 24,300**	$ 60,750
Long Bond		$ 3,240	$ 1,458	**$ 29,160**	$ 72,900
	NASDAQ E-Mini	$ 3,500	$ 1,575	**$ 31,500**	$ 78,750
Coffee		$ 3,640	$ 1,638	**$ 32,760**	$ 81,900
Soybeans		$ 3,712	$ 1,670	**$ 33,408**	$ 83,520
Euro FX		$ 4,050	$ 1,823	**$ 36,450**	$ 91,125
Japanese Yen		$ 4,050	$ 1,823	**$ 36,450**	$ 91,125
Copper		$ 4,725	$ 2,126	**$ 42,525**	$ 106,313
Light Crude		$ 5,400	$ 2,430	**$ 48,600**	$ 121,500
	S&P E-Mini	$ 5,625	$ 2,531	**$ 50,625**	$ 126,563
Natural Gas		$ 6,750	$ 3,038	**$ 60,750**	$ 151,875
NASDAQ		$ 17,500	$ 7,875	**$ 157,500**	$ 393,750
S&P 500		$ 28,125	$ 12,656	**$ 253,125**	$ 632,813

Look at the "*Capital Needed 5%*" column above. You can trade a mini corn contract for as little at $2,673 in your trading account and have 20 tries at beating the market as long as you don't let yourself lose more than $134. But you need a quarter of a million to safely trade the S&P 500 index futures contract.

You can see why successful futures traders master just a few markets at a time… they don't run around trading all the markets willy-nilly. Not only does it take research, Monte Carlo back testing, and patience but also the right amount of trading capital to succeed in this game of chance!

If you follow the table above you'll be ahead of 95% of all people who begin trading futures. And you'll be one of the few starting out with a true advantage from the start!

Chapter 2 Quiz:

1. If you can only afford to fund your account with $6,000 what is the highest initial margin contract you can trade?
    a. Mini corn
    b. S&P 500
    c. Copper
    d. Mini wheat

2. What is the most you could afford to lose on a single trade based on your answer from the last question?

Answers Chapter 1

1. March.
2. C, $200 gain since you make $50 per cent increase in corn if you are long the market.
3. False, maintenance margin is always lower than the initial margin required for initiating a trade. This is intended to give you a little leeway if the market fluctuates slightly against you after you place the trade

Chapter 3: How Much Can You Afford To Trade?

Highlights from This Chapter

- Most beginning traders fail and why you won't.
- Organize your family finances to trade successfully.
- Why you're your own worst enemy and how to get out of the way of yourself.

I was drinking beer one day with a very prominent teacher in the futures industry. We had been talking for a while when an odd look came over his face.

"*You know what pains me the most about my career in futures?*" he asked.

He smirked at the frown on my face and continued, "*I can't tell you how many people have come to me lamenting that they ever started to trade. Some have trading debts in excess of the mortgage they owe on their house!*"

I immediately divulged a trading secret he very excitedly teaches to his students today…

The Worry Free Wealth Ratio

Not only do beginning traders start with too little money in their account but even when they adequately fund their trading it's often too much compared to their worth or how much money the make. I've spent a lot of time and research to come up with a very easy solution to this problem. I call this trading secret the worry free wealth ratio…

Step 1: Don't allow your needs expenses to exceed 50% of your total **after-tax income**. **Needs** expenses are the things you'd have to pay to keep a roof over your head, food and drink in your belly, at the bare comfort level.

Step 2: Set aside 30% of your after-tax income to have **fun** during the year. You can't live an austere monastic lifestyle or you'll go crazy. Celebrate your earnings and have some fun.

Step 3: Always **save** 20% of your after-tax income and use it to (a) pay off your debts (b) build a balanced portfolio in stocks, bonds, and commodities, and (c) use a small portion to fund your futures trading account— adequate **savings** are vital to every traders success.

--- Unsolicited TradeMentors.com Testimonial ---

"Hi Scott Every thing is great here in Missouri right now we are having rain. We did not make as much money in 08 & 09 but we paid off 20,000.00in debt, it is amazing what all you can do with out when you want to get out of debt. After this year I want to invest 1000.00 a month for 1 year to catch up. Have a good weekend and hope to meet you soon in Vegas. I enjoy the calls... Schwartz"

--- Unsolicited TradeMentors.com Testimonial ---

Let me explain imagining that you make $100,000 after-tax as an example.

By following the three steps above you would save $20,000. Of that money you should set aside ¼ to pay off

your (a) credit card debt and (b) mortgage debt on your principal residence — that's $5,000. To simplify I'm assuming you've paid off all your debt.

The 70/30 Rule

Economist Bob Shiller at Yale looked at returns to bondholders, stock holders, and real estate investors since 1873. He found average returns after inflation to real estate investors — in terms of buying and holding — were exactly zero, about 2 ½% for bond investors, and about 7% for stock holders.

For this reason you should put 70% of your money in a balanced "*set it and forget*" portfolio that leans heavily toward stocks.

The best **set-and-forget** stock portfolio out there is **The Gone Fishing Portfolio** by Alex Green. You can learn all about this portfolio by ordering Alex's book on Amazon.com. Seventy percent of the $20,000 you'd save in this example should go into the Gone Fishing Portfolio — that's $14,000 every year if your income remained the same.

I also recommend that you read my Amazon.com bestselling book, **The Worry Free Wealth Guide to Stock Market Investing** to ensure that you have enough of a background to really understand what Alex says.

What about the 30% left over?

The answer depends on your investing ability. If you're new to investing you should put 100% of your savings into

the Gone Fishing Portfolio just to get used to the idea of managing your own money.

Set up a Roth or Standard IRA and deposit your savings. If you save more than the maximum contribution put the rest in an individual investing account. For online stock investing I really like TDAmeritrade.com.

Use a demo account to practice trading futures with the Track n' Trade Live platform. Don't start trading futures with cash until you're very competent after **Monte Carlo** trading and have shown a consistent profit for at least 6 to 12 months.

Worry Free Wealth Ratio					
Income Allocation				Savings Allocation	
Net Income	**50% Needs**	**30% Fun**	**20% Savings**	**70% Gone Fishin' Portfolio**	**30% Futures***
$ 20,000	$ 10,000	$ 6,000	$ 4,000	$ 2,800	**$ 1,200**
$ 30,000	$ 15,000	$ 9,000	$ 6,000	$ 4,200	**$ 1,800**
$ 40,000	$ 20,000	$ 12,000	$ 8,000	$ 5,600	**$ 2,400**
$ 50,000	$ 25,000	$ 15,000	$ 10,000	$ 7,000	**$ 3,000**
$ 60,000	$ 30,000	$ 18,000	$ 12,000	$ 8,400	**$ 3,600**
$ 70,000	$ 35,000	$ 21,000	$ 14,000	$ 9,800	**$ 4,200**
$ 80,000	$ 40,000	$ 24,000	$ 16,000	$ 11,200	**$ 4,800**
$ 90,000	$ 45,000	$ 27,000	$ 18,000	$ 12,600	**$ 5,400**
$ 100,000	$ 50,000	$ 30,000	$ 20,000	$ 14,000	**$ 6,000**
$ 110,000	$ 55,000	$ 33,000	$ 22,000	$ 15,400	**$ 6,600**
$ 120,000	$ 60,000	$ 36,000	$ 24,000	$ 16,800	**$ 7,200**
$ 130,000	$ 65,000	$ 39,000	$ 26,000	$ 18,200	**$ 7,800**
$ 140,000	$ 70,000	$ 42,000	$ 28,000	$ 19,600	**$ 8,400**
$ 150,000	$ 75,000	$ 45,000	$ 30,000	$ 21,000	**$ 9,000**
$ 160,000	$ 80,000	$ 48,000	$ 32,000	$ 22,400	**$ 9,600**
$ 170,000	$ 85,000	$ 51,000	$ 34,000	$ 23,800	**$ 10,200**
$ 180,000	$ 90,000	$ 54,000	$ 36,000	$ 25,200	**$ 10,800**
$ 190,000	$ 95,000	$ 57,000	$ 38,000	$ 26,600	**$ 11,400**
$ 200,000	$ 100,000	$ 60,000	$ 40,000	$ 28,000	**$ 12,000**
$ 210,000	$ 105,000	$ 63,000	$ 42,000	$ 29,400	**$ 12,600**
$ 220,000	$ 110,000	$ 66,000	$ 44,000	$ 30,800	**$ 13,200**
$ 230,000	$ 115,000	$ 69,000	$ 46,000	$ 32,200	**$ 13,800**
$ 240,000	$ 120,000	$ 72,000	$ 48,000	$ 33,600	**$ 14,400**
$ 250,000	$ 125,000	$ 75,000	$ 50,000	$ 35,000	**$ 15,000**
$ 260,000	$ 130,000	$ 78,000	$ 52,000	$ 36,400	**$ 15,600**
$ 270,000	$ 135,000	$ 81,000	$ 54,000	$ 37,800	**$ 16,200**
$ 280,000	$ 140,000	$ 84,000	$ 56,000	$ 39,200	**$ 16,800**
$ 290,000	$ 145,000	$ 87,000	$ 58,000	$ 40,600	**$ 17,400**
$ 300,000	$ 150,000	$ 90,000	$ 60,000	$ 42,000	**$ 18,000**
$ 310,000	$ 155,000	$ 93,000	$ 62,000	$ 43,400	**$ 18,600**
$ 320,000	$ 160,000	$ 96,000	$ 64,000	$ 44,800	**$ 19,200**
$ 330,000	$ 165,000	$ 99,000	$ 66,000	$ 46,200	**$ 19,800**
$ 340,000	$ 170,000	$ 102,000	$ 68,000	$ 47,600	**$ 20,400**
$ 350,000	$ 175,000	$ 105,000	$ 70,000	$ 49,000	**$ 21,000**

*** 30% maximum in futures once you are well trained. In your first year of training as a futures trader it would be wise for you to put 100% of your savings into the Gone Fishin' Portfolio (if you are debt free).**

Never Re-Fund Your Futures Trading Account More Than 2 Years In A Row

Once you know you're a competent future trader you can use 30% of your **savings** no more than 3 years in a row to fund your trading account. If you're making a hundred grand net and saving $20k this works out to $6,000. But here's the catch…

If you blow out year after year for 3 years stop!

If this happens there's something seriously wrong with your trading. So take the opportunity in those first few years to let my course (over at TradeMentors.com) sink in. Also make sure you voraciously study the books that I recommend.

The ideal beginning trader is a person with no debt, a sound understanding of the futures markets, well calibrated in terms of not being over- or under-confident, a net worth in excess of $500,000, income greater than $100,000, younger than 50, and saves at least 20% every year ($20,000). You may not fit all of these criteria but hopefully match up with most so you can eventually catch up with the rest — except for your age.

Finally we have studies in academic finance that show that futures traders generally regard themselves as above average. This comes from our very dangerous human tendency to overestimate our individual achievements and abilities in relation to others.

How Can All Investors Be Above Average?

If you listened to Garrison Keillor's National Public radio show A "*Prairie Home Companion*," you'll remember Lake Wobegon, where "*all the women are strong, all the men are good looking, and all the children are above average*." The **Lake Wobegon** effect where all, or nearly all of a group claim to be above average, has been observed among drivers, futures traders, Forex traders, stock day traders, stock investors, option traders, CEOs, stock market analysts, college students, parents, and even state education officials.

If you come into these markets thinking that you're automatically a better trader than everybody else you will be your own worst enemy. You won't study the markets diligently, or enough, to have an edge when you decide to put your money on the line. You'll trade too frequently instead of waiting for "*prime*" opportunities that come

along infrequently even for the best position trader. Or you won't spend enough time carefully Monte Carlo testing your autopilot settings as a mechanical trader.

The 9 Golden Rules Of Trading

In closing here's the set of rules I follow to guide my own personal trading (yes I do trade!)…

Rule 1: Trade Only To Make Lots Of Money Fast…Never For Excitement!

Rule 2: Study The Diverse Fundamental Factors That Influence Each Market You Trade.

Rule 3: Make An Intense Study Of Technical Analysis.

Rule 4: Develop and PRACTICE Patience, Objectivity, Courage, and Determination.

Rule 5: Identify And Focus On The Major And Minor Price Trends Of Each Market And Trade Only For The Major Moves!

Rule 6: When You Initiate A Position Stay On-board For A Major Move And Trade It Accordingly… Do Not

Initiate Or Close Trades Due To Boredom Or Impatience.

Rule 7: If You're Wrong Get Out Quickly, Shooting For A Draw Or Small Profit… Regroup To Try Again… Never Lose More Than 45% Of Initial Margin!

Rule 8: Do Not Trade If You Lose More Than 50% Of The Time…Trade Less, Be More Patient, Be More Discriminating, And Zero In On High Win Probability Trades.

Rule 9: Keep Things Simple; From Your Market Research Through Your Timing And Price Objective Studies.

Higher Accuracy Reduces Capital Requirements

My favorite futures trader is Stanley Kroll. He's my favorite not just because he was an incredible trader but also because he was a kind person. Plus he published books

methodically detailing step-by-step how to he became wealthy as a futures trader.

Stanley was so skilled at market entry that he could get a successful entry in as little as 2 tries. Mathematically that's a 50% money management rule.

This means that if you master profitable entry and exit strategies you can trade on a lot less capital. Let's say you reached the point to where you can get a successful entry in as little as 4 tries and learn to absolutely control your losses to no more than 45% of initial margin — you could use a 25% money management rule.

If you were truly accurate to two tries you could use a 50% money management rule.

Look at what a 25% or 50% money management rule does to reduce your trading capital requirements…

Higher Accuracy Reduces Capital Requirements					
Market	**Mini Market**	**Initial Margin**	**45% Max Risk**	**Capital Needed (25%)**	**Capital Needed (50%)**
	Mini Corn	$ 297	$ 134	**$ 535**	$ 267
	Mini Wheat	$ 472	$ 212	**$ 850**	$ 425
	Mini Soybeans	$ 742	$ 334	**$ 1,336**	$ 668
Eurodollar		$ 1,282	$ 577	**$ 2,308**	$ 1,154
Feeder Cattle		$ 1,350	$ 608	**$ 2,430**	$ 1,215
Lean Hogs		$ 1,418	$ 638	**$ 2,552**	$ 1,276
Corn		$ 1,485	$ 668	**$ 2,673**	$ 1,337
Pork Bellies		$ 1,620	$ 729	**$ 2,916**	$ 1,458
Orange Juice		$ 1,680	$ 756	**$ 3,024**	$ 1,512
	Mini Natural Gas	$ 1,688	$ 760	**$ 3,038**	$ 1,519
Cotton		$ 2,100	$ 945	**$ 3,780**	$ 1,890
Wheat		$ 2,362	$ 1,063	**$ 4,252**	$ 2,126
Cocoa		$ 2,520	$ 1,134	**$ 4,536**	$ 2,268
Sugar		$ 2,520	$ 1,134	**$ 4,536**	$ 2,268
	Mini Crude	$ 2,700	$ 1,215	**$ 4,860**	$ 2,430
British Pound		$ 2,700	$ 1,215	**$ 4,860**	$ 2,430
Long Bond		$ 3,240	$ 1,458	**$ 5,832**	$ 2,916
	NASDAQ E-Mini	$ 3,500	$ 1,575	**$ 6,300**	$ 3,150
Coffee		$ 3,640	$ 1,638	**$ 6,552**	$ 3,276
Soybeans		$ 3,712	$ 1,670	**$ 6,682**	$ 3,341
Euro FX		$ 4,050	$ 1,823	**$ 7,290**	$ 3,645
Japanese Yen		$ 4,050	$ 1,823	**$ 7,290**	$ 3,645
Copper		$ 4,725	$ 2,126	**$ 8,505**	$ 4,253
Light Crude		$ 5,400	$ 2,430	**$ 9,720**	$ 4,860
	S&P E-Mini	$ 5,625	$ 2,531	**$ 10,125**	$ 5,063
Natural Gas		$ 6,750	$ 3,038	**$ 12,150**	$ 6,075
NASDAQ		$ 17,500	$ 7,875	**$ 31,500**	$ 15,750
S&P 500		$ 28,125	$ 12,656	**$ 50,625**	$ 25,313

Go back and compare with the table in chapter 2. You can see just how much your accuracy reduces your capital requirement.

Don't Kid Yourself!

Make sure that you're really as good as you think you are. This means that you should start off with a lot of simulated trading (called Monte Carlo testing in economics) on the Track n' Trade Live Futures platform. Then start off with a 5% money management rule to give yourself 20 "*rolls of the dice*" to learn the game.

You're probably wondering how to get such a high accuracy rate. You do so through sound forecasting of the markets. In the next two chapters I'll show you how to

forecast the markets with both fundamental and technical analysis.

Chapter 3 Quiz:

1. If you increase your income from $100k to $150k how much more money can you afford to fund your trading account with?
    a. $1,000
    b. $2,345
    c. $3,000
    d. $4,475

2. If you increase your accuracy to be able to use a 25% money management rule what is the contract with the highest initial margin you can trade based on the last answer?

3. What is the most you could afford to lose on a single trade based on your answer from the last question?

Answers Chapter 2

1. D, mini wheat. The amount needed based on a 5% money management rule to trade this contract is $4,248. The next contract in terms of size of initial margin is mini-soybeans but it requires $6,678 to trade — $678 more than you actually have in trading capital.
2. $212. You must limit your losses to 45% of initial margin. In the case of mini wheat this is $212.

Chapter 4: Forecasting the Markets with Fundamental Analysis!

Highlights from This Chapter

- Supply and demand influences prices.
- Weekly and monthly charts are vital to your trading.
- Fundamental analysis isn't enough to trade profitably.

I became a futures trader because it was a natural extension of my produce business. I finished my MBA in international management at the best school in the country in 1989 and moved to Puerto Rico.

I set up shop as a receiving produce distributor here on the island and was very successful in the business. I purchased so many container loads of iceberg lettuce and other

commodities that I soon noticed that I could influence the local price as I desired.

A good friend of mine in the industry was Marc Nail. Marc was an engineer who worked for Dole in their lettuce division. One day over lunch I was complaining about the falling price of lettuce.

Lettuce normally traded wholesale between $10 and $18 a box.

I made the comment that "*lettuce could not fall below $8 a box*." He replied not only that it could drop that low but might "*fall to $2.25 … but no further*."

I laughed since I thought he was joking about an exact lower limit for lettuce prices. When I noticed he wasn't laughing I retorted "*Prove it!*"

Why "*You Can't Lose Trading Commodities!*"

Marc went to the trouble to gather and send me the price data from the California Lettuce Grower's Association (of which he was a member). When I plotted the prices during the 1970s and 1980s my jaw dropped.

There was a near perfect line at $2.25 per box of lettuce!

He explained that the reason for this is that when prices fall to $2.25 farmers plow their crops under since they can't afford to pick their lettuce. This planted a seed in my mind that the same thing might occur in commodity futures;

that there is a lower price limit below which commodity producers will stop producing.

--- Unsolicited TradeMentors.com Testimonial ---

"I read Stanly Knolls book this week and found it very interesting. Thank you for recommending it. The great value was in his epilogue which brings it down to my Penny Anny Piker level. I pretty much trade the way he suggests now, but just intuitively, following his input I will structure it in a more formalized manner. This coupled with your recommendation of trading only a handful of commodities, and looking for extreme tops and bottoms is working very well for me."

Rick Weiss, California

--- Unsolicited TradeMentors.com Testimonial ---

When I began trading commodities in the early nineties I found that the only way I could see this relationship was looking back for many years. But I noticed that the brokerage houses tended to give charts to clients going back a month or two.

In fact they considered a year back to be a long time!

I discovered that charts existed looking back over many years by representing a price bar as a single week or single month. Futures traders call these weekly and monthly charts. This is where I quickly learned to start all of my analysis of the futures markets regardless of whether the contract is for a commodity or a financial asset.

Here's a **weekly chart** of corn where each price bar is a single week of price movement. The top of the bar is the highest price while the bottom is the lowest price for the week, the dash to the left is the open on Monday, and the dash to the right is the close on Friday…

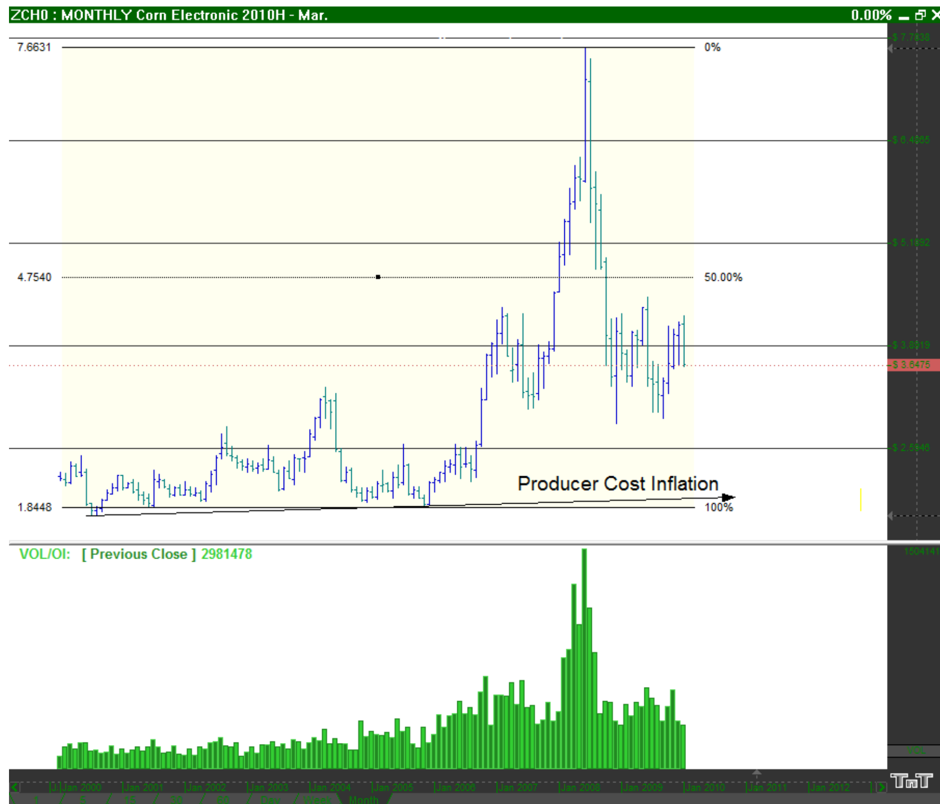
You can see in the chart above that in the last 5 years the corn market has fluctuated between a high of $7.66 and a low of $1.84 a bushel. Another important **fundamental**

level is $4.76 a bushel at the **midpoint** between the **extreme high** and **extreme low** price levels. The price path the market takes between these extremes is the **major trend**.

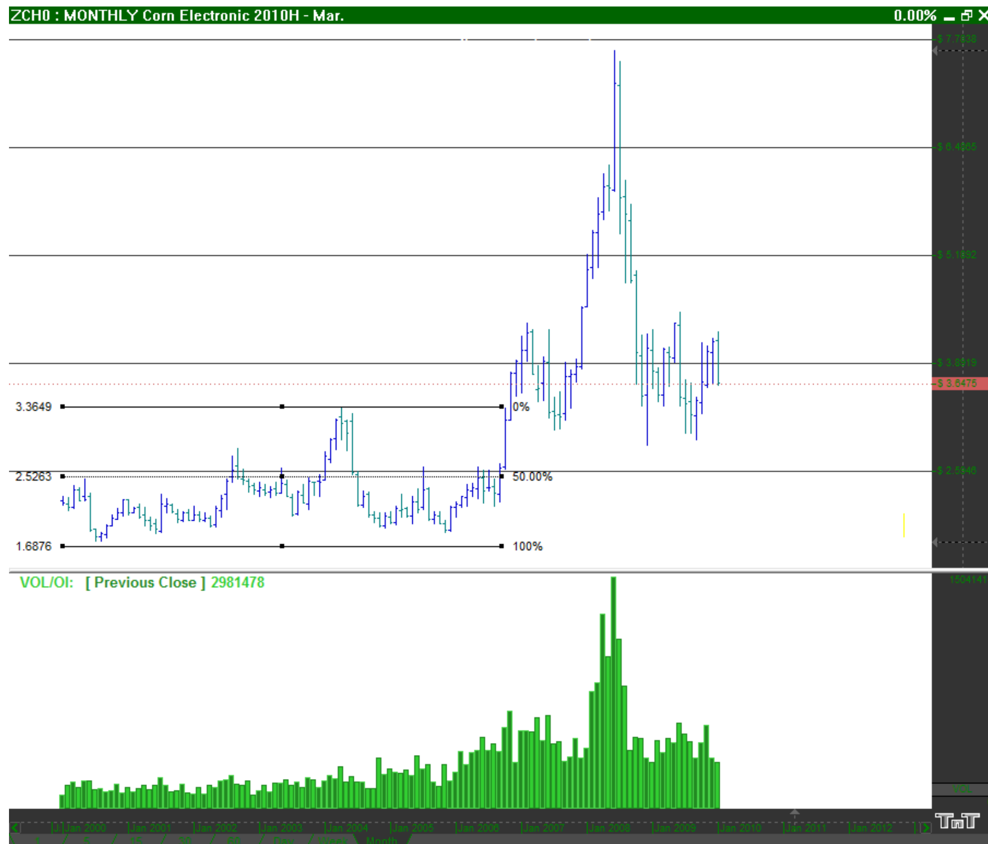
Now look at a **monthly chart** for corn.

Notice how ten years ago the market hit a price low of $1.75 which is just a bit lower than $1.84. Isn't it amazing how the line is almost exactly flat across the extreme lows on a monthly chart?!

It tilts up a little due to inflation but WOW…it's almost an exact flat line.



Also, notice how the market tends to fluctuate unpredictably around the **50% level**.



Here's what's going on. Markets are driven by supply and demand. When there's an over supply the markets are driven too low. This happens because producers never team up together to decide who's going to produce and when (except for the **Organization of Petroleum**

Exporting Countries (OPEC) where the nations of Iran, Iraq, Kuwait, and Venezuela formed a cartel in crude oil).

The Secret

As commodity prices skyrocket upward raw material producers gradually over-mine, pump, fell, finance, or grow whatever it is they peddle to manufacturers. The rapid jump in prices attracts more and more speculators who dog-pile into the market buying futures contracts driving prices even higher. Yet while prices climb demand for the commodity drops as consumers shift to substitutes or simply reduce consumption.

This eventually drives prices back down to producer cost.

Once the futures price falls back to extreme lows the market usually languishes for months or years driving many commodity producers out of business. Or they switch into the production of a more profitable commodity.

This dries up supply.

As supply drops below the threshold needed to service demand the commodity price rebounds upward anew. This is why futures prices oscillate between extremes around the **50% equilibrium** level as this cycle repeats itself over and over from the interaction between supply and demand. This makes for a very dynamic situation where prices frequently rise upward more than people expect and remain low for a very long time grinding futures traders out.

Stanley Kroll surmised, as did I, the great value of first paying close attention to weekly and monthly charts where the major trend is clearly evident. For it is only on these graphs that you can see the effect of **underlying fundamental relationships**. Kroll would sell when the market broke the major trend after a long extended rise, or buy after a long extended drop, which I will explain in the next chapter.

When you buy a contract you make money as the market rises by selling for a higher price than your cost. Conversely you make money selling when the market drops since you can buy back later at a lower price than you sold.

Hence Kroll, when he was alive, bought when the market hit extreme lows and gave signs it was rising again off the bottom! He absolutely avoided initiating positions in the mid-range where the direction of the major trend is least clear.

He also found that shorting was best off of extreme highs.

I myself came to the same conclusion that this is the best way to position trade based on my experience in produce. Over time I've spotted many high probability opportunities others simply couldn't see because they spend too much time being swayed by the market opinions of family members, friends, colleagues, and the media.

This is why the only way you'll become a successful trader is to learn to think for yourself and ignore anybody else's opinion!

Chapter 4 Quiz:

1. The major trend is best seen on a __________ chart?
    a. Daily chart
    b. Weekly chart
    c. Monthly chart
    d. None of the above

2. The most powerful technical indicator by far is the

   ____________.

3. The highest probability trades are found at…
    a. Extreme highs and lows.
    b. The 50% equilibrium level.
    c. A and B above.
    d. None above.

Answers Chapter 3

1. C, \$150,000 X 20% X 30% - \$100,000 X 20% X 30% = \$3,000.
2. Copper. You would be able to commit \$9,000 of your savings and \$8,505 is the initial margin on copper.
3. \$2,126 represents 45% of the \$4,725 initial margin of a copper futures contract. That is you maximum allowable loss per contract.

Chapter 5: Beating the Markets with Technical Analysis!

Highlights from This Chapter

- The only thing that matters is price.
- Price charts are treasure maps to your trading.
- The Bulls n' Bears trend following system is a simple yet powerful fortune building tool.

You know from the last chapter how important supply and demand is to futures prices. This economic theory is as old as the hills, makes sense, and is an orderly way of looking at the markets.

The problem is that our universe is a balance of order and chaos, yin and yang, light and dark, dry and wet, male and female, and so on infinitum.

Top traders have found it impossible to precisely time turning points in the market using fundamental analysis alone. You can measure producer inventory (supply) and manufacturer orders (demand) but nobody knows if there'll be too much rain on the plains or frost in Florida.

Fundamental analysis sets the stage for a big turn in the major trend like pressure building in a volcano. And technical analysis lets you see recurring price patterns that give you clues near the actual point in time the major trend changes.

This is the power and importance of technical analysis.

--- Unsolicited TradeMentors.com Testimonial ---

"It's been a while since I've pestered you, so I figure now is a good time. I wanted to tell you that I'm really impressed by what I've seen of your TradeMentors.com Futures and Forex Course. Yes, this course shows an advantage of the internet in this kind of teaching. Everything is posted for me to download or visit. Very sweet. Thanks again for everything,"

Bruce Hull, New York

--- Unsolicited TradeMentors.com Testimonial ---

Let me give you a secret nobody else will tell you. Most traders blindly follow technical analysis because it's easy; they like it because it seems like they don't have to think much. Most traders aren't very good at trading and technical analysis makes them sound smartly expert at cocktail parties.

They end up like mindless cows grazing a pasture trusting their technical signals without knowing the big picture and never see the butcher's sledge hammer coming.

They follow the Fibonacci sequence and ratios, the Golden Section, Gann angles, and Elliot Wave Theory, and an endless number of patterns and technical indicators without remembering that (1) the market has a fair amount of chaos built into it and (2) technical tools are merely clues that must be assembled along with fundamentals into a solution just as Sherlock Holmes solved crimes.

Most importantly they get all excited when they see a "*divergence in their stochastics*" not realizing that a **simple trend-following method** is best.

A Simple Trend Following Method

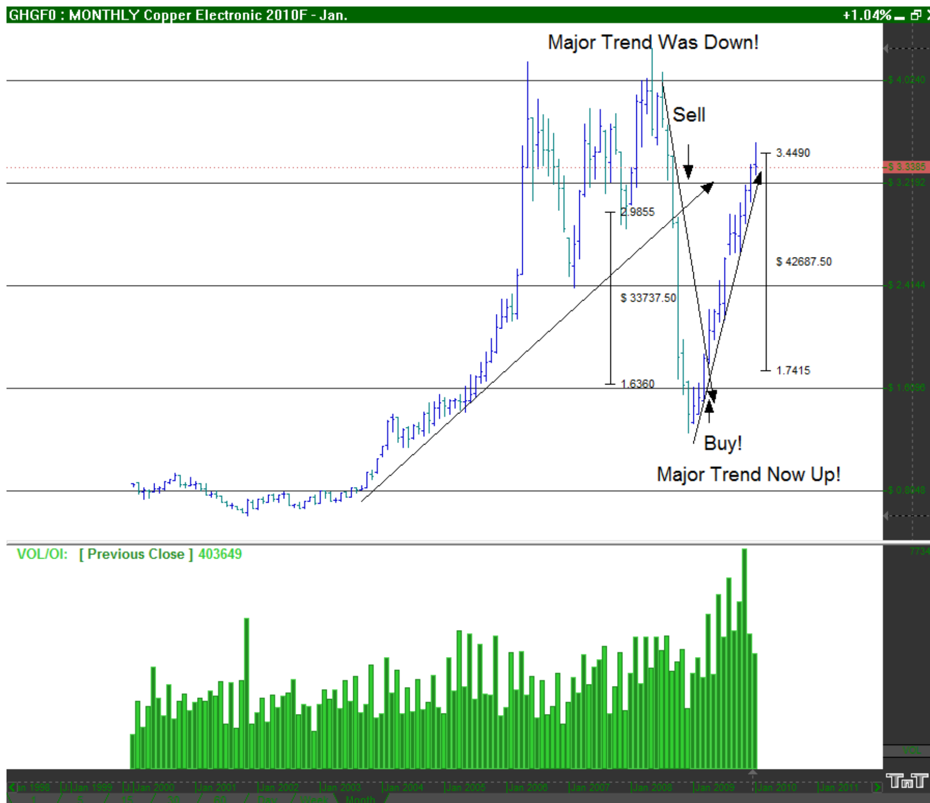
The most powerful indicator is the simplest, the most often overlooked, often forgotten, and it's a **simple trend-line**. There are only two trend lines you need — the major and the minor.

The only way to clearly see the **major-trend** is on a price chart looking back at least 3 years. Always remember that this shows you the tug-of-war between supply, as sellers sell, and demand, as buyers buy.

You can see in the weekly chart of copper above that supply was beating demand in the tug-of-war from July through December of 2008. Since then demand has been beating supply. If you'd have bought 1 contract in December when the major trend was broken upward you'd have a profit of $42,725.

Not bad for an investment of $4,725 in initial margin!

Also notice how dramatic the view of the major trend is on a monthly chart…



The market is now rising into its former highs. Traders not already long the market should be looking for an opportunity to short. Remember that shorting the market makes you money when the major trend shifts downward.

Finally notice that choppy area at the top of the copper market in 2006 and 2007. That's called a "*sideways market*." These are tricky areas when prices channel horizontally. In this case you'll notice that the major uptrend from 2004 through 2008 wasn't broken until July of 2008.

And that created an opportunity for a short trade prior to the one I explained above that was highly profitable.

The signal to sell short was very clear in July of 2008. It would have made you a fast profit of $33,737.50 in 5 quick

months. That's a return of 614% on initial margin of $4,725.[3]

Which is an annualized return of 11,091%![4]

I know this is jaw dropping but if you stop and think about it you should see that this makes sense. The price of copper rose 70.75% over those 5 months.

Since you're controlling $86,225 of copper today with an investment of $4,725 your financial leverage is 18:1. Hence for every 10% increase in the price of copper you get a return of 180%!

The high leverage in futures is what makes some disciplined traders rich very quickly!

---

[3] The Return Factor is $33,737.50/$4,725 = 7.14 meaning a raw return of 614%.

[4] Percent Annualized Return = 100 x ([(Return Factor)$^{12/N}$]-1) = 100 x ([(7.14)$^{12/5}$]-1) =11,191.18%

The Minor Trend

You also need to analyze the **minor-trend** which can best be seen on a daily chart. The minor-trend is the trend over the last few weeks.

Reactions are when the minor-trend runs counter to the major trend. These can be excellent points to buy into the market or add more positions to an already profitable trade.

Just make sure that you don't add more contracts than your initial amount. In other words scale down in adding to the size of your position in the market (not up) so that you don't dangerously increase your leverage. For instance if you'd jumped on board this stellar move in Copper back in December of 2008 with 5 contracts you

shouldn't add more than 1 or 2 contracts to the positions on a reaction to the major trend.

Your successful position would grow to 6 or 7 contracts. This **inverted pyramid strategy** doesn't so greatly endanger your prior profits should the market reverse than if you simply doubled your position on early reactions.

If you started with 1 contract DO NOT add more on reactions.

Notice how I pointed out that the copper market has recently moved into its extreme high range. Because of this you would ignore the buy signals on the daily chart above.

Your Second Most Powerful Technical Tool Is the Oscillator

Behind the all powerful trend as a technical indicator lies the **oscillator**. Notice in the chart above how the minor trend is snaking around the major trend.

Very smart traders in the early part of the last century noticed that a **moving average crossover** is a good map to time entry and exits points as the minor trend snakes in and out of synchronization with the major trend.

In 1980 New York analyst Gerald Appel noticed that the convergence or divergence of two moving averages of different time lengths was even more powerful. This became known as the **moving average convergence divergence indicator**.

In futures trader jargon its called the **MACD**.

The MACD still throws you a lot of false signals. So in 2002 Lan Turner released the **Bulls n' Bears indicator**.

We call it the **BnB** and it nails tops and bottoms not only on the minor but also on the major trend!

My Ninja Assassin Super-Trader Secret!

The perfect indicator would give you a sell signal just before the major trend turns down on a weekly or monthly

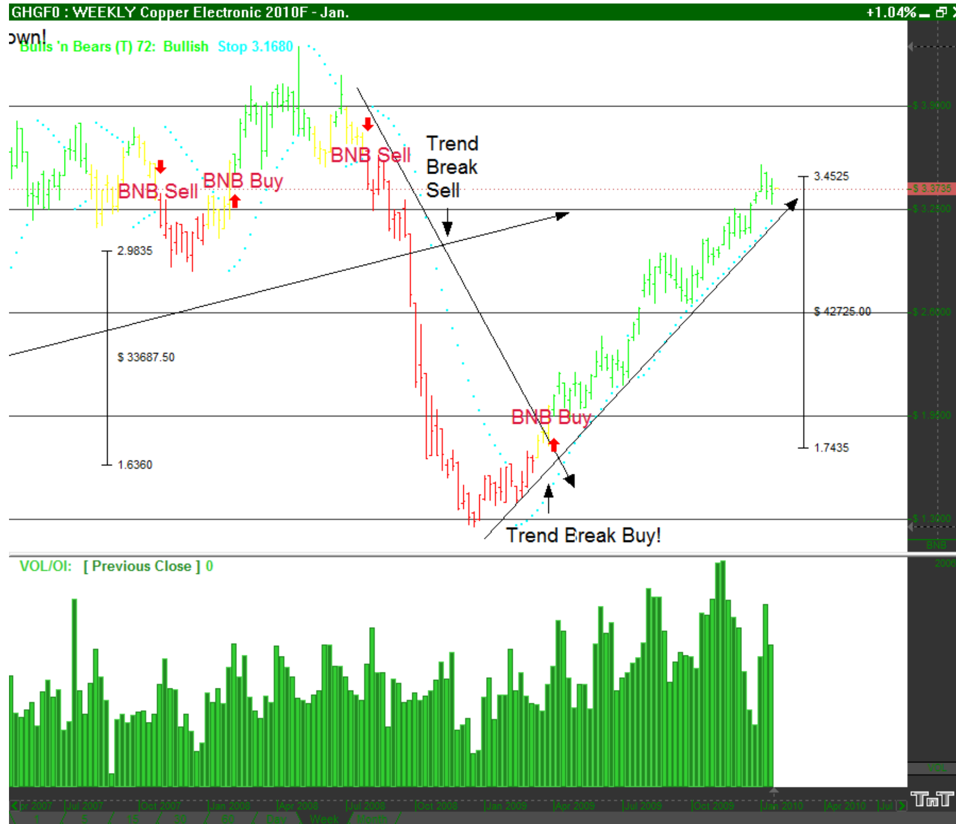
chart and a buy signal just before it turns up. My colleague Lan Turner is the best technical analyst in the markets today.

He has produced so many leading innovations in technical analysis that competitor trading platforms have stolen his indicators in the past. One day he invented the best indicator any of us veteran traders had ever seen.

When he asked me what he should do I told him to keep the inner workings of the indicator a secret to avoid the problem of corporate espionage since Lan can't successfully patent a technical indicator.

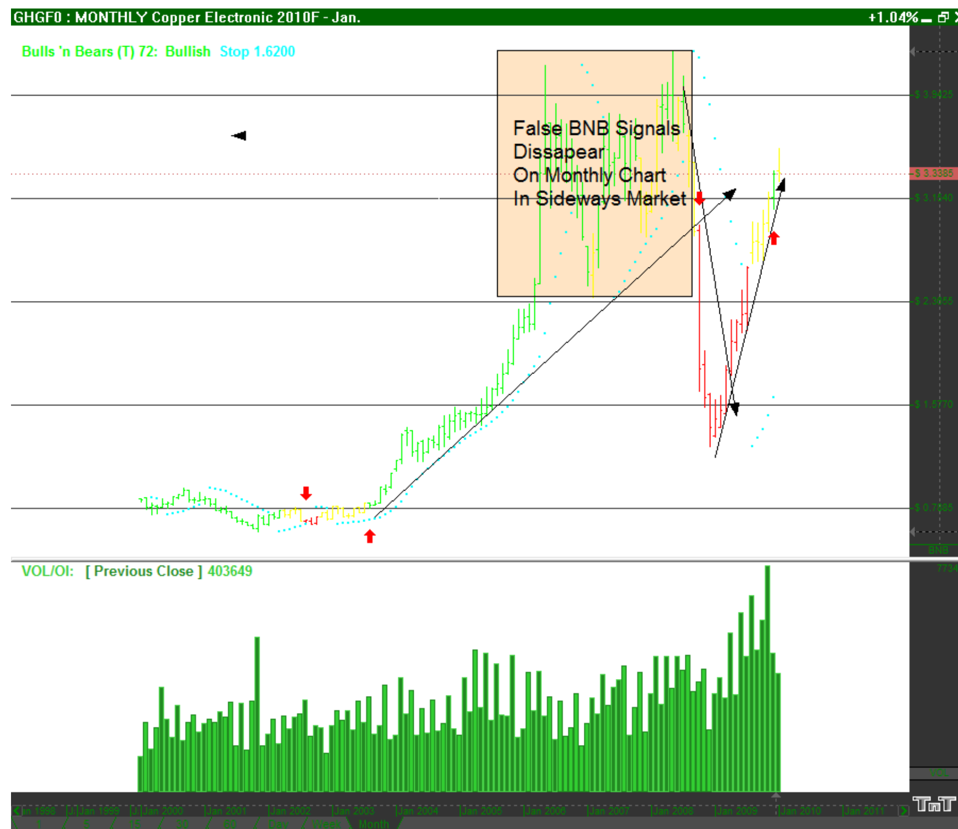
Lan named his incredible innovation proprietary to **Gecko Software** the **Bulls n' Bears technical indicator**. This is the best confirmation of your major and minor-trend

analysis as you can clearly see in the chart of copper below…



Notice how the BnB indicator gave you a sell signal back in August of 2008 a full 3 months BEFORE the major uptrend from 2003 was broken!

Notice those 2 false signals when the market was moving sideways? They are eliminated by looking at a monthly chart…



Lies, Damn Lies, and Statistics

Learn to ignore the popular press. When markets are at rock-bottom the media ignores them. Forget about trying to find support from the lemming pack for your buying campaign. Learn to think for yourself as a futures trader.

When markets get too high they magically garner the attention of journalists. And that's exactly when you should not buy into them. Banish any thoughts from your mind of getting confirmation from anybody for your shorting campaigns.

Again, think for yourself if you want to become a successful futures trader!

From: **The Economist** January 16th 2010

"*By the end of last year metals prices had more than doubled from the depths they plumbed in December 2008. Demand was fueled by emerging economies, many of which saw rapid economic growth last year even as the rich world spent much of the year mired in recession. Copper prices rose by more than 150% between December 30th 2008 and January 12th this year*."

I know the financial writing process well since I'm a contributor to a number of national and global investment publications. With that knowledge in mind I know the gist of the initial conversation between the journalist, who wrote this piece, and his editor…

Journalist: "*Hey boss copper's up almost double*."

Editor: "*Come up with a story that sounds good to the public since the economy stinks*."

Journalist: "*The public is really interested in emerging markets for some unknown reason*."

Editor: "*Go with emerging market growth*."

Journalist: "*Yes, boss!*"

The fact is the only thing anybody really knows for sure is that the major trend on the weekly and monthly copper chart has been up since December 2008. That's all you know with regard to fundamental analysis and don't let friends, family, colleagues, gurus, or the popular press lead you to believe otherwise!

In Conclusion

This by no means completes your training in technical analysis. There are still lots of concepts ahead for you to learn from trader commitments to the Fibonacci sequence.

Yet the simple Track n' Trade Bulls n' Bears trend-following trading system you just learned will beat 99% of all trading systems out there.

Over at TradeMentors.com I have created an MBA level trading curriculum that includes technical analysis for a very modest monthly tuition. Go there now if you want to really develop yourself as a professional trader and very possibly kick your day job to the curb!

Chapter 5 Quiz:

1. The best trading system is…
    a. A multi-variate stochastic ARCH model.
    b. The MACD.
    c. A simple trend following system.
    d. None of the above

2. The best way to scale up the size of your position is through a...
    a. Pyramid.
    b. Inverted Pyramid.
    c. All of the above.
    d. None of the above

3. News sources like CNBC, The Economist, and The Wall Street Journal are excellent sources of information for forecasting the futures markets.
    a. T.
    b. F.

Answers Chapter 4

1. B & C, Weekly and monthly chart.
2. Simple trend line.
3. F, extreme highs and lows.

Chapter 6: The Monte-Carlo Simulation Edge!

Highlights from This Chapter

- A brief history of Monte-Carlo Simulation.
- Las Vegas casino math helps futures traders.
- Account volatility, expected return, and confidence.

Think you've found a sure fire trading strategy? In the past you never really knew for sure if your ideas worked in actual trading.

That's because drawing a few trend lines on paper doesn't really tell you anything about the real costs of actual trading.

Leading economists have recently used the power of super computers to perform "*what if*" research in fully simulated environments — think "*Star Trek Holodeck*."

This methodology is called "*Monte Carlo Simulation*." And Lan Turner's Gecko software company is the first to make this cutting edge technology available to retail traders.

Now even as a "*little guy*" you can know for sure if you can take on the big commercial interests in the futures markets.

Put everything you learn about futures trading to the test with the all-new TNT Autopilot Plug-In for Track 'n Trade LIVE, using Artificial Intelligence! And do it in an environment that so exactly mimics actual trading that

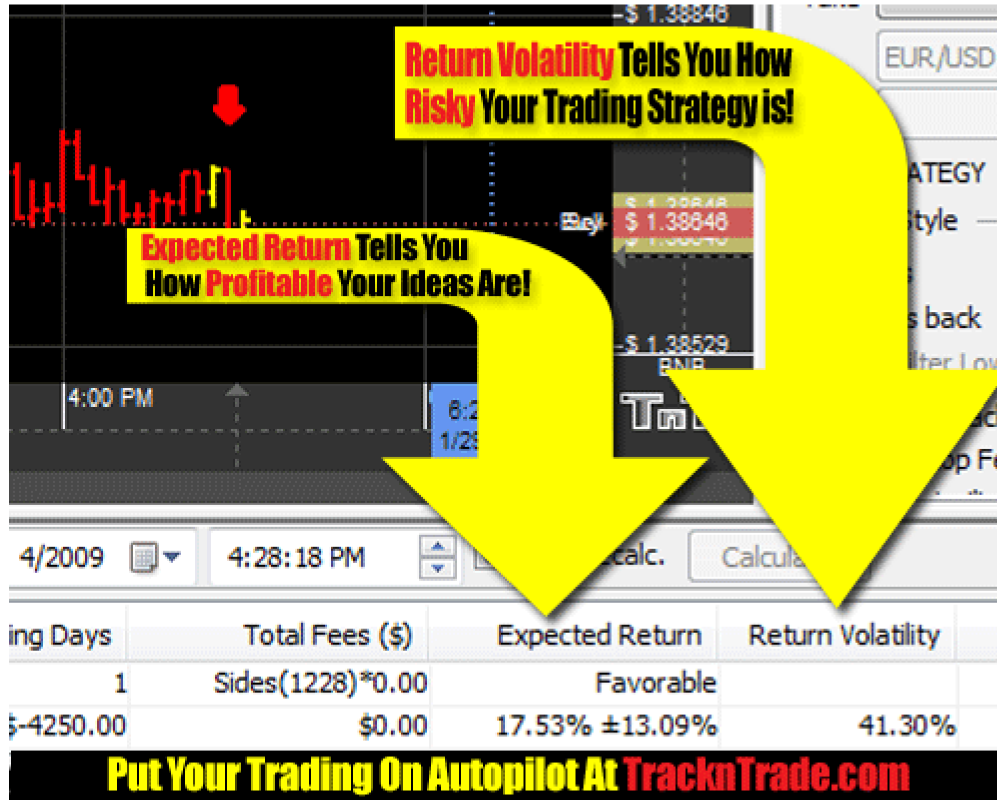
you'll know your percentages even before you start in futures.

The term "*Monte Carlo Simulation*" was coined in the 1940s by physicists working on nuclear weapons. They were trying to figure out if the first nuclear blast would set off a chain reaction that would fry the globe to a crisp!

Monte Carlo simulation methods use computers making repeated random samples on past data to compute their results. The method works best if the physical environment being tested can be closely mimicked in the computer. Monte Carlo methods are used in finance to forecast the returns to traders by simulating the price fluctuations that affect the value of futures contracts.

Then the machine calculates the average value over the range of resultant returns.

Savvy futures traders call this average value the **expected return**. They call the range the **confidence interval**. And to calculate each you have to know the **volatility of your account returns**, also known as the **standard deviation** or **sigma**.



This Isn't The Rocket Science It Sounds!

I remember driving into Reno and Las Vegas as a kid.

Mom always wanted to play slots in the casinos with the highest payouts.

If you've driven, instead of flown, into Las Vegas you'll understand this better. You'll drive by a freeway billboard on the way onto the strip that says, "*Harrah's Has The Loosest Slots In Town…98%!*" Then you'll see another that'll say something like, "*Best Players Club In Town 10X Points On Fridays At The Golden Nugget …then 98.5% Slots at Excalibur!*"

Mom rationally would look for the highest payouts with the hopes of playing her bankroll a little longer for a big jackpot. And she'd look for the most players' club points to get something back in the way of free rooms and buffets.

Mathematically Harrah's is saying "*We Offer You an Expected Return Of Negative 2% For Slot Play!*" Excalibur is saying, "*We Offer You an Expected Return Of Negative 1.5%!*"

A negative return is not very enticing. So clever casino marketers turned it all around to make the billboards sizzle as if getting a small **negative return** were somehow a good deal…

Never Trade With A Negative Expected Return!

A professional player will NEVER play these "*guaranteed to lose in the long run*" **negative expectation games** because they know they're going to lose everything over time for sure. The most you can hope for in any casino game with a **negative expected return** is to have your bankroll bleed

out gradually over time while you suck down as many "*free*" drinks as you can.

And that's ANYTIME you have negative expected returns in ANY **game of chance**.

Here's another way to look at this. Imagine you're standing in front of a quarter slot machine with a 98% payout where you play four quarters a pull. That means that every time you pull the handle you lose 2¢ on average. On the other side the casino wins 2¢ on balance.

If the same machine has a 98.5% **payout** you can expect to lose 1 and ½ cents on each pull. So when you have **negative expected return** you plan to **lose on average** every time you play!

Putting $1 in and getting 98½¢ back is simply a bad investment and is why the casinos in Vegas and Reno are dripping in wealth!

Now imagine that you're playing the same machine with a 15.23% expected return. You'd be playing a slot machine with a 115.23% payout.

This means that every time you put $1 in the machine you'd expect to get $1.15 back!

Why Futures Markets Are One Of The Two Best "*Poker Games*" Out There…

The professional will walk past the one-arm-bandits full of sure losers sitting on slot stools like monkeys pulling levers. A pro makes his way to the poker pit where he

knows that he can get a **positive expected return** playing against **weaker players**.

Alternatively **counting cards** at **blackjack** used to give the professional a positive expected return until the casinos caught on. Since the professional is playing against the casino — not a weaker player — the casino very successfully imposes legal cheats to drive the expected return negative via multiple decks, table limits, dark alleys, and big mean casino thugs.

That's why you see so many professionals on the poker table; none of them seriously counts cards at blackjack. All of the real action today is in the Las Vegas poker pits in games like Texas Hold Em' where smart players can emerge millionaires overnight.

--- Unsolicited TradeMentors.com Testimonial ---

"I really am enjoying learning from you at TradeMentors.com. I am just starting to learn how to trade and so far I am really looking forward to it. My husband taught himself how to trade and did a simulator for a few months. We don't have the money to start trading for real yet but will eventually. He told me that I would be really good at trading and wanted me to learn so he signed me up for your course. I really am enjoying it and look forward to making a good living because of your expertise. I am an older woman with health problems. I don't think I will ever be able to work a 9 to 5 job. I think the trading will give me a wonderful outlet for making money and keeping myself active and mentally vibrant as I get older. Keep up the good work. Thanks!" Kim McDaniel, Utah

--- Unsolicited TradeMentors.com Testimonial ---

Obviously, any casino that allowed their machines to have a positive expected return — let alone this large — would quickly go broke. But let's look at this from the perspective of futures trading.

The futures market is a lot like a Texas Hold 'Em Poker game in Las Vegas. The players don't play against the casino. They all play against one another and the house takes a small cut for making sure that the game is safe and fair — winner gets paid, losers pay up, and players don't shoot one another!

Since the casino simply takes a cut — like the commission charged for trading futures — it's "*the more the merrier*" for the casino!

So, the casino doesn't care if one player is so good that they have a massive advantage on other players. In this game a **well trained player** can have a significant edge over weaker opponents. The pros know that this edge shows in their mathematical expectations in the form of a high expected return.

The weaker players are overconfident of their skills and don't know that they have a negative mathematical expectation because they are playing against a stronger player. They don't know or they wouldn't play.

Same goes for all the wing-ding wanna-be-rich novice futures traders who don't educate themselves, Monte Carlo simulate, and don't know whether or not they have an edge in terms of a positive expected return in their

trading methods. This is another reason beyond undercapitalization and overtrading as to why so many people trade futures and lose…they don't take the game seriously and never become highly paid professionals who trade as a living.

In the massive gaming table that is the futures market if you're one of the players with the big edge you'll come out consistently on top!

It's always the traders with high positive expected returns who win over the long haul in futures!

—Doc Brown

Ps. I said above that there are two best poker games. The other top poker game out there is **Forex** which I also teach at TradeMentors.com.

Chapter 6 Quiz:

1. There are a few very rare situations where it's alright to play a negative expectation game, trade, or investment.
    a. T.
    b. F.

2. An expected return of 14.17 % says...
    a. You expect to make $1.14 back every time you trade a dollar.
    b. You expect to lose $1.14 back every time you trade a dollar.
    c. You expect to make $1.14 back every time you trade a dollar on average.
    d. You expect to lose $1.14 back every time you trade a dollar on average.

3. An payout of 94.17% says...
    a. You expect to make $0.06 back every time you trade a dollar.
    b. You expect to lose $0.06 back every time you trade a dollar.
    c. You expect to make $0.06 back every time you trade a dollar on average.
    d. You expect to lose $0.06 back every time you trade a dollar on average.

Answers Chapter 5

1. C, a simple trend following system.
2. B, inverted pyramid.
3. F, learn to ignore or very selectively listen to the news based on your own internal compass.

Chapter 7: Mechanical Trading On Autopilot!

Highlights from This Chapter

- How the first mechanical trading program came to be.
- Mechanical trading can augment your system trading.
- Performance windows to watch.

Although I tell you to NEVER discuss your trading with friends, acquaintances, and colleagues. There's an exception. It's called a **mastermind group**.

Andrew Carnegie first coined the term **mastermind**. He mentored **Napoleon Hill** who in 1937 formally introduced the concept in Chapter 10 of the timeless classic **Think**

and Grow Rich. Hill was part of a mastermind himself called the **Chicago 6** - which included **Andrew Carnegie** (US Steel), **Charles Wrigley** (Wrigley Gum), **William Hertz** (Yellow Cab Company) and **Henry Ford** (Ford Motors).

As Hill so correctly says in his book, "*Analyze the record of any man who has accumulated a great fortune, and many of those who have accumulated modest fortunes, and you will find that they have either consciously or unconsciously employed the "Master Mind" principle. Great power can be achieved by no other principle!*"

These groups of highly trained and focused individuals endeavor to master their area of mutual expertise. If you create a master-mind group for trading, as I have, it is vital to keep your meetings harmonious since minds only connect in peace.

I have a very simple trading mastermind of three people. I am part of a mastermind that includes Lan Turner and **Massachusetts Institute of Technology (MIT)** educated professional poker player Carlos Vila, MBA.

The way we operate is that I invite Lan to speak at the university every spring. This pays for his expenses. The real benefit comes from the ideas that spring to mind as we sip beers and rum drinks on one of many of Puerto Rico's incomparably spectacular tropical beaches.

A Beer in the Tropics Leads to a Trading Revolution

One day 6 years ago Lan and I were sitting here in Puerto Rico enjoying the tropical weather on one of our master-mind visits. I was ranting about what a pain **position**

trading can be, where you maintain futures trades for long periods of time, since it takes so much on-the-screen monitoring of a trade.

I mentioned how nice it would be to have a machine trade the markets for me in my office. I started moving in my chair and making sounds like a robot. Instead of laughing at my pantomime Lan's face grew still and he remarked, "*I bet we could write a program that would do the same thing!*"

I responded with, "*The large investment houses have proprietary programs costing millions. They automatically scan the markets for opportunities and mechanically buy and sell accordingly. But they are seriously off-limits to the public.*"

That got the creativity going and by the end of the conversation Lan had firmly decided to set his 15

programmers in Gecko Software's Logan, Utah headquarters to the task of creating a program to automatically trade the markets at a price accessible to the little-guy trader.

He announced that he would finish it in 6 months.

--- Unsolicited TradeMentors.com Testimonial ---

"*Dr. Scott Brown is one of the sharpest guys I know. Highly recommended*."
—Alex Green, Oxford Club and Investment U Chairman

--- Unsolicited TradeMentors.com Testimonial ---

Five years later the Track n' Trade autopilot was finished and launched. The task was far more daunting than Lan realized.

This new tool allows you to program your trading methodology into the Gecko Software platform. The autopilot will execute trades according to your specifications based on your Monte Carlo testing results.

World Class Trading Methodology in 5 Simple Steps

A trading system has 5 components; setups, money management, entry, stops, and exits. You have to have each in place to have a solid system.

Setups are the signals that give you an intuition of market direction. These can be fundamental or technical. The Track n' Trade autopilot allows you to set a primary technical indicator and a secondary indicator conditional on the first.

The program then automatically trades based on your indicators which can range from simple moving average cross-overs, through stochastics, to the Bulls n' Bears

advantage system. The Bulls n' Bears is the best indicator I've ever seen.

Then you tell the program how many contracts you want to trade. This can be a fixed number of contracts. Alternatively the program can buy or sell a number of contracts based on a **percentage** of the margin in your account. This is useful to help ensure that you never trade

more than your **money management** rule according to the number of tries you need to get it right based on your Monte-Carlo back-testing, and a 2%, 5%, 25%, or 50% money management rule.

Entry deals with the way in which the program will get into the market buying contracts long or selling them short for you.

ENTRY STRATEGY
Market order on signal
Stop entry on signal
5 pts +/- signal bar high/low Q-Calc
If market gaps enter with MKT order
within 1 pts Q-Calc
- Thrust Signal Prevention
Don't enter if move is > 1 pts
within 1 bars Q-Calc
Take Both Positions
GHGF0 Daily
Q-Calc

Here the program will enter with a **market order** at the prevailing price, or a **limit order** at a price you pre-decide. Then the program will set a stop order in place for you so that you can ensure you don't lose more than 45% of initial margin.

The **stop** order mechanically completes your **money management** system when combined with the **percentage of account** you decide to trade.

Exits deals with getting you safely out of the market. There are two ways to exit. The first is to trail a stop behind your position. The second is to exit when the trade hits a certain level of earnings at a pre-determined price level as a **profit target**.

EXIT STRATEGY
Stop Style
Points
Bars back
30
Ave Bar
0.00
Q-Calc
Filter Lower, Highs / Higher, Lows
Dollars Back
Trailing Stop Feature
No trailing stop
PSAR
Continuous
BNB Blue Light

What's so advanced about the Track n' Trade autopilot system is that the program can link your **trailing stop** according to the calculations of your technical indicators used for entry. You have full control over every aspect of your system. If you don't want to use stops you don't have to. Or you can set your stop at an initial level and leave it.

The autopilot is designed such that you are the master and the machine is your trading servant!

Chapter 7 Quiz:

1. The key components of money management are.
    a. Stop loss and protective options that limit losses to 45% of initial margin.
    b. A percent of account trading rule like 5% that gives you 20 tries as a beginner to beat the market.
    c. A simple trend following entry and exit system with a positive expected return.
    d. All of the above.
    e. None of the above.

2. Which of the following is **NOT** a part of a solid trading system?
    a. Setups.
    b. High hopes.

c. Money management.

d. Stops.

e. Exits.

3. Mastermind groups are large and use conflict to creative advantage...

   a. T.

   b. F.

Answers Chapter 6

1. F, Absolutely false!
2. C, this is a $1.14 expected gain on average for each dollar invested.
3. D, this is a negative $0.06 expected loss on average for each dollar invested.

Chapter 8: Futures Options!

Highlights from This Chapter

- The curious idea that is an option.
- Puts and calls are not the same as long and short options.
- Basic option strategies you need to know.

What Are Options?

At one point in my career I posed the question "*Is it possible to take a very small amount of money and turn it into a small fortune?*"

"*Yes*," you can!

And options are tools that will help give you an additional edge to create your futures trading fortune from scratch lightning fast.

The best way to understand how to effectively mix futures contracts and options is to first understand how options work in stocks. When you own stock outright, as people do in a personal or retirement account, **time is your friend** because there are no margin calls.

Stocks have a tendency to go up over time. Economic genius Bob Shiller at Yale showed that stocks go up far more over time than bonds or real estate! I am writing this at the bottom of the harshest bear market since the great depression. Due to this fact my colleagues and I are buying like crazy.

Nearly all people buy a share of stock outright. For instance if a share of stock is selling for $10 they'll simply pay outright for the stock. They own a piece of the company as long as the stock keeps trading, or the company doesn't go bankrupt, or revert private.

If the stock price goes from $42 to $150,000 per share — as did Warren Buffet's **Berkshire Hathaway** (BRKA:NYSE) — all somebody has to do is hold the stock for a long time. That's how Donald and Mildred Othmer turned $25,000 into $788 million in 33 years — they simply bought and held.

In this case time was their friend as the stock grew over time.

The same applies to physical — and only physical — commodities. If corn is trading at $3.00 a bushel few people realize they could do the exact same thing as with a hot stock. Since there's 5,000 bushels to a corn futures contract a trader could simply fund an account with $15,000 and own the contract outright.

When you own an investment outright **time is your friend**.

As the price of corn increases over time, due to increasing world demand for food, the futures contract value will grow. All the trader has to do is roll the contract over at expiration to a delivery month further out to stay in the market over time.

So it really is possible to have a buy and hold strategy in futures!

When Time Is Your Enemy!

Now imagine a share of stock you buy for $10. In the equity market you can purchase stocks on borrowed money (margin) up to 50%; equity is just a fancy way to say stock.

That means that you can borrow $5 on margin against $5 cash in your stock account to control $10 of stock.

Traders buy on margin to control more stock (or futures contracts) than they otherwise could. So in this case a stock trader will buy 2 shares worth $10 each in his stock

trading account with a dollar balance of $10. That means he or she controls $20 of stock for $10.

Sounds like a great deal but here's the problem. If the market drops from $10 to $5 there'll be no money in the account to cover the $10 loss. If the market drops to $4 there'll be a $2 loss that has to be covered.

This creates a **margin call**.

Let's think of this in terms of **time** instead of cash. Since the market can drop and knock you out of the game any time you're on margin, you hope and pray that the market will rise to your target profit without coming down too far!

You can't sit and wait as you would with a share of stock. Whenever you control an investment on margin **time is your enemy**!

Plain Vanilla Option Strategies Are No Different!

When you buy or sell an option (which I will explain shortly) you're basically buying or selling an insurance contract with an expiration date. Options put you in a position against a ticking time bomb that the market might not go the direction you want fast enough.

Or the option contract will expire worthless!

But that's if you use the strategies 90% of average Joe traders use. What's very interesting is that options allow you to take your straight margin positions you were

protecting with stop-losses — that you can get knocked out of — and convert the position so that it acts like a "*time is your friend*" position.

To do this you have to learn how to use **option profit diagrams** — I teach MBA students going to work on Wall Street how to use these diagrams.

Option profit diagrams allow you to make sure you initiate a futures option position correctly.

Option profit diagrams are way beyond the scope of this mini course so I introduce you to these over at TradeMentors.com…

Make Sure Time Is Always Your Friend

There's a huge difference in mentality between professional futures traders and retail — average Joe — futures traders. The average Joe trader will go into a trade with high hopes and a focus on profits.

They'll spend 95% of the time on forecasting where the market needs to go to make a profit. But they spend little time planning what to do if the market goes against their position.

In other words they simply don't budget for losses.

Professional traders start with an idea of the direction they feel the market will go — that takes about 5% of their time. Then they'll sit down and spend 95% of their time figuring out how to cap losses in the event they're wrong.

Let me recap,

Average Joe Traders spend 95% of the time in hopeful daydreaming about profits and 5% of the time planning a trade with a heavy focus on **risk management**.

Professional traders do the opposite spending 5% of their time daydreaming about profits and 95% of their time planning the trade! Pros have a heavy focus on risk management.

Therein is the biggest difference between professional traders and average Joe traders.

You Already Use Options!

This may surprise you but let me explain. I hope you insure your house.

When you buy home insurance you're paying for the right to regain your equity if your house completely loses value.

The main way this can happen is from a fire. When you pay your insurance premium you're guaranteed to get your money back from catastrophic loss.

Your home is the "*asset*" that underlies the deal since the contract is written based on its price….also called the **underlying asset**. The **appraised value** is the price the insurance company agrees to pay.

This **agree to pay** price in options is called the **strike price**.

The strike price is the price the insurance company agrees to pay you should a specific event occur — in this case the partial or complete destruction of your house. The contract also stipulates how long you're covered. With **American style** stock and futures options you can **exercise** and pay the strike price for the underlying asset any time up to and including the expiration of the option. So you'll also hear the strike price called the **exercise price**.

To get more coverage in time you have to pay more money for another (or a longer) contract.

In stock and futures options this is called the **exercise** or **expiration date**.

--- Unsolicited TradeMentors.com Testimonial ---

"*I wanted to thank you both [Doc Brown & Lan Turner] again for a fantastic Vegas conference. Both of your sessions were incredible, and being able to glean from your knowledge and experience with the markets has been immeasurable. I appreciate having men of your wisdom to bounce these ideas off of. It does wonders to my confidence level with trading knowing I have this support system. Thank you for both your time and attention, and your patience with my questions.*"
Kindest Regards, David D. Washington, DC

--- Unsolicited TradeMentors.com Testimonial ---

To buy insurance on your home you have to bind the contract with some cash called **premium**. This reimburses the insurance company for possibly losing money on the contract if your house burns down during the policy period.

The price you have to pay the stock or futures option seller is also premium. But here it's called **option premium** instead of insurance premium.

Option premium has the same purpose as it does in insurance. It reimburses the futures option contract seller for potential losses over the time the option contract is working.

If you buy an option where you own the right to buy the underlying futures contract it's a **call option**. This is because you're in a position to "*call in*" the transaction.

So in futures trader jargon this is a **call** option.

Buyers Have Rights, Sellers Have Obligations!

With stock or futures options the eventual cost to the seller of an option contract is unknown due to a number of factors other than the stock or futures price. This makes the pricing of financial options very complex.

Option pricing is complex but option strategies are simple! So you don't need to be a great mathematician to be a great futures option trader.

You can **put** something up for sale. So the word "*sell*" in the English language has a similar meaning as the word "*put*" if you ponder the last sentence.

If you purchase the **right to sell** this gives you the option to "*put*" the underlying asset to the buyer. So we call this a **put option**. The terms put and call have been used since

the beginning of options back to the Dutch tulip mania days of the 1630s.

The basic idea is that I can pay for the right to "*Call From You*" **your** futures contract and hence have the **right** to **buy**. Or I can pay for the right to "*Put To You*" **my** futures contract and hence have the **right to sell**. You can **exercise** your right to call or right to put but you're not obligated to do so if you don't have the desire!

Finally, since I bought an option I am **long the futures option contract**. I bought the options contract — entering a long position in either a put or a call making me **long the futures option contract**.

The seller hopes to sell the option for a high price and either buy it back lower or better yet have it expire

worthless. That's why the **seller** of an option is **short the futures option contract.**

The seller ends up **short** a **put** or a **call** depending on which type of futures contract they sold.

The seller wrote up the contract to sell me the futures option; either call or put. Since the seller is "*writing up a contract*" futures trader jargon says that they have **written a futures option contract.** For that reason you'll sometimes hear the seller of an option called the "*writer*."

Short futures option strategies are called **write** strategies while long option strategies are **buy** strategies. Combined positions of long and short options are called **buy-write strategies**. If you sell a futures option contract without a compensating long futures or futures option position —

that makes as much money as the short option contract — you are short a **naked option**.

It's very important that you understand that option **sellers** are **dealing** in the amount of option premium they can bring in. Sellers hope that the underlying market does **not** move in favor of the option. They hope that the market will **fall** if they are long a call and will **rise** if they are long a put.

Option **buyers** are **speculating** on price movements in the underlying market. They hope that the market will **rise** if they are long a call and will **fall** if they are long a put.

That's why you can be long calls or long puts if you want to speculate. You can be short calls or short puts if you want to

deal! And in the futures option markets you can speculate and deal at the same time.

What's really interesting is that you can reduce the cost of your speculative positions by selling options at the same time. The premium you take in as a **dealer** selling options offsets some of the cost of your activities as a **speculator** in underlying futures contracts or futures option contracts. This is the attraction of buy-write strategies!

I went through this long, short, put, call diatribe for a serious reason.

Don't confuse long and short with put or call — my MBA students do it all the time on my university tests. If I ask them to describe a short option position most of the class

will describe a long put which is wrong. A short position in options is either selling a put or selling a call.

A **long position in options** is either buying a put or buying a call.

If you're long the option you own the right to buy or sell depending on whether you own a call or a put. If you're short the option you don't own the right since you sold it; all you can do is take in premium and hope the put or call you sold loses premium value.

First I want you to understand a crucial truth in investing. In unlevered investing where no margin is involved time is your friend. When you invest in long options time is your enemy.

This is because of time decay which I'll explain in a bit.

A short **position in options** is either selling a put or selling a call.

Most important to remember is that you have the obligation to fulfill the deal. So if you **sell** (are short, write, are naked) a **put** to a trader you have to sell the underlying asset to them if they exercise their option regardless of your loss!

If you **sell** (are short, write, are naked) a **call** you have to buy the underlying futures contract for your counterparty who is long the same option… irrespective of your loss!

Options are all about **rights**… that's really what you're buying or selling.

If you own a put you have the **right** that was conferred to you when you paid the option price (premium) to sell at the strike price up to the expiration date. If you own a call you have the **right** that was conferred to you when you paid the option price (premium) to buy at the strike price up to the expiration date.

The seller is the option writer and is on the other side of the contract (counterparty) from the option buyer. So the option writer is really selling rights.

Options Have Two Purposes

You can use options for three very different purposes. First you can use them to protect yourself from catastrophic losses just as you do with home insurance. Second you

can use options to speculate for profit. Third you can use options to engage in trade as a dealer.

Protecting With Options — You must plan carefully to guarantee that you never lose more than a 45% loss of initial margin. This is one of the biggest problems you face as a futures trader. Always remember that the hard and fast rule is to never lose more than 45% of initial margin on any trade.

Loss limiting strategies can have three undesirable consequences you have to pay attention to.

First, in highly volatile markets you may not want to set stop-losses at 45% of initial margin out of concern for getting knocked out of the start of a highly profitable move.

Second, limit days make stop-loss strategies worthless since you are locked into day after day of losses where you can't exit the market despite placing a stop.

Limit up or limit down is the maximum price movement allowed for a futures contract during one trading day. When a market reaches its limit early and stays there all day, and **locks** you in futures traders say the market is **locked limit**. This means you can't get out of your positions. With severe volatility a future's price can lock limit up or limit down for several consecutive days while you helplessly watch as your net worth is decimated.

Third, my doctoral research shows that slippage is symmetrical — the floor isn't out to get you — but futures prices are very volatile under conditions you would expect

to make the market erratic; unexpected news, low open interest, low volume, or speculative asset bubbles. Under these conditions the market can jump your **stop price** creating high slippage.

Slippage means that you'll take larger losses than you expected on your stop loss order.

Instead of placing a stop-loss order you can use an option for protection. If you hold an offsetting option instead of a stop-loss the loss on the limit price move is equally offset by a gain in the option.

Puts are used to protect long positions. Calls are used to protect short positions.

The tradeoff is that stop orders don't cost you anything. Options, on the other hand, cost you premium since you have to pay for protection just as you do with insurance coverage on your house. There's a lot of interesting ways to use options to protect positions cross-market as well. You can protect your Forex positions with currency options in the futures markets.

You can protect your retirement portfolio stock positions using futures index put options. Alternatively you can technically analyze the S&P 500 futures contract on a weekly chart and protect your retirement stock portfolio by taking positions in ETF puts.

There are more advanced protection techniques such as calendarization that I teach at TradeMentors.com.

The main gist I want you to get is that options are tremendously flexible tools for speculating and insuring your futures positions.

Basic Option Strategies

To the rank beginner in options there are a dizzying number of strategies ranging from long and short option plays, credit spreads, limited risk option spreads, synthetic swing trading, ratio spreads, limited risk range positions, and synthetic long option trades.

It's easy to get overwhelmed without a mentor and it's very important that you master the basic strategies first before you move on to the complexities of options.

In fact you may never master all the complexities of options since many highly profitable futures and stock traders often ONLY use a few key strategies.

Stock Strategies: It's very important to note that equity options *speed up the stock investing process*. That's because leverage is increased. It's easy to get confused with the complexity of stock options. This is solved by focusing on 4 very simple stock option strategies.

1. **Covered Calls** – This is where you buy the underlying stock and sell an out of the money call. You get to keep the option premium you take in from selling the call. You make money if the stock languishes because the call expires worthless. You can do these in your Roth and standard IRA retirement accounts.

2. **Put Selling** – Here you sell an out of the money put on an S&P 500 stock you don't expect to weaken. As before if the stock doesn't drop you keep the premium you take in. You can’t sell options in a retirement account. This means that you have to make enough money dealing in options to compensate for the capital gains tax you'll have to pay.

3. **LEAPS** – These are calls with extremely distant expiration dates ranging up to 2 years. This allows you to control the stock for a fraction of the cost of outright purchase. You can purchase LEAPS in your Roth and standard IRA retirement account.

4. **Long Puts and Calls** – Here you use options to control fast moving stocks for a fraction of what it would cost to

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buy them outright. You can purchase puts and calls in your Roth and standard IRA retirement account.

Futures Strategies: Futures trading can be nerve wracking. Especially when you consider that you can actually lose more than you put on the table.

Is there a way to slow the action? Yup. Futures options do the trick!

Let me explain.

With stock investing you buy a stock without leverage. Margin on stock investing is very different than margin on futures or Forex.

Margin on stock is a **loan** the brokerage is making to you where you're charged fees and interest. You should try to avoid any kind of margined stock due to the high cost.

Margin on futures is a **performance bond**. It's your money you put down to bind the deal — it's not a loan. Since it's your saved money you can lend out your futures margin by buying T-bills. Then you actually get paid interest on your futures margin since it's your money.

When you put a position on in futures you have zero investment at the very beginning. This is very different than stock investing where you have to pony up to buy the shares.

Futures options strategies that limit your losses actually slow down the action. Here are 4 simple strategies in futures options that ease the pressure of outright trading...

1. **Long Puts and Calls** – Here you can use options to control the futures contract. You no longer have the unlimited loss potential of the underlying futures. To get this benefit you have to pony up just like when you buy insurance on your house. Plus options decay in value over time such that you get less and less profit per point move in the underlying market.

2. **Bull Put Spread** — *"Bull"* spread means that this is a bullish position. In the TradeMentors.com curriculum I teach bullish options strategies. There you'll learn that a bull spread is created when you buy or already own a put at a lower strike and sell a put at a higher strike. This

strategy is important because your risk is limited in this position. You can use a bull spread to lock in long put profits easier than selling outright the long put. Plus the spread helps you squeeze out a little more profit on a long put trade.

You use this strategy when you expect a minor trend reversal on the daily chart from bearish to bullish.

3. **Bear Call Spread** — This bearish strategy is best used when you already own a highly profitable long call at a higher strike. Here you simply sell a call at a lower strike. It is best to use a bear call spread to lock in long call option profits when you expect the minor trend on the daily chart to reverse from bullish to bearish.

4. **Calendar Spread** — On a 28 day Mediterranean cruise in the summer of 2009 I met a professional commodity trader in Great Britain who owns a significant U.S. equity position. As we sat leisurely playing bridge on deck 14 of the Independence of the Seas he explained to me how he has grown his trading account to over £2,000,000 over 25 years of trading — despite the account drain of annual profits to feed his family.

When he expects the market to drop he sells calls on the FTSE futures contract; the Financial Times Stock Exchange 100 stock index — a market cap weighted index of stocks traded on the London Stock Exchange. If he expects the U.S. stock market to rise he sells puts on the HSI futures contract; the Hang Seng Index — a market value weighted index of the stock prices of the 33 largest companies on the Hong Kong market.

If he's wrong and starts to lose on his writes he protects by "*calendarizing the position*" buying FTSE futures calls or HSI futures puts in a later delivery month at the same strike. This can, at times, turn the losing short futures options write into a winner. I call this triangular arbitrage.

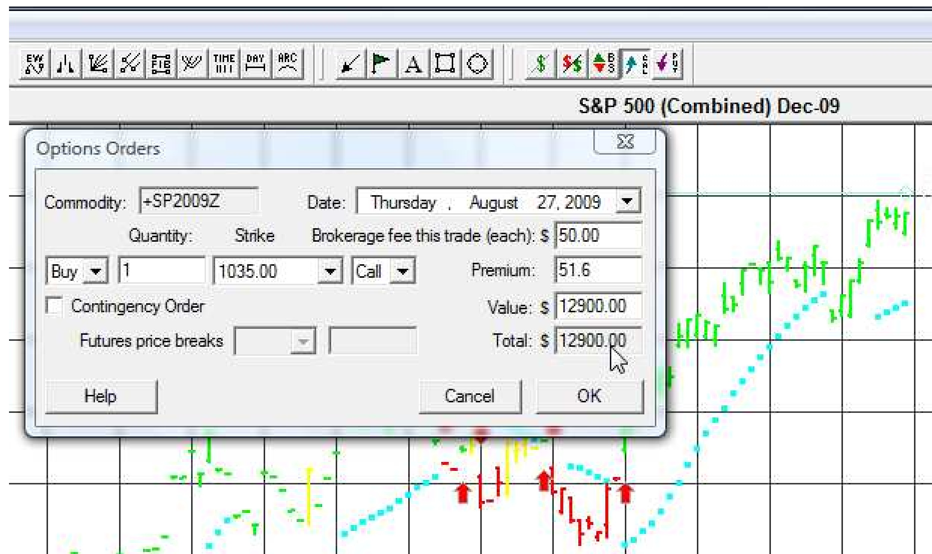
In conclusion notice that you need only master a handful of useful strategies when it comes to futures and stock options.

Track N Trade Option Plug-In

When I started to trade it was a very frustrating experience with regard to options. I had to call my broker who would read information off the screen.

That meant that he knew more than I did.

Since I didn't have all the information my decisions were forcibly sub-par. Track n Trade's option plug-in has changed all that.



This allows you to have full control over your option trading without going through a broker.

This is important!

After a while I started to notice that my broker enthusiastically said "*yes*" to anything that made him more commissions. He was less enthusiastic about any trades that would make him fewer commissions.

And, this was a "*Ken Roberts Recommended*" brokerage!

A few years after I stopped trading with this brokerage I received startling news. My broker had been barred from the futures industry for **account churning**.

He was sneaking into customer's accounts and placing trades without the futures trader's permission. He was stealing their money through commissions on trades his clients had not placed! So from experience I want to

emphasize to you the importance of (1) selecting an honest, intelligent, and capable futures broker or (2) mastering online trading without a broker.

The great thing about the Gecko Software Track n' Trade option plug-in is that you don't need to rely on a futures broker anymore to see option prices. Today you can trade directly online without a broker using the Track n' Trade platform and an account with Gecko Financial Services!

With the TNT options plug in you can see the futures option information all in one place…

Untitled Book (modified) - Track 'n Trade 5.0

File View Help

Export... Calc. Date Strike Rate

Options Strikes in SP 500 (Combined) Dec on

Thursday, 27 of August , 2009, Exp 112 days

Strike	Type	Premium	$ Value	Change	Diff	IVol	Delta	Gamma	Theta	Vega	Rho
1110.00	Call	20.4	5100.00	0.3	4.6	22.07%	0.28	0.00	-68.72	192.42	82.88
1105.00	Call	21.9	5475.00	0.3	5.0	22.21%	0.29	0.00	-70.78	196.90	86.86
1100.00	Put	98.5	24625...	-2.1	5.3	22.29%	-0.69	0.00	-70.51	200.94	-251.32
1100.00	Call	23.5	5875.00	0.4	5.5	22.36%	0.31	0.00	-72.83	201.16	90.91
1095.00	Call	25.1	6275.00	0.3	5.8	22.49%	0.32	0.00	-74.65	205.04	94.91
1090.00	Put	91.9	22975...	-2.1	6.1	22.59%	-0.66	0.00	-74.35	208.61	-240.01
1090.00	Call	26.9	6725.00	0.4	6.3	22.67%	0.34	0.00	-76.64	208.78	99.08
1085.00	Put	88.8	22200...	-2.0	6.7	22.79%	-0.65	0.00	-76.31	212.06	-234.25
1085.00	Call	28.8	7200.00	0.6	6.8	22.87%	0.35	0.00	-78.58	212.20	103.27
1080.00	Call	30.7	7675.00	0.6	7.3	23.03%	0.37	0.00	-80.28	215.24	107.39
1075.00	Put	82.8	20700...	-1.8	7.7	23.17%	-0.62	0.00	-79.86	217.93	-222.79
1075.00	Call	32.7	8175.00	0.7	7.8	23.20%	0.38	0.00	-81.92	217.97	111.52
1070.00	Put	79.9	19975...	-1.8	8.2	23.35%	-0.60	0.00	-81.45	220.35	-217.10
1070.00	Call	34.8	8700.00	0.7	8.3	23.39%	0.40	0.00	-83.50	220.38	115.65
1065.00	Put	77.1	19275...	-1.7	8.7	23.55%	-0.59	0.00	-82.96	222.44	-211.42
1065.00	Call	37.0	9250.00	0.8	8.8	23.58%	0.41	0.00	-85.02	222.46	119.76
1060.00	Put	74.3	18575...	-1.8	9.2	23.71%	-0.57	0.00	-84.24	224.17	-205.82
1060.00	Call	39.2	9800.00	0.7	9.3	23.75%	0.43	0.00	-86.28	224.19	123.81
1055.00	Put	71.6	17900...	-1.8	9.6	23.89%	-0.56	0.00	-85.45	225.58	-200.24
1055.00	Call	41.5	10375...	0.7	9.7	23.92%	0.44	0.00	-87.48	225.60	127.83
1050.00	Put	69.0	17250...	-1.8	10.1	24.08%	-0.54	0.00	-86.58	226.67	-194.69
1050.00	Call	43.9	10975...	0.7	10.2	24.11%	0.46	0.00	-88.61	226.68	131.81
1045.00	Call	46.4	11600...	0.8	10.7	24.31%	0.47	0.00	-89.66	227.45	135.74
1040.00	Put	64.1	16025...	8.6	11.2	24.49%	-0.51	0.00	-88.62	227.89	-183.77
1040.00	Call	48.9	12225...	0.8	11.1	24.48%	0.49	0.00	-90.48	227.89	139.61
1035.00	Put	61.8	15450...	-1.6	11.7	24.71%	-0.50	0.00	-89.54	228.04	-178.41
1035.00	Call	51.6	12900...	0.9	11.7	24.71%	0.50	0.00	-91.39	228.04	143.41
1030.00	Put	59.5	14875...	-1.6	12.1	24.91%	-0.49	0.00	-90.22	227.88	-173.12
1030.00	Call	54.3	13575...	0.9	12.1	24.91%	0.51	0.00	-92.07	227.88	147.14
1025.00	Put	57.3	14325...	-1.6	12.6	25.12%	-0.47	0.00	-90.83	227.44	-167.92
1025.00	Call	57.1	14275...	0.9	12.6	25.12%	0.53	0.00	-92.68	227.44	150.79
1020.00	Put	55.1	13775...	-1.6	12.9	25.29%	-0.46	0.00	-91.22	226.72	-162.79
1020.00	Call	59.9	14975...	0.9	13.0	25.30%	0.54	0.00	-93.06	226.72	154.36
1015.00	Put	53.0	13250...	-1.6	13.3	25.49%	-0.44	0.00	-91.56	225.73	-157.75
1015.00	Call	62.8	15700...	0.9	13.3	25.49%	0.56	0.00	-93.39	225.73	157.85
1010.00	Put	51.0	12750...	-1.6	13.7	25.70%	-0.43	0.00	-91.83	224.49	-152.80
1010.00	Call	65.8	16450...	0.9	13.7	25.70%	0.57	0.00	-93.66	224.49	161.24
1005.00	Put	49.1	12275...	-1.5	14.1	25.93%	-0.42	0.00	-92.06	223.01	-147.96
1005.00	Call	68.8	17200...	0.9	14.0	25.89%	0.58	0.00	-93.73	223.01	164.57
1000.00	Put	47.2	11800...	-1.5	14.4	26.12%	-0.40	0.00	-92.09	221.31	-143.19
1000.00	Call	71.9	17975...	1.0	14.3	26.08%	0.60	0.00	-93.74	221.30	167.79
995.00	Put	45.5	11375...	-1.4	14.8	26.39%	-0.39	0.00	-92.24	219.40	-138.60
995.00	Call	75.2	18800...	1.1	14.7	26.35%	0.61	0.00	-93.89	219.39	170.83
990.00	Put	43.8	10950...	-1.3	15.2	26.62%	-0.38	0.00	-92.19	217.29	-134.08
990.00	Call	78.5	19625...	1.2	15.1	26.58%	0.62	0.00	-93.84	217.28	173.80
985.00	Put	42.1	10525...	-1.2	15.4	26.83%	-0.37	0.00	-91.96	214.99	-129.63
985.00	Call	81.8	20450...	1.3	15.3	26.79%	0.63	0.00	-93.60	214.97	176.70
980.00	Put	40.5	10125...	-1.2	15.6	27.06%	-0.35	0.00	-91.71	212.53	-125.31
980.00	Call	85.2	21300...	1.3	15.6	27.03%	0.65	0.00	-93.34	212.51	179.47
975.00	Put	39.0	9750.00	-1.1	15.9	27.31%	-0.34	0.00	-91.45	209.93	-121.13
975.00	Call	88.7	22175...	1.4	15.8	27.28%	0.66	0.00	-93.07	209.90	182.09
970.00	Put	37.5	9375.00	-1.0	16.1	27.54%	-0.33	0.00	-91.01	207.16	-117.02

I know the graphic above looks daunting but don't fret.

You'll know options in their entirety over time if you enroll

in my futures, Forex, and options curriculum at Trade Mentors.com.

Chapter 8 Quiz:

1. Which of the following is an option strategy to make money with limited risk in a falling market?
    a. Long Put
    b. Long Call
    c. Short Put
    d. Short Call

2. Which of the following is an option strategy to make money with unlimited risk in a rising market?
    a. Long Put
    b. Long Call
    c. Short Put
    d. Short Call

3. A trader should never write options.

c. T.

d. F.

Answers Chapter 7

1. D, all of the above!
2. B, trading on high hopes is trading on emotion hence is a bad way to trade.
3. B, False, Mastermind groups are small, generally less than 7 people, and use peaceful harmony to creative advantage.

Chapter 9: Healthy Investing Psychology Goes Beyond Greed and Fear!

Highlights from This Chapter

- The new field of behavioral finance.
- Investor psychology.
- Common trader brain farts and how to avoid them.

Behavioral finance is a hot area. It deals with **investing psychology** and is increasingly turned to explain markets that should be efficient but clearly are not — especially in the long run.

Errors and biases cut across the investing landscape. Human errors from perceptual illusions, overconfidence, excessively deciding through loose rules of thumb, and

trading on emotion affect futures traders in an extremely detrimental fashion.

Steer Clear Of Heuristic Driven Biases

Most people learn to solve problems experientially through **trial and error** instead of forethought and study. There's a fancy word in English for this called **heuristics**.

You wouldn't learn out how to fly a space shuttle or do brain surgery by trial and error. Surprisingly that's exactly how the average astronaut or surgeon approaches futures trading… with financially disastrous results on balance.

Consider this question: Which is the likely cause for the rise in the gold market up through 2009, India and China buying gold reserves or speculation? Most people rely on

recall, in other words, by seeing in their mind's eye how many times they've heard one idea or the other from casual conversation or watching TV. If more people hear about India and China buying gold reserves they'll answer accordingly and vice versa.

This is a simple rule from psychology called **availability** where people make decisions based on readily available information.

A major error the average investor makes is listening to people and the media around them. Most people are flapping their jaws with economic opinions based on simply remembering how many times a talking head on CNBC said something about gold. For this reason it's very unwise for you to casually discuss your trading. The average person is not willing to undertake a careful

gleaning of less accessible information combined with a methodical and logical review to make a conclusive decision.

That's why you need to do all of your analysis yourself and NEVER listen to anybody's opinion unless you know that they are a very solid, disciplined, and highly profitable trader worth listening to.

Another closely related problem that screws up people's financial decisions is making judgments based on stereotypes called **representativeness** in psychology. A great example is the fact that admissions directors in universities bias acceptance toward students with high GPAs. The truth is that it's the mediocre students in high school who often blossom into shining stars in college.

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"I love your mission to give the "little guy" access to "ultra-wealthy" wealth tactics."

Thanks from Stefanie Hartman!

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The way this trips up futures traders is that they expect markets making extreme highs to continue rocketing skywards. Leading finance professors DeBondt and Thaler found that stocks that have been extreme past losers in the preceding three years do much better than extreme past winners over the subsequent three years.

I remember when crude oil futures were making extreme highs in July of 2008. The only news was scores of "*experts*" explaining why oil could **not** drop in price.

I told anybody who cared to listen that it was time to look for a shorting opportunity in oil futures. Nobody acted because of representativeness in their decision making despite the fact that it turned out to be the top of the market. I have seen time and time again in markets at extreme highs where this brain fart halts people from selling.

The same goes for extremely low priced markets where people halt from buying due to stereotypical thinking.

The Past Does Not Reflect the Future

If five tosses of a fair coin all turn out to be heads, what is the probability that the sixth toss will be tails? Psychologists have found that many people will answer heads because they have it in their mind that a fair toss should have about the same number of heads as tails.

Yet if it's a fair coin it's 50:50 odds between heads or tails!

In other words people expect results to regress back to the mean. This is called the **gambler's fallacy**. The way futures traders mess up their trading with this brain fart is selling out of a winning trade far too early instead of developing ability in expert analysis that tells them when the major trend has turned. After jumping ship too early on a good trade they sit and watch as the market continues on without them without turning their prior trade into spectacular profits.

I've already explained to you the problem of **overconfidence** where below average and average traders consider themselves above average in trading ability. This mental problem leads to overtrading both in position size and frequency.

The next brain fart is subtle. When I offer my MBA students the choice between $10 for sure or an even gamble where they win $0 or $20, about 40% decide to take the gamble.

When I give them the same gamble with unknown odds, as it is in the futures market, many students who prefer the gamble decide to play it safe and take the sure $10. Here people are displaying in their thinking what psychologists call **aversion to ambiguity** where they prefer the familiar

to the unfamiliar. The best example of this is the U.S. government's recent decision to bail out the banks.

Policy makers prefer to preserve a familiar yet bad banking management system rather than let it collapse and ambiguously evolve into something better. Futures traders do the same thing when they meet a margin call rather than closing the position.

When failing to take an initial loss from a margin call traders fail to learn to fix the trading error that created the margin call in the first place. They fail to reflect on the causes of the loss and end up losing so much on the open bad trade they never recover to trade again. They never give themselves a chance to save money to repay the loss. They never rebuild to return as better futures traders.

Is The Same Picture Different In A Different Frame?

In 1992 Nicholas Leeson began to engage in **rogue trading** in **euroyen futures** to hide losses by his subordinates. Eventually he incurred even greater losses of his own and **get-evenitis** set in. In 1995, Leeson became famous for causing the financial collapse of his Great Britain employer, 232 year old Barings, PLC.

Any time you feel the need to get back at the market because you've incurred losses stop trading for a while. You can't trade the markets when you feel something is owed you from past losses. You have to accept losses when they occur, let the regret go from your trading, and reinforce your self control.

Decision making frames are perspectives or maps used by the decision maker to guide the process.

Frame independence is at the core of the **Modigliani-Miller theory** of corporate finance which says it doesn't matter to the value of a firm if it is financed with stocks or bonds. Merton Miller when asked to explain, in twenty-five words or less the essence of his contributions with Franco Modigliani, replied: "*If you transfer a dollar from your right pocket to your left pocket, you are no wealthier. Franco and I proved that rigorously*."

Traditional finance assumes that decision framing is transparently clear (independent). Yet many decision frames are actually not clear at all including the Modigliani-Miller theory — they are **frame dependent**. When a person has difficulty seeing through a complex decision,

his or her decisions typically depend on his or her degree of understanding of the situation. When details are unclear, as they often are in untrained financial decision making, investors and futures traders resort to heuristics through ill thought-out rules of thumb.

We have **inefficient markets** because of all the weird thinking errors investors make at all levels from Main Street to Wall Street! In the end it's up to you to decide whether you join the trading pack in mass hysteria or calmly detach yourself from the concerns of your fellow man. Emotional detachment such as that taught by Buddha leads to clearer thinking and superior decision making.

If you approach the markets correctly such that you are properly prepared mentally for futures trading you will

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have a significant advantage over other traders. Just your **emotional detachment** alone will lead to a healthier lifestyle. And for that very reason **Buddha** would have been a hot rockin' futures trader!

This is a big part of the reason that I give open conference calls to students in the TradeMentors.com program. As I listen I am keenly aware when you are falling into a mental trap that will hamper or destroy your profitability as a futures trader. And I quickly intervene to guide you in your thinking!

Chapter 9 Quiz:

1. Get-even-itis is a mental error where the futures trader angrily tries to get back at the market for losses.
    a. T.
    b. F.

2. Gamblers fallacy causes which of the following problems…
    a. Maintaining a bad trading system when you know its bad.
    b. Cutting winners short and letting losing trades run.
    c. Developing market convictions based on stereotypes.
    d. None of the above.

e. All of the above.

3. Wall Street intentionally makes investing seem complex to create an opaque decision frame for investors.
    a. T.
    b. F.

Answers Chapter 8

1. A, The long put makes money in a falling market.
2. C, the short put brings in premium up front but exposes the writer to unlimited loss potential.
3. B, False, There are many situations where the trader can make excellent money shorting options as long as it's done with proper training, thoughtful planning, and discipline.

Chapter 10: Putting It All Together!

Highlights from This Chapter

- What's really important.
- What's not important.
- How to give yourself the best odds of financial freedom trading futures as a business.

I hope you've come to your own conclusion as to what a great opportunity futures trading really can be. Yet like anything else that's worth doing it must be done well. This means that you have to study, practice, actually trade, reflect on your results, and continually progress as you learn.

It's best to first undertake a methodical study of futures trading

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"*Dr. Scott Brown Ph.D. is a God-send to the individual investor!*"
—Lan Turner, President and CEO Gecko Software, Inc.

--- Unsolicited TradeMentors.com Testimonial ---

I've had a lot of experience with profitable professional gamblers in Las Vegas. They all started on low limit tables before they progressed to high stakes. This is the approach I recommend you apply to your trading.

What's Important!

Take the time necessary to Monte Carlo test your ideas in Track n' Trade thoroughly before putting money on the line. Then, and only then, start with contracts that are within your budget. As a beginner give yourself at least 20 tries to beat the market…that's a 5% money management rule and never let your losses exceed 45% of initial margin.

The recent evolution of the cash Forex market provides an excellent training ground for new futures traders. The mini Forex contract allows you to start with an initial margin of $100 to control a $10,000 contract of foreign exchange.

In addition the clearing firm behind Gecko Financial Services offers a "*no negative account balance*" guarantee.

This allows you to get the feel of trading with a very affordable initial capital of $1,000. There you can trade the

mirror image of the currency futures markets with (1) very little initial capital, (2) no worries about losing your house in a major adverse move, and (3) acclimate yourself to trading on margin.

Good Futures Trading Is Boring!

I am much honored to lead a group of the best individuals in the futures markets who are mastering trading over at TradeMentors.com. One of my favorite students is 72 year old Rick.

He used to trade looking for emotional excitement. His bad investing psychology led to overtrading both in the size and frequency of his positions. This translated into lackluster performance as a futures trader until he enrolled in my TradeMentors.com course.

Rick learned to limit his trading focus to just 3 futures markets and wait for clear entry and exit signals. His trading immediately improved for a year.

Yet a year later he complained that his trading wasn't going so well.

After quizzing him for a while I ascertained that he had fallen back into his old habits of trading on emotion and shooting at everything that moved.

The lesson you must learn from Rick is to convince yourself from the start that this is a business, NOT a recreational game for fun, nor an exciting gamble. You must approach this endeavor with all the seriousness of a professional in any business. It helps to develop the socially unattached

qualities of professionals in games of chance — poker players in particular.

Under-trade in Frequency and Amount

The biggest problem new futures traders face is that they feel like a "*kid in a candy store*" when they begin trading. They get excited about news on copper and buy a contract. They hear a top trader is "*wrong betting*" gold so they short a contract over there too.

They hear Fidel Castro is hoarding sugar so they buy just incase.

Very quickly these traders find that they are undertaking trades based on emotion and are losing more than 50% of

the time. By the time they cut back on their trading it's simply too late.

In addition these traders fall in love with their own ideas about the markets. They spend so much time passively agreeing with the news on the radio and TV that the world is running out of oil that they develop a conviction based on emotion rather than fact. And as the price of oil soars they timidly hold back.

As the price of crude rises higher and higher they regret not having bought at lower prices. This remorse grows until it bursts. They finally buy in at prices much higher than they could have. They keep adding contracts to the position not only to get back at the market but also from representativeness as they listen to the news that bolsters their opinion of a world soon bereft of petrol.

When the market inevitably drops back to normal price levels these traders are wiped out because their positions are far too large for the margin in their account.

Most futures traders are attracted to these high leverage markets because they feel unsuccessful financially. They have relatively low net worth and low income. In a desperate attempt to get ahead of their neighbors they pile way too much money into their futures trading account compared to what they can really afford.

When these traders lose all of the money in their account they're never able to resume trading. The financial loss is far too great of a percentage of their worth. That's why it's vital that you carefully analyze your net income and only dedicate a small percentage of it to funding your account.

To recap, set aside 20% of your net income (or more) for saving toward retirement. Never allocate more than 30% of that to futures, Forex or options. This ensures that you'll never risk more than 6% of your net income on leveraged investments.

The Silver Lining

There's a fantastic silver lining to learning to trade commodities. You can significantly boost the returns in your retirement stock portfolio by adding commodities because they don't co-move. You can do that with commodity based exchange traded funds (ETFs).

ETFs trade like a share of stock hence you can trade options on them. They can also be traded in a standard or

Roth IRA. This gives you a powerful edge over the market because you can use stock option strategies in your standard or Roth IRA. Then you can trade them based on your understanding of the commodity futures markets.

If you know, for instance, that the copper market is primed for a rise you can buy a call on a copper ETF in your IRA. If you know its coming off of extreme highs you can buy a put on that same ETF.

You can also sell covered calls against commodity ETFs. The possibilities are dazzling but you still have to study carefully and methodically prepare for any new strategy.

Get an MBA Level Education for a Tiny Fraction of the Cost

Lan Turner asked me five years ago to teach futures traders properly so that more people had the best shot at beating the market. I was hesitant at first until I began to realize how severely misinformed the public is.

So I finally agreed to Lan's proposal and created TradeMentors.com. This has become the premiere education center for futures and Forex trading in the industry. For more information go to http://www.tradementors.com/club.htm

Trader Talk

We futures traders have our own language we speak among ourselves. If you don't understand trading vocabulary you won't understand the market reports and press releases. So, just like you need to understand charts, it's important for you to understand the way traders talk. This session closes with Trader Talk. I didn't want to bore you with a long list of definitions earlier…

…read this at your leisure with a glass of fine single malt, a cigar, or if you're so inclined — a lemonade in hand!

Delivery Date: Remember how I explained that each contract has a date when the contract expires and buyer and sellers each have to do their part? This date is usually called the delivery date, and named that because a rail car of soybeans, for example, has to be shipped from seller to buyer for physical *delivery* to consummate the contract.

But financial futures themselves aren't physical, so you'll also see this called the maturity date. Delivery of agricultural commodities is made by transfer of warehouse receipts issued by exchange-approved warehouses. In the case of financial futures, delivery is made by wire transfer. In the case of index futures, "*delivery*" is accomplished by cash settlement.

In reality, though, delivery hardly ever happens because counter-parties in the trade usually close out the contract long before maturity, taking gains or losses in cash.

Contract Month: Since most contracts close out before maturity, hardly anyone trading pays attention to the maturity date. Everyone, however, pays close attention to the contract month. This is the month of delivery or maturity.

For instance, the grains have 10 contract months: Feb, Mar, Apr, May, June, July, Aug, Nov, Oct, and Dec. Over time these have been the most popular delivery dates. If a delivery date is not popular a futures contract is not created or the exchange simply gets rid of it.

Month Code: Each contract month is represented with a single letter as displayed below:

F - January	**J** - April	**N** - July	**V** - October
G - February	**K** - May	**Q** - August	**X** - November
H - March	**M** - June	**U** - September	**Z** - December

Symbol: Each commodity is abbreviated with a symbol. Corn is C. Soybeans are S. So, August corn is CQ. July soybeans are SN.

FND: First Notice Day is the day the buyer sends out a notice of intent to accept delivery and pays the full futures contract amount. If you don't pay attention and you miss this date, your introducing person will have to go through the hassle of buying back your contract and will charge you an extra fee. Pay attention to the FNDs on all your positions.

LTD: This is the Last Trading Day for a futures contract. You can't buy or sell after this date. All short contracts still open will be settled by actual delivery.

Contract Size: This is the amount of whatever is being bought or sold. For instance, wheat, corn, soybeans, barley and oats and are all traded in units of 5,000 bushels. Treasury bonds, an interest rate futures contract, are traded in $100,000 units.

Daily Limit: Some commodities or financial futures have price limits. For soybeans, for instance, the futures price can't move more than 70 cents per bushel. Forward markets are not traded across an organized exchange and have no price limits.

The best example today is the interbank foreign exchange markets nicknamed Forex, or Fx that I also teach you in this

course. The higher leverage of Forex markets makes them even more attractive to speculative traders.

Long Position: The futures trader's position, committing to purchasing the commodity or financial asset.

Short Position: The futures trader's position, committing to selling the commodity or financial asset.

Forward Contract: An arrangement between buyer and seller at an agreed-upon future price that is not standardized across a futures exchange (this is the interbank currency market you learned about in part 1 of this series on forex).

Futures Contract: An arrangement between buyer and seller at an agreed-upon future price across a futures exchange for a standardized amount (contract size), on a standardized date (delivery or maturity month), at the prevailing futures price for that standardized contract month.

Clearinghouse: These are firms approved by the futures exchange to arbitrate trading. The clearinghouse intervenes between two traders just as an attorney does in legal contracts to make sure each party does what it promises to do. Sometimes you'll hear these called Futures Clearing Merchants or FCMs.

Futures Brokerage: Most futures brokerages are small "*mom and pop*" operations, and unlike stock brokerages are too small to own a seat on all of the futures exchanges. They operate by associating with a clearinghouse through which they introduce their orders. For this reason you'll sometimes hear these called **introducing brokerages**.

Futures Broker: Most futures brokers work for an introducing brokerage, so sometimes you'll hear these folks called "*introducing persons*."

Marking to Market: The daily settlement of obligations on futures positions where the clearing firm takes money out of the losing account and puts it into the winning account. Daily settlement is unique to futures trading. In the stock market, for instance, settlement is concluded when a position is closed.

Open Interest: The total number of short or long contracts outstanding for each contract month. Open interest is highest in the contract that is closest in time to the cash market because there are more people trading that delivery month.

Nearby Contract: The contract with the shortest time to maturity. This is the contract that is the least time out from today. In other words it's closest in time to the cash market.

Reversing Trade: A trade that closes out a speculative position by neutralizing it. A short position is reversed by buying it back. A long position is reversed by selling it out.

Commission: A total fee that buyers and sellers pay to conduct a transaction in the futures market, which is paid in a single amount that covers the round turn.

Round Turn: The buy or sell trade to open the position, *and* the reversing trade to close it out. Commissions are normally quoted on the round turn.

Point Value: The amount your account changes in value for every point price change in the futures price. For instance, a point in grains is agreed to be 1¢. Since grain is traded in lots

of 5,000 bushels, a 1¢ increase in the futures price means that a long position will change by 5,000¢ — which is $50.00.

Minimum Move: The minimum move is the minimum allowable price change in a market. This is also called the tick size. For grains its ¼¢. That means it's a change in your account value of ¼¢ x $50.00 = $12.50.

Margin: A performance bond that has to be in, or put into, the trader's account to take a position. If it drops to about 75% of the initial maintenance, the trader gets a margin call and has to put more money in, or the clearing firm or introducing brokerage compliance officer will close the position.

Quoted In: The way the contract is quoted. For grains, for instance, the contract is quoted in cents per bushel.

Trading Hours: The time when the market is open and actively trading the commodity. In electronic markets trading hours are usually when people are awake and most active in that time zone.

Option Expires: The date the futures option expires for that futures contract.

Mini Contracts Traded: Some contracts are so big that the margin requirements are very high for small traders. This also means that the point value is high and makes accounts fluctuate massively in value. For the S&P 500 Stock Index futures contract on the CME, the initial margin is $22,500 per contract. The S&P 500 Stock E-mini Index futures contract requires only $4,500 in initial margin, which is much more affordable for smaller traders working their way up.

Cash Market: The actual price for the underlying asset if you want to buy now. This is also called the spot market.

Underlying Asset: The actual asset that is being traded in the futures market. The underlying price is the cash market.

Cash Settlement: The cash value of the underlying asset (rather than the asset itself) is delivered to satisfy the contract at maturity.

Spot Price: This is the price of the underlying asset in the cash market.

Convergence: The futures and spot price have to converge at maturity. This will make more sense as you go through your second read of this course.

Basis: The difference between the futures price and the cash price.

Basis Risk: The risk that hedgers and spread traders face when the basis changes a lot.

Spread: Taking a long position in a futures contract having one maturity and a short position in a contract of a different maturity, both in the same commodity or financial asset.

Zero Sum Game: The sum of long and short daily futures settlement is zero where one trader loses and the other wins.
Shithead: The floor broker's clerk. This really is a term used on the floor…believe it or not!

Answers Chapter 9

1. A, True, and it's is a major cause of losses among professional mutual fund managers.
2. B, If you believe that markets will revert to the mean you will tend to cut your winners for fear of retracement and hold your losers in hopes of recovery. This is very bad for your trading.
3. A, True, They don't want you thinking for yourself. They want you to hand your money over to Wall Street by making you think you are incapable of managing your own money.

More Notes

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DISCLOSURE OF RISK: THE RISK OF LOSS IN TRADING FUTURES, FOREX AND OPTIONS CAN BE SUBSTANTIAL; THEREFORE, ONLY GENUINE RISK FUNDS SHOULD BE USED. FUTURES, FOREX AND OPTIONS MAY NOT BE SUITABLE INVESTMENTS FOR ALL INDIVIDUALS, AND INDIVIDUALS SHOULD CAREFULLY CONSIDER THEIR FINANCIAL CONDITION IN DECIDING WHETHER TO TRADE. OPTION TRADERS SHOULD BE AWARE THAT THE EXERCISE OF A LONG OPTION WOULD RESULT IN A FUTURES OR FOREX POSITION.

HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW.
NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL, OR IS LIKELY TO, ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM.

ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE

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