



NEWSLETTERS & RECOMMENDATIONS - FEBRUARY 7, 2010

Dear Friends and Fellow Traders,

Why do global investors pile into the US dollar and its bonds if the US is a complete financial mess? The same reason the UK is not under fire by the market (yet give it 6-9 more months). Ditto with Japan. These three nations have the ability to kick the can down the road, lowering our standard of living and effectively steal our money. It's called a printing press.

Right now it's the member states of the European Union that are in trouble. They do not have their own "in country" printing press anymore. So they face actual hard decisions. European bank stocks have fallen nearly 20% in weeks.

America and Japan are way to the far right of the European states at 100-200% debt to GDP and are happy to go the backdoor route rather than deal with the issues at hand. They are happy to print money. (On Jan 13, 2010 Kyle Bass of Haman Capital wrote this confirming article: [Kyle Bass of Hayman Capital: Japan Defaults on Debt or Devalues in 3-4 Years; United States in 10 to 12](#) .) Which is why the value of your dollar, over the long run, has been and will continue to be crushed in the future.

Furthermore, Bill Gross from PIMCO Advisors says, "We are Greece with a money tree". The US is a disaster and, aside from Greece etc., we are worse than all the "PIIGS" we are hand-wringing about. I think this is very important for all traders to understand.

As investors, here is the problem. This is not a one week or one month or even one year problem and will be hanging over us constantly. I've been discussing this currency crisis (specific to the US) since 2008 and before Obama became our President. I've been discussing the European issues since mid-2009. For many months this crisis did not matter one iota. But, as I like to say, "It matters only when it matters." Now it matters. Maybe after the IMF rescues Greece et al, the market will surge 5% overnight and we'll cheer! Problem solved! Then what? Then another decade of more sovereign debt issues - one country after another. This is a massive global headwind.

Markets around the world are only now recognizing that sovereign balance sheets in many advanced economies are now in play when it comes to broad positioning considerations. Just look what happened these last three weeks to the deflation trade as traders ran to cover USD shorts and sell commodities. Gold (a safe haven?) dropped over \$175, oil fell nearly \$10 and copper \$0.50.

Now for the good news! The S&P nearly completed the 10% correction I anticipated. The 2:00 PM low was only 6 points from 1035, a 10% correction level, and only another 20-25 points from

the 200 DMA on the daily chart. In addition, the Oscillator on the daily chart is oversold for the first time in 7 months.

NET traders know we get rallies of 50+ S&P points from retests of the 200 Day when we have not retraced back to this level for an extended period of time. Remember, only 6 months ago the S&P was 20% away from this average. We should also remember when I mentioned over 90% of all stocks were over their 50 DMAs. This 90% number serves as a good alert that the market is quite extended. Well, now only 34% of stocks are over their 50 DMA. Under 30% the market is now extended to the downside.

Soon, I will issue a new list of 3-5 stocks to our Alert Email subscriber list that I'm looking to sell naked ATM or ITM puts to create cheaper entry prices. I will then recommend selling calls into strength to further lessen any short term risk.

Trades of the week in review:

First a little background data. I am still too cautious when it comes to buying puts aggressively. I seem to have forgotten what I wrote in ***The Definitive Trading Bible***. Generally according to NET trading methodology, when we are in

strong down markets

we sell in front of the resistance and at the actual resistance level versus selling at the number and behind the number

in strong markets

. So, in

strong down markets

, scale into options just a little lower. It's that simple!

Friday morning before the market opened I placed my scale-in put orders at resistance, 1067-70. I had my Alert Email ready to be sent. The market opened and traded to 1064 in one bar and the up was over and my orders were not executed. I personally hate buying OTM options over \$2.00 with only a day to go. Nevertheless, the 490Ws traded down to \$1.60 hitting \$8.20 near 2:00 PM. "I missed it by that much" as secret agent Maxwell Smart used to say on his TV series.

So, instead I put out two additional option trades. The first involved selling a 490 straddle for at least a \$4.00 credit. After a near death experience for non-NET traders not knowing the market did an ORBO (Opening Range Breakout) near 1:30 PM. NET traders know to short E-minis on market breaks through the opening high or low. I sold an equal number of S&Ps for each put short just before the break and as well relating in the Chat Room to sell a break of 1050. The trade was a nice \$300 winner per straddle with the puts expiring worthless and the calls just over a \$1.00.

The second trade recommended at the same was to buy the 490W calls and hedge aggressively with E-mini shorts. I recommended buying these calls under \$1.00 and scale-in at lower levels. Personally, I was filled as low as \$0.55.

Why is the above strategy safer and better than a straight put buy? Once the market breaks

down after the opening the VIX explodes as everyone is buying puts. I even mentioned in the Chat Room on Thursday when the VIX was 22ish that I thought the VIX could trade up to 28 this week. Friday the VIX almost hit 28. To put this rise in volatility in perspective, imagine if we bought a \$4.00 put on Wednesday with a 20 VIX. On Friday with the VIX at 27 that same \$4.00 option would cost you 33% more or \$5.25. Call prices are affected by the higher VIX but are still much cheaper than a similar strike put. In addition, you have a limited loss with the long calls while you have an opened-ended profit potential with a short E-mini. There is one more great benefit. At an important inflection point (the market could go either way), if you are wrong and the market rallies you can also make money going up. Conversely, you would lose substantial monies on any expensive long put. You only lose if the market stands still for a few hours. In this volatile market movement is highly probable.

The hedges made between \$350 and \$550 per long call depending on your option trading skill level. If you sold the calls near the low subtract \$50-60.00 from the profit. However, if you held these "free" calls until the close you could have sold them for a \$1.30.

On the 2:00 PM "B" Intraday Chart I recommended that if you wanted to continue to hedging buy the 485Ws under a \$1.00. These calls traded down to as low as \$0.60. There were two possible hedges. The first could have earned \$100; the second hedge would have lost \$100-150 when the trade got stopped out at either the breakout of the downtrend line or the ORBO resistance. Remember this common trader maxim: broken resistance becomes support and vice versa. Knowing this the trader could have held long calls into the close. ***The calls closed at \$6.30, another possible 10 bagger (10X) the 4th in 3 weeks!***

Tell me where else could you have so much fun. The market was so volatile at one point I found myself long and short the same 490 calls in two different brokerage firms from the short straddle to the long call with the E-mini hedge on. Yikes! See

[NET Money Chart 2010-02-05 "C" chart](#)

Summary of the Week in Review:

This past week reminded me of the time back in late Feb of '07. The market had just rallied about 240 S&P points from the June '06 lows in a straight line into the year high. At that time the traders were unwinding of the Yen carry trade. Every year there is a strong upward bias in the Yen as Japanese firms repatriate funds back home before the March fiscal year end. The strong Yen was generating substantial margin calls around the world. I wrote that if the Yen broke a certain key level the market could drop 100 S&P points in a matter of days. Every foreign dignitary that was worth anything came out in support of the USD. The Yen stopped rallying but not before the market dropped over 100 S&P points anyway in 3-4 days. After that selloff the market rallied to new all time highs into October '07, the bull market top. This last 110 point S&P decline reached a climatic low Friday after huge USD carry trade unwound and massive reflation trade liquidation took place. The market action may seem similar but the world is in a very different place today.

I did say that 2010 would be the year of the trader where stock selection is key. No longer can traders count on the buy the dip mentally to make easy money as in '09. 2010 has already seen four 10 bagger option trades in 3 weeks. Happily, I'm looking forward to many more before this

year is over.

Regarding BTIM and ISCO, Pat Cox said the *ISCO would report an important company announcement*. In my book, it's an SEC rule violation (Rule 10b-5) when a corporate executive secretly gives out material information to a Pat Cox or any other stock-picker newsletter person without first disclosing the information to the general public. Because there was no such "major" disclosure by ISCO that should have been evidence that there was not going to be some "major" announcement on Feb. 5 as Pat Cox suggested there would be.

I was extremely disappointed with Friday's ISCO investor's conference call. In the first 5 minutes the CEO related there would be *no significant announcement*. This "great announcement of impending news" supports my trading thesis of "Buy the Rumor and Sell (before) the News". Just over 30 days ago ISCO was \$0.50. Three days ago ISCO was at \$1.98 and had a \$200 million fully diluted market cap. Friday morning, the stock was \$1.79. I had already told one of my Chat Room traders who bought ISCO around a \$1.36 to sell almost all (selling at \$1.73 at the time) before the conference call started. As anticipated, ISCO closed lower at \$1.20 Friday. Trading like this isn't Mr. Toad's wild ride, an amusement park ride. For the record, I may consider going long ISCO under \$0.75. Too bad BTIM had to suffer along with ISCO. Keep buying BTIM lower and keep the faith.

As always keep those calls and letters coming. I heard a number of you did quite well this week. Keep up the good work.

Good trading,

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