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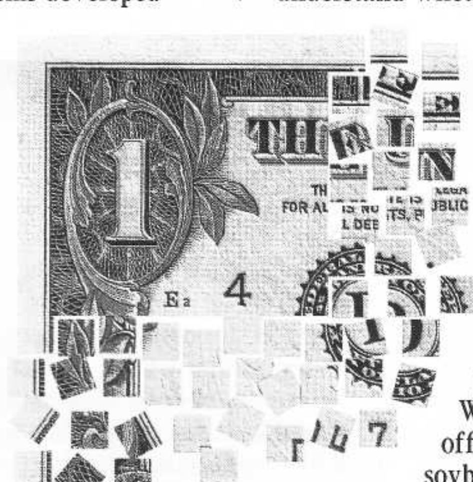
Exploring Trade-Offs in Your Trading

Conquering the markets has been on the minds of traders since civilizations began using primitive currency. Before monetary systems developed into their sophisticated forms of today, the base units of currency were items of trade. Bushels of wheat, ounces of gold or handfuls of pearls were bartered for one another. Native Americans traded wampum (Indian beads) for rifles, whiskey and products from the East. The lack of a common denominator (such as the dollar) left early arbitrators vulnerable to shrewd negotiators. Today there are still relationships within the markets which traders can or should exploit to capture profits. Like our ancestors before us, we modern investors still seek our fortunes by trading off both similar and dissimilar products with each other.



CSI's vast data base of world markets and world currencies can give you an idea of how products are valued at different points in time. Suppose you wished to value every commodity product in terms of ounces of gold. Today a bushel of wheat may be worth 1/64th of an ounce of gold. Back in 1976 when gold reached toward $1,000 per ounce, the relationship may have been that a bushel of wheat was worth 1/130th of an ounce of gold. Capturing key relationships over time, using ounces of gold and viewing the situation with other markets, might make it possible to understand whether the current price of gold is pegged appropriately given market conditions.

Every market has some sort of relationship with every other market. Some relationships, such as those among the grains, have to do with product substitution. Wheat can be traded off for corn, oats or soybeans, for example. There are extremes in the relationships which are reflected in widening or narrowing price ratios. However, the markets will tolerate only so much of a ratio change before market forces bring ratios back into line. Every product has a price level (determined by ratios) below which the market will not let it go. These so called *support levels* make arbitrage, which is the art of playing one related market against another to profit from corrections in ratios, so appealing . Ratios are why arbitrage is such a valuable tool in the trader's bag of tricks.

The grain example, above, refers to clearly related markets which share a common demand. It is less apparent, but equally true, that all markets are related by the currency in which they are priced. Through careful study of several decades of data, the analyst can often find many instances of ratio

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extremes between market pairs. These reveal just how far from the norm the price relationship has strayed before market forces stepped in for the inevitable correction. One might use this information to make choices on when to simultaneously buy and sell seemingly unrelated tradables.

There are many opportunities for profit when markets get too low in price. This happened in February for the grain markets, with corn in the 250s and wheat in the 340s. These markets have since recovered to around 300 and 400, respectively, as we go to press. A simple look at bar charts for these markets reveals that, while their prices have certainly been lower, they were way below recent peaks and were approaching historical lows for the past few years. Further analysis through seasonal charting shows us that wheat, at least, was indeed poised for a turnaround. In that situation, it was a good bet to consider a long position in wheat.

Unfair Advantage® (UA) is not sold as a tool for solving analytical questions on trading strategy. We have left that assignment for the Commodity Trading Advisor and the technical analysis software vendors. But a close look by the average analyst who cares to study intermarket relationships should reveal that there is a definite oscillatory pattern that is apparent when one computes the ratio of related product prices over time, e.g., wheat versus corn or corn versus hogs, etc. This would also be a good opportunity for one to take into account the phasing relationships that are inevitable for crops and products that are grown on the same land, but harvested at different times of the year.

A good example of markets which have an interesting phased relationship lies in corn, and its principal resulting product, live hogs. In this example it would make sense to compare today's corn with hogs eleven months distant, since the decision to produce hogs from today's corn take about 4 months for gestation, six months for feeding and at least one month for marketing, etc. The futures market is the only good avenue one can use to make such a relationship meaningful. Perhaps UA could be programmed to accomplish some of these calculations for you, or if you own a simple tool for building your own systematic procedure of analysis, then you might consider doing some of these tasks on your own. Our plans here at CSI are to provide accurate market data and some tools that support the data precessing needs of the average analyst, but if the demand is there and analysis firms do not care to explore such intermarket ideas, we would consider developing supporting tools in that area.

Users of CSI's new Unfair Advantage software have data on virtually every commodity of any consequence at their disposal and can easily produce seasonal studies. With this software, the markets of any single country can be studied. International opportunities also abound. For example, the markets of Singapore can be studied in relation to those of Germany, London etc. All data supplied with Unfair Advantage, which reaches back to the first day of trading for 95% of the markets, is available for instantaneous review at the click of a mouse.

There is always something to be said for being in the right place at the right time, and then making the most of it. Case in point is a friend of mine who parlayed a few hundred dollars on a couple of world sugar contracts into over a million dollars during the Bay of Pigs crisis in the early '1960s. His initial investment was small, but through pyramiding during a rapid price increase (from 1.5 cents to 13 cents per pound), he was able to realize a tremendous profit. His reason

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Ask Customer Service

Q. *I know that Unfair Advantage has been delayed many times over recent months. Are you really filling orders now?*

A. Yes! By the time this Technical Journal reaches your mailbox, every customer who has ordered UA should have it in hand, except those who have ordered it within one week. We expect to have totally eliminated our backlog and are filling orders as they are received.

Q. *I understand that when I receive my copy of UA, I will get a copy of CSI's commodity data base of nearly 1/2 gigabyte of market data on every world commodity exchange. I don't have that much space on my hard drive, so how can I benefit?*

A. UA squeezes the data down to about 30 megabytes through a very efficient storage methodology. You won't need to worry about hard drive space nor the time to read the data because of the efficiencies of the data warehousing method.

Q. *Must the CD-ROM be in my CD-ROM drive at all times?*

A. No. One load is all you will need.

Q. *What about daily updates and CD-ROM updates?*

A. You won't need CD-ROM updates. The 600 commodity data base on your hard drive is appended in a couple of seconds each day. The updates will consume about 2 megabytes of additional disk space per year. Your routine word processor software probably consumes more space than the Unfair Advantage program and its data base combined.

Q. *How long does it take to download and append all that data to my data base each day?*

A. Approximately 4,000 contracts and cash series are appended in one minute per day.

Q. *What analysis programs are compatible with Unfair Advantage?*

A. In setting up your portfolio, you can select any of the formats below for automatic daily updates. Virtually all analytical programs on the market today can read one or more of these formats and can use data provided through Unfair Advantage.

Unfair Advantage formats: CSI; MetaStock; ASCII (comma, tab or space delimited, with or without century characters); dBase II, III and IV; Lotus (v. 1-5); MS Excel; Paradox; Quatro and MS Access. ✦

Each month in this column our customer service staff addresses a topic of interest to many readers of this journal. This month they are joined by our marketing staff in presenting some questions and answers regarding Unfair Advantage

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for making the original trade? The price was simply too low because sugar was costing more to produce than it would bring at the prevailing market price. He didn't have to trade off one market against another in this case because, for economic reasons, prices were resistant to further declines. Then, as the volatile political situation unfolded, he had the savvy and the guts to stick with it and capitalize on an unusual opportunity.

For traders today, especially those using Unfair Advantage, the opportunities seem endless and they probably are. We have overcome, to some extent, the difficulties our forefathers endured in seeking common ground to assess the value of our goods. The major factor in the modern-day investor's quest for profits is a willingness (or lack thereof) to search for the best trade-off opportunities and then to act on those opportunities wisely. ✦

Bob Pelletier