The Insider Trader

Issue 18 April 2008

Markets at a glance

***Trendspotter Signals** (click on links to obtain up to-date signal)*

Dow Jones (DJ)

S&P 500 (SP)

FTSE 100 (X)

DAX (DY)

£/US$ (BP)

US Dollar Index (DX)

Crude Oil (CL)

Gold (GC)

Coffee (KC)

Orange Juice (OJ)

Sugar (SB)

Wheat

Cotton

Rough Rice

CENTRAL BANK RATES

NZD	8.25%	AUD	7.25%
GBP	5.25%	USD	2.25%
CAD	3.50%	EUR	4.00%
CHF	2.75%	JPY	0.50%

Trading the VIX Rollercoaster - How to profit from the current market swings

So far we can safely say that 2008 has been a volatile year for financial markets in fact according to a Standard & Poor's study of daily price swings, the S&P500 index is at its most volatile in 70 years.

I thought it timely to take another look at the VIX and how we can profit by buying or selling volatility. Whilst I will focus on the VIX based on the S&P500, it is important to remember that the S&P500 still affects European markets greatly, so even if you are not trading US markets; it's still worth watching the VIX.

What is the VIX?

The VIX was introduced in 1993 by the Chicago Board of Trade. It was a weighted measure of the implied volatility of eight S&P 100 at-the-money put and call options. Over the last decade it has been expanded to the broader based S&P 500 futures index, which allows for a more accurate gauge of future market volatility. A VIX level above 30 is generally associated with a high amount of volatility due to investor fear or uncertainty in the market. Traders buy PUT options when they are scared and think markets will fall.

VIX values below 19 usually reflect low investor fear.

Traders who wish to speculate on market volatility may want to consider taking a position in CBOE volatility index (VIX) futures, IG Index offer a spread bet on this market and it's fairly easy to trade.

For example: April volatility is trading at 24.55/24.80. If I think volatility is going up and I buy a £1000 a point at 24.80 and a few days later the quote is 27.80/28.50 and I sell at 27.80 then I have made 3 points X £1,000. The minimum bet size is £50 a point which is a small bet; you are betting on the

Weekly VIX chart click here for current VIX price

whole point 27.10 to 28.10 is only one point.

So far in 2008 we have had two major VIX highs one on the 22nd February 2008 where the VIX hit 37.57 and one on the 17th March 2008 where the VIX 35.60. What did this mean? Putting it politely traders were very scared. It means the price of options became very expensive. If you look back you will find these climaxes of fear points coincide with good buying opportunities as markets tend to move higher in the next few days and volatility after blowing off comes back down again. As a point of reference the VIX hit 41 after the 11th September 2001 World Trade Centre bombing as markets were extremely nervous, however, just a few days afterwards markets rebounding and the VIX fell.

So the way to profit is to wait for extreme fear levels such as 35+ and look to short the VIX and or buy the S&P500, then you would look to cover at around 22. I have done better selling high volatility than buying low volatility as low volatility can carry on for longer. I would mark 16 to 18 as a buying point, if we get down to this calmer reading in the next few months then think about buying volatility and look to cut back on long trades. The last low was around 16 back in October 2008. For free charts of the VIX go to www.stockcharts.com and use $VIX

Seasonal factors

Seasonally April, May and June have seen lower volatility readings the last few years, then July, August and September have seen spikes back up again, then we tend to get lower readings as we head towards the year end.

Glaxo SmithKlein plc (GSK FTSE100)

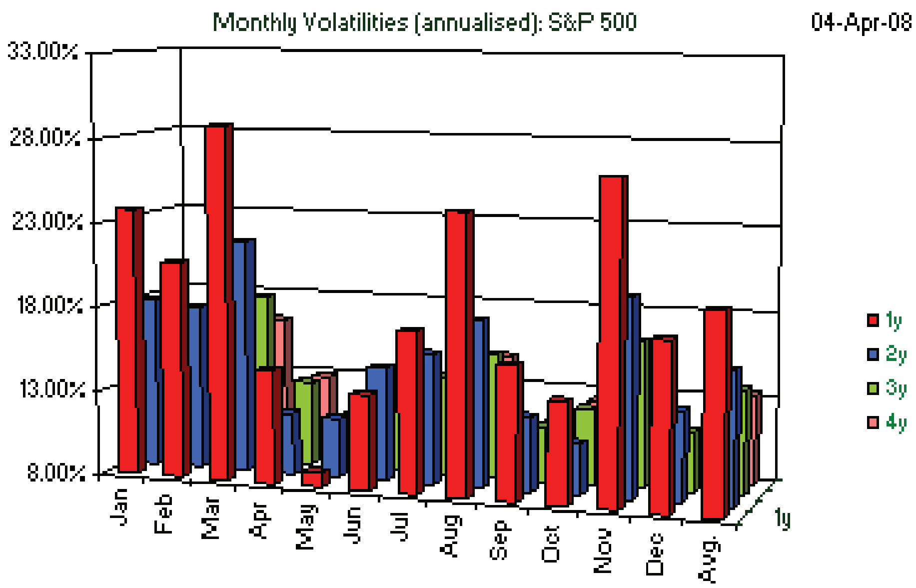
GSK hardly needs an introduction and is the 4th largest company by market cap in the FTSE100. For the last few years this share has been way out of favour as with most pharmaceuticals. GSK has three main divisions; Prescription medicines, Vaccines and consumer healthcare which is made up of many of the Smithklein brands including Panadol, *Aquafresh, Lucozade, Ribena* and Nicorette/Niquitin to name a few.

The shares have halved since a peak in 1999 when they were trading north of £20. Warren Buffet recently took a small stake in GSK obviously seeing the value in buying a world leading pharmaceutical company trading on a P/E of 11 and giving a Yield of 4.6%. The appointment of new CEO Andrew Witty should also see some positive changes.

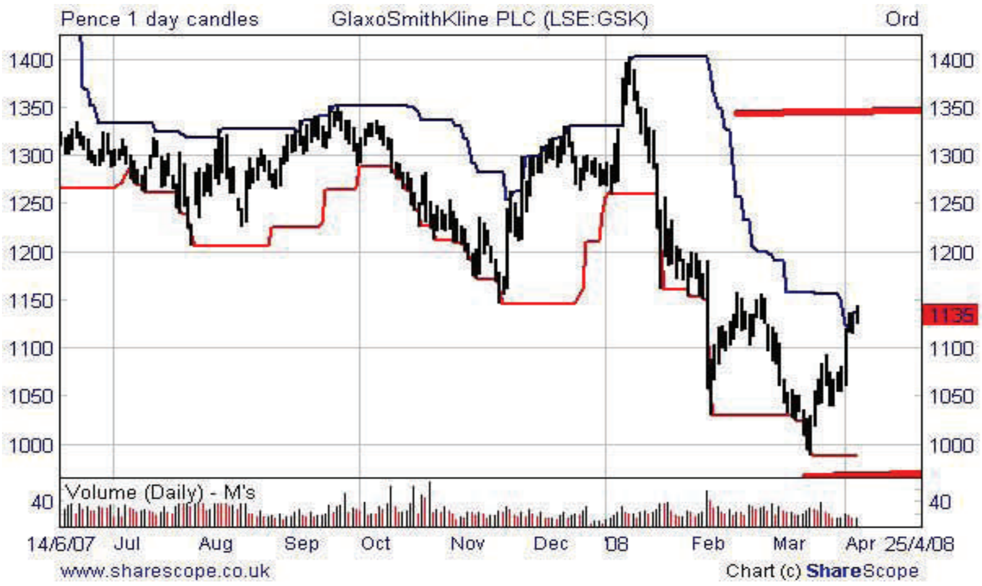
I don't see GSK going much below £10 a share and the recent move up to £11 is the start of a new up trend in the shares. I can see £13.50 plus before December 2008. The best way to play this is with an SG Warrant, Buy the £11 Dec 2008 call which expiries 19/12/08 (SV27). These are currently trading at 17p and based on a £13.50 price in November they would be trading at 26p giving a 51% return. You could also look at the December 08 spread bet on Glaxo and have a stop at around £9.50

Another way to sell volatility with low risk is using fixed odds bets such as those offered at www.betonmarkets.net you can use No touch bets or Bull bets on the S&P500.

Right: Monthly Volatilities on S&P500, April, May and June could see lower volatilities and some temporary stability returning to stockmarkets. This should be seen as a bear market rally rather than a major change in trend.



GlaxoSmithKline very out off favour and down over £4 since the start of the Year. Don't expect a straight line back up however I expect the price to be above the £13.50 before year end.



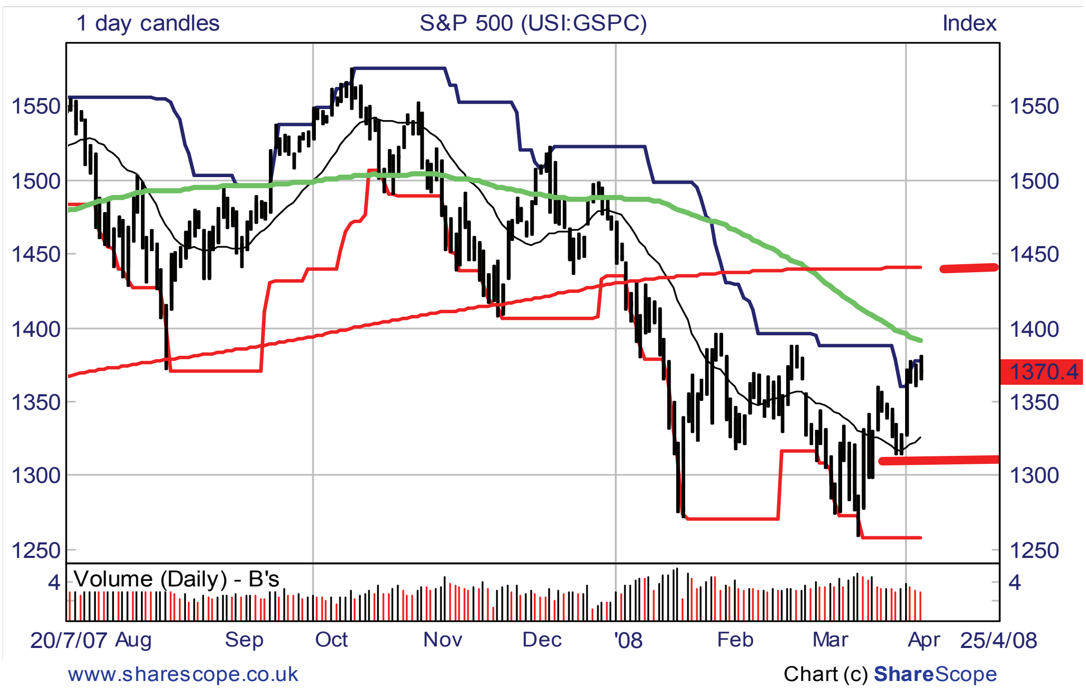
Stock Markets

It's hard to put a positive spin on it, the Dow, S&P500, NASADQ, FTSE100, FTSE250, CAC40 and DAX to name a few are all now giving me bear market sell signals. These signals don't come around very often and tend to last for months if not years.

Short term, by this I mean weeks to a few months, we could see all the markets putting in a good upside bear market rally. This would give the impression that happy days are here again, short traders will be stopped out and have to cover causing more buying and short term technical indictors will turn bullish. We could see the VIX move lower, however it will still be a bear market and all this will do is set up the scene for the next major move down which could start towards the end of Summer 08.

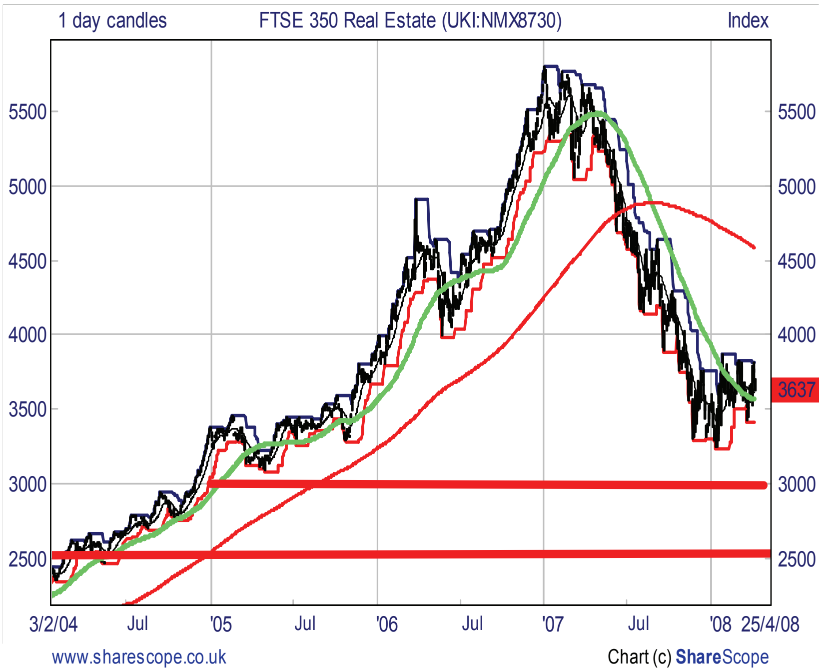
I could be wrong and this could be the shortest bear sell signal I have ever had, but I like to trade by facts and probabilities and they point to lower prices by the end of the year.

Below: S&P500 looking for a better few moths with a possible move back to 1450 but don't be fooled, the trend will still remain down.



Real Estate Sector (UK)

If you look back at the June 2007 edition you will see that my call to short Real Estate has been very profitable, at that time the index was over 4800, today it's 3700 so a nice 1,100 point profit. For now we are seeing a consolidation. I expect this range between 3200 to 3900 to hold up for a few more months, but then the next move is a new break down below the 3200 level and we could see 2500 before the end of this year. Two of the big players in this sector are British Land (BLND) and Land Securities (LAND). If you don't want to trade the sector you could short these shares for December also SG has warrants on both shares with December expirations.



Above: FTSE350 Real Estate, a short term pause and sideways range and then we will see another leg down towards the end of 2008 taking us back down to the 2500

Commodities

Commodities ended the first quarter with a sell off, however, the long term charts and fundamentals still look fine. As previously stated every bull market has sell offs which at the time can seem severe. We will see many shakeouts along the way, just as we saw in the 1982 to 2000 stock market Bull Run; we will see the same in the 2000-2020 commodities bull market. A bit of advice for most – you're better off just holding a core commodities position and not worrying about trying to trade every counter trend. Even the stock market was very bullish in the late 1990's and many still managed to lose money, they would have been better off just buying and holding. I am sure this will happen again in commodities.

We could easily see a 20 to 30% fall in commodity prices in the coming months; however, this would be a buying opportunity. If you are investing a set amount of money each month in commodity ETFs then don't be put off just because prices are down a bit from the highs.

Agribusiness ETF (MOO)

Those that attended the November 2007 trading day will recall that this was one of my featured buys. Since then we are up over 23% which is a very good return considering what the S&P500 has done. Stocks that make up this EFT are all Agri related including:

SYNGENTA AG SVJA 8.20%

POTASH CORP. POC 8.08%

MONSANTO CO MON 8.08%

THE MOSAIC CO. FBO 7.97%

DEERE CO. DCO 7.82%

WILMAR INTL LTD. RTHA 5.15%

YARA INTERNATIONAL IU2 4.81%

KOMATSU LTD KOM1 4.68%

CNH GLOBAL NV NHL 4.58%

IOI CORP. BHD IOI 4.24%

ARCHER-DANIELS-MIDLAND CO ADM4.18%

Although some companies are looking at a bit overbought after this strong run and we could see some profit taking MOO is still a good longer term holding and the recent results buy many Agri companies have been excellent. I did feature ADM,MON and SVJA back in the July 2007 edition. Click here for more info about MOO.