

For All the Reasons, Good & Bad: En route toward 8500



July 26, 2007

NEW YORK

Dow:

Market reports in recent months and weeks have basically communicated what follows below, insofar as strategy is concerned.

As regards the reasons, all the reasons good or bad that the market could choose to focus on were given, while titles and descriptions such as "Final Squiggles" and "IMPEACHMENT" were among the commentaries that defined the imminent end of a bull market that would occur during the perceived "summer doldrums" and "summer rally" period.

On the other hand, I noted that the VIX was in an up-trend that was causing option premiums to be inordinately high vis-à-vis the market. I counterbalanced that with the observation that this has not stopped the market from dropping at points in the past against such a backdrop.

The upshot and recent conclusion was that short term puts should be held in case a full scale downside blow-out were to get going. The conclusion also held that another portion of one's powder should be kept dry, in case option premiums (implied and historical volatilities) would come into line as they have most of the time in the past. Holding product that benefits from a drop in the market on a 2-to-1 basis could also qualify as the partial position, if not a small short term put position, which would be highly levered in the event of a smash.

In one sense, it has been correct to not be 100% short, as recent option prices' action (see last letter) indicates poor performance relative to the size and speed of this market decline. Why? Because premiums were already pricing-in part of this collapse, which isn't ANYWHERE near complete.

But there is something worth noting regarding the VIX. Perhaps the Volatility Index will be well out in front of and leading the market lower (not just bottoming in advance), now that it trades as a distinct product.

This is like put premiums mushrooming in advance of a collapse, as hedge funds and pension funds drive up put option premiums as delta hedges are put in place, in anticipation of their own trashing of the market. Delta hedges create a situation where portfolios profit more from the hedges than the losses being incurred on the underlying securities being hedged!

For this reason, intermediate term put prices are not far off their lows, given what is underway, in that they have not even surpassed recent short term highs that were made at lower stock market levels.

So, for those who do have powder dry for intermediate term puts, the opportunity may yet appear to go 100% short (long puts). Otherwise, short-term puts are en route to reminding everyone of 1987.

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