

>: Investing Playbook: How to Play Today's Market

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Editor's Note: Our weekly telephone call to answer your questions has been posted. [Listen now](#) to hear Teeka answer more reader questions.

Part of being a good trader involves game planning possible market outcomes based upon external events. I picked up this investing habit at the tender age of 18 after reading about it in the book, *Liars Poker*

. In the book, the traders would go back and forth with different external scenarios and would quiz each other on the best trading strategies to profit from them.

The world is always changing, and having at least a loose idea of what areas will be affected by certain predictable changes, helps to clear the investment fog tremendously. The military engages in similar exercises, game planning their response and the enemy's counter response based upon any number of scenarios.

For us there are several scenarios that rotate in and out of the markets. Weak dollar, strong dollar, weak yen, strong yen, expensive oil, cheap oil, recalcitrant Iran, compliant Iran, high interest rates, low interest rates, declining unemployment, increasing unemployment, Republican Presidency, Democratic Presidency and many, many more.

Each scenario impacts the financial markets in a highly predictable way. It's like creating your own playbook based upon what kind of offense or defense you are facing or think you will face. Once you have established the current conditions of the market successfully, it becomes much easier to know what the correct investment strategy is.

It's successfully assessing the correct current condition of the market that can be tricky. It's all too easy to be blinded by the directional bias of one's own positions. Wanting to confirm your own directional bias is a human trait that is very difficult to eradicate. This is where having a playbook already put together really helps in creating the dispassionate temperament needed to be a super-star trader.

Is this habit difficult to develop? You bet it is, but it's not impossible, the way dunking a basketball is or hitting a 100 mph fastball out of the park is. I believe that just about anything can be learned if the motivation is great enough.

Part of what I am working on now is creating an actual written playbook that tells me what to do based upon certain economic and political scenarios. To date it's always been in my head, but I've found that it is too easy for that devil called directional bias to fiddle with my thoughts. That's in part why I created my ETF Master Trader system as well - it's a completely automated program that signals when to go long or short certain sectors, and it's a big help in staving off directional bias.

For those of you that are real students of the market, now is an excellent time for you to start your own playbook. Currently we have a strong dollar, strong yen, low short-term interest rates, tighter credit standards, a global reduction in risk taking (de-leveraging), low consumer confidence, rising unemployment and slowing global economic growth. What I like to do is take each factor and figure out which sectors are affected by the conditions and/or collection of conditions.

For instance, a high U.S. dollar makes our exports less appealing but it also makes imports cheaper because a stronger dollar means more buying power for the same unit of currency. A high U.S. dollar also means that commodity prices drop because commodities are priced in dollars. As dollars become more expensive to the rest of the world, it takes more of another country's currency to buy the same amount of the underlying commodity.

The investment implications from the above scenario are lower demand for commodities because they are becoming more expensive to the rest of the world as their home currency depreciates in value against the U.S. dollar. Dollar strength also leads to lower gold prices as the inverse relationship between gold and the U.S. dollar is well documented.

U.S. exporters typically see their profits decline as they see foreign sales slip due to their product now costing more in foreign countries due to the dollar's strength. If the underlying global economy were strong, it would be reasonable for us to game plan for higher profits from foreign corporations (that hedge their currency risk) exporting their goods to us. Why? Because a stronger dollar makes foreign imports cheaper for us.

In this current economic environment, though, any uptick in imports due to a weak dollar can be reasonably discounted due to overall weak global economic conditions.

Another big playbook theme at work right now is the strength in the Japanese yen. The stronger the yen gets, the more expensive Japanese goods become to the rest of the world. This is important because Japan is an export-driven economy. The strength in the YEN is the reason we are seeing the Nikkei get slammed mercilessly to a 26-year low. Yesterday the Nikkei rocked 6% higher, why? Because we saw the Japanese yen get hit and go down in value, that's why.

Everything is interconnected; when you start to see the connections, you can put your money to work very reliably. Again, the biggest factor to

overcome is one's own directional bias, essentially one's need to be right in spite of the facts.

My own directional bias has led me to losses in certain portions of my commodity-based plays. What it's reinforced in me is a continual risk management approach to every trade. If you're right, your stop should never come close to being hit and if you're wrong the stop (or hedge) is cheap insurance. The key is to not let your losses blind you to the opportunity in front of you right now.

Like many professionals in my business I've had to take a long, hard look at how I have employed leverage and risk management strategies. Some of the smartest money men and women on the planet have been absolutely gutted by this market. A lot of them, along with many individual investors will get washed out during this down cycle but the ones that face their mistakes squarely, learn from them, adjust and change their approach will thrive.

Part of my current game planning has to do with the presidential elections. As it looks right now, Barack Obama looks to be our next president. I don't want to wait until November 4th to figure out how I want to play an Obama win. Take a look at some of the defense contractor indexes: the SPADE index (DXS), has been hammered from 2,731 to 1,359; the **PowerShares Aerospace and Defense Index (PPA)** has been rocked from \$24 to \$12.

What is this telling us? It's a good bet that Barack Obama will gut military spending. I am not advocating shorting the defense indexes here and now, they are already very oversold, but I will in all likelihood short any rally to the 20- or 50-day moving average. Think about it logically, Barack Obama is promising about a trillion in new spending, he can't get it all from tax hikes, he's going to have to raid the military budget. That's a trend that we can play; of course, we have to use stops. There's no guarantee that we are right, if by some miracle we embark on a new phase of fantastic domestic growth that has the tax coffers swelling again, then of course we will adjust our playbook.

Remember, don't get caught up in directional bias.

Another policy of Barack Obama's that we can game plan for is his drive to have America energy independent within 10 years. Now this is a tricky one because the lower oil goes, the less political clout gets put behind energy independence. We have to watch Obama closely to see if he back pedals on that campaign promise. My gut is that he may try to make this the defining legacy of his presidency. The way Kennedy did with his vow to put a man on the moon.

If Barack makes energy independence a defining issue for him, it will have far-reaching investment implications. We will see enormous sums of federal money get thrown into 'Green' technology. So far Green tech has been getting smacked around with the rest of the market, but this is a space to watch for the tell-tale signs of accumulation.

Some ETFs and stocks to keep an eye on include, **PowerShares Progressive Energy (PUW)**, **Wisdomtree Divd Intl Energy Fund (DKA)**, **Market Vectors Nuclear Energy ETF (NLR)**, **PowerShares Cleantech (PZD)**, **Energy Conversion Devices Inc (ENER)** and **Covanta Holding Corp (CVI)**.

High oil prices are what makes these companies attractive to investors (for the most part). Cheaper energy leads to less investment into alternative energy, a Barack Presidency may change that paradigm. But for now, while oil is still declining, I am on the sidelines when it comes to alternative energy.

[**Editor's Note:** Do you have an investing playbook? Do you stick to it? Leave your comments by clicking below. Also, stay tuned Friday for a one-day Halloween special from Teeka. Details to follow!]



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