

OPTION NOTES

MAKING MONEY WITH LIMITED RISK

Volume 4, Issue 6

October 22, 2004

\$139 / year

Categories:

Action Now!

Option trades that are likely to produce results in the immediate future.

Strategic Wealth Builder

Longer-term opportunities that have macro-economic justification that may not be fully recognized in the market.

Value

Trades with a medium length time frame from the perspective of fundamental value using options strategies with edge.

Special Situations

Opportunities that are the result of specific market conditions.

Action Now!

XTO Energy (XTO)

We have just experienced a correction in the oils, natural gas and shipping markets. We believe they are going higher. This is an opportunity to increase positions. We like XTO Energy and recommend the February 35 Calls at 2.50. These calls are not expensive, with a market implied volatility under 30.



Buy XTOBG Feb 35 call at 2.50

Companhia Vale do Rio Doce or CVRD for short (RIO 21.35)

This Brazilian company is the largest iron ore supplier in the world. There is a shortage of steel; China and other developing countries can't get enough. CVRD is searching for more projects that will help it expand and increase capacity. This is a global growth plan that is likely to continue for the foreseeable future. Brazil devalued its currency recently, so it has some competitive advantages and is the market maker for iron ore. We recommend the March 20 Calls at 2.85. While the market implied volatility is in the mid thirty range, they are undervalued relative to the stock price, which currently has a statistical volatility of 53.



Buy RIOCD Mar 20 Call at 2.85

Results from Last Issue

For October we did not close any option positions.

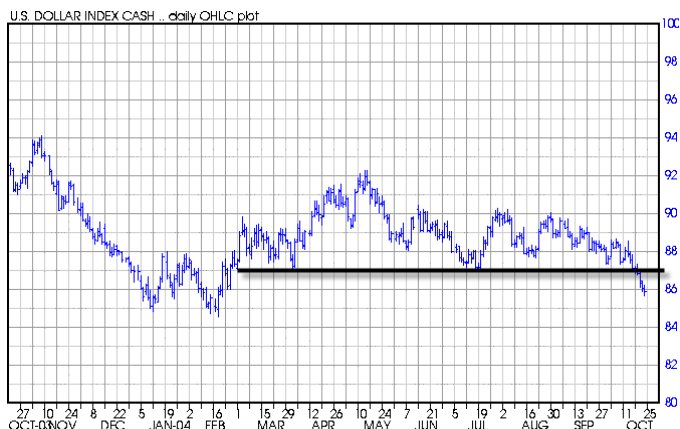
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Special Situation

Newmont (NEM) \$46.12

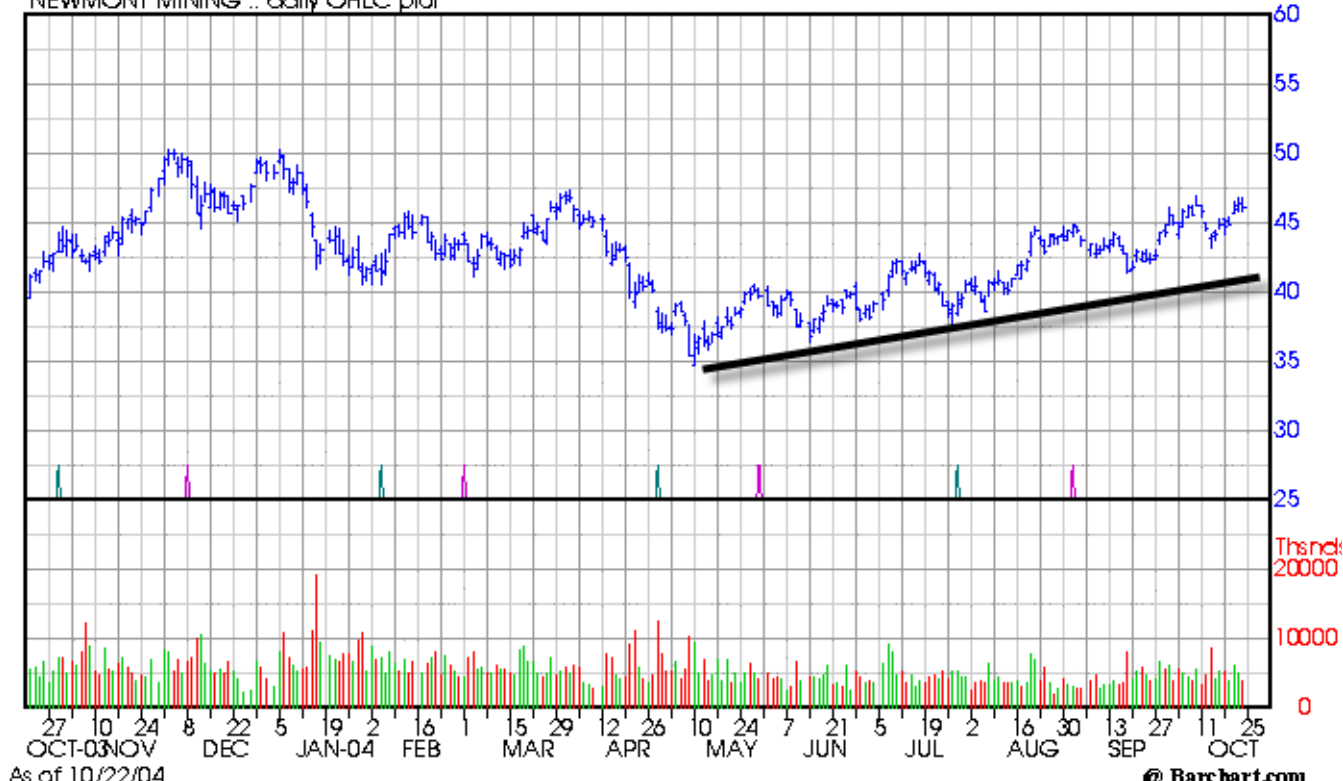
The most noteworthy development in the last week is the decline of the US dollar below its support at 87 on the US dollar index cash. Last January and February it declined to the 85 level before rebounding all the way back to the 92 level. The support at 87 has been tested 4 times since then, but has now given way and seems to be heading lower. We have been amazed that the dollar has held up so long, given the eroding balance of trade and current account that has been accumulated over the last six months. In fact we suspect that the dollar has been supported by the central banks, who hope to postpone the inevitable revaluation of their respective currencies and their loss of competitiveness in the US consumer market.



We know that the Japanese and Chinese central banks have been buying Treasury bonds, and we suspect that other central banks have been active in the futures market selling gold futures contracts. Since gold is considered the antithesis of the dollar, they hope that by keeping gold in a trading range they will influence the dollar's decline. We know that the commercial gold miners, who would be the natural sellers of gold futures against future production, have been closing their short positions. This means that there are only two other sellers of gold futures, the hedge funds and the central banks. We believe the hedge funds are on the right side of the market and expect a lower dollar in the future, so this leaves just the central banks. After all, they can sell futures contracts against their long physical gold stocks. So we think they are two different groups working for a common goal of supporting the US dollar in order to affect trade competitiveness. The Asians are buying bonds and the Europeans are shorting gold. The Japanese want to continue selling overpriced Lexus and the Germans want to continue selling overpriced Mercedes-Benzes. Due to the natural seasonal tendency for gold to rise in the fall in anticipation of the holiday selling period, we believe that gold will continue its rise despite central banks selling. We also know that it is not wise to trade against the central banks, as their resources are larger than ours. This means we need a strategy that gives us the upside if we are right, and limits our downside in the event that the central banks turn this market lower in the near term.

(Continued on page 3)

NEWMONT MINING .. daily OHLC plot

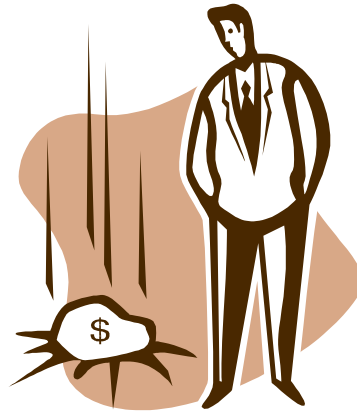


As of 10/22/04

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We think they are acutely aware that we are about to have an election, and we suspect that it has been suggested that a weak dollar before the election would not be very desirable. Chances are this charade will come to an end after the US elections. Here is the limited risk trade. Buy the Jan 45 Newmont calls at 3.60 and sell the Jan 50 Newmont calls at 1.40. Our risk is 2.20 to make 5.00, the difference between the strike prices. While the risk reward ratio does not look that favorable, our strategy will be to adjust the position if Newmont breaks out above the Dec-Jan highs of 50.



Buy NEMAI at 3.60
Sell NEMAJ at 1.40

Special Situation II

Fannie Mae (FNM 67.65)

We believe that the house of cards is starting to fall apart. Momentum is likely to pick up after the elections are over. New administrations want to get all the bad news out quickly so they can avoid blame later in their term. The Securities and Exchange Commission has converted its inquiry into a formal investigation. We think the worst is yet to come. The open interest in the put options is very large, but not yet expensive. The market implied volatility, now around 30, will rise with each announcement. Buy the Jan 65 puts at 3.00.



Buy FNMMM Jan 65 put at 3.00

Current Portfolio

We continue to hold our LNG short put position. While the price has advanced in our favor the volatility has remained quite high. We will hold this position until the volatility declines or the stock breaks out to the upside.

Short LNG Mar 17.5 put @ 2.40 Current market 1.75 Unrealized gain .65

Option Notes is published monthly by:

Jade Capital
7290 Navajo Road
Suite 202
San Diego, CA 92119

Jack Walker – Editor
Carl Snyder – Publisher

Phone: 619 469 6824
Fax: 619 464 9453
Email: info@jadecapital.com
www.jadecapital.com

All prices are based upon the close as of October 22, 2004. Nothing contained in this letter constitutes a recommendation to buy or sell any security. Before entering a position check to see how the prices compare to those used in the recommendation, as the prices are likely to change on the next trading day. Make sure to do your fundamental and technical analysis before making a commitment.

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Jade Capital
7290 Navajo Road, Suite 202
San Diego, CA 92119