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JAMES T. HOLTER

Scott Kimple:
Mastering a dangerous game

Like any good trader, Scott Kimple, president and principal of Warrington Asset Management Corp., a Dallas-based commodity trading advisor (CTA), began by exploiting an opportunity. As a pre-teen, Kimple would visit the floor of the American Stock Exchange with his father, where the family company (Dixico Inc., a flexible packaging operation) was traded. Kimple spent time with the stock's specialist, digesting a unique market perspective. Those trips sparked a deep market interest that drove Kimple to trading stocks by 16 years old. In college, he advanced to futures, which he began analyzing by 6:30 a.m., tracking trades via cell phone between classes.

A family attorney then introduced Kimple to Stan Finney, who had a dual affiliation with Shearson, Lehman Brothers as a CTA and broker. Kimple was able to leverage this acquaintance into

real experience in his final trimester at graduate school at Southern Methodist University.

"I was allowed to do an independent study with this gentleman," Kimple says. "It was a technical analysis study, where we did some research on gap openings, some research on news effects [on the markets]."

That opened the door for Kimple's first job out of graduate school in 1991, working for Shearson and reporting to Finney trading S&P futures options. Finney's branch manager soon offered Kimple a position in discretionary managed futures trading. Kimple, now a dual associated person and CTA, stayed with the firm after its acquisition by Smith Barney Inc. in September 1993 and through the merger with Salomon Brothers.

Kimple's first two years were strong. He was up 49% in 1993 and 66% in 1994, a year when the industry as a whole did poorly. (Futures public funds dropped 7% for 1994 while Barclay's CTA index was down 0.24%.) Kimple's 1995 return was -1%; for 1996, -27%; for 1997, 28%; for 1998, 35%; and for 1999 he earned 33%. Through June 2000, Kimple is up about 10%.

The obvious blemish on Kimple's record is the big loss for 1996. Using detailed trading notes and position sheets, Kimple conducted an in-depth study into what went wrong that year.

"[T]he more aggressive trading caused me to get into trouble. Previously, I would force trades. Now, if I get into a situation where I don't find an easy trade, I just don't do the trade," Kimple says. "Before 1997, I went for home runs. My study showed I should stick with the singles and doubles."

The shift in emphasis from reward to risk control worked. Since he implemented his more patient approach, Kimple has made money nearly 90% of the time on a monthly basis. But while his overall focus has changed, Kimple's core market analysis is basically the same. He describes his approach as a "technical strategy with a fundamental overlay."

Kimple first looks at a collection of classic market indicators, such as the relative strength index, stochastics, regression charts, the Volatility Index (or Vix) and the Black-Scholes options pricing model. Kimple, who explains his use of each tool as traditional, looks for a confluence of signals both across indicators and time frames to develop his technical market bias. Then he considers any overriding fundamental factors, such as an impending Fed move or economic report. But he also will rely on more unconventional sources of information.

In January 1999, Kimple was vacationing in Brazil while that country was about to float its currency, the real. The initial reaction of the U.S. stock market was negative, but Kimple's first hand view of the Brazilian economy was the opposite. Further bolstered by a bullish technical picture, he loaded up on S&P calls and aggressively sold puts. The index recovered strongly. Kimple credits that trade for his 6.77% return that month.

While he does place spreads and occasionally takes outright futures positions, Kimple's favorite trading mechanism is to sell uncovered options, a relatively risky approach. When you sell a put option, for example, you give the buyer of the option the right to sell you the underlying product at the strike price of the option. Options are sophisticated instruments affected not only by the price of the underlying, but factors such as volatility and interest rates. If multiple variables move against an uncovered option seller, losses can be extraordinary.

Kimple's solution involves mental conditioning and agility. First, he's always willing to take a loss, having learned in 1996 he can't force the market. Second, he keeps a constant eye on intraday activity, ready to buy back any position if the underlying moves sharply against him. He's particularly deft if the action exceeds technical parameters that inspired the trade or is supported by fundamental factors. Custom software monitors real-time portfolio statistics to identify problems even quicker.

An example situation was on April 14. The S&P 500 experienced what Kimple calls a "waterfall drop," and he was short puts. By being alert, he was able to cover the puts quickly and sell some calls above the slide, offsetting some losses.

Kimple credits much of his success on the "slow, methodical" development of his approach. An invaluable tool for this careful evolution has been his trading journal.

"A [journal] forces you to go back and do a real analysis of the time you were trading," he says. "It's easy to go back and say you would have done this or that. With a [journal], you can't cheat."

This realistic grasp of the past gives Kimple the perspective to thrive in one of trading's most dangerous games, selling uncovered options.

"I've seen more traders killed by hubris," he says. "I always keep a healthy fear of the markets." **FM**

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