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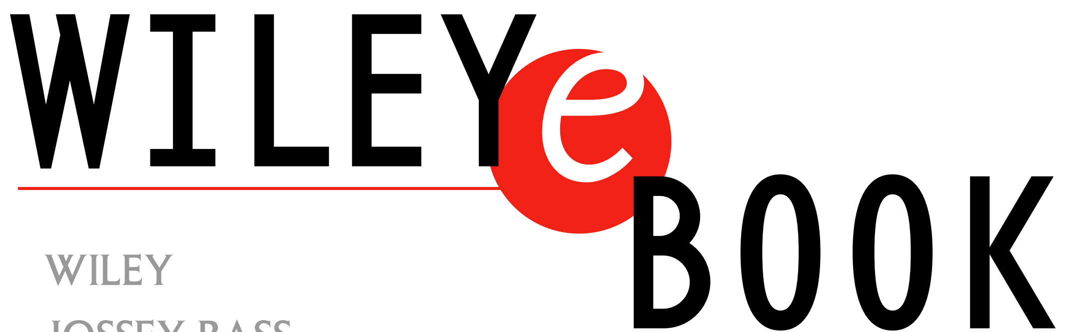

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how I trade options

JON NAJARIAN

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For my daughter Tristen, because when she smiles at me
it feels like I'm kissing God.

preface

When I set out to write a book about my career thus far on Wall Street and my experiences in the options markets, I didn't realize I would be triggering the most volatile period in history. Call it paranoia, or sheer coincidence, but as any trader will tell you, the market just seems to make extraordinary moves as soon as you begin a vacation, or when you leave for an out-of-town business trip. From the week I began writing this book, the Nasdaq exploded higher by 50 percent, lost 40 percent, and was just beginning to claw its way back as I finished the final chapter. Armed with this inside knowledge, if I ever decide to write another book, you may want to switch your money into T-bills and wait out the storm.

I didn't write this book to teach you how to make a million dollars in a week or how to day trade your way to riches. There are plenty of books about that out there already. I wrote this book to help investors like you learn how to manage your money more effectively through the use of listed options. I wrote this book with the experience that I earned through trading millions of options and billions of shares of stock over the past 20 years. I've used these strategies through the greatest bull market in history and through some of the most volatile trading periods imaginable. I've used these strategies to manage hundreds of millions of dollars worth of positions in stocks like IBM, SUNW, MU, EBAY, CMGI, and AOL and I continue to use these strategies today.

Proper use of options and the strategies I teach you in this book have helped me and my trading firms protect and profit through whatever the market has thrown at us. I know from experience that derivatives and spreading strategies can lessen your exposure to adverse market conditions, whether you're bullish or bearish. Controlling or limiting risk is a key factor to staying at the tables longer in games of chance and for my money, no casino offers

better odds than you can get on Wall Street once you understand how to use options correctly. Options can also significantly increase your profit potential and, as a result, your rate of return on invested dollars. Proper use of derivatives and related strategies allows you to keep considerably more of your hard-earned dollars in safe havens such as government bonds or CDs, while you invest substantially fewer dollars in defined risk instruments. Any way you slice it, comparable upside performance with reduced risk means you've put yourself in a position to win.

Additionally, I wrote this book for investors who want to know how to protect their existing investments in stocks or mutual funds, or perhaps create some cash flow from their long-term holdings.

Finally, because investors regularly ask me what the life of a floor trader is like, I thought that this book could answer some of their oft-repeated questions: What amounts of risk do market makers take? How much can we make? How stressful is this job?

I have tried to use examples from my actual trading experiences to answer these questions and illustrate how you can expect option strategies to react. My goal was to make this book both interesting and comprehensible, so that you can begin using options to manage and build your financial future. I hope you share your knowledge and success with other investors.

JON NAJARIAN

Chicago, Illinois
October 2000

acknowledgments

I would like to acknowledge many people who have helped in my growth as a person and as a trader. For shaping me as a person, I have to thank my mother Mignette and my father Dr. John Najarian, for raising me with love for all God's creatures and respect for my fellowman. Without your support during my multiple college careers and at the launch of my trading career, I could not have made it. You are shining examples of how good we can be and I love you for teaching me so much. I hope my wife Brigid and I can give our family as much love and support as you have given me. I also want to thank my brothers David, Paul, and Peter. You guys make enjoying life a full-time job and remind me that what we do for a living is only part of what makes our existence special. I must also thank my wife Brigid for her love, for her support, and for providing time for me to write this book.

I want to thank my friend Tom Haugh for giving me my start in trading and for his friendship and stewardship of our many business ventures. I want to thank Bill Ray, Dan Haugh, Dan Sheridan, my brother Pete, and Mary Gallagher-Parks for doing such a great job trading and managing the Mercury Trading Group, so I can work on projects such as this book. I want to thank the traders at the Chicago Board Options Exchange for their entrepreneurial spirit and their willingness to push the envelope to bring more customers into our markets. Likewise, I want to thank my competitors on the AMEX, PHLX, and PCX for keeping my focus on improving customer service and making our marketplace more efficient. Thanks to the shareholders and staff of PTI Securities & Futures, including Dan Haugh, JD, Dave, Bill, Cliff, Larry, Robin, Margaret, and Matt. I want to thank Rance Masheck and his team at StockMarketWorkshop.com for bringing thousands of investors into the options markets. I want to thank the attendees of our trading

seminars, individuals who use 1010WallStreet.com, and our clients at our brokerage firm for keeping me in touch with what's really important to them. Your input is a thousand times more valuable than any focus group.

I want to thank Bob Sirott and Fox television for believing in me enough to give me a weekly investment show. I want to thank CBS radio and WSCR, Sports Radio 670, for creating a daily outlet on the radio for my financial reports and for giving me a weekly investment show. I want to thank my editor Pamela van Giessen of John Wiley & Sons for keeping this project moving. I also want to thank the animated and talented Tricia Commins for her patience, skill, and hard work, without which, this book would not have been completed.

J.N.

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chapter 1

the making of a trader

Options trading can be a crazy business, with thousands of shares of stock traded every few seconds to hedge positions with face values in the millions of dollars. But if you like action, there is no better business. I intend to show you how options can become a part of your portfolio, whether you have $50,000 in stocks and mutual funds or whether you're a multimillion-dollar speculator. With proper training and dedication, you can use options to both increase cash flow and safeguard your investments.

Trading, like life, does not come easily, and my career in trading is no exception to this rule. My success has been the result of seizing opportunities, enduring losses, and adapting strategies to changing times. The options market is where I earned my graduate degree in making money. Now, I want to share my knowledge and experience. Why? Because a healthy options market benefits all of us—professional traders, retail investors, and speculators alike.

breaking into the markets

What made my success possible was a focus and a dream—quite simply, I wanted to distinguish myself in whatever field I played. I played on the football field for most of my life before becoming a trader. I made it to the NFL, fulfilling my dream to play professional football, an accomplishment that still makes me proud. But like many dreams in life, it was cut short. In my case, after four exciting,

but all-too-brief preseason games, I was cut from the Chicago Bears. In September 1981, I went home, bruised in spirit and probably in body as well. I was down, but certainly not out.

Ironically, it was the football field that led me to trading—a classic example of one door opening when another door shuts. After I was cut from the Bears, my agent asked me if I wanted to play football in Canada. I declined, but said I thought I would like to become a stockbroker. When he asked me why, I said that I had met a number of brokers before and after our practice sessions with the Bears. Who else had time after finishing their working day to be out there watching us sweat under the summer sun? If stockbrokers earned a good living with such great hours, that's what I wanted to dedicate myself to become. Hearing my ideas, my agent told me, "You don't want to be a broker, kid. You want to become a trader on the Chicago Board Options Exchange."

He reasoned that the hours were the same as a stockbroker and that my physical attributes would serve me much better on a trading floor than sitting behind a desk. While I weighed the advantages of each situation, my agent made me the magnanimous offer of trading for him for free. When he threw in a free apartment in Chicago, my mind was made up. That's how, at the age of 22, with my ego still bruised from my failure on the football field, I found myself standing on the floor of the Chicago Board Options Exchange (CBOE). It was a hive of activity that swarmed around me. Traders in loose-fitting jackets with three-letter badges clipped to their lapels shouted at each other about bids and offers for puts and calls. Clerks screamed block stock trades. Computer screens glowed. Time clocks clicked and teletype machines rat-a-tat-tatted. It might as well have been some strange land where an incomprehensible language was spoken—I understood so little of what was going on.

Nobody had taught me the ropes. What little I learned in the first three months I picked up on my own—the jargon, the hand signals, and the pit culture where muscles and bravado were considered good traits.

Luckily, I hung in there. In many ways, I suppose I had no choice. I wanted to distinguish myself just as my father, a noted organ-transplant surgeon who made the cover of *Newsweek* and *Time,* had in his field. None of my three younger brothers or I grew up in our father's shadow, but we were certainly aware of what a

famous, successful, and wonderful person he was. It would be exceedingly difficult to achieve success that would rival my father's in Minnesota, so Chicago seemed like my best bet at being someone other than Doctor Najarian's son. But in my early days in the options pit, my career didn't seem too promising.

It was 1983 and I had moved up from runner and arbitrage clerk for a New York Stock Exchange (NYSE) Specialist firm, to a floor trader at the CBOE. I was making a living on scalping and small spreads on the Midwest Options division of the CBOE. The CBOE had purchased the competing Midwest Options Exchange and absorbed its 350 members into the CBOE in the late 1970s. Those of us who traded on the brown badges (versus the blue badges of full CBOE members) could only make markets on 16 option classes. The remainder of the CBOE was off limits to us. Fortunately, I could afford the $19,000 for a brown badge with the remainder of the money paid to me by the Bears. A full CBOE seat was eight times more than that—$155,000—and since neither could be used as capital in your trading account, the full seat was out of the question. But I knew if I was going to make it to the big time, I had to find a way to get the full seat. Luckily for me, the man for whom I was working wanted to take the summer off and offered me the chance to trade on his full CBOE seat. I seized the opportunity to be part of the big show. Nearly 19 years and billions of dollars of stock options later, I still remember the day my opportunity came and I stepped up to the challenge.

It was as if I, as the linebacker I once was, had intercepted the ball and now had a chance to run for a touchdown. But the trading pit, like the football field, tends to have many people standing between you and the goal.

One of your obligations as a market maker on the floor is making a two-sided market. So if a broker has a customer order to execute—whether it's buying or selling puts or calls—the traders on the floor have to make a market for both the price at which they will buy and the price at which they will sell. Because of this obligation, the Securities and Exchange Commission (SEC) allows market makers to be exempt from Reg-T, a part of the 1934 Securities Act that mandates customers have a minimum of 50 percent of the value of the stock that they are buying in their trading accounts. Without customer margin requirements, we option market makers can trade hundreds of thousands or even millions of dollars of stock per day,

so long as we meet minimum hedging requirements and provide that two-sided market.

The options pit, like other traditional exchanges, still operates as an open outcry auction where bids and offers are called out by buyers and sellers. In the pit, the brokers congregate in the center, like the target of the bull's eye. Traders stand in concentric rings, with the veterans and those who have earned their place standing nearest that center where the brokers hold court. The brokers yell out their customers' orders to the traders who surround them in the pit. When the pit is crowded, chock full with hundreds of traders, the brokers' voices don't project more than five or ten feet. And when a broker yells out an order, the traders chime in at once, with varying bids and offers. A millisecond after the bids and offers are shouted aloud, the broker determines which trader made the highest bid for the broker's customer who is selling or the lowest offer when the customer is buying. That's why a trader's proximity to the brokers is very important.

Brokers have two primary concerns when they are trading for their customers. First, they want a trader who won't stiff them. Trading floors don't have cameras trained on every trader, recording every shouted word. It's just not feasible. So the broker and traders depend on each other's word that when they agree on a trade, it's done. No backing out when the market is 200 points lower. In our business, if the other traders and brokers don't trust you, you might as well be invisible. Second, they need a trader who will bid and offer large quantities, so they don't have to break down an order into many small pieces. The more names a broker has to write on a given ticket, the greater the chance for a mistake, either in quantity or price. The broker's job is a lot easier when he or she can depend on your ability to take on reasonable and sometimes even unreasonable size to fill their order. Keep in mind that brokers don't get paid for bidding or offering. They get paid for filling orders. An honest trader who will do size is every broker's favorite trader.

Up to this time, I had been virtually invisible to the brokers in the IBM pit because I had just moved up from the brown badge—the minor leagues. I hadn't had an opportunity to establish my reputation yet, and I hadn't broken into the inner circle.

To break into that inner circle, you have to know what you are doing. After a year of fighting for two and three lots on the Midwest

seat, I was ready to trade some size (twenty and thirty lots) and rock-and-roll. Being six-foot-two and, in those days, 230 pounds, I did have a physical edge when it came to making my way through the ranks. But bulk alone would not earn me a place in the inner circle. It would take intellect and ability to do that.

At nine o'clock that morning, I started on the edge of the IBM options pit, where I had been trading for nearly a month. It was the biggest and busiest pit on the floor. As traders ebbed and flowed into and out of the pit over the next hour and a half, I made my way closer to the inner circle. By late morning, with the ranks thinned by traders who were having a late breakfast or an early lunch, I made it to the center. There I was, on the trading floor's equivalent of the one-yard line. I was eye-to-eye with brokers from the biggest houses—Salomon, Merrill Lynch, Goldman Sachs, Morgan Stanley—and I was the newcomer. It was as if I had intercepted the ball and now had a chance to run for a touchdown.

Then, as luck would have it, the IBM pit started rocking and rolling.

"Jan '95 calls!" a broker yelled out.

That was verbal shorthand for January call options with a strike price of $95 a share. That meant, if you bought that call you'd have the right to be long IBM shares at $95. In those days, IBM was trading around $88 a share, and put and call options with strike prices from $80 to $100 were actively traded.

Since the big traders the brokers usually relied on had left for lunch, the broker who wanted January 95 calls had to rely on me. I had both the best bid and the best proximity to that broker. Here was the opportunity I was working for; now I had to prove I was prepared to handle the action.

"Even to a quarter!" I yelled back.

I quoted both the bid price—buying at $4.00-even—and the ask price—selling at $4.25. But at that point I did not know if the broker was looking to buy or sell, or how many options were involved in the transaction. Brokers, working on behalf of their customers, never disclose more information than is absolutely necessary.

"Buy 'em at four-and-a quarter!" the broker responded.

"Sell you 20!" I yelled out. I threw out an amount that I felt comfortable selling. I wasn't going to look like a lightweight by offering five options, but I wasn't going to sell 100 either.

"I'm looking for 10," the broker replied.

"Sold!" I yelled triumphantly.

At the end of this seemingly complicated ritual, which took about 10 seconds, I had sold 10 January IBM call options with a strike price of $95 a share for a premium of $4.25. Since each options contract is worth 100 shares, I was short 1,000 IBM shares at $95 ($4.25 × 100 shares × 10 contracts). Those options were worthless until IBM shares rose close to $95 a share, but I still had an open position to cover to hedge my risk.

The more sophisticated you are, the more choices you have to hedge your position risk. In a perfect world, you'd sell 10 calls at $4.25 and buy 10 from someone else at $4.00, and make $25 per contract. If I could fully capture the spread between the bid and the offer on that 10-contract trade, I would have made $250. Since I was a rookie, I took the safe way out and decided to hedge my position with stock. I signaled for a "crowd clerk," whose job was to facilitate stock trades for the options traders on the floor. Getting his attention, I pulled my index finger toward my forehead and then held up my clenched fist. This told the clerk that I wanted to buy 1,000 shares. (A single finger pulled toward my forehead told him I wanted to buy. Having my palms out and facing away from me would have told him I was a seller. A clenched fist indicated that I wanted to buy at the whole number, in this case $88 a share). Moments later the clerk flashed back his confirmation that I had bought 1,000 shares of IBM for $88 a share.

Trade 1:	Sold 10 Jan '95 IBM Calls Strike Price $95/share Premium Collected $4.25/share Hedge: Bought 1,000 IBM shares at $88 a share
Trade 2:	Bought 10 Jan '95 IBM Calls Strike Price $95/share Premium Paid $4.00/share Hedge: Sold 1,000 IBM shares at 87⅞ a share. Net result: Made $0.25 a share, or $25 per contract, for profit of $250 on 10 options contracts. Lost $0.125 a share on 1,000 IBM shares for loss of $125. Net profit on trades before commissions, $125.

From that trade on, I was not invisible to the brokers. I'd be short the stock one minute and long the next. Sometimes I had a profit on the put and call spread, and on the stock I bought and sold to hedge my position. Most often, I scratched—or made no profit—on the stock, or lost an eighth on the stock, while making most of my profits scalping in and out of the options (for example, buy at an eighth and sell at a quarter). When the traders came back from their lunch, they expected to be able to move me out of the way, but that didn't happen. Then they hoped I'd be forced to step behind them and get shoved to the back because I failed to respond with markets and size for the brokers, but that didn't happen either. I stayed on the front lines the rest of the day, buying and selling puts and calls all day and making bigger and bigger markets. The more I traded, the more confident I became. I knew the other big traders didn't appreciate the fact that I'd moved into the neighborhood, but that was their problem. Like thousands of traders before me, I saw my opening and went for it. Once I had my feet under me, nobody was going to stop me. This was pure unadulterated excitement and I knew at that moment that I could make my place in this business.

the front lines of capitalism

My "marketplace" for options, for most of my 20 years of trading, has been the trading floor of the CBOE, which I consider to be the front lines of capitalism. This business is fast and a trader needs to be hedged at all times. We half-jokingly compare this business to dashing in front of moving bulldozers to pick up dimes off the ground. Fumble for the dime, and you could be flattened.

Since I trade, increasingly, off-the-floor myself these days, I know the "upstairs" traders at the desk of any brokerage firm or trading house have the same ego and attitude as the floor traders. Those off-the-floor traders may be trading huge sizes—500 or 1,000 option contracts at a time, and each contract is worth 100 shares of stock. Many of those upstairs traders long to be on the floor where the action is. There is an immediacy we experience on the floor that does not translate to a screen upstairs. You may be a Nasdaq dealer, wheeling and dealing large lots of shares, but when you have an options trade to execute, you still have to call the floor to trade.

Today, much of my time is spent managing trading firms that operate as separate entities under the "Mercury Trading" umbrella. Our firms, located in San Francisco, New York, and my hometown of Chicago, are designated primary market makers—or specialists—in 95 different stocks, such as Micron Technology, Sun Microsystems, and Biogen. Each day we trade nearly 35,000 option contracts and nearly $100 million worth of stock.

Options trading has changed since I started out in 1981 when there were 70 stocks with options on them and no index products. Today, we have options on 1,600 stocks trading on the floor of the CBOE alone. Seats at the Exchange were worth $155,000 in 1981; today, they're worth about $600,000. Volume on the New York Stock Exchange can easily top 1 billion shares on an active day, a dramatic rise from the 48 million shares per day when I began trading.

The floor has also changed. We trade much more now, given a strong influx of both institutional and retail paper. But more and more, the ranks on the floor are young traders with handheld computers the size of a Palm Pilot that record their trades automatically. Many of those computers automatically analyze the market, letting a trader know if an option is "expensive" or "cheap" by color-coding—red for overvalued and green for undervalued. Some of these novices can't even buy or sell unless the computer tells them.

It rankles veterans like me to see a floor dominated by traders holding their miniature computers. But I know why they're there. Trades have become yet another commodity. Why pay veterans like me to trade when you can get computer-savvy youngsters who are more than willing to stand on the floor and trade for $40,000 to $70,000 a year, following the instructions of a handheld computer. It's not so amusing when the computers go down and the trading pits become silent, either because the traders don't know how to trade unassisted or their firms have instructed them not to trade without electronic guidance.

Granted, it's not as "pure" as some of us old-timers (at age 42) would like. But there's no denying that this new breed of trader has accompanied a large influx of capital to the floor. Even trading firms with millions of dollars in backing can't just hire 100 experienced traders to go down to the floor. There are 70 different pits or "posts" on the floor where we trade options on 1,600 stocks. That means you need a minimum of 70 traders on the floor. That means 70 salaries plus 70 seat leases at about $10,000 a month. That puts

the overhead of a trading operation at more than $1 million a month. With seat leases being a fixed cost, the only variable is salary. And that means hiring younger traders who are willing to work at a lower salary. Frequently, I refer to this style of management as "Fat Brain," as the young guns are directed by a group of traders, or in some cases even computers (the Fat Brains), that generate buy-and-sell levels and do most of the hedging, as well.

At my firm, we make sure all our traders know how to trade. Although we use computer assistance, the electronics do not tell us when to buy or sell.

For retail investors, this change in the dynamics of the market has been part of an overall change for the better. With more big money coming to the floor and a proliferation of stocks with options on them, there is a greater depth and liquidity in the market than there has ever been. The four U.S. options exchanges list about 20 to 30 new issues every month, some of them initial public offerings (IPOs) that are only six months old.

It's a different landscape now than when I first came to the trading floor as a 22-year-old, left largely on my own to cull insights into the market where I could. But some of the changes have been for the better. Traders download their "sheets"—lists of put and call option prices and values—at night from the Internet. In many ways, this embracing of technology will help the options pit to survive in the electronic era.

Unlike many of the traditional futures-trading exchanges, which have fought the encroachment of technology, in options we have embraced technology and brought it into the pit. Ours is a hybrid of open outcry and electronic trading, which many of us believe will extend the life of the trading floor, so that when we become fully electronic we won't have an exchange that looks like a ghost town. We will be ready, because we have been at least partially electronic for a decade or more.

The electronic revolution on the floor will continue to bring dramatic change in the experience of the retail customer. Response times—from the placement of an order by a customer to execution on the floor—is being narrowed to just seconds. That means virtual instant gratification for the public. We'll be seeing this, increasingly, with electronic communication networks (ECNs) in stocks, which bring the market to the retail customer. We've also seen the explosion of volume that this direct access to equities has produced. In

options, technology will mean virtual interaction between the public and market makers, and that leveling of the playing field should likewise result in massive increases in the volume of options traded.

When I began trading nearly two decades ago, the average response time was two minutes. First, a customer's order would leave a desk at a brokerage-house office upstairs and be sent to the pit. There, a teletype machine would print the order out at a desk on the floor, where a clerk would separate carbon copies of the order and hand one to a runner (who may or may not be waiting there) who would bring it to a broker in the pit.

In those two minutes, the market could very well have moved, meaning the customer might not get anywhere near the price anticipated. Or, if the customer placed a limit order—with a specified price—it may never be executed if the market moved substantially higher or lower.

Today, 90 percent of the orders come to the floor fully electronic. Orders go from a brokerage office upstairs to the trading floor at electronic speed. By the time the order is offered in the pit, the response time is something like seven seconds. This means slippage—the difference between the price a customer sees on the screen when an order is placed and the price at which the order is executed—is greatly reduced. The result is a more efficient market and a better experience for the customer.

When I began trading, virtually all the trading capital was held in the accounts of individual traders on the floor. Each trader was capitalized to the tune of tens of thousands—and in a few cases, hundreds of thousands—of dollars. Since late 1998, the average firm on the options floor has multimillion-dollar backing and a cadre of young traders. Some of the firms that are offshoots of the major brokerages may have $200 million to $300 million in backing. From a customer perspective, this amount of capitalization means there will be ample liquidity in the market to handle large trades when a Fidelity, a Dreyfuss, Goldman Sachs, or a large hedge fund—which we almost never saw in the market in my early days—comes into the market.

The marketplace may change, but the attributes of a good trader have not. The most important commonality among traders is discipline. If you're an independent trader, discipline is your single most important quality; without it, you have a slim chance of succeeding on your own. If you work for a firm, discipline will help

others have confidence in your ability to trade and carry out a plan. At my own firm, I can only put my trust in traders who I know are disciplined, abide by the rules, and carry out our strategies. I need to know, for example, that when one of my traders is long more than 5,000 shares, he (or she) will cut his losses or start to take profits. If they can't carry out those directives, they won't be with our firm very long.

To trade in the pit, you must have stamina, as well. To earn a place in the front ranks nearest the brokers, you must stand your ground—literally. Among the brokers in that inner circle, the most sought after are those who handle orders from the public. These brokers, working for firms such as Charles Schwab or Fidelity, often have 10- and 20-contract orders to execute on behalf of a retail customer. For independent traders, these are prime orders that offer us a chance to sell 10 call options on Dell, for example, and then buy 10 a minute later in another transaction and make the quarter-point spread between the bid and the ask. That's why the crowd is usually the thickest around these "public" or retail brokers.

The orders these brokers execute are generated when a retail customer reads an article about a company or gets a tip from a friend and decides to invest in the stock via options. As I'll explain a little later, options are a relatively low cost way to speculate in stocks and take advantage of leverage. These retail orders are not based usually on sophisticated technical analysis that shows an option is under- or overvalued. Nor do they reflect a careful study of a company based on concerns over upcoming earnings or product development.

The crowd of traders is a lot thinner around the institutional brokers for major houses such as Goldman Sachs, Morgan Stanley, or Lehman Brothers. These brokers are executing large orders on behalf of institutional clients. The size, alone, precludes many traders from trading, since these brokers are dealing with a "lot of paper"—often in the hundreds of contracts. Since each options contract represents 100 shares of stock, the exposure is considerable on each trade. Additionally, these orders do tend to be based on sophisticated analysis of either the price of an option or the fundamentals of a company. For example, if an institutional investor expects an earnings surprise—either positive or negative—from a company, they may become big buyers of either puts or calls. The market maker who takes the trade must be disciplined and always hedge those

large positions because these institutional customers are usually acting on time-sensitive information. Thus, the market makers must be fast and accurate on their hedging against these trades.

To be a floor trader, in particular, you must be a competitor who will go the distance. For example, when the CBOE prepared to list Dell options in 1999, traders were vying for a place even before trading began. Traders were staying overnight in the pit to mark their spots so no one else could muscle in on their floor territory. At first they were coming in at 2 A.M. to secure a spot on the floor, but quickly learned that they needed to arrive by 10 P.M. to get the best location. One of our traders brought an inflatable mattress to work and slept on the floor of the exchange so he wouldn't lose his spot. There were 20 or 30 traders sprawled out on the floor, using telephone books for pillows. Finally, the Exchange drew the line and no one was allowed to spend the night on the floor. Spending the night to protect your position on the floor may seem a little extreme, but in a business where your position on the floor could mean the difference between getting the other side of a broker order or not, you'll do whatever it takes.

Moreover, trading on the floor is a "people business." The observer sees only the screaming and yelling of prices and the bantering among the traders. But when you're quoting a market to a broker who may be buying 10 options or 500, there is a good deal of negotiating going on. You have to have some kind of personality that makes you stand out, even if it's a friendly combative one. You have to get along with people in the pit; it can't always be war. There are literally hundreds of traders in the stock index options pits. There might be 70 or so in the popular stock options pit, like the AOL. With this kind of population, you must be able to hold your own as a trader and as a human being. If there aren't at least some people with whom you get along, it will be you against the whole pit. That, obviously, doesn't work very well.

Beyond these qualities, you must also have a quick mind and an ability to focus on several things at once, such as the premiums quoted on puts and calls on several options and the price fluctuations of the underlying stocks. That's why some trading firms like to recruit bridge players and chess players, who can think multidimensionally, strategically planning several moves ahead. Others like card-counters, who can keep track of numbers and combinations quickly, as well as the odds of certain events occurring. Many