

Introduction

“Profiting in All Markets” - now that is what we as traders and investors all aim to do! Last weekend the Australian Technical Analysts Association (ATAA) presented a conference aimed at traders and investors who use charting and quantitative share analytics to identify and trade shares successfully.

ATAA Annual Conference

The conference brought together a diverse range of speakers including market makers, market timers, short and long term traders. These speakers covered topics such as:

- Market Timing
- Trading Systems Development
- Trading Psychology
- Spread Trading
- Adapting Trading Methods to Market Conditions
- Penny Stock Trading Methods
- Risk Management
- Trend Identification
- Full Range of Trading Techniques

This conference stands out because the presenters actually trade and they enthusiastically share their experience and knowledge with conference participants.

The key theme of the conference was that trading is a process and traders should be using a systematic and measured approach to trading. Traders must understand that markets move in cycles and they must be able to identify when a stock is in trend transition or in a persistent trend. Trading is dependent on trade expectancy which must be positive.

Trading Systems

Using a systematic approach requires considerable back testing to give the trader confidence. Dr. Howard Bandy the author of the acclaimed book *Quantitative Trading Systems*, said that the design, testing and trading of a mechanical trading system can take anywhere up to 10,000 hours before the trader is completely confident that the system works.

When designing a trading system focus on trade consistency, equity drawdown and profitability, trade expectancy and avoiding over optimisation by careful selection of the market test data sets. Do not be afraid to follow a systematic approach which is consistently profitable, as this simply means that the trading system being used is in sync with the market. Strings of consecutive wins are great!

Market Timing and Cycles

Markets move in cycles, and identifying these cycles gives the quantitative chart trader an advantage over other investors. Trading when the market cycle is trending either up or down produces the big money. Technical analysts aim to trade only when the market is moving and in so doing they must identify trends, whether they are creeping or thrusting. The earlier the trend is identified the bigger the profits attained. However, there is a balance between entering the trade too early and waiting for the trend to be confirmed. The key way to make profits is to ensure that trading capital is deployed in the markets and is consistently working with a positive expectancy. Trend traders, depending on the timeframe they trade in, can face periods of drawdowns of up to 40% and 60% before the trend resumes. Ideally, avoid sustained periods of drawdowns.

Traders need to be able to identify “trendy” stocks and markets, and understand the concepts behind creeping trends and trend thrusts, as their trading strategy will need to be adjusted accordingly. Share prices consistently move between periods of price contraction then price expansion.

The 2007 and 2008 Market Turmoil

The repercussions of the market turmoil experienced during the Global Financial Crisis (GFC) have led investors to question their Buy and Hold strategy, and as a result the demand for full service brokers is in decline. Online trading services, such as Trader Dealer, are looking to grab market share in the investment and trading space into the future.

Patience the Key

A number of presenters referred to *Reminiscences of a Stock Operator* by Edwin Lefèvre, the story of the legendary speculator Jesse Livermore. Most consider this to be essential reading for anyone considering trading as a profession. One of the Jesse Livermore quotes I liked was this:

"And right here let me say one thing: After spending many years in Wall Street and after making and losing millions of dollars I want to tell you this: It never was my thinking that made the big money for me. It always was my sitting. Got that? My sitting tight! ... I found it one of the hardest things to learn. But it is only after a stock operator has firmly grasped this that he can make big money. It is literally true that millions come easier to a trader after he knows how to trade than hundreds did in the days of his ignorance."

Many of the presenters were trend traders and all agreed that the real money that is "earned" by traders is acquired by identifying the underlying primary trend and trading in that direction. Traders need to manage their positions to gain as much exposure to the trend for as long as is possible, given their trading capital. Stick with the trend as long as possible. This is easy to say but very hard to achieve.

An example of where patience would have paid off is demonstrated on the chart below. This shows a trader or investor who used a simple 21 period moving average system would have reaped big money in the past couple of years. The trick is to be able to manage the trader's emotions and psychology in periods of drawdowns.





Figure 1: ASX200 Weekly chart

Patience is the key to successful trading. However this quality is very difficult to acquire in the real world, where market noise created by “realtime” news services feeding directly to your terminal, television or smartphone conspire against you. From the 24/7 financial television and three-second guaranteed executions on Internet trades to after hours trading, the modern market environment lends itself to fostering a culture of continuous “frenzied” trading.

Avoid these temptations by taking a step back and start trading successfully by doing your research, determining the primary trend, trading your positions in that direction, and then just hurry up and hasten slowly.

A Time for Caution

The key philosophy behind quantitative trade selection is that profitable traders must understand that the big money is made by timing the market.

Those presenters who offered an opinion as to where the key world markets may be going generally agreed that the easy money in the current market bounce from the lows of earlier this year has already been made.

Jake Bernstein, the author of over 40 books on trading and investing, is of the view that traders should have a cautious stance in the current market climate. He threw up a number charts to support his view.

We at *MDS Financial Research* have been keeping subscribers abreast of the movements in the Chinese market since the middle of the year. We have been highlighting the fact that the Chinese market has been leading the western world, as markets have recovered from the worst market crash since the Great Depression. Take a look at these charts from *Market Analyser*.

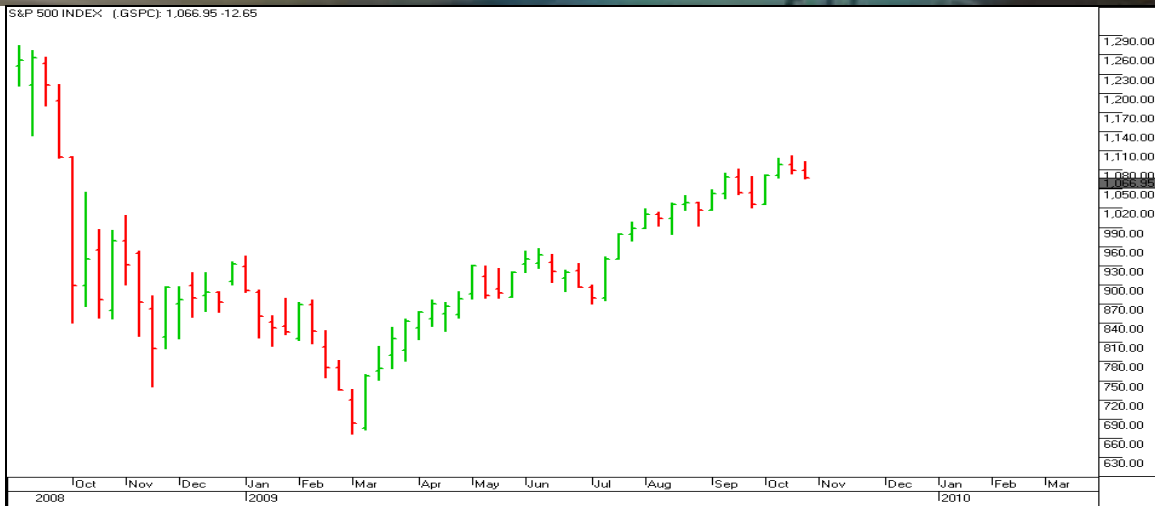


Figure 2.1: United States S&P500 Peak to Trough 55% move in 34 weeks.

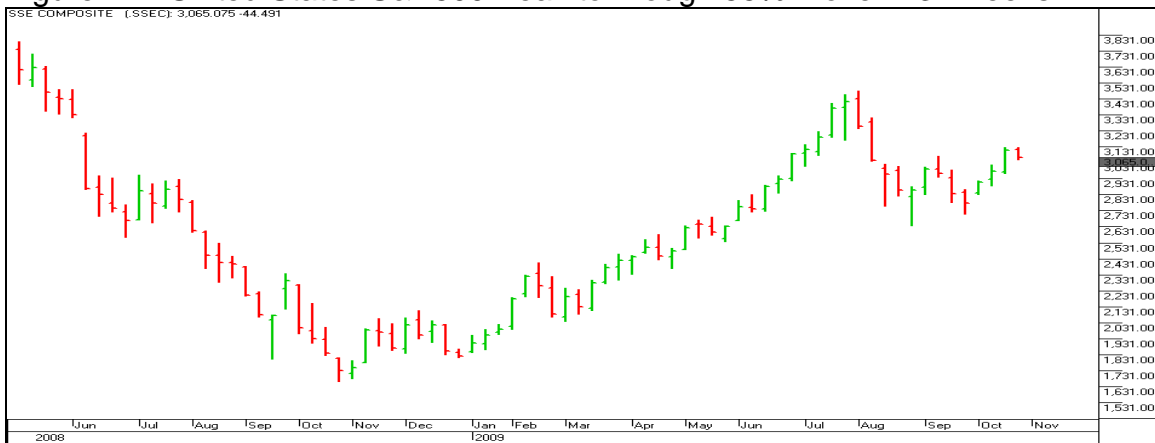


Figure 2.2: China's Shanghai Composite Peak to Trough 100% move in 39 weeks followed by a 25% fall in the space of 5 weeks.

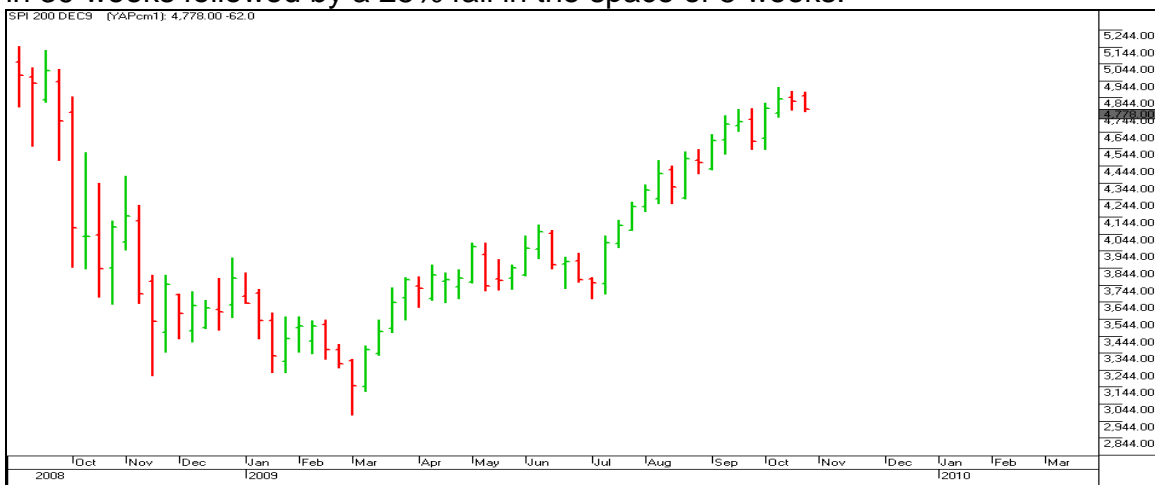


Figure 2.3: Australia's SPI Peak to Trough 55% move in 33 weeks.

The Chinese market has led the markets of the western economies by around six to eight weeks. The recent pullback in the Chinese market was around 25% in the space of five weeks. Those traders and investors who, after the turmoil of 2007 and 2008, agree that successful trading is all about timing the market and not time *in* the markets, should be protecting their capital in the near term.

In the United States the S&P500 has recovered in a sustained move up from trough to peak of 55% move in 34 weeks, while in Australia the SPI has recovered in a similarly sustained move up from trough to peak of 55% move in 33 weeks. These charts show that the US and Australia look to be in sync with the Chinese market, though lagging by around six to eight weeks. If we adjust for the fact that the Chinese have been leading the markets of the western economies we can see that our markets may be in for a pullback in the near term. China has shown that pullbacks in the current market conditions can be quite sharp, hence the suggestion of a cautionary stance.

Conclusion

Trading capital is crucial for successful trading, and the lack of trading capital is probably the single most consistent reason why traders fail. There is no single “right” way to trade, as every individual is different.

Key issues traders must resolve:

- Build up trading capital
- Know your system
- Know your market
- Know yourself
- Concentrate on trading with positive expectancy

The ATAA Conference was well worth the price of admission. The Annual conference is generally held each October and the ATAA endeavors to rotate the location Australia wide. The next conference is scheduled for Queensland next October, but if you cannot wait till then, refer to the ATAA website to find out when the next monthly meeting is being held at a location near you.

To keep up to date with market developments visit *MDS Financial Research* and take up a free trial.

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