REGISTRATION FOR THE OCTOBER 2012 CMT EXAM ADMINISTRATION IS NOW OPEN!
LETTER FROM THE EDITOR

The Market Technicians Association has always been at the forefront of technical analysis and in this issue we demonstrate some of the ways the organization is doing that. We provide summaries of a few of the presentations made at the Annual Symposium in May which included thought provoking and practical ideas. More summaries will be in next month’s issue.

We also offer a review of a book by Paul Ciana, CMT. *New Frontiers in Technical Analysis* includes some original research from Paul and features the work of several other technicians, including some members. This book adds to the Body of Knowledge of technical analysis with the new techniques that are presented and for those without access to a Bloomberg terminal it delivers details on what the most commonly used features of that system are.

Last month, while acknowledging those recognized by the Awards Committee, I inadvertently overstated the role that George Lane had in the development of the stochastics. George Schade, Jr., CMT, provides corrected information in a Letter to the Editor that is included in this month’s issue. George’s work is another example of the leadership that members have in the field. He has studied in depth the history of technical analysis and is an invaluable resource to the organization and this newsletter.

Please let us know what you think about *Technically Speaking* by emailing us at editor@mta.org.

Michael Carr
COMPLEX ADAPTIVE SYSTEMS BY PIERRE VAYSSE, PH.D.
SUMMARIZED BY MIKE CARR, CMT

This is a summary of Dr. Vaysse’s presentation made at the 2012 Annual Symposium on April 19th - 20th, 2012 in New York City. The complete presentation is available in the MTA Archives at http://go.mta.org/320.

The presentation is subtitled “from mind to market” and the intent is to show that the mind and the market are related to each other and they both form complex adaptive systems. Dr. Vaysse meets that objective with his clear and idea-filled presentation.

To understand the idea of a complex adaptive system, Dr. Vaysse asked the audience members to consider the group in the room. Each individual is a singularity and if they all begin interacting with each other, the first product of those interactions will be noise. The noise is actually each individual expressing an articulate thought and a complex adaptive system can identify the output of those individual thoughts.

He has developed an “emotional rational behavior model” of complex adaptive systems. Ideally emotion can be controlled since it can never be fully eliminated. The central idea of the system is to think about thinking. Neuroscience is a multidisciplinary field encompassing psychology, biology, chemistry, and physics that tried to make sense of the functioning of the brain. Dr. Vaysse found an obvious connection between neuroscience and the markets.

The collective mind of all traders in a market will define the mood of the market and that could lead to the development of a probabilistic outcome of the action of the market. This outcome could then be used to make capital allocation and trading decisions. A problem that must be overcome is that the outcome must be determined from all the noise that is a part of the system, a problem that Dr. Vaysse has been working on for thirty years.

The brain is a dynamic organ capable of switching between repetitive and routine behaviors, social interactions and abstract thought. Emotions are a part of brain’s processes and the study of behavioral finance can help traders learn about the role of emotion in the market.

Draw downs in the market, such as the big drop in the stock markets seen in 2008 and 2009, are an emotional challenge. The market grew only 5% of the time in the past 14 years. Growth is defined as the amount of time spent at new highs. That means 95% of the time the market was in a recovery mode.

Reaching a new high is associated with positive emotions and as you move away from those highs, worries are natural. Panic is also possible and even depression or anger is seen in traders and investors after they pass their fear threshold. Traders need to define their personal fear threshold, their MAD (maximum acceptable draw down) in order to maintain emotional control.

One goal of applying neuroscience to markets is to create an automated system that can avoid the MAD level. A complex adaptive system has multiple actors interacting with each other in an adaptive environment...
(adaptive means that the system is influenced by past action). The noise is the result of the interaction. Price movements emerge from all of the experience of all the traders in the market interacting with each other.

Noise is actually the language of the market. Dr. Vaysse has been able to identify 14 letters in the alphabet of the market language and these letters can be combined to form words and sentences that define the market. He refers to the sentences as pathways. These pathways are determined by conditional behavior, and that is the definition of how the markets and your mind work.

The alphabet of the market can be used to read the history of the market and it can be used to develop a forecast of what is likely to happen. This is a complex process but one that he has found can help identify profitable trading opportunities. Dealing with the market is really about dealing with yourself and if you understand your mind and how it works, that could help you to succeed.

Dr. Vaysse has worked on automating this process, he emphasized, because automation helps to control emotion which cannot be eliminated in any trader.

Pierre Vaysse, a neuroscientist with over 30 years’ experience in the field of neuroscience, developed “From Mind to Market.” His knowledge in brain signaling pathways and neural networks has culminated in the marking of NEUROsystem. Pierre holds a Pharm.D. from the University of Toulouse, France, and a Ph.D. in Neuroscience from the Albert Einstein College of Medicine in New York.

From 1988 to 1998, he conducted research into understanding biological cellular systems at Columbia University. In 1991, he joined a biotechnology company specializing in Synaptic neurotransmission. In 2003, he became Vice President for Cellular Sciences at Lundbeck Research USA. Today, as founder of Arthuria, he is devoting all of his time to the implementation of his ground-breaking “Emotional Rational Behavior” model and trading system.

Membership Renewal

The MTA is only as strong as its members! June is an important month as many of you will be renewing your membership. We appreciate all of the positive feedback in the recent membership survey. We are glad to hear that the many improvements and additions to your member services have been valuable. We look forward to continuing our global initiatives in the years to come and look forward to serving you as members and working with you as volunteers.

To renew, simply log into MyMTA and in the middle of that page you will find a section called “My Membership” and there you will find a link to renew your member dues. If you would prefer, you can call the MTA Headquarters at 646-652-3300 and renew over the telephone with any of the MTA Staff members.
TAM’S 100-YEAR MARKET THEORY BY KEVIN TUTTLE
SUMMARIZED BY MIKE CARR, CMT

This is a summary of Kevin Tuttle’s presentation made at the 2012 Annual Symposium on April 19th - 20th, 2012 in New York City. The complete presentation is available in the MTA Archives at http://go.mta.org/317.

When Kevin began working on Wall Street as a broker, he developed a love of technical analysis from a mentor who had a quote from Justice Oliver Wendell Holmes on his desk, ““When I want to understand what is happening today and try to decide what will happen tomorrow; I look back because a page of history is worth a volume of logic.” This quote is in some ways a summary of what charts can tell an intelligent trader.

Before turning to the charts in his presentation, Kevin offered a quote from Benjamin Graham, one of the founders of fundamental analysis. In The Intelligent Investor, Graham said ““It is only through the relentless management of Risk based on Arithmetic metrics in which investors can continually triumph over EMOTION and create success Longevity… NOT by the Management of Returns on Optimism!” Kevin pointed out emotion has been the cause of the professional death of money managers and that technical analysis is a valuable form of risk management based on arithmetic.

The 100-year market theory includes a chart. The chart includes the price-to-earnings (PE) ratio and Kevin noted that “Excess Market Valuations, due to extreme price movement upward over extended periods, may take years to wane as earnings catch up with prices.”

The 100-year theory includes fundamental and technical analysis and the chart shows monthly bars for a long-term perspective. The fundamental data is based on the PE10, a measurement developed by Dr. Robert Shiller. The PE10 is a moving average of the PE ratio using 10 years worth of data, in effect a presentation of fundamental data using a technique employed in technical analysis.

Kevin found that the market moved in three primary cycles. Secular cycles of 5-20 years include cyclical cycles of 1-5 years which break down into secondary cycles that can last from weeks to a year. Within a cycle, prices can be in a bullish trend, a bearish trend or a consolidation channel.
Secular trends are correlated to PE trends. In general terms, overvalued markets equate to a PE ratio of 22 and above. Undervalued extremes are seen when the PE ratio is below 10. Historically, overvaluation has led to consolidation channels with the exception of the bear market which began in 1929. That overbought condition led to a significant decline.

The question Kevin always hears is “where are we today?” In the current consolidation channel, the PE ratio bottomed at only 13.2 and has not yet become oversold. He believes we are now over 12 years into a channel consolidation on the secular level, with more consolidation ahead.

There are a number of characteristics that have been identified of market behavior in channels. Typically, the second selloff in the channel is the deepest and the bull move after that generally exceeds cyclical resistance. Kevin presented slides which showed how each of the four previous secular consolidation channels has developed in the market. The first one is shown to the right.

These examples can offer a roadmap of what to expect in the future. We may be halfway through the current consolidation.
The halfway point is based on the assumptions that the behavior seen in the previous channels will be repeated. That could mean we may see shorter cyclical channels over the next few years. The 100-YMT is intended to establish trends within trends in order to better ascertain long-term risk metrics of the markets’ current position and the presentation provides education that can help traders understand the longer-term trend in the market.

Kevin A. Tuttle, an industry-recognized market technician and statistician, who leads the Management Team of Tesseract Asset Management, LLC (TAM). TAM is a Private Money Management firm which specializes in Risk-Controlled Equity Management and caters to both the sophisticated investor and institutional clientele. It also owns TAM Portfolios, LLC; an RIA featuring the Long Only Growth Portfolio (LOGP) separately managed account (SMA); which has delivered a return greater than 100% of its benchmark since its 2001 inception.

With over 20-years of portfolio management experience, Tuttle is recognized for his industry renowned 100-Year Market Theory and corresponding Dow Chart – the first theory to combine fundamental valuations to technical analysis over extended periods (100-Years). He is also known for his unique quantitative and technical approach to both market evaluation and asset management.
WHAT CAN VOLATILITY DO FOR YOU?
FEATURING CARSON DAHLBERG, CMT AND KIRK NORTHINGTON, CMT
REVIEWED BY MIKE CARR, CMT

This is a summary of a presentation made at the 2012 Annual Symposium on April 19th - 20th, 2012 in New York City. The complete presentation is available in the MTA Archives at http://go.mta.org/318.

This presentation builds on previous work done by the presenters, which includes a presentation called, “Creating and Applying Volatility-Based Technical Analysis” which was offered as part of the MTA’s Educational Web Series. The archive of this webcast can be seen by visiting: http://go.mta.org/189.

Carson began by noting that money is made at the extremes and then began to explain how that idea can be applied to trading. In their work, Carson and Kirk begin with the basic tools of technical analysis and try to take these tools to the next level. They use volatility to make these concepts adaptive to market conditions, fractal in time and useful in any market. They apply a quantitative approach to add statistical validity to their new tools.

Bands were among the first tools developed to define “too high” and “too low” with Bollinger Bands being an example. Using bands offers tradable insights. Average True Range (ATR) is another tool that can offer tradable insights while being adaptive. These tools can be combined and the result can be seen in the chart below. The goal is to find new support and resistance concepts based on volatility, identify tools that will provide predictive relative strength, and show how technical analysis can be used as a stand alone portfolio solution to achieve absolute and relative out performance to a benchmark.

Bands are added to the price chart based on ATRs and these bands can help identify support and resistance levels. Extremes are objectively defined when the price reaches a band. These concepts can all be defined precisely in quantitative terms and tested. Additional bands can also be added. Testing this concept was done with the S&P 500 constituents, adjusted for survivorship bias and covered an eight year period. Trades are compared to the index itself which is assumed to be held during the trade period and the results are then analyzed with Monte Carlo simulations. Testing confirmed that the concepts deliver useful information to traders in real time.
Taken together, their tools offer a complete trading strategy that adapts to the market and can be applied in any market. This presentation includes a number of examples and current examples are often posted to a blog on their website, http://go.mta.org/319.

Carson Dahlberg, CMT, is a Technical and Quantitative Analyst/Trader. He is the co-creator of MetaSwing for Bloomberg Professional. Prior to joining Northington Trading, Carson was an analyst/trader/relationship manager at Schaeffer’s Investment Research, Wachovia, and Morgan Stanley. Carson presently serves as a Director on the Board of the MTA. He received a degree in Chemistry from the University of Cincinnati and was awarded the Chartered Market Technician designation in January of 2008.

Kirk Northington, CMT is the founder of Northington Trading, LLC, and the creator of MetaSwing: advanced analytic software for Bloomberg Professional, MetaStock and TradeStation. He trades his own accounts, and uses MetaSwing technical analysis methods exclusively. The author of Volatility-Based Technical Analysis: Strategies for Trading the Invisible (Wiley Trading Series, John Wiley & Sons Publishers), Kirk is a quantitative technical analyst. He is a member of the MTA, and is a Chartered Market Technician. Kirk has a BS degree from Nicholls State University, in Thibodaux, Louisiana. He has extensive experience in control system and software engineering.
CORRECTION: LETTER TO THE EDITOR

Editor’s note: In last month’s issue, the article about George Lane contained an inaccuracy and we are indebted to George Schade, Jr., CMT, for providing a more accurate description of George Lane’s role in the development of the stochastics indicator.

May 7, 2012

Dear Editor:

I am glad Technically Speaking provided two links to the background of the stochastic oscillator and the late George Lane (MTA Recognizes Six With Awards). I hope the statement that Lane “developed” the stochastic oscillator does not confuse others into believing that Lane invented or originated the oscillator.

George Lane was not the sole originator of the stochastic oscillator. This assertion has been made for many years by those familiar with the story. Among them is trader Larry Williams who has written that Lane “did not invent Stochastic” (Long-Term Secrets to Short-Term Trading). Author John Murphy accepted this point in 1999, when he replaced the word “invented” with “popularized” to describe Lane’s work with the oscillator (Technical Analysis of the Futures Markets).

A group of collegial futures traders, of which Lane was a member, working together originated and invented the oscillator. In fact, Lane in articles and public presentations did not claim otherwise, albeit he named it “Lane’s Stochastics” and did not identify the members of the group. His materials describing the oscillator changed very little in almost three decades repeating what had been originally written. Concerning the variation of slow stochastics, Lane neither originated nor invented it and did not claim to have done so.

Undisputedly, Lane popularized the stochastic oscillator. He promoted its use and acceptance. To this extent, one could say he developed the indicator, but he did not invent it.

George A. Schade, Jr., CMT

CMT Exam Registration is Open!

We are thrilled by the record participation in the CMT Program during the past administration. Over 800 candidates registered to take the exams earlier this month. Nearly half of these candidates were outside the US, reflecting our organization’s global reach.

The next administration of the CMT exams will take place on Saturday, October 20th, 2012. Whether you are advancing to the next level or need to retake a previous exam, please register today.

It is important that you register early for the CMT exam. Several individuals were unable to take the exam during the past administration because they waited until the close of registration before reserving their place at a test center. Please be sure to sign up as soon as possible for these exams to ensure your preferred time and location.
MTAEF SPRING FUNDRAISER RAISES $20,000 WITH LUNCH AUCTION
BY THE MTA EDUCATIONAL FOUNDATION

The MTA Educational Foundation (MTAEF) completed its spring 2012 “Take an Analyst to Lunch” fundraising event. The most recent auction was also referred to as, “Take an Expert to Lunch” and “Take a Trader to Lunch”, reflecting the broad participation by industry giants.

The May auction ran for ten days on EBAY® and included over twenty participants, some of whom graciously continue to support the event time and again. Notable highlights for the event include the following:

- Dan Zanger for the second time running topped the bidding at $3,500
- Nearly $20,000 was raised for the MTAEF

With a top bid of $3,300 last October and a matching bid in May of last year, Mr. Zanger’s participation has raised over $10,000 for the Foundation.

Matching bids received for widely followed analyst and international investor Jim Rogers contributed to the outstanding results in this year’s auction. Matching bids were also received for David Keller, CMT, a Managing Director of Research for Fidelity Investments in Boston and President of the MTA.

The twice yearly fundraiser aids the MTAEF in its mission to provide technical analysis curriculum and support to professors teaching the subject at both undergraduate and graduate levels. In addition, the MTAEF is working towards expanding its reach by providing introductory sessions to colleges and universities around the globe.

The MTAEF would like to thank all the participants and bidders and all those who helped spread the word about the fundraiser, making it a resounding success. The Board would also like to thank Board member Cody Tafel, CMT, for the many hours he spent contacting participants and coordinating the event, as well as his great energy promoting it.

Board Elections Still Open – Voting Ends Friday, June 15th

Members, Honorary Members and Emeritus Members, please note that online proxy voting for the upcoming election is still open for your voting consideration. This year’s slate has seven positions for your consideration—four Officers for terms of two years, and three At-Large Directors for terms of three years. If you haven’t voted, you can do so by clicking here.

You will need your MTA Member ID Number to vote (found on your membership card or under the ‘My Membership’ section on the homepage of MyMTA). If you have any questions regarding the proxy voting process, please contact Marie Penza, MTA Director of Member Services, at 646-652-3300 x12.
GLOBAL EMERGING GROWTH CAPITAL

Investment Courses For Professionals

A sample of a growing list of fundamental and technical courses is shown below. The courses are associated with global destinations and dates, both for open and private client formats. They are produced by various knowledge vendors throughout the world. Details can be provided by contacting NYIF.COM, or John Palicka (palicka@pipeline.com).

Taught by John Palicka CFA CMT

FUSION ANALYSIS-
This is a professional approach that blends fundamental, technical, behavioral and quant strategies.

EQUITY PORTFOLIO MANAGER-
Serious managers will utilize this course to analyze leading Wall Street valuation models and investment strategies for equities using fundamental, behavioral/technical and quant approaches, and then study how these are modified by the best performing equity portfolio managers to produce risk-adjusted excess returns.

INVESTMENT FUND SELECTION-
This is a must attend course for all professionals involved in the selection and management of third-party investment managers.

TECHNICAL ANALYSIS CMT 1-
A must attend course for investment professionals wishing to gain the CMT Level I professional qualification in Technical Analysis from the Market Technicians Association (MTA).

INTRODUCTION TO STEALTH TRADING USING FUSION, ALGORITHMS, AND DERIVATIVES FOR PROFESSIONALS-

Today, portfolio managers increasingly must use stealth trading in order to disguise their intentions and thus benefit from best execution.

ADVANCED CAPITAL MARKETS ANALYSIS
Spot, forwards, futures, swaps, options, and statistical issues are discussed in dynamic capital market strategies.

STRATEGIC GOLD INVESTING
Gold has been one of the very few assets to have created wealth in the past several years. Gold offers investment opportunities for investors, traders, and financial engineers.

GLOBAL SMALL CAP INVESTING
Global small cap stocks offer investors the ability to participate in the world’s future big winners.

PORTABLE WEALTH INVESTING
Portable Wealth (PW) management offers investment opportunities for wealthy investors and their advisors. PW can generate attractive risk-adjusted excess returns to traditional and alternative investments.

Instructor John Palicka CFA CMT is a top-ranked portfolio manager of Global Emerging Growth Capital (WWW.GLGE GC.COM) with over 30 years experience of managing $ billions. He has doubled client money, on average, every 4 1/2 years since 1980*. His high course ratings from major investment firms reflect clear interpretations and practical applications of complex topics; knowledge applied to examples and cases found in the current worldwide and GCC marketplace; his experience with specific situations actually encountered in his career and consulting contracts that parallel the learning topics. John has an MBA from Columbia University and also teaches these courses for leading training institutions, including The New York Institute of Finance (WWW.NYIF.COM).

* Past performance is no guarantee of future results.
NEW FRONTIERS IN TECHNICAL ANALYSIS BY PAUL CIANA, CMT
REVIEWED BY MIKE CARR, CMT

As an Application Specialist at Bloomberg LP, Paul has access to information that many traders will find useful, and in New Frontiers in Technical Analysis he presents some of that data along with ideas and some specific techniques that seem to have never been disclosed before.

The first chapter begins with a definition of technical analysis, which is simply:

> Technical analysis is the extraction of information from market data into objective visualizations through the use of mathematics with an emphasis on investor behavior and supply and demand to explain the current and anticipate the future path of the financial markets.

A precise definition of technical analysis has been the subject of much debate. To those familiar with those debates, it may be surprising how Paul has offered an eloquent solution that requires only 41 words. That definition includes five attributes that any scholar or practitioner would agree are the essence of technical analysis:

1. Market data
2. Objective visualizations
3. Use of mathematics
4. Emphasis on investor behavior and supply and demand
5. Explain the current and anticipate the future

These attributes incorporate the work of chartists and more quantitatively inclined technicians while including some of the more intuitive aspects of the field like Elliott and Fibonacci. While inclusive of all that has come before, this definition also allows room for the future advances in technical analysis. Several of those advances are covered in the remaining chapters of the text but the first chapter includes more than a definition.

Paul also presents the results of a recent study that determined what chart types and indicators Bloomberg users look at most often. The results may be surprising to a number of technicians. Line charts are the most popular among the global population of users although there are some regional variations and the results are slightly different each year. In the Americas, 51% of users prefer line charts, 32% prefer bar charts, 14% prefer candlesticks and 3% prefer log charts. Candlesticks are slightly more popular in Asia with 43% of users preferring this style and 41% preferring line charts.

A similar trend towards simplicity is seen in indicator preference. With more than 200 functions readily available to users, RSI is the most preferred indicator. Again there are regional and year-to-year variations but the top seven world indicator preferences are:
1. RSI (44%)
2. MACD (22%)
3. Bollinger Bands (12%)
4. Stochastics (9%)
5. DMI (5%)
6. Ichimoku (5%)
7. Volume at Time (3%)

After describing these indicators and how they can be applied, the book turns to other experts who share some of their favorite techniques.

In the second chapter, Julius de Kempeneer explains Relative Rotation Graphs, starting with basic concepts and taking the reader through to the more advanced trading ideas.

Relative strength is an important and useful concept to apply to investment decisions. A simple approach to relative strength is to plot a ratio of the stock’s performance compared to an index that tracks the performance of the broad market. The absolute value of relative strength is not as important as the general trend of the relative strength line.

Starting with this well-known concept, Julius details several more advanced strategies for applying relative strength. Moving averages can be added directly to the indicator. He notes that he has been using the 10-week and 30-week moving averages in his work since 1994 although other values could also be applied. When the shorter moving average is above the longer average, relative strength is considered to be in an up trend and the opposite conditions would define a down trend. He has also found that it can be useful to calculate MACD for the relative strength line. The same moving averages are used in this calculation, and a 9-week signal line is added to find MACD signals.

The book illustrates these ideas using Bloomberg charts but they can easily be applied in almost any charting software package. Below is a chart of the MACD applied to relative strength for the DAX Index, using indicators created with Trade Navigator. In the bottom portion of the chart, the red line is the 10-week moving average of the 6-month relative strength and the green line is the 30-week moving average of relative strength.
Other innovative indicators are explained and Julius also illustrates a concept he calls Relative Rotation Graphs (RRG). In his work, Julius has noticed that relative strength moves through the quadrants of a simple grid. His idea is very roughly shown below:

![Diagram of Relative Rotation Graphs (RRG)](image)

In his experience the upper right quadrant, where momentum and relative strength are both strong, is where many investors will find the most profitable investment opportunities. These ideas are more fully explained in *New Frontiers in Technical Analysis*.

The book continues in this way. Philip Erlanger, CMT explains seasonality and shows how this idea can be improved. Many traders simply identify a typical seasonal pattern by averaging past action into a single curve. Phil explains how to test the cycle pattern for validity and identifies specific techniques that can be used to generate more profits from this trading strategy. Cynthia Kase, CMT, MFTA describes some of the tools she has developed and incorporated into Kase StatWare™ which provides a
quantified and statistically sound way to trade. Andrew Kezeli shows how to apply Market Profile and Rick Knox introduces a suite of tools that he has compiled to form Advanced Trading Methods.

Traders can turn to the book for ideas on how to trade. That was one of Paul’s objectives in writing the book. He mentioned that the title uses the plural “frontiers” because he hoped each reader would find multiple ideas in this work. It is impossible to read, or reread, a chapter without having several tradable ideas.

Paul Ciana, CMT, is an Application Specialist at Bloomberg LP where he consults with market participants on developing technical strategies, directs a week long class on technical analysis and proposes the development of new technical tools on Bloomberg. He is the author of the Bloomberg Global Technical Strategy report and contributes quarterly to Bloomberg Markets magazine. He has guest presented at the Traders Expo, Market Technicians Association Annual Symposium, International Federation of Technical Analysts Annual Conference, CFA Institute, MBA programs, and many Bloomberg events. He is the New York Chapter Chair of the Market Technicians Association and is an instructor in the CMT Institute. He graduated from the University at Albany with honors, majoring in finance and management, and minoring in economics.
INTERVIEW WITH ERIC LEAKE
BY AMBER HESTLA-BARNHART

How would you describe your job?

I’m a portfolio manager for two mutual funds and a hedge fund.

What led you to look at futures markets instead of stocks or another tradable?

Managing both global long-short equity and long-short high yield bond strategies, we monitor a variety of markets and asset classes, including both cash and futures indexes.

Do you look at any fundamental or economic inputs to develop your opinions?

The analysis of price, volume and spreads are the primary inputs to our quantitative investment models, but we do consider fundamental and economic data as well.

What advice would you have for someone starting in the business today?

My best advice is to find a mentor, someone who is doing the job you would eventually like to. Second, learn from those who have gone before you by reading their work. There is a tremendous wealth of knowledge publically available that can help formulate your investment thesis.

Can you share any longer term market opinions?

No matter what markets you are trading from commodities to stocks, for the foreseeable future, credit markets remain the primary driver. There is tremendous opportunity for long-short managers over the next several years as the battle between de-leveraging and re-risking is waged.

Eric Leake is a Founding Partner and Chief Investment Officer to Anchor Capital Management in Aliso Viejo, CA. a registered investment advisor and manager to long-short investment strategies. Eric is portfolio manager to the Pyxis Alternative Income Fund (HHFAX) and the Pyxis Alpha Trend Strategies Fund (HATAK), as well as the Alteras Hedge Fund.

Eric is an active member of the Market Technicians Association (MTA), American Association of Professional Technical Analysts (AAPTA), National Association of Active Investment Managers (NAAIM), and former advisory board member to Rydex Financial Services, LLC. Mr. Leake attended Azusa Pacific University majoring in communication. Eric is an active surfer and coach to youth AYSO soccer and NJB basketball. Eric lives in Aliso Viejo, CA along with his wife and three children.

These questions and answers have been compiled by Amber Hestla-Barnhart, an independent market researcher. If you’d like to participate in a future interview, please contact her at amzhondacbr@yahoo.com.
By now, the story is well known. In early May, JPMorgan announced that some hedges designed to limit risk had not worked as planned and the bank was facing losses of at least $2 billion. The trades were on certain tranches of credit-swap indexes.

The MTA enjoys a diverse and growing membership and some members may be involved in these specialized markets or even been on the winning side of these trades. It wasn’t always this way. Originally, the MTA limited membership to technicians focused on the stock market and living in New York. Founding members quickly expanded the organization and today it is possible that a member is an integral part of any news story. It is also possible that some members barely follow the news, profitably focusing solely on charts and ignoring anything else.

Several features of the JPMorgan story show how technical analysis has grown and members are using similar trading strategies and techniques, although most members are not risking billions of dollars in trading capital. This story also provides an opportunity to highlight that technical analysis is a valuable tool for risk management.

The instruments involved in the JPMorgan trade are complex financial instruments. They are derivatives based on credit default swaps which are also derivatives. Credit default swaps pay the buyer the amount they lose if a borrower defaults and fails to meet its debt obligations. Credit-swap indexes aggregate a number of credit default swaps into a single instrument using the same underlying idea for indexing that Charles Dow used to create the Dow Jones Industrial Average in the late 1800s.

Tranches break the index down even further and are available with varying degrees of risk. In some ways, tranches slice up the index into pieces. Some slices will have more risk than others and the price of each tranche should be set by the risk of the underlying credit-swap index and the characteristics of the tranche. The exact variables involved with pricing these products are probably best considered as fundamental analysis and require detailed and specialized knowledge.

Although identifying the specific price that each tranche should trade at can be a complex math problem, they do eventually trade and the price moves are based on supply and demand. This is a principle that the traders at JPMorgan seemed to ignore. According to Bloomberg, “Bloomberg News first reported April 5 that [the trader in London who is at the center of the problem] had built positions that were so large he was driving price moves in the $10 trillion market for credit-swap indexes.”

Most traders will never face this problem, but acquiring too large a position (once known as cornering a market) has led to problems for traders for at least 150 years. On a day known as Black Friday in 1869, two speculators tried to corner the gold market on the New York Gold Exchange. Massive government selling of gold then led to a crash in the price and many
speculators lost money. On Silver Thursday in 1980, a corner in the silver market collapsed. There are other examples throughout history. Technicians understand that market history tends to repeat itself and study incidents like this to learn how to avoid those problems. While most traders never control enough capital to move market prices with their trades, this market reaction is certainly possible in thinly traded stocks or options markets that many members are active in. While the JPMorgan trades are not in the history books yet, they are still providing lessons to traders.

In announcing the troubled trading position, Jamie Dimon, Chief Executive Officer of JPMorgan, noted that the trades were “riskier, more volatile and less effective as an economic hedge than we thought.” He added, “But in hindsight, the new strategy was flawed, complex, poorly reviewed, poorly executed and poorly monitored.”

Traders can draw lessons from each of those problems:

- Flawed: Trading strategies should be developed based on a logical premise that withstands the test of time. There are three basic premises of technical analysis – the markets discount the future; prices move in trends; and history repeats itself. Sound trading strategies should be able to point back to these premises as a source for the underlying logic behind the trades.

- Complex: When the MTA was founded, traders relied on chart patterns and a few indicators. Computers did not add indicators with a click of the mouse and optimization was a manual process that could require days with pencil, paper and a calculator. Simple strategies formed the cornerstone of technical analysis. Over time, complexity has been added but systems which become overly complex are unlikely to work as well in the future as they did in the past if they are based on flawed logic. The more complexity a trader adds, the more likely the strategy is to be curve fit to the past and although the future may be similar to the past, it will not unfold exactly the same way.

- Poorly reviewed: While this probably means something different to everyone, one interpretation of a “poorly reviewed” trading system would be one that is not adequately back tested.

- Poorly executed: Traders need to accept feedback from the markets. Analyzing trades to determine if they are being executed at a low cost is a practice among institutional traders and should merit at least a cursory glance from individual traders. Simple changes like trading at different times of the day could impact execution and trading performance.

- Poorly monitored: Almost every trader reviews their account balances daily. Justifying losses is a problem for some traders who believe “this is just a short-term move and I’m in it for the long-term” or offer other excuses. Successful traders don’t argue with the market and monitor performance so that they can minimize losses and maximize gains.

Another lesson to draw from this loss is that portfolio risk needs to be managed at all times. JPMorgan and other institutions often rely on a measure called value at risk, or VaR, which quantifies how much the trader
believes they can lose on their positions on 95% of trading days. Specific
calculation methods vary but in general terms, the following equation can
be used:

\[
\text{VaR} = (\mu + z \cdot \sigma) \cdot P
\]

Where \( \text{VaR} \) = Value at Risk

\( \mu \) = mean returns

\( z \) = left tail risk assuming a normal distribution

\( \sigma \) = standard deviation of returns

\( P \) = portfolio value

JPMorgan has said that its VaR for these trades was believed to be about
$67 million but a different model showed that the VaR was actually $129
million. As an isolated fact, we can’t draw any conclusions from the amount
of VaR. We do know that Dimon said the method used for calculating this
metric was “inadequate.” Successful traders use some type of active risk
management and limit losses.

In liquid markets, traders can use stops instead of VaR to assess their risk.
They might risk a portion of their capital on each trade. Individual tranches
of a credit-swap may not be liquid and stops may not be practical. Individual
traders may find that stops are not practical in some equity or options
markets. In these cases, individuals often limit the amount of risk they
accept by allocating only a small amount of trading capital to the position.
This rule that almost every novice trader learns may have been ignored by
the risk management desk at JPMorgan.

Some MTA members may read about derivatives markets and billion dollar
trades by institutions and think that is something they will never be a part
of. They can still take lessons from each trading problem large institutions
endure, and we can be certain that there will be additional trades that are
“flawed, complex, poorly reviewed, poorly executed and poorly monitored”
in the future. One of the basic premises of technical analysis tells us that
this will happen again since history tends to repeat itself.

Traders interested in learning from the largest trading losses in history can
find a list of those losses at [http://go.mta.org/315](http://go.mta.org/315)

**DID YOU KNOW:** Reading the Technically Speaking e-Newsletter
qualifies you for 3 MTA CE Credits! [Report your credits here!](http://go.mta.org/315)