LETTER FROM THE EDITOR

We are once again providing short summaries of several moments from the MTA Symposium and we will have more next month. As usual, there was too much information from the two-day event to summarize quickly. In this month’s summary, we present information about the MTA Annual Award Winner Larry Williams, an article with lessons learned over a lifetime in the industry from Steve Leuthold and the rules for a complete trading strategy from Perry Kaufman.

There is also a review of a book written by Michael E. S. Gayed, the late father of this year’s Charles H. Dow Award co-author Michael Gayed. This book was originally published in 1990. It was recently republished by the author’s son as a tribute to his father’s life and work. While the book is certainly a tribute to an insightful mind, it is also a modern day primer on what’s important in the markets. The section on economic indicators is one of the most practical collections of indicators ever assembled, and each section concludes with a clear opinion about the indicator’s usefulness.

We hope you enjoy this issue and ask you to please continue sending your submissions and comments to editor@mta.org.

Sincerely,

Michael Carr
“In recognition of your decades of service to champion technical analysis within the trading and investment communities through speaking engagements, writing and innovation in technical indicator and statistical research.”

The MTA Annual Award winners are recognized for their life-long outstanding contribution to the development and widespread acceptance of technical analysis by institutional practitioners and individual investors. Few have been such prolific contributors as Larry Williams. For decades, Larry has been fully disclosing details of indicators and strategies that really work.

More than a few members of the audience at the 2nd Annual Gala Awards Dinner on April 3rd, 2014 weren’t even born when Larry started his career in the markets. Larry first became interested in the markets when he observed the 1962 market crash.

In introducing Larry at the Dinner, his friend and colleague of more than 30 years Ralph Vince pointed out that Larry was destined to be a great trader. He had passion and ambition and wasn’t content to work as a gas station attendant or a ranch hand in Montana in the 1960s. Jobs like that paid little at the time and Larry set off on his journey through the markets, hoping to make $100 a day whether the markets moved up or down.

By 1965, he was trading and writing a newsletter. Within a year, he had developed Williams %R, the first of many indicators he would contribute to the field of technical analysis.

In 1970, Larry’s first book, The Secret of Selecting Stocks, was published. Over the next forty years, there would be ten more including the first book ever on the seasonality of stocks and futures, Sure Thing Commodity Trading, How Seasonal Factors Influence Commodity Prices. Published in 1973 this work paved the way for others to apply seasonality in their work. In many ways, this book led to the growth of a seasonality sector within the investment analyst industry.

Williams was the first to write about the COT data in 1973 that lead to another book, Trade Stocks & Commodities with the Insiders, which detailed original research and application of the Commitment of Traders (COT) report. It was the first book published on how to apply COT data to trading and led to development of another sector in the industry.

It is hard to imagine, today, a world without Seasonals and COT!
The books offer valuable insights for market professionals, they also offer guidance to market novices. *How I Made One Million Dollars ... Last Year ... Trading Commodities* details exactly what Larry did in 1987 to gain 11,376% in twelve months. Using the ideas in that book, he taught his daughter to trade and she turned a $10,000 account into more than $100,000 in the 1997 Robbins World Cup Championship of Futures Trading.

Among the many books and articles Larry has written are dozens of other techniques that he either developed or refined from original and often long-lost sources.

Pivot points, a technique to project future highs and lows on a price chart, were reintroduced to the world in a book Larry wrote in 1966. As he said, “I know they’re good, I learned them from Owen Taylor’s work in the 1930s.”

Properly attributing the work of others is an important feature of Larry’s work. It is common to see him explain where an idea came from as he adds to the body of knowledge for the global trading community relies on. In effect, he works backwards and forward in time as he builds on an idea. On his web site, Larry describes how he developed the Williams Accumulation/Distribution indicator:

“The first book I ever read about the stock market was Joe Granville’s, and I was taken by his on balance volume idea. There are things I liked about it a great deal and eventually I found the two gentlemen from San Francisco...”

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Woods and Vignolia who were apparently the originators of the concept. But there were problems with OBV. Dave Bostian had his intra-day intensity index, which triggered an idea in my mind to reference the opening price to measure accumulation and distribution. We hand punched computer cards, loaded them into the computer and came up with a new way of measuring accumulation distribution that I still use to this very day. This was a major breakthrough."

As with so much of his work, the formula for this indicator has been widely available for many years.

Williams Accumulation/Distribution

$$= \frac{((\text{Close} - \text{Low}) - (\text{High} - \text{Close}))}{(\text{High} - \text{Low})} \times \text{Period's volume}$$

Trading volatility breakouts were another of Larry’s innovations and this one was also shared in the 1980s. That tool was widely applied in futures trading and later would form the basis of many strategies used by day traders in the stock market.

A partial list of indicators and patterns he’s developed can be found at IReallyTrade.com, Larry’s web site.

Over the years, Larry has worked with some of the most talented analysts in the industry. This includes Tom DeMark who spoke at the dinner and noted that he had been working with Larry for decades. Tom has seen Larry succeed at trading, system development and many other endeavors. Larry has found success as a boxing promoter, a restaurateur, a marathon runner, and as an archeologist.

*The Mountain of Moses* is a book Larry published describing part of his archeological career and detailing his search for the actual location of Mount Sinai, a journey that took him to Saudi Arabia and other countries in the region that included several brushes with authorities who questioned why he was in their country.

The list of accomplishments, both market-related and nonmarket-related, is only a partial description of Larry Williams. He has taught thousands of students in seminars and through his writing and many of them have been successful because of the tools he shared. He also fought for, and successfully defended, your right to share your market opinions.

That may sound overly dramatic but years ago the ability to publish trading ideas was attacked by the Securities Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC).

Larry joined with Bob Prechter and other writers to fund the defense of Christopher Lowe, an investment newsletter publisher. The SEC claimed that Lowe could not publish without being a registered advisor and in Lowe v. SEC, the Supreme Court ruled that newsletters are bona fide publishers and not investment advisors. Larry would join with another
group of writers to fund the defense in the case of Taucher v. Born which extended that right to commodities newsletter writers.

The importance of these cases is impossible to understate. Without the efforts of Larry and a small group of writers, financial writers today would be required to register as investment advisers. The additional expense would have made starting a newsletter more difficult and it could have made maintaining a blog about the markets illegal.

These cases, and Larry’s activism, demonstrate that successful individuals care about more than personal success. The most successful people leave a mark on their industry that will impact future generations.

In Larry’s words,

My father always said you only get out of something what you put into it. I have found that to be very true. The more energy and research you put into markets, the better you get and the more friends you have. The markets have become very much a relationship for me. Not only because of trading, but the marvelous friendships I developed. Putting energy into other things, politics, family, my archaeological efforts…has always paid off in spades.

The more you put out…the more you get back.

Tom DeMark and Ralph Vince have both made valuable contributions to the body of knowledge and they are two of the brightest minds in the business. They both noted at the dinner that Larry Williams was an inspiration to them and an important factor in their professional and personal success in life. Their comments demonstrated Larry has followed the advice his father gave him.

When given the award Larry said, “I wish everyone in the world could be here, not for my award but to meet MTA members to learn firsthand that Wall Street is not a pack of wolves but hard working, great people, solving a great problem.”

Editor’s note: Royalties from the books Larry has written over the past fifty years go to support the Max Wales scholarship at the University of Oregon. Larry notes, “Max was the best professor I had…and this is just one way I have chosen to acknowledge him. The scholarship is to the School of Journalism.”
What follows applies to personal investing, but much of it also applies to professional responsibilities as a portfolio manager. At the tender age of 23, I was a retail stockbroker at Paine Webber. From 1961 through 1966, I dealt with individual investors, traders, and a few high-roller speculators. This time span included two bear markets (1962 and 1966). In retrospect, this experience was invaluable as an education in human nature and investor psychology.

Greed and fear are critical stock market elements and also the twin barriers on the road to long-term investment success. In truth, I probably learned more about investor psychology in those years as a retail broker, than in the following 45 years being a relatively detached analyst, portfolio manager, and investment strategist. For a real understanding of investor psychology, I think it is necessary to deal direct rather than from the relatively remote positions of analyst, portfolio manager and investment strategist.

Anyway, after five decades at various positions in the investment business, here is my version of the Ten Commandments -- the ten lessons I think are most important to keep in mind when managing your serious money...your mother lode. I learned most of these lessons only after first violating many of these “ten commandments.”

I. Know Thyself

Everyone has their own investment strengths and weaknesses. It is particularly important to know your weaknesses so that you can defend against them and compensate for them. Here are some examples:

- You hate to admit you’re wrong, so you have difficulty taking a loss
- You’re a sucker for tech stocks
- You’re inherently pessimistic or optimistic

II. Discipline Is Essential

Establish your own personal set of investment disciplines, carefully considering and counteracting your own investment weaknesses. Write them down and keep them under your desk blotter and in your billfold or purse. Check them out each time you are planning to buy or sell. Revise the disciplines from time to time, but no more than once a year, and never when emotions are high.

III. Always Consider Risk As Well As Return

Before making an investment, make an estimate as to how much you might lose if it does not work out. Focus on the downside as well as the upside, the potential risk as well as the potential reward. Does it make sense if the potential gain
is 25% over the next year, but if things go wrong, the risk is 50%? While admittedly an inexact exercise, you can apply this mental discipline to an entire market (bonds, stocks, real estate), as well as individual stocks.

**IV. Cash Is Not Trash**

Cash reserves reduce overall portfolio risk in declining markets. But, more importantly, cash reserves provide the investor with the ammunition to take advantage of the unexpected opportunities that can develop. Cash reserves can be a great offensive weapon...See “Commandment V”...

**V. Always Consider A Market Crisis As A Potential Market Opportunity**

Your emotions say sell, sell, sell! But, those personal disciplines you previously established say BUY! However, if you have no cash reserves, a great opportunity can be lost. Crisis opportunities seem to develop once or twice a year. There are times when even typically conservative investors might consider using some margin buying power. However, buying on margin should be reserved for special opportunities.

Leverage should never be standard operating procedure when managing your “mother lode.” Maximum leverage (maximum margin) supports your mother lode portfolio “as a rope supports a hanged man.”

**VI. Bonds Can Be Best**

If yield falls from 4% to 3% over a year’s time, a 20-year bond will produce a total return of about 15%. This is 1.5 times the historical annual return achieved by the stock market. What of the risk? If yields rise to 6% rather than falling to 3%, the total return loss from the bond is 23%, thus an unattractive risk/reward ratio (see “Commandment III).

**VII. Stock Market New Valuation Eras Have Always Been Temporary**

When stocks have run up big, like in 1998-2000, and Wall Street uses the term “new era,” saying, “It’s really different this time,”...well, that’s the signal to consider asset class alternatives like cash and bonds. While stock market bubbles can inflate beyond most expectations, they always ultimately burst.

On the flip side, late in a big bear market and even in 2009, many on Wall Street will again conclude it is a “new era,” with a depressed economy, depressed earnings, and depressed equity valuations for as far as the eye can see. Again, the refrain is “It’s really different this time.” These bearish “new eras” have (so far) always proved to be temporary...These bearish “new eras” are typically the prime time to build equity holdings.

Case in Point: Back in late-2002, while we were hearing more and more from the “new era” bears, our own indicators turned positive towards stocks, and we proceeded to increase equity exposure in our Leuthold Core Investment Fund to its maximum guideline level. In retrospect, it was the perfect time to buy. And, many others were running for the exits! (Although we don’t anticipate our timing to normally be quite so perfect.)
VIII. Short Term Trading Is A Loser's Game

It took me about 20 years to learn this lesson. It’s true there are a few full-time professional short-term traders who have been consistent winners, but even they ultimately burn out or go down in flames with one or two huge losing trades. With non-professional short-term traders, about 95% will end up losers if they stay in the game.

Even those with “winning” trades two-thirds of the time can end up losers, since losses on bad trades are typically at least twice as large as the average gains realized on the good trades. Even if successful, the ultimate price can be high, since those few who do win often end up as life’s losers, married to their trading machines and losing their families.

IX. History is Experience...Learn From It

Financial history is not a Xerox machine, and does not repeat itself exactly. But, simply put, history is mankind’s past experience. And, it is said, experience is the best teacher. It is much less painful to learn the hard lessons from the experience of others. This is why financial history is a vast early warning system, and this is why I hope you will learn from and pay attention to these ten investment lessons derived from my experience.

Why does old financial history provide so many guideposts and lessons even in today’s world of advanced technology? Well, regardless of technology, human nature has not changed. Investor psychology in the horse and buggy days was no different than today. Society may have changed, but fear and greed continue to be the ultimate dominant market forces now, just as they were in 1905 and 1805.

X. Don’t Assume The Great Companies of Today Will Be The Great Companies Of Tomorrow

Back in 1970, the popularity of the “Nifty Fifty” buy and hold approach (advocated by McGeorge Bundy and the Ford Foundation) was all the rage with pension funds and bank trust departments. It was simple. Just buy and hold the biggest and best companies in America and focus your attention on golf and tennis. Long-term investment success was thought to be that simple for both individual and institutional investors. At least that is what many of the biggest professional managers had concluded, more than willing to follow the lead of Bundy and the Ford Foundation.

But a century of stock market history tells us shifts in the relative fortunes of America’s leading corporations have taken place in a far more dramatic manner than most of us might perceive. In the last few decades, this reversal of corporate fortunes has shifted into high gear, driven by creative destruction and intensified competition. Here are some examples:

- 1970 Top Tier “Nifty Fifty” Stocks included: GM (#3), Eastman Kodak (#5), Xerox (#9), Avon (#15)….Farther down the list: Polaroid (#33), Kresge (#44), and Burroughs (#45)
- Of the 50 largest market cap stocks January 1, 300, 48% had fallen off the list by 2014, either by merger or declining price
- Only about 8% of the companies included in the S&P 500 in 1957 remain in that index today. McKinsey & Company estimated a few years ago that S&P 500 component companies will now remain in the index as average of ten years or less
“NO GROWTH IS PERMANENT”

Back in my early years in this business, I read a treatise by Mansfield Mills concerning the rise and fall of corporate fortunes. Mills postulated that U.S. companies typically evolved from being growth leaders, to mature growth. The next stage became earnings cyclically and finally earnings decline. This typical life cycle of companies is often ignored by investors, but market history confirms its existence.

Back in 1979, I knew of a longer term IBM holder who gave his heirs strict instructions to never, under any circumstances, sell IBM. An 80 year old gentleman I personally knew told his grandchildren they must hold the Warner Lambert stock he was leaving them for as long as they lived. In the early 1960s, there was a classic case where trustees attempted to challenge the original trust donor’s binding instructions that his beloved Penn Central (then heading for Chapter 11) could never be sold.

In recent years, “creative destruction” was coined, a term describing the dramatic rapid changes in the technology world that create new superstar companies and at the same time destroy the old leaders. Wireless and the internet have destroyed the profitability and business models of what were once blue-chip telephone companies. Polaroid was put out of business by dramatic changes in photography and now Kodak is on the ropes. Burroughs and Sperry Rand were once big names in the computer industry, but no more. Long before the term “creative destruction” was coined, there were evolutionary destructive events in U.S. economic history as airlines replaced passenger trains, discount stores closed many retailers, and decentralized meat processors replaced Armour, Swift, and Wilson.

And, so it goes...even Apple may not be forever!

About the Author
Steve Leuthold has been an investment strategist, manager, and researcher for over 45 years. He is Founder of The Leuthold Group, LLC, an institutional investment research firm established in 1981. Steve is the author of many books and articles, including The Myths of Inflation and Investing and Index Funds, the Risks and Pitfalls. He has been a frequent contributor to leading trade journals, including The Wall Street Journal, Barron’s, the Journal of Portfolio Management, the Financial Analysts Journal, Newsweek, and Business Week. In 1999, Steve and former Leuthold team member Eric Bjorgen co-authored a special study, Corporate Insiders’ Big Block Transaction, for which they won the prestigious Charles H. Dow Award. In addition, Steve’s Financial Analyst Journal article, “Inflation, Deflation and Interest Rates,” was awarded the 1982 Graham and Dodd Scroll Award by the Financial Analysts Federation.
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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.GLGFGC.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.
Every MTA Symposium includes a mix of the theoretical and the practical. There are always a few presentations that give some participants new ideas for trading or analysis. Perry Kaufman’s presentation at the 2014 Symposium gave attendees he detailed rules for a profitable trading strategy. Back tested results are shown in the figure below.

More important than the system rules, Perry provided the detailed though process that goes into developing a trading strategy.

This strategy is based on arbitrage and Perry believes arbitrage is one of the great strategies of all time. Arbitrage can be applied with pairs trading. This requires finding two similar markets which are moving apart. Traders buy the cheaper market and sell the more expensive market, selling when the markets come back together. Arbitrage works in a number of markets. Traders could use the US Treasury and Eurobund market, gold in New York and London, or stock pairs like Ford and GM.

The traditional approach to arbitrage trading is to find two stocks (or ETFs or futures) with correlations between 0.30 and 0.80, as Perry noted the correlation should be “not too strong and not too weak.” The ratio of the prices is then used to
identify overbought and oversold points and trades are implemented when the ratio reaches an extreme. Some traders use cointegration but Perry says that is unnecessarily complicated and he has developed a Stress Indicator to do this. The Stress Indicator was introduced in his book, *Alpha Trading*.

The next chart shows Ford (F) at the top and GM (GM) in the center pane. The ratio of the two prices is shown at the bottom of the chart. Traders should buy F and sell GM when the ratio is low but that introduces the problem of defining low and identifying the level where the trade should be closed. High and low levels will vary for each pair which makes it impossible to create a generalized trading rule.

The Stress indicator addresses those problems. It is made up of three stochastic calculations over a 60-day period.

- **Stochastic 1 (F)** = \( \frac{C(ttoday) - L(60)}{H(60) - L(60)} \)
- **Stochastic 2 (GM)** = \( \frac{C(ttoday) - L(60)}{H(60) - L(60)} \)
- **Stochastic difference (D)**
  \[ D = \text{Stochastic 1} - \text{Stochastic 2} \]
- **Stress** = \( \frac{D(ttoday) - L(60)}{H(60) - L(60)} \)

Stress is oversold at 10 and the symbol in the Stochastic 1 formula is a buy at that level while the other symbol is a short trade. Av reading of 50 is used as the exit signal.

This system works well but average profits are small, often about $0.03 a share, and short sales are not allowed in tax-advantaged accounts so the cost of taxes must be considered.
Studying the trades, Perry noticed that the profits come from the long side of the pair. Eliminating the short sales increases the average profit to $0.30 but the strategy doesn't work with all stocks. In his presentation, Perry noted “trying to figure out (fundamentally or intellectually) which work and which do not is a useless exercise. Running the strategy against each stock and using the ones that work is much easier and just as valid.”

The final problem to address is risk management. Long stock positions can be protected by shorting SPY (or buying SH or SDS) when the trend of the index turns down. Traders could also short QQQ or buy QID as a hedge. A simple hedge can be developed using a 60-day moving average and hedging 50% of the risk when that trend turns down. The amount of the hedge is:

Stock size * (20-day ATR of the stock price / 20-day ATR of the SPY price)

The total hedge size is the sum of the hedge amounts for all the open stock trades and the hedge size is updated as the market moves. An example can help clarify this calculation.

Assume you are holding three stocks. The table below shows the calculations for this portfolio. The shares are the number of shares held for a $10,000 position in each stock, calculated as $10,000 / stock price. The ATR is the 20-day ATR available in any software package. The total risk for each stock is the number of shares times the ATR.

<table>
<thead>
<tr>
<th></th>
<th>Shares</th>
<th>ATR</th>
<th>Total risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAPL</td>
<td>18.4</td>
<td>11.33</td>
<td>208.28</td>
</tr>
<tr>
<td>AMZN</td>
<td>28.0</td>
<td>12.56</td>
<td>351.43</td>
</tr>
<tr>
<td>TSLA</td>
<td>50.4</td>
<td>8.07</td>
<td>407.23</td>
</tr>
<tr>
<td>Total stock risk (TR)</td>
<td></td>
<td></td>
<td>966.94</td>
</tr>
<tr>
<td>SPY size = TR/SPY risk</td>
<td></td>
<td>461.00</td>
<td>Shares</td>
</tr>
<tr>
<td>At 50% hedge</td>
<td></td>
<td>230.50</td>
<td>Shares</td>
</tr>
<tr>
<td>At 1/6 hedge</td>
<td></td>
<td>76.83</td>
<td>Shares</td>
</tr>
</tbody>
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TR is the sum of the individual total risks. SPY size is the TR divided by the 20-day ATR of SPY. If you were using a 50% hedge, you would short 230.50 shares of SPY. A 1/6 hedge size would require shorting 76.83 shares.

A stop-loss entered 15% below the entry price is also used to manage risk. In summary, the system rules are:

- Decide on a pair to trade: AAPL v QQQ
- Calculate the Stress Indicator (SI) for that pair
- Buy the stock when SI < 10
- Exit the long stock position when SI > 50
• Calculate the 60-day moving average of QQQ (or SPY)
• If the trend of QQQ is down, hedge the stock position with QQQ equal to the risk of the stock using the 20-day ATR of each
• Exit the hedge when the stock position exits, or exit the hedge when the trend of QQQ turns up
• Do not trade stocks under $3
• All trades are done on the next day’s open
• To build a portfolio, you should focus on the most volatile stocks since they are potentially the most profitable. Scan all pairs that you are considering trading, calculating
  • The return ratio over the past year (250 days)
  • The recent 20-day return or the recent 20-day price volatility
  • Whether or not this pair has an active trade (stress ratio < 10)

Sort the information in order of the highest long-term ratio and largest recent profits. Ignore any market with a negative ratio or no current position. Add the stocks with the highest ratios to your portfolio until you hold the desired number of positions.

Symposium attendees were shown examples of trades and left with everything they needed to know to begin trading that day.

About the Author
Perry Kaufman began his career as a “rocket scientist,” first working on the Orbiting Astronomical Observatory (OAO-1), the predecessor of the Hubble Observatory, and then on the navigation for Gemini, later used for Apollo missions, and subsequently in military reconnaissance. Perry then transferred the techniques developed in Aerospace for estimating the path of a missile to his systematic programs for trading in markets. His programs serve institutional clients in the financial, forex, energy, and agricultural markets. Mr Kaufman writes extensively on markets and strategies. Trading Systems and Methods, in its fifth edition, is one of the required readings for the CMT program. The strategy presented at the Symposium is a variation of one of the three strategies updated daily at KaufmanSignals.com
A recent headline in *The Wall Street Journal* explained, "Why Some M.B.A.s Are Reading Plato: Schools Try Philosophy to Get B-School Students Thinking Beyond the Bottom Line." With only eighteen words, *The Journal* reminded us why books are important. The true purpose of a book is to prompt the reader to think. Great books provide small pieces of knowledge that can grow to big ideas. By that definition, *Intermarket Analysis and Investing* is a great book.

*Intermarket Analysis and Investing* is a valuable reference of economic, fundamental and technical indicators. The book provides an overview of dozens of indicators and then explains how they can be applied. Gayed provides enough information so that the reader knows where they should direct their attention. For example, in reviewing the data series “building permits for homes,” Gayed concludes “this is one indicator that investors need to monitor closely, as it has an excellent forecasting record.”

Readers who are interested in this idea can then dig deeper. A quick regression analysis could be run to determine the precise relationship between building permits and the stock market. In doing so, I saw the results are promising. While it is not accurate enough to serve as a standalone trading system, downturns in building permits do offer warnings of a stock market downturn most of the time. Monitoring this simple indicator would be useful for avoiding most of the losses in a bear market. Declines in building permits can also be used as confirmation of a bear market because its reliability as a coincident indicator of market action is even higher than its reliability as a leading indicator.

This book also helps readers understand where testing would most likely yield unusable results. The data on monthly changes in manufacturing and trade inventories “offers little help in anticipating major market turning points.”

These examples show that Gayed’s writing is clear and his purpose is to provide useful information to readers.

Gayed provides the same sort of review for fundamental indicators and demonstrates that comparing an individual stock to its industry and sector offer valuable insights. On their own, without context, fundamental ratios offer little information.

His treatment of technical analysis is comprehensive. Gayed’s overview of intermarket relationships can be inspiring to readers, and that is a demonstrably true statement.
There is a two page section in the book describing the impact of utilities on the broad stock market. Like the other sections in the book, a small piece of useful knowledge is imparted and the reader is left with an idea that can lead to fully developed trading strategies. The author’s son, Michael A. Gayed, CFA, was inspired by this section to do the work that culminated in this year’s Charles H. Dow Award-winning paper.

Working with his partner, Charles Bilello, CMT, Michael wrote "An Intermarket Approach to Beta Rotation." This paper starts with the relationship identified in that small section of the book and develops an indicator that forms the basis of a market-beating strategy.

A great book is one which inspires others to find great ideas. Intermarket Analysis and Investing does that and deserves a place on the bookshelf of any serious student of the markets. It won’t stay on the bookshelf for long because it will be a source of ideas. The book also provides enough detail that an investment novice could learn the basics of data-driven investing.

Piper Jaffray Technical Research
Defining the Trend in Technical Analysis

Piper Jaffray Technical Research studies the market through the use of its proprietary MicroGroup charts and intermarket analysis for the purpose of forecasting future price trends in the broader market and individual equities. Through a disciplined study of price action via charts, the Piper Jaffray Technical Research team identifies emerging trends and themes as well as key support and resistance levels in the market.

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Back-testing refers to testing a trading strategy or a predictive model in the financial markets using historical data. A portfolio manager uses this methodology to cross validate his thesis or trading strategy. Developed with the benefit of hindsight, back-testing seeks to estimate the performance of a strategy during a past period and assumes that if the strategy worked before, it has a good chance of working again; the opposite is also true, if the concept has not worked well in the past, it may not work well in the future.

Back-testing fixed income models may contribute to trading efficacy. But there are times when a back-tested system will falter, demanding a fluid model that will adjust based on current market action. In the unconstrained fixed income market, back-testing – in conjunction with a fluid modeling process – can contribute to trading efficacy, especially given the current uncertain interest rate environment.

Indicators and models may benefit from a back-test to show:

- Efficacy in reducing drawdown
- Increased return over a buy-and-hold strategy
- Reduction in the number of trades to keep transaction costs low
- Increase in the number of winning trades vs. losing ones
- Increase in the average profitable trade/decreasing the average losing trade
- Reduction in volatility

The primary goal with back-testing is to see if the indicator that is back-tested will replicate results in different types of markets. Will the indicator or model achieve similar results in an “up,” “down,” or countentrending “sideways” market?

**Back-Testing Indicators in Aggregate**

Back-testing indicators in a model is not just a two-step procedure to weigh them against one another to generate buy and sell signals. Indicators working together as a unit could be used to create one indicator, which in turn is back-tested in aggregate. As each indicator is back-tested to find its aggregate optimal level of sensitivity over a period of price history, one indicator may be found to do well in some types of markets and not well during other periods. Optimal settings for indicators for the future can be impossible to find with past data alone. This is why back-testing can be used as a guide that helps determine weightings for an indicator but may not be applicable in terms of deciding what indicators to weight at any time in a market cycle.

**Applying the Fluid Model**
A fluid model alleviates the pitfalls of a back-tested set of indicators to weigh in a model or to be grouped together as an aggregation and then back-tested for a one-indicator model. When a market is trending, it may be proper protocol to desensitize momentum indicators and to place a higher trailing stop so that one remains in the trade longer.

A model works best if it knows when to switch out of a trend trade and to ‘lock-in’ a profit. Trend indicators work well in following a directional “up” or “down,” but they lag in terms of locking in gains at a market top. Therefore, when the number of momentum indicators signal divergences due to the rate of price change, such as slowing or a movement in an opposite direction, then a reversal of positioning may be warranted to lock in a gain.

One technique in a fluid model would be to attempt to lock in a gain when three or more momentum indicators have signaled divergences. When the weight of evidence from the rate of price change indicator is confirmed with a trailing stop, the two necessary criteria are met to potentially lock in a gain.

**Indicators in Non-Volatile and Volatile Markets**

Trend and momentum indicators work well in a trending non-volatile market. When high levels of volatility and sideways market movement work in unison, then a trend system will generate multiple moves and thus potentially diminish overall returns. When this scenario takes place, one must look to bypass the trend-following system or wait for the volatility to pass. If one bypasses the trend-following system, then the use of a price grid that identifies oversold and overbought levels is used and one seeks to buy low and sell high with an understanding that the market is in a volatile trading range.

**Indicators That Identify Range vs. Trend**

The decision to trade a range rather than to wait out volatility until a trend emerges requires the use of indicators that have the potential to identify if the market is in a range and not a trend. These indicators are trend identification and independent guides to instruct the trader when to weight the model to trading indicators.

A fluid model system bypasses trend and trend momentum aspects of the model and switches to a set of indicators that seeks to identify oversold and overbought areas from which to enter and exit positions. It should be noted that it is difficult to identify and trade a range using overbought and oversold levels found by a price oscillator. Normally, the price oscillator will be used after one decides on a Bull Tilt or Bear Tilt. The price oscillator would then identify an entry and exit area. For example, if the analyst determines a Bull Tilt, an oversold price oscillator would be a possible entry point at a lower price; assuming that the trend is not on the verge of turning negative. Consequently, many traders who define themselves as trend followers will stay defensive until the price breaks out of a range and use the duration of the range to identify future resistance levels.

This discussion illustrates our theory that a back-tested model may have inherent limitations, because it shows that there are times when a back-tested system will fail to navigate a trading range efficiently. This is why we assert that a fluid model would adjust based on current market action and then act when indicators enter a trend or exit one. The rebuttal might be that one has to find an indicator that can navigate different types of markets with optimal efficiency and stay
relatively positive during non-trending periods. From experience we know that this is not likely to be in the best interest of
the client, especially in periods of high volatility such as 2008 or also late 2011.

This construct is a forms basic framework to guide the trading process. Traders at times use a different guideline such as
“trade long” only when price is over a 50-day moving average and “go short” when price is under a 50-day moving
average. Different entry and exit strategies during long and short positioning are then implemented. This technique would
seek to trade within the intermediate-term trend. There are many other strategies to increase probability of having a high
percent of winning trades with gains larger than losses.

Aggregated Indicators

Implementing trades based on back-tested models that aggregate a set of indicators which then become a single indicator
most likely leads to the use of one trend-following indicator with a stop-loss mechanism attached to it that may increase
the number of trades and often violates the system’s ability to generate profits. This is because to generate future signals
based on a back-tested system requires indicators to work in unison; in order for this to happen, a reduction in the number
of indicators in a back-tested model must take place or the system with all the combined indicators will not back test well.

If one has five models that each have one to three indicators and weights each model, then you could call that system
back-tested; but the test would need to identify when, for example, a five model system comprised of the small set of
indicators signaled in unison or majority to issue a signal. We concede that this type of system may be possible, but from
experience we think that such a system becomes further detached from the current market environment and may not
navigate the future price action. It would be much like running indicators on indicators on indicators – which if price-based
would be removed from the price action itself, and this breaks with a confirmation, a requirement in classic trading
methodology.

Shortcomings of Back-Testing

Back-testing can be prone to weaknesses and limitations. Limitations include the requirement of simulating past
conditions with sufficient detail, making one limitation of back-testing the need for detailed historical data. Another
limitation is the inability to model strategies that would affect historic prices, and finally, back-testing is limited by potential
curve fitting. Meaning, it is possible to find a strategy that would have worked well in the past, but will not work well in the
future. Despite these limitations, back-testing provides information not available when models and strategies are tested on
synthetic data.

In Conclusion

When using model-based systems, traders should strive to constantly refine methodology by continually studying charts,
past and current market movements, patterns, indicators, and other data that can give them an edge. Stock market
dynamics constantly change, as evidenced by the elimination of the uptick rule in 2007, Federal policy can change at any
time, and the markets can be subject to quantitative easing.
No one model works in every market condition. Ultimately, we view our job as seeking to determine, through back-testing and modeling, how to identify and then systematically make adjustments that capture returns and reduce risk simultaneously.

About the Author
Matthew A. Pasts, CMT, is CEO, Director of BTS Asset Management, Inc., and an Investment Committee Member. Matt joined BTS in 1989. Since that time, he has worked in various capacities at BTS. He graduated with honors from Babson College in Wellesley, MA receiving a BSBA with a concentration in Finance. Additionally, he has attended Babson Graduate School of Business Administration. Additionally, he has portfolio management responsibilities for funds and separately managed accounts.

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How would you describe your job?

I act as the portfolio manager on a team of Financial Advisors at Wells Fargo Advisors LLC in Melville, NY. My main role is to manage the assets of our clients who are utilizing our discretionary portfolio management platform (PIM). I decide what is purchased, when it is purchased and, most importantly, when it is sold in our clients’ discretionary portfolios. I manage these portfolios using Technical Analysis as the primary decision making tool. The portfolios are constructed using Exchange Traded Funds (ETFs) that meet certain criteria as determined by the Technical Analysis screens that I have chosen to utilize.

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

I would strongly urge anyone getting in the business today to become familiar in the use of technical analysis to aid in their investment selection process. Becoming a Chartered Market Technician would be a plus as it would help advisors become well versed in various different technical analysis methodologies. Clients’ portfolios need focused attention and technical analysis can go a long way toward helping an advisor provide part of that focused attention.

What is most interesting piece of work you’ve seen in technical analysis recently?

In my opinion, as usual, Dorsey Wright & Associates comes out with some very interesting pieces on technical analysis. The most recent piece that caught my attention and which I thought was extremely interesting was from February 11, 2014 after the markets had a move down of approximately 5%. It is a piece titled “Defensive Preparedness: Watch for These Key Signs” and it is a great synopsis of what to look for on a technical basis when markets have a mini correction that can help one determine the likelihood that the mini correction has the potential to be something worse. It compared the markets scenarios in 2008 with those of early 2014 to show the similarities and differences between the two. I found it to be timely and very informative as I had been fielding inquiries from clients about the likelihood that the most recent pullback could be the beginning of something more serious.

About Paul Pitsironis, CMT

Over 16 years of financial services experience coupled with the Chartered Market Technicians designation provides Paul with the ability to navigate portfolios through fluctuating market conditions. By utilizing time-tested methodologies, some of which date back to the late 1800’s and Charles Dow, he appropriately manages risk in our clients’ investment portfolios. Paul received his Bachelor of Arts degree from Stony Brook University.
The Nifty is a benchmark index for the stock market in India. This report updates our analysis from December 2013 for the Nifty.

The Nifty reached our initial upside target in March and the rise was supported by buoyant volume.

We noted in December, “As we head towards the apex (the point where both the trend lines meet) we expect this pattern to be resolved with a breakout to the upside. The price breakout would be confirmed with a volume spike that will ultimately confirm a price-volume breakout on the Nifty. We expect this breakout to be followed by a new bull market with an initial upside target of 6700-7300 based on the pattern. Ultimately, our upside target is 8145, about 28% above the previous all time high of 6357 levels.”

As shown in the chart above, the pattern has decisively given way with an upside breakout based on our view, breaking the upside long term trend line of the triple top pattern highlighted with the vertical line in the chart.

We strongly reiterate and maintain our long-term bullish view on the Nifty and the broad markets. Our next upside targets are 7300 and 8145 in coming quarters.

About the Author

Purab Shah has more than seven years of experience in FII Institutional Sales and Trading services. He is primarily focused on Indian markets but also watches other APAC markets along with developed markets around the world and other asset classes including currencies and commodities. Purab can be reached at pureb@aifl.net or purabs@gmail.com
This chart is provided by Global Financial Data, a provider of economic and financial data that extends from the 1200s for markets and nations around the world. To learn more, contact Ralph Dillon at rdillon@gfdfinaeon.com.