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Letter from the Editor

The Market Technicians Association is continuing to evolve and remain current. We try to capture that in this newsletter, highlighting some of the activities within the organization while featuring the analysis of members and introducing new ideas from the field of technical analysis.

We are also introducing a new feature this month where we will review ethics in our profession. As we grow in stature in the financial community, it becomes more and more important to maintain the highest ethical standards. In fact, our Code of Ethics is one of the biggest benefits of membership – it ensures employers and clients that we follow rules, and that our work is based upon more than guesswork. This column will hopefully focus some thinking on ethics, which needs to be considered in all aspects of analysis.

Relevancy of this newsletter depends on contributions from you. Consider publishing an example of your analysis or an insight into some aspect of the very dynamic field of technical analysis. We will maintain the highest standards of publication, so your work will be showcased along with other high quality writing.

If you have anything you'd like to submit to Technically Speaking, or any comments about our newsletter, please email me at editor@mta.org.

Sincerely,

Mike Carr, CMT



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Welcome, To The Machine

By David Steckler

With apologies to Pink Floyd, "Welcome...to The Machine."

That verse kept running through my head when I tested the newest offering from The Connors Group, called "The Machine." In case you were wondering, 'Connors' is Larry Connors, one of the founders of TradingMarkets.com and the author and co-author of numerous books on trading.

The Machine is the first and only commercially available financial software that allows you to build and actively manage customized, quantified portfolios of equities and ETFs. Accessed through the web, there is nothing for the user to install on his or her computer. Traders, investors, and investment advisors can choose from thousands of back-tested, statistically valid strategy variations to construct their portfolios. These portfolios enable the user to reduce the volatility of their accounts using portfolios that they design, to out-perform their benchmarks.

The Machine is unique in that it allows the user to:

- Build customized, actively managed portfolios with both risk and reward taken into account;
- Reduce portfolio volatility by combining ETF, equity, mean reversion, trend following, and long and short strategies together; and

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Contacts

Editor

Michael Carr, CMT
editor@mta.org

Marketing Director

Tim Licitra
tim@mta.org

Graphics Editor

Shane Skwarek
shane@mta.org

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- Save time with simple to build and easy to manage portfolios.

One of the most difficult tasks a trader or investor has is achieving consistency in the performance of his or her portfolio. Emotions can run high in trading, and that will affect your decisions. But if you use a quantified approach to trading and investing, you can take the emotion out of your trading.

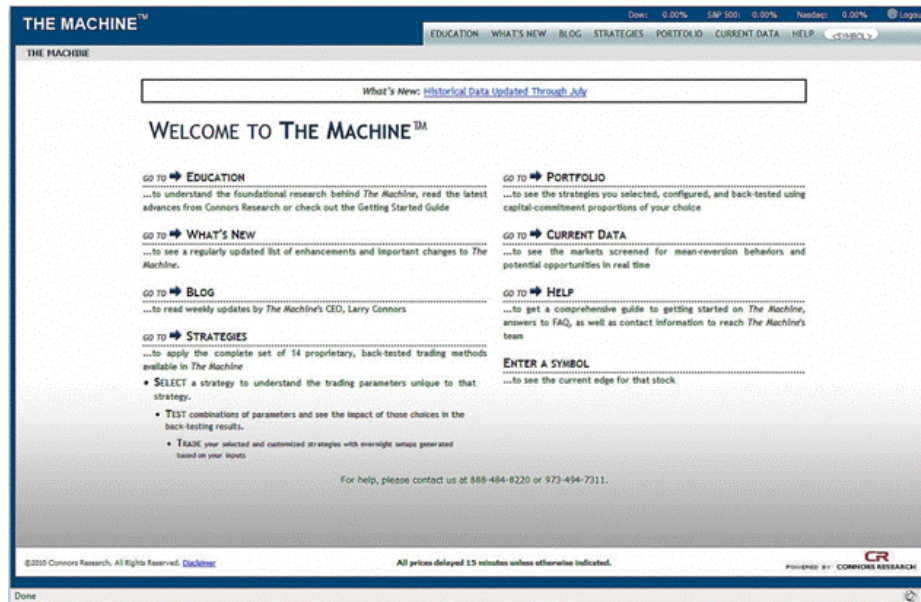
Losses are part of trading and knowing in advance your expected draw-down and how your trading strategies historically performed in bull, bear, and sideways market conditions not only allows you to “sleep easier” but, in fact, helps you create portfolios that reduce the volatility of your account.

As an investment advisor, I know how difficult it can be at times eliminating subjectivity and emotion when making investment decisions and recommendations to clients. Every client is unique and each has specific risk tolerances. Having the ability to create custom portfolios that historically have produced positive returns every year with low draw-downs, helps advisors customize portfolios to meet each clients’ investment goals and objectives.

One of the biggest concerns I have with using a new trading application is how to get past the learning curve. I know many people who have given up in frustration when they “test-drive” a new application and can’t find answers to their questions. The Machine helps overcome this problem by including two training videos that are very much “step-by-step” in how to construct a portfolio and how to use the application. As you will see in a few minutes, The Machine has an entire section devoted to Education, including the aforementioned videos, studies on volatility and leveraged ETFs, and a description of the latest books by Larry Connors that explains in depth many of the strategies used in The Machine.


So without further ado let’s take a look at The Machine. This review covers just one of the features of The Machine – the Portfolio Builder. Additional reviews will cover the other features.

The first screen you see after Login is a welcome screen, describing each of the component parts of The Machine. You access these by clicking on the tabs in the upper-right of the screen, e.g., Education, What’s New, Blog, Strategies, Portfolio, Current data, and Help. You can make any of the screen captures larger by clicking on them:




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The user begins by building a new Portfolio. A “Portfolio” is a list of saved strategies that you run against a database of stocks and ETFs to find those that meet the strategy buy and sell rules. Clicking on the word “Portfolio” in the top right of the screen brings up a drop-down box that lists existing portfolios you created. Just click the word “Portfolio” to get to the “Create New” button:



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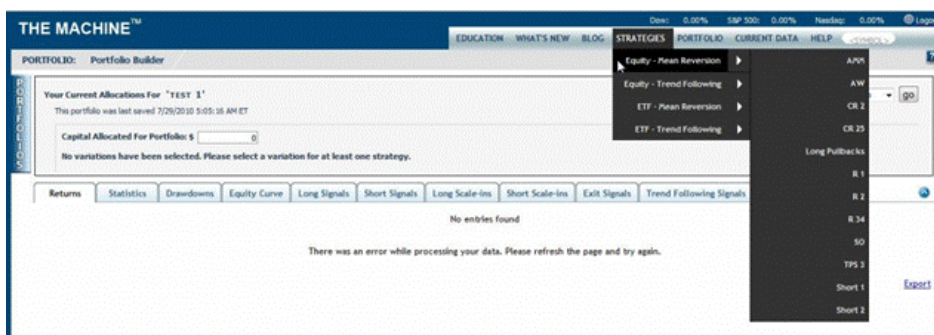
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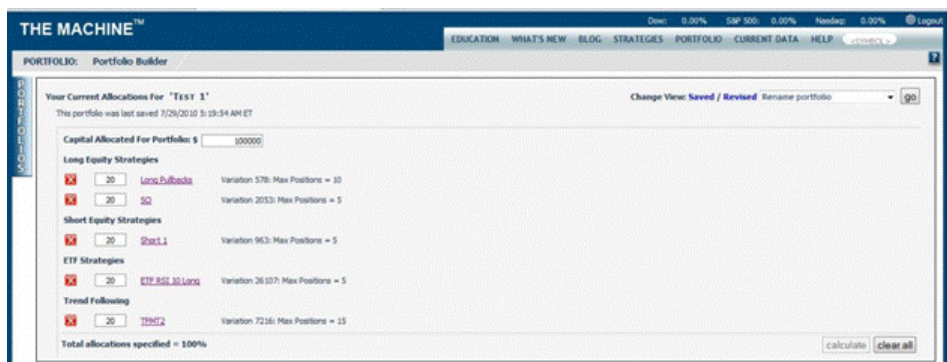
The Machine does not come with any pre-built portfolios but you can copy the portfolios from the webcasts available through the Education tab. After you create a new portfolio you give it a name; I called mine "Test 1." You'll also see the name Test 1 in the screen capture below, in the upper left under the words "Portfolio Builder."

Next, you select the strategy or strategies you want in your portfolio. Click on the Strategies tab on the upper right. The Machine lets you select from several dozen strategies, characterized as Equity – Mean Reversion; Equity – Trend Following; ETF – Mean Reversion; and ETF – Trend Following. The screen capture shows you the strategies in Equity – Mean Reversion. More strategies are constantly being added to The Machine as they are developed and tested by the Connors Group:



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For my Test 1 portfolio I selected both long and short equity and ETF strategies as well as a Trend Following strategy, as you can see below:



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From Long Equity – Mean Reversion I chose the Long Pullbacks and SO (Sell-Off) strategies. From Short Equity – Mean Reversion I chose the Short 1 strategy. From ETF – Mean Reversion I chose the RSI 10 strategy and from Equity – Trend Following I chose one of the strategies. While the mean reversion strategies are discussed in Larry Connors books, the trend following strategies are currently "Black Box" and the formulas are proprietary.

Want to know what each strategy is and what its formula/trading rules are? After you select a strategy, it gets added to your portfolio. I clicked the SO strategy hyperlink and it brings up a screen showing the SO parameters (which I blanked out since they are available only to subscribers):

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Under the words "The Machine" you see the strategy name (SO) and hyperlinks for the strategy's historical returns as well as a description. Not every strategy has a written description quite yet, since that part of The Machine is still a work in progress.

You will see after each strategy name a variation number, such as "variation 578" after Long Pullbacks. Why did I select that variation? The Connors Group backtested thousands of variations of each strategy and I can sort these variations by CAGR (Compounded Annual growth Rate), Sharpe Ratio, Max Drawdown, etc. The statistics are seen in the picture below:

CAGR	SHARPE RATIO	MAX % DD	AVG % P/L	# OF DAYS	EXPOSURE %	SUCCESS %	MAX POSITIONS	VARIATION #
28.18	2.12	-18.17	5.48	5	8.56	74	10	578
34.26	2.07	-22.33	3.98	5	14.54	69.35	10	576
26.76	2.07	-18.17	5.57	5	7.31	73.6	10	11564
60.91	1.99	-32.76	2.66	5	33.57	63.28	5	11480
58.77	1.99	-33.91	2.78	4	30.52	65.1	5	11440
38.03	1.99	-25.17	2.89	4	19.58	65.7	10	11808
37.77	1.99	-24.65	2.85	5	21.65	67.15	10	574
57.03	1.97	-31.7	2.8	5	29.8	65.08	5	11448
32.48	1.86	-22.42	4.01	5	12.58	68.08	10	11736
27.13	1.86	-19.33	5.16	5	8.84	73.24	10	698
26.03	1.85	-19.32	5.32	5	7.42	72.32	10	11656
62.92	1.84	-34.45	2.75	5	36.56	65.02	5	413
43.35	1.83	-32.39	1.95	5	35.43	66.06	10	412
31.19	1.83	-16.99	3.51	4	12.89	66.95	10	596
41.35	1.82	-25.94	2.69	5	25.27	66.25	10	414
38.27	1.81	-24.81	2.78	5	22.41	67.77	10	694
57.18	1.80	-30.9	2.78	5	33.35	66.5	5	693
54.65	1.80	-33.79	2.97	5	28.04	64.58	5	11456
48.78	1.80	-34.07	3.74	5	22	68.32	5	575
55.72	1.89	-36.32	2.98	5	30.78	66.35	5	453

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I sorted this list by Sharpe Ratios. You will see that higher CAGR's generally have higher max drawdowns so I selected a variation with a moderate drawdown, a high Sharpe Ratio, a high average % P/L ratio, and a high success %. That was variation 578. I followed the same procedure with the other strategies as well.

Looking back near the top of the previous picture you see a box for capital application for portfolio. While not required, entering in a dollar value enables The Machine to make recommendations as to how many shares of each security you should purchase. You can leave this box blank if you prefer.

After populating a portfolio with the selected strategy variations, the next step is to assign your allocation percentages. Allocation amounts represent the amount of capital you wish to assign to a variation within a portfolio. I assigned 20% each to the five strategies. You may allocate as little or as much capital as you wish. There are no restrictions on allocation percentages. When new strategies or variations of strategies are added to a portfolio, the allocation, by default, is set to zero. This number may be changed to any percent you wish to allocate to a specific strategy.

After you've assigned your allocation percentages satisfactorily, the next step is to calculate your portfolio's performance reflecting those changes. To calculate the new allocation amounts, click "Calculate" in the bottom right of the Strategy section. It can be found next to the "Clear All" button. The "Clear All" button will clear all of your allocation amounts back to zero.

Before looking at the historic performance of this test portfolio, I'd like to explain how The Machine chooses the stocks and ETFs that generated the portfolio's returns.

The Machine monitors all ticker symbols on the NASDAQ, AMEX, and NYSE Exchanges that meet the minimum price and volume requirements for the specific strategies. Delisted ticker symbols are included in the historical returns. Daily trading signals are generated by analyzing end-of-day data and by ranking all the stocks and ETFs generating trading signals for the next day.



You can limit your database by careful selection of the strategies you choose for your portfolio. Want to search only for ETFs? Then only select ETF strategies when building your portfolio. Don't want ETFs? Select only from the Equity – Mean Reversion and Equity – Trend Following strategies when constructing your portfolio.

Once I finish selecting my portfolio I want to see how it performed historically. Ideally, it will beat the benchmark each year for 10 years. If I find a year where the performance was subpar I can experiment using different variations of the strategies or even adding/deleting strategies. One of the features I'm most impressed with in The Machine is how easy it is to make changes and how fast it is to find out the results of those changes.

The lower half of the Portfolio Builder has ten tabs with useful information for the user. The first tab shows the simulated monthly returns for the last 10 years; the simulated annual return for the portfolio; the annual return for the benchmark (in this case the S&P 500); and the difference. This Test1 portfolio has beaten the benchmark every year since 2001. The 2010 monthly data in the screen capture below is through July:

YEAR	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	ANNUAL	S&P 500	DIFF
2001	4.35%	3.28%	3.37%	2.02%	2.44%	2.92%	1.82%	2.25%	-4.28%	6.83%	4.64%	2.70%	+36.81%	-11.89%	+48.70
2002	1.50%	-0.93%	3.78%	1.94%	0.74%	1.31%	1.10%	0.78%	-0.30%	0.82%	1.81%	4.52%	+17.29%	-21.19%	+39.39
2003	0.97%	1.99%	1.43%	3.58%	4.56%	11.90%	-0.66%	5.38%	3.94%	8.28%	3.08%	0.01%	+53.77%	28.69%	+25.08
2004	5.68%	6.51%	4.48%	-5.09%	5.95%	3.12%	-1.22%	0.55%	1.36%	1.84%	7.53%	5.62%	+41.19%	10.88%	+30.31
2005	-1.01%	2.34%	2.29%	-0.90%	3.19%	6.85%	-4.72%	3.70%	3.29%	2.43%	4.53%	1.30%	+38.06%	4.91%	+33.15
2006	4.30%	3.90%	1.55%	3.62%	1.73%	-0.94%	1.54%	1.74%	1.03%	3.89%	1.52%	1.25%	+26.72%	15.80%	+10.92
2007	4.82%	5.12%	2.57%	-0.23%	7.44%	1.82%	3.31%	5.88%	1.83%	5.99%	1.32%	2.09%	+51.08%	5.49%	+45.59
2008	-3.30%	1.96%	2.02%	4.02%	5.61%	-6.47%	-0.85%	-3.57%	-2.11%	1.81%	2.02%	0.80%	+11.50%	-37.80%	+49.30
2009	4.88%	-0.32%	-0.41%	2.21%	1.93%	-0.70%	1.09%	1.38%	11.69%	-2.87%	2.50%	4.66%	+28.19%	26.46%	+1.73
2010	-3.46%	6.18%	3.49%	4.12%	0.35%	-0.38%	3.47%	-	-	-	-	-	+14.26%	5.39%	+8.87

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At the bottom of the return tab are very useful statistics that tell the user the portfolio's Compounded Annual Growth Rate (CAGR), Sharpe Ratio, % Winning trades, average trades per year, the average percentage of the capital that was invested over the ten years, and the how much time during the year the capital was 100% invested:

STATISTICS	CAGR: 32.69%	SHARPE RATIO: 3.13	WIN %: 69%
AVERAGE TRADES/YR: 397	AVERAGE EXPOSURE: 35%	TIME FULLY INVESTED: 0%	

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The Test 1 portfolio had a compounded annual growth rate of 32.69%, a Sharpe Ratio of 3.13, and a winning percentage of 69%. It averaged 397 trades per year and at any given time an average of only 35% of your initial capital was exposed to market risk (i.e., invested as opposed to sitting in cash). Note that at no time was the test portfolio fully (100%) invested. An almost 33% CAGR with an average exposure ratio (percentage of the account capital invested) of only 35%...impressive! Below you can see the maximum portfolio exposure for the past ten years was in 2010, at 48%.

The Statistics tab lets me look at daily portfolio exposure by percentile, e.g., >=10%, >=20%, etc. It also shows the exposure by year. While there are a very large number of signals (well in excess of 1,000 for all but 2002), only a small percentage are actually filled (Fill% between 15% and 22%). This is because most of the signals came from mean reversion (pullback) strategies that did not pull back to their recommended fill price. Savvy traders are like professional baseball players – they wait for their pitch!

Daily Exposure			Exposure By Year			
EXPOSURE	DAYS	TIME	YEAR	EXPOSURE	SIGNALS	FILL %
>= 10%	2152	89%	2001	21%	1114	22.0%
>= 20%	1873	78%	2002	19%	878	21.5%
>= 30%	1453	60%	2003	34%	1619	20.3%
>= 40%	957	40%	2004	44%	1471	19.4%
>= 50%	526	22%	2005	41%	1235	16.5%
>= 60%	211	9%	2006	42%	1497	15.4%
>= 70%	66	3%	2007	42%	1463	18.6%
>= 80%	7	0%	2008	29%	1352	19.2%
>= 90%	1	0%	2009	34%	1799	19.6%
>= 100%	0	0%	2010	48%	1029	18.5%

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The Drawdowns tab shows me the maximum drawdowns by year and by day (start and end dates for drawdown periods):

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Max Drawdowns By Year

	2001	2002	2003	2004	2005	2006	2007	2008	2009
SBP 500	-29.09	-33.01	-13.78	-7.43	-7.01	-7.46	-9.87	-46.95	-27.19
PORTFOLIO	-6.79	-4.47	-4.32	-8.44	-5.94	-8.17	-5.01	-11.82	-6.40

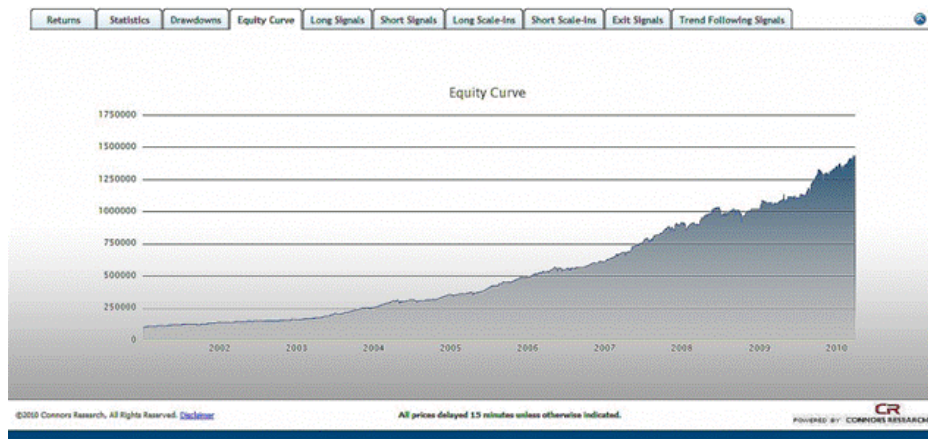
Top 10 Daily Drawdowns For Portfolio

RANK	START OF DD	DAY OF MAX DD	END OF DD	DD DAYS	MAX DD
1	06/20/2008	10/09/2008	01/08/2009	140	-11.82
2	04/27/2004	04/30/2004	09/30/2004	109	-8.44
3	05/09/2006	06/13/2006	09/12/2006	88	-8.17
4	01/11/2008	01/23/2008	03/24/2008	49	-6.84
5	09/04/2001	09/21/2001	10/19/2001	30	-6.79
6	10/12/2009	11/02/2009	12/15/2009	46	-6.40
7	04/29/2009	05/04/2009	07/14/2009	53	-6.21
8	04/07/2005	04/18/2005	05/17/2005	29	-5.94
9	10/31/2007	11/12/2007	11/27/2007	20	-5.01
10	01/20/2010	01/29/2010	02/24/2010	25	-4.76

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In the Test 1 portfolio I see the max drawdown was -11.82% in 2008 and it occurred between June 20, 2008 and October 9, 2008, for a period of 140 days.

The Equity Curve tab shows you how your portfolio grew (or didn't grow) over the last ten years. Ideally, you want to achieve a smooth equity curve with no deep dips or sharp rises:



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In ten years this portfolio grew from \$100,000 to almost \$1.5 million (before taxes). Commissions are built into the calculation at the rate of 1 cent/share. Not a bad return, this Test 1 portfolio!

Now we come to the heart of Portfolio Builder: the trade recommendations. The tabs are self-explanatory – Long Signals, Short Signals, Long Scale-Ins, and Short Scale-Ins. The signals are generated a few hours after market close. Here is long signal generated on August 2 for a potential trade the next day:

Signals generated for 08/03/2010

Symbol	LIMIT PRICE	SHARES	CLOSE PRICE	HV	RSI	INDUSTRY	STRATEGY
APKT	26.03	153	27.11	64.52	2.58	Computer - Technology	50 Variation 2053

Showing 1 to 1 of 1 entries

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Acme Packet, Inc. (APKT) closed August 2 at 27.11. The long signal for "tomorrow" is a limit buy of 153 shares at 26.03. Also shown is the Historical Volatility and the two-day RSI.

Here are the short signals that passed through the strategy filter for August 3. Note that there are more short signals than long signals:

Symbol	LIMIT PRICE	SHARES	CLOSE PRICE	HV	RSI	INDUSTRY	STRATEGY
PNYS	12.92	309	12.42	92.96	95.74	Computer - Technology	Short 1 Variation 963
DBI	9.48	421	9.12	73.33	93.87	Finance	Short 1 Variation 963
URI	13.90	287	13.37	65.08	87.15	Construction	Short 1 Variation 963
BCL	31.04	128	29.85	57.17	89.00	Consumer Discretionary	Short 1 Variation 963
CBG	18.08	221	17.38	50.74	95.77	Finance	Short 1 Variation 963
PNYS	12.85	155	12.42	92.96	95.74	Computer - Technology	Short 2 Variation 3580
URI	13.81	144	13.37	65.08	87.15	Construction	Short 2 Variation 3580
BCL	30.67	65	29.85	57.17	89.00	Consumer Discretionary	Short 2 Variation 3580
CBG	17.84	112	17.38	50.74	95.77	Finance	Short 2 Variation 3580
HWY	49.70	40	49.33	48.57	99.77	Business Services	Short 2 Variation 3580

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When no signal is generated there will be a message that no matching records were found:

Symbol	LIMIT PRICE	SHARES	CLOSE PRICE	HV	RSI	INDUSTRY	SCALE	STRATEGY
No matching records found								

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Trend following signals occur less frequently. The last signal was generated June 8, 2010 and I'm writing this on August 2. This tab shows the symbol, entry date and price, last price and percent change, the industry group, and the strategy number. Since only one trend following strategy was selected for this portfolio, all the stocks will show the same variation used for their selection:

Symbol	STATUS	ENTRY DATE	ENTRY PRICE	SHARES	LAST PRICE	CHANGE	INDUSTRY	STRATEGY
CXA	hold	06/08/2010	36.33	--	39.40	8.45%	Finance	TFMT2 Variation 7216
DGA	hold	05/27/2010	68.24	--	75.22	10.23%	Auto - Tires - Trucks	TFMT2 Variation 7216
DLB	hold	11/25/2009	47.09	--	63.94	35.78%	Finance	TFMT2 Variation 7216
DSCA	hold	11/03/2009	27.48	--	39.36	43.23%	Consumer Discretionary	TFMT2 Variation 7216
DSC	hold	09/04/2009	55.83	--	63.50	13.74%	Retail - Wholesale	TFMT2 Variation 7216
DLB	hold	09/03/2009	11.24	--	13.98	24.38%	Consumer Staples	TFMT2 Variation 7216
KOBB	hold	09/03/2009	58.13	--	65.13	12.04%	Consumer Staples	TFMT2 Variation 7216
TXK	hold	09/02/2009	35.13	--	41.99	19.53%	Retail - Wholesale	TFMT2 Variation 7216
DPS	hold	08/31/2009	26.44	--	37.71	42.62%	Consumer Staples	TFMT2 Variation 7216
AAFL	hold	08/12/2009	184.26	--	261.85	59.41%	Computer - Technology	TFMT2 Variation 7216

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Not a Brokerage Firm

The Connors Group is neither a brokerage firm nor a registered investment advisor. You can use whichever broker or advisor you want to execute your trades.

Cost

Now we get down to the nitty-gritty: how much does this cost? The Machine has an annual lease fee of \$10,000 per year for individuals. Connors Research Group advises a minimum account size of \$100,000 and that makes sense – the annual lease cost is 10% of a \$100,000 portfolio. Even should you make 30%/year, after the annual payment your return is down to 20%. That's quite a hit.

There are two ways you can lower this percentage. The first way is to have a larger account. If your account is \$200,000, then the fee is only 5% of your capital. The second way is to share The Machine with a trading buddy. The signals are generated after the market close and are not updated during the trading day. You and a buddy could each access The Machine at different times in the evening, and split the cost.

For investment advisors the fee is higher: \$14,000 paid quarterly or \$10,000 lump sum. This cost will go up next year but advisors who sign up in 2010 will have this price locked in for three years.

Is it Worth It?

Are you an active trader? Are you looking to create a diversified portfolio that employs multiple methods to reduce risk? Are you a swing trader comfortable with a portfolio where the average holding period of the stocks is 3 – 5 days? If the answer to any of these questions is Yes, then you should consider The Machine.

The Machine is also ideal for intermediate and long-term investors looking to use quantified trend following

strategies. They recently added an ETF Trend Following strategy and will be adding more of these strategies, so they are making efforts to make The Machine suitable for investors and active traders with a longer time-horizon.

If you are interested in learning more about the strategies and methods utilized by The Machine, you may want to pick up Larry Connors and Cesar Alvarez' books: "High Probability ETF Trading" and "Short Term Trading Strategies That Work." Both books are available on the TradingMarkets site or on Amazon.com.

David Steckler is an investment advisor with Global Investment Solutions, L.C. He has 23+ years of experience helping clients design portfolios that best meet their investment goals and objectives.



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More Thoughts on The Machine

By Mike Carr, CMT

While fully reviewed by Dave Steckler elsewhere in this issue of *Technically Speaking*, there are a few more points worth considering about this software package.

Larry Connors has been very open about his strategies for many years. He is well known for printing the exact entry and exit rules, along with verifiable results. This software bundles many of those ideas into one source.

Results shown are backtested, but since they are grounded in logical assumptions, they are likely to be as successful in the future as they have been in the past.

High probability strategies like many of the ones found in The Machine lead to low frequency trading activity. This software combines the strategies into a portfolio testing capability. Infrequent trading means that many strategies can then be used at one time. If you will only be invested a small percentage of the time, using multiple strategies maximizes the potential return on capital.

This may be the only commercially available software that allows for portfolio level testing. This function is critical to how money is managed in the real world, yet is a capability that usually requires custom programming.

The Machine is a turnkey solution for money managers, or individual investors. With this, and a lawyer to help set up an RIA, anyone can enter the business.

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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 (some listed below). Specific details can be provided by contacting them, or John Palicka (palicka@pipeline.com).

Taught by John Palicka, CFA, CMT

[Read More...](#)

Equity Curve Feedback

By Mike Carr, CMT

On October 13, 2008, Ajay Jani spoke at the New York Region Meeting. The video of his talk is available by [clicking here](#).

Ajay focuses on emerging markets, and has done so for more than twenty years. In this talk, he explained that he thinks it's important to have a system with well-designed rules and a position sizing algorithm. The concepts apply to any tradable security in any market.

His research began with the thought that for capital constrained traders (which is everyone except a central government banker), it would be useful to have systematic tools that help "time the model." This would help the trader understand when they are in synch with the market and should use a larger position size.

His first attempt to do this was to place a moving average on the equity curve of the system. The equity curve is a measure of how much money an investor would have in their account by following all system buy and sell signals. Unfortunately, a simple 200-day moving average on the equity curve actually hurt performance with lower profits and higher drawdowns. The drawdown is a measure of how much equity a trader loses in their account from the peak.

The next step in his search for a tool was a more sensitive moving average. The 50-day moving average offered visually appealing results. However, the returns were even lower and drawdowns were even higher. Seeing the results, Ajay wondered if this was a productive research area. He went back to asking what his objective was, and he realized he wanted buy the low, or add money right before the system turns around and the drawdown comes to an end.

He reasoned that buying lows in a system means buying after performance has been relatively poor. To test the idea, he set the buy signal to be those times when the 60-day rate of change (ROC) of the equity was down by at least 5%. The results were promising, however they suffered from a look ahead bias. A dynamic approach to the problem would address this concern.

To make the 60-day ROC a dynamic tool, Ajay applied percentile ranks to the data. He collected the first year's worth of data and began the ranking process. Each day offered a new data point, and he expanded his rankings to include all the available data. This allows the system to learn what good and bad performance is from the experience of the actual results.

When trailing sixty returns are in the lowest quintile, expectancy is probably pretty high and that is a good time to add money to the system. Specifically, he adds money when performance is in the lowest 10% of performance ranks. On average, that happens twice a year, and this process adds significant value to the system performance.

He noted that this idea is similar to card counting in Vegas. Blackjack players look for an edge, and popular wisdom is that an edge exists when the deck still has a lot of tens left to be dealt. They increase their bet size then, even though there is no guarantee that they'll win. Although there is no guarantee, the blackjack player at least has improved their expectancy, which is the mathematical chance of profits.

In this video, Ajay offers the unique insight that using the equity curve to evaluate system performance can add value to a trading system. The lookback period of the ROC can be varied depending upon factors such as risk tolerance and transaction costs. Other indicators like the MACD or Bollinger Bands can also be applied to the equity curve. Of course, this entire process begins with the assumption that you have developed a system with a positive expectancy.

Ajay G. Jani, CMT has been in the investment business since 1989. He is currently Managing Director of Gramercy, an asset management firm focused on investing in Emerging Markets. He also submitted a review of "Trade like an O'Neil Disciple: How we made 18,000% in the stock market" by Gil Morales and Dr. Chris Kacher, which can be read in this issue.

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"Trade like an O'Neil Disciple: How we made 18,000% in the stock market" **By Gil Morales and Dr. Chris Kacher**

Reviewed by Ajay G. Jani, CMT

The first reaction when reading an investment book that has 18,000% in the title would typically be rolling one's eyes, followed by moving on to the next book on the shelf. In this case, that would be a mistake. Co-authors Gil Morales and Dr. Chris Kacher have a strong investment pedigree, both having cut their stock market teeth working for the legendary William O'Neil, founder of Investor's Business Daily and developer of the CAN SLIM

method of investment. Given the copious amount of materials devoted to this method that has already been published by O'Neil himself, the reader might wonder what Morales and Kacher have to add to the subject of stock investing. While much of the material will be very familiar to CAN SLIM devotees, there are several new twists to stock investing introduced in the book that make it worth the read.

The book begins with a quick run down of the O'Neil investment philosophy: Target the best fundamental stocks with fast earnings growth and strong relative strength, and then buy when the stocks breaks out of a well shaped based. Combine this with concentrated positions and a disciplined approach to cutting losses and investors can put the odds on their side.

The early sections of the book focus on specific stocks and markets the authors rode to investment success. Morales and Kacher provide annotated charts showing exactly when they bought and sold and the conditions that they used to single out the best names and markets. Morales and Kacher are quick and profuse in their acknowledgement that "their" strategy is based primarily on that of William O'Neil. However, in the book they introduce several new innovations that they claim help improve on the venerable CAN SLIM system. In particular, they introduce the "pocket pivot", a market timing model, and also discuss in depth the proper techniques for short selling.

The "pocket pivot" is probably the most innovative technique introduced in the book. The idea is to get a jump start on the proper buy point in a CAN SLIM base through the use of price/volume clues. On the right side of a base, stocks will often show high volume accumulation days that are not yet fully fledged breakouts. Morales and Kacher will often use these days to begin accumulating high relative strength stocks in anticipation of a breakout. The chart examples in the book detail exactly what clues to look for in these "pocket pivot" situations.

"Dr. K's Market Direction Model" is an intriguing concept introduced in the book. Dr. Kacher suggests the model's returns are north of 100% annualized and there are several charts in the book showing buy and sell points issued by the model. Distribution days are an important input into the model. Given the importance assigned to this tool in the book, the reader is left disappointed at the lack of a more formal description of how to generate the signals. One sympathizes that the authors want to keep this a proprietary tool, but there is perhaps just enough detail for readers to try and create their own tools for use in the market. The biggest detraction from the book is that the authors try to accomplish two tasks at once. They try to tell a story of great market winnings, and they try to teach an investment methodology. They do a credible job on both, but probably less so than if they had decided to focus on one task or the other. There may be those who feel this is a celebratory victory lap full of braggadocio. However, as Dizzy Dean once said: "It ain't bragging if you can do it."

Ajay G. Jani, CMT has been in the investment business since 1989. He is currently Managing Director of Gramercy, an asset management firm focused on investing in Emerging Markets.

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Ethics Corner

By Mike Carr, CMT

This is the first of what will be a series of case studies related to the MTA Code of Ethics. This one is brief, and seemingly simple, but we want to present the general idea. If you have any questions you'd like to see specifically addressed, please email them to editor@mta.org.

QUESTION: A CMT candidate is completing his MBA program and took a job with a company that cleans office buildings in the evening. While emptying trash cans in the office of the CEO of a well known investment bank, he sees a draft press release indicating that a large software company will be buying the stock of a small technology consulting firm at a 75% premium to the current market price. The deal will be announced a week from now. The candidate immediately buys call options on the stock of the small firm and captures enough gains to quit his cleaning job. Were any standards of the MTA Code of Ethics violated?

ANSWER: Although a cleaning job is not investment related, the Code of Ethics binds candidates in all their behavior, not just in their investment professional role. Therefore, there is at least one violation:

Standard 5 states that, "Members and Affiliates shall not seek, disseminate or act on the basis of material, non-public (inside) information, if to do so would violate the laws and regulations of any government, governmental agency or regulatory organization relating to the use of inside information." By virtue of his education, the candidate would surely understand the information he had seen was material. This assumption may not apply to all persons working for the company, but it would be difficult to argue that someone able to use options strategies would not understand what material information consists of. The fact that it was not released to the public makes it inside information and the candidate should not have acted on it.

Other standards may also have been violated. One could also argue that Standard 1 relating to professional and ethical conduct was violated. Standard 6 requires Members and Affiliates to keep knowledge about their employer's clients in confidence and a case can be made that the candidate violated this standard.

It is clear that this scenario presents a violation of the Code of Ethics. Members and Affiliates must remember that the Code applies to all activities, not just the time when they are acting as an investment professional.

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Long Range Planning: The MTA Looks Ahead

By Mike Carr, CMT

On a beautiful fall weekend, the MTA Board of Directors could be found meeting with volunteers and staff members to discuss several of the important issues facing the organization. Some of these issues included an ongoing review of the CMT program, efforts to enhance the credibility of technical analysis in the financial community, and the efforts of the MTA Educational Foundation to improve the acceptance of technical analysis in the academic community.

The CMT program is truly under constant review. Additional exam questions are always being prepared. The Body of Knowledge faces frequent analysis. The goal is to keep the material relevant and maintain the designation as the gold standard of certifications. From the information presented at the meeting, it is obvious that it's a large effort which is necessary to ensure that the CMT will be respected in the future. You can help by participating in periodic job surveys that are used to update the curriculum. Member responses are a critical input to this process.

For a variety of reasons, technicians occasionally encounter skepticism that technical analysis works. The MTA's leadership demonstrated that they are aware of this, and are taking several steps to address the perception of the financial community. Enhancing the credibility of technical analysis is likely to lead to more career opportunities for talented and ambitious technicians.

As one example of skepticism, a member's firm questioned whether or not to allow the use of the CMT designation on business cards. Among the reasons they cited were that the program does not have a rigorous curriculum, notably lacking a required reading list, and the designation itself was not approved by a nationally recognized accreditation agency. These points were quickly addressed – the designation does have a very well defined curriculum and the test is developed from the recommended reading list; and the SEC has recognized the successful completion of the CMT as qualifying for a Series 86 testing exemption.

Efforts to promote the CMT among professionals in the international community will also increase the recognition of the MTA and the credibility of the profession. The increase in membership outside the United States and Canada has been very impressive. There are now almost 200 members and affiliates in India and more than 100 in Switzerland. Rapid growth is also being seen in South Africa, Singapore, and China.

The MTA Educational Foundation is attacking the misperceptions associated with technical analysis in the academic community. They are highlighting the work of respected professors which supports the idea that some techniques are quantifiable and have been demonstrated to deliver statistically significant results. While they have made great strides in the past few years, the Foundation intends to make even more progress in the future.

The MTA is aggressively pursuing its mission, and succeeding beyond the imagination of the organization's founders. The extent of long range plans, combined with the visible results from continuous contributions of the staff and volunteers, ensures that the MTA will be a powerful industry force for years to come.

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Take a Technician or Trader to Lunch

By the MTA Educational Foundation

The MTA Educational Foundation is reprising its popular 'Take a Technician or Trader to Lunch' fundraiser. Just like last year, dozens of technicians, traders and even economists are making themselves available to help advance the mission of the MTAEF to further the acceptance of technical analysis in the academic community.

To participate, you simply bid on EBay. The high bid wins the chance to sit and learn from industry leaders over a relaxed lunch. Winning bidders coordinate the time and location directly with the winner. Among the success stories from last year, John Bollinger reported that he was inspired to create new indicators after lunch last year.

A year ago, winning bids ranged from \$200 to \$7,000. Many lunches were \$200 to \$300, especially affordable for a good cause and possible tax deduction.

This year's auctions include analysts from around the world:

Ralph Acampora, CMT - New York ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Ralph-Acampora-CMT-/320599225536?pt=LH_DefaultDomain_0&hash=item4aa533f4c0

Guy Adami - Chicago & New York ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Guy-Adami-/320599226063?pt=LH_DefaultDomain_0&hash=item4aa533f6cf

Robert Barbera, Ph.D. - New York ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Robert-Barbera-Ph-D-/320599227275?pt=LH_DefaultDomain_0&hash=item4aa533fb8b

Rick Bensignor - New York ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Rick-Bensignor-/320599227769?pt=LH_DefaultDomain_0&hash=item4aa533fd79

John Bollinger, CFA, CMT - Los Angeles ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-John-Bollinger-CFA-CMT-/320599228165?pt=LH_DefaultDomain_0&hash=item4aa533ff05

Richard Edwards - London ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Richard-Edwards-/320599228449?pt=LH_DefaultDomain_0&hash=item4aa5340021

Peter Eliades - San Francisco ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Peter-Eliades-/320599228653?pt=LH_DefaultDomain_0&hash=item4aa53400ed

Phil Erlanger, CMT - Boston ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Phil-Erlanger-CMT-/320599228932?pt=LH_DefaultDomain_0&hash=item4aa5340204

Robin Griffiths - London ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Robin-Griffiths-/320599229244?pt=LH_DefaultDomain_0&hash=item4aa534033c

Steven Hochberg - Atlanta ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Steven-Hochberg-/320599229596?pt=LH_DefaultDomain_0&hash=item4aa534049c

David Keller, CMT - Boston ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-David-Keller-CMT-/320599230070?pt=LH_DefaultDomain_0&hash=item4aa5340676

Charles Kirkpatrick II, CMT - Portsmouth, NH ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Charles-Kirkpatrick-II-CMT-/320599230933?pt=LH_DefaultDomain_0&hash=item4aa53409d5

Steve Leuthold - Minneapolis ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Steve-Leuthold-/320599231277?pt=LH_DefaultDomain_0&hash=item4aa5340b2d

Ron Meisels - Montreal ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Ron-Meisels-/320599231681?pt=LH_DefaultDomain_0&hash=item4aa5340cc1

John Mendelson - New York ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-John-Mendelson-/320599231917?pt=LH_DefaultDomain_0&hash=item4aa5340dad

Martin Pring - Sarasota, FL ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Martin-Pring-/320599232214?pt=LH_DefaultDomain_0&hash=item4aa5340ed6

John Roque - New York ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-John-Roque-/320599232414?pt=LH_DefaultDomain_0&hash=item4aa5340f9e

Philip Roth, CMT - New York ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Philip-Roth-/320599232896?pt=LH_DefaultDomain_0&hash=item4aa5341180

Adam Sarhan - Boca Raton, FL & New York ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Adam-Sarhan-/320599233353?pt=LH_DefaultDomain_0&hash=item4aa5341349

Katie Townshend Stockton, CMT - Stamford, CT ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Katie-Townshend-Stockton-CMT-/320599233753?pt=LH_DefaultDomain_0&hash=item4aa53414d9

Jason DeSena Trennert - New York ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Jason-DeSena-Trennert-/320599233989?pt=LH_DefaultDomain_0&hash=item4aa53415c5

Stan Weinstein - Ft. Lauderdale, FL ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Stan-Weinstein-/320599234266?pt=LH_DefaultDomain_0&hash=item4aa53416da

Louise Yamada, CMT - New York ([bio information](#))

http://cgi.ebay.com/Take-Analyst-Lunch-Louise-Yamada-CMT-/320599234841?pt=LH_DefaultDomain_0&hash=item4aa5341919

Bidding started on Monday October 4 and will run for ten days. Now is the time to develop your trade plan. For more info, check www.mtaeducationalfoundation.org!

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MTA Announcements

MTA West Coast Regional Seminar - *Video Archives Now Available!*

The MTA is pleased to announce that the archived videos from the West Coast Regional Seminar, held on September 18th, 2010 in San Francisco, CA, is now available! We'd like to extend our deepest gratitude to all of the presenters, attendees, volunteers, and sponsors (ProShares and TradeStation) who helped make this event possible.

[Click here to visit the MTA West Coast Regional Seminar video archives.](#)

MTA Test Development Committee - Two Openings!

The MTA is looking for two CMT charter holders to join the Test Development Committee as subject matter experts. This is a three-year commitment that involves writing exam questions, grading CMT 3 exams, and attending all conference calls.

We are looking for a minimum commitment of 40 hours per year. You will be paid in quarterly installments and will work as an independent contractor to the MTA. If interested, please send your resume and a brief description of your expertise in technical analysis to Jeanette Young at jeanette@mta.org.

Fall 2010 CMT Exams – Registration For Level 3 Closing Soon!

Registration for CMT Level 3 Exam closes on *October 8, 2010!* [Sign up today](#) to ensure your preferred time, date, and location! Contact [Marie Penza](#), 646-652-3300, for information on the CMT Program and/or if you are having trouble scheduling your exam with Prometric.

For detailed instructions on how you can register online, please [click here](#).

Career Development Center - New Additions!

The MTA would like to announce that the following resources have been added to the Career Development Center.

- [Being a Money Manager and a Technician](#) - A video presentation by Ken Winans, CMT, from the West Coast Regional Seminar in San Francisco, CA, originally held on September 18, 2010.
- [Being a Director of Research at Fidelity Behind the Scenes](#) - A video presentation by David Keller, CMT, from the West Coast Regional Seminar in San Francisco, CA, originally held on September 18, 2010.
- CDC Library Addition: "*The Truth About Managing Your Career...and Nothing But the Truth*" by Dr. Karen Otazo

[Visit the Career Development Center](#) for a complete listing of resources. If you have any suggestions of books that should be included in the Bookshelf, please contact [Tim Licitra](#).

Call for Submissions

The MTA is interested in starting a new section in the Career Development Center that is focused around past employment experiences. This new section, Success Stories, will feature personal testimonials and unique stories from our membership about what worked for them in the job search process. If you are interested in submitting a Success Story please email tim@mta.org.

MTA Knowledge Base Blogs - New Resources Added!

The MTA is pleased to announce the addition of several new resources to the MTA Knowledge Base (KB). To access one of the resources, simply click its title and you will be taken to the corresponding page in the KB.

- [Using Cycles to Derive Price Projections \(Video\)](#); Resource ID 4.1.04
- [Being a Money Manager and a Technician \(Video\)](#); Resource ID 1.7.02
- [Trends Break and Trends Bend. Knowing which is Critical \(Video\)](#); Resource ID 10.2.4.12
- [Predicting the Future with Liquidity Waves \(Video\)](#); Resource ID 8.7.05
- [Using and Understanding Point & Figure, Part II \(Video\)](#); Resource ID 2.4.07
- [Media Panel Discussion-2010 West Coast Regional Seminar \(Video\)](#); Resource ID 1.5.13
- [Being a Director of Research at Fidelity Behind the Scenes \(Video\)](#); Resource ID 1.7.01
- [Relative Strength & Portfolio Management \(Video\)](#); Resource ID 1.7.02

The MTA is always looking for volunteers to help populate the Knowledge Base with technical analysis information. If you are interested in volunteering, please email [Tim Licitra](mailto:tim@mta.org) at tim@mta.org.

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