TORTOISE CAPITAL MANAGEMENT

100 essays for traders

Reflections from a trading room

Ken Long

11/1/2010

Essays compiled from a writing project between March 30, 2009 and May 10, 2009. These essays are a response to the 100 most frequently asked questions and which comprise much of our daily discussions inside the Tortoise trading room, where traders gather to apply the principles and concepts of Tortoise style trading.

Reflections on the Practice of Trading

-100 Essays on Tortoise Trading

By Ken Long

Essays compiled from a writing project between March 30, 2009 and May 10, 2009 (with a couple other goodies thrown in for good measure that were written a little earlier)

These essays are a response to the 100 most frequently asked questions and which comprise much of our daily discussions inside the Tortoise trading room, where traders gather to apply the principles and concepts of Tortoise style trading.

I am grateful to the traders who have contributed so much of their time, energy, insight and best practices to the benefit of their fellow room members. And I look forward to learning more every day

Profitable ETF Trading Strategies: refining the exit efficiency index 4
Profitable ETF Trading Strategies: understanding exit efficiency 5
Profitable ETF Trading Strategies: reflecting on the gold ETF 6
Profitable ETF Trading Strategies: applying the laws of large numbers 7
Profitable ETF Trading Strategies: understanding Max pain 9
Profitable ETF Trading Strategies: understanding the Japanese market ETF 10
Profitable ETF Trading Strategies: understanding ETF volatility 11
Profitable ETF Trading Strategies: Appreciating the art and science of trading 12
Profitable ETF Trading Strategies: understand your trader quality number 13
Profitable ETF Trading Strategies: understanding the limits of back-testing 14
Profitable ETF Trading Strategies: the power of back-testing 15
Profitable ETF Trading Strategies: feed the bulldog every day 16
Profitable ETF Trading Strategies: managing your emotional bank account 17
Profitable ETF Trading Strategies: leveraging our need to be right 18
Profitable ETF Trading Strategies: measuring your open risk in minutes per trade 19
Profitable ETF Trading Strategies: 10 ways to improve your span of control 20
Profitable ETF Trading Strategies: understanding your span of control 21
Profitable ETF Trading Strategies: a checklist for battle stations 22
Profitable ETF Trading Strategies: designing a robust trading system 23
Profitable ETF Trading Strategies: trading the morning gaps 24
Profitable ETF Trading Strategies: efficiently developing an effective trading plan 25
Profitable ETF Trading Strategies: a reflection on trend following 26
Profitable ETF Trading Strategies: four sources of traders insight into self 27
Profitable ETF Trading Strategies: can I make a living as a mechanical trader? 28
Profitable ETF Trading Strategies: is mechanical trading right for me? 30
Profitable ETF Trading Strategies: appreciating the power of rehearsals 31
Profitable ETF Trading Strategies: monitoring global markets 32
Profitable ETF Trading Strategies: understanding the evolutionary brain 33
Profitable ETF Trading Strategies: the power of “no lose” trading 34
Profitable ETF Trading Strategies: trading through the metaphorical lens of combat 35
Profitable ETF Trading Strategies: mastering the execution phase 36
Profitable ETF Trading Strategies: the preparation phase of trading 37
Profitable ETF Trading Strategies: the operations order format of structured trading 38
Profitable ETF Trading Strategies: three leadership questions for traders 39
Profitable ETF Trading Strategies: 10 ways to find new edges 40
Profitable ETF Trading Strategies: Kipling’s Jungle Books metaphor in trading 41
Profitable ETF Trading Strategies: fighting for dimes 42
Profitable ETF Trading Strategies: examining uncertainty 43
Profitable ETF Trading Strategies: on having courage 44
Profitable ETF Trading Strategies: the power of re-entry 45
Profitable ETF Trading Strategies: insights from cognitive neuroscience 46
Profitable ETF Trading Strategies: Synchronizing your trading systems into an effective strategy 47
Profitable ETF Trading Strategies: applying the concepts of Mission and Commander’s Intent 48
Profitable ETF Trading Strategies: adapting the best practices of military planning 49
Reflecting on the source of qualitative judgement 50
Profitable ETF Trading Strategies: introducing “ready fire aim” for traders 51
Profitable ETF Trading Strategies: “Ready-Aim-Fire” for traders 52
Profitable ETF Trading Strategies: a craftsman’s approach to trading 53
Profitable ETF Trading Strategies: the psychology of Grail seekers 54
Profitable ETF Trading Strategies: understanding the limitations of professionalism 55
Profitable ETF Trading Strategies: become more professional in your trading 56
Profitable ETF Trading Strategies: understanding what contributes to your trading results 57
Profitable ETF Trading Strategies: what is the nature of the market? 58
Profitable ETF Trading Strategies: developing a master belief list 59
Profitable ETF Trading Strategies: integrating your beliefs about self, market and systems 60
Profitable ETF Trading Strategies: beginning the journey of self-awareness 61
Profitable ETF Trading Strategies: applying Gladwell’s insights from “The Tipping Point” 62

Profitable ETF Trading Strategies: developing a new oscillator, the NDX() 63
Profitable ETF Trading Strategies: a closer look at Williams %R with 2 improvements 64
Profitable ETF Trading Strategies: understanding Williams %R, a simple oscillator 65
Profitable ETF Trading Strategies: a brief look at technical analysis 66
Profitable ETF Trading Strategies: profiting from a good story 67
Profitable ETF Trading Strategies: my 10 best reasons for joining a mastermind 68
Profitable ETF Trading Strategies: how to trade the opening gap 69
Profitable ETF Trading Strategies: are trailing stops better than fixed profit targets?? 70
Profitable ETF Trading Strategies: reflecting on technical and fundamental analysis 71
Profitable ETF Trading Strategies: understanding Average True Range (ATR) 72
Profitable ETF Trading Strategies: 4 ways to measure volatility 73
Profitable ETF Trading Strategies: Respect Volatility, use its power for good 74
Profitable ETF Trading Strategies: Good traders know and exploit their edge 75
Profitable ETF Trading Strategies: Stalking your way to success 76
Profitable ETF Trading Strategies: Choose your self-talk wisely 77
Profitable ETF Trading Strategies: Finding your best mental state for trading 78
Profitable ETF Trading Strategies: Experiencing the Zero-State 79
Profitable ETF Trading Strategies: Trading From the Zero-State 80
Profitable ETF Trading Strategies: How science can improve your trading 81
Profitable ETF Trading Strategies: 8 attributes of quality research 82
Profitable ETF Trading Strategies: You don’t have to be “right” to make money 83
Profitable ETF Trading Strategies: 3 Tips for developing a market classification system that fits your style 84
Profitable ETF Trading Strategies: finding an edge in market classification 85
Profitable ETF Trading Strategies: the Problem of “Maybe” 86
Profitable ETF Trading Strategies: Sources of Psychological Pressure for Mechanical Traders 87
Profitable ETF Trading Strategies: Mastermind Meeting Discussion Topics 88
Profitable ETF Trading Strategies: being a good Mastermind member 89
The Snapping Turtle trading technique: a case study 90
Profitable ETF Trading techniques: Finding a quality Mastermind Trading Group 92
Profitable ETF Trading Techniques; 10 qualities of a good Mastermind group 93
A thought experiment in leadership and identity 94
Reflective learning and Self Talk 95
Leadership in Complex Adaptive Systems 96
The market is in a Washout pattern here 98
A reflection on Gold price volatility compared to the broad market 99
How we read is who we are 100

Profitable ETF Trading Strategies: refining the exit efficiency index

Posted by **Ken Long** on May 10, 2009

Chuck LeBeau developed a powerful analysis tool for traders called the exit efficiency index. Briefly, it's an analytical process to examine the quality of your average trade exit within a reasonable timeframe around your actual trades. Understanding the technique will help you tune your system to typical market conditions where you are seeking to exploit your edge.

In a nutshell, you take your actual profit in each trade and divide it by the perfect exit from a timeframe that represents twice your actual trade to come up with a score between zero and one. If you can reliably get 30 to 40% of the perfect trade in your normal timeframe then you're doing well.

With a few refinements it is possible to examine the quality of the entry as well as the quality of the exit. In this way you can consider how well tuned your trading system is to the general market conditions you seek to trade.

With another refinement you can look at the worst possible exit in the same timeframe to determine how well your profit preservation and capital preservation exits are protecting you against losses.

The same refinement will also show you if there are profit opportunities by reversing your trade direction and going the other way when the first trade is over.

Maybe the hardest piece of analysis to do is to look for opportunities on the other side of the trade when you have a positive expectancy system. It would not normally occur to you to see if you are missing profits by trading in exactly the opposite direction, when you have a system that makes money.

By doing so, however you may be opening yourself up to some real surprises concerning profit opportunities when you normally trade. You may discover that you can trade both sides of your idea in sequence. An example of this would be to stop and reverse instead of just stopping out of your trade.

I have found that there are certain market conditions that favor stop and reverse strategy, while in others it is appropriate to simply stop and scan for new opportunities.

By examining your trading statistics from all angles you'll improve your bottom line as a trader.

Profitable ETF Trading Strategies: understanding exit efficiency

Posted by Ken Long on May 10, 2009

Chuck LeBeau is a master trader and teacher who wanted to examine the quality of his exits, based on the belief that exits are far more important than entries in a trading system.

Since there were no existing measures available to use for his analysis he decided to invent his own, which he called the exit efficiency index.

The idea behind this concept is to examine the quality of your actual exit against the perfect exit in retrospect. He decided to look at all possible trades in approximately the same timeframe as the original trade. Comparing the perfect exit to the actual exit would allow the trader to determine if the system was in tune with the market when the trader is looking to exploit his edge.

Here's how to do it. First, define the time period between entry and exit as the variable “t”. Now examine all price action within double that timeframe and call it “2t”. Find the highest possible price you could've sold at in the “2t” timeframe. In retrospect, that would be the perfect exit. Because we are creating an index of efficiency the scores will range between 1.0 for perfect and 0.0 for worst.

In order to develop the efficiency rating for each trade, divide the actual return by the perfect return and you will come out with a number between zero and one. Convert this to a percentage to see what percentage of the perfect return you actually received.

Based on Chuck's analysis, a trading system that on average can extract 30 to 40% of the perfect trade is doing very well. This is important information for traders who are depressed about leaving too many profits on the table. Regret at missing profits is one of the most powerful psychological forces at work making you change your trading plan. Armed with this information, a trader can maintain the willpower and discipline to stick to good trading rules in the future.

Profitable ETF Trading Strategies: reflecting on the gold ETF

Posted by Ken Long on May 10, 2009

There are two ETFs that focus directly on gold, the commodity. The first one has a symbol of GLD and is by far the most heavily traded of the two ETFs, probably because it was the first one to market. The second symbol is IAU. These two ETFs trade so closely together that it would be hard to fit a razor blade in between them.

Gold has always been a popular hedge and an alternative investment asset through the years. More than other commodities it also has attracted various groups of true believers, various conspiracy theorists whose life seems to revolve around discovering secret alliances of international bankers who work tirelessly to artificially keep the price of gold low. You can find these discussions on Yahoo discussion groups at your leisure.

It is true that many people consider gold as a hedge against inflation because there is a finite amount of gold in circulation and storage. We know the rate at which new supply is mined and we can predict with some certainty the consumption of gold for jewelry and other industrial uses.

When you see the US government printing trillions of new dollars of fiat money, there is a natural inclination to look to gold as a store of value. For reasons I cannot explain there is no direct correlation with the price of gold and the rate of inflation. This is probably due to the buying and selling of gold by institutional money.

For purposes of this essay I just want to look at GLD as a trading vehicle choice.

It is one choice among many in the commodity area and in equity markets in general. I am neither competent nor interested in trying to uncover the true secret of gold price variability.

The only thing that I focus on instead is examining price performance and looking for opportunities to achieve favorable reward to risk ratio trades in the same way that I look at all ETFs. I find this approach allows me to find trade setups that fit within my parameters for risk and reward.

In the last year or so it may surprise you to find out that the volatility of gold has been as little as one third of that of the broad market index, the S&P 500. In fact you could probably win money by asking people which they thought was more volatile: the stock market or gold.

This relative volatility of gold goes through cycles however. There are times when it is more volatile than the market. So the truth about gold as far as I can see is that it goes through cycles just like every other sector as a class and must be studied constantly to find those moments with good trading parameters.

The one thing you can count on is that gold will continue to fascinate and delight traders and investors for years to come and this will create opportunities for effective traders living in the buying and selling at appropriate times. Remain calm, all will be well.

Gold will continue to provide opportunities for agile traders. The use of the ETF is a cost effective and time efficient way to participate in the opportunity without the issues of storage, accountability and liquidity.

Profitable ETF Trading Strategies: applying the laws of large numbers

Posted by Ken Long on May 10, 2009

When you have a statistical edge in the market, the first thing you want to know is how reliable it is. If it turns out that your edge is robust, that means it can be relied upon to work for you in most if not all types of markets. When you have such an edge, the best strategy to adopt is that of a Las Vegas casino. You want to be the house.

Being the house means that you want to play a positive expectancy game with as many iterations as possible, in order to achieve the expected average return of your system.

The statistical edge in the games of chance played in Las Vegas casinos are very small. These small edges though are mathematically certain because of a tightly controlled conditions and the environmental attractions the casinos offer.

Because the conditions are so carefully controlled, the house can expect for its mathematical edge to work in its favor precisely because of the large number of iterations. If you are the house, you want 1 million people playing blackjack for one dollar per hand, rather than one person playing a single hand of blackjack for $1 million.

The results of an individual iteration of a game of chance is not knowable before hand. However, the laws of large numbers work to your advantage when you have the edge.

In the same way, if people in your neighborhood like to gamble, then the best strategy for the whole neighborhood is to pool their money into a single pot and send that money to Las Vegas to play a single hand of blackjack, winner take all. A single iteration at blackjack is the best possible return for your money in Vegas, although it is a slightly negative expectancy gain under most circumstances.

A short-term trader who has plenty of opportunities is better off taking five positions at 1% risk per position than a single position at 5% risk no matter how he decides to rank order the signals by quality. This assumes of course that the signals that pass the screening criteria are equally reliable in the long run.

The greater the number of iterations in the sample size, then the greater your chance of achieving the average expected return of a positive expectancy system. There is a natural tendency among traders to try to concentrate their capital on what they consider to be the best trade available. If your system is generating multiple signals though then you are better off taking all of the signals at reduced risk, provided that you have done your back-testing work and admin costs of trading are low.

Profitable ETF Trading Strategies: understanding the stealth trade

Posted by Ken Long on May 9, 2009

Behavioral psychologists have pointed out that people do not act like rational actors when it comes to investing and trading in the stock market. In addition to fundamental factors like the business cycle, there appear to be psychological motivations at play that help to explain market performance and price fluctuation.

A short-term or intermediate-term trader can take advantage of the power of human psychology to improve their trading practice with respect to timing market entry and exits.

One strategy that can be very useful is the idea of the stealth trade.

The stealth trade occurs when a market sector that is represented by an ETF for example, is in a position where it is no longer the worst performer in the market but has not yet rebounded strongly enough to be considered as a new headline story.

Newspapers, magazines and television shows that cater to traders make their money with exciting news stories and headlines. Headlines sell advertising, so there's always a hunt for the newest and most interesting story.

Consider what might happen to a sector such as semiconductors that is beginning to outperform all other market segments dramatically. The headlines will talk about semiconductors as the way of the future and momentum money will chase this sector until there's nobody left to buy. Semiconductors will then be at an intermediate high and then begin to lose ground as people try to lock in profits or avoid further losses if they are the latecomers to the party.

Once semiconductors have lost their shine and are beginning to descend back into the pack or lower, they are no longer news and no one is talking about them. They will probably continue to fall until they find something like a natural level where only value players are interested. There may be some headlines concerning semiconductors if they achieve bottom rung status by being the worst performing sector available. That is news and they will be back in the headlines.

Now suppose that they have started to attract value investors. Because of their buying pressure, the panic selling will be clearly over. There's nothing exciting about semiconductors anymore as they start putting in a bottom. Institutional money is probably quietly buying at these price levels in such a way as to avoid attention. Only after semiconductors have started to move back into the pack will you start to see headlines about the rebirth of semiconductors.

The trading psychology cycle will begin once more. Institutional money which acquired semiconductors at a value price is now unloading those positions in measured amounts to momentum money that is chasing the sector once more.

The stealth strategy then is simply trying to find the sectors that used to be the worst performers which are now not quite so bad but before they have become headline news. Stealth traders are acting like institutional money, taking the other side of the trade from the masses.

This is an attractive way to use ETFs since you are able to offset or avoid individual company risk while playing the larger macro economic trends.

The difficult part of the stealth strategy is in selling a position that is now finally beginning to catch fire and you should be selling to momentum money. The temptation is always to overstay your welcome in that sector but this is a nice problem to have.

Profitable ETF Trading Strategies: understanding Max pain

Posted by Ken Long on May 9, 2009

Trading psychologists generally agree that there are two dominant emotions in the area of behavioral psychology that influence market price and performance. These two emotions are fear and greed. It is also generally agreed in the scholarly literature that fear is about three times more powerful than greed. It distorts our normal rational analytical mind when it comes to considerations of reward and risk.

Knowing this fact, a short term trader could reasonably conclude that market mispricing occurs more likely in moments of great fear than great greed. A short term outlook is much more likely to be influenced by emotion than the longer-term rational approach to the markets.

For these reasons, a short-term trader could consider the idea of “Max Pain” in the search for tradable short-term opportunities.

Here are some different ways this idea could be used to find low risk tradable ideas.

1. Become familiar with a small set of liquid companies and ETFs and determine what normal conditions of gains and losses are. Then, be on the lookout for moments when losses have exceeded the threshold of normal. Use these moments as opportunities to find high probability reversion to the mean trades.
2. Become an expert in a single stock or ETF and develop an appreciation for how it trades in normal swings in short term time periods and look for moments of exaggerated selling with respect to the recent normal behavior. Chances are you have identified an overreaction on the sell side which may afford you an opportunity to revert to the mean.
3. Pay close attention to the size and direction of the morning gap in a set of tradable instruments. Find those symbols that have lost the greatest percentage from yesterday’s close and treat them as high probability candidates for reversion to the mean. Look for them to find support in the first 30 minutes of the market and be prepared to go long with a tight stop. Even if these symbols only close the morning gap you may have made your daily profit objective in the first couple hours of trading.
4. Look for adverse reactions to news events that take the market by surprise. Chances are that panic selling will misprice a reasonable company and create a moment to buy value at a discount.

The idea behind this “MaxPain” strategy is that you avoid the sudden surprise losses that created the opportunity, and you are positioned to play for the rebound. This is definitely a short-term strategy which happens with such regularity you may find it a valuable addition to your trading arsenal.

Profitable ETF Trading Strategies: understanding the Japanese market ETF

Posted by **Ken Long** on May 9, 2009

The Japanese stock market, the Nikkei, is the world's second-largest equity market in terms of daily dollars traded. Because it is open when the US market is closed it does offer an opportunity to put your dollars to work at different times of the day.

One of the ways to participate in the opportunities found in the Japanese stock market is to trade the ETF symbol: EWJ. This is a broad market index ETF that tracks the Japanese stock market.

While this sounds like an attractive idea on the surface, it is complicated by the fact that the ETF itself trades with very little volatility during the hours the US market is open. Almost all of the gains and losses associated with symbol EWJ are found at the open and close of the trading session.

This is because the Japanese market varies only a little when it is closed; all its gains and losses occur during the time when the Japanese market is open. So the ETF trader is advised not to use symbol EWJ as if it were just another ETF. The gains and losses you would experience while the US market is open are so small as to be almost impossible to trade intraday unless you were to use inadvisable levels of leverage.

The symbol EWJ can be traded, however by sector recycling systems by swing trading system or by position trading systems that were to capture macro-economic track. It can also be used as part of a broad strategy for asset allocation. Then, EWJ is a cost-effective way of getting exposure to the Japanese markets without having to become an expert in individual Japanese companies or opening an account that they trade directly inside the Nikkei.

Profitable ETF Trading Strategies: understanding ETF volatility

Posted by **Ken Long** on May 9, 2009

There are many different useful definitions of the concept of volatility. For the purposes of this essay I just want to consider volatility in a non-technical way, and that is as the amount of variation in returns around the mean, or the average.

In any bundle of returns from a trading system, you will always be able to calculate the average return. If most of the returns are tightly clustered around the average you would normally consider this to be predictable and reliable and low volatility. If individual returns were widely scattered above and below the average, you would normally consider this to be unreliable, risky and high volatility.

That is the general sense of volatility that I want to consider in this essay.

Now, I want to consider some lessons learned concerning volatility in exchange traded funds within your trading practice.

ETFs are much less volatile than individual large cap stocks. This is true even for ETFs whose components holdings are all large cap stocks. Even the big, mature companies in the Dow Jones Industrial 30 index are much more volatile than the composite ETF that holds them. This is ETF trading symbol DIA.

One of the things you get with lower volatility ETFs is the ability to engineer your position sizes more carefully because ETFs have less volatility and also tend to be more range bound. You are much more likely to have an extraordinary event in an individual stock which includes the possibility of a runaway winner whereas ETFs are more likely to give you long regular cyclic waves of winners and losers.

In addition to ETFs having lower average volatility, they also have a lower standard deviation in general than the individual stocks that make up the index. What this means is that the amount of surprise you are subject to is generally less on both the upside and downside.

Of course we want to be careful in overestimating the usefulness of this information. We want to remember that even low volatility ETFs have the possibility of large moves off of overnight surprise news.

So ETFs may isolate you from some individual company risk but at the cost of giving up the opportunity for wildly explosive moves in your favor by surprise. For many traders, this is an excellent trade-off if you are looking for regular normal returns.

Profitable ETF Trading Strategies: Appreciating the art and science of trading

Posted by Ken Long on May 3, 2009

In any profession that features a strong human performance factor, there will surely be a mix of both art and science that contributes to the final product and performance level. Since the trading profession incorporates such a large amount of human psychology at both the individual and organizational level, it's worth considering how both art and science are reflected in your own trading practice. It's also good to know how strong you are in both dimensions so that you can insure you leverage your strengths while protecting your weaknesses.

The scientific aspect of trading has a lot to do with quantifiable considerations like:

1. statistical analysis of market conditions
2. statistical analysis of trading results
3. statistical analysis of various trading systems in order to rank them by effectiveness and risk adjusted return
4. the predictive power of back-testing and forecasting algorithms
5. analysis of repeatable events in order to find efficiencies and economies of scale, such as in hardware and communications throughput factors
6. at institutional level, the relationship between now and supply and demand in determining price
7. the ability to forecast market responses based on the law of large numbers and mass psychology
8. identifying causation and correlation between variables
9. identifying cause-and-effect relationships
10. creating and testing trading hypotheses

The artistic aspect of trading has to do with qualitative judgments that are much more interesting to most traders who share the all too common dislike of all things scientific:

1. self-knowledge in terms of skills attributes and trades
2. psychological and cognitive biases that interfere with trading proficiency
3. interpretation of news events for scenario-based trading
4. hedging positions against forecasted risk scenarios
5. the great area in between the black and white of trading rule sets where the trader's interpretation and judgment that the rules
6. identifying trading strategies, market's targets that harmonize with your preconceived notions of how the market works and where your edge exists
7. the application of the insights from psychology and sociology into human performance
8. tolerance of uncertainty, ambiguity and risk
9. articulation and operationalization of goals and objectives into quantifiable measures
10. qualitative descriptions of successful outcomes of your trading practice

These two lists just scratched the surface of the art and science of trading. You should be able to see how both of these domains are powerful influences on the final outcome of our trading practice. Finding the proper blend between these two domains that represent the two halves of our brain will be crucial to your success as a trader

Profitable ETF Trading Strategies: understand your trader quality number

Posted by Ken Long on May 3, 2009

The system quality number that is taught by the International Institute of Trading Mastery is a very powerful way of calculating a single number that describes the relative quality of a particular system, given a set of trading results that are typical for that system. It is a methodology that allows you to compare average results with typical volatility over a statistically significant data set to determine if there is a quantitative and qualitative difference between two systems.

The system quality number is a powerful idea as far as it goes. Many traders, however, discover that the actual results of the system they propose to trade come in different than those suggested by the back-test. One of the important differences between back-testing and forward testing with real money is the human factor of the trader himself and his effect on system performance.

Sometimes the traders' actions add value to a system. Frequently the traders' actions take away value. The reasons for this can be numerous and varied and usually there is a combination of reasons why the trader degrades the performance of a particular system. It is normal for an inexperienced trader to overrule the specific system rules that add the most value to the new system.

An example of this would be to refuse to take an entry signals because of a particular belief in where the market is going to go next. This will normally occur when you see the system rules putting you into trades that don't make sense to your intuition. It may be the very counter-intuitive nature of the system that adds value to the results. If your psychology is aligned with that of the masses, then you will tend to overrule the system precisely when it is taking advantage of mass psychology.

As a result of this phenomenon, it is useful to think of a trader quality number which incorporates the system quality number as modified by the traders' actions. Only by taking meticulous notes of when and where the trader deviates from the system's rules can we determine if in fact he is adding or subtracting value. By examining the results from numerous examples of trader intervention, we can determine if it's a good idea for the trader to have discretion or not when executing the system.

It takes an incredible strength of will and character to take a look at the results of your own interventions and then act in a professional manner based on your analysis. If you can do that however, you have the fortitude and character to be a great trader.

Know your trader quality number as well as your system quality number and let that be your guide.

Profitable ETF Trading Strategies: understanding the limits of back-testing

Posted by Ken Long on May 3, 2009

One of the downsides of back-testing is that it can lure the trader into overconfidence about systems and the way they have performed in the past.

There is always a real danger of curve fitting and data mining to find a perfect system that would have worked with an exact set of market conditions in the past that can never occur again in the future. This is the problem of over reliance upon the power of computation. It neglects the reality of the market as a complex adaptive system which never shows you the same face twice.

Even if a back-test is performed rigorously and with full knowledge of the limits of its ability to forecast into the future, it is not unusual to see a large discrepancy between back-test results and actual results from live trading.

Some of the causes of this discrepancy in results have to do with some back-tests being conducted in isolation and not as part of a full portfolio of strategies. Often back-tests may use unrealistic values for slippage and commissions. Many times they will not take into account the human dimension of executing a set of trading rules. Experience shows that this is one of the most important aspects overlooked by most back-testing.

Perhaps the biggest challenge with back-testing is understanding the limits of its forecasting power. Some traders place so much reliance on their back-testing that they cannot be convinced by evidence of actual results that they have missed something important in their back-test. They might persist in trading a system that will simply not work in the real world. This can be attributed to the overconfidence bias combined with the need to be right.

Professional engineers and doctors are especially prone to this problem because of their belief systems and testing from their previous professions. Those professions place a premium on being right to be successful and yet in the trading profession, it is the ability to act with incomplete knowledge and a willingness to be wrong that often leads to the best results.

While back-testing offers many powerful advantages to the professional trader, it must be undertaken with full recognition of the limits of its usefulness as well. The professional trader will take back-testing results into consideration, as a way to select a system to prototype with real money, in real markets with the human factors fully engaged to see what the real world results look like before committing to full production system risk.

Profitable ETF Trading Strategies: the power of back-testing

Posted by Ken Long on May 3, 2009

The purpose of this article is to make the strongest case possible for back-testing as a crucially important way of understanding your system. In other articles I will suggest that too much back-testing is bad and that you can learn too many wrong lessons if you're not careful. That said however, back-testing is an essential part of a complete trading plan.

Back-testing can take many forms. In some cases an experienced trader who is considering an idea that is similar to previously reliable systems may only need a minimum of back-testing to be convinced that idea is worth trading with live money at a reduced risk level. There is synergy in professionalism and experience that should not be neglected or underestimated.

But even an experienced trader should carefully consider the results of a detailed back-test when taking on a new strategy or operating in a new time frame in order not to be misled by the constraints of his own experience.

Some people are not convinced by the quality of an idea unless they see it work over multiple time frames, in multiple markets and in all different market conditions. Others are satisfied that an idea only has to work within the definable set of parameters to be tradable.

This is a matter of personal taste since it comes down to a personal risk of capital rather than an academic exercise in the pursuit of absolute truth. Leave that for the academics. We want to make money as traders.

Properly constructed, back-testing will identify whether or not this idea has a persistent edge, and under what conditions it will manifest. By properly controlling for different parameters we can isolate those which add the most value to this particular proposition. We can test for robustness and see how sensitive the edge is to changing parameters.

We may be able to identify specific market conditions where the edge is significant and tradable. We may be able to identify a subset of the total market trading targets in which this idea works best.

Back-testing should tell us what the win rate percentage is likely to be, the importance of slippage and commissions, the trading frequency, the maximum adverse excursion, the longest normal winning and losing streaks, and both the maximum and average wins and losses.

One of the most important result sets for analysis is the distribution of results in the form of a frequency histogram. We would like to see a somewhat normal distribution that has most of the trades clustered around the mean and with an orderly profit tail to the right that suggests we have the possibility of large winning trades. We would also like to see a carefully controlled left tail of losses which suggests that we are able to engineer our risk carefully.

Having this kind of data in hand allows us to determine where, when and under what conditions this idea is tradable and what the expected results should be. When we proceed into live market trading as a prototype system with much reduced real risk, we can then compare actual results with live money to backtest results to see if the trade can be managed as intended.

Under these kinds of conditions and looking for this kind of information, back-testing is an important part of the traders' repertoire.

Profitable ETF Trading Strategies: feed the bulldog every day

Posted by Ken Long on May 3, 2009

In order to build up your emotional and financial bank accounts during the day, short-term traders should consider the technique of “feeding the bulldog” and making this a primary objective of each trading day.

There is an old saying to the effect that “talking doesn’t feed the bulldog”. This is a colorful way of saying that results from cashing winning trades are the only way to grow your account objectively. You must be able to cash winning trades when the time is right in order to have the money to fund future trading operations and meet your financial goals.

“Feeding the bulldog” means taking care of business when it’s time to exit the trade. When you exit to feed the whole block, you take on the persona of a thick-skinned experienced, practical survivor of the trading game. You are taking a professional profit in order to lock in the gains.

Here is an example of how you can use that mindset of “feeding the bulldog” to meet your daily profit target objectives and yet stay very active when you are in tune with the market and on your way to a great trading day.

Consider a trader who is willing to risk up to $1000 a day with a unit of risk being normally $250 and who is capable of managing up to four simultaneous positions and remain within the span of control. This means that the trader could have four open positions with the maximum $250 of risk per position when fully committed to the market. It would be normal for all four of these positions going in the same direction as part of the major theme of the day. It’s not impossible, though, for one or two of those positions to be going against the market in an area of weakness in the form of a pair trade.

This trader’s rule about feeding the bulldog is operationalized at $500 gain per day. What that means is that the first $500 for profit must go into the bank. This money is not available to work additional trading the rest of the day. For the trader to engage new positions he must cash one of the other trades that are still open and use the profits as a means of funding additional positions. A very good first trade may end up feeding the bulldog. This would mean the open profits of three other trades to be available for your wedding or taking on new positions.

This mindset acts to slow you down on days when you think you really have it going on, but it also reinforces the discipline of making positive gains every day as a primary objective of your short-term trading.

It makes you consider very carefully the quality of your open positions compared to the enthusiasm you feel for the next trading idea. By forcing you to choose, it keeps you focused on your best profit opportunity.

These parameters suggested in this article are simply to illustrate the point. To adopt this mindset for your own trading would require you to know yourself and your risk parameters and would incorporate information about your trading capital and risk appetite.

Feeding the bulldog every day can add discipline and professionalism to your daily trading practice.

Profitable ETF Trading Strategies: managing your emotional bank account

Posted by Ken Long on May 3, 2009

Managing your intraday trades when the market is open can be a very nerve-racking experience. Sometimes there's so much going on that it's hard to keep track of what's important. Other times it seems like you're watching paint dry and nothing is going on, and you can feel your nervous energy building up in an urge to do something.

This sense of market condition affects your trading state of mind, as does the sum total of your emotional responses to the results of the trades that you have taken so far that day.

It is as if you have an emotional bank account that tracks the debit and credit of emotional responses to the results of the day. After a couple of losing trades in a row, it would be natural for you to start experiencing a little bit of anxiety with respect to the remaining positions at the open in order to gain back some of that positive feeling of momentum and profits.

If you can feel your emotional state varying as a consequence of the trade results for that day, then it is a good idea for you to reinforce your trading practice which gets you to the "zero state" quickly and easily as soon as you can sense your emotional state changing.

If you are an intraday trader who is relying upon tight stops catching key turning points in the market to create high reward to risk ratio trades, however, you must come to expect a series of losing trades in a row with minor losses in order to be positioned to catch the winning trade which buys them all back and then some when your trade takes off.

If you have unreasonable expectations about your winning rate, you may find yourself becoming depressed by a losing streak that should be considered normal, usual and expected. Knowing your system and the way it performs will help you resist the emotional drain of losing trades that are within a normal distribution.

In addition, trading techniques like getting to "no lose" condition quickly, staying in tune with market cycles intraday, and being ruthless about banking some wins when you have them in hand can help you develop the emotional thick skin to be able to manage trades that go against you in a professional manner.

If you find yourself reaching for the next trade, or getting nervous about looking for the next opportunity to get you back to your winning ways, then you have an indication that you are not trading from emotionally balanced, stable and secure base.

The more your trading relies upon your discretion and judgment in the moment, which is a common feature of intraday trading, the more important it is for you to monitor your intraday emotions.

It's a good idea to include your emotional state in the evaluation checklist you use on each trade, so that you can make sure that you're coming from a place of emotional, psychological and intellectual stability when you enter a new trade rather than as a response to a decaying emotional state.

Monitor that emotional bank account traders!

Profitable ETF Trading Strategies: leveraging our need to be right

Posted by **Ken Long** on May 3, 2009

By learning how to manage your need to be right, you can reduce your trading frequency, improve your trade management skills and add directly to your bottom line.

There is a connection between our need to be right, our self-confidence, and our trading frequency which resides deep in our emotional center. By understanding this connection and learning how to turn it to our advantage, we can make dramatic improvements in many aspects of our trading practice.

It is not unusual to see a trader who over trades his latest and greatest new idea. This is normally explained and understood as an eagerness to get on with exploiting the new idea. In some cases, this takes the form of taking on too many positions and exceeding our span of control or bending the rules in order to get another position on.

This can occur from a confident belief in the quality of our idea and our ability to bend the rules to our own advantage. This self-confidence and the eagerness to act is tied directly to our need to be right and a belief in our ability.

There are very few psychologists who would suggest that traders should not have some level of self-confidence. Without confidence, each and every entry into the market can be excruciating and it is difficult to see how this mental state can be healthy or helpful on a routine basis. You might be successful in the short run with this mindset, but the long-term consequences on your physical and psychological well-being should not be underestimated.

What we are really looking for then is a legitimate level of confidence in our performance and ability. We want to make sure that our need to be right is not interfering with an appropriate level of confidence for taking effective action.

One way to harness the need to be right is to convert that energy and attention into a checklist of performance for each trade. By giving yourself a visual reminder of your trading tasks that you will check off with a green “X” whenever you follow your rules, you get to exercise your need to be right but tie it to a positive action which will improve your disciplined trade performance. This is presupposing that your trading rules and trading practice actually give you a positive expectancy and an edge in the market.

By applying your enthusiastic energy to a self-regulating task, you will reduce the numbers of trades, reduce your trading frequency, improve your discipline and performance and give yourself the basis determine how effective your rules really are.

Your task then is to have a daily trade checklist which you use to monitor the performance of your trading practice for every trade. It’s a good idea to have a visual and physical and right in front of your face as a visual reminder of your own professionalism.

All right traders! Get out those green felt tip pens and keep score on yourself!

Profitable ETF Trading Strategies: measuring your open risk in minutes per trade

Posted by Ken Long on May 3, 2009

The shorter the time frame of your typical trade, the more important the refinement of your entry becomes. In fact, the more important the refinement of each segment of trade management becomes, because there is less time available to correct for errors or to overcome sloppiness in execution.

For short-term trading, such as intraday or swing trading, it would be a reasonable objective to improve the timing of your entries with swings in the marketplace that are favorable to you once you enter the position. If you are doing this on a regular basis, you will do a lot to reduce the intraday stress you feel with the normal process of trading.

Conversely, if you are out of tune with the normal cycling of the market at your moment of entry, you'll experience the phenomenon of trades moving against you right after you enter on a regular basis. You will know if this is happening to you if you have a depressing psychological mind state at the start of each trade which actually expects it to start poorly for you.

A normal way for you to get a bad start is to be waiting too long for confirmation of your move before you enter. You think that by waiting a few extra minutes or an hour and seeing price moving in the direction you anticipate that you are improving your success odds in the trade. In fact, the false comfort of increased confidence is actually costing you time and money.

The price of certainty is underperformance in trading.

By learning how to act sooner and with more uncertainty in the pattern, you may discover that you increase your percentage of success, the average return per trade, and reduce the amount of time until the trade is favorable.

A good way to monitor your entry timing is to measure in minutes the amount of open risk in your trading. The sooner you can move the trade to break even, the more in tune with the follow-through action you are.

For intraday traders would like to see that measure in single-digit minutes. In order to achieve this objective, however, you must have relatively tight stops and be closer to intraday charting points in order to quickly get to "no lose".

By paying attention to detail at the entry, refining your timing, and being in tune with market cycles you can reduce stress, improve your winning percentage and add directly to your bottom line.

Dial in and stay focused, traders!

Profitable ETF Trading Strategies: 10 ways to improve your span of control

Posted by Ken Long on May 3, 2009

Understanding your span of control is essential for knowing the maximum number of trading positions you can have open any single time. Sometimes span of control is the limiting factor in the number of open positions. Sometimes it is trading capital available. Sometimes it is your maximum allowable portfolio heat.

Your portfolio heat means how much you would lose this moment if every single position you have open went immediately against you at every stop loss you have triggered. The amount of money would lose in that duration divided by your total portfolio, expressed as a percentage, is your current portfolio heat.

As a rule of thumb, a trader should not have more than 20% portfolio heat at any given time.

For short-term traders, overnight portfolio heat is more difficult to estimate, since you have to account for exceptional gap moves against you.

If you can improve your span of control, however, you can afford to have more open positions with smaller relative risk per position, still be within your maximum portfolio heat, and therefore reduce the probability of ever experiencing a maximum single moment drawdown.

Here are some things you can do to improve your span of control:

1. simplify your rule sets
2. rehearse contingency situations
3. use automatic trailing stops to manage open positions
4. trade symbols you are familiar with
5. identify the main themes of the day, week or month and stay with them
6. improved speed of execution
7. automate information gathering
8. improve the speed of your decision-making
9. reducing the amount of information required to act
10. stop believing that you are right and look at what’s happening now

By improving your span of control, you will improve trading performance and lower your per trade risk. It’s important to know where you are and how to improve with your active trade management.

Profitable ETF Trading Strategies: understanding your span of control

Posted by Ken Long on May 3, 2009

The military describes managing current operations as command and control. One of the most important concepts in command and control is the idea of span the control.

Span of control describes how many simultaneous, subordinate operations you can successfully manage at appropriate level of detail given the current situation of uncertainty, stress and pressure.
When you are inside your effective span of control, it is easy for you to be aware of all the important events occurring in your environment and for you to make decisions in time to have a positive effect on the outcome.
When you are at the limit of your span of control, there is a very real sense that you are fully engaged in the current operation. You can feel the boundary condition and you may even feel a sense of being about to lose control.

Think of a juggler who can successfully juggle five objects at once. Managing between one and four objects represents little to no challenge beyond the normal attention to detail required for any juggling. At five, the juggler will feel a sense of total immersion and full engagement. The juggler may have difficulty looking at events or objects outside of the current field of vision. There is a feeling of total commitment in the moment and the juggler realizes he must maintain total concentration.

To add one more object into the mix would be to violate the juggler's span of control, and while he may be able to maintain the flow for a few moments, there is a very real sense of being overwhelmed and slowly drifting out of control until the number of objects overcomes his skill and they all crash to the ground in rapid succession.

Span of control for a trader relates to how many open positions a trader can effectively manage at the peak of uncertainty and still maintain effective decision-making.

Information is required to manage individual positions. When we exceed our span of control we are no longer capable of identifying required information, processing it, and acting upon it in a timely manner for best effect.

Therefore, it becomes very important for a trader to understand and appreciate the effect of their span of control upon trading performance.

The trader may have no problems trading according to their rule set when the trade is considered independently. When you start adding multiple trades into the mix, however, the trader may experience a breakdown in performance and mistakenly attribute it to a psychological problem, when it is simply a cognitive load issue associated with span of control. It's not that your discipline is breaking down, it's just that you're trying to do too much.

A weight lifter who is capable of bench pressing 200 pounds, and who tries to take on 300 pounds, didn't suddenly lose their strength and discipline; they simply made a cognitive load error. Focus on your known capabilities under realistic constraints and behave accordingly.

Traders, know your limits!

Profitable ETF Trading Strategies: a checklist for battle stations

Posted by Ken Long on May 3, 2009

Military command posts must monitor the situation around them 24 hours a day and seven days a week. There is never a time when they can take the day off. But there are also times that require extra vigilance and attention to detail such as when the unit is about to engage in a new operation.

It is good practice at these times to initiate a higher level of attention in the command post in order to ensure we have our game face on. Some units called this heightened state of alertness "Battle Stations".

When the chief of staff calls out "Battle Stations", everyone knows it's time to focus on the task at hand and be ready for action.

Traders can employ the same psychology to bring themselves to the highest levels of alertness and readiness regarding the trading session by having a checklist at hand that gets them ready to manage the trade.

Here are some examples of what your battle stations checklist might include:

1. refreshing your understanding of the total market condition.
2. updating the S&P 500 pivot point levels for support and resistance in the broad market.
3. refreshing your list of probable high payoff trading targets
4. checking in on the current dominant daily trends in sectors and countries
5. updating the trailing stops in existing positions so that they will manage themselves when you focus on the next trade
6. updating your stops to account for total portfolio heat
7. reviewing the qualities of your ideal trading type
8. reviewing your list of ironclad trading rules
9. reviewing your lists of primary and secondary objectives
10. look at a picture of your family with love for motivation

Your top 10 checklist should contain as much as you need to get your game face on. It should remind you of your technical and tactical objectives and techniques. It should also remind you of your emotional center, motivation and objectives, and your purpose for trading.

With these ideas firmly in mind you are prepared to take on the trading day or resume trading after high payoff periods intraday.

Now, trader, get ready for "Battle Stations"!

Profitable ETF Trading Strategies: designing a robust trading system

Posted by **Ken Long** on May 1, 2009

One of the first questions the new trader will ask is how to develop a trading strategy that works in all market conditions.

If you think about this as a design problem you will realize that this is always the most difficult task of all. Such a system would have to be both strategic and tactical in outlook. It would have to be able to sense market condition and select the appropriate parameters for effective action.

This means it must distinguish between opportunities for channel trading and opportunities for trend following. It would have to know when to get on board a breakout and when to fade. Because these answers are very conditional based on market context, such a system would have to be very complex indeed.

Think about this design problem from the metaphor of hand tools. The best tools for a new craftsman to use are those that are simple to understand and apply and have been optimized for specific task.

An apprentice becomes a journeyman over time by learning how to master and apply specific simple tools to a wider variety of jobs with each passing day.

No craftsman would intentionally use an overly complex combination if he had a simpler effective tool to use for a carefully defined task.

We need to bring that same sensibility to our trading instead of trying to find systems that master all possible contingencies in the market, we need to be identifying clear moments of advantage that are aligned with our capabilities to exploit. Learning how to recognize those conditions in applying the appropriate tool in a simple direct manner is the way to build task competence.

In this model of professional competence, it makes sense to find relatively frequent opportunities to trade which can be managed with a simple system and in which risk can be managed. You don't start as a craftsman on the most dangerous powerful tools in the shop. You start on simple tools where learning can be experiential but safe.

From a systems design perspective then, instead of trying to master the entire market from the beginning, we should be looking for ways to master certain defined segments that minimize risk and yet provide enough opportunity to learn and master the craft.

Profitable ETF Trading Strategies: trading the morning gaps

Posted by **Ken Long** on April 30, 2009

There are many trading books from excellent traders that described their particular techniques for trading the morning gaps. If you look carefully at their ideas you will see that in many cases we are in complete disagreement about an appropriate strategy for the gap. This sounds stranger than it really is.

The morning gap is so volatile that there are a number of short-term strategies that can make money if executed effectively.

For me, however, the morning gap is so volatile that I like to wait approximately 20 to 30 minutes to get a read on the morning price action before I commit my money.

I conducted several daily analyses concerning the gap, however, that shapes my strategy for the following day.

First, I analyze statistics concerning the science and direction of the morning gap in the market in my target of interest of the past 200 days. It uses information to establish normal and abnormal gap, in order to increase my understanding of the current context of the market and the trade. I actually use this information to help me manage my exit decision near the end of the day regarding the size of the overnight risk I am prepared to take.

There are some times when the correlation between the gap and the subsequent follow-through is so strong that you can use the strategy of linear forecasting to estimate the size of the follow-through based on the morning gap. This only happens 10-20% of the time, but when it does it can help you very carefully engineer a good reward to risk ratio trade.

A persistent finding is that the size of the gap correlates strongly to the size of the follow-through. Unfortunately this will not predict the direction of follow-through reliably.

In terms of standard practices and intraday battle drills, I look for a morning hook or a bungee trade in the direction of closing the morning gap when it’s large.

The morning gap will normally take the form of a large gap down, the sharp see selloff, intraday support established at the low of the day, followed by a reversal to at least close the morning gap. There are a number of sub strategies with the morning hook but the basic idea is pretty simple.

The bungee trade occurs on an exceptionally sharp selloff that begins to immediately rebound on an upward trending day in the broader market. In many cases this strategy allows us to front run a mechanical entry price that we have established during our preparation phase.

Profitable ETF Trading Strategies: efficiently developing an effective trading plan

Posted by **Ken Long** on April 30, 2009

Every day after the market closes I prepare a trading plan for the following day. Every Friday night, I analyze the market conditions on a weekly basis to develop a week long trading strategy that will last entire week. My combined daily trading plan then incorporates both the weekly and daily preparation.

I use a number of methods to generate system signals efficiently for both the daily and weekly trading plans.

Standard stock screens@stockcharts.com: I have about a dozen standard screens that I can quickly run on a standard set of trading baskets. Because I have named these baskets and named the screens, I can link them together to build more complex screens as needed.

Excel macros: I use defined ranges and standard formatting in combination with Excel macros to automate the production of 30 different reports in various spreadsheets. I hotlink the summary action tables of the various spreadsheets into a Microsoft Word document to generate automatically daily and weekend reports. The macros include a linked set of sorting routines and report printing procedures to standardize repetitive tasks. This saves time, energy and improved accuracy a lot.

Excel visual conditional formatting: by defining the correct area which makes certain conditions highlighted I am able to rapidly source and identify trading targets to meet my requirements.

Maintaining your trading Journal: many of tomorrow's setups and trade frames result from continuation patterns from today's setups and trades. Developing familiarity with stocks and ETFs that behave well is a very efficient way to generate trading ideas for tomorrow.

Mastermind sharing: by having a group of like-minded traders who share ideas and a common framework for trading the market, we are able to very efficiently generate a lot of trading ideas from various members.

Staying alert in the moment: since an important part of my trading strategy on an intraday basis is to respond to existing market conditions as they change, I can say that this is an efficient way to generate trading ideas as well. My mindfulness practice includes maintaining a watch list of all my favorite stocks and ETFs sorted by daily percent gain and loss, which allows me to focus on the extreme winners and losers in order to ride momentum intraday.

I find that having about **10 tradable ideas** in mind that are related to market conditions broad indexes favorite stocks and ETFs is more than sufficient to prepare me for the day ahead. Having the automatically generated daily and weekly reports adds rigor and discipline to my preparation.

Profitable ETF Trading Strategies: a reflection on trend following

Posted by **Ken Long** on April 30, 2009

Trend following is one of the most powerful practical trading strategies available to you as an individual trader. It is suitable for multiple time frames and multiple markets. In a very real sense, all trading strategies regardless of time frame incorporate some aspect trend following except for purely random entry systems.

In my own personal strategy I employ trend following in several ways:

On a weekly basis I analyze market conditions to determine what percent exposure to the markets for the following week I should have. If market conditions permit me to expose money for the week ahead, I will then allocate the appropriate amount of money into the strongest trending ETF sectors. I will use a trailing stop from the highest high while in the trade in order to preserve profits and protect capital.

I defined the strongest of the strong ETFs with a composite measurement of strength, consistency and volatility blended into a single metric.

This exit strategy will certainly give back some profits but is a disciplined way of ensuring that I don't exit positions too soon. It also waits to see the far side of the hill before it sells to preserve profits.

In a longer term passive asset allocation strategy, I am fully invested in a diverse set of low correlation asset classes as long as the market trend is positive, as defined by the relationship between price and the 200 day moving average. In a sense, this is trend following related to the markets' overall trend. When that trend is negative, defined by price less than 200 day moving average, then I am out of a position and fully in cash.

The strategy could incorporate going short the market once the bearish trend is established on price weakness. In my personal strategy, however, I go after profits on the short side in a different manner.

In the shortest time frames strategies for trading, I am looking to capitalize on intraday trading prices in high probability setups in order to make more reward than risk in the shortest possible time.

It is fair to say that I am really looking to trend follow in all time frames that I trade.

Michael Covel's book on trend following is the best single resource I have found on this topic. I also like Dr. Elders triple screen pattern to find high probability, high payoff opportunities in strong trends.

Profitable ETF Trading Strategies: four sources of traders insight into self

Posted by **Ken Long** on April 29, 2009

There are a number of ways traders can go about gaining self-knowledge. I want to describe four important sources in this article: assessment instruments, reflective journals, traders mastermind and a trading coach. Each of these can offer important insights into your trading practice, and I recommend that traders use each of these for their self-development.

Assessment instruments: while there are many different kinds of pseudoscientific instruments out there, a couple strongly scientific instruments come to mind. The Myers-Briggs type indicator is one of the most well-known instruments self evaluated personality profiles. While there are many who dispute its claims to scientific knowledge, there is no doubt that it offers powerful insights into preferences and learning styles even if treated as a metaphorical tool. Another odd instrument that I am fond of using is the learning styles indicator which I find particularly useful since I consider trading the markets to be an educational process of focused inquiry. Appreciating the Kolb's learning style model will give you many useful points of departure for self discovery.

Reflective journals: I strongly recommend every trader maintain a comprehensive trade journal that can be used as evidence for behavior during the act of trading. There's nothing more powerful than physical evidence in establishing exactly what it is that you do as a trader as opposed to what you believe you do or think you do or say you do. A reflective journal can be short annotations of standard trades patterns or can be expanded to include recordings of how you feel, what you see, with letter grades and editorial comments included. Journals offer double loop learning, which is learning about the trade as well as learning about yourself in the trade.

Traders mastermind: by having a trading tribe of like-minded practitioners who are open to observation and giving quality feedback you will be able to triangulate your behavior and performance through the eyes of respected others. In addition to being a high-quality social support network, you want access to excellent feedback. It is good for you to give feedback to others and not just received. That is being a good citizen.

Trading coach: this is a powerful tool for supercharging your performance by putting yourself under the watchful eyes of a coach who can help you focus on the important elements of planning, preparation and execution of your trading plan. A good coach will help us see ourselves clearly and move us to those areas where we most need improvement. If Tiger Woods and Michael Jordan pay money for personal coaches, there must be something to it.

By incorporating some or all of these sources of insight a trader can dramatically improve his personal performance.

Profitable ETF Trading Strategies: can I make a living as a mechanical trader?

Posted by Ken Long on April 29, 2009

The short answer is: no, you cannot make a living as a mechanical trader.

In fact, you cannot make a living as any kind of trader, mechanical or otherwise.

This doesn't mean that you are a bad person or stupid or somehow lack the qualities needed to be a success in life. It is simply a realistic appraisal of the statistics of success regarding the trading profession.

Thousands and possibly millions of people around the world have all decided one time or another to try their hand at the trading profession as a way of life.

They have done what you have done, which is to list their strengths and weaknesses, have some kind of market feedback to suggest to them that they could actually do this for a living, developed a plan and put it into action.

They may have received the encouragement of friends and the advice of professionals.

They may have equipped themselves with the finest hardware and software available to give them an edge.

They may have sufficiently capitalized their effort so that they can participate in markets for extended periods of time.

They researched systems that are appropriate for their personality and the kind of markets they propose to trade.

They have written business plans, rehearsed their trading strategy through simulations and prototyping with real money small position sizes.

They may have aligned themselves with a tribe of like-minded people for mutual support and multiple perspectives.

They may have equipped themselves with market insights to recognize longevity and above-average results.

They have done all of these things, and like you they have failed.

These people were not stupid, naïve, or unprofessional. They are all generally good and decent people just trying to make a living.

It's just that the market is hard and unforgiving.

It will crush you without blinking an eye.

The guy on the other side of the trade takes your money without blinking an eye no matter how unfair you feel it is or how professional you are.

He is trying to feed his family just like you were.

But you failed and he didn't.

The reason they succeeded and you fail, you ask?

If you fail to perform any of the good ideas earlier in this article the answer is easy. You were a naïve child unprepared for the world.

But if you were well-prepared as noted above and still feel, the answer is harder to find, and sometimes we can't find it at all.

The market is not only stranger than we know, it's probably stranger than we can know.

And just when you think you have it figured out after a long winning streak, and have taken on more risk than you realize because you're hot, the new kid in town who was luckier or faster than you will take all your money and leave you crying in the street.

But maybe you are different.

Your plan is better. You are smarter. You are faster. Keep telling yourself that.

All I know is that everyone I have met who makes a living as a trader has a ruthless commitment to performance and preparation and specialization in their niche.

They are driven to succeed by an inner fire that cannot be extinguished.

They are relentless about exploiting their edge every time they see the opportunity and they do not quit until they have the prize in hand and then they guard it as if their life depends on it.

That is who you are trading against.

Do yourself a favor and find an easier way to make a living.

Take care of your long-term investment through passive asset allocation.

But if you must trade, prepare yourself well and remember that you have been told.

Your results are entirely your responsibility.

Don't ever forget that.

Now go trade.

Profitable ETF Trading Strategies: is mechanical trading right for me?

Posted by Ken Long on April 29, 2009

Clearly, when you are considering whether or not a particular trading strategy is appropriate for you it comes down to bottom line performance. Can you, in fact, execute the trading strategy according to the rule sets as defined?

In this sense it doesn't matter whether your system is purely mechanical or discretionary or combination of both. You can either follow the rules or not, and the rule set makes money for you according to plan or doesn't.

It would be nice to know, however, if a certain style is appropriate for your personality type or not before we commit a lot of time and money to the effort.

There are a lot of people who believe they can trade a mechanical system until they actually have a good one and try to do it. They discover that they cannot stop themselves from tinkering with it by bending the rules or otherwise adding discretion.
Here's an example from my own trading practice.

I have a mechanical system that is in the market only 10 to 15% of the time in a given year. It waits for specific high probability conditions to arise in the market and then takes a position that is clearly against the mass psychology. It aims to capitalize on the markets tendency to revert to the mean after extreme moves.

This rule set guarantees that you will enter the market in a direction completely opposite of what your human psychological tendencies suggest is about to happen.
Even though I have back-tested the system extensively in the past 15 years in multiple markets and am satisfied with my rational brain that it has a high probability of success and reliable results, and have traded it successfully with real money for more than four years, I still find it uncomfortable to enter the positions because of my psychology.

I can now manage my psychology to enter the position at appropriate risk levels when signals are generated and have had to learn how to accept the uncomfortable feeling as a positive sign of a good trade.
In a larger sense, I think what is necessary for someone to be a pure mechanical trader is that they have the confidence in their analytical judgments, confirmed the reliability of the system and have identified the risk level that allows them to apply their trading system without the danger of blowing up.

They are committed to periodic performance review and can approach the entire situation with analytical mind and rigor.

These would be unusual qualities for most people, but they are ideal for someone who has a good mechanical system and wants to exploit it.

Profitable ETF Trading Strategies: appreciating the power of rehearsals

Posted by Ken Long on April 28, 2009

Rehearsals are considered to be one of the highest payoff practices in the military planning process. It's where units develop and reinforce the patterns of action and decision-making that make all the difference in combat. Rehearsals will improve your trading practice as well, if you understand how to do them well.

There are 4 main reasons why rehearsals can improve your trading practice:

1. Practice essential tasks. By identifying the critical tasks in your systems, you can focus on the ones that contribute the most to success or failure.

2. Identify weaknesses or problems in the plan. You often will not discover gaps in your logic or problems with the concept until you have "driven the route" from start to finish from the perspective of the operator. This is especially true if you have built your plan out of component pieces, each which are individually sound, but have not yet been linked together before.

3. Coordinate subordinate element actions. When you use a building block approach to trading system development, sometimes you will discover that the sum of the parts is different than the whole. This means that there are unknown or unintended consequences of piecing things together which are not revealed until you put the plan into operation, or better yet, have a decent rehearsal to test the seams.

4. Improve understanding of the concept of operations. Once you have driven the entire plan, you will develop a sense of completeness and appreciation for its qualities or problems areas from the top down. You will be able to see the seams, where pieces come together in mutual support or in sequence.

By paying close attention to your rehearsals, and making them as realistic as possible, you will be able to dramatically improve your trading practice.

Taken together with effective After Action Reviews, rehearsals are an important part of your preparation phase. Time spent here will add directly to your bottom line.

Profitable ETF Trading Strategies: monitoring global markets

Posted by **Ken Long** on April 28, 2009

One of the phenomena of a truly global market is the interconnectedness of everything. A good example for situational trader is the recent episode of swine flu that has many people worrying about a worldwide pandemic.
Because of the concentration of confirmed cases in Mexico, the first place we could look to find a potential weakness at the open on Monday morning would be in the Mexican ETF, symbol: EWW. In fact what we saw was a gap down opening of eight percent, followed by weakness throughout the day to close down 9 1/2% for the session.

The next place that we can look is to expand our focus to the geographic region, by looking at the ETF for Latin America, symbol: ILF. As we might have suspected, Latin America was down much greater than the rest of the world also. So, we can see the connection between countries and regions very clearly here.

Mexico and Latin America are both members of what is considered to be emerging markets. This collection of countries is represented by the ETF symbol: EEM. This ETF was also down much more than the rest of the world today. What contributes to the potential weakness in emerging markets is perhaps the relatively less resourced national healthcare systems which may make emerging market countries more vulnerable to a flu epidemic than the mature first and second world countries.

Taken together, these ETF’s show us how macro-economic events in the news unfold across country and regional boundaries and can help us confirm the hypothesis of tradable ideas that appear every day in the news.

By developing trading scenario ideas, the short-term trader is able to assemble a bundle of ETFs that serve both as tradable vehicles and as research instruments. By having all of these on the trading screen it is possible to see the idea of the trade unfold in real time right before your eyes. You can then select which of the targets is moving the most in your preferred direction and you can turn your research idea into a tradable vehicle.

By monitoring a standard set of international, regional, country and specialty ETFs, the short-term trader is able to monitor world events and take advantage of trends in the global market.

Profitable ETF Trading Strategies: understanding the evolutionary brain

Posted by Ken Long on April 27, 2009

Sociobiologists describe the formative years in the development of the human brain as the era of evolutionary adaptation. This was a period of hundreds of thousands and even millions of years in which the law of natural selection shaped and molded our brains into the marvelous workings of the adaptation that we now enjoy.

Unfortunately for traders, however, many of the behaviors and tendencies that are hardwired into our brains do not translate directly into success in the marketplace. Indeed, many evolutionary adaptations are directly opposed to our ability to routinely make money in the market.

It is very clear to me that 10 million years of evolution cannot be set aside through the simple application of catchy phrases and clever slogans. It takes long and sustained effort to begin to offset the power of evolution.

Here is an example of the kinds of problems your evolutionary brain will provide. It helps explain why it is so reliable to go against the crowd if you want to make money.

The evolutionary brain has been conditioned from an environment of scarcity. In our hunting and gathering days, it would have been a significant disadvantage to have missed an opportunity to catch a rabbit or kill a mammoth. There is a distinct advantage to being successful in each and every trade when you cannot be sure that another trade will soon come along.

The extra energy that comes from being afraid of missing the trade would have been helpful in our hunting and gathering days, but in modern markets being driven by emotions will get you killed.

When we look at the equity market as an environment of abundance, filled with infinite opportunities, we can see that it is an advantage to be able to let marginal trades go on without you. It is the panic reaction of scarcity that makes you want to chase a trade that has already departed your entry zone. Chasing false breakouts is one of the most reliable ways of losing your money, yet the emotionally satisfying behavior is compelling to our evolutionary brain.

How can a trader understand and then overcome these kinds of handicaps?

For some traders the only answer is to be strictly mechanical and to program your trading behaviors into software to execute according to the rules and nothing but the rules. Having your trades executed by a broker or an auto-broker falls into this category as well.

Discretionary traders or semi-discretionary traders must find other ways to accommodate their natural tendencies to chase every idea they see. Attention to detail, preparation, self-discipline, a trading mastermind, periodic reflection and after action reviews all will help you develop the self-discipline you need to survive and succeed in the market.

Don’t underestimate the power of the evolutionary brain.

Profitable ETF Trading Strategies: the power of “no lose” trading

Posted by Ken Long on April 27, 2009

The ability to manage your emotions at a comfortable level is a decisive advantage for any trader to have in the market. It takes a live focused attention and energy and commitment to offset the hardwiring of the millions of years of evolution that shaped our evolutionary brain.

A very powerful technique in the battle to manage your emotions as a trader is the idea of ”no lose trading”.

This is especially powerful for shorter term traders who must be able to execute reliably many times a day or week. These traders have many opportunities to let emotions get the best of them because they are so active in the market. This technique is especially for them.

By paying close attention to price action, and the market condition as you are stalking your excellent entry, it is possible to fine-tune your entry with a very narrow stop just prior to a high probability move in your favor.

Ways to develop this skill might include listening to a master percussionist or spending time at the beach watching the waves roll in. A sense of rhythm and volume can be very helpful in finding those moments when low-risk entries can be made.

When we can fine-tune the entry near a moment of reversal, we have the opportunity to establish a tight initial stop which can be quickly moved to break even once the initial surge of price is in our favor.

Once we are in a position to do no worse than break even, our psychology will undergo an important shift of perspective. We are now able to leave behind the fear of losing our capital and can concentrate on the emotions associated with fear of missing profits.

This is a very nice problem to have. You would like to be in a position in the market when you are constantly struggling with how much profit to preserve versus how much additional profit to aim for. It is a lot easier to learn how to manage your greed than it is to overcome your fears.

By applying narrow stops you may experience a lower win rate, but if your system and skills are in tune with the market you can expect an increased number of opportunities and the size of your average winners to increase. This will more than offset the slightly lower winning percentage and will add directly to your bottom line.

Profitable ETF Trading Strategies: trading through the metaphorical lens of combat

Posted by Ken Long on April 26, 2009

In other articles I have considered the usefulness of selecting metaphors to help you place your trading plan in context. Metaphors are powerful devices for focusing your mind in helping provide context for complex behavior in situations where consistency and forceful action are often the critical components of success.

In this article I want to examine the usefulness of the metaphor of trading as combat to see what kinds of insights we can discover. I think you will find that it is a very useful metaphor provided you do not carry it too far.

Some of the most powerful aspects of combat are: fear, surprise, uncertainty, violence, consequences of failure, coordination, stress, leadership and emotional fatigue. Each of these aspects can easily be found inside the trading arena. I want to look more closely at fear in this article, because it is so powerful and pervasive.

Fear: it will freeze you in place when it's time to act or it can prompt you to act when you shouldn't. You will cloud your judgment so that you go left when you should have gone right and will cause you to question your own best judgment. Even the best laid plans, founded on the soundest principles of deliberate planning, may unravel when an unhealthy dose of fear is applied.

Facing fear, either directly or indirectly, is the first step in mastering this powerful emotion. The best way that I know to manage fear as a trader is to reduce your position size until you can trade at a level that allows you to operate with nervous energy but not outright fear.

No matter how effective and experienced you are, I think fear is an element of our trading all-time and one that we should therefore acknowledge and respect. It helps keep us humble and focused on our risk management.

Another useful technique for managing fear is to name it. By moving in the direction of the feeling of fear and putting a face and a name on it, you give yourself a handle with which to manage it deliberately.

By starting with the smaller aspects of the source of fear and learning to manage it carefully, you will soon desensitize yourself to its paralyzing aspects.

You will no longer feel the panic reaction when the environmental cues trigger the feeling because you will have the confidence to know that you can manage it.

Your effective risk management strategies will ensure that you don't trade too large or too often. Your risk management will keep you from exploding and this can reduce an important source of your fears.

Trading with relaxed money, which is another way to say of being well capitalized and staying within your risk profile should also help reduce the source of some of your fears.

Finally, learning how to manage conditions of uncertainty will take away some of the nervousness associated with uncertainty.

Learning to recognize, acknowledge. manage and co-exist with fear will help you move beyond it to your next trading challenge.

Profitable ETF Trading Strategies: mastering the execution phase

Posted by **Ken Long** on April 26, 2009

Successful military operations are characterized by high performance execution of a detailed plan that has been well-prepared and thoroughly rehearsed. The principles that govern military success on a complex, uncertain Battlefield can be successfully applied to improve your trading practice.

In other articles I have examined the phases of planning and preparation in greater detail. Now it's time to take a look at effective execution for traders.

Some of the key insights in the execution phase include:

Engaging in the trade only when you are at your physical, mental and emotional peak.

Monitor the status of yourself, the market, the trade you are stalking and your equipment status on a continuous basis.

Keep market conditions firmly in mind since this will have a powerful impact on the way your specific trading target is performing during the day.

Understand where the key price levels are for futures contracts as well as understanding any key events associated with the day that may affect the market based on psychological reactions of traders around the world.

Constantly review market and price conditions as you approach key decision areas, while you monitor the criteria for your key decisions so that when all are met, you are fully prepared to act in the appropriate way.

Continuously update your market assessment, which is an important reason why a trading mastermind can be so useful to your trading practice. With a tribe of like-minded traders working together, your chances of being surprised about market conditions is reduced. More people watching equals more people protecting your vulnerable areas.

Adjusting your trading plan to changing market conditions is an ongoing process that requires attention, practice and skill. The more you rehearse different possible scenarios, the better you will be at transitioning to different phases of the market narrative.

To support your adaptive trading plan you will need to identify the important signals that tell you which scenario is beginning to emerge. You will then assign an appropriate technical indicator to help you judge when these criteria are met.

Finally, maintaining meticulous records of your decision making and trade results will support your after action review process. This review is perhaps the most critical part of your disciplined trading plan, because it allows you to capture the data that you will need to conduct professional analysis of your performance as a trader as well as the performance of your trading plan.

Powerful execution can make up for shortcomings in planning and preparation, but you will naturally want to have all three phases working for you.

Profitable ETF Trading Strategies: the preparation phase of trading

Posted by Ken Long on April 26, 2009

Successful military planners for years have employed a three phase approach to battlefield success.

By organizing their battle space and time into the phases of: Plan, Prepare and Execute, military planners have established a history of success. This mental model can be applied directly to improve your trading practice.

Each of these phases deserves attention from traders who would seek to achieve high levels of performance in their trading practice.

In other articles, I have examined how to apply planning and execution principles to your trading plan.

Let's look more closely at preparation, and some key points to emphasize.

Traders must have in their hands a detailed plan that has been deliberately developed based on their known strengths and weaknesses, and the nature of the markets and trading targets they propose to employ. The plan should describe filters and scanning criteria, stalking, entry signals, appropriate position size to manage risk, a number of exit strategies that preserve capital and lock in profits, and a plan to re-enter, if required.

Based on the detailed plan then, the trader begins to assemble the resources required to put the plan into operation. This consists of ensuring that your trading environment is suitable for uninterrupted, focused attention to the task at hand.

It includes ensuring that all materials needed for reference are available, and that your hardware and software configuration is in good working order and sufficiently robust to give you an edge or at least allow you to compete on an equal basis. The equipment check also includes plans for backing up critical information and redundant means of communication with the broker in the market itself.

It is during the preparation phase that the trader will conduct critical rehearsals of important decisions with as many iterations and scenarios as is practical and useful. The best rehearsals duplicate the conditions under which the decision in question must be made. A traders reversal, therefore, could include reviewing critical chart patterns or practice trading with a trading simulator or paper trading while the market is open or prototype trading with very small position sizing and real money.

The most important part of rehearsing, though, is to ensure that you are prepared to act in the moment when the conditions are right based on your deliberate plan. This is especially important for traders who experience difficulty in pulling the trigger, based on their uncertainty and nervousness.

These are just a few of the useful and powerful insights that traders can apply from the world of military planning.

Profitable ETF Trading Strategies: the operations order format of structured trading

Posted by Ken Long on April 26, 2009

The military's five paragraph field order is a template for trading success. By adapting this powerful template, you will have an outline of required information to ensure that your plan is complete.

The five sections are: situation, mission, execution, support, command and control.

Let's take a quick look at the contents of each of these with respect to a trading context.

Situation: this is where the trader considers his own personal strengths and weaknesses, the characteristics of the market he is trading, the normal behavior of his trading target, and the psychology of those who are taking the other side of the trade. When complete, this information provides all the context that the trader needs to establish a narrative for the trade.

Mission: a concise statement of the task and purpose of the trade. It describes the particular pattern or system that you will employ and the purpose for taking the risk of entering the trade. It is a short powerful justification and articulation of your trading edge.

Execution: this begins with a short narrative of how you see the trade working and how you will know when you have success. I have described this before as the intent of the trade. This section also includes identifying critical phases and important decisions and coordinating instructions along the way. It may include a description of various trading scenarios that may unfold depending on how price action emerges once you are in the trade.

Support: in many cases this will be standing operating procedures and does not have to be articulated for every trade. This is true the more that your trading takes on a habitual pattern which uses standard support hardware and software to execute the trade. This should also include the supports to your physical, mental and emotional states which are so essential to successful trading.

Command and control: in this section we are concerned with our decision-making and decision support system which will allow us to execute appropriate actions at the right moment based on environmental cues.

Framing the plan for each of your trades in this manner will help you develop the consistent discipline to execute precisely according to plan. It will become a way of life and an unconscious habit that can strongly support your trading practice.

Profitable ETF Trading Strategies: three leadership questions for traders

Posted by Ken Long on April 26, 2009

I had an opportunity to conduct a two-hour interview with the executive director of the Center for Creative Leadership and explore their research into the field of emergent leadership.

It is their opinion that modern leadership for conditions of uncertainty take on a different form than are conventional notions of leaders and leadership. Their insights have some powerful lessons for us to learn as traders as well.

The conventional view of leadership resides in the individual as leader. People usually think of leaders as charismatic people of action that lead us to success as a consequence of their personal qualities and individual excellence. We think that they see farther and deeper than other people and are able to articulate a vision of success which they can convince us is achievable if we will pull together.

This is often called the great man theory of leadership and is the subject of much debate.

Other schools of thought look for organizational structures that provide a framework for action in which individual leadership is less important provided that the organizational values and processes and resource levels support effective action in typical circumstances. In this theory of leadership, organizational excellence replaces individual excellence.

While it is true that organizational culture has a lot to say about success in the world, this view is dissatisfying in many dimensions because it seems to eliminate individual responsibility and initiative without addressing exactly how this effective organizational culture and structure should come about.

The Center for Creative Leadership approach considers leadership to be any emergent property of a situation that is a consequence of individual actions and relationships that create a condition for success that cannot be attributed to a single individual or policy but which seems to permeate successful organizations.

They have identified three persistent qualities which can be measured and which indicate that leadership is present. Each of these is a powerful concept which can be applied to our own trading.

The three concepts are: direction, alignment and commitment.

Direction consists of having a vision of a successful end state toward which our individual and collective actions may be applied in ways that make sense to all of us, even though the details may be uncertain.

Alignment means having all of the network components (individuals and teams) in the organization, working together in harmony and rhythm, making way together like the coordinated members of the rolling team.

Commitment is indicated by what we are prepared to give up for the good of the team in pursuit of our final objective. It might include hardships that we will endure or sacrifices that we will make more investments of our time, energy and personal resources. It represents a measurable, meaningful and significant statement of purpose that will be interpreted by the team as a powerful force for good. It helps to bind us tightly together as a team.

As a trader you can examine your trading plan and yourself and your team in light of these three criteria to determine if leadership is present to help you achieve your objectives.

These three questions can be very powerful:

What is my direction? Am I aligned with my goal? Am I fully committed?

Profitable ETF Trading Strategies: 10 ways to find new edges

Posted by **Ken Long** on April 26, 2009

If you want to find opportunities in the market that no one else can see, then you must admit to looking at the market in a different way than the herd. In practical terms this can mean doing things like:

1. Adjusting the parameters of a popular instrument of technical analysis so that you get a different insight than the mass of people who use the default parameters.

2. Applying existing indicators of technical analysis in a new way.

3. Combining indicators in a unique way.

4. Inventing a new piece of technical analysis of your own.

5. Developing a new concept for how the market works that includes an interpretive scheme that leads to actionable intelligence.

6. Varying the time frames of existing systems.

7. Data mining to find previously undiscovered relationships.

8. Looking for opportunities by taking the opposite actions suggested by conventional wisdom.

9. Creating a new metaphor for trading that offers new insights into trading practice.

10. Discovering old systems from the past that have fallen out of favor but which may come back into season in the current situation.

None of these techniques is a surefire recipe for success, but then again nothing in trading is for certain except that you will pay a commission and take a risk for the possibility of a future return.

Another certainty is that all of your best ideas will someday no longer be effective because the market will adapt to undermine your success. This may sound like a paranoid and pessimistic perspective, but it turns out to be a useful way to remind yourself that you must always be looking for new edges in such a dynamic market.

The minute you stop searching for new ideas and new ways of expressing your edge, is the minute that the pack is gaining on you. Remember that when the pack catches you, it is not a pretty sight.

There is no antelope so swift that it cannot be caught and no hunter is so powerful that he cannot be hunted himself.

The law of the market is the law of the jungle. Traders would do well to reread Kipling's “The Jungle Book”, and reflect upon the Law of Tooth and Claw, the power of the pack and the courage it takes to face your fear.

Profitable ETF Trading Strategies: Kipling's Jungle Books metaphor in trading

Posted by **Ken Long** on April 26, 2009

I have written in previous articles about the power of metaphor in trading. Our evolutionary brain makes powerful use of analogy to reason about new situations to find effective behavior.

To see in a flash that this situation is like that situation and that what worked for success over there might work over here got our species a powerful evolutionary advantage.

Like everything in trading, not even a metaphor is a risk-free solution for success and it is a wise man who understands the limits of his story. We remember that the map is not the territory and that the poetry does not always equal the prose.

Provided that we understand the limits of a good image or story however, there is much that we can learn and apply from other domains and narratives to our trading practice.

As an example, consider Rudyard Kipling's great novel "The Jungle Books and the story of Mowgli". How much are the life and adventures of that young boy like the adventures of a new trader trying to learn the way of the jungle, staying alive long enough to make a way for himself in the world?

Mowgli, the naïve enthusiastic impressionable young boy, full of hope and promise and sadly lacking in worldly experience wanders into the jungle where his fate is unknown and in the hands of those people he meets on his journey. He's fortunate to come across a wise old mentor in Baloo the bear and the crafty sensei of jungle survival, fierce Bagheera the panther.

The panther has the wisdom of getting Mowgli into the wolfpack, the tribe that will raise and teach the young boy and equip him for success in the wild.

Together this band of Brothers has success. The boy not only survives but thrives and grows into a powerful young man, full of himself. He is tested by his arch nemesis and faces his moment of truth in the form of Shere Khan, the tiger. It comes down to the young man by himself, armed only with his strength and wits to overcome his relentless foe. His success comes from planning, preparing and executing in a way that relies upon his strengths and takes advantage of the weaknesses of the tiger.

Mowgli comes through his experience transformed into the fullness of manhood.

Now we know that trading is not like a 19th Century English novel and that we are not babes in the jungle raised by wolves and that we lack a wolfpack to come when we whistle. It may often feel like we are being stalked by Tigers in the market. We certainly don't take the metaphor of the jungle literally as we try to understand the market and trading, but there are more than a few lessons that can be found in that powerful book and it is well worth reading by traders everywhere.

Consider who your mentors are. Where is your loyal pack and to whom are you loyal? Who is your skilled teacher? Where is the tiger that stops you in the night? How will you use your wits and determination to come through the dark night?

Profitable ETF Trading Strategies: fighting for dimes

Posted by **Ken Long** on April 26, 2009

There are some traders who say that it is not worth our time and attention to fight for nickels and dimes. In my opinion though, it depends on the nature of your trading whether this is sensible advice or not.

Here is an example of when fighting for nickels and dimes makes a lot of sense for a short-term trader.

Imagine you have a system that will identify opportunities to take positions in exchange traded funds in stocks that have been beaten down the most in the last two weeks. In the strategy you might be looking for moments when the market will reverse and these candidates reverse sharply back to fair value.

In this strategy you would be looking for moments in the first hour of trading when price seems to have found its lowest point of the day and is making a sideways movement in a narrow trading range. If this happens and you see that the market itself is beginning to reverse and go back up, it would be possible for you to find an entry point on the beginning of the upward movement that could be protected with as little as 20 cents of risk per share.

Let's also suppose that in this strategy, the initial moves happen very quickly and allow you to move your initial stop to break even quickly. In this case you would be essentially holding a no lose trading proposition. Now let's see what happens if we fight for a dime.

In case number one, I have decided to risk $300 in a $30 ETF with $.20 per share of open risk initially. Doing the math, I would be allowed to buy 1500 shares of the stock. If it moves one dollar in my favor my net profit is $1500 minus commission.

In case number two I have decided to risk the same $300 but I am able to fight for an additional $.10 of price improvement upon entry and only need $.10 risk per share of open risk. In this scenario I am able to purchase 3000 shares of the same stock and will essentially double my return because of my increased position size. I am able to do that without taking on any additional risk.

This example is simplified, but not too simple. These opportunities abound every day in the market in US large caps and exchange traded funds that track the performance of large global markets. It is worth your time and attention to sharpen your practice to fight for dimes and nickels if this is your type of trading.

Profitable ETF Trading Strategies: examining uncertainty

Posted by Ken Long on April 26, 2009

Many psychologists who specialize in the training and education of equity traders focus on the importance of managing uncertainty in your trading practice. I agree with their emphasis, because I believe that your trading practice is composed of equal measures of yourself, your systems and the market. Uncertainty plays a major role in each of these three domains.

Uncertainty with respect to yourself consists of the possibility of knowing yourself. We are all complicated mixtures of genetics and environment. We spend our whole life trying to find out who we are and where we came from. It is unrealistic to think that in a high stress situation like trading that we can ever have complete self-knowledge. Perhaps with consistent and focused attention and appreciation for the limits of insights, we can develop enough self-knowledge and self-control to engage successfully in our trading practice.

Uncertainty with respect to your systems has to do with the degree of confidence that you may legitimately have concerning forward performance of the system that you have only back-tested.

Because we know that the market is an ever-changing situation, we can never say with complete confidence that the system will continue to perform as tested. As such, there is always a healthy dose of uncertainty that we must remember when we're deciding at what risk level to trade a particular system.

It is legitimate to use statistical techniques to compare the performance of different systems in different markets but we should never substitute testing for production and results.

Uncertainty with respect to the market itself simply acknowledges that the market is a complex adaptive system that is beyond any amount of compensation. The best we can do is appreciate its mystery and opportunity and respect its power in much the same way that we must respect the power of nature. To think that we can fully understand and therefore control the market is to commit the sin of pride if not foolishness.

Faced with this uncertainty everywhere we look, there may be a temptation to avoid it or to try to control it. In most cases this means you are waiting to feel more confident about your insights and your indicators before you act. Recognize that every second that you wait, every piece of information that you pay for in either time or money, can never completely eliminate the uncertainty. For those trades where you would be successful, this hesitation is eating away at your profits and putting psychological pressure on yourself to chase.

I believe it is better to learn to adapt and learn to act in risk managed ways so that you can capture more of the opportunity while maintaining smaller levels of risk. How you do this has everything to do with your technique for framing the trade once you see a potential opportunity.

Profitable ETF Trading Strategies: on having courage

Posted by **Ken Long** on April 26, 2009

There are many traders who advise you to have the courage of your convictions. They will describe situations in which they were experiencing maximum pain but found the courage and fortitude to hold on and stay with the position and were handsomely rewarded for doing so. They may even have some impressive charts to support their assertion.

I do not doubt that you can get some extraordinary moves after moments of extreme pessimism and panic selling. In fact, that turns out to be a very powerful strategy to employ in many different market conditions.

I just don't think that it is necessary to have to suffer all of the pain on the way down in order to participate in the joy of the massive overreaction back towards fair value when the market reverses.

I find the language of heroism and courage to be appropriate for the discussion of mythic literature and popular action movies. I don't think it is necessary to frame your trading in that light. I believe it puts you into positions where you are experiencing extremes of emotion at crucial decision points. I think that this places unnecessary stress on you.

We are prepared to re-enter quickly with no worries when the following conditions are true:

1. If we have a profit in hand,

2. and we truly believe that the market is filled with an infinite amount of future opportunities,

3. and we are prepared to observe the actual behavior of price in the moment,

4. and we can set aside our ego and emotions,

5. and the cost of re-entry is low,

6. and we have trained ourselves to quickly read a trade for reward to risk ratios,

7. and we can actually frame a low risk trade in the moment.

Because the original trade met our strict requirements for entry, it may be possible to relax some of the constraints for re-entry. This is especially true if the original trade was a win, because now we have evidence that our original idea had merit. It makes it easier to see the re-entry is a continuation trade.

By having trust and confidence in our re-entry strategy, we can actually afford to be wrong more often on the original exit that preserved the profit or took only a partial loss.

If we can truly check our egos at the door, and we can learn to laugh at our nervous behavior which locked in a profit too soon and set us up to have to re-enter a position that is resuming its strength, then we are in a position to capture much more of the opportunity at a very low risk. We will be making multiple decisions in calm mental states routinely.

In my mind this is much more likely to produce a state of satisfaction and peace when trading. This is a decided advantage to a short-term trader that can master this approach.

I would much rather be a more frequent trader, who captures partial pieces of an excellent move in a low risk, low stress manner then the solitary hero who wins the dramatic battle at the end of the movie.

In real life, sometimes the bad guys win. I do not want it to be at my expense.

Profitable ETF Trading Strategies: the power of re-entry

Posted by **Ken Long** on April 26, 2009

Every short-term trader has had the experience of exiting a position to preserve a profit only to see the position immediately resume its favorable ways without you on board.

Most traders have kicked themselves for letting these profits get away and have sat on the sidelines watching the position continued to grow without them.

The real pain we experience of illusory profits lost are as powerful as real dollars lost in a losing trade.

Cognitive scientists have reported that the pain of profits lost are three times as powerful as dollars actually earned.

For example if you just completed a short-term trade that earned you a $3000 profit, and you just watched it reverse and saw it move an additional thousand dollars that you just missed, science says that the positive and negative emotions of this trade would probably cancel out and leave you numb.

This is true even if the trade was more successful in execution than your original design.

No wonder the deck is stacked against the individual trader with emotional hurdles like these to overcome.

The real problem with the profits missed is that the negative emotional charge of lost profit is likely to carry over into the decision-making of the next trade.

This negative charge may not be sufficient to cause you to change your rules but it might be.

If it isn't enough to affect you on the next trade, then the charge will carry over and accumulate with the negative charges of other trades until your self discipline is overcome by the negative energy.

When that happens you might be surprised at the behaviors you are taking that seem to have no basis in your rational mind.

And you would be right.

The accumulated negative charges that live deep in your emotional brain have finally found a way to express themselves at the least opportune moment when you fail to take a planned exit and end up getting smoked for a major loss.

For this reason, your exit strategy and decision-making must allow you to get to the zero state at the end of each and every trade as I have discussed earlier.

To overcome the negative emotions of lost profits, a very supportive strategy is to develop a re-entry plan that allows you to get back on board quickly once your target is moving favorably.

Then all you have to do is account for the small insurance premium you pay to harvest the profits of the first rate.

Since the original trade already met your strict requirements for entry, you may find you can relax some of the constraints for re-entry and get back on board quickly.

How you do this precisely will be a function of the nature of your original trading strategy. In general however this is a very powerful psychological strategy that also pays you a reward.

Profitable ETF Trading Strategies: insights from cognitive neuroscience

Posted by **Ken Long** on April 26, 2009

Cognitive neuroscience has found seven important findings about how your brain is wired that affect your performance.

1. The way you sense information and the way your senses are connected to your brain are unique and diverse.

2. The more you use a particular style of cognition and sensing, the more developed that skill and modality becomes.

3. Different life skills and job requirements need different kinds of cognition to exploit the best opportunity for success, so it's important to match your strengths with your profession.

4. The physical environment you are operating in has a direct impact on your sensing and performance.

5. When you receive information through your preferred mode of sensing, then your ability to accelerate learning and increase performance is enhanced.

6. In the same way you have strengths and preferences and sensing modes and cognition style, you can expect to have certain blind spots as well.

7. At a certain level of stress, performance is reduced no matter which cognitive style and sensing mode you favor.

Taken together, these seven insights which are supported by strong science, suggest that it is very important for you to align your strengths with a favorable environment when you want to rapidly accelerate learning, understanding and productivity.

As an individual, it is worth the time to conduct self awareness exercises that will help you identify your preferences and strengths so you can apply them in your career and personal life.

As a member of a team you will want to know the strengths and preferences of your fellow team members, in order to improve your organization and cooperation.

As a team leader, you'll want to ensure that your processes and policies take into account the rich diversity of human cognition so that you leverage multiple points of view and learning styles and so that you ensure you have no group blind spots.

As a trader, you'll want to ensure that your trading style and trading environment are aligned with your preferred modes of perception and that your physical environment is conducive to high performance.

Profitable ETF Trading Strategies: Synchronizing your trading systems into an effective strategy

Posted by Ken Long on April 19, 2009

Achieving integration and synergy is a critical part of the military planning process, which has a direct connection to the task of trading successfully.

Military units achieve integration and synergy in a variety of ways that include phasing, control measures, decision criteria, a synchronization matrix and rehearsals. Each of these can be a great help to a trader looking to improve performance.

Phasing: a trader should identify time frames for trading that have a clear beginning and an end, and within which he identifies appropriate strategies, purposes and objectives that are specific to that time period. Some times phases are driven by events, and sometimes they relate directly to times and dates. No matter what distractions seek to divert their attention, traders must be clear about what phase they are in, and what the success strategies are.

Control measures: these are reminders and/or decision aids that help remind a trader of critical events that are approaching, and the boundaries they must not cross. For a trader these could include, calendars, automatic reminders, key price levels for support and resistance, alerts to begin preparing for increases in volatility or market reversals. These must be visible and actionable (or audible/kinesthetic depending on the trader's preferred learning style).

Decision criteria: are quantitative definitions of moments when we must be ready to act. This could include price levels that cause us to enter or exit a position, or to adjust a stop, to increase or decrease our position. It could be a combination of filtering or screening criteria that let us know we should be stalking in earnest or preparing our entry or letting us know when a window of opportunity is ready to open or close. The key is to have these reduced to the most important actionable conditions so that we do not fall victim to analysis paralysis.

Synchronization matrix: is a way to graphically represent all subordinate units and their key actions through time and phases. At a glance you can then see how separate but related operations must work together to achieve synergy, which happens when the whole is greater than the sum of the parts.

Rehearsals: are the way that good military units, and good athletes for that matter, become great. By creating conditions as close to the operational trading environment as possible, traders can experience as close to the actual decision environment as possible, so that in the moment they will be able to perform according to plan. Rehearsing a trading strategy with live money in a real market but at a reduced position size is an example of getting the rehearsal conditions as close to live trading as possible, and which is why I recommend it so highly.

Applying these 5 military planning concepts to your trading plan should help you achieve better execution of your carefully planned concept.

Profitable ETF Trading Strategies: applying the concepts of Mission and Commander’s Intent

Posted by **Ken Long** on April 19, 2009

The military planning process offers powerful insights that traders can apply to improve their trading practice dramatically. This article looks at the powerful idea of the Concept of the operation.

The concept of the operation immediately follows the Mission Statement and Commander’s Intent, which lays out the critical tasks and purpose of any operation, and which serves to guide the overall plan.

The Concept of the Operation then takes the plan to the next level of detail and lays out implementing instructions that, if followed in a disciplined yet innovative manner, will help us achieve success. These include the description of phases of the operation, important incremental objectives and coordinating instructions that guide the relationships between supporting units.

Discipline guides units by identifying the boundaries they are expected to operate within. Inside of these boundaries however, commanders are encouraged and expected to exercise as much initiative and creativity as possible. This important balance between discipline and initiative is a large part of the art of command.

A trader could apply these ideas by having a tactical trading plan that laid out clearly how to trade different parts of the day, week, month, business cycle or in response to certain market events like earnings seasons, news events, earnings announcements, or the release of economic reports.

A trader’s discipline would be found in the asset allocation, risk management, and position sizing elements that prevent exploding your account, while creativity and initiative could be exercised in selecting the appropriate strategy for the current market conditions and situation, and in varying rule sets within controlled limits to achieve tactical advantages.

Coordination would encompass how your various trading techniques could be used with synergy to achieve better overall results than they achieve by themselves, but could also be expanded to include how you might employ a mastermind or trading tribe to cover each other’s blind spots because of the multiple perspectives available.

Achieving balance in planning, and recognizing the importance of and relationship between discipline and initiative can give an individual trader a decisive edge in the markets.

Profitable ETF Trading Strategies: adapting the best practices of military planning

Posted by Ken Long on April 19, 2009

The Military Decision Making Process is a reliable way for military unit commanders and their staffs to conduct rapid yet thorough planning and produce highly reliable plans that have an excellent chance of producing success on a complex and uncertain battlefield in the face of a dedicated, adaptive enemy bent on their destruction.

It is not a surprise therefore that such a robust procedure can be very effective in the development of robust trading plans, since the market has many of the same qualities that we find on the battlefield.

The military decision making process is properly understood as the first part of a 3 phase approach to success, namely: Plan, Prepare and Execute. Each of these phases deserves attention from traders who would seek to achieve high levels of performance in their trading practice.

Let's look more closely then at Planning, and some key points to emphasize.

Planners must already have information on the unit, its condition and the enemy in its area before planning may properly begin. We must understand our present situation in order to establish a point of departure.

For the trader, this means, knowing yourself, your strengths and weaknesses, your proficiency in different styles of trading, and having equipment that enables you to compete equally or better in the markets of choice.

Planning begins with a thorough understanding of the Mission which lays out the tasks which must be accomplished to be successful and the purpose which success will serve. For the trader this equates to a deep understanding of your goals and objectives. Being clear on these enables you to develop trading plans that are aligned with your definition of success.

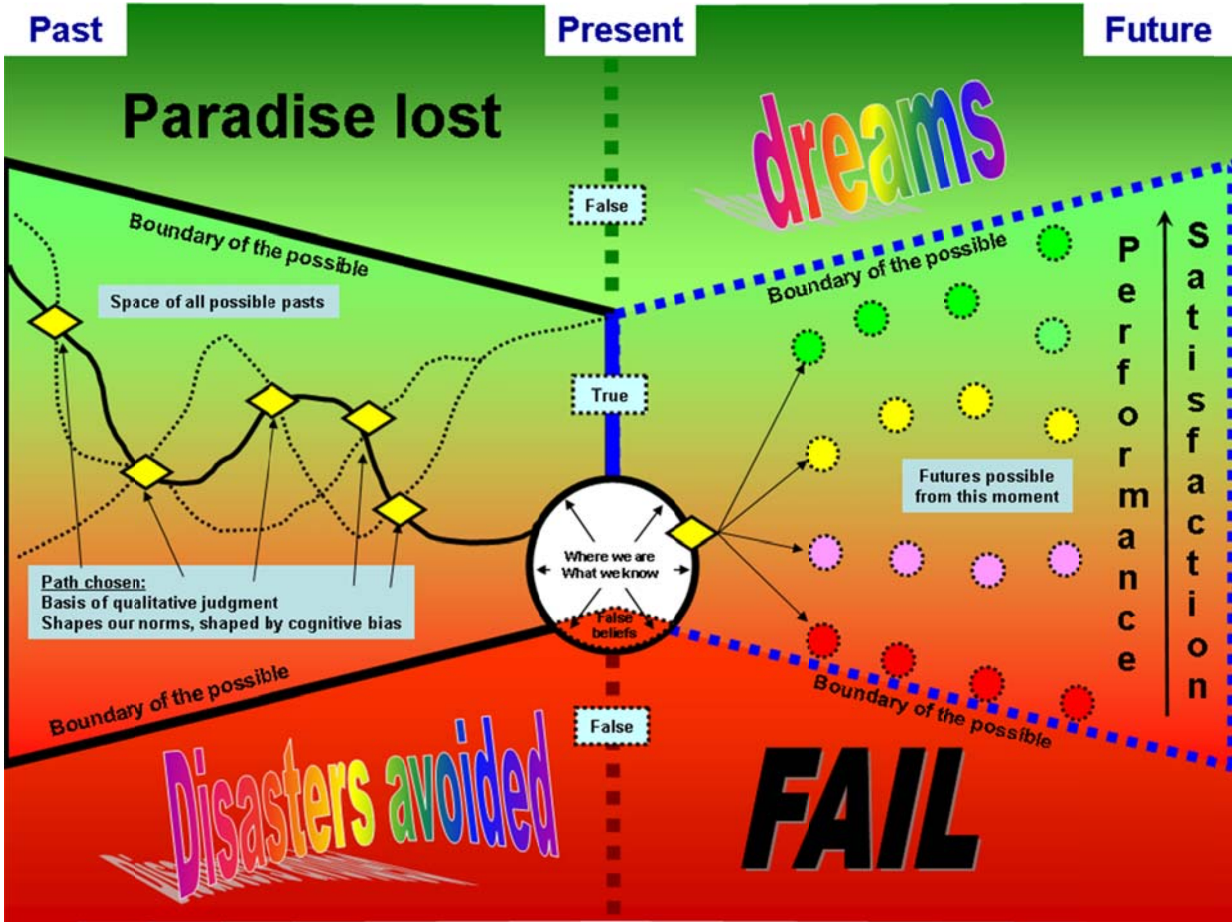
The Commander's Intent is next, which lays out a vision of the successful end-state, identifies critical supporting tasks which must be accomplished to get there, and specific instructions to subordinate units.

For the trader this equates to having a vision of the success firmly in mind to maintain your focus on positive outcomes. It also includes identifying those support functions that must be a part of any robust trading plan, such as a commitment to maintaining your appropriate levels of position sizing and risk in order to protect capital and achieve required results when successful.

These are just a few of the useful and powerful insights that traders can apply from the world of military planning.

Reflecting on the source of qualitative judgement

Posted by **Ken Long** on April 19, 2009



Profitable ETF Trading Strategies: introducing "ready fire aim" for traders

Posted by Ken Long on April 17, 2009

If you don't have confidence in your understanding of the market you are trading, and or have a specific strategy that has a definable set of rules for scanning, filtering, stalking, entering, managing, and exiting your trade, you might think of the opportunities in terms of "Ready-Fire-Aim" instead.

Performing these 3 tasks in a different sequence than the usual "Ready-Aim-Fire" is counterintuitive, and at times seems risky. However, there are some markets with opportunities that are so fleeting and explosive that if you wait for everything to fall into place, by the numbers, you may discover that you are too late to act in time.

The tasks underneath **Ready, Fire, and Aim** are generally as I described in an earlier article, but there are some refinements that will help you understand the crucial shift in perspective.

Being **"Ready"** includes identifying appropriate markets and time frames for strategies that you have already individually mastered. You still must validate strategies through back-testing, prototyping and analysis of results. You must have an adaptable, agile risk management system that allows you to quickly determine position sizing once a strategy is selected based on environmental cues. This must be internalized to the instinctive level to ensure you are not fumbling around in the moment of decision. Heuristics help a lot here, as long as you make your tradeoffs in the direction of lower risk.

"Fire" consists of quickly entering positions at appropriate risk levels given our heightened sense of uncertainty, as we prepare to let the trade unfold along one of several possible paths.

"Aiming" now consists of morphing your trade idea towards the more likely patterns, and adjusting your decision-making and risk management towards the parameters of the more likely patterns. Rehearsing your decision tools and management indicators is absolutely essential in this phase.

The sequence of this trading strategy creates a significant conceptual change, but one in which an adaptable, skilled trader may find opportunities to get early, risk-managed entries into winning trades. It is not for the faint of heart, or for traders who have a need for feelings of control and certainty to guide their trading.

Profitable ETF Trading Strategies: "Ready-Aim-Fire" for traders

Posted by Ken Long on April 17, 2009

If you have confidence in your understanding of the market you are trading, and have a specific strategy that has a definable set of rules for scanning, filtering, stalking, entering, managing, and exiting your trade, you might think of it in terms of "Ready-Aim-Fire".

By getting this sequence right, and performing the required tasks properly, you should be able to increase your bottom line through the disciplined application of your rules, whether they be mechanical, discretionary or a mixture of both.

Being "Ready" would include identifying appropriate markets and time frames for your strategy, conducting sufficient back-testing and prototyping to allow for confidence on applying the rules, performing the necessary screening and monitoring to identify potential trades, carefully defining an optimized entry rule set, creating a manageable system for monitoring open risk to stay within your risk profile, and defining exit rules according to a strategy that is consistent and productive in the context of your overall strategy.

"Aiming" consists of selecting the appropriate strategy from your kitbag based on environmental cues from your market sensors, ensuring you have met your criteria fully and completely before triggering. This should also include a rehearsal of the trade itself, time permitting to ensure you have your aim point firmly in mind.

"Fire" consists of the actions we take when we execute our trade based on our rule set that represent our strategy.

This mental model of a trading process can help you examine the different components of your strategy as you go through phases of planning, preparation, and execution.

By examining your performance in each of these 3 areas you may be able to focus on the topics that most need your attention.

I have a belief that your system will perform as well as your least effective domain in this model.

You can try this idea on for size by asking yourself: What happens when you are good at 2 but terrible at the other? What happens to your performance?

Profitable ETF Trading Strategies: a craftsman's approach to trading

Posted by Ken Long on April 16, 2009

How you think about the activity of trading in the world has a powerful influence on the planning preparation and execution of your trading plan.

Robert Pirsig describes the mindset of Grail seekers in his excellent book Zen and the Art Of Motorcycle Maintenance. He called it the romantic approach and associated with things like the hippie movement, bohemians, the "dabblers in art" crowd.

He described them humanely as people in search of a spiritual connection that was intuitively satisfying to their desire or dream of connecting to the world as it should be on its highest quality plane of existence.

I will be among the first to honor and value the search for meaning in life long journeys in pursuit of excellence. I respect and support the master craftsmen's attention to detail in small things and in all things.

But most of all I admire and aspire to the master craftsmen's appreciation of the art, wisdom, knowledge and goodness that lives in his hands, heart and mind in which he seeks to manifest in the world through right thought and right action. He comes from his center to speak his truth to the world in a quiet, humble, human voice. It acknowledges both the possibilities of the human spirit as well as the shortcomings of those who dream big dreams.

The master craftsman knows better than anyone that he is not perfect in an absolute sense but that his appreciation and pursuit of perfection, his perfection, is perfection. It includes an awareness of the mistakes we will make along the way and a sensible and routine approach to managing risk, doing no harm, caring for tools and their workplace, cultivating calm and patience and then acting with appropriate trigger when the preparations have been made and right action must be called forth to be in harmony with his craft.

Compare this pursuit of perfection with the unachievable, idyllic, overly spiritual, almost narcissism of those in pursuit of the holy Grail.

The quest seeker can never be satisfied at all until the moment of ultimate satisfaction when the Grail is received. Everything short of that moment is filled with yearning and manic-depressive emotions that bounced from ecstasy to despair based on the interpretation of the moment.

The craftsmen who aspires to be a master craftsman respects his art, acquires knowledge of that which is knowable, appreciates that which cannot be known, seeks to live with grace while taking care of business in the usual way.

He accumulates perfection in small daily contributions of virtue, of life lived well and he puts that tiny little piece of the Grail in his spiritual bank. He values the journey and appreciates the way and has earned his rest and just rewards whenever he gets there in his own good time.

Choose your metaphors wisely.

Profitable ETF Trading Strategies: the psychology of Grail seekers

Posted by **Ken Long** on April 16, 2009

How you think about the activity of trading in the world has a powerful influence on the planning preparation and execution of your trading plan.

If you think of it as a quest for the holy Grail, it would not be surprising for you to use the language of mysticism, spirituality, intuition and to find yourself in search of the magic keys to the kingdom or purifying yourself in order to be worthy of receiving divine inspiration.

You might spend your time in search of magical moments where the true knowledge of the world is revealed to you in strange and mysterious ways.

Your success or failure in the markets would be tied deeply and directly to your soul and would be a reflection of God's judgment on your true worth as a human being.

Considering the number of people in Western literature that actually achieved the Grail, I cannot recommend this as a strategy for simply making money in the markets in order to achieve your financial objectives within the parameters of your appetite for risk. Think of the pressure the psychology places on every trade you make, and every decision you make to act or not act.

How can you trade with calm confidence if you believe that every moment is being judged against a heavenly standard while you are not yet in possession of all the rules in the evaluation criteria.

It would not surprise you to see a quest seeker in a constant state of manic depression, with the emotions cycling violently between states of near ecstasy and despair. Final validation only comes if it will at all near the end of your life when the Grail is either received or denied. It's only at that moment when you truly discover whether all your actions have been in vain or validated.

It's like taking one trade in your entire life for all the marbles with the cards stacked against you.

Why in the world would you choose to trade with that mentality? I am having a hard time trying to find a metaphor for trading that makes it harder to be successful than that.

It's a free world though, and you are free to choose your way within it.

Choose your metaphor wisely.

Profitable ETF Trading Strategies: understanding the limitations of professionalism

Posted by Ken Long on April 16, 2009

It is conventional wisdom to advise traders to become more professional in their trading practice. This is almost always very good advice, because professional behavior will help protect you against the kinds of emotional, hurt animal behavior that is your enemy as you struggle to compete for profits in the market.

I say this is almost always very good advice because there are some circumstances in which professional behavior can actually be detrimental if you are not careful.

It is a common occurrence for a profession to define a paradigm of beliefs, theories and behaviors that should govern their domain of action, which collectively we might call doctrine. It is also a very common occurrence in history for professional doctrine to take on a life of its own and fail to adapt to a dynamic world.

Under these conditions, the doctrine can become an end to itself and the professionals may lose sight of the original purpose of the doctrine as a source of authoritative advice and give it an aura of timeless truths instead.

In that case, the professionals will have taken what were provisional solutions and tried to turn them into deep truths about the world and the way it works.

It was precisely this insight that led me to develop what is now one of my most reliable and productive systems which came about as a result of taking the exact opposite of what could reasonably be called conventional wisdom.

I made a list of the top dozen or so beliefs about how the market works and how you should plan to make money in it. These were beliefs that could easily be found in any bestseller on personal finance and investing. I defined a new set of beliefs that were the exact opposite of each one of these, and operationalized them in terms of screening criteria and technical analysis and so forth.

I constructed a system that on the face of it violated every professional norm you could imagine. I then tested the system using back-tests and forward tests in all kinds of market conditions and discovered that I had found a robust strategy for short-term trading that was effective in most market conditions.

I can honestly say that I would never have intentionally developed this system from these anti-beliefs. This simply started out as a thought experiment that turned out to have surprisingly good results.

This is also the kind of the system that professional traders in a professional group with a professional doctrine would be very unlikely to discover as a direct consequence of the constraints of their professional approach which under most circumstances is a positive thing.

Choose your beliefs carefully.

Profitable ETF Trading Strategies: become more professional in your trading

Posted by Ken Long on April 16, 2009

James Q. Wilson is a UCLA sociologist who has written extensively about bureaucracy and professionalism. He said professionals receive important rewards from members of their group, that their group has special membership criteria usually related to formal education and the group defined code of conduct, and that they learn things in ways that are different from most of the population.

This raises the question about whether or not an individual trader can be professional in the performance of their trading practice without being a member of a professional group.

It seems clear to me that an individual trader does not meet the formal definition of being a professional, but I believe that the qualities of professionalism can be adapted and used in your trading practice. I think you would get a lot of benefit from this effort for the following reasons:

We can identify the qualities of professional behavior and hold ourselves to that standard without being a formal member of a professional group.

These qualities have to do with a code of conduct, ways of knowing and learning about the professional domain and bringing the qualities of preparation, self-discipline, attention to detail, rigorous thinking, and a commitment to excellence that will clearly add value to our practice.

One of the members of our trading mastermind observed that professionals identify a baseline of minimum acceptable performance that is not negotiable. As an example, we may experience a string of five losses in a row in a trading system that is designed and tested and reliable at .55 win rate.

The minimum acceptable professional behavior is that we have thoroughly tested and prototyped the system, we understand the reliability and expected distribution of results, and we are trading it at an appropriate level of risk given the known performance parameters. Without these baseline behaviors being performed without exception, then we are just yet shooting like amateurs and not behaving in a professional manner.

Because trading can be such a lonely job, having a traders mastermind to help reinforce professional behavior is a major advantage. This is why I strongly recommend a traders mastermind for every trader regardless of experience level. The positive reinforcement of effective group norms will help you in your darkest hour and keep you humble on what you think is your best day.

Profitable ETF Trading Strategies: understanding what contributes to your trading results

Posted by **Ken Long** on April 15, 2009

Sometimes I think we try to give ourselves too much credit and too much blame for our trading results. There is no doubt that we are responsible for our results in the macro sense, and that it is a healthy philosophical and psychological mind-state to be responsible for results.

It is clear to me though, that the positive edge for many robust systems is small but persistent, and relies on having a large number of opportunities to have a realistic confidence in realizing the expected, average return. The fewer the opportunities, the more the variance of individual trade results influences final results.

This is why casinos want to have a million people wagering $1 rather than 1 person wagering $1 million. They can't predict the outcome of a single event, but the larger the number of chances, then the more likely the expected return will come through.

If the market is really a complex adaptive system and if our judgment is only a small part of the contributing factors that actually causes results, then we are likely to overestimate how much our decision-making contributes to performance.

This is only true concerning systems which have been designed and tested, prototyped and rehearsed and in which the appropriate role for human discretion has been designed. In this kind of system, which is quite different than seat-of-the-pants trading, you might find a win rate of 55%. In that kind of system, if you experienced five losing trades in a row, you might begin to question your own performance and decide you are in a losing streak, when in fact all you have seen is a string of losing trades that should be expected as part of a large number of opportunities.

The right decision is to check your rule set, and the details of your execution and if you are within parameters, simply continue to take the entry signals as they occur rather than trying to reinvent yourself after a normal string of losses.

By the same token, you might be tempted to think you were on a hot streak after five wins in a row and be tempted to change your rules or accept more risk. This would not be justified by the results, because five wins in a row would not be unusual for a 55% accurate system.

By understanding your trading system, and the types of results you can expect given a large number of opportunities, you are in a better position to interpret results and create meaning from data.

Profitable ETF Trading Strategies: what is the nature of the market?

Posted by **Ken Long** on April 14, 2009

What is the nature of the market and why do we care? Based on your belief in the nature of the market, which may or may not be supported by evidence, you should be applying a specific strategy for successful trading.

Based on the academic research into complexity and complex adaptive systems, you can make a strong argument that the market could be any one of the following mutually exclusive environments.

The market could be: simple, complicated, complex, chaotic or random.

It turns out that there is evidence to support all of these judgments. Each different category has an appropriate strategy to follow in order to “solve the problem” or “find the way” in the market.

Here is a brief working definition of each category, and the kind of strategy that could be appropriate.

Simple: laws of cause and effect are well known, and time tested; simple rule sets and nothing fancy works best here. Don’t overthink! Tic-Tac-Toe is simple and there’s one best way to play.

Complicated: cause and effect rules are known, but there may be so many moving pieces that prediction is time consuming. It is knowable but hard; your strategy should be to optimize a rule set that reflects the situation and you apply computing power to make predictions that have validity.

Complex: there are many moving pieces, and many relationships, and in open systems the rules may change periodically so that you cannot hope to fully understand, you can only aspire to manage within established boundaries.

Chaotic: on the border between complex and random, the situation morphs so quickly that patterns cannot be established and boundaries are not useful. Appreciation of our human limitations and seeking to minimize risk above all are the best strategies. Each trade is unique, no pattern is reliable.

Random: in truly random processes, once the distribution percentages of possible outcomes are calibrated, and preferably known, there is an optimal strategy that requires the laws of large numbers to achieve the expected average return over time. This is the casino strategy: they don’t know who will win on any given hand of poker or blackjack or pull of the lever, but they know that over the course of millions of opportunities each year they are mathematically certain of making money.

Some will say that market shows all of these faces at different times, and I will agree. If you take this position, then it is very important how you decide to classify the market and how often, so that your strategy selection is in tune with the market’s current mood.

Profitable ETF Trading Strategies: developing a master belief list

Posted by Ken Long on April 13, 2009

Developing a master belief list is an important part of assembling your total trading plan. This is a list that itemizes every belief that you can think of with respect to self, market and systems. In later stages of analysis and self awareness, you will come back to each belief to identify the source and the evidence for belief in each of these. At the end of this period of analysis you will have a thorough understanding of yourself and the trading world around you.

You will probably begin this process with divergent thinking, by which I mean you generate as broad a set of beliefs as you can come up with. This list should come from trusted others, personal experience, excellent books and recommendations from people who disagree with you. It's important to include divergent thinking in the formative stages so that you don't lock yourself into preconceived notions at an early stage.

After the divergent thinking is over, you can proceed to convergent thinking, where you will begin to integrate the various separate beliefs into an integrated network of coordinated beliefs. After the initial brainstorm, you proceed to test each belief carefully before deciding if it makes the final cut to enter your formal belief structure.

I discovered after doing this drill, that I had many beliefs that were contradictory, whose evidence was not convincing upon closer inspection, and whose source was basically unknown. I have discovered that as I have eliminated unnecessary beliefs that I improved my clarity and my willingness to act on less and less information. This in turn gives me an advantage of speed of execution since I need less information to trigger effective action.

Once you have conducted the first formal cycle of belief inventory, it would be natural for this network of beliefs to support your trading for at least 3 to 5 years as you begin to add practical experience and reflection to this initial undertaking. It has been my experience that after 3 to 5 years though, you need to refresh this exercise in order to see what has changed as a consequence of professional actions and mature reflections. In between these large formal reviews a process of monthly, quarterly and annual reviews should be sufficient to maintain your awareness.

By maintaining a trader's belief journal, you'll have a working document to support you in this ongoing process of self-awareness and deep reflection.

Profitable ETF Trading Strategies: integrating your beliefs about self, market and systems

Posted by Ken Long on April 13, 2009

I have already described in a previous article how I examine each of the three components of my total market performance perspective individually and some of the considerations that I am evaluating. These three components are: self, market and system. Each of these domains is a suitable topic for inquiry and self discovery. But this three-part model is much richer than that.

After first examining each of these areas and my beliefs about them, I can then consider the overlap of interest areas between any two of these three domains, such as the intersection between self and system, and self and market, and that of market and system. Each of these domains is an area of goodness of fit that can be explored and understood to find the sweet spot that works for me.

Finally I can consider all three of these domains simultaneously and once again look for a sweet spot where all three areas contribute to my competitive advantage.

Because of the possibility of learning and feedback in evolutionary change, I consider these three domains to be dynamic and ever-changing and so the importance of regular feedback and analysis and reflection becomes crucial to my continued performance.

I recommend beginning the process of discovery learning by reading a popular book or two from a respected author who trades in a manner that is similar to what intuitively appeals to you. Begin deconstructing their belief system, chapter and verse. By itemizing the beliefs you can start constructing a belief network and determine which of those believes resonate most strongly with you, which will then support analysis into determining what actions logically follow from holding these beliefs and how you can test them.

By starting with a recognized author, you will save yourself much of the early part of the learning curve and since time is your irreplaceable resource any savings here can be very useful later on.

Profitable ETF Trading Strategies: beginning the journey of self-awareness

Posted by Ken Long on April 13, 2009

When I put together my total trading performance system, I consider it from three primary perspectives: self, market, system.

When I consider my Self as part of my trading system, then I am examining my beliefs about self, my strengths and weaknesses, my emotions and rationality, my goals and objectives, my appetite for risk, my habits for success, my self discipline, the assets that I bring to trading that support me, my known weaknesses, my network of friends and associates, the circumstances of my life that surround trading, and so forth.

When I consider the Market, I am taking a look at the broad market, segments of the market, time periods, currencies, macro-economic issues, buyers and sellers, human psychology, news and news making organizations, the behavior of the masses with respect to news surprises, governmental policy, rules and regulations governing trading, taxation, and the laws of cause and effect that I hypothesize may cause the market to behave as it does.

Under system, I am thinking in terms of general systems theory and the idea of input, process, output as the components of the system that perform in an environment. I know from my systems theory training and education that the whole is greater than the sum of the parts, that emergent behavior can arise from simple rules in a dynamic environment. I am aware of the possibilities of second and third order effects and how the laws of unintended consequences can take on a life of their own. I can use an analytical approach to understand and appreciate the components of a system to look for incremental performance improvement and I can use a holistic approach to examine the interface of the system with the environment around it and with competing systems in the same environment to look for competitive advantage.

By preparing yourself properly in this journey of self-discovery into your own beliefs, you are laying the foundations for a thorough understanding of self, markets and systems which will pay dividends later once you add practical experience to this theoretical framework.

Profitable ETF Trading Strategies: applying Gladwell's insights from "The Tipping Point"

Posted by **Ken Long** on April 12, 2009

Malcolm Gladwell's excellent book "The Tipping Point" describes the common characteristics of mass psychology with respect to fans and trends. Even though it is just a popular psychology book, and has been criticized by some for its lack of academic rigor, I still think the book offers a lot of useful insights to the world of trading that can be applied by individual traders to their view of the markets.

This article describes how I apply his insights, which you may find useful in your own trading practice.

Gladwell classifies large populations into five categories, based on how and when they adopt a new trend. Not every new fad develops into a full-blown trend, but every full-blown trend, he suggests, experiences these five categories of people.

To paraphrase, then, here are Gladwell's five classifications, with my naming convention and interpretation:

Innovators: these are the scouts who take the first step into the bold unknown.

Early adopters: people who see how the innovators' ideas and actions have merit on a wider setting.

Early mass adopters: a large group of commercially significant people or businesses who have waited to see how the early adopters applied the new idea before taking it on themselves. They can afford to wait for the first two groups to learn what they're going to learn about the new idea. This group knows that as long as they beat the late mass adopters, group 4, they will retain their competitive advantage in the marketplace.

Late mass adopters: this is the remaining group of commercially significant people or businesses who resisted the new idea for a long time until they see no way out of it but to join the rest of humanity.

Grumpy old men: these are the folks who adopt a new idea because they have no other choice. This group would still be riding in horse and buggies except they don't make them anymore and so they have to buy a car, but they don't like it.

It is my sense that in the lifecycle of trending assets, we see the same five groups manifest in the storyline of the trend no matter what the timeframe is. Ask yourself "which group am I in when I enter and when I plan to sell?" and see if that helps you better understand your strategy in terms of group psychology.

Profitable ETF Trading Strategies: developing a new oscillator, the NDX()

Posted by Ken Long on April 12, 2009

In my last article I described two problems that I had with the otherwise excellent technical indicator known as Williams %R. I dislike the scale which goes from zero to -100 which seems counterintuitive, and I don't like that it uses today's price action when calculating the index value which hides information concerning breakout days.

I suggested that if I were going to design the indicator from scratch I would fix those two problems by making the scale read normally from 0 to 100 like a thermometer, and I would not use today's price action in calculating the index value in order to highlight breakout's above and below the trading range of the look back timeframe.

To support my own trading I have built just such an indicator in Microsoft Excel and I use it for analyzing large numbers of stocks and ETF's as part of my daily trading practice. I have found the modified indicator which I call NDX or "index" does everything that Williams %R does while adding value by fixing the two problems I have identified.

In my spreadsheet reports to use the column heading of NDX(t), where "t" represents the look back timeframe. For example, NDX(10) would represent a 10 day look back period from yesterday to 11 days ago, with today being represented as the zero day.

If the asset traded in a range from 10 to 20 in the look back timeframe, and today closed at a price of 10, it would have an index value of zero. If the close today were 20, then the index value would be 100. If the close today were 21, the index value would be 110 which would indicate a breakout of 10% greater than the previous trading range.

You can see how this information would be very useful if you are scanning for breakout opportunities in a large population of stocks and ETF's. The normal 0 to 100 scale is also more intuitive.

I use conditional formatting in Microsoft Excel to highlight index values greater than 90 in green, and less than 10 in red. I typically rank sets of symbols from highest to lowest or lowest to highest, in order to find those symbols at the most extreme condition compared to their peers. This is consistent with the use of oscillators in general and I have found it very useful to focus on these extremes for short-term trading targets.

When I use a year-long look back timeframe, I write the column header as NDX(52w), as you might expect.

I use Williams %R whenever I am using commercial or public stock screeners, but I use my own NDX indicator on my own spreadsheet reports.

These kinds of refinements come from deep understandings and appreciation for the construction, use and limitations of conventional technical analysis. The refinements don't seem important unless you look very closely at the specific indicator. Attention to detail is rewarded in the practice of trading.

Profitable ETF Trading Strategies: a closer look at Williams %R with 2 improvements

Posted by Ken Long on April 12, 2009

In a previous article, I described how I use Williams %R as a useful oscillator in determining if an asset can be considered to be in overbought or oversold conditions based on the context of recent price action in a defined look back period. I like to use 10 days and one year for context.

I use the 10 days of look back to give me insights into short-term trader psychology. I use the one year look back period to give me insights into long-term trader psychology. In some of my systems I combine both of these measures to give me a consolidated, integrated look at market psychology.

There's nothing magical about the use of these two specific time frames, nor do I believe that they have any predictive power. I simply find them useful to help me frame my trades and understand the market enough so that I can take action.

I have not exhaustively analyzed different time frames to see if there is an incremental advantage for adjusting the parameters, I am simply satisfied that they work good enough to get me into the ballpark for decent trading opportunities.

The two problems that I have with Williams %R are these:

(1) the scale ranges from a high score of zero to a low score of -100. My problem with this is that it is not intuitive and if I were to design this indicator I would use a scale of 0 to 100 which for me is easier to see.

(2) Williams %R incorporates today's price action in the development of the zero to -100 scale. Normally this is good enough, but there are days when the price of the asset has made a bold break out from the last 10 days trading range. The way the indicator is constructed, you cannot tell this from the reading. If I were to design this indicator from scratch, I would describe today's price action on a normal scale of 0 to 100 that looked back 10 days starting from yesterday. That means that if today's price exceeded the highest high of the last 10 days it can have a reading greater than 100 and conversely if it had a lower low than the low of the last 10 days it could have a negative reading. This change would allow you by inspection to identify breakout candidates in both directions and a relative magnitude of the breakout depending on how far from the 0 to 100 scale the new reading stands.

Nevertheless, Williams %R is a simple, excellent indicator for most of my trading purposes, and I highly recommend its use and study for beginning and journeyman traders.

Recently, I have seen some trading systems with simple rule sets built exclusively from Williams %R which happened to use a 30 period look back rather than the standard 10. I've only looked at the rule sets superficially, and while the entries makes sense the exits look clumsy and non-intuitive.

Profitable ETF Trading Strategies: understanding Williams %R, a simple oscillator

Posted by **Ken Long** on April 12, 2009

Oscillators are tools of technical analysis that are used to identify periods of time when price can be considered in an overbought or oversold condition. The overbought and oversold conditions are found at the extremes which vary based on how the oscillator is constructed. Some oscillators look exclusively at price with respect to the range of high and low in the look back period. Others incorporate some measures of statistical description. In most cases, the look back period is required in order to establish what may be considered normal and extreme for the price channel.

Depending on the market condition, your strategy could be one of channel trading in which case you expect price to reverse once it's in this extreme condition or to prepare yourself for breakout trades in which case you expect price to continue explosively through this extreme moment and breakout of the channel.

Williams %R is my favorite oscillator that can be found in all charting packages, because it is the simplest one to understand and is very visual. Created by Larry Williams, the famous technical analyst, this indicator creates an index ranging from zero to -100 for the look back period. An index score of zero is assigned to the highest high of the look back period and a score of -100 is assigned to the lowest low. The look back period is then segmented into 100 equal sections and the oscillator value of price is interpolated.

Readings between zero and -20 are considered to be overbought because they are in the top 20% of price, whereas readings between -80 and -100 are considered to be oversold because they are in the bottom 20% of price during the look back period. Readings between -20 and -80 are considered to be in the normal range of the channel.

I have a trading belief that volatile moves are more likely to occur when price is at an extreme reading either overbought or oversold, and so this oscillator aligns very nicely with my trading believes and is therefore useful for me to help classify market conditions. I use it to help me assess for stalking. It leads me to study assets that I believe are likely to make a vigorous move in the short term.

The only problems that I have with Williams %R are that the scale of zero to -100 is not intuitive and that it includes today's price action in the index. These are only small problems however and for most of my screening filters I find that it works just fine.

I typically examine a look back period of 10 days and one year because both of those time periods are useful for the way that I trade.

Profitable ETF Trading Strategies: a brief look at technical analysis

Posted by **Ken Long** on April 12, 2009

If you are a trader that uses technical analysis, or if you are just considering applying some technical techniques to enhance your investing and trading strategies, my recommendation is make sure you start with just a few tools, and understand them thoroughly, rather than flit about from tool to tool like a bee investigating flowers.

The reason for this is that most technical indicators derive from price, and thus have a lot more in common than may be immediately apparent. If you only examine them superficially, at wave top level, instead of diving deep, chances are you will not get the full value of the insights that even the simplest ones can reliably provide.

You are also more likely to have a partial understanding of many tools and when you put them together you may think you have more information about the market than you really have and may then act with more confidence than is warranted. In the case of technical analysis it is especially true that a little knowledge is very dangerous.

There are some broad categories of technical tools available to describe various dimensions of market conditions. Two of the most important are: measures of trendingness and oscillators.

Measures of strength of trend: because the market seems to have different performance characteristics when the market is trending, it is useful to have an indicator that indicates when the market or the asset trend is sufficiently strong to begin specializing in trend following strategies. These strategies include making an entry with a wide enough stop to allow the trend to fully develop, but close enough that a true change in trend will allow you to exit the position with a percentage of profits intact. In trends that are very strong, the strategy of buying on dips can definitely improve your returns.

Oscillators define periods of Overbought and Oversold, and are especially useful when the market is not trending up or down but can be considered to be in a band or a sideways trend. Authors disagree on what percentage of the time markets are found in this condition, and it is clear by visual inspection that some markets are trendier than others. However, all generally agree that the markets spend enough time in sideways conditions (or non-trending conditions) that having strategies optimized for these conditions can give you a significant edge.

For example, in a sideways market, with prices confined to a definable channel, you are looking to buy low in the channel and harvest near the top of the channel. If the market were trending though you would be inclined to buy near the top of a channel, anticipating a powerful breakout from resistance which would sweep you along to new profits.

Dr Alexander Elder is an author that I recommend for clear explanations of the purpose, construction and application of various technical analysis tools. His books are well suited for beginning traders looking to raise their understanding to the next level.

Profitable ETF Trading Strategies: profiting from a good story

Posted by Ken Long on April 11, 2009

Our trading mastermind has been developing a technique that we call trading narratives in order to develop low risk trading ideas that share the common feature of the acronym SLBG, or “small loss big gain”.

We chose the word “narrative” to capture the idea that we have been developing story lines for our favorite trading targets. We found ourselves becoming interested in stocks and ETFs for particular reasons based on the market condition.
As we framed our trades and the results came in, many times we felt like we were beginning to understand the recent behavior of the stock in a special way. We began to feel that our understanding was giving us an edge in the development of additional trades that would offer themselves as the story of the stock or ETF would unfold in the subsequent days.

Then there would come a day when the story seemed to be over and the logical thread that had tied together the sequence of trades over the last couple weeks had come to an end while the stock or that ETF would muddle around in a congestion area and show no directional bias. We started calling this the “end of the story”.

As we became more comfortable with this technique, we started looking for ways to frame a trade based on a scenario that seemed to have some logical justification for being true.

Our practice then would be to frame the trade in such a way that if the hypothesis were proven true we could expect to achieve outsized returns compared to the market while at the same time enduring only a small loss if we saw a price that would invalidate the main storyline.

From social science we borrowed the idea of a narrative, which is a socially constructed version of reality generated by people and their pattern matching brains and the powerful artifact of their language. Some schools of sociology consider all of our reality to be socially constructed in this way. We don’t really have a position on that one way or the other, we’re just trying to find low risk ideas that reward us handsomely for taking small risks.

We have been framing narratives around federal reserve days, days of the week, reactions to news, rumors of government intervention, and finding our trading targets in both ETFs and large-cap stocks that will react the strongest if our scenarios are true.

Our practice of trading narratives has become an integral part of our trading mastermind which adds value to our trades on a daily basis. The story lines are grounded in sound trading strategies and are combined with the power of our imagination and trading techniques.

Profitable ETF Trading Strategies: my 10 best reasons for joining a mastermind

Posted by Ken Long on April 11, 2009

I have been a member of a trading mastermind for year and a half and have found it to be one of the most powerful edges in my arsenal as a trader. I cannot recommend a mastermind too highly to anyone interested in improving their trading practice, no matter what their skill level may be.

Here are some of the most important lessons that I've learned:

1. A professional but friendly mastermind can offset many of the psychological pressures created by the lonely job of trading.
2. Having a diverse set of perspectives and points of view will lead you see your trading in a completely different and constructive way.
3. Explaining your ideas to others will sharpen your own understanding of your personal style.
4. Taking the time to help others is one of the best ways of helping yourself.
5. To teach is to learn.
6. New ideas can be rapidly assessed, analyzed, developed and implemented so much faster in a group of professionals.
7. The ability to rapidly and independently analyze new trading ideas gives a tremendous return on time invested and will strengthen your research and development process.
8. The mastermind will keep you from becoming too high or too low.
9. If your mastermind forum supports archives and image sharing, you can develop an online trading journal that is most excellent.
10. Even after 500 days in the trading mastermind not a single day goes by where I have not learned at least one useful idea or reinforced one powerful trading behavior.

I cannot imagine trading without a mastermind to support me even though I consider myself to be emotionally secure and professionally competent in the practice of the craft.

Whether you are new to trading or a seasoned pro, I strongly encourage you to become involved as a member or leader of a mastermind trading forum in order to supercharge your performance.

Profitable ETF Trading Strategies: how to trade the opening gap

Posted by **Ken Long** on April 11, 2009

There are literally hundreds of tactical trading books in the marketplace these days. Almost every one of them will discuss the authors favored strategy or strategies for trading the opening gap. The strategies are typically framed as a set of trading heuristic rules, of more or less complexity, and they're backed up with assertions of excellent performance. When you set all the strategies side by side you realize that many of them are diametrically opposed to a different author's favored strategy.

How can all of these authors be right about trading a period of time measured in minutes, where volatility is at its highest, and where false starts, false breakouts, gap closures, and reversion to the mean are so commonplace and confusing to the new trader?

Is the opening gap simply something that new trader should avoid until they have years of experience in hand? Or should a new trader just pick a strategy from a favorite author and try to make it work with small position size and move along until you find something that works? How long should you wait before the morning gap is over and you can start trading intraday on a more reliable basis?

These are not trivial questions. Intraday traders must struggle with these questions until they find the solution that is satisfactory to them.

My own research into gaps discovered some surprising truths. What I found was that the many different authors were occasionally right and occasionally wrong. I found that the truth about the gap and the best way to trade it varied in time on a regular basis.

I studied years worth of opening gaps of the market and found that there are times when the market reliably moves in the same direction as the opening gap, and times when the opening gap is reliably reversed, and many times when the market seems to be random with respect to the follow-through after the gap.

The one reliable correlation that I found was that the magnitude of the gap in either direction correlates to the magnitude of the follow-through in either direction. Simply stated, large gaps make for large follow-through's. But, unfortunately, there is no predictive value on the direction of the gap and the subsequent move on a regular basis.

I also found that the truth of the market's behavior at the gap changes in time periods measured in days and weeks. The truth is not persistent. Study of the gaps may point out moments when you can justify a directional bias but most of the time the correlation is so weak or nonexistent that there is no statistical edge.

What does this all mean?

I conclude that you should be very careful about it accepting wisdom from even the most popular tactical trading authors and conduct your own research with respect to the gap in a way that makes sense for the type of trading that you propose to do. There is very little about the gap that may be safely and universally generalized for the average trader.

I have a set of trading strategies that work for me and my style that took months to refine and only applying under strict conditions with limited opportunities. When those moments occur I am ready to trade according to my edge, but I also know how narrow the windows of opportunity really are.

If you must trade the gap, then be very careful.

Profitable ETF Trading Strategies: are trailing stops better than fixed profit targets??

Posted by Ken Long on April 11, 2009

There is a long-standing and interesting debate on the subject of when to use profit targets and when to use trailing stops for successful trades. There are passionate advocates on both sides of the debate who believe that their answer is correct for all trades, all styles and in all conditions.

My personal opinion is that the exit strategy you employ must make sense for your personality, your trading style, your goals and objectives, and in the timeframe in which you are trading.

No matter what strategy you select, it's important for you to conduct an analysis on a regular basis to determine if the exit strategy is in tune with the market type and trading style you are employing. It is far more important to analyze your exits than it is your entries, because it is through improvement of your exits you will make a far greater positive impact on your bottom line.

It is the general consensus in our trading mastermind that the shorter your time frame, the more likely you are to find that hard profit targets are appropriate. Hard targets take you out of a position as soon as that prices reached. Conversely, the longer your average holding time the more likely you can afford to let the trend run and use a trailing stop designed to simply and easily harvest most of the trend.

Here is an example of a strategy in which hard profit targets make a lot of sense.

Suppose you have identified a market condition in which no-notice explosive breakouts that often fail are very likely. Suppose that your trading target is a large-cap, very liquid exchange traded fund that has a very regular performance statistics. Suppose further that the average false breakout of this index from a congestion zone is a 1% move, and that 80% of the time the breakout will fall back to the middle of the previous congestion zone.

In this scenario a trailing stop would most likely return too much profit to make this scenario worth trading. But if you could fine tune your entry conditions and have a very tight initial capital preservation stop, you might find that reliably harvesting most of the 1% move intraday could return some very valuable returns. The only downside to the hard profit target stop would be that any breakout that continues past that move would not be available to you.

Rather than trying to design a complex set of exit strategies that would catch both the false and the true breakouts, I believe you're better served by having a separate system to trade the true breakouts if you decide that is an opportunity and an edge that you possess.

The bottom line is: analysis of your exit strategy is a high payoff activity for the professional trader.

Profitable ETF Trading Strategies: reflecting on technical and fundamental analysis

Posted by Ken Long on April 11, 2009

To my way of understanding, technical analysis is the application of various forms of mathematical and statistical analysis to the study and description of the price movement of an asset (for me, a stock or an exchange traded fund usually) on a graph or in data tables, with the idea being that we can increase our understanding of the behavior of the asset. This increase in understanding may lead to identification of favorable trading opportunities going forward. This is a relatively humble claim compared to what some traders will claim for technical analysis.

Depending on the school of thought or the claims of the guru traders follow, technical analysis can go from a simple tool of description and classification all the way to being an insight that reveals the Universal Truth that guides the motion of planets and waves in the ocean and the psychology of the collective unconscious which connects all market participants at a very deep level. I have met traders who invest a great deal of their emotional well being and considerable sums of money on their faith in the predictive power of their favored technical approach.

To be fair, I have met many traders who place the same or more faith in their ability to analyze and understand future price action of a company based on their reading of the fundamental analysis facts of their business operations and those of their peers and of the markets in general as a function of publicly disclosed financial documents.

I am not very interested in the philosophical disputes at the extreme ends of either sets of claims, other than to observe that the evidence for the slightest predictive power for either technical or fundamental analysis is so weak when examined in a scholarly way, that I don't place any faith in the more extreme claims. If value cannot be found in the smallest of claims, I am reluctant to believe that the extreme claims bear much truth value.

For my methods of short term trading, with typical holding periods of 1-5 days, I find that fundamental analysis is pointless, since business conditions don't change enough fundamentally to materially affect the price. When fundamentals appear to change however, psychology does seem to take over to move in anticipation of changes down the road, so it would be fair to say that reaction to news about fundamental changes seem to matter in the short term.

While I don't believe that the technical analysis tools I use have any predictive power or Truth, I do believe they help me understand and describe short term market conditions in such a way that I can frame trades in terms of reasonable reward to risk ratios which let me venture into favorable situations for short term trading.

In this sense, then, technical analysis is neither true nor false to me, simply useful, with simpler being better.

Profitable ETF Trading Strategies: understanding Average True Range (ATR)

Posted by **Ken Long** on April 11, 2009

One of the most powerful measurements in the technical trader's toolbox is Average True Range, invented by Welles Wilder, and found prominently near the top of every major charting package that can be found on the web. Its power is what makes it so popular.

I always recommend to traders that they use ATR for their systems if they need a decent measure of short term volatility that is sensitive enough to detect important changes in near term volatility, smooth enough to prevent whipsaws of opinion and action, and reliable enough to be useful in all types of market conditions.

The way the indicator is calculated and displayed though makes it very easy to misinterpret by a trader or investor who is not familiar with how it works. In my opinion, the problem is so profound that it should not be displayed in the raw form on your charts because the visual display of the information is so misleading. Even experienced traders, who look at a lot of indicators, can overlook the problem. In fact the more indicators you use, the easier it is to forget this insight about ATR.

The problem is simply that ATR is measured in dollars and cents and so when you see the ATR line rising on a chart you are naturally led to believe volatility is increasing. The problem is that if price is also rising, volatility may be steady or even declining, which you cannot easily tell by inspection.

For example: an ETF priced at 20 with an ATR of 2 is much more volatile than an ETF priced at 100 with an ATR of 5. If it were the same ETF, and you watched its ATR climbing from 2 to 5 while price went from 20 to 100 you might assume that it was more volatile as price was climbing. The opposite would be the truth of course, but your eyes could lead you to believe otherwise unless you were constantly alert.

Here is the refinement that I recommend. Instead of using ATR in its basic form, simply divide ATR by the current price. This will give you a number which I call "ATR%". This is interpreted to describe the percent fluctuation of the value of the asset that can be considered normal given recent price action. By recent price action I mean the last 14 trading days, in the default construction of the indicator.

Use of the ATR% will allow you to do the following things very easily, things which cannot be done using straight ATR numbers, which represent a dollar denominated "normal" fluctuation.

You can use a time series of a single asset to see how its volatility is truly changing over time.

You can compare the ATR% of an asset against a set of other assets, and rank them into a scheme of relative volatility at that moment.

You can use statistics to further classify and describe a set of assets into logical, statistical sets.

You can compare sets of volatilities against other time periods to help you with market classification.

Average True Range is an important tool of technical analysis, but one which has serious problems in interpretation for novice or very busy traders. Know your tools!

Profitable ETF Trading Strategies: 4 ways to measure volatility

Posted by Ken Long on April 11, 2009

Volatility is such an important part of any shorter term trader's trading strategy that it is worth taking a few moments to consider several different ways that it can be measured and understood. Depending on the typical length of time you plan to hold your positions you may find one or the other of these methods more suitable for you.

The bottom line is that the method you choose should be responsive to significant changes in the time period you favor, and be sensitive enough to give you actionable information. You should be prepared to spend some time trying out different parameter settings until you find the best tradeoff between smoothness and sensitivity.

By smoothness, I mean how well the parameter settings filter out or smooth over normal noise variation in the data, yet still making it clear that an important condition in the market's volatility has just changed.

Long term traders can simply use beta, a comparison of the asset's volatility to that of the market to find out if, in general the asset is more or less noisy than the market. I recommend considering the correlation to the market to see how much in parallel the asset will move when the market moves.

As an example: if you intend to be an intermediate to long term trader you may be well served by considering volatility as defined by "Annualized historical volatility". This method describes volatility as measured by the standard deviation of price for the look back period, then annualizing it using normal statistical methods. This gives us a reasonable approximation of the kind of volatility we could see over longer periods.

Intermediate term traders to swing traders (holding from months to weeks) can get good information from the simple standard deviation of price over the holding period, without a need to annualize, because you don't intend to hold that long.

Swing traders need something a little more sensitive and reliable than standard deviation, which loses its authority to describe volatility when sample size is less than 30 periods. A swing trader would have to look at hourly price data for standard deviation to be meaningful and sometimes that data is hard to get or unreliable.

Average True Range (ATR) is probably a better volatility measure for swing traders as it is more sensitive and accurate than standard deviation in shorter time frames. By going a step further and dividing ATR by price you have ATR% which allows you to fairly compare an asset against itself through time or to compare different assets at the same time. Plotting a time series of ATR% gives a much better representation of volatility through time than straight ATR, whose line is skewed by changes in price.

Simple ATR time series actually disguise changes in volatility. If an asset goes up in price but has exactly the same relative volatility, the ATR time series will rise, which will usually be interpreted as increasing volatility when that is absolutely not the case. Choose your graphs wisely.

Depending on your time frame, you should carefully consider the effect of volatility on your strategy and choose a measure that best meets your analysis needs.

Profitable ETF Trading Strategies: Respect Volatility, use its power for good

Posted by Ken Long on April 11, 2009

At the most fundamental level, volatility is the fluctuation in the price of an asset. The greater the price swings in the shorter periods of time, the greater the volatility. Periods of great volatility are like thunderstorms. They get your attention.

Volatility is an absolute requirement for a trader to make money. Most investors look at volatility with fear and trepidation, and properly so, because wild swings in price are an indication of uncertainty about the fair value of the asset in question. This uncertainty will play havoc with your bottom line as an investor. It is a normal tradeoff consideration for investors to give up the potential of outsize gains in exchange for protection against downside volatility.

It is clear from scholarly studies that increases in volatility correlate strongly with declines in equity value. If you look at bear markets you see volatility everywhere, leading to tremendous gains on up days and tremendous losses on down days. This volatility is what drives longer term investors to the sidelines and creates the window of opportunity for longer term value players to establish excellent entry points for long term holdings in beaten down companies and sectors. This eagerness to buy value at a discount is why we see buying pressure even in the midst of the worst bear markets.

Traders who are looking to make their living off the buying and selling of inventory need the volatility of longer term position traders and short term scalpers to move price in swings that last long enough for them to realize their gains while offering the buyers and sellers from other time frames reasons to get in and out of these positions as well.

Because swing traders do not need fundamental beliefs in their positions they are able to operate successfully in swing trades during bear markets, and provided that they can manage their risk in the periods of higher volatility, should be eager to trade on the most violent of days in the market. For a swing trader the greater the intraday volatility, the easier it is to see opportunities and frame favorable trades in terms of reward to risk.

Like electricity, volatility can be your best friend or your worst nightmare. As a trader you must learn to use the power of volatility responsibly and effectively. Stay grounded and respect the power for your own good.

Profitable ETF Trading Strategies: Good traders know and exploit their edge

Posted by Ken Long on April 10, 2009

As an individual trader, you must be absolutely clear about where your edge is in the market place so that you can ensure your trading strategies are designed to put you into positions where your edge can make the difference against the average market return.

Let's be clear too: your edge must give you a reliable means of achieving better than average market returns or you are much better off simply buying and holding lowest cost broad market index exchange traded funds. To do otherwise would be a waste of your time and get you a lower than easily achievable return on your capital.

When I consider institutional traders, I see their advantages in computing power, depth of fundamental research, administrative trading cost efficiency and legitimate inside information, I quickly conclude that there is no way I can find an edge by trading in direct competition with these organizations on a fundamental basis.

This means I am going to steer clear of situations where my edge would consist of having a better understanding of the fundamental business model and market opportunities of individual firms. The fact that so many businesses go out of business due to misjudgments of market conditions when led by experts who have a made a career out of narrowly focusing on that line of business suggests to me that I cannot hope to have an edge in fundamental analysis.

I also know that I am not capable of scalping better or market making better than brokerage houses who are fighting for fractions of pennies on large volumes in time periods measures in fractions of seconds. So I will stay out of that trading environment as well.

I know that I need enough opportunities to allow my statistical edge in trading to manifest, and so I cannot afford to have overly long holding periods and wait for the ship to come in. I believe I need to be like Walmart and trade in quality merchandise that everyone wants, take my decent profits quickly and cycle through inventory efficiently. I want to be the swing middle man helping the market achieve orderly distribution.

This leads me to look for my edges in the swing trade time periods of 1-5 days, and looking to lock in profits and/establish no-lose positions as early as possible on the entry day, and only hold overnight when I have clear indications that the extra overnight risk is justifiable.

Know your edge and stay within your area of competitiveness.

Profitable ETF Trading Strategies: Stalking your way to success

Posted by Ken Long on April 10, 2009

One of the more neglected topics in trading systems development is the concept of stalking. Traders, particularly early in their career will tend to spend a lot of time, if not all of their time, focusing on the entry, reasoning that if they can get that part right they will have some control over the market's inevitable follow thru, which must go according to plan, because of the predictive power of their perfect entry technique.

If, as a trader, you are able to survive this philosophical approach to the market, based on certainty, control and predictability, you will move along to other aspects of a complete trading system, like the exits, position sizing, trade management of open positions, portfolio heat, overnight risk management, re-entry and matching system performance to specific market conditions.

These are non-trivial issues in the development of an effective system. Stalking the trade however has to do with the period before the trade is engaged, and offers you opportunities to leverage what may be your greatest edge as an individual trader, if you have discipline and patience to do it properly.

I believe that stalking is intimately and directly connected to your deep understanding of the edge your trading system has. The better you understand your system and your edge, and the market conditions that favor its use, the better the position you will be in to stalk effectively.

Think of a group of hungry lions on the hunt. Their stalking consists of knowing their market (their prey) and where they will inevitably congregate in large numbers (watering holes and grazing lands which represent their trading opportunities). Effective stalking consists of taking advantage of their natural strengths in the market conditions that favor their methods.

Lions will sniff the air at a hint of a suggestion of the possibility of their prey. They will scan widely and continuously and begin flowing the scent until they can vector in on their target and begin their hunt in earnest. Their stalking gets them reliably into the right position to begin the hunt. That's what your stalking must do for you.

Your stalking should include some early warning signs that let you know the market and trade conditions that favor your system are starting to emerge from the market mosaic. You can start posturing yourself for action early enough to conduct trade framing and execution rehearsals, and contingency planning, so that if the favorable conditions continue to develop you will be able to take the trade in stride, with full preparation and risk management in hand.

Depending on the nature of your system and your edge, your stalking may take a different form, but it will always incorporate an early warning system, preparation planning and rehearsals if you want to achieve best results.

Patience and discipline are the essential qualities of mind that you will need to exploit your deep understanding of your edge.

Profitable ETF Trading Strategies: Choose your self-talk wisely

Posted by **Ken Long** on April 9, 2009

The words we use matter. Words have power to shape our outcomes and direct our way through the future. Language is connected to our deepest emotional centers and affects us in profound ways. Steven Pinker makes the point that it is the artifact of language which distinguishes us from other species far more than the physical fact of our opposable thumbs.

Our language is our most powerful artifact. Our pattern making, adaptive, evolutionary brain manipulates these word symbols, loaded with deep seated layers of meanings and thereby creates the world that unfolds in our consciousness after the shaping has occurred in the subconscious.

Imagine the following case, where a trader has researched and validated a particular strategy through a combination of rigorous back-testing as well as live system prototyping. The system uses relatively tight stops in order to take advantage of short, sharp intraday moves. Over the past couple weeks, the trader has seen decisions to exit be immediately followed by reversals in the direction of the original trade. Because of the strategy's lack of re-entry rules and criteria, he has had to stand aside and watch profits accumulate that are many multiples of his original risk. It has happened frequently enough that the experience is beginning to cloud his judgment with respect to future trade decisions to enter and exit. The trader says to himself: I can't believe how ***stupid*** I am to be exiting and not re-entering.

Left unattended, the word ***stupid*** will sit and fester in the trader's psyche, charged with negative emotions which accumulate until he reaches a threshold of built up emotional charge that triggers an extreme reaction at a most inopportune moment.

The trader could have just as easily chosen the following words to characterize his behaviors and decisions: "I am grateful for the discipline, foresight and strength of character to adhere to my rigorously tested rules, which prevent me from exploding my account. I will add this new potential opportunity to my research list and discover whether or not I truly have an edge through re-entry or whether this is another example of the pattern matching brain's selective memory that is in force."

I think you can readily see which self talk is healthy and professional and will lead to better future results. Choose your worlds carefully and install positive learning loop words.

Profitable ETF Trading Strategies: Finding your best mental state for trading

Posted by Ken Long on April 9, 2009

In previous articles I have described my concept of the "zero-state", and the combination of personal satisfaction and improved bottomline performance I get when I trade from that state.

In this article I want to describe some other mental states that traders I know find useful and consider the implications for your own journey of self discovery and trading mastery. It is my hope that you may discover that it works for you or that the journey of discovery may awaken you to other states along the way that you will find equally satisfying and useful.

After all, trading from an emotion free state (like my description of the zero state) may not be the best mental state for you. For example, I know traders who find it necessary and useful to achieve a state of emotional alpha male competitiveness in order to enter the ring of combat, which is how they perceive the markets and interpret their role.

Without being mentally prepared for the combat they anticipate, and therefore see, they will be undercutting their own effectiveness in the trading arena.

Another effective trader I know has a need to see himself as a pure mechanical businessman and must take a different approach: that of disinterested observer. He gets so disinterested that he cannot even watch the trades unfolding lest he start adapting his rules in mid trade. His analysis showed that this was not adding value, and so his mental state needed to be as far away from engagement as possible.

These were just 3 examples of different mental states being suitable for effective traders, which implies that there may be as many unique states as there are traders, which means that you must use introspection and self knowledge to discover what works for you psychologically as well as needing to examine trading strategies that suit your personality, time frame, risk profile and working hypothesis of market behavior.

How will you know? Know thyself, consult with trusted others, but above all else, make sure you are trading with real money in very small position sizes to assess the effects of market, system, money and self on your total trader's performance system. Without that essential step you are postponing the day of judgment. The sooner you get into the game, the sooner you will engage in real learning.

Profitable ETF Trading Strategies: Experiencing the Zero-State

Posted by Ken Long on April 8, 2009

For me, achieving the zero-state is a necessary precondition for trading at my peak. In other essays I have described it as a place where adjective pairs of mental states cancel each other out, leaving only a moment of pure being.

It is the space between the words that we know, a moment and a place of freedom, where all notes may be struck, the moment precisely before the next action occurs.

For a horn player, it is the moment where he has gathered his breath and is prepared to initiate the note, the pure balance point between inhale and exhale.

For a diver it is the moment of motionless serenity between ascent and descent.

Imagine a Cartesian coordinate semantic grid system with adjective pairs arrayed about the origin, with each word having its precisely paired antonym and where the midpoint of the ray that connects them is bisected at the origin. That spot in the semantic meaning grid is where I seek to trade from in order to have my trading takes its purest expression in both action and no-action.

When I trade from this moment, this place, my results generate neither joy nor sadness, and simply are what they are. This allows me to enter the next trade with no emotional charge.

It is also keenly important to my style of trading where I am looking for the hesitation point in a channel trade or in a breakout, where price remains poised between fear and greed, where bulls and bears are in timeless balance and the next leg of the move will begin just as the last leg ends.

When I am able to stalk the price to that moment of harmony, that zero-state where momentum transitions I am able to refine my entry to very tight levels and find initial capital preservation stops that are absurdly close, which enable me to minimize open risk and move to "no lose" trade conditions very quickly.

When I know that barring an interruption of connectivity or market discontinuity I will never do worse than break even, this is an immensely freeing psychological state to be in as a professional trader and yet its value for me is in the spiritual nourishment and satisfaction I experience having a brush with Truth and Perfection in a small way for a fleeting moment in my life.

In judo we speak of a moment in a throw where you and your partner are equally sure that the other judo player is throwing you with exactly the same force and skill as you are throwing them. In that moment the throws stop, time slows, and you are suspended in a moment of pure being.

What I like about trading is that as I approach the zero state my equity curve smoothes and my trading practice is rewarded

Profitable ETF Trading Strategies: Trading From the Zero-State

Posted by Ken Long on April 8, 2009

One of the most important qualities of the professional trader is the ability to manage your psychological state.

Psychology is such an important component of shorter term trading that it can make all the difference between success and failure.

In my own trading, the essential state of mind I must be in to trade at an optimal level is what I call the “zero-state”.

For me, it represents an emotionally neutral state that is neither happy nor sad, neither overconfident nor fearful. The adjective “calm” starts to come close to what I mean but there is an important difference.

“Calm” is part of an adjective pair, whose partner has precisely the opposite meaning. “Stormy” is usually given as the antonym. For me, this moment is one that may not be contained in a conventional adjective that describes a state, because I associate adjectives as being part of a word pair, with its opposite on the other side of the continuum whose exact center I think of as “zero”, as on the number line.

Conceptually, the Japanese term “mu” comes fairly close to this idea, having been variously described as neither yes nor no, but a state in-between that does not acknowledge the question being asked as one that may be answered by wither yes or now, with the answer existing in a different plane of reality.

Serenity is a word that describes a state that comes even closer than calm, because it suggests for me something more like a timeless eternity of “no-emotion”, where I am not connected to the outcome in a personal meaningful way.

For me the pure form of the act of trading is to achieve a timeless correctness, to take actions or to refrain from actions in perfect balance with the needs of the market at that moment, to be nothing more or less than that which is required ideally.

In Cartesian coordinates the point (0,0), is called the origin and is central to all subsequent mathematical operations. It is the point from which all action begins and where excursions are grounded for reference. It is the ultimate reference point that links together individual cases.

Profitable ETF Trading Strategies: How science can improve your trading

Posted by **Ken Long** on April 8, 2009

Trading by its very nature is filled with uncertainty. Any human endeavor that has such a strong psychological component must be uncertain, until such time as human nature itself undergoes a fundamental change.

It is uncertainty which helps make a market for assets. It's what helps drive the discovery process to uncover the relative value different parties place on an asset. It encourages risk-taking behavior in real time to anticipate the short term future direction of prices.

Uncertainty and psychology don't necessarily make it easy on the trader to act with confidence and commitment. On the contrary it provides opportunities for self-doubt indecision, and will often keep you on the sidelines when your rational mind and trading system may signal you to act.

Traders that set aside the uncertainty of the moment and act with conviction based on sound trading principles and thoroughly vetted trading strategies have a definite edge over those who are coming from a weak place.

One of the mental disciplines that I have found to be very helpful has been to adopt a trading approach that relies on a scientific metaphor to focus my mind and free me to act in a sound manner. Here is the technique's basic approach.

Once you have a reason to believe in the soundness of a basic strategy, define the boundaries of the idea and circumstances in which you have an edge.

It may be in a price level, in a chart pattern, in a combination of indicators that have yielded statistically sound returns in certain market conditions that are now in play.

Find the specific price levels that give you clear evidence that:

1. the idea is beginning to work

2. the idea is failing

3. the idea has fully manifested itself and the profit target is realized

These specific price levels allow you to define your initial risk, set the triggers for entry, initial capital preservation stop, and profit target to harvest your reward for action.

By clearly defining the terms of your trading idea you have established a hypothesis that can be tested based on the pure evidence of price and eliminate some of the counterproductive self talk that leads to inaction. It allows you to let the trade decide its own results, and gives you a case study that can add to your knowledge of the system's performance.

By trading it at a risk level that allows you to dispassionately separate yourself from the results you allow the trading idea to stand on its own merits and remove the variable of your own discretion from the mix.

This approach is not a natural way to think about the market, but it can do wonders for your discipline and your bottom line if you have reasonably robust trading strategies.

Profitable ETF Trading Strategies: 8 attributes of quality research

Posted by Ken Long on April 7, 2009

There are plenty of snake oil salesmen in the financial advisory business, but there are by far many more conscientious professionals prepared to act as good fiduciaries for you. At the same time there are many people willing to take on full responsibility for the design and implementation of some or all of their own investment program.

This article describes **the characteristics of quality financial research**, to help you identify the difference between quality and snake oil, using the standards of scholarly research to inform our decision-making.

What distinguishes quality research in any field from pure opinion has everything to do with rigor, the design of experiments, and a respect for the difficulties in pursuit of the truth.

If you can see the following qualities in the research of someone who proposes to provide you advice or financial services then you can have more confidence in achieving your financial goals.

Quality research should be: systematic, controlled, empirical, amoral, public and a critical examination of the world, informed by theory, and framed in a hypothesis.

Here are some brief insights to get you started down **the path of critical thinkin**g:

1. **Systematic**: the research program should be unhurried, thorough, comprehensive and organized. There should be evidence of an attention to detail and a commitment to completing the testing no matter the time or complications in performing the work.

2. **Controlled**: care should be given to establish the difference between correlation and causation; in the identification of cause and effect and in identifying dependent and independent variables.

3. **Empirical**: we want to see evidence from the real world, that is replicable, verifiable, in the case of back-testing we want to ensure that only the information available at the time is used in hypothetical decision-making in order to be truly realistic.

4. **Amoral**: we want facts and conclusions to succeed or fall on their own merits, and in pursuit of truth; not simply to support a biased opinion.

5. **Public**: we want to see all the details of the research and they should be independently verifiable; we don’t want to see black boxes or special testing circumstances unavailable for inspection.

6. **Critical examination**: real scientists are concerned about overstating their claims and are in search of evidence to disprove their hypothesis, rather than looking for reasons to agree with their suppositions. A scientist is concerned about finding the hidden flaws in their own reasoning and hypothesis, because of the implications of their conclusions.

7. **Informed by theory**: we want the world to conform to reasonable processes; this bias helps protect us against statistical anomalies and data mining.

8. **Framed in a hypothesis**: we want to see how the experiment can allow the hypothesis to be disproven in a clear-cut, meaningful way. We want the ideas to be testable and falsifiable in unambiguous terms.

These ideas are strongly related to a conceptual approach to trading which establishes price levels at which we can state clearly that our idea is either working or failing, which gives us explicit criteria for entering and exiting.

Profitable ETF Trading Strategies: You don't have to be "right" to make money

Posted by Ken Long on April 7, 2009

What happens when you have placed your trade and you immediately have second thoughts as you watch the market moving against you?

It is a normal trading experience to have a position that has moved in your favor a certain distance but has begin to stall before it reached the price that you were expecting it to reach, or which you have established as a reasonable price target.

As soon as you see the price start to reverse and move against you, you are presented with the age old problem of whether or not you should cash the partial win or remain disciplined, and true to your trading plan and let the price go where it will.

Psychological studies have repeatedly found that we are affected emotionally about three times harder by our losses than our gains. So, to see a profitable position move against you into the red is especially painful because you have experienced the loss of profits (which you will measure from the highest high of the trade) compounded by the triple pain of a loss.

Unfortunately all traders who have experienced this decision have also seen what it feels like when they have taken the partial profit and then witnessed the position reverse once more and zoom upwards to new highs immediately after exiting their position. The emotional response to missed profits hurts just as much as actual dollars lost according to psychologists.

Because of the way our brains are wired the instances where we chose incorrectly stand out more in our memories than all the times we made the "right" decision.

After this has happened to you a number of times, you start to second guess yourself, and you can get gun shy about any decision you make, to the point where you cannot rationally approach the subject. It is common for traders in this psychological state to look for a perfect exit rule that allows them to be "right", to give them an insight into the "correct decision".

The truth is that no one has the perfect solution to this dilemma; no one can be "right" all the time.

The good news is that you don't have to be "right" to have an effective exit strategy.

What you need are psychologically acceptable rules for exiting and for re-entering positions. This means they must be acceptable to you!

By having a good re-entry plan you no longer have to worry about missing the great move that kept you in a position that was moving against you. This gives you the confidence of capturing the profit in hand before it disappears and becomes a tangible loss.

By being effective in preserving capital and profits, and by being able to re-join a winning position you can stop worrying about being "right" all the time, and simply concentrate on making money.

Profitable ETF Trading Strategies: 3 Tips for developing a market classification system that fits your style

Posted by Ken Long on April 7, 2009

In previous articles I have described why a market classification scheme is a high payoff strategy for improving your trading results. I now want to describe a few things for you to consider as you look to take advantage of your edge in market classification.

Focus on the following issues to make sure that your research efforts can be applied to your style and objectives. Remember that you are not in search of eternal truths for all times and places, for all traders and styles. You are just trying to make a reasonable, risk-adjusted return on your invested time and money to achieve financial freedom. This will take you down different paths than those of the pure academic, and with the intent of adding value to your bottom line.

1. **Focus on your time frame for trading**, especially if you are looking initially to supplement your income and have not yet made the leap to full time, professional, independent market trader for a living. You will have constraints placed on your time by the competing demands of work and family and there will be some styles that are simply not within your reach. No sense trying to develop a classification scheme for a style that will not fit you.

2. **Identify interesting markets and targets for you to specialize in**. You want these to offer you the kinds of volatility you can trade yet are within your tolerance for excitement. As a trader you must trade on volatility, the fluctuation of price around the idea of "fair value". It will be important for you in the early years to focus on markets that you find appealing and interesting and about which you will develop a feel and an expertise that will give you an edge. It is these markets where your classification scheme can be informed by both art and science.

3. **Look for a blend of art and science** in your classification scheme. Find elements of the market's behavior that may be expressed as rules, like seasonal volatility cycles, time frames that seem to repeat, typical patterns and express those quantitatively. Find those patterns and themes that seem to emerge in the course of your trading to add an element of qualitative description to your scheme. By blending the best of both worlds you will have a market classification scheme that leverages the 2 primary domains of your cognition: art and science, qualitative and quantitative reasoning.

Your classification scheme will help you to interpret price into useful meaning which can be placed into favorable risk-managed action.

Profitable ETF Trading Strategies: finding an edge in market classification

Posted by Ken Long on April 7, 2009

One of the most common quests for trading excellence early in a trader's career is the search for an all purpose, robust trading secret which can be used to guide the trader through all markets, in all time frames, in any conditions, regardless of the instrument being traded, the size of the position, and your goals and objectives.

In some ways this is a legacy of the increasingly academic pursuit of truth in the marketplace fueled by the need for institutional money and those charged with a fiduciary responsibility for the money of others to employ only the most rigorously tested and objectively powerful strategies. The combination of sizeable management fees and the seriousness of the legal implications of being a fiduciary certainly are compelling reasons alone, but part of me believes that there is also a commitment to the scientific pursuit of objective truth that is there as well.

Almost every sound piece of academic research establishes that there are no enduring edges that an individual trader can take advantage of, and we are advised to follow efficient market theories in various forms to ensure we get the average market returns.

And yet there are traders who consistently make better than average returns. Many are simply lucky and have confused a "to-be-expected" run of luck with skill, and find themselves running out of luck when they are at their maximum exposure level, and are never heard from again except as an admonition to avoid timing the markets or aiming for more than average.

It is a paradox of course, since only by having individual actors striving for abnormal returns will the market mathematically achieve the efficiency required by academic theory.

When you peel back the onion a little and examine the traders who seem to have an edge not completely explainable by luck and the law of large numbers, there are many who have focused on their ability to link an assessment of market conditions for their selected targets to an appropriate strategy designed to exploit their particular edge.

Crucial to this strategy is the development of a market classification scheme that is related to the underlying dynamics of the chosen market, and which is in tune with the average length of holding positions so that favorable moments that are actionable can be identified.

Individual traders who have found a sweet spot for their edge can apply this idea to improve their average returns, and identify moments of higher than average expected returns. In other articles I will describe some ways that offer insights into this strategy.

Profitable ETF Trading Strategies: the Problem of “Maybe”

Posted by Ken Long on April 6, 2009

A lot of professional traders manage the complexity of the human psychological dimension of trading by removing their emotional judgment as much as possible from the system by using a mechanical system. In other articles I have described how even mechanical traders will have to address psychological issues that are a natural consequence of trading in any form. Clearly though, discretionary traders or blended style traders will see it more often and with greater intensity.

The question of maybe will often arise when you are in a position and you wonder “Maybe I should exit this trade?” when you see it moving against you, or stalling, but it has not yet reached either a profit target or your capital preservation stop.

Where does it come from? Maybe from our pattern-making brain which anticipates the near future and combines it with vivid imagery skills, is connected to our emotional brain center and our sense of risk. Maybe it just comes from a deep-seated sense that we are trading at too high of a level of risk for the volatility that’s associated with the current trade.

Our imagination will tend to exaggerate the potential future outcomes in both directions, expecting greater gains or greater failures than are likely to emerge. The more we think about the decision to be made, the more fuel we throw on the fire. We act as if our imagination carries the same force as the objective facts of current price action, and we are moved towards action, propelled by emotions and not facts.

What can you do about the “Maybes”?

1. **Trade at a lower level of risk** so that you can let your rules work as designed.

2. Invest in the effort and energy to e**stablish the validity and value of your trading rules**.

3. **Analyze the quality of your decisions** in the moment by comparing the results of the action you took with the action that would have occurred if your original trading plan were followed.

It should not surprise you to find that your memory of the individual trades turns out to be quite a bit different than the actual results when you analyze them. We will tend to remember those instances that confirm our opinions and forget all the times when it worked out the other way.

Armed with facts and analysis, and trading at a level of risk that you are comfortable with, you may be equipped with what you need to bring more discipline to your trading.

Profitable ETF Trading Strategies: Sources of Psychological Pressure for Mechanical Traders

Posted by **Ken Long** on April 5, 2009

How does a mechanical trading approach adapt to a complex market? When should you adjust your rules as a trader? Is there a place for discretion in mechanical trading?

A lot of professional **traders manage the complexity** of the human psychological dimension of trading by removing their emotional judgment as much as possible from the system.

They know that they **cannot completely eliminate their psychology** from their trading, because they know some or all of the following issues will continually come to the surface of their attention for resolution. Each of these common occurrences are likely to generate considerable psychological pressure that must be addressed even with the best mechanical system around:

1. the **purpose and objectives** of their system

2. their **appetite for risk**

3. their **capacity to manage the risks** that they get (often more than their appetite)

4. their own **response to the system's performance**

5. the response of **their significant others** to their system performance

6. **a changing market** that seems to have altered the availability and frequency of normal returns on capital (when you see other people making "easy money" and you are not, the temptation to intervene is large)

7. their response to **client concerns and ideas** if they are professional money managers

8. a willingness to look for **new opportunities and edges** in changing markets

9. a need to **feel personally connected** to your trading

10. a need to feel that **you are responsible** for your winning results, through your own actions and decision-making

All of these issues will become an integral part of the psychological dimensions of your trading. Some are positive and some are negative, and some depend on the particular results your mechanical system is getting. Each one though puts pressure on you to change your rules to accommodate the emotion that it generates.

It takes **a special kind of preparation and discipline** to be able to trade a proven, back-tested mechanical system strictly according to its rules. We are not naturally inclined to follow these kinds of systems which leads to so many decent systems being cast aside unfairly. Be prepared as a trader to manage these pressures. Notice I didn't say resist, because resistance creates its own problems later down the road. It is necessary to anticipate and then manage these emotional responses for the long term health of your system, your self and your bottom line.

Profitable ETF Trading Strategies: Mastermind Meeting Discussion Topics

Posted by **Ken Long** on April 4, 2009

How can we focus the Mastermind discussion group's attention? What kinds of topics are worth discussing? How do we keep the group on topic?

In previous articles we have seen how to find quality mastermind groups for traders, and how a Mastermind group can improve your trading practice.

When the Mastermind comes together in a group to discuss topics, there can be a danger that dominant personalities can seize the agenda and satisfy their own needs. For the group to remain viable for a long time, it is important that the Mastermind address a wide range of topics so that the needs of the many are satisfied. What can be very useful is to have a standing list of discussion topics, from which the group can rotate their discussions and ensure that over the course of a year that each topic gets sufficient attention.

Here is a set of 15 discussion questions that may help you get started in developing a long term commitment to trading excellence. If your mastermind conducts individual research and reflection on these topics, and then comes together for discussions, you will discover that the individuals will benefit greatly and therefore be more inclined to keep the group going.

1. Methods of identifying the proper strategy for a given market condition.

2. Methods of developing various strategies that can be robustly applied in many market conditions.

3. The difference between art and science in trading; how to improve in each area, and how to blend them into a grand strategy.

4. How to rapidly integrate the various pieces of research available into a coherent narrative that allows for reliable trading.

5. How do you get rapidly plugged into market conditions every day and especially after a long layoff from trading?

6. What does scenario trading mean and how can you use it to frame low risk trades?

7. How can you use multiple profit targets to help you manage decision points within a single trade?

8. Can your learning style affect which kind of trading style fits you best?

9. How does your learning style affect your after action reviews and reflections on closed trades?

10. How can you tell if mechanical trading is appropriate for you?

11. What self-assessments are useful to a trader's reflective practice?

12. How do you use position sizing to manage risks and achieve your system objectives?

13. What are your favorite techniques for trend following? In what time frames?

14. How do you efficiently generate a watch list for your trading style?

15. How do you trade morning gaps?

There are obviously many different answers to these questions based on your personality, psychology and style. And certainly there are more questions worth examining by your Mastermind. This list however will get you started in drilling down deeply into your core beliefs and hearing the philosophy and tips of others.

Good trading!

Profitable ETF Trading Strategies: being a good Mastermind member

Posted by Ken Long on April 3, 2009

We have seen in a couple of other articles the benefits that accrue to members of a good Mastermind trading group, and some ideas on how to find and join a good Mastermind group. Having joined a Mastermind, how should you behave?

Most of your behavior should be guided by the principles of **being a good neighbor**. Supporting the community of the Mastermind group includes the following ideas:

1. Watching out for your neighbors, which means observing their trading style and commentary and offering them thoughtful feedback designed to help them in their trading practice.

2. Integrity: this is an element of good citizenship. Your advice comes from your best place. You speak the truth as you see it. When you offer research ideas or the results of analysis, you have actually done the research and have taken care with numbers, facts, and references. The principles of good scholarship apply here.

3. Observing and respecting boundaries: Masterminds are not families, although they have familial moments. They are professional gatherings of like-minded individuals who share outlooks on the practice of trading which is intended to improve the way we earn a living. Now there may be some groups somewhere that purport to be Masterminds but are really social networks in disguise, either by intention or through lack of professional focus. If your goal is to be a professional trader you should move on to another group which shares your focus.

4. Pitching in to help those in need. Sometimes people will ask for help, and sometimes it is up to you to sense the need and respond even if the recipient doesn't recognize the need yet. Respectful help is called for, perhaps even an intervention. But remember that horses can be led to water but may not want to drink and there is only so much you can do for people. Sometimes all you can do is make a good faith effort to show the way or share an insight.

5. Accepting good faith offers of help. In the same way, there will be times when people offer you advice and help that you may not see a need for, and you may consider this to be a breach of personal space or simply an insult. Give your mastermind members the benefit of the doubt in these cases and presume their intervention is coming from a good place and is intended to help you. Who knows, you just might be wrong and are being shown the way out of a dilemma you may not even recognize.

6. Accepting advice in the spirit it was intended: Even if the truth can be hard to hear, or you disagree with the insights or recommendation, be grateful that the members of your Mastermind have your best interest in mind.

It is true that in the end, **only you are responsible for all of your trading results**. But it is also possible to find a great deal of comfort, insight, support and ideas inside your Mastermind. Cherish the connection to fellow traders and work hard to improve your own practice and the practice of others. Your diligence, patience and care will be rewarded in many ways.

The Snapping Turtle trading technique: a case study

Posted by Ken Long on April 2, 2009

Here is a snapshot of one of our bread and butter intraday trading techniques: the “Snapping Turtle” technique which in Coca Cola (symbol: KO) turned in another reliable trade as the market melted up today. Chart 1 reflects the situation at the moment of entry. Our analysis suggested that if price were to move thru support at 45.30, KO would enter the “green zone” and offer a burst of gains

Chart 2 shows in fact that we got the move we were prepared for, and we cashed a nice gain in fairly short order, earning $3.67 for each dollar risked

Profitable ETF Trading techniques: Finding a quality Mastermind Trading Group

Posted by Ken Long on April 2, 2009

Finding a mastermind that's right for you.

In a previous article I described some of the ideal qualities of a Mastermind for traders and the reasons why the social connections and personal support are so important for the lonely profession of trading. Maintaining emotional balance and energy are so important in this career.

How do you go about finding a Mastermind that fits you?

There are a number of different ways and what's more important than how you find it is the sense of fit you get once you are in it. If your trading style is to focus closely on a small group of symbols, you may have some luck with going to a yahoo or MSN stock room to look for similarly interested traders who hang out in the discussion boards. You will be quickly able to determine who the genuine professional traders are. Chances are though, that the low signal to noise ratio of the discussion boards will chase away the dedicated traders. But, if you do find someone or some group of people genuinely focused on real trading, you can invite them to a discussion area or a Mastermind forum somewhere else where, by invitation only, quality traders can gather to refine their plans.

Most stock gurus (in the positive sense) will have discussion areas on their websites, which is nice, because you know that the members there will share a common approach to the markets, and may be able to help you reduce your learning curve, particularly if the forums have been there for a while and have some archives or help files to share.

There are a number of financial advice or traders websites where many different kinds of traders will generally gather to discuss a wide array of trading ideas, systems, books, websites and so forth. These will generally not be focused enough for you to materially improve your trading, although you may find some people who are kindred spirits and may be interested in sharing some collaborative space elsewhere to mutually support the groups trading styles.

Elite Trader or ETFconnect are typical of these kinds of sites, with Elite Trader being very eclectic and ETFconnect having the added quality of being much more narrowly focused on Exchange Traded Funds.

Local investment clubs, library interest groups or members of a church with an interest in investing offer low risk ways of finding like-minded individuals that may fit nicely with your age and personality type. The only downside may be that as interests diverge you may introduce an uncomfortable element into a close personal relationship.

If all else fails you will find many hits going through Google or yahoo searches, but you will have to sort through a lot of noise these days to find a good group of actual traders.

Far more important than where you find a community of like-minded traders is the commitment you will make to each others' professional development and emotional support, but it is true that you will have to start somewhere finding people who are also looking for a mastermind. A good mastermind will go a long way towards improving your individual performance as a trader, and so it is worth the effort at searching, finding and participating in it.

Profitable ETF Trading Techniques; 10 qualities of a good Mastermind group

Posted by **Ken Long** on April 1, 2009

What can a mastermind do for you? Why should this be part of your trading practice? What are the qualities of a good mastermind?

Trading can be a very lonely profession particularly with online trading through a deep discount broker. At the same time trading places tremendous psychological pressures on you to win or at least not lose. Especially if you are counting on the win today to pay for your lifestyle. If you are in big markets, going against well capitalized institutions with the best in equipment, training, talent, research and size it can quickly become a lonely dark place.

The good news is that a mastermind can develop into a powerful ally for you. A good one will have some or all of the following qualities, at a minimum:

1. The group will have a charter, with a purpose and mission statement.

2. Group members will treat each other with dignity and respect, and be genuinely committed to share their best practices with others.

3. Members will listen carefully to advice, and will treat it as an offer to help.

4.The group will be flexible in its approach to solving the unique needs of its members.

5. It will help with a structured, disciplined approach to exchanging, recording and archiving information in a professional manner.

6. It will not just be a social club, although it will have a social component.

7. The traders will consider the whole person concept and not simply be focused on the relentless pursuit of money.

8. The group will demonstrate and support a professional work ethic.

9. Sensible use of technology will enable the group to collaborate efficiently and effectively through the web.

10. Group members will take care to enforce their standards of conduct with all members.

You will notice that there is a good mix of social and professional values and virtues as well as a description of how to exchange technical information. The Mastermind's social power may be even more important than the technical trading aspects of the markets, which can be simplified into a robust set of trading systems and principles for most people.

In future articles I will describe how to find a mastermind to join or how to create and maintain one with a group of friends and colleagues.

A thought experiment in leadership and identity

Posted by **Ken Long** on March 31, 2009

Here is a thought experiment to get your mental juices flowing:

Who am I?

- a multi-billion dollar enterprise
- with a long and distinguished history, filled with notable achievements, and some dismal failures
- has formerly held a position of international leadership for decades
- associated with a core function of any modern nation and economy
- provides products and services that are indispensible to modern life
- lately, appears to be disconnected from the "customer base" and out of touch with changing global trends
- has had operational failures attributed to leadership failure
- leadership executives have a clear, extensive career path and are carefully selected for promotions and positions of increasing responsibility
- current leaders are highly successful, career professionals with decades in the operational environment at the helm, and supported by world-class analysis and qualitative advice
- little to no evidence of having cost control over their core processes
- constrained by long term contractual obligations that are too expensive to maintain and too expensive to amend
- recent failures have become so visible and widespread as to be an object of public scorn and disgust
- current leaders are by all accounts bright, loyal, innovative, articulate, humble, decisive, experienced, highly educated, nuanced, intelligent, thoughtful, good listeners, respectful of other points of view

Under what conditions do the positive attributes of leadership become irrelevant to the current situation?

By what criteria should we evaluate the situation to determine if those conditions are met?

Can we know the causal factors that reliably lead to success? How would we know we are right?

Can success come from unpredictable variables? If so, what does that say about our model of leadership and the qualities we look for in leaders? Has this dialogue affected your opinion of the concept of leadership? What are your reactions?

Reflective learning and Self Talk

Posted by **Ken Long** on March 30, 2009

At our trading workshop this weekend, we reviewed a number of what I consider to be million dollar ideas: ideas which, over the course of a lifetime should produce a net value add greater than a million dollars in trading performance. While we were doing that in the middle of our assembled traders and institutional money managers, the idea of reflective learning came up several times. Here is a key insight:

When you are viewing charts of previous trades and you suddenly see a pattern or a technique that was not apparent to you the first time, it is easy to classify the failure to see it and act upon it as a “mistake”. Think about the power of the words we use to characterize these kinds of events. If you call it a mistake then you are basically treating your reflective learning as an opportunity to beat yourself up. Is it really healthy or useful to feel terrible about missed opportunities that you only discover by opening yourself up to the possibility of learning? No wonder we hate school.

It's not fair to label the person we were in the past in the heat of the moment of trading, sitting here in the comfort of our ivory tower, no stress and with the perfect insight of hindsight.

Leadership in Complex Adaptive Systems

Posted by **Ken Long** on March 30, 2009

Team Obama is placing their bets on the idea of Leadership being responsible for results.

The latest manifestation of this is in the call for the resignation of the CEO of GM, Rick Wagoner. The proposition is that Obama, from his vantage point of President, USA (CEO, USA?) is in a position to determine that the causal factor in the failure of GM and Ford and Chrysler can be attributed to leadership and not, let's say, to one of the reasonable and possible outcome-states that happen all the time in the conduct of business in a complex adaptive system of world markets, where complexity precludes certainty.

The argument of complex adaptive systems (CAS) is that we lack the ability to compute cause and effect relationships and that we cannot "know" with anything like certainty, that a particular factor is the probable cause of a particular result at a particular time.

The problem with having a pattern-making evolutionary brain is that it uses pattern-making processes that lead to success in individual survival issues, where cause-and-effect is more plainly seen, and applies it inappropriately to situations that are fundamentally different in terms of size, scope, complexity and uncertainty.

Imagine a monkey that beats on a drum and is rewarded with a banana, regularly. Given enough iterations, he would be entitled to conclude that one event influences if not causes the other.

Imagine the monkey then gets thirsty and beats on the drum and it happens to rain and his water bowl fills up and he drinks. Do you imagine the monkey not concluding that his drum has certain important properties? And what if the tribe of monkeys gets mad at the first monkey because now when he beats on the drum it doesn't rain? Would they conclude it is a failure of leadership? The monkey lost his mojo?

Silly monkeys.

We know better than that. We'd never make that foolish mistake. It's obvious that drumbeats have nothing to do with rain. Clearly drums make bananas appear! Look at the evidence!

Is it a reasonable proposition that Obama can diagnose the carmakers' business environment and conclude that it was leadership failures of Mr. Wagoner that were the cause of the problems at GM …AND …. that the appropriate solution, here and now, is to fire him?! and this will have some direct measureable effect on performance in the foreseeable future? and that somehow the President has this ability to diagnose, assess and treat, when the collective wisdom of auto executives and boards, who have life long experience in the nuances of this complex business environment are unable to see that? And is it reasonable that this is his decision to make?

Take a look at Wagoner's background and experience and the collective experiences of the boards and senior leaders of GM and Ford and compare that to the executive experience, and the private commercial business experience of Obama and Team Obama. Now decide that IF YOUR LIFE DEPENDED ON IT, which group of people were in a better position to know what to do with GM going forward? The farther you are from the problem the more certain you are that your simple solution is both obvious and correct.

Now, take that same philosophical approach and apply it to the recommended solutions that Team Obama is applying towards every major issue of national concern and consider the complexity of each decision domain, and then consider the laws of unintended consequences, and the connectivity of the various elements of society and how they can affect each other in unforeseen ways, and consider just how smart it is to allow the newest kids on the block to make sweeping changes of national magnitude in very little time, with little to no public debate.

Then reflect on the wisdom of the Founding Fathers in creating a cumbersome system for creating change which prevents "the wisdom of experts" from changing things too far and too fast. We've plenty of evidence of what happens when you let "experts" run everything according to "expert plans".

My sense is that our national leaders are going thru a shaman's dance to assign blame and hope for the best. We might as well be selecting who we want to hold the rainstick to shake at the clouds to end the drought.

Seriously. Obama is qualified to say that Wagoner should be fired? How about, stick to your enumerated powers and leave the markets alone. Get us out of entangling alliances. Bring the troops home. Secure the borders, enforce the rule of law. Stop borrowing money to get out of debt.

Geithner the Tax Cheat had the nerve to lecture the nation to stop worrying about how much we make and focus on what we can accomplish with what we can keep. How about shut up until such time as you pay your taxes?

Leadership in complexity takes on different dynamics when the cause and effect rules of the system cannot be known.

My working hypothesis is that the adaptivity is improved by maximizing decentralized execution, combined with limiting the consequences of individual situations to the local areas much as possible. This design REQUIRES inefficiency, to allow other elements of the network to react, adapt and respond to “brushfires” in time to save the rest of the network.

This happens to be why DNA is the most successful adaptive construct on the planet: gazillions of small decisions, rapidly tested, where success is rewarded all out of proportion to the initial investment risk, but where failure is localized to immediate surroundings. Bad mutations die fast, and that’s the end of it, sorrowful as the individual case may be. But the successful mutations thrive and propagate and benefit the entire species.

In that kind of model of society or organizations, our understanding of leadership, of what it can do and be and what it should do and be, and how we evaluate it as effective or not, must be radically adjusted.

No, let me eat my own cooking, and say our understanding of leadership should carefully evolve.

The market is in a Washout pattern here

Posted by **Ken Long** on March 10, 2009

The entire market is in a Washout Pattern (WO) pattern here.

meaning:

- there is reason to buy the mechanical entry a nickel above the high of today
- there is reason to buy evidence of momentum prior to the mechanical entry in order to front run it, so that you can get a better average price
- there is reason to buy a gap down and morning hook up
- there is reason to be cautious of gap higher opening, where we should wait for a pullback and evidence of a hook back up
- there is **NO REASON TO BELIEVE** that **THIS ONE IS THE BOTTOM**
- everything gets measured in terms of risk:reward and we feed the bulldog every day

A reflection on Gold price volatility compared to the broad market

Posted by **Ken Long** on March 7, 2009

3/7/2009	Ticker	Avg Vol	Price	Daily$	ATR	ATR%	Seq
SPDR Trust Series 1	SPY	341,695,008	$ 68.92	$23,549,619,951	$ 2.95	4.28%	1
Nasdaq 100 Trust	QQQQ	148,600,000	$ 26.30	$ 3,908,180,000	$ 1.00	3.81%	2
iShares R2000 Index	IWM	71,836,800	$ 35.20	$ 2,528,655,360	$ 1.65	4.69%	3
DIAMONDS Trust	DIA	30,067,800	$ 66.50	$ 1,999,508,700	$ 2.45	3.69%	4
iShares MSCI Emerg Mkts	EEM	80,230,704	$ 21.10	$ 1,692,867,854	$ 1.08	5.10%	5
streetTRACKS Gold Shares	GLD	18,302,800	$ 92.29	$ 1,689,165,412	$ 2.63	2.85%	6
Energy SPDR	XLE	39,103,500	$ 38.79	$ 1,516,824,765	$ 2.18	5.62%	7
Financial SPDR	XLF	188,452,992	$ 6.18	$ 1,164,639,491	$ 0.66	10.74%	8
iShares MSCI EAFE	EFA	34,750,100	$ 32.58	$ 1,132,158,258	$ 1.46	4.49%	9
Oil (barrel USD)	USO	35,656,300	$ 27.99	$ 998,019,837	$ 1.76	6.30%	10
iShares FTSE/Xinhua China	FXI	38,052,700	$ 24.00	$ 913,264,800	$ 1.29	5.38%	11
iShares DJ RE Index	IYR	39,316,300	$ 22.21	$ 873,215,023	$ 1.99	8.95%	12
Oil Services HOLDRs	OIH	12,055,800	$ 66.80	$ 805,327,440	$ 4.87	7.29%	13
MidCap SPDR Trust	MDY	9,265,550	$ 74.43	$ 689,634,887	$ 3.58	4.81%	14
iShares Brazil Index	EWZ	19,786,800	$ 33.47	$ 662,264,196	$ 2.17	6.49%	15
iShares S&P 500	IVV	6,011,110	$ 68.95	$ 414,466,035	$ 2.85	4.13%	16
Retail HOLDRs	RTH	5,478,240	$ 62.06	$ 339,979,574	$ 2.41	3.88%	17
Market Vectors Gld Miners	GDX	9,351,430	$ 32.88	$ 307,475,018	$ 1.99	6.05%	18
iShares Lehman 20+	TLT	2,904,160	$104.26	$ 302,787,722	$ 2.12	2.03%	19
iShares R1000 Index	IWB	8,054,070	$ 37.54	$ 302,349,788	$ 1.55	4.13%	20
Vanguard TSM VIPERs	VTI	7,589,500	$ 34.11	$ 258,877,845	$ 1.42	4.16%	21
iShares DJ Fin Sectr	IYF	10,566,400	$ 24.10	$ 254,650,240	$ 2.18	9.03%	22
iShares Japan Index	EWJ	32,897,600	$ 7.12	$ 234,230,912	$ 0.26	3.64%	23
iShares R1000 Growth	IWF	7,495,090	$ 30.97	$ 232,122,937	$ 1.14	3.69%	24
Semiconductor HOLDRs	SMH	14,337,300	$ 16.12	$ 231,117,276	$ 0.90	5.57%	25
iShares R1000 Value	IWD	6,454,370	$ 34.41	$ 222,094,872	$ 1.64	4.76%	26
Materials Sel SPDR	XLB	9,768,310	$ 18.40	$ 179,736,904	$ 0.90	4.91%	27
Industrial SPDR	XLI	11,367,500	$ 15.50	$ 176,196,250	$ 0.81	5.25%	28
Utilities SPDR	XLU	7,100,790	$ 23.18	$ 164,596,312	$ 0.94	4.04%	29
iShares GS$ InvesTop	LQD	1,554,210	$ 93.10	$ 144,696,951	$ 1.09	1.17%	30

would it surprise you to know that the Gold ETF GLD is one of the least volatile, by far of the most liquid ETFs available? that the equity market (as represented by SPY) is twice as volatile as gold?

How we read is who we are

Posted by **Ken Long** on March 7, 2009

There have been some blog discussions expressing concerns about the either/or problem of academic writing vs. blog writing, about how the digital age is driving us from being a Community of Practice towards communities of interest, inhabiting what Mr. Carr (below) describes as "The Shallows". See this important discussion at: **http://usacac.leavenworth.army.mil/BLOG/blogs/llop/archive/2009/03/03/an-appeal-to-cgsg-students-study-your-doctrine.aspx**

Peter Morville offers sobering cautions concerning how the act of search changes who you become in the digital age in his excellent book; "Ambient Findability" **http://www.amazon.com/Ambient-Findability-What-Changes-Become/dp/0596007655.**

Morville's idea is that you search for information in order to make important decisions which shapes your world and who you are. How and where you search them is crucial to shaping the future decisions and person you will become. Taking this idea to the extreme, you could wonder then about the importance to the human race of the particular ranking algorithm that Google uses (or by extension, any/all of the major search providers). If Google is the authority on what response you get from searching, and you then act on that information as if it represents a true reflection of the state of knowledge on the topic of interest, we have a compelling social and human interest in what lies under the hood. The craft of search engine optimization then takes on a whole new moral dimension. If most people act on information found on the first page of returns from a Google search, AND you can pay for placement of your site in the Google rankings, how are countless social judgments being shaped by something other than a commitment to the highest forms of Truth and scholarship?

The very proliferation of information (only some of which can be charitably called knowledge) creates a requirement for new cognitive skills to navigate the ocean of information and mis-information and places a higher value on critical reasoning and skeptical inquiry than ever before. It almost drives us to the wider but shallower journeys through literature and media just to ensure that what we have discovered through search has the qualities of completeness and representative sampling of thoughts on a topic. I know that this drives me to search widely and then only to selective depths based on my information needs of the moment on a particular project.

Here are a couple links to some additional, better ideas on this subject: **From the article** in The Atlantic "Is Google Making Us Stupid?"

*Thanks to the ubiquity of text on the Internet, not to mention the popularity of text-messaging on cell phones, we may well be reading more today than we did in the 1970s or 1980s, when television was our medium of choice. But it's a different kind of reading, and behind it lies a different kind of thinking—perhaps even a new sense of the self. "We are not only what we read," says Maryanne Wolf, a developmental psychologist at Tufts University and the author of **Proust and the Squid: The Story and Science of the Reading Brain**. "We are how we read." Wolf worries that the style of reading promoted by the Net, a style that puts "efficiency" and "immediacy" above all else, may be weakening our capacity for the kind of deep reading that emerged when an earlier technology, the printing press, made long and complex works of prose commonplace. When we read online, she says, we tend to become "mere decoders of information." Our ability to interpret text, to make the rich mental connections that form when we read deeply and without distraction, remains largely disengaged*

And then more from the same author in **an excellent follow-on interview**:

Cooper: You've quoted Richard Foreman, author of the play The Gods Are Pounding My Head, who says we are turning into "pancake people."

Carr: We used to have an intellectual ideal that we could contain within ourselves the whole of civilization. It was very much an ideal — none of us actually fulfilled it — but there was this sense that, through wide reading and study, you could have a depth of knowledge and could make unique intellectual connections among the pieces of information stored within your memory. Foreman suggests that we might be replacing that model — for both intelligence and culture — with a much more superficial relationship to information in which the connections are made outside of our own minds through search engines and hyperlinks. We'll become "pancake people," with wide access to information but no intellectual depth, because there's little need to contain information within our heads when it's so easy to find with a mouse click or two.

I see this same phenomenon in my own reading, largely propelled by my focused readings for a doctoral research program, but also based on a need to be widely aware, as a way of marking the location of depth-knowledge should I need to return for more data and deeper insights. I too haven't read a long novel cover to cover in the way I used to immerse myself.