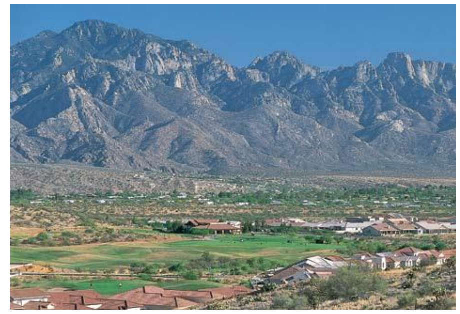
"Sharing real experiences from decades of profitable trading. Focusing on the important factors that lead to trading success."

Hello Oro Valley AZ and the Santa Catalina mountains



Factor Update, January 29, 2017

Market Review

New candidate *Factor Move*™ (trading set-ups) are developing in:

- *German Bobl
- *EUR/NOK

Candidate *Factor Moves*™ are currently ongoing in:

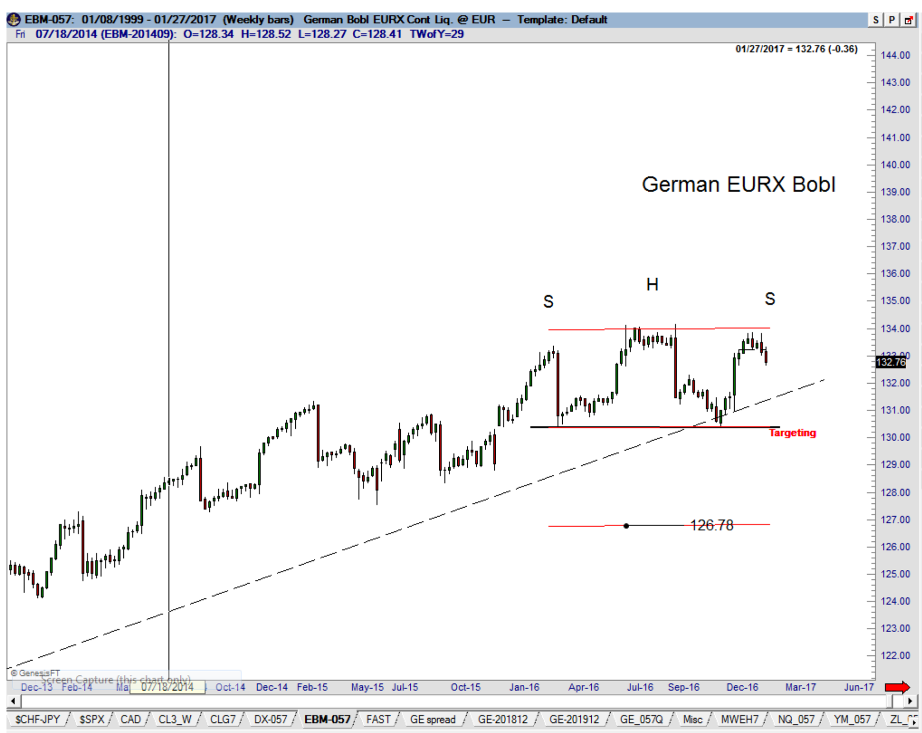
- *FAST
- FTSE 100

Other markets of interest. This issue also comments on *Mpls. Wheat, Crude Oil, Copper (futures and ETF), Silver, EUR/USD and *Corn. *Signifies a position in the Factor $100,000 Tracking Account

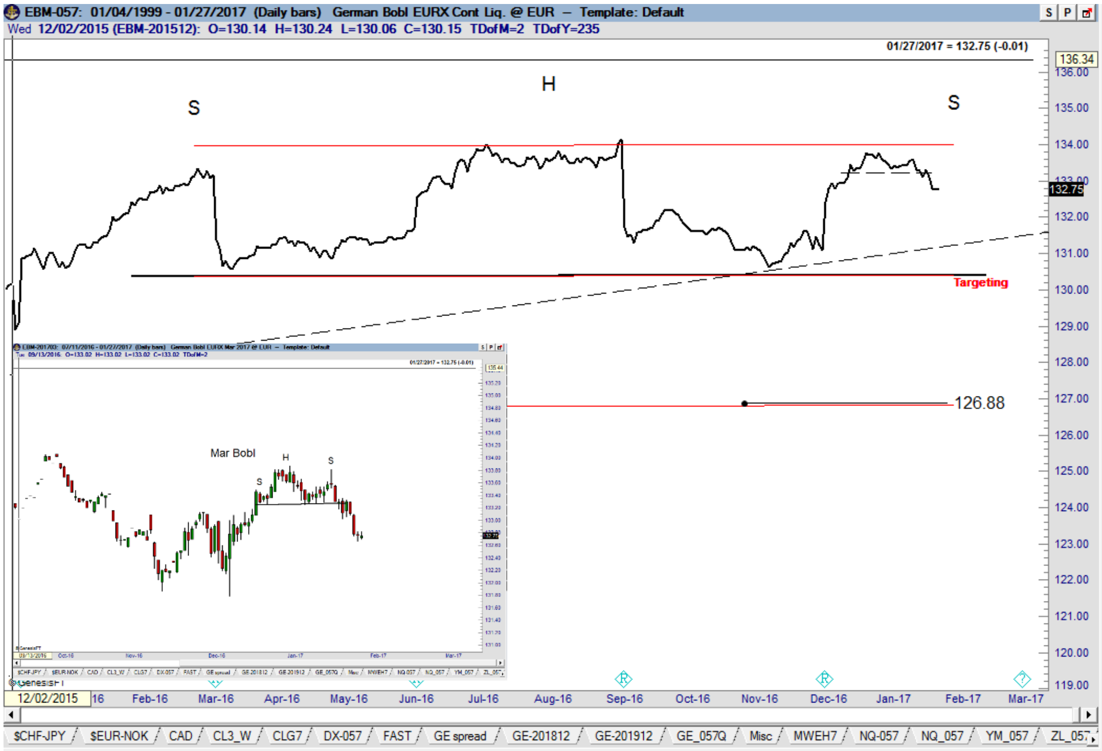
Developing signals	Existing positions
• EUR/NOK – entry order and protective stop • Crude Oil – order entry and protective stop • Silver – alert	• EUR/NOK – protective stop and target • Minneapolis Wheat – protective stop and target • Corn – protective stop and target • German Bobl – protective stop and target • FAST – protective stop
The Factor Tracking Account is currently leveraged at 2.7X The margin-to-equity use for futures and forex positions is 7.2%.	

Candidate Factor Moves™ Setting Up

German Bobl

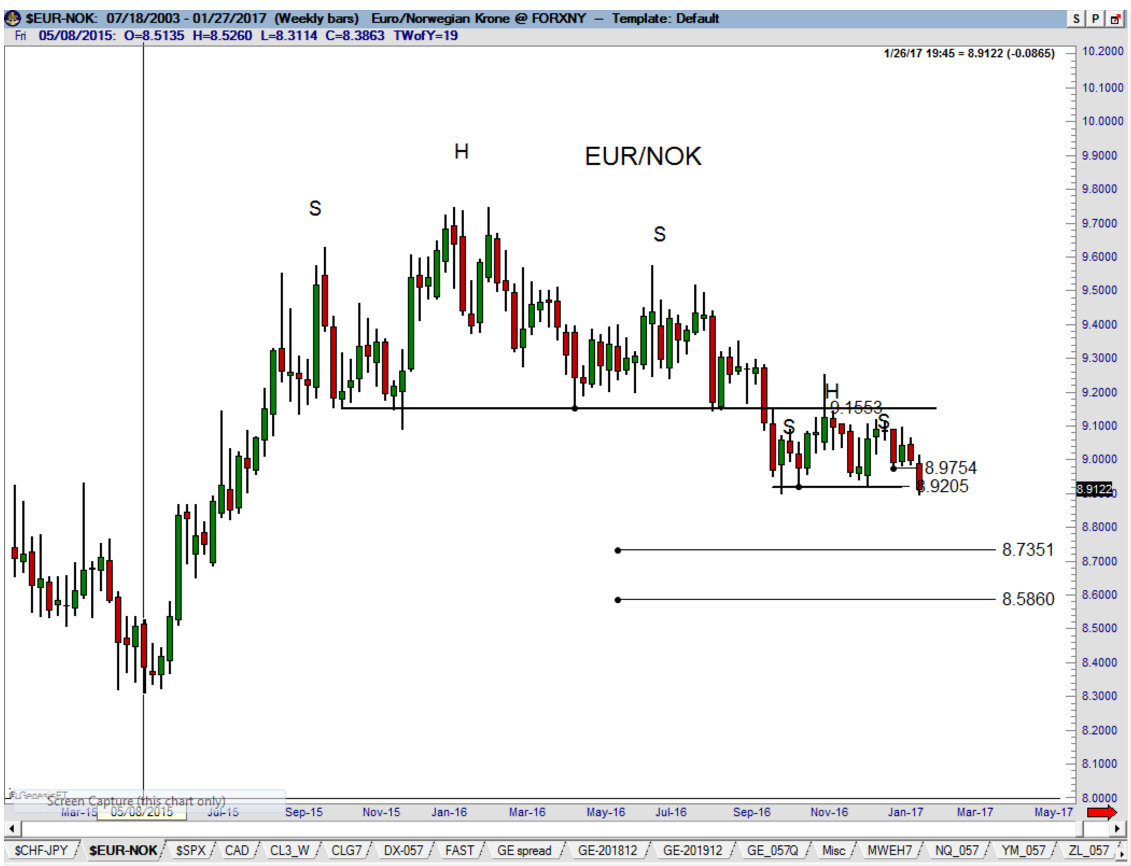


Last week's Factor Update included graphs showing the apparent discrepancy between Germany's inflationary forces and its sovereign debt yields. I concluded the comments on the Bobl (Mar contract closed Friday, Jan 20, at 133.12) by expressing plans to short any minor rally. The market rallied on Monday. Accordingly, the Factor is now short Bobl. The dominant chart construction is the possible 12-month H&S top on the weekly continuation futures graph. A decisive close below 130.20 would complete this pattern and establish a profit target of 126.70. I am well aware that the chart of the cash Bobl yield does not display a H&S pattern with the same clarity as shown by the continuation futures chart. Such a differential is not uncommon in global interest rate futures markets. The right shoulder of the 12-month daily H&S pattern, as displayed on the closing continuation daily closing price chart to the right, is a separate 5-week H&S top with an abbreviated left shoulder (inset on the daily closing price chart. This smaller H&S pattern -- completed on Jan 17 -- was the reason I was willing to short the minor rally on Monday.



EUR/NOK

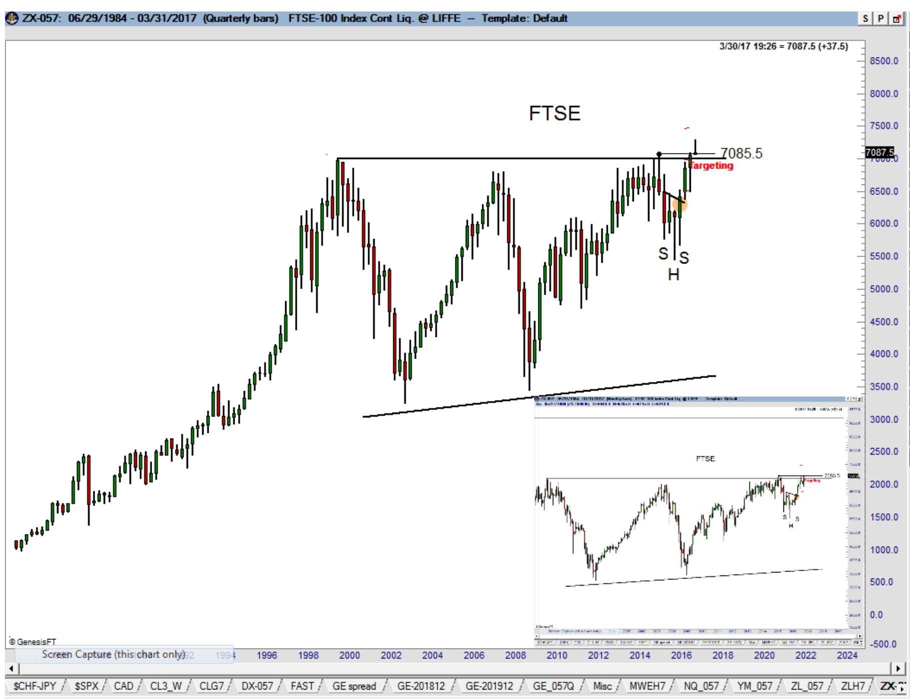
The dominant chart construction in this market is the completed 14-month H&S top on the weekly graph. This pattern has targets of 8.7351 and 8.5860. A 16-week H&S pattern on the daily chart has arguably been completed (see next page). Factor is short already EUR/NOK. I will short an additional layer early in next week's trading and an additional layer on a move below 8.8897.



Candidate Factor Moves™ in Progress

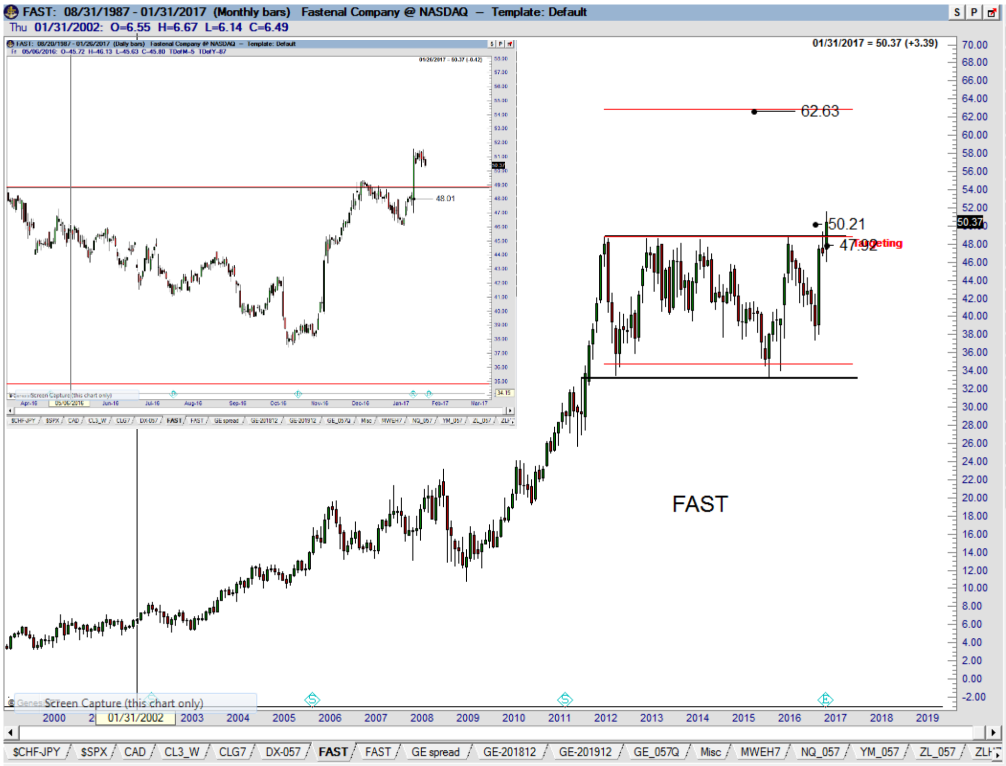
FTSE 100

The dominant chart construction in FTSE is the recent breakout of a 16-year price consolidation, best defined as an ascending triangle. Precisely defining a breakout level is very difficult on patterns of such length. I am interested in the long side, but only if the market can pull back toward 7,000, thus decreasing the risk of a trade. Absent this opportunity I will monitor the market for a continuation pattern.



FAST

The completion of the 46-month rectangle on the monthly chart is struggling to hold upside momentum. Nevertheless, the bull case on the chart has not been damaged. Factor is long FAST with a stop below $48. To date it appears that the upside breakout was a “one-day” wonder.



Other Markets

Crude Oil

A potentially bearish case can be made on the Crude Oil charts. The weekly chart displays a 17-month H&S bottom that is faltering at the neckline. A decisive thrust upwards is required to validate the H&S bottom. A potentially bullish pattern that cannot breakout more often than not results in a price decline of some magnitude. It is important to note that speculators hold a new all-time record long position. This leads to the following question – “Who is left to buy?” Commercials hold a near-record short positon, only exceeded by the short position held at the June 2014 top. Every once in a while record COT positions are resolved in the direction favored by speculators – but this is an EXCEPTION. Combine record commercial short positions with the failure of the weekly chart to hold momentum with a bearish picture on the daily chart and I am extremely interested in betting on a price decline. The daily continuation graph of WTI displays a 9-week H&S top. This pattern varies in appearance depending upon the exact Crude Oil chart being

viewed. The daily chart of Mar Brent Crude displays a rounding top (red box). Factor is flat. A decline and close by the active contract in WTI below 51.59 and by the Mar Brent Crude below 53.58 will represent sell signals with targets of $44 in WTI and $46 in Brent.

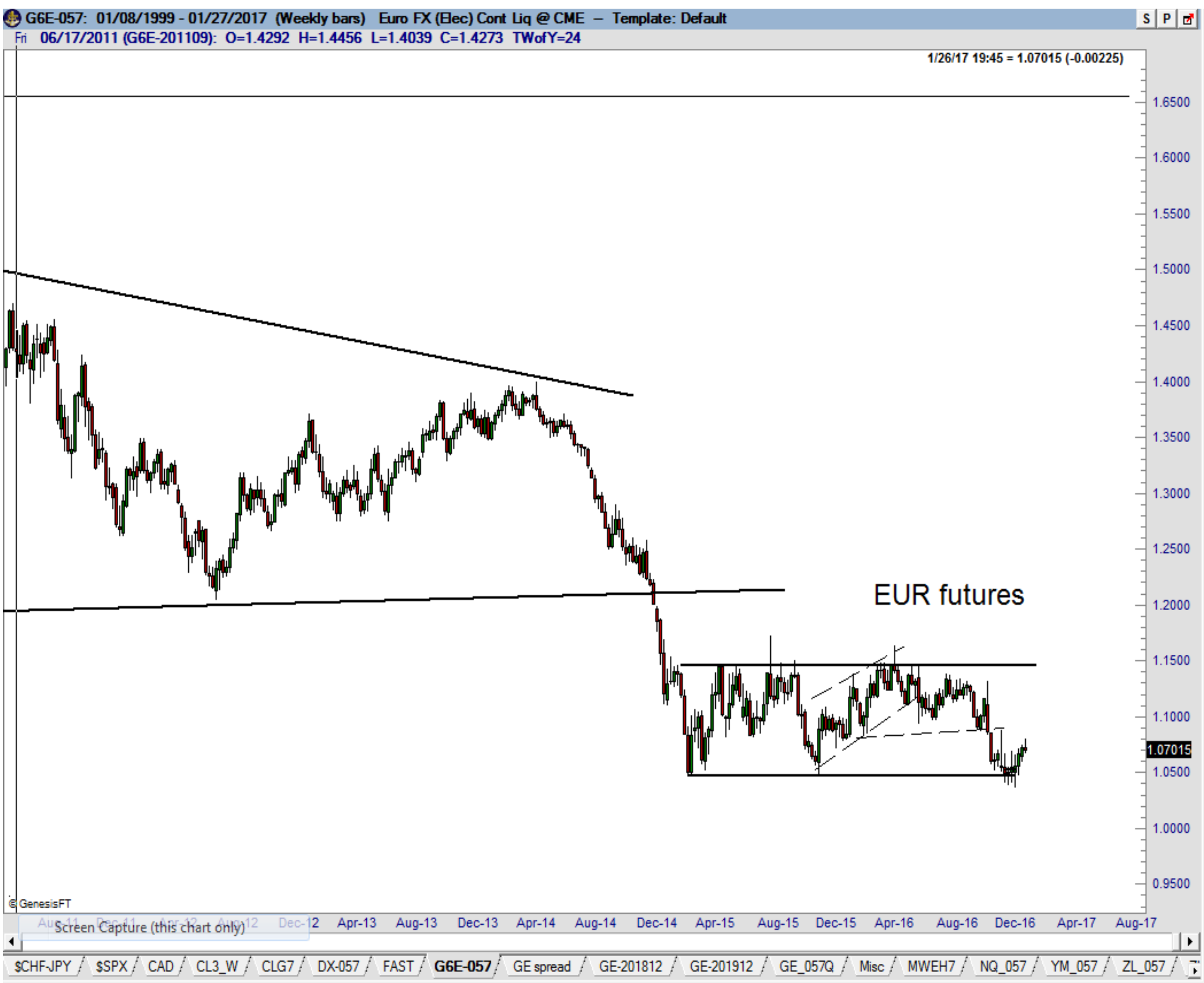
Silver

Silver is a market with a tendency to form H&S patterns with stunted or abbreviated right shoulders. This is currently the case on the daily chart. I would greatly prefer to see a decline below 16.40 followed by an advance and close above 17.50. Such a scenario would entice me to be long Silver. Factor is flat.

EUR/USD (spot and futures)

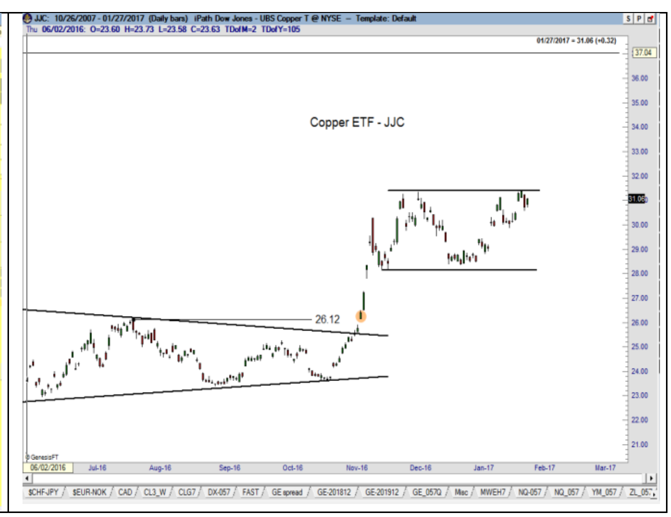
I am well aware that certain technical analysts and authors have assigned "probability-of-success" data to various chart patterns. In fact, there was an entire book dedicated to this idea. I am NOT a believer in assigning a fixed probability to any chart pattern. In the past I have discussed my perception that the vast majority of highly successful traders practice a form of Bayesian Probability – whether or not they are even familiar with the concept or name. I consider myself to be a Bayesian of the *subjective school* (in contract to the *objective school*). The Bayesian theorem assigns a probability to an event – but the probability changes as events unfold. Bayesian probability theory involves a number of extremely complex mathematical formulas. In his recent book, "*The Undoing Project,*" Michael Lewis provides a very brief summary of Bayesian probability (see separate PDF titled "The review of Bayesian probability by Michael Lewis").

So, what does all this have to do with EUR/USD? A lot, in my opinion. I believe there is a 75% probability that the high or the low for 2017 in EUR/USD has been made already or will be made within the next two weeks. Further, I believe there is a 50% probability that EUR/USD will trade at 95 cents in 2017, a 30% probability the cross will trade at $1.24 and a 20% probability that none of the above will occur. But, all of these odds are simply "base rates," not fixed rates. The odds will change as price evolves and more evidence becomes available. Thus, certain price behavior relative to the current 12-month rectangle will alter the odds. I am prepared to be either long or short EUR/USD when the odds favor an asymmetrical trading opportunity. Caution – Bayesian probability theory involves VERY detailed and complex formula. It is not my intent to simplify the complexity of the Bayesian theorem.



<u>Copper</u>

The daily and weekly charts of Copper appear to be forming an 11-week rectangle or ascending triangle, depending on how the boundary lines are drawn. A move and close above 274.40 would complete this consolidation pattern and establish an upside profit target of 300. I am willing to buy the breakout in Copper, but with a huge caveat. The market is coming off a period of all-time record spec long and commercial short positions (by a massive margin compared to the previous records). Normally I would shy away from buying a market with this COT profile. Yet, as I have pointed out elsewhere in this Update, there have been rare occasions when a market is resolved in the direction of a record spec long COT profile. In fact, the most outstanding example of capitulation by commercial interests occured in Copper in Oct 2003 – the period with the previous spec long and commercial short record holdings (see red vertical line on the monthly chart, next page). In that case the market went straight up for 2½ years with prices quadrupling. Usually commercial interests are right – but when they are wrong, they are dead wrong.



Minneapolis Wheat

I can envision at least two possibilities for Minneapolis Wheat. The first possibility is that the double bottom on the weekly graph will hold – and that prices should not drop too far below 5.60 before turning back up. This interpretation argues on behalf of buying Mar Mpls Wheat at 5.60. The second possibility is that the daily chart of the Mar contract will develop a larger H&S bottom pattern (inset) – this interpretation would indicate that the right shoulder high is in place and a decline toward 5.30 is possible. This second interpretation would argue against buying Mar Mpls. Wheat at 5.60, but instead closely protecting any existing long exposure. For now I am leaning toward the second possibility.

Corn

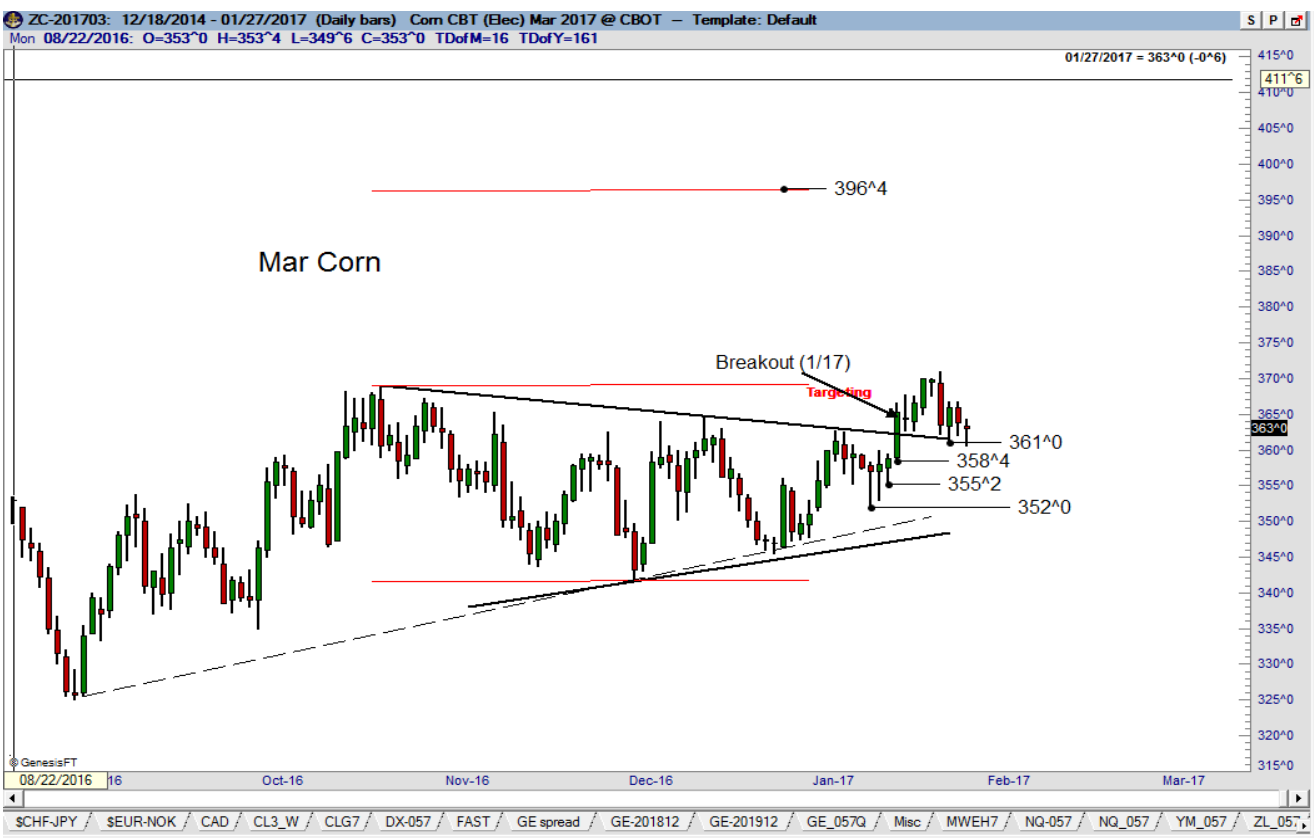
The Jan 22 Factor Update stated that Corn had completed a 12-week continuation symmetrical triangle, but that I had missed the Jan 17 breakout. Corn corrected this past week and retested the upper boundary of the triangle. Accordingly Factor established a long position using a GTC limit order. Remember, I use GTC 24-hour orders when attempting to buy or sell a commodity on an "or-better" basis, but day-session-only stops in all but the most actively traded markets (such as USD/JPY, S&Ps and a few others). Becoming long I was faced with one of four tactics for risk management.

1. Protect under Wednesday's low at 361, considering this to be the retest low. (This low was penetrated on Friday.)
2. Protect under the Jan 17 low at 358½ -- the orthodox Last Day Rule (see definition in "Diary")
3. Protect under the Jan 13 low at 355¼ -- the last full day within the pattern
4. Risk the trade to under the Jan 11 low at 352, the last minor low pivot within the pattern

All four of these risk protection tactics (or a combination thereof) would be correct and appropriate depending upon your approach to trading. I use aggressive and active trade management – meaning that I attempt to move to a "break-even-or-better" stance as quickly as possible. With this approach my sole focus is to lower the average basis point loss for losing trades while allowing profitable trades room to move. Each of the tactical maneuvering carries with it different considerations.

- Larger sizing can be established under #1 above when trade management is active and quicker, but the win rate will decrease
- Slightly smaller sizing would be appropriate under #2and #3 above
- Stop protection set at #4 above would produce the most favorable win rate, but sizing would be the smallest of the three tactical approaches

Over the years I have developed less and less tolerance for losing trades. Thus, my approach has evolved into aggressive and active trade management. I set my initial stop at #3 above then moved it immediately to #2 above. If Corn begins to rally or drifts sideways I will use Friday's low as my risk point. I have the attitude that if the trade works, that's great, but if it does not work – so be it.



Expectations – the enemy of traders

My observation over the years is that a significant discrepancy between expectations and reality exists among newbies and aspiring traders. Unfortunately this gap between "wishful thinking" and "what-is thinking" can be the downfall of an aspiring trader. What are some of the false expectations held by many newbies and aspiring traders?

- Win rates of 60%, 70% and even 80% can be achieved on a continuous basis – this is especially true if a trader expects to achieve a positive win value/loss value ratio
- The win rate over a large number of trades will apply fairly evenly to any subset of smaller number of trades
- A risk of 5% to 10% of capital per trade is reasonable and will produce the maximum profit
- A trader can actually know with a high degree of confidence what a given market will do
- Annual RORs of 50%, even 100%, are achievable if only certain trading systems or gurus are followed
- A trading account can reasonably be funded from savings, a loan, an inheritance
- Day trading is the way to go for most beginning traders
- The secret to trading success comes from trade identification or trade signaling

So, what do I view to be the realities of trading?

- Successful market speculation is one of the most challenging endeavors one can undertake
- It generally requires three years for a beginning trader to gain a sense for how she or he will trade and five years to become proficient with the adopted approach
- A win rate of 50% is fabulous for a position trader
- Even with a win rate of 50%, drawdowns in excess of 30% of capital will occur annually if the bet size exceeds 2% of capital
- Trading outcomes over a series of trades are subject to random probability – and random probability can be a real bitch
- A trader really has no clue what a given market will do
- While day trading can be a profitable approach, a beginning trader needs to understand the reasons why the odds are stacked against day trading. Hint: the reason deals with the need for a trader to have an "edge." The reality is that HFT and quant operations have the edge on a daily basis – so a day trader must compete with firms that know spec orders in advance in order to be profitable. I am NOT saying that ALL spec day traders are doomed. I am simply stating that the odds of success in day trading are far less than for position trading.
- A trader's worst drawdown is the one yet occur
- If there is a "secret" to trading, it has VERY little to do with trade identification and signaling. It has more to do with overcoming the human pitfalls of fear, greed and false hope.

Expectations, part 2

It would be nice to think that every trade … week … month … year will be profitable. But that is not reality – at least not for me. Statistically I can define my average year (although in reality no two years are ever alike). With 25 years of trading basically the same way I have the luxury of knowing my trading benchmarks and metrics inside and out. These trading benchmarks and metrics help me to form expectations. For example, I can reasonably expect four months of an "average" year will be quite good each containing two trades closed at a 350 basis point or more profit. I can also reasonably expect four months to be slightly profitable each containing at least one profit closed at a 200 basis point profit. Then I can expect four months of treading water when good trades are hard to come by and my challenge is holding onto capital.

January has become a water-treading month. Does this mean I traded poorly (or at least sub-par) during the month? Absolutely not! I am completely satisfied with the orders I entered in January – REMEMBER, TRADING CAN BE REDUCED TO THE PROCESS OF ORDER ENTRY. Does this mean I need to "tweak" some aspect of my trade identification, trade entry, sizing or trade management? Absolutely not! My job as a trader is to continue following my overall strategy and tactics through good times and not so good times. The results of the last trade, the last series of trade, the last week or the last month are not determinants of long-term trading success for me.

U.S. stock index market

Your guess is as good as mine. Major trend is up. Those committed to fade this trend have been wrong for eight years.

Factor Special Situation Reports			
Trade management on positions attributable to Factor Special Situation Reports may differ from positions carried by the Factor Tracking Account. The Factor Special Situation Reports are intended for Factor members who want a "*lock-it-in-and-leave-it*" Readers' Digest approach for order entry.			
	Market	Report Date	Trade Status
SSR.2016.01 SSR Update SSR.2016.01B	Mpls. Wheat	29 Nov 2016 5 Jan 2017 Update 17 Jan 2017 Update	The Factor SSR portfolio is flat in Mar Mpls. Wheat having taken profits on a long position (established at 533 on 30 Nov) at 586 on 17 Jan. <u>Plans to re-purchase Mar Mpls. Wheat at 554-1/2 with protective stops at 544 (per the SSR Update dated 17 Jan) have been cancelled. There are no further plans at this time to trade Minneapolis Wheat and the Special Situation Report campaign in this market have concluded.</u> Single contract profit = $2,650
SSR.2017.01	Mar Can Dollar	17 Jan 2017	A long position at .7651 established on 18 Nov was almost immediately stopped out at .7574. Single contract loss = ($770)

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Factor Tracking Account as of Jan 27, 2017

Factor LLC											1/27/2017						
Model Tracking Account Trade History and Portfolio																	
Initial capitalization: $100,000																	
				(See disclaimers and notes below)													
		Entry									Pattern		Exit				
Market		Date	L/S	Price	Size	Initial stop	BP risk	Current Stop	Stop Date Δ	Target	Weekly	Daily	Date	Price	Net	Capital to carry trade	Value of trade (entry)
Positions open as of 12/30/16																	
EXH7	EuroStoxx	12/6/16	L	3102.0	1	3029.0	78	3247	12/28	3289	11+mo H&S	11+ mo H&S	2-Jan	3289	$ 1,970.30	Closed	-
NZD/USD	Spot fx	12/15/16	S	0.7077	70k	0.7126	36	0.7002	12/27	0.6821	Poss 6+ mo H&S	4-wk wedge	5-Jan	0.7003	$ 518.00	Closed	-
												Total -- Carry in positions			$ 2,488.30		
2017 forex roll charges and FX losses on foreign margin deposits; day trade P/Ls on repositioned trades															$ (58.74)		
EUR/USD	EUR/USD	1/3/17	S	1.0445	50k	1.0532	43	1.0502	1/4	0.9621	21-mo sym tri	Jan Effect high	5-Jan	1.0503	$ (290.00)	Closed	-
EUR/NOK	EUR/NOK	1/3/17	S	9.0058	50k	9.1011	55	8.9912	1/27	8.7352	14-mo H&S top	Poss 14-wk H&S				$ 2,601	$ 52,025
MWEH7	Mpls Wheat	1/5/17	L	5.4700	1	5.3900	80	5.690	1/16	5.86	6+ mo H&S	5-wk asc tri	17-Jan	5.86	$ 1,945.00	Closed	-
MWEH7	Mpls Wheat	1/5/17	L	5.4700	1	5.3900	80	554.75	1/27	6.34 r	6+ mo H&S	5-wk asc tri				$ 1,500	$ 27,360
AUD/NZD	AUD/NZD	1/9/17	L	1.0508	70k	1.0419	45	1.0459	1/11	1.0746	Poss 7-mo H&S	10-wk wedge	24-Jan	1.0459	$ (248.49)	Closed	-
6GCH7	Canadian $	1/12/17	L	0.7652	1	0.7584	72			0.8023	9-mo channel	3-mo double bottom	18-Jan	0.7583	$ (695.00)	Closed	-
FAST	Fastenal	1/18/17	L	50.220	200	47.740	50			62.5900	57-mo rectangle					$ 10,044	$ 10,044
FGBMH7	Bobl	1/23/17	S	133.1900	1	133.4200	23	133.13	1/25	130.41	Poss 12-mo H&S	5-wk H&S				$ 1,103	$ 142,398
ZCH7	Corn	1/24/17	L	363.00	1	354.50	45	359.75	1/27	384.750	13-wk sym tri	13-wk sym tri				$ 990	$ 18,150
												Trades as of			$ 3,141.07	$ 16,238	$ 249,977
											Indicates open position value as of					Levered at	2.5
PAST RESULTS ARE NOT NECESSARILY INDICATIVE OF FUTURE PERFORMANCE																	MtE = 6.2%
r = revised	RO = Rollover																

The Factor Service $100,000 Tracking Account represented herein is a proxy representation of the trading executed by Peter Brandt for the Factor LLC's proprietary trading accounts. There are some major differences between the trading activity conducted in the Factor Service $100,000 Tracking Account and trading in the Factor LLC's proprietary accounts. Peter's trade sizing and trade management tactics in the proprietary account is sized and managed per $1MM of proprietary capital. There may be trades Peter believes are not suitable for a $100,000 block of capital, and these trades are not executed in the Factor Service $100,000 Tracking Account. Factor LLC's proprietary account trades multiple contract trades wherein Peter layers into and out of a position at different prices and on different dates. The Factor Services $100,000 Tracking Account most often holds a single futures contract in a trade whereby layering is not possible. Factor LLC's proprietary accounts may also pyramid some trades not pyramided in the Factor Service Tracking Account. Because the Factor Service Tracking Account represents how Peter would trade a $100,000 block of capital in contrast to the actual trading of Factor LLC's proprietary account, the Factor Tracking Account should be considered as hypothetical. Hypothetical trading performance is subject to the following disclaimer required by the Commodity Futures Trading Commission.

CFTC RULE 4.41 - HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT BEEN EXECUTED, THE RESULTS MAY HAVE UNDER-OR-OVER COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFIT OR LOSSES SIMILAR TO THOSE SHOWN.