

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

## Factor Update, February 5, 2017

### Market Review

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

- German Bobl
- AUD/USD

Candidate *Factor Moves*<sup>TM</sup> are currently ongoing in:

- FAST
- \*EUR/NOK
- FTSE 100

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

<u>Developing signals</u>	<u>Existing positions</u>
<ul style="list-style-type: none"> <li>• AUD/USD – alert</li> <li>• Mpls Wheat – Entry order and protective stop</li> <li>• FTSE – Entry order and protective stop</li> </ul>	<ul style="list-style-type: none"> <li>• EUR/NOK – protective stop and target</li> </ul>

The Factor Tracking Account is currently leveraged at 1.4X. The margin-to-equity use for futures and forex positions is 2.9%.

### General market commentary

Last week's Factor Update ("Expectations, Part 2") discussed the fact that my trading has winning trades and losing trades, winning weeks and losing weeks, winning months and losing months, winning quarters and losing quarters and even losing years (since 1981 I have experienced five losing years with an average loss of -6.5%). So far in 2017 – in my opinion and based on my trading approach – the markets have been BRUTAL, characterized by false and volatile breakouts, deep retests and a near complete lack of follow through.

In my prop account (not the Factor Tracking Account), of the trades opened AND closed since Jan 6 my win rate is below 20%. Ouch! The composite closing loss of these trades has been -302 basis points (3.0%). Ugh! Luckily a couple other trades entered since Jan 6 and currently open have offset a portion of that loss – but open profits mean NOTHING until they are covered. Had I risked 3% of my capital per trade with a fixed stop strategy I would have lost 35% of my account – meaning I would need a 50% gain to get my head back above water. This fact is why I use a maximum risk of 100 BPs, cut sizing in a drawdown and employ an active and aggressive approach to risk and trade management.

I try to ignore unrealized profits. Open profits do not belong to me and they can quickly disappear. I maintain a record of my trading with a sequential closed trade NAV graph. The RORs of individual trades against total nominal AUM are the data points needed to calculate Profit Ratio – an important metric I use to monitor my trading.

What should a trader such as myself do under such circumstances? Whenever I face such a trading environment I am reminded of the Bee Gees to "*Stay Alive*." Markets go in streaks. Capital preservation is what matters in the long term. I do not mind a win rate below 20% (OK, to be honest, I hate it). Drawdowns have two dimensions – capital and emotions. Both types of drawdowns can severely impact the ability of a trader to succeed.

There are several temptations for a trader undergoing a slump.

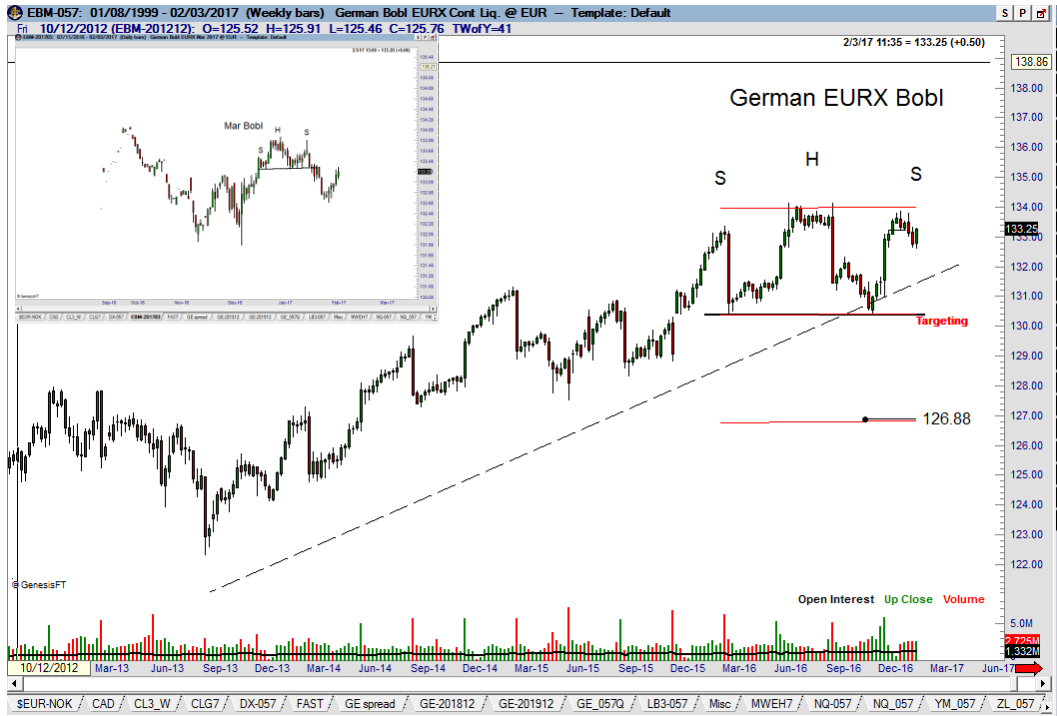
- Figure out what has worked during the drawdown period and switch to that approach. I do NOT do this!
- Double my bet size to catch up. I do NOT do this!
- Stop trading to avoid further damage. I do NOT do this!
- Modify my trading approach adopting tactical modifications that would have prevented the recent losses. I do not do this!
- Keep trading, but keep lowering BP size during drawdown. Don't change a thing with trade identification or trading tactics. Understand that drawdowns occur. Trust that my approach will withstand the storm. THIS IS WHAT I DO!



## Candidate Factor Moves™ Setting Up

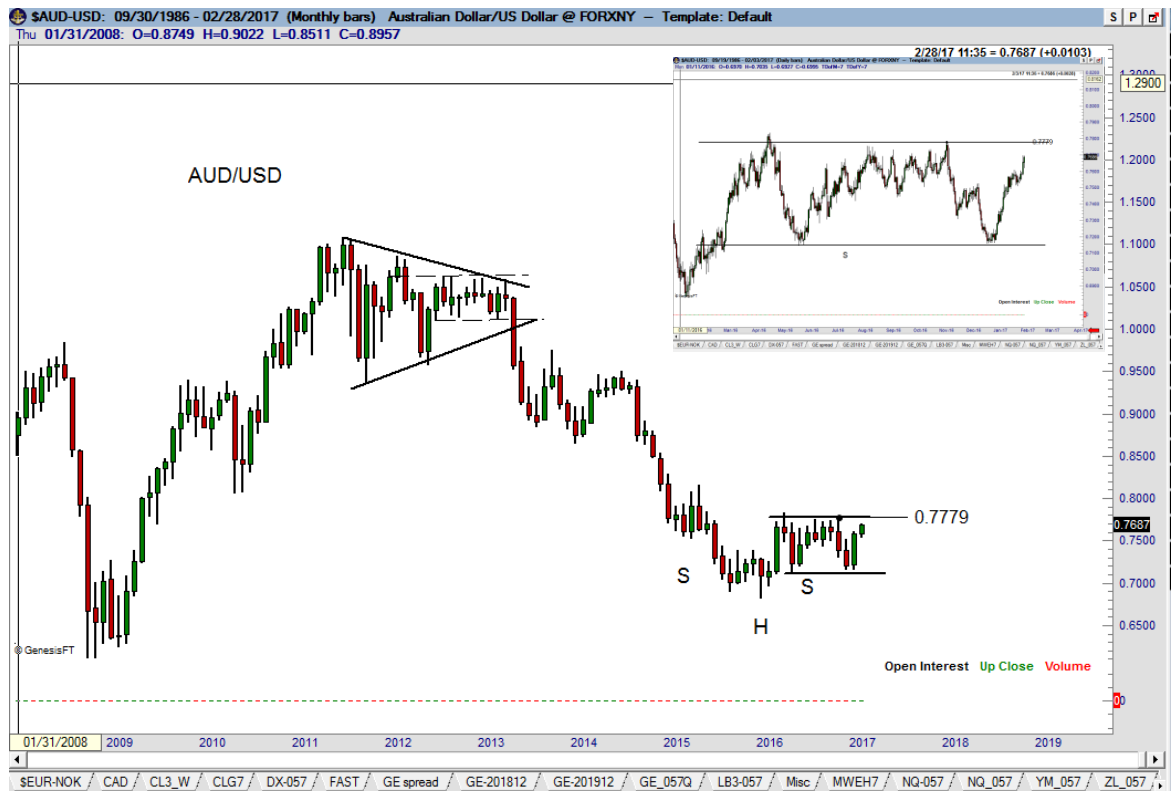
### German Bobl

The dominant chart construction in the Bobl continues to be the ongoing development of a possible 12-month H&S top on the weekly continuation graph. The right shoulder itself formed a smaller H&S pattern on the daily graph of the Mar contract. Accordingly I took a shot at shorting the market thinking I could catch the right shoulder high. I was stopped out on Thursday for a six tick profit. I will continue to monitor this market as long as the weekly chart H&S pattern looks viable. Factor is flat.



### AUD/USD

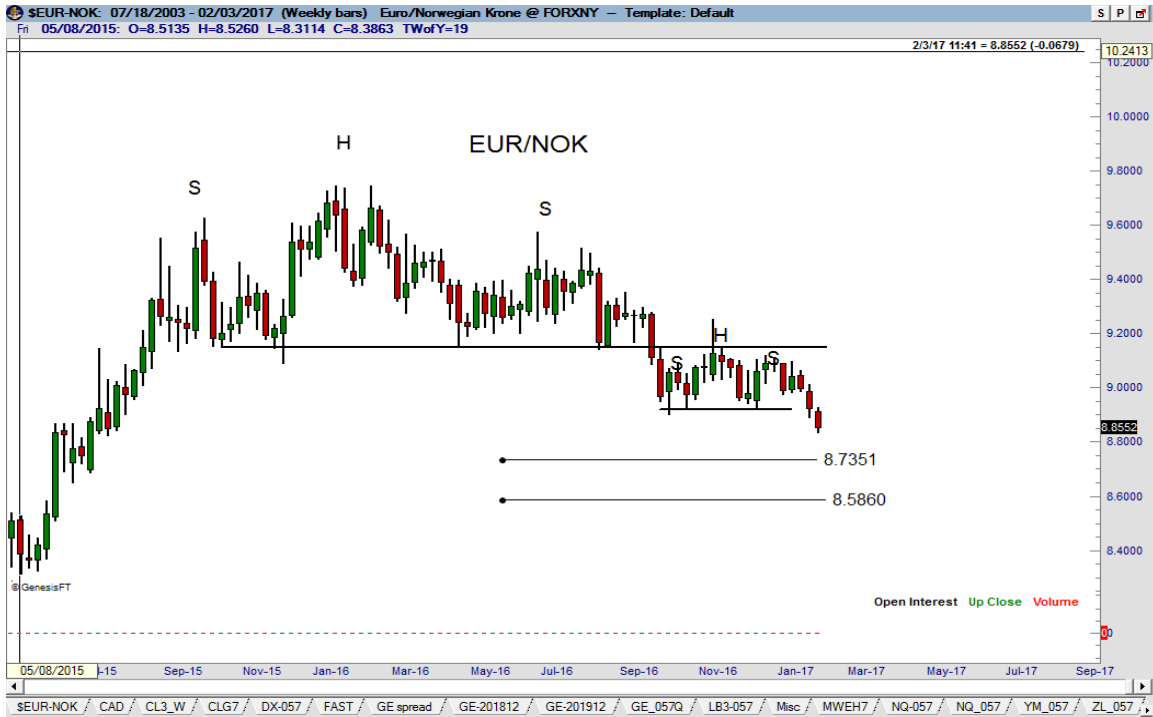
The Aussie \$ is forming a possible 10-month rectangle continuation pattern on the weekly and daily graphs. A decisive close above .7800 would complete this pattern and establish an upside profit target of .8420. Factor is flat.



## Candidate Factor Moves™ in Progress

### 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 was completed on Jan 26. Factor is short a multiple layer position in this forex cross.



## 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. The market almost pulled back to my 7000 buy level on the daily graph (inset) before turning up on Thursday and Friday. I am willing to buy the FTSE at 7067 if given the opportunity next week with a risk to 7023.



## Peter L. Bernstein on the topic of risk

Peter Bernstein was a brilliant economist who contributed much to portfolio theory. His book, *Against the gods, the Remarkable Story of Risk* is a must read for all serious market speculators. This YouTube video, featuring a discussion of risk by Bernstein, is most educational.



<https://www.youtube.com/watch?v=MKcZtwch1w>

## FAST

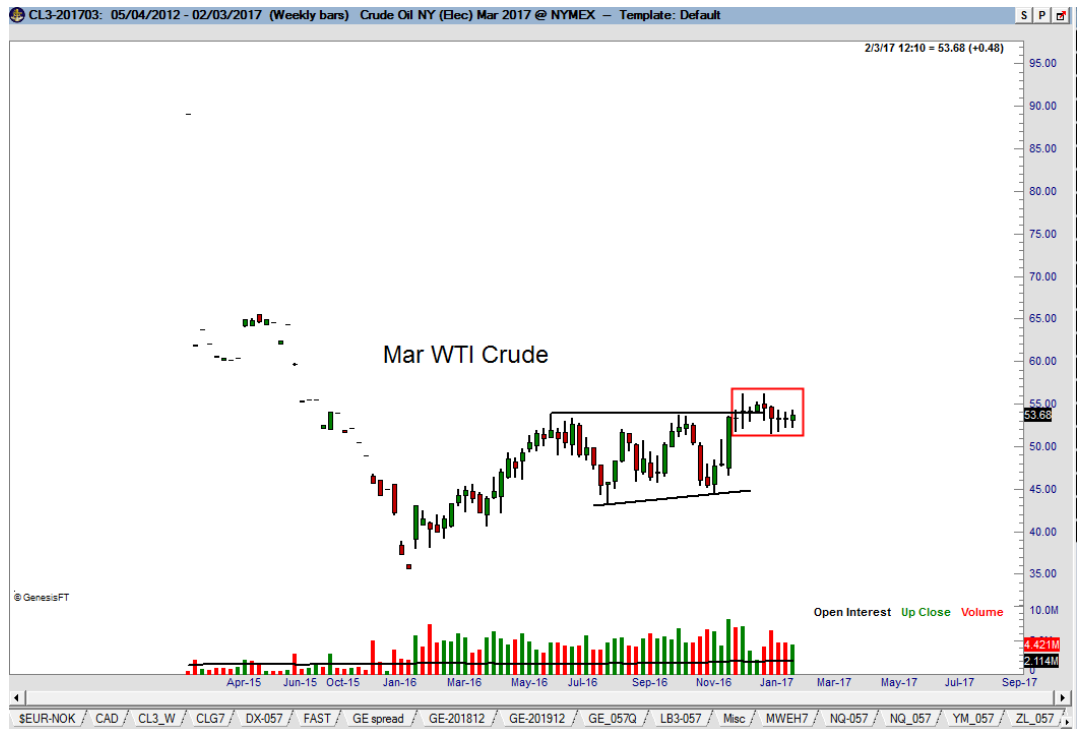
The completion of the 46-month rectangle on the monthly chart is struggling to hold upside momentum. Nevertheless, the bull case on the chart has not been damaged. I have a trading rule to liquidate all trades that carry a loss on Friday. Accordingly, Factor is now flat FAST. Over the years I have come out on the losing end more often than not by over-riding my trading policies.



## Other Markets

### Crude Oil

The daily WTI chart (Mar contract) has stalled at the upper boundary of a 6-month ascending triangle (red box). I have given up on the idea of a flat price trade in WTI. Factor is flat.



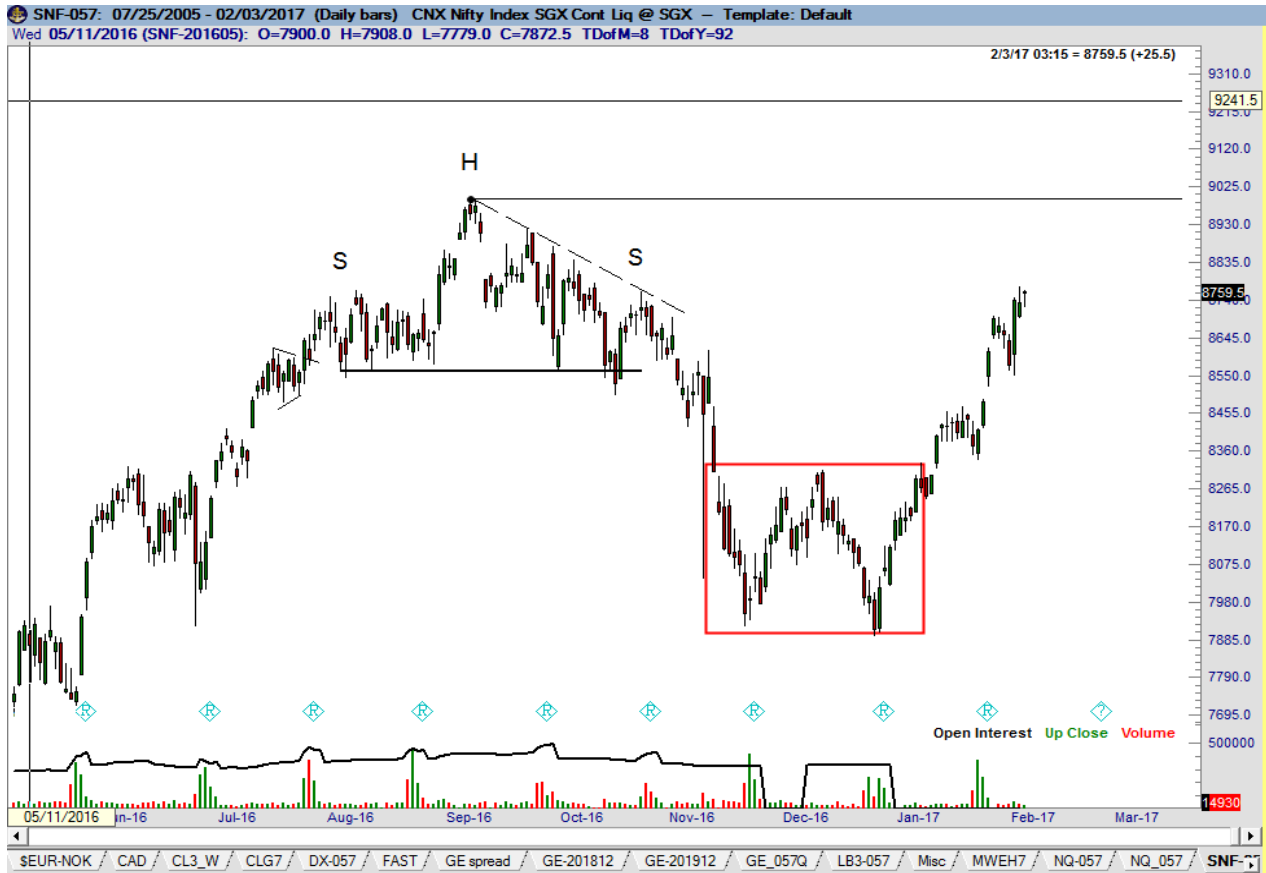
### Silver

The wide-bodied bar (WBB) advance on Tuesday completed an arguable H&S bottom in Silver. I use the word "arguable" because the right shoulder was very poorly formed. I went long Silver at 17.43 on the breakout. I then viewed Wednesday slight correction to constitute the retest low. Because the H&S interpretation was questionable I was eager to be aggressive in trade management. I was stopped out on Friday for an 11 cent loss. The market rallied hard after stopping me out. This happens. Factor is flat with no desire to re-enter the market.



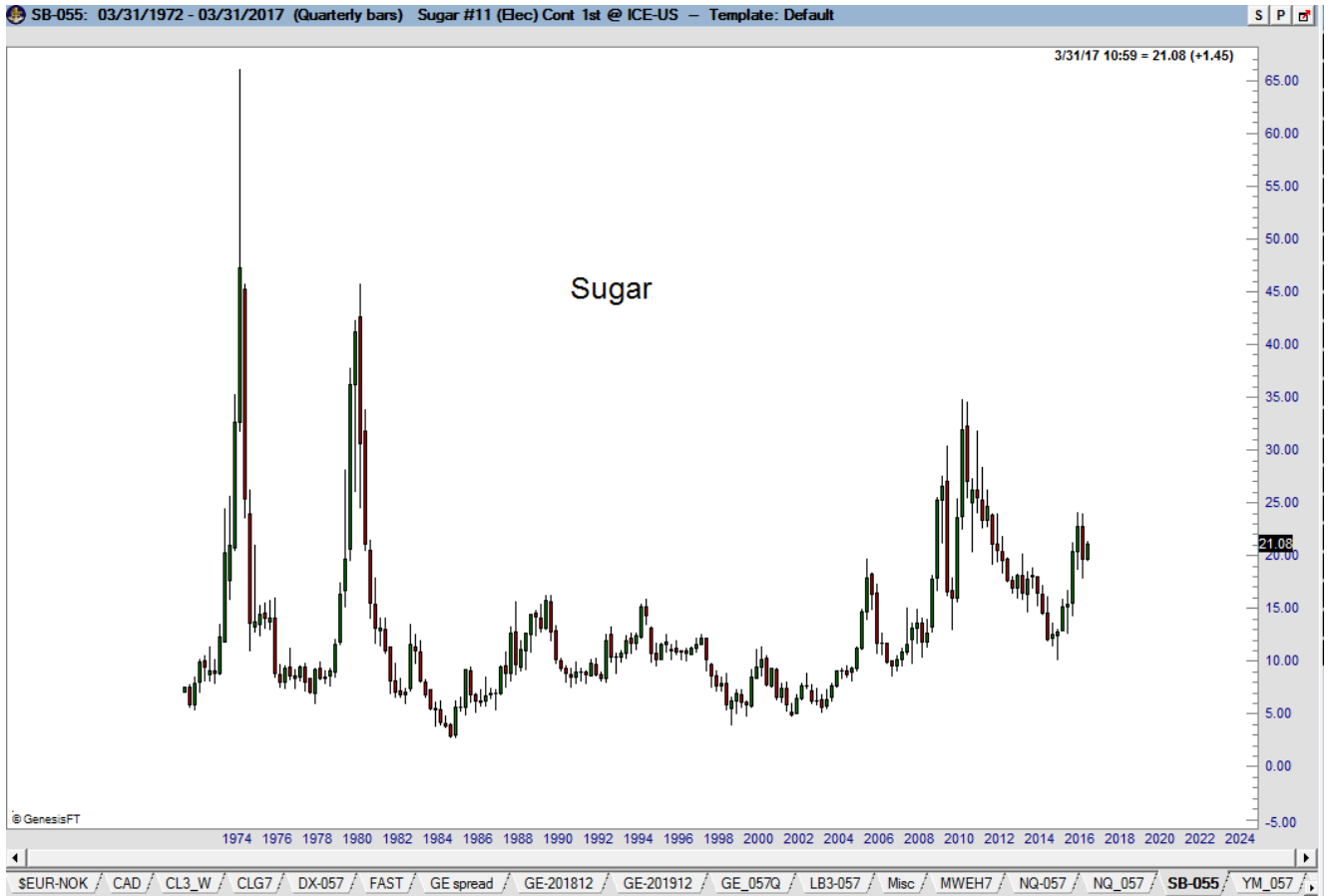
## India Nifty 50

The Nifty (traded in Singapore) is a market I have monitored and traded from time to time. The advance in Mar 2014 completed a 6+ year ascending triangle on the monthly graph with a minimum target of 10287. The decline from Mar 2015 to Feb 2016 was a simple correction within the bull trend. The 15-week H&S top on the daily chart completed in Nov 2016 met its downside target. The advance on the daily graph on Jan 1 completed a small double-type bottom (red box) and indicates that the dominant bull trend should be back on track.



Sugar (futures and ETF)

Sugar is the epitome of a “boom-to-bust-to-new-boom” market, as seen on the quarterly graph. The question is whether the advance from the Sep 2015 low is the next bull boom. Fundamental Sugar traders I know believe that the global supply and demand situation is constructive due to supply problems in India and strong demand. The advance on Friday on the daily chart would argue that another up leg is upon us. Factor is flat. I am considering a buy order next week in the May contract at 20.83 – although my experience has been that when I am able to buy the correction I want the trade is no good. The weekly chart of the Sugar ETF is also shown.



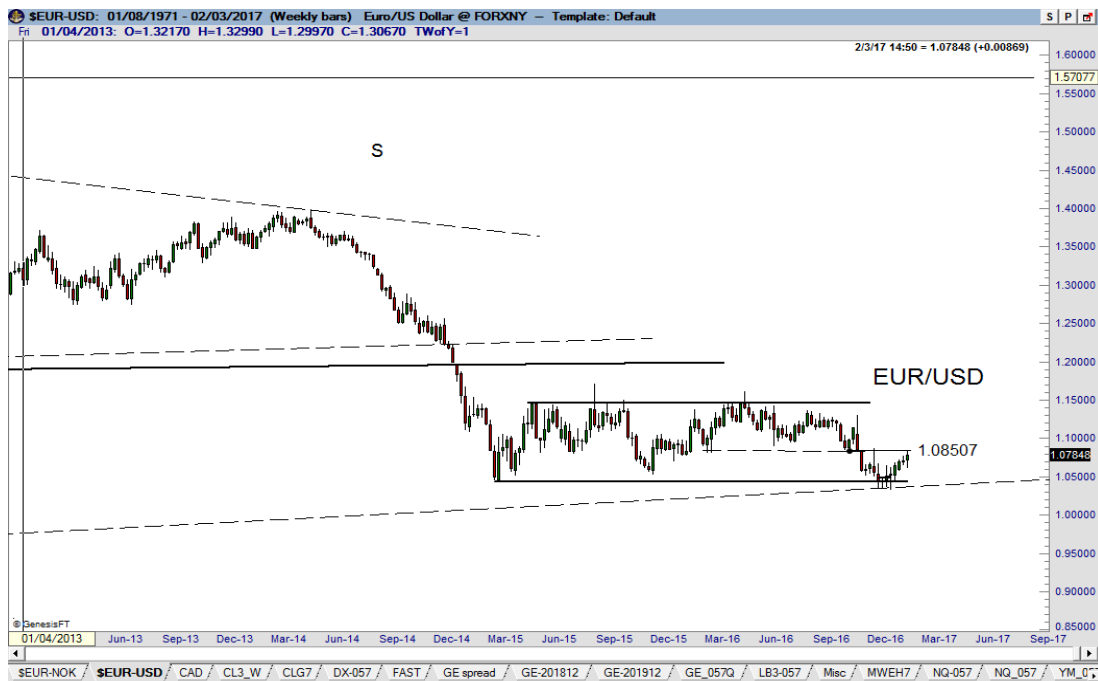
## Lumber

The breakaway gap on Thursday with follow through on Friday indicates that prices on the daily chart have broken free from a sideways congestion zone. A reasonable price target is 386. Factor is flat. Lumber is a market that I trade very rarely.



## EUR/USD (spot and futures)

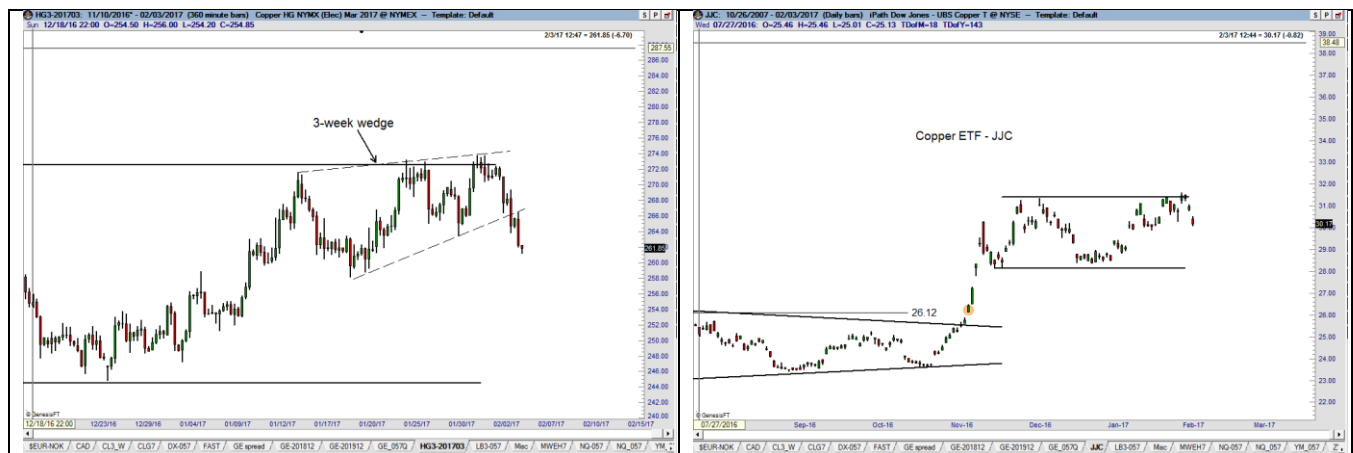
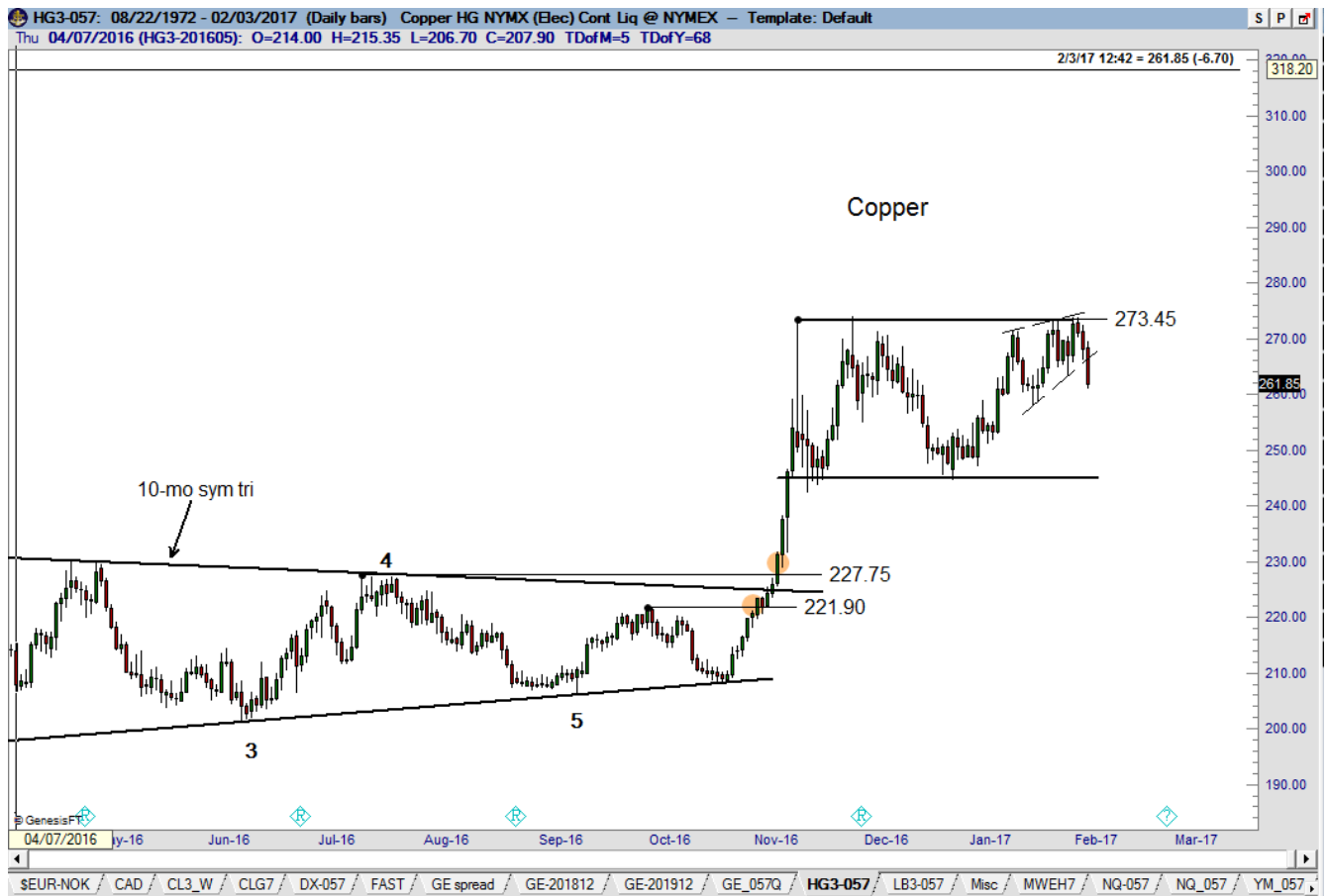
There is a good chance that the 2017 low was established in the early hours of this year's trading. If this analysis is correct, the upside target should be in the 1.19 to 1.24 zone.





## Copper

Prices turned down hard this past week from the upper boundary of a 12-week trading range. It is interesting to note that the price range set by Nov 10 and 11 have contained the market ever since. The intraday graph shows that the market (Mar contract) formed a 3-week rising wedge topping on Wednesday. This market is on my radar screen with a bias toward the long side – yet the COT profile remains quite negative. Factor is flat. The daily chart of the Copper ETF is also shown.



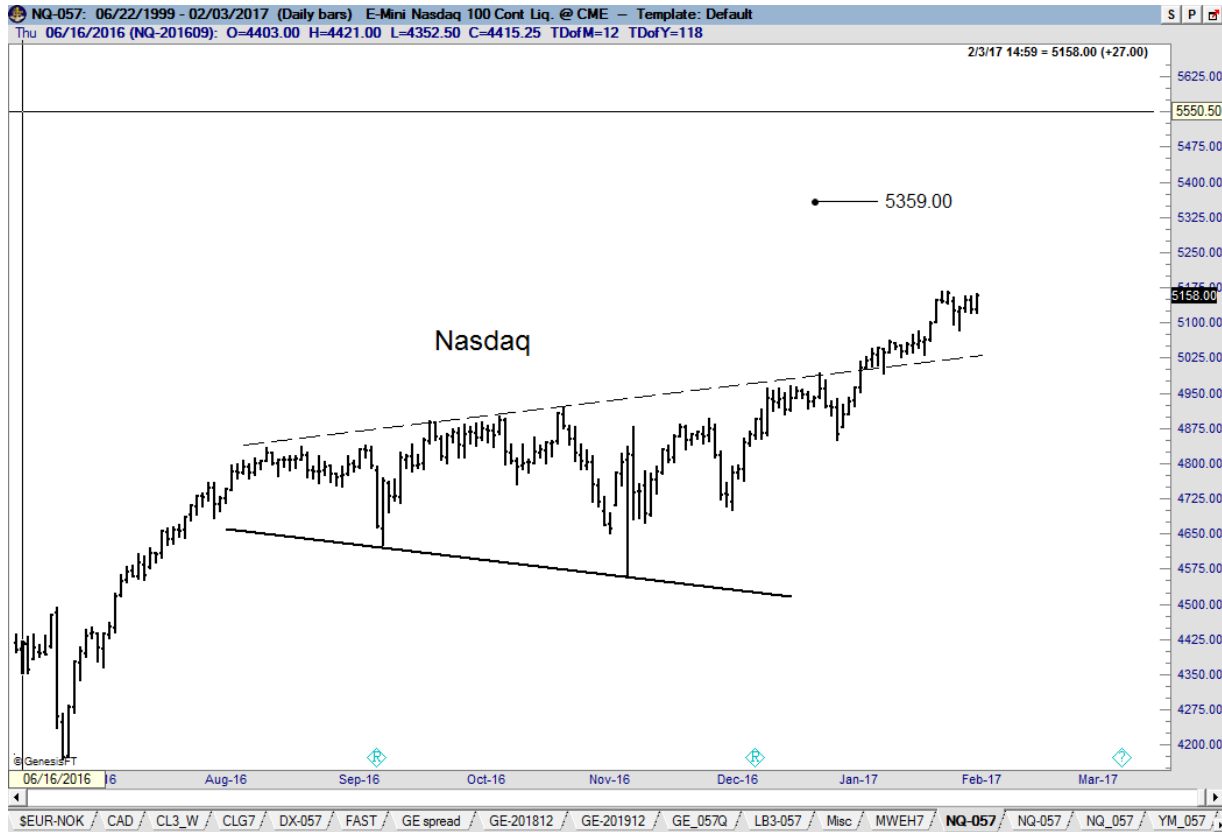
## Minneapolis Wheat

Last week's Factor update suggested that if the 5.60 support level gave way then Mpls. Wheat could decline toward 5.30. The 5.60 level did give way and my guess is that Wednesday low of 5.45 (nearby chart) will be the low of the correction. I am turning my attention from the old crop Mar contract to the new crop Jul contract. The decline into this past week's low was a near perfect retest of the H&S bottom neckline on the Jul daily graph. The Factor Tracking Account is flat. I am willing to buy the Jul contract at 5.53½ should the market pull back one more time.



## U.S. stock indexes

Factor is flat. I have no real clue about the U.S. stock index markets, but I will offer an observation. The NASDAQ might have thrust through the top boundary of a megaphone pattern. If this analysis is correct, the target could be as high as 5359.



## Follow-up regarding Bayesian probability theory

Thanks to many of you for your comments on the coverage in last week's Update on Bayesian probability. I found the following comments from a Factor member to be particularly to the point. Particularly interesting is the observation that a belief in mean reversion may actually be backwards Bayesian [this is not a condemnation on using mean reversion as a trading strategy].

*"What a great reminder of Bayes Theorem and how it impacts investing/trading. I spent my career up to this point in the equity markets as an analyst, and in looking back over the last decade, it's clear that many fundamental equity investors (and I have been guilty of this numerous times) take a fixed probability approach to investment outcomes in the beginning. When it moves against them, they (I?) often adjust probabilities to reflect some reversion to the mean (backwards Bayes?), but futures traders as you rightly point out do have an understanding of Bayes as evidenced by the mantra 'let your winners ride and cut your losses early.' Thanks for sending out!" -- Factor member*

**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  Factor Update 5 Feb 2017	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. Single contract profit = \$2,650 <b>Per the comments in this Update, as a Special Situation Report trade I recommend buying a contract of Jul 2017 Mpls Wheat at 553½ with a protective stop at 545</b>
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)

plb  
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**Factor Tracking Account as of Feb 3, 2017**

Factor LLC																	2/3/2017		
Model Tracking Account Trade History and Portfolio																			
Initial capitalization: \$100,000																			
(See disclaimers and notes below)																			
Market		Date	L/S	Entry					Stop Date Δ	Pattern			Exit		Net	Capital to carry trade	Value of trade (entry)		
				Price	Size	Initial stop	BP risk	Current Stop		Target	Weekly	Daily	Date	Price					
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																	\$ (81.03)		
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	8.9726	2/2	8.7352	14-mo H&S top	Poss 14-wk H&S			\$ 2,601.35	\$ 52,027			
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	30-Jan	5.5450	\$ 378.00	Closed	-		
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	-		
GGCH7	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	47.98	1/30	62.5900	57-mo rectangle			2-Feb	49.04	\$ (241.00)	Closed	-	
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	2-Feb	133.13	\$ 55.44	Closed	-		
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	30-Jan	359.75	\$ (167.00)	Closed	-		
EUR/NOK	EUR/NOK	1/30/17	S	8.9124	80k	8.9442	31				14-mo H&S top	Poss 16-wk H&S			\$ 4,262	\$ 85,241			
YIH7	Mini Silver	1/31/17	L	17.43	2	17.07	36	17.32	2/2	18.8800	11-wk H&S	11-wk H&S	3-Feb	17.32	\$ (230.00)	Closed	Closed		
															Trades as of		\$2,906.22	\$ 6,863	\$ 137,268
															<b>Indicates open position value as of</b>		Levered at		1.4
PAST RESULTS ARE NOT NECESSARILY INDICATIVE OF FUTURE PERFORMANCE																	MTE = 2.9%		
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 Service \$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																			
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