THE FACTOR REPORT

January 8, 2023

Welcome back to the Factor to several former members who have rejoined the community.

<u>Positions at end of week</u>

- Long 75% Gold futures
- Short 100% USDCNH spot
- Long 65% Platinum futures
- Short 50% DJP

Trades are setting up in Rapeseed, 3-Yr Bonds, U.S. equities, LiteCoin, FTSE and Copper.

<u>Trading commentary</u>

My observation is that traders tend to invest too much intellectual and emotional capital in each trade, as if:
- A trade is a direct reflection of one's ability/intellect
- The next trade or series of trades will determine one's future as market speculator

To which I say … that's nonsense!!!! There was a time in my career when I believed this narrative. Over time I began to understand the rule of large numbers. My win rate historically has been 40-45%, but in recent years this has increased to 55% because of active and aggressive trade management.

But let's just use the figure of 50% for a win rate. If my win rate

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In my opinion, (cause it's important), a hurdle to trading is taking personal ownership in individual trades.
A trade is nothing more than a datum point in a series of data points subject to random distribution
That may seem harsh, but to me its reality

12:41 PM · Jan 6, 2023

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is 50%, why should I invest emotional hope in the next trade, or series of trades. The reality is that over an extended series of trades the law of large numbers comes into play. This means that the outcome of the next trade is little more than a statistical event subject to random probability.

In 2013 I entered the longest drawdown of my career (18 months) from peak to valley to new peak and encompassed the worst trading year in my career (-13.7%). This DD pushed me into extensive introspection and research to understand more deeply the concept of performance.

Two subsequent developments began to embed the belief into my DNA that the next trade is nothing more than a datum point in a series of data points subject to random probability.

First, I became involved in a joint research project with members of a legenday trading family that founded the first algo trading firm (known then as CRT). The project had as its intended goal to gain an understanding of the role of random probability in performance outcomes.
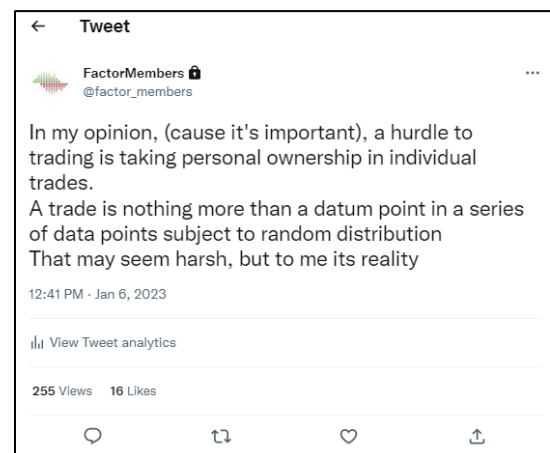
The team developed an Excel randomizer with 721,000 cells of formula. We were able to input a wide variety of trading variables (largest loss, win rate, bet size, avg win/loss ratio and others) into the program. The outputs demonstrated how identical benchmarks can play out in very different (and unexpected) ways. This project helped me grasp the fact that trades are simply statistical events, nothing more, nothing less.

The second development came from understanding the implications of the Pareto Principle to trading. This was a byproduct of learning from the Excel modeling that any variables producing a profitable trading endeavor complied with Pareto. In fact, for flat price traders (investors, swing traders, day traders, et al) there is no escaping the Pareto Principle.

The practical application of Pareto is that 20% of my trades (+/-5%) will produce 80% of my profits (+/-5%) no matter what I do. I selected several years at random from my career and studied the trades that put in my bottom lines. Across the timeline the trades that became big winners worked almost immediately and did not look back.

I am not smart enough to know which 20% of my trades will produce the bottom line – if I was smart enough these would be the only trades I would take. In a real sense, taking trade after trade is part of the process of discovery. In fact, losing is part of the process of finding the winners. So, if I believe that 20% of my trades will produce 80% of my profits if I use tight initial stops but allow winners room to roam (if they remain winners), then my job as a trader is to prevent the 80% of the trades from doing real damage.

It is my hope when I put on a trade that it will become a Pareto trade. But I must assume it will be part of the garbage dump. A trade is a trade is a trade. A trade is not proof of my intelligence or research ability nor is it the foundation for my future prosperity. It is good that we examine charts and consider narratives and conduct research, but in the final analysis we have no idea what any given market is going to do. You have the choice of believing or not believing that this is also true of your trading endeavors.

<u>Current positions</u>

<u>Gold</u> faked me out a bit this past week. I took profits on 25% of my position at the 1863 target from the Chair and Ottoman bottom. My thinking was that a rising wedge could provide a reasonable correction to the bull trend, but the market thrusted on Friday, completing an arguable running wedge. I returned to a 75% position on Friday. We can still not rule out the rising wedge interpretation, so either this market accelerates or I become defensive.
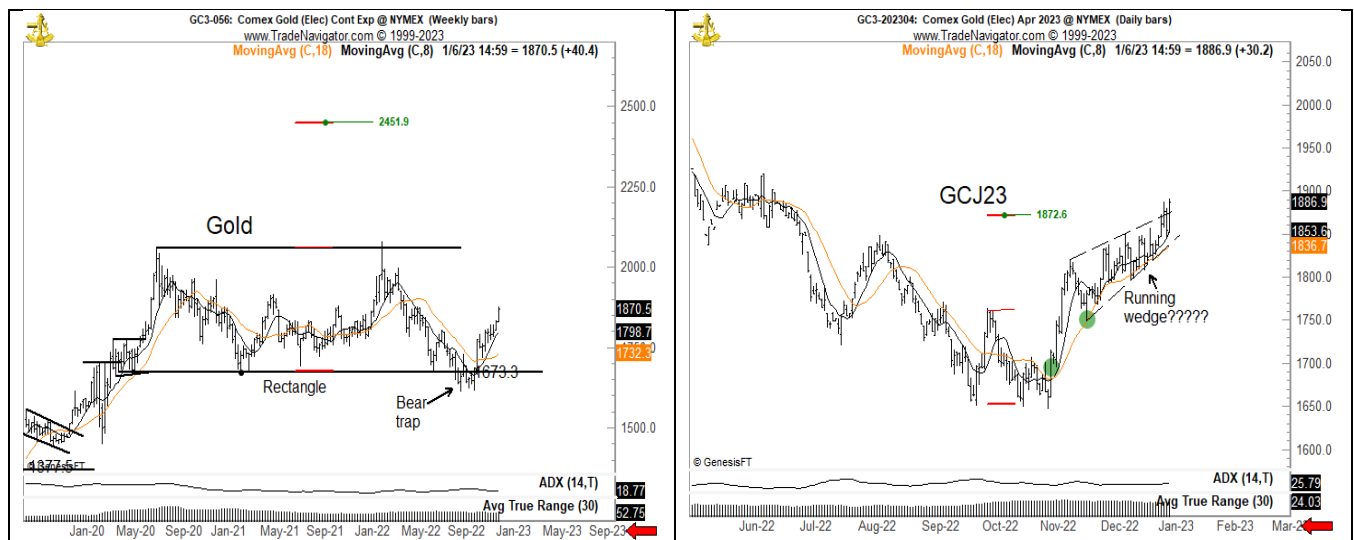
<u>USDCNH</u>. This FX cross is within spitting distance of my target at 6.8141. I covered a quarter of my position on Friday just to take some chips off the table. I will take 50% profits at the target and let the final 25% have some room to dive deeper.

<u>Platinum</u>. I missed the Platinum breakout on Dec 30 (did NOT have order entered) and refused to chase the rally on Jan 3. Platinum has a notorious repulation for hard retests, so I had an order in to buy the Apr contract at 1061.8. I paid no attention to the chart during the week and was surprised Friday when my fill popped up. I will now use Friday's low to protect the 65% long position which equates to a 45 BP risk.
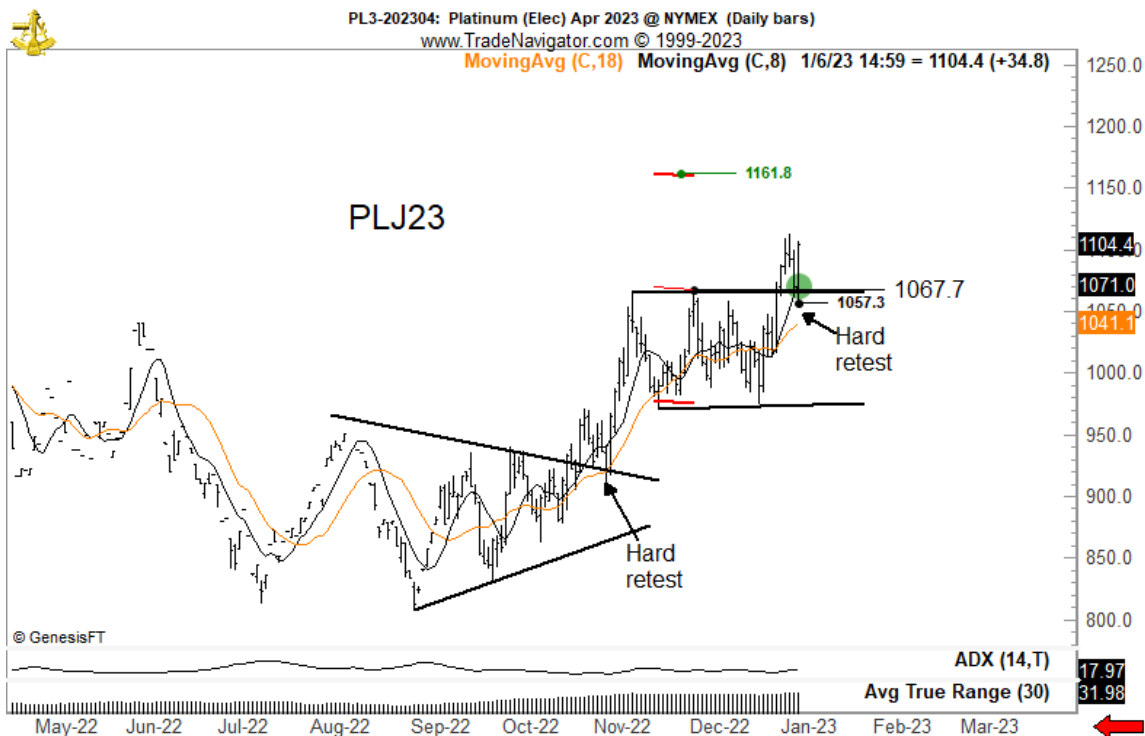
<u>DJP (ETF)</u>. I established a 100% short position in this ETF on Thursday. The market failed to follow through on Friday, yet the descending triangle remains valid. A trading rule I follow is to liquidate positions that show a loss on Fridays. I did cover half of the short on Friday, but overruled my rule to remain short 50% using my initial stop.
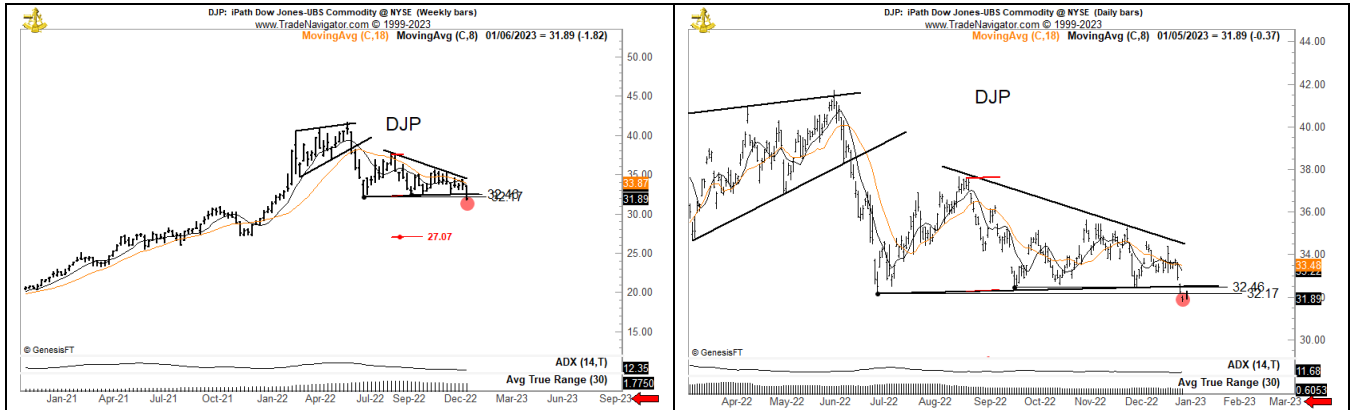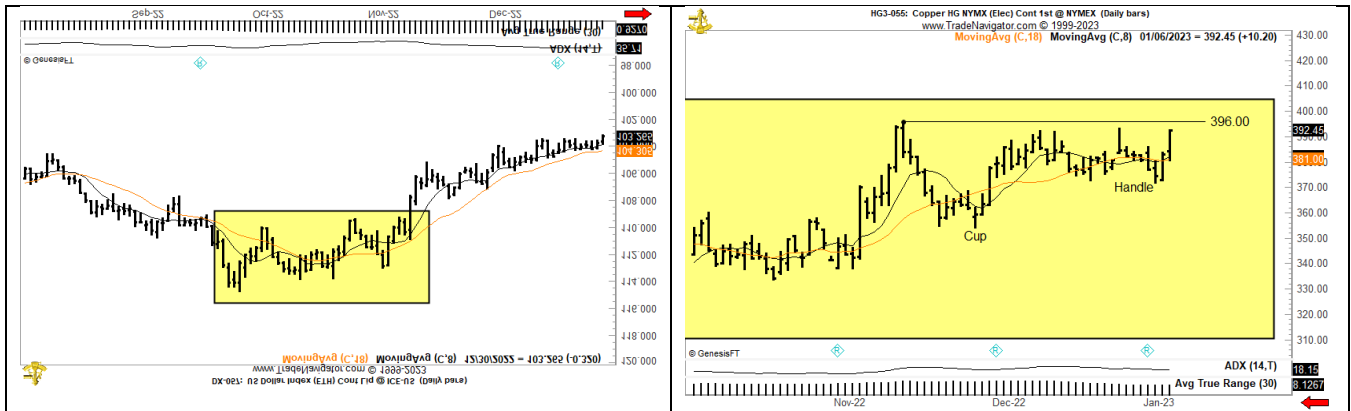

<u>Other markets of interest</u>

<u>Copper</u> is forming a possible horn bottom consisting of two higher highs and three higher lows. Also shown is the inverted daily chart of the U.S. Dollar as a point of comparison. The final component of this pattern in Copper displays a Cup and Handle construction.
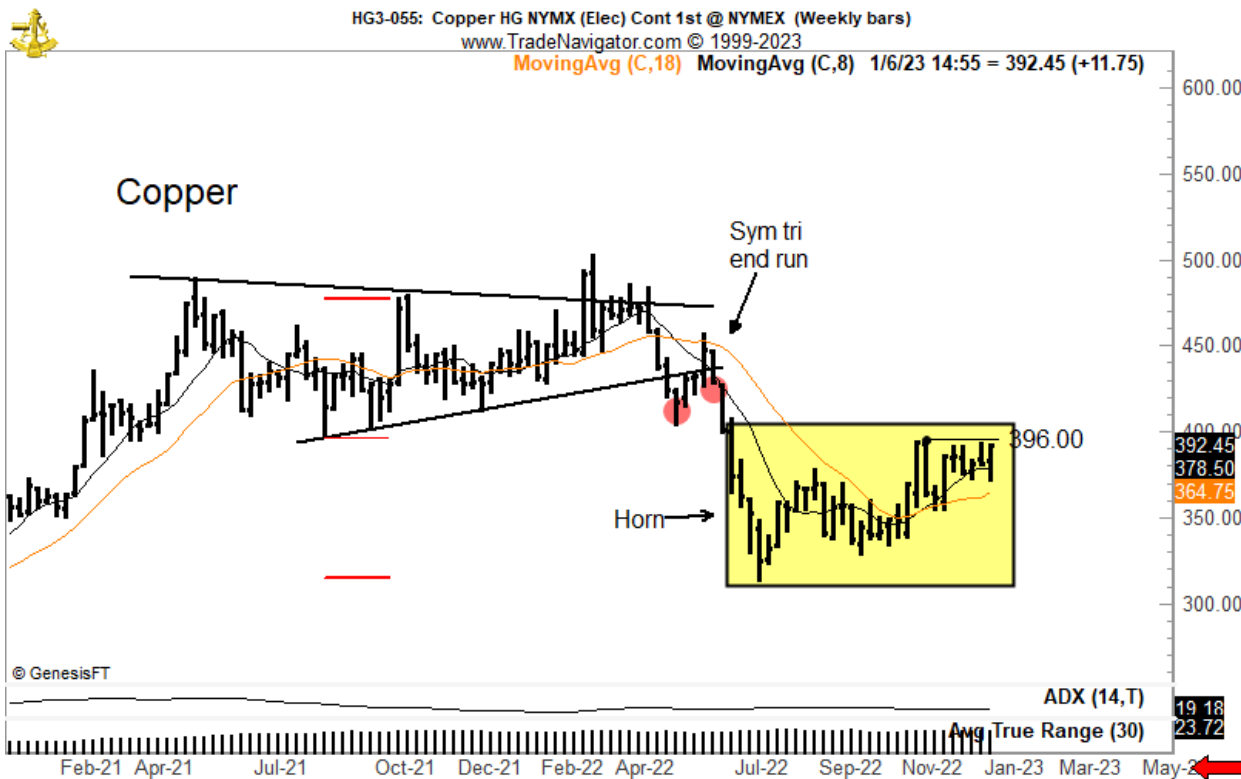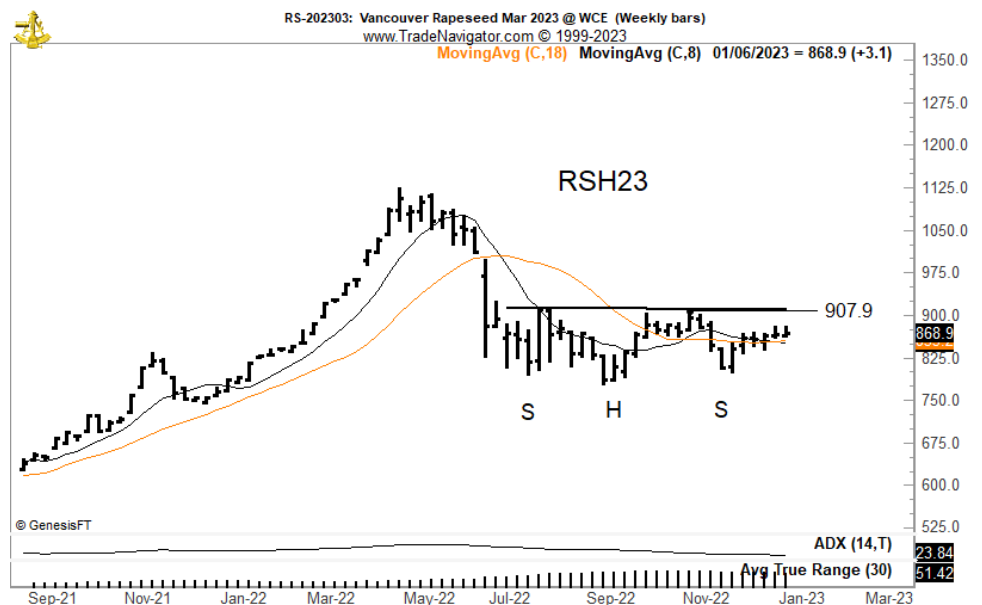

See additional charts, next page.

U.S. 3-Year Treasuries are developing a well-defined symmetrical triangle. This could be a reversal or continuation triangle and I have orders to play it either way.
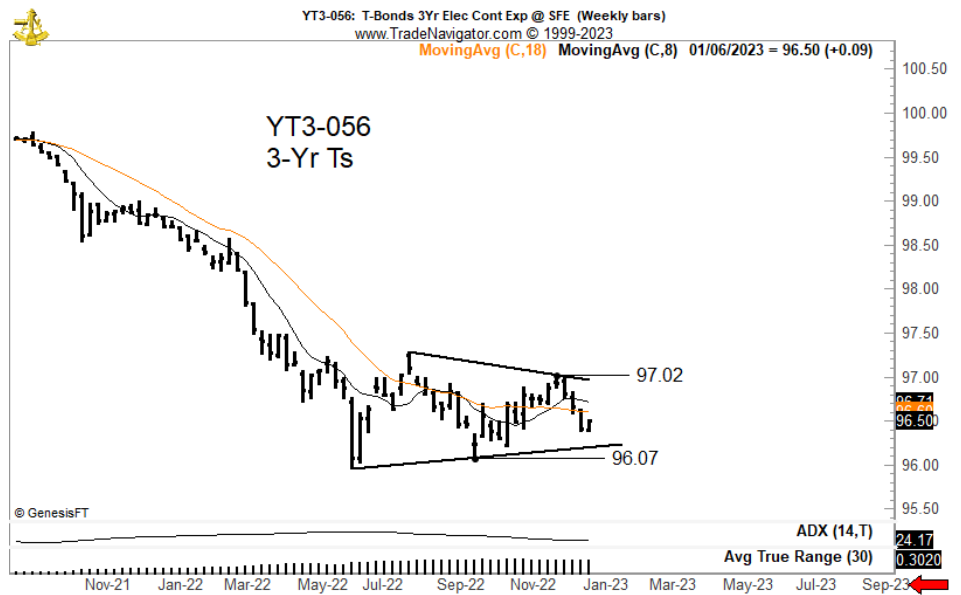

Canadian Rapeseed is forming a possible H&S bottom on the weekly chart. This could prove to be a failure pattern.

U.S. equities. I am perplexed. I am glad I do not have to trade the stock market for a living. The DJIA (not shown) is within striking distance from new ATHs. The S&Ps have been bumping up against a trendline for a year. I hate diagonal construction, but a violation of this trendline would be interesting. The Russell 2000 has had my attention for several months. A decisive move below 1640 would be very negative, yet a double bottom is also a possibility. The daily chart presents a possible "Chair with an Ottoman" pattern. Compare this to the recent bottom in Gold.
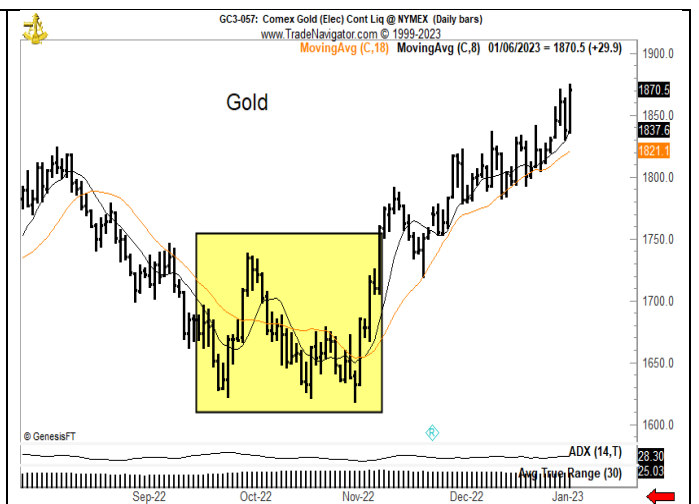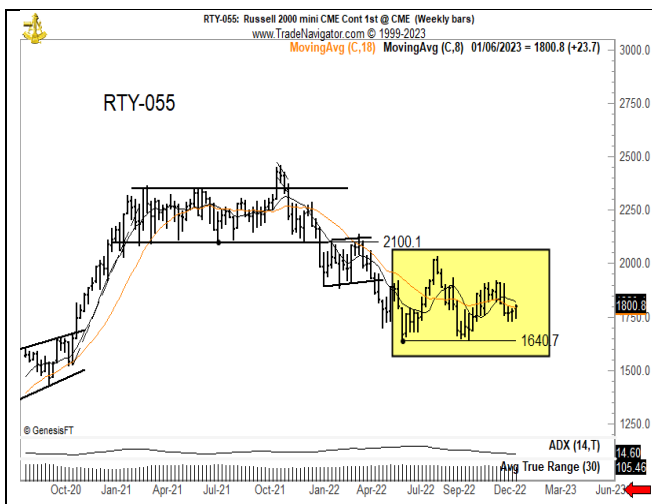
FTSE. The U.K. FTSE is little changed from where it was 23 years ago (chart not shown). The weekly chart is attempting to breakout of an 11-month rectangle. In general, I like the European stock markets. EWU is an ETF expression for U.K. equities.
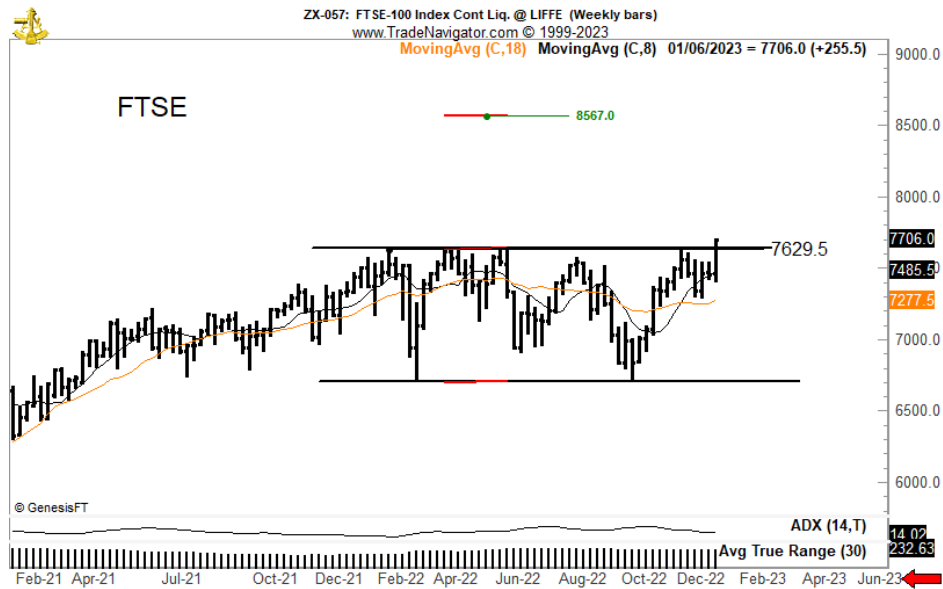
Litecoin. BTC and ETH made possible bottoms in November. By contrast, LiteCoin registered its low in Jun and has displayed considerable relative strength. A common bottom is being constructed. I will take a long-term anticipatory tranche in LTC with a stop below the Dec low on a 30 BP bet.
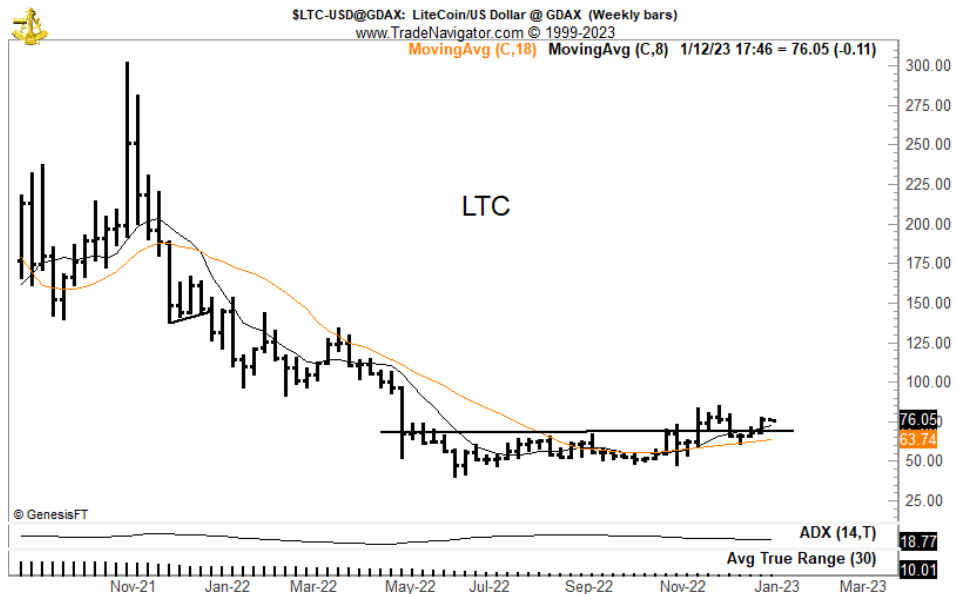
For a Brief Introduction to Probability Theory and the Random Distribution of Results, see here
https://www.peterlbrandt.com/brief-introduction-probability-theory-random-distribution-results-understanding-concept-sequencing-trading-operation/

Weekly position/symbol tracking - Prop ONLY

W/O Jan 1, 2023

Beginning Trades	Beginning Positions	Starting radar list for New Initial Positions	Symbols / orders added during week	Actions, End of week position	BP +/-
FEIZ23	S 100%	Euribor		B 50% Tu 9651, B 50% W 9661; flat	-4
GCG23	L 75%	Gold		S 25% W 1863.4, B 25% (GCJ) F 1889.2; long 75%	85
LEG23	L 100%	Cattle		S 50% Tu 157.10 & 50% 156.75; flat	-14
USDCNH	S 100%	Yuan		B 25% F 6.82772, short 75%	38
ZSX23	L 100%	Soybeans		S 50% Tu 14.605 & 50% 13.97; flat	-28
		EUR/USD	FX	Unable, Cxld	
		PLJ23	PLAT	B 65% F 1061.2; long 65%	
		RSH23	Rapeseed	Unable	
		YT3H23	3-Yr Ts	Unable	
		M2KH23	Russell	Unable	
			HGK23	Unable	
			DJP	S 100% Th 31.83, B 50% F 32.204, short 50%	-10
					67
		Closed trades YTD	58.9%		

Key: B = buy, S = sell; M = Mon., Tu = Tu., W = Wed., Th = Thurs., F = Fri., Sa = Sat.; LT = Long-term position

Weekly position/symbol tracking - Prop ONLY

W/O Jan 8, 2023

Beginning Trades	Beginning Positions	Starting radar list for New Initial Positions	Symbols / orders added during week	Actions, End of week position	BP +/-
PLJ23	L 65%	Platinum			
GCG23	L 75%	Gold			
DJP	S 50%	ETF			
USDCNH	S 75%	Yuan			
		FTSE H23	U.K. FTSE		
		HGK23	Copper		
		RSH23	Rapeseed		
		YT3H23	3-Yr Ts		
		M2KH23	Russell		
		LTC	LiteCoin		
					0
		Closed trades YTD	58.9%		

Key: B = buy, S = sell; M = Mon., Tu = Tu., W = Wed., Th = Thurs., F = Fri., Sa = Sat.; LT = Long-term position

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