

Tutorial: Our simple trading model

5/18/2006

Past + Present = Future

Meeting new people at social functions, the inevitable questions always pop up during small talks :

Q: So, what do you do for a living?

A: I am a market timer.

After a slight pause and a big gulp on his double martini, he fires another one..

Q: So, what do you think gold will do in the next little while?

A: I hope it goes up, because we are on a buy signal.

He raises his eyebrows, shakes my hand, and disappears for another big gulp. I'm sure he's saying to himself, what a moron, calls himself a market timer but has no idea where the market is going.....

Technical analysis is widely misunderstood, and misused.

That is because most believe that by applying technical analysis, we can forecast and predict the future. Well, if the meteorologists still have trouble forecasting the weather with all these fancy modern equipments, what are our chances of predicting the future with a few charts and indicators? 50/50 perhaps? We can achieve that by flipping a coin. So, what is my point?

Technical analysis when applied correctly, allows us to position in the markets when risk is acceptable and manageable, that is all. And if this task is carried out with precision and consistency, we are likely to gain an edge over most other market participants, and as a result, we will be consistently picking their pockets. This is the objective of trading and investing: we are trying to beat others in the markets, not trying to beat the markets. Trading and investing is a zero sum game, someone loses and someone wins.

Back to the question, what will gold do tomorrow?

That is a wrong question, because tomorrow is unknown. We can only apply with what is known, and that is the past and the present. Therefore, the correct questions should be:

What has gold been doing? (past)

What is gold doing now? (present)

By applying what is known to us, the future takes care of itself. Not always in our favor, but as long as we manage our risk, the reward should always triumph over the risk.

Let's get to the nitty gritty.....



A price chart provides us with known information of the past and the present, but without the help of some appropriate technical tools, how do you position for the future and when?



Lets first energize the charts with candlesticks, add a couple of moving averages, draw a couple of trendlines, and throw in a technical indicator called “MACD”, and an extra olive for the martini guy. That should do it. Most technicians use more than that, to me, less is more. (KISS) Keep it simple, sir.

The past – it is obvious that prices have been rising in the past; it rose to the point when gravity took over and the past was history by February, when prices broke support and confirmed by MACD, we call it TLBSS for trendline break sell signal.

The present – prices have been falling since the TLBSS in Feb, and today we have a break of resistance, confirmed by MACD and we have a TLBBS for trendline break buy signal.

The future – do we know the future at this point? Of course not. With the info we have, there are only two viable positions: cash or long.



We know the past, we know the present, and we are positioned for the future. When will the future be over? When support is broken. Therefore, future looks bright as long as support holds, and if support is broken, future becomes the present, we take a small loss and wait for future opportunities.



Fast forward to the future. Today is 5/12, and the present is once again history as support is broken and we have a TLBSS. Again, we do not know what the future holds, but with the information we have, there are only two viable positions: cash or short.



At time of writing, the present is far from over, therefore we either remain in cash or short as no other positions should be contemplated at this point.

Summary

True market timers are followers of the markets, specifically followers of price action. It is the only thing which matters. Leave the predictions and forecasts to the experts, our focus is on the past and present, and let the future unfold as it may, with no arguments and only acceptance.

This is our simple trading model, learn it, use it, and profit from it.

End of tutorial