Year end review for 2008
12/31/2008

Since going public with my trading models in 2001, we have had six straight years of profitable return for an average of 30% a year.
2007 was flat as volatility picked up and we were either unable to execute or we were stopped out on many occasions. I did not know it at the time, but that was only a hint of what was ahead for 2008.
2007 was truly a blessing in disguise because it did prepare us for 2008 which turned out to be a disastrous year for most investors of our generation.
I am not going to repeat what you don't already know.
Lets just look at the bottomlines for 2008:
$HUI – down 26%.
$OSX – down 62%.
$SPX – down 38%.
The combined average yearly loss for the three sectors is 42%.
We are up 6.4%.
Obviously our performance this year is by far the best of the past eight years in relation to market performance and conditions, but to be honest, I am not happy with the single digit return.
We could have done better.
I could have done better.
At the end of every year, I always review my year long activity, to recognize my own weakness and strength, so that I can be more prepared for the coming year.

Looking back

Here are my observations:

- my biggest mistake was not moving some of our profitable positions in the inverse ETFs into a core position by moving stops to B/E fast enough. Had we done that, even the suddenly unexpected increase in volatility in September could not have stopped us out, thus leaving us with a deeply profitable core holdings on the short side of the markets. My estimate is that a 20% core position in QID would have earned us a 20% return for the year instead of the single digit return.
- My other mistakes were buying the inverse ETFs too aggressively in March and April, thus resulting in unnecessary early losses. I should have been more patient, and I should have waited for a VIX buy signal. VIX is an excellent confirming indicator during a bear market.
- My biggest challenge was when Toronto made a new bull market high in June, in total contrary with the major sell signal of $SPX. And because the $TSX was weighted heavily in the resource sectors of energy and mining, I seriously thought that perhaps I was missing a major bull market, that the resource sectors would diverge from the equity markets. In mid July I skipped the set ups on GDX and XGD because risks were over 8% and that did not go well with some members. Gold stocks were in the "buy zone" according to many analysts and it appeared that we have missed the gold train. $HUI was at 450. As it turned out, the $HUI

began to collapse shortly after that. Crystal balls? No, just my conservative risk management.

- My strength was to recognize and respect our major sell signal in the $SPX early this year, long before the chaos began. By adopting a cautious and conservative stance, we managed to sidestep the global equity collapse completely.
- My other strength was staying disciplined to risk management. By not taking any positions since mid September when the extreme volatility began, we have avoided potential sharp trading losses in all three sectors, particularly in the energy and growth sector since Oct when new lows were made in both sectors in November, and the sideways whipsaw price action since. Of course, gold sector's Oct bottom held and the $HUI has rallied 100% since, with us watching from the sideline. Had we traded the gold sector aggressively, we could be up 30 to 40%. But had we also traded the other two sectors aggressively, the potential gains in the gold sector may not be enough to offset the trading losses from the growth and energy sectors. Not an excuse, just the facts. Bear markets are very unpredictable, and managing risks is the best we can do.

My perspective on risk/reward in this tutorial:
http://www.simplyprofits.org/editorials/tutorials/08-1228_Risk_and_reward.pdf

Looking forward

Looking ahead to 2009, I don't expect the bear market to end, but all three sectors are already extremely oversold from a long term perspective, therefore, it is highly likely that 2009 will be a period of either base building, or consolidation. The $VIX will be able to tell us when volatility returns to a "normal" state which is below 20, otherwise, we will remain in a highly volatile zigzag environment with sharp swings both ways.
We do have a potential new bull market as we begin 2009, and that is the US dollar. It gave us a major buy signal in September, and the daily config is bullish. Both investors and traders may want to begin accumulating positions upon signals and set ups and remain long until proven otherwise.
The gold sector was most oversold in 2008, and has recovered the most also. Therefore, it should be the first sector to return to a bullish config, and if and when that happens, we will be aggressive buyers upon set ups.
Can both USD and gold advance in 2009? We'll let the signals and set ups guide us.

Summary

There will be no shortage of predictions and forecasts from the investment communities over the course of the next few weeks. Most of their opinions and arguments will sound very convincing, but unfortunately, most of them will be wrong. Our trading models are trend followers and have no predictive value, therefore, our best bet is to go with the prevailing major trends, until they are reversed.
We are on a major sell signal in all three sectors, investors will remain in cash or fully hedged. And for traders, as long as the configs are bearish, we wait for sell signals and set ups to short the markets, ideally when VIX also confirms with a buy signal.
Buy signals and set ups during a bearish config is a counter trend trade and can be considered only if risks are manageable.

Capital preservation and risk management is top priority in a bear market and I will not be shy to stay in cash.
Thankyou for your continuous support, and look forward to more sharing and learning in the new year. God bless and stay well.

End of update