EVALUATION OF 3 YEAR "OUT OF SAMPLE" PERFORMANCE
OF POWERSTOCKS ALSI TIMING STRATEGIES
10 MARCH 2012

The HedgeTrader-HT1 TOP40 Trading algorithm is one of the most powerful developed by us. It has been running "out of sample" for 2.5 years now with live customers and is the most widely used mechanical trading strategy among our client base.

It is exactly 3 years after the bull market commenced in March 2009 and we wished to evaluate the performance of HT-1 against an ALSH buy and hold strategy (and other PowerStocks timing strategies) to see how she held up.

Firstly you need to realise that no "long only" mechanical strategy has yet managed to beat a buy+hold ALSH strategy in a roaring bull market. Timing strategies have "inefficiencies" in bull markets when their exit triggers get them out the market only for the market to resume upwards a short while later. Since corrections in strong bull markets are small, these inefficiencies are compounded as a mechanical strategy will always be getting in late on the new up-trend and generally getting out late on the downturns. This inefficiency is your "cost of insurance" against large scale bear markets or corrections.

When these bear markets (or large corrections) kick in, the timing strategies have you safely in cash. Thus when evaluating the performance of a timing system you need to take at least a 5 year view where one full business cycle has lapsed (one bear and one bull market). It is the inclusion of the large corrections and bear markets that the mechanical timing systems start streaking ahead of the buy and hold strategies.
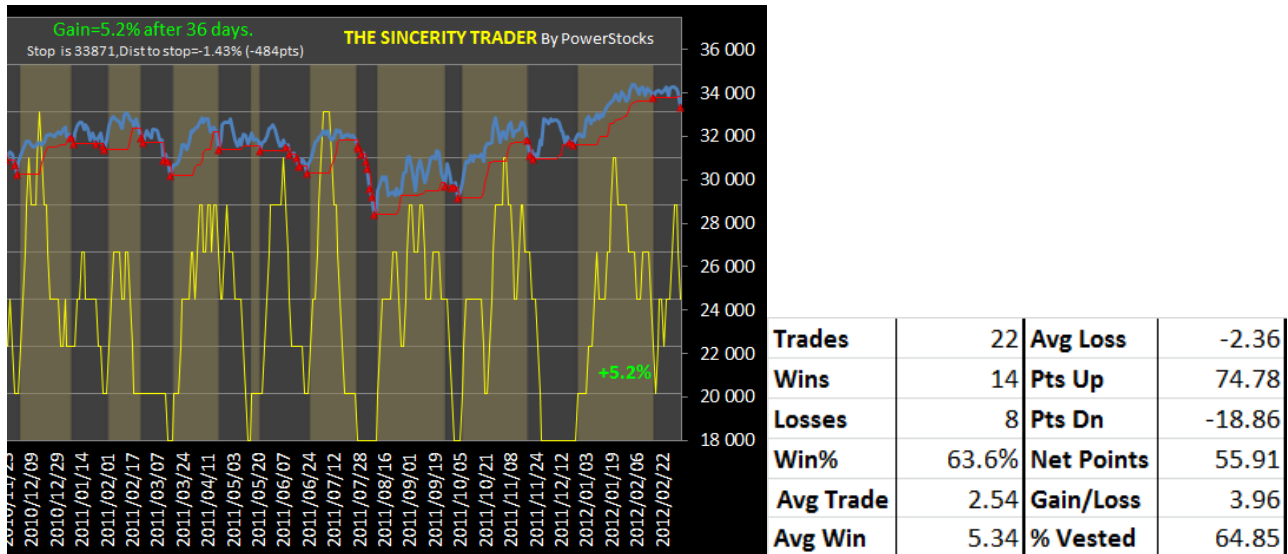
With that in mind, the true mettle of a timing strategy comes out when evaluated in a roaring bull market. If you can find a timing system that came close the performance of the buy+hold in a roaring bull market, but also comprehensively outperforms the buy and hold over a 5, 10 and 15 year history, then you know you are onto a winner.

Below is the 3 year performance of all of our TOP40 trading strategies. ALSH is the TOP40 buy and hold and CASH is an interest bearing money market account:
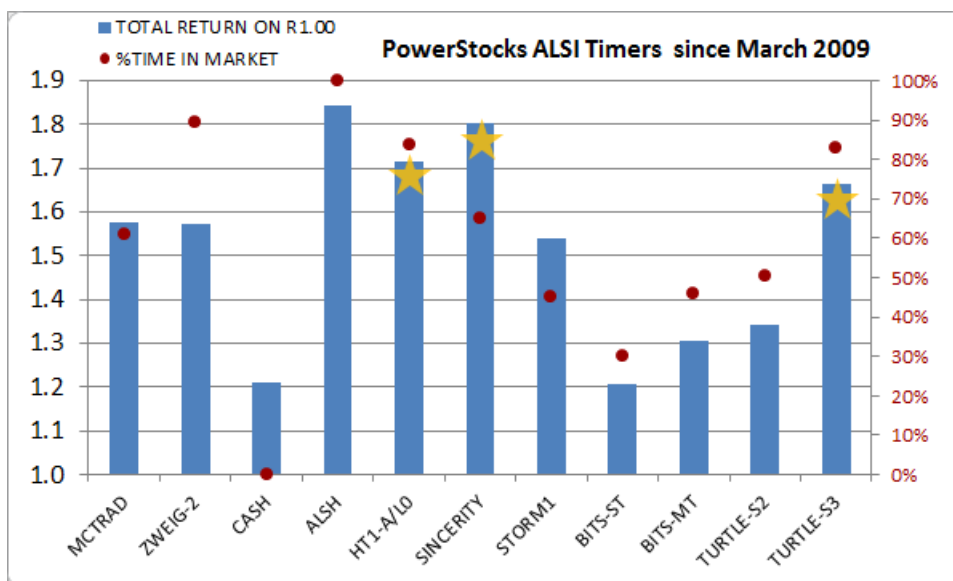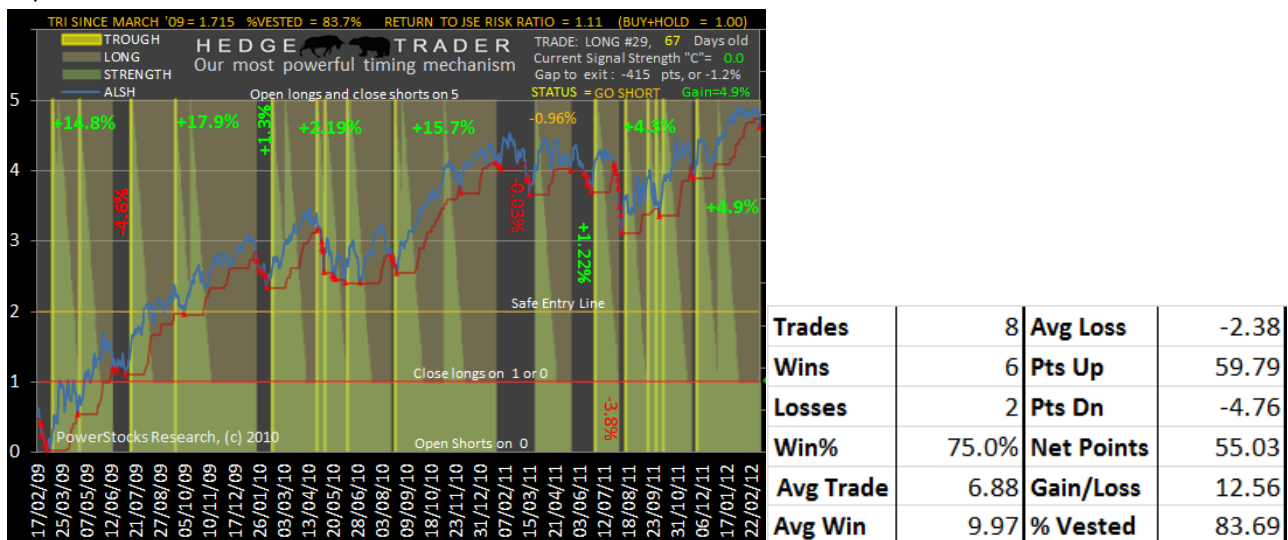
1. SINCERITY TRADER – (84.2% RETURN)

We see that on a TOTAL RETURN basis the ALSI buy-and-hold has returned 84.2% and the best performing timing strategy was the SINCERITY TRADER which returned 80.2% by being in the market only 64.9% of the time. Below are the 22 trades it did with last 2 years signals shown on left:

Trades	22	Avg Loss	-2.36
Wins	14	Pts Up	74.78
Losses	8	Pts Dn	-18.86
Win%	63.6%	Net Points	55.91
Avg Trade	2.54	Gain/Loss	3.96
Avg Win	5.34	% Vested	64.85

We see the top returning strategy is high frequency and not without its losses and it is therefore not suited to beginners.

2. HEDGETRADER HT-1/L0 (71.5% RETURN)

This is our top performing trading system over 18 years and the 2nd best performer on a total return basis since March 2009. The status of the system as at 7 March 2012 as taken straight from the JBAR ALSI TIMER report is below:

Trades	8	Avg Loss	-2.38
Wins	6	Pts Up	59.79
Losses	2	Pts Dn	-4.76
Win%	75.0%	Net Points	55.03
Avg Trade	6.88	Gain/Loss	12.56
Avg Win	9.97	% Vested	83.69

You can easily see why we encourage newbies to start with this system. The 75% win rate will not kill their confidence with strings of losses and although its low trade frequency can be like watching paint dry, the 12.56-to-1 gain/loss ratio says it all. Note this is a highly vested system, being in the market 84% of the time.

If you examine our research note on this system we published some 3 years ago, you will see we have 3 variants of the HedgeTrader. The one shown, the most widely followed is called HT-1/L0 and exits trades when the C-signal reaches 0 on the signal chart, when we are stopped out by the red trailing stop.

The research note encouraged another variant called HT-1/L1 which provides for earlier exits, namely when the C-signal reaches 1 (the horizontal red line in the signal chart tagged "Close longs on 1 or 0".)

We do not track a trade chart for HT-1/L1 in JBAR as the signal can be derived from the chart of HT-1/L0 but we tested the performance of HT-1/L1 over the 3 years and got the following:

HT-1/L1 VARIANT		Tot Return	1.771
Trades	12	Avg Loss	-5.28
Wins	10	Pts Up	62.91
Losses	2	Pts Dn	-10.55
Win%	83.3%	Net Points	52.36
Avg Trade	4.36	Gain/Loss	5.96
Avg Win	6.29	% Vested	55.84

As we stated in our 3-year old research note, HT-1/L1 is a far superior trading strategy which although producing similar returns to HT-1/L0, would do this for much less time in the market and therefore offer superior risk adjusted returns. The last 3 years is no exception as you can see. Not only did L1 produce 77% return versus L0's 71.5% but it did this by only being in the market 56% of the time versus 83% of the time!

Although L0 has a superior 83.3% win rate, her losses are indeed larger (averaging 5.28%) and therefore the gain/loss ratio is not as good as HT-1/L0. It is interesting to note that this strategy delivered 12 trades as opposed to the old ones 8 trades. This is because L0 hangs onto trades for longer.

OUR ADVICE FOR FOLLOWERS OF THIS SYSTEM IS TO TAKE 50% OF POSITIONS OFF THE TABLE WHEN THE C-SIGNAL REACHES 1 AND THE BALANCE WHEN THE C-SIGNAL REACHES 0

The advice we give above is basically a mix of both strategies to get the best of both worlds. Below is a TRI chart of both strategies and the buy-and-hold. The mixed strategy would give a TRI in-between the red and green lines.
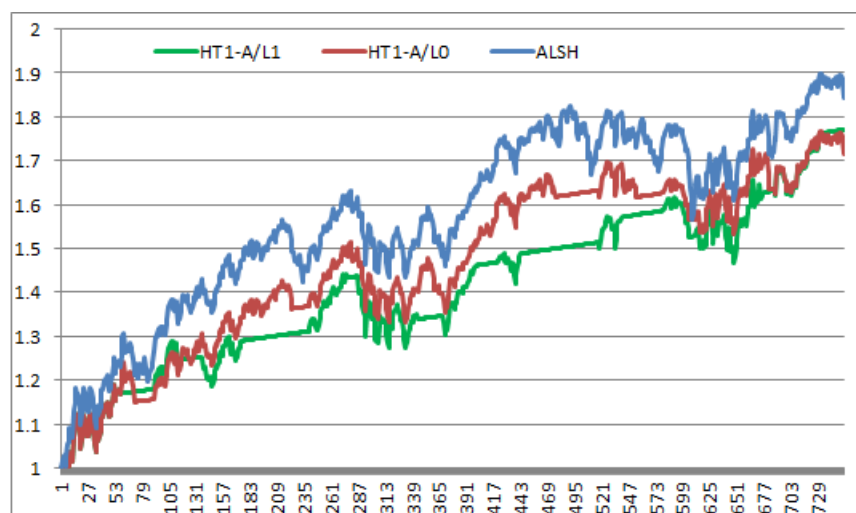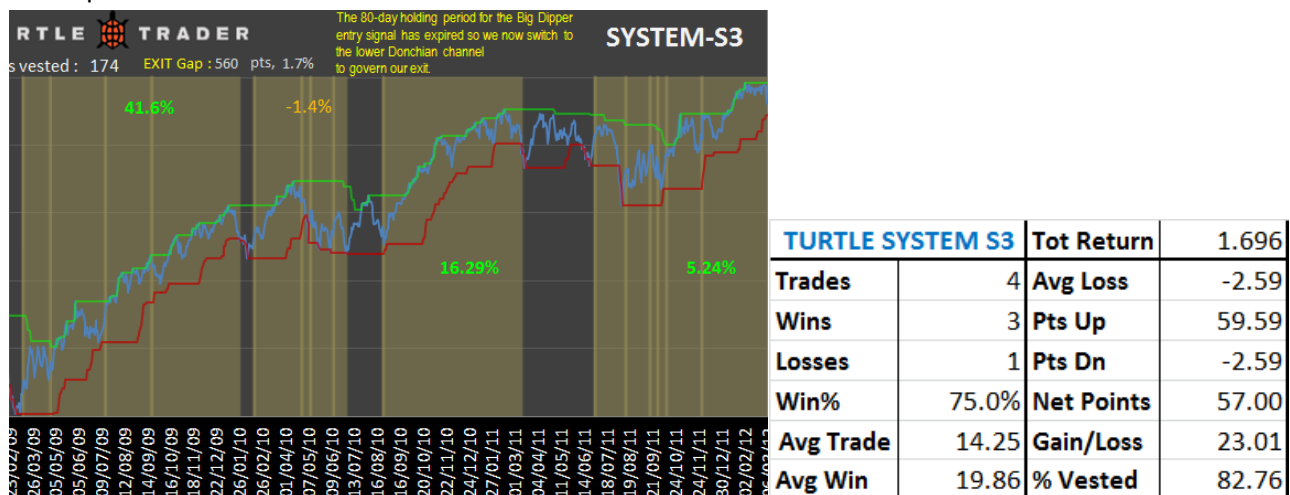

The above chart is a classic rendition of top-class funds-grade timing systems "underperforming" the JSE in a roaring bull market, but the chart below demonstrates the true power of market timing over many business cycles and large corrections showing the returns on an initial R1.00 over the last 5 years:

The power of market timing
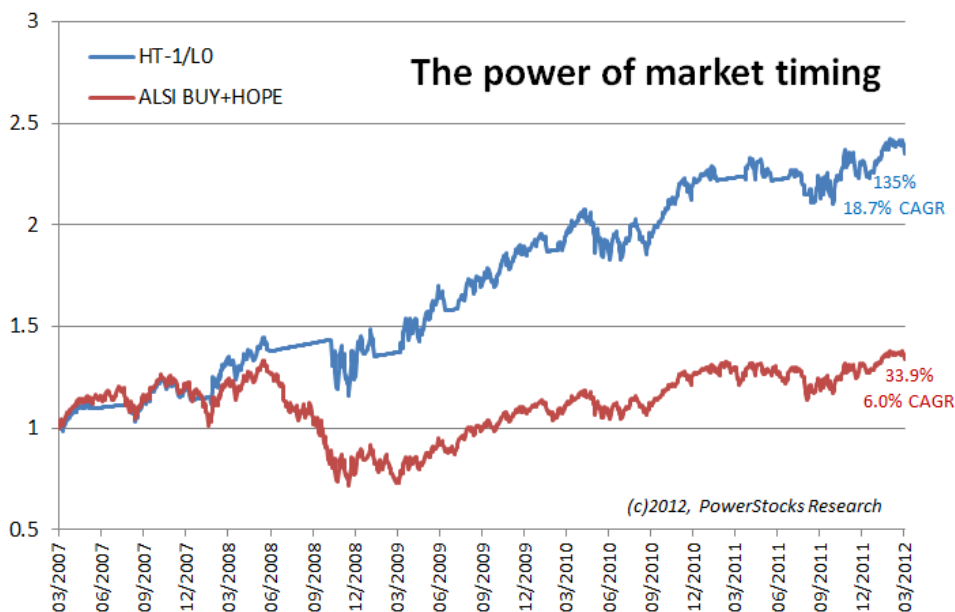
The HedgeTrader delivered a 18.7% compound return per annum versus the buy-and-holds' 6% per annum. All it took was one large bear market in the 2008 crash to decimate the buy-and-hold returns. If you go blow the dust off our old research note you will see the same theme going back 18 years on the JSE.

3. TURTLE-TRADER S3 (69.6% RETURN)

This venerable trader was one of the 1st "complex" (consisting of multiple buy signals) ALSI trading systems we built 4 years ago. It saw us nicely through the 2008 crash and has delivered outstandingly in the subsequent bull market.

| TURTLE SYSTEM S3		Tot Return	1.696
Trades	4	Avg Loss	-2.59
Wins	3	Pts Up	59.59
Losses	1	Pts Dn	-2.59
Win%	75.0%	Net Points	57.00
Avg Trade	14.25	Gain/Loss	23.01
Avg Win	19.86	% Vested	82.76

The name "turtle" suits it well from a trade frequency perspective as it delivered only 4 trades. Note how it side-stepped that 6 month sideways market that ran from March-Aug 2011. The system is currently still long as shown in the trade chart taken from your JBAR report, with a 5.24% gain. The gain/loss ratio on this system is simply stunning but you can see it is a highly vested system, in the market for 83% of the time. This means there are some hefty inter-trade drawdowns particularly observable in the last trade, and this can create some discomfort for the inexperienced trader.

4. THE ZWEIG LAZYBOY (60.2% RETURN)

As the name implies, this is a lazy system like the Turtle S3. It has a slightly higher trade frequency (some 20% more trades on average) and a very good win ratio normally in the high 80's. It is a highly vested system with a very respectable gain/loss of 16:1. As of 6 March 2012 it is still long
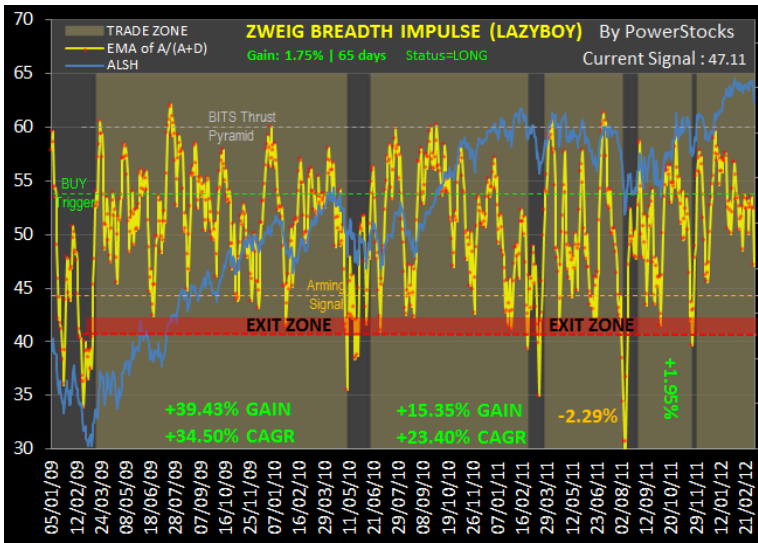

ZWEIG LAZYBOY		Tot Return	1.602
Trades	5	Avg Loss	-3.41
Wins	4	Pts Up	54.57
Losses	1	Pts Dn	-3.41
Win%	80.0%	Net Points	51.16
Avg Trade	10.23	Gain/Loss	16.02
Avg Win	13.64	% Vested	89.26

We recommend this system to newbies as it has an incredible knack for staying out of trouble. Generally when the LazyBoy is out the market, we are nervous for the WHOLE market as trouble is surely looming. This has led to many clients nicknaming her the "canary in the coal mine"

5. THE MCLELLAN TRADER (57% RETURN)

This is a new entrant we ran on pilot for 12 months before launching it to clients in late 2011. It is a high frequency short-to-medium trader that competes with SINCERITY TRADER. They have very similar performance statistics expect of course SINCERTY delivered 84% returns. It is not really part of the "out of sample" test since she is new, but we show her for interest sake.
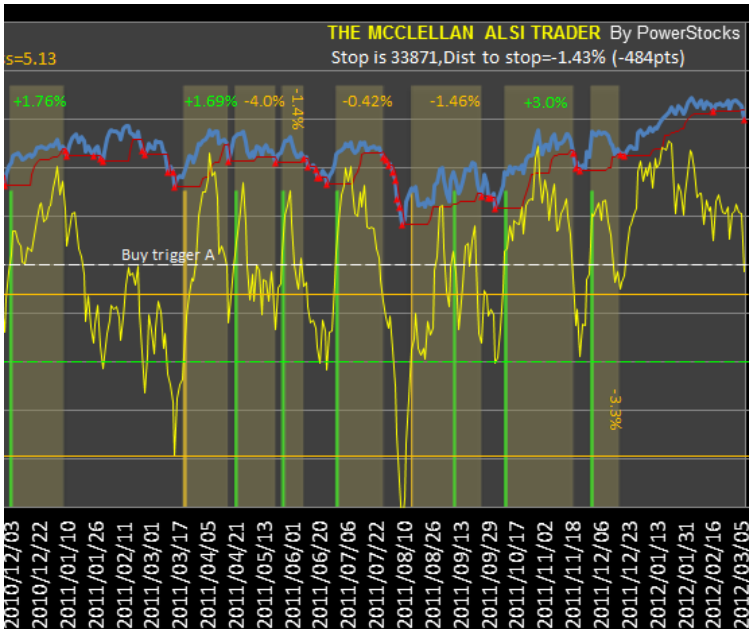

MCCLELLAN TRDR		Tot Return	1.577
Trades	17	Avg Loss	-2.37
Wins	11	Pts Up	55.62
Losses	6	Pts Dn	-14.22
Win%	64.7%	Net Points	41.40
Avg Trade	2.44	Gain/Loss	3.91
Avg Win	5.06	% Vested	61.01

6. STORM-1 (54% RETURN)

This is a very reliable "buy on strength" short-term trader. It has a fantastic win rate and very respectable gain/loss of more than 7:1 (you claw back 7 points for each one you lose). She may have only come 6th in the return stakes but there is a lot more to this than meets the untrained eye – she delivered 54% gains by only being exposed to the stock market for 47% of the time! This makes her, as we shall show later the most powerful trading system from a risk-adjusted return perspective.
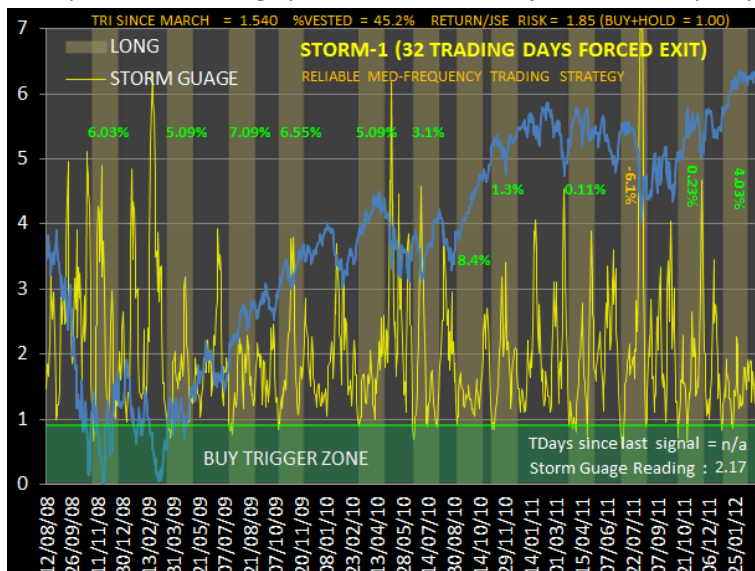

STORM-1		Tot Return	1.540
Trades	11	Avg Loss	-2.74
Wins	9	Pts Up	40.18
Losses	2	Pts Dn	-5.49
Win%	81.8%	Net Points	34.69
Avg Trade	3.15	Gain/Loss	7.32
Avg Win	4.46	% Vested	46.68

It is little wonder then that HedgeTrader HT-1 uses her entry signals in conjunction with Big Dipper trough signals. In fact Storm-1 signals are important *continuation* signals for HT-1 Also, STORM-1 has the lowest standard deviation for her average win meaning she delivers consistent wins of around 4.46%. It is ideal to use with SAFEX INDEX futures and the like as you are guaranteed trades last no longer than 32 trading days (no expiration and contract rollover issues to content with.)

There is one downside – she asks you to climb into the market after the market has already made one hell of a run – which can be psychologically challenging to inexperienced traders.

CONCLUSION

All the mainstream ALSI timers performed as expected in out-of-sample live trading with real customers. The total returns tell one story, with HedgeTrader, Sincerity and TurtleS3 taking the lead. But risk adjusted returns tell another story, where we look at the returns and how much the system was exposed to stock market risk to achieve them. From this measurement, STORM1 and BITS-MT are best performers:
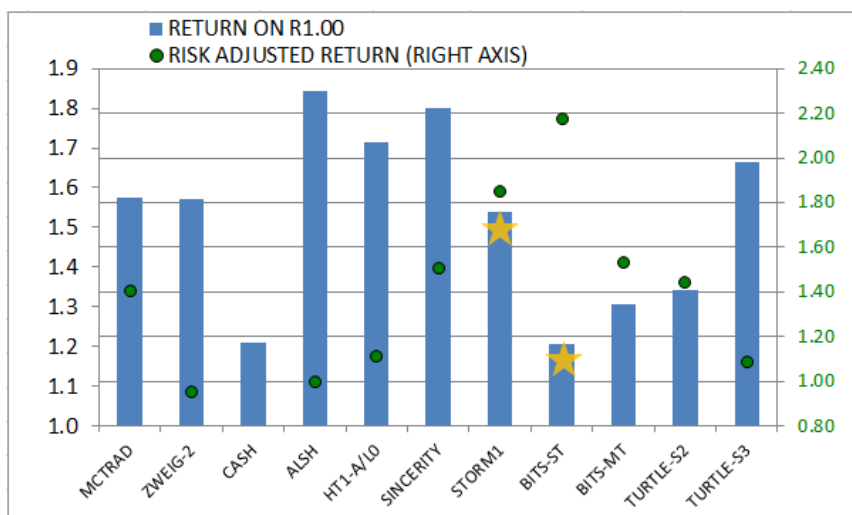
Risk adjusted return is the total return divided by the % of time in the market to achieve those returns, multiplied by 100.