

# CSI NEWS JOURNAL

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\$5.00

## WHAT'S NEW ---

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Please remember to change the ending year  
on all continual contracts to 1989

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Changes to the stock database

See page 6

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Additions to the stock database

See page 6

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Additions to the Commodity data bank

See page 7

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Stock splits

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PERPETUAL CONTRACT are registered  
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## A DISCUSSION OF MANY CHARACTERISTIC OF THE CSI SERVICE

This month we offer extracts from Sabrina Carle's talk on CSI products given at a seminar on trading techniques in West Palm Beach Florida. Sabrina is a very knowledgeable and long standing marketing representative of CSI.

Her talk gives important insight into CSI and CSI products and provides a helpful preview of work in process.

### THE CSI SERVICE (An Overview)

I work for CSI which operates a well-known daily update service from Boca Raton. Many of you may be familiar with CSI as a provider of financial data, including futures, stocks and options, but I want to show you some of the things we offer that are a little different from the standard information available from most data services.

In addition to delivering normal price quotes we process market data in several ways to make it even more useful to commodity traders. The main reason anyone subscribes to a data base service is so that he can learn more about the markets much earlier than tomorrow's paper can tell him. He gains substantial insight with charts and technical analysis programs in the hopes of forecasting what the markets will do tomorrow.

Before I tell you about the data and software we offer, I would like to clarify that CSI does not [currently] provide an intraday quote service or a tick by tick system. The only kind of analysis I will be discussing involves the daily summary of prices - the open, high, low, close, volume and open interest.

I occasionally find among traders and even analysts a tendency to brush off daily update services such as we offer in favor of the up-to-the second, tick by tick systems. In a few minutes I'll show you some forms of analysis that simply cannot be done on a real-time basis.

Many well-known traders wholeheartedly support the daily-update type of analysis. The list of CSI-compatible software vendors reads like a WHO's WHO of the futures industry.

I think most people would agree that it is good to be able to watch the market during the day to track the intraday movement, but these intraday price changes take on more important meaning when viewed as part of the whole for long-term technical analysis.

Many CSI customers spend their days watching market data on their CRT terminals or trading in the pits. But after the exchanges are closed, they spend a little time with their microcomputers performing the long-term analysis that a daily update system offers. As I'll be showing you, it can help them find entry and exit points, set protective stops, and most importantly, it can help them see which markets are bulls and which are bears.

It is important to realize that daytrading and long-term technical analysis are not mutually exclusive.

## II. THE ART OF INTER-MARKET STRADDLING

All you really need to do to be successful in the futures markets is buy low and sell high. That's simple enough, but the question is "WHAT IS LOW? and WHAT IS HIGH?" One way of measuring this is to determine if a commodity is priced higher or lower in relation to other commodities in its particular industry.

There are many industries in which the various components are economically substitutable. That is to say, many of the commodities have the same or very similar supply and demand characteristics. A few examples would be the grains, livestock and metals. These commodities tend to seesaw between being overpriced and underpriced in relation to the other components of their industry. Trading any pair of these

economically substitutable commodities can produce a very profitable, low risk investment. The key is to find a pair of commodities that have strayed substantially from their normal price relationship.

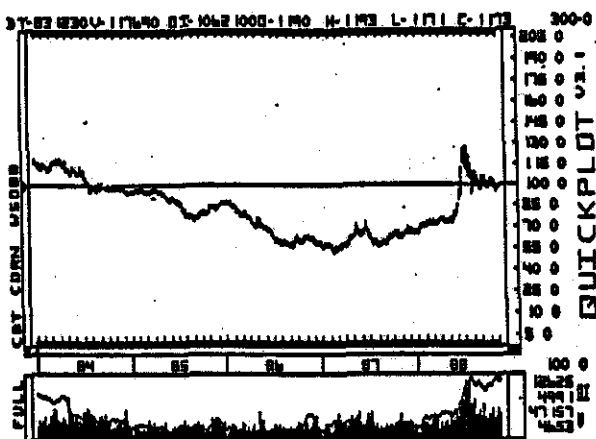
We have developed a simple, visual means of analyzing this relationship with our PERPETUAL INDEX data. This is a way to add strong fundamental ideas to your technical approach. It is a system of indexing commodities to uncover intermarket straddle opportunities. An intermarket straddle, sometimes called an intercommodity spread, involves the simultaneous purchase and sale of two commodities. To make the study meaningful for analysis the two selected commodities should be correlated and economically substitutable.

A brief but accurate statement describing the science of economics is that it is the efficient allocation of resources to the consuming public. The substitution idea is involved in the allocation process. If you are a trader who wants to become a consistent winner then you must appreciate and act upon the substitution concepts I hope to expose to you.

We create PERPETUAL INDEXES for each commodity and industry group. These indexes remove units of measure such as the price per bushel, bale or barrel and eliminate price discrepancies that can make it difficult to compare commodities. They allow us to evenly compare markets that may normally be difficult to compare: Wheat with corn or cattle with hogs, hogs with corn, any pair of economically substitutable, correlated commodities are some examples.

Our PERPETUAL INDEX data help investors determine when any two commodities have strayed substantially from their normal price pattern. The indexes make it easy to buy the underpriced commodity, sell the overpriced commodity and make a profit when they resume their normal relationship.

This is a chart of the PERPETUAL INDEX data for corn. The 100 level on this chart represents the average price for corn in 1982 and 1983. We use this same time period as the basis for indexes for each commodity. We refer to this 82-83 average as the "historical norm."



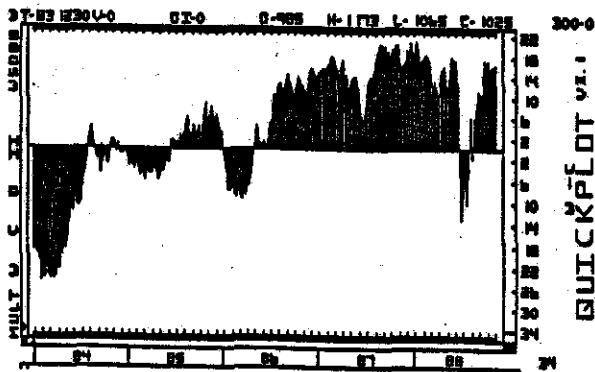
As you can see, this is a weekly chart covering several years of market activity. During the last quarter of '84, the value of corn fell below its historical norm and stayed there until the middle of 1988. Right now corn prices are at just about the same level as the 1982 and 83 average.

This chart is somewhat interesting in that it shows us how corn is priced in relation to its own past, but the real value of this data comes when we put two commodities on the screen together and analyze the difference between the two markets.

This sort of straddle analysis requires you use CSI's QUICKMANAGER<sup>®</sup> software to create a multiple contract file of up to four commodities you may wish to compare.

You can select any two of these indexes for comparison by means of a price difference oscillator.

This chart was made from a file containing wheat, corn, oats and our PERPETUAL INDEX<sup>®</sup> for grains. I displayed just the corn and wheat and made an oscillator of wheat minus corn.



Whenever the wheat index is higher than the corn index, the index difference oscillator is above the line. When wheat's value is below that of corn in relation to the norm, the index differences are below the line.

This technique looks at the relative difference in price as opposed to the actual dollar values. What we're looking for is the level at which the price difference is too great for the economy to bear; the point at which the prices stop growing farther apart and start moving back together. We can simply look at the amplitude reading to see when two markets have strayed significantly from their normal price relationship and when they have returned to normal.

It takes several years of historical data to get a good picture of the relationship between two commodities. It is unlikely that they will go far beyond what have been the limits in the past, so we examine the historical data and set thresholds for our market entry and exit points.

For some commodities, definite thresholds emerge - a level beyond which the amplitudes have little chance of exceeding. For others, you have to pick your entry and exit points by watching for changes of the amplitude's direction.

This wheat/corn chart shows a little of both. You can see that the extremes during this 5 year period were around the 22 mark on either side. But there were also opportunities when the amplitudes only grew to around 10 points in either direction. A point may be considered as an approximate 1% change in price between the pair.

When a good opportunity is uncovered, the trade would involve taking two positions, a long unit in the commodity that is unusually undervalued (wheat) and one short unit in the commodity that is unusually overvalued (which would be corn).

It is important that the investments be roughly equal in the dollar value of the contracts, not necessarily the number of contracts traded. Since wheat is about one and a half times the price of corn, two wheat contracts would represent one wheat unit and three corn contracts would represent one corn unit.

What you get is essentially a hedged market position that carries less risk than a "naked" position trade. This is because it can be expected with favorable odds that the commodity that is historically overvalued will come down in price and/or the commodity that is undervalued will increase in price as they move toward or beyond their normal relationship.

We can do the same analysis to help solidify our decisions by comparing wheat and corn with the grain industry itself, using an index based on the average price of all the grains for 1982 and 1983. We look for the same type of disparity between the particular commodity and its own group of commodities as we did between two members of the group. This would let us see if corn, for example were overpriced just in relationship to wheat or if it were out of line with its entire industry. Obviously, you can't short the grain index, but this type of analysis can help you make a more intelligent trading decision.

True, you can't trade the grain index, and when you get right down to it, you can't call your broker and tell him you want to sell the PERPETUAL INDEX for corn and buy it for wheat. You have to decide on specific contract months for each commodity. The choice is yours, of course, but we offer some general guidelines:

First, always select a contract with sufficient volume and open interest to assure liquidity.

Second, it is important that you allow enough time for the straddle to unfold before your contracts expire. Since most straddles last up to five months, with an average of about three months per pair, selecting the delivery month that is approximately six months from expiration is a good bet. This way, you usually have plenty of time to ride out your position without having to roll-forward into the next actively traded contract.

CSI publishes a list of about 200 pairs of commodities which might constitute good straddle opportunities. It includes the obvious pairs I have shown you here and also some less likely duos. One unusual combination that might be found to be both correlated and economically substitutable

is the light crude oil/lumber straddle. Both of these products can theoretically be burned for fuel and used as building products. Another interesting pair might be aluminum and light crude oil because such a high percentage of the cost of producing aluminum is the cost of electricity.

As you may have noted from the charts, these intermarket straddle opportunities do not come along every day. You can expect to find about one straddle opportunity per year per pair of commodities. By regularly examining 200 viable pairs drawn from about 30 active commodities, a trader can expect to stay very active in the markets while participating in relatively safe trades. "Safe trades" should equate to far fewer losses and much greater profits in the long run.

### III PERPETUAL CONTRACT® DATA

Those of you who like purely technical analysis might prefer another unique CSI data product called PERPETUAL CONTRACT data. This is a way we have devised to create a single, continuous set of data for each commodity without regard for individual delivery months.

The concept was developed by Bob Pelletier, the president and founder of CSI, back in the early 1980s. He was a commodity trader himself and managed an account for one other investor. He was an engineering analyst for G.E. at the time and rented extra computer time from them to develop trading systems.

Bob started out creating trading models on actual contract data, as many of you probably do, but he encountered some problems with analyzing individual commodity contracts that he needed to rectify if he was going to get anywhere. One problem was that the contracts kept expiring! Just as his trading models started working well, his contract would expire and he had to start over again. Since every commodity contract has a finite life cycle of 8 to 35 months, the normal birth and death process makes it difficult to carry out long-term analysis. This was a problem he hadn't encountered as a stock trader and what he wanted to do was make a commodity look more like a stock. Another

problem Bob had with analyzing several months of data on a single futures contract was that most of the information he was processing was from a time period for which there was little trading interest. Bob, like most investors, was only interested in trading contracts that were fairly close to expiration. When he looked at the life of a particular commodity contract, only the last few months were pertinent to the window of time in which he planned to trade.

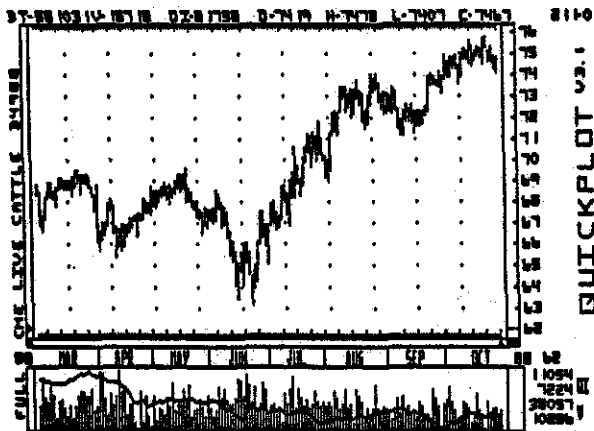
He found that by monitoring the market a fixed number of days forward, he could focus his analysis on the moving window in time where he and most others planned to be trading.

He selected a 91-day forward formula because most commodities have a new delivery month due at least every three months. He applied a time-weighted average to the prices of the two contracts adjacent to the 91-day forward target date and called the result PERPETUAL CONTRACT data.

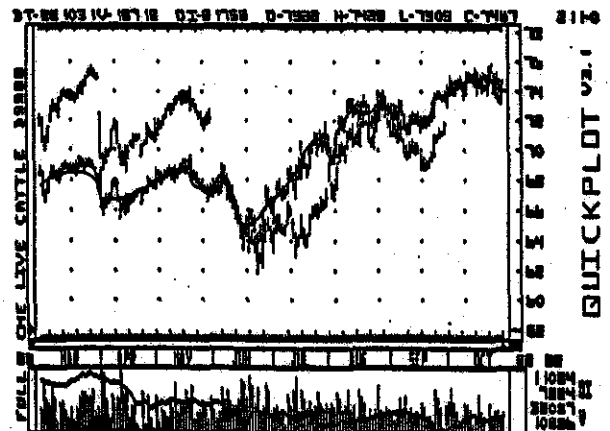
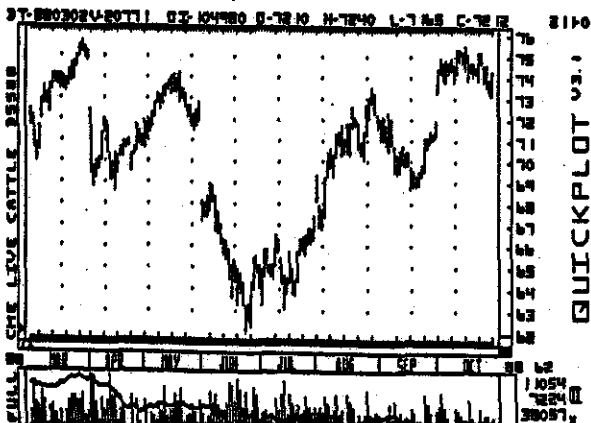
The above chart shows a typical Nearest Futures set of data for cattle. By that I mean, it is the lead month at all times. You can see at several locations that there are large gaps in price that occur when the delivery month is changed. These create real problems for any price-derivative trading system. You can imagine what this gap would do to any moving average crossover study. This jump is certainly out of the five day range for stochastics. The fact is, that most trading systems have no way of screening out these arbitrary jumps and the result is invalid trading signals.

If we examine the two charts carefully, we can see that what is a major drop in the nearest future series is just another day in a continual downtrend in the PERPETUAL CONTRACT chart. The prices move in the same general direction as the nearest future data, but the price jumps have been naturally removed and the gaps have been eliminated. The PERPETUAL CONTRACT chart is by far superior for many types of technical analysis.

I am sometimes asked "what is the exact correlation between PERPETUAL CONTRACT data and the lead month." I have made another transparency of the PERPETUAL CONTRACT chart stacked with the nearest future chart. The PERPETUAL CONTRACT data is marked in blue. You can see for yourselves that at one point the PERPETUAL CONTRACT price is higher than the nearest future, at another point it is lower and when I made the chart they were just about the same.



The above daily bar chart shows our PERPETUAL CONTRACT data for live cattle for the 8 months ending October 31. As you can see, it is a single, continuous set of data for the commodity.



The point I'm trying to get across is that the exact correlation doesn't matter. This is not just a way to avoid having to replace contracts every few months or a way

to keep down data costs or to effortlessly watch many markets at once. PERPETUAL CONTRACT data does all of these things, but it is also a better way to analyze and take the pulse of the markets.

Although many software vendors recommend this type of data for analysis, one system will only operate on the PERPETUAL CONTRACT data. This is the Kroll Wilder Long-Term Trading System and it has been used successfully by traders since 1983. Before basing the KROLL WILDER trading system on the PERPETUAL CONTRACT data, its developers, Stanley Kroll and Welles Wilder did extensive research comparing their results with PERPETUAL CONTRACT data and actual contract months. Stanley Kroll tells me that they found no disadvantages and of course, many advantages to using the PERPETUAL CONTRACT data.

Another common question I hear on the PERPETUAL CONTRACT data is "yes, it looks good, but how do I trade with it."

As far as what studies are best, you can use it with almost anything. It works as well with stochastics, moving averages, Williams ZR - any of the standard technical studies. We highly recommend PERPETUAL CONTRACT data for use with our PDI study. I'll be showing you that later.

Regarding what month to trade, the general guidelines are pretty much the same as for the PERPETUAL INDEX. First, always stay with contracts that have sufficient volume and open interest to suit your trading preferences.

Second, Mr. Pelletier suggests that you should also be sure to give yourself enough time to complete the trade and be out of the market for the last month of trading when volatility is greatest. Using this technique, the length of time you plan to hold the position plays a key role in the selection of the contract month. One last application of PERPETUAL CONTRACT data is actually used by investors who prefer to analyze the markets with specific contract months. Since PERPETUAL CONTRACT data lets you keep tabs on an entire commodity in just one chart, an investor can quickly review a host of markets for possible developments while saving time to focus on several contracts of a few commodities for

current investments.

That pretty much covers some of the more novel data products available to CSI customers. Now I'd like to show you some of the unique software products we offer.

[TO BE CONTINUED NEXT MONTH]

#### ADVERTISEMENTS ENCLOSED

We have enclosed advertisements for the following products and services: The System Writer Plus - Technical Analysis Program developed by Omega Research, Inc., Mesa and Epoch Trading Systems by John Ehlers, and the Best Trading Tools: Trading Seminars, videotapes and books offered by Dr. Alexander Elder.

CSI accepts advertisements to accompany this News Journal for the sole purpose of defraying postage costs.

#### CHANGES TO THE STOCK DATABASE

5377 ICX	IC Industries had a name and symbol change on 881130 to WH Whitman Corp.
6312 BKT	Should be BTT Blackstone T6 Trust
5209 MAN	Manville Corp. is now w/ MVL1 881129
5332 CIL	Continental Illinois Corp. changed its name and symbol to CBK Continental Bank Corp.

#### ADDITIONS TO THE STOCK DATA BASE

5200 HKT	Hong Kong Telecom	881209
5801 MTL	Materials Research Corp.	881216

The following stocks are available on a daily basis only:

6989 OKCPZ	OKC LTD Part Dep Uts
6986 MCAWA	McCaw Cellular Commun
5991 ALDC	Aldus Corp.
7393 SOV	Sovran Financial Corp.
6985 CRFC	Crestar Financial Corp.
6219 FKDNX	Franklin Dxnatech Fund
6220 FKREX	Franklin Equity Fund
6221 FKRCX	Franklin Gold Fund
6222 FKUTX	Franklin Utility Fund