

# CSI NEWS JOURNAL

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VOL. VI NO. 8 \* \* \*

WEDNESDAY, AUGUST 1, 1990

Boca Raton, Florida

\$10.00

## WHAT'S NEWS — \* \* \* \* \*

Free History Data from FMD See Flyer

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Data Accuracy Involving Energy and Precious Metals Products Page 5

\* \* \*

On Perpetual Contracts® & Why They Are Favored Page 2

\* \* \*

Additions to the Commodity Data Base Page 5

\* \* \*

Additions to the Stock Data Base Page 5

\* \* \*

Changes to the Stock Data Base Page 6

\* \* \*

Format Translator<sup>SM</sup> Introduced Page 6

\* \* \*

Stock splits Page 6

\* \* \*

## ARE THERE ANY GOOD

### TRADING SYSTEMS OUT THERE?

At CSI we have found that the prevailing tendency for traders to suffer losses dominates as the reason given when a customer temporarily or permanently leaves our service. We plan to make a concerted effort to influence our users in a positive way by helping to formulate better practices in trading tool usage, and helping our users avoid products that cannot fulfill their advertising claims. We also will be suggesting what traders should expect from optimized system performance.

We are beginning this month with this project by explaining what has worked for us. A brief article on Perpetual Contracts starts off our first effort.

There are some good systems out there and systematic trading isn't a bad idea provided that you are aware of the assumptions and are not misled by the developer's over-optimistic claims.

Be careful when you use tool kits. These are technical trading approaches that are generally offered by a multitude of vendors. If the methods are fully disclosed, they have one thing in common. They are zero sum games, less the commission you are obliged to pay. This means if you use them regularly and often you may break even on the trading, but you will lose on the commissions you must pay. Add up your experience over the years. If you find that your total commission bill equals your total losses then

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you will see that I am correct. If your losses are greater than the commissions then you may also be paying for slippage in the placement of your orders. In this event, market orders often deliver to the trader the most unfavorable side of the bid/ask spread. When you request a "market" fill and you are a buyer you will generally get the ask price for your execution. Sellers get the bid price. This additional cost or slippage may be considered part of the commission but it is a definite cost of playing the game.

We hope to keep you posted on things that can help you. We feel that if we can help keep our customers profitable, they will want to stay with us and it is our goal to build such a mutually beneficial relationship.

### ON PERPETUAL CONTRACTS®

#### AND WHY THEY ARE FAVORED

Back in 1959 when I first discovered the commodity markets (there were only 15 viable markets at that time), I was troubled by the lack of longevity of a given contract on which I wanted to apply certain technical studies. There was also the problem of market volatility which seemed to drive the daily trading range to wider and wider levels as a given contract approached maturity.

These two problems greatly impacted on my analysis. The rather short contract longevity made it difficult to get enough repetition of statistical information to make any projections, and the ever increasing volatility problem made future projections of market behavior all but worthless.

I like to introduce stops into my market analysis because I hate to take a big loss. Both buy and sell stops based on market data drawn from information that is sampled at, say, six months before delivery can't realistically be applied to a contract that is trading less than six months before delivery.

Let me state this problem in another way with an example. Suppose you have a system complete with stop entry and exit logic that applies to T-Bills. More specifically suppose we are looking at September '90 T-Bills. If you view this T-Bill market in March (six months before the contract expires) the volatility of the September contract will tend to be less intense than it will be in say June of 1990. Therefore the buy and sell stops will be set closer to the range of trading in March (6 months before delivery) than in June (3 months before delivery). This volatility problem tends to work against the system trader because the conditions inherent in the data are not translated into adjustments for ever expanding volatility.

In statistical analysis and in particular the study of time series, attention should be given to the little known but very important concept of stationarity. A stationary process is one where the distributional form of the time series is constant. A phenomenon that we don't have in the futures markets is stationarity. Unfortunately, an underlying assumption of most tool kit analysis is that a state of stationarity exists. This false assumption contributes greatly to why the majority of studies and analysis produce flawed results.

Fortunately, there is something that can be done about it. At the risk of offering a solution that may sound self serving, we honestly believe the answer lies in using Perpetual Contracts. Nearest future contracts and the computed series produced by other Data Vendors attempting to emulate continuous contracts do not work because troublesome price discontinuities of adjacent contracts strongly distort the outcome of the analysis. The utilization of Perpetual Contracts will avoid the market discontinuities and allow your trading analysis to focus on the commodity's center of liquidity and volume.

Perpetual Contracts represent the market from a fixed vantage point two to eleven months forward of the current date. They are the closest you will

ever get to the requirement of time series stationarity for Futures data. They are calculated with great precision and the effects of weekends and holidays are factored into each day of data. There are little or no discontinuities, jumps or drops in price and the data represents the true time forward weighted price for the particular series examined.

Two tool kit vendors other than CSI that we know about can use Perpetual Contract data. Computrac and Metastock both have a facility to process CSI Perpetual Contract data.

A printed report that shows how a Perpetual Contract is calculated is free to anyone who doesn't have a copy. Let us know if you want one.

To show the similarities between the Perpetual Contract data and an actual contract, we have shown a three month forward #46 Perpetual Contract and a Sept. 90 T-Bills actual contract. Please notice the relative homogeneity of the

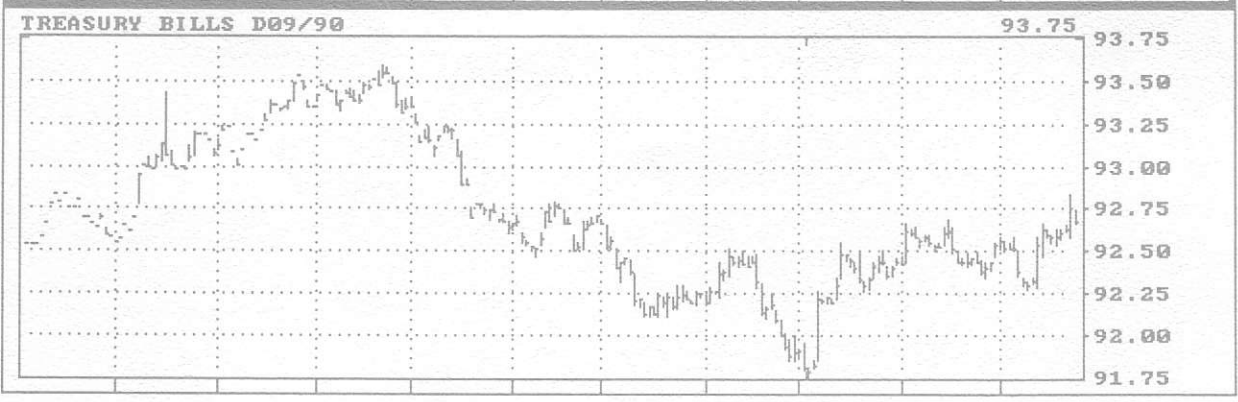
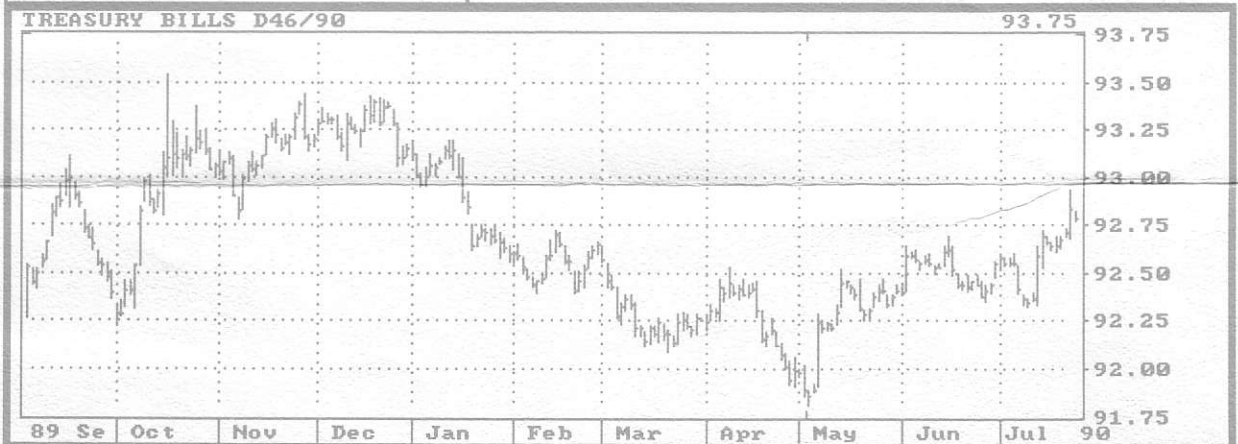
Perpetual data. The trading ranges are well behaved around a norm throughout the eleven month study period, and the market volatility of the actual contract is reflected in the Perpetual Series.

The most recent data covers the period through July 24th and (for the last few months) there is little difference in the markets signature between the two approaches. In fact, there is little reason to suggest that you should avoid technical analysis on the Perpetual Contract data given the intent to apply the results to the actual contract.

The Perpetual Contract data is clearly stationary in form. To be forced to make a trading decision on the actual contract that is based on an averaging of the entire history of the actual contract could leave you with a relatively poor idea of average trading ranges and potential future market movement expectation.

The charts below were drawn from a pre-release copy of our forthcoming version 4.0 QuickPlot®/QuickStudy®.

DATE =	900502	CLOSE=	91.86
DYNUM=	3	HIGH =	91.81
HIGH =	91.89	LOW =	91.73
LOW =	91.81	CLOSE=	91.78



If after reading all of the above arguments you still remain somewhat doubtful about the flaws in actual data, let me make one final point. If you have experienced a systematic technical trading procedure where a given correct signal led to a temporary reversal that was quickly followed by a resumption of the original trend then you may have been dealing with non-stationary data. What could have happened is through the ever gently expanding market volatility characteristic of actual data, the market range, as defined by the more extreme highs and lows, has caused your system's reversal logic to falsely reverse. Since Perpetual Contracts are uniformly stationary, by using them you should avoid most of the nuisance reversals that boot you out of your position, leaving you on the sidelines without courage and confidence to risk resuming the original market direction.

I recommend following both Perpetual Contracts and actual contracts. Get your market signals and wisdom from Perpetual data and your pricing information from actual data. You should be pleased with the results.

The more popular Perpetual Contract choice is the three month forward variety because it emulates trading where volume and liquidity are greatest. However some users opt for further out varieties for timing purposes. If you want to compare the raw material corn with the finished product live hogs then an analyst might wish to compare three month forward corn with nine or eleven month forward live hogs.

In summary, what is happening with Perpetual data is a mathematical transformation of actual data that also helps filter out market imperfections. To say that actual data is flawed is not as ridiculous as it may sound. In radar and sonar signal processing all sorts of filters and transformations are introduced to correct the raw data received. Only through advanced processing and filtering methods do certain targets become visible. There is no reason not to apply the same

principals to raw market information.

### Practical Suggestions On Trading

The most common complaint about Perpetual Contract data is in applying the numeric information to the actual market. There is little difference in the appearance of the data with the exception that the volatility is relatively constant. An actual contract may begin trading with little or no volume or daily trading range. As the actual contract approaches maturity the volume and daily trading range tend to increase. A Perpetual Contract, on the other hand, has a relatively constant volatility and volume, as it tracks the given market where the majority of the trader positions are held. Analysis is best applied to the Perpetual Contract data as though it is an actual contract. An oscillation of trades should then be made on actual contracts or put and call options in the direction indicated by analysis of the Perpetual Contract. The trader should focus on either or both of the futures contracts or options that lie just before and just after the forward time period governed by the chosen forward period.

If the user employs stops in his trading then a Perpetual Contract-to-actual contract blending approach could be used that will permit the analysis of several years of Perpetual Contract data followed by a blend of Perpetual Contract and actual contract data, followed by a set of exclusively actual contract data to near the current delivery date.

In our forthcoming Unfair Advantage<sup>SM</sup> product, for example, that we are working so hard to release, we analyze Perpetual Contract data for up to sixteen years, then a blend of Perpetual Contract and a given actual contract data for about 4 or 5 months, then for a period of about three months we use strictly actual contract data. During the blend period there is a gradual phase-in of the actual contract data from the Perpetual contract data. On the first date of the blend

period nearly all the emphasis is on the Perpetual Contract data; on the final day the reverse is true and nearly all the emphasis is on the actual contract. In this way the user has analyzed stationary data possessing a relatively high but constant volatility for nearly the entire series. He can then actually apply his results to an actual contract with minimal effects caused by market maturing volatility.

We invite your questions and comments about this and any other material produced in this newsletter.

### DATA ACCURACY INVOLVING ENERGY AND PRECIOUS METAL PRODUCTS

The exchanges of Comex and the New York Mercantile Exchange often show settlement prices that lie outside the daily high/low range. We believe this seeming anomaly is more characteristic of these exchanges because of the tendency of metals and energy products to be more driven by interest and positive carrying charges than other Futures and Commodity products.

These markets do not have the characteristic periods of planting and harvest, for example, and they tend not to be characterized by what the London Metals Exchange (LME) calls backwardation.

Many of the contracts of the metals and energy products markets may trade less actively during a given day and, in fact, may not trade at all during the final minutes before the closing bell. Should the leading contract of a given market be heavily traded at the close of the day (or any other contract for that matter) then there is a chance that the more active contracts will experience a range of daily highs or lows that, given carrying charges and interest rates, were not experienced in other lightly traded contracts. This could produce the situation where the

settlement prices of lightly traded contracts could lie outside the high/low range. Since settlement prices do not represent actual traded values, then under the conditions cited the settlement price could lie above the highest actual trade or below the lowest actual trade for the day.

A committee of experts from the exchange are responsible to make the judgement call on settlement prices.

Most CSI QuickTrieve® customers receive high and low prices that are adjusted to be inclusive of settlements. Many of our commercial accounts receive the data in an unexpurgated form. We hope this information will enhance your understanding of the markets.

Best wishes for prosperous trading,

*Bob Pelletier*

### ADDITIONS TO THE COMMODITY DATA BASE

CSI # 56 - MG BASE METAL INDEX  
Exchange: London Fox  
Symbol: MG  
Units of Measure: Percent  
Contract Size: 100 x index  
Delivery Months: 3, 6, 9, 12  
First Day: 6/21/90  
Conversion Factor: +2  
Limit: None  
CSI Point Value: \$1  
Newspaper/CSI Price: 167.50/16750  
Maximum Months Forward: 16

CSI # 137 - DUBAI SOUR CRUDE OIL  
Exchange: IPE (London)  
Symbol: DC  
Units of Measure: \$/Barrel  
Contract Size: 1000 Barrels  
Delivery Months: 1-12  
First Day: 7/19/90  
Conversion Factor: +2  
Limit: None  
CSI Point Value: \$10  
Newspaper/CSI Price: \$17.15/1715  
Maximum Months Forward: 8

### ADDITIONS TO THE STOCK DATA BASE

6619 BGEIX	Benham Gold Equity Index Fund	900620
6445 NQM	Nuveen Investment Quality Muni	900622
7528 RTZ	RTZ PLC ADR	900628
6624 FRESX	Fidelity Real Estate Invest. Fund	900621
6625 FDEQX	Fidelity Disciplined Equity Fund	900625
6626 FICDX	Fidelity Canada Fund	900625