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Banking On CSI Seasonal Charts (A Blueprint Into The Future)

A professional work or writing on commodity trading is not complete without an in-depth examination of seasonal price behavior. Any agricultural product that is a candidate for trading should not be considered unless the seasonal pattern for the given product is reviewed.

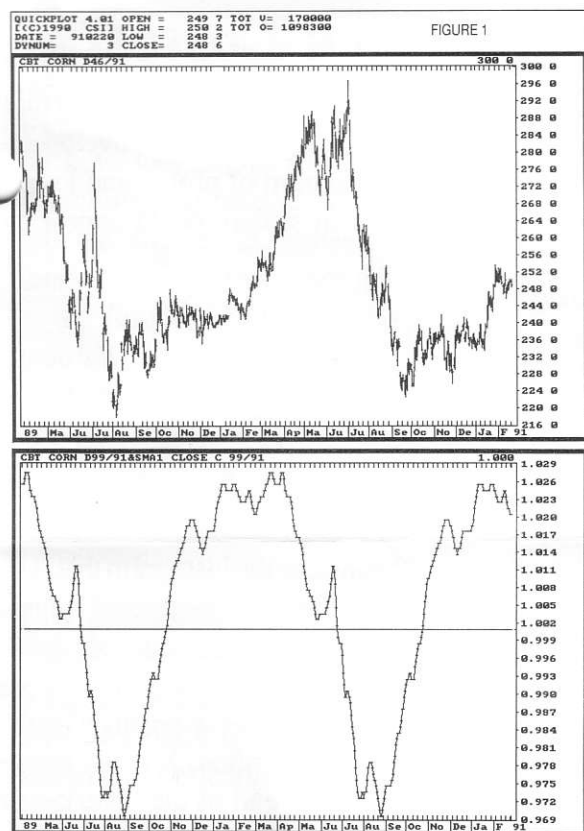
effort, I wanted to share with our readers some of the results of our work on seasonals. A seasonal analysis is used with Unfair Advantage to help measure the tendency of a market to be contraseasonal wherein opportunities for profit are more evident.

Most seasonal analysis considered

on commodity data has been through the use of monthly data. Just twelve points per year is what the average author usually provides in the standard technical analysis publication.

We have developed an annualized 251 trading day seasonal pattern for every commodity. It is derived on a relative basis through an indexing method, and it exactly pictures each commodity's annual price pattern. I thought it would be helpful to reveal a CSI seasonal chart from among up to 40 commodities or so that we calculated to help make a case for seasonal analysis.

The methods used to compute our seasonal indices involve a few interesting calculations which seemed quite normal to us, but which we have not seen used elsewhere. In fact, at the risk of introducing a mys-



We know our readers are patiently waiting for our Unfair Advantage® software project to be completed, and because a study of seasonal characteristics is part and parcel to the total

What's News

- Banking On CSI Seasonal Charts..... 1
- Managing Expected Losses 2
- Do Candlestick Charts Improve Your Market Performance?..... 3
- The New IRM Study Rave..... 4
- Perpetual Contract Data Sale 4
- Ask Customer Service ... 5

tery about our work, I would like to say that I had an interesting conversation with a friend who disagreed with the technique I proposed before actually undertaking the analysis. My friend, a former winner in international competition of the World Economist of the Year Award, suggested that day-to-day information was not sufficiently precise to bother breaking it down any finer than monthly. Perhaps this is why few examples are available where deseasonalization is done on a more detailed basis. My friend has not yet seen the results of our work which absolutely suggests that much greater precision is warranted.

These charts were derived from three-month-forward (#46) Perpetual Contract® data which assumes contract expiration on the 10th day of the

delivery month. We have shown Chicago corn (figure 1) in our example. It is unlikely that you will find a more comprehensive seasonal chart. CSI's full data resources were used to develop our seasonal indices that in many cases reach back before 1950 on a historical basis.

It is fairly obvious from this chart, that one could have profited quite handsomely by anticipating the corn market movement using the seasonal index as a forecasting tool. High readings in the corn index and high readings in relative corn prices (April, 1990) suggested an eventual downturn in prices of corn. Similarly low corn index readings and relatively low corn price readings (Sept., 1990) suggested a strong move up in prices. To profit most heavily, one should have retained long or short positions in the underlying commodity until a price reversal signaled the position should be closed. The corn index was compiled from data over the 40-year span from 1949 through 1989. The corn chart shown in QuickPlot's® top window covers the period April, 1990 through February 15, 1991. The current indication according to the corn seasonal index is to favor the long side of corn if you have remained on corn's long side from the September, 1990 entry. If you are neutral at the present time, the seasonal index suggests at least a month or more wait before taking a short position. (Note the index from January thru April, 1990.)

Also please notice that the seasonal index is replicated year after year and the index waveform does not change.

This is only one suggestion among many. An analysis of seasonal characteristics is an important requirement in the study of a commodity's price movement, but there are many other characteristics which should be considered before a trading decision is made. We hope to give our readers more insight into this area in subsequent News Journals to add to your general market knowledge.

In pursuing our policy to help readers grasp fundamentals of trading that make sense, we have tended to get ahead of ourselves in the release of new products. We plan to

offer software which will address the above matter. But for now we are content to simply suggest that there are, in fact, many ways to view the market that are significantly more powerful than the typical zero-sum less commission methods found in technical tool kits. We have said many times that zero-sum products are readily available in the form of low-priced glitzy graphical public domain tool kits or expensive real-time systems. These products are usually offered with the implied suggestion that they will produce regular net profits. Unfortunately, nothing could be further from the truth! □

Managing Expected Losses

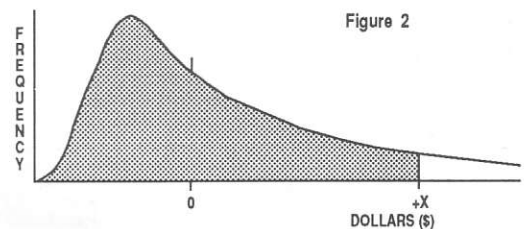
The idea for this brief article comes from our long term loyal customer Mr. H. Green. Mr. Green posed a situation where it would be interesting to determine how many marginal trades one might reasonably be forced to experience before a substantial profit could develop that would move an account into a solidly acceptable credit position.

Mr. Green said he was accustomed to trading a system which historically has delivered 40% profits against 60% losses. If we can assume that successive trades are independent and that the game has a positive expected value, then we can easily introduce some probability generalizations that will help to measure the likely number of losses one must suffer before a larger than normal profit will occur.

To realistically analyze this problem one must examine the distribution of profits and losses to compute

the probability of logging a profit that is outside of a breakeven envelope.

A histogram of profits and losses for a given system could appear as follows:



The area of the histogram that is to the left of the zero point would represent losses (60%, for our example). Given that the system which produces the histogram has a positive mathematical expectation, X could represent the right end of the "breakeven envelope", the point where losses are matched by equivalent profits. The point X also defines the percentage of the total histogram's area where breakeven results are expected. To place some numbers on the chart,

please assume that the area of the shaded portion of the histogram to be 90% of the total. Therefore, to answer our question about the number of trials to suffer before experiencing a significant profit, we can answer it by simply raising .9 to a power of N where N represents the number of trades you should expect to sustain before a substantial profit will appear 99% of the time.

Since $.9^{43}$ is .0097 and
 $.9^{44}$ is .0108

which bounds the 1% objective then a 43 or 44 trade run of breakeven or less performance in the area below X is possible 1% (100-99) of the time.

Don't be surprised to find that, for such an example, a fairly long wait could be the norm before the hoped-for large profit could move your account balance into the black.

The above assessment could be solved in other ways using the full capability of the binomial distribution which is designed to handle such dichotomous events. I will leave it up to the reader applying the same principles to estimate the capital necessary to suffer through the losses. Of course, users of the Trading System Performance Evaluator™, in its employment of simulation methods, can provide a quick answer to this question.

Incidentally, if any other user has an idea he or she would like to have addressed, please jot it down and send it in. We would be happy to consider suggested topics in a subsequent News Journal. □

Best Wishes for Prosperous Trading,

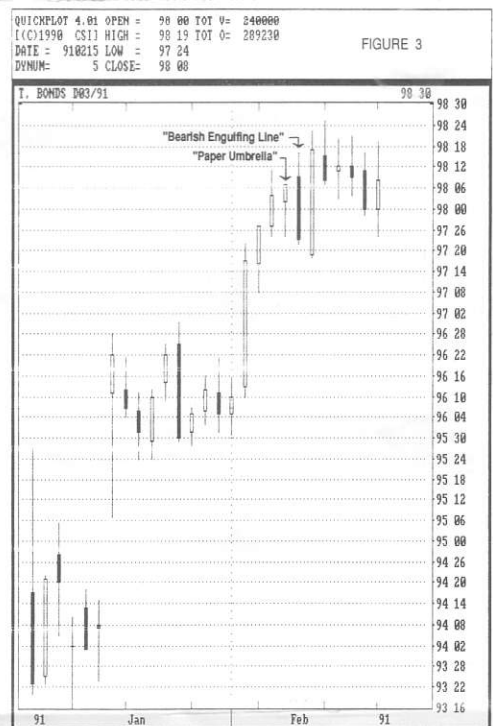
Bob Pelletier

Do Candlestick Charts Improve Your Market Performance?

Traders are always reviewing, recalculating, seeking out new indicators and new interpretations of existing ones. As such, a significant amount of attention has been given recently to the Japanese form of charting called "Candlestick Charts".

Some sources date this form of charting to the Japanese rice market in the mid-1700's. Others trace its inception to the Yokohama silver markets of the late 1800's. However it may have gotten its start, it is an interesting way of portraying price movement. If one does not use a trading system, but reads the price charts to make trading decisions, Candlestick Charts can disclose information that may not be obvious on a standard bar chart. The Candlestick charts are sometimes drawn with red and black ink with the main body consisting of the price movement between the open and close. The main body is then colored red or black depending on whether the close is higher than the open (Red) or the reverse (Black). QuickPlot uses a hollow candle in place of the red candle for the Candlestick charts shown there. Shadow lines extend from the main body up and/or down to show the total daily price movement. There are nine different types or categories which are called "Pole Lines" or daily price movements. These range from the long red or black lines with characteristics indicating extreme strength or extreme

weakness to the situation where the open and close are the same, indicating a probable turn in the market. These nine types of "Pole Lines" are further broken down into other variations and are given unique names for easier recognition. A certain amount of pattern recognition is possible when studying the



"Pole Lines" in a collective manner. Patterns such as "Three Mountains" which traditional methods identify as a "Head and Shoulders", "Nabezoko" or "Saucer" and many others are recognized with similar implications to our western ways of charting.

Recently in looking over T-Bond action, we decided to analyze some of the charting similarities. Looking at a number of examples we will

illustrate only one where on Wednesday the market action was a "Paper Umbrella" or "Red Lower Shadow" (a long line below the body). This indicates that you should be a seller. The following day we had a "Tsutsumi" where a long black line engulfed the prior days action indicating an end to the rise and the start of a fall. This was to be followed the next day, Friday, by a lower opening and a much higher close. So, the trader would have been very surprised if he or she were to blindly follow the Candlestick symbols. Every method suffers a failure rate and Candlestick Charts are as vulnerable as any other technical approach.

Reviewing only a few number of data points is not adequate to draw any firm conclusions. However, the advantages we observed for predicting the future using candlestick charts in lieu of standard price-time charts are not that significant. They are more descriptive of market behavior, but at a price. They use more space to tell their story, and many users give them great endorsements. However if you are a good technical analyst, your fortune may not improve by spending the time and money to switch your system of market viewing to Japanese Candlesticks. □

Last Months News Journal Incorrectly Dated

Last month our February 1991 News Journal, Vol. VII, No. 2 was incorrectly dated as January 1991. We regret this mistake.

Customers Rave About The New IRM Study

We have received several calls from satisfied customers who have uncovered the many advantages of QuickStudy's® new Intermarket Relative Movement™ study. All callers apparently followed the advise of the February 1991 (Vol VII, No. 2) News Journal and drove the study with 10 years of weekly Perpetual Contract data.

Here is your chance to introduce some solid fundamental research into your analysis. Boot up your new

Quickstudy and try this out. You should be pleasantly surprised. □

Seasonal Index Data

Now that we have developed the Seasonal Index Data for all commodities, we can offer it as historical data or as updates for your daily file. If you have an interest please let us know so that we can prepare for an expeditious release of this information. □

Perpetual Contract Data Sale

Regular readers of the CSI News Journal have been learning much about the advantages of long-term market analysis. Several customers have approached us seeking discounts on Perpetual Contract data to help them get started. They plan to use Perpetual Contract data in implementing the ideas we have suggested. We have been happy to accommodate these customers with discounts, but we feel we should offer the same savings to all our subscribers.

Discounts:

20% Discount on any 10-Year Perpetual Contract Data history

10% Discount on any 6-month Perpetual Contract Data history

These sale prices apply to historical data on diskettes only. Please note that the 20% discount is to be applied to Perpetual Contract series for which at least a ten-year history is ordered. The 10% discount will apply to Perpetual Contract series for which less than ten years but more than 6 months of history are ordered.

*All historical data disks are subject to a \$50.00 minimum order.
This sale ends June 1, 1991.*

Ask Customer Service

Each month in this column, the CSI Customer Service staff addresses a subject of interest to many users. This month Dave, Karen, Rudi, Susan and Tami will answer some common questions about QuickTrieve® Automation. This macro feature lets users of QuickTrieve version 4.0 or 4.01 automate many software functions.

Q. What types of things can QuickTrieve Automation do?

A. QuickTrieve Automation can execute almost every normal program function. If you can press the keys to get QuickTrieve to do something, this feature can replicate your keystrokes to repeat the process. Some common uses are:

1. *Retrieve and distribute daily updates.*
2. *Automatically update all your weekly and monthly files.*
3. *Execute a series of technical studies with QuickPlot/QuickStudy.*

Q. What is the advantage of using QuickTrieve Automation for retrieving daily updates over using unattended collection?

A. Both choices can update the most recent trading day with little effort on your part.

Unattended retrieval will pick up data at a specified time if your

computer is on and at the QuickTrieve Main Menu when that time comes.

With QuickTrieve Automation, you can update your files whenever it is convenient for you. Three simple keystrokes execute the entire process. A macro can go on to other functions after data retrieval.

Q. How do I make a daily update macro?

A. Start at the QuickTrieve Main Menu. Hold down the <ALT> key while you press <L>. QuickTrieve will be ready to **learn** a macro. The ENTER QA # prompt at the top of the screen lets you name this macro. Enter any single-digit number or any letter. This will be the permanent name for your macro, so remember it or write it down! (We'll call this sample macro A.)

Now go through the process of collecting a daily update. Select the **CURRENT** week and day G (the rotating current day) when identifying the data to retrieve. When the update is finished, proceed through the distribution process. It is a good idea to request the autocreation of any file types you may need.

After collection and distribution, mark the end of your macro by pressing <ALT> <L> again.

The next time you want to collect a daily update, hold down <ALT> and press <P>. QuickTrieve will be ready to **play back** your

macro. When the Enter QA # prompt appears, enter the number or letter you named your macro. For our example, we would enter <A> to pick up the most recent trading day.

Q. How can QuickTrieve Automation help with updating weekly and monthly files?

A. This feature lends itself to QuickTrieve Automation quite well. It lets you automatically update all your weekly and monthly files with three quick keystrokes.

To make this macro, press <ALT> <L> at the QuickTrieve Main Menu. At the ENTER QA # prompt, enter the letter or number you wish to name this macro.

Proceed through the necessary steps to condense the data. Start with <F> Enter QuickManager and <H> Move/Split a Data File. Select paths to move FROM and TO. Press <F1> to move all to weekly and monthly. Answer the next few questions as they apply to your needs. Enter <Q> to quit asking if you want to change start and end dates. Press any key to proceed and finally, mark the end of your macro by pressing <ALT> <L> again.

You can use this macro whenever you want to update your weekly and monthly files. Press <ALT> <P> at the QuickTrieve Main Menu to play back this macro, being sure to enter the correct QA # for this set of keystrokes.

Next Month watch for an article on technical analysis with QuickTrieve Automation. □