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Quantifying Account Drawdown

A popular indicator of trading system merit is the figure known as account drawdown. Since the release of the Trader's Money Manager™ last month, I have been asked why we do not specifically address account drawdown in the trading system evaluation. At first glance, some might consider the absence of a reference to drawdown to be a deficiency in our new program. I am addressing the topic here to show that we have addressed drawdown through a reference to your capital stake comfort level.

First, let's establish what account drawdown is. In actual trading, it is the maximum loss achieved over time. When based on simulated trading, drawdown is merely a measurement of peak-to-trough capital erosion. This is often considered to be the maximum loss that one might, at the worst, experience.

Before judging any system based on its maximum drawdown, I would ask, "How reliable is the assessment of account drawdown?" When analyzing a simulated trading record, the answer to this question requires a look beyond the artificial hindsight record involved.

When reviewing a trading system through simulation, one assumes that successive trades are independent. It is therefore completely reasonable to randomly scramble the results. Since trading a system is a statistical process that can be reproduced in literally millions of ways, doing so would naturally produce different drawdown assessments. The possibilities for account drawdown are as limitless as the possibilities for loss or profit in

trading any system. It is not reasonable to predict a maximum account drawdown based on only one iteration of possible trading results.

Because developers tend to extract only one sample in their system evaluations, I believe the maximum drawdown statements they offer are seriously lacking. Having expressed this point, the next question is, "Can a viable method of calculating drawdown be formulated?"

For a realistic appraisal of account drawdown, one must sample from the distribution of profits and losses over many random trials. Hindsight bias must also be removed because it likely contributed to an inflation of market performance. Only then can the technician arrive at a statistical assessment of drawdown a predetermined percentage of the time. It is not possible to say with certainty that drawdown can be limited to some specific quantity 100% of the time.

Upon completing the analysis described above, an analyst could say that account drawdown is maximized at, for example, \$12,000 ninety-eight percent of the time. The term "drawdown" is basically meaningless unless you attach a probability statement for any dollar figure you may wish to risk as maximum market commitment.

As TMM users have been advised, we do include a statistically defensible drawdown calculation in TMM. Since the probability of staying within a predetermined probability tolerance is less than 100% (or x%), there would always be a small (100-x)% chance that your account could be drawn down by

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New Accounting Method for Extra Access

Rates for updates in excess of 26 per month

◆ Direct Dial

\$0.05/contract or group of 4
stocks per day

◆ Networks

(including overseas)
\$0.06/contract or group of 4
stocks per day

As most of you know, recent versions of our QuickTrieve software include the ability to collect the last seven to ten weeks of updates through our daily update service. This allows CSI users to quickly and easily fill gaps created by long vacations, temporary hiatuses or hardware outages. Most subscribers have utilized this feature in its intended manner, but a few have considered this a way to get free historical data on a frequently changing portfolio.

Those who have tried this have been surprised to find that our computer imposed a multiple-access surcharge on their CSI bill. The surcharge amounted to 70% of the normal bill for each redundant month of access beyond the first. This surcharge could amount to much more than the cost of a few historical data files.

To more equitably charge all our users for extra accesses, we have eliminated the multiple-access surcharge and instituted a flat rate for excess daily collections. There are normally 21 trading days per month, making 21 days of data the expected number required for any month. Despite the fact that our computer only counts an update if the transmission is completed, we give an additional 5 days for good measure to jointly account for redundant accesses that may be caused either by the customer or CSI. Once 26 updates have been exceeded, we will charge 5 cents per day per commodity contract or group of four stocks for long-distance updates or 6 cents per day per contract (or 4 stocks) for any type of network update.

The user updating 30 contracts daily by long distance access would expect to pay \$49.00 for one month of daily updates. If the entire portfolio were retrieved twice during the month or if the previous month were also updated, (42 updates) the extra cost

would be \$24.00 (16 (accesses over 26) x 30 contracts x .05). If another prior month were retrieved, for a total of three months of updates during one billing cycle, the extra cost over the \$49.00 base fee would be \$55.50. For network users, the rate would be \$0.01 per day per contract additional.

Since the lowest increment of extra access is now only one single day, any extra charge imposed will be relatively insignificant. The charge per day of extra access will amount to 5 or 6 cents times the number of contracts in your portfolio. Regular multiple accessors should notice a substantial reduction beginning with your May statement.

This new pricing procedure can provide an efficient, economical way to easily retrieve a limited supply of past data for an entire portfolio. It may not be an economical way to get history on just a few items, however. This is because the daily rate per contract applies to every item currently in the portfolio, not just new items that may have been added.

Before collecting your portfolio for previous month(s), consider the cost of a historical data order for the items you need. For example, if you wanted to get the last two months on three new futures contracts, that would cost you \$5.70 by direct-dial access. This is less than the cost of accessing even the smallest portfolio for the last two months as daily updates.

New subscribers to the CSI Data Retrieval Service can still pick up two+ months of back data on their initial portfolio at no extra cost.

As part of this change, our computer will always assume the average number of calls per day will be one for pre-billing purposes. Additional charges for multiple accesses will be made through a prior-month service adjustment.

This new accounting practice will be in effect May 1, 1992. ◆

Increased Global Trading Reflected in CSI's Data Offerings

As more investors turn their attention to the global economy, the demand for data from markets around the world increases. This trend is evident in the new futures instruments and indexes that have been added to CSI's data base over the past several months.

Not surprisingly, four of the most recent commodities we've included are from overseas markets. Interest Rate Futures seem to be the most popular new fare for international traders, with new trading on the Italian Government Bond in both Paris and London. We also quote German Bonds from both Germany and London. Japanese Government bonds are traded in Chicago, Tokyo and London. British bonds (Gilt or Sterling rate) are traded only in London. Not to be ignored is the relatively new ECU bond, which trades in both London and Paris. U.S. Treasury Bond futures are traded not only in Chicago, but also in London and Tokyo.

Another area with increased interest is foreign exchange. We now quote prices for non-domestic currencies from Chicago, Singapore and London.

As investors become more aware of international possibilities, more attention is focused on the major stock indexes of industrialized countries. The Nikkei 225 Stock Index, which is considered a major indicator of Japanese industry, is the most prominent example. We quote prices for futures contracts on the Nikkei Index from Chicago, Osaka and Singapore. New stock index futures are now traded on the Australian 50 Leader's Index, for which we quote prices from Sydney. Other overseas indexes include the Financial Times (FTSE) from London, the Hang Seng from Hong Kong, the All Ordinaries from Sydney and the DAX Index from Germany.

By far, the most popular index we

quote to our users around the world is the Granddaddy of them all - the Dow Jones Industrial Average. Many feel that this index shows the financial health of U.S. business. Chicago's S&P 500 futures contracts reflect the broader-based S&P 500 Index, which is also a popular pick among both domestic and international users of the CSI Data Bank.

We receive calls almost daily from investors searching for international market data. Many are delighted to find that we typically offer the information they need beginning with the 1st day of trading. Although we have not been able to accommodate every request, we continue to search for new sources of overseas data. As you may have noticed, the back page of the News Journal often introduces new futures markets that we have added to our inventory. We know how important a dynamic service that grows with the times can be to your success. This is why we extend the extra effort to meet all your data needs. ♦

Flood Interrupts NY & Chicago Trading

A flood in downtown Chicago interrupted trading at the Chicago Board of Trade on Monday, April 13. The grain markets never opened, and trading on the interest rates and metals lasted only briefly. The Chicago Mercantile Exchange, which was unaffected by the flood, closed early to accommodate member firms that were evacuated from their downtown office buildings.

As this News Journal goes to press on the 15th, we believe all data from the CME are complete and accurate. No settlement prices have been received for the 13th from the CBOT on the

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Ask Customer Service

The publicity given the Michelangelo computer virus in March has raised many questions about viruses from CSI subscribers. This month, our Customer Service Staff will address some of the questions they have received.

Q. *I saw a television report that said viruses are often transmitted by phone lines and that anyone who uses a modem is at risk. Should I be concerned about getting a virus when I call CSI?*

A. NO! The type of virus that can be transmitted via modem is called a file virus. These viruses are linked to executable files (those ending in .COM, .EXE, .BAT, etc.). CSI does not transmit any executable files to our users, so this threat is not a factor. In other words, the type of file we transmit cannot spread viruses.

Q. *Is it possible that a data disk or software program I got from CSI included a virus?*

A. Again, the answer is NO. We regularly check all computers involved in software preparation and disk production for viruses. There has never been evidence of a viral infection in any of these systems at CSI.

Q. *I got a virus checking program and found that my hard drive and most of my floppy disks are infected. How could this happen?*

A. You either received a file virus from an executable file or a boot sector virus from an infected floppy disk. These viruses are very rarely found in off-the-shelf programs, and are more likely the result of sharing diskettes with friends or downloading programs through a bulletin board.

Q. *How can I avoid getting a virus in the future?*

A. Practice a little safe computing. That means not sharing diskettes, and installing only software from reputable sources. It's a good idea to run a virus checking program on any new program before installing it. If your computing habits leave you susceptible to infection, it's not a bad idea to execute a virus scan through your

AUTOEXEC.BAT file. This will scan your hard drive for viruses each time you start your computer.

You can avoid boot sector viruses by making sure you never turn on or reset your computer with a floppy disk in drive A. Boot sector viruses reside in the first sector of an infected floppy disk and are transferred to a hard drive when you try to boot the computer with an infected floppy. Once a hard drive is infected, every floppy disk used on the computer becomes infected. The most common PC virus, "Stoned" from New Zealand, is a boot sector virus.

Q. *Can you recommend a good virus scanning program?*

A. We use VIREX PC (\$129.95) here at CSI, but there are many more on the market. PC Magazine's Editor's Choice selections from October 29, 1991 were CENTRAL POINT ANTI-VIRUS (\$129) and DR. SOLOMAN'S ANTI-VIRUS TOOLKIT (\$149.95). These programs can detect, eliminate, inoculate against and in some cases, even repair the damage done by a virus. They are probably available in your local software store.

Q. *I was surprised to find my computer has a virus because it seems to be running normally. Any comments?*

A. A few viruses indeed seem to be completely innocuous, doing nothing but replicating themselves and spreading. Just because you haven't noticed ill effects from a virus, don't be lulled into complacency. Viruses may lay dormant for months or even years until triggered. The trigger may be a date, such as Michelangelo's March 6th birthday, or it could be simply filling a random sector of your hard drive. Viruses are capable of destroying all the data and programs on a hard drive, so they shouldn't be ignored. ♦

Quantifying Account...

(continued from page 1)

the funded amount. In practical terms, the drawdown measured by TMM is the capital stake you are willing to invest. Your percent chance of survival is as readily under your control as your ability to increase your capital stake.

Given the above presentation, a trading advisor might say, "I agree with this, but I don't want my drawdown to exceed 25% of my account size." In this case, the actual capital stake should be inflated by a factor of 4 when entered into TMM. The trader could then be confident X% of the time that drawdown would not exceed 25% of his true capital.

Certainly, trading and the taking of unexpected losses involve serious risks, but knowing what can happen to you on a statistical basis tends to make the risk more understandable. We have made it our job to help you avoid getting into bad situations by making it easier to know the consequences of your trading decisions. ♦

Bob Pelletier

Flood Interrupts...

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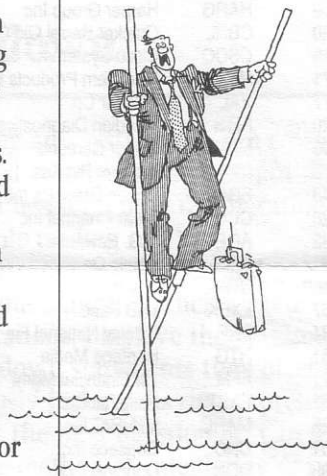
interest rates or metals, so our posted values may be adjusted later if necessary. Any changes in this area will be immediately posted in our electronic error correction file and will be listed in the June News Journal. Anyone updating these markets is advised to retrieve the correction file as soon as possible to incorporate the revisions in your files.

The effects of the flood continued through April 14th as the CBOT remained closed. Since the N.Y. Cotton exchange has their clearing done in Chicago, that exchange also suspended trading and was closed on April 14th. The CBOT planned to resume trading for a partial day on April 15th.

Naturally, there will be no data for the affected markets while the exchange is closed. QuickTrieve® treats missing days as holidays. ♦

Memorial Day Schedule

CSI will be closed for voice communication on Monday, May 25. U.S. exchanges will be closed, but the CSI host computer will be operational for updates as usual.



CSI Software Product Summary

- QuickTrieve®/QuickManager®** - To retrieve, manage & edit data; includes Alert Calendar \$99/Unrestricted use \$39/Daily data user
- QuickPlot®/QuickStudy®** - Charting & analysis software (requires QT/QM) \$156
- Trader's Money Manager™** - Introductory price \$499 (a \$200 savings)
- TraDesk™** - Traders' complete accounting system-(price varies with number of accounts) Starting @ \$446/Unrestricted use \$299/Daily data user or 12-month lease starting @ \$22/Mo.
- Seasonal Index Value Pack** - Three years of history for 33 popular commodities \$444
- CSI News Journal** - Aug. 1990 to present \$35/Yr. or \$5/Reprint
- CSI Mailing List** - \$200/1,000 names (CSI users omitted)

CHECK MASTERCARD VISA

AMOUNT ENCLOSED \$ _____

CARD # _____

EXP. DATE _____

NAME _____

DAY PHONE (____) _____

ADDRESS _____

SIGNATURE _____

5¼" DISK 3½" DISK

05/92

All prices subject to change without notice.