Biiwii Commentary

***e*Research Corporation** is pleased to provide an article and video, courtesy of Biiwii.com, and written by Charlie Bilello (link to the Author is provided on the following page).

The article, starting on the next page, is entitled: **"Stop Searching For The Holy Grail".**

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Along the way, a geek-like interest in technical analysis, a long-time interest in human psychology, and various unique macro market ratio indicators were added to the mix, with the result being a financial market newsletter (and dynamic interim updates), Notes From The Rabbit Hole (NFTRH) that combines these attributes to provide a service that is engaged and successful in all market environments by employing risk management first, and opportunity for speculation second.

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Bob Weir, CFA
Director of Research

Stop Searching for the Holy Grail

By [Charlie Bilello]

December 6, 2017

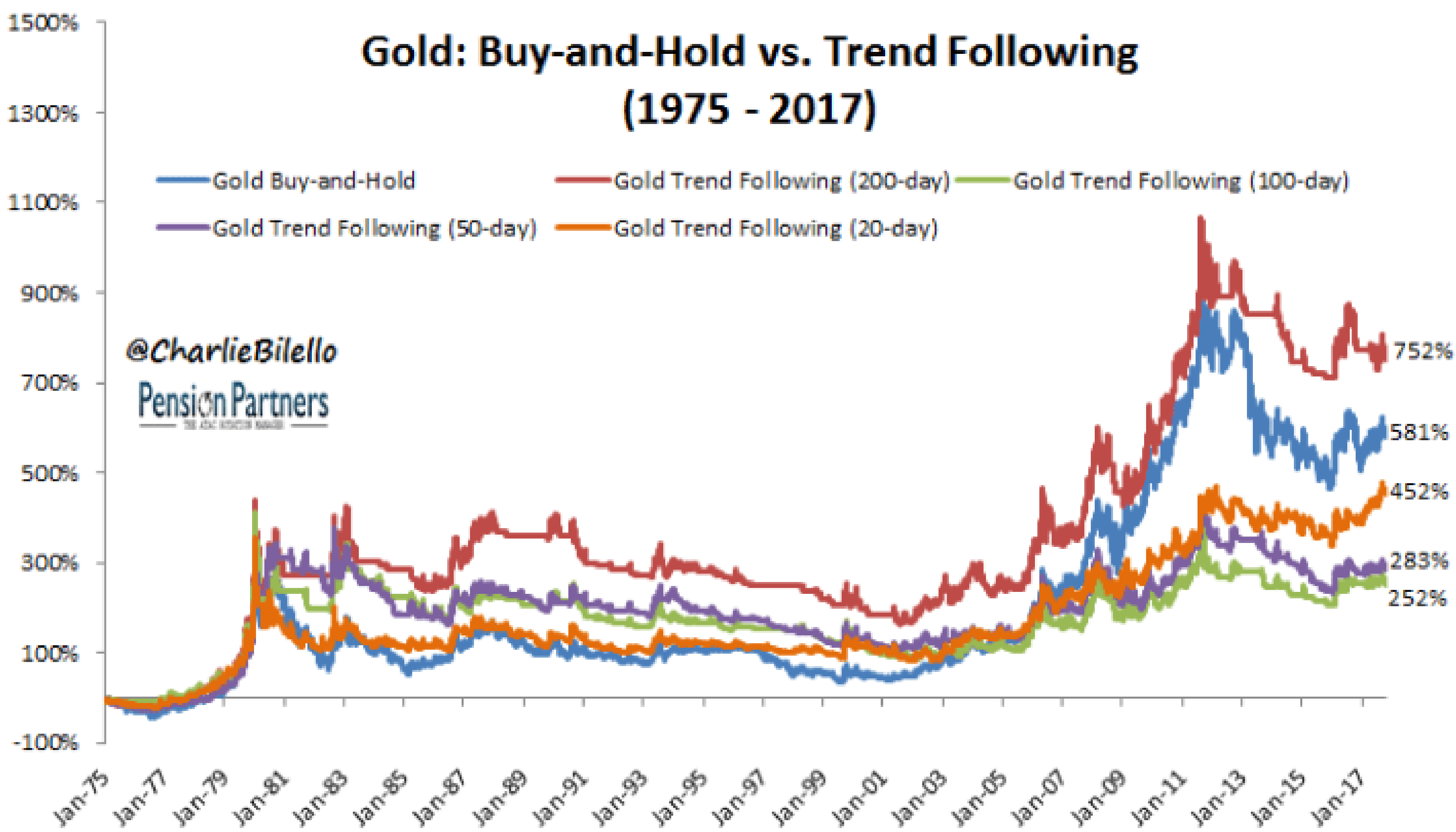
In a recent post, I came to the following conclusion:
"the notion that simply 'following the trend' in Gold will lead to vast riches is a false one."

I made this statement after analyzing a simple trend following system (going back to 1975), using the 200-day moving average as a signal of when to get in (closes above it) and when to get out (closes below it).

The most common response to the post:
"You're using the wrong moving average. You need to use the x-day moving average for Gold. That is the one that works."

Translation: I should have used the Holy Grail. The only problem: it doesn't exist.

In testing other popular moving averages such as the 100-day, 50-day, and 20-day, we find that they actually fared worse than the 200-day.



These shorter-term moving averages also traded in higher frequency, meaning the net returns after commissions/slippage would be even lower.

Metric (Jan 1975 - Oct 2017)	Gold (Buy-and-Hold)	Trend Following (200-Day)	Trend Following (100-Day)	Trend Following (50-Day)	Trend Following (20-Day)
Annualized Return	4.6%	5.1%	3.0%	3.2%	4.1%
Annualized Volatility	20.0%	16.5%	15.4%	15.1%	14.8%
Trades/Year	0.0	3.8	6.3	9.4	14.0
Cost/Year (0.1%/Trade)	0.0%	0.4%	0.6%	0.9%	1.4%

That is not to say there isn't some variation that would have worked better than the 200-day moving average in the past. Given the nearly infinite number of permutations, I am quite sure that there is. Whether it is a change in time period, indicator, or some combination thereof – if you look long and hard enough you will find something that works better.

But that is not the question. The question is whether there is enough evidence to show that trend-following in Gold has been a superior strategy to buy-and-hold.

There doesn't seem to be, and mining the data to prove otherwise would serve no purpose other than confirming some bias. What would be the point of optimizing for the perfect past return unless there was some fundamental reason why a certain time period/indicator should continue its outperformance in the future?

Lacking such a reason, you are merely chasing optimization, trying to find the combination that would have given you the best past result.

Much more important than your choice of indicator or time frame is: (1) whether there is a fundamental/behavioral reason for a strategy to outperform; and (2) whether you are willing to stick with it through the inevitable tough times. When your strategy is out of favor, will you avoid the temptation to constantly re-optimize to what is currently "working"?

Most can't/won't which is yet another reason why most active managers, even when they have an exploitable edge, fail to outperform. You have to be willing to take the bad with the good because: (a) the very best performing strategies all have many periods of bad; and (b) you cannot predict when the good/bad periods are going to occur.

Do yourself a favor and stop searching for the Holy Grail. I realize that is not easy; it goes against human nature which is always searching for something better, striving for perfection. But perfection does not exist in markets and that is probably good thing. For if it did, there would be no risk and, therefore, no reward.

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