Five Trading Myths

eResearch Corporation is pleased to provide an article by Keith Richards of **VALUETREND**.

In this article, Mr. Richards suggests how to invest according to trading time-horizons.

The article is reproduced below, beginning on the next page, or you can go directly to it at the following link: **https://www.valuetrend.ca/5-myths-of-trading/**

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Five Trading Myths

By: Keith Richards (bio at end)

When I first began studying Technical Analysis in the early 1990s, it was considered a form of witchcraft or voodoo. At that time, mutual fund popularity escalated. The investment firms I worked with at the time embraced their products wholeheartedly.

The advent of the "DSC" (deferred sales charge) provided massive commissions to the investment advisors/planners who sold them. They, along with their investment firms, and the mutual fund companies themselves profited greatly.

In order to fund these upfront 5% commissions paid to the Advisor (not to mention the trailing commissions), the fund would lock investors into a 6-7 year declining penalty. And then charge these unsophisticated investors an incredibly high management expense ratio – often 2.5% – 3%, plus built in expenses!

There was much to protect against losing that gravy train of income for both the fund companies and the investment firms which sold them through their network of sales-people. Technical Analysis, which proposed that there are ways to step into and out of markets in order to avoid risk and potentially increase returns was counter to a sales-person's vested interest in selling you a locked-in product like a DSC fund. Thus, the era of "buy and hold" began.

My first myth addresses one of the statistics that industry used to banter around to keep the gravy flowing:

1. Missing The Best Days

One of the favourite tools of the mutual fund "buy & hold" camp was the "perils of missing the best performing days by selling your investments" myth. Since the beginning of 1998 to the end of last year, for example, if you missed the 40 best performing days on the market you would have missed out on 114% of the gains vs. just buying and holding. Wow! Surely that means you MUST never sell out of the market!! WRONG!!

What the buy-and-hold guys forget to point out is the fair comparison of missing out on the 40 worst days during the same period. If you had managed to do that,you would have made an EXTRA profit of 952% over buying and holding. Um, that is like 9 times the potential upside for selling out correctly vs. the potential for lost profits by selling the best performing days. Clearly, you would have to be clairvoyant to sidestep all of the bad trading days over the past 20 years. But, you would have to be equally unlucky to miss all of the good days! Come on guys– the statistics show us that if you have a half decent methodology of spotting overbought vs oversold market conditions, you are nine times better off to sidestep potentially risky situations — all things being equal.

The Allure Of Market Timing: Missing The Worst Days

20 Years (1/1/1998 - 12/31/2017)

$10,000 Invested in the S&P 500 Index	S&P 500 Annualized Return	Value of $10,000 at the End of the Period	Gain/ Loss	Impact of Missing Days
All 5,036 trading days	7.20%	$40,135	$30,135	--
Less the 5 days with the biggest losses	9.52%	$61,675	$51,675	71%
Less the 10 days with the biggest losses	11.31%	$85,277	$75,277	150%
Less the 20 days with the biggest losses	14.23%	$142,997	$132,997	341%
Less the 40 days with the biggest losses	19.05%	$327,107	$317,107	952%

Source: Yahoo! Finance

The Problem With Market Timing: Missing The Best Days

20 Years (1/1/1998 - 12/31/2017)

$10,000 Invested in the S&P 500 Index	S&P 500 Annualized Return	Value of $10,000 at the End of the Period	Gain/ Loss	Impact of Missing Days
All 5,036 trading days	7.20%	$40,135	$30,135	--
Less the 5 days with the biggest gains	5.02%	$26,625	$16,625	-45%
Less the 10 days with the biggest gains	3.53%	$20,030	$10,030	-67%
Less the 20 days with the biggest gains	1.15%	$12,570	$2,570	-91%
Less the 40 days with the biggest gains	-2.80%	$5,670	-$4,330	-114%

Source: Yahoo! Finance

2. **Consistent Outperformance Means Everything**

All successful trading strategies have their outliers: Mind-blowing out-performance one year, and wretched under-performance in another. A good strategy will deliver on its mandate more often than not, but not all of the time.

For example, ValueTrend's mandate is to "limit your risk, keep your money". Our strategy attempts to provide an annual rate of return of about 7-8% after fees with about 7% or so deviation from that return in most markets. **We tend to be pretty consistent in that goal**.

Our lack of big down-swings in bear markets, and lack of big up-swings during exuberant markets helps. Most of the time, we tend to keep the volatility (deviation of returns) tight. Sometimes, however, we under-perform or out-perform beyond our expected parameters. Those years happen occasionally, but they are not the norm.

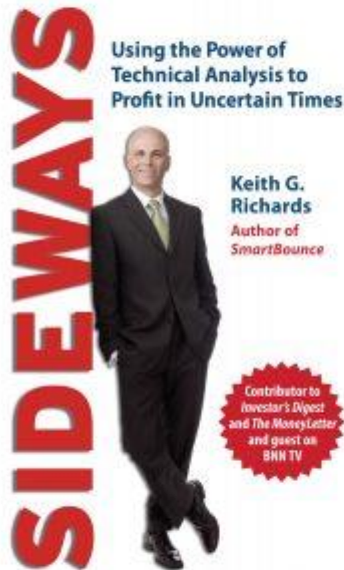
Some managers or investors have a mandate of beating the market. They may have a more passive style, hoping to profit by buying under-valued stocks and eventually seeing their value materialize. Such managers tend to have much greater deviation in return. They can have big negative or positive performance swings. The trade-off is that, if they are good value managers, they can out-perform the market by discovering under-valued stocks very early in their investment cycle. These stocks can materialize into big winners later in the game. Warren Buffett and Peter Lynch come to mind when I think of this style.

Neither strategy (i.e. ValueTrend's *low-volatility strategy*, or the value managers *buy cheap and tolerate volatility*) is "right". It is really up to the investor to decide which strategy makes sense to him/her. In either case, though, you do not get a straight performance line.

4. **Sophisticated Analysis Is Best**

Lots of readers of this blog like to use technical analysis indicators. Be aware: you only need a few indicators to form a trading system. Some indicators cancel each other out due to their trading horizons.

For example: Stochastics and MACD are both momentum indicators, but stochastics should really only be used by shorter-term traders, or to finesse a trade. Its less of a longer-term decision-making tool, whereas MACD is a far greater tool for mid-term traders. Indicators should be chosen to represent trend, momentum, relative strength, money-flow, and/or volume. Too many indicators cause "analysis to paralysis". It is like pouring every spice in the cupboard into your soup. Yuk! If I may humbly suggest, please **read my book Sideways** to help you select amongst the appropriate indicators for your time horizon, and to help you formulate a logical trading strategy. It will help you keep it simple.



5. **Ya' Gotta' Win More Than You Lose**

Actually, you just need to win bigger than you lose – not necessarily more often. I have read studies suggesting that the best traders in the world win only 30% - 70% of the time. This means that, at the very best, they lose on 30% of their trades!

The lesson: take your losses, move on. Find a logical system that bests the odds more often than not, and stick with it.

I have often said that our clients pay us to follow a system, because they are too emotional to follow one for themselves. A system will save you from yourself by saving you from your emotions. Take your losses, move on. Remember, a losing stock owes you nothing!!

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LIMIT YOUR RISK. KEEP YOUR MONEY.

See **About The Author** on the next page.

ABOUT THE AUTHOR

ValueTrend Founder and Owner, Keith Richards, has been in the securities industry since 1990. ValueTrend manages over $100 million through a discretionary investment service for high-net-worth clients.

Keith Richards has been in the securities industry since 1990 and is a highly regarded member of the small, exclusive community of Chartered Market Technicians in Canada. Mr. Richard's articles appear regularly in INVESTORS DIGEST, MONEYLETTER, GLOBE AND MAIL, and the TORONTO STAR newspapers.

His appearances on BNN Television have inspired producers to acknowledge him as **"one of [our] most accurate technical analysts."** Mr. Richard's first book, SMARTBOUNCE: 3 ACTION STEPS TO PORTFOLIO RECOVERY, is available in bookstores and directly through his blog page **www.valuetrend.ca/blog/**. His second book, SIDEWAYS: USING THE POWER OF TECHNICAL ANALYSIS TO PROFIT IN UNCERTAIN TIMES was released in late 2011. He has been critical of the commission-based, follow-the-pack approach to investing – where brokers succeed regardless of performance.

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