

CSI NEWS JOURNAL

© 1991 Commodity Systems, Inc. (CSI), All Rights Reserved

Volume VII, Number 10

October 1991

\$10.00

Monitoring Trade Risk

I have always felt that the management of trade risk is crucial for consistent success in the markets. This fact was eloquently presented by Jack Schwager in his book "Market Wizards," which describes the trading techniques of some of the world's most successful traders. As might be expected, there were as many trading systems as there were traders interviewed. The one common thread that ran through all the interviews was a fundamental concern for risk management. The idea being that if you control trading losses, the profits will take care of themselves. Although the systems of the "wizards" varied, they all employed fail-safe risk control. More than anything else, I think this book underscored the importance of managing trade risk.

"Market Wizards" brought risk control to the limelight, producing a cottage industry that revolves around the subject. Capital management articles, books and computer programs on managing risk are very common. Many of these involve complex formulas and (*even worse*) concepts which are down-right hazardous. Fortunately, comprehensive and statistically sound methods of capital allocation are available. The TraDesk trader's accountant program offers a

simple way to assess your own market risk, which can help you keep risk under control.

Before discussing risk control, I'd like to review some general trading practices that should never be overlooked. A positive expectation trading system should be implemented whenever funds are invested. Diversification by product and currency unit is helpful. I also recommend, whenever

possible, balancing a portfolio with both long and short positions. In addition, positions should only be taken if a sufficient capital stake is available to survive inevitable

*“... if you control
trading losses, the
profits will take care
of themselves.”*

drawdowns. When combined with good risk control, as TraDesk helps you accomplish, these practices can lead to improved market results.

TraDesk offers two daily views of open positions that impact trade risk. The first is a Margin View, which displays the total margin committed to each position. This tells you if you have, on an original position basis, enough capital to meet margin commitments. The second is a Risk View, which displays open risk for each position based on the market price and your current stop-loss point. This tells you whether you have enough funds to keep your position alive should coincident stops be reached. This view

What's News

- | | |
|--|---|
| Monitoring Trade Risk | 1 |
| Introducing QuickTrieve 4.02 | 2 |
| Computer Corner Enhancing Speed | 3 |
| Avoiding Drive Failure How QuickTrieve Helps | 4 |
| Ask Customer Service | 5 |

shows your "Core Equity," which is a worst-case scenario should all existing stops be hit at once.

The Margin View can be used to check the percentage of total margin committed to each position as well as the total percentage of available margin currently employed. If, for example, you allocate a certain percentage of account margin to different trades, this view will tell you what percentage is still available. If you have established a maximum percentage of your account to commit to margin, you will be warned when an account is approaching that threshold.

Some traders control their risks by insuring that only a maximum percentage of current equity can be lost on any one trade. The Open Risk view makes this check for you. Based on current stop losses, you can see at a glance the amount of capital at risk for each trade and account. If the risk

Ask Customer Service:

Sales of the Trading System Performance Evaluator continue to be brisk with many enthusiastic responses. We have had a few interesting questions from TSPE users that may be of interest to all. This month the Customer Service Staff will review some of the questions they have received on this program.

Q. I analyzed a fairly profitable trading record with a large number of trades. I used very conservative parameters, yet TSPE still rated the system highly on both Degree of Merit and Probability of meeting my goal. How can I be sure this is an accurate assessment?

A. TSPE's Degree of Merit rating is based on evaluating a single P&L string, not a combination of two or more. Both the Degree of Merit and Probability charts use statistically sound formulas that assess the probability of reaching a given goal at varying capital levels. Each value shown on these charts is based on thousands of samples with market experience drawn randomly from your trading record. All market experience is degraded based on sample size and other input.

To confirm your results, you should double-check your input profit and loss string. Your input should be representative of the system studied over a long period of time. Make sure the P&L entries are correct. Also consider

the size of your input sample. The more trading results, the more reliable the analysis will be. We recommend at least 50 samples, although more may be necessary. Review the control file information to see that all inputs appear as expected. If no errors are found, you can assume the evaluation is accurate.

Q. *TSPE seems incapable of analyzing any system that it judges to have a negative "degraded profit after commission and slippage." I find this a little curious because one would presumably have some probability of achieving a low goal with such a system given a large capital stake. Is this the intended consequence and if so, what is the rationale?*

A. You are correct in concluding that TSPE will not analyze marginally profitable trading systems. In the spirit of not misleading the user, we decided that after the appropriate degradation of input performance, we would require the system begin with a positive mathematical expectation. The user should be attempting to uncover trading systems that will be consistently profitable. A marginally unprofitable approach, such as the game of roulette, could uncover a profit in the short run. For the long term, the roulette player should always favor sponsoring the house. Beating an otherwise losing game may be interesting to a casino gambler, but we did not feel it was appropriate for market analysis with TSPE.

Q. *How does the Percent-In-Market affect the results?*

A. On a random basis, the Percent-In-Market parameter will influence the actual proportion of the time any one P&L file will receive trading attention. The introduction of several Percent-In-Market parameters for several files will tend to smooth out performance and minimize drawdown over time. This is because the simulation will randomly draw from several systems, all of which are assumed to be independent. If independence cannot be assumed for the market situation at hand, you should not expect valid results from a multiple-system problem.

The Percent-In Market value also determines which P&L strings will receive any consideration. Any trading record represented by a 0 (zero) Percent-In-Market input will be omitted from the analysis.

Q. *I am assuming the number of trades on the Degree of Merit Chart represents the trades required to reach the goal displayed on the chart. It appears that this result has nothing to do with the actual number of trades that I entered into the P&L file. Is this correct?*

A. Your assumption about the number of trades to reach a given goal is correct. The displayed number of trades required has nothing to do with the number of trades in a given P&L string.

annual revision pages and the Commodity Alerts Calendar through December, 1991. A new package including the 1992 Commodity Alert Calendar may be purchased in January for \$20.00. When both copies are ordered at the same time, two shipments will be made. Receive both copies for just \$30.00 (That's \$10.00 savings for acting now.)

To order, clip and fill out the form below. Return it to CSI with your invoice and payment. Prepayment is required for all software orders.

QuickTrieve 4.02 Order Form

(For upgrade orders only)

Name _____

User I.D. _____

Phone day (____) _____

Phone eve. (____) _____

QuickTrieve disk# _____

Disk size (circle one): 5 $\frac{1}{4}$ " or 3 $\frac{3}{4}$ "

Check all that apply:

QuickTrieve version 4.02 upgrade

\$20.00*

QuickTrieve version 4.02 upgrade with Prepaid 1992 Commodity Alerts Calendar (Offer good through 11/1/91) **\$30.00****

Complimentary QuickPlot upgrade (Subject to verification of QuickPlot 4.01 purchase) **\$0-**

* This rate covers QuickTrieve 4.02 with the balance of the 1991 Commodity Alerts Calendar. It applies to current users of QuickTrieve version 4.0 or 4.01 only. All others please see the regular rates in the Product Summary Listing. ** This price covers QuickTrieve 4.02 with the balance of the 1991 Commodity Alerts Calendar and a second shipment in January, 1992, including the 1992 Alerts Calendar. This offer applies to prepaid orders received by November 1, 1991.

For CSI Use Only:

Date mailed _____

How mailed _____

On MROOM _____

2nd label _____

Computer Corner

Enhancing Speed

As software programs become more powerful, they often require more computing time than we would like. This is particularly true on older computers. Those of us who don't upgrade our hardware periodically tend to spend more time waiting than do our colleagues with state-of-the-art equipment. For anyone who doesn't like to wait, we offer some tips that may enhance the speed of your computer.

Disk Caching

A disk cache is an area of memory that is used to hold data read from or written to a disk. When DOS reads a sector from the disk, a copy of the data is stored in the cache. The next time a sector is referenced, the caching software first checks the cache to see if the required information is already in its memory from a prior read. If so, the data is copied from the cache instead of read from the hard disk. If the information is not in the cache, it is physically read from the disk, and a copy is placed in the cache. Copying from memory is ten to 100 times faster than reading from the disk, depending on the speed of the drive.

When the cache is full, the caching software will make room by throwing away data that had been read and stored there previously. With a larger cache, more sectors of data can be kept in memory at one time. This increases the probability that any needed sector will be in memory. Therefore, increasing the size of the cache directly affects performance speed.

Disk caching software that works with extended and expanded memory

is included in recent versions of MS-DOS as well as Windows 3.0. It is called SMARTDRV.SYS. Consult your DOS manual for instructions on how to add SMARTDRV to your CONFIG.SYS file.

If you don't have extended or expanded memory, adding a BUFFERS= statement to your CONFIG.SYS creates a cache of up to 50 Kbytes in the lower 640K of memory. Each "BUFFER" decreases the amount of memory available to applications, however, so a balance must be achieved. For most applications, a statement of "BUFFERS=40", which creates a 20 Kbyte cache, should provide reasonable performance.

Disk Organization

Another area of speed enhancement to consider is disk organization. On a freshly formatted disk, new files are stored in contiguous sectors. The proximity of the sectors allows files to load quickly. As you delete files, DOS uses freed-up areas for new file entries. Since deleted files were probably sandwiched between other data files, blocks of unused sectors are created. The next time DOS needs a sector to store a file, it takes the first unused sector it finds. It does not consider the location on the disk or how close it is to the other sectors a file may occupy. This means that a large database file may be broken into dozens or perhaps hundreds of different areas of a hard disk. This condition is called fragmentation. If it gets severe enough, it can dramatically affect the performance of your computer system. Fortunately,

there are several commercial programs that unfragment disk drives. The most popular ones are NORTON UTILITIES Advanced Edition, and PCTOOLS. These programs also perform analysis of your hard disk, looking for bad or marginal sectors and marking them as unusable. □

Avoiding Drive Failure How QuickTrieve Helps

Hard drive failure is often referred to as a nightmare, but unfortunately, it is more than just a bad dream. When a drive fails, programs, data and important records are lost, sometimes irretrievably.

Any hard drive is a candidate for failure, principally because it is a mechanical device. An over-worked drive is at greater risk. Fragmentation, as discussed in the Computer Corner column, commonly results in an overworked drive.

One advantage of the CSI data format over other formats is the tendency of our data handling techniques to limit fragmentation. When QuickTrieve creates a data file, it reserves as many contiguous sectors as possible for the individual contract or stock. This keeps data points physically close to each other, limiting the number of disk reads required to load the file. If a drive is freshly formatted or unfragmented before file creation, your pre-mapped files will be completely unfragmented.

QuickTrieve reserves all necessary file space before updating a new

time series, but most of our competitors do not. Without the benefit of pre-reserved file space, data points are randomly distributed into available sectors throughout the drive. With this technique, a single contract can be spread out all over the drive, requiring many disk reads with head repositioning to load a file. As you might imagine, even a freshly formatted drive can quickly become

a fragmented quagmire.

To get the full benefit of this QuickTrieve advantage, you may need to unfragment your existing files with an unfragment program. (Be sure to back up your drive first!) Periodically unfragmenting your drive will enhance performance as new QuickTrieve files are added, and improve the performance of your hard drive in general. □

CSI Software Product Summary

	Unrestricted Use	Daily Data User
<input type="checkbox"/> QuickTrieve®/QuickManager® To retrieve, manage and edit data	\$ 99	\$ 39*
<input type="checkbox"/> QuickPlot®/QuickStudy® Charting and analysis software (requires QT/QM)	\$156	\$156
<input type="checkbox"/> Trading System Performance Evaluator™ Computes your system's capital requirements	\$199	
<input type="checkbox"/> TraDe\$K™ (Price varies with # of accounts) Starting @ Traders' complete accounting system 12-month lease starting @	\$446	\$299* \$22/MO
<input type="checkbox"/> Seasonal Index Value Pack Three years of history for 33 popular commodities	\$444	
<input type="checkbox"/> CSI News Journal August 1990 to present	\$35/Yr.	\$5/Reprint
<input type="checkbox"/> CSI Mailing List 1,000 NAMES	\$200	

*A Free non-expiring copy is provided upon request that is not tied to the daily service after 12 months use.
All prices subject to change without notice.

CHECK MASTERCARD VISA AMOUNT ENCLOSED \$ _____

CARD # _____ EXP. DATE _____

NAME _____ DAY PHONE (_____) _____

ADDRESS _____

SIGNATURE _____ 5 1/4" DISK 3 1/2" DISK

Ask Customer Service:

Sales of the Trading System Performance Evaluator continue to be brisk with many enthusiastic responses. We have had a few interesting questions from TSPE users that may be of interest to all. This month the Customer Service Staff will review some of the questions they have received on this program.

Q. I analyzed a fairly profitable trading record with a large number of trades. I used very conservative parameters, yet TSPE still rated the system highly on both Degree of Merit and Probability of meeting my goal. How can I be sure this is an accurate assessment?

A. TSPE's Degree of Merit rating is based on evaluating a single P&L string, not a combination of two or more. Both the Degree of Merit and Probability charts use statistically sound formulas that assess the probability of reaching a given goal at varying capital levels. Each value shown on these charts is based on thousands of samples with market experience drawn randomly from your trading record. All market experience is degraded based on sample size and other input.

To confirm your results, you should double-check your input profit and loss string. Your input should be representative of the system studied over a long period of time. Make sure the P&L entries are correct. Also consider

the size of your input sample. The more trading results, the more reliable the analysis will be. We recommend at least 50 samples, although more may be necessary. Review the control file information to see that all inputs appear as expected. If no errors are found, you can assume the evaluation is accurate.

Q. *TSPE seems incapable of analyzing any system that it judges to have a negative "degraded profit after commission and slippage." I find this a little curious because one would presumably have some probability of achieving a low goal with such a system given a large capital stake. Is this the intended consequence and if so, what is the rationale?*

A. You are correct in concluding that TSPE will not analyze marginally profitable trading systems. In the spirit of not misleading the user, we decided that after the appropriate degradation of input performance, we would require the system begin with a positive mathematical expectation. The user should be attempting to uncover trading systems that will be consistently profitable. A marginally unprofitable approach, such as the game of roulette, could uncover a profit in the short run. For the long term, the roulette player should always favor sponsoring the house. Beating an otherwise losing game may be interesting to a casino gambler, but we did not feel it was appropriate for market analysis with TSPE.

Q. *How does the Percent-In-Market affect the results?*

A. On a random basis, the Percent-In-Market parameter will influence the actual proportion of the time any one P&L file will receive trading attention. The introduction of several Percent-In-Market parameters for several files will tend to smooth out performance and minimize drawdown over time. This is because the simulation will randomly draw from several systems, all of which are assumed to be independent. If independence cannot be assumed for the market situation at hand, you should not expect valid results from a multiple-system problem.

The Percent-In Market value also determines which P&L strings will receive any consideration. Any trading record represented by a 0 (zero) Percent-In-Market input will be omitted from the analysis.

Q. *I am assuming the number of trades on the Degree of Merit Chart represents the trades required to reach the goal displayed on the chart. It appears that this result has nothing to do with the actual number of trades that I entered into the P&L file. Is this correct?*

A. Your assumption about the number of trades to reach a given goal is correct. The displayed number of trades required has nothing to do with the number of trades in a given P&L string.