Jim Berg and John Atkinson

Investing and Online Stock Trading

6 Trading Secrets - How to Outperform the Experts

A Special Report on 'Broker Picks 2006: How Well Did They Go?'

- Rising Uptrends
- Using Weekly Charts
- Volatility Entries & Exits
- Money & Risk Management
- Monitoring Performance
- Creating a Trading Plan

From the Co - Authors of the
Investing & Online Trading
Stock Market Newsletter

Background

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This ebook is a collation of extracts from a series of articles featured in early 2007 in the *'Investing and Online Trading'* mentoring style stock market newsletter.

The original articles, as received by subscribing Newsletter Members contained:

- Further detailed examples of entry and exit comparisons
- Stock ticker codes
- Jim Berg's trading and investing rules and
- Jim's Weight-of-Evidence spreadsheet template.

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Experts Picks 2006 – How Well Did They Go?

By Jim Berg and John Atkinson

Beginning investors often:

1) Have difficulty reducing the market to a manageable number of stock to follow or
2) Search for an 'expert' for stock tips

Searching for trading opportunities by scrolling through hundreds of stocks on a daily basis is a waste of precious time and '*time management*' is a very important part of successful trading.

The average stock portfolio comprises eight to twelve stocks. It is not necessary to have extensive lists of stocks when only one or two replacements are needed to complete a portfolio.

There are a number of different ways to create valuable lists of stocks to watch for entry and exit signals such as newspapers, magazine articles and newsletters. Tips from the experts will save time but some *'filtering'* will still be necessary.

Expert's Picks 2005

The beginning of each calendar year brings out numerous stock 'lists'. Brokers, newsletters and magazines each publish lists of companies that have the potential to produce excellent returns over the next 12 months.

Considerable time and effort in research is expended to produce these lists and many of the companies could indeed be the 'hottest' performers. A recommended 'list', as a portfolio, could also produce acceptable returns. Traders should respect the expert's picks but should not trust that the selections would be 'right' for their portfolio at this point in time. Here is an example:

The *"Experts Picks"* list for 2005 contained 26 companies and the average investor's portfolio would comprise considerably fewer companies, let's say eight, for example. Which eight should the investor purchase and what are the chances they will get a portfolio that under performs?

Fourteen companies underperformed the average return of 15.1%. Seven returned negative results. The bottom eight returned minus 22.1%. Random selection, even from expert's picks, could be risky trading.

Quality watchlists save time but further analysis is needed to determine which companies meet the stringent criteria necessary to be included in a portfolio at this point in time.

Expert's Picks 2006

Every December and January the leading Brokerage Houses are asked to list the companies they believe to have the potential to produce excellent returns over the next 12 months.
In the Sunday Age, December 11th, 2005, six experts from major broking houses selected their six best stock tips for 2006. The thirty stocks, after duplication, are listed below.

Table 1: 2006 Expert Picks 'Buy and Hold' GROSS AND NET Returns

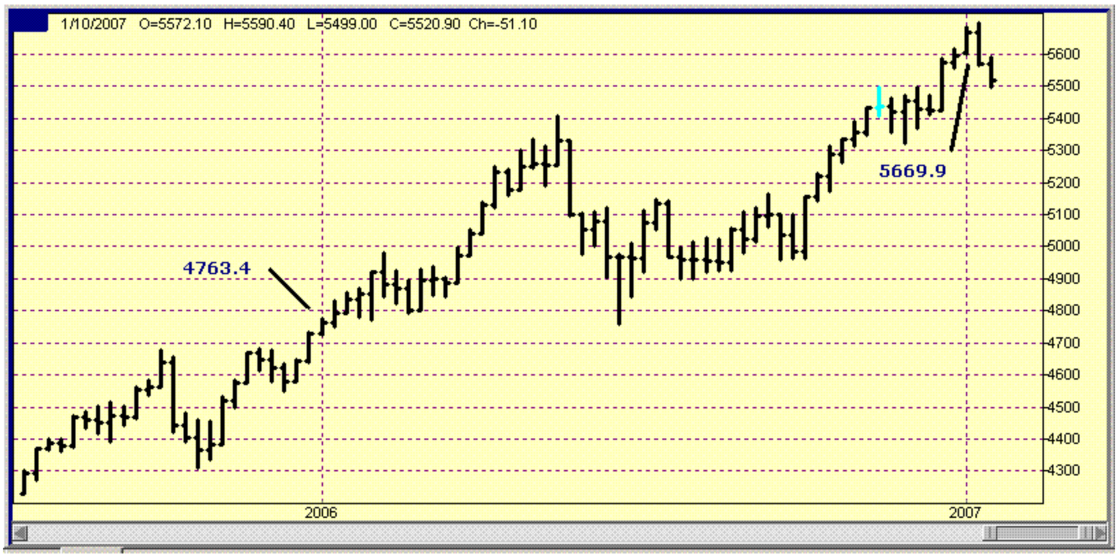
Stock No No.	31/12/05 ClosingPrice	29/12/06 LastPrice	Profit / Loss	GROSS Return	No. of Shares	Entry Cost incl. $30 Brokerage	Sale Proceeds after $30 Brokerage	Net Profit	NET Return
1	22.75	$25.30	$2.55	11.21%	145	$3,329	$3,639	$310	9.31%
2	32.4	$40.40	$8.00	24.69%	100	$3,270	$4,010	$740	22.63%
3	69	$74.30	$5.30	7.68%	45	$3,135	$3,314	$179	5.69%
4	39.19	$38.11	-$1.08	-2.76%	85	$3,361	$3,209	-$152	-4.52%
5	16.85	$23.90	$7.05	41.84%	195	$3,316	$4,631	$1,315	39.65%
6	19.6	$28.85	$9.25	47.19%	170	$3,362	$4,875	$1,513	44.99%
7	20.05	$20.35	$0.30	1.50%	165	$3,338	$3,328	-$10	-0.31%
8	16.48	$21.35	$4.87	29.55%	200	$3,326	$4,240	$914	27.48%
9	12.32	$15.90	$3.58	29.06%	265	$3,295	$4,184	$889	26.97%
10	3.69	$3.35	-$0.34	-9.21%	900	$3,351	$2,985	-$366	-10.92%
11	6.88	$18.79	$11.91	173.11%	480	$3,332	$8,989	$5,657	169.75%
12	12.3	$21.28	$8.98	73.01%	270	$3,351	$5,716	$2,365	70.56%
13	4.05	$4.12	$0.07	1.73%	815	$3,331	$3,328	-$3	-0.09%
14	3.98	$3.46	-$0.52	-13.07%	830	$3,333	$2,842	-$492	-14.75%
15	13.84	$17.55	$3.71	26.81%	240	$3,352	$4,182	$830	24.78%
16	17.56	$20.22	$2.66	15.15%	190	$3,366	$3,812	$445	13.23%
17	5.17	$5.85	$0.68	13.15%	640	$3,339	$3,714	$375	11.24%
18	1.74	$2.08	$0.34	19.54%	1,900	$3,336	$3,922	$586	17.57%
19	2.29	$3.05	$0.76	33.19%	1,440	$3,328	$4,362	$1,034	31.09%
20	3	$3.00	$0.00	0.00%	1,100	$3,330	$3,270	-$60	-1.80%
21	1.65	$0.78	-$0.87	-52.73%	2,000	$3,330	$1,530	-$1,800	-54.05%
22	3.12	$2.17	-$0.95	-30.45%	1,060	$3,337	$2,270	-$1,067	-31.97%
23	4.94	$4.24	-$0.70	-14.17%	670	$3,340	$2,811	-$529	-15.84%
24	3.04	$2.87	-$0.17	-5.59%	1,085	$3,328	$3,084	-$244	-7.34%
25	0.32	$0.37	$0.05	15.63%	10,300	$3,326	$3,781	$455	13.68%
26	1.45	$1.39	-$0.06	-4.14%	2,280	$3,336	$3,139	-$197	-5.90%
27	2.34	$3.34	$1.00	42.74%	1,400	$3,306	$4,646	$1,340	40.53%
28	0.435	$0.43	-$0.01	-1.15%	7,600	$3,336	$3,238	-$98	-2.94%
29	0.96	$1.00	$0.04	4.17%	3,440	$3,332	$3,410	$78	2.33%
30	0.91	$0.55	-$0.36	-39.56%	3,630	$3,333	$1,967	-$1,367	-41.00%
Mean increase of all 30 shares:				14.60%	Totals:	$99,786	$112,424	$12,639	12.67%

The mean increase of all 30 stocks was 14.6%. This is the return a *'buy and hold'* investor would have received if he had bought equal position sizes in all 30 stocks and had held for the year.

An investor choosing eight of these companies for their portfolio could be in for a high risk year. Ten stocks i.e 1/3rd recorded negative results.

Nineteen of the thirty stocks i.e 63% of the experts' list *underperformed* the market, as shown below.

The following chart of the **ASX200** shows 4763.4 at the end of 2005 and 5669.9 for 2006, a 19% increase in value. The **Expert Picks 2006** return of 14.6% underperformed the **ASX200**.



ASX200 *Drawn with JB Premium Charts, FREE with JB Stock Price Data*

We will analyse the list of **2006 Experts Picks** from the perspective of an investor trading with **Volatility Indicators**. We will:

1. Create a disciplined Trading Plan, including Money & Risk Management rules
2. Filter the List to find those which were in an uptrend
3. Look for stocks which give structured volatility entry signals, in accordance with the rules
4. Wait for structured volatility exit signals to be triggered
5. Exit the trades without emotion, then looked for the next stock to provide an entry signal and trading opportunity

We start the filtering process on the **Experts Picks** list for 2006 and determine which of these stocks were in a rising trend.

The rising trend definition criteria we use are:

1. Is the 34 Week Moving Average Rising, or Previously Rising & Now Horizontal?
2. Are Closing Prices Above the 34 Week Moving Average?
3. Are Weekly Prices Making Higher Highs and Higher Lows?

It is important to remember that ***no trading system is or will ever be perfect***. Be prepared that some trades *will still end up in a loss situation.* Strict discipline, *money* and *risk* management must therefore be applied to all trades to ensure that no individual losing trade or combination of trades will cause a significant decrease in overall trading capital.

From the *"Experts' Picks for 2006",* 22 stocks met the rising trend criteria at the start of the 2006. An investor would not likely have purchased stocks in all twenty two companies as the average portfolio contains eight to twelve stocks.

We will show the results of paper trading a 2006 portfolio limited to stocks in eight companies at any one time. The portfolio will reflect the actions of an investor, taking trades in chronological order, as and when entry signals were generated.

Once the portfolio contains eight companies, new trades would only have been added to replace those which had generated an exit signal, been removed and freed up funds. As a result, some stocks may have given entry signals but, with funds already committed, would not have been entered until future opportunities arose. This is what happens in real life trading.

The Trading Rules we will adopt to construct this portfolio for our paper trading of historic 2006 prices will be as documented in Jim Berg's Home Study Course as follows:

a) Entry Criteria

- Rising Weekly Trend
- RSI Oversold 'Alert' *(daily chart)*
- Volatility Blue Bar Entry Signal *(daily chart)*
- Initial Stop Below Pivot Point *(weekly chart)*

b) Exit Criteria

- Initial Stop Below Pivot Point *(weekly chart) or*
- JB Trailing Stop *(weekly chart)*

c) Money Management

- $100,000 trading account
- Compounding – use profits from closed trades
- Factor unrealized losses
- Ignore unrealized profits

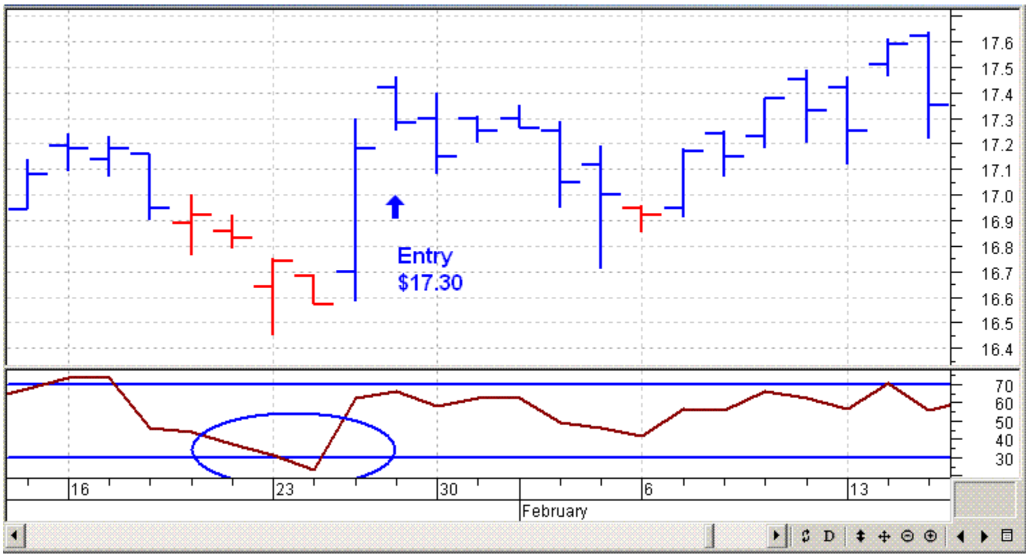
Twenty-two of the original list of 30 *'Experts' Picks for 2006'* list met the rising trend criteria at the start of the 2006. Of these, 7 were in rising trends at the beginning of 2006 but subsequently became falling trends, so were discarded.

17 of the 22 rising stocks generated volatility entry signals as follows:

COMPANY	Entry Date 2006
1	27 Jan
2	10 Feb
3	16 Feb
4	23 Feb
5	23 Feb
6	23 Feb
7	24 Feb
8	16 March
9	20 March
10	21 April
11	20 June
12	28 June
13	3 July
14	13 July
15	26 July
16	4 Aug
17	18 Aug

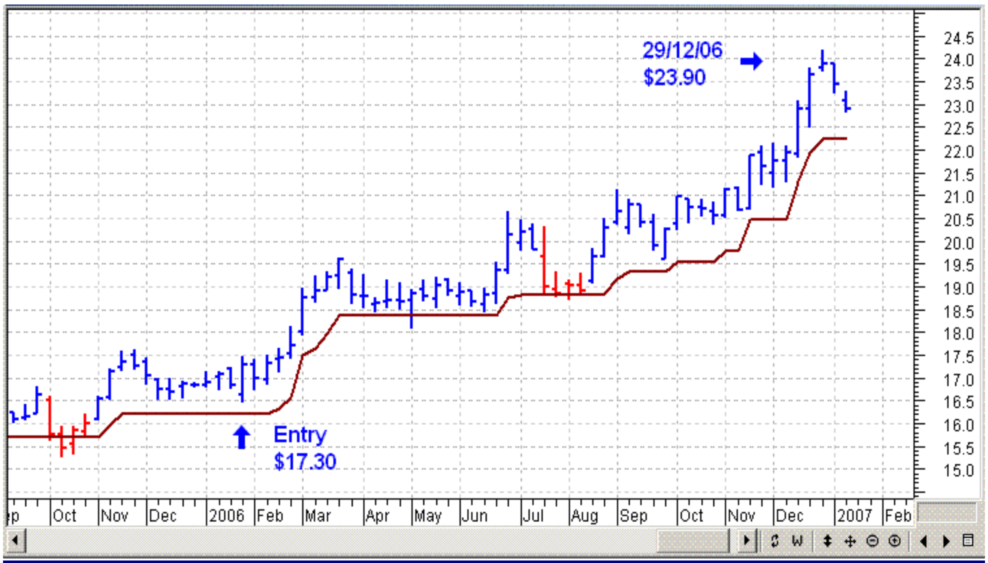
Two trading examples are detailed below:

Stock 1 (Daily): Broker Pick 2006. RSI(7) 'Alert' and blue bar volatility entry signal on January 25th. Enter on the following day when prices retrace to high of signal day.



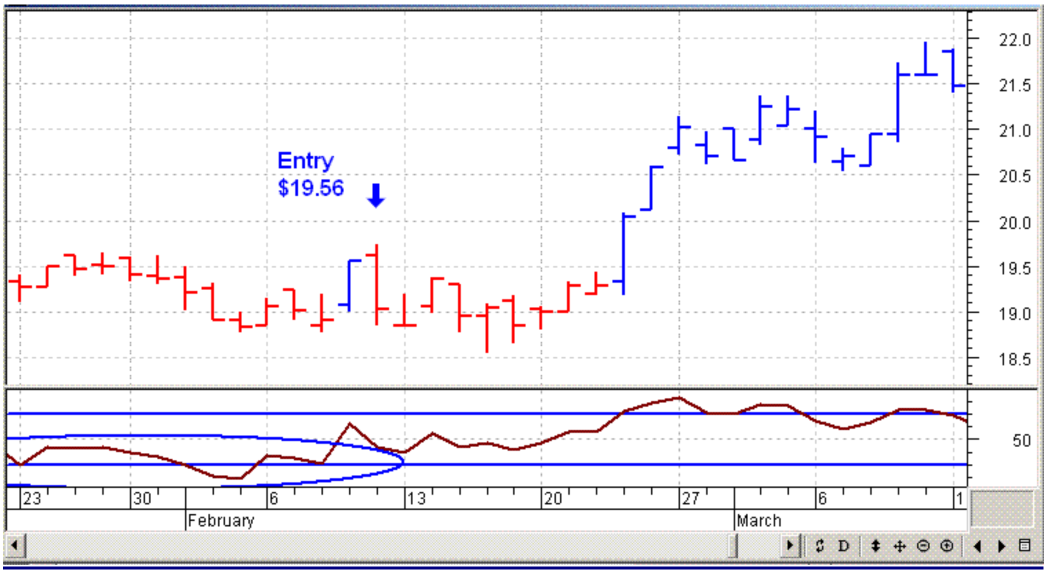
Stock 1 *daily chart with* *JB Volatility Entry.*

Analysis (weekly): Initial stop below pivot point low at $16.38. No exit signals. Position held through to 29/12/06.



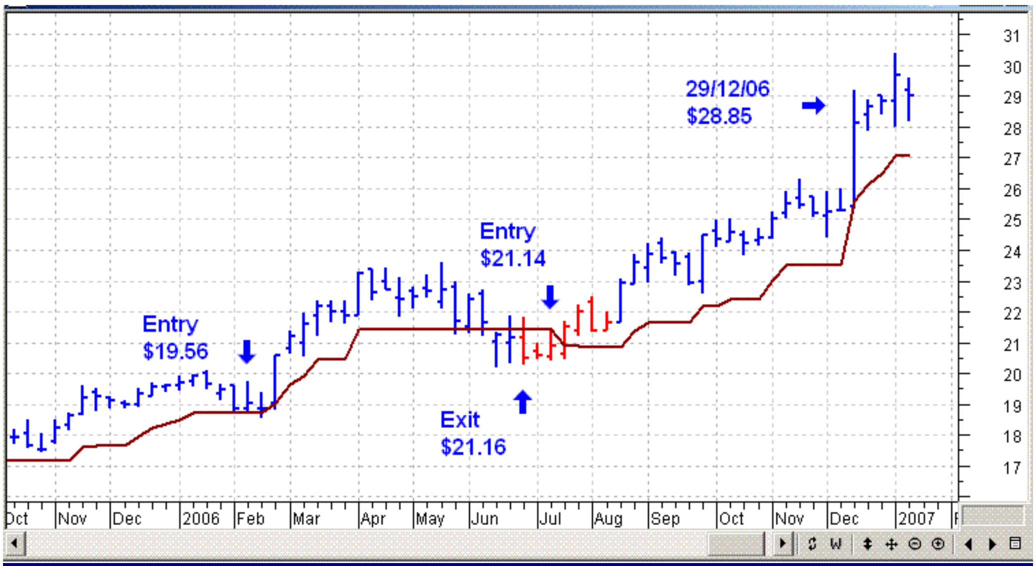
Stock 1 weekly chart with JB Trailing Stop

Stock 2 (Daily): Broker Pick 2006. RSI(7) 'Alert' and blue bar volatility entry signal on February 9th. Enter on the following day when prices retrace to high of signal day.



Stock 2 daily chart with JB Volatility Entry.

Analysis (weekly): Initial stop below pivot point low at $18.67. Two consecutive closes below trailing stop in June and exit first trade at $21.16 (subsequently re-entered at $21.14)



Stock 2 weekly chart with JB Trailing Stop

Analysis of Results

Table 2 below summaries the net results (after brokerage) of all of the trades which would have been taken during 2006. Any trades open as of 29 December 2006 were regarded as if they had been exited.

Table 2: 2006 Expert Picks

Trade No.	ENTRY DATE	ENTRY PRICE	EXIT DATE	EXIT PRICE	Duration (weeks)	No. of Shares	Entry Cost incl $30 bro	Sale Proceeds after $30 bro	Net Profit after costs	Net Return
1	27 Jan	$17.30	29 Dec	$23.90	48	720	$12,486.00	$17,178.00	$4,692	37.58%
2	10 Feb	$19.56	30 June	$21.16	20	635	$12,450.60	$13,406.60	$956	7.68%
3	16 Feb	$13.09	29 Dec	$17.55	45	955	$12,530.95	$16,730.25	$4,199	33.51%
4	23 Feb	$3.21	4 Aug	$3.12	23	3890	$12,516.90	$12,106.80	-$410	-3.28%
5	23 Feb	$42.30	23 June	$42.20	17	295	$12,508.50	$12,419.00	-$90	-0.72%
6	23 Feb	$3.70	30 June	$3.85	18	3375	$12,517.50	$12,963.75	$446	3.57%
7	24 Feb	$11.85	23 June	$12.70	17	1055	$12,531.75	$13,368.50	$837	6.68%
8	17 Mch	$24.63	9 June	$28.62	12	505	$12,468.15	$14,423.10	$1,955	15.68%
	20 Mch	$71.77	*No Trade*							
	21 April	$1.29	*No Trade*							
9	19 June	$8.85	29 Dec	18.790	28	1440	$12,774.00	$27,027.60	$14,254	111.58%
10	28 June	$18.90	1 Dec	$20.75	22	675	$12,787.50	$13,976.25	$1,189	9.30%
11	3 July	$18.00	4 Aug	$17.30	5	720	$12,990.00	$12,426.00	-$564	-4.34%
12	13 July	$21.14	29 Dec	$28.85	24	615	$13,031.10	$17,712.75	$4,682	35.93%
13	26 July	$35.38	29 Dec	$40.40	22	360	$12,766.80	$14,514.00	$1,747	13.69%
14	4 Aug	$75.24	15 Aug	$67.19	2	165	$12,444.60	$11,056.35	-$1,388	-11.16%
15	18 Aug	$6.18	25 Aug	$5.94	1	2060	$12,760.80	$12,206.40	-$554	-4.34%
			Average Duration		20	weeks		Total Net Profit on $100k	$31,950	31.95%

Key Points:

- Completed 15 trades from only 14 of the nominated stocks during 2006
- Had an average duration of trade of 20 weeks
- Had a maximum net loss (after brokerage) of -11.2%
- Had maximum net profit (after bro) of + 111.6%
- Achieved a Total net profit of $31,950 or **32% net return** on $100k, which equates to a performance of *13% better than the 19% ASX200 benchmark.*

1) DIVIDENDS

An advantage our hypothetical Investor *'Buy the Lot and Hold'* might have is that by holding the positions long term he/she would have managed to receive all dividends as they were paid six monthly during the year.

The total dividends received by Investor *'Buy the Lot and Hold'* would have been $2.94k i.e. **2.94%** of a notional $100k portfolio, as shown in Table 5 below.

As a trader, the timing of entries and exits would have been based on volatility signals irrespective of dividend timings. Inevitably, some of the dividend payments would have been missed as positions would not have been open at the time the stocks went 'ex-dividend'.

However, the total dividends received would have increased slightly to $3.68k i.e. **3.7%** of a notional $100k portfolio.

2) SIZE of PROFITS vs. SIZE of LOSSES

Novices, particularly in bull markets when it *'rains pennies'* (Alan Hull), tend to look at the individual profits they make in the market, unaware of how even just one large loss can completely outweigh many months of taking several small profits.

The old cliche *" Cut your losses and let your profits run"* is still certainly very true even today.

More experienced investors therefore appreciate the importance of *minimising losses on every trade* to limit the potential for substantial falls in their overall portfolio.

In fact, focussing on just this one money and risk management factor can make significant improvements to your portfolio, without having to change anything else. Without enhancing your skills in fundamental and technical analysis or in entry and exit techniques, you can **improve your overall performance, simply by controlling the extent of your losses.**

Figure 1 below graphically shows the net returns, including dividends, for our Investor *'Buy the Lot and Hold*'

Figure 1

While there were 21 winning trades averaging **30.7%**, we note:

- The maximum profit was a very healthy 181.3%, but this was only on a small initial notional trade value of $3.3.k (*i.e. $6k profit*)
- There were 9 losses overall, with an average loss of **-19.5%**
- Five losses exceeded 10% of initial trade value
- Three losses exceeded 30% and
- The maximum loss was over **54% !**

In comparison, Figure 2 below shows the net returns, including dividends, for our Trader/Investor:

Figure 2

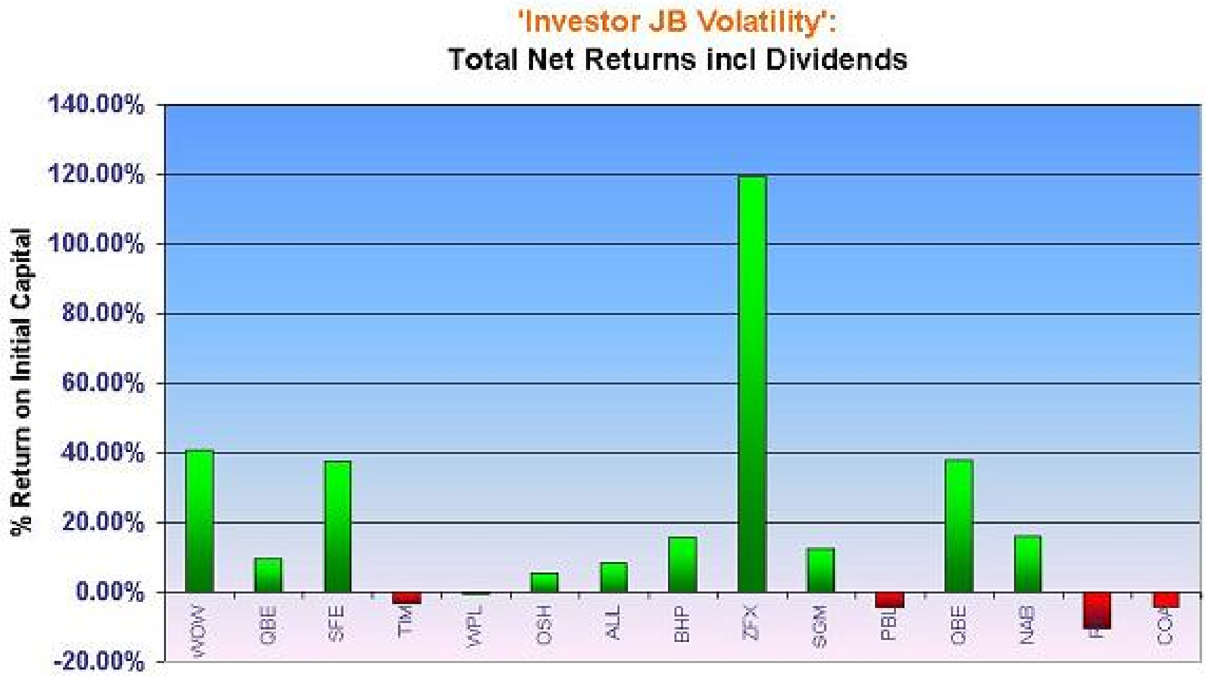


Figure 2 shows that Trader/Investor would have had 10 winning trades averaging **30.4%**, with one rising 119.5%.

This maximum trade *percentage* is lower than that achieved by Investor *'Buy The Lot and Hold'*.

More importantly, as the initial trade capital would have been larger (at $12.8k vs. $3.3k), the *amount* of the maximum trade profit would have been much greater overall i.e. $15.3k vs. $6k.

In addition, while the average profits were the same as Investor '*Buy The Lot and Hold*', it's important to note the strict control of losses using the JB Volatility exit techniques, such that

- There were only 5 losses overall, with an average of only **-4.6%**
- Only one loss exceeded 10% of initial trade value *(10.4%)*
- Final net overall results, after brokerage and dividends for*:*
    - *Investor **'Buy The Lot and Hold'** of* ***15.6%***
    - Trader/Investor of ***35.6%***

Win to Loss Ratio

No trader or investor can possibly hope to *'get it right'* all the time, although sometimes we can get on a winning streak and it may seem like that's what happens.

One measure which experienced traders monitor as a reality check is their ***Win-Loss Ratio***. We could call this their "*Success rate*".

It's the ratio of the ***number of profitable trades to losing trades*** long term.

To put in perspective what traders and investors can expect when they handle their own trades we need to establish what is the *'norm'* (if there is a such a thing.)

For this we turn to Louise Bedford's easy-to-read, yet comprehensive book *'Trading Secrets'* in which she wrote:

"The majority of robust systems produce wins only 50% of time"

To examine this ratio further we also refer to another excellent book, Daryl Guppy's *'Better Trading – Money and Risk Management'* , in which he wrote:

> " Armed with just a little knowledge, **Trader Novice** calls the direction of a trend successfully **50%** of the time.
>
> With more knowledge and skill **Trader Average** finds it relatively easy to boost the success rate to **60%**. This means that for every 10 trades he enters, only 4 are losers or unsuccessful. There are a lot of traders in this grouping.

Getting from **60% to 70%** *is much more difficult*. For every 10 trades, only 3 are failures. This success rate is sufficiently high for **Trader Success** to realistically consider trading as a full-time occupation.

To turn this sustainable trading into a major success we shoot for an **80%** success rate to become **Trader Superstar**. This is like the top of the mast. Very few people make it to this level……."

Table 3 compares the summary of the Win to Loss Ratios (after transaction costs and dividends) for our Investor '**Buy the Lot and Hold'** with those of **Investor/Trader**:

Table 3 Win to Loss Ratio

	'Investor 'Buy the Lot and Hold'	**'Investor /Trader'**
Number of trades	30	15
Total profitable trades:	**21**	**10**
Total losing trades:	**9**	**5**
Win-Loss Ratio	**2.3 to 1**	**2 to 1**
Success Rate	21 in 30 **i.e. 70%**	10 in 15 **i.e. 66.7%**

{***Note:*** Four trades for Investor *'Buy the Lot and Hold'* switched from a small loss, after brokerage, to a small net gain, after receipt of dividends. If we had not included those dividends then this investor would have had 17 wins and 13 losses. This would have been a Win-Loss Ratio of *1.3 to 1* and the success rate drops to 56.7%.}

So far so good. Both investors' approaches have achieved commendable results as far as our benchmark of Win-Loss Ratio is concerned. Now let's dig a little deeper by looking at the Profit-Loss Ratio.

4) Profit to Loss Ratio

Achieving such a very high success rate in selecting and timing entries into profitable trades is one vital component of our performance monitoring.

Anyone who has experienced a large loss knows fully well that it can only take one loss to completely offset a series of small profits gained elsewhere. It is vital therefore to minimise the extent of losses compared with the profits.

The Win-Loss Ratio above examined the **number** of profitable trades compared with losing trades. Now we must consider the Profit-Loss Ratio, which is where we calculate the **amount** we '*win*' on average compared with how much we '*lose*'.

The **Profit - Loss Ratio** is calculated by *dividing the total profits by the total losses.*

A system with a success rate of 50:50 (half winners and half losers) and a Profit - Loss Ratio of 2:1 has the potential to make a lot of money, if it trades frequently.

Table 4 compares the Profit-Loss ratios for both Investors after brokerage and dividends.

Table 4 Profit to Loss Ratio

	'Investor Buy the Lot and Hold'	**'Investor / Trader'**
Total net overall profit	**$15,579**	**$35,663**
Comprising:		
i) **Total profits:**	**$21,424**	**$38,550**
ii)**Total losses:**	**- $5,845**	**- $2,917**
Profit to Loss Ratio:	**3.7 to 1**	**13.2 to 1**

While Investor *Buy the Lot and Hold*'s Profit to Loss Ratio of ***3.7 to 1*** may be regarded as significantly positive, this is completely overshadowed however by the Profit to Loss Ratio performance of *Investor/Trader* of ***13.7 to 1.***

This very positive Ratio was achieved by "*cutting losses short and letting profits run*".

This in turn helped with the improvement in the overall **total** net results by *Investor/Trader*.

5) Expectancy

In his book *'Trade Your Way to Financial Freedom'*, Dr Van Tharp has identified **Six Keys to Trading or Investment Success,** of which the following four contribute to what he calls **Expectancy:**

1. **Reliability** – or what percentage of trades you make money
2. **Relative size** of your profits compared with your losses
3. **Your cost** of making a trade
4. **How often** you get the opportunity to trade

Expectancy is essential for measuring your investing and trading performance.

If you're working for an employer or running your own business, you're probably well aware that in order for the company to survive and then thrive, it needs to keep track of its performance, using a number of key indicators eg for production, safety and finance.

If this is what's necessary in conventional business, then wouldn't you agree it makes sense to track your own trading performance on a regular basis to check how well your System is travelling - and to allow you to continually improve your profitability in the market?

One way to track how well you are going is by using **Expectancy** as a key performance indicator.

Expectancy shows us **how many cents we make or lose** every time we invest one dollar in the market.

Expectancy includes all our profits and losses and transaction costs (including brokerage and interest if applicable).

To do this we need to look at the components which make up the Expectancy formula:

a) The Probability of Winning

This is equivalent to our success rate, as detailed above.

$$\textbf{The Probability of Winning} = \frac{\text{Number of winning trades}}{\text{Total no. of trades}}$$

For our '*Experts Picks for 2006*' we showed that the Probability of Winning for:

i) Investor **'Buy the Lot and Hold'** $= \dfrac{\text{Number of winning trades}}{\text{Total no. of trades}} = \dfrac{21}{30} = \mathbf{70\%}$

ii) 'Investor **'Investor/Trader'** $= \dfrac{\text{Number of winning trades}}{\text{Total no. of trades}} = \dfrac{10}{15} = \mathbf{66.7\%}$

b) The Probability of Losing

This is the flip side of the Win-Loss Ratio, detailed above

$$\textbf{The Probability of Losing} = \frac{\text{Number of Losing trades}}{\text{Total no. of trades}}$$

For our list of *'Expert Picks for 2006'* the Probability of Losing for:

i) Investor **'Buy the Lot and Hold'** = $\frac{\text{Number of losing trades}}{\text{Total no. of trades}} = \frac{9}{30} = \mathbf{30\%}$

ii) 'Investor **'Investor/Trader'** = $\frac{\text{Number of losing trades}}{\text{Total no. of trades}} = \frac{5}{15} = \mathbf{33.3\%}$

c) Average Profit and Average Loss per Dollar

To calculate these factors we need to examine in detail our spreadsheet of all the respective trades for both our hypothetical investors. For completeness, we again include notional dividends received and brokerage costs incurred.

From the set of notional trades for each investor we then calculate their:

$$\textbf{Average Profit per \$1} = \frac{\text{Net Profit after costs}}{\text{Position Size}}$$

and correspondingly their

$$\textbf{Average Loss per \$1} = \frac{\text{Net Loss after costs}}{\text{Position Size}}$$

Table 5 then summarises the results of the *Average Profit per Dollar* and *Average Loss per Dollar* for both approaches.

Table 5 Average Profits and Losses per $:

Investor	Net Profit per $	Net Loss per $
Buy the Lot and Hold	$0.31	-$0.19
JB Volatility	$0.30	-$0.05

Table 5 shows the impact, in a different but quite dramatic way, of *Investor/Trader's* approach of keeping losses small.

d) Calculating Expectancy

As mentioned above, **Expectancy** shows us **how many cents we make or lose** every time we invest one dollar in the market.

Expectancy includes all our profits and losses and transaction costs (*including brokerage and interest if applicable).*

Expectancy of a trading system varies over time so you need to recalculate it regularly as more trades are closed. In practice, its better to analyse over 20-30 or more trades.

The more records you keep over a longer period of time will assist you to calculate a more meaningful result.

Some words of **warning**: The ***expectancy number*** calculated must be a ***positive number,*** otherwise you are going out backwards – in which case **stop trading** and do some serious review, preferably with an experienced coach, to check if it's your:

- analysis of entry/exit points,
- position size
- stop losses
- listening to well intentioned brokers telling you to hold on to falling stocks
- lack of discipline or
- a combination

The **Expectancy** formula pulls together the four items listed:

- The Probability of Winning
- The Probability of Losing
- Average Win
- Average Loss

As follows:

Expectancy =

(**Probability of winning x Average win**) – (**Probability of losing x Average loss)**

Substituting the values we have already calculated above, then the Expectancy for the two approaches adopted by our two hypothetical investors are shown in Table 6.

Table 6 Expectancy

Investor	Calculation	Expectancy
Buy the Lot and Hold	(70.0% * $0.31) - (30.0% * 0.19) =	$0.16
JB Volatility	(66.7% * $0.30) - (33.3% * 0.05) =	$0.18

This means that for every notional dollar our two hypothetical investors were to invest in the market they could expect to earn 16c to 18c after losses and brokerage, after '*closing*' the trades.

In his book, '*Trade Your Way to Financial* Freedom', Van Tharp says that an expectancy of above 50c for every dollar traded is a good system but *you can be happy with a much lower expectancy if you get enough opportunity.*

NOTE: Expectancy should not be confused with the annual % growth on the portfolio that most Fund Managers report on. The key message here is that Expectancy measures the net growth on **every dolla**r invested after losses and costs, **not** on the initial portfolio value.

While at first the Expectancy results above for both investors look very similar, we now need to compare these results even further - in terms of **Frequency**, as discussed below.

6) Frequency

There is no time component for Expectancy.

It's important to understand that it's the **frequency** of trading which also affects your overall *annual performance* outcome.

The more frequently you positively turn over your portfolio, the more you can multiply your results, provided that you're acting on valid entry and exit signals and not overtrading unnecessarily.

In her book *Trading Secrets*, Louise Bedford says:

> *"If you can safely figure out how to get each little dollar panting with exhaustion by the end of the year, then this will have a dramatic effect on your overall returns, assuming that your system has a positive expectancy….*
>
> *….This shows the inherent advantage of maintaining a medium term perspective, rather than a longer term perspective. The more frequently your trading system produces effective buy and sell signals, the more often you can turn over your available equity.*
>
> *Your average hold-time will enable you to factor in how often you turn over your available equity within the course of one year, so you can calculate these figures on your own performance in the markets."*

An Expectancy of 16c in the dollar means that for every dollar invested, a trader would expect to have $1.16 in their trading account, after accounting for all losses and costs.

If this represents an investor's results on all their trades over *six months,* then their system would be making 16% net *per 6 months* overall for every dollar invested.

If continued at the same rate for the next six months, then this would equate to about *32% pa*, without including the effect of compounding.

Let's now look at our two investors' Frequency.

a) Investor 'Buy the Lot and Hold'

In this case study, Investor **'Buy the Lot and Hold'** is *12 month*s would have bought and held for the whole of 2006.

Accordingly, his/her **Frequency** *is actually 12 months.*

By combining their (rounded) Expectancy from of 16c per dollar with a Frequency of 12 months, then their *annual net portfolio growth* would therefore be in the order of 16%. This agrees with the result of $15.6k on an initial $100k.

b) Investor/Trader

The average length of trade for *'Investor/Trader' was 20 weeks.*

This means that if he/she were fully invested all year, then they could effectively turn over their portfolio $\frac{52}{20}$ times i.e. 2.6 times a year.

With an expectancy of 18c per dollar (see Table 6), at first glance we would therefore expect their annual net portfolio growth to be 18% x 2.6 = 46.8%

However, on an initial capital of $100k, Table 4 shows a final net profit of $35.6k i.e. about 35.6%.

As Professor Julius Sumner used to say on the ABC *"Why is It So?"* Here's where we need to drill down one further level. The clue is in the importance of the words above *" ..if he/she were fully invested all year..."*

- No stocks from the *'Experts Picks from 2006'* actually qualified until **Week Ending 29 January** i.e. the notional portfolio would have been empty through most of January 2006 ("*If there's nothing to buy, then there's nothing to buy*" – Max Lewis)
- Additional trades would have been progressively opened as they gave entry signals - during February and March
- It would have taken until W/E 19 March 2006 before this portfolio would have been full with 8 selections
- It took over 2.5 months to fill the portfolio
- There were only 5 to 6 open trades for the four months from the end of August to end of December 2006.
- The average number of open trades at any time over the whole year was only 6.1 trades i.e. *76% of the maximum planned number of eight*

As *'Investor/Trader'* was actually only invested in the market on average 76% of the time throughout 2006, then we need to factor this into the calculation. So his/her net annual return would be:

Expectancy x Frequency Factor x % of year invested

Referring to the numbers above, this equates to 18% x 2.6 x 76% = 35.6%

This figure now agrees with the actual result shown in Table 4.

We have shown how Investor **'Buy the Lot and Hold'** would have had his/her portfolio filled for the whole year – and achieved an annual portfolio growth, after dividends of **15.6%**. In contrast, ***Investor/Trader*** would have had his/her funds **in cash** on average ***for 24% of the year*** in 2006 – yet still achieved an overall return of **35.6%.**

7) Conclusion

This ebook is a collation of extracts from a series of articles featured in early 2007 in the *'Investing and Online Trading'* mentoring style stock market newsletter. The original articles, as received by subscribing Newsletter Members, contained further detailed examples of entry and exit comparisons; Stock ticker codes; Jim Berg's trading and investing rules and Jim's Weight-of-Evidence spreadsheet template.

We have showed how a significant improvement can be achieved as a result of creating a structured trading/investing environment. This series of articles on *'Experts Picks for 2006'* was designed to:

i) Compare the performance of simply *'buying the lot and holding'* for the year vs. filtering the list and selecting stocks which passed our Rules.

ii) Demonstrate, by way of practical historic examples, the importance of:

- Selecting only those stocks which are in rising up-trends
- Using weekly charts for longer term investing
- Developing a set of structured rules for:
    - Volatility based entry and exit strategies
    - Money and Risk Management
- Keeping records and monitoring performance, including:
    - *Transaction costs and dividends*
    - *Total profits and losses*
    - *Win-Loss Ratio*
    - *Profit-Loss Ratio*
    - *Expectancy*
    - *Frequency*
- Creating a Trading Plan and following it with discipline and without emotion

About The Authors

(Click on the links below to discover more information)

John Atkinson and Jim Berg are both very experienced traders, with about 30 years of combined hands-on trading practice.

Through their ebooks and weekly mentoring style 'Investing and Online Trading' stock market newsletter, they have teamed together to share their experience and teach other traders and investors about the pitfalls of the stock market and Jim Berg's *profitable trading strategies that really work.*

John Atkinson achieved a First Class Honours Degree in Civil Engineering in 1975 at Surrey University, Great Britain. Since then he worked as a Civil Engineer in England, South Africa and Australia. In 1999 he and his wife Angela started trading with the help of a broker. As complete novices, they successfully doubled a large portfolio on paper in only six months. They later listened to that broker's so called 'advice' to hold on to their falling stocks as prices cavitated in the tech stock crash of 2000 and beyond – - as a result they lost their Sydney waterfront home and were set back 15 years financially and emotionally.

John and Angela subsequently sourced the very best education they could find - from experienced traders and educators such as Jim Berg, Louise Bedford, Dr Alexander Elder, Daryl Guppy, Alan Hull, Dr Brett Steenbarger and Dr Van Tharp - to discover that which they wished they had sought out beforehand. As a result, John's first ebook: 'The Atkinson Guppy Articles' has a strong focus on exit strategies.

Jim Berg is a former broker, private trader and lecturer with over 20 years experience in the investment industry. Jim has appeared on CNBC Asia and Market Wrap and has been a guest speaker at the Australian Stock Exchange, the Sydney Futures Exchange and the Australian Technical Analysts Association. Jim answers questions on the stock market at the unique Jim Berg User Group segment called '*Ask Jim Berg*' at the ShareScene.com stock market forum.

Jim Berg has educated and helped thousands of traders around the world. Under his guidance, Jim has helped some to develop extra cash flow to assist their weekly budget, others he's helped right through to being able to retire and trade for a living.

His successful proven strategies make sense and can be applied by any stock trader or investor in the Australian or other markets. Jim Berg is the author of 'The Stock Trading Handbook – *Fundamental and Technical Analysis Combined',* and co-author of:

- 'How To Write Your own Stock and Futures Trading Plan' and
- '10 Secrets to Profitable Online Stock and Share Trading'

The first 2 ebooks are included as part of Jim Berg's new JB Premium Charting/ASX Data/Home Study/Support Combo Package.

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4. **Discounts on Other Jim Berg Training Resources**

How to Increase Net Profits by 74% with Less Trading & Zero Stress

Denis and Polina Sheverdyaev

In our *'Experts Picks 2006'* articles we showed how to filter a watch list using Jim Berg's volatility indicators to reduce the number of potential trades to a select few and to increase overall profitability by putting the odds in your favour. We also showed the importance of monitoring your **Win-Loss Ratio** and **Profit to Loss Ratio**. As another example, we thank new member Denis Sheverdyaeva (on behalf of Polina Sheverdyaeva) for their permission to publish a copy of their recent email:

" Hi John, I am not just hoping that I will benefit greatly from being a Newsletter Member, I am completely certain. Just want to share with you how I came to the Jim's System. I'm a novice trader trading small-scale for 5 months. My performance to date is:

Performance - Actual trades

- Winning trades 28
- Losing trades 13
- Total trades **41**
- Win/loss Ratio 68.3%
- Total profits $11,642
- Total losses $ 4,348
- **Total Net Profit $7,294**
- Profit/Loss Ratio 2.68

As you can see it is already profitable trading. But I want to take one step further. What I did is I took Jim Berg's short-term rules # 2 * and applied them to the very same stocks that I actually traded, same time period.

I've compiled all the trades into the attached spreadsheet. One sheet is my actual trades and the other is paper trades **in the same stocks** using Jim's Profit Taking on the 2nd thrust through the Berg Profit Taker or when 25% profit is available. Each position size was assumed to be $10k which matches my actual position sizing. Two-way brokerage of $66 was deducted from every trade and I added dividends and franking credits.

The results amazed me:

Performance – Jim Berg Model - Paper trading in the same stocks

- Winning trades 14
- Losing trades 5
- Total trades **19**
- Win/loss Ratio **73.7%**
- Total profits **$15,016**
- Total losses **$ 2,332**
- **Total Net Profit $12,684** ***(i.e. +74% better than actual)***
- Profit/Loss Ratio **6.44**

So I realized that I can do much better with zero stress, fully mechanical trading, just by following the system! This is why I'm a Newsletter Member now. I am already recommending you to my friends and they are impressed as well. Wish you all the best, Denis"

From Jim Berg's *'Stock Trading Handbook – Fundamental and Technical Analysis Combined'*

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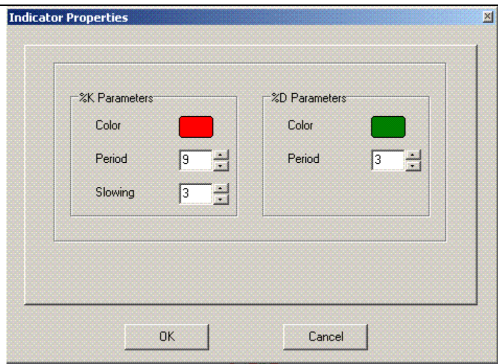

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