SectorSurfer
Change the Game
Shoot The Curl
Monthly Perspective

Perspective: Trend Setting ETFs + Prudent Momentum Portfolios

Jun 07, 2017

Dear Scott,

What About Sell in May and Go Away?

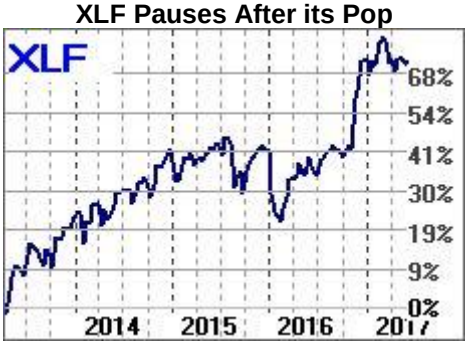
The Sell in May and Go Away crowd was pretty quiet in May while the S&P500 was busy posting a 1.4% return with the NASDAQ besting that at 3.9%. That said, the old adage has until November to prove its worth. The market currently seems to be betting that Washington will manage to get something of value done in the next few months, and I would agree.

6 Years

Why Some Strategies Still Hold Financials ETFs

Financial ETF charts (such as XLF, IYF, IAT, KRE, and others) all look fairly similar to XLF (right), sporting a very sharp election bounce in November, followed by a 5% bump in February, and a subsequent pullback in March. Since the March pullback in financial ETFs tech ETFs have continued their steady push higher, yet seem to get little respect in some Strategies holding both. This has perplexed more than a few subscribers, but can be quickly understood when considering the charts below.

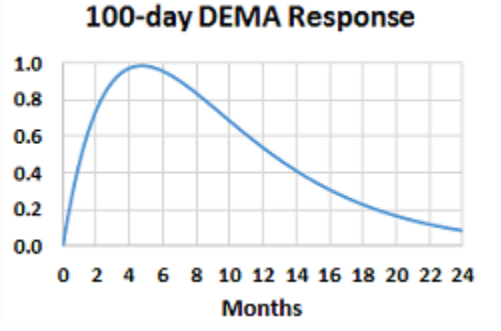
XLF Pauses After its Pop



6 Years

Trend Filter Duration Determination

The 100-day DEMA Response chart (right) illustrates the relative response of the double exponential moving average (DEMA) filter to the daily returns of an ETF. SectorSurfer Strategies typically determine that optimum performance has a filter time constant between 11 and 110 days. This typically varies according to the character of the candidate funds from which it must choose.

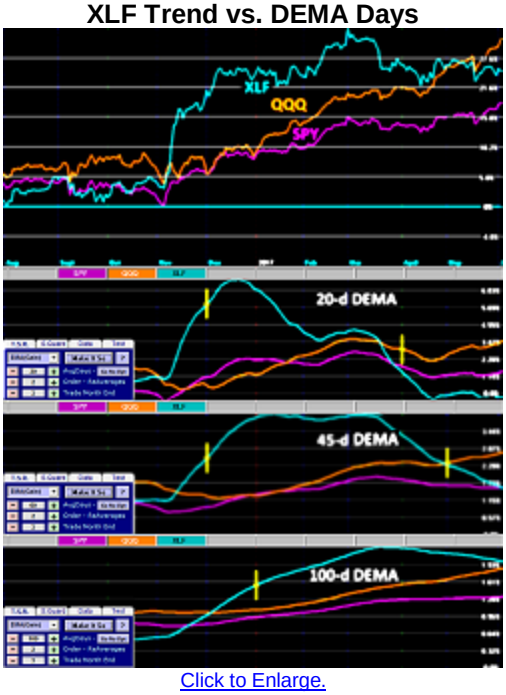


The shape of the 100-day DEMA filter dictates that its response to any market move is negligible at first, but grows over time to a maximum at about five months, before declining slowly into oblivion. Thus, a very sharp pop in daily returns would produce its maximum response from the trend filter five months after the pop. Correspondingly, if the Progressive Tuning algorithm (part of FWPT) determined that a 20-day DEMA filter produced optimum performance, then the response peak would be at about one month. The difference between one month and five months is clearly huge, particularly when itchy trigger fingers are weighing in.

The first portion of the four-part black chart (right) illustrates the relative prices of SPY (S&P500), QQQ (Nasdaq), and XLF (SPDR ETF-Financial) during the past 10 months. The pop in XLF in early November and its subsequent drop in early March (relative to the two other ETFs) is quite significant. The lower three sections of the black chart show the profound difference in response of a 20-day DEMA trend filter, a 45-day DEMA trend filter, and a 100-

day DEMA trend filter. Notably, the 20-day DEMA trend filter has its peak response about one month following the November pop, whereas the 100-day DEMA trend filter has its peak response about 4.5 months after the November pop. While both the 20-day and 45-day filters have already traded away from XLF (in April and May, as indicated by the yellow marker), the 100-day filter has yet to exit XLF.

XLF Trend vs. DEMA Days



Click to Enlarge.

You can determine what the trend filter time constant is for your Strategy by downloading the CSV spreadsheet file and examining the row entitled "Forward-Walk Progressive Tuning Sequential History," which is located just below the listing of trades. The last value in the "Days" row shows the current trend filter time constant. When it is very large, such as 100 days, it begs the question as to what can or should be done about it?

The primary reason a Strategy selects a large trend filter time constant is the value of further reducing noise that is obscuring the signal. Keep in mind that if the FWPT algorithm found a shorter time constant that would work better, it would have selected that instead. However, there are two worthy options for encouraging selection of a shorter time constant to keep decisions a bit more nimble:

1.) In the Advanced Options section of the Strategy Information popup, check the box in the FWPT section indicating to Bias Toward Shorter Trends. This will put a premium value on shorter time constants and encourage the FWPT algorithm to select one of the shorter time constants if they perform well enough. Although shorter time constants allow faster adjustments, being fast can compromise the probability of being right.

2.) The reason a Strategy will select a high filter time constant commonly involves having a particularly noisy ETF among its set of candidate funds. It is the difference in daily noise (volatility) between ETFs that matters in a trend comparison system. For example, a Strategy using all 9 original SPDR ETFs is likely to select a trend time constant greater than 60 days because of the presence of XLU (utilities) and XLB (commodities), both of which march to a slightly different volatility tune than the general stock market. When XLU and XLB are both removed, the Strategy is likely to choose a much lower filter time constant in the neighborhood of 15 days because it has less differential system noise to deal with.

Design of the
Prudent Momentum Portfolios
Streamed Live July 6th, 7PM PST

Click for Event Details.

Design of the Prudent Momentum Portfolios (Thurs. July 6th, 7PM PST Streamed Meetup Details) Risk is not a one-dimensional problem cured by a single dose of diversification. The Prudent Momentum Portfolio family consists of a set of five classically allocated portfolios that apply a double dose of risk-avoidance and double dose of risk-dilution to a high-performance tactical momentum algorithm to address the needs of investors from many walks of life. The portfolio family includes these classic investment styles: Fixed-Income, Conservative, Moderate, Growth, and Aggressive. They are the product of 25 years of R&D and integrate mathematics from the cross-disciplinary field of electronic signal processing to improve investment performance, and automatically adapt to the changing character of the markets.

At least since Markowitz developed Modern Portfolio Theory 65 years ago, risk has generally been measured as the standard deviation from average return. However, both the dictionary and Behavioral Economics suggests risk is actually about the loss of value. Most importantly, ''prudence'' requires reducing the risk of meeting long-term investment objectives, such as retiring early and well. Come see how a pair of Nobel Laureates, a Royal Society Fellow, and a National Medal of Science winner laid the foundation for active risk reduction and forever changed the game as we look under the hood of the design of these portfolios. These **Prudent Momentum Portfolios** are going live on the new **Riskalyze Autopilot** platform in late June 2017 under our AlphaDroid brand for advisors.

Surf Well and Prosper,

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Professional Help - Change the Game

Bryan Sullivan founded AlphaDroid Strategies to provide True Sector Rotation and StormGuard technology to financial advisors in a framework that helps them manage high performance portfolios for their clients. Click HERE