Twitter Thread by Hardik



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5 RULES TO IDENTIFY A STRATEGY THAT WORKS:

There are plenty of trading systems available on the internet and there are many trading systems providers.

But how do you know which ones are going to be potentially profitable?

1/ PREMISE OF THE STRATEGY:

The most important factor in any trading system is the premise or philosophy or logic on which it is built.

The systems must be able to identify certain repetitive behaviors which are inherent to any market.

An example could be #trend or #momentum or #mean reversion etc.

The magnitude of these behaviors could vary over time but they are natural to any markets.

Better yet, you should have multiple systems that attack these behaviors...

This is what I call the Hybrid Approach !!!

2./ SIMPLER, THE BETTER:

Once you have understood the logic behind the system, make sure it's based on simple rules.

If there are more rules, it’s a red flag that the systems are probably over-optimized or curve fit to past data which is unlikely to work in the future.

Most of my strategies have no more than 5-6 rules.

That’s it.

Keep it Simple, Stupid!

3./ VARIOUS MARKET CYCLES:

For any system to work in the future, it must have been applied to many different market cycles over a long period of time.

It must be able to hold up in bull markets, bear markets, high volatility markets, and low volatility markets.

4. DATA INTEGRITY:

The strategies must have been tested on good quality historical data.

This is a very important factor in the success of any strategy.

Most of the strategies are tested on data with "Survivorship Bias"

WHAT'S SURVIVORSHIP BIAS?

The data contains only the currently listed companies and does not include delisted companies.

What if you bought a stock just before it went out of business?

The data with only survivors will not show this trade and boost your results

Many strategies are backtested on, for example, on the current set of Nifty 50 stocks.

The inclusion & deletion of stocks keep on happening in Nifty 50 from time to time.

If you test on the current set of Nifty stocks, it will not be reflective of reality!

5./ SMALL SAMPLE:

If the strategy has too few trades, it probably is curve fit and unlikely to work in the future.

The strategy is simply relying on luck. The strategy must show consistency on a large number of trades to reduce the luck factor.

It's very easy to get lured into get rich quick schemes.

These are not exhaustive but few very important guidelines in my experience to make a better decision at selecting a trading system.

All the best!

Do check out my e-book, The Hybrid Approach: The power of Momentum combined with Mean reversion.

https://t.co/RezNZIUaCo