



MARKET-NEUTRAL TRADING

Combining Technical and Fundamental Analysis
into 7 Long-Short Trading Systems

DR. THOMAS K. CARR

Bestselling author of *Trend Trading for a Living*

MARKET-NEUTRAL TRADING

Combining Technical and
Fundamental Analysis into
7 Long-Short Trading Systems

DR. THOMAS K. CARR
("DR. STOXX")

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MARKET-NEUTRAL TRADING

Other Books by Dr. Thomas K. Carr

Trend Trading for a Living

Micro-Trend Trading for Daily Income

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WHAT THIS BOOK IS ABOUT

*I hated every minute of training, but I said, "Don't quit!
Suffer now and live the rest of your life as a champion!"*

—Mohammed Ali

There are many ways to trade stocks. Some traders rely exclusively on technical analysis. Each night, they scan through hundreds of price charts, searching for just the right combination of technical indicators and price patterns. They run their preset technical scans, isolating stocks making pullbacks, breakouts, relief rallies, and consolidations. They check watch lists of charts for candlestick formations, moving average crossovers, and indicator to price divergence. They scroll up to the weekly chart then down to the hourly chart, making sure there is nothing in either the macro or micro picture that would hinder their technical assessment. This book teaches a better way.

Other traders rely exclusively on fundamental analysis. They spend countless hours poring through reams of company-specific financial data, comparing price multiples with growth metrics, checking their financial rankings relative to industry and competitor standards, all in search

of companies on the verge of dynamic growth. They read reports from financial analysts and research services. They listen in on conference calls and speak to investor relations personnel. They tease out from the news cycle any macro-economic change—changes in commodity prices, currency exchange rates, new tax legislation, etc.—that might affect profit margins, and thus net earnings, of the companies they follow. This book teaches a better way.

This book will teach you seven strategic methods for building a winning portfolio of stocks without having to rely exclusively on either of the previously mentioned research methods. Our approach is to combine the two. We have found that technical and fundamental analyses, long thought to be independent disciplines, complement each other's effectiveness when integrated into the same trading system. Furthermore, we have found that the ideal way to manage such systems is to use the volatility-reducing, returns-enhancing power of bidirectional positioning (i.e., being long and short the market at the same time). The trading systems taught in this book are thus structured in this two-fold, market-neutralizing way: They utilize both technical and fundamental analysis, and they come in two versions, long and short. They are also fully automated, taking advantage of preprogrammed scanning services for true ease of use.

These new systems offer traders the following potential benefits:

- *Never again will you have to spend long hours scanning through charts to find the best setups.*
- *Never again will you have to spend long hours reading through financial reports to find the best companies.*
- *Never again will you have to guess at future market direction to figure out whether you should be long or short the market.*
- *Never again will you have to figure out when to put on or take off hedge positions.*

Imagine the following scenario: It is a Sunday night and you go to your computer to see what trades you need to make the following day. You log in to your technical scanning software and open the encoded filter you are currently using. With two or three clicks of the mouse, a list of 14 stocks pops up on your screen. These satisfy the technical parameters of the long side of the system. With a couple more clicks, you run the short screen for the same system, and 11 more stocks pop up that satisfy the parameters of the short side of the same system. Your next step is to open a web browser and go to two websites that offer fundamentals-based research. You run the remaining 21 stocks through the predetermined grid on one website, then the other. You quickly see that of the 11 remaining longs, only 5 pass muster on the first site, and of those, only 3 pass through the grid of the second site. Of the 9 shorts, only 4 pass both fundamental grids. You are now left with

7 ideal candidates, 3 longs and 4 shorts, that have passed the full range of your system's filters.

Your next step will be performed on Monday morning. A good hour or so before the opening bell, you log in to your trading account platform. Once you are in, you see that you already own three of the seven stocks that came through your trading system's grid (two longs and one short). You already own these three stocks because you performed the same selection process last week and, of the stocks you entered positions in, three of them still satisfy the system's parameters. You now have your trading map for the day: Prior to the open, you will put in orders to close the positions from last week that did not show up in your selection process this week. Last week, they were great candidates. Due to changes in price momentum, valuation, or perhaps a contrary earnings estimate revision, they are no longer ideal. At the same time, you will also enter pre-open orders for new positions in the four stocks of the seven passing candidates that you were not already in from last week.

Your next step is to determine your position size. You check your current account balance. With uninvested cash and open positions included, you see that here at the end of another week of trading, the balance you have dedicated to this particular system is just short of \$28,000. You smile because you started trading this system with \$20,000 just a few short months ago. Yeah! This week, starting from Monday's open, you are going to hold a total of seven

positions (four new, three from last week). You also know that market conditions currently dictate an even 50:50 split between longs and shorts, so 50 percent of your allotted capital, including margin, will go into three long positions (\$9,333 in each) and 50 percent into the four short positions (\$7,000 in each). You then enter three different sets of orders into your trading platform, all set to execute at the open:

- “Market on open” orders to either sell (longs) or cover (shorts) those positions from last week that did not pass your screening filters this week
- “Market on open” orders to buy (longs) or sell (shorts) those new stocks that passed through the filters
- “Market on open” orders to rebalance the three holdover stocks from last week so that your capital is distributed as directed among the longs and shorts, selling or adding shares as needed

At this point, you would repeat the same sequence with any other system or systems you are trading. You happen to be trading four of the systems taught in this book concurrently, with a healthy overall balance spread evenly into each one. If you had only been trading the one system, you are done for the week (or two weeks, or month, depending on how often you choose to rebalance your portfolios). The screening process for this system took you about

15 minutes. Because you are trading four systems at once, you are normally finished with your weekly routine in about an hour (longer if, like me, you get caught up reading headlines and commentary). Tonight you will sleep soundly, resting in the knowledge that you have used the absolute best available information to specify the best possible stocks, and that you have positioned your money in them in such a way that whether the markets go up, down, or sideways next week, you are more likely than not to come out ahead. Trading simply does not get any easier than this!

You have absolutely no hesitation in trading your account in this way because you know, based on 12 years of historical testing and several years of real-money experimentation, that the systems you are trading (along with the others taught in this book) have an amazing profit potential over time. It gives you tremendous confidence to know that this particular set of systems has been generating an average of 1.72 percent return per week, or 144 percent annual return with compounding. Because you have played around with the spreadsheets, you know that this rate of return will transform the \$28,000 you currently have in this system into a nice nest egg of nearly \$700,000 in six years (and that is *after* paying tithes and taxes). Trading four systems at once, each with a different but substantial profit potential, you figure you should hit your first million within five years! Despite a fragile economy, you can rest secure knowing that your ability going forward to generate substantial income is virtually guaranteed.

I am very familiar with this routine. It is one you will see me perform every week. Those years of experience, that nice weekly profit, and those projected rates of return are all mine! Now, with this book in your hands, they can all be yours as well!

Trading success beyond your wildest dreams may seem like a pipe dream. Those who have attained it are easily dismissed as the lucky few. The truth is otherwise. You can be a successful trader. It is not rocket science. That doesn't mean it is easy; consistent trading profits withhold themselves from all but the most persevering and patient. But in this book you have a guide, and in me you have both a coach and a cheerleader (only I'm not going to put on a dress and wave pom-poms!). If someone like me with no financial background, no MBA, and no real interest in what makes businesses tick can "trade for a living," anyone can! Let's get to it!

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**PART
ONE**

alpha:
**PRELIMINARY
CONSIDERATIONS**