The MA crossover method revisited, the whipsawing problem ameliorated, a possibly lossless strategycontemplated

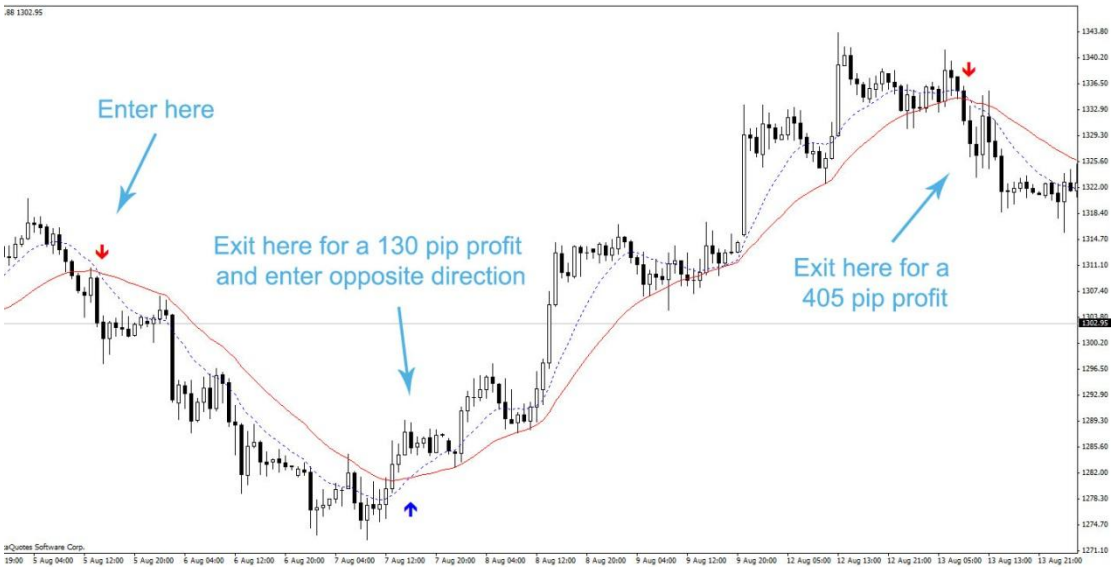
(Note: I thought of this strategy after 5 months of trading forex. Before that I didn't know what the word forex meant. Though I no longer trade this system – not because it failed but because I found a better one – I decided to post it here, thinking it might prove useful somehow. I've written it in such a way so as to capture my thinking at the time. So here it is.)

Ask any trader what the disadvantages are in using the moving average crossover strategy. Invariably they will all mention ranges, whipsaws, choppy markets.

The attempt at a solution I am about to present to you will hopefully ameliorate this problem, if not eliminate it.

Though what I'll be presenting to you can be applied to any MA crossover strategy (as well as HeikenAshi, Parabolic SAR, and any other always-in-the-market binary-signal indicators or systems whose current signal is necessarily the reverse of the previous one), for my examples I'll be using the Sidus method (second version I think), in my opinion one of the better MA crossover systems out there. It is my understanding that it evolved from the Bunnygirl method, quite popular a few years back. Historical minutiaeaside, the Sidus method is what I'll be using to illustrate my strategy.

So, an example of the Sidus method in practice:



Beautiful, right?

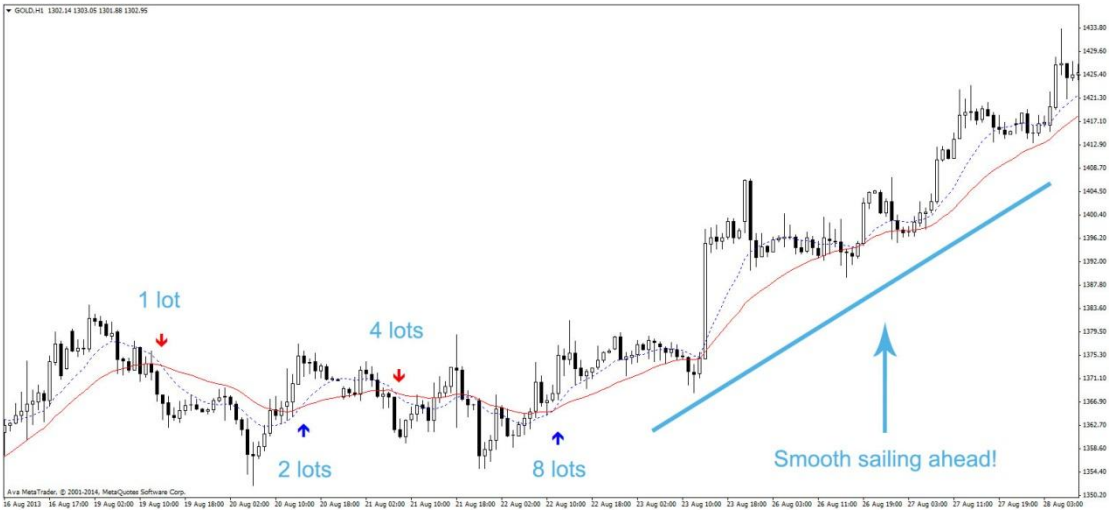
But then what about this:

Oh, that's a bit of a pickle now isn't it? And does it burn the tongue!

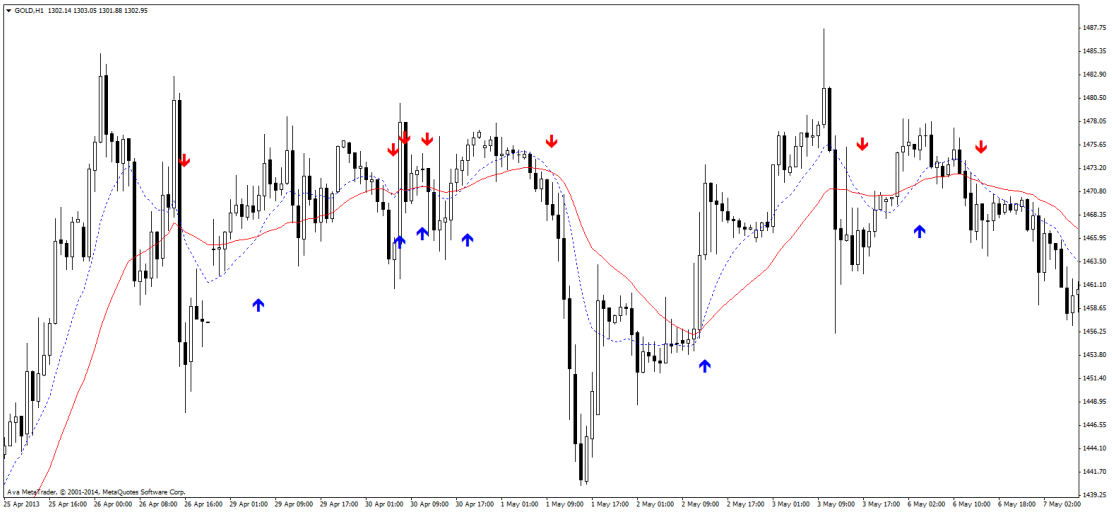
I spent hours looking at the charts, clutching my head, murmuring to myself "there must be a way, there must be a way!"

Martingale - An initial (not final!) stab at a solution

Then it hit me! I will Martingale myself out of this situation!



Now you may think this compounds the problem instead of solving it. But how many false crosses could there be?!



Oh boy!

That's 1 lot, 2 lots, 4 lots, 8 lots, 16 lots, 32 lots, 64 lots, 128 lots, and then, err, then, what'sthe next one? Sorry, let me get my multiplication table. Oh, that's right. Bankruptcy!

Back to the clutching and murmuring. . .

I mean, obviously there are many solutions. But I was looking for a simple one – not just your run-of-the-mill simple, but KISS-simple– and 100% objective and mechanical at that. I studied philosophy for pip's sake, my education demanded something Occamrazor-simple and Karl Popper-testable!

Then once more it hit me!

Instead of doubling every time, I will just increase by one!

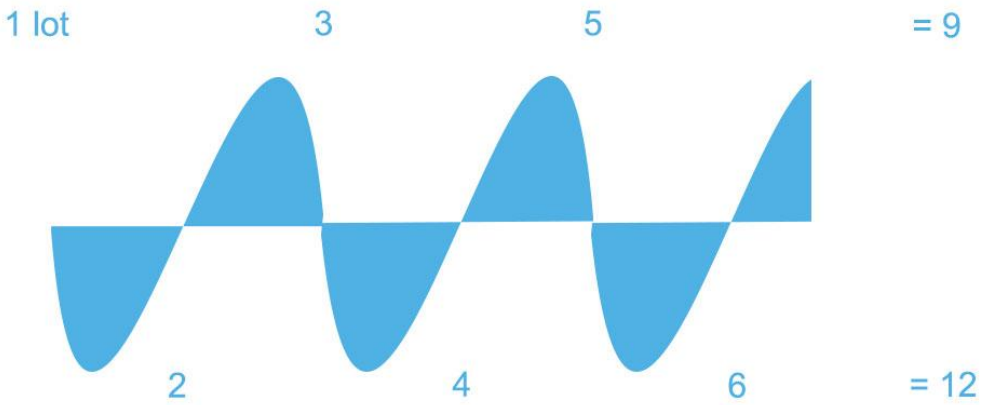
Okay, so my losers are 1x149 pips + 2x65 + 3x128 + 4x48 etc. So how many pips is that? So in order to break even I need my winning trade to make . . . oh, oh my!

It appears that in avoiding the Martingale conundrum, I've created another one in its stead. Because it avoids doubling like the Martingale method does, my method is slower to recover the lost pips, because of the smaller lot-size increment. Now even an otherwise winning trade won't be able to recover all the lost pips. The additive advantage has vanished: I may just as well trade normally, using fixed lots, and take the losses.

"There must be a way. . . There must be a way. . ."

Then again it hit me! (By now my head looked sort of like Darth Maul's from Star Wars.)

What I need is additional lots to save the day. But I already had them before, and I closed them! They would eventually turn out to be winners!Also, every time I added a lot to the opposite direction, the total sum would not increase just by 1, but exponentially. You would expect, for instance, that after 5 additions you would still have just 1 more lot in favor of the new direction, but in fact you have 3:



Let me repeat the lessons from the last paragraph.

One, don't close the losing positions. Since you don't know where the price is going to go, they might turn out to be the winners.

Two, every time the price swings in the opposite direction your positions still increase exponentially, just not as much as they would with the traditional Martingale. So you're still quicker to recap your losses than you would if you closed the trades after every new signal and waited for the last trade to recoup all your earlier losses.

When *do* you close your positions? Only when the total sum is positive. The iExposure MT4 indicator will let you see the sum of all long and short positions. You are essentially treating them as a basket, closing all trades only when the basket's total is a positive number.

So we've got a definite improvement here!

Here I began to actually trade this system. Soon I discovered its weakness. And no it had nothing to do with my equity getting drained.

I discovered that some false signals leave too great a distance from each other. The distance between the blue horizontal lines in the picture below is 82 pips.

So let's say the second trade goes well, price goes up. Even at double the first position size, it would still have to travel for around 60+ pips just to break even, because the first losing trade has an 82-pip head start and by the time the second goes to +41 pips (half of 82) the first trade has lost even more.

Now, the price does go up 60 pips, and more. But not before cajoling us into opening 4 further trades. By that time our basket is still in the negative even after the price reaches the tip.

Another improvement - Define the range

"Define the range? You're not going to start talking about cumbersome and subjective trendlines are you? Last highest swing low what? Now you've lost me completely!"

Do not worry my chart-pattern-challenged friend! I'll explain a way to define the range that is completely objective, simple, rule-bound, mechanical, and will not vary from one trader to another.

What we do is place a line at the opening of the candle where we entered our first position (*not* the signal candle with the arrow above/below it; that was the previous one). Then we do the same for our second position.Basically that's identical to where the blue lines are in the last picture above.

Here's the improvement: we do not reenter positions triggered within the bounds of our lines, 'cause that would be useless – think about it! We reenter only when the bounds are broken, and we move our blue line to the new wider range. (Some advice: wait for the line to be significantly breached, not just touched. Depending on the pair, wait for a 10 to 20 pip penetration.)

So we take the third trade because it breaches the lower blue line. But after the range is broadened this time, it doesn't happen again until shortly after the fourth trade, which will turn out to be profitable. We get the fifth signal to go short, but we don't, since the lower line isn't breached. Additionally, the new signal is so high compared to the earlier short signals, that by now we started to realize that the price is generally going up. The sixth signal, although it breaches the bounds, is unnecessary, since the last trade we took was a long trade, so we already have more long than short positions moving in an upwards direction. We may act on the last signal or not. If we do, we will break even. If we don't, we won't! So even with this amendment it's still sometimes difficult to break even, much less win, in ranges. The particular pair will range for another whole week. By then the good trader will trade with an oscillator, and make a good amount of pips in the process. But that's beyond my purposes here. It does get quite frustrating when markets range for so long and you make no profit, but at least I've described a way that will hopefully help you avoid losing your money during these periods.

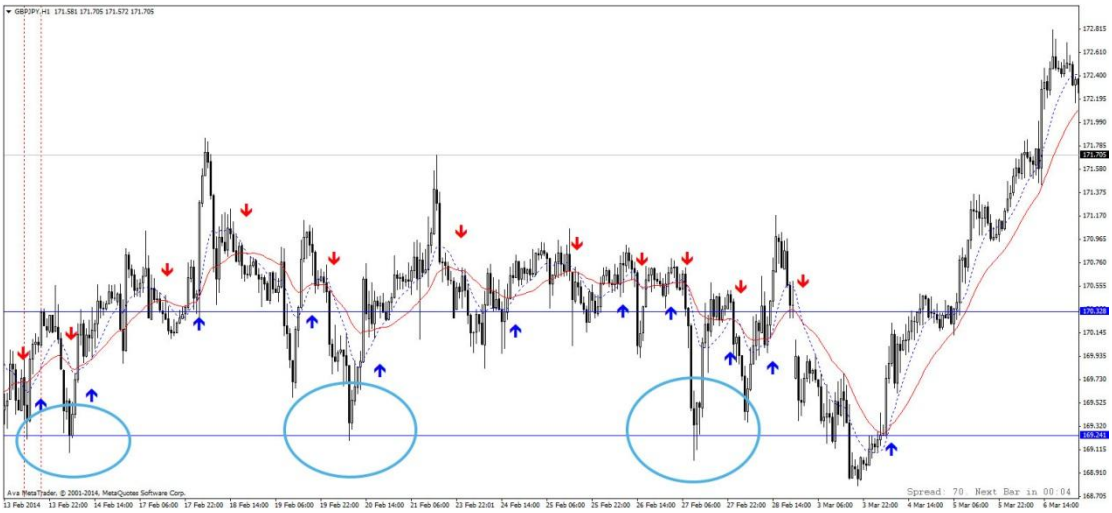
This latest addition to our strategy (i.e. the range-defining addition) will help eliminate quite a few useless trades.

Yet another improvement to the method

As I mentioned above, we should handle all our open positions as a basket.

But, we could also divide it into smaller baskets! In the example above, the first and second positions could be treated as a couple. At the tip, our couple would make 65 pips. At that point we could opt to close them. That would free up some perhaps valuable equity, and even add to it, at least later down the road when the price goes down again.

How does our range-defining method stack up to more traditional methods of drawing resistance and support? I'll let the picture below speak for itself.



Usually you need two points to define a support/resistencelevel. We did it with just one. By placing a line at the open of the candle where we took our trade, we defined a support/resistance level. But only if the price goes against us, of course. For if it continues in our direction, then we win the trade, no blue lines necessary!

Looking at the last picture might make you shudder. But I basically picked the worst ranging period I could find. And you must also ask yourself, "would other trend-following strategies fare better in this kind of market? would they be less nerve-wracking? would their rules be clearer and simpler to follow? would they require trader discretion? would they penalize the noob?" Thinking of it from that perspective, I think my solution is at least satisfactory. And if you think of your trades as groups, as pairs, as baskets, then you'll never lose a trade again! It's highly unlikely a pair will range like this for more than 2 weeks, so if you do your calculations you'll know how much equity is required to withstand such ranges.

Parting thoughts

Remember I said at the beginning that the whipsawing problem is invariably the one single problem every trader will mention. Is that the only problem with an MA strategy? No. Another big issue, for me at least, is that an MA cross strategy does not tell you exactly when to exit. Unless we're talking about ideal trends and ideal reversals, this is a big problem. By the time the MA cross has signaled an opposite position, you've lost all the pips you made from the original signal. Often we're

talking about 100 pips here. Time and time again the method will give you the right place to enter the market, but be very delayed in telling you when to exit.

Well, that's not the problem I set out to ameliorate! I don't have a solution for that, but I'll offer you some advice.

First, pick a currency pair that, historically, goes into nice, long, sustained trends. Just put the Sidus indicator onto a chart, and study it one year back. Second, pick a higher timeframe. The 1H is ideal: not too fast, not too slow. Third, do not be afraid to move from currencies to other instruments. It is not without reason that I used Gold for many of my examples above. It goes into nice, long trends, it doesn't range nearly as protractedly as most currency pairs, and gives you a bigger bang for the buck. S&P500 is also ideal. These two instruments' 1H charts were actually what I ended up trading when I was trading this strategy. Fourth, consider using a fixed TP, so that you don't lose your accumulated pips. How do you figure out your fixed profit? You study the pairs' volatility. For Gold and S&P500 I used 60 pips (or it might be 600, I still call it 60!). I studied the charts and figured out that 60 gave me the best results. You should do the same. A question you may want to ask yourself is this: how much of a pip-distance am I willing to call a range? If you refuse to take profit at 60 pips, that means you are willing to have a potential 60 pip range, and trading it with the above method might result in an equity drawdown that you are not willing to tolerate, and may not be able to endure.

Fifth, a method which I used to employ but is a bit cumbersomely frustrating because it requires you to babysit your trades, is to avoid using a TP altogether and only use a stop loss. You move your SL according to your favorite pivot/support/resistance indicator, leaving the price enough room to breathe. This will actually give you the best results, and will put a new spin/interpretation on the injunction to "cut your losses short and let your profits run", because what is a TP other than a way to cut your profits short, which is exactly the opposite of what the injunction injuncts! So: use a SL to both protect yourself AND take profits. NEVER use a TP to take profit. The only reason I stopped following this method was because I disliked babysitting my trades.

So, that's it. Hopefully the above method will help you, if not to eliminate the whipsaw, at least saw it in half!

Summing up

Let us recapitulate:

1) Use the Martingale method if you dare.

2) Use the amended, safer, 'step-Martingale' method, where you go 1, 2, 3, 4 instead of 1, 2, 4, 8. This is the first deviation from the Martingale method. (You might think that I was rediscovering the wheel instead of inventing something original, but after some online-searching I've seen this method promoted only parenthetically and only in grid-related martingale strategies.)

3) Though it appears sequential, in fact 1, 2, 3, 4 is still exponential as long as you don't close your trades. Not closing our trades is the second deviation from the traditional Martingale method.

4) Treat your trades as a basket, never close them until the basket or sub-basket is profitable.Psychologically that's bound to make us a bit more confident in our trading, since basket-wise you will never lose another trade again!

5) Define the range – this can be done with clear, mechanical rules, no trader discretion required.

6) Take profit at fixed pip-distances instead of waiting for a new signal in order to exit. Otherwise trail the price using your stop loss guided by a good pivot indicator and don't forget to leave the price enough room to breathe.

7) Trade trending instruments. Take a step outside your comfort zone and trade Gold, S&P500, Crude Oil, Natural Gas. They all perform well with this strategy. Regarding the last two, mind the weekend gaps! They might blow up your account

easily. So close your positions on Fridays. And don’t trade on Fridays. Study the gaps. Just trade the first two to be safe! Trade only Gold to be even safer gap-wise. (And don’t trade Silver. Silver ranges.)

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(End note: I believe the above strategy can be traded profitably by an experienced trader as a whole, but I wouldn’t recommend it to a newbie. The ranges will probably scare him, cause doubt in him, and make him screw up.Hopefully the above will prove useful, perhaps as part of another system, or perhaps as a stepping-stone to some better idea or system.)

Alex