Think of all those trading systems you see advertised and hyped. Haven’t you wondered whether they work? Of course you have. John Hill is the president and founder of Futures Truth magazine, which tracks, tests, and evaluates trading systems and then publishes the results. Starting the magazine was his response to the many ineffective or downright fraudulent systems that he saw were being sold to would-be traders. STOCKS & COMMODITIES Editor Jayanthi Gopalakrishnan spoke to Hill via telephone on October 25, 2002, discussing trading systems, the characteristics that make them successful, and what traders should look for when choosing a system. Here is what he had to say.

You’ve evaluated quite a few trading systems through the years with Futures Truth. How did that come about?

Futures Truth was organized back in the mid-1980s with the purpose of showing the actual performance of the many trading systems that were for sale, many of which were completely worthless. The magazine started out in a negative vein, in that I’d purchase a system that I would hear about, it would turn out to be worthless, and I’d get irritated. Finally, I decided enough was enough. That led me to start Futures Truth. Through the years, we took on anybody and everybody and had many, many threats of lawsuits.

Why?

We were dealing with multimillion-dollar businesses. In fact, we were sued once, but the judge threw it out. Futures Truth has been not a very profitable venture, but it has been a satisfying endeavor for me personally.

What happened with Futures Truth was we started publishing hard numbers about how the systems we tested worked. Soon, people with good systems and quality products came to us and asked us to start tracking their systems. We’ve created a few millionaires. This is mainly because some of these people had very good material, but didn’t know how to get the word out to the public about their systems. We tested and tracked them, and published the positive results. A number of them have now gone on to manage big money. And that’s how Futures Truth got started.

You said people with good systems came to you. How do you identify or define a good system?

Back when we started out, we identified people who offered fraudulent systems. The bottom line in a good system is whether it makes money. Are the claims realistically presented? I’d say right off that people can have a good system, but if they don’t manage the system correctly, they’ll lose money on it. That one system everybody is looking for does not exist. But there are good systems out there, which if properly financed will yield profitable returns. Most big money, especially in the managed futures industry, is traded systematically, as opposed to judgmental-type trading.

A lot of individual retail traders still trade based on intuition. I don’t think many have quite caught on to the individual designing of trading systems. Do you think that’s true?

I would say a couple of things. The average retail trader is looking for something that doesn’t exist. They may pick
Here’s an example of the typical mentality: If you buy a $3,000 system, you feel you have to trade it. Your ego is on the line, since you spent $3,000. But you may lose $10,000 or $15,000 more before you decide the system is no good. In that case, you have a lot of things working against you. I tell most people, and I can’t emphasize it enough, do your homework! If the system you are considering purchasing is so good, then ask the developer to show you their trading accounts. Surely they have traded the system they’re selling. Get two or three names of people who have used the system, so you can talk to them about their experience. You have to do your homework, and Futures Truth is just one source of information.

**Why don’t you recommend curve-fitting?**

I’ve seen systems that show an 80% profit if you buy British pounds on June 14 and sell them two months later on August 13. I’ve also seen late-night TV ads promoting that sort of garbage. You have to realize this is just number-crunching. You may be led to think this is an utterly beautiful system: All you have to do is buy British pounds on a certain date and sell 20 days later. But this type of system has absolutely nothing to do with whether you’re going to make money. All it means is that somebody’s crunched a bunch of numbers and has discovered certain dates for various commodities. That sort of thing is just out-and-out fraudulent. I saw that system on a late-night infomercial not too many years ago. Fortunately, the guy who was doing that got thrown out of the NFA [National Futures Association].

**When you say a system should be based on sound market dynamics, what are you referring to?**

I’m a firm believer in technical approaches to trading the markets. This belief is backed up because I know many CTAs [Commodity Trading Advisors] who consistently make money in the market by trading using mechanical approaches. In the long term, fundamentals will win out. But who knows what the fundamentals are? A chart is merely an expression of supply and demand. The technical analyst tries to read the charts and determine who’s in control: the bulls or the bears. He then places his trades accordingly.

**Since you believe in technical approaches to trading, are there any technical indicators or chart patterns you prefer?**

I’m a Wyckoff student, and I believe in studying charts. The charts will tell you more than most of the indicators will — most indicators seem to do the same things. Further, most indicators are lagging indicators. This is why I’m a firm believer in looking at the chart patterns to base my trading decisions.

**What do you look for in a chart to determine supply and demand?**


But what I recommend most is always to think in terms of supply and demand. Who’s in charge of each game? That you can see in the chart patterns. For instance, if a market goes dead in a certain area, and then has a sudden burst expansion out of that in both price and volume, that is demand entering the market. What you try to do is figure out what the big boys are doing and ride their coattails. The people who really know, and I’m always interested in knowing who those people are, make up what I refer to as the collective mind of the market.

**How does a person come to understand the collective mind of the market?**

It takes many years of studying chart
patterns. There are a number of good books out there on the subject. The other thing I tell people is that nobody’s going to tell you how to trade the markets in a weekend seminar. The best source of knowledge is books and your own study.

It would seem that something like the collective mind of the market would be difficult to implement into a mathematical trading system. Is it possible to do that?

Absolutely. There are ways to detect momentum in the market. Most traders concentrate their efforts on how to enter the market, but there are two equally important factors. One, if you’re wrong, where do you exit the trade? And two, if you’re right, where do you exit the trade?

Most of us, when we buy futures or stocks, expect prices to go to the moon. What I tell people, and this is contrary to what others may say, is to take small profits. If you have a 70% chance of making a modest profit versus a 10% chance of making a gigantic gain, which way would you go? I tell people that when they look at a chart, they should determine what conditions will be ideal to enter. Many of the systems I’ve looked at, and we’re trading a number of them ourselves, make it exceedingly difficult to enter the markets. In other words, the chart patterns that suggest you enter a trade don’t occur with great frequency.

What I’ve found, and what works for me, is to use a system that makes it exceedingly easy to exit or get out of the market. If you get a reasonably good profit, don’t let it get away from you. There are other horses coming right around the bend, so take modest profits. And yes, there are systems out there that do that. You can tell when you get a buying force in the market. There are simple indicators that are very helpful for this.

Can you give us some examples?

One is the simple moving average. If the moving average is moving up sharply, it is a candidate for a purchase. But you don’t just go in there and buy at the market. You have to pick the points for entry. If you’ve got a strong uptrend in the market, try to buy it on a one- or two-day correction. Know where your stops are going to be.

There are also other indicators that are useful. For instance, it’s well known that the first hour of trading is amateur hour. There are more false moves in that first hour than you can shake a stick at. But if you can restrain yourself, and we’ve done studies on this, there are mechanical systems that show that the best profits are made by entering after the first hour. The highest percentage winners are made by trading in the afternoon, but your gross profits are not as much as if you enter after the first hour.

How important is money management for anybody who builds a trading system?

I’d say it’s about 80% of it.

What factors should traders focus on?

There are several. First is proper financing: Try to get your finances in order so you don’t trade from fear. You’ll never win if you’re trading from fear. Second, psych yourself up — this is the risk/loss ratio. Know what your odds are. If your system says it’s a 50% or 60% winning trade, don’t bet the house on it. Don’t overbet on any single trade. This way you don’t get uptight about it.

So one, you’ve got the capital, two, you know what the risk is, and three, you know what the potential reward is. Most important, you’ve got to learn to love losses, because you know a winner’s coming sooner or later. But you’ve got to overcome the element of fear; you can’t trade scared and make any money.

Could you say the same thing about greed?

Absolutely. That’s why so many people go broke: They’ll read a fundamental article and it will push something that makes great sense from a fundamental standpoint. For instance, silver. The article will push silver, and it will say silver’s going to $50. It may go up to $50, but it may also go down to $4 before it goes to $50. That’s where the greed factor comes in. Traders think, “This is the one place I’m going to make a killing in the markets.”

Do you trade the futures market predominantly?

No, I trade stocks too. We’ve got patterns working in stocks. We’re trading a couple of stock systems we’re very pleased with.

Do you do intraday trading, or do you hold over a longer term?

We do some intraday trading, but primarily look for short-term moves in the markets of three to five days. There are a number of decent intraday trading systems. The one thing I’d say about trying to daytrade almost anything other than the indexes is that it is probably an exercise in futility. You’ve got to have volatility to trade. The most money is made in three-day patterns, or three- to five-day patterns. I know one fellow who’s managing a billion dollars, and his average trade time is probably under two days.

So he holds on to a trade for a couple of days at the most?

That’s what you call very short-term trading, and what he’s done is develop probably around 30 patterns, over all these markets, and he just trades those. But he has all three elements in place: He knows where he’ll enter a trade, he
knows where he’ll exit a trade if he’s right, and he also knows where he’ll exit if he’s wrong.

When you said “different markets,” it reminded me about trading systems you can use on different markets. There are a lot of systems out there that may work on a single market, but to select a trading system, how would you be able to determine its robustness?

Stock indexes are a class onto themselves. If you get outside of that area and you go into patterns, if I find something that works beautifully and if somebody tries to tell me here’s one system for the British pound, one for soybeans, and another one for bonds, to me that smacks of colossal curve-fitting. If one system doesn’t work in most markets, then I am very suspicious of it. This doesn’t include the stock indexes, because they’re a class onto themselves, because of the volatility. But if a system doesn’t work in most markets, I’m not sure I would want to trade it.

What should you be looking at?

You’re basically looking at patterns, and the one thing that’s common to all markets is money. The collective mind of the markets comes down to that one common denominator. Whether it’s Swiss francs or soybeans or coffee, it’s still people and their money. If you have a system and it doesn’t work in most markets, then I’ll be suspicious of it.

Right, because you’ll have to be able to use it for every market you trade.

Well, you may not trade all markets, but you can look at a system and say it performs decently over most markets. Currencies are notorious for gaps, compared to, say, bonds. So your risk is probably greater in trading a certain pattern with the currencies than with bonds.

Do you recommend people trade uncorrelated markets?

Absolutely. For instance, Treasury notes and bonds are basically trading the same thing. But if you trade bonds, soybeans, and Swiss francs, you should have very uncorrelated markets.

What do you recommend most traders be aware of when confronted by those who sell trading systems?

I was on Mark Haines’ CNBC morning show one time, and he asked me, “John, what’s gold going to do?” I said: “Mark, I know exactly what gold’s going to do. But before I answer that question, your listeners ought to know I’m only correct 23% of the time. If the truth were known, I’m [going to have] a hard time getting bus fare.” The point of that story is this: Beware of people who know all the answers. If I spent $200,000 in your magazine, telling people how good I am, some people would begin to believe it, and would want to send me money for whatever it is I’m peddling. You have to do your homework when it comes to people claiming to be so-called authorities. Do they really make money in the market, or are they just good fakers who can present a convincing dialogue? Be careful of people who know the answers.

Think of the mentality of supply and demand, because that’s all a chart is.

Thanks for talking with us today, John.

SUGGESTED READING


