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See How Trend Following Works

- Thank you for your purchase and interest in Trend Following.
- This Powerpoint presentation is an introductory visual demonstration of the Turtle System rules.
- You will see Trend Following examples that use all 6 rules of the Turtle Systems 1 and 2.
  - Market – What to trade
  - Entry – When to trade
  - Position – How much to trade
  - Tactics – How to maximize gains
  - Stops – When to cut losses
  - Exit – When to profit
- Profitability and backtesting examples through select historical data (Excel spreadsheets) are also available at TrendFollowingWorks.com

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Rule 1: The Market

- For “Market” simplicity, our examples will show well known stocks with sufficient liquidity.
- For a successful system, Trend Following trades must be consistent across the same Market or the profitable trend can be missed. Trend Following does not attempt to predict trends, but is ready to profit when the trend appears. Pick your Market and be consistent.
- When choosing your Market, limit the number of correlated positions you could enter. For example, if trading in stocks from the same sector, they are likely to move up and down together. If correlation is not limited, it increases risk. The Turtles limited their positions to 4 units in a single market, 6 units in closely related markets, 10 units in loosely related markets, and 12 units (long or short) in a single direction.
- Depending on your trading style and risk tolerance, a Market with leverage can increase gains when managed correctly.
- “Market” is both defined as any single stock, Forex pair or Futures commodity as well as your collection of single Markets that your system trades.

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Rule 2: The Entry – System 1

- System 1 enters long at a 20 day high and enters short at a 20 day low.
- Entry is simple and based only on price. The Turtles entered as soon as the high or low occurred during the trading day. If you are unable to trade during market hours, enter the Market the following trading day.
- System 1 long and short entries easily identified using 20 day price channels:

- 3 short position entries and 2 long position entries shown in the chart above as seen when the price creates a new 20 day high or low. Chart courtesy of StockCharts.com

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Rule 2: The Entry – System 2

- System 2 enters long at a 55 day high and enters short at a 55 day low.
- Entry is simple and based only on price. The Turtles entered as soon as the high or low occurred during the trading day. If you are unable to trade during market hours, enter the Market the following trading day.
- System 2 long and short entries easily identified using 55 day price channels:

- 1 short position entry and 1 long position entry shown in the chart above as seen when the price creates a new 55 day high or low. Chart courtesy of StockCharts.com

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Rule 3: The Position

- Positions are calculated by using the 20 day ATR and the risk percentage. This position calculation with its associated stop, limits trading risk and accounts for volatility in the chosen Market.
- The Turtles initially used a 2% risk percentage however lowered it to 1% after research showed a potential for excessive drawdowns with the amount of leverage they used.
- If the risk percentage of your system is 2%, you would limit your position to only the number of shares, lots, or contracts that would result in a loss of no more than 2% if stopped out at 2 times the 20 day ATR (2 times N also known as 2N).
- Depending on the amount of leverage of your system, you may be limited (by available capital) in the maximum number of open trades at a single time. We will explore this on the next slides with an example position in **GOOG** and compare it to a leveraged Forex **EUR/USD** example.
- Required numbers to calculate the entry position:
  - Account Size
  - Risk percentage
  - 20 day ATR
  - $ value of 2N

The calculation is:
account size * risk percentage
divided by
dollar value of stop (20 day ATR * 2)

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Rule 3: The Position

System 2 GOOG chart example:

- Enter long at the high of $510.41 on September 20
- The 20 day ATR is $8.61 on Sept 20
- Our account size is $100,000
- Risk percentage is 2% per trade
- A 2N stop would be $493.19
  ($510.41 - $8.61 - $8.61 = $493.19)
- The calculation is:
  account size * risk percentage
  divided by
  dollar value of stop (20 day ATR * 2)
- With the example numbers:
  $100,000 * 2%
  divided by
  $8.61 * 2
- Or $2000 / $17.22 for a total of 116 shares (always round down)
- In this example, the position is 116 shares of GOOG. If the trade stops out at $493.19, only 2% of the account size is lost
- However at $510.41 per share, 116 shares would require more than half the available $100,000 capital ($510.41 * 116 = $59,207.56) not including broker commissions or transaction costs. Only one trade would be available at a time at this risk percentage
- For this reason, leverage through stock options, Forex or Futures allows for multiple trades across different markets at one time. Additional trades allow increased profits

Rule 3: The Position

System 2 **EUR/USD** example:

- Enter long at the high of 1.5045 on February 26, 2008
- The 20 day ATR is 0.0097 on Feb 26
- Our account size is $100,000 (leverage is 50:1)
- Risk percentage is 2% per trade
- A 2N stop would be
  (1.5045 – 0.0097 – 0.0097 = 1.4851)
- The calculation is:
  account size * risk percentage
  divided by
  dollar value of stop (20 day ATR * 2)
- With the example numbers:
  $100,000 * 2%
  divided by
  $97 * 2 (1 pip = $1.00; 1 pip = 0.0001)
- Or $2000 / $194 for a total of 10 lots (always round down)
- In this example, the position is 10 lots of **EUR/USD**. If the trade stops out at 1.4851, only 2% of the account size is lost
- With 50:1 leverage, if each lot requires $263.78 in margin, 10 lots would only require $2637.80 of the available $100,000 capital not including broker commissions or transaction costs if any. As compared to the **GOOG** example, a minimal amount of capital is tied up and additional trades can be entered.
- Additional trades become essential to increase profits as seen through the Tactics

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Rule 4: The Tactics

- To increase gains and protect profits as the trend progresses, additional positions are added in pyramid fashion while maintaining about the same risk percentage. Both System 1 and System 2 apply this tactic in the same manner until correlation limits are met.
- Additional entries are made at a profitable ½N mark (from the original entry's fill price). Each new +1 position is calculated the same way as the original position using that day's data. The account size (including equity value), the 20 day ATR and the same risk percentage. With the additional entry, the stop moves to 2N of the new entry (fill) price.
- System 2 $WTIC chart (courtesy of StockCharts.com) with the price marks to demonstrate:

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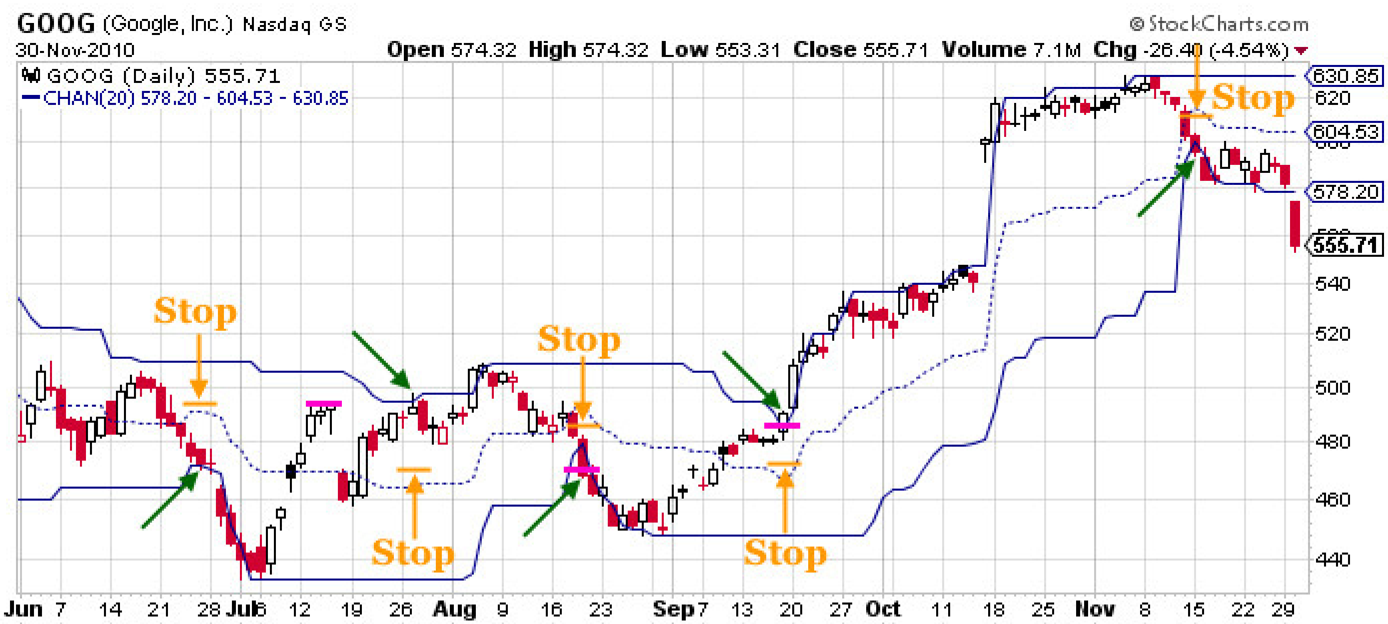
Rule 5: The Stops

- Stops are set at 2 times the 20 day ATR for both System 1 and System 2.
- Shown below on the chart are the stops based on our System 1 **GOOG** entry examples (marked with green arrows). The orange markers show the stop at the time of entry and the pink markers show when the entries get stopped out. Chart courtesy of StockCharts.com
- For the first stop marker at the June 25 short entry, the 20 day ATR was $11.63. If we entered at the low of $470.56, the stop is placed at $493.82 ($470.56 + $11.63 + $11.63)
- For the second stop marker at the July 27 long entry, the 20 day ATR was $9.50. If we entered at the high of $497.50, the stop is placed at $470.14 ($497.50 - $9.50 - $9.50)



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Rule 6: The Exit – System 1

- System 1 exits long positions at a 10 day low and exits short positions at a 10 day high.
- Exit is simple and based only on price. The Turtles exited as soon as the high or low occurred during the trading day. If you are unable to trade during market hours, exit the Market the following trading day or through the use of daily adjusted stops.
- Below are System 1 long and short exits using 10 day price channels (red) shown with the 20 day price channels (blue) on the **GOOG** entry example.

- Example only shows entry and exit. Stops not shown. Chart courtesy of StockCharts.com

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Rule 6: The Exit – System 2

- System 2 exits long positions at a 20 day low and exits short positions at a 20 day high.
- Exit is simple and based only on price. The Turtles exited as soon as the high or low occurred during the trading day. If you are unable to trade during market hours, exit the Market the following trading day or through the use of daily adjusted stops.
- Below are System 2 long and short exits using 20 day price channels (red) shown with the 55 day price channels (blue) on the **GOOG** entry example.

- Example only shows entry and exit. Stops not shown. Chart courtesy of StockCharts.com

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System 1

- Below is the System 1 **GOOG** chart with all triggers marked.
- The first short and long entries are stopped out while the second short entry hits the exit target before the stop is triggered. You have to make it through 60-70% of controlled and small losses to catch and profit from the large gains. Chart courtesy of StockCharts.com

System 2

- Below is the System 2 GOOG chart with all triggers marked.
- The first short entry is stopped out while the long entry pyramids to 4 units and rides a profitable trend until it hits the exit trigger. The trade does not exit until either a stop or exit trigger is met even if that is not the top. Chart courtesy of StockCharts.com

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- Now that we have gone through these simple examples, we hope you have a better understanding of Trend Following and how it works.
- Profitability and backtesting examples through select historical data (Excel spreadsheets) are available at TrendFollowingWorks.com. Additional education is also available through the links on the books and dvds, Systems and Firms pages at TrendFollowingWorks.com.
- Once you are ready to take the next steps to trade through a Trend Following system, you can find backtesting software, purchase a system with coaching or find a Trend Following firm.
- Do not limit yourself to the Turtles System 1 and System 2. Find a system with triggers and timing that works for your style of trading and availability. Understand trading psychology so you find a system that works with you successfully. Have clear expectations that most Trend Following systems result in small losses about 60-70% of the time while big gains occur about 30-40% of the time. Trend Following is systematic risk management and absolute return.