



Bill Poulos, founder of Profits Run

## Choosing a Trading System That Actually Works

### Background

I believe a good trading system should be considered for inclusion in one's portfolio in order to potentially enjoy superior returns.\* Finding a good trading system, however, can be a very difficult process. So it becomes necessary to have a way of distinguishing good systems from the rest. Fortunately, there is a way to do this by using a demanding set of criteria that I believe must be met in order for you to consider using the system.

The purpose of this report is to define the criteria that I believe will enable you to identify the good systems out there from all the rest.

\*Futures trading is not appropriate for everyone. There is a substantial risk of loss associated with trading futures. Losses can and will occur. No system or methodology has ever been developed that can guarantee profits or ensure freedom from losses. No representation or implication is being made that using the Instant Profits methodology or system will generate profits or ensure freedom from losses.

### Criteria

Listed below are the key elements of the criteria set you should use in evaluating a trading system. A good trading system will meet the requirements of each key element whereas many systems will only meet some requirements. For example, a trading system may be advertised as having 80% winning trades which sounds pretty good. However, that same system's losing trades may be 5 times higher than the average winning trade, making the system a net loser.

*The trading system must be 100% mechanical without any human input or overrides.*

### ***Mechanical System***

The trading system must be 100% mechanical without any human input or overrides. It must also not be tweaked or adjusted as time goes on to fit current data. Also, the system algorithms or rules must not be curve-fitting or tailored to short term, non-repetitive patterns of past data that eliminate otherwise losing trades. A good way to screen for curve-fitting is to look for consistently good results over a minimum of 5 years of past data that meet all of the other criteria outlined in this report as well.

### ***Liquid Markets***

The trading system should be aimed at liquid markets where sufficient daily volume exists to easily and consistently execute orders as intended by the system with a minimum of slippage. For example, the S&P 500 Index Futures Market is highly liquid, whereas the Orange Juice Futures Market is far less liquid.

### ***Market Direction Independence***

A good trading system will not be dependent on a bull market for its success. It should have the potential to generate successful trading performance in all market conditions; bull, bear, and sideways trading range.

### ***Hypothetical Performance Results***

The primary way of evaluating a trading system is based on its historical back tested performance (“hypothetical performance”). But the performance record must include real world trading commission and slippage assumptions. Commission and slippage can cause an otherwise winning performance to actually be a net loser. Beware of any futures trading system performance data where commission and slippage assumptions are not included or are understated.

*Before selecting a trading system, you must be able to quantify the drawdown risk and find it suitable, both financially and emotionally.*

### ***Maximum Drawdown***

An inherent characteristic of investing in general and in trading systems in particular is the maximum drawdown in account value from the most recent peak. This is a very important factor in assessing the risk associated with any system. There are two aspects to consider; the dollar amount of the drawdown as a percentage of the total account value (should not exceed ½ of the average annual return) and the duration of the drawdown until a new peak level in equity is realized (should not exceed 6 months). Some trading systems hype great profits over the past several years, but don't disclose drawdowns that sometimes exceed the initial capital invested and last for a year or more. Before selecting a trading system, you must be able to quantify the drawdown risk and find it suitable, both financially and emotionally.

### ***Beginning Account Size***

The maximum past drawdown (over a minimum five year period) plus the margin required for one contract is the absolute minimum account size required to trade a system. And to be conservative, it is prudent to add a buffer since the maximum drawdown for any trading system is always in the future.

### ***Annual Returns***

Annual returns are measured as net profit after commissions and slippage, divided by the beginning account size which gives you annual percent return on beginning account size.

Two things are important here. First, the average annual net profit should be a minimum of twice the maximum drawdown over a period of at least 5 years. Second, ideally there should be no losing years.\*

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*Remember, a trading system must meet all of the criteria elements outlined here to qualify as a system that you would consider trading for your own account.*

## ***Trade Profile***

There are two aspects important here. First, the percent of profitable trades should be in the 40-60% range and the ratio of average win to average loss should be in the 1.3 - 2.0 range. Second, the average trade net profit (total net profits divided by the total number of all trades) should be at a minimum 3 times greater than real world per trade slippage and commission assumptions.\* Beware of systems claiming to deliver greater than 60% winners. Such systems usually exhibit a very poor average win to average loss ratio where a few losing trades can easily wipe out profits from several winning trades.

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## **You Now Have the Tools**

By following the guidelines in this report, I believe you are now in a position to distinguish the difference between good systems that have the potential to deliver superior returns and the rest.\* Remember, a trading system must meet all of the criteria elements outlined here to qualify as a system that you would consider trading for your own account.

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## **The Next Move Is Yours**

Trading systems are not for everyone. In particular, futures trading involves significant risk and should only be considered by those who have determined that futures trading is appropriate for them with regard to their financial situation. However, the appropriate use of a good automated trading system could mean

the difference between mediocre and superior returns.\* I believe you now have the tools necessary to properly evaluate a trading system. I hope this report has been informative and adds to your success in the future.

Good Trading,

A handwritten signature in black ink that reads "Bill Poulos". The signature is written in a cursive, flowing style with a long horizontal stroke at the end.

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