

Tactical Analysis

A Technical Analysis Legacy

In 1978 Stan Ehrlich a founding member of **DCG Financial** invented the **Ehrlich Cycle Finder™**, a universal technical analysis tool, and now the oldest physical technical analysis device in the investment industry. It is used on printed table top charts as a means of discovering cyclical price waves. The peaks, troughs and middle points of price waves are mapped onto future dates and times as a means of identifying points in the future which might reflect the price changing effects of cycles observed in the recent past.

Cyclical Analysis and Classical Technical Analysis

When applying cyclical methods of trading we do not enhance our ability to identify specific buying and selling prices. We are enhancing our ability to buy at times when the price will be relatively low and sell at times when the price will be relatively high. A clear limitation of this time delimited style of trading is that the, expected degree of price change or target prices are not part of cycle finder analysis. The degree of price change or target buying and selling prices must come from other means of analysis or practical experience. Target prices are usually discovered through the use of standard deviation lines (Bollinger Bands 1982), pure geometry (Elliot Wave Principle 1938), or Candle Stick Charts (Dating back to the analysis of the rice trade of 1600 Japan).

An Overview of Tactical Analysis

Tactical analysis has very little in common with Classical Technical Analysis. The only way in which Tactical Analysis and Technical Analysis are similar is that they both use live recent price changes as a primary source of information. Tactical Analysis can be used to investigate the relationship between *any* live contemporaneous data source and a specific price. We have successfully integrated regional temperature changes, interest rate changes and energy consumption into our specialized Institutional Tactical Analysis products.

The Appropriate Application of Tactical Analysis

Tactical analysis should not be used for the purpose of making portfolio allocation decisions. Tactical analysis can be used by a fund manager to out perform other fund managers and performance benchmarks. There are several published academic studies which prove that fund managers who make tactical decisions are consistently outperforming those fund managers who do not make tactical decisions.

A Tactical Decision

A Tactical Decision is a decision to either withhold order entry for a single trading day with the intention to reduce the exposure to an expected trading day risk, or a decision to place an order a day earlier to increase the exposure to an expected gain. A Tactical Decision might also involve the decision to wait for a risk scenario to pass before buying or waiting for a profit scenario to come to pass before selling.

DCG Financial Tactical Trading Software

DCG Financial provides Tactical Trading Software and Tactical Trading Consulting for portfolio managers who would like to see some improvement in performance. We enhance performance by providing and analyzing meaningful time of day statistics which reflect a highly probable forecast of capital flow over the next trading day by the analysis of 280 prices over the most recent two business weeks.

Two Case Studies

We will now provide two examples of floor trader behavior and how some strategies used on the trading floor will persist and how other strategies used on the trading floor will fail in the purely electronic trading environment. The first example involves a professional trader, a crowd of floor traders, and two specialists. The second example involves a tactical trader, three floor traders and four specialists.

The Trend Trader

The Trend Trader is an ex-professional athlete who moves faster on the floor than other traders. He is very observant. He trades gold and bonds. There is some news that bonds may fail due to announced military actions. After seeing confirmation when a small crowd runs to sell off their bonds, the trend trader rushes through the crowd across the floor to the bond specialist and turns his back to the specialist so that he can sell off his bonds to slower members of that crowd. The trend trader steps away from the bond specialist and wipes his brow in relief. He has liquidated his position before the crowd and now he watches the bond prices fall as the crowd bids them down. The trend trader then observes a crowd rushing to the gold specialist. He runs through the crowd to the gold specialist. After he finds a place to stand, he turns his back to the specialist to face the crowd and waits. Some people of this lagging crowd who took losses in bonds are now trying to preserve their capital by buying gold with their remaining cash. The trend trader buys gold from the specialists and waits for the price to rise. He then liquidates his position in gold in accordance with the number of people he sees in the crowd rushing the gold table. At the end of the day the trend trader is liquid and in the money.

This trend trader example illustrates the time value of information and the value of observing a trend as a means of confirming demand and a future relatively higher price. The trend trader has two advantages, he has the ability to get a price from the specialist before the other traders because he is physically superior and he has the ability to assess the crowd behavior because he is observant.

In the present day electronic trading environment there is no physical body present so there is no room for an athletic advantage. There is no floor so there is no crowd to observe. The trend trader will fail with out the information provided by the trading floor.

The next example will also take place on a trading floor but unlike the previous example the strategy employed will persist even in an electronic environment.

The Tactical Trader

The Tactical Trader watches the floor for four weeks. He has chosen to buy and sell British Pounds knowing that its value is not tied to the failure and success of a specific security. He takes note on the behavior of specific floor traders. He observes a floor trader in a blue jacket that sells Crude Oil on Mondays and buys British Pounds on Tuesdays. The blue jacket Crude Oil trader trades in such large volumes that he pushes the price of Oil down on Mondays and causes the British Pound to rise on Tuesdays. The Tactical Trader considers buying immediately before the blue jacket trader is expected to make his large market changing orders on Tuesday so that he might sell them for a profit only moments later. The Tactical Trader does not act on this consideration because he is aware of the fact that this blue jacket trader is only one source of price change. The Tactical Trader takes note of a red jacket trader who sells Gold on Thursdays and buys Pounds on Tuesdays. This red jacketed trader has a similar price changing effect when he makes his large orders. The Tactical Trader takes note of a yellow jacketed trader who sells US Bonds on Fridays and buys Pounds on Tuesdays. This yellow jacketed trader has a similar price changing effect on both US Bonds and Pounds.

The Tactical Trader does not assume that any one of these behaviors will persist. The Tactical Trader investigates plausible logical explanations for these specific buying and selling decisions by these specific market participants. Through due diligence the Tactical Trader discovers that there are British Oil businesses which are selling oil contracts denominated in US Dollars to make cash for the construction of new facilities scheduled a year out in Britain. The Tactical Trader discovers that there is a British Gold Mining Corporation that sells gold in US Dollars to finance mines in the British territories. The Tactical Trader discovers that there is a British Bank who stated their intention to move out of US Bonds and into more British bonds over the next month.

Today is Tuesday and the Tactical Trader has observed red selling Gold last Thursday, yellow selling US Bonds last Friday, and blue selling Oil Yesterday (Monday). The Tactical Trader knows only one fact for certain. He is absolutely certain that there is liquid cash in the hands of those market participants. Those market participants are identified by the probability, which in this case has been %100 probable according to past behavior, that they will buy British Pounds after selling their respective Lots. Normally they would be free to use that liquid cash to purchase any instrument they choose. If there is a reason to believe that these traders are acting on behalf of the institutions previously discovered above, then they are not free to choose. If they are acting on behalf of these Pound demanding institutions than we can be certain that they will buy pounds at some point in time before the Pounds will be needed to complete the stated projects.

Evidentiary Proof

The Tactical Trader now has circumstantial evidence of motive, circumstantial evidence of means, and corroborative evidence stating that each of these traders red, yellow and blue jacketed will buy British Pounds on this Tuesday. The Tactical Trader places a single order for British Pounds and waits for a single jump in price representative of the price change resulting from a single jacketed trader's typical action. After the price jumps he sells for a profit. The Tactical Trader does not wait for the second or third jump in price.

Statistical Proof

If all of the Tactical Trader's motives, circumstantial evidence and corroborative evidence have a factual relationship with the buying action of the jacketed traders only 1/2 of the time, the Tactical Trader will succeed in gleaning one jump's worth in profit 7/8 of the time. This is because he only needs one of these price jumping events to occur. The chance of not a single jump happening is $(1/2 * 1/2 * 1/2)$ 1/8, this means that the chance of at least a single jump happening is the inverse of that fraction which is 7/8.

Performance Track Record

We do not recommend or provide fully automatic trading systems. We do test our trading methods by applying our Tactical Trading Software to historical data as a means of testing the success or failure of our method. If you would like to receive a performance track record you may do so after signing a non-disclosure agreement.

Please contact your DCG Financial Account Manager to make a non-disclosure agreement and a request for the delivery of the results of a historical performance test using our fully automated trading system.