

Navigating Through Volatile Markets

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If interest rates fall the effect on bonds should be;

- 1) Price rises and yield rises
- 2) Price rises and yield falls
- 3) Price falls and yield falls
- 4) Price falls and yield rises

What is the following chart pattern?

- 1) Double- top
- 2) Rounded-top
- 3) Head and shoulders
- 4) Pennant



What does CDS stand for?

- A) Convertible Debt Swap
- B) Collateralised Debt Swap
- C) Credit Default Swap
- D) Collateralised Default Swap

It's a tough game

- Fact: Most traders and investors lose money
- However, survivorship bias may skew your view of the business
- Sorry to be the bearer of bad news but I try to portray a more realistic picture of this business

Just call me Jonah!

- I started my trading career, in the Japanese Equity Warrant market in November 1989
- I enjoyed a full month of the bull market before it turned ugly
- I was given my first trading book in May 1990- the crash had just started in earnest
- On reflection it was a great time to learn to trade
- Learning in boom times can lead to poor techniques being adopted

Bye, bye bull. Or is it au reservoir

- Either way you need to reassess whether past profits were the result of sound skills or bull market conditions
- Time to understand good trading and investing skills which will help you get through these tough times and help you make it through to when good times come back

Up I win, down I lose

- If that sums up your performance you need to reconsider your skills, knowledge and techniques

Discipline

- Cut losses quickly
- Sell what you have to, not what you can

Knowledge

- Of products, markets, companies etc
- Educate yourself, make your own decisions
- Understand what is information and what is noise

Risk – it's not a four letter word (ok it is but...)

- Proper risk assessment of every investment
- What could go wrong?

How do you view your position?

- You bought XYZ stock at \$2.30
- It rose to \$3.10
- It is now trading at \$2.70
- At the moment:
 - A) Are making a profit of 40c
 - B) Have lost 50% of your profit

Mark to Market

- By marking positions to market you become more aware of when a position is turning
- It should make you more likely to cut a position earlier
- Not marking to market was one of the biggest flaws in the accounting of Japanese Banks in the 1980s and 90s

Be Flexible

- Don't be afraid to change your mind when information from the markets change
- This is a strength not weakness
- Clinging to an (old) opinion is called conservativeness and is a well documented bias from behavioural finance
- Keynes, “When the facts change so do I. What do you do Sir?”

Be selective

- There are far fewer opportunities that most investors think
- What many perceive to be opportunities are actually risk
- Understanding the difference between the two is a major factor that separates good traders and investors from the rest

Are you playing the right game?

- Long term investors – how accurate can your risk assessment be for a period of say 6 months from now
- Can you provide an estimate for say Rio Tinto for 6 months from now?
- If I'd have asked that 6 or so months ago how many would have predicted \$50
- Your time frame must suit the market conditions and you must adapt the right strategy for current market
- Otherwise you are relying on hope and risk

It's time...

- ...for taking responsibility
- ...for being proactive
- ...for making decisions
- Not for sitting back and relying on hope

Assumptions are dangerous

- Need to reassess myths and assumptions and make decisions only based on real information
- Assumptions are deadly – just ask Investment Bank risk managers!

Reality or Myth?

- Stocks always go up in the long run

...myth

- Indices usually go up but not necessarily all of its constituents as they are changed
- If you had bought a range of shares of the Dow Jones Industrials say 100 years ago and kept them, most (if not all) would no longer be in existence
- Ask the Japanese about stocks for the long run. It's the 20th anniversary of the peak of the Nikkei

We need the 'Mythbusters'

- The retail side of the business is awash with myths and assumptions
- They are commonly spruiked by those on the sell side
- Or selling charting, technical based courses etc

Stories vs Information

- Broker/analyst presentation in Aug/Sep last year
- Talked about the 'China story'
- This made him very bullish on resource stocks
- But by that time the markets were telling a different story. Resource shares were falling, as were shipping rates (substantially) and commodity prices

The sell side are great at stories

- The 'China' story was a great story to peddle to investors but the story was not supported by facts at that time
- The markets were clearly indicating something different
- Essentially he was saying markets were wrong – this is dangerous for investors
- I believe there was far better information pointing at resource stock weakness. The broker/analyst had no supporting evidence other than an opinion

Now we can see why...

- We need to understand markets. This actually significantly simplifies matters
- Only take cues from markets
- Make our own decisions
- Be prepared to change opinion. The resource story was backed up by the markets for a long period of time but this all changed by about the middle of last year. Our broker/analyst clung to his original opinion

We are all traders now

- Current market conditions mean that even long term investors need to think about the short term

Keynes again (his views will be popular for a while)

- “In the long run we are all dead”
- My take is that to make it to the long run we need to get through the short term. That is why we must manage risk, cut losses etc so that we are around when the markets turn.
- Too many investors will not have sufficient (or any) capital to profit in the long run
- Being a successful trader or investor is not just about making money – you need to keep it!

State of independence

- Be comfortable being different
- Good traders and investors make their own analysis and decisions
- No comfort in failing with everybody else

Summary

- Easy money has gone for now
- Need good skills
- Discipline
- Knowledge
- Risk analysis
- Flexibility

Summary Continued

- Ignore myths, assumptions, generalisations
- Concentrate on real information
- Make your own decisions
- Stay in the game or there will be no long run

More information

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- Book 'Technical Analysis and the Active Trader' published by McGraw Hill
- Trader and investor education courses with 1-2-1 tuition. Advanced options course.