

numbers. The concept is key. Don't lose track of that. If this strategy only worked with these exact parameters, it would be useless. I'll offer these settings as a starting point, but I encourage you to experiment with different values.

The Exact Trading Rules

Yes, I used the heading above to help those who skipped ahead, searching for just the trading rules. This is where I'll list the rules.

- Trade only on Wednesdays.

What we're dealing with here is a long term method of beating the stock market. Part of such a strategy is to avoid acting too fast. To reduce both workload and trading frequency, we'll only check for trade signals once per week. It doesn't matter if a stock plunges 20% in a day, unless that's the day we're supposed to trade we don't do a thing. Note that this doesn't mean that we work with weekly data. All calculations are done on daily data. We just don't trade unless it's a Wednesday. Why Wednesday of all days? Because Wednesdays happen to have a 20% probability of being the best possible weekday to trade. Yes, it's absolutely arbitrary. Pick a day. It doesn't matter.

- Rank all stocks based on volatility adjusted momentum.

Rank all stocks in the S&P 500 Index based on momentum. We'll use annualized exponential regression slope, calculated on the past 90 days, and then multiply it with the coefficient of determination (R^2) for the same period. This gives us a volatility adjusted momentum measurement.

Remember that if a stock is trading below its 100 day moving average or has a recent gap in excess of 15%, it's disqualified.

- Calculate position sizes, based on 10 basis points.

Calculate position size, using a simple ATR based formula, targeting a daily move of 10 basis points. The formula to calculate number of shares is $AccountValue * 0.001 / ATR_{20}$.

- Check index filter.

You're only allowed to open new positions if the S&P 500 Index is above its 200 day moving average. If it's below, no new buys are allowed.

- Construct the initial portfolio.

Start from the top of your ranking list. If the first stock is not disqualified by being below its 100 day moving average or having a 15%+ gap, then buy it and move to the next. Buy from the top until you run out of cash.

- Rebalance portfolio every Wednesday.

Once a week we check if any stock needs to be sold. If a stock is no longer in the top 20% of the S&P 500 stocks, based on the ranking, we sell it. If it's trading below its 100 day moving average, we sell it. If it had a gap over 15%, we sell it. If it left the index, we sell it.

If we have available cash, we look for stocks to buy. If any stock is being sold, there is of course cash available. Buying replacement stocks follow the same logic as above. Only buy if the index is in a positive trend. Buy from the top of the ranking list, if it's in the top 20%, has positive trend and doesn't have a large gap. As long as the index is in a positive trend, we just buy new stocks from the top of the list until we run out of cash again.

- Rebalance positions every second Wednesday.

Twice per month we reset position sizes. As explained earlier, a long term strategy needs to incorporate position size rebalancing to avoid ending up with a completely random risk. Go over each position in your portfolio, compare your current position size with the target size. Calculate target size based on the exact same formula as you used to begin with, but of course with the updated portfolio size and ATR.

If the difference is minor, there's no need to rebalance just for the sake of it. This procedure is here to make sure position risk doesn't spin out of control. If there's any significant deviation, reset position size to target size.

Well, that's about it. Wait, let's look at that again.