"Sharing real experiences from decades of profitable trading. Focusing on the important factors that lead to trading success."

Factor Update, February 19, 2017

Market Review

New candidate *Factor Move*™ (trading set-ups) are developing in:

- AUD/USD
- EUR/USD

Candidate *Factor Moves*™ are currently ongoing in:

- FAST
- *EUR/NOK
- FTSE 100
- Copper

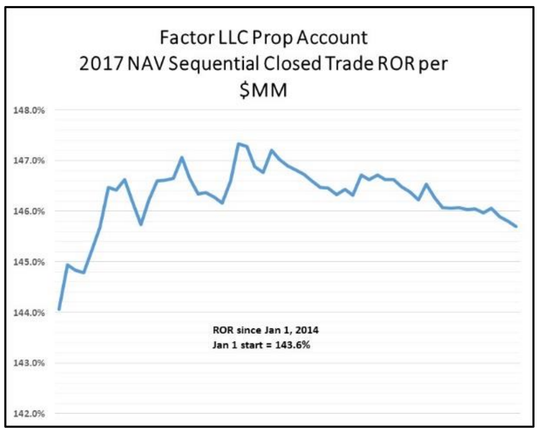
Other markets of interest. This issue also comments on Mpls. Wheat, US Dollar Index, EUR/GBP, EuroSwiss (interest rate) and Crude Oil. *Signifies a position in the Factor $100,000 Tracking Account

Developing signals	Existing positions
• AUD/USD – alert • FAST – entry order and protective stop • EUR/USD – entry order and protective stop	• EUR/NOK – protective stop and target
The Factor Tracking Account is currently leveraged at .5X	The margin-to-equity use for futures and forex positions is 2.6%.

The real-time drawdown of Factor LLC

The Factor Service began in Jan 2014. The Factor Tracking Account began shortly thereafter. While there have been winning trades and losing trades and winning streaks and losing streaks, overall it has been a period of smooth sailing – until 2017. This year has been particularly challenging. Breakouts have been sloppy, retests have been deep and pattern failures have been common.

Over the years I have developed and used about five major trade management protocols or methods. "Active and aggressive" is how I define the particular trade management method I have used the past two years. This can be contrasted with other trade management approaches that have employed wider and slower moving stop protection. Interestingly, wider and slower moving stop protection would have worked better in 2017 YTD.



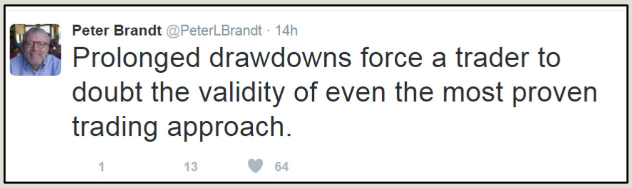
Different approaches to trade management – even with all the same trade set ups – can produce very different performance profiles. Based on trade set ups from classical charting principles, wider and slower moving stop protection can produce the largest gains over an extended period, but with bigger drawdowns and greater asset volatility. My trading has evolved into a more active and aggressive trade management style to reduce asset volatility and avoid drawdowns deeper than 10% (based on a sequential closed trade basis).

Any and all trade selection and management approaches will have periods when they are in synch with market behavior and periods when they are very much out of synch with market behavior. The graph right shows the sequential closed trade NAV for the Factor prop account. The 2017 YTD gain has been 201 BPs (includes trades open as of Dec 31). Yet, trades opened and closed since Jan 1 have lost 112 BPs. More significantly, my win rate on trades opened since Jan 6 has been less than 30%. During such challenging times I will continue to cut back on sizing. I also need to become increasingly selective on trade identification. A small drawdown can easily become a significant drawdown. Every trader needs to find a way to survive challenging times. Numerous paper cuts hurt, but I have avoided being whacked by an axe – so far! AND THAT IS JOB #1 FOR A TRADER.

Further discussion of drawdowns

In my experience, drawdowns originate from five sources.

1. The basic trading approach used if flawed and not compatible with consistent long-term profitability
2. A trader over sizes trades – and becomes the target of probability theory
3. A trading approach is sound, but the trade identification component of the approach becomes out-of-synch with market behavior
4. A trading approach is sound, but the trade management component of the approach becomes out-of-synch with the markets
5. A discretionary trader becomes out-of-synch with his or her trading approach.



I could write an entire dissertation on each of the above five items. Items #3 and #4 are no fun – this is where I am right now. But my biggest danger is item #5. My longest and deepest drawdowns over the years have come during periods when I have lost confidence in my basic methods and decided to “tweak this and tweak that” with my trading plan and its guidelines. I have observed from myself and others that traders learn more in adversity than in victory. The lesson I have learned is to stick with the basics and trust that discipline and patience will be victorious in the end.

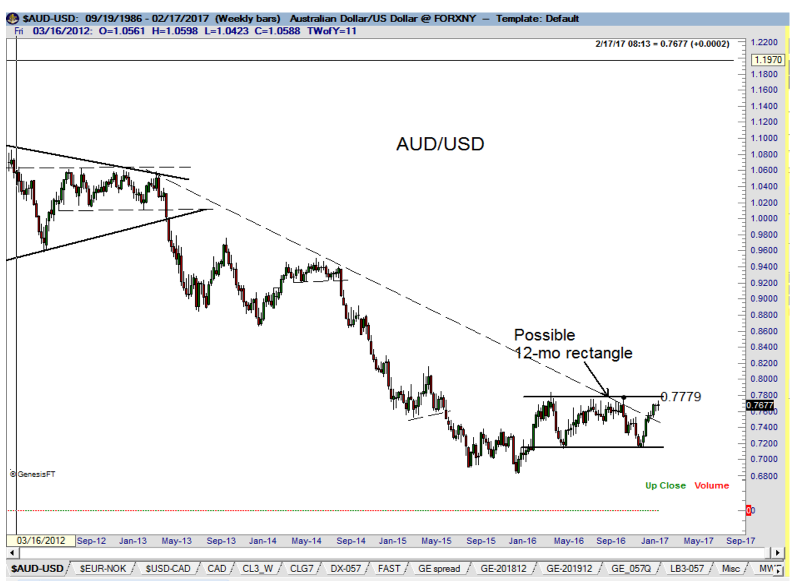
The true breakthroughs in trading occur when a trader learns to keep capital together (relatively) through losing streaks. Capital preservation over the long haul – not brilliance in periodically selecting great trades – is what divides outstanding traders from those traders struggling to gain traction. This is my experience and opinion. There is no way to know how long my trade selection and management approach will remain out of synch with the markets. It might a few more weeks or even a number of months. I have no control over the outcome of trades. The only thing I can control is the orders I place. I need to continue placing orders in accordance with my trading plan. Based on long-established metrics of my trading approach I know a drawdown of 8% is within one standard deviation based on probability theory. I am not there yet (not even close) and hope I do not get there – but I am a believer that probability theory plays an important role in trading and that a single trade is nothing more than a datum point in a series of data points – all subject to random probability sequencing.

Please know that it is important to me to share with Factor members the ingredients for the successful profitable periods of trading. It is equally important to me to share with Factor members the ingredients needed to survive challenging times. Challenging times come to all traders. It is a “no-brainer” to survive the profitable periods. It is the challenging times that can terminate one’s trading aspirations.

Candidate Factor Moves™ Setting Up

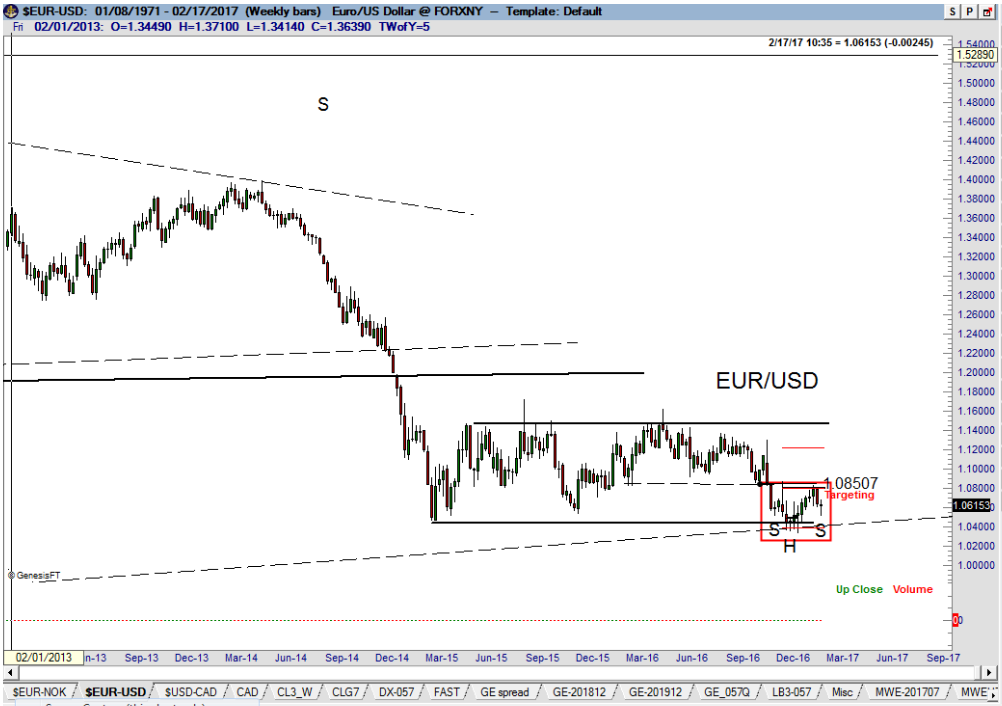
AUD/USD

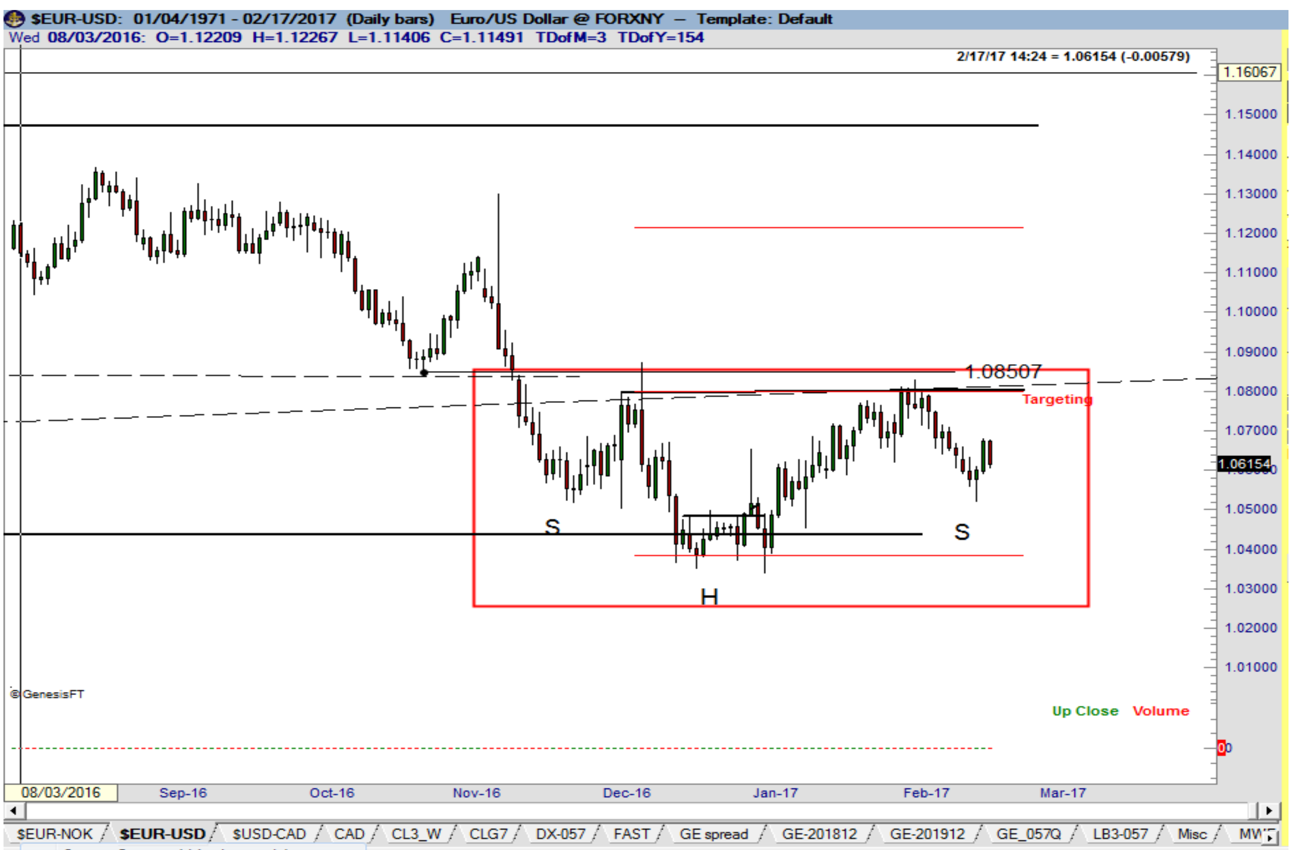
The dominant chart construction in this market is the developing 12-month rectangle. My bias is that this pattern will be resolved to the upside. Factor is flat.



EUR/USD

See Factor Alert dated Feb 16. The dominant chart construction appears to be a possible 13-week H&S bottom developing at the lower boundary of a possible 23-month rectangle. That makes this set up a "double-possible." The question is where a "double-possible" set up is worth a risk position. I deemed that it was – and established a long position on Thursday. Consistent with my trading rule to all losing trades on Friday, Factor is not flat. I will wait for the completion of the H&S before taking any further action. Is there a possibility that this apparent H&S bottom will fail and that the rectangle will at long last be resolved by a downside move? Of course this possibility exists. Anything is possible when charts begin to morph. While as of this day and time I have a trading bias toward the upside, in reality a trader never really knows with certainty which wan a market will go. This is why entrenched biases and refusal to cover losing traders are the two things that can bankrupt a trader.





Candidate Factor Moves™ in Progress

EUR/NOK

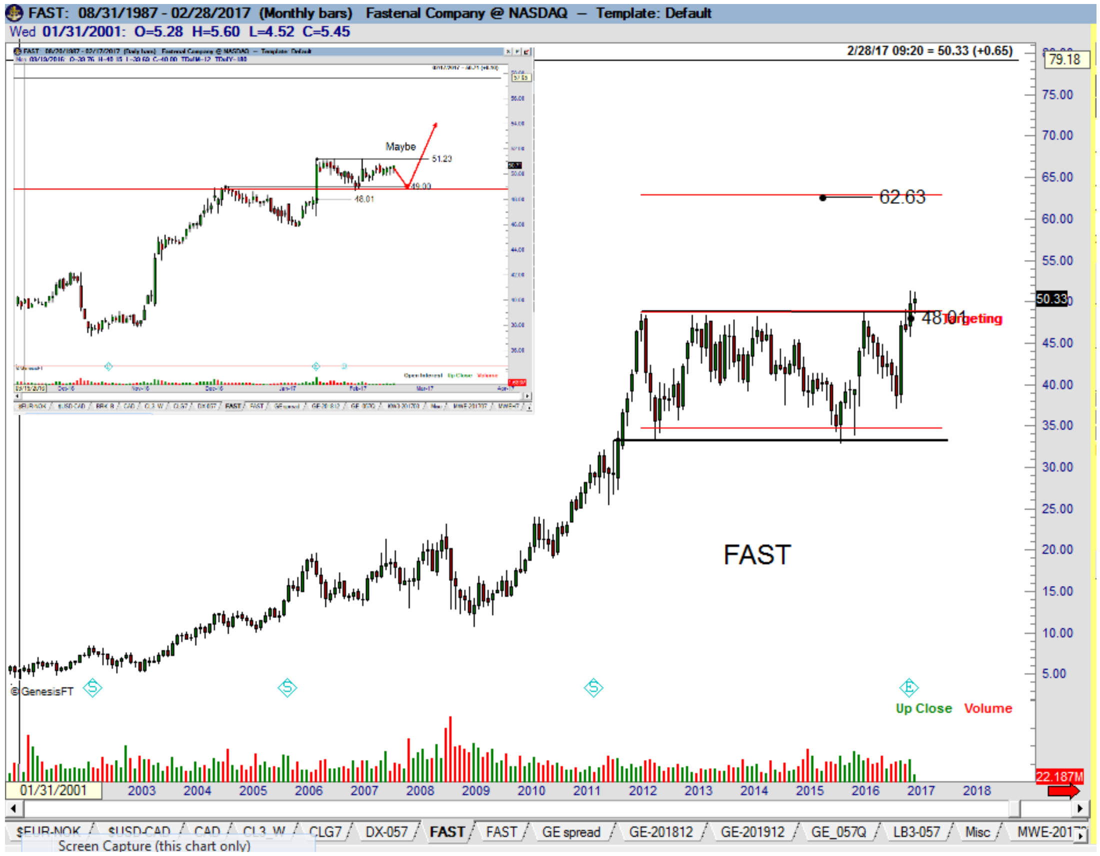
The dominant chart construction is the completed 4-month continuation H&S pattern on the daily graph. Note on the weekly chart (inset) that this H&S pattern was simply a retest of a much larger 13-month H&S top. The Factor Tracking account is short.

FTSE 100

The FTSE has completed a massive 17-year congestion period. The U.K. equity market should trend toward substantially higher levels. Factor is flat. I will continue to monitor the FTSE for buying opportunities.

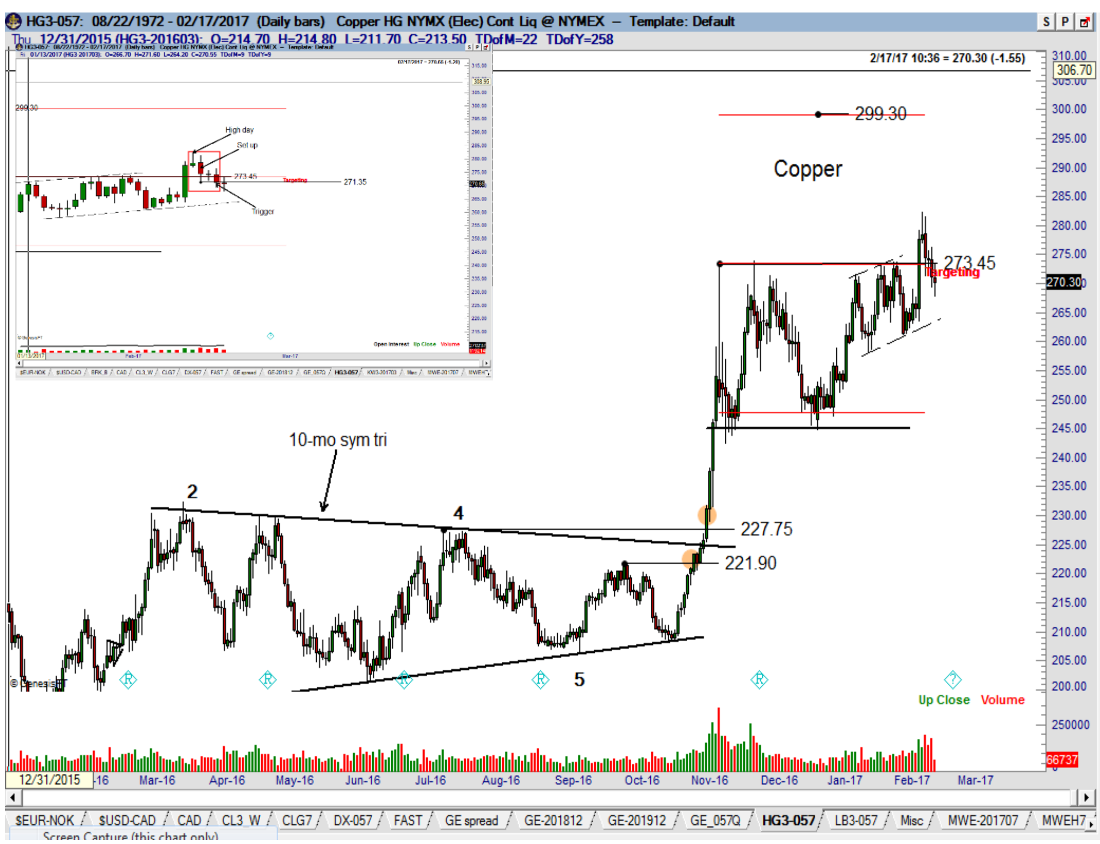
FAST

Factor is flat. I am willing to buy a retest of the $49 level. I am also willing to re-establish some long exposure on a strong move through 51.51.



Copper

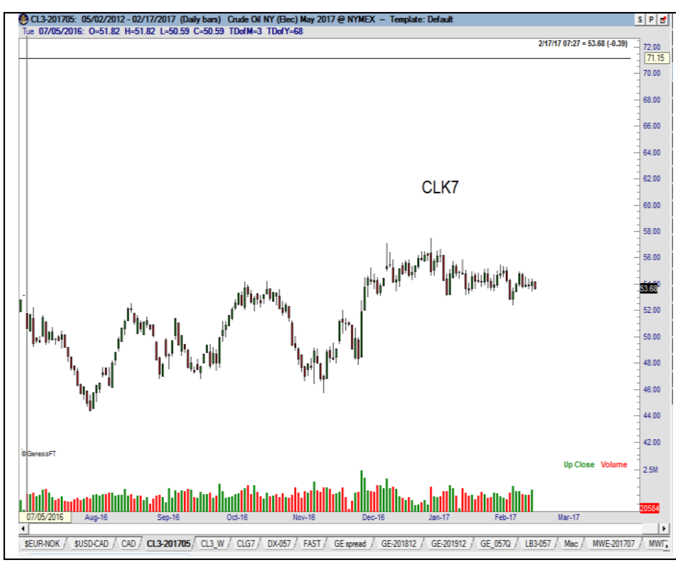
The retracement this past week was sharp, but I am not sure the bull trend has been damaged. I took a shot at the long side of Copper this past week, but a 3-day trailing stop rule was triggered on Thursday (see inset). Factor is flat.

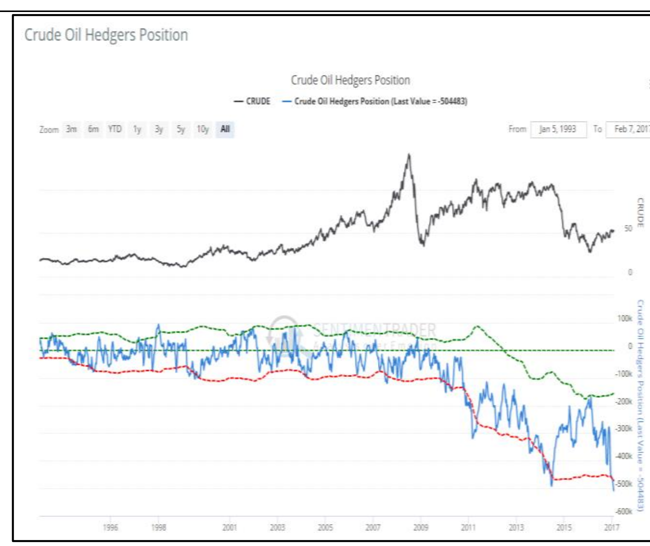


Other Markets

Crude Oil

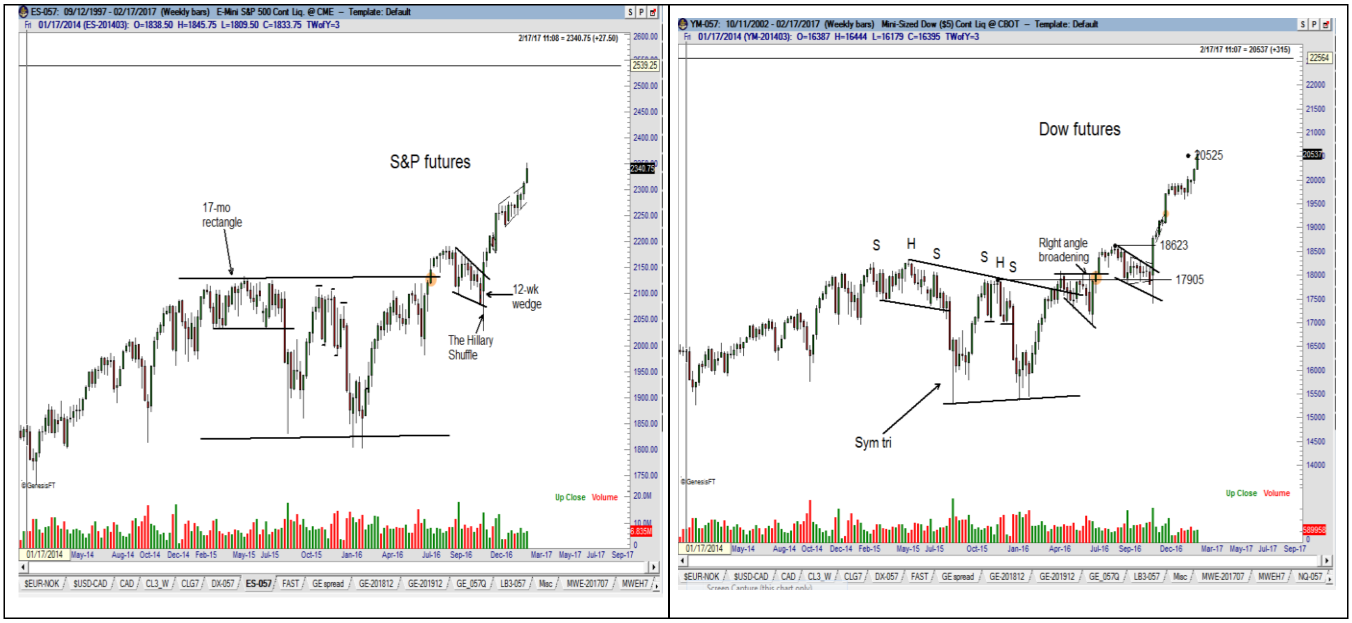
The daily continuation chart of Crude Oil continues to coil. Rumors are flying within the energy industry as to the current stalemate against the backdrop of expanding spec long and commercial short positioning. There was an interesting article in the Financial Times this week reporting on unusual patterns of buying activity. A copy of the article is attached as a pdf herein. Factor is short. The chart structure of the individual contract months is different (and less constructive) than the structure of the daily continuation graphs. I am willing to buy a closing price breakout of the current trading range.





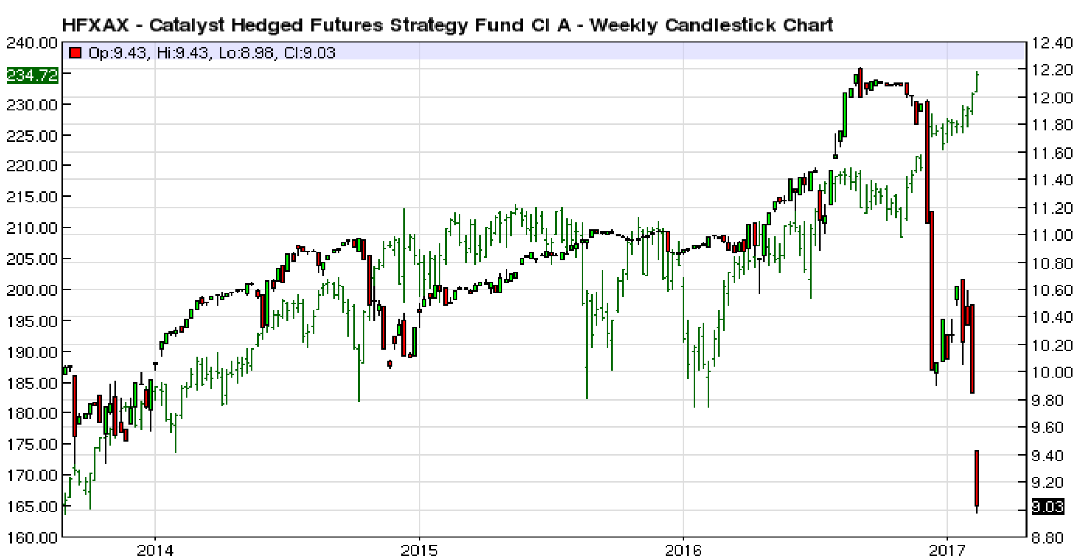
U.S. stock indexes

I have missed this move. I am frankly flabbergasted by the buoyancy of the U.S. stock market and the ability of the stock indexes to shake off selling pressure.



Short gamma – a strategy destined for destruction

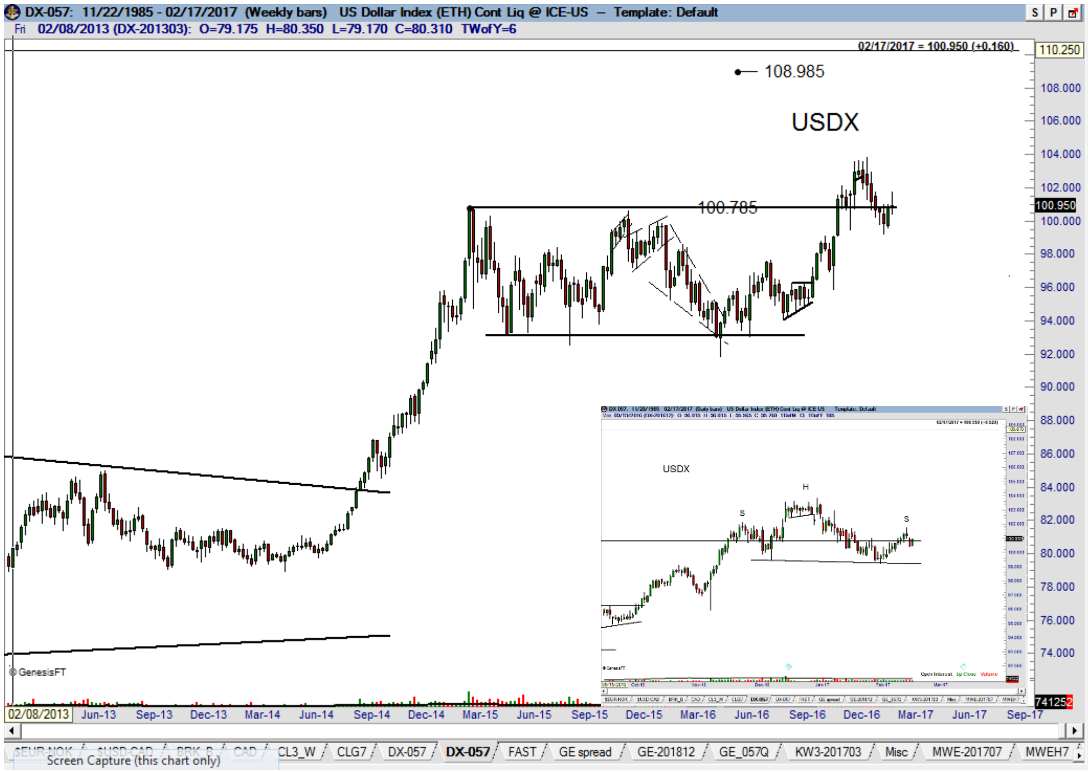
I have discussed short gamma trading in the past – describing it as an approach that makes money every day, every week and every year, until it goes broke. There has been enormous interest in and expansion of short volatility approaches in the U.S. stock market during the past two years. I have even heard some managers describe the shorting of volatility (specifically the selling of U.S. stock index put options) as an annuity. Yet, volatility relative to the price level and momentum of the U.S. stock market indexes is historically very low. As a result, a short gamma trading strategy must engineer increasingly complex strategies to uphold an expected ROR. Eventually the vast majority of short gamma approach will implode. The chart shown herein shows SPY in contrast with the Catalyst Hedge Futures Strategy Fund (HFXAX), a short gamma program. A discussion of the implosion of HFXAX can be found here: http://www.zerohedge.com/news/2017-02-15/multi-billion-trade-meltdown-here-reason-markets-inexplicable-surge



EuroSwiss (the interest rate)

I am seeking the insight of any Factor members familiar with the European debt market. The EuroSwiss yield went negative in Dec 2014 and has remained negative ever since. The weekly graph displays a massive descending triangle, suggesting that a move back toward par is possible. It seems strange to me that distant contracts (such as Dec 2019 trading at a yield of -45 BPs) reflect only a single rate hike by the Swiss National Bank during the next three years. A recent Factor trade being long Eurodollars 15 to 18 months out and short Eurodollars 30 to 36 months out was quite successful. Perhaps Factor members knowledgeable on Swiss rates might let me know if a similar strategy in the EuroSwiss is viable. Factor is flat.

US Dollar Index



I was extremely biased toward the long side of the US Dollar Index for many months. I thought the upside resolution of a massive rectangle on Nov 17 and then again on Dec 8 represented the start of a march to 107, then 120. The large price correction last month threw me completely off the scent. There is a chance that the market can again climb above 102 and consolidate for the bull trend I had expected. It is also possible to identify a possible H&S top on the daily chart. For now I have no interest in trading USDX. Factor is flat.

EUR/GBP

I was surprised to hear some Factor members were filled below .8450 on the close of Feb 12 – It ended up they all had accounts with FXCM. No other forex dealers I am connected with registered trades below .8457. In fact, FXCM filled customer sell orders on Feb 13 at a 11 pips bid/off spread. FXCM has been banned from the U.S. for trading against customer orders – and then lying to regulators about the practice. It seems as if FXCM no longer deals with U.S. clients but is still abusing clients from other countries. Factor members who had this sell order filled by FXCM should send an email insisting for a written response to this question: "*Did FXCM directly or indirectly take the other side of my sale of EUR/GBP under .8451 on Feb 13?*" An honest answer would have to be "YES" because no other dealer was even close to this price. When (if) FXCM responds (negatively or in affirmation), then submit their response to the appropriate regulatory authorities in your country, accusing the company of repeating the actions found here http://www.cftc.gov/PressRoom/PressReleases/pr7528-17

Minneapolis Wheat

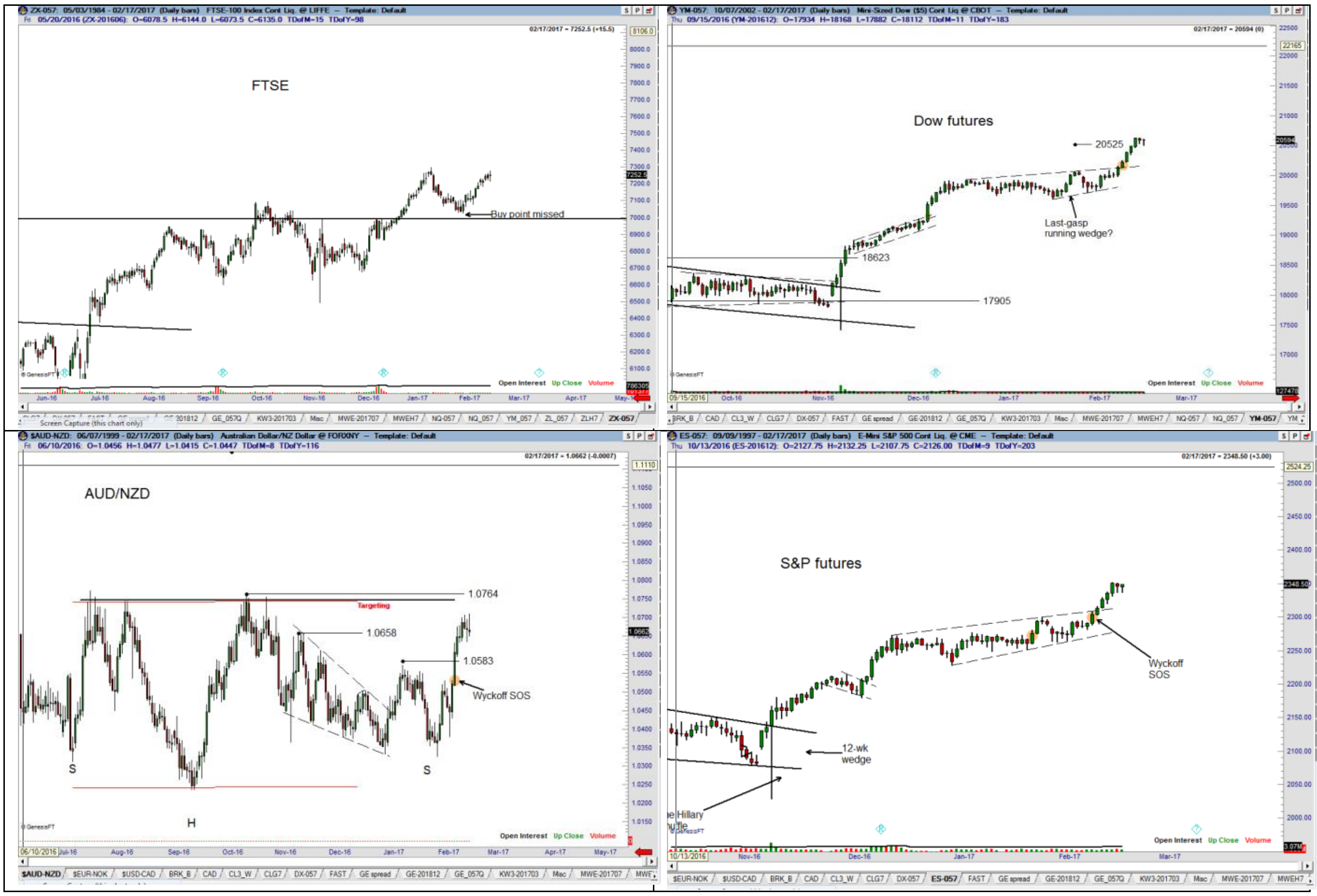
While the daily chart indicates a possible target of 5.90, the sharp decline on Thursday did some injury to the near-term case. The advance from the H&S bottom has not unfolded in the sustained manner I prefer to see, so I am not eager to re-enter this market. Factor is flat.

Factor Special Situation Reports			
Trade management on positions attributable to Factor Special Situation Reports may differ from positions carried by the Factor Tracking Account. The Factor Special Situation Reports are intended for Factor members who want a "*lock-it-in-and-leave-it*" Readers' Digest approach for order entry.			
	Market	Report Date	Trade Status
• SSR.2016.01 • SSR Update • SSR.2016.01B • Factor Update 5 Feb 2017	Mpls. Wheat	• 29 Nov 2016 • 5 Jan 2017 Update • 17 Jan 2017 Update • Factor Update, Feb 5, 2017	The Factor SSR portfolio is flat in Mar Mpls. Wheat having taken profits on a long position (established at 533 on 30 Nov) at 586 on 17 Jan. Single contract profit = $2,650 **There are no working orders in Mpls. Wheat.**
SSR.2017.01	Mar Can Dollar	17 Jan 2017	A long position at .7651 established on 18 Nov was almost immediately stopped out at .7574. Single contract loss = ($770)
SSR.2017.02	EUR/GBP	13 Feb 2017	The contingency to short this cross on a daily NY close below .8454 was not met. **This SSR has been cancelled.**

A practical discussion of "coulda, woulda, shouldas"

Earlier in this Update I discussed a current ongoing drawdown in the Factor's proprietary account as measured by closed trade NAV. Obviously, if measured on a daily marked-to-the-market basis the drawdown would be larger. I do not pay attention to open equity (except for tax liability purposes at the end of each year) because open profits are irrelevant since they are really not mine. Attention to open equity – in my experience and opinion – can cause emotional drawdowns. Emotional capital is more important than trading capital in many respects (a subject for another time). Why should a trader allow something that really does not exist (open equity) be the cause of an emotional drawdown?

There are several trades I have missed by inches or by hesitation that – if caught – would have made the discussion of a drawdown herein a moot point. Shown below are trading actions that I did not engage because I briefly hesitated or because my entry orders were barely missed.



There were also a number of trades in which a slightly different stop price would have kept me in the trades (charts not shown).

BUT HERE ARE THE POINTS:

1. **There will always be missed trades – this is a reality all discretionary traders must face and accept. Missed trades do not count. I purposely created a straw man with the charts shown above.**
2. **It is easy to second guess a stop price. But a trader steps to the betting line, places a order and must live with the outcome.**

Missed trades, a few brain-dead decisions, slightly misplaced stop orders and all – a trader must do those things necessary to protect capital. Results are what they are. It is for this reason that I start cutting back size after two straight losing trades and keep cutting back size. I am now down to a bet size of less than 30 BPs per trade. If necessary I will go lower. If you have an account size that will not allow a futures trade with a bet size of only 30 BPs, my recommendation to you is to paper trade until signals start to work. A trader must do everything possible to preserve capital because eventually a tested trading plan will resynch with market behavior.

Factor Tracking Account as of Feb 17, 2017

Factor LLC											2/17/2017						
Model Tracking Account Trade History and Portfolio																	
Initial capitalization: $100,000																	
				(See disclaimers and notes below)													
		Entry									Pattern		Exit				
Market		Date	L/S	Price	Size	Initial stop	BP risk	Current Stop	Stop Date Δ	Target	Weekly	Daily	Date	Price	Net	Capital to carry trade	Value of trade (entry)
Positions open as of 12/30/16																	
EXH7	EuroStoxx	12/6/16	L	3102.0	1	3029.0	78	3247	12/28	3289	11+mo H&S	11+ mo H&S	2-Jan	3289	$ 1,970	Closed	-
NZD/USD	Spot fx	12/15/16	S	0.7077	70k	0.7126	36	0.7002	12/27	0.6821	Poss 6+ mo H&S	4-wk wedge	5-Jan	0.7003	$ 518	Closed	-
												Total -- Carry in positions			$ 2,488		
2017 forex roll charges and FX losses on foreign margin deposits; day trade P/Ls on repositioned trades															$ (198)		
EUR/USD	EUR/USD	1/3/17	S	1.0445	50k	1.0532	43	1.0502	1/4	0.9621	21-mo sym tri	Jan Effect high	5-Jan	1.0503	$ (290)	Closed	-
EUR/NOK	EUR/NOK	1/3/17	S	9.0058	50k	9.1011	55	8..9316	2/16	8.7352	14-mo H&S top	Poss 14-wk H&S				$ 2,601	$ 52,027
MWEH7	Mpls Wheat	1/5/17	L	5.4700	1	5.3900	80	5.690	1/16	5.86	6+ mo H&S	5-wk asc tri	17-Jan	5.86	$ 1,945	Closed	-
MWEH7	Mpls Wheat	1/5/17	L	5.4700	1	5.3900	80	554.75	1/27	6.34 r	6+ mo H&S	5-wk asc tri	30-Jan	5.5450	$ 370	Closed	-
AUD/NZD	AUD/NZD	1/9/17	L	1.0508	70k	1.0419	45	1.0459	1/11	1.0746	Poss 7-mo H&S	10-wk wedge	24-Jan	1.0459	$ (248)	Closed	-
6GCH7	Canadian $	1/12/17	L	0.7652	1	0.7584	72			0.8023	9-mo channel	3-mo double bottom	18-Jan	0.7583	$ (695)	Closed	-
FAST	Fastenal	1/18/17	L	50.220	200	47.740	50	47.98	1/30	62.5900	57-mo rectangle		2-Feb	49.04	$ (241)	Closed	-
FGBMH7	Bobl	1/23/17	S	133.1900	1	133.4200	23	133.13	1/25	130.41	Poss 12-mo H&S	5-wk H&S	2-Feb	133.13	$ 55	Closed	-
ZCH7	Corn	1/24/17	L	363.00	1	354.50	45	359.75	1/27	384.750	13-wk sym tri	13-wk sym tri	30-Jan	359.75	$ (167)	Closed	-
EUR/NOK	EUR/NOK	1/30/17	S	8.9124	80k	8.9442	31	8.9102	2/9	8.7351	14-mo H&S top	Poss 16-wk H&S	10-Feb	8.9103	$ 20	Closed	-
YIH7	Mini Silver	1/31/17	L	17.43	2	17.07	36	17.32	2/2	18.8800	11-wk H&S	11-wk H&S	3-Feb	17.32	$ (230)	Closed	-
FVAH7	5-Yr Ts	2/9/17	L	118-08	1	108-03	32			119-18	12-wk H&S	12-wk H&S	9-Feb	118-03	$ (318)	Closed	-
JJC -ETF	Copper	2/9/17	L	31.66	800	30.98	55	Mkt	2/14	34.48		HG = 13-wk rect	16-Feb	31.73	$ 51	Closed	-
HGH7	Copper	2/14/17	L	274.10	1	269.3	120	271.9	2/15	299.30	13-wk rectangle	Retest	16-Feb	281.85	$ (568)	Closed	-
AUD/USD	Aussie	2/15/17	L	0.7702	50k	0.7629	36	Mkt	2/17	0.8338	Poss 10-mo rect	2-wk pennant	17-Feb	0.7664	$ (190)	Closed	-
EUR/USD	EUR/USD	2/16/17	L	1.06712	30	1.0498	47	Mkt	2/17	1.0674	Poss 23-mo rect	Poss 13-wk H&S	17-Feb	1.06077	$ (191)	Closed	-
												Trades as of			$ 1,594	$ 2,601	$ 52,027
												Indicates open position value as of				Levered at	0.5
PAST RESULTS ARE NOT NECESSARILY INDICATIVE OF FUTURE PERFORMANCE																	MtE = 2.6%
r = revised	RO = Rollover																

The Factor Service $100,000 Tracking Account represented herein is a proxy representation of the trading executed by Peter Brandt for the Factor LLC's proprietary trading accounts. There are some major differences between the trading activity conducted in the Factor Service $100,000 Tracking Account and trading in the Factor LLC's proprietary accounts. Peter's trade sizing and trade management tactics in the proprietary account is sized and managed per $1MM of proprietary capital. There may be trades Peter believes are not suitable for a $100,000 block of capital, and these trades are not executed in the Factor Service $100,000 Tracking Account. Factor LLC's proprietary account trades multiple contract trades wherein Peter layers into and out of a position at different prices and on different dates. The Factor Services $100,000 Tracking Account most often holds a single futures contract in a trade whereby layering is not possible. Factor LLC's proprietary accounts may also pyramid some trades not pyramided in the Factor Service Tracking Account. Because the Factor Service Tracking Account represents how Peter would trade a $100,000 block of capital in contrast to the actual trading of Factor LLC's proprietary account, the Factor Tracking Account should be considered as hypothetical. Hypothetical trading performance is subject to the following disclaimer required by the Commodity

CFTC RULE 4.41 - HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT BEEN EXECUTED, THE RESULTS MAY HAVE UNDER-OR-OVER COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFIT OR LOSSES SIMILAR TO THOSE SHOWN.

Prop trading record available upon request to jolleen@peterlbrandt.com

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