

MARKET SPECULATORS PRESENTS

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Introduction to Trend Following

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If we were to spend some time speaking with others about what a trend is, we would likely get a range of different answers. Below are some potential answers you could encounter when asking others....

A trend could be spoken of as....

1. A price move in the market over any specific period of time.
2. A series of new highs and higher lows *or* of new lows and lower highs.
3. A favorite trending indicator showing a long or short signal.
4. An upmove or downmove.
5. An Elliott Wave formation.
6. An astrological occurrence.
7. A fundamental news item.
8. My stockbroker's next hot tip on a stock.
9. My coin flipping strategy.
10. My throw-a-dart-on-the-"stock" board strategy.
11. The price that a psychic has pinned the Euro to go to in 1 week.

While some are humorous, some foolish, and others technical, which, if any, is correct? Well, if we decide to enlist our dictionary for assistance, we come to this definition:

The relatively constant movement of a variable throughout a period of time. The period may be short-term or long-term, depending upon whether the trend itself is short-term or long-term. For example, a rising market is taken to mean that prices of most stocks are in an upward trend.

Clearly, number one is the closest choice and a neat fit to the definition provided in the dictionary. Trends may be relatively small or may be relatively large, but all trends have some amount of price movement. In a nutshell, trend following is trading on the idea that a some price movement in one direction could be the start of a bigger price move in the same direction.

To illustrate the basic idea, please look at the following diagram:

Start Price (Day 1) **End Price (Day 7)**
(A)-----**Time Period**----->(B)

where (A) is the current price, the price now, and (B) is the price after some time elapsed.

Referring to the diagram above, note that although the start price and the end price are 2 different prices, they are not necessarily the lowest prices nor the highest prices that the instrument traded at during the specified time period. Below are some sample prices of a mock stock ABCD over a 1 week period. Each price represents the closing price for one day of the week:

Day 1: \$20.00
Day 2: \$21.00
Day 3: \$21.00
Day 4: \$19.00
Day 5: \$18.00
Day 6: \$22.00
Day 7: \$28.00

First notice that for a 7-day trend to have occurred, the closing price on Day 1 must be different from the closing price on Day 7.

Trend = Price at End of Time period - Price at Start of Time Period
must be >0

So, $\$28.00 - \$20.00 = \$8.00$ and $\$8.00$ is $> \$0$, so we have an \$8 uptrend from the close of Day 1 to the close of Day 7.

More importantly, notice that the price on Days 4 and 5 went below the closing price on Day 1. Therefore, although a trend occurred, but the closing price on Day 1 was not the lowest price during the week. Under the concept of trend following, you believe that a price move in one direction could be the beginning of a larger price move. If you intend to buy on the close of Day 1 at \$20 and it falls to \$19, you have a temporary loss of \$1. Even though, in this case, you know that the price on Day 7 closes at \$28, what if you did not know the closing price of Day 7? Would you presume it to be \$28? If you have not read the publication on making decisions, please read it.

In this example, if you did not know how Day 7 shall close, and the price drops to \$19.00, you should assume an upward price pattern is wrong (whether temporarily or not is not important). When you choose to buy, you expect prices to rise from either the price you bought it at or from a price just slightly below where you bought it at. If you exited the trade at \$19 knowing obviously you are either temporarily wrong or permanently wrong, you can always repurchase the stock if it crosses above the current highest closing price of the series to ensure the pattern of prices is resuming upward motion.

Therefore, you should repurchase stock ABCD at a price greater than \$21 which would be \$21.01 . As long as the stock ABCD traded at \$21.01, and you closed the trade at the close on Day 7, you might realize a profit of \$6.99 per share. Please note that the actual trend is greater than what you could have collected actually buying and selling the stock. Moreover, you also sold out of our position once, incurring a \$1 per share loss. Please notice that there was actually a loss incurred. Losses are generally incurred when a trend has price action against our position causing our upward or downward pattern to be broken.

Here is the price sequence of the week. We anticipate an upward pattern and buy at \$20:

\$20 , \$21 , **\$21** , \$19 , \$18 , \$22 , \$28

Note that the underlined prices invalidate the upward pattern because each consecutive price must be greater than the previous price. Therefore, the pattern is wrong, and we must conclude that the pattern is unknown. But if the price goes above the last high price in the sequence, we can claim that the pattern could have reverted to an upward pattern and place another trade at \$21.01 with the hope that the sequence over the remaining period of time turns out to be upward.

In review, trend following is the hope that a price move in a direction could be the beginning of a large price move in the same direction. Trend following is an important concept for the professional investor to understand. Market Speculators utilizes only trend following strategies when trading clients' monies. We at Market Speculators intend to provide clients with knowledge they need to understand our core beliefs to build a strong business relationship. Market Speculators takes the timely burden of trading a market for clients that is generally active 120 hours of the week. Market Speculators intends to provide a profitable vehicle for investing to those individuals seeking capital preservation and appreciation without having to devote countless hours to a market in which the vast majority of traders reportedly lose in.

Thank you again for reading this publication. Please read our other publications to learn more. We at Market Speculators are dedicated to the preservation and appreciation of your invested capital with us. Please consider having us manage an account for you!

Peter Apfelbacher
Co-Founder of Market Speculators

