

Portfolio Alpha from Relative Strength

An Introduction to Relative Rotation Graphs

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About Me

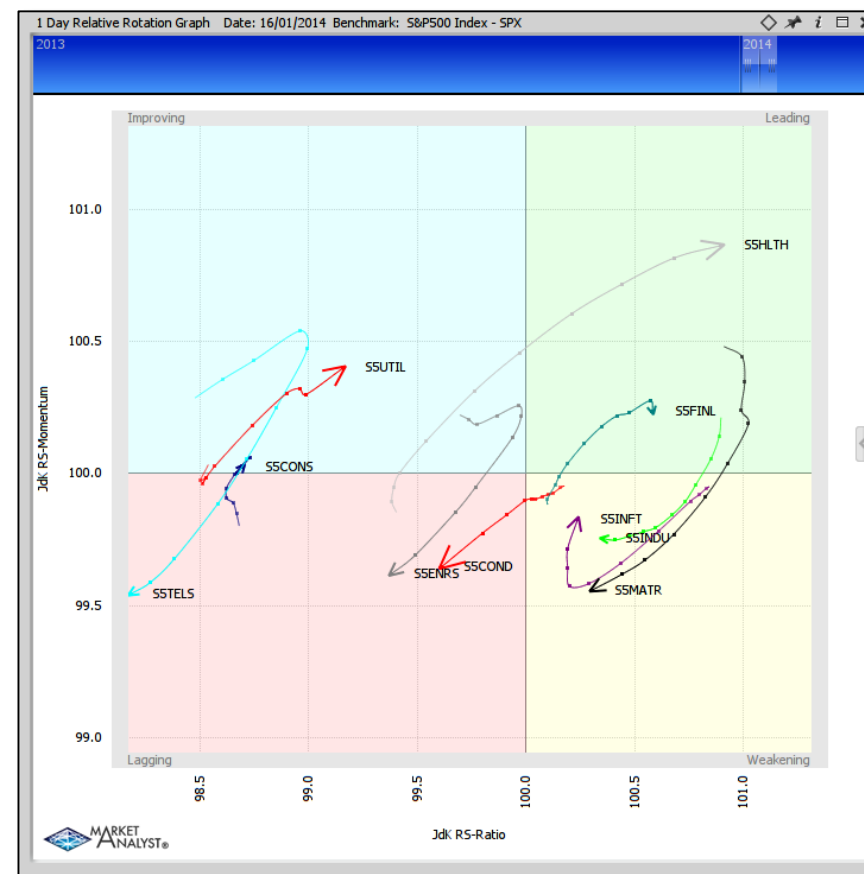
- Honours Degree in Computer Systems Engineering.
- Started Market Analyst in Australia one year after leaving University.
- Designing and building software models for 18 years.
- Based here in Charlotte as we continue to expand our company.
- Obtained the Chartered Market Technician Designation in 2013.
- Passionate about breakthroughs in Financial Analysis.

About Technical Analysis (TA)

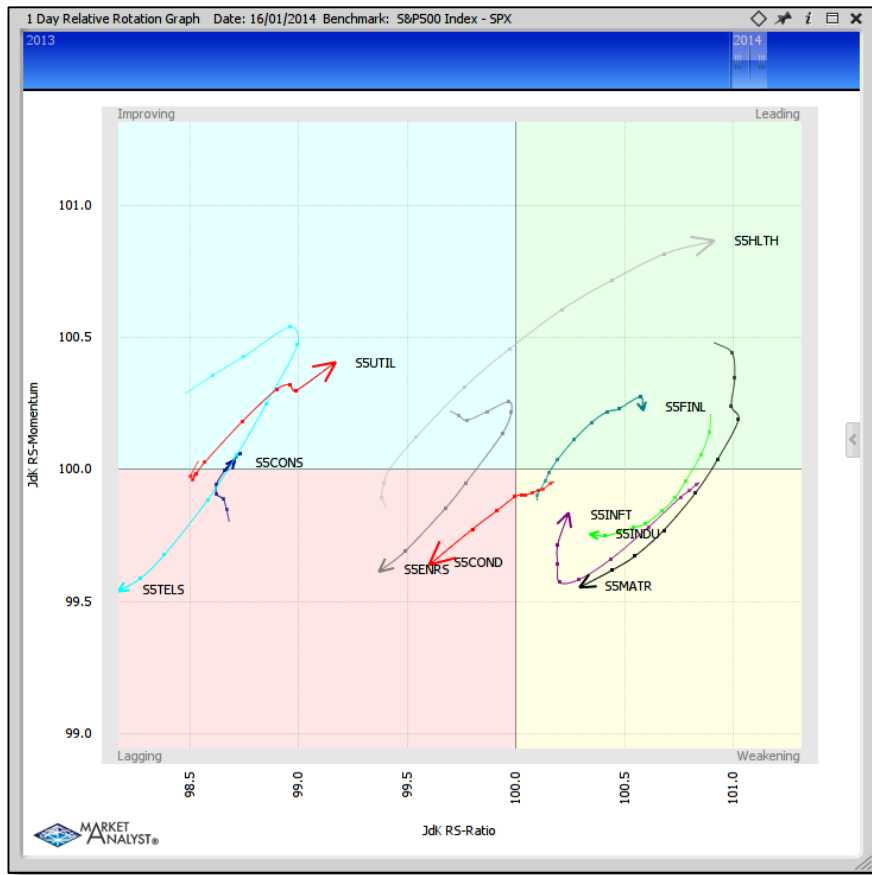
- Technical Analysts are less concerned with Value and more concerned with Price.
- We create mathematical models on price and apply statistics to the signals to determine if there is validity in them.
- There are many sub-disciplines in Technical Analysis, some of which are very subjective.
- Relative Strength is a method that takes a fundamental value concept and fuses it with technicals to produce an amazing result.

About Relative Rotation Graphs

- Developed by Julius de Kempnaer
 - Sell Side Analyst in The Netherlands
 - Not enough to have a position on a security
 - Needed to have a way to get a Market Overview
 - Needed to view that overview relative to a Benchmark
- Available in Bloomberg as a static chart since 2011
- We have made them a dynamic chart.

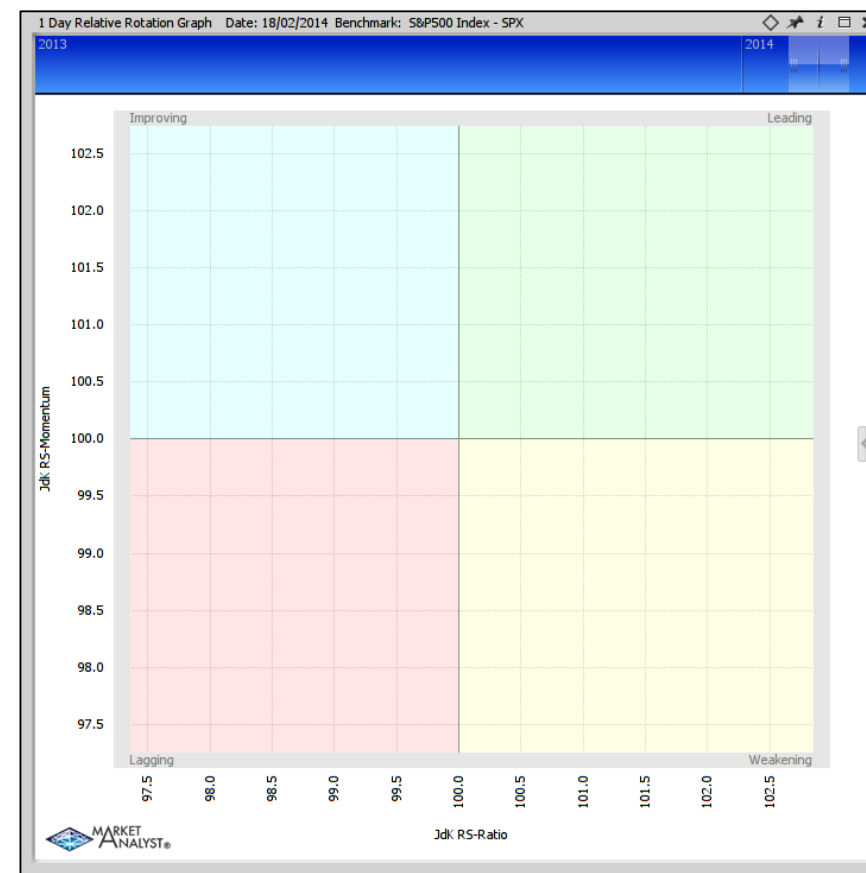


- Based on Relative Strength.
- Take the change in the security and compare that to the change in the Benchmark (Index). The direction of the line is the "Relative Trend".
- Math is applied to determine not only the ratio between the two, but also a measure of the momentum of the rate of change.
- Each of these figures are normalised and plotted on an XY chart.



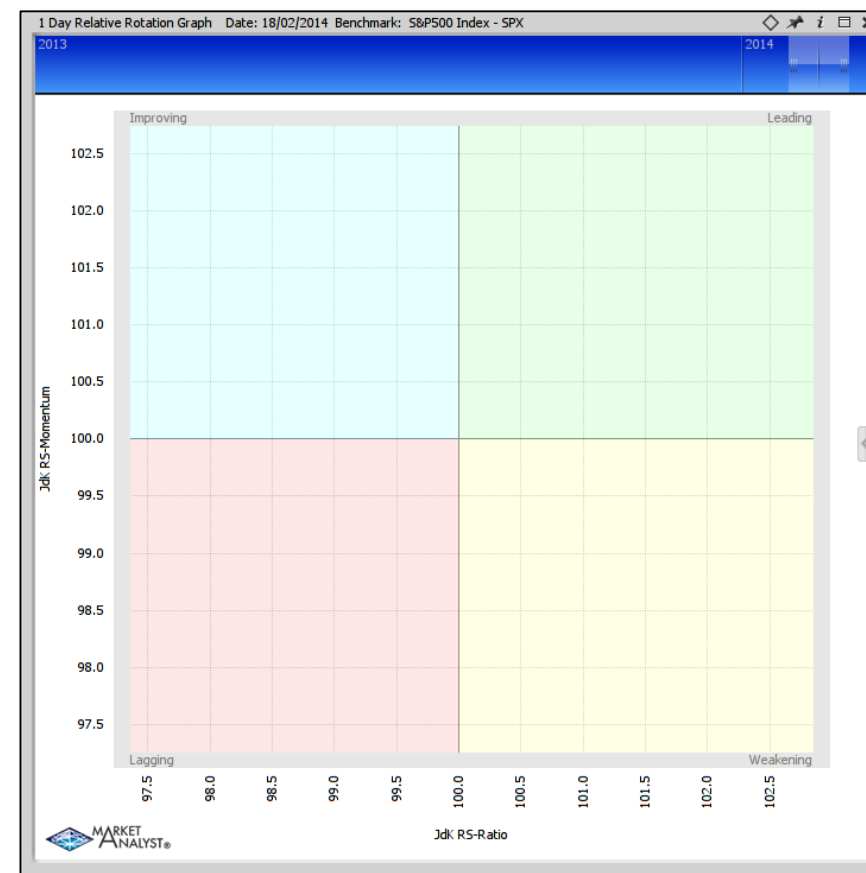
About Relative Rotation Graphs

- Leading (Green).
 - Security here is out-performing the Index.
 - It is one of the strongest in the sector.
 - Relative Trend is positive and it is moving ahead of the Index.



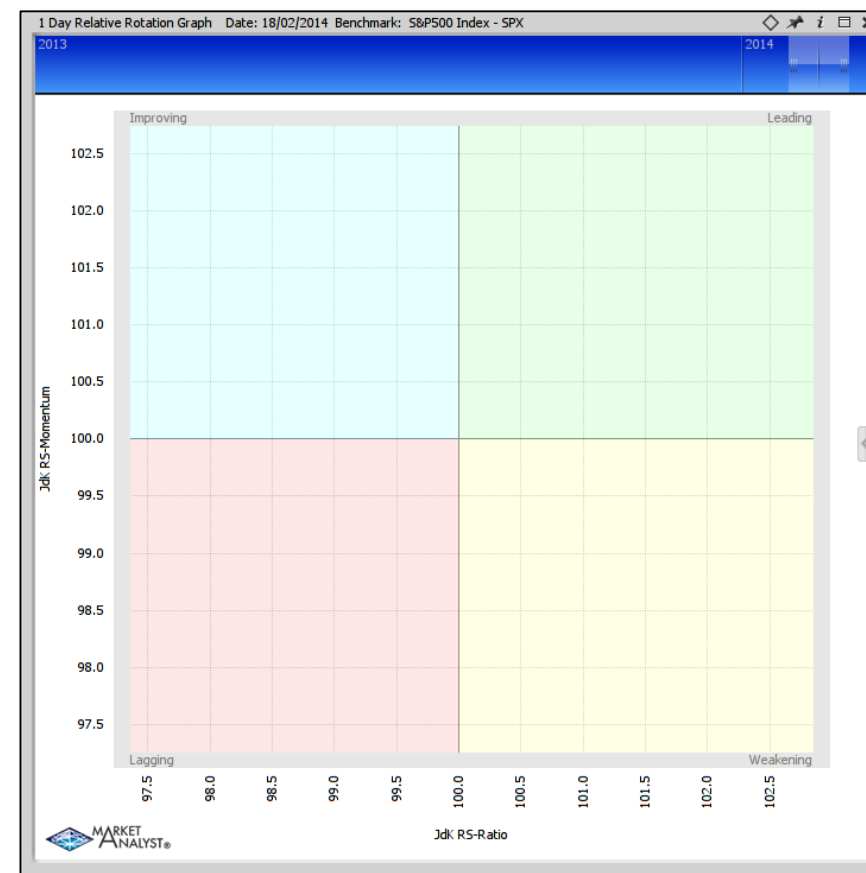
About Relative Rotation Graphs

- Weakening (Yellow).
 - Security is still out-performing.
 - Relative Trend is now negative so it is losing ground on the Index.
 - Exits and short opportunities exist in this quadrant.



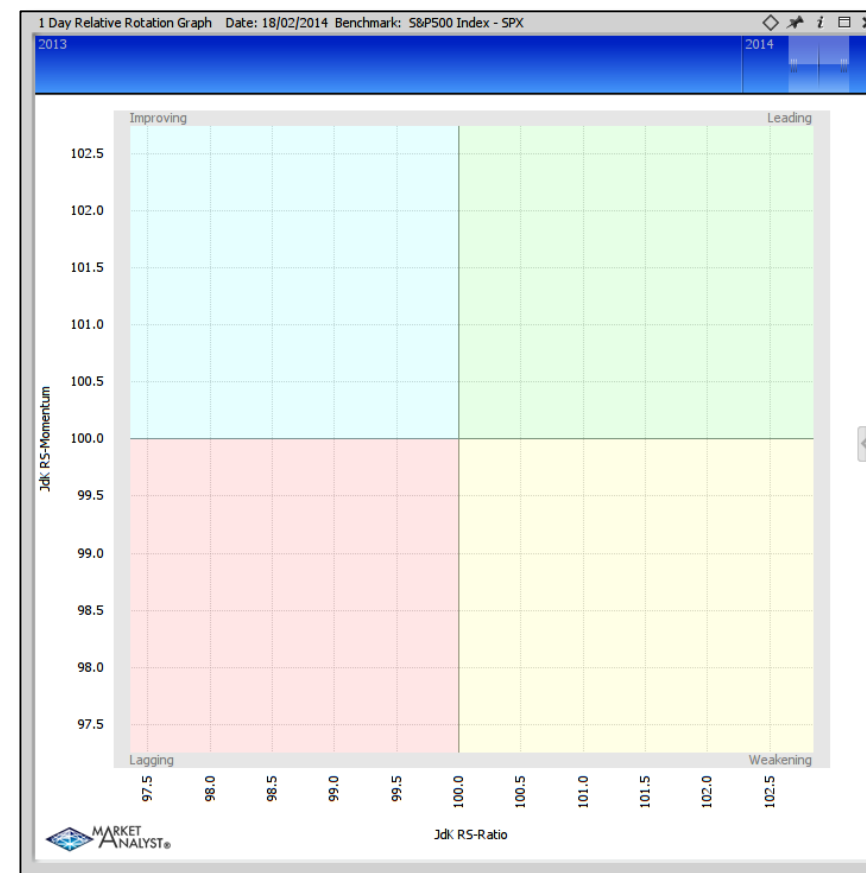
About Relative Rotation Graphs

- Lagging (Red).
 - Security here is now under-performing the Index.
 - It is one of the weakest in the sector.
 - Relative Trend is negative so it is falling further behind.



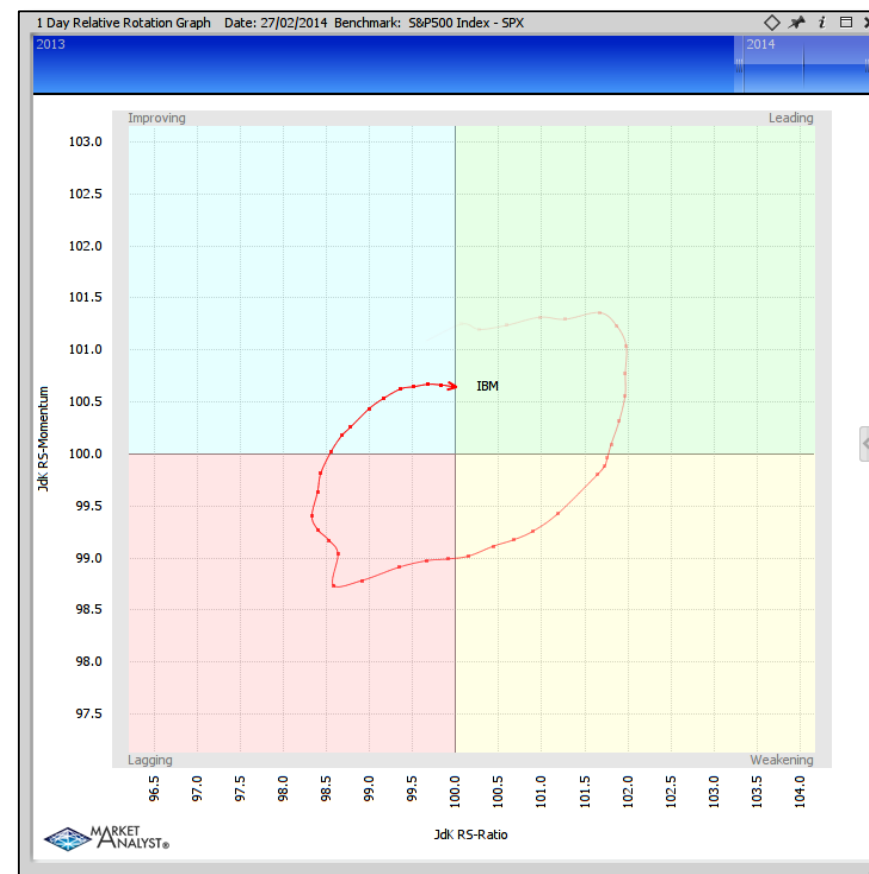
About Relative Rotation Graphs

- Improving (Blue).
 - Security is still under-performing.
 - Relative Trend is now positive so it is gaining ground.
 - Long opportunities exist in this quadrant.

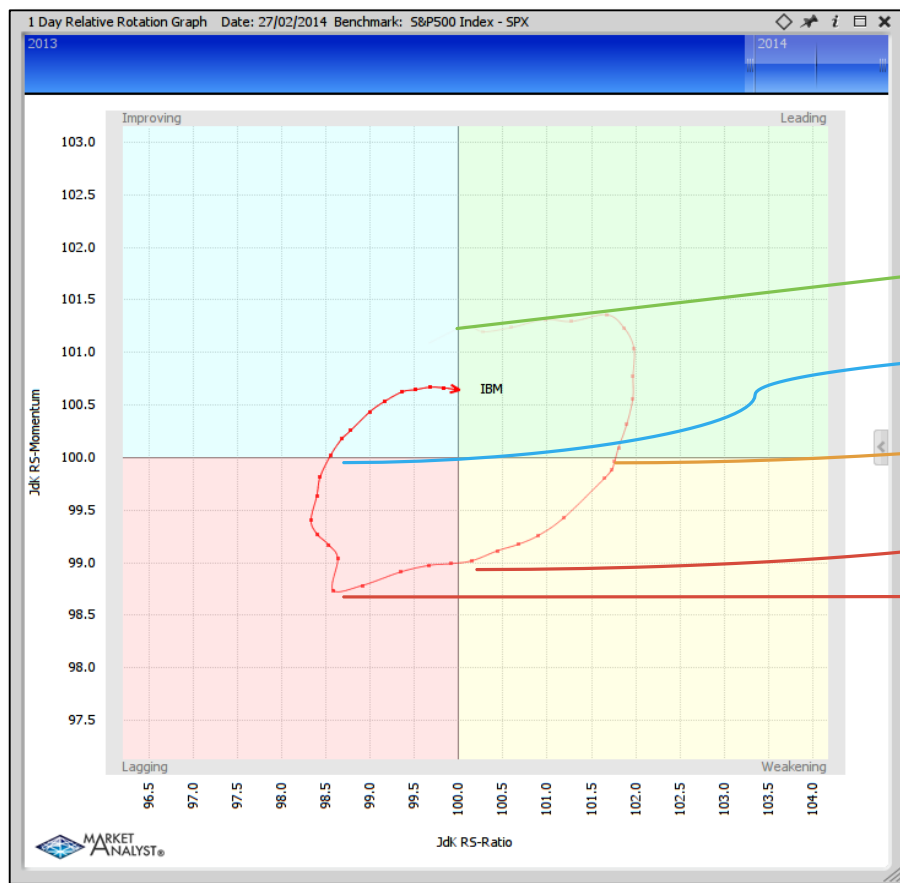


About Relative Rotation Graphs

- Discovery - the securities on the chart tend to rotate in a clockwise direction.
- IBM from 1st Jan to 28th Feb.
- Each dot on the tail is a daily observation.
 - Where it has been is often a clue to where it is going.
- Complete rotation around the S&P500.

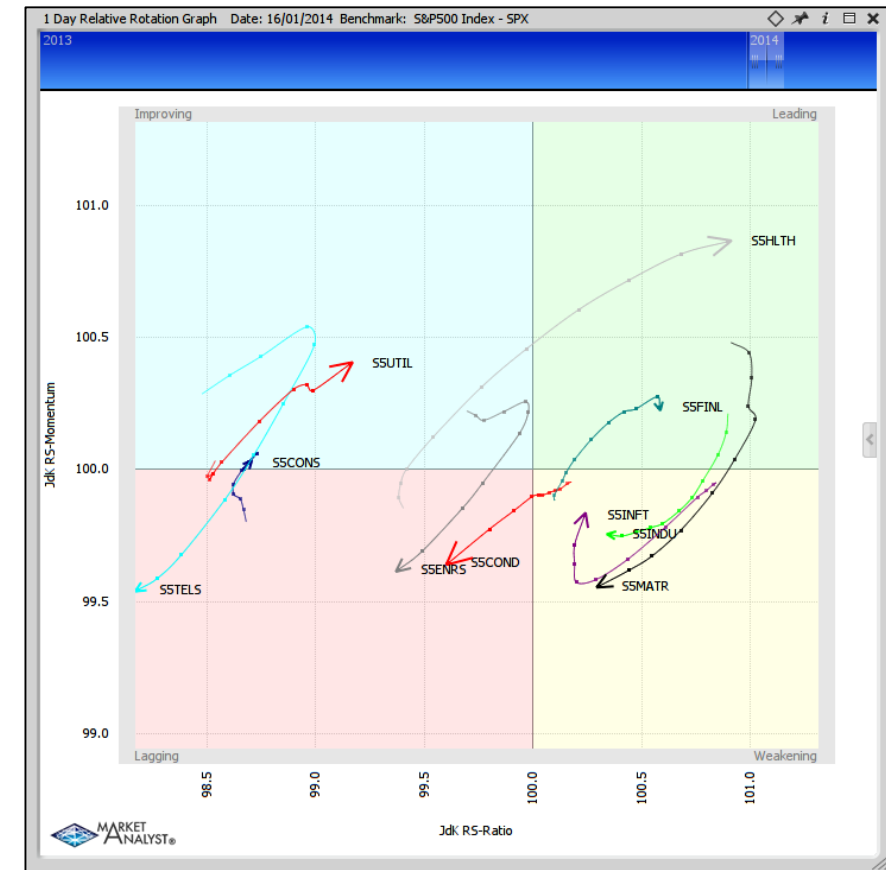


About Relative Rotation Graphs



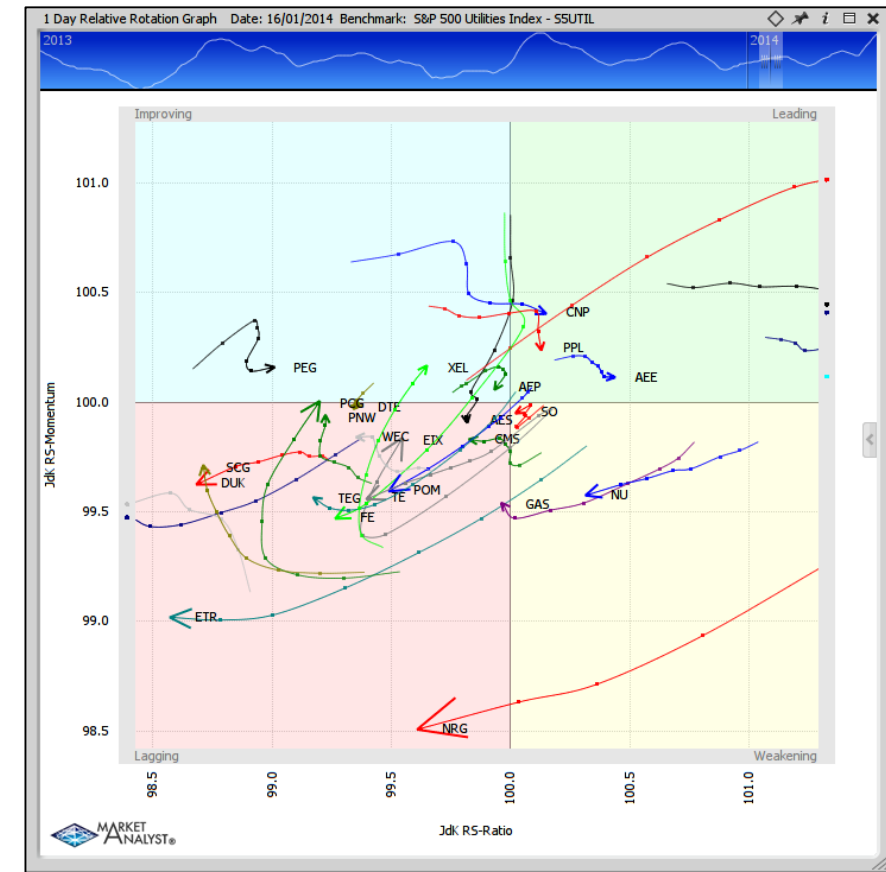
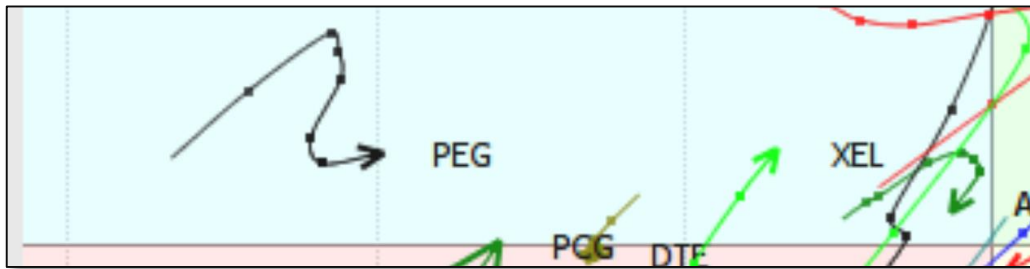
Using Them – Top Down

- Looking for opportunities in the market.
- Top Down Example
 - Start with the S&P 500 Level 1 sectors.
 - Zero in on the sector with the most promise.
 - Find the stock within that sector that shows the most promise.
- January 16th, 2014
 - Utilities Sector is showing the most promise.



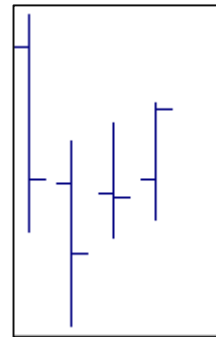
Using Them – Top Down

- We “Drill In” to the Utilities sector to see what we can find.
- It can be messy – we shortened the tails to 5 days.
- PEG is showing the most promise.



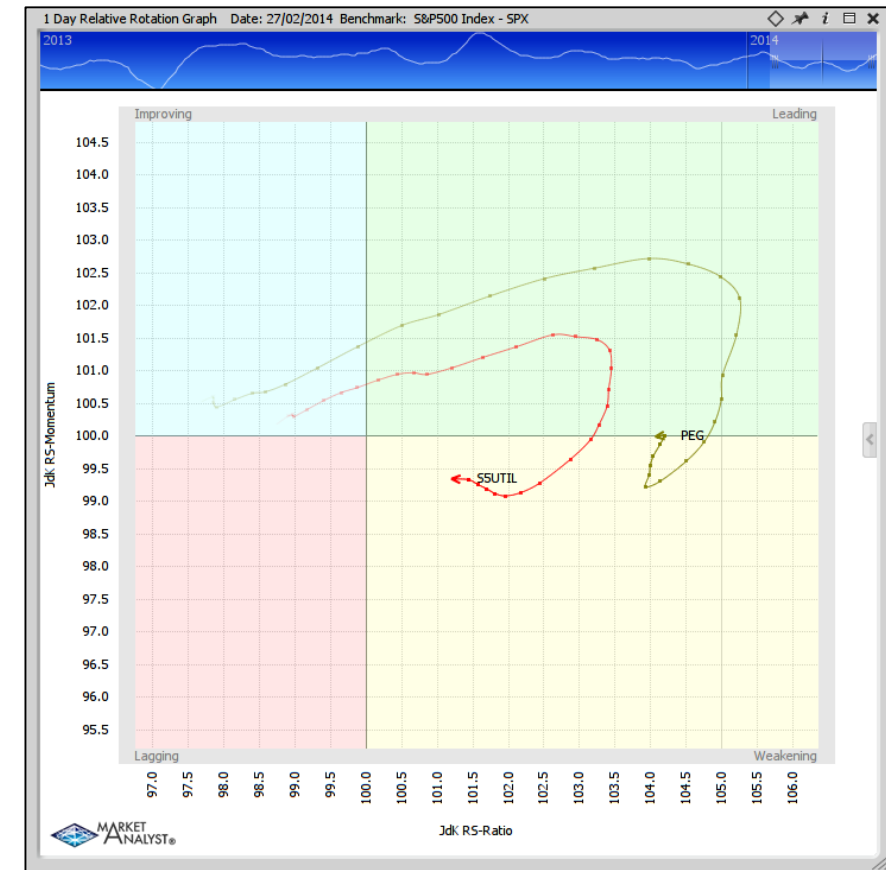
Using Them – Top Down

- At this point I would be looking at a Price Chart to get the confirmation that I need.
- Here is PEG on the 16th Jan
- What I see:
 - Double Bottom
 - RRG Momentum supported by Ratio
 - Very strong price bar

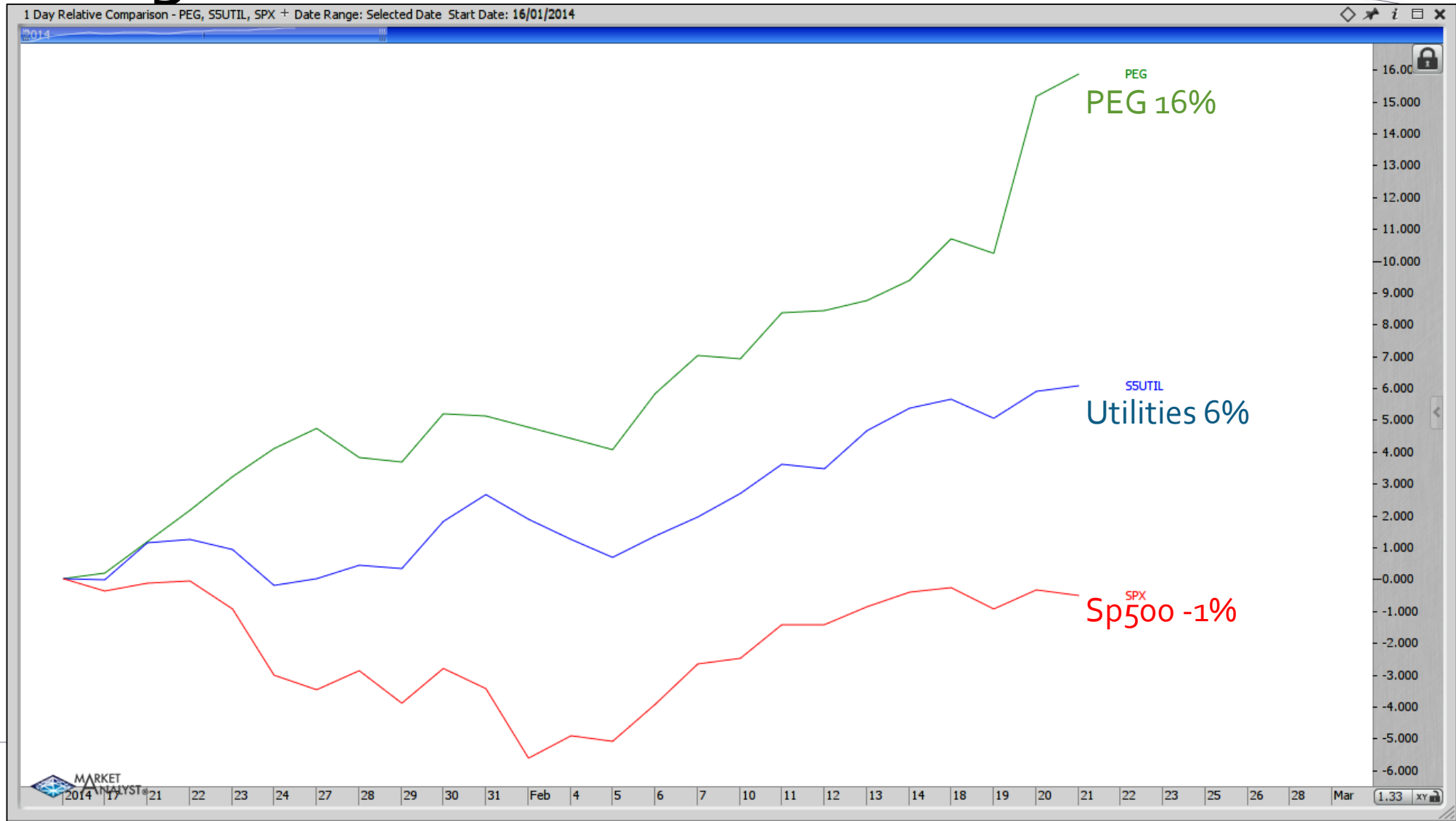


Using Them – Top Down

- Here we can see the Path through the RRG for Utilities (red) and PEG (olive) since Jan 16th.
- Utilities performed well, PEG performed better.
- WARNING!
 - PEG can still outperform the index when both are losing value.
 - PEG may be just losing less than the Index.

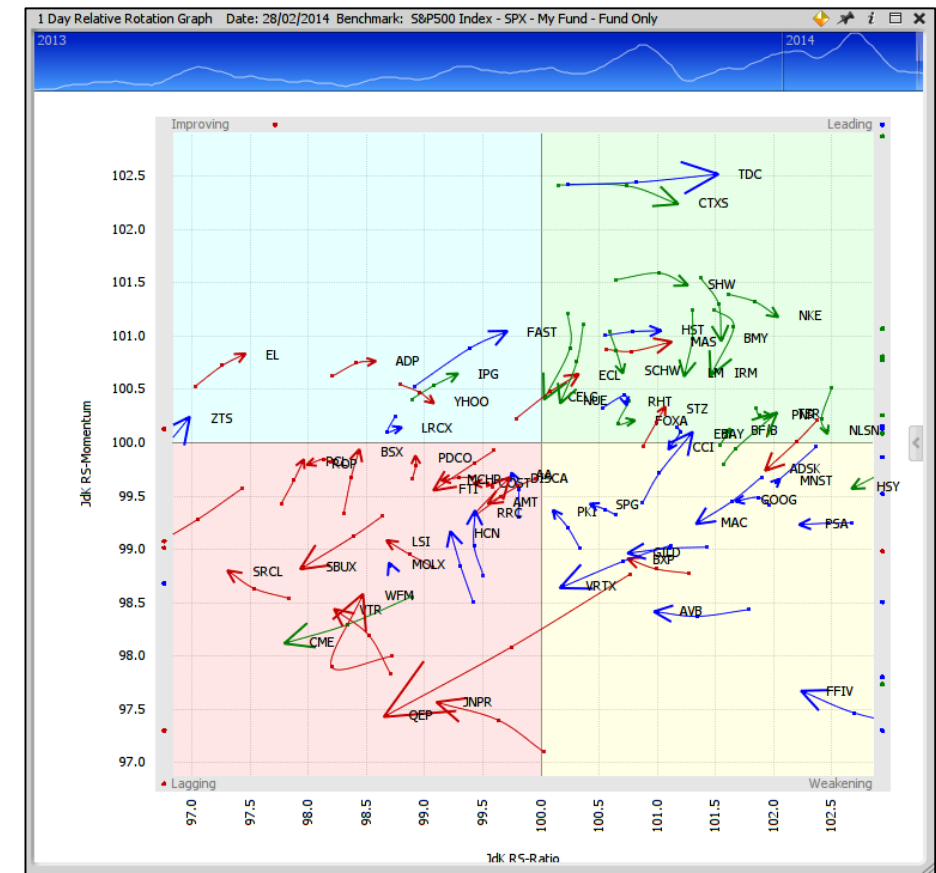


Using Them – Absolute Performance



Using Them – Portfolio Management

- If I am a Portfolio Manager there is always a benchmark that I am judged against.
 - Otherwise may as well invest in an Index fund!
- Sample fund of 100 names with the Sp500 as my benchmark.
- I can use the RRG to find the items in my portfolio that are weak and need to be removed.
- But given that Portfolio Management is not as simple as Buy/Sell, What can I do?



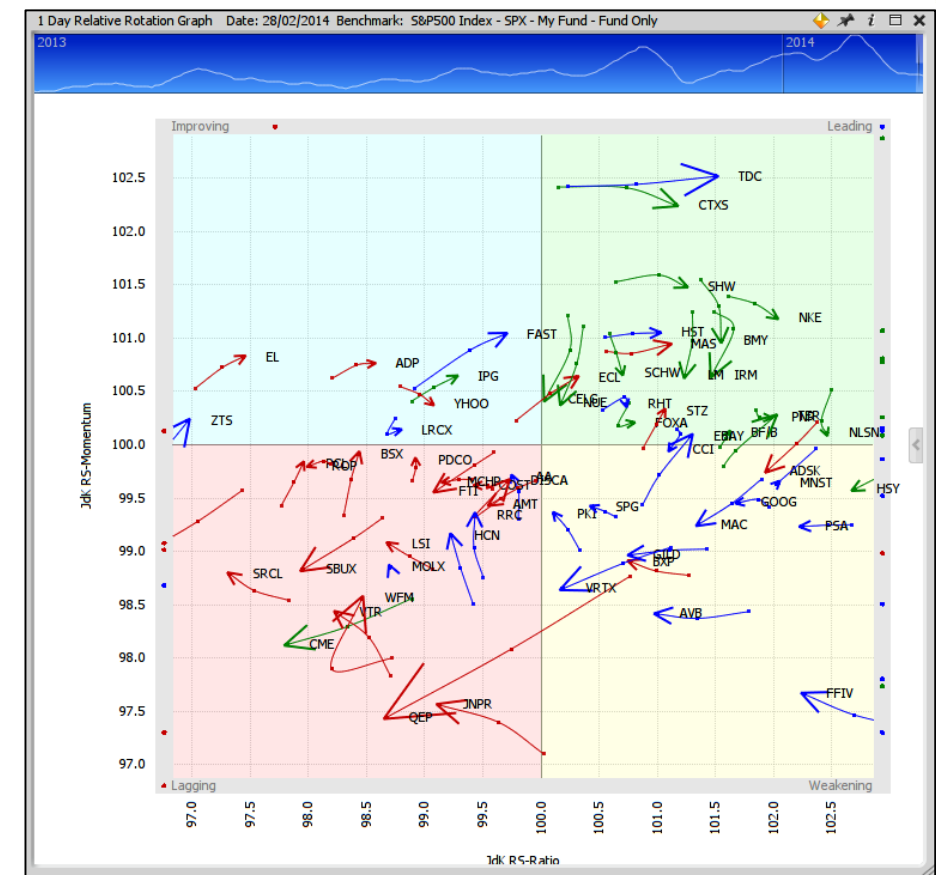
Using Them – Portfolio Management

- With the RRG we can consider the weights of each member of the Portfolio against the weight of that security in the benchmark.
- As a Portfolio Manager, for each security I may choose to :
 - Be Overweight – hold more in the portfolio than the benchmark has.
 - Be Equalweight – hold the same percentage.
 - Be Underweight – hold less than the benchmark has.
- Doing this correctly leads to Alpha.

Ticker		Weight	BM
AA	US Equity	0.078	0.078
ACT	US Equity	0.049	0.03
ADBE	US Equity	0.04	0.03
ADP	US Equity	0.024	0.049
ADSK	US Equity	0.003	0.01
AKAM	US Equity	0.033	0.03
ALXN	US Equity	0.049	0.049
AMAT	US Equity	0.03	0.012
AMT	US Equity	0.012	0.03
ATI	US Equity	0	0.058

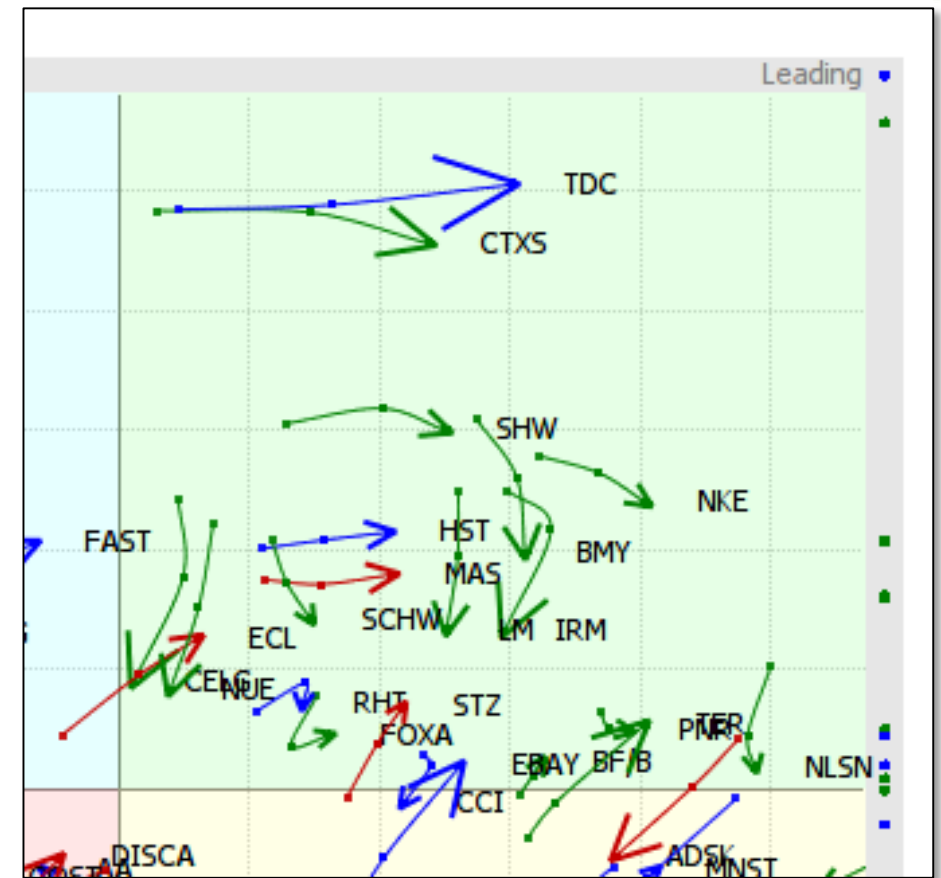
Using Them – Portfolio Management

- Here we have coloured the securities in my Portfolio as follows:
 - Green – Overweight
 - Blue – Equal weight within 1%
 - Red – Underweight
- My Goals are as follows:
 - Be Overweight any security that is in the leading quadrant.
 - Be Underweight any security in the lagging quadrant.
 - Use discretion in the other quadrants.



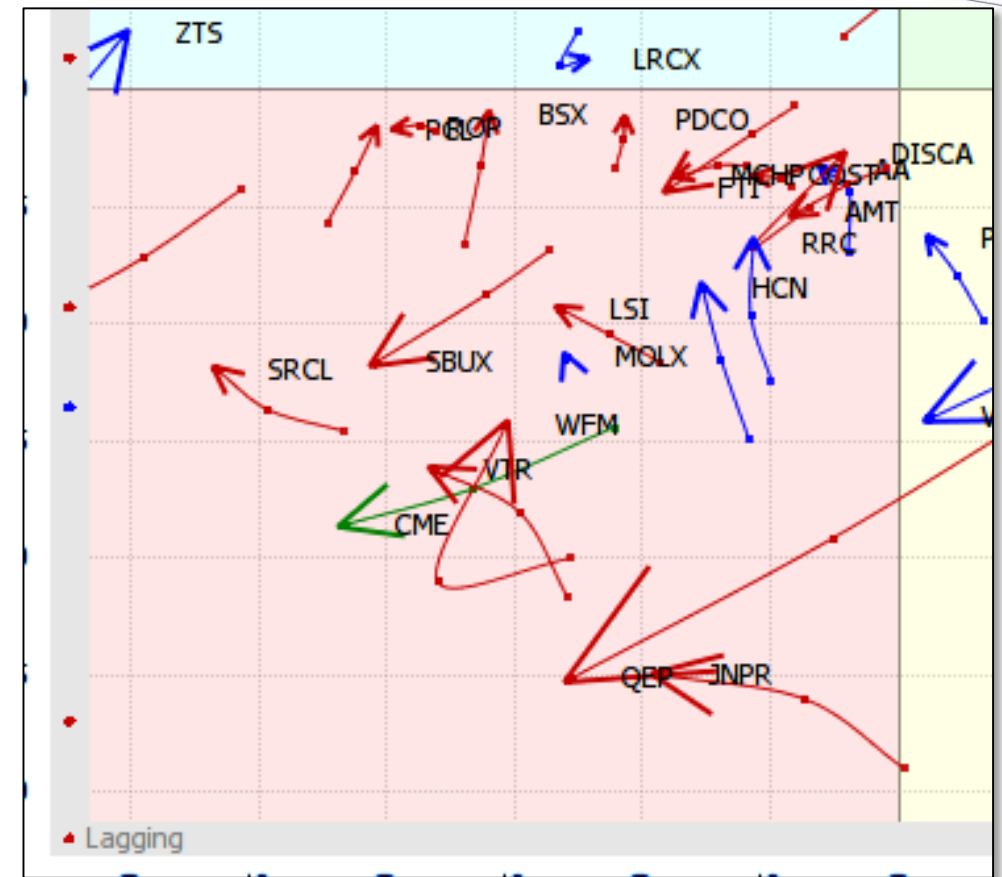
Using Them – Portfolio Management

- I'm Overweight or Equal weight on most of the leaders.
- The exceptions are what I want to have a look at:
 - ECL
 - MAS
 - STZ
- I would even question why I am Equal Weighted on TDC when it has such conviction.
 - Big space between the dots
 - Big arrow.
 - Has not turned.



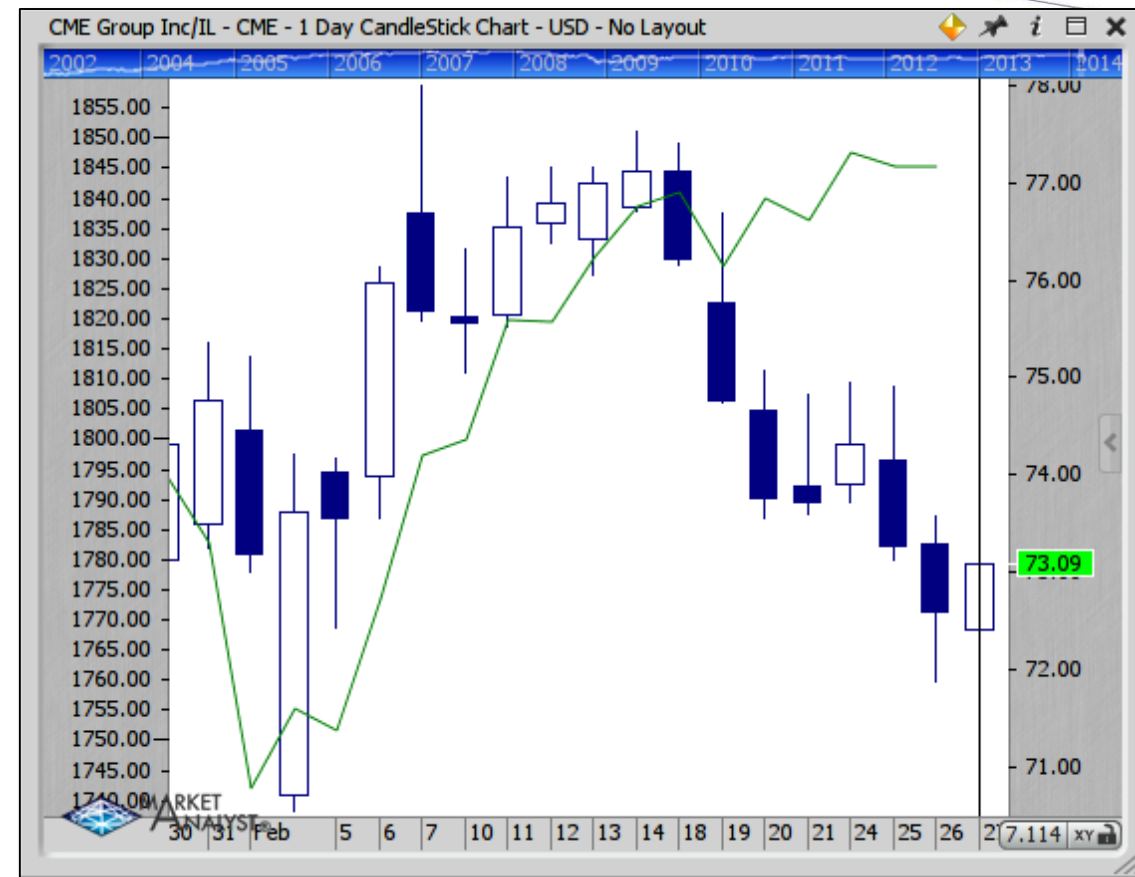
Using Them – Portfolio Management

- I'm Underweight or Equal weight on most of the lagers.
- The exceptions are what I want to have a look at:
 - CME



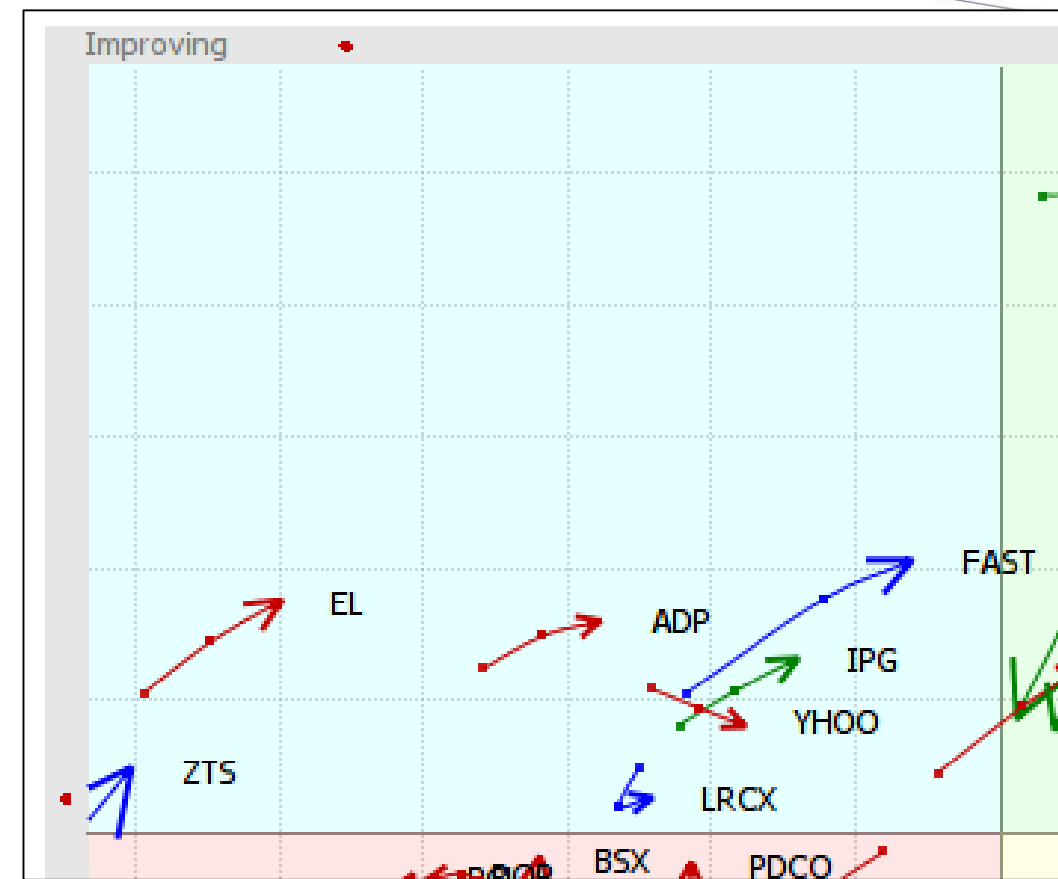
Using Them – Portfolio Management

- CME
 - Divergence between CME and SP500.



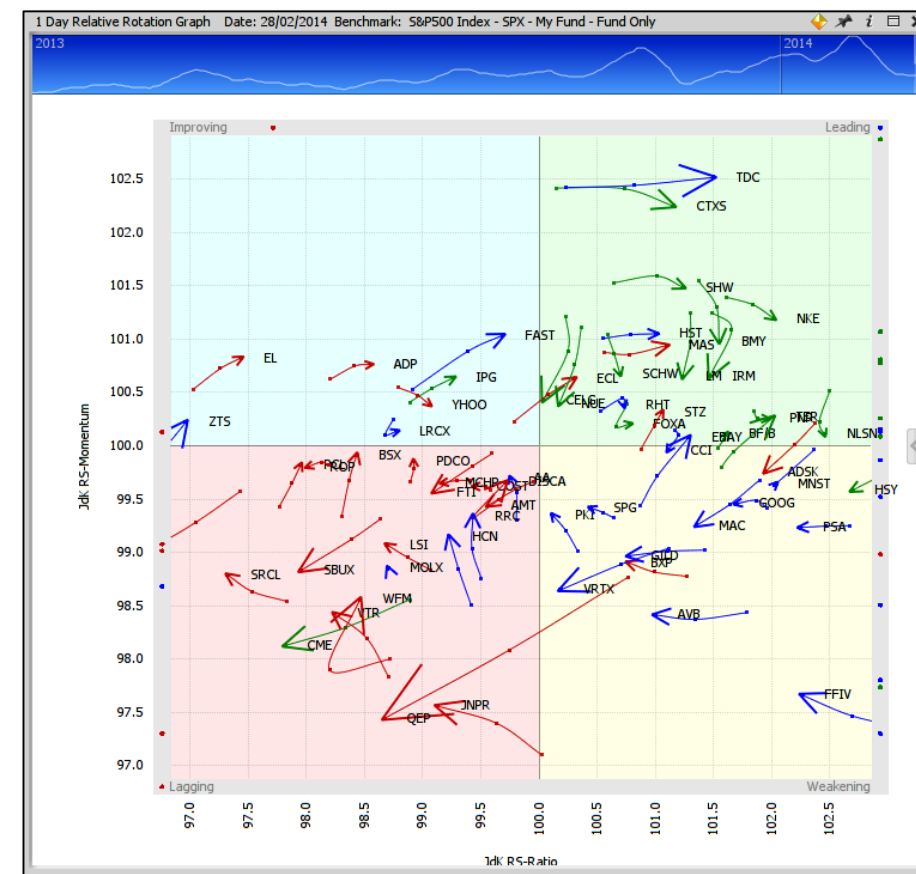
Using Them – Portfolio Management

- The Improving quadrant is where the long opportunities lie.
- FAST, IPG and EL look interesting.



Using Them – Portfolio Management

- By combining Relative Strength against a benchmark with my personal weights, I have a rapid and simple way to zero in on the securities that require my immediate attention.
- There are other dimensions that can be added too.
 - Sector Weights makes an interesting study.
 - Contact me for a white paper on this.
 - Foreign Exchange RRGs
 - Intraday RRGs



Portfolio Alpha from Relative Strength

- Thanks for listening!
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