DV Indicators Review

How This Free Combo System has Made 600% Since 2000

In a recent edition of *What Really Profits* I introduced the DVixl product from DV indicators. The creator, David Varadi, is a veritable trading ideas factory with his DVixl package packed full of fresh new trading indicators and ideas. You can find out more at http://www.dvindicators.com. If you’d like my original review, please drop me an email wrp@canonburypublishing.com.

Two popular indicators created by David Varadi are the DVB which is used for short-term Mean Reversion (MR) and the DVI which is used for slightly longer-term trading long and short.

Mean Reversion trading effectively means that you expect something to bounce back after being heavily sold or to drop if being strongly bought. After a big run in either direction, you expect things to “return to normal”.

In its simplest format, this means it might sell after an up day and buy after a down day, expecting the market to pull back rather than carry on its trend.

The DVB indicator is a short-term, highly sensitive indicator used for catching quick overbought and oversold conditions.

The DVI indicator is an intermediate term version of the DVB which will be trend following for the most part but switch to going short when it matters.

Independent of these two indicators are useful, but when combined they become incredibly powerful. To use a football analogy, think of the DVB as being Ronaldo – incredibly talented, but prone to overreaction and going down too quickly.

The DVI is like Alex Ferguson taking a longer-term view and is able to modulate and improve the behaviour of his more flamboyant counterpart. Arguably, Ronaldo played some of his best football under Ferguson. Separately the two indicators are good, combined they are even better.

The indicators

The DVI and DVB indicators are overbought/oversold oscillators with values that vary between 0 and 100 with 50 used as a centre line. The basic use for both indicators is that a reading above 50 infers a market is running too hot and prone for a reversal, while a reading below 50 indicates that the market has sold off too much and is due a rebound.

When you combine the indicators you get less false signals, thus smoothing returns. Below you can see the result of trading the two indicators separately using the fairly basic rule of buying on a reading below 50 and selling on a reading above 50.

The market is the US S&P 500, an index that the strategy particularly adheres to.

Since 2000, the fast-moving DVB would have turned £1,000 into over £7,000 while the steadier DVI returned £5,500.

When you combine both these indicators you return a similar amount to DVB, but with the added smoothing benefit of the DVI.

You can see how the combo system returned £7,000 in the last decade while buying and holding the S&P 500 would have failed to make any money at all excluding dividends.

Please turn over
Trading rules

The trading rules are simple:

If both the DVI and DVB are below 50% go long the S&P 500 at the close tonight.

If both the DVI and DVB are above 50% go short the S&P 500 at the close tonight.

If they are not BOTH above 50% or not BOTH below 50%, get out of the market and wait for the next trade.

Trading this simple system would have returned 15% in 2010, while buying and holding the S&P 500 would have made around 7%.

The average winner is 1%, with average loser being -0.91%. The strike rate is 55%.

Example trade

Below you can see a chart of the S&P 500 with the DVB and DVI displayed beneath.

On 11th November, the DVB ticked above 50, with the DVI being above 50 for some time.

The system would have sold at the close around 1210.75.

The next day, the market sold off closing around 1194.25, a gain of around 6.5 index points.

At £1 per point spread betting that would have been +£6.50 and at £10 per point, that would have been +£65 excluding the spread.

The next day, the DVB dipped below 50 while the DVI remained above 50, giving you a neutral signal.

Getting the indicators on MetaTrader

These two indicators are innovative, unfortunately as such they are not widely available with most charting packages. They are available with David Varadi’s DVixl package as standard and the Excel plug-in which is an excellent resource. Please email me if you wish to view my original review of this software.

Thankfully, recently the DVI calculation was made public by the Market Sci Blog. The full calculation can be found here. http://tinyurl.com/2u5xepq.

This means that thanks charting versions for the indicators are starting to crop up for software such as MetaTrader. Knowing that many WRP readers use this charting program I made it a priority to find MT4 versions of the indicators.

After much searching, I found the DVI and DVB coded at Forex TSD. Unfortunately, they are available within the premium “Elite” section only. This costs around £30 to join and you can gain access to thousands of bespoke indicators and expert advisors. It’s well worth it to get hold of these innovative and powerful indicators. I will attempt to get a free version coded for WRP readers in the coming months.

You can find a direct link to the DVI and DVB here: http://tinyurl.com/3478XKJ or go to http://www.forex-tsd.com and search for “DVI”.

Not all MetaTrader brokers provide a datafeed for the S&P 500. I personally use FXPro.com which provides the S&P 500 futures, which 90% of the time provides exactly the same signals as the cash S&P 500 index. Another broker, FXCM provide data
for the actual cash S&P 500 index.

**Excel version available to download**

For those readers not put off by a spreadsheet, I’ve created a tool for you to track the system without the need for any software. You need to do is spend less than a minute each day entering the numbers from a free website. Credit for this must go to the Market Sci blog.

Now to access the system:

1. Download the DVIB Combo spreadsheet from the resources page: [http://tinyurl.com/253QQQ5](http://tinyurl.com/253QQQ5)
2. Bring the data up to date by entering the date, the high, the low and the close for today. You don’t enter the open.
3. You get this information from Yahoo finance here: [http://uk.finance.yahoo.com/q?s=^GSPC](http://uk.finance.yahoo.com/q?s=^GSPC). Note ^GSPC is the code for the S&P 500. You will be entering the data as close to the close near 9PM as possible. There will always be some slight discrepancies between what you enter and the actual official closing levels so you’ll need to redo the previous day, but for the most part it shouldn’t make too much difference to the trading signals for that evening.

<table>
<thead>
<tr>
<th>Date</th>
<th>High</th>
<th>Low</th>
<th>Close</th>
<th>DVI</th>
<th>DVB</th>
</tr>
</thead>
<tbody>
<tr>
<td>18/08/2010</td>
<td>1099.77</td>
<td>1085.76</td>
<td>1094.16</td>
<td>8.0%</td>
<td>52.9%</td>
</tr>
<tr>
<td>19/08/2010</td>
<td>1092.44</td>
<td>1070.66</td>
<td>1075.63</td>
<td>10.7%</td>
<td>23.1%</td>
</tr>
<tr>
<td>20/08/2010</td>
<td>1075.63</td>
<td>1063.91</td>
<td>1071.69</td>
<td>14.7%</td>
<td>19.1%</td>
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4. Once you have entered the date, high, low and close, the levels for the DVI and DVB will magically appear.

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As the screenshot shows above, both the DVI and DVB are below 50, giving a clear buy signal.

**Money management & spread betting**

For money management I would work with a worst case scenario of a 500 point trading pot. By this I mean that an account should be able to withstand a 500 point drop times by the amount you trade per point when spread betting. This represents a 50% drop in the S&P 500 itself and although the system has never dropped by this much, it’s often better to be safe than sorry. Two hundred and fifty points could be allocated for the less conservative.

So if you allocate £1,000 to the system, then divide this by 500 points, this would mean trading the system at £2 per point.

I strongly suggest demo trading this first with a firm such as [http://www.ggmarkets.com](http://www.ggmarkets.com).

**The bottom line**

The DVIB combines two highly-effective indicators to smooth returns between them and it does it rather well. The results above do not include any trading frictions such as spreads or rolling costs it should be noted.

However, the system has not been optimized in any way, it simply uses the very basic settings for the DVB and DVI. With some discretionary overlays, such as chart reading, the method could be improved further. As I demonstrate in the next article, blending the DVIB system with calendar effects increases returns even further.

If you enjoy this sort of trading then I recommend reading David Varadi’s blog [http://cssanalytics.wordpress.com](http://cssanalytics.wordpress.com) for a better understanding of how these sort of indicators work.

**Trading System**

**How to Boost Your Profits by Trading the Calendar**

In a recent edition of *What Really Profits* I showed how powerful the first day of the month is for stock markets. The first day of the month has accounted for over half the gains on the FTSE since 1984 and together with ultimate day of the month — please turn over
accounts for nearly 90% of the gains in the FTSE 100.

The chart below shows the average daily gain on the FTSE 100 by day of the month:

(-1 means 1 day before the end of the month etc)

Since 1984, had you invested a FTSE 100 tracker from the last three days of the month to the first three days of the month and put it in the bank with an average rate of 1%, a £1,000 investment would now be £12,000 vs £5,000 buying and holding.

Note that in the last decade the last day of the month has become more of a negative indicator with the bulk of its bias coming from the previous two decades. So the last day of the month is slightly negative.

Now this ignores any trading frictions and the considerable uplift you would achieve from the inclusion of dividends, but it does make you think about applications for short-term trading.

- Is this statistically significant, or is it just a fluke?
- What other calendar effects might there be?
- How can you apply them to your trading?

In this article I’ll be addressing each of these points in turn and showing you how the calendar effects can help complement many trading systems.

**How real are calendar effects?**

There has actually been a number of academic studies published on the subject of calendar effects and in specific cases such as the turn-of-the-month effect (TOM) as mentioned above.

Many of these studies have been neatly summarised by the excellent CXO Advisory http://www.cxoadvisory.com/ which has recently become a pay for subscription service. At just $99 per year I find this a very useful little site for verifying ideas and summarising academic papers that would make my eyes water.

CXO highlight a study Grimbacher et al, in 2009 called “An Anatomy of Calendar Effects” which investigated the significance of a number of effects across a range of stock markets in different time periods.

They identified four major patterns that led to strong buying opportunities.

1. Halloween effect: 1st November to 30th April
2. Turn-of-the-month effect: Last trading day of a month through fourth trading day of following month
3. Holiday effect (US holidays): The single trading day before either New Year’s Day, President’s Day, Good Friday, Memorial Day, July Fourth, Labor Day, Thanksgiving or Christmas
4. Weekend effect: Friday

By running various tests they concluded that on a standalone basis, all of the effects are statistically significant (i.e. highly unlikely to just be a fluke).

The most reliable effect was found to be the turn-of-the-month-effect. Combined with the Halloween effect, the TOM has the strongest impact, often overriding the effect of the other patterns.

Other studies have found that the TOM effect is robust even in bear markets!

**The Halloween/ Sell in May effect.**

You may have heard the old adage to “Sell in May, come back again Saint Swithun’s Day” (15th July). The theory is that stock returns so strong between November and April that you may as well pack up and leave the stock market until May rolls around.

The Halloween indicator is effectively the same effect but re-enters the market later (with Halloween falling just before the start of November).

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Another study highlighted by CXO found that the May to October effect is consistent even when you look at 300 years of stock market data. The only time May to October had a positive risk premium was between the 1930s and 1950s. A “Sell in May”
strategy beats buying and holding the stock market on a rolling five year basis 80% of the time.

It’s thought that there may be a biological basis for the May to October effect based around Seasonal Affective Disorder.

Going back to 1871, a $1 investment in the S&P 500 buying only during the November to May period would now be worth $55.32, while the same $1 would now be worth just $4.49 investing from May to October.

The chart below shows the FTSE 100 (excluding dividends) versus buying only from May to October.

![FTSE 100 vs Buying May to Oct 1984 to 2010](chart1.png)

The May to October effect has been incredibly consistent over the years. Even during the monster bull run of the 90s, the May to October investment barely moved.

The November to April’s returns have not exactly been a smooth ride, but they have produced a profit that exceeded returns from buying and holding the FTSE excluding dividends.

![FTSE 100 vs Buying Nov to Apr 1984 to 2010](chart2.png)

So just what is it that makes these periods different?

To answer that question, I have broken down the performance of an average day for each of the effects to allow us to compare it to the average of every day on the FTSE 100.

<table>
<thead>
<tr>
<th></th>
<th>Strike Rate</th>
<th>Avg. Gain</th>
<th>Avg. Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Days</td>
<td>51%</td>
<td>0.60%</td>
<td>-0.57%</td>
</tr>
<tr>
<td>TOM</td>
<td>56%</td>
<td>0.67%</td>
<td>-0.57%</td>
</tr>
<tr>
<td>Nov-Apr</td>
<td>52%</td>
<td>0.60%</td>
<td>-0.54%</td>
</tr>
<tr>
<td>May-Oct</td>
<td>51%</td>
<td>0.59%</td>
<td>-0.62%</td>
</tr>
</tbody>
</table>

It comes down to fine margins, but fine margins are what matter in the long run. I’ve defined the TOM as the last three and first three trading days of the month.

Buying on the TOM gives you a strike rate of 56% with an average gain significantly higher than the FTSE 100 average. A 56% strike may not sound much of an edge but when you add an average daily gain that is significantly higher than the average for all days, then your edge would add up.

Investing between November and April does not significantly lift your strike rate or your average gain, what it appears to do is reduce the size of your average loss. Indeed the average daily loss between May and October is 0.62% vs a daily loss of just 0.54% for the November to May period.

The bottom line appears to be that the TOM and Halloween periods have an upside edge that exists without increasing volatility. There have been a number of academic papers published which indicate that these two effects are statistically significant and meaningful. It seems to be that they are as least as valid as any other trading system.

The effects may be a self-fulfilling prophecy so as long as enough people continue to believe that these effects will play out in the future then they probably will.

**Other calendar effects**

The TOM effect and the Halloween indicator aren’t the only gigs in town, there are a number of other effects which, although specific to US markets, are still very strong nonetheless. There isn’t the same level of academic research on these effects, but there is still some good evidence to back up their impact.

**Thanksgiving**

Previous studies have shown that weekend holidays can have an impact on returns, but one
holiday in particular appears to stand out. Thanksgiving is probably second only to Christmas for Americans when it comes to the importance of national holidays. Gas prices will tick higher as Thanksgiving approaches due to the prospect of millions of Americans hitting the road to visit family.

It is a significant holiday socially and it turns out it has a powerful impact on US markets (the S&P 500). The excellent blog, http://marketsci.wordpress.com has done the legwork on this and this link will take you to the full research performed by Michael: http://tinyurl.com/26pyhqg.

Market Sci’s findings can be summarised as follows:

<table>
<thead>
<tr>
<th>S&amp;P 500</th>
<th>Strike rate</th>
<th>Avg. Daily return</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Days</td>
<td>54%</td>
<td>0.06%</td>
</tr>
<tr>
<td>1 day before TG</td>
<td>78%</td>
<td>0.36%</td>
</tr>
<tr>
<td>1 day after TG</td>
<td>77%</td>
<td>0.35%</td>
</tr>
<tr>
<td>2 days after TG</td>
<td>40%</td>
<td>-0.18%</td>
</tr>
</tbody>
</table>

The average daily return represents the difference between the average winning and the average losing days unlike the table above which splits these statistics. Statistics are from 1950 to 2009.

Depending on when you receive this magazine, this information may be too late for this year, but may catch that Monday 29th is two days after Thanksgiving and therefore has a negative bias.

**Fed days**

A “Fed” day is when the US Federal reserve meets to set interest rates. This is the US equivalent of the Bank of England. These meetings are scheduled once every other month, but they can often crop up at more frequent intervals and can be subject to change so keep an eye on the trading calendar at www.forexfactory.com.

Once again, the redoubtable http://marketsci.wordpress.com has been on the case, finding that Fed days have had a fairly consistent bias since 1950. One theory is that regardless of the actual decision (to raise rates, cut them or keep them unchanged), Fed days provide traders with clarification after days of speculation on what the Fed might do. More than anything, markets hate indecision and the unknown and this can certainly be the case prior to a Fed decision. When an announcement is made, even if its not what markets want, at least it is an answer! It may be a case of any news being good news.

<table>
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<tbody>
<tr>
<td>All Days</td>
<td>54%</td>
<td>0.06%</td>
</tr>
<tr>
<td>Fed Days</td>
<td>62%</td>
<td>0.37%</td>
</tr>
</tbody>
</table>

Fed days close higher 62% of the time with an average daily return that far outstrips the profit from just any day.

**Options expiry**

Stock & index options expire on the third Friday of every month unless there is a bank holiday in which case they expire on a Thursday. All options have a time expiry so any investor buying a “call” option predicting that the Dow Jones will rise may find that particular option expiring on this third Friday of the month. Often these options are rolled over to the next equivalent contract, but this mix of expiring contracts and new ones being purchased can cause some volatility on stock markets as traders square positions and take up new ones.

For whatever reason, it seems the day after options expiry (the fourth Friday of every month) has a negative bias.

Indeed, according to http://marketsci.wordpress.com buying the fourth Monday of every month would have lost $2,000 on a $10,000 investment since 2000.

<table>
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</tr>
</thead>
<tbody>
<tr>
<td>All Days</td>
<td>54%</td>
<td>0.06%</td>
</tr>
<tr>
<td>Day after OE</td>
<td>42%</td>
<td>-0.18%</td>
</tr>
</tbody>
</table>

Since 1950, just 42% of option expiry Mondays have been positive, indicating a negative bias for the day. There was previously a bias regarding the closing direction of options day itself, but this appears to be petering out.

**How to use calendar effects**

Having looked at calendar effects in greater detail than I ever have before, I am now starting to treat them with more respect. After monitoring them live for most of the year I’ve noticed many trades where I lost out by going against a calendar effect.
However, I do not think the trading calendar is enough to trade on their own. The trends are fairly consistent year to year in the long run, but there are sometimes periods when the opposite rules would have served you well.

So how could you best use these seemingly powerful effects?

**Position size**

One method growing in popularity is to use seasonality effects to modulate the size of any trade you make. E.g. reduce the size of any long trades if the calendar bias is negative, or significantly reduce the size of any short trades on the first trading day of the month.

To do this effectively, you need to identify the calendar effects you think are valuable then apply a weighting or significance to that effect. Once again, http://marketsci.wordpress.com has put this idea to good use, creating a calendar effect map for each month.

The strength of an effect might vary from 100% (for the first trading day of the month) to a smaller effect like 25% as could be applied to options expiry. If two or more effects appear on the same day you could add these together up to a maximum of 100%.

Here’s how such a calendar might look for December. On the back page you’ll find a similar calendar for the next six months.

### Calendar map for December 2010

<table>
<thead>
<tr>
<th>Date</th>
<th>Bias</th>
<th>Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>01/12/2010</td>
<td>100%</td>
<td>TOM</td>
</tr>
<tr>
<td>02/12/2010</td>
<td>75%</td>
<td>TOM</td>
</tr>
<tr>
<td>03/12/2010</td>
<td>75%</td>
<td>TOM</td>
</tr>
<tr>
<td>06/12/2010</td>
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<tr>
<td>07/12/2010</td>
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<td>10/12/2010</td>
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<tr>
<td>13/12/2010</td>
<td></td>
<td></td>
</tr>
<tr>
<td>14/12/2010</td>
<td>50%</td>
<td>Fed</td>
</tr>
<tr>
<td>15/12/2010</td>
<td></td>
<td></td>
</tr>
<tr>
<td>16/12/2010</td>
<td></td>
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<tr>
<td>17/12/2010</td>
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<td>20/12/2010</td>
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<tr>
<td>21/12/2010</td>
<td></td>
<td></td>
</tr>
<tr>
<td>22/12/2010</td>
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</table>

December is given a score of +25% as a whole, indicating a positive bias might be sensible or to reduce the position size of any short trades by 25% (one quarter). For example, if you risk 2% of your account on any trade, then consider risking 1.5% instead.

The first day of the month is given a 100% weighting, meaning if you plan on going long then there is no impact, but if you get a signal to go short, consider ignoring this signal entirely, such is the strength of the effect.

On 14th December we have a Fed meeting with a weighting of +50%. This is a confirmation signal for any long trades to remain at full strength, but if you had a short signal for that day, then consider reducing your planned trade size by half. You might also consider reducing short trades by another 25% given that December falls into what is generally a positive period for stock markets.

The day after options expiry falls on Tuesday the 28th as Monday is a bank holiday in the US. This day has a negative bias of 25%. UK markets are closed in lieu of boxing day which the US don’t celebrate.

### Daily rating

Other method of using the calendar effect is to use them to create a daily rating in conjunction with any trading systems you are trading.

For example, each input (trading systems & calendar) is given a score between -1 and +1, with the aim being to only go long on days above zero and only go short on days below zero. This isn’t the only way you could do this, but it’s something I’ve been applying in recent months.

### The inputs:

- DVIIB Buy signal: +1
- Red Lemming Day +0.5
- Amber Lemming Day +0.5
- TOM (excl last day): +1 each.

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What Really Profits?
From the Publisher...

“If You Knew What Really Sells Online and Where to Get it, How Much Could You Make Each Week?”

I f you want to make money online – whether on eBay, Amazon or anywhere else – you need to find something to sell. But unless you love writing eBooks, making things or fancy joining the ClickBank affiliate mob, then you need to find a reliable source of in-demand products.

But where do you begin trying to identify hot markets?

And once you’ve found a hot product that doesn’t have loads of competition, how can you hunt down wholesalers you can trust?

If you want to make this really easy on yourself I recommend you check out Amanda O’Brien’s new Source Report. As you might recall Amanda is a highly successful eBay Powerseller and she has now released her private research that gives specific hot product recommendations. She’ll give you:

• A precise niche area that has a proven hungry market of prospective buyers.
• The exact product that fulfил’s this demand – right down to specifying the make and model.
• The name and address of the wholesale source.
• Precise instructions on where and how to list that product so that it pulls the most sales possible.

Before you ask, I’m publishing this info, so it comes with all the personal recommendations and guarantees you would normally expect.

So if you are interested in getting a free review copy of Amanda’s Source Report and see how you could easily make £165.55–£708.40 or more each week check out the information enclosed with this issue or go now to:

http://canonburypublishing.com/sourcereportWRP

What Really Profits?

Months November to April: +0.25
Fed Day: +0.5
Day before thanksgiving: +0.5
Day after thanksgiving: +0.5
DVIB Sell signal: -1
2 days after thanksgiving: -0.5
Day after options expiry: -0.25

Total the day’s score:
Long on days above zero.
Short on days below zero.
No trade if zero.

This scoring gives the system a slight positive bias, but I feel that’s about right given that stock markets go up in the long term.

This system improves on the already excellent DVIB Combo system by pruning a number of losing short trades and slightly increasing the number of long trades.

The chart below shows the improvement the rating system would have made to the DVIB Combo, with returns far outstripping that of buying and holding the S&P 500 this year.

£1,000 in January 2010 would now be £1,400, a highly respectably 40% return on your money.

You could no doubt improve this method further by including scores from other systems you might follow such as those shared in the What Really Profits magazine in the last year. The Hassler RSI would certainly be worth an input for +1 point and you might provide a +0.25 or 0.25 score depending on whether the month is offering value + momentum.

To make life a little easier I’ve prepared a trading effect calendar covering the first half of 2011.

To download it go to:
http://www.canonburypublishing.com/wrpcalendar