



Predictive Relationship: Static Combination Regression

Contents

1	Trading Strategy Description	2
2	How to Trade	2
3	Rule Parameters	3
4	Equation	3
5	Glossary	4

1 Trading Strategy Description

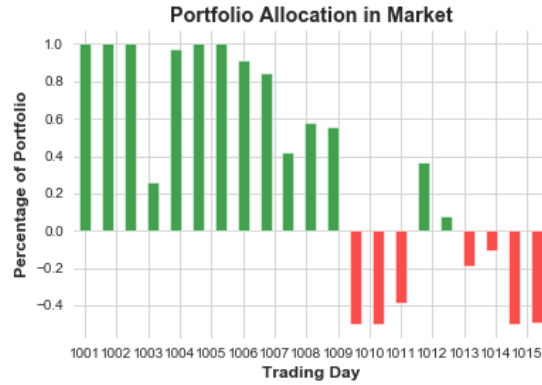
Regresses the one-day price changes against the lagged level and one day change of the signal for the specified number of days, using coefficients estimated from the start of the data.

2 How to Trade

In order to trade with the rules InferTrade provides, we calculate allocations for each day. We then allocate that fraction of our total portfolio value (cash and securities) to the market we are trading - to do this we buy or sell securities to reach the target allocation.



(a) Market series data



(c) Suggested volume to buy or sell



(b) Research series data



(d) Portfolio return

Figure 1: Graphical depiction of the Static Combination Regression algorithm. 20 Days of trading data is visualised in the graphs (1a) A line chart showing changes in the market price for multiple trading days. (1b) A chart displaying the research series data. (1c) Positive values indicate that buying the security by $x\%$. The negative values mean you are shorting the security by $x\%$ (1d) Chart showing the portfolio return when using the Static Combination Regression as the trading rule.

How Allocation Determines Trade Size

The allocation is the fractional amount of the portfolios value used to determine the size of the trading position. For example, if the allocation for Microsoft (MSFT) shares is 50%, and we have \$100, we invest \$50 so that the value of held stock is the same as the value of held cash.

Rule Specific Trading Details

Given default parameter values, if the asset drift is 0.01 and the error is 0.05 (5% daily volatility), this rule will take a $0.01/(0.05)^2 = 4.0$ or 400% position (leveraged).

3 Rule Parameters

Below is a table summarizing the parameters specific to this trading rule.

Parameter Name	Default Value	Description	Symbol
Kelly fraction	1.0	Amplitude weighting. 1.0 is maximum growth if regression is exact. <1.0 scales down positions taken.	F
Regression length	50	This is the number of days used to estimate the regression coefficients.	L

4 Equation

The equations below govern how the static combination regression rule calculates a trading position.

$$y_t = \kappa_1 r_t + \kappa_2 \left(\frac{r_t}{r_{t-1}} - 1 \right) + \kappa_3 \left(\frac{p_t}{r_t} - 1 \right) + c \quad (1)$$

In the equation (1), the predictive price y_t is calculated using the static change regression, static difference regression and static level regression combined in one trading rule. Since we are using a static approach the amplitude coefficients κ remain constant. In order to calculate the resultant fractional portfolio allocation z_t we use the Kelly fraction to obtain the maximum results for the long run.

$$z_t = F \frac{y_t}{\varepsilon_{rms_t y}^2} \quad (2)$$

where

r : is the value of the research series.

y_t : is the predicted price at time t .

$\varepsilon_{rms_t y}$: is the standard error.

F is the Kelly Fraction.

z : is the resultant fractional portfolio investment.

The standard error $\varepsilon_{rms_t y}$ is calculated and included in equation (2) to normalize the predicted price.

5 Glossary

- **Bullish:** Positive outlook on the market. Expectation of positive returns.
- **Bearish:** Negative outlook on the market. Expectation of negative returns.
- **Allocation:** The allocation is the fractional amount of the portfolios value used to determine the size of the trading position.
- **Parameter:** Value used by the trading rule in the calculation for trading position
- **Trading Rule:** Strategy to determine when to buy, hold or sell a position.

Further Links

1. InferTrade: <https://www.infertrade.com>
2. Privacy Policy/Legal notice: <https://www.infertrade.com/privacy-policy>
3. InferStat Ltd: <https://www.inferstat.com>