

972 Project - GRAB Research Project

Yunfeng Liu

December 12, 2022

1 Research Project

1.1 Replication Analysis

To verify if the GRAB algorithm works, I back tested GRAB strategy with AAPL,ADMP, MSFT, TSLA and SPY from 2015-01-01 to 2022-11-01. The GRAB parameters used are $N_n = 10$, $N_f = 20$. There are some modifications on the original algorithm due to the lack of clarity from the original paper [1] regarding the exit procedure. Moreover, in this replication, I will use current date's closed price whenever a limit order or stop order is required. Transaction fees and borrowing costs are also ignored.

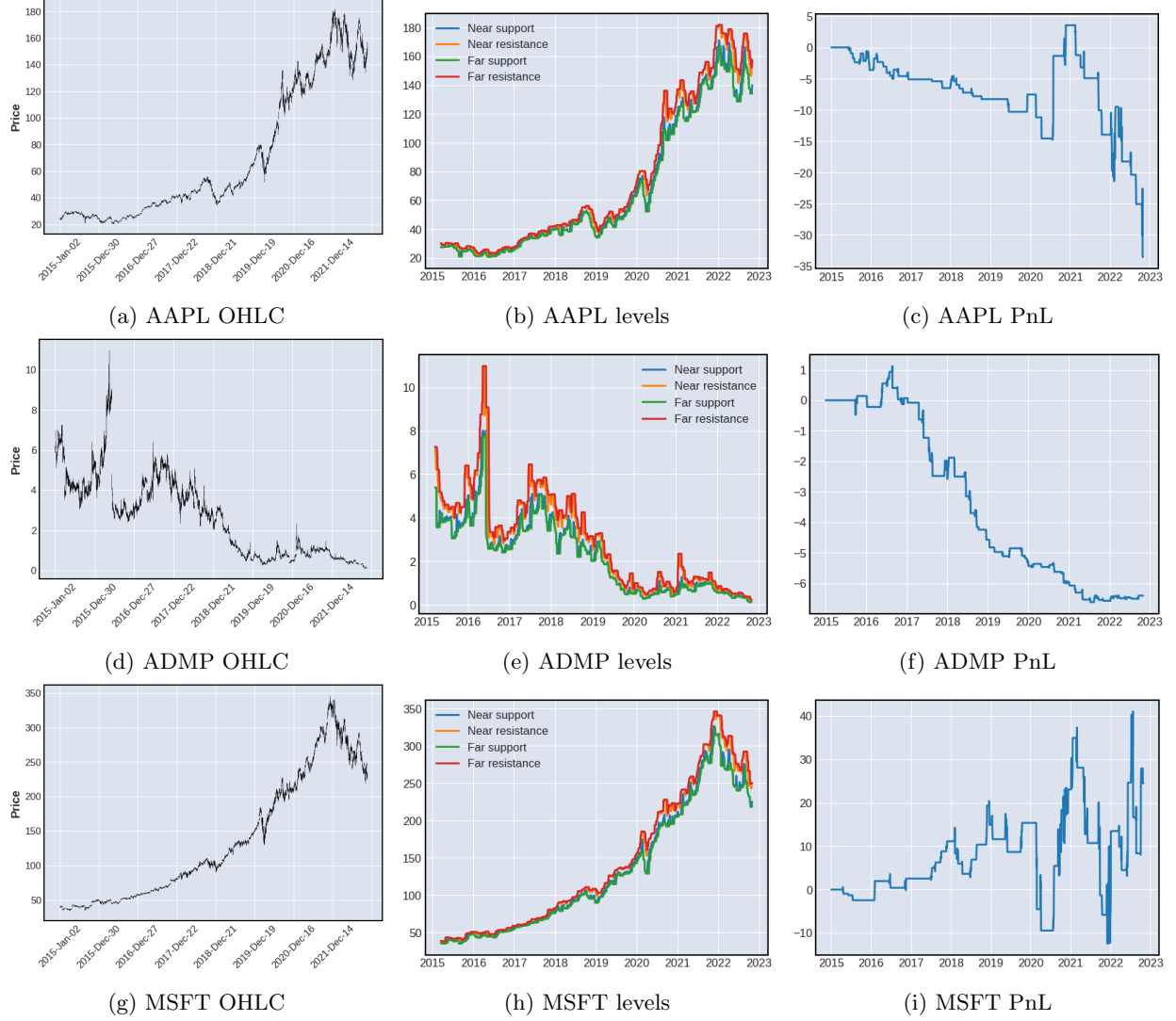


Figure 1: AAPL, ADMP, MSFT

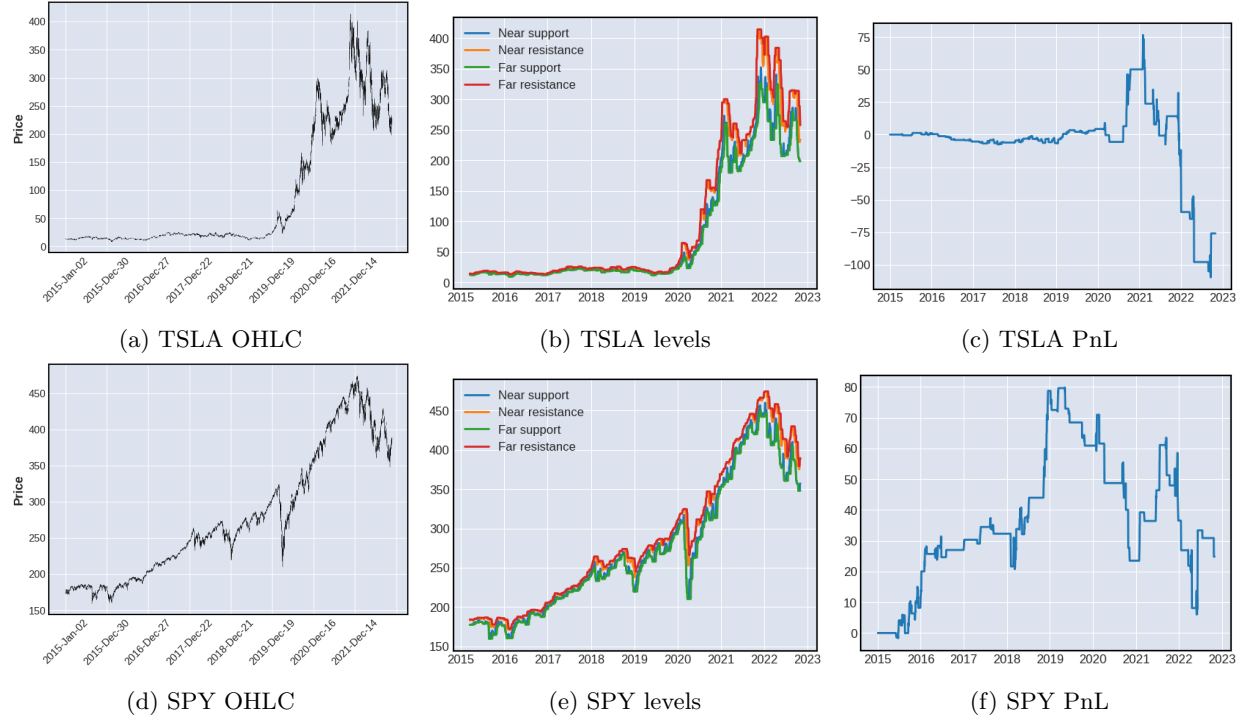


Figure 2: TSLA, SPY

Figure 1 and 2 are the results of back testing the GRAB algorithm with different assets. The PnL charts on the right for all assets are the portfolio value process over time. As we noticed, with zero initial portfolio value, AAPL, ADMP, TSLA all end up with losing money and MSFT, SPY end up with profits but not significant. The volatility of the PnL varies from one asset to another.

1.2 Strengths and Weaknesses

There are couple of weaknesses observed by the author:

1. Sometimes, the far and near term lines are the same. This happens when the N_f and N_n are close to each other. In this case, the system wants to buy and sell at the same time.

In my opinion, such case can be prevented by choosing the trend flipping trade only and ignore the near term swing trade. For example, if the trend flipped and the far and near support levels are equal, the GRAB system should choose to execute the exit procedure of the trend flipping case to sell the share if the trader is holding any, and do not simultaneously buy a share even if the near term support is reached.

2. A losing trade does not accompany every major trend reversal. A losing trade could also happen during the period of a major trend. Sometimes during a major trend period, the exit trade at near resistance level moves below the entry level executed earlier at its near support, therefore producing a losing trade. This is more likely to occur when the far and near parameters N_f , N_n are further apart.

In another word, not all losing trade happen at the trend reversal times, but also during major trend period from the swing trades. This happens if the near term band moves up and down within a much broader far term band and cause the sell price lower than the buy price. However, such issue can be minimized by choosing the N_n closer to N_f thus narrowing the gaps between far and near term levels. However, such solution needs a more scientific method to further quantify it.

3. The market is dynamic. Major events and section trends could potentially altered the price trend patterns. Fixing N_f , N_n parameters could cause entering and exiting a trade to be out of sync with market timing.

I do not see any strength of the GRAB algorithm, but I do observed other weaknesses in GRAB:

1. Exit trades are sent via limit orders, which means there's risk that the limit order may never get fulfilled. For example, when the trend is flipping from up to down, the system wants to exit the holding instrument at near resistance level, which may not be executed for a long period of time.
2. The exit procedures described by the author is ill-designed. For example, because $K_r^f \geq K_r^n > K_s^n$, when a trend is flipped from "down" to "up", the spot price is greater or equal to K_r^f which means buy limit at K_s^n is unlikely to be executed and setting another buy stop at K_r^f will invalidate the previously set buy limit at K_s^n . Same issue also exists in the other direction of trend flipping.
3. There's no scientific reasoning and assumption made on why the algorithm choose look-back maximum and minimum levels as major trends indicator. Therefore, we should be questioning the effectiveness using such measures.

2 Improvement

2.1 Optimal parameters selection

The trade process $G(t; N_f, N_n, T)$ is a function of two parameters N_f and N_n , and instead of fixing these two parameters during the entire trading period, I propose that one can use dynamic parameters at each time t using the optimal N_f^* and N_n^* . The optimal N_f^* and N_n^* are defined as follows:

$$N_f^*, N_n^* = \underset{0 < N_n < N_f < M}{\operatorname{argmax}} G(t; N_f, N_n, T) \quad (1)$$

where M is the the maximum bound allowed specified by the trader.

The idea is that we choose N_n^* and N_f^* such that its historical performance outperforms other N_n , N_f combinations up to time t . I tested this optimal strategy with the same assets and compared them with the fixed $N_n = 10$, $N_f = 20$ strategy. In each row of the charts in Figure 3, first two charts are the fixed parameter strategy and the next two are optimal parameter strategy. (The source code can be found at <https://github.com/YunfengLiu/ACTSC-972-project>)

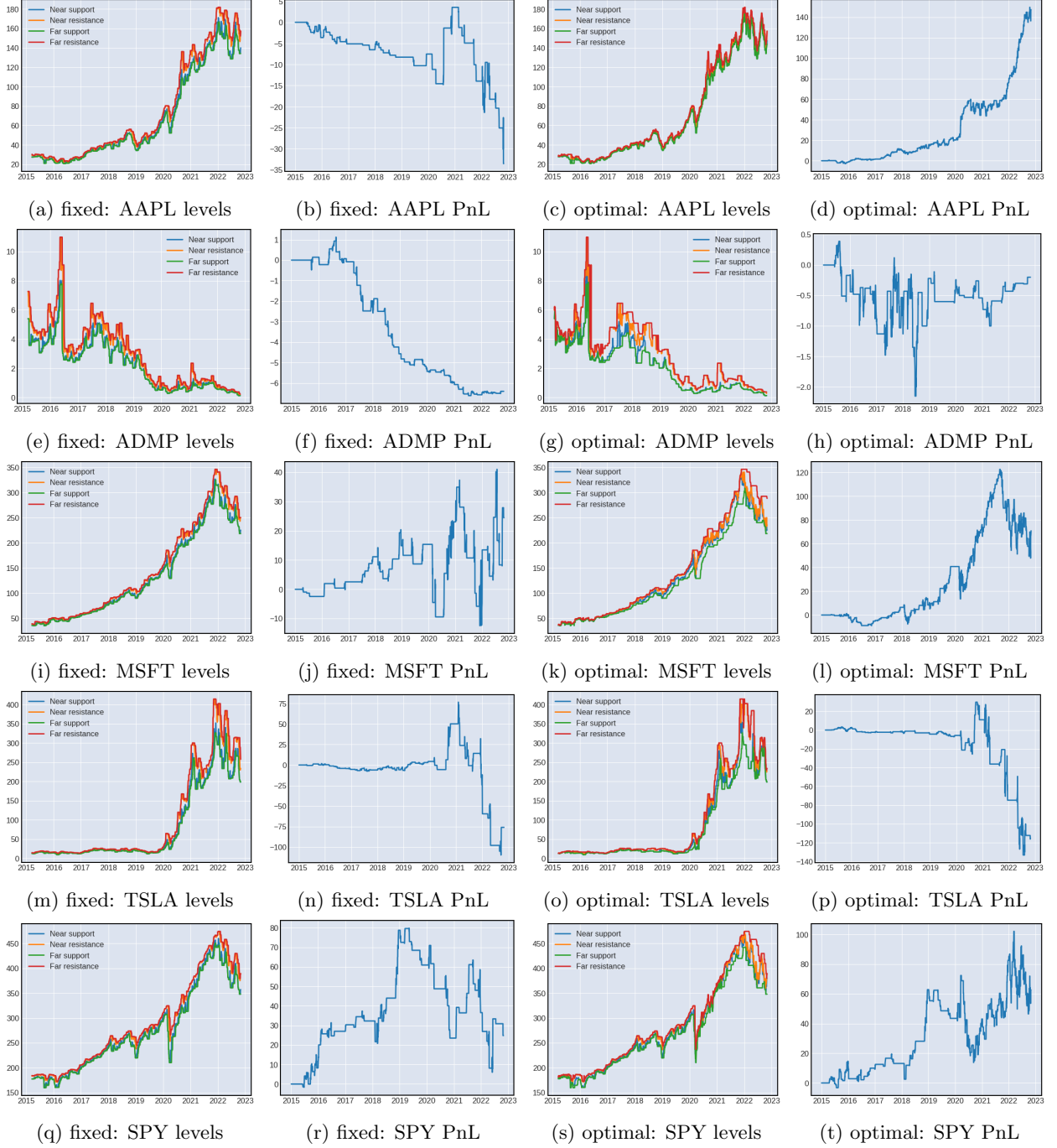


Figure 3: AAPL, ADMP, MSFT, TSLA, SPY

We observed that while AAPL is losing money using fixed parameters, it has turned into a profitable trade with the optimal parameter method. ADMP has reduced the loss of its PnL by choosing the optimal parameter method. However, the volatility of the new portfolio increased dramatically in this case. The support and resistance bands using the optimal N_n^* and N_f^* of all the tested assets are narrower than the fixed parameter

case. Moreover, the most optimal parameters produced on the 5 assets are less than or equal to 10, which means the best GRAB parameters are those that look back only few days in history and older market quotes are irrelevant in most cases.

Although the optimal parameter method looks promising, we can only conclude that the optimal parameter method can improve the GRAB's PnL in some cases. Further research on improving the optimal parameter method can be conducted in the future.

References

- [1] Mark Sleeman. “How to GRAB a Bargain Trading Futures . . . Maybe”. In: *Trend following: How to make a fortune in bull, bear, and black swan markets*. Ed. by Michael W. Covel. John Wiley Sons, 2017. Chap. 25.