Literature Review

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Papers on Trend Following

(Thomas et al. 2012)

The authors test whether a simple trend following strategy can outperform a buy and hold strategy on the S&P500. They alter the complexity of rules, trading frequency, and risk management rules, of the underlying strategy and analyze whether the modifications can improve returns. Finally, the technical strategy is compared with strategies that use fundamental metrics.

The authors analyze the following types of indicators:

1) Simple movig averages (10 to 450 day SMA analyzed)
2) Moving average crossover (25/50 to 150/350 day crossovers analyzed)
3) Breakout signals - index value at a 'x' day high (x ranges from 10 to 450)

The authors find that:

i) simple indicators and signals such as the 200 day SMA dominate the long only investment strategy,
ii) monthly trading frequency is superior to any higher trading frequencies,
iii) there is no benefit to using stop-loss rules,
iv) there is no evidence suggesting that fundamental metrics provide superior trading signals than technical indicators.

Thomas, Steve, James Seaton, Andrew Clare, and Peter N Smith. 2012. "Breaking into the Blackbox: Trend Following, Stop Losses, and the Frequency of Trading: The Case of the s&P500." *Stop Losses, and the Frequency of Trading: The Case of the S&P500 (March 10, 2012).*