Title:
The Evolution Of The Giant Turtle

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Summary:
If you look very closely, as I have, at both the Turtle system in particular as well as other trend following systems in general, there are some things that have changed slightly. An examination of ‘rolling’ five or ten year periods will show some smaller deteriorating statistics since the ‘formal’ origination of the trading method back in the early 1980’s. The total returns are slightly lower, the drawdowns are a little deeper, and the recovery periods are a little longer.

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Article Body:
You know, it’s true what they say. “The more things change, the more they stay the same!” It has been just about three years now, since January of 2003, that I wrote my now classic “I Was Wrong” article, admitting that trend following was not dead after all. And in the past couple of years, we have seen some good trending markets and some nice returns, with the Turtle computer model being up between 50% and 100% for 2003 and 2004 respectively. And while the current final yearly results are not quite in yet, although 2005 got off to a pretty rough start, it looks like a late rally in many of the markets is going to wind up giving us another profitable year.

But the truth of the matter is, if you look very closely, as I have, at both the Turtle system in particular as well as other trend following systems in general, there are some things that have changed slightly. An examination of ‘rolling’ five or ten year periods will show some smaller deteriorating statistics since the ‘formal’ origination of the trading method back in the early 1980’s. The total returns are slightly lower, the drawdowns are a little deeper, and the recovery periods are a little longer.

There are several reasons for this, most of which can be summed up under the wide umbrella of natural progression. On the one hand, we have the good old fashioned Darwinistic “survival of the fittest model”.

Hey, trading is basically still one big zero sum game, where somebody has to win, and somebody else has to lose. The winners are the smarter combatants, the losers will tap out and fall by the wayside (or even become 'brokers'). As with any competition, this means that eventually, you will have the winners competing against other winners, thus raising the bar for the entire level of competition, and making the whole damn game harder to begin with. At least that is the philosophical argument for what happens.

The technical argument is a lot more cut and dried, but it is basically the same story. In the 'old' days, whoever was the first and quickest to figure things out while they were still changing had a huge edge. But then along came that crutch to human thought, the computer. By the early 1990's everybody had one sitting on his desk, and the playing field had been greatly leveled. Information still flowed, but now it flowed faster, and everyone became more quickly aware of it. Which meant that all the traders on the outside were now able to more quickly adjust their positions and come back into line with whatever sudden new information had become available.

I have spoken at great lengths before about how and why trend following works, and the fundamental reasons that trends come about in the first place. Simply put, when something happens to either the supply or demand of a commodity (or stock), the equilibrium fair market value shifts, and the price moves to a new level. In the old days, sometimes it took a while for the market mechanism to find this new level, but nowadays, thanks to more powerful computer speed and efficiency, everything is all happening a lot faster.

The end result as far as we are concerned is two fold. First of all, the trends that do occur are more explosive coming out of the box, which means the trader has to be both quicker and more nimble, both jumping on board, and holding on. Secondly, and more importantly, is the fact that these trends don't run as far, or last as long, as they used to, before all the players have had a chance to adjust their positions, and the market (any market) comes back into balance.

To put it in Turtle terms, a good freeze or heat wave or embargo used to cause a market like Coffee or Soybeans or Crude Oil to run for months, and give us maybe a 40 N move before it was over. I remember a hot dry Summer in 1988 when Beans ran 40 N. I also remember that Crude Oil during the first Gulf War in 1991 ran for just about a 40 N profit as well. Hell, there was even a nice 40 N run in the Stock Indexes during the dot.com bubble of the mid 1990's. But in the past five years or so, I am hard pressed to think of any market that has had such a big super trend.

Back in the 1980's, these were the kinds of moves we got excited about, and we got one or two of them almost every year. 20 N moves were fairly common place, and 10 N was nothing that much to get excited about. But since the turn of the century, I think 20-25 N moves are about the largest I can recall seeing. I think Feeder Cattle last year at 23 N was the largest trend of the year, and a further problem is that not too many people even follow that (relatively) small market.

But remember, we still need these few big home run trades every year to pay for all the small losses and whipsaws and slippage and other costs of doing trading on a daily basis. The basic problem during the ‘difficult’ periods is not that we don’t get any trends, but that the trends we do get are not big enough or long enough to pay for all the other stuff. We are still trading in a distribution that has more losing trades than winning ones, so at least some of the few winners we do hit still have to be large enough to cover all the losses.

The question we face as continually evolving traders becomes, what, if anything, are we supposed to do about this kind of stuff. In the past, I have been a large advocate of the school of thought that says, “if it ain’t broke, don’t fix it”. Sure, the Turtles, or any other trend followers, were not getting the easy triple digit returns from two decades ago. But hey, we were still doing better than anybody else around, and I for one did not see a lot of reason to complain, or even get upset about it.

But my thinking has changed in the past couple of years. I’m no longer holding out for the 40 N outliers, because they just don’t come around that often any more. I have not gotten to the point where if I see a trend approaching 20 N profit, I start putting one foot out the door, and looking around for warning signs to get me to duck out quickly. Those warning signs will come in the form of some other types of indicators I have learned to pay attention to. But keep in mind that all of this is still just a math and probability decision, not one of fear or emotion or just ‘wanting’ to take a profit.

Without getting into too much of the detail, let’s just say that at some point it can still be obvious that if you have a reasonable minimum probability of catching a big move, you should try to hold out for it. On the other hand, if the chances are lower of that big move occurring, then at some point it has to become better to take the smaller but surer profit. And while the odds are not always so quantifiable, and this is as much art as it is science, let’s just say I have been getting better at it with more experience over the years.

The bottom line is that where I used to hold out as long as possible, often times after the trend had reversed on me, now I am quicker to exit first and ask questions later. And to be sure, I have left some money on the table when the trend kept going and I had gotten out prematurely. But I have also saved a lot more by recognizing when the party was over and getting out before everybody else ran for the door. And the funny thing is that one of my brokers thinks I have become a better trader, because he has always been an advocate of locking up a profit and putting some money in your pocket. But that is not the reason I do what I do, my criteria are technical and unemotional in nature.

Of course, Richard Dennis was always an advocate of using personal discretion to override mechanical technical criteria, the trick has been getting good at knowing how and when to do this. And I think this is something that cannot be taught, even by me, but just comes with experience. I can now look at half a dozen different things, including stochastics, market profiles, sentiment indicators, and even news reports, and somehow assimilate that all in my mind and decide when it ‘feels right’ to make a discretionary move.

Last year at Thanksgiving, I exited some Currency trends right near the top of the market. And this year, I got out of the Energies right after Hurricane Katrina, two days off the top. As I have gotten better at this, I have also been able to strengthen the courage of my convictions to stick to my guns and not second guess myself. In the past, if I would get out of a trade too early and it kept on going, I would think I made a mistake and then try to jump back in, ostensibly at a worse price than when I got out. Now, once I’m out, I have the patience and discipline to stay out, and fight the temptation to jump back in and whip myself around.

It seems when I am wrong, I am wrong by a little, because even if the move keeps going, it doesn’t go too far before it eventually peters out and turns around. I got out of the Yen last week, and have left about 1 N on the table so far. And I just got out of some Gold the other night, and right now it is sharply higher again (also by about 1 N). But when I’m right, as in Unleaded Gas this past August, I was able to save myself close to 10 N before the market reversed enough for the computer model to finally give a liquidation signal. So that seems like a pretty fair tradeoff for me. And it is also the big reason that my personal trading account is outperforming the Turtle computer model so far in 2005.

Russell Sands