



US best selling author Michael Covel for FUTURE:

SKILL-BASED RETURN

Trend following methods can make more of your money, but you also have to be ready to sit through choppy periods.

There is a low rumble. It's starting to appear in more and more print articles. Alpha. Everyone is talking about "alpha". Consider this excerpt from the New York Times:

"While that [alpha] may just be Greek to people far removed from Wall Street, when money managers talk about alpha, they are referring to investments that make money even when markets are slumping. It is the opposite of beta, the term applied to investments whose returns tend to track the market."

More importantly than simply making money "even when markets are slumping" (let's face it "slumping" can mean many different things to different people!), generating alpha is about 'skill'.

Skill-based trading is what trend followers do. It's what all great traders do. While many might argue over an exact definition, it makes sense to think of alpha as return a trader can generate up and above the index. Of course, many believe that a skill-based return is impossible. They believe the only return to be had is from following the "index". Trend Following: How Great Traders Make Millions in Up or Down Markets (New and Expanded Edition) lays out clear evidence of this skill in the form of detailed performance reports. Trend following to make money, and as a form of generating alpha, is very doable.

All this said, you only have to look around for a few minutes to find mass confusion among the financial press. For example, I was forwarded the following interview request last week: "What to Do with 2005 Winners/Losers -- Wall Street Journal (United States) I'm looking for investment strategists, money/portfolio managers, financial planners and professors to discuss what investors should do with the big stock winners and losers they hold from 2005 as 2006 approaches. This is for a Sunday Wall Street Journal article."

Don't exit profitable trends. I called this reporter, introduced myself and said that if you have winners - don't exit - keep riding the trend. I said you don't get rich taking profits, so if the trend is still on, stay with the trend. My explanation at its base level was a simple story of how traders generate alpha.

The media want "predictions". She was not buying my message. There was a long pause. Silence. She then said that she could not write that since it was not true. She wanted to know how I could say such a thing. I tried to explain the basics of following the trend. She did not "get" it and did not want to get it.

I was surprised for a moment that this reporter would not listen, but then again was it really a surprise? She of course wanted "predictions".

Sitting through choppy periods is alpha. Right after speaking with this Wall Street Journal reporter, I received a call from a key player at a trend following firm with a track record exceeding 15 years. They had a great November (up +15%) after a choppy most of 2005 (November recouped much of the year). We both agreed trend following is challenge. Meaning can you sit there in the midst of choppy markets waiting for the trend? Can you tolerate the pain of loss for the potential of gain? That's the life of the great traders. That's the life of those who make the millions. For this man, being able to sit through choppy periods waiting for trends is their skill. It's their alpha.

Why mention both of these people? With so many mixed messages zooming into our living rooms, critically picking apart the good, the bad and ugly is sometimes the only way to learn! 🐘



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is the founder and president of Trend Following™. As a researcher for the most successful trend following investment managers, he has been in the alternative investments industry consulting on trend following to individual traders, hedge funds and banks for ten years. His best-selling book, Trend Following: How Great Traders Make Millions in Up or Down Markets (Prentice Hall, May, 2004) is the most complete guide currently available on this fascinating subject. Mr. Covel is also Managing Editor at TurtleTrader.com®, the leading trend following news and commentary resource since 1996.

