

Contents

	Preface	11
	Companion Books	11
	Blog	11
	Educational Material	11
	AmiBroker Development Platform	12
	Excel Spreadsheets	12
	Intended Audience	12
	Organization of the Book	13
	The Author	13
1	Introduction	15
	Why Mean Reversion?	15
	Mean Reversion versus Trend Following	16
	System Overview	17
	Explanations	17
	KISS	20
	Trade-offs	21
2	Development and Analysis	23
	Technical Analysis	23
	The Signal and the Noise	24
	The Development Process	24
	Distributions	31
	The Importance of Consistency	34
	Risk	36
	Position Size	37
	Profit Potential	37
	System Health	37
	Dynamic	37

	Schematic of a Trading System	38
	Flowchart of System Development	39
	Dissonance Alert	40
	Managing Subjectivity with Objective Functions .	41
	Optimization and the Curse of Dimensionality	45
	Why Traders Stop Trading	47
3	Naive System	49
	Buy After an N-Day Sequence	49
4	Development Template	67
5	Transformations	69
	Indicators	69
	The Vertical Axis	71
	The Horizontal Axis	71
	Distribution of Indicators	72
	A Standard	73
	pdfs and CDFs	73
	Transformations	75
	Normalization	76
	Re-scaling	77
	Z Transformation	80
	Out-of-range Values	81
	Softmax Function	83
	Stationarity	87
	Indicators Demystified	87
	Moving Averages	88
	Moving Average Crossover	89
	Detrended Price Oscillator	91
	Position in Range	91
	DV2	94
	Rank Transformation	94
	Diffusion Index	99
	Stochastic	104
	RSI	104
	Exotic Indicators	112
	Back to the Vertical Axis	113
	Quality Matters	113

6	Exits	117
	Logic	118
	Holding Period	124
	Profit Target	127
	Trailing Exit	133
	Maximum Loss Exit	135
	Viewing Trades as Bars	135
	Summary	138
7	Entries	141
	Market on Close of Action Bar	141
	Next Day Open	143
	Limit Order	144
	Stop Order	145
	Future Leak	145
	Anticipating Action	146
8	Controlling Risk	147
	Filters—ATR	148
	Filters—Moving Average	159
	Position Size	163
	Options	163
9	Systems	173
	3 Day High Low	174
	Regime Change	192
	Connors RSI Pullback	198
	Dual Time Frame	201
	VIX	209
	Chapter Summary	216
10	Multi-System Systems	217
	Validation	218
	Degrees of Freedom	218
	Positive Correlation	219
	Using Equity Changes for Analysis	220
	Summary	221
11	It Doesn't Work Anymore	223

References	227
Program Listings	231
About the Programs and Listings	231
Downloadable Code	232
Index	235