



# Everything Moves.

Melissinos Trading bases its investment strategy, the Eupatrid Program, on following trends. Our intention is to monitor, measure and align with trends in the commodity and financial markets. No predictions are made regarding when or where markets may trend. We execute a reactionary rules-based approach that has been thoroughly researched on decades of data.

In the following article, Michael Melissinos, founder of Melissinos Trading, explains adapting to change, the practice of following trends and the problems with traditional long-only investing.

**Survival is all about adapting.** It is about assessing present conditions and adapting to them. The only constant in the markets and in life is change. Developing a system that accounts for change is a logical approach to increasing the chances of survival. By using a set of rules, a system can be designed to 1) measure change, 2) adapt to change and even 3) profit from change. One benefit a system has is that its rules can be back-tested to see how they would have performed in the past. At Melissinos Trading, we believe that organizing a system determining 1) market selection, 2) position sizing and 3) entry and exit points is the most effective way to manage money. It's transparent, efficient and inexpensive. After thorough research and back-testing, we have built tremendous confidence that our system prepares us for ever-changing market conditions.

I want to take this opportunity to outline the principles of Melissinos Trading's trading system, Eupatrid, and explain how we apply them to align investors capital with prevailing market trends. These principles have proven their value as Eupatrid has outperformed its peers since its 2011 inception.

## THE PROBLEM WITH THE TRADITIONAL APPROACH

The traditional approach perpetually buys and holds stocks, bonds and real-estate. There are three problems with this:

- 1) Profits can only come from these highly correlated markets, while disregarding opportunities in other areas.
- 2) Profits can only be generated when these markets go up, leaving capital at risk when their prices go down.
- 3) It predicts that these markets will always go up in value over time.

Historically, stocks, bonds and real-estate have produced similar patterns. They are largely driven by the state of the economy. When the economy grows, they tend to go up in value. When the economy contracts, they decline in value. It is important to understand that even though these sectors are fundamentally different, they produce similar results. Investors of the last 30 years have benefited from massive economic growth (thank you, internet). However, the last 13 years has seen two 50% stock market declines thus exposing the weaknesses of traditional long-only portfolios.

Given that buy-and-hold investors never sell any of their investments, they are constantly at risk of losing money when prices fall. Observing history, one can easily see that downtrends are frequent. Generally, they occur as economic supply and demand imbalances build up over time, but they also occur during unexpected events. Some examples of these include the 9/11 attacks, LTCM collapse and USA debt downgrade. Downtrends are not limited to stocks, bonds and real-estate either. They exist in all corners of the economy – occurring just as easily in commodities, currencies and interest rates. At Melissinos Trading, we understand that the only certainty is uncertainty. Eupatrid's approach is to prepare for changing conditions across all markets while adapting to them as quickly as possible.

Most investors and investment advisors consider downtrends as temporary. They believe that every downtick is an opportunity to invest more because the price will eventually go back up. Tell that to the people who did this during the dot-com collapse, the Financial Crisis or when stocks went bust such as Enron, Bear Stearns and Lehman to name a few. Sometimes, buying the dips works. But when minor dips evolve into major downtrends, investing more actually compounds the pain. Despite living through two of the biggest bull markets in history (1995-2000, 2002-2007), many investors have made very little, if any, progress over the past 13 years. The 50% declines post dot-com and in 2008 have kept investors stuck in the mud. A 13-year stretch without any growth is unacceptable. Eupatrid can help traditional investors protect gains made during bull markets by adapting to downtrends when they come.

There are alternative approaches to investing, but individuals generally have to do their own homework in order to find them. Eupatrid is one of those approaches. I built it in the years following the Bear Stearns collapse and Financial Crisis. Working at Bear during the collapse and J.P. Morgan during the Crisis, I was driven to challenge the traditional approach and find a better way.

## EXPOSING THE PORTFOLIO TO GLOBAL MARKETS

The most important factor in portfolio performance is market selection. One can only earn a profit from XYZ if he has a position in XYZ. At Melissinos Trading, we research ways that allow us to profit from market trends across the globe. We know that limiting our focus to a specific sector, like stocks, is inefficient because stocks do not always provide an opportunity to profit (i.e. stocks don't always trend). Our game is monitoring and following trends in all markets. This helps increase our odds of catching a big trend regardless of the market that produces it. We don't care where trends occur, but only that they occur.

Diversification helps smooth out a portfolio's return stream. The goal of diversification is to average out the gains from individual positions while reducing the portfolio's drawdown below each individual position drawdown. This allows investors to enjoy a smoother ride while not having to suffer as much downside volatility.

## ALIGNING WITH TRENDS

Fact: Betting against trends doesn't work. It's physically impossible. Observe surfers as an example. There's a reason they ride waves toward the shore instead of out to sea – because that's the direction the waves move. It's that simple. In markets, there are countless trends occurring in all different time-frames. Eupatrid focuses on capturing trends that play out of over months and years. These trends occur at a lower frequency, but a higher magnitude. Like a surfer, it lets many little trends (waves) go by instead waiting for that big one to ride.

I conducted a lot of research and used old-fashioned common sense when designing Eupatrid. I identified three truths about markets and life in general that became the foundation:

- 1) Everything moves.
- 2) Movement can be influenced by many different factors.
- 3) No one can predict what will move, when it will move or which direction it will move.

Regarding the first, without movement there is no chance for profit. For anyone to make a profit, they need a trend – a move from price A to a different price B. If both prices are the same, there is no trend and no profit. Next, market movement is a function of both fundamental data and humans' feelings towards that data. If the data is "good", but people don't like it, they sell and drive prices down. The opposite can happen as well. Ultimately, market participants are the final deciders of how markets move. This having been said, it is impossible to know how people will feel in the future. Without the ability to control other people's feelings, it's impossible to predict movement with any consistency.

Eupatrid understands these facts. Rather than pretend they aren't true, instead it elects to:

- 1) Monitor movement of all markets, not a concentrated group.
- 2) Align itself with this movement, not against it.
- 3) Hold positions that work and discard ones that do not.

Never predict, only react.

## TACTICAL ASSET ALLOCATION TARGETS OPPORTUNITY

We do not like distractions. Eupatrid only focuses on the price action of each market. It does not care about opinions on CNBC, Wall Street research, what day-traders are talking about on Twitter or what any other fund manager's positions are. It limits its focus only on what each market is doing since that is the only opinion that actually matters. This focus eliminates distraction allowing us to execute our system every day.

The first thing we do is construct a portfolio of different markets to monitor. It's important to diversify the markets traded since it increases the chances of profiting in different types of environments. For example, trading energy markets allows Eupatrid to take advantage of trends that may develop from geopolitical tensions, disruptions to supply and war; in currencies, trends may develop from monetary policy changes, economic growth or decline and governmental policy changes. The ability to capture trends in different areas for different reasons helps produce a more robust and balanced return stream.

Once a trend is detected, we allocate a fixed percentage of our capital. We always take the signal. Our back-testing efforts give us the confidence in every signal. We back-test to find a system with a long-term edge, so we do not have to second-guess the signals in real-time. Second-guessing is where many people go wrong. We avoid this by sticking to our system.

After a position is taken, we continue to monitor the market's daily movement. Eupatrid holds the position as long as the trend is intact, but abandon it immediately if the trend changes. We don't want to hold positions that go against us for very long. Eupatrid does not set price targets or predict future prices of any position it holds. It only follows along letting the price be its guide.

Focusing only on price is especially difficult for those who desire fundamental data to support market movement. For example, after stock markets bottomed in 2009 many people continued to hold a negative view towards the economy suggesting that stocks shouldn't be going up. Well, they did and have ever since. Those who needed a fundamental reason for the change in trend (i.e. improving GDP, employment data) in order to take a position, likely did not do so. They likely stood on the sidelines watching stocks trend higher month after month. A price-driven system designed to follow trends does not miss out on large moves like this.

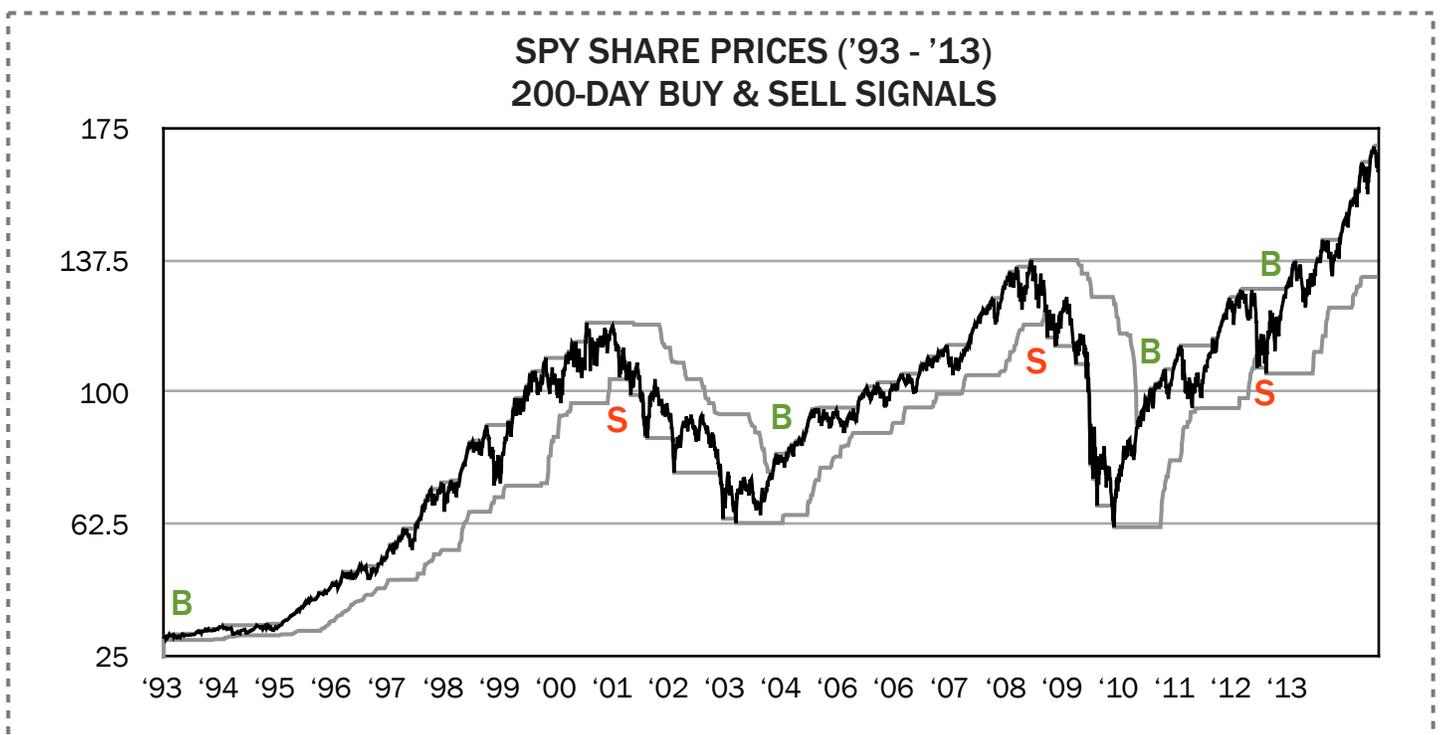
Eupatrid takes a long-term approach. It only enters and exits positions when prices break out of long-term ranges. It aims to filter out short-term noise that many investors get caught up with. Many investors enjoy focusing on the short-term since it keeps them busy and gives them a sense of control, but it inhibits their ability to profit from the biggest opportunities that live in the long-term time frames. Generally, trading on short-term time frames decreases profit potential while increasing transaction costs. We see this is as a grossly inefficient way to navigate markets.

### PUTTING EUPATRID TO THE TEST

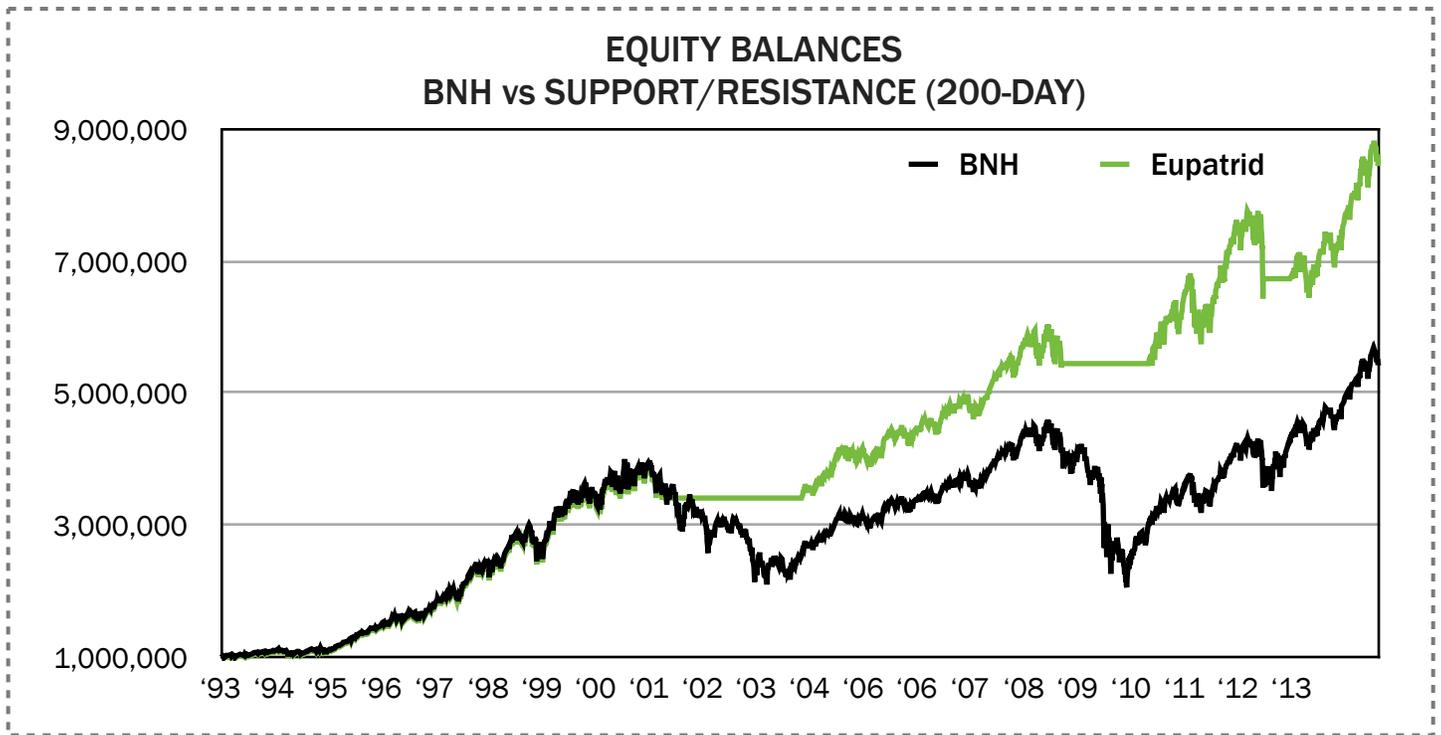
As an illustration of the reliability of Eupatrid's trade-timing parameters, below I show a head-to-head competition using its entry and exit methodology versus the buy-and-hold (BNH) strategy on the SPY (SPDR S&P 500 ETF Trust) from January 1993 through August 2013. Signals register after the close and enter orders on the open the following day.

The account starts with a hypothetical \$1,000,000 on January 1993. When Eupatrid registers a buy signal, it buys SPY shares with all available cash. When the system registers a sell signal, it sells all SPY shares and holds cash. As a control, the BNH strategy buys SPY shares with \$1,000,000 in January 1993 and holds through August 2013. In this test, as many variables as possible are removed to isolate the effect of Eupatrid. Interest earned on cash, trading commissions and tax effects are not included.

The chart below shows Eupatrid in action using 200-day support & resistance signals. Eupatrid buys when the SPY price breaks above long-term resistance and exits when breaks below long-term support. You may notice that Eupatrid buys and holds during uptrends, sits through sideways choppy markets and protects capital during large downtrends. The two most significant downtrends during this test, the post 9/11 bear market and 2008 crisis are avoided fairly easily. In 2008, support was breached in January – a full nine months before the “collapse” took place.



Below are the equity balances for the Eupatrid and BNH accounts. Eupatrid separates itself from BNH over time as it moves to the sidelines each time the trend changes downward. To me, this is a common sense tactic given that we do this in many other facets of our lives. For example, when it rains, we use an umbrella. We do not sit still becoming soaked “hoping” the rain will stop. No, we adjust to the new conditions as fast as possible.



The Eupatrid test outperforms BNH on an absolute return basis while incurring a much less maximum loss. While the BNH strategy does produce a solid rate of return, the maximum loss is 4x higher than Eupatrid’s. At a glance, it seems that adding a “trading with the trend” rule produces a more stable return stream than BNH.

	Buy and Hold	200-Day Support/Resistance
Ending Value	\$5,439,546	\$8,462,063
CAGR	8.58%	10.93%
Max Loss	-50.79%	-13.46%

*Past performance is not necessarily indicative of future results.*

## HEALTH-FOCUSED INVESTING

Following trends is not a new idea. Nature is based on trends. People have been following trends since they first became a species. Before that, flora and fauna followed trends to ensure their survival. The philosophy is based on adapting to evolving conditions in the now. It’s about learning from the past in order to make the right decisions today. The goal is to survive. It is not to eliminate losses from investing, but to manage them in a way that doesn’t kill us.

At Melissinos Trading, we focus on all things pertaining to our health – mental, physical and emotional. When focusing on these, investing becomes profitable and a more rewarding endeavor. We don’t believe in sacrificing health for financial gain. That makes no sense. Integrating investing into our lives helps support our overall health.

Following trends according to a well-researched system supports our mental health by giving us confidence that we are executing a time-tested strategy; our physical health by calming us during turbulent times; and emotional health by keeping us focused only on things we can control. Following trends is a natural fit for us and our investors. We believe having an open mind, reasonable expectations and a humble attitude combined with a disciplined system puts us in the best position to succeed.

## DISCLOSURE

**Commodity trading bears a high degree of risk. People can and do lose money. Past performance does not guarantee future results.**

The information presented in these materials is for general information purposes only. Nothing presented in these materials should be construed as a recommendation to buy or sell any security or to participate in any particular trading strategy. Trading in Commodity Futures is very risky. There is a possibility of substantial financial loss, greater even than monies initially invested. The simulated, hypothetical performance results presented here in have certain inherent limitations, due to the fact that the trades have not actually been executed. Simulated trading results, in general, may be influenced by the fact that the algorithms which generated them were designed in consideration of historical trends, and with the benefit of hindsight. Past real or hypothetical performance of Melissinos Trading LLC's systems is not a guarantee of future results, real or hypothetical. No representation is made that any trading account would, or would be likely to achieve profits or losses similar to the real or hypothetical results described herein. Melissinos Trading LLC ("the Advisor"), including but not limited to all agents and affiliates of the Advisor, participating in the distribution of information contained herein is held harmless and are without liability regarding any use whatsoever of the information presented in these materials or any related materials. Commodity Trading may not be suitable for all readers of this material. You, and not the Advisor, assume the entire cost and risks of any trading you choose to undertake. Under no circumstances shall the Advisor be liable for any special or consequential damages that result from the use of or the inability to use, materials provided by the Advisor. Applicable law may not allow the limitation or exclusion of liability or incidental or consequential damages, so the above limitation or exclusion may not apply to you. The information, data, and methodologies contained in these materials is not intended to be published or made available to any person in any jurisdiction where doing so would result in contravention of any applicable laws or regulations. Accordingly, if it is prohibited to make such information available in your jurisdiction or to you (by reason of your nationality, residence or otherwise) it is not directed at you. Before reviewing these materials you must be satisfied that doing so will not result in such a contravention and is not so prohibited, and by proceeding to review them you will be confirming that this is not the case. The Advisor has taken all reasonable care and precaution to ensure that the information is fair and accurate, or has been compiled from sources believed to be reliable. Nevertheless, the Advisor does not make any representations or warranty, express or implied, as to the accuracy, completeness, or fitness for any purpose or use of the information in these materials. The information may not in all cases be current, and it is subject to continuous change. Accordingly, you should not rely on any of the information contained in these materials as authoritative or a substitute for the exercise of your own skill and judgment in making any investment or other decision. The Advisor does not warrant that the information in these materials is error free, and shall not be liable for any direct, indirect, or consequential loss arising from any use of or reliance on the information contained in the materials.

**HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM.**

**ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR TO ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS WHICH CAN ALSO ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS AND ALL OF WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS.**