Letters to the Editor
Moving Average: Holy Grail or Fairy Tale

July 7, 2009

The following letters are in response to Ted Wong's article, Moving Average: Holy Grail or Fairy Tale - Part 2, which appeared last week.

Dear Mr. Wong,

I appreciated the first two parts on your moving average crossover strategy. However, I think that some flaws in your strategy would have to be addressed before initiating its use. In particular, I think that you underestimate the number of crossovers that will occur when the price approaches the moving average. For example, in Part 1 you indicate that a 12-month MAC averages less than one trade a year. In your response in the next issue, you indicate that your calculations were done assuming a trade will be made at the time of the crossover, or at the latest as of the close of that day.

By my calculations, using this strategy from January 2003 until today would have resulted in 40 trades, about six per year. Many of those trades would have been losers as you were whipsawed while the market tried to settle on a new trend. Methods to avoid this would include waiting for a close a certain percentage away from the moving average or waiting for the end of the month your average was broken and initiating your trade on the first of the next month. Either of these methods would obviously have a deleterious effect on your returns. I do not mean to dismiss the use of moving averages, but believe that anyone who plans to use this strategy should be aware of the issues surrounding its implementation

Thank You,

John O'Meara, CFP®
Managing Partner
Inner Harbor Advisors, LLC
New York, NY

Ted Wong responds:

John,

I appreciate your feedback. Many readers raised the same concern regarding whipsaws. I agree with you that the MAC method has many issues in real-life trading. I never intended to suggest that the MAC system is a realistic active management system. I only use it as a simple illustration to compare to the buy-and-hold results. Perhaps I should make this point clear in Part 3 before many advisors hasten to implement the MAC system in their practices.

Thanks for your advice.

Ted

Theodore:

Interesting article and eagerly awaiting Part 3. Your statement:

> "Even with the 2-month MA, MAC generates only 0.9 round-trip per year, or a holding period of 1.1 years."

intrigued my curiosity. Your buy sell/rule does not state any convention to avoid nasty whipsaws which seem to prevail in all MA timing signals, and which would dramatically increase round trips. How do you avoid whipsaws and achieve a relatively low turnover with even short (fast) range MA's? Does the answer lie in the apparent two-time period shift of the MA line?

Thank You

Bob Amory

Ted Wong responds:

Bob,

Thanks for your comments. The MAC system would no doubt suffer from whipsaws in non-trending markets. But over 138 years, there would have been enough bull and bear phases lasting an extended period of time which, in aggregate, would keep the average holding period down to 1.1 years. But I am sure that in those years when sideway markets prevailed, the 2-month MAC would have more than 0.9 round trips per year.

Hope this helps,

Ted

Ted,

I am curious about what constitutes a “cross” of the MA in your work. Does the MA have to be breached by 1%? 5%? A quick look at the last twenty years finds plenty of breaches of the 10-month MA that were not sustained, both in rising and declining markets.

Thanks,

Michael F. Hussey, CFA
Senior Investment Analyst
Mid-Continent Capital, LLC
Chicago, IL

Ted Wong responds:

Mike,

You are right; MAC is not the Holy Grail. Whipsaws could happen in sideways markets. I use MAC as an illustrative example to disprove the buy-and-hold doctrine, not necessarily as the best active investment system.

"Cross" in my articles simply means the intersection of the index and its MA, and not a 1% or 5% threshold above or below the MA line.

Hope this helps.

Ted

Mr. Wong,

I am enjoying and learning from your articles in *Advisor Perspectives*. I am in the early stages of leaning to manage my own funds. Along with apparently many others, I have questioned the mantra of my two financial advisors over the years regarding “buy and hold” only to be told they had studied it until “their hair fell out.”

I started my personal education without the old-school brain washing that “buy and hold” returns cannot be beaten. As you state in your articles, those “theories” need to be quantitatively tested even if they have been around for decades. I believe that your work will lead to a paradigm shift in the asset management industry around the world for advisors that truly have their client’s best interest at heart. Moving funds in and out of the equity market based on technical analysis requires much more work and agility. Some advisors may have to be awakened from their “buy and hold” sleep.

The results of objective, empirical research such yours often is controversial and could create fear for some in the industry because of the need to change the norm. That takes a lot of time, effort and money.

Advisor Perspectives is a great platform for this debate. I hope that if any readers can refute your results that they will submit their studies for publication.

Needless to say, as a new subscriber, *Advisor Perspectives* is a piece of my portfolio management curriculum

I look forward to your next segment in the study.

Steve Bolton

Mr. Wong,

I have been studying Part 1 and Part 2 of your moving average theory and am very impressed with your findings. I look forward to your results in Part 3.

I have one question: If you were to omit the Great Depression years from your research, would your findings be different?

My theory is that the market may have been set back so significantly that it hasn’t had a chance to catch up with the 6-month MA. So, if someone were to invest starting in 1940 until the present day, what would this look like?

Dan Borchard

Ted Wong responds:

Hi Dan,

You read my mind. That will be covered in Part 3.

Thanks for your comments.

Ted