Connors Research Trading Strategy Series

S&P 500 Trading with ConnorsRSI

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Section 1

Introduction

After moving from Los Angeles (the entertainment capital of the world) to New York City (the financial capital of the world) in 2007, I gained the opportunity to spend quality time with many top traders and money managers located in the City. One of the gentlemen who I had the good fortune to spend an afternoon with ran a well-respected trading firm. His background included being an equity trader on two exchanges over three decades with his specialty being trading in S&P 500 stocks. His philosophy was a lot like a number of professionals who learned to trade before the internet boom/bust of the late 1990's-early 2000's. His philosophy was **"only buy quality".**

What does "buy quality" mean? In his mind it was companies which have been in business for decades; household names that he knew and understood. It's interesting because this is the same philosophy popularized by Warren Buffett. But whereas Buffett tends to buy and hold these stocks, this gentleman made his living (a very good living) trading in and out of these same stocks. He felt that holding quality companies for a few days was far safer than holding high volatility companies which he had barely heard of.

Everyone who succeeds in the financial markets does so because they trade at "comfort points". This gentleman's comfort point (as is Buffet's) was to be in stocks that he knew and that would likely be in business for years to come. He had no interest in owning companies he hadn't heard of. He told me he "liked sleeping at night and owning these companies allowed him to sleep at night." If you share this same philosophy of "buying quality", you're in good company.

When I asked him how he traded, he smiled and said coyly, I "buy low and sell high". I cordially smiled back and then probed further. Ultimately he opened up and without divulging his exact strategy the basis of his philosophy was this:

1.   The majority of money invested in the United States is done by money managers. The majority of that money is pension money. These managers have a mandate to be in quality companies. The best place to find and invest in quality companies is in the S&P 500.

2.   The majority of this money that invests in S&P 500 stocks is usually buy and hold money.

3.   When given the opportunity, these money managers, especially the value buyers, look to buy these stocks if they become cheaper over a short period of time. The better ones know a value when they see one and will allocate more capital to their positions to take advantage of the lower prices.

4.   Buying at lower prices provides a "short-term cushion" to these stocks.

5.   This cushion often allows prices to stabilize and then rise again (it's the core philosophy of mean reversion trading). Having seen it on the floor and then within his trading firm for decades, he understood that there's big money out there waiting to buy more shares at cheaper prices, which increases the probability of the stock prices moving higher (we'll back this up with statistics in the upcoming chapters).

At the end of the day, he knows that big money will always be there in companies he knows and trusts. When he's wrong, he looks to get out. When he's right he makes his money and then moves on to his next positions.

This simplicity in trading makes a lot of sense. Intuitively it's correct. In no way does it mean that every S&P stock behaves this way every time because it does not. S&P 500 stocks like Enron, Lehman and many major banks (especially in 2008) went lower and in some cases out of business. But professional traders are great at understanding what's going on (value buyers buying at lower, better prices), why it's going on (in the majority of cases it's simply a short-term pullback), and they are able to measure the probabilities of the stock moving higher. In this Strategy Guidebook, we're going to provide you with the statistics that support the type of buying behavior discussed above.

How the Tests Were Run

1. We looked at every S&P 500 stock from January 2001 through the first quarter of 2013 (the final quarter ahead of writing this Guidebook).
2. All stocks are included, including the Enrons, Lehmans. etc.
3. All trade signals were generated on the close. Entries took place the next day using a limit order, and exits were executed the next day as a simulated market order using the average price of the day.
4. Slippage and commissions were not included.

Taking into account all simulated trades from this strategy from over a twelve year period of time, you will learn that as this gentleman stated to me in 2009, <u>big institutions like to buy value when they see it</u>. And they often know that because many markets are somewhat efficient longer-term, short-term values often don't last long. And therefore they provide wonderful opportunities for smart traders, like the gentleman mentioned above, to buy these S&P 500 stocks and quickly sell them for profits; oftentimes within a few days.

What you will see in the upcoming chapters are exact rules. Buy low and sell high is nice to know, but we don't want generalities. <u>We want specific, non-optimized, simple-to-apply rules</u> to be able to successfully trade S&P 500 stocks. We will give you the rules, the many parameters you can apply with the rules, and the full test results for more than a decade. By the time you've completed this Strategy Guidebook, you'll know when to buy S&P stocks, when to exit them, and the historical returns for the 12 ¼ years of testing; a period where the market dropped, rose, crashed, and then rebounded -- all in all a rough time for long-term investors. But it was a great time for people who knew when to buy and sell the stocks within the S&P 500 Index.

We hope you enjoy this Strategy Guidebook. After reading the Guidebook if you would like to learn more about trading S&P 500 stocks, please come to our website at www.tradingmarkets.com or click here.

Let's now move ahead.

Section 2

Strategy Rules

The *ConnorsRSI S&P 500 Trading Strategy* executes trades using a simple three-step process consisting of Setup, Entry and Exit. The rules for each of these steps are detailed below.

A **Setup** occurs when all of the following conditions are true:

1. The stock is a current member of the S&P 500.
2. The stock closes with a ConnorsRSI(3,2,100) value less than W, where W is 5 or 10.
3. The stock's closing price is in the bottom X % of the day's range, where X = 25, 50, 75 or 100.

 If the previous day was a Setup, then we **Enter** a trade by:

4. Submitting a limit order to buy the stock at a price Y % below yesterday's close, where Y is 2, 4, 6, 8, or 10.

After we've entered the trade, we **Exit** when:

5. The stock closes with a ConnorsRSI value greater than Z, where Z is 50 or 70.

Let's look at each rule in a little more depth, and explain why it's included in the strategy.

Rule 1 simply limits our trading universe to the S&P 500 stocks.

Rule 2 uses ConnorsRSI to identify a price pullback. A complete description of ConnorsRSI may be found in the Appendix.

Rule 3 determines the extent to which the price has continued to decline heading into the close. Note that variations which use a value of 100 for X are essentially eliminating this rule, i.e. every possible price would be in the bottom 100% of the range. We included this value so that you could see the results of not using Rule 3.

Rule 4 allows us to enter the trade at an optimal price. We're taking an already oversold stock as measured by ConnorsRSI and then waiting for it to become even more oversold on an intraday basis. Because the intraday price drop is occurring for a second consecutive day, it's often accompanied by a great deal of fear. Money managers get especially nervous and often tell their head traders to "just get me out" after they've made the decision to sell. This panic helps create the opportunity.

Rule 5 provides a well-defined exit method. Few strategies have quantified, structured, and disciplined exit rules. **Rule 5** gives you the exact parameters to exit the trade, backed by over twelve years of historical test results. As with all other strategy parameters, we select in advance the type of exit that we will use, and apply that rule consistently in our trading.

Not everyone is available to close their trades right as the market is closing. Therefore, in our testing we closed all trades the day after the Exit signal occurred. To simulate placing a market order at a random time during that day, we use an exit price that is equal to the average of the open, high, low and close for the day: Exit Price = (Open + High + Low + Close) / 4

* * *

Using the different variations of the rules above has historically generated an extremely high percentage of winning trades. We'll take an in-depth look at the test results in Section 3, but for now here's a quick preview of the top 20 strategy variations when sorted by highest win rate:

Top 20 Variations By Highest Win Rate

# Trades	Avg % P/L	Win Rate	Entry CRSI	Closing Range	Limit %	Exit CRSI
278	14.8%	86.0%	5	25	10	50
278	16.9%	84.9%	5	25	10	70
318	13.3%	84.0%	5	50	10	50
317	15.0%	83.0%	5	50	10	70
415	11.2%	82.9%	5	25	8	50
414	12.7%	82.9%	5	25	8	70
325	12.9%	82.8%	5	75	10	50
328	12.8%	82.6%	5	100	10	50
324	14.6%	81.5%	5	75	10	70
327	14.5%	81.4%	5	100	10	70
481	11.6%	81.1%	5	50	8	70
483	10.3%	81.0%	5	50	8	50
493	9.9%	79.9%	5	75	8	50
498	11.2%	79.9%	5	100	8	70
491	11.2%	79.8%	5	75	8	70
500	9.8%	79.6%	5	100	8	50
626	9.4%	77.6%	5	25	6	70
629	7.9%	77.1%	5	25	6	50
652	9.4%	76.8%	10	25	10	50
788	8.7%	76.0%	10	50	10	50

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Finding a quantified, back-tested strategy that produces a profit on 75% of trade signals is somewhat unusual; having 20 different variations that all generate winners 76 - 86% of the time is a testament to the power and consistency of the ConnorsRSI S&P 500 trading strategy!

* * *

Now let's see how a typical trade looks on a chart. For the example below, we'll use a strategy variation that requires the ConnorsRSI value to be below 10 and the closing price to be in the bottom 25% of the day's range. The limit order will be placed 6% below the Setup day's closing price. We will exit when ConnorsRSI closes above 70. In terms of our strategy rules above, that means W = 10, X = 25, Y = 6, and Z = 70.
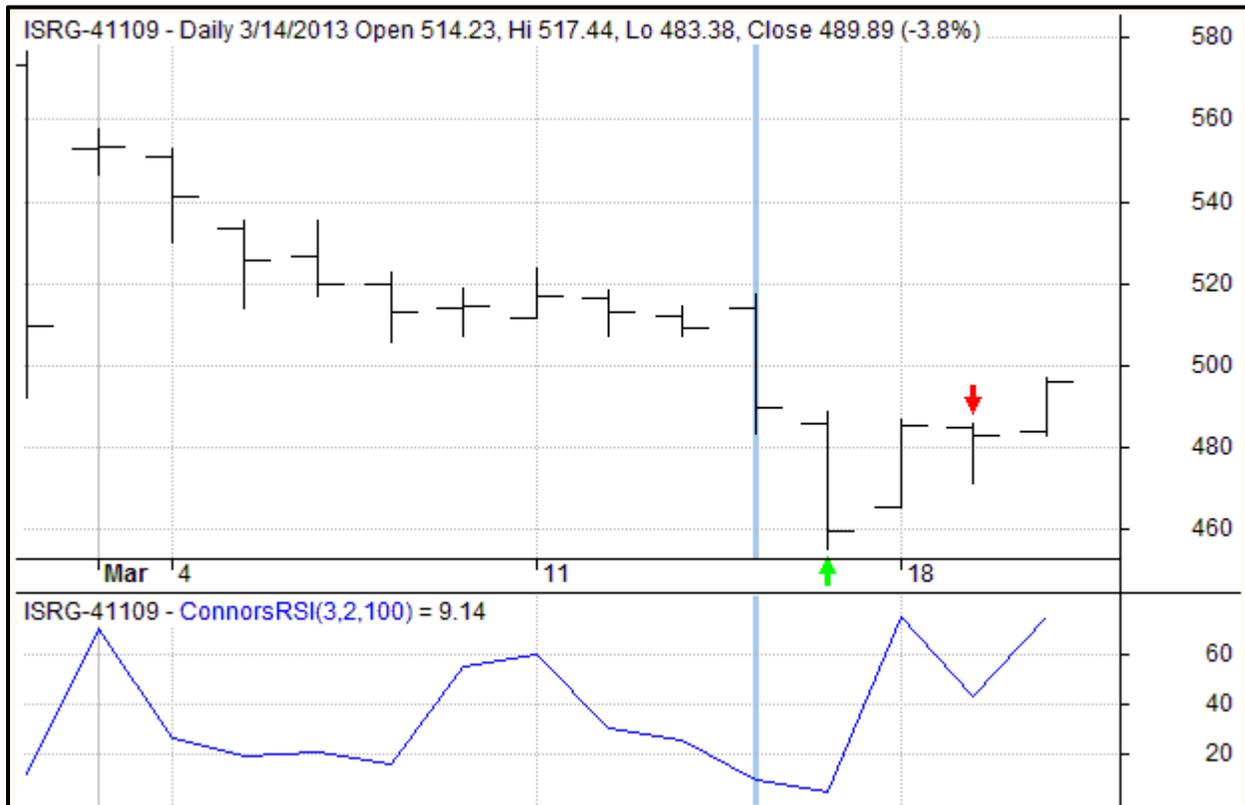
Figure 1: ISRG Trade

The chart above is for *Intuitive Surgical, Inc.*, whose symbol is ISRG. In the chart, the top pane shows the price bars in black, and the vertical blue-gray line marks the currently selected day which also happens to be the Setup day. The green up arrow marks the entry day, and the red down arrow indicates the exit day. The lower pane shows ConnorsRSI as a blue line. Now we'll confirm that each of our entry and exit conditions were correctly met.

Rule 1 requires that the stock be a member of the S&P 500, which ISRG is.

Based on our strategy parameters, **Rule 2** requires the ConnorsRSI(3,2,100) value to be below 10 on the Setup day, which it is: the value shown on the chart on the entry day is 9.14.

Rule 3 states that the stock must close in the bottom 25% of the day's range. The closing range can be calculated as:

Closing Range = (Close – Low) / (High – Low)
= ($489.89 - $483.38) / ($517.44 - $483.38)
= 6.51 / 34.06 = 19%

Since all three Setup rules have been satisfied, we enter a limit order for the next trading day. Our selected strategy variation tells us to use a limit of 6% below the Setup day's closing price, so we would use a limit price of:

Limit Price = Close x (1 – Limit %)
= $489.89 x (1 - .06)
= $489.89 x 0.94 = $460.50

We can see on the chart that on the day after the setup occurs, the price of ISRG falls well below $460, so our limit order gets filled at the limit price of $460.50.

On the very next trading day, March 18, 2013, the price of ISRG closes at $485.52, resulting in a ConnorsRSI value of 75.33. Since this is above our exit threshold of 70, we exit the trade. Notice that the red Sell arrow actually appears the next day, March 19th. As explained previously, this is because our testing simulates an exit using a market order the day <u>after</u> the exit signal occurs. In this instance, the average price of $481.24 on the exit day is slightly less than the closing price on the signal day, so waiting until the next day to exit our trade actually cost us a bit of our gain. However, we still captured a pre-commission profit of 4.5% in just two days:

Profit = Gain (or Loss) / Cost Basis

= ($481.24 – $460.50) / $460.50

= $20.74 / $460.50 = 4.5%

Let's look at another example using the same strategy parameters. The chart below is for Lincoln National (LNC), and uses the same conventions as the previous chart.
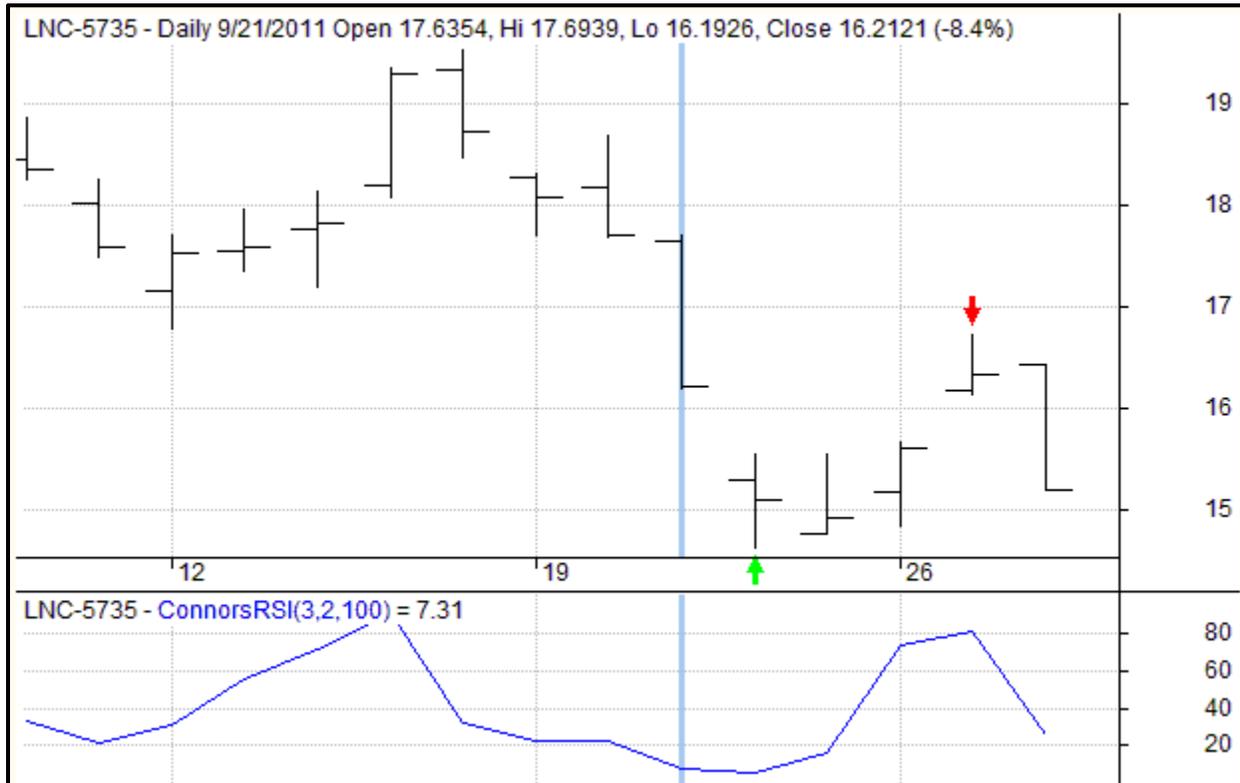
Figure 2: LNC Trade

The Setup day for this trade was September 21, 2011, a day which triggered many setups for this variation of the strategy. As per **Rule 1**, LNC is a member of the S&P 500, and as per **Rule 2** the ConnorsRSI value closed below 10 with a value of 7.31.

Although we could calculate the closing range, it is very easy to see from the chart that the closing range is extremely low. The closing price was only two cents above the low, on a day that the total price range was a dollar and a half ($17.69 – $16.19). A little mental arithmetic tells us that the closing range was less than 2%, verifying what our eyes already knew. Therefore, **Rule 3** has been satisfied and all of our Setup conditions have been met.

We place a limit order on September 22nd using a limit price of $15.24, which is 6% below the Setup day's closing price of $16.21. Since the intraday price fell below $15.00, our order gets filled and we enter the trade.

The next day the intraday price of LNC rallies, but ultimately closes below our entry price. Interestingly, the ConnorsRSI value rises slightly despite the decrease in price, but is still well below our exit target of 70.

On September 26th, the price of LNC rises sufficiently to cause the ConnorsRSI value to close at 73.47, which triggers our exit. We get out of the trade the next day, when the average price is $16.33. Unlike the first example, in this case we actually benefit from closing the trade the day after the exit signal occurs, as the closing price on the signal day was $15.61.

Our testing has shown that this is typical behavior for many robust strategies. When comparing a strategy variation that exits trades at the close with one that exits the next day using average price, the long-term results are generally quite similar. Individual trades may perform better under one scenario than the other, but over time these differences tend to average out.

Our final example in this section will use strategy parameters that are designed to get in and out of trades quickly and frequently. We'll still look for a ConnorsRSI value (W) below 10 on the Setup, but we'll use a closing range (X) of 50, a limit (Y) of 2%, and an exit threshold for ConnorsRSI (Z) of 50.

Figure 3: MTG Single-Day Trade

The chart above is for MGIC Investments (MTG). Although MTG was removed from the S&P 500 in October 2008, at the time of this trade it was still a member. Thus we have satisfied **Rule 1**.

The ConnorsRSI value on the Setup day is 3.45, meeting our **Rule 2** criterion of a value less than 10. The closing price is equal to the low, making our closing range equal to zero and satisfying **Rule 3.**

Having met all our Setup criteria, we enter a 2% limit order on June 24th at a price of $7.55. The low price on June 24th was $7.28 (below our limit price), so our order was filled.

Notice what happens next: the price on June 24th closes at $8.14, resulting in a ConnorsRSI value of 68.44, which is well above our exit threshold of 50. Therefore we close the trade the next day at an average price of $8.32, recognizing a tidy gain of over 10% in approximately 24 hours. Had we been executing our exits at the close rather than on the day following the exit signal, we would have held this trade for less than 7 hours!

Now that you have a good understanding of the trade mechanics, we'll look at the historical test results for different variations of the strategy.

Section 3

Test Results

We can never know for sure how a trading strategy will perform in the future. However, for a fully quantified strategy such as the *ConnorsRSI S&P 500 Trading Strategy* described in this Guidebook, we can at least evaluate how the strategy has performed in the past. This process is known as "back-testing".

To execute a back-test, we first select a group of securities (sometimes called a watchlist) that we want to test the strategy on. In our case, the watchlist consists of past and present members of the S&P 500.

Next we choose a timeframe over which to test. The longer the timeframe, the more significant and informative the back-testing results will be. The back-tests for this Guidebook start in January 2001 and go through the end of March 2013, the latest date for which we have data as of this writing.

Finally, we apply our entry and exit rules to each stock in the watchlist for the entire test period, recording data for each trade that would have been entered, and aggregating all trade data across a specific strategy variation.

One of the key statistics that we can glean from the back-test results is the *Average % Profit/Loss*, also known as the *Average Gain per Trade*. Some traders refer to this as the *edge*. The Average % P/L is the sum of all the gains (expressed as a percentage) and all the losses (also as a percentage) divided by the total number of trades. Consider the following ten trades:

Trade No.	% Gain or Loss
1	1.7%
2	2.1%
3	-4.0%
4	0.6%
5	-1.2%
6	3.8%
7	1.9%
8	-0.4%
9	3.7%
10	2.6%

The Average % P/L would be calculated as:

Average % P/L = (1.7% + 2.1% - 4.0% + 0.6% - 1.2% + 3.8% + 1.9% -0.4% + 3.7% + 2.6%) / 10
Average % P/L = 1.08%

Average % P/L is the average gain based on <u>invested</u> capital, i.e. the amount of money that we actually spent to enter each trade.

For short-term trades lasting three to ten trading days, most traders look for an Average % P/L of 0.5% to 2.5% across all trades. All other things being equal, the larger the Average % P/L, the more your account will grow over time. Of course, all other things are never equal! In particular, it's important to consider the Number of Trades metric in combination with Average % P/L. If you use approximately the

same amount of capital for each trade that you enter, you'll make a lot more money on ten trades with an average profit of 4% per trade than you will on one trade that makes 10%.

Another important metric is the *Winning Percentage* or *Win Rate*. This is simply the number of profitable trades divided by the total number of trades. In the table above, 7 of the 10 trades were profitable, i.e. had positive returns. For this example, the Winning Percentage is 7 / 10 = 70%.

Why do we care about Win Rate, as long as we have a sufficiently high Average % P/L? Because higher Win Rates generally lead to less volatile portfolio growth. Losing trades have a way of "clumping up", and when they do that, the value of your portfolio decreases. This is known as *drawdown*. Those decreases, in turn, can make you lose sleep or even consider abandoning your trading altogether. If there are fewer losers, i.e. a higher Winning Percentage, then losses are less likely to clump, and your portfolio value is more likely to grow smoothly upward rather than experiencing violent up and down swings.

* * *

Let's turn our attention to the test results for the different variations of the *ConnorsRSI S&P 500 Trading Strategy*. First, we'll sort the test results to show the 20 variations that produced the highest Average % P/L.

Top 20 Variations Based on Average Gain

# Trades	Avg % P/L	Avg Days Held	Win Rate	Entry CRSI	Closing Range	Limit %	Exit CRSI
278	16.9%	3.2	84.9%	5	25	10	70
317	15.0%	3.3	83.0%	5	50	10	70
278	14.8%	2.3	86.0%	5	25	10	50
324	14.6%	3.4	81.5%	5	75	10	70
327	14.5%	3.4	81.4%	5	100	10	70
318	13.3%	2.3	84.0%	5	50	10	50
325	12.9%	2.4	82.8%	5	75	10	50
328	12.8%	2.4	82.6%	5	100	10	50
414	12.7%	3.4	82.9%	5	25	8	70
481	11.6%	3.5	81.1%	5	50	8	70
491	11.2%	3.6	79.8%	5	75	8	70
415	11.2%	2.4	82.9%	5	25	8	50
498	11.2%	3.6	79.9%	5	100	8	70
647	11.0%	4.1	75.6%	10	25	10	70
483	10.3%	2.4	81.0%	5	50	8	50
808	10.2%	4.3	75.1%	10	75	10	70
816	10.2%	4.2	74.9%	10	100	10	70
779	10.1%	4.2	75.5%	10	50	10	70
493	9.9%	2.4	79.9%	5	75	8	50
500	9.8%	2.4	79.6%	5	100	8	50

Below is an explanation of each column.

 # Trades is the number of times this variation triggered from January 1, 2001 –March 31, 2013.

Avg % P/L is the average percentage profit or loss for all trades, including the losing trades, based on invested capital. The top 20 variations have all shown positive gains ranging from just under 10% to nearly 17% over the 12+ year testing period. When the Average % P/L is broken down on an annual basis, 15 of these 20 variations show positive results for all 13 years! Once again, that speaks to the consistency of the strategy.

Avg Days Held is the average trade duration expressed as a number of days. In all cases it's less than a week, and in several variations it's less than 3 days.

Win % is the percentage of simulated trades which closed out at a profit. Most of the top 20 variations have win rates over 75%, with several in the mid 80's. This is a high percentage of profitable trades in a world where many traders are aiming for 60%.

Entry CRSI corresponds to Rule 2 of the strategy, which states that the ConnorsRSI value must be below the entry threshold. Recall that we tested with ConnorsRSI thresholds of 5 and 10. As you might expect, the lower ConnorsRSI values dominate the list.

Closing Range corresponds to Rule 3 of the strategy. A closing range of 25 is the most restrictive criterion, while a closing range of 100 encompasses all possible scenarios for the closing price, and thus effectively neutralizes Rule 3.

Limit % is related to Rule 4 of the strategy, and determines the limit price that will be used to enter the trade. We tested limits of 2, 4, 6, 8 and 10% below the Setup day's close.

Exit CRSI is the ConnorsRSI value that must be exceeded to signal an exit. Note that the more stringent exit criterion (higher ConnorsRSI exit threshold) generally produces longer trade durations. We'll discuss this in more detail in a future section.

Next, let's look at the strategy variations that have historically had the highest rate of profitable trades. These are the same variations presented in the previous chapter, but with some additional columns in the table.

Top 20 Variations By Highest Win Rate

# Trades	Avg % P/L	Avg Days Held	Win Rate	Entry CRSI	Closing Range	Limit %	Exit CRSI
278	14.8%	2.3	86.0%	5	25	10	50
278	16.9%	3.2	84.9%	5	25	10	70
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500	9.8%	2.4	79.6%	5	100	8	50
626	9.4%	3.7	77.6%	5	25	6	70
629	7.9%	2.4	77.1%	5	25	6	50
652	9.4%	2.6	76.8%	10	25	10	50
788	8.7%	2.6	76.0%	10	50	10	50

All 20 of the top variations have historically produced a profit on over 75% of the identified trades! Combined with the information presented in the previous section on Average % P/L, you can see that we have a strategy that historically has won consistently while producing excellent edges.

Section 4

Selecting Strategy Parameters

In previous chapters we have described the different values we tested for strategy parameters such as ConnorsRSI entry threshold (W), closing range (X), entry limit % (Y) and ConnorsRSI exit threshold (Z). In this section we'll discuss some things to consider as you decide which variation(s) to use in your trading.

Let's talk conceptually about entries and exits for a moment. Both entry and exit rules can be thought of in terms of how strict they are, i.e. how easy or difficult they are to achieve. You might also say that strictness is a measure of how frequently or infrequently the rule conditions occur. For oscillators such as ConnorsRSI, values that are closer to the extremes (0 and 100) are more strict (less likely to occur) than values that are in the middle of the range.

Stricter entry rules will be satisfied less frequently than more lenient entry rules, and thus a strategy that relies on the stricter rules will generally generate fewer trades than a strategy whose entry rules are more easily satisfied. With a robust strategy, the reward for fewer trades is usually a higher gain per trade, on average. If you buy a slightly oversold stock, it's most likely to have a moderate rebound. But if you wait for the stock to become extremely oversold, the chances are much higher that it will have a significant bounce and create a bigger profit.

In contrast to entry rules, the strictness of exit rules has little effect on the number of trades generated by the strategy. However, just like the entry rules, stricter exit rules typically result in higher average profits. Why? Because stricter exit rules tend to keep you in your trades for a longer time, giving the stock more time to experience the mean reversion behavior that we're attempting to exploit with a strategy like the *ConnorsRSI S&P 500 Trading Strategy*. Thus, for entries the tradeoff is between more trades and higher gains per trade, while for exits the tradeoff is between shorter trade durations and higher gains per trade.

* * *

Now let's turn our attention back to the strategy described in this Guidebook. In the table below, we compare eight variations of the strategy that all use the same limit entry (6%) and the same exit method (ConnorsRSI > 70). Only the ConnorsRSI entry threshold and Closing Range (the Setup variables) are different.

Variations with Constant Limit % and Exit ConnorsRSI

# Trades	Avg % P/L	Avg Days Held	Win Rate	Entry CRSI	Closing Range	Limit %	Exit CRSI
626	9.4%	3.7	77.6%	5	25	6	70
1629	5.7%	4.4	71.6%	10	25	6	70
731	8.2%	3.8	75.9%	5	50	6	70
1953	5.1%	4.5	70.1%	10	50	6	70
751	7.9%	3.8	75.5%	5	75	6	70
2061	5.0%	4.5	69.8%	10	75	6	70
761	7.9%	3.9	75.6%	5	100	6	70
2087	4.9%	4.5	69.7%	10	100	6	70

Notice that the first two entries in the table have identical strategy parameters except for Entry ConnorsRSI threshold. The first entry uses a stricter requirement of 5, and has generated 626 trade signals since 2001, with an Average % P/L of 9.4%. The second variation uses a more lenient criterion of 10 for the ConnorsRSI threshold, and has generated 1629 trade signals with an Average % P/L of 5.7%. The same pattern holds true when comparing the third and fourth entries, the fifth and sixth entries, and the final two entries.

We see that the pattern also holds true if we compare all the entries with the same ConnorsRSI entry threshold, that is, the first, third, fifth and seventh entries in the table. As the Closing Range becomes more lenient, the number of trades increases while the Average % P/L decreases. Likewise for entries 2, 4, 6 and 8.

It should come as no surprise that the pattern emerges again when we hold all parameters constant except the Limit % used to determine the limit entry price. If we keep the Setup conditions constant, then there will obviously be more stocks that experience a price drop of 2% or greater the next day than there will be those that drop by at least 6%.

Variations with Different Limit % Entries

# Trades	Avg % P/L	Avg Days Held	Win Rate	Entry CRSI	Closing Range	Limit %	Exit CRSI
779	10.1%	4.2	75.5%	10	50	10	70
1181	7.6%	4.3	72.8%	10	50	8	70
1953	5.1%	4.5	70.1%	10	50	6	70
3593	3.1%	4.7	68.4%	10	50	4	70
8052	1.5%	4.9	66.6%	10	50	2	70

We have confirmed that stricter entry rules result in fewer trades but higher average gains. Now let's look at the exits. Here we again hold the Setup criteria constant, but for two different Limit % values we vary the exit threshold:

Variations with Different ConnorsRSI Exit Thresholds

# Trades	Avg % P/L	Avg Days Held	Win Rate	Entry CRSI	Closing Range	Limit %	Exit CRSI
1181	7.6%	4.3	72.8%	10	50	8	70
1196	6.5%	2.7	72.4%	10	50	8	50
3593	3.1%	4.7	68.4%	10	50	4	70
3652	2.6%	2.7	66.9%	10	50	4	50

The first two entries both use a Limit of 8%, and as we predicted earlier, they've generated very similar numbers of trade signals. However, the variation that uses the stricter ConnorsRSI exit threshold of 70 has an average trade duration of 4.3 days, as compared to the 2.7 day average duration of the variation using an exit threshold of 50. Also as expected, the Average % P/L is slightly lower with the more lenient exit threshold. The same pattern can be seen with the last two entries, which both use a Limit of 4%.

Armed with this information, you will now be able to select strategy parameters that are most likely to produce the number of trade signals, average gains, and trade duration that best complement your overall trading plan.

Section 5

Using Options

*Please note that the options section in the majority of the **Connors Research Trading Strategy Series** is the same because the strategy set-ups often involve large moves in brief periods of time. In our opinion, and confirmed from friends who are professional options traders (one with over three decades of experience); there is one best way to trade moves like these.*

Options trading has been a major growth industry over the past 5 years in the markets. This is because spreads have tightened, liquidity has increased, and the ability to easily trade complex options has never been simpler.

We'll now focus on applying options trading to the short-term market moves we have just learned. Like everything else in this Guidebook, there are definitive rules as to how to execute an options trade when a strategy signal triggers.

Here is what we know based upon the data:

1. The majority of the moves from entry to exit have been held a very short period of time (2-10 trading days).

2. The average gains per trade have been large – well beyond the normal distribution of prices over that short period of time.

3. A high percentage of the moves have been correct.

When we look at this type of behavior, it can lead to many strategies but one strategy stands out (and this has been confirmed by professional traders). **The strategy is to buy front month, in-the-money long calls.**

Why front month in-the-money long calls? Because they will move most closely to the stock itself. And the closer an option moves with the stock, the greater the gain will be on a percentage basis when the move is correct.

Here are the rules.

1. A signal triggers.

2. Buy the front month in-the money call. If you were to normally buy 500 shares of the stock, buy 5 calls (every 100 shares should equal one call).

3. Exit the options when the signal triggers an exit on the stock.

Let's go further:

1. What does in-the-money exactly mean here?

In this case it's defined as <u>one to two strike prices in the money</u>. If the stock price is at 48, buy the 40 or 45 calls.

2. What does front month mean?

Because the holding period is so short, you want to trade the options whose monthly expiration is the closest. If the closest month is 7 trading days or less from the front month's option expiration date (meaning the second Thursday before or closer) use the following month as the one to trade.

3. What happens if I'm in the position and it expires yet the signal for the stock is still valid?

In this case, roll to the next month. You're trading the stock signals so you want to have exposure to that signal.

4. What about liquidity and spreads?

There's some discretion here. There is no hard and fast rule as to what exactly liquidity means in options. Many traders look for minimum volume and/or open interest to determine liquidity.

Assuming there is active volume in the options, look at the spreads. If the option is trading 3.00 bid -3.30 offer, the spread is 10%. Can you really overcome a 10% spread? Not likely. Now compare this to an option that's trading at 3.25 bid – 3.30 offer. This is far more acceptable and tradable.

5. What are the advantages of buying call options instead of the stock?

Assuming the spreads and liquidity are there, the advantages are large:

1. Greater potential ROI on capital invested.

2. Less money tied up.

3. Less points at risk. This means if a stock signals at 50, it can lose up to 50 points. The options can only lose up to the premium you paid. So, if you bought the 45 calls, the risk is only the premium.

4. There's greater flexibility. For example, let's say the stock triggered a buy signal at 50 and you paid $5.50 for the 45 calls. If the stock immediately moves higher (let's say to 56); you have choices here. You can exit, or you can roll into the 50 calls getting most of your money out and now turning this into a nearly free trade if you believe that prices will continue to run.

There are numerous examples like this and you can find these types of strategy opportunities in most options books. But trading anything exotic or different than simply buying the calls is against the advice of the many professionals we posed this question to.

In conclusion, options provide traders with a good alternative to buying the stock outright. The structured methodology for our strategies is: front-month, in-the-money, with equivalent sizing (1 option per 100 shares), and exiting when the signal exits.

The above options strategy, in many experts' opinion, is the best and most efficient strategy based upon the historical data from these signals.

Section 6

Additional Thoughts

1. As you have seen throughout this Guidebook, the *ConnorsRSI S&P 500 Trading Strategy* has had large quantified edges when applied in a systematic manner.

2. There are literally dozens of potential variations for you to use. By adjusting the input variables described in the rules, you can customize how the strategy will perform for you. Want more trades? Look at variations with a higher ConnorsRSI entry value or Closing Range. Bigger average returns? Check out the variations that have the strictest entry criteria (low entry value for ConnorsRSI and high Limit %) and longest durations (ConnorsRSI 70 exit method). Want to get in and out of trades more quickly to reduce overnight risk and free up your capital for other trades? Try the variations that utilize the ConnorsRSI 50 exit method.

3. What about stops (and we include the answer to this in all our Strategy Guidebooks)?

We have published research on stops in other publications including in our book *Short-Term Trading Strategies That Work.*

What we have found is that stops tend to lessen performance and in many cases they completely remove edges. Yes, it feels good when a stock keeps moving lower and lower and a stop got you out. On the other side, the research which is backed by up to two decades of test results on many short-term trading strategies suggests that stops get hit often and accumulate many, many losses. Few trading strategies can overcome these aggregated losses.

For many traders stops are a must. Psychologically it allows them to take trades, especially difficult trades. Whether you use them or not is a personal choice. On the whole though, the edges you see in this strategy and many other short-term strategies are lower when stops are applied to them. Again this is a personal choice only you can make for yourself. We know successful traders in both camps.

4. Slippage and commission were not used in the testing. Factor them into your trading (the entries are at limit prices so slippage is not an issue) and make sure you're trading at the lowest possible costs. Most firms are now allowing traders to trade for under 1 cent a share, so shop your business, especially if you are an active trader. The online brokerage firms want your business.

We hope you enjoyed this addition to the **Connors Research Trading Strategy Series**. If you have any questions about this strategy please feel free to email us at info@connorsresearch.com

Appendix:

The ConnorsRSI Indicator

Larry Connors and Connors Research have been developing, testing, and publishing quantified trading strategies since the mid-1990's. During that time, we have had the opportunity to evaluate a great number of different technical indicators and to assess their effectiveness in predicting future price action. Now we've taken the next step and created an indicator of our own: ConnorsRSI. In this chapter we will describe the indicator and provide details on its calculation.

ConnorsRSI is a composite indicator consisting of three components. Two of the three components utilize the Relative Strength Index (RSI) calculations developed by Welles Wilder in the 1970's, and the third component ranks the most recent price change on a scale of 0 to 100. Taken together, these three factors form a *momentum oscillator*, i.e. an indicator that fluctuates between 0 and 100 to indicate the level to which a security is overbought (high values) or oversold (low values).

Before we discuss how to calculate ConnorsRSI, let's review Wilder's RSI. RSI is a very useful and popular momentum oscillator that compares the magnitude of a stock's gains to the magnitude of its losses over some look-back period. Wilder himself believed that 14 periods was the ideal look-back. We often use the shorthand notation RSI(14) for the 14-period RSI. The formula below computes RSI(14) for a series of price changes:

$$RSI = 100 - \frac{100}{1 + RS}$$

RS = Average Gain / Average Loss

Average Gain = [(previous Average Gain) x 13 + current Gain] / 14
First Average Gain = Total of Gains during past 14 periods / 14

Average Loss = [(previous Average Loss) x 13 + current Loss] / 14
First Average Loss = Total of Losses during past 14 periods / 14

Note: "Losses" are noted as positive values.

RS = Average of x days up closes / Average of x days down closes

If we wanted to compute RSI for a different number of periods (N), then we would replace 14 in the formula above with N, and replace 13 with N-1. Regardless of the number of periods used in the calculation, the result will always be a number between 0 and 100. Traders who use RSI(14) typically look for values greater than 70 to identify overbought conditions, and values less than 30 to indicate oversold conditions.

Our previous research has shown that using shorter look-back periods makes RSI more effective in predicting short-term price movements. We have published many strategies that utilize RSI(2), as well as several that use RSI(3) and RSI(4). Changing the number of periods also has an effect on the RSI levels

that best identify overbought and oversold conditions. For example, an RSI(2) value of less than 10 is usually a reliable indicator of an oversold condition, while an RSI(2) value over 90 is a good benchmark for an overbought condition.

Now let's turn our attention back to ConnorsRSI. As mentioned previously, ConnorsRSI combines three components, and as you might guess, they are all elements that our research has repeatedly shown to have significant predictive ability:

Price Momentum: As we just discussed, RSI is an excellent way to measure price momentum, i.e. overbought and oversold conditions. By default, ConnorsRSI applies a 3-period RSI calculation to the daily closing prices of a security. We will refer to this value as RSI(Close,3).

Duration of Up/Down Trend: When the closing price of a security is lower today than it was yesterday, we say that it has "closed down". If yesterday's closing price was lower than the previous day's close, then we have a "streak" of two down close days. Our research has shown that the longer the duration of a down streak, the more the stock price is likely to bounce when it reverts to the mean. Likewise, longer duration up streaks result in larger moves down when the stock mean reverts. In effect, the streak duration is another type of overbought/oversold indicator.

The problem is, the number of days in a streak is theoretically unbounded, though we could probably place some practical limits on it based on past experience. For example, we might observe that there have been very few instances of either an up streak or a down streak lasting for more than 20 days, but that still doesn't get us to a typical oscillator-type value that varies between 0 and 100.

The solution is two-fold. First, when we count the number of days in a streak, we will use positive numbers for an up streak, and negative numbers for a down streak. A quick example will help to illustrate this:

Day	Closing Price	Streak Duration
1	$20.00	
2	$20.50	1
3	$20.75	2
4	$19.75	-1
5	$19.50	-2
6	$19.35	-3
7	$19.35	0
8	$19.40	1

The closing price on Day 2 is higher than on Day 1, so we have a one-day up streak. On Day 3, the price closes higher again, so we have a two-day up streak, i.e. the Streak Duration value is 2. On Day 4, the closing price falls, giving us a one-day down streak. The Streak Duration value is negative (-1) because the price movement is down, not up. The downward trend continues on

Days 5 and 6, which our Streak Duration reflects with values of -2 and -3. On Day 7 the closing price is unchanged, so the Streak Duration is set to 0 indicating neither an up close nor a down close. Finally, on Day 8 the closing price rises again, bringing the Streak Duration back to 1.

The second aspect of the solution is to apply the RSI calculation to the set of Streak Duration values. By default, ConnorsRSI uses a 2-period RSI for this part of the calculation, which we denote as RSI(Streak,2). The result is that the longer an up streak continues, the closer the RSI(Streak,2) value will be to 100. Conversely, the longer that a down streak continues, the closer the RSI(Streak,2) value will be to 0. Thus, we now have two components -- RSI(Close,3) and RSI(Streak,2) -- that both use the same 0-100 scale to provide a perspective on the overbought/oversold status of the security we're evaluating.

Relative Magnitude of Price Change: The final component of ConnorsRSI looks at the size of today's price change in relation to previous price changes. We do this by using a Percent Rank calculation, which may also be referred to as a "percentile". Basically, the Percent Rank value tells us the percentage of values in the look-back period that are less than the current value.

For this calculation, we measure price change not in dollars and cents, but as a percentage of the previous day's price. This percentage gain or loss is typically referred to as the one-day return. So if yesterday's closing price was $80.00, and today's price is $81.60, the one-day return is ($81.60 - $80.00) / $80.00 = 0.02 = 2.0%.

To determine the Percent Rank, we need to establish a look-back period. The Percent Rank value is then the number of values in the look-back period that are less than the current value, divided by the total number of values. For example, if the look-back period is 20 days, then we would compare today's 2.0% return to the one-day returns from each of the previous 20 days. Let's assume that three of those values are less than 2.0%. We would calculate Percent Rank as:

Percent Rank = 3 / 20 = 0.15 = 15%

The default Percent Rank look-back period used for ConnorsRSI is 100, or PercentRank(100). We are comparing today's return to the previous 100 returns, or about 5 months of price history. To reiterate, large positive returns will have a Percent Rank closer to 100. Large negative returns will have a Percent Rank closer to 0.

The final ConnorsRSI calculation simply determines the average of the three component values. Thus, using the default input parameters would give us the equation:

ConnorsRSI(3,2,100) = [RSI(Close,3) + RSI(Streak,2) + PercentRank(100)] / 3

The result is a very robust indicator that is more effective than any of the three components used individually, and in most cases, also more effective than combining the three components independently.

Receive ConnorsRSI Readings for Free from the TradingMarkets Screener

Ticker ▲	Close Price ⇕	ConnorsRSI ⇕	RSI2 ⇕	RSI4 ⇕	VR ⇕	HV10 ⇕	HV100 ⇕	ADX10 ⇕	U/D ⇕	Return2 ⇕	Return5 ⇕	StretchMA5 ⇕	%b ⇕
AHL	$37.42	7.19	2.91	14.98	1	12.78	15.04	17.65	-4	-2.02	-3.31	-2.10	-0.22
BIOS	$13.21	9.83	0.27	8.45	3	10.25	33.51	24.25	-8	-1.05	-3.93	-1.59	-0.09
BMRN	$62.43	8.71	5.01	20.13	3	38.11	29.74	23.70	-4	-3.21	-9.32	-5.14	-0.09
CCU	$31.25	5.91	1.77	9.74	2	21.40	18.23	18.79	-3	-4.08	-6.16	-4.15	-0.34
CMCSA	$41.52	6.41	4.35	16.80	1	17.92	18.87	27.26	-3	-3.15	-3.87	-3.03	-0.37
CMCSK	$39.86	7.14	3.88	17.11	1	17.88	17.18	31.56	-3	-3.21	-3.44	-2.98	-0.41
CPB	$45.78	8.62	6.76	24.09	1	25.53	15.85	39.07	-3	-4.33	-1.36	-3.43	-0.48
CYNO	$23.67	8.93	2.66	12.07	2	19.53	28.35	29.32	-4	-3.90	-5.66	-3.77	-0.23
DDC	$14.98	8.71	0.48	7.69	--	12.99	0.00	25.08	-6	-0.93	-5.37	-1.27	0.04
EC	$43.47	9.84	1.52	7.37	2	12.21	23.49	62.55	-3	-3.03	-2.64	-2.27	-0.41

http://analytics.tradingmarkets.com/Screener/

The S&P 500 Low-Volatility Growth Portfolio

Are You Looking For Growth In Bull Markets & Safety In Bear Markets From Your Investments With S&P 500 Stocks?

Introducing: The S&P 500 Low-Volatility Growth Portfolio Growth in a Bull Market, Safety in a Bear Market

You don't need an introduction to S&P 500 stocks. But you may need a better way to trade them -- to maximize your returns.

The majority of money in retirement pension and retirement accounts is in S&P 500 stocks. This is where the safer money likes to invest.

S&P 500 companies tend to be bigger and safer companies. Many are Fortune 500 companies with worldwide operations selling products to millions of customers.

- When the stock market rises, you want to own solid S&P 500 stocks.

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The S&P 500 Low-Volatility Growth Portfolio delivers trading signals for S&P 500 stocks, providing you an optimized balance of both growth and safety for your capital.

In rising markets you are long blue chip stocks. In declining markets you are in cash.

Would you like the potential to earn returns like these -- from S&P 500 stocks?

Sample simulated historical back-test results from The S&P 500 Low-Volatility Growth Portfolio.

YEAR	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	ANNUAL
2001	3.29%	2.07%	2.14%	0.94%	0.22%	-1.44%	3.04%	0.65%	-1.38%	0.61%	1.37%	1.72%	+13.93%
2002	3.13%	0.36%	3.51%	0.61%	1.67%	0.49%	0.14%	2.40%	-0.85%	2.21%	0.25%	1.31%	+16.23%
2003	1.28%	0.13%	-0.73%	4.03%	5.92%	2.09%	1.40%	5.38%	-0.79%	4.36%	3.26%	4.29%	+34.90%
2004	1.19%	3.82%	0.49%	-1.53%	3.03%	2.69%	-1.65%	1.46%	1.72%	0.18%	4.23%	3.74%	+20.94%
2005	0.54%	3.69%	0.90%	-0.62%	3.17%	0.78%	4.49%	-1.07%	2.00%	-0.63%	3.87%	1.43%	+19.99%
2006	3.58%	2.39%	2.11%	1.54%	-3.22%	2.06%	1.54%	2.21%	2.51%	3.04%	-0.50%	2.48%	+21.41%
2007	1.89%	1.11%	1.91%	4.19%	2.30%	-1.11%	-0.36%	4.91%	2.57%	2.32%	-1.27%	-0.07%	+19.79%
2008	-3.89%	1.19%	-1.05%	1.70%	1.58%	-0.88%	2.18%	-0.53%	-0.53%	-1.46%	0.06%	0.01%	-1.76%
2009	0.03%	0.14%	-0.11%	0.00%	2.03%	0.64%	2.14%	3.32%	4.67%	-0.27%	3.55%	3.89%	+21.77%
2010	-1.49%	3.46%	4.54%	1.95%	-3.48%	-2.60%	5.31%	-1.26%	3.66%	4.49%	2.41%	2.66%	+20.93%
2011	0.87%	4.08%	3.09%	2.86%	0.82%	-0.33%	-2.24%	-3.00%	1.86%	3.64%	0.25%	0.74%	+13.11%
2012	1.28%	2.36%	2.51%	1.99%	-1.70%	3.82%	3.15%	0.33%	0.95%	-0.57%	0.29%	0.87%	+16.23%
2013	3.99%	0.48%	-	-	-	-	-	-	-	-	-	-	+4.49%

You Already Learned This Over the Past Decade…'Buy and Hold' is Dead!

You understand that markets change -- as they have over the past decade. In order to take advantage of changing market conditions, The S&P 500 Low- Volatility Growth Portfolio is constantly reviewed, monitored, and updated by Connors Research.

The back-test results indicate that The S&P Low-Volatility Growth Portfolio consistently outperforms the S&P 500 on "buy & hold".

Sample equity curve for $100K invested in The S&P 500 Low-Volatility Growth Portfolio vs. the S&P 500.
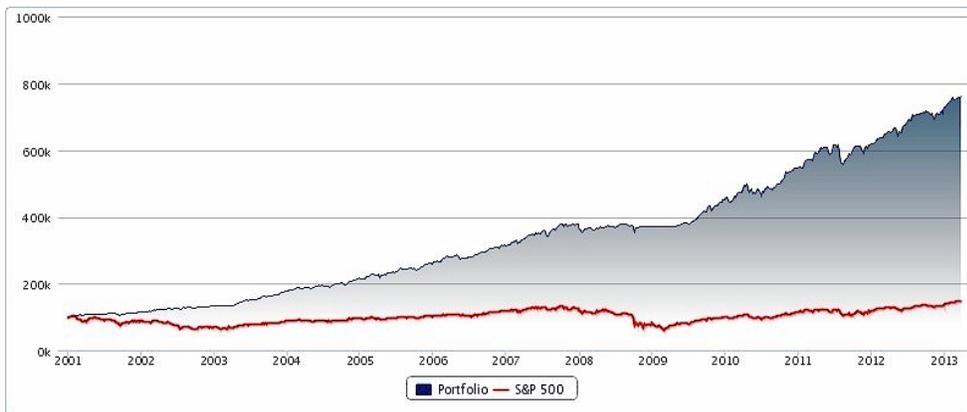
If you would like to see a presentation on *The S&P 500 Low-Volatility Growth Portfolio* click here. If you would like to order and have immediate access to it please click here or call toll free 888-484-8220 ext. 3 (outside the US please dial 973-494-7311 ext. 3).

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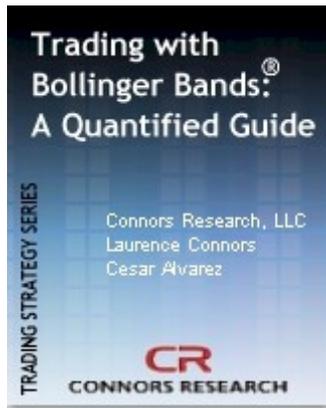
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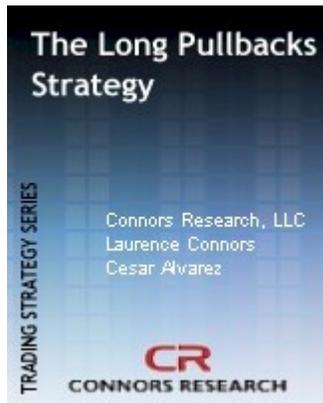
The Long Pullbacks Strategy

In 2005 we published what we consider to be our most powerful short-term trading strategy that we originally named the 5x5x5 Strategy. Many hundreds of traders learned the strategy and many still use it today. Since that time we have updated and improved the strategy, added new entry parameters, added new exit strategies, and have updated the trade results beginning from 2001-2011.

What you will learn with this strategy are many hundreds of variations that have been correct from 72.4% up to over 78% for more than a decade. And the average gain per trade (this includes all winning and losing trades) has averaged over 5.6% a trade on dozens of variations of the strategy.

You will learn how to identify the set-up, select, the entry level, where to place the order and where to exit the order. This is done on all liquid US stocks (and it can be done on global markets as well). And as an added bonus we also added a day trading component to this strategy for those of you who like to exit positions before the close each day.

The Long Pullbacks Strategy comes with a 100% Money Back Guarantee (as do all the Guidebooks in our Strategy Series).

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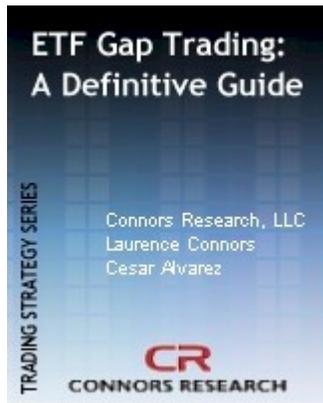
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If you trade ETFs you will soon see that trading Gaps on ETFs, when done correctly, can be the one of the most profitable strategies available to you in ETF Trading.

The average gains per trade from trading the gaps as taught in this Series ranges all the way up to over 4% per trade (a substantial number for ETFs). And we added a Leveraged ETF section where the average gains get above 5.5% trade.

Historically the majority of the ETF Gap set-ups have been correct 71-77% of the time. And like the Long Pullback Strategies we've also added a day trading aspect to trading gaps which allow you to day trade ETFs both on the long and the short side.

The ETF Gap Trading Strategy also comes with a 100% Money Back Guarantee.

If you would like more information on the ETF Gap Trading Strategy click here. If you would like to order and download it now so you can have immediate access to it please click here or call toll free 888-484-8220 ext. 627 (outside the US please dial 973-494-7311, ext. 3).