TRADENCY

How to select strategy providers?

Past performance is not indicative of future results. I am sure you have heard that before.
It is not just a legal warning. It is a reality in trading. It means that the trading history of a strategy provider is not always representative for your future trading results. Fortunately, there are a number of elements you can watch to increase the probability of future profit. The goal of this article is to give you some advice on how to select strategy providers that have a good chance to keep performing in the future.

1) **Equity Curve**
Is the equity curve of the strategy smooth or jagged? How much history is there? The more trades a system has made, the more reliable the information. As a rule of thumb you want **at least 50 trades**, and preferably more. Also, relatively **smooth equity curves are better**, because this means that you have less variation around the average and there will be fewer surprises. Surprises are for birthdays, not for trading accounts.

2) **Intra-trade Draw-down**
We now offer information of the behavior of trades between their opening and closing. The largest amount of pips that the trade has gone against you is called Intra-trade draw-down. The behavior of trades between opening and closing is extremely important because it gives you information about the risk management of the strategy provider. Strategy providers can no longer cheat the system by setting a small take profit and a huge stop loss.

In combination with the equity curve this may very well be the ultimate variable that indicates whether the strategy provider is skillful or just lucky. If a strategy regularly makes a **small profit**, but had to sustain a very **large intra-trade draw-down, then stay away from it**, because there is a large chance that in the next trade, the strategy provider will not be so lucky! Do you really think that his luck will last? And is this a good question to ask? In fact, it does not matter if his luck will last or not. You do not want to be involved with this sort of "strategy". You need strategy providers with trading skill, not trading luck!

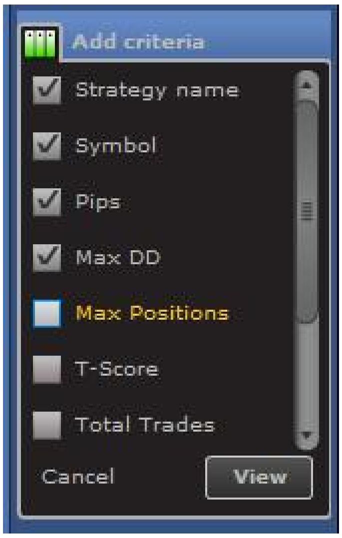
3) Maximum Draw-down (MDD)

MDD is the highest peak-to-valley difference, either expressed in pips or in account %. As with any other investment, to have a realistic idea of what to expect you have to look at risk and reward. Ask yourself how much adversity you are willing to sustain? Most people overestimate their capability of dealing with a losing streak: they change too quickly to another strategy provider. This may not always be the best way to go: MDD can help you to assess the risk. Depending on your personal willingness to accept draw down, you can select strategies with a larger or a smaller MDD.

If you are conservative, you probably do not want to lose more than 10% of your account on 1 single strategy. If you are moderate it is 20%. If you are aggressive, 30% would be the maximum. This means that if you have a 10000 USD account, and you use 1 mini lot for this strategy, then the historical MDD cannot exceed 2*500=1000 pips or 10% if you are conservative. If in your live performance the **draw down exceeds 2*historical MDD**, it may be a good time to start thinking about replacing this strategy with an alternative.

4) Maximum open positions

We have installed a 300 pip strategy stop loss in the platform. It does not matter if the strategy opens 1 position at a time or multiple positions. This protects you from a worst-case-scenario where all the positions close against you. But a scenario where many losing trades all close behind each other is still possible (if their total sum is above -300). To protect your account from such a gap, you need to watch the maximum positions when you add the strategy to your portfolio. **If you have a small account, it is better to avoid strategies that have a maximum open positions larger than 2**. You want to diversify your money across currency pairs and across trading methods to achieve the best result. You can find these strategies in the Custom Filter on the Strategies tab: click on Add criteria, select the Max Positions box and click on view.



Conclusion:

Select strategies with smooth equity curves that have small intra-trade draw-downs. Do not pick a strategy that has a larger Maximum Draw Down than 2 times what you are willing to sustain in the future. Because of the need for diversification it will be better to select strategies with a maximum number of open positions not larger than 2. And remember: the perfect system does not exist.