

Testing the efficacy of Qi Fair Value Gaps as a trading signal in a long/short relative value strategy for single stocks in 4 US sectors.

- Financials
- Industrials
- Consumer
- Tech /media /telecoms

The results of our back-tests are summarised below but of note:

- The hit rates are consistently good.
- A rich source of trade ideas – over 900 signals so far in 2020.
- Overall, **average returns of +1.13% over 11 trading days (+28.8% annualised) suggest a powerful tactical trading tool.**
- The critically important tech sector returns the best results.
- The median return consistently & significantly beats the mean return. That speaks to a core observation – a fat tail of outsized losses skews the results lower. A discretionary overlay plus introducing some risk management would reduce those losses.

	Avg. Return	Hit Rate	Median Return	Avg. Win / Avg. Loss	Annualised	Avg. Holding
All Trades	1.13%	57.8%	2.28%	0.88	28.8%	11.1
Consumer	0.88%	57.5%	2.54%	0.83	20.4%	11.9
TMT	1.79%	58.4%	2.93%	1.04	46.6%	11.7
Industrial	0.69%	58.2%	2.01%	0.82	15.1%	12.3
Financial	1.39%	57.7%	1.91%	0.98	49.7%	8.6

Overleaf we detail the methodology employed. It is a simple back-test designed to show the raw signal power of Qi Fair Value Gaps. There are several additional trading rules that could potentially help further optimize the results of the initial signal.

Critically, there is no stop-loss or risk management; trades are simply held until the exit criteria is met. Similarly, they are 100% systematic – there is no discretionary overlay.

We provide 3 case studies showing how the addition of an experienced pair of eyes would overrule some systematic signals & thereby mitigate the losses.

28 October 2020

Methodology

The screening process involved:

- Models must be in a macro regime (model confidence > 65%)
- Trade Entry. Fair Value Gaps must be at least one sigma from macro-warranted fair value. Longs at least -1σ ; shorts at least $+1\sigma$.
- Trade Exit. One leg of the trade closes within 0.25σ of model value. Long exit > -0.25σ , short exit < $+0.25\sigma$.
- Any stock can only be in one open position at a time.
- No trading costs incorporated.
- Trade execution at daily close.
- History - 2020 YtD. Sample size - 946 trades.

To illustrate how risk management / discretionary oversight could reduce the fat tail of large losses, we offer three case studies.

Case Study 1 - Consumer

Long Steven Madden Ltd (SHOO) / short Workhorse Group (WKHS)
 Trade entry June 9th, trade exit Jul 31st
 Loss 315%

Workhouse surged around 520% over the month of June. Even if the stock had not been on your radar beforehand, the hype around electric vehicles & the search for the next Tesla, plus the incredible price action would have surely brought it to either a PM's or risk manager's attention. That is not to say the signal wouldn't have produced a loss; but not the eye-watering one experienced by holding the position for over 7wks.

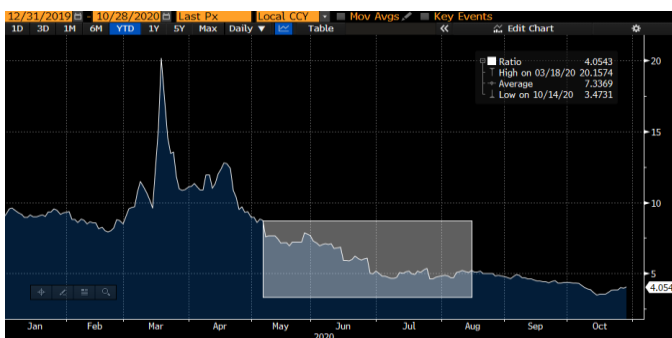


Source: Bloomberg

Case Study 2 – Financials

Long Tompkins Financial Corp (TMP) / short Brightsphere Investment Group (BSIG) Trade entry May 7th, trade exit Aug 14th
Loss 53%

At first, the Brightsphere rally was fairly “vanilla” – decent quarterly earnings produced some broker upgrades – but, by late June, Assicurazioni Generali announced a possible takeover bid & the rally accelerated. The stock rallied 65% between the initial signal in early May & trade exit mid-August. Prudent risk management would surely have mitigated some of that loss.



Source: Bloomberg

Case Study 3 – TMT

Long J2 Global (JCOM) / short MaxLinear (MXL) Trade entry June 15th, trade exit Aug 12th
Loss 38%

Whether a discretionary overlay would have overridden a short signal on a semiconductor company well placed to benefit from remote working during a lockdown, is potentially contentious. Riding that short for 2mths during an earnings beat, a raft of upgrades & a 33% loss, however, does seem unlikely.



Source: Bloomberg

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