THE MEANING OF TRADING

Discover a Trading Strategy That Has Been Successful for 200 Years Across a Diverse Range of Assets

remstone

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INTRODUCTION :

In this Ebook, our objective is to share our vision of Trading and empower you to independently select a Strategy. It is intended for both beginner and experienced investors. We will share our insights about specific strategies using an accessible approach.

First, let's discuss Remstone and its founder.

Remstone develops and markets software designed to assist investors in their Trading activities. The company was founded with the goal of providing high-performance Strategies that are effective regardless of the economic climate. Our software is available for lease and is intended for use on the MetaTrader 5 platform for CFDs and Futures Contracts.

Rémy LOUAT

Leveraging his freelance experience in software development, he passionately developed his first trading robots for various liquid assets, including Forex, gold, Bitcoin, and indices.
Passionate about using Metatrader, whose 20+ years of robustness enables the development of proven trading algorithms, he quickly realized that only quantitative analysis could outperform the markets in the long term.
He develops Remstone's strategies based on several decades of observational data.

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This book is provided for educational purposes and should be used for informational purposes only. It is strongly recommended that you take the time to reflect and conduct your own analysis before making any investment, considering your personal circumstances. It is advisable to consult an independent professional for specific advice.

It is important to emphasize that all investments involve the risk of capital loss, and that past performance is not indicative of future results. Before investing, please consult an investment advisor or conduct your own research.

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01 ACTIVE TRADING OR PASSIVE HOLDING: WHICH SHOULD YOU CHOOSE?

In this first section, we will explore the difference **between active trading and passive holding of an asset.** It is important to note that the comparison between these two approaches should be based on **a return/risk ratio** to consider profitability and **the level of associated risks.**

This analysis only reflects our experience, and it may be relevant, **in a diversification objective**, not to oppose them but rather to focus on their complementary nature.

First, some definitions **to better understand.**

TRADING :

Trading refers to **a dynamic approach** where participants seek to generate returns uncorrelated with the performance of the underlying assets **by applying various strategies.**

For this, they most often use derivatives, such as futures contracts or CFDs, which allow exposure to an asset **without owning the associated underlying asset.** This includes a notion of leverage, which makes this activity risky but potentially lucrative.

Traders employ strategies such as technical and fundamental analysis to identify short-term opportunities.

PASSIVE HOLDING:

Passive holding, often associated with the concept of "Buy and Hold," is an approach that aims to purchase assets and track their performance rather than actively trying to outperform them.

Buying and holding gold or various cryptocurrencies for the long term is an example of passive holding.

Indices are considered passive management in common parlance, but they nevertheless adopt a much more active approach than the passive holding of an asset.

Indeed, indices are composed of stocks, and several times a year, there is a selection and weighting of the stocks that comprise them based on the capitalization of each stock.

In this Ebook, we will therefore consider indices as **long-term trading.**

COMPARATIVE ANALYSIS:

In the realm of trading, we will discuss **active trading as opposed to passive holding.** It is crucial to compare trading to passive holding in terms of risk/return ratios to evaluate their respective performances. Ideally, **a successful active strategy,** implemented by **experienced and skilled professionals,** can offer more controlled risk and a return that is uncorrelated with the performance of the underlying asset.

However, it is important to note that most individual investors who attempt to achieve **gains through active management,** such as stock picking in the stock market or trading, end up underperforming the market and incurring losses. This is due to the difficulty **of quickly adapting to a constantly evolving environment, which** leads to significant sector rotations and variations in volatility.

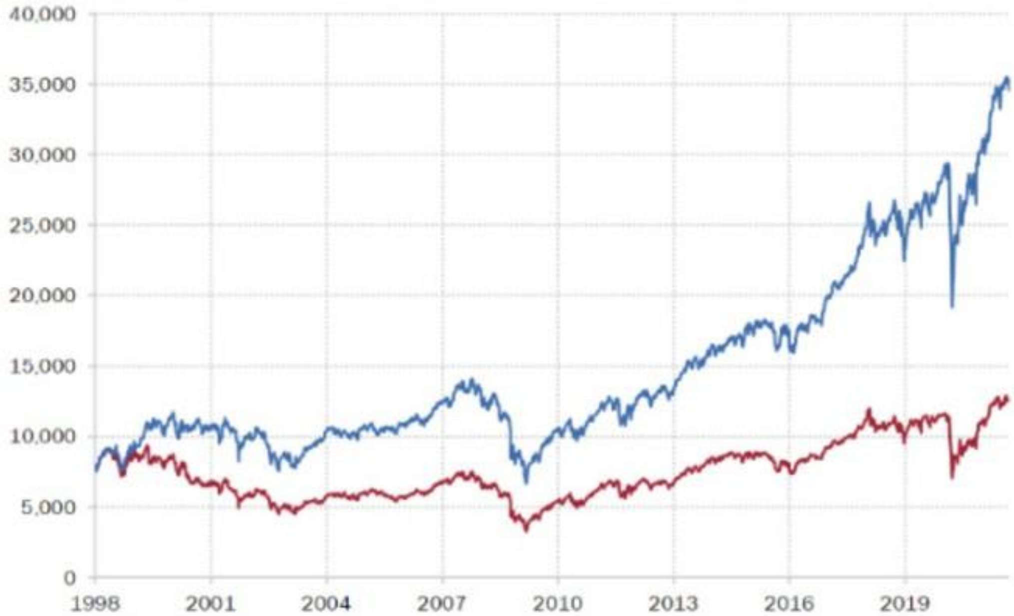
Case Study: We will compare the performance of a basket of stocks bought and held for the long term (Passive Holding) to the performance of a benchmark index, the Dow Jones, which regularly changes its composition (Active Trading).

To illustrate this, statistics show that a company remains within an index for an average of 20 years as of 2020, and this figure is projected to decrease to 15 years by 2030. **This rotation in the companies that make up an index is the main reason why the index has performed well since its creation.**

To compose an index, we find an important concept in trading: Trend Following.
Indeed, a company that is thriving with significant growth can increase in valuation and enter the index. The index thus makes the “bet” that the upward trend will continue for this company in the coming years. Conversely, a struggling company that sees its valuation decrease will be removed from the index as it drags it down.

CHART 2: Where Would the Dow Be If Membership Was Unchanged

United States
(red line; 1997 membership; index)
(blue line; Dow actual; index)



Source: Bloomberg, Rosenberg Research

THE CHART:

The Dow Jones, shown in blue, is an index that benefits from rotations and whose composition evolves over time. In red, we see an investment in Dow Jones stocks from 1997, but without any rotation, maintaining a static composition. This difference in performance is therefore substantial.

An ETF (Exchange-Traded Fund) based on a capitalization-weighted index allows for overweighting stocks that have a positive trend, those that are rising. Conversely, ETF underweights or even excludes stocks that lack momentum and are declining.

Owning an ETF is therefore equivalent to investing according to a trend following strategy, where the most performing stocks are included, and those whose capitalization decreases are progressively eliminated.
This successful strategy uses the famous quote: "Let your profits run and cut your losses." It is a practice that few investors manage to implement well when they choose to invest in a portfolio of individual stocks, which is why index ETFs are so successful.

To mention other assets besides stocks, we can also analyze the passive holding of Bitcoin compared to a trend trading strategy, for example. Beyond allowing for gains in both rising and falling markets, trading primarily enables the placement of Stop Loss orders to limit losses, so the risk is known, or at least controlled, over a defined time frame.

Conversely, if you buy Bitcoin and hold it, there is nothing to assure you that it will never go to zero one day.

CONCLUSION :

Passive holding alone does not ensure long-term performance since no one can predict whether Bitcoin, Apple, Microsoft, or Tesla will continue to grow in the future. **Winning strategies in the stock market or trading are rare and require highly advanced tools.**

Trend following allows investors to capitalize on upward movements in assets that are gaining strength by riding the wave, but more importantly, to quickly exit the asset in case of a reversal, or even to benefit from a downward acceleration by assuming it is just the beginning of a future trend that will continue.

There is, however, **a risk: the absence of movement.** If the assets become stable, trends will become rare or even nonexistent, and the trader will no longer be able to capitalize on them.

Active trading is therefore more profitable and notably less risky than Passive Holding when executed by professionals who can ride the trends and exit at the right moments.

02

WHAT STRATEGIES ARE SUCCESSFUL IN THE LONG TERM IN TRADING?

Over the very long term **(since 1800 for the oldest studies), the only successful strategies belong to** the Trend Following family. **Some books, such as** [Two Centuries of Trend Following], by Capital Fund Management, even describe this as a statistical anomaly.

We operate under the assumption that **trends should persist,** with financial markets being a zero-sum game with fees, but primarily **an environment with winners and losers.** The main advantage of long-term winners is the understanding of one constant over the centuries: **human psychology,** which experiences emotions of fear and euphoria, allowing bullish or bearish trends to continue to accelerate.

We will therefore analyze the different strategies that comprise the trend following family.

WHAT IS TREND-FOLLOWING?

Trend following is an investment strategy used to identify trading opportunities. It is not miraculous and must be accompanied by a good exit strategy, effective money management, and unwavering patience. Indeed, this strategy aims for spectacular gains at the cost of many small losses.

Breakouts of key levels and volatility breakouts are the two strategies used by trend-following purists. We will not focus on pullback strategies that seek entry from a short-term low point in a longer-term uptrend because we consider this a reversal strategy.

THE BREAK OF A KEY LEVEL:

This strategy revolves around two important concepts: support and resistance. Support is formed when we can graphically observe a low point on a chart that has led to an upward price rejection.

Resistance is formed when a new high subsequently leads to a downward price rejection.
Faced with this price level, represented by a black line, for example, in the case of the support below, the price can react in two ways:

- The support bounces as it has in the past. In this case, traders who made a bearish bet will incur a small loss, thanks to a tight Stop Loss that allows them to cut the loss quickly.
- The support breaks at the general surprise of amateurs. In this case, traders who made a bearish bet like us will benefit from a significant gain by letting our profits run to avoid capping them until stabilization in a different price zone.

A breakout of a key level occurs when **the price of an asset breaks above a resistance level or falls below a support level.**

The analysis of key levels can be conducted in various ways and on different time scales. Traders most often use intervals of one hour (H1) or one day (D1). To construct a support or resistance, one can, for example, analyze different numbers of candles, often between 25 and 100 candles, which, for instance, in H1, provides an analysis range of 25 to 100 hours. The entry into a position is made by placing a trigger order just above the resistance or just below the support.

Above, we can see the support in black at 20,000 dollars. At the breakout of the support (blue arrow), the sell order is triggered (circled in blue) with a very tight Stop Loss (in red at 20,400). The Trailing-Stop then follows the price downward to avoid cutting profits too early and exits the position only in case of a reversal, which occurs around 17,300 (Stop Loss in red on the left and exit point circled in blue). **This setup allowed for a profit 7 times greater than the size of the initial Stop Loss.**

VOLATILITY BREAKOUT:

It occurs when an asset's volatility suddenly increases. A significant increase in volatility can signal **strong demand or strong selling pressure,** which may indicate that a trend will continue.

This strategy closely resembles the level breakout, except that the position entry is not made at the breakout of a level but rather **after a sudden change in volatility.**

Trading after a central bank's economic announcement is a form of volatility breakout.

It involves detecting the start of a trend that could accelerate due to the high volatility caused by these events. This involves placing **a BUY STOP order** just above the price and a **SELL STOP order** just below the price as soon as the announcement has taken place.

This strategy, however, has technical limitations as it heavily relies on the broker's proper execution of orders. It is common to encounter significant execution difficulties during announcements, causing the strategy to deteriorate rapidly as the amounts increase.

IMPORTANT POINT: THE EXIT STRATEGY

All successful trend followers enter the market at approximately the same time.
What differentiates them is the optimization of their exit strategy.

To develop strategies with an attractive risk/reward ratio, it is crucial not to cap your profits. We address this need by avoiding the placement of a Take Profit order that would limit the gains.

For example, it is preferable to exit using a trailing stop **that follows the price movements** or in the event of an opposite signal.

By applying these concepts, traders can attempt to profit **from significant price movements** that occur after a breakout of a level or volatility, potentially leading **to spectacular gains.**

CONCLUSION :

Trend Following, like any strategy, **is not foolproof and carries risks.** Financial markets can be unpredictable, and trends may reverse. Breakouts of levels and volatility **may not materialize as expected.**

Prudent risk management, such as **the use of a Stop Loss,** is essential to limit losses if the **movement loses momentum.**

03 THE COGNITIVE BIAS THAT MAKES PEOPLE WANT TO 'BUY LOW' AND 'SELL HIGH'

In this section, we will analyze the case of Orpea, a private French group founded in 1989 **by neuropsychiatrist Jean-Claude Marian,** an entrepreneur active in the healthcare sector.

The company manages a chain of private nursing homes for dependent elderly people, retirement homes, care clinics, and personal services in the form of home care.

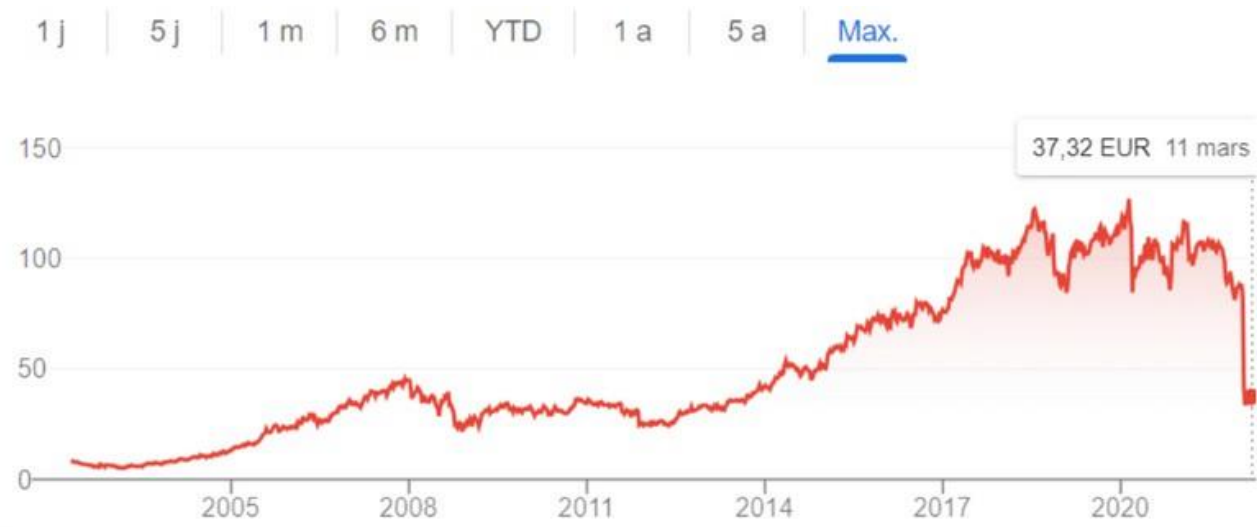
The group was listed **on the stock market in 2002** and is valued at **2.5 billion euros in 2022.**

Below is an image showing the evolution of the stock price from its introduction until 2020:

Everything went well for Orpéa shareholders from its introduction on the stock market until 2020, as the stock price increased by... 25 times!!

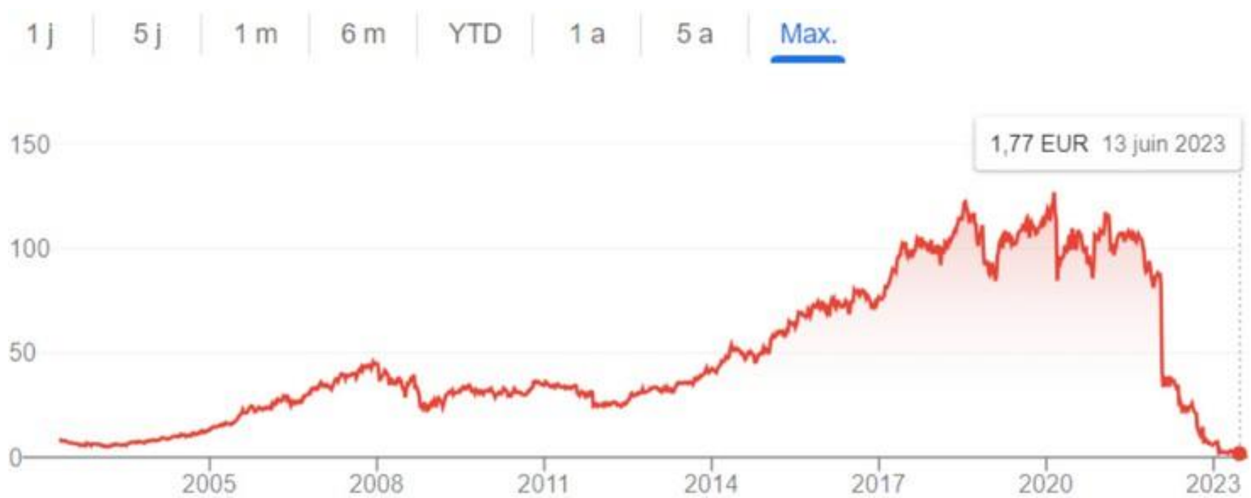
Many investors did not have the opportunity to invest in the stock over all these years. Why? **Because they were waiting for the 'Dip'.** The cognitive bias that drives investors to buy low is the same one that prevents them from buying high. In one year, from March 7, 2003, to March 7, 2004, the stock doubled from 5 euros to almost 10 euros... Any investor would have thought, **'this is not the time to invest, the stock has risen too much; we must wait for a correction to enter.'** Ultimately, the stock increased by 12 times again until 2020, never giving this investor the chance to enter a position because they did not buy when it doubled.

Now let's analyze the sequence after 2020:



Following a major scandal in early 2022, the stock lost 70% of its value in a few days, trading around 37 euros on March 11. **Do you remember the investor who could never buy the stock for 20 years because he always considered it too expensive?** He jumps in, seizing the attractive price as if it were a sale... We can understand him; the stock had been trading between 80 and 125 euros for 5 years, so buying Orpéa at 37 euros seemed like a godsend. We will tell you what happened next.

The complete trajectory of the Orpéa stock until June 2023:



The stock traded at 1.77 euros on June 13, which is more than 98% lower than its all-time high and 95% lower than on March 11, 2022, when it was priced at 37 euros.

The most unfortunate aspect of this situation is that the investor likely did not consider closing their position between March 11, 2022, and June 2023. On the contrary, they probably bought more at 30, then 25, then 15, each time believing the 'bottom' had been reached. There are numerous examples of companies that have never regained their historical highs: Orange, Renault, General Electric, etc.

In the realm of trading, various strategies **claim to be successful in the long term.** However, to achieve profits, it is crucial to challenge certain preconceived notions, **such as 'buy low and sell high.'** This advice lacks a solid foundation and often results in buying assets amid their decline and selling them amid their rises.

In hindsight, it is easy to identify the opportunities to buy and sell stocks over the past decades. However, few people have been able to capitalize on these market opportunities. It is impossible to travel back in time to buy at the market's lowest point, and it is equally impossible **to predict future movements of a stock chart.**

For these reasons, the traditional advice to "buy low and sell high" **lacks relevance and meaning. The concepts of "low" and "high" are subjective, relative to a time scale, and completely ignore** the present and the future by only considering the past.

04

ARE EASY-TO-LIVE AND SHORT-TERM STRATEGIES A MISTAKE?

Investors seek straightforward, short-term strategies. Many are naturally attracted to the prospect of quick and consistent gains, which leads them to adopt strategies that promise frequent results, whether on a **monthly, weekly, or even daily basis.**

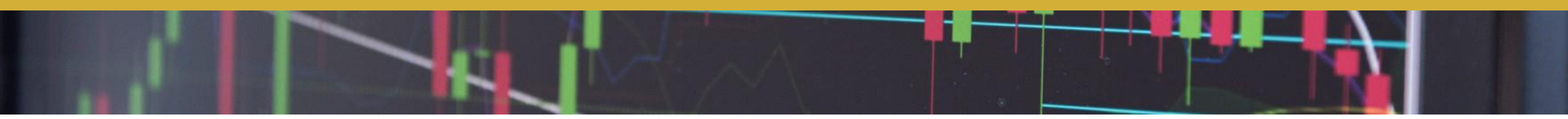
One of the warning signs is the presence of daily, weekly, or monthly gains.
The best investment funds in the world have negative years, so imagine how absurd it is to expect to win every month. This is a dream, driven by the desire to earn a fixed salary in a risky environment. At best, **you are dealing with a poor trader, at worst, a scam.** ⚠

AMONG THESE STRATEGIES...

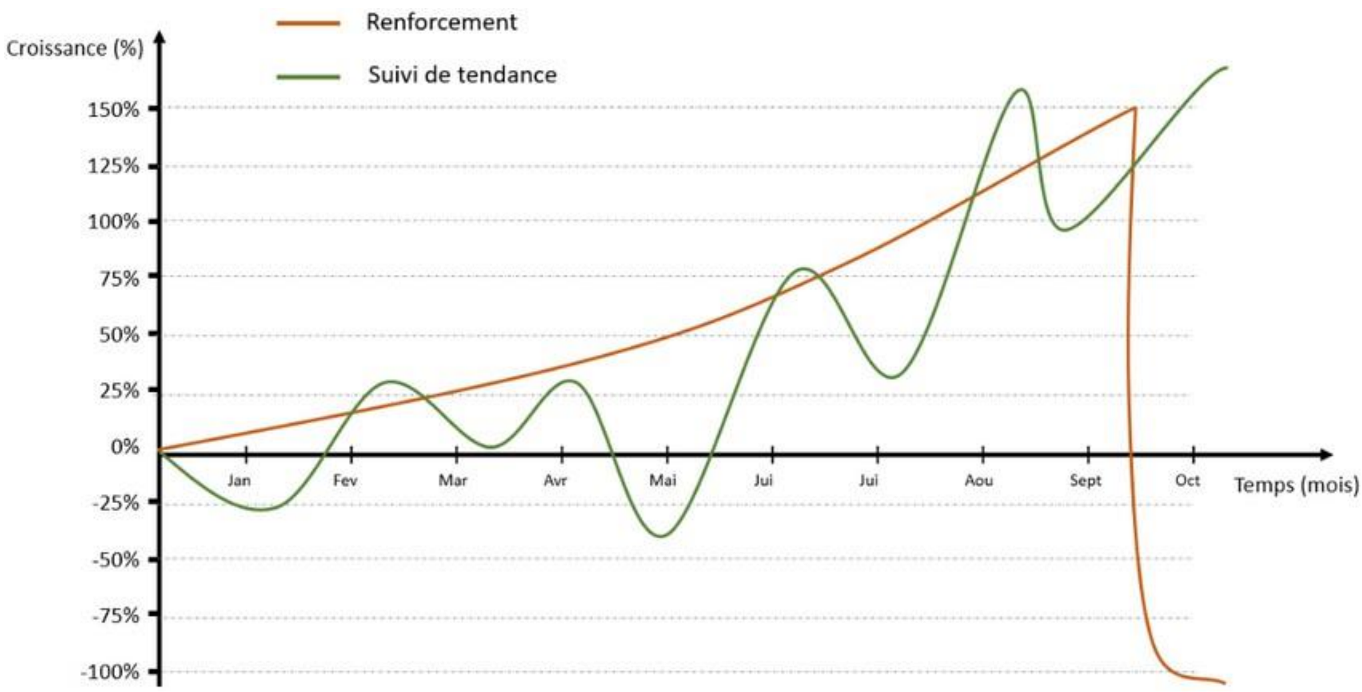
Among these strategies, reinforcement approaches, such as Martingales or Grids, are often popular due to their ability to generate regular gains for a certain period. These strategies originate from the casino world, particularly in games of chance like roulette, and are based on the principle of increasing bets after each latent loss, in the hope of quickly recovering previous losses. This can give investors the impression **that they have found a foolproof method** to generate consistent profits for years.

However, it is essential to understand the risks associated with these strategies. Although they may seem profitable in the short term, they are extremely vulnerable to trends and unexpected market movements. When the trend never reverses and the reinforcement/reversal strategy fails, losses can accumulate quickly and exponentially. **The entirety of the funds is then lost, leaving amateur traders disillusioned.**

As we can see in the diagram below, a reinforcement strategy (in red) appears much more 'comfortable' for the investor since the growth curve is linear **and thus generates regular profits.**
However, on the day the market behaves unexpectedly, the strategy will inevitably lead to bankruptcy...
Conversely, the trend following strategy (in green) is psychologically exhausting for the investor because it is non-linear. **Negative months are common,** but the risk is controlled, and patience often pays off in the long term.



Reinforcement strategies...



They are based on unrealistic assumptions, including the supposition that financial markets follow predictable patterns and will never experience prolonged adverse movements. Markets are systematically unpredictable and can be subject **to sudden fluctuations and unexpected movements.**

It is therefore crucial for investors **to take a step back and adopt a more rational approach** to their investment decisions. Rather than seeking easy-to-implement strategies focused on the short term, it is recommended to concentrate **on more robust approaches, such as trend following.** This approach offers a longer-term perspective, allowing for better risk management and sustainable returns, although the strategy **can be challenging at times.**

In conclusion, what attracts investors to easy-to-implement and short-term strategies can expose them **to significant risks.** Reinforcement strategies, although they may seem appealing with their promises of regular gains, can ultimately lead to catastrophic losses when **markets move** unexpectedly.

It is therefore essential to adopt a more thoughtful approach based on solid principles to achieve sustainable results in trading.

05 CONSIDERING ASSET ROTATION TO GENERATE PERFORMANCE

Considering asset rotation is crucial for generating performance. Trend following primarily works on volatile assets. **Trend-following traders must constantly adapt the assets they trade to accommodate this rotation.**

Forex, for example, often suffers from a lack of volatility. The more liquid a pair is, the fewer opportunities there will be for trend following.

However, despite the absence of volatility in certain pairs, there will always be assets **that maintain a high level of volatility,** thus offering opportunities for investors. A notable example is Bitcoin, known for its significant volatility. **Investors can turn to such volatile assets** to exploit trends and generate returns.

ANOTHER IMPORTANT FACTOR TO CONSIDER

It is the maturity of an asset. More mature assets, such as the Euro-Dollar currency pair, which benefits from a high trading volume, can present additional challenges for traders.

Due to their liquidity and maturity, these assets can be more difficult to exploit **using trend following strategies.** Price movements may be more predictable and less prone to prolonged trends, making it more complex to achieve significant profits. This can be referred to as the asset's efficiency.

It is therefore essential for investors **to closely monitor market trends** and identify those that offer opportunities for each strategy. This may require in-depth market analysis and the search for new emerging and still immature assets, **such as Bitcoin, which presents numerous opportunities.**

06 IS IT POSSIBLE TO PROFIT FROM MANUAL TRADING?

Trend following **is very difficult to apply manually** since the strategies for optimal entry positions are complex. For instance, if we consider **a volatility breakout strategy,** you will need to manually calculate the average range of the last 25 H1 candles and then enter a position when a new H1 candle has a range **5 times greater than this average.**

All this is impossible manually because it is prone to numerous calculations errors and requires **being in front of the charts 24/7,** constantly performing the same calculations to perhaps enter a position once a week. **It is logically impossible, not to mention the emotional aspect that often causes manual traders to make mistakes during challenging periods.**

It is therefore undeniable that the use of trading software **presents advantages**, such as speed and efficiency in analyzing market data in real-time, **reducing emotional errors, and automating tasks.**

However, algorithmic traders are essentially manual traders who have automated their strategy and **benefit from the advantages of automation** while having **the ability to replicate a strategy conceived in their mind.** They can therefore devote more time to improving their strategy and eliminate the repetitive work of entering and exiting positions thanks to automation. This allows them to focus on **more important aspects of their portfolio** and minimize emotional errors related to decision-making.

Having an automated strategy also allows **you to test it over a past period** (Backtest) and improve it accordingly, even though past performance does not guarantee **future results.**

07 CAN YOU PROFIT IN OTHER WAYS THAN TRADING IN THE LONG TERM?

In our opinion, it is possible to generate profits outside of trading by opting for other approaches with a more long-term perspective, but always **with a trend-following mindset.**
If you need a monthly salary, the best advice is **to find an employment contract.** If you are ready to accept **the good times as well as the bad,** if you follow a precise plan, **trading may suit you.**
As we discussed in part 1, one of these approaches is active management, which can be implemented through products such as ETFs (Exchange-Traded Funds).

Index ETFs allow for the easy implementation of a successful strategy. Specifically, these index funds replicate the performance of a specific underlying index, such as the S&P 500, the Dow Jones index, or other sector indices. Unlike purely passive management, the active management of an ETF allows for rotation in the composition of the index.

The selection of stocks that make up the ETF is based on predefined criteria, such as past performance, valuation, company quality, or even market trends. This approach allows for the implementation of a form of trend following, where the least performing companies are excluded from the ETF and the best are included.

Using this approach, ETF managers can adjust the portfolio composition based on market developments and trends. This allows them to maximize profit opportunities by retaining stocks that show positive performance and eliminating those that show signs of weakness.

Active management through ETFs offers investors the opportunity to diversify their portfolios and benefit from professional management while following market trends. This approach allows investors to take advantage of long-term opportunities and benefit from the returns generated by successful companies.
However, the historical returns of indices are often lower than those achieved by trading software employing profitable and robust strategies. Strategies via ETFs also require a longer investment horizon than trading, often at least 4 years compared to 1 year for trading.

Active management through **ETFs and trading** are not the only long-term investment approaches available in the market. **Other strategies can be profitable,** such as rental real estate, for example, but they come with their own drawbacks (illiquid, not easily accessible, and not always profitable).

08 DOES TREND FOLLOWING HAVE LIMITS?

Although the trend-following is a profitable strategy for traders who apply it correctly, **it also has its weaknesses.** For example, it can experience **long periods of stagnation** where no trend emerges, and it is impossible to generate performance with this type of strategy. It is particularly during these periods, more common than sudden trends, that the poor strategies mentioned in part 4 **gain popularity until they abruptly disappear.**

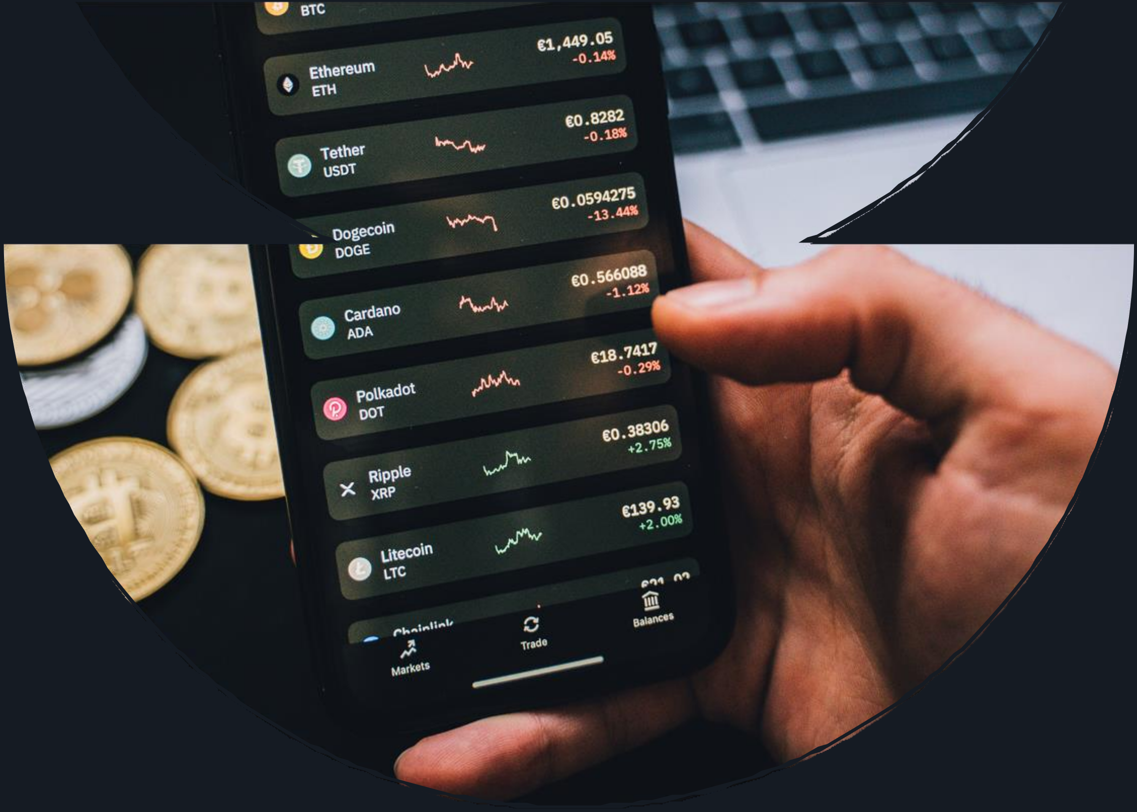
To illustrate this, let's analyze this Bitcoin chart from November 2022 to June 2023:

To illustrate this point, we have added our monthly performances to the BTC chart above **using our Trend Following Strategy.** We can also see the volume bars at the bottom to analyze in more detail what happens month by month. If we look at the period from November to December, we notice that the two negative months correspond to a period **where the price stagnates between $16,000 and $18,000.** The losses are due to false breakouts of the price range, which is not surprising given that the price was completely stagnant during these two months.

Then comes January when the price of Bitcoin takes off with a significant breakout upwards, with volatility continuing until the end of March and beginning of April, coinciding with exceptional gains **(ranging from 19% to 122% monthly).** This volatility is visually noticeable on the chart and on the very significant volumes **at the bottom of the chart.**

Then comes May and June, where we clearly notice (especially in volumes) a decrease in volatility, **with Bitcoin moving towards the reconstruction of a new range around $27,000.** These periods of stagnation are inevitable, and the performance of trend following comes from the fact that losses are controlled during these months of waiting, but the gains are substantial **when volatility returns.**

In conclusion, the weakness of trend-following lies in the fact that from one asset to another, **difficult periods can vary in length** and can sometimes last more than a year. This is why it is important to understand that beyond the need to **think long term,** one must especially keep in mind that poor performance often does not stem from the quality of trading but rather **from the lack of opportunities and trends in the traded asset.**



CONCLUSION

Ultimately, as in any activity, **the key to success in trading lies in education, research, and patience.** Many trend following enthusiasts agree that this strategy is somewhat **a school of thought,** and it is very difficult for someone who has not understood the basics of this strategy to withstand its fluctuations. It is essential to understand **the fundamental principles of this strategy and to remain disciplined in one's time horizon.** If you choose to embark on trading using our software or on your own, keep in mind that the path to gains may be paved with obstacles you could not have imagined. **And above all, all strategies that provide short-term comfort will cause losses in the long term and vice versa.**

We hope this Ebook has provided you with some useful and enlightening information about the world of trading and trend-following, including its advantages and limitations. Whether you are a future user of our software or an independent trader, we encourage you to continue learning, exploring new approaches, and exercising caution in your decisions.

We are here with any questions, so do not hesitate to make an appointment.

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If you enjoy this Ebook, leave us a review on **Google**.

Feel free to visit our **website** or **make an appointment with our teams** if you want to learn more about our business.

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