

The Economist: Trading Programs Outperform Traders

In a recent article on "autonomic trading programs", the Economist magazine reported that a 2001 study conducted by Jeffrey Kephart at IBM showed six basic commodity trading systems outperforming their human trading counterparts by 7%. Now, as any experienced trader will tell you, even a few percentage points in trading can be the difference between a profit and a loss, and Kephart himself believes that "the impact might be measured in billions of dollars annually". But can systems really outperform traders in the long run?

Our experience has shown that robust systems have proven themselves over time, in the face of inevitable pullbacks. Yet in spite of such consistent performance, even superior systems retain an aura of unreliability, as the inevitable draw downs can be sharp, and many traders are prone to play "Monday morning quarterback" regarding any given system trade. We have come to believe that part of the resistance to using auto-traded systems is psychological, as many traders are unwilling or unable to face the facts about their own performance over time compared with those of robust systems. But as the old adage has it, "arithmetic is not an opinion." One of the reasons systems consistently outperform traders has to do with the limits of the human brain.

The Economist quotes Richard Balarkas, "global head of advanced execution services at Credit Suisse, who observes that while human traders are only capable of considering three or four variables at a given time, "computers can take in hundreds of variables simultaneously, and refer back to a wealth of historical data in the blink of an eye". While many traders use a system of some kind when trading the markets, few have the discipline and tenacity to stick with the system in the heat of the battle. A "robotic" approach, in which the computer actually places the trades in addition to generating signals can seem an attractive solution to this problem, but computers, while superior to humans in many regards, are not perfect, and experience has shown that having an experienced team of systems specialists monitoring and executing trading signals is the safest bet for system trading success.

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