VAN THARP INSTITUTE

Sideways Markets: The Rodney Dangerfield of Market Types

by Super Trader Graduate and Sideways Systems Instructor,
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Columnist and market commentator, D.R. Barton recently quoted Warren Buffett on what to do in flat markets: “When there’s nothing to do, do nothing.” That’s very sage advice — especially when a sideways market has very little volatility. Doing nothing is one of the strategies that I advocate traders adopt under certain circumstances but as a system developer for sideways market conditions, I can tell you there are plenty of opportunities in these stagnate markets.

One of Van’s primary tenets of system design is this: Trying to build a trading system that works well in every market type is insane, yet, it is possible to build a Holy Grail system for any one specific market type. When you look at most of the trading systems around, they work in bull markets. In fact, any buy and hold based strategy works well in bull markets. “Anybody” can trade a bull market. Think back to the late ‘90s when everyone, including your hair dresser and restaurant waiter, was making money — and probably was telling you about it too. Conversely, most people find bear markets a difficult environment to make money — likely because they are trying to trade systems meant for bull market. That is, bear markets are difficult unless you trade systems specifically designed for bear markets. To help traders perform better in bear markets, Van launched a bear market type trading workshop several years ago. That bear market will eventually wake from its long hibernation period, so be prepared.

In the meantime, what about trading sideways markets? You can find lots of information on bull markets and bear markets but when was the last time you read anything good on sideways markets? Ask traders you know how they handle sideways markets and see if they dismiss your question quickly. As I searched for information on flat markets and how to trade them, the comedian Rodney Dangerfield’s catchphrase kept coming to mind, “I don’t get no respect.”

Sideways markets get no respect from traders. Simple case in point — unlike their more famous cousins — the bull and the bear, sideways markets lack a totem animal. Why not call them “Cowardly Lions” as Vitaliy N. Katsenelson does in his book “The Little Book of Sideways Markets?” Or what about calling sideways volatile conditions a “Snake Market” and maybe calling sideways quiet a “Worm Market?” By not even dignifying sideways markets with a totem animal, we risk disrespecting their slithery ways.

Why Sideways Markets Deserve Respect

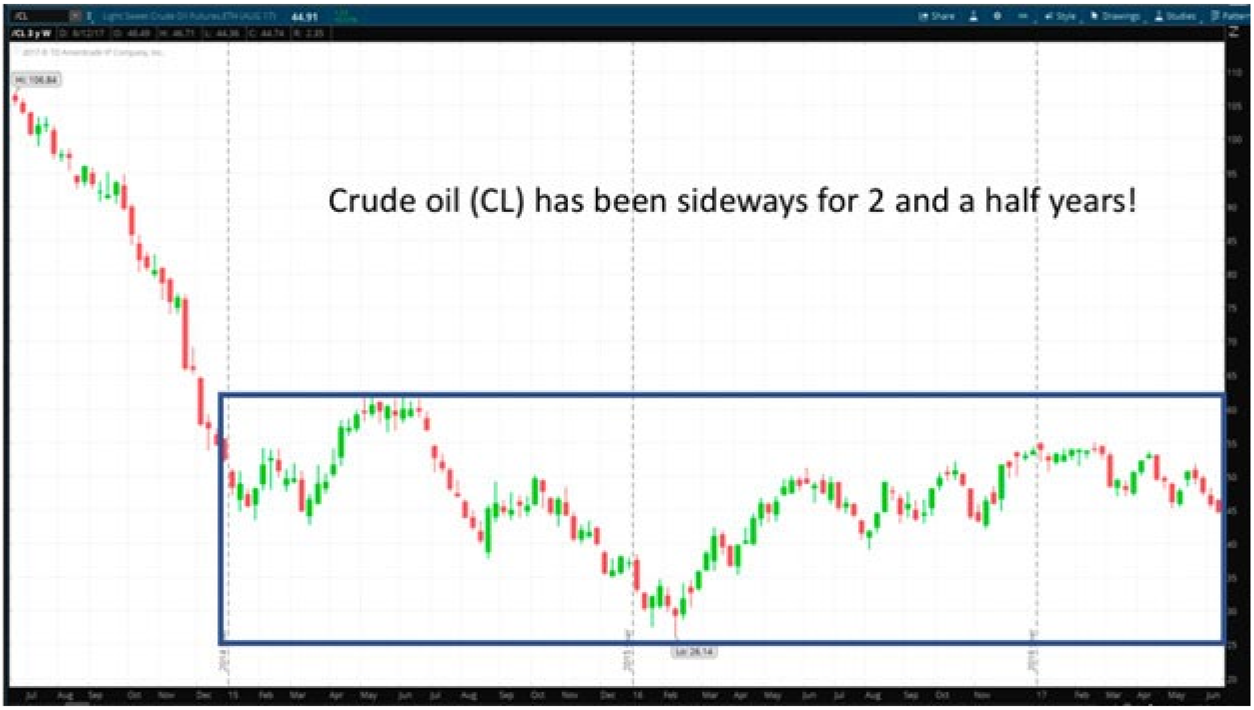
If for no other reason, the sideways market type deserves respect because it happens for more time than bull and bear market types combined. Skeptical? Here are a few pieces of evidence that sideways market show up frequently and tend to persist.

First, Tom Basso found that markets moved sideways about 64% of the time from 1964 to 1999. Second, take a look at the graph below that comes from some of my research. It depicts returns of the Dow Jones Industrial Average from the late 1920s to about 2011. As you can see, the market moved sideways almost 70% of the time over the last 90 years.

Next, look at this more recent and shorter-term example of weekly bars for SPY from April 2014 to July 2016:

You can see the S&P 500 was sideways for over 2 years recently. If you lacked ways to identify that we had entered a sideways market type, you might have tried trading systems that didn't work so well. Without sideways market systems, you may have been frustrated trading (or not trading) for two of the last three years.

Besides equities, commodities move sideways for noticeable periods as well. The chart below indicates that you would have made very little money (if any) trying to "buy low and sell high" or "sell high and buy low" over the last 30 months in the crude contract.



Trading Different Market Types

Compared with other market types, trading bull markets is relatively easy – just get long because almost everything is going up. Bears can be traded well (when you know what you are doing) for two main reasons — they are rare enough that you can prepare for them well ahead of time and because of the rapid price moves. Sideways are the hardest of market types for most traders typically because price moves little in either direction or it moves back and forth a lot within a range.

Another feature of sideways markets — the market can stay sideways for long stretches of time. Have you ever tried to trade through a long sideways market (or sat one out) wondering how long it could go on? A common response by traders after becoming frustrated is to move to the sidelines while remaining determined to trade again once the market decides to move up or down out of its range.

That frustration comes from sideways markets' uncertainty and unpredictability. Bull markets generally go up with relatively lower volatility because confidence is higher. Bear markets move down almost always with much higher volatility. I believe the volatility comes from a broad consensus amongst market participants experiencing similar emotional swings at similar times. Either they want to get out of the market at the same time or they want to get back in believing the "bottom" has been hit.

Unlike the wide mood swings commonly found in bear markets, sideways markets more commonly fill traders with lots of uncertainty. When a sideways market occurs after a bull market stalls, participants wonder, "Is the bull done or is this just a pause?" When the market goes sideways after a large decline, participants wonder, "Is the end of the bear here or will the weakness persist?” Traders wonder what to do next as a sideways market drags on and that uncertainty often turns into frustration.

How to Handle Sideways Market Types

Based on one of Van’s Tharp Think principles relating to systems, traders could create systems specifically tailored to work when price goes nowhere. But do such strategies even exist? Could they make money when price moves neither up or down? Based on my research, my trading systems, and my personal trading results in sideways markets, I’m here today to tell you unequivocally — yes!

Trading sideways markets profitably requires several specific pieces of knowledge:

• You need to know how to recognize when the market is in a sideways condition.
• You need to know what trading systems work in sideways markets and the ones that don’t (quite a few).
• And, most importantly, you need to know when to sit on the sidelines — because that’s the most profitable strategy sometimes.

Trading sideways markets also requires a well-thought plan for trading them. They happen frequently and are challenging from a price action perspective as well as a psychological perspective. Unless you can afford to sit on the sidelines for more than 50% of the time in nearly any given market, grant sideways markets the respect they deserve and learn how to trade them properly.

Bear Markets Happen!

A short history and how any trader can prepare.

by Bear Market Systems Instructor, Kirk Cooper

"Education is the passport to the future,
for tomorrow belongs to those who prepare for it today." — Malcolm X

In my opinion, the heading “Bear Markets Happen” states a simple fact, however, identifying bear markets at their start can be challenging if not impossible for the unprepared and unaware. Numerous boom/bust periods in markets have happened going back as long as we have recorded history. Some of the best-known examples from history include: The Tulip Mania of 1636 in Holland; The South Sea bubble in 1720 in England; and The East India Company collapse in 1772 in Amsterdam.

While these are certainly dated, they have certain similarities with today’s post ‘great recession’ boom — while this is also a very different kind of boom as a result of the unprecedented involvement of the world’s central banks. Consider that since 1854, the US has seen 33 cycles with the boom periods lasting three and a half years on average while the busts have lasted a year and a half on average. The table below includes the cycles from the depression of the 1930s until the present day which provides us an account of the recurring nature of the bull and bear market cycle. When you study the following table for even a short while, you see plainly that this cycle is simply how the markets work. Perhaps that is no surprise given that markets are nothing more than a collection of people — whose emotions vacillate over time.

U.S. Boom and Bust Cycles Since 1929

Cycle	Duration	Comments
Bust	Aug 1929 - Mar 1933	Stock market crash, higher taxes, Dust Bowl.
Boom	Apr 1933 - Apr 1937	FDR passed New Deal.
Bust	May 1937 - Jun 1938	FDR tried to balance budget.
Boom	Jul 1938 - Jan 1945	World War II mobilization.
Bust	Feb 1945 - Oct 1945	Peacetime demobilization.
Boom	Nov 1945 - Oct 1948	Employment Act. Marshall Plan.
Bust	Nov 1948 - Oct 1949	Postwar adjustment
Boom	Nov 1949 - Jun 1953	Korean War mobilization.
Bust	Jul 1953 - May 1954	Peacetime demobilization.
Boom	Jun 1954 - Jul 1957	Fed reduced rate to 1.0%.
Bust	Aug 1957 - Apr 1958	Fed raised rate to 3.0%.
Boom	May 1958 - Mar 1960	Fed lowered rate to 0.63%.
Bust	Apr 1960 - Feb 1961	Fed raised rate to 4.0%.
Boom	Mar 1961 - Nov 1969	JFK stimulus spending. Fed lowered rate to 1.17%.
Bust	Dec 1969 - Nov 1970	Fed raised rate to 9.19%.
Boom	Dec 1970 - Oct 1973	Fed lowered rate to 3.5%.
Bust	Nov 1973 - Mar 1975	Nixon added wage-price controls. Ended gold standard. OPEC oil embargo. Stagflation.
Boom	Apr 1975 - Dec 1979	Fed lowered rate to 4.75%
Bust	Jan 1980 - Jul 1980	Fed raised rate to 20% to end inflation.
Boom	Aug 1980 - Jun 1981	Fed lowered rates. For more, see Historical Fed Funds Rates.
Bust	Jul 1981 - Nov 1982	Resumption of 1980 recession.
Boom	Dec 1982 - Jun 1990	Reagan lowered tax rate and boosted defense budget.
Bust	Jul 1990 - Mar 1991	Caused by 1989 Savings and Loan Crisis.
Boom	Apr 1991 - Feb 2001	Ended with bubble in internet investments
Bust	Mar 2001 - Nov 2001	2001 Recession caused by stock market crash, high-interest rates
Boom	Dec 2001 - Nov 2007	Derivatives created housing bubble in 2006
Bust	Dec 2007 - Jun 2009	Subprime Mortgage Crisis, 2008 Financial Crisis, the Great Recession
Boom	Jul 2009 - Now	American Recovery and Reinvestment Act and Quantitative Easing

Source: https://www.thebalance.com/boom-and-bust-cycle-causes-and-history-3305803

As Confucius Said . . .

History and historic information is certainly limited in its usefulness but it is better than no information. As Confucius said, “Study the past, if you would like to divine the future.” Using history, we can’t predict the precise timing and exact degree of the next bear market cycle but those historical cycles do help us prepare to profit from the next bust when it comes. Having a plan and working that plan stacks the odds in our favor as traders.

Through researching bear markets, I have come to understand one psychological aspect that I had observed previously but never fully grasped: bears cause many people (even professional money managers) to become very conservative. A lot of people worry about bear markets a lot — whether a bear market actually occurs or not. They worry a lot about the potential to suffer great losses during the cycle. You don’t have to look very hard to read a lot about the doom and gloom heading our way — there are many analysts and newsletters that specialize in this — some even promote it. As a result, many people’s fear causes them to miss the great opportunities available in bear markets.

During my years as a fund manager and as a prop trader, I saw many CIOs, CEOs, and other financial services executives hindered by a fear of a “pending” bear market. From a career preservation standpoint, a C level executive is being completely rational by “preparing” for the next bear. But when an executive constantly “prepares” for the next bear, that kind of behavior hurts returns to unit holders and investors. For an individual trader, a fear of bear markets is definitely suboptimal as this market type actually provides great trading opportunities — for those who are ready. For the unprepared, one aspect of bear markets (volatility) can shock unprepared traders and cause a powerful psychological reaction — as well as the potential for a sudden and dramatic loss.

Another Interesting Bear Market Psychological Phenomenon

You have heard Van state the importance of understanding market types and using trading systems that fit you. It is critical, therefore, that you “know thyself” before attempting to trade a bear market. Generally, I have noticed that introverts and extroverts handle bear markets quite differently. Introverts generally focus more on all the warning signs and the risks, which can then prevent them from profiting greatly from the full cycle. On the other hand, extroverted traders tend to focus more on the huge rewards available so they can miss the signs the markets provide about shifts in market type. Missing the signs of a shift in market type can then result in catastrophic losses at the extreme.

Creating Your Plan for the Next Bear

In the process of updating and teaching the bear market trading workshop for Van, I have completed nearly a year of extensive research on bear markets. The most important thing that stands out is planning for a bear market BEFORE you have to deal with one is critical. Even though I developed the following list for the workshop, it’s also a good list for any trader to review and think about now - in advance of a market downturn.

- Clarify who you are as a trader and what your important values and goals are. Without this understanding, you won’t understand what fits you as a trader.
- Outline your objectives for trading — both for bear market types, other market types, and overall.
- Understand the big picture and its various components.

- Ensure you have a monitoring plan to follow for the big picture.
- Understand how you intend to evaluate market type.
- Know if or how you plan to use options or other hedging methods and what additional work you will require to become proficient with these critical tools.
- Evaluate what others have done to immunize their portfolios and determine what fits your trading. Various trading methods can be used throughout the entire cycle and certain ones do particularly well in down markets.
- Analyze bear market trading systems and strategies and determining which fit you. The opportunities in this area range from simple to complex. Consider which you can use to profit from bear markets given your objectives. (I teach these systems and strategies at the workshop.)

Being prepared and having a thorough plan will provide you many benefits including the following abilities:

- to embrace opportunities for every phase of market cycles,
- to fully understand the risks and the opportunities of bear markets,
- to face the next bear market with peace and confidence,
- to allow you to exit the next bear market in better shape than when it started, and
- to allow you to benefit even more from the following bull market.

You can certainly consider how this thinking applies to the broad, global equity markets but you can also apply equally to other specific markets. For example, think of the huge busts in oil and gold in the last few years. Even though we have experienced mostly a bull phase in the equity markets, everything we discuss in this workshop could have been applied in those two markets (for handsome returns!). Regardless of what equities are doing, you can always find a bear market somewhere.

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