The Art of the Switch 2.0

Look before you leap. While the Moose may sound simple and automatic, but there is an art to maximizing your performance.

From 1992 to 2017 there were only two types of signal at the Moose: HOLD and SWITCH. They meant what they sound like they mean and still do. Holding for more than a week or two after a "switch" signal is given is not recommended. Similarly, switching into a position in the middle of its 'hold" signal is not recommended-- particularly if there has been an appreciable price increase in the designated asset since the signal was first given. (See FAQs for more.) Switching out of an old position late, however, and going to cash between signals, may stem further losses.

In 2017, stops were incorporated into the model framework, giving a third type of signal that potentially complicates the switch process in a significant way.

THEORY vs. REALITY

Prior to stops, the Moose was nominally invested in a particular asset ALL week, but anyone who knew the way this site works, and who followed it with real money, realized that's never exactly what happened during a SWITCH week.

A weekly theoretical model, the Moose used to work exclusively off Friday COB ("close of business") data, and for the most part, it still does. The site is still updated over the weekend prior to Monday's open. In switch weeks, it "pretends" to have made the switch on the preceding Friday, when in fact the first opportunity to switch will be Monday. Sometimes you can get Friday's prices (or better) the following week, and sometimes you can't.

As mentioned in the FAQs, the Moose is not a short-term construct. It may spoon-feed you a great intermediate term switch signal, but you do have to do a little of your own chewing before you swallow it. You have to apply your own short-term methods, timing each switch week as best you can. A switch is never automatic. It doesn't have to be at the Monday open (in fact, I generally advise against that), or even by the Monday close. (I've waited up to nine trading days to complete a switch.)

For real people, then, the switch decision is an open-ended one. A weekly predictive decision that needs to be dispassionately assessed, however, cannot be open-ended. A date-certain is required. So we've always used Friday COB data to track weekly switches. If not that number, which one? Why collect, store, and tabulate a second, third, or fourth time series, that is no more valid a benchmark than Friday COB? Keep it simple, stupid... at least as much as possible. The addition of stops in 2017 added some complexity, but arguably, it was needed complexity.

THE PERFECT SWITCH

On the surface, "the perfect switch" would seem to entail selling an undesirable holding on Monday (or after) at a higher price than the previous Friday's. After that, you have to buy something new and theoretically better on Monday (or later) at a lower price than last Friday's. Sounds tough. But does "perfect" mean that? Actually, no, it's far less rigorous.

Sure, you'd like the asset you're selling to go up next week, right as the new asset you intend to buy dips for a moment. However, if you sell higher than last Friday's price, you can now afford to buy in (the same percentage) higher, and still break even. The same holds true if both assets head lower next week. If the asset you're buying falls in price, you can afford to sell at a lower price too.

The only problem occurs when the old asset tanks, as the new one spikes higher, which isn't often. That's because the top two assets in the model at any given moment are usually (more or less) positively correlated. In other words, their prices are generally headed in the same, not an opposite, direction-- albeit with different momentum and different degrees of volatility.

Although I've never done a data analysis, personal experience suggests that my chance of getting a better aggregate price the following week, combining both the sell and the buy, is about 50-50. It really depends on

how well I handle it, but also on conditions at the time of the switch.

MARKET CONDITIONS CAN HELP YOUR SWITCH-- OR NOT

Sometimes, life is wonderful, complacency is nigh, everything is bullish, and one asset simply overtakes another in the model. That is the toughest switch to time, believe it or not, because you're simultaneously trying to sell on a bounce, something that's supposedly losing steam, and after that, buy the purported the new barn-burner on a dip. Although your probability of pulling off that ideal two-fer seems low, ironically, you end up not caring that much-- unless you're really anal. (Once you realize both assets are going up, you know you're getting richer no matter how stupid you were about the switch.)

The November 2006 switch from Europe to Latin America exemplified this. I failed to pull off the perfect short-term switch, but I did have the opportunity. Europe, my sell, did open higher the following Monday, and Latin America, my buy, was lower intraday. Had I put in stops and limits right around the Friday close, I would have been even or in the black. As I recall, I danced around for a few days, sold IEV high, but bought ILF a little higher percentage-wise. (Hey-- sometimes you get the bear, and sometimes the bear gets you.)

So much for hunky dory. Occasionally, the Moose signal hits when life sux, volatility is through the roof, everything is in the tank, and YOUR portfolio is LEADING the herd down into the Fourth Circle of Hell.

(If that situation sounds vaguely familiar to Moose veterans, congratulations! You do NOT suffer from short-term memory loss.) On February 27, 2007, it seemed "Lasciate ogne speranza, voi ch'intrate" was running across my CNBC ticker instead of "ILF". (For the classically curious, that's Dante's account of the inscription above the Gates of Hell- "Abandon all hope, you who enter here.")

Black humor aside, such extremes do lend themselves to an easier short-term switch. When a weekly close in virtually every asset class is really oversold, as we knew and reported that week to be, a one-day bounce the following week is all but assured. And the longer it's delayed, the bigger it gets!

Hence, we enjoyed the spectacle of a bunch of Greedo's bouncing around the next week with their shorts on fire. What is never certain is whether a one-day short-covering rally will carry through to a positive week, although the odds seem to be better than 50-50 when invested in a top-tier asset.

If you followed my switch advice in that week's commentary-- didn't panic on a very scary Monday, and waited for the predicted bounce to sell mid-week, you made out as handily as I did on the week's pop in ILF. (As that signal ended in cash, the second task of the ideal switch- to buy a stronger asset at a lower price- was moot.)

Again there was irony. This was a near perfect switch that yielded an additional 1-5% over the model. But how to break out the champagne, when I still have the tread marks on my forehead from being run over the week before?

HOW AM I DOIN'?

There will almost always be a difference between the theoretical performance calculated herein using Friday COB data and the actual performance you achieve during a switch. Whether that difference is positive or negative (and whether it's significant or minor) will depend on your short-term trading skills, on the volatility of the assets involved, and on market conditions at the time of each switch.

So don't try to judge your success by looking at one switch. Consider each in the context of the entire program. If you miss on a switch this time, you may make it up next time, especially if you've gotten better at switching, or if conditions are more favorable.

Remember, it's a percentage game. It's not about being right every time. If you hit big on a switch and make, say, 2-5% over benchmark, it can erase (in one swell foop) four or five previous small misses you may have had.

DAY TO DAY, WE'RE ALL ON OUR OWN-- SOUNDS LIKE A PLAN

Practically speaking, a switch strategy will, in part, depend on the type of account. Taxable accounts allow borrowing on the margin to buy, while tax-deferred or IRA accounts do not. Margin allows one to buy a new

asset before selling the old one. In tax-deferred accounts (without margin), one must sell first (or simultaneously) to buy. The strategy is also dependent on whether the switch involves cash at one end, or is a switch between two non-cash assets. The decision is half as difficult when the switch is either to or from cash. Since cash is a constant, only the price of the non-cash asset is important.

Whatever the situation, I always suggest getting the lay of the land the following Monday before acting. Before stops were incorporated in 2017, the Moose was an intermediate term construct that provided no short-term switch guidance at all. I might write something in Moosecalls about my intended approach to an upcoming switch, if I did indeed have a clue-- or I might not, and just wing it.

Now, there is a stop-loss implicit in every hold, based on the Donchian 4-week system (price channels), and for simplicity's sake, I use that system to help me evaluate each switch. I also monitor chandelier exits, a volatility-based method of setting stops. Current values for price channels and chandelier exits (and an explanation of each) can be accessed at any time at stockcharts.com.

SWITCHES INVOLVING CASH

The following two tables outline my basic strategies for completing a switch to or from cash. I put them right up there with the best laid plans of men and mice. Market conditions and the non-cash target ETF always play a major role. A fast market and a volatile target can throw the entire strategy to the wind. Nevertheless, it's good to have a plan.

T1: When Selling a non-cash ETF for CASH, if in the following week	Cash Action	ETF Action
ETF SELL price > its Friday closing price	cash in	sell
ETF SELL price < its Friday closing price	wait	wait

Table 1: If I'm selling a non-cash (stock, bond, gold) ETF and going into cash and I'm offered a better price for the ETF I'm exiting on Monday or thereafter, than the model "accepted" on Friday, I take the extra money and run. If Monday's ETF price is lower than Friday's netting me less cash, however, I wait to see if it comes back a bit. Best case: I sell when the price returns to Friday's level. Worst case, I sell when it sinks to the ETFs stop-loss, or its 20-day intraday low.

T2: When switching from CASH into a non-cash ETF, if in the following week	Cash Action	ETF Action
ETF BUY price < its Friday closing price	cash out	buy
ETF BUY price > its Friday closing price	wait	wait

Table 2: If I'm using cash to buy a non-cash (stock, bond, gold) ETF and I'm offered the ETF for a cheaper price on Monday or thereafter, than the model "accepted" on Friday, I take the deal. If Monday's ETF price is higher than Friday's costing me more, however, I wait to see if it backs off a bit. Best case: I buy when the price retreats to Friday's level. Worst case, I buy when it hits the ETFs stop-gain, or its 20-day intraday high.

ETF-TO-ETF SWITCHES

When the switch entails two non-cash (stocks, bonds, gold) ETFs, the decision is more complicated, but the logic is the same. On Monday, I look at the price difference from the Friday close in both the sell and the buy asset. I look at the ETFs individually and on a relative basis. If the prices of the two ETFs on Monday are the same as they were on Friday, or the price action in the two is divergent, the decision is more straight-forward than it is when both ETF's prices are headed in the same direction at different speeds.

T3: When switching from non-cash ETF into non-cash ETF, if in the following week, prices stay the same or diverge	SELL ASSET Action	BUY ASSET Action
SELL ASSET price > its Friday close and BUY ASSET price is < its Friday close	sell	buy
SELL ASSET price = its Friday close and BUY ASSET price is = its Friday close	sell	buy
SELL ASSET price < its Friday close and BUY ASSET price is > its Friday close	wait	wait

Table 3: Obviously, if my sell price is up on Monday and my buy price is down, it's all good, and I switch. If prices are unchanged from Friday, I'm satisfied and complete the switch. If my sell asset is having a much worse day than my buy asset, however, I'll wait. (Even though I'm selling it, it's still a top-tier asset, and will usually bounce.) Best case: I sell when the price returns to Friday's level. Worst case, I sell when it sinks to the ETFs stop-loss, or its 20-day intraday low. Similarly, if my buy asset is through the roof right out of the gate, I'll wait for a retracement. Best case: I buy when the price retreats to Friday's level. Worst case, I buy when it hits the ETFs stop-gain, or its 20-day intraday high.

T4: When switching from non-cash ETF into non-cash ETF, if in the following week, prices head in the same direction	SELL ASSET Action	BUY ASSET Action
SELL ASSET price percent increase from Friday close > BUY ASSET price percent increase from Friday close	sell	buy
SELL ASSET price percent increase from Friday close = BUY ASSET price percent increase from Friday close	sell	buy
SELL ASSET price percent increase from Friday close < BUY ASSET price percent increase from Friday close	sell	wait
SELL ASSET price percent decrease from Friday close < BUY ASSET price percent decrease from Friday close	sell	buy
SELL ASSET price percent decrease from Friday close = BUY ASSET price percent decrease from Friday close	sell	buy
SELL ASSET price percent decrease from Friday close > BUY ASSET price percent decrease from Friday close	wait	buy margin

Table 4: If prices of both buy and sell asset prices are higher on Monday, it gets down to "how much" for each and becomes a game of percentages. If the percentage gain on your sale is greater than or equal to the premium you're paying to buy, the switch is a go. Otherwise, wait to buy. Same thing goes if both prices have fallen on Monday. If a fall in the purchase price is equal to or greater than the fall in the sales price, the switch is a go. Otherwise, wait to sell.

HOW LONG SHOULD I "WAIT"?

When readers used to ask "how long do I wait?" My answer was essentially, "...until you can't stand it anymore". Then I added, "you'll know it when you see it". Pretty lame explanation, if you ask me. More specific guidelines would surely be appreciated, so here they are.

When waiting for a higher price at which to sell, (a) sell when the price returns to that level, or (b) sell when it sinks to the ETFs stop-loss, or its 20-day intraday low.

When waiting for a lower price at which to buy, (a) buy when the price retreats to that level, or (b) buy when it hits the ETFs stop-gain, or its 20-day intraday high.

Since the average signal lasts three months and returns 8%, I start getting antsy after a week or two if the switch in question gets 3%-4% more expensive than the signal prices. It does depend on the assets' beta, however. Some ETFs (ILF, EPP, IWM) are more volatile than others (cash, EDV, SPY, GLD). ILF, for example, can have 3-4% intraday swings. The more volatile, then, the more patient I can be. If the asset seems to be making higher highs and higher lows on decent volume, however, the train is leaving the station. I have to forget patience and chase it.

How far down the tracks do I chase? My "drop dead" limits for a switch (which I have never used) are 8% more expensive than the signal price and/or six weeks into the switch. (For those of you tempted to buy in mid-signal, these limits represent averages over the life of the model, which if exceeded, would lead to a loss in that position. There are however, wide disparities in individual signal length and profitability.)

Personally, I never put in "blind" buy or sell orders over the weekend to catch the Monday open. My back-testing confirmed early on that trading the Monday open is a poor choice more often than not. A little patience appears to yield a better result 60-70% of the time. Readers' back-tests have subsequently confirmed that. Gaps up or down on the open can be painful when locked into the wrong price. Intraday stops and limits are more work, but a better choice.

In the end, for me at least, short-term timing is often a crap-shoot. But the hardest part of it invariably proves to be the most profitable, and that is to stay cool. Keep the greed and the fear in check long enough to make a rational switch.

Still Thinking About it? Please Remember:

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