Left, Left, Right

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Foreword

This post comprises the review, reflection and renovation learned through trading and investment from early 2022 to mid 2023.

I. Review

2022 feels only like yesterday, a period when the market was all about 5% corrections and pessimistic opinions. It was a bear market, undoubtedly. Suddenly, price started to reverse in 2023 in spite of economical and sentimental uncertainty. It is a bull market, doubtedly.

Ironically, This transition is unnoticed and still in question mark by the majority. It feels like the train has left the station while people who miss it expect a back up, though the train is already on the right track.

In all, the takeaway here is to have an adaptive mindset and treasure box so that you can come up with the right tool for the right circumstance. Essentially, the keys are to buy and hold at the bottoms (bear, left), and then to trade the momentum at the intermediate tops (bull, right).

II. Reflection

Specifically, the actionable items are to buy large caps at bottoms, and smaller caps when the trend reverses. The reason for the former are twofold: buying the dips in the darkest days build up your convince to hold the shares longer, and several large caps alone are capable to bring the index back to life. The reason for the latter is sparks can be and have to bonfires. These two scenarios rely heavily on the assumption that a bull market can last for several years, and buying the right ticket ensures a seat on the right train.

III. Renovation

This section covers the knowledge and thoughts that have been refurbished since 2022.

Principles

Human are emotional machines in nature. The subjective sentiments, such as fear, greedy, joy and enthusiasm, hamper trading as it requires objective decisions making and execution. In practice, a variety of books written by traders emphasized the importance of neutrality while the rise of algorithmic trading further validated this scenario. Thus, just like adding regularizers in the loss function, following predefined principles unconditionally would reduce the risk of emotional deviations at best.

First of all, simplicity should be prioritized over complexity. In theory, this idea synchronizes with Occam's razor and the law of entropy. In practice, the principle is relevant to high signal-to-noise ratio. Simplicity requires significant capability to abstract, while much less effort to execute.

Trading as Reinforcement Learning

Trading is just like reinforcement learning (RL). The state, action, and reward in RL is equivalent to market snapshot, {buy, sell}, and {win, loss}. The agent, which can be ourselves, is continuously updated through interaction with the environment, which is the market composed of heterogeneous participants. However, in RL it is assumed there is only one static environment, while in trading this assumption does not hold given periodicity and reflexivity, i.e., the market reacts with actions. In short, trading is RL with dynamic environment. For periodicity, it can refer to macro cycles including downtrend, zigzag and uptrend, or it can be narrowed to microscope including inter- and intra-sector rotations.

Making Trading Plans

Trading without detailed plan is like gambling. Empirically, to make plan through top-down reasoning has better consistency. Firstly, it requires to collect and summarize information from broader sources, and formulate a macro {overview, prediction} of the market at different scales, including weekly, monthly and quarterly. Once the scenario is constructed, it follows with micro plan and strategy to trade options and shares at short-term and long-term scale. While vision and belief are essential for long-term candidates, momentum and trending are necessary for short-term plays. However, both of them require consideration on factors such as sector, market cap and country when selecting the underlyings.