

INTERVIEW

*Where Math And Finance Collide*

# Looking Forward With Jeff Parent

*Jeff Parent has been providing wealth management services to his high net worth clients since 1992. From many years of experience, he has become proficient in portfolio management techniques and has a broad knowledge of estate and tax planning. In his portfolio management role at Quadrexx Asset Management, he applies a strong price discipline to help control risk and improve returns. His specialty is technical analysis with a focus on quantitative methods. He regularly appears on Business News Network and is a recognized writer, public speaker, and educator. Parent is also the past president of the Canadian Society of Technical Analysts.*

*STOCKS & COMMODITIES Editor Jayanthi Gopalakrishnan interviewed Jeff Parent on October 8, 2009.*



**The beauty of technical analysis is that it's not just a great story; it also works in reality.**

**J**eff, what attracted you to technical analysis?

I always had an interest in math and finance. When I was 15, my dad had this idea on how we could make money selling personalized mortgage tables. So we bought a personal computer in the early 1980s, which at the time was unusual. We showed people how changing or accelerating their mortgage payments could save them a lot of money — interest rates were high back then, if you'll recall. So we turned it into a business and since I did the computer programming myself, I saw firsthand how math and finance intersected. That created an interest that has lasted over the years.

**When did you start your financial career?**

I started off working for a financial planner who sold mutual funds and life insurance. There wasn't a lot of math in that, but calculating the returns for the clients did involve some. Eventually, I got interested in getting into stocks and bonds working for an investment firm in 1997. That's when the idea of technical analysis came to me, because when you're a stockbroker, you're trying to differentiate yourself from all the others. And going out there and talking about the same mutual funds or the same stock that everyone else is talking about doesn't allow you to do that. Even the research wasn't very different, and it didn't seem to be as critical as it should have been. And these days, brokers are selling essentially the same in-house products so it's hard to differentiate yourself. So technical analysis

was something you could talk to people about. You could talk about some of the main aspects of technical analysis, like looking at a chart, or the discipline, or something other than just the buy & hold approach.

**How do people respond to it?**

People found it interesting because they could understand the direct relationship to risk reduction and technical analysis, which is a key element that is often overlooked. The other thing people liked about it was that you had a two-sided view of the market. I started off by buying MetaStock, software that had been recommended to me. I didn't know much about it at the time, so I bought a copy of the book *Technical Analysis From A To Z* by Steven B. Achelis, the developer of MetaStock.

After I read that, I joined a Toronto MetaStock users group run by Dave Flemming. This group had meetings a couple times a month. What Flemming did was make everybody give some input and a presentation. So when it was my turn, he said: "Jeff, you have to do a presentation. You have to talk about the MACD."

**What did you do?**

I thought I would look at the history of the moving average convergence/divergence (MACD). So I called Gerald Appel and ended up buying one of his videos and learned not only how it came about but how it was modified. So I started my exploration on things like the MACD and the relative strength index (RSI) and worked up to chart patterns.

**How did you use them?**

I developed the ideas into a type of quantitative analysis, which focuses on statistics. Much of the work I do involves using the data output from analytical software and inputting it into a spreadsheet for further analysis. I've also done some work with neural nets. The markets are random and nonlinear in a lot of aspects, so you have to use these tools to uncover patterns and important relationships.

In addition to the users group, I also joined the Market Technicians Association (MTA) and a sister society, the Canadian Society of Technical Analysts (CSTA), of which eventually I became the president. Through these societies, I met a lot of people and shared ideas. I enjoyed being the program director for the local CSTA chapter. We would have to find speakers for our monthly meetings, generally local technical analysts, but for our annual conferences we would find people from all over the world. This was a great

opportunity to hear from people like Tomasz Janeczko of AmiBroker, who contributes Traders' Tips pieces to your magazine. I enjoyed meeting other technical analysts and being invited to speak at conferences. Connecting with all these different people was really helpful, since I got exposed to all these different ideas, formulating what technical analysis is.

### ***Do you consider yourself an active trader?***

I am not trading very actively. I look more for position trades because as a retail money manager or someone dealing with clients who have about \$1 million in assets, I can't be trading quickly in and out of positions. It's too costly for me and for the client. And I just don't find that it creates any great benefit.

So we incorporate fundamentals, screen stocks, and categorize them based on their earnings. Here's an example. We look at earnings momentum by ranking stocks according to the change in quarterly earnings growth. In another screen, we look at the predictability of earnings. We also look at dangerous stocks, which might have a high debt to equity. This factor is especially important in a high interest rate environment. So we are looking at these categories of stocks and we apply technical analysis to the higher-ranking stocks in each of those categories. That's mainly what we do, and as money managers, we have a high turnover, which is probably 100–200% per year. This is by far above average.

### ***How do you analyze stocks?***

Some of the studies and ideas are based on volatility and price. People manage money around a mandate and then measure their results against appropriate benchmarks. They are segregated into growth or value and large-cap or small-cap. You often see that grid especially if you are looking at mutual funds or pension funds. You invest in more than one of those quadrants to diversify your assets. As a technician, you have access to all that, but you have to wonder if there's another way to do it using only price-based information.

There are a lot of factor-based items affecting prices of stocks. The main factors are the markets, the industry it is in, its size, and by the internal financials of the company. You can categorize a stock and track its movement and find some correlation between other value-based or large-cap stocks. Can we reduce that by just looking at price? Do lower-priced stocks — that is,

less than \$5 — trade together? When they go up and down, is there some correlation between those stocks? Do stocks that trade above \$100 move up and down together?

It is a price-based approach. It does not involve value-based categorizations. It's easy to do and I've found there are many similarities in those stocks. In fact, I compared the fundamentals and found out there was a lot of correlation between, for example, small-cap stocks and growth stocks. Small-cap stocks with lower prices are also growth stocks. And just the opposite, large-cap stocks and value stocks have higher prices. So you can find a lot just by knowing what the price of a stock is: Is it a \$1 stock or a \$50 stock? I find it interesting and technical because it is purely a price-based approach.

But when we ran into the year 2000, there were all these growth stocks in the \$100–200 range and they just threw off all the research. So we couldn't use just price and say these were the fundamental qualities.

### ***So what did you do?***

Then I looked at volatility and determined if it was correlated to the value factors. What I found was if it was volatile, it was a growth stock and probably a small-cap stock. I used different models of volatility, but the one I liked the best was the one-day price range. So you look at the average of that value over 100 days and do a simple ranking.

Based on that, you can categorize stocks into these groups that are similar to what fundamental categorizations do. It's a neat idea because it looks at price only and from that you get so much information. In fact, if you throw in price and volatility, you can guess which fundamental quadrant a stock belongs to. You can remove fundamentals from the picture. That was very interesting to me. This is what I am doing now.

### ***Can you tell us more about the one-day range?***

A lot of people use beta, but beta breaks down quickly over time. Beta in part is a stock's volatility compared to the market's volatility, but the beta of a stock these days is not consistent over time. It'll go through these big phases, but the one-day range is the most consistent. I've studied this and published some research through the MTA about it. That's important information and when you're doing other things like trying to diversify, you want to have some high-

volatility and low-volatility stocks.

It also is useful from the money management aspect. When you're buying an initial position, it's going to be much smaller for a high-risk stock or highly volatile stock. That makes sense. The history of technical analysis has shown that. But it's nice when you are able to do all this research and summarize it quickly and simply make a pitch to a client.

The actual formula of the one-day range is the log of the high divided by the low. I take the median value of that over a period of 100 days and rank them. You can use that for normalizing price change. If it's a low-risk stock, you can find out how other low-risk stocks moved. A half-percent move in a low-risk stock may be a big movement, but a half-percent move in a high-risk stock may not be, so you have to normalize for that. You have to know how these price movements are equivalent. Then you can recreate the graph with normalized price data. It's complicated but when you see it, you'll see that it helps you make better investment decisions because you remove all this randomness. You can aggregate the normalized data by industry and get some smoothed graphs to tell me how the industry group is doing.

### ***How do you get all these different ideas?***

Like I said, meeting other technical analysts has been helpful in finding out what others are doing. Along the way, people like John Bollinger have been very helpful. He is a technician's technician. He runs a chat group that is very popular. People like Larry Williams participate in it. It's a good way to exchange ideas. Bollinger pointed me to others who have worked on similar ideas.

### ***How do you start describing the markets?***

One of the most effective comments I made was during a presentation to a group of financial planners. I started off talking about how investing is not rocket science. Rocket science involves hundreds of years of observations, measurements, theories and ideas, tons of math, computers and so on. NASA can precisely determine where a satellite is, and that's amazing. So I said investing is not rocket science. It's much more difficult. Everybody thinks it can't get more difficult than rocket science. But in reality, in the markets you're dealing with a world of improbabilities, randomness, and emotions. It's not black & white. There are a lot of gray areas and you can't ever be precise.

### ***Do you think that what has happened in the market contributed, in a sense, to people losing faith in the buy & hold approach?***

I hear this question all the time. I started off dealing with investments in the early 1990s. Up here in Canada as well as the US there are a lot of problems with banks. We don't have as many banks in Canada as you do in the US. Banks are very important to our economy. In fact, banks are one of the largest-weighted sectors in our stock market. People were worried about our banks going under. During this time, a buy & hold approach created way too much risk for the average investor. For example, back in the late 1980s and early 1990s, or the peak of 2000 or 2007–08, there were big drops that followed these rallies. If you are buying & holding, and if we were to take today as an example, if you were investing in the Standard & Poor's 500, you would pretty much be where you were 10 years ago. In the buy & hold approach after fees, you'd be lucky to make *any* money.

You have to be trading in these markets. I don't know if this rally is going to be the long rally we saw from 1993 to 2000 or so. That was an incredible run. We might be going to another peak next or going down to the March 2003 or 2009 low. In any market we use stops, we short, and we hedge.

### ***What else?***

I have had a good amount of media exposure. There is a daily call-in show on Business News Network TV. It's titled *Market Call*. I'm asked to appear on this show every month or so and there's a guy who watches each of these episodes and transcribes comments made by the guests. He has a huge database going back to 2000 with close to 100,000 comments. You can search that database at [stockchase.com](http://stockchase.com) by company or expert and read what was said over time. You can see if someone said a stock was a strong buy when it was at \$10 and a year later it was \$5.

But one interesting thing is that there are few people who select stocks to short as the top picks segment. I am a leader along with a couple of other technicians in making short recommendations. When I talk about things on the air, I outline a plan and say where prices are expected to go, where to develop a new target, set loss limits, where you reduce or add to a position. There aren't many people talking about trading plans or technical analysis, although people are getting more interested in technical analysis.

### ***That's good to hear.***

Things are changing. It's related to the markets. When the markets aren't doing well, we do not get a lot of people looking for ideas. They just want to stay out of the markets. We do best when the markets are doing well because people are looking for new ideas and they want to be more active. I have been involved in professional technical analysis societies for the last 10 years. That's not a long time to see any long-term trends in the use of technical analysis.

I do know technical analysis has been around longer than fundamental analysis. Some technical ideas are based on human psychology that has been around for hundreds of thousands of years.

### ***Do you look at the history of the markets?***

I like looking at the way the markets worked a long time ago. *Reminiscences Of A Stock Operator* by Edwin LeFèvre and *Before Dow And Jones*, a self-published book by Tom Kalinke, are two books I really enjoy. Kalinke recreated the Dow average from 1855 to 1896 on a daily basis. There are six different newspapers he got his data from. There are about a million datapoints from all these different stocks and he talks about the history of the markets and how things were done back then. I've never seen anything like this done before. These are the sort of things I get some interesting ideas from.

Another guy named George Bishop wrote a couple of books about Dow theory and how it's viewed today, how it developed, and what Charles Henry Dow would have thought about how his theory is regarded today, because the theory was developed after he died. Dow theory is what most technicians use in the markets to start with. It gives you a feel for the market and from there you can branch out to other things, depending on your time horizon.

Reading about the history of the markets led me to develop my new odd-lot indicator. Back in 1900, the standard blue-chip stock traded near \$100 per share. A full lot of 100 shares cost in the range of \$100,000. That was a lot of money 100 years ago and mostly

only big players participated in this area. After a long bull run, the average investor got interested in investing in these stocks. They would buy one or two or 10 shares, which were known as odd lots. When you saw these people come into the markets, you knew you were getting near a reversal point. A lot of odd-lot orders meant the markets were reaching a top. It's still a good idea to detect when the common man is getting into the market for the same reasons, but odd-lot trading doesn't provide the same information. Now you need to look at the activity in the risky, tiny, "white-chip" stocks.

### ***Why is that?***

In Canada we are fortunate to have a lot of white-chip stocks. The Toronto Stock Exchange started off as a mining exchange. Back then, the Montreal Exchange was the big one. We still have a lot of mining and energy companies and small cap stocks trading in the TSX. For the most part, they attract the speculative investor. I look at the activity in this area and see if the volume is picking up or becoming more consistent, or if the daily number of trades is increasing and so on. That is my new odd-lot indicator. It tells me when we are getting close to the top of the market and it shows some good turning points. The theory is similar to how the odd-lot indicator worked. The same common man still waits for a long bull run before investing, but now invests in riskier stocks.

The idea came up back in 2000 when a company mentioned it was getting involved in the Linux operating system and its stock price shot up and became an active trader. You saw resource companies becoming technology companies to cash in on the trend. Many stocks would go from under \$1 to more than \$5, not over a period of a year but a week. This was all being supported by those last-minute players, or the ones who usually lose a lot of money.

So what I called the new odd-lot indicator was similar to the old one in terms of psychology, but updated. I update other indicators like the RSI by transforming them in minor but significant ways.

### ***How do you do that?***

A transform is a formula that changes data in a known way. For example, look at a 1:1 transform on the RSI. You pass the RSI values into the transform and get the same values going out. A 2:1 transform multiplies all values of the RSI by 2. There's this thing called *hysteresis*, which is a term





used in magnetism. It's refers to a lag time when reversing a magnetic field in iron. I created a hysteresis transform, which alters an indicator in different ways depending on its direction. In essence, it delays the move down or move up of the indicator. There are all sorts of new developments happening in the markets. There are lots of hedge funds actively trading using computers. They might be looking for small movements or longer-term moves, but they are using price based techniques. I visited a trading company and they were showing me their computer rooms. They do trades that they think will trigger an algorithmic order. And once they do trigger that order, they will compete against it. So it is computer vs. computer. Since it's price based, I consider that to be technical analysis. You're looking at pricing information and at the number of trades, who's trading and so on. The fundamentals or earnings have little or no impact on these decisions.

#### ***What's the main benefit, then?***

The main benefit is that it increases the liquidity in the markets. Liquidity is always a problem, especially in the lower-priced stocks. Half of the Toronto stocks, for example, are not actively traded. You can't apply any form of technical analysis whatsoever to those. You don't have anyone following the stocks.

I always try to identify correlations. One area that I did some work on was when a friend, Daniel Ervi, pointed me toward Wealth-Lab. People would create trading routines for Wealth-Lab, run them on real-time data, and show the results. People could talk about them in forums. One series of forums was called "dip-buyers." You would look for stocks dipping below a certain threshold and you buy them. And the trade is that you sell them at the open the next day. It's a simple overnight trade, but how it worked was incredible. You couldn't do that with a lot of volume because the opening price is always a bad thing to use. There might be 100 shares that trade there and the price moves dramatically in the next trade.

Since I found it intriguing, I put all sorts of data into a neural network to see if there were any relationships, and I did find some. In fact, probably the most prominent relationship was where the market is going. So if a stock dips and the markets are going up, the strategy will work well. Some people reading that comment will realize that it's a reversion trade, or a short-term reversion

trade. So there is a mean — that is, the stock market is moving along a certain trend and if price falls outside of that trend — it'll go back to that trend.

Pairs trading works that way as well. The idea of reversion and seeing it work is fascinating. It's more statistical trading, but there's a lot of value in doing those studies.

#### ***So you're looking for new ideas to try out.***

I still like the old-school stuff and find value in it. Chart patterns, support and resistance, and basic trends are all good concepts. I taught my son how to read charts when he was seven. He could determine if a stock was going up or down. It's not difficult. But you can look at other things such as trading ranges, and retracement levels, which are slightly more involved. Everyone should be doing at least those things.

Right now, I find triangle breakouts interesting. I'm seeing a lot of those right now, and head & shoulders reversals and continuation patterns. I am at the point where I can look at a chart and make an assessment using these concepts. The other stuff I am doing is more esoteric, more specific, and related to my interest in math and science. I've got an engineering degree, so maybe my brain is wired to have an interest in the number side of the business. I do like statistical stuff and I believe there are a lot of exploitable inefficiencies, which is what technical analysis takes advantage of. If you're short-term trading or trying to find good entry points, you wait till the stock is dropping down and place a bid close to the most even-dollar amount. If a stock is trading at \$5.10 and it is heading down, I'll put in a bid at \$5. There's no particular value-based reason the stock trades down to \$5.00, and you may get a 10 cent price improvement.

#### ***You talked about the market frothing at the top. Do you see any of that happening right now with the TSX going up as fast as it did?***

I don't. The TSX has a huge component of natural resources and banks. When I say natural resources, it's mostly the energies. We've got a vibrant energy market. In the US, it's different. Even if you look at the Dow and S&P 500, there are a lot of differences between where the peaks occurred and where the new highs are being made.

But the TSX certainly made a new high last year. To get to that high, we are going to have the natural resources prices moving in Canadian dollar terms. Will natural resources go up? Gold is a smaller component, energies are a big component, but so are things like copper, steel, and nickel. Those prices are going up as well. Next year, we could see new highs being made.

In fact, Charles Dow had this idea, which Ralph Elliott used, and that is that there are three stages of the market: accumulation, the big move, and distribution. The Elliott wave theory, with the three upward moves and two retracements in the bullish phase, is very similar. So if I had to use that terminology I would say we are exiting the accumulation phase or the first upward phase. We've seen a consolidation in the last couple of months — that is, August–September — but I am seeing a lot of interest from people now. A lot of people believe that the fundamentals will be picking up, and I am hoping for a lot of evidence to support that down the road.

What we're going to do is enter that second long phase where you get the general population entering the market and I anticipate the distribution phase to take place maybe in 2010–11. I am hoping we can break into new highs. I am currently long. I have no hedges, no shorts. But I have my levels where I will exit my positions. They are trailing levels. As of today, the TSX is trading at 11300, so my current trailing level is at 10800. So if the TSX drops below that, I will not have any hesitation to start cashing out my profits, and shorting.

People always ask me what my long-term outlook is. I respond by saying, "What does it matter?" If I buy a stock at \$50 and it goes to \$60, I am happy. It goes down to \$45, that's okay too, since I will be out of the position. If it goes to \$60, I'll set new levels.

I don't care, and that's the beauty of technical analysis. It's not just a great story to tell clients; it also works in reality.

***Thank you, Jeff.***

#### **SUGGESTED READING**

Bishop, George [1960]. *Charles H. Dow And The Dow Theory*, Appleton-Century-Crofts.

Kalinke, Tom. *Before Dow And Jones*.

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