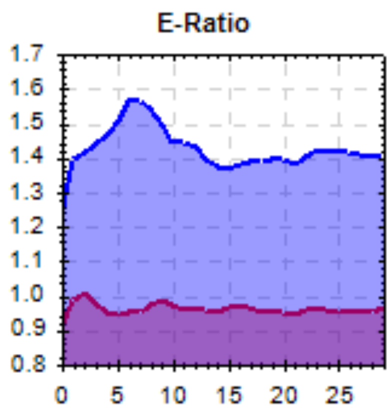
BUILD ALPHA




Edge Ratio or E-Ratio measures how much a trade goes in your favor vs. how much a trade goes against you. The x-axis is the number of bars since the trading signal. A higher y-value signifies more “edge” at that step in time.

Measurements are normalized for volatility; this allows us to use e-ratio across all markets and regimes. Once normalized for volatility, 1 signifies that we have equal amounts of favorable movement compared to adverse movement.

In other words, the y-axis is an expression of how many units of volatility more or against you your trade gets. A measure of 1.2 would indicate .2 units more of favorable volatility and a measure of 0.8 would indicate .2 units more of adverse movement.

The blue line is for the selected strategy’s signal and the red line is for a “random” strategy for the same market. The red line is to serve as a baseline to beat. Ideally, you’ll want to see a blue line above 1 and above the random line.

will withstand the test of time.

Additionally, if E-Ratio falls off a cliff at bar 6… then it probably does not make sense to hold for 15 bars!

Another tool to make sure Build Alpha + Trader = Success.

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How to calculate:

1. Record Maximum Adverse Excursion and Maximum Favorable Excursion at each time step since signal.
2. Normalize MAE and MFE for volatility. To compare across markets we need a common denominator. Let's use ATR or a unit of volatility.
3. Average all MFE and MAE values. Now you should have average MFE and average MAE at 1 bar since signal. Average MFE and average MAE at 2 bars since signal…
4. Divide Average MFE by Average MAE at each time step.

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Example. Calculate E-Ratio at one bar out from signal.

**Signal 1:**

MFE 1.50 ATR 1.27

MAE 1.00 ATR 1.27

**Signal 2:**

MAE 1.04 ATR 1.19

**Signal 3:**

MFE 1.83 ATR 1.67

MAE 1.27 ATR 1.67

Average MFE = ((1.50/1.27)+(1.33/1.19)+(1.83/1.67))/3 = 1.13

Average MAE = ((1.00/1.27)+(1.04/1.19)+(1.27/1.67))/3 = 0.81

E-Ratio at Bar One = 1.13/0.81 = 1.395

So in this example, one bar after our signal, we can expect ~.40 more units of volatility in our favor than against us. In other words, if ATR is 20 points then we can expect the trade to move on average 8 points (8/20 = .4) more in our favor than against us 1 bar after the signal is generated.

TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK OF ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR TO ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS WHICH CAN ALSO ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS AND ALL WHICH CAN ADVERSELY AFFECT TRADING RESULTS.

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# BUILD ALPHA

**Build Alpha** Automated Trading System Builder. Creates, tests, and codes systematic trading strategies with NO programming

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