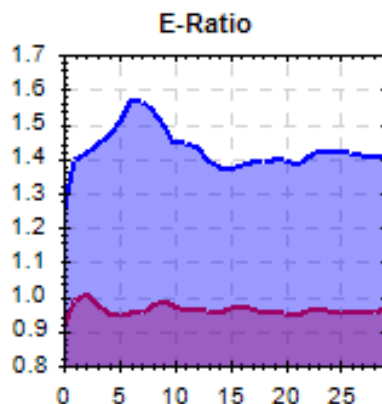


BUILD ALPHA



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.

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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.

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.
-

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:

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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.

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

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