DRS – Dynamic Risk Strategy

Strategy Summary

DRS is a counter-trending system that sells into strength and buys into weakness. The fundamental view of using this system is that currencies tend to reach equilibrium rather than trend smoothly. For example, if the EUR/USD increases by 1% it will have some retracement, even if the retracement is only a percentage of the trend increase. DRS is profiting by that retracement.

To reduce the obvious event risk of a currency pair heavily trending in a single direction with no retracement, DRS trades in pairs of 3. A common example:

EUR/USD EUR/JPY USD/JPY

If there is a move in EUR/USD, EUR/JPY will likely move in the same direction, but not exactly. Because if there is an increase in EUR across the board it will be different against the USD than the JPY. The differences can be seen in USD/JPY. This relationship is a 'triangle' and before the advent of electronic trading the differences could be exploited in "Triangular Arb".

Take an example of a news event that sells off EUR/USD by 200 pips. It may take EUR/GBP 10 minutes to adjust to the value it should be according to 200 pip drop in EUR/USD. Depending on value of GBP, that level could be 20 pips down or 50 pips, but it will be a precise value, calculable by previous (pre-sell off) value of GBP/USD.

Currencies trade in pairs yet they exist alone. You can't 'sell' dollars unless you are buying something else. A trader needs an instrument to sell against. It can be a commodity such as Oil, or another currency, the most common being EUR/USD. This is obvious but few realize that the pairs are not an exact reflection of the currency. This is understood when tracking the dollar index compared with USD/CHF, EUR/USD, and other popular dollar crosses.

DRS utilizes this triangular relationship to 'hedge out' of losing trades thus reducing risk levels to a minimal degree while allowing for substantial returns.

The secret to DRS success is the Money Management Module (MMM) which calculates overall account positions compared to trade positions. Money Managers can adjust settings according to the risk profile of the account and congruent with clearing broker. Trades can be limited in terms of Max Orders, Slippage, Stop Loss, Take Profit, Risk Level, and so on. A percentage of the account value is risked per trade in order to generate that percent of profit (for example 1% of the account value is risked in order to achieve a 1% return on the account).

DRS is a consistent money maker that can be used for smooth, consistent profits, if used correctly. It is a common mistake to increase the risk level of the system to a level where it is more than any account can handle. Used conservatively, it can never fail, aside from entropic probability that anything can happen. Used aggressively, it can be extremely successful but extremely risky at the same time. This seems like a simple concept yet most fail to understand the importance of using this strategy for slow, consistent profits.

DRS Trading Strategy Technicals

Investment Category

Single-Strategy Expert Advisor software program program within the cash foreign exchange markets (FOREX). A single Dynamic Risk Advisor, covering multiple currency pairs are employed simultaneously on fx accounts. Designed to be used by fund managers or professional traders.

Program Objective

Conservative Expert Advisor Program using a dual (long/short) Meta Trader Expert Advisor optimized to work on specific pairs, using pair-specific precision risk models. Investment objectives are to achieve steady returns while using medium to low leverage settings trading spot forex. Returns should be uncorrelated to any market, achievable in any market conditions, as the strategies are engineered to take advantage of both trend and countertrend.

Trading System Summary

DRS trades off price movements (time frame independent) long and short. The long strategy is different from the short strategy, both involve timing mechanisms but have a materially different risk management system in order to capitalize on trend and trend reversals appropriately.

DRS attempts to capitalize on the various opportunities that present themselves in the FOREX market using computer generated strategies that include (but may not be limited to) the following:

1. Short Term Trend Breakouts
2. Counter-Trend and Trend Exhaustion
3. Mean-Reversion

DRS uses indicators only for its risk management module. DRS in itself is a risk management system more than a 'signal' system. That means DRS does not rely on any specific signaling models that forecast price movements. This is why it is felt by the designers that it can work in any market conditions regardless of it's algorithms ability to forecast price movements.

DRS Long: Trending

The Long version increases position as it is in the profit, that means the purchase of 1 lot could be the purchase of 10 lots, if the 1 lot is profitable. This includes a tight stop which trails the price, such that the trade is protected from catastrophic loss while riding an uptrend in the market.

DRS Short: Counter-trending

The short version buys as the pair is declining, or buying into weakness, countertrend. As the pair declines, position side increases.

Pair Weighting

Trending pairs are overweight in the direction of their trend. Trends are decided by trading managers and are subject to change without notice. However, it does not mean DRS will not take a position which is counter-trend. That means pair weighting is an optimization technique not required for profits using DRS but it is optimal. Misallocation of pair weighting techniques may reduce returns but would not fundamentally alter the returns.

Volatility based Indicators

Both Long and Short systems use volatility based indicators for trade size allocation and take profit / stop levels. Higher volatility means smaller trade sizes and tighter stops, vice versa, low volatility means larger position sizes.

Length of trades

DRS trades can last anywhere from several hours to several days (up to 10 days max). Because DRS trades off price only, DRS will wait until the price moves in its favor before trading. If that happens sooner or later depends on the market. No timing mechanisms such as 'end of day' are included in DRS risk management policies.

Weekend trading
If possible, DRS trades are closed for the weekend to avoid event-risk and other weekend related factors. However, it is at the discretion of the managers to allow a position to sit over the weekend.

Risk Management

DRS Risk Management Module
As DRS is more of a risk management system than a trading system per se, the risk is handled by internal algorithms that make trade decisions based on risk factors such as overall account profit and loss, exposure, and volatility of the markets. The volatility based risk algorithms are significant because it is dynamic (based on current market conditions). This enables the managers to have limited involvement in the day to day trading of the system. Managers review performance and continue optimizing and tweaking risk management settings, instead of being involved in the active execution of trading itself.

Dynamic risk control:
Trades are executed electronically via Meta Trader 4 and automatically using dynamically self-adjusting risk control measures that generate initial stop-loss, trailing stops and profit targets based on their individual volatility characteristics. Typically, there are three risk-management strategies used:

- **Initial protective stop loss**— each trade has a static stop loss protecting itself from major market moves. This stop loss can be disabled or widened at the discretion of the user.
- **Trailing stop—**The initial stop loss is modified in real time, adjusted according to pair specific optimization, volatility, and other market factors.
- **Profit target**—Each trade has a profit target, like the trailing stop, the profit target is modified in real time to maximize per trade returns.
- **Volatility based stops** – Chandalier stops move in trailing fashion in accordance with market volatility.

Dynamic Stops
Each of the above are dynamic and depend on market volatility. For example, DRS uses a proprietary version of Chandalier Stops. The Chandelier Stop is a trailing stop that is based on the volatility of the market. It has been successfully used and recommended by a number of traders, including Chuck LeBeau, for trend-following systems.

Position Sizing
The DRS System uses dynamic position sizing based on volatility and calculates from a percentage of equity. In more volatile markets less of the account equity is risked (and subsequently trades will be smaller) and conversely in low-volatility markets positions will be larger.

DRS Account Protection Module
If at any time the account reaches below X% drawdown, trading will cease, positions closed, pending confirmation from clients to continue. This value can be set at any amount comfortable to the manager. Manager also reserves the right to change this value based on prudent money management assessment. Individual trades have individual stop losses, however this module will protect the principle from catastrophic loss. Set to 5%, the account would not drop below 5% drawdown.

DRS Volatility Indicators
Volatility is an especially critical issue in systems trading; a system may trade well for months but then when the market becomes volatile, the models are thrown off. Most systems do not incorporate volatility based indicators in their algorithms. It is for this reason that EES believes most systems have a ‘shelf life’ – in other words; systems are developed for a specific type of market, work for a time, and then lose. EES has attempted to deal with this issue by using volatility based indicators, lot sizing, take profits and

stop losses. DRS volatility based indicators monitor price action on a daily and short term level, in addition to making comparisons to short and long term volatility per pair, to determine volatility trends (the market may become volatile for a period of days or weeks and then settle down, such as we saw in the August 2007 Sub-prime credit crunch).

Prudent Money Management

The DRS system has been designed to protect capital while taking calculated risks for account growth. However, at any time seen fit by EES, the managers can intervene with the DRS system if it seems prudent. That does not mean the managers can protect the system from any losses, it simply means that for any reason EES managers can intervene in the functioning of the system to protect capital if they deem it prudent to do so.

Performance Data

The DRS model has been traded on numerous live accounts. The following performance data is a combination of 3 data models: Backtested "Hypotheticals", Live with paper money, and Live with Real money. We feel this is the best reflection of any system, because looking at any single test data may lead to false or incomplete conclusions.

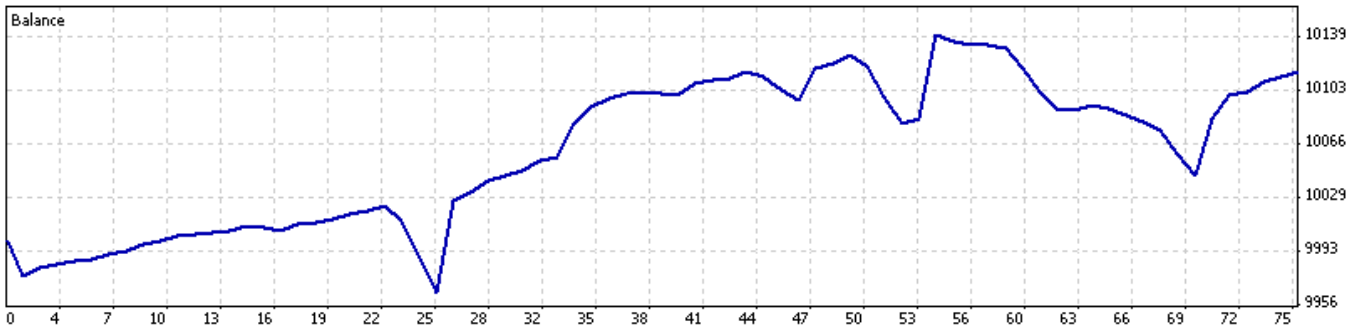
Live (Real Money)

As a model account, trading with $10,000 USD:

Summary:

Deposit/Withdrawal:	10 000.00	Credit Facility:	0.00		
Closed Trade P/L:	115.44	Floating P/L:	-40.99	Margin:	315.88
Balance:	10 115.44	Equity:	10 074.45	Free Margin:	9 758.57

Details:



Gross Profit:	367.11	Gross Loss:	251.67	Total Net Profit:	115.44
Profit Factor:	1.46	Expected Payoff:	1.54		
Absolute Drawdown:	34.89	Maximal Drawdown:	96.08 (0.95%)	Relative Drawdown:	0.95% (96.08)
Total Trades:	75	Short Positions (won %):	55 (60.00%)	Long Positions (won %):	20 (70.00%)
		Profit Trades (% of total):	47 (62.67%)	Loss trades (% of total):	28 (37.33%)
Largest		profit trade:	62.40	loss trade:	-25.80
Average		profit trade:	7.81	loss trade:	-8.99
Maximum		consecutive wins ($):	13 (33.52)	consecutive losses ($):	8 (-51.46)
Maximal		consecutive profit (count):	135.96 (11)	consecutive loss (count):	-59.10 (3)
Average		consecutive wins:	5	consecutive losses:	3

Target Performance

.25% - 1% per week*
1% - 5% per month*
40% - 65% per year*

This target is the basis for risk modeling of the Dynamic Risk Engine. These returns represent overall account returns, not per pair.

*Calculated using 1x leverage

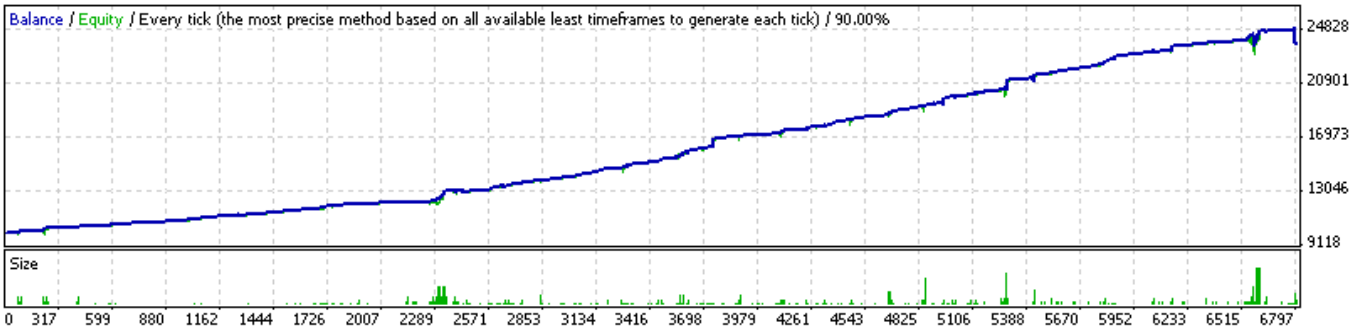
As performance is increased, so does risk. When increasing settings user should be aware it greatly increases your risk.

Backtest – Hypotheticals

HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS ACHIEVED BY ANY PARTICULAR TRADING PROGRAM. ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN 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 OF WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS.

EUR/USD Long

Bars in test	20854	Ticks modelled	6182454	Modelling quality	90.00%
Mismatched charts errors	0				
Initial deposit	10000.00				
Total net profit	13811.20	Gross profit	19410.10	Gross loss	-5598.90
Profit factor	3.47	Expected payoff	2.03		
Absolute drawdown	224.50	Maximal drawdown	1715.20 (7.04%)	Relative drawdown	7.04% (1715.20)
Total trades	6788	Short positions (won %)	0 (0.00%)	Long positions (won %)	6788 (92.58%)
		Profit trades (% of total)	6284 (92.58%)	Loss trades (% of total)	504 (7.42%)
	Largest	profit trade	479.50	loss trade	-399.60
	Average	profit trade	3.09	loss trade	-11.11
	Maximum	consecutive wins (profit in money)	235 (111.50)	consecutive losses (loss in money)	7 (-213.40)
	Maximal	consecutive profit (count of wins)	1100.20 (54)	consecutive loss (count of losses)	-974.80 (4)
	Average	consecutive wins	34	consecutive losses	3



From 2004 – 2007, trading the EUR/USD produced 14,828 in profit, on a 10,000 account. This is per pair statistics not for the entire portfolio. Entire portfolio returns would include a minimum of 5 such other examples, up to a maximum of 10.

Notes on the Backtester

Backtesting has limited accuracy, and past performance does not guarantee future results. That doesn't mean backtesting is totally irrelevant; it is a tool used for optimization and testing of strategies during the strategy building process. It enables traders to perform analytics not otherwise possible.

Trading Foreign Exchange carries a high level of risk and may not be suitable for all investors. There is a possibility that you could sustain a loss of all or more of your investment therefore you should not invest money that you cannot afford to lose. You should be aware of all the risks associated with Foreign Exchange trading. If this performance report and/or document is older than 6 months from today's date, (as dated on the front cover), then this report is outdated; you must contact the representative who gave you this document and request a recently updated version.

For more information please visit www.dynamicriskstrategy.com