

POWERRATINGS®

User Manual

Updated July 1, 2011

What Are PowerRatings: The Tool

PowerRatings is a proprietary stock rating system which ranks stocks on a scale of 1-10. The higher the rating, the greater the one week historical gain has been for stocks with that rating. PowerRatings is an easy-to-use system that assigns a rating based on the relative strength or weakness of particular stocks. This rating system helps traders and investors anticipate their investment strategy over the next 1 to 5 trading days. Each day, PowerRatings publishes several lists of different types of stocks and ETFs: highest rated, lowest rated, low-priced, tech companies and more. The lists make it easy for subscribers to manage different types of portfolios.

Why PowerRatings Work: The Data


PowerRatings are based on a data set of over 4,000,000 trades placed between January 1, 1995 and December 31, 2010. The enormous number of data points is quite simply the main reason why PowerRatings has consistently delivered the kind of trading assistance that has made it our most popular trading tool for over 6 years -- chosen by over 10,000 traders. We know of no comparably sized set of trading data that has been productized for use by the individual investor.

The data has been filtered and analyzed by our proprietary algorithms in order to assign the ratings to individual stocks. The accuracy of the ratings are validated by the historical results discussed here, as well as by the "PowerRatings Weekly Winners" article posted each week at TradingMarkets.com.

Why PowerRatings Work: Swing Trading

Swing Trading is based on buying and holding stocks for 4-7 days; it is the middle ground between the "buy & hold" approach past generations and the "day trading" (and high-frequency trading) used by Wall St. firms. Day Trading is a full time job; Buy & Hold traps your money. So Swing Trading has become the strategy of choice for the individual investor who wants to work his money hard.

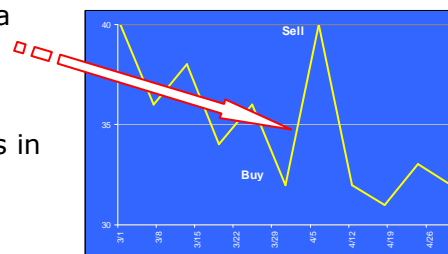
Swing Trading works because stock prices never move in a straight line when viewed daily.

An upward trending stock will typically show one big  move every few days.



Even a downward trending stock will often show a big "reversal".

Swing Traders typically use statistical and quantitative information to catch these big moves in the immediate future.



And **PowerRatings** has done just that for over 10,000 traders in the past 6 years.

Why PowerRatings Work: Quantitative Analysis

Stocks never move in a straight line, but to catch the big moves, we pretend they do by calculating a trend line. For PowerRatings we use the **"5-Day Simple Moving Average"** (5-Day SMA).

Over the course of time, the stock price will tend to bounce around above and below this average. This movement correlates to a well-known statistical principle called **"The Law of Large Numbers"**

To paraphrase this Mathematical Law: Any event that occurs in large numbers (falling snowflakes, vibrating atoms, and stock trades) will show a tendency to **"Revert to the Mean"**.



In the case of stock trades, a stock that falls too far below its 5-Day SMA will "snap back" – often going far above the mean.

Conversely, when a stock rises too far above its mean, above the 5-Day SMA, it will likely snap back, often going below the mean.

Both cases are illustrated in the chart.

As a stock price moves **further away** from the 5-Day SMA, the **tendency to snap back becomes stronger** and stronger ... this again is due to the Law of Large Numbers.

PowerRatings uses the 5-Day SMA as a part of its formula, but there are other components, which are proprietary – part of the "secret sauce" that makes PowerRatings such a reliable and accurate tool.

You can do this for yourself. Just get access to over 4 million trades, track the 5-Day SMA on all of them, add in a couple of other statistical indicators, and figure out how to weight the importance of each. Of course this is an enormous amount of work (and not unlike what staff teams at the Wall St. firms do every day).

Or you can make it easy on yourself and subscribe to **PowerRatings** and spend your time trading, not analyzing.

For a more in-depth explanation of how PowerRatings integrates with Swing Trading & Quantitative Trading Information, please take a look at the How-To Videos listed on the left navigation bar in PowerRatings.

NEXT: How to Best Use PowerRatings

How to Trade with PowerRatings: Entry and Exit Rules

There are 2 Simple Rules you should keep in mind in order to use PowerRatings to your best advantage – and increase your percentage of winning trades.

1. Use Limit Entries:

Only buy stocks with high PowerRatings (7 or higher) on a limit order below yesterday's close.

2. Use Dynamic Exits:

Use a dynamic price exit by selling when the stock closes above its 5-Day Simple Moving Average.

Take a look at what these 2 Rules show in our historical database of 4+ million trades (Jan. 1995 through Dec. 2010).

Rules Not Applied – Static Entry, Exit After 5 Days

PowerRating	Average % Gain	% Correct	No. of Trades
7	+0.7%	54%	224,744
8	+1.3%	56%	148,700
9	+2.0%	58%	25,475
10	+2.9%	62%	5,283
Avg/Totals	1.0%	55%	424,202

A high-volume, Wall St. professional might do well with this range of winning edges. As an individual, you are probably looking to make fewer trades with a higher winning edge – and bigger average gains. The 2 Rules will do that for you.

3% Limit Entry*, 5-day SMA Exit

(*3% below yesterday's close)

PowerRating	Average % Gain	% Correct	No. of Trades
7	+1.9%	68%	62,232
8	+3.1%	71%	48,650
9	+4.3%	75%	8,853
10	+5.9%	75%	1,974
Avg/Totals	2.6%	70%	121,709

The statistical principle of "Reversion to the Mean" is at work here. By using a limit entry, you wait for the price to move even further from the 5-day SMA -- the probabilities for larger snap-back start to increase. The next charts show even better historical results.

5% Limit Entry*, 5-day SMA Exit

(*5% below yesterday's close)

PowerRating	Average % Gain	% Correct	No. of Trades
7	+3.0%	70%	30,376
8	+3.9%	72%	26,215
9	+6.1%	77%	5,019
10	+7.8%	77%	1,185
Avgs/Totals	4.0%	72%	62,795

7% Limit Entry, 5-day SMA Exit

(*7% below yesterday's close)

PowerRating	Average % Gain	% Correct	No. of Trades
7	4.4%	71%	16,262
8	+6.3%	74%	15,075
9	+7.9%	77%	2,962
10	+10%	78%	778
Avgs/Totals	5.6%	73%	35,077

Even though the number of trades drops, the % correct rises to 73%, and the average gain per trade jumps to 5.6% per trade. The edges on the 9's and 10's are even more extreme, with **more than three out of every four signals being profitable** and **returns rising to 10%** per trade for those stocks which had a top PowerRating of 10.

Summary: Implementing the 2 Rules for Limit Entries and Dynamic Exist can potentially improve your winning edge and average % gain. The Rules may also trigger fewer executions, especially as you set the Limit Entry to a larger number.

PowerRatings is Not a “Black Box” (and that’s why it is so popular)

We absolutely encourage you to adjust your Entries and Exits to obtain a risk/reward profile that works best for you.

PowerRatings are viewed by many traders each day. Too many people entering or exiting at a fixed price, or on the open, may potentially have an impact on price behavior (and likely make at least a few specialists and market makers wealthier). Also, in low volatility environments, fewer stocks trade to the 4-7% levels than in high volatility environments. Therefore, when you apply PowerRatings to your trading, please be cognizant of these facts when entering and exiting positions.

Next: One Final Important Tip...

How to Trade with PowerRatings: Trade a Portfolio

If you are an active stock trader, you already know what we're about to say. But it bears repeating. The professionals know that is a generally safer to make several small trades as opposed to putting all your eggs in one basket.

PowerRatings are based on historically proven, statistical outcomes. The quantitative principles involved work in quantity – not single stocks.

We are not implying that you need to make dozens of trades each week to realize the benefits of PowerRatings. However, we do caution against looking at PowerRatings as a single “stock picker”.

Let's take a simple example. We know that by using the 7% Limit Entry and 5-day Dynamic SMA exit, the historical results show a better than 75% winning edge on stocks with PowerRatings 9/10. So, if you trade 4 stocks, you may see a positive return on that small portfolio. However, if you trade just one stock, while your simulated edge is the same, your “sample set” is simply not large enough to let the laws of statistics work for you.

PowerRatings is a tool to help active traders manage their portfolios. This is why we include the My PowerRatings Portfolio feature. While there really is no set minimum number of trades per week you need to make in order to see PowerRatings work, if you just use PowerRatings to pick a stock here, an ETF there...you are not using the tool as intended. We recommend making at least a dozen trades. You can always make these as “paper trades”, simply recording your buys and exits with a tool of your choice – without committing any real money.

We hope this information is helpful to you. If you have any questions on the research or the strategies, please feel free to email us at editor@tradingmarkets.com or call 973-494-7311.

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