

# *RAPTOR-II*

## Strategy Guidebook

*Trading Markets Financial Group, Inc.*

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# Introduction

I'd like to welcome you to the Raptor-II Method. In this guidebook, I'll be providing you with the background of Raptor-II, its rules, and a further description of the rules to help you better understand the reasons behind them. In my taped presentation, we'll go even deeper into the methodology, plus we'll look closely at the past decades test results.

Raptor-II was created by Cesar Alvarez, Director of Research for Connors Capital. In the 1990's, Cesar was a senior engineer at Microsoft who helped build Excel. What Cesar has done in Raptor-II is quantify when to buy a stock after it has had a large short-term decline. As far as we know, the statistical data presented in Raptor-II is amongst the deepest and most robust published on this behavior. Through this guidebook, and the online presentation, I will share with you these findings and teach you how to trade Raptor-II as a portfolio, with options, and with individual stocks. If at any time you need any assistance, please feel free to contact me.

Now let's look at the rules for Raptor-II. Then we'll go deeper into each rule.

## Rules

1. Today's closing price of the stock is greater than its 200-day simple moving average (MA).
2. Today's closing price of the stock is less than its 20-day simple moving average.
3. Today's 2 period RSI is less than 5.
4. The 10 period ADX of the stock is greater than 20
5. The 100-day historical volatility filter is greater than 20%.
6. Liquidity Filter is greater than 3. To calculate the Liquidity Filter use this formula:  
  
If the 20-day ma of the Close\*Volume of stock is greater than the (65-day ma of the Close\*Volume of SP500) times .000003, it's a candidate to trade.
7. Today's close is 15% or more below the close 5 days ago. OR, today's close is 7.5% or more below the close 2 days ago
8. If all of the above occur, tomorrow you will place a limit buy order 8% below today's close.
9. If you are filled, you will wait for the 2 period RSI to close above 70. When this occurs, you'll exit on the next morning's open.

Now let's go deeper into each of these rules:

We use the entire universe of stocks available to us. You can find this list in any database, including TC Net and TradeStation.

**1. Today's closing price of the stock is greater than its 200-day simple moving average.**

We want the stock to be in a longer-term uptrend. As you may have seen in other research we've published, stocks as a whole perform better on the long side when they are trading above a longer term moving average such as 200 days and 300 days. For Raptor-II, we ideally want to be in stocks above their 200-day ma.

**2. Today's closing price of the stock is less than its 20-day simple moving average.**

We then want to stock to exhibit a strong pullback within its longer-term uptrend. We begin this process by looking for it to close under its 20 period moving average.

**3. Today's 2 period RSI is less than 5.**

We want the 2-period RSI to close under 5 today. This gives us even further confirmation that the pullback has been strong. Ideally, we want to always buy strong stocks with

strong pullbacks.

#### **4. The 10 period ADX of the stock is greater than 20.**

ADX stands for Average Directional Index. Even though it can be used to show the strength of the trend, it can also be used as a volatility filter (only a few people know this). This rule, and the next rule are our volatility rules. We want stocks to be moving. It's very difficult to make money in stocks that have been trading sideways and Rule 4 assures we're not in sideways moving stocks.

#### **5. The 100-day historical volatility filter is greater than 20%.**

By combining this with Rule 4, we've added further confirmation that the stock has been moving.

#### **6. Liquidity Filter is greater than 3.**

Typically, price and volume are key factors in identifying liquid stocks, i.e., higher price and higher volume mean better liquidity. But, when modeling trades over an extended history of 10 years or more, the significance of a \$20 price or a 1,000,000 share trading day can change a great deal over time due to splits and the general escalation of prices and trading volumes. To address these effects, we first measure Liquidity as an "average dollar volume", i.e., an average of Closing Price multiplied by Daily Volume, to "neutralize" the im-

part of splits. Then, we require that the stock's liquidity be at least a chosen "Liquidity Filter (or Factor)" times a similar measure of liquidity for the S&P 500 Index to place the stock's liquidity in context of the overall market. This second step reduces the impact of price and volume inflation.

Now that we've established our filters to assure we're in the right stocks, the next two rules are the backbone of Raptor-II:

**7. Today's close of the stock is 15% or more below the close 5 days ago. OR, today's close is 7.5% or more below the close 2 days ago**

We want to be in stocks which have been hit VERY HARD over the past 2-5 days. In our testing, we have found substantial statistical evidence that the harder a stock has been hit (after filtering with the above rules), the greater the short-term bounce has been. And, as you will see from the simulated returns, these short-term bounces are amongst the biggest we have seen in any research to date.

Therefore, we want a stock to close today at least 15% below its closing price 5 days ago. Or, we want it to have dropped 7.5% or more over the past 2 days.

**8. If all of the above occurs, tomorrow morning before the opening you will place a limit buy order 8% below today's close. Meaning if the stock closes at \$50 today, you will place a buy limit order at \$46 for tomorrow (8% below \$50).**

*This rule is the key. We will only buy the stock if it is getting hit again.* Therefore, not only has the stock been recently hit hard, it is getting pummeled again. And if this occurs, our research has quantified that the stock has been very, very close to a near-term bottom. In fact, nearly 80% of the time this occurred from 1995 through the first quarter of 2006, the stock has been higher, on average, 8 days later. And, the average gains when they were higher, were over 15% per trade.

**9. After you are filled, you will wait for the 2-period RSI to close above 70. When this occurs, you'll exit on the next morning's open.**

As you may know from other research we have published, the 2-period RSI exit above 70 (and 75) is very effective. With Raptor-II, we exit on the opening the morning after the RSI is above 70. Since 1995, this exit has led to gains just under 80% of the time.

**10. For the portfolios, you will buy a maximum of 10 positions (10% per position).**

You will never buy the same stock a second time when you are in it (meaning you are in the

stock and another buy signal occurs). If you want to be more conservative, you can trade 15 positions or 20 positions. We have provided the additional research statistics for you for the larger portfolios.

Now let's move on to individual stock trading.

## Individual Stock Trading

You can trade Raptor-II on an individual stock basis (meaning outside the portfolio). The rules are exactly the same. The only difference is that you have more discretion as to which trades to take, and your position size per trade. Please remember though, that these are very volatile stocks and you want to make sure you understand the risks involved.

I'll now discuss some additional points for you to further understand and implement Raptor-II.

### Stocks Questions and Answers

Q: Will all my stock orders get filled?

A: No. Many of your limit orders will not get filled. Why? Because we need the stock to drop another 8% intraday after we have placed our order. The key is to be patient and wait for this to happen. On average approximately 16% of the trades have been filled since 1995.



Q: What if I want to get more signals? Can I loosen the filters?

A: The answer is yes. We looked at literally hundreds of variations for over a decade's time. What we found was that you can loosen the parameters, get more trades, and still have good simulated results. For example, lessening the drop for today from 8% to 5% gives more trades. The average gains/trade was obviously not as high as they were at 8% (because the stretch is not as extreme), but they did create more opportunities and the gains/trade were very good. We'll discuss this even further in my presentation.



Q: Portfolio question. What happens if I have 6 positions and there are 20 set-ups for the upcoming day? What do I do?

A: If you have 6 positions, you only have 4 remaining slots (assuming you are trading a 10 stock portfolio). You will only place orders for the 4 remaining slots. The orders will be placed on stocks with the highest 100-day historical volatility.



Q: Do I have to have my orders exactly at 8%?

A: No, it's a guideline. Adjusting it by a few cents will likely make little difference in the net results in the long term. There's plenty of flexibility here for you.

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## Trading Raptor-II With Options

Raptor-II is not an options trading course but yes, you can trade options with Raptor-II. The average gain per trade has been substantial and the edges in options have also been substantial. We encourage you to learn as much as possible about options before trading them (and please understand that the risk is higher). But, here a few thoughts for you.

Ideally you want to be in front of the screen when the stock drops intraday. That way you can simply place a market order to buy calls. But assuming you can't, you may simply want to place a buy order under the market for the options. For example, if stock XYZ is trading at 50 and the buy order on the stock is 8% lower (46), you will want to look at the \$50 calls. Let's assume the calls are trading at \$2. You can either guesstimate where you want to buy the options (likely under \$1) or you can use options software, which can tell you approximately where the options will be priced if the stock drops 8% today.

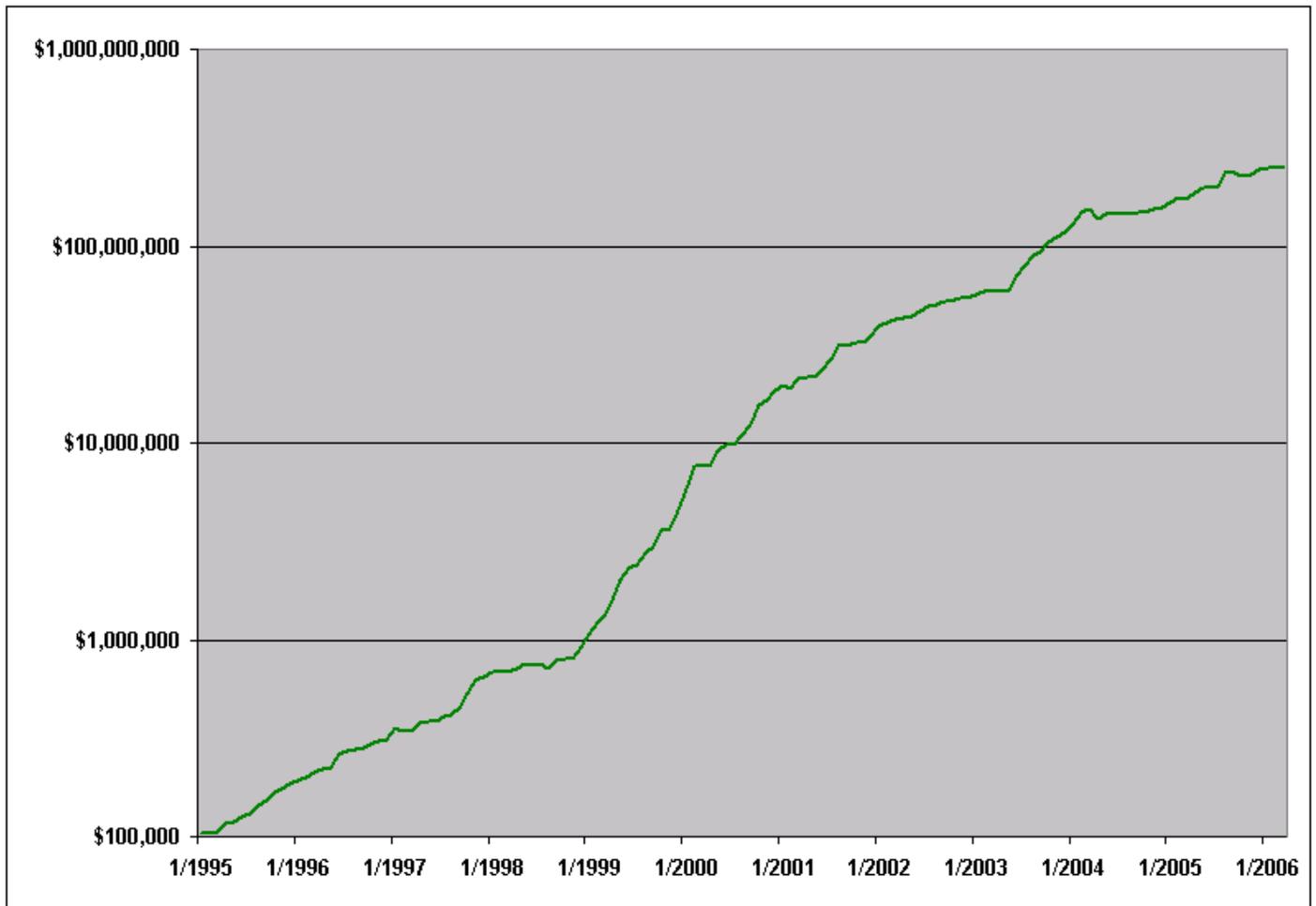
Our guideline is to focus on the near month options that are closest to yesterday's closing price (before today's drop). For example, if the stock closed at 50 yesterday, you'll want to buy the 50 calls if the stock hits 46 today. I'll provide more examples of this in my presentation.

## Raptor-II Monthly Returns 1995—2006 (8% drop)

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
1995	3.14%	1.61%	1.17%	9.52%	1.89%	5.64%	5.77%	8.38%	6.21%	9.66%	5.48%	5.54%	85.77%
1996	3.94%	3.63%	6.67%	3.12%	2.13%	16.14%	4.45%	1.91%	1.72%	3.20%	3.82%	2.11%	66.48%
1997	16.25%	-3.86%	-0.16%	9.55%	1.71%	-0.33%	5.77%	3.45%	7.97%	18.98%	15.30%	5.10%	111.08%
1998	4.63%	0.45%	0.03%	4.69%	4.38%	-0.93%	1.22%	-5.03%	10.99%	0.51%	0.25%	14.36%	39.95%
1999	17.37%	13.48%	11.60%	22.68%	21.43%	13.36%	5.38%	14.07%	7.57%	22.58%	1.64%	22.89%	396.96%
2000	28.35%	30.81%	0.65%	-0.34%	18.77%	8.78%	-0.53%	11.41%	13.85%	24.42%	6.88%	11.40%	306.70%
2001	6.19%	-3.30%	11.53%	2.91%	-0.09%	9.67%	11.69%	19.02%	-1.17%	2.84%	0.78%	8.14%	90.13%
2002	11.95%	4.74%	2.63%	2.16%	1.74%	5.57%	7.08%	2.42%	2.60%	1.33%	2.32%	1.52%	56.40%
2003	3.14%	4.52%	1.30%	-1.40%	1.76%	17.62%	13.42%	11.29%	5.38%	10.44%	6.14%	7.59%	116.19%
2004	8.38%	15.51%	3.42%	-10.10%	6.21%	0.81%	-1.98%	1.21%	0.53%	1.11%	2.44%	2.17%	31.53%
2005	7.18%	5.37%	-2.39%	9.72%	4.43%	1.29%	-0.70%	20.82%	-0.78%	-3.80%	0.42%	5.80%	55.66%
2006	2.12%	0.22%	0.14%										2.49%
<b>Average Compounded Annual Return</b>													<b>100.40%</b>

Based on simulated trading. Past performance is not a guarantee of future results.

## Raptor-II Equity Curve Based on a starting balance of \$100,000 1995—2006 (8% drop)



Past performance is not a guarantee of future returns. Based on simulated trades.

## Raptor-II Annual Returns Summary 1995—2006 (8% drop)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
<b># Trades</b>	86	154	237	132	208	731	176	91	141	121	69	12	2158
<b>Avg % Profit</b>	10.72%	8.69%	12.21%	7.47%	11.76%	11.37%	5.49%	6.47%	9.17%	4.89%	8.11%	3.27%	9.70%
<b>% Winners</b>	86%	80%	83%	78%	87%	80%	73%	76%	89%	64%	78%	50%	79.75%
<b>Avg Hold</b>	7.0	7.4	7.2	7.9	7.2	7.2	8.3	8.1	7.5	8.8	8.4	9.9	7.5
<b>MAE</b>	-8.7%	-11.4%	-8.0%	-10.5%	-9.2%	-16.8%	-11.4%	-10.7%	-7.6%	-10.0%	-9.6%	-11.6%	-12.1%
<b>MFE</b>	15.9%	16.0%	19.1%	14.8%	18.1%	21.0%	13.7%	14.3%	14.3%	13.6%	16.6%	12.8%	17.6%

15.27% Avg % Winner  
 -12.30% Avg % Loser  
 4.91 Profit Factor  
 53% % Double Digit Returns  
 16% % Of Setups That Trigger

Past performance is not a guarantee of future returns. Based on simulated trades.

## Summary

This guidebook gives you the parameters needed to execute Raptor-II. Please join me for my on-line presentation, which discusses Raptor-II further. And again, if you have any questions please feel free to contact me any time at [Stevep@tradingmarkets.com](mailto:Stevep@tradingmarkets.com).

Sincerely,

Steve Primo  
Director of Education  
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