The Simple Indicator That Beats the Market Consistently

Which ETFs to Buy Now and Which ETFs to Avoid
This Simple Indicator Beats the Market Consistently

Seeing trends in the past is easy, but correctly figuring out which ones will continue is not.

If you’re a trader who likes to hold on to trades that trend nicely for weeks or even months at a time then you’ll probably agree that finding the right trend to trade is half the battle in swing trading profitably.

Trading rules are critical to consistent profitability, but big trades from big trends are what create massively profitable swing trading systems.

At MarketGauge.com we have spent over 30 years trading trends in all types of markets including futures, forex, stocks and ETFs.

We have found that across all markets there are some common truths that great traders use to make lots of money.

One of these time tested market truths is that market leaders have superior trends.

You’ve probably heard the cliché, “the trend is your friend”, well, professional traders know the trends in the market leaders are your best friend if you are a trend trader!

A Simple Indicator That Identifies Market Leadership Trends

There is a simple way to identify market leadership trends that can generate huge trades.

There is the powerful indicator that every trader should know about. It has been used by professional traders for decades to solve the problem of finding the trades that make those massive trending moves for weeks and even months.

The indicator is “Relative Strength Rank”. This is NOT the RSI oscillator that is popular among traders. It is completely different. And unlike many indicators you may be accustomed to,

Relative Strength Rank is not an indicator that you necessarily plot on your charts.

Relative Strength Rank is, like it sounds, a ranking of trading instruments based on their price strength. (A more advanced version of this will rank the instruments not just by their price strength, but by the strength of their trends, but more on that later.) This ranking easily works well with stocks and ETFs.

More specifically, Relative Strength Rank is the result of ranking a list of trading instruments by a measure of price performance.

The strongest performers have the highest ‘Rank’.

In this report you’ll see a very specific application of this indicator, and proof, that it can easily identify the instruments that will out-perform the market for weeks and even months at time. With this edge, you can find powerful trends that create great swing trades.

Institutional Research Confirms It Works

I could find dozens of examples of how professional hedge funds have used this concept for years, but here are just a couple examples that you can easily research further in addition to this report.

James O’Shaughnessy literally wrote the book on powerful trading systems that are tested and employed on Wall Street. In his bestselling book, “What Works on Wall Street”, James O’Shaughnessy spends a lot of time showing how Relative Strength Ranking is one of the best performing systems. As he states, “Over six-month and twelve-month periods, winners generally continue to win and losers generally continue to lose” – page 443.

Legendary investor, advisor to professional investors, and founder of Investor Business Daily
newspaper also employs the concept of Relative Strength Rank in his approach to finding winning stocks. In fact, his rule #7 of the “Top 23 Rules” for the active investor reads, “Stock should be in the top 10% of the IBD’s 197 industry sub-group rankings”

**A Simple System That Proves It Works**

At MarketGauge we’ve used this concept for years to find profitable trades. We’ve even used the process below to build trading systems that are 100% rules based and have dramatically outperformed the markets by as much as 15x!

Here is a simple system, 100% rules based, that proves how powerful this indicator can be in finding the right instruments that will continue to trend in the future. This system is based on ETFs that track industry groups, but the same concept can be applied to other ETF themes (i.e. countries) and stocks (as demonstrated above). By using a broad selection of industry groups our strategy will have the opportunity to benefit from any major business trends that develop.

<table>
<thead>
<tr>
<th>11 basic industry group and sector based ETFs to create our system</th>
</tr>
</thead>
<tbody>
<tr>
<td>IYR – Real Estate</td>
</tr>
<tr>
<td>XLV – Healthcare</td>
</tr>
<tr>
<td>IYT – Transportation</td>
</tr>
<tr>
<td>XLB – Materials</td>
</tr>
<tr>
<td>XHB – Homebuilders</td>
</tr>
<tr>
<td>SMH – Semiconductors</td>
</tr>
</tbody>
</table>

First we take this list of 11 ETFs and calculate the six-month percent price change of each of the ETFs. This can easily be done by dividing today’s closing price by the closing price six months ago. Then sort this list from highest to lowest percentage gains.

Next we apply a few basic trading rules and see what the results are. First, sort the sectors daily by 6 month percentage change. Then buy the leading sector ETF on the market open the day after it becomes the highest rank. Just hold one position. If the ETF drops down to second place, sell out of it and buy the new market leader.

This simple strategy crushed the market over the last several years. *If you had been trading it for the last seven years you would have than quadrupled the performance of the S&P 500 over that time period.*

As you can see, especially over time, being in the market leaders without any discretionary analysis has dramatically beaten the market and generated big gains! Plus, It’s out performed the market in the last 1, 3, 5 and 7 year time frame.

There is one more rule that was employed that is important enough to highlight on its own...

This system only bought the leading ETF if it had a positive percentage return for its calculation of the Relative Strength Ranking.

<table>
<thead>
<tr>
<th>Model</th>
<th>SPY</th>
<th>Out-performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Last 8 years</td>
<td>+114%</td>
<td>+39%</td>
</tr>
<tr>
<td>Last 7 Years</td>
<td>+238%</td>
<td>+59%</td>
</tr>
<tr>
<td>Last 5 Years</td>
<td>+111%</td>
<td>+91%</td>
</tr>
<tr>
<td>Last 3 Years</td>
<td>+75.0%</td>
<td>+57.6%</td>
</tr>
<tr>
<td>Last 12 Mo.</td>
<td>+10.9%</td>
<td>+7.5%</td>
</tr>
</tbody>
</table>
In other words if all the ETFs had negative 6-month percent price change the system would be in “cash” or no position.

The reason for this rule is simple. **One of the reasons this system works so well is because market leadership trends persist.** If there is no leadership that is going up then we don’t want to be invested!

As further demonstration of the power of the persistence of trends, if you had used the same ranking system but instead purchased the worst ranked sector your performance would have under-performed the market by 4x!

The simplest take away here is this: buy the leaders, not the laggards! Of course, there are always opportunities in instruments that have been beaten up, but those often require a significant amount of special research to find the right opportunities.

**Warning: Don’t Follow This Blindly. There Is More…**

The results of this system demonstrate how simple and powerful Relative Strength Ranking can be, but there are some weaknesses you’ll quickly discover if you try to implement this exact system “as is”. The most obvious weakness is that you are subject to having to change your position very frequently in periods where the #1 and #2 ranked instruments are neck and neck in the ranking and might trade places frequently. This will create frustrating and expensive “churning” of the portfolio.

This problem, of course, is solvable. **In fact we’ve used this indicator and basic premise for a system to create systems that have outperformed the markets by as much as 15x!**

However, just like our rule to avoid buying the #1 ranked ETF if the 6-month return is negative, we’ve achieved the dramatic and impressive results by making at least 7 other key changes to how the system trades. This includes improving on the basic momentum ranking of 6-month percent change, instrument selection, entry and exit rules, and more.

To learn more about swing trading ETFs and stocks go to: [www.marketgauge.com/etfmodels](http://www.marketgauge.com/etfmodels).

**You Can Profit From This Now**

You could take this concept and start building your own system, or more simply…

Now that you see the power of this simple indicator, there are a number of ways you can easily use to make your trading more profitable. Here are just a few:

1. Focus on trading bullish patterns in ETFs that are the strongest amongst their peers
2. Avoid picking bottoms in the worst performing stocks and ETFs
3. Focus on trading bullish patterns in the top performing stocks, that are also in the top performing industry groups or industry group ETFs that are the strongest amongst their peers

**Never Stop Learning and Improving**

This concept of identifying market leadership in a systematic and momentum based way has been around from the beginning days of the stock market. However, the rise of ETFs that track specific themes in the markets has created incredible trading opportunities for you that were previously only accessible to big institutions.

The ability to leverage Relative Strength Rank in the ways demonstrated above is just one example of how the traders at MarketGauge.com use their collective 90+ years of trading experience to trade the current markets for themselves and their clients.

To learn more about swing trading ETFs and stocks go to: [www.marketgauge.com/etfmodels](http://www.marketgauge.com/etfmodels).