

## Davis, Ned – Being Right or Making Money

John Wiley & Sons, 2014 (3<sup>rd</sup> ed), [Finance] Grade ★★★

Ned Davis, the Senior Investment Strategist and founder of Ned Davis Research, has become legendary in the finance industry for his market letters combining fundamental data with technical indicators over the last 40 years. Without having the data to back it up I am also of the view that he's often been quite correct in reading the market.

The name of the book refers to the practice of making forecasts (trying to predict what the market will do in the future, i.e. "being right") versus developing an investment strategy that could make you money despite the fact that forecasting doesn't work. In the introductory chapter Davis points to the keys to making money as being; using objective data instead of gut feeling, following a disciplined strategy, being flexible to adjust in response to changing environments and employing risk management practices to ensure mistakes don't get out of hand.

The setup of this book is somewhat unusual. The first 4 chapters (or about 115 pages cover) the philosophical aspects of Davis methods, the practical aspects of how to build models to be able to trade financial markets and further examples of a market model for equities and bonds respectively. Then the remaining 3 chapters or 100 pages add on some somewhat unrelated thematic pieces on the risk for a bear market in 2014, the investment implications of demographic developments and whether the US will become energy independent. Most chapters are written by others than Ned Davies and I'm frankly not sure what to make of the second part of the book – is the reader being served samples of the type of research Ned Davis Research can perform? For me the first part is the core, the rest is an appendix – albeit with interesting features.

With the aim of "trying to get into harmony with the reality of the current numbers" Ned Davis Research builds multifactor models out of a number of indicators of different types to gain a

trading view of a specific market. The indicators look to market prices, monetary policy, investor psychology etc. and some of the internal rules at Ned Davis Research are "don't fight the tape", "don't fight the fed" and "be wary of the crowd at extremes". The book gives examples of a number of the indicators in use, including graphs and some data on how they have fared historically. A full model is constructed by giving an indicator +1 if it is sending a positive signal, -1 if it sends a negative and 0 if it's neutral. The models sums up to a total score, although some indicators could have higher weight than others. The combined score is the view on the specific market.

As evident we are talking about trading models with relatively short time horizons. The approach is data driven and very objective and in that way supports the trader in handling his own market psychology. With 40 years' practice Davis and his coworkers have also thought long and deep on which indicators to use to read the market. The indicators used actually look to fairly different time horizons where most are trend following and some are shorter-term contrarian. As they have such different characters I wonder if it's the best practice to simply sum them up. Also adding up to 35 indicators on top of each other to give one numeric grade of what is happening surely brings a valuable simplicity but could also in my view risk concealing what happens beneath the surface and as such obstruct deeper market understanding.

Although I'm not a trader myself I have huge respect for the work Ned Davis does as he looks to numbers and validates what makes money and what does not. I like the approach of reading what the market is doing instead of trying to guess what it will do. As a book however, the first part is relatively short and sketchy and the second fairly unnecessary. If Davis in the next edition would use all of his available space to share his insights into model building that could become a trading literature classic.

Mats Larsson, December 4, 2016