

Kevin Davey was interviewed by Andres Garcia of www.tradingsys.org. This is an excellent trader website, but is unfortunately (for non-Spanish speakers) in Spanish. One can use the Google Translator http://www.google.com/language_tools?hl=en to translate the whole webpage or portions thereof.

A transcript of the interview is provided below in English. Due to translation issues, this may vary slightly from the version found at www.tradingsys.org.



*Kevin Davey has been trading the futures markets for over 18 years. In 2005, he finished in 2nd place in the World Cup Trading Championship with a 148% return. This contest is a year long, real money trading contest for traders around the world. In 2006, Kevin finished in 1st place with a 107% return. And, in 2007, Kevin finished in 2nd place in 2007 with a 112% return. Kevin is currently an advisor with World Cup Advisor (www.worldcupadvisor.com), and writes for magazines and websites such as *Forex Journal* and *Inside Futures*.*

1) I Will begin this small interview with the one in a million question: How did you begin in this? Which were your first steps as a trader in the future markets?

I first started about 18 years ago. I was lured in by a mail order ad for trading commodities. I remember it showed how you could have made millions in sugar. The course was pretty useless, but after that I was hooked. From there I graduated on to simple moving average crosses, and other simple techniques that all lost money. But I just kept trying to learn, and as time went on, my methods became more successful.

2) In your opinion, What type of formation and personal aptitudes do you consider necessary for those who initiate their adventure, as independent traders, developing and managing their own strategies?

To be an independent trader, you need a lot of skills. First, you need to be able to think differently than others - to not follow the crowd. If you are easily influenced by others, you'll have trouble. In one of my favorite books, it is called being a "lone wolf." Second, you have to be extremely detail oriented. You have to pay attention to many little things. For example, when you test a strategy, sometimes the slippage will either make or break the system. So, knowing a proper slippage amount for each market (they might all be different) can be critical. Third, you have to be able to follow a step by step scientific process to develop a trading strategy, but at the same time realize that there is no perfect step by step process. So, on one hand you have to like

structure, but on the other hand you may have to create that structure. Lastly, you have to have the confidence to put your plan into action. I've seen many traders who can develop a system, but are then afraid to trade it, or trade it for a while until it hits an inevitable small rough patch.

3) Many books, some excellent and others of terrible quality exist: Which are your favorite ones on these subjects?

My favorite book, that I referred to earlier, is "Reminiscences of a Stock Operator." Although it is 86 years old, it describes the mind of a trader better than any book I have ever seen. I re-read it about once per year, and I get new something out of it every time. I also like books by Van Tharp, especially "Trade your Way to Financial Freedom." Robert Pardo's book "Design, Testing, and Optimization of Trading Systems" should be required reading for anyone developing a system. And, you can't go wrong with the "Market Wizards" books by Jack Schwager. These books don't give you systems, but instead put you in the right mindset for developing your own.

As I mentioned earlier, I think one key to being a trader is thinking differently. So, I read a lot of non-trading books, to clear my trading mind and open up new ideas. One of my favorites is "Journey To Ixtlan - The Lessons of Don Juan" by Carlos Castaneda. It is a tough read, but certainly changed my way of thinking about things.

4) At the moment we maintain an incessant debate on the advantages of systematic or discretionary trading. What is your attitude on the matter ? What do you think of the automatic systems based on rules?

The only systems I trade are mechanical, where all the rules are established, and I just have to follow them. Many of these are 100% automated, which I really like. So, I am definitely biased in this regard. My background is math and science based – I once worked at the US Space Agency NASA- so I need to be able to test and prove any rules I develop. Many people don't need that rigor - they can look and trade off a chart, or a "feeling." I admire those people, but I know myself well enough to know I could never trade that way.

5) A lot has been said about the systems type "Black Box" based on genetic algorithms and neuronal networks. In your opinion, are they better or worse than the systems based on discreet and simple rules? Is it true the topic "the more simple a system is, the better it works,"?

I have seen very complicated systems that work, and ones that don't work or stopped working. I have also seen simple systems that work, and other that have stopped working. So, I don't think there is an answer to that question. In my development, I have approached new system creation 3 different ways. Sometimes, I start with a very complicated system of over 25 variables or parameters. Other times, I start with a system with between 5-10 variables. And my simplest systems have maybe 1- 3 variables. I have success with all 3 methods, and also failure. I personally like simple systems that have worked over a long period of time. But, those are difficult to find.

6) We all have predilection for some markets, Which ,at the moment, are your favourite markets to operate systems?

Right now, I favor trading the US stock indices - the mini S&P, mini Russell and the mini Nasdaq. But, I also have systems that trade a basket of commodities, either outright or via spreads. I think the key is that all markets have good times and bad, and diversification is important. I personally trade 6 different systems, all with different objectives, timeframes and styles. So a bad day with my stock systems might be offset by a good day with my spread system.

7) In the same way, we also have our favorite strategies. Which are yours; trend following, volatility breakout, pattern recognition, countertrend...?

Again, for diversification purposes, I use different styles. I have trend followers, countertrend strategies, seasonal and volatility breakout systems. I also like the idea of pattern recognition entries, but I haven't yet been able to find anything that meets my criteria.

8) Which are, in your opinion, the favourite ratios at the time of valuing the quality of a trading system? What must we pay attention to ?

Obviously, net profit is a must, but I also look at expectancy, profit factor and drawdown. Return on Account is also good, since it combines Net profit and maximum drawdown (I use the Tradestation definition for Return on Account = Net Profit / Maximum Drawdown). Depending on the strategy, and what I'm looking for, I might be interested in percent time in market, or even the number of consecutive losses. So, I don't have any hard fast rules for what I look for - rather, it depends on the system, and on other systems I have.

I'll give you one example: I have a system called "Gen 2 - Mini S&P Only," that trades the mini S&P. Because of the large drawdowns in this system, I wanted to combine it with another system that mitigated the drawdowns. So, I developed "Mini N&R," which trades the mini-Russell and mini-Nasdaq. My main criteria for "Mini N&R" wasn't the overall profit, but instead how it combined drawdown wise with "Gen 2 - Mini S&P Only." As it turned out, "Mini N&R" is a good money maker on its own, AND when combined with "Gen 2 - Mini S&P Only" it lowers the overall volatility.

My final criteria is Rate of Return, for a year's worth of trades. I calculate this by running a Monte Carlo simulation, with maximum limits set for risk of ruin, maximum drawdown and other parameters. So, this rate of return encompasses many of my objectives in it.

9) A lot of good quality software exists for the development and application of systems at the moment. What platforms do you consider good and recommend to the readers?

I use Tradestation, but I don't know if that is the best or not. It takes a lot of time and effort to become experienced with any software, and since most are pretty similar in function, but not necessarily in computer syntax and language, I think the best approach is to research them all, pick one and stick with it. No software is perfect, but I know the limitations of the software I use, and I am able to work around these limitations.

I also use Excel for many things, including position sizing and Monte Carlo exercises. Writing your own studies in Excel takes more effort, but it greatly increases your understanding of the subject matter. Plus, it can be customized to exactly fit your needs.

10) In your opinion, what is the most decisive element to design a good strategy: entrances, exits, money management or a suitable selection of markets...?

An argument could be made that each of the areas you mention is important, and they all are. To a trader just starting out, entrances and exits are important, but money management is the key - you do not want to run out of capital. As the trader's equity grows, money management and position sizing become key, since the goal is to take a good system and maximize its potential profit (and not lose it all!). As the trader matures, eventually he will have both the capital and the experience to trade multiple systems, so eventually diversification becomes important. Growth becomes steadier, and drawdowns are less severe when diversification is done correctly.

11) Do you, in particular, use in your system any position sizing algorithm?

When I develop strategies, I typically use 1 contract. That is because I like to see the strategy performance by itself, without any position sizing influence. When I start trading with real money, I also typically start with one or two contracts, just to test out the real time performance. Eventually, if things go right, I will use position sizing algorithms to determine size, based on the results of Monte Carlo simulation.

12) I do not want entertain you any more, because I know that you are very busy and that time is scarce. Just to finish, What project are you working on at the moment? How can the readers contact you who are interested in your TRADING strategies?

At any time, I am working on about a half dozen different development projects, along with other trading activities, such as writing and consulting. But since I have found that it takes 100 to 200 trading ideas to develop a working system, development is a slow process.

Anyone interested in learning more can visit my website at <http://www.kjtradingsystems.com> , and you can also see the real time performance of some of my systems at <http://www.worldcupadvisor.com>, <http://www.collective.com/go/mini> or <http://www.collective.com/go/gen2min>  you can also e-mail me at kdavey@kjtradingsystems.com.

Information on My Strategy Factory Webinar

This interview I did with Andres Garcia discussed a lot of the steps I use in my Strategy Factory, although I did not call it a "Strategy Factory" back then. Click the link below to learn more about this unique webinar.

<http://www.kjtradingsystems.com/id177.html>