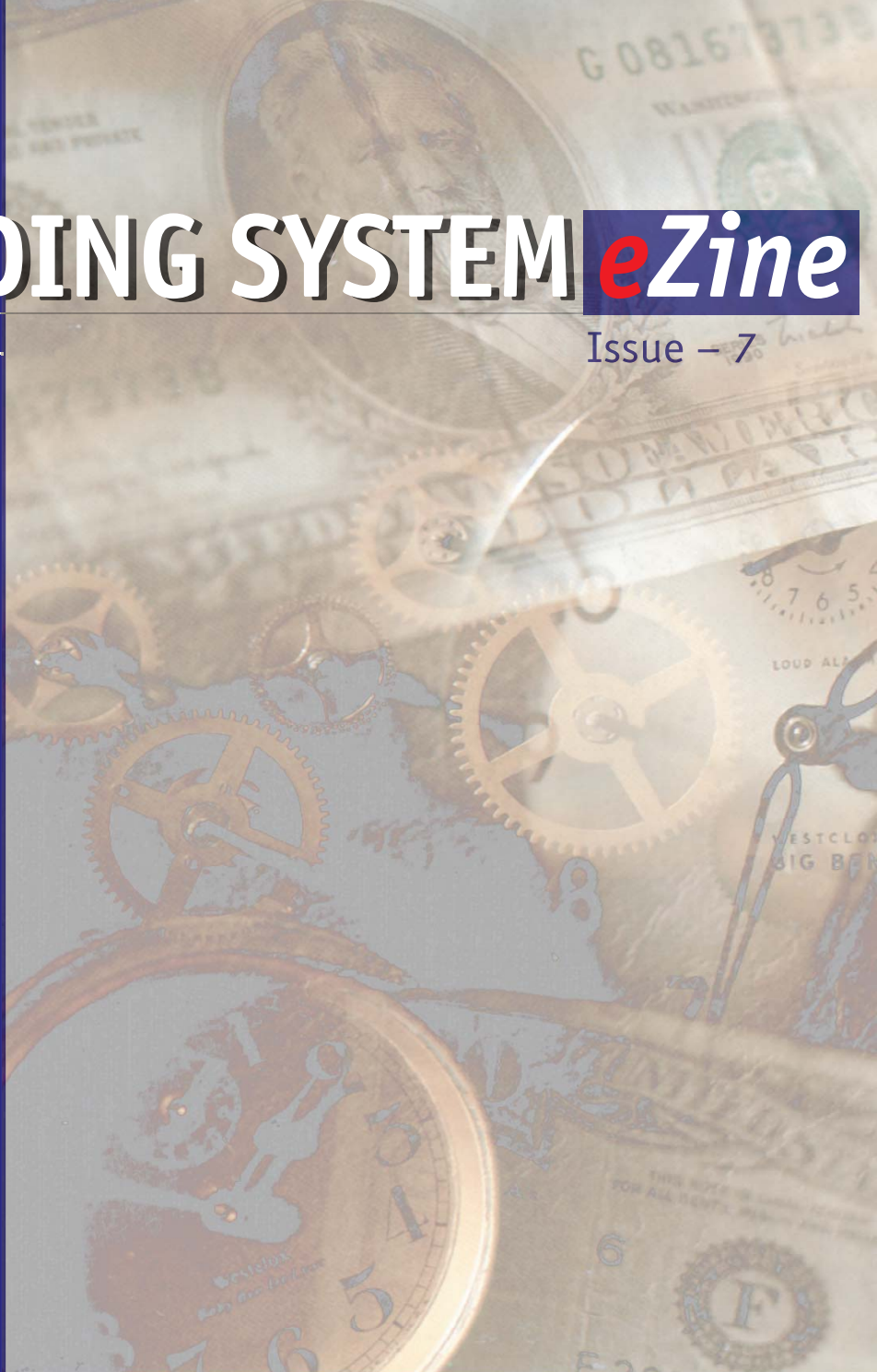


WWW TRADING SYSTEM **eZine**

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Issue – 7



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by Alex Krzhechovsky



Warren Buffett.

Imagine a person who has made more than \$10,000,000,000 during 40 years of his working career (and this career is far from being over). We have got more used to calculating monthly profits; his monthly income is about 21 million USD. An impressive number!

Warren Buffett... Investor in the True Sense of Word.

This person lives in the USA. But not in Florida (a beloved residential area for billionaires), not in New York (the very heart of business spirit), he lives in a small town of Omaha, Middle West. His name is Warren Buffett.

As an incarnation of "American dream" Buffett started from \$100 only. He made money in investment.

People talk a lot about investing, but most of them just use sophisticated words for hiding our incompetence. Investment implies that one should know where to invest and what for it is done. Only a small number of persons know the answers to these questions. Buffett is one of them! He buys companies.

Warren Buffett buys the companies and then does not sell for them a long time. He sticks to long-term investment. He is being written about and writes by himself: books, reports (about the investment activity of his company Berkshire Hathaway); moreover, he is good at delivering the "ultra-sophisticated" financial information to the public.

His approaches towards investment are always under careful analysis, but it seems impossible to copy his peculiar investment style.

He invests into different companies: large enterprises and small businesses. He does not understand the way Microsoft works, he does not understand how the companies of "new economy" make money, and he does not show great interest in all this.

It has been noted that Buffett buys the shares of the companies, the services and goods of which he is using: newspapers, trading networks of supermarkets, enterprises making shoes and food, banks, and insurance companies.

The fact of purchasing by Buffett the shares of Coca Cola is worth mentioning here. Being a child Warren already knew the products of this company very well. He was selling them for those who did not want to make “a long walk” to the shop round the corner.

It is not a secret that Coca Cola is a unique company. There are many soft drinks producers, but Coca Cola enjoys its world popularity standing a little apart from the others. The beverage of this company started its triumphant history in 1886. After a hundred years in 1986 Cherry Cola was proclaimed to be the official drink on Berkshire Hathaway annual meetings. Buffett bought the shares of Coca Cola in 1988. When the journalists asked why he had not bought that shares before, Buffett told that he was looking for the shares of special kind. The shares that could be purchased and left for their own growth for about 10 years. The shares which would be still in demand after those 10 years, because the company would continue its development. Buffett logically added that he knew no company that would be more reliable, stable, and dynamic than Coke. Though in 1986 Coca Cola has difficult times, Warren Buffett bought the shares when believed in the changes made by new management.

Buffett usually buys great percentages of shares, trying to get sufficient control over the companies.

When comparing the possible variants for his investment Warren Buffett uses both technical (careful and detailed financial analysis) and creative approaches (information about the atmosphere inside the company, successful decisions of its management, etc.). He takes his time before making any decisions. Only being absolutely sure in the decisions taken, Warren Buffett starts making important steps.

Buffett seems to become “rooted” to the companies, the shares of which he has bought. Berkshire once bought about 11 % shares of Gillette Company. The one giving “... the best a man can get”. Warren said, «When going to bed it is nice to know that there are 2.5 billion men in the world, who will shave in the morning. Anyone would say something, when the investments in this sphere gave \$700 million out of \$300 million in two years.

Buffett is not afraid to put all the eggs in one basket. He thinks that is better to make one big job – analyze a company up to its last detail and invest into it – instead of scattering the funds among numerous companies which are not that carefully investigated. Warren Buffett also is known for passive strategies in managing his investment portfolio. His credo is: “You should not make much fuss about the investments after they have been made. Otherwise why have you made them?”

His company pays no dividends. But the capital of the shareholders of Berkshire Hathaway keeps growing every year.

Warren Buffett has own opinion about the dividends. There is no point in paying them: the government takes taxes from the dividends. After the taxes are paid, the lesser sum can be used for re-investment. But re-investment can be made without the procedure of getting the dividends; all the funds can be directed to new investment targets. This convincing idea is very popular among the shareholders of his company.

Buffett does not give much credit to the opinions of market analysts. He is sure that market does make mistakes, because it is too “emotional”. These emotions make the prices for either too high or low. It is rather difficult to state whether the market is capable of making mistakes, however Warren Buffett (who sometimes goes against the market) has got his personal experience in winning the market challenges!

Of course, not all of Buffett’s operations were successful. But his failures are also not usual. They can be called failures in comparison to the line of Warren’s VERY successful deals. The purchase of sufficient number of shares of bank Wells Fargo in California by Warren Buffett was more than criticized. After the public announcement of this purchase, the prices for the shares of Wells Fargo went down. The bank had to inform clients on great losses in loans.

However, Warren’s faith in the professionalism of working staff gave its fruitful results in this case also. In three years these shares valued twice. Consequently, Buffett bought more of them one more time.

Buffett admits the fact that his investments in US Air were far from being profitable. But again, it speaks about his ability to find mistakes, even own mistakes.

Buffett has real faith in his partners and employees, not in the outward appearance of the business. Maybe that is why Buffett's investment company is famous for small number of working staff and remote location from Wall Street.

Buffett shows real attention towards the heads of the companies, the shares of which are owned by him. Very often the relations between the investor/Warren and top managers of the companies transform into friendship. Among other "working" features Buffett praises his company leaders for honesty, decency and full compliance with the interests of shareholders.

What can be taken as a good example from Warren Buffett?

- His honest and fair way of business relations.
- His persistence and faith in own powers, abilities and knowledge.
- Ability to control own feelings and actions (just try to gain self-control when your shares become 30% cheaper).
- And, of course, thorough examination of any matter before making decision upon it.

No one says that these features will surely help you to achieve the heights of this great investor, but these features will come in handy in any kind of business and even in your life.

Warren Buffett is well known not only for successful investing; he enjoys the popularity of a person with good sense of humor. His phrases can be gathered under a nice collection. Maybe this helps Warren to reach the heights of his success? ■ _____

What is Better?

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This question remains one of the burning issues among the specialists of the financial markets. So, what method is more effective and precise?

AS FOREX trading experience shows, fundamental analysis is more effective for predicting long-term tendencies (one year and more). Technical analysis shows better results when applied for shorter span of time (up to 90 days). The combination of two methods proved its effectiveness for the time period from 3 months to 1 year.

Though it may seem to contradict with the foregoing idea, both methods are capable for predicting long-term tendencies. The difference is that technical analysis is capable of defining technical components of future price tendencies, whereas the factors of fundamental analysis have great influence of short-term changes.

The falling rate of USD/JPY in 1999 may serve as the good example. In the second half of the year this currency pair lost 16% and reached the minimal annual rate of 101.90. Both technical and fundamental factors could cause it. The specialists in fundamental analysis explained this tendency by the growing incomings of capital into Japanese economy, which reflected the investors' optimism in upsurge of the economic life of this country. Technical analysis showed another reason: the market entered into the falling tendency, which became especially evident after passing through important positions of 115 and 110 yens.

So, most of the analysts made similar conclusions.

It can be heard often that the combination of technical and fundamental analyses is not effective. These methods are different and sometimes give alternative conclusions. Nevertheless, in reality "technical" traders should (and they do) pay attention to the meetings of central banks, current unemployment and inflation reports. The fundamental traders in their turn often determine the levels of relative maximum and minimum, examine dynamic averages, etc.

It is considered by the traders that short-term positions (the positions are opened from several minutes to some days) are the most profitable ones. The usage of technical analysis in this situation is the most effective.

There is no any special formula, which can give optimal approach to the market analysis on FOREX. Of course, fundamental and technical analyses are very important in defining the market tendencies, but there are also two more factors, which are of great importance for short-term market movements. These factors are expectation and behavior. Though these notions may look similar, they have significant divergences.

The expectations occur before some important economic, statistic, or financial data is published. And even taking notice of the published informational reports is not enough to predict future currency movements. For instance, if US gross domestic product (GDP) is rated at 7% (in the previous quarter this index was 5%), the dollar may not change its behavior as you are expecting. It may happen when GDP of the previous quarter was “predicted” to increase up to 8% and in reality it grew up to 7% only. This may undermine the reaction of the market and result in unforeseen currency movements. If you have not heard about “8% forecast” in this situation, your prediction based on GDP raise from 5% to 7% will be false.

Expectations may be subdued by current market behavior, which is the attitude of investors to certain currency rate. This attitude (in its own turn) may reflect the general attitude of the investors towards the economy of a country, certain accents on the market and other factors. In the mentioned case, when GDP has not reached the expected level of 8%, market may not even show any reaction to the failure of this forecast. The behavior on the market in this moment could be in favor of strong dollar, irrespectively of real and predicted indices. Such behavior may be provoked by strong market of assets in the USA or by fundamental forecast, which predicts weakening of another currency in the pair.

Market behavior is often called the market psychology. During two first months of 2000 euro was in a very tight pressure when traded with US dollar, though all fundamental indices for European economy were optimistic. The market psychology triggered favorable attitudes to US dollar, because for a long time the economy of this country was on a raise, inflation was low, the possible future growth of interest rates also promised strong positions for the currency and the economy in general. ■

Capital Management (continuation).

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I would like to remind that in the previous issue of our eZine we have already highlighted some questions about capital management. The process of managing trading funds can be done under the following formula:

$$\text{Number of contracts} = \frac{\text{Sum on your account} \times \text{Risk percentage}}{\text{Maximum system loss}}$$

I personally use the risk percentage of 10% for trading. Some traders consider 10% to be quite a high level of risk percentage, which can result in great losses. Usually the average risk percentage is from 1% to 5%.

However, it should be noted that 10% represent theoretical level of risk. It means that we are ready to risk not more than 10% of our trading funds. The number of contracts is also calculated in the basis of maximum system losses (during the whole period of system's existence). In reality the probability of every unprofitable trade to reach the system's maximum is very low, and losses hardly reach the level of 10%.

After careful examination of trading results of my system I came to the conclusion that real risk level (for one unprofitable trade) is about 3.5%!

The theoretical risk level of 15% would give the real percentage of 5.5% for the system. In other words, the theoretical level of risk percentage at 10% is quite acceptable. This level enables my system to sustain long periods of losses and give sufficient income. ■

August 2003 Trading Results.

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Trade period:	August, 2003
Contract size (lot):	\$100,000
Initial balance:	\$198,694.60
Final balance:	\$288,232.59
Profit:	\$89,538 (45.06%)
Average profit for 1 lot:	96 pips
Average loss for 1 lot:	34,5 pips
Profitable trades:	9 (39%)
Unprofitable trades:	14 (61%)

Open	Price	Date	Close	Price	Date	Commentaries	Lots	Balance
Sell	1.3690	08.01.03	Buy	1.3526	08.05.03		36	242,613.3
Buy	1.3525	08.05.03	Sell	1.3484	08.05.03		44	229,275
Sell	1.3483	08.05.03	Buy	1.3473	08.06.03		42	232,392.3
Buy	1.3499	1.3499	Sell	1.3504	08.07.03		42	233,948
Sell	1.3504	08.07.03	Buy	1.3522	08.07.03		43	228,224
Buy	1.3523	08.07.03	Sell	1.3494	08.08.03		41	219,431.6
Sell	1.3493	08.08.03	Buy	1.3563	08.08.03		40	198,787.2
Buy	1.3563	08.08.03	Sell	1.3585	08.11.03		36	204,626.6
Sell	1.3585	08.11.03	Buy	1.3625	08.12.03		37	193,764.2
Buy	1.3625	08.12.03	Sell	1.3677	08.13.03		35	207,122
Sell	1.3678	08.13.03	Buy	1.3682	08.14.03		38	206,011.1
Buy	1.3681	08.14.03	Sell	1.3920	08.19.03		37	267,673.2
Sell	1.3912	08.19.03	Buy	1.3932	08.19.03		49	260,639.1
Buy	1.3932	08.19.03	Sell	1.3884	08.20.03		47	244,446.1
Sell	1.3884	08.20.03	Buy	1.3937	08.20.03		44	227,713.7
Sell	1.3881	08.20.03	Buy	1.3913	08.20.03		41	218,283.7
Buy	1.3920	08.20.03	Sell	1.4169	08.25.03		40	289,835.4
Sell	1.4162	08.25.03	Buy	1.4156	08.25.03		53	292,081.8
Buy	1.4187	08.25.03	Sell	1.4151	08.26.03	stop order	53	278,223.1
Sell	1.4114	08.26.03	Buy	1.4154	08.26.03		51	263,769.4
Sell	1.4099	08.27.03	Buy	1.4144	08.27.03		48	248,449.1
Buy	1.4144	08.27.03	Sell	1.4138	08.27.03	stop order	45	246,539.4
Sell	1.4139	08.27.03	Buy	1.4008	09.01.03		45	288,232.599

A stockbroker made quite a fortune all of a sudden. Being not a greedy person he gave part of his money to the friends. He told them, "You can return the money on my funerals."

Time passed. One of the friends became a doctor; another chose the career of a politician. The third friend made money as a financier. When their benefactor died, all of the friends came to the funeral: to pay both their last respect and financial debts.

The doctor said, "I have spent more than earned" and put 1/10 of the debt to the coffin.

The politician promised "I will return the rest when we meet in another life" and put 1/5 of his debt.

The financier came closer and spoke "You know, my friend, I am not such a miser as my friends. I will return everything right now" and put a promissory note to the coffin.

A stockbroker on vacation is sitting in a nodding mood at the Thames. A homeowner approaches him and says:

- Sir, the Thames is 20 points up.
- (broker) Sell it, immediately!

Two tired brokers trudge home after a hard day. One says to another:

- Hey, the subway has already closed.
- Yeah? At what price?

In the next issue of *WWW TRADING SYSTEM eZine* you will find information about:

- 1. Personality: George Soros.**
- 2. 40 Rules of a Trader.**
- 3. WWW TRADING SYSTEM COMMENTS:**
How to Monitor the Market 24 Hours a Day.
- 4. September 2003 Trading Results.**
- 5. Trades and Humor.**