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Mukul Pal

THE TIME INDEX

Can we trade time as an asset class?

On one side we have comments like will the equilateral triangle lose symmetry as time triads move and on the other side is a clear idea of time triads being an empty philosophy. A controversy is a start, at least there is a debate, a thought. Volatility has been around since markets started trading, but it was not until 1993 that the idea started trading as a VIX index. Now we have hedge funds trading volatility, as an asset class. Will the market evolve to trade new asset classes? Can the market trade time as an asset class? Can we have something called time indexing?

As a start it looks counterintuitive. We are already trading time indirectly, but how can you trade time directly? And even if you could, how will you commoditize time as an asset class? Before we understand how time triads can itself become an asset class, one should realize that indexing techniques over the last centuries have moved from price weighting to free float to fundamental indexing. The idea of a benchmark is simple and investible.

So what's time indexing? The time index tracks the performance of a pair of assets, a quantifiable study of pair performance. Pairs can be between Nikkei- Bovespa, Dow Industrials - Dow Transports, Gold - Oil, Sensex - Dow, Sensex - Gold or between any two economic time series. Pairs can tell us a lot about markets and where we are headed tomorrow. But what do pairs have to do with time? When you are long on an asset class and short on the other, you are taking out the price and just trading on time. This is why long Dow Industrials and short Dow Transports (or vice versa) is a pair idea, which lets us trade time as an asset class. Now conventionalists may argue, what fun is it to trade two indices, which move up and down together?

This is where we come in. Performance cyclicity was highlighted first time in the Kyoto University journal, Nistor, Pal. The paper illustrated performance cycles between Nikkei and the other BRIC countries. The research proved that performance between two economic zones illustrated through the countries composite equity index was not just cyclical, but even quantifiable. One of the conclusions of the paper was demonstrated through our feature here 'Long India - Short China'.

The pair delivered 50% over a quarter. Markets are quantifiable and they allow even regional indices to be pegged against each other profitably. What the paper demonstrated was that irrespective of the tight or loose correlation of an asset, performance cyclicity can be demonstrated at all time frames. The paper was indirectly demonstrating time fractals, triads.

There are some clear advantages of trading on time triads, time indexing, or say performance as an asset class. Being long and short two high correlated assets can reduce market risk i.e. offer market neutrality. This makes the strategy attractive. What is the investment world looking for? The first and foremost is a reduction in risk. For example shorting Nsebank and going long on Nifty reduces portfolio volatility and captures performance between the two sector indices creating relative alpha. Now this strategy may not perform better in a trended market, but it will surely outperform stagnation or declining market. The pace of wealth destruction and changing risk appetites also makes time indexing a viable option.

So what's at the soul of the investment strategy? It is the ability to isolate the performance cycle. How do you do it? First, you accept that cyclicity of time exists and Kitchin, Juglar, Berry and Strauss were thinkers and not just illusionary pattern watchers. Second, one should understand that cycle regularity is not just about equality but power law proportionality. Third, one should start connecting or overlaying larger time fractals with smaller fractals. This again brings us to time triads, triangle in a triangle essence.

What kind of pairs? Large capitalization against Small capitalization indices, value vs. growth indices, mid economic vs. late economic etc. what if we go wrong? Well! If you can invest in a naked asset with a risk return history, you can invest in a market neutralizing, capital conserving simulated spot time index too. Above all if speculative volume can trade anything that moves, this is still an open source model. What about risk management? A diversified time index with many components could take care of emerging risk from the strategy.

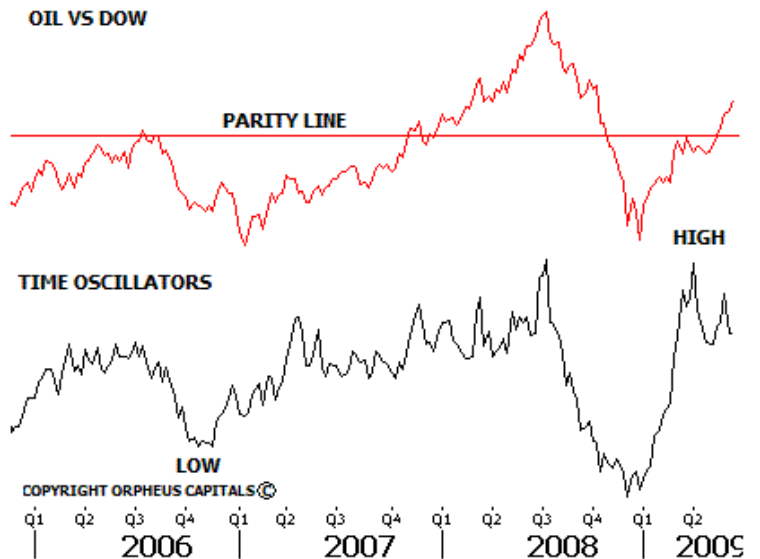
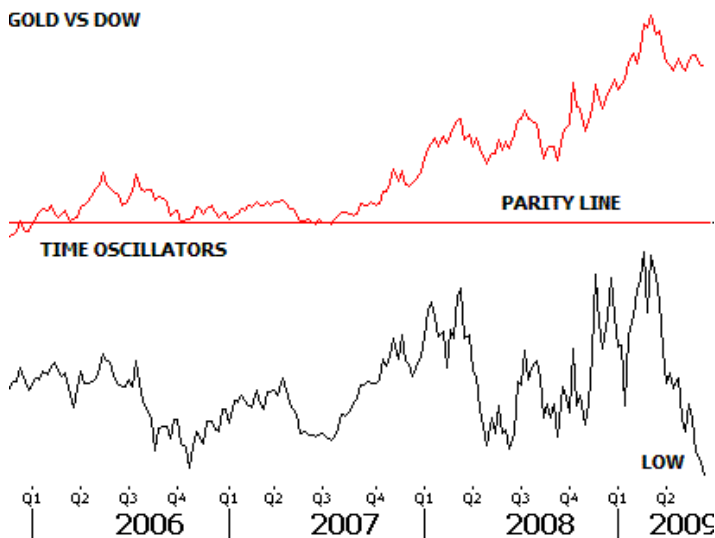
We have been carrying pairs in this feature starting 2004. Frankly speaking it took us a lot of time to comprehend that what we were really trading, pairs or time. It took us more time to understand the fractal aspect in the subject. Long India, short China was one such pair we featured profitably. We have illustrated Oil - Sensex, CNXIT - Sensex, BSE500 -Sensex and many such pairs to highlight not only performance cyclicity but also market, economic perspectives and direction. We are not very far from the first Indian TIME index.

Another example of performance cyclicity can be built around the three pillars of global economy, Gold, Dow and Oil. So what does the Gold - Dow pair (ratio line) tell us? It says that Gold has hit an intermediate underperformance low against not only Dow, but also Sensex. This means that long Gold, Short Dow (Sensex) should be profitable pair for more than a few weeks. Even the larger primary performance cycle is also up in favor of Gold and against Dow. The respective performance cycle has been working from 1976 with an average 5 year cyclicity. The last cycle turned up in 2008 and should complete sometime in 2012. This means there is more for Gold ahead against American equity. This could mean that Dow should underperform and fall against Gold, Gold should rise or outperform Dow or Gold should fall but less compared to Dow. The very fact that Gold did not collapse against anything also suggests that the underlying larger cycle of Gold (2008-2012) outperformance against Dow continued to work.

If we need more confirming evidence we can look at Dow - Oil pair (ratio line). It might seem like a counterintuitive pair, but though Gold and Oil belong to the same commodity class, they can behave differently. Unlike Gold, Oil has pushed up to cycle highs against Dow. This could be owing to extreme oversold levels, reprieve in recession worries, or simply putting volatility cycles ruling OIL.

There could be a thousand more reasons to explain why Oil shot up against both Gold and Dow. What really matters is where is the performance cycle (time oscillators) between Oil and Dow headed now? The respective pair has reached an extreme against Oil and is non confirming suggesting topping Oil performance against Dow. This means that the OIL intermediate topping could be near. Even if Dow pushes up above 8,800-9,000 levels in the ongoing leg, Oil needs magic to sustain and push to further highs against Dow. So if Oil is turning down against Dow, and Gold is turning up against Dow, what equity strength are we speaking about for the next few weeks? We have a history of contrarian calls from Oil at 100, when we said the oil rocket was not sustainable. The MAR low call on markets and Bsemetals compelling valuations were made at a time when \$5 was thrown as another achievable figure for Oil. We are at \$70 now.

Performance cycles (time oscillators) are easy to understand, but they become tougher to grasp when you start to explain them fundamentally. The real counterintuitive thinking is not how we can have long Dow and Short Oil and still call Gold as a performer, but how time indexing can revolutionize how we understand and trade time as an asset class.



COMMENTS

Behavioral Finance and Father of Fractals say price predictability is an illusion. Do you agree or disagree? Why?

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I believe price is predictable. The more difficult question to answer is how often will your price predictions be right vs. wrong and if there is anyway to predict with greater accuracy than a coin toss.

Michael Fashtchi

President at Comprehensive Wealth Management

Hello Mr. Pal,

I enjoyed your article, "Time Triads," that appeared this week in the Business Standard. I thought you might be interested that Bob Prechter wrote a critique in response to Mandelbrot's 1999 article in the Scientific American titled "A Multifractal Walk Down Wall Street." Bob's Elliott Wave Theorist Special Report is justly entitled "Credit Where It Is Due."

Ben Hall

Socionomics Coordinator, Socionomics Institute

www.socionomics.net

Dear Ben,

Thanks a lot for your kind words. We are aware of Bob's perfect reply. The article (TIME TRIADS) was pretty detailed and critically written. We did not want to push the Elliott debate in the respective feature. We are reserving those ideas for another feature.

PS: Ben is mentioning about the following critique.

http://www.elliottwave.com/education/SciAmerican/Mandelbrot_Article2.htm

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For more on TIME TRIADS and related services, mailto: support@or-phe-us.com

Hi Mukul,

I read your writeup on time indexing & it is really amazing - thought provoking!

Ashish Kyal

Join the TIME TRIADS group

Thanks Ashish

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<http://www.linkedin.com/groupInvitation?groupId=1932850&sharedKey=57D9143E1176>

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