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Quick Guide for Trading a Ready-2-Go Model

Welcome to Portfolio123's model marketplace – Ready-2-Go. We have a terrific line-up of models designed by our advanced community of investors and professionals. Using the search filters you should have been able to refine the models down to a choice few based on such factors as liquidity, maximum drawdown (max loss), average market out-performance, average days held and the underlying approach.

Now that you have a few models to trade you are no doubt wondering how much capital you should use to trade each model. This brief guide will give new investors a few tips for trading the Ready-2-Go models responsibly.

Allocating Capital Per Model

How much capital should you allocate to each of your models? Each investor will need to review his risk profile to determine how much of his overall portfolio should be weighted towards smallcaps, S&P 500 stocks or specific sectors. Those decisions are outside the scope of this article. The question we will try to answer is this: what is the maximum amount of capital that a novice investor could put in a model without extremely impacting the prices negatively?

Rule of Thumb:
Trade up to 5% of the daily turnover.

A basic rule of thumb would be 5% of the daily turnover. The daily turnover is the share price multiplied by the volume. So if a stock has a turnover of $100,000 per day, you could buy or sell $5,000 without too much trouble is you used sound practices such as limit orders.

How can you quickly discover the daily turnover in each model? Portfolio123 has provided the daily turnover of the lowest liquidity stocks in the portfolio – the bottom 20% of the holdings. Why would Portfolio123 only give the average turnover statistics of the bottom 20% instead of the entire portfolio? Imagine you had a model with huge liquid stocks such as Google and Apple mixed in with some thinly traded microcaps. Your average turnover amount would not be meaningful when trying to buy and sell the thinly traded stocks and would give a false sense of confidence.

The **Buy Daily Average (bottom 20%)** statistic is found under the **Trading Stats** tab on the individual Ready-2-Go model pages.

Here is one example of a theTrading Stats where the Buy Daily Average for the bottom 20% of the portfolio is $273,234 per day. Five percent of that number is $13,661.70 – which would be the maximum suggested

amount of capital per stock for a new investor. If this portfolio has 7 stocks, the amount of capital to invest could be up to $95,631.90.

Before you run out and set your maximum portfolio size based on the average daily turnover, there are a few other considerations that you need to keep in mind. Your ability to efficiently buy and sell stocks without undue slippage will also be influenced by the **depth of liquidity** and the **average amount of days a stock is held**.

Liquidity Depth

Another basic rule is that smaller capitalization stocks often have a shallower depth of liquidity. What is liquidity depth? Consider how two stocks trade.

- Stock ABC is a microcap stock with average daily turnover of $100,000. The bid is at $10 and the ask is at $10.05. You want 500 shares. You buy 200 shares at $10.05, 100 at $10.20, 100 at $10.50 and the final 100 shares at $10.75. Your average share price was $10.31 meaning your slippage was a whopping 3.1%
- Stock XZY is a large cap stock which also has an average daily turnover of $100,000. The bid is at $10 and the ask is at $10.05. You want to buy 500 shares. After buying the 300 shares at $10.05 more shares become available at $10.10 and $10.15. Your average price is $10.08 or 0.8% slippage.

While both stocks have the same average daily turnover and the same bid/ask spread, stock XYZ has more liquidity depth. When buying shares at the ask in stock XYZ, more shares become available at a nearby tier. It may very well be that you can get a better average price(less slippage) in a large cap stock than a smaller cap stock with the same liquidity statistics.

Average Days Held

Another factor to consider is how many days on average a stock is held. How will this affect your trading?

- If the stock is held an average of 7 days, you will need to quickly buy the shares on the Monday it is recommended.
- If the average holding time is 3 months you easily build a position over many days. Thus, you may be able to buy up 10 or 15% of the average daily total when spreading your order out.

So to modify the rule of thumb, you can buy up to 5% of the average daily turnover *each day* that you accumulate a position…if you are careful. But you should also be aware that this makes unwinding a position quickly more challenging. You may need to sell over a period of days as well.

Trading the Portfolio

You have determined the maximum amount of capital you can trade in each model – or at least you have a good idea. What are some good practices to follow when actually buying and selling stocks recommended by a model?

Determining Model Slippage

Before you set out to buy all the positions in a portfolio, you should be aware of the parameters used by the model designer. How much slippage did they factor into the model when backtesting their strategy? What is the maximum amount of slippage you can accept in order to achieve similar results to the Ready-2-Go model?

Model designers have two options when factoring the cost of slippage in their models.

1. They can add a fixed slippage amount (e.g. 0.15%)
2. They can select a variable slippage which is adjusted internally by Portfolio123

Variable Slippage

Below is a guideline for the variable slippage formula used by Portfolio123. If the bottom 20% of stocks in a portfolio have an Average Daily Turnover of $200,000, the variable slippage would be 0.75%. If the bottom 20% had a turnover of more than $5 million the variable slippage would be 0.10%.

10 day $ Turnover		Median	#	Buy/Sell
From	To	MktCap	Stocks	Slippage
$5M	INF	3.5B	2,000	0.10%
$1M	$5M	500M	1,000	0.25%
$350K	$1M	200M	500	0.50%
$100K	$350K	100M	500	0.75%
$50K	$100K	50M	300	1.50%
0	$50K	15M	2,000	5%

In addition to this variable slippage amount, Portfolio123 has added one penny to the total. Why? Imagine you are trading a super liquid stock where the bid is $1 and the ask is $1.01. Even though variable slippage would suggest 0.10%, you would lose a minimum of 1% if you bought at the ask…which is one penny. So in order to more accurately reflect the slippage of lower priced stocks, one penny was added.

This is important information to know. You will find the slippage statistics under the **Key Stats** tab. If it says **variable** in that row, the designer is using the automated Portfolio123 slippage

factors. If the slippage for that particular portfolio works out to 0.5% (using variable slippage chart above), you should attempt to stay within that parameter to achieve similar returns to the posted model results. You can manage your slippage amount by using limit orders and patiently waiting to be filled.

Fixed Slippage

Designers have the ability to set a pre-determined slippage amount for their portfolio. The lowest amount of slippage allowed is 0.15%. If the designer has set the slippage to a fixed amount, it is important for you decide whether the amount is realistic for you or not.

As a hypothetical example, you see a model with outstanding annual returns. The annualized turnover is 2,000%. The slippage is set to a fixed 0.15%. The buy daily average (bottom 20%) is only $100,000. With stocks trading at such a low liquidity, will you really get an average slippage of 0.15%? If the slippage was closer to 1%, how would this affect performance? Your returns would be 34% less than the posted amount if you applied this higher slippage number.

So before you grab the model with the highest returns, consider if the applied slippage number makes sense to you based on the liquidity and market cap size.

One other variable that you may wish to watch for is when the order is executed. Many models use the opening price plus slippage while others will use the average of the daily high and low plus slippage. Which is better and which is worse? It really depends on the system and how you trade it. If you use Foliofn mentioned below, using the average of the high and the low may be a closer fit to your actual trading costs. If you manage the trade yourself and typically buy the open, this may be a closer fit.

Alternative Brokerage and Cost Per Trade

Some models have factored in a commission per trade to represent this additional cost. Other investors feel that calculating brokerage fees is too difficult for a publicly traded model and have purposely left it out. Brokerage fees vary greatly and the amount of capital being traded influences the impact of the transaction cost. If this is left out, you will need to mentally factor this in yourself.

One brokerage option is called Foliofn (folioinvesting.com). While Portfolio123 is not affiliated with this brokerage, they do have an easy to use service making it worthy of mention. What do you get at Foliofn?

- Flat monthly rate commission of $29
- Unlimited ‘window trading’

- Up to 100 stocks per folio
- Unlimited amount of folios in your account
- Ability to trade fraction of shares

You can still perform market, limit and stop orders at $3 per trade but all your portfolio trades (window trading) is covered in your $29 per month fee. You enter the list of stocks you wish to trade in your folio and the weight of each holding. As an example, you may buy 100 stocks with 1 percent weighting on each holding and invest with only $1,000…which is $10 per stock. You can re-balance this twice a day if you wish or replace stocks twice a day - this is included in your flat-rate monthly fee. You don't set the dollar amount you wish to pay since Foliofn will either match the trade internally with another member wishing to perform the opposite trade (you want to buy and they want to sell) or they will send it to a market maker for fullfillment. This makes trading your portfolio easy and cost effective, although you do give up control on the final transaction price. Just keep an eye on the actual slippage amounts to ensure they are within your acceptable parameters.

We hope that covering these brief points will help you trade our Ready-2-Go models with confidence and ease.