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Capitalise AI

Applying a Strategy or Model to Historical Data to Determine its Accuracy

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Backtesting Analysis

Applying a Strategy or Model to Historical Data to Determine its Accuracy

In this webinar, we'll discuss how backtesting can be used to improve and optimize your trading strategies.

We'll delve into the inherent limitations involved with backtesting and discuss why traders still use backtesting for portfolio analysis. We'll also look at the goals that backtesting seeks to accomplish.

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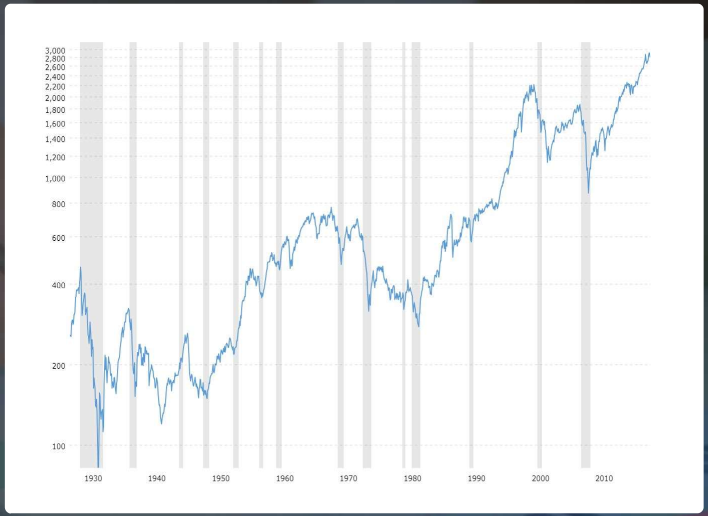
What Is Backtesting?

Understanding the limitations & the benefits

BACKTESTING IS A TERM USED IN MODELING TO REFER TO TESTING A STRATEGY OR MODEL ON HISTORICAL DATA

- Backtesting seeks to estimate the performance of a strategy.
- How well a strategy or model would have done ex-post.
- Discovering how the strategy would play out using historical data.
- Confidence.



Why Backtesting?

#1 Prove your strategy works

It's difficult to create a strategy or trading plan that really works without extensively testing it over historical data, first.

The amount of time it takes to forward-test strategies is extremely limiting.

Without backtesting you are essentially trading blind.

Why Backtesting?

#2 Optimize your approach

You can painlessly determine whether or not a strategy is for you without losing any money in the process.

Identify your strategy's flaws and introduce new filters that increase its potential returns and reduce its drawdown.

Why Backtesting?

#3 Create trading ideas

Backtesting is like a mirror to reality.

With backtesting you can come up with an idea and then put it through the grinder, whatever comes out is what you pay attention to.

The feedback loop allows you to tweak and perfect your approach until you find a set of filters, rules, or as we at Capitalise.ai refer to conditions, that not only work, but play to your psychological strengths.

Why Backtesting?

#4 Gain confidence

Know what to expect from your strategy.

Make Key decisions

Your backtest is a good marker to compare with to your live strategy.

Limitations

#1 Data

The quality of a backtest is determined by the level of details and quality of the historical market data used for the test.

Historical market data could be one dimensional (e.g. market prices only), or could be multidimensional and taking in consideration different kinds of datasets such as prices, news events, market events, etc.

Limitations

#2 Market effects

When running a backtest, none of our simulated trades have an effect on the markets

e.g the effect of very large short order on a specific stock.

Limitations

#3 Over fitting

We run the potential of overfitting, when we decide on our trading scenario and adjust its parameters, what we might inadvertently do is overfit our criteria to the historical data set at hand.

A possible solution for such a scenario is to test the strategy on multiple instruments/data sets.

Rules For Backtesting

Take into account the broad market trends in the time frame a given strategy was tested.

Take into account the universe in which backtesting occurred.

Determining optimal position sizing and money management.

Backtesting is not always the most accurate way to gauge the effectiveness of a given trading system.

Backtesting Accomplishes 3 Things

1

Shows if a strategy performs well in periods when it is supposed to, and vice versa.

2

Provides an understanding of how the strategy performs in different markets.

3

Produces insights on how the strategy might be improved on.

ENTRY

If **AAPL RSI**(14, 1h, Close) crosses **above 60** then **buy 10 AAPL** and

EXIT

Close position at trailing stop of **1%** #

RUN STRATEGY

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