

Contents

Foreword	xi
Preface	xiii
Acknowledgments	xvii
Main Contributing Authors	xix
Introduction: More Interesting Times	xxiii
The Hammer Principle	
Flaws of Technical Analysis	
Overview of Advanced Trading Technology	
What Makes This Book Unique?	

Part One Trading with Neural Networks	1
1 Neural Network Techniques	3
<i>Casimir C. "Casey" Klimasauskas</i>	
What Are Neural Networks?	
Time-Series Prediction	
Measuring Performance	
Neural Network Development Methodology	
Summary	
References	
2 Pre- and Postprocessing of Financial Data	27
<i>Guido J. Deboeck and Masud Cader</i>	
Setting Objectives	
Data Collection, Analysis, and Transformations	
Sample Scripts for Data Transformations	
Types of Data and Data Scaling	
Identification of Output Indicators	
Preparing Training and Test Data Sets	
Testing and Evaluation of Neural Trading Systems	
Summary	
References	
3 Adaptive Selection of U.S. Stocks with Neural Nets	45
<i>James W. Hall</i>	
Style-based Stock Portfolios	
The Deere & Company Style-Rotation Portfolio	
Sizing Up the Problem	
Guidelines for Modeling Evolutionary Complex Systems	

	Summary	
	References	
4	Predicting the Tokyo Stock Market	66
	<i>Morio Yoda</i>	
	Can the Tokyo Stock Market Be Predicted?	
	The Neural Net Prediction System	
	Testing and Evaluation of the System	
	Comparison of a Neural Versus Mechanical System	
	Trading in Noisy Markets	
	Summary	
	References	
5	Intelligent Trading of an Emerging Market	80
	<i>Gia-Shu Jang and Feipei Lai</i>	
	Problem Statement	
	Stock Trading Using Adaptive-Structure Neural Networks	
	Stock Data Modeling	
	System Architecture	
	Performance Evaluation	
	Summary	
	References	
6	Trading U.S. Treasury Notes with a Portfolio of Neural Net Models	102
	<i>Guido J. Deboeck and Masud Cader</i>	
	Daily Returns of U.S. Treasury Securities	
	Trends in U.S. Treasuries	
	Design of Neural Net Models	
	Model Performance and Sensitivity of Results	
	Performance of a Portfolio of Neural Net Models	
	Summary	
	References	
7	Neural Nets for Foreign Exchange Trading	123
	<i>Henry Green and Michael Pearson</i>	
	Foreign Exchange Markets	
	Design Strategy	
	References	

Part Two Strategy Optimization with Genetic Algorithms **131**

8	Genetic Algorithms and Financial Applications	133
	<i>Laurence Davis</i>	
	The Origin of Genetic Algorithms	
	Genetic Algorithms and Financial Applications	
	Application Principles	
	Conclusions	
	References	

- 9 Genetic Algorithms for Financial Modeling** 148
Andrew M. Colin
 Background
 Using a Genetic Algorithm
 Example 1: A Trend-Following Trading Model
 Example 2: Strategy Acquisition
 Example 3: Optimizing Combinations of Rules
 Commercially Available GA Packages
 Exercises
 References
- 10 Using GAs to Optimize a Trading System** 174
Guido J. Deboeck
 Building a Hybrid Trading System
 Conclusions
 References

Part Three Portfolio Management Using Fuzzy Logic 189

- 11 Why Use Fuzzy Modeling?** 191
Guido J. Deboeck
 Neural Versus Fuzzy Models
 Basic Math with Fuzzy Sets
 Creating a Fuzzy Rule Base
 Defuzzifying Results
 Practical Applications
 References
- 12 A Fuzzy System for Trading the Shanghai Stock Market** 207
Zhongxing Ye and Liting Gu
 Introduction
 Data Selection, Preprocessing, and Classification
 Fuzzy Rules Selection
 Fuzzy Decision and Trend Forecasting
 Empirical Results
 References
- 13 Smart Trading with FRET** 215
Dalila Benachenhou
 Fuzzy Systems for Trading
 Fuzzifying a Time Series
 Formulating or Extracting Fuzzy Rules
 How Do Fuzzy Systems Work?
 Letting FRET Trade
 Conclusions
 Appendix: An Object-Oriented Approach to Building FRET
 References

14	Hybrid Neural, Genetic, and Fuzzy Systems	243
	<i>Francis Wong and Clarence Tan</i>	
	Strengths and Weaknesses of Advanced Techniques	
	Hybrid Systems	
	Conclusions	
	References	

Part Four	Nonlinear Dynamics and Chaos	263
------------------	-------------------------------------	-----

15	Basic Concepts of Nonlinear Dynamics and Chaos Theory	265
	<i>Mark Embrechts</i>	
	What Is a Fractal?	
	Methods for Computing Fractal Dimensions	
	What Is Chaos?	
	Methods for Detecting Chaos	
	Methods for Determining Predictability	
	Methods for Measuring Memory	
	References	
16	Nonlinear Data Analysis Techniques	280
	<i>Ted Frison</i>	
	Financial Time Series as Dynamic Systems	
	Nonlinear Data Analysis Techniques	
	Data Processing Guidelines	
	References	
17	Nonlinear Dimensions of Foreign Exchange, Stock, and Bond Markets	297
	<i>Mark Embrechts, Masud Cader, and Guido J. Deboeck</i>	
	Introduction	
	Antipersistent Trends of U.S. Fed Fund Returns	
	Biased Random Walk of U.S. Treasury Notes	
	Predictability of Treasury Yields	
	Analysis of Swiss Franc/U.S. Dollar Returns	
	Analysis of the Japanese Stock Market	
	Conclusions and Implications	
	References	

Part Five	Risk Management and the Impact of Technology	315
------------------	---	-----

18	Risk Management Measures	317
	<i>Henry Green, Robert Mark, and Michael Pearson</i>	
	Financial Risk Defined	
	Risk Management Strategies	
	Position Management and Strategies	
	Improving Portfolio Risk Management	
	Summary	
	References	

19	The Impact of Technology on Financial Markets	329
	<i>Guido J. Deboeck</i>	
	A Historical Perspective	
	A Taxonomy of Market Hypotheses	
	New Market Paradigms Based on Rational Beliefs	
	Impact of Neural, Genetic, and Fuzzy Modeling	
	Conclusions	
	References	
20	The Cutting Edge of Trading Technology	344
	<i>Guido J. Deboeck</i>	
	Virtual Reality	
	Robotic Trading	
	Conclusions	
	Glossary	353
	Bibliography	363
	Index	373