PredictWallStreet™
The Stock Prediction Community

Investing with PredictWallStreet Data – September 2013 Update

On Feb 5, 2008, PredictWallStreet released a White Paper entitled: Investing with PredictWallStreet Data. That paper described how we gather investor sentiment data by polling users for their stock predictions. Further we described how these stock predictions were processed by proprietary quantitative algorithms to produce daily Forecasts which we began releasing publically, before the U.S. markets open for trading, starting May 24, 2007. Since then, we have continued to release our daily forecasts, ahead of market open, both on our own site as well as on partner sites.

In our original White Paper, we showed the theoretical performance of our Forecasts (Figure 10) up until the date of publication – Feb 5, 2008. Over five years have passed since the publication of that white paper, so we wanted to update Figure 10 to bring it up to date. Also, although there are arguably more (and perhaps also less) profitable ways to trade our Forecasts, we have chosen to keep the methodology for evaluating performance exactly the same as we described back in Feb 2008, for the sake of consistency.

All of our Forecasts are forward-looking – i.e. they were released publically before the U.S. markets open for trading, and before anyone even knew what the opening price would be. The forecasts are all of the form: "Stock XYZ will close higher (or lower) than it opens today." Each forecast is either right or wrong, and the difference between opening and closing prices is a matter of public record. The only remaining question is whether we used particular assumptions regarding stop losses, capital allocation to the Forecasts, and the like in order to produce favorable results. We adhered to the same assumptions and methodology that we used more than five years ago in order to legitimately demonstrate the forward-looking performance of the forecasts.

To recap the simulation methodology which we first published in 2008 and continue to use:

- We traded every forecast, on stocks with a previous closing price >= $5, since we first began releasing them publically on May 24, 2007 until July 31, 2013.
- As of July 31, 2013 there have been 12,235 Forecasts on stocks above $5.
- Each day, we assumed that whatever trading capital was available would be equally distributed across whatever forecasts were available that day. For example, if there were 10 forecasts on a given day, 10% of the capital would be placed on each forecast that day.

- If the Forecast was for a stock to close HIGHER than its open, we subtracted the opening price from the closing price and then divided by the opening price to get the % P&L.
- If the Forecast was for a stock to close LOWER than its open, we subtracted the closing price from the opening price and then divided by the opening price to get the % P&L.
- No money was held overnight. We began and ended each day 100% in cash.
- No leverage was used.
- The only risk management rule we had was: If any position lost 2% during the day's trading, we immediately exited that position and took a 2% loss on the capital allocated to that position (a 2% stop loss rule).
- We assumed that any profits or losses increased or decreased the amount of capital available to trade the following day (daily compounding).
- No commission costs were assumed.
- No market impact or other transactions costs or fees were assumed.

One of the limitations of our simulation methodology is that it did not include the effect of commissions, market impact, and other transaction costs – nor did it include the largely beneficial effects of low correlation. However it is impossible to simulate these without more information—for example: the amount of money being traded, the brokerage commission rates (if indeed there are any), and the other positions the investor might have.
Finally, all investors should be aware that **past performance doesn't guarantee future results.** Just because our forecasts have historically produced positive hypothetical returns on an open to close basis, doesn't mean that this will continue in the future. Indeed, as simple inspection of the Hypothetical Performance Chart shows, **there have been period of times when trading the Forecasts would have lost money. There have been periods of high volatility as well. We caution every investor to consult with his/her broker or financial professional before making any trades in the stock market.**

Now, having explained the methodology, and provided important cautionary disclaimers, let's consider the hypothetical Forecast performance Chart.

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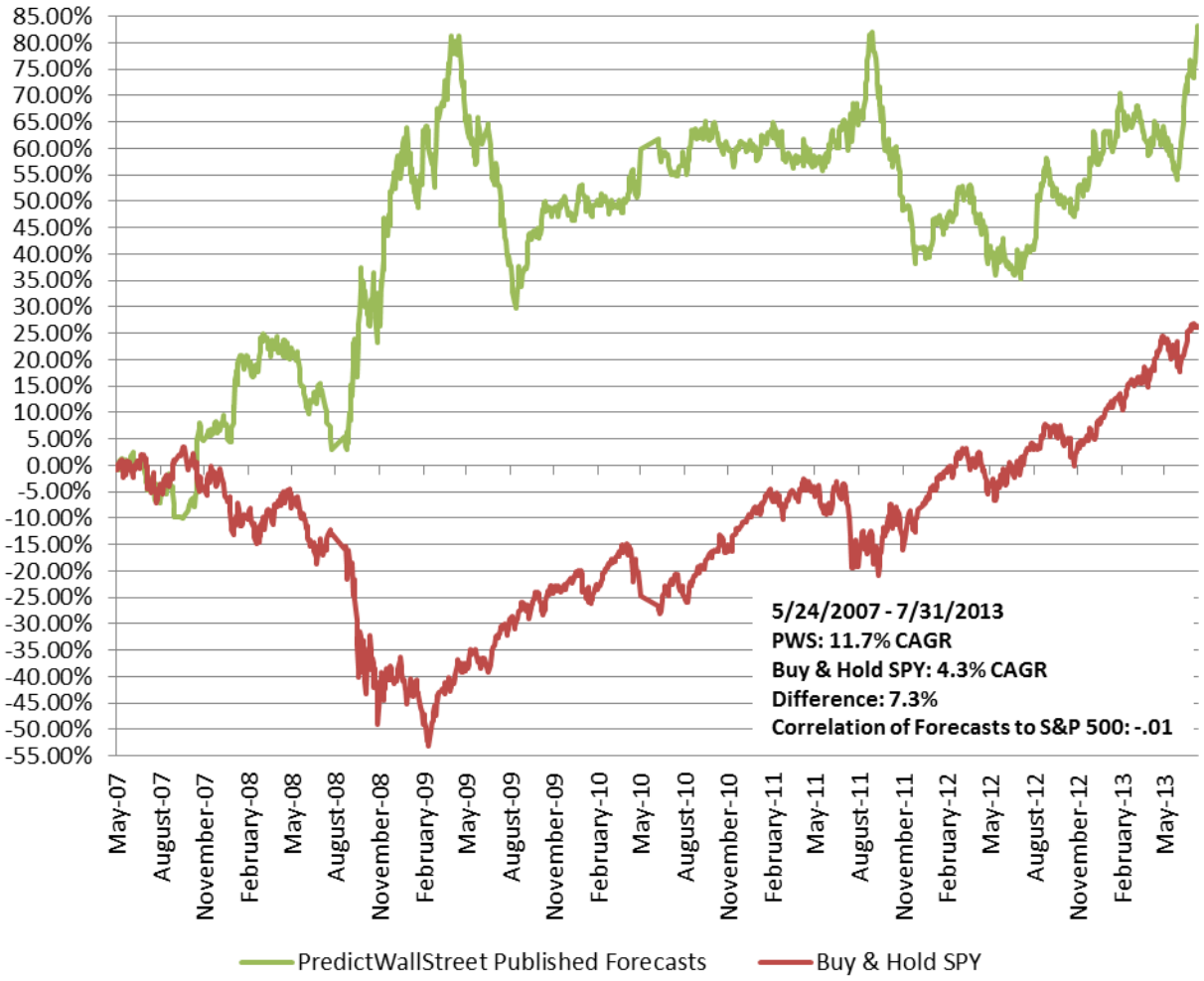
Profit Results from PredictWallStreet Forecasts



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The Hypothetical performance chart shows, that over the 5+ year period since we have publically been releasing Forecasts, the Compounded Average Annual Return has been 11.7%.

If we define "the market" as the performance of simply "buying and holding" the S&P 500 index (e.g. via an ETF such as SPY) the return would have been significantly worse – only 4.3% CAGR. So our hypothetical performance, historically, has been more than twice as good as the market.

That level of performance is really hard to achieve. Several studies have been done that show simply buying and holding the market typically outperforms about 80% of all professional money managers. So just matching the return of the market would be a significant accomplishment for a new approach such as harnessing Collective Intelligence. To be able to beat the market by such a margin for the entire 5+ year history during which we have published our forecasts seems significant to us.

Further, sophisticated investors will note the extremely low (-.01) daily correlation between the P&L stream of our Forecasts and the daily movement so of the S&P 500 (SPY).

Most investors, or money managers, with large investments in equities are almost by definition highly correlated with the market. They can't help it. Over the long term markets have historically gone up. So if you are a money manager with a stock strategy, you typically need to be long the market. When the market goes up, so does your strategy. When the market goes down, so does your strategy. A lot of the return of most strategies is really due to the movement of the market as a whole, and a relatively small amount is due to the stock picking skill of the typical money manager. (There are of course long/short strategies that try to eliminate the effect of the market and isolate the skill of the manager, but generally the poor performance of the Global Hedge Fund Index relative to the market suggests that, in aggregate, they have not been overly successful.) Correlation is a big part of the reason that simply buying and holding the S&P 500 outperforms 80% of the financial professionals.

However, the "holy grail" for money managers is an uncorrelated strategy that produces good returns. With an uncorrelated strategy, the strategy makes or loses money independently of what the market as a whole does. That's a good thing because when you mix the uncorrelated strategy with buying and holding the market, or with any of the many strategies out there today that basically move with (are highly correlated with) the market, you find that the uncorrelated strategy reduces the volatility (smooths out the bumps) in the combined portfolio.

Even if our Forecasts had identical return with the market, or even somewhat less return than the market, many sophisticated investors would find them useful because of their lack of correlation – that is, because of their ability to reduce volatility when mixed in with the other stock holdings the investor already has which likely are moving up and down with the market.

To summarize:

1) PredictWallStreet's forecasts are public and forward-looking.
2) The forecasts are powered exclusively via the predictions of individual investors, processed via proprietary algorithms developed by our research team.
3) The hypothetical trading methodology has not changed since first published in 2008 and the number of forecasts publically released to date (12,235) is reasonably large.
4) The hypothetical performance of our Forecasts has been more than twice as good as the market over the same period.
5) The performance has been essentially uncorrelated with the market – a desirable trait.

We conclude there is good evidence so far that it has been indeed possible to "beat the market" by harnessing the power of Collective Intelligence.

Since "beating the market" is considered an extremely difficult problem, and since there is tremendous competition among the smartest minds on the planet to solve this problem due to the large monetary rewards involved, the fact that Collective Intelligence can be harnessed in this way suggests that other very difficult problems might also be solved via Collective Intelligence. We would like to see that happen.

Some Important Final Notes:

Finally, we want to reiterate that all the performance results described are hypothetical. We have tried to lay out the assumptions and methodology as clearly as possible, but there are many factors related to actual trading (including but not limited to: commission costs, market impact, potential trading errors, or the inability to sell short,) that are not reflected in our hypothetical analysis.

This paper was written to demonstrate theoretical performance of our forecasts. We do not make trading recommendations. We do not advocate any trading methodology including the one described in this paper. Past results do not guarantee future results. Ideas and methods that worked once might stop working at any time. PredictWallStreet, LLC is not an investment adviser and all investors should consult with a financial professional before placing any trades in the stock market.