The Improved R2 Strategy: 84% Correct with Just 6 Rules

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In early 2005, we published the R2 Strategy on TradingMarkets which quickly became one of our more popular strategies. The strategy was also presented at "The Traders Expo" in Fort Lauderdale last year. In the "MoneyShow.com Best Webcasts of 2006" it was voted the number one presentation in the "Best for Traders" category. We recently updated and improved our research, leading to this article that shares our latest findings with you.

What is the Improved R2 Strategy?

The Improved R2 Strategy is a simple six-rule Market Timing Strategy which uses the 2-period RSI as its primary tool. Our research has shown that there is little statistical evidence using the standard 14-period RSI. But, when you shorten the period to a 2-, 3- or 4-period RSI, test results significantly improve. By using the 2-period RSI as we do here, you can see back-tested results of 84.31% correct in the S&P 500 Index going back to 1995 (12 years).

Here are the Rules:

1. **The SPX is above its 200-day simple moving average (you can use any S&P 500 derivative product, including the SPYs, E-minis, etc).**
2. **Day 1 - the 2-period RSI is below 65. This tells us that the market is in a neutral to possibly oversold condition.**
3. **Day 2 - the 2-period RSI closes lower than Day 1.**
4. **Day 3 - the 2-period RSI closes lower than Day 2.**
5. **Buy the market (SPX, SPY, E-mini, etc) on the close Day 3.**
6. **Exit when the 2-period RSI closes above 75.**

Here are the simulated results from Jan 1, 1995 to December 31, 2006:

Number of trades: 102
Percent correct: 84.31%
Total S&P points gained: 1013.90
Average holding period/trade: 5.76 days

Here are some recent trade examples using the Improved R2 Strategy to trade the SPY. In each example, the SPY is trading well above the 200-day simple moving average (rule 1) and therefore not shown.

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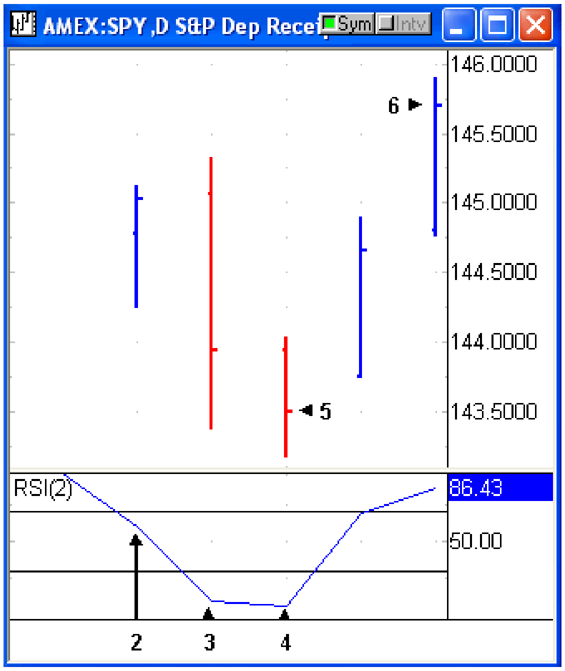
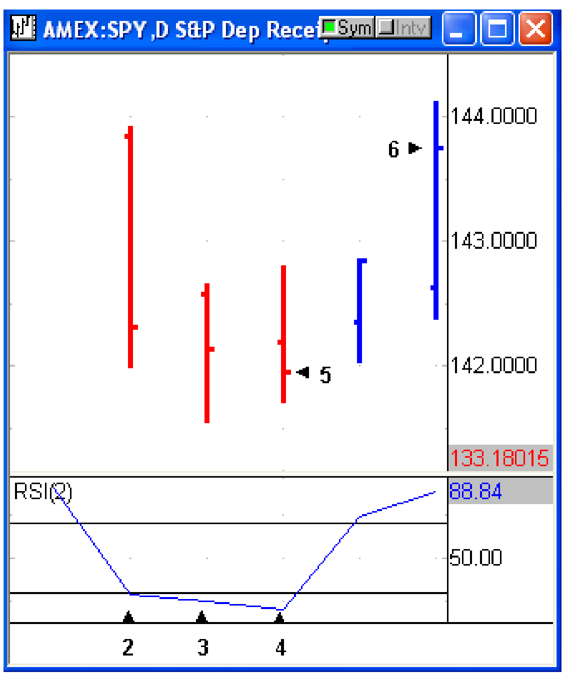
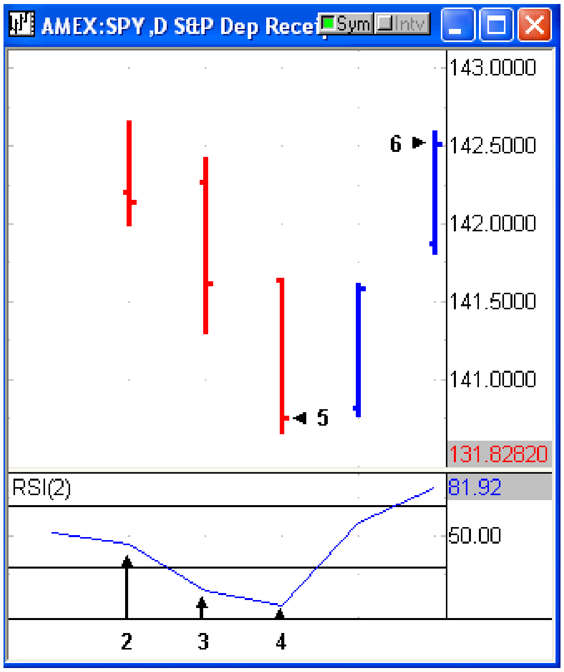


1. The SPX is above its 200-day simple moving average (not shown).
2. Day 1 - the 2-period RSI is below 65. On 02/08/07 the 2-period RSI is 59.80.
3. Day 2 - the 2-period RSI closes lower than Day 1. On 02/09/07 the 2-period RSI is 9.73.
4. Day 3 - the 2-period RSI closes lower than Day 2. On 02/12/07 the 2-period RSI is 5.80.
5. Buy the market on the close Day 3. On 02/12/07 buy SPY at 143.50.
6. Exit when the 2-period RSI closes above 75. On 02/14/07 sell SPY at 145.78.



1. The SPX is above its 200-day simple moving average (not shown).
2. Day 1 - the 2-period RSI is below 65. On 01/25/07 the 2-period RSI is 29.15.
3. Day 2 - the 2-period RSI closes lower than Day 1. On 01/26/07 the 2-period RSI is 25.37.
4. Day 3 - the 2-period RSI closes lower than Day 2. On 01/29/07 the 2-period RSI is 20.15.
5. Buy the market on the close Day 3. On 01/29/07 buy SPY at 141.95.
6. Exit when the 2-period RSI closes above 75. On 01/31/07 sell SPY at 143.75.



1. The SPX is above its 200-day simple moving average (not shown).
2. Day 1 - the 2-period RSI is below 65. On 12/20/06 the 2-period RSI is 44.46.
3. Day 2 - the 2-period RSI closes lower than Day 1. On 12/21/06 the 2-period RSI is 14.45.
4. Day 3 - the 2-period RSI closes lower than Day 2. On 12/22/06 the 2-period RSI is 4.43.
5. Buy the market on the close Day 3. On 12/22/06 buy SPY at 140.75.
6. Exit when the 2-period RSI closes above 75. On 12/27/06 sell SPY at 142.51.

Applying this Research and Strategy to your Trading

You can immediately begin applying the Improved R2 Strategy to your trading using the rules above. If you wish to attend a free live class presented by Larry Connors, CEO and Founder of TradingMarkets.com and Connors Research, click here.

We have often been asked if the R2 strategy is transferable to stock trading, and the answer is yes. We have created simulated portfolios using a variation of the R2 strategy (known as the R3/R4 strategy). If you would like more information on the R3/R4 Strategy, click here.

Summary

As you can see from the above results, the Improved R2 strategy has done an excellent job of identifying buying opportunities in the market going back more than a decade. And, it's a simple indicator that you can apply immediately. If you have any questions on the research or the strategy please feel free to email us at editor@tradingmarkets.com or call us at 213-955-58585 ext 1.

Larry Connors *is CEO and Founder of TradingMarkets.com and Connors Research.*

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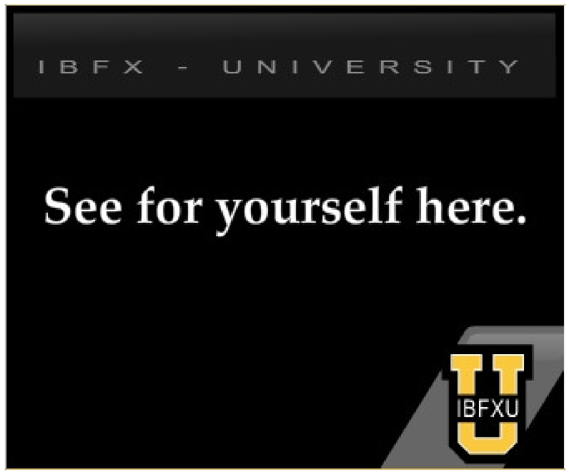
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