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Methodology

TradingEdge.Pro's methodology describes a multi-step process for building and validating trading strategies, structured into two parts: strategy development and testing, and practical use. In the testing phase, a strategy is defined as a set of objective rules, validated through initial tests, optimised, and assessed for stability (robustness), and then evaluated using Walk-Forward Analysis. The detailed testing assumptions (including the instrument universe, in-sample/out-of-sample periods, data sources, transaction costs, and execution rules) are described in the "Testing Specification" document. The full methodology and metric definitions are available on the TradingEdge.Pro "Methodology" page.

Gilligans Island v.1

Investment Strategy Testing Summary

Gilligans Island v.1 is a short-term reversal system, attributed to Larry Williams' approach, in which **the signal is a gap in line with the trend** (gap up or down), followed by **its negation within the same session.** An additional condition is the occurrence of a candle at **a local extreme** (highest high or lowest low in the last 100 session), which is intended to indicate a moment of temporary "drag" of the market. **Entry is executed with a stop order only after the direction is confirmed by a breakout of** the minimum/maximum of the signal candle, and the risk is defined by the initial stop on the opposite side of this candle. The position is held for a short time: **we close it after several sessions** (time-exit) or earlier with a stop.

Although the strategy is based on **rational assumptions** and attempts to exploit **the stock market effect,** its **effectiveness in real-world trading remains questionable.** It has not even passed **preliminary testing,** meaning **it is not recommended for use in real-world trading.**

Our goal is to have a strategy that remains **profitable and effective across a wide range of parameters,** because the market is a volatile organism, and optimal parameters can change over time. **I can't** emphasize enough that for **a strategy to work** in real-world conditions, it must also perform under **suboptimal parameters** and **conditions.** In short, **it must be stable** to changing market conditions.

I don't know who said these words, but they perfectly capture the problem of many optimizations:

"I've never seen a strategy that didn't work in backtests."

We don't know the future, we don't know future market conditions, but if we know that our strategy **has historically generated acceptable results** in various market conditions and across various parameter ranges, then we are **one step ahead of other** market participants.

Contents

Step 1: Formulate an investment strategy

The Gilligans Island v.1 strategy looks for a situation in which **the market makes a strong push through a price gap,** but in the same session, **the direction of the gap is negated — the candle closes near the opposite end of the daily range.** The idea is simple: **a gap often attracts late market participants** (buyers on the upside gap or sellers on the downside gap), and a candle closing near the end of the range suggests that supply/demand has "burned out" within that session. To increase selectivity, **the system also requires that the signal candle fall at a local extreme calculated within a 100-day window** (the highest high for a short or the lowest low for a long).

For **a short position,** a setup is created when:

- today's **high** is the highest of the last 100 sessions,
- the session opens **with a gap up** from yesterday's high,
- the candle is **bearish** (close below open),
- the candle closes **at the lower end of the daily range** (below 20% of the daily range).

For **a long position,** the conditions are mirrored:

- today's **low** is the lowest of the last 100 sessions,
- the session opens **with a downward gap** from yesterday's low,
- the candle is **bullish** (close above open),
- the candle closes **at the top of the daily range** (above 80% of the daily range).

Entry doesn't occur "at the close of the signal day". Instead, the strategy forces **directional confirmation:** after the signal, we set a stop order on the breakout of the signal candle's extreme (for shorts: below its low, for longs: above its high). This ensures **that the position is activated only when the market actually begins to move towards the negated gap.**

The strategy uses:

- **Donchian Channel** – Context Filter: the signal is to be created at a local high/low;
- **Price gap** – the condition of “dragging” the market to the opening of the session;
- **Candle range closing position** – qualitative rejection filter (close close low for short/close close high for long);
- **Trigger stop T+1** – entry only after breaking the minimum/maximum of the signal candle;
- **Initial stop on the signal candle** – risk defined on the opposite side of the setup;
- **Time-exit** – short horizon of maintaining the position (5 days).

Characteristics of the strategy and its strengths and weaknesses:

- **mechanical and easy to test** (gap + extreme + close position + stop input);
- **the Donchian filter** limits trading in the middle of the range and forces an "extreme" context;
- **entering a stop** gives natural confirmation – fewer transactions “against the market without proof”;

- **Holding a position for a short period** reduces exposure to long counter-trends.
- **gap dependence** – in some markets signals may be rare or unrepresentative;
- **risk of slippage when the stop is broken,** especially after sessions with high volatility;
- **the stop on the signal candle can be wide** if the gap day has a large range;
- **in a strong trend, a gap may be a "start of continuation" and not exhaustion** - then the system catches losing counterattacks.

The Gilligans Island v.1 strategy is a tool for traders who want to capitalize on **sudden supply-demand imbalances** and **extreme price impulses** that occur after periods of strong trends. Although its premise is simple, effective implementation requires **disciplined rule execution,** consistent **risk management,** and the awareness that trades are being executed **against the prevailing trend.** Due to the specific setup and operational risks, the strategy is best suited for investors who understand its profile (less frequent signals, possible quick reversals, volatile results) and can maintain consistency in conditions of increased volatility.

Step 2: Determine investment principles

Below is **the pseudocode** for the **Gilligans Island v.1 strategy** on daily charts:

1. **Calculating Indicators:**
    a. **HighestHigh(XX)** – the highest high of the last XX sessions (Donchian channel);
    b. **LowestLow(XX)** – the lowest low of the last XX sessions (Donchian channel);
    c. **TopBottom(YY%)** – a parameter determining whether the close falls "close enough" to the top or bottom of the daily range;
    d. **ExitBars(Z)** – number of sessions to hold the position (timed exit);
2. **Setup Identification – Short Position (sell setup):**
    a. **Extreme:** Today's high is the highest in the XX window.
    b. **Gap up:** Today's open is above yesterday's high.
    c. **Rejection:** Today's candle is bearish (close below open).
    d. **Close at the bottom of the range:** Today's close is near the candle's low, in line with the YY% parameter.
3. **Entry – Short Position:**
    a. **Order:** After the setup occurs, set **a sell stop order for the next session** one tick below the low of the signal candle.
    b. **Initial Stop:** Set your stop loss one tick above the high of the signal candle.
4. **Setup Identification – Long Position (buy setup):**
    a. **Extreme:** Today's low is the lowest in the XX window.
    b. **Gap Down:** Today's open is below yesterday's low.
    c. **Rejection:** Today's candle is bullish (close above open).
    d. **Close at the top of the range:** Today's close is near the candle's high, in line with the YY% parameter.
5. **Entry – Long Position:**
    a. **Order:** After the setup occurs, set a buy stop order one tick above the high of the signal candle for the next session.
    b. **Initial Stop:** Set your stop loss one tick below the low of the signal candle.
6. **Closing a position:**
    a. **Timed exit:** If the stop loss has not been activated before, close the position at the opening of the session after Z sessions have passed since the entry date.
    b. **Stop Exit:** If the market touches the stop loss level, close the position as per the defensive order.
7. **Daily Monitoring:**
    a. Every day, update the HighestHigh and LowestLow and the TopBottom candle closing position assessment.
    b. The system detects long/short setups and sets appropriate stop orders for the next session, and for open positions it runs a counter to ExitBars and controls the activation of stop loss.

The above rules are described in a way that allows them to be directly converted into a script in the chosen testing platform, which ensures the accuracy of the historical simulation and the reliability of the test results.

Testing is performed assuming that **the risk of one position is 1.0% of total capital.**

Step 3: Pre-test your investment strategy

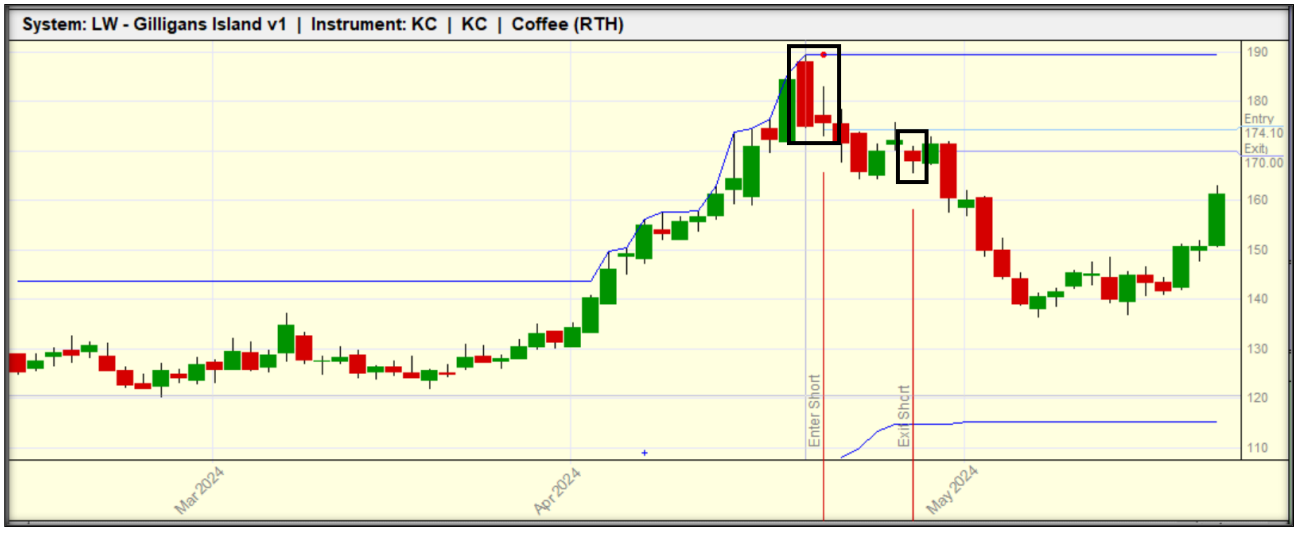
Below are some purchase and sale transactions that allow you to verify the following aspects:

- **Correctness of generated signals;**
- **Direction of opening a position;**
- **Moment of opening the position;**
- **The opening price of the position;**
- **Moment of closing the position;**
- **Closing price of the position;**
- **Compliance of the transaction with the theoretical assumptions of the investment strategy.**

At this stage, **it doesn't matter** whether the trades are **profitable,** what **instrument was used,** or whether they occurred **recently** or **in the distant past.** The key is **to verify that the trades are generated correctly** and in line with the assumptions described in the previous step.

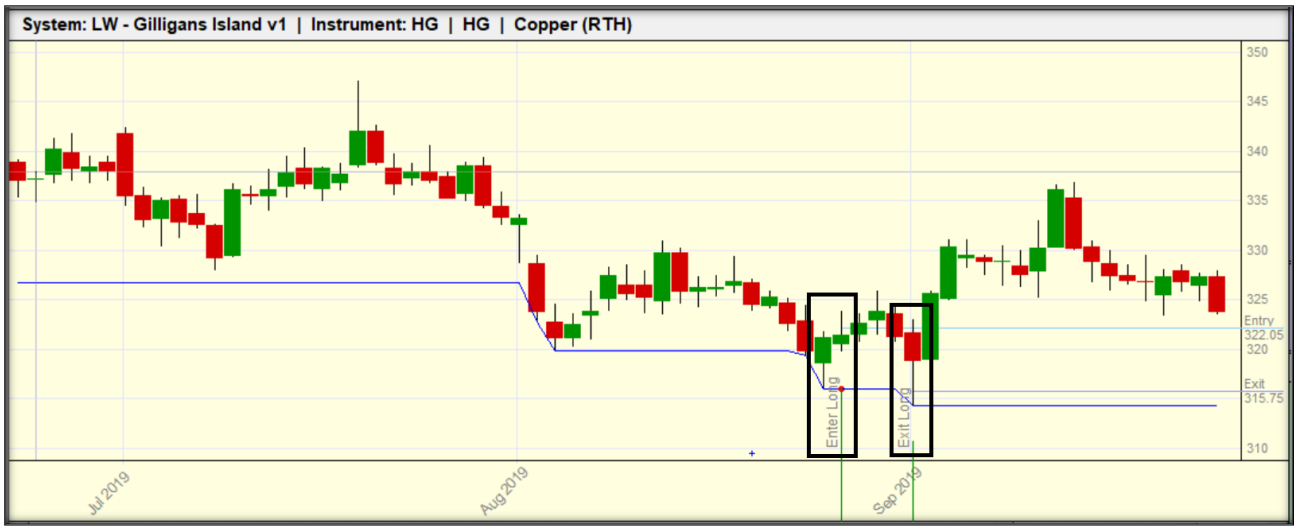
The first trade was made on the **coffee futures contract (KC).** At the end of April 2024, the market was in **an uptrend** and established **a new upside breakout** within the long-term Donchian channel (100). At this point, **a signal candle appeared** (the first candle in the rectangle): **the session opened with a clear upside gap,** but by the end of the day, **the price had retraced and closed near the candle's low,** fulfilling the conditions **of the "Gilligans Island" formation for a short position.**

For the next session, we set a sell stop order one tick below the low of the signal candle. The order was activated the next day, opening a short position (the "Enter Short" line). Simultaneously, **the initial stop loss was set one tick above the high of the signal candle** (the red dot above the candle in the rectangle), in accordance with the protection principle on the opposite side of the setup candle. **The strategy assumes a timed exit** – if the stop is not violated earlier, the position is closed after five sessions from entry, i.e., at the open of day 6. In this case, **the trade was closed according to the timed exit rule** (the "Exit Short" line, a small rectangle). **The system worked correctly.**



Another example. The trade was conducted on **a copper (HG) futures contract.** At the end of August 2019, the market was in **a downtrend** and established **a new downward breakout** within the long-term Donchian channel (100). At this point, **a signal candle appeared** (the first candle in the rectangle): **the session opened with a clear downward gap,** but by the end of the day, **the price had retraced and closed near the candle's high,** fulfilling the conditions **of the "Gilligans Island" formation for a long position.**

For the next session, we set a buy stop order one tick above the high of the signal candle. The order was activated the next day, opening a long position (the "Enter Long" line). Simultaneously, **the initial stop loss was set one tick below the low of the signal candle** (the red dot above the candle in the rectangle), in accordance with the principle of protection on the opposite side of the setup candle. **The strategy assumes a timed exit** – if the stop is not violated earlier, the position is closed after five sessions from entry, i.e., at the open of day 6. In this case, **the stop loss was reached several days after entry,** so the position was closed at a loss (the "Exit Long" line, the second rectangle). **The system worked correctly.**



Once we are sure that the transactions are generated correctly, we can proceed to the first test of the strategy on the full **in-sample data set.** These tests are performed on **the basic parameters,** which – according to my assessment – should correspond to the assumed goals of the strategy.

First, **we reject strategies that linearly lose capital.** If a strategy exhibits this pattern, it's a clear signal that any parameter optimization is pointless.

Our basic expectation is that the strategy generates **positive results,** even if they are at a low level.

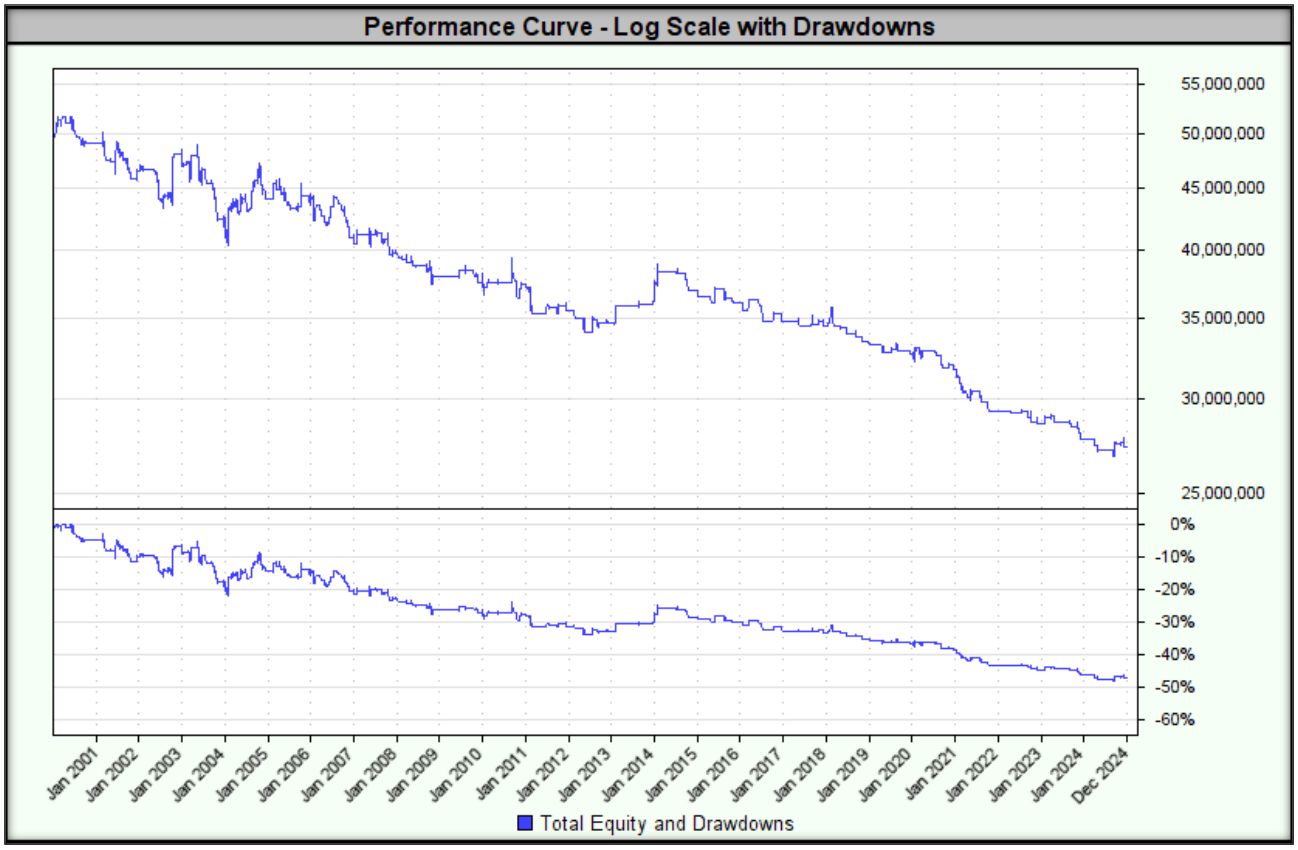
Tested base parameters:

- **HighestHigh & LowestLow:** 100 days
- **TopBottom:** 20%;
- **ExitBars:** 5 days;
- **Position opening method:** 1 tick below (for a short position)/above (for a long position) the extreme of the signal candle;
- **Stop loss:** 1 tick above (for short position)/below (for long position) the extreme of the signal candle;
- **Position Size:** Fixed Fractional; Risk Equity 1.0% of total capital;

- **Position direction:** long (buy) and short (sell) positions.

The test result is shown below.

Historical or simulated results do not guarantee similar results in the future.



Historical or simulated results do not guarantee similar results in the future.

Indicators/Measures	Concluding a transaction at the opening price
CAGR%	-2.38%
MAR Ratio	-0.05
RAR%	-2.15%
R-Cubed	-0.04
Robust Sharpe Ratio	-0.46
Max Drawdown	48.0%
Wins	33.8%
Losses	66.2%
Average Win%	1.26%
Average Loss%	0.91%
Win/Loss Ratio	1.38
Average Trade Duration (days)	5
Percent Profit Factor	0.71
SQN	-
Number of transactions	325

In summary, the system works properly and generates signals as expected. However, **tests on the underlying parameters yielded poor results.** Therefore, **further testing of the strategy is not warranted,** as its use in real-world trading **is highly questionable.**

Step 4: Optimizing and assessing the stability of the investment strategy

1. **Stability across a wide range of optimized parameters**

The step was skipped due to **failure of previous tests.**

2. **Monte Carlo simulation**

The step was skipped due to **failure of previous tests.**

3. **Stability over a moving time window**

The step was skipped due to **failure of previous tests.**

4. **Long/short stability**

The step was skipped due to **failure of previous tests.**

5. **Stability in the portfolio of financial instruments**

The step was skipped due to **failure of previous tests.**

6. **Money Management (Position Sizing)**

The step was skipped due to **failure of previous tests.**

7. **Strategy Risk Management**

The step was skipped due to **failure of previous tests.**

Step 5: Walk-Forward Analysis

The step was skipped due to **failure of previous tests.**

Step 6: Using the strategy in real time

The step was skipped due to **failure of previous tests.**