Building a read, and what it does not give you

> **A READ**
>
> A stated view of where an index is, what would change that view, and what you would expect to see if it were wrong. It is not a forecast, and its most useful component is the falsification condition, because that is the part a plan and a review can act on.

Eight lessons of tools. This is what assembling them into something usable looks like, and what it still cannot do.

The parts of a read

Context: where the index sits against its own recent range, on a named series and timeframe.Driver: what is currently moving it - rates, earnings season, a megacap, or nothing identifiable.Participation: whether breadth supports the move or a few constituents are carrying it.Level: the price that would say the read is wrong.Expectation: what a normal outcome looks like against a surprising one.

Four of those five are descriptive. Only the level commits you to anything, which is the point.

The arithmetic that follows from a level

Once a read has an entry and an invalidation, it has a ratio - and a ratio implies how often the read must be right to be worth holding.

Worked example - figures in USD

An index near 5,300 with the read invalidated at 5,260 and an objective at 5,420. Index levels are unitless, so these figures are identical whatever a USD account converts them into.

1. The read puts entry at 5300, the level that would falsify it at 5260, and the objective at 5420.
2. That is 40 points of risk against 120 points of reward - a ratio of 3.
3. So the read has to be right 25.0000% of the time merely to break even, before any cost. The ratio is not the question; the ratio together with how often you are right is.

Twenty-five percent is not a low bar because the ratio is generous; it is exactly the bar that ratio sets. A read you believe in 30% of the time clears it, and one you believe in 20% of the time does not, however confident it feels.

What a read does not give you

Certainty, obviously. Less obviously, it does not give you a reason to trade. A correct read of a market you have no edge in is still not a position, and module 6 is where a read becomes a rule that can be tested rather than a view that can be held.

The index caveat, one last time

Every technique in this module operates on a weighted sum. The read is about the sum. Whether the sum represents the market you think it does is a question about concentration, breadth and composition - and the answer changes over time.

Module 6 turns reads into rules and tests them. Module 8 goes back underneath, to how the sum is built.

Check your understanding

1. Which part of a read commits you to anything?

a. The context
b. The driver
c. The level that would falsify it

Answer: c. The rest is description. The invalidation level is the part a plan and a review can act on, which is why it is the most useful output.

2. A read gives a 3:1 ratio. What does that imply?

a. It only needs to be right 25% of the time to break even
b. It will be right three times out of four
c. It is a better read than a 2:1

Answer: a. The ratio sets the break-even hit rate and nothing more. Whether you clear that rate is a separate question the ratio cannot answer.

3. Is a correct read a reason to trade?

a. Yes, that is what analysis is for
b. No - a correct read of a market you have no edge in is still not a position
c. Only if breadth confirms it

Answer: b. Module 6 is where a read becomes a rule that can be tested. Being right about direction and having an edge are different claims.