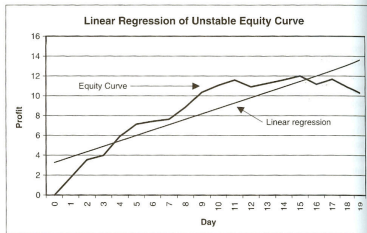
**FIGURE 4.12**

Linear Regression of Stable Equity Curve. We fit a best fit line to the path of the equity curve in order to generate statistics for calculating the K-ratio. The equity curve above appears to rise consistently over time.

**FIGURE 4.13**

Linear Regression of Unstable Equity Curve. The equity curve above performs well in the first half but then flattens towards the end of the test.

Day	System 1	System 2
0	0.00	0.00
1	-0.15	1.76
2	0.72	3.55
3	1.23	3.99
4	2.50	5.90
5	2.33	7.13
6	2.54	7.41
7	3.63	7.64
8	4.91	8.84
9	6.25	10.35
10	6.32	11.05
11	6.60	11.59
12	6.75	10.90
13	7.92	11.25
14	8.30	11.60
15	9.00	11.99
16	9.22	11.16
17	9.36	11.67
18	9.37	10.89
19	10.17	10.30
b1	=SLOPE(B2:B21,\$A2:\$A21)	=SLOPE(C2:C21,\$A2:\$A21)
s.e. b1	=STEYX(B2:B21,\$A2:\$A21) / SQRT(DEVSQ(\$A2:\$A21))	=STEYX(C2:C21,\$A2:\$A21) / SQRT(DEVSQ(\$A2:\$A21))
Observations	20	20
K-ratio	=B22/(B23*A24)	=C22/(C23*A24)
b1	0.58	0.55
s.e. b1	0.02	0.07
K-ratio	1.32	0.40

FIGURE 4.14

Excel formulas for calculating the K-ratio. The K-ratio can be calculated in Excel using the above formulas.

The K-ratio is a unitless measure of performance that can be compared across markets and time periods. Weekly performance of corn futures can be compared with tick data performance of trading IBM. Traders should search for strategies yielding K-ratios greater than +0.50. Together, the Sharpe ratio and K-ratio are the most important measures when evaluating trading strategy performance.

Note: When I created the K-ratio in 1996, I thought I had created a robust measure to evaluate performance. In mid-2000, trader Bob Fuchs brought a small error to my attention regarding the scaling of the K-ratio. He was correct in his critique and I have corrected the error in this text. Publications prior to 2002 will show a different formula for the K-ratio. The updated formula in this book is correct.