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TRADING STRATEGIES REVIEW

HOW ARE THEY PERFORMING? AN UPDATE ON PREVIOUSLY PUBLISHED TRADING STRATEGIES

By David Vomund

We recently heard from a rather frustrated user who said that he did not have confidence in TradingExpert Pro because in the *Opening Bell* newsletter we constantly introduce new strategies and approaches to using the software. The user reasons that if we introduce a new strategy each month, that must mean that the old ones are no longer working.

Nothing could be further from the truth. Different people have different styles so when we find something that works we publish it. Some strategies are for short-term traders, some strategies are for less active traders, some are for people who like to short securities, etc.

So that we are held accountable for our analysis, we will review some of the strategies that we have presented in the last two years and update their performance.

In last month's *Opening Bell*, we reported the 1998 return for the AIQ mechanical strategy that combines the Weighted Action List report with the market timing Expert Ratings. With this strategy, the average holding period is 1 1/2 months. Needless to say, the AIQ



DAVID VOMUND

mechanical strategy's 75% return for 1998 topped all other strategies.

Performance updates on other previously published strategies follow.

"Needless to say, the AIQ mechanical trading strategy's 75% return for 1998 topped all other strategies."

Mechanical strategy using Relative Strength Report (published April '97)

Another AIQ mechanical strategy (introduced in the April 1997 *Opening Bell*) uses the Relative Strength Report. This strategy is exactly the same as the AIQ mechanical model (above) except the Relative Strength Report is used instead of the Weighted Action List.

This second strategy is more volatile because high relative strength stocks can fall like a rock in a bearish market. However, with the exception of 1998, these two mechanical strategies have performed about the same historically.

In review, we ran the daily Relative Strength Long-Term Strong Report every time there was an AIQ market timing buy signal (an Expert Rating of 95 or greater on ticker DJIA). Only the first market timing signal in a string of buy signals is used and no confirmation is applied to market timing signals. When a market timing buy is registered, the top five stocks that appear on the Relative Strength Report are purchased and held until a market sell signal is registered, at which time all positions are moved to cash. Only Standard & Poor's 500 stocks are purchased.

Like the strategy using the Weighted Action List, the Relative Strength Report model has an average holding period of 1 1/2 months.

To obtain percentage return figures, we made the following assumptions:

- The buy and sell points for the stocks were the opening prices the day after the market timing Expert Rating.
- Commissions were factored in using a discount commission rate of \$20 per trade.
- Slippage, dividends, and money market interest received were not factored in.

Since this strategy was first published in April 1997, we have continuously updated the trades so the stock purchases reflect the infor-

1998 Results - Relative Strength

ER Buy Date	ER Sell Date	S&P 500 % Change	Stocks % Change	Portfolio Holdings (Stock Symbols)
12/31/97	01/08/98	-1.48	-0.31	CINF,U,NAV,TCOMA,T
01/12/98	04/17/98	19.54	19.81	U,CINF,DELL,T,TCOMA
06/02/98	06/10/98	1.76	-1.82	UIS,DELL,NC,F,EMC
06/16/98	07/21/98	7.12	14.24	UIS,DEL,AAPL,EMC,LOW
07/29/98	09/03/98	-12.70	-10.23	DELL,COF,UMG,C,MCIC
09/08/98	10/05/98	-3.41	-9.57	DELL,AAPL,EMC,UMG,CSCO
10/08/98	12/03/98	19.88	4.05	PE,DELL,BLS,PEG,PDG
12/29/98	12/31/98	-1.01	-3.17	SCH,LU,GPS,CSCO,SPLS

1998 Return = 11.5%

mation that was available at that time. This is more accurate than running a backtest using today's S&P 500 stocks.

For the year ending 1997, the strategy returned 51.6%. In 1998, the performance dropped to 11.5%, which is close to what the average equity mutual fund returned. A list of the individual trade dates and the securities that were purchased are found in **Table 1**.

This table lists the average return of the five stocks that were purchased for each trade along with the S&P 500's return. Again, the percent change figures are based on the opening price the day after the market timing Expert Rating.

When we introduced this strategy we emphasized, as noted above, that it was a volatile strategy because high relative strength stocks can nose-dive in a bearish market. Indeed, when the AIQ timing model was on the wrong side of the market in August of 1998 the portfolio fell more than 10%, which represents its worst drawdown in our historical testing.

Dogs of the OEX (published March 1998)

Last March we presented a model that applied the Dogs of the Dow

strategy to Standard & Poor's 100 stocks. Our point in the article was that too many people were following the Dogs of the Dow strategy so the strategy was losing its effectiveness. Yet, the philosophy of buying high yielding large-capitalization stocks is sound.

Therefore, instead of applying the strategy to only Dow stocks, we applied the strategy to Standard & Poor's 100 (OEX) stocks.

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To review the Dogs of the Dow strategy, on the first trading day of each year you buy the ten highest yielding Dow stocks and hold them for the rest of the year. The portfolio is rebalanced using the same strategy at the start of every year. Obviously, this is a strategy for long-term investors.

In our modified strategy, we made a list of the 20 highest yielding OEX stocks and then eliminated the five highest yielders (we found the five highest yielding were either utility stocks or were truly dogs). The remaining 15 stocks were then purchased and held for the remainder of the year.

In the March *Opening Bell*, we listed the 15 Dogs of the OEX stocks. **Table 2** contains the same list of stocks and updates their total return figures for 1998. This strategy produced an average return of 19.4% which once again beat the actual Dogs of the Dow strategy. This is an attractive return considering the average S&P 500 stock gained about 13% in 1998 and you only had to work one day out of the year in order to achieve this 19.4% return!

Table 2**1998 Dogs of the OEX**

Ticker	Yield	1998 Yrly. % Ch.	1998 Total Return (%)
BEL	3.4	18.7	22.1
AN	3.3	40.7	44.0
GM	3.3	17.8	21.1
WY	3.3	3.6	6.9
AIT	3.0	57.5	60.5
EK	2.9	18.9	21.8
IFF	2.9	-14.2	-11.3
MOB	2.9	20.7	23.6
PNU	2.9	54.6	57.5
XON	2.7	19.5	22.2
MMM	2.6	-13.3	-10.7
NSC	2.6	3.9	6.5
ALT	2.5	-21.0	-18.5
AMP	2.5	24.0	26.5

1998 Average Return = 19.4%

In order to keep tracking the

Table 3**1999 Dogs of the OEX**

Ticker	Stock	Yield
ETR	Entergy Corp	3.9
DOW	Dow Chemical	3.8
IFF	Int'l Flavors & Frag.	3.4
PRD	Polaroid Corp.	3.2
ALT	Allegheny Teledyne Inc.	3.1
F	Ford Motor	3.1
MMM	Minn. Mining & Manuf.	3.1
WY	Weyerhaeuser Co.	3.1
ONE	Banc One	3.0
BAC	BankAmerica Corp.	3.0
BEL	Bell Atlantic	2.9
GM	General Motors	2.8
BHI	Baker Hughes	2.6
DD	Du Pont	2.6
HRS	Harris Corp.	2.6

results from this strategy, we have published the 1999 Dogs of the OEX list in **Table 3**. Few AIQ users have the temperament to buy and hold stocks for an entire year but this list can also be used in an effective trading strategy that switches between growth and value stocks.

The Dogs of the OEX is a good list of value stocks. The Relative Strength Report used in our previous strategy produces a list of attractive growth stocks. By creating an industry group that represents value stocks and an industry group that represents growth stocks, you can use the RSMD indicator to trade between the two investment philosophies. When the market environment favors value investing, you purchase the Dogs of the OEX stocks. Conversely, when the market environment favors growth stocks, then you purchase high relative strength stocks (this strategy was covered in the May 1998 *Opening Bell*).

Trading Strategies Review continued on page 4

Divergence EDS Model (published April 1998)

One of the most popular *Opening Bell* articles last year related to an Expert Design Studio (EDS) model that was published in the April 1998 issue. This model is an effective trading strategy for active traders (average holding period of 14 days).

For this strategy, there are seven rules that must be met for a stock. These rules are as follows:

1. Its price must be below its 200 day moving average.
2. Its volume must be greater than 200,000 shares.
3. It must have a positive divergence in its OBV Percent indicator (i.e., the stock went down at the same time that its OBV Percent indicator increased).
4. It must have a positive divergence in its Money Flow indicator (i.e., the stock went down at the same time that its Money Flow indicator went up).
5. Its 7 day RSI Wilder indicator must be greater than 50.
6. Its MACD indicator must be on a buy (fast line above slow line).
7. Its Money Flow RSI (MF RSI) indicator must be greater than 70.

Our historical test published in the April 98 *Opening Bell* covered the time period 01/02/96 to 03/02/98. Results showed the average trade gained 4.21% before commissions with a 14-day holding period. If you were to buy the S&P 500 index instead of each stock for each trade, the average trade would have been only 1.91%. The annualized return assuming you could trade every selection was 72.68%. There were 128 trades.

In the April article, we were convinced that we didn't over-optimize the system. That means it should work in the future. So how has it performed?

Table 4 shows the results of a test from March 1998 through December 1998. The model continued to outper-

Table 4

	Winners	Losses	Neutral
Start test date:	03/02/98		
End test date:	12/31/98		
Number of trades in test:	147	97	49
Average periods per trade:	10	10	12
Minimum Profit/Loss:		36.07%	(24.11)%
Average Drawdown:	(5.00)%	(1.72)%	(11.58)%
Average Profit/Loss:	2.72%	9.97%	(11.57)%
Average SP% Profit/Loss:	1.42%	3.03%	(1.75)%
Probability:		65.99%	33.33%
Average Annual ROI:	63.00%	244.57%	(241.74)%
Annual SP% (Buy & Hold):	19.94%		
Reward/Risk Ratio:	1.71		

form. The average stock gained 2.72% excluding commissions with a 10-day holding period. If you were to trade the S&P 500 index instead of the stocks, the average trade would have only gained 1.42%.

This model is designed to work on a large database. The performance dramatically falls when it is run just on the S&P 500 stocks. For our most recent test, we used the Historical Data CD that comes with TradingExpert Pro and installed all the stocks that are over \$10 and have a minimum average volume of 100,000 shares (a setting of 1000). That installed about 1800 stocks.

When we first published this model, we received comments that there were not enough trades. For those who want more buy signals, try

taking out the moving average rule and lower the requirement for the MF RSI to 60 (the default in the model is MF RSI greater than 70). This model can be downloaded from AIQ's web page at www.aiq.com. Click on the educational products folder and then Opening Bell.

This article contains just a sample of the material that has been covered in the *Opening Bell* newsletter. If you are interested, you can purchase back issues for the last two years for \$75. Call AIQ sales at 800-332-2999 for more information. ■

David Vomund publishes VIS Alert, a weekly investment newsletter. For a sample copy go to www.visalert.com or call (775) 831-1544.

Changes to S&P 500 Index and Industry Groups

The following is a recent change to the Standard & Poor's 500 structure:

McKesson-HBOC (MCK) replaces HBO & CO (HBOC) and MCK is added to the Distributors (Food & Health) group.

MARKET TIMING

PUTTING MARKET TIMING IN PERSPECTIVE

By David Vomund

In the last few months we've run a series of articles on market timing. The attention we've devoted to this subject may give the impression that market timing is the most important element of a trading system. It's not. Security selection is more important. In this article, we'll put market timing in perspective.

For much of this decade the market has been so strong that market timing has been almost unnecessary. That was true until the last few years when a few severe corrections interrupted the bull run.

To help demonstrate the importance of stock selection, we'll look at the hypothetical performance of a perfect market timer versus the performance of a perfect stock selector. In order to obtain performance figures of a perfect market timer, we'll use the Zig Zag indicator to help spot the high and

low points in the market.

The Zig Zag indicator is designed for backtesting and has no forecasting value. New users often say that they plan to use the Zig Zag indicator because it has worked so well in the past. The reason it always works well in the past is because it is a self-

correcting indicator. It finds the high and low points in price action and then connects these points with a straight line (see **Figure 1**).

By default, Zig Zag looks for 5% moves. That is, the line will change

direction every time a 5% move is made in the opposite direction. We'll repeat that this indicator is self-correcting so it is always right in the past but should not be used for current analysis.

For our backtest, we changed the Zig Zag setting to 3 so that every 3% move is significant. A perfect market timer would buy the day the Zig Zag bottoms and sell the day the Zig Zag tops.

That means that the market timer is long the market on every 3% or more advance, and moves to cash the day the market tops whenever there is at least a 3% correction. **Table 5** (next page) shows the individual trades of the perfect market timer. Assuming that all profits are reinvested, the perfect market timer would have made 76% in 1996, 129% in 1997, and 140% in 1998. Obviously these are impressive results. Yet, if someone had the foresight to simply buy the best performing industry group on January 1 and then hold it for the remainder of the year, this person would have beaten the perfect market timer over the three-year period.

In 1996 his Oil (Drilling) industry group investment would have made 182%, in 1997 his Retail (Discount & Variety) investment would have made 123%, and in 1998 his Computer (Internet) investment would have made 513%.

Obviously no one could be a perfect market timer and only someone who is very lucky can pick the year's best performing group on January 1. Nonetheless, this should help demonstrate the important role of security selection.

Some people claim that market timing should not play a role in investing. They argue that, histori-

"...if you are going to need the money within three years, then market timing is essential. For money set aside for retirement or college education, then stay invested and let the law of averages work in your favor."

correcting indicator. It finds the high and low points in price action and then connects these points with a straight line (see **Figure 1**).

By default, Zig Zag looks for 5% moves. That is, the line will change



Market Timing continued on page 6

Table 5

The Perfect World
Market Timing S&P 500 Index

Buy Date	Sell Date	% Gain
01/10/96	02/12/96	10.52
03/08/96	04/03/96	5.11
04/11/96	05/24/96	7.50
07/24/96	08/22/96	7.03
09/05/96	11/25/96	16.57
12/16/96	12/31/96	13.22

1996 Return = **76.4%**

Best Group:

Oil (Drilling) = **182%**

12/31/96	02/18/97	26.81
04/11/97	08/06/97	30.19
08/15/97	08/20/97	4.28
08/29/97	10/07/97	9.30
10/27/97	11/05/97	7.50
11/12/97	12/05/97	8.59
12/24/97	12/31/97	4.04

1997 Return = **128.5%**

Best Group:

Retail (Disc. & Variety) = **123%**

12/31/97	01/05/98	0.68
01/09/98	04/22/98	21.81
04/28/98	05/04/98	3.41
06/03/98	06/09/98	3.30
06/15/98	07/17/98	10.19
08/14/98	08/18/98	3.62
08/31/98	09/08/98	6.89
09/10/98	09/23/98	8.76
10/08/98	11/27/98	24.27
12/03/98	12/07/98	3.27
12/14/98	12/31/98	7.71

1998 Return = **140.3%**

Best Group:

Computer (Internet) = **513%**

cally, the return on equities is well above that seen on bonds or money-market instruments and stocks go up when looking at long-term time horizons. For example, holding stocks continuously for any 10-year period since 1945 has always proven profitable. Moreover, 96% of all the five-year periods were profitable.

What about the risk of buying at the market top? According to a study published in *The Wall Street Journal*, if you invested \$5,000 at the peak of the market every year over the past 20 years, you still would have quadrupled your investment.

How much market timing is used in a portfolio is a matter of personal preference. Many people who attend our seminars are surprised when they find out that I believe that market timing is an effective tool for lowering risk but in the long run it is not an effective tool for raising return.

In my view, if you are going to need the money within three years, then market timing is essential. For money set aside for retirement or college education, then stay invested and let the law of averages work in your favor.

Here is how I treat my portfolio. For my childrens' education and 401k money, I'm always fully invested. In the long run, a fully invested portfolio will beat a market-timed portfolio. That's why in my managed account program, we are always fully invested. Our focus is on good stock selection.

My first form of market timing comes in 10% increments. When

the market corrects 10% I buy. If it corrects another 10% I buy more. These are typically good opportunities to buy the "Wheaties" type stocks such as Microsoft, Intel, Applied Materials, Sun Microsystems, and Cisco Systems.

The next form of market timing uses the AIQ software. This is applied to the trading portion of your portfolio as well as money that may be needed in the next few years.

If you are near or are in retirement and can't afford to lose money, then short-term timing is important. Also, if you are a conservative investor focused on capital preservation, then short-term timing is important.

As for myself, I have a house that is scheduled for large-scale improvements. I can't afford to lose the money set aside for these projects but I still want the money to grow, so short-term market timing is important.

This is my view on market timing but this view is not widely held by other analysts. There is no correct answer on the role that market timing plays in everyone's analysis. It is an individual decision and you should simply do what you are comfortable with. ■

Year-End Index of 1998 Articles

Opening Bell subscribers may obtain a free Index of 1998 Opening Bell articles by calling 1-800-332-299.

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READERS FORUM

This Question & Answer feature will appear regularly in the *Opening Bell*. Send your questions to Editor, Opening Bell, P.O. Box 7530, Incline Village, NV 89452.

Q: Why are some of the technical indicators blank when you pull up an index in AIQ charts?

A: Indices do not usually have volume provided by the data service and therefore any indicator based on volume will not be computed.

Q: How do I add additional stocks to my database that came with the program?

A: Two ways. First, you can click on **Ticker** and **New**, in *Data Manager*. Second, while in *Data Manager*, type in the symbol you want to add (just start typing on the keyboard and a box will pop up that says "search for ticker"). If the symbol is not in your Master Ticker List, a box will pop up asking if

you wish to search the Historical Data CD. This will add that symbol to your master ticker list. Check page 42 in the User Manual for additional features for the Historical Data CD.

Q: What are the "Hot Keys" in charts?

A: The "Hot Keys" are:

A - changes the vertical cursor to a diamond.

G - adds gridlines.

M - puts the program into a trendline mode.

Z - zooms the chart larger (good for Point & Figure charting).

T - tags the current chart to the selected tag list.

? - brings up the Expert Rules.

S - to adjust for splits.

O - for overlays.

R - to refresh real-time data.

C - to reconnect for real-time charts.

F - fundamentals

Q: Where do we find updates or fixes for the program?

A: From the TradingExpert Main Menu, click on **Help** (at the top of the screen), choose **Tech Support/Product Updates**. Check this periodically for updates.

Q: How do I deselect reports that I do not want generated?

A: In *Reports*, click on **Generate/Setup Parameters**. Deselect the reports that you do not want generated.

Q: Do I need to have the MyTrack program running in order to use Real Time in TradingExpert Pro?

A: No. MyTrack is a separate program and does not have to be running.

STOCK DATA MAINTENANCE

The following table shows past and future stock splits and large dividends:

Stock	Ticker	Split/Div.	Approx. Date	Stock	Ticker	Split/Div.	Approx. Date
Yahoo Inc.	YHOO	2:1	02/08/99	Linear Technology	LLTC	2:1	02/22/99
Merck & Co.	MRK	2:1	02/09/99	Ha-Lo Industries	HMK	3:2	02/22/99
Atlas Air	CGO	3:2	02/09/99	Heritage Commerce	HTBK	3:2	02/22/99
Broadcast.com	BCST	2:1	02/12/99	Go2Net inc.	GNET	2:1	02/23/99
Advanced Mktg. Svs.	ADMS	3:2	02/16/99	Ameritrade Holding	AMTD	2:1	02/22/99
Medicis Pharm.	MRX	3:2	02/17/99	Xerox Corp.	XRX	2:1	02/24/99
Broadcom Corp.	BRCM	2:1	02/18/99	Solelectron Corp.	SLR	2:1	02/25/99
Jabil Circuit	JBL	2:1	02/18/99	Coast Bancorp	CTBP	2:1	02/26/99
Insight Enterprises	NSIT	3:2	02/19/99	Pediatrix Medical Grp.	PDX	2:1	03/01/99

Trading Suspended:

Equity Corp Int'l (EQU), HBO & Co. (HBOC), Quaker State Corp (KSF), Spaghetti Warehouse Inc (SWH), Tetra Tech (WATR), Valley Forge (SCI)

Name/Ticker Changes:

Allied Waste Inds. (AWIN) to Allied Waste Inds. (AW), Alluminum Co of America (AA) to Alcoa Inc. (AA), BB & T Corp (BBK) to BB & T Corp. (BBT), Cracker Barrel (CBRL) to CBRL Group Inc. (CBRL), Lithia Motors Inc. (LMTR) to Lithia Motors Inc. (LAD), McKesson Inc. (MCK) to McKesson HBOC Inc. (MCK), Monaco Coach (MCCO) to Monaco Coach Corp. (MNC), Pennzoil Co (PZL) to Pennz Energy Co (PZE), Platinum Technology (PLAT) to Platinum Technology Int'l Inc. (PLAT), Specialty Equip Cos. (SPEQ) to Specialty Equip Cos. (SEC)

MARKET REVIEW

If the month of January is a barometer of the rest of the year, 1999 will be a great year. The S&P 500 rose 4% but the real winner was the Nasdaq Composite which increased 14%. Looking at individual industry groups, the Telecommunications-Cellular group rose 26%, Biotechnology rose 20%, and Computers-Peripherals rose 20%. Looking at the laggards, the losing groups of last year continued to underperform in January. The oil related industry groups all fell more than 10%.

Building onto their gains from last year, the internet stocks started out very strong but near the end of January they finally experienced some weakness. How volatile are the internet stocks? From January 11 to January 20, Amazon.com (AMZN) experienced a 39% correction. Amazingly, AMZN was still higher on the year even after the correction. Similarly, Yahoo (YHOO) fell 36% from January 11 to January 20 but it also was above its December 31 price.

Many investors have heard the phrase "the January effect." This implies that small company stocks typically outperform large company stocks in the month of January. As happens very often, the January effect

came early and then failed to work in January. In **Figure 2** we are showing the Russell 2000 along with its RSMD SPX indicator. Notice this indicator had been falling from late 1997 until last November implying that the S&P 500 was outperforming the Russell 2000. After November the indicator began to point toward strength in the Russell 2000. In January, the weekly

RSMD SPX indicator lost its upward momentum and was flat. The daily chart (not shown) gives a shorter-term picture and it turned negative, implying that in January leadership began to shift back to large company stocks.

Two market timing signals were registered in January. A 100 down signal was registered on January 13 which was followed by a 95 buy signal on January 25. There has not been much market movement after either of these signals. This sideways movement is best seen on a Point & Figure chart of the S&P 500 (**Figure 3**). On this chart, Xs represent rallies and Os represent declines. During January, the chart shows level tops and level bottoms. That means that when the S&P 500 breaks above or below the consolidation, a Point & Figure buy or sell signal will be registered.

For market timing it is helpful to combine Expert Rating signals with trend analysis. At the end of January the model was on a buy signal but the S&P 500 was at the upper end of its trading range. In order for both elements to be bullish, the S&P 500 needs to rally to 1285, at which point the Point & Figure chart will once again show an uptrend. ■

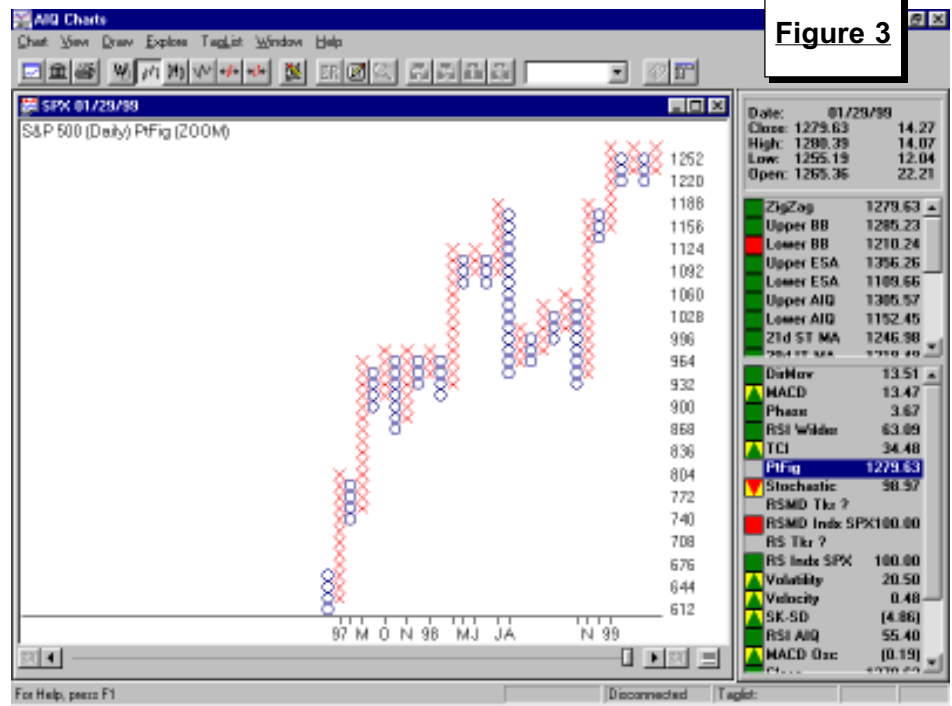


Figure 3

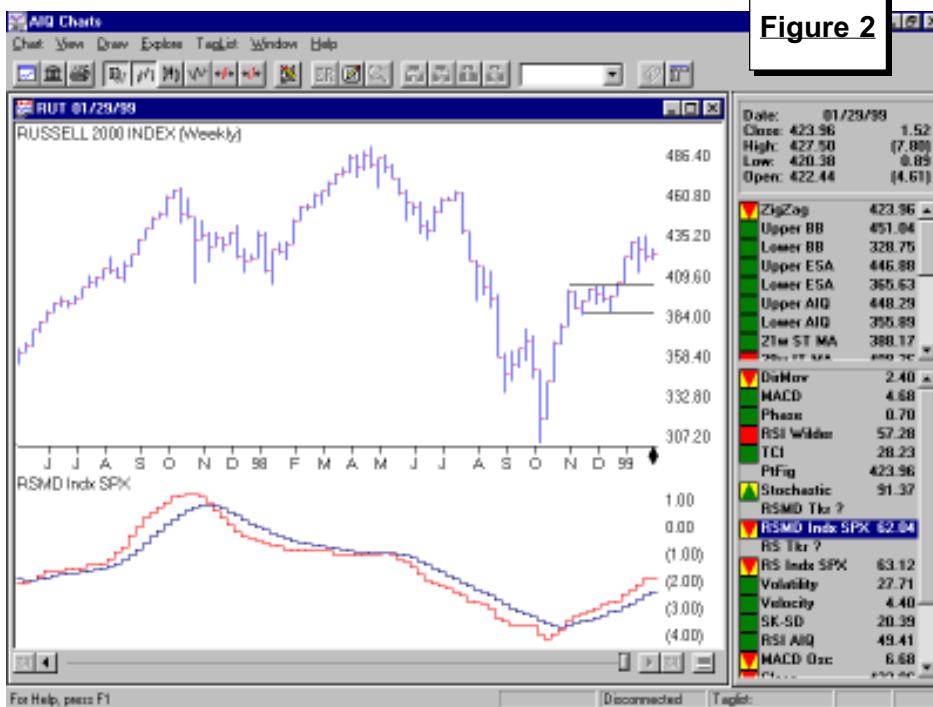


Figure 2