AIQ

Opening Bell
Newsletter

In This Issue

Using Exchange Traded Funds (ETFs)

Our Style Index Strategy Rotates To Best Performing Market Segments —Here's How It Works

By David Vomund

DAVID VOMUND

AIQ is known for spotting sector rotation. The Style Index strategy, first covered in the October 2003 *Opening Bell*, applies the concepts of sector rotation but instead of buying individual sectors, the strategy rotates to the best performing market segments. These market segments include large-cap growth, large-cap value, small-cap growth, small-cap value, mid-cap growth, and mid-cap value. In effect, it rotates to the corners of the Morningstar style box.

Exchange Traded Funds (ETFs) are the trading vehicles used in this strategy (mutual funds from ProFunds can also be used). ETFs combine elements of index funds in that they track specific market indexes, but they trade on stock exchanges just like stocks.

While this strategy can be applied to any list of ETFs, **Table 1** shows the

ETFs that are used for this article. These also are the ETFs that are used for the *Model Portfolio* in my VISalert.com newsletter, so I've tracked their performance every week for three years. If you are following this strategy on a smaller list of ETFs, then you can

> *"The strategy rotates to the segments of the market that have the best performance. During bullish years, returns will often be led by the strength of the Nasdaq 100 holding. During bearish years, the portfolio is designed to rotate to less volatile value-based securities."*

add these ETFs to your list or have AIQ technical support email you the AIQ list file of these ETFs (email *support@aiqsystems.com*).

The Style Index strategy utilizes AIQ's Relative Strength report. The

Short-Term Relative Strength Strong report is run every other Friday on the ETFs listed in Table 1. This report looks at the last 120 trading days (approx. six months) and breaks them into quarters. A percentage return figure is calculated for each quarter. These returns are then averaged with twice the weight placed on the most recent quarter's worth of data.

To begin the strategy, the Relative Strength report is run on the ETFs after Friday's close. The top two in the ranking are purchased, making a fully invested portfolio. Two weeks later, the Relative Strength report is run again.

If the current holdings are rated in the top half of the report (in this case the top five), then there are no trades. If a holding falls in the Relative Strength report to where it is no longer in the top half, then it is sold and the highest rated ETF is purchased. This process is repeated every two weeks.

The strategy is designed to rotate to the segments of the market that have the best performance. During the bullish years, returns will often be led by the strength of the Nasdaq

Table 1. Style Index Trading Vehicles

Ticker	ETF	Market Segment
IVE	iShares S&P 500 Value	Large-Cap Value
IVW	iShares S&P 500 Growth	Large-Cap Growth
SPY	S&P 500 SPDR	Large-Cap Index
QQQQ	Nasdaq 100 ETF	Large/Mid Cap Growth
IJJ	S&P 400 Value	Mid-Cap Value
IJK	S&P 400 Growth	Mid-Cap Growth
MDY	Mid-Cap SPDR	Mid-Cap Index
IJS	iShares S&P 600 Value	Small-Cap Value
IJT	iShares S&P 600 Growth	Small-Cap Growth
IWM	iShares Russell 2000	Small-Cap Index

100 (QQQQ) holding. During the bearish years, the portfolio is designed to rotate to less volatile value-based securities.

Table 2 shows the results for the last three years. The average annual rate of return on the Style Index strategy was 20%, beating the S&P 500's 13% return. For a strategy backtest covering 1998 through 2002, please refer to the October 2003 *Opening Bell* (*http://aiqsystems.com/oct2003obm.pdf*).

Table 3 shows the individual trades. As can be seen, there is an average of five round-trip trades per year. As of December 31, the portfolio held the Nasdaq 100 Tracking Stock (QQQQ) and iShares Mid-Cap Growth (IJK).

I find many people ignore the Style Index approach because of its simplicity. If you compare the returns, however, you'll find they

"Table 2 shows the results for the last three years. The average annual rate of return on the Style Index strategy was 20%, beating the S&P 500's 13% return."

compare favorably to most stock traders. The strategies 20% three-year annual rate of return is better than most, and since ETFs track market indexes you don't have to worry that one of your stock holdings will give a profit warning or release other bad news.

Table 2. Yearly Percentage Returns

Year	Style Index	S&P 500
2003	45.64	26.38
2004	12.78	8.99
2005	2.34	3.00

The Style Index strategy is market dependant. That is, when the market goes down the portfolio will go down. The same is true when the market goes up. For that reason, some AIQ users choose to time the portfolio by moving to cash during uncertain times. The strategy is suited for this because it only holds two securities. That means it only takes one trade to move to 50% cash. For our percentage return figures, we assumed an always fully invested portfolio.

Some AIQ users also choose to add more ETFs to the list. As the Style Index ETF choices track market indexes instead of individual sectors, an obvious choice is to add some diversified international ETF choices. For my managed account program (*www.ETFportfolios.net*), I recently added iShares Developed Markets (EFA) and iShares Emerging Markets (EEM).

Over the next few Opening Bell issues, we'll show backtesting results using different baskets of ETFs. As is always the case, past performance does not guarantee future results.

David Vomund publishes VIS Alert, a weekly investment newsletter. For a sample copy, go to *www.visalert.com*.

Table 3. Closed Positions

Ticker	Buy Date	Sell Date	% Change
QQQQ	12/31/02	05/05/03	15.40
IJT	01/06/03	03/24/03	-4.96
IVW	03/24/03	05/05/03	4.97
IJS	05/05/03	05/17/03	-0.43
IWM	05/05/03	02/23/04	42.20
IJJ	02/23/04	05/16/05	7.68
IVE	05/17/04	06/01/04	3.51
IJT	06/01/04	08/09/04	-7.74
IVE	08/09/04	10/04/04	7.86
IJS	10/04/04	01/10/05	1.24
IVE	01/10/05	01/24/05	-1.10
IJT	01/24/05	05/02/05	-3.50
MDY	05/02/05	09/26/05	10.42
IVW	05/16/05	05/31/05	5.19
IJJ	05/31/05	10/24/05	2.03
IJT	09/26/05	12/19/05	3.00

STOCK DATA MAINTENANCE

The following table shows stock splits and other changes:

Stock	Ticker	Split	Approx. Date
J&J Snack Foods	JJSF	2:1	1/6/06
Papa John's Int'l	PZZA	2:1	1/17/06

Trading Suspended:
Cable & Wireless PLC (CWP)

Name Changes:
Allmerica Financial (AFC0 to Hanover Insurance Group (THG)
Department 56 Inc. (DFS) to Lenox Group Inc. (LNX)

S&P 500 Changes

Changes to the S&P 500 Index and Industry Groups:

Genworth Financial (GNW) replaces Calpine Corp (CPN). GNW is added to the Insurance-Multiline (INSURAML) group.

Amazon Corp. (AMZN) replaces AT&T (T). AMZN is added to the Internet-Retail (RETAILIN) group.

MARKET REVIEW

The market was about unchanged in December and it closed with modest gains for the year.

In mid-December some market indexes were hitting multi-year highs but these averages fell in the second half of the month. The Nasdaq Composite was weaker than the S&P 500, falling 1.25%.

Precious Metals and Energy were the strongest sectors in December, gaining about 7%. Air Transportation jumped 5%. The weakest sector was technology, falling 4%.

What Every AIQ User Should Know, Part 1

AIQ's Powerful List Feature:
Build Lists of Stocks, Easily Track Charts,
& Browse Reports Limited to Your Lists

By David Vomund

I n the age of the internet, there are lots of sites that give you free stock charts. For many people, a chart is all they need for their trading. Obviously AIQ offers much more than charting, but even if all you need are charts then you'll love AIQ's list feature. This feature allows users to very quickly browse through the stock charts that they are interested in.

Every AIQ power user heavily relies on the list feature. Knowing how to create and manage lists allows users to focus on the stocks they want to purchase, to more easily manage a large database, to effortlessly chart their favorite stocks, etc.

TradingExpert Pro comes with the S&P 500 and the AIQALL list. Many other AIQ list files can be downloaded from AIQ's web page. The web page includes lists of the S&P 1500, Russell 1000, Russell 2000, Nasdaq 100, optionable stocks, etc. The web site is *www.aiqsystems.com/ lists.htm.*

After downloading one of these list files, you can very quickly and easily scroll through charts of the stocks. In AIQ Charts, use the drop-down arrow on the tool bar to highlight a list name. For this example, we'll choose a list of the Nasdaq 100

stocks. By hitting the *Enter* key, the Control Panel is replaced by the list of Nasdaq 100 ticker symbols (**Figure 1**).

By clicking on the *Explore Right* icon on the toolbar (or clicking on the individual ticker symbols), you'll get a chart of each stock in the list. There is no need to type in the individual ticker symbols. Simply

> *"Knowing how to create and manage lists allows users to focus on the stocks they want to purchase, to more easily manage a large database, to effortlessly chart their favorite stocks, etc."*

keep clicking the *Explore Right* icon and you can see every Nasdaq 100 chart in a matter of minutes.

While AIQ places many lists on its web site, some users may have a particular list of stocks that they want to closely track. This might include recommendations from Value Line or a favorite investment newsletter. In this case, users can create their own individual lists.

Creating a list is a simple process. In Data Manager, click *List* on the menu bar and then *New*. Enter a name for the list you want to create. The list will appear on the left section of the Data Manager window. With your list name highlighted, click *List* again and *Insert Tickers*. To save time, enter a list of tickers separated by semicolons. Click *OK* and the list will be created.

If you have a list of ticker symbols in a spreadsheet, TradingExpert Pro can import that list. That means

Figure 1. AIQ Charts window with list of Nasdaq stocks displayed in panel on right side.

if you subscribe to *Investor's Business Daily's* online service then you can download its top recommendations into a spreadsheet and then import the list into AIQ. To do this, first save the list to a CSV format. Then go to the Data Manager and create the new list name using the process just described. With the list name created, select *List* and then *Import*. Highlight the CSV file and click *OK*.

AIQ allows users to merge two lists as well. Some people like to track a list that combines two list files, such as the S&P 500 and Nasdaq 100. AIQ's *Advanced List Edit* function allows you to merge two lists. You simply open both lists and then drag one list into the other. Be sure to save the new combined list to a new name.

So far we've discussed how list files help save time in charting. They are also helpful when you run Reports. When you run reports on your individual list file, only stocks that you are interested in will appear. The noise from other stocks that you'd never buy is eliminated. For instance, you can check for a breakout on AIQ's Point & Figure

Breakout report using your particular list of stocks. There is no need to filter through a bunch of stock symbols looking for the ones of interest to you.

To accomplish this, go to Reports and right-click on *Stock Reports*. The *Global Properties* box will appear (**Figure 2**). Use the drop-down arrow next to *Stock* to select the name of the list you want to run and click *OK*. We'll choose to run reports on the Nasdaq 100 stocks.

Figure 3 shows the Point & Figure Breakout report. Notice that only the stocks in the Nasdaq 100 that have given recent Point & Figure buy signals appear. With only six stocks on the report we can simply double-click their ticker symbols to pull up charts of the stocks.
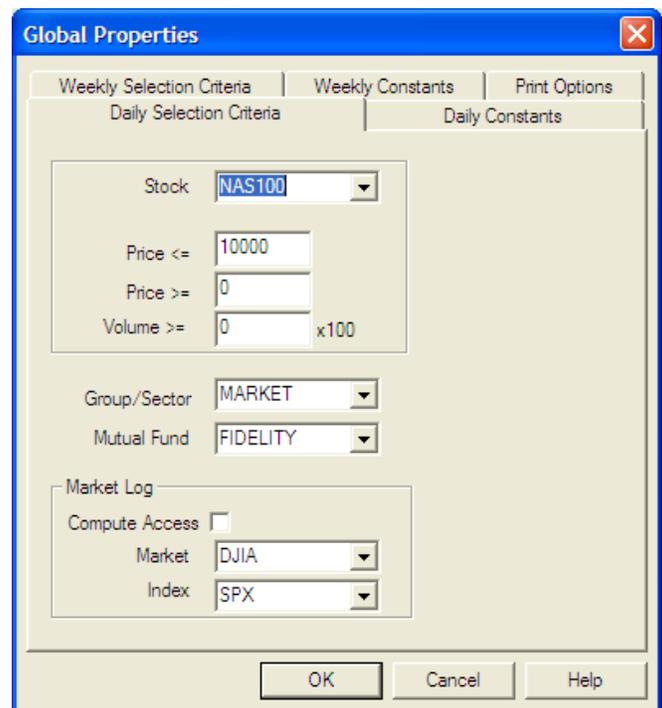
Figure 2. AIQ Reports *Global Properties* function (*Daily Selection Criteria* page) with NAS 100 list selected.

Some reports, however, show many stock choices. To quickly scroll through the list of stocks on a report, you can click the *Build Report List* icon on the toolbar. This will create a list of the stocks on a report. After naming the list, the first stock on the report will automatically be charted. Click the *Explore Right* icon to see the other stocks.

Similar to Reports, Expert Design Studio (EDS) scans can be run on individual lists. In EDS click the *Properties* icon and select the appropriate list. After the scan is complete, you can chart the stocks by clicking the *Chart List* icon.

The ability to create and use lists is a basic function of TradingExpert Pro. Although basic, this function is very powerful. It allows you to quickly scroll through charts and enables you to focus on the stocks you are most interested in.

Next month we'll cover another feature all AIQ users should know— how to create industry groups.
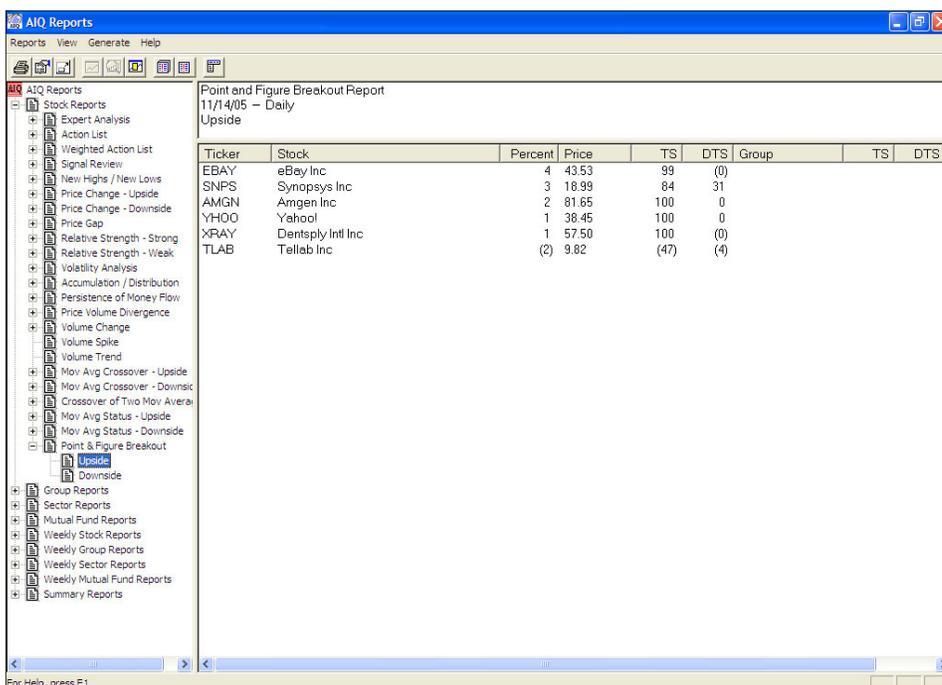
Figure 3. AIQ's Point & Figure Breakout report run on the Nasdaq 100 list. Report lists only those Nasdaq 100 stocks with recent P&F buy signals.

AIQ Seminars 2006

One Day Seminars Across the Country with
David Vomund and Steve Palmquist

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Here's what previous attendees had to say

"Palmquist was great! A nice combination of good systems and good methodology clearly presented in an engaging manner"
"David Vomund. Very knowledgeable, very good speaker, extremely practical advice-a great asset to AIQ!!"

VENUES

San Diego	2/25/2006
Tampa	3/25/2006
Manchester	4/22/2006
Denver	6/17/2006

AIQ's One Day Seminar Agenda Offers Top Class Education at a Great Price

Short Term Trading Techniques for Trading Both Long and Short Positions   *by Steve Palmquist*

In this session Steve will be sharing one of his favorite short term trading techniques for trading both Long and Short positions. This is not a theoretical approach, but one Steve uses every day with his own money. He will discuss the specific system, show how it was developed and tested, and provide tips and techniques for using it based on his nearly 20 years of market experience.

Market Truths   *by David Vomund*

David Vomund will reveal important market truths that he has learned from actively studying and trading the market for nearly 20 years. These are the truths that experienced investors learn over time. New investors learn these truths the hard way – by losing money. Topics include market behavior, position sizing, and trading psychology.

Market Adaptive Trading   *by Steve Palmquist*

Steve has developed a Market Adaptive Trading Technique that he uses to determine when to trade specific systems and when to stand aside. Successfully analyzing current market conditions is one of the keys to trading success. Learn when to focus on Longs, when to trade Shorts, and when to stay in cash. Just trading a single system all the time without a careful analysis of the market conditions can give you a lot of practice at taking draw downs. Learn from Steve's experience and take your trading to the next level.

Getting Started Right With AIQ *by David Vomund*

David Vomund will cover the features within TradingExpert that every AIQ user should know. Basic features such as charting, report generation, and exploring will be discussed. Advanced features such as industry group creation and the use of Expert Design Studio will also be covered.

Sign up now 1-800-332-2999 x115

2006 Seminar Venues

San Diego, CA
Saturday 2/25/2005

Holiday Inn
San Diego Downtown
1617 First Avenue
San Diego CA 92101
Reservations 800-366-3164

- Room rate $129/night
- Complimentary Shuttle San Diego
  International Lindbergh Field Airport
- Guest parking $12/day
- Day parking $7.00/day

Manchester, NH
Saturday 4/22/2006

Radisson Hotel-Center of
New Hampshire
700 Elm Street
Manchester NH 03101
Reservations 800-333-3333

- Room rate $109/night
- Complimentary airport shuttle
- Guest parking $2/day
- Day parking $1

David Vomund
Chief Analyst
AIQ Systems

Steve Palmquist
Founder
Daisydogger.com

Tampa, FL
Saturday 3/25/2006

Tampa Westshore Marriott
1001 N. Westshore Blvd.
Tampa FL 33607
Reservations: 800-564-3489

- Room rate $179/night
- Complimentary airport shuttle
- Free parking

Denver, CO
Saturday 6/17/2006

Country Inn and Suites
4343 Airport Way
Denver CO 80239
Reservations 800-456-4000

- Room rate $99/night
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  (call 303-375-1105 to schedule)
- Complementary breakfast buffet
  with lodging
- Free parking

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