AIQ Opening Bell® Monthly

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Feature

Sections

The *Opening Bell Monthly* is a publication of
AIQ Systems
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INTERVIEW

Professional Trader Martha Sipe Uses MatchMaker & Expert Design Studio To Help Find Attractive Stocks

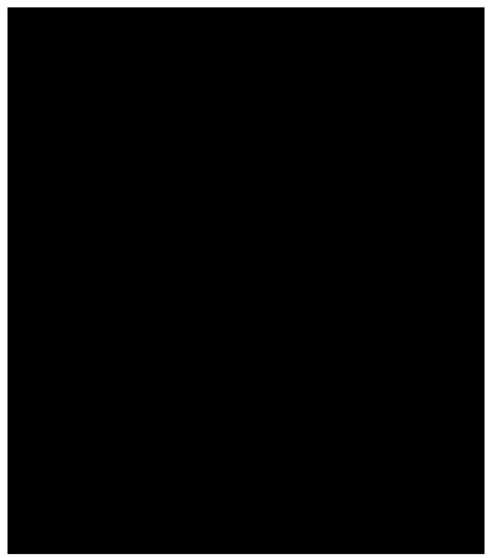
By David Vomund

Martha Sipe, CFA, is president of GSAinvestors.com and an AIQ user since 1990. She has 30 years of professional investing experience on and off Wall Street. Martha will be a keynote speaker at AIQ's Fall Seminar October 4, 5 & 6 at Lake Tahoe.

Vomund: *Can you please tell me about your background?*

Sipe: I grew up in a family that was active in stocks and learned basic technical analysis from my mother. A natural path was to pursue a career on Wall Street and, in 1971, I joined the corporate finance department at Shearson. I moved on to their investment management group, managing equities in pension and profit sharing accounts and the Shearson Mutual Funds. From there I joined Drexel Burnham at the request of Fred Joseph, with whom I had worked at Shearson.

After a skiing vacation in Colorado, I succumbed to Rocky Mountain High and moved there to start my own firm managing private investment assets. In the early Nineties, I moved to Washington D.C. for a political time out. About three years ago, I returned to investments and began publishing the first of my online letters, *Technical Touch*, specializing in equity options.



MARTHA SIPE

Vomund: *Was it a daily newsletter?*

Sipe: It began as a daily newsletter but I saw so many missed opportunities using AIQ's 30-minute charts that I began publishing an intraday letter

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INTERVIEW *continued . . .*

along with *Equity Focus*, which is a weekly stock letter with recommendations for core portfolio holdings.

Vomund: *Can you describe your trading style?*

Sipe: That is hard to answer because I have different styles depending on the model that I use. The *Equity Focus* letter, which deals strictly with stocks and covers both long and short recommendations, typically holds a stock for about two months. For the trading newsletter, *Technical Focus*, we recommend equity options so it's much shorter term. The average holding period may only be three to five days. But in these recent months of small, choppy moves, I am finding that the individual holding periods have either extended or shortened considerably. As with all changing markets, the trading style must adapt to prevailing trends.

Vomund: *Why did you choose AIQ over other software packages?*

Sipe: I began using the software over 10 years ago when I was looking for a substitute for a New York soft dollar service I had used for many years. AIQ was the only service that offered an indicator that closely matched the "momentum" indicator of the New York service. This AIQ indicator, which is my primary analytic tool, is the Phase indicator.

Vomund: *What parts of the program do you use?*

Sipe: I particularly like MatchMaker and Expert Design Studio (EDS). I scan through a hard copy of *Daily Graphs* looking for attractive stocks. When an attractive pattern forms, then I know other stocks may have the same pattern. I run the weekly or daily MatchMaker comparing the attractive stock to all the stocks in my database and it gives me a list of those stocks that have similar chart patterns. This focuses my attention, thus saving a lot of time. In addition to getting the stocks with the highest correlation, it provides a list of stocks with the least correlation. If a bullish pattern was identified, then those stocks with the least correlation are possible short candidates. MatchMaker quickly identifies both sides of the market.

"MatchMaker quickly identifies both sides of the market. With EDS (Expert Design Studio) ... I scroll through the list of stocks to identify those offering the best potential returns."

With EDS, I like to do a simple search for stocks that have a daily range greater than $3 or sometimes $5. With this list I then click the Browser icon and scroll through the list of stocks to identify those offering the best potential returns. Another standby EDS screen looks for oversold/overbought stocks. This worked with great success in mid-March and very early April for oversold stocks and again in early to mid-July. There are two things I look at: one, what percent of my database is oversold as this will indicate turning points; and two, which of these stocks have a Stochastic of less than 2 and are low priced stocks. Focusing on the low priced stocks can lead to greater percentage gains as the trend reverses.

Vomund: *How much experimenting did you do before you settled in with your current trading style?*

Sipe: It keeps changing. The indicators are the same but the time frame keeps compressing. When I started publishing three years ago, a trade could take three to six weeks. Then a little over a year ago, it seemed more like three to six days. It was this shortened time span that led to forming the "Go To The Sea" intraday model. I call it that because it is like the parable of Jesus and Peter, when Jesus says, "Go to the sea, cast your hook, take the first fish, open its mouth, take out the gold coin and pay the taxes."

The last two years have shown that the markets have changed and with this change it's important to keep modifying the tools and techniques that are used. It really is easier to "cast your hook and take the first fish" rather than buy/hold through the next 12-18 months of range bound trading. Through experimentation and observation I refined the model that uses three principle indicators.

Vomund: *What indicators are those?*

Sipe: I use the Phase, the MACD, and the MACD Osc. These are all related but are very important. Of secondary importance would be the Stochastic, Volume, On Balance Volume, and Money Flow indicators.

Vomund: *Can you give us some examples of how your model works?*

Sipe: I'll start with a weekly

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INTERVIEW *continued . . .*

example because it is useful in the current market environment. In Figure 1 we see a weekly chart of McDermott (MDR). In late 1999 the rest of the market was hitting new highs but MDR was making new lows. MDR plunged and the weekly Phase indicator moved to negative 47. When a stock has a large negative Phase reading on the weekly chart then it almost always takes a very long time for it to work off the downside momentum. This is important in current markets because so many stocks have weekly Phases at this level or lower.

For MDR, it took from December 1999 to January 2001 before the Phase momentum worked off that downside level and moved close to zero. I've found that during the time that the stocks work off their negative weekly Phase readings that they tend to trade in a large range in percentage terms and that it can be very profitable to trade the highs and the lows of the range because they are so predictable.

I also find that when the weekly or daily Phase indicator approaches zero that there is usually a significant pop in the stock. For MDR it only took five or six weeks for the stock to go from $10 to $17, a 70% return, once the weekly Phase reached zero. Another entry point came in late April when MDR fell back to $10 once again. As it retraced to $10, its weekly Phase stayed positive and the stock price held at the 50 week moving average.

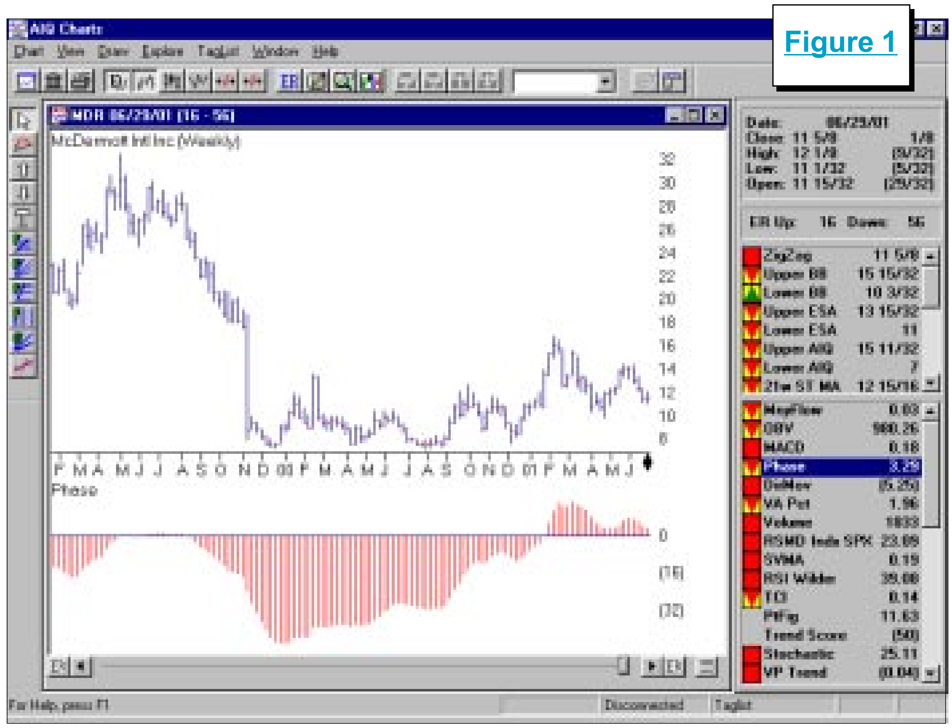

Figure 1

I recommended this stock in the newsletter on April 23 at $10 ½, expecting a move back up to $16 or $17. MDR rallied but didn't make it to $17. It was sold on May 29 at $14, a 33% gain in just over a month. The reason for the sell was that on the daily chart the momentum was abating as the stock came close to testing its highs. The daily MACD Osc was falling and the MACD was approaching the Signal Line. There were fundamental reasons behind the sell as well. The Senate changed from Republican controlled to Democratic controlled, which made for a less favorable environment for MDR's industry group. Currently the stock has retraced to $11.

I use the same type of analysis to go short. A short example is Redback Networks (RBAK). Like most other technology stocks, the Phase indicator was so incredibly negative on the weekly chart (Figure 2). We shorted RBAK on April 23 at $19 3/8 when the Phase was negative 65. As I said

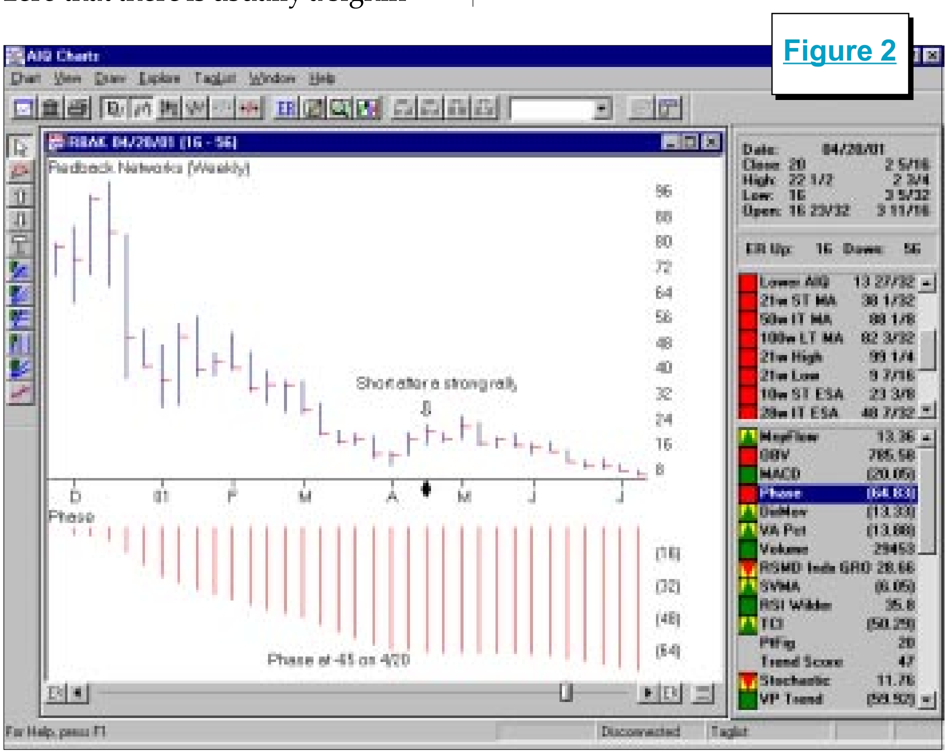

Figure 2

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INTERVIEW *continued . . .*

before, when the weekly Phase is that negative stocks don't go anywhere. Yet RBAK had just doubled in price. With the weekly Phase so negative I expected a move back to its lows and that is what happened. This position was closed at $8 1/2 on June 29 for a gain of 56% in just over two months.

Vomund: *Can you give me an example of a short-term trade?*

Sipe: Sure. I was impressed with the eight month base that semiconductor stocks were forming. They had worked off their negative momentum very well. The stock I chose to examine was Intel (INTC) because it is a component of the Dow. Technology stocks were also very oversold.

Using the MACD Osc on a 30-minute chart, the buy signal came at 10:00 on June 15. That is when MACD Osc moved above zero (Figure 3). Since the MACD Osc turned positive we know there was a crossover in the MACD lines. Because of the daily chart, this position was held through the next two days of declines; then the price turned from $26 1/4 and rallied to $30 3/4 on June 29, which generated about a 90% gain in the option. This is another example of time frames extending from several days to two weeks.

I use 30-minute charts for signals because it eliminates a lot of the noise that occurs in shorter time segments. Since I'm hoping to hold the option for a few days, the 30-minute chart allows me to get in and be more comfortable riding out some of the very short-term swings. But I also check the shorter segments to fine tune entry and exit and the longer term daily/weekly charts to identify the overall trend.

Vomund: *Is this your "Go to the Sea" model?*

Sipe: Yes. Let me explain it further with another example.

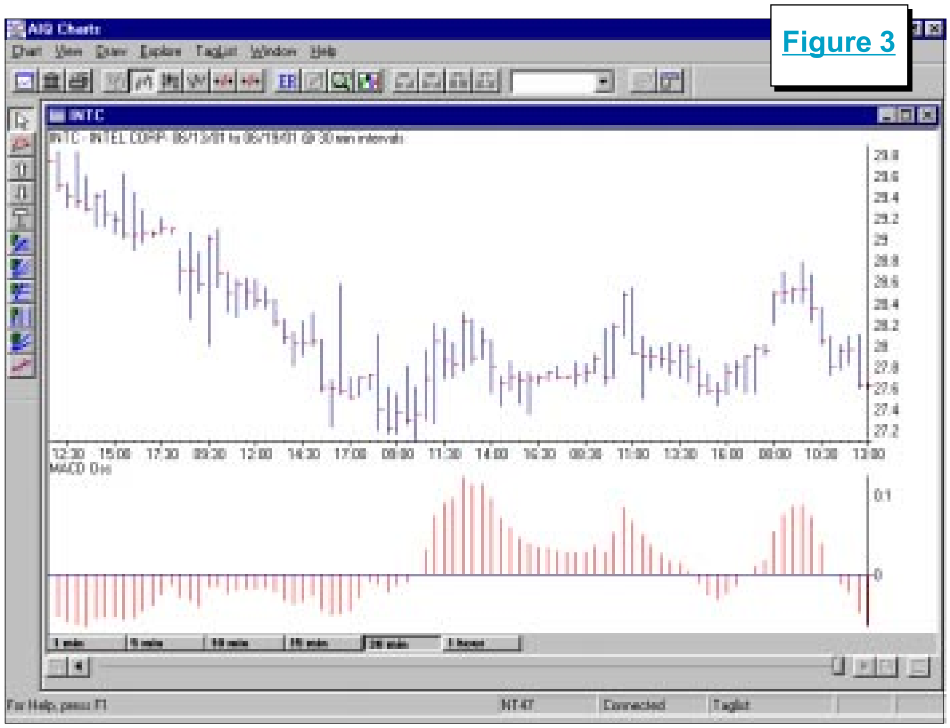

Figure 3

Verisign's (VRSN) Phase momentum using a 30- minute chart peaked at about 6.4 at 8 a.m. And, here's the great attribute of Phase -- it works through ALL time segments. Because the intraday Phase was at such a high level, experience shows that it will take extended time to work it off, either up or down. In the intraday chart, a Sell Signal was triggered when the MACD Osc went negative about 10 a.m. But because the Phase momentum was so high, I knew that the stock would likely chop around for a day or two, forming a top. A short sale or put option purchase could have been entered at any time in the two days of topping. I actually waited for the breakdown and recommended the purchase of a put on the opening June 26 as the Phase finally approached zero.

Initially, the stock plunged quickly, rallied after the open, and then turned lower. This can be seen on the 5-minute chart in the 9:00 to 10:30 segment (Figure 4). When the next rally occurred from 11:00 a.m to about 11:15, there were two factors to take note of. First, at about 11:05 the 5-minute chart gave a buy signal, or a cover/short position signal. However, because the Phase was so negative at minus 2.4, which is HUGE for a 5-minute chart, experience says that the price almost always tests the lows before sustaining a reversal of trend. So, for an option position where the premium can disappear so quickly, I knew that it was feasible to wait for the pullback that then occurred about 11:45. This was when this position was closed.

The reasons behind selling the Put option were: first, the MACD Osc was positive and stayed positive even on the test of the lows; second, at 11:45 when the 5-minute price made a new low, the Phase indicator did not make a new low. This is always, through all time frames, a confirmation that the trend is changing. And, in this example, reversing to the upside.

Vomund: *Can you discuss your sell strategy?*

Sipe: Certainly. The MACD indicator is the most important indicator I follow for buy/sell

INTERVIEW *continued . . .*

signals. If you are using an intraday chart for buying then continue to follow the indicator, watching for a negative crossover on the intraday chart. It is always useful to follow the MACD and Phase on the larger time segment charts so that a framework of the bigger picture can be kept in mind.

John Bollinger once said that he thought trendlines ought to be drawn with FAT markers. I feel the same way about sell strategies. They should be very forgiving and flexible depending on the market environment and should be tailored to the time frame of the investment. For instance, I will use a much tighter strategy when there are one or two weeks until an option expires than if there are four-eight weeks or longer.

Vomund: *What advice can you give to new AIQ users?*

Sipe: I would tell them to keep exploring the different tools and the changes made in new editions of TradingExpert Pro. The pundits love to use the word "hubris". And I think it applies here in that my hubris led to my contentment with the indicators and basic charting tools with which I was familiar. It has only been in recent times that I have moved into exploring the program further.

This exploring led to discovering the huge time-saving features of "Charting the List" and then browsing it both daily and intraday; the Alerts feature; writing simple EDS programs to create small sectors to monitor. In fact, I have discovered so many new features in recent months that I am making an effort to explore something new each week.

Vomund: *Since you've worked with the markets for so long can you tell us how this market compares to 1973-74?*

Sipe: The first major difference is that the 73-74 market reaction was

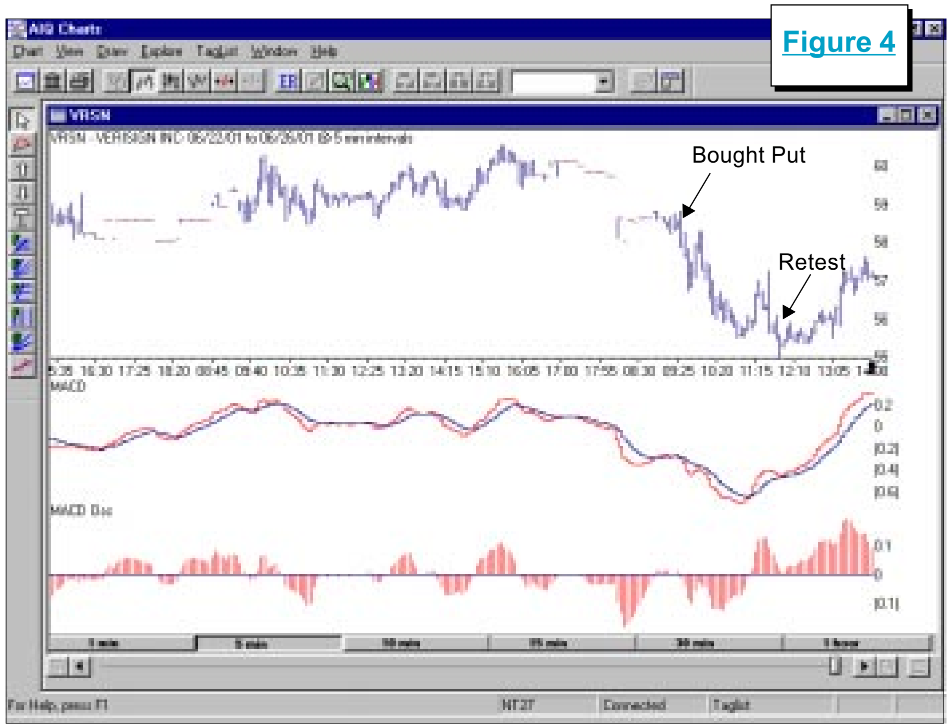

Figure 4

an economic event. This one currently is more of a market event creating an economic one. And, therefore, even a rebound in the economy is unlikely to reinflate prices to year-ago levels. A huge bubble was created in prices as valuations focused on revenues rather than earnings. During the past year valuations have refocused on earnings, leading to the collapse in prices. That's why they are called "church steeples."

In an interview back in the Eighties, Fred Joseph of Drexel Burnham was asked about "excesses" in the junk bond market. His response was that "there isn't anything Wall Street hasn't done to excess, but there are no signs of it yet." During the last couple of years, I was frequently asked about the markets and my response was "they don't go up any faster than 90 degree angles. And when they go up this fast, they come down this fast."

The second major difference is one of time. Back then it took two years for stocks to lose 50% of their value. This time it took about a year for many stocks to lose 90%. Because of this disparity, it is likely to take far longer to recover from this decline than it did in the Seventies. But, the trading opportunities are going to be fantastic. I call it the "Bungie cord bounce" pattern. Once the full measure of the decline is reached, the first bounce up is the largest. Each subsequent bounce is a little less resilient.

So, stocks like Aether are great examples of this on their weekly charts. But as market traders, what's important for us to focus on is that while the size of the bounce in dollars may be smaller, the percentage change in price will get bigger and this is where the trading profits will be generated over the coming 12 months.

Back in 1987, it took 15 months to regain the lost ground. This time it is likely to take two years just to form a base. The semiconductor group has been bottoming for nine months and on the weekly charts show no sign of doing anything but easing toward the upside, but

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INTERVIEW *continued . . .*

generally within the trading range already established. This is the hardest aspect of this market to deal with going forward. Every time a new up trend starts, we will all want to believe that it will sustain itself. But it won't. At least not until those pesky weekly PHASE numbers get closer to zero. So, be ready for a fixed seesaw trading range that will create longer time spans between the highs/lows of the range as time passes.

I think the third difference now is the hype around the markets and the inconsistency of commentary. I stopped watching CNBC because it seemed to be more interested in entertainment and ratings than in creating perspective on the market trends and direction. I don't think this is unique to the financial world but is part of the frenetic pace that has been birthed out of the information age. No longer are people content with the "long term".

And, actually, it is foolish to limit our potential to anemic annual returns when a little bit of attention and study using AIQ can generate multiples of three and four times what a buy and hold strategy creates. This is why I was led to create the "Go To The Sea Trading Model" which will be available in book form on my web site soon.

Vomund: *Thanks for sharing your thoughts with us.* ■

For information on Martha Sipe's newsletters, visit her web site at www.gsainvestors.com. She can be reached at mdsipe@gsainvestors.com.

MARKET REVIEW

Heading into July, AIQ's market timing model had not reversed its March 26 buy signal. Several additional buy signals were registered in July, on the 10th, 11th, 12th, and 13th of July. However, the market failed to respond to these signals and moved sideways over the next five days.

After being on a buy signal for close to four months, the AIQ timing model switched to a sell when it registered a 96 down signal on July 23. That signal was short-lived as a 99 buy came on July 27.

July's best performing sector was Retailing, which increased 9%. Utilities and Telecommunications were the worst performers, losing 5% of their value. ■

Important Changes for Dial/Data and myTrack Users

Track Data Corporation has changed its domain name to **trackdata.com**. This change will impact your end of day downloads and real-time functions (Charts, Alerts, Quotes and OptionExpert). To avoid interruption of your downloads or real-time functions, you need to change a few program settings and obtain the latest myTrack software.

Change Data Retrieval settings:

1. Open Data Retrieval and click on **Setup Options**.
2. Click **Setup** next to the Network choices.
3. Change the Primary Data Server Address to **dd.trackdata.com**.
4. Change the Alternate Data Server Address to **dd.trackdata.com**.
5. Click **OK**.

Install latest version of myTrack: (for real-time functions Charts, Alerts, Quotes and OptionExpert)**:**

1. Go to www.mytrack.com and click **"download myTrack"**.
2. Follow the steps to download and install the latest myTrack version.

If you have any questions, email AIQ at support@aiqsystems.com, or call 775-831-2999.

STOCK DATA MAINTENANCE

The following table shows stock splits and other changes:

Stock	Ticker	Split	Approx. Date
Block HR	HRB	2:1	08/02/01
Biomet Inc.	BMET	3:2	08/07/01
Harlysville Nat'l	HNBC	2:1	08/13/01
Rex Stores	RSC	3:2	08/13/01
CoBiz Inc.	COBZ	3:2	08/14/01
Alliance Gaming	ALLY	2:1	08/21/01
Roslyn Bancorp	RSLN	3:2	08/23/01
Annapolis Bancorp	ANNB	4:3	08/27/01
Courier Corp.	CRRC	3:2	09/03/01
Fiserv Inc.	FISV	3:2	09/03/01

Trading Suspended:

Alza Corp. (AZA), Harcourt General (H), Skymall Inc. (SKYM), Stillwater Mining (SWC)

Name/Ticker Changes:

HCA-HealthCare Co. (HCA) to HCA Inc. (HCA), Kana Communications (KANA) to Kana Software (KANA)
Schuff Steel (SHF) to Schuff Int'l (SHF)

DR. VAN K. THARP

KEYS TO THE TRADING GAME — EXIT STRATEGIES, POSITION SIZING, DISCIPLINE

This is the conclusion of an interview with Dr. Van K. Tharp. The first part of the interview was published in last month's Opening Bell. Dr. Tharp will speak at AIQ's Lake Tahoe Seminar scheduled October 4, 5 & 6.

David Vomund: *The buy side of a trading strategy always receives more attention than the sell side. Even in this newsletter we almost always discuss entry techniques and only give a small mention to exit strategies. Yet, knowing when to sell is just as important as knowing when to buy. In fact, a case can be made that the exit strategy is the most important part of a trading system. Can you discuss common mistakes people make in their sell decisions?*

Dr. Tharp: First, they don't have a system. They simply have some entry strategies. When you don't know how to get out, you can make all sorts of errors.

Second, people are afraid of losses. If you are afraid of losses, you probably won't set stop levels or you won't keep the stop losses that you might have. Thus, a 1R loss could turn into a 3R loss. And if the 1R loss was hard to take then the 3R loss could be awful. And if you don't take the 3R loss, then it might become a 10R. And at this point, after making these types of mistakes, we're beginning to talk about losing months or even losing years.

Third, people love profits so much that they sell as soon as they have one. They have no concept of letting the profit run. Thus, they might end up with only ½ R gains.

Now imagine people who are really concerned about being right. They look to be right all the time, so they work on a system that is right 70% of the time. And let's suppose they have one. However, all the gains are ½ R and all the losses a 10R. Thus, in 10 trades they have 30R of losses and 3.5R of gains. Over the ten trades, they are down — 26.5R. That's horrendous, but that's the way most people are wired — they've got to be right 70% of the time or more.

Vomund: *Please discuss the tradeoffs between having tight stops compared to having loose stops?*

Dr. Tharp: Tight stops allow you to have profits that are many times the size of your losses. I already gave the example of the $50 stock starting to break out. You might take 4 $1 losses and then one $10 gain. You are right 20% of the time, but you make $6 per share. Or if each trade represents one percent of your equity, you'd be up 6%. Not bad.

> *"...people love profits so much that they sell as soon as they have one. They have no concept of letting the profit run."*

Wide stops allow you more leeway. You don't have to watch the stock as much. For example, rather than be a buy and hold trader, I recommend 25% trailing stops. If it moves more than 25% against you, you are in big trouble, so you need to get out. However, it's not that likely to get hit in a bull market, so it's similar to buy and hold.

I'm an advisor to the Oxford Club, where they suggest 25% trailing stops on all their recommendations. I did an analysis of their trades from Feb. 1999 until they were stopped out of everything in April 2000. One of their trades during that time period, JDSU, produced a 32-R gain. That's right — even with a 25% trailing stop it was still up enough to produce a gain of 32 times the initial risk. Overall, their portfolio had an average R value of about +2.3 during that period, which is spectacular. That really means that for every dollar they risked they returned $2.30.

I also looked at various risk levels in the same study of their recommendations. If they risked 1% per position during the time, then they were never more than 50% invested, but they had a 55% return in 14 months. If they risked 2%, then they were 100% invested and had a return of 111% over the 14 months. And because of the wide stop they seldom had to do anything except move it up as the stock made new highs.

Vomund: *Using our Expert Design Studio backtesting module, we often find the highest returns for short-term trading systems utilize a time stop. That is, the position is held for a fixed number of days. Have you found this to be an effective sell strategy?*

Dr. Tharp: Well one of the advantages of that method is that you don't sell when it goes up a little just to be right. However, it would be very difficult for the average person to follow and thus not very effective.

Vomund: *In your work you have found Position Sizing to be extremely important. Can you explain what Position Sizing is and how traders should consider applying it to their portfolios?*

Dr. Tharp: We actually have a trademark on that term and a game

Interview continued on page 8

DR. VAN K. THARP *continued . . .*

designed around it. Position sizing is a trademark of Position Sizing Technologies. Anyway, it is the most important thing a trader can focus on and the most neglected area. We have a free trial version of that game on our web site (www.iitm.com), which can be downloaded for free.

When I talk at your fall seminar, we'll play a simulated trading game. I will have a bag of marbles that will represent a trading system. Sixty percent of the trades will be winners while 40% will be losers. Most of the trades will be 1R winners or losers. However, there will be one marble that represent a 10R win and another that represents a 5R loss. That's the system. Everyone will begin with $100,000. And your only decision will be one of Position Sizing — how much to risk on the next marble draw.

I'll have a prize for the winner who has the most money at the end of the session and we'll fine anyone going bankrupt $5. The bankrupt pot gets divided among the five top winners. What I can promise you is that if there are 100 people in the room, except for the ones who go bankrupt, we will have nearly 100 different equities at the end of the game. They'll probably range from zero to well over a million (I've seen $89 million at the end of one game). The interesting thing about the game is that everyone will get the same trades. The only difference will be psychological differences and Position Sizing — how much is risked on each trade.

There was a study of 100 different portfolio managers over a 10-year period which showed that Position Sizing produced 91% of the variation in performance. Most people think the game is all about being right. It's not. Instead, the trading game is about having a positive expectancy system and using Position Sizing to achieve your objectives. I won't say much more about it here, because I'll be talking about it during your fall seminar.

Vomund: *Building a system is one thing but following it is another. What steps can people take to be more disciplined in their trading?*

Dr. Tharp: I've developed a Peak Performance Course for Investors and Traders that covers the trading process. In that course, I've developed a 10-task model that covers what most great traders have in common. I've found that when people follow those 10 tasks, their discipline is good. When they don't, then the discipline usually falls away.

"...if you don't have any rules, (i.e., you haven't developed a business plan or a trading plan) then you shouldn't even be trading."

While it would be a small book to cover those tasks, one of them is to do a daily debriefing at the end of the day. You simply ask yourself, did I follow my rules. If you did, even if you lost money, then you pat yourself on the back. However, if you don't follow your rules (i.e., you had a discipline problem), then you need to figure out what caused you to make the error and rehearse in your mind doing it right. This is a well tested process to help people correct mistakes. And, of course, if you don't have any rules, (i.e., you haven't developed a business plan or a trading plan) then you shouldn't even be trading.

Vomund: *Kenneth Fisher wrote in a Forbes article, "I improve my results more by shunning pride and accumulating regret than by working still harder or smarter in an already long day." Can you explain how ego can get in the way of effective trading?*

Dr. Tharp: Trading is about cutting losses short and letting profits run. You can't do that if you need to be right, as I've already explained.

Trading is about watching what happens with the market. You can't do that if your ego gets in the way of being a neutral observer.

Trading is about taking from the market what the market is willing to give you. You can't do that if you let your emotions get in the way of the market.

All of those things have to do with ego.

Vomund: *We look forward to seeing you at our fall seminar at Lake Tahoe. What do you plan to cover?*

Dr. Tharp: We're going to play the game as I've already mentioned and then I'm going to talk about the three keys to the game: understanding R-multiples and how to use them to understand systems and their expectancy; Position Sizing as I already mentioned because it is the key to the game; and discipline factors such as taking personal responsibility for what happens to you and ego and self esteem and how they affect your trading performance. It should be fun. ■

Dr. Van K. Tharp is President of the International Institute of Trading Mastery, Inc., 519 Keisler Drive, Suite 204, Cary, NC 27511. 919-852-3994.

S&P 500 Changes

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

AT&T Wireless Group (AWE) replaces Potlach Corp. (PCH). AWE is added to the Telecommunications-Cellular/Wireless (WIRELESS) group.