AIQ Opening Bell® Monthly

IN THIS ISSUE VOL. 5 ISSUE 1 JANUARY 1996

*Feature*



*Sections*



**The *Opening Bell Monthly* is a publication of AIQ Incorporated**
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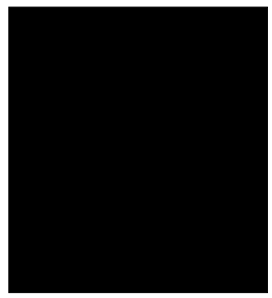
**P.O. Box 7530**
**Incline Village, Nevada 89452**

MARKET ANALYSIS

# A SECRET REVEALED

**By David Vomund**



DAVID VOMUND

The Nasdaq market is becoming increasingly popular. In 1995, there were several occasions where volume on the Nasdaq exceeded the volume on the New York Stock Exchange. People often express their desire to be able to use AIQ more directly with the Nasdaq market. With the release of TradingExpert for Windows, we made a last minute decision to include the ability to plot the Nasdaq Composite with breadth and volume figures for the Nasdaq market. Our market timing knowledge base can now be used on the Nasdaq market.

Most people are unaware that we now have the ability to plot Nasdaq breadth and get buy and sell signals on the Nasdaq. We've never featured this in our marketing material and the documentation only mentions it briefly. Why? Because we didn't know how well it would work. AIQ's market timing model uses the Dow Jones Industrial Average and breadth on the New York Stock Exchange. We didn't know how well the same model would work on the Nasdaq. I personally doubted very much whether the signals would be reliable.

***"Most people are unaware that we now have the ability to plot Nasdaq breadth and get buy and sell signals on the Nasdaq."***

Before we get to the testing of the timing signals, we'll cover the mechanics of plotting the Nasdaq. The symbol for the Nasdaq Composite is "OTC". In our DOS version, we could use this symbol to plot the Nasdaq Composite, but breadth and volume figures were absent. In the Windows version, we can now use the symbol "OCEXCH" to plot the Nasdaq Composite with breadth and volume figures. **Figure 1** shows the Nasdaq Composite with the Advance Decline Line computed from Nasdaq stock data.

If your system says "File Not Found" when trying to plot the symbol "OCEXCH," then you must go to the *Data Manager* and add new ticker symbols. On the *Data Manager* menu bar, click *Ticker*

*Market Analysis continued on page 2*

## MARKET ANALYSIS *continued* . . .

then select *New*. Enter the ticker symbol **OTC** for the Nasdaq Composite, click *Index* for *Type*, then click *OK*. On the next screen, type **Nasdaq Composite** for the *Description* and **PH** for *Market*. Using Dial/Data, the Nasdaq Composite has high, low and closing values starting on May 24, 1988. There is little reason to take data back before that time period.

We also need to add the OCEXCH ticker. Again, click the *Ticker* menu command, then *New,* and type in **OCEXCH**. This time, click on *Market* for the *Type*. For *Description*, type **OTC Exchange**. For the *Market Breadth* and *Price* choices, select *OTCDATA* and *OTC*. Click *OK*, and the next time you retrieve market data, the system will update these files.

Now we will test the effectiveness of the Expert Ratings for the Nasdaq. The most direct method of testing the effectiveness of a timing model is to ignore confirmation. That way our test is on the Expert Ratings and not on the indicator used for confirmation. Our study dates back to 1991. In this time period, we purchased the Nasdaq Composite the day the system gave an up signal of 95 or greater and sold when the system gave a sell signal of 95 or greater. Interest is not factored in.

The trade by trade results are found in **Table 1**. There is an average of five round trip trades per year. There are many more signals than those listed, but we are only concerned with the first buy signal and the first sell signal in a string of signals. During time periods when the model was on a buy signal, the Nasdaq Composite gained an average of 4.2%. During times of sell signals, the index gained 0.3%.

Yearly comparisons of the timing model vs. buy and hold are shown in **Table 2** and **Figure 2**. We see that the model worked surprisingly well in the years 1991 through 1994. The model performed especially well in 1994 as it kept us out of a 7.5% decline that began in March and avoided a 3.7% decline in June. 1995 is a different story. It profited from most of the advance in the first quarter but had us out of the market from April 19 to July 14. The Nasdaq rallied an amazing 22% during that time period.

Overall, the return on trading the Nasdaq is about equal to a buy-and-hold approach. This result is better than what I expected and I've begun to look at the Nasdaq Expert Ratings on a regular basis. Still, I believe the best way to perform market timing is to use our regular market timing Expert Ratings, which have consistently proven to be effective, and then use Relative Strength analysis to judge whether large-cap or small-cap stocks will be the best performers (we'll discuss this in an upcoming issue).

One problem I see with using our timing model for the Nasdaq Composite is that the Composite is a poor measurement of what is happening to Nasdaq stocks. It is more of a technology index as large firms like Microsoft, Intel, and Apple dominate the weighting. Therefore, comparing the Nasdaq Composite to Nasdaq breadth is like comparing apples to oranges. It may work better to apply an index of small company stock activity, like the Russell 2000, to the breadth on the Nasdaq. We'll test this and report th next month. ■

**Figure 1**

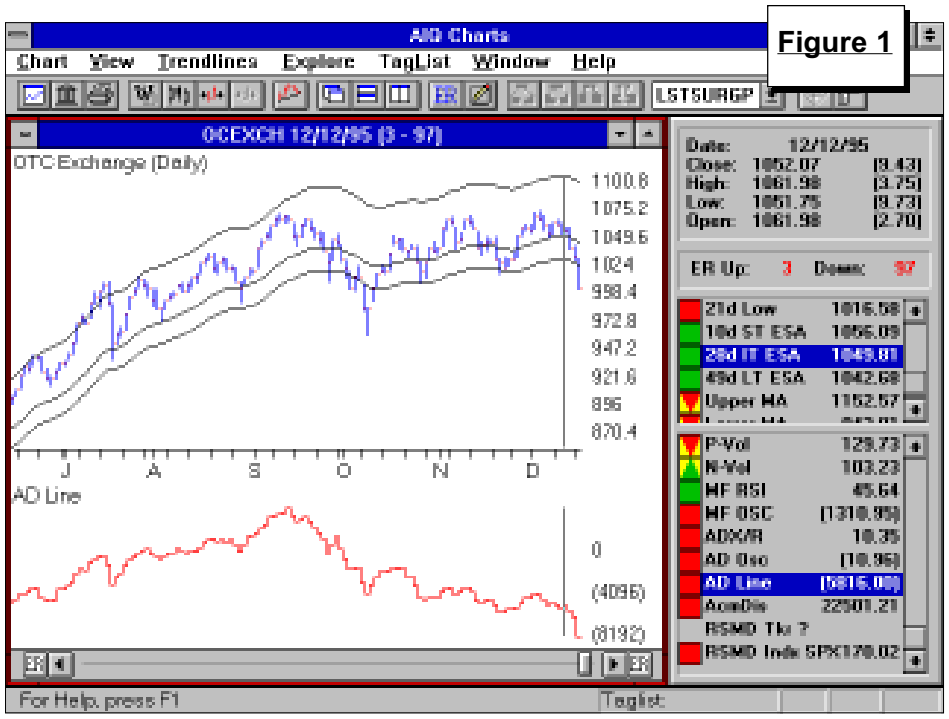



**Table 2**

**Nasdaq Trading Study**
**Annual Percentage Gains**

| | Buy & Hold | Trading |
|---|---|---|
| 1991 | 56.84 | 54.99 |
| 1992 | 15.45 | 26.97 |
| 1993 | 14.75 | 10.11 |
| 1994 | -3.20 | 13.42 |
| 1995 | 33.00 | 7.24 |

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MARKET ANALYSIS *continued* . . .

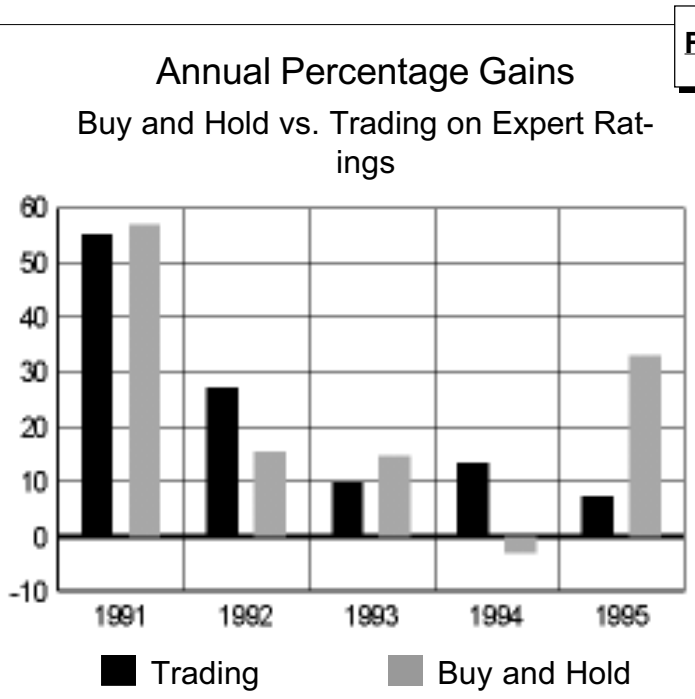
**Table 1**

## Nasdaq Trading Study 1991-1995

| ENTRY DATE | EXPERT RATING | NASDAQ VALUE | EXIT DATE | EXPERT RATING | NASDAQ VALUE | NASDAQ % CH. |
|---|---|---|---|---|---|---|
| 01/17/91 | 98 | 375.81 | 04/11/91 | 95 | 499.31 | 32.86 |
| 05/22/91 | 99 | 487.29 | 06/07/91 | 100 | 498.54 | 2.31 |
| 07/01/91 | 100 | 481.31 | 07/24/91 | 98 | 487.42 | 1.27 |
| 09/12/91 | 96 | 521.13 | 11/15/91 | 100 | 531.29 | 1.95 |
| 12/02/91 | 97 | 530.91 | 04/16/92 | 98 | 591.81 | 11.47 |
| 04/29/92 | 98 | 569.94 | 05/15/92 | 97 | 574.43 | 0.79 |
| 05/19/92 | 98 | 578.05 | 06/08/92 | 96 | 582.01 | 0.69 |
| 06/29/92 | 95 | 558.80 | 08/06/92 | 97 | 574.02 | 2.72 |
| 08/27/92 | 100 | 563.27 | 09/22/92 | 99 | 583.00 | 3.50 |
| 10/14/92 | 98 | 576.22 | 12/30/92 | 99 | 671.85 | 16.60 |
| 02/25/93 | 99 | 667.07 | 04/02/93 | 95 | 669.85 | 0.42 |
| 04/12/93 | 100 | 673.12 | 06/08/93 | 99 | 687.74 | 2.17 |
| 06/25/93 | 100 | 694.81 | 07/16/93 | 100 | 699.73 | 0.71 |
| 07/28/93 | 95 | 705.59 | 09/07/93 | 99 | 739.35 | 4.78 |
| 12/01/93 | 97 | 763.81 | 02/04/94 | 98 | 777.28 | 1.76 |
| 02/28/94 | 99 | 792.50 | 03/24/94 | 99 | 786.68 | -0.73 |
| 04/14/94 | 97 | 727.31 | 06/08/94 | 96 | 729.79 | 0.34 |
| 06/27/94 | 97 | 702.68 | 08/05/94 | 100 | 718.67 | 2.28 |
| 08/09/94 | 96 | 722.61 | 09/21/94 | 99 | 760.71 | 5.27 |
| 10/05/94 | 95 | 746.28 | 10/24/94 | 96 | 761.21 | 2.00 |
| 12/14/94 | 99 | 725.67 | 03/07/95 | 100 | 791.33 | 9.05 |
| 03/14/95 | 96 | 808.24 | 04/19/95 | 98 | 816.55 | 1.03 |
| 07/14/95 | 95 | 999.33 | 07/19/95 | 100 | 952.83 | -4.65 |
| 07/25/95 | 98 | 993.76 | 08/16/95 | 96 | 1025.75 | 3.22 |
| 10/11/95 | 96 | 1001.57 | 10/25/95 | 96 | 1026.47 | 2.49 |

This analysis is believed to be reliable but accuracy is not guaranteed.
Past performance is not a guarantee of future results.

**Figure 2**

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TOOLS OF THE TRADE

# POINT & FIGURE CHARTING, III

**By David Vomund**

Last month, we examined Point & Figure chart patterns, covering the symmetrical triangle, double top, and triple top formations. This month we'll cover three additional patterns: the catapult, signal reversal formation, and the spread triple top.

## CATAPULT

The bullish catapult formation starts with the triple top pattern covered last month. Instead of proceeding to move straight upward after the triple top buy signal, however, the stock has enough of a correction to form a column of Os. The correction is short and the stock reverses to the upside from a higher level than its previous correction.

A hypothetical example of a bullish catapult is shown in **Figure 3**. Notice a triple top buy signal at $32. The stock moved to $33 but came under selling pressure. The third column of Os is higher than the previous column so we see a pattern of higher lows.

The bullish catapult buy signal (see shading) comes when the fourth column of Xs moves higher than the third column of Xs. The reverse is true for a bearish catapult.

An example of the bullish catapult formation is found in **Figure 4**. A triple top buy is registered in September when the column of Xs moved higher than the Xs drawn in June. U.S. Healthcare corrected in September but made a higher low. The stock proceeded to rally and gave a buy signal (see arrow).

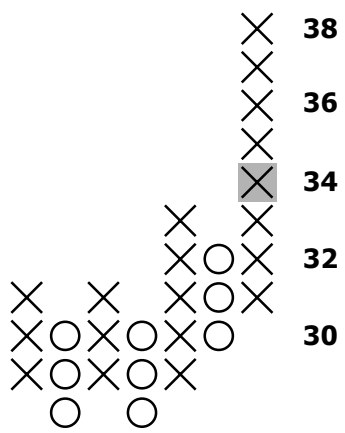
Another example of the bullish catapult can be seen by plotting Foster Wheeler (FWC).

## SPREAD TRIPLE TOP

The spread triple top is a very broad formation and can take a long time to develop. The buy signal is generated when the stock penetrates three level tops.

A hypothetical example is shown in **Figure 5**. The buy signal is regis-

Figure 3




*Bullish Catapult Formation*

Figure 4

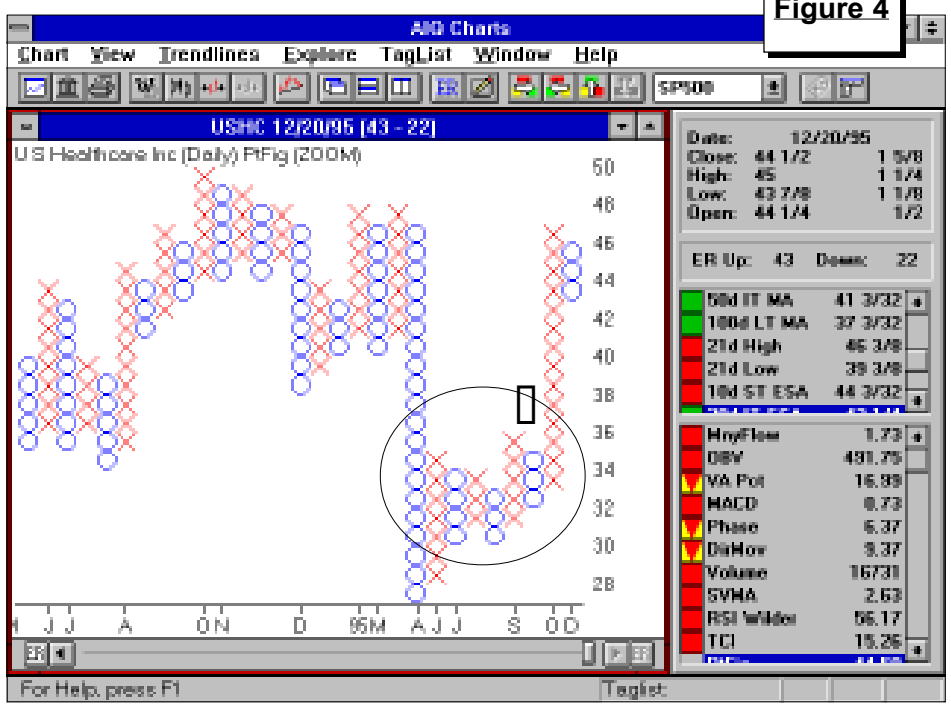
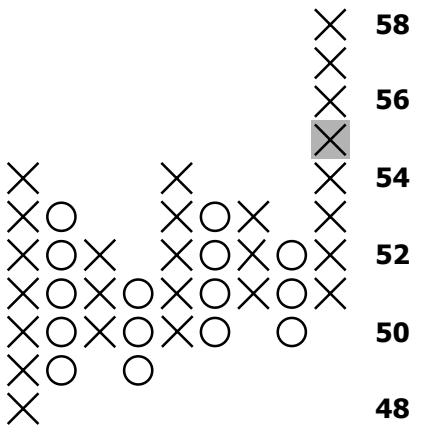



Figure 5




*Spread Triple Top Formation*

## TOOLS OF THE TRADE *continued* . . .

tered at $55, when the previous highs are generated (see gray shading).

An example of the spread triple top is found in **Figure 6**. The arrow points to the buy signal. During the formation of the spread triple top, other patterns may have occurred. In fact, we see that right after the spread triple top pattern is formed, a bullish catapult signal is registered.

For more examples of the spread triple top signal, look at charts of Nationsbank (NB) and American Home Products (AHP).

### SIGNAL REVERSAL

In order to have a bullish signal reversal, there must be at least five columns of lower highs and lower lows. During this time, the Point & Figure chart is bearish. The buy signal is registered when there is finally a column of Xs higher than the previous column.

The opposite is true for a bearish signal reversal.

**Figure 7** shows a bearish signal reversal. Notice the pattern of higher highs and higher lows until the stock falls to $53. The uptrend is no longer in place. The sell is registered when a column of Os moves below the previous column of Os (see gray shading).

**Figure 8** shows a real example of a bullish reversal pattern. Chase Manhattan had a pattern of lower highs and lower lows through much of 1994. In early 1995, the downtrend was broken and the buy comes when the column of Xs moves higher than the previous column. This pattern infrequently appears but is usually very profitable when it does occur.

These are the most common patterns used in Point & Figure analysis.

Next month, we'll wrap up the subject by charting stocks that demonstrate multiple patterns. ■

**Figure 6**

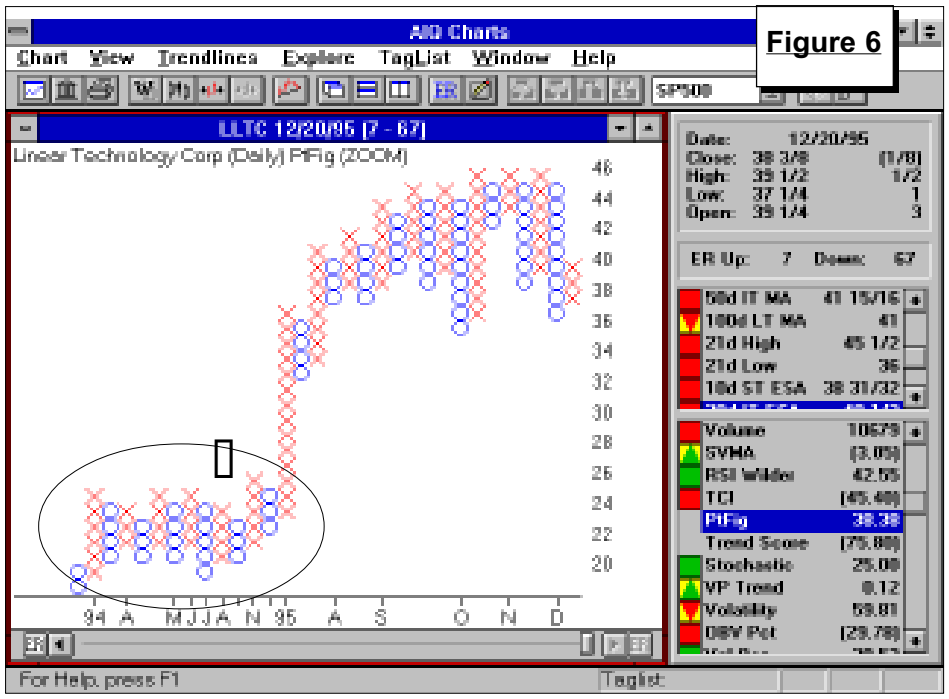
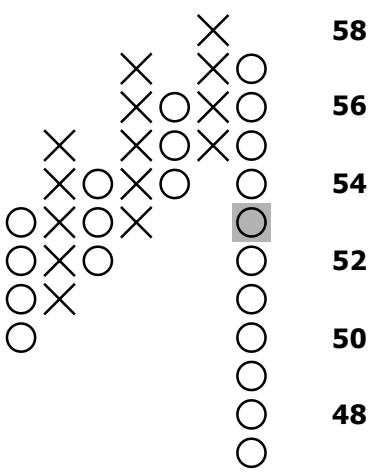
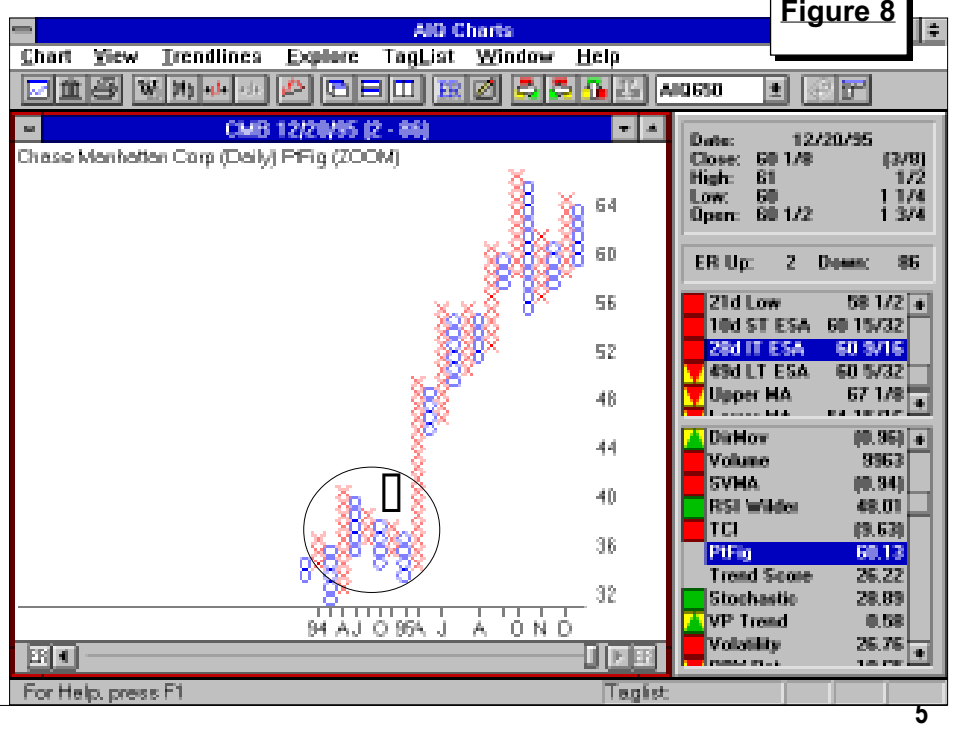



**Figure 7**

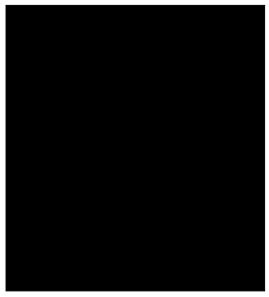



*Bearish Signal Reversal Formation*

**Figure 8**



WINDOWS COMMENTARY



STEVE HILL

# More Tips on Using MatchMaker for Windows

**By Steve Hill**

In the previous two issues of the *Opening Bell*, I discussed the first stages of correlating the groups and sectors of the AIQ 1500 structure. At the end of the second article, I finished correlating all the tickers that were unassigned to groups against all the newly computed correlated groups.

Several questions have come up concerning "leftover" tickers or tickers without good "fits." I will address these questions, before continuing with correlation of the AIQ 1500 at the sector level.

## Finding a "fit"

When I attempted to correlate the pool of stocks that did not fit in any of the industry groups after the first round of correlations, some stocks still remained without finding good homes.

Figure 9

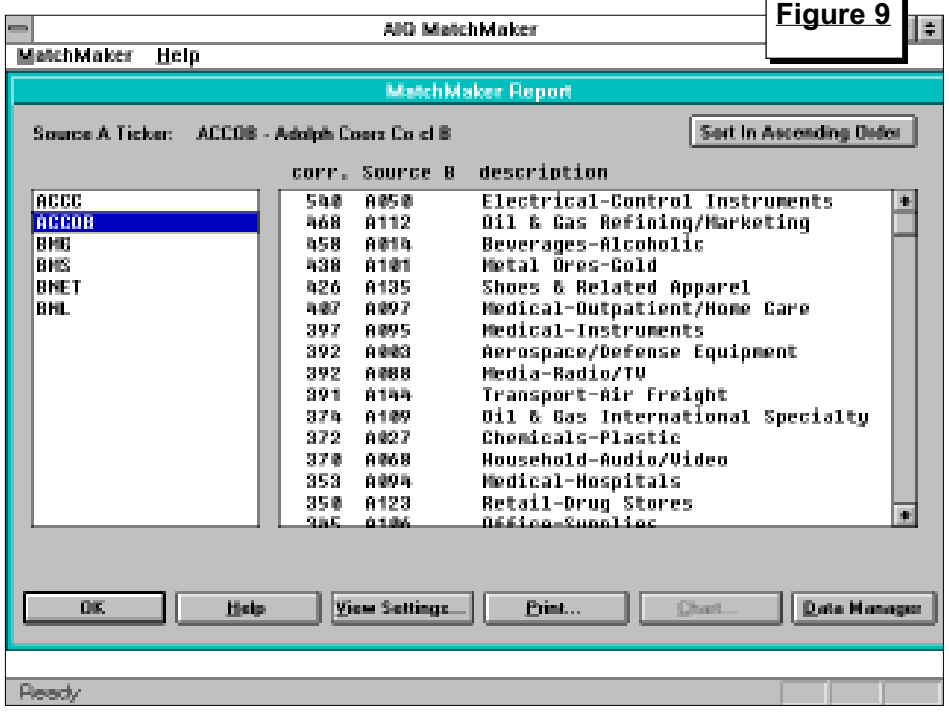
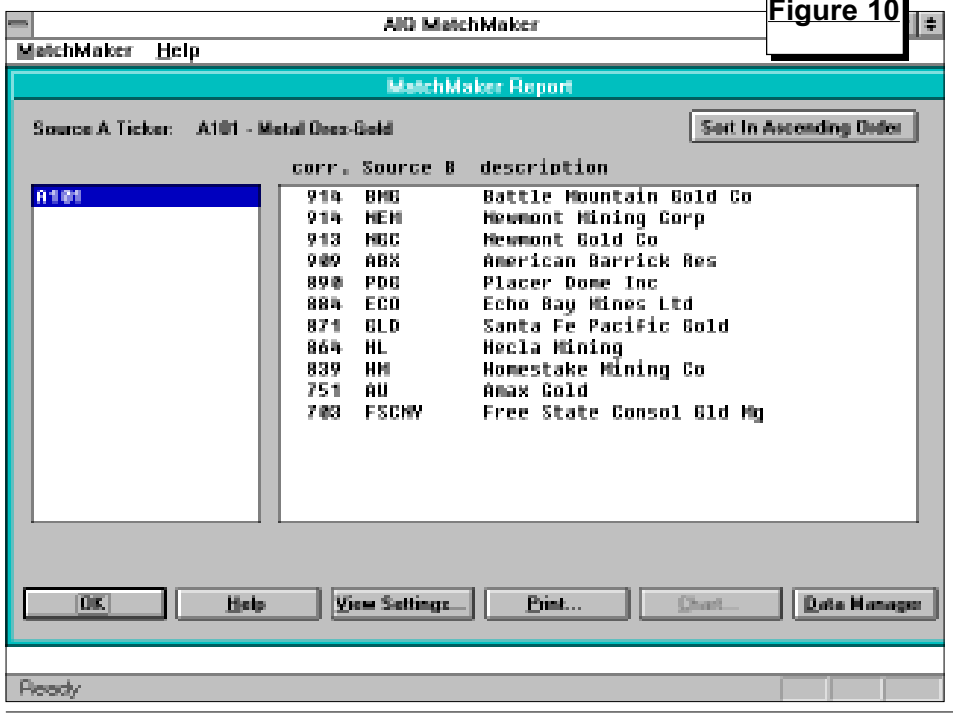



**Figure 9** shows an example of this. (Note: the correlation of unassigned tickers after the first round involved some 450 stocks against 120-plus groups, and took over a day to compute.)

Figure 10




In this case, the unassigned stock ACCOB, Coors Co., had a high correlation with only one group, A050 Electrical -Control Instruments. Unless I'm mistaken, Coors has very little relationship fundamentally to an electrical group. Hence, I decided Coors did not correlate with any existing group and the stock remained in the pool of uncorrelated stocks.

## Returning tickers to groups they came from

Some tickers can actually end up correlating with the same groups they were originally removed from. This situation happens because the group index the tickers were originally removed from was recomputed with only stocks showing a high correlation

WINDOWS COMMENTARY *continued . .*

to the index.

**Figure 10** is an example of this situation using the group A101, Metal Ores-Gold. Three symbols, BMG, HL, and AU, that previously did not correlate were reinserted into group A101. For the purpose of this example, the group was then recomputed and run through MatchMaker again. The results shown in Figure 2 reveal that BMG, HL, and AU now correlate.

### What to do with remaining uncorrelated tickers

With the first stages of correlations complete, I still had a pool of uncorrelated tickers that I could either leave unassigned to any groups, or attempt to form new groups by correlating all tickers in the uncorrelated list to all tickers in the uncorrelated list (see **Figure 11**). This process, however, would likely take several days and result in only a handful of newly correlated groups that made any fundamental sense. I decided not to proceed with this process.

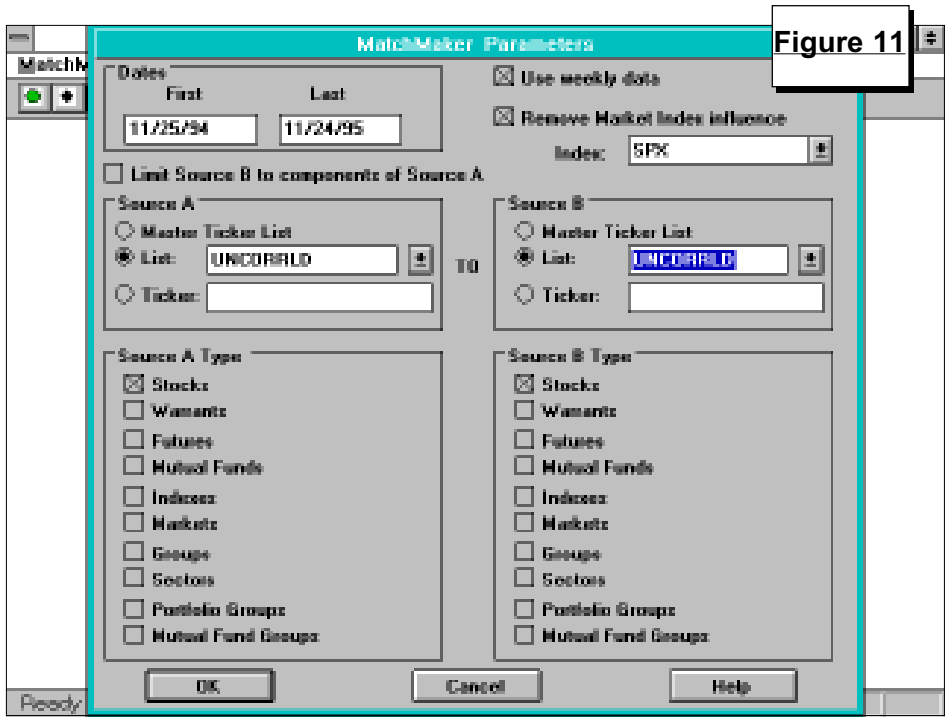



Figure 11

As a final check of my efforts thus far, I recomputed the correlated AIQ 1500 structure and again ran MatchMaker on all stocks in groups to make sure that all stocks correlated correctly.

Next month, I will move on to sector correlation to complete the process of correlating the group/sector structure of the AIQ 1500. ■

## STOCK DATA MAINTENANCE

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

| Stock | Ticker | Split/Div. | Approx. Date |
|---|---|---|---|
| Analog Devices | ADI | 3:2 | 01/04/96 |
| Cominco Fert. | CLT | 3:1 | 01/08/96 |
| Wynn's Int'l | WN | 3:2 | 01/08/96 |
| Amer. Mgmt. Sys. | AMSY | 3:2 | 01/08/96 |
| United Fire & Cas. | UFCS | 3:2 | 01/08/96 |
| Wackenhut | WAK | 5:4 | 01/10/96 |
| Input/Output | IO | 2:1 | 01/10/96 |
| Computer Horizons | CHRS | 3:2 | 01/10/96 |
| System Software | SSAX | 3:2 | 01/11/96 |
| FMS Financial | FMCO | 2:1 | 01/15/96 |
| IBP Inc. | IBP | 2:1 | 01/22/96 |
| Champion Ind. | CHMP | 5:4 | 01/23/96 |
| Iomega Corp. | IOMG | 3:1 | 02/01/96 |

**Ticker Changes:**

Aames Financial (AAMS) to Aames Financial (AAM)
The Lori Corp (LRC) to The Comforce Corp (CFS)

**Trading Suspended:**

BIC Corp (BIC) Conesco Inds. (CNSC) NBD Bancorp (NBD)
ReadiCare Inc. (RDI) Roadway Services (ROAD)

MARKET REVIEW

# LESSON OF 1995: DON'T FIGHT THE TREND

**By David Vomund**

They say a picture is worth a thousand words. If that is true, **Figure 12** tells the story of 1995. 1995 was the year of the buy-and-hold. Anyone who incorporated market timing probably underperformed as there was not even a 4% correction in the S&P 500. If there was one lesson to be learned in 1995, it was that trends are powerful and going against the trend is dangerous.

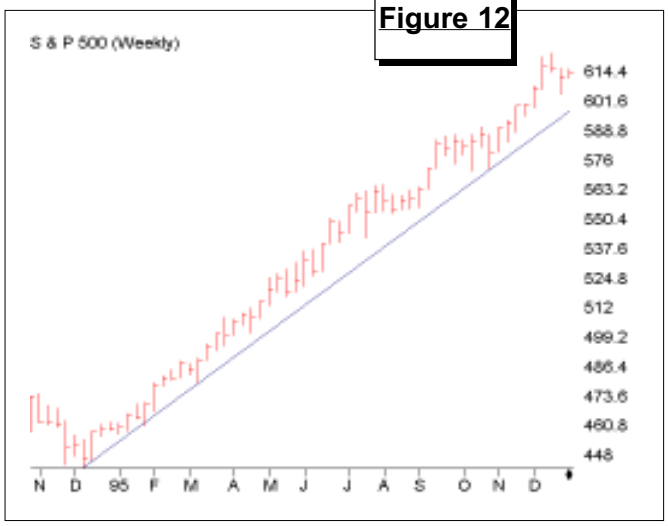
The AIQ timing system proved its merit as it recognized the trend and kept investors in for most of the year. The system worked well in 1994's trendless market and then performed well in 1995's trending market. Most non-AIQ technicians were unable to match this performance (in fact, 1995 was a bad year for many technicians because indicators were "overbought" for most of the year).

The signal that triggered the entire move was seen on November 28, 1994. Anyone who hasn't reviewed this signal should. The Market Log for that day shows that over 75% of the stocks giving confirmed and unconfirmed signals were on the buy side. These percentages became more bullish over the next few weeks.

Except for a one-day whipsaw, the system kept us in the market until June 16 when a 98 down signal was registered. The market timing model remained on a buy signal the first half of the year but then became active in the second half. The model turned bullish at the end of August, then bearish in early October. A round trip trade was seen in October and the next buy came in mid-November. The final signal, a sell, came on December 18.

In my own analysis, I became a firm believer in the trendline shown in **Figure 12** and decided to err on the side of being too bullish as long as the market was above the trendline. As a result, I turned neutral instead of bearish on the June 16 down signal and remained neutral for only two weeks. I turned bullish once again and remained bullish despite the 57 point drop in the Dow on July 19 and the sell signal registered that day.

Figure 12




Like many users, I got caught in the October 2 whipsaw sell signal but no damage was done because the market was at the same level a few days later when a buy was given (this was a great signal for technology holders!). Unfortunately, on November 10 I ignored the fact that the S&P 500 was still above its trendline and succumbed to a series of sell signals by briefly turning bearish.

With AIQ currently on a sell signal, I'm taking a neutral stance because the S&P 500 is still above its trendline. Despite the mishaps of being neutral when the market went up and being caught in two whipsaw signals, the AIQ timing model helped me become the 6th best timer in the country for 1995, as tracked by *Timer Digest*.

The S&P 500's trendline not only shows support but it can also be used to measure overbought/oversold levels. Using weekly data, our market chart shows that the S&P 500 has never been more than 6% above its trendline (it came close on 6/23, 7/14, and 9/15). On December 13, the day of the market's high, the S&P 500 was about 5.5% above its trendline.

The fact that there was not a correction this year does not mean we should all be "buy-and-holders." In a *Barron's* article, noted technician Ned Davis points out that there has not been so much as a 12% market correction since the current market advance began in 1990. This is the longest period on record. The four previous longest advances in the Dow without a 12% correction (1934-37; 1942-46; 1962-66; and 1984-87) all ended in market drops averaging nearly 35%.

One reason the market keeps marching is sector rotation. Many technology issues (especially semiconductors) rose about 80% in the first three quarters of 1995 and have since corrected 25%. Financial and airline issues were also strong while retail and metal sectors lagged badly. ■

*David Vomund publishes two advisories for stock and sector fund investing ( fax or mail). For a free sample of the advisories, phone 702-831-1544.*

## 1995 Index Available

An Index of 1995 *Opening Bell* articles is available free to subscribers. Call your sales representative at 800-332-2999. A review of the articles for the past year reveals an interesting diversity of topics. Highlights include interviews with highly regarded investors (Jim Yates, Marc Chaikin, etc.), and in-depth studies of Expert Rating confirmation techniques and new reports such as Price Volume Divergence. We will continue to test the effectiveness of reports and to give you insight on how to use to your advantage the new features available in the Windows version of TradingExpert.

Happy New Year!