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Monthly

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Feature

Sections

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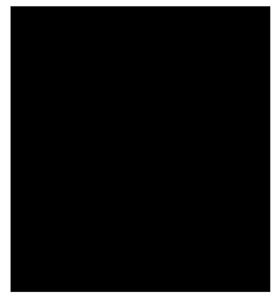
CANDLESTICK CHARTING TECHNIQUES

BULLISH/BEARISH PATTERNS TO LOOK FOR ON CANDLESTICK CHARTS



DAVID VOMUND

By David Vomund

During our AIQ seminars, we find many effective trading techniques being used by attendees. This month we are pleased to present an interview with Nicolas Williams, an AIQ power user from Florida. Mr. Williams combines Japanese Candlestick charting analysis with indicator readings in his investment approach. He is a retired chemical engineer and now trades stocks to supplement his income.

Nicolas Williams
AIQ power user combines technical indicators with Candlestick patterns to enhance trading.

Before we begin with the interview, we will briefly review Candlestick analysis.

Most people use bar charts in their analysis. Candlestick charting is simply another means of charting price activity. Whereas bar charts emphasize the high, low, and closing price, Candlesticks place great importance on the opening price as well as the high, low, and closing price. Since the opening price is of great importance, Candlestick patterns offer unique signals often not recognized with traditional bar charts.

The Candlestick consists of a body and a shadow. The body is defined by the open and close. If the close is above the open, signifying that the bulls have pushed the stock up, the Candlestick body is white. If the stock closes below the open, indicating bearish sentiment, the body is black.

The shadow, drawn as a line extending above and below the real body, is determined by the high and low price and resembles the Candle's

Candlestick Charting continued on page 2

CANDLESTICK CHARTING TECHNIQUES *continued . . .*

"wick," hence the name of the chart (see **Figure 1**). On the Candlestick charts, there are several patterns to look for which signify bullish and bearish conditions. TradingExpert's Technical Indicator Reference Manual has a good desciption of Candlestick construction along with patterns to look for beginning on page 86.

To learn more about Candlestick analysis, refer to Steve Nison's two books, *Japanese Candlestick Charting Techniques* and *Beyond Candlesticks.* For a catalog of investment books, call Traders' Library at 800-272-2855. Let them know you are an *Opening Bell* subscriber and you will receive a 15% discount for Mr. Nison's books.

Our interview with Mr. Williams follows.

Vomund: Thank you for giving us input on your trading strategy. Why do you use Candlesticks?

Williams: Most people use technical indicators to forecast activity. Bar charts are then used to simply tell you where the stock has been. By combining the indicators with a few basic Candlestick patterns, you can enhance your trading. One Candlestick that is very easy to spot has a long body. Another is one with long shadows. With the market on a confirmed buy signal, a long white Candlestick at or near the lower Bollinger Band should command your attention for a possible buy. The reverse is true for a large black Candlestick at or near the upper band.

Vomund: What type of stocks work best with Candlesticks?

Williams: Candlesticks work well for high, medium, or low priced stocks. They also work well for stocks having high, medium, or low average volume. I often concentrate on the low capitalization stocks. The low-cap stocks are often not considered by portfolio and fund managers who have huge sums to invest. This is an area where the small investor using AIQ plus Candlesticks can win.

Vomund: Do you use Candlesticks for overall market timing?

Williams: Yes. One Candlestick pattern mentioned in Steve Nison's book is the Spinning Top with long shadows. Spinning Top Candlesticks have small real bodies. When this pattern is accompanied by high volume, it indicates accumulation or distribution depending on the price level. An excellent example of this occurred on July 16, 1996. The Dow Jones Industrial Average and no fewer than 15 of the 30 Dow stocks exhibited a Spinning Top at or near the lower Bollinger Band along with high volume (**Figure 2**). AIQ issued an Expert Rating buy signal of 99-1 on July 12, and a few days later the Candlesticks were screaming to buy. At the same time, the 9-day Stochastic moved above the 20 level and the 14-day Commodity Channel Index (CCI) crossed above -100 two days later, thus confirming the move.

Figure 1

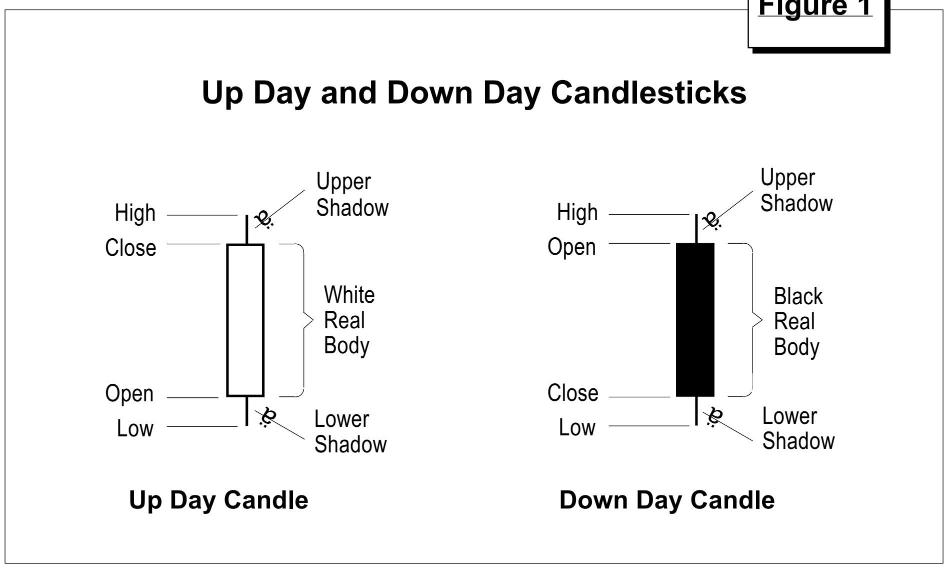
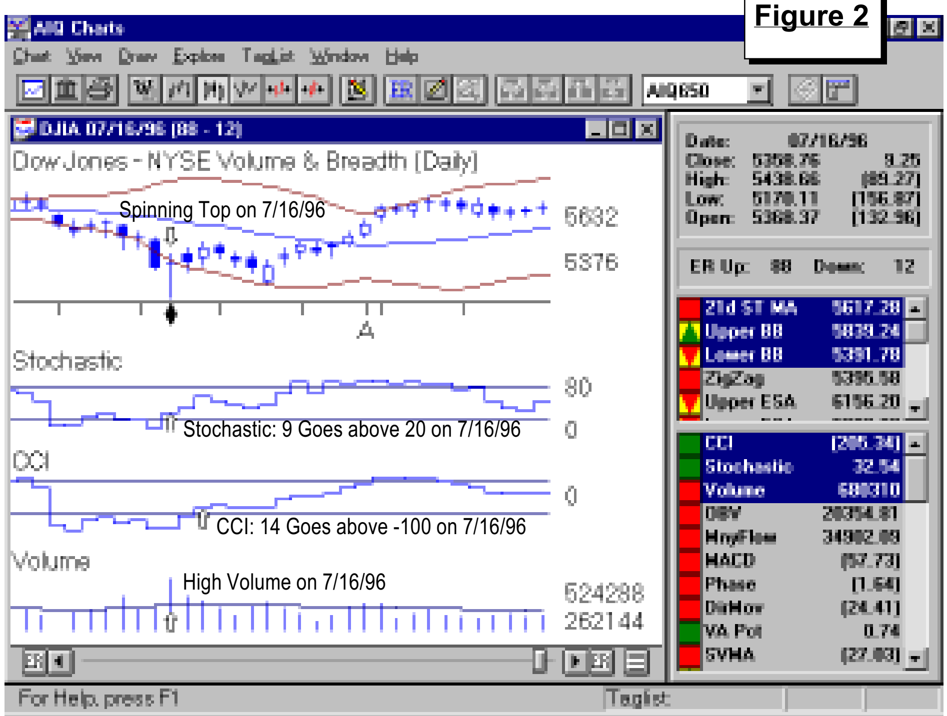


Figure 2



CANDLESTICK CHARTING TECHNIQUES *continued . . .*

Vomund: Can you give us an example of how you use Candlesticks on stocks?

Williams: A great example of how easy it is to spot bullish patterns is found on the IBM chart on July 25 (**Figure 3**). On that day, there was a very large white Candlestick with high volume. The prior day was a 21-day low but both the 9-day Stochastic and the 14-day CCI crossed above their oversold lines. While there were no high Expert Ratings and the Candlestick reached the upper Bollinger Band, there was a huge Window (price gap). The chart signaled a buy and IBM never looked back.

Another fairly long white Candlestick, also at the upper band, came on September 13, which should provide support for a future decline. A warning sign for stocks occurs when they break below a long white body.

Vomund: Is the analysis different for small-cap stocks?

Williams: Not really. Tredegar (TG) is a very low average volume stock and is not apt to be on the data base of many users (**Figure 4**). Several things worked together on 9/5/96 to signal a buy. First, there was an Expert Rating of 99-0. There were two recent high Expert Ratings counting a 16-56, which I believe is an effective bullish rating. On that day, there was a long white Candlestick which was a bullish engulfing pattern. TG formed an SMTP pattern (see *Note* below) and the 9-day Stochastic crossed above 20. Its 14-day CCI crossed above -100.

Another long white Candlestick, which is also a Belt Hold, came on 9/16/96 providing support for the sideways movement and negating the possible decline which was hinted by the Bearish Engulfing pattern.

The Shooting Star with light volume which came on 10/11/96 could have been cause for short term traders to exit. However, the Harami on 10/22/96 ended the decline. Since then, several fairly long white

Figure 3

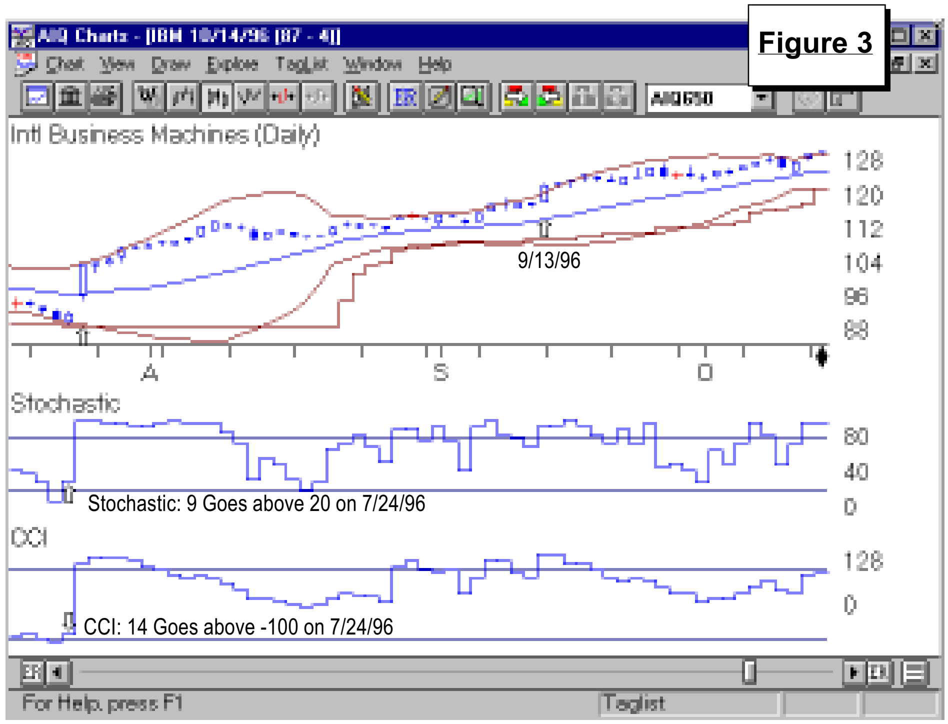
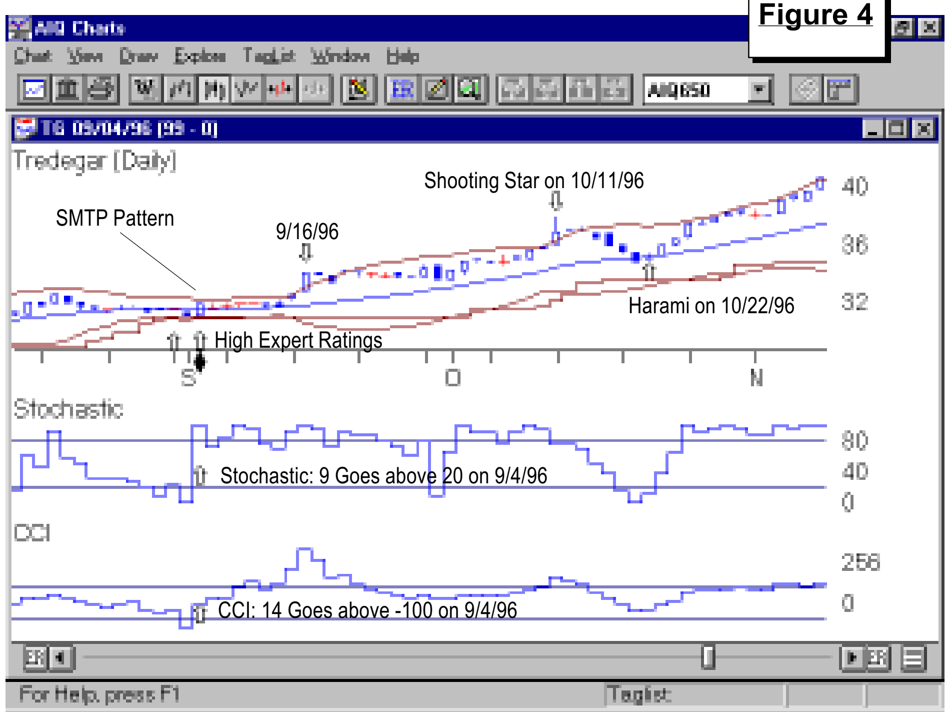


Figure 4



Candlesticks may provide support for any future decline.

Vomund: Thanks for sharing your techniques with us.

Note: The SMTP pattern is from the *Professional Traders Journal* and occurs when the security hits a 10-day low plus the range on the 10th day is the largest of the past 10 days. A final requirement is that the close on the 10th day must be in the top 25% of the day's trading range. ■

MARKET REVIEW

Year-End Summary: Analyzing AIQ's Market Timing

By David Vomund

Our market timing model registered one signal in December — a 95 up Expert Rating on December 17. This signal was generated using data from either Dial/Data or Interactive Data. Because of the difference between theoretical high/low values versus actual high/low values, people who use Telescan did not get this buy signal. (For an explanation of the difference between actual and theoretical data, see the June 1996 issue of the *Opening Bell*).

The December 17 buy signal was simply a continuation buy signal, since the initial buy signal was registered on September 9 (no matter which data vendor you use).

In the following review, we'll examine the December 17 buy signal to summarize a lot of the market timing analysis previously covered in *Opening Bell* newsletters.

Monitoring trendlines for support and resistance

We'll first look at a long term picture of the market by plotting the S&P 500 using weekly data (see **Figure 5**). We've drawn a trendline which begins with the December 1994 lows and connects the market lows of early 1996. This is the same trendline that was highlighted in the January 1996 and August 1996 *Opening Bells*.

This trendline acted as support for the entire 1995 rally and continued as support in early 1996. It wasn't until July 1996 that the market fell below this trendline, signaling the start of a strong correction. While the S&P 500 only fell 7 1/2%, small company stocks were harder hit. The Russell 2000 and the Nasdaq Composite fell about 16% from their high points.

When a support trendline is broken, it shouldn't immediately be erased. What was support now becomes resistance.

When a support trendline is broken, it shouldn't immediately be erased. What was support now becomes resistance. The market surprised most people when in late summer it rallied and once again approached this trendline. As you can see in Figure 5, the trendline acted as resistance during August but the market rose above it in September. The trendline acted as support once again in October and the S&P 500 was just above the trendline at the time of the December 17 buy signal.

The December 17 AIQ market timing chart with daily data plotted is displayed in **Figure 6**. The chart shows the 95 Expert Rating buy signal. We've drawn a short term trendline connecting the July, September, and October low points of the Dow Jones Industrial Average. At the time of the buy signal, the Dow was just above support.

Signals from the Stochastic indicator

In the April 1996 *Opening Bell*, we discussed how the Stochastic indicator for a trending security will give very accurate signals in the direction of the trend. The direction of the market in December provides a good example.

We see in Figure 6 that the Dow is in an uptrend — it is above its upward sloping support trendline. Even though the market is in an uptrend, the small correction in early December was enough to move the Stochastic into oversold territory (a value below 20). On the day of the buy signal, the Stochastic rose above 20. The Stochastic gave a buy signal during an uptrending market.

Figure 5

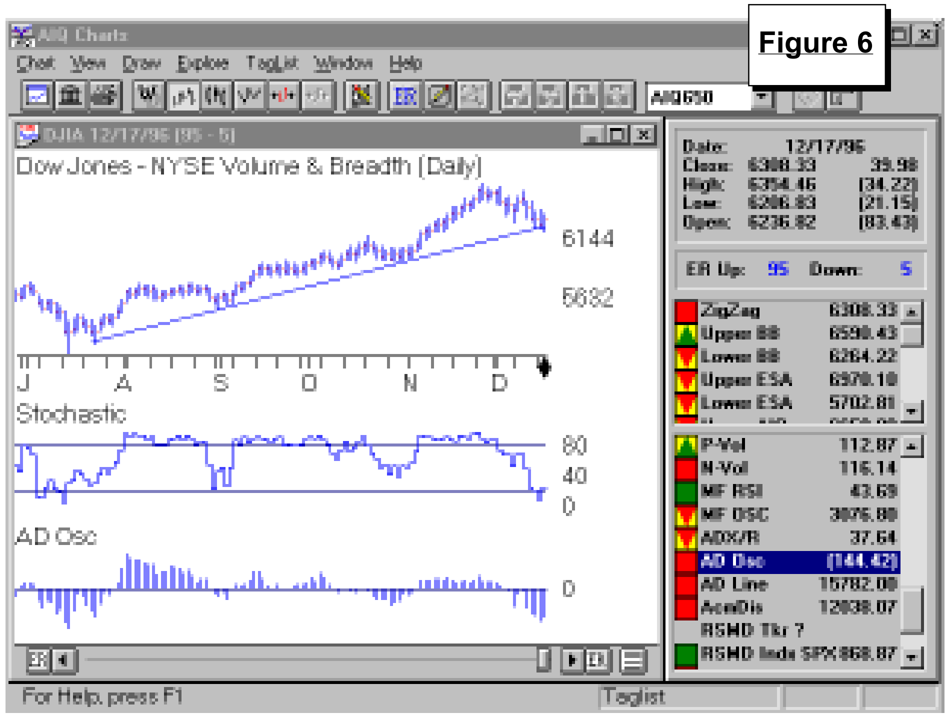
MARKET REVIEW *continued . . .*

Advance/Decline Oscillator at work

In the July 1996 issue of the *Opening Bell*, we discussed how overbought and oversold levels can be set for the Advance/Decline Oscillator. We found that the market tends to rebound from weakness when the Advance/Decline Oscillator moves below a value of -100. This is especially true for an uptrending market.

At the time of the December 17 buy signal, the Advance/Decline Oscillator was well below -100 (see Figure 6).

Figure 6



Market Log's WAL and US Scores

Examining the Market Log (**Figure 7**), we see the majority of the indicators on both the Market Plot and the Access Plot sections were moving lower at the time of the December 17 buy signal. This is fairly typical since the Expert Ratings are counter-trend. The indicators were moving lower but the technical picture was improving.

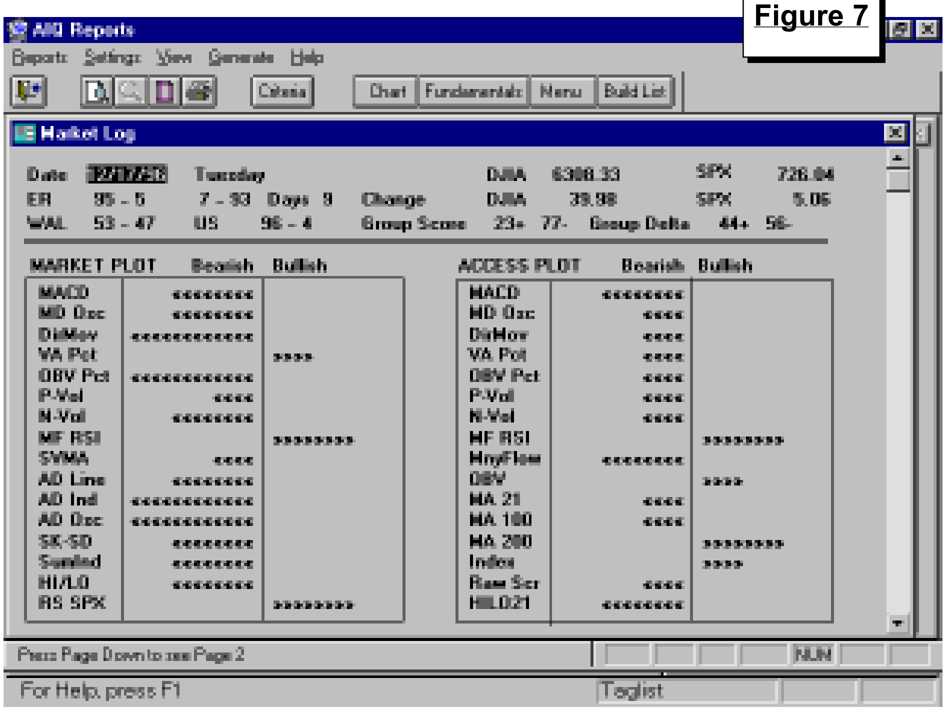
The US Score (upper left of the Market Log) was 96 - 4. This means that of the stocks giving unconfirmed signals, 96% were on the buy side, a very bullish indication.

The WAL Score (from the Weighted Action List) was a neutral 53 - 47. This tells us that of the stocks giving confirmed signals, 53% are on the buy side and 47% are on the sell side. The WAL score was neutral but we knew that if the market began to advance, then we would see a high percentage of stocks giving confirmed buy signals simply because there was such a high percentage of stocks giving unconfirmed buy signals. As the market moved higher, many of the unconfirmed buy signals would be confirmed.

Analysis of the WAL and US Scores were covered in the November 1994 *Opening Bell* newsletter, and are also discussed in the new AIQ video on market timing.

Market Review continued on page 6

Figure 7



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MARKET REVIEW *continued . . .*

Checking the Russell 2000

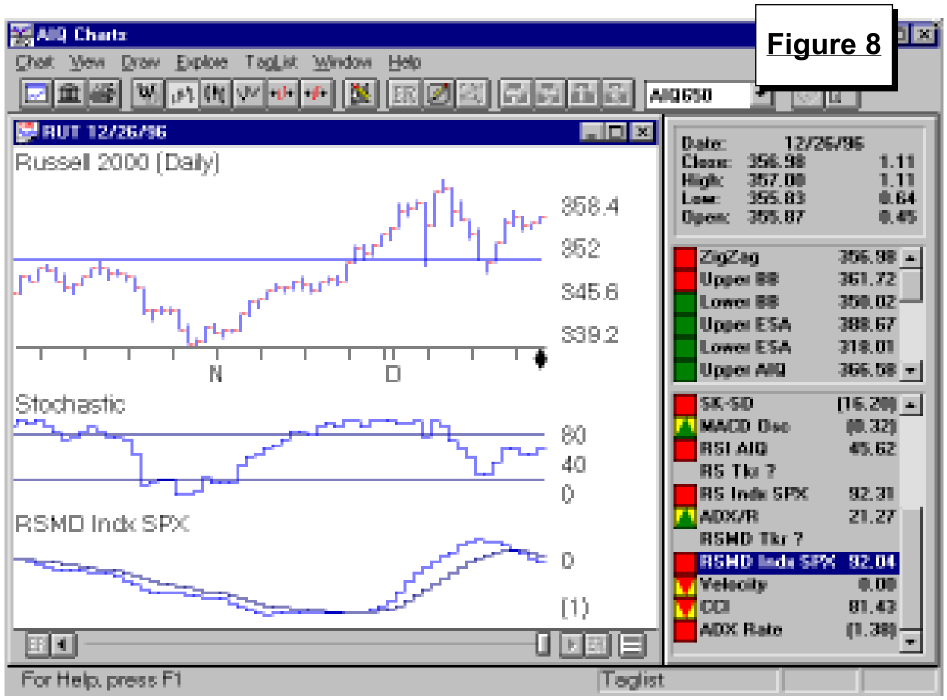
Turning to small company stocks, we see that the Russell 2000 dropped to the support trendline that was charted in the November 1996 *Opening Bell*. Whereas the S&P 500 corrected enough to move the Stochastic into oversold territory, the early December correction was less severe for small company stocks as the Russell 2000's Stochastic came close to but was unable to move into oversold territory (see **Figure 8**).

The RSMD Index SPX indicator, plotted in Figure 8, is the relative strength of the Russell 2000 versus the S&P 500 plugged into the MACD formula. This indicator began to move higher in late November, shortly after the Russell 2000 rose above its resistance trendline.

At the time of the December 17 buy signal, the RSMD Index SPX indicator was flat. Since large company stocks were at oversold levels, they bounced back the strongest when the market rallied after the buy signal. In the three days after the buy signal, the S&P 500 rose just over 3%. The Russell 2000 on the other hand only rose 1.9%. This was enough to turn the RSMD Index SPX lower, indicating large company stocks were outperforming on a short term basis.

An article on the RSMD Index SPX indicator appeared in the April 1996 *Opening Bell*.

Figure 8



AIQ's market timing worked well in 1996

For the year 1996, AIQ's market timing model worked well. **Table 1** shows the buy and sell dates for Expert Ratings greater than 95 along with the percent change in the S&P 500. Listed are the entry and exit dates for no confirmation and for Price Phase confirmation.

Waiting for confirmation helped keep you out of the market during the July downturn, but acting without confirmation produced a higher return for the year. Using a no confirmation strategy, the return from trading the S&P 500 was 26% (this assumes you buy or sell the S&P 500 the day of the signal and no money market interest is factored in).

1996 in review

1996 will be remembered as the year of the large company stocks. This was the second straight year of above average returns but the rallies were driven by only a few stocks. The narrowest measure of price activity, the Dow Jones Industrial Average, rose 26.01% in 1996. The slightly broader S&P 500 rose 20.26%.

The New York Composite, which measures the activity of stocks on the New York Composite, rose 19.06%. The Russell 2000, which measures the activity of 2000 small company stocks, only rose 14.76%. ■

In addition to managed accounts, David Vomund publishes the Stock Alert Newsletter, an advisory for stock investing. To receive a free copy of Stock Alert, phone 702-831-1544.

Table 1

1996 Market Timing

-- No Confirmation --			-- Phase Confirmation --		
Buy Date	Sell Date	% Change	Buy Date	Sell Date	% Change
01/16/96	04/03/96	7.80	01/18/96	04/08/96	5.92
04/15/96	04/17/96	-0.14	04/16/96	04/17/96	-0.53
05/08/96	06/07/96	4.42	05/10/96	06/10/96	3.08
07/09/96	08/29/96	0.41	07/18/96	08/29/96	2.15
09/09/96	N/A	11.60	09/09/96	N/A	11.60

Return w/o Confirmation = 25.96%

Return with Confirmation = 23.80%

S&P 500 Return = 20.26%

GROUP ANALYSIS

TESTING 'THE JANUARY BAROMETER' ON S&P INDUSTRY GROUPS

By David Vomund

Many traders look to January as a guide for the rest of the year. According to the *Stock Traders Almanac*, the direction of the market in January correctly predicted the direction of the market for the rest of the year 89% of the time.

Since 1950, the market has followed the January direction of the S&P 500 Index for 41 out of 46 years. Only one very good year — 1982 — followed a January loss.

Does the same hold true for industry groups? We set our Price Change Report to 22 days and ran the report on the Standard & Poor's industry group structure for January 31 for the years 1992 to 1996. This gave us a list of the best and the worst performing groups for the month of January for each year. We then looked at the performance of these groups for the remainder of each year (February to December).

Table 2 shows the results of our study. The percentage change figures represent statistics for February through December. Therefore, the second column in the Table lists the February through December figures for the five groups that performed best during the month of January. The third column lists the February through December figures for the groups that were the worst performers during the month of January.

Table 2

Year	Best January Groups (%)	Worst January Groups (%)	S&P 500 (%)
1992	47.31	9.55	6.59
1993	30.55	-10.07	6.31
1994	5.50	0.92	-4.64
1995	31.59	49.92	30.93
1996*	21.06	24.00	17.25
Five Year Avg.	**27.20**	**14.86**	**11.29**

* Through 12/19/96

We see that the best performing groups in the month of January did outperform the market (S&P 500) in each of the last five years. The best results came in 1992 and 1993. More recently, the groups have only slightly outperformed.

While the results are good for the groups that performed the best in January, the same cannot be said for the worst performing groups in January. In 1993 and 1994, the worst performing groups in January continued to underperform but they performed very well in 1995 and 1996. In 1995, three of the five worst performing groups in January were technology related. By the end of the year, these technology related groups were some of the best performing industry groups.

Five years of study is perhaps an insufficient amount of time to draw definite conclusions, but the results of the study are nonetheless quite interesting. ■

Year-End Index of 1996 Articles

Opening Bell subscribers may obtain a free Index of 1996 *Opening Bell* articles by calling 1-800-332-2999. *Happy New Year.*

GROUP OF THE MONTH

Group 1381A Oil-Drilling

One of the best performing AIQ Pyramid groups for the year was oil-drilling, which gained about 60%. The AIQ Pyramid industry group structure contains groups whose stocks are highly correlated to their industry group indexes. To form this group, we began with the Dow Jones oil-drilling group and used AIQ's MatchMaker to test the correlations of the stocks within the industry group, keeping those stocks that were highly correlated to the industry group index. The group was recalculated and we then ran the resulting oil-drilling group on a database of 1500 stocks, hoping to add more stocks to the group. The result is a group of eight stocks that all show a high correlation to the group index. Table 3 lists the stocks in the group along with each stock's correlation coefficient reading. Coefficients between 500 and 1000 represent high correlation readings.

There were several ways to spot this group as it began its nice advance. The first indication came right at the group's low point in November 1995. The oil-drilling group fell about 15% from September 1995 through October 1995. Despite the fact that there was a good correction, the Money Flow indicator was close to making new highs. Because of the strength of the Money Flow indicator, the oil-drilling group appeared on the bullish section of the Price Volume Divergence report.

As the group advanced, the Money Flow indicator remained strong and in May 1996 the group appeared on the Persistence of Money Flow report. From May to the end of the year, the group advanced 35%. The Price Change reports should also be used to keep abreast of which groups are the best and worst performers. ■

Table 3

Group 1381A
AIQ MatchMaker Weekly Analysis
12/29/95 - 12/30/96

Coef.	Ticker	Stock
829	ESV	Ensco Int'l Inc.
820	HP	Helmerich & Payne Inc.
811	TDW	Tidewater Inc.
766	RDC	Rowan Cos.
707	SFR	Santa Fe Energy Res.
685	PPP	Pogo Producing
661	EOG	Enron Oil & Gas
644	SEI	Seitel Inc.

STOCK DATA MAINTENANCE

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

Stock	Ticker	Split/Div.	Approx. Date
First Midwest Fin'l	CASH	2:1	01/03/97
Sigma Aldrich	SIAL	2:1	01/03/97
Altera Corp	ALTR	2:1	01/07/97
Analog Devices	ADI	4:3	01/07/97
Hayes Wheels Int'l	HAY	2:1	01/07/97
Microchip Tech.	MCHP	3:2	01/07/97
CKE Restaurants	CKR	3:2	01/13/97
Consol. Graphics	COGI	2:1	01/13/97
Longs Drug Stores	LDG	2:1	01/13/97
Fed. Home Loan Mfg.	FRE	4:1	01/13/97
Franklin Resources	BEN	3:2	01/15/97
St. Paul Bancorp	SPBC	5:4	01/15/97
Alex Brown	AB	3:2	01/16/97
Carlisle Cos.	CSL	2:1	01/16/97
Tribune Co.	TRB	2:1	01/16/97
Wynn's Int'l	WN	3:2	01/16/97
Crestar Fin'l	CF	2:1	01/27/97
Donnelly Corp	DON	5:4	01/31/97
Idex Corp	IEX	3:2	02/03/97
Unison Software	UNSN	3:2	02/03/97

Trading Suspended:
Augat Inc. (AUG)

Name/Ticker Changes:
Community Psychiatric Ctrs (CMY) to Transitional Hospitals Corp (THY)
Deposit Guaranty Corp (DEPS) to Deposit Guaranty Corp (DEP)
Richfood Holdings (RCHF) to Richfood Holdings (RFH), OM Group (OMGI) to OM Group (OMP)
AG Services of Amer (AGSV) to AG Services of Amer (ASV)