AIQ Opening Bell® Monthly

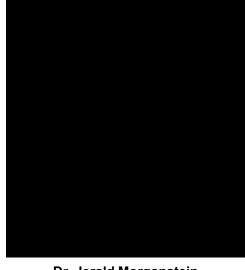**INTERVIEW WITH DR. JERALD MORGANSTEIN**

VALUABLE ADVICE FOR NEW (AND NOT SO NEW) AIQ USERS

By David Vomund

We are pleased to present an interview with AIQ power user Jerry Morganstein. Jerry is a retired doctor who now trades equities and sector funds for a living. He has used AIQ products for more than 10 years and he leads the Naples, Florida, User Group, which is one of the most active in the country. Jerry will present his techniques in two sessions at our fall seminar at Lake Tahoe.

OBM: As a User Group leader, you've talked to new users who struggle with the program. What advice do you give to speed up their learning curve?

Morganstein: It helps to have an understanding of basic technical analysis. That way, you only have to learn how to run the software. Those that know technical analysis are ahead of the game. TradingExpert's manuals are very thorough but intimidating because they are so large. My advice is to just do one section at a time rather than try to master everything at once. The videotapes that come with the software are helpful as well. The more advanced videos that AIQ sells are well

Dr. Jerald Morganstein

worth the price. Those that use myTrack software can get a lot of their questions answered on the Chat Room on Channel 7. Joining a good user group if there is one in the area can be helpful. Finally, attending an AIQ seminar is a wonderful way to learn and network among the AIQ staff and other users.

OBM: What books would you recommend to learn about technical

AIQ Opening Bell

analysis?

Morganstein: *Technical Analysis of the Financial Markets* by John Murphy is a very good book. His book *The Visual Investor* is good for novices. *Trading for a Living* by Alexander Elder should be read as well. A very good book that most people have not heard of is *Technical Analysis: A Personal Seminar* by the New York Institute of Finance. Excellent but more advanced is *Technically Speaking* by Chris Wilkinson. You can purchase these books from Trader's Library at www.traderslibrary.com.

OBM: You lead one of the best AIQ User Groups in the country. What advice do you give to other User Groups to make them successful as well?

Morganstein: We have a definite agenda for each meeting which is published in advance. We try to run a very serious structured meeting, much like a mini seminar. We <u>focus</u> on AIQ topics. It is easy to let a group discuss miscellaneous general information but these "bull sessions" are the downfall of many user groups. We keep our focus on all aspects of the program, covering features that many of the users want to explore.
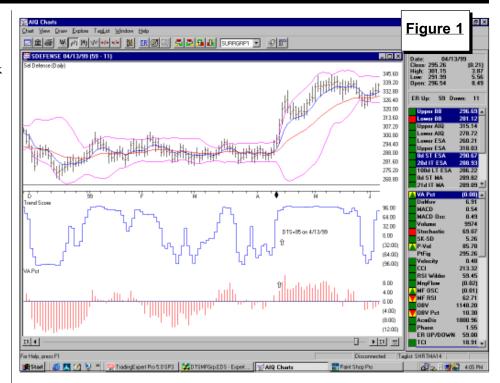
We try to get as many of the

Figure 1

members as possible involved in the presentations. In the beginning I gave most, but last year I gave less than half of the presentations. Some users are initially intimidated but they find that the preparation and study are good learning tools.

OBM: You've tried most of the investment software packages. Why do you choose TradingExpert as your main analysis tool?

Morganstein: I have tried more than 20 different investment software packages. When I started using AIQ's software in the late 1980s, it lacked many of the features that TradingExpert has today. Back then I had to use other packages in conjunction with AIQ. What brought me to AIQ was the market timing signals and the organized reports. No other package had those capabilities. Once the group and sector analysis tools were added, TradingExpert became my most important software package. Now, with MatchMaker, Breadth Builder, Expert Design Studio, and real-time analysis, I've been able to discard most of the other programs. The program really meets my needs better than any other program on the market.

OBM: Because of TradingExpert's group analysis, you place part of your trading portfolio in sector funds while the other part is for equity trading. Can you tell us the advantages of each investment style?

Morganstein: Originally, I traded general growth mutual funds and did quite well with them using AIQ's market timing model. I switched to sector funds when my confidence grew. Sector funds were more risky but I wanted higher returns. Back then, two-thirds of my trading portfolio was in sector funds and one-third was in stocks. The sector portion of the portfolio was the better performer. In the last three years, while the sector trading is still very good, my stock trading techniques have improved so much that the stock portion of the portfolio is now double the sector portion.

The advantage of sector funds is that you can do very well while only requiring about 20 minutes a day. Stock investing can provide higher returns but it requires several hours a day. Being that I'm a short-term trader, I monitor my stocks almost all day. I'm not glued to the screen, but I monitor them nonetheless.

OBM: Do you think sector funds serve as a good vehicle for people to practice with before they trade stocks?

Morganstein: Yes, they are less volatile than individual stocks but more active than general funds.

OBM: In your sector fund trading, you create surrogate groups to represent the Fidelity sector funds and then run AIQ's Group Analysis report on the surrogate group structure. How do you use the Group Analysis report to select attractive sector funds?
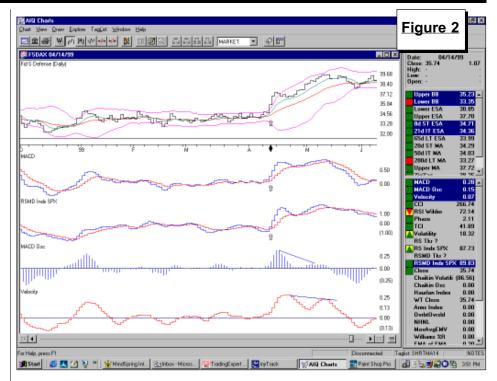
Editors Note: The process of creating surrogate groups was covered in the March 1999 *Opening Bell*.

Morganstein: I create a group structure which represents Fidelity sector funds. In creating this surrogate group structure, I use the ten largest stock holdings of each fund. I then run the daily Group Analysis report on this surrogate group structure in order to identify the rotation of the sector funds.

The most important part of the report is the Delta Trend Score (DTS) readings. You can either search the Group Analysis report for high DTS surrogate groups or you can run an Expert Design Studio (EDS) routine to rank all the surrogate groups by their DTS values. I then follow the groups that have high DTS readings.

Instead of applying price indicators on the surrogate groups, I'll apply them to the actual sector funds. The indicators that I find helpful are the MACD, MACD Oscillator (look for divergences), 14-day Velocity, RSMD SPX, and RSMD OTC. On the surrogate groups, I'll always apply the Volume Accumulation Percent (Vapct) indicator and perhaps other volume-based indicators.

An example of a good trade using this technique is found in the Fidelity Select Defense & Aerospace fund. On April 13 this fund came to my attention because its surrogate group showed a positive DTS reading of 95 (**Figure 1**). Its Vapct indicator turned positive the following day. On April

Figure 2

14 the price-based indicators confirmed the signal (**Figure 2**). Its MACD indicator turned positive and was moving higher. Velocity was above zero and increasing. Most important, the RSMD SPX indicator was moving higher. A few weeks after entering the trade, negative divergences formed in the MACD Oscillator and in Velocity. It was time to move to another sector.

OBM: I just want to verify that you run volume based indicators on the surrogate groups but price based indicators on the actual mutual funds.

Morganstein: That is right. If you plot both the mutual fund and the surrogate group you will see that they match pretty well. When you make a trade, you are buying the fund and not the surrogate group, however, so price based indictors are run on the actual funds.

I should note that I use a similar technique to identify industry group rotation for stocks. I'll look at the groups with Trend Score readings between 25 and 70 and then examine those with the highest DTS readings. I use AIQ's MatchMaker to make sure the stocks in each group are highly

correlated to one another. If a group is attractive, then more frequently I'll buy the stocks that have not participated, especially if the early ones had a large move. Since the groups are highly correlated, the lagging stocks should eventually catch up.

OBM: How many stocks do you have in your database?

Morganstein: I keep about 2500 stocks. More than that increases problems in keeping the data clean each day. If you run a screen on the whole universe of stocks using a criteria of price greater than $20 and an average volume greater than 150,000 shares, then you will get about 1100 stocks. Those are the minimum limits of stocks that I want to trade. The other stocks are in the database to make the industry groups more accurate.

OBM: Does that give you a good mix of NYSE and Nasdaq stocks?

Morganstein: Yes it does. I'll trade both NYSE and Nasdaq stocks. I avoid the Amex stocks. I once went to a seminar where a speaker that I have a lot of respect for said that he avoided
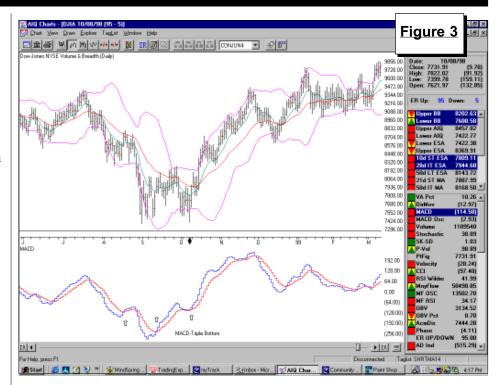
Amex stocks because all the Amex specialists were trained in Sicily! However, since the Nasdaq-Amex merger I have traded the Nasdaq-100 Shares (ticker symbol QQQ) and the SPDRs.

OBM: You're a short-term trader but it sounds like you mostly monitor your trades during the day rather than move in-and-out during the day. Why?

Morganstein: I prefer short term, position, and swing trading. That suits my temperament, which is very important for success. I become a day-trader when my principal protect stops or my profit protect stops force me to close my positions within the same day. Normally my stocks are held for several days. Occasionally, I'll hold a stock for several weeks, which is great because that means the stock has continued to increase.

I'm not interested in trading stocks for sixteenths or small fractions. To do that you have to remain glued to your screen, ready to move at any second, reluctant to eat lunch or use the bathroom. I have done it profitably. But for me day-trading for small moves is strenuous and takes the fun out of the process.

OBM: Would you say that most

Figure 3

of your analysis is on end-of-day data and then you use the real-time data to determine when to place a trade?

Morganstein: That's right. Mostly, I'll perform the analysis at the end of the day but I won't buy a stock the next day until that stock increases. If it gaps up too much, then I'll avoid the trade or follow it for a pullback and a move up again. At times I do an intra-day data update and perform a

scan.

OBM: How important are the Expert Rating signals on individual stocks and on the overall market in your analysis?

Morganstein: Expert Rating signals of 95 or greater up and down on the market (ticker DJIA) are very important. For many years, the AIQ market timing signals were better than anything else available. The narrowness of the market has caused some problems recently. I look at the WAL and US scores on the Market Log report along with support and resistance lines to help fine tune my market timing.

As for stocks, I prefer ER signals of 96 or greater on the buy side. I run some EDS screens that look for multiple buy signals in a ten-day time period. The more buy signals the better. The stocks then need to become confirmed using some of the technical indicators. The Expert Rating down signals for stocks are not important to me. Because the signals are counter-trend, I find that a lot of uptrending stocks register sell signals but continue to move higher. Other methods are used for exiting a stock.

Figure 4

Breakout to 31 day high closing price

PriceVol if [close]>20 and [volume ESA]>1500.

HiVol if [volume]>[volume ESA]*1.5.

HiClose is HiVal([close],30,1).

LoClose is LoVal([close],30,1).

Diff is HiClose-LoClose.

Congestion if Diff/HiClose<=0.2.

GoodClose if [close]>HiClose.

Breakout if PriceVol and HiVol and Congestion and GoodClose.

First if CountOf(Breakout,5,1)=0 and Breakout.

Breakout rule has some repeaters if they increase and do not reach the 20 % limit. The First rule shows them on first day of breakout only.

OBM: What other methods do you use to time the overall market?

Morganstein: With the narrowness of the market, I've created markets using TradingExpert's Breadth Builder function. Markets have been created for the Nasdaq 100, the S&P 500, and the S&P 100. I found that in the past year the signals on the Nasdaq 100 and the S&P 100 have been more accurate than the regular DJIA signals.
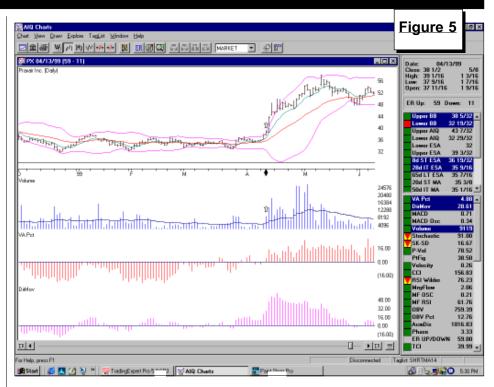
A very effective indicator to watch after a downturn is the MACD. If the MACD is below zero and forms a double bottom then you are likely near a low. The MACD is at its best and it gives very reliable buy signals when the indicator rises above its signal line after forming a double bottom below zero. Last October we actually had a triple bottom while the MACD was below zero (**Figure 3**).

Finally, I have some EDS scans on stocks that can be used for market timing. When the number of stocks that pass one of these scans dramatically increases, as was the case last October, then the market is about to move higher. When few stocks appear, then the market is either heading sideways or moving lower. One EDS scan uses the Larry Connors' Spent Market Trading Pattern (SMTP). Briefly it looks for stocks at a ten-day low. On the day of the low, the stock's daily range must be the largest in the last ten days and the close must be in the upper 25% of the range. Another EDS scan is what I call "Congestion Scan." It looks for stocks that have broken above 30-day consolidation.

Editors Note: The process of creating a market was described in the April 1999 *Opening Bell.*

OBM: Please tell us more about your "Congestion Scan."

Morganstein: This is an EDS scan that I showed at AIQ's spring seminar in Safety Harbor, although it has been slightly revised. It identifies a congestion as a 20% or less difference between the highest close and the lowest close in the last 30 days. I also

Figure 5

put in rules that only accept stocks that are over $20 and have an average volume of at least 150,000 shares. The EDS code is found in **Figure 4**. A 20% variance between high and low prices isn't a very tight congestion. Users can change the parameters of this screening technique as they see fit.

This screening will find stocks in a tight consolidation as well as those with 20% fluctuations. Users therefore need to look at the individual charts to determine which one to trade. I look for support and overhead resistance areas to make sure there is enough room for a decent trade. I also look at Vapct and the stock's relationship to the 28-day moving average.

A good example is found in Praxair Inc. (PX). On April 13, PX broke above a tight consolidation with above average volume (**Figure 5**). It is best when daily volume is at least 50% greater than a 50-day moving average of volume. PX's Vapct indicator just turned positive and its Directional Movement Index was above zero and increasing. You can visually see the tight trading range before the breakout by the narrowness of the Bollinger Bands.

Editors note: Readers can download both the SMTP and Congestion EDS files from AIQ's web page. Go to www.aiq.com. Click on *Educational Products* and then *Opening Bell.*

OBM: I know you plan on revealing several of your techniques at our fall seminar. Would you mind giving us one more technique to work with?

Morganstein: I like the Persistence of Money Flow report. Stocks on this report are typically high quality stocks with good relative strength and solid earnings growth. A very simple technique is to buy these stocks on pullbacks to either the 28-day moving average or to the lower Bollinger Band. As always, never buy the stock until it actually starts to go up.

Excellent buy examples can be seen in VISX Inc. (**Figure 6** on page 6). We see VISX's Vapct indicator is above zero every day in the last six months. That implies that its Money Flow indicator is strong as well. Buying VISX on pullbacks has been a great strategy.

OBM: It sounds like after you

run an EDS screen you always apply judgment to determine which stocks to buy.

Morganstein: I have to use some judgment because I can't code an EDS screen to look for everything (like chart patterns) that I want to check. There are a few scans where I'm willing to buy exactly what the screen gives me but if too many stocks pass the test I cannot buy them all. I use judgment because chart reading works for me.
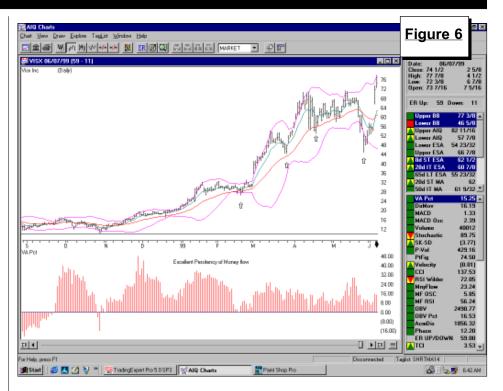
OBM: What are your favorite indicators?

Morganstein: I'm an indicator freak. Over time I've used more than 100 indicators and have coded many others as I see them in various publications. I have tried some very exotic indicators but for the most part very few do anything more than the old standbys. My favorite indicator is Vapct. For divergences, the MACD Oscillator works best. I also use DMI, MACD, RSI, Stochastic, On Balance Volume, 14 period CCI, and 14 period Velocity. These indicators aren't used all together but in various combinations with volume bars.

OBM: Do you use a mechanical sell strategy or do you use some other approach?

Morganstein: For the most part, I sell based on principal protect and profit protect. Good money management techniques are a very important part of being a successful trader. I'll use a minimum principal protect of 94% and a minimum profit protect of 80%. Very often these levels are increased because I try to never take a loss and never want to give back most of my profits. In a few cases, I'll use a trendline or indicator break as sell criteria.

I use a mechanical exit system but there are a few cases where I do some ad-libbing. For example, when I traded several internet high flyers last year for large gains I modified my limits and stayed with them longer. Still, I'd advise most people to stick to a mechanical sell strategy.

Figure 6

OBM: Thank you for sharing your insights with us. We look forward to your presentation at AIQ's seminar in October at Lake Tahoe. ∎

Changes to S&P 500 Index and Industry Groups

(PWJ) PaineWebber Group replaces (BT) Bankers Trust. PWJ added to the InvestBB group.

(WLP) WellPoint Health Holdings replaces (HPH) Harnischfeger Indus. WLP added to HealthMC group.

(NGH) Nabisco Group Holdings replaces (RN) RJR Nabisco Holdings Corp. NGH added to Foodcomp group.

(FPC) Florida Progress replaces (MII) Morton Int. FPC added Electcom group.

(ODP) Office Depot replaces (ASC) American Stores. ODP added to Retails group.

(NTAP) Newtwork Appliance replaces (ASND) Ascend Communications. NTAP added to Computer group.

(BBY) Best Buy replaces (ATI) Airtouch Communications. BBY added to Retailco group.

(VMC) Vulcan Materials replaces (PVT) Provident Companies. VMC is added to a new sector called Construc and a new group called Cementag (Cement & Aggregates).

(AFL) AFLAC Inc replaces (FMY) Fred Meyers. AFL added to the Insurali group.

TRACKING INTER-DAY MARKET ACTIVITY FOR 'EARLY' EXPERT RATING SIGNALS

People often ask if there is a way to get the market timing Expert Ratings before the market closes each day. Knowing if there will be a buy or sell signal would allow traders to make portfolio adjustments without having to wait for the next day's opening price (or closing price for mutual fund traders).

In the past, it was hard to get all the data necessary, such us up and down volume and the number of issues hitting new highs and new lows. With the aid of the myTrack software, we now have access to all the data that is required.

The AIQ market timing model (ticker DJIA) requires the open, high, low, and close on the Dow Jones Industrial Average. Breadth and volume statistics for NYSE stocks are required as well.

To see the data inputs for the market timing model, go to AIQ's *Data Manager*. Type DJIA in order to find the Dow Jones Industrial Average market ticker. Next double-click the DJIA ticker symbol to bring up the *Modify Market* dialog box and click on the *Data...* command button. The data fields appear. This is the screen where we manually enter the data so that we can see the market timing Expert Rating mid-day.

Getting the open, high, low, and close on the DJIA is easy. Simply go to either AIQ's quote screen (Real Time News and Quotes application) or to the myTrack quote screen and enter ticker INDU. The open, high, low and closing data will appear.

The myTrack software is used to get the breadth, volume and new high/new low data. Users of TradingExpert Pro can click on the myTrack icon from AIQ's menu bar. If you don't have the myTrack software, you can download it from their web page at *www.mytrack.com.*

Once in myTrack, click on the *Market Pulse* icon. By default the screen will look at the NYSE exchange and list the most active stocks. Change the NYSE dropdown menu to *Statistics*. A screen similar to **Figure 7**

will appear. This screen lists the breadth and volume statistics required for AIQ's market timing model. In Figure 7 we see the advancing issues is 2016, declining issues is 1141, and unchanged issues is 534. Advancing volume is 592530, declining volume is 269904, and unchanged volume is 35600. The number of new highs is 198 and there are 83 new lows.

Instead of entering myTrack's Market Pulse screen, users can retrieve the data from AIQ's Quotes page. The symbols are listed in Figure 7. For example, the symbol for advancing issues is U.PN, declining issues is D.PN, advancing volume is U.PVN, declining volume is D.PVN, new highs is NH.N, new lows is NL.N.

After typing this data into the *Data Manager's Modify Market* dialog box (see above), we can plot ticker DJIA and see its Expert Rating.

Predicting what the end-of-day Expert Rating will be is never perfect but if you input the market timing data shortly before the market closes you can generally get a good indication of what the rating will be.

On June 29, we manually entered the market timing data 20 minutes before the market closed and saw that AIQ was going to register a 100 buy signal. Getting the signals before the close allows mutual fund traders to place orders the day of the signal rather than waiting until the next day's close. ∎

Figure 7

MARKET REVIEW

In many ways, the market behaves like three-year-old children. Young children seem to be able to focus on one thing. With the market, the focus in the month of June was on interest rates.

Until the Fed had its meeting at month's end, the market was on unstable ground. The AIQ timing model was on a sell for the majority of the month. A 98 sell signal was registered on June 9 and confirmed on the same by the Price Phase indicator.

However, there were more stocks giving buy signals than sell signals. The Market Log report showed that of the stocks giving confirmed signals, 75% were on the buy side. After the

sell signal, market risk appeared to be very high and some selected groups underwent severe selling, but overall the market failed to correct.

On the day before the Fed's decision to raise interest rates, the market timing model went into a buy mode. On June 29, a 100 buy signal was registered. This buy signal was immediately confirmed and more stocks were giving buy signals than sell signals. The Market Log report showed that of the stocks giving confirmed signals, 76% were on the buy side.

As soon as the Fed raised interest rates, the market rallied. On July 1, the S&P 500 rallied to new high ground

and its Point & Figure chart registered a triple-top buy signal.

Despite a terrible second quarter, the Computers-Internet group remains a top performer in the first half of the year, gaining 140%. Other technology groups also performed well. Software & Computers gained 70% and Semiconductors gained 50%. Oil staged a recovery from last year's doldrums. The Oil-Drilling group rallied 65% in the first half of the year.

Weakest groups in the first half of the year were Precious Metals and Tobacco, each falling about 10%. ∎

STOCK DATA MAINTENANCE

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

Stock	Ticker	Split/Div.	Approx. Date	Stock	Ticker	Split/Div.	Approx. Date
Shoreline Financial	SLFC	5:4	07/05/99	Circuit City Stores	CC	2:1	07/16/99
Ameritrade Holdings	AMTD	3:1	07/05/99	Southwest Airlines	LUV	3:2	07/20/99
TriQuint Semiconductor	TQNT	3:2	07/05/99	EchoStar Commun.	DISH	2:1	07/20/99
Monaco Coach	MNC	3:2	07/08/99	Tiffany & Co.	TIF	2:1	07/22/99
Veritas Software	VRTS	2:1	07/09/99	Global TeleSystems Grp	GTSG	2:1	07/22/99
Tommy Hilfinger	TOM	2:1	07/12/99	Ohio Casualty	OCAS	2:1	07/23/99
Brill China Auto	CBA	3:2	07/13/99	CEC Ent.	CEC	3:2	07/26/99
Labor Ready Inc.	LRW	3:2	07/13/99	Salton Inc.	SFP	3:2	07/29/99
QRS Corp	QRSI	3:2	07/13/99	Sonesta Int'l Hotel	SNSTA	2:1	08/02/99
Interpublic Group	IPG	2:1	07/16/99				

Trading Suspended:

Vencor Inc. (VC), American Stores (ASC), Amerin Corp (AMRN), Bankers Trust (BT), Excite Inc. (XCIT), Genentech Inc., (GNE), Getchell Gold Corp (GGO), J. Ray McDermott (JRA), Lawter Int'l (LAW), Meyer-Fred (FMY), Midland Co. (MLA), Morton Int'l (MII), NAC Re (NRC), Nine West Group (NIN), Shelby Williams Ind. (SY), Sunstrand Corp. (SNS)

Name/Ticker Changes:

Brown Group (BG) to Brown Shoe (BWS), Circus Ent. (CIR) to Mandalay Resort Group (MBG)
Crystal Oil (COR) to Crystal Gas Storage (COR), Dave & Busters (DANB) to Dave & Busters (DAB)
Gateway 2000 Inc. (GTW) to Gateway Inc. (GTW), KeySpan Corp (KSE) to KeySpan Energy Corp (KSE)
Nordstrom Inc. (NOBE) to Nordstrom Inc. (JWN), Proactive Technologies (PTE) to Flightserv.com (FSW)
RJR Nabisco Holdings (RN) to Nabisco Group Holdings (NGH), UnionBanCal Corp (UNBC) to UnionBanCal Inc. (UB)