AIQ

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Monthly

PROBLEMS WITH ADVANCE/DECLINE LINE

USE AIQ'S BREADTH BUILDER FEATURE FOR MORE ACCURATE PICTURE OF MARKET'S HEALTH

By David Vomund

DAVID VOMUND

Market breadth has always played an important role in determining the health of the overall market. Market breadth represents the number of stock issues that increase on a given day versus the number of issues that decline on a given day. If there is a large one-day advance in the market but market breadth shows there were as many declining issues as advancing issues, then that is considered bearish for the market. In effect, the generals are marching but the troops aren't following.

Conversely, if market breadth is positive but the market averages are flat, then it is considered bullish.

> *"...the advance/decline data that is provided by data vendors and published in newspapers gives a misleading picture of the market... AIQ's TradingExpert has the capability to calculate market breadth figures that solve the problems..."*

The indicator most widely used to measure market breadth is the Advance/Decline Line.

By plotting ticker DJIA, you will find in the Indicator Panel the Advance/Decline Line that is widely followed by Wall Street. This Advance/Decline Line is published in newspapers such as *Investor's Business Daily* and it is calculated using the same New York Stock Exchange (NYSE) breadth data that is reported in newspapers such as *The Wall Street Journal*.
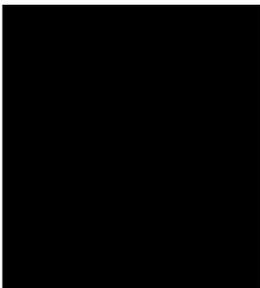
During the summer months, and especially in August, the AIQ market timing model registered several buy

signals, most of them based on positive market breadth. In **Figure 1** it is easy to see why many market timing models were bullish. As the market corrected from May through August, the Advance/Decline Line was very strong and was hitting new highs at the end of August. This indicator was showing a huge positive divergence.

In August, the strength in the Advance/Decline Line implied that the market wasn't as bad as the market averages were saying. It implied that the majority of the stocks were actually increasing. The problem, however, is that this was not the case. If you were to browse through a set of industry groups very few, if any, were actually increasing during this time.

Richard Russell (*Dow Theory Letters*, P.O. Box 1759, La Jolla, CA 92038) wrote an article on why the Advance/Decline Line was giving misleading information. He pointed out "approximately 48% of the NYSE issues are now preferreds, closed-end bond funds, closed-end stock funds, foreign stocks, ADRs, and warrants." Therefore, while the advancing and declining figures

Figure 1

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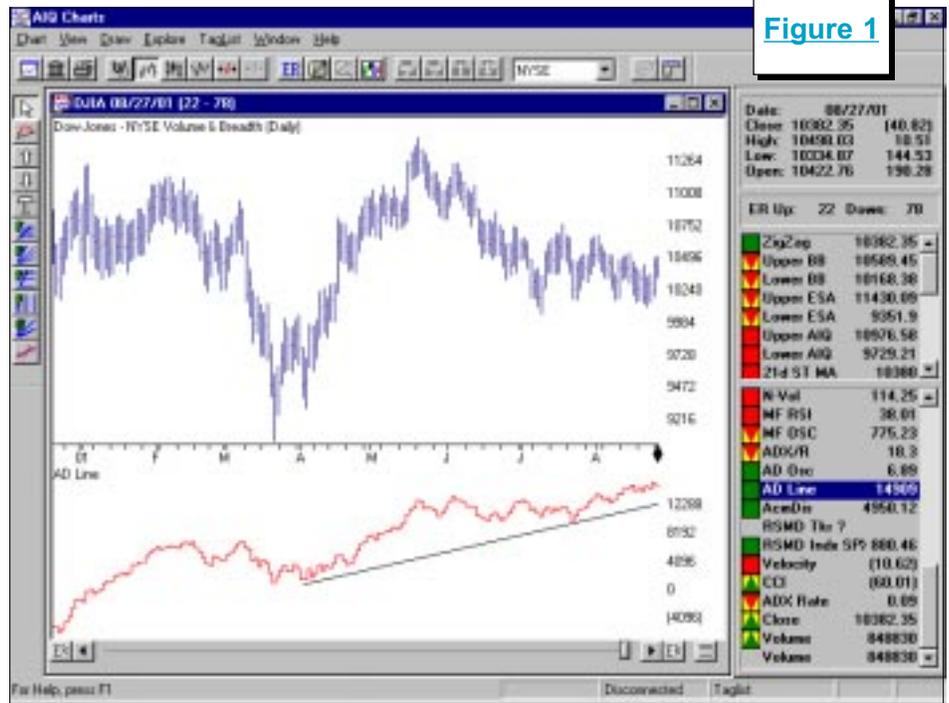
are technically correct, they are misleading because about one-half of the issues represent "irregular" equities.

AIQ's TradingExpert is one of only a few packages that have the capability to calculate market breadth data. Having the software calculate market breadth figures solves the problems with the advance/decline data that is reported from the New York Stock Exchange (NYSE). In our first test, we used TradingExpert to calculate market breadth data based on the 500 stocks that comprise the S&P 500 index. The result is found in **Figure 2**.

Figure 2 shows the Dow Jones Industrial Average along with the Advance/Decline Line calculated

> *"It is important to understand that it is not the (Advance/Decline) indicators that are faulty. It's that the data used in calculating the indicators is distorting their readings. Even a Porsche runs lousy on bad gas."*

from the S&P 500 stocks. You can see a dramatic difference when you compare this chart to Figure 1. While the Advance/Decline Line in Figure 1 was hitting new highs, the Advance/Decline Line based on the S&P 500 stocks in Figure 2 moved dramatically lower and was closer to its lows than it was to its highs. The AIQ-calculated Advance/Decline Line gave a very different, and more accurate, picture of the market's health.

To have TradingExpert calculate market breadth, we use AIQ's Market Breadth Builder feature. To create the Advance/Decline Line based on S&P 500 stocks, go to Data Manager and click *Ticker* and *New*. Enter a ticker symbol to represent the new market (we used ticker *SPMKT*). Click on

Market and *OK*.

On the New Market screen, enter a description for the market. Under Market Breadth Data Source click on *Compute From All Stocks in List* and select *SP500*. Since we chose to plot the Dow Jones Industrial Average with the Advance/Decline Line, for Price Ticker we used the *INDU* default ticker symbol. Click *OK*.

On the next screen, click *Compute It Now*. After completing this process, you can chart the new ticker symbol (in this example *SPMKT*). A more detailed outline on how to use the Breadth Builder function is found in the *AIQ User Reference Manual* beginning on page 49.

In our first test, we found that an Advance/Decline Line calculated on the S&P 500 stocks was very different than the Advance/Decline Line that is widely followed. One explanation is that the well-known Standard & Poor's stocks performed much worse than the average NYSE stock.

To see if that was the case, we

Figure 2
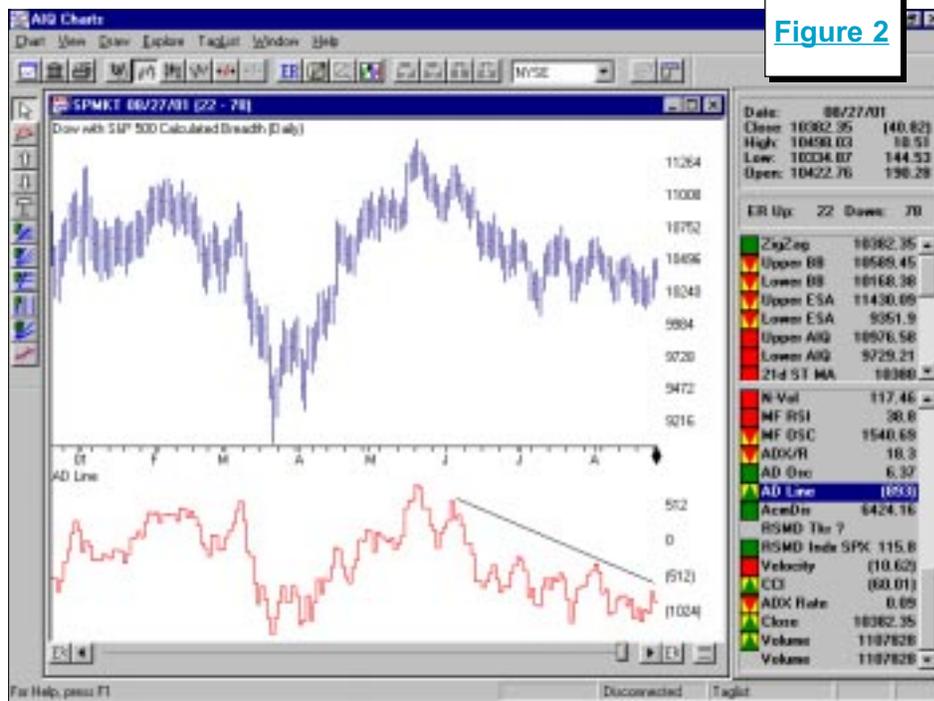
created a market based on about 2000 NYSE stocks. To get the list of NYSE stocks, we first used AIQ's Historical Data CD to install all NYSE stocks. There may be a few preferred issues in this database but not many. To make a List file of the NYSE stocks, we used

the following code in AIQ's Expert Design Studio:

Rule1 if marketcode( ) = "NY".

We ran this rule on our entire database to pick every stock that trades on the NYSE in our database. Then, by clicking the *Chart List* icon on the Expert Design Studio toolbar, we created a List file of these stocks.

With the list completed, we then used Breadth Builder to create a market, this time using our newly created list as the *Market Breadth Data Source*. The Advance/Decline Line using this list of about 2000 NYSE stocks is found in **Figure 3**. Similar to our earlier finding, the Advance/Decline Line does not show an advancing market during the summer months.

We have now found that an Advance/Decline Line calculated on S&P 500 stocks showed that most stocks were declining. An Advance/Decline Line based on 2000 NYSE stocks, while stronger

Figure 3

PROBLEMS WITH ADVANCE/DECLINE LINE   *continued . . .*
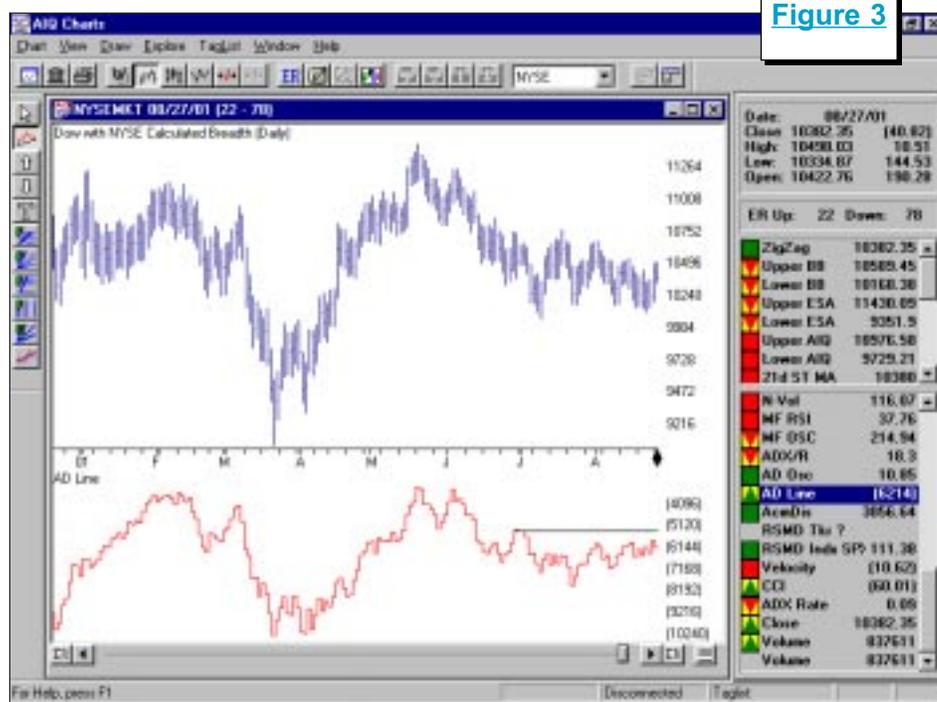
than the S&P 500 stocks, also showed most stocks were declining.

By performing these studies, we can confidently say that the advance/decline data that is provided by data vendors and published in newspapers gives a misleading picture of the market.

While disturbing, it is important to understand the problems associated with the widely used advance/decline data. Nearly every day there are technicians appearing on financial programs that are bullish on the market, citing the strength in market breadth. Their logic is sound but the data used is faulty.

Misleading market breadth data affects the Advance/Decline Line and plays a role in other indicators as well. The TRIN indicator (also know as ARMS) has been cited as being very bullish. After applying this indicator to the market breadth data we created, we see a TRIN reading that is less bullish.

Other indicators that are affected by misleading market breadth data are the Advance/ Decline Oscillator, Advance/ Decline Indicator, Summation Index, and the New High/New Low indicator.

It is important to understand that it is not the indicators that are faulty. It's that the data used in calculating the indicators is distorting their readings. Even a Porsche runs lousy on bad gas.

Hopefully, at some point in the future the standard breadth figures that are reported will exclude the preferred and other "irregular" issues. In the meantime, we must understand and be suspicious of the indicators that use market breadth data.

This problem has always existed but this bear market seems to have exposed the issue. It seems that the high-yielding preferred issues are making the breadth figures look better than what they really are.

Luckily for AIQ users, the TradingExpert software has the capability to calculate market breadth on any List. As we've seen, this can yield extremely valuable information. The Advance/Decline Lines for S&P 500 stocks or for 2000 NYSE stocks reveal a lot about the market's real health. This is information very few people have access to.

AIQ users can download the list file we used for the NYSE stocks by visiting AIQ's web page at *www.aiqsystems.com*. Click on *Educational Products* and then *Opening Bell*. Look at the bottom right section of the screen. ∎

David Vomund publishes VIS Alert, a weekly investment newsletter. For a sample copy of the newsletter, call (775) 831-1544 or go to **www.visalert.com**.

STOCK DATA MAINTENANCE

The following table shows stock splits and other changes:

Stock	Ticker	Split	Approx. Date
Protien Design Lab	PDLI	2:1	10/10/01
Redwood Empire	REBC	3:2	10/22/01

Trading Suspended:

American General (AGC)

AmeriSource Health (AAS)

Bergen Brunswig (BBC)

MP3.Com Inc. (MPPP)

Tosco Corp. (TOS)

XTRA Corp. (XTR)

Name/Ticker Changes:

JetForm Corp. (FORM) to Accelio Corp. (ACLO)

We'd like to hear from you...

Do you have questions about using any of TradingExpert Pro's functions, indicators, reports? Are there specific subjects you would like to see covered in the *Opening Bell* newsletter?

Send your thoughts to:

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UNKNOWN GEMS IN MYTRACK

DISCOVER VALUABLE HIDDEN TOOLS IN MYTRACK SOFTWARE -- THEY CAN HELP YOUR TRADING

By David Vomund

When you install TradingExpert, the myTrack software and quote system is installed as well. To open myTrack, select the MYTRACK icon on AIQ's Main Menu.

TradingExpert is a much more powerful analysis package but myTrack has outstanding features as well. The primary features are well known by many AIQ users, but there are some valuable lesser-known tools in myTrack that are extremely useful.

We have selected five of the myTrack features that AIQ users should find very informative.

Feature #1
Plot an end-of-day chart that is updated through the current price anytime during the day

During the trading day, it is often useful to see an end-of-day chart updated through the current price. In TradingExpert, you can plot real-time charts anytime during the day but if you want to update an end-of-day chart you have to perform an intraday update in Communications (Data Retrieval). That takes time.

In myTrack, you can plot an end-of-day chart that is updated through the current price anytime during the day. Go to the myTrack quote screen, highlight the ticker you want to chart, and right-click your mouse. Select the *AIQ Historical Charting* option and click on the number *1*. A chart

Figure 4

updated through current prices will appear.

The myTrack charts aren't as efficient as TradingExpert charts but you do have the ability to change the number of days plotted. You can plot indictors and

> *"Here are five lesser-known myTrack features that AIQ users should find very informative."*

trendlines as well.

To choose which indicators to plot, right-click anywhere on the myTrack chart and select *Indicators*. Check whichever indicators you would like to use.

To draw a trendline, right-click anywhere on a chart and select *Draw Attributes* and *Trendline*

(**Figure 4**). Click and hold down the mouse where you want the trendline to start and unclick where you want the trendline to connect.

Feature #2

The myTrack program shows when a company plans to release earnings for almost every stock

When you hold a stock or are thinking of buying a stock, it is important to know when the company plans to release its earnings. This is especially true during the first month of a new quarter because the majority of companies release their earnings during this time.

The myTrack program shows when a company plans to release

earnings for almost every stock. To see when a company plans to release its earnings, right-click on the appropriate ticker symbol on the myTrack quote screen.

Choose *Third Party Information* and then *Earnings Calendar*. The next screen shows the date of the scheduled earnings release (see [Figure 5](#)).

It is important to monitor this calendar in the month of October when most companies release their earnings.

Feature #3

To see how news events affect stock prices, use myTrack's quote screen to get extended hours pricing

A lot of news is released after the market closes. To see how news events affect stock prices and the issues you own, use myTrack's quote screen to get extended hours pricing.

On the myTrack quote screen, pick one of the columns and right-click on the title that you want to change. A list of all possible

Figure 5
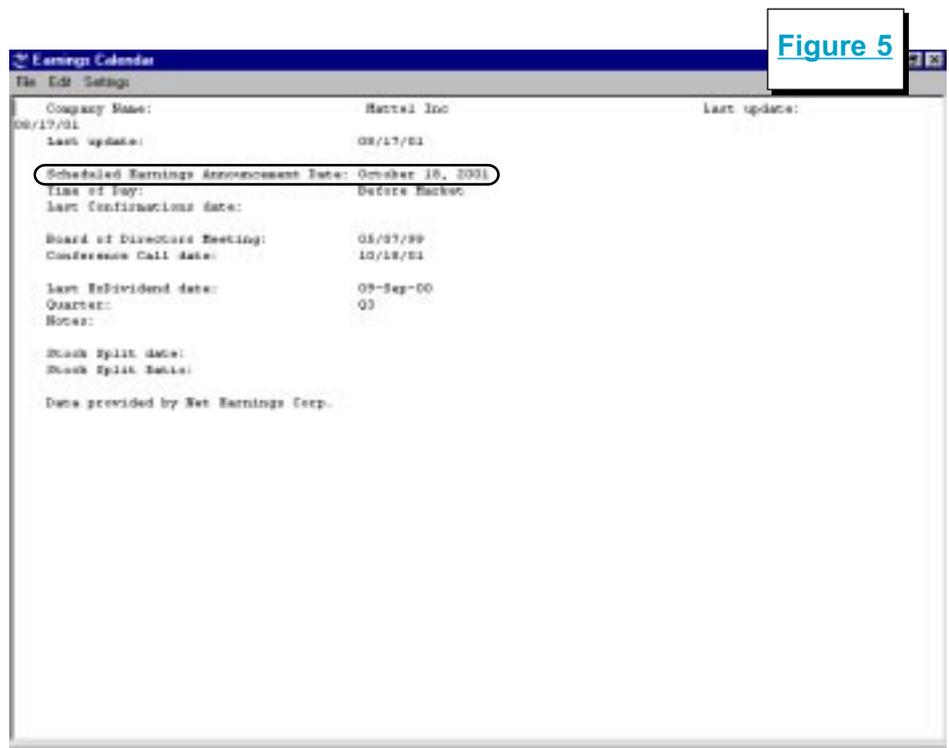
column choices appears.

By clicking on *Last Price-Extended Hours (xLast)* you'll get after hours market quotes. These quotes appear after the market closes and only for Nasdaq stocks.

Figure 6

Feature #4

Find out what type of business a company is involved in or see its financial information

If you ever want to see what type of business a company is involved in or see its financial information, myTrack's Market Guide feature will be useful.

Go to myTrack's quote screen and right-click on the specific ticker. Select *Third Party Information* and then *Market Guide*. The following screen lists the stock's name and ticker symbol along with a paragraph describing its business ([Figure 6](#)).

Feature #5

Obtain useful mutual fund information for specific mutual funds

Thanks to an easy link to *Morningstar*, useful mutual fund information can be obtained for specific mutual funds. On myTrack's quote screen, right-click
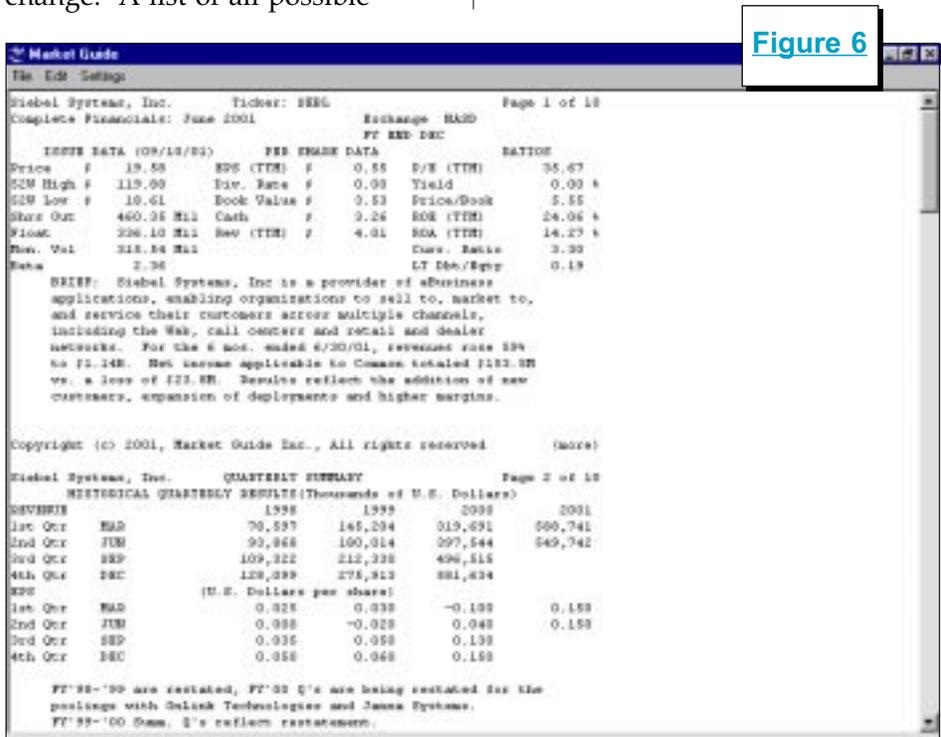
on a mutual fund ticker symbol. Select _Third Party Information_ and then _Morningstar_.

A very informative _Morningstar_ page will appear with information specific to that fund.

Many Other Useful Features in myTrack Software

If you don't have the myTrack software on your system you can download it for free at _www.mytrack.com_. This software package has many useful features in addition to those listed in this article.

Some AIQ users will find the calculated _Implied Price_ column very useful. Others will value the information under _Market Pulse_.

Try experimenting with the software and discover the hidden gems that can help your trading. ∎

S&P 500 Changes

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

XL Capital (XL) replaces Wachovia Corp. (WB). XL is added to the Property & Casualty Insurance (INSURAPC) group.

International Game Technology (IGT) replaces Broadvision (BVSN). IGT is added to the Casino & Gaming (GAMINGL) group.

Immunex Corp. (IMNX) replaces Tosco Corp. (TOS). IMNX is added to the Biotechnology (BIOTECHN) group.

Amerisource Bergen Corp. (ABC) replaces ONEOK Inc. (OKE). ABC is added to the Health Care Distributors & Services (HEALTHSS) group.

The tragic events of September 11 not only undermined Americans' sense of security, they helped push the markets dramatically lower. In all of the 2000-01 bear market, the third quarter and the month of September was the weakest.

In September alone, the Dow fell 11.1%, the S&P 500 fell 8.2%, and the Nasdaq fell 17.0%. The Dow finally fell into bear territory, falling more than 24% from its high while the Nasdaq was 70% off its high.

Unlike previous selloffs where the damage was limited to the Nasdaq, the September selloff was broad-based. Only one industry group, Gold, rose during the month and its gain was only 2%. All other groups lost money with the biggest damage confined to the technology groups. Electronics, Software, Computers, and Networking all lost about 25%. The Airlines group also lost about 25% in September.

For the third quarter, Medical Delivery, Food, and Gold rose about 2%. Once again, technology groups were the biggest losers with Networking and Software groups falling 40%.

Two market timing signals were registered in September. A 99 buy signal was registered on September 5 and a 96 buy signal was registered on September 25. The September 5 buy signal was never confirmed by an increasing Phase indicator but the September 25 signal was confirmed two days later when the phase increased in value.

In **Figure 7** we see how devastating the month of September was. The weekly chart of the S&P 500 is downtrending with the market falling below the lower AIQ band with each strong selloff. The 28-week moving average acts as resistance.

In an _Opening Bell_ interview several years ago, John Bollinger said that many market lows form when the first leg down falls below the lower trading band but a second leg down remains above the lower trading band. That is something to look for in today's market. ∎

Figure 7
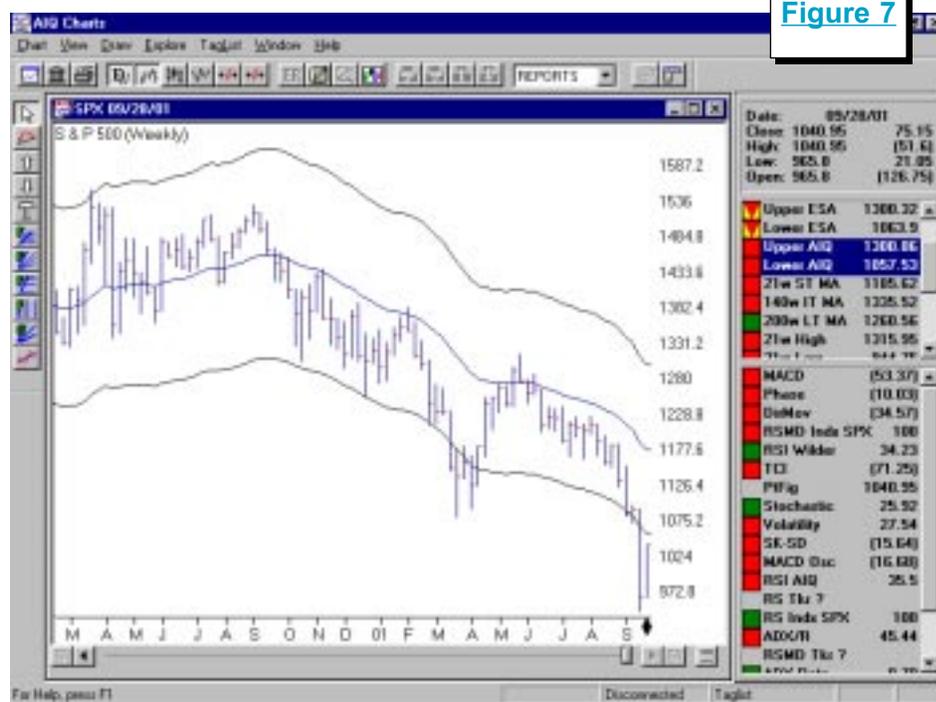
BOOKS ABOUT FAMED TRADER JESSE LIVERMORE PROVE THAT 'SOME THINGS NEVER CHANGE'

Reminiscences of a Stock Operator

Originally published in 1923, *Reminiscences of a Stock Operator* by Edwin Lefevre is a fictionalized biography of famed trader Jesse Livermore. It serves as a history lesson on Wall Street as Mr. Livermore began his trading in the early 1900s at street corner bucket shops. It also reminds us how little has changed in the stock market.

As the book says, "No-where does history indulge in repetitions so often or so uniformly as in Wall Street. When you read contemporary accounts of booms or panics the one thing that strikes you most forcibly is how little either stock speculation or stock specula-tors today differ from yesterday. The game does not change and neither does human nature."

This investment classic is unique because its stories are both entertaining and informative. The book captures a trader's mind so accurately that many consider it to be one of the most useful books on trading psychology ever written.

There is a wealth of knowl-edge in the book that only those who have traded for many years understand. Readers who follow the lessons spread throughout this book can significantly improve their trading.

Here are some of our favorite quotes. The first concerns using news for market timing:

"Any piece of news given out between the closing of one market and the opening of another is usually in harmony with the line of least resistance. The trend has been established before the news is published, and in bull markets bear items are ignored and bull news exaggerated, and vice versa."

Two years ago many people quit their jobs for the easy money of online trading. Here is Mr. Livermore's message:

"Reminiscences of a Stock Operator is one of the most useful books on trading psychology ever written... Readers who follow the lessons can significantly improve their trading."

"People who look for easy money invariably pay for the privilege of proving conclusively that it cannot be found on this sordid earth."

Everybody has losing steaks. Some get depressed. Others have a constructive attitude and learn from their mistakes:

"There is nothing like losing all you have in the world for teaching you what not to do. And when you know what not to do in order not to lose money, you begin to learn what to do in order to win."

Jesse Livermore is a fascinating character. A movie could be made of his life. The unanswered question for readers of this book is what happened to him during the crash of 1929? Did he call the crash or get wiped out?

That question is answered in the next book.

Jesse Livermore – Speculator King

After reading *Reminiscences of a Stock Operator*, readers will want to know more about Jesse Livermore and his life. *Jesse Livermore-Specu-lator King* by Paul Sarnoff provides the information. It turns out that Jesse Livermore's life after *Remi-niscences* was published is even more fascinating than before it was published.

Although there are won-derful insights presented in *Reminiscences*, we learn from *Jesse Livermore-Speculator King* that Mr. Livermore, like many of us, had trouble following his own rules. After accumu-lating great wealth we learn that Mr. Livermore once again fell into bankruptcy. This time it was hard to recover. In 1933 a Securi-ties Bill was put in place, which ended pool operations and stock manipulation. Mr. Livermore's methods were no longer legal.

He was in financial trouble so he decided to capitalize on his celebrity by writing a book detail-ing his trading methods. It didn't sell well. Imagine—an analyst capitalizing on an image of being more successful than he actually is. As we said earlier, some things never change. ■

These and other trading books can be purchased at Trader's Library-- *www.traderslibrary.com* or by phoning 800-272-2855.