AIQ Opening Bell ®

Monthly

AIQ EXPERT RATINGS

THE 16-56 DEBATE -- IS IT A BULLISH SIGNAL?

By David Vomund

For a number of years, there have been AIQ users who use 16-56 Expert Ratings as bullish signals for stocks. AIQ has never endorsed the 16-56 Expert Rating, but every year we find more users who are following this rating (and this was true even before the age of the Internet).

In past issues of the *Opening Bell*, we have reported that testing results showed that the 16-56 ratings were not effective in predicting future price movement. However, AIQ user Nicolas Williams, who was featured in January's *Opening Bell*, claims that the overall number of stocks giving 16-56 readings can be used as an effective tool in forecasting market movement.

Mr. Williams may have a case. Many people rely heavily on the US Score found on the Market Log as a market timing tool (the US Score gives the percentage of stocks giving unconfirmed buy and sell signals). Yet, a test of unconfirmed Expert Rating buy and sell signals on individual stocks shows poor results.

DAVID VOMUND

> *"AIQ user Nicolas Williams (claims that) the overall number of stocks giving 16-56 readings can be used as an effective tool in forecasting market movement."*

Individually, the results of unconfirmed signals are poor. But taken as a whole, as reflected in the US Score, unconfirmed signals work well in predicting market price movement.

Mr. Williams is an avid user of Microsoft Access, the same program we use to calculate our screening reports. In Access, he created a method which counts the number of stocks giving 16-56 readings. Using a database of the S&P 500 stocks, he found it to be bullish when over 100 stocks give 16-56 readings on any given day.

They say a picture is worth a thousand words. **Figures 1** and **2**

provide a very strong case that an aggregate of 16-56 readings is useful in predicting price movement. Figure 1 is a chart of the Dow while Figure 2 charts the number of S&P 500 stocks giving 16-56 readings.

We see that in the two cases where the number of 16-56 readings was greater than 100 (July 96 and April 97), the market made an important low. In September and December, the count moved above 90 and in both cases the market reached a low right after a short term selloff.

The arrows on Figure 1 represent places where there was a market timing Expert Rating signal of 95 or greater at the same time that the number of stocks giving 16-56 readings was greater than 100. Very impressive.

Mr. Williams also likes 16-56 readings on individual stocks when combined with other indicator readings.

When examining 16-56 readings on individual stocks, Mr. Williams likes to use the CCI, Stochastic, and Candlestick readings. He likes to see a stock give a 16-56 rating at the lower end of the Bollinger Bands, especially if it has a bullish Candle-stick pattern.
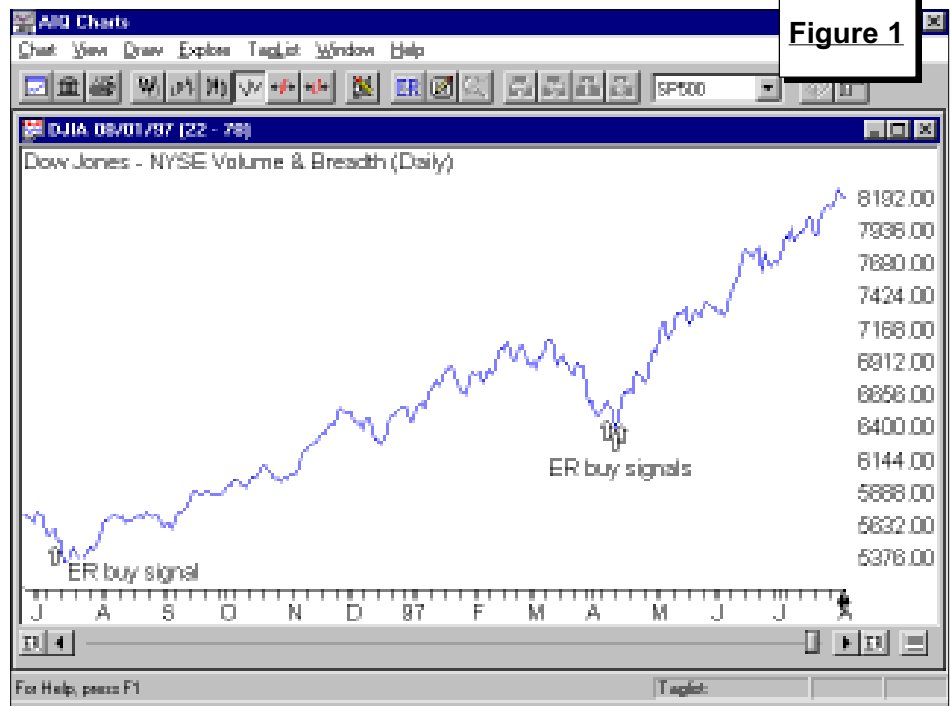
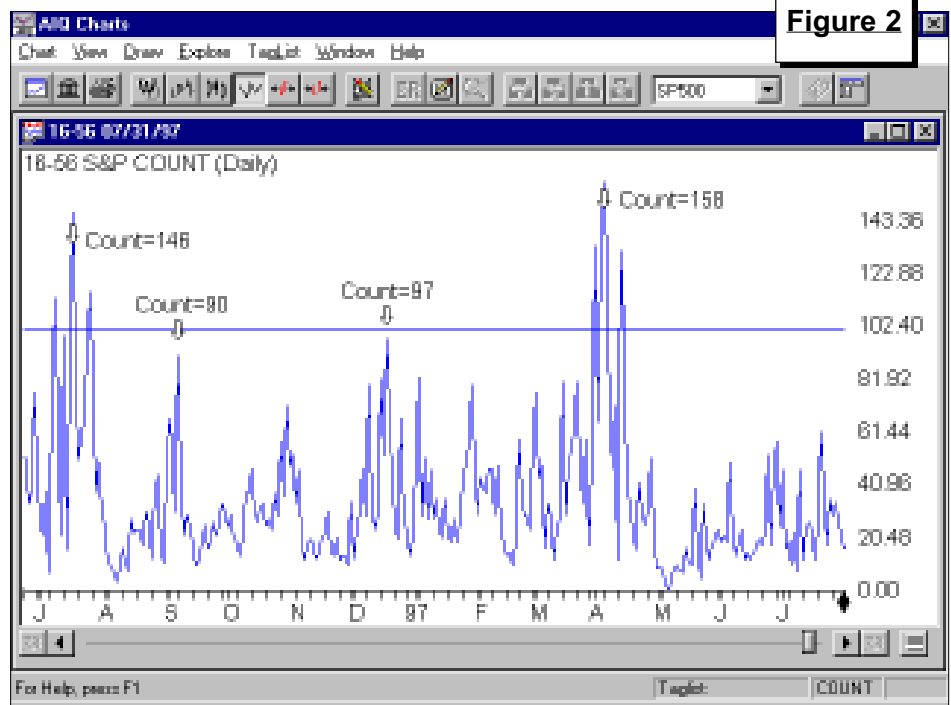When the stock gives a 16-56

Figure 1

Figure 2

reading, he wants the 14 day CCI indicator to move above negative 100 and a 9 day Stochastic to move above 20. An example is found in Sears (**Figure 3**). In late May, Sears moved from the top Bollinger Band to the lower Bollinger Band and hit a support trendline. At the same time,

its Stochastic and CCI indicators reached oversold territory. These indicators gave buy signals about the same time that a 16-56 reading was registered. The stock rallied shortly thereafter.

TradingExpert version 3.0 or greater has the ability to screen for

stocks with 16-56 readings. To accomplish this, go to *Reports*. Under *Settings*, go to *Report Criteria*, then *Daily Stock Criteria*, and highlight the Expert Analysis report. Change the Up ER Value (*EQ*) setting to 16. The next time reports are generated, only stocks with 16-56 readings will appear on the Expert Analysis report.

In the next version of AIQ TradingExpert, we'll have the ability to count the number of stocks giving 16-56 Expert Ratings as well as other Expert Ratings. ∎

Figure 3

MARKET REVIEW

The strong bullish advance beginning in April came to an end in August. During the late spring early summer advance, there were five occasions where the Dow closed at a loss of more than 130 points but the system remained on a buy signal. Activity on August 8 was different. On that day, the Dow fell 156 points and there was enough technical damage to warrant a 98 down signal. On the day of the sell signal, the S&P 500 broke below a support trendline drawn connecting the April and July lows. At the time of the sell signal, there was already a high percentage of stocks giving unconfirmed buy signals.

The market in early August looked very much like it did in March. In both cases, the AIQ timing model gave continuation buy signals near the top. There was a buy on March 7 (a continuation buy from a January 7 buy) and a buy on July 30 (a continuation buy from a March 21 buy). Also in both cases, a sell was registered after a big down day and the

market continued to move lower.

The one major difference between the March and August correction was that in August the broader market outperformed the S&P 500. When the S&P 500 hit its low on August 29, the Russell 2000 was in new high ground. With the broader market outperforming, the correction didn't feel like a correction.

The rotation from large-cap stocks to small-cap stocks is best seen in a weekly chart of the Russell 2000 along with its RSMD indicator (see **Figure 4**). Notice from May of 1996 to May 1997, the RSMD SPX indicator moved lower indicating strength in the large-cap stocks. This sum-

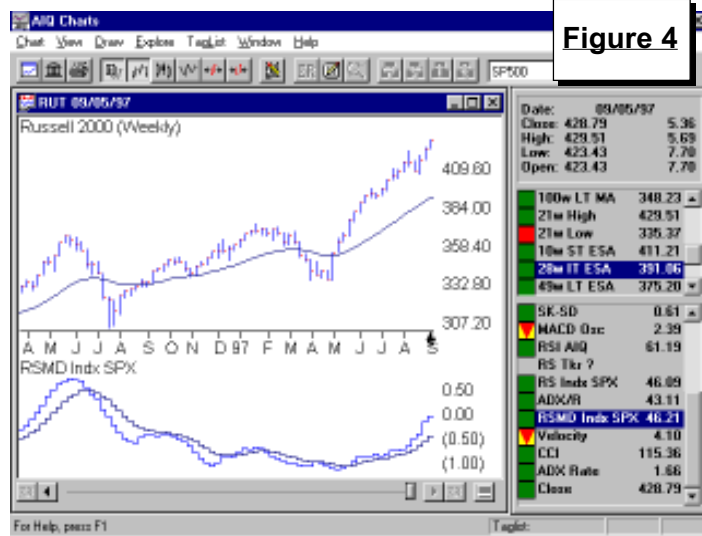**Figure 4**

mer, this indicator made a decisive break above its signal line, pointing toward outperformance in the small-cap stocks.

After the Labor Day weekend, the market staged a strong advance and our timing model gave a 100 buy signal on September 2. This signal was confirmed on that day by the Phase indicator while a high percentage of stocks were registering unconfirmed buy signals. ∎

TESTING THE ACCURACY OF TELESCAN MARKET TIMING SIGNALS

By David Vomund

Given the current market environment, we feel it is important to again address the issue of market timing Expert Rating signals that are generated for people who use Telescan as a data vendor. The market timing Expert Ratings for Telescan users are different than the market timing ratings for those who use Dial/Data or Interactive Data Corp.

This is an important issue since there are times, such as at the end of August, when Telescan users are on a market timing buy signal while Dial/Data and Interactive Data users are on a sell signal. In this article we'll explore why the timing signals for Telescan users are different, and then we'll test their accuracy.

The main difference between the data vendors is that Telescan reports the underline actual high and low values for the Dow (DJIA) whereas the other vendors report the underline theoretical high and low values. Theoretical high and low prices differ from actual price data. The theoretical high for the DJIA is the price that would be reached if all 30 Dow stocks traded at their daily high prices at the same time. The theoretical low price for the DJIA is the price if all 30 stocks were to reach their daily low prices at the same time. The actual high and low price is simply the highest/lowest price that the Dow actually traded on a given day. Since stocks rarely reach their daily high price at the same time, the actual high price for the DJIA will be lower than the theoretical high price. Conversely, the actual low price on the DJIA will be higher than the theoretical low price.

While the actual high and low prices make more intuitive sense, the theoretical values have been the standard. Only in the last few years has *The Wall Street Journal* begun reporting the actual high and low values along with the theoretical high and low values.

All of the research in developing the AIQ Expert System was based on theoretical high and low values. This continues to be our standard. TradingExpert is shipped with market timing data that corresponds to the theoretical values that are reported in *The Wall Street Journal*.

When we list the latest timing signals in the *Market Review* section of this newsletter, we are reporting the signals that are generated using the theoretical high and low values for the DJIA. That is, the signals we

report are the same as those generated when using Dial/Data or Interactive Data.

How accurate are the signals using Telescan data? In the first section of **Table 1**, we list the market timing buy and sell dates along with the percentage change figures for the S&P 500 using theoretical high/low values for DJIA (Dial/Data and Interactive Data). The second section lists the buy and sell dates along with the percentage change in the S&P 500 using actual high/low values for DJIA (Telescan). Expert Rating signals of 95 or greater were used and only the first buy signal in a string of buy signals was considered.

Figure 5

Annual Trading Results For Two Different Market Data Sources

Legend: ▨ Theoretical ■ Actual
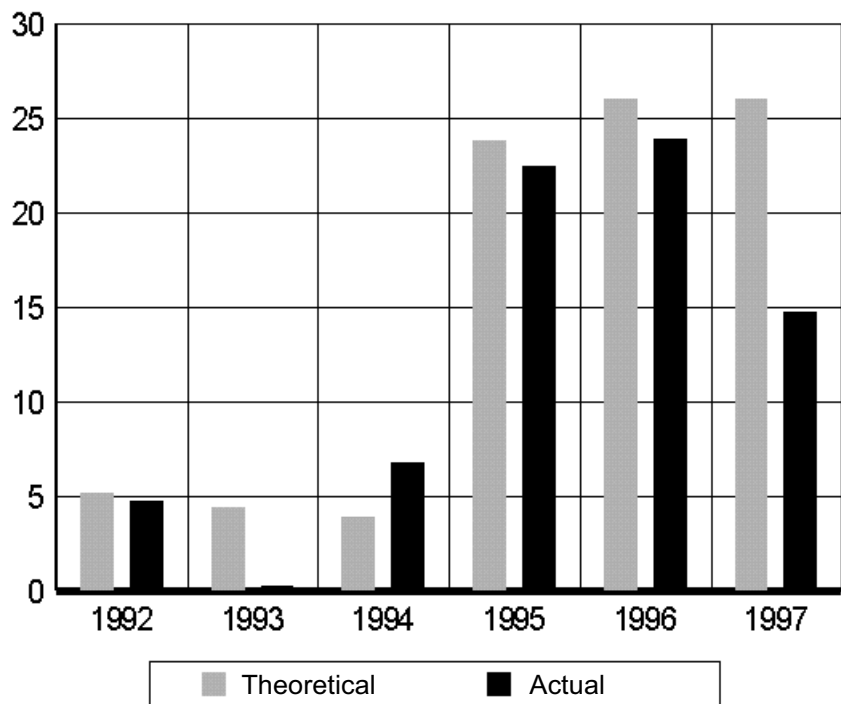
MARKET TIMING *continued . . .*

Table 1

Comparison of Market Timing Signal Effectiveness
Percent Change S&P 500 Index

Theoretical High/Low Values			Actual High/Low Values		
Entry Date	**Exit Date**	**% Change**	**Entry Date**	**Exit Date**	**% Change**
12/31/91	02/24/92	9.87	12/31/91	02/28/92	-1.05
04/10/92	05/15/92	1.43	03/13/92	03/23/92	1.00
05/29/92	06/05/92	-0.45	04/10/92	08/06/92	4.03
06/22/92	07/20/92	2.57	09/02/92	09/08/92	-0.85
07/27/92	08/06/92	2.20	09/10/92	09/17/92	0.00
08/14/92	09/08/92	-1.30	09/18/92	11/04/92	-1.38
09/10/92	09/22/92	-0.67	11/18/92	01/07/93	1.86
09/28/92	12/14/92	3.89	04/08/93	04/20/93	0.74
12/18/92	01/07/93	-2.39	06/24/93	07/02/93	-0.17
01/12/93	02/16/93	0.67	07/06/93	07/21/93	1.30
07/06/93	10/22/93	4.95	10/01/93	10/07/93	-0.46
12/17/93	02/04/94	0.74	12/17/93	02/04/94	0.74
02/28/94	03/24/94	-0.60	02/25/94	03/24/94	-0.37
03/28/94	06/20/94	-0.98	03/25/94	06/20/94	-1.11
06/27/94	08/05/94	2.19	06/27/94	08/05/94	2.19
08/23/94	09/19/94	1.36	08/12/94	09/16/94	2.00
09/26/94	09/29/94	0.31	10/10/94	10/20/94	1.70
10/10/94	10/20/94	1.70	11/25/94	03/07/95	6.60
11/07/94	04/20/95	9.12	04/21/95	07/19/95	8.36
04/21/95	06/16/95	6.16	08/24/95	10/19/95	5.95
08/25/95	10/02/95	3.86	11/16/95	12/18/95	1.59
10/12/95	10/19/95	1.29	01/16/96	03/08/96	4.12
11/16/95	12/18/95	1.59	03/11/96	04/08/96	0.66
01/16/96	04/03/96	7.80	04/18/96	05/02/96	-0.04
04/15/96	04/17/96	-0.14	05/07/96	06/07/96	5.49
05/08/96	06/07/96	4.42	07/09/96	08/29/96	0.40
07/09/96	08/29/96	0.40	09/09/96	01/06/97	12.64
09/09/96	01/06/97	12.64	01/07/96	01/24/97	2.30
01/07/97	03/13/97	4.82	03/07/97	03/13/97	-1.91
03/21/97	08/08/97	19.60	03/21/97	07/18/97	16.73
07/30/97	08/08/97	-1.97	08/18/97	N/A	

Average Gain Per Trade = **3.23%**		AverageGain Per Trade = **2.29%**
Average Holding Period = **48 days**		AverageHolding Period = **54 days**

THE STOCHASTIC IS BEST USED TRADING IN THE DIRECTION OF THE TREND

By David Vomund

The Stochastic indicator, developed by George C. Lane, is designed to give overbought or oversold readings for individual securities or the market as a whole. It works very well in certain market conditions but should be used in conjunction with other indicators (Lane himself does not recommend using only the Stochastic).

The Stochastic is expressed as a percentage on a scale of 0-100. The lower the number, the more oversold the market is. A value below 20 designates oversold territory. A buy signal is registered when the Stochastic rises above 20. The higher the number, the more overbought the market is. A value above 80 designates overbought territory. A sell signal comes when the Stochastic falls below 80.

AIQ uses as the default value the 21 day period that Lane determined to be optimum, but as you become familiar with the indicator you can tune it to fit your trading style. Lengthening the number of days slows the indicator down; shortening the number of days speeds the indicator up.

In a sideways market, the Stochastic overbought/oversold levels tend to coincide with short-term tops and bottoms for the security. Typically, when the Stochastic is above 80 the security is at the upper end of its trading range and when the Stochastic is below 20 the security is in the lower end of its trading range. A good example is found in **Figure 6** (see arrows).

The problem with trading a nontrending security based on Stochastic

For each trade, we held the S&P 500 until the first sell signal of 95 or greater was registered. Since we are strictly testing Expert Ratings, no confirmation technique was used. The test began in 1992, since Telescan switched from theoretical to actual high and low values in mid-1991.

Examining the data, we see that the signals are often in agreement. Both models went bullish on March 21, 1997 and stayed bullish until this summer. There are times, however, when the models are not in agreement. From January 24, 1997 to March 7, 1997, Telescan users were on a sell signal while Dial/Data and Interactive Data users were on a buy signal.

As for accuracy, we see that theoretical high/low values of the Dow work better. The S&P 500 gains 3.23% for the average buy signal using theoretical high and low values with a 48 day holding period. Using actual high/low values, the average signal is 2.3% with a 54 day holding period.

The yearly results of trading the S&P 500 using the different data

	Theoretical Values	Actual Values
Annual Trading Results For Two Different Market Data Sources		**Table 2**
1992	5.22	4.76
1993	4.46	0.27
1994	3.89	6.82
1995	23.80	22.43
1996	25.96	23.84
1997*	25.97	14.77

* Through August 28, 1997

vendors is found in **Table 2** and **Figure 5**. We see that in most years the results are fairly close. The one year where Telescan users had the edge was in 1994. So far this year, however, the market timing model has clearly worked better for Dial/Data and Interactive Data users. Not only is the overall return higher, but there has been less trading activity.

Theoretical high and low values for the DJIA will remain the standard for AIQ and it is the timing signals

from those values that we'll report in the *Opening Bell*. We do monitor both sets of timing signals, however. In all likelihood, the best signals are those where the timing signals are in agreement no matter who the data vendor is.

Overall, the timing signals seen for each data vendor are probably more accurate than the forecasts of most six figure Wall Street professionals! ∎

TOLLS OF THE TRADE   *continued* . . .

readings is that eventually the consolidation ends and a trend is formed. When this happens, you'll typically be on the wrong side of the market. One method of lowering risk is to use the Stochastic on trending securities but only trade in the direction of the trend (i.e., for an uptrending security, only Stochastic buy signals are acted on).

An example of using the Stochastic by trading in the direction of the trend is found in **Figure 7.** Rayonier (RYN) is clearly in an uptrend, moving from $38 to $48 over the five months charted. With this uptrending security, Stochastic sell signals were ineffective but the buy signals were perfect.

We ran a screening technique which searched for stocks that were in an uptrend above their 200 day moving averages and also gave Stochastic buy signals. (The next version of TradingExpert will have this screening capability). We ran the screening at the beginning of the month, looked at the performance of the stocks during that month, then a new report was run.

The results are found in **Table 3**. Using a database of 2000 stocks, the

Figure 6

Figure 7

Table 3

Average Monthly Gains
Screen Derived Stocks

	1996	1997
Jan	3.26	9.15
Feb	4.66	-5.08
Mar	1.52	-4.08
Apr	3.66	2.70
May	3.07	9.72
Jun	-4.13	9.52
Jul	-5.11	8.85
Aug	5.51	0.53
Sep	6.04	
Oct	1.07	
Nov	3.63	
Dec	-1.37	
Average = **2.66**		
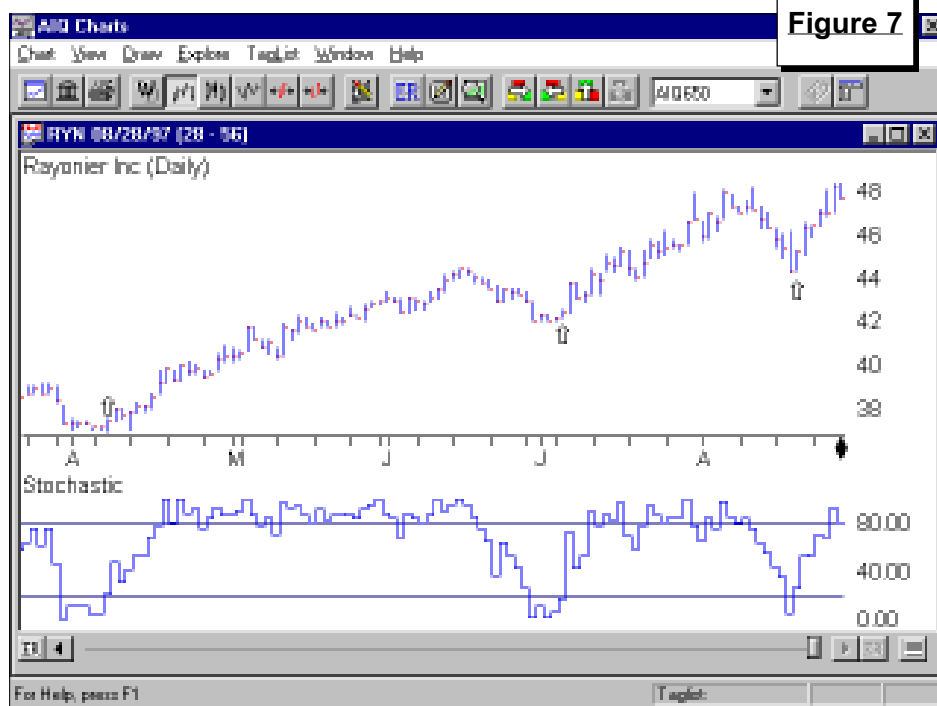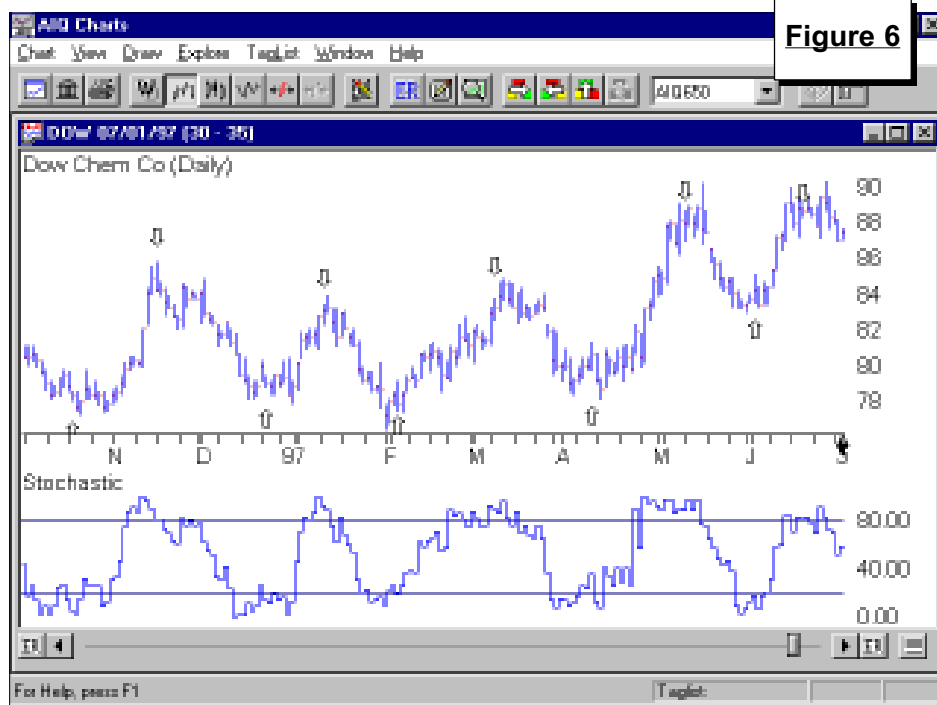
average stock that is above its 200 day moving average and also gives a Stochastic buy signal at the beginning of the month rises an average of 2.66% that month. That sounds very good but the amazing bull run didn't hurt! The 2.66% average monthly return is slightly greater than the average stock's increase.

When choosing another indicator to use in conjunction with the Stochastic, it is best to use an indicator that incorporates volume activity. Since the Stochastic is based on price alone, indicators such as Money Flow, On Balance Volume, or the Positive Volume Index will give readings independent of the Stochastic. ∎

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
Ethan Allen Int.	ETH	2:1	09/03/97	Valley Forge Corp.	VF	3:2	09/17/97
Clorox Co.	CLX	2:1	09/03/97	Guidant Corp	GDT	2:1	09/17/97
DII Group Inc.	DIIG	2:1	09/03/97	Amcore Fin'l	AMFI	3:2	09/18/97
Plantronics Inc.	PLT	2:1	09/03/97	Procter & Gamble	PG	2:1	09/22/97
Ingersoll Rand	IR	3:2	09/03/97	Transocean Offshore	RIG	2:1	09/22/97
Parker Hannifin	PH	3:2	09/08/97	Helen of Troy	HELE	2:1	09/23/97
Allied Products	ADP	3:2	09/08/97	SunGard Data Sys.	SDS	2:1	09/23/97
UTI Energy	UTI	3:1	09/08/97	Tandy Corp.	TAN	2:1	09/23/97
Essef Corp.	ESSF	2:1	09/10/97	Barnes & Noble	BKS	2:1	09/23/97
HBO & Co.	HBOC	2:1	09/10/97	Dolar General	DG	5:4	09/23/97
MedQuist Inc.	MEDQ	3:2	09/10/97	US Industries	USI	3:2	09/24/97
Ambac Fin'l Group	ABK	2:1	09/11/97	Legg Mason	LM	4:3	09/25/97
Cymer Inc.	CYMI	2:1	09/12/97	Anchor Fin'l	AFSC	3:2	09/29/97
Morgan Keegan	MOR	3:2	09/12/97	Harley Davidson	HDI	2:1	09/29/97
Medtronic Inc.	MDT	2:1	09/15/97	Harris Corp	HRS	2:1	09/29/97
Veritas Software	VRTS	3:2	09/15/97	Robert Half Int'l	RHI	3:2	09/29/97
Schwab Charles	SCH	3:2	09/16/97	Texaco Inc.	TX	2:1	09/30/97
Dave & Busters	DANB	3:2	09/16/97				

Trading Suspended:

Duty Free Int'l (DFI), Fort Howard (FORT), Healthsource Inc. (HS), Logicon Inc. (LGN), McDonnell Douglas (MD), Noram Energy (NAE), NYNEX Corp. (NYN), Value Health (VH)

Name/Ticker Changes:

Waban Inc. (WBN) to Homebase Inc. (HBI)

Student Loan Marketing (SLM) to SLM Holding Co. (SLM)

Public Service of Colorado (PSR) to New Century Energies Inc. (NCE)

First Bank Systems (FBS) to U.S. Bancorp (USB)

Atwood Oceanics (ATWD) to Atwood Oceanics (ATW)

James River (JR) to Fort James (FJ)

US Long Distance Corp (USLD) to USLD Communications Corp (USLD)

COMING NEXT MONTH

The October *Opening Bell* will feature a study that examines the best screening techniques for identifying turnaround situations.

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• Michael Burke: timing industry groups with Point and Figure analysis
• Henry Brookins: growth stock investing

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