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Testing Expert Design Studio Rules

Which EDS Pre-Built Rules Are the Most Effective? Our Tests Answer the Question

By David Vomund

When we created the Expert Design Studio (EDS) module, we wanted to enable people to create their own screening models but we also understood that many people do not want to do their own programming. In that regard, over 200 pre-built screening techniques were created, allowing users to simply copy and paste these rules as they build their own models.

Most of the pre-built rules are based on the action of a specific indicator. For each indicator, several rules were created to represent most of the indicator's technically significant actions.

With over 200 pre-built screening rules shipped with every TradingExpert Pro system, the question that most users ask is which of the pre-built rules are the most effective? To find out, we tested each rule over the last six years. The years 1999 through 2004 is a great testing range because it covers up, down, and sideways markets. In this

article, we will report the results of our tests.

Running over 200 tests is an arduous, time-consuming process and we expect few, if any, users have actually completed similar tests. If you create EDS trading systems, then you will want to refer to this article often.

Our tests were run on a database of the S&P 1500 stocks. The tests were run from 1999 through 2004. A fixed holding period of 22 business days (approx-

“Running over 200 tests is an arduous, time-consuming process and we expect few, if any, users have actually completed similar tests. If you create EDS trading systems, then you will want to refer to this article often.”

mately one month) was used. This is a longer time period than what most of the pre-built rules were designed for. For that reason, many of the trading results were very similar and represent simple market activity. For example, a Stochastic buy signal may be significant for a few days after the buy but it is insignificant for the next month. The rules that performed the best were ones

that were designed for longer time periods.

Table 1 shows the 25 most effective rules, sorted by their annual return on investment (ROI). To help identify the pre-built rules listed, we indicate which folders they reside in and give the rule names. The first column of the table displays the name of the folder (or folders) followed by the file name. The second column shows the file name. The third column shows the rule that was tested. Finally the ROI and number of trades are shown.

To find a pre-built rule, open Expert Design Studio (EDS) and select *File, Open*, and double-click the EDS *Strategies* folder. This accesses the folder list found in Table 1. Double-click the appropriate folder name and then highlight and open

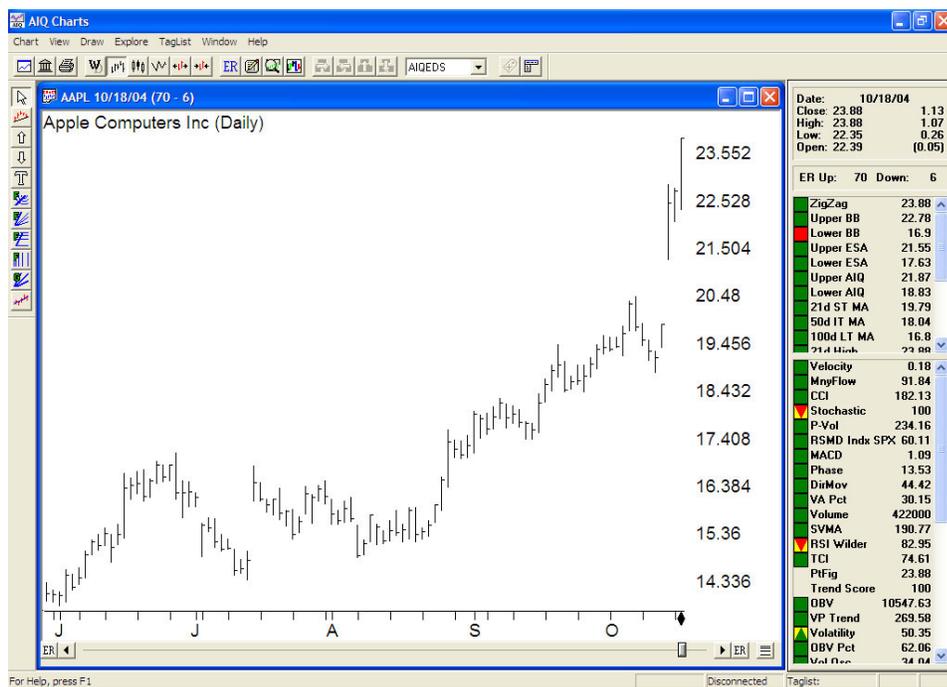


Figure 1. Daily chart of Apple Computer showing stock's price jump in October 2004.

“We are very pleased to see that five of the top ten strategies were models that were created and published in the Opening Bell. These models are standing the test of time.”

the file name. With the file open, the rule will be displayed in the *Rule Library* page of the EDS window.

The average ROI on all the models that were

tested was 21%. Consider that figure to be the return on the market. Results above that figure beat the market while results below that figure under-performed the market.

Please use the ROI as a reference for the effectiveness of the strategy instead of the return that you would actually have seen. The ROI on an EDS backtest does not show the return the model would have made. AIQ's Portfolio Simulator is needed for that task.

We are very pleased to see that five of the top ten strategies were models that were created and

published in the *Opening Bell*. These models are standing the test of time. We'll review these EDS models in an upcoming issue.

Congratulations to AIQ power user Richard Denning, creator of the most effective strategy. It showed an 80% ROI with 1227 trades. See the interview on page five for more information on this model.

Another AIQ power user, Wesley Nevels, created the 10th best rule. This model was designed for one-day trades but it works for longer time periods as well.

“Knowing which are the most effective rules is important. With this knowledge, we can combine some of the effective rules to make new and even more powerful trading models.”

The third most effective rule, Tri Star Doji, had a great return but with only 21 trades. You can't make money with so few trades and it can be ignored.

The fourth best rule, however, has 3078 trades. This rule looks for

AIQ Opening Bell Newsletter

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While the information in this newsletter is believed to be reliable, accuracy cannot be guaranteed. Past performance does not guarantee future results.

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Table 1 - Highest ROI Trades

The following lists the results of testing the pre-built EDS rules using an S&P 1500 database. A fixed 22-business day holding period was used. The testing time period was 1/1/99 to 12/31/04.

Folder/Subfolder	File Name	Rule Name	ROI	# of Trades
Miscellaneous/Opening Bell Strategies	Denning VCR	GoLong	80.43	1227
Miscellaneous/Opening Bell Strategies	December	allworks	66.63	571
Technical Indicator Strategies/Strategies using Candlesticks	Candlestick - Tri Star Doji	TriStarDoji	59.19	21
Price and Volume Based Strategies	Price up 20% on 2x avg volume	Up20	53.50	3078
Price and Volume Based Strategies	Close within a % range of close days back	Close60to70	52.70	8689
Miscellaneous/Opening Bell Strategies	November	allworks	48.38	503
Shorter term strategies/ Hit and Run Trading - Jeff Cooper	Boomer Short	BoomerShort	46.51	1221
Miscellaneous/Opening Bell Strategies	Jun99obm	allworks	46.37	4726
Swing Trading Strategies/ Street Smarts - Linda B Raschke	Turtle Soup plus one	TSPO_BT	42.99	1943
Miscellaneous/Opening Bell Strategies	OBM Dec99	buy	42.41	1890
Swing Trading Strategies/ Street Smarts - Linda B Raschke	Holy Grail strategy	HolyGrail	39.83	24495
Longer Term Strategies/ Strategies Based on AIQ Reports	Volume Trend	VOltrend	37.73	11766
Technical Indicator Strategies/ Strategies using one indicator/RSI Wilder	RSI Wilder in oversold territory	RSIWilderunder30	36.55	15298
Price and Volume Based Strategies	price down 20% on 2x avg volume	Up20	35.52	21392
Miscellaneous/Opening Bell Strategies	OBMdec98	allworks	34.47	812
Technical Indicator Strategies/ Strategies using one indicator/RSI Wilder	RSI Wilder rises from below to above 30	RSIWilderupCUT30	32.46	14747
Technical Indicator Strategies/ Strategies using one indicator/VP Trend	VP Trend slope up while price slope is down	VPTupPRICEdn	32.43	37754
Technical Indicator Strategies/ Strategies using one indicator/ADX	ADX trend in place and Directional Movement Down	ADXupDirMovdn	32.04	19511
Miscellaneous/Opening Bell Strategies	Aprilobm	allworks	31.96	586
Technical Indicator Strategies/ Strategies using Candlesticks	Candlestick - Long Leg Doji	LongLegDoji	31.71	5468
Technical Indicator Strategies/ Strategies using multiple indicators	ADX-RSI	BUY	31.31	3841
Technical Indicator Strategies/ Strategies using one indicator/Exp. Smoothed Avg	Price crosses from above to below the Upper ESA	ESAupperDN	31.24	20659
Technical Indicator Strategies/ Strategies using one indicator/OBV	OBV has reached a new low	OBVnewLO	30.70	16253
Miscellaneous/Opening Bell Strategies	OBM April 2000	Best of Kane	30.49	757

Continued from page 2.

stocks that have jumped at least 20% in the last five days with recent volume being twice its average. That's interesting. These stocks are difficult to buy due to their rapidly rising prices but the test worked well. Apple Computers (AAPL) in **Figure 1** (on page 2) is representative of what these stocks look like.

The fifth most effective rule also chases strength. It looks for stocks that closed 60% to 70% higher than their 40-day high price. Needless to say, the majority of the trades came in 1999 and 2000.

Knowing which are the most effective rules is important. With this knowledge, we can combine some of the effective rules to make new and even more powerful trading models.

In the next issue of the *Opening Bell* we'll reveal the least effective rules using a five-business day holding period. These rules can be used to develop short-selling rules.

MARKET REVIEW

Down in January, up in February, down again in March. The S&P 500 fell 1.9% in March and is off less than three percent this year, but that's not to say things have been dull. Outside of Energy, most stocks fell much worse than 3%. The Nasdaq fell 2.5% in March and is down 8% year-to-date.

Last year's best performing sector remains this year's best performing sector. Energy is already up 15% in 2005. Biotechnology, down 13%, is the worst performing sector.

S&P 500 Changes

There are no S&P 500 changes this month.

Timer Digest National Ranking

Vomund Is Again Ranked One of Top Ten Market Timers

AIQ analyst David Vomund's advisory newsletter *VIS Alert* is ranked as one of the 10 best market timing newsletters in the nation by *Timer Digest* (www.timerdigest.com), an independent tracking service of newsletter market timing performance. Vomund uses unique tools found in AIQ's TradingExpert Pro to achieve this high ranking.

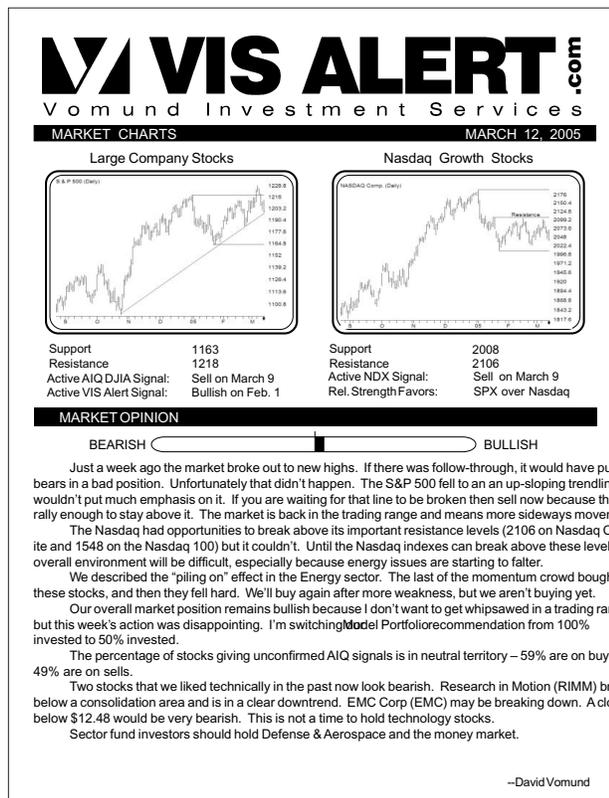
In addition to his work as senior analyst for AIQ and his contributions to AIQ's *Opening Bell* newsletter, David is president of Vomund Investment Services and publisher of the *VIS Alert* advisory newsletter. His market timing performance in *VIS Alert* ranks seventh best in the country by *Timer Digest* for the 10-year time period ending December 31, 2004. Vomund relies exclusively on TradingExpert Pro for his market timing decisions. As the market has changed over the last 10 years, his market timing techniques have evolved. He currently relies heavily on the unconfirmed signal ratio (US) found on the Market Log



David Vomund

report and also on the reading of the Nasdaq's RSMD SPX indicator, an indicator unique to AIQ's TradingExpert Pro.

While others have temporarily held the top timer slot, Vomund takes pride in the consistency of his results. He explains, "an AIQ user once told me that the key to investment success is to understand that you can be wrong, but you can't be wrong for a long period of time. I've been on the wrong side of the market on plenty of occasions, but I don't stay there long."



For information on David Vomund's *VIS Alert* Newsletter, visit www.visalert.com.

Opening Bell Interview with Richard Denning

What's he using now? Creator of EDS Model with Highest Return Shares His Ideas for New Systems

Richard Denning, a CPA, has been investing since 1973 and has been an AIQ user since 1987. He is an active member in an AIQ chart forum at www.yahogroups.com. This interview with Denning was conducted by David Vomund.

Vomund: In our test of all the pre-built models that come with AIQ, you created the one with the highest back-tested return (VCR model). Congratulations. You first discussed this model in the September 2001 Opening Bell. Would you please remind us what this model is screening for?

Denning: My original idea was based on trying to capture a volume climax situation where traders are panicking to get out of a position

“Most of my ideas for systems come from books and magazine articles or from dialogue with other traders including some of the discussions on the AIQ Yahoo groups email lists.”

and the shares are being dumped at any price (or are being acquired in panic buying frenzy). The characteristics are a large volume increase coupled with a rapid rate of change (either up for a short sale, or down to take a long position). I think you only tested the long side of the system. The short side is not as profitable as the long side. As part of the system, I created an indicator to help identify these situations.

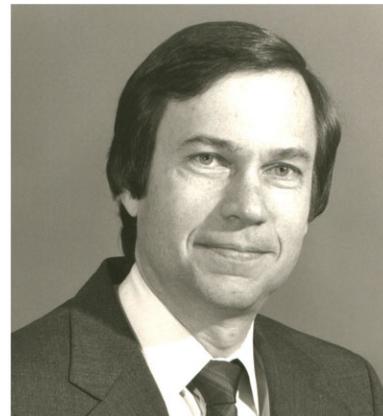
Vomund: How did you come up with the idea of creating that screening technique?

Denning: Most of my ideas for systems come from books and magazine articles or from dialogue with other traders including some of the discussions on the AIQ Yahoo groups email lists. This system was based on Ed Downs' book, *Seven Chart Patterns That Consistently Make Money*.

Vomund: You prefer mechanical systems and I'm sure you've developed several more EDS models. Is your VCR model still in your trading arsenal or are you using newer and even more effective models?

Denning: I don't currently trade this system and I only traded this system and others like it for a short period of time. There are a number of problems with this type of system. Actually, the test you ran is not the original system that was in the September 2001 *Opening Bell* since you have changed the exit to a fixed 22 days. In changing the exit you may have created a much better system than the original! I will have to revisit this system and run some new tests. The original system had a very different and shorter-term exit and used pyramiding of positions.

One of the problems with this system is that it is attempting to catch a falling knife and the first entry is not always at the bottom of the fall so the pyramiding helped to



Richard Denning

get a better average entry price. This system is very hard to trade because of the falling knife issue – it's hard to pull the trigger and buy into a panic selling situation. Also the pyramiding of positions goes against the rule of averaging down – its Martingale type of position sizing. Generally I have found that Anti-Martingale position sizing is better at controlling risk. By holding for 22 days you have solved the problem of averaging down since you are only buying one position.

The other two problems with this system are the possibility of large drawdowns and the tendency for the signals to bunch together during periods when the whole market is dropping. By using EDS to compute an average return, the result can be very misleading because in real trading capital limitations limit the number of positions per day and many of the best trades are missed.

A more realistic test is to use the AIQ Portfolio Simulator and then look at both the returns and several other metrics for risk like the Sigma, the peak to valley drawdown, the Sharpe ratio, the Reward / Risk, and the average annualized return / maximum peak to valley drawdown.

The models I currently trade are more effective from the standpoint of minimizing risk. At least that is my objective. One of my main objectives in developing new models is to minimize the maximum drawdown. I have had the experience time and time again that as soon as you start trading a new system, it immediately goes into a drawdown and when this happens the first thought is that the system is broken, it's overly curve fitted, and shouldn't be traded. So the smaller the probable drawdown, the more likely the system will continue to be traded.

Vomund: How do you determine when to stop trading one model in favor of another?

Denning: This is a difficult question to answer since it's partly science and partly "seat of the pants." I am constantly looking for new ideas or better ways of developing old ideas into new systems. Each system has to fit into a grid and I will look at how my current mix of systems is fitting into the grid for diversification purposes.

If I develop a new system but I am already trading two systems that fall in the same grid square, I am not going to trade three system within the same grid (unless two are long and one is short) so at least one has to go. The new system would have to have better risk and better return metrics to kick out one of the systems currently being traded.

It's also "seat of the pants" based on how it "feels" to trade the system. If it doesn't feel good to trade it, then it is much more likely to get

	Penny	Small cap	Mid Lrg HV	Lrg LV	Groups & ETFs
<5 days	XXXXX	XXXXX	3 (stk) 1 (idx fut)	XXXXX	XXXXX
>5 <18 days	XXXXX	XXXXX	2 (stk) 1 (idx fut)	XXXXX	0
>17 < 50 days	XXXXX	1	XXXXX	XXXXX	1 (grp-uc)
> 50 days	1	0	XXXXX	0	1 (grp-uc)

replaced by a new system.

The grid I use groups systems into categories based on time frame and market segment. When I build a system, I first determine the objectives of the system, including the time frame and the market segment that it will trade. For time frames I have four categories based on holding periods:

- 1) Short term – day trading up to 5 days
- 2) Intermediate swings with holding periods of 5 to 17 days
- 3) Intermediate term trend following of 18 to 50 days
- 4) Long-term trend following of over 50 days

For market segments, I categorized the systems between A) small cap, B) penny stocks under \$10, C) mid and large cap with above average volatility, D) large caps with lower volatility, and E) stock groups including ETFs and mutual funds. The grid shown above would then have 20 squares and to be completely diversified you might try to have one system in each square, but many of the squares can be blocked out.

The squares in the grid with XXXXX indicate I do not feel this is a category worthy of a system. For example, penny and small cap stocks are rather illiquid and because of high slippage should not be traded in the shorter time frames. Large (lrg) low volatility (LV) stocks won't make large enough moves in the short time frames while high volatility (HV) stocks and index futures (idx fut) are harder to sleep with on the longer time frames. Groups, ETFs, and mutual funds have a greater tendency

to trend than individual stocks so these are best suited for longer-term trend following.

I am currently trading eight systems; six are long and two are short. The numbers in the above grid indicate how many systems I am currently trading or are under construction (uc) in each cell.

Vomund: Do you periodically review your past models to see their performance?

Denning: I have some of the past models set up as standard simulations that I rerun every several months along with the ones currently being traded. I am most interested in how the simulations compare to my actual trading and also to see if I can improve the mix of systems being traded by switching a system within a category. TradingExpert Pro's Portfolio Manager module has a feature that allows graphing the equity curves of the simulated and actual trading together on the same graph.

Vomund: Would you mind sharing another one of your EDS models with us in an upcoming issue?

Denning: I would be happy to share my thoughts in an upcoming issue on some of the trend following models that I am working on for the longer-term group trading, as well as review the VCR model in depth using some risk metrics and portfolio simulations. Thank you for asking.

Vomund: Excellent. Thank you.

Richard Denning can be reached at richard.denning@earthlink.net

Now Available -- Updated Version of the Group Pyramid, AIQ's Industry Group Structure

The AIQ Group Pyramid, an industry group structure that is classified on both a fundamental and technical basis, has been updated and the new version is now available.

Most industry group structures are classified only on the basis of fundamentals – stocks with comparable products are placed into an industry group. AIQ has taken it a step further by performing a technical test to ensure that all the stocks in each group are behaving similarly with respect to price action.

The AIQ MatchMaker program is used to test the correlation of the stocks within an industry group to its industry group index. Only stocks with high correlations are kept in their respective groups. Only those stocks that fit on a technical and fundamental basis are added. The industry group index then becomes a better representation of the underlying stocks.

An example of a MatchMaker output for an industry group is found in **Figure 1**. The correlation values are shown to the left of the ticker symbols. A value of zero represents no correlation and 1000 represents perfect correlation. Values above 500 show strong correlation.

The AIQ Pyramid structure is primarily designed for investors who use a top-down approach (i.e., they analyze sectors and groups and then find attractive stocks within the bullish groups). The structure has 1,347 stocks classified into 159 groups and 23 sectors.

The AIQ Pyramid sells for \$188. If you are a registered owner of a previous version of the AIQ Pyramid, you can purchase the newly updated version for \$44.

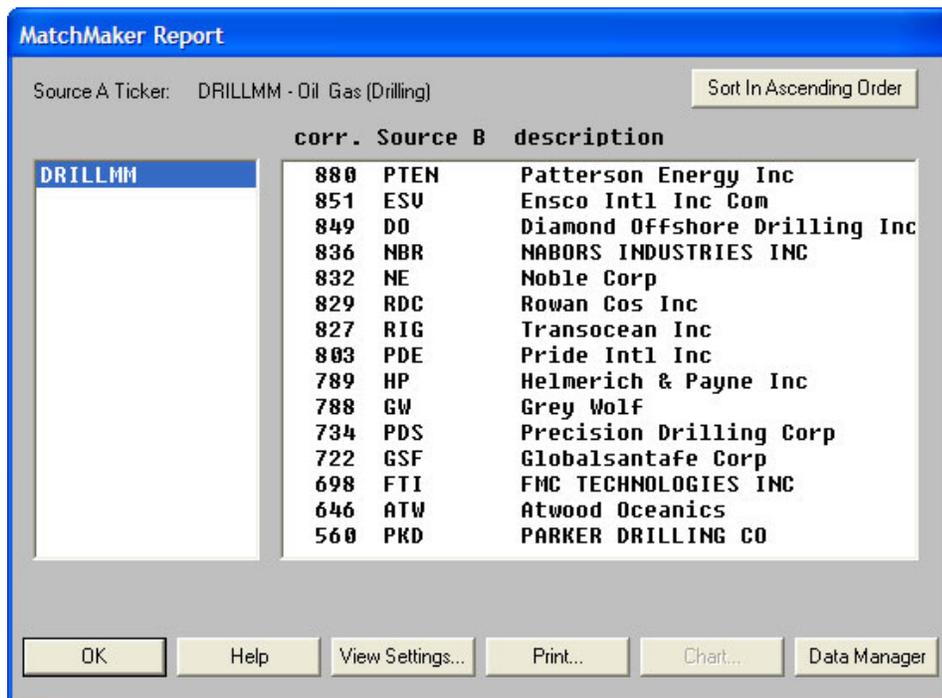


Figure 1. AIQ MatchMaker Report screen listing correlations for Oil & Gas Drilling group stocks.

If you are interested in ordering the Pyramid or an updated version, call your AIQ sales representative at 800-332-2999.

STOCK DATA MAINTENANCE

The following table shows stock splits and other changes:

Stock	Ticker	Split	Approx. Date
Temple Inland	TIN	2:1	04/04/05
Weyco Group	WEYS	2:1	04/04/05
Coach Inc.	COH	2:1	04/05/05
Comtech Telecom.	CMTL	3:2	04/05/05
Take-Two Software	TTWO	3:2	04/12/05
Magellan Midsteam	MMP	2:1	04/13/05
Toro Co.	TTC	2:1	04/13/05
Tootsie Roll	TR	3%	04/15/05
Americas Car Mart	CRMT	3:2	04/15/05
Staples Inc.	SPLS	3:2	04/18/05
Engineered Support	EASI	3:2	04/18/05
Sportman's Guide	SGDE	3:2	04/18/05
Cheniere Energy	LNG	2:1	04/22/05
Cincinnati Fin'l	CINF	5%	04/27/05

Trading Suspended:

Atlantis Plastics (AGH), EMOI Inc. (EMP), Ionics (ION), MSC. Software Corp. (MNS), WHS Corp. (WHX), Winn-Dixie Stores (WIN)

Name Changes:

Nautilus Group Inc. (NLS) to Nautilus Inc. (NLS)
 U.S. Restaurant Properties (USV) to Trustreet Properties Inc. (TSY)
 Vista Medical Technologies (VMTI) to iVow Inc. (IVOW)



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Topics

Topics

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Many investors have some form of trading strategy that they adopt for their investing. In this session Steve Hill will discuss

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- How to take your trading ideas and formalize them.
- How to take a strategy through a vigorous back testing and portfolio simulation process.
- The common mistakes that can be made when evaluating the effectiveness of a trading strategy.

Becoming a Successful Trader:

In his presentation, David Vomund will discuss what successful traders need to know about the market. He will show how trading models are created using the AIQ software and will discuss some pitfalls that one can fall into in creating a system. Finally, he will highlight the system he uses for longer-term Exchange Traded Fund (ETFs) trading.

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