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Opening Bell Interview

Interested in Trading ETFs? Here's Some Valuable Advice from 'Market Wizard' Linda Bradford Raschke

By David Vomund

This month we are pleased to present an interview with Linda Bradford Raschke. She is featured in Jack Schwager's book, *The New Market Wizards*, and co-authored the best selling book *Street Smarts - High Probability Short Term Trading Strategies*. Our interview focused on methods for trading Exchange Traded Funds (ETFs).

slower movers.

ETFs are so broad and encompassing that they can be classified into two groups. A small number of ETFs are heavily traded and



Linda Bradford Raschke
President of LBRGroup, a CTA firm that manages money in both futures and equities.

very liquid, such as Spyder (SPY) that tracks the S&P 500, but most aren't liquid enough for active day-trading. Many global and sector ETFs might only trade 50,000 shares a day.

The vehicle you choose to use for day-trading depends on your execution platform, your commission structure, and your objectives. I know people who successfully trade the Spyder (SPY), but most professional day-traders will choose the E-mini S&P Futures instead because of the greater leverage.

The advantage of ETFs is that they cover such a broad spectrum. They allow investors to easily buy equities

"ETFs allow investors to easily buy equities from many countries or individual sectors. And because an ETF contains a basket of stocks, one bad apple is usually offset by the other stock holdings. When you trade a basket of stocks, you'll do better trading a longer time frame as opposed to a shorter time frame."

Vomund: Is it worth day-trading ETFs?

Raschke: In my opinion, no. There are far better vehicles for day-trading. Either futures or higher beta stocks are better. The problem is that few ETFs have the volume and liquidity for fast and effective execution, and the ones with sufficient volume tend to be the

from many countries or individual sectors. And because an ETF contains a basket of stocks, one bad apple is usually offset by the other stock holdings. When you trade a basket of stocks, you'll do better trading a longer time frame as opposed to a shorter time frame. Longer time frame charts show smoother price movement and less noise.

Vomund: So professional day-traders typically aren't interested in trading ETFs. How about the trading investor? By that I mean someone who doesn't follow the market throughout the day but places trades with a holding period of several days to a few weeks.

Raschke: The more volatility and liquidity an individual market has, the shorter the time period that you can trade and use for your analysis. With ETFs, I'd use daily and weekly charts exclusively, and turn off the real-time charts. If you placed an order on many of the foreign market ETFs, you might as well execute the order on the open or the close because these ETFs don't trade much throughout the day.

Still, whether you use intra-day



Figure 1. Weekly chart of iShares Japan fund with Momentum indicator plotted in lower window. Time period is 2000 through 2005.

charts or weekly charts, you always go through the same process of determining if you should be a buyer or a seller, determining support and resistance, determining the trend, determining consolidation points, etc. The foreign ETFs were some of the best investment vehicles last year.

Vomund: What methods do you use to time your entry points?

Raschke: Because ETFs hold baskets of stocks and are more diversified than individual stocks, they respond very well to simple chart analysis. I believe that there are no more powerful tools than the techniques that have been written about in classic technical analysis literature. I trade the basic chart patterns like the triangle. I trade breakouts, and I trade pullbacks after breakouts.

This is simple stuff but it is all that is needed to be successful, and it eliminates a lot of the noise in the market when the techniques are applied correctly. Watch the previous swing highs and swing lows as

“With ETFs, I’d use daily and weekly charts exclusively, and turn off the real-time charts. If you placed an order on many of the foreign market ETFs, you might as well execute the order on the open or the close because these ETFs don’t trade much throughout the day.”

well as the length of the swings up and down when timing entries.

Vomund: Can you give some examples?

Raschke: Sure. Because it has had lots of movement, let's look at the weekly chart of iShares Japan Fund (EWJ) (**Figure 1**). It is easy to notice that during 2000-03 all the major swings were greater to the downside than the upside. Notice the lower highs and lower lows.

Within this time period there

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was a drop in 2001, followed by a reaction move to the upside (point 1). Since the trend is down, traders should short into this reaction. A second leg down ensued in 2001 followed by another reaction up. The reaction was also a classic ABC type move (rallies to point A, falls to a higher low in point B, and rallies above point A for point C) with a classical momentum divergence on the way up (see trendline on momentum indicator). This is one of the best shorting signals that you can get.

The last leg down had a clear loss of momentum, as the drop was not as great as the second leg lower. As a result, a positive divergence forms in the momentum indicator. That is, the oscillator made higher lows.

Then in June/July 2003 there was a very sharp spike up. This was the first swing greater in the opposite direction than the previous downswing. As it was much greater than the previous swing high, the summer swing high showed that the market had changed its character. You now switch from shorting reactions to buying pullbacks.

Beginning in the summer of 2004, EWJ began to drift. After the breakout from the triangle, you can see at point 2 that momentum made new highs confirming the breakout. An uptrend was in place so traders should now buy the pullbacks.

Weekly charts display longer-term moves and, as they filter out a lot of the market noise, they tend to show smooth and consistent swings. They are very easy to read but their analysis will not provide many trades. More active traders can perform the same style of analysis on daily charts.

Looking at the daily chart (Figure 2), EWJ drifted sideways for about a year before activity increased in August 2005. In the months preceding August, there was a classic contraction in volatility,

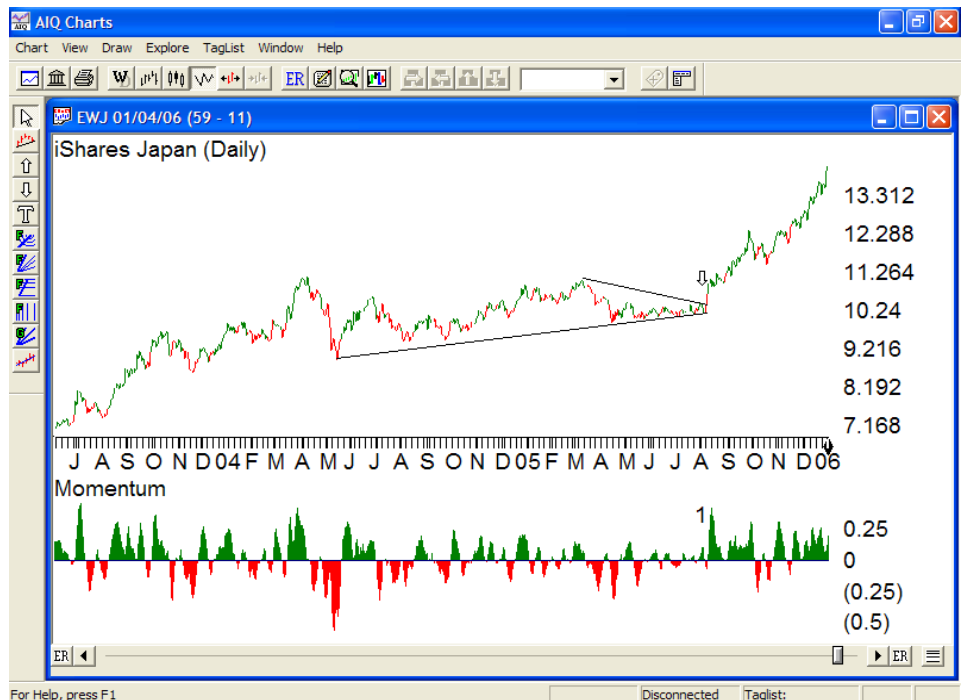


Figure 2. Daily chart of iShares Japan fund with Momentum indicator plotted in lower window. Arrow points to upside breakout from triangle pattern and corresponding increase in momentum.

demonstrated by the converging trendlines. Every good breakaway from a low volatility point will have either a gap or a large range increase with increasing volume. With EWJ, there was a large gap on August 10 with heavy volume. If you don't see the start of the uptrend on the chart you certainly will on the momentum indicator (point 1), where the oscillator far exceeded its previous high points. Daily chart traders can begin to trade the pullbacks after this new momentum high.

It is important to choose ahead of time what side of the market, long or short, you will play. That's how you work most efficiently. In the case of the Japan Fund, you look to short the reactions until mid-2003, and then you look to buy the pullbacks once the trend has changed.

You don't want to work both sides. Instead, work the side with the most potential gain.

Vomund: Taking advantage of pullbacks against the overall trend is

“Because ETFs hold baskets of stocks and are more diversified than individual stocks, they respond very well to simple chart analysis. I believe that there are no more powerful tools than the techniques that have been written about in classic technical analysis literature.”

an important part of your strategy. Is there a certain moving average that you like to see the security pull back to?

Raschke: Moving averages can be tools for your eye to spot pullbacks but there isn't an optimal moving average that works best. I use a 20-period exponential moving average as a default, though.

Vomund: At what point during a reaction against the overall trend

should you enter a trade?

Raschke: That depends on how aggressive or conservative a trader you are. An aggressive trader might initiate a small-scale entry if he perceives a slowing of the reaction whereas a conservative trader should wait until the market starts to turn back toward its trend. It also depends on the liquidity of the security. In a less liquid market, a trader will get a more advantageous price entering a long position when there are lots of sellers and vice versa. In other words, you should try to enter before the security turns, as long as you are still confident that you are trading in the direction of the higher time frame trend.

Vomund: Do you limit yourself to trading just the first two or three pullbacks, figuring that at that point a true trend reversal is due?

Raschke: You never want to limit yourself in a strongly trending market. Look at Crude Oil or Gold—there have been lots of pullbacks but the trend is still higher. You should be careful late in the game because the security might be ripe for a bigger shakeout but you

“It is important to choose ahead of time what side of the market, long or short, you will play. That’s how you work most efficiently...You don’t want to work both sides. Instead, work the side with the most potential gain.”

try to differentiate whether it is a normal trading environment or if a really powerful force is at work.

It takes a lot of time to reverse a strong trend. There is usually an extended period of accumulation or distribution so it would be extremely rare that a trend reverses on a dime without plenty of advance warning. Trend reversals are a process that often shows up in classic chart

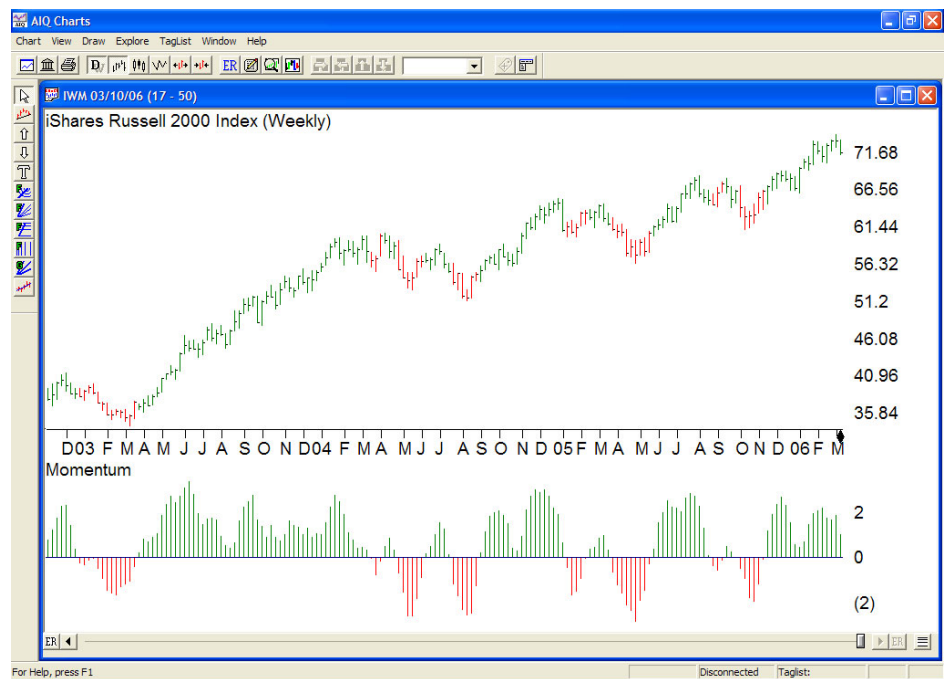


Figure 3. Weekly chart of iShares Russell 2000 fund with Momentum indicator plotted in lower window. Time period is November 2002 through February 2006.

formations like head and shoulders or broadening formations.

Vomund: Let me give you another example to look at, the iShares Russell 2000 (IWM).

Raschke: This has actually become a better trading vehicle than the Nasdaq 100 (QQQQ). Let’s start with the weekly chart for IWM. Remember, weekly charts offer cleaner, prettier, and more symmetrical swings than charts with shorter time frames.

Using the longer time frame, you get smoother data, less noise, and a clearer picture of the trend.

The weekly chart is in a solid uptrend where all of the upswings are greater than the downswings (**Figure 3**). There have been strong corrections, but the ETF remained in an uptrend. That’s because for an uptrend to reverse, the security must have a lower high, a lower low, and

then turn down. Because there are swings in a long-term uptrending pattern, weekly chart traders should trade the periods when the momentum indicator is increasing.

You also have to be aware of what time frame you are trading on—someone using a weekly chart will just trade long while someone using a 15-minute chart, although the security is in a long-term uptrend, may go short. And IWM is one of the few ETFs that can be effectively day-traded.

Looking at its 15-minute chart, the trend reversal that occurred in early March was a great shorting spot. In **Figure 4** at point 1, the security made a lower low. The momentum oscillator at point 2 was lower than previous swings, implying the start of a bearish move. Active traders can short the pullbacks. So a day-trader can short even though longer time frames show an uptrending pattern. You have to know your time frame. You can see that 15-minute charts have a lot more noise in the data and don’t have the same rhythmic swings that the weekly chart does.

Vomund: You're right when you say you are using simple classic technical analysis tools.

Raschke: I have to be honest with you; the stuff I do is so basic. It is very basic but this is what works for me. There will always be books covering new forms of technical analysis but that doesn't mean the simple classical technical analysis techniques don't work. They worked in the past, they work now, and they will work in the future.

It doesn't matter if you are a short-term aggressive professional or a longer-term investor, success depends on simply understanding the basic swings. You've noticed I'm not using fancy indicators. It is more important to simply understand the significance of the patterns, whether the security is in an uptrend with higher highs or in a downtrend with lower lows.

That's all I'm doing. I'm analyzing supply and demand shifts by the length of the swings, by whether momentum is increasing or decreasing, by whether there are higher highs or lower lows.

Vomund: Whether you use real-time, daily, or weekly charts, are there some common themes for managing a trade?

Raschke: Managing a trade means two things: placing an initial stop and following an exit strategy. Here are the common themes. Back testing and modeling price behavior shows that the great majority of the time maximum profitability is achieved by playing for small wins as opposed to shooting for a large gain. Few patterns test out where one can play for a larger gain by using a trailing stop type of strategy. Instead, our work shows that you should at least be pulling up your stop to a break even once the trade begins to work and then have a mechanism that forces you to take profits.

Our work shows that a combination of an initial fixed stop plus a

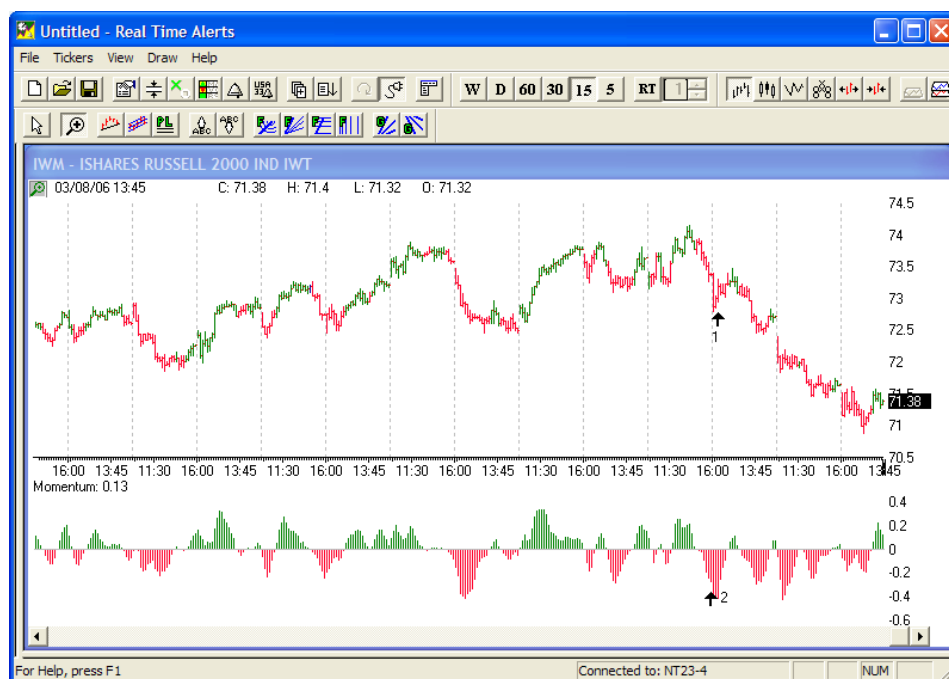


Figure 4. 15-min RT chart of iShares Russell 2000 fund with Momentum indicator plotted in lower window. Trend reversal was apparent at point 1 and confirmed by momentum low (point 2).

time stop is ideal. I often employ an eight bar time stop in conjunction with a fixed stop (i.e., using a 10-minute chart you use an 80-minute time stop, using a daily chart you use an 8-day time stop, etc.). If a trade is not working in eight bars, then it can be exited. This is true regardless of what time frame you are using.

Finally, it is important to minimize the risk of having a large loss. You don't want to take a large loss. Sometimes traders end up with a big loss because they were hoping for a big profit. The best traders first learn how to play good defense.

Vomund: What advice do you give to those who want to trade ETFs?

Raschke: Go to where the action is. Don't pick a dead market that isn't doing anything, hoping it will eventually break out. You have so many markets available to you that you should find choices with nice readable swings. Go to where the volatility is and where supply and demand imbalances exist. One last consideration with ETFs is relative strength work. The leaders continue

to remain the leaders while the dogs will tend to continue to underperform.

For your average readers I would also recommend to never get discouraged at the overwhelming amount of noise that there is in the market. Classic technical analysis eliminates this noise. Simply pull up charts and examine the trend, and within the trend the individual swings. You'll see they are pretty predictable. Of course it is always easier to see the swing patterns in hindsight but with a little practice you'll identify them as they develop as well.

Vomund: Thank you for sharing your insights.

You can visit Linda Bradford Raschke's web site at www.LBRgroup.com.

Recommended Reading:

- *Mastering Technical Analysis* – John Brooks
- *Technical Analysis of Stock Trends* – Robert Edwards & John Magee

Custom Indicators and Color Studies

Need an Indicator Not Found in TradingExpert? Create One Using Expert Design Studio

By David Vomund

In the article on page 1, Linda Bradford Raschke discusses the use of a momentum indicator, which is the difference between a 3-period and a 10-period simple moving average. This is not one of the standard indicators in AIQ's TradingExpert Pro.

Fortunately, TradingExpert provides users with the ability to create indicators using the Expert Design Studio module.

To create an indicator, we first need to create a User Defined Function (UDF) in Expert Design Studio.

To create a User Defined Function, do the following:

- Enter the Expert Design Studio and select **File** from the menu bar, then **New**.
- To create a rule that calculates the difference between two moving averages, type at the cursor:

**Momentum is
simpleavg([close], 3) -
simpleavg([close], 10).**

- Save the file by selecting **File** from the menu and then click **Save**. We'll call the file *Raschke*.

To create an indicator, use the following procedure:

- Enter the Charts application. Select **Chart** from the menu bar and click **Settings, Indicator Library, and EDS Indicators**.
- The *Custom Indicators* screen that appears lists the EDS indicators that have been previously created. Click **Add** to create a new EDS indicator (**Figure 1**).
- Use the *Open* dialog box to find

and open the *Raschke.eds* file.

- In the *Plot Type* dialog box, select **Histogram** and click **Next** (**Figure 2**).
- The *Histogram Indicator* dialog box will appear. In the box labeled *Description*, type a name for the new indicator. From the *UDF to Plot* text box, select *Momentum*. Click **Finish**.
- When the *Custom Indicators* box reappears, click **Done**.

The newly created indicator, *Momentum*, will now appear at the bottom of the Control Panel in *Charts*.

While it is nice to have the indicator, you may find it helpful to plot the indicator and the price bars in green any time the indicator is above zero or in red whenever the indicator is below zero, just as the charts show in the Raschke interview article (page 1). Use AIQ's *Color*

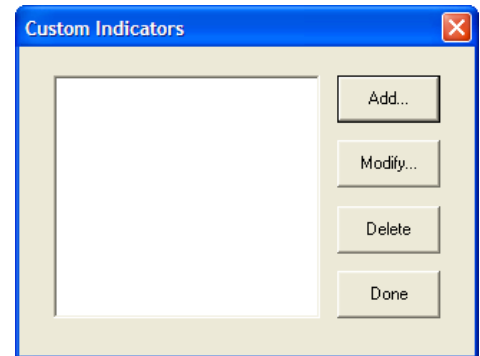


Figure 1. From the *Charts* Custom Indicators screen, click **ADD** to create an EDS indicator.

Studies feature to accomplish this.

To do this, we have to add some rules to our *Raschke* EDS file. Two rules need to be added which identify when the indicator is bullish and when it is bearish.

Here are the rules:

Bullish if Momentum > 0.

Bearish if Momentum < 0.

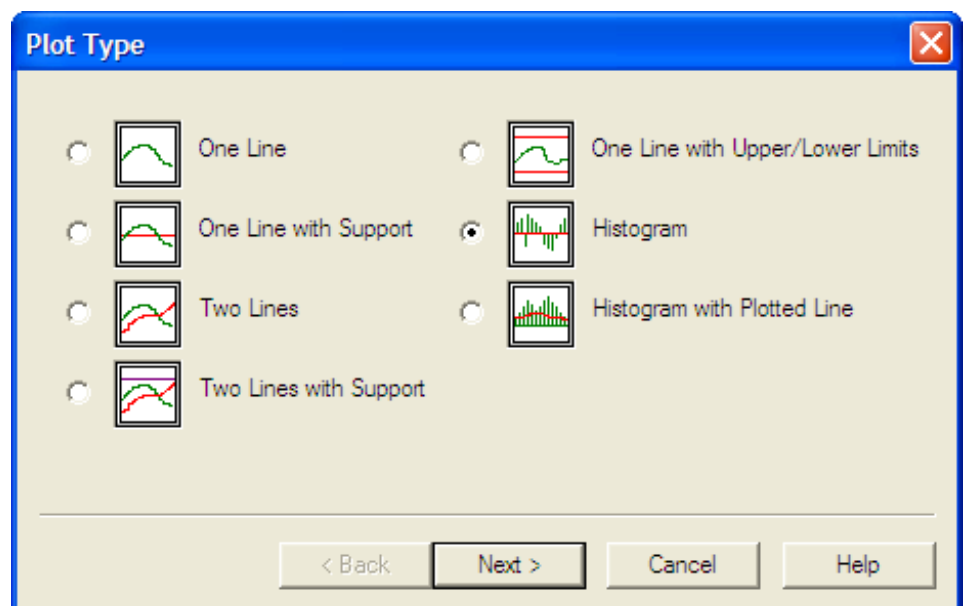


Figure 2. Plot Type screen appears after the file containing the UDF is selected. For the new *Momentum* indicator, plot type *Histogram* is selected.

Our next step is to open the Charts module, click the **Color Studies** toolbar button (labeled Define Studies), and continue as follows:

- In the Color Studies dialog box, click the button at the right end of the *EDS File* text box. Use the *Open* dialog box to find and highlight the **Raschke** file and then click **Open**.
- Click on **Create New Color Study**.
- On the next screen, accept the default for **Price Plot** and click **Next**.
- On the *Select EDS Rule* screen, highlight one of the two rules, click **Next**, and select its color (choose green for the *Bullish* rule, and red for the *Bearish* rule).
- Follow the on-screen instructions and click **Finish**.
- Repeat the same steps for the *Bearish* rule.
- To change the colors of the indicator as well, repeat the above steps but choose **Indicator** instead of **Price Plot**.

The results of our created indicator and Color Study are found in **Figure 3**. By creating a simple indicator with chart colors, we can

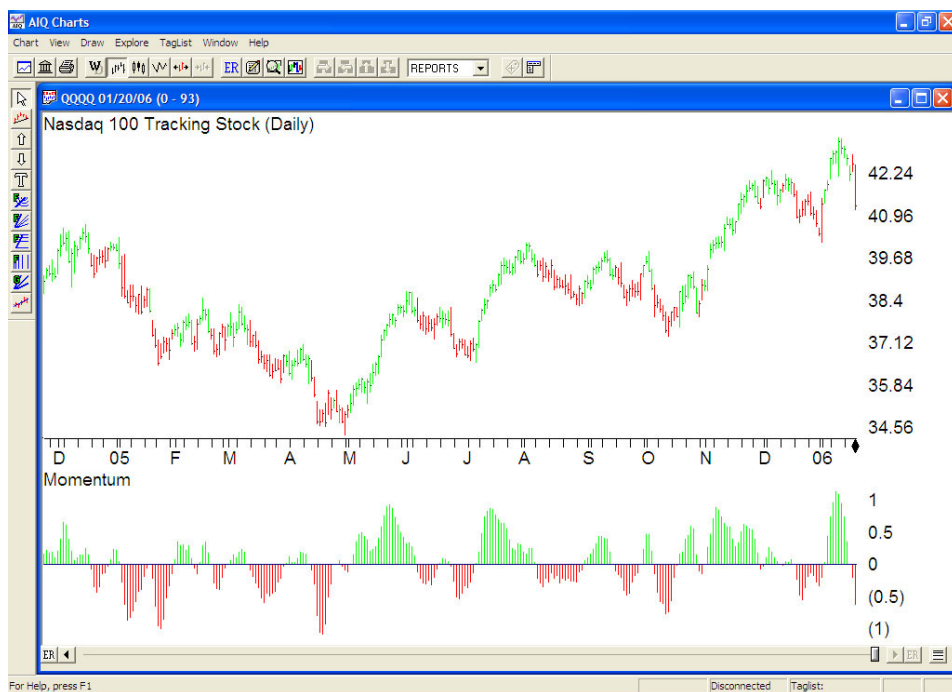


Figure 3. Daily chart of QQQQ with new custom Momentum indicator plotted in lower window. Bullish and bearish periods are differentiated with green and red colors.

For example, Linda Raschke likes to plot a 16-period moving average of the Momentum indicator. This is easily done by first adding a line to the Raschke EDS file to define the moving average.

You can also add a third yellow color to the chart, to show when the

“The results of our created indicator and Color Study are found in Figure 3. By creating a simple indicator with chart colors, we can better see the swings in the index.”

“You may find it helpful to plot the indicator and the price bars in green any time the indicator is above zero or in red whenever the indicator is below zero... Use AIQ’s Color Studies feature to accomplish this.”

better see the swings in the index. Further modifications can also be made.

with **Plotted Line** option for *Plot Type*.

You can then use the Custom Indicator function in Charts to add the moving average to the Momentum indicator. To add the moving average line, select the **Histogram**

Momentum indicator is near zero. Then, when the chart turns to yellow it gives a warning that momentum may be about to turn.

For those who would like to add the Momentum indicator, we have saved the EDS file to AIQ’s web page. It can be downloaded at www.AIQsystems.com under *Opening Bell Monthly*.

Check Out Back Issues of the Opening Bell Newsletter

For a 12-year archive of back issues of the *Opening Bell* newsletter, visit:
<http://www.aiqsystems.com/OBMyears.htm>

You can also search for particular topics on this site

MARKET REVIEW

March Sees New Yearly Highs for All Major Market Averages

The S&P 500 gained 3.7% in the first quarter, its best quarterly performance since 1999, despite a host of worries (Iran, bird flu, energy and commodity prices, etc.). While most of that gain came in January, stocks continued their rise in the most recent month.

In March, the S&P 500 gained 1.1% and the Nasdaq Composite gained 2.6%. While that sounds good, the real area of leadership came in small-cap stocks as the Russell 2000 gained 4.7%.

All the major market averages, whether large-cap, mid-cap, or small-cap, closed at new yearly highs in March. While many analysts talk about a trading range, in truth there is an upward sloping trading channel.

Since the broader market outperformed large-company stocks, most of the industry groups had a good month in March. The leading groups were Defense & Aerospace, Energy Services, and Gold. These groups gained about 10%. The lagging group was Biotechnology, which lost 2% in March.

S&P 500 Changes

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

Chesapeake Energy (CHK) replaces Dana Corp (DCN). CHK is added to the Oil Exploration & Production (OILEXPLO) group.

STOCK DATA MAINTENANCE

The following table shows stock splits and other changes:

Stock	Ticker	Split	Approx. Date
Brown Shoe Co.	BWS	3:2	04/04/06
Berkley (W.R.)	BER	3:2	04/05/06
American Vanguard	AVD	4:3	04/05/06
Nvidia Corp.	NVDA	2:1	04/07/06
Schlumberger Ltd.	SLB	2:1	04/10/06
Atwood Oceanics	ATW	2:1	04/10/06
Manitowoc Co.	MTW	2:1	04/11/06
Nabors Inc.	NBR	2:1	04/18/06
Chubb Corp.	CB	2:1	04/19/06
Curtis Wright	CW	2:1	04/24/06

Trading Suspended:

Beverly Enterprises (BEV), Dana Corp. (DCN), Net2Phone Inc. (NTP), Placer Dome (PDG), Scientific Atlanta (SFA), Westcorp Inc. (WES)

Name Changes:

ActivCard Corp. (ACTI) to ActivIdentity Corp (ACTI)
 Alliance Capital Mgmt. Holding LP (AC) to AllianceBernstein Holding LP (AB)
 Alliance Gaming Corp. (AGI) to Bally Technologies Inc. (BEF)
 Cal Drive Int'l (CDIS) to Helix Energy Solutions Group (HELX)
 Interland Inc. (INLD) to Web.com Inc. (WWW)
 Nexus Telocation Systems (NXUS) to Pointer Telocation Ltd. (PNTR)

Check Out These AIQ Seminars

Free Web Seminars

AIQ offers free online seminars for both beginning and experienced AIQ users. For April's schedule of these popular seminars, please visit www.aiqsystems.com and on the right side of the page click *Web Seminars*.

April speakers include Dan Zanger, David Vomund, Steve Hill, Chuck Inman, and other trading pros.

One-Day Seminars - Across the Country

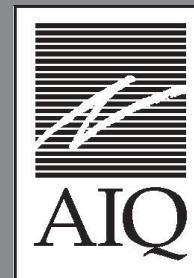
Manchester, NH	April 22
San Diego, CA	May 20
Denver, CO	June 17

Topics include the use of TradingExpert Pro's more important features plus trading techniques and market timing.

See page 9 or visit www.aiqsystems.com for more details

AIQ Seminars 2006

One Day Seminars Across the Country with
David Vomund and Steve Palmquist



\$288

Here's what previous attendees had to say

"Palmquist was great! A nice combination of good systems and good methodology clearly presented in an engaging manner"

"David Vomund. Very knowledgeable, very good speaker, extremely practical advice-a great asset to AIQ!!"

AIQ's One Day Seminar Agenda Offers Top Class Education at a Great Price

Short Term Trading Techniques for Trading Both Long and Short Positions *by Steve Palmquist*

In this session Steve will be sharing one of his favorite short term trading techniques for trading both Long and Short positions. This is not a theoretical approach, but one Steve uses every day with his own money. He will discuss the specific system, show how it was developed and tested, and provide tips and techniques for using it based on his nearly 20 years of market experience.

Market Truths *by David Vomund*

David Vomund will reveal important market truths that he has learned from actively studying and trading the market for nearly 20 years. These are the truths that experienced investors learn over time. New investors learn these truths the hard way – by losing money. Topics include market behavior, position sizing, and trading psychology.

Market Adaptive Trading *by Steve Palmquist*

Steve has developed a Market Adaptive Trading Technique that he uses to determine when to trade specific systems and when to stand aside. Successfully analyzing current market conditions is one of the keys to trading success. Learn when to focus on Longs, when to trade Shorts, and when to stay in cash. Just trading a single system all the time without a careful analysis of the market conditions can give you a lot of practice at taking draw downs. Learn from Steve's experience and take your trading to the next level.

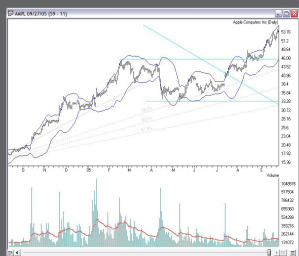
Getting Started Right With AIQ *by David Vomund*

David Vomund will cover the features within TradingExpert that every AIQ user should know. Basic features such as charting, report generation, and exploring will be discussed. Advanced features such as industry group creation and the use of Expert Design Studio will also be covered.

VENUES

Manchester 4/22/2006

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David Vomund
Chief Analyst
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Steve Palmquist
Founder
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