AIQ

Opening Bell
Newsletter

In This Issue

TradingExpert Pro's Advantage

Will AIQ's Unique Breadth Analyzer Identify Next Major Market Top?

By David Vomund

Last month's *Opening Bell* contained an impressive research paper by Paul Desmond of Lowry's Reports, Inc. which looked at factors that signal market tops. As a brief summary, in the article he looked at major market tops dating back to the early 1900s and found that the vast majority of stocks topped out before the market averages did. On average, about 6% of the stocks were hitting new highs at the market top, and 22% of the stocks had already fallen more than 20% at the market high.

Those are important statistics to remember as we move forward. Still, they are meaningless if we can't calculate the current market statistics on our own system. Fortunately, this is the kind of analysis that AIQ's Breadth Analyzer feature was designed for. In this article, we'll calculate the breadth statistics and apply them to Mr. Desmond's research article. Before proceeding, I encourage you to re-read the February issue of the

Opening Bell that is posted on AIQ's web page.

The Breadth Analyzer is a feature that was added to TradingExpert Pro's version 8.1. Briefly, this function looks at a list of stocks and determines how many of these stocks pass any criteria programmed into Expert Design Studio (EDS). In effect it

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> *"Being able to plot these two indicators (to calculate the current market statistics) gives AIQ users a huge advantage over most other investors. Few software products can perform a similar analysis. By following these statistics…we might identify the next major top as it is forming."*

calculates market breadth statistics based upon any measurement you choose.

For example, the Breadth Analyzer allows you to plot the percentage of stocks that are above their 200-day

moving averages. In our case, we want to plot the percentage of stocks hitting new 240-day highs, and the percentage of stocks that have corrected at least 20% from their 240-day highs.

This sounds complicated but the EDS code is quite simple. Here is the code for new highs:

! Search for stocks hitting new high.

Newhigh if [close] = HiVal([close],240).

!Search for stocks that are at least 20% off their highs.

Welloffhigh if [close] < HiVal([close],240) * 0.8.

We saved this code in an EDS file named Breadth Analyzer.

Editor's Note: this file can be downloaded from AIQ's web page. See the end of this article for details.

The next step in building the system that we will use to compute new highs breadth statistics is to create a ticker symbol that will represent the new highs indicator. From the TradingExpert's *Quick Launch* menu select the *Data Manager*. From the *Data Manager* menu

bar select *Ticker* and then *New*. We'll first create a ticker that will represent the number of stocks hitting new highs. We chose to call our ticker NEWHIGH. Check the *Breadth* option and click *OK*. When entering a ticker symbol, I suggest choosing one that is more than five letters; that way it won't conflict with an actual stock's ticker symbol.

The *New Ticker* screen will appear (**Figure 1**). Enter an appropriate description. We are choosing to calculate our new high and correction statistics on the S&P 1500

Figure 1. The *New Ticker* screen (found on AIQ Data Manager *Ticker* menu) is used to create the new breadth ticker named NEWHIGH.

stocks so under *Source List* choose an S&P 1500 list file. Under EDS file highlight the *Breadth Analyzer* file and select the EDS Rule NEWHIGH.

Editor's note: The S&P 1500 list file can be downloaded from AIQ's web page at www.aiqsystems.com. Click *Data* and then *List Files.*

With this ticker created, we can compute market breadth. From the menu bar select, *Utilities* and then *Compute Breadth Analysis*. Breadth Analysis is computed from ticker NEWHIGH.

With breadth calculated, we can now chart the percentage of S&P 1500 stocks hitting new 240-day highs. In *Charts*, enter the ticker symbol NEWHIGH. The closing value of the bar represents the percentage of S&P 1500 stocks that hit a new high while the high price of the bar represents the number of stocks that hit a high. For example, in **Figure 2** we see that 142 of the S&P 1500 stocks hit new highs on February 16, which is 9.5% of the 1500 stocks.

This process needs to be repeated to create a chart of the per-
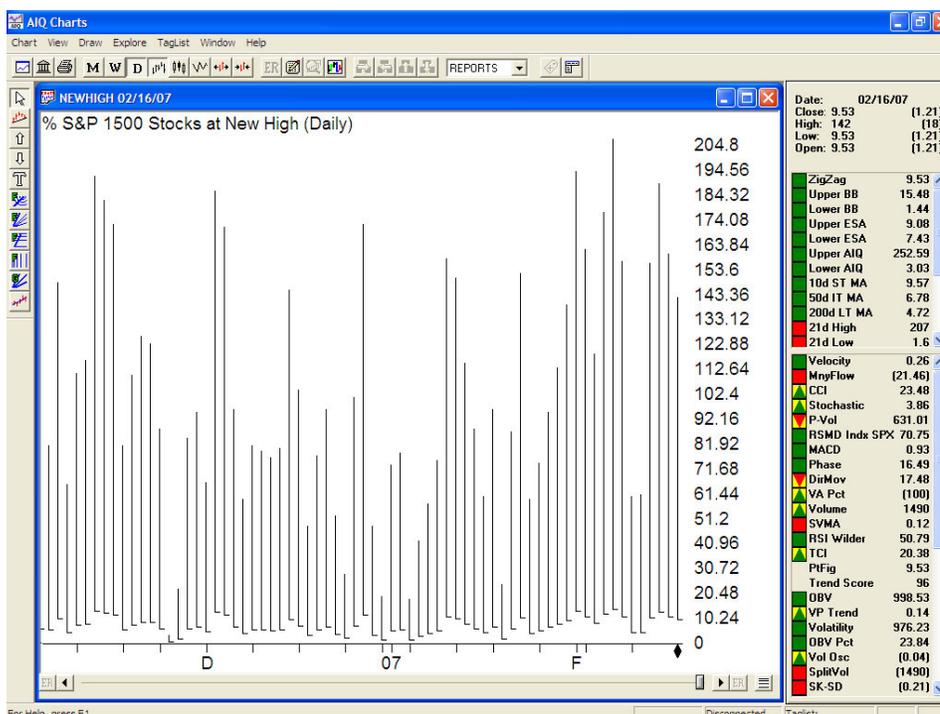
Figure 2. Daily chart of NEW HIGH indicator computed for the S&P 500 list of stocks. High price is the number of stocks with new highs and the close value is the percentage of stocks.

centage of stocks that have corrected 20% or more. We called this ticker OFFHIGH.

After creating the two breadth tickers, we want the system to update the tickers automatically after each download. In *Communications*, on the lower right box check *Update Breadth Tickers* and then click *Save Setup*. The breadth tickers will be automatically updated after each data update.

Breadth Analyzer Indicators

While the graph in Figure 2 gives us the statistics we are seeking, the format of the graph can be improved. We are only interested in knowing the percentage of stocks that pass our screening, not the number. The price bars get in the way of the indicator and it is hard to plot both a market index along with our breadth results. By creating a custom indicator, however, we can get the graph format that we desire and it will be available as one of the indicators that can be displayed when we enter any chart.

For the NEWHIGH and OFFHIGH tickers that we created above, we are only interested in the close rather than the length of the price bar. Remember, for ticker
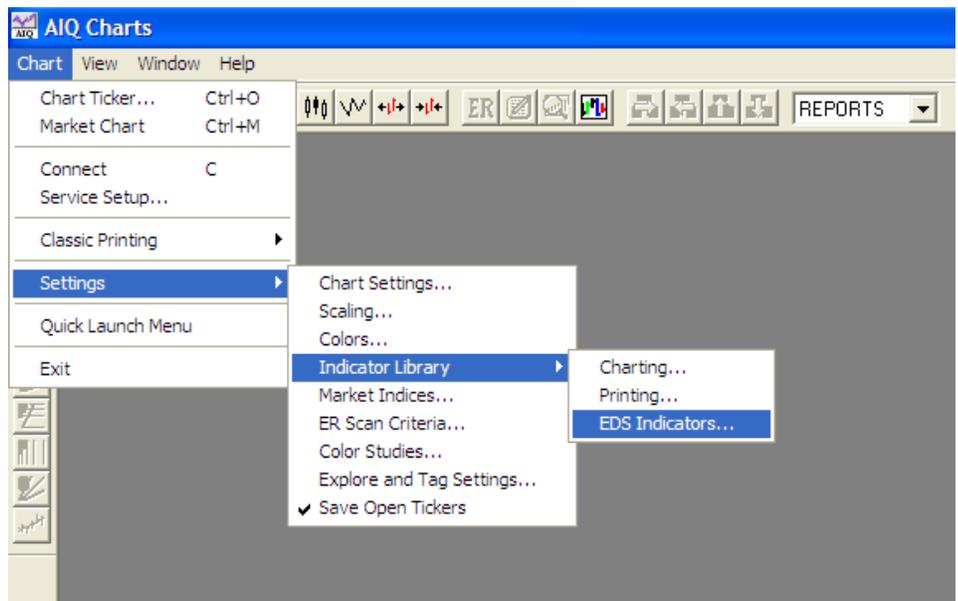
Figure 3. AIQ Charts screen with Chart function drop-down menus displayed. *EDS Indicators* function that is selected from the final menu is used to create a custom EDS indicator.

NEWHIGH the close represents the percentage of S&P 1500 stocks hitting new 240-day highs. For ticker OFFHIGH the close represents the percentage of stocks that are more than 20% below their highs.

Creating a custom indicator that plots the closing price from our two ticker symbols is an easy process. In the EDS file created above, add the following lines and then save the file:

close is [close].

highs is
tickerudf("newhigh",close).

offhigh is
tickerudf("offhigh",close).

To create the custom indicator, go to Charts and select *Chart, Settings, Indicator Library, EDS Indicators* (**Figure 3**). Under the *Custom Indicators* box click *Add*. On the next *Open* screen, highlight the Breadth Analyzer EDS file that we just created and click *Open*. Under *Plot Type*, highlight *One Line* and click *Next*. Under *One Line Indicator*, enter a description such as "% at New Highs." Next to *UDF to plot* choose "highs" from the drop down bar (**Figure 4**). Click *Finish*.

Repeat the same process for an indicator that we called "20% off highs." The only change is that when it asks what UDF to plot you must select "offhigh."

With this complete, we can chart any ticker symbol and our two market breadth indicators will be ready to be viewed just like any other standard indicators.

Figure 5 shows the S&P 500 along with our two custom indicators for the market top on March 24.
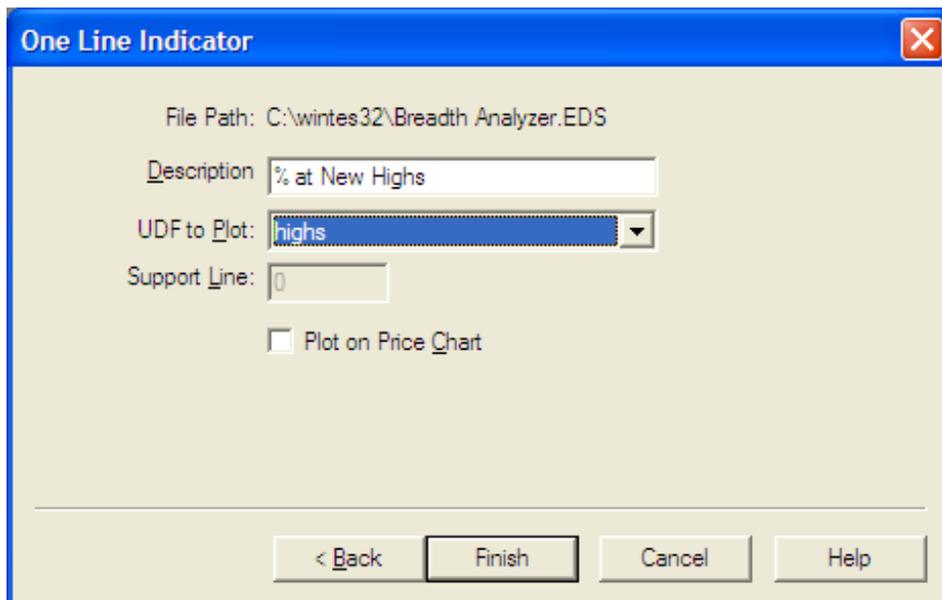
Figure 4. *One Line Indicator* is an AIQ Charts function that is the final step in transforming the NEW HIGH indicator to a single line plot of close which is percentage of stocks with new highs.

The first thing we notice is that by plotting only the closing value the indicator charts are much more meaningful when compared to the bar type plot shown in Figure 2. The direction and level of each indicator is easy to see and the indicators can be plotted with any market index such as the S&P 500.

Upon closer examination of Figure 5 we see the reason we went through this exercise. The result is stunning. On March 24, 2000, the day the S&P 500 hit its bull market high, only 3.76% of today's S&P 1500 stocks hit new highs. Even more amazing is that 59.83% of the S&P 1500 stocks had already corrected 20% or more off their highs! This deterioration even as the indexes are moving higher is exactly what Paul Desmond discussed in the February *Opening Bell*.

Being able to plot these two indicators gives AIQ users a huge advantage over most other investors. Few software products can perform a similar analysis. By following these statistics and applying them to Paul Desmond's conclusion, we
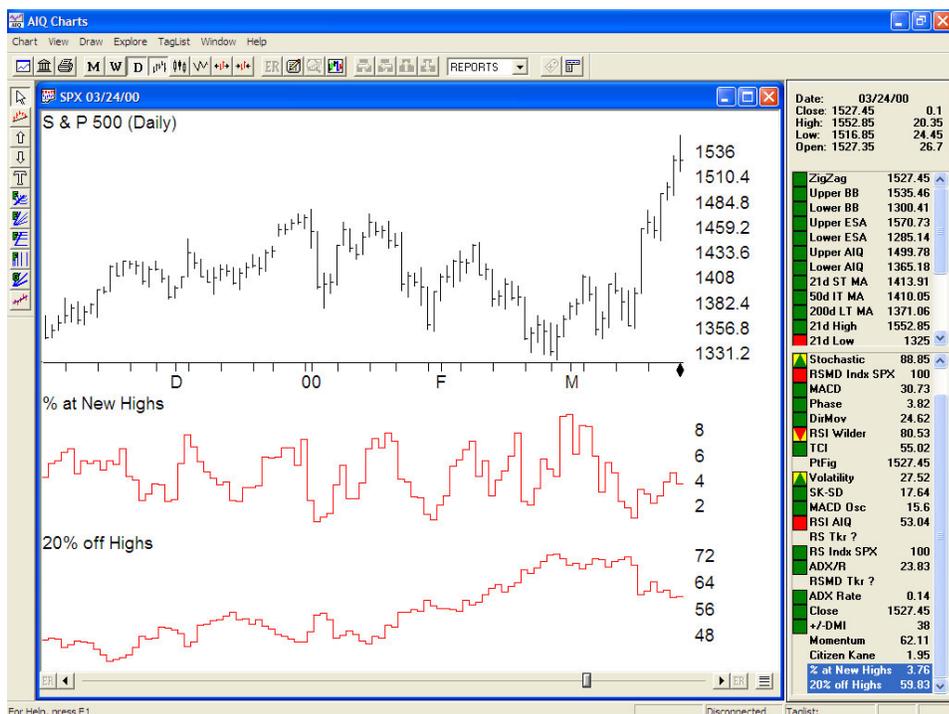
Figure 5. Chart of S&P 500 for months prior to March 2000 bull market high. Indicators plotted in lower window show that percentage of stocks with at least a 20% correction was already high.

might identify the next major top as it is forming.

All of this leads to the question of whether these indicators were predicting a major market top at the late February high? **Figure 6** shows

the S&P 500 on February 20, the day it hit a new 240-day high, along with our indicators. Compared to Figure 5, this chart paints a different picture. The top indicator shows that the percentage of stocks hitting new highs was trending higher and the percentage of stocks that were 20% off their highs was moving lower. 17% of the S&P 1500 stocks were hitting new highs while 15% had corrected 20% or more from their highs. Market breadth was much better than what has been seen historically at major market tops.

AIQ users can download the EDS file used to create the indicators discussed in this article from AIQ's web page at www.aiqsystems.com. Click *Training* and *Education* and then *Opening Bell Monthly*. The file is found in the lower right.

David Vomund publishes VIS Alert, a weekly investment newsletter. For a sample copy, go to *www.visalert.com*.
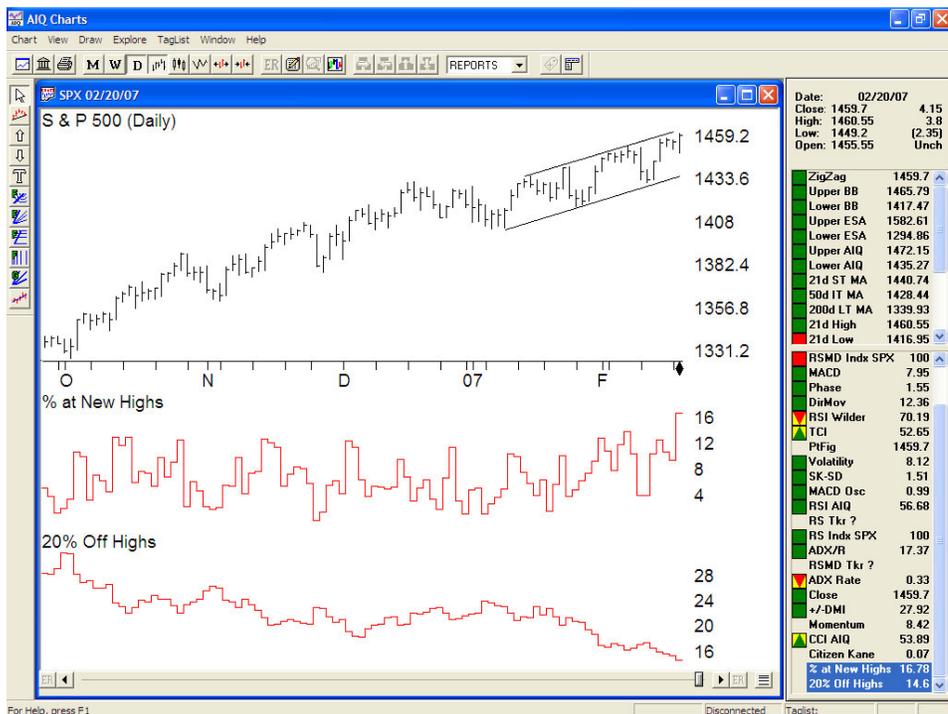
Figure 6. Chart of S&P 500 on 2/20/07. Indicators plotted in lower window show % new highs is currently increasing and stocks with at least a 20% correction is at low level and still declining.

How Has Style Index Strategy Performed?

Style Index Strategy's Average Yearly Return Is Well Ahead of the S&P 500

By David Vomund

AIQ is known for spotting sector rotation. The Style Index Strategy, first covered in the October 2003 Opening Bell, applies the concepts of sector rotation but instead of buying individual sectors the strategy rotates to the best performing market segments. These segments are broader and are more diversified than what is found in sectors.

The market segments include large-cap growth, large-cap value, small-cap growth, small-cap value, mid-cap growth, and mid-cap value. In effect, the strategy rotates to the corners of the Morningstar style box.

While this strategy can be applied to any list of ETFs, **Table 1** shows the ETFs that are used for this article. These also are the ETFs that are used for the Model Portfolio in my *VISalert.com* newsletter, and I have tracked their performance every week for four years.

In review, the Style Index Strategy utilizes AIQ's Relative Strength report. The Short-Term Relative Strength report is run every other Friday on the ETFs listed in Table 1. To begin the strategy, the top two in the ranking are purchased, making a fully invested portfolio. Two weeks later, the Relative Strength report is run again.

If the current holdings are listed in the top half of the report (in this case the top five), then there are no trades. If a holding falls in the Relative Strength report to where it is no longer in the top half, then it is sold and the highest rated ETF is purchased. This process is repeated every two weeks.

The Nasdaq 100 (QQQQ) is the most volatile ETF so this strategy does exceptionally well when the Nasdaq outperforms. In 2006, the Nasdaq was a lagging segment so it was rarely held. Instead, the less volatile Large-Cap Value (IVE) and the S&P 500 SPDR (SPY) were held for long periods of time.

The 2006 trades are listed in **Table 2**. Notice this isn't an active trading strategy. In fact, there wasn't even a single trade after July.

Table 3 shows the four-year return of the Style Index Strategy. Although the return slightly trailed the market's return in 2006, the average yearly percentage return on the Style Index Strategy of 18% is

Table 1. Style Index Trading Vehicles

Ticker	ETF	Market Segment
IVE	iShares S&P 500 Value	Large-Cap Value
IVW	iShares S&P 500 Growth	Large-Cap Growth
SPY	S&P 500 SPDR	Large-Cap Index
QQQQ	Nasdaq 100 ETF	Large/Mid Cap Growth
IJJ	S&P 400 Value	Mid-Cap Value
IJK	S&P 400 Growth	Mid-Cap Growth
MDY	Mid-Cap SPDR	Mid-Cap Index
IJS	iShares S&P 600 Value	Small-Cap Value
IJT	iShares S&P 600 Growth	Small-Cap Growth
IWM	iShares Russell 2000	Small-Cap Index

Table 2. 2006 Trades

Ticker	Buy Date	Sell Date	% Change
IJK	N/A	02/27/06	5.28
QQQQ	N/A	01/30/06	4.28
IWM	01/30/06	06/19/06	-4.95
IJS	02/27/06	07/31/06	-4.84
IVE	06/19/06	N/A	13.36
SPY	07/31/06	N/A	10.93

well ahead of the S&P 500.

I find that many people ignore the Style Index approach because of its simplicity and lack of trading. This is a great approach for the long-term growth portion of your portfolio. The returns speak for themselves.

The Style Index Strategy is market dependant. That is, when the market goes down the portfolio will go down. The same is true when the market goes up. For that reason, some AIQ users choose to time the portfolio by moving to cash during uncertain times. The strategy is suited for this because it only holds two securities. That means it only takes one trade to move to 50% cash. For our percentage return figures, we assumed an always fully invested portfolio.

In the next *Opening Bell* we'll apply this same approach to sectors.

For information on David Vomund's new *Tactical Allocation Portfolios* managed account program, which trades sector, country and long/short ETFs, visit www.ETFportfolios.net.

Table 3. Yearly Percentage Returns

Year	Style Index	S&P 500
2003	45.64	26.38
2004	12.78	8.99
2005	2.34	3.00
2006	11.61	13.62
Avg. =	**18.09**	**13.00**

S&P 500 Changes

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

Polo Ralph Lauren (RL) replaces Comverse Technology (CMVT). RL is added to Apparel & Accessories (TEXTILEA).

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STOCK DATA MAINTENANCE

The following table shows stock splits and other changes:

Stock Splits:
No stock splits this month

Trading Suspended:
Brunswick Bancorp (BRB)
Equity Office Properties (EOP)
GameStop Cl. B (GMEB)
Navistar Int'l (NAV)
People's Energy (PGL)
RailAmerica (RRA)
Sitel (SWW)Yankee Candle (YCC)

Name Changes:
Acquicor Technology (AQR) to Jazz Technologies (JAZ)
Minco Mining & Metals (MMK) to Minco Gold (MGH)
NTL (NTLI) to Virgin Media (VMED)
WPS Resources (WPS) to Integry Energy Group (TEG)

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

Will Market Follow the Statistics and Trade Higher After One-Day February Plunge?

The market had a down February, with most of the losses coming on February 27. For the month, the S&P 500 lost 2.2% and the Nasdaq Composite lost 1.9%. This marked the end to what was a tranquil seven-month run for stocks. Before the end of February, the S&P 500 rallied for seven months without so much as a 2% correction. February 27 was a day of massive selling. The S&P 500 fell 3.5% and the Nasdaq plunged 3.9%. Such a drop is rare but not unprecedented. Since 1950, we have seen 30 similar or greater one-day market declines. Typically, the market trades higher after such occurrences.

After a 3% or greater decline, the market is up 67% of the time one month later, up 90% of the time six months later, and up 80% of the time twelve months later. The median gain six months after the one-day drop is 12%, and the median gain twelve months later is 18%.

A strong case can be made, however, that the current market won't rise as much as these statistics imply. In many of the previous cases, the one-day plunge came after a period of weakness. For example, in 1987 the S&P 500 had already dropped 16% before the October 19 crash. So in many cases the drop of 3% or more was a capitulation after a period of weakness.

The same can't be said of the present case. The February 27 fall came just days after most indexes were hitting new multi-year highs. That day simply put the major market averages close to where they were at the start of the year, and most averages remain above their 200-day moving averages. **Figure 1**
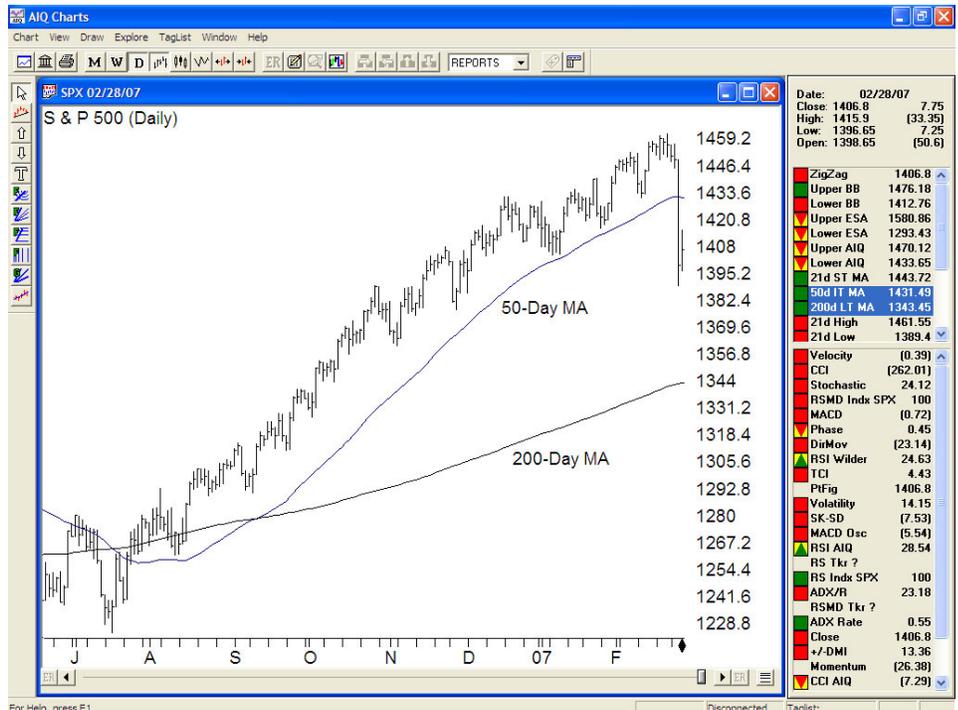
Figure 1. Daily chart of S&P 500 price action with 50-day and 200-day moving averages.

shows the S&P 500 falling below its 50-day moving average but still well above the 200-day moving average. Even the ETFs that track the Chinese markets are above their 200-day moving averages, and it was the plunge in Chinese stocks that supposedly triggered the global selling.

Needless to say most industry groups experienced losses in February, but there were some that had an up month. Looking at the Fidelity sector funds, Utilities was the leader, gaining 5.1%. Electronics rose 3.8% and Paper rose 3.4%.

Most of the sector funds had moderate losses in February. Multimedia was the weakest, losing 4.5%. Brokerages lost 4.0% and Computers dropped 3.5%.

ETF Trading Strategies Revealed

Want to know how to trade the hottest new investment vehicle?

In his new book, David Vomund, AIQ's Chief Analyst reveals the secrets of profiting from a new and growing investment vehicle - the Exchange Traded Fund. Pulling from experts in the field like Linda Bradford Raschke and Steve Palmquist, this book has all the information you need to begin trading ETF's for profit.

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- Study simple but highly effective mechanical ETF rotation techniques (style, sector, and international) that are now available to the. individual investor.
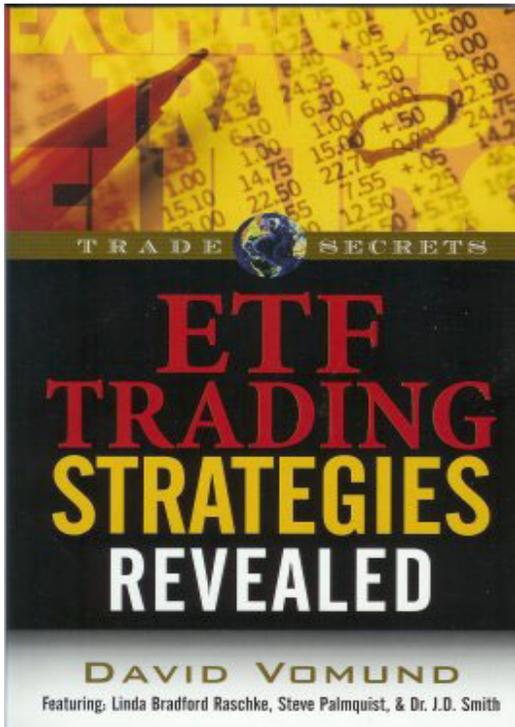
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"Finally... a comprehensive book on Exchange Traded Funds! I have always enjoyed reading David Vomund's insights on the markets and his interviews with other successful traders, and I know you will prosper from the wealth of information contained in this ground-breaking book." **Price Headley, CFA, CMT**

**Don't miss these 2 FREE David Vomund events at the Wealth Expo in Atlanta
March 16-18, 2007 register at http://www.thewealthexpo.com/registration.asp?location=Georgia**

ETF Trading Strategies Revealed

Friday March 16th at 2pm

Saturday   March 17th at 3pm,

In this session David Vomund, Chief Analyst at AIQ Systems and author of the best-selling book ETF Trading Strategies Revealed will discuss his successful Market Rotation Strategy. Which segment of the market should you be in growth, small-cap, large cap or value? Using ETFs to track major market indices, David will show you how to be in the right segment at the right time. David will also share with us his sector rotation strategy using ETFs to track industry sectors.

AIQ webinars are now archived

If you couldn't attend one of the many educational webinars AIQ scheduled last month, don't worry we've archived them so you can view them at your convenience.

Check the February webinar calendar at

http://www.aiqsystems.com/webinarsfeb07.htm and look for the movie icon for archived events

How To Magnify Your Profits by Using Volume Analysis
Current Market Trends
Trading Leveraged Long and Short ETFs
How To Design Swing Trading Strategies for Stocks and Options
Current Market Analysis

The **ChartProfit Service**
Bob Debnam Editor
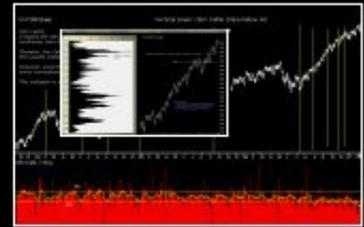
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