

AIQ

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First in Series

Vomund Shares 'Market Truths' —His Time-Proven Concepts Based on Years of Testing

By David Vomund

AIQ's webinars (online seminars) have become very popular. Each month, several analysts present their trading techniques using the AIQ software. Between 50 and 200 people typically view each webinar and we constantly receive positive feedback on how useful the online seminars are. Most webinars are free; some have fees. To see the list of November webinars, visit www.aiqsystems.com.

One of the fee-based webinar events that I've presented is called Market Truths. A condensed version of that presentation begins with this article, the first in a series.

The Market Truths are concepts that I've learned from being a technical analyst for 20 years. People with a lot of trading experience will agree with most of the truths. Many of us have learned these truths by losing money in the market. My objective in this series of articles is to present the truths to new investors so that they won't fall into the same pitfalls.

Market Truth — Don't trade based on CNBC

Most AIQ users perform their AIQ analysis after the market closes in order to develop game plans for the next trading day or trading week. There is no point to performing this analysis if your game plan changes once you watch the Squawk Box morning show.



DAVID VOMUND

"Many of us have learned these truths by losing money in the market. My objective in this series of articles is to present the truths to new investors so that they won't fall into the same pitfalls."

In order to increase ratings, CNBC adds a dramatic element to the market. The CNBC anchors treat the trading day as a sporting event, where the game starts and stops with the sound of a bell.

The anchors report amidst the crowds on the floor of the exchange, even though they struggle to even get price quotes. This action plays on our emotions, and for technical analysts emotion is the enemy. Emotion gets in the way of good analysis. CNBC can be watched, but it must not influence our trading.

Market Truth — Lock in Profits

I've found that most traders correctly limit losses. Letting a small loss turn into a big loss is devastating, and most people don't let that happen. Traders don't know what to do, however, when they have a profitable position. "Letting your profits run" is a good maxim but all too often the stock doesn't run and it is sold after it falls back to its entry point. Testing shows that it is better to lock in the profit rather than letting the stock run, hoping it turns into a big winner.

Let's use Expert Design Studio (EDS) to demonstrate this point. We created a very generic stock entry system that screens for S&P 1500 stocks that have risen above their 200-day Moving Average. Every stock eventually rises above this

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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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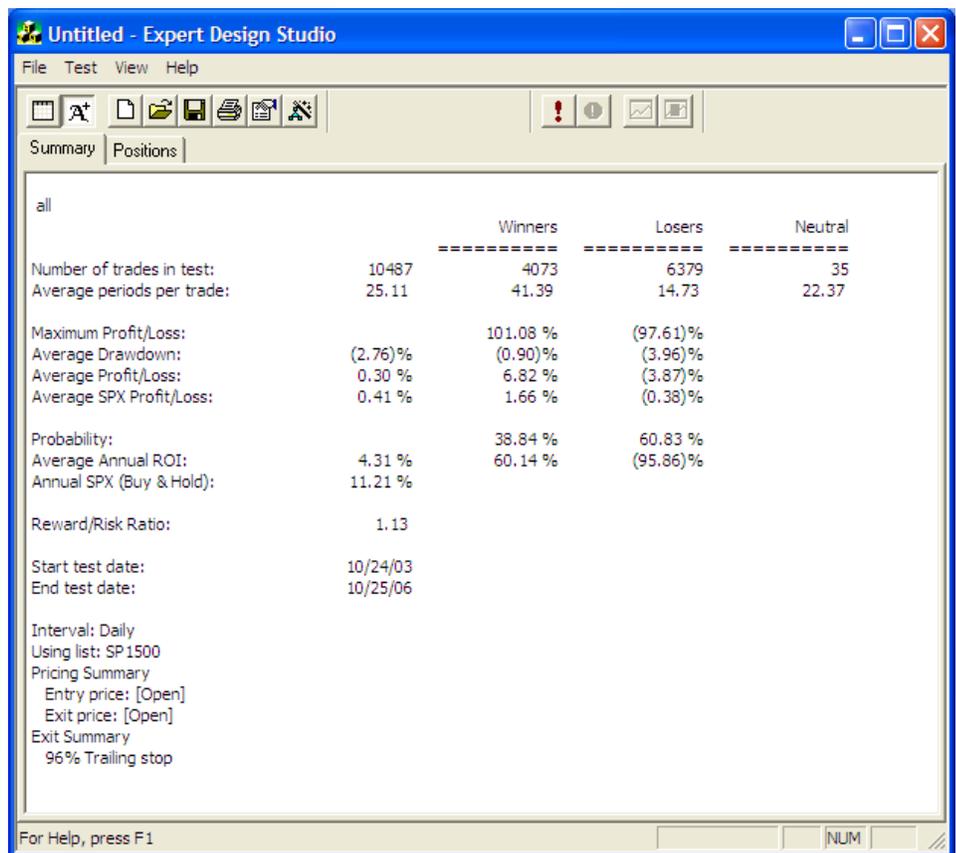


Figure 1. AIQ's EDS Summary report with test results for 96% trailing stop exit system.

Moving Average so there are a lot of trades.

The entry system is generic, but we'll test various exit systems. The first test uses a 96% trailing stop. This stop system moves to a sell anytime a stock falls 4% from its high point after it is purchased. The trailing stop effectively cuts losses short and lets profits run. As long as the stock doesn't pull back 4%, then traders remain invested, hoping for a parabolic move.

Our test of the 96% trailing stop is found in **Figure 1**. During the three-year testing period there were 10,487 trades with an average holding period of 25 days. With that many trades we can rely on the results. The key statistic is the Average Annual ROI of 4.3%. That isn't the return you'll get by using this system but we can use it for comparison purposes.

Next, let's look at a simple 25-calendar-day time stop. We chose 25 days as that was the average holding period from our previous test. Under this sell strategy, you sell the stock after 17 business days (approx. 25 calendar days) no matter how the stock has performed.

"Testing shows that it is better to lock in the profit rather than letting the stock run, hoping it turns into a big winner."

The results appear in **Figure 2**. The holding period is the same and once again there are a lot of trades, but this time the Average Annual ROI jumps to 11.25%. The fixed holding period is much more effective than the trailing stop exit strategy (in actual trading you should also employ a capital protect in case you bought at the high).

Our final test uses the profit

protect strategy that is one of the pre-built sell strategies within TradingExpert Pro. We'll use a 95% capital protect in case we bought the stock at its high. Once there is a 5% profit on a stock, then we'll lock in 95% of that profit. That way, we don't give back our gains. We chose these numbers because they also lead to a 25-day average holding period.

Figure 3 shows the results of this new test. The 9.53% Average Annual ROI is slightly less than the fixed holding period, but far higher than the trailing stop.

What does this mean? The trailing stop, designed to keep investors in while the stock moves higher, was the worst performer. That's true for this system, and it is true for most stock entry systems. It is especially true for short-term trading systems. I encourage you to run similar tests with your own entry system.

Trailing stops keep you invested in stocks that go parabolic, but that rarely happens. More often, you get a good profit on a stock but give back most of that profit before the stop is triggered.

Stop systems that force you to take profits lead to better results. A fixed period stop system locks in profits because it forces a sell no matter what the stock has done. With a fixed period approach, you must sell a stock even if it is making a parabolic advance. The profit protect strategy obviously also forces you to lock in profits as it doesn't allow a stock to move back to its entry point once the profit threshold is reached.

Traders should lock in their profits, not give them back. More Market Truths next month.

David Vomund publishes VIS Alert, a weekly investment newsletter. For a sample copy, go to www.visalert.com.

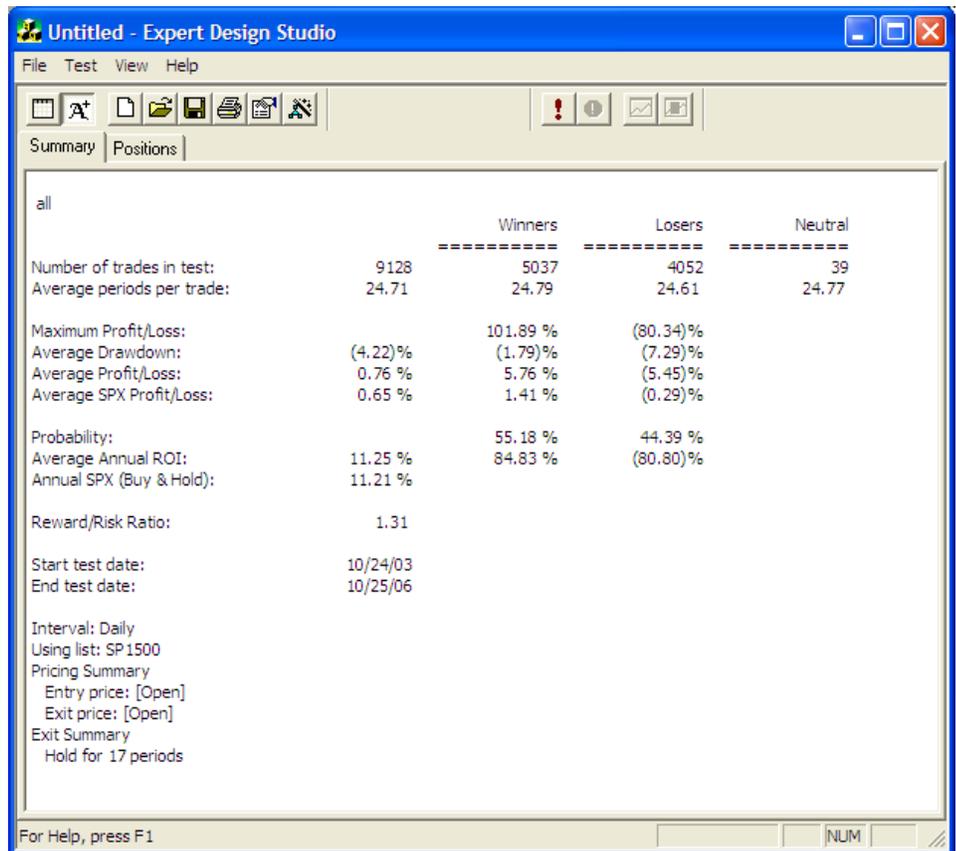


Figure 2. AIQ's EDS Summary report with test results for 25-day time stop exit system.

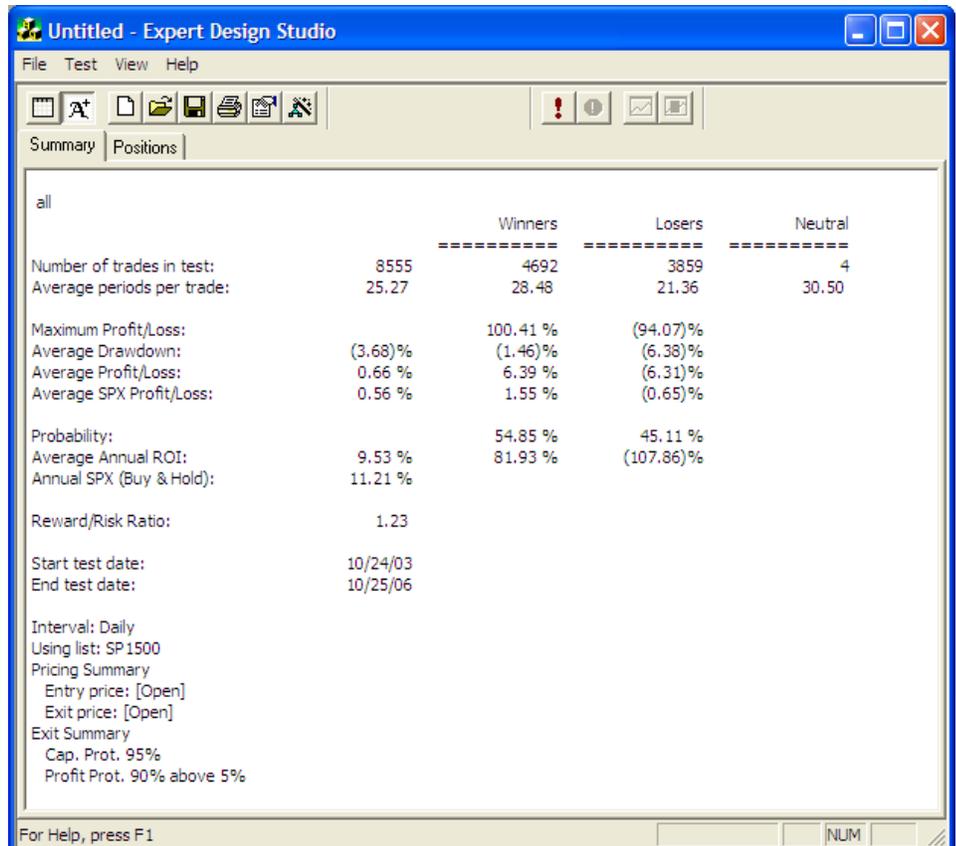


Figure 3. AIQ's EDS Summary report with test results for 95% profit protect (after 5% gain) stop exit system.

Industry Group Analysis, Part III

Identify Group/Sector Rotation With AIQ's Unique Analysis Report

By David Vomund

One of TradingExpert Pro's most powerful features is its ability to identify industry group and sector rotation. In the two previous issues of the *Opening Bell* (September and October), we discussed the advantages and disadvantages of several AIQ industry group structures, and covered how AIQ's industry groups and sectors are calculated. This month, we'll feature one of AIQ's pre-built screening reports — the Sector Analysis report.

Since both price and volume data is available for AIQ's industry groups and sectors, the same analy-

sis that you perform on stocks can be performed on groups/sectors. There is an additional benefit in that the Group Analysis and Sector Analysis reports can be used to identify group rotation. We'll cover the Sector Analysis report but the same techniques can be used on the Group Analysis report as well.

“You'll need to understand the Trend Score and Delta Trend Score indicators that are found on the Sector Analysis report. Trend Score (TS) is a special AIQ expert system that measures the strength or weakness of several indicators...Delta Trend Score (DTS) is the rate of change, or momentum, of the TS.”

sis that you perform on stocks can be performed on groups/sectors. There is an additional benefit in that the Group Analysis and Sector Analysis reports can be used to identify group rotation. We'll cover the Sector Analysis report but the same techniques can be used on the Group Analysis report as well.

The Sector Analysis report is unique to AIQ and very helpful in identifying sector rotation. To properly use this report, you'll need

to understand the Trend Score and Delta Trend Score indicators that are found on this report.

Trend Score (TS) is a special AIQ expert system that measures the strength or weakness of several indicators including the MACD, Volume Accumulation Percentage, Directional Movement, On Balance Volume, Positive Volume, and Average Directional Movement Index. Since TS is based on the strength of the technical indicators, and indicators tend to lead price action, TS is a leading indicator. The TS values vary between +100 and -100, where +100 signifies a very strong uptrend.

Delta Trend Score (DTS) is the rate of change, or momentum, of the TS. Depending on whether you prefer to buy into strength or enter near the lows, you will want to focus on either the TS or the DTS readings.

Buying After Weakness

To identify a sector whose indicators have been weak but are beginning to show signs of strength, look for a high DTS score relative to the other sectors. DTS looks at the rate of change in the TS and gives a short-term reading. Since high DTS scores are the first indication of new strength, buying high DTS sectors can get you in early but you must

also be aware of false signals.

What is a high score one day may not be a high score the next day so it is important to scan through the DTS column to see what constitutes a high score. The sectors with high DTS scores will typically appear in the lower half of the ranking. The sectors near the top of the ranking already have strong indicators so the rate of change in the indicators is typically close to zero.

Buying Into Strength

What is high can go higher. Buying into strength is a strategy followed by growth investors. In this strategy, you want to focus on sectors near the top of the ranking. These sectors have the strongest indicators and are showing signs of accumulation so it is unlikely that they are in a topping process.

“The trend is your friend” is a motto followed by growth investors. Therefore, with this strategy you want to plot the top ranked sectors making sure that they are in an overall uptrend. Those that are near the top of the ranking and are in an overall uptrend pass the test.

The Trend Score gives a short-term reading of a sector's strength. There are many examples of sectors that appear at the top of the Sector Analysis report because of very recent strength, even though they are in long-term downtrends. For a longer-term and more stable picture, use the weekly version of this report.

Rotation Example

Here is an example of the stages of a group/sector that forms a bottom and enters a strong uptrend. Our example uses the Standard &

Poor's industry group structure. Because many of Standard & Poor's industry groups contain too few stocks, we'll perform the analysis on sectors. Whether you use the Group Analysis or Sector Analysis report, the analysis techniques are the same.

We will follow the rotation of the Utilities and Energy sectors as they form their September lows, and then outperform the other sectors during the October advance.

Figure 1 shows these two sectors. Notice that for most of September the sectors were moving lower and there was no reason to buy them. Their low points came around September 22, signified by the downward arrows. In hindsight, this was a great entry date. Three trading days later the sectors were off their lows with good momentum (see upward arrows). Finally, on October 20 both sectors were in established uptrends and were outperforming the other sectors.

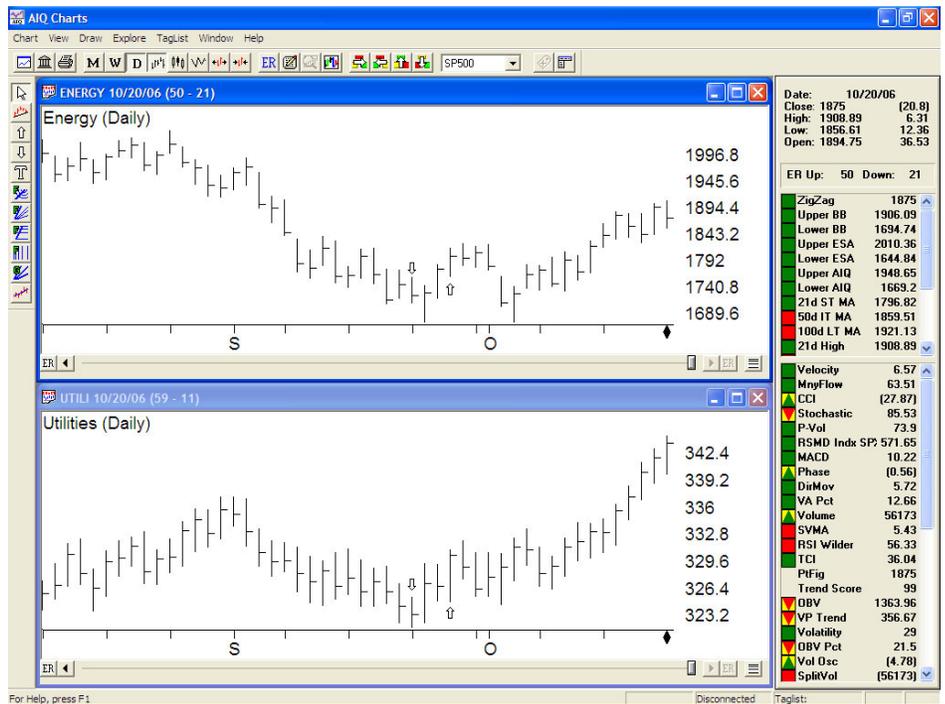


Figure 1. Daily charts of the Energy and Utilities sectors. In late September, both sectors began moving off their lows (see arrows).

Now let's look at how one can identify this rotation with the Sector Analysis report. We begin on

in Figure 1). The Sector Analysis report on this day showed both sectors at the bottom of the ranking (**Figure 2**). There was no reason to be interested in either sector.

Just three trading days later, both sectors bounced off their lows, quickly reversing the direction of the indicators. **Figure 3** shows the Sector Analysis report on this date. Scanning the DTS column, both Utilities and Energy had a DTS of 108, well above the DTS of the other sectors. The upward momentum on these sectors was clearly stronger than all other sectors. This was the first indication that a new uptrend was emerging.

Entering a group or sector based on a high DTS is very rewarding when it works, because it allows you to enter near the market low, but there are more false signals. After the September 27 buy, Utilities never looked back but Energy retested its lows before its uptrend emerged.

By mid-October Utilities held the top spot on the Sector Analysis report and both sectors were outperforming (**Figure 4**). This doesn't

Score	TS	DTS	nu
84+	16-	Delta: 44+	56-
	Ave Delta: 2+	12-	
TS	DTS	nu	
100	0		HOUSE Household & Personal Products
99	0	1	RETAIL Retailing
99	1		FINAN Diversified Financials
99	(0)		TELECMMS Telecommunication Services
98	2		TECHNLGY Technology, Hardware, Tools & Equip
98	1		INSUR Insurance Sector
98	1		LEISU Consumer Services
95	(1)		REALESTA Real Estate
95	0		COMPT Software and Services
95	1		CONSU Consumer Durables & Apparel
93	(3)		PHARMBIO Pharmaceuticals & Biotechnology
93	(2)		BANKING Banks
92	0		MEDIAS Media
91	(0)		SEMICOND Semiconductors & Semiconductor Eqpt
91	9		SERVI Commercial Services and Supplies
88	(7)		FOODDRUG Food & Staples Retailing
79	(6)		HEALT Healthcare Equipment and Services
66	(13)		CAPGOODS Capital Goods
49	(11)		TRANP Transportation
42	3		AUTOM Automobiles and Components
(26)	(68)		FOODS Food, Beverage & Tobacco
(47)	(15)	1	MATERIAL Materials
(89)	(27)		UTILI Utilities
(99)	(7)		ENERGY Energy

Figure 2. AIQ Sector Analysis Report for 9/22/06. On this date, the Utilities and Energy sectors were at bottom of list, both having highly negative Trend Scores.

mean the move was over or that the sector could only fall. What is high can go higher. Growth investors profit by rotating to the groups and sectors that appear at or near the top of this report.

Combination Strategy

There is a very effective strategy which combines the elements of the two strategies discussed above. For long positions, look for sectors that are near the top of the ranking but also have a larger than average DTS. The higher the DTS the better. Since the sectors are near the top of the ranking, we know that their indicators are strong. Not only are they strong but also the positive DTS value implies they are still improving.

The opposite is true for identifying weakness. An example of a bearish condition is found in the Food-Beverage & Tobacco sector in Figure 2 and Figure 3. In both cases Food was ranked at or near the

Ticker	Sector	TS	DTS	nu
FINAN	Diversified Financials	100	0	
SERVI	Commercial Services and Supplies	100	2	
RETAI	Retailing	100	0	1
HOUSE	Household & Personal Products	100	(0)	
MEDIAS	Media	100	4	
CONSU	Consumer Durables & Apparel	99	1	
INSUR	Insurance Sector	99	0	
LEISU	Consumer Services	99	0	
COMPT	Software and Services	98	0	
TELECMMS	Telecommunication Services	98	(1)	
TECHNLGY	Technology, Hardware, Tools & Equip	98	(0)	
AUTOM	Automobiles and Components	97	28	
BANKING	Banks	97	3	
CAPGOODS	Capital Goods	96	21	
REALESTA	Real Estate	96	2	
SEMICOND	Semiconductors & Semiconductor Eqpt	95	1	
PHARMBIO	Pharmaceuticals & Biotechnology	89	2	
TRANP	Transportation	70	28	
HEALT	Healthcare Equipment and Services	68	5	
UTILI	Utilities	47	108	
ENERGY	Energy	40	108	
MATERIAL	Materials	(49)	28	1
FOODDRUG	Food & Staples Retailing	(65)	1	
FOODS	Food, Beverage & Tobacco	(98)	(12)	

Figure 3. AIQ Sector Analysis Report for 9/27/06. The Utilities and Energy sectors both show early signs of strength with high DTS values of 108.

Ticker	Sector	TS	DTS	nu
UTILI	Utilities	100	0	
AUTOM	Automobiles and Components	100	(0)	
REALESTA	Real Estate	100	0	
PHARMBIO	Pharmaceuticals & Biotechnology	100	(0)	
COMPT	Software and Services	100	0	
MEDIAS	Media	100	(0)	
ENERGY	Energy	99	(0)	
CAPGOODS	Capital Goods	97	(2)	
SERVI	Commercial Services and Supplies	97	(2)	
TRANP	Transportation	89	(8)	
INSUR	Insurance Sector	89	(10)	
MATERIAL	Materials	83	(12)	1
HOUSE	Household & Personal Products	79	(5)	
HEALT	Healthcare Equipment and Services	77	3	
BANKING	Banks	77	(3)	
TECHNLGY	Technology, Hardware, Tools & Equip	77	(13)	
RETAI	Retailing	76	1	1
CONSU	Consumer Durables & Apparel	76	(8)	
FINAN	Diversified Financials	75	(5)	
FOODDRUG	Food & Staples Retailing	56	(25)	
FOODS	Food, Beverage & Tobacco	30	76	
TELECMMS	Telecommunication Services	(54)	(1)	
LEISU	Consumer Services	(93)	(33)	
SEMICOND	Semiconductors & Semiconductor Eqpt	(99)	(33)	

Figure 4. AIQ Sector Analysis Report for 10/20/06. By this date, both sectors are outperforming with Utilities the top ranked sector and Energy just below.

bottom of the report. The sector was underperforming. At the same time the indicators were losing momentum, indicated by the negative DTS reading. In Figure 2 Food's DTS reading of -68 was well below all other DTS readings on that day. The same applies for Figure 3.

Indeed Food-Beverage & Tobacco failed to participate in the market's ensuing rally. We can see that by its continued low ranking on October 20 (Figure 4). Interestingly, on October 20 this sector has the largest DTS reading, indicating its period of weakness was ending.

The Sector Analysis report is one of many pre-built screening reports. The most conventional report to identify rotation is the Price Change report. This report concentrates on the groups or sectors that have performed the best. We'll have more on using price change analysis next month.

Market Review

Rally Continues As Stocks Hold Their Own Despite 'Bad News'

The amazing market rally continued through October. The S&P 500 rose 3.2% in October, while the Nasdaq Composite leaped 4.8% and the Russell 2000's 5.7% gain was stronger still. Since their July lows, the S&P 500 is up 11.4%, the Nasdaq Composite is up 17.1%, and the Russell 2000 is up 14.1%.

You can tell a lot about the market environment by how it reacts to news. When stocks hold their own in the face of bad news — they did during the summer — it becomes more and more likely that prices will soon move higher. It works the other way, too. If stocks don't rise during periods in which the news is positive, they'll soon head south.

During the rally, fundamental analysts could make a bearish case. Interest rates are on hold and not to

be cut anytime soon, North Korea and Iran will have nuclear weapons, Iraq continues to inch along, and profit growth is slowing. Yes, it's easy to make a bearish case but market movement is based on supply and demand, and demand was strong.

Trendlines on the S&P 500 show a parabolic pattern. A trendline drawn from the mid-September low is steeper than a trendline drawn from the early September low, which in turn is steeper than the trendline drawn from the July low. A break of the steep trendlines is inevitable.

Given the parabolic advance, it is surprising to see that there hasn't been a high percentage of stocks giving unconfirmed sell signals. The percentage of stocks giving unconfirmed sell signals remained in neutral territory, keeping short-term market timers in the rally.

Web Seminars

AIQ is offering online seminars (webinars) for both beginning and experienced AIQ users. Check out AIQ's November webinars, including free ones!

For more information and also to register, visit:
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S&P 500 Changes

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

Western Union (WU) replaces Andrew Corp. (ANDW). WU is added to the Services-Data Processing (SERVICEP) group.

Smith International (SII) replaces Golden West Financial (GDW). SII is added to the Oil & Gas Equipment & Services (OILGASEQ) group.

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STOCK DATA MAINTENANCE

The following table shows stock splits and other changes:

Stock	Ticker	Split	Approx. Date
Carolina Trust Bank	CART	10%	11/06/06
Commerce Bancshares	CBSH	5%	11/30/06

Trading Suspended:

Aames Investment Corp. (AIC)
Royal Group Technologies (RYG)
Vaalco Energy (EGY)

Name Changes:

Allianz AG ADS (AZ) to Allianz SE ADS (AZ)
Bank of Wilmington Corp (BKWW) to Cape Fear Bank Corp. (CAPE)
Euro Currency Trust (FXE) to CurrencyShares Euro Trust (FXE)
Sunset Financial Resources (SFO) to Alesco Financial Inc. (AFN)