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Tweezer Bottom Candlestick Model

Combine Two Pre-built Rules That Test Well and You Have an Effective EDS Strategy

By David Vomund

In the October 2002 *Opening Bell*, we reported testing results that determined which of the Expert Design Studio (EDS) pre-built rules are the most effective. In this article, we'll combine two of these rules to create an effective EDS trading model.

Many of the pre-built rules that tested well were based on candlestick chart patterns. The candlestick pattern that we will focus in our trading model is the Tweezer Bottom.

A Tweezer Bottom occurs when a security has two days with the same low price. The two low prices can occur on near by or consecutive sessions. For our EDS model, we require the same low price to occur on consecutive days. The pattern is called

Tweezer Bottom because it is compared to the two prongs of a tweezer.

The Tweezer Bottom is not supposed to be a vital reversal signal. Candlestick chartists like to see a secondary bullish pattern form right

after the Tweezer Bottom pattern. Our testing, however, revealed that the Tweezer Bottom is an effective stand-alone tool for signifying a short-term rally in the security. About 200 pre-built screening rules were tested, and the Tweezer

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DAVID VOMUND

“Many of the pre-built rules that tested well were based on candlestick chart patterns. The pattern that we will focus on in our trading model is the Tweezer Bottom... The second rule requires the Color Barometer on the RSI AIQ indicator to have a red down arrow.”

Bottom was the 16th most effective.

AIQ's pre-built Tweezer Bottom rule has two components. The first component is the requirement that the current day's low price equals the previous

day's low price. The second component requires the current day's low price to equal the previous day's closing price. This second component is not part of the actual candlestick pattern and testing shows that it adds no value. It doesn't raise the overall return and it eliminates about 85% of the trades. The pre-built rule is better off without the second component, so we eliminated it.

To find a secondary filter we once again turned to the October *Opening Bell* and began applying other highly effective rules. We knew that combining another candlestick rule with the Tweezer Bottom rule would eliminate most or all of the trades so our focus was on indicator-based rules.

Having the Money Flow RSI indicator fall below 90 tested well, but when this rule was combined with the Tweezer Bottom rule there were too few trades. The 9,919 trades from the Tweezer Bottom rule was reduced to only 32 trades when the Money Flow RSI rule was added.

Having a stock fall below the Upper ESA trading band tested well on its own and did well when

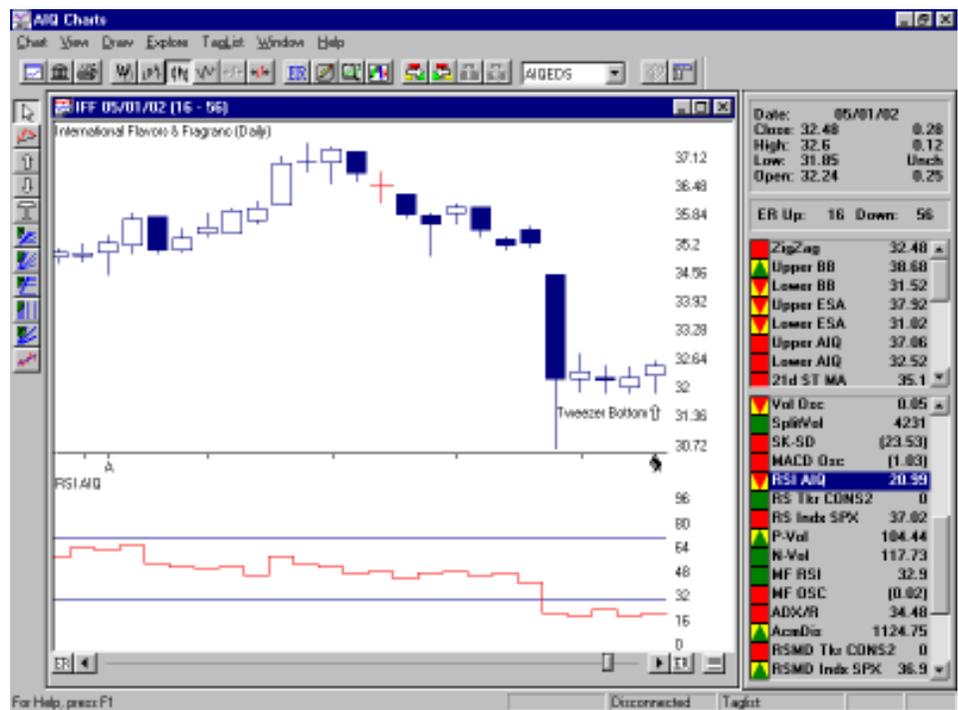


Figure 1. Candlestick chart of IFF. The arrow shown on 05/01/02 marks the completion of a Tweezer Bottom pattern when the same low price occurred on consecutive days.

combined with the Tweezer Bottom rule. Using the S&P 500 database and the same time period as our previous tests, its Average Annual ROI was 38% with 259 trades. The model, in effect, looks for stocks that have pulled back after a recent rally and have formed a Tweezer Bottom pattern.

After more research we found a better rule, which we combined with the Tweezer Bottom rule for our final model. The new second rule looks at the Color Barometer next to the RSI AIQ indicator. It requires the Color Barometer for this indicator to show a red down arrow. Surprisingly, this was the twelfth most effective rule.

The only time this indicator can show a red down arrow is when it is overbought (above 70) or oversold (below 30). Most of the time, red down arrows appear when the RSI AIQ indicator is above 70.

Therefore, our screening model requires the following two events to occur simultaneously:

1. Tweezer Bottom pattern, meaning two consecutive low prices at the same dollar amount.
2. Red down arrow next to the

"An EDS backtest of this (Tweezer Bottom Candlestick) strategy on the 1700 AIQ Pyramid stocks from 01/02/98 to 10/30/02 shows an Average Annual ROI of 44.8% with 7799 trades."

RSI AIQ indicator.

An example of a stock that passed this model is International Flavors and Fragrances (IFF). On May 1, IFF formed a Tweezer Bottom when for the second consecutive day the low price was exactly \$31.85. In addition, its RSI AIQ indicator showed a red down arrow as the indicator was in oversold territory (**Figure 1**).

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An EDS backtest of this strategy on the 1700 AIQ Pyramid stocks from 01/02/98 to 10/30/02 shows an Average Annual ROI of 44.8% with 7799 trades. Again, the sell strategy is a fixed 22 business day holding period.

The trades are significantly reduced using an S&P 500 database but the results are still good. This test shows 943 trades with an Average Annual ROI of 31.7% (Figure 2).

While the backtests show that the model is effective, they don't show what kind of return you would have seen. After all, these tests make the unrealistic assumption that all the trades are acted on and the annualized return is computed based on this assumption. For a more realistic representation of what portfolio returns would have been, we'll use the Portfolio Simulator.

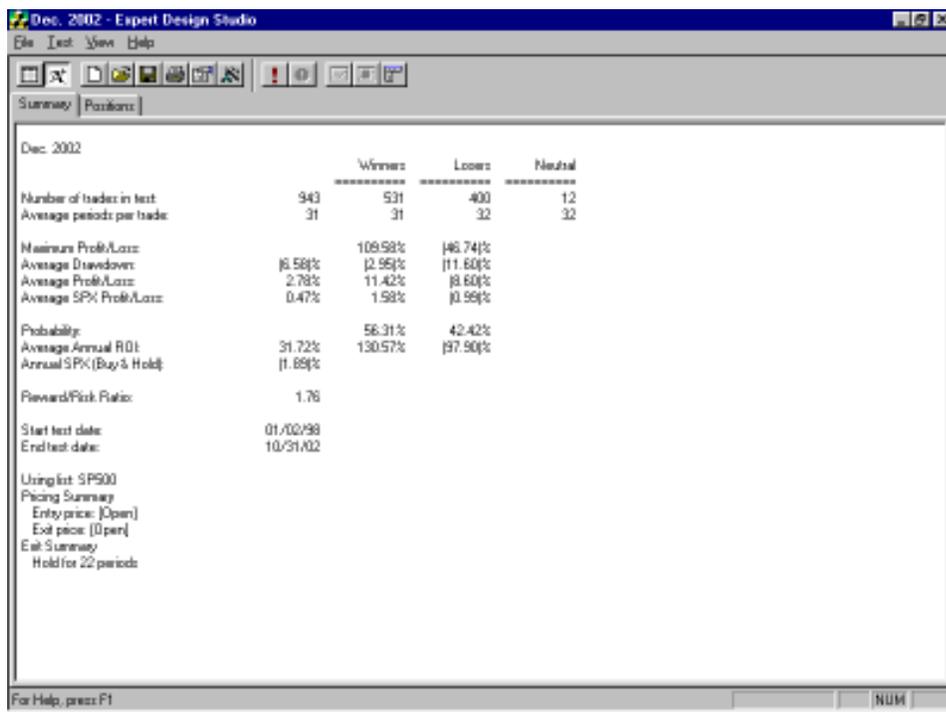


Figure 2. Results of 4 yr. + 10 mo. EDS backtest of screening model using S&P 500 stock database. The test indicates an average annual ROI from 943 trades of 31.7%.

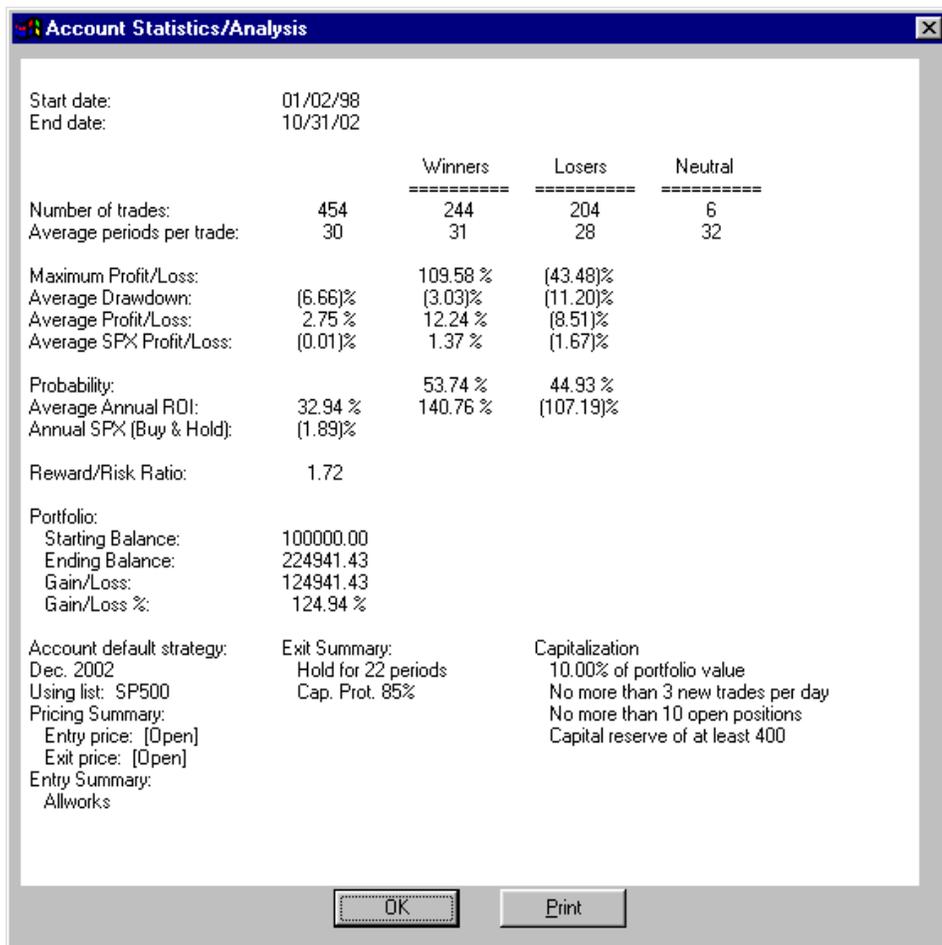


Figure 3. Simulated trading results for screening model (same time period and database). The average annual ROI from 454 trades is 32.9%.

Using the Portfolio Simulator, we began with a portfolio of \$100,000 in cash and specified that each position would represent 10% of the portfolio value and, therefore, a fully invested portfolio consists of ten positions. No more than three trades could be placed per day. The sell strategy was a fixed 22 business day holding period combined with an 85% capital protect. The time period used was 01/02/98 to 10/31/02.

The results are found in Figure 3. The overall return was an outstanding 125%. Over the same time period, the S&P 500 lost 9%. Here is a breakdown of the yearly returns:

1998	59.0%
1999	45.0%
2000	23.0%
2001	-7.6%
2002	-4.8%

This EDS model can be downloaded from AIQ's web page at www.aiqsystems.com. Click on *Educational Products* and then *Opening Bell*.

An Overbought/Oversold Indicator for the Market

Control your Emotions with AIQ's Unique Market Timing Tool -- the US Score

By David Vomund

When the market is falling and the charts look terrible, your emotions want you to sell. Conversely, when the market is rallying and the news is good, your emotions want you to buy. Unfortunately, this can lead to selling at the low or buying at the high.

One way of controlling your emotions is to set some market timing rules based on AIQ's US score, a unique indicator that can be found on the Market Log report.

While the Expert Ratings on an individual stock can be suspect, the Expert Ratings taken from a large database of stocks are effective in classifying the health of the market. That is, when a lot of stocks are giving AIQ Expert Rating buy signals, a market rally may be near. Conversely, when a large number of stocks are giving AIQ sell signals, a market decline may be approaching.

Expert Ratings are either "con-

"It is important to keep in mind that AIQ Expert Ratings fire against the trend. As the market declines, the percentage of stocks giving unconfirmed AIQ buy signals increases. As the market rallies, few stocks give buy signals and more stocks register sell signals."

firmed" or "unconfirmed." A confirmed buy signal occurs when a stock has a recent Expert Rating up signal of 95 or greater along with an

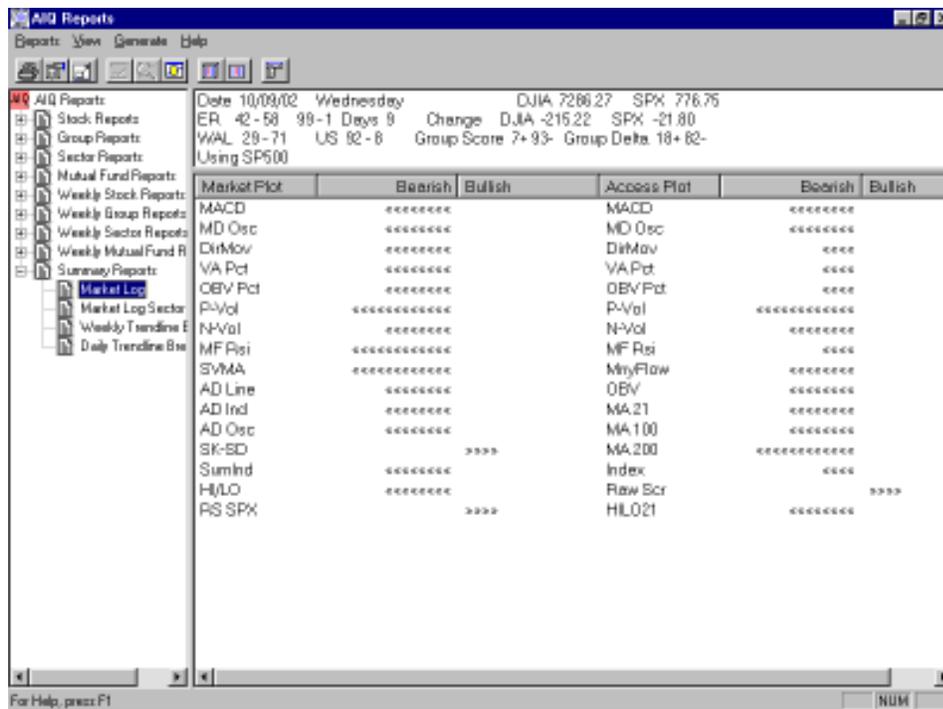


Figure 1. Market Log report for 10/09/02. US score (92-8) appears in upper section next to WAL score.

increasing Phase indicator. The opposite is true for confirmed sell signals. Unconfirmed signals, however, occur when there is an Expert Rating of 95 or greater but the Phase indicator fails to move in the direction of the signal. It is the unconfirmed signals that you should be interested in.

AIQ's Market Log report lists the percentage of stocks giving unconfirmed signals (US). The US score is found near the top of the report (**Figure 1**). The percentage of stocks giving unconfirmed AIQ buy signals appears to the left of the

hyphen and the percentage of stocks giving unconfirmed AIQ sell signals appears on the right side of the hyphen. In **Figure 1** we see that of the stocks giving unconfirmed signals, 92% are on the buy side and 8% are on the sell side.

To open the Market Log report, go to Reports and double-click *Summary Reports* and then *Market Log*. I run the Market Log report on the S&P 500 database.

It is important to keep in mind that AIQ Expert Ratings fire against the trend. As the market declines, the percentage of stocks giving unconfirmed AIQ buy signals increases. As the market rallies, few stocks give buy signals and more stocks register sell signals.

The US score serves as an overbought/oversold indicator for the market. That is, when the US score

shows 85% or more on the buy side, then that implies the market has recently experienced a sharp decline, is oversold, and due for a rally. Conversely, when the US score shows 85% or more on the sell side, then the market has rallied and is overbought.

Some AIQ users immediately enter the market when the US score moves to 85% or more on the buy side. They exit any-time the US score is 85% or more on the sell side.

I don't recommend this approach because the market can stay overbought or oversold for quite some time. Instead, it may be best to wait for a trend-following indicator such as the Directional Movement Index to confirm the new trend direction.

Rather than using the US score

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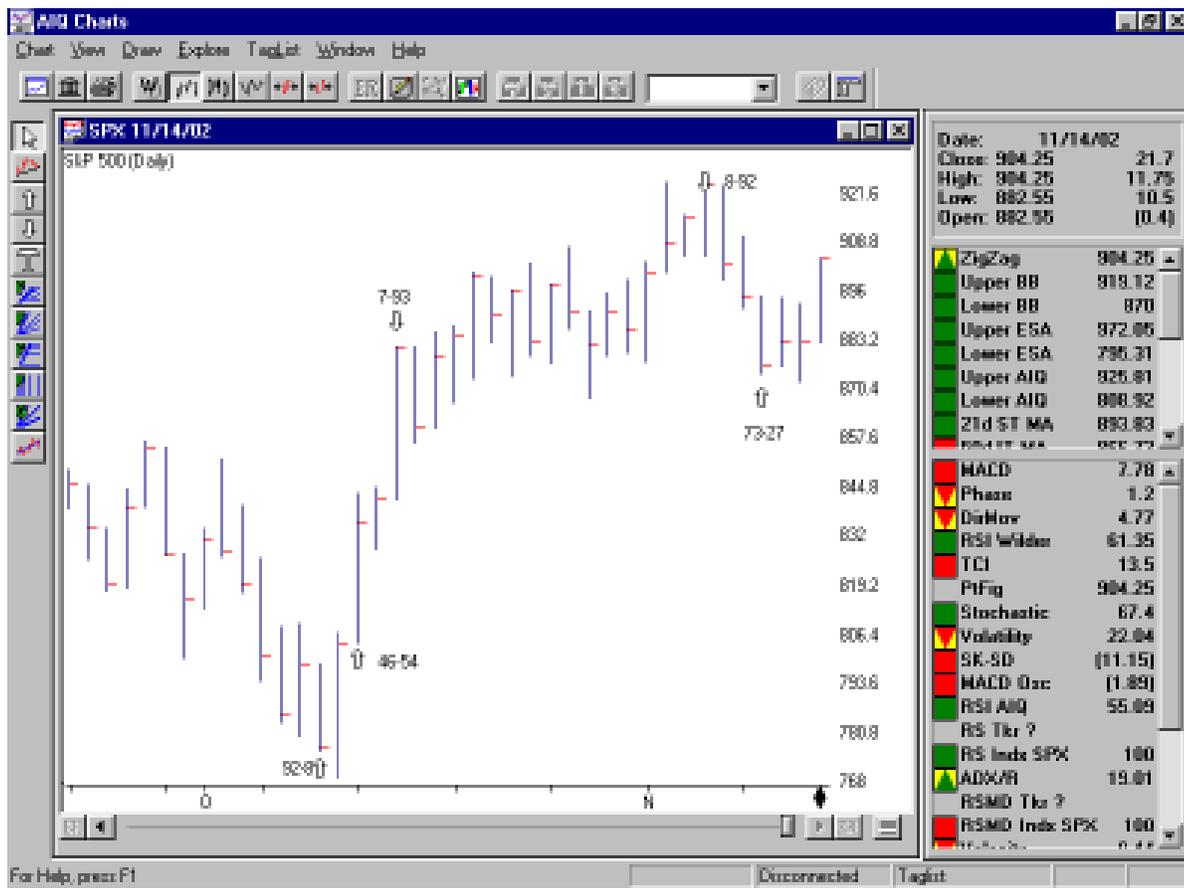


Figure 2. Daily chart of S&P 500 index with US scores (arrows) shown at market extremes. The bullish score of 92-8 on 10/09 says don't sell even though market prospects look bad. When market turns up, US score first shifts to neutral (46-54 on 10/11), then bearish (7-93 on 10/15). During market advance over next three weeks, US score remains bearish (8-92 on 11/06). Then, after three strong down days, the score moves out of bearish territory (73-27 on 11/11).

as a strict market timing model, use it as a simple tool to keep your emotions in check. It helps you avoid buying high or selling low.

Here is the rule: Don't turn bearish on the market and sell positions when the US score shows 85% or more buy signals. Similarly, never turn bullish or add positions when the US score shows 85% or more sell signals.

This rule sounds simple but your emotions will tell you otherwise. When the US score has a high percentage of buy signals, the market has fallen and news reports are gloomy. That's when your emotions tell you to bail. You may be selling right at a low, however. You either should have already sold or you should wait until the market rallies enough to where the US score is no longer giving a bullish reading.

When the market rallies it gets easier to buy. News reports are better and you think you may miss a big rally if you don't immediately buy. Your emotions tell you to buy more but the US score can counteract your emotions. Don't buy until the market pulls back enough to bring the US score out of bearish territory. Preferably, wait until the US score turns bullish.

Let's see how using this indicator works. **Figure 2** shows the S&P 500 and the US score at market extremes. Just examining this chart shows how the US score keeps you from buying high or selling low.

The market looked horrible on October 9 and emotions told you to sell. The US score, however, showed that 92% of the S&P 500 stocks with unconfirmed signals were on the buy side. This was not the time to

turn bearish. The market rallied over the next two days and the US score moved to a neutral 46-54 reading. If you were still bearish this represented a better time to sell.

The market kept rallying, however. As it moved higher, the percentage of stocks giving unconfirmed sell signals increased.

On October 15 the market had rallied enough to turn the US score bearish. Emotions told you to buy but the US score told you it would be best to wait. The market didn't fall from that level but the advance stalled.

The US score was still bearish on November 6 with 92% sell signals. All it took was three strong down days and the score had already moved out of bearish territory and had 73% of the stocks on the buy side.

If you were bullish and wanted to add to positions, it was better to wait for the US score to hit 73-27 than it was to buy when the US score was 8-92. It would be better yet to have the market fall enough to turn the US score to a bullish 85% or more.

Monitoring the US score on a daily basis gives you a good indication of the market's health. It helps to control your emotions because it turns more bullish as the market falls and it turns more bearish as the market rises.

As we move forward, the US score will become even more impor-

"The US score helps you avoid buying high or selling low. Here is the rule: Don't turn bearish on the market and sell positions when the US score shows 85% or more buy signals. Similarly, never turn bullish or add positions when the US score shows 85% or more sell signals."

tant if the market enters a prolonged consolidation period following the bear market.

David Vomund publishes *VIS Alert*, a weekly investment newsletter. For free trial issues, call 775-831-1544 or go to www.visalert.com.

STOCK DATA MAINTENANCE

The following table shows stock splits and other changes:

Stock	Ticker	Split	Approx. Date
JetBlue Airways	JBLU	3:2	12/13/02
CCF Holding Co.	CCFH	3:2	12/20/02

Trading Suspended:

CTB Int'l (CTBC), Golden State Bancorp (GSB), Sonus Corp. (SSN), US Laboratories Inc. (USLB), US Vision Inc. (USVI)

Name Changes:

Banknorth Group (BKNG) to Banknorth Group (BNK)
 Concord EFS (CEFT) to Concord EFS Inc. (CE)
 Countrywide Credit Ind. (CCR) to Countrywide Financial (CFC)
 Getty Images (GETY) to Getty Images (GYI)
 Nortek Inc. (NTK) to Nortek Holdings (NTK)
 Right Management Cts. (RMCI) to Right Management Consultants (RHT)
 St. Mary Land & Exploration (MARY) to
 St. Mary Land & Exploration (SM)

S&P 500 Changes

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

Comcast Corp. (CMCSA) replaces Comcast Class A (CMCSK). CMCSA is added to Broadcasting & Cable TV (BROADCASTAS) group.

Market Review

The market was very strong in November with the S&P 500 gaining 5.7% and the Nasdaq Composite gaining 11.2%. The Nasdaq was able to move above its August highs, its first higher high since the bear market began. The S&P 500, however, was still stuck in its consolidation range where 965 represented the upper end of the range.

The best performing groups in November were those that took the brunt of the selling during the bear market. The Cellular Telecommunications group gained 70%!

No market timing Expert Rating signals were fired in November. The AIQ market timing model is on a September 26 buy signal.

What Every AIQ User Should Know, Part I

AIQ's Powerful List Management Tools Allow You To Focus on Stocks That Interest You

There are a lot of technical software packages available today. All of them, including AIQ, chart securities and apply standard technical indicators. Some AIQ users are content with using these standard applications. That's a shame because AIQ has some features that nearly every user would find beneficial.

In a series of articles beginning with this one, three basic tools available in the AIQ TradingExpert Pro software will be discussed — tools that every AIQ user should know how to use.

The first important tool we'll cover relates to list management. Knowing how to create and manage lists allows users to focus on the stocks they want to purchase, to more easily manage a large database, to effortlessly chart their favorite stocks, etc.

TradingExpert Pro comes with the SP500 list, a list of the S&P 500

“Having a list of the stocks you are interested in helps filter out the noise of the other stocks... There is no longer a need to filter through a bunch of stock symbols looking for the ones you are interested in.”

stocks. Most users find that they would like to create additional lists to fit their trading needs. For example, people who prefer to trade the brand-name Nasdaq stocks can create a list of the Nasdaq 100 stocks. Those who want to track low Price-to-Earnings (PE) ratio stocks can create a list of stocks with below

market PE ratios. Followers of *Value Line* can create a list of VL's most timely stocks. Similarly, those who use *Investor's Business Daily* can create a list of IBD's weekly selections.

Having a list of the stocks you are interested in helps filter out the noise of the other stocks. For instance, you can check for a breakout on AIQ's Point & Figure Breakout report using your particular list of stocks.

There is no longer a need to filter through a bunch of stock symbols looking for the ones you are interested in. Expert Design Studio (EDS) scans can be run on specific lists as well.

Creating a list is a simple process. In Data Manager, click *List* on the menu bar and then *New*. Enter a name for the list. The list will appear in the left section of the Data Manager. With the list name highlighted, click *List* again and *Insert Tickers*. To save time, enter a list of tickers separated by semicolons. Click *OK* and the list will be created.

If you have a list of ticker symbols in a spreadsheet, TradingExpert Pro can import that list. First, save the list to a CSV format. Then go to the Data Manager and create the new list name using the process just described. With the list name

created, select *List* and then *Import*. Highlight the CSV file and click *OK*.

AIQ allows users to merge two lists as well. Some people like to track a list that combines the S&P 500 stocks with the Nasdaq 100 stocks. The *Advanced List Edit* function allows you to merge two

“The ability to create and use lists is a basic function of TradingExpert Pro. Although basic, this function is very powerful.”

lists (see page 118 in the *TradingExpert Pro User Reference Manual*).

Let me demonstrate the advantages of creating a list of stocks. I created a list of the stocks that appeared in the *Your Weekly Review* section of *Investor's Business Daily* (IBD). The stocks listed in this section are greater than \$10, are within 15% of their 12-month high, have an earnings per share (EPS) and relative strength rating of 85 or greater (i.e. in the top 15% of all stocks), and have an average volume greater than 10,000 shares.

Technicians love to examine charts so with our IBD list created we can quickly and easily scroll through the charts in our list. In *Charts*, use the drop down arrow in the tool bar to highlight the new list name (we named our list “IBD”). **Figure 1** (page 8) shows Coach Inc. (COH), one of the stocks in our list. By clicking the *Explore Right* icon on the toolbar we'll get a chart of each stock in our list. There is no need to type in the individual ticker symbols. By pressing the *Enter* key, the



Figure 1. Chart of COH, one of the stocks in list IBD. To display charts of symbols in a list sequentially, click the *Explore Right* icon on toolbar.

Control Panel is replaced by the list of the symbols. Click on a symbol and its chart will appear.

With our list created, we can run reports on this list rather than the entire database. To accomplish this, go to Reports and right-click on *Stock Reports*. The *Global Properties* box will appear (**Figure 2**). Use the drop-down arrow next to *Stock* to select the name of the list you want to run and click *OK*. Expert Design Studio scans can be run on selected lists as well.

IBD screened its stocks for relative strength and EPS strength so now we can use AIQ reports to run additional filters on these stocks. As we examine the reports, only the stocks that passed IBD's screening will appear. That can be a big advantage over running reports on the entire database.

Figure 3 shows the Persistence of Money Flow report. This report lists the three IBD stocks that have had very strong Money Flow readings over the last six months. If we had run this report on a large database of stocks, these three selections would have been hidden in a report full of stocks that we knew nothing about.

With only three stocks on the report we can simply double-click

their ticker symbols to pull up charts of the stocks. Some reports, however, will show many stock choices. To scroll through charts of the individual stocks that appear on a report, click the *Build Report List* icon on the toolbar. This will create a list of the stocks on a report. After naming the list, the first stock on the report will automatically be charted. Click the *Explore Right* icon to see the other stocks. Lists can be built after running an Expert Design Studio scan as well.

The ability to create and use lists is a basic function of Trading-Expert.

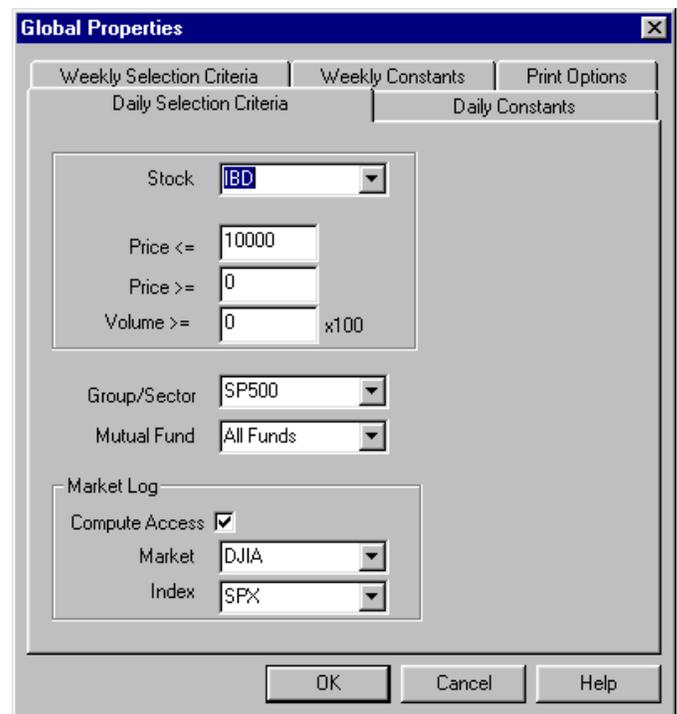


Figure 2. Daily Selection Criteria page of *Global Properties* box, a Reports function. Use the list box at the top (titled *Stock*) to select the list of symbols for analysis when reports are generated.

Although basic, this function is very powerful. It saves time and allows users to focus on the stocks they are most interested in.

Next month we'll cover another feature all AIQ users should know — how to create industry groups.

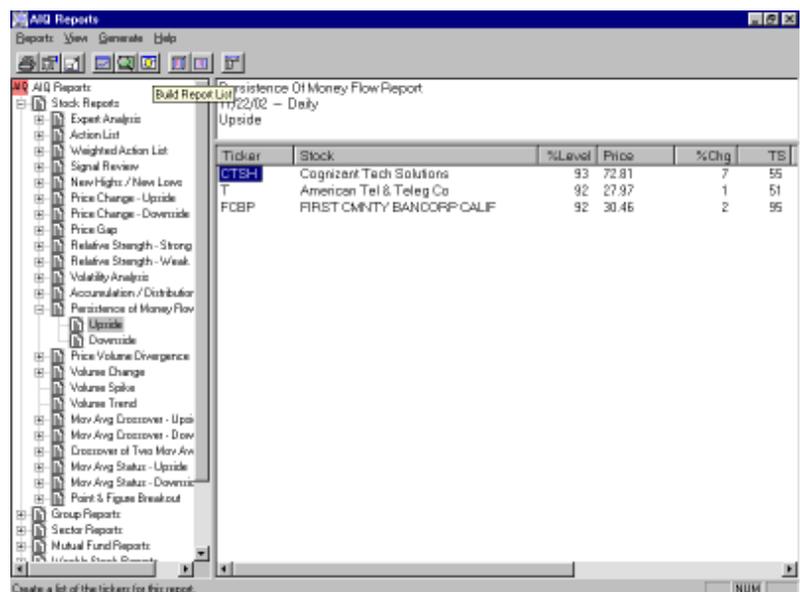


Figure 3. Daily Upside Persistence of Money Flow report run on list IBD. Main window lists three IBD stocks with strong Money Flow over past 6 mos.