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The *Opening Bell Monthly* is a publication of AIQ Systems
David Vomund, Chief Analyst
P.O. Box 7530
Incline Village, Nevada 89452

EXTREME GROWTH INVESTING

Growth Model Update: Narrowing Down Which Stocks To Buy

By David Vomund

Growth investors buy stocks in strong uptrends. The higher the stock rises before being purchased the more risky the position after the purchase. Although one wouldn't expect that buying a stock after it doubles in price would be a good strategy, historical testing shows otherwise.

Growth investing is very risky and is appropriate for those who can accept a lot of volatility. I've found growth investing works best when the Nasdaq outperforms the S&P 500. Looking at **Figure 1**, we see a weekly chart of the Nasdaq Composite along with its RSMD SPX indicator. Using this indicator, the Nasdaq outperforms when the

RSMDSPX indicator is rising. It is during these time periods that growth investing typically works well.

In the November *Opening Bell* we used the Expert Design Studio to

DAVID VOMUND

"During strong bull markets, more stocks can appear than is possible for most people to purchase...The indicator that we found added the most value (to further narrow our growth model) is Volume Accumulation Percent."

demonstrate that buying stocks after a large advance was actually an effective strategy. One model that we used looked for stocks that have increased by at least

150% in the last 66 business days but have stalled or moved lower for the last 10 days. Testing results over the last three years produced very good results. During strong bull markets, however, more stocks can appear on the list than is possible for most people to purchase.

For this article, we tested a

EXTREME GROWTH INVESTING *continued* . . .

number of indicators to further narrow our growth model. The indicator that we found added the most value is Volume Accumulation Percent (VaPct). This indicator is similar to Money Flow in that it looks at whether the stock closes near its daily high or low price and then factors in volume. It is bullish when a stock closes near its daily high on heavy volume. The higher the level of VaPct, the more bullish the stock.

Here is the code for our Expert Design Studio model:

```
Uptrend if [close]/val([close],66)>1.5.
Pause if HiVal([close],9)<val([close],10).
VA if [VA pct]>25.
Allworks if Uptrend and Pause and VA.
```

The *Uptrend* rule states that the security must increase by at least 150% in the last 66 business days. The *Pause* rule states that the stock must have fallen over the last ten days (i.e., its 10 day high price occurred 10 days ago). This rule is included to take away some of the over-extended nature of the stocks. The *VA* rule states that Volume Accumulation Percent must be above 25. Finally, the *Allworks* rule states that the previous three rules are true.

This model can be downloaded

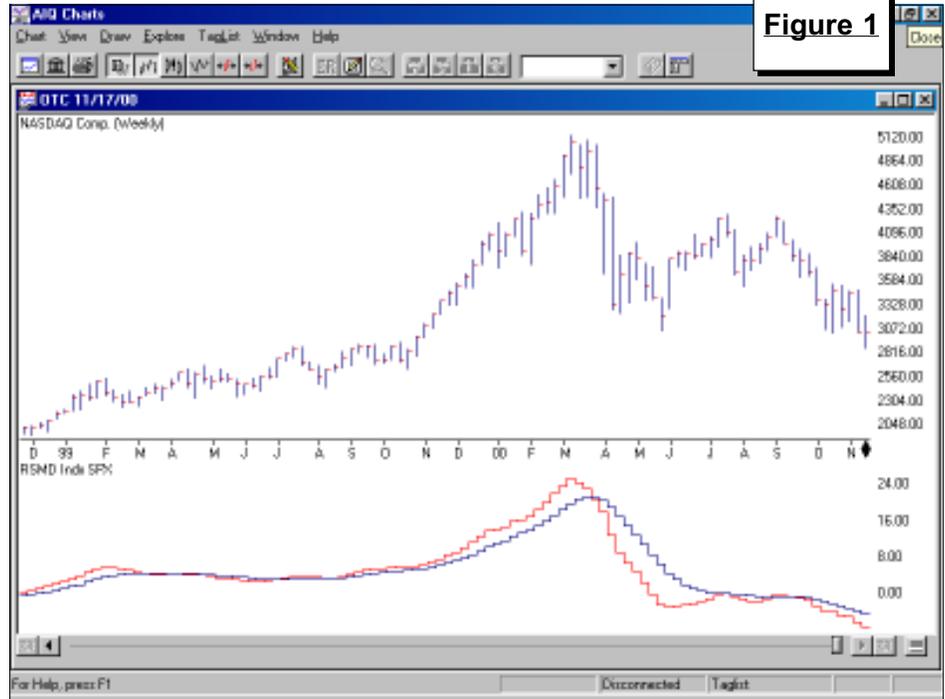


Figure 1

from the internet by visiting www.aiq.com. Click on *Educational Products* and then *Opening Bell Monthly*.

The levels of the *Uptrend* and *VA* rules can be changed depending on how many stocks you want to pass the model.

Looking closely at the *VA* rule, the level of the VaPct directly affects performance and how many stocks pass the test. The higher the level, the better the results. In **Figure 2** we ran a test from 12/31/97 to 11/15/00 using a database of Nasdaq 100 stocks. We ran the

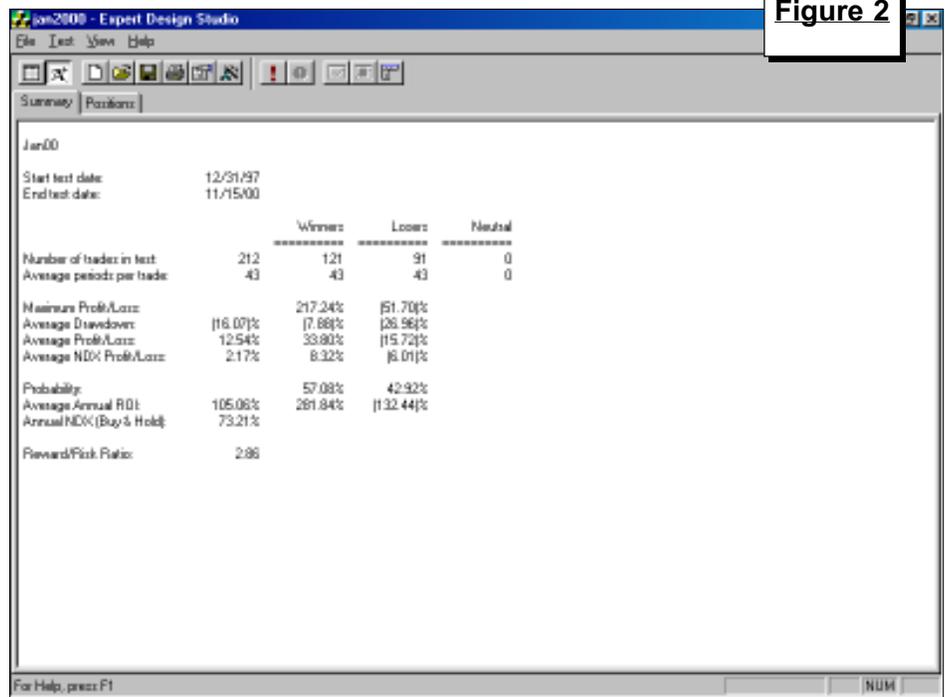


Figure 2

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G.R. Barbor, Editor
P.O. Box 7530
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EXTREME GROWTH INVESTING *continued* . . .

model but said the Volume Accumulation Percent level must simply be above zero. A 30 day fixed holding period was used. We see the average gain per trade was 12.54% versus a 2.17% return in the Nasdaq 100 index.

In **Figure 3** we changed the model to state that VaPct must be above 25. Results are much improved – the average trade gained 24.18% compared to 5.75% in the Nasdaq 100 index. The number of trades is dramatically reduced, however. When we required the VaPct to be above zero, there were 212 trades. By requiring the indicator to be above 25, the number of trades was reduced to 22. This testing demonstrates that growth investors can use the level of the Volume Accumulation Percent indicator to narrow down which stocks to buy.

Using the level of the Volume Accumulation Percent indicator is one way of determining which stocks to buy. Another method is to use chart pattern interpretation. In our Expert Design Studio model

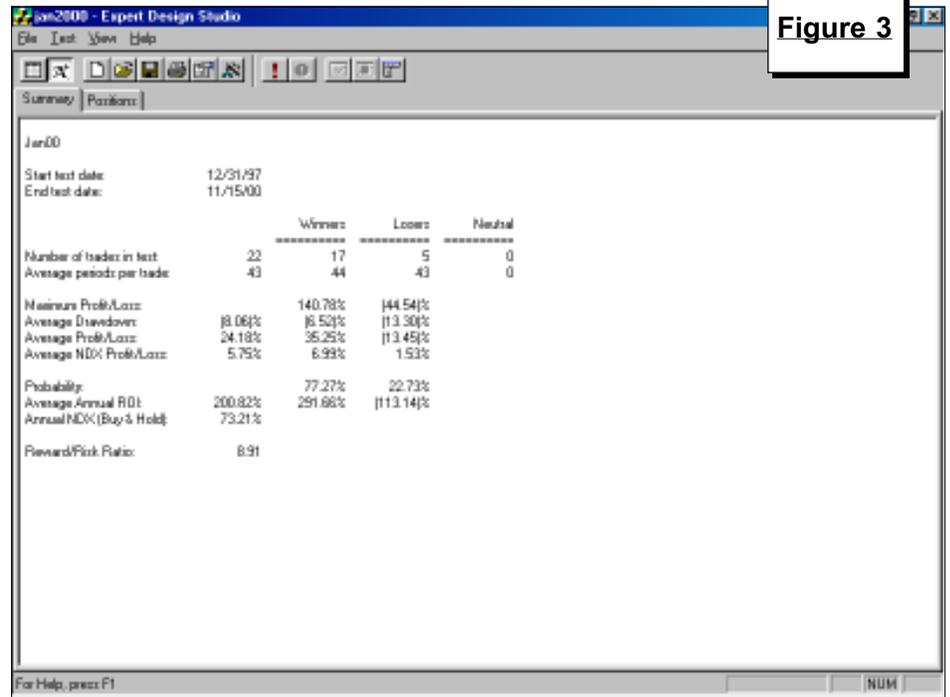


Figure 3

we said that the stock must have paused for 10 days after staging a strong rally. Very often, you can connect a trendline on the high prices during the 10-day pause. The stock is not a buy until the trendline is broken.

An example of this technique is found in **Figure 4**. Here, KLA-Tencor (KLAC) experienced a strong rally until mid-January. At that time, KLAC entered its 10-day pausing period. By connecting a trendline to the high points during this period we establish its short-term resistance. It wasn't until February 2 that KLAC gave its buy signal by rallying above its resistance trendline.

In our Expert Design Studio screening we stated that the Volume Accumulation Percent indicator needs to be above 25. When examining a chart, I prefer to look at VaPct's sister indicator, Money Flow. The advantage of plotting Money Flow is that it is easier to spot divergences. Ideally, you want the Money Flow indicator to be stronger than the price trend.

In Figure 4 we see that KLAC was below its 10-day high but the Money Flow indicator was hitting new highs. Another example is Broadvision Inc. (BVISN) on



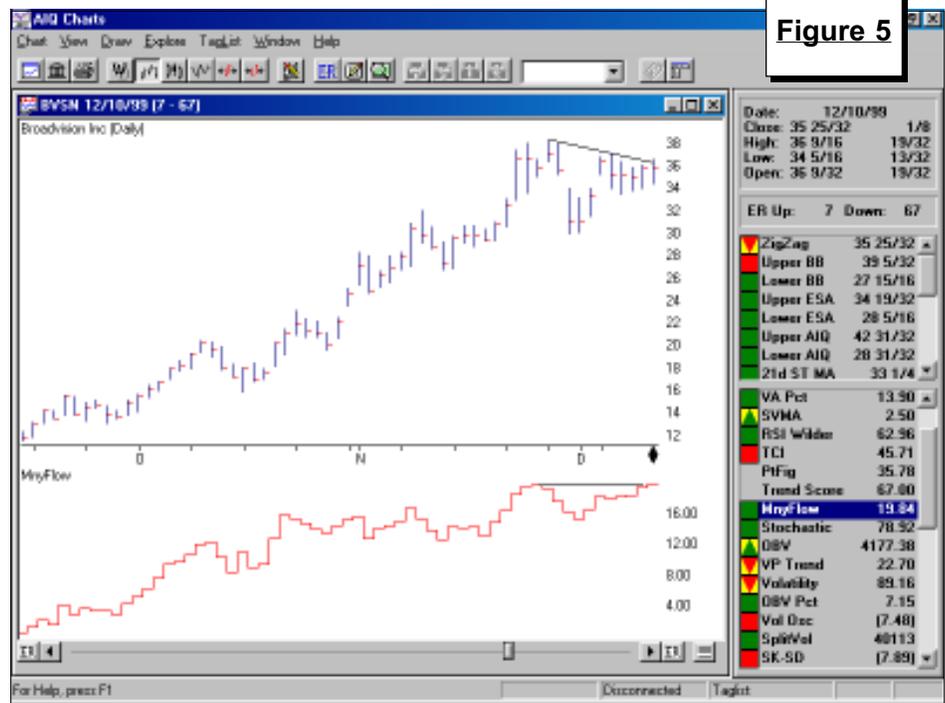
Figure 4

Growth Investing continued on page 4

12/10/99 (Figure 5). Along with other growth stocks, BVSN experienced a strong rally in October and November. Then it began to pause. A trendline is drawn connecting the high points during the pause. A buy occurs once the trendline is broken. At the same time BVSN began to stall, its Money Flow indicator continued advancing and was hitting new highs.

In some cases, price can move sideways during its 10-day pause instead of moving lower. I encourage you to pull up a chart of SDLI Inc. (SDLI) on 03/04/99. SDLI experienced a strong rally and then in February began to move sideways. A horizontal resistance trendline can be drawn connecting its high points. The buy came when this trendline was broken. While SDLI moved sideways, its Money Flow indicator continued to move higher.

In our analysis we've looked at trendline analysis and Money Flow analysis. Of the two, trendline analysis is more important. When using our Expert Design Studio model, some stocks fall dramatically during the 10-day pausing period. When this happens, you won't be able to draw a good trendline so these



stocks are not purchased. In other cases, trendlines are drawn but never broken so the stock is not

points. This style of investing provides incredible returns during the right market environment. As

“Look for stocks that have an orderly 10-day pause and where a trendline can be drawn connecting two or three high points. This...provides incredible returns.”

purchased. Look for stocks that have an orderly 10-day pause and where a trendline can be drawn connecting two or three high

of this writing, growth investors are not doing well but that will change. The best time to apply this strategy is when the Nasdaq outperforms in a rising market. ■

David Vomund publishes VIS Alert, a weekly investment newsletter. For a sample copy, call (775) 831-1544 or go to www.visalert.com.

MARKET REVIEW

November was a horrible month for Nasdaq investors. During the month the Nasdaq Composite fell 23%, its second worst month since its inception in 1971. The November return was only slightly better than the stock crash in October 1987.

The yearly return for the Nasdaq now sits at negative 36%. The Dow, however, fell only 5.1% in November. The S&P 500 fell 8%

and is down 10.5% for the year.

There were groups that bucked the trend such as Waste Management, which increased 32%, and Precious Metals, which rose 20%. Most groups fell, however, with the 37% slide in Computers-Networking leading the way.

Heading into the month, the AIQ timing model was on a buy signal. On November 10 it regis-

tered a 100 sell signal, which was confirmed by the Phase indicator on that day. It remained on a sell signal until November 22 when a 95 buy was registered. An additional buy signal was registered on November 24. These signals were confirmed when the Phase indicator rose in value on November 27. A whipsaw ensued when a confirmed 96 sell signal came on November 30. ■

RELATIVE STRENGTH ON THE DOW

RESULTS OF TESTING -- WHAT STRATEGY SHOULD RELATIVE STRENGTH INVESTORS FOLLOW TO REDUCE RISK?

By David Vomund

Relative strength investing is risky. This is especially true if you buy into extreme strength. What goes up fast often goes down faster. Because of the risk, many people are not willing to buy stocks that are making new highs.

In this article we will examine a strategy for reducing the risk inherent to relative strength investing.

Growth investing is not always in favor. For much of this year, the "old economy" stocks have performed better than the growth stocks. A good measure of old economy or value stocks is the Dow Jones Industrial Average. When the Dow outperforms most growth stocks, then relative strength investors struggle.

During periods when the Dow is outperforming, what strategy should relative strength investors follow? One possible way to reduce risk and still do well is to limit stock selections to large well-established companies.

When the Dow and S&P 500 outperform the Nasdaq, I'll often run the Relative Strength report on a database of the highest capitalized S&P 500 stocks. This filters out the lesser-known highly volatile stocks. Yet this still produces a set of very aggressive stocks, most of which trade on the Nasdaq.

To further reduce risk, we can limit our selections to the 30 stocks

that make up the Dow Jones Industrial Average. This makes sense because if the Dow is outperforming then we should limit our selections to the Dow stocks. But does buying high relative strength Dow stocks actually work?

"After running these tests we see that... Relative strength investing works when the Nasdaq outperforms but when the S&P 500 takes leadership, it may be best just to buy the index instead of buying individual stocks."

For our first test we ran a simple system to see if buying high-relative strength Dow stocks outperforms the market. At the end of every quarter, we ran the

Relative Strength-Long Term report on a list of the 30 Dow stocks.

The top five stocks were purchased and held for the next quarter at which time a new report was run and a new set of stocks was purchased.

The results are found in **Table 1**. Shown is the percentage return from the five high relative strength stocks as well as the percentage return in the Dow. The final column lists which five stocks were held. Since Intel and Microsoft were

only recently added to the Dow, these stocks were never purchased in our backtest.

Relative Strength on Dow continued on page 6

The Dow 30 Stocks

T	AT&T	HON	Honeywell
AA	Alcoa	IBM	IBM
AXP	American Express	IP	Int'l Paper
BA	Boeing	INTC	Intel
CAT	Caterpillar	JNJ	Johnson & Johnson
CAT	Citigroup	MCD	McDonalds
KO	Coca Cola	MRK	Merck
DIS	Disney	MSFT	Microsoft
DD	DuPont	MMM	MinnMnManuf.
EK	Eastman Kodak	JPM	Morgan JP
SOM	Exxon Mobile	MO	Philip Morris
GE	General Electric	PG	Procter & Gamble
GM	General Motors	SBC	SBC Comm.
HWP	Hewlett Packard	UTX	United Tech.
HD	Home Depot	WMT	Wal Mart Stores

RELATIVE STRENGTH ON THE DOW *continued* . . .

The average high relative strength Dow stocks gained an average of 6.08% per quarter. This compares favorably to the 4.17% average quarterly gain for the Dow. This is a very simple test but we can see the results are favorable enough to continue our testing.

Our next test is one that is geared toward using a high relative strength Dow stock strategy during periods when value investing is in favor. The strategy that I use in my *VIS Alert.com* newsletter trades either Nasdaq 100 or S&P 500 stocks depending on which index is outperforming (see December 1999 *Opening Bell*).

When the Nasdaq 100 (NDX) is outperforming the S&P 500, I'll purchase a portfolio of Nasdaq stocks using the Relative Strength and Weighted Action List reports. When the S&P 500 is outperforming, I'll run reports on a list of the S&P 500 stocks.

When the Nasdaq is outperforming in a bull market, there is no problem making money. Unfortunately, when the S&P 500 outperforms then growth investors often give back their profits.

I've found limiting your selections to S&P 500 stocks doesn't fix the problem. How would it work to limit the selections to Dow stocks?

For this test we plotted the Nasdaq 100 index (NDX) and looked at its weekly RSMD SPX indicator. When this indicator decreased in value for two straight weeks, we then ran the Relative Strength Long Term report on the list of Dow stocks.

The top five stocks were purchased and held until the RSMD SPX indicator rises in value for two straight weeks.

The results of this test are

Table 1

Quarterly Percentage Return

	Top RS Dow Stocks	Dow Jones Indus. Avg.	Stock Holdings
1994 Q1	2.13	-3.15	GM,CAT,IBM,UTX,BA
1994 Q2	1.04	-0.30	CAT,BA,UTX,GM,MCD
1994 Q3	3.46	6.02	CAT,IBM,JNJ,DD,BA
1994 Q4	0.70	-0.23	IBM,AA,JNJ,IP,MO
1995 Q1	9.38	8.43	KO,IBM,HWP,JNJ,HD
1995 Q2	16.71	9.58	HWP,JNJ,MRK,IBM,KO
1995 Q3	6.70	5.11	MCD,HWP,BA,MRK,IBM
1995 Q4	8.27	6.85	BA,HWP,AXP,C,MRK
1996 Q1	7.61	9.19	BA,C,MRK,HON,JNJ
1996 Q2	0.78	1.21	UTX,BA,C,HWP,AXP
1996 Q3	0.87	4.02	KO,MO,GE,JNJ,C
1996 Q4	11.17	9.62	DD,HON,IBM,C,CAT
1997 Q1	1.10	2.10	MMM,HWP,IBM,C,AXP
1997 Q2	21.54	16.54	MRK,PG,C,UTX,DD
1997 Q3	12.66	3.55	C,AXP,IBM,CAT,GE
1997 Q4	0.89	-0.47	AXP,CAT,IBM,HWP,C
1998 Q1	14.48	11.27	T,HD,WMT,C,PG
1998 Q2	5.08	1.73	WMT,T,SBC,HD,C
1998 Q3	-14.07	-12.39	HD,WMT,MCD,T,AXP
1998 Q4	34.27	17.07	HD,WMT,SBC,EK,EBM
1999 Q1	10.99	6.59	HD,IBM,WMT,MCD,UTX
1999 Q2	-1.95	12.11	MCD,HD,WMT,GM,UTX
1999 Q3	-8.01	-5.78	IBM,HWP;AA;HON;UTX
1999 Q4	26.11	11.22	AXP,AA,IBM,HD,HWP
2000 Q1	-5.47	-5.00	AA,HD,WMT,HWP,AXP
2000 Q2	-2.87	-4.34	C,HWP,HD,DIS,GE
2000 Q3	0.68	1.94	DIS,HWP,JNJ,GE,C
Average =	6.08	4.17	

found in **Table 2**. The first column lists the time periods when the S&P 500 outperforms. The second column lists the average percentage return of the top five high relative strength Dow stocks. The third column lists the percentage return for the S&P 500 index and the final column lists which stocks were purchased.

The results, unfortunately, show that buying the highest

relative strength Dow stocks lags the S&P 500 index during time periods when the S&P 500 outperforms the Nasdaq.

It is hard for growth investors to do well when the S&P 500 outperforms the Nasdaq and I was hoping that applying a relative strength strategy to the 30 Dow stocks (i.e. value stocks) would work during these difficult periods. It doesn't.

RELATIVE STRENGTH ON THE DOW *continued* . . .

After running these tests we see that buying high relative strength Dow stocks may outperform the Dow Jones Industrial Average, but when the S&P 500 is outperforming the Dow stocks fail to keep pace with the S&P 500 index.

Relative strength investing works when the Nasdaq outperforms but when the S&P 500 takes leadership, it may be best just to buy the index instead of buying individual stocks. ■

Table 2

Time Periods when RS Favors the S&P 500

Time Period	% Change Top RS Dow Stocks	% Change S&P 500	Stock Holdings
06/01/98 - 06/29/98	3.83	3.87	HD,WMT,T,C,AXP
09/08/98 - 09/21/98	-0.26	4.74	WMT,HD,EK,JNJ,SBC
10/12/98 - 11/23/98	16.19	18.20	WMT,MRK,HD,IBM,EK
02/22/99 - 03/29/99	3.77	3.52	HD,IBM,WMT,MCD,T
05/03/99 - 06/30/99	5.26	1.22	HD,AA,WMT,IBM,UTX
08/09/99 - 09/07/99	1.61	4.06	HWP,AA,IBM,HON,UTX
03/27/00 - 06/26/00	-6.06	-5.63	HWP,DIS,HD,GE,C"
08/07/00 - 09/05/00	3.98	2.80	C,HWP,AXP,DIS,BA
09/25/00 - 10/30/00	-4.90	-3.45	BA,JPM,HWP,C,GE

STOCK DATA MAINTENANCE

The following table shows past and future stock splits:

Stock	Ticker	Split	Approx. Date
CH Robinson World	CHRW	2:1	12/04/00
Innodata Corp.	INOD	2:1	12/04/00
Techne corp.	TECH	2:1	12/04/00
SurModics Inc.	SRDX	2:1	12/07/00
Beckman Coulter	BEC	2:1	12/08/00
Cree Inc.	CREE	2:1	12/11/00
Prima Energy	PENG	3:2	12/12/00
Informatica Corp.	INFA	2:1	12/14/00
Sysco Corp.	SYU	2:1	12/18/00
Shaw Group	SGR	2:1	12/18/00
Emulex	EMLX	2:1	12/18/00
Corinthian College	COCO	2:1	12/18/00
Barra Inc.	BARZ	3:2	12/19/00
United Health Group	UNH	2:1	12/25/00

Trading Suspended:

Anicom Inc. (ANIC), Columbia Energy Group (CG), Eastern Enterprises (EFU), Hello Direct Inc. (HELO), Lycos Inc. (LCOS), Nexen Inc. (NXY), Simula Inc. (SMU)

Name/Ticker Changes:

Foundation Health Sys. (FHS) to Health Net Inc. (HNT)
Universal Foods Corp. (UFC) to Sensient Technologies Corp.(SXT)
Canadian Occidental Petroleum Ltd. (CXY) to Nexen Inc. (NXY)
Symix Systems Inc. (SYMX) to Front Step Inc. (FSTP)

S&P 500 Changes

The following are changes to the S&P 500 Index and Industry Groups:

Forest Laboratories (FRX) is replacing Seagate Technology (SEG). FRX is added to the Health Care-Drugs Major Pharmaceuticals (HEALTHDR) group.

Chiron Corp. (CHIR) replaces Fort James (FJ). CHIR is added to the Biotechnology (BIOTECHN) group.

Starwood Hotels & Resorts (HOT) replaces Armstrong Holdings (ACK). HOT is added to the Lodging-Hotels (LODGINGH) group.

Calpine Corp. (CPN) replaces Florida Progress (FPC). CPN is added to the Power Producers-Independent (PWRPROD) group.

MARKET LOG REPORT

AIQ'S MARKET LOG IS PICTURE OF MARKET'S HEALTH

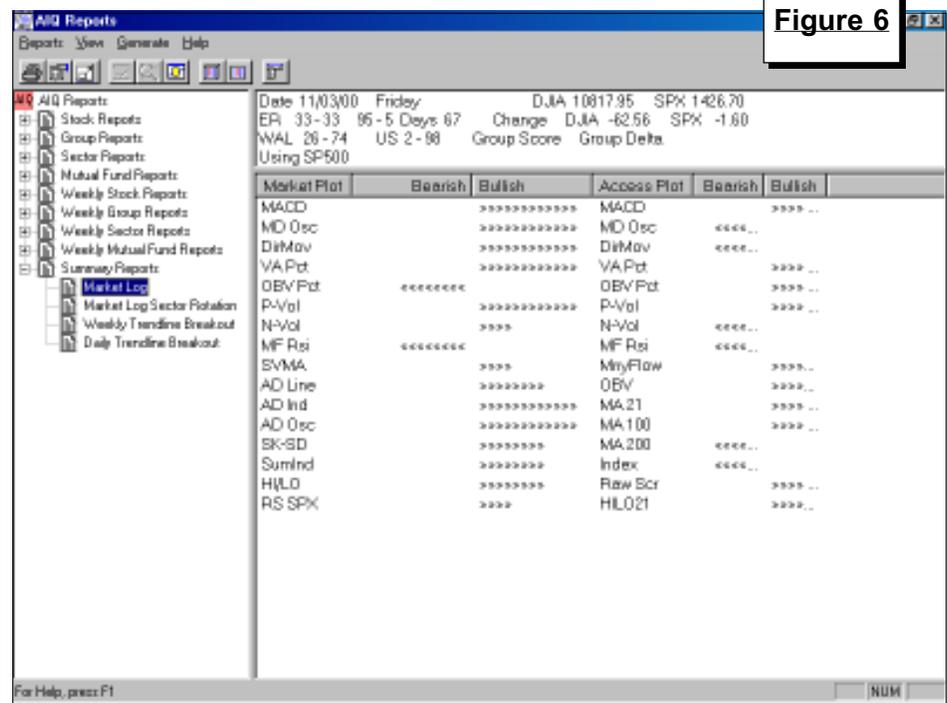
The Market Log is an important market timing report. It gives a picture of the health of the market and has valuable tools to determine future market direction. The market Log is found in TradingExpert's Reports module and is under the Summary Reports grouping.

Two important ratios are found near the top of the report. The WAL score lists the percentage of stocks giving confirmed AIQ Expert Rating signals. The US score gives the percentage of stocks giving unconfirmed signals. Look for a number greater than 85% for either.

In **Figure 6** we see that of the stocks giving confirmed signals, 26% are on the buy side and 74% are on the sell side. Confirmation is based on the direction of the Phase indicator. Looking at signals that are not yet confirmed, only 2% are on the buy side and 98% are on the sell side.

Whereas the WAL score is an indication of the health of the current market, the US score is anticipatory. With such a bearish US score on November 3, we know that stocks have been rallying but many of the stocks are registering AIQ sell signals. Once the market turns and the stocks begin to fall, many of the unconfirmed sell signals will become confirmed and the WAL score will turn bearish.

The left side of the report contains the Market Plot section. This is a graphical representation of the indicators on AIQ's market plot chart (ticker DJIA). Indicators based solely on price are calculated from the Dow Jones Industrial Average. Indicators based on breadth or volume are based on all



the stocks on the New York Stock Exchange. The Market Plot section in Figure 6 shows that there are two indicators that are bearish but the vast majority are bullish.

On the right side of the report is the Access Plot. Whereas the Market Plot uses a market index to evaluate the health of the market, the Access Plot determines market health by evaluating individual stocks. For each indicator, the software calculates the percentage of stocks with rising values versus the percentage of stocks with falling values. A graphical representation is then displayed. In Figure 6 we see that most stocks have bullish Money Flow and OBV indicators, but the majority of stocks have a bearish MD Osc indicator.

Note: If your Access Plot is empty, then you need to click on *Reports* and then *Global Properties*. On the *Daily Selection Criteria* screen put a check mark next to

Compute Access.

We are often asked how the Market Plot section can be bullish and the Access Plot be bearish. That happens when the Dow Jones Industrial Average is stronger than the average stock. In these cases, the Dow is masking the deterioration in the internal market.

In Figure 6 we see a bullish Market Plot but a neutral Access Plot and a bearish US score. That means the strength in the Dow is masking weakness in the overall market. The Dow's indicators are strong but individual stock indicators are not as strong. Stocks may be rising but there is enough weakness in their indicators to warrant AIQ sell signals.

By following the daily changes in the Market Log report you will quickly learn how the three elements of the report interact with each other. Based on this report, you'll be able to make an informed judgment on the market's health. ■