

# Predefined Strategies

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# 1. Introduction

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The easiest way to use MatchMaker is to select a strategy from the list of predefined strategies, which is accessed by clicking the **Strategies** button on the MatchMaker toolbar. This list is divided into two basic categories: Surrogate Strategies and Group/Sector Strategies. These two categories include most of the common methodologies for using MatchMaker.

The predefined strategies available include the following:

## Surrogate Strategies

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- **Create an Index Surrogate Group**  
Correlates all stocks in the Master Ticker List to a specified index.
- **Create a Mutual Fund Surrogate Group**  
Correlates all stocks in the Master Ticker List to a specified mutual fund.

## Group/Sector Strategies

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- **Check Stocks (against their current groups)**  
Correlates all stocks in a specific list to their parent groups.  
— or —  
Correlates all stocks in a specific group to that group.
- **Check Groups (against their current sector)**  
Correlates all groups in a specific list to their parent sectors.  
— or —  
Correlates all groups in a specific sector to that sector.
- **Find Appropriate Group for a Ticker**  
Correlates a specific ticker to all groups in a specific list.
- **Find Appropriate Sector for a Group**  
Correlates a specific group to all sectors in a specific list.

As you can see, there are many methodologies for using MatchMaker. For the methodology that you require, you can select one of the predefined strategies (click **Strategies** button on toolbar). If your strategy is not included, you can develop your own utilizing the flexibility provided by the MatchMaker Parameters dialog box (click **MatchMaker** button on toolbar). While the latter option provides greater flexibility, the *Strategies* option is much easier to use and provides most of the common methodologies.

## 2. Changing default settings

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A number of data items must be specified for a MatchMaker analysis. In addition to the data sources and types of the two data sets that will be compared, there are three other data input items that must be specified. The three data items and their default settings are as follows:

### Important

The three default settings are always used for all MatchMaker runs made with any of the predefined strategies functions. Runs made from the MatchMaker Parameters dialog box use the settings from the last MatchMaker run.

1. First and last dates of the exact time period for the comparison.

**Default:** One year time period. This year ends on the date of the latest data in your data base.

2. Whether you want to use weekly data or daily data.

**Default:** Use weekly data.

3. Whether to remove the influence of a market index from the price action of both tickers and, if so, what market index do you want to remove.

**Default:** Influence of a market index is removed. Initially, the default index is the S&P 500. However, once the index is changed, the default is the last index entered.

### To change default settings

The settings for these three items are found on the MatchMaker parameters dialog box.

► *To change default settings, do the following:*

1. After completing all the required entries for a strategy, click on the **MatchMaker** button at the bottom of the strategy dialog box. The MatchMaker Parameters dialog box will appear.
2. Based on the particular strategy that you have selected and the entries that you have made in the strategy dialog box, the *Source* and *Source Type* entries will be completed. To change any of the three default data items, do the following:
  - **Dates:** Change the dates to reflect the period of time that you want to use for the comparison. The *Last* date is set by default to the date of your most recent data and you will only have reason to revise this entry if you are doing some sort of historical study. It is extremely important that your data base contain data for all tickers being analyzed and that the data is correct.
  - **Use weekly data:** To change to daily data, remove the check in the check box by clicking on the box.

- **Market Index influence:** You can elect not to remove any market index by unchecking the check box for *Remove Market Index influence*. Or, you can change the index to be removed (SPX is default) by selecting another from the *Index* text box.

3. After making your changes, click **OK** to begin the computation.

**MatchMaker Parameters**

Dates

First: 08/24/94 Last: 08/24/95

Use weekly data

Remove Market Index influence

Index: SPX

Limit Source B to components of Source A

**Source A**

Master Ticker List

List: SP500

Ticker:

**Source B**

Master Ticker List

List: SP500

Ticker:

**Source A Type**

Stocks

Warrants

Futures

Mutual Funds

Indexes

Markets

Groups

Sectors

Portfolio Groups

Mutual Fund Groups

**Source B Type**

Stocks

Warrants

Futures

Mutual Funds

Indexes

Markets

Groups

Sectors

Portfolio Groups

Mutual Fund Groups

OK Cancel Help

*MatchMaker Parameters dialog box*

### 3. Surrogate Group Strategies

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A surrogate group is a collection of specially selected stocks compiled to represent a particular index or mutual fund. By forming surrogate groups to represent mutual funds or market indexes, you can expand your analysis to include volume indicators and Expert Ratings which are otherwise not available for these types of securities.

MatchMaker correlations are ideally suited for developing surrogate groups. You simply use MatchMaker to find stocks in your data base that are highly correlated to the particular mutual fund or index and then you construct a group of those stocks.

#### Creating an Index Surrogate Group

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This strategy computes correlation coefficients for all the stocks in your Master Ticker List compared to the index that you specify. You then use *Data Manager* functions to (1) construct a group containing those stocks with the highest correlation coefficients, and (2) compute an index for the group. Since this group contains only stocks that have moved like the index in the past, it should move like the index in the future. If the group has a strong Expert Rating, you can then decide to trade options on the index.

To create an Index Surrogate Group using a predefined strategy, all you need to know is the symbol for the index that you want the surrogate group to represent.

► *Follow this procedure:*

1. After opening MatchMaker, click the **Strategies** button on the toolbar.
2. Select **Surrogate Strategies**.
3. From the *Surrogate Group Strategies* dialog box, select **Index Surrogate Group**. The *Create Index Surrogate Group* dialog box will appear.
4. In the text box located at the top, choose the index that you want the surrogate group to represent by doing the following:
  - Click the arrow on the text box to display a drop-down list of all the indexes contained in your Master Ticker List.
  - Click on the name of the index that you wish to select.

#### 'Clean Data' Reminder

Before starting a MatchMaker analysis, you should make sure that your data is "clean." Use the *Check Ticker Data* function (submenu of *Utilities* in *Data Manager*) to check and clean up your data. After correcting your data, recompute your group/sector indices using *Compute Group/Sector Indices* function.

*Create Index Surrogate Group dialog box*



5. Click **OK** to initiate the MatchMaker computation using the default options or click the **MatchMaker** command button to change any of the default options (see *Changing default settings*, Section 2 of this chapter).
6. When correlation coefficients for all the stocks in the Master Ticker List have been completed and sorted, the MatchMaker Report screen is displayed. (For more information about the MatchMaker Report screen, see Chapter V.)
7. Choose the stocks with the highest correlations.
8. Build a group of the highly correlated stocks by placing the stocks in a list in *Data Manager*. Finally, compute an index for the group. (See *Creating an index for a group of tickers*, in Part 1, Chapter II, Managing Your Data.)

### **Error Messages**

When an error occurs while running MatchMaker, an error message will be displayed. All error messages are self explanatory. Some errors are also written to the Messages file which can be viewed by clicking on the *Messages* icon on the Quick Launch Menu.

## Creating a Mutual Fund Surrogate Group

This strategy computes correlation coefficients for all the stocks in your Master Ticker List compared to the mutual fund that you specify. You then use the *Data Manager* functions to (1) construct a group containing those stocks with the highest correlation coefficients, and (2) compute an index for the group. Since this group contains only stocks that have moved like the mutual fund in the past, it should move like the mutual fund in the future. If the group has a strong Expert Rating, you can then consider buying the mutual fund.

To create a Mutual Fund Surrogate Group, all you need to know is the symbol for the mutual fund that you want the surrogate group to represent.

► *Follow this procedure:*

1. After opening MatchMaker, click the **Strategies** button on the toolbar.
2. Select **Surrogate Strategies**.
3. From the *Surrogate Group Strategies* dialog box, select **Mutual Fund Surrogate Group**. The *Create Mutual Fund Surrogate Group* dialog box will appear.



*Create Mutual Fund Surrogate Group dialog box*

4. In the text box located at the top, choose the mutual fund that you want the surrogate group to represent by doing the following:
  - Click the arrow on the text box to display a list of all of the tickers designated as mutual fund types in your Master Ticker List.
  - Click on the name of the mutual fund that you wish to select.

5. Click **OK** to initiate the MatchMaker computation using the default options or click the **MatchMaker** command button to change any of the default options (see *Changing default settings*, Section 2 of this chapter).
6. When correlation coefficients for all the stocks in the Master Ticker List have been completed and sorted, the MatchMaker Report screen is displayed. (For more information about the MatchMaker Report screen, see Chapter V.)
7. Choose the stocks with the highest correlations.
8. Build a group of the highly correlated stocks by placing the stocks in a list in **Data Manager**. Finally, compute an index for the group. (See *Creating an index for a group of tickers*, in Part 1, Chapter II, Managing Your Data.)

## 4. Group/Sector Strategies

### 'Clean Data' Reminder

Before starting a MatchMaker analysis, you should make sure that your data is "clean."

Use the *Check Ticker Data* function (submenu of *Utilities* in *Data Manager*) to check and clean up your data. After correcting your data, recompute your group/sector indices using *Compute Group/Sector Indices* function.

### Using Check Stocks strategy to modify existing groups

When you first installed TradingExpert you had the choice of installing the S&P 500 industry groups list or the AIQ industry groups list. These groups were formed on the basis of fundamental information. For example, the S&P 500 industry group "Paper & Forest Products" (group PAPER-FOR) includes paper company stocks.

It would be optimal to make sure all the stocks within the group follow the group index based on price activity. If the stocks all followed the pattern of the group index, it is most likely that the reliability of the Expert Ratings of the group index will improve. This will provide the strong trading synergism of a signal on a group index combined with a concurrent signal in the same direction on a stock from the same group.

► *To revise your existing groups, follow this procedure:*

1. After opening MatchMaker, click the **Strategies** button on the toolbar.
2. Select **Group/Sector Strategies**.
3. From the *Group/Sector Strategies* menu, choose **Check Stocks**. The *Check Stocks in Groups* dialog box appears.

**Check Stocks in Groups**

Step 1:  Correlate all Stocks in List  to their parent Groups.  
OR  
 Correlate all Stocks in Group  to the parent Group.

Step 2: After the report is generated, remove the Stocks which do not correlate to their Group(s).

Step 3: Recompute all Groups in the Group/Sector pyramid by using the Compute Group/Sector Indices function in the Data Manager.

Step 4: You now have three choices of action for the Stocks which were removed:

- 1) Run the MatchMaker "Find Appropriate Group" function to determine which Groups the Stocks should go into. (recommended choice)
- 2) Do not place the removed Stocks in any Group.
- 3) Delete the Stocks from your Master Ticker List in the Data Manager.

OK Cancel Help MatchMaker

*Check Stocks in Groups dialog box*

4. Click the option button for **Correlate all Stocks in List to their parent Groups**.
5. In the text box, select the name of your Group/Sector List (e.g., SP500 for the S&P 500 Group/Sector List).
6. Click **OK** to initiate the computation.
7. After MatchMaker has finished computing correlations for all the groups in your list, the MatchMaker Report screen appears. This screen displays two lists. The smaller list box on the left lists all of the groups in your Group/Sector List. The larger list box on the right lists all of the stocks in the currently selected group. (To select another group, simply click on the group name in the box on the left). The correlations for each stock relative to their parent group index are shown in the first column (*corr.*). Notice the stocks are listed in order of their correlation coefficients with the highest correlation at the top.
8. To restructure any of the groups in your list, go to **Data Manager** and display your Group/Sector List in the list window (left side of **Data Manager** screen). In this window, click on the group that you are revising to display a list of the stocks in that group.
9. Eliminate any stocks with correlation coefficients less than the minimum level for inclusion in the group (using *Remove from List* toolbar button). AIQ has arbitrarily set a minimum correlation of 500 to indicate that the stock actually belongs to the group. You may use another figure.
10. Recompute the group index using the *Compute Group/Sector Indices* function (*Utilities* submenu).
11. Repeat steps 4 through 10 until all the stocks in all of the groups conform to your minimum correlation value.

### Error Messages

When an error occurs while running MatchMaker, an error message will be displayed. All error messages are self-explanatory. Some errors are also written to the Messages file which can be viewed by clicking on the **Messages** icon on the Quick Launch Menu.

### To check a single Group

While the above procedure checks the correlations of all the groups in your Group/Sector List, you can use the same strategy (*Check Stocks*) to check a single group. The procedure is the same with the exception of step 4. In step 4 of the above procedure, click the button for the second option, *Correlate all Stocks in Group to the parent Group*. Then enter the name of the group that you want checked.

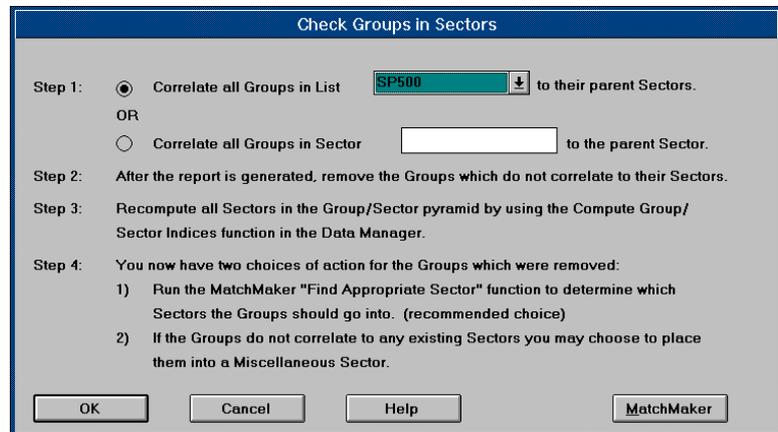
## Using Check Groups strategy to modify existing sectors

After modifying your groups to make sure that all the stocks within each group follow their parent group index, the next logical step is to modify your sectors to make sure that all the groups within each sector follow their parent sector index.

If the groups all followed the pattern of their sector index, it is most likely that the reliability of the Expert Ratings on the sector indices will improve. This opens the possibility of even stronger trading synergisms such as a three-tiered signal — a sector index signal in combination with a concurrent signal from a group in that sector and a concurrent signal on a stock from the same group and sector.

► *To revise your existing sectors, follow this procedure:*

1. After opening MatchMaker, click the **Strategies** button on the toolbar.
2. Select **Group/Sector Strategies**.
3. From the *Group/Sector Strategies* menu, choose **Check Groups**. The *Check Groups in Sectors* dialog box appears.



*Check Groups in Sectors dialog box*

4. Click the option button for **Correlate all Groups in List to their parent Sectors**.
5. In the text box, select the name of your Group/Sector List (e.g., SP500 for the S&P 500 list).
6. Click **OK** to initiate the computation.

**Note**

For more information about the MatchMaker Report screen, see Chapter V.

7. After MatchMaker has finished computing correlations for all the sectors in your list, the MatchMaker Report screen appears. This screen displays two lists. The smaller box on the left lists all of the sectors in your Group/Sector List. The larger box on the right lists all of the groups in the currently selected sector. To select another sector, simply click on the sector name in the box on the left. The correlations for each group relative to their parent sector index are shown in the first column (*corr*). Notice the groups are listed in order of their correlation coefficients with the highest correlation at the top.
8. To restructure any of the sectors in your list, go to **Data Manager** and display your Group/Sector List in the list window (left side of **Data Manager** screen). In this window, click on the sector that you are revising to display a list of the groups in that sector.
9. Eliminate any groups with correlation coefficients less than the minimum level for inclusion in the sector (using *Remove from List* toolbar button). AIQ has arbitrarily set a minimum correlation of 500 to indicate that the group actually belongs to the sector. You may use another figure.
10. Recompute the sector index using the *Compute Group/Sector Indices* function (*Utilities* submenu).
11. Repeat steps 4 through 10 until all the groups in all of the sectors conform to your minimum correlation value.

**To Check a Single Sector**

While the above procedure checks the correlations of all the sectors in your Group/Sector List, you can use the same strategy (*Check Groups*) to check a single sector. The procedure is the same with the exception of step 4. In step 4 of the above procedure, click the button for the second option, Correlate all Groups in Sector to the parent Sector. Then enter the name of the sector that you want checked.

## Using Find Appropriate Group strategy

The *Find Appropriate Group* strategy is useful in several situations. After using the *Check Stocks* strategy to revise your groups, the question then is “Where, if anywhere, do you put a stock when it is removed from its group?.” Suppose you run an analysis and find that the stock JPM (J.P. Morgan) does not correlate to group BANKSMON, Money Center Banks. To help you decide where to put an orphaned stock, you can run a MatchMaker correlation to see if the stock correlates well with some other group.

A similar problem occurs when you add a new stock to your data base and you don’t know where it belongs in your Group/Sector List. Again, you can run a MatchMaker correlation to see which of your existing groups correlates best with the stock. The *Find Appropriate Group* strategy, which computes correlations of a stock to all groups in a specified list, can be used to answer these questions. All you need to know is the stock ticker symbol and the name of your Group/Sector List.

► *To find the appropriate group for a ticker, follow this procedure:*

1. After opening MatchMaker, click the **Strategies** button on the toolbar.
2. Select **Group/Sector Strategies**.
3. From the *Group/Sector Strategies* menu, choose **Find Appropriate Groups**. The *Find Appropriate Group for a Ticker* dialog box will appear.



*Find Appropriate Group for a Ticker dialog box*

4. Enter the ticker symbol of the stock you want to correlate in the first text box. From the second text box, select the name of your Group/Sector List (e.g., SP500 for the S&P 500 list).
5. Click **OK** to initiate the computation.

### Note

For more information about the MatchMaker Report screen, see Chapter V.

6. After MatchMaker has finished computing correlations for all the groups in your list, the MatchMaker Report screen appears. This screen displays two lists. The smaller box on the left contains only one item, the ticker symbol of the stock that you are correlating to the groups in your Group/Sector List. The larger box on the right lists all of the groups in your Group/Sector List. The correlations for each group relative to the stock are shown in the first column (*corr*). Notice the groups are listed in order of their correlation coefficients with the highest correlation at the top.
7. To add this stock to one of the highly correlated groups, go to **Data Manager** and display your Group/Sector List in the list window (left side of Data Manager screen). In this window, click on the sector that contains the group to display a list of the groups in that sector. Next, click on the group to display a list of the stocks in that group.
8. With both the group name in the list window and the stock in the Master Ticker List selected, move the stock into the selected group (using the *Insert to list* toolbar button).
9. Recompute the group index using the *Compute Group/Sector Indices* function (*Utilities* submenu).
10. Use the *Check Stocks* strategy to compute correlations for all of the stocks in the newly modified group. If any of the stocks in the group no longer conform to your minimum correlation value, modify the group by eliminating the stocks with low correlations.

### 'Clean Data' Reminder

Before starting a MatchMaker analysis, you should make sure that your data is "clean." Use the *Check Ticker Data* function (submenu of *Utilities* in **Data Manager**) to check and clean up your data. After correcting your data, recompute your group/sector indices using *Compute Group/Sector Indices* function.

## Using Find Appropriate Sector strategy

When you have finished modifying your groups and sectors, you may find that you have eliminated some groups from their original sectors (i.e., groups that did not correlate adequately with their parent sectors). To help you decide where to put these orphaned groups, you can run MatchMaker correlations to see if the groups correlate well with other sectors. The *Find Appropriate Sector* strategy, which computes correlations of a group to all sectors in a specified list, is designed for this purpose. All you need to know is the group ticker symbol and the name of your Group/Sector List.

► *To find the appropriate sector for a group, follow this procedure:*

1. After opening MatchMaker, click the **Strategies** button on the toolbar.
2. Select **Group/Sector Strategies**.
3. From the *Group/Sector Strategies* menu, choose **Find Appropriate Sectors**. The *Find Appropriate Sector for a Group* dialog box will appear.



*Find Appropriate Sector for a Group dialog box*

4. Enter the ticker symbol of the group you want to correlate in the first text box. Next, from the second text box, select the name of your Group/Sector List (e.g., SP500 for the S&P 500 list).
5. Click **OK** to initiate the computation.
6. After MatchMaker has finished computing correlations for all the sectors in your list, the MatchMaker Report screen appears. This screen displays two lists. The smaller box on the left contains only one item, the ticker symbol of the group that you are correlating to the sectors in your Group/Sector List. The larger box on the right

lists all of the sectors in your Group/Sector List. The correlations for each sector relative to the group are shown in the first column (*corr*). Notice the sectors are listed in order of their correlation coefficients with the highest correlation at the top.

7. To add this group to one of the highly correlated sectors, go to **Data Manager** and display your Group/Sector List in the list window (left side of **Data Manager** screen). In this window, click on the sector that you want to add the group to. A list of the groups in that sector will appear.
8. With both the sector in the list window and the group in the Master Ticker List selected, move the group into the selected sector (using the *Insert to list* toolbar button).
9. Recompute the sector index using the *Compute Group/Sector Indices* function (*Utilities* submenu).
10. Use the *Check Groups* strategy to compute correlations for all of the groups in the newly modified sector. If any of the groups in the sector no longer conform to your minimum correlation value, modify the sector by eliminating the groups with low correlations.

### **Error Messages**

When an error occurs while running MatchMaker, an error message will be displayed. All error messages are self explanatory. Some errors are also written to the Messages file which can be viewed by clicking on the **Messages** icon on the Quick Launch Menu.

## More ideas to improve your group/sector structure

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- To find a place for an orphaned stock, you can try to find a group which correlates well with the stock using the *Find Appropriate Group* strategy. Another option is to use the MatchMaker Parameters dialog box to find another stock that correlates well with the stock in question (high correlation coefficient). For example, suppose you found two stocks from the same group that correlated well, and formed a new group composed of these two stocks. To find other stocks that fit well against this new group, you would run a correlation of the new group to all of the stocks in your data base. (Using the MatchMaker Parameters dialog box.) These stocks can then be added to the new group.
- After some examination of your groups, you may choose to adopt a policy that all stocks in your data base must fit into a group. If you drop a stock from a group, you may try to find a better group for it or try to build another group around it. If neither of these are possible, then the stock may be dropped from the data base or entered into a miscellaneous group.
- Some users of MatchMaker may want to take a purely technical approach. That is, start from scratch and create a new group/sector pyramid based entirely on the correlation coefficients of the stocks in their data bases. Although this might be rewarding, it is a very time consuming and disk space intensive procedure even if you limit your data base to the 500 S&P stocks. If this approach improves the Expert Ratings of some groups, then it might be beneficial. However, you should experiment and paper-trade with historical data to see if this approach is for you. One logical argument against the purely technical approach is that you would undoubtedly wind up with groups of stocks that are not fundamentally related. For example, you might have a paper company stock in the same group with a bank stock. There are no clear cut answers to this argument.
- The more practical approach is to start with one of the published industry group listings, such as the S&P 500 industry groups, and refine it using the *Check Stocks* strategy. Another approach is to combine into groups only those stocks that have high correlation coefficients and are at least somewhat in the same industry. This synergistic approach combines both worlds of technical and

fundamental analysis. AIQ prefers this approach over the purely technical approach.

- Once you have refined the groups, the next step in the process is to see how well your groups correlate to your sectors. You may do this by using the *Check Groups* strategy. AIQ has found that a few of the existing sectors can be improved by switching to a miscellaneous sector those groups with low correlation coefficients or low affinity for the sector. By moving a group from a sector where it does not belong to a miscellaneous sector, you not only improve the former home but you can view the group as a stand alone group without any sector influence.

