

*Feature*

Trading Insights from Professional Trader Yacov Twena ..... 1

*Sections*

Market Review ..... 6  
 Add Stochastic RSI to Your Indicator Library ..... 7  
 S&P 500 Changes ..... 8  
 Data Maintenance ..... 8

The *Opening Bell Monthly* is a publication of AIQ Systems  
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INTERVIEW: AIQ USER SHARES EXPERTISE

## SUCCESSFUL TRADING REQUIRES COMMITMENT, PERSISTENCE, AND PRACTICE, PRACTICE, PRACTICE

By David Vomund

**Y**acov Twena, an electronics engineer, left the semiconductor industry to become a full-time trader and portfolio manager in 1992. He began using AIQ in 1994 and continues to use TradingExpert along with other software packages in his analysis. Twena is co-publisher of "The Morpheus Report," a daily investment newsletter. He resides in Newport Beach, California.



Yacov Twena

**Vomund:** How did you get involved in the investment field?

**Twena:** When I came to the USA in 1970, I had about \$400 in my pocket and a California dream in my head. I enrolled in school, ultimately receiving a BSEE in electronics engineering, an MBA in Business Administration, and a MS in Creative Intelligence. I also spent

two years in Switzerland studying the science of Creative Intelligence at MERU.

I began my career in the aerospace/defense industry, which led me later into semiconductors. I worked for corporate giants like GE, RCA, and Intel but all the while I was investing in real estate and in stocks. My desire was to become

financially independent.

I always thought that if brokers were so smart and knowledgeable they would just trade for themselves. With that in mind, in the mid-90's I began trading my own portfolio full time. I have to say that I have worked harder at trading than any other job I had in the past - but the rewards are many.

I find that being a full-time trader is much like being an athlete. It has the same ups and downs, noise and silence, and success vs. failure. You have to be in top form, manage your mind, and control your emotions to play a good game. You need to have a lot of discipline, inner strength, and perseverance to succeed.

Anyone and his uncle can call good trades, but to do it daily with consistent results takes skill. Currently, I trade my own account, manage several other accounts, and with fellow trader Andy Gabor publish a daily newsletter called *The Morpheus Report* ([www.morpheusreport.com](http://www.morpheusreport.com)). We are in the process of forming a hedge fund managed by Morpheus Investments LLC.

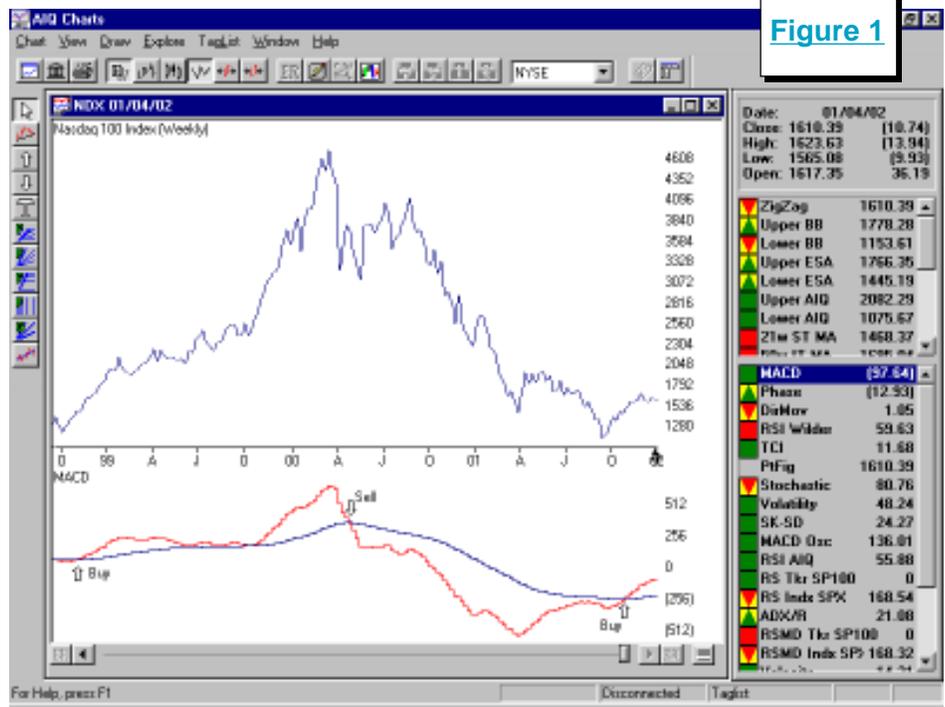


Figure 1

**Vomund:** Tell me more about *The Morpheus Report*.

**Twena:** Andy Gabor and I started *The Morpheus Report* in July of 2001. I had been working with Gabor for four years on custom scans and we

were trading closely together. I had another dream — that we should join forces. He agreed and so began *The Morpheus Report*.

Since Morpheus is the Greek god of dreams it was only fitting to use the name Morpheus. In this daily letter we do market analysis, with appropriate charts showing key indicators and support, resistance, and trend changes. We start each newsletter with an inspirational quote because it helps people to focus and to bring out the best in them-

selves. We have a section called *Trader's Notes* where we discuss psychological or technical aspects of better trading. And finally, we

make stock selections based upon our research.

Each stock pick comes with

target sells and protective stops. Our aim is to make 7 to 20 percent on the good trades and leave with 2 to 3 percent stop losses or less on the ones that don't perform to our expectations.

We have a unique approach to trading that tackles some of the inherent challenges to trading: greed and fear. Using what we call the Morpheus 2 by 3 Matrix, we set a plan: we set a targeted buy, sell, and stop loss. By sticking to the plan and addressing the potential for gain or loss, we

*"I find that being a full-time trader is much like being an athlete... you have to be in top form, manage your mind, and control your emotions to play a good game."*

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INTERVIEW *continued* . . .

eliminate the emotional decisions that occur during trading that cause most people to lose. We don't mind leaving some profit on the table for others who are more risk orientated. We are not shooting for home runs, only consistent daily gains.

**Vomund:** *How important is market timing in your trading process? What market timing methods do you use?*

**Twena:** Market timing is very important in the stock market because trend is very crucial. If you trade against the trend, you are in essence working upstream. Thus, in bullish markets we trade the long side more aggressively. In bear markets, we go short and trade counter trend rallies long. We don't mind staying on the sidelines and being in cash for extended periods if it makes sense.

As for market timing methods, we use a series of technical indicators. For example, the Macd Oscillator is very valuable. We look at a longer time frame on the daily and weekly charts, using a setting such as 13-34-55.

If you look at the Nasdaq 100 (NDX), the Macd Oscillator turned long on a weekly chart at the beginning of November 1998 and stayed above zero until the end of April 2000. It stayed below zero until early November 2001 (**Figure 1**). This is a good macro indicator.

The same indicator on a daily chart using a setting of 13-34-21 shows more intermediate-term trends. In **Figure 2** we see a candlestick chart for the Nasdaq 100 in a daily format. On December 27, the NDX was in the upper

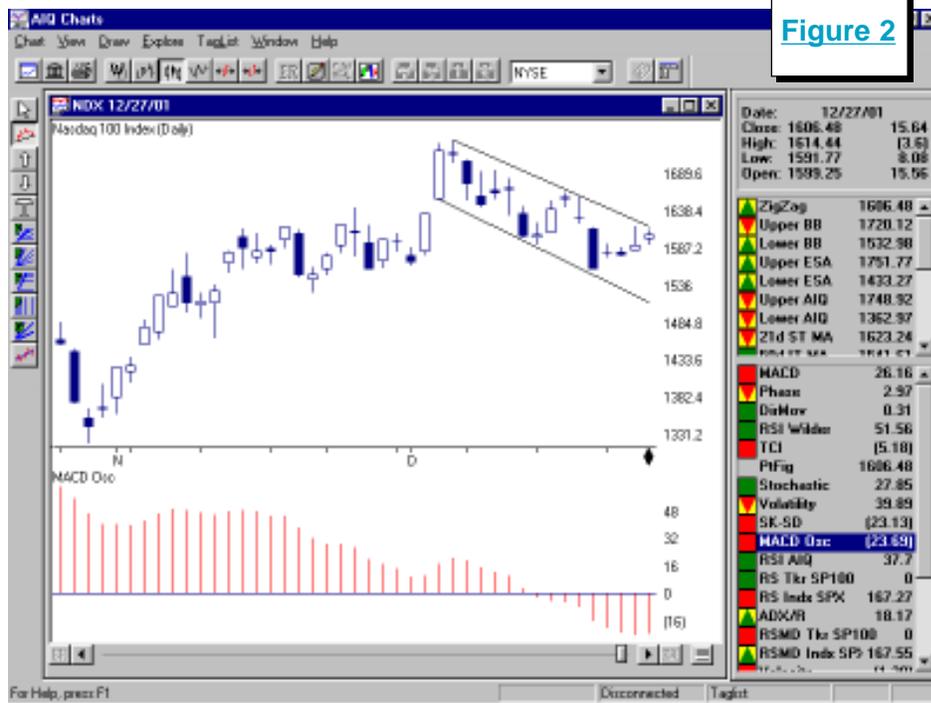


Figure 2

half of a trading range. At that time, the Macd Oscillator moved up for the first time since December 6. That was a bullish sign that foretold the Nasdaq's break above resistance.

We also use proprietary scans

reversal. We also have scans that do the reverse, for shorting. We perform these scans on market sectors as well as individual stocks.

**Vomund:** *In your newsletter, most of your selections are based on bottom-picking strategies instead of growth strategies. Is that your trading style or is that related to the market being so low?*

**Twena:** It is not related to the market being low. We have been trading stocks that are oversold for a long

*"In our back testing we have found that for short-term trading, stocks that have pulled back substantially are most likely to snap up in a short period of time."*

time, in both bull and bear markets. In our back testing we have found that for short-term trading, stocks that have pulled back substantially are most likely to snap up in a short period of time. Thus, we do not look for bottoms only. We look for stocks that have made a significant retracement and have based for a couple of days.

that look for oversold stocks using a number of indicators that show extreme oversold conditions. When we get significant numbers of hits in a range of a few days, we know the market is turning.

For example, we had one scan which had a very high level of hits on September 18 and 19. We then knew that in a few days the market would show signs of

time, in both bull and bear markets. In our back testing we have found that for short-term trading, stocks that have pulled back substantially are most likely to snap up in a short period of time. Thus, we do not look for bottoms only. We look for stocks that have made a significant retracement and have based for a couple of days.

*Interview continued on page 4*

INTERVIEW *continued* . . .

**Vomund:** What is the concept behind your strategy and what is your average holding period?

**Twena:** We look for stocks that are potentially discounted. When a stock moves, for example, more than 15 to 20 percent below the 13-day moving average, it has traveled statistically too far from its mean and must find a way to come back to the moving average. We watch the sell-off and then look for the stock to base. At that point, a tension forms similar to that of a bow pulling an arrow back. Once the stock breaks above its new base, we buy and try to ride it.

We set relatively tight stops and move the stops up as the price progresses upward. We try to play those moves for a period from one to ten days. We do study the fundamentals enough to make sure there is something there. However, in the short run technicals play a bigger role than fundamentals.

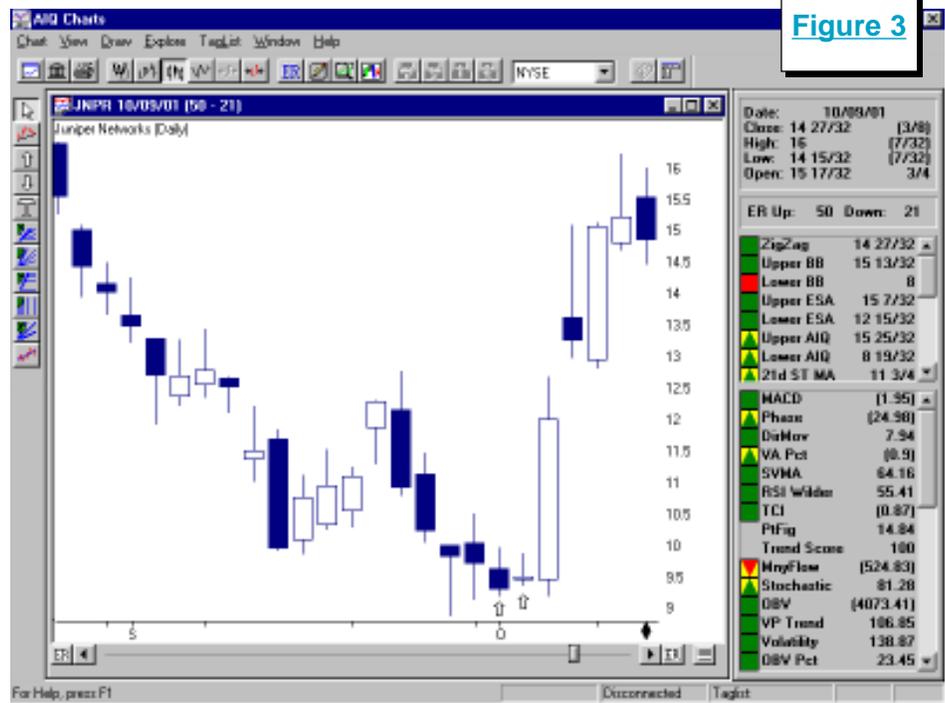


Figure 3

Once a stock has established an up trend, we do not abandon it. We instead look for the company to retrace and once it bases we buy the breakout and ride it again for another short-term move.

**Vomund:** You often look at candlestick charts. What advantages do you see with candlestick charts over bar charts?

**Twena:** The thing I like about candlesticks is that they tell the story more vividly than bar charts. For instance, a “hammer” pattern at a market reversal is important.

Inside or outside days are also important and are visually depicted more clearly in candlestick charts. Inside days are days when the low and high are less than that of the prior day. When this occurs two days in a row, often a sharp move occurs, either up or down. A good example is Juniper Networks (JNPR) on October 2 (Figure 3, see arrows).

**Vomund:** What are your favorite indicators?

**Twena:** By far my favorite indicator is Stochastic RSI. This is RSI converted into a stochastic measurement. I use multiple measures on multiple time



Figure 4

INTERVIEW *continued* . . .

frames. These include the daily and weekly as well as intraday time frames.

(Editors Note: See page 7 for a detailed description of this indicator and how to create it using TradingExpert Pro.)

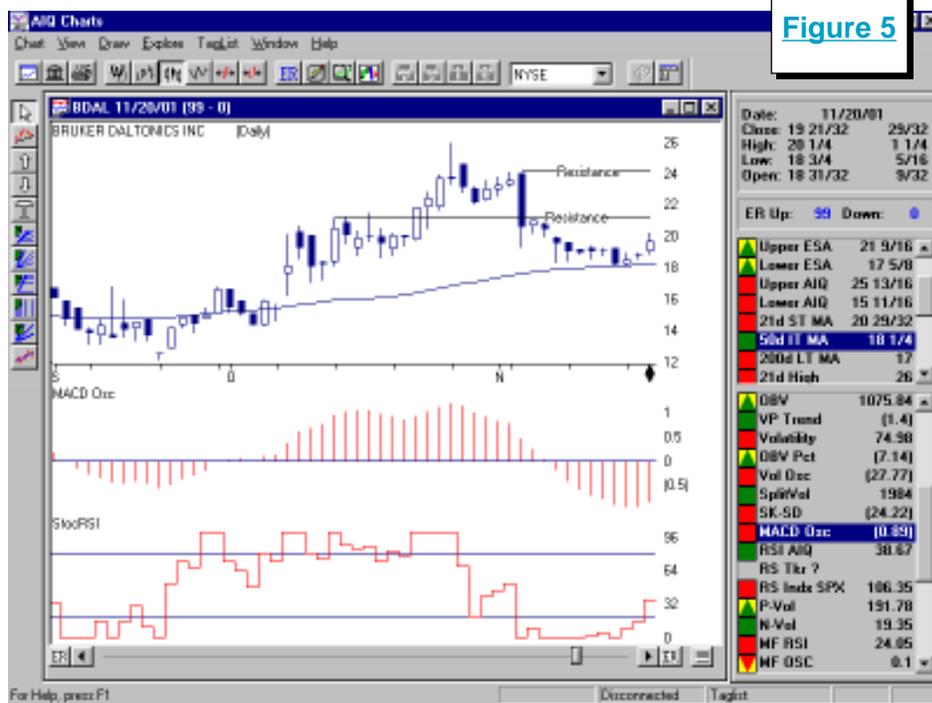
I also look at volatility. We measure volatility by calculating average true range as a percentage of the overall price range of a stock, generally over a 55-day period. I look at volume. A stock cannot sustain a move without above average volume.

Another favorite is the Macd Oscillator. I look for change in slope as well as divergence from price. In addition, I like Moving Averages; the 200, 150, 50, and 20. I use them as support and resistance for price movement.

**Vomund:** *Can you give us some examples of trades and how you decided to enter them?*

**Twena:** I look for intraday signals such as breakouts. For example, I selected Time Warner Telecom (TWTC) in our newsletter on October 10 at \$6.49 (Figure 4). The reasons were that it had fallen sharply and on the daily chart my oscillators were showing very oversold. The MACD histogram had turned up and it had been basing at its low for almost two weeks. Price turned up on the 9th and Stochastic RSI was rising as well. Volume was also quite strong.

When TWTC broke the previous day's high, I bought it. However, I immediately put a stop in below the recent low of 5.75 and raised it the next day after the price rose. Within two days the stock rallied well over 50%. I sold some at \$8, some more at \$9, and



the balance at \$10.55 — leaving the rest of the run-up to \$11.30 for others to seize.

Another example is Bruker Daltonics (BDAL). In Figure 5 we see that in mid-November the

*“Someone once said that trading is 60% mental. One of the things we focus on in our newsletter as well as our actual trading is positive mental attitude.”*

stock hit the 50-day moving average while simultaneously retracing 60% of the move up from 12 to 26. At the same time, the Macd Osc (settings 13,34,21) and the StochRSI both changed their slopes upwards. BDAL had resistance at around \$21 and \$24 so we placed our targets below these marks.

**Vomund:** *What is your sell strategy?*

**Twena:** Whenever we enter a trade, we set a stop that will minimize our losses. Simultaneously, we set a target which can be anywhere from 5 to 15% higher than our entry price. It is important to have a plan; this is ours at Morpheus. When the target is reached, we sell 1/3 to 1/2 of our position and then follow up with trailing and rising stops.

**Vomund:** *I visited your office and saw how you use seven computer monitors to follow the activity during the trading day. What role do real-time charts play in your analysis?*

**Twena:** I use several real-time software packages. I use the 130-minute and 65-minute time frames to determine that a reversal has been achieved. I look for a turn in the Stochastic RSI and the Macd Oscillator and then also look at the daily chart to determine the key support and resistance levels.

*Interview continued on page 6*

**Vomund:** *As a hedge fund manager, you are trading other people's money in addition to your own money. Tell me about the psychological struggles that short-term traders face and how you overcome them.*

**Twena:** Someone once said that trading is 60% mental. One of the things we focus on in our newsletter as well as our actual trading is positive mental attitude. Being a trader is more than a job - it is a personal journey that will take you to the depths and boundaries of who you are. I liken it to the qualities of a successful athlete. Trading requires commitment, persistence, and

practice, practice, practice.

But more than that, it is a belief in one's self. We need to clear negative mental habits and re-program ourselves. The use of positive affirmations helps us believe in ourselves.

**Vomund:** *What advice can you give to new AIQ users?*

**Twena:** Study technical indicators. Paper trade as much as you can. Try to develop trading systems which include not only entry but also exit strategies. Work on your plan. Back test. Then work on building self-confidence and self-esteem.

I have found that the success

rate of a trade relates to the mental state of the trader. I believe the inner consciousness of a person will surface during trading and will affect trading results. Being a tennis player, I found that my game improved when I got a coach — the focus, belief, and actions transferred over into my trading style. It is important to continually surround oneself with mentors or group support.

**Vomund:** *Thanks for sharing your thoughts with us. □*

To receive more information on *The Morpheus Report* including a free trial, visit the web site [www.morpheusreport.com](http://www.morpheusreport.com).

## MARKET REVIEW

**O**n the first trading day of the year, the AIQ timing model registered a 100 sell signal. This signal initially seemed ill-timed as the market rallied the next two days but once earnings season began the market retreated.

By January 17, the day AIQ switched back to a buy signal, the S&P 500 had fallen about 3% from the highs it set just two weeks earlier.

In the second half of the month, the AIQ timing model registered a series of buy signals. A 98 buy came on January 17, a 97 buy came on January 23, another 98 buy was registered on January 25, another 97 buy was registered on January 30, and finally a 100 buy was registered on January 31.

The Dow moved slightly higher after the initial January 17 up signal but the S&P 500 and the Nasdaq Composite drifted lower.

We've grown accustomed to a lot of volatility in the market but

in January there weren't many wild swings. By the end of the month, the market averages were only fractionally lower than where they were when they began the year.

As always, some sectors were big winners and some were big losers. The best performing sector fund was Precious Metals, which rose 14%. Both Airlines and Defense & Aerospace rose 6%.

More sectors lost money, however. The Wireless sector lost 21% and Biotechnology lost 18%. Finally, Developing Communications lost 12%. □

David Vomund publishes VIS Alert, a weekly investment newsletter. For a sample copy of the newsletter, call 775-831-1544 or go to [www.visalert.com](http://www.visalert.com).

### All Day Seminar with AIQ Chief Analyst David Vomund

During Florida Money Show  
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- Stock Selection Processes
- Mechanical Trading Systems
- Trading Psychology

David Vomund, editor of AIQ's *Opening Bell*, is co-founder of Legarza Vomund Investment Management, LLC, and president of *VIS Alert*, the newsletter ranked one of the nation's top 10 market timers by *Timers Digest*.

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## STOCHRSI INDICATOR

# ADD STOCHASTIC RSI TO YOUR INDICATOR LIBRARY FOR SHORT-TERM TRADING SIGNALS

By David Vomund

DAVID VOMUND

The StochRSI indicator is an oscillator that measures the level of the Wilder RSI indicator relative to its range. In effect, it takes the value of the RSI Wilder indicator and plugs it into a Stochastic formula.

In their book, *The New Technical Trader*, Tushar Chande and Stanley Kroll explain that there are times when the RSI indicator stays out of overbought and oversold territory for extended periods of time. There can be too few buy and sell signals.

To increase its sensitivity, the RSI Wilder indicator value is plugged into George Lane's Stochastic formula. Here is the formula:

$$\text{StochRSI} = ((\text{RSI Wilder}) - (\text{Lowest RSI Wilder in } n \text{ periods}) / (\text{Highest RSI Wilder in } n \text{ periods}) - (\text{Lowest RSI Wilder in } n \text{ periods})) \times 100$$

Here is the Expert Design Studio (EDS) formula using a 14-day time period:

$$\text{StochRSI is } ([\text{RSI Wilder}] - \text{loval}([\text{RSI Wilder}],14)) / (\text{hival}([\text{RSI Wilder}],14) - \text{loval}([\text{RSI Wilder}],14)) * 100.$$

From these formulas we see that the StochRSI's value is 0 anytime the RSI records a new low for the period. When the RSI records a new high for the period, the StochRSI's value is 100.

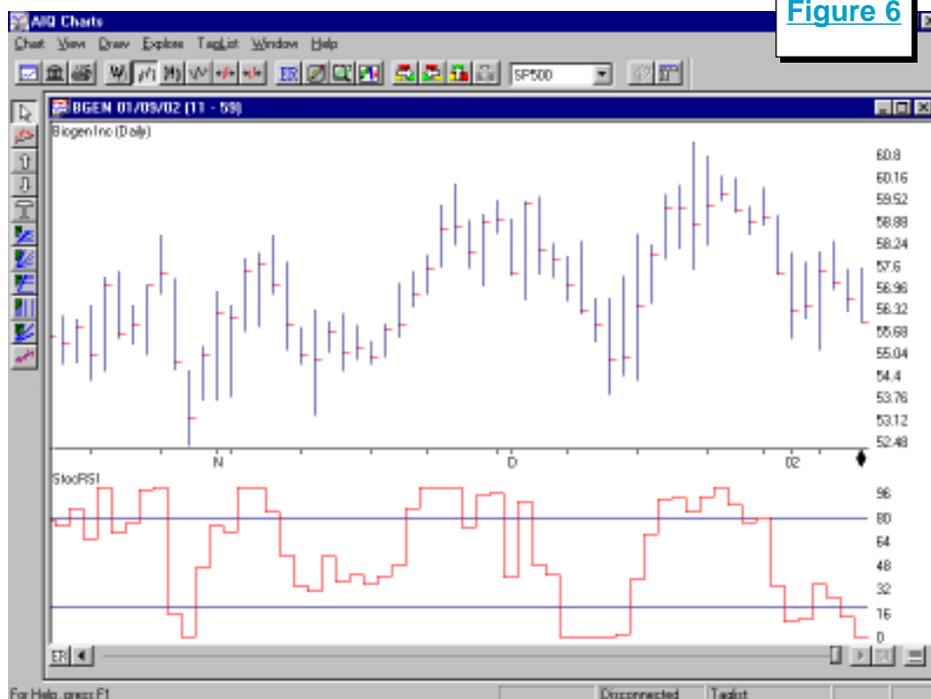


Figure 6

The StochRSI is not one of AIQ's pre-built indicators so users will have to create this indicator using TradingExpert Pro. First, create an EDS file that contains the formula above. Go to the EDS application, click **File** on the menu bar, then **New**. Type in the EDS formula shown above. Save the file by clicking **File**, then **Save**, and type in its name. We called our file *StochRSI*.

Continue by following this procedure:

- Enter the Charts application. Select **Chart** from the menu bar and click **Settings, Indicator Library, and EDS Indicators**.
- The *Custom Indicators* screen that appears lists the EDS

indicators that have been previously created. Click **Add** to create a new EDS indicator.

- In the *Open* dialog box, open the EDS file that contains the StochRSI formula.
- In the *Plot Type* dialog box, select **One line with upper/lower limits** and click **Next**.
- In the next box, enter **StochRSI** under the box labeled *Description*. Next to the *UDF to plot* box, select the **StochRSI** rule name. Set the *Upper Limit* to 80 and the *Lower Limit* to 20. Click **Finish**.
- When the *Custom Indicators* dialog box reappears, click **Done**.

*StochRSI Indicator continued on page 8*

STOCHRSI INDICATOR *continued* . . .

The newly created indicator will now appear as one of the indicator choices in the Control Panel of AIQ charts.

In **Figure 6** we see Biogen Inc. (BGEN) with its 14-day StochRSI indicator. Notice that when this indicator is in overbought territory (above 80), the stock is at the upper end of its trading range and ready to move lower.

Conversely, when the indicator is in oversold territory (below 20), the stock is in the lower half of its trading range and is set to move higher. This is the simplest interpretation of the indicator and this type of analysis only works for non-trending stocks.

If the stock is in a strong trend, then this indicator can stay at overbought or oversold levels

for an extended period of time. For a strong uptrending stock, look for a quick move above 80. When the indicator moves to 100 then the stock is considered to be very strong.

*“StochRSI increases the sensitivity of the RSI indicator so it is most appropriate for short-term traders.”*

Finally, look for positive and negative divergences. For instance, a negative divergence followed by a move below 80 could constitute a sell signal. That’s what happened on the Biogen chart in late-November and early-December.

Notice in Figure 6 how the stock hit a new closing high in

early December but the StochRSI indicator hit its high in late November and then stair-stepped lower. The opposite would be true for a positive divergence.

We’ve seen how the StochRSI is actually an indicator of an indicator. It increases the sensitivity of the RSI indicator so it is most appropriate for short-term traders. □

**Please Note**

The information in this newsletter is believed to be reliable but accuracy cannot be guaranteed. Past performance does not guarantee future results.

**STOCK DATA MAINTENANCE**

The following table shows stock splits and other changes:

Stock	Ticker	Split	Approx. Date
Freds Inc.	FRED	3:2	02/03/02
Greenbriar Corp.	GBR	5:4	02/05/02
Hot Topic	HOTT	3:2	02/07/02
Sonic Corp.	SONC	3:2	02/11/02
Rex Stores	RSC	3:2	02/12/02
Multimedia Game	MGAM	3:2	02/12/02
Hibbett Sporting	HIBB	3:2	02/20/02
BISYS Group	BSYS	2:1	02/25/02
Ball Corp.	BLL	2:1	02/25/02
First IN Corp.	FINB	5:4	02/28/02
Central Coast Bancorp.	CCBN	5:4	03/01/02

**Trading Suspended:**

Anchor Gaming (SLOT), Aquila Inc. (ILA)  
 Aviron (AVIR), Craig Corp. (CRG)  
 Dime Bancorp (DME), Eagle Point Software (EGPT)  
 Encad Inc. (ENCD), Enron Corp. (ENE)  
 IT Group (ITX), MCB Financial (MCB)

**S&P 500 Changes**

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

Plum Creek Timber (PCL) replaces Kmart (KM). PCL is added to the Real Estate Investment Trust (REITRUST) group.

MeadWestvaco Corp. (MWV) replaces Mead Corp. (MEA). MWV is added to the Paper Products (PAPERPRD) group.

ACE Ltd. (ACE) replaces Westvaco Corp. (W). ACE is added to the Insurance-Prop. & Casualty (INSURAPC) group.

Rational Software (RATL) replaces Niagara Mohawk (NMK). RATL is added to the Application Software (COMPUTES) group.