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The *Opening Bell Monthly* is a publication of AIQ Systems
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BEWARE OF TOO MANY STOCKS

IMPORTANT! IDENTIFY STOCKS THAT DON'T WORK WELL IN TRADINGEXPERT

By David Vomund

TradingExpert comes with a Historical Stock CD that contains about 10,000 stocks. New users often install all 10,000 stocks simply because they are there. This can be a mistake.

We have found that there are only about 2,000 stocks that most stockholders might be willing to own. Beyond that are stocks with insufficient volume or huge bid-to-ask spreads. Installing too many stocks increases your data download time, lengthens data maintenance, and lowers the effectiveness of screening reports and Expert Design Studio models.

There are stocks that don't work well in TradingExpert. Their Expert

Ratings and indicator readings are meaningless.

It is important to be able to identify these issues. For technical analysis to work, a stock needs to have a history of reasonably consistent volume. Stocks that trade at very

DAVID VOMUND



“For technical analysis to work, a stock needs to have a history of reasonably consistent volume. Stocks that trade at very low volume provide inadequate data for the volume based indicators to give accurate readings.”

low volume or have frequent zero volume days provide inadequate data for the volume based indicators to give accurate readings.

Volume is not the only consideration.

The price level of a stock is also important. Low priced and penny stocks often close on either their high or their low prices every day. The closing price from one day to another varies very little in actual terms; however, the percentage change can be very large.

BEWARE OF TOO MANY STOCKS *continued . . .*

Stocks that don't work well are easy to identify. In **Figure 1** we see JPE Inc. (JPEI). The first problem with this stock is its low price of less than \$1. Partially because of the low price, the stock's price bars appear "blocky." Notice that at the start of the chart all the price bars have the same high price and the same low price.

In addition, the stock always closes on either its daily high price or its daily low price. Rarely does the stock close in between its high and low prices. That's because its closing price is simply its bid or its ask price. When a stock always closes on its high or low value, it will have invalid Money Flow, Volume Accumulation Percent, and On Balance Volume indicators.

JPE Inc. has short periods of volume over 100,000 shares but notice that its volume is typically less than 50,000 shares a day.

The biggest problem with having stocks like JPE Inc. in your system is that they make the AIQ reports and Expert Design Studio screenings difficult and time consuming to use. In **Figure 2** we've run the Weighted Action List report on a database of 10,000 stocks. Notice how many low

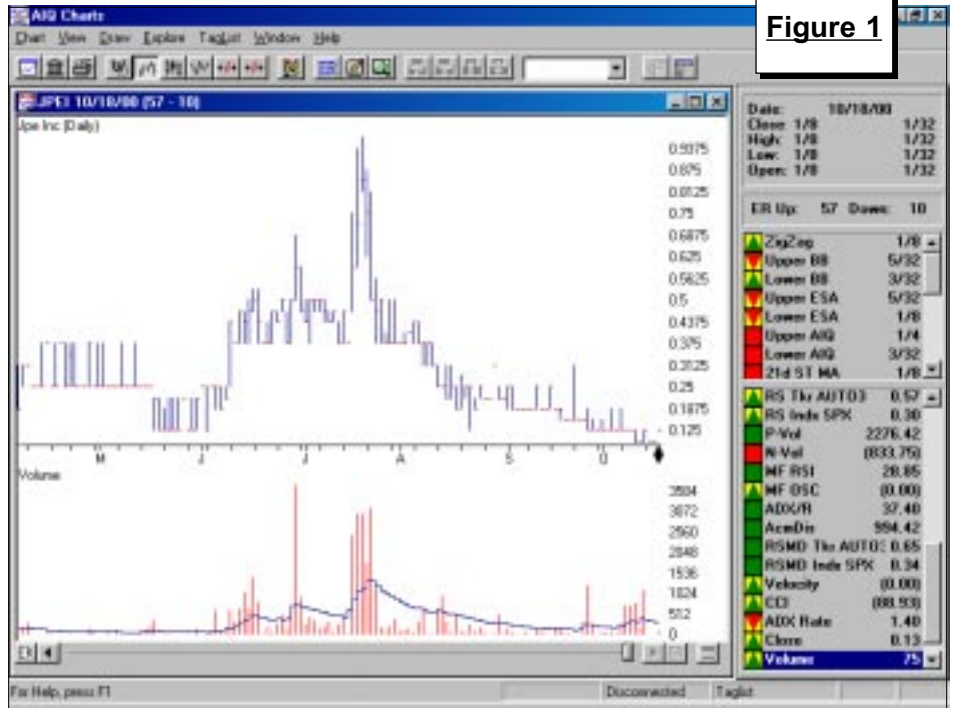


Figure 1

priced stocks appear on the report.

Of the top 10 stocks on the report, all but one have a price less than \$2. These are low volume stocks as well. If someone were to use this report hoping to find a good stock, he would have to sift through a bunch of stocks that aren't

worth analyzing in order to find a few stocks that are worth considering.

The Weighted Action List isn't the only report that will be dominated by low priced/low volume stocks. Low priced stocks will dominate the top of the Relative Strength report because they went from \$1 to \$2. Stocks that always close on their high or their low price will dominate the Accumulation/Distribution report.

Some say it is a problem that TradingExpert's Expert Ratings

don't work with low price/low volume stocks. That's not entirely true. It isn't the Expert Ratings that are faulty, it is the indicators that the Expert Ratings are based on that don't work. Most technical indicators won't work with low price/low volume stocks no matter which software package you use.

The low priced stocks can hurt the calculation of industry groups as well. When a stock closes at

its bid of \$0.25 one day and then closes at its ask of \$0.50 the next, then a 100% price gain is factored into its parent group. That makes the group look more bullish than it actually is.

If you are reluctant to delete stocks from a large database, you can generate AIQ reports only on stocks with sufficient price and volume. In the Reports module, highlight *Stock Reports* and right-

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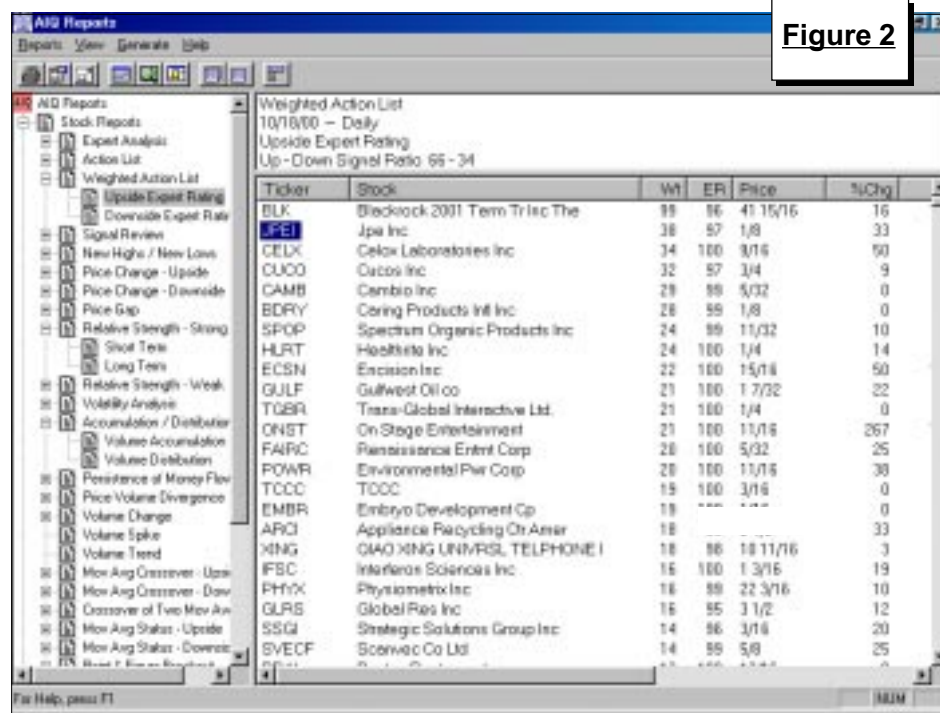
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BEWARE OF TOO MANY STOCKS *continued . . .*

click the mouse (alternatively, you can click on *Reports* and then *Global Properties*). The *Global Properties* dialog box will appear. To have reports generated only on stocks greater than \$10 and volume greater than 200,000 enter 10 next to *Price* >= and enter 2000 next to *Volume* >=.

If you have installed too many stocks in your database and want to reduce the database size, use the *Advanced Ticker Delete* function in the Data Manager (see page 64 of the User Manual).

If you are installing stocks from the Historical Stock CD, you can use a minimum price and minimum volume filter. Start out with a minimum price of \$10 and a minimum volume of 200,000 shares (volume is listed in 100s so enter 2,000 as the minimum volume instead of 200,000). The system will tell you how many stocks pass the test before installing them. If you want more stocks, then loosen the param-

**Figure 2**

eters. Conversely, if you want less stocks then tighten the parameters. The process of installing stocks from the Historical Stock CD is described in the User Manual on page 42. ■

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.

STOCK DATA MAINTENANCE

The following table shows past and future stock splits:

Stock	Ticker	Split	Approx. Date	Stock	Ticker	Split	Approx. Date
U.S. Physical Ther.	USPH	2:1	01/08/01	Scholastic Corp.	SCHL	2:1	01/17/01
Sanmina Corp.	SANM	2:1	01/09/01	IDEC Pharm.	IDPH	3:1	01/18/01
Home Fin'l Bancorp	HWEN	2:1	01/11/01	Gallagher (AJ)	AJG	2:1	01/19/01
Green Mount. Coffee	GMCR	2:1	01/12/01	TALX Corp.	TALX	3:2	01/22/01
Forest Labs	FRX	2:1	01/12/01	Southwest Water	SWWC	5:4	01/22/01
Direct Focus	DFXI	3:2	01/16/01	Duke Energy	DUK	2:1	01/29/01
Brinker Int'l	EAT	3:2	01/17/01				

Trading Suspended:

Applied Biosystems (ABIO), Biomatrix Inc. (BXM), Cobalt networks (COBT), Cooker Restaurant Corp. (CGR), Florida Progress (FPC), Fort James (FJ), Lilly Industries (LI), MotherNature.com (MTHR), National Discount Brokerages (NDB), Rainforest Café Inc. (RAIN), Seagram Co. (VO), Simpson Ind. (SMPS)

Name/Ticker Changes:

China Broadband Corp. (CRBC) to China Convergent Corp. (CVNE)
 CNF Transportation (CNF) to CNF Inc. (CNF), CP&L Energy (CPL) to Progress Energy Inc. (PGN)
 Flour Corp. (FLR) to Massey Energy (MEE), PE Corp. (PEB) to Applera Corp-Applied Biosystems (ABI)
 Sybron Int'l (SYB) to Apocent Technologies (AOT)

LEARN TO IDENTIFY TRENDS TO FIND VALID STOCKS AND COMMODITIES POSITIONS

By Bobby Florez

Editor: Edward Robert "Bobby" Florez, a financial professional for almost three decades, retired from the Chicago Board of Trade in 1996 and now devotes his time to helping others learn how to trade. In the October and November 2000 issues of the Opening Bell, Mr. Florez discussed the basics of futures and how futures can give a perspective of financial trends. In this issue, he covers analysis methods to identify valid trading positions for both stocks and commodities.

Important to Identify Trends and Themes

Those new to trading should gain market experience by examining the markets that interest them. In doing so, they should learn to identify the kinds of trends that compose those markets. Trends are among the first things you should study and comprehend.

Trends are almost always associated with some well-publicized "theme." If one looks at any kind of social or cultural trend, be it fashion, food, transportation, advertising, or even politics, there is always a *thematic* tone associated with it. Shrewd and successful people are quick to identify and act upon these themes and trends.

Themes and trends abound in the markets and being able to identify them is very important. Knowledgeable, successful traders are always the first to take positions at the onset of an identifiable trend or theme. Conversely, they

are the first to get out when the trend or theme has been overplayed or has served its purpose.

Two Kinds of Trends

There are two kinds of trends — *lateral* and *angular*. And there are two kinds of angular trends — *up* and *down*.

In **Figure 3** we see a bar chart of the Dow Jones Industrial Average. Notice how the Dow swings in a noticeably wide yet precise trading range since the middle of April.

Consider its tendency to want to hold above 10,112 (support) and below 11,880 (resistance). It

upper and lower boundaries of resistance and support there were many up and down swings, or angular trends, each one lasting for at least a week.

Although a lateral trend may stretch sideways for weeks or even months, you will always be able to identify *minor* up and down swings within the confines of the lateral trend.

As long as the lateral trend remains in place, the strength of these up and down swings is considerably less than the power of the lateral movement. However, if the strength of one of these swings becomes greater than the

lateral trend's power, then it will break through the trading range in either an up or down direction.

Looking again at Figure 3, the upper boundaries of the Dow's trading range was broken in August. At that time, an up swing with enough strength behind it broke

through the resistance level at about 11,880. The Dow moved higher for several weeks after the breakout.

Incidentally, at this time another trading range of greater magnitude and power than the one we have been reviewing was becoming apparent. The top, or resistance level, of this trading range is the all-time record high of the Dow Jones Industrial Average, which was set in April of this year.

In Figure 3, we see that the ability of the overall trend to contain any rally is greater than the power of minor uptrends — i.e., the lateral trend is of greater

"Knowledgeable, successful traders are always the first to take positions at the onset of an identifiable trend or theme. Conversely, they are the first to get out when the trend or theme has been overplayed or has served its purpose."

wasn't until August that a successful upside penetration (breakout) of the resistance level at 10,880 occurred. Thereafter, for a few weeks, the market successfully tested its all-time record high above 11,520 in early April.

Lateral trends are very important market phenomena for traders and analysts to pay attention to. The lateral trend, or trading range, is the womb from which a majority of up and down trends usually come.

This action, which we have identified since April in the Dow Jones Industrial Average, is called a *major lateral trend*. Within its

TREND ANALYSIS *continued* . . .

magnitude and power than the minor up and down swings.

Recognizing Trends

A market is likely to reverse its trend at or about the old support or resistance levels. After reversing, it swings towards the opposing side of the trading range. This leads us to two important trading rules:

Always take profits, no matter how small, the first time a previously identified support or resistance point is *tested*. Profits can be taken the second, third, or fourth time that they are tested as well.

Never anticipate breakouts! You should always wait for the actual break of the lateral trend.

These rules sound simple but the majority of traders do just the opposite. They would rather "wait and see" what the market will do rather than exit their positions whenever a market tests a key support or resistance point. Or, they initiate a position in anticipation of either an upside or downside breakout of the market from its prevailing trading range.

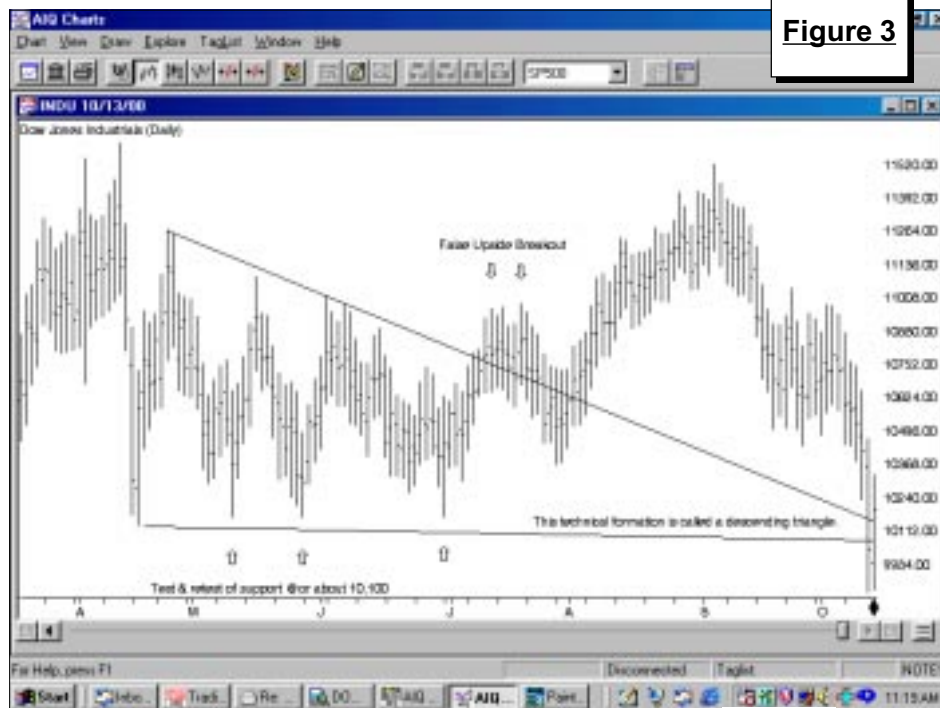


Figure 3

Trading within lateral trends is difficult and only for short-term traders. A simpler method of making money is to play the breakouts from the lateral trends.

The Definitive Trend: A Position Entry & Exit Signal

If a market is trending up, it

will trend in higher up swings and higher down swings. For down trending markets, the market will make lower down swings and lower up swings.

Whenever a market violates its last corrective swing in its prevailing trend, it is an indication that the trend may be changing. You must be prepared to act if the prevailing trend does not resurrect itself right away. I can reveal countless examples of major trends that began when a definitive trend violation like this occurred.

The S&P 500

On Friday July 17, the S&P 500 made what appeared to be an upside breakout from a torturous month long lateral trend, **Figure 4**. However, instead of maintaining its upward momentum, it abruptly reversed.

The question to ask when viewing price activity at the time of a breakout is: what is the precise position risk? To answer

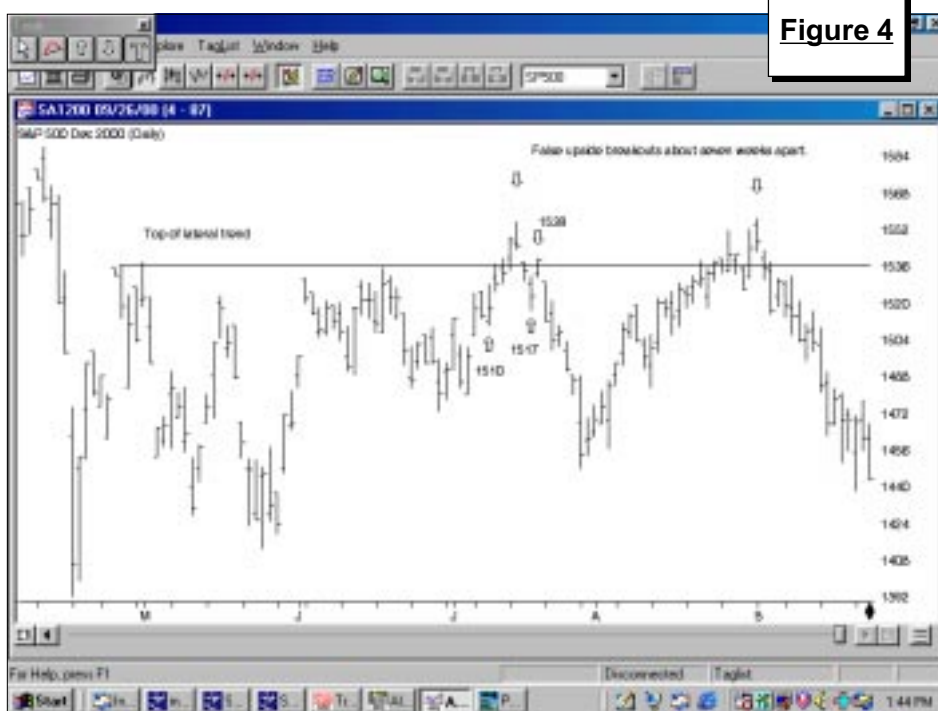


Figure 4

Trend Analysis continued on page 6

that question, let's recount the activity from July 17, the day the market actually attempted to break out.

Notice that on July 19, two trading days after breakout, the market incurred a normal downside reaction. The next day, the market rallied and attempted to resume its upward trend. But this rally lasted only one day. Thereafter, not only did the market fail to rally and regain its up trending momentum and make another new up swing above the July 17 high, but it also declined below the last down swing that occurred on July 19.

Thus, in one fell-swoop, the market gave two negative signals. These were signals that would have prevented the bullish but prudent trader from maintaining or initiating any bullish strategies. Once the market broke below its previous lows, professional and institutional traders were not only dumping shares from their portfolios, they were probably also initiating bearish trading strategies.

Traders who neglected these signals were subject to a profound plunge in the market and a resounding deflation of buying power in their portfolios.

The purpose of the point we are making is to encourage you to pay attention to the market's trend - its definitive trend. If you do, you will always be able to fix your position risk at an objective point no matter what market you trade. And you can do this before actually taking a position in the market.

For example, let's say that you wanted to buy a stock index future but wanted to limit your risk exposure in case the market reversed its trend. Where would you place your protective sell



stop? An objective stop could be placed just below its last down swing. You would not want to maintain any bullish positions below that point. In other words you should not maintain any bullish posture in this market if the last down swing is broken by any *future* down swing.

When you look at the price differential where the market is compared to its last down swing, you may get cold feet because the difference may be more than what you want to risk. If it's more than you want to risk then you probably wouldn't take a position, which is in itself a natural mechanism of risk control.

With this analysis, you have automatically and without much conjecture, let the protocol of the *definitive trend* determine what your action should be in accord with your personal sense of risk. We might add here that had you taken a long position on or around July 17, your stop should have been moved up to the level of the last down swing on July 19, from

the July 11 level.

To be successful with short-term trading, it is important to make daily observations and make daily adjustments to your positions when needed. Even if you only have one day to make the adjustment, it should be done.

Day Trading

Let's take a look at the fastest growing market for day traders, the E-mini Nasdaq 100. This contract is an index futures contract and is traded at the Chicago Mercantile Exchange.

Figure 5 is a four-minute bar chart of the December 2000 contract on October 16. This short-term time frame is about as fast as any trader can analyze and execute. You have to be quick to figure and act. Yet, using only four-minute intervals does somewhat diminish your risk in extremely active markets. This kind of trading, however, is only for those who crave extreme action.

The December 2000 contract

Trend Analysis continued on page 8

MARKET REVIEW

2000 IN REVIEW

By David Vomund

Market historians know that 1973-74, 1982, and 1990 were very bad market years. We can now add 2000 to that list. From its high to its low, the once-invincible Nasdaq Composite fell over 50%. Drops of 50% or more in major markets are historic events. The Nasdaq fell 59.9% between January 1973 to October 1974, but it has never had so steep a fall since. It took until 1979 for the Nasdaq to recover those losses.

The sharp selloff was mostly limited to the Nasdaq growth stocks. For the year, the S&P 500 fell 10%.

Simple trendline analysis tells a lot about the market. In **Figure 6** we show a weekly log-scale chart of the S&P 500 along with its support trendline. This trendline began at the 1994 low and acted as support through the rest of the decade. This is a very strong trendline since it was successfully tested on several occasions.

In September 2000 the support

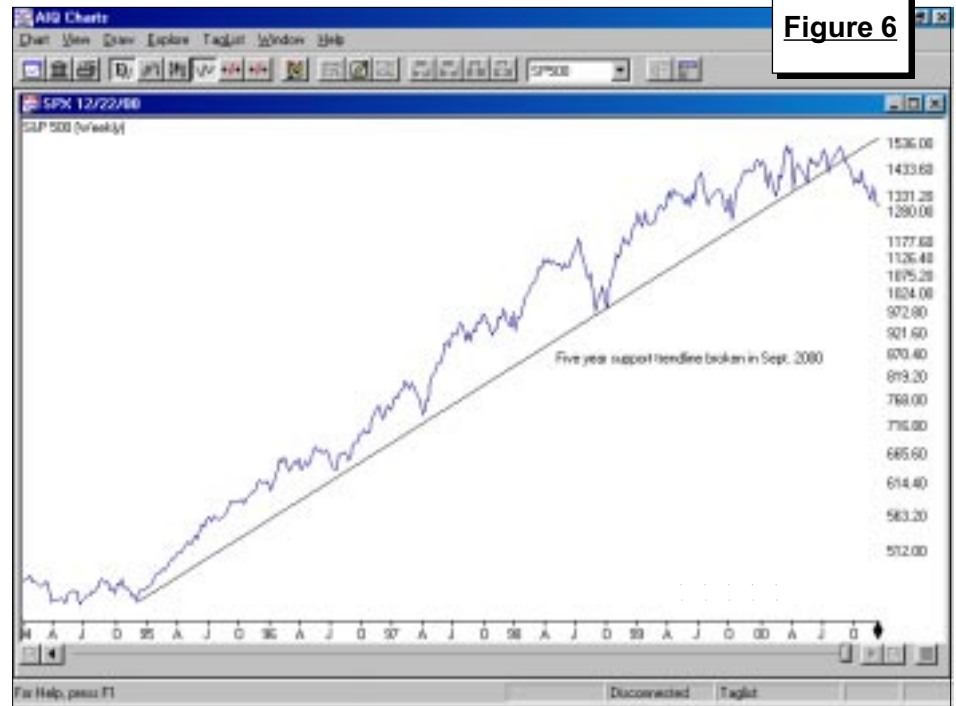


Figure 6

trendline was finally broken. A break of this support trendline didn't necessarily mean that the market would go lower but it did imply that the uptrend is over. The S&P 500 fell a quick 10% once the trendline was broken.

In **Figure 7** we show a log-scale weekly chart of the Nasdaq Composite. A ten-year support trendline connects the 1990 bear market low with the 1994 and 1998

lows. Despite the 50% correction in the Nasdaq, this support trendline has not been broken. This is testimony to the extreme run-up we saw in 1999. This trendline represents important

support as we move into the year 2001.

For growth investors, one of the best market timing techniques is to look at the relative strength of the Nasdaq versus the S&P 500. In **Figure 8** we see a chart of the Nasdaq in the year 2000 along with its weekly RSMD SPX indicator. This indicator rose in value for the first two months of the year, implying the Nasdaq was outperforming the S&P 500. The indicator then turned south from mid-March until June. During the summer months the indicator drifted sideways but fell once again during the fourth quarter. Unlike in 1999, the RSMD SPX favored the Nasdaq over the S&P 500 only a few months during the whole year.

Figure 8 shows two resistance levels on the Nasdaq. The lower horizontal trendline connects the May and October lows. In December the Nasdaq rallied to this trendline but could not break above the resistance. An addi-

Market Review continued on page 8



Figure 7

TREND ANALYSIS *continued* . . .

formed a trading range between 3240 and 3280 (a 40 point range) early in the trading session. The dollar difference in this range is \$800 per contract (or \$20 per point). And, as you can see, for nearly three hours the market swung several times from one side to the other before finally making up its mind to rally. But once it did, the market rallied about \$1600 per contract over the next 40 minutes.

This was a short hard swing with only one noticeable correction that lasted less than five minutes. In addition, notice that from the time of breakout no prior down swing was violated. Thus, a successful day trade could have been made if the trader entered at the market breakout and placed a sell-stop at or about the bottom of the last down swing.

This demonstrates that the protocols of the definitive trend method work as well for day traders as they do for longer-term traders.

Again, once you are convinced that a breakout from a trading range has occurred, take a position in accord with the trend with an initial stop at or about the extreme of the last reaction against the trend. Thereafter, take profits or at least adjust your protective stop in accord with the tenets of the definitive trend.

Every successful trader must know the difference between lateral and angular trends and how to identify each one. When an angular trend begins (either up or down), traders must also know how to apply the definitive trend protocols for positioning. Otherwise, they may be incorrectly positioned in the market, and that can be very costly. ■

Mr. Florez offers free training online at www.synchronomics.com.

MARKET REVIEW *continued* . . .

tional resistance trendline is drawn connecting the July and September highs.

While the S&P 500 and the Nasdaq Composite were down on the year, several sectors posted strong returns.

Looking at the Fidelity Sector funds, the year's biggest winner was Medical Delivery, which primarily invests in HMO stocks.

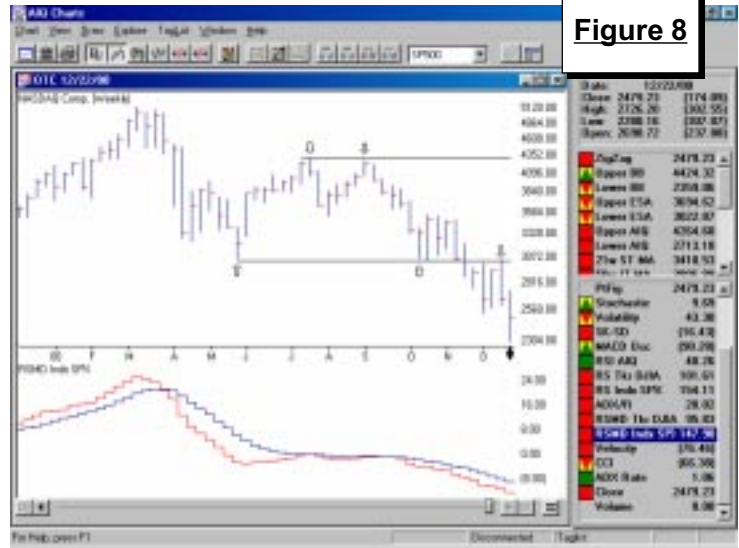


Figure 8

Medical Delivery rose 68%. Financial sectors also performed well. Insurance rose 53% and Home Finance rose 50%. Energy Service rose 50%. ■

S&P 500 Changes

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

Robert Half Int'l (RHI) replaces Associates First Capital (AFS). RHI is added to the Services-Employment (SERVICEE) group.

Alleghany Energy (AYE) replaces Bethlehem Steel (BS). AYE is added to the Financial-Diversified (FINANCID) group.

Symbol Technologies (SBL) replaces W.R. Grace & Co. (GRA). SBL is added to the Electrical Equipment (ELECTRIE) group.

Intuit Inc. (INTU) replaces Owens-Illinois (OI). INTU is added to the Computers-Software & Services (COMPUTES) group.

Qlogic Corp. (QLGC) replaces Polaroid Corp. (PRD). PRD is added to the Electronics-Semiconductors (EQUIPSEM) group.

Vitesse Semiconductor (VTSS) replaces Springs Industries (SMI). SMI is added to the Electronics Semiconductors (ELCTRONS) group.

Stryker Corp. (SYK) replaces Russell Corp. (RML). SYK is added to the Health Care-Medical Products & Supplies (HEALTHMP) group.

Jabin Circuit (JBL) replaces Coastal Corp. (CGP). JBL is added to the Manufacturing-Specialized (MANUFACS) group.

Applied Micro Circuits (AMCC) replaces J.P. Morgan (JPM). AMCC is added to the Electronics-Semiconductors (ELCTRONS) group.

Kinder Morgan (KMI) replaces Nabisco Group Holdings (NGH). KMI is added to the Natural Gas (NATURALG) group.

Flour Corp. (FLR) replaces Massey Energy Co. (MEE). FLR is added to the Engineering & Construction (ENGINEER) group.

Noble Drilling (NE) replaces Time Warner (TWX). NE is added to the Oil & Gas-Drilling & Equipment (OIL&GASD) group.