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Unweighting the S&P 500 Index

Use AIQ's Unique Tools to Create an Unweighted S&P 500 For Superior Analysis

By David Vomund

Most industry professionals use the Standard & Poor's 500 Index (S&P 500) to represent "the market." This index contains well established companies from a broad set of industries. Although it contains only 500 stocks, these stocks make up 80% of the U.S. stock market capitalization. By tracking 80% of the capitalization, the S&P 500 truly does represent "the market."

The S&P 500 tracks the overall market capitalization because the index is capitalization weighted. Capitalization weighted indexes measure change in market value. Higher capitalized S&P 500 stocks, like General Electric and Microsoft, move the index more than the smaller stocks in the index.

Some would argue that the index should not be capitalization weighted. The top 10 stocks in the S&P 500 make up 24% of the index's total capitalization. The top 40 stocks make up just

over 50%. That means that 460 stocks represent the remaining half of the index's market value.

That can make a big difference in performance. Since the larger stocks at the market peak in 2000 included many technology stocks that have since fallen hard (Intel, EMC, JDS Uniphase, Lucent,



DAVID VOMUND

"An unweighted S&P 500 index treats all the stocks equally...An unweighted index of the S&P 500 stocks outperformed the capitalization-weighted index by 11 percent annually for the past three years."

Oracle, Sun Microsystems, etc.), the performance of the index has been worse than most stocks in it.

An unweighted index treats all the stocks equally. For example, a 5% change in a high-priced stock has the

same affect on the index as a 5% change in a low-priced stock. An unweighted index of the S&P 500 stocks outperformed the cap-weighted index by 11 percent annually for the past three years. On an equal-weight basis, the S&P has a lower price-earnings ratio and a higher dividend yield.

Beginning in April 2003, there is a way to trade an S&P 500 unweighted index. The Rydex Funds (www.rydexfunds.com) have created an Exchange Traded Fund (ETF) that trades on the American Stock Exchange just like a stock. The ticker symbol is RSP.

TradingExpert Pro gives traders access to tools not found elsewhere. There is no history for the S&P Unweighted ETF but you can create an unweighted S&P 500 index in TradingExpert. This is done by creating an industry group containing all of the S&P 500 stocks.

Creating an industry group of the S&P 500 stocks is easy, and there is no need to manually type in the ticker symbols. Instead, you can get a list of the S&P 500 stocks from the Standard and Poor's web site at www.standardandpoors.com. This site allows you to save the stocks to an Excel spreadsheet.

In Excel, delete all the columns except the first column that contains the 500 ticker symbols. Save the spreadsheet using a CSV format.

Next, get TradingExpert ready to create a group of the S&P 500 stocks. Go to the Data Manager and create a new list by clicking *List* and then *New*. We called our list SPSTOCKS. Then create a group by clicking *Ticker* and *New*. We called our group SPGROUP. Check *Group* and click *OK*. Enter a ticker description.

With the group created, we are ready to import the list of the S&P 500 stocks from our spreadsheet to our S&P 500 industry group. In Data Manager, click *List* and *Advanced List Edit*. Select *File* and *Open*, highlight the SPSTOCKS list and click *Open*.

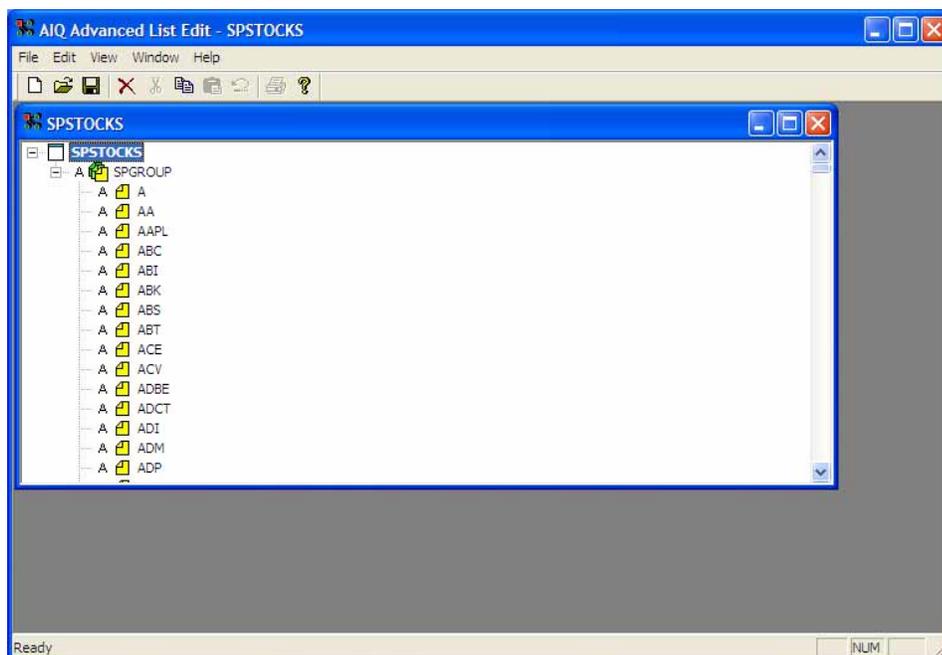


Figure 1. Advanced List Edit window after importing ticker symbols for all S&P 500 stocks into list SPSTOCKS. This list will be used to create an unweighted S&P 500 index.

We want to import the stocks to the industry group rather than the list, so highlight the SPGROUP ticker. Select *File* and *Import*. Find the Excel file that you created and click *Open*. The 500 tickers will appear under the group name as shown in **Figure 1**.

To save the new structure, click *File* and *Save*.

Before charting the SPGROUP, it must first

be calculated. In Data Manager, click on *Utilities* and choose *Compute Group/Sector Indices*. Check the *Selected Group Symbols*, highlight the SPGROUP, and click *OK*.

Figure 2 shows the calculated SPGROUP along with the actual S&P 500 index. Notice they have a tendency to move in the same direction but the unweighted SPGROUP tends to perform better than the S&P 500 index.

At the start of the bear market, the S&P 500 began its steady fall but the unweighted SPGROUP rose in

value throughout most of 2000. At the start of 2001, the S&P 500 made a lower high (see trendline in Figure 2) but the SPGROUP had a higher high. In 2002, the bear market was fierce and both indices fell in value. Finally in 2003, the S&P 500 rallied to

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its late 2002 highs but the unweighted SPGROUP was much stronger and has recovered most of its 2002 losses.

We've seen that AIQ has the tools to calculate an unweighted S&P 500 industry group but there are additional tools available to analyze this group. By creating the group, we have access to volume statistics calculated on the S&P 500 stocks. Along with volume data, we have access to volume-based indicators such as Money Flow and the Positive Volume Index (P-Vol).

An additional tool that is unique to AIQ is the capability to create a market on the S&P 500 stocks, which allows us to plot an Advance Decline Line calculated on the S&P 500 stocks.

Calculating a market is a simple process. In Data Manager, click *Ticker* and *New*. We entered the ticker symbol SPMKT. Check *Market* and click *OK*. On the next screen, type in a description (we entered S&P 500 Unweighted Market). Under *Market Breadth Data Source*, choose the second selection and compute the breadth from the SPSTOCKS list. Under *Price Ticker*, we want it to chart our unweighted S&P 500 group so we entered SPGROUP. Click *OK*. The group can then be calculated.

With the market calculated, we can use ticker SPMKT every time we want to chart the unweighted S&P 500 group. This allows us to chart the group along with volume indicators and an Advance Decline Line.

Figure 3 shows the unweighted S&P 500 group along with its Advance Decline Line and its P-Vol



Figure 2. Comparison of unweighted S&P 500 (upper chart) with the normal (cap-weighted) S&P 500 index (lower chart). Note that the unweighted group has outperformed.

indicator. Notice the Advance Decline Line supports the view that the major market low came in March 2003 rather than October 2002. Since March, the Advance Decline Line has been very strong, showing broad

participation.

Looking at the P-Vol indicator, it fell with the market during the two sell-offs in the summer and fall of 2002 but in early 2003 this indicator rose while the market fell. That implies the market fell on below average volume.

The ability to create an unweighted S&P 500 index is not available to traders who do not use AIQ. Tools unique to AIQ allow you to create a historical group and analyze volume and breadth-based indicators based solely on the S&P 500 stocks. This analysis can be used to trade the new Rydex Unweighted S&P 500 Exchange Traded Fund (RSP).

Believers in small stocks who also want the security of investing in well-known names may find the Rydex ETF appealing. When the broad market outperforms the largest-cap stocks, the equal weighting in the ETF allows for better performance.

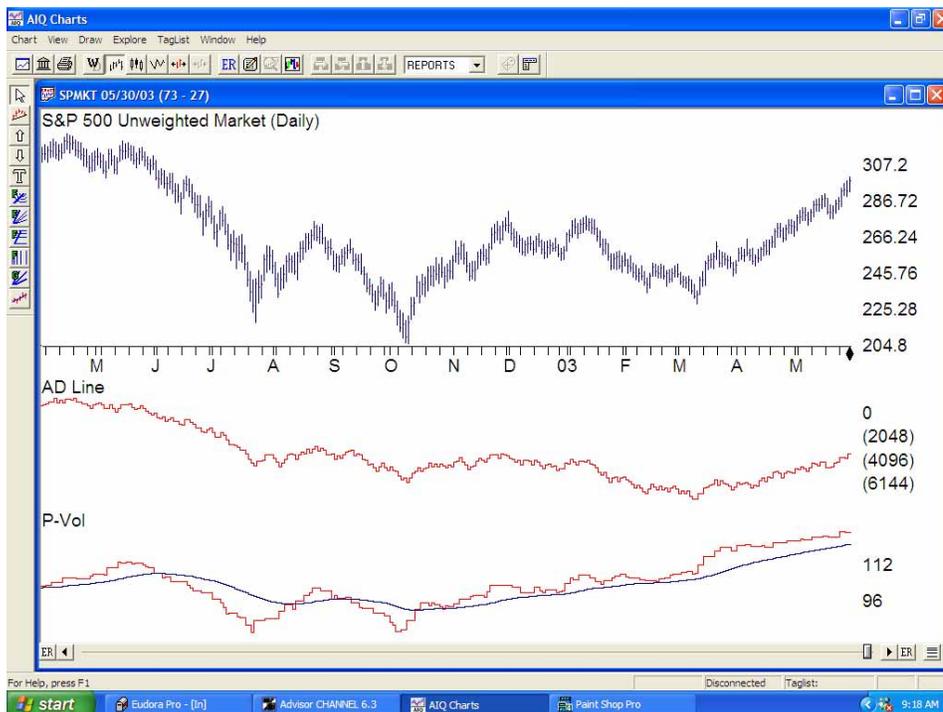


Figure 3. Daily chart of unweighted S&P 500 with Advance Decline Line and P-Vol indicators displayed below. Note AD Line does not turn up until March 2003.

AIQ and IBD Combined

Increase Returns and Save Time! Filter Stocks Using 'Rational' Approach

By David Vomund

Investor's Business Daily (IBD) has always been a popular newspaper with AIQ users. That's because it offers a quantitative approach to stock coverage. A popular approach that combines two methodologies is to take IBD's favorite stocks and then use AIQ's technical timing reports and EDS scans to determine what and when to buy.

Each Monday, IBD publishes the IBD 100 stocks. This is a computer-generated ranking of the leading companies in America. The ranking is based on a combination of each company's earnings growth, return on equity, sales growth, profit margins, and price performance.

IBD's quantitative screening is based mostly on fundamental data. That's why combining the IBD approach with the AIQ technical approach works well. IBD provides a fundamental screening while AIQ provides the technical timing. Combining fundamental with

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technical analysis is often called "Rational Analysis."

In the past, AIQ users had to manually enter the ticker symbols from the IBD list into AIQ. That is no longer necessary. IBD has just added a feature to its web site

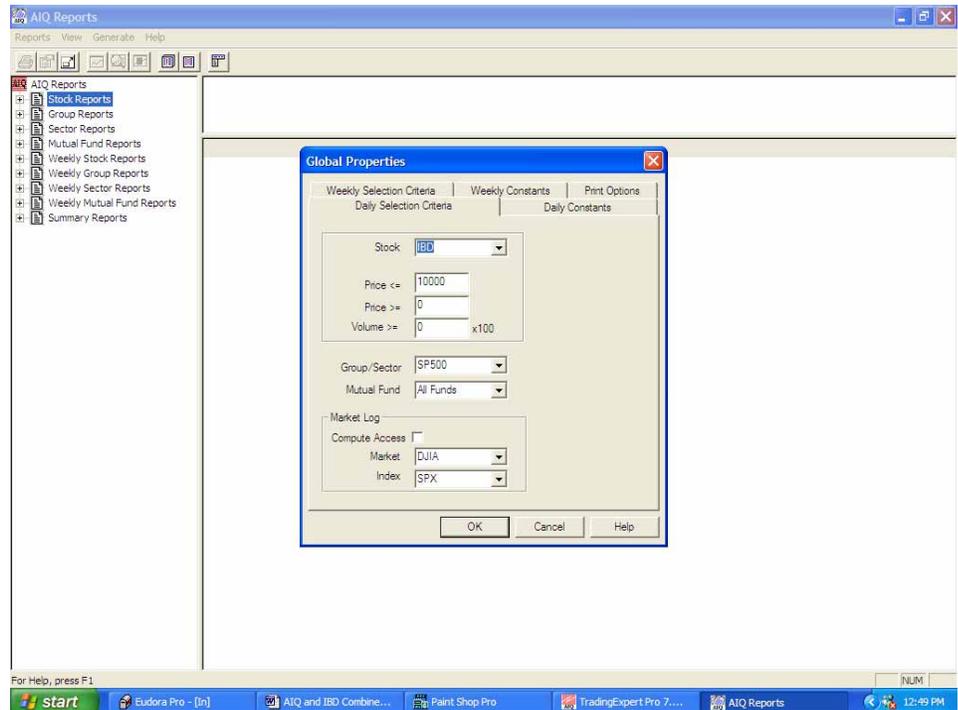


Figure 1. AIQ's Reports screen with list IBD selected in the *Global Properties* dialog box. To duplicate, select *Reports/Global Properties* from main menu. Then select the IBD list from the drop down menu located next to first item (*Stock*).

(www.investors.com) that allows you to export the stock names to an Excel spreadsheet. At the IBD web site, click on "Today in IBD." This takes you to a link to the IBD 100 download. You have to be an IBD subscriber to be able to access this section.

With the stocks in the spreadsheet, erase all the columns and titles until column A contains all of the ticker symbols. Save the file using a CSV format.

To make an AIQ list of these stocks, go to the Data Manager.

Click *List* and *Advanced List Edit*. On the *Advanced List Edit* screen, click *File* and *New*. For the name type *IBD* and click *OK*. To import the spreadsheet of the IBD list, click *File* and *Import*. Highlight the spreadsheet you created and click *Open*. Save the file by clicking *File* and *Save*.

Some of the stocks in the IBD list are emerging stocks that might not be in your database. If most of the IBD selected stocks are not in your database, then use the historical stock CD to add them (see page 39 in *AIQ's User Reference Manual*).

If the majority of IBD stocks are in your database, then you can use an online feature to add the missing stocks. Assuming you are a myTrack user, adding the stocks that are not in your database is an easy

process.

Open the Data Manager and make IBD the active list. The IBD 100 ticker symbols should appear in the left section of the screen. Click *List* and *Find and Create*. The ticker symbols from the stocks that are in the IBD 100 list but are not in your database will appear. Click *MyTrack Online* and each stock's name will appear. Click *Make DTA Files* and *Done*. The next time you retrieve data, these stocks will be updated.

With the list created, we are able to run AIQ Reports and Expert Design Studio (EDS) screens on the selected list. One problem people run into when using Reports on a large database of stocks is that each report contains stocks that for one reason or another would never be purchased. Their bid-to-ask spreads may be too large or they might not have enough volume.

Running reports on a large database of stocks forces you to look through the list of stocks on each report searching for the ones you are interested in. By running the reports only on the IBD list, each stock that appears in a report has passed the IBD fundamental screening.

To run AIQ's stock reports on the IBD list, open Reports. From the

“Running reports on a large database of stocks forces you to look through the list of stocks on each report searching for the ones you are interested in. By running the reports only on the IBD list, each stock that appears in a report has passed the IBD fundamental screening”

menu bar select *Reports* and *Global Properties*. Next to the *Stock* option, use the drop down menu and select the IBD list. The screen should look like **Figure 1**. Click *OK*.

To perform the same function in

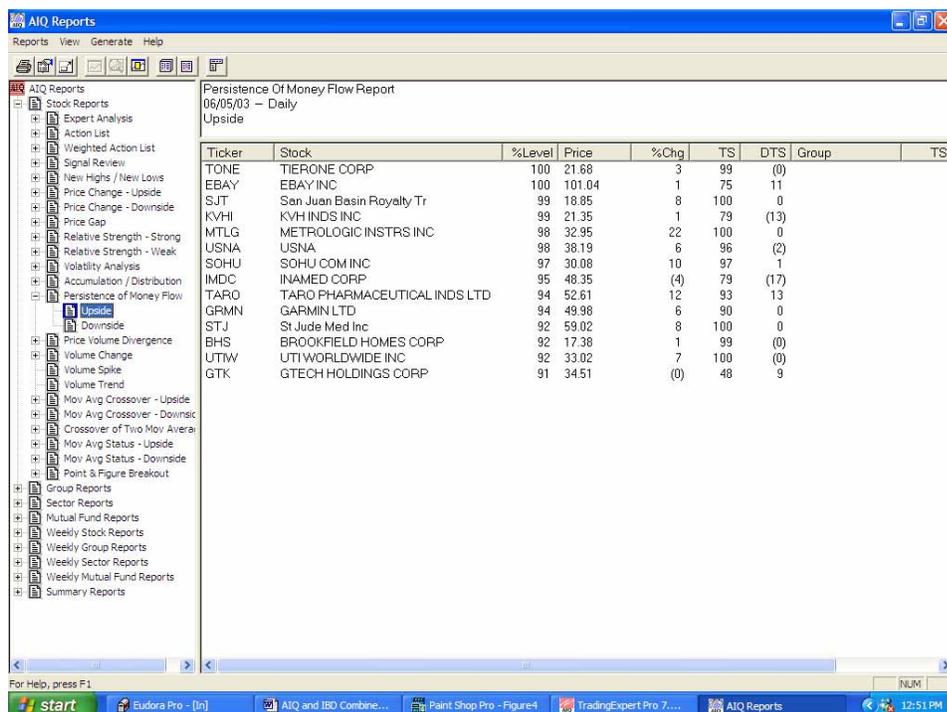


Figure 2. AIQ's Reports screen displaying *Persistence of Money Flow* report run on a list of IBD-screened stocks.

EDS, click the *Properties* icon in the EDS module.

Figure 2 shows the Persistence of Money Flow report on the list of IBD-screened stocks. All the stocks on the list have been screened by the IBD parameters including high earnings growth and high relative strength. In addition, all the stocks have had a very strong Money Flow indicator during the last six months.

Filtering the stocks to analyze in AIQ's TradingExpert Pro using a rational approach can increase returns and

it also saves time. By using a rational approach, all the stocks that appear on the AIQ reports or EDS scans are worthy of analysis. In this article, we concentrated on IBD-screened stocks but you can also use

recommended stocks from other services as well.

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

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Unique Advantages of PtFig Charting

Point & Figure Charts Make It Easier to Identify Important Patterns & Support/Resistance Levels

By David Vomund

Last month we discussed chart patterns using traditional bar charts. Another charting form, Point & Figure, is lesser known but offers some unique advantages over the more traditional charting methods. The Point & Figure charting technique first became popular in 1948 when A.W. Cohen published *The Chartcraft Method of Point & Figure Trading*.

Unlike bar charts, where the vertical coordinate is based on price and the horizontal coordinate is based on time, the Point & Figure chart is only concerned with price. Although the year and months are reported on the horizontal axis, they are shown merely to establish a frame of reference. Since time is not a factor, small fluctuations in price are often not charted. Without these disturbances, it is easier to spot critical support and resistance levels. It is also easier to visually locate chart patterns.

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AIQ's *Technical Indicators Reference Manual* has a good explanation of the mechanics of Point & Figure charting (page 101). To give a short summary, Point & Figure charts are plotted with X's and O's. Vertical columns of X's represent increasing

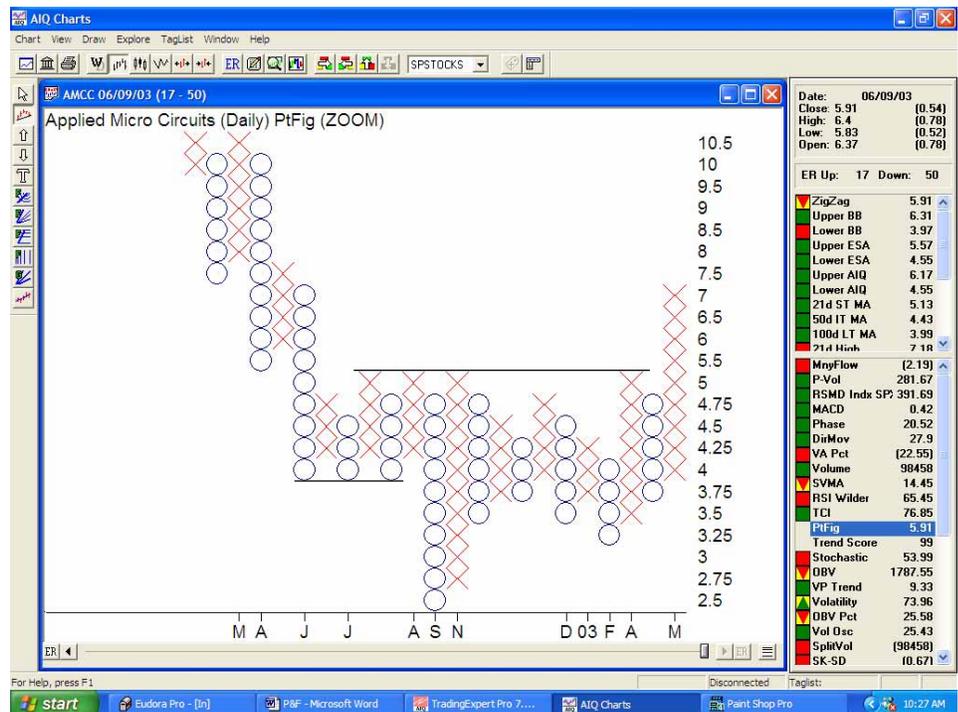


Figure 1. Point & Figure chart of Applied Micro Circuits. The former resistance level at the 5.00 to 5.50 level is easily seen as is support at the 3.75 level that held until late summer of 2002.

prices while the O's represent decreasing prices. Each X or O represents a specific increment of change in price, which is called the box size.

For example, each X may represent a \$2 increase in the price of the stock. Every time the stock increases by \$2, an X is plotted. Time is irrelevant so

it doesn't matter how long it takes for the security to make the \$2 advance.

When X's are being plotted, the stock is advancing. TradingExpert Pro's preset default values specify that a stock must fall by three times

the box size before a new column of O's will appear to indicate a trend reversal. In our example of a \$2 box size, a stock must fall by \$6 (3 times \$2) before a new column of O's is plotted. The three box reversal is what eliminates all minor and sometimes confusing fluctuations.

To plot a security using the Point & Figure technique, first chart the security and click on the PtFig indicator on the Control Panel. The chart will initially appear very small so AIQ's Zoom feature must be used. Place your mouse cursor on the Point & Figure plot at the bottom of the screen and press the "Z" key. The plot will then fill the entire window. Pressing the "Z" key again restores the plot to its original size.

A big advantage of Point & Figure charting is that it makes it easier to identify support and

resistance levels.

For resistance levels, look for a level where several columns of X's end. For example, in **Figure 1** it is easy to see that the \$5 to \$5.50 range was resistance for Applied Micro Circuits (AMCC). AMCC rose to that level in four separate columns, and in each case the price fell.

To find support levels, look for a level where several columns of O's end. In **Figure 1** notice \$3.75 was support until late summer 2002 when the column of O's fell below that level.

Editor's Note: We drew trendlines on the Point & Figure charts to help clarify the examples discussed in this article. TradingExpert Pro does not have the ability to draw these lines.

A buy signal is registered on a Point & Figure chart when one column of X's moves higher than the previous column of X's. The theory behind a buy signal is that the stock is able to rise above the previous level where sellers once appeared and drove prices lower. The stock then remains on a buy signal until a column of O's falls below a previous

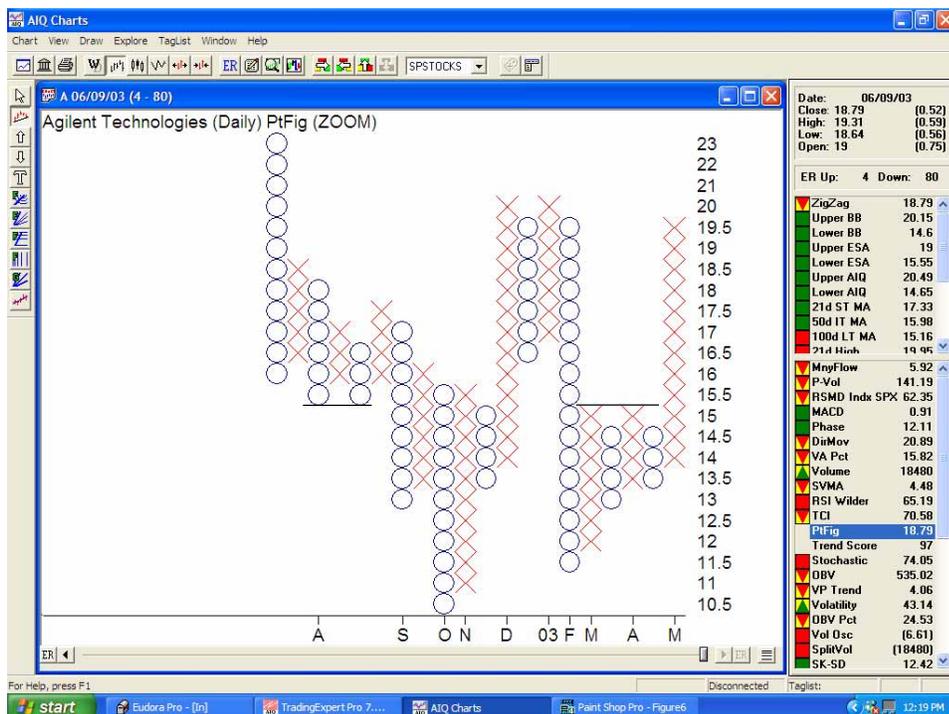


Figure 2. Point & Figure chart of Agilent Technologies. The horizontal trend lines drawn at the 15.50 level define Triple-Bottom and Triple-Top patterns. Both signalled significant moves.

column of O's.

Using this methodology, a lot of buy and sell signals occur. Which are the best signals? There are patterns that can be identified which point toward the more significant

buy and sell signals.

The pattern that AIQ's Point & Figure Breakout report screens for is the Triple-Top/Triple Bottom pattern. The Triple-Top pattern is a bullish pattern where two rally attempts fail at the same level (i.e. two columns of X's that end at the same level) but on the next attempt the security rises above the resistance level.

The Triple-Bottom pattern is just the opposite. The security falls but finds support at the same area. On the next attempt, it falls below the previous lows registering its sell signal.

Figure 2 shows a Triple-Bottom and a Triple-Top pattern. In August, Agilent Technologies (A) had two O columns end at about \$15.50. On the third attempt it fell below the previous column lows giving its sell signal.

More recently, Agilent Technologies had two rallies fail at about \$15.50. Two consecutive X columns ended at the same level. On the third attempt, Agilent Technologies rose above its previous column highs

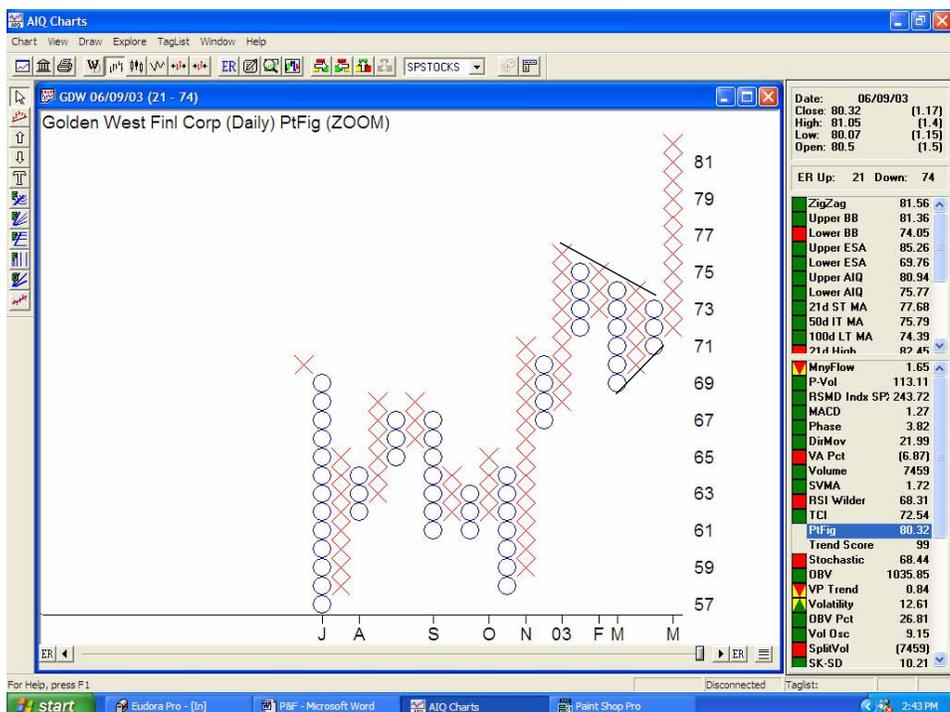


Figure 3. Point & Figure chart of Golden West Financial. The chart displays a bullish Symmetrical Triangle pattern that signalled an upside move in the stock.

giving its buy signal. This buy signal is even more powerful because each decline during the pattern was less than the previous decline. A Triple-Top buy signal was registered but the pattern is also an Ascending Triangle (see June 2003 *Opening Bell*).

Another popular pattern is the Symmetrical Triangle. This pattern requires at least five columns and there is a pattern of higher bottoms and lower tops. For a bullish pattern, the buy comes when the security rises above its pattern of lower tops and moves above the previous column of X's. The opposite is true for the bearish pattern.

Figure 3 shows an example of a bullish Symmetrical Triangle.

During the first quarter of this year, Golden West Financial (GDW) entered a pattern of lower tops and higher bottoms. During this period it was unclear which direction the eventual break would take. It wasn't until this spring that GDW rose above a previous column of X's.

Through these examples we see that by using Point & Figure charts you won't buy at the lows or sell at the highs. It takes upward price movement before a buy signal is registered. With Point & Figure analysis, you don't guess the bottom,

you wait for it to happen.

Point & Figure charting wasn't

“Which are the best signals? There are patterns that can be identified which point toward the more significant buy and sell signals.”

designed to eliminate bar charts. Each charting method has its advantages. Bar charts allow you to run indicators with the graph. With Point & Figure charting, you can more easily identify important chart patterns as well as support and resistance levels as they develop.

Market Review

For most market segments, the second quarter of 2003 was the strongest in four years. The market continued its advance in June, albeit at a slower pace. In June the S&P 500 rose 1.1% and the Nasdaq Composite rose 1.7%. No AIQ timing signals were fired in June.

Airline stocks were the big winners in June, gaining 27%. Retail-Consumer & Electronics along with Wireless Telecommunications were the next strongest, gaining 19%. Health Care along with Oil & Gas Drilling were the worst performing groups, falling about 7%.

The March through June advance was so strong that market charts show few support levels. By the end of June, a short-term support level did develop. A horizontal trendline can be drawn on the S&P 500 and the Nasdaq Composite from the June 9 low (**Figure 1**). The levels are 972 on the S&P 500 and 1598 on the Nasdaq Composite. A close below these levels could bring short-term pressure on the market.

One can make a good case that the support will hold and the market

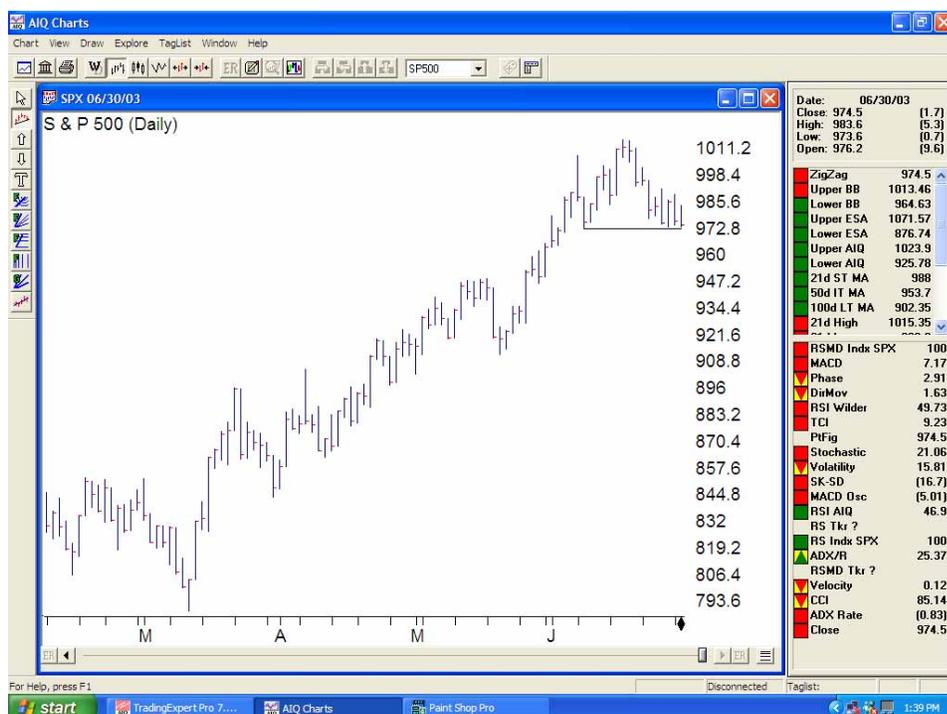


Figure 1. Daily chart of S&P 500. A support line is drawn at the 972 level to coincide with the low that occurred on 6/09/03.

can rally from here. That's because the mini-correction in the second half of June moved the market at or near oversold territory. Of the S&P 500 stocks giving unconfirmed AIQ signals, 99% are on the buy side. The S&P 500's stochastic is at 40. Oversold is a nearby 20. It wouldn't

take much selling to bring the stochastic to that level.

The market has priced in an economic recovery in the second half of the year. We'll see if the July earnings reports support that view.