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International Exchange Traded Fund Investing

Successful Relative Strength Strategy Is Tested on International ETFs — Here Are the Results

By David Vomund

In the October 2003 *Opening Bell*, we wrote about a strategy that used Exchange Traded Funds to rotate to different segments of the market. Results were very good. In the December 2003 *Opening Bell*, we employed the same strategy on the Fidelity sector funds. Once again, the results were exceptional. In this article, we'll apply the same strategy to a set of international Exchange Traded Funds.

While this strategy could be employed to international mutual funds, we chose to use Exchange Traded Funds (ETFs) as the trading vehicle. First launched in the early 1990s, ETFs are securities that combine elements of index funds, but do so in a different way. Like index funds, ETFs are pools of securities that track specific market indexes at a very low cost. Like stocks, ETFs are traded on major U.S. exchanges and can be bought and sold anytime during normal trading hours. For more information on ETFs, visit www.amex.com.

We chose to follow the international

ETFs from iShares (www.ishares.com). iShares has 20 international fund choices. A list of these international ETFs along with yearly returns is found in **Table 1**. In order to include the United States as an investment choice, we added the S&P 500 Spyder (SPY) to the list.

When examining the yearly percentage returns for the ETFs, we immedi-



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“The goal of our strategy is to outperform by holding the best performing international ETF. The strategy utilizes AIQ’s Relative Strength report.”

ately see that the percentage returns for the different countries appear to be related. Just like our market, the average international ETF rose in 1998 and 1999, fell in 2000 to 2002, and then recovered in 2003. That’s disappointing.

Table 1. Global ETF Yearly Returns (percent)

		1998	1999	2000	2001	2002	2003	2004	Average
iShares Australia	EWA	1.39	16.42	-14.10	-0.53	-3.92	47.14	-2.62	6.25
iShares Austria	EWO	-8.74	-15.29	-9.03	-3.70	18.27	55.05	19.93	8.07
iShares Belgium	EWK	28.32	-24.14	-20.91	-14.12	-9.86	31.21	3.63	-0.84
iShares Canada	EWC	-13.15	42.73	-18.97	-20.57	-11.11	50.95	-6.25	3.38
iShares France	EWQ	36.75	27.75	-10.64	-24.03	-21.07	37.77	-2.31	6.32
iShares Germany	EWG	26.28	19.91	-26.91	-22.56	-34.83	64.53	-4.82	3.08
iShares Italy	EWI	35.49	-8.02	-9.52	-28.82	-9.32	35.07	1.27	2.31
iShares Japan	EWJ	3.74	59.12	-32.19	-30.29	-9.86	38.71	5.19	4.92
iShares Netherlands	EWN	14.44	-1.71	-10.39	-25.18	-22.16	23.85	-3.24	-3.48
iShares Singapore	EWS	0.00	0.00	-29.19	-22.00	-15.78	40.52	1.67	-3.54
iShares Spain	EWP	44.44	-5.42	-18.83	-9.90	-14.28	55.84	-0.25	7.37
iShares Sweden	EWD	6.57	52.77	-39.42	-23.28	-30.34	63.35	6.28	5.13
iShares Switzerland	EWL	10.17	-5.88	5.06	-25.40	-11.40	32.67	1.15	0.91
iShares United Kingdom	EWU	15.95	4.89	-17.78	-16.63	-17.29	28.23	0.06	-0.37
iShares Brazil	EWZ	N/A	N/A	N/A	-23.03	-37.17	113.03	-15.88	9.24
iShares Malaysia	EWM	-31.40	105.83	-28.33	2.77	-3.46	28.49	1.86	10.82
iShares Mexico	EWV	-37.99	76.20	-26.30	14.05	-17.98	37.19	10.13	7.90
iShares South Africa	EZA	N/A	N/A	N/A	N/A	N/A	N/A	-7.41	-7.41
iShares South Korea	EWY	N/A	N/A	N/A	44.57	3.61	36.46	3.23	21.97
iShares Taiwan	EWT	N/A	N/A	N/A	2.08	-24.40	37.91	-0.62	3.74
United States SPDR	SPY	27.05	19.11	-10.68	-12.87	-22.81	26.12	-0.25	3.67
Average		9.37	21.43	-18.71	-11.97	-14.76	44.20	0.51	

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A rotation strategy could be more effective if some ETFs went up when others went down.

Still, there are a few cases where countries bucked the global trend. In 2001, South Korea market rose 44% and Mexico rose 14% during a time when nearly all other international markets fell in value.

There were potential pitfalls as well. Year 1999 was one of the market's best years but Belgium fell 24% and Austria fell 15%. Looking at the ETFs with price history dating back to 1998, the best performing country was Malaysia, gaining 10.8% annually.

The goal of our strategy is to outperform by holding the best performing international ETF. The strategy utilizes AIQ's Relative Strength report. The Short-Term

Relative Strength-Strong report was run every other Friday on the 21 ETFs found in Table 1. This report looks at the last 120 trading days (approximately six months) and breaks them into quarters. A percentage return figure is calculated for each quarter. These returns are then averaged, with twice the weight placed on the most recent quarter's worth of data.

At the start of the test, the two highest ranked ETFs were purchased with equal dollar amounts to establish a fully invested portfolio. Two weeks later, the same Relative Strength report was run again. If the current holdings were rated in the top half of the report, then there were no trades. If a holding had fallen in the Relative Strength report to where it was no longer in the top

half of the report, then it was sold and the highest rated ETF was purchased. The portfolio was always fully invested in two ETFs.

In an attempt to make the backtest as realistic as possible, I hand-entered the individual trades into the Portfolio Manager. Execution prices were based on the close

equal weighting.

Most of the ETFs have enough price history to run a backtest starting in 1998, but some do not. The backtest used the ETF choices found in Table 1 but EWS could not be purchased until the start of 2000, while EWZ, EWY, and EWT could not be purchased until January 2001, and EZA could not be purchased until 2004.

The backtest trading results are found in **Table 2**. The good news is that the average yearly return is close to 3 1/2% higher than the return from the average interna-

tional ETF. The strategy outperformed. The bad news is that the level of outperformance is not high enough for me to recommend or employ this approach.

Figure 1 displays a graph of the portfolio's return along with the S&P 500. The blue line represents the

“Results are found in Table 2. The good news is that the average yearly return is close to 3 1/2% higher than the return from the average international ETF...The bad news is that the level of outperformance is not high enough for me to recommend this approach.”

the day after the signal. Commission rates were \$25 per trade and 0.3% was withdrawn each quarter to represent management fees or slippage. The portfolio was always fully invested in two ETFs, and the holdings were rebalanced at the end of each year to bring them back to an

Table 2.
Trading Results (percent)

	Rotation Strategy	Global Index
1998	11.68	9.37
1999	46.79	21.43
2000	-23.70	-18.71
2001	-26.19	-11.97
2002	-4.43	-14.76
2003	54.52	44.20
2004	-3.65	0.51
Avg.	7.86	4.30

Updated through April 30, 2004

Past performance does not guarantee future results.

international ETF portfolio while the red line represents the S&P 500. The ETF portfolio is more volatile than the S&P 500.

As I entered the individual trades in the Portfolio Manager, I was able to spot a few problems in this technique. One problem is that some of the ETF prices were very low during the first half of the backtest. It is easier for a low-priced security to rise to the top of the relative strength ranking. For that reason, high priced ETFs such as the U.S. Spyder (SPY) were never purchased. For more information on this problem, refer to the April 2003 *Opening Bell*. The pricing issue is less of a problem now, which may explain the better performance in the latter half of the backtest.

The bigger problem is that the international markets tend to move together. Like the song says — “It’s a small world after all.” To see how closely the international markets move with the U.S. market, we used AIQ’s MatchMaker module and tested each international ETF’s correlation to the S&P 500 index over the last five years. The results are found in **Table 3**. In this table, a correlation of 1000 denotes a perfect correlation while a score greater than 500 shows a high correlation.

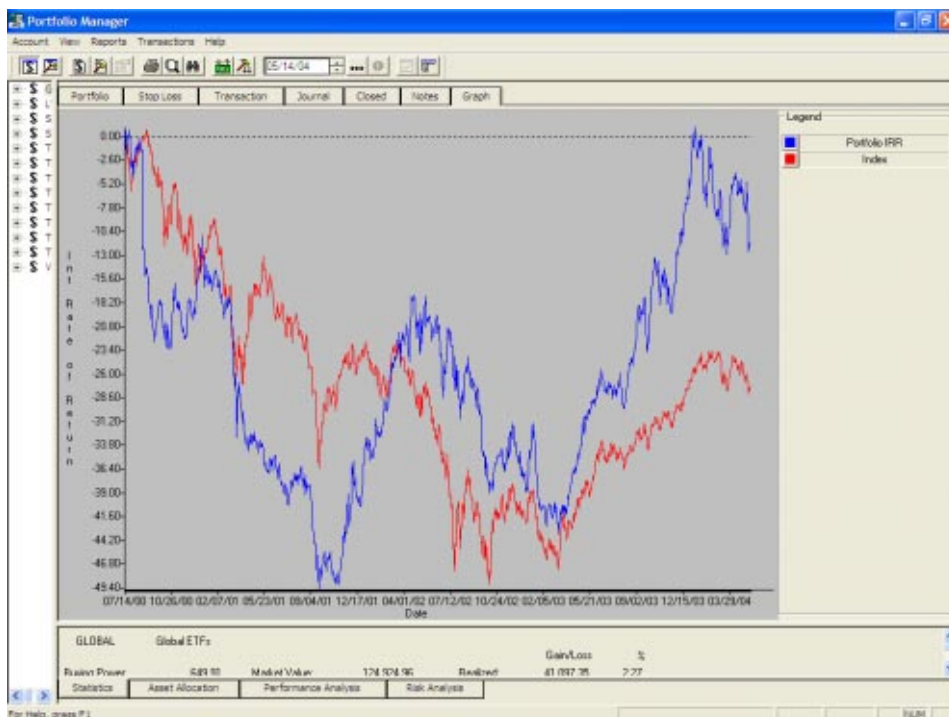


Figure 1. AIQ Portfolio Manager graph of International ETFs portfolio results (blue plot). The S&P 500 performance (shown in red) demonstrates less volatility.

Not surprisingly, the U.S. SPDR, which is designed to track the S&P 500, shows the highest correlation. The important finding is that nearly all the international ETFs are highly correlated to the S&P 500. Only Austria and Malaysia tend to move independently from our market.

For me, I'd prefer to stick to the U.S.-based securities (such as the ETFs found in the October 2003 *Opening Bell*) and then possibly add a few of the lower correlated ETFs such as Japan, Belgium, Malaysia, and Austria as international choices.

After completing this study, I used AIQ's automated Portfolio Simulator to backtest various trading techniques on the international ETFs, hoping to achieve better results. I tested many systems including buying those with the strongest MACD momentum, strongest DMI momentum, highest RSI value, lower RSI value, and best Velocity.

Some systems matched the Table 2 results, but none showed a higher result. Apparently, those who successfully trade international markets are using a different and

more effective set of international securities.

Knowing what doesn't work is as important as knowing what does work. Heading into this test, I thought trading the international equity ETFs was very promising. Indeed, the portfolio made 31% over the backtest. This was not a high enough return, however, to commit funds to the strategy.

If you trade international securities with a successful trading system, please let us know and we'll publish your system in the *Opening Bell*.

Table 3. MatchMaker Correlation

Correlation	Ticker	ETF
984	SPY	United States SPDR
732	EWQ	iShares France
707	EWG	iShares Germany
678	EWC	iShares Canada
674	EWN	iShares Netherlands
664	EWD	iShares Sweden
657	EWU	iShares United Kingdom
639	EWV	iShares Mexico
568	EWP	iShares Spain
561	EWL	iShares Switzerland
555	EWI	iShares Italy
548	EWS	iShares Singapore
530	EWA	iShares Australia
480	EWJ	iShares Japan
472	EWK	iShares Belgium
380	EWM	iShares Malaysia
157	EWO	iShares Austria

David Vomund publishes VIS Alert, a weekly investment newsletter. For a sample copy, go to www.visalert.com.

STOCK DATA MAINTENANCE

The following table shows stock splits and other changes:

Stock	Ticker	Split	Approx. Date
Burlington Res.	BR	2:1	06/02/04
Pacific Corp Bancorp	PCBC	4:3	06/09/04
Zale Corp	ZLC	2:1	06/09/04
MGI Pharma Inc.	MOGN	2:1	06/10/04
SFBC Int'l	SFCC	3:2	06/11/04
Hershey Foods	HSY	2:1	06/16/04
Applebee's Int'l	APPB	3:2	06/16/04
Procter & Gamble	PG	2:1	06/21/04
Northrup Grumman	NOC	2:1	06/22/04

Trading Suspended:

Great Lakes REIT (GL), Gucci Group NV (GUC), Oneida Ltd. (OCQ), Bentley Pharmaceuticals (BNT), Tom Brown (TBI)

Name Changes:

Reliant Resources (RRI) to Reliant Energy (RRI), HON Industries (HNI) to HNI Corp (HNI), WRP Corp (WRPC) to AHPC Holdings (GLOV), Roto-Rooter Inc. (RRR) to Chemed Corp (CHE), Sylvan Learning Systems (SLVN) to Laureate Education (LAUR)

MARKET REVIEW

April's difficulties spilled over into the first half of May. The market moved lower until mid-month when the market jumped higher. For the month, the S&P 500 rose 1.2% and the Nasdaq Composite rose 3.5%.

From its yearly high to its yearly low, the S&P 500 corrected 6.4%. That understates the severity of the correction, however. In mid-May AIQ's Advance Decline Oscillator moved lower than anytime during the bear market.

The best performing groups in May were Precious Metals up 11%, Electronics up 7%, and Banking up 6%. The worst performing group was Energy Services, losing 9%.

Real-Time Trading the Symmetrical Triangle

Active Traders! See Chart Patterns in Real Time With New Version of TradingExpert Pro

By David Vomund

Every trading day, the price of a stock is determined by a struggle between supply and demand. In technical analysis, charting a security is critical because it shows the interaction of supply and demand. The demand fluctuates at any given moment from a variety of factors, some rational and some irrational.

As a stock enters into a period of fluctuation, one of several traditional chart patterns may emerge. The pattern we'll focus on in this article is the Symmetrical Triangle.

The Symmetrical Triangle pattern has two sloping trendlines that converge to each other. That is, a stock fluctuates up and down but each move is smaller than its predecessor. The descending tops in the price movement are defined by a downward sloping boundary line (resistance line) and the low points in the fluctuation can be defined by an upward sloping line (support line). The top and bottom bound-

“The Symmetrical Triangle pattern is attractive for active traders because tradeable moves often come after periods of reduced volatility and it lends itself to tight stops.”

aries need not be of equal length.

With the Symmetrical Triangle pattern, it's seldom that a clue is given on the chart indicating which direction will eventually be broken.

This is an attractive pattern for day-traders. That's because good tradable moves come after a period of reduced volatility and because the



Figure 1. Real-time (one min.) chart of S&P 500 Index. Trendlines show Symmetrical Triangle pattern that precedes upside breakout and continued upward move.

pattern lends itself to tight stops. I'll explain with an example.

Figure 1 shows a one-minute chart of the S&P 500 on May 19. Notice that after rallying in the morning, the S&P 500 stalls and begins to move sideways. In the 11:00 hour the index enters the Symmetrical Triangle pattern. Each rally is less than the previous rally and each decline is less than the previous decline. As the pattern develops, volatility falls. The eventual break came to the upside. After the break, investors had several minutes to act on the signal before the S&P 500 jumped higher.

Once the pattern is broken, a tight stop can be placed using

trendlines. In this case, the break was to the upside so the stop is placed just below the support trendline (lower trendline). If the break occurred to the downside, the stop would be placed just above the resistance trendline.

With the 7.3 version of TradingExpert Pro, we can use real-time Point & Figure charts to help identify this pattern. Unlike bar charts where the vertical coordinate is based on price and the horizontal coordinate is based on time, the Point and Figure chart is only concerned with price. Since time is not a factor, small fluctuations in price are often not charted. Without these disturbances, it is easier to spot emerging patterns.

Editor's note: AIQ's Technical Indicators Reference Manual has a good explanation of the mechanics of

Point & Figure charting. We'll also discuss this in detail in an upcoming issue.

Figure 2 shows the S&P 500's Point & Figure chart using the same date as Figure 1. The Symmetrical Triangle is seen at the very end of the pattern. Looking at the last five columns, each rally (the Xs in the chart) is less than or equal to the previous rally and each decline (the Os in the chart) is greater than or equal to the previous decline.

In this chart I elected to have a small box size (1.5 S&P 500 points per box) to make the chart more responsive and appropriate for active trading. It is also the reason behind the small Xs and Os. By increasing the box size, the Xs and Os will appear larger on the monitor.

To change the box size, right-click your mouse and choose Point & Figure. The real-time box size can be changed in the lower half of the screen under *Fixed Box Size*.

Figure 3 shows Bed Bath & Beyond (BBBY) using a \$0.20 box size. The larger Xs and Os make it easy to spot the Symmetrical Triangle pattern. In the center of the

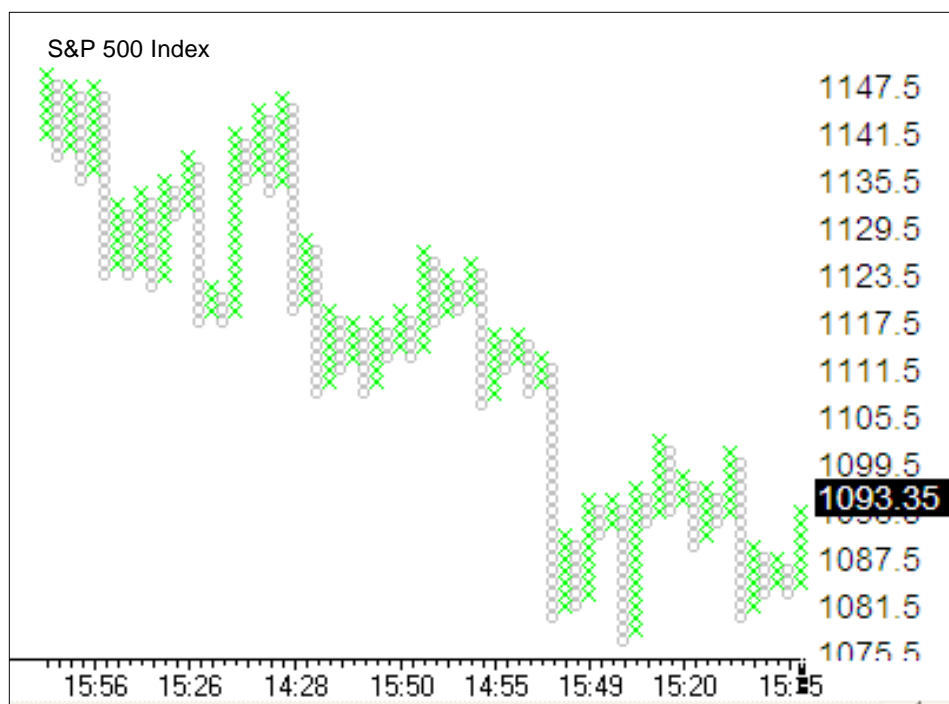


Figure 2. Real-time Point & Figure chart of S&P 500 Index for same date shown in Fig. 1.

pattern, BBBY enters a period where each rally is less than the previous rally and each sell-off is less than the previous sell-off. The bearish signal came once BBBY fell below the pattern and the column of Os fell below the previous column of Os. We have drawn trendlines around the pattern.

The Symmetrical Triangle pattern is an attractive pattern for active traders because tradeable moves often come after periods of reduced volatility and because the pattern allows for time stops. You can identify the pattern using traditional bar charts or with the new real-time Point & Figure charts. Most people find it is easier to identify the pattern using the Point & Figure technique.

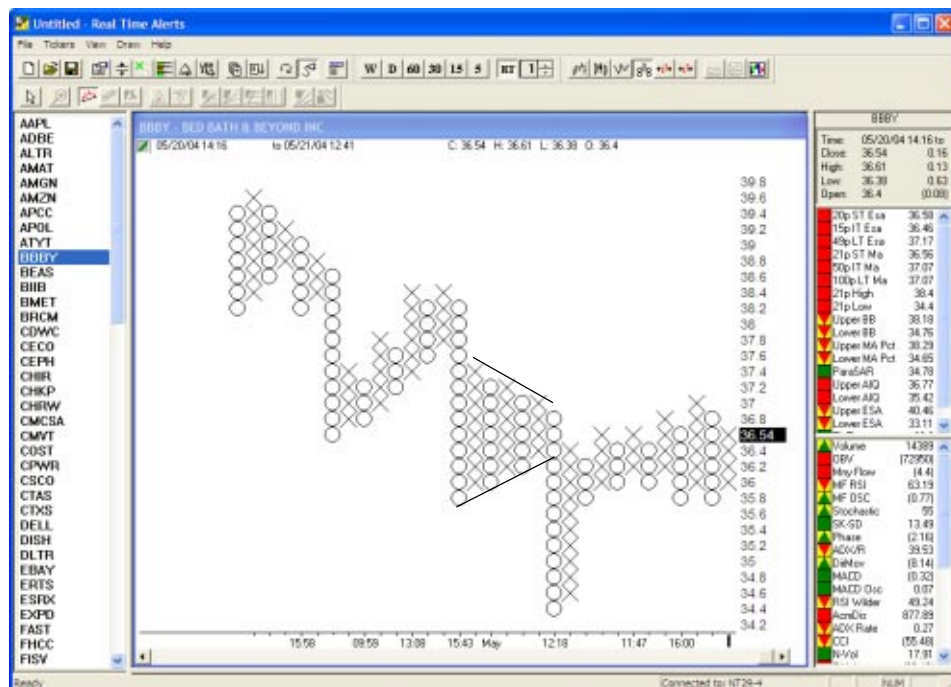


Figure 3. Real-time Point & Figure chart of BBBY. Symmetrical Triangle pattern, defined by trendlines, is followed by sharp price decline.

S&P 500 Changes

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

Myland Laboratories (MYL) replaces Sprint PCS (PCS). MYL is added to the Pharmaceuticals (PHARMAC) group.

Valero Energy (VLO) replaces John Hancock Financial (JHF). VLO is added to the Oil & Gas-Refining and Marketing (OIL&GASR) group.

Hospira Inc. (HSP) replaces American Greetings (AM). HSP is added to the Health Care Facilities (HEALTHLT) group.

An AIQ list file of the S&P 500 group structure can be downloaded at www.aiqsystems.com/lists.html

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At the Chicago show, take advantage of a hands-on introduction to AIQ's latest version of TradingExpert Pro. This hands-on event will be oversubscribed, so come by AIQ's booth #419 beforehand and reserve a place.

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- Larry Williams Personal Patterns to Short Term Profits
- The Truth About Systems Trading
- The Nuts and Bolts of Foreign Exchange Trading
- How to Profit in Unpredictable Markets
- Option Trading: Should You Speculate or Spread—Which is Best?
- Introduction to Fibonacci Time and Price Analysis
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Hope to see you there!

* Registration to the Chicago Traders Expo is FREE until June 17. Registrations received after June 17 will incur a \$69 per person processing fee, waived with event ticket purchase.