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TRADING TECHNIQUES

VETERAN AIQ USER SHARES HIS STOCK SELECTION TECHNIQUES

By Grace Barbor
Opening Bell Editor

Lee Clayton has been using AIQ products since 1990 and is currently a beta tester for AIQ's development team. He practices general dentistry in Denison, Texas. A serious investor, he averages 18-20% a year trading stocks using AIQ TradingExpert. In the following interview, Dr. Clayton discusses his trading approach using TradingExpert.

OBM: What is your trading style and what instruments do you trade?

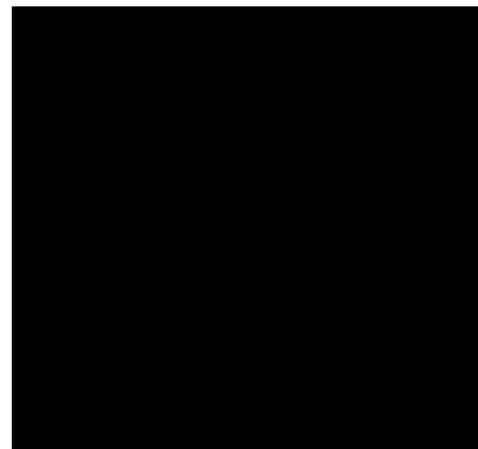
Clayton: I am a short to intermediate term trader and I trade stocks, both long and short, and mutual funds.

OBM: What is your asset allocation?

Clayton: 20% stocks and 80% mutual funds. My mutual funds are long term. I trade mutual funds in my IRA accounts and my son's college accounts. I use AIQ TradingExpert both for trading stocks and for the selection of Invesco Sector Funds.

OBM: How many issues do you track?

Clayton: I have 1700 issues in my database. I basically follow the 650



Lee Clayton, D.D.S.

stocks that come with AIQ's Pyramid structure and other fundamentally attractive stocks from the S&P Outlook Report. I especially like to monitor stocks moving from 3-star or 4-star status to 5-star status. I know that these are fundamentally sound stocks.

OBM: Would you tell us how you use TradingExpert to select issues to trade?

Clayton: I'm a top-down investor. The first thing I do after my nightly download is look at the Market Timing chart — I want to make sure I'm not shorting if we are getting a buy signal,

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or not buying long when there's a major sell signal. I check the Volume, MACD, Phase, Trend Score, and Directional Movement indicators on the markets. I also look at the Advance/Decline Line and the Advance/Decline Indicator on the DJIA to see if there's any breakdown or breakout. I will draw trendlines on indicators that may be breaking out or breaking down.

Next, I look at the Market Log. Specifically I look at the US (Unconfirmed Signal Ratio) and WAL (Weighted Action List Confirmed Signal Ratio). I believe that these numbers are *as important as* the Expert Rating on the market. I want to make sure a market buy signal is coming with a very bullish US and at least a positive WAL number. If there's a buy signal with a neutral US, that tells me that even if there is a bit of an up move there is no fire power to propel it. If there is a 95 buy signal and a large US number — 80 or 90 — there are a lot of stocks with buy signals and enough fire power ready to push the market up.

OBM: What do you do after checking the Market Timing chart?

Clayton: I look at the Delta Trend Scores at the bottom of the Market Log to see what sectors are starting to move. Then I look for groups ready

to move by checking the Group Analysis Report and finding groups with large Delta Trend Scores, 50 to 80 point moves from the day before. These are usually found in the middle of the Group Analysis Report.

Next, I scan my database using the Weighted Action List to find stocks that have Expert Ratings greater than 95 in the last five to six days. I build a tag list of these stocks, then I check the chart of each stock looking for Delta Trend Scores that have moved 80 points in the last four to five days. I also like to see stocks

"I want to see a jump in the Trend Score, as much as 80 points. It seems to me that Trend Score leads price action...something is happening in the stock before the price starts to move."

under accumulation — with the OBV, Money Flow, and Accumulation/Distribution indicators all turning up or already turned up and starting to lead the price movement. If I don't see *all three* of these indicators moving up, I usually move on to another security.

OBM: Where do you find the Delta Trend Scores on stocks?

Clayton: I use the Trend Score indicator. When looking at the charts of stocks on my tag list, I will have the stock in the top window and in the window below I will plot the MACD, Money Flow, OBV, and Trend Score. I use my left arrow key and go back one day at a time and evaluate the change in the Trend Score over four or five days. I want to see a jump in the Trend Score, as much as 80 points. It seems to me that Trend Score *leads price action*. It's a composite of several different directional indicators and it can show you that something is happening in the stock before the price starts to move. The way I determine the Delta Trend Score is to see how much the Trend Score has changed from the

day before.

Editor's Note: The Trend Score indicator is computed by combining the values of six trend-following indicators — MACD, Directional Movement, Positive Volume, Volume Accumulation, ADX/ADXR, and On Balance Volume. A special expert system developed by AIQ founder Dr. J. D. Smith computes Trend Score from the values of these indicators.

OBM: When you find a stock that meets all your criteria, do you add it to your portfolio?

Clayton: I will if I have a position open. Or, I will put it on a list and watch it.

OBM: When would you actually buy it?

Clayton: When I see price movement in the direction of the Trend Score. A lot of times I will set a buy entry point a little higher

(i.e., 1/4 pt. from where I determine the breakout to be).

OBM: Do you have in your portfolio a limited number of stocks?

Clayton: I usually will maintain five positions at a time. However, if I find a really good stock, I don't have a problem adding it.

OBM: Which AIQ reports do you use and how do they fit into your trading process?

Clayton: I use several reports as screening devices for stock ideas. I check the Point & Figure Breakout report and if a stock breaks out, I look at it with the other indicators that I use. I also get ideas from the Price Volume Divergence report which shows stocks that are down in price but the OBV and Money Flow are heading in the other direction, indicating that the stock is under accumulation. I also look at the Persistence of Money Flow because this report also reflects accumulation.

When scanning these reports, if I don't recognize the company name, I seldom look further at the stock. If it's a company name that I know,

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TRADING TECHNIQUES *continued* . . .

such as International Paper, Phelps Dodge, JP Morgan, or Chevron, I will look at a chart of the stock. If I have a choice, I am going to trade a company that I know something about, or one that's an S&P 4-star or 5-star stock.

OBM: What are your criteria for shorting?

Clayton: I look for a stock that has penetrated its 50-day moving average on large volume, with the Price Phase turning around at the same time and heading down. It always adds to my confidence level if the stock is in a group and sector that is breaking down on the MACD and the Price Phase. When a stock takes a plunge through the 50-day moving average on heavier than normal volume, a lot of people will short that stock or sell it.

OBM: Do you have to be on a market timing sell signal to short?

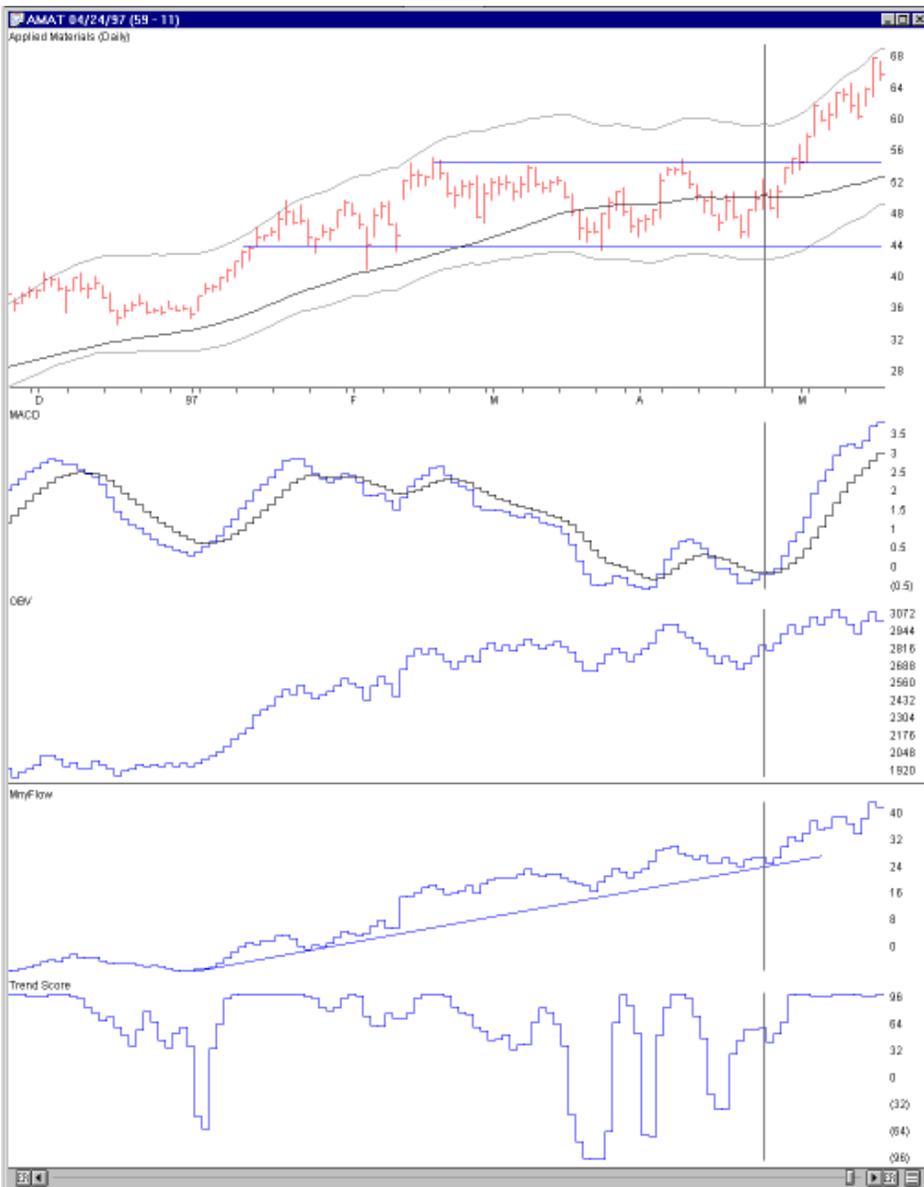
Clayton: No, but if I am not on a sell signal I like to be a good ways away from an AIQ buy signal. If it is six weeks since an AIQ buy signal, then I do not have a problem with a short if I see something that meets my criteria, especially if the stock's group and sector are also turning down.

OBM: Are there any other features of TradingExpert that you use?

Clayton: I use the AIQ Fundamentals module. When I have found a stock that I am interested in purchasing, I will hit the F key and bring up the fundamental data window. I am not interested in buying stocks that have a PE of 50, 60, or 70 — I would rather stay down in the 25 to 30 range or lower. I like to see that there are Earnings — I check the Growth Rate of the company and the PE.

OBM: Is there anything else that you use?

Clayton: I use a data management product called ConnectR Utilities developed for use with TradingExpert by AIQ user Dennis Nichols, whom I met at an AIQ



Applied Materials (AMAT)

Entry: Bought long 4/24/97 & 5/01/97 **Exit:** Still holding

AMAT is an example of a recently entered long position. From early January through most of April, AMAT had traded in range between 44 and 55. In late April, AMAT showed up on the Weighted Action List (98-0 upside ER on 4/23/97). At this time, the stock met most of Clayton's buy criteria: OBV, MACD and Money Flow were rising, and the Trend Score had recently moved more than 90 points in the upside direction. On 4/23/97, in addition to recording the Expert Rating buy signal, the stock broke above its 50-day MA. The next day, 4/24/97, Clayton entered a long position. On 5/1/97, he added to his position when the stock moved above the near term resistance trendline at 55.

seminar. It's a program that you install as a TradingExpert utility. ConnectR has five modules, and the two I use most are JudgeTD for removing low quality stocks and LisTesT for testing AIQ reports.

It's important that you have good data to work with, and the JudgeTD module helps me to remove low quality stocks from my database. JudgeTD checks first to see if my data

Trading Techniques continued on page 4

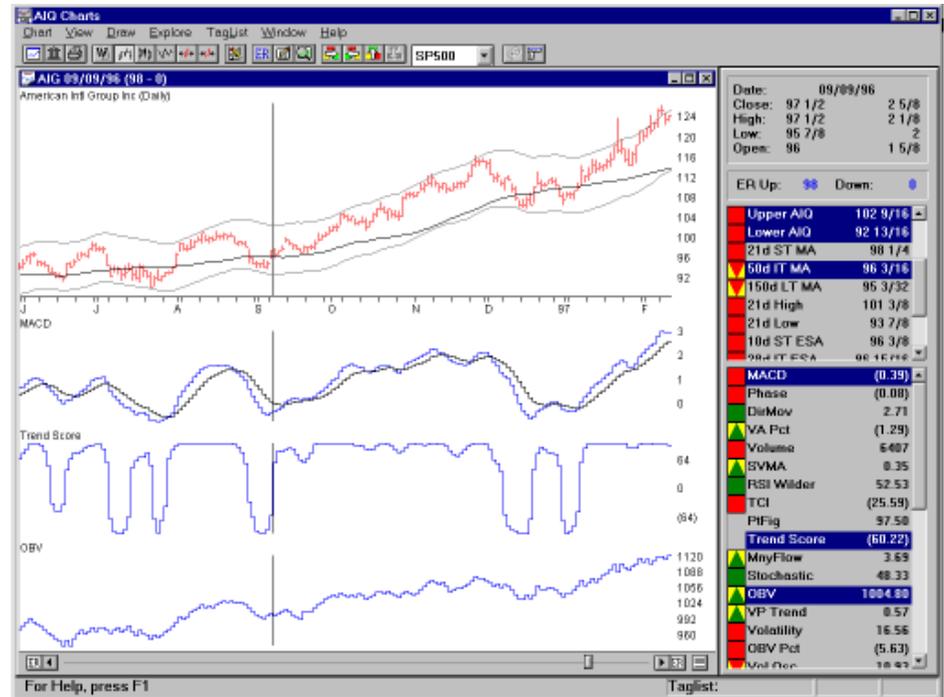
is up to date through my last market date and flags stocks that are not being updated. It also flags for me those stocks that don't trade over \$5 and stocks that don't have a distinct closing price at least 30% of the time. In addition, the program pinpoints any stocks that don't trade over 15,000 shares a day over the last 100 days, and any stocks that have five days of zero volume during that same 100 day period. All of these parameters are user definable.

The program builds a tag list of these stocks. All I have to do is go into Data Manager, bring up the tag list, and delete the stocks. I run JudgeTD once a week to clear out low quality stocks. The functionality of TradingExpert is affected if your database has low quality stocks. Important figures such as the Unconfirmed Signal ratio and the Weighted Action List ratio depend on the quality of your database.

The other module that I use, LisTesT, measures the performance of stocks in tag lists produced from TradingExpert reports. For example, if you want to check the performance of the Price Volume Divergence report, you can run the report on the first of every month, save the stocks in tag lists, then ask LisTesT to test a particular tag list if you bought on the open this particular day and sold on the close a month later. LisTesT tells you the percentage gain on each stock, the aggregate gain for all of them, and the gain of the S&P 500 over that same period. I tested the Price Volume Divergence report and the Weighted Action List and find that these are two of the better AIQ reports of the ones I use and have checked with LisTesT.

OBM: What are the other three modules of ConnectR?

Clayton: A third module, called MOVER, finds stocks that meet different parameters that you set, such as a range of ER ratings or crossed above lower ESA Band on a certain date. The fourth module,



American Intl Group (AIG)

Entry: Bought long 9/9/96 **Exit:** Sold 2/19/97

After a substantial runup throughout 1995, AIG peaked in mid-February, 1996 at 103. During the following three months, the stock corrected, eventually retreating to 88 in May, 1996. From May to September, the stock made several unsustained upward moves and at the end of August was trading around 95. From 8/29 to 9/9, AIQ issued five buy signals on AIG of magnitude 98 or 99 and the stock appeared poised for another run to new high ground. Finally on 9/9, the stock gapped up on the open crossing its 50-day moving average. Clayton decided it was time to take a position. In addition to the Expert Rating signals, all of his important indicators were in buy territory. Money Flow was positive, MACD and OBV were rising, and the Trend Score was increasing rapidly. This position was closed on 2/19/97 at a handsome profit.

VPRO, looks for highs, lows, gaps up, gaps down, volume up, volume down. You set the criteria.

like the 95 or higher, for buy or sell.

Editor's Note: ConnectR with all five modules sells for \$125. You can also purchase each module separately. For information, contact AIQ user Dennis Nichols, 608-251-7355.

"I have heard users talk about the 16-56 ER — I have checked these numbers...and I have not seen anything that indicates these are good numbers to buy on."

The fifth module, XtractER, looks for specific ER's. I have heard users talk about the 16-56 ER — I have checked these numbers and I haven't found that they are all that effective. I have not seen anything to indicate these are good numbers to buy on. I

OBM: You say you are a short term to intermediate term trader. How do you know when to sell? What is your exit strategy?

Clayton: Buying is the easy part; selling is always hard. When I buy a stock, I put a 10% stop under the purchase price. Once I have a 10% profit, I raise the stop to at least the entry price. After that I use different techniques to lock in gains. When I

TRADING TECHNIQUES *continued* . . .

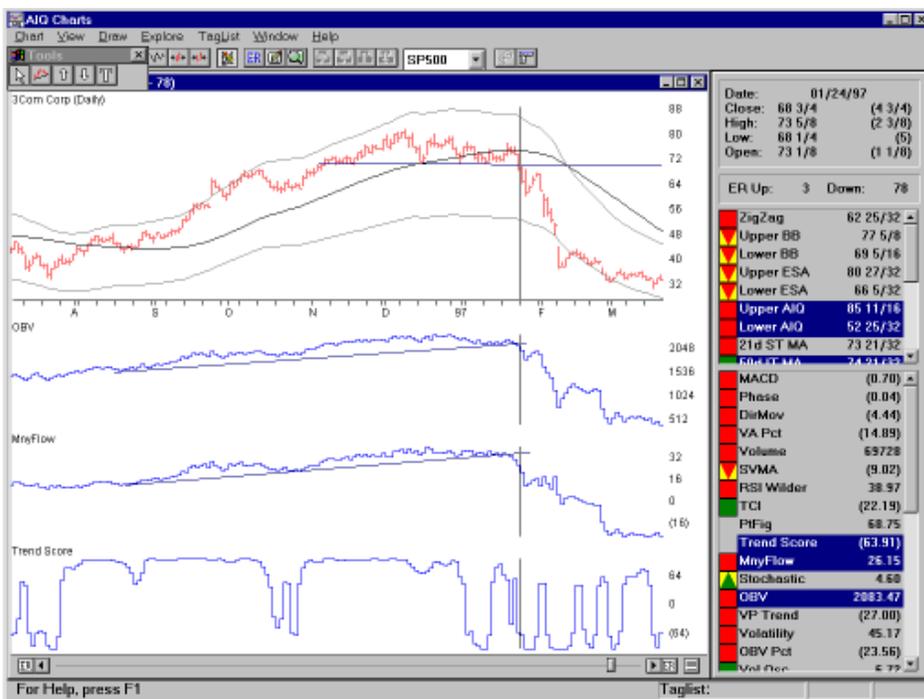
have a 25% gain, I try to lock in at least 50% of the gain. If I get a 50% gainer, I try to hold 80% of my profits. I also will use a trendline to get out if I have a 50 to 60% gainer. When there is a break on the trendline, I'm gone. When I'm stopped out I just count my profits and don't look back.

OBM: Do you set the stops in the Profit Manager?

Clayton: Yes. Immediately after making a buy, I always set a stop on my Internet brokerage account. After I've got a profit locked in, I cancel the stop and start using the Profit Manager to calculate my stops. These are mental stops that I will act on at the end of day should they be broken. If I am going to be out of town, I will place the stops with the broker.

OBM: How do you handle losses?

Clayton: It was hard at first to take losses, but I have come to realize that a small loss is much better than getting taken down into a 20-30% loss. Once you're down that much, it takes a tremendous move just to get back even. I am constantly learning that small losses can improve your trading results. Once I'm stopped out (either with a loss or a gain), I want to leave that stock alone for a while. When I'm taken out of a stock, I usually take the stock off my tag list. I use TradeStation for live quotes during the day, and I also remove the stock from that list so that I don't see it if it runs up another 10-15%.



3 Com Corp (COMS)

Entry: Sold short 1/27/97 **Exit:** Covered short 2/12/97 at 40

During the last five months of 1996, COMS gained almost 130% (rising from 35 to 80). On 12/10/96, AIQ issued a 95 down sell signal. During the following six weeks, the stock declined gradually. By mid January, although trading below its 50-day MA, COMS appeared to have established solid support at 70 1/2. Then, on 1-24-97, COMS broke below support closing at 68 3/4 on increased volume. At this time, OBV and Money Flow both broke below their previously upward sloping trendlines while MACD and Trend Score were falling rapidly. Having met his short selling criteria, Clayton entered a short position on 1/27/97 and the stock continued its rapid descent. Clayton covered at 40 after the stock fell well below the lower Trading Band and began to recover.

There's a famous saying – Nobody ever went broke taking profits.

OBM: Any final words?

Clayton: TradingExpert is an

awesome product. It's an excellent charting package but also has the screening properties that give you buy and sell ideas. I try to stay away from stories about stocks, from listening to somebody hyping a particular stock. I try to just look at the technicals. I don't like hot tips. I use a discount broker and I trade over the Internet. I am not influenced by what brokers are hyping. I even turn off CNBC most of the time and concentrate on market timing and stock selection. ■

Dr. Clayton can be contacted by email at dds2@texoma.net.

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USING AIQ REPORTS

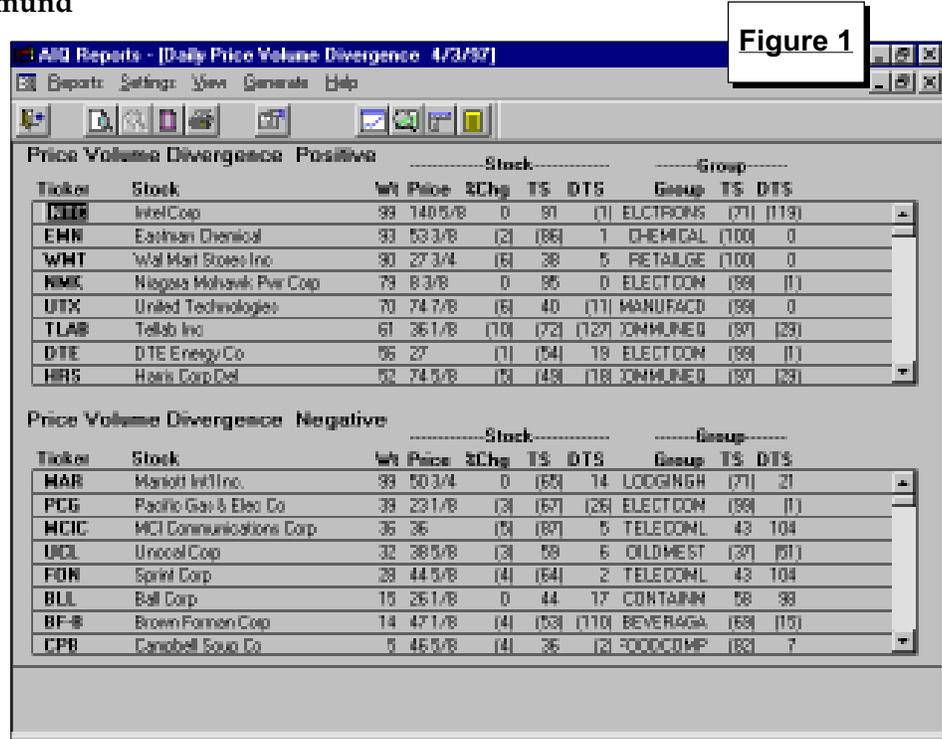
REDESIGNED PRICE VOLUME DIVERGENCE REPORT GIVES BETTER RESULTS

By David Vomund

DAVID VOMUND

Searching for positive and negative divergences has always played an important role in technical analysis. A positive divergence occurs when an indicator is increasing at the same time that a stock is decreasing. The opposite is true for negative divergences. AIQ's Price Volume Divergence report is designed to act as a time saver for those interested in seeking such divergences.

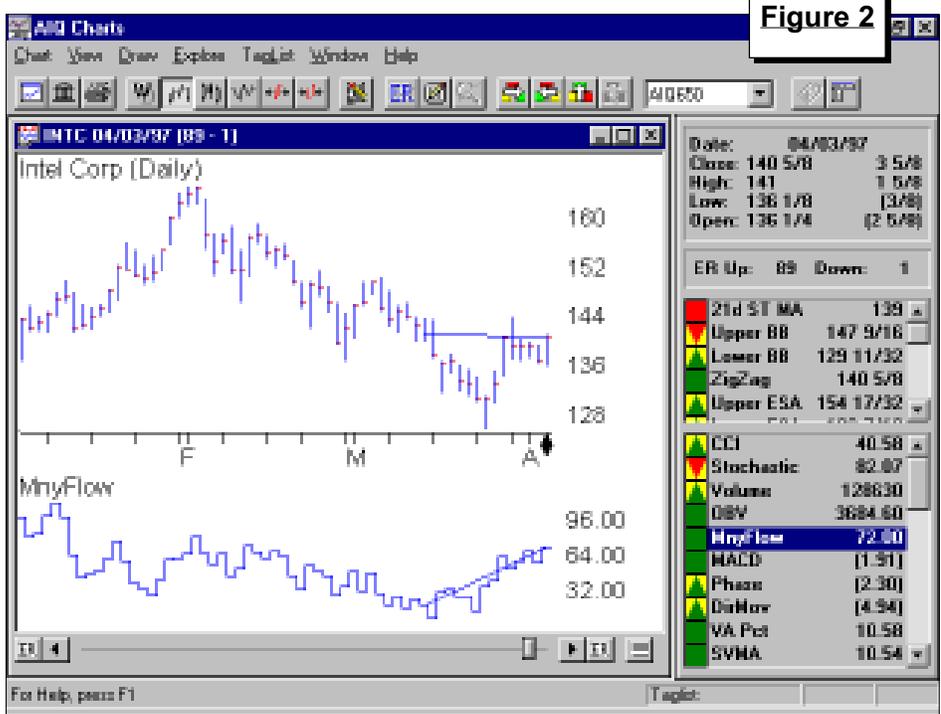
The difficult part in creating this report was to design a formula that would pick stocks whose divergences were obvious when looking at their charts. In most cases, it was apparent as to why a stock appeared at the top of the report but there were cases where the divergences were hard to see. After experimenting, we have



redesigned the formula for the divergence report and are getting a better selection of stocks with diver-

gences that are more easily seen. This new formula is used in the Price Volume Divergence report in the new 4.0 version of TradingExpert, which will begin shipping later this month.

In designing the new formula, we wanted to see whether the recent price movement in the Money Flow or On Balance Volume indicators was significant or if the recent movement was simply a part of normal fluctuation. To accomplish this, we looked at the recent indicator activity (by default 15 days) and compared it to the overall range in the indicator over the last few months. Those stocks whose indicators were showing significant strength/weakness relative to their normal range had a higher ranking on the report. Another factor in the ranking is difference between the indicator activity relative to the activity in the stock price. Those stocks whose indicators are significantly stronger/weaker than the activity of the stock will have



USING AIQ REPORTS *continued . . .*

a higher ranking on the report. In order for a stock to appear on the positive divergence section of the report, the stock must have decreased over the last 15 days at the same time that a composite of its Money Flow and On Balance Volume indicators has risen.

To clarify this screening technique, we'll look at Intel Corp., the stock that appeared on the top of the report on April 3 (**Figure 1**). Intel along with its Money Flow indicator is displayed in **Figure 2**. We drew a trendline connecting the closing price of the security over the last 15 days and then drew a similar trendline on the Money Flow indicator. Notice that the price of Intel decreased slightly over this time period. At the same time, its Money Flow indicator made a low in mid-March and began a steady advance. Intel's On Balance Volume indicator (not shown) was moving in line with the stock.

How do the results of the new Price Volume Divergence report compare to the original report? We performed the same test as was reported in the February 1997 *Opening Bell*, using the new report calculations, and compared the results to the

Table 1

New vs. Old Price Volume Divergence Report

Results computed with default settings

	Old Report		New Report	
	Positive Div. Stocks (%)	Negative Div. Stocks (%)	Positive Div. Stocks (%)	Negative Div. Stocks (%)
1993	1.95	1.94	2.69	0.07
1994	0.95	-0.03	0.65	-1.15
1995	2.43	3.00	2.34	3.71
1996	0.49	-0.60	1.40	0.22
1997 *	3.20	2.12	2.78	1.88
Average =	1.80	1.29	1.97	0.95

* Through May 1.

original report. Specifically, at the beginning of each month, we ran the Price Volume Divergence report on a database of the S&P 500 stocks. The top five stocks that appeared on the report were purchased and held for the remainder of the month at which time a new report was generated. Our test dates back to 1993.

Table 1 shows the results of this study. We are encouraged to see that

the average gain in the positive divergence stocks is higher with the new report. Also, the spread between the return on the positive divergence stocks compared to the negative divergence stocks is twice as much using the new report. There is a 1% difference between the positive divergence stocks and the negative divergence stocks per month. Ignoring commissions and slippage, that means you can have a market neutral position by going long the positive divergence stocks and shorting the negative divergence stocks and end up with a 12% annual return.

This is not a strategy that we recommend because the commissions and slippage would lower that return and the monthly results are far from consistent. Nevertheless, we can see that the report is effective in determining what will outperform and underperform so it should be used along with other elements of a trading process.

Our Intel example provides a good illustration of how the divergence report is used with a broader investment strategy. In AIQ's Growth Stock Investing video tape, we discuss a method of using the weekly trading bands to identify



USING AIQ REPORTS *continued . . .*

attractive stocks. (For information on AIQ's educational video tapes, call 1-800-332-2999.) Specifically, we first look for a stock that tends to stay between the upper band and the 28-week moving average. It is particularly attractive to see the stock move from the upper band to the 28-week moving average and then turn upward. In our Intel example, we see the stock corrected from the top band right to the 28-week moving average, and then found support and was able to break its downward sloping trendline (see **Figure 3**).

The Price Volume Divergence report is primarily a report for short term traders. In our tests, we used a 30 day holding period. We found that with this holding period, the default setting of a 15 day divergence worked better than shorter divergence time periods. Longer term investors can use the report as one element of a long term trading process. After all, it is always nice to have a stock advance shortly after purchase. ■

MARKET REVIEW

The March-April correction has become a distant memory as the market's advance continued through May. It is no longer just a large-cap rally. All the major indexes, including the Nasdaq Composite and Russell 2000, moved to new highs. How strong was the advance? Not only did all the indexes reach new highs, but all indexes also moved above AIQ's trading bands. This is extremely unusual.

Because of the advance, the Market Log showed a high percentage of stocks giving unconfirmed AIQ sell signals. This indicated that the market was overbought, but the market showed that it can continue to advance even while being overbought. It would have been bearish to see a high percentage of stocks giving sell signals at the same time that a market sell signal was registered, but that didn't

happen. No market timing buy or sell signals were registered in May. The last signal was a buy on April 15.

The Advance/Decline Oscillator (same as the McClellan Oscillator) rose above 235 in May. This is the highest the oscillator has been any time in the last 20 years and is a sign of strong market participation. It reached the 190 level in January 1975 and in August 1982, right at the beginning of new bull markets. We can't say that this is the start of a new bull market because we have not had a bear market, but it does show the strength of the current uptrend.

The strongest industry groups in May were technology related, with the networking groups leading. The networking stocks rose about 35%. The weakest groups were food and electric utilities. ■

--DV

STOCK DATA MAINTENANCE

The following table shows past and future stock splits and large dividends:

Stock	Ticker	Split/Div.	Approx. Date	Stock	Ticker	Split/Div.	Approx. Date
Mellon Bank	MEL	2:1	06/03/97	Teleflex Inc.	TFX	2:1	06/17/97
Bay View Capital	BVCC	2:1	06/03/97	Comdisco Inc.	CDO	3:2	06/17/97
Bergen Bruswig	BBC	5:4	06/03/97	Columbus Energy	EGY	5:4	06/17/97
Schering Plough	SGP	2:1	06/04/97	Gateway 2000	GTW	2:1	06/17/97
Western Digital	WDC	2:1	06/04/97	Tuesday Morning	TUES	3:2	06/18/97
Mail-Well Inc.	MWL	3:2	06/06/97	Cellstar Corp.	CLST	3:2	06/18/97
Boeing Co.	BA	2:1	06/09/97	Mobil Corp.	MOB	2:1	06/25/97
Computer Horizons	CHRZ	3:2	06/10/97	TJX Cos.	TJX	2:1	06/27/97
Quantum Corp.	QNTM	2:1	06/10/97	Selas Corp. Amer.	SLS	3:2	06/30/97
Cliffs Drilling	CDG	2:1	06/10/97	Marsh & McLennan	MMC	2:1	06/30/97
Littelfuse Inc.	LFUS	2:1	06/11/97	KCS Energy	KCS	2:1	07/01/97
Bell Industries	BI	20%	06/12/97	Chart Indus.	CTI	3:2	07/01/97
Atlantic Richfield	ARC	2:1	06/16/97	Manitowoc Cos.	MTW	3:2	07/01/97
Regions Fin'1	RGBK	2:1	06/16/97				

Name/Ticker Changes:

Bank of Boston (BKB) to BankBoston Corp (BKB), Consolidated Freightways (CNF) to CNF Transportation Inc. (CNF), MCN Corp (MCN) to MCN Energy Group (MCN), Bancorp Hawaii Inc. (BOH) to Pacific Century Fin'1 (BOH), The Duriron Co. (DURI) to Durco Int'l Inc. (DURI), KLA Instruments Corp (KLAC) to KLA-Tencor Corp. (KLAC), Volt Info Sciences (VOLT) to Volt Information Sciences (VOL), Energy Ventures (EVI) to EVI Inc. (EVI), WMX Technologies (WMX) to Waste Management Inc (WMX), One Valley Bancorp (OVVW) to One Valley Bancorp (OV), Rollins Environmental (REN) to Laidlaw Environmental Services (LLE), Titan Wheel Int'l (TWI) to Titan Int'l Inc. (TWI), Dillard Dept. Stores (DDS) to Dillard's Inc. (DDS), Gateway 2000 Inc. (GATE) to Gateway 2000 Inc. (GTW), ITT Hartford Group (HIG) to Hartford Financial Services Group (HIG)