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## Testing Determines Best Performers

# Are You an Active Trader? Here Are the Most Effective EDS Trading Rules for You

By David Vomund

**I**n the October 2002 *Opening Bell* we wrote about the testing we did on the nearly 200 pre-built Expert Design Studio (EDS) rules and reported on those that were the most effective. For that article, the holding period for the testing was 22 business days, or approximately one month. Now the active traders will have their day. This month's article reveals the best EDS rules using a 5-business-day holding period.

When AIQ created the Expert Design Studio, we wanted to enable people to create their own screening models but we also understood that many people aren't prepared to do their own programming. To deal with this, about 200 pre-built screening techniques were created, allowing users to simply copy and paste these rules to build their own models.

Most of the pre-built rules are based on the action of a specific indicator. For each indicator, several rules were created to represent most of the indicator's technically significant actions.

With 200 pre-built screening rules included with every TradingExpert Pro system, the question that most users ask is - which of the pre-built rules are the most effective? To answer that question, we performed the arduous task of testing



DAVID VOMUND

*"This month's article reveals the best Expert Design Studio rules using a 5-business-day holding period... If you use EDS and are an active trader, then this may be for you one of the most important articles that we've printed."*

each rule on a large database of stocks. The October 2002 *Opening Bell* reported our findings using a 22-business-day time period. This article, however, is directed toward active traders and we've reduced the holding period to 5 business days. If you use EDS and are an active trader, then this may be one of

the most important articles that we've published.

When we began running tests similar to these in the late 1990s, we were limited to bullish market environments. With the unfavorable market activity of the last few years, we can now run backtests on a time period that includes both bullish and bearish market environments. That

*"With the unfavorable market activity in the last few years, we can run backtests on a time period that includes both bullish and bearish market environments. That is one of the few advantages of the bear market!"*

is one of the few advantages of the bear market!

The tests were run on a database of the AIQ Pyramid stocks, which includes about 1700 issues, and on the 01/01/98 to 07/31/02 time period. A fixed 5-business-day holding period was used. For all

tests except *Opening Bell* strategies and strategies taken from investment books, a minimum volume filter of 10,000 shares was added.

Many of the technical indicators are designed to predict short-term price movement so the 5-day holding period is very appropriate to many of the rules.

Due to space limitations, we are not able to list the results of all the rules. Because of the importance of this time-consuming test, we are listing as many rules as possible. **Table 1** shows the 40 best performing rules, sorted by their annual return on

investment (ROI).

To help identify the pre-built rules listed in Table 1, we indicate which folders they reside in and what the rule names are. The first column in the table displays the name of the folder (or folders) followed by the file name. The next column shows the name of the rule that was tested.

To find a pre-built rule, open the Expert Design Studio and select *File, Open*, and double click the *EDS Strategies* folder. This accesses the list of folders in which the rule files reside. Double-click the appropriate folder name and then highlight and open a file. With the file open, the rule will be displayed in the *Rule Library* page of the EDS window.

For a description on how to create and run an EDS screening, refer to the February 2003 *Opening Bell*.

Congratulations to AIQ power

user Richard Denning, creator of the most effective strategy. The annual ROI on his model was well above all other models and it had lots of trades. Denning's EDS model, which was covered in the September 2001 *Opening Bell*, relies heavily on a technical indicator he developed called VCR. The *Opening Bell* which describes this model can be downloaded at [www.aiqsystems.com/september2001.pdf](http://www.aiqsystems.com/september2001.pdf).

Another AIQ power user, Wesley Nevels, created the third most effective strategy. This EDS model was designed to pick stocks for good one-day trades but it works for one-week selections as well. An interview with Mr. Nevels can be found in the December 1999 *Opening Bell* and can be downloaded at [www.aiqsystems.com/december1999.pdf](http://www.aiqsystems.com/december1999.pdf).

We are pleased to see that the top three strategies and half of the top ten were all featured in the *Opening Bell*. The second best system looks for stocks that have increased in value by at least 50% in the last three months but are off their

*"Congratulations to AIQ power user Richard Denning, creator of the most effective strategy. The annual ROI on his model was well above all other models and it had lots of trades."*

ten-day highs. In addition, their Volume Accumulation Percent indicators must be above 25. This is a growth investing strategy so the majority of the 870 trades came in 1998 and 1999.

The fourth best rule involves a candlestick chart pattern but it only had 31 trades so it can be ignored.

AIQ has created models based on strategies found in some of the most respected technical analysis

## AIQ Opening Bell Newsletter

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## Table 1 - Highest ROI Trades

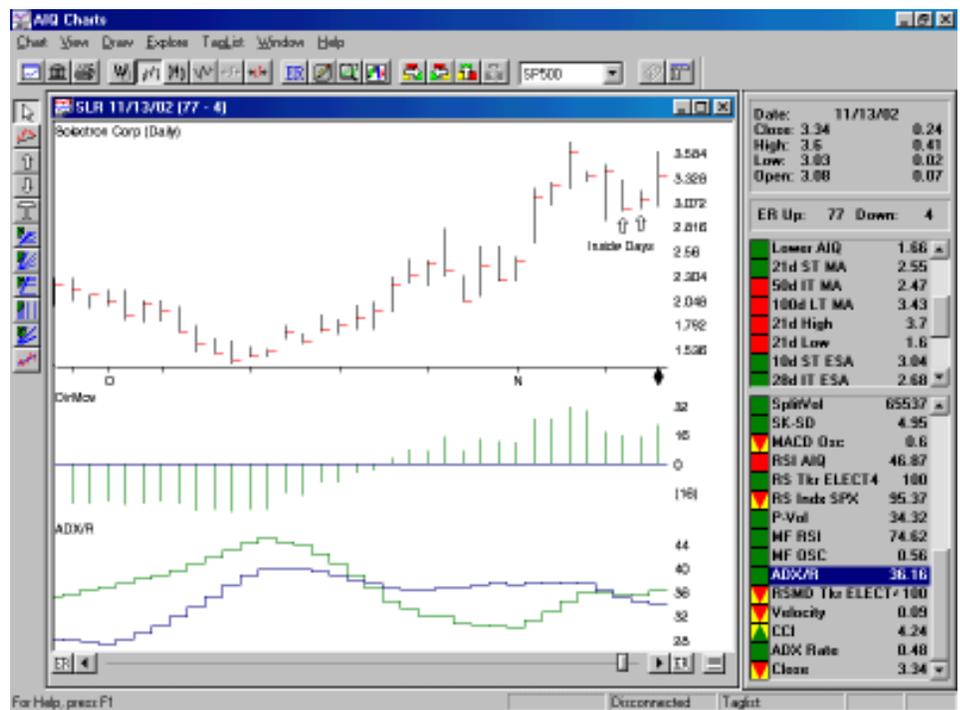
The following lists the results of testing the pre-built EDS rules using a stock database of the 1700 AIQ Pyramid stocks. A fixed 5-business-day holding period was used. The testing time period was 01/01/98 to 07/31/02.

Folder/File	Rule Name	Annual ROI
1 OBM\Denning VCR	GoLong	211.82
2 OBM\December	allworks	111.81
3 OBM\Dec99	buy	83.72
4 Basic Indicator Strategies\Candlesticks\Tri Star Doji	TriStarDoji	78.47
5 Hit and Run Trading\Boomer Buy	BoomerBuy	76.26
6 Basic Indicator Strategies\Candlesticks\3Crows	ThreeCrows	66.76
7 OBM\April-2000 (RS Wilder at 14)	bestofkane	62.47
8 Street Smarts\Holy Grail Strategy	HolyGrail	50.72
9 OBM\Aprilobm (with 100 day MA)	allworks	50.19
10 Basic Indicator Strategies\RSI Wilder\RSI Wilder in oversold territory	RSIWilderunder30	47.71
11 Basic Indicator Strategies\ESA's\Price crosses from above to below the Upper ESA	ESAupperDN	46.80
12 Basic Indicator Strategies\MF RSI\MFRSI crosses from above to below 90	MFRSicross90	45.58
13 Basic Indicator Strategies\CCI\CCI cuts from above to below 100	CCIdn	43.92
14 Basic Indicator Strategies\Split Volume\Split Volume down 5 days price is descending	SplitVoldnPricedn	42.00
15 Basic Indicator Strategies\RSI Wilder\RSI Wilder falls from above to below 70	RSIWilderdncut70	41.31
16 Hit and Run Trading\Gilligans Island Shorts	GilligansIslandShortBuy	39.92
17 OBM\April-2000	citizenkane	38.79
18 Basic Indicator Strategies\Candlesticks\Long Leg Doji	LongLegDoji	37.44
19 Basic Indicator Strategies\Candlesticks\Tweezer Bottom	TweezerBottom	36.24
20 Basic Indicator Strategies\AIQ Bands\Price crosses from above to below the Upper Band	AIQupperDN	35.79
21 Street Smarts\Linda Bradford Raschke MACDI exit	macdexit	35.10
22 Basic Indicator Strategies\ADX\ADX trend in place, ADX rate up	ADXRATEup	34.98
23 Basic Indicator Strategies\Candlesticks\White	WhiteMaubozu	34.06
24 Basic Indicator Strategies\Volume\Spike if Volume is 100% above the ESA of volume	volumespike	33.64
25 Basic Indicator Strategies\ADX\ADX trend in place and Directional Movement down	ADUpDIRMOVdn	33.59
26 Basic Indicator Strategies\Candlesticks\Dragonfly	DragonFly	33.53
27 Hit and Run Trading\Boomer Short	BoomerShort	32.19
28 Basic Indicator Strategies\RSI AIQ\RSI AIQ is in overbought territory	RSIAIQover70	32.12
29 Hit and Run Trading\5-day Momentum Buy	BuyLong	32.06
30 Basic Indicator Strategies\RSI AIQ\RSI AIQ falls from above to below 70	RSIAIQdncut70	31.97
31 Expert Rating Strategies\ER down 95 or greater	erdown	31.57
32 Basic Indicator Strategies\ADX\ADX Trend	GoodADX	31.56
33 Basic Indicator Strategies\Volume\Volume Spike and price change	spikedup	31.20
34 Hit and Run Trading\Stepping in Front of Size	SteppinginFrontofSize	31.13
35 Basic Indicator Strategies\Candlesticks\3 White Soldiers	ThreeSoldiers	30.45
36 OBM\April-2000 (RS Wilder at 7)	bestofkane	30.15
37 OBM\April-2000	bottomfishing	29.98
38 OBM\Jun99obm	allworks	29.93
39 Basic Indicator Strategies\Candlesticks\Harami Cross	HaramiCross	29.79
40 Basic Indicator Strategies\ADX\ADX increasing and above the 25 level	ADUp	29.76

books. The fifth best rule is based on a system published in Jeff Cooper's *Hit and Run Trading*. The Boomer model requires an ADX indicator above 30 and a positive DMI indicator. This implies that the stock is in an uptrend. Next, there is a requirement that the stock have two consecutive inside days (an inside day occurs when the high is less than the previous day's high and the low is greater than the previous day's low). After the two inside days, the buy signal comes when the stock rises above the previous day's high.

**Figure 1** shows an example of a stock that passes the Boomer strategy. Solectron (SLR) has the positive DMI indicator and an ADX above 30. More importantly, there are two consecutive inside days. The buy signal came on November 13, the day SLR rose above the high price on the second inside day.

The eighth rule uses a strategy published in Linda Bradford Raschke's *Street Smarts* book. The Holy Grail system looks to buy uptrending stocks that have recently pulled back. To identify a trend, the



**Figure 1.** Chart of Selection with Boomer strategy buy signal in Nov. of 2002. Arrows show two consecutive inside days. At same time, ADX is above 30 and DMI indicator is positive.

*“AIQ has created models based on strategies found in some of the most respected technical analysis books... The eighth rule uses a strategy published in Linda Bradford Raschke's 'Street Smarts' book.”*



**Figure 2.** Chart of Citrix Systems with Holy Grail strategy buy signal in early Jan. of 2003. Price is clearly uptrending but has pulled back to 28-day ESA while ADX remains above 30 level.

model requires the stock's ADX indicator to be above 30. For the retracement, the Holy Grail strategy buys the stock once it falls to its 20-period ESA. In our test of the EDS strategy, we used the AIQ default of 28 days instead of 20 days.

**Figure 2** shows an example of a stock that passed the Holy Grail strategy. Citrix Systems (CTXS) was uptrending but pulled back to the intermediate term ESA. Despite the pullback, the ADX indicator remained above 30.

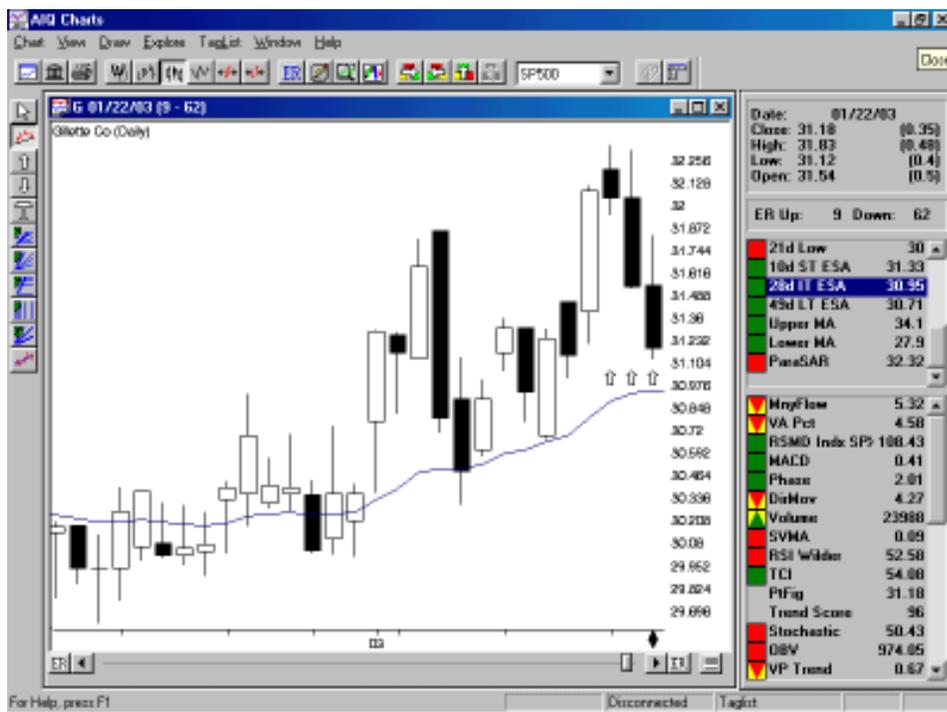
The sixth rule involves the Three Black Crows candlestick charting pattern. Three Black Crows occur when a stock's daily closing price is below its opening price for three straight days. In addition, each of the opening prices must be within the prior day's real body. **Figure 3** is a chart of Gillette showing a Three

Black Crows pattern (see arrows).

Candlestick chartists view this as a bearish pattern as long as it occurs at high price levels. AIQ's pre-built EDS rule searches for the pattern but it doesn't necessarily have to occur at high prices. EDS only requires the pattern to occur when the stock is above its 28-day ESA. Although this is designed to be a bearish pattern, testing results show just the opposite. This strategy effectively buys stocks on a pullback.

Rules 10 through 15 all involve indicators and, with the exception of rule 12, have more than 25,000 trades over the testing time period. These rules can easily be combined with other effective rules to form a trading system. A common element of most of these rules is that, similar to the Holy Grail and Three Black Crows patterns, they buy stocks on pullbacks. For traders, buying continuation patterns works.

In the next issue of the *Opening Bell*, we'll reveal the least effective rules using a 5-business-day holding



**Figure 3.** Candlestick chart of Gillette with Three Black Crows buy signal. Main criteria is that daily closing price is below its opening price for three straight days (see arrows).

period. These rules can be used to develop short-selling models.

David Vomund publishes *VIS Alert*, a weekly investment newsletter. For free trial issues, call 775-831-1544 or go to [www.visalert.com](http://www.visalert.com).

**STOCK DATA MAINTENANCE**

The following table shows stock splits and other changes:

Stock	Ticker	Split	Approx. Date
Expedia	EXPE	2:1	03/11/03
FFLC Bancorp	FFLC	3:2	03/17/03
Barr Labs	BARR	3:2	03/18/03
XTO Energy	XTO	4:3	03/19/03

**Trading Suspended:**

- Echo Bay Mines (ECO)
- Italy Fund (ITA)
- TVX Gold (TVX)
- WestPoint Stevens (WXS)

**Name Changes:**

- Philip Morris (MO) to Altria Group (MO)
- Telex-Chile SA ADS (TL) to Chilesat Corp. SA ADS (CSA)

**S&P 500 Changes**

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

Rational Software (RATL) is replaced by Auto Nation Inc. (AN).

AN is added to Specialty Retailing (RETAILSP).

**Year-End Index of 2002 Articles**

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*Invaluable Trading Insights*

## Important to Remember! 'Words of Wisdom' from Experienced AIQ Users

**A**fter publishing the *Opening Bell* newsletter for over 10 years, we believe some of our best articles come from our interviews with AIQ users. The trading perspective these experienced users provide is invaluable. In 2002, we published many articles and interviews from experienced AIQ users. Here are some favorite quotes from these articles, with additional comments from David Vomund. These "words of wisdom" are invaluable insights for both novice as well as veteran traders.

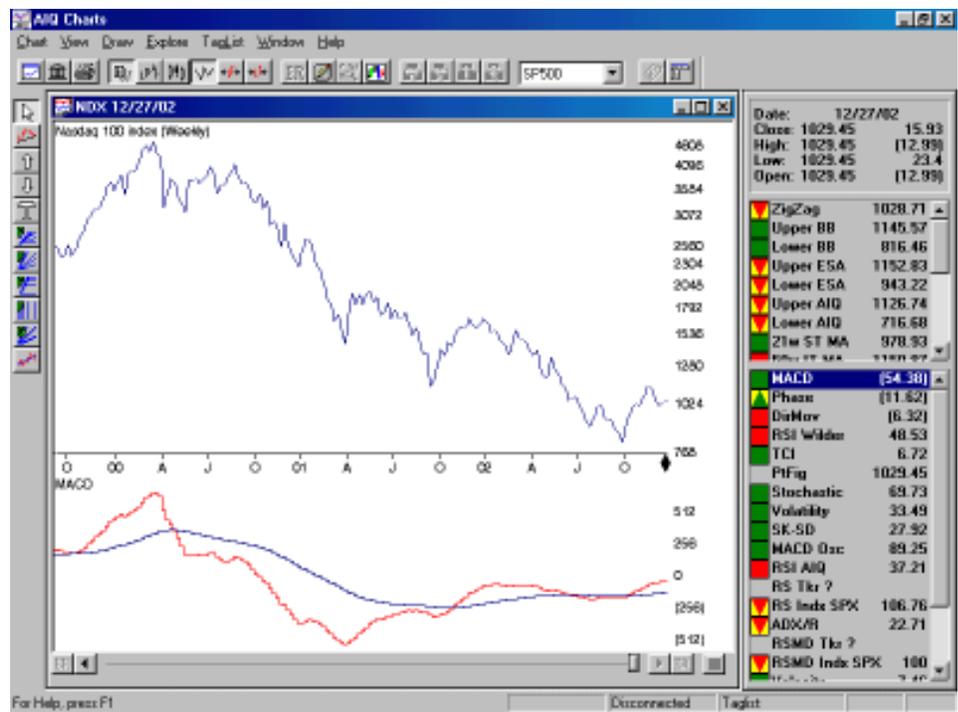
### Yacov Twena – February 2002

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

*"As for market timing methods, we use a series of technical indicators. For example, ...on the Nasdaq 100 we look at a longer time frame on the daily and weekly charts, using a setting such as 13-34-55."*

**DV:** A lesson from the bear market is the importance of trend analysis. Fighting the trend can be very frustrating. For his long-term view, Yacov uses a weekly chart of the MACD with settings of 13-34-55. **Figure 1** shows the Nasdaq 100 along with its MACD indicator. This indicator works well when there is a strong trend.

*"Someone once said that trading is 60% mental. One of the things we*



**Figure 1.** Weekly chart of Nasdaq 100. Strong downtrend is confirmed by MACD indicator.

*focus on in our trading is positive mental attitude. Being a trader is more than a job – it is a personal journey that will take you to the depths and boundaries of who you are. I liken it to the qualities of a successful athlete. Trading requires commitment, persistence, and practice, practice, practice.*

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

**DV:** In the *Opening Bell*, we often focus too much on strategies and indicator analysis and not enough on the psychological factors of trading. You often get what you believe. If you are in a slump and believe you are going to buy at the high or sell at the low, then that's what will likely happen. Conversely, if you have a

positive attitude you'll see greater success. It's OK to sit on the sidelines in a bad market. It's also OK to sit on the sidelines if you aren't emotionally ready to trade.

### Dr. Gerald Smith – March 2002

*"Losing teaches us discipline. If all our experience in the market occurred during a long, bullish trend where it is easy to pick winners, we would begin to believe that this is an easy game to play. We would be totally unprepared to react to the inevitable correction. We would be totally unprepared to deal with a down market. We would not have the discipline to practice market timing, group analysis, and stock selection. And we would not have the discipline to exit when the market, and our rules, tell us to exit."*

**DV:** We have all taken our lumps over the last few years. We

can benefit from this by learning from our mistakes.

### Linda Bradford Raschke – March 2002

*“A lot of people get into scenario building. They might examine what they perceive to be fundamental data and then make evaluation judgments...On the other side of every trade is somebody who is equally convinced that it is going in*

*“When I started out in the early 1980’s, market timing was a big deal. By the end of the 90’s you were considered a fool if you tried to time the market...Now market timing is enjoying renewed interest.” Jay Kaeppl*

*the opposite direction. Who is right? The market is. The market is going to do what it wants regardless of your convictions.”*

**DV:** It is easy to form an opinion on the market and then run an analysis to simply support your opinion. That leads to mistakes. Your view of the market should be a result of your unbiased analysis. The market will then tell you if your analysis was right or wrong.

### Steve Palmquist – July 2002

*“Each evening I prepare for the next trading day by first looking at the market and determining if it is in an uptrend, downtrend, or is moving sideways. I look at the volume to determine if there is conviction in the movement, and trendlines to determine if the short-term movement is just beginning or nearing an end.”*

*“These different strategies can affect the risk and return profile of the system, and should be matched to the traders’ style and the amount of time they have available to monitor the market.”*

**DV:** Applying a trading approach that fits your personality is

critical. A strategy that works very well for one person may not work for another person. If you apply a strategy that doesn’t fit your emotional makeup, then you’ll end up leaving the strategy after its first drawdown.

### Allen Thomas – July 2002

*“Most of us have probably heard the cliché phrase ‘All boats rise in a rising tide.’ While choosing stocks to trade isn’t quite as simple as merely determining the underlying trend of the overall market and jumping in accordingly, this time-tested market dogma does have merit in selecting stocks to trade within certain sectors and industry groups. It’s been well acknowl-*

*edged that stocks within certain sectors tend to trade in sympathy with one another.”*

### Henry Brookins – Sept. 2002

*“Big Money is what moves stocks. These days, I go long and short and primarily focus on technical analysis and limiting draw-downs.”*

**DV:** The importance of limiting drawdowns was revealed during this vicious bear market. In many cases, the tortoise beat the hare.

### Jay Kaeppl – October 2002

*“There are a lot of people who wish they had gotten out of the stock market – or at least lightened up somewhat – before the recent collapse. Lots of things go in cycles in the market. When I started out in the early 1980’s, market timing was a big deal. By the end of the 90’s you were considered a fool if you tried to time the market. By then, the question was not ‘should I be in the market,’ but ‘how do I make the most money?’ Now market timing is enjoying renewed interest.”*

## Market Review

**T**he market declined in February, its third straight monthly decline. For the month, the S&P 500 lost 1.70% and the Dow lost 2.02%. Amazingly, when most of Wall Street is focusing on dividend paying stocks, the Nasdaq Composite outperformed in February and actually rose in value. For the month, the Nasdaq gained 1.26%.

The 870 level acted as support for the S&P 500 in late October 2002 and again in December 2002. That level was broken in January and has become a resistance level that ended each rally attempt in February.

The AIQ timing model registered three signals in February. A 99 buy was registered on February 3, a 99 buy on February 14, and a 95 buy on February 18.

Internet and Oil Service were the best performing groups in February. Each gained about 12%. The worst performing groups were Steel, Tires & Rubber, and Airlines. These groups lost about 20% of their value.

Here is a shocking statistic that shows how severe the bear market has been and gives hope for the coming years. The worst ten-year period for the S&P 500 ended in 1938, in which you would have lost 0.9% annually. If the ten-year period that began in March of 2000 is going to match that worst-ever record, the S&P 500 would need to rise 5.7% annually for the next seven years.

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## Test of AIQ's Expert Rating Signals

# AIQ Mechanical Portfolio - How Is It Performing?

**A** trading system that we developed and have tracked since the early 1990s is what we call the AIQ Mechanical Portfolio. We named it the AIQ Portfolio because it relies exclusively on Expert Rating signals, the feature that was the heart of AIQ when the software was first released.

This mechanical trading system combines AIQ's market timing

signals.

When a market timing buy is registered, the top five stocks that appear on the Weighted action List with Expert Rating signals greater than 95 are purchased.

These stocks are held until a market sell signal (Expert Rating of 95 down or greater) is registered, at which time all positions are moved to cash. Only Standard & Poor 500 stocks are purchased.

To obtain the percentage return figures, we made the following assumptions:

- The buy and sell points for the stocks are the opening prices the day after the market timing Expert Rating.
- Commissions are factored in using a

commission rate of \$20 per trade.

- Slippage, dividends, and money market interest received are not factored in.

Since this strategy was first published, we have continuously updated the trades so the stock purchases reflect the information that was available at the time. This

is more accurate than running a backtest using today's S&P 500 stocks.

In 2002 the AIQ system underperformed the S&P 500 index. The market timing element of the model unfortunately remained on a buy signal during the summer sell-off. **Table 1** shows the individual trade dates and the securities that were purchased.

Although this system has underperformed over the last two years, those people who kept a long-term time horizon and followed the strategy through good and bad times have seen returns well above the market averages.

**Table 2** shows the yearly return figures. Since the AIQ system was first developed, the average yearly return is about twice the S&P 500. If you remove most of the 1990s and just look at the last five years, the system still made money. Buy-and-hold investors lost money during this time period.

*"The AIQ mechanical trading system combines AIQ's market timing model with the Weighted Action List report... Since the AIQ system was first developed, the average yearly return is about twice the S&P 500."*

model with the Weighted Action List report. For this strategy, we run the Weighted Action List stock report every time there is an AIQ market timing buy signal (an Expert Rating of 95 or greater on ticker DJIA). Only the first market timing signal in a string of buy signals is used and no confirmation is applied to the

**Table 1 - 2002 Trading Detail**

ER Buy Date	ER Sell Date	% Change S&P 500	% Change Stocks	Portfolio Holdings (Stock Symbols)
N/A	01/02/02	0.57	0.52	PEP,NEM,QTRN,ITT,CCE
01/17/02	02/19/02	-4.88	0.99	SEBL,UST,SOTR,NSC,PGR
02/25/02	05/21/02	-2.66	-9.99	CTXS,SOTR,AAPL,NKE,GT
06/05/02	08/28/02	-12.58	-23.63	BBBY,ODP,QTRN,TER,WEN
09/04/02	09/17/02	-2.23	-0.07	KMB;PCL;COL;BA;GR
09/26/02	12/09/02	4.33	6.86	NSM;WOR;GLT;LOW;CTAS
12/10/02	N/A	-2.73	-4.95	AZO;SHW;ITT;RATL;WOR

**Table 2  
Yearly Percentage Returns**

	AIQ	S&P 500
92	13.53	4.46
93	17.26	7.06
94	35.75	-1.54
95	18.90	34.11
96	27.88	20.26
97	37.73	31.01
98	76.23	26.67
99	2.32	19.53
00	4.94	-0.14
01	-24.78	-13.04
02	-29.98	-23.37
<b>Avg. =</b>	<b>16.34</b>	<b>8.64</b>

Past performance does not guarantee future results.