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MARKET TIMING

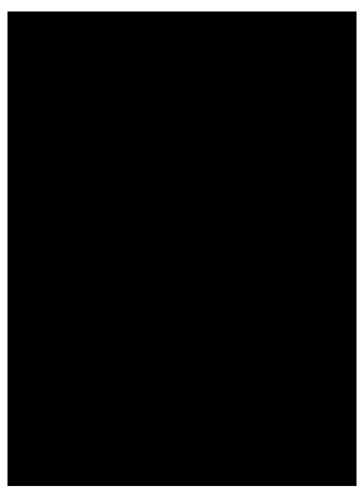
DO YOU HAVE WHAT IT TAKES TO BE A SUCCESSFUL MARKET TIMER?

By Paul A. Merriman

Market timing works, and it works well for people who actually practice it as a discipline. In theory, every investor is capable of following the disciplines of timing. But not everybody has the right emotional makeup to do timing right. In real life, most people who try are ultimately unsuccessful.

Timing puts investors on the front lines, face to face with the realities of the market, every business day. To be a successful timer, you've got to buy and sell without flinching even when you don't feel like it. You've got to follow your discipline even when you're sure it's a mistake. You've got to do it even when you don't understand why your timing system is telling you to act. Nike had it right: "Just do it." But it's so much easier to say than to do!

Timing is not for sissies. Sometimes it takes a strong faith and a strong stomach. I like this quote from the legendary Benjamin Graham: "To achieve satisfactory results is easier than most people realize. To achieve superior results is harder than it looks."



Paul A. Merriman

Here are six questions to help you determine if you have what it takes. There are no right or wrong answers, only what's true for you.

Six Questions

1. Do you have the necessary perseverance?

Timing can get you in real trouble if you try it for a while, become discouraged, and then abandon your plan in favor of something you find more palatable. If you let your feelings guide you, you're likely to bail out of a timing strategy at the very worst time, when your investments are down. Can you adopt a strategy and stick to it for the long term? Can you follow the system regardless of how you feel about it and

Market Timing continued on page 2

MARKET TIMING *continued . . .*

regardless of what's going on around you? Can you resist the temptations to act on impulse? Can you ignore the many "hot tips" you may come upon every week?

2. Are you independent and self assured enough to resist the temptation to constantly look over your shoulder to see how somebody else is doing?

There aren't many certainties about investing, but here's something I can guarantee: No matter how your investments are doing, there will always be somebody who has recently outperformed you and seems to have struck it rich. Nervous investors constantly look over their shoulders, hoping to find somebody who has found "the one true path" to wealth. That path is a myth, and nervous investors don't make good timers. Confident, successful investors know what they want and need, adopt a strategy to achieve their objectives, and stick with that strategy regardless of what others are doing. If your goal is to increase your assets by 10 percent a year, and a timing system lets you achieve that, can you be satisfied even when other people are making 12 percent or 15 percent or even 20 percent? If so, you may have what it takes to succeed as a timer.

3. Can you accept that your portfolio will underperform the market?

This should be obvious, but you would be surprised to know how many people forget it: A timing system is not designed to produce the same returns as the untimed market. When you outperform the market, you are likely to be pleased. But your pleasure may be mild compared with the fury or betrayal you can experience when your portfolio is underperforming and when your timing system produces a losing trade. That's especially true when you just "knew" that the signal you got from your system was the wrong thing to do.

4. Can you accept that your timing system will be imperfect?

Imperfection is one of the media's biggest criticisms of timing. When you are underperforming and experiencing losing trades, that media criticism may shake your confidence. The media often says market timing requires you to be right twice: when you buy and when you sell, in contrast to a buy-and-hold approach in which you have to be right only once: when you buy. Most of the time, you can count on your system to get you into or out of the market "too soon" or "too late" to catch the tops and bottoms. If getting out at the very top and getting back in at the very bottom are your goals, timing is guaranteed to let you down. And if that failure will drive you nuts, think twice before embarking on a timing strategy, because what you will perceive as timing mistakes will erode or destroy your willingness to follow the discipline. Your goal should not be to achieve perfection. It should be to put the probabilities on your side. And a good timing strategy will do that.

5. Can you ignore the mass media?

Almost unanimously, the popular press seems to have a blind spot when it comes to timing. They say timers are misguided, and this view is widely echoed by the mutual fund and brokerage industries. Can you pull out of the market when everybody else is either getting in or already making money? Can you get back in when your friends, colleagues, the media and possibly your own gut are telling you it's a dumb idea?

6. Are you decisive?

Some people stew and fret and delay making decisions, even when they are convinced they should be doing something. They are unlikely to be successful timers. Successful timing requires quick action to move into and out of the markets. One of the most obvious truths about timing (and one of the most widely overlooked) is that by the time your friends, your colleagues, your gut and the experts all agree on what you should do, it's already far too late for you to extract the maximum opportunity from it. If you usually take lots of time to make decisions, this is not a suitable arena for you.

The bottom line for me is that timing is very challenging. I believe that for most investors, the best route to success is to have somebody else make the actual timing moves for you. You can hire a professional. Or you can have a colleague, friend or family member actually make the trades for you. That way your emotions won't stop you from following the discipline. You'll be able to go on vacation knowing your system will be followed. Most important, you'll be one step removed from the emotional hurdles of getting in and out of the market. ■

Paul Merriman is president of Paul A. Merriman & Associates, an investment advisory firm specializing in buy-and-hold and market timing strategies using no-load mutual funds. He is also editor of FundAdvice.com, a free internet mutual fund newsletter and free e-mail market timing service. For a free copy of his latest audiotape, "The ultimate 20% Strategy," call 1-800-423-4893.

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MARKET REVIEW

December was an active month for AIQ's market timing model. After being on a buy from October 8, the system finally switched to a sell mode when it registered a 98 down signal on December 3. A repeat sell came on December 10 when a 99 down was registered. Negative market breadth played a big role in both sell signals. Looking at the market log, more than 80% of the stocks giving unconfirmed signals were on the buy side, an indication that it wasn't a major top.

After the sell, the Dow decreased some but there was little downward movement. During the sell, the Russell 2000 representing small company stocks was in a trading range. It wasn't until Christmas that the Russell 2000 broke out of its trading range (see **Figure 1**).

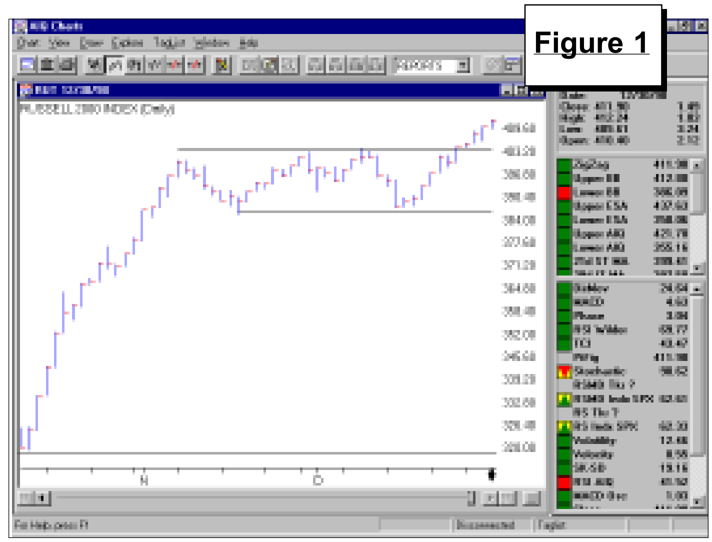


Figure 1

The week between Christmas and the New Year is typically bullish for stocks. This year was no exception. After the Russell 2000 broke out, market breadth improved and a 96 buy signal was registered on December 29. Early in the month, the upward movement was limited to technology and internet companies. Late in the month, market participation began to improve.

For the year, technology groups were the biggest winners. Fidelity's Computers sector fund gained an amazing 95%, and their Technology fund gained over 70%. The worst groups were oil related. Fidelity's Energy Service sector fund, which contains oil equipment and drilling stocks, lost 50% and their Energy fund fell 15%. ■

READERS FORUM

This Question & Answer feature will appear regularly in the *Opening Bell*. Send your questions to Editor, Opening Bell, P.O. Box 7530, Incline Village, NV 89452.

Q: I have a stock in my database that has recently changed symbols. How do I rename the symbol and keep all the old history?

A: In ***Data Manager***, highlight the old symbol. Then click on **Ticker** and choose **Rename**. Enter the new symbol, description, and market if needed. This will rename the old symbol and also retain all its history.

Q: I am a flat fee subscriber to Dial/Data but when I do an *End of Day* download a cost appears on the Communications log. Is this cost in addition to the flat fee?

A: No. This cost no longer applies and should be disregarded. It is simply leftover from the days when data services charged per-quote fees. All services now charge on the basis of flat fee subscriptions.

Q: When I press the **ER** button while viewing a ticker to review rules that have fired on a buy (or sell) signal, why do I sometimes see rules that are contrary to the ER signal?

A: It is true that one or more contrary rules may appear regardless of the magnitude of the ER. They are shown because all rules, including contrary rules, have a bearing on the ER. However, contrary rules are more likely for an ER of 95-5 than for an ER of 100-0. In effect, contrary rules downgrade the ER and without the firing of a contrary rule a higher ER would very probably be generated.

Q: When I update my data at night, I am unable to get the current day's data. This happens even when the time is after the current quotes are posted at the data vendor. What should I do?

A: Check your system date and time. If your date is current, ensure that the time and a.m./p.m. designation are correct. Also, in ***Data Retrieval*** click on **Setup Options** and make sure the *market open* and *market close* are set correctly for your time zone.

Q: Do I need to have the ***MyTrack*** program running in order to use Real Time in Trading Expert Pro?

A: No. ***MyTrack*** is a separate program and does not have to be running.

Bug Fix for TradingExpert Pro

There is a service pack available on the internet that fixes many of the known bugs in the TradingExpert 5.0 software. To download the service pack, go to AIQ's Quick Launch Menu and select **Help** from the menu bar. Next, select **Technical Support** and then **Product Updates**. That will launch a web page. On that page you can download **Service Pack 1**, which is a choice in the lower portion of the screen. To get a list of what features are corrected with the Service Pack, choose **Known Issues**.

YEAR-END ANALYSIS

THE BEST YEAR YET FOR AIQ'S MECHANICAL TRADING PORTFOLIO

By David Vomund

The year 1998 was the best yet for AIQ's mechanical trading strategy—up an amazing 76.78%. The strategy combines the market timing model with the individual stock buy and sell signals. Before we examine the strategy, let's first look at how the market timing model fared in 1998.

Market Timing – No Confirmation

In 1998, AIQ's market timing model had some periods of brilliance and some periods where it was off the mark. In the end, the results were in line with a buy-and-hold return, which is better than what most timers can claim.

The model started the year on a buy and was on a buy for all but two trading days until April 17. That was impressive because it avoided giving a sell signal in a market environment that turned out to be very bullish. From the January 12 buy signal to the April 17 sell signal, the S&P 500 rallied 20%.

The April 17 sell signal was perfectly timed as the large company stocks ended their uptrend and began to move sideways. At the same time, small company stocks entered into a bear market. The April 17 sell signal was registered three days before the Russell 2000 hit its highest level, a level that has yet to be penetrated.

A quick and profitable trade occurred from mid-June to mid-July. For the first half of the year, the market timing model could hardly have been better. But that is when the trouble started. The July 21 sell signal was well timed as it was registered only two days after the market formed a major top. Unfortunately, the model registered a buy signal soon after the market began to drop. A buy came on July 29 and the system remained on a buy until early September. The market experienced a 12.7% loss over this time period, which represents the largest loss our system has experienced since it was introduced in early 1987.

Just when confidence in the market timing model was shaken, the system registered a buy on October 8, which represents the low point in the S&P 500, Nasdaq Composite, and Russell 2000. The S&P 500 rallied 20% after that buy until a sell was registered in early December.

"This (mechanical) strategy, which combines the market timing Expert Ratings with the top stocks on the Weighted Action List report, was introduced in May 1992... This was the strategy's best year."

Despite the late summer setback, if you traded the S&P 500 based on the Expert Ratings you would have seen a 28.5% return in 1998. The buy-and-hold return was 26.7%. The individual trades are shown in **Table 1**.

Market Timing – With Confirmation

In past articles, we have reported that applying a confirmation technique typically lowers both risk and return. That was the case in 1998. Since the AIQ market timing model was deadly accurate in the first half of the year, applying a Phase confirmation meant that you acted on the signals a few days after they were registered. The return from each trade was lowered by about 2% as a result of the confirmation delay.

The benefit of using confirmation came during the late summer selloff. The July 29 sell signal was registered in a falling market. It wasn't until August 17 that the market rallied enough to bring an increase to the Phase indicator.

When the buy signal came at the October 8 low, it wasn't immediately confirmed so once again some of the profit was lost. In the end, the market timing model gained 23% using Phase confirmation in 1998. The individual trades are shown in **Table 2**.

AIQ's Mechanical Trading Portfolio

We now will review our mechanical model that uses both Expert Ratings on the overall market and on individual stocks.

This strategy, which combines the market timing Expert Ratings with the top stocks on the Weighted Action List report, was introduced in the May 1992 *Opening Bell* and we've followed it each year after that. This was the strategy's best year.

The following is a review of this mechanical strategy:

We ran a Weighted Action List report every time there was a market timing buy signal (an Expert Rating of 95 or greater). Only the first signal in a string of buy signals was used and no confirmation was applied. The top five stocks that appeared on the Weighted Action List were purchased and held until a market sell signal was registered, at which time all positions were moved to cash. Only stocks over $10 were purchased and the Expert Rating buy signals on the stocks had to be 95 or greater.

To obtain percentage return figures, we made the following

YEAR-END ANALYSIS *continued* . . .

assumptions:

- All profits/losses were reinvested in the next block of trading with each of the five stocks receiving an equal amount of capital.
- The buy and sell points of the stocks were the opening price the day after the market Expert Rating.
- Commissions were factored in using a flat rate of $20 per trade.
- Slippage, dividends, and money market interest received were not factored in.

The trade-by-trade details are found in **Table 3**. The market timing buy and sell signal dates are listed in the first two columns. The third column lists the percentage change in the S&P 500 index, while the fourth column shows the results of trading the five stocks listed in the far right column (top five stocks from the Weighted Action List) using the opening price the day after the market timing signal.

The return for 1998 is an amazing 76.78%, including commissions. Since the portfolio is limited to S&P 500 stocks, the high return is not a result of internet speculation. This demonstrates that good stock selection is much more important than good market timing.

Table 1

No Confirmation

ER Buy Date	ER Sell Date	S&P 500 Buy Price	S&P 500 Sell Price	S&P 500 % Change
12/31/97	01/08/98	970.42	956.04	-1.48
01/12/98	04/17/98	939.20	1122.72	19.54
06/02/98	06/10/98	1093.02	1112.28	1.76
06/16/98	07/21/98	1087.58	1165.06	7.12
07/29/98	09/03/98	1125.20	982.26	-12.70
09/08/98	10/05/98	1023.46	988.56	-3.41
10/08/98	12/03/98	959.44	1150.14	19.88
12/29/98	12/31/98	1241.80	1229.40	-1.00

1998 Return = **28.47%**

A yearly breakdown of this strategy is as follows:

1992	13.53%
1993	17.26%
1994	35.75%
1995	18.90%
1996	27.88%
1997	37.73%
1998	76.78%
Average	32.55%

When we publish an article on this mechanical strategy, two things invariably happen.

First, people start to follow the strategy until there is a bad period. After the 8% drop in August, few people stuck with the strategy and failed to purchase the five stocks from the October 8 signal.

Second, people try to duplicate our results and find that the stocks on their Weighted Action List are different than what we are reporting. This can happen for a variety of reasons. One reason is that we are buying stocks with Expert Rating signals that are greater than 95. The default on the Weighted Action List report uses an Expert Rating value of 90. Therefore, you should change the UP ER Criteria on the Weighted Action List report to 95 (see page 244 in the TradingExpert Pro user manual).

In addition, only Standard & Poor's 500 stocks are purchased using this strategy so the reports should be generated on the S&P 500 list instead of the entire database (see page 234 in the TradingExpert Pro manual).

Because the stocks in the S&P 500 index change over time, your S&P 500

Year-End Analysis continued on page 6

Table 2

Phase Confirmation

Buy Date	Sell Date	S&P 500 Buy Price	S&P 500 Sell Price	S&P 500 % Change
12/31/97	01/08/98	970.42	956.04	-1.48
01/14/98	04/20/98	957.94	1123.64	17.30
06/05/98	06/10/98	1113.86	1112.28	-0.14
06/17/98	07/21/98	1107.10	1165.06	5.24
08/17/98	09/03/98	1083.66	982.26	-9.36
09/08/98	10/05/98	1023.46	988.56	-3.41
10/09/98	12/03/98	984.32	1150.14	16.85
12/29/98	12/31/98	1241.80	1229.40	-1.00

1998 Return = **22.99%**

YEAR-END ANALYSIS *continued* . . .

structure needs maintenance. Since each program that we send out has a current S&P 500 structure, those of you who have upgraded to TradingExpert Pro and have been using a Standard & Poor's structure from several years ago should reinstall the structure from the current program disk.

To do this, first go to the ***Data Manager*** application and make the S&P 500 structure the active structure. Then select **List** and **Delete**.

After deleting the old structure, you can then install the newer structure from the TradingExpert Pro CD. You can do this by performing a *Custom* installation and then installing only the S&P 500 files (see installation instructions in your New Users Guide if you need help).

By doing the above, you will get a recent structure. But you will also want to make the changes to the S&P 500 structure as they occur. To get a list of the changes in the structure or a list of the current S&P 500 stocks, visit Standard & Poor's web page at *www.spglobal.com*. The *News* section will list the changes.

Starting with this issue, we will list recent changes to the S&P 500 structure in the *Opening Bell*.

Data quality is very important to those who want to follow this mechanical strategy. TradingExpert Pro makes it much easier for you to get the same list of stocks that we get when we follow the system. It is best to install all the stocks in the S&P 500 from the AIQ (historical) Data CD even if you feel that all the S&P 500 stocks are in your database. With TradingExpert Pro, you can delete all the stocks in the S&P 500 structure and then install all the stocks in the structure from the Data CD.

To delete the stocks in the S&P 500 list, use the *Advanced Ticker Delete* function found in the ***Data Manager*** application and delete all the stocks in the S&P 500 list (see page 64 in your TradingExpert Pro manual).

Next, you will want to install the S&P 500 stocks from the AIQ Data CD. In ***Data Manager***, use the *Ticker Import Utility* and install all the stocks in S&P 500 list (see page 42 in the TradingExpert Pro manual).

Each time there is a new AIQ market timing buy signal, I delete and reinstall the stocks from the historical Data CD just to make sure the data is accurate. Users can receive quarterly CD updates for $99 per year. This process may seem excessive but it helps to insure that the Weighted Action List signals are accurate.

When real money is on the line, an extra hour of work on days that AIQ registers a market timing buy signal is a small price to pay. ■

*David Vomund publishes VIS Alert, a weekly investment newsletter. For a sample copy go to **www.visalert.com** or call (702) 831-1544.*

Table 3

1998 Results - Weighted Action List

ER Buy Date	ER Sell Date	S&P 500 % Change	Stocks % Change	Portfolio Holdings (Stock Symbols)
12/31/97	01/08/98	-1.48	4.93	EMC,UIS,ADSK,BAY,DELL
01/12/98	04/17/98	19.54	31.30	DH,FJ,DELL,X,ABT
06/02/98	06/10/98	1.76	5.83	LEH,DGN,LUV,SFA,KBH
06/16/98	07/21/98	7.12	12.15	MG,PFE,TWX,MCIC,ADSK
07/29/98	09/03/98	-12.70	-8.19	PDG,APC,PPW,MIR,BEL
09/08/98	10/05/98	-3.41	-1.97	AAPL,UMG,UIS,CMCSK,LUV
10/08/98	12/03/98	19.88	20.24	LEH,BSX,BSC,NMK,MCD
12/29/98	12/31/98	-1.00	0.68	LUV,AGN,DH,CCE,TMK

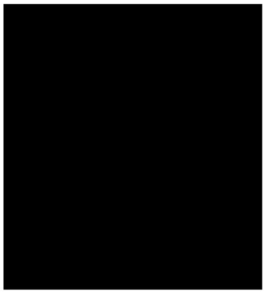
1998 Return = **76.78%**

Changes to S&P 500 Index and Industry Groups

The following are recent changes to the Standard & Poor's 500 structure:

1. (FSR) Firstar Corp. replaces (AN) Amoco Inc. (FSR) added to the Financial Banks Major group.
2. (CCL) Carnival Corp. replaces (GRN) General Re. (CCL) added to the Leisure Lodging Hotel group.
3. (CPWR) Compuware Corp replaces (SAI) SunAmerica. (CPWR) added to Computer Software group.
4. (AOL) America Online replaces (Z) Venator Group. (AOL) added to Computer Software group.
5. (SLR) Solectron Inc replaces (PZL) Penzoil. (SLR) added to Electrical Equipment group.

EDS MODELS



DAVID VOMUND

Follow-Up Analysis On Our EDS Short Model

By David Vomund

In the December, 1998 issue of the Opening Bell, we created a highly effective Expert Design Studio (EDS) model for shorting Standard & Poor's 500 stocks. We received a lot of positive feedback on this model, and we expect that many AIQ users will use it in the year to come. The analysis in this follow-up article should help people to further understand how the model works.

To quickly review the model, there are only three simple criteria that must be met before a stock can be selected as a short candidate. First, the stock must move from below to above its Lower ESA. Second, the stock's Directional Movement indicator must be less than –25. Third, the stock's Volume Accumulation Percent indicator must be less than –20.

The actual model can be downloaded off AIQ's web page at *www.aiq.com.* The EDS file can be found under the Educational Products folder.

When we introduced the model in December, we ran the test using a fixed 10-day holding period. The results of the test are very similar if you use one of AIQ's traditional stop techniques. In **Figure 2** we are displaying the testing results of shorting stocks using a sell strategy of 95% principal protect, and 90% profit protect after a gain of 5%. For those who want a longer holding period, try a 90% principal protect and 90% of profit after a 10% gain.

Over the three-year testing period, there were 184 trades, which equates to 61 trades per year. Some people expressed an interest for more trades. If you want more trades, simply ease the parameters on the Directional Movement and VaPct rules. By requiring the Directional Movement indicator be less than –20 instead of less than –25, 100 more trades are produced and the effectiveness drops only slightly.

> *"We expect many AIQ users will use this model in the year to come. This analysis should help people to further understand how the model works."*

From our testing results we know that the model is effective in picking short candidates. In Figure 2, we see that the average short position gained 1.72% (excluding commissions) with an 11 day holding period. If you would have shorted the S&P 500 index instead of shorting the stocks, the average short trade would have lost 0.3%.

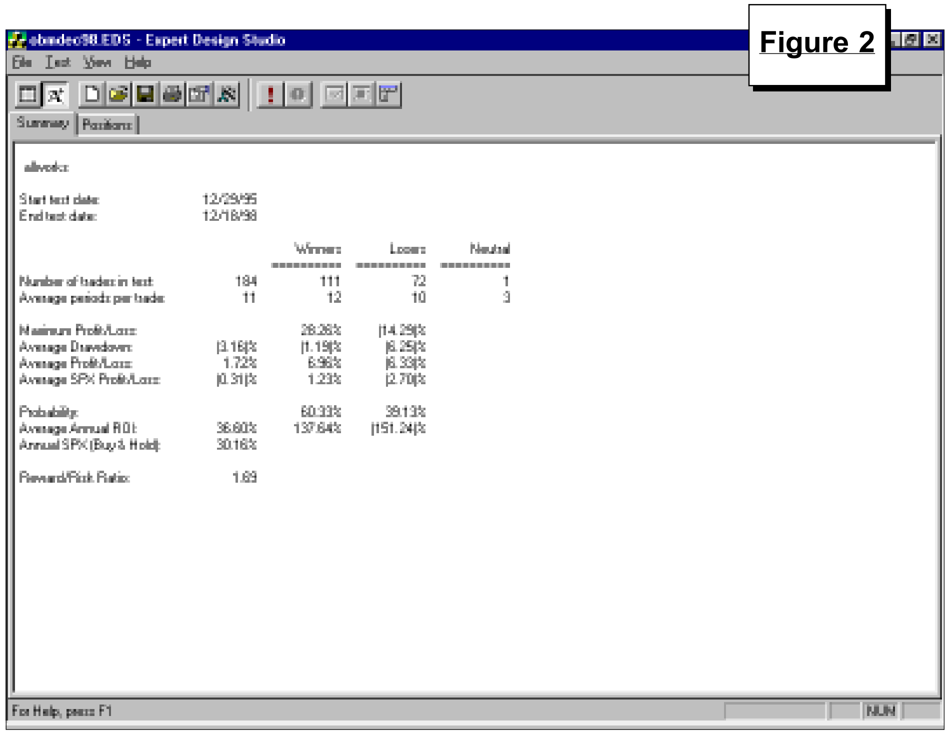
This leads to the question: can this model be used as a market timing model? That is, when a lot of stocks appear on the EDS report on a given day does that mean the market will move lower?

To answer this question, we exported the EDS Positions page to an excel spreadsheet, manipulated the data, and then used the Data Transfer Utility to import the data back to AIQ (I wouldn't recommend this process to anyone!).

The end result of this exercise is displayed in **Figure 3**. In this graph, we show the S&P 500 along with the number of stocks in the S&P 500 that

EDS Models continued on page 8

Figure 2



		Winners	Losers	Neutral
Start test date:	12/29/95			
End test date:	12/18/98			
Number of trades in test:	184	111	72	1
Average periods per trade:	11	12	10	3
Maximum Profit/Loss:		28.28%	(14.29)%	
Average Drawdown:	(3.16)%	(1.19)%	(6.25)%	
Average Profit/Loss:	1.72%	6.96%	(6.33)%	
Average SPX Profit/Loss:	(0.31)%	1.23%	(2.70)%	
Probability:		60.33%	39.13%	
Average Annual ROI:	36.60%	137.64%	(151.24)%	
Annual SPX (Buy & Hold):	30.16%			
Reward/Risk Ratio:	1.69			

EDS MODELS *continued* . . .

appear as short selections using the EDS model. The price scale for the S&P 500 appears on the right while the scale that corresponds to the number of short selections is on the left (a future version of the EDS software will have the ability to produce this graph).

One element is immediately apparent. When the market is in a strong uptrend, no stocks are selected by the short model. No short selections appear from May 97 to August 97 as the market moved higher. Similarly, no stocks appeared from mid-January 98 to May of 98.

More recently, a short candidate appeared nearly every day from July to mid-September, 1998 and there hasn't been a single selection from mid-October through the end of our testing time period.

When the market environment is shaky, the model produces selections and the stocks selected are good short candidates. However, the model is not good at calling market tops. The majority of the selections come after the market has rolled over.

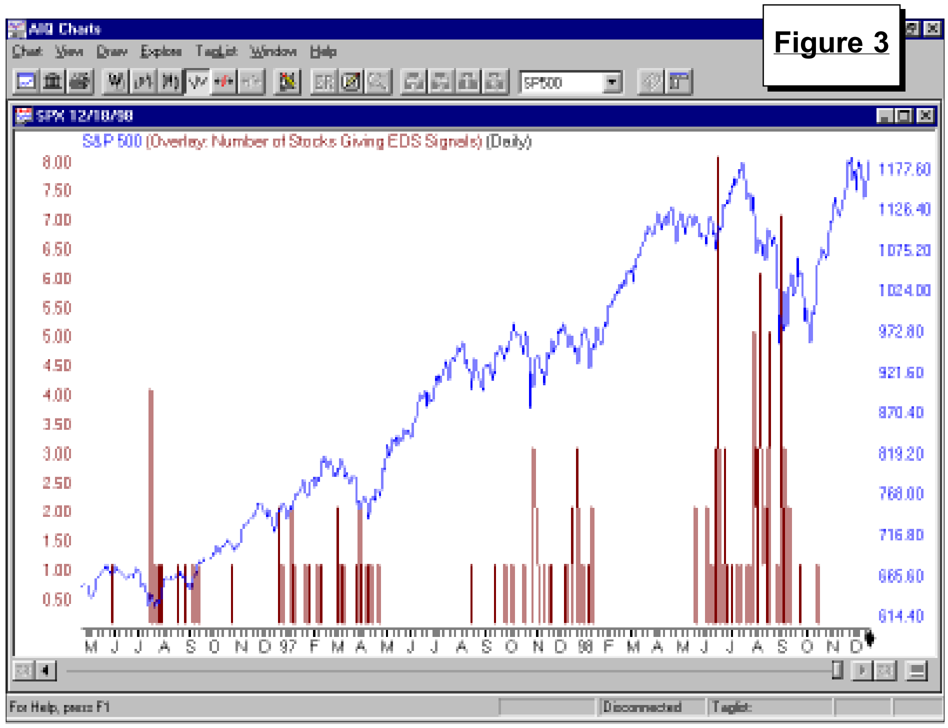


Figure 3

In fact, the time that the most stocks were selected as short candidates came at a near term low. In mid-June 98, there was a day in which eight stocks appeared. This occurred just before the market staged its final advance before the fall correction.

This analysis should help people to better understand how often signals are registered as well as how the model works. ■

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
Dycom Indust.	DY	3:2	01/05/99	VISX Inc.	VISX	2:2	01/14/99
CMGI Inc.	CMGI	2:1	01/11/99	Transamerica Corp.	TA	2:1	01/18/99
Gallery of History	HIST	2:1	01/11/99	Astec Ind.	ASTE	2:1	01/19/99
Flextronics	FLEXF	2:1	01/12/99	Sonic Automotive	SAH	2:1	01/26/99
Intervoice Inc.	INTV	2:1	01/12/99	Guidant Corp.	GDT	2:2	01/28/99

Trading Suspended:

CKS Group (CKSG), Cliffs Drilling Co. (CDG), DeKalb Genetics Corp. (DKB), Special Devices (SDII)

Name/Ticker Changes:

CMG Information Svs (CMGI) to CMGI Inc. (CMGI), Key Energy Group (KEG) to Key Energy Services Inc. (KEG),
Washington Mutual (WAMU) to Washington Mutual Inc. (WM),
Westwood One (WONE) to Westwood One Inc. (WON)