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Feature

Sections

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TRADING TECHNIQUES

AIQ POWER USER JAMES MCCONNELL DISCUSSES 'ASSET ALLOCATION' TECHNIQUES

By David Vomund

James McConnell is a financial services and technology executive with more than 25 years investment experience. He became an AIQ user in 1992 and is now a TradingExpert for Windows power user. Mr. McConnell is a Registered Investment Advisor and a Registered Financial Planner. He specializes in asset allocation and portfolio management for individuals using technical analysis techniques. His services are fee based and AIQ users are eligible for a reduced rate. Mr. McConnell can be reached at (408) 395-5155 or by e-mail at Adviser999@aol.com.

James McConnell

DV: *Thanks for taking the time for this interview. I know that you use other software packages in addition to TradingExpert. What role does TradingExpert play in your analysis?*

JM: AIQ plays a significant role in several areas. It's my key overview of where I think the market is headed and where major components of the market are headed. The decision of which components of the market to concentrate in is often more important than the overall market timing decision. I use the group capabilities of TradingExpert to create what I call "style boxes" to measure the activity of different market components. For example, there is a large company style box, small company style box, growth company style box, and a value company style box.

DV: *It sounds like you've created a group structure to help in asset allocation.*

JM: Yes, asset allocation is basically where you are going to make the most of your gain in investments today. If you decided to allocate your

Trading Techniques continued on page 2

TRADING TECHNIQUES *continued* . . .

assets into the Japanese stock market over the U.S. market for the last year, you would be underperforming. Likewise, if you invest in U.S. securities, the small-cap or large-cap decision is important.

DV: *How do you use AIQ's TradingExpert to determine which area to concentrate in?*

JM: I use AIQ MatchMaker to get a list of stocks and mutual funds that are highly correlated to indexes that measure the style boxes. Some of the indexes that I use are the Barra Growth which measures large-cap growth companies, Barra Value which measures large-cap value companies, Russell Growth which measures small-cap growth companies, and Russell Value which measures small-cap value companies. By running MatchMaker, I get a list of stocks that correlate to each index. These stocks are then placed into separate groups. These groups then represent the style boxes and can be used for either short term trading decisions or for identifying long term trend changes.

With this completed, I'll run reports on these groups and that tells me where my focus should be. My favorite reports are the Price Change - Upside and Group Analysis. These tell me which groups are outperforming. My focus is on what appears at the top of the report as well as what is moving to the top of the report. The best scenario is catching a style box when it first appears in the top position.

DV: *Do you use the default settings on the report?*

JM: I typically use the default settings unless I want to catch a short term trend change. If I'm looking for short term movement, I'll decrease the time period used on the Price Change report.

DV: *Can you give me an example on how you use this technique?*

JM: Looking at the market in August, the Dow peaked on August 7. The Small Company Growth group gave an Expert Rating buy on August 14, which was confirmed by the Phase on August 19. On August 20 its Delta Trend Score was 80, which showed it was moving higher in the report. By August 22 it became obvious that this was the most attractive group. On that day, this group appeared at the top of the Group Analysis report and at the top of the Short Term Upside Price Change report. (See **Figure 1**)

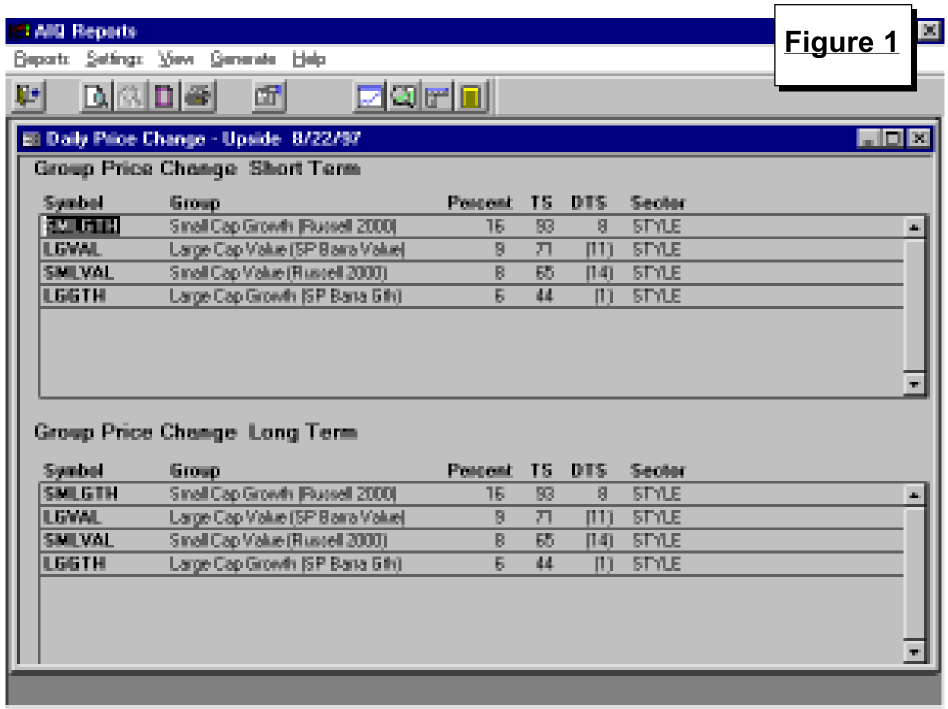

Figure 1

Looking at the charts, the Phase indicator should be increasing. It is best if this indicator is positive as well. The RSMD SPX indicator should also be increasing. The crossover is desirable although not essential. (See **Figure 2**)

DV: *How often do you rebalance using this technique?*

JM: A minimum of once a quarter. I typically run the weekly reports at the end of every week. That doesn't mean I'll make a switch every week. I'll ride out the dips and don't mind it if the Phase indicator starts to decrease. It becomes a concern if the indicator moves below zero, however.

DV: *Much of your focus is in the technology arena and, in a way, following the technology stocks is part of your asset allocation. How do you evaluate the technology sector?*

JM: Living in San Jose, there are many active investors who closely follow the local technology companies. These companies have been the underpinning to the bull market. The leaders in the market have not been the rust belt companies. The

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TRADING TECHNIQUES *continued . . .*

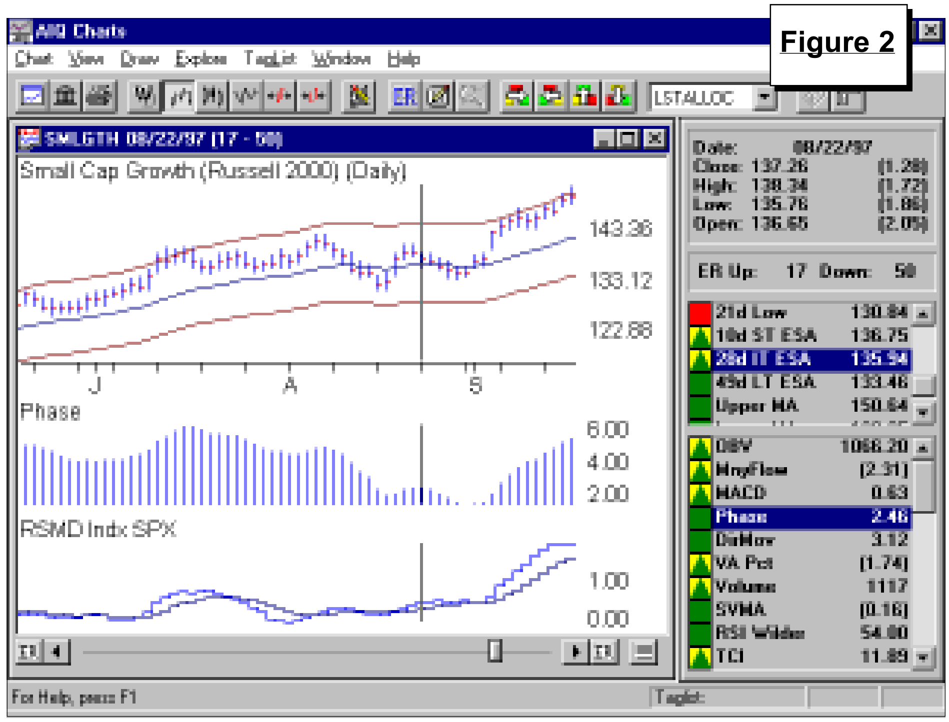


Figure 2

leaders include firms like Intel and Hewlett Packard, both of which are local companies.

DV: *Being that your firm is in Silicon Valley, how much of an advantage is that for you in your technology investments?*

JM: There are advantages. First, the local newspapers print a very nice list of local companies broken down into different technical industry groups. I'll use TradingExpert to create a group structure using these published groups. Being that the companies are local, it is easy to visit them or simply watch their activity. It is better to see a company with a full parking lot with a very active loading dock rather than one with sporadic parking and paint peeling off the walls.

DV: *You create industry groups which represent overall technology companies and some groups that represent local technology companies. How do you narrow down which areas to be in?*

JM: The group/sector analysis in TradingExpert is used to identify areas of strength. Sticking with the local companies, I've created a market of the San Jose technology companies. Within this market are nine industry groups which is what the local newspapers follow. The stock and group reports can then be run just on the San Jose market.

DV: *Which reports are your favorites?*

JM: Much of this analysis is similar to the style box analysis. In addition to the Group Analysis report and the Price Change report, I'll follow the Group's Price Volume Divergence report and the Point & Figure Breakout report as well. I'm not aware of any other software package that takes the price level into account when constructing the Point & Figure charts. The default settings on the Point & Figure charts work well although I do increase the number of months plotted in order to see more historical data.

I'll run the daily stock reports as well. These reports, including the Price Gap report and the Point & Figure Breakout report, are examined to see if a predominance of one type of stock appears. In addition, I look for high Expert Ratings and volume increases because these often precede news items such as earnings and stock split announcements.

DV: *Can you give me an example of your analysis on the San Jose market?*

JM: We'll look at the best buying opportunity this year which came in the early spring. On March 11, the

Trading Techniques continued on page 4

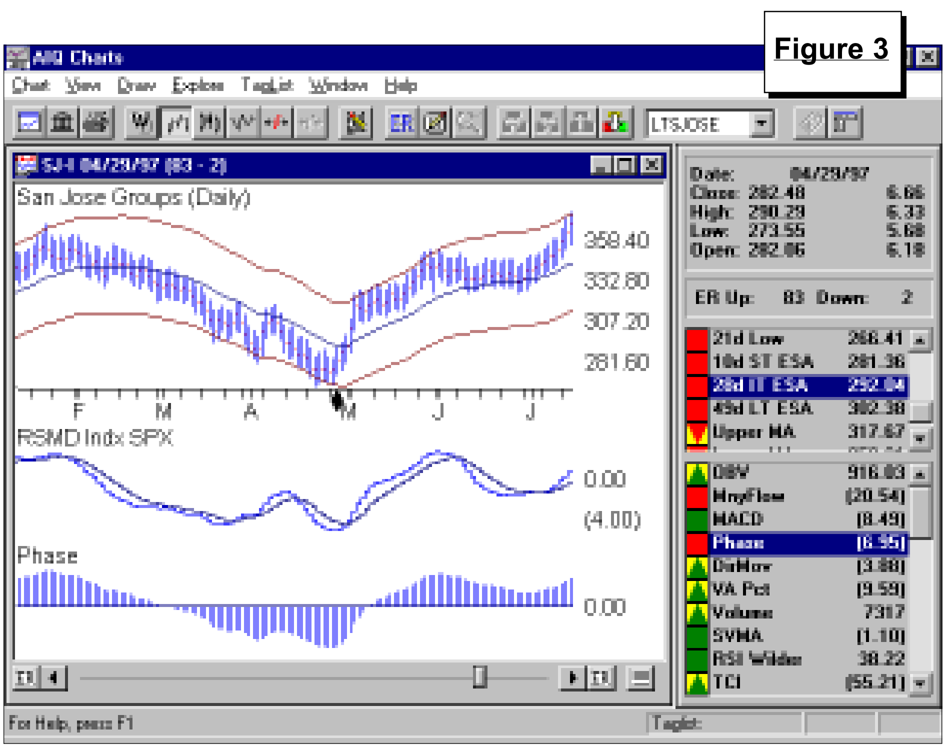


Figure 3

TRADING TECHNIQUES *continued* . . .

Dow peaked. Its low came on April 14 and on April 15 there was an Expert Rating buy signal on the market. It wasn't until April 29 that the indicators turned positive for the San Jose sector (**Figure 3**). That was when the Phase was increasing, the RSMD SPX was increasing, the Trend Score was moving higher, and the Delta Trend Score was nearly 100. Now, which groups do you buy?

The Valley Semiconductor & Equipment Mfg. group gave a 92 upside rating on April 29 (**Figure 4**). That was somewhat bullish but the indicators I follow were all falling into place. The group's Phase indicator was increasing along with the RSMD SPX indicator. Its Trend Score was headed coast-to-coast, from -95 to +99 and its Delta Trend Score was an impressive 109 on April 30.

Within this group, my selection was Applied Materials (AMAT). AMAT gave a 98 buy signal on April 23 and the indicators soon fell into place.

Another attractive group was the Valley Computers & Software group which gave an Expert Rating buy on April 29. Similar to the San Jose sector and the Semiconductor group, Computer & Software's Phase indicator was increasing as was its RSMD. Its Trend Score was not at 100 but it was close and was moving higher. Sun Microsystems and Hewlett Packard were both good selections in this group.

Figure 4

DV: *In earlier conversations, you discussed a locally run technology fund with a money manager that you have a lot of confidence in. Which fund is this and how do you track it?*

JM: The fund is Interactive Technology Value Fund (TVFQX), run by Ken Kam and Kevin Landis (888-883-3863). Kevin recently spoke to our AAII group and is very impressive. The fund's average annual rate of return since inception (mid-1994) is about 50%. You can either buy this fund or closely follow their largest stock holdings (see **Table 1** for their recent holdings).

DV: *Technology stocks most often lead the market higher but they can turn on a dime, as can be seen with recent price activity. Does your asset allocation take care of these turns in the market?*

JM: I've always thought that it is easier picking bottoms in the market rather than tops. The reason for this is that fear is so overpowering when the market bottoms that it is hard to miss. At market tops, on the other hand, everybody gets comfortable and you don't notice what is happening. Expert Ratings help but the market timing model is based on the overall market. Unless a decline is very steep, there are usually some arenas or style boxes that hold up well during a correction. In most cases you don't want to be in technology stocks in a weak market.

To help market timing, I have created some specialized industry groups. One group is comprised of what I call leadership stocks. When the leaders fall, the market usually follows. The leadership stock group is actually a market of a group of stocks that are highly correlated to

Table 1

Interactive Investments Technology Value Fund

Ten Largest Holdings as of 09/30/97

Cisco	CSCO
Medtronic	MDT
Ascend Comm.	ASND
Arterial Vascular	AVEI
Int. Process. Equip.	IPEC
PMC-Sierra	PMCS
Boston Scientific	BSX
Texas Instruments	TXN
HMT Technology	HMTT
Technology Modeling	TMAI

TRADING TECHNIQUES *continued* . . .

the Dow. I'll use MatchMaker to check the correlations and then will visually examine the charts to see if they make sense. This group is set up to give me Expert Ratings that are independent of the normal market timing Expert Ratings.

A case in point came in March of this year. The leadership stock group gave a sell signal on March 6, a week before the market timing sell signal on March 13. It wasn't that I became bearish on the 6th but it gave me an indication that I should be wary and when the market timing sell signal came on the 13, I was mentally prepared for it.

Another recent and excellent example was when the same group of leaders began to show signs of weakness over August and September in the form of a down channel of lower tops and bottoms, declining advances in the Advance/Decline indicator, and a sharp decline in the Money Flow Oscillator (**Figure 5**). Then, on October 15 TradingExpert gave the group of leaders a 5-95 rating.

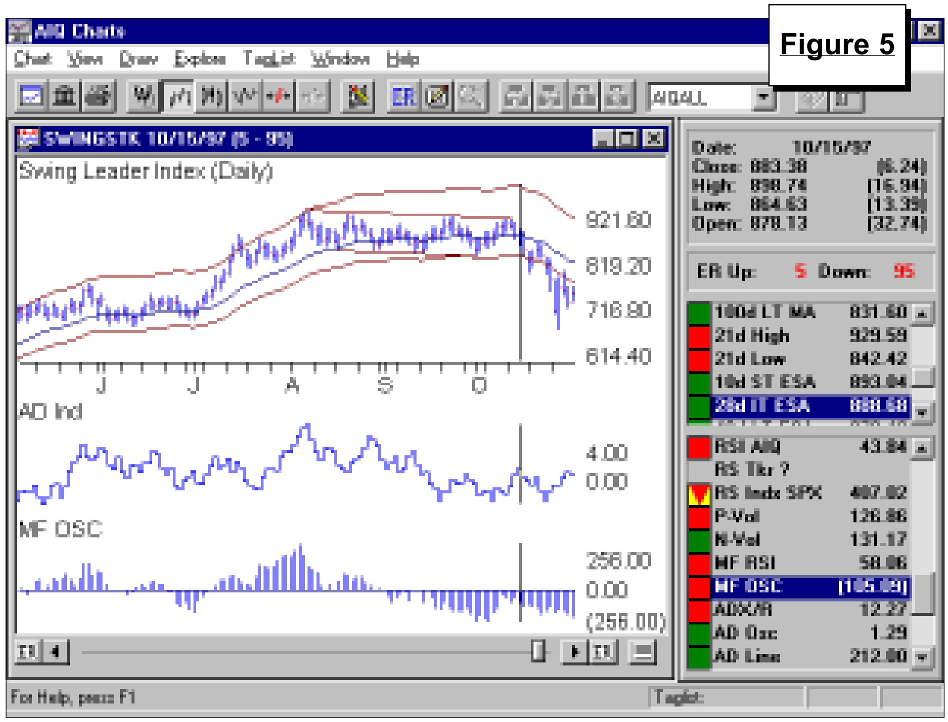


Figure 5

During this same period, the S&P 500 had been rising and topped out on October 7th followed by a more than 100 point decline and more than 10% over the next 14 trading days. The key to being prepared for the decline was developing the right group of leaders and getting timely market breadth signals on the leadership stocks as a separate but closely correlated market.

DV: *Thank you.* ■

STOCK DATA MAINTENANCE

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

Stock	Ticker	Split/Div.	Approx. Date
U.S. Office Prod.	OFIS	3:2	11/07/97
Darling Int'l Inc.	DAR	3:1	11/10/97
Elcor Corp.	ELK	3:2	11/13/97
Helix Tech.	HELX	2:1	11/14/97
Comair Holdings	COMR	3:2	11/14/97
CPB Inc.	CPBI	2:1	11/17/97
Cadence Design Sys.	CDN	2:1	11/18/97
Paine Webber Grp.	PWJ	3:2	11/18/97
EMC Corp.	EMC	2:1	11/18/97
TSR Inc.	TSRI	2:1	11/18/97
York Financial	YFED	5:4	11/18/97

Stock	Ticker	Split/Div.	Approx. Date
Varlen Corp.	VRLN	3:2	11/19/97
Cintas Corp.	CTAS	2:1	11/19/97
Harris Financial	HARS	3:1	11/19/97
Travelers Group	TRV	3:2	11/20/97
Texas Instruments	TXN	2:1	11/24/97
Brightpoint Inc.	CELL	2:1	11/24/97
VF Corp.	VFC	2:1	11/25/97
Southwest Airlines	LUV	3:2	11/27/97
Computer Assoc.	CA	3:2	11/27/97
Allied Group	GRP	3:2	12/01/97

Name/Ticker Changes:

Crown Casino (DICE) to Crown Group (CNGR), Ha-Lo Industries (HALO) to Ha-Lo Industries (HMK)
Hunt Manuf. (HUN) to Hunt Corp. (HUN), Lindsay Manuf. (LINZ) to Lindsay Manuf. (LNN)
Simpson Manuf. (SMPS) to Simpson Manuf. (SIC), Sunrise Resources (SUNL) to Sunrise Int'l Leasing (SUNL)
Tetra Technologies (WATR) to Tetra Technologies (TTI), Texas Industries (TXI) to TXI Corp (TXI)
Tyson Foods 'A' (TYSNA) to Tyson Foods 'A' (TSN)

Trading Suspended:

Columbus Realty Trust (CLB), Horizon/CMS Healthcare Corp. (HHC), Louisiana Land & Expl. (LLX)

SCREENING TECHNIQUES - 2

LOOKING FOR TURNAROUND SITUATIONS USING AIQ'S SCREENING REPORTS

BY David Vomund

Given today's highly volatile market, our series on how to mechanically screen stocks looking for turnaround situations is very timely. We are in the beginning stage of forming a model that will screen for stocks that are down and out of favor but are ripe for a reversal. In the first part of this series, we tested various price patterns. Now we'll turn to reports to see which are the most effective in identifying bullish reversals.

Since we are looking for turnaround situations, we'll apply AIQ's screening reports to stocks that are in clear downtrends. Our goal is to build an effective bottom fishing mechanical screening tool.

To begin our test using reports, we identified five periods where the market corrected, formed a bottom, and then rallied. In each case, we tested several screening reports at the market low (since the database we are using is comprised of 2000 stocks, we often used the Russell 2000 as a measure of the market).

The five dates that we used were 04/20/94, 06/27/94, 12/09/94, 07/23/96, and 04/11/97. These were all great times to buy stocks. Since our focus is on buying out of favor stocks rather than how to time the market, we don't mind this "hindsight is 20/20" market timing analysis.

On each of the five dates, we ran various stock screening reports on a database of 2000 stocks in order to see which reports best picked the bottoms of individual stocks. Since we are searching for turnaround situations, only stocks that were below both their 200-day and their 50-day moving averages were examined. The reports that we tested were Price-Volume Divergence, Persistence of Money Flow, Accumulation/Distribution, and the Weighted Action List.

Table 2

Stocks Chosen with AIQ Reports vs. Russell 2000
Avg.Change from Date of Purchase
For Five Best Market Reversals 1994-97

	1 Day*	5 Day*	1 Month*	3 Month*
Russell 2000	0.00	1.76	4.23	8.41
Price Vol. Divergence	0.16	2.29	4.80	9.10
Persistence of MF	-3.59	1.75	6.26	11.13
Accum/Dist	-0.54	0.95	3.15	8.59
Weighted Action List	0.49	3.32	6.85	9.81

* Time since entry date

Results of testing

The results of our testing are found in Table 2. Listed is the average percentage change of the stocks that fit each pattern over a one day, five day, one month, and three month time period. For reference, we also show the percentage change figures for the Russell 2000 index.

The results from this test are better than what we saw last month when we tested price patterns. This is not surprising since the calculation of the individual reports is much more complex than simply looking at a stock's price bar over the last few days.

The best performing report for the 1 day, 3 day, and 1 month time period was the Weighted Action List. This report lists the stocks that have registered confirmed Expert Rating buy signals. The Weighted Action List beat the market and had higher returns than the other three reports that were tested.

Similar to our findings in earlier *Opening Bell* articles, the Persistence of Money Flow report was a bad performer over short time periods but was the best performer over the intermediate term. This is our best report for people who hold stocks for months rather than weeks.

The worst performer was the Accumulation/Distribution report, which lagged the market for the first month but caught up to the market when looking at a three month time horizon.

Summary to date

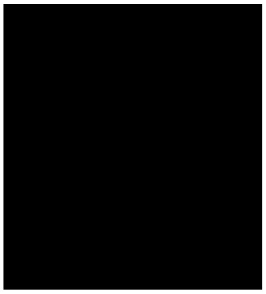
In our two articles on bottom fishing investing, we have tested several screening techniques that can be used to identify reversal situations. Our goal is to develop a model that can be used to select out of favor stocks during a market uptrend or to identify which stocks to purchase when the market undergoes a big selloff and is poised to rebound.

So far, our best screening techniques are outside reversal days (the stock moves lower than its previous day's low but closes higher than its previous day's high) and the Weighted Action List (stocks on confirmed Expert Rating buy signals). These two screening techniques will be used in our final model. We'll also want to incorporate the Persistence of Money Flow report when we build an intermediate term model. ■

GROUP ANALYSIS

More Testing -- Which Groups Stage the Big Moves?

BY David Vomund



DAVID VOMUND

One of TradingExpert's most powerful features is its group analysis capability. Whether you take a top-down approach by analyzing industry groups and then buy the attractive stock(s) within those groups, or a bottom-up approach by confirming that an attractive stock is in a good industry group, the industry analysis is critical. Traders want to make sure that the industry has the propensity to stage a powerful move. People don't trade high yielding utility stocks. They concentrate on groups that are volatile and can make a nice move.

Some industry groups are more likely to stage big advances than others. In a strong bullish market, a technology group very often beats the market's return whereas an electric utility group will typically underperform the market. The question we want to answer is what groups have the propensity to stage big moves.

When we discussed which groups have the propensity to stage big moves in last month's *Opening Bell*, we focused on the AIQ Pyramid industry group structure which contains large company stocks. This month, our focus is on the AIQALL structure, which contains both large and small company stocks.

The AIQALL industry group structure comes free with the TradingExpert software package. It is a large industry structure that classifies about 6000 stocks into industry groups. Anytime you add a stock to your database, it will be automatically placed into an industry group as long as the newly added stock is one of the 6000 stocks classified in the structure.

In calculating our AIQALL structure in this test, I used a database of about 2300 stocks. Some people have larger databases but I find that the maintenance of a large database of stocks is not worth the effort. Many of the companies in large databases are thinly traded, have large bid-ask spreads, and do little to improve the accuracy of industry groups.

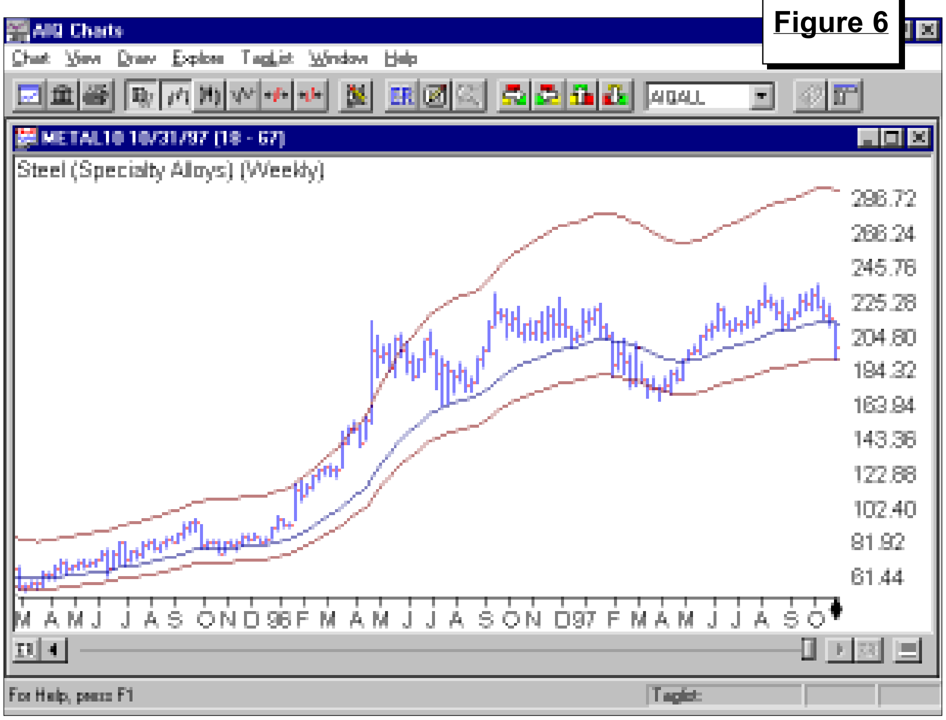
To determine which groups have a propensity to move, we calculated the quarterly returns for the AIQALL industry groups beginning in 1994. We counted the number of times that each group was one of the 15 best performers or one of the 15 worst performers for the quarter. The groups that often rise to the top or fall to the bottom of the quarterly Price Change report are the ones that have the inherent volatility to stage a strong advance or undergo a steep drop.

A list of the groups that appeared most often in the Price Change report appears in **Table 3** (see page 8). The groups are sorted by the number of times that they appear at the top or bottom of the report. Most people expect technology groups to lead the list of volatile groups, and that is just what happened. The group that appeared at either the top or bottom of the Price Change report most often was the Electrical (Semiconductor Equipment) group. It appeared at the top or bottom of the report nine times over our testing time period. Several other technology groups appeared often in our testing.

Some of the groups that appeared often in the Price Change report surprised us. One surprise is the Steel (Specialty Alloys) group

Group Analysis continued on page 8

Figure 6



GROUP ANALYSIS *continued . . .*

which appeared only two times less than the Semiconductor Equipment stocks. Looking at **Figure 6**, we see that this is a group that should not be ignored. The same is true for Retail (Wholesale Computers), Building (Heavy Construction) and Metal (Steel, Pipe and Tube).

If you use the AIQALL industry group structure, your results may be different than our results because the performance of the groups is dependent on how many and which particular stocks are in your database. Nevertheless, it is likely that the results will be close to my figures.

You may want to add an "*" to the description field for the groups that appear in Table 3. That way, when these groups appear on a group report, they'll stand out and you'll pay more attention to them. ■

Table 3

Groups that Move

Industry Group	Count
Electrical (Semiconductor Equip)	9
Retail (Wholesale Computers)	7
Steel (Specialty Alloys)	7
Building (Heavy Construction)	6
Computer (Mainframes)	6
Computer (Software/Games)	6
Metal (Steel, Pipe and Tube)	6
Retail (Consumer Electronics)	6
Computer (Graphics)	5
Computer (Integrated Systems)	5
Computer (Peripheral Equipment)	5
Energy (Alternate Sources)	5
Insurance (Accident and Health)	5
Lasers (System Components)	5
Leisure (Movies)	5
Oil and Gas (US Royalty Trust)	5
Rubber (Tires and Miscellaneous)	5
Transportation (Truck)	5
Beverages (Soft Drinks)	4
Computer (Memory Devices)	4
Electrical (Military Systems)	4
Electrical (Semiconductors)	4
Food (Confectionery)	4
Household (Audio and Video)	4
Household (Textiles & Furnishings)	4
Machinery (Mtl Hdlg and Automation)	4
Media (Periodicals)	4
Medical (Generic Drugs)	4
Metal Ores (Gold)	4
Oil & Gas (US Explorations & Prods)	4
Oil and Gas (Drilling)	4
Retail (Discount and Variety)	4
Retail (Wholesale Food)	4
Retail (Wholesale Jewelry)	4
Schools	4
Tobacco	4
Transportation (Airline)	4
Transportation (Equipment Mfg)	4
Transportation (Services)	4
Transportation (Ship)	4

MARKET REVIEW

Once again, October proved to be an active month for the market. There were wide daily fluctuations, but for most of the month the large-cap stocks were consolidating.

The S&P 500 moved sideways for three months. This consolidation ended on October 27 when the Dow fell about 550 points. That wave of selling continued on Tuesday morning, then a flood of buyers emerged. It only took five business days for the market to recover its 550 point loss.

AIQ remained on a buy signal throughout the month. In fact, it gave a 95 buy on October 20 and a 96 buy on October 21. These buys were mostly a result of a strong Money Flow indicator. On October 21, Money Flow hit a two month high at the same time that the market was below its early October high. Another 96 buy was registered on October 28, the day after the sharp drop.

Now that the market has moved back to its old consolidation level, the 550 point drop does not seem like a big move. On that Monday, it was big.

What indicators pointed toward a correction that the AIQ timing model missed? The only indicator that was very weak was On Balance Volume, which hit a two month low on September 25. That's not enough to warrant an overall bearish stance, however.

A warning sign for those who use the Market Log report was that the WAL score showed that over 90% of the stocks giving confirmed Expert Rating signals were on the sell side. From the October 7 high to the October 27 low, the S&P 500 corrected 10%. Through the beginning of November, we've retraced half of that move. ■

Visit David Vomund's Web site at www.visalert.com.