AIQ Opening Bell® Monthly

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Feature

Sections

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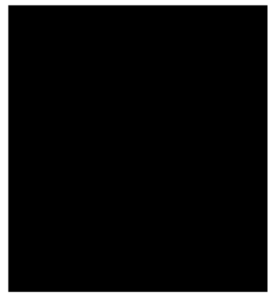
GROWTH INVESTING

'BUY HIGH AND SELL HIGHER' — GROWTH INVESTING WORKS



DAVID VOMUND

By David Vomund

Those new to stock trading often choose to buy stocks that have experienced sizable corrections instead of buying stocks that are near their highs. This is easy to understand because they are attempting to "buy low and sell high." Many equate trading stocks to shopping at a clothing store—if a clothing item has a 20% off sale tag then it is a better purchase. Unfortunately, the same isn't true for the stock market. Those who bought Intel Corp (INTC) in mid-September when it had its "20% off sale" can testify that the stock was no bargain!

Over time, I've learned that good things happen to stocks that are moving higher and bad things happen to stocks that are moving lower. Obviously, I'm a growth investor. Instead of trying to "buy low and sell high," growth investors attempt to "buy high and sell higher."

"Would you consider buying stocks after they have doubled in price in the last three months? This is a highly aggressive strategy and is not for the faint of heart, but the results are phenomenal."

Buying something that is near its highs and "expensive" sounds like a bad strategy but growth investors buy into strength, hoping to ride the stock higher until the strength subsides. Like a surfer constantly looking for a bigger wave, growth investors switch out of faltering stocks and move to better performing stocks.

I often use weekly charts to look for stocks that are trending higher, but are closer to their 28-week moving average than they are to

Growth Investing continued on page 2

GROWTH INVESTING *continued* . . .

their upper AIQ band. Making sure the stock is near is 28-week moving average is simply a way of lowering risk. Testing with AIQ's Expert Design Studio actually shows returns are higher when you buy stocks that are near or even above their upper AIQ trading bands.

To demonstrate that buying high is an effective strategy, I ran an Expert Design Studio screening on stocks that have doubled in price in the last 66 business days but have stalled or moved lower for the last 10 days. Would you consider buying stocks after they have doubled in price in the last three months? This is a highly aggressive strategy and is not for the faint of heart, but the results are phenomenal. In our backtest (**Figure 1**) we see the average stock gained 15.16% over the 31 days following the purchase. This clobbered the Nasdaq 100's average return of 1.24%.

For this backtest we used a time frame of January 2, 1998 to October 16, 2000. There were 91 trades and we used a fixed holding period of 22 business days. Only stocks that were in the Nasdaq 100 index at the start of the year 2000 were purchased. There is an upward bias in our backtest, as some of the stocks we bought were added to the index after we purchased them. Nevertheless, it is clear that stocks that had experienced sizable recent rallies continued to show strength.

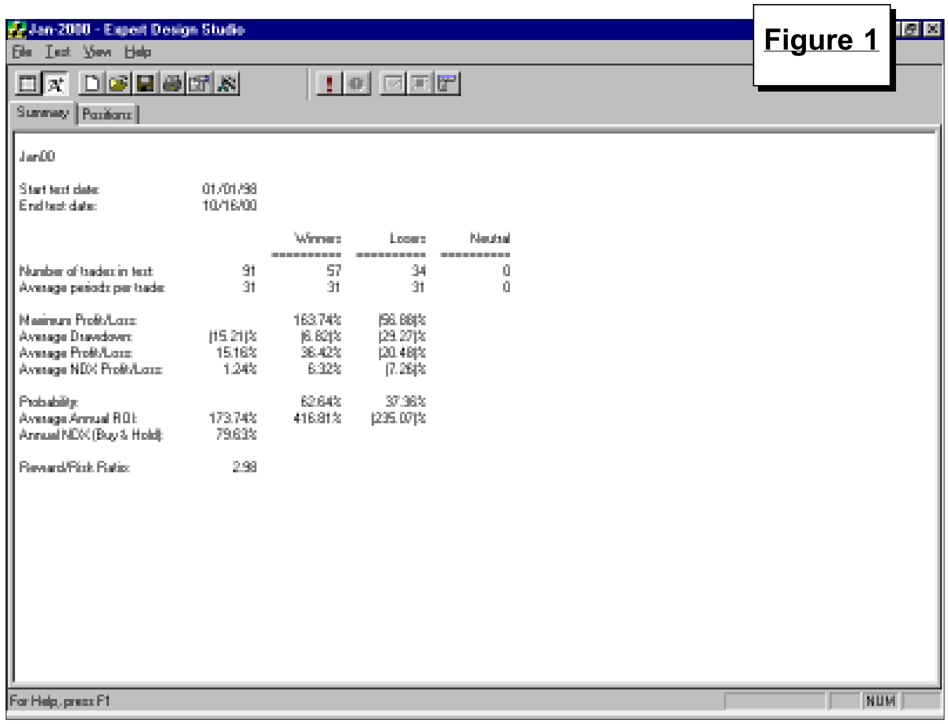


Figure 1

The Expert Design Studio code for this simple model only has three rules:

Uptrend if [close]/val([close],66)>2.

Pause if HiVal([close],9)<val([close],10).

Allworks if Uptrend and Pause.

The first rule called *Uptrend* states that the stock must have doubled in price over the last 66 business days. The *Pause* rule says that the stock has fallen over the last ten days (i.e. Its 10 day high price occurred 10 days ago). This rule was added to take away some of the over-extended nature of the stocks. Finally, the *Allworks* rule states that the previous two rules are true.

If it is true that buying strong stocks is an effective strategy, then it must be true that returns should decrease when we loosen the parameters and buy stocks that are not showing as much strength. For our second test we loosened the parameters for the *Uptrend* rule. Instead of requiring that the stock double in value before it is purchased, we stated that the

Table 1

Summary of Results

Minimum Price Increase Before Purchase	Avg. Gain Per Trade	Number of Trades
100%	15.16%	91
50%	9.32%	312
25%	7.29%	696
10%	7.18%	1031

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GROWTH INVESTING *continued . . .*

stock must increase by 50% before being purchased.

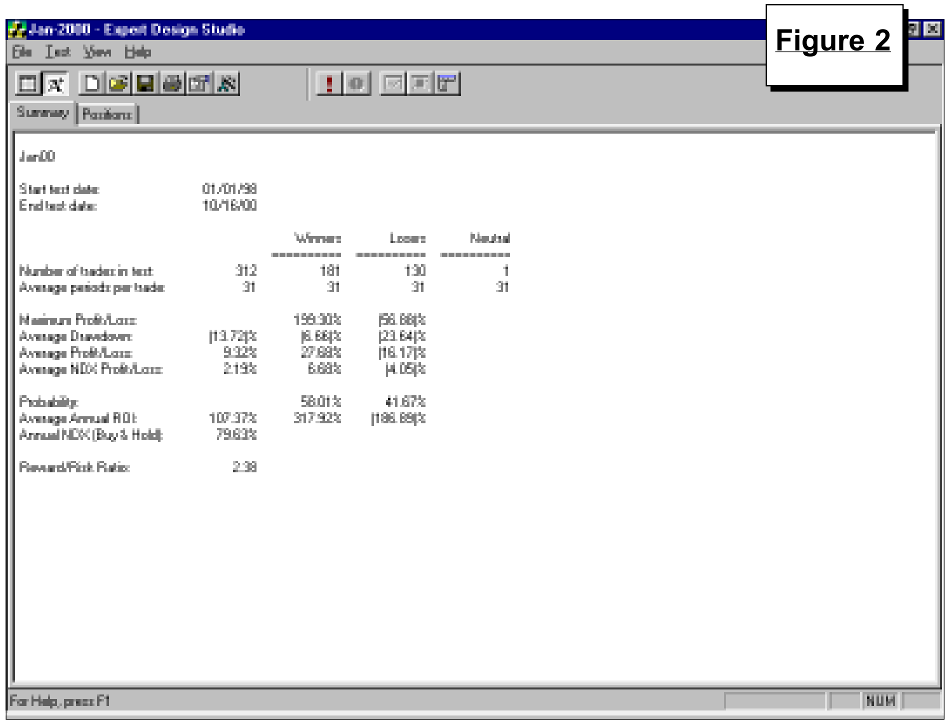
The results are found in **Figure 2**. Using the same 30 day holding period, there were 312 trades and the average stock rose 9.32% after being purchased. This return figure is lower than the 15.16% return from our previous test.

It turns out that the more we loosen the parameters from our *Uptrend* rule the lower the return. If we state that the stock must rise 25% before being purchased then there were 696 trades with an average gain per trade of 7.29%. If we state that the stock must rise only 10% in value before being purchased then there were 1031 trades with an average gain per trade of 7.18%.

These results are summarized in **Table 1**. We see that the more the stocks rose before they were purchased, the more they rose on average after they were purchased.

Our backtesting results are run over a very bullish time period, a period when growth investing was in favor. How has it performed during this year's Nasdaq bear market?

Figure 2



Jan00

Start test date:	01/01/98			
End test date:	10/16/00			
		Winners	Losers	Neutral
Number of trades in test:	312	181	130	1
Average periods per trade:	31	31	31	31
Maximum Profit/Loss:		199.30%	(56.88)%	
Average Drawdown:	(13.72)%	(6.66)%	(23.64)%	
Average Profit/Loss:	9.32%	27.68%	(16.17)%	
Average NDX Profit/Loss:	2.19%	6.68%	(4.05)%	
Probability:		58.01%	41.67%	
Average Annual ROI:	107.37%	317.92%	(186.89)%	
Annual NDX (Buy & Hold):	79.63%			
Reward/Risk Ratio:	2.38			

Figure 3 shows testing results for this year through mid-October. For this test, we said the stock must rise by at least 50% before stalling for 10 days. Despite the enormous correction in Nasdaq stocks, the average gain per trade was still positive at 3.77% with 98 trades. The majority of the trades came in January and February when the market was still strong, but there were trades during the summer and fall correction as well.

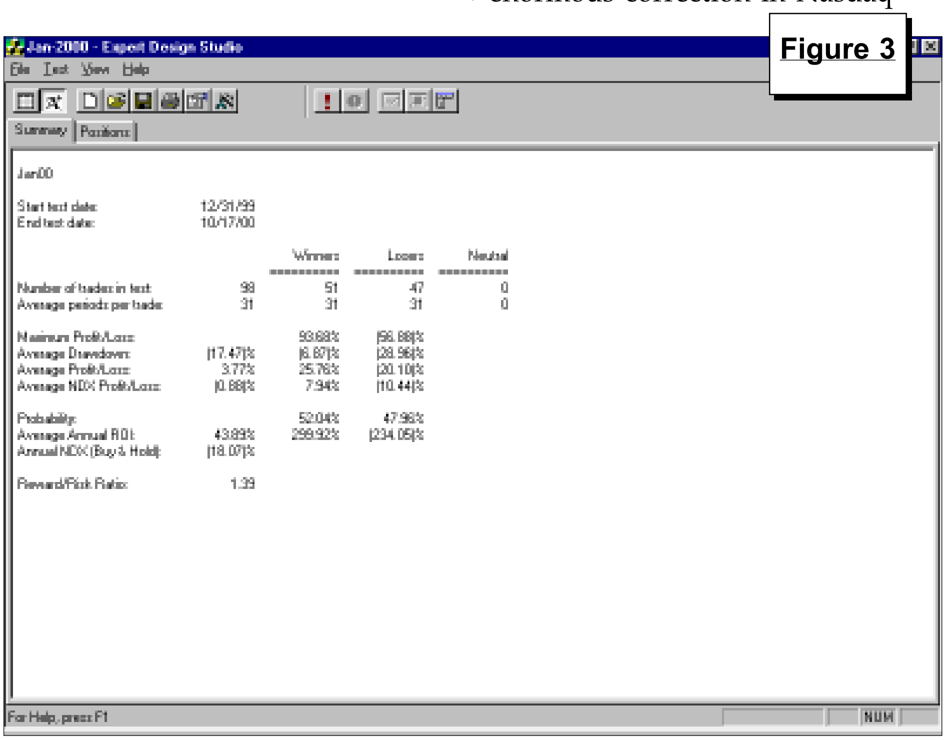
Growth investing doesn't always work. As of this writing the Nasdaq is very low and buying into strength hasn't worked. Nevertheless, there will come a time when the market is strong and Nasdaq stocks are the leaders. That's when growth investors make big money.

This article's focus on growth is not meant to imply that bottom-fishing strategies don't work. In the April 2000 issue we showed an effective Expert Design Studio strategy for buying into weakness.

Growth investing works. Next month we'll discuss how to apply the analysis from this article into an actual trading strategy. ■

David Vomund publishes VIS Alert, a weekly investment newsletter. For a sample copy, call (775) 831-1544 or go to ***www.visalert.com****.*

Figure 3



Jan00

Start test date:	12/31/99			
End test date:	10/17/00			
		Winners	Losers	Neutral
Number of trades in test:	98	51	47	0
Average periods per trade:	31	31	31	0
Maximum Profit/Loss:		93.68%	(56.88)%	
Average Drawdown:	(17.47)%	(6.87)%	(28.96)%	
Average Profit/Loss:	3.77%	25.76%	(20.10)%	
Average NDX Profit/Loss:	(0.88)%	7.94%	(10.44)%	
Probability:		52.04%	47.96%	
Average Annual ROI:	43.89%	299.92%	(234.05)%	
Annual NDX (Buy & Hold):	(18.07)%			
Reward/Risk Ratio:	1.39			

UNDERSTANDING FUTURES - Part 2

Critical Items To Consider Before Engaging In Stock Index Futures Trading

By Edward "Bobby" Florez

Editor: This is the second of two articles on futures trading by Edward Robert "Bobby" Florez. Mr. Florez has been a professional trader, analyst, broker, and author for almost three decades. He retired from the Chicago Board of Trade in 1996 and now devotes his time to helping others learn how to trade. He was featured in the March 2000 issue of Technical Analysis of Stocks & Commodities.

In the October issue of the Opening Bell, Mr. Florez discussed the basics of futures and how futures can give a perspective of financial trends. This month, he continues with a look at interest rates and inflationary indicators, and gives a summary of "market moving" federal and private reports.

Interest Rates *(Figures 4 and 5)*

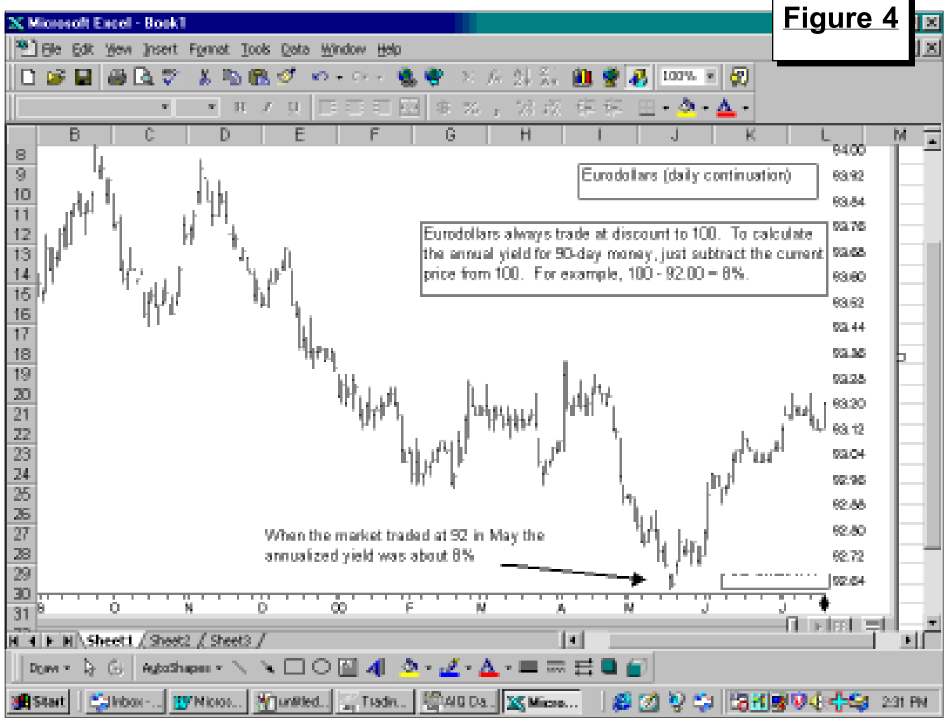
Last month, we discussed the significance of keeping an eye on the trend of the U.S. Dollar against the currencies of its major international trading partners.

After the trader has ascertained the dollar's trend, the next thing to pay attention to is the trend of both short and long-term interest rates.

Again, a quick perusal of the commodity futures prices of Eurodollars and US Treasury notes and bonds provides an excellent perspective of the short-term and long-term trends of interest rates.

The term "Eurodollars" is a bit of a misnomer. Eurodollars actually represent any off shore

Figure 4



dollar deposit. They are equivalent in almost every respect to US Treasury bills, except that they lack federal guarantee. And because of this risk, Eurodollar yields are always a bit higher than a corresponding Treasury bill's yield will be.

Eurodollars are traded worldwide and not just in Europe, as the word seems to imply. It is one of the largest markets in the world, second only to the actual market for US dollars.

For a short-term perspective of interest rate trends, a trader should take a look at the Eurodollar market. The Eurodollar is also traded at the IMM. It is the most widely traded commodity in the U.S., both in terms of volume and total value.

For a longer-term perspective of interest rate trends, a trader should check out the US Treasury Note (maturity of one to 10 years) and the US Treasury Bond markets (maturity beyond 10 years). Both are traded at the Chicago Board of Trade. (end-of-day Treasury Note ticker symbol is NO1600; end-of-day Treasury Bond ticker symbol is TR1600).

All of the interest rate futures contracts trade inversely to interest rates. That is, if interest rates are rising or expected to rise, then all interest rate futures contracts will decline.

Conversely, if interest rates are declining or are expected to decline, then interest rate futures contracts will rise in accord. This can be a little disconcerting for novice traders to comprehend. But they will soon get used to it.

Generally, if the dollar is rising or steady, interest rates tend to be

FUTURES *continued* . . .

relatively stable. The greatest gyration of interest rates occurred between 1978 and the early 1980's. This was a period of great political uncertainty in the U.S. and extreme weakness in the US dollar.

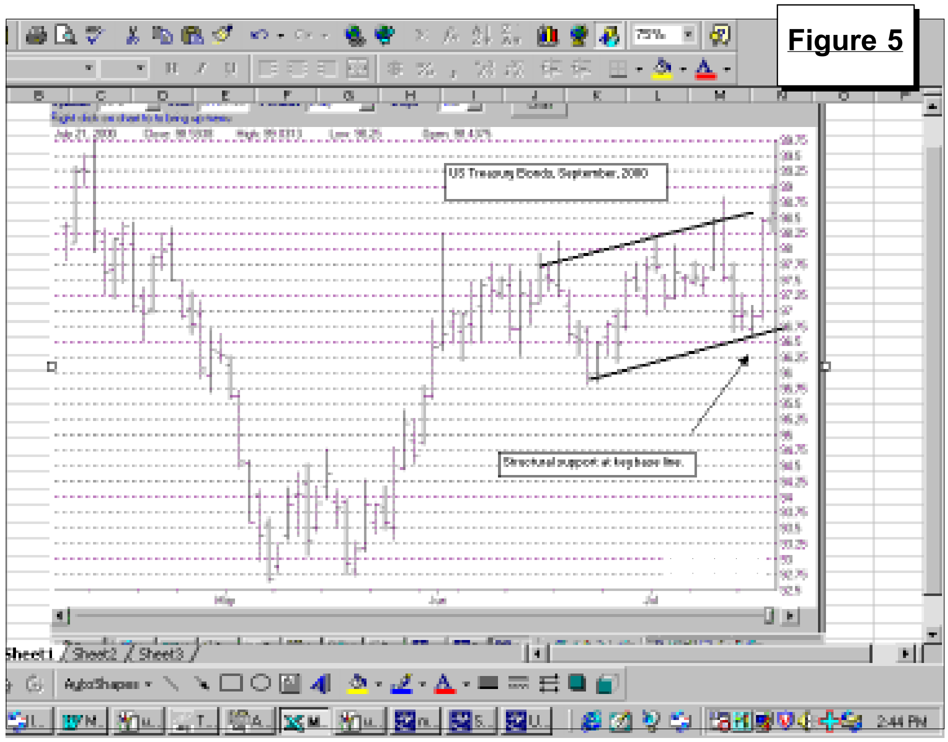


Figure 5

Inflationary Indicators

(Figure 6)

Once the trend of the dollar and interest rates are observed, the trader would then take a look at the CRB Index (the Commodity Research Bureau Index) to get an idea about the overall inflationary trends of many traditional kinds of commodities. This would include markets such as grain, livestock, foods, industrial and precious metals, energy etc. (end-of-day CRB Index ticker symbol is RB1600).

From the trends of these markets, a trader can get an overall perspective of the trend for financial and hard asset values. As a result of this perspective, the trader can form a *psychological* opinion about the position of stock trends relative to these *outside markets.*

Thus, the trader is acquiring a perception of *position risk* in the overall stock market as a result of a change in the dollar, interest rates, or inflation.

Economic Data for a Fundamental Perspective

In order to get a fundamental perspective, a trader should be familiar with the release of market moving information. For federal and private reports, the dates of such releases are pre-announced. Usually, the most important ones occur at the end and beginning of each month.

These reports can be market moving events, and an experienced trader will warily anticipate the actual result as compared to the pre-report estimates. If the report is a surprise — that is, if it falls outside of the pre-release estimates — then it can become a dramatic and immediate market moving event.

Following is a summary of some of these important reports.

Purchasing Managers Reports

At the end of each month, a private report from an association of purchasing managers in Chicago includes an index and comments about their general activity during the previous month.

This report, the National Purchasing Managers Report, is released on the first business day of the month. It reveals a national index of purchasing managers activity and includes the Chicago Purchasing Managers index as well.

If the trader wants to get a tip from the actual market itself about what this report might reveal, all he has to do is take a look at Inflationary Indicators (discussed above) compared to the latest report.

Unemployment

Usually on the first Friday of the month, the U.S. Department of Labor releases figures and comments of national unemployment for the previous month, plus some supplementary figures such as the number of people added to or removed from non-farm payrolls.

This latter figure is volatile but it is one whose trend generally supports the psychological view of the economy. As long as the payrolls figure remains strong, it supports the view that the economy is vigorous and expanding. If the number is shrinking, a weak economy is indicated.

Currently, the figures from the unemployment report are probably the most important ones of the month. They generally set the tone of the market. This is because of the market's immediate psychological perception and anticipation

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FUTURES *continued* . . .

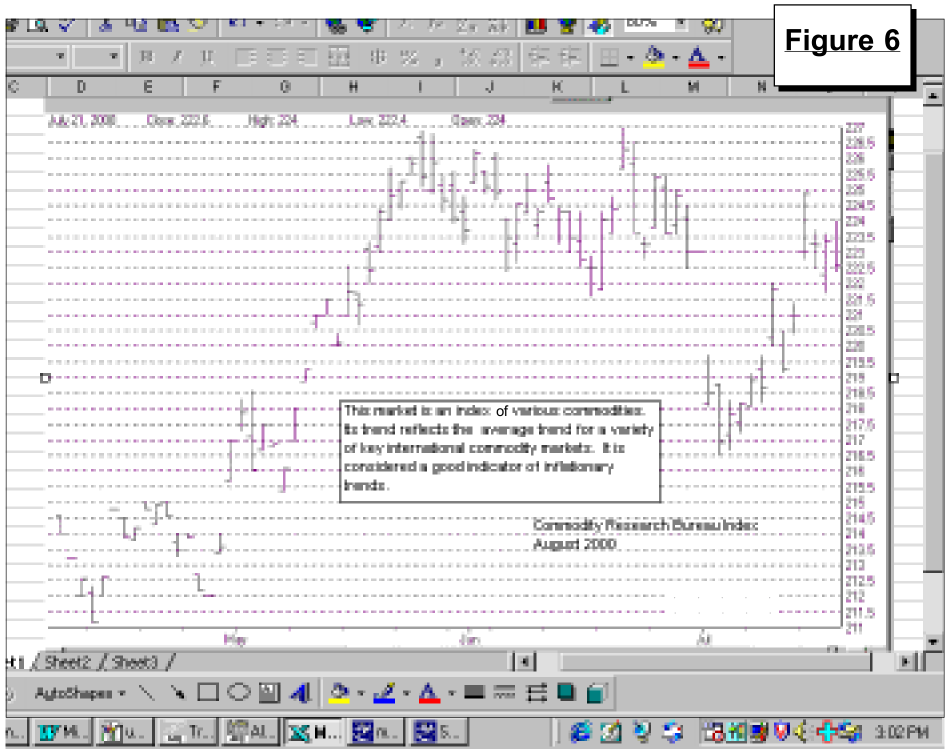
of what the Federal Reserve might do with interest rates.

If these figures reveal a vigorous and strong economy, this invokes the perception that business activity and the demand for goods, services, commodities, and labor is strong. Thus, the cost of these items tend to increase along with wages. If they do, then the Fed may decide to raise the short-term interest rates.

In addition to the monthly reports of employment and payrolls, there are weekly estimates of *jobless claims*. This report is released every Thursday at 8:30 a.m. (EST).

Just like the Inflationary Indicators mentioned above, a trader should take a look at the markets composing the Interest Rates indicator as well. All they have to do is go back one month to the date when the last unemployment report was released. Then take a look at what the interest rate futures have done in the meantime.

If they have *rallied*, then that would be an indication that unemployment may be higher and/or the non-farm payroll number may be lower than anticipated. Conversely, if the rates have increased a bit and the interest rate futures have *declined*, then it would not be



unlikely that unemployment will be lower, or non-farm payrolls will be higher than pre-release reports are anticipating.

There are several other monthly reports that are concerned with inflation. They are PPI (Producer Price Index), CPI (Consumer Price Index), and the estimates of the Quarterly GDP (Gross Domestic Product). All of these reports can have a dramatic impact upon interest rates, the dollar, and subsequently the stock market if the pre-report guesses are way out of line with the report's result. ■

Mr. Florez offers free training online at www.synchronomics.com.

S&P 500 Changes

The following are changes to the S&P 500 Index and Industry Groups:

Broadvision (BVSN) is replacing Paine Webber Group (PWJ). BVSN is added to the Computers-Software & Services (COMPUTES) group.

Nabors Industries (NBR) is replacing Mallinckrodt Inc. (MKG). NBR is added to the Oil & Gas-Drilling & Equip. (OIL&GASD) group.

NiSource Inc. (NI) is replacing Columbia Energy (CG). NI is added to the Natural Gas (NATURALG) group.

Power One Inc. (PWER) is replacing Unicom Corp. (UCM). PWER is added to the Electrical Equipment (ELECTRIE) group.

MARKET REVIEW

Heading into October, AIQ's market timing model was on a buy signal and it fired three additional buy signals in mid-October.

The first 98 up signal was registered on October 13, a second 98 up was registered on October 16, and a third 96 up signal was registered on October 18. Most of these signals were a result of a Stochastic buy signal combined with improving Money Flow and improving market breadth.

When the buy signals were registered, relative strength favored the Dow and S&P 500 over the Nasdaq Composite. After the signals, it was the Dow and S&P 500 that led the way. From the Dow's low on October 18 to the end of the month, the Dow rallied 10%. The Nasdaq rallied 6.2%. ■

MOMENTUM INDICATOR

USE AIQ'S VELOCITY INDICATOR TO FIND OVERBOUGHT AND OVERSOLD LEVELS

By David Vomund

Momentum is a term that is frequently used by technicians. Yet it is a generic term and is not defined by a specific method of calculation. In general, momentum is a term used to describe the rate of change of price movement.

In AIQ's Group and Sector Analysis reports, the momentum of Trend Score is measured by the Delta Trend Score. The MACD is an indicator that measures the momentum of price action. AIQ's purest momentum indicator, however, is Velocity.

The most common calculation for momentum takes the current price of a security divided by its price 21 days ago (the number of days can be adjusted). The problem with this calculation is that it presumes that what happened 21 days ago is just as important as what is happening today. If there was a price spike 21 days ago, then the indicator will show a spike today.

In creating the Velocity indicator, AIQ resolved this problem by applying least squares methodology. It looks at the slope of the line that most closely approximates a momentum or rate of change line. This makes for a smoother and more consistent indicator.

The Velocity indicator has a center line corresponding to the zero level. At this level there is neutral price momentum. Even if a stock is moving higher it can have neutral price momentum. For example, if it gains a point a day over a given week, then the stock rose in value but its momentum stayed constant.

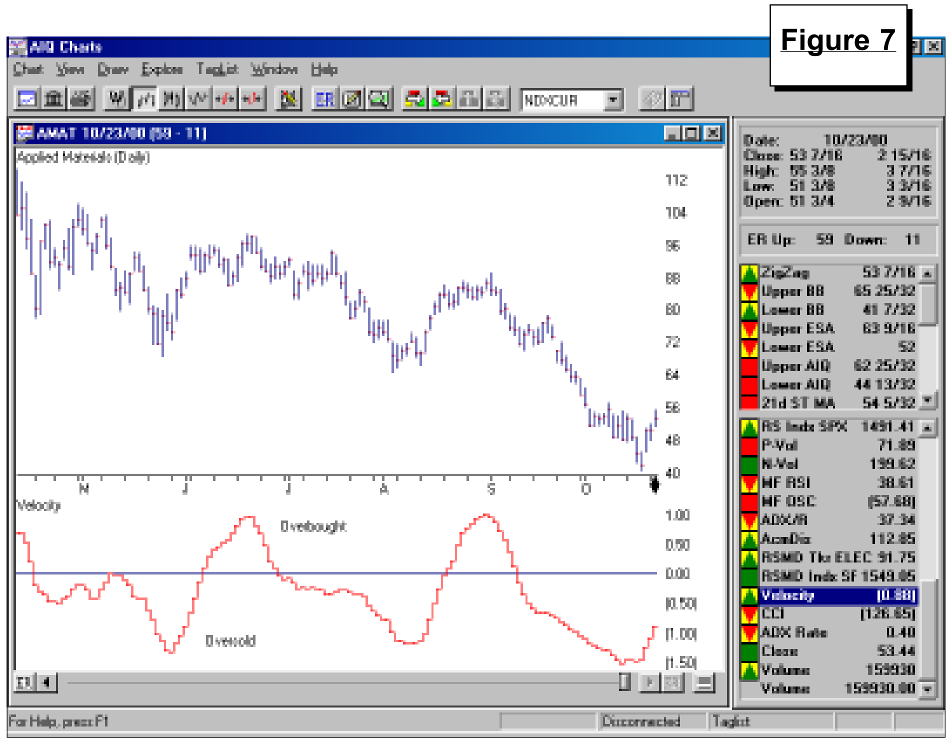


Figure 7

When Velocity is above the zero line and rising, then the security's price is accelerating to the upside. That can occur if a stock gains a half-point one day, a point the next, and two points on the third day.

If, on the other hand, the indicator is below zero and falling, the security's price is accelerating to the downside.

> *"One application for the Velocity indicator is to look for overbought and oversold levels. Another application for this indicator is to look for reversals when the indicator diverges from price."*

One application for the Velocity indicator is to look for overbought and oversold levels. Looking at **Figure 7** we see price reversals occur when the indicator moves to extreme levels.

What is an extreme level depends on the individual stock, and just because the indicator hits an extreme level doesn't necessarily mean the stock will immediately turn. Instead, the extreme readings simply alert you to price reversals that may occur.

Another application for this indicator is to find potential reversals when the indicator diverges from price. A positive divergence occurs when the stock price trends lower at the same time that the Velocity indicator

Momentum Indicator continued on page 8

MOMENTUM INDICATOR *continued* . . .

moves higher. A negative divergence occurs when the stock trends higher but the indicator moves lower. This implies that the new high is occurring on weaker momentum and the stock is vulnerable for a reversal.

In **Figure 8** we see a negative divergence in March through July. Tellab Inc (TLAB) hit a new high in July but the Velocity indicator failed to reach a new high. An exit point is when the support trendline is broken.

A positive divergence occurred in August through October. TLAB was in a pattern of lower highs and lower lows but the Velocity indicator was off its lows. A divergence can last for a long time so you want to wait until there is further indication to buy. TLAB's resistance trendline was not broken.

The degree to which this indicator reflects short-term or long-term price action depends on the time period used in the indicator's calculation. AIQ's default is 21 days. Short-term traders may want to change this to 10 days which should increase the number of divergences. ■

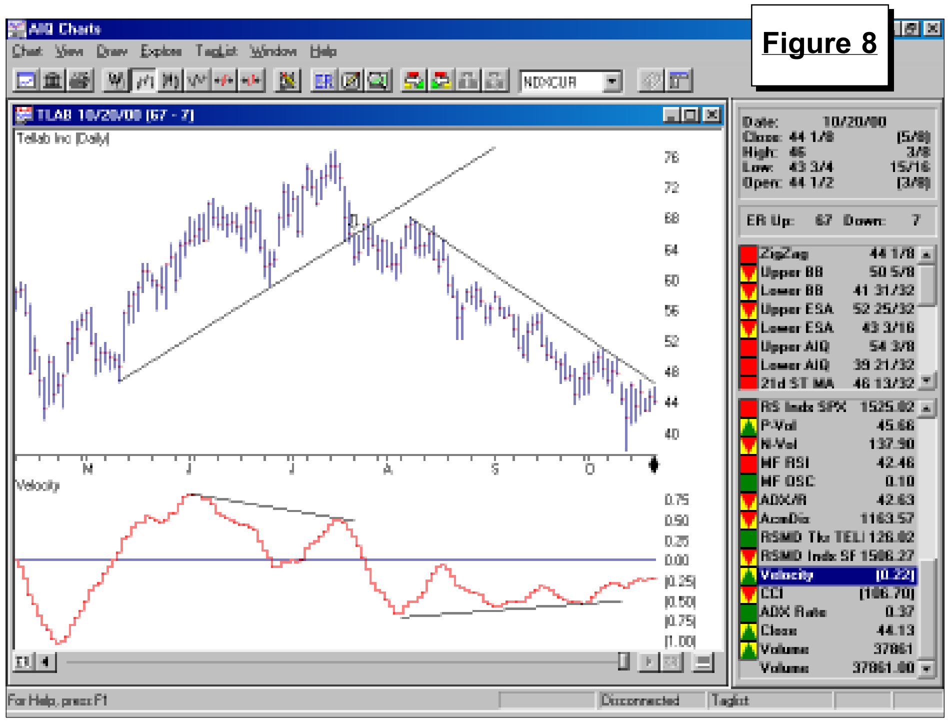


Figure 8

STOCK DATA MAINTENANCE

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

Stock	Ticker	Split/Div.	Approx. Date
Talbots Inc.	TLB	2:1	11/08/00
Park Electro	PKE	3:2	11/09/00
Harleysville Nat'l	HNBC	5%	11/10/00
Eaton Vance	ETN	2:1	11/14/00
E.Piphany Inc.	EPNY	3:2	11/14/00
Documentum Inc.	DCTM	2:1	11/14/00
Calpine Corp.	CPN	2:1	11/15/00

Stock	Ticker	Split/Div.	Approx. Date
BAB Holdings	INCU	2:1	11/21/00
BEI Techs.	BEIQ	2:1	11/22/00
Priority Healthcorp.	PHCC	2:1	11/23/00
Matec Corp.	MXC	3:2	11/28/00
Technitrol Inc.	TNL	2:1	11/28/00
Providian Fin'l	PVN	2:1	12/01/00
Shuffle Mastew Inc.	SHFL	3:2	12/01/00

Trading Suspended:
Allied Products (ADP), Bestfoods (BFO), Eskimo Pie (EPIE), ITC Learning Corp (ITCC), K-tel Int'l (KTEL), United Asset Mgmt. (UAM), Young & Rubicam Inc. (YNR)

Name/Ticker Changes:
Conagra Inc. (CAG) to CanAgra Foods Inc. (CAG)
Men's Wearhouse Inc. (MENS) to Men's Wearhouse Inc. (MW)
NextLink Commun. (NXLK) to XO Communications (XOXO)
Policy Mgmt. Systems (PMS) to Mynd Corp. (YND)