MARKET TIMING USING RSMD

Testing Confirms That AIQ's RSMD Indicator Is Significant Market Timing Tool

By David Vomund

The RSMD indicator plays an important role in my analysis. In past articles, we've discussed how this relative strength indicator can be used to help decide whether to concentrate on Nasdaq or S&P 500 stocks. This indicator can also be used as a market timing tool.

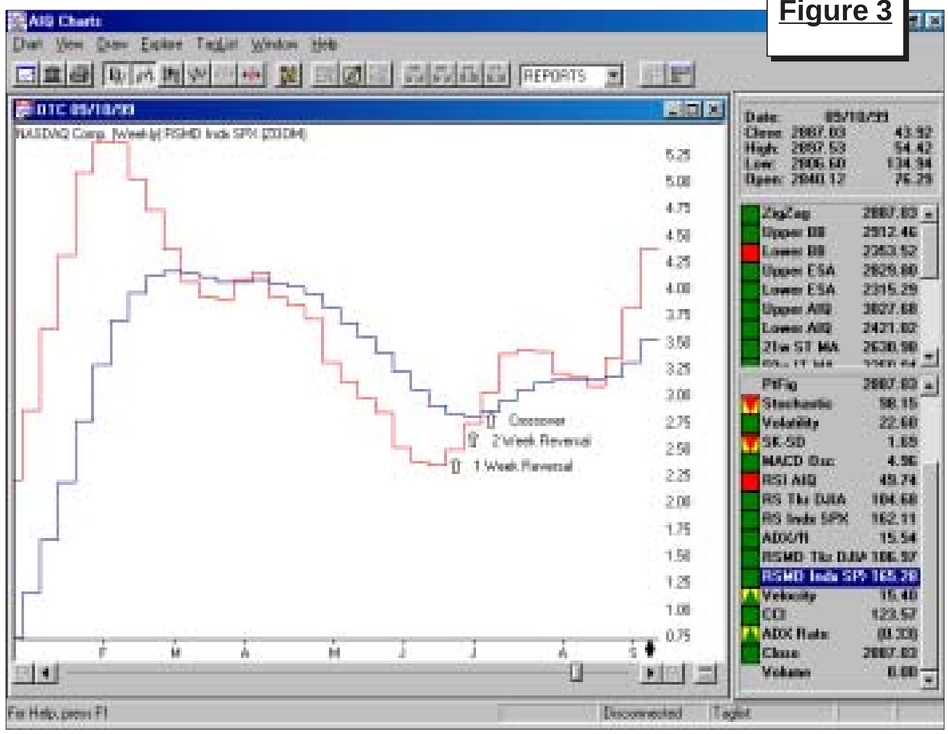
When the RSMD indicator favors the Nasdaq over the S&P 500, then people are willing to take more aggressive positions and the market is generally more favorable. When the indicator favors the S&P 500 over the Nasdaq, then money has moved to more conservative stocks and the market is generally unfavorable. In this article, we'll put this market timing technique to the test.

RSMD is a relative strength indicator that is exclusive to AIQ's TradingExpert. It takes the commonly used relative strength indicator and plugs it into the MACD formula. In effect, RSMD is a momentum of relative strength indicator.

When plotting the Nasdaq Composite (OTC), you plot the RSMD SPX indicator to get the relative strength of the Nasdaq versus the S&P 500. When this indicator is rising then the Nasdaq is outperforming the S&P 500. When the indicator is falling then the S&P 500 is outperforming the Nasdaq.

Although this indicator is designed to tell which of two markets is outperforming, it can also be used for market timing.

Figure 3



We've noticed that the market environment is much more friendly when the Nasdaq outperforms the S&P 500. This is especially true for growth investors but it is also true if you buy non-Nasdaq stocks as well. When the Nasdaq is outperforming then people are willing to aggressively invest their portfolios, implying confidence in the market. The opposite is true when the S&P 500 outperforms.

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We've found that using the RSMD SPX indicator with daily charts gives too many whipsaws but using crossovers on weekly charts is too slow. Rather than changing the settings, we use the indicator in the weekly format and look for a trend reversal of two straight weeks rather than waiting for a crossover.

Until now, we have never tested to see if the two-week reversal is the best use of the indicator. For our test we used a one-week reversal, a two-week reversal, and the crossover of the two lines. Let me explain this with the aid of a graph.

In **Figure 3** we are plotting the Nasdaq Composite's weekly RSMD SPX indicator.

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Table1

Trade Details During Times When OTC Outperforms S&P 500

RSMD SPX 1 Week Reversal Buy Date	Sell Date	S&P 500 % Ch.	RSMD SPX 2 Week Reversal Buy Date	Sell Date	S&P 500 % Ch.	RSMD SPX Crossover Buy Date	Sell Date	S&P 500 % Ch.
2/16/96	6/7/96	3.91	2/23/96	6/14/96	1.03	3/15/96	6/28/96	4.5
8/30/96	10/18/96	9.02	9/6/96	10/25/96	6.90	9/20/96	11/1/96	2.44
12/6/96	12/20/96	1.25	12/13/96	12/27/96	3.86	1/10/97	2/14/97	6.45
1/3/97	2/7/97	5.55	1/10/97	2/14/97	6.45	5/23/97	11/7/97	9.50
4/11/97	4/18/97	3.89	5/9/97	10/24/97	14.17	2/13/98	5/29/98	6.93
5/2/97	6/13/97	9.88	1/30/98	5/29/98	11.29	7/10/98	8/28/98	-11.78
6/20/97	7/4/97	1.50	7/3/98	8/28/98	-10.40	11/13/98	3/12/99	15.00
7/11/97	10/17/97	3.00	11/6/98	2/26/99	8.53	4/2/99	4/16/99	-0.16
1/23/98	3/20/98	14.78	4/9/99	4/23/99	22.16	7/9/99	8/20/99	-4.75
3/27/98	4/10/98	1.30	7/2/99	8/13/99	-4.57	8/27/99	3/31/00	11.15
4/17/98	5/22/98	-1.09	9/3/99	10/29/99	0.42	9/1/00	9/15/00	-3.61
6/26/98	8/21/98	-4.59	11/12/99	3/24/00	9.41			
9/25/98	10/2/98	-4.03	6/16/00	8/4/00	-0.10			
10/30/98	2/19/99	12.79	9/1/00	9/15/00	-3.61			
4/2/99	4/16/99	1.95	1/19/01	2/16/01	-3.05			
6/25/99	8/6/99	-1.14						
8/27/99	10/22/99	-3.46						
11/5/99	3/17/00	6.88						
6/9/00	7/28/00	-2.54						
8/25/00	9/8/00	-0.79						
1/12/01	2/9/01	-0.27						

TradingExpert's Zoom feature was used to make the indicator cover the entire screen. This helps us to more clearly see the movement in the indicator. When the indicator's fast line is rising then the Nasdaq Composite is outperforming the S&P 500, making for a more bullish market.

*Tip: To expand an indicator plot to fill the entire chart window, position your mouse cursor on the indicator plot and press the **Z** key. Pressing the **Z** key again restores the indicator plot to its original size.*

A buy signal using the RSMD SPX indicator is when the fast line crosses above the slower signal line. A quicker interpretation is to simply look for direction changes instead of crossovers. For example, in Figure 3 the indicator was moving lower in April and May but began to reverse direction in June. Using a one-week reversal method, we buy when the indicator rises for the first time (see first arrow). Using a two-week reversal method, we wait for the indicator to rise for two consecutive weeks (see second arrow). Finally, we tested the indicator using a crossover of its signal line (see third arrow).

Since we are testing the indicator's market timing effectiveness, in our testing we purchase the S&P 500 index during time periods when the Nasdaq Composite outperforms and then move to cash during time periods when the S&P 500 outperforms. The reason we purchase the S&P 500 instead of the Nasdaq Composite is because we are testing for market timing and the S&P 500 is a better measure of the entire market.

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Table 2

Summary Statistics (1/1/96 - 03/23/01)

	S&P 500 % Return when the SPX Outperforms	S&P 500 % Return when the OTC Outperforms	Trades Per Year	% of Time in the Market
1 Week Reversal	9.72%	72.00%	4.0	52%
2 Week Reversal	28.60%	76.39%	2.8	54%
Crossover	33.64%	38.00%	2.1	48%

Past performance does not guarantee future results

The trade-by-trade results for the one-week and two-week reversals are found in **Table 1**. We see that using a one-week reversal technique, the Nasdaq Composite's RSMD SPX indicator was moving lower until February 16, 1996, the week the indicator first rose in value. We purchased the S&P 500 on the following day's opening price and held it until June 7, 1996. June 7 represents the day that the indicator had its first decrease in value. Funds were moved to the money market on the following day's opening price.

Table 2 shows the all-important summary statistics. The time period of our testing is from January 1996 through March 23, 2001. This time period includes both bull and bear markets.

Previous to the study, we believed that the market was more favorable when the Nasdaq outperformed the S&P 500. Our study confirmed this is the case. Looking at the one-week reversal method, the five year return was only 9.72% when you bought the S&P 500 during time periods when the RSMD indicator favored the S&P 500 over the Nasdaq. However, by buying the S&P 500 when the Nasdaq Composite was outperforming, the return dramatically increased to 72%. This demonstrates the most critical point of this article: *the overall market is more bullish when the Nasdaq outperforms the S&P 500.*

Further examining Table 2, we see that the highest return was realized by waiting for the RSMD SPX indicator to rise or fall on two consecutive weeks before making a market timing move. The return using this technique was 76.4%. Waiting for a crossover of the two lines is too slow a technique as its overall return fell to 38.0%.

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To use this two-week reversal strategy, plot the Nasdaq Composite (OTC) and display its RSMD SPX indicator. Once this indicator rises for two consecutive weeks, then buy the S&P 500 index. Hold the S&P 500 until the indicator falls for two consecutive weeks, at which time move to cash and wait for the next signal.

By using the two-week reversal method, the 1995 to March 2001 return was 76% with an average of only 2.8 trades per year. Although this return is about 10% less than buying-and-holding the S&P 500 over the same time period, the results are exceptional since you are in the market only about 54% of the time.

Before applying this market timing technique, verify the two-week reversal trade dates in Table 1. Once you can duplicate the trade dates on your system, then you understand the technique.

When viewing the weekly RSMD SPX indicator, you should plot as little data as possible and use the Zoom feature to more closely see the indicator. To detect the buy and sell signals, you must look at the movement of the indicator lines on the chart rather than the RSMD indicator value, which is meaningless.

In next month's *Opening Bell*, we'll perform the same study using the S&P 500's MACD indicator. ■