EXTREME GROWTH INVESTING

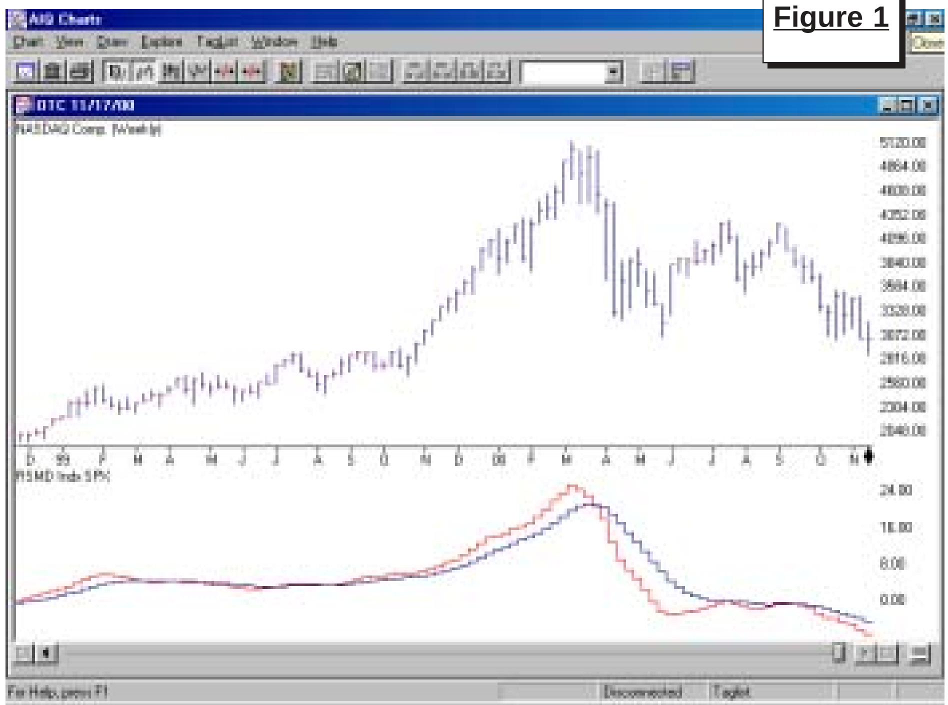
Growth Model Update: Narrowing Down Which Stocks To Buy

By David Vomund

Growth investors buy stocks in strong uptrends. The higher the stock rises before being purchased the more risky the position after the purchase. Although one wouldn't expect that buying a stock after it doubles in price would be a good strategy, historical testing shows otherwise.

Growth investing is very risky and is appropriate for those who can accept a lot of volatility. I've found growth investing works best when the Nasdaq outperforms the S&P 500. Looking at **Figure 1**, we see a weekly chart of the Nasdaq Composite along with its RSMD SPX indicator. Using this indicator, the Nasdaq outperforms when the RSMD SPX indicator is rising. It is during these time periods that growth investing typically works well.

Figure 1



In the November *Opening Bell* we used the Expert Design Studio to demonstrate that buying stocks after a large advance was actually an effective strategy. One model that we used looked for stocks that have increased by at least 50% in the last 66 business days but have stalled or moved lower for the last 10 days. Testing results over the last three years produced very good results. During strong bull markets, however, more stocks can appear on the list than is possible for most people to purchase.

For this article, we tested a number of indicators to further narrow our growth model. The indicator that we found added the most value is Volume Accumulation Percent (VaPct). This indicator is similar to Money Flow in that it looks at whether the stock closes near its daily high or low price and then factors in volume.

> ***"During strong bull markets, more stocks can appear than is possible for most people to purchase...The indicator that we found added the most value (to further narrow our growth model) is Volume Accumulation Percent."***

It is bullish when a stock closes near its daily high on heavy volume. The higher the level of VaPct, the more bullish the stock.

Here is the code for our Expert Design Studio model:

```
Uptrend if [close]/val([close],66)>1.5.
Pause if HiVal([close],9)<val([close],10).
VA if [VA pct]>25.
Allworks if Uptrend and Pause and VA.
```

The *Uptrend* rule states that the security must increase by at least 50% in the last 66 business days. The *Pause* rule states that the stock must have fallen over the last ten days (i.e., its 10 day high price occurred 10 days ago). This rule is included to take away some of the over-extended nature of the stocks. The *VA* rule states that Volume Accumulation Percent must be above 25. Finally, the *Allworks* rule states that the previous three rules are true.

This model can be downloaded from the internet by visiting *www.aiq.com*. Click on *Educational Products* and then *Opening Bell*

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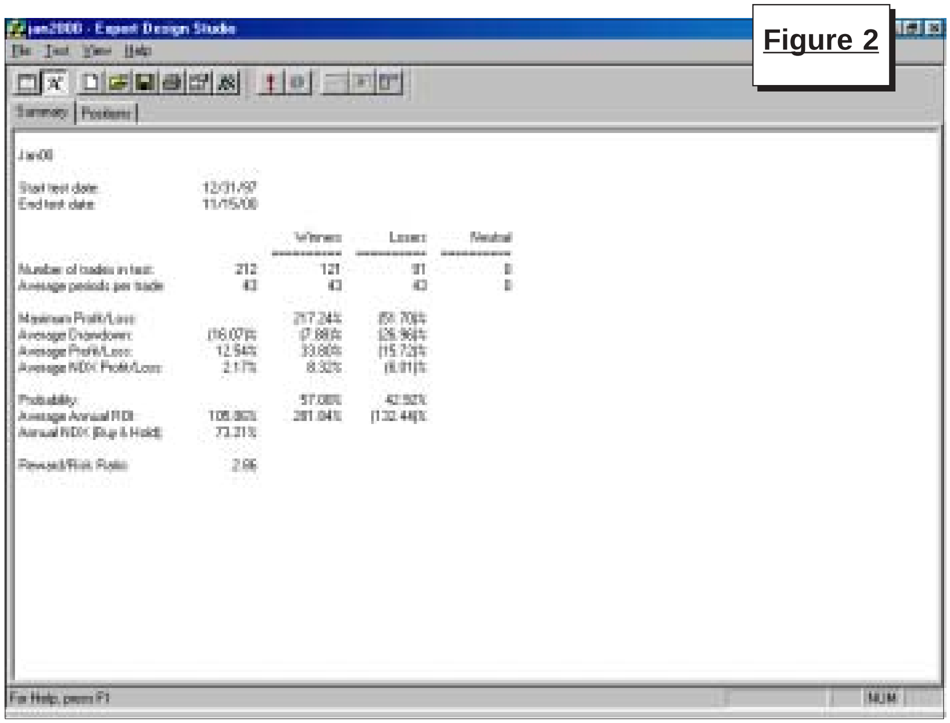
Monthly.

The levels of the *Uptrend* and *VA* rules can be changed depending on how many stocks you want to pass the model.

Looking closely at the *VA* rule, the level of the VaPct directly affects performance and how many stocks pass the test. The higher the level, the better the results. In **Figure 2** we ran a test from 12/31/97 to 11/15/00 using a database of Nasdaq 100 stocks. We ran the model but said the Volume Accumulation Percent level must simply be above zero. A 30 day fixed holding period was used. We see the average gain per trade was 12.54% versus a 2.17% return in the Nasdaq 100 index.

In **Figure 3** we changed the model to state that VaPct must be above 25. Results are much improved — the average trade gained 24.18% compared to 5.75% in the Nasdaq 100 index. The number of trades is dramatically reduced, however. When we required the VaPct to be above zero, there were 212 trades. By requiring the indicator to be above 25, the number of trades was reduced to 22. This testing demonstrates that growth investors can use the level of the Volume Accumulation Percent indicator to narrow down which stocks to buy.

Figure 2



Jan00

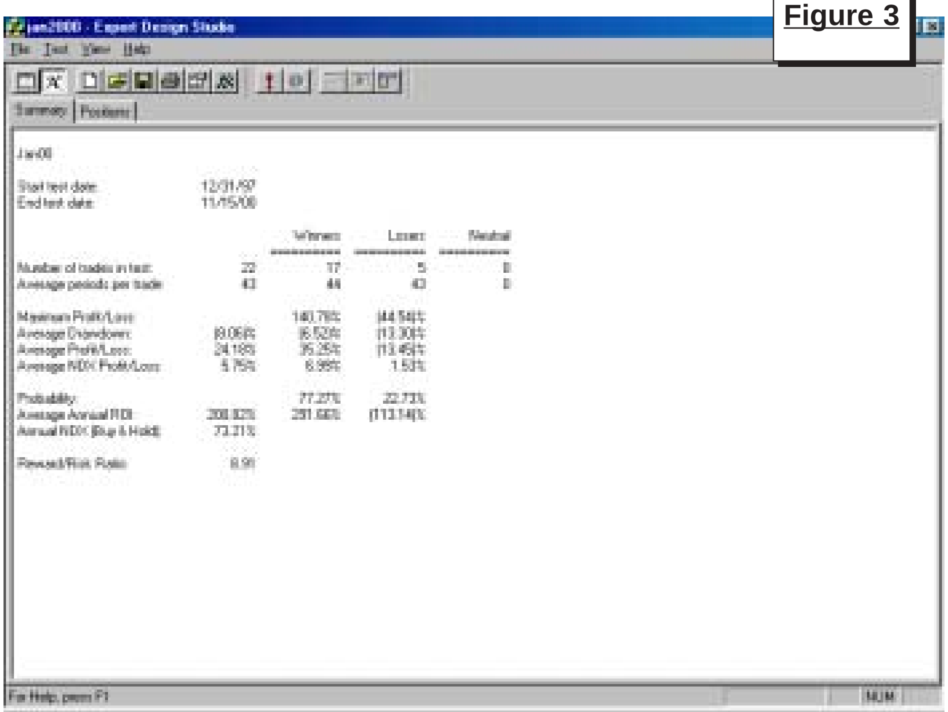
		Winners	Losers	Neutral
Start test date:	12/31/97			
End test date:	11/15/00			
Number of trades in test:	212	121	91	0
Average periods per trade:	43	43	43	0
Maximum Profit/Loss:		217.24%	(51.70)%	
Average Drawdown:	(16.07)%	(7.88)%	(26.96)%	
Average Profit/Loss:	12.54%	33.80%	(15.72)%	
Average NDX Profit/Loss:	2.17%	8.32%	(6.01)%	
Probability:		57.08%	42.92%	
Average Annual ROI:	108.86%	281.04%	(132.44)%	
Annual NDX (Buy & Hold):	73.21%			
Reward/Risk Ratio:	2.96			

Using the level of the Volume Accumulation Percent indicator is one way of determining which stocks to buy. Another method is to use chart pattern interpretation. In our Expert Design Studio model we said that the stock must have paused for 10 days after staging a strong rally. Very often, you can connect a trendline on the high prices during the 10-day pause. The stock is not a buy until the trendline is broken.

An example of this technique is found in **Figure 4**. Here, KLA-Tencor (KLAC) experienced a strong rally until mid-January. At that time, KLAC entered its 10-day pausing period. By connecting a trendline to the high points during this period we establish its short-term resistance. It wasn't until February 2 that KLAC gave its buy signal by rallying above its resistance trendline.

In our Expert Design Studio screening we stated that the Volume Accumulation Percent indicator needs to be above 25. When examining a chart, I prefer to look at VaPct's sister indicator, Money Flow. The advantage of

Figure 3



Jan00

		Winners	Losers	Neutral
Start test date:	12/31/97			
End test date:	11/15/00			
Number of trades in test:	22	17	5	0
Average periods per trade:	43	44	43	0
Maximum Profit/Loss:		140.78%	(44.54)%	
Average Drawdown:	(8.06)%	(6.52)%	(13.30)%	
Average Profit/Loss:	24.18%	35.25%	(13.45)%	
Average NDX Profit/Loss:	5.75%	6.98%	1.53%	
Probability:		77.27%	22.73%	
Average Annual ROI:	308.82%	251.66%	(113.14)%	
Annual NDX (Buy & Hold):	73.21%			
Reward/Risk Ratio:	8.91			

EXTREME GROWTH INVESTING ***continued*** . . .

plotting Money Flow is that it is easier to spot divergences. Ideally, you want the Money Flow indictor to be stronger than the price trend.

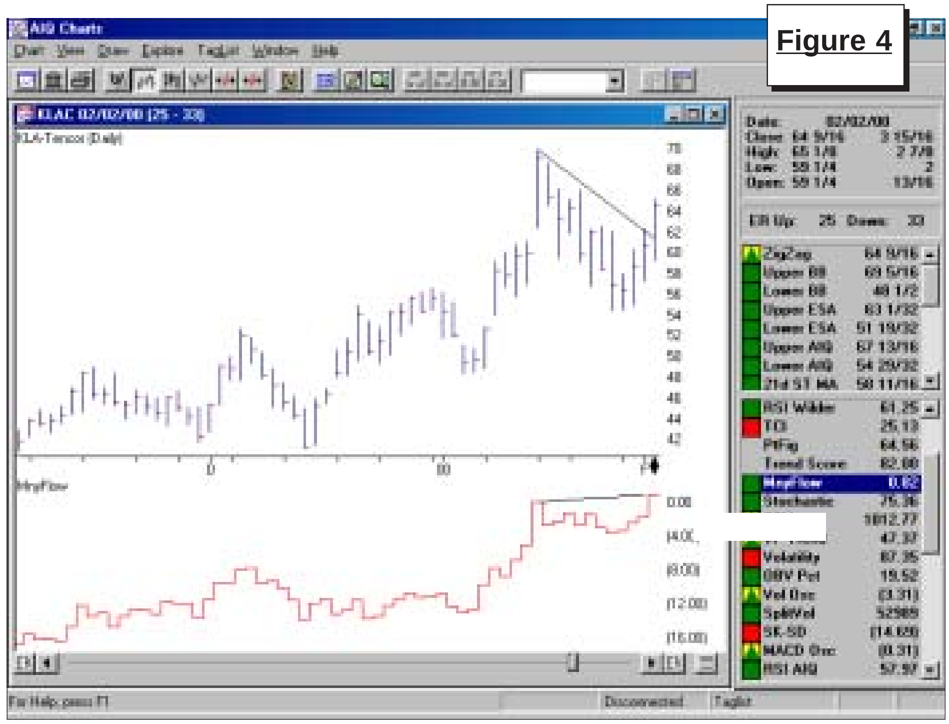


Figure 4

In Figure 4 we see that KLAC was below its 10-day high but the Money Flow indicator was hitting new highs. Another example is Broadvision Inc. (BVSN) on 12/10/99 (**Figure 5**). Along with other growth stocks, BVSN experienced a strong rally in October and November. Then it began to pause. A trendline is drawn connecting the high points during the pause. A buy occurs once the trendline is broken. At the same time BVSN began to stall, its Money Flow indicator continued advancing and was hitting new highs.

In some cases, price can move sideways during its 10-day pause instead of moving lower. I encourage you to pull up a chart of SDL Inc. (SDLI) on 03/04/99. SDLI experienced a strong rally and then in February began to move sideways. A horizontal resistance trendline can be drawn connecting its high points. The buy came when this trendline was broken. While SDLI moved sideways, its Money Flow indicator continued to move higher.

In our analysis we've looked at trendline analysis and Money Flow analysis. Of the two, trendline analysis is more important. When using our Expert Design Studio model, some stocks fall dramatically during the 10-day pausing period. When this happens, you won't be able to draw a good trendline so these stocks are not purchased. In other cases, trendlines are drawn but never broken so the stock is not purchased. Look for stocks that have an orderly 10-day pause and where a trendline can be drawn connecting two or three high points. This style of investing provides incredible returns during the right market environment. As of this writing, growth investors are not doing well but that will change. The best time to apply this strategy is when the Nasdaq outperforms in a rising market. ■

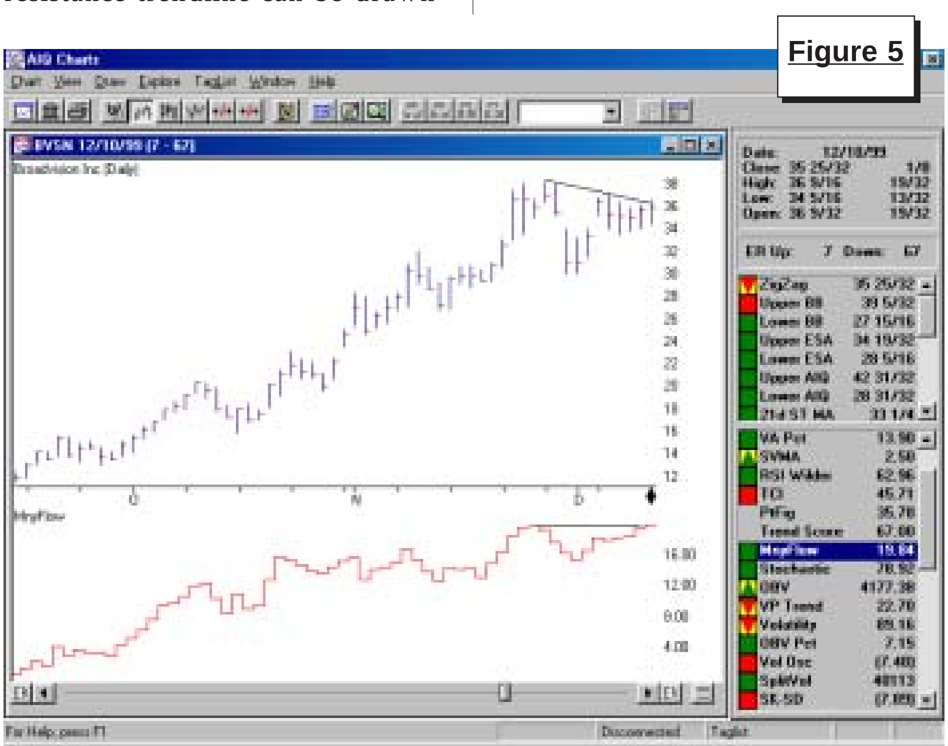


Figure 5

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