THE NASDAQ-100 SIGNALS

The NASDAQ-100 timing signals use a mix of traditional and proprietary technical analysis to create computerized Buy (Up) and Sell (Down) signals for the future direction of the NASDAQ-100. The signals are 100% mechanical. That is they are based on programmed buy and sell RULES that have worked in the PAST and there is no discretionary judgment required. These rules collectively make up the trading system which is run nightly to issue signals for the next market day. An important aspect of this system is that it is ALWAYS in the market predicting either an UP or DOWN move in the NASDAQ-100. There are never any "STOP" signals predicting you should NOT be invested. Every UP signal is ALWAYS followed by a DOWN signal and vice versa. The logic of the rules is based ONLY on the past action of the NASDAQ-100 Index from 01/02/1987 to the PRESENT in terms of PRICE, VOLUME, and TIME.

The **MAIN RULES** used try to determine if there is a trend in price or not and then act accordingly.

- If price has moved UP ENOUGH to define an **UP TREND** then the system issues an UP SIGNAL.
- If price has moved DOWN ENOUGH to define a **DOWN TREND** then the system issues a DOWN SIGNAL.
- If there is NO TREND AND price has moved UP ENOUGH to be **OVERBOUGHT** then a DOWN SIGNAL is issued.
- If there is NO TREND AND price has moved DOWN ENOUGH to be **OVERSOLD** then an UP SIGNAL is issued.
- The only other main rule, that deviates from the above rules, is if price has been **TRENDING** DOWN ENOUGH that the market may now be considered a bargain because it is **OVERSOLD** ENOUGH then an UP SIGNAL is issued.

All the other **MINOR RULES** are rules that look at short-term price and volume **PATTERNS** that may sometimes form and contradict the main rules and either:

- Delay or cancel the signals from the main rules until conditions are more favorable and in line with the main rules. For instance if the market has now entered an UP TREND and the main logic wants to issue an UP SIGNAL but the last few days have been way above average up days and the short-term odds are now for a short-term pullback (down move) then the UP SIGNAL may be filtered out for a period of time.
- Take short-term high probability trades contrary to the main rules. For instance if the market has entered an UP TREND and the logic of the main rules have issued an UP SIGNAL that is expected to continue BUT short-

tem price and volume patterns indicate a good chance of a short-term pullback a DOWN SIGNAL may be issued to try to capture a few days profit from the expected short-term move down. After a short time period has passed then another UP SIGNAL would be issued by the slower responding main rules still in effect.

Notice that in the above descriptions of the main rules I use the word "**ENOUGH**". What is enough? That is the million dollar question. The answer is that I let the computer backtest the various system parameters daily ("enough thresholds") to determine what optimized thresholds were most profitable in the PAST and then use those. That means that as "new history" is generated over time the "best" NASDAQ-100 thresholds can change and therefore so can past signals! I think that is a "plus" that allows the system to slowly adapt to conditions over time but be aware that many if not all academicians would disagree. They would point out that any change, however small, in the logic of a trading system means you are now using a DIFFERENT trading system and therefore you cannot rely on the performance of the "new" system until you have seen it perform in real time for an extended period and created a new track record. For this same reason you should also be aware that if I can find additional rules (based solely on past action of the NASDAQ-100 itself), that I believe are conceptually sound and that in my opinion improve the overall historical performance by working synergistically with the systems existing rules, I may decide to add them to the system in the future. These "system improvement" factors should be considered additional risks to the investment and system risks discussed in the **RISK** section below.

INVESTMENT VEHICLES

In order to attempt to profit from the above mentioned signals one must purchase an investment. You can't make or lose money until you do. You have to be in to have a chance to win. Because the signals are based on the NASDAQ-100 stock index I believe it is best to pick an investment that moves as closely as possible with the up and down movements of this index. This means for our purposes Exchange Traded Funds (ETF's) such as QQQ, QLD & QID, or Mutual funds that correlate highly with the NASDAQ-100 index. According to my research the greater RISK but also the greater potential reward is to be found by investing in the **RYDEX NASDAQ-100 2x Mutual funds** - symbol RYV**Y**X (for UP signals) and RYV**N**X (for DOWN signals). These funds attempt to produce a return TWICE the underlying movement of the NASDAQ-100 Index. The 2x return

(return - not to be confused with profit) is NOT due to my signals. It is due to being invested in the 2x RYDEX funds that use leverage to try to produce returns, based on the movement in price of the NASDAQ-100 Index, that are TWICE the UP & DOWN movement of the NASDAQ-100. So this means that…

- If on a given day the **NASDAQ-100 is UP** 1% the RYV**Y**X (RYDEX Long Strategy) should move UP approximately 2% (make money), and the RYV**N**X (RYDEX Inverse Strategy) should move DOWN approximately 2% (lose money).
- Likewise, if the **NASDAQ-100 is DOWN** 1% then the RYV**Y**X (RYDEX Long Strategy) should move DOWN approximately 2% (lose money) and the RYV**N**X (RYDEX Inverse Strategy) should move UP approximately 2% (make money).

Whatever profit or LOSS you might incur by investing in the movement of the NASDAQ-100 is simply approximately doubled. The 2x funds can give you close to a double return when the market is moving in your favor and can double your loss when the market moves against you.

RISK

My understanding is the RYDEX funds use such investment vehicles as EQUITY INDEX SWAPS, OPTIONS and/or FUTURE CONTRACTS on the NASDAQ-100 in order to try to achieve the "extra" return on the movement of the NASDAQ-100. One thus runs the RISK of making less than the return of the NASDAQ-100 if the market does not move "enough" in your favor to overcome any "premium" paid for the use of the leveraged investments used. In addition I would assume one runs even greater RISK of severe and perhaps total loss in the event of a global economic collapse than if one was just invested in the NASDAQ-100 without leverage. In a financial collapse other institutions, which RYDEX uses to create the leverage, may be unable to honor their financial contracts with RYDEX.

When using the 2x Rydex funds our RISK and potential reward are approximately doubled. If we are right we can make nearly twice as much and if we are wrong we can LOSE nearly twice as much. This means we must be willing to watch our account go DOWN 50%! I say this because in backtesting I've seen the account equity correct (give back profits) of 23%. Indeed you yourself have probably seen individual stocks go down at least this much since individual stocks often move more than the indexes which represent the movement of a group of stocks as a whole. If the NASDAQ-100 makes a sudden extreme move like during the 1987 crash or if we invest based on signals that are wrong (LOSE money) five or more times in a row - then we may find not only that we have a 25% loss, based on the corresponding movements of the NASDAQ-100, but that because we are using Rydex 2x funds our loss is actually nearly double this - or 50%! In other words this is a strategy that I think most experts would define as being EXTREMELY RISKY – at least if you define risk as VOLATILITY as most experts do! One can potentially lose ALL ones money when investing in the stock market and with 2x funds this can happen TWICE as fast! In order NOT to lose one must be right more often than one is wrong and/or one must lose less when one is wrong than one makes when one is right. Obviously this is not easy to do or there would not be so many people who underperform the S&P 500 and/or lose money when investing in equities.

SUMMARY

The NASDAQ-100 trading system issues signals, based on the hindsight of past NASDAQ-100 movements (which is NO GURANTEE OF FUTURE RESULTS), to make an "educated guess" about the future direction of the NASDAQ-100. One may then use these signals in an attempt to make money by using investments such as the RYDEX mutual funds. When the signals are right about the future UP or DOWN direction one can make money and when the signals are wrong one will LOSE money.

The **reasons I like this strategy**, as I personally use it with the RYDEX funds, are:

- You are always in the market and thus always have a chance to make money and catch the next trend or market move.
- You have a chance to make money in both an up and down trending market as well as in the up and down movements of a sideways market.
- When using the RYDEX funds for signals in a TD Ameritrade account there are no commissions, no SEC sell side fees, no minimum investment size, no minimum holding period and every dollar goes to work for you since you can buy fractions of a share with mutual funds.
- With the RYDEX funds you have the chance of doubling the return of the NASDAQ-100 if you get the direction right. I don't know about you but I would guess that most investors, who are long a portfolio of stocks in an up market, make money but don't usually beat the market by a factor of nearly 2!
- For most investors to have a chance of beating the market by a factor of 2 they must employ the use of margin. Margin rates are often expensive and you cannot use margin in a retirement account because you run the

risk of losing more than you have invested. RYDEX funds, including the inverse funds used to profit in a down market, can be used in a retirement account because you cannot lose more than you invest in them. You can however make or lose money twice as quickly.

- You don't have to monitor the performance of a portfolio of stocks but only your one RYDEX position. Less work.
- Although you hold only one position at a time you have the diversification and financial size of the stocks that make up the NASDAQ-100 index which limits your risk. Compare this to holding the stock of one individual company that can then announces earnings, after the close or before the open of the market, which causes the stock to gap up or down in price before you have a chance to act.
- The computerized signals are 100% mechanical and based on the action of the NASDAQ-100 only. This takes emotion, ego, and subjective judgment out of the signal equation and allows NASDAQ-100 action alone to force it to correct its "mistakes". Thus there is no way you can end up holding a losing position just because some analyst thinks the market should be going the other way or because the dollar, or some commodity, or some economic indicator is "indicating" the market "should" be behaving differently than it is.
- The system that generates the signals is self-adjusting. Although the rules are fixed the thresholds that trigger each rule are constantly backtested from 1/1/1987 to the present and each day signals are generated from the current optimized set of parameters. So the hope is that if the trading characteristics of the NASDAQ-100 slowly change over time so will the system.
- The system has performed very well now for over two years in independently verified real time.

This strategy, as defined above, should be considered **EXTREMLY RISKY** because of:

- The use of the RYDEX 2x funds as investment vehicles which can double losses when the signals are wrong and which may not be profitable even if the NASDAQ-100 moves in the direction of the signals.
- The daily optimization of system parameters.
- The possibility of new rules being added to the system, which generates the signals, by the system developer.

Because of the risky nature of the above strategy one should only invest money one can afford to lose in this approach!

The NASDAQ-100 system only provides you with signals which may, and often will, prove to be wrong in their future prediction of NASDAQ-100 movement. How you use these signals is up to YOU! The strategy outlined above is only how I use the signals in my own account and is NOT and should NOT be considered investment advice. You should consult with your own financial advisor before deciding if and how you wish to use the signals in your own personal financial situation.