

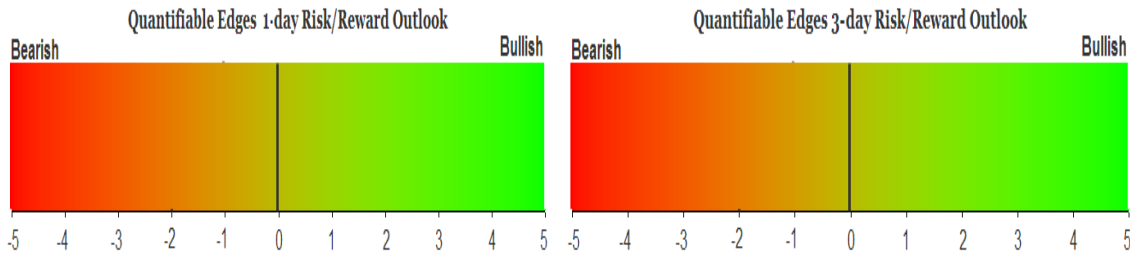
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 16, 2010

Volume 3 Issue 30

Market Overview



Tonight's Research Points

- The gap down and move up on Friday could be viewed as bullish or bearish depending on how you design the study suggesting no substantial edge.
- New Follow Through Day research suggests the Nasdaq provides better risk/reward than the S&P 500 following FTD's.
- The Aggregator System changed to flat at Thursday's close.

Short-term Outlook – updated 2/16

The Bottom Line

The studies just aren't showing a strong edge at this point. Additionally the market has performed right in line with expectations over the last few days. This leaves me without a decent short-term edge. I'm playing the waiting game to see if the market tips its hand here in the next few days.

Summary of Recent Active Studies (see <http://QuantifiableEdges.blogspot.com> or Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Max Move
Active				
February 12, 2010	2 of 3 75% Up Issues % No 10-day high	1-9 days	Bearish	-4.40%
February 12, 2010	IBD Follow Through Day	1-6 days	Bullish	2.70%
February 5, 2010	2% Drop 10 low bottom 10% range	1-7 days	Bullish	4.50%
Active - Long Term				
February 16, 2010	Nasdaq/S&P RS Indicator Positive	int. term	Bullish	
February 12, 2010	IBD Follow Through Day	int. term	Bullish	
February 8, 2010	Worden %>200ma - %>40ma > 40	3 - 7 weeks	Bullish	
February 1, 2010	McClellan -60 for 6 days in a row	1-20 days	Bearish	
January 13, 2010	No bearish divergence at high	int. term	Bullish	
Dropped Tonight				
February 12, 2010	Friday before Presidents Day	1 day	Bearish	
February 9, 2010	Put/Call Ratio 3-day spike	1-4 days	Bullish	2.50%

If the avg max move is achieved the study will appear in **bold italic blue** and no longer be active.

The Evidence

After a big gap down the market made its lows within 15 minutes on Friday. It fought its way higher throughout the rest of the day and finished near its highs. The SPX didn't quite get positive as it finished down 0.3%. The Nasdaq and Russell 2000 did manage some gains, closing up 0.3% and 0.9%. Breadth was mixed as the NYSE Up Issues % came in at 52% but the Up Volume % was just 43%. Total volume rose again Friday and was above average.

Friday's action was certainly interesting, but I'm not sure it was terribly predictive. The large gap and partial rebound brought about an interesting study from the 2/23/09 Subscriber Letter. I've updated those results below:

SPY gaps down over 1%, closes below yesterday's close but more than 0.5% above the open. But on close. Sell X days later. \$100k/trade. 1993 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	36,252.62	30	20	10	66.67	4,069.86	-4,514.46	0.90	1.80	1,208.42
9	47,416.89	30	23	7	76.67	3,339.25	-4,197.99	0.80	2.61	1,580.56
8	53,085.67	31	19	12	61.29	4,307.82	-2,396.92	1.80	2.85	1,712.44
7	45,889.43	31	20	11	64.52	4,088.31	-3,261.53	1.25	2.28	1,480.30
6	52,981.42	32	23	9	71.88	3,854.32	-3,963.12	0.97	2.49	1,655.67
5	42,573.71	34	20	14	58.82	4,093.26	-2,806.53	1.46	2.08	1,252.17
4	35,470.09	36	21	15	58.33	3,552.01	-2,608.14	1.36	1.91	985.28
3	21,813.37	38	23	15	60.53	2,631.19	-2,580.27	1.02	1.56	574.04
2	53,911.41	38	27	11	71.05	2,768.88	-1,895.29	1.46	3.59	1,418.72
1	34,227.74	38	23	15	60.53	2,528.17	-1,594.68	1.59	2.43	900.73

79% of instances closed above the trigger price on one of the next 2 days.

This test would suggest an upside edge over the next few days. Unfortunately when I did some slicing and dicing of this test with regards to the current market setup I found substantial inconsistencies.

I ran these tests about 15 different ways, but let me show you two of the more extreme examples so that you may understand why I don't feel there is a clear edge at the present. This next test takes into account the fact that the price never got back to the previous day's close and that the close is above the 10ma.

SPY gaps down over 1%, never trades as high as yesterday's close but closes more than 0.5% above the open and > 10ma. Buy on close. Sell X days later. \$100k/trade. 1993 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	14,849.08	4	4	0	100.00	3,712.27	0.00	100.00	100.00	3,712.27
9	13,053.36	4	4	0	100.00	3,263.34	0.00	100.00	100.00	3,263.34
8	12,626.73	4	4	0	100.00	3,156.68	0.00	100.00	100.00	3,156.68
7	7,678.06	4	3	1	75.00	2,931.69	-1,117.00	2.62	7.87	1,919.52
6	8,506.62	4	3	1	75.00	2,869.05	-100.53	28.54	85.62	2,126.66
5	7,676.27	4	3	1	75.00	2,912.47	-1,061.15	2.74	8.23	1,919.07
4	3,971.69	4	3	1	75.00	1,682.23	-1,075.00	1.56	4.69	992.92
3	3,846.48	4	3	1	75.00	2,156.49	-2,623.00	0.82	2.47	961.62
2	2,245.29	4	2	2	50.00	2,055.38	-932.74	2.20	2.20	561.32
1	585.45	4	2	2	50.00	1,503.70	-1,210.98	1.24	1.24	146.36

A positive but less powerful start is followed by all winners. Of course the instances are VERY low here.

Let's now look at one other way I filtered it.

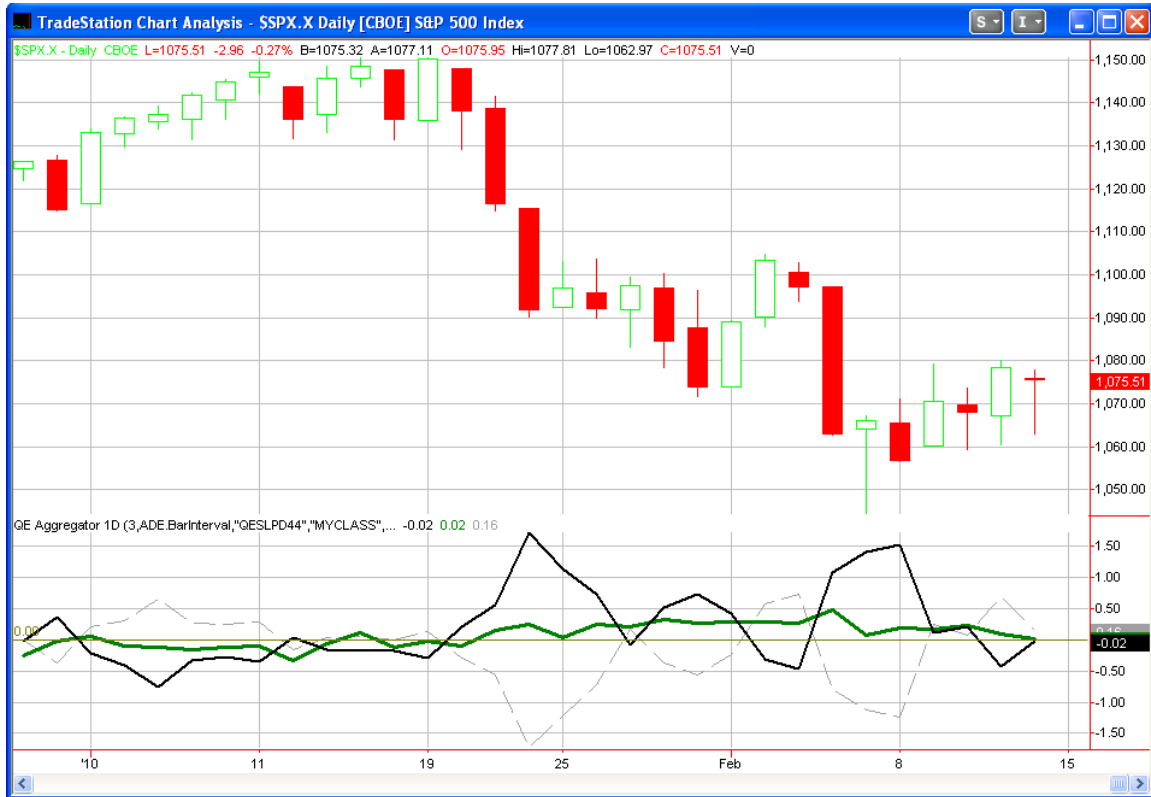
SPY gaps down at least 1%. It closes below yesterday's close but above the open, above the 200ma and above the 10ma. Buy on close. Sell X days later. \$100k/trade. 1993 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	-17,888.45	6	2	4	33.33	2,582.48	-5,763.35	0.45	0.22	-2,981.41
9	-19,926.32	6	2	4	33.33	2,006.33	-5,984.74	0.34	0.17	-3,321.05
8	-20,979.03	6	2	4	33.33	1,421.30	-5,955.41	0.24	0.12	-3,496.51
7	-16,452.19	6	2	4	33.33	806.88	-4,516.49	0.18	0.09	-2,742.03
6	-16,211.19	6	2	4	33.33	1,421.00	-4,763.30	0.30	0.15	-2,701.87
5	-14,704.93	6	1	5	16.67	129.00	-2,966.79	0.04	0.01	-2,450.82
4	-16,819.76	6	0	6	0.00	0.00	-2,803.29	0.00	0.00	-2,803.29
3	-17,851.75	7	1	6	14.29	294.72	-3,024.41	0.10	0.02	-2,550.25
2	-6,611.35	7	2	5	28.57	795.39	-1,640.43	0.48	0.19	-944.48
1	-5,126.98	7	2	5	28.57	725.32	-1,315.52	0.55	0.22	-732.43

So while the previous one was 100% bullish (on a very small sample size), this one is 100% bearish – again on a small sample size.

It's also worth considering the fact that Friday's action was very borderline in regards to some of these tests. While SPY closed down on the day, it was just by a few cents, and some of the other indices were up. And while the 1% gap down requirement was met – it was just barely met as SPY gapped 1.05%. This seems to be one of those cases where someone with an agenda could build a bullish or bearish case depending on how they wanted the tests to come out. In my book that suggests the edge simply isn't clear. Perhaps the best way to view Friday's action is by taking a simple look at the closing prices. The indices were mixed with little change. How much edge do you really want to try and extract from a day's action that was mixed with little change, and on mixed breadth? I'll leave it alone and wait for the market to tip its hand more clearly.

With nothing to add from tonight I have updated the [Aggregator](#) chart below.



The Aggregator readings couldn't get much more neutral than we are seeing tonight. The green Aggregator line is at 0.02 and the black Differential line reading is -0.02. This means the Active studies are expecting very slight upside over the next few days, and the SPX has just barely outperformed expectations over the net few days. Both lines on opposite side of zero signal a neutral configuration and with them both so close tonight the market isn't tipping its hand at all based on our studies. The Aggregator System remains flat awaiting its next signal.

Looking ahead the green Aggregator line is positioned to move down below the 0 line on Tuesday unless we see new bullish studies strong enough to overcome the current bearish influences. Meanwhile the pivot level for the Differential line isn't far off at 1,074.25. In other words, a close at or below 1,074.25 would flip the Differential line to positive. I'll be monitoring action closely on Tuesday to anticipate which way the Aggregator is likely to point Tuesday evening. As always, subscribers may check the intraday Quantifinder around 3pm and the Systems page shortly before the bell to see how I things are shaping up. I always send Twitter alerts when I update these pages near the end of the day. If you would like to sign up to follow me you may do that at <http://twitter.com/qerob>

Intermediate-term Outlook (2 weeks – 2 months)– updated 2/16 –slightly bullish

I discussed on Friday in the Subscriber Letter and the blog that Thursday's action qualified as a follow through day (FTD) under Investors Business Daily's classic definition in which a rise of 1% or more in one of the major indices is required. Apparently IBD didn't count it since it didn't quite meet their new 1.7% rise definition. I'm not a big fan of the new rule and believe the 1% requirement is more useful than the new 1.7%. For details on why I feel this way you may refer to this old blog post on the subject:

<http://quantifiableedges.blogspot.com/2008/01/follow-through-days-pt-2-does-every.html>

I thought it might be interesting to examine a few new ideas with regards to FTD's today. Before I do that I'll first point you to the post where I defined the rules of the tests. I basically followed all of the rules as IBD laid them out. Two rules that IBD has never clearly defined are what entails "success" or "failure". I defined "failure" to be a close below the intraday low of the bottom prior to the FTD. I defined "success" as a move either 1) twice as large as the distance from the low of the potential bottom to the close of the FTD, or 2) a new 52-week high. More detailed explanations of the rules may be found using the link below:

<http://quantifiableedges.blogspot.com/2008/01/ibd-follow-through-days-pt-1-are-they.html>

Under these rules, and requiring an 8% pullback before looking for a FTD, there have now been 71 FTD's since 1971. 37 have been "successes" and 34 have been "failures" for a winning % of 52%. One of the findings I published during the 2008 series on FTDs was that [FTD's coming after smaller pullback had a better success rate than FTD's coming after larger pullbacks](#). It was this research that led me to ponder whether this FTD may have a better chance of success because the rally attempt is occurring while the SPX is above its 200ma. It would seem to make sense that there might be a better chance of success since the long-term uptrend has not clearly turned down at this point. What I found when examining the 71 follow through days that now qualify based on the original study was that only 23 closed above the 200ma. Of those 23, 14 turned out to be winners and 9 losers. This 61% success rate is better than the 48% success rate that has occurred below the 200ma with 23 winners and 25 losers. It isn't overwhelmingly better, though. I'm not sure the distinction is worth making.

I received an interesting note from Mark Minervini this week who said that he's heard that the Nasdaq has had better success with FTD rallies than the S&P. Mark is a former U.S. investing champion and was featured in the book "Market Wizards" by Jack Schwager. You can find Mark's thoughts these days on his blog at <http://markminerviniblog.blogspot.com> While he didn't have details on how the study he cited was set up, it did seem to be a reasonable claim and one worth pursuing. I've found in the past that the Nasdaq often takes on a leadership position when the market emerges from an extended downtrend. I thought perhaps this might explain the phenomenon.

I put the claim to the test. To do so I decided to use the 71 FTD rally attempts identified in the original study. In order to fairly compare S&P versus Nasdaq performance I decided I would enter and exit the Nasdaq on the same days that the S&P was entered and exited based on the original definitions of “success” and “failure”. By using the same entry and exit dates we could easily compare performance between the two indices.

These first results show the performance of the S&P from the FTD date to the “success” date.

SPX performance on "successful" FTD rally attempts.			
TradeStation Performance Summary			Collapse ↕
All Trades			
Total Net Profit	\$285,723.45	Profit Factor	n/a
Gross Profit	\$285,723.45	Gross Loss	\$0.00
Total Number of Trades	37	Percent Profitable	100.00%
Winning Trades	37	Losing Trades	0
Even Trades	0		
Avg. Trade Net Profit	\$7,722.26	Ratio Avg. Win:Avg. Loss	n/a
Avg. Winning Trade	\$7,722.26	Avg. Losing Trade	\$0.00
Largest Winning Trade	\$22,449.07	Largest Losing Trade	\$0.00

Keep in mind that these results do not encompass the entire rally but only the time it took to get from the FTD to the success target. Now let’s look and see how the Nasdaq performed over the exact same time periods.

Nasdaq performance on "successful" FTD rally attempts.			
TradeStation Performance Summary			Collapse ↕
All Trades			
Total Net Profit	\$341,981.97	Profit Factor	106.74
Gross Profit	\$345,216.21	Gross Loss	(\$3,234.24)
Total Number of Trades	37	Percent Profitable	94.59%
Winning Trades	35	Losing Trades	2
Even Trades	0		
Avg. Trade Net Profit	\$9,242.76	Ratio Avg. Win:Avg. Loss	6.10
Avg. Winning Trade	\$9,863.32	Avg. Losing Trade	(\$1,617.12)
Largest Winning Trade	\$26,572.44	Largest Losing Trade	(\$2,098.80)

Here we see that while the Nasdaq actually had two losers, it still averaged about 1.5% better per trade on the whole. Not shown in the above tests it that the average trade lasted just over 9 weeks.

So as was suggested earlier it appears the Nasdaq has done better when the FTD led to a successful rally. But what of those times when the rally attempt failed? Let's start again by examining the stats of the S&P FTD losers:

SPX performance of "failed" FTD rally attempts.			
TradeStation Performance Summary		Collapse ^	
All Trades			
Total Net Profit	(\$177,044.99)	Profit Factor	0.00
Gross Profit	\$0.00	Gross Loss	(\$177,044.99)
Total Number of Trades	31	Percent Profitable	0.00%
Winning Trades	0	Losing Trades	31
Even Trades	0		
Avg. Trade Net Profit	(\$5,711.13)	Ratio Avg. Win:Avg. Loss	0.00
Avg. Winning Trade	\$0.00	Avg. Losing Trade	(\$5,711.13)
Largest Winning Trade	\$0.00	Largest Losing Trade	(\$11,565.12)

Here we see the average loser lost about 5.7% from the FTD close to the point of failure. So how did that Nasdaq do?

Nasdaq Performance on "failed" FTD's.			
All Trades			
Total Net Profit	(\$167,303.06)	Profit Factor	0.09
Gross Profit	\$16,175.91	Gross Loss	(\$183,478.97)
Total Number of Trades	31	Percent Profitable	19.35%
Winning Trades	6	Losing Trades	25
Even Trades	0		
Avg. Trade Net Profit	(\$5,396.87)	Ratio Avg. Win:Avg. Loss	0.37
Avg. Winning Trade	\$2,695.98	Avg. Losing Trade	(\$7,339.16)
Largest Winning Trade	\$4,919.46	Largest Losing Trade	(\$26,335.19)

These results were actually quite impressive. Almost 20% of the time when the S&P had clearly failed, the Nasdaq was still positive on its rally attempt. And even with the largest losing trade substantially bigger than the S&P's, the average trade actually lost less.

So not only has the Nasdaq offered more substantial rewards following FTD's, but the risks have historically been lower as well. This confirms the claim that the Nasdaq is a better place to be when a rally is being attempted. It suggests traders may be better served focusing on areas like smallcap and technology than on large caps.

It's also notable that the S&P/Nasdaq Relative Strength Indicator shown on the website flipped on Friday so that relative strength is now favoring the Nasdaq. I've pasted a copy of that indicator below. The line will appear in green just like the result next week. It is imperceptible at this point because it just turned green at the close.

S&P 500/Nasdaq Relative Strength Weekly



Historically when this configuration has been in place it has been a bullish sign for the market as measured by the S&P 500. And if you invested in the Nasdaq rather than the S&P you'd see results were even better. More information on this indicator may be found using the link below:

<http://quantifiableedges.blogspot.com/2009/06/tweaking-nasdaq-leadlag-model.html>

I'm optimistic that the current rally attempt will have some legs. Not just because we have the Nasdaq now in position, but more so because of some of the breadth studies I've cited the last few weeks that are listed in the Active Studies table at the top of this Letter. I would also suggest that the Nasdaq may have better potential than the S&P based on the Nasdaq/S&P research discussed above.

Catapult and Capitulative Breadth Statistics

(Catapult Presentation Part 1) (Catapult Presentation Part 2)

Open Catapult Triggers

none

Catapult for ETF's Trades

none

Broad Market Large Cap CBI – 0

Additional New Trade Ideas

A full listing of system triggers can be found at the [system triggers page](#) each night. I will cherry pick some of my favorite setups from the S&P 100 and ETF lists along with occasional other trade ideas to track below.

None tonight.

The NDX Timer System which I enhanced and finally was able to provide some details for last week is up on the systems page. It triggered a long at the close Friday (barely). I've had a few questions about it. It's fairly volatile and will sometimes sit in positions for weeks at a time. Returns have been strong but there have been a few sizable drawdowns. While I discuss the basic concepts on the overview sheet, it will remain a black box at least for now since I may decide to license it separately at some point. To give traders a better feel for the trades I have added a 2nd sheet to the Overview Sheet. On the 2nd sheet I show all trades back to the beginning of 2009. Feel free to contact me with any questions about it. I won't track the trades in the Subscriber Letter, but like the Aggregator System, I will update the overview sheet regularly.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
VXX(s)	2/8/2010	\$33.31	\$31.43	5.64%		

The VXX partial exit missed by just \$0.04. I will look to cover ½ at \$31.43 limit on Tuesday. Should the System page show the Aggregator System is likely to give a short signal for the close on Tuesday, I will exit the 2nd half at the close. Otherwise I will continue to hold it.

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