

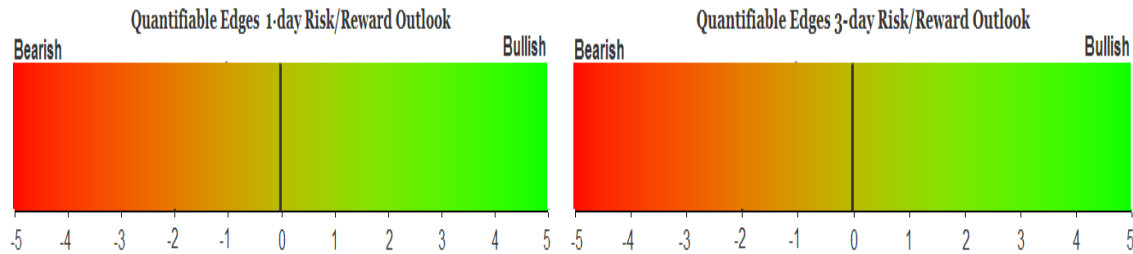
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 17, 2010

Volume 3 Issue 31

Market Overview



Tonight's Research Points

- Tuesday's weak volume is unlikely to derail the strong breadth rally.
- The recent breadth thrust and 10-day high is a good sign for both the short and intermediate-term.
- The Aggregator System remains flat.
- The NDX Aggressive Trend Timer moved to flat at the close as well.

Short-term Outlook – updated 2/17

The Bottom Line

The strong breadth is suggesting more gains are yet to come. The rally is a bit overheated at this point though. I'll wait for an entry point with better risk/reward before increasing exposure.

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 17, 2010 | 2 of 3 75% Up Iss. 10-high above 200ma | 1-9 days | Bullish | 3.50% |
| February 12, 2010 | IBD Follow Through Day | 1-6 days | Bullish | 2.70% |
| Active - Long Term | | | | |
| February 17, 2010 | 2 of 3 75% Up Iss. 10-high above 200ma | 1-20 days | Bullish | 5.90% |
| 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 | 2 of 3 75% Up Issues % No 10-day high | 1-9 days | Bearish | -4.40% |
| February 5, 2010 | 2% Drop 10 low bottom 10% range | 1-7 days | Bullish | 4.50% |

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 up the market only pulled back a little bit before spending most of the day working its way higher. It closed near its highs with strong gains from all the major indices. The S&P rose 1.8%, the Nasdaq 1.4% and the Russell 2000 finished up 1.7%. Breadth was extremely strong as the NYSE Up Issue % came in at 83% and the Up Volume % was just over 90%. Total volume was weak, though as it declined on both the S&P and Nasdaq.

It's rare to see volume decline on a day when breadth is so overwhelmingly positive – especially when the market is in a long-term uptrend. Going back to 1970 I was only able to identify 6 other instances.

| NYSE Up Vol % close above 90% while NYSE volume declines. SPX > 200ma. Buy SPX on close. Sell X days later. 100k/trade. 1970 - 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 | 9,214.74 | 6 | 4 | 2 | 66.67 | 3,568.30 | -2,529.22 | 1.41 | 2.82 | 1,535.79 |
| 9 | 10,901.19 | 6 | 5 | 1 | 83.33 | 2,678.61 | -2,491.84 | 1.07 | 5.37 | 1,816.87 |
| 8 | 9,474.04 | 6 | 4 | 2 | 66.67 | 3,238.97 | -1,740.93 | 1.86 | 3.72 | 1,579.01 |
| 7 | 7,560.89 | 6 | 3 | 3 | 50.00 | 3,572.56 | -1,052.26 | 3.40 | 3.40 | 1,260.15 |
| 6 | 3,955.35 | 6 | 2 | 4 | 33.33 | 4,252.15 | -1,137.24 | 3.74 | 1.87 | 659.23 |
| 5 | 6,148.53 | 6 | 4 | 2 | 66.67 | 2,345.72 | -1,617.17 | 1.45 | 2.90 | 1,024.76 |
| 4 | 7,520.24 | 6 | 5 | 1 | 83.33 | 1,863.45 | -1,797.00 | 1.04 | 5.18 | 1,253.37 |
| 3 | 6,715.44 | 6 | 4 | 2 | 66.67 | 2,099.25 | -840.78 | 2.50 | 4.99 | 1,119.24 |
| 2 | 5,576.98 | 6 | 5 | 1 | 83.33 | 1,190.87 | -377.37 | 3.16 | 15.78 | 929.50 |
| 1 | 2,726.22 | 6 | 3 | 3 | 50.00 | 1,400.42 | -491.68 | 2.85 | 2.85 | 454.37 |

The 6 occurrences were 11/23/84, 11/20/86, 1/2/87, 3/6/07, 8/29/07, and 8/3/09.

I've found many times that extreme breadth will often trump volume. Instances here are too few to draw any solid conclusions, but there is certainly no suggestion that the weak volume spells doom for the rally.

Tuesday strong breadth also triggered a setup that I showed just a few days ago on the 2/12/10 Subscriber Letter. Below is the table from that Letter.

**NYSE Up Issues % > 75% in 2 of last 3 days and makes a 10-day intraday high.
Buy SPX on close. Sell X days later. \$100k/trade. 1970 - 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 |
|--------|-----------------|-------------------|---------------------|--------------------|-------------------|------------------------|-----------------------|---------------------|-------------------|----------------|
| 20 | 107,484.86 | 36 | 27 | 9 | 75.00 | 5,166.10 | -3,555.54 | 1.45 | 4.36 | 2,985.69 |
| 15 | 92,949.90 | 37 | 27 | 10 | 72.97 | 4,246.02 | -2,169.27 | 1.96 | 5.28 | 2,512.16 |
| 10 | 71,424.42 | 39 | 30 | 9 | 76.92 | 3,341.47 | -3,202.19 | 1.04 | 3.48 | 1,831.40 |
| 9 | 71,150.64 | 39 | 28 | 11 | 71.79 | 3,481.40 | -2,393.52 | 1.45 | 3.70 | 1,824.38 |
| 8 | 59,700.36 | 39 | 29 | 10 | 74.36 | 2,916.50 | -2,487.81 | 1.17 | 3.40 | 1,530.78 |
| 7 | 54,559.48 | 39 | 28 | 11 | 71.79 | 2,891.16 | -2,399.37 | 1.20 | 3.07 | 1,398.96 |
| 6 | 47,615.27 | 40 | 30 | 10 | 75.00 | 2,408.70 | -2,464.58 | 0.98 | 2.93 | 1,190.38 |
| 5 | 41,881.89 | 41 | 29 | 12 | 70.73 | 2,156.81 | -1,721.65 | 1.25 | 3.03 | 1,021.51 |
| 4 | 33,006.29 | 43 | 26 | 17 | 60.47 | 2,019.98 | -1,147.83 | 1.76 | 2.69 | 767.59 |
| 3 | 27,801.06 | 44 | 28 | 16 | 63.64 | 1,729.99 | -1,289.92 | 1.34 | 2.35 | 631.84 |
| 2 | 15,797.54 | 50 | 31 | 19 | 62.00 | 1,219.09 | -1,157.60 | 1.05 | 1.72 | 315.95 |
| 1 | 11,269.24 | 54 | 32 | 20 | 59.26 | 773.69 | -674.45 | 1.15 | 1.84 | 208.69 |

93% of instances close above their entry price at some point in the next week.

With Thursday and Tuesday both posting strong breadth numbers and with the move to a new 10-day high on Tuesday, this study suggests bullish implications over the next few weeks.

I also filtered this test by the 200ma and found the results to be incredibly strong.

**NYSE Up Issues % > 75% 2 of last 3 days. SPX makes a 10-day intraday high. SPX > 200ma.
Buy SPX on close. Sell X days later. \$100k/trade. 1970 - 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 |
|--------|-----------------|-------------------|---------------------|--------------------|-------------------|------------------------|-----------------------|---------------------|-------------------|----------------|
| 20 | 74,377.41 | 17 | 15 | 2 | 88.24 | 5,070.41 | -839.37 | 6.04 | 45.31 | 4,375.14 |
| 19 | 74,861.54 | 17 | 16 | 1 | 94.12 | 4,726.66 | -765.00 | 6.18 | 98.86 | 4,403.62 |
| 18 | 72,146.75 | 17 | 17 | 0 | 100.00 | 4,243.93 | 0.00 | 100.00 | 100.00 | 4,243.93 |
| 17 | 72,570.25 | 17 | 17 | 0 | 100.00 | 4,268.84 | 0.00 | 100.00 | 100.00 | 4,268.84 |
| 16 | 70,819.97 | 17 | 17 | 0 | 100.00 | 4,165.88 | 0.00 | 100.00 | 100.00 | 4,165.88 |
| 15 | 62,605.96 | 17 | 15 | 2 | 88.24 | 4,193.12 | -145.41 | 28.84 | 216.28 | 3,682.70 |
| 14 | 59,145.23 | 17 | 17 | 0 | 100.00 | 3,479.13 | 0.00 | 100.00 | 100.00 | 3,479.13 |
| 13 | 56,453.52 | 18 | 16 | 2 | 88.89 | 3,575.13 | -374.29 | 9.55 | 76.41 | 3,136.31 |
| 12 | 53,367.59 | 19 | 16 | 3 | 84.21 | 3,554.18 | -1,166.43 | 3.05 | 16.25 | 2,808.82 |
| 11 | 52,230.54 | 19 | 16 | 3 | 84.21 | 3,512.60 | -1,323.67 | 2.65 | 14.15 | 2,748.98 |
| 10 | 45,699.75 | 19 | 16 | 3 | 84.21 | 3,189.40 | -1,776.86 | 1.79 | 9.57 | 2,405.25 |
| 9 | 46,533.73 | 19 | 15 | 4 | 78.95 | 3,378.31 | -1,035.24 | 3.26 | 12.24 | 2,449.14 |
| 8 | 40,329.66 | 19 | 16 | 3 | 84.21 | 2,696.82 | -939.81 | 2.87 | 15.30 | 2,122.61 |
| 7 | 37,834.45 | 19 | 15 | 4 | 78.95 | 2,724.73 | -759.11 | 3.59 | 13.46 | 1,991.29 |
| 6 | 37,366.21 | 20 | 18 | 2 | 90.00 | 2,249.84 | -1,565.46 | 1.44 | 12.93 | 1,868.31 |
| 5 | 30,373.18 | 21 | 16 | 5 | 76.19 | 2,122.07 | -715.97 | 2.96 | 9.48 | 1,446.34 |
| 4 | 24,762.55 | 22 | 17 | 5 | 77.27 | 1,660.36 | -692.72 | 2.40 | 8.15 | 1,125.57 |
| 3 | 19,056.39 | 22 | 16 | 6 | 72.73 | 1,389.11 | -528.24 | 2.63 | 7.01 | 866.20 |
| 2 | 11,031.27 | 25 | 16 | 9 | 64.00 | 1,122.32 | -789.54 | 1.46 | 2.59 | 441.25 |
| 1 | 7,433.32 | 27 | 17 | 10 | 62.96 | 730.67 | -498.81 | 1.46 | 2.49 | 275.31 |

100% of instances closed above their entry price at some point in the next 6 days.

It really doesn't get much more bullish than this from either a short or intermediate-term perspective. I've placed this study in both places in the Active Studies list. I've also removed the study from 2/12/10 that looked at strong breadth without a new 10-day high.

I have updated the [Aggregator](#) chart below.



Tuesday's move higher on strong breadth had a strongly bullish effect on net expectations. The green Aggregator line is now squarely above 0 with no negative readings currently in sight. Meanwhile, the black Differential line has fallen far below 0, illustrating the fact that the SPX has strongly outperformed expectations over the last few days. Overbought with positive expectations is generally considered neutral. Neutral configurations appear whenever the lines are on opposite sides of 0. Therefore the Aggregator System remains flat tonight.

Looking ahead to tomorrow the green Aggregator line is scheduled to remain positive barring some very strong bearish studies emerging. Meanwhile the pivot level for the black Differential line is 1083.55. In other words, it would take an SPX close at or below this level to move the Differential line into positive territory. I am neither eager to try and short this strong upmove nor am I eager to try and chase it without waiting for a pullback.

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-nasdaqs-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.

Active Trades Table

| Symbol | Entry Date | Entry Price | Current Price | % Gain/Loss | Stop | Notes |
|---------------|-------------------|--------------------|----------------------|--------------------|-------------|-----------------------|
| VXX(s) | 2/8/2010 | \$33.31 | \$29.82 | 10.48% | | covered 1/2 @ \$30.75 |

I will let the 2nd half of the VXX trade ride for now.

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2009 Hanna Capital Management, LLC.