

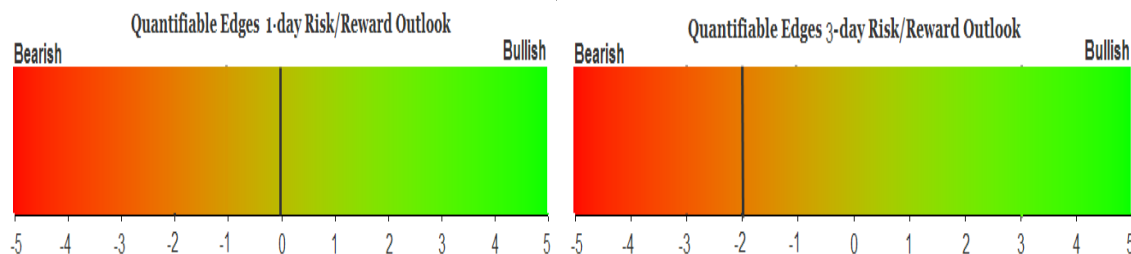
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 18, 2010

Volume 3 Issue 32

Market Overview



Tonight's Research Points

- No new compelling studies tonight.
- The Aggregator System triggered a short at the close.
- The NDX Aggressive Trend Timer remains flat.

Short-term Outlook – updated 2/18

The Bottom Line

The rally is weakening and it failed to produce any bullish studies today. With the bearish study below now exerting more influence the Aggregator System has triggered a short. I'm looking for a pullback.

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	90% Up Vol on low Vol > 200ma	1-2 days	Bullish	
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%
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	

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

The Evidence

Another gap up today, but this time it was followed by very quiet trading. The major indices all closed higher and not too far from where they opened. The S&P gained 0.4% while the Nasdaq and Russell 2000 were up 0.6%. Breadth was somewhat positive as the NYSE Up Issues % came in at 65% and the Up Volume % at 67%. Total volume declined for the 2nd day in a row.

I looked at Thursday's action a number of different ways tonight. I examined the doji at a 5-day high, I looked at the 2 consecutive up gaps. I looked at the low range, the low QQQQ volume and more. No matter how I looked at it I didn't see anything that was terribly compelling. Mild, low-volume rises in an uptrend often leave you with little to go on and today was no exception.

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



So the strong breadth without a new high study is starting to exert its influence on the Aggregator. For the 1st time in a while the green Aggregator has dipped below 0. This indicates the net expectation from the active studies is for lower prices over the next few days. Also the black Differential line is still substantially below 0, illustrating the SPX's outperformance over the last few days versus expectations. So with expectations negative and the SPX overbought versus recent expectations both lines are now below zero. Historically this configuration has provided a downside edge. As indicated was likely on the systems page this afternoon the Aggregator System has gone short based on this configuration.

Looking ahead to tomorrow the green Aggregator value is set up to remain negative. To move the Aggregator line back to positive it would take some bullish studies. Meanwhile the pivot number for the Differential looks to be 1,078.84. In other words, it would take a close at or below this level in the SPX to move the Differential line back above 0.

On a personal note I will not be in my office tomorrow nor will I likely have access to the internet at any point during the day. There is a strong possibility that neither the Intraday Quantifinder nor the Systems page will be updated. It's extremely difficult to anticipate which of our over 700 studies are going to trigger. With that in mind I might go by the following guidelines when trying to anticipate tomorrow's edges. 1) A strong move up that sees an Up Issue % of at least 75% and a high above Thursday's high would trigger a breadth thrust signal that would likely be strong enough to pop the Aggregator value back above 0. 2) A mild move in either direction would be unlikely to move the signal off of a short. 3) I suspect a close down of 1%-2% could generate a few bullish studies and may turn the Aggregator System flat. 4) A close below 1,078.85 in the SPX could possibly flip both lines and trigger a long – at the very least it would move the Aggregator System flat.

The NDX Aggressive Trend Timer will likely need a close of around 1,801 or lower to trigger a 100% long signal. Any close above there would keep that system flat for the time being.

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.

SPY short 1/4 index position @ \$110.26 limit. – Based on short-term market outlook and Aggregator System.

SPY short 1/4 index position @ \$110.51 LIMIT ON OPEN. If not filled, cancel order and then look to short @ \$110.26 LIMIT ON CLOSE. – I'll look for a 2nd lot if the market gaps up at the open. Without a gap up, I'll wait until the close and short the 2nd lot on any even or up close.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
VXX(s)	2/8/2010	\$33.31	\$28.94	13.12%		covered 1/2 @ \$30.75

Buy to cover VXX @ \$29.20 limit. With the Aggregator System short, I expect we may see an increase in volatility and fear here soon. I'll look to take profits on the 2nd half of the VXX trade and will even pay a little higher than today's close if it happens to gap up at the open.

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