

# The Path Of Least Resistance

The Newsletter Of High Probability Power Law Trading

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## Commentary:

It was the change in my own attitude that was of supreme importance to me. It taught me, little by little, the essential difference between betting on fluctuations and anticipating inevitable advances and declines, between gambling and speculating. Jesse Livermore

Last night we stated that we would be short the major index's at the open today. I hope that was because we were speculating and not gambling. We did receive some emails asking me why now. One was the summation index which we use every day. The other was a somewhat unknown pattern that shows up very rarely and that is Joe DiNapoli's Double Repo. I think I have seen it about 3 or 4 times in index's in the 10 years as a full time trader. It has been deadly accurate in parabolic moves. Most likely it will be years before I get to dust it off again but in parabolic moves it's a great to know when the [music stops](#).

The weakest stocks have already failed and not a lot of use in chasing them now. Our thesis is to trade in the direction of the advance decline line not the index numbers. Since about April 15 the market has been hemorrhaging with more stocks going down than going up. Eventually you find the tipping point.

There is a great book called [Predictably Irrational](#) by Dan Ariely that talks about how people's minds work.

"In one trial of one study we offered students a Lindt Truffle for 26 cents and a Hershey's Kiss for 1 cent and observed the buying behavior: 40 percent went with the truffle and 40 percent with the Kiss. When we dropped the price of both chocolates by just 1 cent, we observed that suddenly 90 percent of participants opted for the free Kiss, even though the relative price between the two was the same."

Today the markets are looking and wondering if the same thing happened. Have the markets been predictably irrational once again. Medium and long term changes in direction for Mr. Market don't change everyone minds at once. There are three stages to the market mentality changing.

- First it is ridiculed.
- Second, it is violently opposed.
- Third, it is accepted as being self-evident.

Thank you Arthur Schopenhauer (1788-1860)

Here's a list of the stocks we had as this morning on our bearish list.

Aecom Technology Corporation Co	30.07	ACM	Down 1.60%
American Greetings Corporation	24.56	AM	Down 3.04%
Cerner Corporation	84.77	CERN	Down 3.12%
Con-Way, Inc. Common Stock	38.84	CNW	Down 2.51%
Charles River Laboratories Inte	33.48	CRL	Down 2.33%
China Yuchai International Limi	21.10	CYD	Up 1.30%
ProShares Ultra Oil & Gas	37.26	DIG	Down 2.31%
ProShares UltraShort Oil & Gas	55.46	DUG	Up 2.38%
EZCORP, Inc.	20.74	EZPW	Down 7.99%
FactSet Research Systems Inc. C	75.25	FDS	Up 0.43%
Hansen Natural Corporation	44.15	HANS	Down 0.59%
Illumina, Inc.	41.83	ILMN	Down 1.62%
Gartner, Inc. Common Stock	24.06	IT	Down 2.00%
Joy Global Inc.	56.80	JOYG	Down 7.61%
CarMax Inc	24.57	KMX	Down 3.23%
Men's Wearhouse, Inc. (The) Com	23.63	MW	Down 8.02%
MarkWest Energy Partners, LP Co	30.72	MWE	Down 0.68%
PPG Industries, Inc. Common Sto	70.37	PPG	Down 1.22%
PartnerRe Ltd. Common Stock	77.64	PRE	Down 1.33%
QLogic Corporation	19.37	QLGC	Down 10.24%

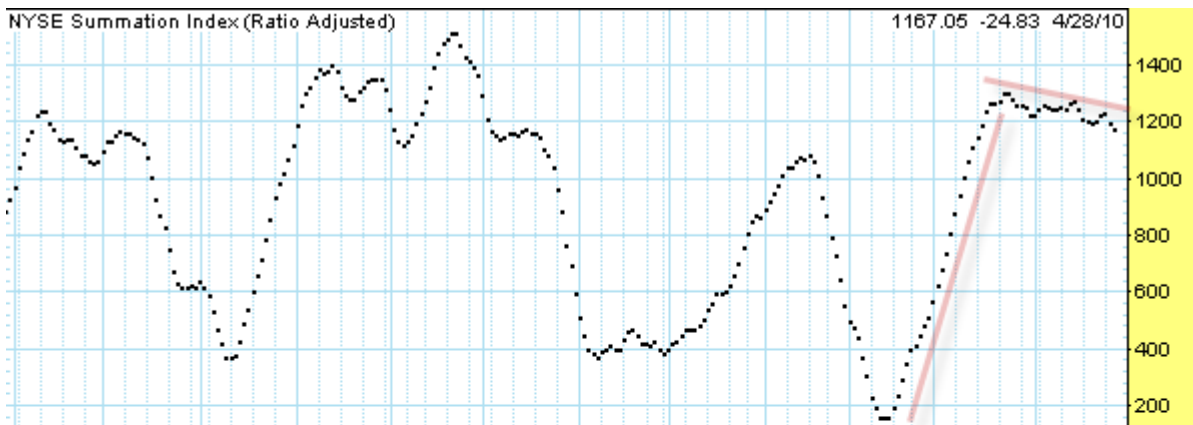
Not a lot of reason to be putting on new trades now. We will be spending the weekend looking for stocks that might bounce and give us yet another chance. If you were not short this morning then you should wait for the next wave.

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If you have more questions you can Email: Path@TFNN.com.



In a parabolic move there are a couple of tools to know when to wait that its over. The one I like is called the double repo. It is a more than ten days above the 3x3 displaced moving average. Then a close below and a close back above. Then one more close below and you are ready to start thinking short from the whole market. We should see a lot of stocks testing highs with light volume today and the next few day the market moving down as a whole with the advance decline line heavily bearish. Typically we should see a pullback to the 1170 area.



The one big tenant on using the path of least resistance is stay of the side of the summation index. It is a oscilator of advancers and decliners. If would had you either long or staying out of being short until at least mid April. Even with light volume you don't fight the tape.

When the amount of stocks holding up a rally like this one turns its usually a sign of the only the most well know or hot stocks will be holding the indexes as the broad market gets sold.

Usually surprises also happen in the direction of the summations trend.

**Methodology:**

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We have constructed a new mathematical tool to scan over 5000 stocks in the US markets each day to find the stocks with the best and brightest signals. While it's easy to look at the volume difference at swing points it's much harder to look at the relative strength between the swings.

Power Law is a special kind of mathematical relationship between two quantities. Power laws describe relationships, such as the metabolic rate of a species and its body mass, and the size of a city and the number of patents it produces. What this relationship means is that there is no typical size in the conventional sense. So it's an answer on how to compare apples and oranges.

We can now compare the strength of the up and down moves between swing points. One place where this is easy to see is a test of a high where the stock went down 5 days and took 10 days to retest the high. Looking at volume alone skews the actual power in that move because they are not symmetrical. Using Power Law we can correct and test for big changes in strength mathematically.

In short we have a system for comparing time price and volume into one easy to understand number. We look for where that number changes drastically. Each day we look for the strongest and weakest stocks that are giving clear unambiguous signals.

The *Path of Least Resistance* describes the physical or metaphorical pathway that provides the least resistance to forward motion by a given object or entity, among a set of alternative paths.

### **Using Power Law Charts:**

50 percent of getting a stock trade right is getting market direction correct. For testing and advising purposes we use the advance and decline line to see if there are more or less stocks moving in concert with the major indexes. Trades should be placed in the direction of the majority of advance and decliners. This is known as the [summation index](#). There is a summation index for both the [NYSE](#) and [NASDAQ](#).

25 percent of getting a stock trade right is the sector. There is also a listing of sectors and how there summation index's are ranked. You can find that list as ETFs [here](#). Short the weak and go long the strong. Another good resource is to look for contradiction in the advancers and decliners versus the straight [sector rankings](#).

The old saying is if a stock can't take out the highs it will try and take out the lows. If it can't take out the lows it will try for the highs. So once the stock, ETF, or index proves the point with a test on price you wait for a close back in the trading range set by the previous swing. That is your buy or short point. Your stop is 6% loss from that swing point. The first major swing (your first target) should be at least 10% or greater to have an acceptable risk reward. If volume does not remain light ala 40% less of the previous swing you can stop out early. Trends end in a whimper most times not a bang. Also if the summation index for the major index of the stock you are trading changes direction close your position.

In picking stocks to play we want a strong move and then an extremely weak counter move with a swing test of 40% or less volume. The energy in the leg should also show a 40% change. If it's an ETF we look for 25% changes and 20% in broad indexes.

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