

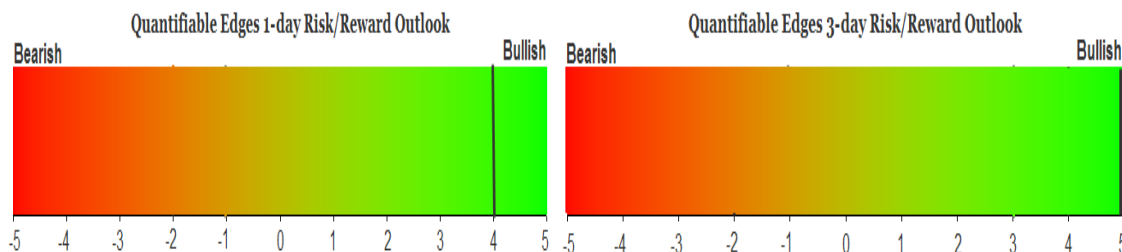
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 28, 2009

Volume 2 Issue 185

Market Overview



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				
September 28, 2009	Pullback from 20-high drying up	1-5 days	Bullish	2.60%
September 25, 2009	50-high to 8-low in 2 days	1-6 days	Bullish	2.10%
September 24, 2009	SPX down 1% SOX up	1-6 days	Bullish	
Active - Long Term				
September 14, 2009	Nasdaq/S&P Lead/Lag Model		Bullish	
July 14, 2009	VIX:VXV drops below 0.9	2-5 months	Bearish	
Dropped Tonight				
September 11, 2009	Appel Daily Breadth Impulse Signal	1-20 days	Bullish	5.00%

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

Short-term Outlook – updated 9/28

The Bottom Line

While the pullback has now gone longer and deeper than I first anticipated, Friday's action gave more signals that a bounce is likely within a few days. The selling slowed and it could leave an opening for the dip-buyers. The pullback has begun to damage the intermediate-term outlook slightly, but the bounce (should it arrive) will tell us more about the intermediate-term

The Evidence

After gapping lower the market rallied a bit off the open. The bulls couldn't celebrate for long, though, as the SPX peaked after just over 40 minutes of trading. From there it slid for the next 3+ hours and then traded within that range over the course of the afternoon. It was the 3rd down day in a row for the SPX after closing at a 50-day high. For the SPX Friday's damage was the smallest of the last 3 days with only a 0.5% loss. The Nasdaq dropped a bit more, finishing down 0.8% for the day. Breadth was somewhat negative as the NYSE Up Issues % came in at 44% and the Up Volume % at 31%. Total volume fell to the lowest level in nearly 3 weeks.

Over the last couple of days we've seen some evidence suggesting the market was likely to bounce in short order. The evidence was based upon a few things. First we saw that Fed-day selloffs tend to reverse fairly quickly. Next, we saw that sharp 2-day drops from 50-day highs also have a tendency to bounce. So far these price (and Fed) based tendencies have failed to exert themselves. Friday's action is suggest that the selling is drying up and a fairly sharp bounce is near.

Two bullish indications of Friday's decline are that fact that it was the smallest drop of the 3-day pullback and the fact that it was accompanied by a dry up in volume. Both of these indications suggest the selloff may be losing steam and a short-term swing back up could occur.

Below is a study examining other declines of 3 days or more where the current day was the day with the smallest % decline.

SPX at least 3 lower closes. Today has the mildest drop of the decline. Buy on close. Sell X days later. \$100k/trade. 1990 - 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	79,932.07	91	65	26	71.43	2,540.06	-3,275.84	0.78	1.94	878.37
9	99,394.28	93	66	27	70.97	2,631.53	-2,751.35	0.96	2.34	1,068.76
8	89,166.79	93	64	29	68.82	2,512.37	-2,469.82	1.02	2.24	958.78
7	92,875.90	96	63	33	65.63	2,464.02	-1,889.61	1.30	2.49	967.46
6	81,239.63	96	63	33	65.63	2,107.00	-1,560.64	1.35	2.58	846.25
5	80,334.28	97	60	37	61.86	2,126.02	-1,276.40	1.67	2.70	828.19
4	70,177.17	99	63	36	63.64	1,913.08	-1,398.53	1.37	2.39	708.86
3	44,139.80	99	62	37	62.63	1,552.49	-1,408.50	1.10	1.85	445.86
2	39,631.95	104	63	41	60.58	1,280.50	-1,000.97	1.28	1.97	381.08
1	29,882.09	111	65	44	58.56	971.98	-756.74	1.28	1.90	269.21

These results suggest a decent upside edge.

Now if you look at the fact the market was pulling back from a 20-day high you'll see the edge is even more pronounced:

SPX at least 3 lower closes. Today has the mildest drop of the decline. Just prior to the pullback the market closed at a 20-day high. 1990 - 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	58,481.59	34	27	7	79.41	2,550.59	-1,483.48	1.72	6.63	1,720.05
9	58,795.00	34	27	7	79.41	2,597.56	-1,619.88	1.60	6.19	1,729.26
8	51,983.53	34	27	7	79.41	2,331.46	-1,566.54	1.49	5.74	1,528.93
7	48,328.93	35	25	10	71.43	2,476.86	-1,359.27	1.82	4.56	1,380.83
6	50,485.47	35	25	10	71.43	2,306.45	-717.57	3.21	8.04	1,442.44
5	45,220.53	35	27	8	77.14	2,027.08	-1,188.83	1.71	5.75	1,292.02
4	44,469.60	35	23	12	65.71	2,308.29	-718.43	3.21	6.16	1,270.56
3	37,261.31	35	25	10	71.43	1,873.65	-957.99	1.96	4.89	1,064.61
2	27,774.07	36	26	10	72.22	1,413.06	-896.55	1.58	4.10	771.50
1	11,547.22	40	25	14	62.50	791.49	-588.57	1.34	2.40	288.68

A week later 77% of instances are positive and the average trade is 1.3%. Again – impressive results.

Next you can see what happens if instead of filter on the 20-day high, I combine the low % decline with the lowest volume in 5 days:

SPX at least 3 lower closes. Today has the mildest drop of the decline and the lowest volume in 5 days. Buy on close. Sell X days later. \$100k/trade. 1990 - 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	33,647.97	28	22	6	78.57	2,541.33	-3,710.20	0.68	2.51	1,201.71
9	36,394.40	28	21	7	75.00	2,766.17	-3,099.31	0.89	2.68	1,299.80
8	28,460.34	28	19	9	67.86	2,687.33	-2,510.98	1.07	2.26	1,016.44
7	29,649.94	28	18	10	64.29	2,734.62	-1,957.32	1.40	2.51	1,058.93
6	31,453.54	28	18	10	64.29	2,556.40	-1,456.17	1.76	3.16	1,123.34
5	30,902.10	28	17	11	60.71	2,415.71	-924.09	2.61	4.04	1,103.65
4	18,195.06	28	16	12	57.14	1,848.23	-948.06	1.95	2.60	649.82
3	16,106.46	28	18	10	64.29	1,685.23	-1,422.77	1.18	2.13	575.23
2	21,777.27	28	21	7	75.00	1,324.07	-861.17	1.54	4.61	777.76
1	15,369.97	28	21	6	75.00	811.03	-276.95	2.93	10.25	548.93

25 of 28 instances (89%) closed above the entry price either the next day or the day after.
 27 of 28 instances (96%) closed above the entry price at some point in the next 4 days.
 All 28 instances closed above the entry price at some point in the next 2 weeks.

While the follow-through was a little better in the previous test, this one still shows a high average return. You'll also note the stats below the chart. While there wasn't strong of follow through, nearly everything bounced within a few short days.

What if we combine all the variables? I decided to break out this last test to show times the market was coming off a 20-day high versus times it wasn't. First let's look at times it wasn't.

SPX at least 3 lower closes. Today has the mildest drop of the decline and the lowest volume in 5 days. Just prior to the pullback the market DID NOT close at a 20-day high. Buy on close. Sell X days later. \$100k/trade. 1990 - 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	6,790.72	14	11	3	78.57	2,439.56	-6,681.48	0.37	1.34	485.05
9	7,321.06	14	10	4	71.43	2,632.47	-4,750.91	0.55	1.39	522.93
8	5,620.25	14	9	5	64.29	2,609.90	-3,573.78	0.73	1.31	401.45
7	9,110.12	14	9	5	64.29	2,415.46	-2,525.80	0.96	1.72	650.72
6	5,481.46	14	9	5	64.29	1,923.53	-2,366.07	0.81	1.46	391.53
5	5,407.77	14	6	8	42.86	2,253.03	-1,013.80	2.22	1.67	386.27
4	-1,286.56	14	7	7	50.00	1,141.54	-1,325.34	0.86	0.86	-91.90
3	-3,722.95	14	8	6	57.14	1,022.64	-1,984.02	0.52	0.69	-265.93
2	5,727.74	14	10	4	71.43	1,044.44	-1,179.16	0.89	2.21	409.12
1	8,516.50	14	11	3	78.57	870.58	-353.31	2.46	9.03	608.32

Three – five days out here the edge is minimal or nonexistent.

How about those time where it DID come off a 20-day high?

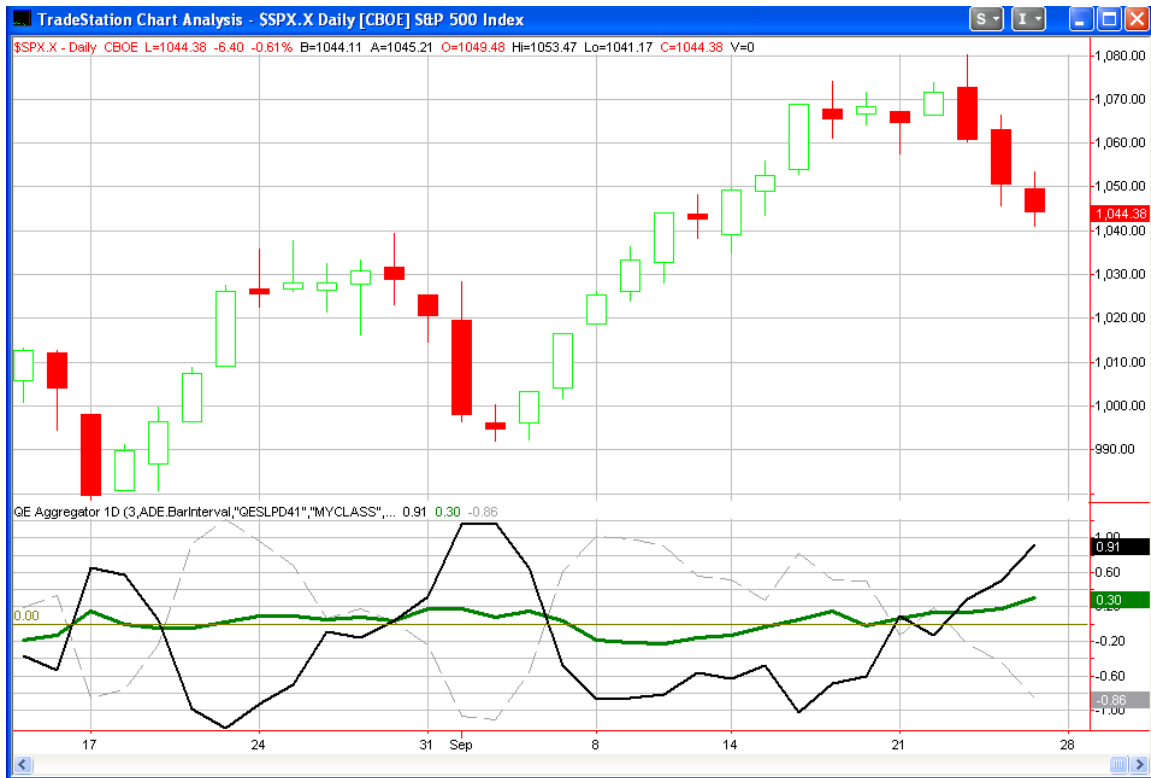
SPX at least 3 lower closes. Today has the mildest drop of the decline and the lowest volume in 5 days. Just prior to the pullback the market closed at a 20-day high. Buy on close. Sell X days later. \$100k/trade. 1990 - present

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	26,857.25	14	11	3	78.57	2,643.09	-738.91	3.58	13.12	1,918.38
9	29,073.34	14	11	3	78.57	2,887.72	-897.18	3.22	11.80	2,076.67
8	22,840.09	14	10	4	71.43	2,757.01	-1,182.49	2.33	5.83	1,631.44
7	20,539.82	14	9	5	64.29	3,053.79	-1,388.85	2.20	3.96	1,467.13
6	25,972.08	14	9	5	64.29	3,189.27	-546.28	5.84	10.51	1,855.15
5	25,494.33	14	11	3	78.57	2,504.45	-684.86	3.66	13.41	1,821.02
4	19,481.62	14	9	5	64.29	2,397.88	-419.86	5.71	10.28	1,391.54
3	19,829.41	14	10	4	71.43	2,215.31	-580.91	3.81	9.53	1,416.39
2	16,049.53	14	11	3	78.57	1,578.28	-437.19	3.61	13.24	1,146.40
1	6,853.47	14	10	3	71.43	745.52	-200.59	3.72	12.39	489.53

13 of 14 instances (92%) closed above the entry price either the next day or the day after.
All 14 instances closed above the entry price at some point in the next 4 days.

While I'd prefer more instances, the incredibly consistent returns are compelling. 92% closing higher within 2 days and 100% at some point in the next 4 is especially notable.

The [Aggregator](#) chart is updated below.



Both the green Aggregator line and the black Differential line are at or close to as stretched as they've been above the 0 line in many weeks. I've uncovered no convincing evidence over the last few days that this selloff is likely to implode. I've seen numerous indications that we are likely to bounce and in fact overdue at this point. The very bullish configuration of the Aggregator and the new studies discussed tonight have me looking to add to my long position in an aggressive manner.

Intermediate-term Outlook (2 weeks – 2 months)– updated 9/28 – slightly bullish

While the short-term outlook is about as bullish as it gets after the 3-day pullback, the intermediate-term outlook has taken a little bit of a hit. The Appel Daily Breadth Impulse Signal was turned off as the market sold off hard on Thursday. While the signal was goof for a small 2 week gain, it did not lead to the kind of upside follow-through that it looks to capture. In any case, breadth is no longer signaling an intermediate-term rise.

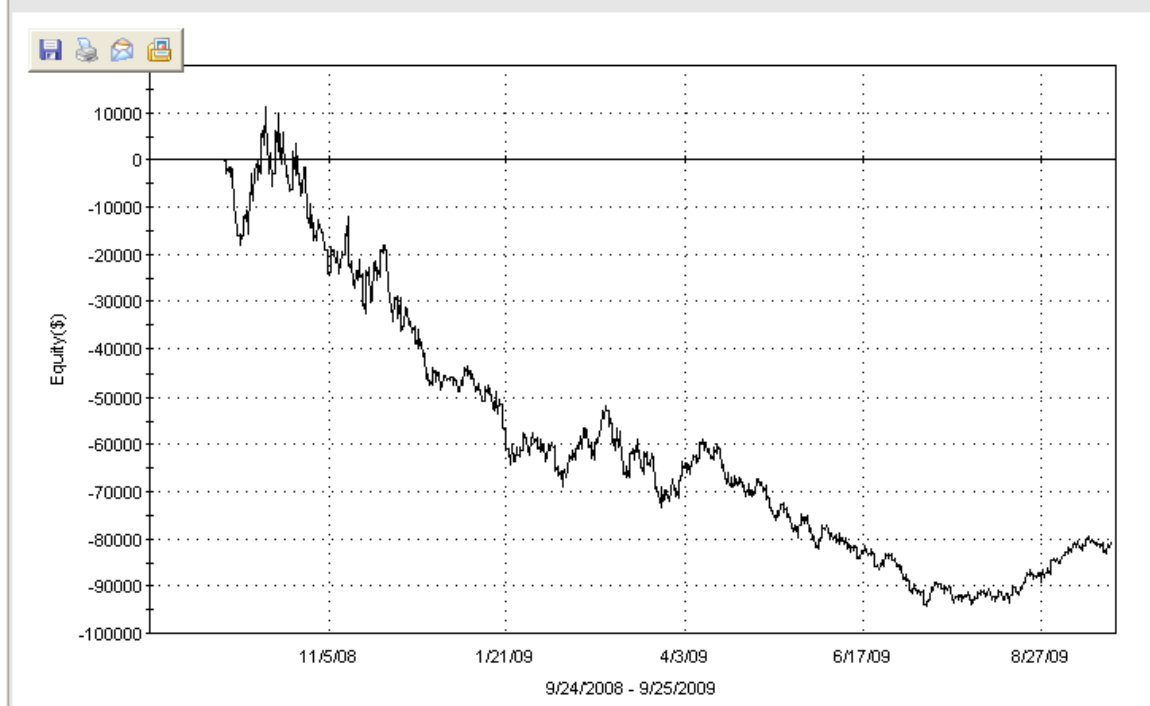
The Nasdaq/S&P 500 Relative Strength remains precariously bullish. This is now the 3rd weeks in a row the Nasdaq has been in a leading position. The lead is extremely small, though and will again depend on more outperformance this week to remain bullish. I've copied the chart from the website below.

S&P 500/Nasdaq Relative Strength Weekly



Another notable chart is the Trend vs. Chop from the website. As you can see below the past 3 months we've seen more follow-through on a daily basis in the S&P 500 index than we have choppy behavior. This has made for a difficult time for mean reverting strategies. Runs have persisted substantially more than we've become accustomed to over the last few years. The last time the market spent this long without exhibiting choppy behavior was 2006.

Trend vs. Chop Daily



I am not yet convinced that it is time to break out strategies that rely on trendy day-to-day behavior. The chart does warrant watching, though. And traders should keep in mind we are no longer seeing consistent chop. You're swimming upstream a little bit at the present with short-term mean reversion strategies.

For more information on “trend vs. chop” and a longer-term chart, you can check out the [Trend vs. Chop detail page](#) on the website.

Bottom line is we've seen a slight weakening of the bullish case this week. With the short-term bias strongly bullish it will be important to monitor intermediate-term indications if we do get the anticipated short-term bounce. A weak bounce could suggest another leg down and perhaps worse. A strong bounce could lead to another leg higher. So far the outlook is slightly favoring upside, but that could change easily and quickly depending on the next few days.

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 – buy ¼ index position @ \$104.45 limit. Based on short-term market outlook.

SPY – buy final ¼ position @ \$103.75 limit ON CLOSE. One more down day tomorrow and we may be “all-in” with the index position and ready for a [Turnaround Tuesday](#).

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
TGT	9/24/2009	\$47.56	\$46.75	-1.70%	\$46.75	stopped out
SPY(1/4)	9/24/2009	\$106.18	\$104.45	-1.63%		
SPY(1/4)	9/25/2009	\$104.78	\$104.45	-0.31%		

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