

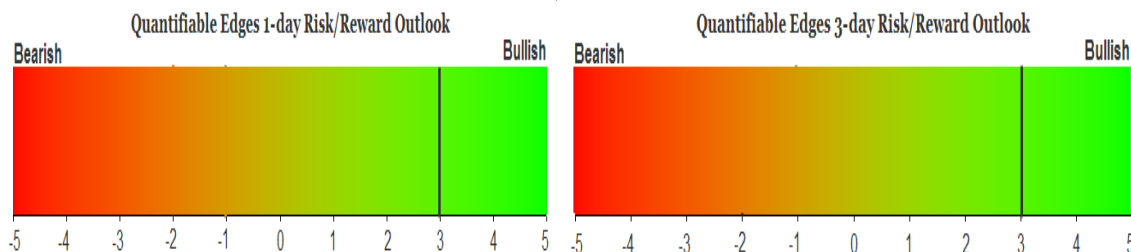
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 2, 2009

Volume 2 Issue 189

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				
October 2, 2009	Less than 5% up volume	1 day	Bullish	
October 2, 2009	2% drop over 200ma to 10-low bot10%	1-5 days	Bullish	2.80%
October 1, 2009	2 Down Days End the Quarter	1-2 days	Bullish	
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%
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 29, 2009	SPX up 1% on lowest vol in 20	1-3 days	Bearish	-1.80%
September 24, 2009	SPX down 1% SOX up	1-6 days	Bullish	

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

Short-term Outlook – updated 10/2

The Bottom Line

The market underwent a selloff on Thursday that was so extreme comparable selloffs have most often led to at least a short-term bounce. The Aggregator System gave a long signal after being flat for the last 2 days. There is a fair amount of evidence suggesting a bounce is likely. Of course the wildcard is the jobs report. Always highly anticipated, the jobs report has the ability to cause large gaps. Since the market is already oversold, a large gap down would suggest an even greater upside edge. See the below study for more information on large gaps down after the market has already fallen.

<http://quantifiableedges.blogspot.com/2009/04/putting-large-gaps-down-into-context.html>

The Evidence

October got off to a rough start. The market gapped down, never gained traction, put in a solid trend-day lower and closed near its lows. The S&P 500 closed down 2.5% and the Nasdaq 3%. Breadth was extremely negative. The NYSE Up Issue % came in at 16% and the Up Volume % just below 5%. NYSE volume fell slightly while Nasdaq volume rose slightly.

A lot came up in the Quantifinder and on my screens this evening. The action was fairly extreme on Thursday and that typically leads to some interesting results. I won't go through everything but will highlight some of the more significant occurrences today.

As I noted above, breadth was extreme. In the 4/21/09 blog studied other times the NYSE suffered a 95% down volume day. I've updated that study below:

NYSE Up Volume % closes under 5%. 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
5	55,348.37	34	19	15	55.88	4,968.93	-2,604.09	1.91	2.42	1,627.89
4	36,820.23	36	20	16	55.56	4,111.38	-2,837.96	1.45	1.81	1,022.78
3	19,258.13	37	19	18	51.35	3,501.99	-2,626.65	1.33	1.41	520.49
2	26,345.60	37	25	12	67.57	2,534.47	-3,084.67	0.82	1.71	712.04
1	30,790.01	38	27	11	71.05	2,404.59	-3,103.09	0.77	1.90	810.26

When selling gets this extreme it normally leads to a reflex bounce. There appears to be a good chance of a short-term move up. Most of the upside in this study is realized in just 1 day.

We can see the bounce tendency using many different metrics. One way is just looking at 2% moves, which on their own are fairly extreme. In the study below I also added the stipulation that the SPX should close above its 200ma.

SPX closes down 2% and above its 200ma. Buy on close. Sell X days later. \$100k/trade. 10/20/87 - 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	55,693.30	41	26	15	63.41	3,436.88	-2,244.37	1.53	2.65	1,358.37
9	60,201.45	42	29	13	69.05	3,126.33	-2,343.25	1.33	2.98	1,433.37
8	63,767.80	43	28	15	65.12	3,401.21	-2,097.73	1.62	3.03	1,482.97
7	43,059.71	43	27	16	62.79	2,926.30	-2,246.90	1.30	2.20	1,001.39
6	38,578.79	43	25	18	58.14	2,927.84	-1,923.17	1.52	2.11	897.18
5	32,569.12	43	22	21	51.16	2,900.55	-1,487.77	1.95	2.04	757.42
4	30,747.98	44	23	21	52.27	2,699.57	-1,492.48	1.81	1.98	698.82
3	24,720.84	44	25	19	56.82	2,061.71	-1,411.68	1.46	1.92	561.84
2	22,660.50	45	29	16	64.44	1,584.91	-1,456.37	1.09	1.97	503.57
1	19,099.83	46	33	13	71.74	908.33	-836.55	1.09	2.76	415.21

Here again we see a sharp move south – this time during a long-term uptrend – is typically followed by a substantial bounce. To better describe today’s action I elected to also add a few more stipulations. I looked at times the price finished near its low of the day and also at a 10-day low.

SPX drops more than 2%, closed at a 10-day low and above its 200ma. Close is in bottom 10% of daily range. Buy SPX on close. Sell X days later. \$100k/trade. 10/20/87 - 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	9,343.00	18	9	9	50.00	3,055.05	-2,016.94	1.51	1.51	519.06
9	15,815.71	19	12	7	63.16	2,960.33	-2,815.47	1.05	1.80	832.41
8	26,933.40	20	14	6	70.00	3,224.79	-3,035.61	1.06	2.48	1,346.67
7	27,588.20	20	14	6	70.00	3,083.89	-2,597.72	1.19	2.77	1,379.41
6	28,089.89	20	14	6	70.00	2,980.22	-2,272.19	1.31	3.06	1,404.49
5	31,609.35	20	14	6	70.00	2,804.34	-1,275.25	2.20	5.13	1,580.47
4	29,754.58	20	13	7	65.00	2,925.35	-1,182.13	2.47	4.60	1,487.73
3	22,768.12	20	13	7	65.00	2,494.59	-1,380.22	1.81	3.36	1,138.41
2	17,122.11	20	14	6	70.00	2,033.91	-1,892.10	1.07	2.51	856.11
1	14,950.34	20	16	4	80.00	1,156.81	-889.64	1.30	5.20	747.52

90% of instances closed above their entry price at some point in the next 3 days.

Much of the edge here occurs on day 1. And the rest of the edge is played out within 5 days. But even though it is short-term in nature, the short-term bounce appears fairly reliable.

I’ve already seen quite a bit written today about the spike in the VIX. From my standpoint that was one of the least notable occurrences with today’s trading. While VIX spike 10% or more above their 10-day moving average are often cited, they’re often not as reliable or significant as the SPX price patterns that accompany them. Today’s simple 2% study showed a much greater edge than a 10% over the 10ma VIX cross. Below is a study to exemplify this.

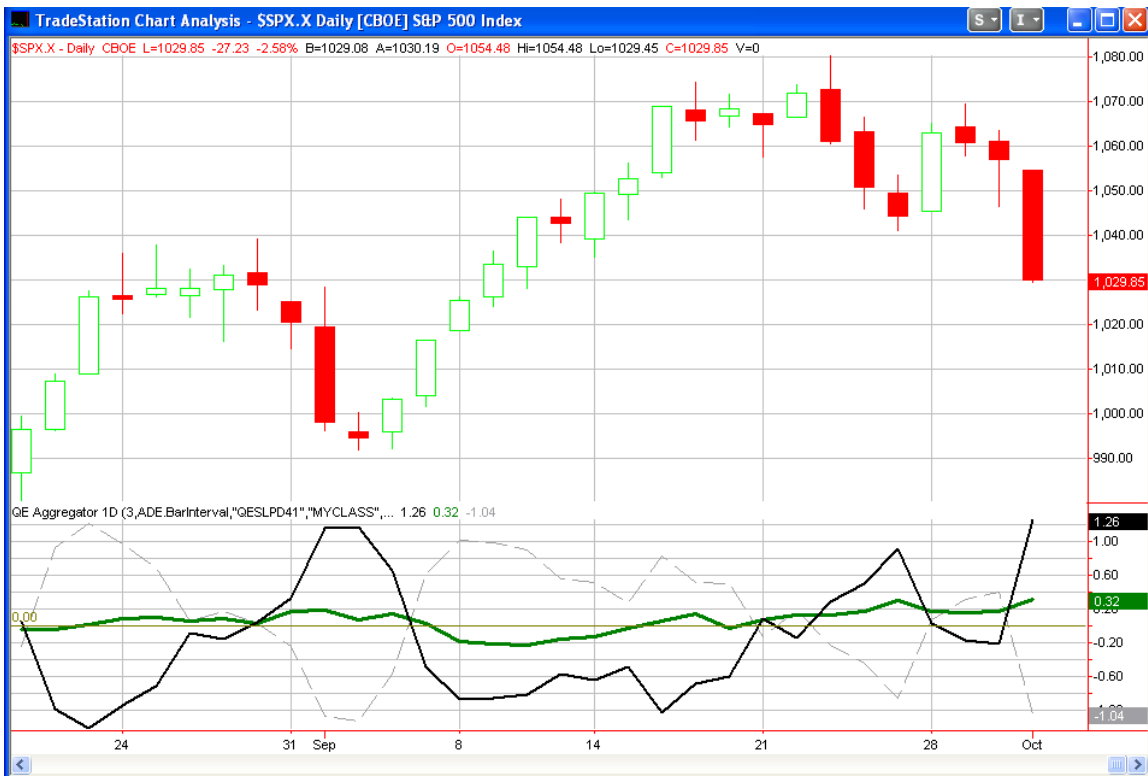
VIX crosses over and closes more than 10% above its 10ma.
Buy SPX on close. Sell X days later. \$100k/trade. 1991 - present.

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	91,584.21	154	91	63	59.09	2,627.75	-2,341.92	1.12	1.62	594.70
9	79,993.01	158	98	60	62.03	2,568.05	-2,861.27	0.90	1.47	506.28
8	68,254.34	161	100	61	62.11	2,255.49	-2,578.59	0.87	1.43	423.94
7	78,215.90	166	97	69	58.43	2,444.67	-2,303.15	1.06	1.49	471.18
6	87,024.24	174	105	69	60.34	2,208.43	-2,099.44	1.05	1.60	500.14
5	100,182.37	179	110	69	61.45	1,938.26	-1,638.05	1.18	1.89	559.68
4	70,264.33	191	113	78	59.16	1,758.23	-1,646.35	1.07	1.55	367.88
3	29,889.47	205	117	88	57.07	1,472.79	-1,618.49	0.91	1.21	145.80
2	8,115.51	219	118	101	53.88	1,292.79	-1,430.04	0.90	1.06	37.06
1	6,849.63	219	114	105	52.05	897.51	-909.20	0.99	1.07	31.28

While positive, the 1st 2 days don't even keep up long-term with market drift. This isn't a study to base a trade on.

The extreme selling today does suggest an edge and I've added 2 studies to the active list.

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



The Aggregator configuration moved back to bullish today. The green Aggregator line is squarely positive, illustrating the net positive expectations from the active studies. Of course without any active bearish studies net expectations would have to be bullish.

Meanwhile the black differential line shows the market is as oversold versus expectations as it has been since early July. With both lines now back above 0, the Aggregator System triggered a buy this afternoon as was suggested was likely on the systems triggers page before the close.

I began scaling in at the close Thursday and will continue to do so near the close Friday should the market fail to rebound.

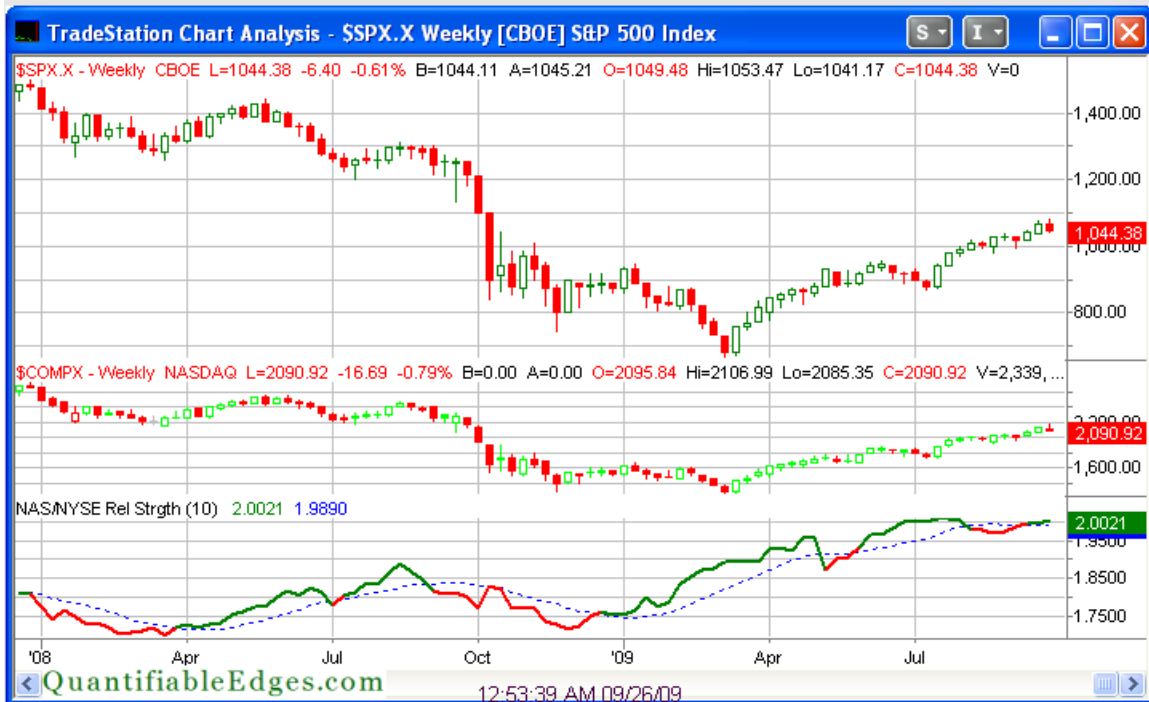
Today's action was a great example of why I don't like taking positions from the middle of a trading range. Even with an assumed edge, risk/reward is generally working against you. Today's action was also a great example of why I normally require both lines on the Aggregator chart to be in agreement before taking on index positions. I uploaded the Aggregator System document to the systems page tonight ([click here to view systems page](#)). In addition to the original sections which describe the concept and discuss performance, I also added a section that looks at trading the open vs. trading the close. Subscribers are encouraged to review it. The next step, which I hope to have completed by tomorrow, is to get the entire Aggregator history in a downloadable format for subscribers to use in their own research.

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 good 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.

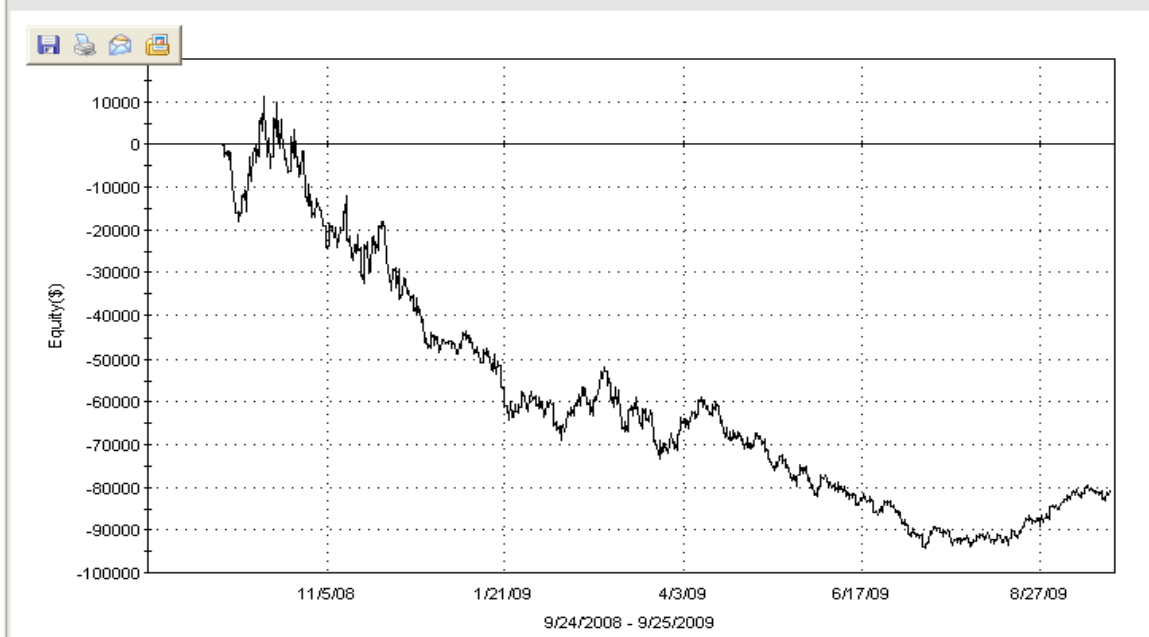
The Nasdaq/S&P 500 Relative Strength remains precariously bullish. This is now the 3rd weeks in a row the Nasdaq has been in a leading position. The lead is extremely small, though and will again depend on more outperformance this week to remain bullish. I've copied the chart from the website below.

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

XRX @ 7.68 – (entry not filled)

New

UTX buy 1/3 @ \$59.99.

Catapult for ETF's Trades

none

Broad Market Large Cap CBI –2(XRX,UTX)

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 1/4 index position @ \$102.00 limit ON OPEN. Based on the short-term market outlook above. The jobs report could cause a gap tomorrow morning. Large gaps down when the market is already oversold have a strong tendency to rebound. I'll be a buyer in such a case. Otherwise, I will wait until the close and look to buy 1/4 index position @ \$102.99 limit on CLOSE. I am only looking for 1/4 more going into the weekend, so if the gap down fills, I won't be looking for more at the close.

XRX – buy 1/3 position @ \$7.45 limit (based on unfilled open Catapult)

UTX – buy 1/3 @ \$59.99. New Catapult trigger listed above.

Traders should recall that while the Catapults have done very well, they are also very volatile. Consider your position sizes carefully if you look to trade a catapult.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
IBB	10/1/2009	\$81.21	\$78.84	-2.92%		system 80609
SPY(1/4)	10/1/2009	\$103.00	\$103.00	0.00%		

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