

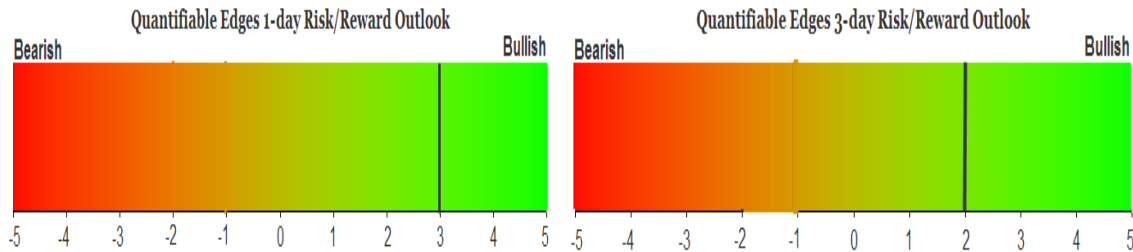
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 22, 2009

Volume 2 Issue 203

## Market Overview



## Tonight's Research Points

- Mixed studies tonight net out to a bullish expectation for tomorrow.
- A 10-day high & a 5-day closing low on the same day have historically had bearish implications over the next 1-2 days.
- The 1<sup>st</sup> 5-day low in at least 2 weeks often leads to a short-term bounce.
- 2 Days Down In Chop suggests bounce is likely.
- Very large late-day selloffs have been followed by a higher close the next day fairly consistently since 1997.
- The Aggregator System went from flat to long at today's close.

## Short-term Outlook – updated 10/22

### The Bottom Line

A late-day turnaround ruled tonight's thinking. Several studies appeared in the Quantifinder. I chose the most compelling and examined some new ideas as well. On the whole Wednesday's action appears to have the market primed for a bounce

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
<b>Active</b>				
October 22, 2009	10-day high & 5-day closing low	1-2 days	Bearish	-1.20%
October 22, 2009	2 Days Down In Chop	1-3 days	Bullish	
October 22, 2009	Extreme last hour selloff	1 day	Bullish	
October 20, 2009	SPX & VIX both close higher on Monday	1-3 days	Bearish	-1.70%
<b>Active - Long Term</b>				
October 19, 2009	VIX:VXV drops below 0.9	2-5 months	Bearish	
<b>Dropped Tonight</b>				
October 19, 2009	Big drop from 10-high above 200	1-3 days	Bearish	-1.40%
October 15, 2009	Breakout above 50-day high	1-5 days	Bullish	1.80%

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

### ***The Evidence***

A morning rally was followed by an afternoon smackdown as just about everything went from green to red in the last hour. In the last 45 minutes of the day the SPX fell nearly 1.5%. When it was over the Nasdaq Composite was down 0.6% and the S&P 500 was down 0.9%. Banks were hit especially hard. They dropped 2.4% and actually sliced through their 50-day moving average. Breadth came in solidly negative. The NYSE Up Issues % was 33% and the Up Volume % was 27%. Total volume spiked to its highest level since the October 1<sup>st</sup> selloff.

I examined today's selloff a number of different ways tonight. MOST of what I saw suggested an upside edge. I thought I might as well start with the exception and show a bearish study.

**SPX posts the highest high in 10 days and the lowest close in 5 days. Close > 200ma.  
Buy on close. Sell X days later. \$100k/trade. 1978 - present.**

<b>X Days</b>	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	-924.49	26	12	14	46.15	1,770.21	-1,583.36	1.12	0.96	-35.56
9	-7,990.42	26	11	15	42.31	1,412.03	-1,568.18	0.90	0.66	-307.32
8	-12,345.44	26	9	17	34.62	1,550.71	-1,547.17	1.00	0.53	-474.82
7	-16,822.60	26	10	16	38.46	1,283.94	-1,841.38	0.70	0.44	-639.33
6	-15,967.57	26	10	16	38.46	1,178.67	-1,734.64	0.68	0.42	-614.14
5	-6,453.48	26	11	15	42.31	1,028.07	-1,184.15	0.87	0.64	-248.21
4	-14,165.51	26	7	19	26.92	1,088.84	-1,146.70	0.95	0.35	-544.83
3	-15,440.49	26	10	16	38.46	595.25	-1,337.06	0.45	0.28	-593.87
2	-15,796.78	26	8	18	30.77	466.34	-1,084.86	0.43	0.19	-607.57
1	-6,921.59	26	13	13	50.00	314.09	-846.52	0.37	0.37	-266.22

**84% of instances closed lower than the entry price at some point within a week.**

The fact that the market hit both a 10-day intraday high and a 5-day closing low suggests it was in a bit of congestion prior to the drop. It would be tough to accomplish this feat if the range over the last week was very wide. Breakdowns from areas of congestion often have a better chance of following through than a move that is already extended down. The apparent edge here isn't very long-lasting and basically maxes out after just 2 days.

But while the last few days have been somewhat sideways and choppy the market generally has been locked in a fairly strong uptrend. This condition is baked into the next study that first appeared on 8/7/2009 and again on 9/24/2009.

SPY closes at a 5-day low after not having done so for at least 10 days.  
Buy on close. Sell X days later. \$100k/trade. 1993 - 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	69,919.49	98	64	34	65.31	2,192.55	-2,070.70	1.06	1.99	713.46
9	60,208.41	98	63	35	64.29	2,012.57	-1,902.39	1.06	1.90	614.37
8	58,012.68	98	62	36	63.27	2,002.73	-1,837.68	1.09	1.88	591.97
7	49,356.65	98	63	35	64.29	1,890.59	-1,992.87	0.95	1.71	503.64
6	33,053.56	98	60	38	61.22	1,712.26	-1,833.75	0.93	1.47	337.28
5	33,512.65	98	60	37	61.22	1,595.08	-1,680.87	0.95	1.54	341.97
4	44,171.44	98	62	36	63.27	1,508.90	-1,371.67	1.10	1.89	450.73
3	28,775.43	98	59	39	60.20	1,356.22	-1,313.88	1.03	1.56	293.63
2	16,583.19	98	54	43	55.10	1,112.76	-1,011.77	1.10	1.38	169.22
1	7,465.36	98	54	44	55.10	849.96	-873.46	0.97	1.19	76.18

The edge here isn't as pronounced but there does appear to be some upside advantage over the next few days.

With today being the 2<sup>nd</sup> day down in a row, the "2 Days Down In Chop" system triggered a buy. Below is an updated stats sheet for "2 Days Down In Chop".

SPX closes down for the 2nd day in a row. Buy on close. Sell next profitable close up to 3 days later. On day 3 sell regardless of profitability. \$100k/trade. 6/1/2007 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$45,963.68	Profit Factor	2.17
Gross Profit	\$85,313.38	Gross Loss	(\$39,349.70)
Total Number of Trades	70	Percent Profitable	84.29%
Winning Trades	59	Losing Trades	11
Even Trades	0		
Avg. Trade Net Profit	\$656.62	Ratio Avg. Win:Avg. Loss	0.40
Avg. Winning Trade	\$1,445.99	Avg. Losing Trade	(\$3,577.25)
Largest Winning Trade	\$10,716.03	Largest Losing Trade	(\$10,506.45)

And below is a profit curve. The system remains basically on track at the current time.



While all of the above studies are descriptive of Wednesday's action, they all use daily bars. What I found most interesting and was most looking forward to studying was not the daily bars but rather the selloff in the last hour. That's the action that really made the day what it was. It's also where I found some of the most compelling evidence.

I found it notable that the size of the last hour selloff was greater than the average true range of the daily bars for the last 2 weeks. I decided to test last hour selloffs based on that criteria. What I found is over the last 12 years or so there has been a consistent tendency to bounce the next day. After day 1 returns become more random. Below is a summary of the 1-day results.

SPX drops more from the high to the close in the last hour than the size of yesterday's 10-day average true range. Buy on close. Sell next day. \$100k/trade. 2/1/97 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ↕</span>			
All Trades			
Total Net Profit	\$22,546.17	Profit Factor	18.45
Gross Profit	\$23,838.13	Gross Loss	(\$1,291.96)
Total Number of Trades	17	Percent Profitable	82.35%
Winning Trades	14	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	\$1,326.25	Ratio Avg. Win:Avg. Loss	3.95
Avg. Winning Trade	\$1,702.72	Avg. Losing Trade	(\$430.65)
Largest Winning Trade	\$5,114.04	Largest Losing Trade	(\$948.46)
Largest Winner as % of Gross Profit	21.45%	Largest Loser as % of Gross Loss	73.41%

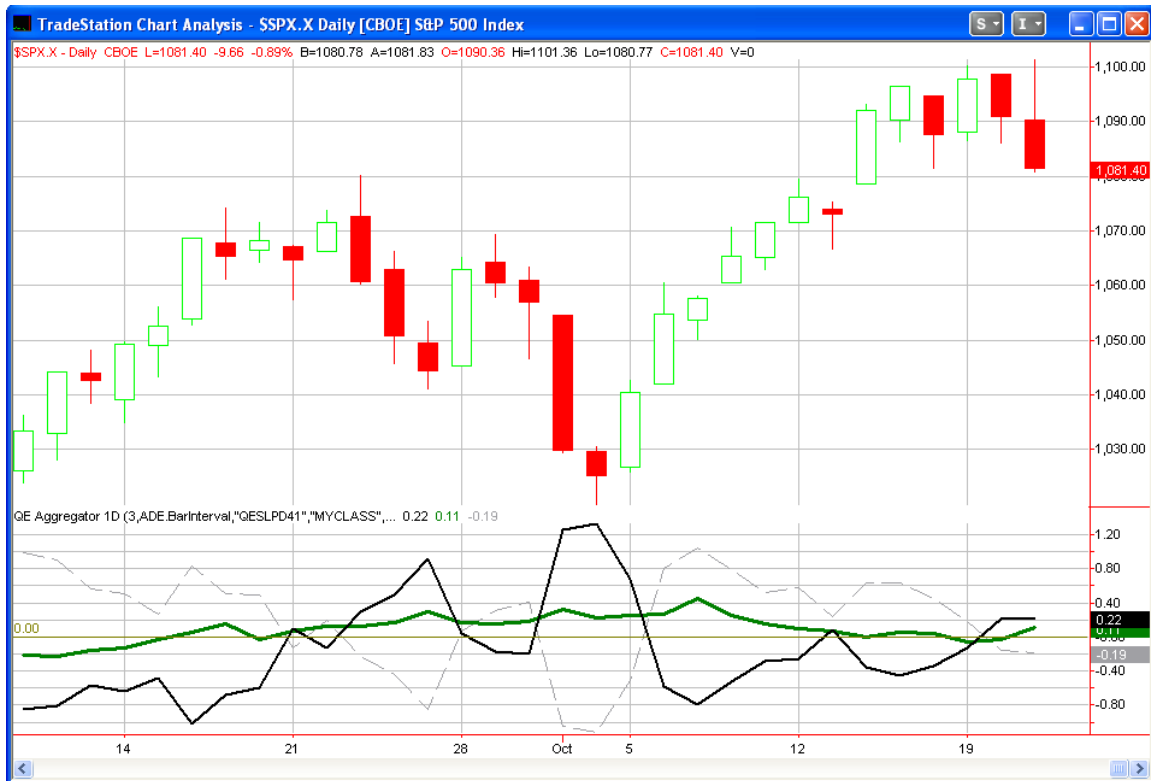
These are some compelling numbers and strongly suggestive of a 1-day upside edge. Below I have listed every instance and provided a few observations.

SPX drops more from the high to the close in the last hour than the size of yesterday's 10-day average true range. Buy on close. Sell next day. \$100k/trade. 2/1/97 - present.					
Date/Time	Signal	Price	% Profit	Run-up	DrawDown
02/05/97 16:00	Buy	\$778.18	0.25%	\$277.76	
02/06/97 16:00	Sell	\$780.13			(\$477.44)
06/23/97 16:00	Buy	\$878.62	2.02%	\$2,048.69	
06/24/97 16:00	Sell	\$896.34			\$0.00
10/27/97 16:00	Buy	\$876.99	5.12%	\$5,253.12	
10/28/97 16:00	Sell	\$921.85			(\$2,476.08)
08/04/98 16:00	Buy	\$1,072.15	0.86%	\$1,176.45	
08/05/98 16:00	Sell	\$1,081.41			(\$1,376.40)
08/31/98 16:00	Buy	\$958.57	3.69%	\$4,368.00	
09/01/98 16:00	Sell	\$993.92			(\$1,933.36)
12/03/98 16:00	Buy	\$1,149.67	2.34%	\$2,328.02	
12/04/98 16:00	Sell	\$1,176.59			\$0.00
05/25/99 16:00	Buy	\$1,284.38	1.59%	\$1,574.65	
05/26/99 16:00	Sell	\$1,304.76			(\$450.45)
09/23/99 16:00	Buy	\$1,280.41	(0.24%)	\$62.40	
09/24/99 16:00	Sell	\$1,277.36			(\$1,296.36)
09/04/01 16:00	Buy	\$1,132.94	(0.11%)	\$227.04	
09/05/01 16:00	Sell	\$1,131.74			(\$1,591.04)
01/09/02 16:00	Buy	\$1,155.14	0.12%	\$411.94	
01/10/02 16:00	Sell	\$1,156.55			(\$368.94)
03/11/04 16:00	Buy	\$1,106.79	1.25%	\$1,245.60	
03/12/04 16:00	Sell	\$1,120.60			(\$0.90)
04/20/04 16:00	Buy	\$1,118.09	0.54%	\$679.07	
04/21/04 16:00	Sell	\$1,124.12			(\$183.34)
07/21/04 16:00	Buy	\$1,093.88	0.27%	\$528.71	
07/22/04 16:00	Sell	\$1,096.84			(\$884.52)
02/27/07 16:00	Buy	\$1,399.04	0.56%	\$1,196.35	
02/28/07 16:00	Sell	\$1,406.82			(\$169.69)
07/27/07 16:00	Buy	\$1,458.95	1.03%	\$1,287.24	
07/30/07 16:00	Sell	\$1,473.91			(\$314.84)
09/17/08 16:00	Buy	\$1,156.39	4.33%	\$4,708.50	
09/18/08 16:00	Sell	\$1,206.51			(\$1,968.54)
09/23/09 16:00	Buy	\$1,060.87	(0.95%)	\$509.48	
09/24/09 16:00	Sell	\$1,050.78			(\$1,411.88)

Observations:

- 1) Only twice was there not some downside the next day.
- 2) Only 3 of 17 instances did the max intraday loss exceed the AVG closing gain. (1.7%)
- 3) 13 of 17 instances had an intraday run-up of at least 0.5% the next day.

I placed the 3 most compelling studies into the Active Studies list tonight. The [Aggregator](#) chart is updated below.



The green Aggregator line curled up with today's studies factored in. It now sits squarely above 0 with a value of 0.11. This illustrates the net expectations from the active studies over the next few days is positive. The black Differential line, which measures the performance of the SPX over the last few days versus expectations, is indicating it has underperformed expectations recently. Both lines above 0 is the configuration I look for when considering long positions. Since the inception of the Subscriber Letter in Feb, 2008 this configuration has provided a substantial upside edge. This confirms the probable long call made on the systems page shortly before the close.

Interesting about the current makeup of the Aggregator is that without additional studies triggering tomorrow the green Aggregator line is set to turn just barely below 0. A positive close would almost certainly move it below 0 as the "2 Days Down In Chop" system would come off the Active List. A close down would need to be examined further to see if more bullish or bearish influences appear tomorrow. The last few trades have been very quick and we're hoping for the same thing here.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 10/19 – slightly bullish***

The intermediate-term outlook is unchanged since the 10/19 Letter. That Letter may be accessed using the link below:

[2009-10-19 QE Subscriber Letter.pdf](#)

**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 1/4 index share @ \$108.23 limit. Based on short-term outlook and Aggregator System.*

*SPY buy 1/4 index share @ \$107.50 LIMIT ON OPEN. If not filled on open, cancel order. The "Last Hour" study suggested downside would likely be limited intraday. Should the market gap down to open the day, I'll look to take on some extra exposure. I will likely trail a stop on this portion of the trade should it turn profitable during the morning or afternoon.*

**Active Trades Table**

None.

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