

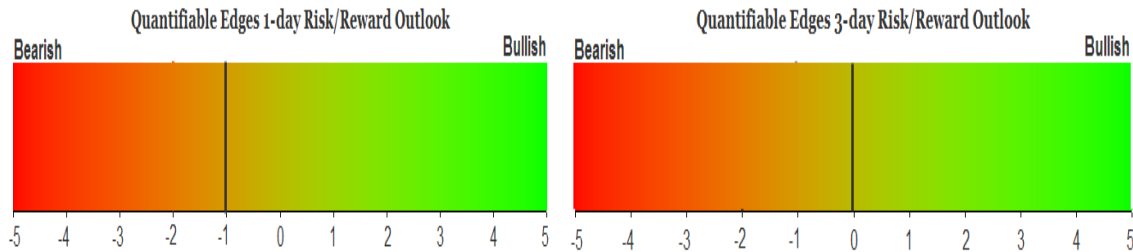
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 23, 2009

Volume 2 Issue 204

## Market Overview



## Tonight's Research Points

- Thursday's rally led to both bullish studies from last night being removed from the Active List.
- The back to back reversal days under similar market conditions have led to mildly bearish short-term returns in the past. (See studies for details.)
- Aggregator chart is back to a neutral configuration.

## Short-term Outlook – updated 10/23

### The Bottom Line

Last night's edges played out nicely on Thursday. The constant back and forth lately has eroded most edges and put the market in a sideways congestion. I see very little edge to either side at the present.

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%
<b>Active - Long Term</b>				
October 19, 2009	VIX:VXV drops below 0.9	2-5 months	Bearish	
<b>Dropped Tonight</b>				
<b>October 22, 2009</b>	<b>2 Days Down In Chop</b>	<b>1-3 days</b>	<b>Bullish</b>	
<b>October 22, 2009</b>	<b>Extreme last hour selloff</b>	<b>1 day</b>	<b>Bullish</b>	
October 20, 2009	SPX & VIX both close higher on Monday	1-3 days	Bearish	-1.70%

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

### The Evidence

The market put in a nice rebound Thursday. Early morning selling was well contained and after hitting a low around 10am it stair-stepped higher for the rest of the day. The S&P and Dow both rose over 1% while the Nasdaq was up 0.7%. Breadth was solidly positive. The NYSE Up Issues % came in at 67% and the Up Volume % was 74%. NYSE volume came in lower but was still a little above average.

The last two days we've seen opposing reversals. Wednesday the market made a new high but closed down on the day. Thursday it hit a 7-day low before reversing to close up on the day. A reversal off a 7-day high followed by a reversal off a 7-day low would seem a bit unusual. I looked back to 1978 and found out just how unusual it was. Below is what I found.

Yesterday SPX makes a 7-day high and closes down on the day. Today SPX makes a 7-day low and closes up on the day. Buy on close. Sell X days later. \$100k/trade. 1978 - 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	-4,059.19	5	1	4	20.00	849.31	-1,227.13	0.69	0.17	-811.84
4	-4,148.89	5	0	5	0.00	0.00	-829.78	0.00	0.00	-829.78
3	-4,050.64	5	0	5	0.00	0.00	-810.13	0.00	0.00	-810.13
2	-4,384.07	5	0	5	0.00	0.00	-876.81	0.00	0.00	-876.81
1	-3,642.14	5	0	5	0.00	0.00	-728.43	0.00	0.00	-728.43

It'd be dangerous to trade based off of just a sample set of 5, but I was still fairly amazed that there wasn't a single instance of a profitable close within the next 4 days.

Narrowing the requirement to 5 days or 3 days showed little edge at all. But what if we broaden the requirement and only insist on a high above the previous day's high on day 1 and a low below the day 1 low on day 2? Looking at these kind of situations above the 200ma since 2000 produced the following results:

Yesterday SPX makes a higher high and closes down on the day. Today SPX makes a lower low and closes up on the day. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	21,904.46	36	24	12	66.67	1,360.56	-895.74	1.52	3.04	608.46
4	12,423.98	37	24	13	64.86	1,199.99	-1,259.68	0.95	1.76	335.78
3	4,964.56	37	23	14	62.16	1,034.51	-1,344.94	0.77	1.26	134.18
2	6,358.71	37	22	15	59.46	831.52	-795.65	1.05	1.53	171.86
1	1,993.98	37	19	18	51.35	551.28	-471.13	1.17	1.24	53.89

These results would seem to suggest an upside edge. The false breakdown often sees short-term bullish follow through. It isn't quite that simple, though.

One thing I've learned about reversal bars is that they typically only provide a decent edge when the market is stretched. Reversals off lows can generate some frenetic short covering and with room to the upside they are often worth taking.

The current situation appears quite different, though. After today's rally the market is nearing its highs again already. One way to determine if price is relatively high or low is to compare it to the 10-day moving average. Today the SPX actually closed ABOVE its 10-day moving average. Below I show results for times it closed above the 10ma and times it closed below it. First let's check out times like the present where it closed above the 10ma.

Yesterday SPX makes a higher high and closes down on the day.  
Today SPX makes a lower low and closes up on the day. Close > 200ma and **close > 10ma**.  
Buy on close. Sell X days later. \$100k/trade. 2000 - 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	-4,198.02	22	12	10	54.55	842.20	-1,430.44	0.59	0.71	-190.82
4	-4,671.81	22	11	11	50.00	885.89	-1,310.60	0.68	0.68	-212.36
3	-3,325.86	22	12	10	54.55	872.67	-1,379.79	0.63	0.76	-151.18
2	-478.08	22	12	10	54.55	529.13	-682.76	0.77	0.93	-21.73
1	-816.30	22	11	11	50.00	397.58	-471.79	0.84	0.84	-37.10

The positive results above turned negative pretty quickly with just a 10ma filter. The winning % turned to a coin flip, and with more room to fall than to rise the average win was dwarfed by the average loss. This would suggest the current setup does NOT have bullish implications.

So what of those times the SPX formed the pattern and closed *below* the 10ma?

Yesterday SPX makes a higher high and closes down on the day.  
Today SPX makes a lower low and closes up on the day. Close > 200ma and **Close < 10ma**.  
Buy on close. Sell X days later. \$100k/trade. 2000 - present.

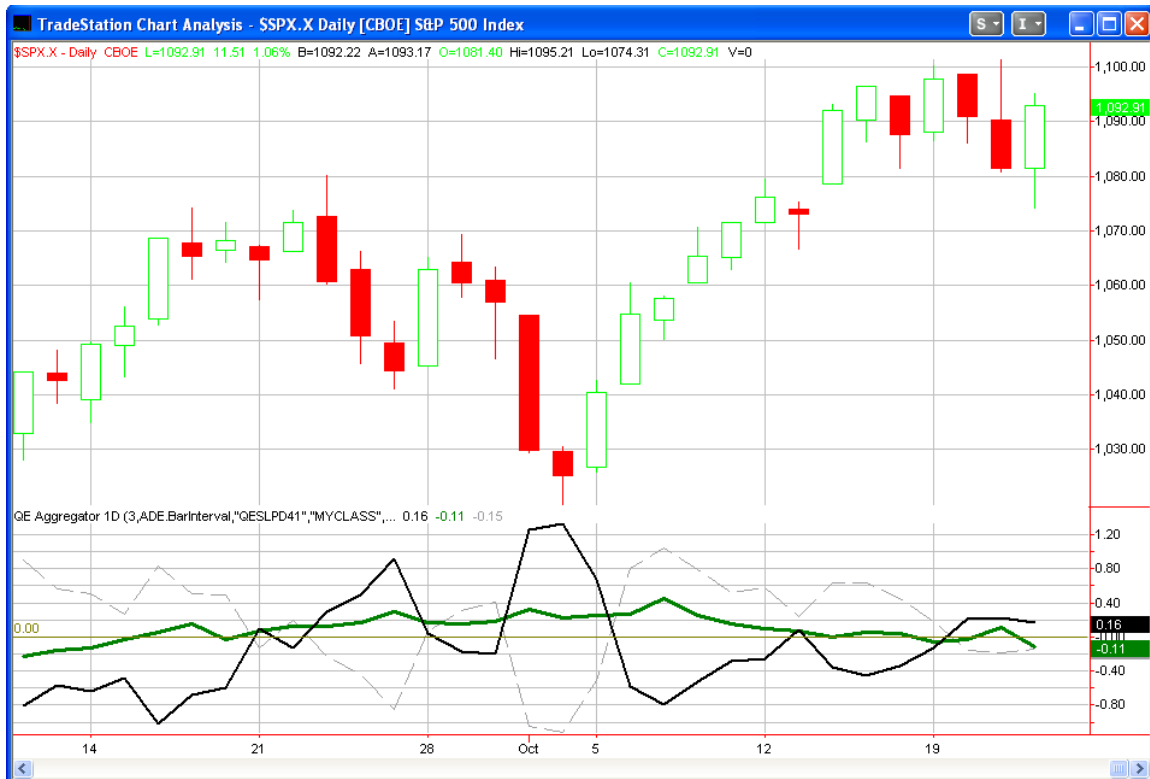
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	22,331.88	15	12	3	80.00	1,878.92	-71.70	26.21	104.82	1,488.79
4	17,095.79	15	13	2	86.67	1,465.77	-979.62	1.50	9.73	1,139.72
3	8,290.42	15	11	4	73.33	1,211.07	-1,257.84	0.96	2.65	552.69
2	6,836.79	15	10	5	66.67	1,194.39	-1,021.41	1.17	2.34	455.79
1	2,810.28	15	8	7	53.33	762.62	-470.10	1.62	1.85	187.35

**14 of 15 instances (93%) closed above the entry price at least once during the next 5 days. Looking out 7 days, 100% had a profitable close.**

Here's where the upside edge lies. Unfortunately for the bulls, Thursday didn't cut it. But while it's clear the pattern of the last two days doesn't suggest a bullish edge, the downside edge is a bit iffy. I'm therefore going to leave it off the active studies list.

This concept of examining where you are within the recent range is an important one. In the next few days I'll be posting an addendum to the Aggregator System working document that shows how this concept could be utilized to improve results. Speaking of the Aggregator...

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



There have been some quick exits for Aggregator System positions lately and Thursday was one. With the market rising strongly the bullish studies were successful and removed the from Active Studies list. With just one active study left – an incredible rarity – the green Aggregator line flipped down to bearish. The black Differential line is still above 0, illustrating the fact that the SPX has underperformed expectations over the last few days. With the lines back on opposite sides of 0, the bias is back to neutral.

This seems like a good place to step aside for a day or two. SPX is near the center of a congestion area. I prefer trading from the outer edges or at extreme levels rather than from mid-congestion in most cases.

**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.*

*None tonight.*

**Active Trades Table**

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)	10/22/2009	\$108.19	\$109.33	1.05%		<i>bought open/sold close</i>

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