

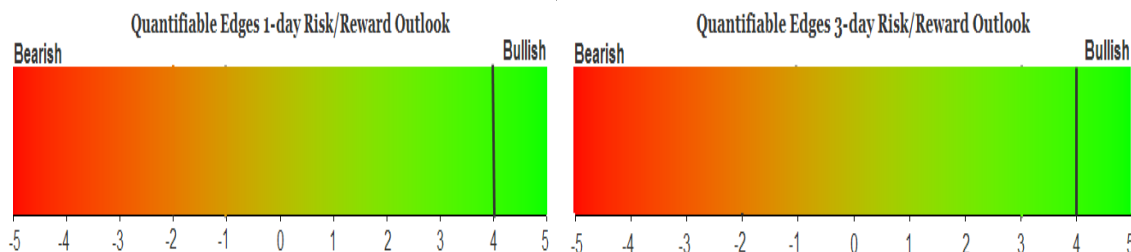
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 27, 2009

Volume 2 Issue 206

Market Overview



Tonight's Research Points

- Back to back days of 33.3% Up Issues have historically led to an upside edge.
- A positive SOX while the SPX dropped over 1% is a potentially bullish sign.
- Weak closes have consistently led to bounces since the market bottom in March.
- For SPX to go from a 1% gain intraday to a 1% loss at the close is very unusual when trading above the 200ma. Historically it has led to generally bullish results, but there have been no instances prior to Monday for about 10 years.
- Tuesday has been the most likely day of the week to see an oversold bounce.
- The Aggregator System remains long.

Short-term Outlook – updated 10/27

The Bottom Line

Highly unusual action Monday as the expected bounce failed to hold up after early morning. Several indicators are now suggesting a move up. While I am continuing to scale in and expecting a bounce in the next few days, I am watching carefully. A failure to bounce could be a sign of possible intermediate-term trouble.

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 27, 2009	SPX drops 1% while SOX gains	1-6 days	Bullish	3.00%
October 27, 2009	Up Issue % < 33.3% 2nd day in a row	1-2 days	Bullish	2.40%
October 26, 2009	4th Friday under 200ma drops 1%	1-2 days	Bullish	2.10%
October 26, 2009	1% Dn Decliners double advancers	1-9 days	Bullish	3.00%
Active - Long Term				
October 26, 2009	Nasdaq/SPX Rel Strength Favors Nas		Bullish	
October 19, 2009	VIX:VXV drops below 0.9	2-5 months	Bearish	

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

The Evidence

A good start on Monday turned sour. Led by a dollar bounce, commodities and financials suffered strong selloffs. Tech held up relatively well. The SPX went from a 1% gain intraday to a 1.2% decline at the close. Breadth was strongly negative for the 2nd day in a row. The NYSE Up Issues % came in at 24% and the Up Volume % was 12%. Total volume rose and was above average.

There were a good number of signs Monday that the selling has been strong enough the last few days that a bounce appears likely. Several bullish studies were identified by the Quantifinder. I'll identify some of the most prominent.

Not only was Monday the 2nd down day in a row (2 Days Down In Chop setup), but both days decliners have outpaced advancers by more than 2 to 1. The 8/18/09 Subscriber Letter showed a study that looked at this. I've updated those results below:

NYSE Up Issues % < 33.3% for the 2nd day in a row. Buy SPX on close. Sell X days later. \$100k/trade. 1/1/99 - 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	33,869.77	56	31	25	55.36	3,585.98	-3,091.83	1.16	1.44	604.82	
9	63,659.01	59	38	21	64.41	3,510.13	-3,320.29	1.06	1.91	1,078.97	
8	79,978.95	59	39	20	66.10	3,562.57	-2,948.07	1.21	2.36	1,355.58	
7	68,616.02	60	41	19	68.33	2,955.91	-2,767.17	1.07	2.31	1,143.60	
6	73,480.79	62	41	21	66.13	3,056.92	-2,469.19	1.24	2.42	1,185.17	
5	65,637.47	62	41	21	66.13	2,619.77	-1,989.20	1.32	2.57	1,058.67	
4	64,061.88	64	39	25	60.94	2,933.01	-2,013.01	1.46	2.27	1,000.97	
3	45,082.21	68	43	25	63.24	2,515.24	-2,522.92	1.00	1.71	662.97	
2	66,913.25	70	46	24	65.71	2,361.27	-1,737.72	1.36	2.60	955.90	
1	57,260.35	89	56	33	62.92	1,801.41	-1,321.78	1.36	2.31	643.37	

91% of instances close above the entry price at some point in the next week.

These results suggest an upside edge. A good portion of the upside takes place in the first two days.

Two interesting and unrelated studies from the 9/24/09 Subscriber Letter were identified. The first looked at times the SPX suffered a strong selloff while the SOX closed up on the day. The results below have NOT been updated from 9/24/09:

SPX drops more than 1% while SOX closes positive on the day.
Buy SPX on close. Sell X days later. \$100k/trade. 1995 - 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
20	91,591.22	35	29	6	82.86	3,938.10	-3,768.95	1.04	5.05	2,616.89
19	80,625.51	35	28	7	80.00	3,893.75	-4,057.09	0.96	3.84	2,303.59
18	79,862.72	36	28	8	77.78	4,007.52	-4,043.49	0.99	3.47	2,218.41
17	87,329.39	36	31	5	86.11	3,578.63	-4,721.62	0.76	4.70	2,425.82
16	90,998.96	36	30	6	83.33	3,608.40	-2,875.51	1.25	6.27	2,527.75
15	89,496.45	38	32	6	84.21	3,418.23	-3,314.51	1.03	5.50	2,355.17
14	82,469.93	38	29	9	76.32	3,510.81	-2,149.30	1.63	5.26	2,170.26
13	68,128.29	39	31	8	79.49	3,163.58	-3,742.83	0.85	3.28	1,746.88
12	55,304.42	39	30	9	76.92	2,773.84	-3,101.20	0.89	2.98	1,418.06
11	59,499.84	39	29	10	74.36	3,259.40	-3,502.27	0.93	2.70	1,525.64
10	40,218.70	39	29	10	74.36	2,668.81	-3,717.69	0.72	2.08	1,031.25
9	34,405.79	41	28	13	68.29	2,571.61	-2,892.25	0.89	1.92	839.17
8	48,546.57	41	28	13	68.29	2,680.37	-2,038.75	1.31	2.83	1,184.06
7	53,549.57	42	29	13	69.05	2,808.18	-2,145.21	1.31	2.92	1,274.99
6	53,557.93	43	32	11	74.42	2,744.65	-3,115.52	0.88	2.56	1,245.53
5	44,549.88	44	29	15	65.91	2,693.81	-2,238.05	1.20	2.33	1,012.50
4	40,465.18	44	28	16	63.64	2,369.19	-1,617.01	1.47	2.56	919.66
3	24,069.86	46	27	19	58.70	2,231.22	-1,903.84	1.17	1.67	523.26
2	19,152.78	47	26	21	55.32	2,010.52	-1,577.18	1.27	1.58	407.51
1	16,006.30	49	23	26	46.94	1,611.25	-809.71	1.99	1.76	326.66

87% of instances closed higher than the entry price at some point in the next week.

The positive inclinations here have often played out well beyond the initial 5-6 days.

Also notable from the 9/24/09 Letter was the study that looked at weak closes since the March bottom. I have updated the stats for that study below:

SPX closes in bottom 10% of daily range. Buy on close. Hold X days.
\$100k/trade. 3/6/09 - 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
3	28,703.35	16	13	3	81.25	2,590.60	-1,658.16	1.56	6.77	1,793.96
2	17,567.33	18	12	6	66.67	2,140.96	-1,354.03	1.58	3.16	975.96
1	9,989.30	18	11	7	61.11	1,252.97	-541.91	2.31	3.63	554.96

Of the 18 instances, only 1 (5/11/09) failed to close higher than the entry price at some point in the next 3 days.

Of the 18 instances, only 1 (5/20/09) failed to trade above the closing price at some point the next day.

I consider this particular study to be environmental. It is indicative of the strength of the rally of the last 7 months and not necessarily an all-weather setup. While I won't be

adding this study to the Aggregator I do think it will be important to see how it plays out over the next few days.

Coming into today there seemed to be a bullish edge. Although the market had only dropped one day, it quickly achieved readings that have been consistently bought over the last several months. And they were bought early this morning, but that rally failed to stick. Should the market continue to fail to bounce from oversold conditions that could indicate a change of character for the market.

It has been quite unusual to see such a strong intraday rally turn and close the day so poorly, especially when the market is in a long-term uptrend. In fact there have only been 5 instances since 1983 where a 1% intraday gain has turned into a 1% closing loss. Below are stats on those:

SPX trades up over 1% intraday before closing down over 1%. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1983 - present.											
QE Finder Tester: daysin	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	17,717.20	5	5	0	100.00	3,543.44	0.00	100.00	100.00	3,543.44	
9	15,774.55	5	5	0	100.00	3,154.91	0.00	100.00	100.00	3,154.91	
8	16,786.07	5	5	0	100.00	3,357.21	0.00	100.00	100.00	3,357.21	
7	15,854.29	5	5	0	100.00	3,170.86	0.00	100.00	100.00	3,170.86	
6	13,929.09	5	4	1	80.00	3,615.98	-534.83	6.76	27.04	2,785.82	
5	11,840.83	5	4	1	80.00	3,467.98	-2,031.09	1.71	6.83	2,368.17	
4	8,801.50	5	3	2	60.00	3,884.69	-1,426.29	2.72	4.09	1,760.30	
3	9,339.29	5	3	2	60.00	4,102.39	-1,483.94	2.76	4.15	1,867.86	
2	4,766.20	5	3	2	60.00	2,520.88	-1,398.22	1.80	2.70	953.24	
1	1,720.34	5	2	3	40.00	1,732.79	-581.74	2.98	1.99	344.07	

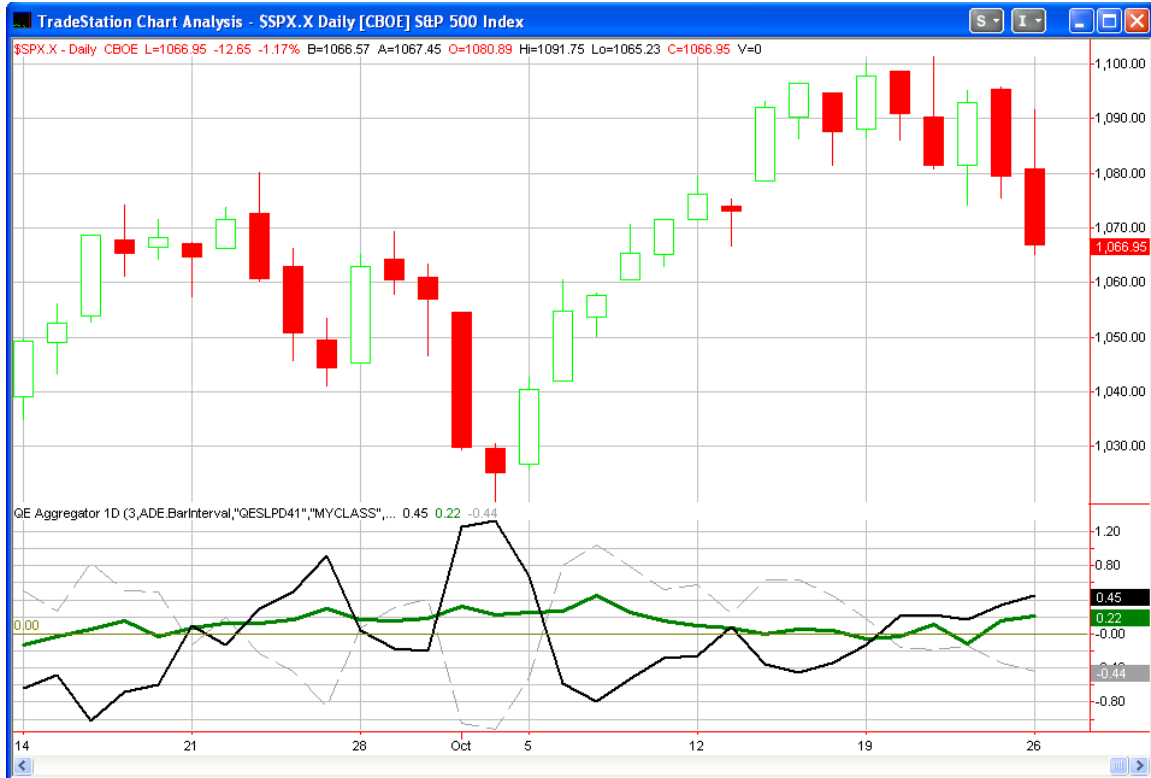
Unfortunately, the most recent instance was in 1999. Below are the 5 instances between '83 and '99 using the 10-day exit criteria.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/03/83	Buy	\$138.33	6.06%	\$7,761.50
01/17/83	Sell	\$146.71		(\$743.66)
01/23/87	Buy	\$270.10	3.68%	\$4,499.20
02/06/87	Sell	\$280.04		(\$880.60)
01/23/97	Buy	\$777.56	0.33%	\$1,939.20
02/06/97	Sell	\$780.15		(\$2,023.68)
02/24/99	Buy	\$1,253.41	2.67%	\$3,186.07
03/10/99	Sell	\$1,286.84		(\$2,953.02)
04/19/99	Buy	\$1,289.48	5.05%	\$6,328.63
05/03/99	Sell	\$1,354.63		(\$92.40)

With such a low number of instances and none since '99, I'm not compelled to make much of it. It will be interesting to see if the rally can continue as it has in the past.

Lastly, as I demonstrated in the 1/13/09 blog, if there is going to be a bounce, Tuesday is normally a good day for it.

The **Aggregator** chart is updated below.



The green Aggregator line remains squarely above zero, illustrating the net positive expectations from the active studies. The black Differential line rose to levels suggesting the market is even more oversold versus recent expectations than yesterday. Both lines above 0 has historically been a bullish configuration. I typically prefer this configuration when considering long exposure.

A bounce tomorrow would be unlikely to relieve any of the current conditions. It appears that even if the market goes our way tomorrow the Aggregator System signal would be doubtful to change.

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/26 – slightly bullish

The last few weeks we've had a decent amount to explore from an intermediate-term perspective. This week I'm simply not seeing much.

The market did post a slight decline for the week and the action has turned choppy but I don't see any evidence pointing to a deep or sustained intermediate-term drop at this point in time.

One issue that several people may point to as a warning sign is the fact that there has been high volume occurring on the down days recently. This is often seen as institutional selling and considered a negative. In the past my research has shown that clusters of distribution days are more likely to lead to higher prices over the next 1,2 and 3 months

than they are lower prices. One detailed study from August that addresses this may be found using the link below.

<http://quantifiableedges.blogspot.com/2009/08/distribution-days-quantified.html>

One potential positive from this past week is that the Nasdaq/SPX Relative Strength model saw strength shift back to the Nasdaq. I've noted this in the active studies list above.

At this point I'm viewing this past week's choppy action as just that. From a short-term perspective the Aggregator has suggested a bullish edge currently exists. Since the March bottom there has been only one Aggregator buy signal that has lost more than 0.3% on a closing basis. That signal occurred in late August / early September and suffered a 1.22% loss. Should the current short-term bullish configuration not play out as expected, that may suggest a change of market character which could lead to a deeper correction. It's something I'll have in mind this week when examining action. I see no reason to try and catch a top just yet, though.

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 @ \$106.90 LIMIT ON CLOSE. Based on the short-term market outlook, I'll continue to scale in should we get more selling tomorrow.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)	10/26/2009	\$108.08	\$106.91	-1.08%		bought at limit
SPY(1/4)	10/26/2009	\$106.91	\$106.91	0.00%		bought on close

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