

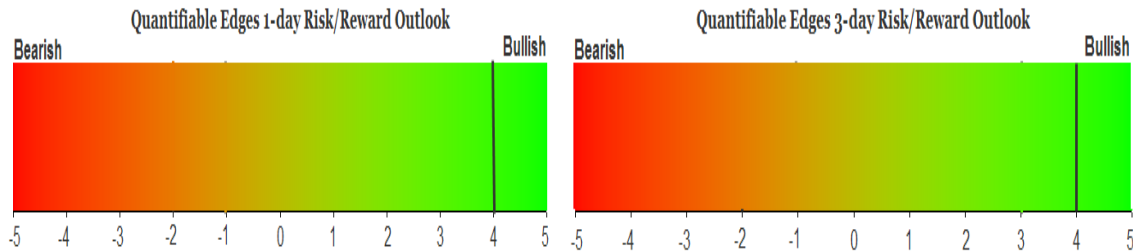
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 29, 2009

Volume 2 Issue 209

Market Overview



Tonight's Research Points

- Price and breadth have repeatedly suggested a bounce the last few days – yet none has arrived.
- By Worden Bros. measure of the McClellan Oscillator, breadth is as bad as it has ever been.
- The VIX has now spiked more than 20% above its 10ma – suggesting a bounce is near.
- The failure to bounce and today's breakdown both suggest the intermediate-term uptrend is on shaky ground.

Short-term Outlook – updated 10/29

The Bottom Line

Extremely oversold is now extremely extremely oversold. Price and breadth action continue to suggest upside short-term. The intermediate-term is now in doubt, though.

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 29, 2009	VIX > 20% above 10ma	1-4 days	Bullish	
October 28, 2009	McClellan < -225, SPX > 200ma	1-9 days	Bullish	3.40%
October 28, 2009	SPY selloff decelerating	1-6 days	Bullish	2.50%
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	
Dropped Tonight				
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.

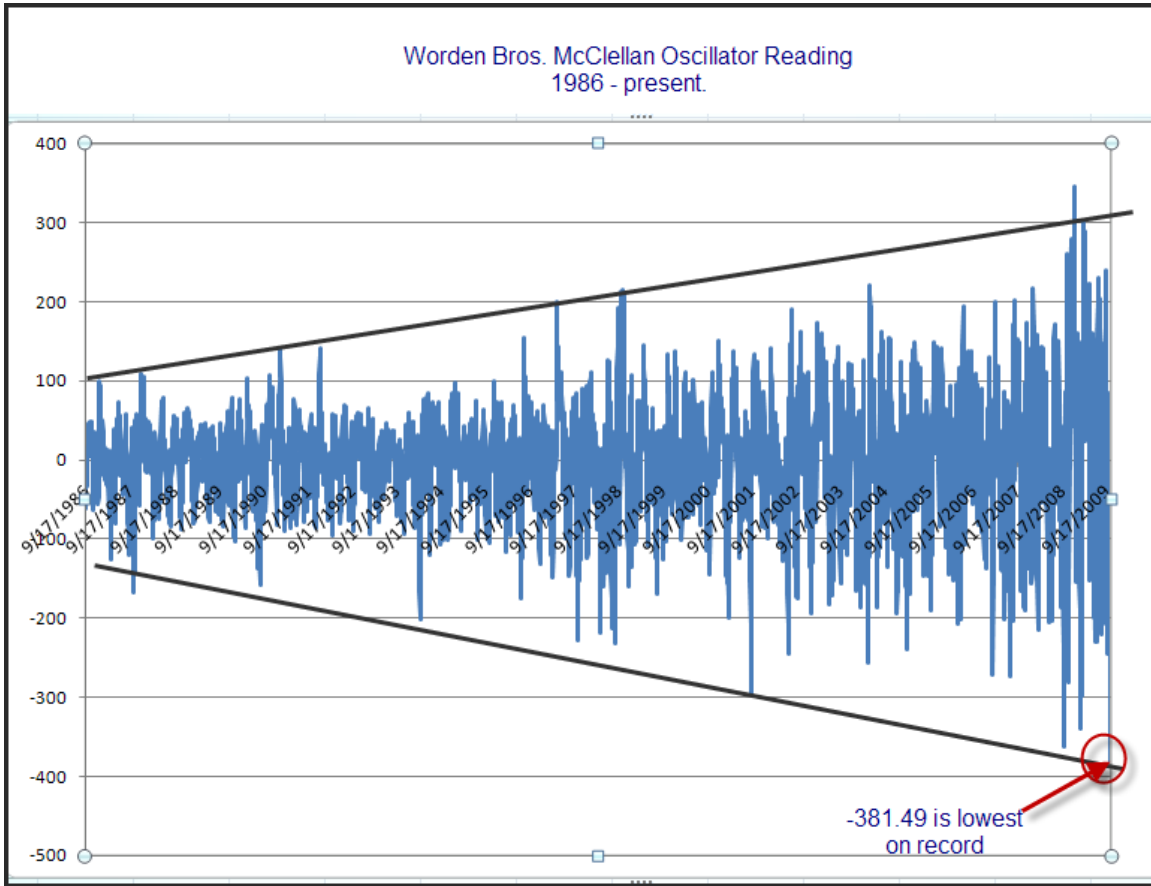
The Evidence

Despite a deluge of studies suggesting the market was primed to bounce, Wednesday saw a broad and strong selloff. The S&P 500 fell 2%, the Nasdaq 2.7% and the Russell 2000 3.5%. Breadth was horrible. The NYSE Up Issues % and Up Volume % both came in just shy of 10%. Total volume spiked to the highest level of the month on the NYSE and Nasdaq.

There comes a point when the market is so oversold and the studies so overwhelmingly suggesting a bounce that examining additional studies becomes almost meaningless. How many different ways does someone need to see that the selling is overdone and the readings extreme?

Tonight’s Quantifinder was littered with examples of price and breadth action similar to many studies I already have active. I won’t rehash most of them as they’re similar to much of what we’ve already seen. I did note an interesting breadth statistic.

As I discussed last night, the McClellan oscillator will vary from provider to provider as there are often slight differences among advance/decline data. Worden Bros. is one data provider I use. Their measure of the McClellan Oscillator hit -381.49 on Wednesday. This is the lowest reading since they began tracking advance/decline data in 1986. Below is a chart of the McClellan Oscillator over that time period.



One notable about this chart is that breadth readings have become more extreme over time. Whereas moves above 100 and below -100 were rare from '86 – '93, they are considered ordinary today.

About the only breadth indicator that hasn't kicked into gear at this point is the Quantifiable Edges CBI. As you'll see below, WAG triggered a second entry, but nothing else has yet triggered. In looking at how stocks are set up currently, it's unlikely we'll see a huge spike anytime soon.

One indicator that popped up on the Quantifinder tonight that wasn't previously represented was the VIX. I've updated a study from last January that looked at spikes in the VIX that were over 20% above the 1-day moving average. (Note the lookback period shown last January was mistakenly listed as 1990 – present rather than 2000 – present.)

VIX closes more than 20% above its 10-day moving average. 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	60,119.29	28	18	10	64.29	4,609.35	-2,284.90	2.02	3.63	2,147.12
4	52,123.31	28	20	8	71.43	4,101.17	-3,737.51	1.10	2.74	1,861.55
3	33,682.44	31	19	12	61.29	3,291.66	-2,404.93	1.37	2.17	1,086.53
2	50,928.59	34	23	11	67.65	3,295.85	-2,261.46	1.46	3.05	1,497.90
1	33,563.32	34	23	11	67.65	2,179.91	-1,506.78	1.45	3.02	987.16

As you'd expect, there appears to be a decent upside edge when the VIX gets this extreme.

Three things that made Wednesday's action look scary were that 1)the SPX slice through its 50ma 2)on high volume and 3)extremely negative breath. Support breaks on accompanied by extreme breadth and volume are often interpreted as bearish. I decided to take a look and see.

SPX crosses down through the 50ma on 90% downside volume and the highest NYSE volume in 10 days. Buy on close. Sell X days later. 1970 - present.

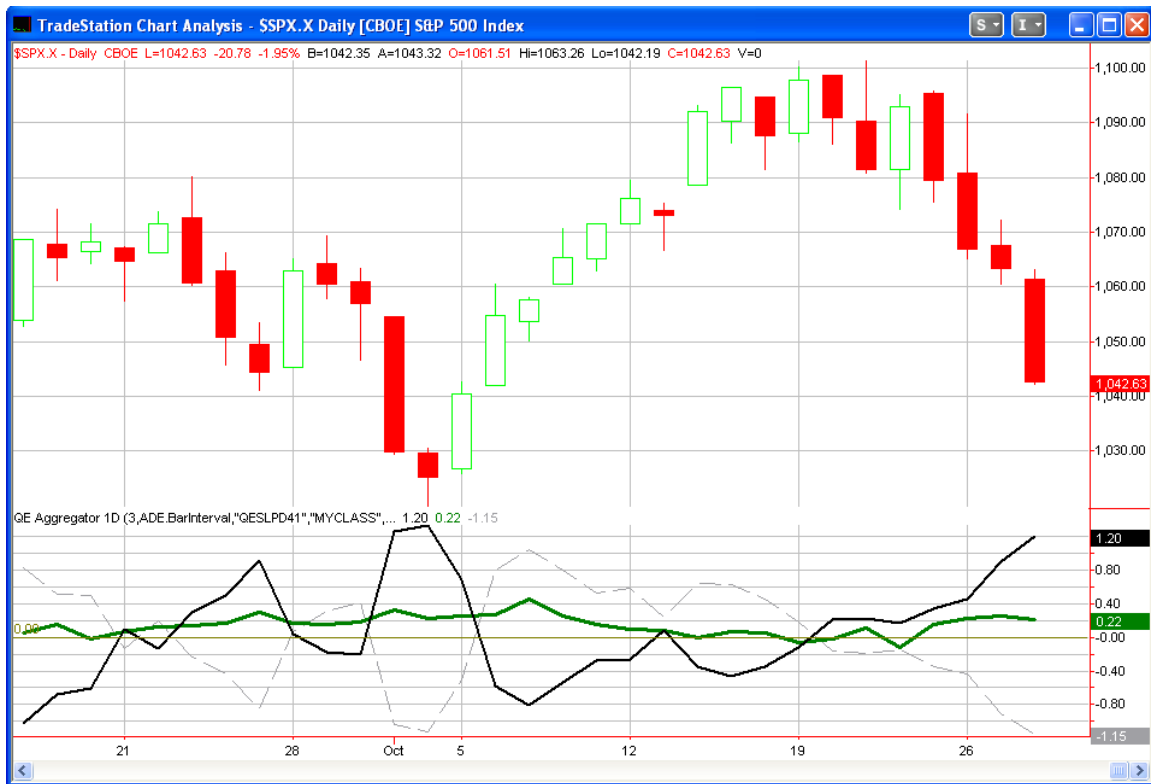
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
140	50,931.60	12	9	3	75.00	12,600.30	-20,823.71	0.61	1.82	4,244.30
120	33,682.91	12	9	3	75.00	11,470.26	-23,183.13	0.49	1.48	2,806.91
100	40,777.42	13	10	3	76.92	9,386.82	-17,696.93	0.53	1.77	3,136.72
80	51,501.97	13	10	3	76.92	7,912.93	-9,209.11	0.86	2.86	3,961.69
60	44,583.25	15	11	4	73.33	7,772.62	-10,228.88	0.76	2.09	2,972.22
40	43,280.86	16	12	4	75.00	6,737.56	-9,392.46	0.72	2.15	2,705.05
20	-22,537.34	16	9	7	56.25	2,703.31	-6,695.30	0.40	0.52	-1,408.58
19	-18,392.63	16	8	8	50.00	3,100.93	-5,400.00	0.57	0.57	-1,149.54
18	-24,573.57	16	6	10	37.50	3,546.39	-4,585.19	0.77	0.46	-1,535.85
17	-28,639.20	16	6	10	37.50	3,595.57	-5,021.26	0.72	0.43	-1,789.95
16	-19,577.11	16	5	11	31.25	4,445.16	-3,800.26	1.17	0.53	-1,223.57
15	-15,983.93	16	6	10	37.50	3,359.82	-3,614.28	0.93	0.56	-999.00
14	-20,126.93	16	7	9	43.75	2,467.28	-4,155.32	0.59	0.46	-1,257.93
13	-16,384.48	16	6	10	37.50	3,288.24	-3,611.39	0.91	0.55	-1,024.03
12	-12,109.03	16	7	9	43.75	2,762.18	-3,493.81	0.79	0.61	-756.81
11	-3,887.35	16	8	8	50.00	2,535.29	-3,021.21	0.84	0.84	-242.96
10	-8,164.09	16	7	9	43.75	2,736.71	-3,035.67	0.90	0.70	-510.26
9	-4,544.21	16	9	7	56.25	2,505.63	-3,870.70	0.65	0.83	-284.01
8	-6,212.90	16	9	7	56.25	2,347.78	-3,906.13	0.60	0.77	-388.31
7	699.24	16	8	8	50.00	2,669.00	-2,581.60	1.03	1.03	43.70
6	4,174.79	16	8	8	50.00	2,698.55	-2,176.70	1.24	1.24	260.92
5	3,614.87	16	7	9	43.75	2,882.27	-1,840.12	1.57	1.22	225.93
4	-2,351.13	16	5	11	31.25	3,158.36	-1,649.36	1.91	0.87	-146.95
3	-788.49	16	5	11	31.25	2,748.37	-1,320.94	2.08	0.95	-49.28
2	6,044.01	16	7	9	43.75	2,079.92	-946.16	2.20	1.71	377.75
1	4,599.89	16	13	3	81.25	665.25	-1,349.44	0.49	2.14	287.49

Such breakdowns have often been followed by a quick bounce and then some choppy sideways action. Most often the market would then struggle for a few weeks before working it out and continuing its uptrend. From an intermediate-term standpoint I'd view this as somewhat bearish. Beyond 20 days is really anyone's guess.

I've also mentioned repeatedly this week that a failure to bounce when so many studies were suggesting it was likely could be viewed as a change of character for the market. It seems this may now be the case. The market has failed to conform to historical edges up to this point. This implies all is not well with the uptrend. Some extra caution will likely be required in the weeks ahead.

From a short-term standpoint a bounce remains the highest probability. There really is nothing indicating a short-term downside edge at this point. I will continue to play for that bounce.

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



The market is as overdone as it has been in quite a while. Both the green Aggregator line and the black Differential line are squarely above zero. A sizable bounce is expected in the next few days. Of course that has been the case the last few days. In any event, I'll be looking to put on the remaining portion of my SPY trade.

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/28 – neutral (see short term notes above)

Catapult and Capitulative Breadth Statistics

(Catapult Presentation Part 1) (Catapult Presentation Part 2)

Open Catapult Triggers

WAG(1/3) @ \$37.70

WAG(1/3) @ \$37.09

Catapult for ETF's Trades

none

Broad Market Large Cap CBI – 2 (WAG)

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.

WAG – buy 1/3 position @ \$37.09 limit. Catapult trade. This is the 2nd 1/3 lot. Traders should keep in mind the extreme volatility of Catapult trades when considering position size.

SPY – buy final 1/4 position @ \$104.50 limit. Cancel after 1st 1/2 hr. if not filled. I'm looking to get in and will even pay up slightly here. I won't chase a large gap up but traders should keep in mind that if a very large gap up does occur it could ignite a short-covering rally. Historically large gaps up from 10-day lows have provided a bullish edge from open to close.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)	10/26/2009	\$108.08	\$104.41	-3.40%		Aggregator
SPY(1/4)	10/26/2009	\$106.91	\$104.41	-2.34%		Aggregator
SPY(1/4)	10/27/2009	\$106.42	\$104.41	-1.89%		Aggregator
WAG(1/3)	10/28/2009	\$37.70	\$37.09	-1.62%		Catapult

Average price of the SPY position is currently \$107.14.

Some thoughts on trade management

One of the bigger challenges for traders when trading extreme conditions like the present is controlling risk. We are at a point where the market has almost always bounced in the past. Of course that doesn't mean we won't see an additional 3%, 5%, 10% downside or even a crash before the bounce arrives. When trading index positions I often manage my risk by purchasing in-the-money call options rather than an index proxy like SPY. I prefer options because they provide a natural stop. I've paid \$7-\$8 over the last few days for some options. If SPX tanks another 10%, I can't possibly lose more than the price of the options. Also it allows me to participate in potential upside. Another way to play it would be to use intraday stops.

I don't often use stops in the subscriber letter. One reason is that when the market is as oversold as it is currently, there's a good chance I'm going to want to get back into a trade near the end of the day. There's nothing wrong with exiting on breaks of support intraday with the intention of trying to get back in at a lower price. It just isn't a strategy that can be employed in a Letter format. Also, should you get stopped out and the market doesn't collapse, it will take a good amount of discipline to re-enter the trade at a slightly higher price before it takes off without you. You don't want to suffer drawdown during a trade and then get stopped out just before it begins to bounce, and then miss your re-entry trigger. Most often I prefer passive management and use of options, but risk may be controlled either passively or actively. A trader's expertise and personality would help determine the preferred technique.

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