

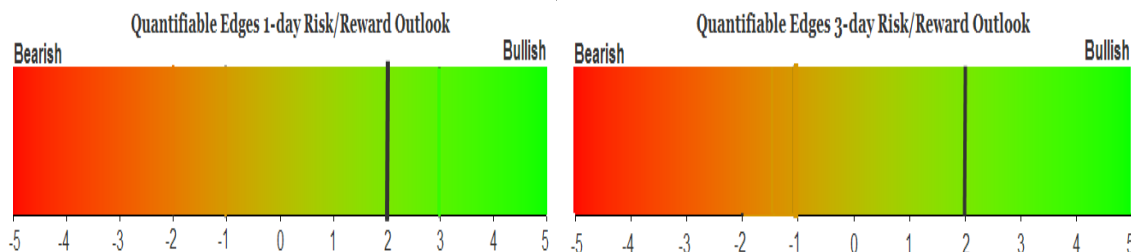
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 30, 2009

Volume 2 Issue 210

Market Overview



Tonight's Research Points

- The lower volume on Thursday's bounce is not a concern and could be a positive.
- Even though the move was sizable, it failed to relieve many oversold conditions.
- The McClellan Oscillator is still very oversold. The system outlined in the short-term outlook suggests holding a bit longer before taking profits.
- The Aggregator System remains long. An SPX close around 1070 or higher would most likely turn it neutral since it would flip the Differential line.

Short-term Outlook – updated 10/30

The Bottom Line

A solid bounce has relived SOME oversold measures. Many remain oversold and are still suggesting more of a bounce. At this point it is unclear how much more the market will bounce. Odds do favor a continuation. The action over the next few days may be very telling of the intermediate-term.

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 30, 2009	Low vol bounce from ext oversold	1-4 days	Bullish	1.90%
October 29, 2009	VIX > 20% above 10ma	1-4 days	Bullish	3.50%
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 26, 2009	4th Friday under 200ma drops 1%	1-5 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	

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

The Evidence

A gap up never looked back and a big oversold rebound occurred Thursday. The S&P closed up 2.25% while the Nasdaq rose 1.8%. Breadth was strong. The NYSE Up Issues % closed at 82% and the Up Volume % was 89%. Volume came in quite a bit lower than Wednesday, though.

So Thursday's action was nice, but it leaves several apparent questions to be answered. Should the lower volume be a concern? Is the bounce likely to continue? Are we likely to resume the uptrend or once this bounce is complete will it lead to another leg down?

Let's go through these one by one.

In the September 4th Subscriber Letter I looked at bounces from extremely oversold conditions (based on RSI(2)) that occurred on higher volume vs. lower volume. I found that the lower-volume bounces performed significantly better over the next week. I have updated the study that looked at low volume in the table below. The original study only looked back to 1999. Tonight I decided instead to look back to 1997 which increased the sample size to nearly 30.

Yesterday SPX RSI(2) closes < 5. Today the SPX closes up on lower volume. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1997 - 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	22,354.80	27	16	11	59.26	2,643.44	-1,812.74	1.46	2.12	827.96
4	26,396.43	29	19	10	65.52	2,061.75	-1,277.67	1.61	3.07	910.22
3	17,266.96	29	18	11	62.07	1,666.81	-1,157.78	1.44	2.36	595.41
2	19,114.32	29	19	10	65.52	1,558.68	-1,050.05	1.48	2.82	659.11
1	14,985.74	29	20	9	68.97	1,033.31	-631.16	1.64	3.64	516.75

26 of 29 instances (90%) closed above the entry price at some point in the next 4 days.

Here we see bullish tendencies over the next week. Day 1 are the most bullish and the market has followed through positively on day 1 about 2/3 of the time.

While the bounce Thursday was strong, the market certainly was extremely oversold Wednesday night. I've discussed the McClellan Oscillator the last couple of nights. I thought it might act as a nice tool to see if a further bounce could be expected. While the bounce was solid on Thursday, the McClellan Oscillator still didn't manage to close above -200. This indicates that from a breadth standpoint the market is still quite oversold. Below I show a simple system that looks to enter the market when the McClellan Oscillator crosses below -250 and exits on a cross back above X.

**McClellan Oscillator crosses under -250 and SPX closes > 200ma. Buy SPX on close.
Sell when McClellan Oscillator closes above X. \$100k/trade. 1970 - present.**

X	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
0	16,298.70	8	6	2	75.00	3,265.28	-1,646.50	1.98	5.95	2,037.34
-25	19,007.02	8	7	1	87.50	2,808.37	-651.56	4.31	30.17	2,375.88
-50	16,075.01	8	7	1	87.50	2,389.51	-651.56	3.67	25.67	2,009.38
-75	15,067.91	8	7	1	87.50	2,245.64	-651.56	3.45	24.13	1,883.49
-100	15,239.27	8	6	2	75.00	2,652.28	-337.19	7.87	23.60	1,904.91
-125	12,158.92	8	6	2	75.00	2,189.25	-488.28	4.48	13.45	1,519.87
-150	9,085.88	8	6	2	75.00	1,664.79	-451.42	3.69	11.06	1,135.74
-175	9,825.86	8	6	2	75.00	1,776.14	-415.48	4.27	12.82	1,228.23
-200	9,681.53	8	6	2	75.00	1,778.93	-496.01	3.59	10.76	1,210.19
-225	10,210.70	9	6	3	66.67	2,078.10	-752.63	2.76	5.52	1,134.52

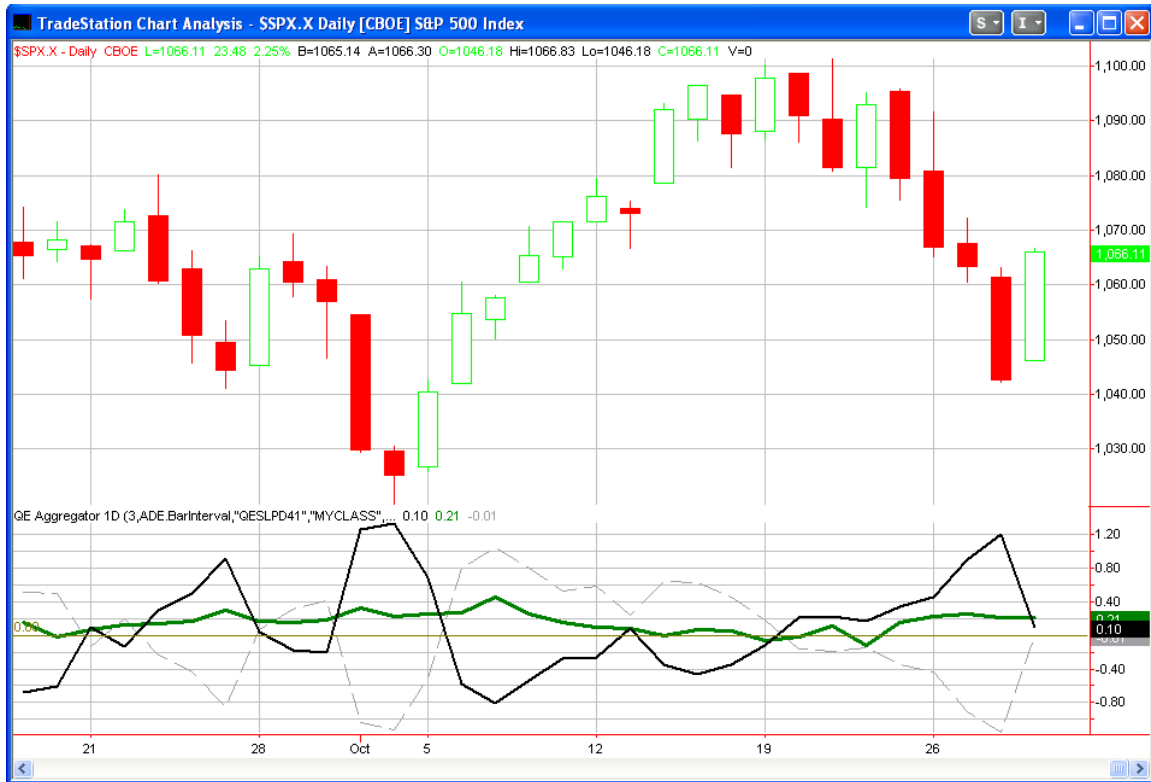
What you can see in the above table is that while the system win % was fairly steady throughout, many profits were left on the table when taking a quick exit and not waiting for the oversold condition to dissipate further.

So it appears we may get more upside. Yet I'm cautious with the current SPY trade idea and took partial exits Thursday at the close. Why would I do that? First let me mention some reasons that AREN'T valid for doing that.

When a trade gets off to a bad start as the SPY trade idea did, it is natural for many traders to feel anxious and want to take small profits or get out around breakeven when the market does get back to their buy point. Getting back to even is not a logical reason for exiting a trade. The market doesn't know where you entered and doesn't care. Decisions to be in or out of a trade should normally be based on 1 thing – does your position have an edge? If so, stay in. If not, get out.

So why the partial exit? Because a healthy market should not pull back as much and become as extremely oversold as just happened. The correction was too severe to continue to trust the uptrend. If I feel I'm trading with the trend, I am more comfortable taking aggressive positions. If the trend is uncertain or against me then I will take more conservative position sizes. We got a bounce Thursday. If I had more faith in this market, I'd have left the whole thing on. The intermediate-term doubt that has arisen the last few days leaves me with the desire to maintain reduced exposure. That's the reason for the partial exit.

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



The green Aggregator line remains squarely above zero, illustrating the solidly positive outlooks from the studies over the next few days. The black Differential line is still above 0 indicating the SPX has underperformed expectations over the last few days. The most notable action in the Aggregator chart tonight is the steep drop in the Differential line. To move the Differential line below 0 at tomorrow's close, the SPX would need to close only about 4 points higher. Should that happen the Aggregator System would almost certainly turn neutral and go flat.

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(no fill)

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.

None tonight. There are several setups on the triggers page for those looking for action. I'll just manage the open positions for now. I prefer buying near the outer edges of the range and Thursday's move put the market squarely back into its recent range.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)	10/26/2009	\$108.08	\$106.65	-1.32%		sold on close
SPY(1/4)	10/26/2009	\$106.91	\$106.65	-0.24%		Aggregator
SPY(1/4)	10/27/2009	\$106.42	\$106.65	0.22%		Aggregator
WAG(1/3)	10/28/2009	\$37.70	\$38.40	1.86%		Catapult

I will likely institute and trail a stop on 1 lot tomorrow. This is because I'm of the opinion that the selloff was too overdone for comfort. I don't want to sit through another leg down with a sizable position size.

The last quarter position I intend to keep until the Aggregator System flips or I feel there is no longer an edge to being long.

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