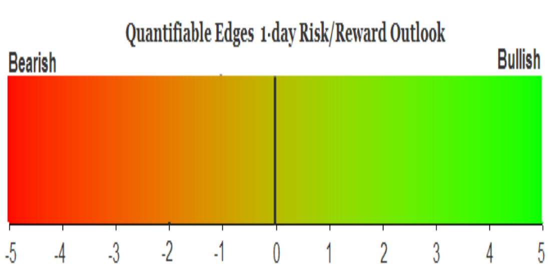
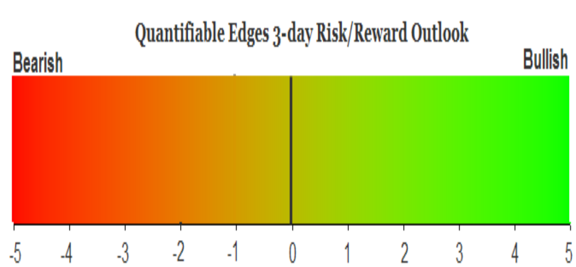
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 5, 2009 Volume 2 Issue 214

Market Overview





Tonight's Research Points

- A strongly positive Fed day would have suggested a short-term pullback.
- A strongly negative Fed day would have suggested a short-term bounce.
- Neither was clearly achieved, leaving today's action questionable.
- The Aggregator system is now flat since the market is no longer oversold.

Short-term Outlook – updated 11/5

The Bottom Line

The last half hour changed the bias from bearish to neutral. The current setup can be viewed a few different ways and an edge isn't clear. I'm not excited about either side of the market right now and would rather let things play out for a day or two before committing new capital.

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				
November 3, 2009	Weak breadth bounce	1-4 days	Bearish	-4.00%
October 28, 2009	McClellan < -225, SPX > 200ma	1-9 days	Bullish	3.40%
October 26, 2009	1% Dn Decliners double advancers	1-9 days	Bullish	3.00%
Active - Long Term				
Dropped Tonight				
October 30, 2009	Low vol bounce from ext oversold	1-4 days	Bullish	1.90%
October 28, 2009	SPY selloff decelerating	1-6 days	Bullish	2.50%
November 4, 2009	Tomorrow is Fed Day	1 day	Bullish	

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

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

The Evidence

As expected, the market rose up until the 2:15pm Fed announcement on Wednesday. Unfortunately for our Fed Day trade idea, much of the gain occurred overnight. After the announcement there was some exaggerated indecision. When it was over the S&P 500 finished up a measly 0.1%. Meanwhile the Nasdaq Composite closed down 0.1% and the Russell 2000 was down a much larger 1.3%. Breadth was mixed. The NYSE Up Issues % came in at 53% while the Up Volume % was 45%. On the Nasdaq both measures were negative. Volume declined on the NYSE and rose on the Nasdaq.

Some days the action is very difficult to classify. Wednesday seems to be one of those days. As we approached the last half hour of trading, it seemed pretty clear where the edge may lie. I sent out the following study to subscribers as part of the late-day intraday update:

SPY posts an unfilled gap up on a Fed Day and closes above the open.
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
5	-25,690.85	23	7	16	30.43	1,356.25	-2,199.04	0.62	0.27	-1,116.99
4	-18,465.23	23	10	13	43.48	1,152.17	-2,306.68	0.50	0.38	-802.84
3	-21,706.04	23	7	15	30.43	1,004.32	-1,915.75	0.52	0.24	-943.74
2	-18,755.69	23	10	13	43.48	525.10	-1,846.67	0.28	0.22	-815.46
1	-10,994.50	23	9	14	39.13	483.11	-1,095.89	0.44	0.28	-478.02

87% of instances closed below their entry price at some point in the next week.

The fact that the market was looking to close higher for the 3rd day in a row, and the 2nd day in a row of lower volume also suggested a downside edge. Below is a study identified by tonight's Quantifinder that demonstrates this. It's from the 6/3/09 Subscriber Letter (and has not been updated).

SPX advances for at least the 3rd day in a row. Volume falls both today and yesterday. Todays rise is the smallest rise of the upmove. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 6/1/1997 - present.

X days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	(18,233.43)	25	8	17	32.00	1,232.92	(1,652.75)	0.75	0.35	(729.34)
4	(11,580.45)	25	8	17	32.00	1,483.97	(1,379.54)	1.08	0.51	(463.22)
3	(9,592.38)	25	11	14	44.00	1,034.03	(1,497.62)	0.69	0.54	(383.70)
2	(7,610.95)	25	8	17	32.00	930.17	(885.43)	1.05	0.49	(304.44)
1	(4,230.31)	25	10	15	40.00	542.60	(643.75)	0.84	0.56	(169.21)

So with a half-hour left in the day, the bias was fairly clear. As long as there wasn't a sharp selloff then odds seemed to favor a bit of a pullback over the next few days.

Then it all fell apart in the last ½ hour. The study just above that looks at price and volume still qualified. But just barely. With SPX closing up 0.1% after being up about

1.5% intraday, calling it an "up day" is a little dicey – especially when the Russell and Nasdaq finished down. Still, it does qualify. But what if we looked at the action of the last half hour on its own and considered the fact that it was a Fed day?

On a Fed day SPY closes at least 0.75% below the high of the last 30 minutes of trading. 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	-12,560.07	12	5	7	41.67	2,552.40	-3,617.44	0.71	0.50	-1,046.67
9	-1,923.85	12	6	6	50.00	2,650.89	-2,971.53	0.89	0.89	-160.32
8	-6,472.02	12	4	8	33.33	3,087.14	-2,352.57	1.31	0.66	-539.34
7	-7,241.29	12	6	6	50.00	2,794.72	-4,001.60	0.70	0.70	-603.44
6	-5,799.12	12	6	6	50.00	2,741.36	-3,707.88	0.74	0.74	-483.26
5	6,946.44	12	6	6	50.00	3,693.48	-2,535.74	1.46	1.46	578.87
4	9,971.31	12	5	7	41.67	4,438.33	-1,745.76	2.54	1.82	830.94
3	5,077.98	12	7	4	58.33	2,074.37	-2,360.66	0.88	1.54	423.17
2	6,257.74	12	6	6	50.00	3,225.02	-2,182.06	1.48	1.48	521.48
1	5,404.99	12	8	4	66.67	1,770.02	-2,188.80	0.81	1.62	450.42

11 of 12 instances closed higher than the entry price at some point in the next 4 days.

In this case you generally got some bounce-back in the next few days – day 1 being the most prominent day. Also notable is that the bounce often failes to follow through and instead rolls over.

I looked at this a few other ways as well. One way was to say the SPX closed higher but more than 1% below its high of the day.

SPY closes up but 1% below high on Fed Day.
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
5	3,441.52	7	4	3	57.14	2,673.85	-2,417.96	1.11	1.47	491.65
4	3,922.56	7	5	2	71.43	1,786.72	-2,505.52	0.71	1.78	560.37
3	7,915.32	7	5	2	71.43	2,524.46	-2,353.50	1.07	2.68	1,130.76
2	-1,355.30	7	5	2	71.43	1,183.43	-3,636.23	0.33	0.81	-193.61
1	468.99	7	5	2	71.43	884.22	-1,976.07	0.45	1.12	67.00

Instances are too low for significance but this also suggests a possible upside edge over the next few days. What if I eliminate the Fed day requirement?

SPY closes up but 1% below high. 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
5	25,357.39	81	44	36	54.32	2,734.36	-2,637.63	1.04	1.27	313.05
4	26,483.03	85	48	37	56.47	2,634.50	-2,701.97	0.98	1.26	311.57
3	47,106.26	87	49	37	56.32	2,567.23	-2,126.71	1.21	1.60	541.45
2	65,388.59	94	63	31	67.02	1,987.40	-1,929.59	1.03	2.09	695.62
1	33,753.92	102	63	39	61.76	1,368.77	-1,345.61	1.02	1.64	330.92

Here we see there appears to be a bit of a short-term edge that primarily plays out in the next 2 days.

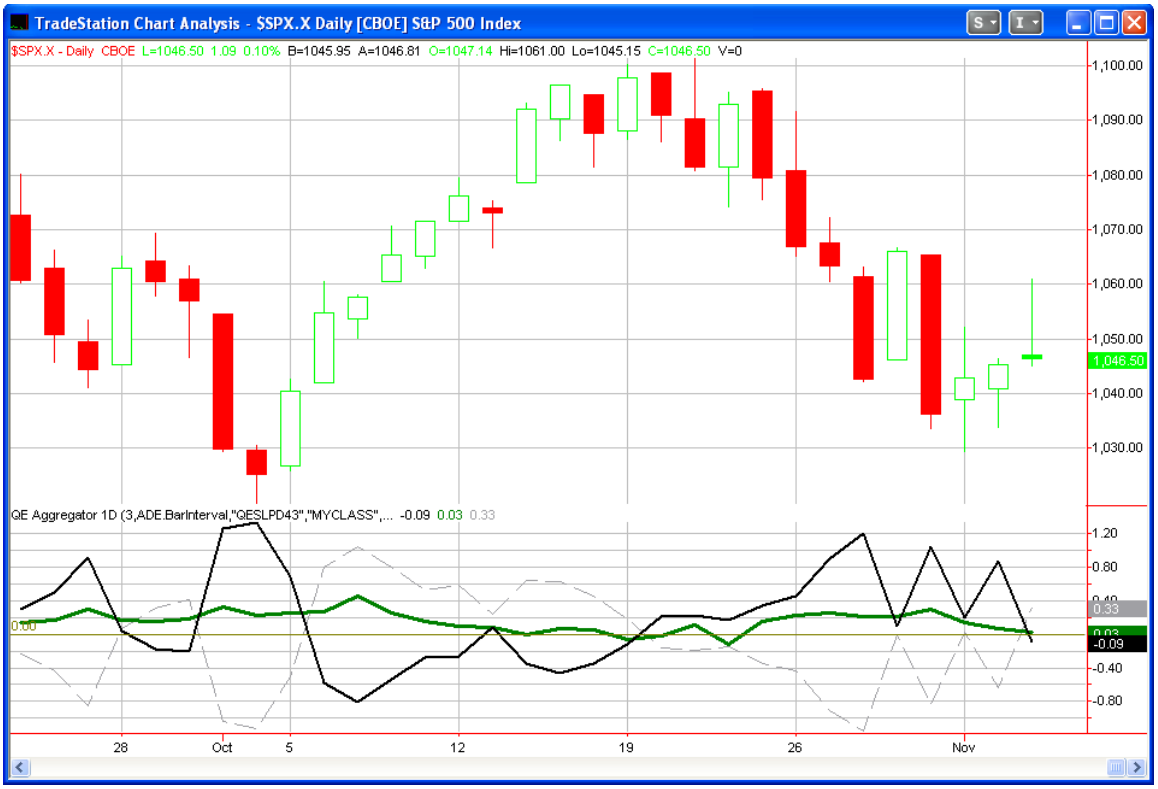
Being that the SPX only managed a 0.1% gain I also wondered what the results would have looked like had it not managed to hold on and instead closed down on the day.

SPY closes down and 1% below high on Fed Day. 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
5	33,544.62	27	18	9	66.67	2,749.98	-1,772.77	1.55	3.10	1,242.39
4	29,049.52	27	17	10	62.96	2,507.63	-1,358.02	1.85	3.14	1,075.91
3	22,104.42	27	20	7	74.07	1,612.43	-1,449.16	1.11	3.18	818.68
2	21,802.62	27	19	8	70.37	1,833.16	-1,628.44	1.13	2.67	807.50
1	21,907.57	27	22	5	81.48	1,297.99	-1,329.66	0.98	4.30	811.39

These results are very strongly bullish and suggestive that a bounce would be likely to ensue under such circumstances.

So where does this all leave us? Well, from my perspective, if the market had closed about 1/2 hr earlier we would have had a nice bearish short-term edge to try and play tomorrow. The late selling seems to have taken away much of that short edge. A definitive up or down day may have provided some kind of worthwhile setup. As it stands, the studies are conflicting and which factors deserve the most weighting seems unclear. In light of all this I'm not willing to stick my neck out on any of the studies. I'd prefer to watch and examine the action as it continues to unfold over the next few days and see if anything more decisive appears.

The Aggregator chart is updated below.



The green Aggregator line is barely holding above zero. This shows that the net expectations over the next few days are slightly positive. The black Differential line fell just a little below zero at the close Wednesday. A close below zero suggests the SPX has outperformed expectations over the last few days. I prefer to have both lines on the same side of zero when considering index positions. I consider configurations like the current one to be basically neutral.

It should be noted that 1) with out any further studies added to the active list tomorrow, the Aggregator value is set to flip slightly negative, and 2) for the black Differential line to remain negative, the SPX will need to close above 1049.75 or so. While the current situation is unclear, an edge could easily emerge in the next few days.

Another study that appeared tonight was the 3/10 Offset HV study. It suggests there could be a sizable move in the next few days. If it occurs it's very possible I will be looking to fade that move.

Intermediate-term Outlook (2 weeks – 2 months)– updated 11/2 – neutral approaching bearish

Breadth has been a strong tell of the recent rally. While in periods like July and September when price, volume and sentiment-based indications suggested a pullback was likely, breadth studies often provided results suggesting the trend should persist. So when the McClellan Oscillator registered incredibly low readings on Wednesday I took a look at some short-term studies.

I decided this weekend to see if there might be some longer-term implications from such negative readings in the McClellan Oscillator. For these tests, rather than using the standard oscillator, I decided to use the Ratio Adjusted McClellan Oscillator. The ratio adjusted version accounts for the fact that the number of issues trading on the NYSE has increased over time. When using very a long look-back and wanting to compare readings from decades ago to current readings the ratio adjusted number provides much better comparisons.

I wanted to look and see if very weak readings in an uptrend might be suggestive of intermediate-term weakness. The Ratio Adjusted McClellan Oscillator on Wednesday came in at -113. Using S&P and advance/decline data all the way back to 1950 I constructed the following study.

Ratio Adjusted McClellan Oscillator crosses below -110. SPX close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1950 - 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
55	26,730.54	6	5	0	83.33	5,346.11	0.00	100.00	100.00	4,455.09
50	16,941.16	6	3	3	50.00	7,638.87	-1,991.81	3.84	3.84	2,823.53
45	7,291.78	6	3	3	50.00	6,459.21	-4,028.62	1.60	1.60	1,215.30
40	7,800.71	6	3	3	50.00	6,291.79	-3,691.55	1.70	1.70	1,300.12
35	2,986.94	6	3	3	50.00	5,450.71	-4,455.07	1.22	1.22	497.82
30	1,197.12	6	3	3	50.00	5,442.28	-5,043.24	1.08	1.08	199.52
25	-3,018.21	6	1	5	16.67	9,323.60	-2,468.36	3.78	0.76	-503.04
20	-3,180.62	6	2	4	33.33	6,513.78	-4,052.05	1.61	0.80	-530.10
15	-5,714.61	6	3	3	50.00	3,875.56	-5,780.43	0.67	0.67	-952.44
10	-3,649.07	6	3	3	50.00	2,530.88	-3,747.23	0.68	0.68	-608.18
5	-2,400.54	6	2	4	33.33	2,853.07	-2,026.67	1.41	0.70	-400.09

As you might have suspected it appears very strong negative breadth readings in a supposed uptrend often led to difficulties – at least for the next 5 weeks. Below is the list of instances along with their 25-day returns.

Ratio Adjusted McClellan Oscillator crosses below -110. SPX close > 200ma. Buy on close. Sell 25 days later. $100k/trade. 1950 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up DrawDown**
10/22/51	Buy	$22.75	(0.35%)	$1,538.25
11/29/51	Sell	$22.67		($1,538.25)
03/14/55	Buy	$34.96	9.32%	$9,466.60
04/19/55	Sell	$38.22		$0.00
07/28/75	Buy	$88.69	(3.62%)	$1,555.26
09/02/75	Sell	$85.48		($7,302.96)
10/19/78	Buy	$99.33	(3.56%)	$0.00
11/24/78	Sell	$95.79		($7,726.08)
03/06/80	Buy	$108.65	(4.47%)	$285.20
04/11/80	Sell	$103.79		($13,266.40)
04/14/87	Buy	$279.16	(0.34%)	$6,991.74
05/20/87	Sell	$278.21		($1,052.52)
10/28/09	Buy	$1,042.63	n/a	$2,299.00
open	n/a	$1,036.19		($878.75)

The 1955 instance led to a very big rally over the next 5 weeks. Other than that the market struggled.

The problem with the above is that the study has a small sample size. I lowered the requirement for the McClellan reading and found it wasn't robust either. Below are the results for drops below -105 that didn't hit and didn't overlap any of the -110 results.

Ratio Adjusted McClellan Oscillator crosses below -105 but not -110. SPX close > 200ma. Buy on close. Sell 25 days later. $100k/trade. 1950 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up DrawDown**
08/31/54	Buy	$29.83	9.82%	$9,821.36
10/06/54	Sell	$32.76		$0.00
09/29/80	Buy	$123.54	4.45%	$9,983.06
11/03/80	Sell	$129.04		$0.00
12/11/80	Buy	$127.36	5.50%	$10,173.60
01/19/81	Sell	$134.37		($164.85)
05/10/04	Buy	$1,087.12	4.27%	$5,010.46
06/16/04	Sell	$1,133.56		($982.80)

In this case all 4 instances put in very strong performances over the next 5 weeks. In looking at the winning trades – both here and the one in the -110 study, I see a common theme that could be worth considering. In no (winning) case did the S&P drop even as much as 1% from the oversold trigger during the next 25 days.

Now recall the McClellan trigger I'm using above didn't occur on Friday. It occurred Wednesday. Friday's action saw the S&P hit a low about 0.87% below Wednesday's closing level. In other words, if the market can't hold above Friday's low, this study hints at more pain in the coming weeks.

How much pain is impossible to tell, but 3 of the 5 losers saw drops of between 7.3% and 13.3%, so there is certainly some large downside potential.

Some people might point to the 10/2 lows around 1020 in the SPX as important support. If the market breaks Friday's low, I personally don't think those will provide much support. The SPX is one of the few indices that hasn't broken through them at this time. The Nasdaq Composite (barely) took the October lows out on Friday. The S&P midcaps are below them. The Russell 2000 is far below them, and so are former rally leaders the SOX(semis) and the BKX(banks).

This market was SUPPOSED to bounce last week. It did on Thursday after getting extremely oversold but that bounce only lasted 1 day. The current studies are all suggesting now that it's SUPPOSED to bounce Monday (Tuesday at the latest). Again, if it doesn't, and if Friday's lows can't hold, then extra longside caution would seem warranted.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Triggers

AVP(1/3)@32.05

Catapult for ETF's Trades

none

Broad Market Large Cap CBI – 1 (AVP)

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. This is basically a "wait and see" day.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)	10/27/2009	$106.42	$104.92	-1.41%		sold on close
SPY(1/4)	11/4/2009	$105.51	$105.67	0.15%		Fed Day Trd-sold @2pm
AVP(1/3)	11/2/2009	$32.05	$32.48	1.34%		Catapult