

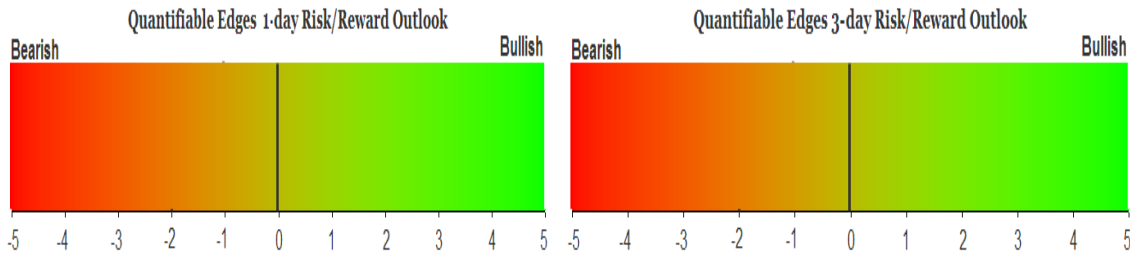
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 6, 2009

Volume 2 Issue 215

## Market Overview



## Tonight's Research Points

- There was a shift towards riskier assets today as the Russell and Nasdaq led the way.
- Extremely high Nasdaq Up Volume % has historically led to positive short-term SPX returns.
- The Aggregator System remains flat.

## *Short-term Outlook – updated 11/6*

### *The Bottom Line*

The big move today brought about some bearish-looking studies in the Quantifinder. Closer examination led to an unusual occurrence where the bearish appearance actually led to bullish results. This puts the Aggregator in a neutral configuration.

*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>				
November 6, 2009	Nasdaq Up Vol % > 90%	1-3 days	Bullish	1.40%
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%

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 Thursday morning never filled and the market stair-stepped higher throughout the day. Among the broad indexes, the Russell led the way with a 3.2% gain. The Nasdaq gained 2.4% and the S&P 500 brought up the rear with “only” a 1.9% gain. Bread was solidly positive. The NYSE Up Issues % was 82% and the Up Volume % came in at 85%. The Nasdaq Up Volume % managed a 90% reading. NYSE volume was the lowest of the last 9 days – since 10/23. Meanwhile Nasdaq volume actually rose. It appears there was a bit of an appetite for risk today as the Nasdaq and Smallcaps received most of the volume and the gains vs. NYSE and S&P 500.

The extreme Nasdaq Up Volume % was notable. In the March 27, 2009 Letter I looked at a study that broke down next day performance by the Nasdaq Up Volume %. I’ve pasted the table from that report below (stats not updated).

Nasdaq Up Volume % exceeds X%.										
Buy S&P 500 on close. Sell next day. \$100k/trade. 2001-present.										
X %	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
0.88	(\$8,096.30)	51	22	29	43.14	\$846.32	(\$921.22)	0.92	0.70	(\$158.75)
0.89	(\$7,590.62)	44	17	27	38.64	\$918.94	(\$859.73)	1.07	0.67	(\$172.51)
0.9	(\$4,781.52)	35	14	21	40.00	\$791.45	(\$755.33)	1.05	0.70	(\$136.61)
0.91	(\$4,259.77)	25	11	14	44.00	\$662.83	(\$825.06)	0.80	0.63	(\$170.39)
0.92	(\$4,123.78)	16	6	10	37.50	\$703.06	(\$834.21)	0.84	0.51	(\$257.74)
0.93	(\$5,442.93)	10	3	7	30.00	\$618.15	(\$1,042.48)	0.59	0.25	(\$544.29)
0.94	(\$3,728.51)	5	1	4	20.00	\$242.88	(\$992.85)	0.24	0.06	(\$745.70)

In March, when the market was well below its 200ma, I decided not to filter by the 200ma. Tonight I thought that might be a good idea. First lets see updated results without filtering.

Nasdaq Up Volume % > 90%										
Buy SPX on close. Sell X days later. \$100k/trade. 2001 - 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	20,623.83	32	18	14	56.25	2,820.33	-2,153.01	1.31	1.68	644.49
4	13,892.72	33	20	13	60.61	2,414.36	-2,645.73	0.91	1.40	420.99
3	11,481.32	37	21	16	56.76	2,206.24	-2,178.10	1.01	1.33	310.31
2	-4,956.21	39	20	19	51.28	1,727.64	-2,079.42	0.83	0.87	-127.08
1	-7,580.21	39	16	23	41.03	762.16	-859.77	0.89	0.62	-194.36

There is a hint of a mild 1-day downside edge here. But what about those times it was above the 200ma?

Nasdaq Up Volume % > 90%. SPX closes above 200ma.  
Buy SPX on close. Sell X days later. \$100k/trade. 2001 - 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	4,390.90	7	4	3	57.14	1,593.51	-661.04	2.41	3.21	627.27
4	6,122.04	7	6	1	85.71	1,042.55	-133.25	7.82	46.94	874.58
3	7,363.90	7	6	1	85.71	1,252.93	-153.66	8.15	48.92	1,051.99
2	4,587.03	7	6	1	85.71	775.66	-66.95	11.59	69.51	655.29
1	1,263.46	7	3	4	42.86	740.71	-239.67	3.09	2.32	180.49

All 7 instances closed higher than the entry price on one of the next 2 days.

Instances are lower than I'd typically like to see, but with all 7 closing higher in the next day or 2, it appears worth noting this one. Extremely strong volume breadth going into riskier Nasdaq stocks has often led to some follow through when the market is in a long-term uptrend. Below I have listed all 7 instances with a 3-day exit.

Nasdaq Up Volume % > 90%. SPX closes above 200ma.  
Buy SPX on close. Sell 3 days later. \$100k/trade. 2001 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
03/25/04	Buy	\$1,109.28	1.60%	\$1,648.80
03/30/04	Sell	\$1,127.00		(\$283.50)
06/29/06	Buy	\$1,272.87	(0.15%)	\$585.78
07/05/06	Sell	\$1,270.90		(\$542.88)
08/15/06	Buy	\$1,285.58	1.30%	\$1,287.44
08/18/06	Sell	\$1,302.30		\$0.00
03/06/07	Buy	\$1,395.41	0.53%	\$1,046.54
03/09/07	Sell	\$1,402.85		(\$338.67)
08/29/07	Buy	\$1,463.76	1.75%	\$2,219.52
09/04/07	Sell	\$1,489.42		(\$850.68)
09/18/07	Buy	\$1,519.78	0.39%	\$1,232.40
09/21/07	Sell	\$1,525.75		(\$218.40)
07/15/09	Buy	\$932.68	1.98%	\$2,026.58
07/20/09	Sell	\$951.13		(\$559.61)

Especially notable to me is the fact that the worst drawdown for any instance was only 0.85%. Meanwhile, only 1 instance didn't see a run-up of at least 1% within the next 3 days. This suggests downside may be limited.

The Quantifinder actually had a fair amount of bearish-looking studies tonight, but in an unusual twist, none of them seem pertinent. Two looked at UUP (dollar bullish etf) action, which was skewed today by a trading halt and an issuance of additional shares. The gain in UUP greatly exaggerated dollar gains today. The other, like the Nasdaq breadth study above, didn't hold true when the market was in an uptrend. Another such

study was the SPX vs. the dollar bearish fund (UDN) from the 6/19/09 nightly letter. I've updated that study below:

SPX rises at least 0.5% and outperforms UDN (dollar bearish) by at least 1.25%. Buy SPX on close. Sell X days later. \$100k/trade. 2008 - 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	-56,023.45	51	27	24	52.94	2,076.83	-4,670.74	0.44	0.50	-1,098.50
4	-54,761.95	56	22	34	39.29	2,591.18	-3,287.29	0.79	0.51	-977.89
3	-52,134.37	66	26	40	39.39	2,301.24	-2,799.16	0.82	0.53	-789.91
2	-74,723.63	74	31	43	41.89	1,777.77	-3,019.41	0.59	0.42	-1,009.78
1	-35,652.01	89	44	45	49.44	1,172.18	-1,938.40	0.60	0.59	-400.58

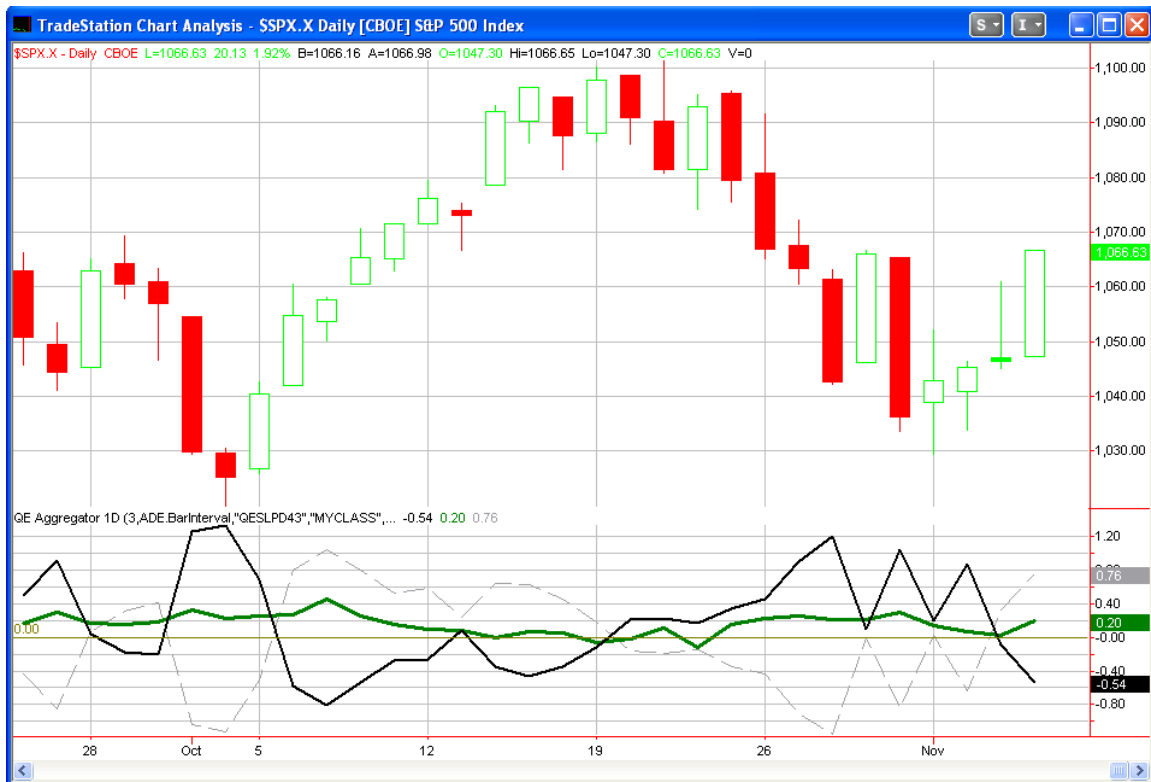
Of course most of this time period the market was locked in a strong downtrend. Almost all criteria would come out looking bearish over this time. What if I filter by the 200ma here as well to see how this has performed when the market's been rising? Those results are below.

SPX rises at least 0.5% and outperforms UDN (dollar bearish) by at least 1.25%. Close > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 2008 - 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	2,903.07	10	6	4	60.00	1,434.25	-1,425.60	1.01	1.51	290.31
4	1,703.05	10	5	5	50.00	1,874.11	-1,533.50	1.22	1.22	170.31
3	1,646.18	10	5	5	50.00	1,939.96	-1,610.72	1.20	1.20	164.62
2	-989.96	11	6	5	54.55	1,203.18	-1,641.81	0.73	0.88	-90.00
1	1,223.88	12	7	5	58.33	680.24	-707.56	0.96	1.35	101.99

No apparent edge.

Instances are low but the bearish tendency doesn't appear evident in strong uptrends.

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



In a somewhat surprising move the Aggregator line has spike up while the Differential line spiked down. With so many red studies appearing in the Quantifinder near the bell, I figured expectations would be negative and the green Aggregator line would be below 0. With the black Differential line clearly dropping well below zero, this would have set up a short-side edge. Tonight's research flipped some of those red studies and uncovered a bullish one worth tracking. This is the 1<sup>st</sup> time that I can remember that the "likely signal" near the close did not match the signal that night. Rather than the anticipated short, the Aggregator is neutral.

The environment is quite tricky at the moment. The differential shows we are now strongly overbought versus expectations, yet the studies are still projecting more upside. Finding good short entries has been difficult and remains so at the moment. I'll pay attention to the neutral bias and step aside for a short while. Perhaps tomorrow will provide a better edge. Much of what goes on tomorrow may be dictated by the employment report rather than the action and resulting studies of the last few days. I'll try and look at gap odds time-willing in the morning if it appears we are going to get a large one. In all likelihood a large gap (1%+ in either direction) should be sold.

***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.

<b>Ratio Adjusted McClellan Oscillator crosses below -105 but not -110.</b> <b>SPX close &gt; 200ma. Buy on close. Sell 25 days later. \$100k/trade. 1950 - present.</b>				
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***

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. This is basically a “wait and see” day.

### **Active Trades Table**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Pr</b>	<b>% Gain/Lo</b>	<b>Stop</b>	<b>Notes</b>
AVP(1/3)	11/2/2009	\$32.05	\$33.25	3.74%		<b>sold on close</b>

AVP put in a nice gain. The Catapults have performed very well of late.

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