

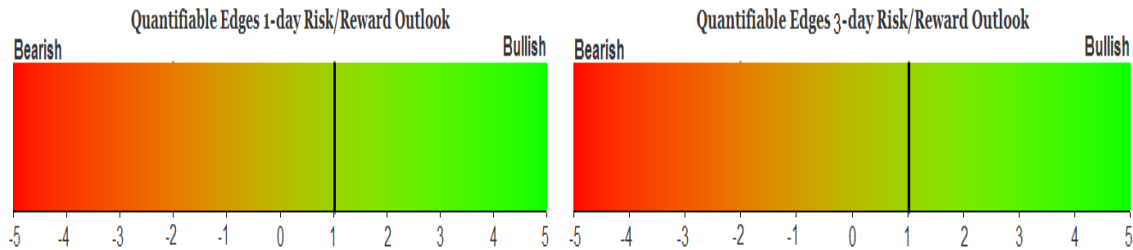
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 13, 2009

Volume 2 Issue 220

Market Overview



Tonight's Research Points

- It is often difficult to determine how powerful a pullback might be based on the 1st day. That appears to be the case here. I am seeing conflicting indications at this point.
- The Aggregator System triggered a buy.

Short-term Outlook – updated 11/13

The Bottom Line

A one-day pullback so far. While I'm expecting a bounce here soon I'm not eager to rush in with much capital. The market is still near the top of its recent range and risk/reward isn't great.

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 9, 2009 | 10-day high close on 10-day low vol | 1-5 days | Bearish | -2.50% |
| Active - Long Term | | | | |
| November 10, 2009 | 75% Up Issues 2 of 3 above 200 & 10 hi | 1-20 days | Bullish | 5.90% |
| Dropped Tonight | | | | |
| November 12, 2009 | SPX 50-day high and VIX up | 1-2 days | Bearish | -0.80% |

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

The Evidence

After a week and a half of persistent buying the market took it on the chin today. The selling accelerated in the afternoon and the indices all finished fairly close to their lows. The S&P lost 1%, the Nasdaq 0.8% and the Russell 2000 lost 2%. Breadth was strongly negative as the NYSE Up Issues % was 19% and the Up Volume % was 15%. Total volume rose slightly but continues to come in below average.

So the market with all the momentum finally takes a hit. This leads to the question of whether the momentum will quickly reassert itself or whether it's going to take several days of selling to work off the excesses of the last 8 days. Should we be looking to jump aboard right now at the first sign of a pullback, or wait for a better risk/reward scenario?

Unfortunately the studies are doing a poor job of providing clarity tonight. It's often tough to read much into the 1st day of a pullback from a high level. Today is no exception. I looked at a lot tonight. Below are a few examples of the kinds of muddle that's appearing.

First is a study that appeared in the 5/12/09 Letter.

| SPX drops 1% and decliners more than double advancers. Yesterday SPX closed at a 20-day high. Buy on close. Sell X days laer. \$100k/trade. 10/20/87 - 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 | -1,071.45 | 30 | 21 | 9 | 70.00 | 1,970.04 | -4,715.81 | 0.42 | 0.97 | -35.72 |
| 9 | 2,169.17 | 30 | 20 | 10 | 66.67 | 2,002.93 | -3,788.94 | 0.53 | 1.06 | 72.31 |
| 8 | -598.98 | 31 | 19 | 12 | 61.29 | 2,161.08 | -3,471.62 | 0.62 | 0.99 | -19.32 |
| 7 | 4,715.64 | 31 | 18 | 13 | 58.06 | 2,187.08 | -2,665.52 | 0.82 | 1.14 | 152.12 |
| 6 | -1,629.99 | 31 | 17 | 14 | 54.84 | 1,780.89 | -2,278.94 | 0.78 | 0.95 | -52.58 |
| 5 | -12,304.51 | 31 | 16 | 15 | 51.61 | 1,600.67 | -2,527.68 | 0.63 | 0.68 | -396.92 |
| 4 | -6,378.38 | 33 | 16 | 17 | 48.48 | 1,442.03 | -1,732.40 | 0.83 | 0.78 | -193.28 |
| 3 | 4,774.78 | 35 | 22 | 13 | 62.86 | 1,102.36 | -1,498.24 | 0.74 | 1.25 | 136.42 |
| 2 | 3,450.19 | 35 | 18 | 17 | 51.43 | 1,166.89 | -1,032.58 | 1.13 | 1.20 | 98.58 |
| 1 | 8,193.10 | 35 | 25 | 10 | 71.43 | 862.92 | -1,338.00 | 0.64 | 1.61 | 234.09 |

What we saw at the time and still do is a mild edge for a 1-day bounce. After that all bets are off and the results are inconclusive.

Tonight I decided to look at the above test with a 200ma filter as I've been doing lately to see if that makes a difference. Those results are below.

SPX drops 1% and NYSE decliners more than double advancers. Close > 200ma. Yesterday SPX closed at a 20-day high. Buy on close. Sell X days laer. \$100k/trade. 10/20/87 - 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 | 7,908.47 | 15 | 10 | 5 | 66.67 | 2,229.10 | -2,876.51 | 0.77 | 1.55 | 527.23 |
| 9 | 6,284.73 | 15 | 10 | 5 | 66.67 | 1,962.30 | -2,667.66 | 0.74 | 1.47 | 418.98 |
| 8 | 7,833.02 | 16 | 9 | 7 | 56.25 | 2,065.89 | -1,537.15 | 1.34 | 1.73 | 489.56 |
| 7 | 3,222.29 | 16 | 8 | 8 | 50.00 | 2,069.70 | -1,666.92 | 1.24 | 1.24 | 201.39 |
| 6 | 3,106.48 | 16 | 8 | 8 | 50.00 | 1,835.52 | -1,447.21 | 1.27 | 1.27 | 194.16 |
| 5 | -895.95 | 16 | 8 | 8 | 50.00 | 1,400.40 | -1,512.40 | 0.93 | 0.93 | -56.00 |
| 4 | 4,006.14 | 16 | 9 | 7 | 56.25 | 1,265.12 | -1,054.28 | 1.20 | 1.54 | 250.38 |
| 3 | 1,717.36 | 16 | 11 | 5 | 68.75 | 605.86 | -989.42 | 0.61 | 1.35 | 107.34 |
| 2 | 707.91 | 16 | 9 | 7 | 56.25 | 579.45 | -643.88 | 0.90 | 1.16 | 44.24 |
| 1 | 4,684.14 | 16 | 12 | 4 | 75.00 | 588.71 | -595.10 | 0.99 | 2.97 | 292.76 |

14 of 16 instances (87.5%) closed above the entry price at some point in the next 3 days.

The edge still lies primarily on day 1. Stats are a little better here, though.

But rather than filtering on a 20-day high what if I instead used a 50-day high and eliminated the 1% drop requirement?

SPX closes down & NYSE decliners more than double advancers. Close > 200ma. Yesterday SPX closed at a 50-day high. Buy on close. Sell X days laer. \$100k/trade. 10/20/87 - 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 | -1,445.11 | 24 | 14 | 10 | 58.33 | 1,501.25 | -2,246.27 | 0.67 | 0.94 | -60.21 |
| 9 | -3,053.22 | 24 | 15 | 9 | 62.50 | 1,424.91 | -2,714.10 | 0.53 | 0.88 | -127.22 |
| 8 | -1,984.60 | 25 | 12 | 13 | 48.00 | 1,526.78 | -1,562.00 | 0.98 | 0.90 | -79.38 |
| 7 | 1,204.17 | 25 | 12 | 13 | 48.00 | 1,400.70 | -1,200.32 | 1.17 | 1.08 | 48.17 |
| 6 | -5,452.23 | 25 | 12 | 13 | 48.00 | 1,144.77 | -1,476.11 | 0.78 | 0.72 | -218.09 |
| 5 | -2,555.55 | 25 | 14 | 11 | 56.00 | 961.88 | -1,456.54 | 0.66 | 0.84 | -102.22 |
| 4 | -7,178.80 | 26 | 12 | 14 | 46.15 | 870.95 | -1,259.30 | 0.69 | 0.59 | -276.11 |
| 3 | -11,933.04 | 26 | 12 | 14 | 46.15 | 519.56 | -1,297.70 | 0.40 | 0.34 | -458.96 |
| 2 | -16,095.37 | 26 | 9 | 17 | 34.62 | 482.49 | -1,202.22 | 0.40 | 0.21 | -619.05 |
| 1 | -8,666.48 | 26 | 12 | 14 | 46.15 | 581.81 | -1,117.73 | 0.52 | 0.45 | -333.33 |

So the edge here again is very short-term – only 2 days. In this case it's suggesting bearish implications though.

Now if I put the 1% drop filter back in and run the stats above and below that number you'll notice something interesting. The 1% filter appears to matter very much.

SPX closes down at least 1% & NYSE decliners more than double advancers.
Close > 200ma. Yesterday SPX closed at a 50-day high. Buy on close. Sell X
days later. \$100k/trade. 10/20/87 - 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 | -3,925.70 | 12 | 6 | 6 | 50.00 | 1,180.19 | -1,834.47 | 0.64 | 0.64 | -327.14 |
| 4 | 1,529.95 | 12 | 7 | 5 | 58.33 | 1,065.37 | -1,185.53 | 0.90 | 1.26 | 127.50 |
| 3 | 666.50 | 12 | 8 | 4 | 66.67 | 607.92 | -1,049.22 | 0.58 | 1.16 | 55.54 |
| 2 | -382.03 | 12 | 6 | 6 | 50.00 | 610.80 | -674.47 | 0.91 | 0.91 | -31.84 |
| 1 | 4,302.72 | 12 | 9 | 3 | 75.00 | 637.61 | -478.60 | 1.33 | 4.00 | 358.56 |

SPX closes down less than 1% & NYSE decliners more than double advancers.
Close > 200ma. Yesterday SPX closed at a 50-day high. Buy on close. Sell X
days later. \$100k/trade. 10/20/87 - present.

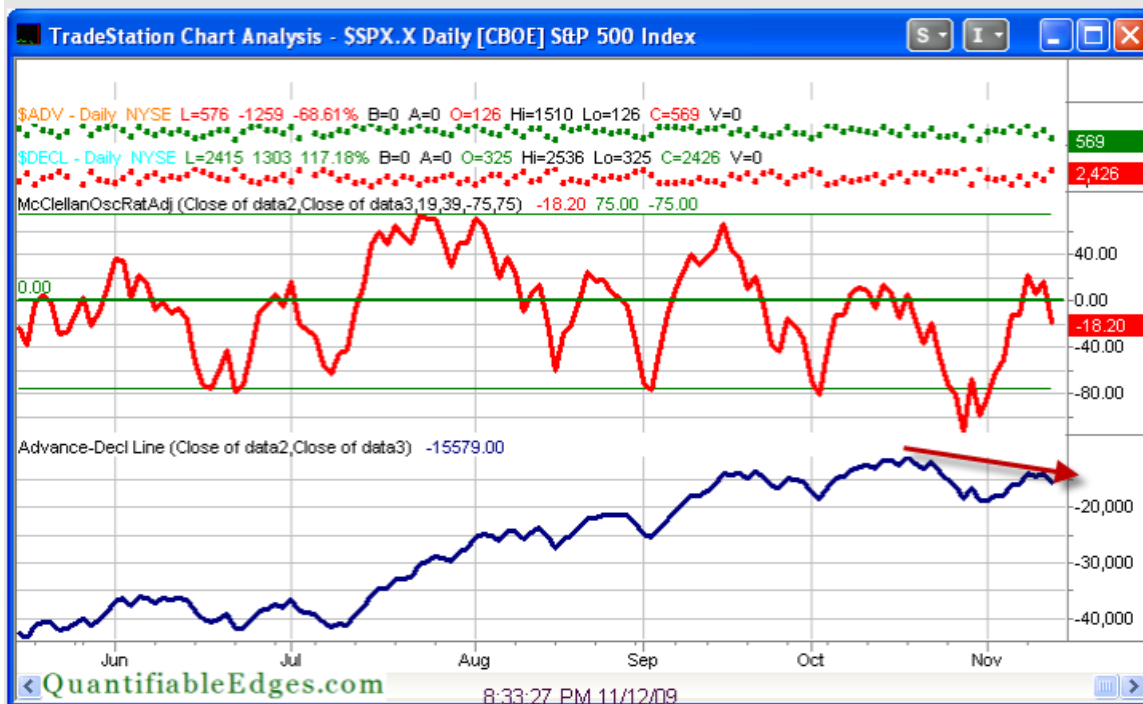
| X Days | All: Net Profit | All: Total Trades | All: Winning Trades | All: Losing Trades | All: % Profitable | All: Avg Winning Trade | All: Avg Losing Trade | All: Win/Loss Ratio | All: ProfitFactor | All: Avg Trade |
|--------|-----------------|-------------------|---------------------|--------------------|-------------------|------------------------|-----------------------|---------------------|-------------------|----------------|
| 5 | -3,514.60 | 14 | 8 | 6 | 57.14 | 798.15 | -1,649.97 | 0.48 | 0.64 | -251.04 |
| 4 | -8,708.75 | 14 | 5 | 9 | 35.71 | 598.76 | -1,300.28 | 0.46 | 0.26 | -622.05 |
| 3 | -12,599.54 | 14 | 4 | 10 | 28.57 | 342.85 | -1,397.09 | 0.25 | 0.10 | -899.97 |
| 2 | -15,713.34 | 14 | 3 | 11 | 21.43 | 225.89 | -1,490.09 | 0.15 | 0.04 | -1,122.38 |
| 1 | -12,969.20 | 14 | 3 | 11 | 21.43 | 414.38 | -1,292.03 | 0.32 | 0.09 | -926.37 |

The bottom line is that today's action could be interpreted a number of ways. And with the SPX down 1.03% today should we believe that the 0.03% difference is substantial in predicting the Friday's action? That would seem absurd. The edge here just isn't clear, and rather than squint too hard or try and pick sides for no good reason, I'll just avoid making judgment on today's action just yet.

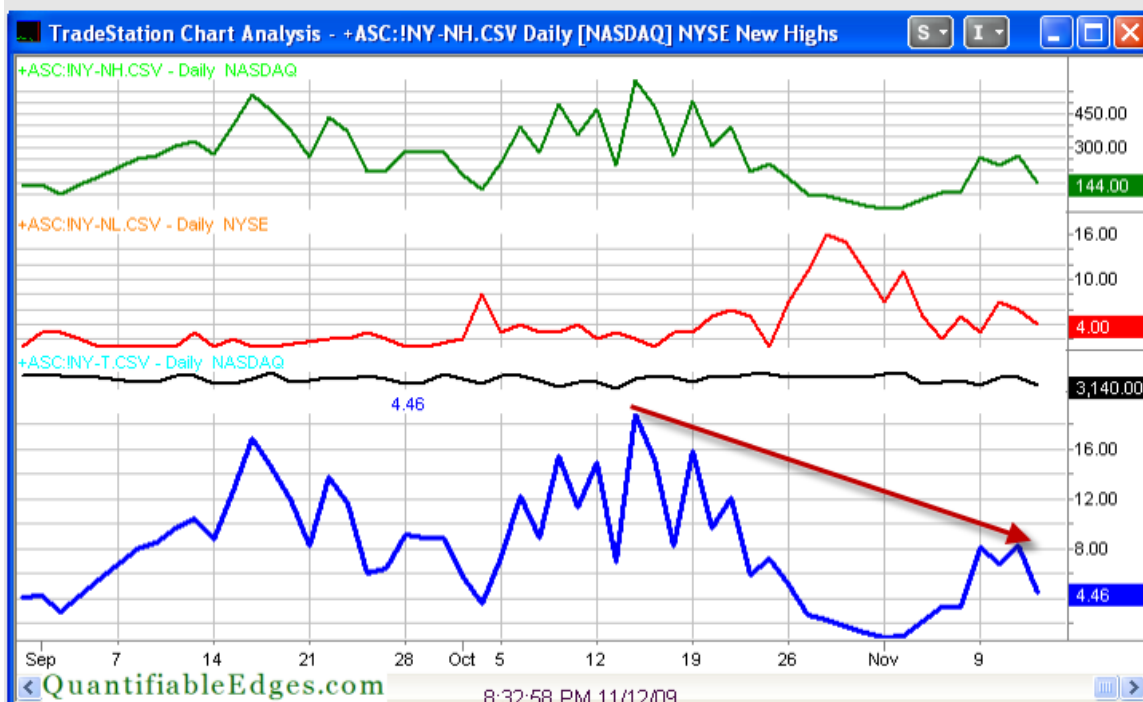
The one real positive study that's active is the breadth thrust study from last Thursday and this past Monday. The action of those 2 days strongly indicated that breadth was suggesting further upside over the next few weeks. Of course it will be important not to be foolish about relying too heavily on the breadth action of just 2 days. Other breadth indicators are now flashing warnings.

I am seeing divergences currently in both the A/D line and the New High % numbers. Below are the charts from the website. I've placed arrows showing the divergences that have occurred over the last month.

NYSE Ratio Adjusted McClellan Oscillator & NYSE Advance/Decline Line



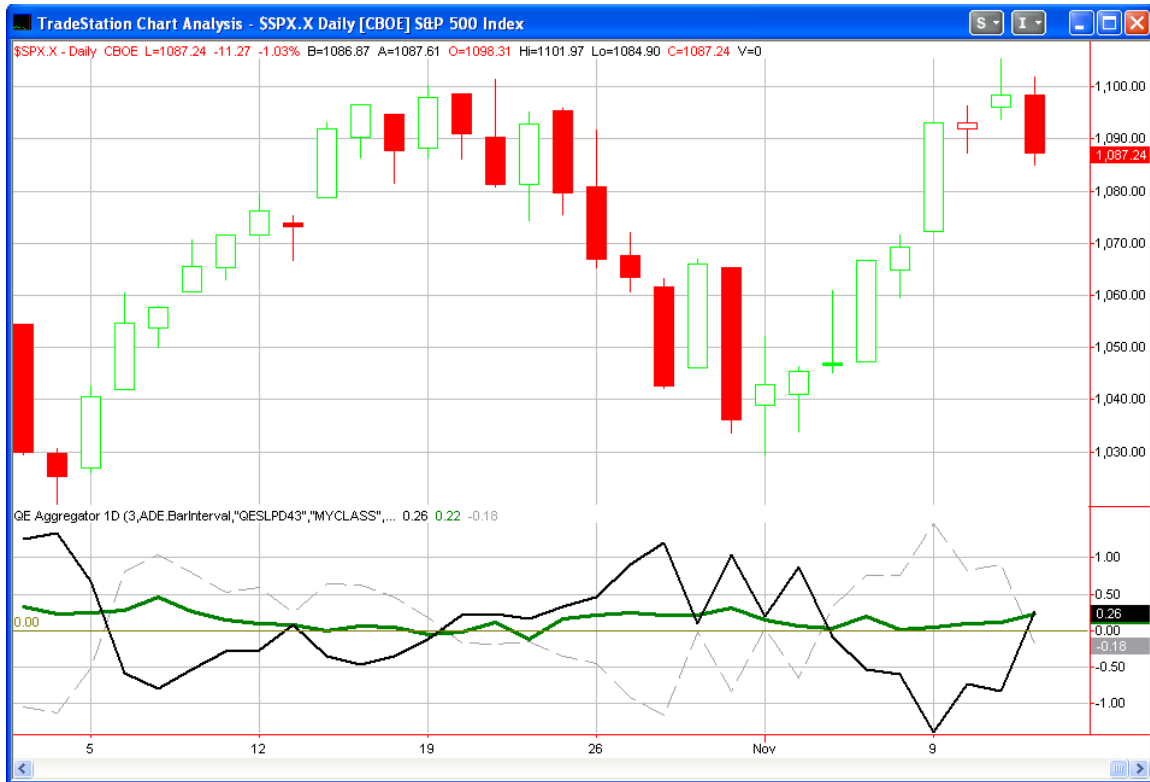
NYSE Net New Highs



In the intermediate-term outlook of the October 12th Letter I showed how divergences in these breadth indicators occurred prior to all the major tops back to 1970. Most often these divergences persisted for between 2 and 12 months before the ultimate price top. I don't mean to imply anything here, except that they are worth keeping an eye on. I also

wanted point out that breadth may not be quite as strong as our breadth thrust study suggests. I'll discuss my thoughts on these indicators a bit more over the weekend.

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



The combination of Thursday's selloff and the elimination of Monday's rise from the Differential calculation has caused a large spike up in the black Differential. No longer is the SPX overbought versus expectations. In fact it is now a bit oversold relative to recent expectations. The green Aggregator line has remained above 0 as net expectations are positive over the next few days.

With both the green Aggregator and the black Differential lines above 0 the Aggregator System has triggered its first signal in over a week. It suggests an upside edge over the next few days.

Personally, I'm a bit wary of buying at these levels. While the Aggregator formation is favorable, we are still a lot closer to the top of the recent range than we are to the bottom. Potential risks appear sizable compared to potential rewards. With an active Aggregator signal I will look to put on a small amount. I won't add to the position unless we get a bit more selling though. Details are in the trade ideas section below.

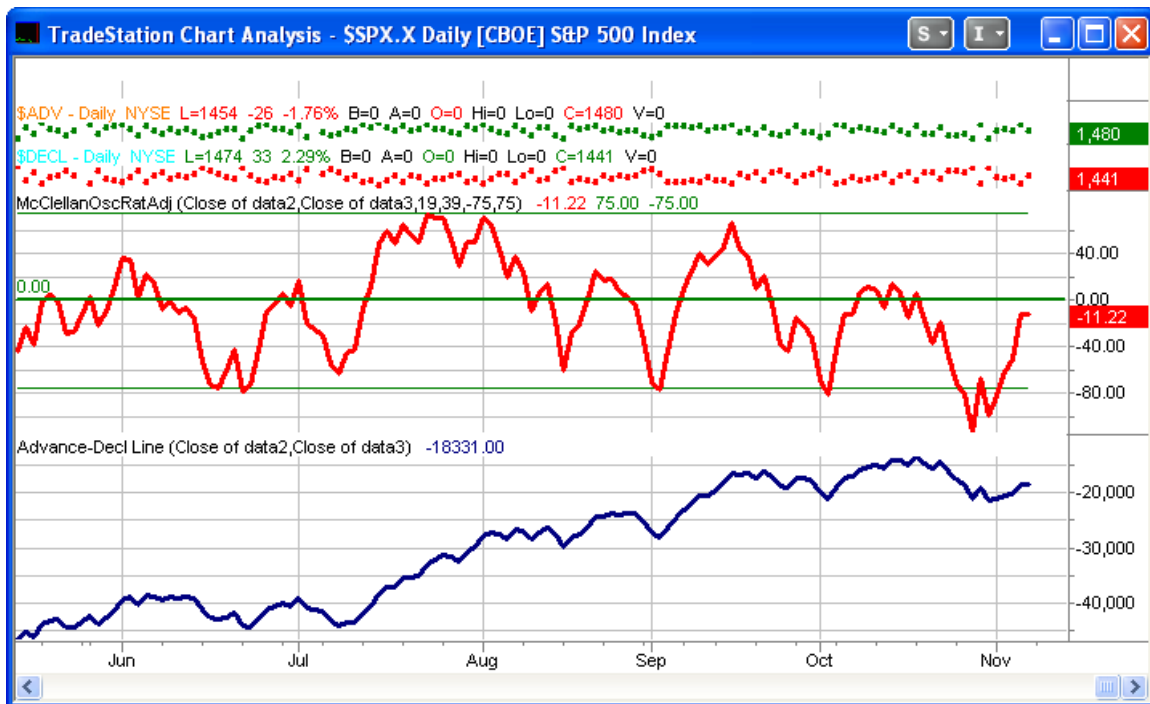
Intermediate-term Outlook (2 weeks – 2 months)– updated 11/9 – neutral

In last weekend's intermediate-term outlook I discussed the extremely stretched state of the Ratio Adjusted McClellan Oscillator. That study suggested that selling had reached levels that normally shouldn't occur in an uptrend. The study also suggested the low of

Friday October 30th could be a line in the sand. A move much below that level would mean a deeper decline lasting at least a few weeks was likely. If that line could hold, though, then the market might actually be able to begin a substantial rally over the next 4-5 weeks. So far so good as the market has risen 5 days in a row since then. I'll still be watching the low of the recent pullback as important. The short-term outlook is suggesting a pullback is likely early this week. Should the pullback hold above the recent swing low, then a bullish outlook would appear reasonable. A close below that level would suggest a bearish outlook. Those wishing to review last week's study may use the link below:

[2009-11-02 QE Weekly Research Letter.pdf](#)

I've shown a few breadth studies in recent weeks that looked at measures other than those included on the charts page. Based on subscriber requests, I've created a new chart on the charts page that from now on will show on a daily basis the Ratio Adjusted NYSE McClellan Oscillator and the NYSE Advance/Decline line. A copy of that chart is below.



The Ratio Adjusted McClellan Oscillator is the red line and the Advance / Decline line is blue. In the near future I will add a new page with a longer-term chart and research links similar to the other chart detail pages.

Most major tops have seen breadth divergences occur prior to the actual price peak. Of course it's entirely possible that the current rally could top out without breadth divergences that I'd noted were prevalent in past reports. To review the study that looked at divergent breadth action prior to significant tops see the October 12th Letter below.

[2009-10-12 QE Weekly Research Letter.pdf](#)

A top from here may or may not be considered “major” since the market is not near all-time highs. Still I’ll continue to watch the New Highs and the A/D line for divergence clues. For now the uptrend remains in tact. A move below last weeks low or a new high that isn’t soon accompanied by an expansion of New Highs and a breakout in the A/D line would suggest trouble ahead.

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 @ \$108.25 limit. If not filled by close buy @ \$109 limit ON CLOSE. This trade idea is based on the Aggregator chart.

Active Trades Table

| Symbol | Entry Date | Entry Price | Current Pr | % Gain/Lo | Stop | Notes |
|-------------|------------|-------------|------------|-----------|------|-------------|
| SPY(1/4)(s) | 11/9/2009 | \$107.95 | \$110.26 | -2.14% | | stopped out |

The small SPY trade was stopped out this morning before the selloff took hold. This trade was brutal due to a combination of bad luck and bad management on my part. I’ll discuss how I feel I erred in the next letter. It’s worth reviewing since I believe there is a valuable lesson in this one.

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