

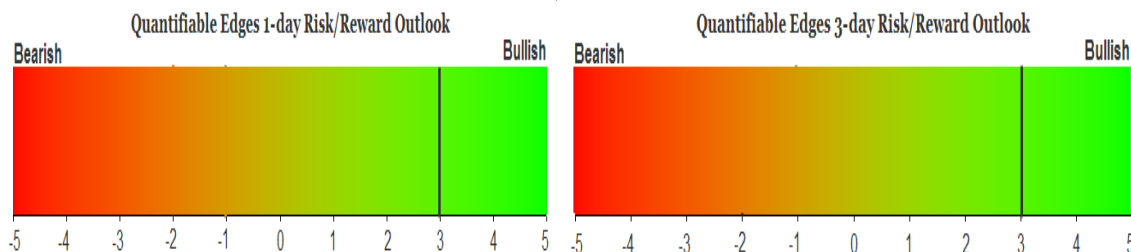
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 20, 2009

Volume 2 Issue 225

Market Overview



Tonight's Research Points

- The strong broad selling on Thursday triggered some bullish studies. Most notable was that when the SPX declines 1% and Decliners double Advancers the market has had a bullish tendency over the following days.
- The Aggregator System triggered a long signal at the close today. .

Short-term Outlook – updated 11/20

The Bottom Line

The pullback I was expecting and hoping for arrived. Now let's see if it will indeed provide a nice bounce. I'm favoring the long side at this point.

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 20, 2009	SPX 1% drop & Advancers 2x Decliners	1-9 days	Bullish	2.90%
November 18, 2009	20-day low vol. SPX above 10ma & 200ma	1-3 days	Bearish	
November 17, 2009	70% Up Issues 2 in row & SPX 50 high	1-8 days	Bullish	2.40%
Active - Long Term				
November 10, 2009	75% Up Issues 2 of 3 above 200 & 10 hi	1-20 days	Bullish	5.90%

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

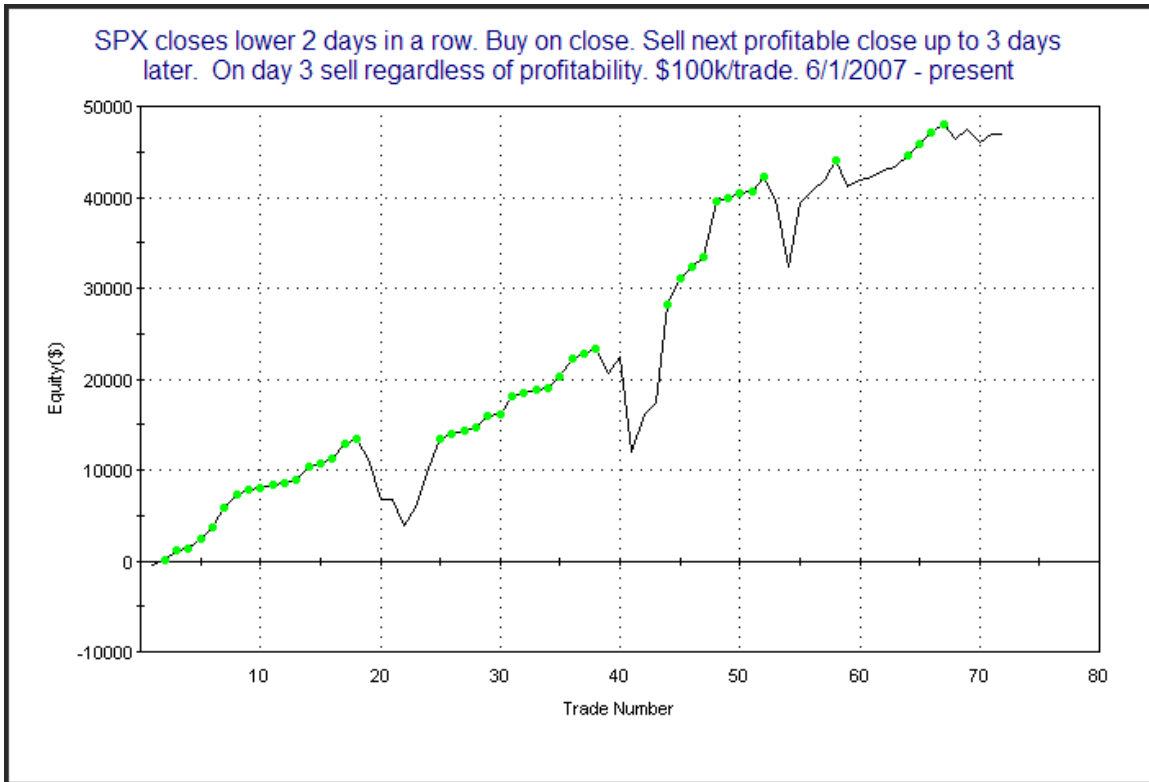
The Evidence

After several days of overbought readings the market pulled back in a sizable way Thursday. A large overnight gap led to further selling during the morning. The low was hit around 11am and then the market crept higher for the rest of the afternoon. While well off its lows the damage was still fairly large. The SPX dropped 1.3%, the Nasdaq 1.7% and the Russell 2.4%. Breadth was very weak as the NYSE Up Issues % came in at 18% and the Up Volume % was 11% - barely avoiding a 90% down day. NYSE volume came in slightly higher than Wednesday but wasn't extreme.

The "2 Days Down In Chop" system triggered Thursday. I haven't focused on the 2 days in chop systems much recently. The primary reason is that since the market action has been less choppy since July or so they haven't performed as well. The stats back to 2007 are below and they are still respectable for "2 Days Down In Chop".

SPX closes lower 2 days in a row. Buy on close. Sell next profitable close up to 3 days later. On day 3 sell regardless of profitability. \$100k/trade. 6/1/2007 - present			
TradeStation Performance Summary			Collapse 
All Trades			
Total Net Profit	\$46,944.48	Profit Factor	2.19
Gross Profit	\$86,372.30	Gross Loss	(\$39,427.82)
Total Number of Trades	72	Percent Profitable	83.33%
Winning Trades	60	Losing Trades	12
Even Trades	0		
Avg. Trade Net Profit	\$652.01	Ratio Avg. Win:Avg. Loss	0.44
Avg. Winning Trade	\$1,439.54	Avg. Losing Trade	(\$3,285.65)

The issue with the system is that it simply hasn't done a whole lot over the last few months. Below is the profit curve.



The steep upslope has tapered off and the move has basically been sideways lately. I'm not going to include it in the Aggregator but will continue to monitor the results as well as the Trend vs. Chop chart. I suspect that should the market begin to trade in a more choppy manner as it did from June 07 through June 09 the "2 Days In Chop" systems will begin to work quite nicely again.

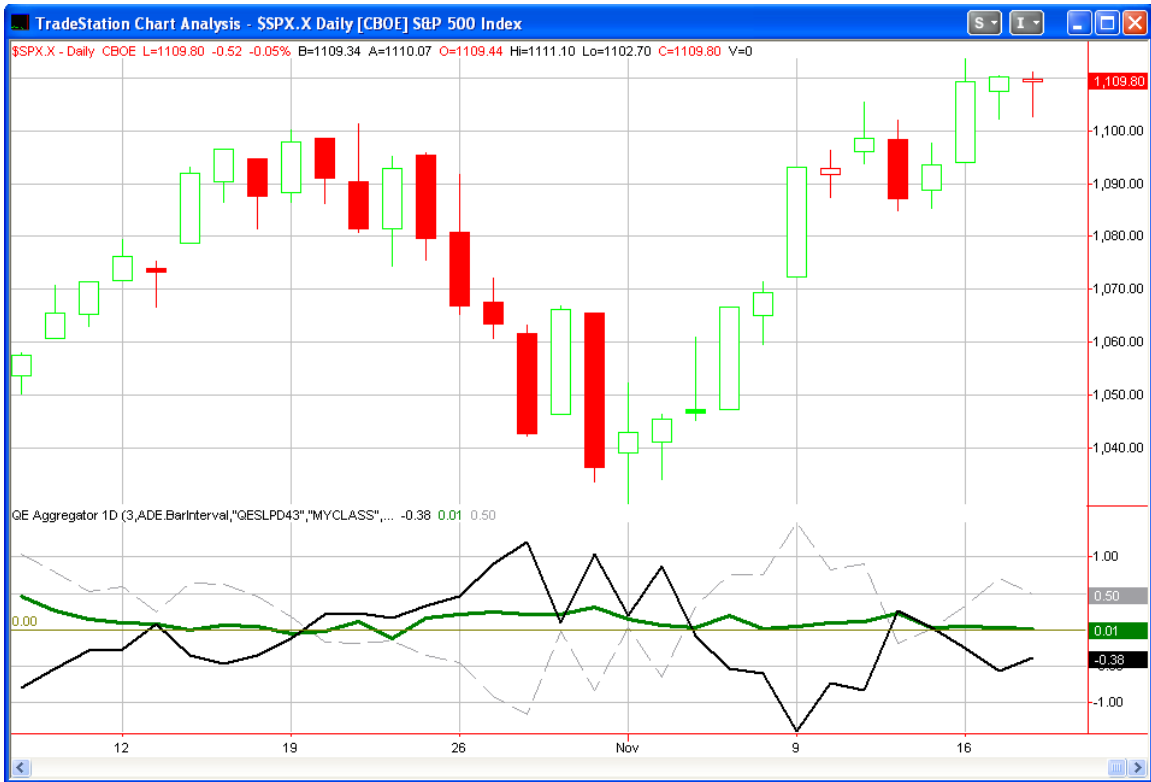
Another study that triggered tonight was from the 5/12/09 Subscriber Letter. It looked at 1% drops with 2:1 negative breadth. I've updated the results below:

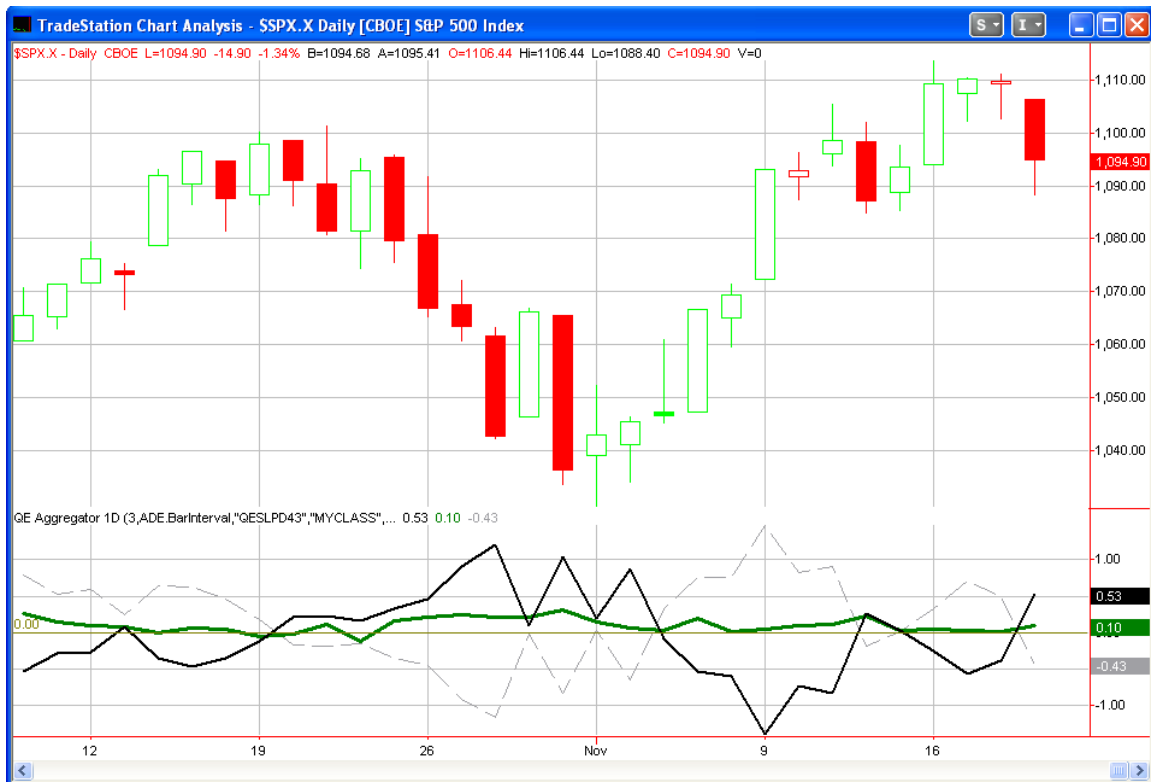
SPX drops 1% and decliners more than double advancers.
Buy on close. Sell X days later. \$100k/trade. 10/20/87 - present.

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
10	235,602.99	240	163	77	67.92	2,743.93	-2,748.79	1.00	2.11	981.68
9	255,707.89	245	169	76	68.98	2,676.16	-2,586.35	1.03	2.30	1,043.71
8	216,633.56	260	169	90	65.00	2,632.58	-2,536.37	1.04	1.95	833.21
7	228,249.43	279	174	105	62.37	2,636.09	-2,194.57	1.20	1.99	818.10
6	208,816.23	295	183	112	62.03	2,489.96	-2,203.98	1.13	1.85	707.85
5	188,491.90	324	194	130	59.88	2,300.94	-1,983.77	1.16	1.73	581.77
4	133,721.78	346	199	147	57.51	2,052.82	-1,869.32	1.10	1.49	386.48
3	158,022.48	378	234	144	61.90	1,760.67	-1,763.71	1.00	1.62	418.05
2	149,772.40	431	242	189	56.15	1,694.83	-1,377.65	1.23	1.58	347.50
1	112,368.23	483	289	194	59.83	1,126.89	-1,099.50	1.02	1.53	232.65

Here we see a decent upside edge over the following 2 weeks. In the 5/12/09 Letter I also broke it down by times the SPX was coming off a 20-day high vs. times it wasn't. Since the SPX was only 1/2 a point from its 20-day high close on Wednesday I decided not to apply that filter.

I have updated the [Aggregator](#) chart below.





As expected the selloff today caused a rise in both the Aggregator and Differential lines. The green Aggregator line is now squarely above 0, which means the net expectations from the active studies over the next few days is positive. The black Differential line in positive territory illustrates the fact that the SPX has now underperformed expectations over the last few days and is now oversold vs. expectations. This is generally considered a bullish configuration and as such triggered a long entry for the Aggregator System.

Of course we're only down 2 days here. There's always a chance of a deeper pullback. I'll play it conservatively and look to scale in as described in the Trade Ideas section below.

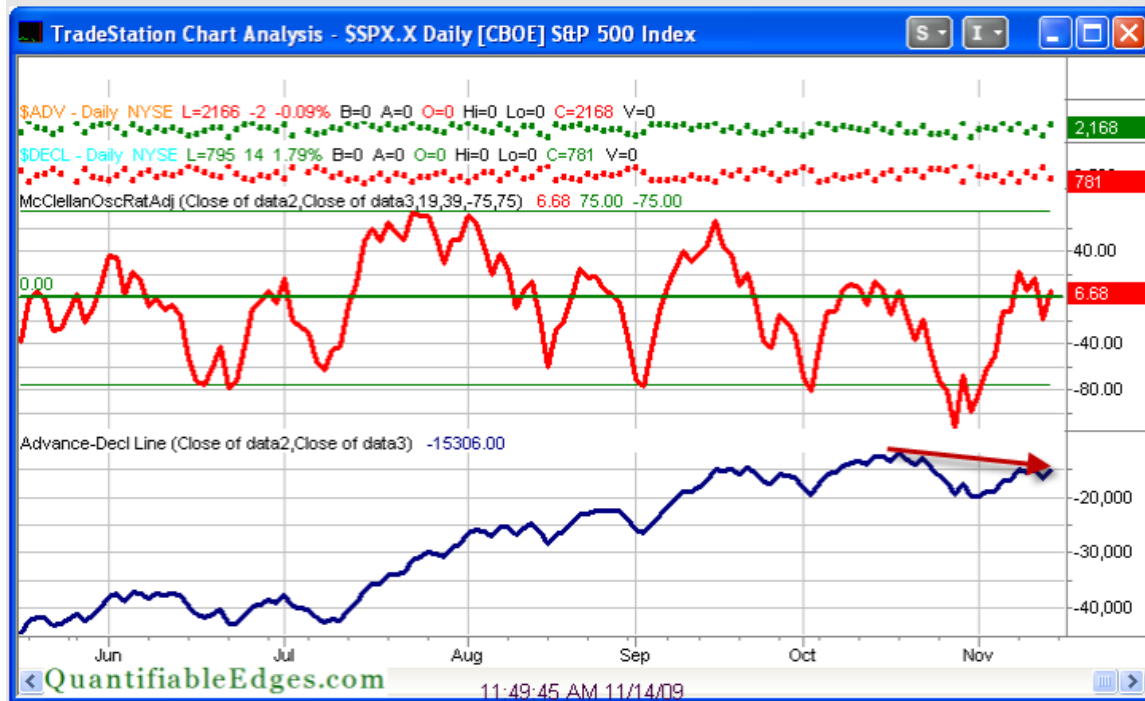
Intermediate-term Outlook (2 weeks – 2 months)– updated 11/16 – very slightly bullish
 Breadth has been the topic the last couple of weeks and from an intermediate-term standpoint it continues to keep my interest this week.

On Monday the 9th the market rallied in a big way and breadth was exceptionally strong for the 2nd time in 3 days. This created a breadth thrust type situation. I outlined this in a special report on Monday afternoon. If you'd like to review that report you may use the link below:

[2009-11-09 QE Special Report.pdf](#)

While the above study paints the breadth picture in a very positive light, I did note some divergences forming on Thursday night. Below are updated charts of the NYSE Advance/Decline Line and the NYSE Net New Highs. First let's look at the A/D Line.

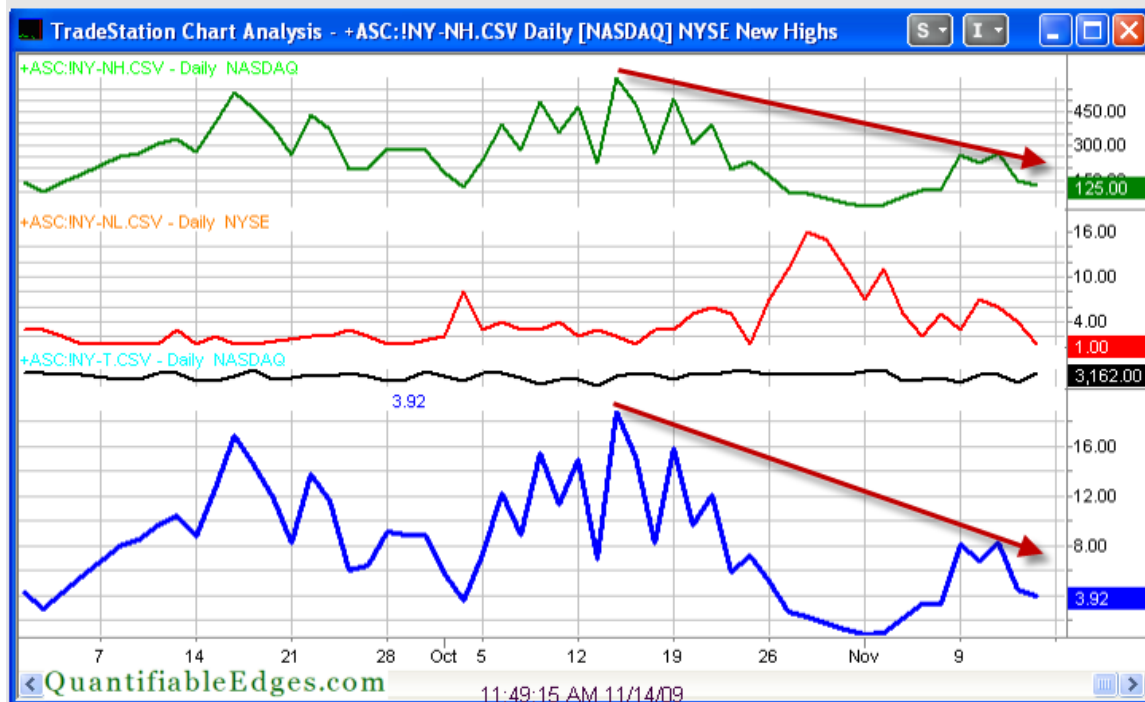
NYSE Ratio Adjusted McClellan Oscillator & NYSE Advance/Decline Line



The A/D Line is the blue line in the bottom panel. The indicator above that is the Ratio Adjusted McClellan Oscillator. As you can see the A/D Line peaked about a month ago. While new price highs were made this week, it's happening on weaker breadth. The A/D Line doesn't always hit new highs ahead of or at the same time as the indices. It is possible that breadth will confirm the price highs with new A/D Line highs in the coming days or weeks. If so, then that would be a positive sign. Failure to do so would suggest continued internal deterioration. This kind of deterioration would likely eventually lead to a significant top.

The new highs is another breadth measure I look at. Below is that chart from the website.

NYSE Net New Highs



The top panel contains the raw number of new 52-week highs on the NYSE. The bottom panel shows the net new high %. As a reminder the calculation for net new high % is “(New highs – new lows) / total issues”. Here again we see new highs peaked about a month ago. The net new high % has dropped substantially since then. It was over 16% in mid-October and was only around 8% when the market hit a new high on Wednesday.

So with both indicators suggesting breadth is waning even as the market advances traders should be on alert for a potential top. I looked at how such divergences had led to past tops in the 10/12/09 letter. Those who wish to review it may use the link below:

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

From a price standpoint I'm viewing the S&P 500 11/2/09 lows around 1030 as important. The 11/2/09 Letter contained a study based on the McClellan Oscillator that suggested the SPX has reached its line in the sand. A close much below there would signal a deeper correction. An ability to hold above that area could spark a nice rally. Those lows held nicely and the market hit new highs. Let's see if it revisits those lows or if it can continue to hit new highs. And if it reaches new highs can breadth expand and confirm the rally?

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 position at @ \$109.82 limit. Based on short term market outlook and Aggregator signal.

Active Trades Table

None.

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