

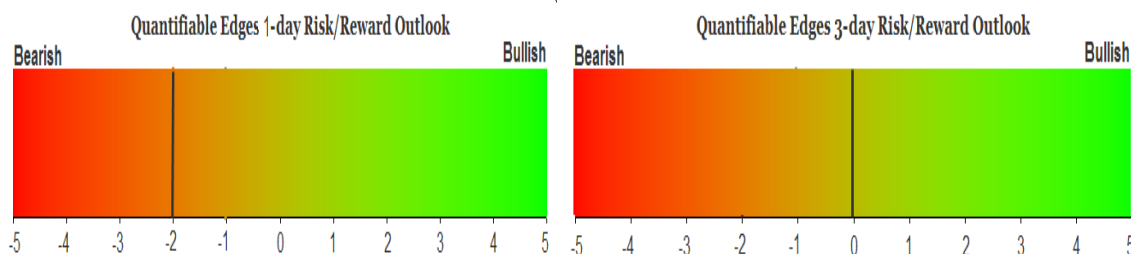
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 13, 2010

Volume 3 Issue 8

Market Overview



Tonight's Research Points

- Strong negative breadth coming off a high for the SPX that is not accompanied by strong selling leaves the market vulnerable to further short-term selling.
- SPY's unfilled gap down from a high along with its high volume suggest a rebound 4-6 days out..
- The Aggregator System is now flat.

Short-term Outlook – updated 1/13

The Bottom Line

While tonight's studies suggest more downside is likely, the SPX is already oversold versus expectations. This leaves the Aggregator char market neutral.

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				
January 13, 2010	2:1 Neg brdth from 50-hi. No 1% drop	1-2 days	Bearish	-1.80%
Active - Long Term				
December 23, 2009	SPX and TNX hit 50-day high	1-10 weeks	Bearish	
December 23, 2009	Low p/c without strong SPX rise	1-5 weeks	Bearish	
December 7, 2009	Nasdaq Leading S&P	int. term	Bullish	
December 2, 2009	VIX:VXV crosses below 0.9	2-5 months	Bearish	
Dropped Tonight				
January 11, 2006	SPY successive 50-hi on lower volume	1-3 days	Bearish	-1.10%
January 8, 2010	Outside day at a high w/ rising vol	1-3 days	Bearish	

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

The Evidence

The market gapped down Tuesday, and after a weak attempt at a bounce, it sold off further. There was a bounce going into the close but the major indices all suffered poor performances. The SPX lost 0.9%, and the Russell and Nasdaq both lost 1.3%. Breadth was strongly negative as the NYSE Up Issue % came in at 27% and the Up Volume % was 18%. Total volume increased over the level of the last 2 days.

So what needed to be studied tonight was how the market typically reacts after pulling back from a high. I looked at it several different ways and I'll go through a few of the more interesting test results.

As I mentioned in the intraday update, strongly negative breadth that was not accompanied by a large price drop seemed to look much different than those times it occurred along with a large price drop. Below is an example of how I broke it down. First with a large price drop:

SPX closes more than 1% lower. Decliners more than double advancers. Yesterday's close was at a 50-day high.. Today's close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1988 - 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	-1,910.96	14	8	6	57.14	1,136.98	-1,834.47	0.62	0.83	-136.50
4	4,349.13	14	9	5	64.29	1,141.86	-1,185.53	0.96	1.73	310.65
3	4,381.12	14	10	4	71.43	857.80	-1,049.22	0.82	2.04	312.94
2	3,205.19	14	8	6	57.14	906.50	-674.47	1.34	1.79	228.94
1	5,246.39	14	11	3	78.57	607.47	-478.60	1.27	4.65	374.74

In such cases the selling was often met with an immediate bounce the next day.

Now let's look at times like Tuesday where the price drop was more muted:

SPX closes less than 1% lower. Decliners more than double advancers. Yesterday's close was at a 50-day high.. Today's close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1988 - 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	-2,315.08	15	9	6	60.00	842.75	-1,649.97	0.51	0.77	-154.34
4	-7,678.91	15	6	9	40.00	670.60	-1,300.28	0.52	0.34	-511.93
3	-12,472.70	15	5	10	33.33	299.64	-1,397.09	0.21	0.11	-831.51
2	-14,976.66	15	4	11	26.67	353.59	-1,490.09	0.24	0.09	-998.44
1	-12,329.96	15	4	11	26.67	470.60	-1,292.03	0.36	0.13	-822.00

Here we see that times the market did not suffer as much the risk became much greater over the next couple of days.

Below I have listed all the instances with the 1-day exit rule:

SPX closes less than 1% lower. Decliners more than double advancers. Yesterday's close was at a 50-day high.. Today's close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1988 - present				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
06/28/89	Buy	\$325.81	(1.88%)	\$0.00
06/29/89	Sell	\$319.67		(\$1,918.62)
02/27/95	Buy	\$483.96	0.71%	\$716.88
02/28/95	Sell	\$487.38		(\$39.14)
07/18/95	Buy	\$558.46	(1.34%)	\$0.00
07/19/95	Sell	\$550.98		(\$2,855.05)
04/23/98	Buy	\$1,119.58	(1.04%)	\$287.47
04/24/98	Sell	\$1,107.90		(\$1,706.13)
01/03/00	Buy	\$1,455.22	(3.83%)	\$0.00
01/04/00	Sell	\$1,399.42		(\$3,929.72)
10/07/04	Buy	\$1,130.65	(0.75%)	\$199.76
10/08/04	Sell	\$1,122.14		(\$920.48)
05/25/05	Buy	\$1,190.01	0.64%	\$750.96
05/26/05	Sell	\$1,197.62		\$0.00
07/21/05	Buy	\$1,227.04	0.54%	\$579.15
07/22/05	Sell	\$1,233.68		(\$72.09)
08/04/05	Buy	\$1,235.86	(0.76%)	\$0.00
08/05/05	Sell	\$1,226.42		(\$819.20)
11/28/05	Buy	\$1,257.47	0.00%	\$680.98
11/29/05	Sell	\$1,257.48		\$0.00
09/06/06	Buy	\$1,300.26	(0.48%)	\$75.24
09/07/06	Sell	\$1,294.02		(\$617.88)
06/05/07	Buy	\$1,530.95	(0.89%)	\$0.00
06/06/07	Sell	\$1,517.38		(\$1,093.30)
07/16/07	Buy	\$1,549.52	(0.01%)	\$371.20
07/17/07	Sell	\$1,549.37		(\$113.92)
08/14/09	Buy	\$1,004.09	(2.43%)	\$0.00
08/17/09	Sell	\$979.73		(\$2,532.42)
10/20/09	Buy	\$1,091.06	(0.89%)	\$937.30
10/21/09	Sell	\$1,081.40		(\$936.39)

As you can see the have 5 have all suffered losses the next day. The last one that didn't was in 2005.

Also interesting about Tuesday's action was that it left an unfilled gap down. Below is a study that looks at results following all unfilled gaps down from 50-day highs in the SPY.

After closing at a 50-day high yesterday, SPY posts an unfilled gap down today.
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
6	6,524.28	59	35	24	59.32	1,204.90	-1,485.31	0.81	1.18	110.58
5	5,975.39	61	30	31	49.18	1,322.67	-1,087.25	1.22	1.18	97.96
4	-1,810.82	62	31	31	50.00	1,037.87	-1,096.28	0.95	0.95	-29.21
3	-10,033.13	62	29	33	46.77	692.81	-912.87	0.76	0.67	-161.82
2	-17,928.34	66	26	40	39.39	704.35	-906.04	0.78	0.51	-271.64
1	-9,345.35	66	28	38	42.42	573.86	-668.78	0.86	0.63	-141.60

Here again we see that the initial drop is often followed by more downside. I also filtered to look at times when the unfilled gap down was accompanied by high SPY volume like today.

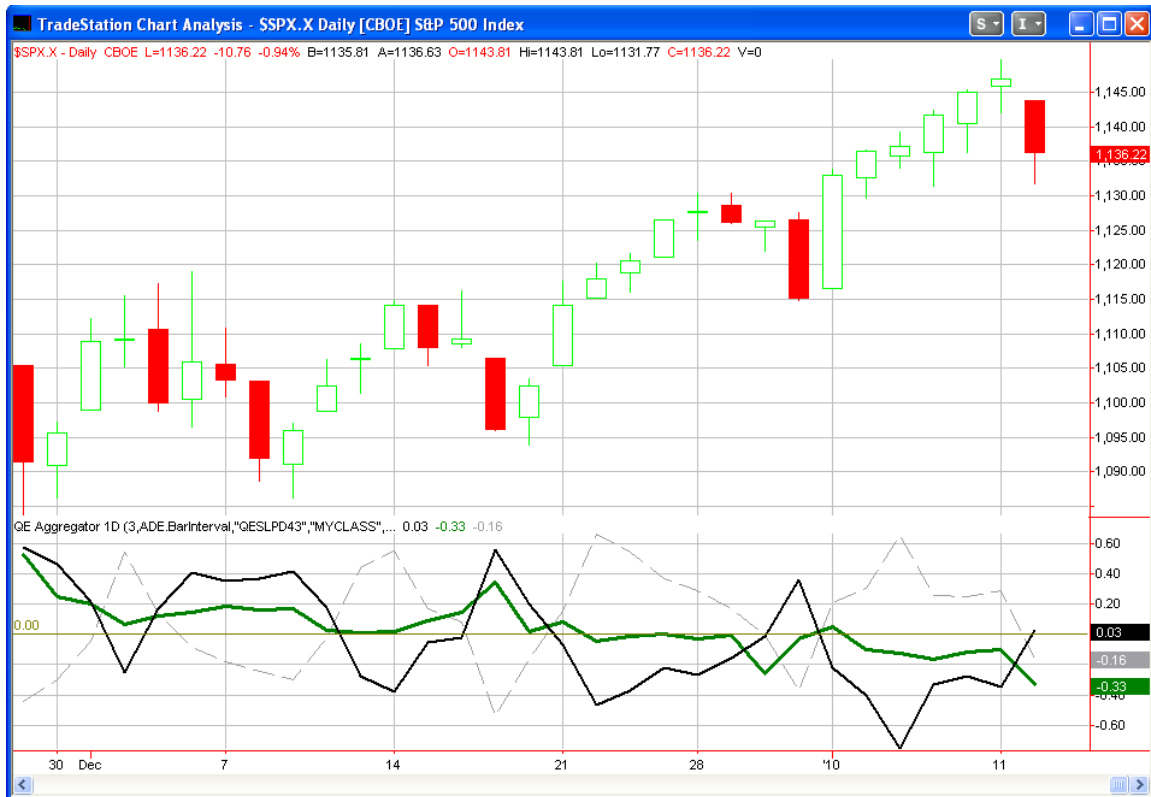
After closing at a 50-day high yesterday, SPY posts an unfilled gap down today. Volume is the highest in 10 days. Buy on close. Sell X days later. \$100k/trade. 1993 - present.

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
6	14,787.23	14	11	3	78.57	1,753.80	-1,501.53	1.17	4.28	1,056.23
5	13,418.97	14	10	4	71.43	1,699.92	-895.05	1.90	4.75	958.50
4	8,931.18	14	11	3	78.57	1,145.58	-1,223.40	0.94	3.43	637.94
3	3,754.08	14	8	6	57.14	864.20	-526.58	1.64	2.19	268.15
2	2,693.47	14	8	6	57.14	752.76	-554.77	1.36	1.81	192.39
1	1,941.33	14	7	7	50.00	813.26	-535.92	1.52	1.52	138.67

Here the numbers actually appear fairly bullish. I considered hard tonight whether to include this study in the Active Studies list. Ultimately I decided not to for 3 reasons. First, the edge doesn't really kick in strongly until after 3 days. Secondly, what makes this study work is the high volume. On Tuesday the high SPY volume was not confirmed by high exchange volume. Lastly, the instances are just a bit low to include something I'm already hedging on.

Excluding this study could be a mistake. It won't make a difference for tonight's Aggregator values but it will in upcoming days. It means more bullish evidence is going to be demanded before getting long.

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



The short Aggregator signal that was present for the last week closed on Tuesday with basically a scratch. The green Aggregator line is still showing a negative expectancy from the studies. The black Differential line is the one that made the difference today. It rose back above 0, illustrated the SPX has underperformed expectations over the last few days. This means although expectations are negative, the SPX is already oversold versus expectations over the last few days. This is considered a neutral configuration with the lines on opposite sides of 0. The Aggregator System went flat at the close.

Tomorrow the green Aggregator line is scheduled to remain slightly negative. This could easily change with the emergence of a bullish study. Meanwhile the pivot level for the Differential value is 1,140.33. The SPX would need to close here or above to flip the Differential back below 0.

I flat and awaiting the next substantial edge to trade.

Intermediate-term Outlook (2 weeks – 2 months)– updated 1/11 –slightly bullish

On Wednesday the NYSE New Highs reached 588. This was the highest level since 596 in October. It was also a good sign for the market. In the 10-12-09 Subscriber Letter I conducted a study of all the major market tops in the S&P 500 since 1970. What I found was that there was breadth deterioration evident in every case in either the advance/decline line, the new high %, or most often both. The advance/decline lines stopped showing a negative divergence a few weeks ago. Wednesday's move came within a whisker of eliminating the NH % divergence. You'd need to draw the trendline with an exceptionally sharp pencil to detect any kind of divergence at this point. In the

study I showed that every major market top had a divergence in place for at least 2 months before price topped out. In most cases the divergence lasted significantly longer than that. Should we see new highs make a new high this week that should end all doubt about a divergence. It would also suggest we have at least 2 months before a significant price high will be established. A link to the 10/12/09 Letter is below.

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

The Nasdaq continued to hold on to its leadership position this week although it looked dicey at times. As I often discuss, this is a positive.

On the negative side we still are showing some outstanding intermediate-term studies that suggest a pullback appears likely. These include studies related to volatility, bonds, and options action.

Even with these negatives the trend remains up, breadth is not diverging, and Nasdaq leadership remains in tact. That's not often a good combination to bet against. I'll exhibit a slightly bullish outlook for the time being.

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.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)(s)	1/5/2010	\$113.63	\$113.61	0.02%		stopped out intraday
SPY(1/4)(s)	1/6/2010	\$113.63	\$113.66	-0.03%		covered on close

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