

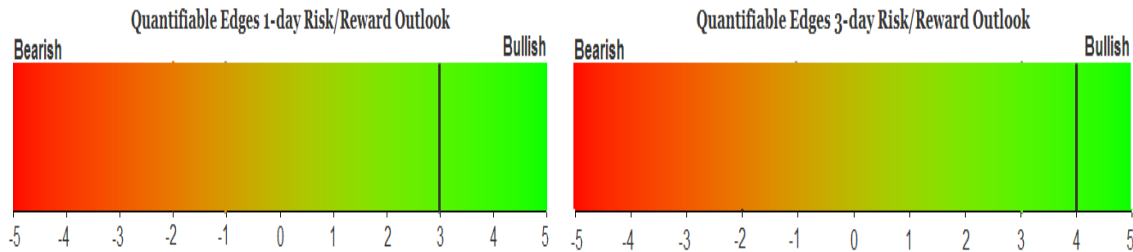
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 22, 2010

Volume 3 Issue 14

Market Overview



Tonight's Research Points

- Strongly negative breadth 2 days in a row suggests a bullish edge.
- Such sharp pullbacks from 50-day highs are often followed by a bounce.
- The VIX spiking more than 20% above the 10ma at also suggests an upside edge.
- The Aggregator System went long at the close on Thursday.

Short-term Outlook – updated 1/22

The Bottom Line

Indications of breadth, volume, price action and sentiment are all suggesting the market should bounce. I'm positioning myself long.

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	Avg MM - 1/3 Std Dev
Active					
January 22, 2010	2:1 negative breadth for 2 days	1-8 days	Bullish	2.10%	1.70%
January 22, 2010	50 high to 8 low in 2 days	1-4 days	Bullish	1.60%	1.20%
January 22, 2010	VIX 20% above 10ma.	1-7 days	Bullish	2.50%	1.90%
Active - Long Term					
January 13, 2010	No bearish divergence at high	int. term	Bullish		
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					
<i>January 21, 2010</i>	<i>Unfilled gap dn with open & close high</i>	<i>1-3 days</i>	<i>Bearish</i>	<i>-1.60%</i>	<i>-1.10%</i>
<i>January 19, 2010</i>	<i>10 high drop on highest vol and %</i>	<i>1-3 days</i>	<i>Bearish</i>	<i>-1.40%</i>	<i>-1.00%</i>
January 21, 2010	1% drop from 50 high. 2:1 neg breadth	1 day	Bullish		

If the avg max move minus 1/3 std deviation is achieved the study will appear in **italic blue** and no longer be active.

The Evidence

After opening flat the market experienced it biggest selloff in months today. The S&P fell 1.9%, the Nasdaq 1.1% and the Russell 2000 lost 1.8%. Breadth was strongly negative as the NYSE Up Issues % came in at 21% and the Up Volume % was 13%. Total volume rose to the highest level in over a month.

Several studies appeared in the Quantifinder and I examined this selloff a number of ways. First let's look at it from a breadth perspective. The study below last appeared in the 10/27/09 Subscriber Letter. I've updated the stats.

NYSE Up Issues % < 33.3% for the 2nd day in a row. Buy SPX on close. Sell X days later. \$100k/trade. 1999 - 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	33,328.93	57	28	29	49.12	4,059.94	-2,770.67	1.47	1.41	584.72	
9	60,809.03	60	39	21	65.00	3,353.02	-3,331.36	1.01	1.87	1,013.48	
8	78,358.96	60	38	22	63.33	3,667.37	-2,772.78	1.32	2.28	1,305.98	
7	64,805.60	61	42	18	68.85	2,913.61	-3,198.11	0.91	2.13	1,062.39	
6	69,917.53	63	41	22	65.08	3,032.24	-2,472.91	1.23	2.29	1,109.80	
5	62,797.63	63	40	23	63.49	2,721.01	-2,001.86	1.36	2.36	996.79	
4	65,772.70	65	39	26	60.00	2,984.52	-1,947.05	1.53	2.30	1,011.89	
3	41,971.83	69	44	25	63.77	2,470.44	-2,669.10	0.93	1.63	608.29	
2	63,438.84	71	47	24	66.20	2,339.79	-1,938.80	1.21	2.36	893.50	
1	54,570.77	90	56	34	62.22	1,808.82	-1,374.20	1.32	2.17	606.34	

Indications from this suggest a strong bullish sedge is now in play. Tonight I also decided to break this one out by uptrends vs. downtrend. First, using the 200ma as a filter, let's look at uptrending tendencies like now.

NYSE Up Issues % < 33.3% for the 2nd day in a row. SPX > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1999 - 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	17,340.33	25	12	13	48.00	2,359.93	-844.53	2.79	2.58	693.61	
9	20,949.64	25	17	8	68.00	1,794.85	-1,195.35	1.50	3.19	837.99	
8	23,150.17	25	17	8	68.00	1,994.09	-1,343.66	1.48	3.15	926.01	
7	16,238.18	26	18	8	69.23	1,639.64	-1,659.43	0.99	2.22	624.55	
6	11,598.57	26	15	11	57.69	1,588.16	-1,111.28	1.43	1.95	446.10	
5	9,226.40	26	13	13	50.00	1,716.69	-1,006.97	1.70	1.70	354.86	
4	8,455.73	26	14	12	53.85	1,713.80	-1,294.79	1.32	1.54	325.22	
3	8,513.47	27	17	10	62.96	1,035.22	-908.52	1.14	1.94	315.31	
2	2,627.71	27	15	12	55.56	584.30	-511.41	1.14	1.43	97.32	
1	4,015.84	34	20	14	58.82	738.53	-768.20	0.96	1.37	118.11	

79% of instances closed above the entry price at some point in the 4 days. All instances posted a close above the entry price within 12 days.

The edge is also evident in this study, though seemingly not as powerful. So how's this one look when SPX is below its 200ma?

**NYSE Up Issues % < 33.3% for the 2nd day in a row. SPX < 200ma.
Buy SPX on close. Sell X days later. \$100k/trade. 1999 - 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	14,484.44	33	20	13	60.61	4,200.61	-5,348.28	0.79	1.21	438.92
9	39,380.02	36	21	15	58.33	4,898.70	-4,232.84	1.16	1.62	1,093.89
8	54,411.59	36	23	13	63.89	4,615.98	-3,981.22	1.16	2.05	1,511.43
7	48,941.49	36	24	12	66.67	3,850.07	-3,621.68	1.06	2.13	1,359.49
6	62,099.83	38	27	11	71.05	3,819.83	-3,730.50	1.02	2.51	1,634.21
5	53,599.39	38	29	9	76.32	2,960.30	-3,583.27	0.83	2.66	1,410.51
4	55,388.31	40	26	14	65.00	3,531.97	-2,603.07	1.36	2.52	1,384.71
3	35,974.71	43	26	17	60.47	3,482.94	-3,210.69	1.08	1.66	836.62
2	62,837.23	45	32	13	71.11	3,145.86	-2,910.02	1.08	2.66	1,396.38
1	52,915.29	56	36	20	64.29	2,391.91	-1,659.67	1.44	2.59	944.92

98% of instances closed above the entry price at some point in the next 4 days.

The edge here is very pronounced. Worth noting for future reference.

So breadth is suggesting a bounce is likely. What about a price-based study? Below I have updated one last seen on 9/25/09.

**SPX closes at a 50-day high and then 2 days later closes at an 8-day low.
Buy on close. Sell X days later. \$100k/trade. 1987 - 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	30,193.60	31	22	9	70.97	1,852.58	-1,173.70	1.58	3.86	973.99
9	28,839.63	31	20	11	64.52	2,157.50	-1,300.95	1.66	3.02	930.31
8	32,976.63	31	21	10	67.74	2,208.96	-1,341.14	1.65	3.46	1,063.76
7	31,394.23	31	21	10	67.74	2,121.27	-1,315.24	1.61	3.39	1,012.72
6	29,777.78	31	23	8	74.19	1,929.49	-1,825.07	1.06	3.04	960.57
5	27,622.63	31	22	9	70.97	1,903.21	-1,583.12	1.20	2.94	891.05
4	28,390.98	31	23	8	74.19	1,509.83	-791.89	1.91	5.48	915.84
3	15,589.39	31	21	10	67.74	1,112.46	-777.23	1.43	3.01	502.88
2	5,865.88	31	20	11	64.52	768.19	-863.44	0.89	1.62	189.22
1	6,885.84	32	20	12	62.50	681.70	-562.34	1.21	2.02	215.18

90% of instance closed above their entry price at some point in the next 3 days.

Indications here too are quite strong that we will see a bounce shortly.

The VIX provided some other notable action today. It closed up over 19% and is now stretched over 20% above its 10ma. Below is a test of other times we saw such a sharp VIX spike while the SPX was trading above its 200ma.

**VIX crosses more than 20% above its 10ma. SPX > 200ma.
Buy SPX on close. Sell X days later. \$100k/trade. 1990 - 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	39,535.99	27	20	7	74.07	2,670.09	-1,980.83	1.35	3.85	1,464.30
9	37,393.66	27	22	5	81.48	2,246.32	-2,405.06	0.93	4.11	1,384.95
8	40,191.04	28	21	7	75.00	2,560.42	-1,939.67	1.32	3.96	1,435.39
7	44,880.41	28	22	6	78.57	2,335.75	-1,084.34	2.15	7.90	1,602.87
6	40,824.17	28	21	7	75.00	2,340.83	-1,190.46	1.97	5.90	1,458.01
5	33,249.31	28	20	8	71.43	1,976.39	-784.82	2.52	6.30	1,187.48
4	19,968.78	28	19	9	67.86	1,742.80	-1,460.50	1.19	2.52	713.17
3	11,669.16	31	21	10	67.74	1,240.19	-1,437.48	0.86	1.81	376.42
2	23,965.52	32	23	9	71.88	1,321.04	-713.15	1.85	4.73	748.92
1	18,542.75	32	24	8	75.00	992.13	-658.55	1.51	4.52	579.46

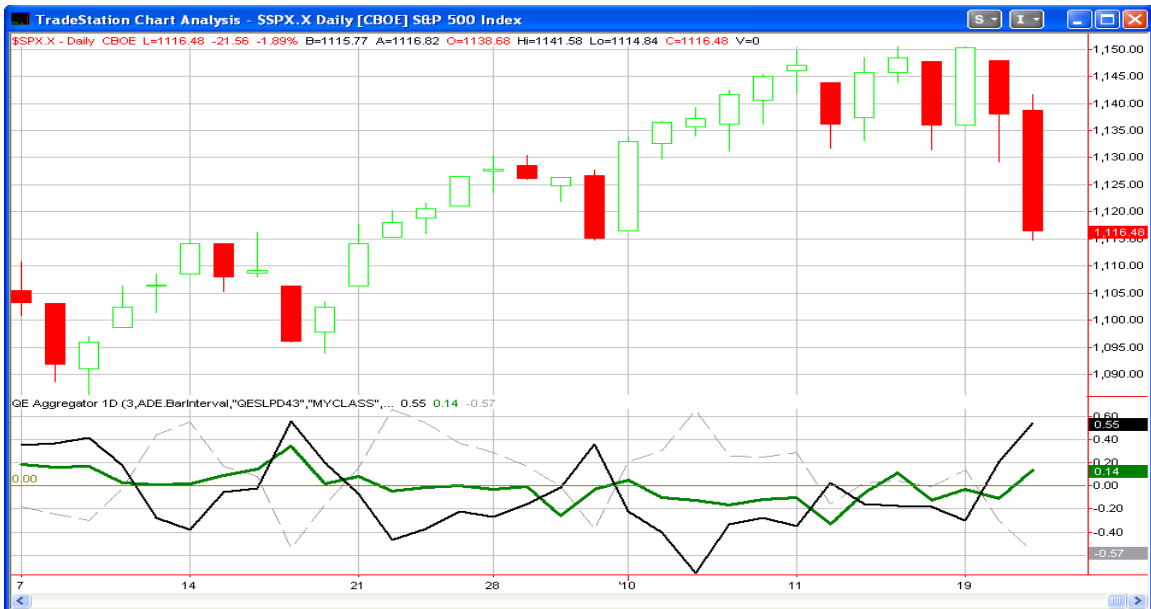
84% of instances closed above the entry price at some point in the next 3 days.

Here again we see a strong inclination to bounce.

So breadth, price action, and sentiment (as measured by the VIX) are all suggesting this pullback is getting overdone and a longside edge is beginning to emerge.

I don't have time to get into the volume but I will say that Volume Spyx levels over 100 as we saw Thursday tend to be solidly bullish indications.

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



Thursday's action caused spikes in both the green Aggregator and black Differential lines. The green Aggregator line represents the net expectations of the active studies. Expectations are strongly positive over the next few days. The black differential line illustrates the large underperformance of the SPX versus expectations over the last few days. Positive expectations in an oversold market have historically provided an upside edge. The Aggregator System went long at the close on Thursday.

Barring some extreme movement tomorrow it appears likely that the green Aggregator line will once again close positive on Friday. Meanwhile, for the black Differential line to drop into negative territory it would have to close at or above 1149.05 – an unlikely scenario. These numbers will soften over the next few days but a quick 1-day turnaround appears quite unlikely at this point.

Intermediate-term Outlook (2 weeks – 2 months)– updated 1/19 –somewhat bullish

When the SPX hit a new high on Monday the 11th, it was also accompanied by a new high in the advance/decline line and a new high in the % of new 52-highs on the NYSE. I discussed last week that every major top since 1970 has seen a divergence lasting a minimum of 2 months in at least one of these breadth measures before the ultimate top was hit in the SPX. I provided a link to that study last week and have included it again below. It can be found in the intermediate-term section of the letter.

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

The one major difference between all the tops I examine in the study and the current situation is that the others all took place at all-time highs. While the SPX has run up close to 70% from the March bottom, it is still nowhere near an all-time high. A top here could exhibit different characteristics than those previous tops. Still, the evidence would seem to suggest to me that the market is not yet ripe to undergo any type of major correction and we will probably be hitting new highs again before any major correction occurs.

While these broad breadth measures are arguing for a continuation of the rally, there has been what could be perceived as a lack of buying conviction lately. Enthusiasm seems to be waning. The last time there was a 90% up volume day was early November. And it's not just breadth, but total volume has also been failing to spike on up days. It was this strong buying conviction that kept the Aggregator positive for most of the fall, and it's the lack of this type of action that has allowed for negative Aggregator readings over the last few weeks. Positive Aggregator readings will also typically arise when the market gets overdone to the downside. And in uptrends like we are in now, even mild pullbacks often suggest a bullish edge. But there haven't been any. Since Thanksgiving there has only been once instance where the S&P pulled back two days in a row. That was December 7th and 8th. Other than that, every down day has been followed by an up day. Generally, it would seem that that lack of enthusiastic breadth and volume on up days leaves the market more susceptible to a minor pullback. I wouldn't expect we'll see a whole lot more than that, though – even with the bearish intermediate-term studies that may be found on the studies list near the top of this letter.

Also contributing to the bullish outlook is the fact that the Nasdaq continues to lead the S&P in terms of relative strength.

I won't be betting against this uptrend on an intermediate-term basis until I see real evidence of weakness.

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 @ \$112.

SPY – buy ¼ index position @ \$111.70.

I want to get long and if we gap up Friday I'll be looking to enter even prior to a gap fill. The 2nd lot I will demand a decent price for.

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