

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 2, 2010

Volume 3 Issue 21

## Market Overview



### Tonight's Research Points

- Very low volume reversals off of a 50-day low have consistently led to further upside over the last 40 years.
- Unfilled gaps that close higher on the day following a 50-day low are dependent on the long-term trend to establish an edge. When above the 200ma no bearish edge exists.
- The Aggregator System remains long.

### *Short-term Outlook – updated 2/2*

#### *The Bottom Line*

The bounce on Monday has started to relieve oversold conditions. Despite the low volume and the unfilled gap up, indications suggest more upside is likely. The Aggregator system remains 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
<b>Active</b>				
February 2, 2010	50-low followed by low volume rally	1-2 days	Bullish	1.10%
February 1, 2010	4 Lower Lows & 20-day low	1-8 days	Bullish	2.50%
February 1, 2010	Failed Gap Up Bottom 10% Close	1-8 Days	Bullish	4.50%
January 29, 2010	Outside day down bottom of range	1-6 days	Bullish	2.40%
January 28, 2010	False Breakdown >200ma & <10ma	1-5 days	Bullish	2.30%
January 25, 2010	VIX, price, or breadth studies	1-7 days	Bullish	4.20%
January 22, 2010	2:1 negative breadth for 2 days	1-8 days	Bullish	2.10%
<b>Active - Long Term</b>				
February 1, 2010	McClellan -60 for 6 days in a row	1-20 days	Bearish	
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	
<b>Dropped Tonight</b>				
February 1, 2010	1st Day of Month	1 day	Bullish	

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

### The Evidence

The market actually put in a decent move higher on Monday. It did so by gapping up to start the day and then never looking back. The SPX rose 1.4%, the Russell 2000 was up 1.2% and the Nasdaq rose 1.1%. Breadth was very strong. The NYSE Up Issues % was 78% and the Up Volume % was 89%. Total volume came in at the lowest level in over 2 weeks.

Based on the low volume bounce I expected to find some bearish studies tonight. What I found surprised me. The Quantifinder noted a study today from 1/27/09 that looked at SPX rises on low volume. I've updated that study below:

SPX closes higher on the lightest NYSE volume in 10 days. Buy 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
5	-48,020.55	140	66	74	47.14	1,860.74	-2,308.51	0.81	0.72	-343.00
4	-39,901.05	144	66	78	45.83	1,625.33	-1,886.83	0.86	0.73	-277.09
3	-38,439.34	150	72	77	48.00	1,326.52	-1,739.60	0.76	0.71	-256.26
2	-28,171.36	155	72	83	46.45	1,063.49	-1,261.96	0.84	0.73	-181.75
1	-9,678.02	176	89	87	50.57	778.80	-907.95	0.86	0.88	-54.99

Implications here seem to suggest a mild bearish edge over the next few days based on the low-volume bounce. I decided to dig a little deeper, though. Today wasn't just any low-volume move higher. Today we were coming off a 50-day low for the SPX.

I've seen it written several places tonight that the bounce cannot be trusted because of the low volume. So I decided to put this to the test.

Yesterday SPX closes at a 50-day low. Today it rises on the lowest NYSE volume in 10 days. Buy on close. Sell X days later. \$100k/trade. 1970 - 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	23,810.24	23	13	10	56.52	3,588.59	-2,284.14	1.57	2.04	1,035.23
9	18,226.93	24	14	10	58.33	2,964.78	-2,327.99	1.27	1.78	759.46
8	18,373.81	24	14	10	58.33	2,931.50	-2,266.72	1.29	1.81	765.58
7	10,275.06	24	16	8	66.67	2,276.99	-3,269.60	0.70	1.39	428.13
6	12,108.33	25	15	10	60.00	2,478.97	-2,507.63	0.99	1.48	484.33
5	8,311.74	25	15	10	60.00	2,118.75	-2,346.95	0.90	1.35	332.47
4	5,455.14	25	12	13	48.00	2,036.91	-1,460.60	1.39	1.29	218.21
3	6,085.57	25	14	10	56.00	1,465.74	-1,443.48	1.02	1.42	243.42
2	9,092.73	25	16	9	64.00	1,248.66	-1,209.53	1.03	1.84	363.71
1	1,384.70	25	16	9	64.00	707.97	-1,104.76	0.64	1.14	55.39

**23 of 25 instances (92%) closed above the entry price at some point in the next week.**

From this standpoint it doesn't appear that the low volume is any kind of a warning sign. In fact it appears this setup has a bit of a bullish edge. Of course everyone always wants to see high volume on the bounces, so we might as well take a look at that for comparison.

Yesterday SPX closes at a 50-day low. Today it rises on the highest NYSE volume in 10 days. Buy on close. Sell X days later. \$100k/trade. 1970 - 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	43,977.38	41	27	14	65.85	3,240.23	-3,107.78	1.04	2.01	1,072.62
9	46,941.71	44	24	20	54.55	3,889.79	-2,320.66	1.68	2.01	1,066.86
8	26,300.54	45	26	19	57.78	3,061.58	-2,805.30	1.09	1.49	584.46
7	30,439.97	45	22	23	48.89	3,728.23	-2,242.65	1.66	1.59	676.44
6	18,463.16	45	22	23	48.89	3,095.34	-2,158.01	1.43	1.37	410.29
5	35,823.68	45	29	16	64.44	2,494.76	-2,282.78	1.09	1.98	796.08
4	44,738.99	45	26	19	57.78	2,894.37	-1,606.03	1.80	2.47	994.20
3	45,985.50	47	30	17	63.83	2,373.68	-1,483.83	1.60	2.82	978.41
2	32,441.24	49	29	20	59.18	1,803.97	-993.69	1.82	2.63	662.07
1	24,146.13	49	28	21	57.14	1,732.82	-1,160.61	1.49	1.99	492.78

When volume comes in at the highest in 10 days, statistics aren't greatly different from the lowest volume in 10 days.

Lastly I looked at times volume fell between these extremes when bouncing from a 50-day low.

Yesterday SPX closes at a 50-day low. Today it rises on neither the highest nor lowest NYSE volume in 10 days. Buy on close. Sell X days later. \$100k/trade. 1970 - 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	25,151.03	125	69	56	55.20	2,685.65	-2,859.98	0.94	1.16	201.21
9	28,257.39	130	76	54	58.46	2,732.53	-3,322.50	0.82	1.16	217.36
8	40,135.95	134	77	57	57.46	2,859.75	-3,159.03	0.91	1.22	299.52
7	16,785.70	140	79	60	56.43	2,660.04	-3,222.62	0.83	1.09	119.90
6	36,650.51	148	90	58	60.81	2,397.90	-3,088.97	0.78	1.20	247.64
5	21,267.45	156	95	60	60.90	2,164.23	-3,072.24	0.70	1.12	136.33
4	-797.61	168	103	65	61.31	1,859.91	-2,959.51	0.63	1.00	-4.75
3	-6,094.98	191	105	85	54.97	1,580.91	-2,024.59	0.78	0.96	-31.91
2	-5,216.46	203	102	101	50.25	1,564.46	-1,631.60	0.96	0.97	-25.70
1	5,629.86	203	106	97	52.22	925.18	-952.98	0.97	1.06	27.73

Interestingly, these appear to be the worst results of all. It appears very strong volume can attract strong follow through. It also appears that perhaps very weak volume may leave just enough doubters that they end up chasing the market higher over the next several days.

An examination of unfilled gaps higher might lead someone to believe that Monday's unfilled gap following a 50-day low is likely to be followed by downside. Below is a test that examines this.

SPY posts an unfilled gap up and close above the open. Yesterdays close was lowest in 50 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: WinLoss Ratio	All: ProfitFactor	All: Avg Trade
10	-20,520.52	30	12	18	40.00	2,717.92	-2,951.98	0.92	0.61	-684.02
9	-43,377.53	31	12	19	38.71	2,717.25	-3,999.19	0.68	0.43	-1,399.28
8	-49,240.54	32	15	17	46.88	1,839.05	-4,519.20	0.41	0.36	-1,538.77
7	-39,666.58	33	15	18	45.45	2,503.41	-4,289.88	0.58	0.49	-1,202.02
6	-16,481.24	33	17	16	51.52	2,296.47	-3,470.08	0.66	0.70	-499.43
5	-10,867.24	33	16	16	48.48	2,424.92	-3,104.12	0.78	0.78	-329.31
4	-15,258.22	34	19	15	55.88	1,797.28	-3,293.77	0.55	0.69	-448.77
3	-8,565.74	34	19	15	55.88	1,494.78	-2,464.44	0.61	0.77	-251.93
2	-17,504.86	34	16	18	47.06	1,526.45	-2,329.34	0.66	0.58	-514.85
1	-4,100.05	34	15	18	44.12	942.63	-1,013.31	0.93	0.78	-120.59

While the win % isn't too telling the Average Trade appears quite compelling for the downside case. It really isn't this cut and dry, though. This is one of those cases where the results differ greatly depending on whether the market is in an uptrend or a downtrend. Below I break out this test by times the SPX was above or below its 200ma.

First let's look at instances below the 200ma.

SPY posts an unfilled gap up and closes above the open. Yesterdays close was lowest in 50 days. Close < 200ma. 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: WinLoss Ratio	All: ProfitFactor	All: Avg Trade
10	-22,883.43	21	7	14	33.33	3,643.39	-3,456.23	1.05	0.53	-1,089.69
9	-45,034.17	22	6	16	27.27	4,306.16	-4,429.45	0.97	0.36	-2,047.01
8	-51,448.06	22	9	13	40.91	2,286.64	-5,540.60	0.41	0.29	-2,338.55
7	-42,372.24	23	11	12	47.83	2,692.07	-5,998.75	0.45	0.41	-1,842.27
6	-21,302.80	23	11	12	47.83	2,801.89	-4,343.63	0.65	0.59	-926.21
5	-11,263.95	23	12	10	52.17	2,775.88	-4,457.45	0.62	0.75	-489.74
4	-17,616.58	23	12	11	52.17	2,299.05	-4,109.56	0.56	0.61	-765.94
3	-9,969.98	23	12	11	52.17	1,917.54	-2,998.22	0.64	0.70	-433.48
2	-17,540.84	23	10	13	43.48	1,844.96	-2,768.50	0.67	0.51	-762.65
1	-5,024.87	23	11	11	47.83	790.52	-1,247.32	0.63	0.63	-218.47

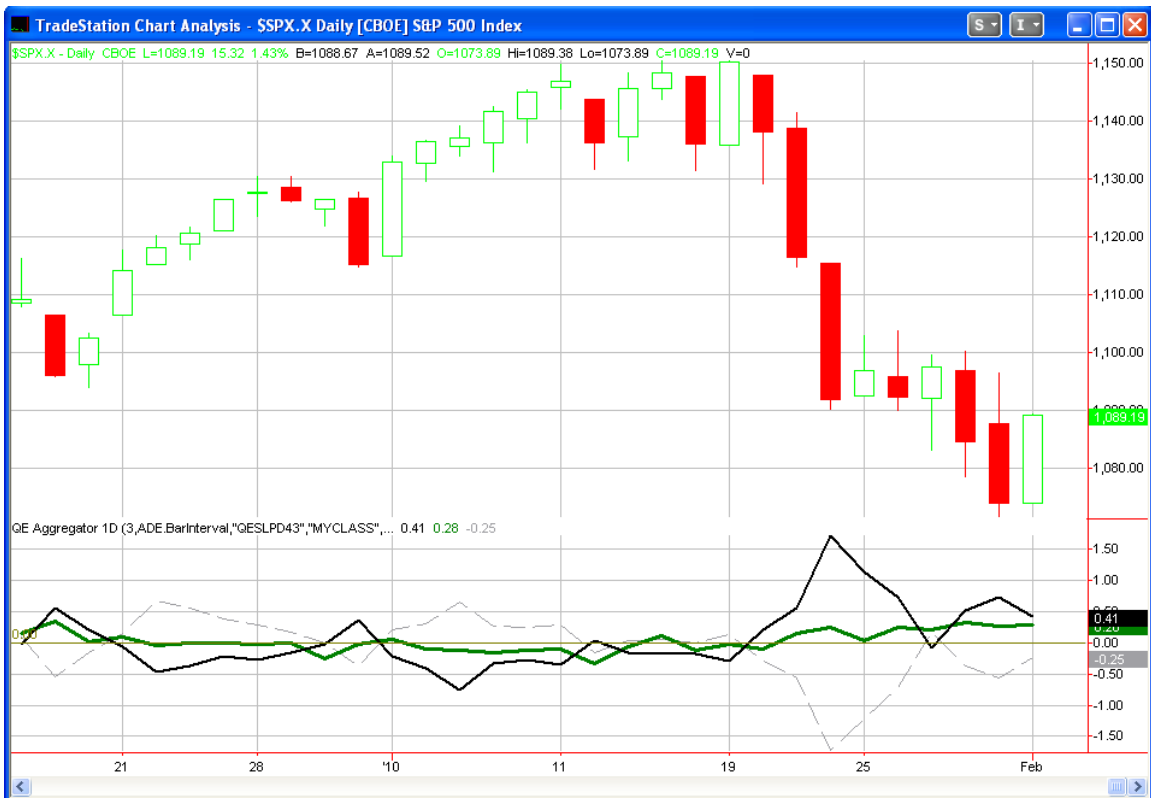
As you can see, the implications here are substantially more bearish. So where does that leave the > 200ma instances?

SPY posts an unfilled gap up and closes above the open. Yesterdays close was lowest in 50 days. Close > 200ma. 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
10	2,362.91	9	5	4	55.56	1,422.27	-1,187.11	1.20	1.50	262.55
9	1,856.64	9	6	3	66.67	1,128.34	-1,704.47	0.66	1.32	184.07
8	2,207.52	10	6	4	60.00	1,167.67	-1,199.63	0.97	1.46	220.75
7	2,705.66	10	4	6	40.00	1,984.62	-872.14	2.28	1.52	270.57
6	4,821.56	10	6	4	60.00	1,369.88	-849.42	1.61	2.42	482.16
5	396.71	10	4	6	40.00	1,372.04	-848.58	1.62	1.08	39.67
4	2,358.36	11	7	4	63.64	937.11	-1,050.36	0.89	1.56	214.40
3	1,404.24	11	7	4	63.64	770.05	-996.53	0.77	1.35	127.66
2	35.98	11	6	5	54.55	995.61	-1,187.53	0.84	1.01	3.27
1	924.82	11	4	7	36.36	1,360.95	-645.57	2.11	1.20	84.07

Instances are low here and they aren't exactly strongly bullish. But as you can see, there doesn't appear to be a bearish edge when the market is in a long-term uptrend.

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



The rally on Monday didn't do much to change the look of the Aggregator this evening. The green Aggregator line remains well above zero, showing that net expectations from the active studies is bullish over the next few days. Meanwhile the black Differential line is also well above zero, illustrating that the SPX has substantially underperformed

expectations over the last few days. Oversold with positive expectations has historically provided an upside edge. The Aggregator System remains long.

Looking ahead to tomorrow the green Aggregator line is scheduled to remain strongly bullish. It would take some very strong bearish studies to change this. The black Differential line won't take much to flip though. The pivot number for tomorrow is 1,092.74. In other words the SPX need only close a little more than 3.5 points higher to turn the black Differential line negative and cause the long Aggregator signal to close out.

**Intermediate-term Outlook (2 weeks – 2 months)– updated 2/1 –neutral to bullish**

Other than the McClellan Oscillator study mentioned in the short-term section tonight, there were a few other notables from an intermediate-term perspective.

First, the extremely sharp selling in the Nasdaq this week cause the Nasdaq/S&P 500 Relative strength indicator to move on Friday. The S&P is now exhibiting relative strength over the Nasdaq. This is not necessarily a bearish configuration, but rather neutral. Most of the market's gains over the years have come with the Nasdaq leading.

One study that popped up in the Quantifinder tonight looked at the fact that the 10-day average true range of the SPY had now increased to greater than 1.25 times the 100-day average true range. In the 9/29/08 Letter I looked at range expansions above certain levels. I've copied those results below (not updated):

SPY 10-day average true range crosses over X times the 100-day average true range. Buy on close. Sell 20 days Later. \$100k/trade. 1993-present.												
X * Normal	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
2	\$8,894.13	4	4	0	100.00	\$3,071.64	\$0.00	\$2,223.53	\$0.00	100.00	100.00	\$2,223.53
1.75	\$44,244.60	12	10	2	83.33	\$13,070.55	(\$1,394.86)	\$4,701.15	(\$1,383.43)	3.40	16.99	\$3,687.05
1.5	\$48,433.58	23	15	8	65.22	\$13,380.02	(\$7,534.80)	\$4,728.97	(\$2,812.62)	1.68	3.15	\$2,105.81
1.25	\$53,265.08	47	29	18	61.70	\$12,068.76	(\$19,949.25)	\$3,867.86	(\$3,272.39)	1.18	1.90	\$1,133.30

We see in the table that 1.25 times does suggest bullish implications, but if we see range expand even further then those implications would become even more bullish. Below is an updated detailed breakdown of the 1.25x level.

**SPY 10-day average true range increases more than 1.25 times the 100-day average true range. 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
20	42,402.69	51	32	19	62.75	4,025.62	-4,548.28	0.89	1.49	831.43
19	59,194.70	52	33	19	63.46	4,219.49	-4,213.07	1.00	1.74	1,138.36
18	59,313.66	53	32	21	60.38	4,217.30	-3,601.89	1.17	1.78	1,119.13
17	57,372.38	53	32	21	60.38	3,816.66	-3,083.84	1.24	1.89	1,082.50
16	63,374.77	55	34	21	61.82	3,656.79	-2,902.67	1.26	2.04	1,152.27
15	55,842.46	56	36	20	64.29	3,289.32	-3,128.66	1.05	1.89	997.19
14	54,415.12	58	38	20	65.52	2,996.47	-2,972.54	1.01	1.92	938.19
13	53,240.29	60	34	26	56.67	3,324.11	-2,299.21	1.45	1.89	887.34
12	50,746.57	63	39	24	61.90	2,739.22	-2,336.79	1.17	1.90	805.50
11	34,126.50	64	37	27	57.81	2,582.76	-2,275.39	1.14	1.56	533.23
10	29,523.16	64	32	31	50.00	2,921.94	-2,063.83	1.42	1.46	461.30
9	38,052.35	64	35	29	54.69	2,492.01	-1,695.45	1.47	1.77	594.57
8	41,823.12	65	35	30	53.85	2,576.87	-1,612.25	1.60	1.86	643.43
7	44,150.85	66	39	27	59.09	2,516.20	-1,999.29	1.26	1.82	668.95
6	42,938.79	68	41	27	60.29	2,376.34	-2,018.20	1.18	1.79	631.45
5	31,192.10	73	42	31	57.53	1,892.94	-1,558.44	1.21	1.65	427.29
4	40,471.15	77	49	28	63.64	1,915.09	-1,906.01	1.00	1.76	525.60
3	46,899.95	79	51	27	64.56	1,770.34	-1,606.95	1.10	2.08	593.67
2	26,447.19	83	48	35	57.83	1,563.73	-1,388.91	1.13	1.54	318.64
1	21,336.25	83	50	33	60.24	1,271.74	-1,280.32	0.99	1.50	257.06

Implications are bullish, but not overwhelmingly so.

This pullback so far has been quite extreme. We are beginning to run low on historical comparisons. Additionally, we are now starting to see some signs that it could be negative for the intermediate-term. These include the McClellan Oscillator study from the short-term section and the switch in the Nasdaq/S&P Relative Strength model.

Despite this, I'm still of the opinion that it is unlikely a new bear market has begun. In the study of tops I referred to several times over the last few weeks we found that all previous major tops showed sign of a weakening market prior to the ultimate price high. This was seen using breadth indicators like the New 52-Week High % and the Advance/Decline line. In every case there was a divergence in place prior to ultimate high. There was no such divergence this time. It's now looking very possible that this current pullback may be a warning of things to come. The oversold studies should eventually kick in here and lead to a very sharp bounce. I would be surprised if the market didn't manage to hit new highs in the next few months. What very well may happen, and what traders should be careful to watch out for, is that the next high may come with a breadth divergence. Damage is already being done to the A/D line. When the price rises again, if this damage is unable to correct itself, we may THEN have the makings of a major top in place that could lead to the next big bear move.

## **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***

**Still no Catapults – and not much is even close.**

## **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.*

*No new trade ideas tonight.*

## **Active Trades Table**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
SPY(1/4)	1/26/2010	\$109.31	\$109.06	-0.23%		Aggregator
VXX(s)	1/25/2010	\$31.89	\$30.16	5.42%		
SPY(1/4)	1/25/2010	\$109.50	\$109.06	-0.40%		Aggregator
SPY(1/4)	1/22/2010	\$111.20	\$109.06	-1.92%		Aggregator
SPY(1/4)	1/22/2010	\$111.20	\$109.06	-1.92%		Aggregator

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2009 Hanna Capital Management, LLC.