

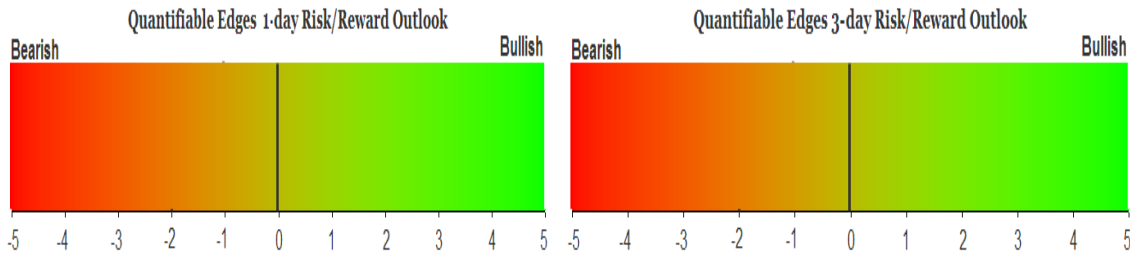
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 3, 2010

Volume 3 Issue 22

## Market Overview



## Tonight's Research Points

- Breadth is looked at a number of ways. The end result is that my studies show the strong breadth the last 2 days suggests bullish implications for the short-term.
- I continue to believe the relatively weak volume on this bounce is of no concern.
- The Aggregator System changed to flat at today's close..

## Short-term Outlook – updated 2/3

### The Bottom Line

The market has quickly become short-term overbought (at least relative to recent expectations). Still, there is no strong indication that the rally is about to roll over. This leaves me neutral and awaiting a more substantial edge to take a position.

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 3, 2010	75% Up Issue 2 in a row. SPX > 200ma.	1-4 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>				
<b>February 2, 2010</b>	<b>50-low followed by low volume rally</b>	<b>1-2 days</b>	<b>Bullish</b>	<b>1.10%</b>
<b>February 1, 2010</b>	<b>4 Lower Lows &amp; 20-day low</b>	<b>1-8 days</b>	<b>Bullish</b>	<b>2.50%</b>

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

### ***The Evidence***

Tuesday saw a nice continuation to Monday's bounce. The major indices all rallied higher and closed near their highs. The SPX rose 1.3%, the Nasdaq gained 0.9% and the Russell 2000 was up 0.8%. Breadth was again very strong. The NYSE Up Issues % came in at 77% and the Up Volume % was 84%. Total volume rose from Monday's level but was still below average.

The edges tonight appear to be related to breadth. Studies were a bit mixed in the Quantifinder so some explanation and interpretation is needed. First let's consider the Up Volume %. The Quantifinder identified a study from the 4/2/09 Subscriber Letter that looked at 2 strong Up Volume % days that were not accompanied by a 10-day high. I've updated that study below.

NYSE Up Vol % > 75% for 2 days in a row. SPX fails to make a 10-day intraday high. 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	-30,831.83	43	16	27	37.21	2,892.93	-2,856.25	1.01	0.60	-717.02
9	-31,877.97	43	15	28	34.88	2,843.75	-2,661.94	1.07	0.57	-741.35
8	-34,146.61	44	16	28	36.36	2,365.06	-2,570.99	0.92	0.53	-776.06
7	-30,869.75	44	18	26	40.91	2,552.94	-2,954.72	0.86	0.60	-701.59
6	-21,927.58	44	20	24	45.45	2,278.16	-2,812.12	0.81	0.68	-498.35
5	-14,139.97	44	20	24	45.45	1,975.95	-2,235.79	0.88	0.74	-321.36
4	-10,756.15	44	20	24	45.45	1,677.26	-1,845.89	0.91	0.76	-244.46
3	88.73	44	25	19	56.82	1,436.42	-1,885.36	0.76	1.00	2.02
2	-8,844.80	45	22	23	48.89	1,312.11	-1,639.62	0.80	0.77	-196.55
1	-1,435.86	46	25	21	54.35	944.31	-1,192.55	0.79	0.94	-31.21

Results here appear to be somewhat bearish. One issue is that this study doesn't take the long-term trend into account. I decided to break it out further tonight to better understand any potential edge.

First, I'll show times like now when the market is above the 200ma.

NYSE Up Vol % > 75% for 2 days in a row. SPX fails to make a 10-day intraday high. Close > 200ma. 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	1,532.49	22	9	13	40.91	2,499.49	-1,612.53	1.55	1.07	69.66
9	1,031.36	22	9	13	40.91	2,645.10	-1,751.89	1.51	1.05	46.88
8	-6.33	23	10	13	43.48	2,258.26	-1,737.61	1.30	1.00	-0.28
7	427.26	23	12	11	52.17	2,354.93	-2,530.17	0.93	1.02	18.58
6	4,301.65	23	12	11	52.17	2,172.34	-1,978.77	1.10	1.20	187.03
5	3,246.37	23	12	11	52.17	1,878.50	-1,754.14	1.07	1.17	141.15
4	4,661.80	23	12	11	52.17	1,696.29	-1,426.70	1.19	1.30	202.69
3	6,606.12	23	14	9	60.87	1,384.99	-1,420.42	0.98	1.52	287.22
2	626.31	23	13	10	56.52	1,021.84	-1,265.77	0.81	1.05	27.23
1	4,091.35	24	16	8	66.67	723.40	-935.39	0.77	1.55	170.47

What we see here is basically choppy action with no real discernable edge. This would seem to imply that this setup only has bearish implications when occurring below the 200ma. Below are the results for those instances.

NYSE Up Vol % > 75% for 2 days in a row. SPX fails to make a 10-day intraday high. Close < 200ma. 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	-32,364.32	21	7	14	33.33	3,398.78	-4,011.13	0.85	0.42	-1,541.16
9	-32,909.33	21	6	15	28.57	3,141.73	-3,450.65	0.91	0.36	-1,567.11
8	-34,140.28	21	6	15	28.57	2,543.08	-3,293.25	0.77	0.31	-1,625.73
7	-31,297.01	21	6	15	28.57	2,948.95	-3,266.05	0.90	0.36	-1,490.33
6	-26,229.23	21	8	13	38.10	2,436.89	-3,517.26	0.69	0.43	-1,249.01
5	-17,386.34	21	8	13	38.10	2,122.12	-2,643.33	0.80	0.49	-827.92
4	-15,417.95	21	8	13	38.10	1,648.71	-2,200.59	0.75	0.46	-734.19
3	-6,517.39	21	11	10	52.38	1,501.87	-2,303.80	0.65	0.72	-310.35
2	-9,471.11	22	9	13	40.91	1,731.39	-1,927.20	0.90	0.62	-430.51
1	-5,527.21	22	9	13	40.91	1,337.04	-1,350.81	0.99	0.69	-251.24

This is where the real edge lies with this study. It obviously doesn't apply to the current market, though.

Now let's look at a couple of studies from the 10/7/09 Subscriber Letter. These studies look at Up Issues % rather than Up Volume %. Generally is it less common to see the Up Issue % exceed 75% than it is for the Up Volume % to exceed it. This first study is similar to the ones we just looked at in that it required no 10-day high was achieved.

NYSE Up Issues % closes above 75% for 2 days in a row. SPX fails to make a 10-day intraday high. Buy SPX on close. Sell 10 days later. \$100k/trade. 1969 - 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	-17,726.90	8	2	6	25.00	2,269.32	-3,710.92	0.61	0.20	-2,215.66
15	-7,688.85	8	4	4	50.00	2,636.69	-4,558.90	0.58	0.58	-961.11
14	-12,089.28	8	5	3	62.50	1,569.62	-6,645.79	0.24	0.39	-1,511.16
13	-5,851.82	8	5	3	62.50	1,918.39	-5,147.92	0.37	0.62	-731.48
12	-8,665.59	8	4	4	50.00	2,495.46	-4,661.85	0.54	0.54	-1,083.20
11	-3,557.22	8	3	5	37.50	3,033.10	-2,531.30	1.20	0.72	-444.65
10	-5,631.77	8	3	5	37.50	2,904.00	-2,868.76	1.01	0.61	-703.97
9	-6,433.75	8	3	5	37.50	3,437.29	-3,349.12	1.03	0.62	-804.22
8	-4,741.21	8	3	5	37.50	3,368.89	-2,969.57	1.13	0.68	-592.65
7	-2,043.14	8	3	5	37.50	3,771.81	-2,671.72	1.41	0.85	-255.39
6	2,027.94	8	3	5	37.50	3,049.05	-1,423.84	2.14	1.28	253.49
5	7,304.18	8	5	3	62.50	1,972.91	-853.45	2.31	3.85	913.02
4	12,484.58	8	8	0	100.00	1,560.57	0.00	100.00	100.00	1,560.57
3	10,127.79	8	6	2	75.00	2,156.49	-1,405.56	1.53	4.60	1,265.97
2	9,163.63	8	5	3	62.50	2,019.64	-311.52	6.48	10.81	1,145.45
1	8,485.25	9	6	3	66.67	1,691.80	-555.18	3.05	6.09	942.81

What we see here is a low number of instances but strongly bullish implications over the first few days. Interestingly, longer-term implications appear somewhat bearish.

This next study is similar but without the 10-day high requirement, and instead using the 200ma as a filter.

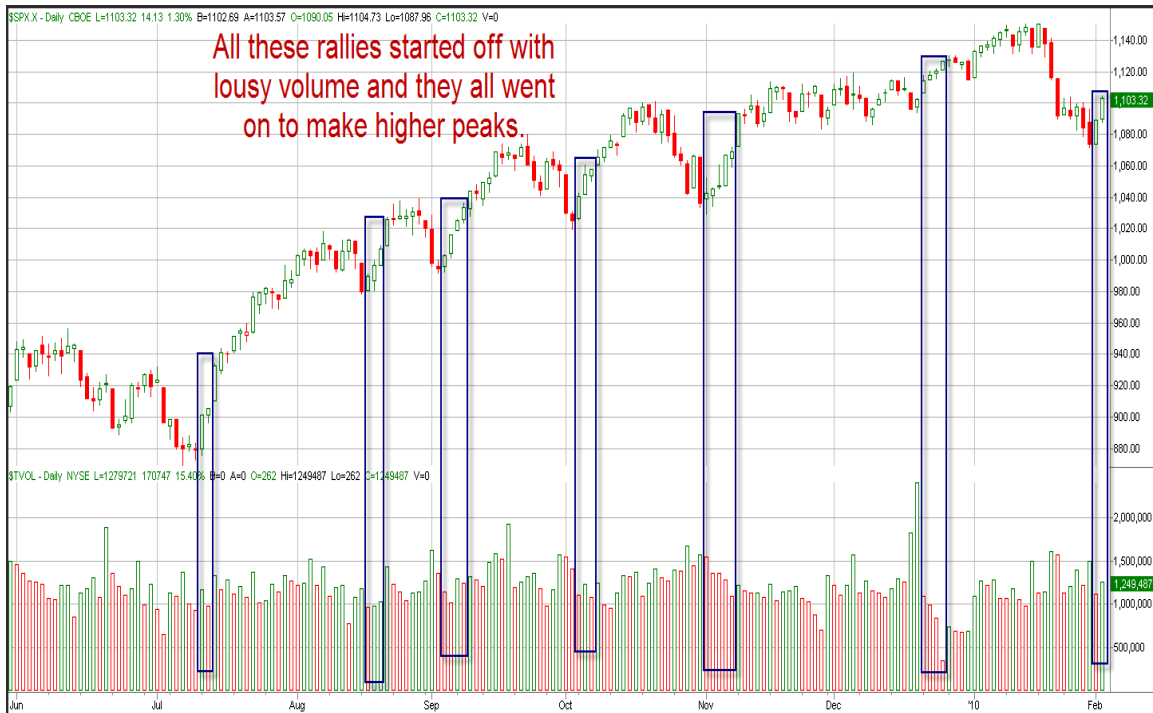
NYSE Up Issues % closes above 75% for 2 days in a row. SPX closes > 200ma. Buy SPX on close. Sell 10 days later. \$100k/trade. 1969 - present.

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	53,876.66	13	11	2	84.62	5,120.62	-1,225.07	4.18	22.99	4,144.36
15	40,067.63	14	12	2	85.71	3,871.10	-3,192.80	1.21	7.27	2,861.97
14	35,585.22	14	13	1	92.86	3,271.79	-6,948.06	0.47	6.12	2,541.80
13	37,836.20	14	12	2	85.71	3,706.70	-3,322.08	1.12	6.69	2,702.59
12	37,195.48	14	12	2	85.71	3,636.90	-3,223.68	1.13	6.77	2,656.82
11	39,322.33	14	12	2	85.71	3,720.73	-2,663.24	1.40	8.38	2,808.74
10	40,176.49	14	12	2	85.71	3,736.60	-2,331.33	1.60	9.62	2,869.75
9	36,541.04	14	11	3	78.57	4,000.44	-2,487.95	1.61	5.90	2,610.07
8	28,035.50	14	11	3	78.57	3,171.11	-2,282.22	1.39	5.09	2,002.54
7	28,818.32	14	10	4	71.43	3,371.51	-1,224.19	2.75	6.89	2,058.45
6	30,114.96	15	13	2	86.67	2,554.00	-1,543.55	1.65	10.76	2,007.66
5	25,292.49	15	11	4	73.33	2,564.25	-728.57	3.52	9.68	1,686.17
4	26,090.47	15	14	1	93.33	1,871.32	-108.00	17.33	242.58	1,739.36
3	19,863.77	15	12	3	80.00	1,832.57	-709.02	2.58	10.34	1,324.25
2	15,212.99	16	12	4	75.00	1,364.50	-290.27	4.70	14.10	950.81
1	6,306.99	18	12	6	66.67	752.51	-453.86	1.66	3.32	350.39

100% of instances closed above the entry price at some point in the next 4 days.

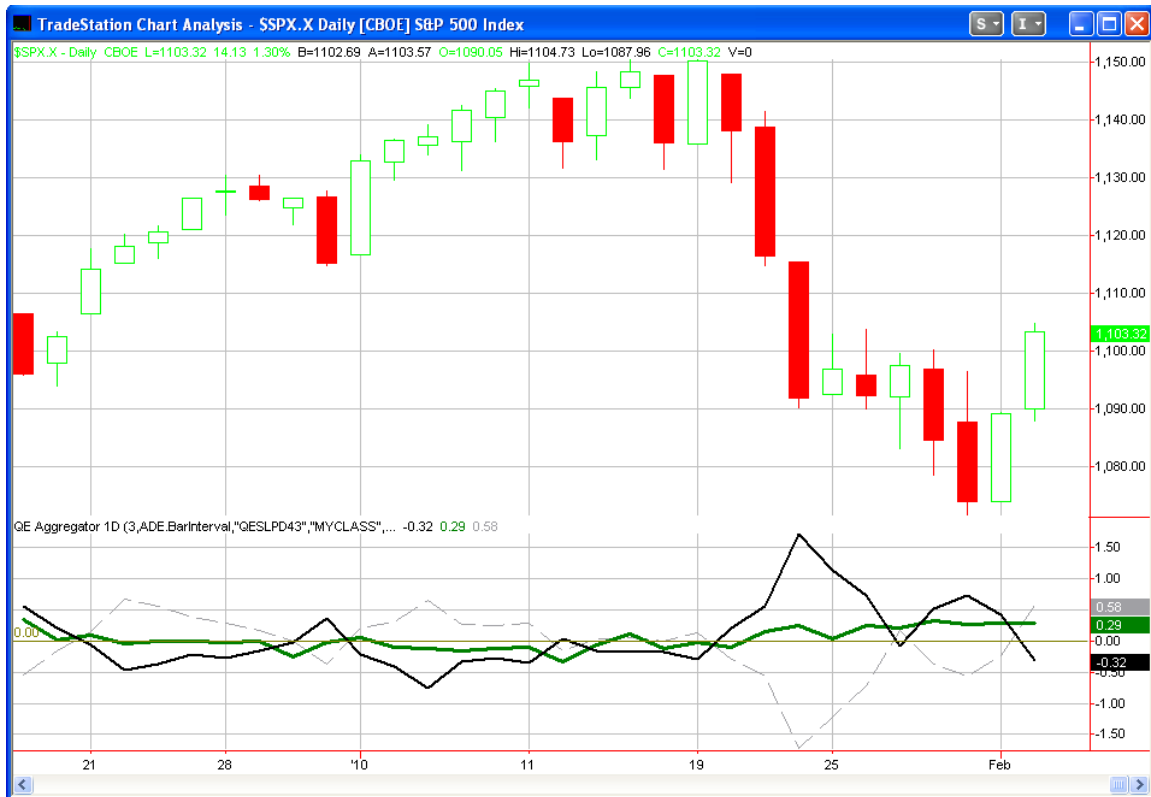
Here again we see very bullish implications when looking out 4 days. In contrast to the 1<sup>st</sup> study the short-term edge continues into the intermediate-term. This seems odd but when I looked there were only 3 overlapping trades. They were 11/3/82, 9/4/09, and 10/6/09. I'll keep it simple and ignore the long-term implications for my analysis and instead focus on the short-term where these studies confirm each other nicely.

Last night I showed a study that demonstrated how Monday's low volume at the beginning of the bounce was in fact bullish, and not bearish. This is something that many people have difficulty believing. For the more visually inclined I've created a chart below that examines many of the moves up since July.



Note that in basically every instance where the market was coming off a strong pullback, technicians could've complained about the volume. Volume can be a useful indicator, but it is constantly overvalued and misinterpreted. It's certainly possible that this bounce could roll right over and substantial downmove could ensue. If it happens it isn't because of the relatively low volume the last 2 days.

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



Bullish studies keep emerging and the green Aggregator line is holding firm as a result. The positive value of the green Aggregator line indicates the net expectations for the active studies over the next few days is for upside. The strong move higher in SPX over the last two days has caused the black Differential line to fall precipitously. It is now below zero, illustrating the fact that the S&P has outperformed expectations over the last few days. The green and black lines on opposite sides of zero is considered a neutral configuration. In this case we see bullish short-term expectations but the market is already overbought. The overbought reading has a negative impact on risk/reward. With the neutral configuration the Aggregator System is now flat.

Based on the current studies the green Aggregator line is set to remain positive for the near future. It will take some bearish studies over the next few days to flip it. Tomorrow's pivot level for the black Differential line is 1,081.83. In other words the SPX will need to close at or below this number for the Differential line to flip positive. That would entail a selloff of more than 2% tomorrow. In all likelihood the Aggregator System will remain flat for another day.

***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 caused 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

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	1/26/2010	\$109.31	\$110.38	0.98%		<b>sold on close</b>
VXX(s)	1/25/2010	\$31.89	\$29.02	9.00%	\$32.00	out 1/2 @ \$29.02
SPY(1/4)	1/25/2010	\$109.50	\$110.38	0.80%		<b>sold on close</b>
SPY(1/4)	1/22/2010	\$111.20	\$110.38	-0.74%		<b>sold on close</b>
SPY(1/4)	1/22/2010	\$111.20	\$110.38	-0.74%		<b>sold on close</b>

The SPY trade idea made a modest amount the hard way. From a management perspective the big mistake I made with this trade was trying to get too fine with the exit on 1/28. If I had exited part of the trade idea on 1/27 or 1/28 then I could have easily bought it back lower. Since I was “all in” and my limit order just missed on 1/28, I wasn’t able to maneuver in this manner. Hopefully some of you played it a little better.

With a nice cushion in VXX and no immediate bearish indications I decided to hold on to a portion and see if I can get a little more out of it.

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