

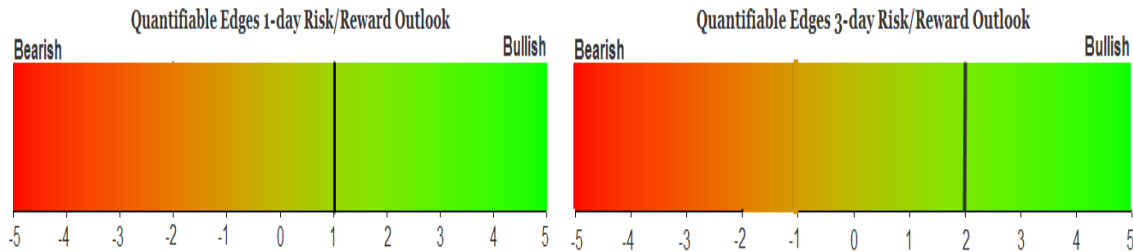
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 10, 2010

Volume 3 Issue 27

Market Overview



Tonight's Research Points

- Large unfilled gaps from 50-day lows rarely continue higher without at least pulling back short-term.
- The Aggregator System remained long again tonight..

Short-term Outlook – updated 2/10

The Bottom Line

Tuesday's action looked strong but it rarely leads to additional short-term follow through when coming of an intermediate-term low. Still the active studies in total are still suggesting a small upside edge.

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				
February 10, 2010	Unfilled large gap from 50-low	1-2 days	Bearish	
February 9, 2010	Put/Call Ratio 3-day spike	1-4 days	Bullish	2.50%
February 5, 2010	2% Drop 10 low bottom 10% range	1-7 days	Bullish	4.50%
February 1, 2010	Failed Gap Up Bottom 10% Close	1-8 Days	Bullish	4.50%
Active - Long Term				
February 8, 2010	Worden %>200ma - %>40ma > 40	3 - 7 weeks	Bullish	
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	
Dropped Tonight				
February 9, 2010	50-day SPX low on 20-day NYSE vol	1-5 days	Bullish	2.00%
February 8, 2010	SPX bounces on weak breadth	1-2 days	Bearish	-3.50%

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

The Evidence

Tuesday saw the market gap up considerably and generally hold on to its overnight gains. The major indices mostly put in doji formations. The S&P gained 1.3% on the day, the Nasdaq was up 1.2% and the Russell gained 1.5%. Breadth was strong as the NYSE Up Issues % came in at 77% and the Up Volume % at 87%. If it weren't for yesterday, today would have been the lowest volume in a month.

I looked at today's action quite a number of different ways tonight, but really didn't spot anything more compelling than the study that was identified in tonight's Quantifinder from the 3/5/09 Letter. (The Quantifinder mistakenly marked it 3/11/09.) This study looked at what has followed when the SPY gaps up from a 50-day low and then manages to not only leave the gap unfilled but also close higher than the open.

SPY gaps up at least 0.75% from a 50-day low. The gap does not fill and it closes higher than the open. Buy on close. Sell X days later. \$100k/trade. 1994 - 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	All: Max Losing Trade	All: Max Winning Trade
5	-6,159.32	17	8	8	47.06	3,350.78	-4,120.70	0.81	0.81	-362.31	-13,757.52	8,323.85
4	-17,196.33	17	9	8	52.94	2,125.01	-4,540.18	0.47	0.53	-1,011.55	-9,714.74	5,110.65
3	-14,665.36	17	6	11	35.29	2,266.82	-2,569.66	0.88	0.48	-862.67	-7,473.88	5,429.20
2	-18,889.14	17	7	10	41.18	1,836.91	-3,174.75	0.58	0.41	-1,111.13	-11,171.38	4,612.05
1	-7,361.05	17	5	11	29.41	782.06	-1,024.67	0.76	0.35	-433.00	-2,203.74	1,274.58

14 of 17 instances (82%) closed below their entry price at some point in the next 3 days.

Some people may find the negative results here somewhat surprising. The unfilled gap and move higher would seem to be a show of strength. Too often it appears that coming off a 50-day low it is viewed as short-covering and the downtrend doesn't surrender quite so easily.

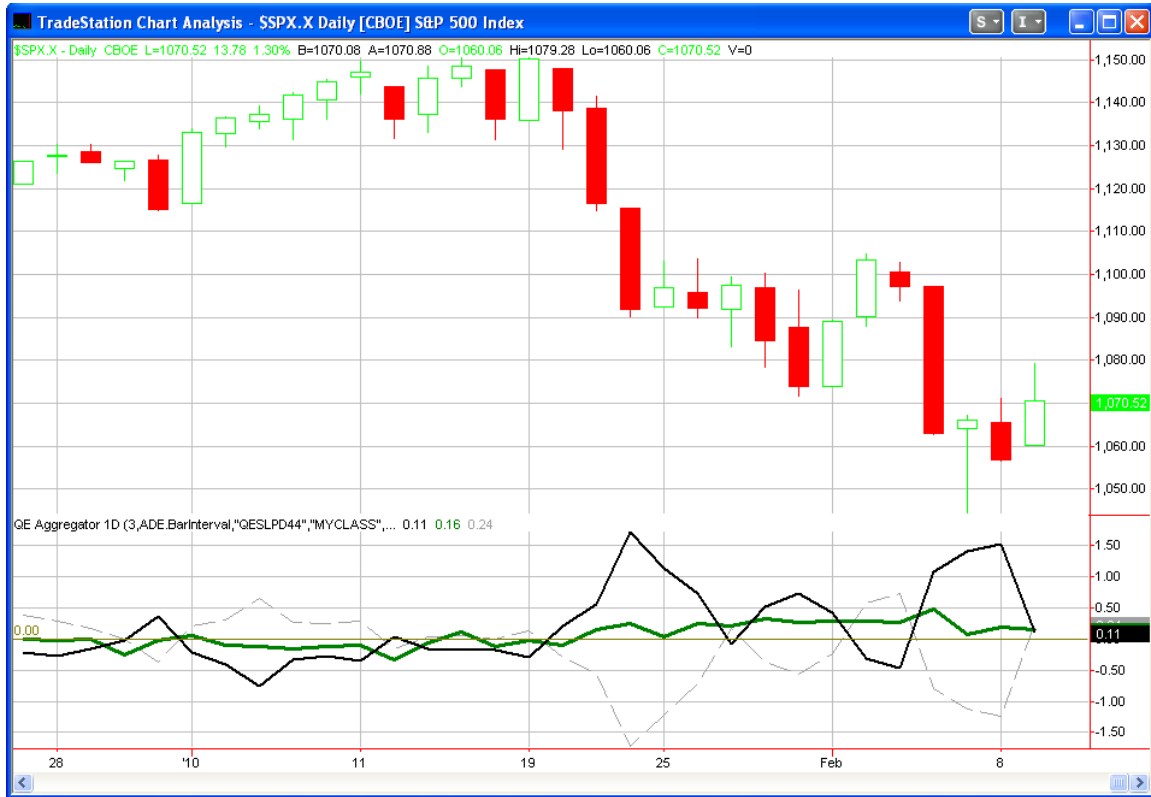
I did highlight the max losing trade above because it was such a large outlier. In a larger sampling I wouldn't worry much about it but with only 17 instances it has a significant impact on the "average" results. Therefore, to get what I believe may be a better estimate of the implications of such a study I eliminated the outlier and re-ran the results.

SPY gaps up at least 0.75% from a 50-day low. The gap does not fill and it closes higher than the open. Buy on close. Sell X days later. \$100k/trade. 1994 - present. 10/13/08 excluded.

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	-3,654.88	16	8	7	50.00	3,350.78	-4,351.59	0.77	0.88	-228.43
4	-9,170.29	16	9	7	56.25	2,125.01	-4,042.20	0.53	0.68	-573.14
3	-7,191.48	16	6	10	37.50	2,266.82	-2,079.24	1.09	0.65	-449.47
2	-7,717.76	16	7	9	43.75	1,836.91	-2,286.24	0.80	0.62	-482.36
1	-5,882.05	16	5	10	31.25	782.06	-979.24	0.80	0.40	-367.63

The average trade numbers change substantially here. It's important to note that there is still an apparent bearish edge.

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



The configuration remains the same but we see a decided shift in the strength of the edge in tonight's Aggregator. The green Aggregator line fell slightly with the addition of tonight's study. Still, it wasn't nearly enough to turn it negative. Meanwhile, with Thursday's huge selloff leaving the Differential calculation and Tuesday's strong rise, the black Differential line dropped sharply. Still, they are both above 0, signaling a market that is oversold versus expectations over the last few days and with positive expectations the next few days. This has historically provided a bullish edge and it the reason the Aggregator system remains long.

Flipping the green Aggregator line down below zero tomorrow night would require some strongly bearish studies. Getting the black Differential line below 0 wouldn't be all that hard. The Differential pivot number for Wednesday will be 1,074.82. It would take a close at or above this level to move the black Differential line into negative territory.

Intermediate-term Outlook (2 weeks – 2 months)– updated 2/8 –slightly bullish

Two useful breadth statistics that are tracked by Worden Bros. are the % of Stocks Trading Above the 200ma (T2107) and the % of Stocks Trading Above the 40ma (T2108). At the current time the difference between these two readings is very large. 72% of stocks remain above their 200ma, but only 24% stocks are above their 40ma. The

only other time since 1986 when Worden Bros. began tracking these statistics that the difference has been this large was late October / early November of 2009. To get such a large difference between the readings you would need to have a strong pullback occur in a strong uptrend. I was curious to see whether such a strong pullback was likely to derail the long-term uptrend and lead to further selling. To get a better sense I lowered the required difference between the 2 to 40. Below are those results.

Worden Bros T2107 (% stocks > 200ma) minus T2108 (% stocks > 40ma) crosses over 40. Buy SPX on close. Sell X days later. \$100k/trade. 1986 - 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
35	21,475.58	4	4	0	100.00	5,368.90	0.00	100.00	100.00
30	23,219.60	4	4	0	100.00	5,804.90	0.00	100.00	100.00
25	21,741.08	4	4	0	100.00	5,435.27	0.00	100.00	100.00
20	20,572.12	5	5	0	100.00	4,114.42	0.00	100.00	100.00
15	19,107.91	5	5	0	100.00	3,821.58	0.00	100.00	100.00

The 5 dates shown for the 20-days out test are:
10/27/97, 3/11/04, 3/2/07, 10/27/09, and 11/27/09.

In general returns were positive from day 1. From a long-term perspective, such sharp pullbacks have been followed by additional buying. Any uptrend strong enough that such a large number of stocks were trading above their 200ma that the difference could be as large as 40 simply didn't fall apart when a strong selloff occurred. The 2004 instance saw a retest of the highs before the market underwent a lengthy but shallow selloff. The other instances all rallied through their old highs and kept rising. Instances are definitely low but results couldn't be any more bullish.

While we are now way above a difference of 35, I also ran that to get a few more instances.

Worden Bros T2107 (% stocks > 200ma) minus T2108 (% stocks > 40ma) crosses over 35. Buy SPX on close. Sell X days later. \$100k/trade. 1986 - 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
35	23,068.19	10	9	1	90.00	5,402.87	-25,557.66	0.21	1.90	2,306.82
30	22,283.78	10	9	1	90.00	5,187.10	-24,400.14	0.21	1.91	2,228.38
25	33,480.55	10	8	2	80.00	4,272.10	-348.13	12.27	49.09	3,348.06
20	24,726.47	10	9	1	90.00	2,876.02	-1,157.70	2.48	22.36	2,472.65
15	35,452.69	12	11	1	91.67	3,320.18	-1,069.30	3.11	34.16	2,954.39

This seems to confirm the previous findings and suggests the current breadth differential is indicative of not a market about to fall apart, but rather a market that is likely to resume its uptrend.

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 Price	% Gain/Loss	Stop	Notes
SPY(1/4)	2/5/2010	\$106.56	\$107.22	0.62%		Aggregator
SPY(1/4)	2/5/2010	\$106.44	\$107.22	0.73%		Aggregator
VXX(s)	2/8/2010	\$33.31	\$32.30	3.03%		

Sell 1 lot of the SPY at \$107.23 *limit on close*. I'll be looking to exit part of the position should we get an up day tomorrow.

Sell both lots of SPY at \$107.70 *limit on close*. A close this high should flip the Differential negative and cause the Aggregator buy signal to close.

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