

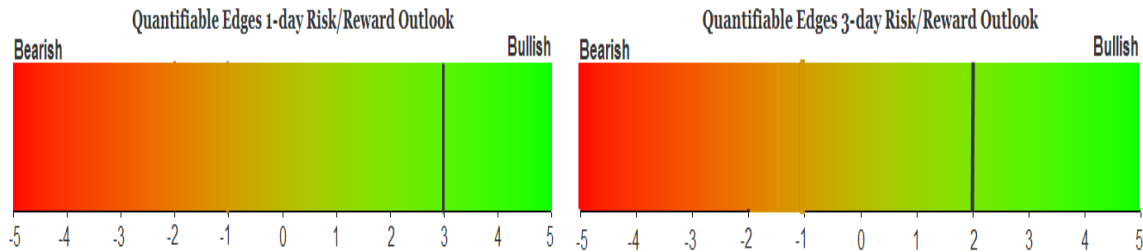
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 22, 2010

Volume 3 Issue 54

Market Overview



Tonight's Research Points

- A pullback from a short-term very overbought reading does not have the same bearish implication during an uptrend as it does during a downtrend.
- The late-day drive that put SPY near its \$116 strike doesn't appear to have implications for Monday.
- Over the last year down Fridays have provided a big edge for the next trading day. This has not been the case with up Fridays.
- The 1st pullback after such a long, sustained uptrend appears unlikely to mark a significant top.
- The Aggregator System triggered long at the close.
- The NDX Aggressive Trend Timer triggered long at the close.

Short-term Outlook – updated 3/22

The Bottom Line

The first minor pullback in over a month is quickly triggering some buy signals. While we are certainly due for at least a dip to the 10ma, an upside edge is already appearing. The Aggregator went long by the skin of its teeth on Friday. Health care reform could be a wildcard early in the week.

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					
March 22, 2010	SPX Down Friday over last year	1 day	Bullish		
March 19, 2010	SPX down. RSI(2) > 90. Close > 200ma	1-2 days	Bullish	1.10%	0.80%
March 17, 2010	100-day closing high on a Fed Day	1-8 days	Bullish	2.00%	1.70%
Active - Long Term					
March 22, 2010	25+ Days Above 10ma	int. term	Bullish		
March 10, 2010	Ttl Put/Call 40-low. SPX no 0.5% up.	1-5 weeks	Bearish	-4.90%	-3.30%
February 22, 2010	VIX:VXV Ratio falls below 0.9	int. term	Bearish		
February 16, 2010	Nasdaq/S&P RS Indicator Positive	int. term	Bullish		
Dropped Tonight					
March 16, 2010	SPY 10 high Vol 5 low, Lower hi & low	1-4 days	Bearish	-1.80%	-1.30%

If the avg max move – 1/3 Std Dev is achieved the study will appear in **bold italic blue** and no longer be active.

The Evidence

After trading relentlessly higher for a few weeks the market actually dropped a bit on Friday. While the selling wasn't terribly strong it was fairly broad. The major indices all fell with the SPX down 0.5%, the Nasdaq down 0.7% and the Russell 2000 down 1.1%. Breadth was weak as the NYSE Up Issues % closed at 28% and the Up Volume % was 23%. Total volume is typically quite a bit higher on options expiration day and Friday was no exception. It posted the highest NYSE volume of 2010.

The Quantifinder once again picked up on the fact that the market closed down following an RSI(2) reading of greater than 90. The July study found a bit of a downside edge under such circumstances, but when filtering this test using the long-term trend I found that the edge really only existed below the 200ma. Below are results above the 200ma which demonstrate this.

The RSI(2) of the SPX closed at 90 or higher yesterday. Today SPX closed down. Close > 200ma. 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	-3,011.16	120	63	57	52.50	1,249.06	-1,433.36	0.87	0.96	-25.09
4	8,488.66	127	66	61	51.97	1,222.68	-1,183.74	1.03	1.12	66.84
3	3,793.28	134	70	64	52.24	1,000.02	-1,034.50	0.97	1.06	28.31
2	3,560.23	143	78	65	54.55	789.88	-893.09	0.88	1.06	24.90
1	5,665.55	145	88	57	60.69	561.62	-767.67	0.73	1.13	39.07

Pretty toothless looking results here.

Another approach I played around with was examining the fact that the SPX posted an outside day with a down close under similar market conditions. I found the results to be inconsistent and a bit conflicting depending on exactly how I set the test up. When this happens I tend to throw them all out since it decreases the chance of a real edge, and increases the chance of a data mining anomaly. I will say that the inconsistencies were

generally associated with the first few days. When looking at a market already trading at or near a high level, after 3-5 days had passed there was generally an upward bias following this outside days down. Rarely did they mark a significant top. This observation was somewhat confirmed by another approach I took and will discuss in the intermediate-term section below.

I did receive an email from a fellow trader about 15 minutes before the close on Friday noting that it was strange to see SPY trading at \$115.50. Often on op-ex it will close near a strike price. For SPY that would mean \$115 or \$116. The market began to rally as soon as he pushed the send button and SPY closed at \$115.96 – very close to \$116. I found this to be a keen observation and wondered whether a late-day drive to a strike price like this tended to get reversed the next day. If the move was somehow contrived then an immediate unwinding would seem to make sense.

SPY closes at least 0.2% above 3:45 price on options expiration Friday. Buy on close. Sell Monday's close. 2000 - present.

All Trades			
Total Net Profit	\$3,918.98	Profit Factor	1.36
Gross Profit	\$14,901.49	Gross Loss	(\$10,982.51)
Total Number of Trades	17	Percent Profitable	58.82%
Winning Trades	10	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	\$230.53	Ratio Avg. Win:Avg. Loss	0.95
Avg. Winning Trade	\$1,490.15	Avg. Losing Trade	(\$1,568.93)
Largest Winning Trade	\$5,697.52	Largest Losing Trade	(\$3,395.33)
Largest Winner as % of Gross Profit	38.23%	Largest Loser as % of Gross Loss	30.92%

Based on my somewhat simple test I found no evidence of a possible unwinding the next day. I also decided to see what happened if there was a quick drop prior to the close rather than a quick rise.

SPY closes at least 0.2% BELOW 3:45 price on options expiration Friday. Buy on close. Sell Monday's close. 2000 - present.

All Trades			
Total Net Profit	\$3,782.37	Profit Factor	1.30
Gross Profit	\$16,357.90	Gross Loss	(\$12,575.53)
Total Number of Trades	12	Percent Profitable	58.33%
Winning Trades	7	Losing Trades	5
Even Trades	0		
Avg. Trade Net Profit	\$315.20	Ratio Avg. Win:Avg. Loss	0.93
Avg. Winning Trade	\$2,336.84	Avg. Losing Trade	(\$2,515.11)
Largest Winning Trade	\$7,244.68	Largest Losing Trade	(\$4,266.84)

These numbers couldn't be more similar. Bottom line is I don't see any edge for Monday's trade based on this late-day op-ex move.

Where there has been an edge over the last year is in buying Fridays that closed down. Below is a study that illustrates this.

SPX performance on the day following a down Friday. \$100k/trade. 3/20/09 - 3/19/10			
TradeStation Performance Summary			Collapse
All Trades			
Total Net Profit	\$21,414.50	Profit Factor	3.69
Gross Profit	\$29,362.73	Gross Loss	(\$7,948.23)
Total Number of Trades	23	Percent Profitable	78.26%
Winning Trades	18	Losing Trades	5
Even Trades	0		
Avg. Trade Net Profit	\$931.07	Ratio Avg. Win:Avg. Loss	1.03
Avg. Winning Trade	\$1,631.26	Avg. Losing Trade	(\$1,589.65)
Largest Winning Trade	\$7,069.40	Largest Losing Trade	(\$3,466.02)

These are some fairly incredible results for just looking to buy a down Friday. Even if you eliminate the 7% winner, which was actually the 1st instance from 3/20/09, results are still very strong. The average trade would be 0.7% instead of 0.9%.

I also looked at how the market has performed over the same time period when Friday has closed up.

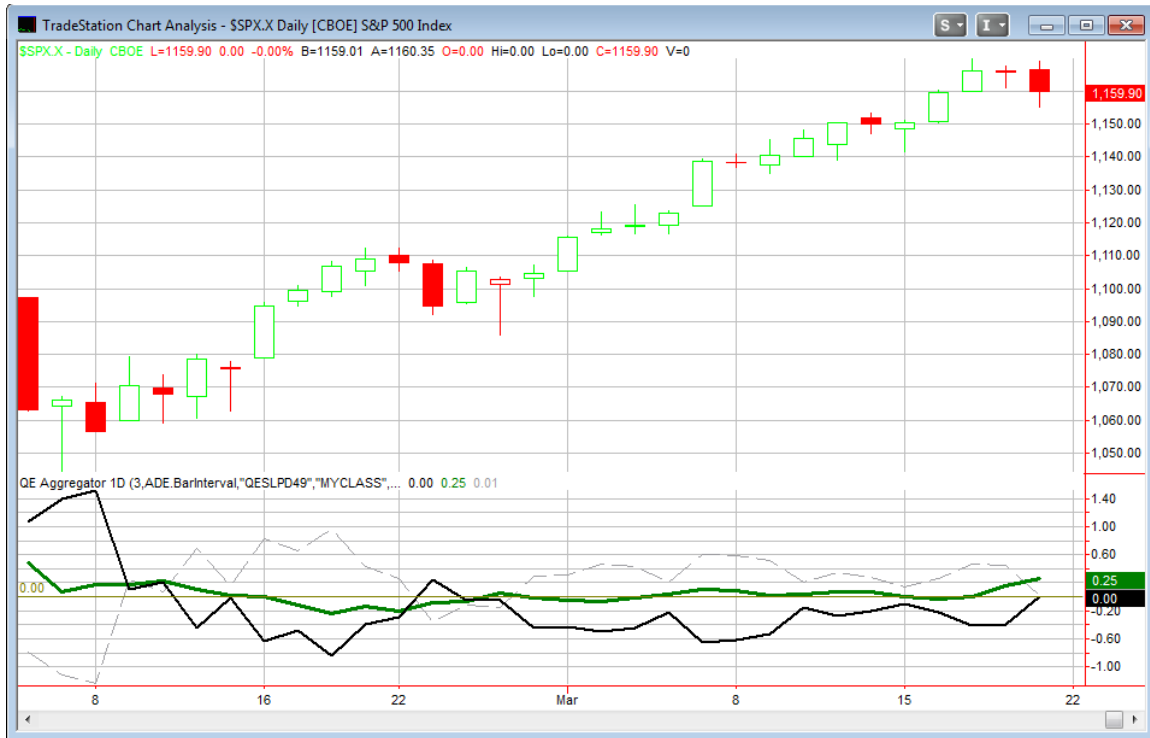
SPX performance on the day following an up Friday. \$100k/trade. 3/20/09 - 3/19/10			
TradeStation Performance Summary			Collapse
All Trades			
Total Net Profit	\$49.04	Profit Factor	1.00
Gross Profit	\$15,637.47	Gross Loss	(\$15,588.43)
Total Number of Trades	25	Percent Profitable	48.00%
Winning Trades	12	Losing Trades	13
Even Trades	0		
Avg. Trade Net Profit	\$1.96	Ratio Avg. Win:Avg. Loss	1.09
Avg. Winning Trade	\$1,303.12	Avg. Losing Trade	(\$1,199.11)
Largest Winning Trade	\$3,358.36	Largest Losing Trade	(\$4,241.94)

It appears the edge has only been in down Fridays.

It is important to understand that this is what I often refer to as an “environmental edge”. In other words, it is something that has worked in the recent past and seems to be a result of the current market environment. It is not an edge that has persisted over a long period of time nor do I expect it to continue to persist for a long period of time from now. That

doesn't mean it isn't a useful observation, though. In such cases where I believe a setup contains an environmental edge I will look to use it to my advantage until it appears to be losing its effectiveness. Of course I do this with all edges, but this will be on a tighter leash than most.

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



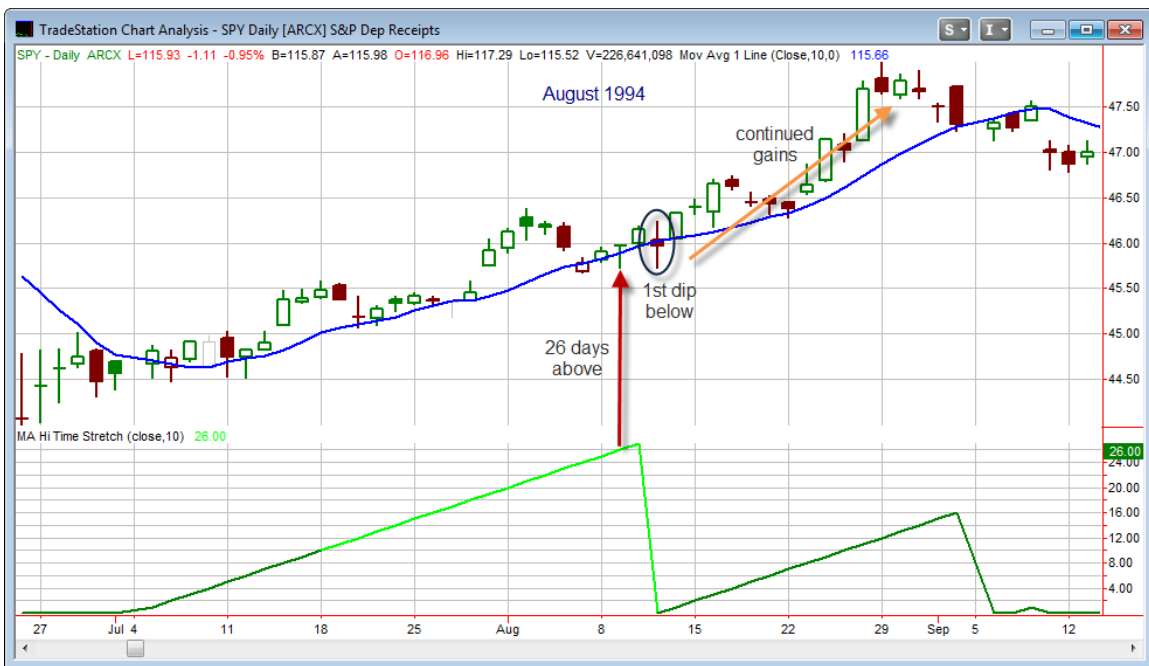
With the short-term active studies list now void of bearish studies the green Aggregator line has moved up to strongly positive. Expectations for the next few days are bullish. I noted Thursday night that the pivot level for the Differential line would be 1,160.04 on Friday. The SPX closed only just a hair under that. So the Differential reading tonight is a positive 0.004, which is showing up as 0.00 on the chart. With positive expectations over the next few days and the SPX (just barely) underperforming expectations over the last few days the Aggregator System barely triggered a long signal on Friday afternoon. Those who follow my tweets at <http://twitter.com/qerob> or who checked the intraday Quantifinder or Systems page as we approached the close would have seen that this configuration was setting up.

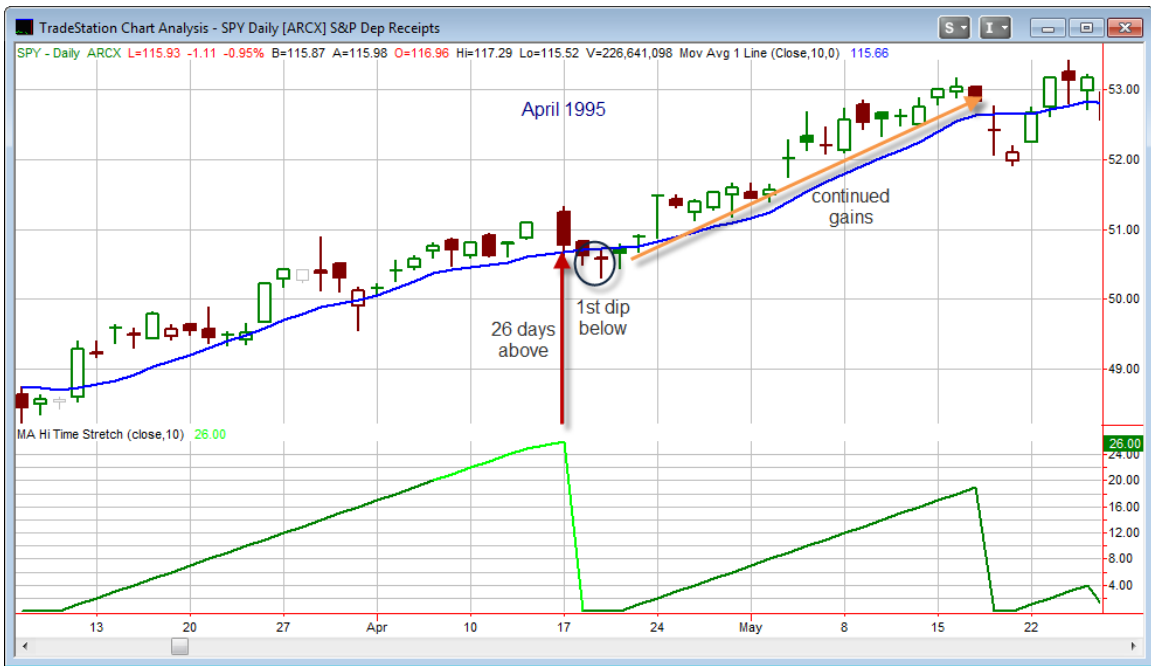
Looking ahead the number of active studies is quite low at the moment. The Aggregator value is set to remain positive over the next few days but that will be largely dependent on studies that emerge early this week. For Monday the pivot level for the Differential value is set at 1165.99. It will take a close at or above this level in order for the Differential to slide back below the 0 line.

Of course as well as the studies tend to do over time there is currently a large wildcard in the form of the health care bill. I expect reaction to that may have a substantial impact on the trading over the next few days.

Intermediate-term Outlook (2 weeks – 2 months)– updated 3/22 – somewhat bullish

Friday marked the 26th day in a row that the SPY has closed above its 10-day moving average. This is fairly rare to see. Since its inception in 1993 there have only been 5 other instances where SPY had a run of 25 days or more. In examining these other instances I found 2 strong consistencies. First, a dip below the 10ma came pretty soon after. Second, the 1st pullback below the 10ma never marked the top. Below are charts of all the instances to illustrate this. The indicator in the bottom pane shows the number of days the SPY has closed above its 10ma.







Strong and persistent upside movement like we have seen lately hasn't just ended and lead to an immediate correction. The 1st dip has always been just that – a dip. New highs were always made in short order. After these new highs were made there may have been a loss of momentum that turned into a substantial top. It never came on the 1st dip, though – and the 1st dip is what we are waiting for at the moment. The caveat here is obviously the very low sample size, but I'm not seeing a whole lot that says a strong sustained selloff is likely.

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 @ \$115.90 LIMIT ON CLOSE. If we close down again tomorrow by even a small amount I'll be looking to add another piece to the long trade.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	3/19/2010	\$115.96	\$115.96	0.00%		bought on close

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