

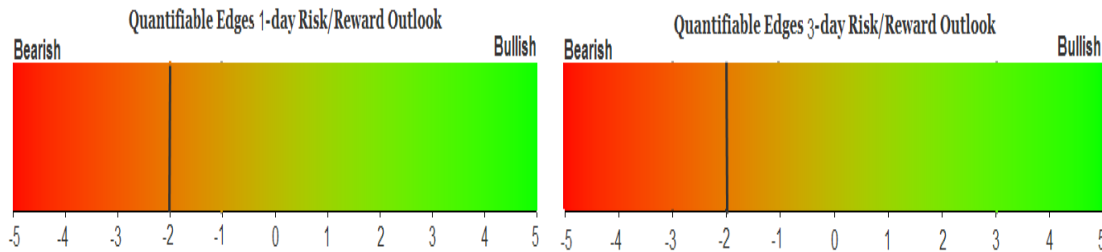
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 14, 2010

Volume 3 Issue 70

Market Overview



Tonight's Research Points

- The SPX closing at a 50-day high while the VIX rises creates a setup that has led to short-term weakness in the past.
- Breadth was weak but that doesn't pose a problem with the current market configuration.
- The Aggregator System went short at the close.
- The NDX Aggressive Trend Timer remained flat.

Short-term Outlook – updated 4/14

The Bottom Line

The active studies list is looking predominantly red and that is reflected tonight in the fact that the Aggregator is going negative. There is some suggestion that the downside edge could be as short as a 1-day affair, but I'm still going to try and take advantage of it.

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					
April 14, 2010	SPX up VIX up midweek at 50 high	1-2 days	Bearish	-0.80%	-0.60%
April 13, 2010	SPY up w/ vol low 3 days	1-3 days	Bearish		
April 13, 2010	New highwith put/ call low	1-2 days	Bearish		
April 6, 2010	70% Up Issues 2 days in row 50 high	1-8 days	Bullish	2.30%	1.60%
Active - Long Term					
April 13, 2010	Ttl Put/Call 40-low. SPX no 0.5% up.	1-5 weeks	Bearish	-4.90%	-3.30%
April 13, 2010	VIX:VXV hits 100-day low	int. term	Bearish		
April 6, 2010	SPX and TNX hit 50-day closing highs	int. term	Bearish		
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					
April 12, 2010	April Op-Ex Week	1-2 days	Bullish		

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 opening a bit weak with a mild gap down the market dropped further this morning. About 10:30am it bottomed out and found its footing. It then rallied for most of the rest of the day and managed to close positive. The SPX rose 0.1% while the Nasdaq and Russell 2000 gained 0.3% Breadth was weak fro an up day as the NYSE Up Issues % came in at 48% and the Up Volume % was just under 40%. NYSE volume inched just slightly higher than Monday's levels.

Unusual about Tuesday's action was that the VIX rose nearly 4% while the SPX also rose. The VIX has a natural tendency to decline on Friday's and a natural tendency to rise on Monday. Therefore, I often break down VIX directional studies by day of week. Below is a study that last appeared in the 11/12/09 blog.

SPX & VIX both close higher on Tuesday, Wednesday, or Thursday. Close > 200ma and at 50-day high. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	-14,987.92	39	18	21	46.15	702.14	-1,315.54	0.53	0.46	-384.31
4	-9,365.05	41	16	25	39.02	905.86	-954.35	0.95	0.61	-228.42
3	-4,969.30	41	18	23	43.90	750.96	-803.76	0.93	0.73	-121.20
2	-10,392.33	41	12	29	29.27	666.81	-634.28	1.05	0.44	-253.47
1	-6,369.38	48	22	26	45.83	264.41	-468.71	0.56	0.48	-132.70

93% of instances closed below the entry price at some point in the next week.

The average move is a little weak compared to many studies we show, but the consistency is solid.

As I mentioned above, the VIX didn't just close up slightly. It rose almost 4%. Below I used an additional filter on the 1st test to only look at times the VIX rose 2.5% or more – with all other conditions being the same.

SPX closes at a 50-day high and VIX rises at least 2.5% on Tuesday, Wednesday, or Thursday. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	-4,765.57	11	5	6	45.45	880.57	-1,528.07	0.58	0.48	-433.23
4	-8,951.29	11	2	9	18.18	1,446.15	-1,315.95	1.10	0.24	-813.75
3	-7,790.69	11	4	7	36.36	645.13	-1,481.60	0.44	0.25	-708.24
2	-5,275.47	11	1	10	9.09	321.48	-559.70	0.57	0.06	-479.59
1	-1,063.94	13	7	6	53.85	179.48	-386.72	0.46	0.54	-81.84

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

Instances are a bit low but these numbers are quite compelling anyway.

Breadth being weak on an up day is something I looked at just a couple of weeks ago in the 3/31/10 Subscriber Letter. Below is an excerpt from that Letter.

The other weakness we saw...was in the breadth numbers. Below is a breadth-related study from the Quantifinder. It last appeared in the 7/22/09 Subscriber Letter.

NYSE Up Vol % < 45% and SPX closes up on the day.
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	-37,461.80	43	19	24	44.19	2,844.24	-3,812.60	0.75	0.59	-871.20
9	-38,509.03	43	19	24	44.19	2,663.84	-3,713.42	0.72	0.57	-895.56
8	-26,082.10	45	21	24	46.67	2,409.12	-3,194.73	0.75	0.66	-579.60
7	-25,491.22	46	24	22	52.17	2,230.03	-3,591.45	0.62	0.68	-554.16
6	-27,517.85	47	21	26	44.68	2,182.94	-2,821.52	0.77	0.62	-585.49
5	-24,033.43	47	19	28	40.43	2,130.74	-2,304.20	0.92	0.63	-511.35
4	-27,214.52	47	21	26	44.68	1,644.05	-2,374.60	0.69	0.56	-579.03
3	-27,895.95	49	19	30	38.78	1,545.34	-1,908.58	0.81	0.51	-569.31
2	-33,347.58	50	25	25	50.00	940.40	-2,274.30	0.41	0.41	-666.95
1	-23,364.89	50	20	30	40.00	822.18	-1,326.95	0.62	0.41	-467.30

... this one also seems to suggest a downside edge. This study doesn't incorporate a long-term trend filter though. When I incorporated that I found that the downside edge doesn't hold up when the market is trading above the 200ma. This can be seen in the results below.

NYSE Up Vol % < 45% and SPX closes up on the day. Close > 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	19,753.95	27	16	11	59.26	2,914.43	-2,443.36	1.19	1.73	731.63
9	14,096.90	27	16	11	59.26	2,433.04	-2,257.43	1.08	1.57	522.11
8	13,885.33	27	17	10	62.96	2,030.48	-2,063.28	0.98	1.67	514.27
7	12,200.30	28	19	9	67.86	1,852.83	-2,555.93	0.72	1.53	435.73
6	1,167.95	28	17	11	60.71	1,738.38	-2,580.42	0.67	1.04	41.71
5	3,307.39	28	15	13	53.57	1,906.36	-1,945.23	0.98	1.13	118.12
4	1,151.35	28	15	13	53.57	1,631.17	-1,793.55	0.91	1.05	41.12
3	1,091.39	29	15	14	51.72	1,380.70	-1,401.36	0.99	1.06	37.63
2	3,843.72	30	19	11	63.33	945.98	-1,284.53	0.74	1.27	128.12
1	-1,779.13	30	15	15	50.00	713.54	-832.15	0.86	0.86	-59.30

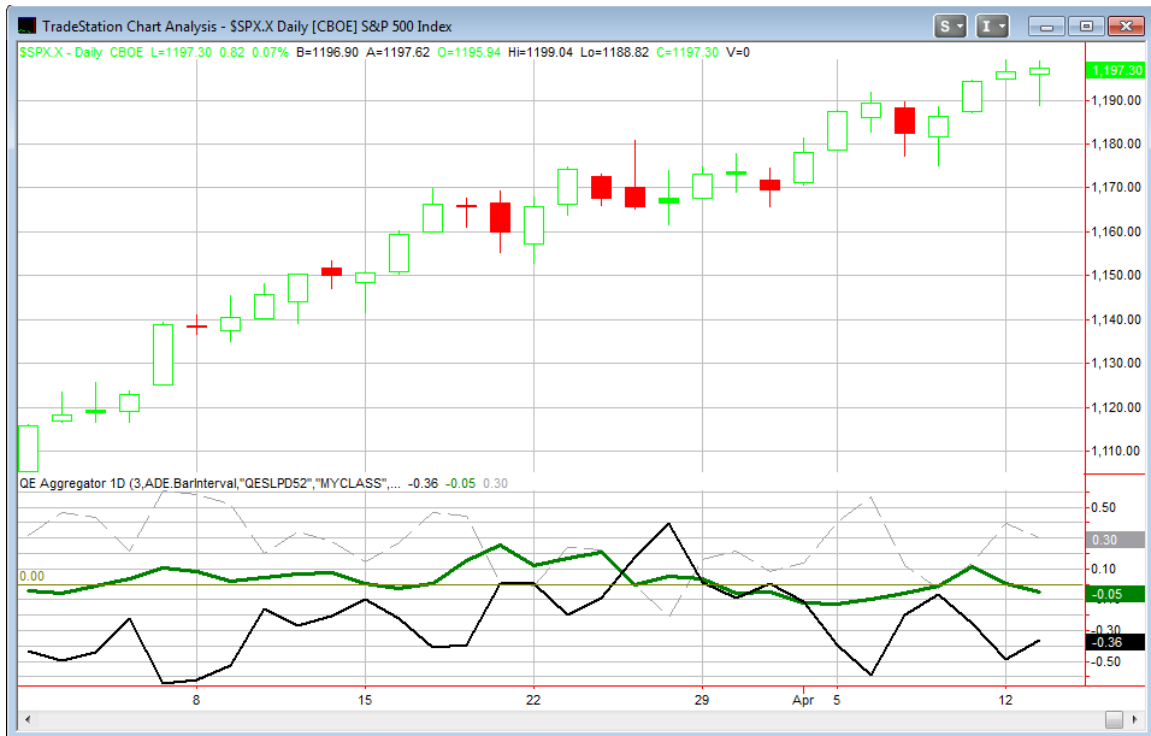
Of course if there is no edge present when the SPX is in a long-term uptrend, that would mean the downtrend numbers must be very compelling. While we obviously don't qualify currently I have produced them for you to see.

NYSE Up Vol % < 45% and SPX closes up on the day. Close < 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	-56,775.56	17	4	13	23.53	1,962.48	-4,971.19	0.39	0.12	-3,339.74
9	-52,976.04	17	3	14	17.65	3,894.77	-4,618.60	0.84	0.18	-3,116.24
8	-39,967.43	18	4	14	22.22	4,018.34	-4,002.91	1.00	0.29	-2,220.41
7	-37,691.52	18	5	13	27.78	3,663.39	-4,308.34	0.85	0.33	-2,093.97
6	-28,685.80	19	4	15	21.05	4,072.29	-2,998.33	1.36	0.36	-1,509.78
5	-27,340.82	19	4	15	21.05	2,972.18	-2,615.30	1.14	0.30	-1,438.99
4	-28,365.87	19	6	13	31.58	1,676.25	-2,955.64	0.57	0.26	-1,492.94
3	-28,987.34	20	4	16	20.00	2,162.75	-2,352.40	0.92	0.23	-1,449.37
2	-37,191.30	20	6	14	30.00	922.74	-3,051.98	0.30	0.13	-1,859.57
1	-21,585.76	20	5	15	25.00	1,148.10	-1,821.75	0.63	0.21	-1,079.29

19 of 20 instances (95%) closed below the entry price at some point in the next 3 days.

These numbers are extremely powerful and certainly worth tracking going forward.

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



As I hinted may happen last night and again this afternoon in the intraday Quantifinder, the green Aggregator line has once again dropped below 0. This means the net expectation from the Active Studies is now slightly bearish. The black Differential line is squarely below 0 as the SPX has soundly outperformed expectations over the last few days. So we now have a negative expectation and a relatively overbought market. Historically this has translated into a downside edge (though the last month and a half has been difficult for shorting). It can easily be seen with both lines below 0. The downside edge means the Aggregator System has triggered short as of Tuesday's close.

Looking ahead to tomorrow it currently appears that the Tax Day edges described in the Sunday night Subscriber Letter may overpower the current mild bearish studies. Of course things can easily change based on Wednesday's action. Meanwhile with Friday's strong upmove falling out of the Differential calculation the Differential pivot on Wednesday will be 1,194.92. So a close at or below this number would cause the black Differential line to move into positive territory. If the short trade does work out tonight it doesn't appear that it will require much of a selloff in order for a long signal to quickly trigger. I'll be carefully monitoring action tomorrow as usual and updating subscribers via the intraday Quantifinder and the Systems pages.

Intermediate-term Outlook (2 weeks – 2 months)– updated 4/12 somewhat bullish

As we've been seeing for a while, the market is continuing to trudge ahead, but there are some mixed signs at the moment.

Two things the market really has going for it are breadth and leadership. Leadership can be seen in the form of the Nasdaq/S&P Relative Strength indicator that we track on the charts page. As most subscribers are well aware at this point the market has made nearly

all of its gains in the last 40 years when relative strength is favoring the Nasdaq. Breadth also remains strong as the Advance/Decline line is still hitting new highs. New 52-week highs have lagged a little bit in the last few weeks but you typically need a divergence of AT LEAST two months before this will matter much and manifest itself in the form of a substantial selloff.

On the downside we see rising interest rates and complacency among options players. The complacency has been shown in studies we've looked at that have included both the VIX:VXV ratio and put/call ratios. None of these have proven to be great at exact timing, but a pullback does generally occur when you hit readings around where we have been.

Volume has been another concern. We have seen several studies lately that have suggested some of the low-volume rallies we are seeing will often lead to a pullback. It has struck me that perhaps it might be worth looking at low-volume rallies in a slightly different way.

One tool that some analysts use is the concept of Distribution Days. Distribution days are basically days where the market sells off on relatively high volume. The theory is that when clusters of these days are seen near a market high it suggests an intermediate-term selloff is likely to ensue. Back in August I posted a study that examined this. [It found the concept to be dead wrong.](#) It is most often better to buy into these clusters of high-volume selloffs rather than looking for further selling.

Below I re-ran the results of that August study back to 1988 using the same parameters.

Short S&P on close of 4th distribution day within the last 12 if it is above its 200ma and has come within 1% of its 200day high in the last 12 days. Cover X days later. \$100k/trade. 1988 - 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	-23,444.75	42	16	26	38.10	3,067.73	-2,789.56	1.10	0.68	-558.21
19	-13,934.99	42	19	23	45.24	2,776.66	-2,899.63	0.96	0.79	-331.79
18	-19,709.80	43	18	25	41.86	2,597.53	-2,658.61	0.98	0.70	-458.37
17	-24,561.58	43	14	29	32.56	2,796.48	-2,196.98	1.27	0.61	-571.20
16	-17,575.91	44	19	25	43.18	2,371.99	-2,505.75	0.95	0.72	-399.45
15	-20,928.08	44	19	25	43.18	2,242.65	-2,541.53	0.88	0.67	-475.64
14	-27,472.31	46	20	26	43.48	2,048.79	-2,632.62	0.78	0.60	-597.22
13	-23,605.57	47	19	28	40.43	2,376.08	-2,455.40	0.97	0.66	-502.25
12	-33,895.26	47	18	29	38.30	2,134.59	-2,493.72	0.86	0.53	-721.18
11	-30,321.93	47	21	26	44.68	1,531.91	-2,403.54	0.64	0.51	-645.15
10	-32,983.03	50	21	29	42.00	1,482.85	-2,211.13	0.67	0.49	-659.66
9	-31,417.17	57	23	34	40.35	1,555.74	-1,976.45	0.79	0.53	-551.18
8	-18,949.31	61	30	31	49.18	1,499.06	-2,061.97	0.73	0.70	-310.64
7	-28,801.36	65	33	32	50.77	1,143.62	-2,079.40	0.55	0.57	-443.10
6	-16,363.97	69	39	30	56.52	1,199.94	-2,105.39	0.57	0.74	-237.16
5	-23,773.09	76	35	41	46.05	1,537.10	-1,891.99	0.81	0.69	-312.80
4	-22,818.70	87	40	47	45.98	1,397.14	-1,674.56	0.83	0.71	-262.28
3	-10,693.88	102	45	57	44.12	1,262.41	-1,184.25	1.07	0.84	-104.84
2	-9,394.19	133	62	71	46.62	1,066.63	-1,063.74	1.00	0.88	-70.63
1	-9,354.53	225	97	128	43.11	764.99	-652.80	1.17	0.89	-41.58

Recall that this study looks to go short, rather than buy. Therefore you are looking at a market that typically rose following such clusters.

Next, instead of looking for clusters of distribution days, I decided to substitute days that rose on volume that was lower than the previous day's volume. Here's how those results came out.

Short S&P on close of 4th low-volume rally day within the last 12 if it is above its 200ma and has come within 1% of its 200day high in the last 12 days. Cover X days later. \$100k/trade. 1988 - 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	13,120.79	72	27	45	37.50	3,503.32	-1,810.42	1.94	1.16	182.23
19	-5,895.61	75	26	49	34.67	3,303.96	-1,873.44	1.76	0.94	-78.61
18	-18,900.13	77	26	51	33.77	2,920.53	-1,859.49	1.57	0.80	-245.46
17	-13,391.61	77	28	49	36.36	2,934.41	-1,950.10	1.50	0.86	-173.92
16	-413.32	79	31	48	39.24	2,945.61	-1,910.99	1.54	1.00	-5.23
15	-5,288.20	82	34	48	41.46	2,642.74	-1,982.11	1.33	0.94	-64.49
14	-9,793.45	83	31	52	37.35	2,657.45	-1,772.58	1.50	0.89	-117.99
13	-18,465.24	84	31	53	36.90	2,280.87	-1,682.49	1.36	0.79	-219.82
12	-18,403.57	85	29	56	34.12	2,334.11	-1,537.37	1.52	0.79	-216.51
11	-26,667.98	91	34	57	37.36	2,029.38	-1,678.37	1.21	0.72	-293.05
10	6,235.13	96	43	53	44.79	2,209.87	-1,675.27	1.32	1.07	64.95
9	-5,306.79	101	42	59	41.58	2,179.16	-1,641.21	1.33	0.95	-52.54
8	10,014.12	109	46	63	42.20	2,246.45	-1,481.31	1.52	1.11	91.87
7	-6,014.40	119	50	69	42.02	1,645.44	-1,279.51	1.29	0.93	-50.54
6	-7,153.65	132	56	76	42.42	1,673.77	-1,327.43	1.26	0.93	-54.19
5	10,226.67	147	68	79	46.26	1,692.79	-1,327.63	1.28	1.10	69.57
4	-4,005.11	165	71	94	43.03	1,361.10	-1,070.68	1.27	0.96	-24.27
3	-17,750.27	200	87	113	43.50	1,076.17	-985.64	1.09	0.84	-88.75
2	-5,601.36	263	123	140	46.77	821.68	-761.92	1.08	0.95	-21.30
1	3,841.99	455	224	231	49.23	589.04	-554.56	1.06	1.03	8.44

It's interesting to see here that results are mixed rather than suggestive of upside as the distribution day clusters were. This isn't terribly surprising since many of the volume-related studies we see suggesting downside are due to low-volume rises rather than high-volume declines.

At this point the research is a bit half-baked, but I plan on expanding on this line of thought in the future.

So as far as the intermediate-term outlook, I like the current breadth and leadership. Interest rates, sentiment, and volume are suggesting a selloff is coming. At this point price has done nothing wrong. We are again at new highs and I'm inclined to stick with the trend until I see more convincing evidence that it is ending or done.

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 short ¼ index position @ \$119.90 limit. If not filled in first 30 minutes of trading, cancel order. I'm looking to take advantage of a move down tomorrow, but I don't want to take a trade late in the day since there appears to be a good chance the trade will be closed at the end of the day.

SPY short ¼ index position @ \$120.00 limit ON OPEN. If not filled on open, cancel order. The Gap Guides on Master The Gap are showing strong probabilities in regards to up gaps filling tomorrow. The confluence of both gap (day) and swing-trade edges has me looking to take on more exposure if the SPY gaps up.

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