

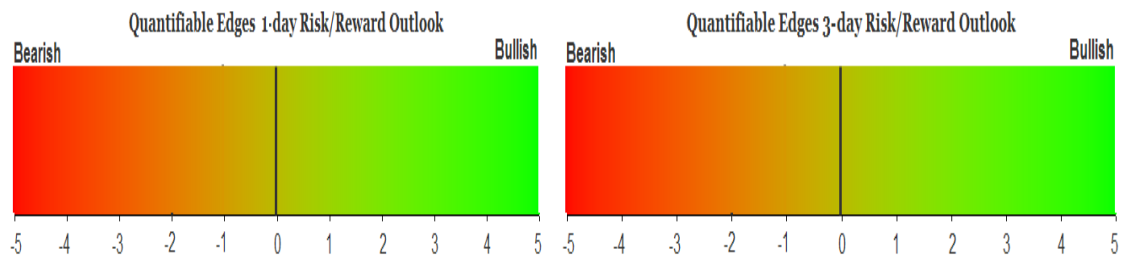
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 27, 2010

Volume 3 Issue 79

## Market Overview



## Tonight's Research Points

- A weak close tomorrow could set up a substantial edge for Wednesday's Fed Day.
- The NYSE New Highs % hit a new rally high, suggesting the uptrend likely has some more to go.
- The Aggregator System remained flat at the close.
- The NDX Aggressive Trend Timer went long at the close.

## *Short-term Outlook – updated 4/27*

### *The Bottom Line*

While tomorrow again looks like a bit of a tossup from a risk/reward standpoint, a move down could set up a decent bullish edge going into Wednesday.

*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
<b>Active</b>					
April 26, 2010	Low vol breakout to 50-day high	1-3 days	Bullish	1.30%	1.00%
April 26, 2010	SPX & VIX up 2 days in row / on Fri	1-2 days	Bearish	-1.00%	-0.80%
<b>Active - Long Term</b>					
April 26, 2010	No breadth divergence at new high	int. term	Bullish		
April 19, 2010	1st drop below 10ma in long time	int. term	Bullish		
April 13, 2010	Ttl Put/Call 40-low. SPX no 0.5% up.	1-5 weeks	Bearish	-4.90%	-3.30%
April 6, 2010	SPX and TNX hit 50-day closing highs	int. term	Bearish		
February 16, 2010	Nasdaq/S&P RS Indicator Positive	int. term	Bullish		
<b>Dropped Tonight</b>					
April 22, 2010	SPX down while NYSE Up Issues > 55%	1-3 days	Bullish	1.20%	0.90%

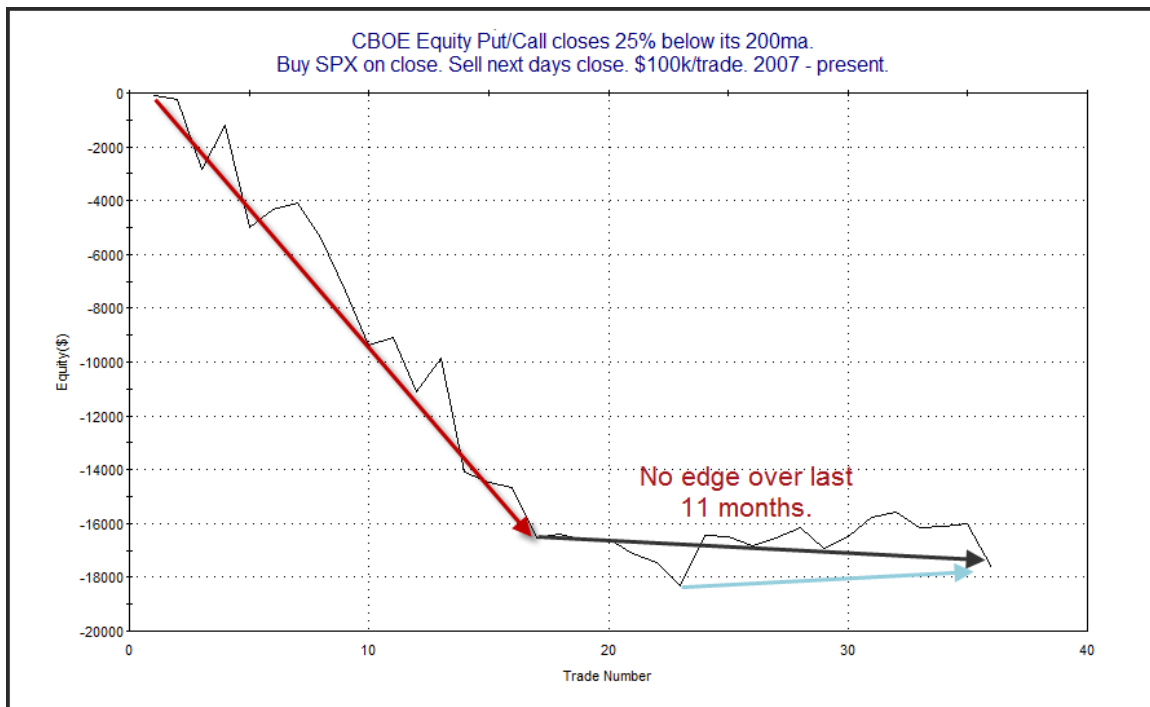
If the avg max move – 1/3 Std Dev is achieved the study will appear in **bold italic blue** and no longer be active.

## *The Evidence*

Monday was a relatively quiet day that saw the major indices close at the lower end of their daily ranges and down a bit. On the day the SPX and Russell 2000 dropped 0.4% while the Nasdaq fell 0.3%. Breadth was a bit negative as the NYSE Up Issues % came in at 46% and the Up Volume % was 38%. Total NYSE volume was up slightly, but Nasdaq volume was a little lower than Friday.

One thing to note today that I mentioned was a strong possibility in last night's letter is that the % of stocks hitting new 52-week highs reached a new rally high. This means there is no divergence in place and suggests continued price appreciation over the intermediate-term. Over the weekend I examined short-term studies that looked at new highs being hit at the same time the 52-week NH % hit a new high. I did not find anything strongly predictive for the short-term.

Several studies related to put/call ratios appeared in the Quantifinder tonight. Unfortunately the Tradestation data isn't entirely reliable and several of them were false alarms. According to the CBOE data the one that did qualify looked at times the Equity Put/Call closed more than 25% below its 200ma. I noted in early April that this study had not performed as well lately. I've updated that graphic below.



I'll continue to monitor this study but will not be including it in the Aggregator unless it again begins to assert itself.

One thing we do need to prepare for is the fact that Wednesday is a Fed Day. Fed Days have exhibited a bullish tendency over the years. This tendency has strengthened a bit over the last 3-4 years. One aspect of the Fed Day edge that my research has recently uncovered is that it is substantially affected by the previous day's closing range. Below I

broke out Fed Day performance by what quartile the closing price fell in the day before the Fed Day. First let's look at the top quartile.

SPY closes in top 25% of daily range. Tomorrow is a Fed Day.  
Buy on close. Sell tomorrow's close. \$100k/trade. 1994 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$9,025.44	Profit Factor	1.57
Gross Profit	\$24,784.21	Gross Loss	(\$15,758.77)
Total Number of Trades	52	Percent Profitable	51.92%
Winning Trades	27	Losing Trades	23
Even Trades	2		
Avg. Trade Net Profit	\$173.57	Ratio Avg. Win:Avg. Loss	1.34
Avg. Winning Trade	\$917.93	Avg. Losing Trade	(\$685.16)
Largest Winning Trade	\$2,238.25	Largest Losing Trade	(\$2,739.69)

This quartile boasts nearly twice as many instances as any of the others. I suspect this is because the market often gets bid up in the afternoon in anticipation of the next day's Fed announcement. What you'll find is that while the results are positive here, they are weaker than any other quartile. Next is the 2<sup>nd</sup> quartile which means a finish in the top 50% but not the top 25% of the daily range.

SPY closes > 50% and <= 75% of daily range. Tomorrow is a Fed Day.  
Buy on close. Sell tomorrow's close. \$100k/trade. 1994 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$11,008.31	Profit Factor	2.04
Gross Profit	\$21,590.26	Gross Loss	(\$10,581.95)
Total Number of Trades	28	Percent Profitable	53.57%
Winning Trades	15	Losing Trades	12
Even Trades	1		
Avg. Trade Net Profit	\$393.15	Ratio Avg. Win:Avg. Loss	1.63
Avg. Winning Trade	\$1,439.35	Avg. Losing Trade	(\$881.83)
Largest Winning Trade	\$4,704.07	Largest Losing Trade	(\$2,246.40)

The win rate is only marginally better but the profit factor and average trade improve quite a bit here. Now let's look at the 3<sup>rd</sup> quartile.

SPY closes > 50% and <= 75% of daily range. Tomorrow is a Fed Day.  
Buy on close. Sell tomorrow's close. \$100k/trade. 1994 - present.

TradeStation Performance Summary		Collapse ^	
All Trades			
Total Net Profit	\$10,029.46	Profit Factor	2.53
Gross Profit	\$16,598.62	Gross Loss	(\$6,569.16)
Total Number of Trades	24	Percent Profitable	70.83%
Winning Trades	17	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	\$417.89	Ratio Avg. Win:Avg. Loss	1.04
Avg. Winning Trade	\$976.39	Avg. Losing Trade	(\$938.45)
Largest Winning Trade	\$2,943.00	Largest Losing Trade	(\$2,066.62)

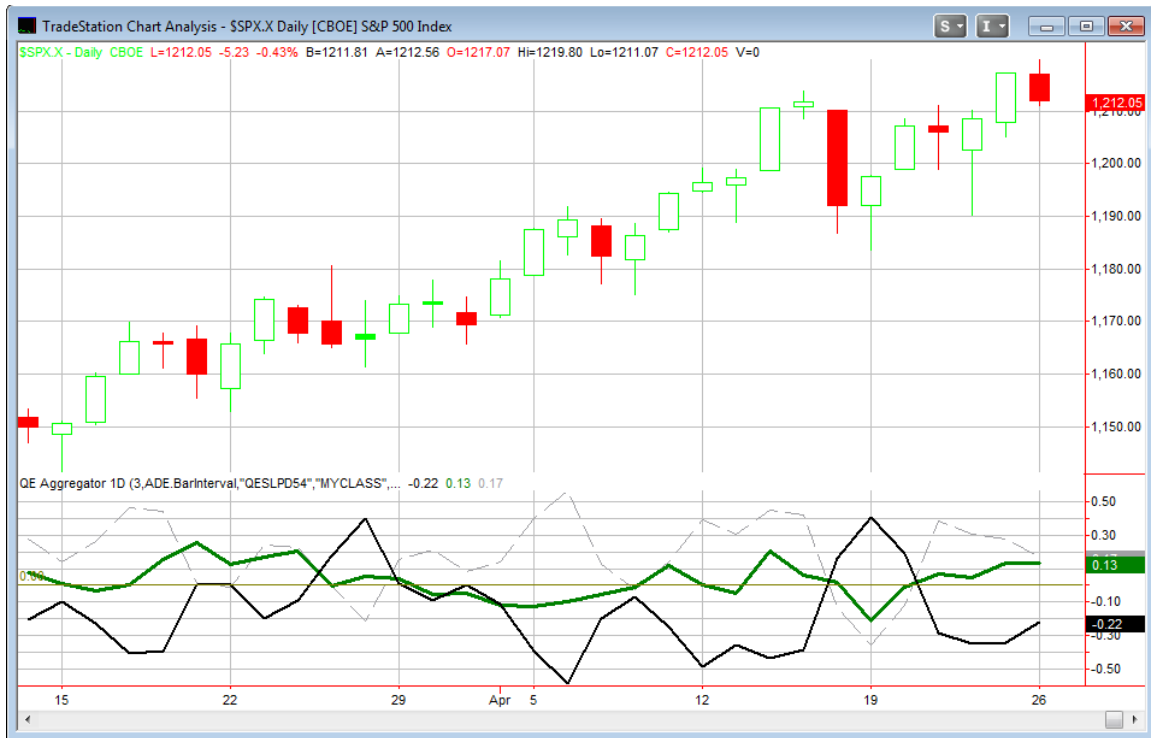
Here again we see the stats improve. The % profitable jumps up to 70% and the profit factor and average net profit also increase nicely. Lastly let's look at the bottom quartile.

SPY closes in bottom 25% of daily range. Tomorrow is a Fed Day.  
Buy on close. Sell tomorrow's close. \$100k/trade. 1994 - present.

TradeStation Performance Summary		Collapse ^	
All Trades			
Total Net Profit	\$16,874.00	Profit Factor	6.69
Gross Profit	\$19,840.21	Gross Loss	(\$2,966.21)
Total Number of Trades	26	Percent Profitable	80.77%
Winning Trades	21	Losing Trades	5
Even Trades	0		
Avg. Trade Net Profit	\$649.00	Ratio Avg. Win:Avg. Loss	1.59
Avg. Winning Trade	\$944.77	Avg. Losing Trade	(\$593.24)
Largest Winning Trade	\$2,696.00	Largest Losing Trade	(\$1,141.01)

These are by far the strongest numbers. All of the stats are substantially better in this case. While strong closes before a Fed Day carry a mild bullish edge, it is the poor closes that provide a sizable advantage.

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



There is very little change in the Aggregator values tonight. The green Aggregator line remains close to where it was at yesterday as the current active studies are still suggesting upside over the next few days. Meanwhile the black Differential line is positioned below 0, illustrating the fact that the SPX has outperformed expectations over the last few days. Positive expectations in an overbought market are leaving the lines on opposite sides of 0 and with a neutral configuration. The Aggregator System remained flat at the close on Monday.

Looking ahead the green Aggregator line is again set to close positive tomorrow unless substantial bearish studies emerge. Meanwhile the pivot level for the black Differential line is 1,209.80. So it would take an SPX close at or below this level to flip the Differential line back to positive. This isn't much of a selloff, so traders may want to keep that level in mind.

Overall, if the market can manage to pull back for one more day I expect to see a tradeable bullish edge emerge. Of course I'll monitor things intraday and will post updates to the intraday Quantifinder and the Systems page.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 4/26 somewhat bullish***

A few times recently I discussed the incredible string of days the SPX went without closing below its 200ma. Today I will show the NDX and the Dow streaks. First I'll review my comments from last week.

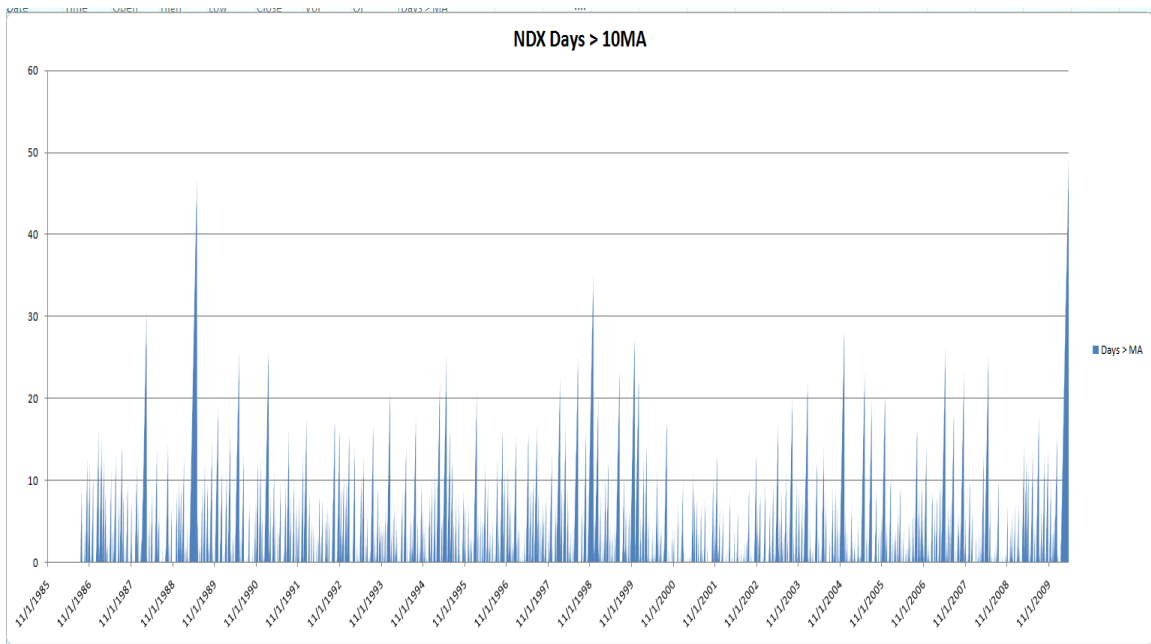
*Another notable about Friday's selloff that demonstrates how persistent the uptrend has been is the fact that it caused the SPX to close below the 10ma for the 1<sup>st</sup> time since February 12<sup>th</sup>. That streak consisted of 42 trading days above the 10ma before Friday.*

*In the 3/22/10 Letter I discussed the fact that the SPY had gone more than 25 days above its 10ma. (The SPY streak was broken on 3/26 after going 30 days.) In that Letter I showed the 5 other times since 1993 that SPY had gone at least 25 days above the 10ma. My conclusion after viewing the charts was the following...” Strong and persistent upside movement like we have seen lately hasn’t just ended and lead to an immediate correction. The 1<sup>st</sup> dip has always been just that – a dip. New highs were always made in short order.” With this Letter already quite long I decided not to reproduce those charts again. Instead, if you would like to view them you may find the in the intermediate-term section of the 3/22 Letter which I have provided a download link to below:*

[2010-03-22 QE Weekly Research Letter.pdf](#)

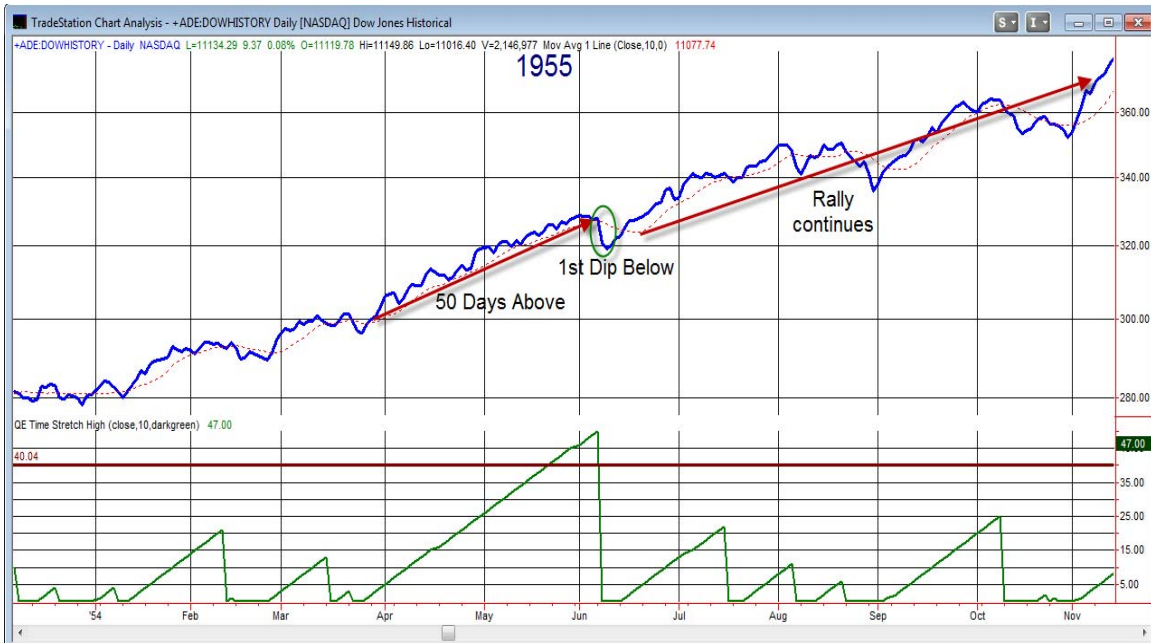
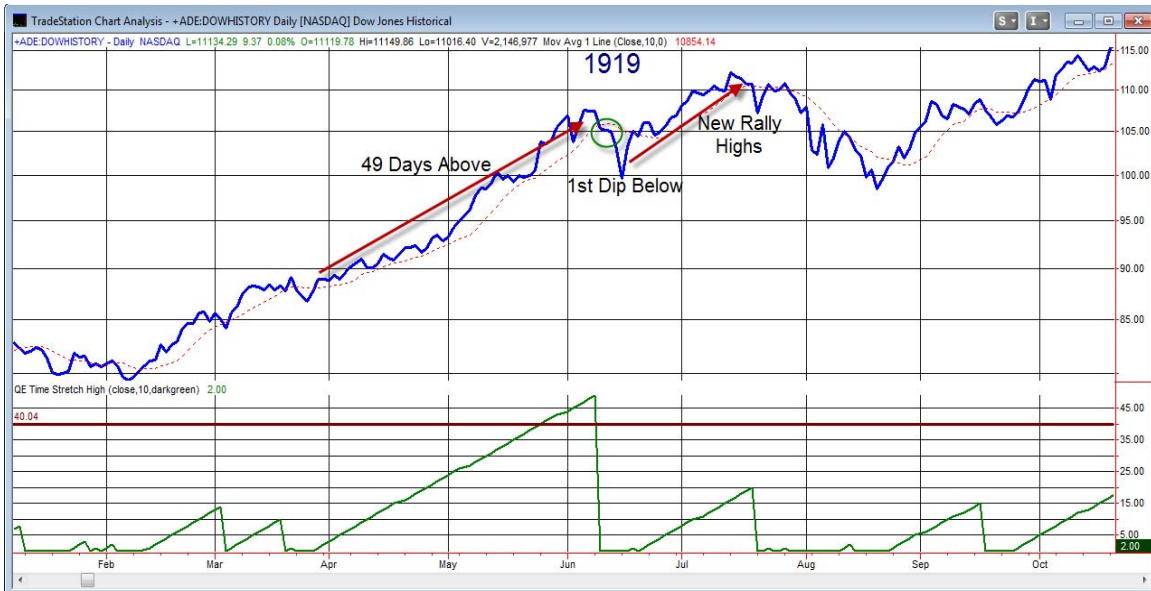
*Along these lines this weekend I looked for other times the SPX closed above the 10ma for at least 40 days in a row. Looking back to 1960 there were only 4 other instances – the most recent occurring in 1972. The dates when the other 4 instances finally dipped below the 10ma were Feb 1961, Oct 1968, Feb 1971, and Jan 1972. In looking at those instances I am drawn to the same conclusion as the 3/22 study referenced above. Persistent strength never just ended on that 1<sup>st</sup> pullback. The market went on to make new highs each time and the rally continued.*

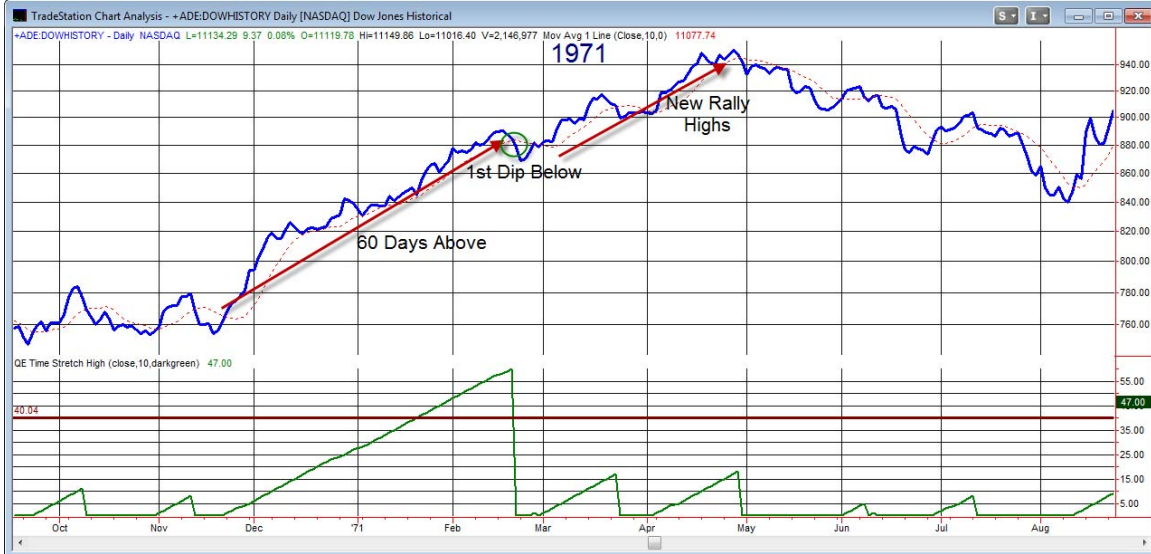
The NDX and the Dow STILL haven’t dropped below their 10-day ma’s. For the NDX the streak is now 50 days. The DIA is also 50, but the cash Dow is “just” 48 days. For the NDX this is the longest streak since its inception in 1986. Below is a chart that shows the number of days the NDX has spent above it 10ma at any point in time.



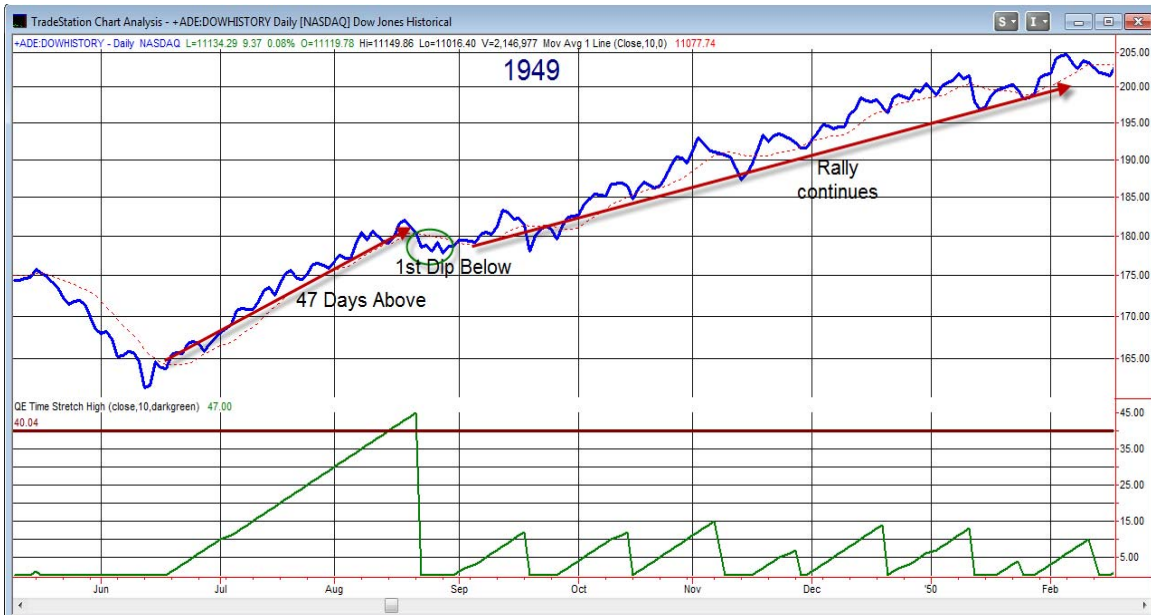
It’s a little difficult to read when try to jam so much history into a small area, but the spike on the right is the current count and it is up to 50. The previous high lasted 47 days in 1989.

The Dow streak of 48 days is also remarkable. For the Dow Index I was able to look back to 1915 in search of similar streaks. I produced a graphic like the NDX one above, but as you can imagine with history going back that far it was imperceptible. I therefore produced some charts to show the action around similar streaks. There have only been 3 that have lasted as long as the current one. They were in 1919, 1955, and 1971. Their charts are below. The indicator on the bottom is simply a count of the number of days the Dow spent above the 10ma.



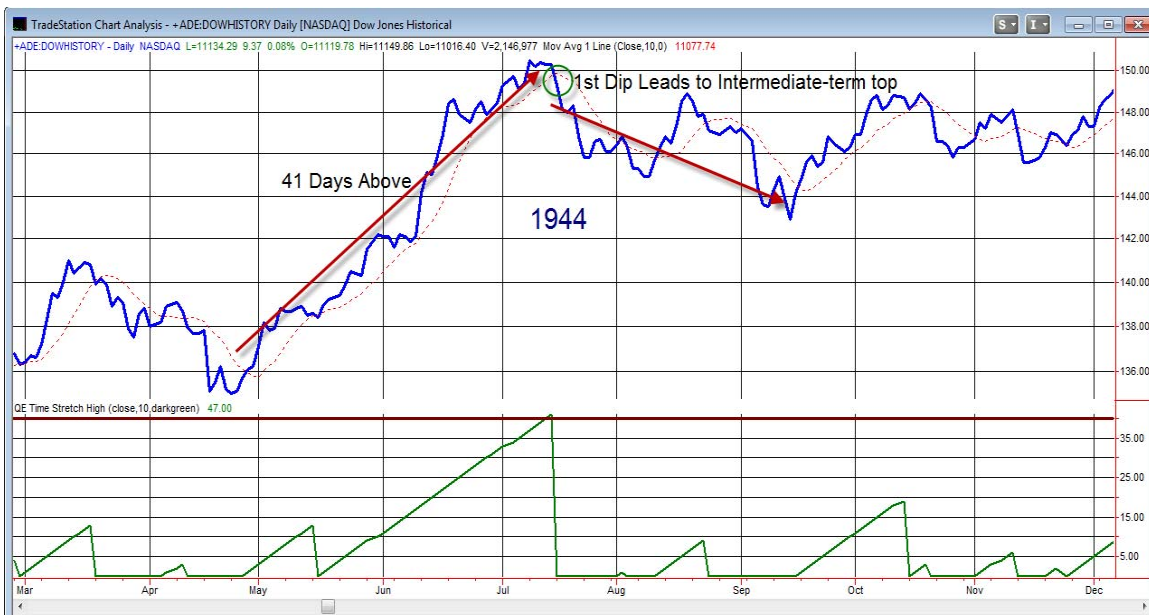


As with the SPX observations we see here that the rally continued in each case after that 1<sup>st</sup> dip. Rallies this strong and persistent seem unlikely to end on the 1<sup>st</sup> pullback. In 1949 and 1968 there were rallies that almost reached the current length. I've posted those below.





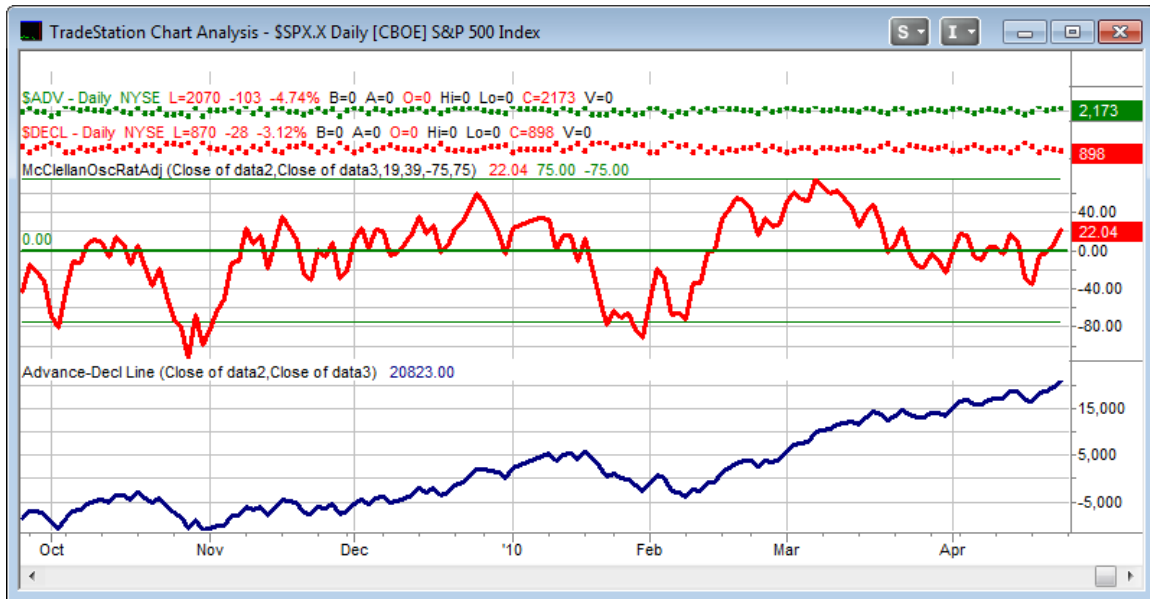
I did look to find the longest streak that ended with the first dip marking an intermediate-term top. 1944 was the winner with a streak of 41 days. That chart is below.



So 1944 could be considered our lone exception as a long streak ended abruptly. Of course it wasn't as long as the current rally or any of those others that went on to further gains.

Another bit of evidence to keep an eye on is the % of 52-week highs on the NYSE. As I've discussed a number of times over the last six months, all SPX tops since 1970 have seen a divergence lasting at least 2 months in either the A/D line or the % of stocks hitting new 52-week highs prior to the ultimate price high. A move higher early this

week has the potential to see the 52-week NH % hit a new high. Below is a chart with the NYSE A/D line shown in blue in the bottom panel.



There are a few intermediate-term studies active with bearish implications. They are related to bond action and option ratios. To this point they haven't made a difference. We will get an intermediate-term decline at some point here but for now evidence appears to favor continued upside. It's been a tough trend to fight and I wouldn't suggest it at this point.

## **Catapult and Capitulative Breadth Statistics**

*(Catapult Presentation Part 1) (Catapult Presentation Part 2)*

### ***Open Catapult Triggers***

*MON 1/3 position @ \$64.73 limit (not filled)*

### ***Catapult for ETF's Trades***

*None*

### ***Broad Market Large Cap CBI – 1 (MON)***

### **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 share on SPX close below 1,209.81. Another down close along with the Fed Day Wednesday should trigger a long in the Aggregator System.*

*SPY – buy ¼ index share if SPY closes in bottom 50% of daily range. As shown above a weak close should create a nice edge for the next day.*

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