

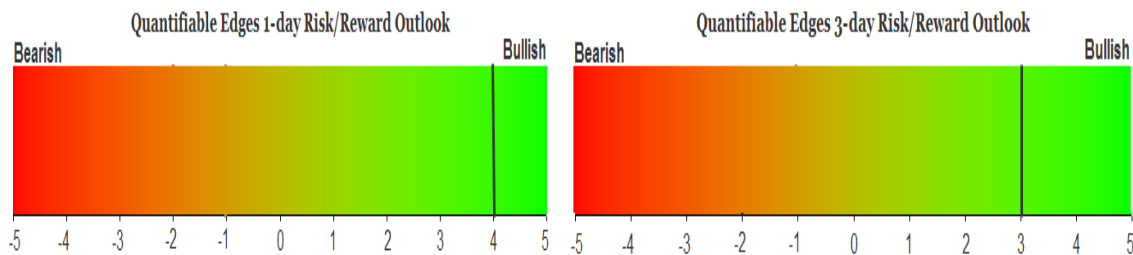
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 3, 2010

Volume 3 Issue 83

Market Overview



Tonight's Research Points

- The 1st day of the month is seasonally bullish – especially 1) in May and 2) after a big down day to finish the month.
- A few days of strong selling here near the highs are suggesting short-term bullish implications.
- Big drops on Fridays have consistently led to a bounce since 1987.
- Over the last year+ any drop on Friday has led to a Monday bounce on a consistent basis.
- The Aggregator System remained long at the close.
- The NDX Aggressive Trend Timer stayed long at the close.

Short-term Outlook – updated 5/3

The Bottom Line

The evidence tonight is strongly suggesting a bounce early in the week. I'll be looking to take advantage of such a bounce.

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					
May 3, 2010	1.5% drop > 200ma 2nd time in 5 days	1-4 days	Bullish	2.50%	1.90%
May 3, 2010	Big Friday drop	1 day	Bullish		
May 3, 2010	1st day of month	1 day	Bullish		
April 30, 2010	2 Up Don't Overcome Dn. Unfill gap tday	1-3 days	Bullish	1.40%	1.20%
April 29, 2010	1.75% drop then bounce of 1/4 - 3/4 up.	1-6 days	Bullish	3.50%	3.00%
April 28, 2010	2% drop to bottom 10% of range in uptrd	1-7 days	Bullish	4.00%	3.20%
Active - Long Term					
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	Til 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		

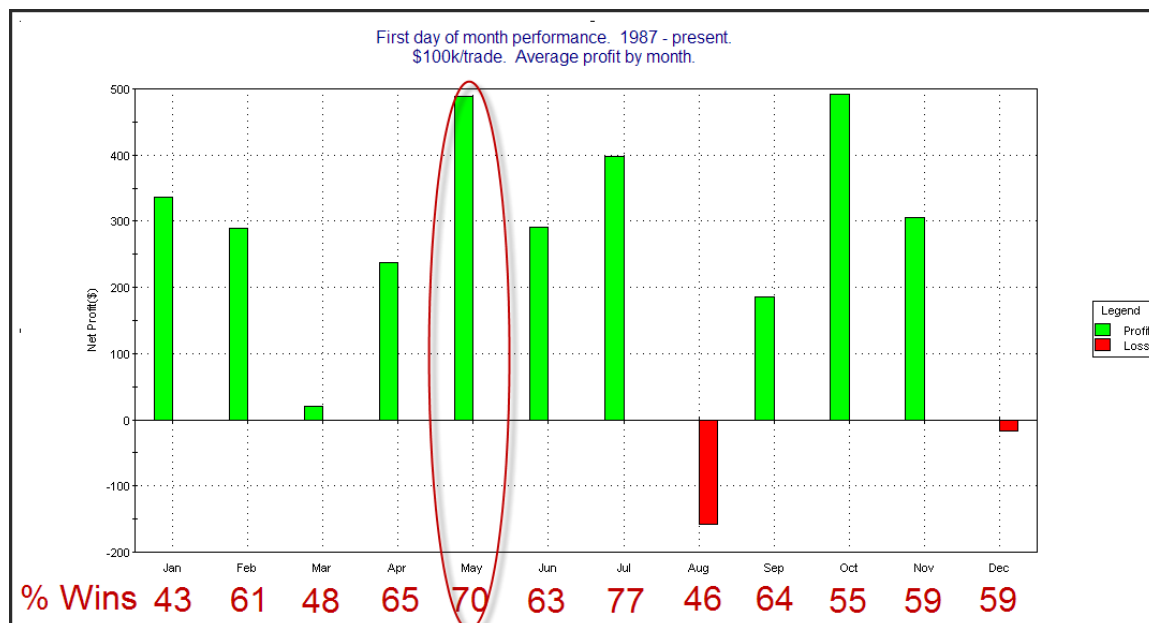
If the avg max move – 1/3 Std Dev is achieved the study will appear in ***bold italic blue*** and no longer be active.

The Evidence

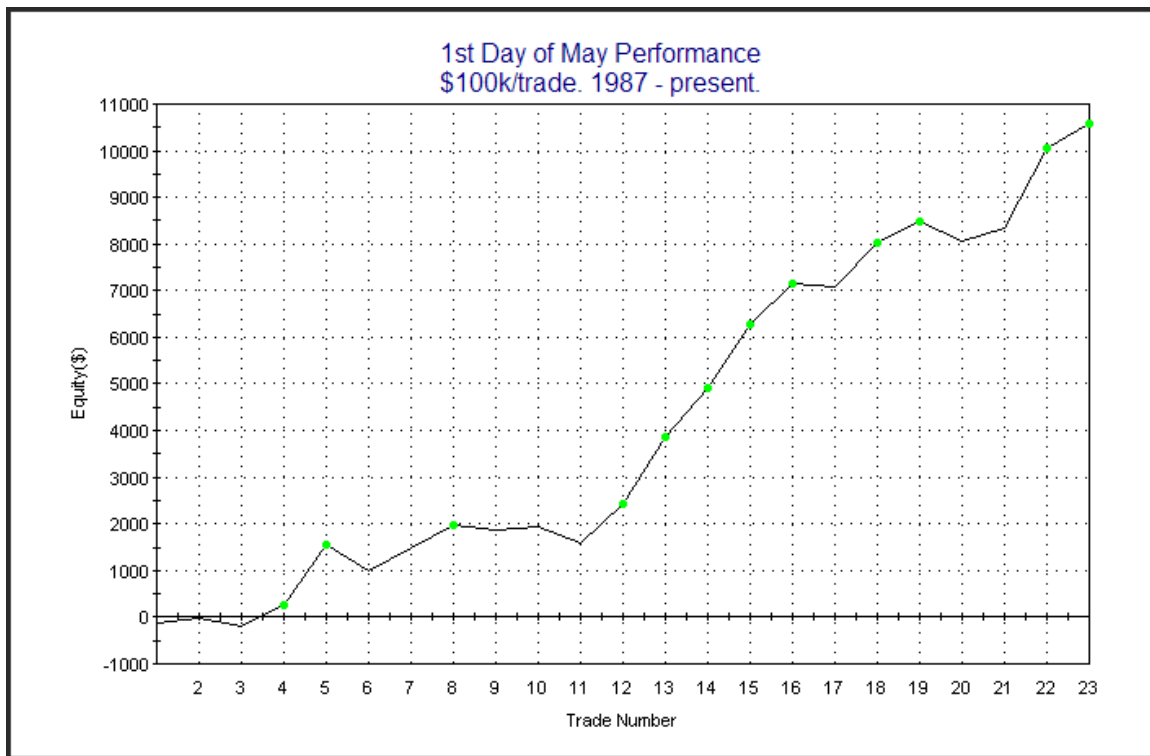
The market got hit hard on Friday. After opening about even it stair stepped lower throughout the day and finished near its lows. The SPX closed down 1.6%, the Nasdaq lost 2.0% and the Russell 2000 dropped a whopping 2.9%. Breadth was poor as you'd expect with the NYSE Up Issues % coming in at 25% and the Up Volume % at 13%. Volume fell on the NYSE but rose on the Nasdaq.

There are a fair amount of edges to discuss tonight, and everything I examined came up either without an edge or with a bullish one.

Monday is the 1st trading day of May. I've discussed many times before how the 1st trading day of the month tends to be seasonally bullish. In the blog last July I showed a breakdown of performance by month since 1987. Below is a copy of that graphic.



As you can see, May has been one of the strongest months, both based on total return and % profitable. Below is a graph showing performance on the 1st day of May since 1987.



Also notable is that 22 of the last 23 years the SPX has closed above the final April close on either the 1st or 2nd day of May. The lone exception was 1989, which lost a total of 0.5% over the 2 days.

Nine times in the last 23 years the SPX has closed down on the last day of April. Only once did it fail to then close higher on the 1st day of May. That was in 2003 when it lost a mere 0.07%.

I also ran a study looking at times the month (any month) finished with a 1% drop on the last day. Results of that study are below.

**SPX drops over 1% on the last day of the month.
Buy on close. Sell X days later. \$100k/trade. 1987 - present.**

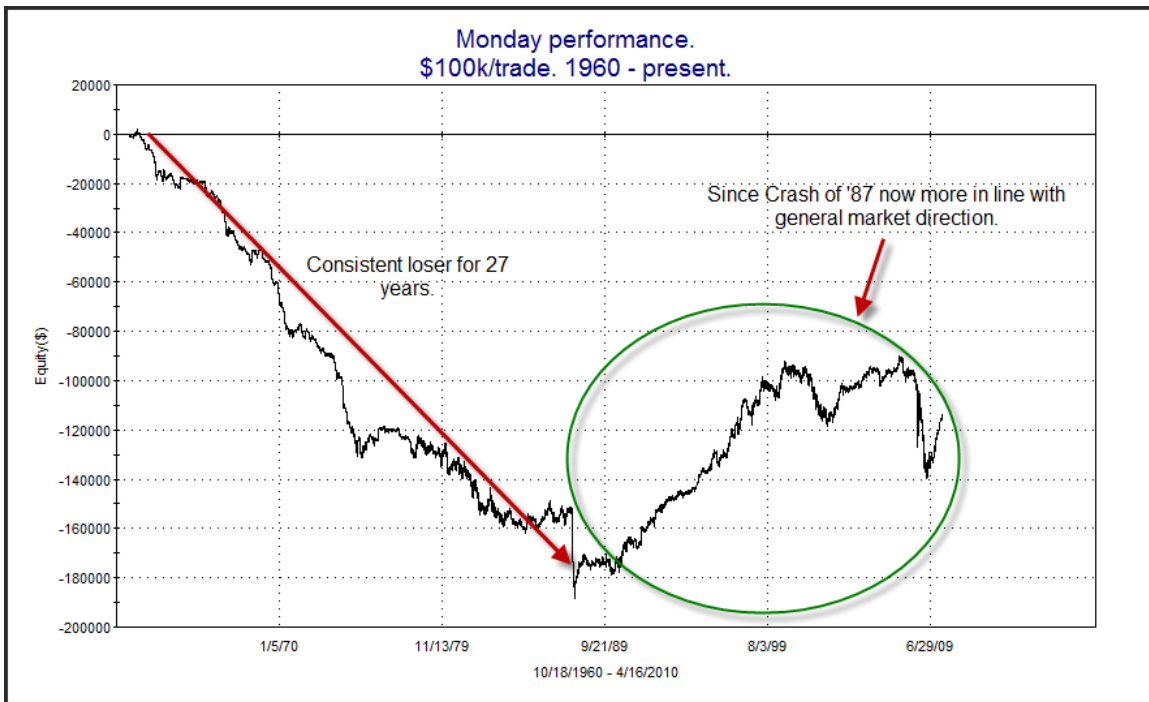
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: WinLoss Ratio	All: ProfitFactor	All: Avg Trade
5	19,484.82	12	10	2	83.33	2,263.62	-1,575.71	1.44	7.18	1,623.74
4	16,590.98	12	10	2	83.33	1,954.07	-1,474.88	1.32	6.62	1,382.58
3	6,605.12	12	8	4	66.67	1,706.31	-1,761.34	0.97	1.94	550.43
2	8,042.63	12	10	2	83.33	1,328.80	-2,622.69	0.51	2.53	670.22
1	6,916.46	12	9	3	75.00	945.03	-529.60	1.78	5.35	576.37

July 31, 1998 was the only instance that didn't close above the entry price on either day 1 or day 2. It was down over 4% on Tuesday and finished the week down nearly 3%.

I was a bit surprised at the low number of instances over a 23 year period. Still the results appear to be quite bullish.

The sharp Friday selloff may also have reminded subscribers of the Friday selloff from just 2 weeks ago. Below I have copied an excerpt from the 4/19 Letter. **Note that the statistics ARE UPDATED from the letter 2 weeks ago.**

Friday selloffs and Monday reactions have an interesting history. First let's look at a chart I've shown a few times before that represents SPX performance on Mondays. (In actuality it is the day after Friday for simplification purposes of designing the study.)



Mondays on their own used to be a bearish day. This changed after the Crash of '87. So when running studies based on performance following something that happened on a Friday, I never go back past the Crash of '87.

In the 1/25/10 Letter I looked at large Friday drops. For this study I used Average True Range (ATR) to define “large”. If the size of the drop was larger than 1.5 times the 20-day ATR then regardless of the size of the % drop, that was considered “large”. Drops of this magnitude on a Friday have almost always led to a bounce. In January I only ran the test back to 1995. I went back to 1993 this time.

Today is Friday. The SPX falls more than 1.5 times yesterday's 20-day ATR. 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	
5	29,968.60	26	19	7	73.08	2,158.97	-1,578.83	1.37	3.71	1,152.64	
4	21,913.09	26	18	8	69.23	1,813.27	-1,340.72	1.35	3.04	842.81	
3	24,533.95	26	18	8	69.23	1,830.89	-1,052.75	1.74	3.91	943.61	
2	18,905.65	26	18	8	69.23	1,509.33	-1,032.80	1.46	3.29	727.14	
1	14,742.28	26	23	3	88.46	775.50	-1,031.38	0.75	5.76	567.01	

An 88% bounce rate the next day is extremely impressive – especially considering the study is only based on 2 simple parameters (day of week and large drop). The Crash of '87 occurred on a Monday after a sizable drop on Friday. The Crash of '29 also occurred on a Monday. It seems that Wall St.'s collective consciousness since '87 calls for protecting yourself going into the weekend if Friday is bad. This means that big drops on Friday's have often been overreactions and have resulted in a consistent propensity to bounce on Monday.

Since the market bottomed in March of 2009, Mondays following down Fridays of any magnitude have performed exceptionally well. In the March 22, 2010 blog post I broke out Monday performance over the last year by Mondays following up Fridays and Mondays following down Fridays. The results were compelling. I have updated the performance following down Fridays below.

SPX performance on a day following a down Friday. \$100k/trade. 3/20/09 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$22,370.13	Profit Factor	3.81
Gross Profit	\$30,318.36	Gross Loss	(\$7,948.23)
Total Number of Trades	25	Percent Profitable	80.00%
Winning Trades	20	Losing Trades	5
Even Trades	0		
Avg. Trade Net Profit	\$894.81	Ratio Avg. Win:Avg. Loss	0.95
Avg. Winning Trade	\$1,515.92	Avg. Losing Trade	(\$1,589.65)
Largest Winning Trade	\$7,069.40	Largest Losing Trade	(\$3,466.02)

This study seems to provide what I often refer to as an “environmental edge”. It isn’t something that has performed consistently over many years but in the recent past it has provided a quantifiable advantage. I never expect environmental edges to last for a very long time, and this study may fall out of consideration a few months from now, but as long as it is working and continuing to suggest an edge I will look to incorporate it in my analysis.

One concern that some traders may have is that we are seeing some fairly strong selling days in the midst of this uptrend. So one question is whether 2 strong down days are often followed by more selling. For the short-term at least, history suggests an upside edge. Over the intermediate-term results were a bit more mixed. Below is the results table from the study.

**SPX closes lower today by at least 1.5% for at least the 2nd time in the last 5 days.
Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1987 - 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	35,504.40	27	18	9	66.67	2,736.10	-1,527.26	1.79	3.58	1,314.98
4	36,883.62	28	20	8	71.43	2,401.33	-1,392.88	1.72	4.31	1,317.27
3	30,169.59	29	21	8	72.41	1,908.62	-1,238.93	1.54	4.04	1,040.33
2	29,575.87	31	20	11	64.52	1,935.90	-831.10	2.33	4.24	954.06
1	19,677.71	33	26	7	78.79	1,190.08	-1,609.18	0.74	2.75	596.29

28 of 31 instances (90%) closed above the entry price at some point in the next 3 days.

This appears to be another high percentage setup.

I also decided to look and see what happened during those occurrences where the market was trading near a 1-month high. Those results are below.

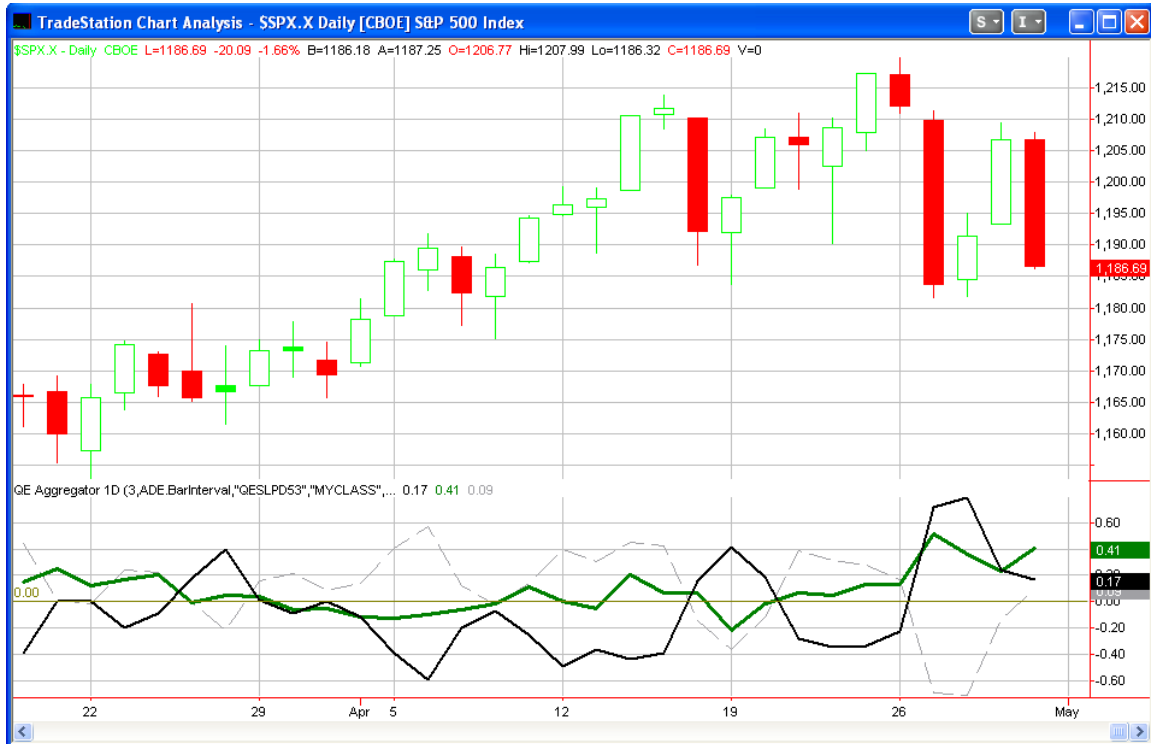
SPX closes lower today by at least 1.5% for at least the 2nd time in the last 5 days. The highest high of the last 5 days = the highest high of the last 20 days. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1987 - present.

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	21,226.54	9	8	1	88.89	2,856.82	-1,627.99	1.75	14.04	2,358.50
4	18,294.61	9	7	2	77.78	2,888.22	-961.46	3.00	10.51	2,032.73
3	19,416.25	9	8	1	88.89	2,530.34	-826.50	3.06	24.49	2,157.36
2	15,948.52	9	8	1	88.89	2,045.63	-416.50	4.91	39.29	1,772.06
1	8,120.89	9	8	1	88.89	1,298.17	-2,264.50	0.57	4.59	902.32

All 9 instances closed above the entry price at some point in the next 3 days.

Really there aren’t enough instances here to extrapolate expectations with much confidence. Still it seems the consistently bullish results appear at least notable.

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



Not much change to the Aggregator chart tonight. The green Aggregator line remains well above zero. This shows the net expectation from the Active Studies list is for more gains over the next few days. This should be no surprise since all of the short-term studies are bullish. Meanwhile the black Differential line also remains well above zero. This illustrates the fact that the SPX has underperformed expectations over the last few days. When the market has been oversold versus expectations and current expectations have been positive that has historically provided an upside edge. Both lines still above zero means the Aggregator System remained long on Friday.

Looking ahead it will take some bearish studies in order to flip the green Aggregator line back below zero. Meanwhile the Differential pivot level is 1,203.01 for Monday. This means the SPX would need to close above 1,203 for the black Differential line to drop below 0. With expectations as strong as they've been lately this number is set to continue higher as well.

Bottom line is the studies are suggesting a fairly sizable bounce in the next few days. I'll be looking to take advantage of that bounce. I'm not seeing anything that suggests a continued selloff in the near term but will continue to watch for such evidence. As always we're looking at probabilities here – not certainties.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/3 somewhat bullish

Last week I looked at the lengthy amount of time the Nasdaq and Dow had spent above their 10ma's. Those streaks ended abruptly this week. History suggests we are likely to see additional highs in these indices rather than an immediate intermediate-term top.

I also looked at breadth indicators such as the A/D line and the number of new 52-week highs. The 52-week highs had lagged slightly but right on cue that made a new high early this past week as well. Breadth normally deteriorates well before the index price top and so this too suggests there is more upside to come.

Another indicator that has been supporting the bull case since February is the Nasdaq/S&P Relative Strength. We are again seeing the Nasdaq leading this week. [This is formation that has led to almost all of the market gains since 1971.](#)

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.

I also noted the fact that the S&P posted its 2nd consecutive outside week this week. This is quite unusual but unfortunately doesn't appear to be very predictive. I looked at it a few different ways but did not come up with anything compelling enough for publication.

So the intermediate-term basically remains the same as last week. We will get a 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 (filled @ \$62.60)

MON – 1/3 position @ \$62.25 limit (not filled – cancel order for now)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 2 (MON-2)

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 @ \$118.81 LIMIT. I'll look to re-enter based on the Aggregator and the short-term outlook above.

SPY – buy ¼ index position @ \$118.80 LIMIT ON CLOSE. Should the market close down I will continue to scale in.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Loss	Stop	Notes
SPY(1/4)	4/28/2010	\$118.48	\$119.74	1.06%		sold via intraday stop
MON(1/3)	4/29/2010	\$62.60	\$63.06	0.73%		Catapult

Gold subscribers were sent an intraday email on Friday that placed a stop on the open SPY position @ \$119.74, which was \$0.10 below the morning low at the time. This stop order was filled fairly quickly after being sent. I normally try and send these out well ahead of time. The market just happened to tank right after I sent it

One time I really do like to use stop orders is in a situation like Friday. The stop was placed at a point where the trade would have been exited anyway at the end of the day. This is because the market was above the Differential pivot. Additional selling gave Aggregator traders the opportunity to re-enter at the end of the day if you noted the Systems page still showed a long Aggregator signal. I never send out entry emails to be posted in the Letter, though. All tracked trades in the letter are posted in the letter. I may move a stop intraday but will never initiate a new position. This is because I feel traders should carefully consider any new positions and sending out purchase orders intraday would not allow for such careful consideration.

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