

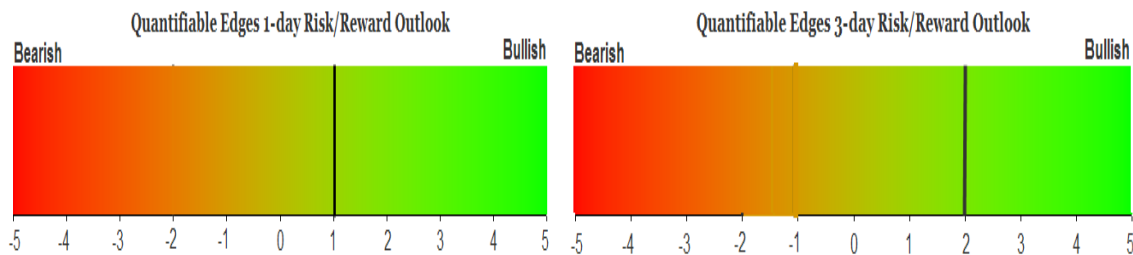
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 4, 2010

Volume 3 Issue 84

## Market Overview



## Tonight's Research Points

- Inside days with unfilled upside gaps have led to a mild downside edge in the following days.
- The Aggregator System remained long at the close.
- The NDX Aggressive Trend Timer stayed long at the close.

## Short-term Outlook – updated 5/4

### The Bottom Line

The bounce arrived on Monday. While there is some indication based on tonight's study that the market could struggle the next few days, our previous studies are still looking for more upside. I'm expecting a little more from this bounce at this point.

*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>					
May 4, 2010	Inside day with unfilled gap up > 200ma	1-2 days	Bearish	-1.00%	-0.80%
May 3, 2010	1.5% drop > 200ma 2nd time in 5 days	1-4 days	Bullish	2.50%	1.90%
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%
<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>					
May 3, 2010	<b>Big Friday drop</b>	<b>1 day</b>	<b>Bullish</b>		
May 3, 2010	<b>1st day of month</b>	<b>1 day</b>	<b>Bullish</b>		

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

As was expected the market bounced back strongly on Monday. It started with a gap up and then trended higher for most of the day. When it was over the SPX had risen 1.3%, the Nasdaq 1.5%, and the Russell 2000 2.3%. Breadth was very strongly positive as the NYSE Up Issues % was 76% and the Up Volume % was 78%. Total NYSE volume declined to the lowest level in over a week.

One study that appeared in the Quantifinder was from the 2/25/10 Letter. It looked at inside days like Monday where the market gapped higher, never filled, and moved higher from open to close without making a higher high. It suggested mildly bearish implications and I have updated the results below.

SPY posts unfilled gap up but a lower high than yesterday. Close > open & close > 200ma.  
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
10	-7,108.39	33	15	18	45.45	1,595.90	-1,724.83	0.93	0.77	-215.41
9	-10,061.64	34	12	22	35.29	1,762.72	-1,418.83	1.24	0.68	-295.93
8	-8,240.53	36	15	21	41.67	1,685.09	-1,596.04	1.06	0.75	-228.90
7	-652.66	37	18	19	48.65	1,808.68	-1,747.84	1.03	0.98	-17.64
6	-4,754.78	38	20	18	52.63	1,281.13	-1,687.63	0.76	0.84	-125.13
5	-7,737.92	38	16	22	42.11	1,271.03	-1,276.11	1.00	0.72	-203.63
4	-2,442.08	38	18	20	47.37	1,104.23	-1,115.91	0.99	0.89	-64.27
3	-1,859.17	39	18	21	46.15	929.60	-885.33	1.05	0.90	-47.67
2	-6,307.83	40	14	26	35.00	1,093.30	-831.31	1.32	0.71	-157.70
1	-4,708.35	40	15	25	37.50	918.24	-739.28	1.24	0.75	-117.71

35 of 40 instances (87.5%) closed below the entry price at some point in the next 5 days.

The edge isn't terribly strong, but it is fairly consistent and worth considering.

In the notes on the intraday Quantifinder page I indicated that I did not feel inclined to use the SPY/UUP study from 8/10/2009 that covered 2008-2009 and suggested bearish implications when both closed up quite a bit. The reason is that the relationship between the stock market and the dollar has changed since around November/December. Below is a chart of SPX (green) and UUP (orange), which is the dollar bullish ETF. This chart goes from September 2008 – December 2009.



As you can see there was a strong inverse correlation for most of the period. It appeared that inverse correlation began to decouple in late 2009. Below is a chart of the recent period from late 2009 – now.



As you can see here over the last several months the two have moved generally in the same direction. So a strong 1-day move in the same direction therefore is unlikely to have the same implications as during the prior period.

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



As you can see the green Aggregator line is still well above 0. This means the net expectation from the active studies is positive over the next few days. Most notable about tonight's chart is the fact that the black Differential line closed just barely above zero. As noted last night the Differential pivot number was 1,203.01. The SPX closed just below this at 1,202.26. Another  $\frac{3}{4}$  of a point and the Differential line would have gone negative. A positive Differential like now means the SPX has underperformed expectations over the last few days. A negative Differential would mean the SPX has outperformed expectations. So the SPX is just barely oversold versus expectations while expectations over the next few days are solidly positive. This configuration has historically provided an upside edge. The Aggregator system remained long as of the close.

Looking ahead to tomorrow the Aggregator value is expected to remain positive. A move a little above 1,220 intraday could mean the bullish studies will all hit their targets and be removed from the active list. Additionally, the Aggregator could turn negative if additional bearish studies emerge. Meanwhile the Differential pivot value will rise all the way to 1,219.74. So it will take a close at least this high in order to drop the black Differential line below 0. On Wednesday the pivot is expected to move back down to about 1,199, though.

So the Aggregator is suggesting there may still be some room left in this bounce. Since the market gapped up and never filled this morning there was no entry based on last night's trade ideas. If there was an entry, I would've been inclined to take partial profits at today's close. Even though the Aggregator is still suggesting upside, the Differential came very close to turning negative. In such a situation, I'd want to lock in some gains. While the Aggregator System is purely mechanical, I still prefer to trade it with some

discretion. The math behind it is based on estimates. Even if I used the absolute optimal methods for calculating the estimates, perfect math doesn't equate to perfect results. It needs to be remembered that the market is not just mathematical, but also emotional. The Aggregator does a nice job of quantifying short-term edges and determining whether substantial directional advantages exist. But that doesn't mean some common sense trade management can't be applied to enhance trader performance.

***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 2<sup>nd</sup> 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.*

*None tonight.*

### **Active Trades Table**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Pr</b>	<b>% Gain/Lo</b>	<b>Stop</b>	<b>Notes</b>
MON(1/3)	4/29/2010	\$62.60	\$63.37	1.23%		Catapult

***MON is quite close to hitting its exit trigger. Since Catapult exits need to be calculated that day, I will need to send the trigger prices via email tomorrow if it looks at all likely. The standard exit is for the next day's open. I will sometimes use stops to protect against an intraday reversal or will also often sell at the close rather than waiting for the next open.***

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