

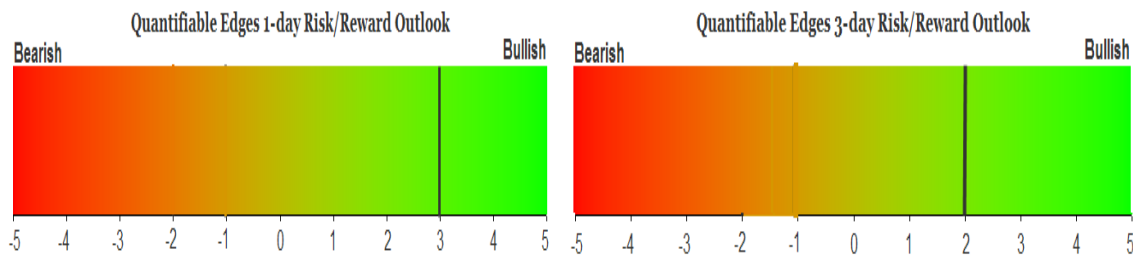
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 5, 2010

Volume 3 Issue 85

## Market Overview



## Tonight's Research Points

- Another drop of 1.5% along with a 10-day low suggests a bounce tomorrow.
- The VIX spike appears somewhat bullish but a little higher would've provided more convincing evidence.
- An unfilled gap up followed by an unfilled gap down can provide bearish implications – but only in a long-term downtrend.
- The Aggregator System remained long at the close.
- The NDX Aggressive Trend Timer stayed long at the close.

## Short-term Outlook – updated 5/5

### The Bottom Line

The market is very skittish. Another strong selloff appears to be setting up another short-term bounce. Evidence is not as clear-cut or convincing as the last 2 drops though.

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 5, 2010	1.5% drop > 2nd time 10 low	1 day	Bullish		
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 uptrend	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	Td 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 4, 2010	Inside day with unfilled gap up > 200	1-2 days	Bearish	-1.00%	-0.80%
April 30, 2010	2 Up Don't Overcome Dn. Unfill gap tday	1-3 days	Bullish	1.40%	1.20%
May 3, 2010	1.5% drop > 200ma 2nd time in 5 days	1-4 days	Bullish	2.50%	1.90%

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**

For the 3<sup>rd</sup> time in six days the market got hit hard on Tuesday. The SPX lost 2.4%, the Nasdaq 3.0% and the Russell 2000 was down 3.1%. Breadth was extremely negative with the NYSE Up Issues % coming in at 14% and the Up Volume % at 6%. Total volume rose sharply.

With the extreme move a substantial number of studies again appeared. I'll go through a few of the more interesting ones tonight.

The one bearish study that appeared in the Quantifinder was from the 9/2/08 Letter. It looked at unfilled gaps higher followed by unfilled gaps lower. In taking another look at this one tonight I found the long-term trend appeared to make a big difference. First let's look at instances where the long-term trend was down.

**SPY has an unfilled gap up that closes higher than the open followed by an unfilled gap down that closes lower than the open. Both gaps are at least 0.25%. 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
5	-11,609.90	14	3	11	21.43	2,677.33	-1,785.63	1.50	0.41	-829.28
4	-25,285.41	14	2	12	14.29	4,162.73	-2,800.91	1.49	0.25	-1,806.10
3	-15,392.05	14	6	8	42.86	1,438.60	-3,002.96	0.48	0.36	-1,099.43
2	-4,359.02	14	6	8	42.86	1,693.03	-1,814.65	0.93	0.70	-311.36
1	-10,831.41	14	3	11	21.43	1,113.27	-1,288.29	0.86	0.24	-773.67

Numbers here appear to be strongly bearish. Now let's look at times like the present where the SPX is above its 200ma.

**SPY has an unfilled gap up that closes higher than the open followed by an unfilled gap down that closes lower than the open. Both gaps are at least 0.25%. 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
5	-1,729.59	14	6	8	42.86	1,986.25	-1,705.89	1.16	0.87	-123.54
4	1,280.37	14	7	7	50.00	1,446.89	-1,263.98	1.14	1.14	91.46
3	-2,251.49	14	6	8	42.86	1,394.48	-1,327.30	1.05	0.79	-160.82
2	940.62	14	8	6	57.14	1,089.56	-1,295.98	0.84	1.12	67.19
1	2,689.97	14	9	5	64.29	802.76	-906.97	0.89	1.59	192.14

Here we see the results are mixed. The bearish implications no longer hold. So based on this I wouldn't fret about this pattern.

There were also a few studies from the Quantifinder that related to the VIX spike. Tuesday the VIX closed about 22% above its 10ma. We actually just saw a study in the April 28<sup>th</sup> letter that looked at VIX spikes more than 25% above the 10ma. I've updated that study below:

VIX crosses over 25% above its 10ma on a closing basis SPX closes > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1990 - 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	16,163.14	15	9	6	60.00	2,524.25	-1,092.51	2.31	3.47	1,077.54
4	19,804.91	16	11	5	68.75	2,196.88	-872.16	2.52	5.54	1,237.81
3	14,834.05	16	13	3	81.25	1,338.07	-853.62	1.57	6.79	927.13
2	17,671.44	16	12	4	75.00	1,602.16	-388.62	4.12	12.37	1,104.47
1	16,603.76	16	15	1	93.75	1,151.17	-663.78	1.73	26.01	1,037.74

Results here were strongly suggestive of a short-term bounce. The studies in the Quantifinder tonight looked at instances above 20%. They also suggested short-term strength. But those of course included all of these instances. What if I looked at times like the present when the VIX spiked up to over 20% above the 10ma, but didn't reach the 25% threshold?

VIX crosses over 20% above its 10ma on a closing basis but does NOT close more than 25% above its 10ma. SPX closes > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1990 - 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	15,430.15	18	13	5	72.22	1,645.00	-1,190.97	1.38	3.59	857.23
4	4,727.26	18	12	6	66.67	1,321.51	-1,855.14	0.71	1.42	262.63
3	-2,747.68	21	13	8	61.90	863.84	-1,747.20	0.49	0.80	-130.84
2	6,053.33	21	13	8	61.90	1,010.25	-884.98	1.14	1.86	288.25
1	3,098.51	21	13	8	61.90	761.79	-850.59	0.90	1.46	147.55

What we see here are relatively mild bullish implications. It's nothing to get excited about and nothing I would base a trade on. I'd rather wait for the 25% spike before putting much weight on this kind of study.

Lastly I decided to take another look at a study I published just 2 days ago in the 5/3 Letter. It looked at times the SPX sold off 1.5% or more for at least the 2<sup>nd</sup> time in the last 5 days. Tonight I went back to 1988.

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. 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: WinLoss Ratio	All: ProfitFactor	All: Avg Trade
5	22,938.40	23	14	9	60.87	2,620.27	-1,527.26	1.72	2.67	997.32
4	27,035.54	24	16	8	66.67	2,386.16	-1,392.88	1.71	3.43	1,126.48
3	26,207.28	25	17	8	68.00	2,124.63	-1,238.93	1.71	3.64	1,048.29
2	27,248.03	28	17	11	60.71	2,180.78	-893.20	2.44	3.77	973.14
1	20,894.24	29	24	5	82.76	1,224.46	-1,698.56	0.72	3.46	720.49

We see here what appear to be quite strong short-term bullish implications. What's different today than a few days ago is that we are now hitting new short-term lows. I

filtered to just look at those times the SPX made a 10-day intraday low in conjunction with this. Those results are below.

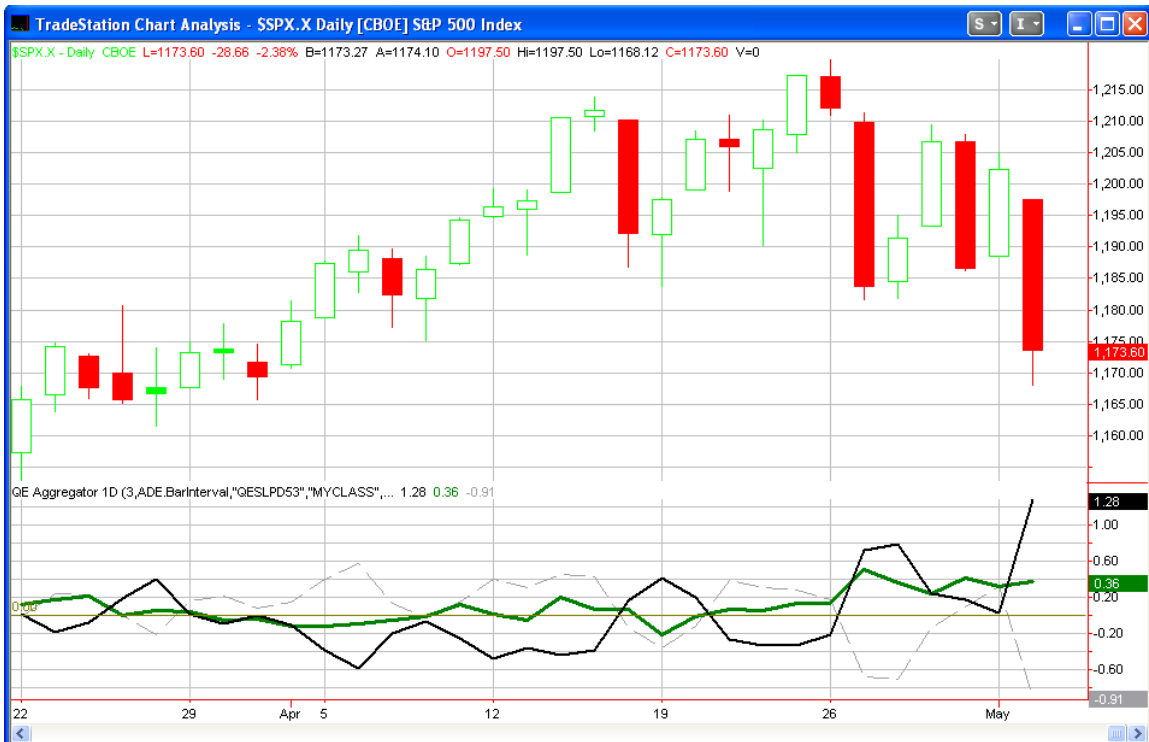
SPX closes lower today by at least 1.5% for at least the 2nd time in the last 5 days. Close > 200ma. Today's low is the lowest in 10 days. Buy on close. Sell X days later. \$100k/trade. 1988 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	29,014.03	15	11	4	73.33	2,905.30	-736.06	3.95	10.85	1,934.27
4	24,048.14	15	11	4	73.33	2,625.90	-1,209.18	2.17	5.97	1,603.21
3	17,421.87	15	10	5	66.67	2,364.72	-1,245.07	1.90	3.80	1,161.46
2	20,297.97	16	12	4	75.00	2,040.31	-1,046.45	1.95	5.85	1,268.62
1	17,669.94	17	16	1	94.12	1,203.66	-1,588.57	0.76	12.12	1,039.41

Again we see implications that appear strongly bullish, but very short-lived.

A few things strike me about all the things I looked at tonight. First, other than this last study, evidence doesn't appear as convincing as it did on the 2 recent drops. Also, the positive implications I saw tonight were all very short-term. When I looked out further results were more mixed.

I did also look at the fact that we were seeing a 2<sup>nd</sup> 90% down volume day in a short time span while above the 200ma. Implications there appeared mixed both short and long term.

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



With the short-term Active Studies list dominated by bullish studies the green Aggregator line is showing the net expectation is for upside over the next few days. The black Aggregator line is showing that the SPX has underperformed expectations over the last few days to a larger degree than any time shown on the chart. A strongly oversold (versus expectations) market with positive expectations suggests a short-term upside edge. Based on this configuration the Aggregator System remained long at the close.

Tomorrow the green Aggregator line is expected to remain positive. With studies expiring rapidly the Aggregator will be highly dependent on studies that may emerge in the next few days. The pivot level for the Differential value on Wednesday will be 1,197.87. In other words, it will take a close at or above this level in order to flip the Differential line negative.

It again appears the SPX is setting up for a short-term bounce and I will look to take advantage of it.

***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)*

### ***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 @ \$117.65 LIMIT. I'll look to re-enter based on the Aggregator and the short-term outlook above. This limit price is \$0.13 above the close in case of a gap up. I am being a little aggressive here in that I don't want to pay up too much but I won't wait for a fill to enter.*

*SPY – buy ¼ index position @ \$117.51 LIMIT ON CLOSE. Should the market close down again I will continue to scale in.*

*MON – buy 1/3 position @ \$61.47 LIMIT. I will look to enter the 2<sup>nd</sup> Catapult trigger tomorrow as well.*

## **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	\$61.47	-1.81%		Catapult

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