

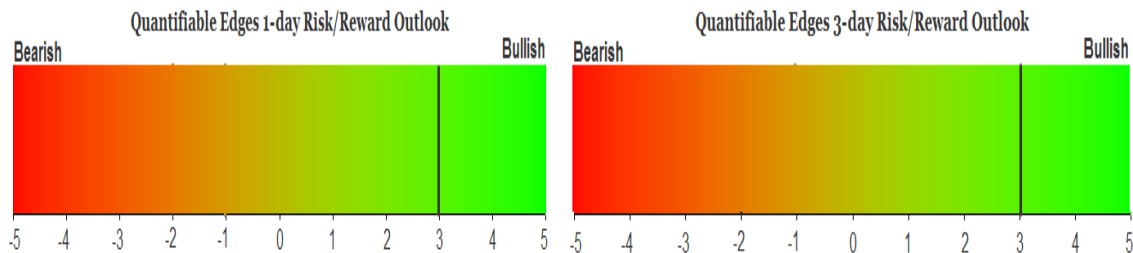
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 10, 2010

Volume 3 Issue 88

Market Overview



Tonight's Research Points

- The market situation is very abnormal as selloffs this strong don't often happen right after a strong move up.
- Mondays after down Fridays have performed very well over the last year plus.
- If the SPY can manage to gap up at least 1.5% on Monday then odds favor continued buying throughout the day.
- The Aggregator System remained long at the close.
- The NDX Aggressive Trend Timer changed to flat at the close.

Short-term Outlook – updated 5/10

The Bottom Line

The market is extremely oversold. It has been primed to bounce. Bailout news arrived today and so far the reaction is strongly positive. If the strong reaction can continue through the open then it SHOULD continue throughout Monday. Monday may begin to tell a lot about the bounce's potential for success.

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
Active				
May 10, 2010	Mondays after down Fridays Since 3/09	1 day	Bullish	
May 7, 2010	VIX 40% above 10ma.	1-2 days	Bullish	
May 6, 2010	Gap & partial reverse from 5-day low	1-10 days	Bullish	3.30%
Active - Long Term				
April 26, 2010	No breadth divergence at new high	int. term	Bullish	
Dropped Tonight				
February 16, 2010	Nasdaq/S&P RS Indicator Positive	int. term	Bullish	

If the avg max move is achieved the study will appear in **bold italic blue** and no longer be active

The Evidence

The stock market bludgeoning continued on Friday as the major indices all fell by sizable amounts yet again. The S&P sank 1.5%, the Nasdaq 2.3% and the Russell 2.9%. Breadth was again very negative as would be expected. The NYSE Up Issues % was 28% and the Up Volume % came in at 14%. Total volume was only down a small amount from Thursday's wild ride day.

Except for my CBI indicator, which is still at a fairly insignificant "4", nearly every other short-term indicator is extremely oversold. The market remains primed for a bounce. Of course this bounce is several days overdue as the market has been gripped in fear and has ignored historical precedents.

Most unusual about this selloff is that it came from a market that had been acting so strong – both in term of breadth and price. Massive selloffs almost never occur at times the market is engaged in a strong uptrend as the market was just a couple of weeks ago. Ordinarily there is a weakening of breadth and then price follows. And when price tops it is often done quietly. Crashes most often occur in a market that has already been exhibiting some weakness.

Using my SPX data going back to 1960 I looked for other times the SPX had fallen 12.5% from high to low over a 10-day period, closed at a 10-day low, and still managed to close above its 200ma. Thursday was the first time ever. I also ran the same parameters in the Dow. I found a few instances there that occurred between 1928 and 1933. The moral here is that the recent rally has now deteriorated in such a way that no trader under about 90 years old has experienced.

I'd encourage readers to review the intermediate-term section from the October 12, 2009 Letter. In this letter I examined all major SPX market tops since 1970 and showed how there was at least some breadth deterioration evident among all of them. At the top two weeks ago there was no such deterioration. This is no guarantee of anything but it implies that price may very well make another high here at some point before the next big bear market emerges. It also suggests that breadth should deteriorate as this next high is reached if in fact a bear is readying to emerge.

A link to that Letter is below:

[2009-10-12 QE Weekly Research Letter.pdf](#)

Going back to examining price drops from highs I did loosen the requirements some to find a few examples of other steep drops. I looked for any time time market closed at least 8% below it's 10-day intraday high (which was also a 100-day high). I was able to find 3 other instances. The charts are below.



In 1980 the sharp drop from highs was soon followed by a bounce. This bounce didn't quite make it back to the previous highs and a move down began.

Next is 1982.



This 8% drop from a high ended up looking like a hiccup as the market bounced immediately and then resumed its uptrend.

The only other instance was in April of 1987.



Here again we see an immediate bounce. In this case the low was tested a couple of times over the next month before the uptrend reasserted itself.

I wouldn't draw too many conclusions from just 3 instances. What I notice though is that all three experienced a quick bounce very shortly after they reached these levels. What happened after that was different in each case. One bounce led to the market rolling over, one led to a period of consolidation before the uptrend resumed and the other one saw the uptrend resume right away.

Also interesting about the current drop is that fear has spiked so rapidly. The VIX has now closed more than 25% above its 10ma for 3 days in a row. This is something that has only happened 5 other times. I ran those charts as well for subscribers to examine tonight. Those charts are all below. I won't comment on them individually but will offer some observations after showing all of them.







So what I see here is that each selloff ended with a sharp bounce. In no case did the selloff persist for more than 2 more days before the bounce occurred. The bounce was often short-lived, though. Other than the 2001 instance, the lows were always retested. Lastly, the only instance that occurred within a short time from when the market had been making new highs was in 2007. The rest were either established downtrends or tops that were a month old or more.

In the May 3rd Letter I showed how the market had performed on Mondays that followed down Fridays since just after the bottom in March 2009. I've updated those results below.

SPX Performance on the Day Following a Down Friday.
\$100k/trade. 3/20/09 - present.

TradeStation Performance Summary			
All Trades			
Total Net Profit	\$23,678.01	Profit Factor	3.98
Gross Profit	\$31,626.24	Gross Loss	(\$7,948.23)
Total Number of Trades	26	Percent Profitable	80.77%
Winning Trades	21	Losing Trades	5
Even Trades	0		
Avg. Trade Net Profit	\$910.69	Ratio Avg. Win:Avg. Loss	0.95
Avg. Winning Trade	\$1,506.01	Avg. Losing Trade	(\$1,589.65)
Largest Winning Trade	\$7,069.40	Largest Losing Trade	(\$3,466.02)

The last 11 instances and 15 of the last 16 have been winners.

Stats here are overwhelmingly bullish. Below I have listed the last 16 instances dating back to last September.

SPX Performance on the Day Following a Down Friday.
\$100k/trade. 9/09 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
09/11/09	Buy	\$1,042.73	0.63%	\$665.95
09/14/09	Sell	\$1,049.34		(\$734.35)
09/25/09	Buy	\$1,044.38	1.78%	\$1,971.25
09/28/09	Sell	\$1,062.98		\$0.00
10/02/09	Buy	\$1,025.21	1.49%	\$1,684.89
10/05/09	Sell	\$1,040.46		\$0.00
10/16/09	Buy	\$1,087.68	0.94%	\$1,136.59
10/19/09	Sell	\$1,097.91		(\$109.20)
10/23/09	Buy	\$1,079.60	(1.17%)	\$1,117.80
10/26/09	Sell	\$1,066.95		(\$1,322.04)
10/30/09	Buy	\$1,036.19	0.65%	\$1,535.04
11/02/09	Sell	\$1,042.88		(\$653.76)
11/20/09	Buy	\$1,091.38	1.36%	\$1,911.00
11/23/09	Sell	\$1,106.24		\$0.00
11/27/09	Buy	\$1,091.50	0.38%	\$522.34
11/30/09	Sell	\$1,095.63		(\$477.75)
01/15/10	Buy	\$1,136.03	1.25%	\$1,268.96
01/19/10	Sell	\$1,150.23		(\$7.04)
01/22/10	Buy	\$1,091.76	0.46%	\$1,020.11
01/25/10	Sell	\$1,096.78		\$0.00
01/29/10	Buy	\$1,073.87	1.43%	\$1,442.43
02/01/10	Sell	\$1,089.19		\$0.00
02/12/10	Buy	\$1,075.51	1.80%	\$1,854.72
02/16/10	Sell	\$1,094.87		\$0.00
03/12/10	Buy	\$1,149.99	0.05%	\$85.14
03/15/10	Sell	\$1,150.51		(\$734.44)
03/19/10	Buy	\$1,159.90	0.51%	\$681.12
03/22/10	Sell	\$1,165.81		(\$603.72)
04/16/10	Buy	\$1,192.13	0.45%	\$476.42
04/19/10	Sell	\$1,197.52		(\$701.35)
04/30/10	Buy	\$1,186.69	1.31%	\$1,548.96
05/03/10	Sell	\$1,202.26		\$0.00
05/07/10	Buy	\$1,110.88	n/a	\$0.00
open	n/a	\$1,110.88		\$0.00

After finishing much of the research tonight and getting some of the writing of the Letter done I see that the futures are up sharply. They are about 2.5% above the Friday's close as I type a little after 11pm EST.

I've shown a few times before that large gaps up when the market is extended downwards, tend to follow through to the upside during the day. There is still a lot of time before the open tomorrow morning, so there's really no telling how much the market gaps up if at all, but with the head start it has tonight I thought it would be worthwhile to run some stats.

The study below looks at different size up gaps that occurred immediately after SPY 10-day lows. It looked to buy SPY at 9:31, just after the gap occurs, and sell it at the 4pm close.

After closing at a 10-day low, SPY gaps up at least X% the next morning. Buy at 9:31am EST and sell at 4:00pm EST. \$100k/trade.										
X%	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
2.5	15,195.53	3	3	0	100.00	5,065.18	0.00	100.00	100.00	5,065.18
2.0	23,161.27	7	6	1	85.71	4,130.46	-1,621.50	2.55	15.28	3,308.75
1.5	30,644.47	11	10	1	90.91	3,226.60	-1,621.50	1.99	19.90	2,785.86
1.0	17,211.89	18	13	5	72.22	2,602.61	-3,324.41	0.78	2.04	956.22

What I see here is that any gap of 1.5% or more stands a very good chance of continuing higher from open to close. Note that while the stats look good for “above 1%”, really between 1% and 1.5% there were 7 trades. Only 3 were winners and they lost a net of about 13% among those 7. So a 1% gap up I wouldn’t get excited about.

Below I have listed all the instances of 1.5% or higher.

After closing at a 10-day low, SPY gaps up at least 1.5% the next morning. Buy at 9:31am EST and sell at 4:00pm EST. \$100k/trade.					
Date/Time	Signal	Price	% Profit	Run-up	DrawDown
09/24/01 09:31	Buy	\$99.80	0.68%	\$1,362.72	
09/24/01 16:00	Sell	\$100.48			(\$741.48)
05/08/02 09:31	Buy	\$106.98	2.07%	\$2,222.92	
05/08/02 16:00	Sell	\$109.19			(\$177.46)
07/17/02 09:31	Buy	\$92.50	(1.62%)	\$864.80	
07/17/02 16:00	Sell	\$91.00			(\$2,972.75)
03/11/08 09:31	Buy	\$130.65	1.32%	\$1,384.65	
03/11/08 16:00	Sell	\$132.38			(\$1,300.50)
09/18/08 09:31	Buy	\$117.95	2.24%	\$3,252.48	
09/18/08 16:00	Sell	\$120.59			(\$3,515.05)
10/13/08 09:31	Buy	\$94.08	7.21%	\$7,349.04	
10/13/08 16:00	Sell	\$100.86			(\$966.42)
10/28/08 09:31	Buy	\$87.59	7.32%	\$7,462.14	
10/28/08 16:00	Sell	\$94.00			(\$3,491.46)
11/21/08 09:31	Buy	\$77.02	4.34%	\$4,555.98	
11/21/08 16:00	Sell	\$80.36			(\$3,478.64)
01/21/09 09:31	Buy	\$81.96	2.54%	\$2,781.60	
01/21/09 16:00	Sell	\$84.04			(\$1,817.80)
03/04/09 09:31	Buy	\$71.27	0.65%	\$2,244.80	
03/04/09 16:00	Sell	\$71.73			(\$1,206.58)
03/10/09 09:31	Buy	\$69.48	3.93%	\$4,158.71	
03/10/09 16:00	Sell	\$72.21			(\$115.12)

While 10 of 11 were winners, many of the winners had large intraday pullbacks below the opening price.

I pointed out that even with the high number of winners, many of them saw sizable pullbacks intraday. Intraday traders may want to keep an eye on such pullbacks since they could prove to be nice long-side trading opportunities.

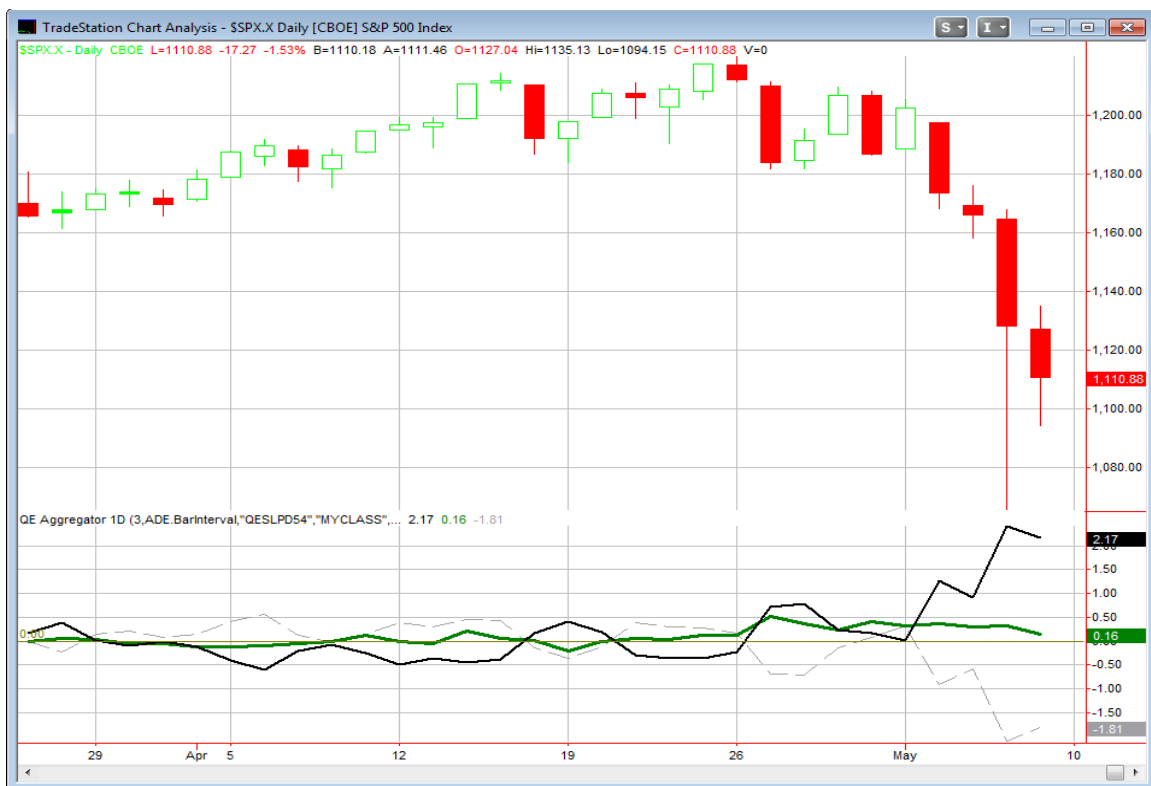
The reason for the large gap up at this point is thanks to a bailout package announced over the weekend. Subscribers may recall that I discussed on Thursday night that “good news” would be forthcoming very soon. Governments will want to “save” the market. When a package arrives the reaction to that “good” news will be extremely important. Should they fail to prop the market up for even a short while then watch out below. Below is a quote from the [Bloomberg column tonight discussing the EU announcement](#).

...Obama yesterday emphasized "the importance of the members of the European Union taking resolute steps to build confidence in the markets," White House spokesman Bill Burton told reporters in Hampton, Virginia.

*"In the night, when the markets are opening, we cannot afford a disappointment," said Finance Minister **Anders Borg** of Sweden, one of 11 EU nations not in the euro...*

So far the announcement has been received positively. Based on the current market conditions and how the market has typically reacted in the past, we should see some follow through Monday. If we don't that could signal more very bad days just ahead.

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



Same story tonight from the Aggregator chart. The green Aggregator line continues to hold well above zero, illustrating the net expectation over the next few days from the active studies is for more upside. Meanwhile the black Differential line also remains well above 0. This shows the SPX has strongly underperformed expectations over the last few days. So with the market strongly oversold versus expectations and current expectations positive, both lines are above zero and a bullish edge is suggested. The Aggregator System remained long at the close.

Looking ahead the green Aggregator line is likely to remain positive as long as this selloff persists. I don't envision this changing until a bounce arrives. The strength of that bounce may very well be a large key to its success. Often after a strong selloff, if the resulting bounce is meek then the market will quickly roll over. If the bounce gets off to a strong start that ups the odds for further success.

The pivot level for the black Differential line will be 1,174.84 on Monday. This means the SPX will need to gain over 5.75% for the Differential line to flip negative.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/10 neutral

I actually discussed most of the intermediate-term implications in the short-term section above, so I don't have a lot more to add here tonight. One notable is that Nasdaq/S&P Relative Strength indicator which is tracked on the charts page, flipped this week so that the S&P is now leading for the 1st time in a few months. This isn't necessarily bearish, but rather a neutral position.

There were also 2 bearish studies that were eliminated from the active list on Thursday night as they met their targets with the big selloff Thursday.

As shown above, breadth and price action are suggesting new highs. Meanwhile the VIX stretch charts seen above are suggesting a bit of a consolidation is likely. In any case, judging the intermediate-term is more difficult when the short-term is so in flux. I'll be watching the bounce closely this week and evaluating further based on the implications suggested by the bounce.

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)

NEW

AMGN -1/3 position @ \$54.46

FCX - 1/3 position @ \$67.59

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 2 (MON-2, AMGN, FCX)

In times of trouble the Catapult System becomes my favorite way to trade outside of my Aggregator-based index positions. There haven't been many Catapults yet. Hopefully the market will bounce strongly from here as seems likely. If not we could see the number of Catapults increase quickly. I am hoping to be able to update the Catapult presentation later this week since that is long overdue.

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.

AMGN – buy 1/3 position @ \$54.46. Based on Catapult trade shown above.

FCX – buy 1/3 position @ 67.59 Based on Catapult trade shown above.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pri	% Gain/Los	Stop	Notes
MON(1/3)	4/29/2010	\$62.60	\$59.09	-5.61%		Catapult
MON(1/3)	5/5/2010	\$60.74	\$59.09	-2.72%		Catapult
SPY(1/4)	5/5/2010	\$116.56	\$111.26	-4.55%		
SPY(1/4)	5/5/2010	\$116.82	\$111.26	-4.76%		
SPY(1/4)	5/6/2010	\$112.94	\$111.26	-1.49%		

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