

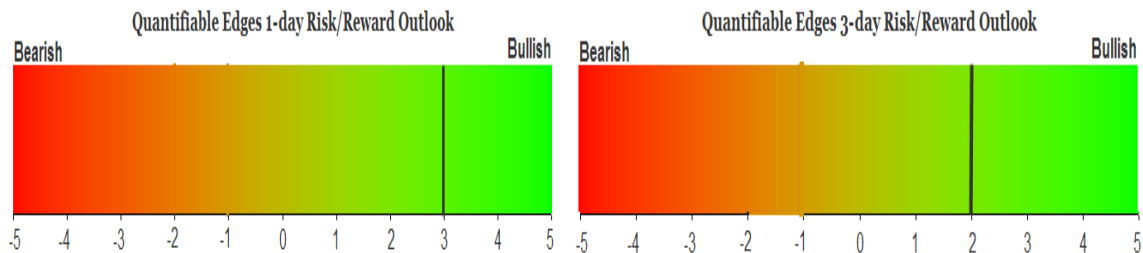
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 17, 2010

Volume 3 Issue 93

Market Overview



Tonight's Research Points

- NYSE Up Volume % of under 5% suggests some panic selling was present on Friday, which typically leads to a bounce.
- Down Fridays have consistently been followed by up Mondays over the last year plus.
- A large gap down after the market has already dropped 2 days in a row has historically led to a positive risk/reward setup for the rest of the day.
- The Aggregator System remained long at the close.
- The NDX Aggressive Trend Timer went long at the close.

Short-term Outlook – updated 5/17

The Bottom Line

The bottom line hasn't really changed since Thursday. Expectations are positive. The situation does remain tenuous and volatile, though. I'm looking to slowly scale in to a long index position.

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 17, 2010	Down Friday	1 day	Bullish	
May 17, 2010	5% Up Vol. SPX >200ma or >10day low	1-3 days	Bullish	3.80%
May 14, 2010	Gap lower then outside day down	1-4 days	Bullish	2.10%
May 6, 2010	Gap & partial reverse from 5-day low	1-10 days	Bullish	3.30%
Active - Long Term				
May 17, 2010	Nasdaq/SPX Relative Strength Indicator	int. term	Bullish	
May 13, 2010	2 of 3 75% Up Issues. No 10-high.	1-2 weeks	Bearish	
April 26, 2010	No breadth divergence at new high	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 market got hammered again on Friday. After gapping down and selling off all morning it fell into a range in the afternoon. When it was over the SPX had lost 1.9%, the Nasdaq 2.0% and the Russell 2000 2.2%. Breadth was extremely negative as the NYSE Up Issues % came in at 12% and the Up Volume % was a measly 4.5%. Total volume rose on both the NYSE and Nasdaq.

The Quantifinder showed a high number of green studies at the close on Friday, suggesting a bounce should be near. I'll discuss of the more compelling ones.

Breadth that was so extremely negative as was seen on Friday is rare. It is especially rare when the market is not already downtrending and reaching oversold levels. The NYSE Up Volume % of 4.5% suggests nearly everything was being sold. Indiscriminate selling like this hints at panic. Below are a couple of former studies that exemplify this. This 1st one is from the 11/30/09 Letter.

NYSE Up Vol % < 5%. SPY closes > lowest close in last 10 days. Buy SPY 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	26,389.22	10	9	1	90.00	3,477.50	-4,908.24	0.71	6.38	2,638.92
4	24,893.68	10	8	2	80.00	4,389.67	-5,111.84	0.86	3.43	2,489.37
3	19,032.49	10	7	3	70.00	4,004.52	-2,999.71	1.33	3.11	1,903.25
2	16,547.60	10	9	1	90.00	2,279.82	-3,970.80	0.57	5.17	1,654.76
1	17,953.85	10	9	1	90.00	2,037.01	-379.24	5.37	48.34	1,795.39

**All 10 instances closed above the entry price
on either day 1 or day 2.**

Instances are low, but with all ten bouncing in the next day or two this does suggest a bit of an upside edge – especially when considering the size of the average trade.

Another study that keyed off the low Up Volume % was last seen in the 2/5/10 blog. I've updated that study below.

NYSE Up Volume % < 5%. SPX > 200ma. Buy SPX 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
10	23,183.65	7	6	1	85.71	4,114.69	-1,504.49	2.73	16.41	3,311.95
9	24,149.94	7	7	0	100.00	3,449.99	0.00	100.00	100.00	3,449.99
8	23,033.92	7	7	0	100.00	3,290.56	0.00	100.00	100.00	3,290.56
7	22,689.72	7	7	0	100.00	3,241.39	0.00	100.00	100.00	3,241.39
6	20,992.73	7	6	1	85.71	3,583.63	-509.07	7.04	42.24	2,998.96
5	20,595.57	7	6	1	85.71	3,476.73	-264.83	13.13	78.77	2,942.22
4	13,209.11	7	6	1	85.71	2,497.59	-1,776.42	1.41	8.44	1,887.02
3	11,183.36	7	6	1	85.71	2,005.54	-849.87	2.36	14.16	1,597.62
2	9,871.43	7	6	1	85.71	1,745.04	-598.78	2.91	17.49	1,410.20
1	8,302.80	7	5	2	71.43	1,816.38	-389.54	4.66	11.66	1,186.11
All 7 instances closed above the entry price on either day 1 or day 2.										

Again we see very positive results from a very low number of instances.

One way to sometimes get instances up to a reasonable level and generate better estimates is to combine similar studies. I therefore tried combining the above studies to see how the results looked. There wasn't much overlap between the two so the instances did increase a bit.

NYSE Up Volume close < 5%. SPX closes either > 200ma or > 10-day low. Buy SPX 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	37,369.76	15	11	4	73.33	4,071.14	-1,853.20	2.20	6.04	2,491.32
4	28,892.77	15	11	4	73.33	3,855.06	-3,378.24	1.14	3.14	1,926.18
3	32,976.09	15	11	4	73.33	3,202.11	-561.78	5.70	15.67	2,198.41
2	28,501.71	15	13	2	86.67	2,254.75	-404.99	5.57	36.19	1,900.11
1	25,786.52	15	13	2	86.67	2,043.51	-389.54	5.25	34.10	1,719.10
All 15 instances closed above the entry price on either day 1 or day 2.										

Results here are consistent with the 1st 2 tests.

One edge I've discussed several times recently is that down Fridays have been consistently followed by up Mondays since just after the bottom in March 2009. I've updated that study again below.

SPX performance on the day following a down Friday.
\$100k/trade. 3/20/09 - present.

TradeStation Performance Summary Collapse ↕			
All Trades			
Total Net Profit	\$28,074.51	Profit Factor	4.53
Gross Profit	\$36,022.74	Gross Loss	(\$7,948.23)
Total Number of Trades	27	Percent Profitable	81.48%
Winning Trades	22	Losing Trades	5
Even Trades	0		
Avg. Trade Net Profit	\$1,039.80	Ratio Avg. Win:Avg. Loss	1.03
Avg. Winning Trade	\$1,637.40	Avg. Losing Trade	(\$1,589.65)
Largest Winning Trade	\$7,069.40	Largest Losing Trade	(\$3,466.02)

The last 12 instances and 16 of the last 17 have been winners.

Stats here are overwhelmingly bullish. Below I have listed the last 17 instances dating back to last September.

SPX performance on the day following a down Friday.
\$100k/trade. 9/9/09 - 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	4.40%	\$4,767.30
05/10/10	Sell	\$1,159.73		\$0.00

While tonight's studies are all bullish, I should point out a few cautionary notables.

- 1) Last week I looked at the 5 other instances where the VIX closed at least 25% above its 10ma for 3 days in a row. One thing I noted after examining those charts was that *"Other than the 2001 instance, the lows were always retested."* The bounce is now obviously pulling back. A retest of the recent lows is a possibility.
- 2) Very little is oversold from a price standpoint. This is evidenced not only by the low CBI, but also the very low number of triggers on the system triggers page.

- 3) The study from Thursday night's Letter showed a strongly bullish short-term tendency. This was obviously completely ignored and overrun on Friday. When bullish setups are sold that hard it suggests that long-side risk is elevated.

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



The Active Studies List is dominated by bullish studies and this is reflected in the fact that the green Aggregator line is well above 0. The black Differential is also above zero, illustrating the SPX has solidly underperformed expectations over the last few days. Both lines above zero has historically provided a bullish short-term edge. The Aggregator System is long based on this configuration.

Looking ahead the green Aggregator line is set up to remain positive unless some compelling bearish evidence arrives. Meanwhile the Differential pivot value on Friday will be 1,169.13. In other words it would take a close at or above this level in order to flip the Differential line negative.

So under typical circumstances we should expect a bounce here based on several studies. Unfortunately as was pointed out in the cautionary notes above, we are not trading under normal circumstances. While I'm favoring the long side, I don't think it is a good time to get very aggressive.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/17 neutral

One positive intermediate-term indicator that emerged Friday was the Nasdaq/S&P 500 Relative Strength again began to favor the Nasdaq. I've discussed this indicator several times before, but for those who would like a refresher, below is a link to the original post:

<http://quantifiableedges.blogspot.com/2009/05/simple-powerful-timing-indicator.html>

The 2 strong up days on Monday and Wednesday last week that occurred without the SPX managing to hit a 10-day high suggest bearish implications. Below is the study from the Wednesday night letter that illustrated this:

NYSE Up Issues % > 75% in 2 of last 3 days. High < highest high of last 10 days. Buy SPX on close. Sell X days later. \$100k/trade. 1970 - 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	-24,084.16	14	4	10	28.57	2,422.57	-3,377.44	0.72	0.29	-1,720.30
9	-25,100.34	15	6	9	40.00	2,388.07	-4,380.97	0.55	0.36	-1,673.36
8	-22,911.44	15	6	9	40.00	1,909.19	-3,818.51	0.50	0.33	-1,527.43
7	-14,751.96	15	6	9	40.00	2,735.37	-3,462.69	0.79	0.53	-983.46
6	-10,851.43	15	5	10	33.33	2,553.51	-2,361.90	1.08	0.54	-723.43
5	-8,955.02	15	7	8	46.67	1,939.97	-2,816.86	0.69	0.60	-597.00
4	4,662.08	15	10	5	66.67	1,517.92	-2,103.42	0.72	1.44	310.81
3	5,531.01	15	9	6	60.00	2,254.85	-2,460.44	0.92	1.37	368.73
2	786.94	16	10	6	62.50	1,430.05	-2,252.25	0.63	1.06	49.18
1	10,166.79	17	10	7	58.82	1,312.77	-422.99	3.10	4.43	598.05

Bottom line right now is that risk is elevated and intermediate-term signals are mixed. There is a high amount of uncertainty and although a bounce appears likely, what's beyond that is unclear. Using a bit extra caution when considering risk management and also looking to the short-term analysis to aide more in guiding decisions are two steps traders may want to consider.

Special Late Sunday Note

News out of Europe is being viewed unfavorably by the currency (Euros) and the U.S. stock index futures markets. As I type the S&P futures are down over 1%. Traders may want to review the below blog post from April of 2009 that discusses 1% gaps down. The current situation is reflected in the last study shown in the post.

<http://quantifiableedges.blogspot.com/2009/04/putting-large-gaps-down-into-context.html>

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 (filled @ \$60.74)

MON – 1/3 position @ \$55.54 limit (filled @ \$54.79)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 3 (MON-3)

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 @ \$113.34 LIMIT. If not filled in 1st ½ hour, cancel order and place as \$113.88 Limit ON CLOSE order. This is based on the short-term outlook and the Aggregator configuration. I will look to buy a gap down or early move lower in anticipation of a bounce. I am entering these trades slower than normal due to the increased risk noted in the short-term outlook as well.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pri	% Gain/Los	Stop	Notes
MON(1/3)	4/29/2010	\$62.60	\$54.61	-12.76%		Catapult
MON(1/3)	5/5/2010	\$60.74	\$54.61	-10.09%		Catapult
MON(1/3)	5/14/2010	\$54.79	\$54.61	-0.33%		Catapult
SPY(1/4)	5/14/2010	\$115.12	\$113.89	-1.07%		Aggregator

The MON triggers are getting hammered so far. This occasionally happens to Catapult triggers. Should the selloff worsen and a large cluster of other Catapults emerge, the later triggers often occur in groups and frequently post gains that eclipse the early triggers' losses. Of course as I frequently mention the volatile nature of these trades demands small position sizes or some kind of options strategy. I meant to update the Catapult presentation last week and hopefully will get to it this week.

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