

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

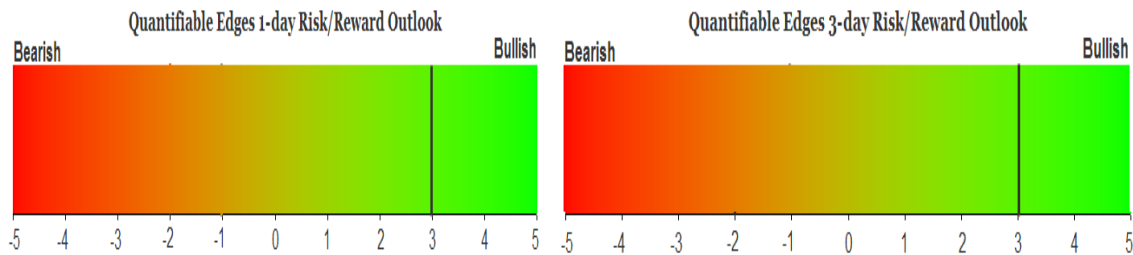
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June 7, 2010

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## Market Overview



## Tonight's Research Points

- Extremely low Up Volume % suggests selling overdone and likely to bounce.
- Strong selloff's on Fridays have also suggested upside.
- The SPY gap down and further selloff after a short-term move higher suggests there could be more downside.
- The Aggregator System changed to long at the close.
- The NDX Aggressive Trend Timer change to long.

## ***Short-term Outlook – updated 6/7***

### ***The Bottom Line***

The market has again quickly moved to short-term overdone. Additionally there is substantial evidence that it is likely to bounce. I'm favoring the long side.

*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
<b>Active</b>				
June 7, 2010	Gap dn 0.5% and close 1% below that	1-4 days	Bearish	-3.60%
June 7, 2010	Up vol % < 3%	1-2 days	Bullish	3.20%
June 7, 2010	2.5% drop on Friday	1-3 days	Bullish	2.80%
May 28, 2010	2.5% Rise CBI Still Over 5	1-5 days	Bullish	
May 28, 2010	Double 90% Up Vol	1-9 days	Bullish	
<b>Active - Long Term</b>				
June 1, 2010	Nas/S&P Relative Strength favors Nas	int. term	Bullish	
May 25, 2010	Rat Adj McClellan < -60 for 6 in row	1-20 days	Bearish	-5.80%
April 26, 2010	No breadth divergence at new high	int. term	Bullish	
<b>Dropped Tonight</b>				
<i>June 3, 2010</i>	<i>VXO 15% below 10ma.</i>	<i>1-5 days</i>	<i>Bearish</i>	<i>-2.50%</i>
<i>June 4, 2010</i>	<i>Low vol low range and close &gt; 10m</i>	<i>1-4 days</i>	<i>Bearish</i>	<i>-1.90%</i>
June 4, 2010	Friday after Memorial Day	1 day	Bullish	

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

***The Evidence***

Friday was another very bad day on Wall St. A large gap down never filled and the market spent nearly the entire day hitting lower and lower levels. The Nasdaq and SPX both fell around 3.5% while the Russell 2000 lost a little over 5%. Breadth was extremely bad as well. The NYSE Up Issues % was slightly under 10% and the Up Volume % was incredibly below 1%. Total volume spiked above the low levels we'd seen over the last 5-6 days, but was still quite a bit below the May volume peaks.

Breadth this extreme is remarkable. According to my database there have only been 4 other days since 1970 where the NYSE Up Volume % came in at under 1%. I've listed them below along with their next-day returns.

NYSE Up Volume % < 1%. Buy SPX on close. Sell next days close. \$100k/trade. 1970 - present.				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
10/19/87	Buy	\$224.83	5.34%	\$9,226.32
10/20/87	Sell	\$236.83		(\$3,716.28)
10/26/87	Buy	\$227.66	2.43%	\$4,451.46
10/27/87	Sell	\$233.19		\$0.00
10/27/97	Buy	\$876.97	5.12%	\$5,257.68
10/28/97	Sell	\$921.86		(\$2,473.80)
02/27/07	Buy	\$1,399.14	0.55%	\$1,189.25
02/28/07	Sell	\$1,406.82		(\$176.79)

Traders may also want to look at these dates on a chart. You'll note that they all either marked an intermediate-term low, or were very close to one.

In the 2/5/10 letter I looked at days with the Up Vol % was less than 3%. I revisited that study tonight and reran the stats:

NYSE Up Volume % < 3%. 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	24,040.89	10	6	4	60.00	6,143.57	-3,205.13	1.92	2.88	2,404.09
4	12,549.73	10	5	5	50.00	4,469.41	-1,959.46	2.28	2.28	1,254.97
3	12,724.72	10	7	3	70.00	2,315.33	-1,160.87	1.99	4.65	1,272.47
2	20,373.39	10	8	2	80.00	2,722.23	-702.22	3.88	15.51	2,037.34
1	13,067.95	10	8	2	80.00	2,545.59	-3,648.40	0.70	2.79	1,306.80

**All 10 instances closed above the entry price at some point in the next 3 days.**

Instances are still very few but there does appear to be a propensity for the market to bounce over the next few days.

It's also notable that the strong drop occurred on a Friday. Prior to the Crash of '87, which occurred on a Monday, the market dropped over 6% on the Friday. Since that time there has been a substantial upside tendency for the market to bounce over the next few days following an especially weak Friday. I showed this in the 11/2/09 blog and have updated the study below:

SPX closes down at least 2.5% on a Friday.  
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
10	36,521.28	22	16	6	72.73	3,342.16	-2,825.56	1.18	3.15	1,660.06
9	42,701.97	22	15	7	68.18	3,612.27	-1,640.29	2.20	4.72	1,941.00
8	49,236.10	22	15	7	68.18	4,292.25	-2,163.94	1.98	4.25	2,238.00
7	59,150.61	22	15	7	68.18	4,604.58	-1,416.87	3.25	6.96	2,688.66
6	53,172.51	22	16	6	72.73	4,188.50	-2,307.26	1.82	4.84	2,416.93
5	36,177.07	22	16	6	72.73	3,307.97	-2,791.74	1.18	3.16	1,644.41
4	21,303.17	22	14	8	63.64	3,156.13	-2,860.33	1.10	1.93	968.33
3	31,202.51	22	18	4	81.82	2,344.54	-2,749.81	0.85	3.84	1,418.30
2	29,354.57	22	16	6	72.73	2,402.09	-1,513.16	1.59	4.23	1,334.30
1	7,583.22	22	16	6	72.73	1,240.96	-2,045.36	0.61	1.62	344.69

21 of 22 instances closed above the entry price at some point in the next week. The lone exception was 11/14/2008.

These stats appear quite bullish for the short-term.

Of course I've noted in recent weeks that down Friday's since the market bottom in March 2009 have had a strong inclination to bounce the next day. This is demonstrated in the below study.

SPX closes down on Friday.  
Buy on close. Sell next day's close. \$100k/trade. 3/9/2009 - present.

TradeStation Performance Summary				Collapse ^
All Trades				
Total Net Profit	\$26,483.69	Profit Factor	3.74	
Gross Profit	\$36,133.62	Gross Loss	(\$9,649.93)	
Total Number of Trades	29	Percent Profitable	79.31%	
Winning Trades	23	Losing Trades	6	
Even Trades	0			
Avg. Trade Net Profit	\$913.23	Ratio Avg. Win:Avg. Loss	0.98	
Avg. Winning Trade	\$1,571.03	Avg. Losing Trade	(\$1,608.32)	
Largest Winning Trade	\$7,069.40	Largest Losing Trade	(\$3,466.02)	

So if big drops on Fridays have shown a bullish edge for the next few days over a long period of time, and down Fridays have been especially bullish the next day over recent history, then the combination would seem to point to an upside edge over the next day or so.

Not all the studies came up roses though. When the SPY has been moving higher short-term and then gaps down big and closes much lower than the open, often there has been more downside follow-through. This can be seen in the study below from the 1/30/09 Subscriber Letter.

SPY gaps lower by 0.5%, does not fill its gap, and then closes 1% below the open. Yesterday's 3-period RSI > 60. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 1994 - 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	-20,212.00	18	6	12	33.33	2,948.74	-3,158.70	0.93	0.47	-1,122.89
4	-24,083.41	18	6	12	33.33	3,102.87	-3,558.39	0.87	0.44	-1,337.97
3	-22,573.74	19	7	12	36.84	1,637.41	-2,836.30	0.58	0.34	-1,188.09
2	-5,097.61	19	9	10	47.37	1,871.84	-2,194.42	0.85	0.77	-268.30
1	-6,931.38	19	10	9	52.63	1,103.80	-1,996.60	0.55	0.61	-364.81

16 of 19 instances (84%) closed below the entry price at some point in the next week.

So there is a bit of conflict, which isn't unusual. Overall the net expectation is for upside and that will be reflected in the [Aggregator](#) chart below.



Once again tonight the green Aggregator line remained above zero. This shows the net expectations from the active studies is for upside over the next few days. Meanwhile the black Differential line illustrates the SPX has underperformed expectations over the last few days. So we have positive expectations and a market that is oversold versus expectations. Historically this configuration has suggested a short-term upside edge. Based on this the Aggregator System went long at the close on Friday.

Looking ahead more bearish studies will need to emerge if the green Aggregator line is going to turn negative tomorrow. Meanwhile with the SPX as oversold as it is it will take quite a pop tomorrow to get above the Differential pivot, which will be 1,100.49. This means it would take an SPX close at or above this level in order for the Differential line to turn negative.

So while there is some suggestion of downside in the studies, overall I'm expecting the market to bounce over the next few days. I have some long exposure and will be looking to add more tomorrow.

I'm not looking to get too aggressive just yet. Even with the close so low, the SPY is still only a little below mid-range over the last 10-days on an intraday basis. So there is some room to the downside and I'll take a scaling-in approach.

As I finish this late on Sunday night the futures is down close to 1%. I ran the test below to see how the market had reacted to sizable gaps down under similar conditions in the past.

SPY gaps down at least 1% after closing at a 50-day low.  
Buy on open. Sell on close. \$100k/trade. 2003 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/22/08 09:30	Buy	\$126.46	3.61%	\$4,574.10
01/22/08 16:00	Sell	\$131.02		(\$363.40)
01/23/08 09:30	Buy	\$127.14	5.25%	\$5,289.78
01/23/08 16:00	Sell	\$133.81		(\$235.80)
09/16/08 09:30	Buy	\$117.22	3.97%	\$4,154.11
09/16/08 16:00	Sell	\$121.87		(\$59.71)
10/06/08 09:30	Buy	\$107.11	(0.78%)	\$475.83
10/06/08 16:00	Sell	\$106.27		(\$6,036.51)
10/08/08 09:30	Buy	\$97.59	0.86%	\$4,700.16
10/08/08 16:00	Sell	\$98.43		(\$798.72)
10/10/08 09:30	Buy	\$86.81	4.26%	\$8,206.63
10/10/08 16:00	Sell	\$90.51		(\$3,717.73)
10/27/08 09:30	Buy	\$85.96	(1.27%)	\$4,128.65
10/27/08 16:00	Sell	\$84.87		(\$1,488.64)
11/20/08 09:30	Buy	\$80.13	(5.43%)	\$2,967.86
11/20/08 16:00	Sell	\$75.78		(\$6,297.35)
02/20/09 09:30	Buy	\$76.73	0.89%	\$2,097.83
02/20/09 16:00	Sell	\$77.41		(\$1,250.88)
03/02/09 09:30	Buy	\$72.51	(2.66%)	\$565.39
03/02/09 16:00	Sell	\$70.58		(\$2,951.06)
05/21/10 09:30	Buy	\$105.91	3.00%	\$3,275.68
05/21/10 16:00	Sell	\$109.09		(\$254.88)

The incidents above have favored the upside, but it isn't overwhelming. Stops may be important for daytraders tomorrow as some of the drawdowns were sizable.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 6/7 neutral***

I've been seeing a fair amount of evidence that suggests to me the market is in a bottoming mode. Volatility has been elevated in way that is often seen around bottoms. By that I don't just mean readings like the short vs. long term average true range, or the VIX, or other standard measures of volatility. I also mean the absolute extremes we are seeing in indicators. The 1% Up Volume % on Friday is one example. The CBI remaining elevated for a substantial period of time is another. I discussed this last week in the Letter and in the blog. A link to the blog post is below:

<http://quantifiableedges.blogspot.com/2010/06/what-cbis-extended-stay-in-double.html>

It's dangerous to get too gung-ho on an intermediate-term basis until there is some upside confirmation. Therefore my outlook will remain neutral. I'm at the ready to move to intermediate-term bullish though once we see a nice bounce with some continued follow-through.

## **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)*

*EXC - 1/3 position @ \$40.59 limit (filled @ \$40.11)*

*EXC - 1/3 @ \$39.31 limit*

*EXC - final 1/3 @ \$38.06 limit*

*GILD - 1/3 @ \$34.82 limit (no fill)*

### ***Catapult for ETF's Trades***

*none*

### ***Broad Market Large Cap CBI - 7 (MON-3, EXC-3,,GILD)***

### **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 1/4 index position at \$106.82 limit. Based on the Aggregator and the short-term outlook above, I've look to edge back up to a 1/2 position with 1 SPY lot already active.*

### **Active Trades Table**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
MON(1/3)	4/29/2010	\$62.60	\$49.02	-21.69%		Catapult
MON(1/3)	5/5/2010	\$60.74	\$49.02	-19.30%		Catapult
MON(1/3)	5/14/2010	\$54.79	\$49.02	-10.53%		Catapult
SPY(1/4)	5/21/2010	\$105.91	\$106.82	0.86%		Aggregator
EXC(1/3)	5/20/2010	\$40.11	\$37.63	-6.18%		Catapult
EXC(1/3)	5/21/2010	\$38.50	\$37.63	-2.26%		Catapult
EXC(1/3)	6/2/2010	\$37.40	\$37.63	0.61%		Catapult

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