

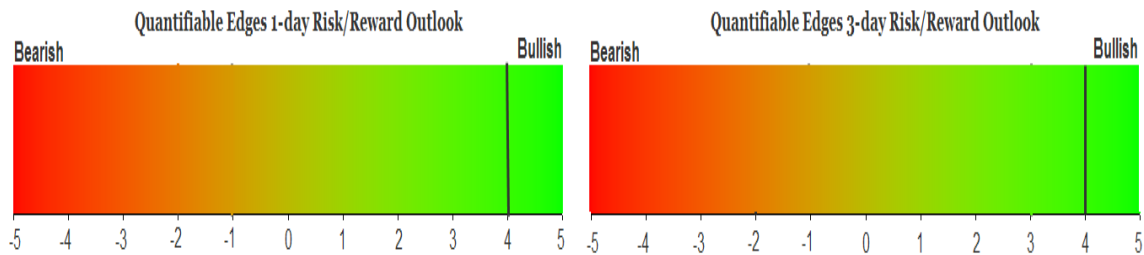
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 8, 2010

Volume 3 Issue 108

Market Overview



Tonight's Research Points

- 2nd day in a row with decliners more than doubling advancers makes for a strong edge.
- This edge is even more pronounced since tomorrow is a Tuesday.
- The Aggregator System remained long at the close.
- The NDX Aggressive Trend Timer remained long.

Short-term Outlook – updated 6/8

The Bottom Line

If the market doesn't bounce in the next day or so we will be operating well out of historical norms and it will be time to reconsider our positions. For now it appears the market IS poised to bounce.

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 | | | | |
| June 8, 2010 | Up Issue % < 33.3% 2 days in a row | 1-2 days | Bullish | 3.00% |
| 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 | Double 90% Up Vol | 1-9 days | Bullish | |
| Active - Long Term | | | | |
| 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 | |
| Dropped Tonight | | | | |
| May 28, 2010 | 2.5% Rise CBI Still Over 5 | 1-5 days | Bullish | |

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

The Evidence

After some fairly weak attempts to rally the market fell apart again in the last 2 hours of trading Monday. The SPX finished down 1.4% while the Nasdaq lost 2% and the Russell 2000 lost 2.5%. Breadth was again strongly negative. The NYSE Up Issues % closed at 26% and the Up Volume % at 15%. Total volume declined a bit from Friday's levels.

The most compelling study in the Quantifinder was actually a study that also just appeared last week on 6/2/10. It looked at 2 strong negative breadth days in a row. I've updated the results below:

| NYSE Up Issues % closes < 33.3% for exactly the 2nd day in a row. SPX < 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1999 - 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 | 52,844.23 | 37 | 28 | 9 | 75.68 | 3,039.06 | -3,583.27 | 0.85 | 2.64 | 1,428.22 |
| 4 | 27,484.89 | 39 | 23 | 16 | 58.97 | 3,119.32 | -2,766.22 | 1.13 | 1.62 | 704.74 |
| 3 | 34,675.43 | 42 | 25 | 17 | 59.52 | 3,571.34 | -3,212.24 | 1.11 | 1.63 | 825.61 |
| 2 | 49,305.96 | 42 | 29 | 13 | 69.05 | 3,004.70 | -2,910.02 | 1.03 | 2.30 | 1,173.95 |
| 1 | 44,851.13 | 42 | 28 | 14 | 66.67 | 2,210.69 | -1,217.73 | 1.82 | 3.63 | 1,067.88 |

41 of 42 instances (98%) closed above the entry price at some point in the next week.

For the considerable sample size and low number of criteria these results are astonishingly consistent. The stat at the bottom of the table is what seems most striking.

I should also point out that tomorrow is Tuesday, which happens to be the most likely day of the week for a turnaround – or at least a bounce. I examined this in the [1/13/09 blog](#). I therefore re-ran the above study with the following 2 adjustments: 1) I said that the Up Issues % had be below 33.3% for AT LEAST the 2nd day in a row, rather than EXACTLY the 2nd day in a row. 2) The trigger only occurred at the close if today was Monday. Below are those results:

NYSE Up Vol% closes under 33.3% for at least the 2nd day in a row. Today is Monday.
Buy SPX on close. Sell X days later. \$100k/trade. 1999 - 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 | 36,151.83 | 17 | 11 | 6 | 64.71 | 5,493.54 | -4,046.18 | 1.36 | 2.49 | 2,126.58 |
| 4 | 39,616.97 | 17 | 11 | 6 | 64.71 | 5,003.61 | -2,570.45 | 1.95 | 3.57 | 2,330.41 |
| 3 | 23,228.73 | 17 | 12 | 5 | 70.59 | 3,607.87 | -4,013.14 | 0.90 | 2.16 | 1,366.40 |
| 2 | 29,442.13 | 17 | 14 | 3 | 82.35 | 2,774.50 | -3,133.63 | 0.89 | 4.13 | 1,731.89 |
| 1 | 32,552.30 | 17 | 13 | 4 | 76.47 | 2,864.18 | -1,170.52 | 2.45 | 7.95 | 1,914.84 |

All 17 instances closed above their entry price either the next day or the day after.

As would be suspected the combination of the 2 studies tests even better.

So again tonight we are seeing strong evidence that the market is likely to bounce. Under almost every circumstance tested in the above studies the market did bounce within a few short days. In most cases it was within 1-2 days.

Unfortunately we have seen several studies with similar convictions over the last couple of weeks that just haven't panned out. The market has been a bit out of whack with historical norms. When it starts doing things it's never done before then it becomes harder to define risk and it makes for a more dangerous environment. Which means there is nothing wrong with taking a few extra precautions, such as reducing position sizes or utilizing option strategies to protect against catastrophe.

I have updated 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 strongly 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 remained long.

Looking ahead more the current batch of bullish studies is very short-term oriented. With all the expirations set to occur in the next 2 days the Aggregator could turn negative as soon as tomorrow depending on Tuesday's market action and studies. Meanwhile with the SPX as oversold as it is it would take quite a pop tomorrow to get above the Differential pivot, which will be 1,104.58. This means it would take an SPX close at or above this level in order for the Differential line to turn negative.

So I'm ½ in already on the long side for the index trade. Under more normal circumstances I might aggressively buy more here. In this case I'll simply look to add a bit more only if weakness is shown tomorrow. Details in the trade ideas section below.

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 ¼ index position at \$105.48 LIMIT ON CLOSE. Based on the Aggregator and the short-term outlook above, I will look to add another ¼ on a down close tomorrow..

Active Trades Table

| Symbol | Entry Date | Entry Price | Current Price | % Gain/Loss | Stop | Notes |
|----------|------------|-------------|---------------|-------------|------|------------|
| MON(1/3) | 4/29/2010 | \$62.60 | \$49.52 | -20.89% | | Catapult |
| MON(1/3) | 5/5/2010 | \$60.74 | \$49.52 | -18.47% | | Catapult |
| MON(1/3) | 5/14/2010 | \$54.79 | \$49.52 | -9.62% | | Catapult |
| SPY(1/4) | 5/21/2010 | \$105.91 | \$105.49 | -0.40% | | Aggregator |
| EXC(1/3) | 5/20/2010 | \$40.11 | \$37.73 | -5.93% | | Catapult |
| EXC(1/3) | 5/21/2010 | \$38.50 | \$37.73 | -2.00% | | Catapult |
| EXC(1/3) | 6/2/2010 | \$37.40 | \$37.73 | 0.88% | | Catapult |
| SPY(1/4) | 6/7/2010 | \$106.82 | \$105.49 | -1.25% | | Aggregator |

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