

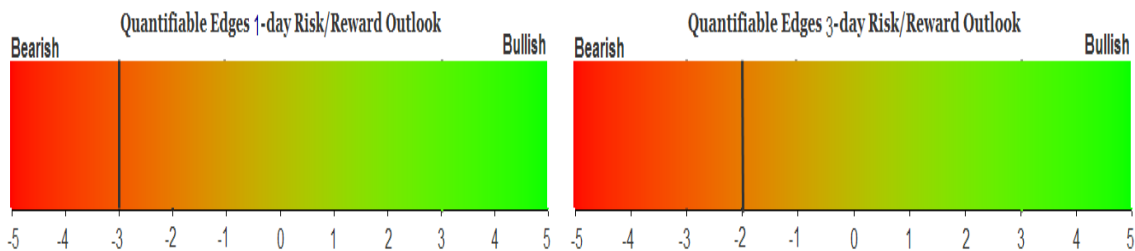
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 14, 2010

Volume 3 Issue 112

## Market Overview



## Tonight's Research Points

- Very low volume on the move higher suggest a pullback.
- 2<sup>nd</sup> day of strong breadth under the 200ma suggests a pullback.
- Sizable gap down and strong positive close suggest a pullback.
- The Aggregator System remained short at the close
- The NDX Aggressive Trend Timer remained long.

## Short-term Outlook – updated 6/14

### The Bottom Line

Volume, breadth and price action are all suggesting a short-term pullback. The general position of the market being one that is potentially emerging from an intermediate-term low increases short side risk. I'm looking for a pullback but positioning cautiously.

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 14, 2010	Low vol 20 days positive close up rng	1-2 days	Bearish	-1.20%
June 14, 2010	Gap down 0.5% close up & top 10% rng	1 day	Bearish	
June 14, 2010	Up Issue % >66.67 2nd day under 200	1-2 days	Bearish	-3.00%
June 11, 2010	SPX up 2.5%-3.5% on low vol	1-3 days	Bearish	-3.20%
June 7, 2010	Gap dn 0.5% and close 1% below that	1-4 days	Bearish	-3.60%
<b>Active - Long Term</b>				
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>				
June 9, 2010	SPX up Russ dn & 1% diff	1-3 days	Bearish	-3.00%

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

### *The Evidence*

A sizable gap down Friday morning marked the low of the day. The market quickly recovered then spent most of the day consolidating a little below breakeven before a burst in the final 30 minutes led to a strongly positive close. The SPX finished up 0.4% while the Nasdaq was up 1.1% and the Russell 2000 gained 1.5%. Breadth was strongly positive as the NYSE Up Issue % came in at 67% and the Up Volume % was 66%. There was very little volume behind the move, though as the NYSE and Nasdaq volume both came in at the lowest levels in over a month.

The Quantifinder showed studies associated with volume, breadth, and the gap down & reverse up price pattern seen Friday. All of these short-term studies suggest bearish implications. Below are some examples.

First, let's look at a couple of volume studies. This 1<sup>st</sup> one uses NYSE volume and is from the 11/16/09 Letter. The second one below uses SPY volume.

SPX closes up and > 10ma while NYSE volume is the lowest in 20 days. Buy 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	-36,076.12	67	29	38	43.28	1,533.73	-2,119.85	0.72	0.55	-538.45
4	-26,007.73	69	31	38	44.93	1,201.36	-1,664.47	0.72	0.59	-376.92
3	-29,605.87	73	32	41	43.84	1,082.37	-1,566.87	0.69	0.54	-405.56
2	-33,388.82	75	28	47	37.33	742.69	-1,152.85	0.64	0.38	-445.18
1	-14,935.97	82	38	44	46.34	646.59	-897.87	0.72	0.62	-182.15

SPY posts lowest volume in 20 days and closes at a 5-day high. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	-43,686.84	49	23	26	46.94	1,972.55	-3,425.21	0.58	0.51	-891.57
9	-41,790.94	50	27	23	54.00	1,905.27	-4,053.62	0.47	0.55	-835.82
8	-30,334.49	52	28	24	53.85	1,841.50	-3,412.36	0.54	0.63	-583.36
7	-36,019.64	53	28	25	52.83	1,616.96	-3,251.79	0.50	0.56	-679.62
6	-27,846.46	54	26	28	48.15	1,493.90	-2,381.71	0.63	0.58	-515.68
5	-33,996.08	58	26	32	44.83	1,415.60	-2,212.55	0.64	0.52	-586.14
4	-21,979.89	59	30	29	50.85	1,046.55	-1,840.56	0.57	0.59	-372.54
3	-28,664.34	60	24	36	40.00	974.75	-1,446.07	0.67	0.45	-477.74
2	-30,052.14	61	20	40	32.79	947.31	-1,224.96	0.77	0.39	-492.66
1	-17,233.04	64	26	38	40.63	892.40	-1,064.09	0.84	0.57	-269.27

Results are quite similar in both cases and are typical of the volume related studies I examined. For the most part the downside edge was pretty well played out in the first 2 days, though there were some possible mildly bearish implications a bit further out.

It was the 9/15/09 Subscriber Letter that examined gap downs that reversed and closed strong like Friday. Below I have updated the 1<sup>st</sup> study from that Letter.

SPY gaps lower by at least 0.5%. It then closes positive and in the top 10% of its daily range. 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	-13,060.09	45	22	23	48.89	1,887.08	-2,372.86	0.80	0.76	-290.22
4	-5,027.42	46	25	21	54.35	1,702.87	-2,266.63	0.75	0.89	-109.29
3	-18,464.21	47	23	24	48.94	1,408.36	-2,119.02	0.66	0.64	-392.86
2	-26,827.79	48	20	27	41.67	1,165.30	-1,856.81	0.63	0.46	-558.91
1	-25,534.38	49	16	32	32.65	837.96	-1,216.93	0.69	0.34	-521.11

Again we see a bearish suggestion that plays out within the first day or two.

Lastly, this was the 2<sup>nd</sup> day in a row of strongly positive breadth. The Quantifinder identified this as a pattern I examined in the 4/17/09 Subscriber Letter. I have updated the results below.

NYSE Up Issue % > 66.67% for 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
10	-42,867.20	18	6	12	33.33	2,176.58	-4,660.55	0.47	0.23	-2,381.51
9	-47,537.19	18	7	11	38.89	1,651.46	-5,372.49	0.31	0.20	-2,640.96
8	-39,322.16	18	6	12	33.33	1,571.11	-4,062.40	0.39	0.19	-2,184.56
7	-37,940.42	18	4	14	22.22	3,072.52	-3,587.89	0.86	0.24	-2,107.80
6	-32,563.79	19	7	12	36.84	1,718.96	-3,716.38	0.46	0.27	-1,713.88
5	-36,491.96	19	6	13	31.58	1,034.88	-3,284.71	0.32	0.15	-1,920.63
4	-41,675.41	21	6	15	28.57	951.55	-3,158.98	0.30	0.12	-1,984.54
3	-28,699.51	21	6	15	28.57	2,095.73	-2,751.59	0.76	0.30	-1,366.64
2	-36,488.05	21	4	17	19.05	2,790.12	-2,802.85	1.00	0.23	-1,737.53
1	-22,323.07	21	7	14	33.33	1,008.96	-2,098.98	0.48	0.24	-1,063.00

Again we see a large portion of the bearish implications realized in the first 2 days. The magnitude of the implications in this case is much greater as the average instance lost 1.7% in the first 2 days rather than the ½% drops the other tests were showing.

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



With tonight's bearish studies the green Aggregator line has moved further below zero. This shows the net expectations from the active studies is for lower prices over the next few days. Meanwhile the black Differential line illustrates the SPX has outperformed expectations over the last few days. So we have negative expectations and a market that is overbought versus expectations. This combination has historically provided a downside edge and is illustrated with both lines below zero. Based on this the Aggregator System remained short at the close.

Looking ahead the Aggregator is set up to remain negative tomorrow. This could change if we see some strongly bullish evidence. Meanwhile the Differential pivot will be 1,054.75 on Monday. This means it would take an SPX close at or below this level in order for the Differential line to turn positive. That would be over a 3% drop. So without a 3% drop on Monday there is no chance the Aggregator System will trigger a long signal.

As I mentioned Thursday night I'm not entirely comfortable getting aggressively short at this point. We are coming off a potential intermediate-term low which often means moves higher can be partially fueled by short-covering and have an ability to remain overbought and run farther and faster than at other times. Still, with so much evidence pointing to a pullback I'd be remiss if I didn't at least attempt a small short at this point.


***Intermediate-term Outlook (2 weeks – 2 months)– updated 6/14 neutral***


Before I discuss my outlook I'd like to show my version of a study that several subscribers asked me about this week. Somewhere it was published that drops of 13% or more in a 30-day period typically meant the market was likely to drop at least another 10%. Not knowing the exact parameters for this study, I created my own version.

A table showing all of the results is below.

SPX closes at least 13% below its 30-day high after not having done so for at least 20 days. Buy on close. Sell 20 days later. \$100k/trade. 1960 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
05/25/62	Buy	\$59.47	(11.80%)	\$268.96
06/25/62	Sell	\$52.45		(\$11,800.62)
08/29/66	Buy	\$74.53	4.79%	\$7,442.55
09/27/66	Sell	\$78.10		\$0.00
05/12/70	Buy	\$77.85	(2.06%)	\$860.28
06/09/70	Sell	\$76.25		(\$10,991.04)
11/26/73	Buy	\$96.58	(3.81%)	\$1,417.95
12/24/73	Sell	\$92.90		(\$4,574.70)
07/10/74	Buy	\$79.99	3.33%	\$6,250.00
08/07/74	Sell	\$82.65		(\$1,750.00)
08/21/74	Buy	\$73.51	(4.65%)	\$0.00
09/19/74	Sell	\$70.09		(\$11,301.60)
12/06/74	Buy	\$65.01	9.24%	\$9,320.28
01/07/75	Sell	\$71.02		\$0.00
08/21/75	Buy	\$83.07	3.38%	\$4,583.43
09/19/75	Sell	\$85.88		(\$1,178.94)
03/17/80	Buy	\$102.25	0.37%	\$3,390.19
04/15/80	Sell	\$102.63		(\$4,425.81)
09/18/81	Buy	\$116.25	2.53%	\$6,037.20
10/16/81	Sell	\$119.19		(\$5,211.60)
10/16/87	Buy	\$282.69	(13.11%)	\$0.00
11/13/87	Sell	\$245.63		(\$23,379.19)
08/22/90	Buy	\$316.55	(1.60%)	\$3,143.70
09/20/90	Sell	\$311.47		(\$3,269.70)
08/28/98	Buy	\$1,027.25	2.09%	\$3,768.45
09/28/98	Sell	\$1,048.70		(\$8,463.25)
03/12/01	Buy	\$1,180.30	(3.62%)	\$1,472.52
04/09/01	Sell	\$1,137.58		(\$8,325.24)
09/17/01	Buy	\$1,038.77	4.93%	\$5,797.44
10/15/01	Sell	\$1,089.98		(\$9,025.92)
07/02/02	Buy	\$948.09	(3.85%)	\$4,774.35
07/31/02	Sell	\$911.62		(\$18,103.05)
09/23/02	Buy	\$833.70	7.92%	\$7,969.43
10/21/02	Sell	\$899.72		(\$7,738.57)
01/22/08	Buy	\$1,310.51	3.78%	\$6,498.76
02/20/08	Sell	\$1,360.02		(\$3,074.96)
07/15/08	Buy	\$1,214.90	6.15%	\$8,056.50
08/12/08	Sell	\$1,289.60		(\$287.82)
09/29/08	Buy	\$1,106.42	(23.27%)	\$5,544.90
10/27/08	Sell	\$848.92		(\$23,995.80)
01/20/09	Buy	\$805.22	(2.09%)	\$9,007.36
02/18/09	Sell	\$788.42		(\$3,073.96)

 = instances that did NOT close 10% below entry within 75 days

 = instances whose 30-day high was also the 250-day high

The % profit column only shows 1-month results. Different time periods didn't look any more bearish. The suggestion that the current drop means we are in for at least another 10% downside doesn't seem to hold true if you limit the time frame to 75 days (a little over 3 ½ months). You can see this by noticing all the instances with the purple circle. I also marked the 4 times where the 30-day drop occurred when the market was coming off its high (green outlined boxes). This would match the current situation. None of those 4 saw an additional 10% drop. Based on these results it doesn't appear that the recent 13% market drop carries dire implications moving forward.

Overall the intermediate-term still remains a bit unclear to me. We reached some pretty hefty oversold extremes a couple of weeks ago that suggested a potential bottom could be appearing. Additionally there had been no breadth divergence at the highs which suggested an ordinary correction was much more likely than a new bear market.

There was a follow-through day on 6/2 that also marked the 2<sup>nd</sup> 90% up day within a week. Studies at that time suggested that perhaps the bottom was in place. Then the market tumbled right back down near its lows. The closing lows were broken but the intraday lows just barely held. So now the market is again trying to ramp higher. The last 2 times the SPX has closed above 1,100 it has quickly been struck back. A strong move through that area could complete a double bottom formation and lead to a rally.

In the short-term section we saw ample evidence that a pullback seemed likely. Also, while the NDX Aggressive Trend Timer is still on a buy signal the Nasdaq/S&P Relative Strength indicator now favors the S&P – which is no longer bullish. Often when the market is coming out of an intermediate-term bottom the Nasdaq and its higher beta will lead the S&P. So I'd like to see the Nasdaq regain some strength this week as well.

I'll watch the upper end of the recent range around 1106 to be broken before getting too bullish and I'll look at a close below the lower end of the range around 1040 as a potential bearish sign. Until one of those things happens I likely won't get too aggressive either way.

### **Catapult and Capitulative Breadth Statistics**

*(Catapult Presentation Part 1) - (Catapult Presentation Part 2)*

#### ***Open Catapult Triggers***

*GS – 1/3 @ \$133.77 limit*

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

*None*

#### ***Broad Market Large Cap CBI – 1 (GS)***

### **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 – short 1/4 position @ \$109.68 limit. Based on short-term outlook above.*

### **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>
GS(1/3)	6/11/2010	\$133.33	\$135.64	1.73%		Catapult

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