

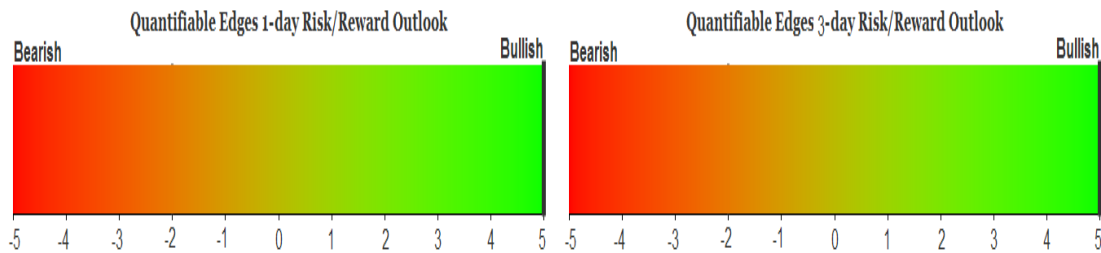
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 1, 2010

Volume 3 Issue 125

## Market Overview



## Tonight's Research Points

- The new month and new quarter after a bad last 2 days should bring in some buying.
- The low RSI2 and a new 50-day low are now suggesting a bounce.
- The Aggregator System remained long.
- The NDX Aggressive Trend Timer remained long.

## *Short-term Outlook – updated 7/1*

### *The Bottom Line*

Historical probabilities have been run over the last few days and we are now in some rare territory with some studies. A bounce appears the most likely scenario. Of course it would now be occurring at a lower level than initially anticipated.

*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>				
July 1, 2010	2 Down Days to finish quarter	1-2 days	Bullish	
July 1, 2010	2-day RSI < 2 & 50 low	1-2 days	Bullish	
June 30, 2010	CBI moves to 10 or higher	1-4 days	Bullish	
June 30, 2010	1% Gap then down to 50-low close	1-5 days	Bullish	4.70%
June 25, 2010	2 90% Down Days in 1 week	1-5 days	Bullish	4.70%
June 24, 2010	Fed Day / slowing from 20-hi pullbacks	1-6 days	Bullish	2.00%
June 23, 2010	1% drop and bad breadth	1-8 days	Bullish	1.90%
<b>Active - Long Term</b>				
June 21, 2010	Nas/SPX Relative Strength favors Nas	int. term	Bullish	
<b>Dropped Tonight</b>				
June 28, 2010	5 Lower Lows	1-3 days	Bullish	2.00%

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

### *The Evidence*

The market selling is starting to seem as though it will never end. In the last 8 days the SPX has fallen nearly 8%. Wednesday saw the SPX, Nasdaq, and Russell 2000 all lose between 1% and 1.2%. Breadth was solidly negative as the NYSE Up Issues % was 37% and the Up Volume % closed at 27%. Total volume declined from Tuesday's levels.

Studies appeared in the Quantifinder tonight related to breadth and seasonality. From a seasonality standpoint, Thursday is the 1<sup>st</sup> day of the month. Typically the 1<sup>st</sup> day of the month has been bullish and over the last 23 years July has started with 18 up days and just 5 down. I have also found that if the end of a month finished with 2 or more down days then the first few days of the next month were even stronger. And the edge seems to be even more pronounced when it is a quarter end. Below is a table from the October 1, 2009 blog that illustrates this. (Table not updated.)

<p style="text-align: center;">SPX closes down last 2 days of quarter. Buy on close. Sell X days later. \$100k/trade. 12/31/86 - present.</p>										
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	29,059.20	21	17	4	80.95	2,061.24	-1,495.49	1.38	5.86	1,383.77
4	25,934.28	21	17	4	80.95	1,874.96	-1,485.03	1.26	5.37	1,234.97
3	20,000.12	21	17	4	80.95	1,489.55	-1,330.56	1.12	4.76	952.39
2	24,400.44	21	18	3	85.71	1,466.25	-664.02	2.21	13.25	1,161.93
1	10,247.49	21	13	8	61.90	996.91	-339.05	2.94	4.78	487.98

One price study that appeared in the Quantifinder tonight used the 2-period RSI. It was last published in the 2/20/09 Letter and blog. I've updated results below.

**SPX 2-day RSI closes at 2 or lower while SPX closes at a 50-day low.  
Buy on close. Sell X days later. \$100k/trade. 1985 - 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	15,216.21	33	23	10	69.70	3,126.18	-5,668.60	0.55	1.27	461.10
4	36,212.25	33	24	9	72.73	2,518.16	-2,691.51	0.94	2.49	1,097.34
3	40,048.36	33	25	8	75.76	2,256.90	-2,046.77	1.10	3.45	1,213.59
2	48,877.40	36	28	8	77.78	2,425.02	-2,377.88	1.02	3.57	1,357.71
1	42,431.49	46	33	13	71.74	2,032.61	-1,895.74	1.07	2.72	922.42

**97% of all instances have posted a close above the entry price at some point in the next 4 days. This includes the last 20 in a row dating back to 1994.**

The positive implications are primarily seen in the first 2 days. And while we often seen studies with larger expectancies, the consistency of this one has been remarkable.

It's also notable that SPY finally triggered a Catapult for ETF's setup today. I showed QQQQ results in last night's Letter. Below are the returns for SPY dating back to its inception.

**SPY Catapult for ETF's Performance.  
\$100k/trade. 1993 - present.**

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$78,639.81	Profit Factor	24.68
Gross Profit	\$81,960.53	Gross Loss	(\$3,320.72)
Total Number of Trades	20	Percent Profitable	95.00%
Winning Trades	19	Losing Trades	1
Even Trades	0		
Avg. Trade Net Profit	\$3,931.99	Ratio Avg. Win:Avg. Loss	1.30
Avg. Winning Trade	\$4,313.71	Avg. Losing Trade	(\$3,320.72)
Largest Winning Trade	\$12,275.00	Largest Losing Trade	(\$3,320.72)

More strong numbers suggesting an upside edge. The average trade here lasted between 5 and 6 trading days.

So again we are seeing strong evidence that a bounce is well overdue. I'm full up on the index position and will only be adding Catapults at this point. My position is fairly

aggressive. I fully expect a bounce in the next few days. Should the bounce fail to materialize, based on the number and strength of the present active studies, we would find ourselves in an unprecedented situation.

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



With nothing but bullish studies still, the green Aggregator line again remains well above 0. This represents higher net expectations from the Active Studies over the next few days. Meanwhile the black Differential line illustrates the SPX has substantially underperformed expectations over the last few days. So we have positive expectations and a market that is oversold versus recent expectations. This setup has historically provided a bullish edge. The Aggregator configuration is considered bullish whenever both lines are above 0. Based on this the Aggregator System is again long.

Looking ahead the green Aggregator line is set up to remain positive tomorrow. Of course strong bearish evidence could change that outlook. Meanwhile the Differential pivot will be 1,080.09 tomorrow. This means it would take an SPX close at or above this level in order for the black Differential line to turn negative. That would be a very big up day.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 6/28 - slightly bullish***

After attempting to break out of a double bottom formation 2 weeks ago, the SPX got smacked right back down into the middle of that double bottom pattern this past week. On the week it lost over 3.5% and likely has put a quite a scare into traders that bought the breakout. We did see overall fear spike a bit this week with sentiment measures like the VIX and the CBOE Equity put/call ratios rising from complacent to mildly overdone levels.

I also got some notes about the fact that some intermediate and long term moving averages were starting to cross downward and that this was a potential bad sign. For instance on Friday the 40ma crossed and closed beneath the 200ma. Since 1960 when the 40ma has been below the 200ma the market has done slightly worse than breakeven. The performance has been pretty typical of what you see on the “short” side of a long-term moving average crossover system. For the 40/200 since 1961 there have been 25 down crosses. If you shorted every one and then covered or went long when the averages crossed again you would have made a profit 8 times and lost money 17 times. Obviously slightly better than breakeven short-side results were primarily due to a few sizable bear markets. During these times the winning short trades made up for all the instances where the market chopped lower and then rose again. The last signal which lasted from 12/13/07 to 6/18/09 was good for over a 38% gain on the short side. This actually accounts for nearly 30% of all short-side gains over the last 50 years.

I’m not a big fan of trading a moving average crossover system like this. I do think it could do a decent job of keeping someone out of the market if a massive bear market is about to begin. But bear markets create their own kind of opportunities – many of which occur in a short or swing-style time frame. So if a bear market does occur after this cross it should be viewed opportunistically rather than with great trepidation.

Personally, I still think the market is unlikely to fall into a protracted bear market at this point. We’ve seen fear and volatility levels hit areas that are capable of launching bull markets several times over the last month and a half. A number of breadth studies have also suggested the intermediate-term outlook favors the upside. I believe the market still has an attempt at new highs in it. And with the short-term outlook so full of bullish studies the move back up could begin at any moment.

Some upside confirmation would be helpful. A move higher in the next few days could mark a higher low on the SPX chart. Additional confirmation could come in the form of the SPX sticking above its 200ma and 50ma and making a few higher highs. So I don’t want to get carried away just yet, but I’m leaning slightly towards the long side.

## **Catapult and Capitulative Breadth Statistics**

[\*Catapult & CBI Presentation Link\*](#)

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

*LOW – 1/3 position @ \$21.76*

*AMZN – 1/3 position @\$118.33*

*RTN – 1/3 position @\$50.38 limit*

*MSFT – 1/3 position @ \$24.53 limit*

*MON – 1/3 position @ \$48.27 limit*

*F – 1/3 position @\$10.43 limit*

*MSFT – 1/3 position @ \$24.31 limit*

*MON – 1/3 position @ \$47.80 limit*

*F – 1/3 position @\$9.88 limit (no fill)*

*MSFT – 1/3 position @ \$23.31 limit (all in)*

*MON – 1/3 position @ \$47.34 limit (all in)*

*WAG – 1/3 position @ \$26.49 limit*

*MDT – 1/3 position @ \$36.21 limit*

*GD – 1/3 position @ \$59.43 limit*

***NEW***

*GD – 1/3 position @ \$58.56 limit*

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

*QQQQ @ \$43.37 limit*

***Broad Market Large Cap CBI – 14 (LOW, AMZN, RTN, MSFT-3, MON-3, F-2, WAG, MDT, GD-2)***

### **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.

GD – 1/3 position @ \$58.56 limit (Catapult trigger)

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY	6/23/2010	\$109.57	\$103.22	-5.80%		Aggregator
LOW	6/23/2010	\$21.71	\$20.42	-5.94%		Catapult
SPY	6/24/2010	\$108.69	\$103.22	-5.03%		Aggregator
SPY	6/25/2010	\$107.42	\$103.22	-3.91%		Aggregator
AMZN	6/25/2010	\$118.14	\$109.26	-7.52%		Catapult
RTN	6/28/2010	\$50.38	\$48.39	-3.95%		Catapult
MSFT	6/28/2010	\$24.51	\$23.01	-6.12%		Catapult
MON	6/28/2010	\$48.27	\$46.22	-4.25%		Catapult
F	6/29/2010	\$10.12	\$10.08	-0.40%		Catapult
MSFT	6/29/2010	\$24.13	\$23.01	-4.64%		Catapult
MON	6/29/2010	\$46.84	\$46.22	-1.32%		Catapult
MSFT	6/30/2010	\$23.30	\$23.01	-1.24%		Catapult
MON	6/30/2010	\$46.68	\$46.22	-0.99%		Catapult
WAG	6/30/2010	\$26.47	\$26.70	0.87%		Catapult
MDT	6/30/2010	\$36.16	\$36.27	0.30%		Catapult
GD	6/30/2010	\$58.92	\$58.56	-0.61%		Catapult
QQQQ	6/30/2010	\$43.23	\$42.71	-1.20%		Catapult
SPY	6/30/2010	\$103.92	\$103.22	-0.67%		Aggregator

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