

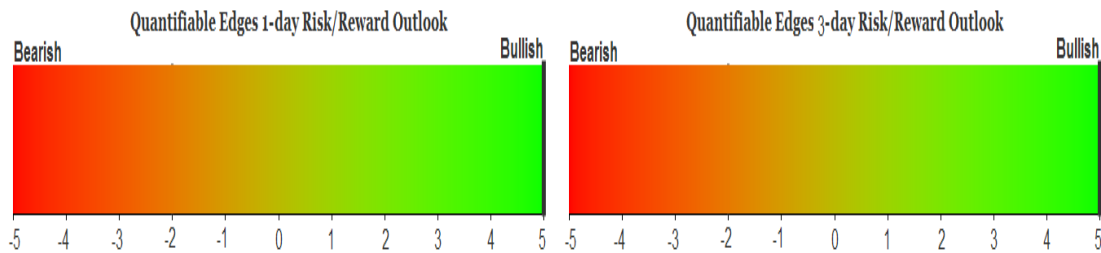
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 2, 2010

Volume 3 Issue 126

Market Overview



Tonight's Research Points

- Failing to immediately bounce from the RSI2<2 and 50-low setup appears to provide an even greater edge to the upside over the next few days.
- The Aggregator System remained long.
- The NDX Aggressive Trend Timer remained long.

Short-term Outlook – updated 7/2

The Bottom Line

Extremely oversold and bullish studies dominating the outlook. The market is very overdue for a bounce. Friday's employment report is a wildcard and could set the tone early.

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				
July 2, 2010	2-day RSI < 2 & 50 low	1-3 days	Bullish	4.40%
July 1, 2010	2 Down Days to finish quarter	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 23, 2010	1% drop and bad breadth	1-8 days	Bullish	1.90%
Active - Long Term				
June 21, 2010	Nas/SPX Relative Strength favors Nas	int. term	Bullish	
Dropped Tonight				
June 28, 2010	5 Lower Lows	1-3 days	Bullish	2.00%
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%

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

The Evidence

Another down day for the markets. Thursday the SPX closed down 0.3%, the Nasdaq 0.4% and the Russell 2000 shed 0.8%. Breadth was tilted negative as the NYSE Up Issues % was 40% and the Up Volume % came in at 42%. Total volume rose from Wednesday's levels.

The Quantifinder tonight was again dominated by bullish studies – though there weren't quite as many as we'd seen the last few days. An interesting and compelling study that has now appeared two nights in a row is the one that looks at when the SPX closes at a 50-day low with a 2-day RSI under 2. I showed updated results for this study last night. Since it repeated with the PSX making another down close, I thought it might be interesting to see how things have played out in the past when the setup has occurred 2 days in row.

SPX 2-day RSI closes below 2 while SPX closes at a 50-day low, both for the 2nd day in a row. 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	20,578.94	9	5	4	55.56	6,012.97	-2,371.47	2.54	3.17	2,286.55
4	14,414.90	9	5	4	55.56	4,154.66	-1,589.61	2.61	3.27	1,601.66
3	23,827.49	9	8	1	88.89	3,364.70	-3,090.08	1.09	8.71	2,647.50
2	24,154.34	10	7	3	70.00	4,201.99	-1,753.20	2.40	5.59	2,415.43
1	25,316.88	13	9	4	69.23	3,386.27	-1,289.90	2.63	5.91	1,947.45

Instances are low but there does appear to be an upside edge over the next few days. It appears Thursday's failure to bounce from the RSI2 / 50-low setup doesn't mean the market is now going to head lower. In fact the opposite appears more likely since 3 days later 8 of 9 instances are higher with an average return of about 2.65%.

In the 2/20/09 Letter when I first showed the RSI2 < 2 & 50-day low setup I showed how it would have performed using an RSI exit rather than just looking X days out. I've updated that study below as well.

SPX 2-day RSI closes at 2 or lower while SPX closes at a 50-day low.
Buy on close. Sell when RSI closes over X. \$100k/trade. 1985 - present.

X	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
70	28,494.88	30	25	5	83.33	2,601.33	-7,307.65	0.36	1.78	949.83
65	55,222.77	31	27	4	87.10	2,646.45	-4,057.82	0.65	4.40	1,781.38
60	61,663.83	31	27	4	87.10	2,683.83	-2,699.87	0.99	6.71	1,989.16
55	58,765.06	31	27	4	87.10	2,577.73	-2,708.45	0.95	6.42	1,895.65
50	54,895.56	31	27	4	87.10	2,438.09	-2,733.21	0.89	6.02	1,770.82
45	49,968.63	31	27	4	87.10	2,258.57	-2,753.21	0.82	5.54	1,611.89
40	48,691.90	31	27	4	87.10	2,211.29	-2,753.21	0.80	5.42	1,570.71
35	41,208.36	31	27	4	87.10	1,934.12	-2,753.21	0.70	4.74	1,329.30
30	41,208.36	31	27	4	87.10	1,934.12	-2,753.21	0.70	4.74	1,329.30
25	40,838.97	32	28	4	87.50	1,604.74	-1,023.42	1.57	10.98	1,276.22
20	41,908.27	32	30	2	93.75	1,507.68	-1,661.07	0.91	13.61	1,309.63
15	41,752.39	32	30	2	93.75	1,502.48	-1,661.07	0.90	13.57	1,304.76
10	41,752.39	32	30	2	93.75	1,502.48	-1,661.07	0.90	13.57	1,304.76

Regardless of the exit level there appears to be a solid upside edge.

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 1,048.09 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 sizable 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

MSFT – 1/3 position @ \$24.31 limit

MON – 1/3 position @ \$47.80 limit

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

GD – 1/3 position @ \$58.56 limit

NEW

GD – 1/3 position @ \$58.50 limit

WY– 1/3 position @ \$35.14 limit

WFC– 1/3 position @ \$25.18 limit

RTN– 1/3 position @ \$47.73 limit

Catapult for ETF's Trades

QQQQ @ \$43.37 limit

Broad Market Large Cap CBI – 17 (LOW, AMZN, RTN-2, MSFT-3, MON-3, WAG, MDT, GD-3, WY, WFC)

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 @ \$58.50 limit

WY– 1/3 position @ \$35.14 limit

WFC– 1/3 position @ \$25.18 limit

RTN– 1/3 position @ \$47.73 limit

All based on Catapults.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY	6/23/2010	\$109.57	\$102.76	-6.22%		Aggregator
LOW	6/23/2010	\$21.71	\$20.41	-5.99%		Catapult
SPY	6/24/2010	\$108.69	\$102.76	-5.46%		Aggregator
SPY	6/25/2010	\$107.42	\$102.76	-4.34%		Aggregator
AMZN	6/25/2010	\$118.14	\$110.96	-6.08%		Catapult
RTN	6/28/2010	\$50.38	\$47.73	-5.26%		Catapult
MSFT	6/28/2010	\$24.51	\$23.16	-5.51%		Catapult
MON	6/28/2010	\$48.27	\$46.05	-4.60%		Catapult
F	6/29/2010	\$10.12	\$10.57	4.45%		Sell on open
MSFT	6/29/2010	\$24.13	\$23.16	-4.02%		Catapult
MON	6/29/2010	\$46.84	\$46.05	-1.69%		Catapult
MSFT	6/30/2010	\$23.30	\$23.16	-0.60%		Catapult
MON	6/30/2010	\$46.68	\$46.05	-1.35%		Catapult
WAG	6/30/2010	\$26.47	\$26.56	0.34%		Catapult
MDT	6/30/2010	\$36.16	\$36.04	-0.33%		Catapult
GD	6/30/2010	\$58.92	\$58.50	-0.71%		Catapult
QQQQ	6/30/2010	\$43.23	\$42.59	-1.48%		Aggregator
SPY	6/30/2010	\$103.92	\$102.76	-1.12%		Aggregator
GD	7/1/2010	\$58.56	\$58.50	-0.10%		Catapult

F hit its end-of-day trigger price. Normally I will send out an intraday email with an alert when Catapults have hit or are likely to hit their exit triggers. I was on vacation and unable to do so today. I'm back now and will do so over the coming days. In any case, when an exit is hit the standard play is to sell the stock on the next day's open, so intraday alerts are a convenience rather than a necessity.

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