

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

---

July 12, 2010

Volume 3 Issue 131

---

## Market Overview



## Tonight's Research Points

- Several indications are now pointing to a pullback, and this combination seems unaffected by the fact we are bouncing off an intermediate-term low.
- IBD declared a Follow-Through-Day on Wednesday. Being that it was only the 2<sup>nd</sup> day off the bottom. History suggests you're better off requiring an FTD on day 4 or later.
- The Aggregator System remained flat.
- The NDX Aggressive Trend Timer remained flat.

## *Short-term Outlook – updated 7/12*

### *The Bottom Line*

The market is short-term overbought. The low volume and small range indicate a pullback is likely. The Aggregator is still neutral but that will change to bearish Monday at the close unless Monday brings about a strong selloff or additional bullish evidence.

*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 12, 2010	Low range low vol overbought < 200	1-4 days	Bearish	-3.20%
July 9, 2010	VXO 15% under 10ma	1-8 days	Bearish	-3.30%
July 9, 2010	3 up Low Range From 50-low	1-4 days	Bullish	2.50%
July 7, 2010	Low HV, no SPX highs	1-8 days	Bearish	-3.30%
July 7, 2010	McClellan Oscillator Bottom Divergence	1-4 days	Bullish	
July 6, 2010	inside day nr3 under 200ma	1-3 days	Bearish	
<b>Active - Long Term</b>				
July 5, 2010	5 down under 200 and 50 low	1-20 days	Bullish	
July 7, 2010	McClellan Oscillator Bottom Divergence	int term	Bullish	
<b>Dropped Tonight</b>				
July 7, 2010	SPX strong Russ weak	1-3 days	Bearish	-3.50%

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

***The Evidence***

Friday saw further price follow through as the market moved higher for the fourth day in a row. The major indices all put in solid gains as the SPX closed up 0.7%, the Nasdaq rose 1% and the Russell 2000 added 1.5%. Breadth was strongly positive. The NYSE Up Issues % came in at 77.5% and the Up Volume % was 82%. Total volume came in very light, though. On the NYSE it was the lowest volume in over a month.

A huge number of related studies appear in the Quantifinder Friday evening. They looked at measures such as low volume, narrow range, the short-term overbought nature of the market and the intermediate-term downtrend. I looked at some of these things on Thursday as well. At that point low volume was not an issue and the market was less overbought short-term. But while many of the studies suggested a bit of a pullback, the fact that the market was coming off a 50-day low took away the bearish edge.

This weekend I took another look with these now more extreme indications that included volume. Below is a combination of extremes that hit the market. And while the market closed at a 10-day high, I simply required a close above the 10ma. Otherwise instances would have been extremely low.

NYSE volume is the lowest in 10 days. SPX posts the narrowest range in 10 days and closes > 10ma but < 200ma. Buy on close. Sell X days later. \$100k/trade. 1989 - 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	-38,706.78	33	11	22	33.33	2,795.14	-3,156.97	0.89	0.44	-1,172.93
4	-45,986.12	33	14	19	42.42	1,711.43	-3,681.38	0.46	0.34	-1,393.52
3	-35,822.98	34	12	22	35.29	1,875.63	-2,651.39	0.71	0.39	-1,053.62
2	-33,641.37	34	12	22	35.29	1,376.43	-2,279.94	0.60	0.33	-989.45
1	-22,028.31	35	11	24	31.43	1,242.40	-1,487.28	0.84	0.38	-629.38

**86% of instances closed below the trigger price at some point in the next 4 days.**

Results here are strongly indicative of a bearish edge over the next few days. But we already know that short-side risk is elevated due to the fact that the market is in an initial thrust off a potential intermediate-term low. So I ran the test again and filtered to see only those instances where the 5-day low was equal to the 50-day low.

NYSE volume is the lowest in 10 days. SPX posts the narrowest range in 10 days and closes > 10ma but < 200ma. SPX 5-day closing low = 50-day closing low. Buy on close. Sell X days later. \$100k/trade. 1989 - 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
6	-10,279.37	7	1	6	14.29	5,748.96	-2,671.39	2.15	0.36	-1,468.48
5	-7,988.03	7	1	6	14.29	6,877.04	-2,477.51	2.78	0.46	-1,141.15
4	-5,746.68	7	3	4	42.86	2,138.92	-3,040.86	0.70	0.53	-820.95
3	-3,266.15	7	3	4	42.86	2,044.62	-2,350.01	0.87	0.65	-466.59
2	-1,199.33	7	4	3	57.14	1,129.89	-1,906.30	0.59	0.79	-171.33
1	2,893.37	7	4	3	57.14	1,672.19	-1,265.13	1.32	1.76	413.34

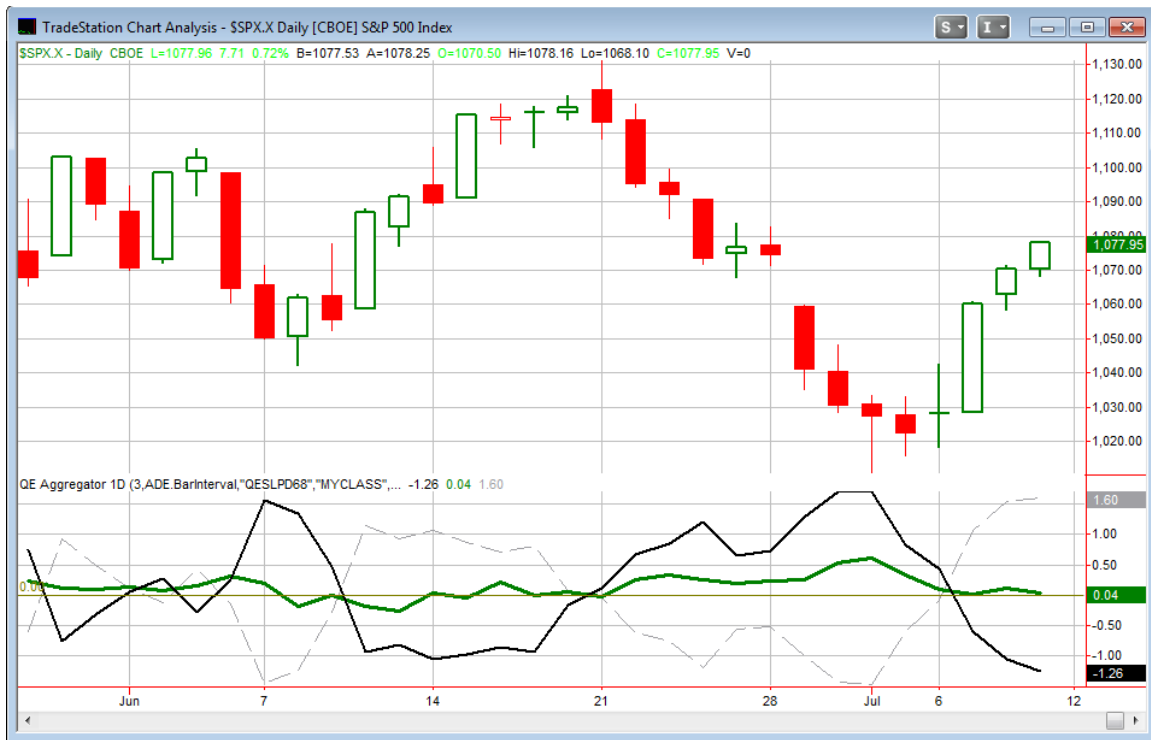
I wouldn't base any trades on these results all by themselves. What they do suggest to me is that when so many bearish forces are in play the fact that the market is coming off a potential intermediate-term low has not mattered. They suggest that the results of the 1<sup>st</sup> test may be useful and should not be discarded.

This upcoming week is option expiration week. Often this is a bullish week for the market. Historically, though, this has not held true for July. It has been one of the weakest months for options expiration. And while not outright bearish the bullish

influence is neutralized. I showed a breakdown by month in the 3/15/10 subscriber letter and blog.

<http://quantifiableedges.blogspot.com/2010/03/options-expiration-week-performance-by.html>

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



The green Aggregator line above 0 continues to reflect net upside expectations from the Active Studies List. Meanwhile the black Differential line shows the SPX has strongly outperformed expectations over the last few days. So we have positive expectations but a market that is substantially overbought versus recent expectations. This is considered a neutral setup. Based on this the Aggregator System remains flat.

Based on the current studies the green Aggregator line is set to flip to negative tomorrow. Of course strong bullish evidence could change that outlook. Meanwhile the Differential pivot will be 1,064.55 tomorrow. This means it would take an SPX close at or below this level in order for the black Differential line to turn positive. In all likelihood this means that another up day, or even perhaps a mild down day, will trigger a short signal for the Aggregator. Traders should be aware of this possibility.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 7/12 - neutral***

Last week I examined the large divergence that was forming in the McClellan Oscillator. The studies found that such a large divergence greatly increased the chances of an intermediate-term bottom being put in place should the market bounce. The market has bounced and that bottom now remains a possibility.

It was pointed out to me that IBD declared Wednesday to be a Follow-Through-Day. Since it was only the 2<sup>nd</sup> day off the bottom this seemed odd to me. I've done an [extensive series quantifying Follow-Through-Days](#). IBD's rules have been fluid over time and sometimes nonsensical based on the evidence. From all appearances they have done very little actual research on their own indicator, and have never shared any verifiable results.

One basic guideline IBD has suggested with Follow-Through-Days is that they should occur between the 4<sup>th</sup> and 10<sup>th</sup> day of the beginning of a rally. I examined FTD's after the 10<sup>th</sup> day in the [February 29, 2008 blog post](#). At that time I found that FTD's after day 10 are NOT less reliable as IBD claims. In fact, the small sample was much *more* reliable.

But what of FTD's that occur prior to Day 4?

Using the [original basic assumptions](#) from the January 14, 2008 study I adjusted the requirement from 4 days (standard) to 2 days (Wednesday's "FTD"). Below is a quick comparison since 1970. Again, refer to the original basic assumptions for definitions of success and failure of an FTD.

4<sup>th</sup> Day of Rally Is Earliest Possible FTD – 38 winners and 35 losers.  
2<sup>nd</sup> Day of Rally Is Earliest Possible FTD – 39 winners and 43 losers.

So it appears that allowing FTD's on day two did identify one additional rally. I looked to see when this additional "success" took place. It was July of 1973. The total rally only lasted 3 weeks. The reason it was "successful" if you entered on the FTD on the 2<sup>nd</sup> day off the bottom was that the "success" target of a move of twice the size of the distance from the bottom to the FTD was more easily achieved. This "successful" July rally never even went on to break the swing highs of May. Not exactly the kind of winner most traders would be disappointed to miss out on. And while it met the test definition, when looking at a chart it likely isn't a rally that most traders would even consider successful. Also note that shortening the requirement to 2 days from 4 days triggers 8 more losers.

I don't agree with many of IBD's teachings on FTD's, but in my eyes this particular rule (waiting until day 4) is a very good one. I personally wouldn't ignore it and am a bit surprised that they did.

So at this point the market has made a bounce with a sizable McClellan Oscillator divergence in place. It's certainly possibly that the market is on its way to a sizable rally and perhaps new highs. I'll want to see a bit more evidence before declaring that, though. Short-term the market appears nearly ready for a pullback. If the bulls can power through this short-term inclination, or if the pullback is able to hold above recent lows, then that could indicate probable success. I'm alert but non-committal at this point.

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

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

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

*none*

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

*none*

#### ***Broad Market Large Cap CBI – 0***

### **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.*

*None tonight.* Traders could check the Systems page to see if a short bias is setting up tomorrow in the Aggregator. If so, I will likely suggest a short for Tuesday in tomorrow night's letter.

### Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
LOW	6/23/2010	\$21.71	\$20.22	-6.86%		Sold on open
MON	6/28/2010	\$48.27	\$47.82	-0.93%		Sold on open
MON	6/29/2010	\$46.84	\$47.82	2.09%		Sold on open
MON	6/30/2010	\$46.68	\$47.82	2.44%		Sold on open
SPY	6/30/2010	\$103.92	\$107.96	3.89%		sell @ \$108.00 limit
LOW	7/6/2010	\$20.27	\$20.22	-0.25%		Sold on open
CVS	7/7/2010	\$28.55	\$29.48	3.26%		Sold on open
HD	7/7/2010	\$27.34	\$28.10	2.78%		Sold on open
LOW	7/7/2010	\$19.96	\$20.22	1.30%		Sold on open

Note I am now looking to exit the last bit of the SPY trade. I will likely look to re-enter once the bearish forces abate.

The current Catapult cluster is now closed. All trades took place between 6/23 and 7/9. There were 30 “fills” in the subscriber letter that were tracked. The average trigger made over 2% and the total gains (63.83% additive) were the highest for a single cluster since November of 2008. I’ve updated the results spreadsheet on the downloads page to reflect the recent activity. (Note it doesn’t include the current open SPY trade.)

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2010 Hanna Capital Management, LLC.