

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 16, 2010

Volume 3 Issue 135

Market Overview



Tonight's Research Points

- SPX up & VIX up again suggest a pullback in the next few days.
- The Aggregator System remained short.
- The NDX Aggressive Trend Timer remained flat.

Short-term Outlook – updated 7/16

The Bottom Line

The studies are still suggesting a pullback is likely, but I'm feeling a little cautious at this point. The failure of the bears to take advantage of bearish inclinations the last few days could give the bulls a chance. I'm watching just above \$110 as a possible important area.

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 16, 2010	SPX Up VIX Up	1-4 days	Bearish	-3.10%
July 15, 2010	SPY down but RSI(2) > 85	1-3 days	Bearish	-3.00%
July 14, 2010	Follow Through Day	1-6 days	Bullish	
July 14, 2010	75% Up Issue twice in 3 days	1-9 days	Bullish	3.30%
July 14, 2010	1% Gap No Fill 10-high < 200	1-5 days	Bearish	-3.70%
July 7, 2010	Low HV, no SPX highs	1-8 days	Bearish	-3.30%
Active - Long Term				
July 14, 2010	Follow Through Day	int term	Bullish	
July 14, 2010	75% Up Issue twice in 3 days	1-20 days	Bullish	
July 13, 2010	5 higher close from a 50-day low	int term	Bullish	
July 7, 2010	McClellan Oscillator Bottom Divergence	int term	Bullish	
July 5, 2010	5 down under 200 and 50 low	1-20 days	Bullish	
Dropped Tonight				
July 9, 2010	VXO 15% under 10ma	1-8 days	Bearish	-3.30%
July 12, 2010	Low range low vol overbought < 200	1-4 days	Bearish	-3.20%

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

The Evidence

After spending most of the day in negative territory the market rallied late on rumors of Goldman Sachs settling and BP capping the oil spill. At the end many indices were back near where they started. The SPX finished up 0.1% and the Nasdaq was just below breakeven. The Russell 2000 did a bit worse, closing down 0.9%. Breadth stats were just barely negative as the NYSE Up Issues % and Up Volume % both registered 48%. Total volume rose on the NYSE but not on the Nasdaq.

In Tuesday's Letter I examined times the SPX and VIX both closed higher. Below is an excerpt (studies not updated).

Also notable about Tuesday's action was that while the SPX put in a decent move higher, the VIX also rose. The study below was last published on 11/12/2009.

SPX & VIX both close higher on a Tuesday, Wednesday, or Thursday. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	-24,224.60	24	9	15	37.50	1,380.04	-2,443.00	0.56	0.34	-1,009.36
4	-39,097.95	25	7	18	28.00	1,214.18	-2,644.29	0.46	0.18	-1,563.92
3	-27,223.53	25	8	17	32.00	1,251.28	-2,190.22	0.57	0.27	-1,088.94
2	-22,321.60	25	8	17	32.00	1,567.26	-2,050.57	0.76	0.36	-892.86
1	-5,491.11	26	13	13	50.00	1,064.74	-1,487.14	0.72	0.72	-211.20

21 of 24 instances (87.5%) closed below the entry price at some point in the next week.

Implications here are solidly bearish.

Often when this study arises it does so when both the SPX and VIX are only up mildly. I though the day's sharp rise in the SPX was noteworthy and filtered further based on the size of the gain. I had the keep the requirement down to a fairly mild 0.75% in order to get even a handful of instances.

SPX rises > 0.75% and VIX closes higher on a Tuesday, Wednesday, or Thursday. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	-11,928.91	6	1	5	16.67	810.03	-2,547.79	0.32	0.06	-1,988.15
4	-15,541.26	6	1	5	16.67	82.08	-3,124.67	0.03	0.01	-2,590.21
3	-18,092.10	6	0	6	0.00	0.00	-3,015.35	0.00	0.00	-3,015.35
2	-6,919.57	6	1	5	16.67	2,494.32	-1,882.78	1.32	0.26	-1,153.26
1	-3,187.61	6	2	4	33.33	559.91	-1,076.86	0.52	0.26	-531.27

Too few instances to make much out of but the stats do provide additional bearish fodder.

So we see that the SPX up & VIX up combination has implied a bearish bias over the next few days. But this bias has been quite a bit stronger on the occasions when the market was up a large amount. Thursday the SPX only closed up 0.1% - a very tame number. So does this mean the edge is diminished or even eliminated? I ran the stats on other times when the SPX/VIX up combination occurred and the SPX was only slightly higher (less than 0.25%). I found the results a bit surprising.

SPX rises between 0% and 0.25% and closes < 200ma. VIX closes up. Today is Tuesday, Wednesday, or Thursday. Buy on close. Sell X days later. \$100k/trade. 1998 - present.										
QE Finder Tester: daysin	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	-18,754.93	7	0	7	0.00	0.00	-2,679.28	0.00	0.00	-2,679.28
4	-18,928.78	7	1	6	14.29	126.15	-3,175.82	0.04	0.01	-2,704.11
3	-13,539.01	7	1	6	14.29	856.95	-2,399.33	0.36	0.06	-1,934.14
2	-20,259.30	7	0	7	0.00	0.00	-2,894.19	0.00	0.00	-2,894.19
1	-5,698.79	7	3	4	42.86	575.54	-1,856.35	0.31	0.23	-814.11

Times the SPX has only risen a little while under the 200ma when the VIX has also risen there has been strong selling on a consistent basis. A nearly 3% drop on average over the next 2 days and no instances trading higher. Instances are very low, but the results are very compelling and worth consideration. Below I have listed all 7 instances along with their 2-day exit.

SPX rises between 0% and 0.25% and closes < 200ma. VIX closes up. Today is Tuesday, Wednesday, or Thursday. Buy on close. Sell X days later. \$100k/trade. 1998 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
09/29/98	Buy	\$1,049.00	(5.97%)	\$0.00
10/01/98	Sell	\$986.40		(\$6,431.50)
03/08/01	Buy	\$1,264.76	(6.68%)	\$0.00
03/12/01	Sell	\$1,180.30		(\$6,950.42)
05/02/01	Buy	\$1,267.42	(0.06%)	\$7.02
05/04/01	Sell	\$1,266.60		(\$2,762.76)
11/14/01	Buy	\$1,141.21	(0.22%)	\$456.75
11/16/01	Sell	\$1,138.65		(\$982.23)
06/04/02	Buy	\$1,040.69	(1.11%)	\$904.32
06/06/02	Sell	\$1,029.15		(\$1,322.88)
06/08/06	Buy	\$1,257.93	(1.71%)	\$367.35
06/12/06	Sell	\$1,236.41		(\$1,716.67)
01/15/09	Buy	\$843.74	(4.57%)	\$1,698.02
01/20/09	Sell	\$805.22		(\$4,633.86)

Avg runup = 0.5%. Max Runup = 1.7%
 Avg drawdown = -3.5%. Smallest drawdown = -1.0%

The average downside was over 7 times the size of the average upside for the next 2 days.

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



The Active List remains dominated by bearish studies and this is reflected in the green Aggregator line. The negative Aggregator line value indicates the net expectation from the Active Studies over the next few days is for downside. Meanwhile the black Differential line shows the SPX has outperformed expectations over the last few days. So we have negative expectations and a market that is overbought versus recent expectations. This configuration has historically provided a downside edge. Based on this the Aggregator System remained short at the close.

Based on the current studies the green Aggregator line is now set to remain negative through Monday before turning back to bullish. Yesterday it looked as though the Aggregator might turn bullish after Friday. Tonight's SPX/VIX redux has pushed that likelihood off until Monday's close. Of course strong bullish evidence could change this. Meanwhile the Differential pivot will be 1,091.33 tomorrow. This means it would take an SPX close at or below this level in order for the black Differential line to turn positive. That's not much of a selloff at this point.

It's been a fairly tight range the last few days. A move through \$110 at this point could spark some more buying. If we open lower on Friday and don't scream higher immediately I may consider implementing a stop around \$110.20 or so. Once above the highs of the last few days there isn't much resistance until around the 200ma near \$111.43. I'd rather not let things go against me that much, so I'd perhaps take a stop out and consider re-entry if we approach the 200ma or close a bit above my stop.

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 2nd 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 4th and 10th day of the beginning of a rally. I examined FTD's after the

10th 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.

4th Day of Rally Is Earliest Possible FTD – 38 winners and 35 losers.

2nd 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 2nd 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

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	7/13/2010	\$109.15	\$109.68	-0.49%		
SPY(1/4)(s)	7/14/2010	\$109.66	\$109.68	-0.02%		

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