

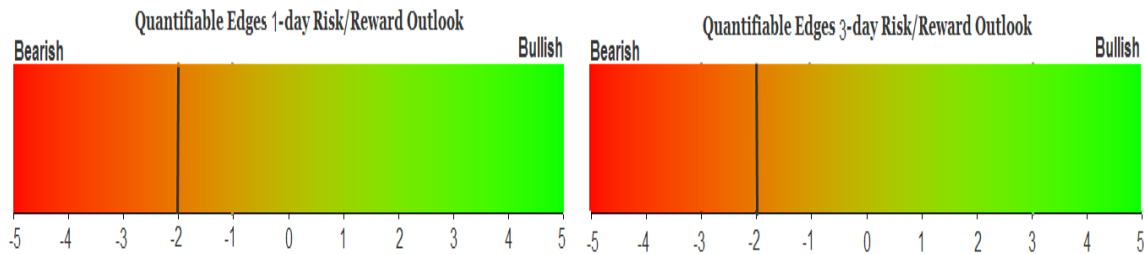
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 27, 2010

Volume 3 Issue 142

Market Overview



Tonight's Research Points

- 3 70% Up Days in the past has consistently led to further gains.
- 3 higher close while volume declines the last 2 suggests a pullback.
- The Aggregator System remained short.
- The NDX Aggressive Trend Timer remained flat.

Short-term Outlook

The Bottom Line

A bullish study tonight not quite enough to tip the scales to the bulls.

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 27, 2010	3 70% Up Issues Days	1-2 days	Bullish	1.80%
July 27, 2010	3 up 2 lower vol SPX > 200ma	1-3 days	Bearish	-1.20%
July 26, 2010	SPY 20-hi under 200ma. Volume lower.	1-2 days	Bearish	-1.70%
July 26, 2010	2 70% Up Days under 200ma 20 hi	1-3 days	Bearish	1.40%
July 20, 2010	2% drop. Then Up Issue%>60, dn vol	1-6 days	Bearish	-5.50%
Active - Long Term				
July 26, 2010	Nasdaq/S&P RS favors Nasdaq	int term	Bullish	
July 20, 2010	Down 1 week after FTD	int term	Bearish	
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 22, 2010	1% drop. No 20 high. Bad breadth.	1-9 days	Bullish	3.00%

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

The Evidence

Despite overbought conditions and evidence favoring a pullback the market powered forward on Monday. The SPX rose 1.1%, the Nasdaq 1.2% and the Russell 2000 gained 2.3%. Breadth was again strong as the NYSE Up Issues % came in at 80% and the Up Volume % was 88%. Total NYSE volume came in at the lowest level in over a week.

There was mixed studies pointed out by the Quantifinder tonight. There were several positive breadth related studies. There were also a few bearish studies that examined 3 up days. Most of them looked at SPY because it finished under its 200ma (by \$0.01). The SPX meanwhile closed above the 200ma. Therefore I'm inclined to ignore the studies with the sub-200ma requirement.

Below is one study from the 3/3/10 Subscriber Letter that looks at the price and volume pattern.

SPX closes higher at least 3 days in a row. NYSE volume declines at least 1 of the last 2 days. Close > 200ma. Buy SPX 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	595.73	125	68	57	54.40	1,331.51	-1,578.02	0.84	1.01	4.77
4	-13,487.48	135	68	67	50.37	1,202.27	-1,421.52	0.85	0.86	-99.91
3	-11,526.46	144	75	69	52.08	1,010.31	-1,265.21	0.80	0.87	-80.04
2	-869.31	161	85	76	52.80	711.67	-807.39	0.88	0.99	-5.40
1	-9,931.98	231	112	119	48.48	488.73	-543.44	0.90	0.85	-43.00

We see here a very mild downside inclination. But volume has not just dropped one of the last 2 days. It has dropped both of them. What if we use that as a requirement?

SPX closes higher at least 3 days in a row. NYSE volume declines last 2 days. Close > 200ma. Buy SPX 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	-7,093.11	53	27	26	50.94	1,071.93	-1,385.97	0.77	0.80	-133.83
4	-8,104.27	54	26	28	48.15	1,183.54	-1,388.44	0.85	0.79	-150.08
3	-12,376.89	54	28	26	51.85	982.55	-1,534.16	0.64	0.69	-229.20
2	-6,774.87	58	26	32	44.83	751.25	-822.11	0.91	0.74	-116.81
1	-6,683.07	68	32	36	47.06	532.85	-659.29	0.81	0.72	-98.28

Here the implications are a bit more bearish. Still not terribly strong though.

There is no doubt that the market is overbought. Often we see extreme strength reverse as profits are taken and price pulls back a bit. But sometimes when readings are extremely strong they instead suggest further strength. This is the case with several of the breadth related studies that appeared in the Quantifinder this evening. The most compelling of all though was not from the Quantifinder, but rather from the intraday update I sent to gold subscribers this afternoon.

NYSE Up Issues % closes > 70% for exactly the 3rd day in a row. Buy SPX on close. Sell X days later. \$100k/trade. 1967 - 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	23,507.31	16	11	5	68.75	2,905.20	-1,689.99	1.72	3.78	1,469.21
4	20,065.52	16	11	5	68.75	2,217.75	-865.94	2.56	5.63	1,254.10
3	14,636.85	16	9	7	56.25	2,647.91	-1,313.48	2.02	2.59	914.80
2	18,573.85	16	16	0	100.00	1,160.87	0.00	100.00	100.00	1,160.87
1	10,323.14	16	12	3	75.00	929.64	-277.53	3.35	13.40	645.20

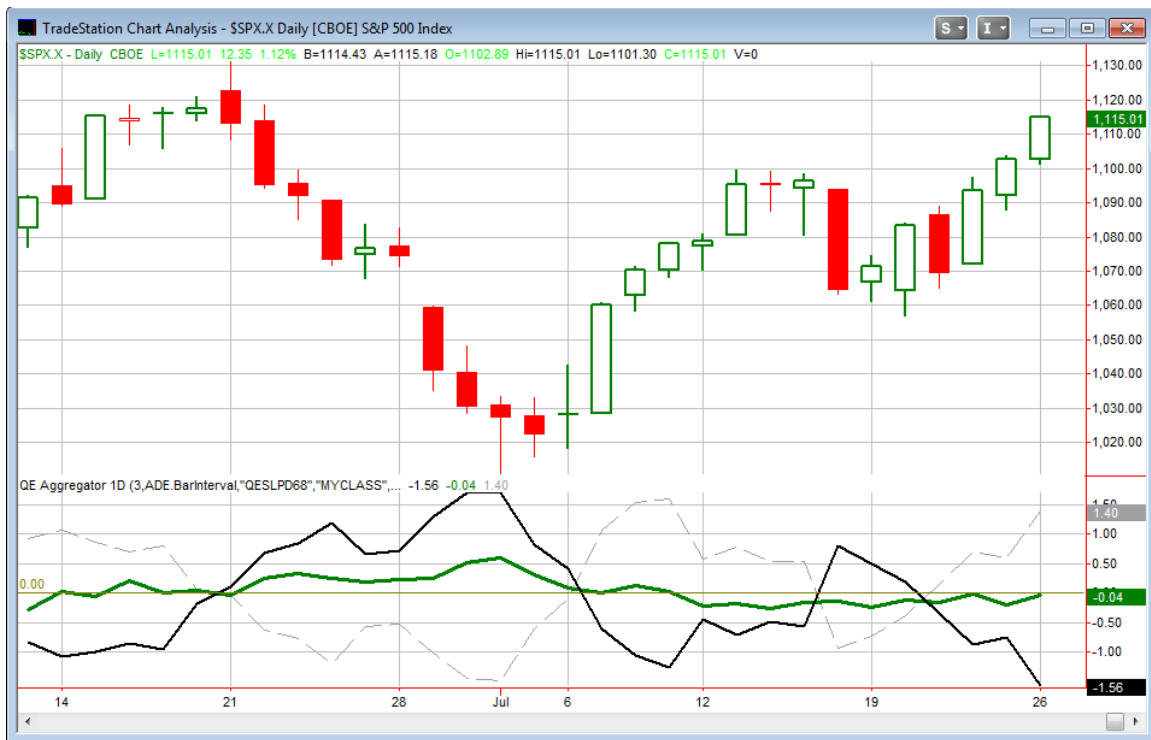
Sixteen for sixteen is some amazing consistency when looking 2 days out. Below I have listed all instances with their 2-day exit.

NYSE Up Issues % closes > 70% for exactly the 3rd day in a row.
Buy SPX on close. Sell 2 days later. \$100k/trade. 1967 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/09/67	Buy	\$82.81	0.80%	\$796.62
01/11/67	Sell	\$83.47		\$0.00
05/29/70	Buy	\$76.55	1.69%	\$1,684.74
06/02/70	Sell	\$77.84		\$0.00
10/11/74	Buy	\$71.14	0.42%	\$2,248.00
10/15/74	Sell	\$71.44		\$0.00
01/03/75	Buy	\$70.71	0.44%	\$509.04
01/07/75	Sell	\$71.02		\$0.00
01/05/76	Buy	\$92.58	1.48%	\$1,479.60
01/07/76	Sell	\$93.95		\$0.00
01/05/79	Buy	\$99.13	0.20%	\$836.64
01/09/79	Sell	\$99.33		(\$1,310.40)
08/18/82	Buy	\$108.52	4.15%	\$4,577.37
08/20/82	Sell	\$113.02		(\$1,077.57)
10/08/82	Buy	\$131.05	2.59%	\$4,555.11
10/12/82	Sell	\$134.44		\$0.00
03/03/83	Buy	\$153.47	0.12%	\$956.97
03/07/83	Sell	\$153.66		(\$1,269.45)
08/03/84	Buy	\$162.35	0.22%	\$1,795.80
08/07/84	Sell	\$162.71		(\$953.25)
12/26/91	Buy	\$404.84	2.54%	\$2,541.63
12/30/91	Sell	\$415.13		(\$61.75)
03/21/07	Buy	\$1,435.04	0.07%	\$265.65
03/23/07	Sell	\$1,436.11		(\$356.04)
01/02/09	Buy	\$931.80	0.31%	\$1,289.35
01/06/09	Sell	\$934.70		(\$1,312.89)
04/02/09	Buy	\$834.38	0.13%	\$966.28
04/06/09	Sell	\$835.48		(\$1,379.21)
09/08/09	Buy	\$1,025.39	1.83%	\$1,818.75
09/10/09	Sell	\$1,044.14		(\$137.74)
07/09/10	Buy	\$1,077.95	1.61%	\$1,978.92
07/13/10	Sell	\$1,095.34		(\$690.00)

So it appeared the Aggregator was ready to turn bullish when I ran the numbers as we approached the close. At the time I neglected to notice that our “1% drop on bad breadth” study had reached its target price. Due to this it was removed from “Active” status tonight. The basic idea behind doing this is that once a study reaches its target then any further movement is attributable to forces other than the study. It could go up or down from here but the move suggested by the study has already been realized and therefore it is removed from “active” status.

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



Despite the extreme breadth study tonight the green Aggregator line remained below 0. 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. Historically this configuration has provided a downside edge. Therefore the Aggregator System remains short.

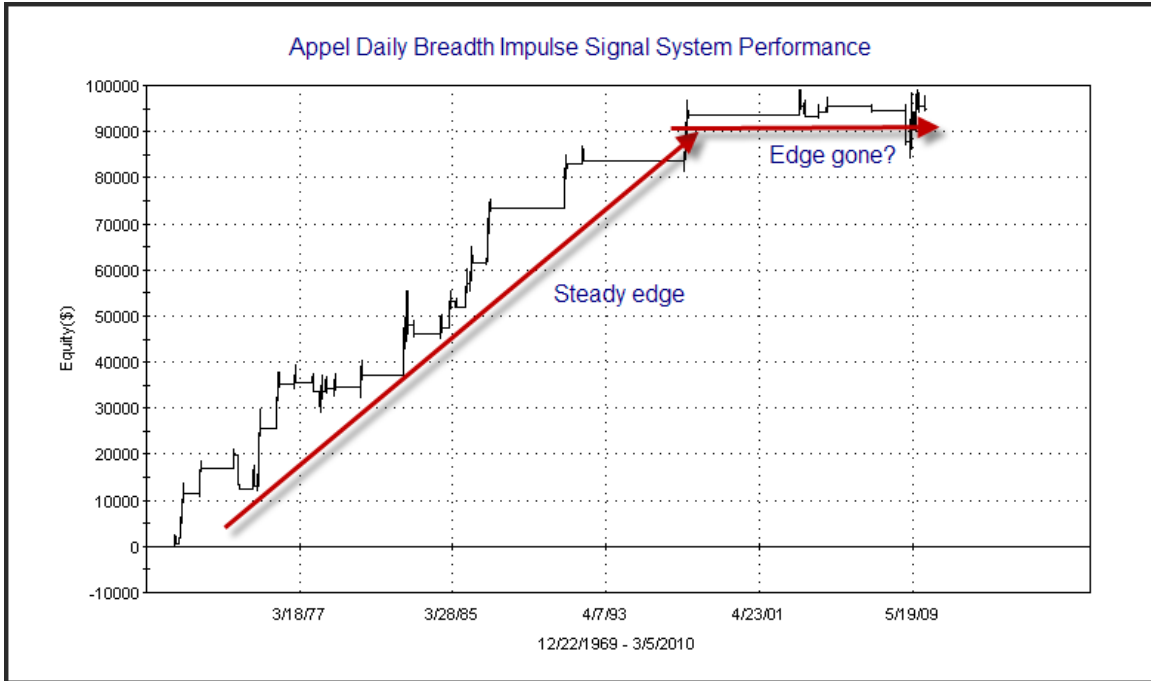
With the current studies the green Aggregator line is set up to remain negative tomorrow. Of course strong bullish evidence could change this. Meanwhile the Differential pivot will be 1,090.36 tomorrow. This means it would take an SPX close at or below this level in order for the black Differential line to turn back positive.

Intermediate-term Outlook (2 weeks – 2 months)– updated 7/26 – somewhat bullish

Two new studies with possible positive intermediate-term implications triggered on Friday. One was an Appel Daily Breadth thrust signal and the other was a flip in the Nasdaq/S&P 500 Relative Strength Indicator.

I last discussed the Appel Daily Breadth Impulse Signal in the 3/8/10 Subscriber Letter. Here is an excerpt:

Another interesting breadth achievement from Friday that was identified by the Quantifinder was the triggering of Gerald Appel's Daily Breadth Impulse Signal from his book "Technical Analysis – Power Tools for Active Investors". The signal is activated when the 10ema of the Up Issue % hits a certain point and is removed when it drops below a certain point. I am not giving specifics because it is not my copyrighted work. You see can details on pages 142 – 145 of his book. From 1970 – 2003 this indicator was a pretty good buy signal as these breadth thrusts often led to significant rallies. In recent years it has faltered a bit. Below is a long-term performance graph.



This is the 9th signal since 2005. Below is a listing of how all the recent ones worked out.

Appel Daily Breadth Impulse Signal System Performance

Date/Time	Signal	Price	% Profit	Run-up DrawDown
03/21/07	Daily Breadth	\$1,435.04	(1.24%)	\$265.65
03/28/07	Sell	\$1,417.23		(\$1,446.93)
01/02/09	Daily Breadth	\$931.80	(6.60%)	\$1,289.35
01/12/09	Sell	\$870.26		(\$7,220.36)
03/18/09	Daily Breadth	\$794.35	(0.86%)	\$4,825.00
03/30/09	Sell	\$787.53		(\$3,518.75)
04/02/09	Daily Breadth	\$834.38	5.94%	\$11,399.01
05/13/09	Sell	\$883.92		(\$2,362.15)
06/01/09	Daily Breadth	\$942.87	(2.03%)	\$1,416.16
06/15/09	Sell	\$923.72		(\$2,461.32)
07/16/09	Daily Breadth	\$940.74	4.14%	\$8,189.56
08/17/09	Sell	\$979.73		(\$645.54)
09/10/09	Daily Breadth	\$1,044.14	0.64%	\$3,420.95
09/24/09	Sell	\$1,050.78		(\$868.30)
12/24/09	Daily Breadth	\$1,126.48	(0.89%)	\$2,109.36
01/21/10	Sell	\$1,116.48		(\$1,026.96)
03/05/10	Daily Breadth	\$1,138.70	n/a	\$0.00
open	n/a	\$1,138.70		\$0.00

Certainly this is not as strongly suggestive as it once was. The question now is whether it is providing any edge at all. Rather than put much faith in it I'll just continue to monitor it for the time being.

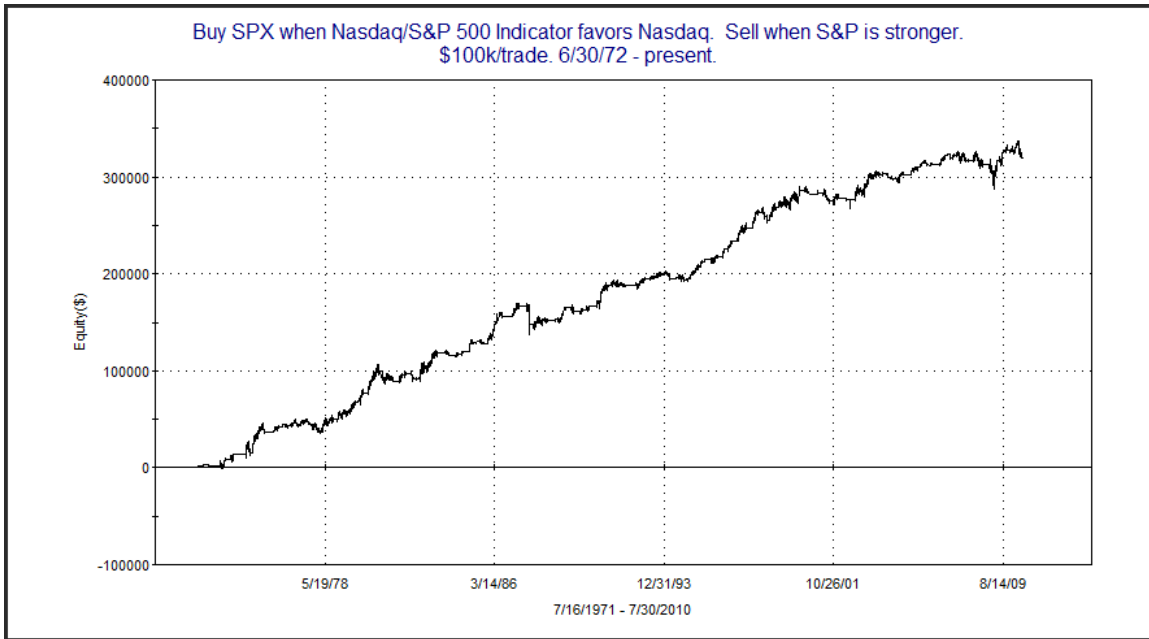
Since I wrote this there have been 2 signals. The 1st was from 3/5/10 to 4/19/10 and it posted a gain of 5.17%. The 2nd signal lasted from 6/15 – 6/22 and it posted a loss of 1.79%. As I did in March I'll just continue to monitor this signal rather than give it substantial weight in my intermediate-term bias.

The Nasdaq/S&P 500 Relative Strength indicator is found on the charts page. I wrote about that indicator in detail on the blog last year. Links are below:

<http://quantifiableedges.blogspot.com/2009/05/simple-powerful-timing-indicator.html>

<http://quantifiableedges.blogspot.com/2009/06/tweaking-nasdaq-leadlag-model.html>

The bottom line with this indicator is that the market has historically performed substantially better when the Nasdaq has led the S&P 500. Below is an equity curve of a simple strategy that uses the indicator:



As you can see the indicator has provided a nice edge on a fairly consistent basis. But since last October the indicator has not worked so well. Below is a list of all signals over this recent time period.

Nasdaq / S&P 500 RS triggers.
10/16/2009 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
10/23/09	Buy	\$1,079.60	(4.02%)	\$1,117.80
10/30/09	Sell	\$1,036.19		(\$4,238.44)
12/04/09	Buy	\$1,105.98	(2.90%)	\$4,002.30
01/29/10	Sell	\$1,073.87		(\$3,095.10)
02/12/10	Buy	\$1,075.51	3.29%	\$13,274.68
05/07/10	Sell	\$1,110.88		(\$894.24)
05/14/10	Buy	\$1,135.68	(4.23%)	\$1,142.24
05/21/10	Sell	\$1,087.69		(\$7,020.64)
05/28/10	Buy	\$1,089.41	0.20%	\$1,479.66
06/11/10	Sell	\$1,091.60		(\$4,298.84)
06/18/10	Buy	\$1,117.51	(3.65%)	\$1,221.08
06/25/10	Sell	\$1,076.76		(\$4,416.18)

While I don't think a relatively short period like this should raise big alarms, I do think it is worth noting that the indicator has been out of sync lately.

Part of what I believe has made the indicator effective over time is the fact that it has done a decent job of measuring risk appetite. Since the Nasdaq has traditionally been

more risky than the SPX when the Nasdaq is leading then that means investors are more willing to accept risk. In recent times though, financials, which make up a large part of the SPX, have been viewed as one of the riskiest sectors. Over the last few months there has been a lot of focus on bank problems in Greece, Spain, and Portugal among others. So perhaps in recent times risk acceptance was occurring when the SPX was leading and not the Nasdaq.

So if technology is viewed as riskier than financials again this indicator may again become effective.

Friday's signal occurred the same day that stress tests of European banks came back with favorable results. Perhaps this could signal a return to normalcy for this indicator and an upside edge for the market.

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.

SPY – short ¼ index position at \$112.25 LIMIT ON OPEN. If not filled on open then cancel order. I'll take a favorable entry if it becomes available. Otherwise I'll wait one more day. I'm not eager to bet strongly against tonight's study.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	7/23/2010	\$109.90	\$111.56	-1.51%		Aggregator

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