

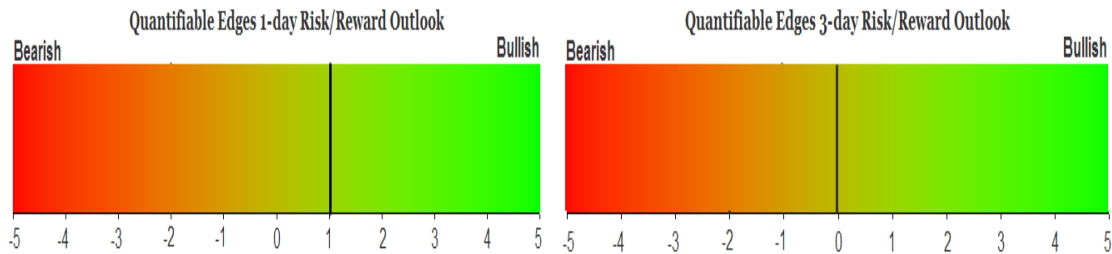
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 2, 2010

Volume 3 Issue 146

## Market Overview



## Tonight's Research Points

- Friday's nearly flat close brought about some old interesting studies.
- The mild up close in SPX after a down move suggests a mild bearish inclination over the next few days.
- The weak SOX is also a potential negative.
- The Aggregator System turned flat.
- The NDX Aggressive Trend Timer turned flat.

## Short-term Outlook

### The Bottom Line

We are not at a place where a clear short-term edge is apparent.

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>				
August 2, 2010	Down 1 week after FTD	1-3 days	Bearish	-1.60%
July 30, 2010	3 days down. 3/10 HV < 0.25	1-3 days	Bullish	2.00%
July 28, 2010	Higher hi, higher low streak, dn close	1-4 days	Bullish	1.60%
<b>Active - Long Term</b>				
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	
<b>Dropped Tonight</b>				
July 26, 2010	Nasdaq/S&P RS favors Nasdaq	int term	Bullish	

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

## *The Evidence*

Friday saw some wild action. A sizable gap down opened the day, Then a morning rally led to an early afternoon fade before the market again got moving and finished in the upper end of its range and near even on the day. The SPX finished up 0.01% while the Nasdaq and Russell 2000 each gained about 0.1%. Breadth was slightly positive as the NYSE Up Issues % came in at 59% and the Up Volume % was 53%. Total volume fell a bit on both exchanges.

While the SPX closed up, the SPY closed down creating a bit of an oddball situation. Prior to about a year and a half ago this wasn't that unusual because the SPY closing price was determined at 4:15 in accordance with the futures close. But now the SPY and the SPX close at the same time, so to have them close in opposite directions is a rarity. Several of the studies we utilize will consider the market's closing direction, so while the difference may seem insignificant, it isn't. It matters – and not just when considering which studies are likely to trigger. It also matters when considering how the market is likely to behave over the next several days. I examined this concept a bit in the June 18, 2009 Subscriber Letter. There is a link below if you'd like to read it.

[2009-06-18 QE Subscriber Letter.pdf](#)

There's some debate when something like this happens as to what measure is more "valid" – the SPX or the SPY. The SPX is the index and the SPY is a derivative instrument based on that index so many people would consider the SPX movement more valid. On the other hand, the SPY is an actual security with real buyers and sellers. What's more real and valid than price movement in that? Personally I'm undecided on the matter, but figured I'd throw it out there for readers to consider.

The Quantifinder came up with studies on Friday that looked at both the SPY and the SPX. I'll take both into consideration. Frankly, I'm a little more inclined to favor the view that the market closed up in this case (SPX) since that movement is confirmed by the Nasdaq, the Russell, and by breadth.

I'll show the "SPY down" study first, though. It was last published in the 2/16/10 Subscriber Letter and it looks at large gaps lower that partially recover but still finish down on the day.

SPY gaps down at least 1%. It closes down on the day but at least 0.5% above the open. Buy on close. Sell X days later. \$100k/trade. 1993 - 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	47,238.62	36	22	14	61.11	3,933.18	-2,806.53	1.40	2.20	1,312.18
4	39,809.48	38	23	15	60.53	3,431.81	-2,608.14	1.32	2.02	1,047.62
3	25,849.71	40	25	15	62.50	2,582.15	-2,580.27	1.00	1.67	646.24
2	57,066.57	40	29	11	72.50	2,686.72	-1,895.29	1.42	3.74	1,426.66
1	35,863.45	40	25	15	62.50	2,391.34	-1,594.68	1.50	2.50	896.59

The implication here is a decent upside edge over the next couple of days. But...

...when looking at these type of potential reversal patterns in the past I have found it useful to consider the short-term positioning of the market. A large gap down and partial reversal like this can often lead to further upside when it is marking a bottom. But in this case the market is much closer to the top of its recent range. So I'll use an old trick and simply break out this test by instances that closed above their 10ma versus instances that closed below it. The current case is well above the 10ma.

Let's look at that first.

SPY gaps down at least 1%. It closes down on the day but at least 0.5% above the open. Close > 10ma. Buy on close. Sell X days later. \$100k/trade. 1993 - 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	817.83	11	6	5	54.55	3,207.06	-3,684.90	0.87	1.04	74.35
4	-5,091.56	11	6	5	54.55	2,598.03	-4,135.94	0.63	0.75	-462.87
3	-6,304.82	11	6	5	54.55	2,202.60	-3,904.08	0.56	0.68	-573.17
2	2,063.00	11	7	4	63.64	1,544.78	-2,187.62	0.71	1.24	187.55
1	-210.85	11	6	5	54.55	1,318.35	-1,624.19	0.81	0.97	-19.17

What looked like an upside edge now looks like meaningless chop with this extra filter. So what's that mean for those instances that occur in the bottom part of their 2-week range?

SPY gaps down at least 1%. It closes down on the day but at least 0.5% above the open. Close < 10ma. Buy on close. Sell X days later. \$100k/trade. 1993 - 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	40,169.56	27	16	11	59.26	4,205.48	-2,465.28	1.71	2.48	1,487.76
4	41,310.04	28	17	11	60.71	3,726.08	-2,003.03	1.86	2.87	1,475.36
3	32,154.53	29	19	10	65.52	2,702.01	-1,918.36	1.41	2.68	1,108.78
2	55,003.57	29	22	7	75.86	3,050.06	-1,728.25	1.76	5.55	1,896.67
1	36,074.30	29	19	10	65.52	2,730.19	-1,579.92	1.73	3.28	1,243.94

86% of instances closed above the entry price at some point in the next week. (93% within 6 days.)

These are the kind of results that would get me excited about the long side. Too bad (for bulls) this isn't the current setup.

Now let's move on to some of the "SPX up" studies that triggered. This first one below is from the 4/16/09 Subscriber Letter. It looks at days the SPX closes positive while the SOX drops quite a bit.

SPX closes up but < 200ma. SOX closes down. SPX outperforms SOX by at least 1%. Buy on close. Sell X days later. \$100k/trade. 1995 - 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	-18,154.56	80	41	39	51.25	2,806.74	-3,416.18	0.82	0.86	-226.93
4	-15,135.23	86	41	45	47.67	2,589.72	-2,695.86	0.96	0.88	-175.99
3	-37,383.10	92	45	47	48.91	2,153.01	-2,856.78	0.75	0.72	-406.34
2	-35,955.11	102	45	57	44.12	1,935.67	-2,158.95	0.90	0.71	-352.50
1	-36,191.33	106	50	56	47.17	1,279.32	-1,788.52	0.72	0.64	-341.43

Over the years such a setup has suggested pretty bearish short-term implications.

There are some questions with the current case, though. For one, as discussed the positive SPX close barely triggered. Secondly, the SOX only finished down 1.05%, so the spread between them also barely qualified. If those were the only two issues then I'd probably still include these results in the Aggregator, but I also noticed that very recent performance hasn't fallen in line with norms. Below is a list of the last seven instances using a 2-day exit.

SPX closes up but < 200ma. SOX closes down. SPX outperforms SOX by at least 1%. Buy on close. Sell 2 days later. \$100k/trade.				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
03/06/09	Buy	\$683.38	5.30%	\$5,288.12
03/10/09	Sell	\$719.60		(\$1,533.00)
04/13/09	Buy	\$858.73	(0.78%)	\$0.00
04/15/09	Sell	\$852.06		(\$2,685.40)
04/15/09	Buy	\$852.06	2.06%	\$2,757.69
04/17/09	Sell	\$869.60		(\$587.34)
04/23/09	Buy	\$851.92	0.66%	\$2,325.96
04/27/09	Sell	\$857.51		\$0.00
05/08/09	Buy	\$929.23	(2.25%)	\$0.00
05/12/09	Sell	\$908.35		(\$3,506.39)
06/08/10	Buy	\$1,062.00	2.34%	\$2,429.90
06/10/10	Sell	\$1,086.84		(\$916.50)
07/08/10	Buy	\$1,070.25	0.79%	\$979.29
07/12/10	Sell	\$1,078.75		(\$199.95)

Four out of the last five and five of the last seven have posted gains. Again, by itself with such an ample sample size already, I likely wouldn't ignore the study. But based on the fact that the setup is so borderline already, I'm not putting any faith in it.

This next series of studies has its roots in the 6/18/2009 Letter that I reference above. Those people that clicked the link will recognize the setup, which calls for a slight up day after at least 2 down days. In the 3/29/10 Subscriber Letter I found that the bearish implications of the setup were thanks to those times the SPX was trading under its 200ma. So I have included that filter when updating the tests below. This first one looks back to 1988.

SPX closes up today after closing down 2 in a row. Todays rise is less than 0.2%.  
Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 1988 - 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	-8,252.12	23	12	11	52.17	1,424.91	-2,304.64	0.62	0.67	-358.79
4	-15,448.31	24	12	12	50.00	1,338.38	-2,625.74	0.51	0.51	-643.68
3	-12,233.52	25	11	14	44.00	1,048.30	-1,697.49	0.62	0.49	-489.34
2	-5,764.59	25	13	12	52.00	908.36	-1,464.44	0.62	0.67	-230.58
1	-1,971.42	25	12	13	48.00	870.23	-954.94	0.91	0.84	-78.86

Implications here appear mildly bearish over the next few days. Similar to the study from last June I also wanted to see how this had been holding up more recently.

SPX closes up today after closing down 2 in a row. Todays rise is less than 0.2%.  
Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-11,025.61	13	5	8	38.46	1,756.02	-2,475.71	0.71	0.44	-848.12
4	-16,725.57	14	6	8	42.86	1,219.81	-3,005.56	0.41	0.30	-1,194.68
3	-12,155.34	14	4	10	28.57	1,134.63	-1,669.39	0.68	0.27	-868.24
2	-10,445.71	14	5	9	35.71	747.80	-1,576.08	0.47	0.26	-746.12
1	-5,849.52	14	4	10	28.57	1,214.31	-1,070.68	1.13	0.45	-417.82

**10 of 12 instances (86%) closed below the entry price at some point in the next 3 days.**

Results here confirm the longer-term test.

We've had a lot to look at but really this last concept is the only one that made it into the short-term Active Studies List.

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



With tonight's studies taken into consideration the green Aggregator line has now slipped back into negative territory. The negative value indicates the net expectation from the Active Studies over the next few days is for downside. Meanwhile the black Differential line is above zero, indicating the SPX has underperformed expectations over the last few days. So we have negative expectations but a market that is oversold versus recent expectations. This is considered a neutral configuration. Due to this the Aggregator System turned flat at the close.

With the current studies the green Aggregator line is set up to remain negative tomorrow. Of course with the low number of active studies some bullish evidence could easily change this. Meanwhile the Differential pivot will be 1,106.42 tomorrow. This means it would take a close at or above this number in order to turn the Differential line negative. That would be about a 0.5% rally from today's close.

I'm not terribly excited about the current setup and would prefer a more substantial edge before taking on aggressive positions.

Also notable is that Friday's flat close kept the 3/10 Offset HV indicator very low. This suggests a big move could occur in the next few days. It also sets up a nice environment for trading ORBs. I've again provided a link to the old ORB's study below.

[Quantifiable Edges ORBs Study.pdf](#)

***Intermediate-term Outlook (2 weeks – 2 months)– updated 8/2 – somewhat bullish***

Not a lot to new to discuss from an intermediate-term standpoint this week. We've experienced a fairly mild pullback over the last few days. Some short-term studies are now suggesting the pullback could deepen but I'm not seeing much that indicates the bullish influences we've noted over the last few weeks are dead.

One positive that did fall off the board was the Nasdaq/SPX relative strength indicator flipped back to favoring the SPX. While not outright bearish, in the past the market has not really made any headway under this condition. It's been in flip-flop mode recently with neither offering clear upside leadership.

So I'm still favoring the long side a bit and would prefer trades in that direction. Further confirmation in the form of continued upside – including a move through and continued closes above the 200ma – would likely brighten my outlook further.

**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 – buy ¼ index position @ \$110.29 LIMIT ON CLOSE. With an upside edge I certainly *could* look to enter early in the day. I’m not setting it up that way because the 3/10 Offset HV has me concerned about a strong selloff should the market fail to bounce. Personally I may look to go long on weakness in the morning or to buy an Opening Range Breakout if the first half hour or so is tight and we get an upside breakout. Tough to lay out exact details in a subscriber letter though, so the trade idea tonight will just look to enter on a down close.*

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	7/30/2010	\$110.27	\$110.27	0.00%		sell @ \$110.29 limit

In Thursday’s Letter I set up a SPY trade ideas in which I would look to buy a down close. The assumption was that a down close for the SPY would also mean a down close for the SPX and with the Aggregator on a buy signal it would be unlikely to switch off that with a down close. As I’ve discussed the SPX closed up. Partially due to this the Aggregator turned flat. But with the SPY closing down slightly a buy was still triggered based on the entry criteria laid out in the last letter. So the Aggregator is now neutral, but the Letter took a somewhat unintentional position.

This happens in trading. Some “unintentional executions” become famous. Most just lead to some anguish for the trader. But if you’ve traded for any length of time, it’s highly unlikely you haven’t entered a trade in a way you didn’t intend. Often when it happens I’ll just look to exit the position right away. In a case like this, tough where the trade was executed at the close and the next tick could occur at a much different price (Monday’s open) it takes some consideration to decide what to do. Under what circumstances would I want to exit? Is there anything that would make me want to hold?

There’s really no right answer as to how to handle an unintentional fill, but as with anything, having a plan helps. So I’ll try and lay out a reasonable one for this situation. A few things to consider are 1) most opening gaps do fill at some point during the day, and 2) while the Aggregator line is bearish, it is based on 3-day expectations. The 1-day expectations are actually for upside on Monday based on the current Active Studies. Therefore, I’d prefer not to panic out of the trade if it gaps down. Instead I will place a limit order just above the gap fill to get me breakeven and cover my commissions.

You also recall that the 3/10 Offset HV is very low and the market is capable of a big move at this point. Therefore, I’ll look to sell a breakdown of the early range should the SPY gap down, not fill, and then break lower after establishing its early range. Should it be necessary, I’ll send out an intraday update to gold subscribers.

If it gaps up, then “thanks for the gift, I’ll take it.” I’m out and no worse off except for a bit of weekend worry.

Of course most of this would be moot if I elected to take the opening entry on Friday. I discussed this as a possibility and that an upside move in the AM could be buyable, so hopefully some traders that may have taken the trade would have done so a better price than the end-of-day fill. If not, we’re in the same boat.

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.