

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 12, 2010

Volume 3 Issue 154

Market Overview



Tonight's Research Points

- 3% Up Volume suggests a bounce.
- A large gap down that opens near the high and closes near the low often leads to a sharp, quick rebound.
- 2 Unfilled gaps down are often followed by a bounce.
- The Aggregator System remained long.
- The NDX Aggressive Trend Timer remained flat.

Short-term Outlook

The Bottom Line

The strong selling today triggered some very bullish short-term studies. There is some risk this turns into a breakdown that could accelerate. I'm playing the long side – but lightly.

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				
August 12, 2010	1% gap. Open top 12% Close bottom 12%	1-3 days	Bullish	4.70%
August 12, 2010	Less than 3% Up Volume	1-2 days	Bullish	2.75%
August 12, 2010	2 Unfilled Down Gaps	1-5 days	Bullish	2.46%
Active - Long Term				
August 3, 2010	50 high 90% volume	1-25 days	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	
Dropped Tonight				
August 11, 2010	Fed Day down from 10-high	1 day	Bullish	
August 11, 2010	2/1 Neg breadth small drop from 5	1-2 days	Bearish	-1.80%
August 5, 2010	SPX 10-high on NYSE 10 low vol	1-5 days	Bearish	-2.10%

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

The Evidence

The selling was extreme on Wednesday. Everything on my screen went down (except the VIX), and most of it went down a lot. The day started with a large gap down, which proved to be just about the high of the day. It then endured persistent selling all the way to the closing bell. In the end the SPX had dropped 2.8%, the Nasdaq was down 3.0% and the Russell 2000 suffered the worst with a 4.0% drop. Breadth numbers showed that almost nothing was bid higher. The NYSE Up Issues % came in at 12% and the Up Volume % was between 2% and 3%. Total volume came in at the highest level in about two weeks.

Large gaps down rarely fail to bounce at all and sell off so persistently. In the past this behavior has often been followed by a bounce. This is shown in the study below from 7/6/09 Subscriber Letter.

SPY gaps down at least 1%. It closes lower than the open. The open is in the top 12% of the daily range and the close is in the bottom 12% of the daily range. 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	19,545.37	8	6	2	75.00	4,596.41	-4,016.54	1.14	3.43	2,443.17
4	27,609.86	8	6	2	75.00	5,061.34	-1,379.10	3.67	11.01	3,451.23
3	25,430.63	8	7	1	87.50	3,920.74	-2,014.53	1.95	13.62	3,178.83
2	16,311.94	8	6	2	75.00	3,281.62	-1,688.88	1.94	5.83	2,038.99
1	16,387.03	8	7	1	87.50	2,342.59	-11.13	210.48	1,473.33	2,048.38

Instances are low but the numbers are very favorable for the bulls. The 1 failure to close up on day 1 and 3 was the last instance in July 2009. Below I have listed all occurrences along with their 1-day returns.

SPY gaps down at least 1%. It closes lower than the open. The open is in the top 12% of the daily range and the close is in the bottom 12% of the daily range.
Buy on close. Sell next days close. \$100k/trade. 1993 - present

Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/04/00	Buy	\$139.75	0.18%	\$1,272.70
01/05/00	Sell	\$140.00		(\$1,787.50)
12/20/00	Buy	\$126.25	0.70%	\$2,051.28
12/21/00	Sell	\$127.13		(\$570.24)
09/03/02	Buy	\$88.28	1.43%	\$2,230.04
09/04/02	Sell	\$89.54		(\$249.04)
09/29/08	Buy	\$111.38	4.14%	\$4,807.92
09/30/08	Sell	\$115.99		\$0.00
10/15/08	Buy	\$90.02	4.17%	\$5,272.50
10/16/08	Sell	\$93.77		(\$3,862.80)
12/01/08	Buy	\$82.11	3.85%	\$4,113.46
12/02/08	Sell	\$85.27		(\$85.19)
04/20/09	Buy	\$83.43	1.95%	\$2,036.60
04/21/09	Sell	\$85.06		(\$814.64)
07/02/09	Buy	\$89.81	(0.01%)	\$133.56
07/06/09	Sell	\$89.80		(\$1,279.95)

SPX actually closed up slightly on this day while SPY fell \$0.01.

Powerful, persistent selling like occurred on Wednesday rarely persists any longer and often reverses quickly.

Another extreme that I mentioned above was the Up Volume % closed below 3%. This brought about the following study from the 6/7/10 Subscriber Letter.

NYSE Up Volume % < 3%.
Buy SPX 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	28,352.73	12	8	4	66.67	5,146.66	-3,205.13	1.61	3.21	2,362.73
4	13,326.73	12	6	6	50.00	4,064.89	-1,843.77	2.20	2.20	1,110.56
3	10,078.69	12	7	5	58.33	2,315.33	-1,225.73	1.89	2.64	839.89
2	18,774.03	12	8	4	66.67	2,722.23	-750.95	3.63	7.25	1,564.50
1	10,716.94	12	8	4	66.67	2,545.59	-2,411.95	1.06	2.11	893.08

All 12 instances closed above the entry price at some point in the next week.

While this is just the 13th instance since 1988, it is actually the 5th instance in 2010. Also notable is that the last 2 saw a bit more selling before the bounce occurred. They were on 6/4/10 and 6/29/10.

Another study that popped up again was this one from the Sunday night Letter. (Not updated.)

**SPY posts an unfilled downside gap today and yesterday.
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	33,112.09	30	23	7	76.67	1,860.83	-1,383.85	1.34	4.42	1,103.74
4	18,934.52	30	17	13	56.67	2,207.13	-1,429.74	1.54	2.02	631.15
3	15,947.66	30	17	13	56.67	1,767.47	-1,084.56	1.63	2.13	531.59
2	10,027.63	31	14	17	45.16	1,925.52	-995.86	1.93	1.59	323.47
1	9,559.50	33	20	13	60.61	938.96	-709.21	1.32	2.04	289.68

90% of instances posted at least 1 close above the entry price during the next week.

So we have a number of mostly unrelated studies suggesting the market is primed for a bounce. Unfortunately there is one common theme among them. None of them address the position of the market. Indicator readings and price bars mean different things in different contexts. The link below that examines 2.5% drops illustrates this.

<http://quantifiableedges.blogspot.com/2009/02/importance-of-positioning-in-analysis.html>

Tonight's action qualified as a selloff coming from a low as described in the link above. But it also qualified as a selloff coming from a high area (from the 1/22/10 Subscriber Letter):

SPX closes at a 50-day high and then 2 days later closes at an 8-day low.
Buy on close. Sell X days later. \$100k/trade. 1987 - 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	21,943.70	59	34	25	57.63	1,928.00	-1,744.34	1.11	1.50	371.93
4	26,980.91	59	37	22	62.71	1,542.56	-1,367.91	1.13	1.90	457.30
3	16,112.59	59	34	25	57.63	1,250.45	-1,056.11	1.18	1.61	273.09
2	12,866.79	59	35	24	59.32	923.30	-810.36	1.14	1.66	218.08
1	6,712.90	61	33	28	54.10	695.30	-579.71	1.20	1.41	110.05

So coming in to today the market wasn't clearly overbought and it wasn't clearly oversold. You could suggest either, though. In the short-term we are now definitely stretched. The issue as I see it is that the move today could also be viewed as a breakdown from a consolidation. There are a few ways to draw a consolidation pattern on the SPX chart. I show a few in the Aggregator chart tonight. One being a breakdown from the recent ledge that had formed over the last 6 days and the other being a break of the trendline.

The problem with a strong move creating a fresh breakdown is that it can accelerate further. If we saw this type of selling after the market had already dropped several days in a row then I'd be much more confident that it was capitulative. (Note also the CBI remains at 0.)

So you could say this is a pullback from a 50-day high. You could also say that today's selloff followed yesterday closing at a short-term low. Both are accurate, and both would suggest a bounce, but I'm not sure either captures the essence of what is happening. I nibbled long at the close today and I think there is a decent shot that the trade will make money, but I also see risk. Give me another day or two of strong selling and I'll really begin to get excited about the long side.

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



The short-term bearish studies all surpassed their targets and were removed from the Active Studies List today. And with a few powerful bullish studies emerging today the green Aggregator line spiked sharply. The strongly positive value indicates the net expectation from the Active Studies over the next few days is for upside. The black Differential line also spiked up as the SPX has now soundly underperformed expectations over the last few days. So we have strongly positive expectations and a market that is very oversold versus recent expectations. This is considered a bullish configuration and is shown when both lines are above 0. Due to this the Aggregator System remained long at the close.

Currently the green Aggregator line is set up to remain positive tomorrow. It would take some very bearish studies to change this. Meanwhile the Differential pivot will be 1,126.31 tomorrow. This means it would take a close at or above this level in order to turn the black Differential line negative. That would be over a 3% gain from Wednesday's close.

Intermediate-term Outlook (2 weeks – 2 months)– updated 8/9 – bullish

Monday's SPX breakout on strong breadth led to a few studies with intermediate-term implications that appear in the August 3rd Letter Monday night. They both looked at times the market hit new 50-day highs on extremely strong breadth. The first one simply looked at any 50-day high on a 90% or greater NYSE Up Volume %.

SPX closes at a 50-day high while the NYSE Up Volume % close > 90%.
Buy on close. Sell X days later. \$100k/trade. 1970 - 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
21	66,250.56	16	13	3	81.25	5,314.80	-947.29	5.61	24.31	4,140.66
20	59,416.79	17	13	4	76.47	5,105.66	-1,739.19	2.94	9.54	3,495.11
19	56,188.99	17	14	3	82.35	4,568.72	-2,591.04	1.76	8.23	3,305.23
18	52,597.01	17	13	4	76.47	4,768.23	-2,347.49	2.03	6.60	3,093.94
17	45,628.34	17	13	4	76.47	4,442.24	-3,030.20	1.47	4.76	2,684.02
16	43,642.00	17	12	5	70.59	4,744.13	-2,657.51	1.79	4.28	2,567.18
15	45,653.48	17	13	4	76.47	4,391.20	-2,858.02	1.54	4.99	2,685.50
14	35,151.48	18	13	5	72.22	4,142.55	-3,740.34	1.11	2.88	1,952.86
13	30,920.05	18	13	5	72.22	3,773.18	-3,626.26	1.04	2.71	1,717.78
12	33,165.24	18	11	7	61.11	4,500.07	-2,333.65	1.93	3.03	1,842.51
11	37,504.81	18	11	7	61.11	4,264.55	-1,343.60	3.17	4.99	2,083.60
10	35,501.76	18	12	6	66.67	3,824.66	-1,732.36	2.21	4.42	1,972.32
9	25,265.04	18	11	6	61.11	3,476.45	-2,162.66	1.61	2.95	1,403.61
8	24,873.22	18	12	6	66.67	3,305.37	-2,465.20	1.34	2.68	1,381.85
7	24,220.47	18	12	6	66.67	3,197.44	-2,358.14	1.36	2.71	1,345.58
6	25,043.14	18	12	6	66.67	2,797.62	-1,421.39	1.97	3.94	1,391.29
5	29,139.19	19	15	4	78.95	2,331.05	-1,456.62	1.60	6.00	1,533.64
4	23,823.24	19	16	3	84.21	1,935.10	-2,379.47	0.81	4.34	1,253.85
3	20,616.55	19	14	5	73.68	1,778.35	-856.06	2.08	5.82	1,085.08
2	20,893.52	19	17	2	89.47	1,261.72	-277.87	4.54	38.60	1,099.66
1	13,553.71	20	14	6	70.00	1,119.17	-352.45	3.18	7.41	677.69

These results suggested bullish tendencies both in the short-term and the intermediate-term.

I also examined the implications of fresh breakouts to new highs versus a repeated new high. Fresh breakouts typically provide a better edge and I found that was true in this case as well. This 2nd study from the August 3rd letter demonstrated this.

SPX closes at a 50-day high after not having done so for at least 10 days. NYSE Up Volume % > 90%. Buy SPX on close. Sell X days later. \$100k/trade. 1970 - 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
25	50,143.03	10	9	1	90.00	5,867.85	-2,667.60	2.20	19.80	5,014.30
20	45,876.72	10	7	3	70.00	7,144.22	-1,377.60	5.19	12.10	4,587.67
15	38,685.53	10	7	3	70.00	6,262.94	-1,718.35	3.64	8.50	3,868.55
10	35,095.45	10	8	2	80.00	4,657.74	-1,083.25	4.30	17.20	3,509.55
9	29,807.00	10	7	2	70.00	4,616.82	-1,255.38	3.68	12.87	2,980.70
8	26,436.14	10	8	2	80.00	3,968.24	-2,654.88	1.49	5.98	2,643.61
7	26,064.35	10	8	2	80.00	3,950.95	-2,771.63	1.43	5.70	2,606.44
6	21,595.12	10	8	2	80.00	3,382.30	-2,731.65	1.24	4.95	2,159.51
5	24,817.77	10	8	2	80.00	3,549.12	-1,787.58	1.99	7.94	2,481.78
4	17,452.07	10	8	2	80.00	2,867.70	-2,744.75	1.04	4.18	1,745.21
3	21,710.82	10	9	1	90.00	2,432.15	-178.50	13.63	122.63	2,171.08
2	17,810.14	10	10	0	100.00	1,781.01	0.00	100.00	100.00	1,781.01
1	12,193.10	10	9	1	90.00	1,362.43	-68.80	19.80	178.23	1,219.31

Follow through so far has been weak. Wednesday (day 2) is the only day that the market closed above Monday at this point. But down days have been muted and with the short-term outlook now appearing positive we could get another leg up here soon.

Overall there are still a good number of intermediate-term studies in effect suggesting upside. Meanwhile, very little is appearing that would favor the bears. I'm still feeling more comfortable buying the dips than I am shorting the rallies.

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 @ \$108.25 LIMIT ON OPEN. CANCEL IF NOT FILLED ON OPEN then look to buy @ \$108.50 LIMIT ON CLOSE. The possibility of a breakdown means I'll wait until tomorrow's close before looking to put any more on. But if the morning opens down big, I'll bet we don't get 3 unfilled gaps in a row and I'll buy right at the open instead of waiting for the close.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
IJR	8/9/2010	\$57.50	\$54.92	-4.49%		System 90609
SPY(1/4)	8/9/2010	\$109.30	\$109.30	0.00%		bought @ close

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