

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 18, 2010

Volume 3 Issue 158

## Market Overview



## Tonight's Research Points

- The unfilled gap is suggesting a pullback.
- ORBs continue to do well in combination with a low 3/10 Offset HV setup.
- The Aggregator System remained long.
- The NDX Aggressive Trend Timer turned flat.

## Short-term Outlook

### The Bottom Line

There still appears to be a mild upside edge. I'll be looking to reduce my long index position but not exit completely.

*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 18, 2010	Unfilled gap up 0.5-1% under 200ma	1-2 days	Bearish	-1.60%
August 17, 2010	SPX up slightly after 2 or more down	1-4 days	Bearish	-1.90%
August 17, 2010	SPY 5th lower gap down	1-5 days	Bullish	4.70%
August 16, 2010	SPY Inside day lr3 < 200ma no low vol	1-3 days	Bearish	-2.30%
August 16, 2010	SPX 3 lower closes & decline slowing	1-5 days	Bullish	2.20%
August 12, 2010	2 Unfilled Down Gaps	1-5 days	Bullish	2.46%
<b>Active - Long Term</b>				
August 16, 2010	1 (borderline) Hindenburg Omen Day	int term	Bearish	
August 3, 2010	50 high 90% volume	1-25 days	Bullish	
July 20, 2010	Down 1 week after FTD	int term	Bearish	
July 13, 2010	5 higher close from a 50-day low	int term	Bullish	
July 7, 2010	McClellan Oscillator Bottom Divergence	int term	Bullish	
<b>Dropped Tonight</b>				
August 16, 2010	3 Down into op-ex week	1-3 days	Bullish	1.80%
July 14, 2010	75% Up Issue twice in 3 days	1-20 days	Bullish	

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

## The Evidence

The bounce I'd been looking for finally arrived today. The market gapped up to open the day and after a brief consolidation it broke out and ran higher until about 1:30pm EST. It then consolidated near its highs for a couple of hours before dropping hard and giving a chunk back heading into the close. When it was over the SPX had risen 1.2%, the Nasdaq 1.3% and the Russell 2000 tacked on 1.8%. Breadth was strongly positive. The NYSE Up Issues % came in at 78% and the Up Volume % was 82%. Total volume rose but still wasn't terribly high.

Tuesday's rally put the SPX back near the middle of its recent range. And with the bounce neither very weak nor very strong the unremarkable action hasn't triggered many Quantifinder studies. The one study that appeared to provide a decent edge was from the 5/11/09 Letter. It looked at unfilled up gaps that occurred during downtrends. In that letter I mostly looked at gaps > 1%. Tuesday's gap up was 0.86% so tonight I examined the range between 0.5% and 1%. Results are below.

SPY gaps up between 0.5% and 1%. The gap never fills and it closes higher than the open. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	-16,119.71	30	18	12	60.00	1,537.98	-3,650.28	0.42	0.63	-537.32
4	-20,171.73	31	16	15	51.61	1,648.99	-3,103.70	0.53	0.57	-650.70
3	-9,847.30	31	17	14	54.84	1,389.94	-2,391.16	0.58	0.71	-317.65
2	-14,799.20	31	14	17	45.16	1,124.40	-1,796.52	0.63	0.52	-477.39
1	-6,625.17	32	15	17	46.88	787.32	-1,084.41	0.73	0.64	-207.04

There appears to be a bit of a downside edge, but it is due primarily to the win/loss ratio rather than the % profitable. Not shown above is that at some point over the next week 71% of instances closed below the entry price. This isn't a high number – especially compared to most of the studies I show. So this setup appears to elevate risk a bit but it doesn't reliably predict a downmove.

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



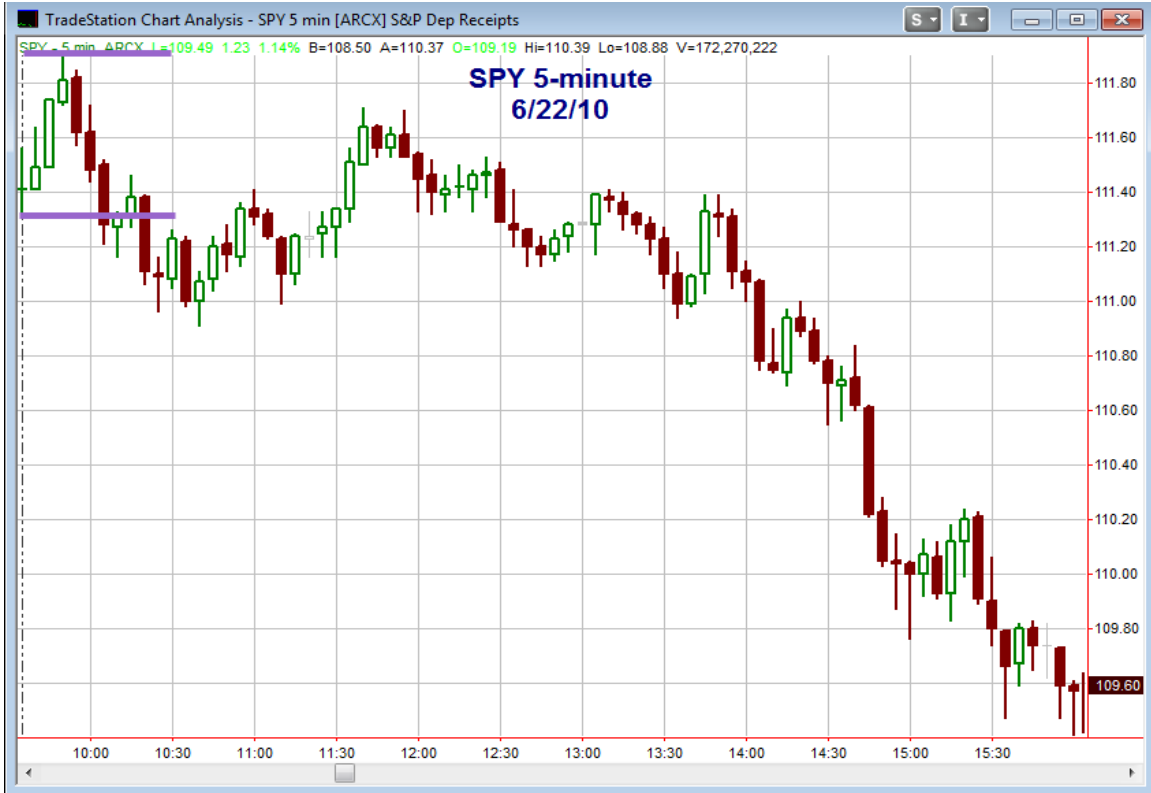
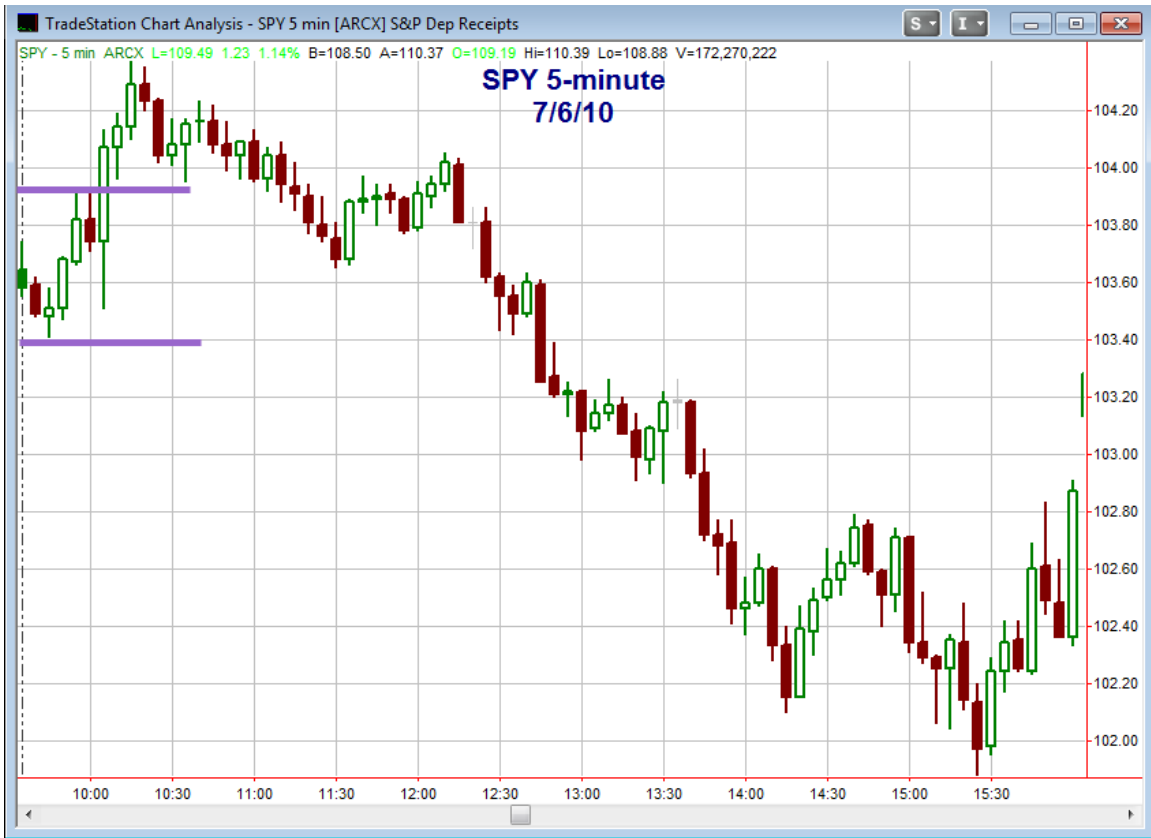
With the op-ex week study meeting its target and tonight's bearish study being added to the Active List, the green Aggregator link sunk a little bit more. Still it managed to close above zero. The positive value indicates the net expectation from the Active Studies over the next few days is for upside. The black Differential line also dropped but remained above its high. So while the SPX has risen some it has underperformed expectations over the last few days. We therefore have positive expectations and a market that is just barely oversold versus recent expectations. Both lines above 0 is considered a bullish configuration though the edge is mild now whereas a couple of days ago it appeared very strong. Due to this the Aggregator System remained long at the close.

Currently the green Aggregator line is again set up to remain positive tomorrow. This could change should some bearish studies emerge. Meanwhile the Differential pivot will be 1,093.21 tomorrow. This means the SPX would need to close less than a point higher in order to turn the black Differential line negative. So just about any close higher tomorrow would cause the Aggregator System to come off its long signal.

If we get any kind of a move up tomorrow I'll likely be looking to take profits or trail a stop on at least part of the SPY position. While there is still an upside edge, it isn't huge. The market has been poised to bounce for several days and hasn't really done much with that. So now that there are some profits in the trade, I'll hopefully get a chance to lock in a portion tomorrow. The last portion I'll decide on as the next few days unfold. I may









These could be managed a number of different ways. The point here is to simply demonstrate that they offer a nice risk/reward opportunity for day traders.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 8/16 – bullish***

There has been an awful lot written about [the Hindenburg Omen](#) this past week. For those unaware, the Hindenburg Omen is a technical setup that suggests the market could be in for a decline if it is in an uptrend and the market has become “split”. A split market is suggested when there is both a high number of new highs and new lows. The definition varies somewhat depending on where you read about it. The link I provided above was to a Wikipedia page. A couple of days ago Tom McClellan wrote an interesting piece on the history of the indicator. He also discussed the fact that the signal which was reported to occur on Thursday by a number of publications was based on the looser Wikipedia definition, and not one of the stricter definitions found elsewhere. Additionally, he enlightened me on some stock market history and noted that prior to 1979 new high/low data was calculated differently. Therefore testing back before 1979 creates problems. Anyway, I’d encourage you to read his thoughts here:

[http://www.mcoscillator.com/learning\\_center/kb/special\\_market\\_reports/hindenburg\\_omen\\_signaled\\_but\\_also\\_not/](http://www.mcoscillator.com/learning_center/kb/special_market_reports/hindenburg_omen_signaled_but_also_not/)

I've seen a number of discrepancies over the last few days with regards to the exact criteria used for the Hindenburg Omen. Below are 3 worth mentioning.

- 1) *50-day vs. 10-week moving average.* This one shouldn't matter much. They are both looking at the same time frame. The idea is that average should be moving higher and that will occur if the market is higher than it was 10 weeks (or 50 days) ago. For my testing I used 50-days. I've had some funky issues in the past with Tradestation when I've tried mixing daily and weekly bars. I decided to keep it simple and just use the 50-day instead of the 10-week. (One "problem" with doing this is that Thursday's signal occurred above the 10-week but below the 50-day moving average. So my test would not have triggered an entry.)
- 2) *NH's and NL's must be greater than (2.2% or 2.4% or 2.8%) of new issues.* I saw all 3 listed. Tom addressed this issue in his article. I used 2.2% in my testing since as Tom pointed out, the 2.8% didn't trigger.
- 3) *Clusters vs. single occurrences* – Some people suggested a single Hindenburg Omen trigger is not enough. That it is more reliable with multiple signals. This I examine a bit below.

So let's look at some numbers. This first table results of entering the market when the 1<sup>st</sup> signal triggers.

Buy the SPX when the 1st Hindenburg signal triggers. Sell X days later. \$100k/trade. 1980 - 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	All: Max Losing Trade	All: Max Winning Trade
100	1,902.42	22	11	11	50.00	6,728.46	-6,555.51	1.03	1.03	86.47	-19,079.85	13,171.60
95	-13,372.86	22	10	12	45.45	6,649.20	-6,655.41	1.00	0.83	-607.86	-22,416.88	14,163.76
90	-22,094.69	22	10	12	45.45	6,017.82	-6,856.07	0.88	0.73	-1,004.30	-20,572.65	15,961.92
85	-10,729.27	22	11	11	50.00	6,883.85	-7,859.23	0.88	0.88	-487.69	-21,465.22	16,615.04
80	-23,674.83	22	10	12	45.45	6,275.47	-7,202.46	0.87	0.73	-1,076.13	-21,552.30	16,583.84
75	-21,825.71	23	11	12	47.83	5,918.55	-7,244.15	0.82	0.75	-948.94	-22,917.59	13,423.28
70	-29,266.29	23	10	13	43.48	6,682.63	-7,391.73	0.90	0.70	-1,272.45	-20,289.64	17,714.32
65	-39,072.08	24	11	13	45.83	5,863.50	-7,966.97	0.74	0.62	-1,628.00	-21,508.76	16,609.84
60	-60,348.58	24	10	14	41.67	5,042.14	-7,912.14	0.64	0.46	-2,514.52	-24,323.31	17,197.44
55	-75,244.02	25	10	15	40.00	4,832.27	-8,237.78	0.59	0.39	-3,009.76	-27,246.71	14,306.24
50	-42,606.20	27	12	15	44.44	5,712.20	-7,410.17	0.77	0.62	-1,578.01	-29,846.67	14,509.04
45	-26,991.01	27	13	14	48.15	5,059.27	-6,625.83	0.76	0.71	-999.67	-23,971.88	12,815.92
40	-25,230.32	30	14	16	46.67	5,258.71	-6,178.26	0.85	0.74	-841.01	-23,520.93	10,011.04
35	-36,441.42	33	14	19	42.42	5,086.64	-5,666.02	0.90	0.66	-1,104.29	-24,659.19	9,534.72
30	-41,339.35	38	18	20	47.37	3,753.63	-5,445.24	0.69	0.62	-1,087.88	-22,460.42	8,538.40
25	-33,775.14	50	24	26	48.00	3,689.54	-4,704.77	0.78	0.72	-675.50	-27,340.01	8,409.42
20	-36,337.57	54	28	26	51.85	2,954.77	-4,579.65	0.65	0.69	-672.92	-19,533.91	9,311.76
15	-47,092.50	67	28	39	41.79	2,870.73	-3,268.53	0.88	0.63	-702.87	-18,397.02	9,103.68
10	-36,998.98	96	49	47	51.04	1,938.25	-2,807.94	0.69	0.72	-385.41	-18,826.95	9,012.33
5	-39,508.89	183	89	94	48.63	1,729.58	-2,057.89	0.84	0.80	-215.90	-15,319.95	10,340.00

The numbers here certainly aren't encouraging for the bull case, but they don't appear to be terribly dire either.

Let's now look at results if instead of entering after the 1<sup>st</sup> trigger, you purchase only if the trigger is at least the 2<sup>nd</sup> one in a 30-day period. (I read statements suggesting 30 days and others suggesting 36 days. I chose to test 30.)

Buy the SPX when the 2nd Hindenburg signal triggers. Sell X days later. \$100k/trade. 1980 - 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	All: Max Losing Trade	All: Max Winning Trade
100	12,735.90	12	7	5	58.33	7,161.22	-7,478.53	0.96	1.34	1,061.33	-18,879.12	17,883.98
95	10,304.18	13	8	5	61.54	6,708.09	-8,672.11	0.77	1.24	792.63	-21,212.88	17,605.78
90	12,929.58	13	9	4	69.23	5,844.03	-9,916.68	0.59	1.33	994.58	-20,011.68	20,476.59
85	-8,790.00	14	6	8	42.86	8,074.71	-7,154.78	1.13	0.85	-627.86	-21,883.68	20,455.19
80	-5,741.91	14	7	7	50.00	7,050.97	-7,871.24	0.90	0.90	-410.14	-21,961.68	18,961.47
75	-2,203.77	14	7	7	50.00	7,236.71	-7,551.54	0.96	0.96	-157.41	-23,181.60	17,861.51
70	-10,468.09	14	8	6	57.14	6,242.54	-10,068.06	0.62	0.83	-747.72	-19,060.08	21,700.67
65	-30,295.51	14	6	8	42.86	7,024.41	-9,055.25	0.78	0.58	-2,163.97	-23,131.68	20,504.41
60	-17,534.41	14	7	7	50.00	5,978.88	-8,483.79	0.70	0.70	-1,252.46	-22,011.60	19,457.95
55	-39,694.79	14	6	8	42.86	5,534.79	-9,112.94	0.61	0.46	-2,835.34	-26,329.68	18,625.49
50	-33,344.93	14	5	9	35.71	7,503.02	-7,873.34	0.95	0.53	-2,381.78	-29,889.60	17,961.02
45	-28,242.39	15	6	9	40.00	5,788.01	-6,996.72	0.83	0.55	-1,882.83	-24,766.56	16,345.32
40	-28,414.39	15	6	9	40.00	5,774.23	-7,006.64	0.82	0.55	-1,894.29	-24,853.92	14,615.13
35	-21,009.69	15	7	8	46.67	5,406.97	-7,357.31	0.73	0.64	-1,400.65	-22,211.28	13,303.31
30	-26,272.01	15	7	8	46.67	4,767.58	-7,455.63	0.64	0.56	-1,751.47	-20,354.88	11,007.09
25	-28,902.81	15	7	8	46.67	4,493.03	-7,544.25	0.60	0.52	-1,926.85	-23,381.28	10,173.56
20	-27,760.30	16	6	10	37.50	4,302.55	-5,357.56	0.80	0.48	-1,735.02	-22,295.52	8,886.35
15	3,603.54	17	7	10	41.18	3,492.16	-2,084.16	1.68	1.17	211.97	-6,748.56	8,305.02
10	-8,526.25	22	7	15	31.82	2,622.35	-1,792.18	1.46	0.68	-387.56	-5,748.21	9,247.23
5	-779.07	27	10	17	37.04	2,352.99	-1,429.94	1.65	0.97	-28.85	-3,352.36	6,245.73

Some of these numbers look a little worse, but you'd probably need to squint to notice. So lastly I checked instances that triggered a 3<sup>rd</sup> signal in a 30-day period.

Buy the SPX when the 3rd Hindenburg signal triggers. Sell X days later. \$100k/trade. 1980 - 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	All: Max Losing Trade	All: Max Winning Trade
100	18,189.83	9	6	3	66.67	6,521.01	-6,978.75	0.93	1.87	2,021.09	-16,065.07	18,512.90
95	9,304.48	9	5	4	55.56	6,711.67	-6,063.47	1.11	1.38	1,033.83	-16,770.54	16,070.66
90	101.55	9	4	5	44.44	9,036.94	-7,209.24	1.25	1.00	11.28	-19,277.67	18,595.58
85	6,033.07	9	5	4	55.56	7,852.24	-8,307.03	0.95	1.18	670.34	-21,362.25	18,884.96
80	-10,368.80	10	4	6	40.00	8,639.87	-7,488.05	1.15	0.77	-1,036.88	-19,449.82	16,528.58
75	-4,108.84	10	4	6	40.00	10,775.33	-7,868.36	1.37	0.91	-410.88	-22,758.23	18,289.24
70	-12,895.26	10	4	6	40.00	8,797.08	-8,013.93	1.10	0.73	-1,289.53	-21,021.08	19,119.22
65	-25,072.11	10	3	7	30.00	8,434.30	-7,196.43	1.17	0.50	-2,507.21	-23,731.66	17,909.76
60	-23,437.47	10	4	5	40.00	5,846.03	-9,364.32	0.62	0.50	-2,343.75	-22,576.69	17,209.10
55	-29,818.46	10	2	8	20.00	10,436.19	-6,336.35	1.65	0.41	-2,981.85	-20,673.65	17,905.52
50	-25,203.09	10	2	8	20.00	11,705.02	-6,076.64	1.93	0.48	-2,520.31	-22,263.69	17,255.74
45	-32,230.99	10	3	7	30.00	7,255.22	-7,713.81	0.94	0.40	-3,223.10	-25,143.29	15,507.80
40	-40,485.19	10	3	7	30.00	6,532.64	-8,583.30	0.76	0.33	-4,048.52	-26,846.01	13,700.50
35	-32,141.50	10	2	8	20.00	8,676.37	-8,186.78	1.40	0.35	-3,214.15	-22,795.79	11,461.78
30	-32,085.92	11	4	7	36.36	6,414.52	-8,249.14	0.78	0.44	-2,916.90	-23,844.34	10,991.14
25	-36,341.93	11	4	7	36.36	5,376.68	-8,264.09	0.65	0.37	-3,303.81	-25,105.73	9,841.04
20	-37,079.86	11	4	7	36.36	4,136.00	-7,660.55	0.54	0.31	-3,370.90	-21,406.07	8,458.80
15	-26,985.45	13	6	7	46.15	3,205.22	-6,602.39	0.49	0.42	-2,075.80	-26,924.26	7,078.68
10	-39,038.35	14	5	9	35.71	1,892.94	-5,389.23	0.35	0.20	-2,788.45	-25,784.94	3,159.86
5	-9,973.42	18	5	13	27.78	1,848.15	-1,478.01	1.25	0.48	-554.08	-3,509.22	4,174.28

Between 35 and 55 days out there appears to be some pretty poor returns on a very small sample size.

I looked at the 50-day holding period a bit closer. A few write-ups I read noted that a decline of at least 5% should be expected. Below are all 10 instances and their 50-day holding period stats. The column to the far right shows runup & drawdown.

Buy the SPX when the 3rd Hindenburg signal triggers. Sell 50 days later. \$100k/trade. 1980 - present.				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
02/12/80	Buy	\$117.89	(11.45%)	\$1,975.84
04/24/80	Sell	\$104.39		(\$17,104.16)
07/23/86	Buy	\$238.66	(1.99%)	\$6,528.02
10/02/86	Sell	\$233.91		(\$4,433.02)
10/06/87	Buy	\$319.21	(22.28%)	\$53.21
12/16/87	Sell	\$248.08		(\$32,160.75)
03/14/94	Buy	\$467.39	(2.36%)	\$788.10
05/25/94	Sell	\$456.34		(\$6,715.89)
10/25/95	Buy	\$582.47	6.18%	\$7,185.42
01/08/96	Sell	\$618.46		(\$1,699.74)
01/12/98	Buy	\$939.21	17.33%	\$18,429.16
03/25/98	Sell	\$1,102.00		\$0.00
12/07/99	Buy	\$1,409.17	(1.48%)	\$4,818.10
02/17/00	Sell	\$1,388.25		(\$4,138.40)
04/17/06	Buy	\$1,285.33	(3.59%)	\$3,185.49
06/27/06	Sell	\$1,239.20		(\$5,085.08)
07/18/07	Buy	\$1,546.17	(0.96%)	\$577.92
09/27/07	Sell	\$1,531.38		(\$11,236.48)
10/18/07	Buy	\$1,540.08	(4.66%)	\$811.52
12/31/07	Sell	\$1,468.29		(\$8,574.72)

Six of the ten instances listed had a drawdown of over 5% within 50 days of the entry point. I found this to be a bit disappointing.

So here's my overall impression of the Hindenburg Omen signal.

- 1) Great name – much more marketable than names like “Aggregator” or “Rob”.
- 2) Lots & lots of hype.
- 3) Lots of rules – and lots of confusion about those rules.
- 4) Not a lot of big selloffs following these signals – but certainly some.

The rule confusion suggests to me that over time there have been people who likely have “improved” the system by adding rules to filter out bad signals. Normally a dangerous endeavor.

It appears the original intent of the system was to identify when a rally was narrowing and susceptible to a tumble. This is a concept I can buy into.

Are we really at that point now? Perhaps. Or perhaps the new lows is higher thanks to inverse ETFs and bond funds (if that matters).

The term “rally” is certainly questionable. While the 10-week ma was rising on Thursday, the 50-day ma was not. And in fact the 50ma had only spent 8 days moving up before starting to turn down on Thursday.

If I view Thursday’s signal as “valid”, then I would say that the Hindenburg Omen could be a potential warning sign that traders could keep in mind. In my eyes it’s nothing dire and nothing more than a small piece of the puzzle. I’ll note it on the Active Studies List and will monitor any further signals. I’m not panicked, though.

In fact, I’m still leaning to the bullish side.

*Note: With all the differing rules and opinions I realize some subscribers may want to research it further themselves. I’ll place a link in the subscriber download section in the next day or so with Tradestation code and a workspace set up for subscribers. Then you can more easily explore the Hindenburg Omen and determine for yourself which rules you want to adhere to - if any.*

### **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**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
IJR	8/9/2010	\$57.50	\$55.29	-3.84%		System 90609
SPY(1/4)	8/11/2010	\$109.30	\$109.59	0.27%		Aggregator
SPY(1/4)	8/12/2010	\$107.65	\$109.59	1.80%		Aggregator
KO	8/13/2010	\$55.64	\$56.12	0.86%		<b>sold on close - 11111 criteria</b>

CMCSA missed my entry by \$0.01 so it isn't listed above.

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