

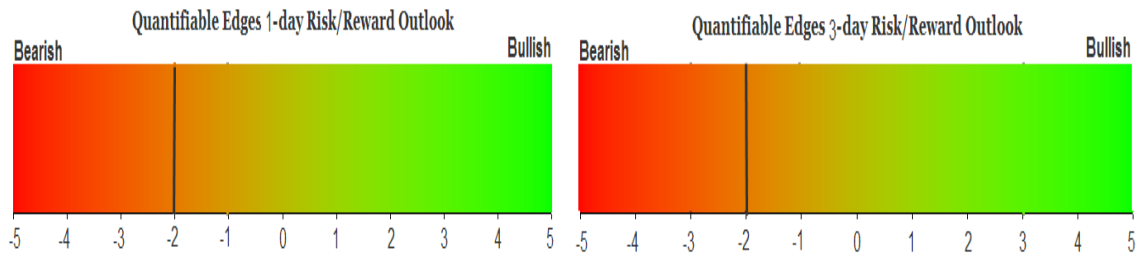
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 19, 2010

Volume 3 Issue 159

Market Overview



Tonight's Research Points

- The rally is exhibiting several characteristics that suggest it will pull back short-term.
- Inside days under the 200ma have led to a negative risk/reward.
- The Aggregator System flipped from long to short.
- The NDX Aggressive Trend Timer remained flat.

Short-term Outlook

The Bottom Line

The studies tonight are suggesting this bounce may have run its course for the time being. I am looking to exit the longs and start building a short position.

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 19, 2010	3 up SPX < 200ma. No 50-low. Wk vol	1-3 days	Bearish	-2.70%
August 19, 2010	Inside day < 200ma	1-3 days	Bearish	-1.70%
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	SPX 3 lower closes & decline slowing	1-5 days	Bullish	2.20%
Active - Long Term				
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	
Dropped Tonight				
August 12, 2010	2 Unfilled Down Gaps	1-5 days	Bullish	2.46%
August 16, 2010	SPY Inside day lr3 < 200ma no low vol	1-3 days	Bearish	-2.30%

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

The Evidence

After trading back and forth within Tuesday's range, the market closed moderately higher on Wednesday. The SPX gained 0.2% while the Nasdaq and Russell 2k gained 0.3%. Breadth was positive as the NYSE Up Issues % came in at 57% and the Up Volume % was 63%. Total volume pulled back a bit from Tuesday's levels.

The Quantifinder was filled with bearish studies today. Several of them carried common themes. These included the fact that the SPX had now risen 3 days in a row under the 200ma. We also saw studies that revealed 3 up days is more bearish when 1) at least one of the last 2 days sees a decrease in volume and 2) the rise is not coming from an extremely low level (50-day low). With all of these triggering I decided to combine some filters and see how the market performed over the next few days. Results are below.

SPX closes up for exactly the 3rd day in a row but below the 200ma. It did not close at a 50-day low prior to the rally. Volume has declined at least 1 of the last 2 days.
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	-36,864.52	29	11	18	37.93	1,297.23	-2,840.78	0.46	0.28	-1,271.19
4	-45,565.76	31	9	22	29.03	902.76	-2,440.48	0.37	0.15	-1,469.86
3	-52,196.83	31	7	24	22.58	767.27	-2,398.65	0.32	0.09	-1,683.77
2	-35,135.64	31	6	25	19.35	757.28	-1,587.17	0.48	0.11	-1,133.41
1	-17,186.29	31	11	20	35.48	1,090.17	-1,458.91	0.75	0.41	-554.40

29 of 31 instances (94%) posted at least one close lower than the entry price at some point in the next 4 days.

This suggests a sizable and consistent downside edge over the next few days.

Another aspect of today's trading with bearish implications is that it was an inside day. Inside days have had a negative risk/reward when they occur under the 200ma. The last time I demonstrated this was in the 1/23/09 Subscriber Letter. I have updated that study below.

SPY posts an inside day and close < 200ma.
Buy on close. Sell X days later. \$100k/trade. 1994 - present.

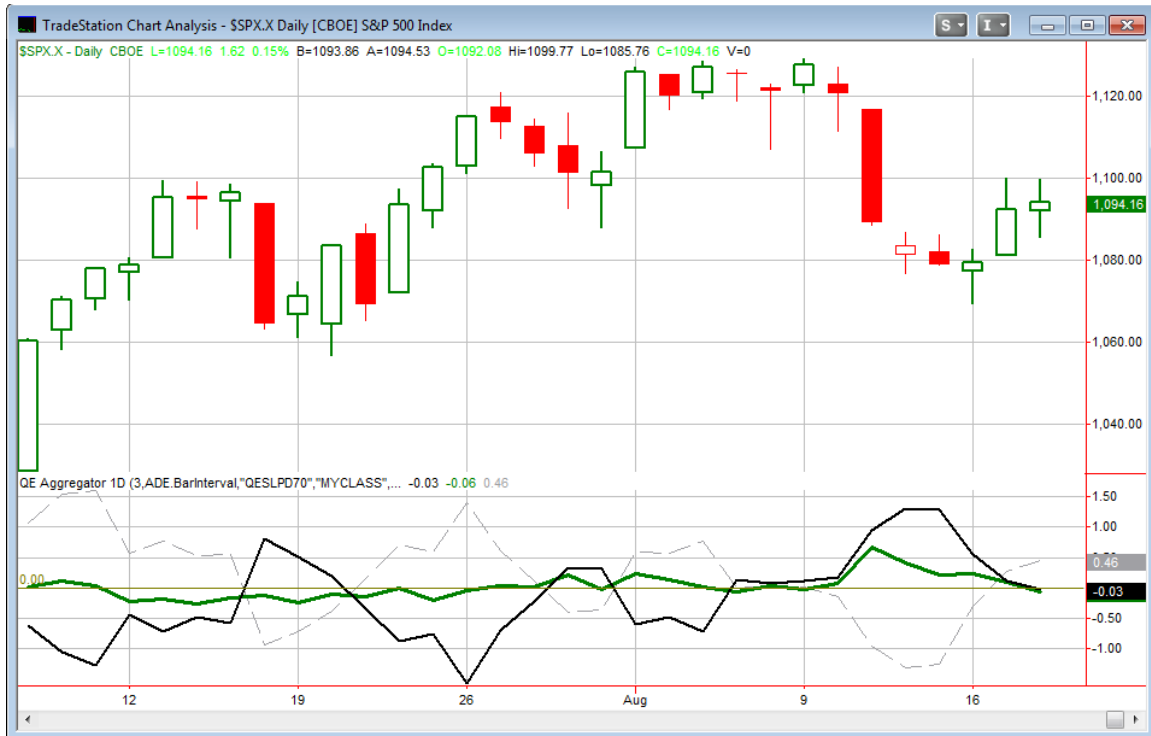
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-40,062.83	95	46	48	48.42	2,172.91	-2,917.01	0.74	0.71	-421.71
4	-24,900.68	107	56	51	52.34	1,998.26	-2,682.42	0.74	0.82	-232.72
3	-45,482.09	113	55	57	48.67	1,960.24	-2,689.39	0.73	0.70	-402.50
2	-41,721.36	127	60	66	47.24	1,330.39	-1,841.59	0.72	0.66	-328.51
1	-27,994.12	133	64	69	48.12	1,009.82	-1,342.35	0.75	0.70	-210.48

These numbers continue to suggest a downside edge – primarily due to the negatively skewed win/loss ratio.

There were also a few studies that appeared that showed a positive SPX and a positive VIX was potentially bearish. I decided not to take these into account tonight. The VIX closes 15 minutes later than the SPX. At 4pm the VIX was down on the day. Between 4

and 4:15 (VIX closing time) the market tanked and the VIX spiked. So while the setup qualified for these studies, the action wasn't in the spirit of the study.

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



Tonight's bearish studies proved enough to flip the green Aggregator line negative. The negative value indicates the net expectation from the Active Studies over the next few days is for downside. The black Differential line also dropped below 0. The 3 up days in a row has allowed the SPX to slightly outperform expectations over the last few days. We therefore have negative expectations and a market that is just barely overbought versus recent expectations. Both lines below 0 is considered a bearish configuration, though the edge somewhat mild. Due to this the Aggregator System flipped from long to short at the close. I noted this was likely to occur on the systems page shortly before the bell. Traders who are interested may check this page each day a few minutes before the bell. Alternately, you could set up a Twitter account and follow me at <http://twitter/qerob> Each day after updating the systems page I try and tweet a link to it.

Currently the green Aggregator line is again set up to remain negative tomorrow. This could change if some bullish studies emerge. Meanwhile the Differential pivot will be 1,088.61 tomorrow. This means the SPX would need to close at or below this level in order to turn the black Differential line positive.

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/

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 1st 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 1st trigger, you purchase only if the trigger is at least the 2nd 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 3rd 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	-16,085.07	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	-6,186.78	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.

SPY short 1/4 index position @ \$109.79 limit ON CLOSE (assuming Aggregator Systems page suggests Aggregator will remain short). I'll start scaling in to an index position tomorrow should the SPY close higher.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
IJR	8/9/2010	\$57.50	\$55.55	-3.39%		System 90609
SPY(1/4)	8/11/2010	\$109.30	\$109.78	0.44%		sold on close - email update
SPY(1/4)	8/12/2010	\$107.65	\$109.78	1.98%		sell @ \$109.78

With the short signal in the Aggregator I'll look to exit the rest of the long SPY. If it gaps down at the open I'll give it a chance to fill. Should it appear unlikely to fill then I may place a stop under the early morning low.

Personally I tried to get a little short exposure at the close on Wednesday thanks to the Aggregator short signal. I got a bit too cute with my entry near the close and didn't get filled. I chased it lower for a few minutes and then let it go as it dropped way down within 5 minutes after the bell. I find few things more frustrating than poor execution.

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