

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 31, 2010

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## Market Overview



## Tonight's Research Points

- Inside days don't provide much edge when they occur on very low volume.
- Breadth was extreme down Monday after extreme up Friday. Interesting but apparently not predictive.
- The Aggregator System switched back to long.
- The NDX Aggressive Trend Timer remained short.

## Short-term Outlook

### The Bottom Line

The market is back to short-term underperformance and the current studies suggest we go higher the next few days. I'll adding back some long exposure.

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 27, 2010	Bounce immediately fails	1-4 days	Bullish	2.65%
August 25, 2010	SPX down 1%. Decliners 2x advancers	1-9 days	Bullish	3.00%
August 24, 2010	3 lower closes into Turnaround Tuesday	1-9 days	Bullish	3.70%
August 24, 2010	HV low SPX no highs	1-8 days	Bearish	-3.20%
<b>Active - Long Term</b>				
August 30, 2010	AAII Survey very bearish	1-30 days	Bullish	
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 7, 2010	McClellan Oscillator Bottom Divergence	int term	Bullish	
<b>Dropped Tonight</b>				
August 26, 2010	SPY gap dn 10-low reverse up	1-3 days	Bearish	-3.70%

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

## The Evidence

The market reversed direction for the 4<sup>th</sup> day in a row on Monday. It continues to chop as neither bulls nor bears have been able to follow through. The damage increased as we approached the close and the final numbers were substantially negative. The SPX lost 1.5%, the Nasdaq lost 1.6% and the Russell 2000 dropped over 2.4%. Breadth was extremely negative as the NYSE Up Issues % came in at 22% and the Up Volume % was a mere 7%. Total NYSE volume appeared to be the lightest in about 2 weeks.

I'm seeing very little of substance today that would provide a compelling a short-term directional edge. The Quantifinder noted a few studies that looked at inside days in SPY during downtrends. I discussed some research associated with these recently in the 8/16/10 Subscriber Letter. There I showed that when these inside days occur without very low volume that they tend to more bearish than in general. Below is a copy of a study from that letter (not updated).

SPY posts an inside day under the 200ma. Today is the smallest range in 3 days. It is not the lowest volume in 5 days. 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
10	-53,572.12	43	20	23	46.51	2,549.14	-4,545.86	0.56	0.49	-1,245.86
9	-42,939.06	44	22	21	50.00	2,174.43	-4,322.69	0.50	0.53	-975.89
8	-37,482.32	45	21	24	46.67	2,083.60	-3,384.91	0.62	0.54	-832.94
7	-39,214.97	48	20	27	41.67	2,085.21	-2,997.01	0.70	0.52	-816.98
6	-56,724.77	49	20	29	40.82	1,833.96	-3,220.82	0.57	0.39	-1,157.65
5	-52,168.80	51	21	30	41.18	1,691.01	-2,922.66	0.58	0.41	-1,022.92
4	-48,007.66	51	21	30	41.18	1,716.29	-2,801.66	0.61	0.43	-941.33
3	-46,979.58	53	24	29	45.28	1,586.45	-2,932.91	0.54	0.45	-886.41
2	-29,797.05	53	22	29	41.51	1,149.38	-1,899.43	0.61	0.46	-562.21
1	-28,692.80	54	22	32	40.74	700.08	-1,377.95	0.51	0.35	-531.35

So here we see a suggestion of a downside edge. But what if just we look at instances that DID come on the lowest volume in 5 days? I've run those results tonight:

SPY posts an inside day under the 200ma. Today is the smallest range in 3 days. **It is** the lowest volume in 5 days. 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
10	34,172.74	34	20	14	58.82	3,870.88	-3,088.92	1.25	1.79	1,005.08
9	20,905.43	34	22	12	64.71	3,053.91	-3,856.72	0.79	1.45	614.87
8	27,846.81	35	24	11	68.57	2,755.54	-3,480.56	0.79	1.73	795.62
7	8,858.16	36	21	15	58.33	2,862.71	-3,417.24	0.84	1.17	246.06
6	9,397.15	38	18	20	47.37	3,116.15	-2,334.68	1.33	1.20	247.29
5	-1,582.37	38	18	19	47.37	2,504.72	-2,456.17	1.02	0.97	-41.64
4	7,987.33	39	20	19	51.28	2,378.15	-2,082.93	1.14	1.20	204.80
3	-2,306.70	40	19	21	47.50	2,414.36	-2,294.26	1.05	0.95	-57.67
2	-2,045.41	42	22	20	52.38	1,503.52	-1,756.14	0.86	0.94	-48.70
1	-131.95	43	21	22	48.84	1,288.67	-1,236.10	1.04	1.00	-3.07

When volume is very light there no longer appears to be a downside edge.

In the 8/27 subscriber letter I showed a study that looked at the “failed bounce” that occurred on 8/25 and 8/26. Today didn’t set up the same way be we again have an attempted rally being beat back right away. Tonight I designed another study that described the action over the last couple of days to see how similar scenarios have played out in the past. Below are the description and the results.

SPY either closes at a 20-day low 2 days ago or makes a 20-day intraday low yesterday. Yesterday it closed up. Today is an inside day with a down close. 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	All: Max Losing Trade	All: Max Winning Trade
10	38,084.96	10	10	0	100.00	3,808.50	0.00	100.00	100.00	3,808.50	0.00	20,713.48
9	26,342.33	10	8	2	80.00	3,762.06	-1,877.08	2.00	8.02	2,634.23	-2,882.00	12,624.80
8	21,183.09	10	7	3	70.00	4,267.72	-2,896.97	1.47	3.44	2,118.31	-5,475.84	15,898.44
7	15,603.55	10	6	4	60.00	4,983.77	-3,574.77	1.39	2.09	1,560.36	-7,242.24	17,351.76
6	13,516.06	10	6	4	60.00	4,518.66	-3,398.98	1.33	1.99	1,351.61	-6,447.36	14,782.76
5	676.64	10	6	4	60.00	3,942.75	-5,744.97	0.69	1.03	67.66	-11,713.44	11,377.00
4	10,317.10	10	6	4	60.00	4,355.30	-3,953.68	1.10	1.65	1,031.71	-9,229.44	11,714.64
3	10,588.64	10	7	3	70.00	3,260.73	-4,078.81	0.80	1.87	1,058.86	-6,458.40	10,848.52
2	9,199.34	10	7	3	70.00	2,418.58	-2,576.91	0.94	2.19	919.93	-3,047.04	6,650.04
1	8,206.29	10	6	4	60.00	2,322.76	-1,432.57	1.62	2.43	820.63	-1,883.84	5,960.08

The overall stats here seem to favor the bulls – especially two weeks out when all 10 instances are positive. But I am not terribly confident in this study. A big issue in my eyes is how much of the gains are due to the best single trade. If you look out 3,4,5,6 or 7 days you can see that the max gain (far right column) is actually larger than the total

gains (2<sup>nd</sup> column). So without that one trade most of the table looks red instead of green. I also listed the instances individually so that you could see the dates and the runup/drawdown of each instance.

SPY either closes at a 20-day low 2 days ago or makes a 20-day intraday low yesterday. Yesterday it closed up. Today is an inside day with a down close. Buy on close. Sell 10 days later. \$100k/trade. 1993 - present.				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
03/03/94	Buy	\$46.56	1.48%	\$1,631.72
03/17/94	Sell	\$47.25		(\$300.58)
01/06/00	Buy	\$137.75	4.86%	\$7,134.00
01/21/00	Sell	\$144.44		\$0.00
05/09/02	Buy	\$107.75	2.18%	\$3,248.00
05/23/02	Sell	\$110.10		(\$1,995.20)
07/16/02	Buy	\$90.56	0.42%	\$3,024.96
07/30/02	Sell	\$90.94		(\$14,219.52)
10/02/02	Buy	\$83.15	4.09%	\$6,695.14
10/16/02	Sell	\$86.55		(\$7,308.16)
12/17/02	Buy	\$90.85	0.24%	\$495.00
01/02/03	Sell	\$91.07		(\$4,114.00)
08/30/05	Buy	\$121.05	1.78%	\$3,047.94
09/14/05	Sell	\$123.21		(\$256.06)
01/22/09	Buy	\$82.75	2.20%	\$6,281.60
02/05/09	Sell	\$84.57		(\$2,633.44)
03/09/09	Buy	\$68.11	20.72%	\$20,816.24
03/23/09	Sell	\$82.22		\$0.00
05/28/10	Buy	\$109.37	0.13%	\$1,599.50
06/14/10	Sell	\$109.51		(\$4,314.08)

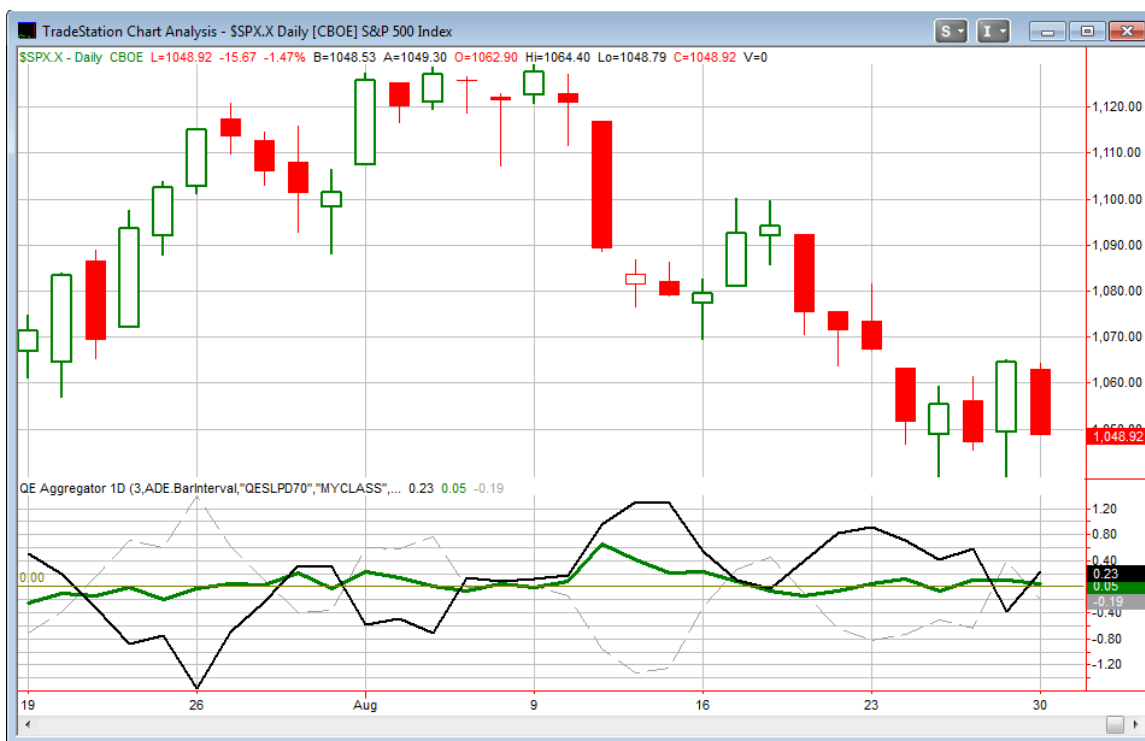
January 2000 and March 2009 rallied strongly and right away. Other than that most instances had to withstand some heat before finishing the period positively. July and October of 2002 were especially volatile.

Also interesting about the last 2 days is that Friday's action saw an NYSE Up Volume % > 90% and Monday was less than 10%. The only other time this has occurred according to my database was October 22, 1987 – a few days after the crash.

Friday's Up Vol % put it above 96% of all days in the last year. Monday was in the bottom 7%. I looked at other time the Up Vol % Ranks were > 92% one day and < 8% the next. I found 14 other instances and since 1970 and no edge in either direction.

So while Monday had plenty of action, it didn't provide any great edge that I was able to discern.

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



Without anything new the green Aggregator remained a bit above 0. The positive value indicates the net expectation from the Active Studies over the next few days is for upside. Meanwhile Monday's decline helped lift the black Differential line back above 0. This means the SPX has underperformed expectations over the last few days. So we have positive expectations and a market that is oversold versus recent expectations. This is considered a bullish configuration. Due to this the Aggregator System turned back to long at the close.

Currently the green Aggregator line is set up to remain positive tomorrow. This could change depending on what studies emerge. Meanwhile the Differential pivot will be 1,048.54 tomorrow. A close below this would mean a positive Differential and a close above it would cause a negative Differential.

The Aggregator has done a nice job sidestepping the down days on Thursday and Monday while capturing the up days on last Wednesday and Friday. Expectations are for the pattern to play out again and I'm looking to get back in.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 8/30 – neutral to bullish***

One indicator I thought it was worth taking a closer look at this weekend was the [AAII Investor Sentiment survey](#). In general the survey is viewed by technicians as a contrary indicator when it reaches extremes.

This past week the number of bears rose to 49.5% and the bulls dropped to 20.7% so it is now at fairly extreme levels. The last time the Bull-Bear Spread was this low was in early July as the July rally was just beginning. Prior to that it was the first week of November of '09 just as that rally was kicking off, and the time before that was early March of '09 just before that rally began.

I looked at the data a number of different ways this weekend. (For those interested you may get all the data using the AAI link I provided above. Just scroll down and you'll find a link to a historical spreadsheet on the right hand side of the page.) Below is a sample of the kind of results I saw when conducting some studies.

AAII Investor Survey Bull-Bear Spread crosses below -25%. Buy SPX on close. Sell X days later. \$100k/trade. 7/87 - 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
50	37,460.19	18	12	6	66.67	6,830.14	-7,416.91	0.92	1.84	2,081.12	-16,443.76	20,975.06
45	48,998.82	19	15	4	78.95	6,372.73	-11,648.05	0.55	2.05	2,578.89	-27,020.80	18,085.65
40	63,192.00	20	16	4	80.00	6,566.10	-10,466.40	0.63	2.51	3,159.60	-27,533.60	18,300.41
35	78,304.76	22	17	4	77.27	6,723.64	-8,999.29	0.75	3.18	3,559.31	-23,596.80	17,152.87
30	80,709.06	21	17	4	80.95	7,128.92	-10,120.63	0.70	2.99	3,843.29	-27,275.20	24,058.32
25	44,567.69	24	18	6	75.00	5,124.79	-7,946.43	0.64	1.93	1,856.99	-24,209.60	15,441.36
20	32,088.11	27	17	10	62.96	5,230.95	-5,683.81	0.92	1.56	1,188.45	-27,130.40	17,878.08
15	20,894.96	27	16	11	59.26	4,143.71	-4,127.67	1.00	1.46	773.89	-10,781.60	16,802.28
10	15,122.51	28	17	11	60.71	3,920.26	-4,683.82	0.84	1.29	540.09	-12,337.92	16,319.16
5	33,080.64	28	16	12	57.14	3,689.49	-2,162.60	1.71	2.27	1,181.45	-4,845.44	18,981.60

So what we see here is that an extremely pessimistic outlook from investors has been followed by a rise in the market on pretty consistent basis. Six weeks later the market has been higher 81% of the time and the average gain was over 7%. The problem is that the failures have been very, very large. Using the same 6-week time frame the average loss was 10% and the max loss was 27%. The max loss occurred in September/October of 2008. August of 1990 also saw a sharp decline in the spread to levels similar to current levels. That was followed by further selling that maxed out around a 12% decline

between then and October. Other instances that were followed by large selloffs included July of 2002 with a 12% decline and February 2009 with a 14% decline.

So it appears the AAI Investment Survey is suggesting there is a good chance of a rally emerging over the next several weeks. But if the market can't manage to rally then the probable alternative is a substantial selloff.

### **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 @ \$105.31 limit. Based on the Aggregator I'll be looking to add back exposure again.*

### **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>
SPY(1/4)	8/12/2010	\$107.65	\$105.31	-2.17%		
CMCSA	8/24/2010	\$17.29	\$17.00	-1.68%		System 80402
<b>SPY(1/4)</b>	<b>8/12/2010</b>	<b>\$105.23</b>	<b>\$106.86</b>	<b>1.55%</b>		<b><i>sold @ \$106.86 limit</i></b>

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