

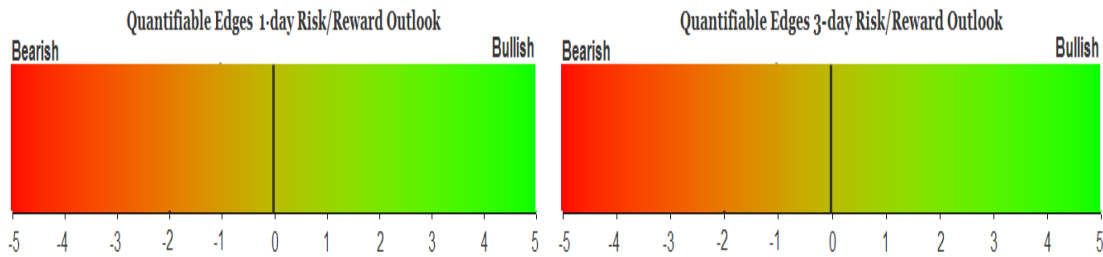
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 1, 2010

Volume 3 Issue 168

## Market Overview



## Tonight's Research Points

- 1<sup>st</sup> Day of Month is seasonally bullish.
- After bad Augusts, September has often performed poorly.
- The Aggregator System switched back to flat.
- The NDX Aggressive Trend Timer remained short.

## Short-term Outlook

### The Bottom Line

The Aggregator turned back to neutral but that will only last 1 day unless the market either rallies strongly or more bearish evidence emerges. Without one of those things happening it could flip back to bullish tomorrow.

## 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>				
September 1, 2010	1st Day of Month	1 day	Bullish	
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>				
September 1, 2010	August down > 4%	1 month	Bearish	
August 30, 2010	AAII Survery 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	

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

### *The Evidence*

After much wiggling the market put in a mixed day on Tuesday. The SPX and Russell both closed up less than 0.1% while the Nasdaq fell about 0.3%. Breadth was mildly positive as the NYSE Up Issues % came in at 55% and the Up Volume % was 60%. Total volume hit its highest level in over a month on the NYSE.

The market remains stuck in a choppy, sideways consolidation. Despite this and the fact that it has alternated between positive and negative the last 5 days we still have a few pieces of evidence to consider tonight.

Wednesday is the first day of the month. Most subscribers are well aware that since the late 80's the 1<sup>st</sup> day of the month has carried a bullish bias. Below is a link to the July 1, 2009 study that looked at this in more detail.

<http://quantifiableedges.blogspot.com/2009/07/1st-day-of-month-tendencies.html>

Also noted by the Quantifinder tonight was a study that looked at days where the SPX rose while the SOX declined and there was a large performance gap between them. I reviewed this study in some detail in the 8/2/10 Subscriber Letter a few weeks ago. I found that although the setup suggested bearish tendencies over the long haul, more recent performance was not bearish. I've updated one table from that letter below.

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)
07/30/10	Buy	\$1,101.60	1.71%	\$2,313.00
08/03/10	Sell	\$1,120.46		\$0.00

Since the March 2009 bottom there has not been any hint of bearishness with this setup. I'll continue to monitor the study but will not be including it among the active studies tonight.

September has a well-earned reputation as the worst month of the year for the stock market. But with August performing so poorly I wondered how that might affect September's performance. The SPX finished August down 4.7%. Below I conducted a study showing how September has performed following August returns worse than X%.

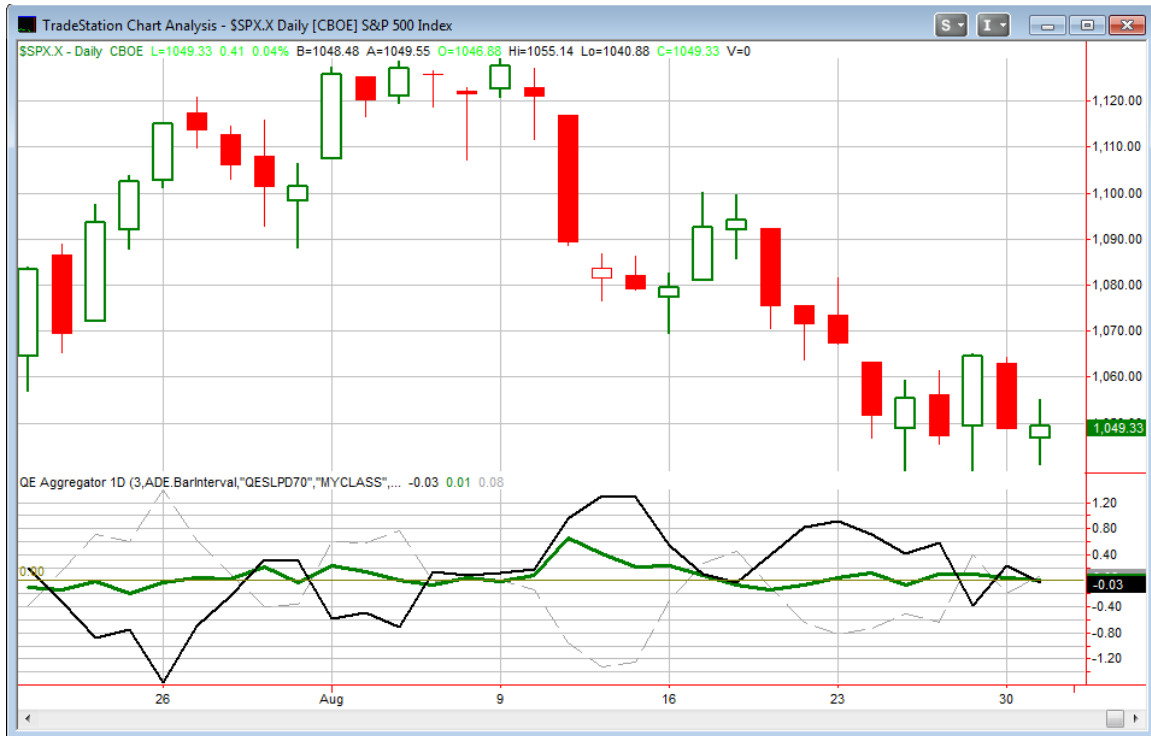
August closes lower by at least X%. Buy SPX at close on last day of August. Sell the last day of September. \$100k/trade. 1961 - present.												
X%	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade	All: Max Losing Trade	All: Max Winning Trade
0	-7,833.65	19	10	9	52.63	3,346.26	-4,588.47	0.73	0.81	-412.30	-11,933.46	6,188.00
-1	-11,256.39	16	8	8	50.00	3,401.54	-4,808.59	0.71	0.71	-703.52	-11,933.46	6,188.00
-2	-14,619.97	12	5	7	41.67	4,075.45	-4,999.60	0.82	0.58	-1,218.33	-11,933.46	6,188.00
-3	-11,816.11	9	4	5	44.44	4,867.17	-6,256.96	0.78	0.62	-1,312.90	-11,933.46	6,188.00
-4	-19,789.89	7	2	5	28.57	5,747.46	-6,256.96	0.92	0.37	-2,827.13	-11,933.46	6,188.00

While we're not looking at a huge number of instances it does appear that going into September on a bad note in the past has not alleviated any risk. The worse August was the worse September was. Below I've listed the 7 instances where, like now, August finished down over 4%.

August closes lower by at least X%. Buy SPX at close on last day of August. Sell the last day of September. \$100k/trade. 1961 - present.				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
08/31/66	Buy	\$77.10	(0.70%)	\$3,865.06
09/30/66	Sell	\$76.56		(\$1,361.85)
08/30/74	Buy	\$72.15	(11.93%)	\$0.00
09/30/74	Sell	\$63.54		(\$11,933.46)
08/31/81	Buy	\$122.78	(5.38%)	\$1,465.20
09/30/81	Sell	\$116.17		(\$10,248.26)
08/31/90	Buy	\$322.56	(5.12%)	\$1,230.70
09/28/90	Sell	\$306.05		(\$8,242.90)
08/29/97	Buy	\$899.47	5.32%	\$6,784.32
09/30/97	Sell	\$947.28		\$0.00
08/31/98	Buy	\$957.55	6.21%	\$11,289.20
09/30/98	Sell	\$1,017.05		(\$1,825.20)
08/31/01	Buy	\$1,133.58	(8.17%)	\$1,920.16
09/28/01	Sell	\$1,040.94		(\$16,617.04)

What stands out to me here is the size of the drawdowns. Four of seven instances saw September swoons of over 8%. While not statistically significant, I do think this is worth considering.

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



It's difficult to see in the graph but the green Aggregator line is still just a smidge above 0. The positive value indicates the net expectation from the Active Studies over the next few days is for upside. Meanwhile the black Differential line fell below 0. This means the SPX has outperformed expectations over the last few days. So we have slightly positive expectations but a market that is a little overbought versus recent expectations. With both lines so close to 0 but on opposing sides it doesn't get much more neutral than this. Due to this the Aggregator System turned back to flat 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 1,065.82 tomorrow. A close below this would mean a positive Differential and a close above it would cause a negative Differential. So to keep the Differential line in negative territory the SPX would need to rally about 1 1/2% tomorrow.

I'll be looking to take profits and exit part of my SPY position should we get further strength tomorrow.

**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 is 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 if 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.*

*No new trade ideas to track tonight.*

**Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	8/12/2010	\$107.65	\$105.31	-2.17%		
CMCSA	8/24/2010	\$17.29	\$17.09	-1.16%		System 80402
SPY(1/4)	8/31/2010	\$104.92	\$105.31	0.37%		see exit strategy below

I'll look to exit 1 lot of SPY at a limit price of \$106.36, which is about 1% above Tuesday's close. While things could change dramatically between now and the open, futures are higher as I type this late at night. Should they gap higher without hitting the \$106.36 limit, I will place a sell stop at Tuesday's close of \$105.31.

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