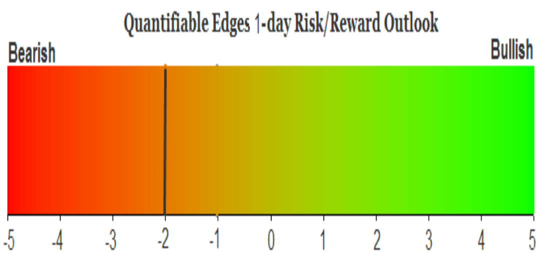
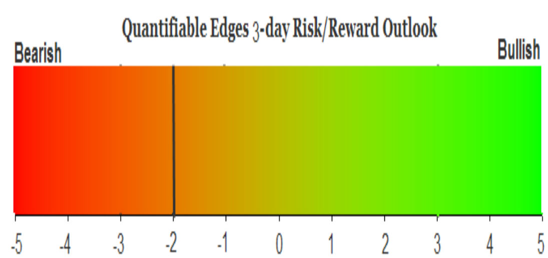
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 2, 2010 Volume 3 Issue 169

Market Overview





Tonight's Research Points

- Short-term highs with strong breadth but weak volume often lead to pullbacks.
- Gains of 2.5% or more on the 1st day of the month suggest a short-term downside edge.
- The strong gap up and trend day higher under the 200ma suggest a pullback is likely.
- The 90% Up Volume day in 1 weeks suggest bullish intermediate-term edge.
- The Aggregator System turned short.
- The NDX Aggressive Trend Timer remained short.

Short-term Outlook
The Bottom Line

There is a lot of evidence suggesting Wednesday's move is more likely to pull back than follow through. I've closed out my longs and am conservatively looking to gain short exposure.

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

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				
September 2, 2010	1st day of month up 2.5%	1-6 days	Bearish	-3.35%
September 2, 2010	10-high, strong breadth, low vol, <200	1-7 days	Bearish	-2.40%
September 2, 2010	SPY gap up, trend up, < 200	1-5 days	Bearish	-4.00%
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%
Active - Long Term				
September 2, 2010	2 90% Up Vol days in 1 week	1-20 days	Bullish	
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	
Dropped Tonight				
September 1, 2010	***1st Day of Month***	***1 day***	***Bullish***	
August 27, 2010	***Bounce immediately fails***	***1-4 days***	***Bullish***	***2.65%***

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

The Evidence

Boom! The market exploded higher to open the month. The day started with a huge gap, never really dipped and then rallied for a good part of the morning and again as it approached the close. The SPX and Nasdaq both rose 3.0% while the Russell 2000 gained 3.8%. Breadth was very strong as the NYSE Up Issues % came in at 85% and the Up Volume % was 96%. The rally was not accompanied by an increase in volume though. Volume was a little above average but it still couldn't match Tuesday's volume.

Just closing at a new short-term high in a downtrend often sets up a shortable scenario as I demonstrated in the April 3, 2009 blog. But action was much more interesting than just closing at a new short-term high. On 4/5/10 I looked at other times a short-term high was accompanied by strong breadth but weak volume. In that letter I broke it out above and below the 200ma. Results were bearish and I also noted the following: 1) The bearish tendencies became more pronounced around 1997, 2) Most instances occurred above the 200ma, and 3) those that occurred below the 200ma, while few, had led to especially poor returns.

Below is a table showing this setup but without any 200ma stipulation.

SPX closes at a 10-day high. The NYSE posts the highest Up Vol % of the last 10 days. Total NYSE volume is < yesterday. Buy SPX on close. Sell X days later. $100k/trade. 1997 - 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	-18,644.39	36	17	19	47.22	1,651.93	-2,459.32	0.67	0.60	-517.90
9	-21,846.09	36	18	18	50.00	1,494.24	-2,707.92	0.55	0.55	-606.84
8	-25,380.61	36	17	19	47.22	1,209.01	-2,417.57	0.50	0.45	-705.02
7	-37,354.88	36	15	21	41.67	902.11	-2,423.17	0.37	0.27	-1,037.64
6	-34,923.71	37	15	22	40.54	640.31	-2,024.01	0.32	0.22	-943.88
5	-29,122.76	38	17	21	44.74	616.52	-1,885.88	0.33	0.26	-766.39
4	-25,664.59	38	14	24	36.84	642.28	-1,444.02	0.44	0.26	-675.38
3	-17,750.15	39	15	24	38.46	616.56	-1,124.94	0.55	0.34	-455.13
2	-14,504.17	39	18	21	46.15	376.70	-1,013.56	0.37	0.32	-371.90
1	-9,896.05	39	17	22	43.59	331.55	-706.02	0.47	0.36	-253.74
87% of instances posted a close below the entry price at some point in the next week.										

Here the overall bearish tendency can be clearly seen. Now let's look at occurrences below the 200ma. I ran this test back to 1992. Prior to that no bearish tendency was apparent.

SPX closes at a 10-day high and below the 200ma. The NYSE posts the highest Up Vol % of the last 10 days. Total NYSE volume is < yesterday. Buy SPX on close. Sell X days later. $100k/trade. 1992 - 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
6	-15,300.74	6	0	6	0.00	0.00	-2,550.12	0.00	0.00	-2,550.12
5	-16,099.18	6	0	6	0.00	0.00	-2,683.20	0.00	0.00	-2,683.20
4	-12,935.83	6	0	6	0.00	0.00	-2,155.97	0.00	0.00	-2,155.97
3	-5,681.85	6	1	5	16.67	1,202.74	-1,376.92	0.87	0.17	-946.98
2	-6,402.26	6	1	5	16.67	214.20	-1,323.29	0.16	0.03	-1,067.04
1	-6,225.75	6	1	5	16.67	123.90	-1,269.93	0.10	0.02	-1,037.63

With so few instances I'll simply take my estimates from the first study. Still, the strength and consistency of the bearish inclination here is notable.

Another study from the Quantifinder tonight that I took a new look at examined performance following large (2.5%+) rallies on the 1st day of the month. I last looked at this study on 6/2/09. I have updated the results below.

SPX rises at least 2.5% on the first day of the month.
Buy on close. Sell X days later. $100k/trade. 1961 - 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
6	-24,267.63	12	2	10	16.67	2,743.90	-2,975.54	0.92	0.18	-2,022.30
5	-12,523.28	12	4	8	33.33	1,638.22	-2,384.52	0.69	0.34	-1,043.61
4	-15,824.19	12	5	7	41.67	890.88	-2,896.94	0.31	0.22	-1,318.68
3	-7,659.03	12	5	7	41.67	1,035.24	-1,833.61	0.56	0.40	-638.25
2	-2,172.79	12	6	6	50.00	912.94	-1,275.07	0.72	0.72	-181.07
1	-2,976.90	12	6	6	50.00	286.59	-782.74	0.37	0.37	-248.08

Low instances in this test too. Still I find it very interesting how both studies with completely unrelated criteria have produced such powerful and consistently negative results.

In addition to volume, short-term highs, and seasonality all suggesting a pullback the price action in the SPY also provided some hints of downside. The study below was last published in the 5/11/09 Letter. I've updated the results

SPY gaps up over 1%, never fills, closes > the open and < 200ma.
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	-24,583.44	33	15	18	45.45	3,518.44	-4,297.78	0.82	0.68	-744.95
9	-9,268.70	35	18	17	51.43	3,727.05	-4,491.51	0.83	0.88	-264.82
8	-14,329.48	36	21	15	58.33	2,780.96	-4,848.64	0.57	0.80	-398.04
7	-13,981.84	39	18	21	46.15	3,167.36	-3,380.68	0.94	0.80	-358.51
6	4,240.26	40	18	22	45.00	3,688.68	-2,825.27	1.31	1.07	106.01
5	-29,826.65	44	22	21	50.00	2,676.17	-4,223.92	0.63	0.66	-677.88
4	-43,894.42	47	22	25	46.81	2,003.58	-3,518.93	0.57	0.50	-933.92
3	-22,894.55	47	20	27	42.55	2,281.19	-2,537.71	0.90	0.67	-487.12
2	-23,875.81	49	26	23	53.06	1,701.25	-2,961.23	0.57	0.65	-487.26
1	-16,492.77	50	26	23	52.00	708.74	-1,518.26	0.47	0.53	-329.86

Especially over the first few days a downside edge seems apparent. Often when this setup has occurred the market has also opened near its lows and closed near its highs. This was the case today and I reran the above results to see how this kind of intraday trend move have affect results.

SPY gaps up over 1%, never fills, leaves the open in the bottom 25% of the daily range and the close in the top 25% and close < 200ma. 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	-21,078.87	18	7	11	38.89	3,867.31	-4,377.28	0.88	0.56	-1,171.05
9	-31,393.90	21	9	12	42.86	3,216.25	-5,028.35	0.64	0.48	-1,494.95
8	-41,361.33	21	9	12	42.86	2,715.54	-5,483.43	0.50	0.37	-1,969.59
7	-31,172.75	22	9	13	40.91	3,120.49	-4,558.24	0.68	0.47	-1,416.94
6	-27,921.01	22	6	16	27.27	4,528.91	-3,443.41	1.32	0.49	-1,269.14
5	-27,446.09	22	9	12	40.91	2,257.47	-3,980.28	0.57	0.43	-1,247.55
4	-23,174.34	22	11	11	50.00	1,610.99	-3,717.75	0.43	0.43	-1,053.38
3	-14,516.59	22	9	13	40.91	1,741.89	-2,322.58	0.75	0.52	-659.85
2	-16,496.84	23	10	13	43.48	1,668.89	-2,552.75	0.65	0.50	-717.25
1	-6,885.78	23	13	9	56.52	458.87	-1,427.90	0.32	0.46	-299.38

As you can see hear, the strong upward intraday move where the market opened near its lows and closed near its highs actually provided more of a downside edge than just the base scenario. In fact, nearly the entire bearish edge was due to instances like this.

And while the bearish studies ruled the day there was some good news for the bulls. Today was the 2nd 90% Up Volume day within 5 days. In the past this has been a positive sign for the intermediate-term. I've updated results from the 6/16/10 Subscriber Letter below.

NYSE Up Volume % > 90% for the 2nd time in a week. 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
20	50,331.69	10	8	2	80.00	6,795.66	-2,016.78	3.37	13.48	5,033.17
19	44,421.55	10	8	2	80.00	6,156.53	-2,415.33	2.55	10.20	4,442.16
18	45,000.78	10	8	2	80.00	6,092.35	-1,869.02	3.26	13.04	4,500.08
17	48,842.56	10	8	2	80.00	6,417.21	-1,247.55	5.14	20.58	4,884.26
16	50,769.30	10	9	1	90.00	5,708.20	-604.52	9.44	84.98	5,076.93
15	45,805.40	10	8	2	80.00	5,895.45	-679.08	8.68	34.73	4,580.54
14	43,534.40	10	9	1	90.00	4,943.24	-954.72	5.18	46.60	4,353.44
13	41,662.51	10	9	1	90.00	4,803.70	-1,570.80	3.06	27.52	4,166.25
12	24,392.58	11	8	3	72.73	4,303.07	-3,343.98	1.29	3.43	2,217.51
11	26,903.76	11	8	3	72.73	4,565.64	-3,207.13	1.42	3.80	2,445.80
10	28,639.37	11	8	3	72.73	4,729.25	-3,064.86	1.54	4.11	2,603.58
9	27,284.83	11	9	2	81.82	3,595.93	-2,539.27	1.42	6.37	2,480.44
8	22,086.69	11	9	2	81.82	3,308.20	-3,843.57	0.86	3.87	2,007.88
7	23,663.84	12	7	5	58.33	4,686.25	-1,827.98	2.56	3.59	1,971.99
6	6,897.11	12	6	6	50.00	3,422.71	-2,273.19	1.51	1.51	574.76
5	2,543.10	13	6	7	46.15	3,404.27	-2,554.65	1.33	1.14	195.62
4	13,322.90	13	6	7	46.15	3,509.18	-1,104.60	3.18	2.72	1,024.84
3	3,404.71	15	9	6	60.00	1,912.64	-2,301.51	0.83	1.25	226.98
2	-4,585.38	15	9	6	60.00	1,183.72	-2,539.80	0.47	0.70	-305.69
1	7,120.48	17	11	6	64.71	1,071.55	-777.76	1.38	2.53	418.85

The first week or so have shown no edge but once you get out a bit further there has been strong, consistent upside. Below is a list of the 10 (non-overlapping) instances with a 15-day exit.

NYSE Up Volume % > 90% for the 2nd time in a week.
Buy SPX on close. Sell 15 days later. $100k/trade. 1970 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
11/29/71	Buy	$93.41	8.71%	$8,709.80
12/20/71	Sell	$101.55		$0.00
08/20/82	Buy	$113.02	8.16%	$10,440.04
09/13/82	Sell	$122.24		($928.20)
08/02/84	Buy	$157.99	5.77%	$6,831.92
08/23/84	Sell	$167.11		$0.00
01/05/87	Buy	$252.19	6.91%	$11,388.96
01/26/87	Sell	$269.61		($23.76)
08/31/07	Buy	$1,473.99	2.97%	$4,338.25
09/24/07	Sell	$1,517.73		($2,324.90)
11/28/07	Buy	$1,469.01	(1.09%)	$3,710.08
12/19/07	Sell	$1,452.99		($2,268.48)
11/26/08	Buy	$887.68	(0.27%)	$3,491.04
12/18/08	Sell	$885.28		($8,062.88)
03/12/09	Buy	$750.74	11.14%	$12,617.71
04/02/09	Sell	$834.38		($1,101.24)
05/27/10	Buy	$1,103.06	1.31%	$1,615.50
06/18/10	Sell	$1,117.51		($5,480.10)
07/13/10	Buy	$1,095.34	2.29%	$2,908.36
08/03/10	Sell	$1,120.46		($3,499.86)

I've included this study on the intermediate-term active list. For the short-term, the bearish studies have dominated the letter this evening.

I have updated the Aggregator chart below.

With so many short-term bearish studies appearing today the green Aggregator line turned squarely negative. The negative value indicates the net expectation from the Active Studies over the next few days is for downside. Meanwhile the black Differential line fell further below 0. This means the SPX has solidly outperformed expectations over the last few days. So we have negative expectations and a market that is overbought versus recent expectations. Historically, this has provided a downside edge. The condition is represented by both lines closing below 0. Due to this the Aggregator System turned short at the close.

Currently the green Aggregator line is set up to remain negative tomorrow. This could change depending on what studies emerge. Meanwhile the Differential pivot will be 1,050.72 tomorrow. It would take a close at or below this level to flip the black Differential line positive. That's nearly a 3% drop from Wednesday's close.

Trying to short into such a strong move coming from an area near an intermediate-term low typically adds risk. Therefore, I will look to conservatively add short exposure as described in the trade ideas section below.

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 AAII 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 AAII 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 – short ¼ index position @ $109.00 LIMIT ON OPEN. If not filled on open, cancel order and look to enter at $108.46 limit ON CLOSE. Based on the short-term outlook and the Aggregator. I'll take a gap up. Otherwise, I'm hoping for a better entry price than just Wednesday's close.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	8/12/2010	$107.65	$108.46	0.75%		sold on close
CMCSA	8/24/2010	$17.29	$17.94	3.76%		sold on close
SPY(1/4)	8/31/2010	$104.92	$106.73	1.73%		sold on open

The 2nd lot of SPY and the CMCSA were sold on the close. CMCSA hit its exit trigger for System 80402. Gold subscribers were send an email about 3:30pm reminding them of CMCSA and alerting them that I would exit SPY on the close since the Aggregator was likely to trigger a short.