

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

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September 8, 2010

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## **Market Overview**



## **Tonight's Research Points**

- Weak volume just after Labor Day has been rare but bearish.
- Very low SPY volume while trading > 10ma suggests a downside edge.
- Unfilled gap up followed by unfilled gap down in SPY < 200ma has had bearish implications in the past.
- The 1%+ selloff on weak breadth has been a good predictor of upside over the last several years.
- The Aggregator System remained short.
- The NDX Aggressive Trend Timer remained long.

## ***Short-term Outlook***

### ***The Bottom Line***

Despite the selloff Tuesday more short-term bearish evidence appeared. It looks like this selloff may have a little further to go.

**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 8, 2010	SPX dn 1%. Decliners double advancers	1-9 days	Bullish	3.65%
September 8, 2010	SPY vol 20-day low while close > 10ma	1-5 days	Bearish	-2.10%
September 8, 2010	Unfilled gap up + unfilled gap dn < 200	1-4 days	Bearish	-3.60%
September 7, 2010	3 Unfilled Up Gaps in SPY	1-3 days	Bearish	-1.40%
September 7, 2010	VXO < 15% below 10ma	1-5 days	Bearish	-3.80%
September 7, 2010	SPX up 3 days, NYSE Up Vol % > 90%	1-7 days	Bullish	2.90%
September 3, 2010	Up 0.75% on lower vol 2 days < 200ma	1-5 days	Bearish	-3.90%
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%
<b>Active - Long Term</b>				
September 1, 2010	Tues after Labor Day lowest volume 5	1 month	Bearish	
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	
<b>Dropped Tonight</b>				
September 3, 2010	Up 3, low range, no 50-low, < 200ma	1-2 days	Bearish	-1.80%

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

***The Evidence***

The market got off to a bad start on Tuesday and never recovered. It finished near its lows for the day. Damage for the SPX was 1.2% while the Nasdaq lost 1.1% and the Russell 2000 dropped 2.2%. Breadth was weak as the NYSE Up Issues % came in at 26% and the Up Volume % was 15%. Total NYSE volume was the lowest of the last 5 days.

In a post last year [I discussed how low volume on the Tuesday after Labor Day](#) was often a bad sign. I looked at what happened when 1) volume came in lower than the Friday before Labor Day, and 2) when volume failed to hit the highest level in at least 5 days. Tuesday not only did volume fail to hit the highest level in 5 days, it actually came in at the *lowest* level of the last 5 days. Since 1970 this has only happened 7 other times. As you'll see below, it hasn't been a good sign going forward.

NYSE volume is the lowest in 5 days on the Tuesday after Labor Day.  
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	-18,873.63	7	1	6	14.29	502.03	-3,229.28	0.16	0.03	-2,696.23
19	-18,376.20	7	1	6	14.29	115.22	-3,081.90	0.04	0.01	-2,625.17
18	-20,363.82	7	1	6	14.29	502.03	-3,477.64	0.14	0.02	-2,909.12
17	-22,148.52	7	0	7	0.00	0.00	-3,164.07	0.00	0.00	-3,164.07
16	-18,996.45	7	1	6	14.29	222.21	-3,203.11	0.07	0.01	-2,713.78
15	-16,019.84	7	1	6	14.29	1,547.24	-2,927.85	0.53	0.09	-2,288.55
14	-15,050.24	7	1	6	14.29	1,851.75	-2,817.00	0.66	0.11	-2,150.03
13	-13,234.21	7	1	6	14.29	1,613.08	-2,474.55	0.65	0.11	-1,890.60
12	-11,842.05	7	1	6	14.29	2,008.12	-2,308.36	0.87	0.14	-1,691.72
11	-14,319.38	7	1	6	14.29	2,164.49	-2,747.31	0.79	0.13	-2,045.63
10	-12,515.68	7	1	6	14.29	2,896.96	-2,568.77	1.13	0.19	-1,787.95
9	-13,229.93	7	1	6	14.29	938.22	-2,361.36	0.40	0.07	-1,889.99
8	-13,839.34	7	1	6	14.29	979.37	-2,469.79	0.40	0.07	-1,977.05
7	-7,900.72	7	3	4	42.86	1,063.22	-2,772.59	0.38	0.29	-1,128.67
6	-3,077.18	7	2	5	28.57	2,082.02	-1,448.24	1.44	0.58	-439.60
5	-2,563.59	7	2	5	28.57	1,912.26	-1,277.62	1.50	0.60	-366.23
4	-1,048.58	7	3	4	42.86	1,092.83	-1,081.77	1.01	0.76	-149.80
3	1,667.62	7	4	3	57.14	934.00	-689.46	1.35	1.81	238.23
2	147.55	7	4	3	57.14	537.21	-667.10	0.81	1.07	21.08
1	-1,749.00	7	3	4	42.86	644.48	-920.61	0.70	0.53	-249.86

Instances are low, and the 1<sup>st</sup> week has been a bit of a tossup. But when traders fail to show interest after many summer vacations traditionally end, then a move down has always followed.

Below are more details on the 7 instances using a 20-day exit:

NYSE volume is the lowest in 5 days on the Tuesday after Labor Day.  
Buy SPX on close. Sell 20 days later. \$100k/trade. 1970 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
09/05/72	Buy	\$111.23	(0.84%)	\$0.00
10/03/72	Sell	\$110.30		(\$2,858.82)
09/03/74	Buy	\$70.52	(10.11%)	\$1,276.20
10/01/74	Sell	\$63.39		(\$10,110.34)
09/05/78	Buy	\$104.49	(1.81%)	\$3,406.92
10/03/78	Sell	\$102.60		(\$3,665.31)
09/07/82	Buy	\$121.36	0.50%	\$4,888.62
10/05/82	Sell	\$121.97		(\$1,835.29)
09/03/85	Buy	\$187.91	(2.05%)	\$473.48
10/02/85	Sell	\$184.05		(\$4,506.04)
09/04/90	Buy	\$323.09	(2.44%)	\$1,062.96
10/02/90	Sell	\$315.20		(\$8,380.08)
09/06/94	Buy	\$471.86	(2.14%)	\$622.45
10/04/94	Sell	\$461.77		(\$2,825.29)

**The average max upside was 1.7%. The average drawdown was nearly 3 times that at 4.9%. And even if you eliminate the very large 1974 instance the average drawdown was still slightly over 4%.**

I don't feel with the low number of instances and the slow 1<sup>st</sup> week this is worth adding to the Aggregator. I do feel in conjunction with the "August down greater than 4%" study from last week it is worth considering. We could be getting some warning signs of a September swoon. I have added it to the long-term active list.

Another volume-related study with bearish implications was last updated in the 2/23/10 Subscriber Letter. This one looked at SPY volume and I have updated it below.

SPY posts lowest volume in 20 days and closes > 10ma.  
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	-35,012.52	142	77	65	54.23	2,225.29	-3,174.76	0.70	0.83	-246.57
9	-39,684.82	146	86	60	58.90	1,933.95	-3,433.41	0.56	0.81	-271.81
8	-24,233.81	155	90	64	58.06	1,917.03	-3,074.48	0.62	0.88	-156.35
7	-34,417.61	158	82	75	51.90	1,827.78	-2,457.27	0.74	0.81	-217.83
6	-49,944.16	161	77	83	47.83	1,694.06	-2,173.34	0.78	0.72	-310.21
5	-77,924.82	172	77	94	44.77	1,535.07	-2,086.44	0.74	0.60	-453.05
4	-56,025.73	181	87	94	48.07	1,283.69	-1,784.11	0.72	0.67	-309.53
3	-56,330.47	187	76	110	40.64	1,332.78	-1,432.93	0.93	0.64	-301.23
2	-46,569.37	199	83	115	41.71	1,100.62	-1,199.31	0.92	0.66	-234.02
1	-42,719.53	227	94	132	41.41	774.40	-875.10	0.88	0.63	-188.19

I also looked at more recent performance of this study tonight. Even focusing on just the period from the March 2009 bottom though the present this one has managed to suggest a downside edge over the 1-5 day period.

The Quantifinder today also showed a study that suggested when the SPY is below the 200ma and it experiences a strong “gap up & go” day followed by a “gap down & crap” day, that there is typically more short-term selling. Below I have copied that results table from the 5/5/10 Subscriber Letter. (Results are the same since it didn’t trigger then and this is the first instance since.)

SPY has an unfilled gap up that closes higher than the open followed by an unfilled gap down that closes lower than the open. Both gaps are at least 0.25%. 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
5	-11,609.90	14	3	11	21.43	2,677.33	-1,785.63	1.50	0.41	-829.28
4	-25,285.41	14	2	12	14.29	4,162.73	-2,800.91	1.49	0.25	-1,806.10
3	-15,392.05	14	6	8	42.86	1,438.60	-3,002.96	0.48	0.36	-1,099.43
2	-4,359.02	14	6	8	42.86	1,693.03	-1,814.65	0.93	0.70	-311.36
1	-10,831.41	14	3	11	21.43	1,113.27	-1,288.29	0.86	0.24	-773.67

Results here are strongly negative over the next 1-4 days. I also decided tonight to show the 14 instances and the stats associated with a 4-day holding period.

SPY has unfilled gap up that closes higher than the open followed by an unfilled gap down that closes lower than the open. Close < 200ma.  
Buy on close. Sell 4 days later. \$100k/trade. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
09/24/98	Buy	\$104.38	(2.52%)	\$1,848.94
09/30/98	Sell	\$101.75		(\$2,874.00)
09/20/00	Buy	\$144.89	(1.21%)	\$807.30
09/26/00	Sell	\$143.13		(\$1,904.40)
04/06/01	Buy	\$113.30	4.90%	\$5,018.58
04/12/01	Sell	\$118.85		(\$458.64)
09/27/02	Buy	\$82.75	(0.53%)	\$3,648.16
10/03/02	Sell	\$82.31		(\$3,309.92)
10/16/02	Buy	\$86.55	3.43%	\$4,562.25
10/22/02	Sell	\$89.52		\$0.00
02/19/03	Buy	\$85.18	(0.83%)	\$656.88
02/25/03	Sell	\$84.47		(\$3,472.08)
06/16/06	Buy	\$124.65	(0.15%)	\$842.10
06/22/06	Sell	\$124.46		(\$882.20)
01/15/08	Buy	\$138.17	(5.39%)	\$686.85
01/22/08	Sell	\$130.72		(\$8,798.91)
06/06/08	Buy	\$136.29	(1.35%)	\$886.93
06/12/08	Sell	\$134.45		(\$2,030.41)
06/26/08	Buy	\$128.23	(1.60%)	\$724.47
07/02/08	Sell	\$126.18		(\$1,791.70)
08/29/08	Buy	\$128.79	(3.39%)	\$1,489.92
09/05/08	Sell	\$124.42		(\$5,269.04)
10/21/08	Buy	\$95.86	(12.42%)	\$0.00
10/27/08	Sell	\$83.95		(\$12,682.88)
01/29/09	Buy	\$84.55	(1.44%)	\$1,004.70
02/04/09	Sell	\$83.33		(\$3,829.68)
05/11/09	Buy	\$91.24	(2.77%)	\$646.64
05/15/09	Sell	\$88.71		(\$3,386.64)

The last time this pattern resulted in a 4-day gain was 2002.

Another Quantifinder study, but with bullish implications, appeared tonight as well. This one was last updated in the 5/19/10 Subscriber Letter. I have updated it again tonight.

SPX closes down 1% and decliners double advancers. Yesterday did not close at a 20-day high.  
Buy on close. Sell X days later. \$100k/trade. 10/20/87 - 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
10	110,019.31	117	74	43	63.25	3,445.68	-3,371.19	1.02	1.76	940.34
9	133,201.72	123	80	43	65.04	3,425.40	-3,275.12	1.05	1.95	1,082.94
8	118,401.38	133	84	48	63.16	3,329.82	-3,360.48	0.99	1.73	890.24
7	126,686.02	143	84	59	58.74	3,273.46	-2,513.30	1.30	1.85	885.92
6	119,479.10	152	91	61	59.87	3,194.33	-2,806.64	1.14	1.70	786.05
5	126,204.31	170	108	62	63.53	2,702.56	-2,672.12	1.01	1.76	742.38
4	93,144.08	179	107	72	59.78	2,533.28	-2,471.06	1.03	1.52	520.36
3	110,952.91	205	126	79	61.46	2,253.67	-2,189.99	1.03	1.64	541.23
2	110,650.06	235	135	100	57.45	2,092.76	-1,718.73	1.22	1.64	470.85
1	73,637.88	273	155	118	56.78	1,492.35	-1,336.24	1.12	1.47	269.74

This study is fairly common but it has worked well in both up a down markets and the effectiveness has not waned.

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



Despite the selloff Tuesday more bearish evidence emerged and the green Aggregator line remains strongly below zero. The negative value indicates the net expectation from

the Active Studies over the next few days is for downside. Meanwhile the black Differential line is still well below 0. This means the SPX has 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 remained short.

Currently the green Aggregator line is set up to remain negative tomorrow. It would be difficult for enough bullish studies to appear tomorrow to change this. Meanwhile the Differential pivot will be 1,086.27 tomorrow. It would take an SPX close at or below this level to flip the black Differential line positive. That's about a 0.5% drop from Tuesday's close.

I'm holding on to my shorts but not looking to add at this point. I may start scaling out tomorrow if the market continues to head south.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 9/7 – slightly bullish***

There's quite a bit active right now on the intermediate-term active studies list. There is pull from both sides and I'm not seeing overwhelming evidence in either direction.

The most compelling studies for the bears are the Hindenburg Omen from the August 16<sup>th</sup> letter and the [September seasonality study](#). There is also the study that noted the weak performance after the Follow Through Day in July. That is still on the board because by the study's definition the FTD has neither succeeded nor failed at this point. Still, I'm not sure the trading action from that week is having a great influence on current action so I'm discounting that one heavily at this point.

The bulls have seen some studies (including the 1<sup>st</sup> one tonight) that have suggested strong A/D Breadth and/or A/D Volume Breadth are paving the way for further upside. Additionally, the [AAII Investor Sentiment Survey study](#) is also suggesting an intermediate-term upside edge.

So we have a bit of push and pull going on here. Overall I'm leaning towards the bullish side. I think we've seen enough evidence of buying interest that the April highs are more likely to be broken over the next few months than the July lows are. I'm inclined to play the long side slightly more aggressive than the short side at this point.

## **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 entry ideas 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>
SPY(1/4)(s)	9/2/2010	\$109.47	\$109.64	-0.16%		Aggregator
SPY(1/4)(s)	9/3/2010	\$110.54	\$109.64	0.81%		Aggregator
SPY(1/4)(s)	9/3/2010	\$110.54	\$109.64	0.81%		Aggregator

Since most gaps have a tendency to fill and we haven't seen one do so in 4 days, if the market gaps down below the Differential pivot I will cover 1 SPY lot on the open. If not filled on the open I will cancel the order.

Should the SPX close at or below the Differential pivot of 1,086.27 I will exit all but 1 lot at the close.

Should I determine market action warrants adjustments to these exit criteria tomorrow I will send out an intraday email.

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