

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

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September 14, 2010

Volume 3 Issue 176

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## Market Overview



## Tonight's Research Points

- Monday's gap up being larger than the intraday range suggests some mild downside risk.
- The low 3/10 Offset HV means volatility alert remains active.
- The Aggregator System remained short.
- The NDX Aggressive Trend Timer remained flat.

## *Short-term Outlook*

### *The Bottom Line*

The market has continued to ignore negative studies. It still appears a pullback is likely in the next few days.

*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 13, 2010	AAII Spread Spike Up 40% in 2 weeks	1-9 days	Bullish	2.60%
September 13, 2010	RSI(3) > 70, 3/10 OffHV < 0.25 und 200	1-3 days	Bearish	-2.90%
September 13, 2010	SPX Up 3 < 200. No 50 low. Vol lower	1-3 days	Bearish	-2.65%
September 13, 2010	Low Vol 10. Low Range 10. >10ma < 200	1-4 days	Bearish	-3.20%
September 10, 2010	SPY 20-hi close. < 200. Vol lower.	1-5 days	Bearish	-2.40%
September 10, 2010	SPY 2 Unfilled Up Gaps < 200ma	1-5 days	Bearish	-2.50%
September 9, 2010	NDX Up 1%. SOX down. Buy SPX	1-6 days	Bearish	-3.20%
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 7, 2010	SPX up 3 days, NYSE Up Vol % > 90%	1-7 days	Bullish	2.90%
<b>Active - Long Term</b>				
September 13, 2010	Low Vol 20. Low range 20. Close < 200	1-18 days	Bearish	
September 8, 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	
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 2, 2010	10-high, strong breadth, low vol, < 200	1-7 days	Bearish	-2.40%
September 8, 2010	Unfilled gap up + unfilled gap dn < 200	1-4 days	Bearish	-3.60%
September 7, 2010	VXO < 15% below 10ma	1-5 days	Bearish	-3.80%

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

### **The Evidence**

Overbought conditions and light volume have been no match for this march higher. Monday saw a continuation of last week's theme with the market gapping higher and never touching the previous day's close. The major indices all gained ground. The SPX was up 1.1%, the Nasdaq rose 1.9% and the Russell 200 was up a whopping 2.5%. As you'd expect breadth was strongly positive. The NYSE Up Issues % came in at 73% and the Up Volume % was 84%. Volume rose above the levels of the last several days as few traders are now vacationing.

There was a decent amount to look at tonight but very little that suggested a substantial edge. The move through the 200ma in the S&P is certainly notable. I looked at other times this happened on a gap for the SPY and the 200ma was never touched. This is the 9<sup>th</sup> such time and the other 8 showed very mixed results.

It was interesting that the intraday range today couldn't even match the size of the gap up this morning. This is a fairly rare occurrence, and even more so when it results in a 10-day closing high. In looking at this I found some possible mildly bearish inclinations.

SPY gaps up and close at a 10-day high. The size of the gap is greater than the high-low range for the day. Close > 200ma. Buy SPY 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	-6,588.98	30	17	13	56.67	719.49	-1,447.71	0.50	0.65	-219.63
4	-7,033.14	30	14	16	46.67	955.95	-1,276.03	0.75	0.66	-234.44
3	-3,597.42	30	17	13	56.67	848.47	-1,386.26	0.61	0.80	-119.91
2	-1,722.85	30	16	14	53.33	596.93	-805.27	0.74	0.85	-57.43
1	-5,072.96	30	13	17	43.33	576.03	-738.91	0.78	0.60	-169.10

I also looked at this one below the 200ma. It seemed to make little difference. In both cases the edge was fairly muted and short-term. Not something I believe is even worthy of including in the Aggregator tonight.

One somewhat interesting study from the Quantifinder looked at the breadth thrust we've seen in the Nasdaq lately. The study was from the 2/9/09 Letter. It suggested that a rise in the 10-day exponential moving average of the Nasdaq Up Volume % over 64% could signal a rise in the weeks ahead. Unfortunately this study has not fared as well lately. 2010 has been unusual in that breadth has been more lopsided than historically typical. So extreme readings have been more common. This has meant a high number of triggers relative to past years. This wouldn't be a problem if the effectiveness did not appear to be waning, but it does. Below are the 20-day returns following the other triggers in 2010.

10-day Exp MA of the Nasdaq Up Volume % crosses 64%.  
Buy Nasdaq on close. Sell 20 days later. \$100k/trade. 12-24-09 - present.

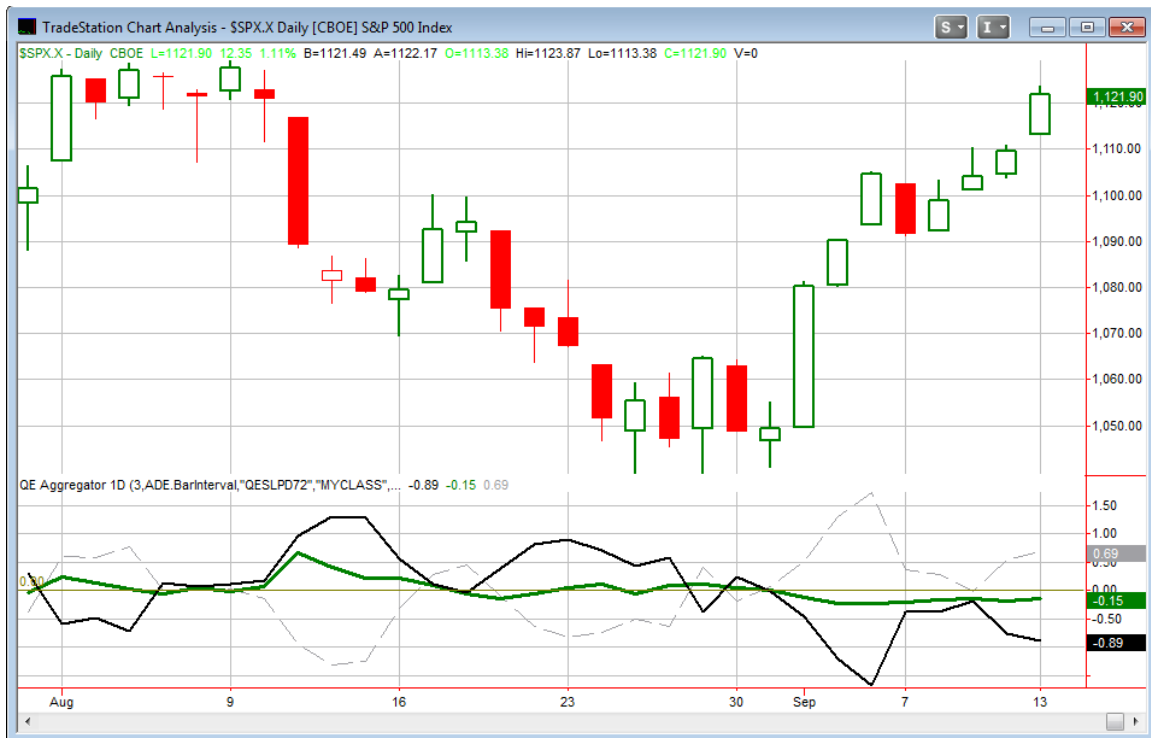
Date/Time	Signal	Price	% Profit	Run-up DrawDown
12/24/09	Buy	\$2,285.69	(3.59%)	\$1,745.37
01/26/10	Sell	\$2,203.73		(\$3,880.75)
03/09/10	Buy	\$2,340.68	3.87%	\$4,318.44
04/07/10	Sell	\$2,431.16		\$0.00
04/14/10	Buy	\$2,504.86	(3.19%)	\$1,186.38
05/12/10	Sell	\$2,425.02		(\$12,445.29)
07/26/10	Buy	\$2,296.43	(5.96%)	\$559.00
08/23/10	Sell	\$2,159.63		(\$6,053.11)
09/03/10	Buy	\$2,233.75	n/a	\$2,452.56
open	n/a	\$2,285.71		(\$1,193.72)

As you can see this setup has struggled recently and I'm not inclined to put any weight into it.

I also found it notable that despite Monday's strong move higher the 3/10 Offset HV indicator still registered an extremely low reading. So the volatility alert is still on. Directional clues associated with this indicator aren't as potent above the 200ma. Still, the volatility alert sets up the possibility of sizable daytrading opportunity. One method I've written about in the past is to look for an Opening Range Breakout (ORB) after the 1<sup>st</sup> half-hour or so of trading. Personally, I only look to play ORBs in the direction of my short-term bias – putting a little wind at my back. So should the 1<sup>st</sup> 30 minutes or so trade in a fairly tight range tomorrow, I'd consider shorting a breakdown of that range for a daytrade. More details on this concept can be found in the ORBs Study, which I've linked to below. Subscribers may also find it on the Downloads page on the website.

[ORBs Study.pdf](#)

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



The Aggregator chart remained much the same tonight. 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 also 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 to remain negative. It would be difficult for enough bullish studies to appear tomorrow to change this. Meanwhile the Differential pivot will be 1,098.36 tomorrow. It would take an SPX close at or below this level to flip the black Differential line positive. That's about a 2.1% decline from Monday's closing level.

The upward persistence of the market in the face of all this bearish evidence continues to suggest elevated risk. Still, I am now "all-in" with my index trade. Nothing compelling is appearing on the trade triggers spreadsheet and I am not looking to add exposure beyond my index trade at this point. I still expect to see a fairly sharp decline occur in the near future. I will be looking to exit the short trade at that point and reassess conditions as I always do.

**Intermediate-term Outlook (2 weeks – 2 months)– updated 9/13 – neutral**

A couple of weeks ago I looked at the [AAII Investor Sentiment Survey](#). It had become extremely bearish. The study showed bullish intermediate-term inclinations following such extreme bearishness. These inclinations generally played out over the next 30 days. Over the last 2 weeks though as the market has rallied there has been a large swing in sentiment from extremely bearish to slightly bullish. I wondered whether this swing might mean the anticipated rally was already nearing its end. So I devised a study that looked at other similar instances in the past.

The reading 2 weeks ago was 29% net bears. This week it came in at 12% net bulls. So I looked for other times there was a spike of 40% or more in the bull spread over a 10 (trading) day period.

AAII Sentiment Survey Bull-Bear Spread jumps more than 40 points in the last 10 days. Buy SPX on close. Sell X days later. \$100k/trade. 1987 - 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	-5,560.14	16	10	5	62.50	2,859.66	-6,831.35	0.42	0.84	-347.51
19	4,896.14	15	7	8	46.67	3,190.41	-2,179.59	1.46	1.28	326.41
18	8,222.21	15	8	7	53.33	2,663.42	-1,869.30	1.42	1.63	548.15
17	9,835.26	15	9	6	60.00	2,211.39	-1,677.88	1.32	1.98	655.68
16	15,684.17	15	8	7	53.33	3,433.25	-1,683.12	2.04	2.33	1,045.61
15	14,606.83	15	8	7	53.33	3,424.62	-1,827.16	1.87	2.14	973.79
14	9,311.34	15	8	7	53.33	2,373.14	-1,381.97	1.72	1.96	620.76
13	13,669.17	15	11	4	73.33	1,710.25	-1,285.90	1.33	3.66	911.28
12	18,115.21	15	9	6	60.00	2,267.62	-382.23	5.93	8.90	1,207.68
11	18,095.66	15	10	5	66.67	2,192.92	-766.70	2.86	5.72	1,206.38
10	24,095.45	15	13	2	86.67	1,916.84	-411.74	4.66	30.26	1,606.36
9	25,969.57	16	14	1	87.50	1,858.47	-49.00	37.93	530.99	1,623.10
8	24,696.64	18	14	2	77.78	1,890.22	-883.19	2.14	14.98	1,372.04
7	14,624.26	19	11	6	57.89	1,972.87	-1,179.56	1.67	3.07	769.70
6	14,880.88	19	12	6	63.16	1,808.03	-1,135.92	1.59	3.18	783.20
5	15,042.21	19	9	8	47.37	2,329.92	-740.88	3.14	3.54	791.70

I ran these results out much further as well. It appears the rush of people from bearish to bullish often kept the market momentum going for a couple of weeks, but beyond that there was no discernable edge. Looking out as far as 70 days the net “Avg Trade” never got much above the 1.6% gain realized in the first 2 weeks. So I don’t see any reason to take the AAI study from a few weeks ago off the board just because the bulls jumped. In fact, I’ve added this new one to the short-term list.

But while the AAI remains active, the long-term active list studies has slowly been looking more bearish. The August 3<sup>rd</sup> new high on strong breadth study has expired. And today’s low range, low volume study was the 2<sup>nd</sup> bearish one in a row to make the

list. At this point factors such as breadth and sentiment are suggesting upside in the coming weeks while seasonality and the low volume are suggesting a pullback. Momentum certainly favors the bulls but we are now bumping up against resistance in the form of the 200ma and the August highs. With all this conflicting evidence I'm not strongly inclined to favor either side at this point. I'll be looking equally at both long and short opportunities.

**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.

None tonight.

**Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	9/2/2010	\$109.47	\$112.72	-2.97%		Aggregator
SPY(1/4)(s)	9/3/2010	\$110.54	\$112.72	-1.97%		Aggregator
SPY(1/4)(s)	9/3/2010	\$110.54	\$112.72	-1.97%		Aggregator
SPY(1/4)(s)	9/13/2010	\$112.58	\$112.72	-0.12%		Aggregator

I'll look to cover 2 SPY lots at the close tomorrow if the SPX finishes at 1,098.36 or lower.

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