

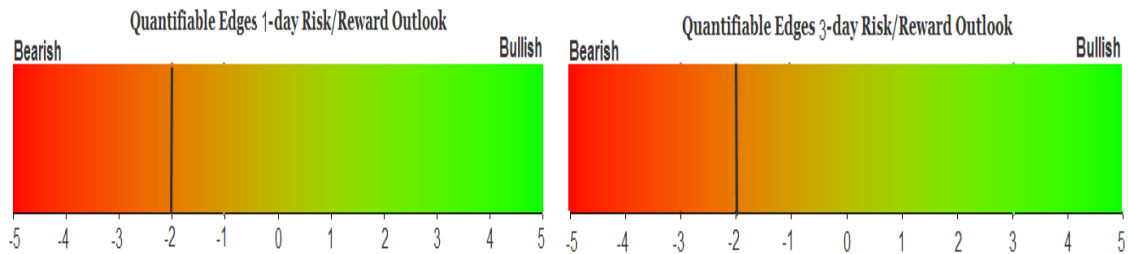
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 16, 2010

Volume 3 Issue 178

Market Overview



Tonight's Research Points

- With more than 10 days now above the 5ma, the SPY is due for a pullback.
- SPX closing at a new 10-day high while the VIX rises is unusual during mid-week. It has also been short-term bearish in the past.
- The Aggregator System remained short.
- The NDX Aggressive Trend Timer remained flat.

Short-term Outlook

The Bottom Line

Some more bearish studies extended the downside outlook another day. I'm still waiting for a pullback or a change in the Aggregator before exiting.

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 16, 2010	SPX Up VIX Up. 10 high > 200. Mid-wk	1-2 days	Bearish	-0.80%
September 16, 2010	SPY 10 days > 5ma & 10 day high	1-4 days	Bearish	-1.50%
September 13, 2010	AAII Spread Spike Up 40% in 2 weeks	1-9 days	Bullish	2.60%
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%
Active - Long Term				
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	
Dropped Tonight				
September 7, 2010	SPX up 3 days, NYSE Up Vol % > 90%	1-7 days	Bullish	2.90%
September 13, 2010	SPX Up 3 < 200. No 50 low. Vol lower	1-3 days	Bearish	-2.65%
September 13, 2010	RSI(3) > 70, 3/10 OffHV < 0.25 und 200	1-3 days	Bearish	-2.90%

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

The Evidence

The grind higher seems as though it may never end. Wednesday was another day with the major averages all up. The final results saw the SPX up 0.4%, and the Nasdaq and Russell 2000 up 0.5%. Breadth was very mildly positive as the NYSE Up Issues % came in at 52% and the Up Volume % was 54%. Total volume declined for the 2nd day in a row.

A few studies appeared in the Quantifinder tonight and they were all neutral to bearish despite the market now trading above its 200ma. This first one looked at rallies that spent an extended amount of time above the 5ma without pulling back. It was last shown in the 3/12/10 Subscriber Letter. I've updated the results below.

SPY closes above 5ma for at least 10 days in a row and today is the highest close of the last 10 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
5	-9,990.04	43	22	21	51.16	1,099.51	-1,627.58	0.68	0.71	-232.33
4	-18,833.89	45	19	26	42.22	878.26	-1,366.19	0.64	0.47	-418.53
3	-16,689.75	52	19	33	36.54	834.14	-986.01	0.85	0.49	-320.96
2	-16,731.81	61	25	35	40.98	644.63	-938.50	0.69	0.49	-274.29
1	-14,443.45	89	39	50	43.82	444.61	-635.66	0.70	0.55	-162.29

83% of instances posted a close below the entry price at some point in the next week.

This seems to suggest a decent downside edge over the next few days.

Other interesting action appeared as the VIX rose along with the market today. Most of the time the VIX and SPX will trade in opposite directions. In the 3/10/10 Subscriber Letter I showed a study that examined performance following a rise in both the VIX and SPX on days other than Mondays. The VIX has a natural tendency to fall on Fridays and rise on Mondays. Therefore I will often examine those days separately. The original study looked at any day other than Monday. Tonight I also eliminated Fridays from the equation. Friday would be the most unusual day for this to happen and it also has historically been the most bearish. The new results are below.

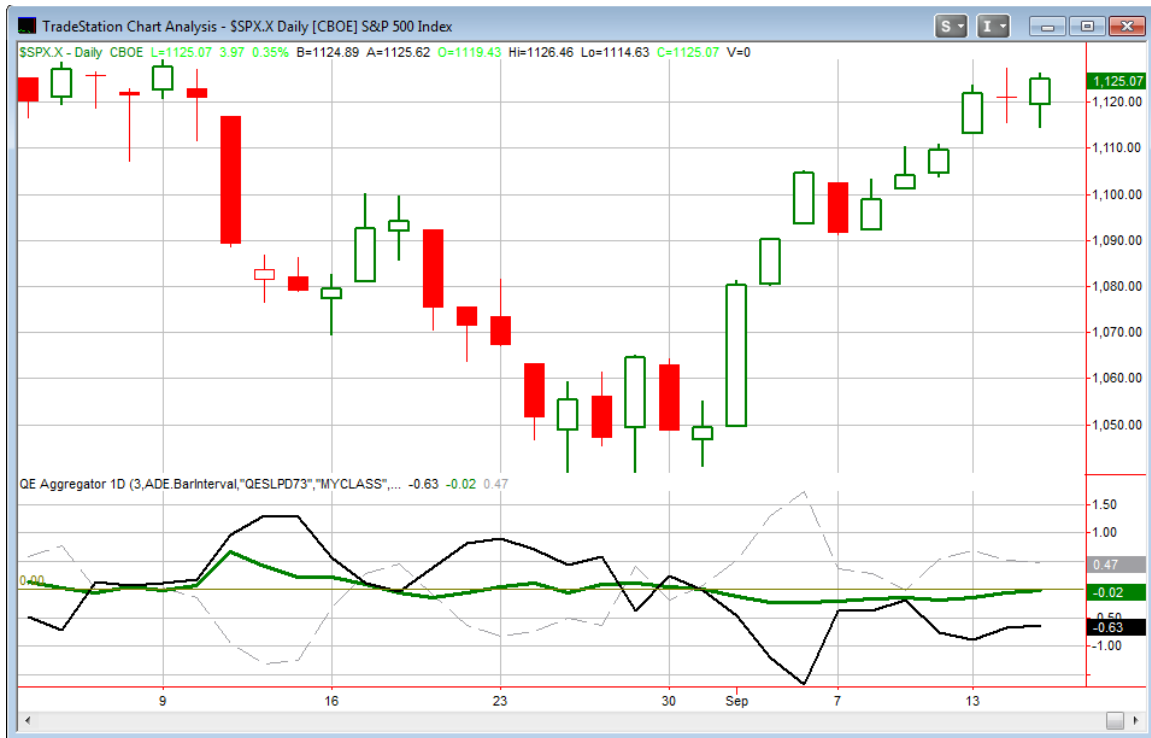
SPX and VIX both close higher. Today is Tues, Wed, or Thurs. SPX closes > 200ma and at a 10-day high. Buy SPX on close. Sell X days later. \$100k/trade. 1993 - present.

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	-13,849.93	51	25	26	49.02	809.27	-1,310.83	0.62	0.59	-271.57
4	-12,500.72	53	22	31	41.51	909.76	-1,048.88	0.87	0.62	-235.86
3	-8,904.00	53	23	30	43.40	754.42	-875.19	0.86	0.66	-168.00
2	-11,977.60	54	18	36	33.33	686.64	-676.03	1.02	0.51	-221.81
1	-7,423.89	62	29	33	46.77	353.80	-535.88	0.66	0.58	-119.74

87% of instances posted at least 1 close below the entry price at some point in the next week.

The average drop isn't terribly deep but the downside consistency is solid.

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



The Aggregator chart is barely hanging on to its negative outlook. The green Aggregator line remains 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.

The green Aggregator line may flip to positive tomorrow depending on market action and studies. Meanwhile the Differential pivot will be 1,116.50 tomorrow. It would take an SPX close at or below this level to flip the black Differential line positive. That's about a 0.8% decline from Wednesday's closing level.

Waiting for a pullback that has seemed so probable has been a real test of patience these last several days. Traders that may be new to Quantifiable Edges should understand that it is patience and not stubbornness. Stubbornness would be holding on to the short in spite of the evidence turning bullish because the pullback hasn't been as deep as I like. Here it still appears there is a quantifiable edge to the downside. As long as that edge

exists and the as long as the Differential line shows the market is overbought I will remain in my short positions. The Aggregator could flip as early as tomorrow. If it does, I won't hesitate to exit the positions regardless of profitability. When an edge is not present I prefer to hide out in cash until the next solid edge avails itself. So for now I will continue to hold the short.

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 3rd new high on strong breadth study has expired. And today's low range, low volume study was the 2nd 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	\$113.08	-3.30%		Aggregator
SPY(1/4)(s)	9/3/2010	\$110.54	\$113.08	-2.30%		Aggregator
SPY(1/4)(s)	9/3/2010	\$110.54	\$113.08	-2.30%		Aggregator
SPY(1/4)(s)	9/13/2010	\$112.58	\$113.08	-0.44%		Aggregator

Unless I send out an intraday update to the contrary I'll look to cover the entire SPY position at the close tomorrow if the SPX finishes at 1,116.50 or lower.

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