

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

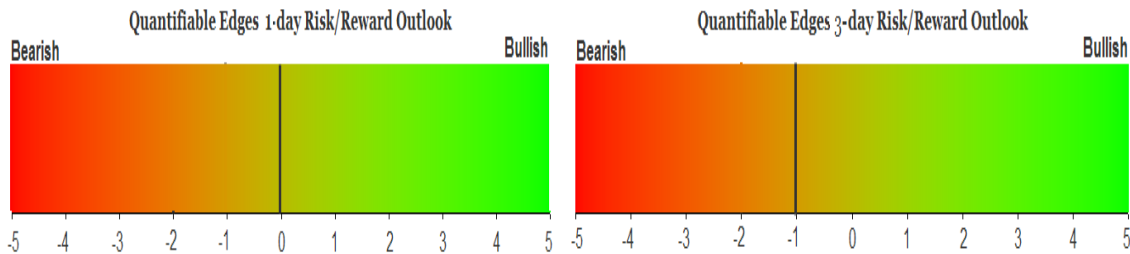
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September 27, 2010

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## Market Overview



## Tonight's Research Points

- Large gap-n-go formations at new highs are typically followed by a pullback.
- The lower number new highs versus earlier in the week does not appear to a concern. In the past it may have been.
- Very strong months often mean there is more upside to come.
- The Aggregator System flipped from long to short.
- The NDX Aggressive Trend Timer changed to flat.

## *Short-term Outlook*

### *The Bottom Line*

The studies have changed to a downside expectation over the next few days. There aren't nearly as many active as typical, though. And while we are expecting downside, the bearish studies aren't terribly strong. Additionally, with a bullish intermediate-term bias, I am looking to play the short-side with a conservative approach.

*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 27, 2010	1% gap-n-go to a 50-day high	1-3 days	Bearish	-1.50%
September 21, 2010	50-high breakout. Lower NYSE volume.	1-5 days	Bullish	1.75%
<b>Active - Long Term</b>				
September 20, 2010	Nas/SPX RS favors Nasdaq	int term	Bullish	
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	
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>				
<b>September 24, 2010</b>	<b>3 down including Fed Day.</b>	<b>1 day</b>	<b>Bullish</b>	
September 20, 2010	September op-ex	1-5 days	Bearish	-2.40%

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

### ***The Evidence***

Prices exploded higher on Friday. It began with a large gap up and never looked back as the market opened near its lows and closed near its highs. When it was all over the SPX had gained 2.1%, the Nasdaq was up 2.3% and the Russell 2000 rose 3.4%. Breadth was strongly positive as the NYSE Up Issues % came in at 82% and the NYSE Up Volume % was just a small fraction below 90%. Total volume rose as participation was strong.

Action this past week was a bit odd. Last weekend we saw numerous studies suggesting a pullback was likely. We got that pullback but only after a strong move up on Monday. Monday's strong move up triggered a number of studies shown in the nightly subscriber letter and in Tuesday's blog that suggested the breakout was likely a short-run positive. And we did see the market make a new high Friday, but it first endured a pullback over the Tuesday-Thursday period. So the studies generally worked out this past week but not in the typical way.

There were a couple of similar studies that appeared in the Quantifinder this weekend that looked at large "Gap-n-Go" scenarios where the market gaps up and finishes higher without ever closing its gap. This 1<sup>st</sup> one is from the 8/3/10 Subscriber Letter.

SPY gaps at least 1% above yesterdays close and never fills. It makes a 10-day intraday high and close > open. Close > 200ma. Buy 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	6,129.36	20	11	9	55.00	1,671.23	-1,361.57	1.23	1.50	306.47
4	4,821.41	21	11	10	52.38	1,579.38	-1,255.17	1.26	1.38	229.59
3	-4,651.96	21	11	10	52.38	948.93	-1,509.02	0.63	0.69	-221.52
2	-6,531.67	21	10	11	47.62	417.62	-973.44	0.43	0.39	-311.03
1	-2,810.74	21	10	11	47.62	586.39	-770.42	0.76	0.69	-124.32

**17 of 21 instances (81%) posted a close below the entry price at some point in the next 4 days.**

There's a mild suggestion here that the market is likely to suffer a pullback at some point over the next few days. The edge isn't terribly strong and is short-term in nature. Still, I think it is worth considering.

Of course we didn't just close at a 10-day high. It was actually a 50-day high that was made. In the 10/15/09 blog I looked at these type of situations and found that a 50-day high suggested a bit more of a downside edge than just a 10-day high. I've updated that study below.

SPY gaps at least 1% above yesterdays close and never fills. It makes a 50-day intraday high and close > open. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1994 - present.

QE Finder Tester: daysin	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	-3,871.86	9	4	5	44.44	557.13	-1,220.08	0.46	0.37	-430.21
4	-2,681.59	10	5	5	50.00	613.34	-1,149.66	0.53	0.53	-268.16
3	-5,296.18	10	3	7	30.00	304.59	-887.14	0.34	0.15	-529.62
2	-2,867.77	10	5	5	50.00	271.90	-845.46	0.32	0.32	-286.78
1	-273.27	10	6	4	60.00	362.47	-612.02	0.59	0.89	-27.33

**9 of 10 instances (90%) posted a close below the entry price at some point in the next 3 days.**

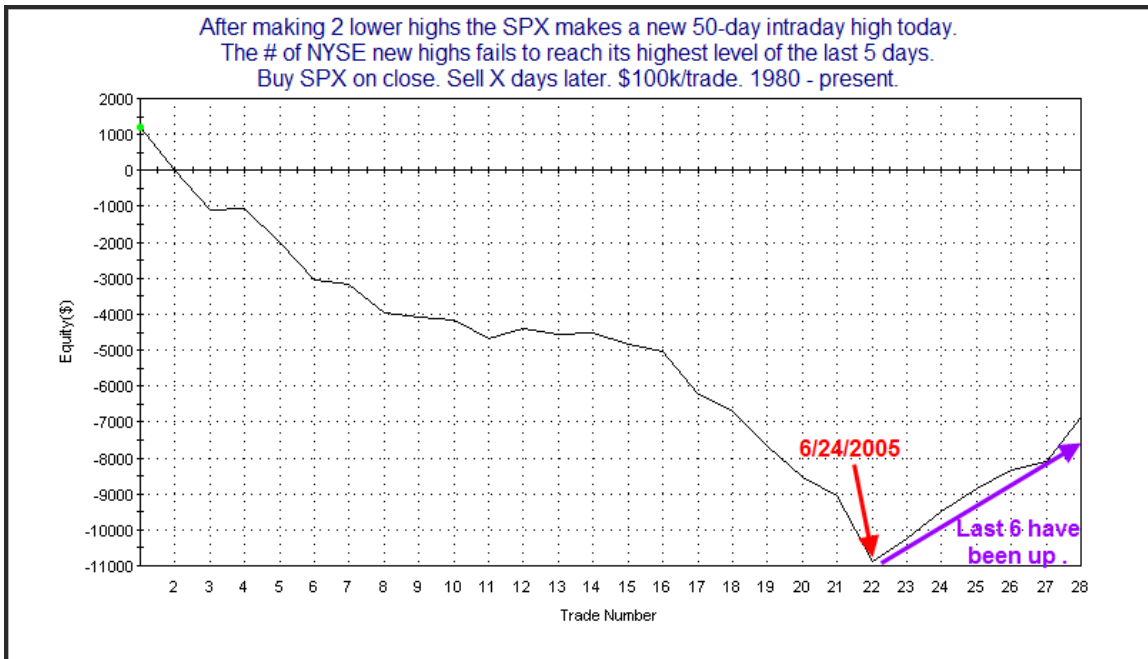
Instances are a little low here but the results are strong enough for me to include them among the active studies.

I also noted that despite the SPX making new highs on Friday the number of NYSE stocks making new highs failed to reach levels seen earlier in the week. I ran a study to see how the market had reacted following other instances in the past.

After making 2 lower highs the SPX makes a new 50-day intraday high today.  
The # of NYSE new highs fails to reach its highest level of the last 5 days.  
Buy SPX on close. Sell X days later. \$100k/trade. 1980 - 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: WinLoss Ratio	All: ProfitFactor	All: Avg Trade
5	-4,472.86	27	13	14	48.15	962.03	-1,212.80	0.79	0.74	-165.66
4	-5,204.67	27	14	13	51.85	652.30	-1,102.83	0.59	0.64	-192.77
3	-5,665.76	28	12	16	42.86	803.68	-956.87	0.84	0.63	-202.35
2	-6,858.07	28	10	18	35.71	554.56	-689.09	0.80	0.45	-244.93
1	-2,939.45	28	13	15	46.43	307.36	-462.34	0.66	0.58	-104.98

At first blush these numbers appear to suggest a downside edge. But when I looked closer I found the numbers to be a bit misleading. Below is an equity curve with the above setup and using a 2-day exit strategy.



So for 25 years or so the setup had been followed by downside on a pretty consistent basis. But since mid-2005 there have been 6 instances and every one has lead to higher prices over the next 2 days. I don't have an explanation for why the apparent edge may

have stopped working over the last few years. I do know that the action over the last few years is enough for me to deem this particular study unreliable. I won't be taking the reduction of new highs into consideration.

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



We've seen a large drop in the number of short-term active studies over the last few days. And while this weekend's studies are only mildly suggestive of a pullback, they are strong enough to move the green Aggregator line from above to below 0. The negative value indicates the net expectation from the Active Studies over the next few days is for downside. Meanwhile the sharp rise in the SPX on Friday caused the black Differential line to fall back below 0. This means the SPX has now outperformed expectations over the last few days. So we have negative expectations and a market that is overbought versus recent expectations. This is considered a bearish configuration. It is reflected on Aggregator chart when both lines are below 0. Due to this the Aggregator System changed to short at the close.

With so few studies active the green Aggregator line will be highly dependent on any new studies that are appearing in the next few days. Meanwhile the Differential pivot will be 1,137.55 tomorrow. It would take an SPX close at or above this level to flip the

black Differential line positive. This means the SPX will need to fall nearly 1% in order to avoid be viewed as “overbought” vs. expectations.

At this point the market has been in strong uptrend and it is making new highs. As you’ll note below my intermediate-term outlook is bullish. With this in mind I’m not inclined to aggressively short, even with a bearish short-term outlook. I will look to take on some short-exposure, but will look for a favorable entry and will keep the position small

**Intermediate-term Outlook (2 weeks – 2 months)– updated 9/27 – bullish**

The SPX is now up over 9% for September. I thought it would be interesting to look and see how the market had performed in the past following other months that saw strong rallies. This first study looks at months that gained at least 9%.

SPX closes up 9% for the month. Buy on close. Sell X months later. \$100k/trade. 1960 - present.										
QE monthly: daysin	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	79,152.18	11	7	4	63.64	14,543.47	-5,663.04	2.57	4.49	7,195.65
5	69,084.50	11	8	3	72.73	11,347.75	-7,232.50	1.57	4.18	6,280.41
4	33,914.95	11	6	5	54.55	9,669.03	-4,819.84	2.01	2.41	3,083.18
3	30,579.97	12	7	5	58.33	7,969.35	-5,041.10	1.58	2.21	2,548.33
2	22,253.30	13	7	6	53.85	6,467.01	-3,835.96	1.69	1.97	1,711.79
1	4,555.36	13	6	7	46.15	3,443.40	-2,300.72	1.50	1.28	350.41

Over the next few months there hasn’t been a real strong inclination but mild upside has been the net result. What if we isolate the front month and look at a range the market rises the month before?

SPX closes up X% for the month. Buy on close. Sell X months later. \$100k/trade. 1960 - present.										
QE monthly: pctup	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
9	4,555.36	13	6	7	46.15	3,443.40	-2,300.72	1.50	1.28	350.41
8	35,476.75	21	14	7	66.67	3,684.41	-2,300.72	1.60	3.20	1,689.37
7	40,058.45	35	23	12	65.71	3,333.55	-3,051.10	1.09	2.09	1,144.53
6	59,273.29	45	32	13	71.11	3,161.21	-3,221.95	0.98	2.42	1,317.18
5	83,775.30	74	54	20	72.97	2,782.18	-3,323.12	0.84	2.26	1,132.10

Results are generally good across the board. It does appear that when the % rise is very large that the edge for the next month is reduced some. Perhaps those very large gains need to be consolidated a bit before the move up can continue. I also filtered using the

10-month moving average. I did this because a good amount of the time the market made very large advances it was bouncing back from a very oversold level.

SPX closes up X% for the month. It closes > 10-month ma. Buy on close. Sell X months later. \$100k/trade. 1960 - present.										
QE monthly: pctup	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: WinLoss Ratio	All: ProfitFactor	All: Avg Trade
9	4,591.03	11	5	6	45.45	3,075.75	-1,797.96	1.71	1.43	417.37
8	20,484.44	17	11	6	64.71	2,842.93	-1,797.96	1.58	2.90	1,204.97
7	15,325.50	27	16	11	59.26	2,913.84	-2,845.08	1.02	1.49	567.61
6	25,015.41	35	23	12	65.71	2,677.54	-3,047.34	0.88	1.68	714.73
5	52,860.71	60	42	18	70.00	2,571.86	-3,064.29	0.84	1.96	881.01

There still appears to be a small upside edge present here. It does seem to be greatly reduced from the results that include times the market closed below its 10-month moving average.

Overall the market is acting well. In the SPX this week the pullback held above the 200ma. The 1,114 – 1,123 level should act as support. There are presently a few levels of price support as well as the 200ma right in that area.

The intermediate-term studies remain mixed. Volume and seasonality are favoring the bears while breadth and leadership structure favor the bulls. We're overbought here short-term, but as long as we continue to make new highs and the studies at least remain split, I'll be favoring the long side. At this point I will be a bit extra conservative with my short trades and a bit more aggressive with my long trades

### **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 1/4 index position at \$115.40 LIMIT ON OPEN. If this trade is NOT filled on the open, it should be cancelled. I will then look to enter the position on a close that is both above Friday’s close of \$114.82 and above Monday’s opening price. This trade is based on the Aggregator and the short-term outlook above. I am looking to scale in a small amount if I can get a favorable entry price.*

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY	9/23/2010	\$112.50	\$114.82	2.06%		<b>sold on close</b>

The SPY trade was exited on the close as per the intraday update sent on Friday afternoon.

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