

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 4, 2010

Volume 3 Issue 190

Market Overview



Tonight's Research Points

- The tight consolidation after making a new high has the SPX set up for another leg higher.
- The NDX underperformance last week could provide a boost to the market this week as it looks to mean revert.
- The Aggregator System remained flat.
- The NDX Aggressive Trend Timer remained long.

Short-term Outlook

The Bottom Line

The short-term outlook is becoming more bullish. It is not currently set up for a low risk entry though. I'm exercising some patience. If we get a pullback in the next day or two, I'll look to get long.

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				
October 4, 2010	50-day high then 5-day tight range	1-10 days	Bullish	2.30%
October 1, 2010	2 Days Down to finish Up Quarter	1-8 days	Bullish	2.90%
Active - Long Term				
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	
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	
Dropped Tonight				
September 29, 2010	Outside day 50-high	1-3 days	Bearish	-1.10%
September 28, 2010	Nasdaq Spyx < 0. QQQQ 10-day high.	1-4 days	Bearish	-1.75%
September 1, 2010	August down > 4%	1 month	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	

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

The Evidence

The market had a rather quiet day on Friday. After gapping up about 0.75% (in the SPY) the high for the day was made in the first 5 minutes. A morning decline that took the market into negative territory was followed by an afternoon drift higher. In the end it was mostly modest gains for the indices. The SPX rose 0.4%, the Nasdaq was up 0.1%, and the Russell 2000 gained 0.5%. Breadth was solidly positive as the NYSE Up Issues % came in at 68% and the Up Volume % was 77%. Total volume declined on both the NYSE and the Nasdaq.

After closing at a new high on Friday the 24th, the SPY has consolidated in a tight, sideways range. Every close this week was within the daily range of the 9/24 bar. It is said that consolidations are often resolved in the direction of the trend. This guideline suggests that we're more likely to see another leg up from here than a breakdown. Using the current setup, I put this to the test.

After closing at a 50-day high SPY closes between the high and the low of the new high day for the next 5 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
10	23,919.95	18	15	3	83.33	1,987.61	-1,964.71	1.01	5.06	1,328.89
9	19,947.65	18	16	2	88.89	1,426.85	-1,440.96	0.99	7.92	1,108.20
8	17,874.93	18	15	3	83.33	1,487.70	-1,480.21	1.01	5.03	993.05
7	12,209.97	18	13	5	72.22	1,520.19	-1,510.50	1.01	2.62	678.33
6	3,221.21	18	11	7	61.11	1,146.41	-1,341.32	0.85	1.34	178.96
5	5,810.04	18	9	9	50.00	1,402.73	-757.17	1.85	1.85	322.78
4	8,893.35	18	11	7	61.11	1,211.41	-633.16	1.91	3.01	494.08
3	8,056.50	18	13	5	72.22	989.24	-960.73	1.03	2.68	447.58
2	1,873.22	18	11	7	61.11	672.22	-788.75	0.85	1.34	104.07
1	848.84	18	10	8	55.56	574.80	-612.40	0.94	1.17	47.16

- 15 of 18 instances (83%) closed above the entry price at some point in the next 3 days.
- All instances closed above the entry price at some point within the next 2 weeks.
- 15 of 18 instances also posted a new 50-day high at some point in the next 2 weeks.

It certainly appears the old technical adage has some merit. Results favor the long side over the immediate 3-day period and they are even more impressive when looking out 8 to 10 days. And with 83% of instances seeing a new closing high within the next 2 weeks I'd say this past week's action seems to favor the bulls for the short-term.

I did find it interesting that the NDX struggled this week in comparison to the SPX. While the NDX closed lower every day except Tuesday, QQQQ closed lower every day. It's very unusual to see QQQQ closing down for a 5th consecutive day while SPY is closing at a 3-day high. In fact, it has only happened 3 other times. I listed them below.

QQQQ closes down for at least the 5th day in a row while SPY closes at a 3-day high. Buy QQQQ on close. Sell 3 days later. \$100k/trade. 2000 - present.

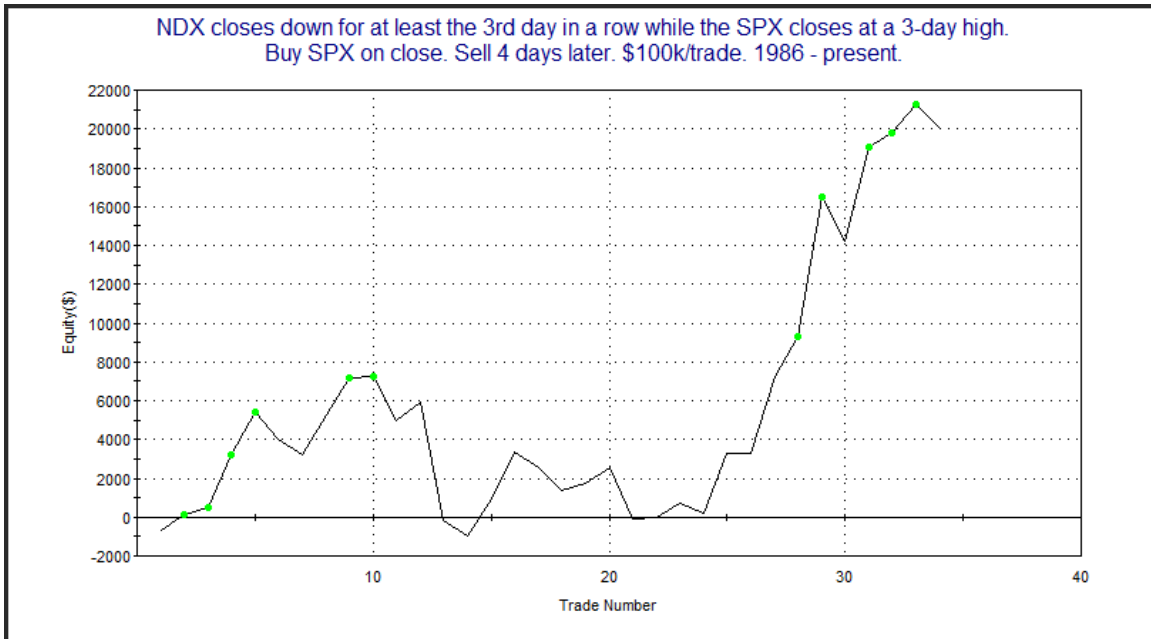
Date/Time	Signal	Price	% Profit	Run-up DrawDown
12/31/02	Buy	\$24.37	8.00%	\$9,108.66
01/06/03	Sell	\$26.32		\$0.00
01/23/08	Buy	\$44.02	0.70%	\$4,201.35
01/28/08	Sell	\$44.33		(\$1,021.95)
09/08/08	Buy	\$43.31	0.67%	\$1,107.84
09/11/08	Sell	\$43.60		(\$2,631.12)

It's dangerous to try and draw any solid conclusions from just 3 instances. I decided to use NDX instead and loosen the requirement to 3 down days instead of 5. Doing so gave me a fair amount of instances when looking back to 1986.

**NDX closes down for at least the 3rd day in a row while the SPX closes at a 3-day high.
Buy SPX on close. Sell X days later. \$100k/trade. 1986 - 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	17,963.48	34	21	13	61.76	2,008.93	-1,863.38	1.08	1.74	528.34
4	20,020.53	34	22	12	64.71	1,857.12	-1,736.34	1.07	1.96	588.84
3	17,228.46	34	20	14	58.82	1,606.92	-1,064.99	1.51	2.16	506.72
2	14,266.20	34	19	15	55.88	1,467.88	-908.23	1.62	2.05	419.59
1	6,188.58	34	15	19	44.12	1,339.14	-731.50	1.83	1.45	182.02

Nothing terribly strong but the numbers do suggest perhaps a mild upside edge. I looked closer at the 4-day returns to see what the possible edge has looked like over time.



As you can see there was really no edge until recently. Dates aren't shown but the chart really begins to ramp up in 1997. Most of the gains were between '97 and '04. The only instance that has occurred since the market topped in 2007 was the last one, which was a loser.

Overall, there doesn't appear to be a strong or consistent edge here. I did also look at results of buying NDX instead of SPX. I thought perhaps since that was the oversold index that it would have a stronger tendency to bounce.

NDX closes down for at least the 3rd day in a row while the SPX closes at a 3-day high. Buy NDX on close. Sell X days later. \$100k/trade. 1986 - 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	41,945.29	34	20	14	58.82	3,670.15	-2,246.98	1.63	2.33	1,233.69
4	26,257.94	34	21	13	61.76	2,864.42	-2,607.29	1.10	1.77	772.29
3	25,848.26	34	19	15	55.88	2,593.05	-1,561.32	1.66	2.10	760.24
2	28,400.48	34	18	16	52.94	2,818.66	-1,395.96	2.02	2.27	835.31
1	15,248.38	34	19	15	55.88	1,712.04	-1,152.03	1.49	1.88	448.48

It was more volatile and the average trade was higher than the SPX. Still it wasn't any more reliable. So overall, I think perhaps the oversold NDX may lead to a bounce and perhaps there is a slight edge based on this setup. On its own I wouldn't put much weight into this study. When combined with the 1st study above, the implication seems to be that we could see an upside resolution to the range this week.

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



The bearish studies have now all expired and the Active List is all short-term bullish. This has the green Aggregator line squarely above 0. The positive value indicates the net expectation from the Active Studies over the next few days is for upside. But while the Aggregator line is above 0 the black Differential line remains below it. This means the SPX has outperformed expectations over the last few days. So we have positive expectations and a market that is already overbought versus recent expectations. This is considered a neutral configuration. It is reflected on Aggregator chart when both lines are on opposite sides of 0. Due to this the Aggregator System remained flat at the close.

The green Aggregator line is set up to close above 0 again tomorrow but that could change if bearish studies arrive. Meanwhile the Differential pivot will be 1,140.74 tomorrow. Any close at or below this level would move the black Differential line positive. That would require about a 0.5% decline from Friday's close.

So it appears there is a bit of an upside edge based on recent studies. Still, I prefer to buy when the market is relatively oversold. I'll see if we get a pullback in the next day or two to buy into.

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/4 – bullish

There were 3 intermediate-term studies that expired this week. Two were seasonality-based and suggested bearish implications. The other was a breadth study that was strongly bullish for the short-term. Obviously breadth trumped seasonality over the last month.

We found last week that strong moves during a month often lead some follow through over the next few months. September did close well so I would look at that as a small positive.

While the NDX did struggle a little this week, the Nasdaq / SPX Relative Strength indicator tracked on the charts page is still showing the Nasdaq to be squarely leading. This is a positive formation.

Lastly, we are close to new highs and the market has positive momentum. Without compelling evidence of a top it would be very difficult for me to turn bearish.

So while I'll continually monitor price action, breadth, volume, sentiment, intermarket relationships and more, I'm not seeing compelling evidence of a big selloff at this point. I'll continue to favor long-side trades over short ones until this changes.

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. There were quite a few setups that appeared on the triggers page tonight. I typically prefer only to take them when I also have an edge via the Aggregator. With a neutral Aggregator, traders could consider taking a hedged position. For instance, going long AAPL or QQQQ based on system 11111 and then going short EEM based on system -80514. You could then leg out as each triggers their respective exits, or you could treat them as a spread and take both off when one triggers an exit.

Current Open Trade Ideas

None.

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