

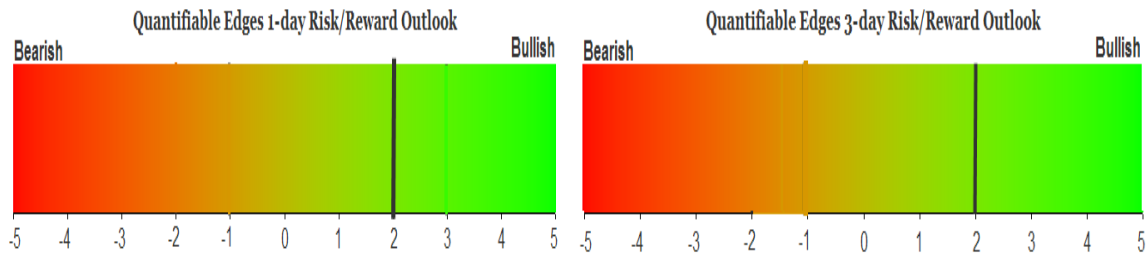
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 11, 2010

Volume 3 Issue 195

## Market Overview



## Tonight's Research Points

- Columbus Day after an up week has performed very well since 1971.
- October op-ex week has been bullish since 1984.
- The Aggregator System remained flat.
- The NDX Aggressive Trend Timer remained long.

## Short-term Outlook

### The Bottom Line

Despite the move up on Friday the Aggregator turned from flat to long. I'm looking to take advantage of any weakness early on Monday.

*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>				
October 11, 2010	Columbus / Op-Ex Monday Seasonality	1 day	Bullish	
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%
<b>Active - Long Term</b>				
September 21, 2010	50-high breakout on 90% Up Vol	1-25 days	Bullish	
September 20, 2010	Nas/SPX RS favors Nasdaq	int term	Bullish	
July 20, 2010	Down 1 week after FTD	int term	Bearish	
<b>Dropped Tonight</b>				
July 7, 2010	McClellan Oscillator Bottom Divergence	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	
October 8, 2010	1.5% Rise the flat 2 days	1 day	Bearish	

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

## The Evidence

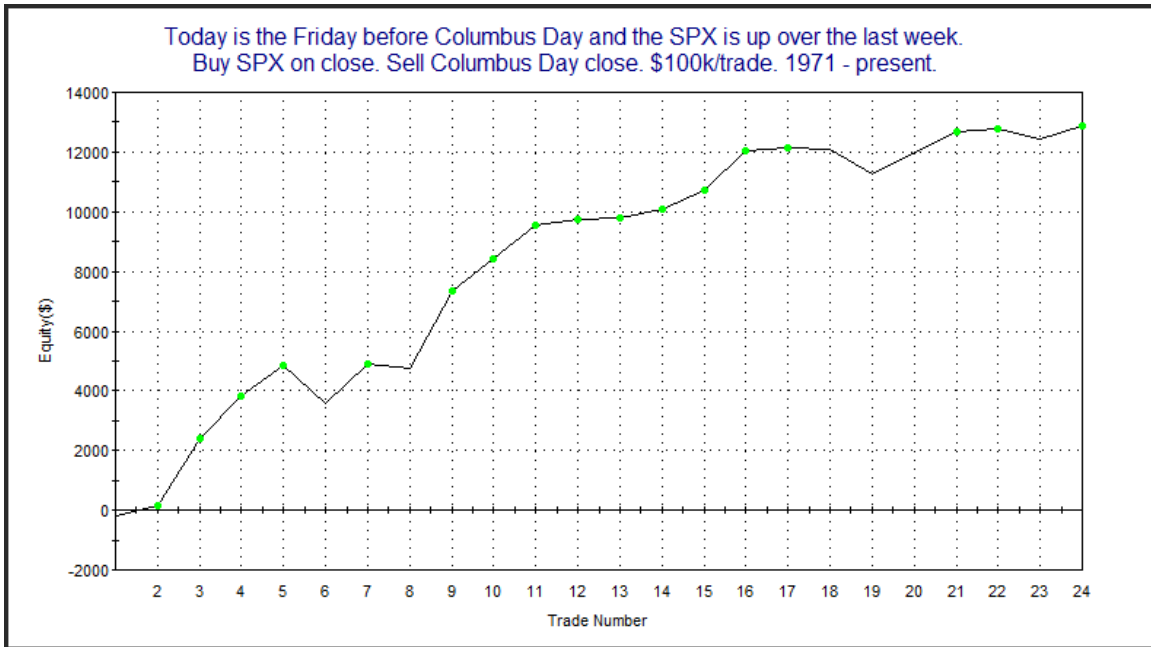
After a flat open and a morning dip into negative territory Friday the market managed to rally for much of the afternoon and post solid gains. The SPX gained 0.6%, the Nasdaq was up 0.8% and the Russell 2000 rose 1.4%. Breadth was solidly positive as the NYSE Up Issues % came in at 73% and the Up Volume % was 75%. Total NYSE volume rose slightly over Thursday's level.

While the stock market is open on Monday, banks, schools, government offices, and the bond market are closed. In past years with the bond market closed, the stock market has done quite well on Columbus Day. Of course the most famous Columbus Day rally was in 2008 when the market gained over 11% after having crashed the week before. This year circumstances are much different and the market has put in some nice gains this week. I have found that positive momentum leading up to Columbus Day has generally led to a positive Columbus Day. This weekend I realized while Columbus Day has only been celebrated on the 2nd Monday of October since 1971, some previous tests I have shown looked back a little further than this. Below is a study that looks at times when the week leading up to Columbus Day has been positive. It goes back to 1971.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$12,871.13	Profit Factor	5.52
Gross Profit	\$15,721.84	Gross Loss	(\$2,850.71)
Total Number of Trades	24	Percent Profitable	75.00%
Winning Trades	18	Losing Trades	6
Even Trades	0		
Avg. Trade Net Profit	\$536.30	Ratio Avg. Win:Avg. Loss	1.84
Avg. Winning Trade	\$873.44	Avg. Losing Trade	(\$475.12)
Largest Winning Trade	\$2,609.46	Largest Losing Trade	(\$1,248.22)

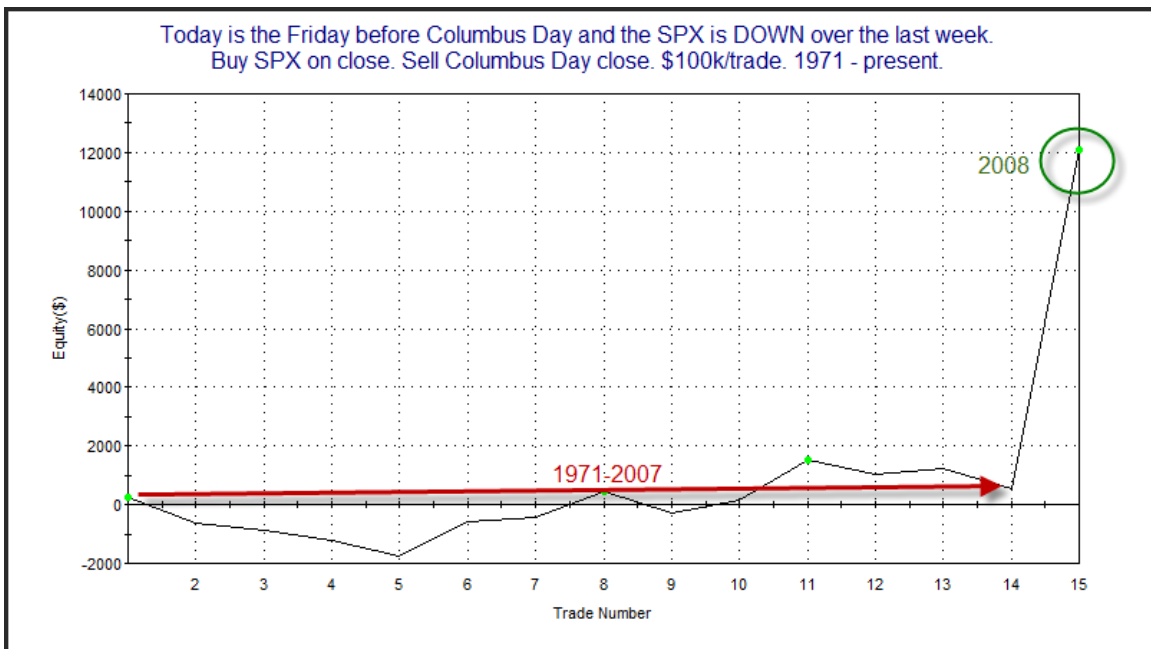
21 of 24 instances (87.5%) closed above the entry price at some point in the next 3 days. The 3 that didn't were 1979, 1991, and 1999. All 3 saw steep drawdowns the next week. The drawdowns reached levels of 8.0% ('79), 2.8% ('81) and 6.7% ('99).

I've circled some of the more impressive stats here. With 75% of trades profitable and winners nearly twice the size of losers risk/reward has been very favorable. Below is the profit curve.



We see a fairly steady upslope here. Combined with the stats above I'd say Columbus Day with upside momentum appears to provide a solid seasonal edge.

What about times without positive momentum? Below is an equity curve showing results of that setup.



As I mentioned above, 2008 was a huge outlier. Take away that one year and Columbus Day showed no edge whatsoever when the prior week was down.

The Quantifinder pointed out another seasonal edge that could be in play this week. It is options expiration. Below is the table from the 3/15/10 Subscriber Letter that broke out op-ex week performance by month. (Not updated.)

Op-ex week performance by month. 1984 - present. (Excludes September of 2001.)										
Month	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
12	24,139.10	26	21	5	80.77	1,419.40	-1,133.66	1.25	5.26	928.43
11	4,373.94	26	16	10	61.54	1,437.97	-1,863.36	0.77	1.23	168.23
10	20,372.02	26	18	8	69.23	2,593.34	-3,288.50	0.79	1.77	783.54
9	4,340.25	25	15	10	60.00	1,375.10	-1,628.62	0.84	1.27	173.61
8	9,724.48	26	16	10	61.54	1,481.73	-1,398.31	1.06	1.70	374.02
7	-1,288.69	26	12	13	46.15	1,623.03	-1,597.31	1.02	0.94	-49.57
6	-4,566.75	26	13	13	50.00	1,264.23	-1,615.52	0.78	0.78	-175.64
5	8,987.54	26	14	12	53.85	2,029.22	-1,618.46	1.25	1.46	345.67
4	25,280.66	26	17	9	65.38	2,361.00	-1,650.70	1.43	2.70	972.33
3	24,505.86	26	17	9	65.38	2,267.48	-1,560.14	1.45	2.75	942.53
2	3,989.13	27	14	13	51.85	1,705.32	-1,529.65	1.11	1.20	147.75
1	2,831.59	27	13	14	48.15	2,286.94	-1,921.33	1.19	1.11	104.87

October (#10) is the 4th strongest month in terms of average week and the 2nd strongest in terms of winning %. Below is the daily breakdown of October op-ex week.

Today is Friday before October op-ex week. Buy SPX on close. Sell X days later. \$100k/trade. 1984 - 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	20,372.02	26	18	8	69.23	2,593.34	-3,288.50	0.79	1.77	783.54
4	28,247.97	26	18	8	69.23	2,438.77	-1,956.23	1.25	2.81	1,086.46
3	10,293.72	26	17	9	65.38	1,304.83	-1,320.93	0.99	1.87	395.91
2	24,251.55	26	17	9	65.38	1,808.96	-722.31	2.50	4.73	932.75
1	23,204.58	26	20	6	76.92	1,259.22	-329.98	3.82	12.72	892.48

As you can see the largest part of the gains primarily occur on Monday with the rest of the week rather stagnant.

So between the positive Columbus Day seasonality and the positive op-ex week seasonality, it appears there are some fairly strong seasonal forces that could impact trading on Monday.

There are still 2 bullish studies from last week on the short-term active list. Price has moved favorably in the anticipated direction but the price targets have not quite been reached, so they will stay active for the time being. I'm not seeing any other short-term evidence that is terribly compelling based on price, breadth, or volume. While there has been a dearth of new studies making the active list lately, it's not unusual to see a lower-than-normal number of studies triggering in a low-volatility environment where we are stair-stepping higher. Last fall we saw similar situations where the number of active studies was often fairly low.

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



We have a rather unusual occurrence with the Aggregator today. Despite the rise to new highs a new bullish signal was triggered. With all the short-term studies still bullish the green Aggregator remains above 0. The positive value indicates the net expectation from the Active Studies over the next few days is for further gains. Meanwhile the black

Differential line moved above 0. This means the SPX has underperformed expectations over the last few days. Despite being at new highs, we are now oversold versus recent expectations. And oversold with currently positive expectations has historically provided an upside edge. It is reflected on the Aggregator chart when both lines are above 0. Due to this the Aggregator System switched to long at the close.

The green Aggregator is set up to finish positive again tomorrow but with the low number of studies that could easily change should some bearish ones emerge. Meanwhile, the Differential Pivot will be 1,164.72. Any close at or above this level would move the black Differential line into negative territory. The pivot is very near Friday's close, so just about any down day will leave the market underperforming expectations and any up day will leave it outperforming expectations.

I'm currently looking to the long side, with tomorrow being the most likely day to get some upside action in the next few. I will therefore look to buy morning weakness. If that doesn't occur I'll wait until late afternoon and then look to buy if the market looks to close lower without bearish studies taking over.

**Intermediate-term Outlook (2 weeks – 2 months)– updated 10/11 – bullish**

The initial breakout on September 20<sup>th</sup> looked good for a number of reasons and so far it has done well. One reason for optimism at the time was the strong breadth that occurred on the breakout. Below is a copy of a study I posted in the 9/21 Subscriber Letter.

SPX closes at a 50-day high after not having done so for at least 10 days. NYSE Up Volume % > 90%. 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
25	47,149.27	11	9	2	81.82	5,867.85	-2,830.68	2.07	9.33	4,286.30
20	39,106.00	11	7	4	63.64	7,144.22	-2,725.88	2.62	4.59	3,555.09
15	33,537.53	11	7	4	63.64	6,262.94	-2,575.76	2.43	4.26	3,048.87
10	31,005.21	11	8	3	72.73	4,657.74	-2,085.58	2.23	5.96	2,818.66
9	25,705.32	11	7	3	63.64	4,616.82	-2,204.14	2.09	4.89	2,336.85
8	22,718.14	11	8	3	72.73	3,968.24	-3,009.25	1.32	3.52	2,065.29
7	22,862.03	11	8	3	72.73	3,950.95	-2,915.19	1.36	3.61	2,078.37
6	21,172.72	11	8	3	72.73	3,382.30	-1,961.90	1.72	4.60	1,924.79
5	24,987.61	11	9	2	81.82	3,173.64	-1,787.58	1.78	7.99	2,271.60
4	17,080.71	11	8	3	72.73	2,867.70	-1,953.62	1.47	3.91	1,552.79
3	21,706.42	11	9	2	81.82	2,432.15	-91.45	26.60	119.68	1,973.31
2	17,931.58	11	11	0	100.00	1,630.14	0.00	100.00	100.00	1,630.14
1	11,717.90	11	9	2	81.82	1,362.43	-272.00	5.01	22.54	1,065.26

We had also just seen the Nasdaq take over a leadership role. A leading Nasdaq has often been a positive sign for the market as well. I track this on the Nasdaq/SP500 Relative Strength chart on the charts page.

As we move forward, breadth and Nasdaq leadership are two indications to keep an eye on. I've noticed breadth has been middling a bit in the last couple of weeks. For instance, while the market has consistently been hitting new 50-day highs, the McClellan Oscillator hasn't even managed a new 20-day high. I ran some tests based on this and found the market odds to be pretty breakeven over the next several weeks. This is no reason to sell but you'd ordinarily prefer breadth to be gaining strength and not losing it. Eventually a narrowing market will matter.

The Nasdaq is still leading according to our indicator but the lead is shrinking. Again, no cause for concern just yet, but worth keeping an eye on.

So despite a few intermediate-term studies falling off the board this week, I remain very much where I was a week ago with the outlook. Momentum has been good. The market is hitting new highs. I won't bet against it without compelling evidence, and I am simply not seeing any right now.

### **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 buy ¼ index position at \$116.50 LIMIT BEFORE 10am EST. Cancel if not filled by then and switch it to a LIMIT ON CLOSE order. Based on the short-term market outlook above. Monday is looking to be a positive day. If I get a chance to jump aboard early I will. If not then I will look for an end-of-day entry should Monday fail to live up to expectations.*

### **Current Open Trade Ideas**

None.

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