

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 12, 2010

Volume 3 Issue 196

## Market Overview



## Tonight's Research Points

- Volume appeared extremely low but was really just typical of Columbus Day.
- The low VIX:VXV Ratio is getting a bit concerning.
- The Aggregator System turned flat.
- The NDX Aggressive Trend Timer turned long.

## Short-term Outlook

### The Bottom Line

Studies are still looking for a little more upside but the market is back to overbought. I'm sidelined awaiting a more compelling edge.

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 12, 2010	SPX 50-day high. VIX:VXV 50-day low	1-2 days	Bearish	-0.80%
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>				
October 11, 2010	Columbus / Op-Ex Monday Seasonality	1 day	Bullish	

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

### *The Evidence*

The bond market was closed Monday and the stock market may as well have been. There was low holiday volume and almost no movement in the indices. None of the majors even changed 0.1% from Friday's close. The SPX rose 0.01% while the Nasdaq rose 0.02% and the Russell 2000 fell 0.03%. It doesn't get more dead even than that. Breadth was mixed as the NYSE Up Issues % came in at 55% but the Up Volume % was 46%. Total NYSE volume came in at the lowest level in over a month.

Ordinarily very low volume occurring as the market is hitting a high level tends to be a bad sign. There were several studies that appeared in the Quantifinder tonight related to this. In the comments on the intraday Quantifinder I noted that I would be inclined to ignore all volume-related studies tonight due to the Columbus Day holiday. Holidays typically post light volume as many traders will take vacation. To confirm my inclination I looked back at Columbus Day volume to 2004. I found that the NYSE posted a 20-day low in volume in 2004, 2006, 2007, and 2009. Now it has been 5 of the last 7 years we've seen Columbus Day post the lowest volume in a month. After seeing that streak I didn't bother looking back any further. My suspicion was confirmed and I believe eyeing Monday's low volume as extreme and using it as part of a trigger in a study would be a mistake. Of course traders are free to disagree in which case the outlook would be much more bearish for the market.

Another indicator that triggered some studies tonight was the VIX:VXV Ratio. With the big drop in the VIX Monday there was also a big drop in the indicator. Historically this has suggested mildly bearish implications. Below is a study that last appeared in the 6/22/09 Letter.

VIX:VXV Ratio hits 100-day low.  
Buy SPX on close. Sell X days later. \$100k/trade. 2002 - 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	-19,295.15	14	8	6	57.14	1,446.10	-5,143.99	0.28	0.37	-1,378.23
19	-17,904.66	15	8	7	53.33	1,905.84	-4,735.91	0.40	0.46	-1,193.64
18	-13,778.99	15	7	8	46.67	2,203.62	-3,650.54	0.60	0.53	-918.60
17	-7,973.07	15	7	8	46.67	1,677.23	-2,464.21	0.68	0.60	-531.54
16	-2,987.82	17	6	11	35.29	3,711.19	-2,295.90	1.62	0.88	-175.75
15	-93.91	17	7	10	41.18	3,050.56	-2,144.78	1.42	1.00	-5.52
14	-6,385.48	17	9	8	52.94	2,059.97	-3,115.65	0.66	0.74	-375.62
13	-4,864.08	17	8	9	47.06	2,327.51	-2,609.35	0.89	0.79	-286.12
12	-5,122.49	17	7	10	41.18	2,452.72	-2,229.15	1.10	0.77	-301.32
11	-6,251.43	17	8	9	47.06	1,969.89	-2,445.62	0.81	0.72	-367.73
10	-3,579.43	17	8	9	47.06	1,746.16	-1,949.86	0.90	0.80	-210.55

Results here suggest the market has often struggled to make gains between 2-4 weeks after such a setup occurs. It's not a very large edge and not nearly as impressive as it once looked. Also, between 1-9 days there doesn't appear to be an edge at all.

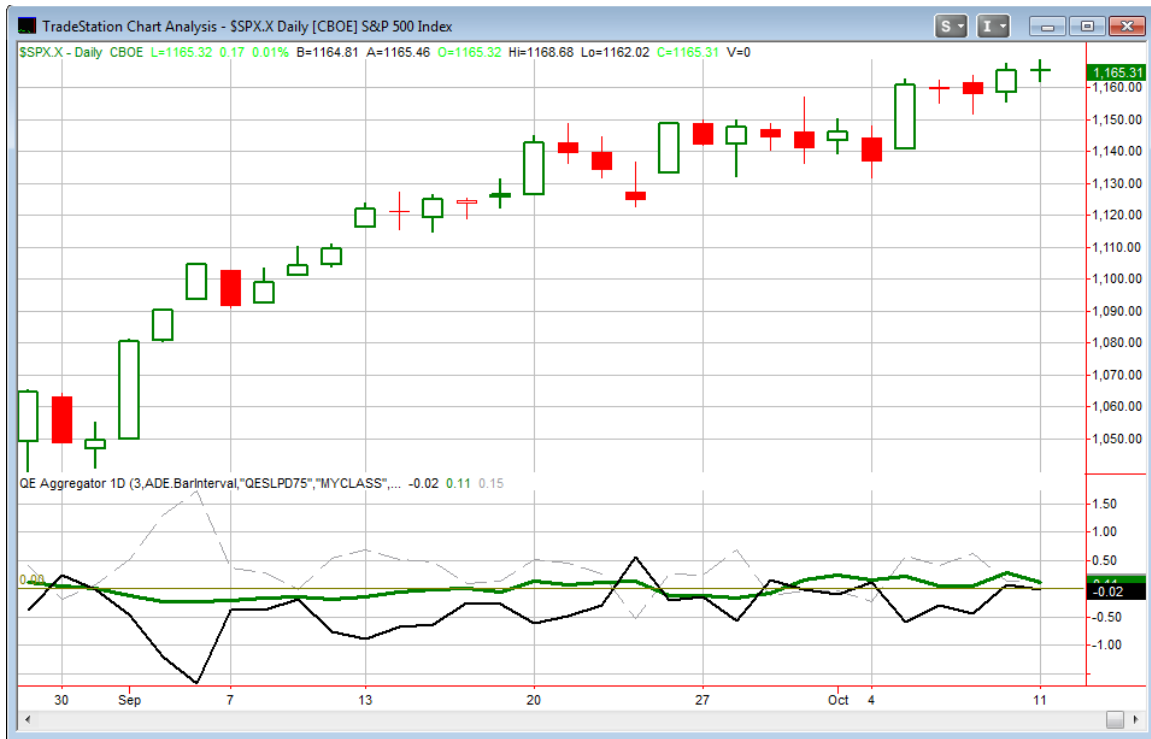
In the 8/9/10 Subscriber Letter I showed a study that suggested a VIX:VXV Ratio under 0.85 was typically bearish for the next day. Today not only saw a low VIX:VXV, but also a new closing high for the SPX. I decided to see how that combination has performed over the last several years.

VIX:VXV Ratio < 0.85 and SPX closes at a 50-day high.  
Buy on close. Sell X days later. \$100k/trade. 2003 - 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	-6,728.35	11	4	7	36.36	1,027.52	-1,548.34	0.66	0.38	-611.67
9	-5,786.93	11	4	7	36.36	1,236.76	-1,533.42	0.81	0.46	-526.08
8	-5,577.94	11	5	6	45.45	757.16	-1,560.62	0.49	0.40	-507.09
7	-3,731.01	11	4	7	36.36	539.77	-841.44	0.64	0.37	-339.18
6	-6,585.49	12	5	7	41.67	654.10	-1,408.00	0.46	0.33	-548.79
5	-6,541.23	14	7	7	50.00	452.46	-1,386.92	0.33	0.33	-467.23
4	-6,863.49	14	5	9	35.71	412.46	-991.76	0.42	0.23	-490.25
3	-5,636.50	16	8	8	50.00	378.26	-1,082.83	0.35	0.35	-352.28
2	-6,044.00	16	5	11	31.25	397.73	-730.24	0.54	0.25	-377.75
1	-5,478.17	21	10	11	47.62	142.04	-627.15	0.23	0.21	-260.87

Implications here appear to be mildly bearish, but are mostly exhausted after just 2 days.

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



Despite tonight's bearish study the green Aggregator line 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 dropped just below 0. This means the SPX has outperformed expectations over the last few days. So we have positive expectations but a market that is already overbought. This is considered a neutral configuration. Neutral Aggregator conditions occur whenever both lines are on opposite sides 0. Due to this the Aggregator System switched to flat at the close.

The green Aggregator line 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 1,161.64. Any close at or below this level would move the black Differential line back into positive territory. That's only about a 0.3% drop from Monday's close.

So it's back to the sidelines for me as I await more clarity.

**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.*

*None tonight.*

## **Current Open Trade Ideas**

None. Last night's SPY trade idea missed filling by \$0.01 this morning. Had it filled I would have been looking for an exit at the close anyway since the Aggregator was turning back neutral. So while it was disappointing not to get filled, we really only missed out on a very small win.

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