

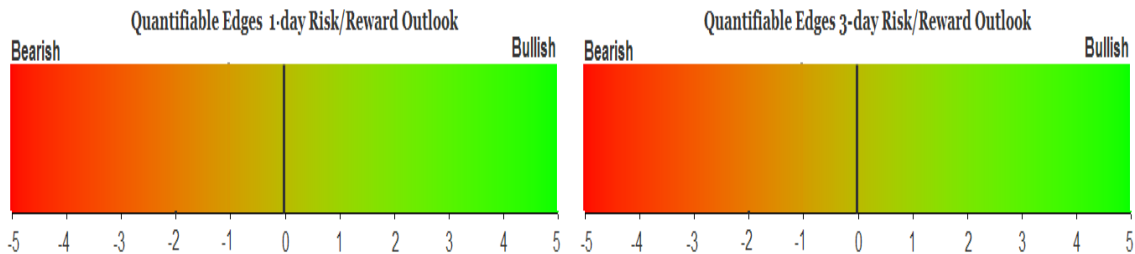
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 14, 2010

Volume 3 Issue 198

Market Overview



Tonight's Research Points

- 7 higher highs at a 50-day high often means further gains.
- Both the SPX and VIX rising when the SPX is at a new high is normally followed by a pullback.
- The Aggregator System remained flat.
- The NDX Aggressive Trend Timer remained flat.

Short-term Outlook

The Bottom Line

Still looking for more upside, but risk is elevated since the market remains overbought. I'm waiting for a better setup.

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 14, 2010	50-high breakout on 90% Up Vol	1-5 days	Bullish	1.60%
October 14, 2010	SPX 50 high. VIX up.	1-2 days	Bearish	
October 13, 2010	Outside up day at 50-high	1-3 days	Bearish	-1.10%
Active - Long Term				
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	
Dropped Tonight				
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 rang	1-10 days	Bullish	2.30%

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

The Evidence

A gap up Wednesday morning only pulled back briefly and slightly. From there the market rallied up until about 2:30. At that point some profit taking came in and some of the gains were given back in the last 90 minutes. Still it closed solidly positive and above the open. The SPX finished up 0.7%, the Nasdaq rose 1.0% and the Russell gained 1.5%. Breadth was strong as the NYSE Up Issues % came in at 75% and the Up Volume % was 74%. Total volume rose strongly and was well above average.

One way that upmoves differ from downmoves is in how the odds change as they become more extreme. With a down move, the more stretched the market gets the more prone it is to a snap back. Statistical studies tend to show a greater and greater edge the lower the market moves. With an upmove it doesn't quite work like that. Often you'll see studies suggesting a pullback after a few days of buying. But if the market is able to power through those tendencies and continues to move higher, you eventually see momentum become favored over reversion. (Of course this is just taking price into account. Breadth, volume, etc. can also provide hints of when an overbought market is likely to roll over.) We seem to be reaching the point now where overbought may stop suggesting a downside edge and instead begin suggesting an upside edge.

Today was the 7th day in a row that the SPY made a higher high. It also made a 50-day intraday high and closed at a 50-day closing high. Using these parameters I ran the study below:

SPY posts at least the 7th higher high and makes a new 50-day intraday high and closing high. This is the 1st such instance of this in the last week. 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	12,776.47	12	9	3	75.00	1,527.43	-323.47	4.72	14.17	1,064.71
4	10,099.14	12	8	4	66.67	1,544.45	-564.11	2.74	5.48	841.60
3	8,759.14	12	8	4	66.67	1,310.04	-430.29	3.04	6.09	729.93
2	6,497.59	12	8	4	66.67	995.00	-365.61	2.72	5.44	541.47
1	2,383.42	12	8	4	66.67	490.62	-385.39	1.27	2.55	198.62

Stats here are somewhat compelling but instances are low. So below is a closer look using the 5-day exit.

SPY posts at least the 7th higher high and makes a new 50-day intraday high and closing high. This is the 1st such instance of this in the last week.
Buy on close. Sell 5 days later. \$100k/trade. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
08/16/94	Buy	\$46.65	(0.02%)	\$471.46
08/23/94	Sell	\$46.64		(\$792.91)
09/08/95	Buy	\$57.36	1.90%	\$2,544.78
09/15/95	Sell	\$58.45		\$0.00
02/05/96	Buy	\$64.16	3.38%	\$3,848.26
02/12/96	Sell	\$66.33		(\$109.06)
09/16/96	Buy	\$68.80	(0.25%)	\$261.54
09/23/96	Sell	\$68.63		(\$929.92)
01/14/97	Buy	\$76.75	1.99%	\$2,343.60
01/21/97	Sell	\$78.28		(\$481.74)
02/10/98	Buy	\$102.14	1.17%	\$1,311.86
02/18/98	Sell	\$103.34		(\$1,233.54)
03/16/98	Buy	\$108.28	1.25%	\$1,873.69
03/23/98	Sell	\$109.63		(\$572.26)
11/03/04	Buy	\$114.98	1.73%	\$2,311.54
11/10/04	Sell	\$116.97		(\$260.70)
03/16/06	Buy	\$131.03	(0.70%)	\$0.00
03/23/06	Sell	\$130.11		(\$1,205.54)
04/16/07	Buy	\$146.70	0.93%	\$1,382.43
04/23/07	Sell	\$148.06		(\$231.54)
09/14/09	Buy	\$105.28	1.11%	\$2,638.22
09/21/09	Sell	\$106.45		(\$493.48)
01/11/10	Buy	\$114.73	0.29%	\$357.11
01/19/10	Sell	\$115.06		(\$1,332.63)

I found much of what I see here to be appealing. I like the consistency of the returns. Most instances gained between 0.93% and 1.99%. The lone upside outlier was a 3.38% gain, which is an outlier based on this group, but not so massively outsized that it skews the stats in a substantial way. The losses were quite small with the largest only mere 0.7% loss. More compelling about the downside was that the largest drawdown for any of the instances was 1.3% over the 5 days. This suggests that a move as persistent as this is unlikely to suddenly correct in a very sharp manner. So even with a fairly low number of instances I decided the results were compelling enough to include in the Aggregator.

But while persistence is suggesting more upside, the VIX is hinting at a pullback. Below is a study last seen in the 4/16/10 Subscriber Letter. It looks at other times the VIX rose on a day where the SPX closed at a 50-day high. Day of week is important in VIX studies because it has a tendency to drift down on Fridays and drift back up on Mondays. Mid-week moves are more natural.

SPX and VIX both close higher on a Tuesday, Wednesday, or Thursday. SPX > 200ma and at a 50-day high. Buy on close. Sell X days lower. \$100k/trade. 1998 - 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	-14,168.71	40	19	21	47.50	708.30	-1,315.54	0.54	0.49	-354.22
4	-9,346.79	42	17	25	40.48	853.65	-954.35	0.89	0.61	-222.54
3	-5,398.41	42	18	24	42.86	750.96	-788.15	0.95	0.71	-128.53
2	-10,359.92	43	13	30	30.23	707.26	-651.81	1.09	0.47	-240.93
1	-6,863.61	50	23	27	46.00	301.09	-510.69	0.59	0.50	-137.27

The size of the pullback isn't too impressive but the consistency is good enough to take this study under consideration.

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



So again tonight there is little change to the Aggregator chart. Like it has for the last several nights, the green Aggregator line remains a little 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 remains below 0. This means the SPX has outperformed expectations over the last few days. So we have positive expectations but a market that continues to register overbought. This is considered a neutral configuration.

Neutral Aggregator conditions occur whenever 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 finish positive again tomorrow. Of course that could change if compelling bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,170.37. Any close at or below this level would move the black Differential line back into positive territory. That's about 0.65% below Wednesday's close.

The bullish momentum study today kept me from getting involved on the short side yet. And to enter a long position I'm going to need to see a pullback below the Differential pivot. Overbought in an uptrend is one of the trickiest places to trade. Traders sometimes need to remind themselves that it is ok to lag a bit when the market makes these strong moves. It's not about keeping up on every up day. It's about trading conservatively or not at all when the odds are poor, and trading aggressively when odds are favorable. The overbought nature of the market increases longside risk, and the studies suggest short-side risk is also high. So I'll continue to exercise patience and wait for a better setup.

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

The initial breakout on September 20th 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. As I mentioned above, I want a better edge before taking on new exposure. For those inclined to try shorting, there were a few short setups that triggered tonight that can be found on the systems triggers page.

Current Open Trade Ideas

None.

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