

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 15, 2010

Volume 3 Issue 199

Market Overview



Tonight's Research Points

- VIX:VXV ratios remains extremely low suggesting bearish implications.
- The Aggregator System remained flat.
- The NDX Aggressive Trend Timer turned long 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 15, 2010	VIX:VXV < 0.85	1 day	Bearish	
October 14, 2010	50-high breakout on 90% Up Vol	1-5 days	Bullish	1.60%
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 14, 2010	SPX 50 high. VIX up.	1-2 days	Bearish	

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

The Evidence

The bearish studies won out on Thursday as the market pulled back a bit. It wasn't a complete victory for the bears, though. After being down about 1% heading in to the last hour, a late surge made back much of the losses. In the end the SPX finished down 0.4% and the Nasdaq and Russell lost just 0.2%. Breadth finished negative as the NYSE Up Issues % came in at 40% and the Up Volume % was 30%. Total volume declined from Wednesday's level.

A few studies showed up during the day, but with the market fighting back to near breakeven there was little tonight suggesting much of an edge. The VIX:VXV ratio remains low, which can provide a bit of a bearish influence. Below is an updated performance report from the 8/9/10 Letter that demonstrated this.

VIX:VXV Ratio closes below 0.85. Buy on close. Sell next day's close. \$100k/trade. 1/2002 - present.			
TradeStation Performance Summary			Collapse 
All Trades			
Total Net Profit	(\$7,707.62)	Profit Factor	0.69
Gross Profit	\$16,942.30	Gross Loss	(\$24,649.92)
Total Number of Trades	78	Percent Profitable	48.72%
Winning Trades	38	Losing Trades	40
Even Trades	0		
Avg. Trade Net Profit	(\$98.82)	Ratio Avg. Win:Avg. Loss	0.72
Avg. Winning Trade	\$445.85	Avg. Losing Trade	(\$616.25)
Largest Winning Trade	\$2,952.40	Largest Losing Trade	(\$1,602.28)

We see here that while the “% profitable” is fairly close to even down days were a bit bigger than up days. Complacency can create shocks and exaggerated moves down. It rarely will lead to outsized moves higher. So the edge here lies not in the winning %, but in the risk:reward. Complacency and a low VIX:VXV suggest increased risk. (Note that while the VXV was only introduced in 2007, the CBOE calculated it back several more years. I was therefore able to run this test back to 2002 using that data.)

The bullish study last night that looked at 7 higher highs and a 50-day high suggested a pullback was likely to be contained to 1% - 1.5% in the SPX. Thursday's drop was about

1% at the lowest so will see if that holds. Google has helped provide some juice to the afterhours which means we may start off a bit higher in the morning.

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 1,174.90. Any close at or below this level would move the black Differential line back into positive territory. So if the SPX is to continue its string of recent outperformance it will need to rise at least 1 point tomorrow. Even a flat close could see the Differential line flip positive and trigger a long signal.

It's very unusual for the Aggregator to sit neutral as much as it has been lately. It does sometimes happen in persistent uptrends though. Patience remains important. I'm only interested in putting capital at risk when odds and risk/reward line up. I suspect a playable edge will avail itself in the next few days.

Speaking of patience it has been about 3 months since the last Catapult signal triggered. This is about as long as I have ever seen between Catapult trades. I did notice some stocks that appeared to be getting close today. If the market sells off on Friday we could actually see some Catapults trigger. For those that are new to the site or who would like a refresher on Catapult trades, you could check out the Catapult & CBI webinar on the educational videos page of the website.

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.

Current Open Trade Ideas

None.

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