

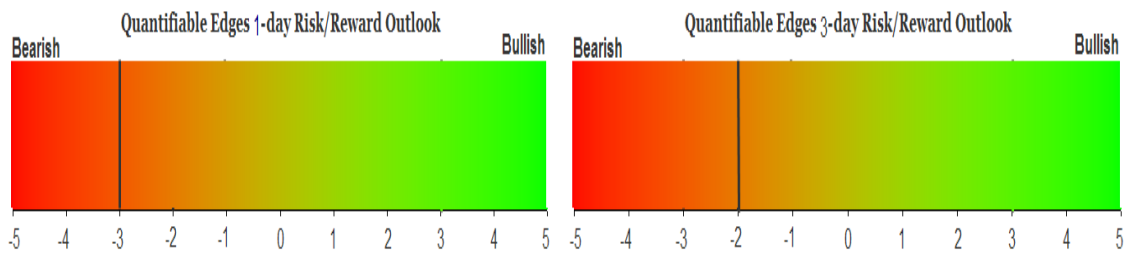
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 18, 2010

Volume 3 Issue 200

Market Overview



Tonight's Research Points

- High volume up days on options expiration tend to lead to short-term weakness.
- Such negative breadth on an up day as we saw on Friday has often been followed by declines.
- The Aggregator System turned short at the close.
- The NDX Aggressive Trend Timer turned back to flat from long.

Short-term Outlook

The Bottom Line

Breadth and volume Friday provided some strong hints that we should see some downside in the next few days. I'm looking to get some short exposure and take advantage.

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 18, 2010	SPX up on op-ex. Volume highest in 20	1 day	Bearish	
October 18, 2010	SPX up. Issue% and Vol% very low	1-3 days	Bearish	-2.10%
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				
October 18, 2010	SPX up. Issue% and Vol% very low	1-3 days	Bearish	-2.10%
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 15, 2010	VXI:VXV < 0.85	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 morning gap higher the market put in a mixed performance Friday. The SPX managed a mildly higher close with a 0.2% gain. The Nasdaq was the clear leader with the Nasdaq Composite rising 1.4% and the largecap Nasdaq 100 up 2.1%. But despite the strength in those areas the Russell 2000 closed down 0.2%. Breadth was tilted squarely negative – a rarity on a day where the SPX and Nasdaq rise. The NYSE Up Issues % came in at 38% and the Up Volume % was just 33.5%. Total volume spiked to the highest level since September op-ex.

When op-ex closes up and is accompanied by a volume spike, it has often led to a pullback in the next few days. I last discussed this in the 12/21/09 Letter. Below I have updated that study.

SPX rises on option expiration Friday on the highest NYSE volume in the last 20 trading days.
Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1996 - 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	-9,023.71	25	10	15	40.00	1,444.19	-1,564.37	0.92	0.62	-360.95
4	-7,951.74	25	10	15	40.00	1,161.00	-1,304.12	0.89	0.59	-318.07
3	-6,122.72	25	9	16	36.00	1,112.47	-1,008.44	1.10	0.62	-244.91
2	-6,359.90	25	10	15	40.00	639.47	-850.31	0.75	0.50	-254.40
1	-8,350.10	25	7	18	28.00	665.26	-722.61	0.92	0.36	-334.00

23 of 25 instances posted a close below the entry price at some point in the next 4 days.

The downside edge is often realized on day 1. In the 12/21/09 Letter I also ran this test and filtered on times the volume did NOT come in at the highest level in 20 days. I've updated those results below.

SPX rises on option expiration Friday. NYSE volume is NOT the highest in the last 20 trading days.
Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1996 - 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	-4,079.50	42	21	21	50.00	1,170.57	-1,364.83	0.86	0.86	-97.13
4	2,845.95	42	22	20	52.38	1,266.79	-1,251.17	1.01	1.11	67.76
3	12,391.04	42	25	17	59.52	1,158.67	-975.05	1.19	1.75	295.02
2	9,617.93	42	27	15	64.29	911.18	-998.94	0.91	1.64	229.00
1	7,273.75	42	23	19	54.76	795.20	-579.78	1.37	1.66	173.18

We see here some mild follow through rather than the downside edge that was apparent when volume was high.

But very high volume on an up day is not *normally* a bad thing. Op-ex day appears to be an exception. Below is another study from the 12/21/09 Letter that demonstrates this. I have not updated these results.

SPX rises on the highest NYSE volume in the last 20 trading days. Today is NOT op-ex Friday. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1996 - 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: WinLoss Ratio	All: ProfitFactor	All: Avg Trade
12	59,060.60	39	28	11	71.79	2,821.86	-1,813.78	1.56	3.96	1,514.37
11	51,851.14	39	30	9	76.92	2,369.53	-2,137.18	1.11	3.70	1,329.52
10	53,068.46	41	30	11	73.17	2,139.71	-1,011.16	2.12	5.77	1,294.35
9	49,210.79	41	31	10	75.61	1,973.68	-1,197.34	1.65	5.11	1,200.26
8	47,205.58	41	33	8	80.49	1,777.86	-1,432.96	1.24	5.12	1,151.36
7	34,120.74	43	31	12	72.09	1,810.30	-1,833.22	0.99	2.55	793.51
6	34,831.52	45	31	14	68.89	1,848.62	-1,605.41	1.15	2.55	774.03
5	24,586.11	45	30	15	66.67	1,597.62	-1,556.17	1.03	2.05	546.36
4	22,691.64	48	30	18	62.50	1,477.04	-1,201.09	1.23	2.05	472.74
3	15,595.93	50	33	17	66.00	1,151.59	-1,318.02	0.87	1.70	311.92
2	5,967.53	51	31	20	60.78	840.76	-1,004.81	0.84	1.30	117.01
1	10,023.99	63	38	25	60.32	611.87	-529.08	1.16	1.76	159.11

Unfortunately, Friday was op-ex and so what might otherwise be bullish inclinations appear to be a bit bearish.

Volume was not the most concerning aspect of Friday's up move, though. Breadth was.

In the 3/16/10 subscriber letter I looked at other time the SPX rose while the Up Vol% and the Up Issue % were less than 45%. I broke it out by times the SPX was above and below the 200ma. Below I have updated the results for those times it occurred above the 200ma.

SPX rises while NYSE Up Issue % < 45% and Up Volume % < 45%. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	-8,972.80	16	7	9	43.75	1,346.14	-2,043.97	0.66	0.51	-560.80
4	-15,362.81	16	6	10	37.50	958.51	-2,111.39	0.45	0.27	-960.18
3	-16,659.31	16	6	10	37.50	744.88	-2,112.86	0.35	0.21	-1,041.21
2	-7,741.63	16	7	9	43.75	739.65	-1,435.47	0.52	0.40	-483.85
1	-6,323.12	16	5	11	31.25	570.81	-834.29	0.68	0.31	-395.20

Results remain strongly suggestive of a downside edge.

But breadth wasn't just below 45%. Both breadth measures actually came in below 40%. I last showed results for instances this extreme in the 7/7/09 letter. Below I have updated that table.

SPX rises while NYSE Up Issue % < 40% and Up Volume % < 40%. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	-16,199.48	7	2	5	28.57	471.02	-3,428.30	0.14	0.05	-2,314.21
4	-17,349.14	7	1	6	14.29	754.80	-3,017.32	0.25	0.04	-2,478.45
3	-14,724.81	7	0	7	0.00	0.00	-2,103.54	0.00	0.00	-2,103.54
2	-10,532.07	7	2	5	28.57	222.50	-2,195.41	0.10	0.04	-1,504.58
1	-13,178.99	7	0	7	0.00	0.00	-1,882.71	0.00	0.00	-1,882.71

Instances appear very low here. I don't recall why I only went back to 2000 when I first ran this study in July of 2009. This weekend I decided to look back to 1970. Those results are below.

SPX rises while NYSE Up Issue % < 40% and Up Volume % < 40%. Buy 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
5	-16,974.56	18	7	11	38.89	1,645.70	-2,590.40	0.64	0.40	-943.03
4	-13,827.85	18	7	11	38.89	1,986.11	-2,520.97	0.79	0.50	-768.21
3	-14,845.02	18	5	13	27.78	1,994.68	-1,909.11	1.04	0.40	-824.72
2	-14,178.43	18	7	11	38.89	967.22	-1,904.45	0.51	0.32	-787.69
1	-20,182.55	18	1	17	5.56	1,843.80	-1,295.67	1.42	0.08	-1,121.25

The day 1 consistency here is quite remarkable. Upon seeing this I decided to take a closer look at the day 1 results. Below I have listed all the instances.

SPX rises while NYSE Up Issue % < 40% and Up Volume % < 40%. Buy on close. Sell 1 day later. \$100k/trade. 1970 - present.				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/23/73	Buy	\$118.22	(1.26%)	\$0.00
01/24/73	Sell	\$116.73		(\$1,259.05)
05/21/74	Buy	\$87.91	(0.93%)	\$0.00
05/22/74	Sell	\$87.09		(\$932.34)
03/04/80	Buy	\$112.77	(1.45%)	\$1,036.62
03/05/80	Sell	\$111.13		(\$1,940.34)
03/27/80	Buy	\$101.23	(0.55%)	\$187.53
03/28/80	Sell	\$100.67		(\$3,464.37)
07/21/81	Buy	\$129.64	(1.94%)	\$61.68
07/22/81	Sell	\$127.13		(\$2,274.45)
01/25/82	Buy	\$115.41	(0.19%)	\$1,030.54
01/26/82	Sell	\$115.19		(\$796.72)
11/19/86	Buy	\$237.66	1.85%	\$1,843.80
11/20/86	Sell	\$242.05		\$0.00
04/19/94	Buy	\$442.54	(0.13%)	\$555.75
04/20/94	Sell	\$441.96		(\$706.50)
10/04/94	Buy	\$461.77	(1.79%)	\$0.00
10/05/94	Sell	\$453.52		(\$2,700.00)
06/07/96	Buy	\$673.30	(0.17%)	\$45.88
06/10/96	Sell	\$672.16		(\$466.20)
05/17/99	Buy	\$1,339.31	(0.45%)	\$455.10
05/18/99	Sell	\$1,333.32		(\$1,179.56)
04/23/04	Buy	\$1,140.60	(0.45%)	\$389.76
04/26/04	Sell	\$1,135.50		(\$669.03)
03/23/05	Buy	\$1,172.53	(0.09%)	\$644.30
03/24/05	Sell	\$1,171.42		(\$94.35)
12/13/07	Buy	\$1,488.42	(1.38%)	\$0.00
12/14/07	Sell	\$1,467.95		(\$1,382.88)
06/09/08	Buy	\$1,361.77	(0.24%)	\$370.11
06/10/08	Sell	\$1,358.44		(\$745.33)
06/23/08	Buy	\$1,318.02	(0.28%)	\$600.00
06/24/08	Sell	\$1,314.29		(\$1,020.00)
09/26/08	Buy	\$1,213.53	(8.83%)	\$0.00
09/29/08	Sell	\$1,106.42		(\$8,783.02)
07/06/09	Buy	\$898.72	(1.97%)	\$0.00
07/07/09	Sell	\$881.03		(\$2,085.69)

So the last time we saw such a setup lead to a rise the next day was 1986. And since then there hasn't even been one instance where the market was up as much a 0.7% at any point the next day.

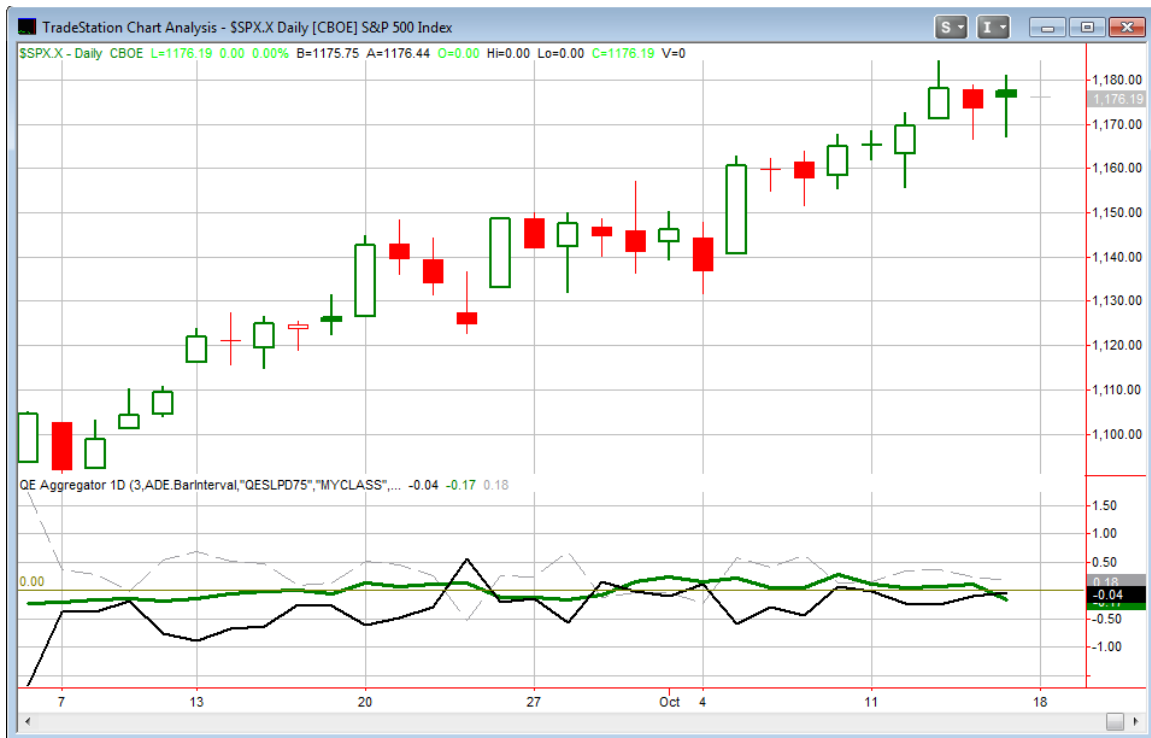
I also wondered how often this setup has triggered while in an uptrend versus a downtrend. As it turned out the number of instances were even – 9 apiece. Below are results for times like now where the SPX is above its 200ma. I also decided to look out beyond just the next few days to see if there might be longer-term implications for the uptrend.

SPX rises while NYSE Up Issue % < 40% and Up Volume % < 40%. Close > 200ma. Buy 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	-24,591.16	9	2	7	22.22	6,434.13	-5,351.35	1.20	0.34	-2,732.35
20	-15,508.39	9	2	7	22.22	6,485.21	-4,068.40	1.59	0.46	-1,723.15
15	-17,119.08	9	1	8	11.11	9,264.06	-3,297.89	2.81	0.35	-1,902.12
10	-11,465.96	9	3	6	33.33	2,890.53	-3,356.26	0.86	0.43	-1,274.00
9	-13,024.44	9	3	6	33.33	2,349.78	-3,345.63	0.70	0.35	-1,447.16
8	-9,884.59	9	4	5	44.44	1,904.92	-3,500.85	0.54	0.44	-1,098.29
7	-9,755.92	9	4	5	44.44	1,478.26	-3,133.79	0.47	0.38	-1,083.99
6	-14,072.47	9	3	6	33.33	540.89	-2,615.86	0.21	0.10	-1,563.61
5	-12,785.90	9	3	6	33.33	604.17	-2,433.07	0.25	0.12	-1,420.66
4	-15,744.83	9	1	8	11.11	754.80	-2,062.45	0.37	0.05	-1,749.43
3	-15,397.42	9	0	9	0.00	0.00	-1,710.82	0.00	0.00	-1,710.82
2	-12,210.09	9	2	7	22.22	256.42	-1,817.56	0.14	0.04	-1,356.68
1	-8,979.20	9	0	9	0.00	0.00	-997.69	0.00	0.00	-997.69

Most of the damage was done in the 1st 3 days. Still, it doesn't appear the market was quick to recover in most instances. You see the numbers 3, 4, and 5 weeks out are still skewed substantially to the bearish side. While I didn't show it earlier, I also ran the long-term results without the 200ma filter. Instances below the 200ma were just as bad from a consistency standpoint, and worse from an average trade standpoint.

No matter how you break it down the very poor breadth appears to be a bad omen

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



The breadth related studies caused the green Aggregator line to drop from positive to negative. The negative value indicates the net expectation from the Active Studies over the next few days is for a move down. Meanwhile the black Differential line remains below 0. This means the SPX has outperformed expectations over the last few days. So we have negative expectations and a market that continues to register overbought. This has historically provided a downside edge. This negative configuration can be seen whenever both lines are below 0. Due to this the Aggregator System turned short at the close.

The green Aggregator line is set up to finish negative again tomorrow. Of course that could change if compelling bullish evidence emerges. Meanwhile, the Differential Pivot will be 1,180.77. Any close at or below this level would move the black Differential line back into positive territory. So the SPX will need to rise about 0.4% on Monday if it is to remain overbought.

Unfortunately when I ran the Quantifinder and posted the systems page on Friday I missed the short signal and instead anticipated the Aggregator System was going to be flat. This is the 1st time in about six months that the “probable” signal shown on the systems page didn’t match the actual Aggregator signal. This occurred because when I checked studies earlier in the day the Up Issues % was not so low. The Up Volume % was. The studies that appeared suggested a low Up Volume % on its own was only bearish when the market under the 200ma.

So I didn't start building a short position on Friday but I will on Monday. Of course as I tend to do when trading against my intermediate-term bias, I will be trading it conservatively.

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/18 – bullish

Not much to say this week with regards to the intermediate-term. The breadth studies above were the only studies that appeared this week with potential intermediate-term implications. They don't provide overwhelming evidence but it's the first intermediate-term study in a while suggesting downside. So for now I'll just list it and keep an eye out for any further bearish evidence.

On the plus side the breakout from a few weeks ago continues to look good. The September 21st study suggested it had a good chance to continue higher and so far it has. The Nasdaq continues to lead the charge and this is a good sign as well. Momentum is strong and the market continues to make new highs. I don't anticipate changing my positive bias until I see more compelling evidence for the bears.

Catapult and Capitulative Breadth Statistics

[*Catapult & CBI Presentation Link*](#)

Open Catapult Triggers

HD @ \$30.70

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1 (HD)

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 – short ¼ index position @ \$117.70 limit. If not filled in 1st 30 minutes of trading, then cancel. Short instead at the close if the SPX closes above the 1,180.77 Differential pivot. If I don't get a fill early in the day I don't want it until later and only on a close above the pivot. As noted above the pivot is about 0.4% above Friday's close. So the short Aggregator signal will come off at the end of the day unless the SPX rises and closes above the Differential pivot.

HD – buy 1/3 position at \$30.70 limit. This is the 1st Catapult trade to trigger since early in the summer. It doesn't have the classic Catapult shape, and is unlikely to trigger 3 full entries, but it is a valid signal that I will track nonetheless. For newer subscribers or trial users who haven't followed Catapults before, I'd encourage you to check out the Catapult & CBI presentation on the educational videos page.

<http://www.quantifiableedges.com/members/videos.php>

Current Open Trade Ideas

None.

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