

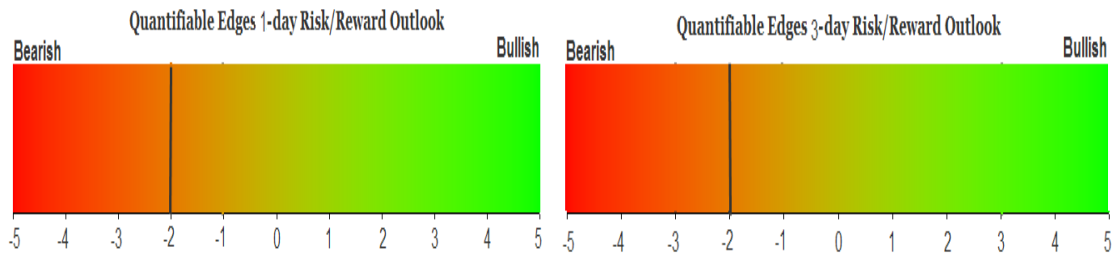
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 25, 2010

Volume 3 Issue 205

Market Overview



Tonight's Research Points

- A 20-day low in volume while the SPX rises and is above its 10ma has commonly led to a short-term pullback.
- The Aggregator System changed to short.
- The NDX Aggressive Trend Timer changed to flat.

Short-term Outlook

The Bottom Line

The move up is showing signs of weakness. This has triggered several bearish studies and has moved the Aggregator into a bearish formation.

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 25, 2010	Vol 20-day low. SPX overbought.	1-3 days	Bearish	-1.40%
Active - Long Term				
October 25, 2010	SPX Golden Cross	int term	Bullish	
October 20, 2010	20-high to 5 -low after persistent rise	1-12 days	Bullish	
October 18, 2010	SPX up. Issue% and Vol% very low	int term	Bearish	
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 21, 2010	Unfilled gap up after unfill gap dn	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

Friday was a dull day for the market as low volume and mostly sideways drift led to somewhat small gains for the indices. The SPX finished up 0.2% while the Nasdaq and Russell 2000 each gained 0.8%. Breadth was mildly positive as the NYSE Up Issues and Up Volume % both came in at 60%. Total volume was extremely light.

The Quantifinder identified a good number of studies on Friday. All of them were either bearish or neutral. The bearish studies stemmed from a few observations: 1) The market is overbought (up 3 days in a row and/or above the 10ma), 2) volume was very low, 3) it was a narrow range / inside day.

The narrow range / inside day studies typically only applied to declining markets (those under the 200ma). Therefore I won't show them.

The weak volume in an overbought market was a consistently bearish theme. Below is one example from the 3/31/10 Subscriber Letter.

NYSE volume is the lowest in 20 days. SPX close above the 200ma & the 10ma. Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-19,144.39	63	30	33	47.62	1,199.97	-1,671.01	0.72	0.65	-303.88
4	-23,625.73	68	32	36	47.06	859.92	-1,420.64	0.61	0.54	-347.44
3	-22,859.25	70	31	39	44.29	858.69	-1,268.68	0.68	0.54	-326.56
2	-19,329.39	75	33	42	44.00	745.85	-1,046.25	0.71	0.56	-257.73
1	-6,387.90	91	50	41	54.95	475.09	-735.18	0.65	0.79	-70.20

This study suggests that extremely low volume in an overbought market will often be followed by a pullback. Several studies also suggested that very low volume occurring on an up day was a bad sign. The direction of the close isn't factored in to the above test, so I added that criteria and reran it.

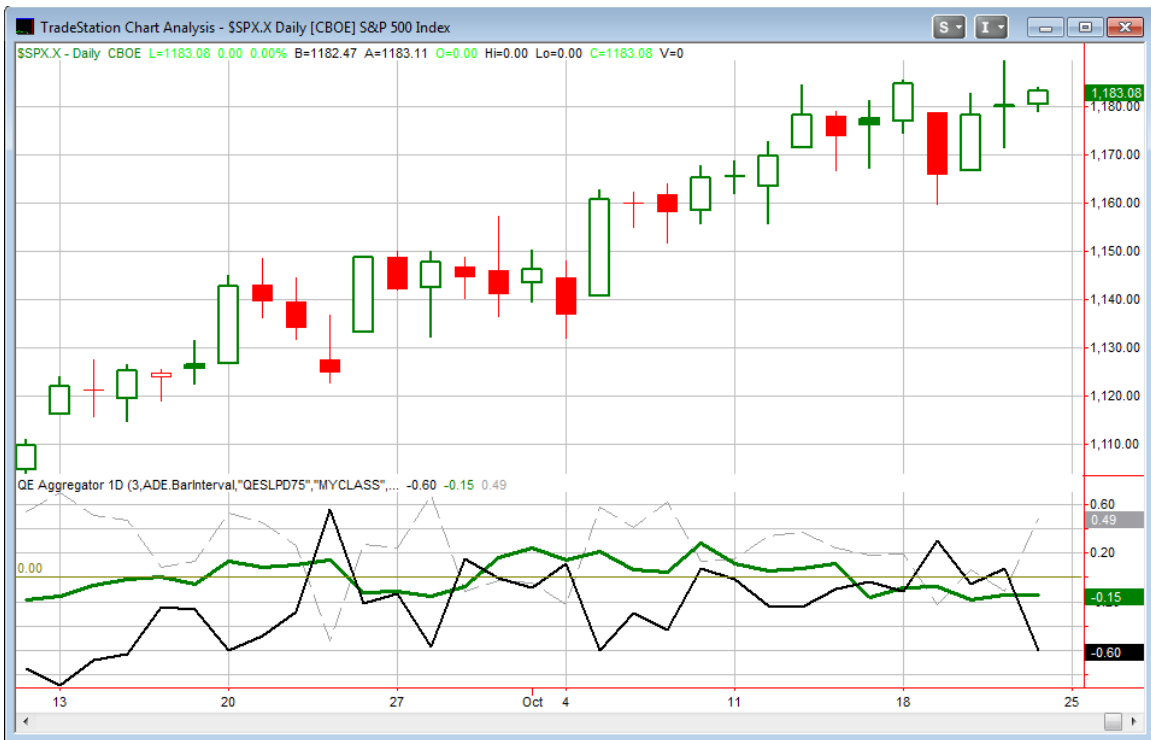
NYSE volume is the lowest in 20 days. SPX closes up and above the 200ma & the 10ma.
Buy on close. Sell X days later. \$100k/trade. 1999 - present.

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	-22,771.84	52	24	28	46.15	1,260.75	-1,893.92	0.67	0.57	-437.92
4	-19,507.80	54	24	30	44.44	939.11	-1,401.55	0.67	0.54	-361.26
3	-24,714.78	56	26	30	46.43	833.94	-1,546.58	0.54	0.47	-441.34
2	-19,649.70	58	22	36	37.93	719.52	-985.53	0.73	0.45	-338.79
1	-9,060.99	63	30	33	47.62	466.54	-698.70	0.67	0.61	-143.83

85% of instances closed below the entry price
at some point in the next week.

Results here are even a bit more compelling for the bearish case than the 1st test.

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



With tonight's studies factored in the green Aggregator line remains below zero. 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 dropped back below 0. This means the SPX has outperformed expectations over the last few days. So we have

negative expectations and a market that is relatively overbought. Historically this has provided a downside edge. This occurs whenever both lines are below 0. Due to this the Aggregator System changed from flat to short.

The green Aggregator line is set up to remain negative tomorrow. Of course that could change if bullish evidence emerges. Meanwhile, the Differential Pivot will be 1,174.10. Any close at or below this level would move the black Differential line back into positive territory. This would require a pullback of about 0.8%.

The weakening rally appears ready to pull back. I'm looking to take advantage of this with a short position. Since my intermediate-term outlook remains bullish I consider this a counter-trend trade. Therefore, I'll be taking a conservative approach to trading it and will likely max out at ½ or ¾ of a full position.

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/25 – bullish

Friday saw the SPX make a golden cross. A golden cross occurs when the 50ma crosses over the 200ma. Having the 50ma above the 200ma is commonly considered a bullish market condition – and generally it is. Much had been written about golden crosses over the past few years. Two blogs that have covered it nicely are MarketSci and Wooshedder's blog. Below are some links for anyone that would like to check out their research:

<http://marketsci.wordpress.com/2010/07/15/roundup-trading-the-golden-cross-2/>

<http://ibankcoin.com/woodshedderblog/2009/06/10/spx-golden-cross-coming-soon/>

I don't think the setup is worth spending an inordinate amount of time on – especially when so many others have done so as well. I didn't notice the trades listed anywhere else so I decided I would do that for anyone interested.

Buy SPX when 50ma crosses over 200ma.
 Sell when 50ma crosses back below 200ma. \$100k/trade. 1961 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/04/61	Buy	\$58.36	13.13%	\$24,461.64
05/07/62	Sell	\$66.02		\$0.00
01/03/63	Buy	\$63.72	31.59%	\$41,656.95
07/22/65	Sell	\$83.85		\$0.00
09/20/65	Buy	\$90.08	1.09%	\$4,417.80
04/29/66	Sell	\$91.06		(\$3,030.30)
02/03/67	Buy	\$87.36	3.63%	\$11,703.12
02/27/68	Sell	\$90.53		(\$1,029.60)
05/20/68	Buy	\$96.45	2.01%	\$12,349.12
03/13/69	Sell	\$98.39		\$0.00
05/27/69	Buy	\$103.57	(7.09%)	\$0.00
06/23/69	Sell	\$96.23		(\$7,083.10)
10/21/70	Buy	\$83.66	17.32%	\$25,226.45
09/24/71	Sell	\$98.15		(\$1,039.65)
01/26/72	Buy	\$102.50	8.82%	\$17,296.50
04/18/73	Sell	\$111.54		\$0.00
03/07/75	Buy	\$84.30	21.58%	\$27,906.58
12/01/76	Sell	\$102.49		(\$4,684.70)
01/04/77	Buy	\$105.70	(4.56%)	\$0.00
03/03/77	Sell	\$100.88		(\$5,884.12)
05/22/78	Buy	\$99.08	(3.06%)	\$9,050.73
12/13/78	Sell	\$96.05		(\$7,506.96)
03/22/79	Buy	\$101.66	1.73%	\$18,244.48
04/22/80	Sell	\$103.42		(\$4,099.11)
06/18/80	Buy	\$116.25	10.65%	\$22,110.60
07/02/81	Sell	\$128.63		(\$2,700.40)
09/28/82	Buy	\$123.24	30.57%	\$40,436.46
02/03/84	Sell	\$160.91		(\$3,333.21)
09/12/84	Buy	\$164.67	43.78%	\$54,368.99
11/18/86	Sell	\$236.77		(\$2,822.55)
11/25/86	Buy	\$248.16	2.54%	\$36,067.44
11/05/87	Sell	\$254.47		(\$12,743.40)
06/28/88	Buy	\$272.31	20.69%	\$32,398.76
02/26/90	Sell	\$328.66		(\$5,791.26)
05/25/90	Buy	\$354.58	(8.80%)	\$4,286.40
09/07/90	Sell	\$323.39		(\$13,651.62)
02/15/91	Buy	\$369.06	19.91%	\$30,723.30
04/19/94	Sell	\$442.54		(\$1,857.60)
09/15/94	Buy	\$474.81	120.93%	\$150,311.70
09/29/98	Sell	\$1,049.00		(\$6,705.30)
12/08/98	Buy	\$1,181.38	15.99%	\$20,055.84
11/05/99	Sell	\$1,370.23		(\$3,738.00)
11/10/99	Buy	\$1,373.46	1.83%	\$12,917.52
10/30/00	Sell	\$1,398.65		(\$4,872.24)
05/14/03	Buy	\$939.28	16.60%	\$23,738.70
08/18/04	Sell	\$1,095.17		(\$2,886.38)
11/05/04	Buy	\$1,166.17	8.03%	\$13,645.05
07/19/06	Sell	\$1,259.81		(\$2,551.70)
09/12/06	Buy	\$1,313.12	13.05%	\$19,985.72
12/21/07	Sell	\$1,484.50		(\$165.68)
06/23/09	Buy	\$895.10	14.85%	\$36,041.70
07/06/10	Sell	\$1,028.06		(\$2,861.58)
10/22/10	Buy	\$1,183.08	n/a	\$0.00
open	n/a	\$1,183.08		\$0.00

A few things really stand out here. First, the winning percentage is terrific with 22 winners and only 4 losers. Also with the winners substantially larger than the losers risk/reward is very good. The profit factor on these trades is about 18. Just as notable is the fact that the golden cross has done exceptionally well over the last 10 years while the market has struggled. In fact there has not been a losing trade since 1990.

In addition to the golden cross, the Nasdaq continues to lead, momentum continues to favor the bulls, and the move up has been persistent the last few weeks. Until the market begins to falter and more bearish evidence emerges I'll continue to give the uptrend the benefit of the doubt.

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 – short 1/4 index position @ \$118.35 limit. Based on short-term outlook above.

Current Open Trade Ideas

none

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