

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 26, 2010

Volume 3 Issue 206

Market Overview



Tonight's Research Points

- VIX up and SPX up make for bearish inclinations.
- Unfilled up gaps that close near their lows have often been followed by more upside.
- The Aggregator System changed to short.
- The NDX Aggressive Trend Timer changed to flat.

Short-term Outlook

The Bottom Line

Mixed studies are leaving me without a clear edge. I'm looking to get flat.

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 26, 2010	Unfilled gap up with poor close.	1-3 days	Bullish	
October 26, 2010	SPX up. VIX uup.	1 day	Bearish	
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	

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

The Evidence

A sizable gap up to start the day never filled. While the indices closed positive the market was unable to add to the morning gains and finished the day near its lows. The SPX finished up 0.2%, the Nasdaq gained 0.5% and the Russell 2000 gained 0.7%. Breadth was positive as the NYSE Up Issues % came in at 61% and the Up Volume % was 65%. Total volume rose from Friday's extremely low level.

In the 10/19/10 Letter just a week ago I looked at other times the SPX and VIX both rose on a Monday. As a refresher, the VIX has a natural tendency to rise a little on Mondays, so while the SPX and VIX will often move in opposite directions, Monday is the most frequent day of the week to see them both close higher. Last week I broke out the results by uptrends and downtrends. I've updated those results below. First is the instances above the 200ma like now.

SPX and VIX both close up on a Monday. SPX > 200ma. Buy on close. Sell X days later. \$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	-5,387.36	86	43	43	50.00	1,467.03	-1,592.32	0.92	0.92	-62.64
4	-13,000.90	88	41	47	46.59	1,263.13	-1,378.49	0.92	0.80	-147.74
3	-17,630.88	88	40	48	45.45	1,023.53	-1,220.25	0.84	0.70	-200.35
2	-20,316.98	88	37	51	42.05	749.91	-942.43	0.80	0.58	-230.87
1	-22,047.39	88	33	55	37.50	483.62	-691.03	0.70	0.42	-250.54

As you can see there appears to be a downside edge, but it has typically exhausted itself on day 1. Now for those instances below the 200ma.

SPX and VIX both close up on a Monday. SPX < 200ma. Buy on close. Sell X days later. \$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	-45,333.30	28	9	19	32.14	3,148.08	-3,877.16	0.81	0.38	-1,619.05
4	-30,934.75	29	10	19	34.48	2,865.57	-3,136.34	0.91	0.48	-1,066.72
3	-28,932.61	29	11	18	37.93	1,952.12	-2,800.33	0.70	0.43	-997.68
2	-19,158.02	29	12	17	41.38	1,620.77	-2,271.02	0.71	0.50	-660.62
1	-11,090.78	29	12	17	41.38	1,305.36	-1,573.83	0.83	0.59	-382.44

Day 1 isn't a whole lot different, but the instances that pull back do so much harder and for a longer period of time. If the market was trading below the 200ma then we could view this as a 5-day bearish edge rather than a 1-day bearish edge.

To many traders the poor close today might appear to be a weak sign. I have examined this a few different ways over the years and found that when you have an unfilled gap associated with a new high but a poor close, it is generally a bullish setup. Below are some studies related to this idea. This first excerpt below is from the 3/3/10 Letter. I have not updated the 1st study, but have updated the 2nd one that pertains to today's action.

I ran a test of performance following unfilled upside gaps that make a 20-day high. Below I've broken out the results by times the SPY closed above the open versus times where it closed below the open.

First let's look at those times where the finish was relatively strong:

SPY posts a 20-day intraday high & a low above yesterday's close. It then closes ABOVE the open and above the 200ma. 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	5,660.93	111	57	52	51.35	1,083.08	-1,078.35	1.00	1.10	51.00
4	7,684.00	121	67	53	55.37	1,001.35	-1,120.87	0.89	1.13	63.50
3	1,501.68	132	75	56	56.82	728.72	-949.15	0.77	1.03	11.38
2	-3,487.55	139	71	67	51.08	589.35	-676.59	0.87	0.92	-25.09
1	3,663.97	148	76	71	51.35	449.06	-429.08	1.05	1.12	24.76

There doesn't appear to be any edge in either direction here. Now let's examine times like the present where SPY closed below the open.

SPY posts an intraday 20-day high & a low above yesterday's close. It then closes below the open but above the 200ma. 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	13,589.77	23	13	10	56.52	1,815.53	-1,001.21	1.81	2.36	590.86
4	14,478.96	23	17	6	73.91	1,202.81	-994.79	1.21	3.43	629.52
3	17,217.51	25	18	6	72.00	1,212.34	-767.44	1.58	4.74	688.70
2	12,495.13	26	17	9	65.38	1,065.88	-624.98	1.71	3.22	480.58
1	4,632.96	27	16	11	59.26	609.93	-465.99	1.31	1.90	171.59

23 of 27 instances (85%) posted a close above the entry price at some point in the next 3 days.

These results are substantially better than earlier where the finish was good. Rather than worrying about the weak finish bulls should be excited by it.

I also added another filter today to see what a rise in volume might mean.

SPY posts an intraday 20-day high & a low above yesterday's close. It then closes < the open but above the 200ma. Volume rises. 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	10,605.15	14	7	7	50.00	2,078.63	-563.60	3.69	3.69	757.51
4	13,994.34	14	12	2	85.71	1,249.26	-498.39	2.51	15.04	999.60
3	14,080.17	15	13	1	86.67	1,101.81	-243.36	4.53	58.86	938.68
2	10,086.07	16	12	4	75.00	1,009.49	-506.94	1.99	5.97	630.38
1	6,996.38	16	12	4	75.00	685.66	-307.88	2.23	6.68	437.27

15 of 16 instances (94%) posted a close above the entry price at some point in the next 3 days.

Results here appear to be even stronger.

Not only did the SPY close below its open, it also closed near the very bottom of its daily range. In the 7/24/09 blog I looked at unfilled up gaps in SPY that closed at the bottom of the range. I have updated those results below.

SPY close in the bottom 10% of the day's range but still above yesterday's close. 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	7,513.81	18	11	7	61.11	1,485.85	-1,261.50	1.18	1.85	417.43
4	10,625.00	18	14	4	77.78	1,211.03	-1,582.36	0.77	2.68	590.28
3	16,758.65	18	14	3	77.78	1,278.91	-382.05	3.35	15.62	931.04
2	14,252.99	18	14	3	77.78	1,100.72	-385.69	2.85	13.32	791.83
1	9,085.95	19	15	4	78.95	741.24	-508.17	1.46	5.47	478.21

All 19 instances posted a close equal to or above the entry price at some point in the next 2 days.

Even though the number of instances is a little low, the results are strongly suggestive of an upside edge. The profit factor and winning % are both very compelling.

Also notable about today's action is that the 3/10 Offset HV Indicator has fallen into "extremely low" territory. This means there has been a sharp contraction in volatility the last few days as compared to the previous couple of weeks. Contractions this sharp are often followed by volatility expansions. These expansions tend to create a favorable environment for daytrading Opening Range Breakouts (ORBs). A few weeks ago I did a presentation on precisely this. Should you wish to view it you may find it on the videos page. (Gold subscribers only.) The video is about 39 minutes in length.

<http://www.quantifiableedges.com/members/QE20101004ORBs.php>

I've also created below a list of ETFs whose 3/10 Offset HV is below 0.25.

Symbol	Description	Close	3/10 Offset HV	ATR %
EWK	iShs MSCI Belgium Invest Mkt	14.14	0	1.43
IVE	iShares S&P 500/Barra Val Ind	55.88	0.02	1.16
EZA	iShares MSCI So Africa Index	68.54	0.02	1.97
VV	Vanguard Large Cap ETF	54.15	0.03	1.13
EWM	iShares MSCI Malaysia(Free)Ind	13.96	0.04	1.14
XLY	S&P Sel Consum Discretion'y Sp	35.18	0.04	1.34
EZU	iShares MSCI Emu Index Tr	37.15	0.05	2.04
EWV	iShs MSCI Mexico Invest Mkt	57.08	0.06	1.66
SPY	S&P Dep Receipts	118.7	0.07	1.2
IVW	iShares S&P 500/Barra Gwth Ind	62.35	0.08	1.2
EWQ	iShares MSCI France Index Fd	25.62	0.08	1.81
XLP	S&P Sel Consum Staples Spdr Fu	28.88	0.09	0.8
PHO	PwrShs Water Resources Prtflio	17.64	0.1	1.97
VTI	Vanguard Total Stock Mrkt ETF	60.77	0.11	1.19
XLK	S&P Sel Technology Spdr Fund	24.18	0.11	1.34
XLF	S&P Sel Financial Spdr Fund	14.55	0.12	1.8
IEV	iShares S&P Europe 350 Ind Tr	39.88	0.13	1.52
EWG	iShares MSCI Germany Index Fd	24.03	0.15	1.76
DVY	iShares DJ Select Divid Index	48.43	0.16	1.02
ECH	iShs MSCI Chile Invest Mkt	74.11	0.17	1.74
EWD	iShares MSCI Sweden Index Fd	30.12	0.17	1.89
FCG	First Trust ISE-Reserve NatGas	16.97	0.19	1.87
ACWI	iShrs MSCI ACWI Idx Fd	45.06	0.19	1.24
IYG	iShares DJ US Finl Svc Index T	51.18	0.2	1.86
VO	Vanguard Mid-Cap ETF	68.79	0.22	1.31
QQQQ	PowerShares QQQ Trust Series 1	51.89	0.22	1.42
EWN	iShs MSCI Netherlands Invest	21.27	0.22	1.7
IYR	iShares DJ US R/E Index Tr	56.15	0.23	1.42
IYT	iShares DJ Transp Avg Ind Fd	86.18	0.25	1.62

This list is taken from my swing trading list. The liquidity requirements for this list are not as high as I would use for daytrading, so some of those ETFs listed may not be as liquid as most people would prefer. In the last column I showed the Average True Range as a %. Securities that trade in wider ranges will typically offer greater intraday opportunities. Traders could look for ORB opportunities among these ETFs as well as SPY.

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



With tonight's studies factored in the green Aggregator line has moved back above zero. The positive value indicates the net expectation from the Active Studies over the next few days is for a move up. Meanwhile the black Differential line remained 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. This occurs whenever both lines are on opposite sides of 0. Due to this the Aggregator System changed from short to flat.

The green Aggregator line is set up to remain positive tomorrow. Of course that could change if bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,175.52.

Any close at or below this level would move the black Differential line back into positive territory. This would require a pullback of about 0.85%.

The market is still overbought but a continued move up appears a strong possibility. There doesn't appear to be a strongly compelling risk/reward trade setting up here. And with the 3/10 Offset HV indicator at such a low level a big move could be on tap. I'll be watching the early morning action to see if an ORB opportunity avails itself. I would prefer the early action to be tight if I am going to take an ORB trade.

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 has 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.

None.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Pri	% Gain/Los	Stop	Notes
SPY(1/4)(s)	10/26/2010	\$119.14	\$118.74	0.34%		look to exit

Cover SPY at \$119.00 limit.

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