

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 5, 2010

Volume 3 Issue 214

Market Overview



Tonight's Research Points

- Gap-n-Go formations at 50-day highs often pull back.
- Strong breadth and volume while hitting a new high has historically led to further upside follow through.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

The studies continue to suggest the market is likely to go higher. Unfortunately the recent rise has kept it overbought. I'm waiting for a better entry opportunity.

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				
November 5, 2010	Gap-n-Go to a 50-day high	1-3 days	Bearish	-1.00%
November 5, 2010	Strong breadth and vol at a 10-day high	1-5 days	Bullish	1.30%
November 5, 2010	Very strong breadth & 50-day high	1-5 days	Bullish	2.00%
November 4, 2010	Outside day 50-high, strong volume.	1-3 days	Bearish	-0.90%
November 4, 2010	SPX 100-day high on Fed Day	1-8 days	Bullish	2.10%
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	1-25 days	Bearish	
September 20, 2010	Nas/SPX RS favors Nasdaq	int term	Bullish	
Dropped Tonight				
October 28, 2010	1st Day Down After 5 up. Close > 20	1-9 days	Bullish	2.10%

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

The Evidence

After a large gap up to start the day the market never looked back. It charged hard into the close and made new 52-week highs in most indices. The SPX rose 1.9%, the Nasdaq was up 1.5%, and the Russell 2000 gained 2.6%. Breadth was strongly lopsided as the NYSE Up Issues % came in at 83% and the Up Volume % registered 90%. Total volume came in strong.

Quantifinder studies that triggered were mixed. I saw negative studies related to pure price action, but breadth and volume studies suggested bullish implications.

Just recently in the 9/27/10 Subscriber Letter I looked at patterns of large unfilled gaps that made new highs and closed above their opens. I've updated those studies below.

This first one simply requires a 10-day high during an uptrend.

SPY gaps about 1% above yesterday's close and never fills. It makes a 10-day intraday high and close > open. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1994 - 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	5,946.66	21	11	10	52.38	1,671.23	-1,243.69	1.34	1.48	283.17
4	4,221.11	22	11	11	50.00	1,579.38	-1,195.64	1.32	1.32	191.87
3	-4,956.46	22	11	11	50.00	948.93	-1,399.52	0.68	0.68	-225.29
2	-6,662.17	22	10	12	45.45	417.62	-903.20	0.46	0.39	-302.83
1	-3,089.24	22	10	12	45.45	586.39	-746.10	0.79	0.65	-140.42

Implications aren't terribly strong but risk does outsize reward by a sizable amount over the 1st couple of days. Of course Thursday wasn't just a 10-day high. I also updated the study that required a 50-day high.

SPY gaps about 1% above yesterday's close and never fills. It makes a 50-day intraday high and close > open. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1994 - 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	-4,054.56	10	4	6	40.00	557.13	-1,047.18	0.53	0.35	-405.46
4	-3,281.89	11	5	6	45.45	613.34	-1,058.10	0.58	0.48	-298.35
3	-5,600.68	11	3	8	27.27	304.59	-814.31	0.37	0.14	-509.15
2	-2,998.27	11	5	6	45.45	271.90	-726.30	0.37	0.31	-272.57
1	-751.77	11	6	5	54.55	362.47	-585.32	0.62	0.74	-68.34

10 of 11 instances (91%) posted a close below the open at some point in the next 3 days.

Instances are low here, but the results are consistent enough for me to take them under consideration. It would be unusual to see the market continue higher over the next few days without any pullback.

Notable about today though was not just the price action. Breadth and volume can often suggest directional clues and they both came in very strong. In the 8/24/09 Letter I looked at other times the SPX made a new short-term high during an uptrend and breadth and volume both came in at the strongest levels in 2 weeks. I've updated that study below.

SPX closes at a 10-day high and above its 200ma. Today's rise came with the highest NYSE Up Issues % in 10 days on the highest NYSE volume in 10 days. 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	9,328.61	17	11	6	64.71	1,226.20	-693.26	1.77	3.24	548.74
4	10,042.40	17	13	4	76.47	960.89	-612.29	1.57	5.10	590.73
3	7,175.21	18	12	6	66.67	1,008.51	-821.16	1.23	2.46	398.62
2	110.41	18	8	10	44.44	575.87	-449.66	1.28	1.02	6.13
1	4,399.61	19	13	6	68.42	471.20	-287.66	1.64	3.55	231.56

18 of 19 instances (95%) posted a close above the entry price at some point in the next 4 days.

In the 8/24/09 Letter I ran this test back as far as 1970 as well as back to 2000. The 1970 results were also positive, though the edge was not as pronounced during the 70s. Since instances are low here I decided to run it back a bit further and see where the edge began

to accelerate. It appears around 1987/1988 it began to gain some steam. So I reran the results back to 1988.

SPX closes at a 10-day high and above its 200ma. Today's rise came with the highest NYSE Up Issues % in 10 days on the highest NYSE volume in 10 days. 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	22,437.73	39	25	14	64.10	1,337.10	-784.99	1.70	3.04	575.33
4	18,904.95	39	26	13	66.67	1,127.15	-800.08	1.41	2.82	484.74
3	10,892.05	41	24	17	58.54	1,068.33	-867.52	1.23	1.74	265.66
2	12,265.10	41	27	14	65.85	723.73	-519.68	1.39	2.69	299.15
1	11,262.56	44	29	15	65.91	554.84	-321.85	1.72	3.33	255.97

While the results don't appear quite as consistent, the larger sample size adds some comfort and may also generate better estimations.

The NYSE Up Volume % was also notably strong today as it just eeked out a 90% up day. First introduced by Paul Desmond of Lowry's, 90% days have long been viewed as a sign of exceptional breadth. (Desmond's definition also had a few nuances beyond simply looking at greater than 90% upside volume, but I'm simplifying for my own study.) I've used the 90% level as a benchmark in many studies and a few of those triggered today. The most compelling looked at times the SPX made a 50-day high in conjunction with a 90% up volume day. It was most recently shown just a month ago in the 10/6/10 Subscriber Letter. I've updated the results below.

SPX closes at a 50-day high. The NYSE Up Volume % > 90%.
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
50	89,622.05	15	15	0	100.00	5,974.80	0.00	100.00	100.00	5,974.80
40	83,459.18	16	14	2	87.50	6,138.60	-1,240.61	4.95	34.64	5,216.20
30	72,836.55	17	16	1	94.12	4,578.46	-418.88	10.93	174.88	4,284.50
25	67,046.71	18	15	3	83.33	4,883.16	-2,066.88	2.36	11.81	3,724.82
20	56,300.07	19	14	5	73.68	5,001.97	-2,745.50	1.82	5.10	2,963.16
15	42,471.68	19	14	5	73.68	4,217.98	-3,316.01	1.27	3.56	2,235.35
10	31,360.26	21	13	8	61.90	3,564.52	-1,872.32	1.90	3.09	1,493.35
9	23,531.03	21	13	7	61.90	3,123.74	-2,439.66	1.28	2.38	1,120.53
8	22,351.69	21	13	8	61.90	3,153.25	-2,330.07	1.35	2.20	1,064.37
7	22,317.05	21	14	7	66.67	2,833.45	-2,478.74	1.14	2.29	1,062.72
6	26,546.97	21	14	7	66.67	2,535.55	-1,278.68	1.98	3.97	1,264.14
5	30,036.90	22	17	5	77.27	2,112.43	-1,174.87	1.80	6.11	1,365.31
4	23,712.67	23	18	5	78.26	1,770.69	-1,631.93	1.09	3.91	1,030.99
3	19,092.21	23	15	8	65.22	1,685.02	-772.88	2.18	4.09	830.10
2	19,965.82	23	18	5	78.26	1,198.37	-320.98	3.73	13.44	868.08
1	12,190.15	24	14	10	58.33	1,119.17	-347.82	3.22	4.50	507.92

22 of 24 instances (92%) close above the entry price at some point in the next week. All within 8 trading days.

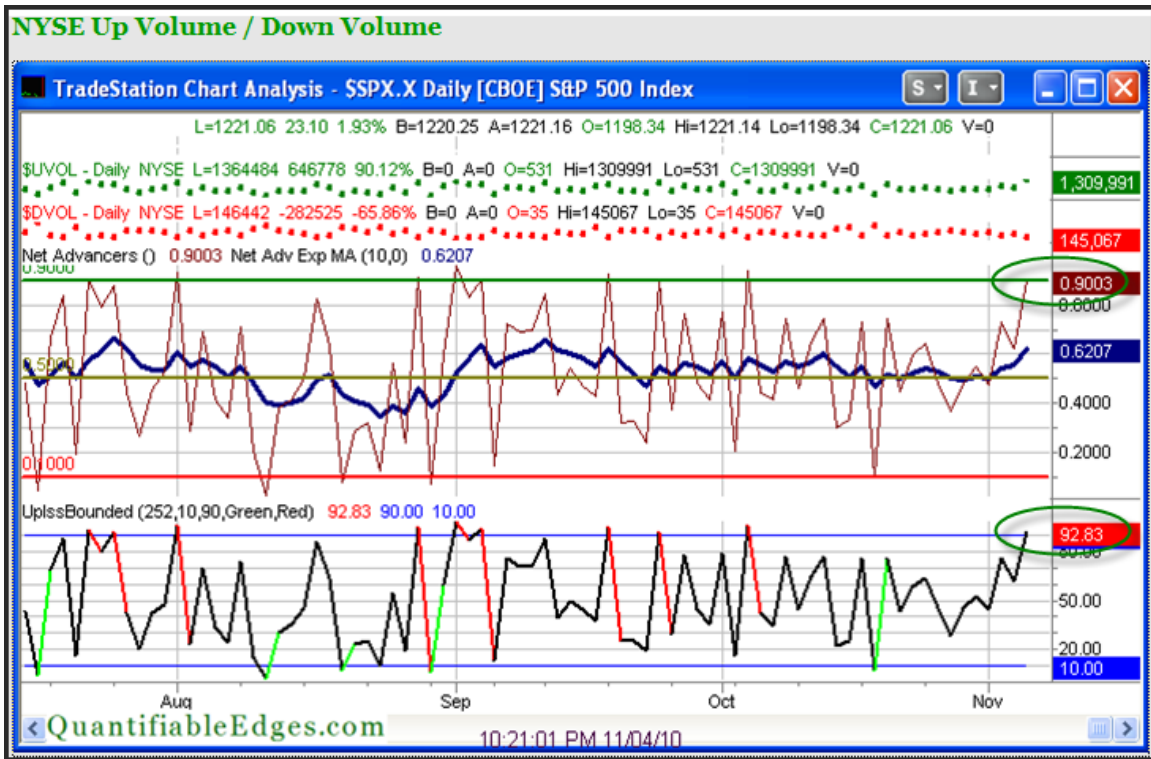
As with most of my studies instances decline because I don't allow for overlap. As I look further out the possibility for overlap increases and the number of tracked instances decreases. I find it interesting that this setup has shown strong results both short and long-term. For those that would like to review examples below is the list of instances using the 50-day exit criteria.

SPX closes at a 50-day high. The NYSE Up Volume % > 90%.
Buy on close. Sell X days later. \$100k/trade. 1970 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
11/30/70	Buy	\$87.20	11.69%	\$11,815.26
02/10/71	Sell	\$97.39		\$0.00
01/27/75	Buy	\$75.37	9.91%	\$14,108.64
04/09/75	Sell	\$82.84		\$0.00
01/05/76	Buy	\$92.58	9.01%	\$10,281.60
03/16/76	Sell	\$100.92		\$0.00
04/14/78	Buy	\$92.91	1.82%	\$9,597.92
06/26/78	Sell	\$94.60		(\$172.16)
08/02/78	Buy	\$102.91	1.91%	\$4,990.94
10/12/78	Sell	\$104.88		(\$2,184.75)
08/20/82	Buy	\$113.02	19.86%	\$27,722.24
11/01/82	Sell	\$135.47		(\$928.20)
11/03/82	Buy	\$142.86	2.65%	\$4,347.78
01/14/83	Sell	\$146.64		(\$7,535.22)
08/02/84	Buy	\$157.99	3.91%	\$7,362.80
10/12/84	Sell	\$164.17		\$0.00
01/04/88	Buy	\$255.94	3.98%	\$5,779.80
03/15/88	Sell	\$266.12		(\$6,154.20)
05/12/89	Buy	\$313.84	6.38%	\$7,488.90
07/25/89	Sell	\$333.87		\$0.00
05/11/90	Buy	\$352.00	1.08%	\$5,049.52
07/24/90	Sell	\$355.79		(\$542.44)
02/11/91	Buy	\$368.58	3.85%	\$6,146.28
04/24/91	Sell	\$382.76		(\$1,734.40)
05/04/09	Buy	\$907.24	2.80%	\$5,388.90
07/15/09	Sell	\$932.68		(\$4,171.20)
08/03/09	Buy	\$1,002.63	7.04%	\$7,674.48
10/13/09	Sell	\$1,073.19		(\$2,387.88)
08/02/10	Buy	\$1,125.86	3.90%	\$4,111.36
10/12/10	Sell	\$1,169.77		(\$7,582.08)

The results are outstanding across the board, and based on these numbers a case could be made for loading the boat to the long side whenever this setup occurs. But there is a potential issue with this study.

I mentioned before that 90% days have become associated with exceptional breadth. And for most of history 90% upside volume was exceptional. In the last couple of years, though, it has become much more common. Historically a 90% day would register in the top 1% - 2% of all days in a given year. Today's 90% day ranks "only" in the 92nd percentile. This can be seen on the charts page of the QE website. A copy of the chart is below.



The top line and circled value represent the NYSE Up Volume % for the day. The bottom line represents the percentile rank of that reading over the last 252 trading days. Percentile ranking of an indicator is something I first learned from David Varadi of CSS Analytics, who does it with many indicators. So you can see above that today was a 90% day with a 92.83% ranking.

Let's take a look at the 92.8% reading to get a different perspective of today's breadth. Rather than look at the raw Up Volume % as I did in the 1st test, below I set up a study that looked at 50-day highs occurring with breadth strong enough to place it in the 90% - 95% ranking.

SPX closes at a 50-day high. The 252-day Up Volume % Rank falls between 90% - 95%.
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
30	74,054.08	89	54	35	60.67	3,716.63	-3,618.40	1.03	1.58	832.07
25	45,177.89	95	51	44	53.68	3,492.82	-3,021.72	1.16	1.34	475.56
20	27,463.19	101	54	47	53.47	2,984.02	-2,844.13	1.05	1.21	271.91
15	64,768.00	107	63	44	58.88	2,724.20	-2,428.56	1.12	1.61	605.31
10	44,282.29	119	72	47	60.50	1,861.64	-1,909.69	0.97	1.49	372.12
9	30,568.11	120	70	49	58.33	1,814.57	-1,968.41	0.92	1.32	254.73
8	34,534.58	125	70	55	56.00	1,747.49	-1,596.18	1.09	1.39	276.28
7	33,195.93	130	69	61	53.08	1,685.48	-1,362.33	1.24	1.40	255.35
6	16,182.40	134	71	62	52.99	1,469.35	-1,421.64	1.03	1.18	120.76
5	8,302.28	137	76	61	55.47	1,234.27	-1,401.68	0.88	1.10	60.60
4	15,629.66	137	78	59	56.93	1,053.42	-1,127.75	0.93	1.23	114.09
3	22,581.48	142	77	65	54.23	1,049.36	-895.68	1.17	1.39	159.02
2	21,829.57	147	81	65	55.10	753.87	-603.60	1.25	1.56	148.50
1	12,840.26	150	82	67	54.67	490.99	-409.26	1.20	1.47	85.60

Results here, while mildly positive, are nowhere near the eye-popping figures seen when using the raw 90% Up Volume criteria. You can also see just how much more frequent instances become.

To use a percentile rank that would put the number of occurrences more in line with the raw 90% upside volume study, I would need to require a % Rank of about 99%. I've done that below.

SPX closes at a 50-day high. The 252-day Up Volume % Rank > 99%.
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
30	60,280.94	22	18	4	81.82	4,146.69	-3,589.88	1.16	5.20	2,740.04
25	53,062.23	22	17	5	77.27	4,005.49	-3,006.21	1.33	4.53	2,411.92
20	41,833.05	24	18	6	75.00	3,221.98	-2,693.77	1.20	3.59	1,743.04
15	39,663.98	24	16	8	66.67	3,291.03	-1,624.07	2.03	4.05	1,652.67
10	20,895.29	24	16	8	66.67	2,436.17	-2,260.44	1.08	2.16	870.64
9	17,714.61	24	14	10	58.33	2,705.71	-2,016.53	1.34	1.88	738.11
8	18,193.79	24	14	10	58.33	2,597.79	-1,817.53	1.43	2.00	758.07
7	22,333.02	24	14	10	58.33	2,832.47	-1,732.15	1.64	2.29	930.54
6	17,891.82	24	17	7	70.83	1,801.98	-1,820.26	0.99	2.40	745.49
5	17,045.22	26	17	9	65.38	1,738.19	-1,389.33	1.25	2.36	655.59
4	10,978.47	27	18	9	66.67	1,442.72	-1,665.61	0.87	1.73	406.61
3	11,506.16	27	19	8	70.37	1,132.13	-1,250.55	0.91	2.15	426.15
2	11,582.25	27	20	7	74.07	947.79	-1,053.37	0.90	2.57	428.97
1	9,318.25	28	19	9	67.86	752.74	-553.76	1.36	2.87	332.79

25 of 28 instances (89%) posted at least 1 close above the entry price at some point in the next week.

While not as strong, results here are a bit more in line with the 90% Up Volume test. Keep in mind that with this adaptive % Rank method, there will be times where an Up Volume % in the very high 90s would be required and there are times where it would only require an Up Volume % in the 80s. Of course since the % Rank was only 92.8% today, this test didn't trigger.

So we are left with the question now of how best to interpret today's breadth. Should we rely on the raw Up Volume %, whose reading isn't nearly as exceptional now as it has been historically? Or should we look to the % Rank, whose comparative values mostly all came on much weaker breadth days than this? My inclination is to take both under consideration.

The breadth was strong no matter how you measure it and the studies all suggested that strong breadth when making a new intermediate-term high is a good thing. So I'll view it as a positive. I don't think it is as bullish as the 90% Upside Volume test might suggest, but it's probably a bit more positive than the 90%-95% Rank test suggests. For my short-term estimates I'm simply splitting the difference.

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



The green Aggregator line tonight remains mildly 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 is now further below 0 than it has been in 2 months. The negative value means the SPX has strongly outperformed expectations over the last few days. So we have positive expectations but a market that is strongly overbought. This is considered a neutral configuration. This can be seen on the Aggregator chart 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 remain positive tomorrow. Of course that could change if enough bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,197.16. Any close at or below this level would move the black Differential line back into positive territory. So for the SPX to move to oversold versus recent expectations and possibly trigger a long it will need to close almost 2% lower tomorrow.

It's sometimes a little frustrating sitting on the sidelines while the market is running higher. This is especially true when my studies are suggesting the market is likely to go up. One big enigma that I've struggled to figure out is how to determine when it is ok to ignore the Differential line and simply make decisions based on the Aggregator. Is there an indicator I could apply to my trading that would suggest positive expectations on their own are enough, and it's ok to swing long even if the market is overbought? I haven't unearthed it yet, but it isn't for lack of effort. And I remain optimistic that I will someday solve (or stumble across the answer to) this problem. Until I do, I will continue to wait

for pullbacks or underperforming consolidations in order to allow for a better risk/reward entry.

Intermediate-term Outlook (2 weeks – 2 months)– updated 11/1 – bullish

Not much to discuss from an intermediate-term standpoint. The market again made new rally highs this week. With the very tight action in the market over the past week, no studies of intermediate-term consequence emerged. I'm still not seeing strong evidence that the uptrend is about to end.

The Nasdaq/SPX relative strength indicator continues to favor the Nasdaq. A leading Nasdaq has historically been a good sign. The Advance/Decline line hit another new high this past week suggesting breadth remains positive. Momentum is certainly favoring the upside and the market is trading above important moving averages. Until the market begins to falter and more bearish evidence emerges, I'll continue to trade with a bullish bias. For my own trading a bullish bias means I tend to trade the long side with a little more aggressiveness and I will be extra selective with short trades.

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.

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2010 Hanna Capital Management, LLC.