

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 12, 2010

Volume 3 Issue 219

## Market Overview



## Tonight's Research Points

- 1<sup>st</sup> 5 day closing low in QQQQ in over 10 days typically bullish below 200ma and neutral above 200ma.
- Inside days are bearish below the 200ma but neutral above it.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

## Short-term Outlook

### The Bottom Line

No follow through on Wednesday's bounce. There still appears to be an upside edge. Potential support still in the \$120 area for SPY. I'll look to add to my exposure should the market act poorly on Friday.

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
<b>Active</b>				
November 9, 2010	Low volume drop from 50-day high	1-6 days	Bearish	-1.80%
November 9, 2010	SPX 5+ up days then 1 down	1-6 days	Bullish	2.10%
November 8, 2010	%b > 1.15 2 days in row. 20-day high	1-6 days	Bullish	2.20%
<b>Active - Long Term</b>				
November 5, 2010	Very strong breadth & 50-day high	1-30 days	Bullish	
October 25, 2010	SPX Golden Cross	int term	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	
<b>Dropped Tonight</b>				
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%

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 down to start the day the market did manage to fight back some. It never closed the opening gap, but did manage to contain the damage and close near the top of its daily range. In the end the SPX and Russell 2000 both lost 0.4% while the Nasdaq dropped 0.9%. Breadth was weak as the NYSE Up Issues % came in at 34% and the Up Volume % was 38%. Total NYSE volume declined for the 2<sup>nd</sup> day in a row.

There was some interesting action today, and couple of studies appeared in the Quantifinder, but in the end nothing worth getting too excited about.

One study that appeared looked at other times the QQQQ had closed at a 5-day low after not having done so for at least 10 days. It suggested a mild upside edge. I had not previously broken this study down by long-term trend and decided to do so tonight. The results may surprise you. First let's look at times like now where the market is above its 200ma.

QQQQ closes at a 5 day low for the 1st time in more than 10 days. 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
10	23,719.45	44	25	18	56.82	2,862.72	-2,658.26	1.08	1.50	539.08
9	18,713.15	44	23	21	52.27	3,005.51	-2,400.65	1.25	1.37	425.30
8	-2,643.83	44	23	20	52.27	2,708.23	-3,246.66	0.83	0.96	-60.09
7	-2,330.90	44	25	19	56.82	2,550.63	-3,478.77	0.73	0.96	-52.98
6	3,612.32	44	22	22	50.00	2,819.04	-2,654.85	1.06	1.06	82.10
5	6,296.81	44	21	23	47.73	2,719.59	-2,209.33	1.23	1.12	143.11
4	2,285.01	44	25	18	56.82	1,772.89	-2,335.40	0.76	1.05	51.93
3	-1,085.87	44	21	23	47.73	1,936.84	-1,815.63	1.07	0.97	-24.68
2	13,289.59	44	28	16	63.64	1,453.18	-1,712.47	0.85	1.49	302.04
1	8,128.20	44	27	17	61.36	1,003.01	-1,114.89	0.90	1.43	184.73

Here there really doesn't appear to be any edge at all. So now let's look at instances below the 200ma.

QQQQ closes at a 5 day low for the 1st time in more than 10 days. 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
10	37,269.88	18	13	5	72.22	5,163.71	-5,971.68	0.86	2.25	2,070.55
9	36,845.63	18	13	5	72.22	4,513.33	-4,365.52	1.03	2.69	2,046.98
8	44,237.21	18	12	6	66.67	5,158.46	-2,944.04	1.75	3.50	2,457.62
7	39,648.17	18	12	6	66.67	5,137.68	-3,667.33	1.40	2.80	2,202.68
6	45,159.05	18	12	6	66.67	5,118.42	-2,710.34	1.89	3.78	2,508.84
5	27,868.48	18	14	4	77.78	3,607.63	-5,659.58	0.64	2.23	1,548.25
4	16,784.43	18	12	6	66.67	3,611.22	-4,425.04	0.82	1.63	932.47
3	17,364.58	18	13	5	72.22	3,103.86	-4,597.11	0.68	1.76	964.70
2	12,947.21	18	12	6	66.67	1,768.47	-1,379.08	1.28	2.56	719.29
1	4,253.01	18	12	6	66.67	1,106.09	-1,503.34	0.74	1.47	236.28

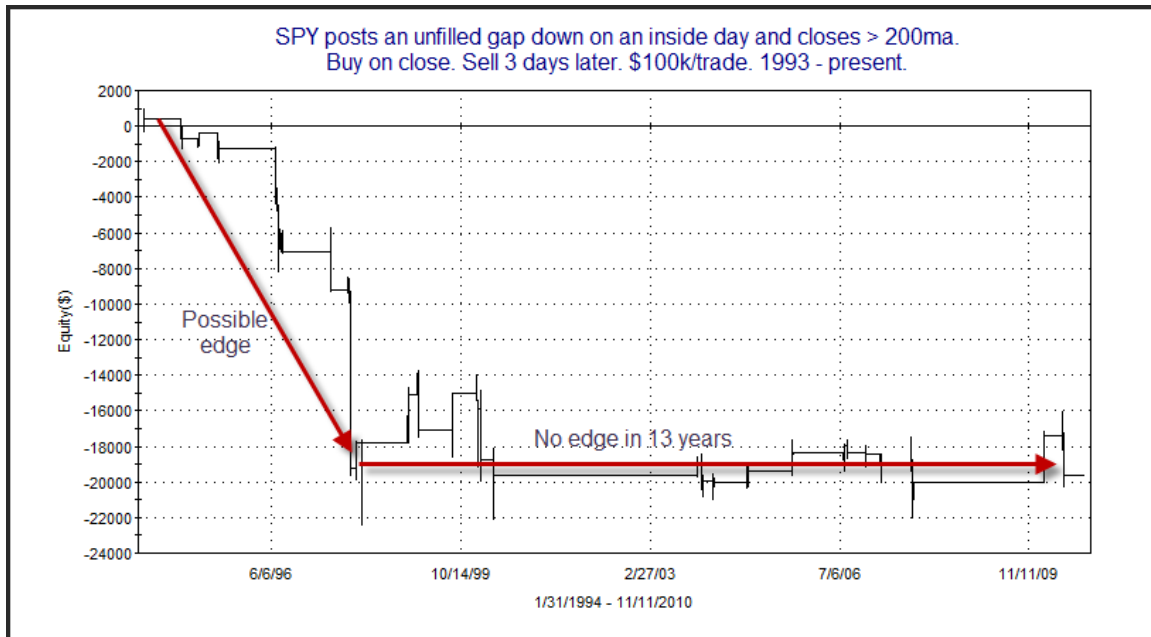
The number of instances is just a little on the low side, but the results are so strong I'd probably consider them if we were in a downtrend.

There was also a study related to inside days in the SPY that triggered. Inside days have generally suggested a bearish edge when the market is below the 200ma and no edge much better than upside drift when above the 200ma. I found it unusual that the inside day came with an unfilled gap down so I tested the possible effects under these circumstances.

At first glance the numbers seemed to suggest a downside edge. A closer look showed the numbers to be misleading. Here are the results in table format.

SPY posts an unfilled gap down on an inside day and closes > 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	-13,669.13	32	14	18	43.75	1,313.72	-1,781.18	0.74	0.57	-427.16
4	-11,960.06	32	15	17	46.88	1,099.16	-1,673.38	0.66	0.58	-373.75
3	-19,603.96	32	12	20	37.50	1,063.72	-1,618.43	0.66	0.39	-612.62
2	-19,401.16	33	13	20	39.39	726.37	-1,442.20	0.50	0.33	-587.91
1	-11,236.27	33	10	23	30.30	787.51	-830.93	0.95	0.41	-340.49

Based on this the next 1-3 days would seem to have a bearish inclination. But here is a picture of the equity curve.

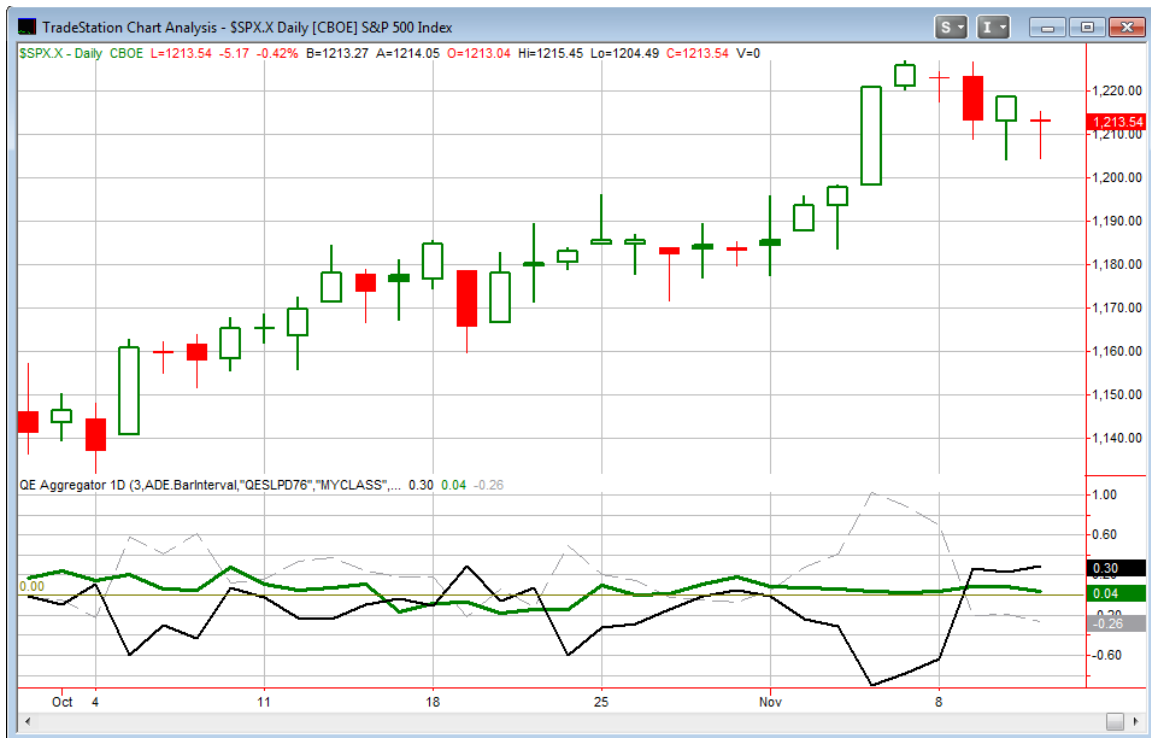


As you can see it has been a long time since this setup has produced compelling odds.

The large spike in Nasdaq volume as related to NYSE volume was unusual. The Nasdaq/NYSE volume ratio closed well above normal levels. This was in large part thanks to CSCO. Looking at similar instances in the past I was unable to find a consistent edge.

Fridays have been strong lately. SPY has closed higher 7 Fridays in a row going back to mid September. I played around with this some last weekend. I found that such streaks have been extremely rare (only 3 other times if I recall correctly). I couldn't find that it provided any significant edge.

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



The Aggregator stayed much the same tonight. The green Aggregator line remains 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 also remains above 0. The positive value means the SPX has underperformed expectations over the last few days. So we have positive expectations and a market that is oversold. Historically this combination has provided an upside edge. This can be seen on the Aggregator chart whenever both lines are above 0. Due to this the Aggregator System stayed long 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 1,215.19. Any close at or above this level would move the black Differential line back into negative territory. This means the SPX would need only to gain a little over 0.1% in order to be considered overbought versus expectations.

As I finish this up late at night the futures are down over 1% and have been steadily weakening the last few hours. Large gaps can be tricky. A big determinant in whether the gap reverses after the open or whether the selling accelerates is the position of the market prior to the gap. If the market is already extended in the direction of the gap then that seems to increase the odds of an immediate reversal. On the other hand, gaps down

from high areas will often lead to more selling that day. The tricky part here is that the market isn't overextended in either direction. This makes it hard to determine an edge.

Below is a link to an old blog study that looks at the importance of market position prior to the gap.

<http://quantifiableedges.blogspot.com/2009/04/putting-large-gaps-down-into-context.html>

I also checked [www.MasterTheGap.com](http://www.MasterTheGap.com) to see whether the odds posted there suggested a large gap down might reverse. Over the last year I have gotten to know Scott Andrews quite well and feel his gap work is very solid. Based on their Gap Guides it appeared there would be substantial risk in buying a large gap down tomorrow. He did show some stats tonight in his video that showed a gap down on a Friday after and unfilled gap was very prone to a reversal and gap fill.

So there is some conflicting evidence with regards to the morning gap. I'm not inclined to try and take on more long index exposure immediately. I suspect if we get additional selling tomorrow then some bullish studies should trigger. (Bullish Monday after down Friday since 3/09 for instance.) I've listed below conditions for another lot of SPY, but only at the end of the day.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 11/8 – bullish***

The acceleration to new highs on strong breadth produced some strong intermediate-term studies in Thursday night's letter. I won't repeat that whole discussion here, but it seems to provide another bit of evidence that the move up may have further to go. We also went another week without any bearish studies of intermediate-term significance emerging.

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 and the number of NYSE new 52-week highs is approaching its spring peak. Momentum is certainly favoring the upside and the market is trading above important moving averages. As I've been saying, 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.*

*SPY – buy ¼ index position at close if it closes down on the day AND below the open.*

*The Aggregator is still expecting a bounce and I suspect a move down Friday would create more bullish evidence.*

*GD – buy on gap down of 1% or more. If not filled at open, cancel and the buy on close if down on the day and below the open. Based on System 11111.*

### **Current Open Trade Ideas**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Pri</b>	<b>% Gain/Los</b>	<b>Stop</b>	<b>Notes</b>
SPY(1/4)	11/10/2010	\$121.58	\$121.65	0.06%		Aggregator
AMGN	11/11/2010	\$54.28	\$54.62	0.63%		System 80509

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