

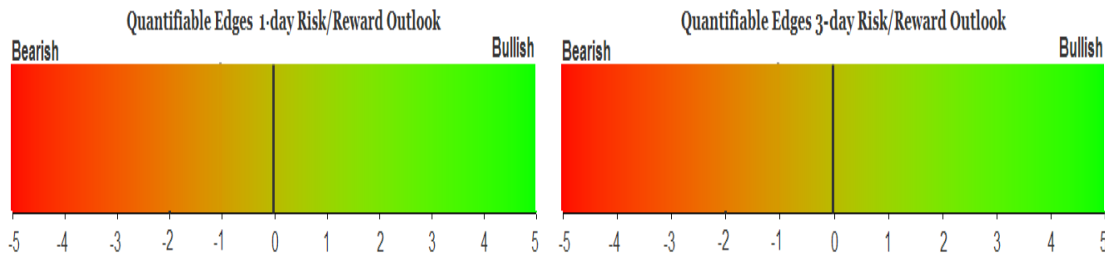
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 10, 2010

Volume 3 Issue 238

Market Overview



Tonight's Research Points

- 2 50-day highs for SPY on lower volume has been followed by weakness in the past.
- The 3/10 Offset HV indicator is again very low and expecting a big move.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

Bottom line hasn't changed. My short-term expectation remains bullish and I'm looking for a pullback to get long. I'll also be looking at a possible ORB trade tomorrow.

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				
December 10, 2010	SPY 2 50-day highs on lower vol	1-3 days	Bearish	-1.10%
December 9, 2010	NYSE Up Issues % < 40. SPX up & > 200	1-3 days	Bearish	-1.80%
December 9, 2010	Base breakout to 50-day high	1-5 days	Bullish	1.70%
December 7, 2010	SPY 3 up H,L,C then down C but up H,L	1-4 days	Bullish	1.60%
December 6, 2010	VIX 10% up to 10% dn in 1 week	1-5 days	Bullish	1.60%
Active - Long Term				
December 9, 2010	SPX & TNX 50-day highs	1-50 days	Bearish	
December 6, 2010	SPY 3 lower volume up days	1-19 days	Bearish	
December 2, 2010	2 90% Up Volume % days in 5 days	1-16 days	Bullish	
November 22, 2010	High number of POMO Days recently	int term	Bullish	
November 15, 2010	QQQ 5 lower lows and large drop	1-20 days	Bullish	
November 15, 2010	SPX down 1% SOX Up	1-20 days	Bullish	
November 5, 2010	Very strong breadth & 50-day high	1-30 days	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
September 20, 2010	Nas/SPX RS favors Nasdaq	int term	Bullish	

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

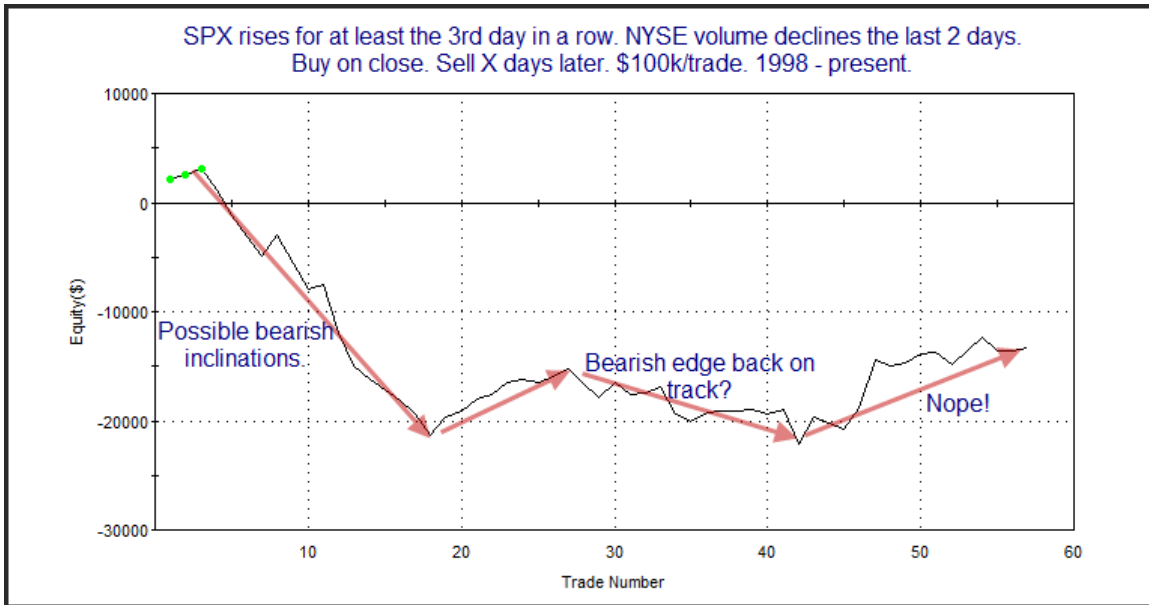
The Evidence

The overnight has been providing the movement lately and that was the case again on Thursday. The market gapped up quite a bit but made its high in the first few minutes of trading. After closing the morning gap briefly it then worked its way higher during the afternoon and made it almost back to the open price. When all was said and done the SPX had gained 0.4%, the Nasdaq was up 0.3% and the Russell 2000 tacked on 0.5%. Breadth was positive as the NYSE Up Issues % came in at 55% and the Up Volume % was 72%. As it has done the last few days, Citi trading has had a strong influence on volume figures. They were down again today on the NYSE. The Nasdaq did see volume rise, though.

Declining volume on a rally is frequently a bad sign. We looked at some patterns related to this in the 12/6 letter earlier this week. Neither of those triggered again but the fact that we are up 3 days in a row while volume has declined the last 2 did bring about some studies in the Quantifinder. The one below was last updated on 7/27/10. I've updated it again tonight.

SPX rises for at least the 3rd day in a row. NYSE volume declines the last 2 days. 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	-6,112.34	55	29	26	52.73	1,031.82	-1,385.97	0.74	0.83	-111.13
4	-9,238.96	56	27	29	48.21	1,141.88	-1,381.71	0.83	0.77	-164.98
3	-13,629.53	56	28	28	50.00	982.55	-1,469.32	0.67	0.67	-243.38
2	-7,427.91	61	27	34	44.26	731.39	-799.28	0.92	0.73	-121.77
1	-6,702.63	71	33	38	46.48	523.17	-630.72	0.83	0.72	-94.40

Results here suggest a possible mild bearish edge, though the win % is pretty split. I decided to take a closer look at some equity curves since I hadn't in a while. They all looked much the same. Below is an example using a 3-day exit strategy.



This study looked to have a bearish edge for a while. Over the last year or so the equity curve has turned up for the 2nd time. This appears too inconsistent to continue to rely on. I'll keep an eye on it but am not inclined to include it among active studies any longer.

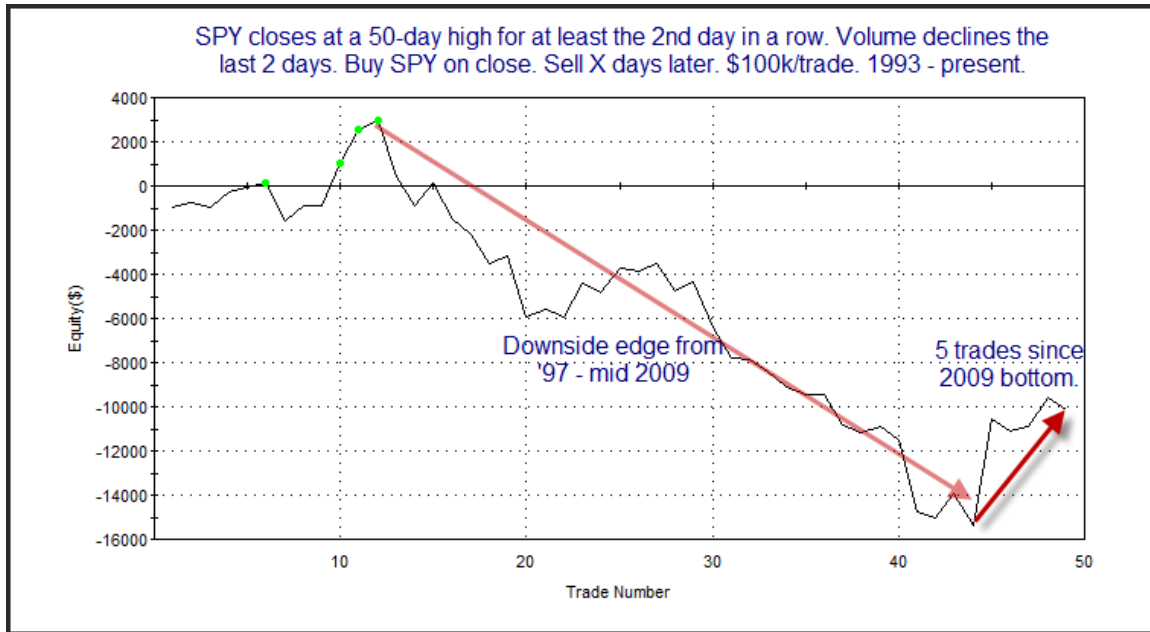
While studies that look at NYSE volume may be called into question this week thanks to Citi activity, SPY volume doesn't have that issue. SPY volume also declined the last 2 days. This brought about the following study last seen in the 11/8/10 letter.

SPY closes at a 50-day high for at least the 2nd day in a row. Volume declines the last 2 days. Buy SPY 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	-10,296.90	48	22	25	45.83	1,004.05	-1,295.44	0.78	0.68	-214.52
4	-10,406.43	49	21	28	42.86	915.89	-1,058.57	0.87	0.65	-212.38
3	-10,105.54	49	21	28	42.86	889.56	-1,028.08	0.87	0.65	-206.24
2	-8,462.63	49	21	28	42.86	653.56	-792.41	0.82	0.62	-172.71
1	-3,442.40	52	15	36	28.85	706.27	-389.90	1.81	0.75	-66.20

90% of instances closed below the entry price at some point in the next week.

This one also suggests mild negative implications. As you'll see below the equity curve has been a bit better.



There have been 3 trades (out of 5) since the 2009 bottom that have been followed by a move higher. This has caused a bump here at the end of the chart. It's too early to be terribly concerned about it though. I'll continue to monitor the effectiveness of this study. At this point I still think it is worthy of inclusion among the active studies.

For the 3rd day in a row the 3/10 Offset Historical Volatility indicator came in extremely low. Below is an excerpt from Tuesday night's letter that addresses this.

Also notable about current conditions is that the 3/10 Offset Historical Volatility Indicator came in at an extremely low 0.14 on Tuesday. I first introduced this indicator in July of 2009. It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low readings suggest there has been a contraction in volatility. High numbers suggest there has been an expansion. Anything below 0.25 is regarded as extremely low. Often after sharp contractions like this we see a volatility expansion take place. In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts. A link to that study is below:

[Quantifiable Edges ORBs Study.pdf](#)

For anyone who is interested in seeing some techniques for actually trading these ORBs I published a webinar on the subject a couple of months ago.

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

It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. As you'll find out below the Aggregator is neutral tonight so I'd be willing to consider a breakout either long or short tomorrow if I elect to trade an ORB.

Neither of the last 2 days would have led to great gains if you shorted the breakdown of the 1st half-hour. Trend days are prone to occur out of this condition though, and I'll continue to be on the lookout for one.

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



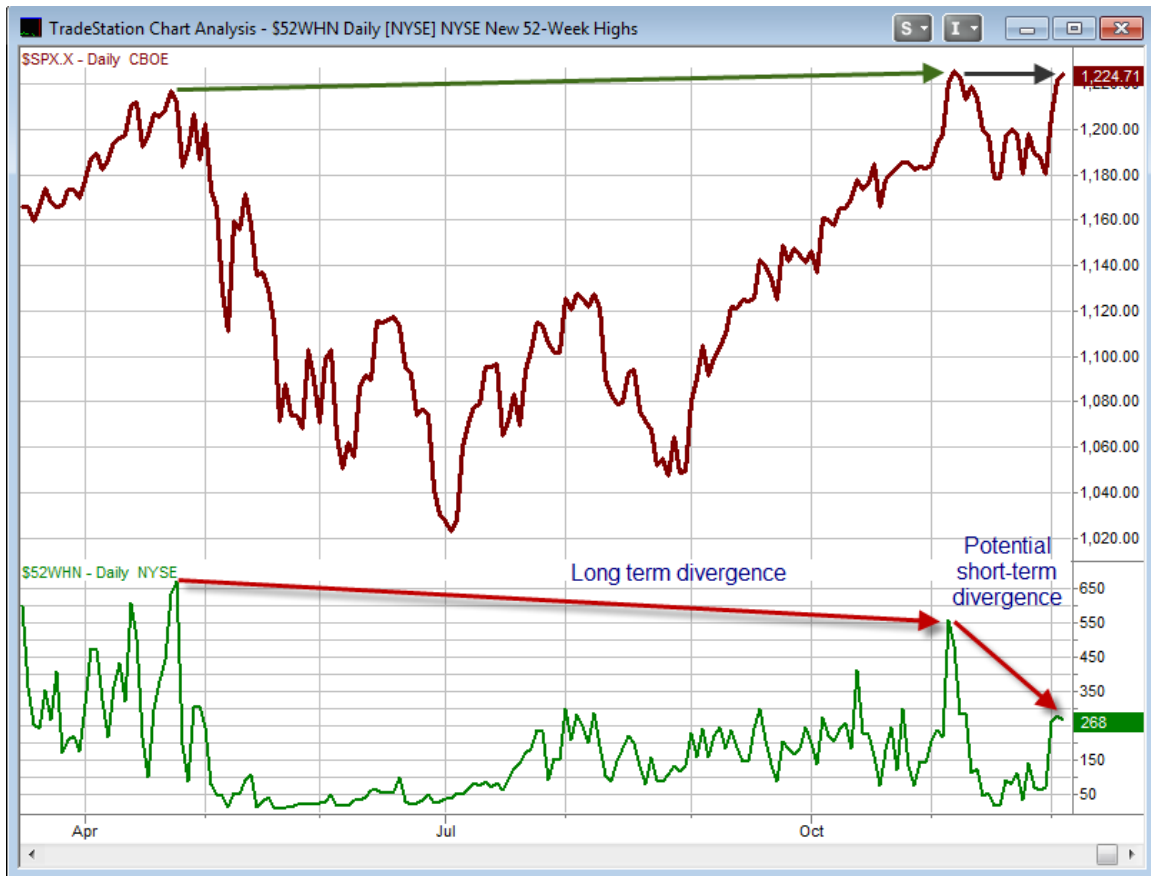
Not much change again to the Aggregator chart tonight. The bearish SPY volume study had a negative impact on the green Aggregator line. Still it managed to hold above 0. The positive value indicates the net expectation from the Active Studies over the next few days is for a move higher. The black Differential line remains negative. The still negative value means the SPX has outperformed expectations over the last few days. So we have positive expectations but a slightly overbought market. This is considered a neutral configuration. A neutral configuration occurs whenever the Aggregator and Differential 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 again tomorrow. This could change should additional bearish evidence emerge. Meanwhile the Differential Pivot will be 1,225.83. Any SPX close at or below this number would flip the Differential line into positive territory. This would require about a 0.6% decline. Without such a decline the Aggregator System will not trigger a long signal.

I've been trying to get long the last couple of days but the market has not managed to pull back and fill the trade ideas in the letter. I'll try once again Friday should opportunity arise. I will personally again keep my eye out for an ORB daytrading opportunity.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/6 – bullish

The SPY study from the short-term section above (12/6) is the first study we've seen in a while with bearish intermediate-term implications. I'll be on the lookout for additional evidence that the rally could be in danger of serious correction. One concern I've brought up a few times recently is the divergence in the number of stocks making 52-week highs as opposed to other recent peaks. Below is a chart that demonstrates what I am talking about. The top line is the SPX and the bottom indicator is the NYSE 52-week highs.

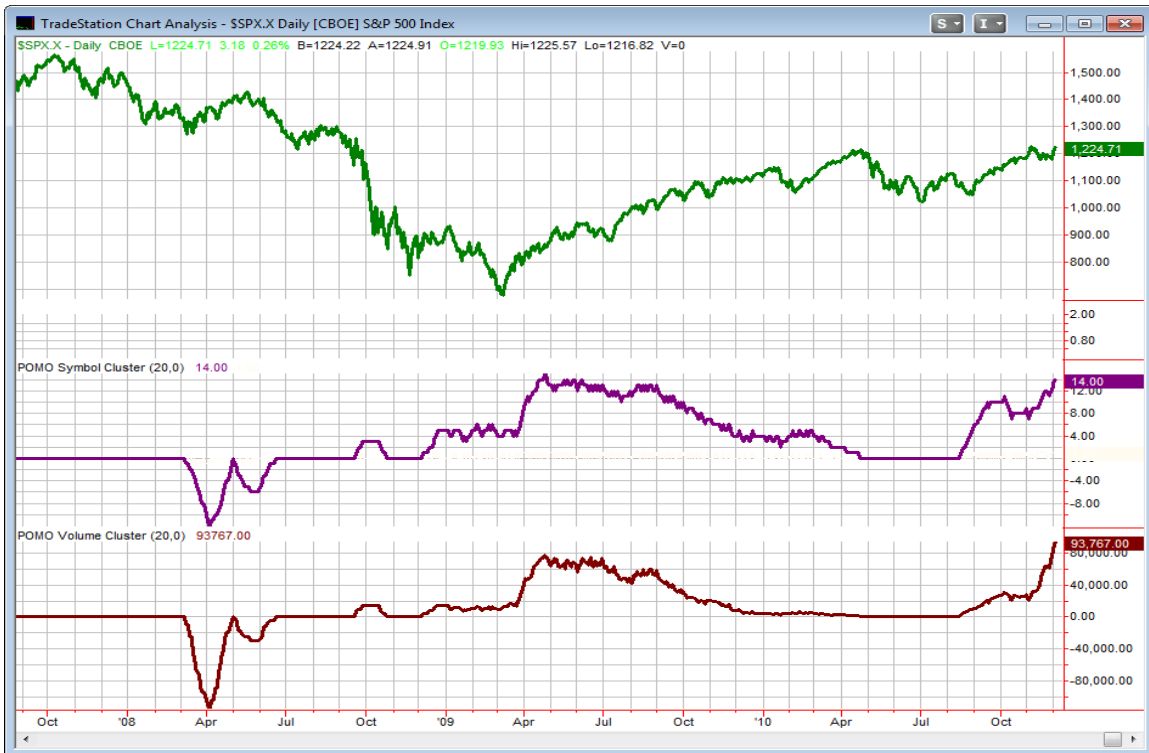


When the SPX made a new high in November we saw a divergence in the new highs versus April levels. To this point that divergence has persisted and appears to be worsening. Though the SPX is extremely close to a new high, the number of stocks making new highs is about half of what we saw last month.

I did a fair amount of research on broadening and narrowing rallies last winter. I found that divergences like this can persist for some time before the market actually suffers a substantial pullback. What was more interesting was that without such a divergence it was highly unlikely that a serious market correction would take place. So as long as we continue to see this divergence the market may be susceptible to a decline, but if the number of new highs expands and the divergence is eliminated, then that would be a strong positive for the market. I'll likely conduct further research this week should the magnitude of the divergence remain so large and the SPX actually make it to new highs.

A bullish indicator I've been showing the last few weeks is the POMO activity. Below is a refresher from last week.

POMO stands for Permanent Open Market Operations and it is how the Fed goes into the open market to buy securities. The net effect of this buying is an influx of cash into the system. It appears a portion of that cash makes its way to the stock market and works as a bullish influence. A “POMO Day” is simply a day where these operations take place... The chart below (shows a couple of POMO indicators). The top pane is the S&P 500. The middle pane is the rolling number of days in the last 20 that have been POMO days. The bottom pane is the total amount of money infused into the system over the previous 20 days.



As you can see monetary POMO stimulus over the last 20 days has now spiked to an all-time high – far exceeding even the levels reached in the summer of 2009. I suspect this will act as a strong bullish force on the market.

In addition to POMO there are still several other intermediate-term studies on the active list with bullish implications. They include studies related to breadth, price patterns, leadership (relative strength), and momentum. We are also about to enter some seasonally strong periods. I’ll be discussing them in more detail in the next few weeks. For those that might want a preview I’ve posted links to some old blog posts below. Bottom line is that I’ll continue to favor the long side and trade extra selectively from the short side.

<http://quantifiableedges.blogspot.com/2009/12/most-wonderful-tiiiiime-of-yearrrrrr.html>

<http://quantifiableedges.blogspot.com/2009/12/twill-be-3-nights-before-christmas.html>

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 1/4 index position on SPX close of 1,225.83 or lower. This is based on the short-term outlook above.

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.