

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 27, 2011

Volume 4 Issue 18

Market Overview



Tonight's Research Points

- A 100-day high on a Fed Day has traditionally been followed by further gains.
- Unfilled up-gaps with strong closes on Fed Days have often been followed by pullbacks.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

Net expectations are still for upside, but the SPX remains overbought. I'm exercising some patience and waiting for a pullback to enter.

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				
January 27, 2011	100-day high on a Fed Day	1-6 days	Bullish	1.70%
January 27, 2011	Unfilled gap up & close > open Fed Day	1-5 days	Bearish	-2.60%
January 24, 2011	Nas/Rus down 3. SPX 3-day high.	1-5 days	Bullish	
January 21, 2011	1st close < 10ma in over 25 days	1-11 days	Bullish	3.60%
January 21, 2011	SPY gap down & partial revers fr 5-low	1-10 days	Bullish	3.20%
January 19, 2011	SPX 20-day high. Vol 20-day high.	1-9 days	Bullish	2.40%
Active - Long Term				
January 21, 2011	SPY 1st close < 10ma in over 25 days	1-20 days	Bullish	
January 19, 2011	SPX 20-day high. Vol 20-day high.	int term	Bullish	
December 30, 2010	SPX closes > 10ma every day of month	1 month	Bullish	
December 16, 2010	2 Hindenburg Signals	1-50 days	Bearish	
December 9, 2010	SPX & TNX 50-day highs	1-50 days	Bearish	
November 22, 2010	High number of POMO Days recently	int term	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
Dropped Tonight				
January 26, 2011	Fed Day	1 day	Bullish	
January 26, 2011	SPX up < 0.25% and in top 10% of range	1 day	Bearish	

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

The Evidence

As often happens on Fed Days, the market put in a nice move higher Wednesday. Most of the gains occurred either overnight or before 11am EST. The 2:15 announcement didn't have much of an effect on prices. Gains were already in, and the market mostly consolidated between the announcement and the close. At the close the SPX was up 0.4%, the NASDAQ had gained 0.7%, and the Russell 2000 led the way with a 1.8% gain. Breadth was solidly positive as the NYSE Up Issues % came in at 69% and the Up Volume % was 63%. Total volume rose a little from Tuesday's level but was not extreme.

In the Quantifiable Edges Guide to Fed Days I discussed Fed Days that close at new highs. The basic finding was that when the market closed at a short-term high on a Fed Day, then it was likely to pull back over the next few days. But when it closed at a long-term high, then the rally was likely to continue. Below is a study from the guide that last appeared in the 12/15/10 Subscriber Letter.

SPX closes at a 100-day high on a Fed Day.
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
10	22,368.71	21	16	5	76.19	1,834.30	-1,396.02	1.31	4.20	1,065.18
9	22,870.17	21	16	5	76.19	1,938.23	-1,628.30	1.19	3.81	1,089.06
8	26,693.04	21	18	3	85.71	1,541.12	-349.04	4.42	26.49	1,271.10
7	21,047.72	21	18	3	85.71	1,275.78	-638.79	2.00	11.98	1,002.27
6	22,392.96	21	19	2	90.48	1,245.83	-638.93	1.95	18.52	1,066.33
5	18,439.20	21	18	3	85.71	1,147.86	-740.77	1.55	9.30	878.06
4	15,296.41	21	15	6	71.43	1,267.29	-618.82	2.05	5.12	728.40
3	9,598.44	21	14	7	66.67	946.01	-520.82	1.82	3.63	457.07
2	11,181.11	21	14	7	66.67	1,018.50	-439.70	2.32	4.63	532.43
1	5,562.80	21	14	7	66.67	664.09	-533.50	1.24	2.49	264.90

All 21 instances posted at least 1 close above the Fed Day close at some point in the next week.

This suggests further upside is likely over the next 1-2 weeks. Below I have listed all 21 instances using the 6-day exit criteria.

SPX closes at a 100-day high on a Fed Day.
Buy on close. Sell 6 days later. \$100k/trade. 1994 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
08/16/94	Buy	\$465.01	0.86%	\$868.60
08/24/94	Sell	\$469.03		(\$763.25)
03/28/95	Buy	\$503.90	0.33%	\$841.50
04/05/95	Sell	\$505.56		(\$1,623.60)
05/23/95	Buy	\$528.58	0.93%	\$1,064.07
06/01/95	Sell	\$533.49		(\$1,360.80)
07/06/95	Buy	\$553.99	1.06%	\$1,441.80
07/14/95	Sell	\$559.88		(\$169.20)
11/15/95	Buy	\$593.96	1.01%	\$1,134.00
11/24/95	Sell	\$599.97		(\$73.92)
01/31/96	Buy	\$636.01	3.15%	\$3,223.21
02/08/96	Sell	\$656.06		(\$361.10)
07/02/97	Buy	\$904.05	1.39%	\$2,113.10
07/11/97	Sell	\$916.66		(\$172.70)
02/04/98	Buy	\$1,006.90	1.71%	\$1,920.60
02/12/98	Sell	\$1,024.14		(\$656.37)
07/01/98	Buy	\$1,148.56	1.37%	\$1,598.19
07/10/98	Sell	\$1,164.35		(\$484.59)
12/22/98	Buy	\$1,203.56	2.13%	\$3,432.88
12/31/98	Sell	\$1,229.23		\$0.00
06/30/99	Buy	\$1,372.86	2.22%	\$2,337.12
07/09/99	Sell	\$1,403.28		(\$871.20)
11/16/99	Buy	\$1,420.03	(0.21%)	\$366.80
11/24/99	Sell	\$1,417.08		(\$1,460.20)
12/21/99	Buy	\$1,433.43	2.17%	\$2,737.23
12/30/99	Sell	\$1,464.47		(\$302.22)
03/21/00	Buy	\$1,493.82	0.98%	\$3,897.30
03/29/00	Sell	\$1,508.52		(\$428.34)
05/06/03	Buy	\$934.39	0.52%	\$1,403.84
05/14/03	Sell	\$939.28		(\$1,569.69)
12/14/04	Buy	\$1,203.38	0.51%	\$667.32
12/22/04	Sell	\$1,209.57		(\$831.66)
10/25/06	Buy	\$1,382.22	(1.08%)	\$520.56
11/02/06	Sell	\$1,367.34		(\$1,440.72)
05/09/07	Buy	\$1,512.58	0.01%	\$300.96
05/17/07	Sell	\$1,512.75		(\$1,396.56)
03/16/10	Buy	\$1,159.46	0.71%	\$1,312.36
03/24/10	Sell	\$1,167.72		(\$565.88)
11/03/10	Buy	\$1,197.96	1.30%	\$2,416.96
11/11/10	Sell	\$1,213.54		\$0.00
12/14/10	Buy	\$1,241.59	1.39%	\$1,424.00
12/22/10	Sell	\$1,258.84		(\$684.80)

The average 6-day runup was \$1,668. This is larger than the max drawdown of \$1,623, which I have circled above.

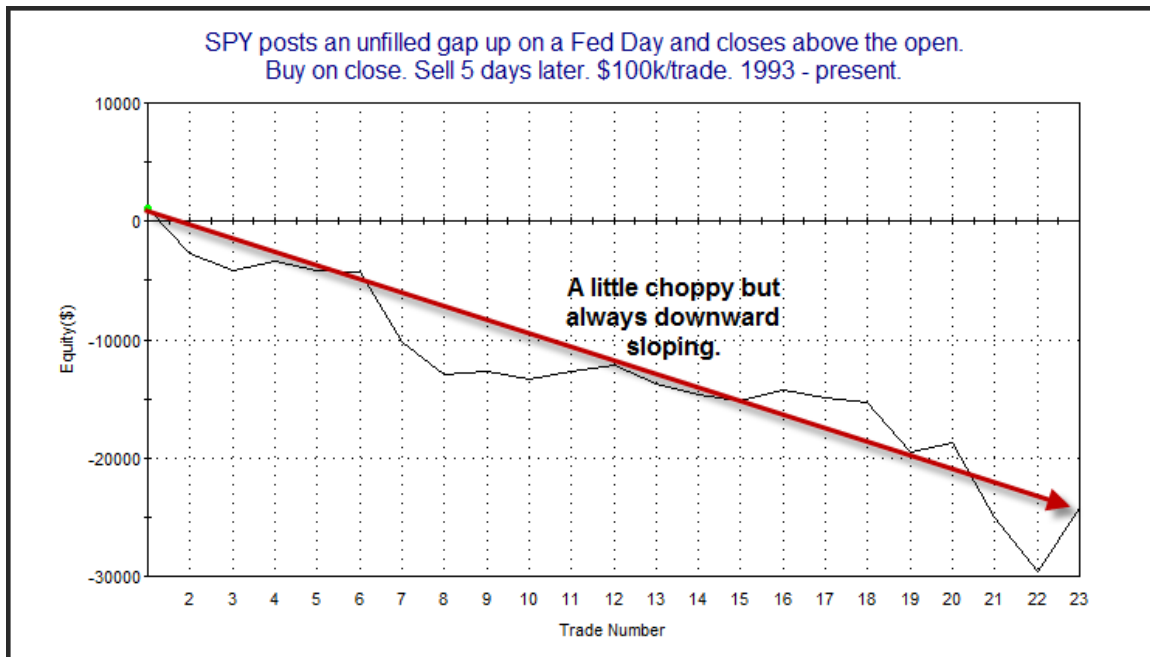
These are some very consistent results. The note at the bottom of the list provides an especially compelling stat. Also notable is that the average drawdown was just slightly over 0.7% - less than half the average run-up. No matter how you slice it, risk/reward has been strongly favorable for the long side.

But something interesting happened Wednesday. The Quantifinder identified another Fed Day study that showed compelling results, except this study suggested bearish implications. It looked at Fed days that exhibited exceptional strength by 1) gapping up, 2) leaving the gap unfilled, and 3) closing higher than the open. The study was last seen in the 11/5/09 Subscriber Letter and I have updated it below.

SPY posts an unfilled gap up on a Fed Day and closes above the open. 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	-24,177.97	23	8	15	34.78	1,292.21	-2,301.04	0.56	0.30	-1,051.22
4	-14,853.01	23	11	12	47.83	1,198.49	-2,336.37	0.51	0.47	-645.78
3	-19,574.08	23	8	14	34.78	967.95	-1,951.26	0.50	0.28	-851.05
2	-18,253.89	23	10	13	43.48	575.28	-1,846.67	0.31	0.24	-793.65
1	-12,428.80	23	8	15	34.78	377.26	-1,029.79	0.37	0.20	-540.38

20 of 23 instances (87%) closed below the entry price at some point in the next week.

The statistics seem to suggest a downside edge. When I examined the equity curves this view was not changed. Below is the equity curve using a 5-day exit strategy.



So it appears we have some conflict among the studies tonight. I did run a third test to see how much overlap there might be among Fed Day instances. I was only able to find two instances where there was an unfilled gap up, a close above the open, and a close at a 100-day high. I wouldn't attempt to draw any conclusions from only two instances, but for those that are curious, they occurred on 11/15/95 and 7/1/98. Both instances went on to post solid gains over the next couple of weeks.

It's certainly possible that both studies could turn out right. A dip lower for a day or two followed by a strong rally is one way this could occur. Rather than try and guess if one study will prove to be dominant and run the risk that my line of reasoning may be unduly biased by my current outlook, I have decided to simply include both studies in the Aggregator.

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



Not much change tonight to the Aggregator configuration. The green Aggregator line remains above 0. The positive value means the net expectation from the Active Studies List is for upside over the next few days. But the black Differential is below 0. The negative value means the SPX has outperformed expectations over the last few days. So net expectations are for upside but the SPX has outperformed recent expectations. This is considered a neutral configuration. A neutral configuration is evident on the chart whenever both lines are on opposite sides of zero. Due to this the Aggregator System remained flat at the close.

The green Aggregator line is tentatively set up to remain above 0 on Thursday. Of course this could change if strong bearish evidence emerges. Meanwhile the Differential Pivot will be 1,296.64. This means the SPX closed today almost exactly where the studies anticipated it will close tomorrow. It got to where it was supposed to 1 day in advance. Therefore the Differential line will close above 0 on any down SPX close and it will close above zero on any positive SPX close.

The bottom line is that the SPX remains too overbought for a low-risk entry. Should the market pullback Thursday, this will no longer be the case. A pullback would almost certainly trigger a long Aggregator System signal. Should this occur I will most likely look to begin building a long position Friday morning. Those looking to take a more aggressive approach could begin scaling in as early as Thursday's close.

Intermediate-term Outlook (2 weeks – 2 months)– updated 1/24 - mildly bullish

The intermediate-term outlook may be found in the 1/24/11 Subscriber Letter. There is a link below.

[2011-01-24 QE Subscriber Letter.pdf](#)

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

None.

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