

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

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Volume 2 Issue 7

## Market Overview

*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	Avg MM + 1 Std Dev
<b>Active</b>					
January 9, 2009	NDX 1% while SOX down	1-6 days	Bearish	-4.70%	-9.60%
January 8, 2009	Gap n Crap From Sht Term OvrB	1-3 days	Bearish	-2.70%	-5.20%
January 8, 2009	2.5% - 5% Declines In Bear	1-3 days	Bearish	-4.96%	-9.70%
January 5, 2009	Appel Breadth Thrust	1-20 days	Bullish	3.70%	5.70%
December 31, 2008	10/200 Put/Call < 0.85	1-9 days	Bearish	-2.70%	-5.00%
December 29, 2008	10/100 ATR < 0.60	n/a	Bearish	n/a	n/a
<b>Active - Long Term</b>					
December 18, 2008	Break above 50-day		Neutral - Trading Range		
December 21, 2008	Nasdaq Lagging		Bearish		
December 21, 2008	Nasdaq Vol Spyx Low	1-5 weeks	Bearish		
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish		
<b>Dropped Tonight - none</b>					
<b>January 9, 2009</b>	<b>Gap dn and Reverse To Close Well</b>	<b>1 day</b>	<b>Bearish</b>	<b>-1.20%</b>	<b>-2.40%</b>

If the avg max move is achieved it will appear in **bold and brown**. If the avg + 1 std deviation is achieved, the study will in **bold italic blue**.

### **Short-term Outlook (1-5 days) –neutral – updated 01/12**

The positive reaction to Friday's employment report lasted less than 5 minutes. When the report was released at 8:30 the market popped about 1% immediately. By the time the market open an hour later the S&P barely gapped up at all. By 10am it was down over 1.5%. It then moved sideways for most of the rest of the day, although a bout of selling near the close made it a bit worse. Breadth was weak as the NYSE Up Issues % came in at 30% and the Up Volume % was 14%. Volume came in light both compared to the day before and the 50-day moving average. It was especially light considering the strength of the selloff.

In contrast to the last couple of days I was unable to find any substantial edge based on Friday's action. Volume coming in lower while the market drops so much was a bit unusual but did not lead to a consistent edge either way.

One thing I've gone over quite a bit is the tendency for strong moves on Friday to carry through Monday and sometimes beyond. This is generally true in both directions. Strong Fridays tend to favor strong Mondays and weak Fridays tend to favor weak Mondays. I've gone over different iterations of this theme several times in the last 8 months or so. This past Friday was a bit odd though in that it could have fallen into a couple of categories.

Some previous tests have shown the week prior to expiration has had a bit of a positive bias. That bias is especially strong following strong Fridays. Looking at the opposite scenario, below is Monday performance based on how much was *lost* on the Friday prior to option expiration:

<i>Friday before options expiration closes down X%.</i>										
<i>Buy on close. Sell Monday at close. \$100k/trade. 1987-present.</i>										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
2	\$1,039.06	15	8	7	53.33	\$1,393.41	(\$1,444.04)	0.964944	1.1027933	\$69.27
1.5	\$4,992.18	19	12	7	63.16	\$1,258.37	(\$1,444.04)	0.871425	1.4938718	\$262.75
1	\$22,706.78	35	23	12	65.71	\$1,613.13	(\$1,199.61)	1.344718	2.5773768	\$648.77
0.5	\$23,741.96	66	42	24	63.64	\$1,115.77	(\$963.35)	1.158219	2.0268827	\$359.73
0	\$29,349.50	109	67	42	61.47	\$978.13	(\$861.56)	1.135309	1.8110888	\$269.26

In this case we don't see any follow-through but rather a tendency to reverse. What most unusual about this past Friday is that employment data was released. This almost always occurs on the first Friday of the month. In this case it was delayed due to the holidays. Therefore it could be argued that the attributes of this Friday could be better represented by look at 1<sup>st</sup> Fridays then 2<sup>nd</sup> Fridays. In that case below is the table showing Monday performance after price drops on 1<sup>st</sup> Fridays:

<i>1st Friday of month closes down at least x%.</i>										
<i>Buy on close. Sell Monday at close. \$100k/trade. 1987-present.</i>										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
2	(\$1,548.59)	10	6	4	60.00	\$783.82	(\$1,562.88)	0.501524	0.7522862	(\$154.86)
1.5	(\$6,771.77)	18	10	8	55.56	\$600.27	(\$1,596.81)	0.375918	0.4698969	(\$376.21)
1	(\$15,995.41)	33	15	18	45.45	\$543.95	(\$1,341.93)	0.40535	0.3377917	(\$484.71)
0.5	(\$10,089.32)	63	34	29	53.97	\$750.31	(\$1,227.59)	0.611211	0.7165921	(\$160.15)
0	\$138.91	115	67	48	58.26	\$711.69	(\$990.50)	0.718511	1.0029217	\$1.21

The average trade here is bearish as opposed to the bullish results above. Frankly I think it would be a stretch to say this Friday's action presents a clear edge. Therefore I'll just call it a wash.

The other unusual activity I noticed was in the CBOE put/call ratios. The total put/call ratio dropped on Friday even as the S&P lost over 2%. While somewhat suggestive of a bounce the edge in these situations is not exactly cut and dry. Should this type of behavior continue I will to study it further. For tonight I'll consider it an oddity without a clear edge.

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



The situation remains much as it has over the past couple of days. While the studies are predominantly bearish and suggesting more downside, the market has already underperformed expectations. Looking to take on a short position at this point would carry more risk for potentially less reward when compared to seeing the green Aggregator and black Differential lines on the same side of zero. This is the first pullback in some time that hasn't immediately produced some bullish studies. So although the market had declined quite a bit over the last couple of days heading into Friday, it wasn't a surprise to see it sell off more.

***Intermediate-term Outlook (2 weeks – 2 months)–very slightly bullish -updated 1/12/9***

This week's action did little to change current long-term studies or to ignite new ones. Last week's breadth thrust failed to follow through as major indices pulled back 4% or more this week. Still it remains above recent swing lows which would equal about 860 in the S&P 500.

The study that's shown to be the most predictive among the long-term actives is the "Break above 50-day" which suggested a choppy trading range was more likely than a strong trend.

Last week I wrote "between the price breakout and the breadth thrust there may be some hope for an intermediate-term rally. I'm slightly bullish right now and without further evidence that the rally is likely to fail I may begin to buy oversold conditions more aggressively than I short overbought ones." The problem so far with this 1<sup>st</sup> pullback is that it has failed to reveal bullish edges. While I'd love to be able to get aggressive we

remain in the unusual position of experiencing a selloff where bearish short-term studies continue to dominate.

If support levels fail to hold that could invalidate both the breadth thrust and the inverse head and shoulders breakout ideas from last week – effectively wiping out the bullish thesis for now. I’m keeping an eye on the 850-860 range and also looking to see whether study results come out bullish or bearish these next few days. This week could be a critical test of the upmove.

**Catapult and Capitulative Breadth Statistics**

*(Catapult Presentation Part 1) (Catapult Presentation Part 2)*

***Open Catapult Trades***

none

***Catapult for ETF’s Trades***

None

***Broad Market Large Cap CBI – 0***

***Sector CBI Breakdown (% of stocks with active catapult triggers within each sector.)***

<b>Index</b>	<b>ETF</b>	<b>CBI %</b>	<b>Index</b>	<b>ETF</b>	<b>CBI %</b>
DJ US Broker Dealers	IAI	0.00	DJ US Energy	IYE	0.00
DJ US Insurance Index	IAK	0.00	DJ US Financial	IYF	0.00
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	0.00
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	0.00
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	0.00
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	0.00
DJ US Healthcare Providers	IHF	0.00	DJ US Real Estate	IYR	0.00
DJ US Medical Devices	IHI	0.00	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	0.00	DJ US Technology Sector	IYW	0.00
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	5.26
DJ US Consumer Svcs	IYC	0.00	Nasdaq 100	QQQQ	0.00

*Nothing doing.*

**Additional New Trade Ideas**

*No official trade ideas tonight.*

**Active Trades Table**

None currently open.

## **December Final Trade Idea Results**

December was an extremely quiet month for trade ideas. There were only 7 trade ideas closed during the Month. April and July both had 13 trade ideas closed, which was the previous low. This was due to a few reasons.

First, there were several trade ideas that didn't receive fills. This was primarily due to the market gapping in our direction and not providing an entry opportunity.

Another reason for the low number of "official" trade ideas was the fact that no Catapults triggered. Catapults were plentiful in October and November. Typically 2-3 times each year there will be a decent sized cluster of catapult trades for traders to try and take advantage of.

In October or November I added the "system triggers" page to the website. This has served 2 purposes. First it has provided many more potential trade ideas to subscribers than the "official" trades would alone. Second, it has allowed me to be a bit choosier about the official trade ideas I track. Prior to the system triggers page the top request I would get was for more trade ideas. Those traders that are more comfortable trading aggressively than I typically am in the Subscriber Letter can use this as a resource for ideas.

January has already had nearly as many trade ideas closed out as December did. While I would be surprised to see activity levels as low as December again for quite some time, I will say that opportunities are never consistent. Neither are returns for that matter. Scratching out gains or even breaking even when your primary strategies are not in favor is paramount to survival. But when trade opportunities become more plentiful and of higher quality, traders need to look to trade more aggressively to best take advantage of them.

Now while the trade ideas weren't plentiful in December, those that were taken were of high quality as 6 of 7 made gains. First below are my monthly caveats and then the results table.

*I don't suggest position sizes. The primary reason for this is I'm not acting as a financial advisor. I don't feel it is appropriate to suggest allocation sizes without understanding someone's financial situation and risk tolerance. Even for my own trading I run different portfolios with different levels of aggressiveness. For instance, my most aggressive portfolio is my IRA. Here I may use options to sometimes get 400-500% leveraged. The partnership I manage on the other hand takes much more conservative stances and rarely reaches or exceeds 100% exposure.*

*Since I don't suggest position sizes this is not truly a performance report, but rather a trade idea scorecard. Therefore, no matter how objective I try to be the reporting of the results is always going to be skewed depending on how you approach the trades. For instance, I always recommend scaling into the Catapult positions in 3 parts, whereas the "System" trades (whatever system I unveil other than Catapult) are normally one entry. The "QE Index" trades I normally recommend scaling into as well. For my own trading*

*I normally trade larger size with a Catapult than most “system” trades since Catapult is my favorite system. I trade much much larger size with the index trades than any of the individuals.*

*I also control my exposure by limiting the total amount invested per day. As I mentioned, this will very depending on the account I’m trading. My most aggressive account I may put in up to 100%/day and get heavily leveraged using options. A conservative account may max out at 15%-20% per day.*

*It’s unlikely anyone would have taken all of the trades with equal amounts, so results could vary greatly depending on your approach.*

With all that out of the way, below is a complete list of December’s trade ideas:

Security	Type	Strategy	Position	Entry Dt	Entry Prc	Exit Date	Exit Prc	Pct G/L
<b>December</b>								
SPY	Index	QE Index	Short	11/26/2008	\$86.05	12/1/2008	\$85.00	1.2%
SPY	Index	QE Index	Short	11/28/2008	\$90.09	12/1/2008	\$82.11	8.9%
SPY	Index	QE Index	Short	12/9/2008	\$92.00	12/10/2008	\$90.00	2.2%
HAL	Stock	QE System	Short	12/16/2008	\$17.48	12/16/2008	\$18.41	-5.3%
FXE	ETF	QE System	Short	12/18/2008	\$145.27	12/19/2008	\$139.13	4.2%
QQQQ	Index	QE Index	Long	12/23/2008	\$29.06	12/26/2008	\$29.19	0.4%
IEF	ETF	QE System	Short	12/19/2008	\$99.85	12/29/2008	\$99.75	0.1%
<b>December Totals</b>								<b>11.7%</b>

And here are some of the breakdown stats:

December	Trades	Wins	Losses	Win %	Avg Win	Avg Loss	Avg Trade	Profit Factor	Total Gains
Total	7	6	1	85.71%	2.84%	-5.32%	1.67%	2.39	11.7%
Index	4	4	0	100.00%	3.17%	0.00%	3.17%	na	12.7%
Catapult	0	0	0	0.00%	0.00%	0.00%	0.00%	0.00	0.0%
System	3	2	1	66.67%	2.16%	-5.32%	-0.33%	0.81	-1.0%

In the next few days I’ll provide 2008 summary results.

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