

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 22, 2009

Volume 2 Issue 14

## 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 22, 2009	Volume Weak Bounce	1-2 days	Bearish	-2.60%	-4.90%
<b>January 21, 2009</b>	<b>VIX 20% Stretch Above 10ma</b>	<b>1-4 days</b>	<b>Bullish</b>	<b>4.10%</b>	<b>8.35%</b>
January 21, 2009	5% Drop	1-4 days	Bullish	5.50%	8.67%
January 5, 2009	Appel Breadth Thrust	1-20 days	Bullish	3.70%	5.70%
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 Vol Spyx Low	1-5 weeks	Bearish		
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish		
<b>Dropped Tonight</b>					
<b>January 16, 2009</b>	<b>Weak Breadth Rebound</b>	<b>1-10 days</b>	<b>Bearish</b>	<b>-4.10%</b>	<b>-5.70%</b>
<b>January 16, 2009</b>	<b>Weak Bounce</b>	<b>1-10 days</b>	<b>Bearish</b>	<b>-4.30%</b>	<b>-8.65%</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) –bullish – updated 1/22*

The bounce I was expecting occurred Wednesday. The banking sector which was featured prominently in the Catapult section last night got the best of the rebound. The S&P 500 and Nasdaq were both up over 4% and the Russell 200 closed over 5% higher. Breadth was strong and close to extreme levels but not quite there. The NYSE Up Issues % came in at 78% and the Up Volume % was 88%. Volume came in higher than Tuesday but not much. And it wasn't even the highest volume of the past week.

The bounce was strong both price and breadth-wise. Volume has me concerned, though. I've shown many times how sharp up days or reversals or a combination of both have a much higher expectancy when they are accompanied by a surge in volume. Below are some studies that exemplify this in the context of the current situation.

The first test looks at any time the market rose by 3% or more but did not see a spike in volume to a 1-week high:

SPX rises 3% or more. Volume is NOT the highest volume in 5 days.												
Buy on close. Sell X days later. \$100k/trade. 1960-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$33,113.04)	28	14	14	50.00	\$13,158.45	(\$15,288.57)	\$4,266.42	(\$6,631.63)	0.64	0.64	(\$1,182.61)
9	(\$21,003.90)	28	15	13	53.57	\$11,280.87	(\$12,531.42)	\$3,970.36	(\$6,196.87)	0.64	0.74	(\$750.14)
8	(\$3,339.60)	29	16	13	55.17	\$9,572.58	(\$9,554.20)	\$3,842.63	(\$4,986.28)	0.77	0.95	(\$115.16)
7	(\$33,608.86)	30	14	16	46.67	\$8,279.82	(\$21,797.40)	\$3,969.06	(\$5,573.48)	0.71	0.62	(\$1,120.30)
6	(\$20,819.07)	31	17	14	54.84	\$9,988.11	(\$15,420.70)	\$3,556.30	(\$5,805.45)	0.61	0.74	(\$671.58)
5	(\$24,431.68)	35	19	16	54.29	\$11,988.81	(\$14,461.05)	\$3,537.39	(\$5,727.63)	0.62	0.73	(\$698.05)
4	(\$28,007.86)	36	19	17	52.78	\$9,526.41	(\$10,971.63)	\$3,036.83	(\$5,041.63)	0.60	0.67	(\$778.00)
3	(\$16,905.73)	38	19	19	50.00	\$7,448.76	(\$11,884.77)	\$2,833.21	(\$3,722.99)	0.76	0.76	(\$444.89)
2	(\$34,922.76)	41	19	22	46.34	\$5,468.05	(\$9,986.13)	\$2,195.40	(\$3,483.43)	0.63	0.54	(\$851.77)
1	(\$14,454.43)	41	19	22	46.34	\$3,833.82	(\$5,245.02)	\$1,278.71	(\$1,761.36)	0.73	0.63	(\$352.55)

A bit of a downside edge persists here throughout the next two weeks.

Now let's look at those same 3% 1-day moves but this time accompanied by a spike in volume:

SPX rises 3% or more on the highest volume in 5 days.												
Buy on close. Sell X days later. \$100k/trade. 1960-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$71,651.88	36	26	10	72.22	\$10,507.25	(\$8,872.20)	\$3,979.75	(\$3,182.16)	1.25	3.25	\$1,990.33
9	\$76,017.42	36	25	11	69.44	\$11,435.28	(\$7,579.50)	\$4,203.13	(\$2,641.89)	1.59	3.62	\$2,111.60
8	\$64,019.45	36	26	10	72.22	\$10,693.76	(\$7,212.15)	\$3,720.46	(\$3,271.26)	1.14	2.96	\$1,778.32
7	\$64,798.97	36	27	9	75.00	\$11,879.20	(\$8,207.38)	\$3,581.45	(\$3,544.48)	1.01	3.03	\$1,799.97
6	\$61,292.95	38	27	11	71.05	\$9,978.28	(\$12,127.34)	\$3,607.36	(\$3,282.35)	1.10	2.70	\$1,612.97
5	\$47,665.80	38	28	10	73.68	\$9,334.72	(\$17,314.65)	\$3,182.99	(\$4,145.80)	0.77	2.15	\$1,254.36
4	\$47,177.46	38	28	10	73.68	\$11,930.04	(\$11,413.39)	\$3,021.94	(\$3,743.69)	0.81	2.26	\$1,241.51
3	\$48,912.04	38	25	13	65.79	\$10,868.60	(\$5,686.53)	\$3,123.70	(\$2,244.65)	1.39	2.68	\$1,287.16
2	\$25,212.76	38	23	15	60.53	\$7,112.64	(\$6,598.86)	\$2,195.21	(\$1,685.14)	1.30	2.00	\$663.49
1	\$29,200.33	38	23	15	60.53	\$9,089.88	(\$4,142.00)	\$1,957.36	(\$1,054.59)	1.86	2.85	\$768.43

The volume surge turns the negative expectancy positive and the stats are better all around.

If I narrow the scope a bit and look for 4% plus moves as occurred on Wednesday then the results of the above tests look like this:

SPX rises 4% or more. Volume is NOT the highest volume in 5 days.												
Buy on close. Sell X days later. \$100k/trade. 1960-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$2,595.81)	13	8	5	61.54	\$13,158.45	(\$15,288.57)	\$4,155.12	(\$7,167.35)	0.58	0.93	(\$199.68)
9	\$3,984.73	13	8	5	61.54	\$11,280.87	(\$12,531.42)	\$4,197.00	(\$5,918.25)	0.71	1.13	\$306.52
8	\$4,222.98	13	6	7	46.15	\$9,572.58	(\$9,428.76)	\$4,250.31	(\$3,039.84)	1.40	1.20	\$324.84
7	(\$41,491.50)	14	4	10	28.57	\$8,279.82	(\$21,797.40)	\$3,545.49	(\$5,567.35)	0.64	0.25	(\$2,963.68)
6	(\$23,575.62)	15	8	7	53.33	\$9,988.11	(\$15,420.70)	\$3,337.68	(\$7,182.44)	0.46	0.53	(\$1,571.71)
5	(\$34,863.62)	17	8	9	47.06	\$11,988.81	(\$14,461.05)	\$3,999.80	(\$7,429.11)	0.54	0.48	(\$2,050.80)
4	(\$42,227.22)	17	8	9	47.06	\$9,526.41	(\$10,971.63)	\$2,693.06	(\$7,085.75)	0.38	0.34	(\$2,483.95)
3	(\$18,990.23)	17	9	8	52.94	\$7,448.76	(\$11,884.77)	\$2,846.04	(\$5,575.57)	0.51	0.57	(\$1,117.07)
2	(\$30,113.42)	18	7	11	38.89	\$4,479.84	(\$9,986.13)	\$3,002.62	(\$4,648.34)	0.65	0.41	(\$1,672.97)
1	(\$24,614.33)	18	4	14	22.22	\$2,860.08	(\$5,245.02)	\$1,271.25	(\$2,121.38)	0.60	0.17	(\$1,367.46)

SPX rises 4% or more on the highest volume in 5 days.												
Buy on close. Sell X days later. \$100k/trade. 1960-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$22,604.10	13	9	4	69.23	\$9,600.99	(\$7,562.86)	\$3,754.59	(\$2,796.80)	1.34	3.02	\$1,738.78
9	\$26,596.46	13	8	5	61.54	\$7,984.24	(\$3,726.90)	\$4,596.12	(\$2,034.51)	2.26	3.61	\$2,045.88
8	\$18,273.47	13	8	5	61.54	\$8,372.32	(\$5,875.10)	\$4,349.72	(\$3,304.86)	1.32	2.11	\$1,405.65
7	\$14,893.58	13	9	4	69.23	\$8,729.84	(\$8,207.38)	\$4,014.47	(\$5,309.16)	0.76	1.70	\$1,145.66
6	\$20,451.77	14	10	4	71.43	\$7,840.35	(\$12,127.34)	\$4,052.30	(\$5,017.80)	0.81	2.02	\$1,460.84
5	\$10,957.81	14	10	4	71.43	\$8,046.42	(\$17,314.65)	\$3,779.52	(\$6,709.35)	0.56	1.41	\$782.70
4	\$20,377.50	14	9	5	64.29	\$11,930.04	(\$11,413.39)	\$5,036.58	(\$4,990.35)	1.01	1.82	\$1,455.54
3	\$30,184.27	14	9	5	64.29	\$10,868.60	(\$5,686.53)	\$4,970.27	(\$2,909.64)	1.71	3.07	\$2,156.02
2	\$8,949.45	14	8	6	57.14	\$7,112.64	(\$6,598.86)	\$3,088.99	(\$2,627.08)	1.18	1.57	\$639.25
1	\$19,465.67	14	8	6	57.14	\$9,089.88	(\$4,142.00)	\$3,367.01	(\$1,245.06)	2.70	3.61	\$1,390.41

Instances are now a bit low but results over the 1<sup>st</sup> week are more extreme in both directions.

In the past I've also showed how reversal bars off lows tended to do better if the reversal came with a surge in volume. Here I loosened the 1-day % move to 2.5% in order to get a half-decent number of occurrences:

SPX rises 2.5% or more. Volume is NOT the highest volume in 5 days. Yesterday SPX closed at 20-day low.												
Buy on close. Sell X days later. \$100k/trade. 1960-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$13,109.06)	16	8	8	50.00	\$8,721.35	(\$14,309.75)	\$4,318.86	(\$5,957.49)	0.72	0.72	(\$819.32)
9	(\$26,042.56)	17	6	11	35.29	\$9,514.20	(\$13,855.85)	\$5,603.49	(\$5,423.95)	1.03	0.56	(\$1,531.92)
8	(\$32,319.74)	17	6	11	35.29	\$8,645.60	(\$22,706.90)	\$5,008.27	(\$5,669.94)	0.88	0.48	(\$1,901.16)
7	(\$32,714.62)	17	8	9	47.06	\$8,044.65	(\$21,797.40)	\$3,430.32	(\$6,684.13)	0.51	0.46	(\$1,924.39)
6	(\$22,712.83)	17	8	9	47.06	\$7,888.10	(\$15,420.70)	\$3,259.06	(\$5,420.59)	0.60	0.53	(\$1,336.05)
5	(\$3,684.19)	17	9	8	52.94	\$7,282.10	(\$14,461.05)	\$3,687.31	(\$4,608.75)	0.80	0.90	(\$216.72)
4	(\$18,206.73)	17	8	9	47.06	\$6,383.20	(\$9,304.95)	\$2,730.95	(\$4,450.48)	0.61	0.55	(\$1,070.98)
3	(\$21,445.19)	18	7	11	38.89	\$2,993.44	(\$5,706.05)	\$1,968.09	(\$3,201.99)	0.61	0.39	(\$1,191.40)
2	(\$28,256.73)	18	6	12	33.33	\$1,841.74	(\$9,455.49)	\$1,160.60	(\$2,935.03)	0.40	0.20	(\$1,569.82)
1	(\$3,803.01)	18	8	10	44.44	\$2,842.84	(\$2,340.00)	\$1,027.63	(\$1,202.41)	0.85	0.68	(\$211.28)

Again we see a fairly strong negative expectancy without volume...

SPX rises 2.5% or more on the highest volume in 5 days. Yesterday SPX closed at 20-day low.												
Buy on close. Sell X days later. \$100k/trade. 1960-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$44,038.66	18	12	6	66.67	\$13,599.08	(\$7,562.86)	\$4,762.87	(\$2,185.97)	2.18	4.36	\$2,446.59
9	\$47,259.58	18	12	6	66.67	\$11,435.28	(\$3,726.90)	\$4,802.57	(\$1,728.54)	2.78	5.56	\$2,625.53
8	\$36,568.73	18	13	5	72.22	\$10,693.76	(\$5,885.81)	\$3,739.62	(\$2,409.26)	1.55	4.04	\$2,031.60
7	\$32,283.82	18	13	5	72.22	\$11,879.20	(\$8,207.38)	\$3,740.16	(\$3,267.66)	1.14	2.98	\$1,793.55
6	\$29,703.31	18	13	5	72.22	\$9,978.28	(\$6,154.16)	\$3,131.16	(\$2,200.35)	1.42	3.70	\$1,650.18
5	\$32,954.67	18	16	2	88.89	\$9,334.72	(\$5,742.69)	\$2,514.59	(\$3,639.39)	0.69	5.53	\$1,830.82
4	\$39,232.67	18	15	3	83.33	\$11,930.04	(\$4,114.70)	\$3,259.82	(\$3,221.54)	1.01	5.06	\$2,179.59
3	\$38,216.08	18	13	5	72.22	\$10,868.60	(\$2,035.00)	\$3,524.66	(\$1,520.90)	2.32	6.03	\$2,123.12
2	\$17,367.83	18	11	7	61.11	\$7,112.64	(\$3,081.26)	\$2,379.71	(\$1,258.43)	1.89	2.97	\$964.88
1	\$22,588.32	18	9	9	50.00	\$9,089.88	(\$1,441.44)	\$3,077.10	(\$567.28)	5.42	5.42	\$1,254.91

...and a fairly strong positive expectancy with volume. In either case the edge is strongest over the 1<sup>st</sup> 2-3 days. The bottom line with all the above examples is that it's highly preferable to see a spike in volume accompany the price spike. We didn't get that today, so strength of the bounce is called into doubt.

Since both the weak bounce studies already met their average max move prior to today's bounce I am removing them from the active list. The expected move already came from them.

Below is tonight's [Aggregator](#) chart:



Both the green Aggregator and the black differential line remain slightly above zero, suggesting the bullish bias remains in tact – barely. Wednesday's SPY entry turned out to be a good one. It's very close to the swing low, which could act as a support point if the market pulls back. With gains of over 4% on the position I'm inclined to take half off and then place a stop on the 2<sup>nd</sup> half hoping for some further follow through. Patience could be shown with the 2<sup>nd</sup> half of the position. Traders who are so inclined could try and hold it for more than just a swing trade. I'll likely use a stop and then exit the 1<sup>st</sup> time I get a short setup.

**Intermediate-term Outlook (2 weeks – 2 months)–neutral -updated 1/20**

Notable for the bullish case this week is that the Nasdaq has taken the lead from the NYSE based on the 10-week EMA relative strength. This can be seen in the chart below with the RS indicator in the bottom pane crossing above the dashed line:



I've discussed this chart in the past. Historically the market has made nearly all its gains while the Nasdaq has been in a leading position. In looking at relative strength crosses as we've seen above I found little to no value in using them as a timing indicator. Still, the market is typically better off with the Nasdaq leading so I consider this development to be a positive one.

The break below the 850 support level this past week suggests this latest rally may be on life support. The exceptionally weak bounce leaves me no confidence that Thursday's intraday low will hold, allowing the market to avoid another swing lower. We're still quite a ways from the November lows of 741 so there remains plenty of room for the market to be able to right itself before those would be taken out.

I believe we will get a strong rally of intermediate-term duration at some point here, but so far the market has given little indication that it is imminent. The inauguration studies posted to the blog and mentioned above provide some hope that optimism will prevail over the coming weeks and months. For now I'm keeping an open mind and a neutral intermediate-term bias until I see more evidence that a strong trending move is emerging.

This means I shall be favoring neither bullish nor bearish setups but rather be looking to trade both sides as the setups dictate.

## **Catapult and Capitulative Breadth Statistics**

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

### ***Open Catapult Triggers***

BAC (1/20)

BAC (1/21)

C (1/21)

USB (1/21)

DOW (1/21)

The gap up left us without any fills on the DOW or KBE trades.

### ***Catapult for ETF's Trades***

KBE (1/21)

### ***Broad Market Large Cap CBI – 5 (BAC-2, C, USB, DOW)***

#### ***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	3.08
DJ US Regional Banks	IAT	6.25	DJ US Financial Services	IYG	5.59
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	0.70
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	5.41	DJ US Basic Materials	IYM	1.35
DJ US Healthcare Providers	IHF	0.00	DJ US Real Estate	IYR	1.22
DJ US Medical Devices	IHI	2.44	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	2.63
DJ US Consumer Svcs	IYC	0.44	Nasdaq 100	QQQQ	0.00

Still not much capitulation.

### **Additional New Trade Ideas**

*None – Not looking for additional entries tonight. Aggregator is close to neutral and the market already put in a big bounce day. Volume is a concern. I'll just manage the current SPY position and wait for the next setup.*

### **Active Trades Table**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
SPY(1/4)	1/21/2009	\$80.57	\$84.05	4.32%	\$80.39	sell 1/2 @ \$83.89 limi

I'm looking to exit half the SPY tomorrow. I don't want to sell into a big gap down though. Should we get a gap down, the limit price is a bit below Wednesday's close. This will increase the odds of a trade execution since the gap won't need to completely fill. The stop is a little below Wednesday's low.

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