

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 10, 2009

Volume 2 Issue 27

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
Active					
February 10, 2008	NR10 Low V 10 Under 200ma Hi 5	1-4 days	Bearish	-2.80%	-5.00%
February 10, 2008	Low Nasdaq Spyx w/ Q RSI > 90	1-7 days	Bearish	-4.10%	-8.70%
February 9, 2009	1st Friday Up 1%	1-5 days	Bearish	-2.70%	-5.60%
February 9, 2009	Up 2.5%-5% During Bear	1-2 days	Bearish	-3.00%	-5.00%
February 9, 2009	2 Days Up In Chop	1-4 days	Bearish		
Active - Long Term					
February 9, 2009	Nasdaq Breadth Thrust	1-20 days	Bullish	5.90%	9.60%
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish		
Dropped Tonight					
February 6, 2009	Gap Dn & Reverse w/ Strong Close	1-2 days	Bearish	-2.80%	-5.90%
February 5, 2009	Gap Up & Fail With Poor Close	1-3 days	Bullish	2.70%	5.60%
February 4, 2009	S&P Up 1.25% while Spyx < 25	1-4 days	Bearish	-2.20%	-4.10%

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) – updated 2/10 – bearish

Today's trading was marked by an extremely tight range and low volume ahead of economic stimulus and bank bailout news. The indices all finished very close to dead even with the S&P up slightly and the Dow and Nasdaq down slightly. Breadth was basically neutral as NYSE Up Issues % and Up Volume % both came in at 54%. Total volume was the lowest we've seen in weeks.

In the December 24th Letter I looked at days that traded within their narrowest range of the last 10 days (NR10) that were accompanied by the lowest volume in 10 days while the market is below the 200ma. Below I have updated that study to include recent instances.

SPX has NR10 day on lightest volume in 10 days and closes under 200ma.										
Buy on close. Sell X days later. \$100k/trade. 1978-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	(\$53,276.24)	82	37	45	45.12	\$1,898.95	(\$2,745.27)	0.69	0.57	(\$649.71)
4	(\$62,181.70)	83	35	48	42.17	\$1,546.80	(\$2,423.32)	0.64	0.47	(\$749.18)
3	(\$58,491.48)	83	31	51	37.35	\$1,526.44	(\$2,074.73)	0.74	0.45	(\$704.72)
2	(\$44,229.75)	83	34	49	40.96	\$1,266.25	(\$1,781.27)	0.71	0.49	(\$532.89)
1	(\$28,357.47)	89	38	51	42.70	\$991.30	(\$1,294.64)	0.77	0.57	(\$318.62)

Such instances hold a bit of a downside edge. With the SPX at a short-term high I decided to run the test also using that as a filter.

SPX has NR10 day on lightest volume in 10 days and closes at a 5-day high but under the 200ma.										
Buy on close. Sell X days later. \$100k/trade. 1978-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	(\$18,897.54)	17	7	10	41.18	\$1,870.08	(\$3,198.81)	0.58	0.41	(\$1,111.62)
4	(\$20,669.76)	17	6	11	35.29	\$1,577.19	(\$2,739.35)	0.58	0.31	(\$1,215.87)
3	(\$11,304.59)	17	5	12	29.41	\$1,895.83	(\$1,731.98)	1.09	0.46	(\$664.98)
2	(\$15,540.66)	17	6	11	35.29	\$1,137.88	(\$2,033.45)	0.56	0.31	(\$914.16)
1	(\$7,324.61)	17	7	10	41.18	\$1,363.95	(\$1,687.23)	0.81	0.57	(\$430.86)

The downside edge here is even a little stronger.

We've seen numerous times how low Spyx readings typically lead to weakness or at least underperformance over the next few days. Both the S&P and the Nasdaq posted low readings on Monday. I decided to look at the situations where an extremely low reading came in an extremely overbought market as we're seeing currently with the Nasdaq. This first test uses a Spyx level of 20 or below:

Nasdaq volume Spyx < 20 while 3-day RSI of QQQQ > 90.										
Buy QQQQ on close. Sell X days later. \$100k/trade. 2000 - 2/9/2009										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
7	(\$25,503.40)	24	12	11	50.00	\$2,091.25	(\$4,599.86)	0.45	0.50	(\$1,062.64)
6	(\$27,849.47)	25	10	14	40.00	\$1,681.67	(\$3,190.44)	0.53	0.38	(\$1,113.98)
5	(\$30,412.92)	27	12	15	44.44	\$1,331.07	(\$3,092.38)	0.43	0.34	(\$1,126.40)
4	(\$33,082.43)	27	12	15	44.44	\$1,271.50	(\$3,222.70)	0.39	0.32	(\$1,225.28)
3	(\$20,723.21)	27	11	16	40.74	\$1,153.44	(\$2,088.19)	0.55	0.38	(\$767.53)
2	(\$18,787.91)	29	11	18	37.93	\$729.34	(\$1,489.48)	0.49	0.30	(\$647.86)
1	(\$15,147.94)	32	8	24	25.00	\$620.70	(\$838.06)	0.74	0.25	(\$473.37)

The actual Nasdaq Spyx reading today was about 5. Lowering the Spyx requirement from 20 to 10 produced the following results:

Nasdaq volume Spyx < 10 while 3-day RSI of QQQQ > 90.										
Buy QQQQ on close. Sell X days later. \$100k/trade. 2000 - 2/9/2009										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
7	(\$26,963.46)	12	5	7	41.67	\$1,589.13	(\$4,987.01)	0.32	0.23	(\$2,246.96)
6	(\$21,820.07)	12	5	7	41.67	\$1,686.63	(\$4,321.89)	0.39	0.28	(\$1,818.34)
5	(\$16,019.80)	13	6	7	46.15	\$1,441.76	(\$3,524.33)	0.41	0.35	(\$1,232.29)
4	(\$20,139.50)	14	4	10	28.57	\$1,991.44	(\$2,810.53)	0.71	0.28	(\$1,438.54)
3	(\$16,580.34)	14	5	9	35.71	\$1,122.45	(\$2,465.84)	0.46	0.25	(\$1,184.31)
2	(\$10,442.30)	14	4	10	28.57	\$739.86	(\$1,340.18)	0.55	0.22	(\$745.88)
1	(\$9,478.80)	14	3	11	21.43	\$521.72	(\$1,004.00)	0.52	0.14	(\$677.06)

Instances here are a bit low but it appears the edge is even more pronounced with the extremely low Spyx reading.

Tonight's [Aggregator](#) chart is below:



Little has changed with the Aggregator chart this evening. The negative position of the green Aggregator line still indicates the studies are suggesting downside in the days to come. Meanwhile the black differential line is still indicating the S&P has outperformed expectations by a large degree over the last few days. Overbought with negative expectations makes for a prime shorting configuration. News from the government could help to spark a further rally over the next day or two. Should that occur I will look to use further strength to continue to scale into our current short position.

Intermediate-term Outlook (2 weeks – 2 months)–SLIGHTLY bullish -updated 2/9

One nice sign we've seen of late is the emerging leadership position of the Nasdaq relative to the NYSE. Below is a chart I sometimes refer to which shows the Nasdaq vs. NYSE relative strength:



I first discussed this indicator [on the blog last February](#). Since the inception of the Nasdaq in 1971, close to 100% of the gains in the NYSE have come when the Nasdaq has been in a leadership position. The indicator is a bit controversial since part of the reason it works is due to the fact that the Nasdaq typically has a higher beta. In other words, it goes up more in up markets and down more in down markets. Since it goes up more in up markets it will often be in the lead when the NYSE is rising. Still, another possible reason this indicator works well is that it measures investors' appetite for risk. Nasdaq stocks have traditionally been riskier than NYSE stocks. When investors are more willing to take on that additional risk, it normally means good things for the stock market as a whole. In any event, the track record is good enough that it deserves a glance once in a while, and when it's in a leading position as it is now I consider that a positive.

Another Nasdaq positive is that Nasdaq breadth has been especially strong lately. As can be seen on our charts page, [the 10-day ema of the Nasdaq Up Volume %](#) is now close to 64%. This is the highest level it has been at since the bear market began. The chart on that page uses Tradestation's data, which only goes back to 2000. To get a longer term look at the indicator I used Quotes Plus data, which goes back to 1/1/92. There are normally minor discrepancies between data sources when looking at breadth and volume data and Quotes Plus data currently puts the 10-day ema at almost 65%. The test below looks at breadth thrusts that move the ema above 64%:

Nasdaq Up Volume % 10-day ema crosses over 64%.										
Buy Nasdaq on close. Sell X days later. \$100k/trade. 1992-2/6/2009										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fac	Avg Trade
30	\$75,056.27	19	13	6	68.42	\$7,414.21	(\$3,554.75)	2.09	4.52	\$3,950.33
20	\$65,533.02	20	16	4	80.00	\$5,134.87	(\$4,156.21)	1.24	4.94	\$3,276.65
15	\$51,774.69	23	15	8	65.22	\$4,863.23	(\$2,646.72)	1.84	3.45	\$2,251.07
10	\$18,455.29	23	17	6	73.91	\$1,742.47	(\$1,861.11)	0.94	2.65	\$802.40
9	\$27,723.57	23	16	7	69.57	\$2,339.08	(\$1,385.95)	1.69	3.86	\$1,205.37
8	\$28,370.26	24	18	6	75.00	\$2,136.44	(\$1,680.96)	1.27	3.81	\$1,182.09
7	\$16,080.32	24	15	9	62.50	\$1,827.48	(\$1,259.10)	1.45	2.42	\$670.01
6	\$10,124.79	24	14	10	58.33	\$1,949.10	(\$1,716.26)	1.14	1.59	\$421.87
5	\$4,087.16	24	12	12	50.00	\$1,708.39	(\$1,367.79)	1.25	1.25	\$170.30
4	\$9,701.14	25	15	10	60.00	\$1,637.33	(\$1,485.88)	1.10	1.65	\$388.05
3	(\$1,260.22)	28	16	12	57.14	\$1,643.20	(\$2,295.95)	0.72	0.95	(\$45.01)
2	(\$3,929.78)	29	18	11	62.07	\$955.48	(\$1,920.77)	0.50	0.81	(\$135.51)
1	(\$7,608.66)	29	14	15	48.28	\$731.38	(\$1,189.86)	0.61	0.57	(\$262.37)

A slight pullback has often been followed by bullish action. Rather than looking at just an exit of X days out, I also decided to use a drop in the 10-day ema as a possible exit as well. Below are the results of buying into an Up Volume % 10-day ema thrust above 64% and then holding until the indicator dips below X%:

Nasdaq Up Volume % 10-day ema crosses over 64%.										
Buy Nasdaq on close. Sell when Up Vol % ema crosses below X. \$100k/trade. 1992-2/6/2009										
X% ema	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fac	Avg Trade
0.44	\$112,624.78	17	11	6	64.71	\$11,798.99	(\$2,860.69)	4.12	7.56	\$6,624.99
0.45	\$105,842.15	18	11	7	61.11	\$11,615.21	(\$3,132.17)	3.71	5.83	\$5,880.12
0.46	\$115,435.57	18	12	6	66.67	\$11,197.13	(\$3,155.00)	3.55	7.10	\$6,413.09
0.47	\$118,500.16	18	12	6	66.67	\$11,426.80	(\$3,103.56)	3.68	7.36	\$6,583.34
0.48	\$59,627.05	20	10	10	50.00	\$8,273.10	(\$2,310.40)	3.58	3.58	\$2,981.35
0.49	\$37,459.30	21	10	11	47.62	\$6,542.43	(\$2,542.27)	2.57	2.34	\$1,783.78
0.5	\$42,355.20	21	11	10	52.38	\$6,250.12	(\$2,639.62)	2.37	2.60	\$2,016.91

Making the exits too tight here reduced profitability greatly. Once the exit trigger dropped to 0.47 or below it appears to be fairly solid. Below is a more detailed performance report which enters on a move above 64% and uses the 47% number as the exit.

All Trades

Total Net Profit	\$126,672.37	Profit Factor	7.80
Gross Profit	\$145,293.75	Gross Loss	(\$18,621.38)
Roll Over Credit	\$0.00		
Open Position Profit/Loss	\$0.00		
Select Total Net Profit	\$126,672.37	Select Profit Factor	7.80
Select Gross Profit	\$145,293.75	Select Gross Loss	(\$18,621.38)
Adjusted Total Net Profit	\$77,127.53	Adjusted Profit Factor	3.94
Adjusted Gross Profit	\$103,351.06	Adjusted Gross Loss	(\$26,223.53)
Total Number of Trades	18	Percent Profitable	66.67%
Winning Trades	12	Losing Trades	6
Even Trades	0		
Avg. Trade Net Profit	\$7,037.35	Ratio Avg. Win:Avg. Loss	3.90
Avg. Winning Trade	\$12,107.81	Avg. Losing Trade	(\$3,103.56)
Largest Winning Trade	\$40,548.60	Largest Losing Trade	(\$4,386.96)
Largest Winner as % of Gross Profit	27.91%	Largest Loser as % of Gross Loss	23.56%

Most of the numbers here look outstanding. Twice as many winners as losers and the average win is nearly 4 times the average loss. This puts the profit factor at a gaudy 7.8. The one red flag on this report is the “largest winning trade”, which I circled above. This trade makes up nearly 28% of all the gross profits. So to more deeply analyze the results I’ve shown below the listing of all the individual trades.

#	Type	Date/Time	Signal	Price	Roll Over Pips	Shares/Ctrts	Gross P/L Profit/Loss	Cum Net Profit	% Profit
1	Buy	10/16/92	Daily Breadth	\$582.61	\$0.00	171	\$14,155.38	\$14,155.38	14.21%
	Sell	02/16/93	Sell	\$665.39			\$14,155.38	\$14,155.38	
2	Buy	06/19/95	Daily Breadth	\$922.09	\$0.00	108	\$12,523.68	\$26,679.06	12.58%
	Sell	09/26/95	Sell	\$1,038.05			\$26,679.06	\$26,679.06	
3	Buy	04/25/96	Daily Breadth	\$1,184.17	\$0.00	84	\$2,436.84	\$29,115.90	2.45%
	Sell	06/14/96	Sell	\$1,213.18			\$2,436.84	\$29,115.90	
4	Buy	05/05/97	Daily Breadth	\$1,339.24	\$0.00	74	\$24,243.14	\$53,359.04	24.46%
	Sell	10/17/97	Sell	\$1,666.85			\$24,243.14	\$53,359.04	
5	Buy	11/02/98	Daily Breadth	\$1,800.91	\$0.00	55	\$28,043.40	\$81,402.44	28.31%
	Sell	02/09/99	Sell	\$2,310.79			\$28,043.40	\$81,402.44	
6	Buy	07/02/99	Daily Breadth	\$2,741.02	\$0.00	36	(\$4,386.96)	\$77,015.48	(4.45%)
	Sell	07/26/99	Sell	\$2,619.16			(\$4,386.96)	\$77,015.48	
7	Buy	11/16/99	Daily Breadth	\$3,293.05	\$0.00	30	\$40,548.60	\$117,564.08	41.04%
	Sell	03/29/00	Sell	\$4,644.67			\$40,548.60	\$117,564.08	
8	Buy	04/19/01	Daily Breadth	\$2,182.04	\$0.00	45	(\$3,364.20)	\$114,199.88	(3.43%)
	Sell	05/11/01	Sell	\$2,107.28			(\$3,364.20)	\$114,199.88	
9	Buy	11/13/01	Daily Breadth	\$1,892.11	\$0.00	52	\$1,374.36	\$115,574.24	1.40%
	Sell	12/20/01	Sell	\$1,918.54			\$1,374.36	\$115,574.24	
10	Buy	11/01/02	Daily Breadth	\$1,360.70	\$0.00	73	(\$3,030.23)	\$112,544.01	(3.05%)
	Sell	11/11/02	Sell	\$1,319.19			(\$3,030.23)	\$112,544.01	
11	Buy	11/21/02	Daily Breadth	\$1,467.55	\$0.00	68	(\$2,529.60)	\$110,014.41	(2.53%)
	Sell	12/04/02	Sell	\$1,430.35			(\$2,529.60)	\$110,014.41	
12	Buy	05/02/03	Daily Breadth	\$1,502.88	\$0.00	66	\$7,119.42	\$117,133.83	7.18%
	Sell	06/23/03	Sell	\$1,610.75			\$7,119.42	\$117,133.83	
13	Buy	08/29/03	Daily Breadth	\$1,810.45	\$0.00	55	\$373.45	\$117,507.28	0.38%
	Sell	09/25/03	Sell	\$1,817.24			\$373.45	\$117,507.28	
14	Buy	01/12/04	Daily Breadth	\$2,111.78	\$0.00	47	(\$1,617.27)	\$115,890.01	(1.63%)
	Sell	01/28/04	Sell	\$2,077.37			(\$1,617.27)	\$115,890.01	
15	Buy	04/05/04	Daily Breadth	\$2,079.11	\$0.00	48	(\$3,693.12)	\$112,196.89	(3.70%)
	Sell	04/15/04	Sell	\$2,002.17			(\$3,693.12)	\$112,196.89	
16	Buy	05/19/05	Daily Breadth	\$2,042.58	\$0.00	48	\$513.12	\$112,710.01	0.52%
	Sell	06/24/05	Sell	\$2,053.27			\$513.12	\$112,710.01	
17	Buy	08/30/06	Daily Breadth	\$2,185.73	\$0.00	45	\$10,355.40	\$123,065.41	10.53%
	Sell	12/21/06	Sell	\$2,415.85			\$10,355.40	\$123,065.41	
18	Buy	09/04/07	Daily Breadth	\$2,630.24	\$0.00	38	\$3,606.96	\$126,672.37	3.61%
	Sell	10/19/07	Sell	\$2,725.16			\$3,606.96	\$126,672.37	

While the 41% gain was certainly an outlier, half of the 12 winners achieved gains of greater than 10%, and the largest loser was less than 5%. Even in the low volatility environment of 2006 we see a 10% gain. So while more instances would certainly be

preferable, it appears we have a decent amount of evidence here to suggest an upside edge.

The Nasdaq has now moved through its 50-day moving average and the S&P in on the verge of doing so. Support for the S&P around 800 held last week and there has been a lengthy consolidation from the November lows. With the Nasdaq attempting to take on a leadership position it is possible a rally could develop here. While I'm still not optimistic about the long-term picture a decent intermediate-term rally lasting a few months convincing some participants the worst may be behind us is already overdue. Intermediate-term traders may want to be at the ready to see if they can catch a multi-month move here soon. Should a rally emerge though it should be treated with great skepticism as it appears unlikely that it will be the beginning of a multi-year bull run. Selloffs may remain treacherous and traders may need to be nimble to avoid giving back rally gains.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Triggers

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.)

Index	ETF	CBI %	Index	ETF	CBI %
DJ US Broker Dealers	IAI	0.00	DJ US Energy	IYE	0.00
DJ US Insurance Index	IAK	0.00	DJ US Financial	IYF	1.37
DJ US Regional Banks	IAT	3.75	DJ US Financial Services	IYG	2.80
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	0.50
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.44	Nasdaq 100	QQQQ	0.00

No significant capitulative action evident.

Additional New Trade Ideas

SPY – short (1/4) index position @ \$87.50 limit ON CLOSE. This would be the 3rd ¼ of the position if filled and is based on the short-term market outlook.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
IEF	2/5/2009	\$93.90	\$93.55	-0.37%		exit on close>10ma
SPY(s)(1/4)	2/6/2009	\$86.98	\$87.10	-0.14%		
SPY(s)(1/4)	2/9/2009	\$87.10	\$87.10	0.00%		shorted @ close
QQQQ(s)	2/9/2009	\$31.39	\$31.50	-0.35%		shorted @ open

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