

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 27, 2009

Volume 2 Issue 39

## 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>					
February 27, 2009	2 Days Dow In Chop	1-3 days	Bullish		
February 26, 2009	SPX down 1% while SOX up 1%	1-15 days	Bullish	4.60%	7.10%
February 25, 2009	Recover drop of 1.5% at 50 low	1-5 days	Bullish	3.40%	6.40%
February 23, 2009	CBI = 7	1-5 days	Bullish	1.80%	4.20%
February 20, 2009	McClellan < -200	1-6 days	Bullish	3.85%	6.92%
<b>Active - Long Term</b>					
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish		
<b>Dropped Tonight</b>					
February 26, 2009	Late day selloff	1 day	Bullish	2.10%	4.90%
February 25, 2009	VXO 15% Drop @ SP 50-low	<b>1-2 days</b>	<b>Bearish</b>	<b>-2.40%</b>	<b>-5.10%</b>
February 25, 2009	90% Up Vol After 50-low	<b>1-2 days</b>	<b>Bearish</b>	<b>-2.90%</b>	<b>-6.00%</b>
February 23, 2009	5 Lower Closes at 50 Low	1-4 days	Bullish	2.10%	3.90%

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 2/27 –somewhat bullish**

The market opened well but it all started to go sour a little before lunch. Strong selling in the afternoon wiped out the gains and more as the major averages closed down over 1.5% after being up close to 2% during the morning. Breadth was somewhat negative. Volume declined for the 2<sup>nd</sup> straight day, which is better than the alternative.

The fact that the S&P closed lower for the 2<sup>nd</sup> day in a row set up a “2 days down in chop” trigger. This simple system has done quite well since the environment became exceptionally choppy in June of 2007. Basically it looks to go long the S&P 500 any time it closes lower 2 days in a row. The exit occurs on the first profitable close up to 3 days later. After 3 days the trade is exited regardless of profitability. The last time this system triggered was on 2/17, which turned out to be the 1<sup>st</sup> losing trade since early October. Below is the performance report from June 1, 2007 to present:

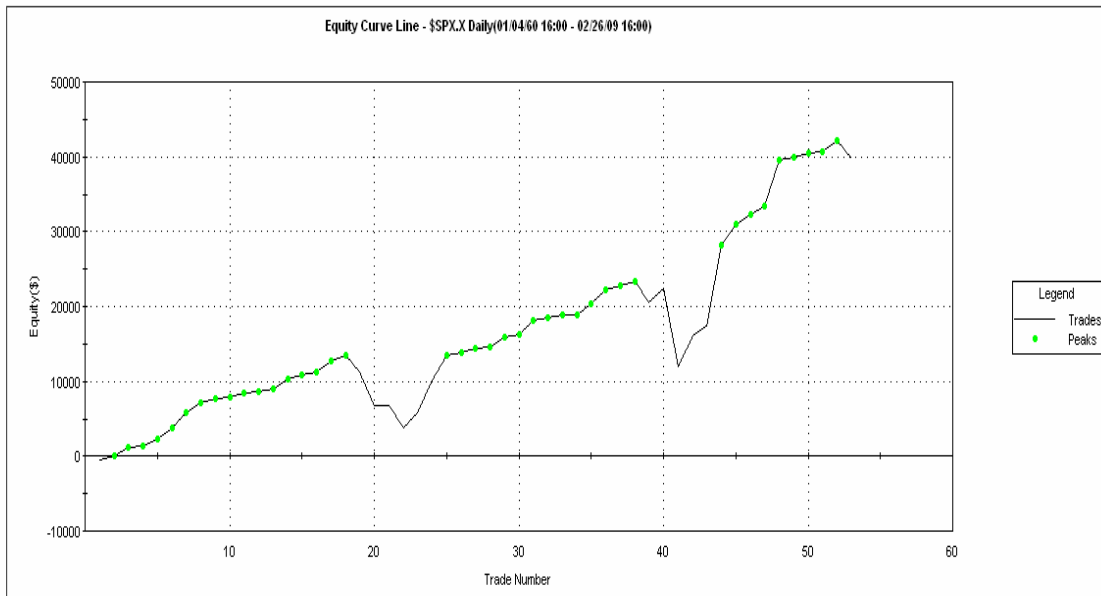
TradeStation Performance Summary

Collapse 

All Trades

Total Net Profit	\$39,787.60	Profit Factor	2.54
Gross Profit	\$65,629.46	Gross Loss	(\$25,841.86)
Roll Over Credit	\$0.00		
Open Position Profit/Loss	\$0.00		
Select Total Net Profit	\$29,071.57	Select Profit Factor	2.12
Select Gross Profit	\$54,913.43	Select Gross Loss	(\$25,841.86)
Adjusted Total Net Profit	\$20,343.76	Adjusted Profit Factor	1.57
Adjusted Gross Profit	\$55,952.92	Adjusted Gross Loss	(\$35,609.16)
Total Number of Trades	53	Percent Profitable	86.79%
Winning Trades	46	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	\$750.71	Ratio Avg. Win:Avg. Loss	0.39
Avg. Winning Trade	\$1,426.73	Avg. Losing Trade	(\$3,691.69)
Largest Winning Trade	\$10,716.03	Largest Losing Trade	(\$10,506.45)
Largest Winner as % of Gross Profit	16.33%	Largest Loser as % of Gross Loss	40.66%

Quite solid considering the strength of the downtrend over that period of time. I've also included an equity curve below.



As far as the price action went on Thursday, I'm not quite sure what to make of it. Studies looking at the morning strength turning into a loss were mixed. The action actually fit a study from a few weeks ago which was written in the February 5<sup>th</sup> Subscriber Letter:

I ran a few studies on Wednesday's bar pattern. For this 1<sup>st</sup> test I simply used a requirement that the SPY had to gap higher, trade a bit above the open and then close a bit below the open. Results below:

<b>SPY gaps up at least 0.25%, makes a high at least 0.5% above the open, then closes down on the day and at least 0.5% below the open. Buy SPY on close. Sell X days later. \$100k/trade. 1993-present.</b>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	\$25,957.56	46	30	16	65.22	\$2,917.36	(\$3,847.71)	0.76	1.42	\$564.29
4	\$35,966.02	48	30	18	62.50	\$2,853.85	(\$2,758.30)	1.03	1.72	\$749.29
3	\$39,298.65	49	29	20	59.18	\$2,746.97	(\$2,018.17)	1.36	1.97	\$802.01
2	\$36,014.12	50	33	17	66.00	\$2,191.39	(\$2,135.39)	1.03	1.99	\$720.28
1	(\$8,304.80)	50	29	21	58.00	\$1,165.09	(\$2,004.40)	0.58	0.80	(\$166.10)

Here we see a tendency to bounce back over the next few days. Next I added the condition that the SPY needed to close in the bottom 25% of its daily range:

<b>SPY gaps up at least 0.25%, makes a high at least 0.5% above the open, then closes down on the day, at least 0.5% below the open and in the bottom 25% of the daily range. Buy SPY on close. Sell X days later. \$100k/trade. 1993-present.</b>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	\$23,853.38	37	24	13	64.86	\$3,143.53	(\$3,968.56)	0.79	1.46	\$644.69
4	\$31,896.96	40	25	15	62.50	\$2,972.24	(\$2,827.27)	1.05	1.75	\$797.42
3	\$41,032.47	40	25	15	62.50	\$2,721.84	(\$1,800.90)	1.51	2.52	\$1,025.81
2	\$39,723.41	40	27	13	67.50	\$2,337.39	(\$1,798.93)	1.30	2.70	\$993.09
1	\$8,456.34	40	24	16	60.00	\$1,177.46	(\$1,237.66)	0.95	1.43	\$211.41

Most instances did close in the bottom 25%. As you can see, adding this filter improves the results even further. What if we require it closes very close to the low of the day as happened on Wednesday? Below are those results:

<b>SPY gaps up at least 0.25%, makes a high at least 0.5% above the open, then closes down on the day, at least 0.5% below the open and in the bottom 10% of the daily range. Buy SPY on close. Sell X days later. \$100k/trade. 1993-present.</b>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	\$39,351.99	22	16	6	72.73	\$3,354.98	(\$2,387.94)	1.40	3.75	\$1,788.73
4	\$30,339.12	22	13	9	59.09	\$3,524.66	(\$1,720.17)	2.05	2.96	\$1,379.05
3	\$31,368.82	22	14	8	63.64	\$2,894.09	(\$1,143.56)	2.53	4.43	\$1,425.86
2	\$29,994.04	22	15	7	68.18	\$2,417.17	(\$894.78)	2.70	5.79	\$1,363.37
1	\$7,925.85	22	14	8	63.64	\$1,200.51	(\$1,110.17)	1.08	1.89	\$360.27

Instances are a little low here, but as you can see, the worse the finish, the better the setup.

The issue with Thursday's action is that the gap and selloff were so large. Below is a study that looks at 1% gaps in the SPY that close lower on the day:

<b>SPY gaps up at least 1% but closes negative on the day. Buy at close. Sell X days later. \$100k/trade. 1993-present.</b>										
X days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	(\$12,873.69)	17	8	9	47.06	\$2,592.33	(\$3,734.71)	0.69	0.62	(\$757.28)
4	(\$12,820.85)	17	8	9	47.06	\$1,915.52	(\$3,127.22)	0.61	0.54	(\$754.17)
3	(\$24,308.57)	17	5	12	29.41	\$2,048.12	(\$2,879.10)	0.71	0.30	(\$1,429.92)
2	(\$20,827.82)	19	7	12	36.84	\$3,397.88	(\$3,717.75)	0.91	0.53	(\$1,096.20)
1	(\$31,529.51)	19	7	12	36.84	\$1,321.81	(\$3,398.52)	0.39	0.23	(\$1,659.45)

The results here appear fairly negative. But when I run the same test on QQQQ I get these results:

<b>QQQQ gaps up at least 1% but closes negative on the day.</b>										
<b>Buy at close. Sell X days later. \$100k/trade. 1999-present.</b>										
X days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	\$14,163.15	55	30	25	54.55	\$5,080.92	(\$5,530.57)	0.92	1.10	\$257.51
4	\$4,473.42	61	34	27	55.74	\$3,713.66	(\$4,510.78)	0.82	1.04	\$73.33
3	\$39,541.89	65	39	26	60.00	\$3,428.09	(\$3,621.30)	0.95	1.42	\$608.34
2	\$52,399.07	67	39	28	58.21	\$3,586.84	(\$3,124.55)	1.15	1.60	\$782.08
1	\$8,810.64	70	35	34	50.00	\$2,524.22	(\$2,339.33)	1.08	1.11	\$125.87

In this case there seems to be a slight bullish bias.

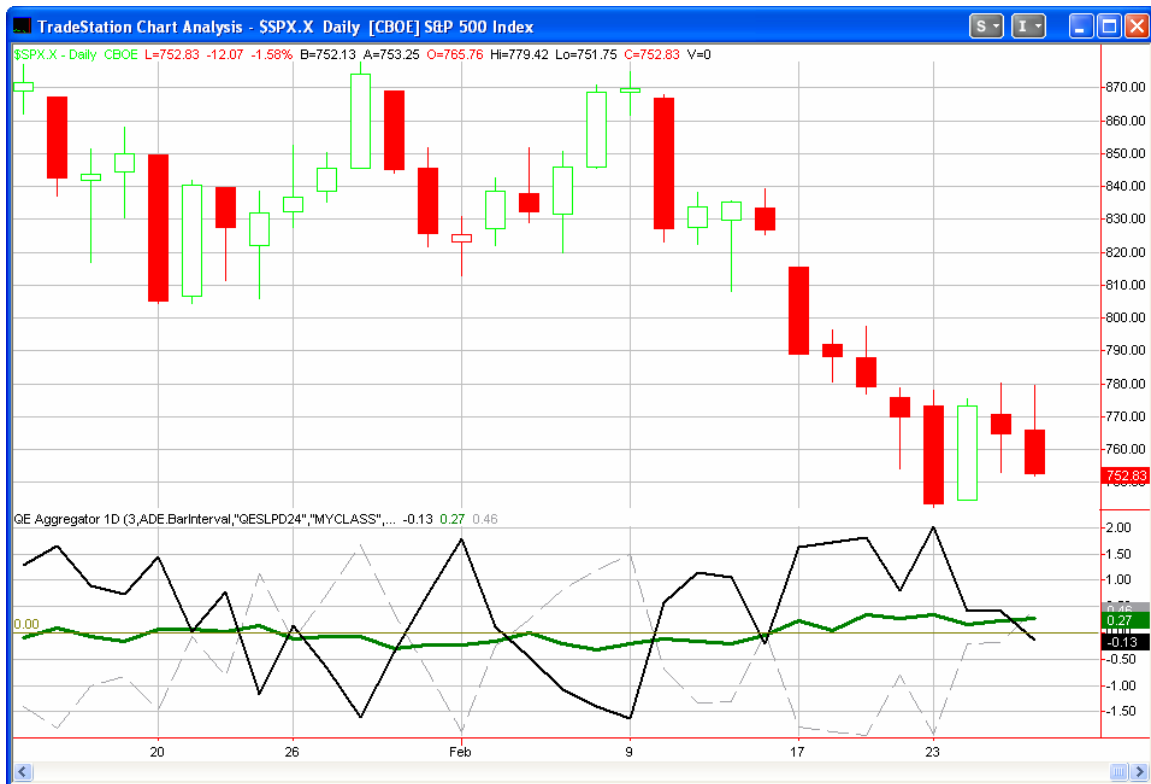
Bottom line for me is that Thursday's price action doesn't appear to be clearly bullish or bearish.

The one sector that held up very well today was the Banking Index (BKX). Last night I showed a study that suggested a bullish bias following a negative SPX day where the SOX thrives. Below is a similar test using the BKX instead of the SOX:

<b>SPX closes lower by 1% and the BKX closes up by at least 1%.</b>										
<b>Buy at close. Sell X days later. \$100k/trade. 1992-present.</b>										
X days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
15	\$18,468.21	7	6	1	85.71	\$3,806.35	(\$4,369.86)	0.87	5.23	\$2,638.32
14	\$14,000.98	7	6	1	85.71	\$3,502.25	(\$7,012.50)	0.50	3.00	\$2,000.14
13	\$6,070.55	7	6	1	85.71	\$2,681.12	(\$10,016.16)	0.27	1.61	\$867.22
12	\$14,655.44	7	6	1	85.71	\$3,182.54	(\$4,439.82)	0.72	4.30	\$2,093.63
11	\$4,159.80	8	5	3	62.50	\$2,685.14	(\$3,088.64)	0.87	1.45	\$519.98
10	\$10,091.18	8	5	3	62.50	\$2,642.54	(\$1,040.50)	2.54	4.23	\$1,261.40
9	\$18,014.84	8	6	2	75.00	\$3,109.26	(\$320.36)	9.71	29.12	\$2,251.86
8	\$20,379.23	8	6	2	75.00	\$3,489.43	(\$278.67)	12.52	37.57	\$2,547.40
7	\$21,100.20	8	5	3	62.50	\$4,912.05	(\$1,153.35)	4.26	7.10	\$2,637.53
6	\$19,311.51	8	5	3	62.50	\$4,584.07	(\$1,202.95)	3.81	6.35	\$2,413.94
5	\$12,534.39	8	5	3	62.50	\$3,316.66	(\$1,349.64)	2.46	4.10	\$1,566.80
4	\$13,329.01	8	5	3	62.50	\$3,338.28	(\$1,120.79)	2.98	4.96	\$1,666.13
3	\$488.11	8	5	3	62.50	\$1,599.69	(\$2,503.44)	0.64	1.06	\$61.01
2	\$6,723.41	8	5	3	62.50	\$3,679.20	(\$3,890.86)	0.95	1.58	\$840.43
1	\$10,937.51	9	6	3	66.67	\$2,822.06	(\$1,998.28)	1.41	2.82	\$1,215.28

Instances are too few here to draw any solid conclusions. It does appear worthwhile to keep an eye on the BKX as well as the SOX, though. Interesting about this study is that there were two occurrences in 2008. They were on 1/22/08 and 10/10/08. Both near notable market lows.

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



The green Aggregator line remains solidly bullish as we are continuing to see evidence that a bounce is more likely than a further selloff. The black differential line dropped below zero as expected. Unless there is a huge rally tomorrow it will move back above 0 as Tuesday's rally falls out of the calculation. Already half in I'm going to sit tight on my index position for now. We aren't far from the recent lows. I expect a move below there could set up for a sharp drop and quick rebound if we drop below that area in the next couple of days I will likely ratchet up the exposure. There is one system trade mentioned in the trades ideas below.

***Intermediate-term Outlook (2 weeks – 2 months)–neutral -updated 2/23***

The S&P 500 lost nearly 7% this past week and is down just shy of 15% so far for 2009. The Dow has fallen through its November lows and they aren't far behind for the S&P. The Nasdaq – with hardly any exposure to the financial sector is still above its January lows and far above the November bottom.

With the November S&P bottom fast approaching one thing we haven't seen yet is a sharp spike in the VIX. Some may find this concerning. I've looked at this a few times in the past and failed to find evidence that a VIX spike is a necessary component for making a bottom. One such study was posted to the blog on [July 1, 2008](#). Tonight I decided to compare a 50-day low that is accompanied by a VIX spike to a 50-day low that isn't.

First let's look at instances where the 50-day low is accompanied by a VIX spike:

<b>SPX closes at a 50-day low. VIX stretched more than 10% above its 10-day ma.</b>										
<b>Buy on close. Sell X days later. \$100k/trade. 1990-2/20/2009.</b>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
12	\$39,220.05	50	29	21	58.00	\$3,476.42	(\$2,933.14)	1.19	1.64	\$784.40
11	\$42,178.74	50	29	21	58.00	\$3,166.90	(\$2,364.83)	1.34	1.85	\$843.57
10	\$22,479.00	50	26	24	52.00	\$3,380.46	(\$2,725.54)	1.24	1.34	\$449.58
9	\$25,834.31	55	32	23	58.18	\$3,370.74	(\$3,566.50)	0.95	1.31	\$469.71
8	\$36,021.98	58	35	23	60.34	\$3,167.85	(\$3,254.47)	0.97	1.48	\$621.07
7	\$34,637.59	60	34	26	56.67	\$3,151.44	(\$2,788.90)	1.13	1.48	\$577.29
6	\$40,678.40	62	37	25	59.68	\$2,821.36	(\$2,548.47)	1.11	1.64	\$656.10
5	\$49,714.63	66	38	28	57.58	\$2,569.25	(\$1,711.31)	1.50	2.04	\$753.25
4	\$17,536.97	71	44	27	61.97	\$1,965.76	(\$2,553.94)	0.77	1.25	\$247.00
3	\$30,767.71	80	52	28	65.00	\$1,823.81	(\$2,288.22)	0.80	1.48	\$384.60
2	\$41,125.51	94	56	38	59.57	\$2,091.91	(\$2,000.56)	1.05	1.54	\$437.51
1	\$40,629.20	135	74	61	54.81	\$1,760.50	(\$1,469.63)	1.20	1.45	\$300.96

Now let's look at a 50-day low with a VIX spike:

<b>SPX closes at a 50-day low. VIX not stretched more than 10% above its 10-day ma.</b>										
<b>Buy on close. Sell X days later. \$100k/trade. 1990-2/20/2009.</b>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
12	\$18,727.57	36	23	13	63.89	\$3,140.27	(\$4,115.28)	0.76	1.35	\$520.21
11	\$41,069.19	37	24	13	64.86	\$3,389.58	(\$3,098.52)	1.09	2.02	\$1,109.98
10	\$38,325.09	39	27	12	69.23	\$2,925.21	(\$3,387.98)	0.86	1.94	\$982.69
9	\$56,900.65	40	27	13	67.50	\$3,392.41	(\$2,668.80)	1.27	2.64	\$1,422.52
8	\$41,206.16	40	26	14	65.00	\$3,110.93	(\$2,834.15)	1.10	2.04	\$1,030.15
7	\$43,021.13	42	28	14	66.67	\$2,791.73	(\$2,510.52)	1.11	2.22	\$1,024.31
6	\$26,299.24	42	26	16	61.90	\$2,619.28	(\$2,612.63)	1.00	1.63	\$626.17
5	\$23,026.84	47	24	23	51.06	\$2,942.60	(\$2,069.38)	1.42	1.48	\$489.93
4	\$16,421.58	49	30	19	61.22	\$2,087.02	(\$2,431.00)	0.86	1.36	\$335.13
3	\$28,712.59	51	35	16	68.63	\$1,986.15	(\$2,550.18)	0.78	1.70	\$562.99
2	\$17,981.18	62	31	31	50.00	\$1,982.54	(\$1,402.50)	1.41	1.41	\$290.02
1	\$17,533.60	76	49	27	64.47	\$1,007.94	(\$1,179.82)	0.85	1.55	\$230.71

It's more common to see a spike in the VIX than not. Comparison between the two sets of results, though, shows very little difference. This suggests the VIX is not an effective filter when considering whether a drop in the market is likely to mark a low. While I'm sure a very sharp spike would produce some bullish studies and help provide some possible juice for a rebound, it's not something I'm going to worry over a great deal.

From an intermediate-term standpoint it appears too late to get strongly bearish but without some real signs of strength too early to get strongly bullish. My summary from last week still works for me so I'll repeat it below.

*As I've been saying, I expect we're likely to see a decent rally of 30% or more lasting at least 2-3 months emerge here at some point. I have serious doubts that next rally will lead to a multi-year bull market run, though. Until I see signs otherwise, I'm treating this market as one that is more similar to the 1930's than any other period in time. Past evidence of this includes volatility studies, Dow Trend vs. Chop studies, and studies of severe selloffs such as we saw in the fall. I'll be sure to revisit these studies when appropriate. For now my focus remains short-term.*

## **Catapult and Capitulative Breadth Statistics**

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

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

DOW (Dow Chemical) –@ \$9.29 (1/3)

DOW (Dow Chemical) –@ \$8.62 (1/3)

DOW (Dow Chemical) – bought last 1/3 position @ \$8.60

CAT – bought 1/3 position @ \$28.44

CAT – bought 1/3 position @ \$26.14

CAT – bought final 1/3 position @ \$26.66

PFE – bought 1/3 position @ \$13.27 limit

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

*DIA – bought @ \$73.73 limit*

***Broad Market Large Cap CBI – 7/3 (DOW-3, CAT-3 , PFE)***

### ***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	3.45	DJ US Energy	IYE	3.49
DJ US Insurance Index	IAK	9.46	DJ US Financial	IYF	2.74
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.70
DJ US Utilities	IDU	4.05	DJ US Healthcare	IYH	6.34
DJ US Oil&Gas Expl & Prod	IEO	3.45	DJ US Industrial Sector	IYJ	4.21
DJ US Oil Equip & Svcs	IEZ	7.69	DJ US Consumer Goods	IYK	4.76
DJ US Pharmaceuticals	IHE	10.81	DJ US Basic Materials	IYM	9.46
DJ US Healthcare Providers	IHF	2.04	DJ US Real Estate	IYR	2.44
DJ US Medical Devices	IHI	4.88	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	2.78	DJ US Technology Sector	IYW	4.02
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	2.63	Nasdaq 100	QQQQ	2.00

## **Additional New Trade Ideas**

*FXV – buy @ \$101.23 limit.* This is system 80402 from the triggers sheet. It's the 2<sup>nd</sup> night in a row this has triggered for FXV. It's extremely extended and November price support as well as the 200-day moving average are approaching just below. The standard exit is a close above the 10-day ma. I may not wait that long since the 10-ma is so far away.

## Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
DOW(1/3)	2/17/2009	\$9.29	\$7.45	-19.81%		Catapult
DOW(1/3)	2/18/2009	\$8.62	\$7.45	-13.57%		Catapult
SPY(1/4)	2/18/2009	\$79.22	\$75.62	-4.54%		
DOW(1/3)	2/19/2009	\$8.60	\$7.45	-13.37%		Catapult
CAT(1/3)	2/19/2009	\$28.44	\$24.23	-14.80%		Catapult
SPY(1/4)	2/19/2009	\$78.18	\$75.62	-3.27%		
CAT(1/3)	2/20/2009	\$26.14	\$24.23	-7.31%		Catapult
CAT(1/3)	2/23/2009	\$26.66	\$24.23	-9.11%		Catapult
DIA	2/23/2009	\$73.73	\$71.84	-2.56%		Catapult
PFE	2/24/2009	\$13.27	\$12.70	-4.30%		Catapult

The Catapults in this cluster have been punished hard. I'll discuss this in some detail along with some new thoughts and research this weekend.

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