

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 2, 2009

Volume 2 Issue 40

## 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>					
March 2, 2009	2% Gap Down	1-3 days	Bullish	2.70%	5.30%
March 2, 2009	Gap Dn to 50 low and Close Lower	1-5 days	Bullish	6.30%	12.20%
March 2, 2009	Last Friday 1% Drop	1 day	Bearish	-1.50%	-3.20%
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%
<b>Active - Long Term</b>					
none					
<b>Dropped Tonight</b>					
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%

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 3/2 – bullish**

A large gap down Friday rose right from the open. After rising over 2% during the day the S&P failed to hold its intraday gains. A late selloff put it below its open and down over 2% on the day. Breadth was strongly negative as decliners led advancers 2 to 1 and declining volume led advancing volume by nearly 4 to 1. Total volume was extremely high as it posted the highest level since November.

One of the first things many subscribers may have noticed is that we again had a strong move on a Friday. I've shown numerous times how strong moves on Friday's tend to carry through to Mondays. Below is an excerpt from the February 2, 2009 Subscriber Letter discussing Friday-Monday follow through and specifically the last Friday of the month.

*As you may recall, from the 60's until the late 80's Mondays were generally bearish. In the late eighties this changed and Mondays suddenly became much stronger and tended to follow the general market. (Note: For all Friday-Monday testing Monday is actually defined as "the day after Friday". In other words I did not exclude instances where Monday was a holiday. Instead, in those cases the returns for Tuesday were used.)*

*First let's consider some baseline numbers. Since the beginning of 1987 (excluding Black Monday) the market has gained an average of 0.05% on Monday. If instead of*

looking at all Monday's, you only look at those Mondays that follow the last Friday of the month then the average return doubles to 0.1%. So over the time period Mondays have had a positive bias and this positive bias has been twice as strong following the last Friday of the month.

Now let's look at Monday performance following Friday's that finished down by at least a certain amount. First I'll show all Monday's that DON'T follow the last Friday of the month.

Friday other than last Friday of month closes down at least X%.										
Buy on close. Sell next day's close. \$100k/trade. 1987-present.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fac	Avg Trade
0.5	\$952.56	281	157	123	55.87	\$887.72	(\$1,125.36)	0.79	1.01	\$3.39
0.75	(\$19,313.76)	203	105	97	51.72	\$937.32	(\$1,213.73)	0.77	0.84	(\$95.14)
1	(\$13,417.70)	145	77	67	53.10	\$998.13	(\$1,347.37)	0.74	0.85	(\$92.54)
1.25	(\$12,848.12)	101	57	44	56.44	\$931.31	(\$1,498.47)	0.62	0.81	(\$127.21)

As you can see, the positive Monday bias turns negative following especially weak Fridays. The weaker Friday was the weaker Monday tended to be.

Now let's look at the last Friday of the month to see if it holds true for those as well.

Last Friday of month closes down at least X%.										
Buy on close. Sell next day's close. \$100k/trade. 1987-present.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fac	Avg Trade
0.5	\$4,997.43	61	38	23	62.30	\$869.53	(\$1,219.34)	0.71	1.18	\$81.93
0.75	(\$7,344.27)	40	22	18	55.00	\$803.62	(\$1,390.22)	0.58	0.71	(\$183.61)
1	(\$12,478.90)	27	13	14	48.15	\$932.59	(\$1,757.33)	0.53	0.49	(\$462.18)
1.25	(\$6,358.32)	22	12	10	54.55	\$967.64	(\$1,797.00)	0.54	0.65	(\$289.01)

The bearish bias is even more pronounced here. This suggests a possible bearish bias for Monday.

Now let's look at how it typically plays out the rest of the week. First let's look at all Mondays following the last Friday of the month where the market did NOT drop at least 1%.

Last Friday of month NOT down at least 1%.										
Buy on close. Sell X days later. \$100k/trade. 1987-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fac	Avg Trade
5	\$76,662.82	212	131	81	61.79	\$1,661.02	(\$1,739.89)	0.95	1.54	\$361.62
4	\$54,894.87	212	130	82	61.32	\$1,415.53	(\$1,574.68)	0.90	1.43	\$258.94
3	\$64,296.63	212	131	80	61.79	\$1,299.25	(\$1,323.81)	0.98	1.61	\$303.29
2	\$44,399.48	212	135	77	63.68	\$986.67	(\$1,153.25)	0.86	1.50	\$209.43
1	\$35,231.75	212	124	88	58.49	\$839.92	(\$783.17)	1.07	1.51	\$166.19

Here we see a generally bullish bias for most of the next week. This is not surprising considering the end of month / beginning of month period is a nototiously bullish time period. What of those times when Friday saw a 1% plus drop?

Last Friday of month down at least 1%.										
Buy on close. Sell X days later. \$100k/trade. 1987-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fac	Avg Trade
5	\$8,391.25	27	14	13	51.85	\$2,905.64	(\$2,483.67)	1.17	1.26	\$310.79
4	\$1,499.57	27	15	12	55.56	\$1,900.92	(\$2,251.18)	0.84	1.06	\$55.54
3	\$3,260.20	27	15	12	55.56	\$1,509.12	(\$1,614.72)	0.93	1.17	\$120.75
2	\$368.82	27	15	12	55.56	\$1,342.43	(\$1,647.30)	0.81	1.02	\$13.66
1	(\$12,478.90)	27	13	14	48.15	\$932.59	(\$1,757.33)	0.53	0.49	(\$462.18)

You can see here that the weakness has not carried through beyond Monday. In fact Tuesday has been an exceptionally strong day in these cases. Again this isn't terribly surprising considering the "Turnaround Tuesday" phenomenon which I showed on the blog a few weeks back.

Another notable past study that triggered Friday is the 2% Gaps Down study for the SPY. As you may recall, when the SPY has gapped down 2% or more there has been a strong past tendency for it to bounce at some point over the next few days. For purposes of the study I defined a bounce as a close higher than the gap down. Friday just barely failed to close higher than the open as the late selling pushed it below. To be a "success" it will need to close above \$74.01 by Thursday at the latest. Below is the updated table of 2% gaps down:

SPY Gaps Down 2+%		
Instance	Date	Closed >= Gap Open (Up to 5 days)
1	April 4, 1994	same day
2	March 8, 1996	1 day later
3	April 8, 1996	same day
4	December 6, 1996	same day
5	October 28, 1997	same day
6	September 10, 1998	same day
7	September 17, 1998	3 days later
8	September 21, 1998	same day
9	October 8, 1998	same day
10	January 13, 1999	same day
11	May 14, 1999	3 days later
12	March 13, 2000	same day
13	April 27, 2000	same day
14	March 14, 2001	same day
15	September 17, 2001	same day
16	September 21, 2001	same day
17	June 26, 2002	same day
18	July 24, 2002	same day
19	January 22, 2008	same day
20	January 23, 2008	same day
21	March 17, 2008	same day
22	September 15, 2008	1 day later
23	September 16, 2008	same day
24	September 17, 2008	1 day later
25	October 6, 2008	<b>NO</b>
26	October 8, 2008	3 days later
27	October 10, 2008	same day
28	October 15, 2008	3 days later
29	October 22, 2008	4 days later
30	October 24, 2008	same day
31	November 11, 2008	2 days later
32	December 1, 2008	4 days later
33	December 3, 2008	same day
34	December 12, 2008	same day
35	January 23, 2009	same day
36	February 17, 2009	<b>NO**</b>

**\*\*U.S. Holiday when gap occurred represented 2 days overseas trading.**

What's also interesting about these 2% gap down days is that regardless of whether they close above the open or not, they still tend to move higher over the next few days. If you were to buy the close of any day that began with a 2% gap down and then look to sell at the close of the next day that would give you a profit up to 4 days later, you would have 89% winning trades with an average trade of 1.25%.

In a bit of a repeat of last weekend, the Friday action looks horrid but studies of history have shown similar patterns have led to a quick bounce. I looked at it several different ways. Below are some of the more interesting.

First, you'll note that SPY gapped down large, closed the gap from the open to yesterday's close, and then reversed and closed below the open. Below are the results of buying this formation and selling the 1<sup>st</sup> profitable close up to 3 days later – based on the size of the gap:

<b>SPY gaps down at least X% closes the gap then closes under open.</b>										
<b>Buy on close. Sell 1st profitable exit up to 3 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
0.75	\$47,129.57	22	19	3	86.36	\$2,896.59	(\$2,635.18)	1.10	6.96	\$2,142.25
1	\$34,809.82	14	12	2	85.71	\$3,243.23	(\$2,054.45)	1.58	9.47	\$2,486.42
1.25	\$22,898.21	8	8	0	100.00	\$2,862.28	\$0.00	100.00	100.00	\$2,862.28

With only 8 instances of 1.25% or more I decided to look at 1% gaps a bit closer:

<b>SPY gaps down at least 1% closes the gap then closes under open.</b>										
<b>Buy 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
3	\$26,415.82	13	8	5	61.54	\$5,599.17	(\$3,675.50)	1.52	2.44	\$2,031.99
2	\$18,315.16	14	8	6	57.14	\$5,114.20	(\$3,766.41)	1.36	1.81	\$1,308.23
1	\$10,708.38	14	7	7	50.00	\$4,302.15	(\$2,772.39)	1.55	1.55	\$764.88

There's a decent edge over the 1<sup>st</sup> 3 days. The average loss is high, but it is swamped by the extremely high average gain. After 3 days the edge dissipated.

If we forget about the requirement to see the gap close and instead focus of the large gap and lower close occurring at a low point the following test becomes relevant:

<b>SPY gaps down at least 1% then closes under open and at 50-day low.</b>												
<b>Buy on close. Sell X days later. \$100k/trade. 1993-present.</b>												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	Max Win	Max Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$40,304.85	17	11	6	64.71	\$6,250.84	(\$4,742.40)	\$15,560.60	(\$8,996.91)	1.32	2.42	\$2,370.87
9	\$37,627.43	17	11	6	64.71	\$6,512.76	(\$5,668.83)	\$14,686.12	(\$20,523.36)	1.15	2.11	\$2,213.38
8	\$24,792.99	19	12	7	63.16	\$5,589.26	(\$6,039.73)	\$15,522.02	(\$18,549.96)	0.93	1.59	\$1,304.89
7	\$25,891.77	20	11	9	55.00	\$5,702.23	(\$4,092.53)	\$14,577.84	(\$12,441.39)	1.39	1.70	\$1,294.59
6	\$37,207.92	20	10	10	50.00	\$7,480.88	(\$3,760.08)	\$19,603.86	(\$10,180.95)	1.99	1.99	\$1,860.40
5	\$32,814.48	20	12	8	60.00	\$5,603.42	(\$4,303.32)	\$15,673.56	(\$11,755.88)	1.30	1.95	\$1,640.72
4	\$19,934.46	20	13	7	65.00	\$4,889.61	(\$6,232.92)	\$15,340.08	(\$15,473.88)	0.78	1.46	\$996.72
3	\$19,341.23	21	15	6	71.43	\$3,298.14	(\$5,021.81)	\$14,708.85	(\$13,375.08)	0.66	1.64	\$921.01
2	\$3,870.10	23	11	12	47.83	\$4,514.31	(\$3,815.61)	\$10,873.83	(\$9,235.25)	1.18	1.08	\$168.27
1	\$11,478.12	24	12	12	50.00	\$3,296.09	(\$2,339.58)	\$11,683.71	(\$7,417.30)	1.41	1.41	\$478.26

Here again we see bullish tendencies. Apologies if the numbers look a bit scrunched. I added Max Win and Max Loss columns since they were so large. I highlighted those along with Avg Win and Avg Loss. What's remarkable about this study is the volatility average gains of 5% - 7% and average losses of 4% - 6% are extraordinary for such a short time period.

In the above test we require that the SPY closes at a 50-day low. What if we also require it to open at a 50-day low?

<b>SPY gaps down at least 1% to 50-day low then closes under open.</b>												
<b>Buy on close. Sell X days later. \$100k/trade. 1993-present.</b>												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	Max Win	Max Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$54,993.78	13	9	4	69.23	\$7,662.78	(\$3,492.81)	\$16,536.00	(\$5,638.14)	2.19	4.94	\$4,230.29
9	\$47,954.29	13	8	5	61.54	\$8,129.54	(\$3,416.40)	\$14,686.12	(\$10,980.54)	2.38	3.81	\$3,688.79
8	\$31,290.91	15	9	6	60.00	\$7,207.78	(\$5,596.53)	\$15,727.75	(\$10,446.30)	1.29	1.93	\$2,086.06
7	\$36,381.38	15	10	5	66.67	\$6,498.97	(\$5,721.66)	\$14,577.84	(\$14,023.80)	1.14	2.27	\$2,425.43
6	\$46,341.32	15	9	6	60.00	\$7,243.47	(\$3,141.66)	\$19,603.86	(\$6,470.72)	2.31	3.46	\$3,089.42
5	\$47,013.19	15	10	5	66.67	\$6,733.09	(\$4,063.54)	\$19,027.00	(\$11,755.88)	1.66	3.31	\$3,134.21
4	\$33,839.09	15	11	4	73.33	\$6,080.53	(\$8,261.69)	\$17,914.00	(\$15,473.88)	0.74	2.02	\$2,255.94
3	\$33,857.00	16	13	3	81.25	\$4,306.58	(\$7,376.16)	\$14,708.85	(\$13,375.08)	0.58	2.53	\$2,116.06
2	\$20,000.28	17	9	8	52.94	\$5,471.52	(\$3,655.43)	\$12,693.50	(\$9,235.25)	1.50	1.68	\$1,176.49
1	\$7,203.85	17	8	9	47.06	\$3,330.42	(\$2,159.95)	\$11,683.71	(\$6,980.25)	1.54	1.37	\$423.76

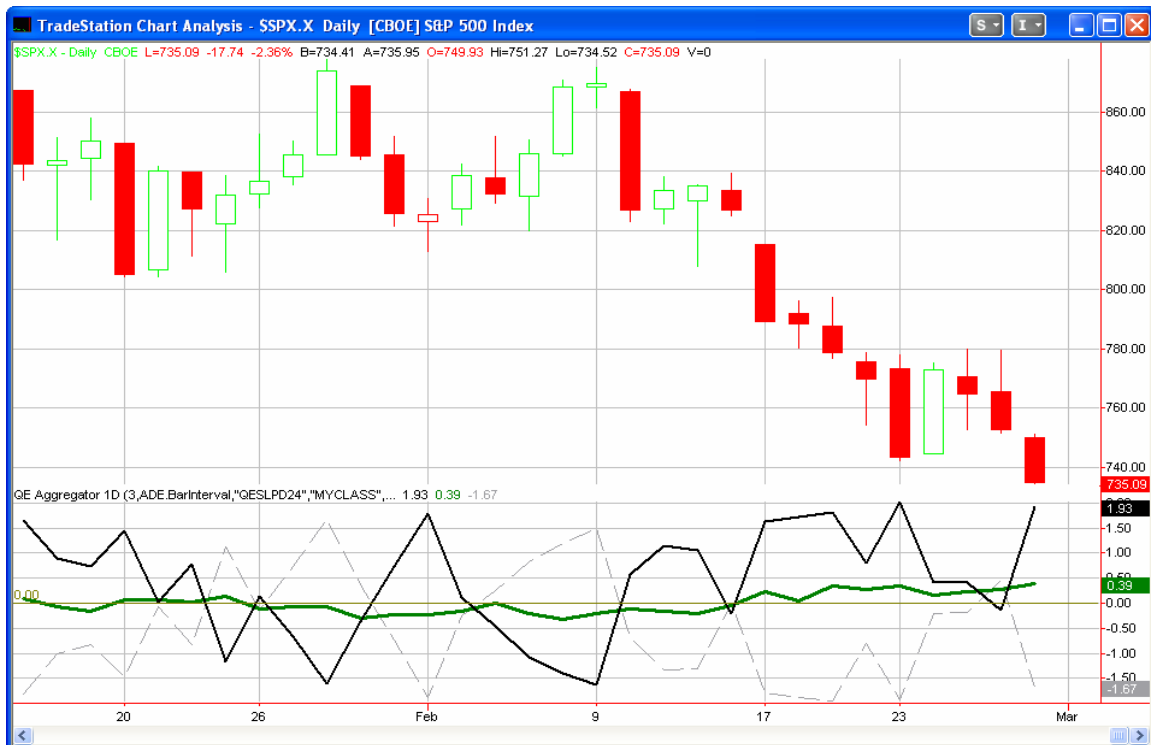
Instances are getting a bit low but there are some even more compelling numbers here. 13 of 16 are profitable after 3 days. The average 1-week return is over 3%. The average winner after 9 days is up over 8%. There are some strongly bullish numbers here. The caveat? The average losses are also huge. When wrong the results are not mildly negative. It's a potentially big, sharp, drop.

Another observation I've seen several traders make is that while the S&P fell hard this past week, the VIX (and VXO) didn't rise. The interpretation by some is that this suggests a lack of fear and is short-term bearish. I was unable to find evidence to support this theory. Below is one test I ran that looked at other times the S&P fell at least 2.5% while the VXO also fell.

<b>SPX drops 2.5% over the last 5 days and the VXO also drops.</b>										
<b>Buy on close. Sell X days later. \$100k/trade. 1986-present.</b>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$9,713.40	18	10	8	55.56	\$3,384.73	(\$3,016.73)	1.12	1.40	\$539.63
9	(\$10,927.62)	19	9	10	47.37	\$2,875.06	(\$3,680.32)	0.78	0.70	(\$575.14)
8	(\$2,733.87)	19	12	7	63.16	\$2,162.65	(\$4,097.95)	0.53	0.90	(\$143.89)
7	\$20,638.56	20	11	9	55.00	\$3,609.64	(\$2,118.61)	1.70	2.08	\$1,031.93
6	\$14,111.52	20	12	8	60.00	\$3,001.02	(\$2,737.59)	1.10	1.64	\$705.58
5	\$10,465.92	20	14	6	70.00	\$2,128.44	(\$3,222.04)	0.66	1.54	\$523.30
4	\$2,402.30	20	13	7	65.00	\$2,128.89	(\$3,610.47)	0.59	1.10	\$120.12
3	(\$2,117.87)	20	13	7	65.00	\$1,925.16	(\$3,877.85)	0.50	0.92	(\$105.89)
2	(\$7,771.80)	23	14	9	60.87	\$1,280.32	(\$2,855.14)	0.45	0.70	(\$337.90)
1	(\$6,990.89)	29	17	12	58.62	\$1,078.39	(\$2,110.30)	0.51	0.72	(\$241.07)

I wouldn't call the results bullish but I wouldn't call them bearish either. I would suggest that perhaps the VIX simply an indicator lacking a solid edge for the time being.

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



The Aggregator chart is strongly bullish. The green Aggregator line is as high as it has been in a long time. This suggests the studies net expectations are strongly bullish. Meanwhile the black differential line shows the S&P has underperformed expectations over the last few days by a massive amount. With both the lines well above zero this is a bullish configuration. My current position is partially long and I intend to make it longer early this week.

While potential rewards are high at the current time, potential risks are as well. Moves in either direction at this point will likely be very sharp. Traders should consider how aggressively they want to play in such a market. In extreme market conditions I find it helpful to try and make most risk management decisions outside of market trading hours when it can be done less emotionally.

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

Another down week. Another new low. ‘m seeing nothing from an intermediate-standpoint that has me excited about either side right now. Too low to aggressively short and no evidence of an ability to rally. Most notable from a technical perspective is that the S&P 500 broke its last nearby level of technical support this past week. There’s no telling where it might next find support. Still, the overall intermediate-term mantra will remain the same as it has:

*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

#### **New**

PM – buy 1/3 position @ \$33.47

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

DIA – bought @ \$73.73 limit

### ***Broad Market Large Cap CBI – 8/4 (DOW-3, CAT-3, PFE, PM)***

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

Index	ETF	CBI %	Index	ETF	CBI %
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	2.70	DJ US Healthcare	IYH	6.34
DJ US Oil&Gas Expl & Prod	IEO	3.45	DJ US Industrial Sector	IYJ	4.98
DJ US Oil Equip & Svcs	IEZ	5.77	DJ US Consumer Goods	IYK	4.08
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

No huge standouts like banks were last week before their bounce.

#### **Additional New Trade Ideas**

*SPY – buy 1/4 index position @ \$72.82 limit ON OPEN. If not filled on open, the order will be cancelled and I will look to purchase 1/4 index position @ \$73.93 limit ON CLOSE.* Basically I'm looking to get long on a further drop tomorrow. Should the market gap significantly lower (which it is setting up to do as of now) then I'd look to take the opening discounted price. If this doesn't happen, then I'll enter the order on a

close lower. More agile traders may be able to find a more opportune place to purchase during the day. For purposes of the subscriber letter I try and keep the entries and exits fairly simple. And as far as entries go, I never adjust them during the day – only exits. I prefer all subscribers have a chance to absorb all the information before making an entry decision – which is why I never adjust entries during the day.

*PM – see catapult section above.*

### **Active Trades Table**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
DOW(1/3)	2/17/2009	\$9.29	\$7.16	-22.93%		Catapult
DOW(1/3)	2/18/2009	\$8.62	\$7.16	-16.94%		Catapult
SPY(1/4)	2/18/2009	\$79.22	\$73.93	-6.68%		
DOW(1/3)	2/19/2009	\$8.60	\$7.16	-16.74%		Catapult
CAT(1/3)	2/19/2009	\$28.44	\$24.61	-13.47%		Catapult
SPY(1/4)	2/19/2009	\$78.18	\$73.93	-5.44%		
CAT(1/3)	2/20/2009	\$26.14	\$24.61	-5.85%		Catapult
CAT(1/3)	2/23/2009	\$26.66	\$24.61	-7.69%		Catapult
DIA	2/23/2009	\$73.73	\$70.76	-4.03%		Catapult
PFE	2/24/2009	\$13.27	\$12.31	-7.23%		Catapult

I did some additional testing on the Catapult trades this weekend. One issue with Catapults is that when a large cluster forms the early trades tend to get punished. This is normally more than made up for by the trades at the back end of the cluster. The problem is it is extremely difficult to predict how large a cluster might get. My approach has always been to simply take all the trades. If it turned out to be a small cluster then I'd likely make money on the 1 or 2 trades that were in it. If it became large then the late trades often bailed me out.

To help me better make decisions on the early trades I ran some tests. I already knew that when the market is uptrending large clusters are less likely to form and taking early trades is a solid approach. When I first started trading the Catapult system live in 2005 my first trade was a loser. After that there were 43 winners in a row over about 10 months. This is extreme but demonstrates the reliability of the trades in a healthy environment.

In testing, the best year from 1995-2005 was 2002, which was the worst year for the market. Last year turned out to be even better than 2002 with massive gains made in October and November, solid gains in January and March, and a rough patch in June/July. There were plenty of losing trades, though. Many of them at the beginin of a cluster. I looked back at all the trades that occurred prior to a cluster posting a CBI reading of 5 or higher. Last year this group of trades was a significant net loser. Net losses among these trades also outnumbered net gains.

I then looked back to 1995 to see how other trades that occurred when the S&P was trading below its 200-day moving average performed if they were taken before the CBI reached 5. Prior to 2008 there were 150 such trades. 118 of the (79%) were winners. The average trade in this basket returned 2.5%. The average trade is below typical for the period, but you're still looking at a fairly solid system – even with difficult market conditions.

I've mentioned before the possibility that traders could wait until a cluster begins to gain size before beginning to take Catapults. (See Feb 17<sup>th</sup> Letter for some such discussion.) What these tests suggest to me is that taking the early trades when the market is locked in a downtrend is not a bad trade. It is an aggressive trade, though, and the expectations aren't as high as buying into the later trades or buying when the market is in an uptrend.

I also did some evaluation of my approach with the index trade ideas recently. While the market did not go my way the last few days, I don't believe it was due to some great tactical trading error on my part. If I could have been a little more aggressive and been able to put on another lot last Monday afternoon or Tuesday morning, or if I'd been a little more conservative and sold 2 lots on the bounce rather than just one, then that would have helped the trade some. Neither of these were huge errors in my eyes, though. I wanted some exposure and I got it. The edges that were present were suggesting upside and they still are – hence my current and anticipated positions. Bottom line is the trades aren't all going to work out as planned. As long as I trade with an edge, manage risk well, and keep probabilities on my side, it should all work out in the long-term.

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