

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 11, 2009

Volume 2 Issue 47

## 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 10, 2009	CBI crosses under 9	1-4 days	Bullish		
March 11, 2009	GapUp & move higher from 50 low	1-2 days	<b>Bearish</b>		
March 11, 2009	90% Up From 50-low	1-2 days	<b>Bearish</b>		
March 10, 2009	200-day low on lowest vol 5	1-12 days	Bullish		
March 6, 2009	Bounce from 50 low fails	1-7 days	Bullish	5.30%	10.00%
March 5, 2009	Rally after CBI >= 10	1-5 days	Bullish		
March 4, 2009	5 lower closes @ 50-low	1-4 days	Bullish	2.10%	3.90%
February 26, 2009	SPX down 1% while SOX up 1%	1-15 days	Bullish	4.60%	7.10%
<b>Active - Long Term</b>					
none					
<b>Dropped Tonight</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) – updated 3/11 – slightly bullish**

The market gapped higher and continued to run right from the open – forcing shorts to cover and building momentum throughout the day. When it was over the market had put in a very strong rally with most of the major indices up in excess of 6%. Breadth was extremely strong. The NYSE Up Issue % came in a 93% and the NYSE Up Volume % was 96%. Overall volume was very strong as well.

Most of the very-short term results I'm getting suggest one-day rallies of this type often pull back in the next 1-2 days. After that there is some suggestion that the market could continue higher.

First let's look at a study from the March 5<sup>th</sup> Subscriber Letter. Below I'm looking to find out how the market typically reacts after gaps up and continued moves higher like today:

<b>SPY gaps at least 0.75% higher from 50-day low. The gap does not fill and it closes higher than the open.</b>										
<b>Buy on close. Sell X days later. \$100k/trade. 1995-present.</b>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
10	(\$11,238.18)	13	6	7	46.15	\$1,714.96	(\$3,075.42)	0.56	0.48	(\$864.48)
9	(\$25,807.56)	14	6	8	42.86	\$1,844.00	(\$4,608.94)	0.40	0.30	(\$1,843.40)
8	(\$33,117.15)	14	7	7	50.00	\$1,506.13	(\$6,237.15)	0.24	0.24	(\$2,365.51)
7	(\$29,750.37)	15	6	9	40.00	\$2,184.14	(\$4,761.69)	0.46	0.31	(\$1,983.36)
6	(\$24,924.16)	16	6	10	37.50	\$2,044.77	(\$3,719.28)	0.55	0.33	(\$1,557.76)
5	(\$14,483.17)	16	7	8	43.75	\$2,640.34	(\$4,120.70)	0.64	0.56	(\$905.20)
4	(\$22,306.98)	16	8	8	50.00	\$1,751.81	(\$4,540.18)	0.39	0.39	(\$1,394.19)
3	(\$20,094.56)	16	5	11	31.25	\$1,634.34	(\$2,569.66)	0.64	0.29	(\$1,255.91)
2	(\$23,501.19)	16	6	10	37.50	\$1,374.39	(\$3,174.75)	0.43	0.26	(\$1,468.82)
1	(\$8,012.00)	16	4	11	25.00	\$814.84	(\$1,024.67)	0.80	0.29	(\$500.75)

After the market gaps and moves higher without filling as it did on Tuesday it has almost always experienced a short-term pullback. Not shown above is that 14 of 16 instances saw at least 1 close below the trigger day close within the next 3 days. Looking out 6 days would make it 15 of 16.

The extreme breadth reading coming off a 50-day low is of some concern as well. Below is an updated study from the Feb 25<sup>th</sup> Letter that examined this.

<b>NYSE Up Volume % exceeds 90% 1 day after the S&amp;P 500 closes a 50-day low.</b>										
<b>Buy on close. Sell X days later. \$100k/trade. 1970-present.</b>										
Days In	Net Profit	Trades	Wins	Losses	Win %	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
10	(\$31,856.69)	7	1	6	14.29	\$1,102.63	(\$5,493.22)	0.20	0.03	(\$4,550.96)
9	(\$36,116.30)	7	1	6	14.29	\$472.15	(\$6,098.08)	0.08	0.01	(\$5,159.47)
8	(\$31,872.42)	7	0	7	0.00	\$0.00	(\$4,553.20)	0.00	0.00	(\$4,553.20)
7	(\$29,984.60)	8	1	7	12.50	\$1,524.21	(\$4,501.26)	0.34	0.05	(\$3,748.08)
6	(\$16,929.54)	8	2	6	25.00	\$1,743.78	(\$3,402.85)	0.51	0.17	(\$2,116.19)
5	(\$8,636.92)	8	2	6	25.00	\$4,851.87	(\$3,056.78)	1.59	0.53	(\$1,079.62)
4	(\$15,958.11)	8	4	4	50.00	\$1,470.74	(\$5,460.27)	0.27	0.27	(\$1,994.76)
3	(\$8,539.04)	8	3	5	37.50	\$1,825.02	(\$2,802.82)	0.65	0.39	(\$1,067.38)
2	(\$13,161.18)	8	3	5	37.50	\$825.71	(\$3,127.66)	0.26	0.16	(\$1,645.15)
1	(\$7,354.91)	8	0	8	0.00	\$0.00	(\$919.36)	0.00	0.00	(\$919.36)

Below is a list of all instances along with their 1-day returns:

Date/Time	Signal	Price	Roll Over USD/Lot	Shares/Ctrts	Net Profit	Cum Net Profit	% Profit
11/01/78	Buy	\$96.85	\$0.00	1032	(\$1,279.68)	(\$1,279.68)	(1.28%)
11/02/78	Sell	\$95.61			(\$1,279.68)	(\$1,279.68)	
04/05/94	Buy	\$448.29	\$0.00	223	(\$53.52)	(\$53.52)	(0.05%)
04/06/94	Sell	\$448.05			(\$53.52)	(\$1,333.20)	
03/06/07	Buy	\$1,395.41	\$0.00	71	(\$244.24)	(\$244.24)	(0.25%)
03/07/07	Sell	\$1,391.97			(\$244.24)	(\$1,577.44)	
11/13/07	Buy	\$1,481.01	\$0.00	67	(\$769.83)	(\$769.83)	(0.78%)
11/14/07	Sell	\$1,469.52			(\$769.83)	(\$2,347.27)	
11/23/07	Buy	\$1,440.70	\$0.00	69	(\$2,311.50)	(\$2,311.50)	(2.33%)
11/26/07	Sell	\$1,407.20			(\$2,311.50)	(\$4,658.77)	
10/13/08	Buy	\$1,003.35	\$0.00	99	(\$528.66)	(\$528.66)	(0.53%)
10/14/08	Sell	\$998.01			(\$528.66)	(\$5,187.43)	
10/28/08	Buy	\$940.51	\$0.00	106	(\$1,104.52)	(\$1,104.52)	(1.11%)
10/29/08	Sell	\$930.09			(\$1,104.52)	(\$6,291.95)	
02/24/09	Buy	\$773.14	\$0.00	129	(\$1,062.96)	(\$1,062.96)	(1.07%)
02/25/09	Sell	\$764.90			(\$1,062.96)	(\$7,354.91)	

Interesting that most of the instances have occurred during the current bear market and all but 2 instances have occurred in the last 2 years.

One reading that concerned me when I first looked tonight was the S&P 500 Spyx reading from the charts page. Typically a very low Spyx reading has bearish implications. As you can see in the table below, this bearish implication seemingly disappears when the move higher is large.

<i>Quantifiable Edges Volume Spyx closes under 15 and the S&amp;P 500 closes over X% higher.</i>										
<i>Buy on close. Sell next day's close. \$100k/trade. 1995-present.</i>										
Days In	Net Profit	Trades	Wins	Losses	Win %	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
0	(\$14,713.88)	114	50	64	43.86	\$689.69	(\$768.72)	0.90	0.70	(\$129.07)
0.25	(\$6,469.74)	77	37	40	48.05	\$705.00	(\$813.86)	0.87	0.80	(\$84.02)
0.5	(\$2,473.65)	44	21	23	47.73	\$898.40	(\$927.83)	0.97	0.88	(\$56.22)
0.75	(\$2,410.07)	26	16	10	61.54	\$723.63	(\$1,398.82)	0.52	0.83	(\$92.70)
1	\$4,225.44	17	10	7	58.82	\$863.06	(\$629.31)	1.37	1.96	\$248.56
1.25	\$5,870.09	14	9	5	64.29	\$882.36	(\$414.23)	2.13	3.83	\$419.29
1.5	\$5,599.09	9	6	3	66.67	\$1,032.03	(\$197.69)	5.22	10.44	\$622.12
1.75	\$5,189.12	6	5	1	83.33	\$1,078.30	(\$202.40)	5.33	26.64	\$864.85

So there's some evidence that the market may undergo a 1-2 day pullback from here. There's also evidence that a rally of just a single day is not enough to work off the markets oversold conditions. There's a good chance we'll be seeing further upside in the next several days.

One extreme condition I've noted was the high CBI, which spiked as high as 18 last week. The standard exit I've normally discussed when trading the S&P based on a high CBI is to exit when the CBI hits 3 or lower. To measure the difference between exiting when the CBI returns to 8 vs. 3, I created the following system: If CBI crosses under 9 but remains above 3, buy S&P 500 on close. Sell when it returns to 3 or lower. Below are the results:

## TradeStation Performance Summary

Collapse 

## All Trades

Total Net Profit	\$20,063.02	Profit Factor	4.85
Gross Profit	\$25,268.69	Gross Loss	(\$5,205.67)
Roll Over Credit	\$0.00		
Open Position Profit/Loss	\$0.00		
Select Total Net Profit	\$20,063.02	Select Profit Factor	4.85
Select Gross Profit	\$25,268.69	Select Gross Loss	(\$5,205.67)
Adjusted Total Net Profit	\$11,143.01	Adjusted Profit Factor	2.43
Adjusted Gross Profit	\$18,951.52	Adjusted Gross Loss	(\$7,808.50)
Total Number of Trades	20	Percent Profitable	80.00%
Winning Trades	16	Losing Trades	4
Even Trades	0		
Avg. Trade Net Profit	\$1,003.15	Ratio Avg. Win:Avg. Loss	1.21
Avg. Winning Trade	\$1,579.29	<a href="#">Avg. Losing Trade</a>	(\$1,301.42)
Largest Winning Trade	\$5,198.31	Largest Losing Trade	(\$3,162.31)
Largest Winner as % of Gross Profit	20.57%	Largest Loser as % of Gross Loss	60.75%
Net Profit as % of Largest Loss	634.44%		
Slct. Net Profit as % of Largest Loss	634.44%	Adj. Net Profit as % of Largest Loss	352.37%
Max. Consecutive Winning Trades	10	Max. Consecutive Losing Trades	2
Avg. Bars in Winning Trades	3.63	Avg. Bars in Losing Trades	7.25
Avg. Bars in Total Trades	4.35		

80% of the time exiting on the move below 9 would have resulted in money being left on the table. The stats here are skewed quite bullish and suggest it would be a mistake to completely exit the long positions at this point.

Here's tonight's [Aggregator](#) chart:



The green Aggregator line remains in bullish territory. Tuesday's huge gains have caused the black differential line to spike south, though. The means that for the first time in a while the market has managed to outperform expectations over the last 3 days.

This is a formation where I will often take profits. I took some profits on Tuesday's close and I will look to scale out of more over the next few days. The most explosive part of a rally, though is often the beginning. Therefore, while I'll be looking for a place to exit my long positions, I will not be looking to short in the immediate future. At the very least I would prefer to see the CBI return to 3 or lower before considering shorts. It will probably take much more than that, as well. Coming off a bottom, overbought will often get more extremely overbought than it might otherwise. It can be a dangerous time to short.

### ***Intermediate-term Outlook (2 weeks – 2 months)–neutral -updated 3/9***

Over the last week and a half the market has deteriorated rapidly without the requisite bounce that has historically occurred. Of course the period we are now dealing in is worse than anything seen in a very long time. One of the criticisms of some of the studies is that they mostly only go back to 1960 at the latest. And yet by my own admission we seem to be in a market that perhaps resembles the 30's more than any other previous decade.

There are different schools of thought when it comes to the historical analysis. One says that you should find a period most similar to the current period and use that as a roadmap for your decision making. Human nature remains the same and it is likely the market will act in a similar fashion under similar circumstances. The other school of thought says

that rather than focusing on a distant but similar past, you are better off focusing on the more recent past. Market behavior is determined by its participants. If we're considering comparing today's market to 1930 that's fine, but there is no one trading now that was trading then. The makeup and experience of the current market participants is based on their own experiences in the last 5, 10, 20 years. It is their patterns of behavior over this time period that is more likely to determine their actions and ultimately the gyrations and direction of the market going forward.

I tend to favor the 2<sup>nd</sup> school of thought but readily admit the answer is probably more grey than black and white. But for those who subscribe more to the 1<sup>st</sup> school of thought I thought it would be an interesting exercise to run some recent tests over the 25 year period of 1929-1954 and see if results were similar or vastly different. Most of my breadth data only goes back as far as 1969 or so. Therefore I decided just to look at a couple of price studies.

First from Thursday night's Letter:

<b>S&amp;P 500 closes at 50-day low 2 days ago. Yesterday it rises more than 1%. Today is again closes at 50-day low.</b>										
<b>Buy S&amp;P 500 on close. Sell X days later. \$100k/trade. 1960 - present.</b>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$31,343.36	8	5	3	62.50	\$6,811.87	(\$905.33)	7.52	12.54	\$3,917.92
9	\$30,112.27	8	7	1	87.50	\$4,377.66	(\$531.34)	8.24	57.67	\$3,764.03
8	\$17,145.23	8	4	4	50.00	\$6,490.51	(\$2,204.21)	2.94	2.94	\$2,143.15
7	\$23,500.92	8	6	2	75.00	\$4,830.01	(\$2,739.56)	1.76	5.29	\$2,937.62
6	\$21,082.74	8	6	2	75.00	\$4,844.94	(\$3,993.44)	1.21	3.64	\$2,635.34
5	\$14,934.23	8	5	3	62.50	\$4,724.79	(\$2,896.58)	1.63	2.72	\$1,866.78
4	\$14,756.46	9	6	3	66.67	\$4,575.75	(\$4,232.67)	1.08	2.16	\$1,639.61
3	\$13,191.78	9	6	3	66.67	\$3,409.96	(\$2,422.66)	1.41	2.82	\$1,465.75
2	\$10,136.83	9	4	5	44.44	\$5,076.88	(\$2,034.14)	2.50	2.00	\$1,126.31
1	\$2,583.80	9	5	4	55.56	\$1,557.24	(\$1,300.60)	1.20	1.50	\$287.09

Now let's look at the same test from '29-'54 for the Dow:

<b>Dow makes a 50 day low. Then closes 1% higher the next day. Then the day after that closes at a new 50-day low.</b>										
<b>Buy on close. Sell X days later. \$100k/trade. 1929 - 1954.</b>										
X Days	Net Profits	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$9,343.90	18	12	6	66.67	\$5,200.61	(\$8,843.90)	0.59	1.18	\$519.11
9	(\$8,531.90)	19	9	10	47.37	\$5,928.09	(\$6,188.47)	0.96	0.86	(\$449.05)
8	(\$19,757.80)	19	6	13	31.58	\$7,447.70	(\$4,957.23)	1.50	0.69	(\$1,039.88)
7	(\$19,996.30)	19	8	11	42.11	\$5,768.71	(\$6,013.27)	0.96	0.70	(\$1,052.44)
6	(\$26,741.90)	19	7	11	36.84	\$4,738.24	(\$5,446.33)	0.87	0.55	(\$1,407.47)
5	(\$8,475.00)	20	10	10	50.00	\$5,885.19	(\$6,732.69)	0.87	0.87	(\$423.75)
4	\$20,677.00	21	12	9	57.14	\$6,029.23	(\$5,741.52)	1.05	1.40	\$984.62
3	\$36,102.90	22	12	10	54.55	\$5,657.28	(\$3,178.44)	1.78	2.14	\$1,641.04
2	\$10,257.70	23	12	11	52.17	\$4,204.63	(\$3,654.35)	1.15	1.26	\$445.99
1	\$2,412.50	23	9	12	39.13	\$3,799.60	(\$2,648.66)	1.43	1.08	\$104.89

Rather than seeing the rally last 2 weeks or more, during the 30's and 40's the bounce often petered out after 3-4 days. Still, for the very short-term there still appeared to be a slight bullish bias.

Another recent bullish study looked at 5 lower closes at a 50-day low. Below is a similar study for the Dow from '29 – '54:

<b>Dow Industrials make 5 lower closes and close at a 50-day low.</b>										
<b>Buy on close. Sell X days later. \$100k/trade. 1929 - 1954.</b>										
X Days	Net Profits	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$28,116.40	22	14	8	63.64	\$4,454.57	(\$4,280.95)	1.04	1.82	\$1,278.02
9	\$13,039.60	22	12	10	54.55	\$4,944.38	(\$4,629.30)	1.07	1.28	\$592.71
8	\$14,599.50	22	12	10	54.55	\$4,433.89	(\$3,860.72)	1.15	1.38	\$663.61
7	\$17,222.20	23	12	11	52.17	\$4,285.63	(\$3,109.57)	1.38	1.50	\$748.79
6	\$25,693.40	23	13	10	56.52	\$4,110.85	(\$2,774.77)	1.48	1.93	\$1,117.10
5	\$17,063.40	23	13	10	56.52	\$3,278.53	(\$2,555.75)	1.28	1.67	\$741.89
4	\$23,943.90	23	15	8	65.22	\$2,918.31	(\$2,478.85)	1.18	2.21	\$1,041.04
3	\$11,667.50	23	15	8	65.22	\$2,828.79	(\$3,845.55)	0.74	1.38	\$507.28
2	\$15,741.90	23	15	8	65.22	\$2,260.12	(\$2,269.99)	1.00	1.87	\$684.43
1	\$22,530.10	23	16	7	69.57	\$1,880.31	(\$1,079.27)	1.74	3.98	\$979.57

Here again we are seeing bullish results. While I'm not sure it's necessary, I find it encouraging that some of the recent bullish studies I've cited also seemed to provide a bullish edge even during the difficult 29-54 period.

I'm still expecting a sizable multi-month rally to emerge here at some point. I've yet to see strong evidence that any such rally has begun or is days from beginning. I'll continue to watch for such evidence. Even while trying to capture such a rally I will remain alert to the idea that there is a good chance the anticipated rally will be largely or completely retraced.

### **Catapult and Capitulative Breadth Statistics**

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

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

RTN – bought 1/3 position @ \$37.71  
 RTN –  
 JNJ – buy 1/3 position @ \$47.64 limit  
 UTX –no fill  
 KFT – no fill  
 COV – bought 1/3 position @ \$28.31 limit  
 COV – bought 1/3 position @ \$27.70  
 COV – bought 1/3 position @ \$27.99

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

*none*

***Broad Market Large Cap CBI – 8/4 ( RTN-2, JNJ, UTX, KFT, COV-3)***

### **Additional New Trade Ideas**

*None tonight*

## **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)	2/18/2009	\$79.22	\$72.21	-8.85%		<b>sold on close</b>
SPY(1/4)	2/19/2009	\$78.18	\$72.21	-7.64%		
DIA	2/23/2009	\$73.73	\$69.23	-6.10%		<b>sold on close</b>
SPY(1/4)	3/2/2009	\$72.52	\$72.21	-0.43%		
RTN(1/3)	3/3/2009	\$37.71	\$34.61	-8.22%		Catapult
SPY(1/4)	3/3/2009	\$70.07	\$72.21	3.05%		
JNJ(1/3)	3/4/2009	\$47.64	\$47.70	0.13%		Catapult
RTN(1/3)	3/4/2009	\$36.45	\$34.61	-5.05%		Catapult
COV(1/3)	3/6/2009	\$28.31	\$28.66	1.24%		Catapult
XLF	3/9/2009	\$6.05	\$7.18	18.68%		<b>sold on close</b>
COV(1/3)	3/9/2009	\$27.70	\$28.66	3.47%		Catapult
COV(1/3)	3/10/2009	\$27.99	\$28.66	2.39%		Catapult

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