

# QUANTIFIABLE EDGES

## SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 12, 2009

Volume 2 Issue 48

### 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 11, 2009	2 Days Up In Chop	1-4 days	Bearish		
March 11, 2009	CBI crosses under 9	1-4 days	Bullish		
March 11, 2009	GapUp & move higher from 50 low	1-2 days	Bearish		
March 11, 2009	90% Up From 50-low	1-2 days	Bearish		
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 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>					
March 5, 2009	Rally after CBI >= 10	1-5 days	Bullish		

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 3/12 – neutral**

Another gap higher Wednesday morning held up fairly well for much of the day. When it was over the S&P closed below the open, but was slightly higher than Tuesday's close. Breadth was tilted slightly bullish. Volume was quite a bit lower than the day before.

Not a whole lot to go over tonight. I looked back in the Subscriber Letter archives at some recent previous rally attempt day 2's that looked similar such at 7/1708 and 10/14/08 to see what studies I may have posted those nights. (That would be the 7/18 and 10/15 Letters.) I found those nights to be light in the research as well. One way that subscribers can currently use the archives is to look for similar setups and see what my comments were on those nights. In the future I will be adding new functionality to the archives section which will allow subscribers to find relevant studies much easier.

One setup that did trigger today was the "2 Days Up In Chop" system. This system looks to short the S&P 500 any time it closes higher 2 days in a row. It then covers the position at the first profitable close up to 4 days later. After 4 days the trade is covered regardless of profitability. Since the market became especially choppy in June of 2007 it has produced the following results:

## TradeStation Performance Summary

Collapse 

## All Trades

Total Net Profit	\$70,914.90	Profit Factor	17.02
Gross Profit	\$75,340.89	Gross Loss	(\$4,425.99)
Roll Over Credit	\$0.00		
Open Position Profit/Loss	\$0.00		
Select Total Net Profit	\$62,131.88	Select Profit Factor	15.04
Select Gross Profit	\$66,557.87	Select Gross Loss	(\$4,425.99)
Adjusted Total Net Profit	\$58,200.59	Adjusted Profit Factor	9.34
Adjusted Gross Profit	\$65,181.93	Adjusted Gross Loss	(\$6,981.34)
Total Number of Trades	58	<a href="#">Percent Profitable</a>	94.83%
Winning Trades	55	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	\$1,222.67	Ratio Avg. Win:Avg. Loss	0.93
Avg. Winning Trade	\$1,369.83	Avg. Losing Trade	(\$1,475.33)
Largest Winning Trade	\$8,783.02	Largest Losing Trade	(\$3,230.74)
Largest Winner as % of Gross Profit	11.66%	Largest Loser as % of Gross Loss	72.99%
Net Profit as % of Largest Loss	2195.00%		
Slct. Net Profit as % of Largest Loss	1923.15%	Adj. Net Profit as % of Largest Loss	1801.46%
Max. Consecutive Winning Trades	23	Max. Consecutive Losing Trades	1
Avg. Bars in Winning Trades	2.75	Avg. Bars in Losing Trades	5.00
Avg. Bars in Total Trades	2.86		

With 55 winners and only 3 losers in the last 21 months it's tough to bet against this simple system. Below are the trades for almost the last six months:

Date/Time	Signal	Price	Roll Over USD/Lot	Shares/Ctrts Profit	Net Profit Cum Net Profit	% Profit	Run-up DrawDown
08/27/08	Short	\$1,281.65	\$0.00	78	\$319.02	0.32%	\$737.10
09/02/08	Cover#2	\$1,277.56		\$319.02	\$28,627.31		(\$1,668.42)
09/08/08	Short	\$1,267.80	\$0.00	78	\$3,374.28	3.41%	\$3,374.28
09/09/08	Cover#2	\$1,224.54		\$3,374.28	\$32,001.59		(\$67.08)
09/11/08	Short	\$1,249.05	\$0.00	80	\$4,424.00	4.43%	\$4,424.00
09/15/08	Cover#2	\$1,193.75		\$4,424.00	\$36,425.59		(\$483.20)
09/19/08	Short	\$1,255.08	\$0.00	79	\$3,791.21	3.82%	\$3,889.17
09/22/08	Cover#2	\$1,207.09		\$3,791.21	\$40,216.80		\$0.00
09/26/08	Short	\$1,213.53	\$0.00	82	\$8,783.02	8.83%	\$8,783.02
09/29/08	Cover#2	\$1,106.42		\$8,783.02	\$48,999.82		\$0.00
10/31/08	Short	\$968.75	\$0.00	103	\$252.35	0.25%	\$1,022.79
11/03/08	Cover#2	\$966.30		\$252.35	\$49,252.17		(\$702.46)
11/24/08	Short	\$851.81	\$0.00	117	\$4,165.20	4.18%	\$4,226.04
12/01/08	Cover	\$816.21		\$4,165.20	\$53,417.37		(\$5,199.48)
12/03/08	Short	\$870.74	\$0.00	114	\$2,909.28	2.93%	\$4,233.96
12/04/08	Cover#2	\$845.22		\$2,909.28	\$56,326.65		(\$554.04)
12/08/08	Short	\$909.70	\$0.00	109	\$2,292.27	2.31%	\$2,650.88
12/09/08	Cover#2	\$888.67		\$2,292.27	\$58,618.92		(\$715.04)
12/26/08	Short	\$872.80	\$0.00	114	\$385.32	0.39%	\$1,793.22
12/29/08	Cover#2	\$869.42		\$385.32	\$59,004.24		(\$102.60)
12/31/08	Short	\$903.25	\$0.00	110	(\$374.00)	(0.38%)	\$429.00
01/07/09	Cover	\$906.65		(\$374.00)	\$58,630.24		(\$4,466.00)
01/16/09	Short	\$850.12	\$0.00	117	\$5,253.30	5.28%	\$5,341.05
01/20/09	Cover#2	\$805.22		\$5,253.30	\$63,883.54		\$0.00
01/26/09	Short	\$836.57	\$0.00	119	\$1,272.11	1.28%	\$1,773.10
01/30/09	Cover	\$825.88		\$1,272.11	\$65,155.65		(\$4,874.24)
02/06/09	Short	\$868.60	\$0.00	115	\$4,765.60	4.77%	\$5,245.15
02/10/09	Cover#2	\$827.16		\$4,765.60	\$69,921.25		(\$717.60)
02/12/09	Short	\$835.19	\$0.00	119	\$993.65	1.00%	\$1,187.62
02/13/09	Cover#2	\$826.84		\$993.65	\$70,914.90		(\$504.56)
03/11/09	Short	\$721.36		138	n/a	n/a	\$0.00
open	n/a	\$721.36		n/a	n/a		\$0.00

Keep in mind this simple system is not profitable over much of the history of the stock market. It will likely lose effectiveness at some point. Until that happens it is worth noting and paying attention to.

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



The Aggregator chart remains much the same as yesterday. The market is overdone to the upside. The black differential line illustrates that the S&P has strongly outperformed expectations over the last few days. The green Aggregator line in positive territory suggests there still may be more upside to come.

The fact that the market didn't sell off as has happened every other time there was a 90% up day after a 50-day low suggests exceptional strength in this rally. Combined with some of the bullish studies there appears to be a decent chance that the market could put in a multi-week rally here. The bearish studies, including tonight's "2 Days Up In Chop" are suggesting we're likely to see a short-term pullback before another leg higher. With the overbought readings and short-term negative studies I'm going to look to sell another lot of the SPY trade idea. The last remaining lot I am going to look to hold on to in the hopes of a longer-term gain. I likely won't exit it until I see an outright short formation. I may even add back some long exposure if the market pulls back neatly and the studies remain bullish.

As I mentioned last night I will remain cautious when considering short positions due to the fact that the market is coming off of extremely oversold conditions near a long-term low.

SPY exit details in trade idea section below.

**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

RTN – bought 1/3 position

JNJ – bought 1/3 position

KFT – no fill

**Catapult for ETF's Trades**

*none*

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

**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	2.33
DJ US Insurance Index	IAK	6.76	DJ US Financial	IYF	2.74
DJ US Regional Banks	IAT	2.50	DJ US Financial Services	IYG	1.40
DJ US Utilities	IDU	12.16	DJ US Healthcare	IYH	2.11
DJ US Oil&Gas Expl & Prod	IEO	5.17	DJ US Industrial Sector	IYJ	5.75
DJ US Oil Equip & Svcs	IEZ	1.92	DJ US Consumer Goods	IYK	4.76
DJ US Pharmaceuticals	IHE	8.11	DJ US Basic Materials	IYM	1.35
DJ US Healthcare Providers	IHF	0.00	DJ US Real Estate	IYR	2.44
DJ US Medical Devices	IHI	2.44	DJ US Transportation	IYT	4.76
DJ US Aerospace & Defense	ITA	5.56	DJ US Technology Sector	IYW	0.50
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	2.63
DJ US Consumer Svcs	IYC	0.88	Nasdaq 100	QQQQ	1.00

CBI %'s have dropped dramatically in the last 2 days as oversold conditions have ben relieved.

**Additional New Trade Ideas**

*None tonight*

## Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	2/19/09	\$78.18	\$72.60	-7.14%		
SPY(1/4)	3/2/09	\$72.52	\$73.00	0.66%		<b>sold @ intraday stop</b>
RTN(1/3)	3/3/09	\$37.71	\$33.57	-10.98%		Catapult
SPY(1/4)	3/3/09	\$70.07	\$72.60	3.61%		
JNJ(1/3)	3/4/09	\$47.64	\$47.96	0.67%		Catapult
RTN(1/3)	3/4/09	\$36.45	\$33.57	-7.90%		Catapult
COV(1/3)	3/6/09	\$28.31	\$30.01	6.00%		<b>sold on close</b>
COV(1/3)	3/9/09	\$27.70	\$30.01	8.34%		<b>sold on close</b>
COV(1/3)	3/10/09	\$27.99	\$30.01	7.22%		<b>sell on open</b>

*SPY – sell @ \$73.50 limit.* Since I'm of the opinion that a pullback may be short-lived I don't want to sell into a gap down open. I will initially look to sell at \$73.50 on a morning gap or early rally higher. Should that not materialize I will likely trail a stop during the day as I did today.

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