

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 16, 2009

Volume 2 Issue 50

## 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 16, 2009	4 Up From 200 Low	1-10 days	Bearish	-4.10%	-8.40%
March 12, 2009	2 Days Up In Chop	1-4 days	Bearish		
February 26, 2009	SPX down 1% while SOX up 1%	1-15 days	Bullish	4.60%	7.10%
<b>Active - Long Term</b>					
March 13, 2009	2 90% Up Days	1-25 days	Bullish	8.00%	11.40%
<b>Dropped Tonight</b>					
<b>March 10, 2009</b>	<b>200-day low on lowest vol 5</b>	<b>1-12 days</b>	<b>Bullish</b>	<b>3.90%</b>	<b>7.90%</b>
<b>March 6, 2009</b>	<b>Bounce from 50 low fails</b>	<b>1-7 days</b>	<b>Bullish</b>	<b>5.30%</b>	<b>10.00%</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 3/16 – neutral**

The bulls refused to step aside again on Friday. The selloff so many seem to be expecting after this strong bounce simply hasn't materialized yet. The S&P, Dow and Nasdaq all rose by less than 1% on Friday. Breadth was moderately positive with both NYSE Up Issues and Up Volume coming in about 3:2 over Down Issues and Down Volume. Total volume declined a bit to the lowest level in 4 days. The range for the S&P 500 was the narrowest in weeks.

I looked at the fact the market put in a narrow range day at a 10-day high while trading under its 200-day moving average. I expected to find a decent short-side edge based on those criteria. What I found was barely a hint of mild downside. I looked at it a number of different ways and consistently found what appeared to be a mild downside edge. The edge was not significant enough to warrant publishing and tracking.

Much of what I looked at this weekend fell into that same category. Friday did mark the 4<sup>th</sup> day higher in a row. Coming of a 200-day low that gave some interesting results.

S&P 500 Rises 4 days in a row after closing at a 200-day low.										
Buy on close. Sell X days later. \$100k/trade. 1960 - present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$36,197.67)	18	7	11	38.89	\$1,846.47	(\$4,465.73)	0.41	0.26	(\$2,010.98)
9	(\$31,064.10)	18	9	9	50.00	\$1,756.93	(\$5,208.49)	0.34	0.34	(\$1,725.78)
8	(\$26,008.11)	18	8	10	44.44	\$2,124.52	(\$4,300.43)	0.49	0.40	(\$1,444.90)
7	(\$18,776.77)	18	8	10	44.44	\$2,242.30	(\$3,671.52)	0.61	0.49	(\$1,043.15)
6	(\$14,662.36)	18	8	10	44.44	\$2,291.32	(\$3,299.29)	0.69	0.56	(\$814.58)
5	(\$12,333.28)	18	10	8	55.56	\$1,758.93	(\$3,740.32)	0.47	0.59	(\$685.18)
4	(\$10,859.70)	18	10	8	55.56	\$1,653.58	(\$3,424.44)	0.48	0.60	(\$603.32)
3	(\$13,101.73)	18	10	8	55.56	\$1,241.53	(\$3,189.62)	0.39	0.49	(\$727.87)
2	(\$11,247.97)	18	9	9	50.00	\$1,324.43	(\$2,574.21)	0.51	0.51	(\$624.89)
1	\$824.58	18	10	7	55.56	\$812.07	(\$1,042.30)	0.78	1.11	\$45.81

Notable here is that the downside edge isn't so much in the winning %. It's the size of the losses vs. then wins. After running up for 4 days in a row from a 200-day low, additional short-term gains are somewhat muted. Losses, on the other hand, are not. Short-term overbought in a long-term downtrend can make for some quick selloffs.

I'll look at some of the results of this study a bit more in the intermediate-term outlook.

Notable on the active studies list is that two bullish studies have reached their Average Max Move + 1 Standard Deviation. That means any further gains are unlikely due to their influence. Therefore they have been dropped tonight thanks to the recent sharp runup.

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



Despite the additional bearish study tonight and the fact that 2 bullish studies fell of the board, the green Aggregator line still remains solidly above 0. This indicates continued net positive expectations from the studies. Meanwhile the black differential line remains well below 0, indicating the S&P has strongly outperformed expectations over the last few days. This is essentially a neutral configuration as the lines are remain on opposite sides of 0.

The green Aggregator line could easily slip down into negative territory should additional bearish studies arise in the next day or two. While it is tempting to try and short “overbought in a long-term downtrend”, I’m just not seeing a strong edge yet. The primary reason being that it is much more dangerous to short strong moves coming off bottoms than it would be if the market was simply overbought after floating around under the 200ma for a while. I’ll wait another day and reevaluate again tomorrow night. If I miss the pullback lower – so be it. If that pullback is orderly it could provide a nice long entry.

***Intermediate-term Outlook (2 weeks – 2 months)–neutral -updated 3/16***

So I’ve been saying for a while now that I expect a rally to emerge here at some point that will likely last a few months and could see a rise of 30% or more. The current bounce gives some hope that this rally could already be underway. When a market makes a move off a low you’d like to see it quickly become overbought and then stay that way for a while and continue to move higher. So far so good as none of the bounce from the lows has been given back yet.

I looked at the 4 higher closes from a 200-day low in more detail to see how many of those instances went on to further gains and how many fell apart. In order to determine success I simply said they would have to rally as much as they already had from their lows. A failure would occur if the lows were taken out before the trade was deemed successful.

Looking at it this way I found the following:

- 1) Eight of the 18 instances led to a successful continuation move higher.
- 2) Of the 8 successes, 5 of them marked long-term lows. These occurred in 7/62, 7/65, 5/70, 11/71, and 10/02.
- 3) Ten of 18 trades would have failed.
- 4) Of the 10 failures, 6 of them failed almost immediately.

I’m going to continue to watch price and volume action for clues. I anticipate we’ll see some further evidence as the week unfolds. Ideally we want the first pullback here to be relatively mild.

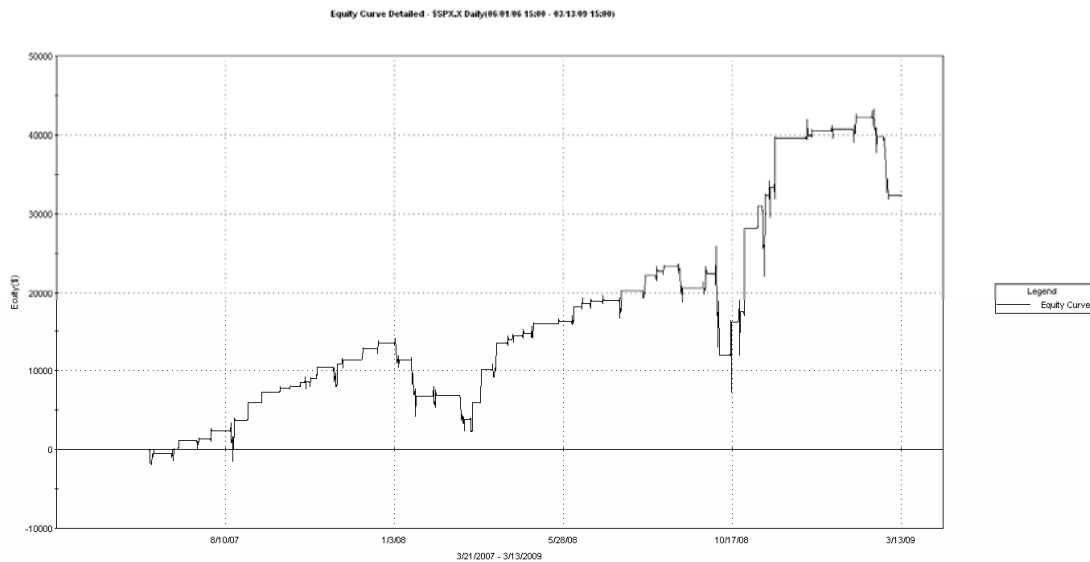
## Thoughts On Recent Action In Trend vs. Chop

I received a question from a subscriber on Friday. He noted that the last two “2 Days Down In Chop” triggers had been sizable losers and the current “2 Days Up in Chop” signal was quickly underwater. He wondered 1) Whether this might signal a change in market character from choppy to trendy and 2) If so, how would that affect the approaches that are used in the Quantifiable Edges Subscriber Letter?

For those unfamiliar with the “Trend vs. Chop” concept and the 2 Days Up and Down strategies I’d suggest you follow the links from the “[Trend vs. Chop Chart Page](#)” before continuing.

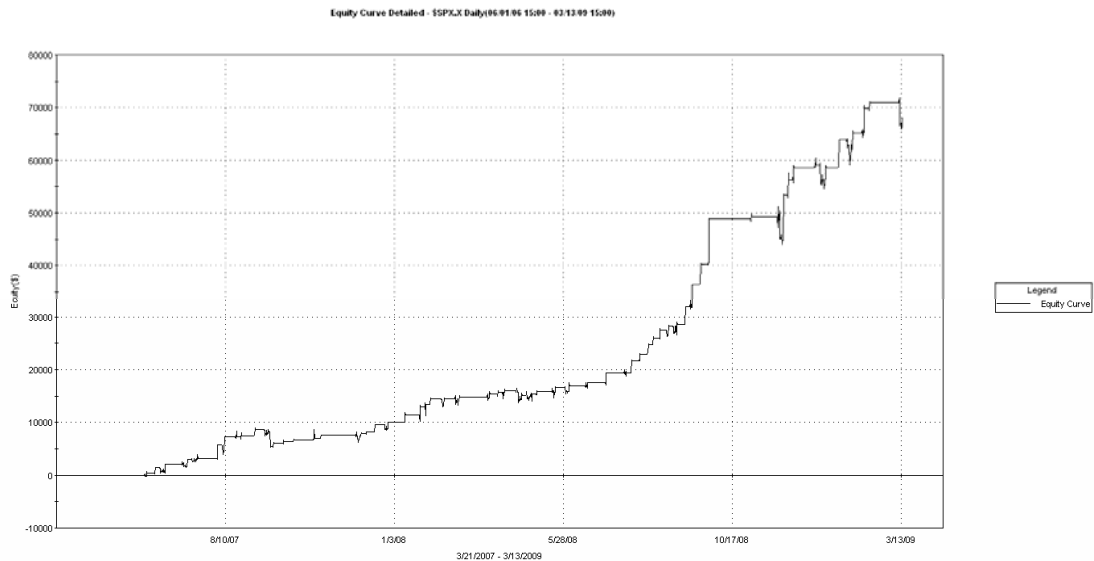
To answer this I thought I’d first examine the equity charts of both 2-days in Chop Strategies. First we’ll look at the “2 Days Down” which looks to get long when the market stats pulling back. It looks to exit upon the 1<sup>st</sup> profitable close up to 3 days later. After 3 days the systems exits regardless of profitability.

### **2 Days Down In Chop.**



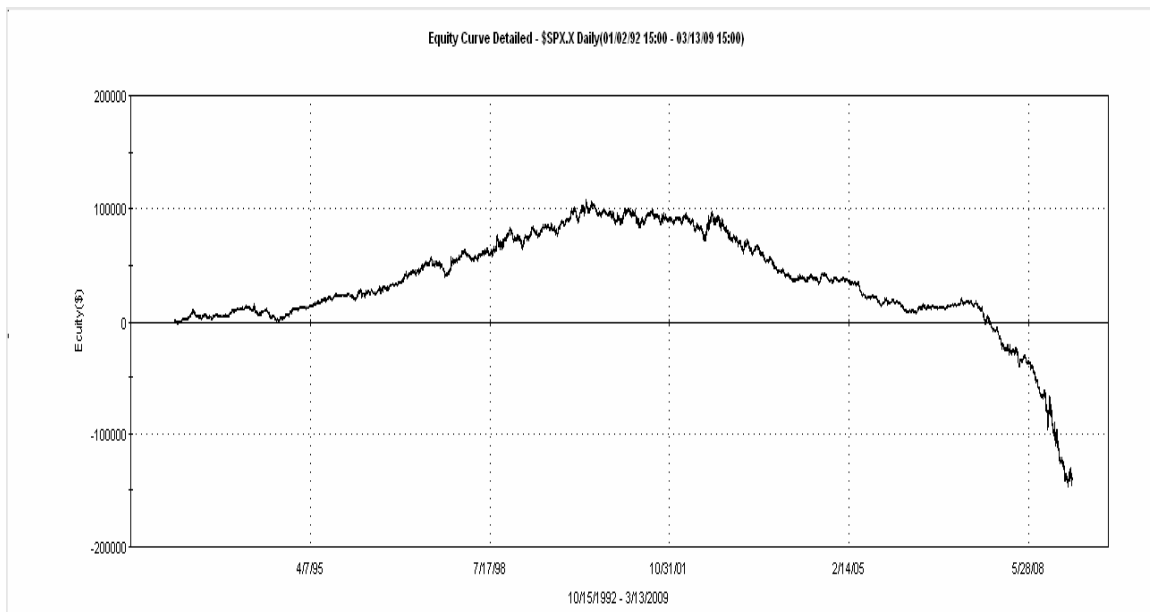
As you can see the last couple of trades have put a nice dent in the accumulated profits. So far the pullback isn’t deeper than anything seen before. Now let’s look at “2 days Up In Chop”.

## 2 Days Up In Chop



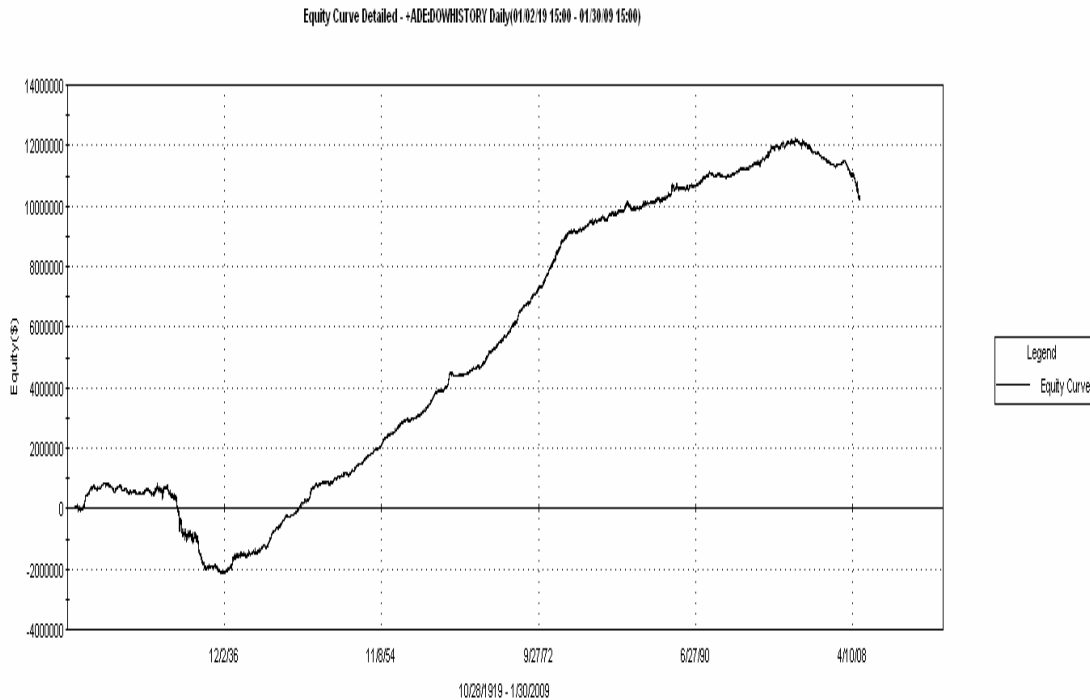
Here again we're seeing a downswing at the end, though not as severe as the one above.

At this point it appears some caution may be warranted, but really the recent sideways to slightly positive action on the Trend vs. Chop chart is barely discernable long term. As a reminder, basic "trend vs. chop" looks to buy any up day and short any down day. Therefore in the chart below a rising equity line would indicate a trendy environment while a falling one would suggest predominate choppyness.



Another thing to keep in mind is that huge character changes such as going from a trendy environment to a choppy one do not normally occur overnight. Rather such shifts in market character are gradual. Below is a Dow Trend vs. Chop chart. Here you can see that very sharp and sustained movements simply haven't occurred. Before the market changes to one that strongly favors trend it is likely we will see a period where neither is heavily favored.

### Dow Trend vs. Chop from 1919



So the recent action may be an early warning sign that the environment is becoming less choppy. Should this continue to happen the first thing I will do is to eliminate the “2 Days In Chop” strategies from consideration when reviewing market studies. Should the current choppy edge remain dormant I will eventually look to incorporate strategies that could take advantage of either neutral or trendy markets. It should be noted that the current systems, which look to take advantage of the chop, have historically done poorly and I would not expect them to continue to produce substantial profits indefinitely.

As an example of what could occur in a trendy environment I did some testing using 1970's data. That decade saw a strong amount of follow through and very little chop. First let's look and see how the “2 Days Down In Chop” would have performed during the 70's:

## All Trades

Total Net Profit	(\$92,071.36)	Profit Factor	0.56
Gross Profit	\$119,419.29	Gross Loss	(\$211,490.65)
Roll Over Credit	\$0.00		
Open Position Profit/Loss	\$0.00		
Select Total Net Profit	(\$87,160.44)	Select Profit Factor	0.55
Select Gross Profit	\$107,147.49	Select Gross Loss	(\$194,307.93)
Adjusted Total Net Profit	(\$119,495.93)	Adjusted Profit Factor	0.48
Adjusted Gross Profit	\$110,911.02	Adjusted Gross Loss	(\$230,406.95)
Total Number of Trades	322	Percent Profitable	61.18%
Winning Trades	197	Losing Trades	125
Even Trades	0		
Avg. Trade Net Profit	(\$285.94)	Ratio Avg. Win:Avg. Loss	0.36
Avg. Winning Trade	\$606.19	Avg. Losing Trade	(\$1,691.93)
Largest Winning Trade	\$5,021.64	Largest Losing Trade	(\$5,833.76)
Largest Winner as % of Gross Profit	4.21%	Largest Loser as % of Gross Loss	2.76%
Net Profit as % of Largest Loss	(1578.25%)		
Slt. Net Profit as % of Largest Loss	(1494.07%)	Adj. Net Profit as % of Largest Loss	(2048.35%)
Max. Consecutive Winning Trades	11	Max. Consecutive Losing Trades	6
Avg. Bars in Winning Trades	2.33	Avg. Bars in Losing Trades	4.00
Avg. Bars in Total Trades	2.98		

As you can see, in a 1970's style environment, this system would be a disaster. In such an environment one thing you'd want to do with a short-term reversal system is give it more room to run. In the below example I looked for at least 5 days down before entering and then rather than looking to sell the 1<sup>st</sup> profitable exit I look for a move above the 10ma up to 4 days later (instead of 3). Below are those results:

## All Trades

Total Net Profit	\$18,133.80	Profit Factor	1.51
Gross Profit	\$53,674.46	Gross Loss	(\$35,540.66)
Roll Over Credit	\$0.00		
Open Position Profit/Loss	\$0.00		
Select Total Net Profit	\$10,637.43	Select Profit Factor	1.30
Select Gross Profit	\$46,178.09	Select Gross Loss	(\$35,540.66)
Adjusted Total Net Profit	\$499.24	Adjusted Profit Factor	1.01
Adjusted Gross Profit	\$43,148.03	Adjusted Gross Loss	(\$42,648.79)
Total Number of Trades	51	Percent Profitable	50.98%
Winning Trades	26	Losing Trades	25
Even Trades	0		
Avg. Trade Net Profit	\$355.56	Ratio Avg. Win:Avg. Loss	1.45
Avg. Winning Trade	\$2,064.40	Avg. Losing Trade	(\$1,421.63)
Largest Winning Trade	\$7,496.37	Largest Losing Trade	(\$4,093.74)
Largest Winner as % of Gross Profit	13.97%	Largest Loser as % of Gross Loss	11.52%
Net Profit as % of Largest Loss	442.96%		
Slect. Net Profit as % of Largest Loss	259.85%	Adj. Net Profit as % of Largest Loss	12.20%
Max. Consecutive Winning Trades	5	Max. Consecutive Losing Trades	4
Avg. Bars in Winning Trades	4.42	Avg. Bars in Losing Trades	5.00
Avg. Bars in Total Trades	4.71		

Here you see that by giving the trade more profit potential the winners tend to outsize the losers and gains are therefore obtainable.

Another way to look at it would be that in a trendy environment you want to try and jump on a trend quick and ride it for several days. Below is a far-too-simple system that looks to go short any down day. If the trade closes a day unprofitable (above the entry price) it is closed out. Otherwise it is allowed to run for 5 days before being closed. In this case instead of looking to quickly exit if we're right (because the environment is choppy and it is likely to reverse and cost us profits), we're looking to quickly exit if we're wrong (because the environment is trendy and it is likely to continue to go against us).

## TradeStation Performance Summary

Collapse 

## All Trades

Total Net Profit	\$180,369.19	Profit Factor	2.06
Gross Profit	\$350,928.23	Gross Loss	(\$170,559.04)
Roll Over Credit	\$0.00		
Open Position Profit/Loss	\$0.00		
Select Total Net Profit	\$172,038.09	Select Profit Factor	2.11
Select Gross Profit	\$326,862.99	Select Gross Loss	(\$154,824.90)
Adjusted Total Net Profit	\$142,795.02	Adjusted Profit Factor	1.79
Adjusted Gross Profit	\$323,184.92	Adjusted Gross Loss	(\$180,389.90)
Total Number of Trades	461	Percent Profitable	34.71%
Winning Trades	160	Losing Trades	301
Even Trades	0		
Avg. Trade Net Profit	\$391.26	Ratio Avg. Win:Avg. Loss	3.87
Avg. Winning Trade	\$2,193.30	Avg. Losing Trade	(\$566.64)
Largest Winning Trade	\$8,467.20	Largest Losing Trade	(\$4,595.16)
Largest Winner as % of Gross Profit	2.41%	Largest Loser as % of Gross Loss	2.69%
Net Profit as % of Largest Loss	3925.20%		
Slct. Net Profit as % of Largest Loss	3743.90%	Adj. Net Profit as % of Largest Loss	3107.51%
Max. Consecutive Winning Trades	7	Max. Consecutive Losing Trades	10
Avg. Bars in Winning Trades	6.00	Avg. Bars in Losing Trades	2.74
Avg. Bars in Total Trades	3.87		

Here we see that although there are almost twice as many losers as winners, the average winner is nearly 4 times the size of the average losers. Therefore the total gross profits are over twice the size of the gross losses.

This isn't what I would call a tradeable system. But it does do a nice job of demonstrating how the market has acted during a trendy period and a few things to consider when looking to take advantage of it.

To summarize, if the market changed from the current choppy to trendy, I'd expect it would be a process and there may likely be an extended period where neither was particularly favored. The first step from a trading standpoint would be to eliminate any very-short term strategies that depended on the chop. If the character did change to trendy then instead of just trading the chop, we'd begin to look for trend continuation strategies. Rather than taking quick profits and being patient with stops as works well in choppy environments the approach would call for letting profits run a little more and using tight stops as demonstrated above.

## **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

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

*none*

### ***Broad Market Large Cap CBI – 2/1 ( RTN-2)***

#### ***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	0.00	DJ US Energy	IYE	1.00
DJ US Insurance Index	IAK	0.00	DJ US Financial	IYF	0.00
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	2.70	DJ US Healthcare	IYH	0.00
DJ US Oil&Gas Expl & Prod	IEO	1.72	DJ US Industrial Sector	IYJ	1.00
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	2.00
DJ US Pharmaceuticals	IHE	2.70	DJ US Basic Materials	IYM	0.00
DJ US Healthcare Providers	IHF	0.00	DJ US Real Estate	IYR	1.00
DJ US Medical Devices	IHI	0.00	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	2.78	DJ US Technology Sector	IYW	0.00
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	1.00
DJ US Consumer Svcs	IYC	0.00	Nasdaq 100	QQQQ	0.00

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

### **Additional New Trade Ideas**

*None tonight. The triggers page came up empty for the 2<sup>nd</sup> day in a row after going several weeks without doing so. Additionally, index edges just aren't strong enough for me to warrant taking a shot at one. I'll wait another day.*

## Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
RTN(1/3)	3/3/2009	\$37.71	\$33.82	-10.32%		Catapult
SPY(1/4)	3/3/2009	\$70.07	\$76.01	8.48%		<b>sold on open</b>
RTN(1/3)	3/4/2009	\$36.45	\$33.82	-7.22%		Catapult

### Note on February Results

I had intended to publish all of the closed trade ideas for February in tonight's Letter. It's getting very late though, so I will hold off on that until tomorrow. I will get that information into tomorrow's Letter, though.

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