

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 18, 2009

Volume 2 Issue 52

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
Active					
March 18, 2009	Overbought going in to Fed day	1 day	Bullish		
March 18, 2009	Lowest vol and highest close in 15	1-4 days	Bearish	-1.40%	-3.70%
March 17, 2009	Gap Up 1% then close negative	1-3 days	Bearish	-5.80%	-10.70%
March 16, 2009	4 Up From 200 Low	1-10 days	Bearish	-4.10%	-8.40%
February 26, 2009	SPX down 1% while SOX up 1%	1-15 days	Bullish	4.60%	7.10%
Active - Long Term					
March 13, 2009	2 90% Up Days	1-25 days	Bullish	8.00%	11.40%
Dropped Tonight					
March 12, 2009	2 Days Up In Chop	1-4 days	Bearish		

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 3/18 – neutral

Prices continued their recent relentless move higher. The S&P rose over 3% while the Nasdaq was up more than 4%. Breadth was strongly positive. Tuesday was the 3rd 90% Up Volume day in the last 6. That's fairly remarkable to have 3 90% days in a 6-day span. The only other instance I could find was in early August of 1984. While breadth was strong, volume was very light, and actually came in at the lightest level in over 3 weeks.

Very light volume is not what you want to see when the market is making new short-term highs. It suggests buying interest is drying up and often leads to at least a mild pullback.

S&P 500 posts its lowest volume in 15 days and its highest close in 15 days.										
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 Fact	Avg Trade
10	(\$9,070.05)	69	35	34	50.72	\$1,766.96	(\$2,085.69)	0.85	0.87	(\$131.45)
9	(\$11,095.03)	70	34	36	48.57	\$1,713.69	(\$1,926.68)	0.89	0.84	(\$158.50)
8	(\$17,326.71)	70	37	33	52.86	\$1,326.38	(\$2,012.20)	0.66	0.74	(\$247.52)
7	(\$12,812.75)	70	32	38	45.71	\$1,459.21	(\$1,565.98)	0.93	0.78	(\$183.04)
6	(\$13,453.69)	71	34	37	47.89	\$1,290.20	(\$1,549.20)	0.83	0.77	(\$189.49)
5	(\$21,931.61)	73	36	37	49.32	\$1,083.68	(\$1,647.14)	0.66	0.64	(\$300.43)
4	(\$27,453.58)	75	35	40	46.67	\$966.94	(\$1,532.41)	0.63	0.55	(\$366.05)
3	(\$15,470.46)	75	36	39	48.00	\$790.93	(\$1,126.77)	0.70	0.65	(\$206.27)
2	(\$15,973.04)	77	39	38	50.65	\$583.91	(\$1,019.62)	0.57	0.59	(\$207.44)
1	(\$7,503.18)	86	40	46	46.51	\$419.25	(\$527.67)	0.79	0.69	(\$87.25)

The underperformance isn't too dramatic but there is a slight bearish tilt. To baseline this study a bit, below is performance following 15 day highs that were not accompanied by either exceptionally high or low volume:

S&P 500 posts its highest close in 15 days. Volume is neither at its highest nor lowest level of the period.										
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 Fac	Avg Trade
10	\$33,211.05	452	236	216	52.21	\$2,060.12	(\$2,097.12)	0.98	1.07	\$73.48
9	\$28,630.74	474	245	229	51.69	\$1,903.80	(\$1,911.79)	1.00	1.07	\$60.40
8	\$36,907.55	495	273	221	55.15	\$1,677.65	(\$1,905.39)	0.88	1.09	\$74.56
7	\$32,644.29	530	289	241	54.53	\$1,531.45	(\$1,701.02)	0.90	1.08	\$61.59
6	\$20,861.73	580	310	270	53.45	\$1,513.73	(\$1,660.72)	0.91	1.05	\$35.97
5	\$16,624.75	645	358	287	55.50	\$1,316.93	(\$1,584.80)	0.83	1.04	\$25.77
4	\$32,396.50	718	384	334	53.48	\$1,188.51	(\$1,269.43)	0.94	1.08	\$45.12
3	\$8,068.31	837	454	383	54.24	\$1,000.44	(\$1,164.83)	0.86	1.02	\$9.64
2	\$25,804.64	1016	538	478	52.95	\$799.45	(\$845.81)	0.95	1.06	\$25.40
1	\$18,963.12	1431	723	702	50.52	\$558.44	(\$548.14)	1.02	1.05	\$13.25

The expectation here is a positive drift that is slightly under the average long-term drift of the market. Ideally what you'd like to see is the market making new highs on high volume. Below are the statistics for that:

S&P 500 posts its highest volume in 15 days and its highest close in 15 days.										
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 Fac	Avg Trade
10	\$93,050.30	207	125	82	60.39	\$2,131.19	(\$2,114.01)	1.01	1.54	\$449.52
9	\$79,678.40	207	122	84	58.94	\$2,045.83	(\$2,022.77)	1.01	1.47	\$384.92
8	\$65,921.94	210	115	95	54.76	\$2,007.83	(\$1,736.62)	1.16	1.40	\$313.91
7	\$73,121.80	214	125	89	58.41	\$1,835.47	(\$1,756.31)	1.05	1.47	\$341.69
6	\$62,326.24	225	128	96	56.89	\$1,752.75	(\$1,687.76)	1.04	1.38	\$277.01
5	\$59,197.44	235	130	105	55.32	\$1,506.60	(\$1,301.53)	1.16	1.43	\$251.90
4	\$61,111.92	239	135	104	56.49	\$1,292.41	(\$1,090.04)	1.19	1.54	\$255.70
3	\$50,643.55	251	140	110	55.78	\$1,080.05	(\$914.22)	1.18	1.50	\$201.77
2	\$51,321.80	263	145	117	55.13	\$871.92	(\$641.94)	1.36	1.68	\$195.14
1	\$40,992.19	308	172	135	55.84	\$606.89	(\$469.58)	1.29	1.65	\$133.09

As you can see the high volume is preferable. Today's exceptionally low volume is the worst case scenario.

Wednesday is an FOMC meeting. In the past I've produced numerous studies examining how the market has performed surrounding these meetings. One scenario I have not yet shown is how the market has performed when it is short-term overbought go into the meeting. Fro this test I used a 2-day RSI to measure different levels of overbought.

S&P 500 2-day RSI closes at X or higher on the day before a scheduled Fed meeting.										
Buy on close. Sell 1 day later. \$100k/trade. 1990-present.										
X RSI	Net Profit	Trades	wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fac	Avg Trade
90	\$6,499.27	22	14	8	63.64	\$735.50	(\$474.72)	1.55	2.71	\$295.42
85	\$8,118.46	32	22	10	68.75	\$660.85	(\$642.03)	1.03	2.26	\$253.70
80	\$15,065.72	44	27	17	61.36	\$876.58	(\$505.99)	1.73	2.75	\$342.40

Over the last 19 years when the market has had positive momentum going into a meeting it has most often been able to maintain that momentum through the day of the announcement.

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



As I indicated was likely to happen last night the green Aggregator line has flipped back to positive. This means the net expectation of the studies over the next 3 days is mildly positive. As the market has continued its march higher the black differential line has remained negative, illustrating the fact that the S&P has exceeded expectations over the last few days.

While I was a bit too early in exiting the long index positions after the market began to bounce, I feel fortunate to have avoided being sucked in to the “overbought in a long-term downtrend” short trigger. I’ve said it before but it bears repeating...the most dangerous time to short is when the market is bouncing strongly off long-term lows. Such bounces can sometimes last longer and bounce higher than most market participants suspect. There is a big difference between shorting short-term overbought in early February to shorting short-term overbought this past week. In early February the market wasn’t working off extended conditions at long-term lows. Properly playing overbought/oversold requires more than just going long or short when the market has moved in one direction for a few days. It requires frequently viewing the move in a greater context.

We're still overbought and I'm still having a hard time finding evidence that a short position carries strong risk/reward. I'm continuing to wait for a pullback to buy in to or more compelling bearish evidence to short. In any case, a solid edge will eventually reveal itself. Until then it is a matter of patience.

Also notable is the fact that the "2 Days Up In Chop" system produced a loser. This is the 3rd chop-based loser in a row (after two 2-days Down In Chop failures). Anyone who may have missed my comments on the recent move away from choppy behavior may want to check out Monday's Subscriber Letter. (link below)

[2009-03-16 QE Subscriber Letter.pdf](#)

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.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Triggers

none

Catapult for ETF's Trades

none

Broad Market Large Cap CBI – 0

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	1.16
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	0.00	DJ US Healthcare	IYH	0.00
DJ US Oil&Gas Expl & Prod	IEO	1.72	DJ US Industrial Sector	IYJ	0.00
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	0.00
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	0.00
DJ US Healthcare Providers	IHF	0.00	DJ US Real Estate	IYR	0.00
DJ US Medical Devices	IHI	0.00	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	0.00	DJ US Technology Sector	IYW	0.00
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	2.63
DJ US Consumer Svcs	IYC	0.00	Nasdaq 100	QQQQ	0.00

Additional New Trade Ideas

None tonight. A few short triggers did make the systems sheet tonight.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
RTN(1/3)	3/3/2009	\$37.71	\$35.39	-6.15%		sell on open
RTN(1/3)	3/4/2009	\$36.45	\$35.39	-2.91%		sell on open

A late-day surge allowed RTN to hit its target price. It will be closed out as a trade idea at Wednesday's open.

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