

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 23, 2009

Volume 2 Issue 55

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 21, 2009	Op-ex Friday 1% Drop	1-4 days	Bearish	-2.90%	-5.20%
March 21, 2009	High Volume 1% Drop	1-5 days	Bearish	-1.50%	-3.60%
March 21, 2009	2 Down In Chop	1-3 days	Bullish		
March 20, 2009	Nas Spyx < 0 whil Nas > 10ma	1-7 days	Bearish	-5.10%	-10.90%
March 20, 2009	Gap Up 1% then close negative	1-3 days	Bearish	-5.80%	-10.70%
March 19, 2009	Fed Day Spike	1-8 days	Bearish		
March 19, 2009	Appel Daily Breadth	1-20 days	Bullish		
March 18, 2009	Lowest vol and highest close in 15	1-4 days	Bearish	-1.40%	-3.70%
March 16, 2009	4 Up From 200 Low	1-10 days	Bearish	-4.10%	-8.40%
Active - Long Term					
March 13, 2009	2 90% Up Days	1-25 days	Bullish	8.00%	11.40%
Dropped Tonight					

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 3/23 – neutral

The market continued to pull back on Friday. The selloff was broad and sharp. The S&P lost 2% while the Nasdaq lost 1.8%. Breadth was solidly negative. The NYSE Up Issues % closed at 24% and the Up Volume % at 15%. Volume, aided somewhat by options expiration, came in at the highest level in months.

In the past I've discussed that the week following option expiration has had a negative expectation and this expectation has been worse when option expiration Friday closed down. Below are some tests from the 10/19 Subscriber Letter:

First, let's look at a few stats to provide some baselines.

This study shows how the market has performed in weeks not following an options expiration.

Today is a Friday with no options expiration.												
Buy SPX on close. Sell X days later. \$100k/trade. 1987-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	\$257,016.23	763	454	309	59.50	\$7,515.60	(\$18,000.90)	\$1,731.83	(\$1,712.73)	1.01	1.49	\$336.85
4	\$215,978.61	841	499	342	59.33	\$7,145.28	(\$17,037.90)	\$1,429.39	(\$1,454.06)	0.98	1.43	\$256.81
3	\$168,219.58	842	496	343	58.91	\$6,877.26	(\$10,286.10)	\$1,224.81	(\$1,280.72)	0.96	1.38	\$199.79
2	\$147,855.42	842	481	359	57.13	\$10,965.69	(\$9,270.00)	\$1,068.42	(\$1,019.65)	1.05	1.40	\$175.60
1	\$112,606.22	842	499	343	59.26	\$11,558.43	(\$8,265.12)	\$763.59	(\$782.58)	0.98	1.42	\$133.74

As you would expect it has typically risen over the last 21 years.

Now let's look at weeks following option expiration:

Today is options expiration.												
Buy SPX on close. Sell X days later. \$100k/trade. 1987-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	(\$71,086.79)	257	121	136	47.08	\$7,739.42	(\$12,167.91)	\$1,321.99	(\$1,698.88)	0.78	0.69	(\$276.60)
4	(\$63,300.30)	257	117	140	45.53	\$5,439.43	(\$12,157.32)	\$1,222.89	(\$1,474.13)	0.83	0.69	(\$246.30)
3	(\$39,430.09)	257	118	139	45.91	\$4,592.40	(\$8,584.96)	\$1,154.56	(\$1,263.80)	0.91	0.78	(\$153.42)
2	(\$72,341.85)	257	116	141	45.14	\$4,786.41	(\$16,188.58)	\$876.65	(\$1,234.28)	0.71	0.58	(\$281.49)
1	(\$64,249.59)	257	104	152	40.47	\$3,877.95	(\$20,424.58)	\$746.38	(\$933.38)	0.80	0.55	(\$250.00)

As you can see, the stats are not only significantly worse, but also carry a negative expectation. A look at the Max Loss column reveals that Black Monday occurred following option expiration. So as not to skew some results more negatively, I'll exclude this outlier date for the rest of the tests. First I'll re-run the above test look at performance after all op-ex Friday's.

Today is options expiration. 10/16/87 excluded.												
Buy SPX on close. Sell X days later. \$100k/trade. 1987-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	(\$58,918.88)	256	121	135	47.27	\$7,739.42	(\$5,973.00)	\$1,321.99	(\$1,621.33)	0.82	0.73	(\$230.15)
4	(\$51,142.98)	256	117	139	45.70	\$5,439.43	(\$6,334.85)	\$1,222.89	(\$1,397.28)	0.88	0.74	(\$199.78)
3	(\$30,845.13)	256	118	138	46.09	\$4,592.40	(\$5,455.74)	\$1,154.56	(\$1,210.75)	0.95	0.82	(\$120.49)
2	(\$56,153.27)	256	116	140	45.31	\$4,786.41	(\$5,855.85)	\$876.65	(\$1,127.46)	0.78	0.64	(\$219.35)
1	(\$43,825.01)	256	104	151	40.63	\$3,877.95	(\$3,791.21)	\$746.38	(\$804.30)	0.93	0.64	(\$171.19)

Even with Black Monday excluded the results remain strongly negative.

Next is performance following options expirations when the SPX is trading under its 200-day moving average:

Today is options expiration. SPX closes < 200ma. 10/16/87 is excluded.												
Buy SPX on close. Sell X days later. \$100k/trade. 1987-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	(\$23,650.57)	72	36	36	50.00	\$7,739.42	(\$5,973.00)	\$1,387.34	(\$2,044.30)	0.68	0.68	(\$328.48)
4	(\$30,179.80)	72	30	42	41.67	\$5,439.43	(\$6,334.85)	\$1,327.23	(\$1,666.59)	0.80	0.57	(\$419.16)
3	(\$27,296.94)	72	32	40	44.44	\$4,508.00	(\$5,455.74)	\$1,247.20	(\$1,680.18)	0.74	0.59	(\$379.12)
2	(\$27,231.30)	72	31	41	43.06	\$4,786.41	(\$5,855.85)	\$1,023.42	(\$1,437.98)	0.71	0.54	(\$378.21)
1	(\$12,039.86)	72	31	40	43.06	\$3,877.95	(\$3,791.21)	\$936.16	(\$1,026.52)	0.91	0.71	(\$167.22)

Under the 200ma performance has been even worse.

What about if op-ex Friday the market closed lower?

Today is options expiration. SPX closes < yesterday's close. 10/16/87 excluded.												
Buy SPX on close. Sell X days later. \$100k/trade. 1987-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	(\$18,207.79)	108	53	55	49.07	\$7,739.42	(\$5,973.00)	\$1,381.47	(\$1,662.29)	0.83	0.80	(\$168.59)
4	(\$30,638.56)	108	50	58	46.30	\$5,439.43	(\$6,334.85)	\$1,237.29	(\$1,594.88)	0.78	0.67	(\$283.69)
3	(\$20,458.17)	108	49	59	45.37	\$4,277.94	(\$3,701.20)	\$1,236.16	(\$1,373.39)	0.90	0.75	(\$189.43)
2	(\$37,715.99)	108	45	63	41.67	\$4,786.41	(\$5,855.85)	\$994.92	(\$1,309.32)	0.76	0.54	(\$349.22)
1	(\$33,715.02)	108	43	64	39.81	\$3,877.95	(\$3,264.30)	\$713.91	(\$1,006.45)	0.71	0.48	(\$312.18)

This also has a negative impact – especially early in the week.

Lastly, let's see what happens when it's all combined:

Today is options expiration. SPX closes < 200ma and lower than yesterday. 10/16/87 excluded.												
Buy SPX on close. Sell X days later. \$100k/trade. 1987-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	(\$5,135.90)	34	19	15	55.88	\$7,739.42	(\$5,973.00)	\$1,537.24	(\$2,289.57)	0.67	0.85	(\$151.06)
4	(\$19,849.03)	34	15	19	44.12	\$5,439.43	(\$6,334.85)	\$1,481.86	(\$2,214.58)	0.67	0.53	(\$583.80)
3	(\$15,385.66)	34	14	20	41.18	\$4,247.72	(\$3,701.20)	\$1,356.58	(\$1,718.89)	0.79	0.55	(\$452.52)
2	(\$17,498.79)	34	12	22	35.29	\$4,786.41	(\$5,855.85)	\$1,298.15	(\$1,503.48)	0.86	0.47	(\$514.67)
1	(\$10,009.11)	34	14	19	41.18	\$3,877.95	(\$3,264.30)	\$1,008.53	(\$1,269.92)	0.79	0.59	(\$294.39)

Losses of over 1/2% on average for the next 2-4 days are the worst in the sample.

What wasn't reviewed in the October testing was what happens if the Friday selloff is sizable. Below are those stats and they are even more bearish:

Today is options expiration. S&P closes < 200 ma and down over 1% from yesterday 10/16/87 excluded.												
Buy S&P 500 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		
5	(\$10,994.14)	29	15	14	51.72	\$2,004.81	(\$2,933.31)	0.68	0.73	(\$379.11)		
4	(\$30,806.55)	29	11	18	37.93	\$1,953.89	(\$2,905.52)	0.67	0.41	(\$1,062.29)		
3	(\$21,496.64)	29	11	18	37.93	\$1,598.84	(\$2,171.32)	0.74	0.45	(\$741.26)		
2	(\$23,558.07)	29	8	21	27.59	\$1,594.73	(\$1,729.33)	0.92	0.35	(\$812.35)		
1	(\$18,633.53)	29	11	17	37.93	\$835.24	(\$1,636.54)	0.51	0.33	(\$642.54)		

As was done with the October tests, I also ran this one back to 1987. Those results were consistent with the results above for days 1-4.

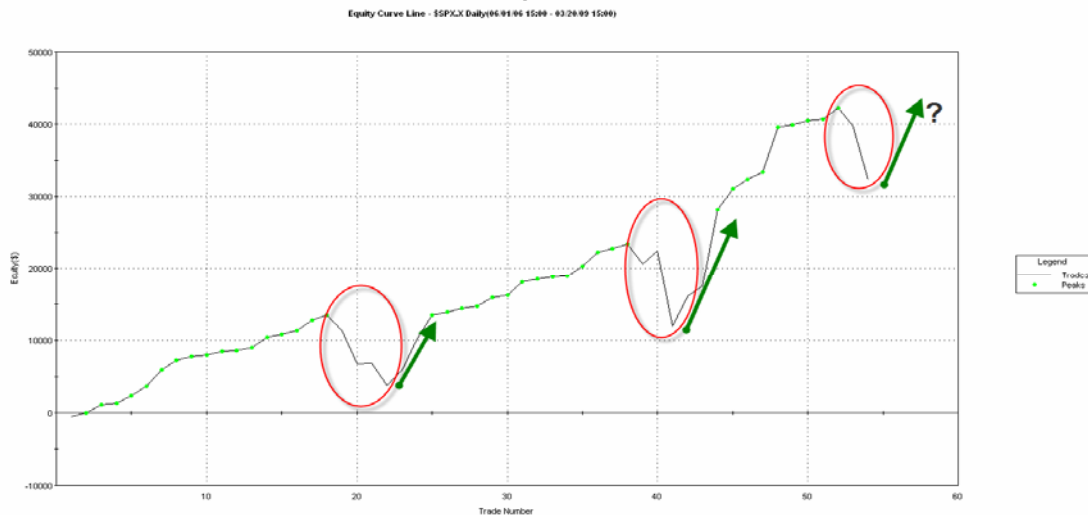
The fact that the sharp drop on Friday also occurred on high volume and not at a low point is also a bit troublesome. When the market sells off on high volume and is simultaneously hitting a 10 or 20-day low then is sometimes a sign of capitulation. Those times cancel out the times it isn't and the end result is there is no significant edge on high volume selloffs at lows. When you're not at a low and the chance of the selloff being capitulatory is therefore eliminated, then the implications are more bearish short-term.

NYSE volume is highest in 20 days. S&P 500 closes down at least 1% but not at a 10-day low.												
Buy S&P 500 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		
5	(\$14,902.73)	16	6	10	37.50	\$1,287.03	(\$2,262.49)	0.57	0.34	(\$931.42)		
4	(\$14,108.59)	16	4	12	25.00	\$1,813.03	(\$1,780.06)	1.02	0.34	(\$881.79)		
3	(\$9,417.07)	16	4	12	25.00	\$2,068.50	(\$1,474.26)	1.40	0.47	(\$588.57)		
2	(\$11,118.07)	16	6	10	37.50	\$1,596.68	(\$2,069.82)	0.77	0.46	(\$694.88)		
1	(\$5,589.48)	16	6	10	37.50	\$559.82	(\$894.84)	0.63	0.38	(\$349.34)		

On the positive side, Friday was the 2nd day down in a row – activating our “2 days down in chop” system. As review, the system looks to go long any time the S&P closes lower 2 days in a row. It exits at the 1st profitable close up to 3 days later. After 3 days the trade is exited regardless of profitability. It is a simple system that has been effective during the incredibly choppy market conditions since 6/1/2007. Below is an updated performance report covering the period of 6/1/2007 – present.

TradeStation Performance Summary				Collapse ^
All Trades				
Total Net Profit	\$32,329.60	Profit Factor	1.97	
Gross Profit	\$65,629.46	Gross Loss	(\$33,299.86)	
Roll Over Credit	\$0.00			
Open Position Profit/Loss	\$0.00			
Select Total Net Profit	\$21,613.57	Select Profit Factor	1.65	
Select Gross Profit	\$54,913.43	Select Gross Loss	(\$33,299.86)	
Adjusted Total Net Profit	\$10,879.79	Adjusted Profit Factor	1.24	
Adjusted Gross Profit	\$55,952.92	Adjusted Gross Loss	(\$45,073.14)	
Total Number of Trades	54	Percent Profitable	85.19%	
Winning Trades	46	Losing Trades	8	
Even Trades	0			
Avg. Trade Net Profit	\$598.70	Ratio Avg. Win:Avg. Loss	0.34	
Avg. Winning Trade	\$1,426.73	Avg. Losing Trade	(\$4,162.48)	
Largest Winning Trade	\$10,716.03	Largest Losing Trade	(\$10,506.45)	

While it looks fairly solid on the surface, the last two trades have been big losers. This has raised concern that the environment may be changing to one that may not favor these trades anymore. To see how the recent drawdown stacks up with others over the test period I've included below an equity curve.



As you can see there were only two other losing periods. Both included sharp losses similar to the recent one. Both of them also saw extremely sharp rebounds from those losses. If the equity curve can recover sharply as it's done in the past, my concerns about the changing environment making the system obsolete will be largely alleviated.

With these studies in mind, below is tonight's [Aggregator](#) chart:



The green Aggregator line remains squarely below 0 while the black differential line has moved above 0 for the first time in a few weeks. This indicates that the net expectations of the studies is bearish for the next few days while the S&P has underperformed expectations over the last few days. Ideally you'd want to see both lines on the same side of zero when considering taking a position.

We've had a few breadth-related studies that have suggested the rally from the lows was so strong that an intermediate-term continuation is likely. Unfortunately we've yet to uncover additional evidence based on price movements, volume, or sentiment that would confirm what breadth is saying. Most of the recent short-term studies remain bearish.

This is making it difficult to find an entry point with favorable risk/reward. Rather than press I'll continue to remain patient and wait for a more obvious edge to reveal itself before taking positions. From a technical support standpoint, the 1st level where I see anything is around 740. If I'm going to enter long it would be nice to be a bit closer to that level before doing so.

From an individual stocks standpoint, the triggers page has been quiet lately as well. That normally doesn't stay quiet for too long so I'll continue to monitor that for opportunities as well.

Intermediate-term Outlook (2 weeks – 2 months)–neutral -updated 3/23

Just two quick points to discuss tonight for the intermediate-term. First, while I've been expecting a substantial rally at least lasting several weeks to emerge at some point, the fact is that the current rally already ran up over 20% from low to high. On Thursday I discussed the fact that this is the third such 20% rally since the fall. The only other period of time with such a close cluster of 20% rallies occurred in 1931-33. Results were mixed following those rallies, but the ones in the fall both petered out almost immediately. There's a possibility that the market has already come so far so fast that it may not have a lot left in this rally.

I've also been asked about the propensity of the market to test lows before forming a lasting bottom. In looking back at major bottoms in the S&P 500 from 1960 – present I did find a large percentage of them had some kind of retest. I haven't yet quantified the results, but it raises the possibility that the S&P may drop down to a few percentage points of the 666 bottom before continuing its rally.

Overall I've been quite impressed with the magnitude of the rally of the recent lows – especially from a breadth standpoint. While there's a bit of a lack of short-term bullish studies at the moment, I'm still optimistic that the breadth thrusts we've seen will help to lead this market on a rally lasting several weeks or months and taking us up 30% or more. The evidence isn't yet overwhelming so from a trading standpoint I'll forego a strong intermediate-term bias and defer to my short-term bias.

Special Note For Intraday Traders

Last year I did some studies on the blog look at how the market reacted to different morning gap sizes. I defined a “large gap” as anything greater than 0.75%. Since early fall that hasn't even been an average size gap. As I'm finalizing the Letter late Sunday night the S&P futures are trading up close to 2%. Below are the results of a test that looked to by just after a large gap up and then sell at the end of the day. They are run for varying gap sizes going back to September 2008.

SPY gaps up at least X%.										
Buy at close of 1st minute. Sell at 4pm market close. \$100k/trade. September 2008 - present.										
X% Gap	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
2	\$15,645.58	15	9	6	60.00	\$3,622.78	(\$2,826.57)	1.28	1.92	\$1,043.04
1.5	\$9,874.05	22	12	10	54.55	\$3,264.15	(\$2,929.57)	1.11	1.34	\$448.82
1	\$9,117.76	31	16	15	51.61	\$3,129.72	(\$2,730.52)	1.15	1.22	\$294.12

Large gaps higher in downtrends have historically shown a propensity to squeeze shorts and continue higher over the course of the trading day. This propensity has continued to exist over the last 6 months or so while the market has been especially “gappy”.

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	0.00
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	0.00	DJ US Healthcare	IYH	0.70
DJ US Oil&Gas Expl & Prod	IEO	0.00	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	0.00
DJ US Consumer Svcs	IYC	0.00	Nasdaq 100	QQQQ	0.00

Nothing doing from a CBI standpoint currently..

Additional New Trade Ideas

None tonight

Active Trades Table

None

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