

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

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## 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 27, 2009	2 Days Up In Chop	1-4 Days	Bearish		
March 25, 2009	20day high with low volume & range	1-10 days	Bearish	-2.50%	-4.60%
March 24, 2009	High Volume 1% Drop	1-6 days	Bearish	-5.30%	-9.50%
March 23, 2009	High Volume 1% Drop	1-5 days	Bearish	-1.50%	-3.60%
March 20, 2009	Nas Spyx < 0 whil Nas > 10ma	1-7 days	Bearish	-5.10%	-10.90%
March 19, 2009	Fed Day Spike	1-8 days	Bearish		
March 19, 2009	Appel Daily Breadth	1-20 days	Bullish		
March 16, 2009	4 Up From 200 Low	1-10 days	Bearish	-4.10%	-8.40%
<b>Active - Long Term</b>					
March 26, 2009	Rise after follow through day		Bullish		
<b>March 13, 2009</b>	<b>2 90% Up Days</b>	<b>1-25 days</b>	<b>Bullish</b>	<b>8.00%</b>	<b>11.40%</b>
<b>Dropped Tonight</b>					
March 23, 2009	Op-ex Friday 1% Drop	1-4 days	Bearish	-2.90%	-5.20%
March 24, 2009	2% Gaps Up	1-2 days	Bearish	-3.70%	-7.70%

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 3/27 – slightly bearish*

The market continued to roar ahead again Thursday despite all of the bearish indications from the market studies. The S&P rose over 2% and the Nasdaq nearly 4%. Breadth was again strongly positive – especially on the Nasdaq where the Up Volume % came in at 94%. Total NYSE volume was close to Wednesday's.

Such strong breadth on the Nasdaq has often led to a pullback the next day. Below are the S&P returns the day after Nasdaq Up Volume % exceeded certain levels:

<i>Nasdaq Up Volume % exceeds X%.</i>										
<i>Buy S&amp;P 500 on close. Sell next day. \$100k/trade. 2001-present.</i>										
X %	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
0.88	(\$8,096.30)	51	22	29	43.14	\$846.32	(\$921.22)	0.92	0.70	(\$158.75)
0.89	(\$7,590.62)	44	17	27	38.64	\$918.94	(\$859.73)	1.07	0.67	(\$172.51)
0.9	(\$4,781.52)	35	14	21	40.00	\$791.45	(\$755.33)	1.05	0.70	(\$136.61)
0.91	(\$4,259.77)	25	11	14	44.00	\$662.83	(\$825.06)	0.80	0.63	(\$170.39)
0.92	(\$4,123.78)	16	6	10	37.50	\$703.06	(\$834.21)	0.84	0.51	(\$257.74)
0.93	(\$5,442.93)	10	3	7	30.00	\$618.15	(\$1,042.48)	0.59	0.25	(\$544.29)
0.94	(\$3,728.51)	5	1	4	20.00	\$242.88	(\$992.85)	0.24	0.06	(\$745.70)

Generally the stronger the breadth the better the chance of a pullback the next day.

Over a year ago on the blog I posted a simple study that looked at S&P performance following [two consecutive days where it rose at least 0.75%](#) and closed below the 200ma. At the time the 0.75% hurdle was a good sized 1-day move. In the last year a move of that magnitude hasn't been significant. Still, I thought it would be interesting to go back and run the results again using the same parameters.

<b>S&amp;P 500 close up over 0.75% two days in a row and under the 200ma.</b>										
<b>Buy on close. Sell X days later. \$100k/trade. 1980-present.</b>										
<b>X days</b>	<b>Net Profit</b>	<b>Trades</b>	<b>Wins</b>	<b>Losses</b>	<b>% Wins</b>	<b>Avg Win</b>	<b>Avg Loss</b>	<b>W/L Ratio</b>	<b>Profit Factor</b>	<b>Avg Trade</b>
10	(\$69,076.34)	67	27	40	40.30	\$2,723.96	(\$3,565.58)	0.76	0.52	(\$1,030.99)
9	(\$44,287.09)	72	34	38	47.22	\$2,497.74	(\$3,400.27)	0.73	0.66	(\$615.10)
8	(\$36,762.12)	74	33	41	44.59	\$2,597.36	(\$2,987.20)	0.87	0.70	(\$496.79)
7	(\$55,282.18)	77	31	46	40.26	\$2,864.37	(\$3,132.13)	0.91	0.62	(\$717.95)
6	(\$34,083.53)	81	37	44	45.68	\$2,684.39	(\$3,031.95)	0.89	0.74	(\$420.78)
5	(\$38,470.91)	82	37	45	45.12	\$2,106.89	(\$2,587.24)	0.81	0.67	(\$469.16)
4	(\$60,654.10)	87	37	50	42.53	\$1,616.26	(\$2,409.11)	0.67	0.50	(\$697.17)
3	(\$45,057.98)	91	40	51	43.96	\$1,526.86	(\$2,081.02)	0.73	0.58	(\$495.14)
2	(\$27,016.13)	93	42	51	45.16	\$1,253.50	(\$1,562.02)	0.80	0.66	(\$290.50)
1	(\$42,014.19)	106	39	67	36.79	\$900.98	(\$1,151.53)	0.78	0.46	(\$396.36)

These results are similar to the ones I showed last year. In fact the negative influence is now even more pronounced. To see how poorly the market has performed under these conditions in the last year I re-ran the test to show just the time period since the original blog piece:

<b>S&amp;P 500 close up over 0.75% two days in a row and under the 200ma.</b>										
<b>Buy on close. Sell X days later. \$100k/trade. 2/24/08-present.</b>										
<b>X days</b>	<b>Net Profit</b>	<b>Trades</b>	<b>Wins</b>	<b>Losses</b>	<b>% Wins</b>	<b>Avg Win</b>	<b>Avg Loss</b>	<b>W/L Ratio</b>	<b>Profit Factor</b>	<b>Avg Trade</b>
10	(\$37,543.54)	9	3	6	33.33	\$2,184.00	(\$7,349.26)	0.30	0.15	(\$4,171.50)
9	(\$20,334.62)	12	5	7	41.67	\$4,134.50	(\$5,858.16)	0.71	0.50	(\$1,694.55)
8	(\$22,396.24)	12	5	7	41.67	\$2,739.38	(\$5,156.16)	0.53	0.38	(\$1,866.35)
7	(\$30,783.17)	13	3	10	23.08	\$2,935.66	(\$3,959.01)	0.74	0.22	(\$2,367.94)
6	(\$25,154.30)	13	4	9	30.77	\$3,200.13	(\$4,217.20)	0.76	0.34	(\$1,934.95)
5	(\$21,138.87)	13	4	9	30.77	\$1,480.83	(\$3,006.91)	0.49	0.22	(\$1,626.07)
4	(\$24,823.23)	13	5	8	38.46	\$1,562.73	(\$4,079.61)	0.38	0.24	(\$1,909.48)
3	(\$7,183.15)	16	6	10	37.50	\$3,830.69	(\$3,016.73)	1.27	0.76	(\$448.95)
2	(\$14,725.93)	16	6	10	37.50	\$2,452.75	(\$2,944.24)	0.83	0.50	(\$920.37)
1	(\$21,308.20)	17	6	11	35.29	\$814.46	(\$2,381.36)	0.34	0.19	(\$1,253.42)

The fact that the 0.75% hurdle has become easier to achieve hasn't weakened the bearish influence of the setup. I attribute the primary reason for this to be the [exceptionally choppy environment](#) the market has been in over the time period.

To that end, "2 Days Up In Chop" has once again triggered. Below is an updated performance report of the system since 6/1/07. As a refresher, the system looks to sell short following the 2<sup>nd</sup> consecutive up day and then covers the 1<sup>st</sup> profitable close up to 4 days later. On day 4 the position is closed out regardless of profitability. Results are based on \$100k/trade.

## All Trades

Total Net Profit	\$64,020.42	Profit Factor	6.22
Gross Profit	\$76,279.29	Gross Loss	(\$12,258.87)
Roll Over Credit	\$0.00		
Open Position Profit/Loss	\$0.00		
Select Total Net Profit	\$55,237.40	Select Profit Factor	5.51
Select Gross Profit	\$67,496.27	Select Gross Loss	(\$12,258.87)
Adjusted Total Net Profit	\$47,605.49	Adjusted Profit Factor	3.59
Adjusted Gross Profit	\$65,993.79	Adjusted Gross Loss	(\$18,388.30)
Total Number of Trades	59	Percent Profitable	93.22%
Winning Trades	55	Losing Trades	4
Even Trades	0		
Avg. Trade Net Profit	\$1,085.09	Ratio Avg. Win:Avg. Loss	0.45
Avg. Winning Trade	\$1,386.90	Avg. Losing Trade	(\$3,064.72)
Largest Winning Trade	\$8,783.02	Largest Losing Trade	(\$7,832.88)
Largest Winner as % of Gross Profit	11.51%	Largest Loser as % of Gross Loss	63.90%

Results remain excellent and the system is now further helped by the fact that it also meets the 0.75% per day criteria.

Not only is there a deluge of bearish studies, but the bullish ones are now nearing their targets. The double 90% days Max Move + 1 Standard Deviation would be about 836 in the S&P. It's only just over 3 points away. Regardless of whether it achieves it tomorrow or not, I'm likely going to remove it from the board. It's close enough for such a large target. I believe further upside will depend on additional bullish influences and will no longer be attributable to the initial double 90% thrust. Removing this bullish study will have a similar affect on the Aggregator as adding a strongly bearish study would.

Speaking of the [Aggregator](#) tonight's chart is below:



While not as stretched as yesterday, both the green Aggregator line and the black differential line remains squarely below zero. This indicates bearish expectations from the studies over the next few days and illustrates the market has outperformed expectations over the last few days. The configuration therefore remains one that favors the short side.

I scaled in to the first  $\frac{1}{4}$  of an index position Thursday afternoon and will look to add to it on Friday should we get a muted move higher. Details in the trade idea section below.

### ***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.

**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.)***

<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	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	0.00
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

Absolutely nothing.

### **Additional New Trade Ideas**

*SPY* – short another 1/4 index position on a close between \$83.11 and \$83.90. If it moves strongly higher then I'll hold off until Monday to add more. The reason being we have seen many times that strong moves on Friday tend to carry through into Monday.

### **Active Trades Table**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
KO(s)	3/26/2009	\$44.85	\$44.85	0.00%		cover on close < 5ma
SPY(1/4)(s)	3/26/2009	\$83.11	\$83.11	0.00%		shorted on close

A few subscribers have asked me to demonstrate how I might use options to take advantage of some of the trade ideas. For those not familiar with how I often use options in my short-term trading you may refer to [these posts](#).

Coke (KO) is a decent candidate for an option trade instead of an outright short. This is due to its relatively high price (\$44.85) and the fairly narrow spread on the options. As you may recall, I normally go front month deep in the money. This keeps me from having to pay much premium (although with a VIX at 40 instead of 20 options are a bit more expensive these days than when I wrote those blog posts). I opted for trading the KO stock this afternoon since I wasn't taking a very large position and my account was heavy in cash. If either of those were not true then I'd likely be looking at buying a put option.

The option that I'd most likely trade would be KO PX (the April 52.5 strike). It is carrying very little premium and had a \$0.10 spread at times during the day. The spread maxed out at \$0.20, which is larger than desirable if it was always there, but it wasn't. Also, you should keep in mind, it isn't always necessary to pay the full spread. You can place a bid in between and wait for someone to hit it.

The big points to remember when considering an option vs. a stock for a short-term trade is that using the option provides a natural stop (0) as a worst-case scenario. It also requires much less cash outlay. On the other hand, you will lose some to slippage because of the wider spreads and depending on the option, the length of the trade, and the time to expiration, time decay could also become a factor.

I'll follow up on this idea as the KO trade plays out.

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