

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 8, 2009

Volume 2 Issue 67

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					
April 8, 2009	1% drop with 2:1 decliners	1-9 days	Bullish	2.60%	5.50%
April 8, 2009	2 down in chop	1-2 days	Bullish		
April 8, 2009	Big Gap Low Range Down	1 day	Bearish		
April 8, 2009	SPX down 1% on lowest Vol in 20	1-2 days	Bearish		
April 7, 2009	NYSE Volume 20-day low, SPX>10ma	1-2 days	Bearish	-1.80%	-3.20%
April 6, 2009	Bearish Perfect Storm	1-3 days	Bearish	-3.30%	-5.20%
April 2, 2009	2 Strong Breadth Days - No 10 High	1-8 days	Bearish	-3.30%	-6.00%
April 1, 2009	1% below high but up on day	1-7 days	Bullish	6.10%	9.90%
March 30, 2009	20 low range and vol while SPY>10ma	1-10 days	Bearish	-4.40%	-9.90%
Active - Long Term					
April 6, 2009	Appel Daily Breadth	1-20 days	Bullish		
March 26, 2009	Rise after follow through day		Bullish		
Dropped Tonight					
April 2, 2009	2 Days up in chop	1-4 days	Bearish		
March 31, 2009	Double Dn 1.75% No 10-low	1-9 days	Bullish	5.00%	7.90%
March 25, 2009	20day high with low volume & range	1-10 days	Bearish	-2.50%	-4.60%

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 4/8 – slightly bearish

Tuesday was a bit of an oddball day. After gapping down over 1.5% the market traded in a tight range on low volume. The major indices all closed down well over 2%. Breadth was strongly negative as the NYSE Up Issue % came in at 21% and the Up Volume % at 15%. Total volume again was the lowest in over a month.

The “bearish perfect storm” I discussed Sunday night has played out largely as expected over the last two days. Unfortunately due to the gap down that went unfilled on Monday, all but futures traders who were able to take a position early Monday morning, or those traders who took a more aggressive approach to entry than the Subscriber Letter, were unable to take advantage of the move lower. While it can be quite frustrating at times, missing out on occasional trades is just part of trading. Another opportunity will come along soon enough. Most months we see 3-4 decent swing trading opportunities for the indices.

The current setup is no longer a perfect storm. I’m now seeing some mixed indications that suggest little short-term edge. Let’s review a few of them.

As discussed a few days ago, the low volume and low range help to make an argument for the bearish case. The low volume on a sizable down day is something I discussed on the blog [on August 19, 2008](#). I discussed bearish implications of low range just a couple of nights ago. What I found interesting today was just how low the intraday range was in comparison to the size of the gap. Large gaps often lead to volatile trading during the regular session. Tuesday's gap down had almost no reaction. Rarely has there been a gap down that was larger than the intraday range and led to a close below the open. Below is a table showing SPY performance following such occurrences:

SPY gaps down, closes below the open and the intraday range is less than the size of the overnight gap.										
Buy on close. Sell X days later. \$100k/trade. 1987-present.										
X Days	New Profits	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$16,809.46)	11	5	6	45.45	\$1,670.72	(\$4,193.84)	0.40	0.33	(\$1,528.13)
9	(\$15,365.23)	11	4	7	36.36	\$1,812.97	(\$3,231.01)	0.56	0.32	(\$1,396.84)
8	(\$8,006.37)	11	5	6	45.45	\$2,159.87	(\$3,134.29)	0.69	0.57	(\$727.85)
7	(\$6,914.87)	11	5	6	45.45	\$2,145.42	(\$2,940.33)	0.73	0.61	(\$628.62)
6	(\$6,032.32)	11	6	5	54.55	\$1,141.09	(\$2,575.77)	0.44	0.53	(\$548.39)
5	(\$2,743.48)	11	6	5	54.55	\$1,072.90	(\$1,836.17)	0.58	0.70	(\$249.41)
4	(\$6,463.80)	11	5	6	45.45	\$1,960.36	(\$2,710.93)	0.72	0.60	(\$587.62)
3	(\$5,781.02)	11	4	7	36.36	\$814.78	(\$1,291.45)	0.63	0.36	(\$525.55)
2	(\$5,370.78)	11	3	6	27.27	\$598.61	(\$1,194.44)	0.50	0.25	(\$488.25)
1	(\$6,283.78)	11	2	9	18.18	\$56.66	(\$710.79)	0.08	0.02	(\$571.25)

Interesting about today is that while the S&P dropped well over 2%, the VIX (and VXO) also dropped. Often traders will interpret this as bearish. The thought process is that when the VXO doesn't drop with the market it suggests a possible complacency among traders. The theory is that this complacency may lead to further selling until participants become somewhat fearful again. At that point a rally will become more probable.

I looked at [this theory last month](#) when considering action over the course of several days. At the time I found no evidence to support the bearish case. For testing I looked at a 5-day divergence to measure the return in the VXO and S&P prior to triggering. Tonight I looked at a 1-day divergence.

SPX drops at least 1% and VXO also closes lower on the day.										
Buy on close. Sell X days later. \$100k/trade. 1986-present.										
X Days	New Profits	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$42,404.49	33	17	16	51.52	\$4,250.29	(\$1,865.65)	2.28	2.42	\$1,284.98
9	\$37,716.50	34	20	14	58.82	\$3,144.88	(\$1,798.65)	1.75	2.50	\$1,109.31
8	\$32,656.07	34	19	15	55.88	\$3,461.06	(\$2,206.94)	1.57	1.99	\$960.47
7	\$43,829.60	35	24	11	68.57	\$2,791.05	(\$2,105.06)	1.33	2.89	\$1,252.27
6	\$43,891.93	35	23	12	65.71	\$2,860.86	(\$1,825.66)	1.57	3.00	\$1,254.06
5	\$27,697.93	35	22	13	62.86	\$2,822.72	(\$2,646.30)	1.07	1.81	\$791.37
4	\$6,212.85	36	19	17	52.78	\$2,475.10	(\$2,400.83)	1.03	1.15	\$172.58
3	\$9,161.11	38	19	19	50.00	\$2,203.73	(\$1,721.56)	1.28	1.28	\$241.08
2	(\$3,282.87)	39	16	23	41.03	\$2,058.02	(\$1,574.40)	1.31	0.91	(\$84.18)
1	\$8,727.63	39	21	18	53.85	\$1,429.10	(\$1,182.41)	1.21	1.41	\$223.79

Not only is there a lack of bearish evidence but these results could be considered borderline bullish. I also looked at more extreme 2% SPX drops:

SPX drops at least 2% and VXO also closes lower on the day.										
Buy on close. Sell X days later. \$100k/trade. 1986-present.										
X Days	New Profits	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$7,870.38	6	3	3	50.00	\$3,961.96	(\$1,338.50)	2.96	2.96	\$1,311.73
9	\$6,110.05	6	3	3	50.00	\$3,273.93	(\$1,237.25)	2.65	2.65	\$1,018.34
8	\$6,768.53	6	3	3	50.00	\$3,190.07	(\$933.90)	3.42	3.42	\$1,128.09
7	\$11,605.11	7	6	1	85.71	\$1,997.47	(\$379.68)	5.26	31.57	\$1,657.87
6	\$9,497.23	7	5	2	71.43	\$2,265.40	(\$914.88)	2.48	6.19	\$1,356.75
5	\$13,335.07	7	5	2	71.43	\$3,312.30	(\$1,613.23)	2.05	5.13	\$1,905.01
4	\$6,192.15	7	4	3	57.14	\$3,220.28	(\$2,229.66)	1.44	1.93	\$884.59
3	\$3,872.85	7	4	3	57.14	\$2,637.73	(\$2,226.02)	1.18	1.58	\$553.26
2	\$463.57	8	2	6	25.00	\$3,949.34	(\$1,239.19)	3.19	1.06	\$57.95
1	\$4,475.50	8	5	3	62.50	\$1,744.08	(\$1,414.97)	1.23	2.05	\$559.44

If the number of instances wasn't so small then I'd certainly consider the results strongly bullish.

As I mentioned above, there were also some actual positive indications on Tuesday. First, there's this study updated from the [June 3, 2008 blog](#):

SPX drops 1% and decliners more than double advancers.										
Buy on close. Sell X days later. \$100k/trade. 1987-present.										
X Days	New Profits	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$199,743.70	230	154	76	66.96	\$2,665.28	(\$2,772.49)	0.96	1.95	\$868.45
9	\$222,313.69	235	162	73	68.94	\$2,560.11	(\$2,635.96)	0.97	2.16	\$946.02
8	\$194,897.13	249	162	86	65.06	\$2,571.68	(\$2,578.08)	1.00	1.88	\$782.72
7	\$203,775.41	268	166	102	61.94	\$2,578.13	(\$2,197.99)	1.17	1.91	\$760.36
6	\$189,728.22	284	175	109	61.62	\$2,457.05	(\$2,204.18)	1.11	1.79	\$668.06
5	\$166,007.55	309	183	126	59.22	\$2,263.35	(\$1,969.72)	1.15	1.67	\$537.24
4	\$111,413.42	329	188	141	57.14	\$2,009.29	(\$1,888.89)	1.06	1.42	\$338.64
3	\$132,909.00	360	220	140	61.11	\$1,723.90	(\$1,759.64)	0.98	1.54	\$369.19
2	\$131,553.90	410	227	183	55.37	\$1,690.87	(\$1,378.54)	1.23	1.52	\$320.86
1	\$102,409.31	460	276	184	60.00	\$1,128.08	(\$1,135.54)	0.99	1.49	\$222.63

Another short-term bullish indication comes from our "2 Days Down In Chop" system. This simple system looks to buy the market any time it closes lower 2 days in a row. It then sells the 1st profitable close up to three days later. At the end of three days the position is exited regardless of profitability. Below is an updated performance report of the system. \$100k/trade. June, 2007 – present.

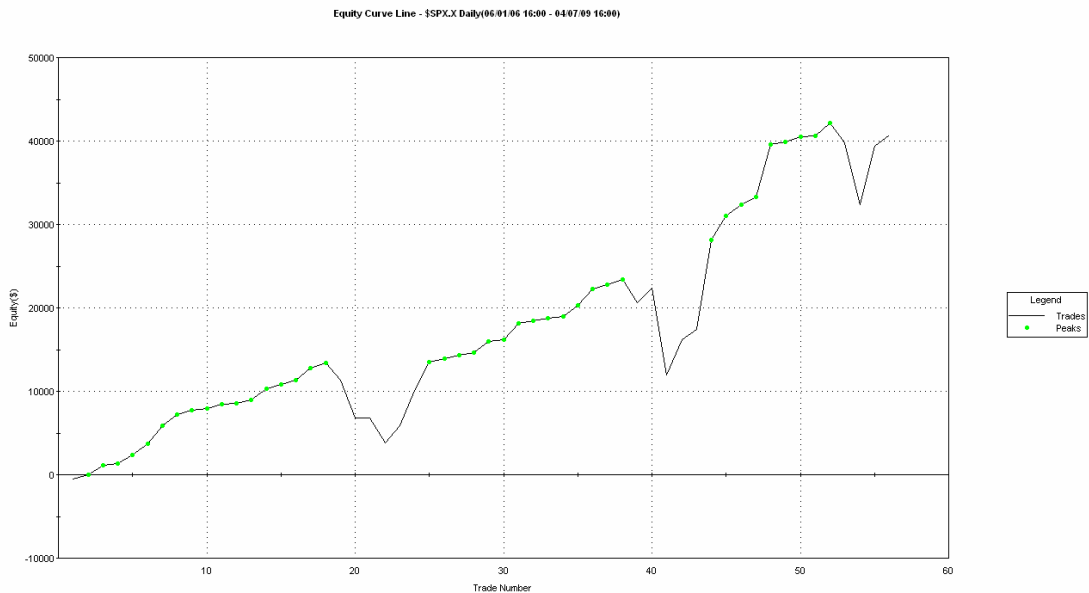
TradeStation Performance Summary

Collapse ^

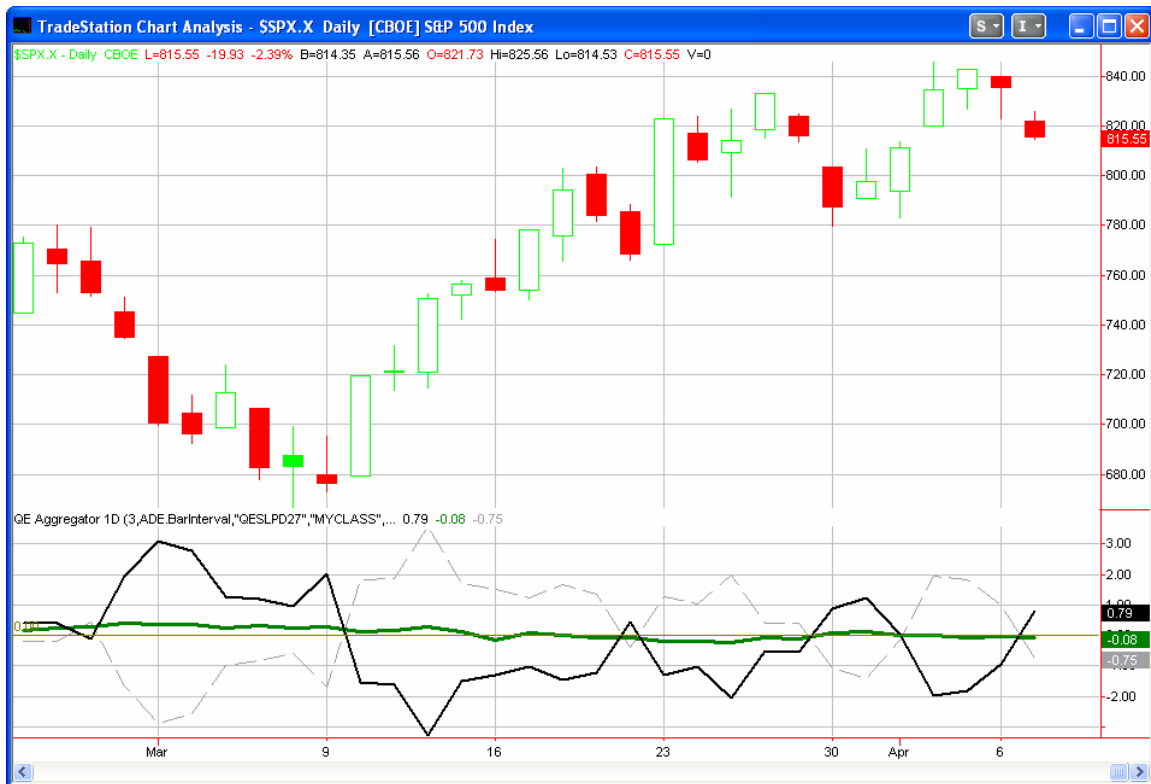
All Trades

Total Net Profit	\$40,701.84	Profit Factor	2.22
Gross Profit	\$74,001.70	Gross Loss	(\$33,299.86)
Roll Over Credit	\$0.00		
Open Position Profit/Loss	\$0.00		
Select Total Net Profit	\$29,985.81	Select Profit Factor	1.90
Select Gross Profit	\$63,285.67	Select Gross Loss	(\$33,299.86)
Adjusted Total Net Profit	\$18,247.34	Adjusted Profit Factor	1.40
Adjusted Gross Profit	\$63,320.47	Adjusted Gross Loss	(\$45,073.14)
Total Number of Trades	56	Percent Profitable	85.71%
Winning Trades	48	Losing Trades	8
Even Trades	0		
Avg. Trade Net Profit	\$726.82	Ratio Avg. Win:Avg. Loss	0.37
Avg. Winning Trade	\$1,541.70	Avg. Losing Trade	(\$4,162.48)
Largest Winning Trade	\$10,716.03	Largest Losing Trade	(\$10,506.45)
Largest Winner as % of Gross Profit	14.48%	Largest Loser as % of Gross Loss	31.55%

Next below is an equity chart of this simple system.



With all that taken into account, below is tonight's [Aggregator](#) :



Tonight's studies did not manage to flip the green Aggregator line to positive. The net expectations remains for more downside. The black differential line is showing that the market has strongly underperformed over the last few days. This is a fairly neutral configuration. I always prefer to take positions when both sides of the line are either positive or negative.

I'll hold off on an index trade for now. There is a new Catapult trigger in the catapults section.

Intermediate-term Outlook (2 weeks – 2 months)–neutral -updated 4/6

I've mentioned before Gerald Appel's Daily Breadth Impulse Signal. It was published in his book "Technical Analysis - Power Tools for Active Investors". Essentially it looks to enter the market when the 10-day exponential average of advancers/decliners hits an extreme. The trade closes when the same measure eventually declines to a certain number. (Since it's not my system I'm not comfortable revealing it in whole but for those interested it can be found in chapter 6 on page 142.) A chart of the indicator can be found on the Quantifiable Edges charts page. The system triggered again at the close on Thursday.

The system was published in 2004 and up until that time it had a terrific track record. Since then it has registered 4 new signals (not including this most recent one). The last 3 of those four signals have all been losers. Perhaps the system was over optimized and perhaps breadth signals in general have become less reliable lately. I suspect it is a little of both. In any case, it will be important to monitor the success of this system as I'm close to removing it from my arsenal as a long signal.

Below is the long-term performance:

TradeStation Performance Summary				Collapse
All Trades				
Total Net Profit	\$86,964.45	Profit Factor	4.38	
Gross Profit	\$112,698.81	Gross Loss	(\$25,734.36)	
Roll Over Credit	\$0.00			
Open Position Profit/Loss	\$966.28			
Select Total Net Profit	\$86,964.45	Select Profit Factor	4.38	
Select Gross Profit	\$112,698.81	Select Gross Loss	(\$25,734.36)	
Adjusted Total Net Profit	\$55,846.57	Adjusted Profit Factor	2.63	
Adjusted Gross Profit	\$90,159.05	Adjusted Gross Loss	(\$34,312.48)	
Total Number of Trades	34	Percent Profitable	73.53%	
Winning Trades	25	Losing Trades	9	
Even Trades	0			
Avg. Trade Net Profit	\$2,557.78	Ratio Avg. Win:Avg. Loss	1.58	
Avg. Winning Trade	\$4,507.95	Avg. Losing Trade	(\$2,859.37)	
Largest Winning Trade	\$12,471.48	Largest Losing Trade	(\$7,424.82)	
Largest Winner as % of Gross Profit	11.07%	Largest Loser as % of Gross Loss	28.85%	

If you switch the exit to a simple time-based trigger, the results would look like this:

<i>Appel Daily Breadth Signal triggers. Buy on close. Sell X days later. \$100k/trade. 1970-present.</i>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	\$101,766.94	37	29	8	78.38	\$4,412.13	(\$3,273.10)	1.35	4.89	\$2,750.46
19	\$101,511.72	38	30	8	78.95	\$4,309.58	(\$3,471.96)	1.24	4.65	\$2,671.36
18	\$95,810.91	39	30	9	76.92	\$4,151.70	(\$3,193.34)	1.30	4.33	\$2,456.69
17	\$82,110.22	39	30	9	76.92	\$3,738.31	(\$3,337.67)	1.12	3.73	\$2,105.39
16	\$81,564.03	39	29	10	74.36	\$3,817.92	(\$2,915.57)	1.31	3.80	\$2,091.39
15	\$78,469.37	39	30	9	76.92	\$3,483.85	(\$2,894.01)	1.20	4.01	\$2,012.04
14	\$74,643.95	39	31	8	79.49	\$3,229.80	(\$3,184.96)	1.01	3.93	\$1,913.95
13	\$74,840.86	41	33	8	80.49	\$3,077.91	(\$3,341.28)	0.92	3.80	\$1,825.39
12	\$76,901.82	42	33	9	78.57	\$3,093.96	(\$2,799.89)	1.11	4.05	\$1,831.00
11	\$67,295.11	43	36	7	83.72	\$2,673.88	(\$4,137.78)	0.65	3.32	\$1,565.00
10	\$66,023.56	43	35	8	81.40	\$2,551.80	(\$2,911.19)	0.88	3.83	\$1,535.43
9	\$55,739.07	45	34	11	75.56	\$2,474.20	(\$2,580.35)	0.96	2.96	\$1,238.65
8	\$48,163.27	48	32	16	66.67	\$2,631.71	(\$2,253.22)	1.17	2.34	\$1,003.40
7	\$43,192.96	49	35	14	71.43	\$2,158.46	(\$2,310.93)	0.93	2.34	\$881.49
6	\$40,330.12	50	35	15	70.00	\$2,033.69	(\$2,056.60)	0.99	2.31	\$806.60
5	\$33,713.71	54	38	16	70.37	\$1,680.90	(\$1,885.02)	0.89	2.12	\$624.33
4	\$18,987.16	56	32	24	57.14	\$1,496.81	(\$1,204.62)	1.24	1.66	\$339.06
3	\$1,609.70	59	28	31	47.46	\$1,489.02	(\$1,293.00)	1.15	1.04	\$27.28
2	\$2,803.11	61	33	28	54.10	\$942.04	(\$1,010.15)	0.93	1.10	\$45.95
1	\$7,115.39	62	36	26	58.06	\$686.44	(\$676.79)	1.01	1.40	\$114.76

While results from 1-4 weeks look good, it is interesting to not that there is no edge over the 1st 3 days. The next three days are when our short-term bearish signals are most prolific.

The other intermediate-term signal that is still active is the [short-term Follow Through Day success signal](#). In my detailed study on Follow through days I found that their

ultimate success could most often be predicted by their short-term success. In the case of the March 12th follow through day, the market continued higher over the next week. This suggests the S&P 500 is likely to hit 920 before breaking below 666.

The intermediate-term remains tricky. We have some intermediate-term indications that the rally could continue. Indicators with bearish implications are all short-term at this point. Still, how high is too high? The S&P has already risen over 25% off its bottom less than a month ago. That would seem to be an unmanageable pace, although it's tough to say anything is impossible these days.

I would expect what we will begin to see fairly soon is a consolidation phase where volatility will likely drop and the monster moves of the last several months will dissipate. Having not found any substantial warning signs as of yet I'm inclined to maintain a short-term focus.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Triggers

ABT – buy 1/3 position @ \$42.92 limit.

ABT is the 1st Catapult in a while. I'm always a bit more conservative when taking positions early in a cluster. I'd also be more excited if I had a positive market outlook. One thing I do like about ABT is that the options are tradeable and could be used to control exposure. The April 37.5 calls (ABT DU) have very little premium in them and may likely be my choice. The 40's (ABT DH) could also be used and would require little outlay. There is only 7 days until expiration so if the trade doesn't go your way quickly it may cost a bit more to roll it out a month.

One subscriber did some interesting Monte Carlo analysis on the Catapult trades recently. When I get a chance I plan to share his findings and observations along with my own observations about those results.

Catapult for ETF's Trades

none

Broad Market Large Cap CBI – 1 (ABT)

Additional New Trade Ideas

See ABT trade from Catapult section above.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
TIP	4/7/2009	\$101.26	\$101.15	-0.11%		

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