

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 13, 2009

Volume 2 Issue 69

## 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>					
April 13, 2009	2 Days Up In Chop	1-4 days	Bearish		
April 13, 2009	2% Gap Up and 0.5% Rise & 10-high	1-2 days	Bearish	-4.50%	
April 9, 2009	Lowest Spyx 20 on up day<200	1-5 days	Bearish	-3.00%	-5.90%
<b>April 8, 2009</b>	<b>1% drop with 2:1 decliners</b>	<b>1-9 days</b>	<b>Bullish</b>	<b>2.60%</b>	<b>5.50%</b>
April 2, 2009	2 Strong Breadth Days - No 10 High	1-8 days	Bearish	-3.30%	-6.00%
<b>April 1, 2009</b>	<b>1% below high but up on day</b>	<b>1-7 days</b>	<b>Bullish</b>	<b>6.10%</b>	<b>9.90%</b>
March 30, 2009	20 low range and vol while SPY>10ma	1-10 days	Bearish	-4.40%	-9.90%
<b>Active - Long Term</b>					
April 6, 2009	Appel Daily Breadth	1-20 days	Bullish		
March 26, 2009	Rise after follow through day		Bullish		
<b>Dropped Tonight</b>					
April 8, 2009	SPX down 1% on lowest Vol in 20	1-2 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 4/13 – bearish**

A strong gap up led to additional buying on Thursday. The market put in a very strong day all around. The banking index led the way with a massive 20% gain. The S&P 500 and Nasdaq closed almost 4% higher while the Russell 2000 closed nearly 6% higher. Breadth was extremely strong. The NYSE Up Issues % came in at 87% and the Up Volume % at 93%. Overall volume increased substantially vs. the previous days this week.

While overall volume rose, the Quantifiable Edges Volume Spyx indicator once again dropped precipitously. It came in at -12, which is an incredibly low number. I looked back at other times the S&P 500 volume Spyx indicator dropped this low. Going back to 1995, there were only 4 readings of -10 or lower. They occurred on 6/10/04, 4/28/08, 5/30/08, and 11/3/08. In every instance the market was trading lower 2 days later. The average drop for the 2 days was over 1%.

Loosening the requirements to look at instances with a close below 0 produced the following results:

Volume Spyx closes below 0.										
Buy at close. Sell X Days later. \$100k/trade. 1995-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	(\$15,784.83)	26	10	16	38.46	\$1,356.28	(\$1,834.22)	0.74	0.46	(\$607.11)
4	(\$12,946.24)	26	10	16	38.46	\$1,476.97	(\$1,732.24)	0.85	0.53	(\$497.93)
3	(\$8,536.43)	26	12	14	46.15	\$1,267.03	(\$1,695.77)	0.75	0.64	(\$328.32)
2	(\$11,036.42)	27	11	16	40.74	\$1,108.88	(\$1,452.13)	0.76	0.52	(\$408.76)
1	(\$6,972.90)	28	13	15	46.43	\$973.15	(\$1,308.25)	0.74	0.64	(\$249.03)

As you'd expect we see bearish tendencies here. As I've discussed in the past the volume Spyx can be especially effective when you also take the day's direction into account. Low readings on up days tend to be especially bearish while high readings on down days tend to be especially bullish when looking out over the next few days. Below you can see the results following readings below 0 when the market also closed up on the day.

Volume Spyx closes below 0 and the SPX closes positive on the day.										
Buy at close. Sell X Days later. \$100k/trade. 1995-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	(\$16,443.54)	15	3	12	20.00	\$1,260.62	(\$1,685.45)	0.75	0.19	(\$1,096.24)
4	(\$14,155.35)	15	4	11	26.67	\$1,093.47	(\$1,684.47)	0.65	0.24	(\$943.69)
3	(\$9,467.89)	15	5	10	33.33	\$832.23	(\$1,362.91)	0.61	0.31	(\$631.19)
2	(\$10,842.82)	16	7	9	43.75	\$532.87	(\$1,619.21)	0.33	0.26	(\$677.68)
1	(\$10,249.48)	16	6	10	37.50	\$613.73	(\$1,393.18)	0.44	0.26	(\$640.59)

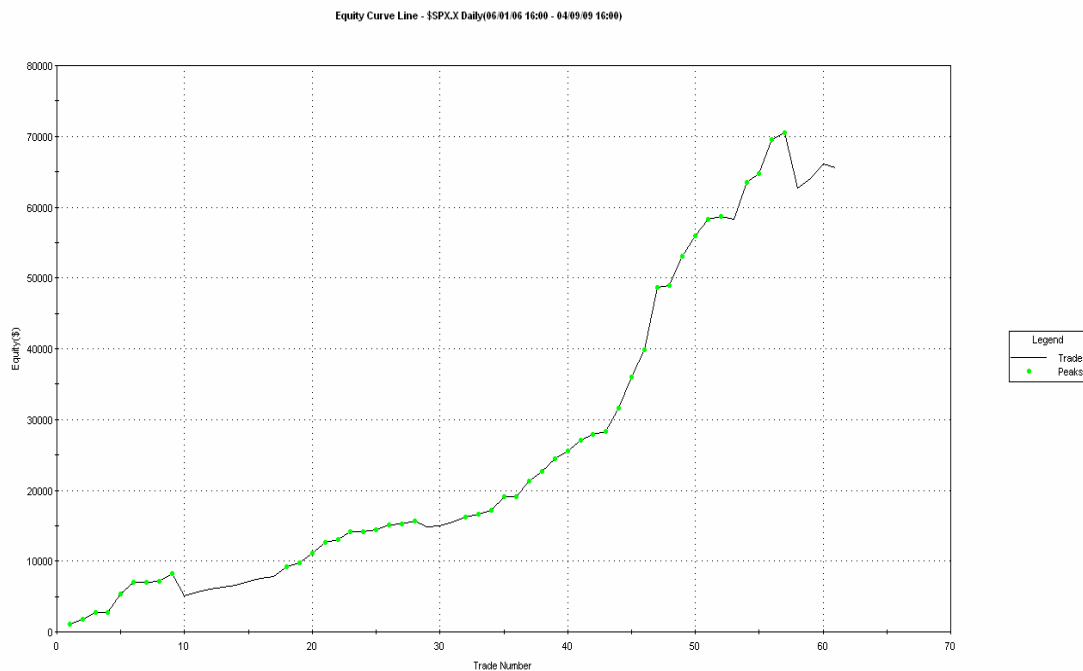
These results are quite bearish. Normally I'd include them in the Active Studies list and as part of the Aggregator. I decided not to tonight simply because yesterday's Volume Spyx study is fairly similar and it is already active.

Many subscribers will also have noticed that Thursday was the 2<sup>nd</sup> close higher in a row and triggered the "2 Days Up In Chop" system that we've followed for several months. The system looks to short the S&P after 2 consecutive up closes. It then exits at the 1<sup>st</sup> profitable close up to 4 days later. At the end of 4 days the trade is exited regardless of profitability. It is an extremely simple system. Over much of the market's history it would not have been profitable. Since the market became substantially more choppy in 2007 it has been a system that has performed quite well and could take advantage of the choppy environment as long as it persists. Below is an updated performance report, based on \$100k/trade from June 2007 – present. *Note these results measure going short.*

## All Trades

Total Net Profit	\$65,501.01	Profit Factor	6.11
Gross Profit	\$78,309.69	Gross Loss	(\$12,808.68)
Roll Over Credit	\$0.00		
Open Position Profit/Loss	\$0.00		
Select Total Net Profit	\$56,717.99	Select Profit Factor	5.43
Select Gross Profit	\$69,526.67	Select Gross Loss	(\$12,808.68)
Adjusted Total Net Profit	\$49,308.22	Adjusted Profit Factor	3.66
Adjusted Gross Profit	\$67,845.12	Adjusted Gross Loss	(\$18,536.90)
Total Number of Trades	61	Percent Profitable	91.80%
Winning Trades	56	Losing Trades	5
Even Trades	0		
Avg. Trade Net Profit	\$1,073.79	Ratio Avg. Win:Avg. Loss	0.55
Avg. Winning Trade	\$1,398.39	Avg. Losing Trade	(\$2,561.74)
Largest Winning Trade	\$8,783.02	Largest Losing Trade	(\$7,832.88)

The recent strong uptrend has caused a few losers recently. Below is a equity curve of the system.



The recent dip is the largest of the period. Currently I'm not anticipating enough of a change in character for the market that the system would be deemed ineffective.

Also notable about Thursday's action is that the market gapped up such a large amount and then added to its gains during the day. When the market is coming off a low point

this could incite further short-covering. In this case the market actually rallied to short-term highs. It's been rare to see such a large gap followed by further strength at new highs. On those rare occasions where it has happened it has consistently led to a pullback over the next couple of days:

<b>SPY gaps up 2%, closes 0.5% above the open and makes a 10-day intraday high.</b>										
<b>Buy at close. Sell X Days later. \$100k/trade. 1993-present.</b>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	(\$26,307.79)	6	1	5	16.67	\$924.14	(\$5,446.39)	0.17	0.03	(\$4,384.63)
4	(\$18,731.61)	6	1	5	16.67	\$1,656.69	(\$4,077.66)	0.41	0.08	(\$3,121.94)
3	(\$17,407.77)	6	1	5	16.67	\$1,082.24	(\$3,698.00)	0.29	0.06	(\$2,901.30)
2	(\$18,919.54)	6	0	6	0.00	\$0.00	(\$3,153.26)	0.00	0.00	(\$3,153.26)
1	(\$13,920.43)	6	0	6	0.00	\$0.00	(\$2,320.07)	0.00	0.00	(\$2,320.07)

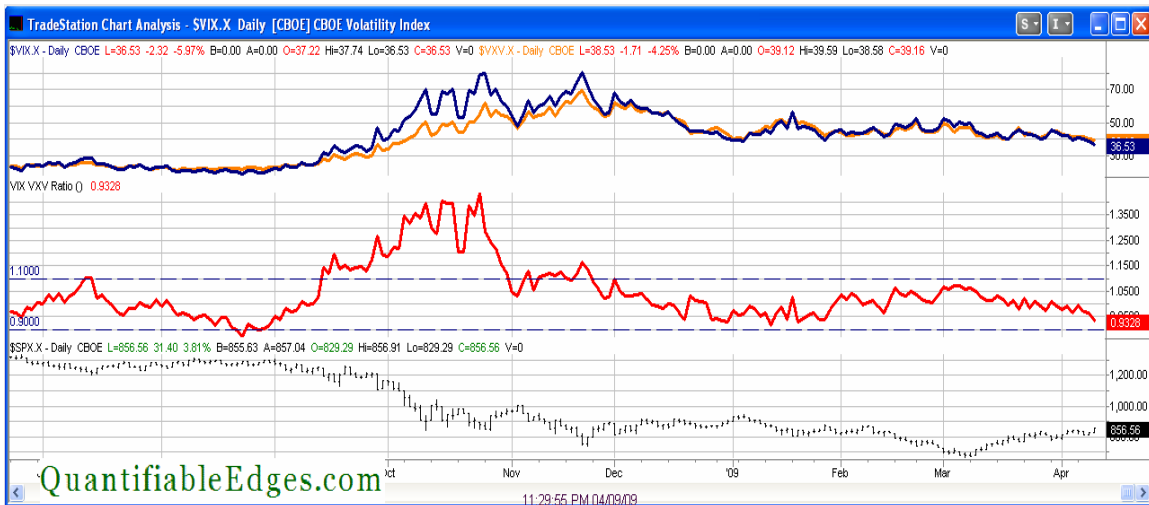
Four of the six instances have occurred in the last six months. Below I've listed all six instances along with their 1-day performance.

Date/Time	Signal	Price	Roll Over USD/Lot	Shares/Ctrts Profit	Net Profit Cum Net Profit	% Profit	Run-up DrawDown
12/11/00	Buy	\$138.63	\$0.00	721	(\$432.60)	(0.43%)	\$129.78
12/12/00	Sell	\$138.03			(\$432.60)		(\$901.25)
10/15/02	Buy	\$88.70	\$0.00	1127	(\$2,423.05)	(2.42%)	\$0.00
10/16/02	Sell	\$86.55			(\$2,855.65)		(\$3,133.06)
11/04/08	Buy	\$100.41	\$0.00	995	(\$4,198.90)	(4.20%)	\$298.50
11/05/08	Sell	\$96.19			(\$7,054.55)		(\$5,382.95)
12/08/08	Buy	\$91.00	\$0.00	1098	(\$1,647.00)	(1.65%)	\$1,240.74
12/09/08	Sell	\$89.50			(\$1,647.00)		(\$2,217.96)
01/28/09	Buy	\$87.39	\$0.00	1144	(\$3,248.96)	(3.25%)	\$0.00
01/29/09	Sell	\$84.55			(\$11,950.51)		(\$3,340.48)
03/23/09	Buy	\$82.22	\$0.00	1216	(\$1,969.92)	(1.97%)	\$170.24
03/24/09	Sell	\$80.60			(\$1,969.92)		(\$2,079.36)
04/09/09	Buy	\$85.81		1165	n/a	n/a	\$0.00
open	n/a	\$85.81		n/a	n/a		\$0.00

As suggested in the 1<sup>st</sup> table, you can see here that following similar setups in the past the market has seen immediate, sharp pullbacks.

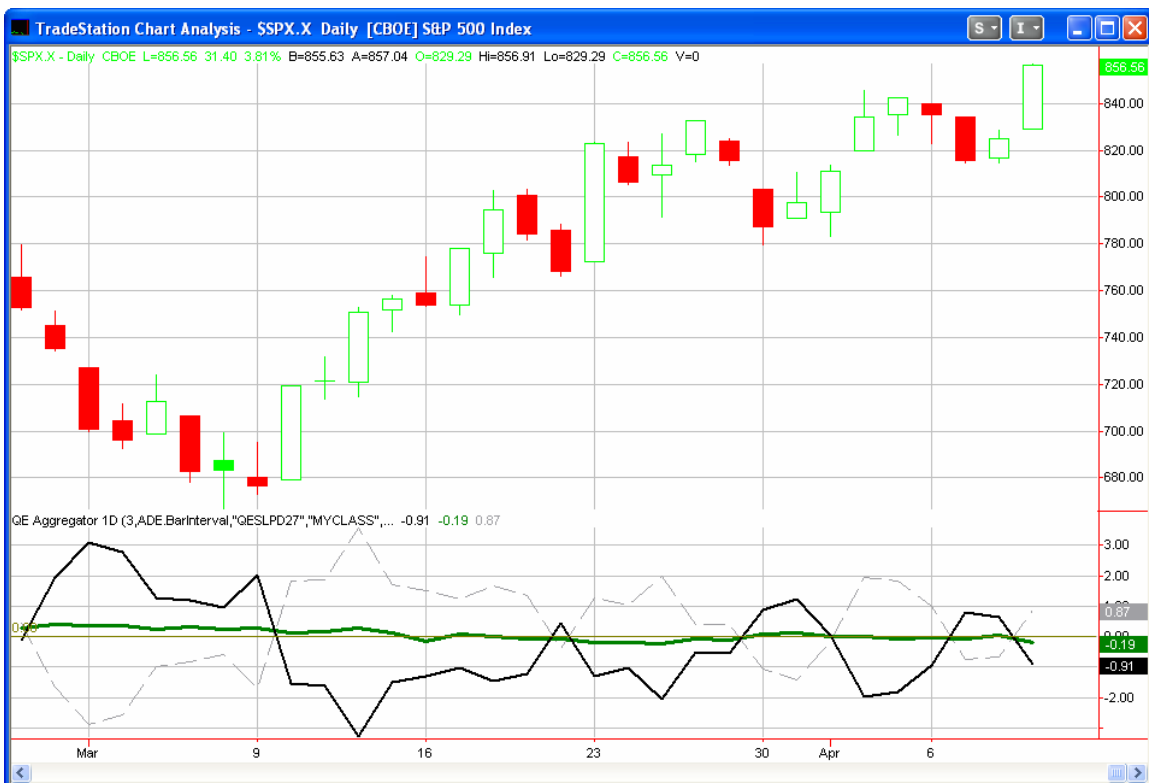
The simple fact that we are hitting new short-term highs during a long-term downtrend is also indicative that the market is likely to pull back. This is something [I discussed recently on the blog](#).

Another indicator that is starting to get extended and bears watching is the VIX. On Thursday it closed at 36.5, which is the lowest level since September. More notable than the absolute level is the fact that the VIX is becoming stretched from its 10-day moving average. A 10% down stretch isn't yet a significant level, but if it goes much further then it may provide an edge. The VIX/VXV ratio is also getting stretched. I prefer this indicator to a straight VIX stretch when considering possible downside. I've attached a long-term chart of this ratio from the website below:



The ratio currently stands at 0.93. Based on my August 2008 research into this indicator, moves below 0.90 tend to provide a sizable bearish edge. I'll be watching for any further dip in this indicator. For those who would like to review that August study, you may read it [here](#).

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



Both the green Aggregator line and the black Differential line are squarely below 0 at this point. This indicates the net expectation of the studies is for lower prices over the next

few days and the S&P has outperformed expectations over the last few days. Overbought with a negative outlook is what I look for when considering short positions.

Of further note is the fact that both short-term bullish studies have reached their average max move. While I sometimes wait for them to reach their Max move + 1 standard deviation, I may consider removing these from the active list in the next day or so. In any case I'll be looking for additional bullish evidence before taking long positions.

At this point I'll be looking to take advantage of potential downside early in the week.

***Intermediate-term Outlook (2 weeks – 2 months)–neutral -updated 4/13***

From an intermediate-term standpoint the market has yet to show serious cracks. The bullish case is supported by the intermediate-term studies listed in the active studies table at the top of the letter. Both the positive action after the March 12<sup>th</sup> follow-through day and the Appel Daily Breadth Thrust signal suggest more upside is in store.

Potential intermediate-term bearish indications could creep up in volume statistics of the VIX/VXV ratio discussed above. The volume has been especially light lately suggesting enthusiasm may be waning for stocks. This will require continued monitoring. A drop in the VIX/VXV ratio below 0.9 would also generate additional concern.

Last week I discussed Gerald Appel's Daily Breadth Impulse Signal from his book "Technical Analysis - Power Tools for Active Investors". One concern I raised was that the system had performed poorly since publication, including losses in the last 3 trades. One possible reason that a system could struggle like this after publication is that the system was over-optimized. One way to test this would be to run optimization reports around the entry and exit criteria to see if the edge remains for similar setups. If so, this would suggest the design of the system is sound.

First I tested the entry criteria. I ran this test from 1970 – 7/2004. This excludes any instances post-publication. Those results are below:

<i>Buy on close of day when 10-day EMA of Up Issues % closes above X.</i>										
<i>Sell when Appel daily breadth impulse exit signal triggers. \$100k/trade. 1970-7/2004.</i>										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
0.600	\$110,151.40	56	34	22	60.71	\$4,791.35	(\$2,397.94)	2.00	3.09	\$1,966.99
0.605	\$118,469.87	41	29	12	70.73	\$5,264.02	(\$2,848.90)	1.85	4.47	\$2,889.51
0.610	\$97,061.03	36	26	10	72.22	\$4,785.85	(\$2,737.10)	1.75	4.55	\$2,696.14
0.615	\$94,306.22	30	24	6	80.00	\$4,640.60	(\$2,844.70)	1.63	6.53	\$3,143.54
0.620	\$82,156.77	25	20	5	80.00	\$4,827.89	(\$2,880.22)	1.68	6.70	\$3,286.27
0.625	\$71,995.91	23	17	6	73.91	\$5,109.51	(\$2,477.62)	2.06	5.84	\$3,130.26
0.630	\$64,948.07	20	14	6	70.00	\$5,717.52	(\$2,516.19)	2.27	5.30	\$3,247.40
0.635	\$47,797.85	16	11	5	68.75	\$5,539.98	(\$2,628.39)	2.11	4.64	\$2,987.37

These results appear fairly robust, suggesting a true edge when there is a breadth thrust in the market.

Next I tested the exit criteria. Those results are below:

<b>Appel daily breadth impulse signal triggers a buy of the S&amp;P 500 on close.</b>										
<b>Sell when the 10-day EMA of the Up Issues % closes below X. \$100k/trade. 1970-7/2004</b>										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
0.47	\$95,973.25	30	23	7	76.67	\$5,007.44	(\$2,742.56)	1.83	6.00	\$3,199.11
0.48	\$88,698.04	30	23	7	76.67	\$4,732.17	(\$2,877.41)	1.64	5.40	\$2,956.60
0.48	\$89,811.61	30	23	7	76.67	\$4,780.59	(\$2,877.41)	1.66	5.46	\$2,993.72
0.49	\$94,306.22	30	24	6	80.00	\$4,640.60	(\$2,844.70)	1.63	6.53	\$3,143.54
0.5	\$95,383.27	30	24	6	80.00	\$4,685.48	(\$2,844.70)	1.65	6.59	\$3,179.44
0.5	\$98,830.05	30	24	6	80.00	\$4,761.40	(\$2,573.91)	1.85	7.40	\$3,294.34
0.51	\$92,401.68	31	24	7	77.42	\$4,663.64	(\$2,789.37)	1.67	5.73	\$2,980.70

Here again we see strong results across the board. While there's a chance that the "best" results were chosen for publication, there's really no foul in doing that. The concept appears sound, which means the recent failures are likely either due to 1) bad luck or 2) a change in market dynamics. It could be a combination of the two. There hasn't been a market as weak as the current bear since well before the test period. It wouldn't be the first system to struggle in the recent environment. Bottom line is it appears it would be a mistake at this point to write off the system.

The neutral stance means I'm willing to take longs and shorts with an equal level of aggressiveness at this point. Though we may get more upside, the market is somewhat overdone and a consolidation phase still appears likely to me. Volume and the VIX/VXV are two indicators I'll be watching closely for sign of possible market difficulty.

### **Catapult and Capitulative Breadth Statistics**

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

#### ***Open Catapult Triggers***

ABT (no fill)

The ABT entry didn't receive a fill for the subscriber letter. Should it begin a new leg down, I may consider attempting entry again.

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

*none*

#### ***Broad Market Large Cap CBI – 1 (ABT)***

#### ***Sector CBI Breakdown (% of stocks with active catapult triggers within each sector.)***

There is virtually 0 capitulation occurring at the moment. I've left the table off tonight. It will return next week.

### **Additional New Trade Ideas**

*SPY – short ¼ index position @ \$85.81 limit – based on short-term outlook above.*

As an additional note, experienced readers may be able to anticipate some of my index entries and could consider taking partial positions at the close if they're concerned about a non-fill due to a gap the next day. As an example in Wednesday night's Letter I noted the following "The green Aggregator line is only slightly positive and based on the current studies it is expected to flip back to slightly negative tomorrow evening." Knowing this and the fact that the "2 day up in chop" system would trigger along with the realization that such a strong move Thursday would also move the Differential line negative, many traders could have anticipated tonight's trade idea. In less gappy markets trading at the close vs. the open isn't much of an issue. Lately there has been a fair amount of entries that have gone without fills due to these gaps. This is something some traders may want to consider.

### **Active Trades Table**

*none*

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