

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 14, 2009

Volume 2 Issue 70

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 13, 2009	3 up under 200 on low vol & increase	1-3 days	Bearish	-2.30%	-4.50%
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%
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 8, 2009	1% drop with 2:1 decliners	1-9 days	Bullish	2.60%	5.50%

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 4/14 – bearish

A sizeable gap down was reversed Monday as the market hit bottom around 10am and then rose until 3:45. Some selling in the last 15 minutes of the day eliminated most of the gains but the Nasdaq and S&P 500 still managed to finish in the green. Breadth was fairly positive as the NYSE Up Issues % came in at 55% and the Up Volume % at 67%. Overall volume dropped quite a bit from Thursday's levels.

In the April 6th Subscriber Letter I identified what I referred to as a “bearish perfect storm” setup. Bearish indications from the 4/3 action that were identified in that letter included the following list:

- 1) *The market has risen for at least 3 days in a row while under the 200ma.*
- 2) *Friday's percent rise was the smallest of the recent rally.*
- 3) *The volume was weak.*
- 4) *The S&P 500 hit a new 20-day high.*
- 5) *SPY volume was the lowest in over a month.*
- 6) *The range was small.*
- 7) *SPY had an inside day (especially bearish in a short-term up move).*

In looking at Monday's action you'll note that points 1-5 all apply. Only points 6 and 7 which looked at contracted range situations failed to trigger on Monday.

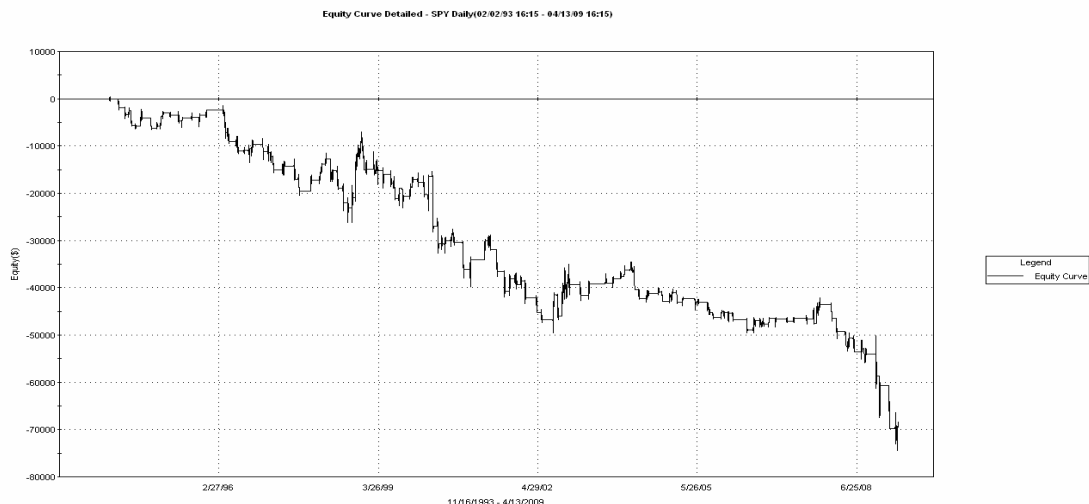
Edges #1, #2 and #3 are from the 6/17/08 blog post. In that post it was shown that when there are 3 higher closes under the 200ma and the most recent rise is the smallest, it often leads to a pullback. Further, the study showed the bearish edge is significantly stronger when there is not a pattern of rising volume. I'd recommend clicking the link above and checking out the post for further details. You may read the details of that study by [clicking here](#).

The S&P hitting new highs was discussed [recently](#) as well. It has often set the stage for a pullback.

Extremely low SPY volume is something else I discussed in that Letter and also in the past. Below is an updated version of the 4/22/08 blog study.

SPY posts lowest volume in 20 days ad closes above its 10-day moving average.										
Buy on close. Sell X days later. \$100k/trade. 1993-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
10	(\$47,076.40)	125	64	61	51.20	\$2,228.79	(\$3,110.15)	0.72	0.75	(\$376.61)
9	(\$46,613.56)	128	73	55	57.03	\$1,925.76	(\$3,403.53)	0.57	0.75	(\$364.17)
8	(\$31,788.98)	136	77	59	56.62	\$1,901.74	(\$3,020.73)	0.63	0.82	(\$233.74)
7	(\$43,850.51)	139	70	68	50.36	\$1,854.19	(\$2,553.58)	0.73	0.75	(\$315.47)
6	(\$53,291.81)	142	68	73	47.89	\$1,688.89	(\$2,303.24)	0.73	0.68	(\$375.29)
5	(\$69,244.92)	152	68	83	44.74	\$1,522.37	(\$2,081.52)	0.73	0.60	(\$455.56)
4	(\$52,672.55)	161	76	85	47.20	\$1,244.03	(\$1,731.99)	0.72	0.64	(\$327.16)
3	(\$53,244.06)	166	64	101	38.55	\$1,330.06	(\$1,369.98)	0.97	0.62	(\$320.75)
2	(\$41,102.84)	177	74	103	41.81	\$1,072.32	(\$1,169.46)	0.92	0.66	(\$232.22)
1	(\$39,672.01)	202	82	119	40.59	\$773.80	(\$866.58)	0.89	0.62	(\$196.40)

While the edge here is not the strongest in terms of % or magnitude it has been consistent over time. Below is an equity graph of the 5-day exit that was highlighted in yellow above.



If I combine the 3-day move with the low volume for the SPY I get the following:

<i>SPX close under the 200ma and up for at least the 3rd day in a row. Today's volume is the lowest of the runup.</i>										
<i>Buy on close. Sell X days later. \$100k/trade. 1993-present.</i>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
10	(\$27,381.78)	39	20	19	51.28	\$2,632.38	(\$4,212.07)	0.62	0.66	(\$702.10)
9	(\$38,080.92)	40	22	18	55.00	\$2,502.66	(\$5,174.41)	0.48	0.59	(\$952.02)
8	(\$28,664.73)	41	18	23	43.90	\$2,765.03	(\$3,410.23)	0.81	0.63	(\$699.14)
7	(\$27,751.73)	42	20	21	47.62	\$2,213.52	(\$3,429.62)	0.65	0.61	(\$660.76)
6	(\$20,758.21)	42	21	21	50.00	\$2,207.52	(\$3,196.01)	0.69	0.69	(\$494.24)
5	(\$16,511.17)	45	24	20	53.33	\$1,428.99	(\$2,540.34)	0.56	0.68	(\$366.91)
4	(\$26,373.70)	46	19	27	41.30	\$1,370.76	(\$1,941.41)	0.71	0.50	(\$573.34)
3	(\$26,597.12)	46	16	30	34.78	\$1,520.99	(\$1,697.76)	0.90	0.48	(\$578.20)
2	(\$23,276.69)	47	18	29	38.30	\$1,136.98	(\$1,508.36)	0.75	0.47	(\$495.25)
1	(\$8,035.94)	53	25	28	47.17	\$1,230.12	(\$1,385.32)	0.89	0.79	(\$151.62)

A fairly strong downside edge is prevalent – especially in the 1st 3 days. About 70% of the instances closed below the trigger day close within 2 days. If you look out 4 days that percentage increases to 87% (40 of 46).

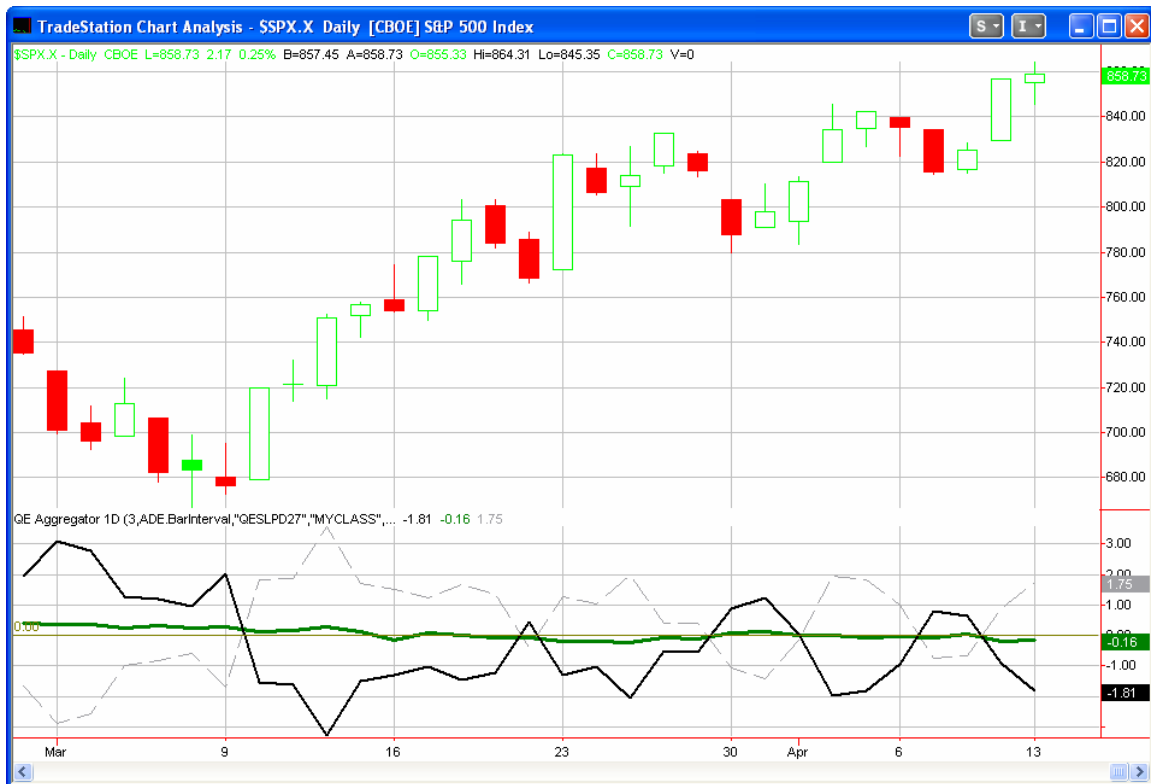
While range did not contract as described in points 6 and 7 above, the % gain was the smallest of the last 3 days. The 6/17/08 blog post I referred to above looked at price, volume and range in this manner. NYSE volume wasn't extremely low, though. Therefore I ran a similar test on the SPY tonight.

<i>SPX close under the 200ma and up for at least the 3rd day in a row. Today's volume is the lowest of the runup.</i>										
<i>Today's price increase is the smallest of the runup. Buy on close. Sell X days later. \$100k/trade. 1993-present.</i>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
10	(\$47,034.81)	23	12	11	52.17	\$2,070.58	(\$6,534.70)	0.32	0.35	(\$2,044.99)
9	(\$46,936.11)	23	12	11	52.17	\$2,127.21	(\$6,587.51)	0.32	0.35	(\$2,040.70)
8	(\$37,661.46)	23	9	14	39.13	\$2,415.76	(\$4,243.09)	0.57	0.37	(\$1,637.45)
7	(\$34,540.20)	23	9	13	39.13	\$2,191.43	(\$4,174.08)	0.53	0.36	(\$1,501.75)
6	(\$29,087.66)	23	11	12	47.83	\$1,882.81	(\$4,149.88)	0.45	0.42	(\$1,264.68)
5	(\$20,277.52)	24	12	12	50.00	\$1,589.54	(\$3,279.33)	0.48	0.48	(\$844.90)
4	(\$19,596.05)	24	9	15	37.50	\$1,500.74	(\$2,206.84)	0.68	0.41	(\$816.50)
3	(\$20,532.54)	24	8	16	33.33	\$1,269.79	(\$1,918.18)	0.66	0.33	(\$855.52)
2	(\$14,087.33)	24	6	18	25.00	\$1,565.38	(\$1,304.42)	1.20	0.40	(\$586.97)
1	\$415.79	26	14	12	53.85	\$1,345.19	(\$1,534.74)	0.88	1.02	\$15.99

Here again we see a strong tendency to pull back. In this case, by day four, 22 of 24 (92%) instances had a close below the trigger day close.

Also notable tonight is that the April 8th bullish study hit its Avg Max Move + 1 Std Deviation price target. Therefore it is being removed from the “active” list.

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



Both the green Aggregator line and the black Differential line remain squarely below 0. 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. We're still overbought with a negative outlook.

Odds appear strongly in favor of a pullback here. It needs to be kept in mind, though, that this is a countertrend trade. Therefore, while I want short exposure, I'm not willing to chase. Additionally, with countertrend trades like the current one, I normally look to take profits fairly quickly.

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 12th 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:

Buy on close of day when 10-day EMA of Up Issues % closes above X.										
Sell when Appel daily breadth impulse exit signal triggers. \$100k/trade. 1970-7/2004.										
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:

Appel daily breadth impulse signal triggers a buy of the S&P 500 on close.										
Sell when the 10-day EMA of the Up Issues % closes below X. \$100k/trade. 1970-7/2004										
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

none

Catapult for ETF's Trades

none

Broad Market Large Cap CBI – 0

Additional New Trade Ideas

SPY – short 1/4 index position @ \$86.00 limit – based on short-term outlook above.

SPY – short ANOTHER 1/4 index position at \$86.50 LIMIT ON CLOSE.

I'm looking to get fairly aggressive on the short side tomorrow if the market continues higher.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	4/13/2009	\$85.81	\$85.83	-0.02%		shorted @ limit

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