

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 15, 2009

Volume 2 Issue 71

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 15, 2009	1% drop with 2:1 decliners	1-9 days	Bullish	2.60%	5.50%
April 13, 2009	3 up under 200 on low vol & increase	1-3 days	Bearish	-2.30%	-4.50%
April 9, 2009	Lowest Spyx 20 on up day<200	1-5 days	Bearish	-3.00%	-5.90%
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 1, 2009	1% below high but up on day	1-7 days	Bullish	6.10%	9.90%
April 2, 2009	2 Strong Breadth Days - No 10 High	1-8 days	Bearish	-3.30%	-6.00%
April 13, 2009	2% Gap Up and 0.5% Rise & 10-high	1-2 days	Bearish	-4.50%	
April 13, 2009	2 Days Up In Chop	1-4 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 4/15 – somewhat bearish

The selloff we were expecting arrived Tuesday. The major indices gapped down and after trying to rally and recover, ended up closing near their lows. Breadth was very weak. Decliners and declining volume both outpaced advancers and advancing volume by about 7 to 3. Overall volume rose.

Today's action provided some small short-term bullish indications. Below is a study last published in the 4/8/09 subscriber letter that looks at 1% drops on bad breadth.

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

The edge here is a little mild, but there does seem to be a bullish bias over the next two weeks.

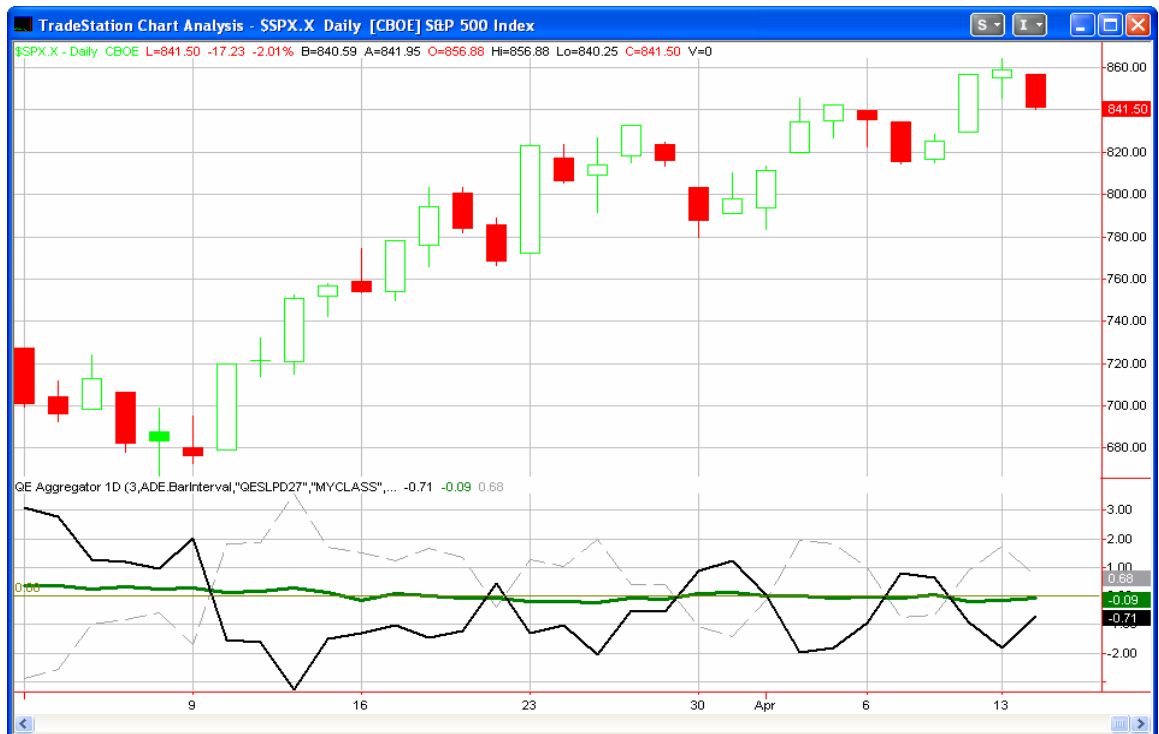
Another indicator that has received some attention lately is the CBOE Equity Put-Call ratio. Many people believe that very low readings can be a sign of complacency and an impending top. I have not found this to be the case.

Below I look at the 3-day equity p/c ratio compared with the 100-day. On Tuesday the 3-day average dropped over 25% below the 100 day. This is quite rare. To gain some more occurrences I used a 20% trigger instead.

<i>The 3-day average CBOE equity put/call ratio falls 20% below the 100-day average.</i>										
<i>Buy SPX on close. Sell X days later. \$100k/trade. 6/2004 - present.</i>										
X Days	Net Profit	Trades	Wins	Losses	Win %	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$18,520.57	14	10	4	71.42857	\$2,641.25	(\$1,972.99)	1.338708	3.3467702	\$1,322.90
9	\$14,693.39	14	10	4	71.42857	\$2,271.40	(\$2,005.16)	1.13278	2.8319496	\$1,049.53
8	\$23,224.57	15	10	5	66.66667	\$3,093.10	(\$1,541.28)	2.006839	4.013677	\$1,548.30
7	\$17,350.15	15	10	5	66.66667	\$2,379.25	(\$1,288.47)	1.846574	3.6931483	\$1,156.68
6	\$12,387.27	15	8	7	53.33333	\$2,989.01	(\$1,646.40)	1.815481	2.0748351	\$825.82
5	\$14,239.61	16	9	7	56.25	\$2,852.09	(\$1,632.75)	1.746807	2.2458952	\$889.98
4	\$10,955.94	18	8	10	44.44444	\$2,929.25	(\$1,247.80)	2.347524	1.8780191	\$608.66
3	\$2,370.87	18	11	7	61.11111	\$1,384.52	(\$1,836.98)	0.753694	1.1843767	\$131.72
2	\$6,027.67	19	10	9	52.63158	\$1,791.74	(\$1,321.08)	1.356269	1.5069653	\$317.25
1	\$4,403.23	20	11	9	55	\$998.69	(\$731.38)	1.365498	1.6689419	\$220.16

Not only is the extremely low Equity P/C not bearish – it actually appears to be somewhat bullish over the following 2 weeks.

Below is tonight's **Aggregator** :



Even with several bearish studies coming out of the Aggregator and a bullish one going in the net expectation remains for more downside. This can be seen with the green aggregator line below zero. The black differential line is also below zero, indicating that despite today's selloff, the market has still solidly outperformed expectations over the last few days. The black Differential line will likely move above zero tomorrow as Thursday's rally will exit the equation.

Half of the SPY position was exited Tuesday and I plan on looking to take additional profits Wednesday should the market experience additional weakness. It needs to be kept in mind that this is a counter-trend trade. Therefore I look to take profits more quickly than I might if we were trading with then trend.

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:

<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:

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

None tonight. ETR from the triggers page looks interesting, but with the negative market outlook I'd prefer to wait another day before taking on long positions. Aggressive traders could consider it. I'll wait one more night and see what happens tomorrow.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	4/13/2009	\$85.81	\$84.31	1.75%		covered 1/2 @ close

Should SPY close lower tomorrow I will exit the remaining on the close. Unless SPY gaps to over \$85 at the open, I will place a stop on the remaining at \$85.85. This is just above Tuesday's high and Monday's close. It is also very close to break-even. I will likely adjust the stop during the day tomorrow but would like to see the opening range before I do so.

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