

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 20, 2009

Volume 2 Issue 74

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 20, 2009	3 days up to 10-high. Low % & range	1-3 days	Bearish	-2.10%	-3.70%
April 20, 2009	Strong Op-ex week	1-5 days	Bearish	-1.60%	-3.00%
April 17, 2009	Advancers double decliners & < 200ma	1-4 days	Bearish	-4.00%	-6.80%
April 17, 2009	2 Up in Chop	1-4 days	Bearish		
April 15, 2009	1% drop with 2:1 decliners	1-9 days	Bullish	2.60%	5.50%
March 30, 2009	20 low range and vol while SPY>10ma	1-10 days	Bearish	-4.40%	-9.90%
Active - Long Term					
April 20, 2009	Low Nasdaq Weekly Vol Spyx	1-5 weeks	Bearish		
April 6, 2009	Appel Daily Breadth	1-20 days	Bullish		
March 26, 2009	Rise after follow through day		Bullish		

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 4/20 – bearish

Friday was a relatively tame day for the market. All of the major indices edged higher, with the S&P 500 finishing up about 0.5%. NYSE breadth was solidly positive with the Up Issues % coming in at 66% and the Up Volume % at 59%. Overall volume rose a bit as often happens on option expiration Friday.

We're seeing a lot of the same signs that have historically led to short-term pullbacks, including over the last few weeks. While under the 200ma, these signs would now include (click on any of the below to see a write-up on it):

- 1) [Three higher closes for the S&P 500](#)
- 2) [The S&P closing at a 20-day high](#)
- 3) [The S&P closing up the lowest amount of its recent rise](#)
- 4) [The S&P trading in a narrow range](#)

As I've done with some other recent moves, I ran a study to see what the above combination has led to over the years. My intraday range data goes back to 1978, so that's as far back as I ran this test.

S&P 500 makes at least 3 higher highs and closes at 10-day high and < 200ma. Today's range & % rise are the smallest of the runup. Buy S&P 500 on close. Sell X Days later. \$100k/trade. 1978-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	(\$15,949.63)	19	10	9	52.63	\$1,187.79	(\$3,091.95)	0.38	0.43	(\$839.45)
4	(\$17,870.74)	19	8	11	42.11	\$1,060.36	(\$2,395.78)	0.44	0.32	(\$940.57)
3	(\$23,043.88)	19	5	14	26.32	\$750.56	(\$1,914.05)	0.39	0.14	(\$1,212.84)
2	(\$20,196.80)	19	4	15	21.05	\$789.99	(\$1,557.12)	0.51	0.14	(\$1,062.99)
1	\$755.41	20	11	9	55.00	\$545.80	(\$583.15)	0.94	1.14	\$37.77

Also notable about this study is that 17 of 19 (89%) of the instances closed below their trigger price within the next 3 days. Looking out over a week would raise that number to 18 of 19. Pretty good odds for a bearish setup. The lone instance that continued to rise was 10/16/98, which occurred about a week after the '98 market bottom. (This shouldn't be a surprise. I've also discussed many times that the most dangerous time to short an overbought condition is just after a potential major market bottom. It was this knowledge that kept us from trying to short the March rally. Many others that quickly viewed the sharp rally as "overbought in a downtrend" were decimated trying to short it.)

There's a bit of bearish seasonality this upcoming week as well. I've discussed in the past that the week following options expiration has historically been a difficult week for stocks. Since 1987 the 1-5 day periods following option expiration have all been negative.

Below is a study that shows how the market has performed following a positive 5 days leading up to options expiration:

Today is option-expiration Friday. SPX closes higher than 5 days ago. Buy S&P 500 on close. Sell X Days later. \$100k/trade. 1987-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	(\$48,202.02)	156	69	87	44.23	\$1,306.43	(\$1,590.18)	0.82	0.65	(\$308.99)
4	(\$23,943.43)	156	67	89	42.95	\$1,347.37	(\$1,283.34)	1.05	0.79	(\$153.48)
3	(\$20,820.79)	156	70	86	44.87	\$1,163.03	(\$1,188.76)	0.98	0.80	(\$133.47)
2	(\$21,247.56)	156	74	82	47.44	\$826.20	(\$1,004.71)	0.82	0.74	(\$136.20)
1	(\$10,434.86)	156	60	96	38.46	\$905.38	(\$674.56)	1.34	0.84	(\$66.89)

The returns over the next week are consistently negative. Looking at the 5-day returns I also broke it down by the size of the options-week gains:

Today is option-expiration Friday. SPX closes X% higher than 5 days ago. Buy S&P 500 on close. Sell 5 days later. \$100k/trade. 1987-present.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
3	(\$14,506.69)	23	10	13	43.48	\$1,249.42	(\$2,076.99)	0.60	0.46	(\$630.73)
2.5	(\$20,533.49)	37	16	21	43.24	\$1,027.96	(\$1,760.99)	0.58	0.44	(\$554.96)
2	(\$22,601.15)	48	23	25	47.92	\$945.94	(\$1,774.31)	0.53	0.49	(\$470.86)
1.5	(\$33,546.15)	74	32	42	43.24	\$1,211.70	(\$1,721.92)	0.70	0.54	(\$453.33)
1	(\$39,543.46)	107	48	59	44.86	\$1,186.58	(\$1,635.58)	0.73	0.59	(\$369.57)
0.5	(\$45,408.99)	134	59	75	44.03	\$1,290.06	(\$1,620.30)	0.80	0.63	(\$338.87)
0	(\$48,202.02)	156	69	87	44.23	\$1,306.43	(\$1,590.18)	0.82	0.65	(\$308.99)

While the % winners remains fairly steady around 44%, you can see that risk/reward shifts more favorably towards the bearish side the higher the returns during op-ex week.

This past week the S&P had a 1.5% gain. Therefore I also decided to break down that slice.

Today is option-expiration Friday. SPX closes between 1%-2% higher than 5 days ago.												
Buy S&P 500 on close. Sell X Days later. \$100k/trade. 1987-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	Max Win	Max Loss	W/L Ratio	Profit Factor	Avg Trade
5	(\$16,942.31)	59	25	34	42.37	\$1,407.98	(\$1,533.58)	\$6,162.00	(\$4,961.56)	0.92	0.68	(\$287.16)
4	(\$7,834.98)	59	23	36	38.98	\$1,489.86	(\$1,169.49)	\$8,361.60	(\$4,046.70)	1.27	0.81	(\$132.80)
3	\$3,109.26	59	28	31	47.46	\$1,180.48	(\$965.94)	\$5,894.20	(\$2,818.64)	1.22	1.10	\$52.70
2	(\$256.73)	59	32	27	54.24	\$738.28	(\$884.51)	\$4,914.00	(\$2,917.60)	0.83	0.99	(\$4.35)
1	\$2,765.42	59	23	36	38.98	\$837.76	(\$458.42)	\$7,069.40	(\$2,470.65)	1.83	1.17	\$46.87

I also included Max Win and Max loss columns in this table. Much of the reduced edge is actually due to the massive outlier trade that occurred just last month. Even with such a high max win factored in, the average return is still in line with the other tests after you get out 5 days.

Factoring in the new studies the [Aggregator](#) now looks like this.



The green Aggregator line remains below zero, indicating the net expectation from the studies is bearish. The black Differential line is also below the zero line, meaning the S&P has outperformed expectations over the last few days. This is all pretty obvious today when looking at the Active Studies list as the top of the Letter. Nearly everything is bearish.

With most everything I'm looking at suggesting downside over the next few days I'm now short and looking to get shorter. Short trades here are countertrend and will be managed as such. In other words, I'm stingy with my entries and relatively quick to take profits.

Intermediate-term Outlook (2 weeks – 2 months)–starting to lean bearish -updated 4/20

I looked at a few indicators with possible intermediate-term influence this weekend.

I've seen it pointed out a few places that the number of stocks above intermediate-term moving averages (40 or 50-day) is now at an extreme level. I've done some testing on this in the past and found such indicators to be of limited value. Worden Bros. has several indicators that show the % of stocks trading relative to the 40-day moving average. In addition to the simple % above/below, they also show how many are at least 1 and 2 standard deviations above and below the 40ma. I believe these indicators are more telling. I've found this information to be especially useful in looking at extreme selloffs and have compared the % 1-standard deviation below the 40-ma indicator (T2114) to my Capitulative Breadth Indicator (CBI). ([Click here for that post.](#))

Part of what gives the CBI and T2114 their effectiveness is the propensity for sharp and powerful short-covering rallies to emerge from such extreme conditions. In developing the Catapult method and CBI indicator I was unable to find an overbought equivalent. Of course the market is dealing with different emotions near tops than it is near bottoms. Fear, which is prevalent near bottoms, is much more powerful than greed, which is prevalent near tops.

So the question then becomes, since there is no CBI reading for extremely overbought, what might the Worden 1-standard deviation measure suggest when it gets extremely high? As of Friday it was certainly extremely high. Over 80% of stocks closed at least 1 standard deviation above their 40-day moving average. Worden Bros. maintains data back to 1986 and this is the 1st time the indicator has cracked the 80% level. I looked at other overbought levels to study the 1-month returns following some less-extreme readings.

<i>X% of stocks trading at least 1 standard deviation above their 40ma.</i>										
<i>Buy S&P 500 on close. Sell 20 Days later. \$100k/trade. 1986-present.</i>										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
80	\$0.00	0	0	0	0.00	\$0.00	\$0.00	100.00	100.00	\$0.00
75	\$9,641.73	4	2	1	50.00	\$5,259.87	(\$878.00)	5.99	11.98	\$2,410.43
70	\$10,550.55	6	5	1	83.33	\$4,282.47	(\$10,861.82)	0.39	1.97	\$1,758.43
65	\$16,657.10	13	9	4	69.23	\$3,590.91	(\$3,915.27)	0.92	2.06	\$1,281.32
60	\$17,295.26	23	16	7	69.57	\$2,947.31	(\$4,265.96)	0.69	1.58	\$751.97

As you can see above, returns have generally been positive following other times the indicator has reached extreme levels. On the low end the results are about the same as the long-term market drift. As you move higher they look better but instances are incredibly low, so not much can be extrapolated. I see two points to take away from this exercise: 1) When the market gets extremely overbought that is not necessarily a bad

thing, and on its' own is certainly not a signal to sell short. 2) By this measure the market is now more overbought than it has been in at least 23 years.

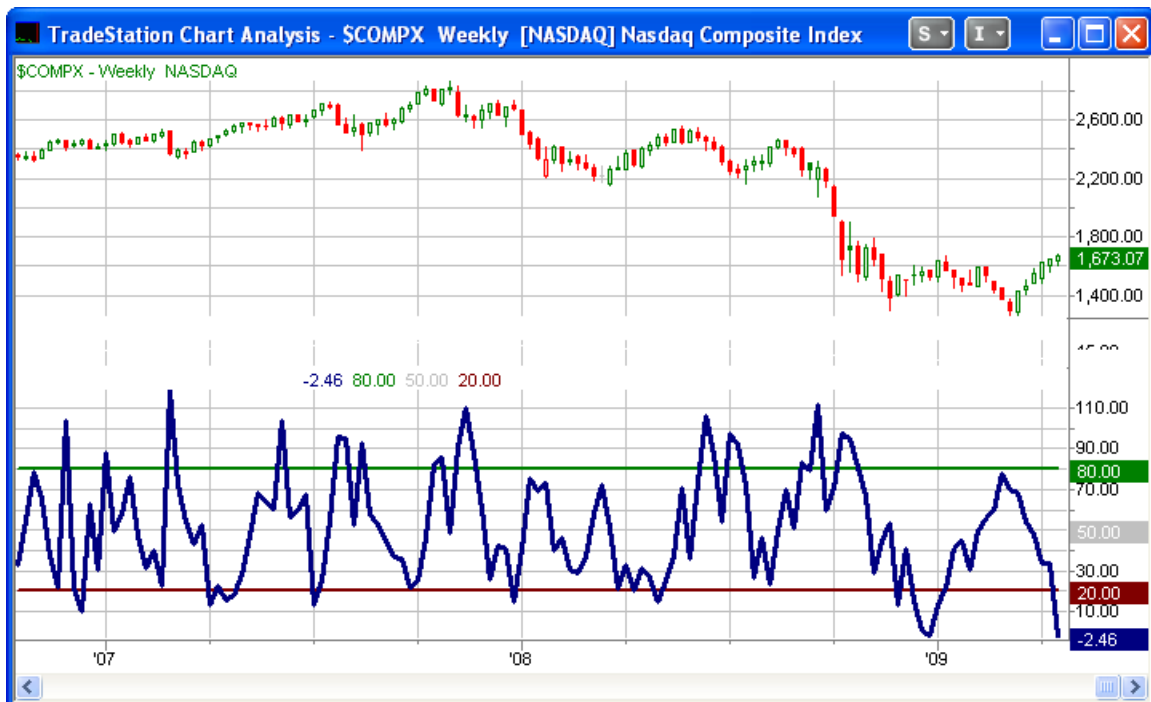
The most overbought ever would seem to suggest the market is unlikely to continue to rise at anywhere near its recent pace. On the other hand, those expecting a sharp selloff from here had better have additional evidence other than just overbought breadth.

On a price basis the market is also quite overbought. The S&P has now closed higher for 6 weeks in a row. In looking at this, returns following other such runs in the past had remained positive. What is so unusual about the current setup is that it is occurring completely below the 40-week moving average.

The only other time the S&P closed higher 6 weeks in a row and still under 200ma was April 23rd, 1982. Oddly similar to the current situation, there was a bottom attempt in the Fall of '81, and then again in mid-March of '82. The market began heading lower shortly after its six-week move off the March bottom. It then continued lower until finally bottoming in August.

If you lower the requirement to 5 weeks higher under the 40-week ma then the results would also include 11/11/66 and 8/23/02. August of 02 would have been a horrible time to buy stocks, as a big drop followed that. November of '66 wasn't nearly as bad and generally led to a slight drift lower over the next several weeks.

One indicator that does appear to have bearish intermediate-term ramifications is the Nasdaq Weekly Volume Spyx. I've been meaning to add the weekly Spyx to the charts section on the website and will get around to it at some point. Below is a current chart of the Weekly Nasdaq Spyx.



This past week's -2.46 reading is the lowest in years. I looked at other time the indicator closed below 0 and found instances to be scarce. Below are the returns over the next 1/4:

Nasdaq Weekly Volume Spyx closes below 0.										
Buy Nasdaq on close. Sell X weeks later. \$1,000,000/trade. 2000-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
13	(\$472,879.08)	7	1	6	14.29	\$9,768.88	(\$80,441.33)	0.12	0.02	(\$67,554.15)
12	(\$503,444.35)	7	1	6	14.29	\$632.28	(\$84,012.77)	0.01	0.00	(\$71,920.62)
11	(\$557,511.90)	7	0	7	0.00	\$0.00	(\$79,644.56)	0.00	0.00	(\$79,644.56)
10	(\$556,597.58)	7	0	7	0.00	\$0.00	(\$79,513.94)	0.00	0.00	(\$79,513.94)
9	(\$520,935.75)	7	1	6	14.29	\$1,231.03	(\$87,027.80)	0.01	0.00	(\$74,419.39)
8	(\$468,287.40)	7	1	6	14.29	\$1,566.33	(\$78,308.96)	0.02	0.00	(\$66,898.20)
7	(\$182,791.46)	7	2	5	28.57	\$22,924.13	(\$45,727.94)	0.50	0.20	(\$26,113.07)
6	(\$151,638.97)	7	2	5	28.57	\$38,099.52	(\$45,567.60)	0.84	0.33	(\$21,662.71)
5	(\$256,628.53)	7	2	5	28.57	\$29,390.60	(\$63,081.94)	0.47	0.19	(\$36,661.22)
4	(\$309,549.13)	7	2	5	28.57	\$24,163.21	(\$71,575.11)	0.34	0.14	(\$44,221.30)
3	(\$262,482.44)	7	2	5	28.57	\$22,889.62	(\$61,652.33)	0.37	0.15	(\$37,497.49)
2	(\$134,227.84)	7	4	3	57.14	\$16,267.61	(\$66,432.75)	0.24	0.33	(\$19,175.41)
1	\$34,749.89	7	4	3	57.14	\$32,883.81	(\$32,261.78)	1.02	1.36	\$4,964.27

Note the above table used position sizes of \$1,000,000 rather than the usual \$100,000. Ten-eleven weeks out the Nasdaq was down every time. There was some slight overlap though. Below I've listed all occurrences along with their 10-week return.

Date/Time	Signal	Price	Roll Over USD/Lot	Shares/Ctrts	Net Profit	% Profit
				Profit	Cum Net Profit	
12/28/01	1	\$1,987.26	\$0.00	503	(\$28,967.77)	(2.90%)
03/08/02	Sell	\$1,929.67			(\$28,967.77)	
07/05/02	1	\$1,448.36	\$0.00	690	(\$108,302.40)	(10.84%)
09/13/02	Sell	\$1,291.40			(\$137,270.17)	
11/22/02	1	\$1,468.74	\$0.00	680	(\$100,524.40)	(10.07%)
01/31/03	Sell	\$1,320.91			(\$237,794.57)	
11/29/02	2	\$1,478.78	\$0.00	676	(\$132,705.56)	(13.28%)
02/07/03	Sell#2	\$1,282.47			(\$370,500.13)	
11/12/04	1	\$2,085.34	\$0.00	479	(\$24,462.53)	(2.45%)
01/21/05	Sell	\$2,034.27			(\$394,962.66)	
11/26/04	2	\$2,101.97	\$0.00	475	(\$7,272.25)	(0.73%)
02/04/05	Sell#2	\$2,086.66			(\$402,234.91)	
12/26/08	1	\$1,530.24	\$0.00	653	(\$154,362.67)	(15.45%)
03/06/09	Sell	\$1,293.85			(\$556,597.58)	
04/17/09	1	\$1,673.07		597	n/a	n/a
open	n/a	\$1,673.07		n/a	n/a	

The instances with overlap were 11/02 and 11/04

To increase the sample size, I also looked at instances where the Nasdaq Weekly Volume Spyx came in at less than 10. Those results are below.

Nasdaq Weekly Volume Spyx closes below 10.										
Buy Nasdaq on close. Sell X weeks later. \$1,000,000/trade. 2000-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
13	(\$840,499.03)	24	8	16	33.33	\$75,643.35	(\$90,352.87)	0.84	0.42	(\$35,020.79)
12	(\$745,708.63)	24	8	16	33.33	\$77,306.95	(\$85,260.26)	0.91	0.45	(\$31,071.19)
11	(\$653,544.20)	24	7	17	29.17	\$105,589.40	(\$81,921.77)	1.29	0.53	(\$27,231.01)
10	(\$650,591.81)	24	9	15	37.50	\$75,966.77	(\$88,952.85)	0.85	0.51	(\$27,107.99)
9	(\$406,792.03)	24	10	14	41.67	\$72,780.38	(\$81,042.56)	0.90	0.64	(\$16,949.67)
8	(\$368,172.88)	24	10	14	41.67	\$56,955.03	(\$66,980.23)	0.85	0.61	(\$15,340.54)
7	(\$127,736.29)	24	10	14	41.67	\$45,180.25	(\$41,395.63)	1.09	0.78	(\$5,322.35)
6	(\$281,556.96)	24	8	16	33.33	\$56,600.76	(\$45,897.69)	1.23	0.62	(\$11,731.54)
5	(\$434,638.81)	24	7	17	29.17	\$56,905.58	(\$48,998.70)	1.16	0.48	(\$18,109.95)
4	(\$478,229.91)	24	8	16	33.33	\$45,679.29	(\$52,729.01)	0.87	0.43	(\$19,926.25)
3	(\$193,171.16)	24	11	13	45.83	\$40,148.96	(\$48,831.52)	0.82	0.70	(\$8,048.80)
2	(\$83,925.74)	24	12	12	50.00	\$37,534.53	(\$44,528.34)	0.84	0.84	(\$3,496.91)
1	\$11,243.32	24	11	13	45.83	\$27,481.50	(\$22,388.71)	1.23	1.04	\$468.47

Even with the loosened criteria, results are still quite bearish.

This is the first all-out bearish intermediate-term indication I've seen since the rally began six weeks ago. With the market so extended based on breadth and price, and with several short-term indications suggesting a pullback is likely, it will be interesting to see if the rally will be able to persist. My expectation is for a pullback leading to a consolidation over the next several weeks. I think the market is highly unlikely to continue at its current rate of ascent.

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.)

Index	ETF	CBI %	Index	ETF	CBI %
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	0.70
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

No signs of capitulative selling at the present time.

Additional New Trade Ideas

SPY – short 1/4 index position @ \$87.08 limit.

SPY – short 1/4 index position @ \$87.50 limit ON CLOSE.

Based on the short-term outlook I'm looking to get more aggressively short on Monday. Should the market continue higher I'll likely get a full index position short on Tuesday or Wednesday. Since this is a counter-trend trade, if the market turns lower I anticipate looking to take profits within a few days.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	4/17/2009	\$86.90	\$87.08	-0.21%		

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