

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 22, 2009

Volume 2 Issue 76

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 21, 2009	2% drop from 20-high	1-4 days	Bearish	-2.20%	-3.90%
April 17, 2009	Advancers double decliners & < 200ma	1-4 days	Bearish	-4.00%	-6.80%
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		
Dropped Tonight					
April 21, 2009	95% down volume day	1 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 4/22 – neutral

After selling off hard on Monday the market bounced back a bit on Tuesday. Both the Nasdaq and S&P closed up close to 2% after gapping down to start the day. Breadth was strong as the NYSE Up Issues % came in at 77% and the Up Volume % at 86%. Overall volume dropped from yesterday's levels.

The quick rebound today has been typical of the recent rally off the March lows. There still has not been a pullback of more than 2 days since those lows. Hence my desire to take quick profits Monday on the SPY short setup. We've been able to make some nice, quick gains off of some short trades in the last couple of weeks. Unfortunately the pullbacks have been so quick that they barely gave us time to cover the shorts and not enough time to allow for a decent long entry. Such is sometimes the case in a strong uptrend.

Every couple of weeks when reviewing market action I have a night where I completely struggle to find any substantial edge. Tonight was just one of those nights. Everything I looked at provided either choppy or what I would consider marginal results.

When looking at the SPY it's no coincidence that it is dead smack in the center of its recent 8-day range. My least favorite place to trade is in the middle of a trading range.

The list of active studies has shrunk substantially over the last few days. Many were removed yesterday as a result of profit targets being achieved. All that is left on the short-term list are 2 bearish studies.

I've updated the [Aggregator](#) chart below.



As I indicated was set to happen last night the green Aggregator line has now flipped back to bearish. Meanwhile the black Differential line remains squarely above zero, illustrating that despite Tuesday's bounce the S&P remains in a state of "underperformance" over the last few days.

I prefer taking trades when both lines are on the same side of zero. In this case, while we have a negative expectation from the studies over the last few days, the market has already underperformed expectations over the last few days. This limits downside profit potential. I'd rather wait for a more substantial edge before committing capital.

As far as individual setups, I'm not excited about anything on the triggers page. There isn't much there, either, which is to be expected when the market is in the midst of a choppy consolidation period. All this means I'm in "wait and see" mode. I doubt it will be long before more substantial edges avail themselves.

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 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. While not shown, periods leading up to 20-days are also all generally positive. As the indicator moves higher the results look even more bullish. 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.

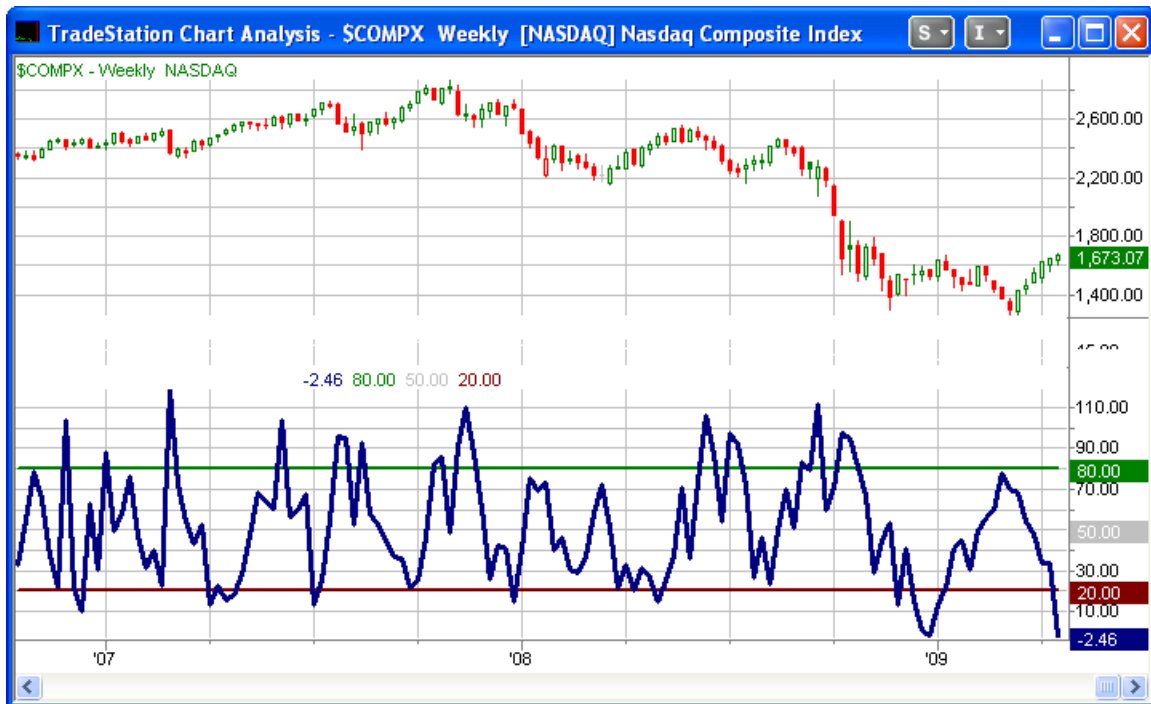
The most overbought ever would seem to suggest the market is unlikely to continue to rise at anywhere near its recent pace. On the other hand, those expecting a sharp selloff from here had better be basing their expectation on evidence other than just overbought breadth.

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 ¼:

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	Cum Net Profit	% 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)	(\$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			(\$108,302.40)	(\$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			(\$100,524.40)	(\$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			(\$132,705.56)	(\$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			(\$24,462.53)	(\$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			(\$7,272.25)	(\$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			(\$154,362.67)	(\$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

None tonight.

Active Trades Table

None tonight.

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