

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 11, 2009

Volume 2 Issue 89

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					
May 11, 2009	Friday-Monday Momentum	1 day	Bullish		
May 11, 2009	Gap-n-go 10 high	1-3 days	Bearish	-3.00%	-5.60%
May 11, 2009	Banks Up 10%	1-2 days	Bearish		
May 8, 2009	High Vol 10 WR10 Drop From 10-high	1-3 days	Bearish	-1.40%	-2.50%
May 6, 2009	WR10 Up then NR10	1-5 days	Bearish	-2.20%	-3.60%
May 5, 2009	3% up on strong volume	1-7 days	Bullish	3.20%	6.60%
Active - Long Term					
April 20, 2009	Low Nasdaq Weekly Vol Spyx	1-10 weeks	Bearish		
Dropped Tonight					
May 4, 2009	10-high low volume low bar pattern	1-5 days	Bearish	-2.00%	-3.50%

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 5/11 – bearish

The market reacted favorably to stress test and unemployment news on Friday and charged ahead strongly. Banks again led the way as they have for the last week +. Semiconductors were among the sectors not participating. After gapping up over 1%, the S&P finished nearly 2% higher on the day. Breadth was strong. The NYSE Up Issues % was 85% and the Up Volume % came in at 88%. Overall volume was down from Thursday's level but still above its 20-day average.

Most of what's currently happening appears to have short-term bearish implications. Let's first start with the bit of bullish news, though. I've shown many times how strong Fridays can often lead to follow-through on Mondays. Below is a table that looks how Mondays have performed after the 2nd Friday of the month closes up at least X%.

2nd Friday of month closes X% higher but under the 200ma.										
Buy on close. Sell 1 day later. \$100k/trade. 1960-present.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
2	\$8,784.23	9	8	1	88.89	\$1,149.67	(\$413.10)	2.78	22.26	\$976.03
1.75	\$10,778.62	13	11	2	84.62	\$1,277.37	(\$1,636.20)	0.78	4.29	\$829.12
1.5	\$11,849.65	15	13	2	86.67	\$1,163.23	(\$1,636.20)	0.71	4.62	\$789.98
1.25	\$11,408.85	20	15	5	75.00	\$1,118.26	(\$1,073.00)	1.04	3.13	\$570.44
1	\$14,227.57	29	21	8	72.41	\$998.06	(\$841.45)	1.19	3.11	\$490.61
0.75	\$16,383.92	35	25	10	71.43	\$961.80	(\$766.11)	1.26	3.14	\$468.11
0.5	\$15,277.31	49	31	18	63.27	\$956.25	(\$798.14)	1.20	2.06	\$311.78
0.25	\$14,036.55	67	39	28	58.21	\$899.14	(\$751.07)	1.20	1.67	\$209.50
0	\$11,255.61	86	49	37	56.98	\$871.66	(\$850.15)	1.03	1.36	\$130.88

As you can see, historically, the stronger the 2nd Friday has been, the stronger the following Monday has been and the higher percent chance that Monday has been up.

Taking the 1% up Fridays I also looked at returns for the rest of the week.

2nd Friday of month closes 1% higher but under the 200ma.										
Buy on close. Sell X days later. \$100k/trade. 1960-present.										
X days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	\$15,910.57	29	18	11	62.07	\$2,493.88	(\$2,634.48)	0.95	1.55	\$548.64
4	\$17,717.88	29	18	11	62.07	\$2,143.53	(\$1,896.87)	1.13	1.85	\$610.96
3	\$10,439.66	29	17	12	58.62	\$1,649.90	(\$1,467.39)	1.12	1.59	\$359.99
2	\$12,790.65	29	17	12	58.62	\$1,451.57	(\$990.51)	1.47	2.08	\$441.06
1	\$14,227.57	29	21	8	72.41	\$998.06	(\$841.45)	1.19	3.11	\$490.61

As you can see here, the follow-through is basically a 1-day phenomenon.

What's also interesting is that the carry over momentum from Friday-Monday has been extremely consistent over the last 26 years or so. Below are the results on Mondays following a 1% up day on the 2nd Friday of the month. As you can see, since mid-1982 they've all been winners.

Date/Time	Signal	Price	Roll Over USD/Lot	Shares/Ctrts Profit	Net Profit Cum Net Profit	% Profit
07/09/82	Buy	\$108.83	\$0.00	918	\$679.32	0.68%
07/12/82	Sell	\$109.57		\$679.32	\$679.32	
08/13/82	Buy	\$103.85	\$0.00	962	\$221.26	0.22%
08/16/82	Sell	\$104.08		\$221.26	\$900.58	
04/08/88	Buy	\$269.42	\$0.00	371	\$270.83	0.27%
04/11/88	Sell	\$270.15		\$270.83	\$1,171.41	
05/13/88	Buy	\$256.78	\$0.00	389	\$746.88	0.75%
05/16/88	Sell	\$258.70		\$746.88	\$1,918.29	
10/12/90	Buy	\$300.03	\$0.00	333	\$1,062.27	1.06%
10/15/90	Sell	\$303.22		\$1,062.27	\$2,980.56	
11/09/90	Buy	\$313.73	\$0.00	318	\$1,825.32	1.83%
11/12/90	Sell	\$319.47		\$1,825.32	\$4,805.88	
09/11/98	Buy	\$1,009.05	\$0.00	99	\$2,044.35	2.05%
09/14/98	Sell	\$1,029.70		\$2,044.35	\$6,850.23	
10/09/98	Buy	\$984.30	\$0.00	101	\$1,353.40	1.36%
10/12/98	Sell	\$997.70		\$1,353.40	\$8,203.63	
10/13/00	Buy	\$1,374.10	\$0.00	72	\$37.44	0.04%
10/16/00	Sell	\$1,374.62		\$37.44	\$8,241.07	
12/08/00	Buy	\$1,369.54	\$0.00	73	\$780.37	0.78%
12/11/00	Sell	\$1,380.23		\$780.37	\$9,021.44	
02/08/02	Buy	\$1,096.22	\$0.00	91	\$1,430.52	1.43%
02/11/02	Sell	\$1,111.94		\$1,430.52	\$10,451.96	
10/11/02	Buy	\$835.32	\$0.00	119	\$728.28	0.73%
10/14/02	Sell	\$841.44		\$728.28	\$11,180.24	
02/14/03	Buy	\$834.89	\$0.00	119	\$1,937.32	1.95%
02/18/03	Sell	\$851.17		\$1,937.32	\$13,117.56	
06/13/08	Buy	\$1,360.02	\$0.00	73	\$8.76	0.01%
06/16/08	Sell	\$1,360.14		\$8.76	\$13,126.32	
08/08/08	Buy	\$1,296.31	\$0.00	77	\$693.00	0.69%
08/11/08	Sell	\$1,305.31		\$693.00	\$13,819.32	
05/08/09	Buy	\$929.23		107	n/a	n/a
open	n/a	\$929.23		n/a	n/a	

A few observations with possible bearish implications include the fact that the SOX failed to participate in the rally, the banks gained over 10%, the S&P again is at new highs and there was another gap-n-go formation. Many of these situations have occurred

over the last 1-2 weeks. While they have failed to slow the move higher in the last week or so, historically they've all been short-term bearish. Let's review a few past studies that relate to the above observations.

We've looked at days the BKK (banks) closes up 10% or more a few times recently. While it would normally be a case of overenthusiasm (and likely short-covering), it didn't have a negative effect this past week. Below is an updated table.

BKK closes up 10% on the day. Buy SPX at close. Sell X days later. \$100k/trade. 1993-present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: Profit Factor	All: Avg Trade
10	-20,548.43	11	4	7	36.36	5,129.52	-5,866.64	0.87	0.50	-1,868.04
9	-23,062.14	12	4	8	33.33	6,207.12	-5,986.33	1.04	0.52	-1,921.85
8	-58,961.65	13	3	10	23.08	3,659.60	-6,994.05	0.52	0.16	-4,535.51
7	-62,856.86	13	2	11	15.38	4,943.56	-6,613.09	0.75	0.14	-4,835.14
6	-29,784.21	13	7	6	53.85	2,911.54	-8,360.83	0.35	0.41	-2,291.09
5	-17,902.80	14	7	7	50.00	3,734.34	-6,291.88	0.59	0.59	-1,278.77
4	-22,586.05	15	7	8	46.67	2,225.97	-4,770.98	0.47	0.41	-1,505.74
3	-11,880.35	16	7	9	43.75	2,750.59	-3,459.39	0.80	0.62	-742.52
2	-18,535.79	18	8	10	44.44	1,753.15	-3,256.10	0.54	0.43	-1,029.77
1	-18,937.76	19	7	12	36.84	1,034.87	-2,181.82	0.47	0.28	-996.72

With Monday, Wednesday, and Friday all putting in a 10%+ day for the banks, it would certainly seem a pullback would be in order.

I last discussed the "Gap-n-Go" formation on May 7th. It has now occurred once again. Below is a quick review of the previous studies. "Gap-n-Go" refers to days where the market gaps higher, never fills its gap, and then closes above the open. They are fairly unusual, and while some people view them as a sign of strength, they more often lead to short-term weakness. This is especially true when the market is locked in a long-term downtrend (as defined by the 200-day moving average).

First, a breakdown by gap size:

SPY gaps at least X% above yesterday's close. It never trades <= yesterday's close and closes > the open. Close < 200ma.										
Buy on close. Sell 5 days later. \$100k/trade. 1994-present.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
2	(\$21,850.74)	18	10	8	55.56	\$2,960.20	(\$6,431.59)	0.46	0.58	(\$1,213.93)
1.5	(\$29,924.27)	26	13	13	50.00	\$3,030.09	(\$5,331.96)	0.57	0.57	(\$1,150.93)
1	(\$28,494.20)	40	20	19	50.00	\$2,768.95	(\$4,414.38)	0.63	0.66	(\$712.36)
0.5	(\$53,106.69)	64	34	29	53.13	\$2,058.03	(\$4,244.12)	0.48	0.57	(\$829.79)
0	(\$78,496.85)	100	52	47	52.00	\$1,747.89	(\$3,603.98)	0.48	0.54	(\$784.97)

As you can see, the downside edge here is not due to the % of profitable trades, but rather the Win/Loss Ratio. Losers have outsized winner by a wide margin over the test period.

Looking at the 1% gaps stats more closely led to the following study:

SPY gaps at least 1% above yesterday's close. It never trades <= yesterday's close and closes > the open. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 1994-present.										
X days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	(\$28,494.20)	40	20	19	50.00	\$2,768.95	(\$4,414.38)	0.63	0.66	(\$712.36)
4	(\$44,290.67)	43	20	23	46.51	\$2,012.70	(\$3,675.85)	0.55	0.48	(\$1,030.02)
3	(\$24,033.10)	43	18	25	41.86	\$2,265.32	(\$2,592.35)	0.87	0.63	(\$558.91)
2	(\$23,980.34)	45	23	22	51.11	\$1,824.66	(\$2,997.62)	0.61	0.64	(\$532.90)
1	(\$15,965.99)	46	24	21	52.17	\$711.43	(\$1,573.35)	0.45	0.52	(\$347.09)

The case becomes more compelling when you look at times where the SPY also makes a 10-day high.

SPY gaps at least 1% above yesterday's close. It never trades <= yesterday's close, makes a 10-day intraday high and closes > the open. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 1994-present.										
X days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	(\$15,094.79)	14	7	7	50.00	\$1,612.24	(\$3,768.64)	0.43	0.43	(\$1,078.20)
4	(\$17,113.60)	15	6	9	40.00	\$1,346.53	(\$2,799.20)	0.48	0.32	(\$1,140.91)
3	(\$21,076.11)	15	4	11	26.67	\$1,474.13	(\$2,452.06)	0.60	0.22	(\$1,405.07)
2	(\$19,250.20)	16	8	8	50.00	\$539.73	(\$2,946.00)	0.18	0.18	(\$1,203.14)
1	(\$14,168.38)	16	7	9	43.75	\$448.94	(\$1,923.44)	0.23	0.18	(\$885.52)

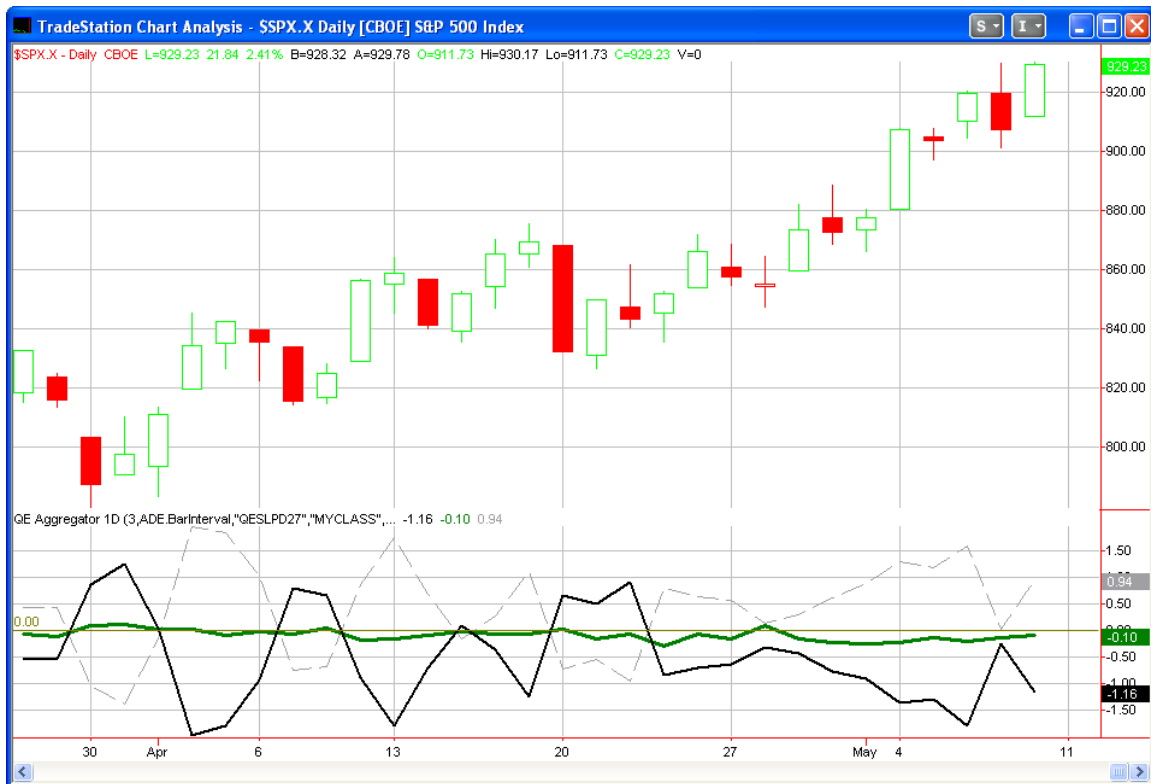
As the S&P is now nearing its 200-day moving average, it is becoming prudent to also consider behavior when the market is not necessarily locked in a long-term downtrend. Below is the last test run when the market is ABOVE its 200-day moving average:

SPY gaps at least 1% above yesterday's close. It never trades <= yesterday's close, makes a 10-day intraday high and closes > the open. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 1994-present.										
X days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	\$3,763.27	14	7	7	50.00	\$2,106.38	(\$1,568.77)	1.34	1.34	\$268.81
4	\$2,309.35	14	7	7	50.00	\$1,949.73	(\$1,619.82)	1.20	1.20	\$164.95
3	(\$5,111.69)	14	7	7	50.00	\$1,115.62	(\$1,845.86)	0.60	0.60	(\$365.12)
2	(\$5,464.16)	14	7	7	50.00	\$364.63	(\$1,145.22)	0.32	0.32	(\$390.30)
1	(\$4,111.62)	14	5	9	35.71	\$735.43	(\$865.42)	0.85	0.47	(\$293.69)

Not visible above is that 11 of 14 instances (79%) closed lower than the trigger day close at some point in the next 3 days.

While not as outright negative when above to 200ma, the market may still be expected to struggle even if it is a long-term uptrend.

The [Aggregator](#) chart has been updated below.



The green Aggregator line remains below 0. This means the net estimates of the current active studies suggest downside over the next few days. Meanwhile the black Differential line is strongly below 0, indicating the S&P has strongly outperformed expectations over the last few days. Both lines squarely below 0 is the kind of configuration I look for when taking on short exposure.

Over the last week and a half the market has consistently and strongly bucked the bearish indications and rocketed higher. Outperformance of this magnitude is something rarely seen except when the market is first emerging from a strongly oversold low. In March I avoided shorting due to such dangers and it panned out. Opportunistic entries and quick exits made for good short-side trade ideas in April. With some of the bearish intermediate-term studies that began to appear in the last couple of weeks it appeared the market was setting up to struggle a bit during May. That has not played out to this point.

I still think at this point it is worth taking a conservative approach to counter-trend short trades. Although the market has exhibited exceptional strength over the last week plus, I'd be surprised to see that strength continue without a respite. With some short exposure already, I'll be looking to add more should the market begin the week on a strong note.

Intermediate-term Outlook (2 weeks – 2 months)–starting to lean bearish -updated 5/11

As mentioned above the market has managed to defy some fairly compelling bearish indications over the past couple of weeks. The abnormal strength in the face of such bearish expectations suggests caution is warranted – both on the short side and the long side.

One indicator I've referenced the last few weeks was the Quantifiable Edges Nasdaq Weekly Volume Spyx indicator. The extremely low reading over the last few weeks have previously only been found prior to market pullbacks. This week the reading has moved up to around 13. This is still quite low and a reading that often carries downside implications. On the heels of an unheard-of 3 sub-zero readings in a row, the Nasdaq Weekly Volume Spyx continues to flash warning signs.

Of further concern is that we are seeing leadership from areas that don't typically lead the market during a healthy advance. Last week I showed two studies that examined leadership. One looked at XLU and the other at IYT. Additionally, just on Friday we saw that the SOX is lagging and that banks are. This also is a possible danger sign.

[On the blog last week I showed](#) a breadth indicator tracked by Worden Bros. that measures the % of stocks trading at least 2 standard deviations above their 40-day moving average. Friday that measure again hit an all-time high with a 56% reading.

We've got volume statistics suggesting downside, leadership coming from suspect areas of the market, and breadth indicating the market is as overdone as its been in at leadership. On the other hand all these bearish indications have yet to be confirmed by price. Agility is key when trading against the trend, and until the market rolls over the intermediate-term trend should remain thought of as up. That means short trades should only be taken with favorable entries and the profits should be taken quicker than usual. With conditions so overbought and so much suggesting downside, it's not a bad idea to treat new long trades in a similar manner.

Basically I'll be keeping my time frame short-term and looking for quick exits until either price succumbs and I can more aggressively play the downside, or until I begin to get some more bullish indications suggesting the rally has a good chance to continue.

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	0.00
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

Still no signs of capitulative selling.

Additional New Trade Ideas

ETR – short @ \$74.70 limit. Place stop at \$76.51 if filled. ETR put in a possible reversal bar on Friday. This allows us to try and take advantage of system -80505 and also institute a reasonable stop. The exit target is a close below the 5-day moving average.

SPY short 1/4 index position @ \$93.00 limit on close. – This trade idea is based on the short-term market outlook above. Another up day tomorrow would also trigger the “2 days up in chop” system at the very least.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)(s)	5/5/2009	\$90.75	\$92.98	-2.46%		
IYT(s)	5/5/2009	\$60.15	\$59.98	0.28%		exit on close < 5ma
CPB(s)	5/6/2009	\$26.53	\$26.40	0.49%	\$26.85	exit on close < 5ma
SPY(1/4)(s)	5/7/2009	\$93.01	\$92.98	0.03%		

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