

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 12, 2009

Volume 2 Issue 90

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 12, 2009	Narrow range down	1-5 days	Bearish	-2.40%	-4.20%
May 12, 2009	1% Drop on bad breadth	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 11, 2009	Friday-Monday Momentum	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 5/11 – neutral

Monday saw the market sell off. Much of the selloff happened before the bell as the market gapped down substantially and then traded in a very tight range during the day. The Nasdaq only closed down about 0.5% while the S&P dropped over 2%. NYSE breadth was quite weak as would be expected. The Up Issues % came in at 28% and the Up Volume % at 17%. Total volume dropped quite a bit from Friday's levels.

What really stood out today were the small range and the sizable pullback. Many tests tonight should inconclusive or weak results. The extremely low range provided some interesting results, though.

Below is an updated version of a table that appeared in the 3/30 Letter.

SPY posts lowest intraday range in 60 days.										
Buy on close. Sell X days later. \$100k/trade. 1999-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profti Fact	Avg Trade
10	(\$45,545.61)	44	20	24	45.45	\$1,420.72	(\$3,081.67)	0.46	0.38	(\$1,035.13)
9	(\$44,428.22)	45	19	26	42.22	\$1,604.66	(\$2,881.41)	0.56	0.41	(\$987.29)
8	(\$34,606.95)	48	20	28	41.67	\$1,467.55	(\$2,284.21)	0.64	0.46	(\$720.98)
7	(\$22,138.26)	49	20	29	40.82	\$1,899.87	(\$2,073.64)	0.92	0.63	(\$451.80)
6	(\$13,699.23)	49	20	29	40.82	\$1,916.15	(\$1,793.87)	1.07	0.74	(\$279.58)
5	(\$14,692.27)	52	24	28	46.15	\$1,678.22	(\$1,963.20)	0.85	0.73	(\$282.54)
4	(\$15,007.89)	56	23	33	41.07	\$1,636.13	(\$1,595.12)	1.03	0.71	(\$268.00)
3	(\$10,841.35)	58	23	35	39.66	\$1,526.61	(\$1,312.95)	1.16	0.76	(\$186.92)
2	(\$18,602.87)	60	28	32	46.67	\$999.37	(\$1,455.78)	0.69	0.60	(\$310.05)
1	(\$17,001.89)	63	29	34	46.03	\$663.51	(\$1,065.99)	0.62	0.53	(\$269.87)

The low range by itself has seemed to have somewhat bearish implications. What if the low range came on a down day for the market?

SPY posts lowest intraday range in 60 days. Close < yesterday's close.										
Buy on close. Sell X days later. \$100k/trade. 1999-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profti Fact	Avg Trade
10	(\$27,791.40)	24	11	13	45.83	\$1,202.00	(\$3,154.88)	0.38	0.32	(\$1,157.98)
9	(\$25,055.63)	24	8	16	33.33	\$1,807.11	(\$2,469.53)	0.73	0.37	(\$1,043.98)
8	(\$28,154.76)	25	10	15	40.00	\$1,125.15	(\$2,627.08)	0.43	0.29	(\$1,126.19)
7	(\$18,696.14)	26	11	15	42.31	\$1,500.29	(\$2,346.62)	0.64	0.47	(\$719.08)
6	(\$17,528.29)	26	10	16	38.46	\$1,606.14	(\$2,099.36)	0.77	0.48	(\$674.17)
5	(\$18,087.32)	28	11	17	39.29	\$1,783.82	(\$2,218.19)	0.80	0.52	(\$645.98)
4	(\$14,480.15)	29	10	19	34.48	\$1,714.47	(\$1,664.47)	1.03	0.54	(\$499.32)
3	(\$9,050.58)	29	10	19	34.48	\$1,694.38	(\$1,368.12)	1.24	0.65	(\$312.09)
2	(\$12,702.77)	29	14	15	48.28	\$936.30	(\$1,720.73)	0.54	0.51	(\$438.03)
1	(\$10,681.11)	29	11	18	37.93	\$518.65	(\$910.35)	0.57	0.35	(\$368.31)

In that case the results were even a bit more bearish. There are a few things to note here that aren't evident in the above table. First, 24 of 29 instances (86%) saw the SPY close below its trigger day close at some point in the next 4 days. This is quite a high number. Interestingly, the last 2 times it has occurred, 4/7/09 and 5/5/09, it has led to swift rises and there was no lower close. That speaks to the power of the recent up move from the March lows.

The sharp pullback can be looked at a number of ways. We've seen many times that sharp pullbacks often lead to bounces. This has especially been true as the market has evolved over the last decade or so and become increasingly more choppy. The exception to the rule, though, is when the market is extended upwards prior to the sharp pullback. For example let's look at days where the S&P 500 has dropped more than 1% and advancers have led declines by at least 2:1.

The below table last appeared in the 4/15 subscriber letter:

SPX drops 1% and decliners more than double advancers. Buy SPX on close. Sell X days later. \$100k/trade. From 10/20/87 – present.

QE bad breadth pullb: daysin	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: ProfitFactor	All: Avg Trade
10	209,160.38	232	156	76	67.24	2,691.47	-2,772.49	0.97	1.99	901.55
9	234,845.87	237	164	73	69.20	2,605.31	-2,635.96	0.99	2.22	990.91
8	201,802.01	251	164	86	65.34	2,582.42	-2,578.08	1.00	1.91	803.99
7	215,319.51	270	168	102	62.22	2,616.16	-2,197.99	1.19	1.96	797.48
6	198,530.12	286	177	109	61.89	2,479.01	-2,204.18	1.12	1.83	694.16
5	179,244.85	312	186	126	59.62	2,298.01	-1,969.72	1.17	1.72	574.50
4	119,886.30	333	191	142	57.36	2,027.72	-1,883.16	1.08	1.45	360.02
3	145,611.16	364	224	140	61.54	1,749.82	-1,759.64	0.99	1.59	400.03
2	142,575.80	414	231	183	55.80	1,709.30	-1,378.54	1.24	1.57	344.39
1	106,678.01	464	279	185	60.13	1,132.22	-1,130.88	1.00	1.51	229.91

There's a clear upside edge here. Now let's look at times it was coming off of a new high vs. times it wasn't. First, times without a new high:

SPX drops 1% and decliners more than double advancers. Yesterday the SPX did NOT close at a 20-day high. Buy SPX on close. Sell X days later. \$100k/trade. From 10/20/87 – present.

QE bad breadth pullb: daysin	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: ProfitFactor	All: Avg Trade
10	206,671.42	217	141	76	64.98	2,928.93	-2,714.57	1.08	2.00	952.40
9	241,653.31	225	157	68	69.78	2,760.53	-2,819.86	0.98	2.26	1,074.01
8	209,396.43	237	155	81	65.40	2,752.59	-2,682.15	1.03	1.96	883.53
7	213,644.30	254	157	97	61.81	2,675.58	-2,128.06	1.26	2.03	841.12
6	198,827.77	269	168	101	62.45	2,541.39	-2,258.68	1.13	1.87	739.14
5	189,551.97	290	177	113	61.03	2,326.72	-1,967.06	1.18	1.85	653.63
4	137,226.48	308	181	127	58.77	2,109.98	-1,926.81	1.10	1.56	445.54
3	140,714.83	338	208	130	61.54	1,826.33	-1,839.71	0.99	1.59	416.32
2	143,263.80	384	217	167	56.51	1,758.36	-1,426.95	1.23	1.60	373.08
1	97,848.15	431	254	177	58.93	1,161.60	-1,114.12	1.04	1.50	227.03

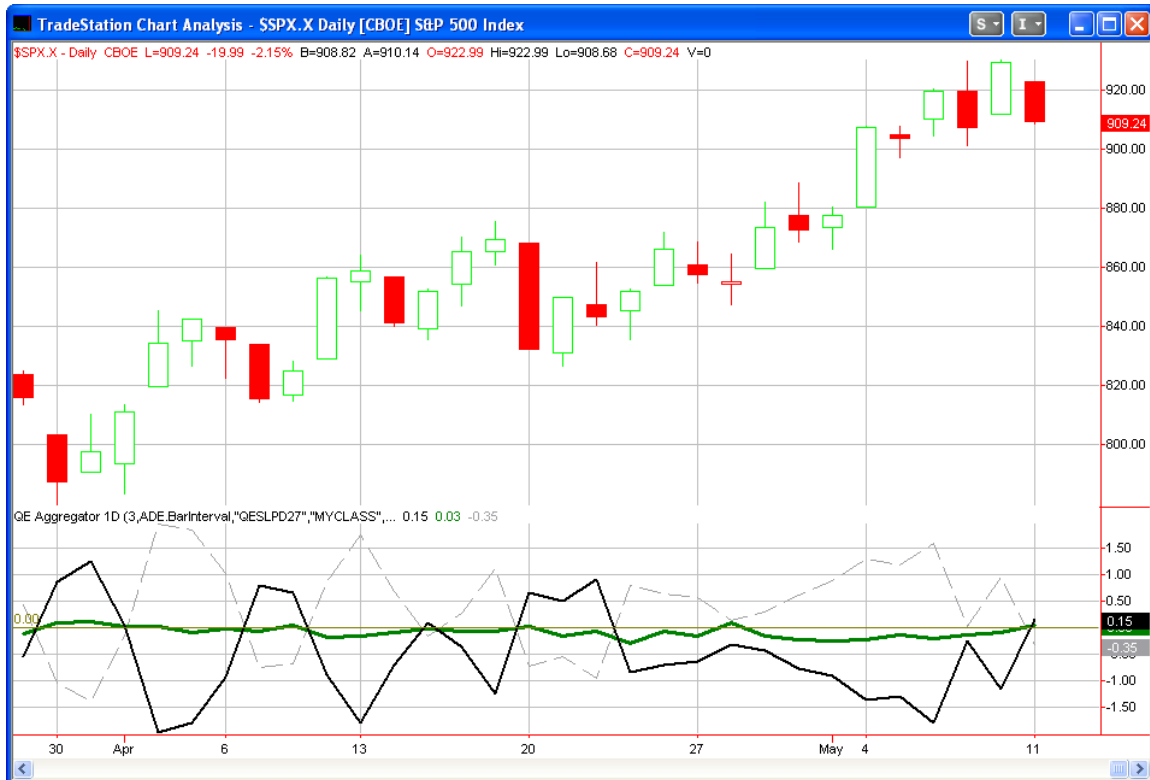
Results generally improved here as you'd expect. Now with a new high in the mix:

SPX drops 1% and decliners more than double advancers. Yesterday the SPX closed at a 20-day high. Buy SPX on close. Sell X days later. \$100k/trade. From 10/20/87 – present.

QE bad breadth pullb: daysin	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: ProfitFactor	All: Avg Trade
10	3,429.34	29	21	8	72.41	2,077.11	-5,023.74	0.41	1.09	118.25
9	9,060.26	29	21	8	72.41	2,019.43	-4,168.46	0.48	1.27	312.42
8	4,874.27	29	20	9	68.97	2,151.03	-4,238.48	0.51	1.13	168.08
7	8,371.76	29	18	11	62.07	2,218.57	-2,869.32	0.77	1.27	288.68
6	1,820.95	29	17	12	58.62	1,794.95	-2,391.10	0.75	1.06	62.79
5	-9,188.73	29	15	14	51.72	1,694.20	-2,471.56	0.69	0.73	-316.85
4	-4,422.96	31	15	16	48.39	1,462.05	-1,647.11	0.89	0.83	-142.68
3	5,291.00	33	21	12	63.64	1,117.25	-1,514.27	0.74	1.29	160.33
2	6,140.74	33	17	16	51.52	1,183.10	-873.25	1.35	1.44	186.08
1	8,829.86	33	25	8	75.76	833.75	-1,501.75	0.56	1.73	267.57

When the market is coming off a 20-day high the only edge appears to be a 1-day reflex bounce. Other than that the edge completely disappears. This is consistent with other pullback scenarios I looked at. The edge tends to be greatly reduced or eliminated when the market is pulling back from a high point.

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



Both the green Aggregator line and the black Differential line are now very slightly positive. The Aggregator has moved up primarily on the fact that there will be 3 bearish studies expiring at tomorrow's close. Without a selloff tomorrow the black Aggregator line will flip back down below 0.

All this means the Aggregator chart is neutral. The studies are no longer providing a substantial edge. When this happens I typically look to get flat. I'll be looking to exit the SPY positions tomorrow morning as described in the trade ideas section below.

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

CSCO – buy @ \$18.61 limit. Place stop at \$18.25 if filled. CSCO has pulled back and triggered system 11111. It also bounced off its 200-day moving average for the 1st time since blasting through it about 2 weeks ago. I'll place a stop a little below Monday's low, risking about 2% on the trade. If it looks to gap below \$18.40 then the order will be cancelled since we will be buying too close to the stop.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)(s)	5/5/2009	\$90.75	\$91.24	-0.54%		
IYT(s)	5/5/2009	\$60.15	\$57.66	4.14%		sold on close < 5ma
CPB(s)	5/6/2009	\$26.53	\$26.85	-1.21%	\$26.85	stopped out
SPY(1/4)(s)	5/7/2009	\$93.01	\$91.24	1.90%		

IYT and CPB were both covered on Monday. CPB hit its stop and IYT hit its target.

Based on the neutral short-term market outlook I will be looking to exit the SPY. I will initially place a limit order to cover at \$91.35. Basically, I am not interesting in buying into a gap up. Should it gap up and not fill in the first 20-30 minutes of the day, I may send out an intraday update with an adjusted target or stop level.

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