

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 13, 2009

Volume 2 Issue 91

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 13, 2009	2 Down In Chop	1-3 days	Bullish	***	***
May 12, 2009	Narrow range down	1-5 days	Bearish	-2.40%	-4.20%
May 11, 2009	Gap-n-go 10 high	1-3 days	Bearish	-3.00%	-5.60%
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 6, 2009	WR10 Up then NR10	1-5 days	Bearish	-2.20%	-3.60%
May 8, 2009	High Vol 10 WR10 Drop From 10-high	1-3 days	Bearish	-1.40%	-2.50%
May 11, 2009	Banks Up 10%	1-2 days	Bearish		
May 12, 2009	1% Drop on bad breadth	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 5/13 – neutral

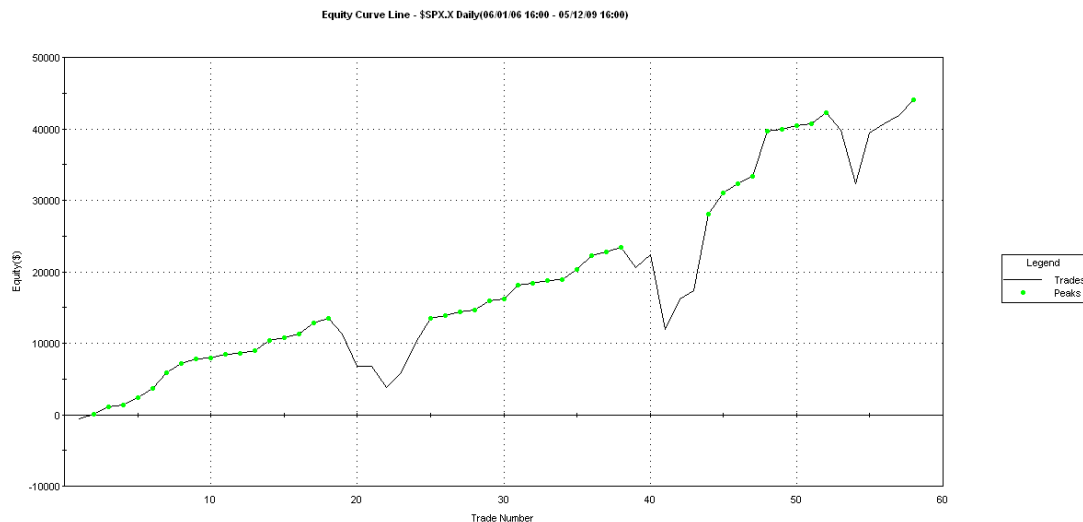
Tuesday saw some additional selling in the market. While the S&P bounced back in the afternoon and nearly managed to close positive, several other indices such as the Nasdaq, Russel 2000, Semiconductors, and S&P Equal Weighted all finished substantially lower. Breadth was poor. NYSE Up Issues % closed at 42% and the Up Volume % came in at 29%. Total volume rose slightly over the previous day.

What may stand out immediately to some subscribers is the triggering of the “2 Days Down In Chop” strategy. To review, this simple system looks to go long the S&P 500 anytime it closes lower for the 2nd day in a row. It then exits the position at the 1st profitable close up to 3 days later. It will exit on the close of the 3rd day regardless of profitability. Below are updated results for the period of June, 2007 (when the market became especially choppy) to present. They assume \$100k/ trade.

All Trades

Total Net Profit	\$44,017.94	Profit Factor	2.32
Gross Profit	\$77,317.80	Gross Loss	(\$33,299.86)
Roll Over Credit	\$0.00		
Open Position Profit/Loss	\$0.00		
Select Total Net Profit	\$33,301.91	Select Profit Factor	2.00
Select Gross Profit	\$66,601.77	Select Gross Loss	(\$33,299.86)
Adjusted Total Net Profit	\$21,310.27	Adjusted Profit Factor	1.47
Adjusted Gross Profit	\$66,383.41	Adjusted Gross Loss	(\$45,073.14)
Total Number of Trades	58	Percent Profitable	86.21%
Winning Trades	50	Losing Trades	8
Even Trades	0		
Avg. Trade Net Profit	\$758.93	Ratio Avg. Win:Avg. Loss	0.37
Avg. Winning Trade	\$1,546.36	Avg. Losing Trade	(\$4,162.48)
Largest Winning Trade	\$10,716.03	Largest Losing Trade	(\$10,506.45)

Quite impressive statistics for a long-only system in a bear market environment. Some traders may recall that the system underwent a sharp drawdown in early March. That drawdown has already been completely overcome and the system just began hitting new highs again. This can be seen in the equity performance curve below.



While the system is extremely simple, one thing I particularly like about it is that while drawdowns were sharp, the recoveries from the drawdowns were always quick.

Action like today where a mild S&P selloff was followed by a big down day is something that I've looked at in the past. Below is an excerpt with some studies from the 2/19/09 Subscriber Letter. (Tables have not been updated.)

The line can sometimes be fine between a weak bounce and a mild selloff, but let's look at the implications of each to better understand why a close below that target area was not a bearish event.

First let's look again at the "weak bounce" price study. (There were also some based on breadth – one of which I linked to today.) The table below is updated through January 14th:

SPX drops 1.75% or more yesterday. Today it closes higher but recovers less than 1/4 of yesterday's drop.										
Buy on close. Sell X days later. \$100k/trade. Last 20 years.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$47,182.29)	40	12	28	30.00	\$2,570.33	(\$2,786.65)	0.92	0.40	(\$1,179.56)
9	(\$44,659.82)	41	15	26	36.59	\$2,149.67	(\$2,957.88)	0.73	0.42	(\$1,089.26)
8	(\$37,642.83)	43	15	28	34.88	\$2,519.91	(\$2,694.34)	0.94	0.50	(\$875.41)
7	(\$39,016.23)	45	16	29	35.56	\$2,588.13	(\$2,773.32)	0.93	0.51	(\$867.03)
6	(\$36,530.37)	45	15	30	33.33	\$2,299.72	(\$2,367.54)	0.97	0.49	(\$811.79)
5	(\$32,646.73)	48	20	28	41.67	\$1,651.43	(\$2,345.55)	0.70	0.50	(\$680.14)
4	(\$30,136.20)	48	19	29	39.58	\$1,520.78	(\$2,035.55)	0.75	0.49	(\$627.84)
3	(\$31,784.77)	50	17	33	34.00	\$1,763.11	(\$1,871.44)	0.94	0.49	(\$635.70)
2	(\$21,661.55)	51	24	27	47.06	\$1,167.61	(\$1,840.16)	0.63	0.56	(\$424.74)
1	(\$21,286.71)	51	20	31	39.22	\$743.77	(\$1,166.52)	0.64	0.41	(\$417.39)

What I saw here was an immediate and consistent downside edge – both with regards to % Wins as well as Avg. Trade. But what if instead of the weak bounce we examine a mild selloff? Below are results that look at this:

After dropping over 1.75% yesterday the S&P 500 falls less than 0.5% today.										
Buy on close. Sell X days later. \$100k/trade. 1988-present										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$43,484.65	32	22	10	68.75	\$3,132.99	(\$2,544.11)	1.23	2.71	\$1,358.90
9	\$51,688.97	33	24	9	72.73	\$2,940.02	(\$2,096.83)	1.40	3.74	\$1,566.33
8	\$56,550.70	33	23	10	69.70	\$3,125.03	(\$1,532.49)	2.04	4.69	\$1,713.66
7	\$46,578.79	33	25	8	75.76	\$2,540.72	(\$2,117.42)	1.20	3.75	\$1,411.48
6	\$41,041.18	33	22	11	66.67	\$2,495.38	(\$1,259.73)	1.98	3.96	\$1,243.67
5	\$26,962.97	33	21	12	63.64	\$2,170.26	(\$1,551.05)	1.40	2.45	\$817.06
4	\$22,265.55	34	21	13	61.76	\$2,345.70	(\$2,076.47)	1.13	1.82	\$654.87
3	\$16,305.69	34	22	12	64.71	\$1,842.00	(\$2,018.18)	0.91	1.67	\$479.58
2	\$8,890.54	34	21	13	61.76	\$1,405.85	(\$1,587.10)	0.89	1.43	\$261.49
1	\$7,185.04	34	22	12	64.71	\$1,039.10	(\$1,306.27)	0.80	1.46	\$211.32

Here we see that over the last 21 years there has been an immediate and consistent upside edge. Both % wins and Avg. Trades are nearly inverted from the 1st study. Let's take this one a step further, though. To help ensure the 0% to -0.5% isn't over optimized I ran a test showing % drop ranges:

First let's look at this in the context of "next day" performance:

After dropping over 1.75% yesterday the S&P 500 falls less than X% today.										
Buy on close. Sell at tomorrow's close. \$100k/trade. 1988-present										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
-0.1	\$1,578.45	6	4	2	66.67	\$794.25	(\$799.27)	0.99	1.99	\$263.08
-0.2	\$723.02	16	10	6	62.50	\$660.36	(\$980.10)	0.67	1.12	\$45.19
-0.3	\$7,837.36	21	15	6	71.43	\$914.53	(\$980.10)	0.93	2.33	\$373.21
-0.4	\$12,540.72	27	20	7	74.07	\$988.41	(\$1,032.51)	0.96	2.74	\$464.47
-0.5	\$7,185.04	34	22	12	64.71	\$1,039.10	(\$1,306.27)	0.80	1.46	\$211.32
-0.6	\$8,483.42	39	25	14	64.10	\$1,145.18	(\$1,439.01)	0.80	1.42	\$217.52
-0.7	\$6,746.09	41	25	16	60.98	\$1,145.18	(\$1,367.72)	0.84	1.31	\$164.54
-0.8	\$6,035.19	47	30	17	63.83	\$1,050.24	(\$1,498.35)	0.70	1.24	\$128.41
-0.9	\$9,748.19	53	34	19	64.15	\$1,141.70	(\$1,529.97)	0.75	1.34	\$183.93
-1	\$4,658.76	58	37	21	63.79	\$1,097.43	(\$1,711.72)	0.64	1.13	\$80.32

Here we see the bullish edge, while not huge, is evident across the spectrum. Now let's look at the 5-day returns:

After dropping over 1.75% yesterday the S&P 500 falls less than X% today.										
Buy on close. Sell 5 days later. \$100k/trade. 1988-present										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
-0.1	\$7,158.41	6	3	3	50.00	\$3,959.16	(\$1,573.02)	2.52	2.52	\$1,193.07
-0.2	\$11,748.32	16	9	7	56.25	\$2,509.77	(\$1,548.51)	1.62	2.08	\$734.27
-0.3	\$22,812.76	21	13	8	61.90	\$2,607.11	(\$1,384.96)	1.88	3.06	\$1,086.32
-0.4	\$31,975.18	27	17	10	62.96	\$2,659.69	(\$1,323.95)	2.01	3.42	\$1,184.27
-0.5	\$26,962.97	33	21	12	63.64	\$2,170.26	(\$1,551.05)	1.40	2.45	\$817.06
-0.6	\$27,832.23	38	23	15	60.53	\$2,179.11	(\$1,485.81)	1.47	2.25	\$732.43
-0.7	\$29,512.26	39	24	15	61.54	\$2,158.31	(\$1,485.81)	1.45	2.32	\$756.72
-0.8	\$29,569.55	45	27	18	60.00	\$2,173.47	(\$1,617.45)	1.34	2.02	\$657.10
-0.9	\$48,497.38	51	31	20	60.78	\$2,579.87	(\$1,573.93)	1.64	2.54	\$950.93
-1	\$52,928.22	56	34	22	60.71	\$2,628.66	(\$1,656.65)	1.59	2.45	\$945.15

More of the same here as the bullish edge is again apparent across the spectrum. The average trade numbers of around 1% are fairly sizable for a 5-day holding period.

I also looked at the one-day performance of the S&P vs. other indices (Russell, Nasdaq, SOX, etc.) to evaluate possible implications of its relative outperformance on a down day. Unfortunately I was unable to uncover anything substantial.

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



The current studies are now collectively suggesting possible bullish implications over the next few days. This can be seen in the fact that the green Aggregator line is positive. Meanwhile the black Differential line is slightly negative, indicating the market has outperformed expectations over the last few days.

Should the S&P close lower again tomorrow the black Differential line would flip squarely to the upside.

The current outlook appears neutral to slightly bullish. I'll be looking to get long should the S&P close down again tomorrow. Details 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

SPY – buy 1/4 index position @ \$90.96 limit ON CLOSE. Based on the short-term market outlook above, I'm hoping to take advantage of further weakness.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)(s)	5/5/2009	\$90.75	\$91.35	-0.66%		closed at limit price
SPY(1/4)(s)	5/7/2009	\$93.01	\$91.35	1.78%		closed at limit price
CSCO	5/12/2009	\$18.61	\$18.72	0.59%	\$18.25	

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