

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 18, 2009

Volume 2 Issue 94

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 + 1/2 Std Dev
Active					
May 15, 2009	5 Lower lows from 50-day high	1-10 days	Bearish	-2.40%	-3.30%
May 15, 2009	Strong breadth weak volume	1-3 days	Bearish	-3.40%	-4.80%
May 14, 2009	3 Dn & 2 Drop 1.75%	1-10 days	Bullish	5.70%	7.60%
Active - Long Term					
April 20, 2009	Low Nasdaq Weekly Vol Spyx	1-10 weeks	Bearish		
Dropped Tonight					
May 13, 2009	2 Down In Chop	1-3 days	Bullish	***	***
May 12, 2009	Narrow range down	1-5 days	Bearish	-2.40%	-3.30%

If the avg max move is achieved it will appear in **bold and brown**. If the avg + 1/2 std deviation is achieved, the study will in *bold italic blue*.

Short-term Outlook (1-5 days) – updated 5/18 – neutral

Thursday's volume signaled a warning sign for us that the bounce may be fleeting. Friday showed that it was. A morning rally failed just below Thursday's high. Sellers then came in and took control for the rest of the day. Even after managing to rally a bit in the last hour, the S&P still finished over 1% lower on the day. Breadth was squarely negative. The NYSE Up Issues % came in at 37% and the Up Volume % was 20%. Total volume came in below both Thursday's level and the 20-day average.

Friday also marked the 5th day in a row that the S&P 500 made a lower low. Five lower lows is often cited as a pattern with an upside bias, but it is actually largely dependent on where the pattern takes place. I'll illustrate this a few different ways. First I'll break it out in a way that I originally did in the May 12, 2008 Letter – by times it was coming off a 50-day high and times it wasn't. First let's look at times it wasn't:

S&P 500 makes 5 consecutive lower lows. The highest high of the last 6 days < the highest high of the last 50 days.										
Buy on close. Sell X days later. \$100k/trade. 1978-present.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	\$127,273.89	77	52	25	67.53	\$4,945.67	(\$5,196.03)	0.95	1.98	\$1,652.91
15	\$80,761.85	78	49	28	62.82	\$3,982.75	(\$4,085.46)	0.97	1.71	\$1,035.41
10	\$54,640.46	81	47	34	58.02	\$3,619.14	(\$3,395.85)	1.07	1.47	\$674.57
9	\$61,143.65	83	49	34	59.04	\$3,350.43	(\$3,030.21)	1.11	1.59	\$736.67
8	\$61,871.65	83	48	35	57.83	\$3,492.04	(\$3,021.32)	1.16	1.59	\$745.44
7	\$52,820.74	85	50	35	58.82	\$3,092.58	(\$2,908.80)	1.06	1.52	\$621.42
6	\$28,094.98	87	53	34	60.92	\$2,506.91	(\$3,081.51)	0.81	1.27	\$322.93
5	\$35,419.85	87	49	38	56.32	\$2,508.31	(\$2,302.29)	1.09	1.40	\$407.12
4	\$50,879.49	87	54	33	62.07	\$2,328.14	(\$2,267.88)	1.03	1.68	\$584.82
3	\$65,921.65	87	53	34	60.92	\$2,146.18	(\$1,406.65)	1.53	2.38	\$757.72
2	\$53,863.79	87	57	30	65.52	\$1,669.24	(\$1,376.10)	1.21	2.30	\$619.12
1	\$46,534.66	87	55	32	63.22	\$1,369.30	(\$899.28)	1.52	2.62	\$534.88

The potential upside bias I mentioned above is evident here. It's also quite consistent over the period of 1-day to 4 weeks.

Now I'll show times when the market is coming off an intermediate-term high.

S&P 500 makes 5 consecutive lower lows. The highest high of the last 6 days = the highest high of the last 50 days.										
Buy on close. Sell X days later. \$100k/trade. 1978-present.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	(\$5,425.35)	24	9	15	37.50	\$3,350.68	(\$2,372.10)	1.41	0.85	(\$226.06)
15	(\$7,369.13)	24	9	15	37.50	\$3,313.50	(\$2,479.38)	1.34	0.80	(\$307.05)
10	(\$22,212.05)	24	5	19	20.83	\$1,794.25	(\$1,641.23)	1.09	0.29	(\$925.50)
9	(\$15,595.29)	24	10	14	41.67	\$1,051.54	(\$1,865.05)	0.56	0.40	(\$649.80)
8	(\$15,418.19)	24	9	15	37.50	\$1,090.18	(\$1,681.98)	0.65	0.39	(\$642.42)
7	(\$4,330.81)	24	13	11	54.17	\$1,115.34	(\$1,711.83)	0.65	0.77	(\$180.45)
6	(\$603.04)	24	13	11	54.17	\$1,027.90	(\$1,269.61)	0.81	0.96	(\$25.13)
5	(\$4,844.85)	24	10	14	41.67	\$1,461.94	(\$1,390.30)	1.05	0.75	(\$201.87)
4	\$1,265.24	24	11	13	45.83	\$1,406.48	(\$1,092.77)	1.29	1.09	\$52.72
3	(\$2,459.76)	24	12	12	50.00	\$934.05	(\$1,139.03)	0.82	0.82	(\$102.49)
2	(\$1,145.02)	24	11	13	45.83	\$952.44	(\$893.99)	1.07	0.90	(\$47.71)
1	(\$399.64)	24	12	12	50.00	\$626.65	(\$659.95)	0.95	0.95	(\$16.65)

The difference here is striking. The downside bias is quite strong over the next 2 weeks. After 10 days only 5 of 24 (21%) instances were trading higher. In fact there was only 1 instance of the 24 that didn't post a lower close at some point over the next two weeks. Even looking out as far as 4 weeks there is a surprising downside bias.

What I also found is that the 5 lower lows pattern provides most of its upside edge when it is a potentially exhaustive situation. Below I illustrate this by looking at times the 5th lower low also coincided with a 50-day low.

S&P 500 makes 5 consecutive lower lows and today is the lowest low of the last 50 days.										
Buy on close. Sell X days later. \$100k/trade. 1978-present.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	\$104,473.83	29	21	8	72.41	\$6,170.08	(\$3,137.24)	1.97	5.16	\$3,602.55
19	\$116,403.77	30	24	6	80.00	\$5,841.51	(\$3,965.43)	1.47	5.89	\$3,880.13
15	\$74,791.62	30	21	9	70.00	\$4,903.92	(\$3,132.30)	1.57	3.65	\$2,493.05
10	\$50,412.53	30	18	12	60.00	\$4,713.87	(\$2,869.77)	1.64	2.46	\$1,680.42
9	\$57,349.29	30	20	10	66.67	\$3,987.05	(\$2,239.17)	1.78	3.56	\$1,911.64
8	\$51,181.77	30	18	12	60.00	\$4,429.46	(\$2,379.04)	1.86	2.79	\$1,706.06
7	\$49,855.64	30	19	11	63.33	\$3,904.30	(\$2,211.46)	1.77	3.05	\$1,661.85
6	\$34,759.58	30	19	11	63.33	\$3,347.82	(\$2,622.63)	1.28	2.20	\$1,158.65
5	\$20,942.99	30	18	12	60.00	\$2,901.67	(\$2,607.25)	1.11	1.67	\$698.10
4	\$39,344.61	30	20	10	66.67	\$3,334.35	(\$2,734.23)	1.22	2.44	\$1,311.49
3	\$39,996.84	30	18	12	60.00	\$3,113.01	(\$1,336.45)	2.33	3.49	\$1,333.23
2	\$29,484.54	30	19	11	63.33	\$2,624.12	(\$1,852.16)	1.42	2.45	\$982.82
1	\$29,829.66	30	19	11	63.33	\$2,285.85	(\$1,236.51)	1.85	3.19	\$994.32

Here we see an extremely strong upside edge. Whether looking at winning %, profit factor, w/l ratio, or average trade, all the stats over the entire time period strongly favor the bulls. The edge is so strong in fact, that without a 50-day low, I wouldn't consider it a tradable advantage at all. Below is another table that shows the 5 lower lows pattern when there is neither a 50-day high nor low associated with it.

S&P 500 makes 5 consecutive lower lows. The highest high of the last 6 days < the highest high of the last 50 days.										
Today is NOT a 50-day low. Buy on close. Sell X days later. \$100k/trade. 1978-present.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	\$13,715.48	52	32	20	61.54	\$4,069.35	(\$5,825.19)	0.70	1.12	\$263.76
15	\$13,393.77	53	31	21	58.49	\$3,521.73	(\$4,560.95)	0.77	1.14	\$252.71
10	\$9,125.34	53	30	23	56.60	\$3,038.45	(\$3,566.44)	0.85	1.11	\$172.18
9	\$10,785.05	55	30	25	54.55	\$3,080.47	(\$3,265.17)	0.94	1.13	\$196.09
8	\$16,216.76	55	31	24	56.36	\$3,038.60	(\$3,249.16)	0.94	1.21	\$294.85
7	\$139.39	57	31	26	54.39	\$2,595.07	(\$3,088.76)	0.84	1.00	\$2.45
6	(\$6,664.60)	57	34	23	59.65	\$2,037.00	(\$3,300.98)	0.62	0.91	(\$116.92)
5	\$14,476.86	57	31	26	54.39	\$2,279.90	(\$2,161.54)	1.05	1.26	\$253.98
4	\$11,534.88	57	34	23	59.65	\$1,736.25	(\$2,065.12)	0.84	1.24	\$202.37
3	\$25,924.81	57	35	22	61.40	\$1,648.96	(\$1,444.94)	1.14	1.82	\$454.82
2	\$24,379.25	57	38	19	66.67	\$1,191.81	(\$1,100.50)	1.08	2.17	\$427.71
1	\$16,705.00	57	36	21	63.16	\$885.57	(\$722.64)	1.23	2.10	\$293.07

Here you can see there is a bit of an upside edge that lasts for only 3 days. After day three there are actually mildly negative expectations up to 4 weeks out. As you can see, the pattern is largely dependant on market positioning, and it is important to consider the bigger picture when evaluating the pattern.

As for the current situation, I'll repeat what I said a little over a year ago. *It appears a strongly up-trending healthy market should not make lower lows for 5 days in a row. It just did, though, which suggests perhaps the up-trend is not so healthy.*

I've shown many times how strong moves on Fridays tend to carry through into Monday and sometimes further. I've also found value in viewing the data based on where the Friday fell within the month and whether the market was trading above or below the 200-day moving average. Let's review some of the concepts and see whether the 1% drop on Friday provides a meaningful edge for Monday or next week.

First, let's look at a chart I haven't shown in a while. This shows the result of buying on Friday and then selling one day later (normally Monday). The chart goes back to 1960 and there are two distinct periods as noted on the chart below.



Taking into account the fact that Mondays generally performed poorly until around 1990, I will often just look at results starting then. At the least I'll place more emphasis on 1990-present.

Let's now look at how the market has performed on Mondays based on the degree of Fridays' selloffs. I'll break this down into option expiration Fridays and non-option expiration Fridays. First let's look at non-option expiration Fridays in long-term downtrends.

Friday non-option expiration closes down X% and under the 200ma.										
Buy on close. Sell next day. \$100k/trade. 1990-present.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
2	(\$22,171.24)	24	9	15	37.50	\$1,019.92	(\$2,090.04)	0.49	0.29	(\$923.80)
1.75	(\$25,981.92)	28	10	18	35.71	\$980.12	(\$1,987.95)	0.49	0.27	(\$927.93)
1.5	(\$20,581.12)	35	16	19	45.71	\$957.99	(\$1,889.94)	0.51	0.43	(\$588.03)
1.25	(\$27,210.89)	50	23	27	46.00	\$1,037.97	(\$1,892.01)	0.55	0.47	(\$544.22)
1	(\$21,847.19)	59	26	33	44.07	\$1,411.44	(\$1,774.08)	0.80	0.63	(\$370.29)
0.75	(\$28,936.30)	75	30	45	40.00	\$1,439.95	(\$1,603.00)	0.90	0.60	(\$385.82)
0.5	(\$30,134.68)	89	38	51	42.70	\$1,283.88	(\$1,547.49)	0.83	0.62	(\$338.59)
0.25	(\$21,228.51)	110	54	56	49.09	\$1,136.51	(\$1,475.00)	0.77	0.74	(\$192.99)
0	(\$19,062.12)	123	63	60	51.22	\$1,124.46	(\$1,498.38)	0.75	0.79	(\$154.98)

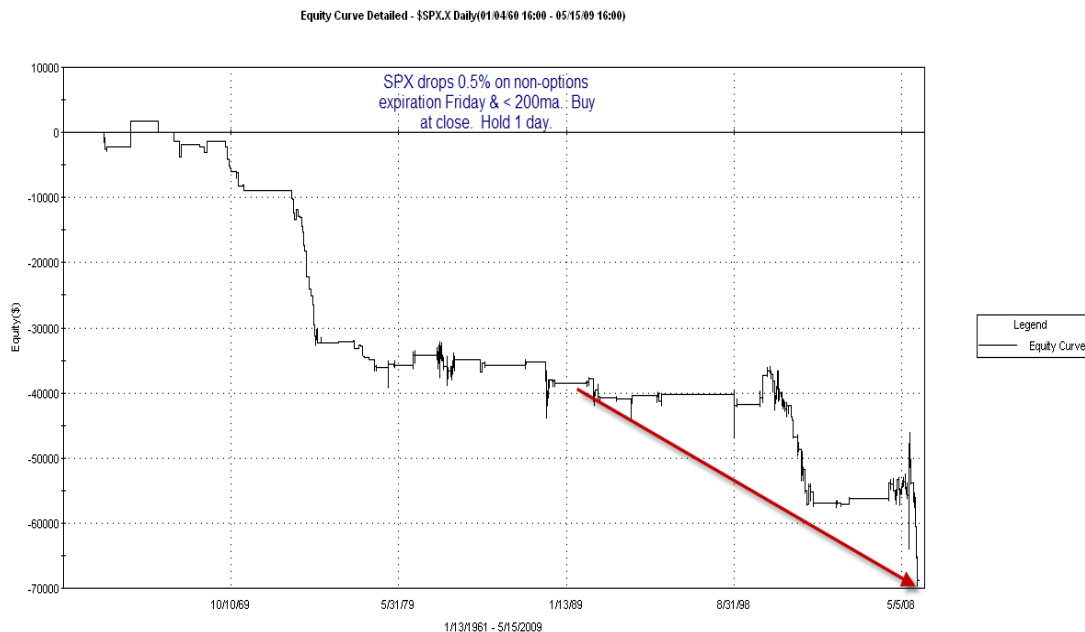
As you can see, poor Friday performance has often followed through into Monday. In general the worse Friday has performed, the worse Monday has performed.

Now let's look at option expiration Fridays during long-term downtrends.

<i>Option expiration Friday closes down X% and under the 200ma.</i>										
<i>Buy on close. Sell next day. \$100k/trade. 1990-present.</i>										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
2	(\$1,483.34)	4	3	1	75.00	\$593.65	(\$3,264.30)	0.18	0.55	(\$370.84)
1.75	\$9,510.19	9	7	2	77.78	\$2,069.32	(\$2,487.53)	0.83	2.91	\$1,056.69
1.5	\$10,905.46	12	10	2	83.33	\$1,588.05	(\$2,487.53)	0.64	3.19	\$908.79
1.25	\$9,555.26	14	11	3	78.57	\$1,462.54	(\$2,177.55)	0.67	2.46	\$682.52
1	\$4,232.78	17	11	5	64.71	\$1,462.54	(\$2,371.03)	0.62	1.36	\$248.99
0.75	\$159.10	21	11	9	52.38	\$1,462.54	(\$1,769.87)	0.83	1.01	\$7.58
0.5	\$4,042.05	25	13	11	52.00	\$1,730.12	(\$1,677.23)	1.03	1.22	\$161.68
0.25	(\$105.87)	33	15	17	45.45	\$1,573.10	(\$1,394.25)	1.13	1.00	(\$3.21)
0	(\$752.97)	36	16	19	44.44	\$1,621.44	(\$1,405.05)	1.15	0.97	(\$20.92)

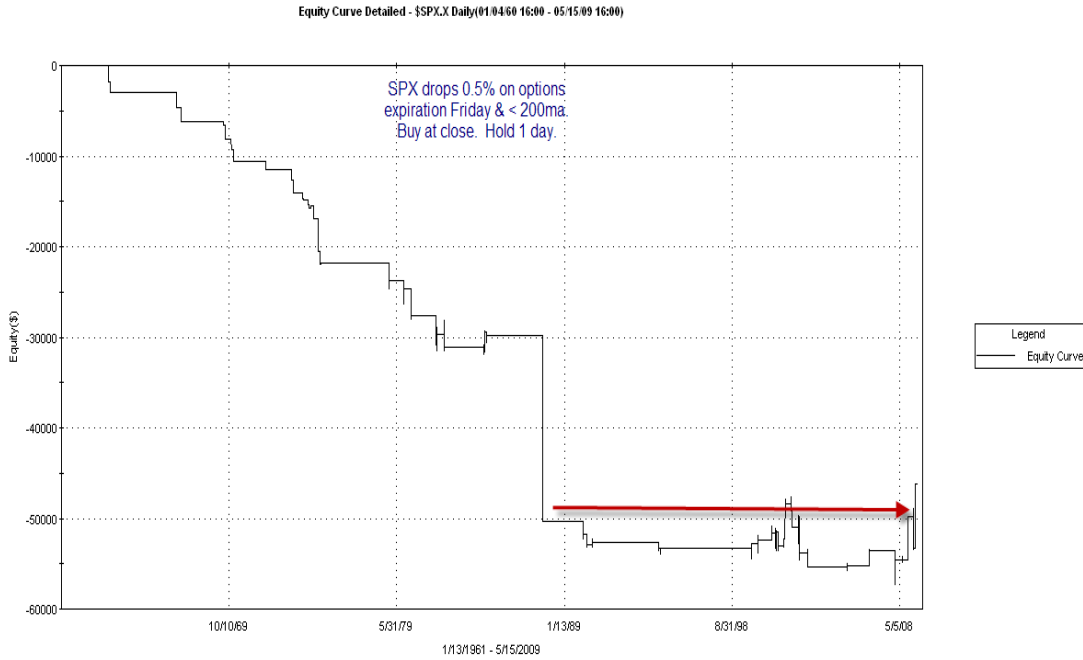
The downside edge is no longer apparent. In fact, while instances are quite low, once the performance drops to -1% or lower the results suggest there's more of a tendency to reverse rather than follow through.

Let's now look at the equity curves of the op-ex vs. non op-ex. These charts reflect drops of 0.5% or more from 1960 to the present. 1990-present is shown with the red arrow.



Non op-ex the downside tendency has been fairly strong during the recent bear market periods. Note this only looks at performance under the 200ma. The long flat periods are typically times when the market is locked in an uptrend.

Now the same chart with op-ex Fridays.



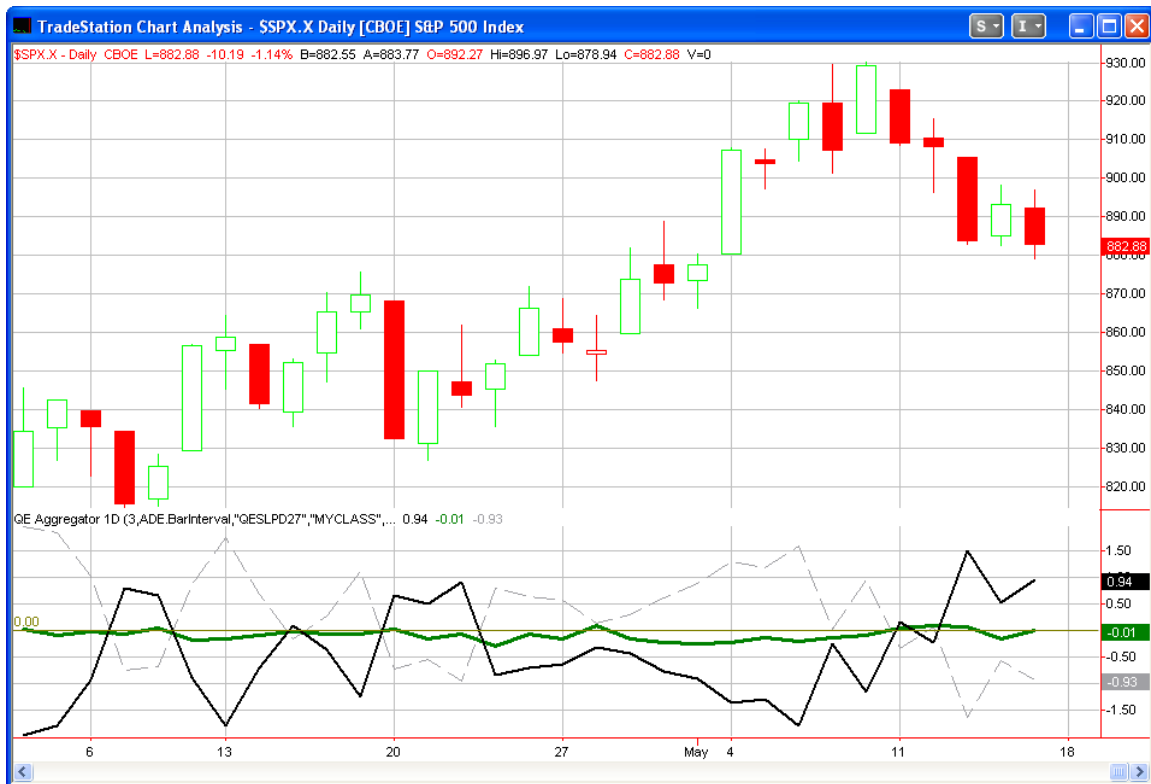
What appeared to be a downside edge from 1960 to 1990 has vanished. There doesn't appear to be a substantial edge provided by down moves on op-ex Fridays.

This is a bit surprising considering 1) other weak Fridays do seem to carry the Monday downside bias and 2) the Monday and the week following options expiration has had a downside bias over the period covered. Point number 2 is illustrated in the table below:

<i>Today is an option expiration Friday</i>										
<i>Buy on close. Sell X days later. \$100k/trade. 1990-present.</i>										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	(\$47,041.06)	228	106	122	46.49	\$1,436.11	(\$1,633.35)	0.88	0.76	(\$206.32)
4	(\$28,366.65)	228	104	124	45.61	\$1,416.10	(\$1,416.46)	1.00	0.84	(\$124.42)
3	(\$19,077.02)	228	104	124	45.61	\$1,340.78	(\$1,278.37)	1.05	0.88	(\$83.67)
2	(\$38,725.18)	228	105	123	46.05	\$987.92	(\$1,158.19)	0.85	0.73	(\$169.85)
1	(\$30,937.77)	228	96	131	42.11	\$910.52	(\$903.42)	1.01	0.74	(\$135.69)

Bottom line is that although it would have been reasonable for subscribers to expect a downside edge based on both Friday's drop and some of the previous research I've posted on Friday-Monday follow through, there doesn't appear to be one.

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



The black differential line shows that the S&P has strongly underperformed expectations over the last few days. This is another way of saying the market is currently oversold. The green Aggregator line still remains slightly below 0, though. Values below 0 indicate a negative net expectation from the studies over the next few days. So while the market is oversold, the studies are not yet expecting a bounce. This effectively creates a neutral short-term bias.

From an index-trading standpoint I am now flat and intend to stay that way on Monday.

It may be worth noting that while the green Aggregator line is barely negative at this point, it could easily flip to positive in the next day or two. Should there be further selling this may well be the case. With both lines above 0, a short-term upside edge would appear and I may consider taking a short-term trade on the long side of the market.

Intermediate-term Outlook (2 weeks – 2 months)–starting to lean bearish -updated 5/18

Over the last few weeks we've seen some intermediate-term bearish evidence building up. The [Nasdaq Weekly Volume Spyx](#) readings were the 1st sign of impending [weakness](#). While the market seemingly ignored those readings to begin with, they do remain in effect for the next several weeks. Next, in the May 4th subscriber Letter I showed two studies that questioned the leadership at that point.

The strong outperformance by transports and telecom suggested a bearish edge for at least 4 weeks from that point. There's still two weeks to go for those studies.

Worden Bros. T2112 indicator, which measures the number of stocks trading at least 2 standard deviations above their 40-day moving average, hit a historical peak on May 8th at 55.93%. (I looked at this indicator in the May 5th blog.) The reaction this past week was strongly negative. So much so that the 10-day ema of the Up Issues % is now registering multiple sub-50 readings for the 1st time since the March bottom. Continued weakness would be worrisome.

Lastly, we saw in tonight's short-term outlook the implications of 5 lower lows coming off of a 50-day high. While the downside edge was most prevalent over the 1st two weeks, even as far out as 4 weeks there were negative expectations. What's quite unusual about the current setup is that it is occurring under the 200-day moving average. To have a 50-day high occur under a 200-day moving average it needs to first be preceded by a strong downtrend. Below are charts of the last 4 times the S&P has posted 5 lower lows following a 50-day high while under the 200ma. The blue arrow indicates where the setup took place.

May 2008



December 2002



May 2001



April/May 1982



Interesting that 3 of the 4 were “sell in May and go away” setups. Only one occurred that wasn’t in May.

From an intermediate-term perspective I am now seeing indications of volume, leadership, breadth, and price that suggest we should see some additional downside in the next few weeks. I am therefore changing the bias to bearish. For my trading this means that I will be more demanding of long entries and quicker to take profits on the long side. On the short side I will be more aggressive with my setups and perhaps hope to catch longer moves.

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	1.35	DJ US Healthcare	IYH	0.00
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	1.90
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	2.84
DJ US Pharmaceuticals	IHE	2.86	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	1.62
DJ US Home Construction	ITB	4.17	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	4.81	Nasdaq 100	QQQQ	3.00

Nothing substantial yet, but keeping an eye on consumer services and construction.

Additional New Trade Ideas

None tonight

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)	5/13/2009	\$88.68	\$89.07	0.44%		stopped out intraday

The SPY trade was stopped out on Friday. The failure to close at or above \$89.50 on Thursday cost us a little bit since our target was missed by \$0.06. Perhaps I should have been more aggressive in taking profits, but in any case I'm pleased to get out of such a tricky trade with a small profit rather than a loss.

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