

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 19, 2009

Volume 2 Issue 95

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 19, 2009	2.5% rise low volume	1-5 days	Bearish	-5.30%	-7.70%
May 18, 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					

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 5/19 – bearish

The market shot up on Monday with most indices gaining between 3% and 4%. After gapping higher it continued to show strength throughout the day and finished near its highs. Breadth was extremely strong with the NYSE Up Issues % coming in at 87% and the Up Volume % at 93%. Most notable outside the price movement, though was the complete lack of volume. The NYSE posted the lowest volume in two weeks and the Nasdaq volume was the lowest in a month.

The lack of volume on such a strong move has historically been a bad sign for bulls. I've looked at this a multitude of ways over the last year and a half. Just two nights ago I looked at rallies that occurred on strong breadth and weak volume. Those that would like to review those studies may find the May 15th Subscriber Letter here: [2009-05-15 QE Subscriber Letter.pdf](#)

I looked at light volume when the market made strong percentage gains back in the 3/24/09 Subscriber Letter. Below are some studies from that:

S&P 500 rises at least 2.5%. NYSE volume is under its 10ma.										
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 Factor	Avg Trade
10	(\$63,218.19)	26	10	16	38.46	\$2,388.27	(\$5,443.81)	0.44	0.27	(\$2,431.47)
9	(\$73,096.53)	26	11	15	42.31	\$1,788.72	(\$6,184.83)	0.29	0.21	(\$2,811.41)
8	(\$74,768.06)	28	12	16	42.86	\$1,967.32	(\$6,148.49)	0.32	0.24	(\$2,670.29)
7	(\$69,375.00)	29	9	20	31.03	\$3,113.59	(\$4,869.87)	0.64	0.29	(\$2,392.24)
6	(\$66,110.04)	31	12	19	38.71	\$2,539.20	(\$5,083.18)	0.50	0.32	(\$2,132.58)
5	(\$70,881.03)	33	14	19	42.42	\$1,957.23	(\$5,172.75)	0.38	0.28	(\$2,147.91)
4	(\$44,141.96)	34	12	22	35.29	\$2,449.23	(\$3,342.40)	0.73	0.40	(\$1,298.29)
3	(\$42,892.41)	38	12	26	31.58	\$3,086.89	(\$3,074.43)	1.00	0.46	(\$1,128.75)
2	(\$46,204.56)	39	15	24	38.46	\$1,724.15	(\$3,002.78)	0.57	0.36	(\$1,184.73)
1	(\$2,566.75)	41	20	21	48.78	\$1,218.78	(\$1,282.97)	0.95	0.90	(\$62.60)

Such light volume moves have been punished going forward over the next couple of weeks. I also updated the statistics for the 1-week returns based on the magnitude of the low-volume move:

S&P 500 Up X%. NYSE Volume under 10-day moving average.										
Buy on close. Sell 5 days later. \$100k/trade. 1960-present.										
X% Rise	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
4	(\$37,189.49)	9	4	5	44.44	\$2,637.56	(\$9,547.95)	0.28	0.22	(\$4,132.17)
3.5	(\$47,604.91)	13	6	7	46.15	\$1,953.67	(\$8,475.27)	0.23	0.20	(\$3,661.92)
3	(\$54,081.48)	19	9	10	47.37	\$1,960.53	(\$7,172.62)	0.27	0.25	(\$2,846.39)
2.5	(\$70,881.03)	33	14	19	42.42	\$1,957.23	(\$5,172.75)	0.38	0.28	(\$2,147.91)
2	(\$54,499.83)	60	30	30	50.00	\$2,126.29	(\$3,942.95)	0.54	0.54	(\$908.33)
1.5	(\$30,180.56)	130	70	60	53.85	\$2,024.08	(\$2,864.43)	0.71	0.82	(\$232.16)

As you can see, the stronger the move higher, the stronger the ensuing pullback over the next week.

I also noted that the bearish influence of the sharp light volume rallies has been more pronounced since 2001. Below are tables of the same tests as shown above, but from 2001-present:

S&P 500 rises at least 2.5%. NYSE volume is under its 10ma.										
Buy on close. Sell X days later. \$100k/trade. 2001-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$80,073.63)	13	2	11	15.38	\$1,036.62	(\$7,467.90)	0.14	0.03	(\$6,159.51)
9	(\$79,117.01)	13	3	10	23.08	\$1,597.98	(\$8,391.10)	0.19	0.06	(\$6,085.92)
8	(\$77,044.55)	14	4	10	28.57	\$1,635.33	(\$8,358.59)	0.20	0.08	(\$5,503.18)
7	(\$61,533.13)	15	4	11	26.67	\$4,426.77	(\$7,203.66)	0.61	0.22	(\$4,102.21)
6	(\$72,467.31)	17	2	15	11.76	\$4,666.60	(\$5,453.37)	0.86	0.11	(\$4,262.78)
5	(\$76,773.02)	19	5	14	26.32	\$1,848.08	(\$6,143.81)	0.30	0.11	(\$4,040.69)
4	(\$48,603.11)	19	4	15	21.05	\$3,661.27	(\$4,216.55)	0.87	0.23	(\$2,558.06)
3	(\$44,338.48)	22	6	16	27.27	\$3,662.48	(\$4,144.58)	0.88	0.33	(\$2,015.39)
2	(\$49,720.98)	23	7	16	30.43	\$1,560.25	(\$3,790.17)	0.41	0.18	(\$2,161.78)
1	(\$7,175.43)	24	11	13	45.83	\$1,340.33	(\$1,686.08)	0.79	0.67	(\$298.98)

S&P 500 Up X%. NYSE Volume under 10-day moving average.										
Buy on close. Sell 5 days later. \$100k/trade. 2001-present.										
X% Rise	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
4	(\$42,529.34)	7	2	5	28.57	\$2,605.20	(\$9,547.95)	0.27	0.11	(\$6,075.62)
3.5	(\$52,944.76)	11	4	7	36.36	\$1,595.54	(\$8,475.27)	0.19	0.11	(\$4,813.16)
3	(\$54,653.01)	13	5	8	38.46	\$1,821.81	(\$7,970.26)	0.23	0.14	(\$4,204.08)
2.5	(\$76,773.02)	19	5	14	26.32	\$1,848.08	(\$6,143.81)	0.30	0.11	(\$4,040.69)
2	(\$69,083.12)	27	10	17	37.04	\$1,741.37	(\$5,088.05)	0.34	0.20	(\$2,558.63)
1.5	(\$48,292.27)	46	20	26	43.48	\$1,785.60	(\$3,230.94)	0.55	0.43	(\$1,049.83)

{End of excerpt}

All of the above tests suggest a strong tendency for the market to pull back after a sharp runup on weak volume. Not only was volume under the 10ma, though. It was actually the lightest volume in 10 days. Using the same 2.5% rise criteria, I tested the volume also hitting a 10-day low.

S&P 500 rises at least 2.5% on the lowest volume in 10 days.										
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	(\$27,215.88)	7	2	5	28.57	\$2,819.25	(\$6,570.88)	0.43	0.17	(\$3,887.98)
4	(\$17,180.94)	7	2	5	28.57	\$3,929.01	(\$5,007.79)	0.78	0.31	(\$2,454.42)
3	(\$25,180.95)	7	1	6	14.29	\$2,166.21	(\$4,557.86)	0.48	0.08	(\$3,597.28)
2	(\$15,390.14)	7	3	4	42.86	\$732.75	(\$4,397.10)	0.17	0.12	(\$2,198.59)
1	(\$2,132.46)	7	4	3	57.14	\$852.60	(\$1,847.62)	0.46	0.62	(\$304.64)

In this case the number of instances was quite low, but the results were strongly negative as would be expected. Below I've listed all the instances along with their 3-day exit.

Date/Time	Signal	Price	Roll Over USD/Lot	Shares/Ctrts Profit	Net Profit Cum Net Profit	% Profit
11/03/97	Buy	\$938.99	\$0.00	106	(\$101.76)	(0.10%)
11/06/97	Sell	\$938.03			(\$101.76)	
01/31/00	Buy	\$1,394.46	\$0.00	71	\$2,166.21	2.19%
02/03/00	Sell	\$1,424.97			\$2,064.45	
06/17/02	Buy	\$1,036.17	\$0.00	96	(\$2,868.48)	(2.88%)
06/20/02	Sell	\$1,006.29			(\$804.03)	
07/05/02	Buy	\$989.03	\$0.00	101	(\$6,924.56)	(6.93%)
07/10/02	Sell	\$920.47			(\$7,728.59)	
10/20/08	Buy	\$985.40	\$0.00	101	(\$7,806.29)	(7.84%)
10/23/08	Sell	\$908.11			(\$15,534.88)	
11/07/08	Buy	\$930.99	\$0.00	107	(\$8,419.83)	(8.45%)
11/12/08	Sell	\$852.30			(\$23,954.71)	
03/17/09	Buy	\$778.12	\$0.00	128	(\$1,226.24)	(1.23%)
03/20/09	Sell	\$768.54			(\$25,180.95)	
05/18/09 open	Buy n/a	\$909.71 \$909.71		109 n/a	n/a n/a	n/a

To increase the number of instances I lowered the volume requirement to a 5-day low:

S&P 500 rises at least 2.5% on the lowest volume in 5 days.										
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	(\$46,963.90)	14	4	10	28.57	\$1,769.03	(\$5,404.00)	0.33	0.13	(\$3,354.56)
4	(\$24,442.05)	14	4	10	28.57	\$2,547.20	(\$3,463.08)	0.74	0.29	(\$1,745.86)
3	(\$26,939.30)	14	3	11	21.43	\$3,255.45	(\$3,336.88)	0.98	0.27	(\$1,924.24)
2	(\$17,042.69)	14	8	6	57.14	\$1,126.30	(\$4,342.18)	0.26	0.35	(\$1,217.34)
1	\$1,534.77	14	9	5	64.29	\$819.66	(\$1,168.44)	0.70	1.26	\$109.63

Still a little low on instances but again a strong tendency for downside. To illustrate how much of an effect the volume has on the results, below is a study that looks at a 10-day high in volume rather than a 10-day low:

S&P 500 rises at least 2.5% on the highest volume in 10 days.										
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	\$48,783.78	45	32	13	71.11	\$2,738.37	(\$2,988.02)	0.92	2.26	\$1,084.08
4	\$50,825.24	45	31	14	68.89	\$2,839.17	(\$2,656.36)	1.07	2.37	\$1,129.45
3	\$49,313.87	45	28	17	62.22	\$2,822.22	(\$1,747.54)	1.61	2.66	\$1,095.86
2	\$19,708.71	45	26	19	57.78	\$1,782.12	(\$1,401.39)	1.27	1.74	\$437.97
1	\$35,835.95	47	32	15	68.09	\$1,563.76	(\$946.96)	1.65	3.52	\$762.47

In this case the results would change from strongly bearish to strongly bullish.

The Nasdaq gave basically the same setup tonight. Very low volume on a large move higher. Looking at similar studies with the Nasdaq would yield similar results. Rather than take up a lot of space here, subscribers may want to refer to the [10/14/2008 blog](#) for examples. I may update those results in tomorrow's blog.

The bottom line is that the very low volume most often will lead to a decline in the next few days.

One other thing to note is that today was a "gap-n-go" setup, where the market gapped higher, never closed the gap, and then closed above its opening price. Below is an excerpt from the 1/29/09 Subscriber Letter that examines these kind of setups:

Days that gap higher, don't fill their gap and close above their open (Gap & Go's) have a tendency to pull back over the next several days. Generally the larger the gap the stronger this tendency is. Below is a study that breaks down 1-week performance 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 Factor	Avg Trade
2	(\$25,698.62)	13	7	6	53.85	\$2,424.73	(\$7,111.96)	0.34	0.40	(\$1,976.82)
1.5	(\$33,744.51)	21	10	11	47.62	\$2,680.23	(\$5,504.26)	0.49	0.44	(\$1,606.88)
1	(\$37,764.10)	34	16	17	47.06	\$2,337.01	(\$4,420.96)	0.53	0.50	(\$1,110.71)
0.5	(\$48,817.79)	57	30	26	52.63	\$1,867.86	(\$4,032.83)	0.46	0.53	(\$856.45)
0	(\$69,335.71)	92	48	43	52.17	\$1,604.92	(\$3,403.99)	0.47	0.53	(\$753.65)

With the "% Wins" column is basically a coin toss risks have outweighed rewards on average by 2:1 or more. The poor risk/reward is what creates the negative expectancy.

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



While the market was strongly oversold heading into Monday, the studies just weren't indicating a strong chance of a move higher. As I mentioned, it did appear another day down might have led to a buy signal. The market ignored the indications and forged higher Monday before allowing me another chance to take a shot at the long side. The move was so strong from a price perspective that it drastically changed the look of the Aggregator.

With tonight's volume studies included the green Aggregator line is now solidly negative. The sharp move up also flipped the black Differential line to far below 0, illustrating the fact that the market has now strongly outperformed expectations over the last few days. In other words, we are now short-term overbought and the indicators are expecting lower prices. This is the kind of configuration I typically use to short.

There has only been one up day and the S&P is really just in the middle of its recent range. If my outlook were not leaning to the bearish side as described in the intermediate-term section below, I may give it another day or so before attempting to short. In this case, I'll play it a bit more aggressively, but will still look for a favorable entry as described in the trade ideas section below.

Intermediate-term Outlook (2 weeks – 2 months)– 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

RTN – buy 1/3 position @ \$45.13

Catapult for ETF’s Trades

none

Broad Market Large Cap CBI – 1

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

RTN – buy 1/3 position @ \$45.13 from the Catapult section above. This is the 1st Catapult trigger in over a month. Those who haven't traded the Catapult trades before should keep in mind that they are extremely volatile. I always scale in to them in 3 parts. The greatest advantage with Catapults is when you have a large cluster occurring. In this case it is a 1-off trade, and so it doesn't provide as much of an edge. I don't use stops with Catapults. Since they are so volatile, I do often trade options instead of the actual stock. RTN is priced fairly high and its options appear fairly liquid, so some in the money calls could be a lower-cost way to trade them and provide a natural stop (zero). In any case, keep the extreme volatility in mind when considering position size.

SPY – short 1/4 position under 1 of the following circumstances: 1) a gap up to \$91.75 or higher or 2) if it doesn't gap up to at least \$91.75, wait until the close and short @ \$91.23 or higher.

A gap up after a strong up move often reverses, so a gap higher could provide a favorable entry price. Otherwise, I'll want to short a 2nd higher close.

Active Trades Table

None.

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