

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 21, 2009

Volume 2 Issue 97

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 21, 2009	Failed Gap Up Closes Near Low	1-3 days	Bullish	2.80%	4.30%
May 21, 2009	2 Down In Chop	1-3 days	Bullish		
May 20, 2009	NR10 Low Volume 10	1-4 days	Bearish	-3.00%	-5.20%
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 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 5/22 – neutral

Wednesday was marked by a strong start and a weak finish. After gapping up almost 1%, the SPY rose further Wednesday morning and made a 5-day high before reversing course and closing down on the day. Breadth was neutral as the NYSE Up Issues % came in at 51% and the Up Volume % was 46%. Total volume spiked a little bit and made a 5-day high.

These kind of reversal can be viewed a number of different ways. I look at several things tonight including the high volume, the fact that it was an outside day, and the fact that we say a reversal and lower close for the 2nd day in a row. A lot of it suggested some mild upside over the next few days. The most significant tests turned out to be the ones I sent in my intraday email today. (Apologies to trial users as I was only able to get the intraday alert out to subscribers.) First, let's review the failed gap pattern. I looked at this in depth in the Feb. 5th Subscriber Letter. Below is an excerpt. (Note: All tables ARE UPDATED through today.)

Bars like the one put in today where the market gaps higher and then closes down and near its lows are generally considered bearish by most analysts. Some might consider it a bearish key reversal. When I've studied gap failures like this in the past I've found them to normally be short-term bullish rather than bearish. [This blog post](#) from February of last year is an example.

I ran a few studies on Wednesday's bar pattern. For this 1st test I simply used a requirement that the SPY had to gap higher, trade a bit above the open and then close a bit below the open. Results below:

SPY gaps up 0.25%, makes a high at least 0.5% above the open, then closes down on the day											
Buy SPY on close. Sell X days later. \$100k/trade. 1993-present.											
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade	
5	\$27,421.83	48	32	16	66.67	\$2,998.58	(\$4,283.29)	0.70	1.40	\$571.29	
4	\$34,684.31	50	31	19	62.00	\$2,789.22	(\$2,725.34)	1.02	1.67	\$693.69	
3	\$41,343.58	51	31	20	60.78	\$2,839.83	(\$2,334.56)	1.22	1.89	\$810.66	
2	\$39,559.87	52	35	17	67.31	\$2,339.43	(\$2,489.43)	0.94	1.93	\$760.77	
1	(\$6,486.59)	52	30	22	57.69	\$1,259.24	(\$2,011.99)	0.63	0.85	(\$124.74)	

Here we see a tendency to bounce back over the next few days. Next I added the condition that the SPY needed to close in the bottom 25% of its daily range:

SPY gaps up 0.25%, makes a high at least 0.5% above the open, then closes down on the day and in the bottom 25% of the daily range. Buy SPY on close. Sell X days later. \$100k/trade. 1993-present.											
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade	
5	\$25,331.05	39	26	13	66.67	\$3,227.32	(\$4,506.10)	0.72	1.43	\$649.51	
4	\$30,619.67	42	26	16	61.90	\$2,891.72	(\$2,785.32)	1.04	1.69	\$729.04	
3	\$43,083.49	42	27	15	64.29	\$2,831.39	(\$2,224.26)	1.27	2.29	\$1,025.80	
2	\$43,268.13	42	29	13	69.05	\$2,506.72	(\$2,263.60)	1.11	2.47	\$1,030.19	
1	\$10,246.24	42	25	17	59.52	\$1,290.44	(\$1,294.98)	1.00	1.47	\$243.96	

Most instances did close in the bottom 25%. As you can see, adding this filter improves the results even further. What if we require it closes very close to the low of the day as happened on Wednesday? Below are those results:

SPY gaps up 0.25%, makes a high at least 0.5% above the open, then closes down on the day and in the bottom 10% of the daily range. Buy SPY on close. Sell X days later. \$100k/trade. 1993-present.											
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade	
5	\$40,511.54	23	17	6	73.91	\$3,640.70	(\$3,563.38)	1.02	2.89	\$1,761.37	
4	\$29,372.98	23	14	9	60.87	\$3,341.50	(\$1,934.22)	1.73	2.69	\$1,277.09	
3	\$28,960.95	23	15	8	65.22	\$2,965.19	(\$1,939.61)	1.53	2.87	\$1,259.17	
2	\$29,205.37	23	16	7	69.57	\$2,595.94	(\$1,761.38)	1.47	3.37	\$1,269.80	
1	\$8,263.06	23	14	9	60.87	\$1,382.51	(\$1,232.46)	1.12	1.74	\$359.26	

Instances are a little low here, but as you can see, the worse the finish, the better the setup. While this may fly in the face of what some believe it is consistent with past studies I've conducted on failed gaps.

Also notable about today was the fact that it was the 2nd close lower in a row. This again triggers 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.

TradeStation Performance Summary

Collapse ^

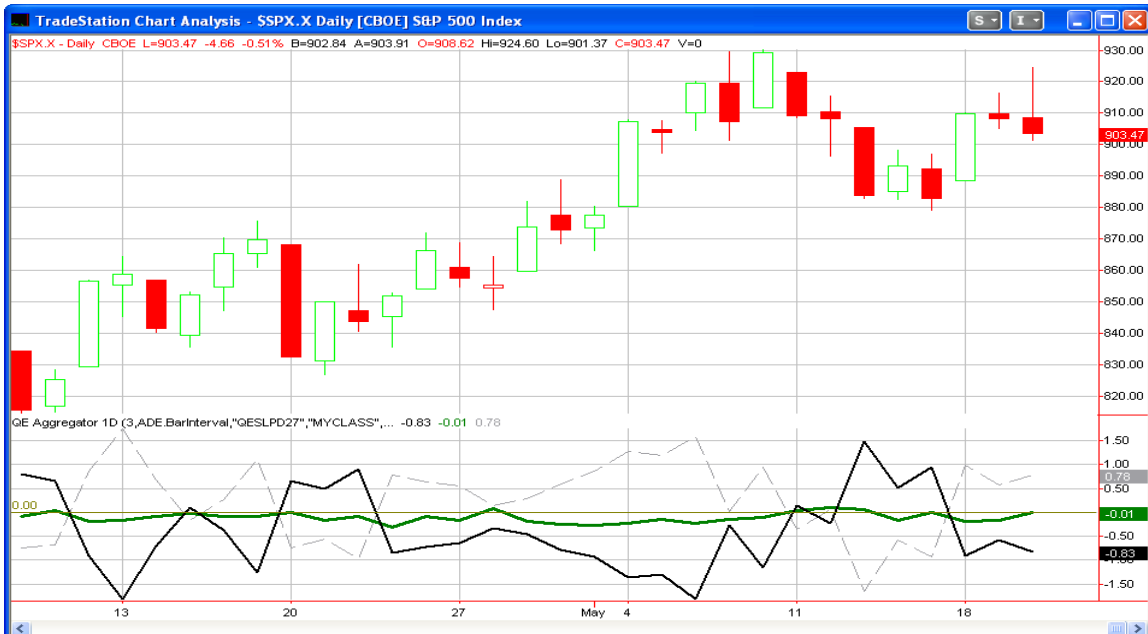
All Trades

Total Net Profit	\$41,216.24	Profit Factor	2.14
Gross Profit	\$77,317.80	Gross Loss	(\$36,101.56)
Roll Over Credit	\$0.00		
Open Position Profit/Loss	\$0.00		
Select Total Net Profit	\$30,500.21	Select Profit Factor	1.84
Select Gross Profit	\$66,601.77	Select Gross Loss	(\$36,101.56)
Adjusted Total Net Profit	\$18,248.00	Adjusted Profit Factor	1.38
Adjusted Gross Profit	\$66,383.41	Adjusted Gross Loss	(\$48,135.41)
Total Number of Trades	59	Percent Profitable	84.75%
Winning Trades	50	Losing Trades	9
Even Trades	0		
Avg. Trade Net Profit	\$698.58	Ratio Avg. Win:Avg. Loss	0.39
Avg. Winning Trade	\$1,546.36	Avg. Losing Trade	(\$4,011.28)
Largest Winning Trade	\$10,716.03	Largest Losing Trade	(\$10,506.45)

The last occurrence was on May 12th. It led to a 2.8% loss and came on the heels of 4 consecutive winners that led to a new equity high. The system is extremely simple and its success is due to the choppy environment. Should the environment change from choppy to trendy then this system will struggle. For more on this you may refer to the detailed discussion starting on page 4 of the 3/16/09 Subscriber Letter. A link is below:

[2009-03-16 QE Subscriber Letter.pdf](#)

The **Aggregator** chart has been updated below.



Even tonight's bullish studies couldn't quite get the green Aggregator line above 0. It is close, though and may very well drop below 0 tomorrow. The black Differential line is also still below 0. Additionally, the Differential too could easily flip to positive tomorrow.

With a nice gain on half of the SPY trade idea taken at the close today (as per the intraday update), traders need to decide how they'd prefer to handle their remaining shares. With my intermediate-term outlook turning bearish a few days ago there's the possibility of holding on for longer gains. Even if we get a bounce here, another leg down seems likely. So the choice then becomes, do you sit through a bounce hoping for another leg down, or look for an exit and then hope for an opportunity to re-enter the short at a higher price? There's no right answer. It's really a matter of preference. For the Subscriber Letter I tend to keep most of the trades short. Therefore I will be looking for opportunities to take the remaining profits tomorrow in all likelihood. Profit taking details can be found 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 – bought 1/3 position @ \$44.87

RTN @ \$44.44 limit (hold off for now)

Catapult for ETF’s Trades

none

Broad Market Large Cap CBI – 2/1(RTN-2)

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	0.00
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	2.94	DJ US Technology Sector	IYW	1.62
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.48	Nasdaq 100	QQQQ	2.00

Additional New Trade Ideas

None tonight

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
RTN(1/3)	5/19/2009	\$44.87	\$44.72	-0.33%		Catapult
SPY(s)(1/4)	5/20/2009	\$91.95	\$90.51	1.57%		covered 1/2 @ close

RTN came within \$0.02 of the limit order price but never made it there. It remains to be seen whether this will turn out to be a good or bad thing, but I am feeling a bit snakebit as far as entries go this month. Several very near makes and misses that went they wrong way. Such is trading sometimes. I will remove the open buy order for now. I may look to enter the 2nd lot if RTN continues lower.

With SPY down 2 days in a row and some bullish studies arriving I'll look for a favorable exit. I have no interest in a quick exit should the market gap higher. On the other hand, a large gap lower could make for a nice opportunity to cover. Therefore I'll look to COVER ON OPEN @ \$90.00 limit. Should the SPY fail to open at \$90 or lower then that order will be cancelled. I'll then look to COVER ON CLOSE @ \$90.50 limit. In all likelihood I will send out an intraday update after I get a chance to view the morning action that will contain updated stops/targets.

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