

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 8, 2009

Volume 2 Issue 108

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					
June 8, 2009	NDX components overbought	1-3 days	Bearish	-2.30%	-3.10%
June 8, 2009	Gap up & reverse from 20-day high	1-6 days	Bullish	2.60%	3.70%
June 5, 2009	Nasdaq Spyx < 0 QQQQ 10-high	1-2 days	Bearish		
June 5, 2009	Strong Breadth Low Vol	1-3 days	Bearish		
June 4, 2009	Low vol selloff cluster	1-5 days	Bullish	4.10%	6.00%
June 4, 2009	Gap unfilled from high w/ partial rvs	1-3 days	Bearish	-1.20%	-1.80%
June 3, 2009	3up, 2 lower vol, today weakest	1-5 days	Bearish	-1.70%	-2.30%
June 2, 2009	2 strong breadth days & 10-day high	1-10 days	Bullish	2.10%	3.00%
May 28, 2009	1% Drop on Bad Breadth	1-9 days	Bullish	2.90%	3.90%
Active - Long Term					
June 8, 2009	Treasury Spread Rapidly Accelerating		Bullish		
May 28, 2009	SOX up 1% while SPX down 1%	1-20 days	Bullish	13.10%	16.10%
June 1, 2009	Nasdaq Relative Strength Leading		Bullish		
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 6/8 slightly bearish

Excitement over the unemployment report led to a large gap up Friday morning. The excitement didn't last, though as the market was sold basically right from the opening bell. It quickly turned negative but hit bottom about 45 minutes into the day. From there it oscillated above and below breakeven for the rest of the day before finally finishing the day near Thursday's closing levels. Breadth was slightly negative. The NYSE Advancing Issues % came in at 49% and the Up Volume % was 43%. Volume declined for the 5th day in a row.

Friday's action brought up very little on the Quantifinder. The one study that did appear was one that was borderline notable when I initially published it over a year ago. There were only 7 instances and the suggested downside edge was quite mild. I re-ran the study over the weekend. The updated results are below:

SPY gaps up at least 1%, makes a 50-day high and closes under its open.										
Buy 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
10	\$8,881.89	9	6	3	66.67	\$2,822.26	(\$2,683.89)	1.05	2.10	\$986.88
9	\$2,154.19	9	6	3	66.67	\$2,122.84	(\$3,527.61)	0.60	1.20	\$239.35
8	\$5,937.88	9	6	3	66.67	\$2,250.78	(\$2,522.26)	0.89	1.78	\$659.76
7	\$7,376.27	9	7	2	77.78	\$1,736.27	(\$2,388.81)	0.73	2.54	\$819.59
6	\$7,836.49	9	6	3	66.67	\$2,264.65	(\$1,917.13)	1.18	2.36	\$870.72
5	\$1,542.88	9	6	2	66.67	\$1,515.88	(\$3,776.20)	0.40	1.20	\$171.43
4	\$227.06	9	5	4	55.56	\$1,740.15	(\$2,118.42)	0.82	1.03	\$25.23
3	(\$278.30)	9	4	5	44.44	\$1,821.02	(\$1,512.47)	1.20	0.96	(\$30.92)
2	\$2,305.14	9	4	5	44.44	\$2,307.35	(\$1,384.85)	1.67	1.33	\$256.13
1	\$1,929.28	9	7	2	77.78	\$603.06	(\$1,146.08)	0.53	1.84	\$214.36

Certainly no suggestion of a downside edge anymore. While it appears the upside is now slightly favored, there are still far too few instances to base a decision on. To increase the sample size I lowered the gap requirement to 0.75% and only required a 20-day high.

SPY gaps up at least 0.75%, makes a 20-day high and closes under its open.										
Buy 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
10	\$23,022.22	17	11	6	64.71	\$3,022.80	(\$1,704.77)	1.77	3.25	\$1,354.25
9	\$18,683.40	17	13	4	76.47	\$2,325.12	(\$2,885.78)	0.81	2.62	\$1,099.02
8	\$14,412.68	17	11	5	64.71	\$2,160.24	(\$1,870.00)	1.16	2.54	\$847.80
7	\$20,687.50	17	12	5	70.59	\$2,272.93	(\$1,317.53)	1.73	4.14	\$1,216.91
6	\$21,691.47	17	11	6	64.71	\$2,747.16	(\$1,421.22)	1.93	3.54	\$1,275.97
5	\$13,427.61	18	11	5	61.11	\$2,289.71	(\$2,351.84)	0.97	2.14	\$745.98
4	\$12,824.82	18	12	6	66.67	\$1,962.56	(\$1,787.65)	1.10	2.20	\$712.49
3	\$5,143.00	18	8	9	44.44	\$1,839.93	(\$1,064.04)	1.73	1.54	\$285.72
2	\$13,121.71	18	11	7	61.11	\$1,924.80	(\$1,150.15)	1.67	2.63	\$728.98
1	\$1,248.98	18	12	6	66.67	\$695.79	(\$1,183.41)	0.59	1.18	\$69.39

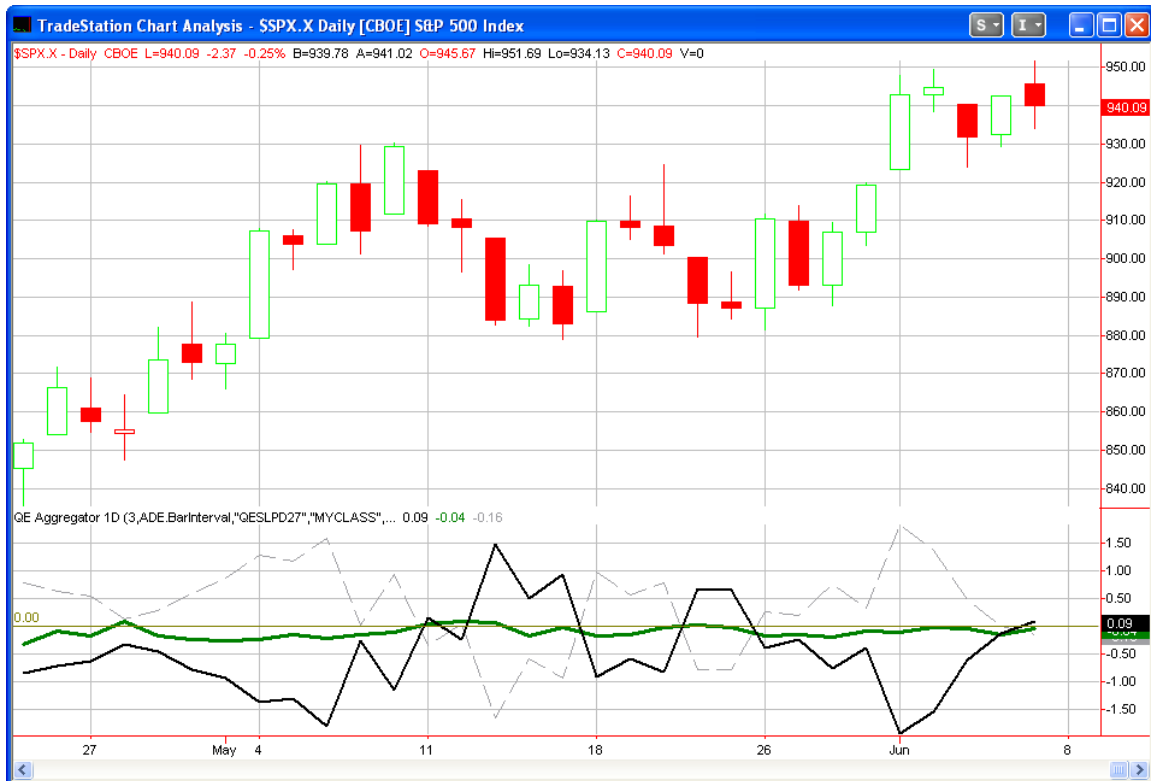
These results suggest there may actually be a bit of an upside edge to the setup. I'll be replacing the old bearish study with this bullish one in the Quantifinder as I feel it's more representative of a possible edge.

I noted in Thursday night's Subscriber Letter that AAPL and GOOG had both risen for 8 days in a row. Additionally, those two along with MSFT and ORCL all had 2-day RSI's of over 98. That's an extremely overbought level. These 4 stocks are among the top 7 and make up about 26% of the Nasdaq 100. Using the list of current Nasdaq 100 stocks I studied action among the current Top 8. In addition to the 4 above that includes RIMM, QCOM, CSCO and GILD. I looked at other times at least 4 of these 8 stocks closed with a 2-day RSI in excess of 94. Those results are below:

At least 4 of the current top 8 NDX stocks post a 2-day RSI of greater than 94.										
Buy NDX on close. Sell X days later. \$100k/trade. 2005-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$8,940.17)	12	5	7	41.67	\$3,013.32	(\$3,429.54)	0.88	0.63	(\$745.01)
9	(\$10,443.02)	12	6	6	50.00	\$2,508.45	(\$4,248.96)	0.59	0.59	(\$870.25)
8	(\$16,772.28)	12	7	5	58.33	\$2,236.41	(\$6,485.43)	0.34	0.48	(\$1,397.69)
7	(\$18,940.41)	13	7	6	53.85	\$1,858.17	(\$5,324.60)	0.35	0.41	(\$1,456.95)
6	(\$19,437.54)	14	8	6	57.14	\$1,229.07	(\$4,878.36)	0.25	0.34	(\$1,388.40)
5	(\$11,115.95)	14	7	7	50.00	\$1,057.13	(\$2,645.12)	0.40	0.40	(\$794.00)
4	(\$7,232.66)	15	6	9	40.00	\$1,262.33	(\$1,645.18)	0.77	0.51	(\$482.18)
3	(\$15,111.84)	15	5	10	33.33	\$873.23	(\$1,947.80)	0.45	0.22	(\$1,007.46)
2	(\$15,877.58)	17	6	11	35.29	\$764.82	(\$1,860.59)	0.41	0.22	(\$933.98)
1	(\$7,316.83)	21	9	12	42.86	\$521.46	(\$1,000.83)	0.52	0.39	(\$348.42)

It's not exactly a layup that a pullback should immediately begin. Still, risk appears to greatly outweigh reward when several of the top components are strongly overbought short-term. A brief look at the W/L Ratio suggests this. A pullback DOES normally come at SOME POINT in the next FEW DAYS though. In fact of the 21 instances where the conditions were met, only one did not experience a close below the trigger day's close within the next 4 days.

With all this in mind, I've updated the [Aggregator](#) chart below:



The green Aggregator line is slightly below 0, illustrating a net negative expectancy from the active studies over the next few days. The black differential line is barely positive, indicating the S&P has underperformed expectations by a small amount over the last few days. Both lines should be solidly positioned on the same side of 0 to suggest a strong edge. This current configuration is basically neutral. The NDX is overbought and could be used as a short idea for aggressive traders.

Over the next 2-3 days several bearish studies are set to expire, while some bullish ones will remain. In all likelihood the green Aggregator line will be moving above 0 in the next day or two, suggesting a positive expectancy.

I'd keep this in mind if looking to short the overbought NDX. Traders should be careful not to overstay their welcome. Another way to play it would be to wait for the short-term pullback to appear and then look to get long strongly trending NDX stocks such as AAPL or GOOG. Rarely does the Aggregator chart stay neutral for long and I suspect we'll see the recent SPX range broken soon and a more definitive edge appear.

Intermediate-term Outlook (2 weeks – 2 months)– updated 6/8 – very slightly bullish

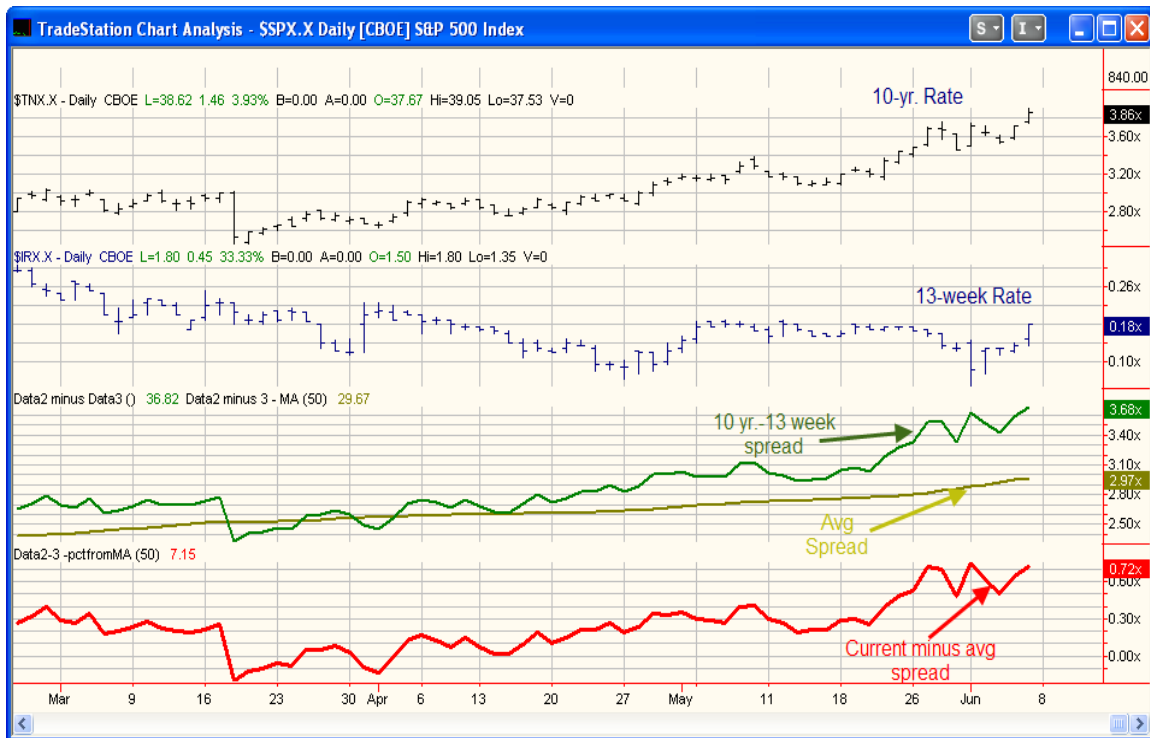
Some of the most interesting action lately has not been in the stock market, but rather in the bond market. Long-term rates have begun to soar while short-term rates have remained stagnant. This has led to a rapid steepening of the yield curve. There's been a fair amount of debate about the effect this may have on the stock market. Bulls say a steep yield curve helps banks make money. It will help the banks balance sheets and will therefore help the economic recovery. Bears say high long-term rates will hurt an already bad housing market, driving prices lower, prompting more "walk away" foreclosures and hurting both the banks and the economy. As subscribers know, I rarely take it upon myself to ponder the fundamentals. So I ran some studies to help get a better feel for how the stock market has reacted in the past to sharp drops in bond prices.

Both the S&P and the 10-year treasury rate (TNX) closed at new 50-day highs on Monday. It nearly happened again on Friday before the S&P slipped to slightly negative on the day. Below are the results following other times the S&P and TNX both closed at 50-day highs.

SPX and TNX (10-yr bond rates) both close at 50-day highs.										
Buy SPX on close. Sell X days later. \$100k/trade. 1963-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
50	(\$41,925.73)	32	13	19	40.63	\$3,506.76	(\$4,605.98)	0.76	0.52	(\$1,310.18)
45	(\$31,255.44)	33	14	19	42.42	\$3,872.64	(\$4,498.55)	0.86	0.63	(\$947.13)
40	(\$20,592.19)	34	16	18	47.06	\$3,650.93	(\$4,389.28)	0.83	0.74	(\$605.65)
35	(\$22,158.93)	36	16	20	44.44	\$3,206.75	(\$3,673.35)	0.87	0.70	(\$615.53)
30	(\$19,453.78)	37	15	22	40.54	\$3,221.40	(\$3,080.67)	1.05	0.71	(\$525.78)
25	(\$1,396.59)	39	18	21	46.15	\$2,884.59	(\$2,539.01)	1.14	0.97	(\$35.81)
20	(\$28,125.61)	40	21	19	52.50	\$1,716.55	(\$3,377.54)	0.51	0.56	(\$703.14)
15	(\$26,996.27)	40	20	20	50.00	\$1,596.33	(\$2,946.14)	0.54	0.54	(\$674.91)
10	(\$11,218.76)	45	26	19	57.78	\$1,227.63	(\$2,270.38)	0.54	0.74	(\$249.31)
5	(\$6,866.07)	61	32	29	52.46	\$1,060.31	(\$1,406.76)	0.75	0.83	(\$112.56)

Note the number of days I'm looking at is 5-50 rather than short-term. As you can see, the market has more often struggled than prospered under such circumstances.

But what's most intriguing about the current bond picture is not the fact that 10-year rates are hitting new intermediate-term highs, but rather the rapid ascension in the spread between 10yr and short-rates. Below is a chart to help illustrate what I'm looking at.



Please review the labels on the chart to understand what I'm looking at. The red line at the bottom is the one I am going to focus on. It is what I'll refer to as the Spread Ascension Value (SAV). Basically what it is looking at is how much higher or lower the current spread is vs. the 50-day average spread. (I also looked at the 100-day average with success.) This way we are not measuring the absolute spread, but rather how stretched the current spread is versus typical recent spreads. A rapid widening would cause this number to spike and that is just what we're currently seeing.

On the above chart you can see that the Spread Ascension Value moved back over 0.7 on Friday. The Spread Ascension Value (SAV) using a 100-day moving average spiked over 0.9 on Friday. I looked back at other times the SAV had reached these kinds of extremes to see how the S&P had performed during such periods. The first test used a 100-day Spread Ascension Value of 0.9. Going back to 1960 I looked see how the S&P performed on those days where the SAV was above this number. What I found is that 0.9 was exceeded about 5% of the time. This amounts to a total of about 2 years and 5 months over the last almost 49 years.

During this 2year and 5 month period of time the S&P gained 94.8%.

One issue I noted when looking through the results is that there was a decent amount of time where the SAV was high because the market was in the process of unwinding an inverted yield curve. In other words, the 10 yr. – 13 week spread was either below 0 today or the average was below 0. I decided to eliminate those instances since we're far from an inverted yield curve.

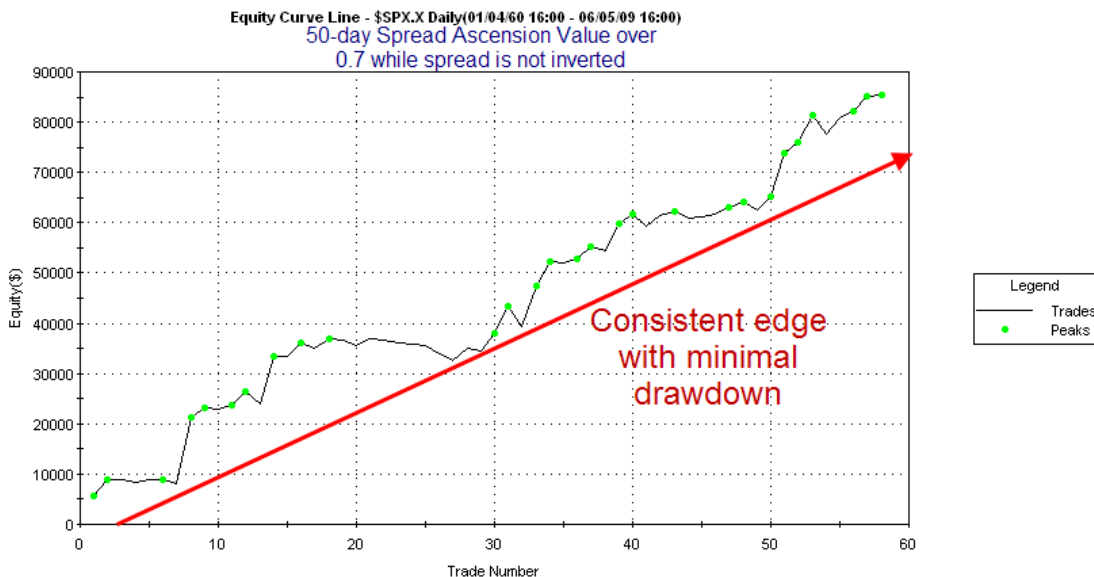
I was surprised to see the results here were even better. In this case the market spent between 3.5% and 4.0% of its time with a 100-day SAV above 9 without a current or 100-day average inversion. That equates to about 20 months. Over the course of those 20 months the S&P gained an outstanding 85.7%. (These gains are additive and not compounded.)

As noted above and shown in the chart I also looked at a 50-day SAV. Like the 100-day test, here I looked at any time the 50-day SAV was 0.7 or above. The basic test without the inversion check showed the bond spread to be in this state a little over 3.5% of the time or just a few days beyond 19 months. Over this time the S&P gained a non-compounded 101.2%. If I perform the inversion exclusion as in the 100-day test then you're looking at a little less than 14 months, or a bit under 2.5% of the time. During these 14 months the market gained a non-compounded 85.2%.

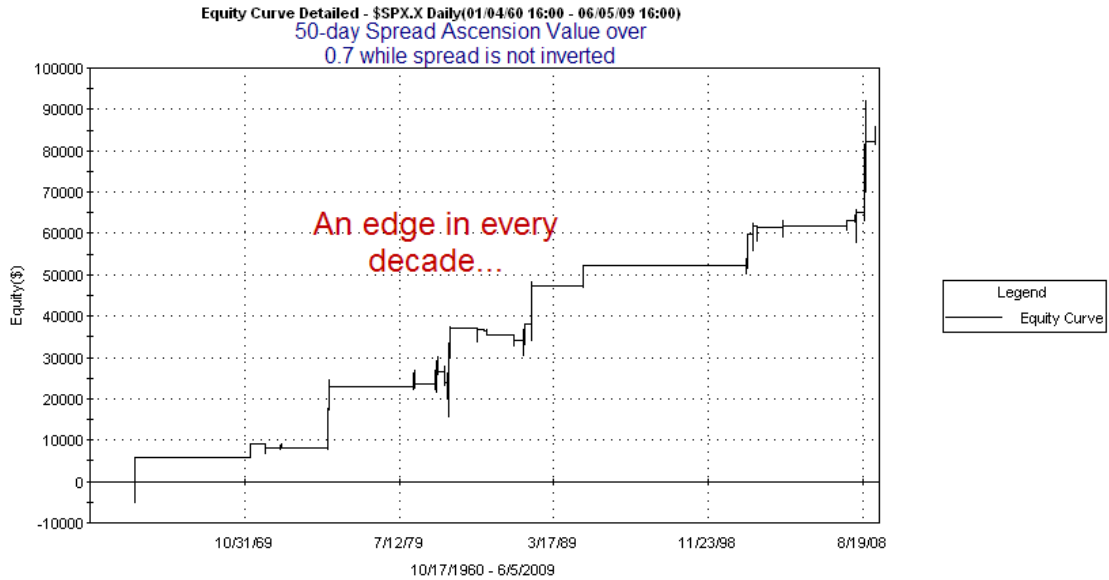
A check of more recent performance shows that in 2008 the S&P gained 19.2% while the 50-day SAV was above 0.7. So far in 2009 the previous day's SAV has been above 0.7 only 3 days – 5/28, 5/29, and 6/2. Over those 3 days the S&P has gained over 3%.

Just as impressive is that the gains have been consistent over time and have not been subject to large whipsaws. Below are the equity graphs from the last test (though they all look basically the same).

This first graph is trade-based.



Next is a time-based look.



No matter how I break it down, it appears a rapidly growing spread suggests a strong edge for the stock market for as long as the SAV stays elevated.

These models seem to be in a bit of conflict with the first bond/stock test I ran above. My interpretation is the following. When stocks and bond rates hit new intermediate-term highs at the same time it often means that stocks may be extended upwards while bonds are extended downwards. This often leads to a reversion. The combination of the stock market being overbought and the bond market being oversold suggests the stock market is likely to struggle over the next several weeks. The 2nd set of studies essentially shows what happens when the oversold bond market remains oversold and the spread between long and short rates continues to widen. Recall the exit parameter in the 2nd set of studies was a reversion of the rapid widening of the long-short spread. With so much money rapidly leaving bonds, stocks often get a nice boost. (The money has to go somewhere.) It's when the bond market begins to stabilize and the flow into stocks slows that the stock market then begins to struggle.

I will look at this concept in a bit more detail this week. In all likelihood I'll add an SAV chart to the charts pages. I'll also include the model in the Quantifinder so that subscribers are alerted to high SAV's.

In addition to monitoring the bond action this week I'll also be carefully watching the VIX:VXV ratio. It is currently down near 0.94 and dropping. A close below 0.9 would suggest a short bias.

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

Additional New Trade Ideas

QQQQ – short $\frac{1}{4}$ index position at \$37.05 limit ON OPEN. The NDX remains overbought. Unfortunately we missed the Friday morning gap up by a short while as the initial employment report excitement died before the open. If there's a substantial gap up tomorrow I'll look to play it for a quick short trade, which I could exit as early as the afternoon. Barring a gap up, I'll simply wait another day for some more pronounced edges to appear.

We should start seeing some more long trade ideas trigger on the systems page in the next few weeks if the market is able to hold above the 200ma. While it doesn't look at the 200ma, system 11111 does look at the recent trend. When it is strong, sharp pullback will often cause triggers. I suspect we'd see several stocks set up with this system should a decent 2-3 day pullback appear.

Active Trades Table

None.

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2009 Hanna Capital Management, LLC