QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 12, 2009 Volume 2 Issue 112

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 12, 2009	Equity P/C very low	1 day	Bearish	-1.65%	-2.20%
June 9, 2009	Low volume near high	1-5 days	Bearish	-2.10%	-3.30%
June 8, 2009	Gap up & reverse from 20-day high	1-6 days	Bullish	2.60%	3.70%
June 2, 2009	2 strong breadth days & 10-day high	1-10 days	Bullish	2.10%	3.00%
Active - Long Term					
June 11, 2009	4-day tight range above 10-ma	1-20 days	Bullish	4.00%	4.80%
June 10, 2009	Nasdaq/NYSE Volume High	1-20 days	Bearish		
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					
June 4, 2009	Low vol selloff cluster	1-5 days	Bullish	4.10%	6.00%
June 10, 2009	20 low vol rally	1-2 days	Bearish		

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 6/12 slightly bullish

The market rose, but Thursday's trading was primarily marked by the failed breakout attempt in the S&P. After moving strongly above its recent range, a late-day selloff put it right back in that range. Breadth was positive with the NYSE Up Issues % coming in at 57% and the Up Volume % at 61%. Total volume rose on both the NYSE and the Nasdaq.

So one concern that I'm hearing expressed is that Thursday's failed breakout attempt may signal trouble for the bulls. Using SPY I looked at other times the market hit new intraday highs before reversing hard back into its range. Results are below.

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

SPY makes a 50-day high before closing over 1% below its high and below the highest high of the previous 50 days. Buy on close. Sell X days later. $100k/trade. 1993-present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
15	32,380.21	33	21	12	63.64	3,083.25	-2,697.34	1.14	2.00	981.22
14	30,102.10	34	22	12	64.71	3,021.49	-3,030.89	1.00	1.83	885.36
13	28,614.18	34	22	12	64.71	2,980.14	-3,079.08	0.97	1.77	841.59
12	24,750.17	35	23	12	65.71	2,413.12	-2,562.64	0.94	1.80	707.15
11	23,894.82	35	22	13	62.86	2,354.61	-2,146.65	1.10	1.86	682.71
10	13,394.08	35	21	14	60.00	2,127.03	-2,233.83	0.95	1.43	382.69
9	19,245.72	35	22	13	62.86	2,081.94	-2,042.85	1.02	1.72	549.88
8	24,516.23	37	24	13	64.86	1,935.12	-1,686.67	1.15	2.12	662.60
7	17,676.11	37	22	15	59.46	2,110.37	-1,916.80	1.10	1.61	477.73
6	15,703.15	39	25	14	64.10	1,920.65	-2,308.09	0.83	1.49	402.64
5	19,751.41	41	23	18	56.10	1,878.78	-1,303.36	1.44	1.84	481.74
4	8,207.92	43	22	21	51.16	1,799.34	-1,494.17	1.20	1.26	190.88
3	6,234.96	43	23	20	53.49	1,372.18	-1,266.26	1.08	1.25	145.00
2	-131.07	44	22	22	50.00	1,104.78	-1,110.73	0.99	0.99	-2.98
1	-406.02	47	26	19	55.32	725.83	-1,014.61	0.72	0.98	-8.64

I wouldn't necessarily call the above results significantly bullish, but other than some underperformance over the first 2 days there don't seem to be any negative repercussions from other such failed breakouts.

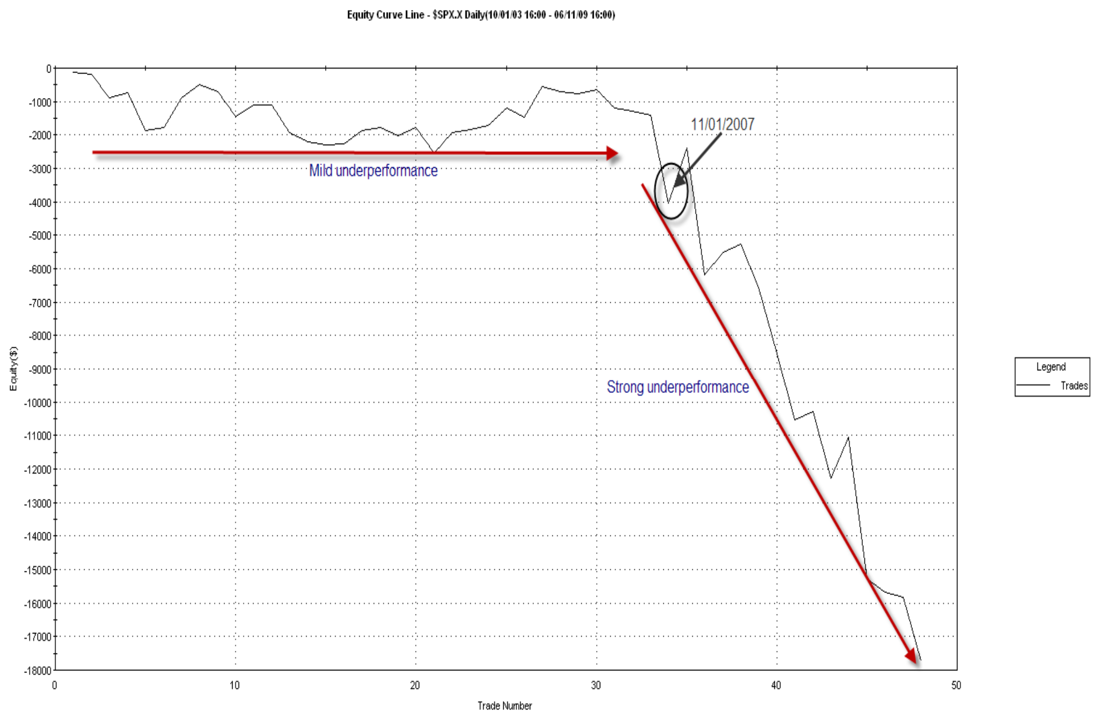
One blog I enjoy reading is Cobra's Market View. He shows a lot of charts and often does a good job finding where there is unusual action. On Thursday night he noted the CBOE Equity Put/Call Ratio had come in extremely low. I decided to do a study on performance following extremely low 1-day readings.

When looking at put/call ratios I always normalize them with a long-term moving average. To understand why this is necessary you may review this post from June of 2008. For today's study I normalized using the 200-day moving average. The Equity P/C Ratio today came in at 0.55, which is a little over 25% below the 200ma of 0.74. I then looked at all other times the Equity P/C came in more than 25% below its 200ma.

CBOE Equity Put/Call finishes more than 25% below its 200-day average.
Buy SPX on close. Sell X days later. $100k/trade 11/2004 - present

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	9,682.10	31	17	14	54.84	1,555.27	-1,196.96	1.30	1.58	312.33
4	9,010.80	33	20	13	60.61	1,350.96	-1,385.26	0.98	1.50	273.05
3	4,662.03	38	21	17	55.26	1,316.35	-1,351.84	0.97	1.20	122.69
2	-2,204.03	40	18	22	45.00	1,248.25	-1,121.48	1.11	0.91	-55.10
1	-17,715.56	48	20	28	41.67	451.87	-955.46	0.47	0.34	-369.07

As you can see in the above table, while there seem to be negative implications from such readings, they only last 1 day. Now let's take a deeper look at those 48 trades and see what the results looked like over time. (Chart from Tradestation.)



From 2004 until near the end of 2007 there wasn't much of an edge provided. From November 2007 – present though there has been a strong bearish tendency. Seeing this graph would make many people wonder whether the negative performance is primarily just a byproduct of a horrible bear market.

There's no way to answer this for sure. One thing we can do though is to see what performance has looked like since the March bottom. All qualifying trades are listed below:

Date	Signal	Price	% Gained	Runup/ Drawdown
03/10/09	Buy	$719.60	0.24%	$1,700.16
03/11/09	Sell	$721.36		($793.50)
03/18/09	Buy	$794.35	(1.30%)	$1,111.25
03/19/09	Sell	$784.04		($1,566.25)
03/19/09	Buy	$784.04	(1.98%)	$618.49
03/20/09	Sell	$768.54		($2,265.68)
03/23/09	Buy	$822.92	(2.01%)	$88.33
03/24/09	Sell	$806.34		($2,110.24)
04/09/09	Buy	$856.56	0.25%	$899.00
04/13/09	Sell	$858.73		($1,300.36)
04/13/09	Buy	$858.73	(2.01%)	$0.00
04/14/09	Sell	$841.50		($2,143.68)
04/14/09	Buy	$841.50	1.25%	$1,348.74
04/15/09	Sell	$852.06		($698.56)
04/17/09	Buy	$869.60	(4.28%)	$0.00
04/20/09	Sell	$832.39		($4,241.94)
05/04/09	Buy	$907.24	(0.38%)	$50.60
05/05/09	Sell	$903.80		($1,089.00)
05/18/09	Buy	$909.71	(0.17%)	$728.12
05/19/09	Sell	$908.13		($489.41)
05/26/09	Buy	$910.33	(1.90%)	$382.59
05/27/09	Sell	$893.06		($2,012.14)
06/11/09	Buy	$944.89	n/a	$0.00
open	n/a	$944.89		$0.00

Even during the furious rally of the last 3 months low readings in the Equity P/C Ratio have been followed by strongly negative action. This leads me to conclude that the CBOE Equity P/C Ratio may provide a short-term edge and its suggesting downside for Friday's trading.

Tonight's Aggregator chart is below:

One thing to keep in mind when looking at the Aggregator is that it looks out over the next 3 days to estimate expectations. It does not break down the expectations on a day by day basis. Most of the time the chart represents a pretty good illustration of expectations. Tonight it seems to be lacking a bit. While we see the green Aggregator line is solidly positive, we don't see the breakdown of the next 3 days. In fact, expectations for tomorrow are negative, in large part due to the Equity P/C Ratio study above. At this point Monday, Tuesday, and Wednesday's expectations are even stronger to the bullish side.

The black Differential line remains mildly negative, indicating that the S&P has outperformed expectations over the last few days.

Aggressive traders who are nimble and practiced enough to daytrade could view tomorrow with a negative bias. I'd be wary of overstaying my welcome as next week is currently setting up positive. Should we get a down day tomorrow, this could help move the black Differential line back above zero and could set us up for a long-side swing trade early next week.

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

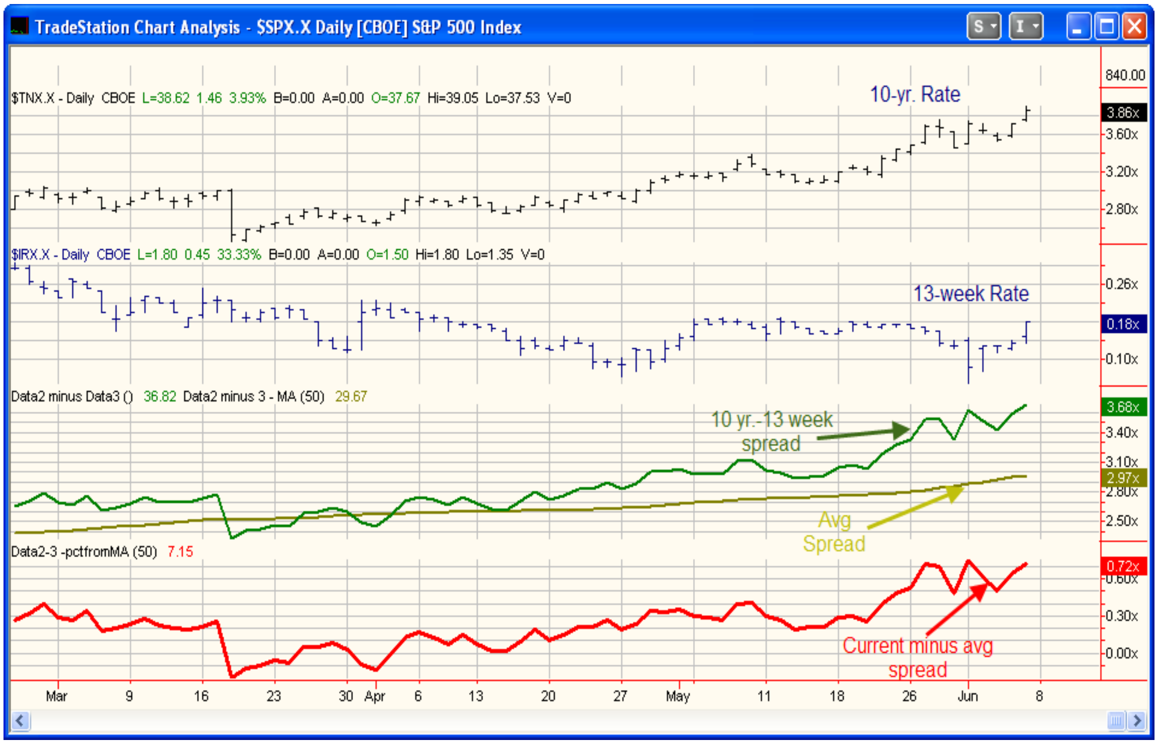
Some of the most interesting action lately has not been in the stock market, but rather in the bond market. Long-term rates have begun to soar while short-term rates have remained stagnant. This has lead to a rapid steepening of the yield curve. There's been a fair amount of debate about the effect this 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.

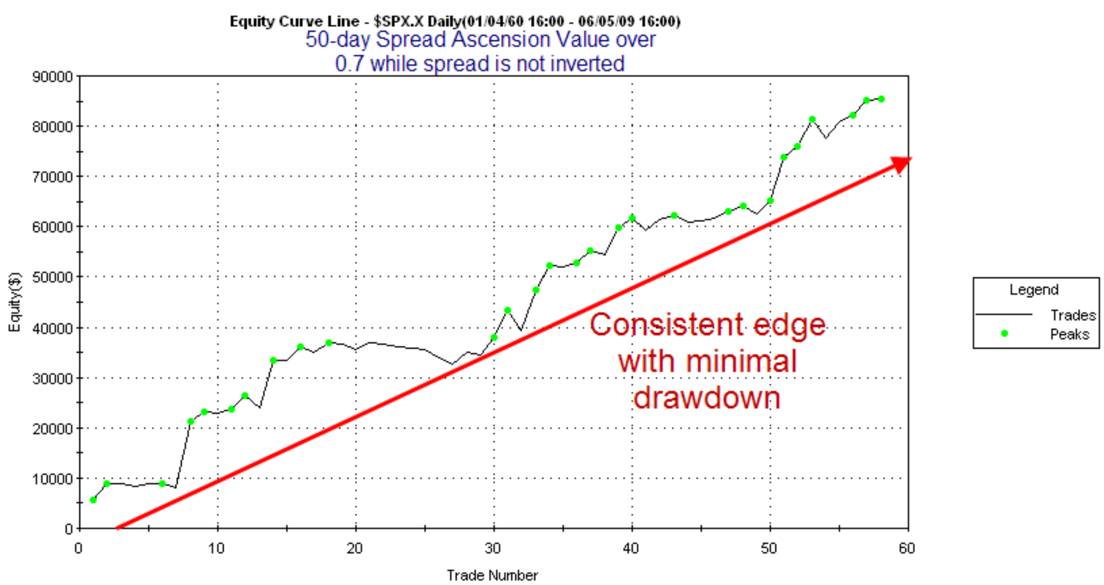
I was surprised to see the results here were even better. In this case the market spent between 3.5% and 4.0% of its time with a 100-day SAV above 9 without a current or 100-day average inversion. That equates to about 20 months. Over the course of those 20 months the S&P gained an outstanding 85.7%. (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%.

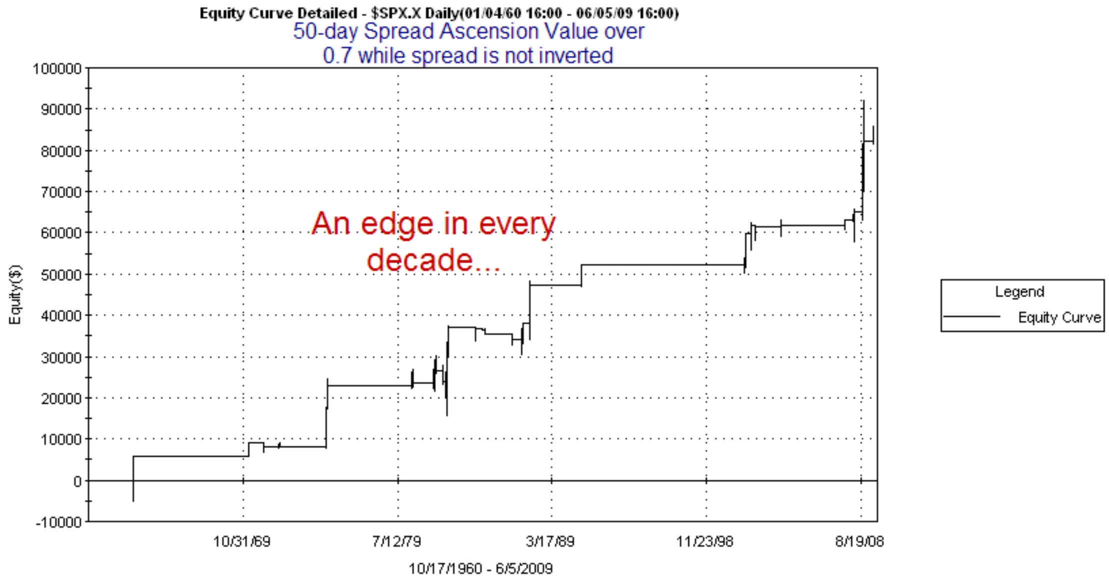
A check of more recent performance shows that in 2008 the S&P gained 19.2% while the 50-day SAV was above 0.7. So far in 2009 the previous day's SAV has been above 0.7 only 3 days – 5/28, 5/29, and 6/2. Over those 3 days the S&P has gained over 3%.

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

A full listing of system triggers can be found at the system triggers page each night. I will cherry pick some of my favorite setups along with other trade ideas to track below.

GOOG – buy ½ lot @ $429.00. I've mentioned GOOG several times in the last week or so. I've been waiting for a pullback opportunity to get long and with 4 lower closes and system 11111 triggering it looks like we have an edge to enter with. What I don't like is that there isn't support nearby. GOOG could easily pull back to the 410-412 area. Therefore, I'll be looking to take a reduced size here. Should we get closer to a potential support zone I'll likely then look to put on the 2nd half.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
GDX	6/9/2009	$41.30	$40.92	-0.92%		sell 1/2 on close > 10ma
AAPL	6/11/2009	$139.55	$139.95	0.29%		

AAPL was entered at the open.