

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 22, 2009

Volume 2 Issue 118

## 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
<b>Active</b>					
June 22, 2009	2 days up in chop	1-4 days	Bearish		
June 19, 2009	SPX & Dollar both strong	1-3 days	Bearish	1.60%	2.20%
June 18, 2009	Down 3 with slowing rate of decline	1-6 days	Bullish	2.50%	3.20%
<b>Active - Long Term</b>					
June 22, 2009	VIX:VXV hits 100-day low	1-20 days	Bearish	-3.80%	-5.50%
June 11, 2009	4-day tight range above 10ma	1-20 days	Bullish	4.00%	4.80%
June 10, 2009	Nasdaq/NYSE Volume High	1-20 days	Bearish		
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		
<b>Dropped Tonight</b>					
<b>June 16, 2009</b>	<b>7-day high to 7-day low</b>	<b>1-4 days</b>	<b>Bearish</b>	<b>-1.80%</b>	<b>-2.50%</b>

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 6/22 - neutral**

After gapping up on Friday the market was unable to gain any upside momentum. Once it closed its gap in the early afternoon it spent the rest of the day oscillating between positive and negative. The Nasdaq finished with a nice gain of over 1% but the S&P gained just 0.3% and the Dow was down slightly. Breadth was mildly positive. The NYSE Up Issues % was 62% and the Up Volume % closed at 63%. Volume came in at the highest level in over a month, though much of the reason for that can be credited to options expiration.

While I'll go over a few things, I am finding very little that is suggesting a strong edge based on the action of the last couple of days. The 1<sup>st</sup> and probably most obvious edge to many subscribers is that our "2 days up in chop" system triggered on Friday, and this was noted by the Quantifinder. Although the March reversal caused a drawdown in this system it quickly recovered and has performed quite well even in the face of a rising market and reduced volatility. Much of this is due to the fact that even with the rally, the choppy environment has persisted. Below is a copy of the "Trend vs. Chop" chart from the website. Recall that an upsloping chart indicates a trendy environment where up days are typically followed by up days and down days are typically followed by down days. A downsloping line indicates a choppy environment where moves are more likely to reverse than to follow through.



Below I've updated the stats for "2 Days Up In Chop".

SPX closes higher 2 days in a row. Short on close. Cover next profitable close up to 4 days later. Day 4 cover regardless of profitbaility. \$100k/trade. 6/1/2007 - present.

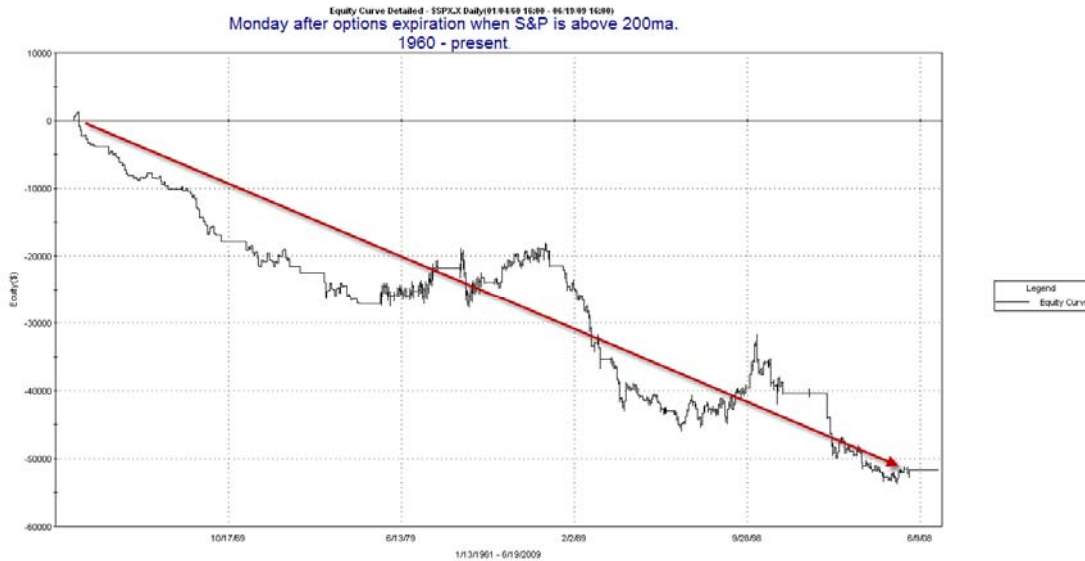
TradeStation Performance Summary			
All Trades			
Total Net Profit	\$72,256.71	Profit Factor	5.71
Gross Profit	\$87,583.95	Gross Loss	(\$15,327.24)
Total Number of Trades	67	Percent Profitable	91.04%
Winning Trades	61	Losing Trades	6
Even Trades	0		
Avg. Trade Net Profit	\$1,078.46	Ratio Avg. Win:Avg. Loss	0.56
Avg. Winning Trade	\$1,435.80	Avg. Losing Trade	(\$2,554.54)
Largest Winning Trade	\$8,783.02	Largest Losing Trade	(\$7,832.88)

The system has been tracked since mid-2007 because that is when the market's character became especially choppy.

A huge reason that the Quantifinder has been a bit low on studies lately is my poor timing in releasing it. I started the blog in January of 2008. The entire time I was writing the blog and Subscriber Letter up until I unveiled the Quantifinder the S&P 500 was trading below its 200-day moving average. I released the Quantifinder on a Sunday and the next day the S&P closed above the 200ma for the 1<sup>st</sup> time in about a year and a half. This means a large number of studies that used the filter "S&P close below the 200ma" were

eliminated and there were effectively 0 that filtered on action above the 200ma. The studies that were eligible were those that didn't discern. With the number of studies I produce this "lull" shouldn't last long.

In the past I looked in some detail at performance directly following option expiration. The focus at the time was behavior when the market was below the 200ma. This weekend I also looked at behavior above the 200ma. The chart below shows how the S&P has performed on Mondays following option expiration since 1960 while trading above its 200ma. (Note: "Monday" for this test is really just the day after option expiration and could be a Tuesday if Monday is a holiday.)



In the 80's there wasn't a discernable edge, but in every other period, save for a brief period in the late nineties, there has been a noticeable downside bias on the day following options expiration. Below I break it down by the size of Friday's gain.

Option expiration Friday closes above the 200ma and up X%. Buy on close.  
Sell Mondays close \$100k/trade. 1960-present.

QE Friday pop: pctup	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
0.00	-3,067.41	220	103	117	46.82	605.73	-559.47	1.08	0.95	-13.94
0.25	1,918.80	140	70	70	50.00	621.53	-594.11	1.05	1.05	13.71
0.50	10,824.80	79	44	35	55.70	685.81	-552.88	1.24	1.56	137.02
0.75	6,285.10	39	22	17	56.41	792.47	-655.84	1.21	1.56	161.16
1.00	277.23	23	12	11	52.17	772.74	-817.78	0.94	1.03	12.05

Once you get a decent sized move on Friday (about 0.5%), your chances of follow through on Monday improve substantially.

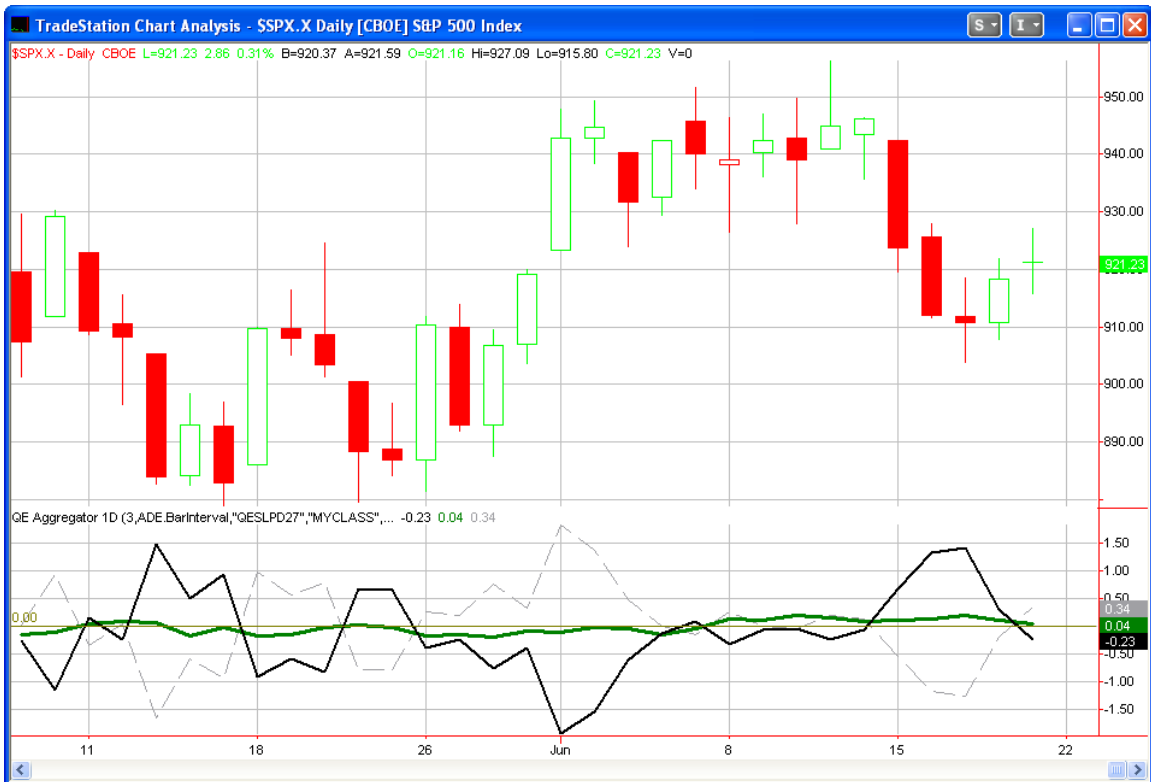
I also looked at down closes on op-ex Friday to see what that led to on Mondays.

Option expiration Friday closes above the 200ma and down X%. Buy on close.  
Sell Mondays close.\$100k/trade. 1960-present.

QE Friday pop: pctup	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
1.50	-3,177.18	10	4	6	40.00	635.22	-953.01	0.67	0.44	-317.72
1.25	-2,390.02	15	7	8	46.67	579.16	-805.51	0.72	0.63	-159.33
1.00	-5,489.93	32	15	17	46.88	605.58	-857.27	0.71	0.62	-171.56
0.75	-14,812.87	51	20	31	39.22	602.99	-866.86	0.70	0.45	-290.45
0.50	-13,374.43	80	39	41	48.75	590.13	-887.55	0.66	0.63	-167.18
0.25	-35,941.94	120	49	71	40.83	558.59	-891.73	0.63	0.43	-299.52
0.00	-48,729.79	164	60	104	36.59	577.96	-802.00	0.72	0.42	-297.13

The negativity is fairly consistent here. Down op-ex Friday have often seen downside follow-through on Mondays. Friday's severity didn't seem to have a tremendous effect.

Tonight's [Aggregator](#) chart is below:

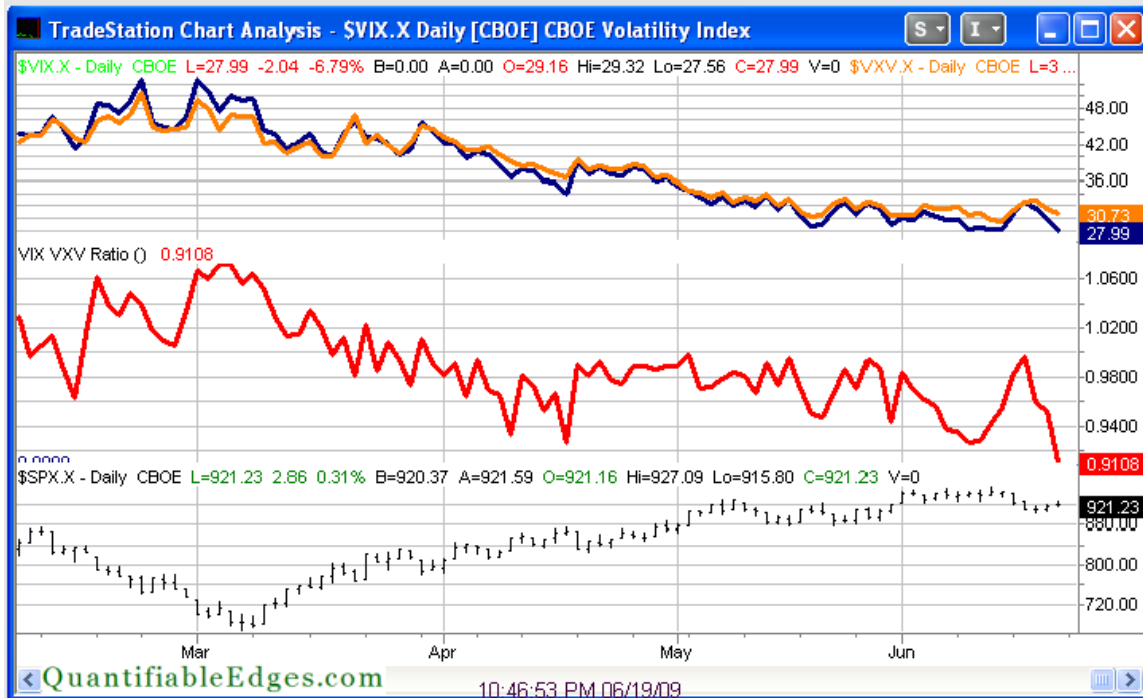


The Aggregator chart is now in a perfectly neutral state. The green Aggregator line has dropped down to just slightly bullish. (Tomorrow it is scheduled to close even more neutral at 0.01.) Meanwhile the black Differential line dropped down to just below the 0 line, indicating a slight outperformance by the S&P 500 over the last few days. Tradable edges typically occur when both lines are solidly place in the same direction – like the long signal from a couple of days ago. At this point it's a matter of waiting and observing to see when the next tradable edge appears.

**Intermediate-term Outlook (2 weeks – 2 months)– updated 6/22 - neutral**

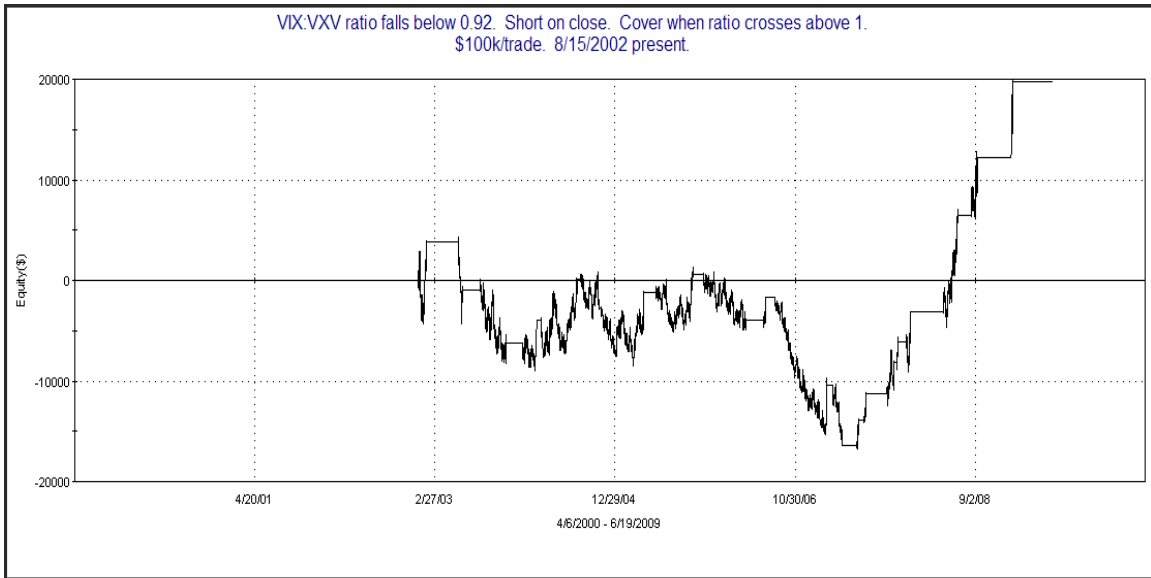
One notable intermediate-term indicator that is beginning to provide some interesting readings is the VIX:VXV ratio. The ratio compares short-term volatility expectations (VIX 30-day) to long-term volatility expectations (VXV 90-day). A low reading suggests that volatility is likely to rise over the next 1-3 months. Rising volatility is often associated with a falling market and therefore a low VIX:VXV ratio can be interpreted as possibly bearish. The VIX:VXV chart is updated on the members' chart page. Below is a copy of the most recent chart.

**VIX:VXV Ratio**



Friday's 0.9108 reading is the lowest since last August. At that time I showed some studies which suggested that moves below 0.90 carried a bearish bias. (*Note: The VXV has only been listed since late 2007. The CBOE back-calculated the data to 2002 and I was fortunate enough to get my hands on this data. Therefore, rather than just using 18 months worth of data I'm able to look back nearly 7 years.*) If you'd like to review the studies from last August [you may do so here](#).

This weekend I tweaked the system discussed in that Letter and used 0.92 for the trigger instead of 0.90. The loosened criteria still gave negative results, but they were not as consistent and depended entirely on the most recent run of trades. Below is an equity curve to illustrate.



My inclination after seeing this was that you'd be quite a bit better off waiting for a 0.90 stretch rather than jumping the gun at 0.92.

Another way I looked at the indicator did seem to suggest a downside edge, though. Below is a performance table showing how the SPX has performed following other occurrences where the VIX:VXV ratio posted a 100-day low.

VIX:VXV ratio hits 100-day low.  
Buy on close. Sell X days later. \$100k/trade. 8/15/2002-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
25	-27,771.25	12	3	9	25.00	2,174.80	-3,810.63	0.57	0.19	-2,314.27
24	-25,975.57	12	3	9	25.00	2,373.62	-3,677.38	0.65	0.22	-2,164.63
23	-25,819.41	12	4	8	33.33	1,599.44	-4,027.15	0.40	0.20	-2,151.62
22	-24,091.90	12	4	8	33.33	1,633.94	-3,828.46	0.43	0.21	-2,007.66
21	-21,887.34	12	5	7	41.67	1,400.79	-4,127.33	0.34	0.24	-1,823.95
20	-24,940.85	12	6	6	50.00	987.18	-5,143.99	0.19	0.19	-2,078.40
19	-23,508.06	13	6	7	46.15	1,607.21	-4,735.91	0.34	0.29	-1,808.31
18	-19,171.07	13	5	8	38.46	2,006.65	-3,650.54	0.55	0.34	-1,474.70
17	-11,843.27	13	5	8	38.46	1,614.09	-2,464.21	0.66	0.41	-895.64
16	-11,060.60	13	4	9	30.77	2,052.08	-2,140.99	0.96	0.43	-850.82
15	-7,456.54	13	5	8	38.46	1,391.62	-1,801.83	0.77	0.48	-573.58
14	-8,085.31	13	7	6	53.85	872.36	-2,365.31	0.37	0.43	-621.95
13	-7,384.93	13	6	7	46.15	1,112.78	-2,008.80	0.55	0.47	-568.07
12	-7,102.97	13	5	8	38.46	1,311.49	-1,707.55	0.77	0.48	-546.38
11	-8,100.96	13	6	7	46.15	828.92	-1,867.79	0.44	0.38	-623.15
10	-6,412.05	13	6	7	46.15	752.04	-1,560.61	0.48	0.41	-493.23

Market losses greatly outweighed then gains over the next 2-5 weeks. The bearish tilt can be observed in several of the above columns.

Below is a list of all the trades with a 25-day exit:

**VIXVXV ratio hits 100-day low.**  
**Buy on close. Sell X days later. \$100k/trade. 8/15/2002-present.**

<b>Date/Time</b>	<b>Signal</b>	<b>Price</b>	<b>% Profit</b>	<b>Run-up DrawDown</b>
08/12/03	Buy	\$990.35	3.60%	\$4,206.00
09/17/03	Sell	\$1,025.97		(\$999.00)
02/12/04	Buy	\$1,152.11	(3.68%)	\$956.32
03/19/04	Sell	\$1,109.74		(\$4,257.00)
04/12/04	Buy	\$1,145.22	(5.34%)	\$225.33
05/17/04	Sell	\$1,084.08		(\$5,994.30)
07/12/04	Buy	\$1,114.35	(3.14%)	\$467.25
08/16/04	Sell	\$1,079.34		(\$4,773.07)
12/17/04	Buy	\$1,194.22	(2.16%)	\$1,965.44
01/25/05	Sell	\$1,168.41		(\$2,529.01)
07/15/05	Buy	\$1,227.92	(0.67%)	\$1,453.14
08/19/05	Sell	\$1,219.71		(\$971.19)
09/16/05	Buy	\$1,237.87	(4.71%)	\$0.00
10/21/05	Sell	\$1,179.59		(\$5,573.60)
12/14/05	Buy	\$1,272.74	(0.70%)	\$1,728.48
01/23/06	Sell	\$1,263.83		(\$2,106.00)
08/16/06	Buy	\$1,295.43	1.74%	\$2,548.70
09/21/06	Sell	\$1,318.03		(\$457.38)
12/11/06	Buy	\$1,413.04	1.24%	\$1,556.10
01/19/07	Sell	\$1,430.50		(\$634.90)
12/20/07	Buy	\$1,460.12	(6.70%)	\$2,633.64
01/29/08	Sell	\$1,362.29		(\$12,924.76)
05/15/08	Buy	\$1,423.57	(7.43%)	\$1,166.90
06/20/08	Sell	\$1,317.86		(\$7,637.70)
06/19/09	Buy	\$921.23	n/a	\$0.00
open	n/a	\$921.23		\$0.00

The maximum intratrade drawdown above is the 4,206 (4%) from the 1<sup>st</sup> trade in August of 2003.

The recent success of moves below 0.92 combined with the fact that the ratio has made a 100-day low suggests the VIX:VXV ratio is indicating a bearish edge over the next several weeks.

Unfortunately, this bearish indication is doing little but keeping our intermediate-term indicators mixed. For now I continue to look for opportunities on both sides of the market and further evidence that a clearer bias is emerging.

## **Catapult and Capitulative Breadth Statistics**

*(Catapult Presentation Part 1) (Catapult Presentation Part 2)*

### ***Open Catapult Triggers***

DIS – buy 1/3 @ 23.49 (\$23.43 purchase on 6/17)

### ***Catapult for ETF's Trades***

*none*

### ***Broad Market Large Cap CBI – 1(DIS)***

### ***Sector CBI Breakdown (% of stocks with active catapult triggers within each sector.)***

<b>Index</b>	<b>ETF</b>	<b>CBI %</b>	<b>Index</b>	<b>ETF</b>	<b>CBI %</b>
DJ US Broker Dealers	IAI	3.85	DJ US Energy	IYE	1.00
DJ US Insurance Index	IAK	4.69	DJ US Financial	IYF	3.30
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	3.13
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	0.00
DJ US Oil&Gas Expl & Prod	IEO	1.64	DJ US Industrial Sector	IYJ	1.52
DJ US Oil Equip & Svcs	IEZ	4.26	DJ US Consumer Goods	IYK	1.42
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	1.35
DJ US Healthcare Providers	IHF	0.00	DJ US Real Estate	IYR	1.23
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	1.08
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	3.03
DJ US Consumer Svcs	IYC	4.33	Nasdaq 100	QQQQ	1.00

### **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 from the S&P 100 and ETF lists along with occasional other trade ideas to track below.*

None tonight. All of the triggers in the system page are long entries and the market is already up 2 days in a row. I'm going to sit out new entries for another day. I'll likely be looking for possible exits in the GOOG and AAPL trades..

## Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/L	Stop	Notes
GDX	6/9/2009	\$41.30	\$38.39	-7.05%		sell on close > 10ma
AAPL	6/11/2009	\$139.55	\$139.48	-0.05%		<b>sold 1/2 on close</b>
GOOG (1/2)	6/12/2009	\$426.86	\$420.09	-1.59%		
GOOG (1/2)	6/15/2009	\$416.77	\$420.09	0.80%		<b>exit on close</b>
DIS (1/3)	6/17/2009	\$23.43	\$23.53	0.43%	\$23.24	Catapult
SPY(1/4)	6/17/2009	\$91.25	\$92.62	1.50%		<b>stopped out intraday</b>

DIS has made a swing low only a few cents below our entry price and then bounced higher for a few days. I will place a stop \$0.12 below that swing low. If it is going to make another leg down, I would prefer not to participate. Catapults tend to be very volatile trades, where fairly sizable gains and losses are made in a relatively short time period. The biggest edge with Catapults occur when a sizable cluster of them becomes active. As a lone trade, I have much less enthusiasm about this one and would prefer to play a little defense.

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