

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 2, 2009

Volume 2 Issue 126

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					
July 2, 2009	Strong breadth weakest vol 10	1-3 days	Bearish		
July 2, 2009	Low HV cluster - no 20 high	1-8 days	Bearish	-3.40%	-4.60%
June 30, 2009	High close 10 on low vol 10	1-3 days	Bearish	-1.80%	-2.70%
June 29, 2009	Low range and vol above 10ma	1-15 days	Bearish	-4.40%	-6.90%
June 26, 2009	2 Days 7:3 up issues - no 10 high	1-8 days	Bearish		
Active - Long Term					
June 26, 2009	VIX:VXV drops below 0.9	2-5 months	Bearish		
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		
June 1, 2009	Nasdaq Relative Strength Leading		Bullish		
April 20, 2009	Low Nasdaq Weekly Vol Spyx	1-10 weeks	Bearish		
Dropped Tonight					
July 1, 2009	1st Day of Month	1 day	Bullish		

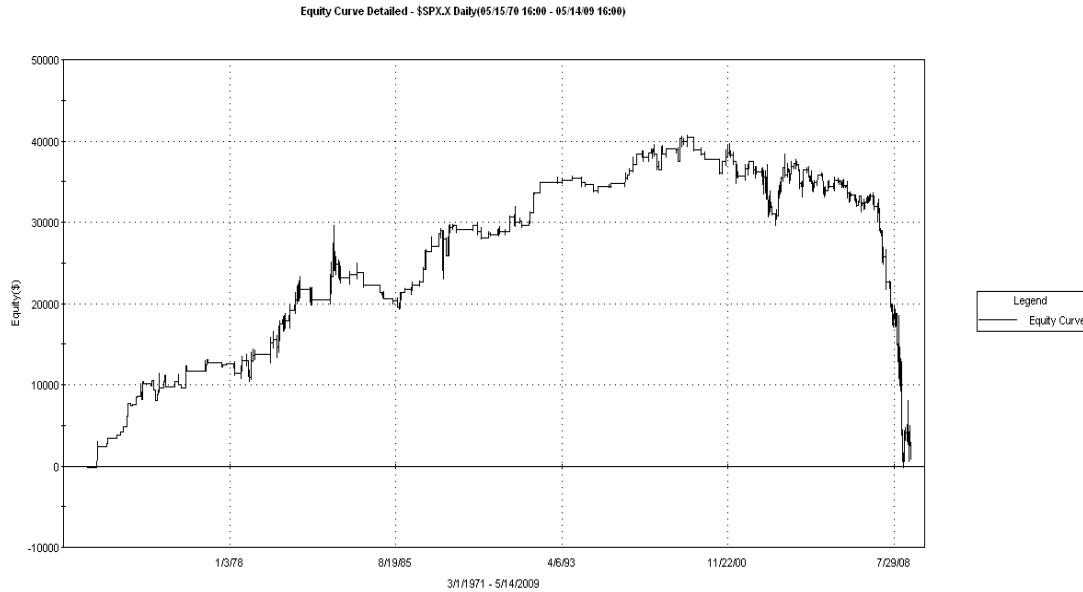
If the avg max move is achieved the study will appear in **bold and brown**. If the avg + 1/2 std deviation is achieved, it will appear in **bold italic blue** and no longer be active.

Short-term Outlook (1-5 days) – updated 7/2 – bearish

After gapping up and looking strong in the morning the market faded all afternoon and closed near its lows of the day. Still it managed to post gains in all the major indices. Breadth was solid as the NYSE Up Issues % close at 73% while the Up Volume % posted 64%. Volume came in at the lowest levels in over 2 weeks.

One study that has posted a significant downside bias as of late that showed up in the Quantifinder tonight is below. It was published in the 5/15/2009 Subscriber Letter. An excerpt from that Letter is below. Stats have not been updated.

Below is a chart that shows the equity curve of buying any day that advancers outnumber decliners 2 to 1 while volume declines. The holding period for each trade is 1 day.



From 1970 until August of 2007 this setup had no bearish implications. In fact, for most of the period, the strong breadth had bullish implications on the next day's trade. This bear market has seen sharp, consistent selling following such days. Below is a table breaking down the 1-5 day performance over the recent period:

Advancers outnumber down issues by at least 2 to 1. Volume declines from yesterday.										
Buy S&P 500 on close. Sell X days later. \$100k/trade. 08/01/2007 - present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	(\$71,244.40)	34	12	22	35.29412	\$1,690.66	(\$4,160.56)	0.406355	0.221648	(\$2,095.42)
4	(\$56,060.01)	36	12	24	33.33333	\$1,880.45	(\$3,276.06)	0.573997	0.286999	(\$1,557.22)
3	(\$59,506.71)	45	15	30	33.33333	\$2,075.83	(\$3,021.47)	0.687026	0.343513	(\$1,322.37)
2	(\$70,400.52)	46	15	31	32.6087	\$839.52	(\$2,677.20)	0.313581	0.151733	(\$1,530.45)
1	(\$32,523.85)	47	18	29	38.29787	\$935.06	(\$1,701.89)	0.549423	0.341021	(\$692.00)

Looking at the recent past there seems to be a pretty strong indication of a downside edge.

I've discussed the low VIX and VIX:VXV ratio several times in the last week or so. Wednesday afternoon Dr. Brett Steenbarger of the Tradersfeed blog ran a study that looked at 20-day lows in the VIX that did NOT coincide with 20-day highs in the SPX. A link to his post is below:

<http://traderfeed.blogspot.com/2009/07/when-volatility-is-falling-but-stocks.html>

It's an interesting idea so I decided to examine it a little further. Instead of looking at single instances where the VIX posted a 20-day low without a corresponding SPX high, I looked for clusters of such occurrences. In other words I wanted several VIX lows to occur while the SPX was not hitting new highs.

VIX makes a new 20-day low for at least the 3rd time in the last 10 days. SPX has 0 20-day highs in the last 10 days. Buy on close. Sell X days later. \$100k/trade. 1999-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
20	-27,647.90	13	3	10	23.08	3,010.66	-3,667.99	0.82	0.25	-2,126.76
19	-28,303.06	13	3	10	23.08	2,607.25	-3,612.48	0.72	0.22	-2,177.16
18	-28,724.41	13	4	9	30.77	1,668.26	-3,933.05	0.42	0.19	-2,209.57
17	-30,559.54	13	3	10	23.08	1,728.90	-3,574.62	0.48	0.15	-2,350.73
16	-30,419.26	13	3	10	23.08	1,686.78	-3,547.96	0.48	0.14	-2,339.94
15	-25,942.28	13	3	10	23.08	2,229.66	-3,263.13	0.68	0.20	-1,995.56
14	-17,314.02	13	3	10	23.08	2,541.22	-2,493.77	1.02	0.31	-1,331.85
13	-11,211.22	13	4	9	30.77	2,231.20	-2,237.33	1.00	0.44	-862.40
12	-13,289.52	13	4	9	30.77	1,808.41	-2,280.35	0.79	0.35	-1,022.27
11	-9,311.93	13	5	8	38.46	1,882.67	-2,340.66	0.80	0.50	-716.30
10	-12,827.05	14	8	6	57.14	1,065.98	-3,559.15	0.30	0.40	-916.22
9	-15,073.20	14	7	7	50.00	1,147.24	-3,300.56	0.35	0.35	-1,076.66
8	-15,893.88	14	6	8	42.86	1,084.31	-2,799.97	0.39	0.29	-1,135.28
7	-14,367.93	14	6	8	42.86	1,416.22	-2,858.15	0.50	0.37	-1,026.28
6	-16,221.86	14	6	8	42.86	1,868.17	-3,428.86	0.54	0.41	-1,158.70
5	-17,744.60	15	6	9	40.00	1,732.61	-3,126.70	0.55	0.37	-1,182.97
4	-21,148.03	15	5	10	33.33	1,088.21	-2,658.91	0.41	0.20	-1,409.87
3	-10,202.25	15	5	10	33.33	1,584.84	-1,812.65	0.87	0.44	-680.15
2	-3,905.92	18	9	9	50.00	991.11	-1,425.10	0.70	0.70	-217.00
1	-168.31	23	12	11	52.17	737.95	-820.33	0.90	0.98	-7.32

There's only been one other time like the present with 5 20 day lows in the VIX within a 10-day period while the S&P failed to register a 20-day high. That was 12/28/01 – another holiday trading period.

Below are all the instances along with their 15-day holding period returns.

VIX makes a new 20-day low for at least the 3rd time in the last 10 days. SPX has 0 20-day highs in the last 10 days. Buy on close. Sell 15 days later. \$100k/trade. 1999-present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
06/17/99	Buy	\$1,339.91	4.73%	\$4,840.34
07/09/99	Sell	\$1,403.28		(\$2,324.34)
05/17/00	Buy	\$1,447.79	0.96%	\$2,445.36
06/08/00	Sell	\$1,461.68		(\$5,982.30)
07/07/00	Buy	\$1,478.90	(3.99%)	\$2,574.14
07/28/00	Sell	\$1,419.89		(\$4,355.67)
08/14/00	Buy	\$1,491.54	1.04%	\$2,582.85
09/05/00	Sell	\$1,507.08		(\$1,058.60)
02/15/01	Buy	\$1,326.61	(7.02%)	\$0.00
03/09/01	Sell	\$1,233.42		(\$8,408.25)
07/02/01	Buy	\$1,236.72	(5.26%)	\$0.00
07/24/01	Sell	\$1,171.65		(\$5,694.40)
12/26/01	Buy	\$1,149.37	(0.91%)	\$2,401.20
01/17/02	Sell	\$1,138.88		(\$1,903.56)
11/20/02	Buy	\$914.15	(1.37%)	\$4,378.53
12/12/02	Sell	\$901.59		(\$2,414.35)
07/11/03	Buy	\$998.14	(1.80%)	\$1,727.00
08/01/03	Sell	\$980.15		(\$2,251.00)
10/30/03	Buy	\$1,046.94	(1.27%)	\$1,587.45
11/20/03	Sell	\$1,033.65		(\$1,284.40)
04/23/04	Buy	\$1,140.60	(3.94%)	\$542.88
05/14/04	Sell	\$1,095.66		(\$5,592.36)
02/25/08	Buy	\$1,371.79	(6.94%)	\$1,191.60
03/17/08	Sell	\$1,276.60		(\$8,266.32)
12/16/08	Buy	\$913.18	(0.38%)	\$3,343.03
01/08/09	Sell	\$909.73		(\$6,115.99)
06/29/09	Buy	\$927.23	n/a	\$501.83
open	n/a	\$923.33		(\$1,537.59)

Since the beginning of 2001 there have been 9 losers in a row.

One potential problem with the above study is that the VIX is naturally declining ahead of the July 4th holiday. Adam Warner pointed this out in his comments which are still in our intermediate-term outlook below from 6/29. This holiday lowering suggests that the current implications may not be as bearish as the study would otherwise suggest.

It's not just the VIX that is falling, though. Historical volatility is hitting new lows. Rather than looking for the forward-looking vix to clue us in, I ran a similar test using the 20-day historical volatility.

20-day Historical Volatility makes a new 20-day low for at least the 3rd time in the last 10 days. SPX has 0 20-day highs in the last 10 days. Buy on close. Sell X days later. \$100k/trade. 1999-present.

QE VIX dn index dn: daysin	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
20	-45,324.67	18	7	11	38.89	3,009.18	-6,035.36	0.50	0.32	-2,518.04
19	-40,291.54	18	8	10	44.44	2,452.27	-5,990.97	0.41	0.33	-2,238.42
18	-48,212.18	18	7	11	38.89	2,428.05	-5,928.05	0.41	0.26	-2,678.45
17	-47,116.93	18	5	13	27.78	2,805.63	-4,703.47	0.60	0.23	-2,617.61
16	-56,415.38	18	5	13	27.78	1,857.51	-5,054.07	0.37	0.14	-3,134.19
15	-51,394.12	18	5	13	27.78	1,880.65	-4,676.72	0.40	0.15	-2,855.23
14	-35,417.19	18	5	13	27.78	2,443.84	-3,664.34	0.67	0.26	-1,967.62
13	-25,341.08	18	7	11	38.89	1,999.80	-3,576.33	0.56	0.36	-1,407.84
12	-26,599.52	19	7	12	36.84	1,851.45	-3,296.64	0.56	0.33	-1,399.97
11	-29,056.24	19	7	12	36.84	2,149.67	-3,675.33	0.58	0.34	-1,529.28
10	-34,799.95	19	8	11	42.11	1,597.78	-4,325.65	0.37	0.27	-1,831.58
9	-31,245.58	19	6	13	31.58	1,982.71	-3,318.60	0.60	0.28	-1,644.50
8	-35,032.64	21	6	15	28.57	1,812.20	-3,060.39	0.59	0.24	-1,668.22
7	-21,850.76	21	7	14	33.33	1,353.13	-2,237.33	0.60	0.30	-1,040.51
6	-17,235.15	21	8	13	38.10	1,109.03	-2,008.26	0.55	0.34	-820.72
5	-20,142.01	23	9	14	39.13	1,206.91	-2,214.59	0.54	0.35	-875.74
4	-11,162.85	26	10	16	38.46	1,928.67	-1,903.10	1.01	0.63	-429.34
3	-14,108.77	30	13	17	43.33	1,545.03	-2,011.42	0.77	0.59	-470.29
2	-8,259.97	37	17	20	45.95	1,212.51	-1,443.63	0.84	0.71	-223.24
1	-5,200.75	51	24	27	47.06	1,091.80	-1,163.11	0.94	0.83	-101.98

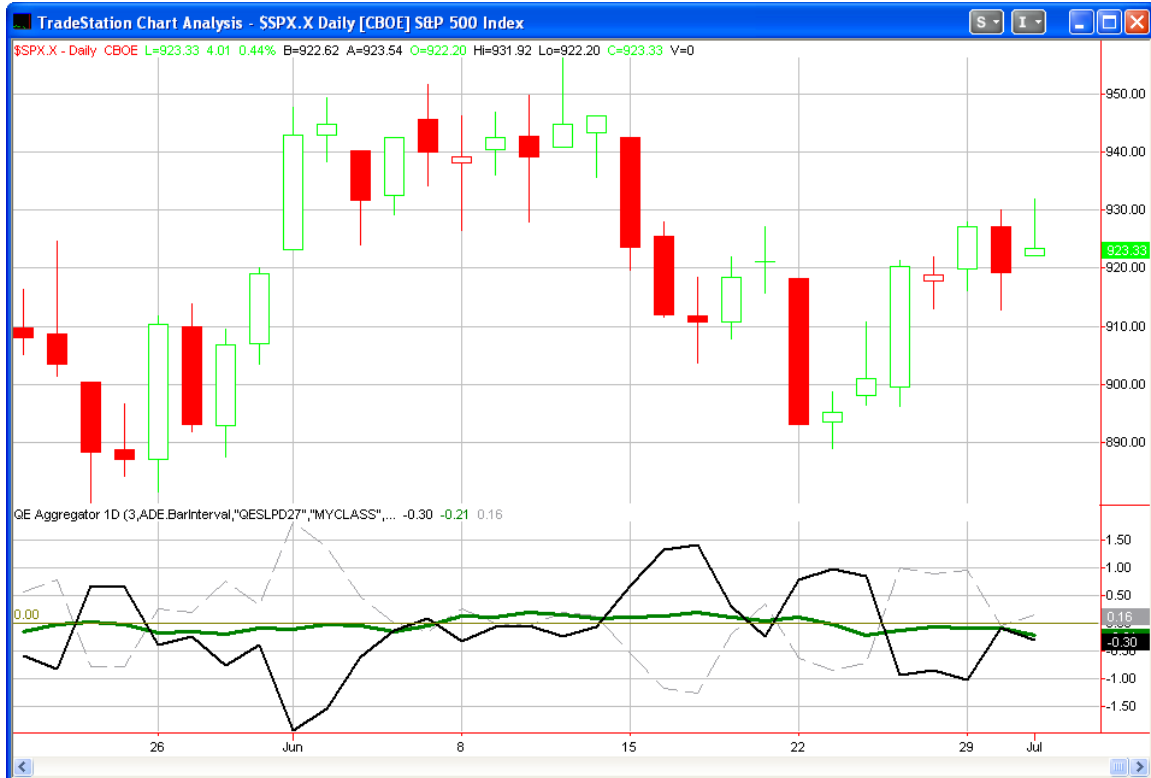
Similar results here. Interestingly, there were only 3 time periods with much overlap between the 2. However you look at it, very low volatility while the market is failing to reach new highs is often followed by a selloff.

Below are all the trades for the above study with an 8-day exit.

20-day Historical Volatility makes a new 20-day low for at least the 3rd time in the last 10 days. SPX has 0 20-day highs in the last 10 days. Buy on close. Sell 8 days later. \$100k/trade. 1999-present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
10/05/99	Buy	\$1,301.35	(4.14%)	\$2,872.80
10/15/99	Sell	\$1,247.41		(\$4,252.96)
05/17/00	Buy	\$1,447.79	(1.95%)	\$707.25
05/30/00	Sell	\$1,419.56		(\$5,982.30)
11/29/00	Buy	\$1,341.77	2.87%	\$3,498.72
12/11/00	Sell	\$1,380.23		(\$3,468.38)
06/15/01	Buy	\$1,214.36	(0.27%)	\$2,122.16
06/27/01	Sell	\$1,211.07		(\$797.04)
06/27/01	Buy	\$1,211.07	(2.44%)	\$2,354.22
07/10/01	Sell	\$1,181.52		(\$2,553.48)
08/16/01	Buy	\$1,181.66	(1.71%)	\$435.96
08/28/01	Sell	\$1,161.51		(\$2,378.88)
04/04/02	Buy	\$1,126.34	0.18%	\$613.36
04/16/02	Sell	\$1,128.37		(\$2,369.84)
06/10/02	Buy	\$1,030.74	(2.37%)	\$978.73
06/20/02	Sell	\$1,006.29		(\$4,763.67)
09/06/02	Buy	\$893.92	(2.74%)	\$3,336.66
09/18/02	Sell	\$869.46		(\$4,053.72)
09/18/02	Buy	\$869.46	(6.23%)	\$0.00
09/30/02	Sell	\$815.28		(\$7,958.00)
08/19/03	Buy	\$1,002.35	0.56%	\$857.34
08/29/03	Sell	\$1,008.01		(\$1,859.22)
10/29/03	Buy	\$1,048.11	(0.10%)	\$1,356.60
11/10/03	Sell	\$1,047.11		(\$407.55)
04/27/04	Buy	\$1,138.12	(3.46%)	\$0.00
05/07/04	Sell	\$1,098.69		(\$3,435.63)
07/12/04	Buy	\$1,114.35	(1.57%)	\$467.25
07/22/04	Sell	\$1,096.85		(\$2,686.91)
07/18/06	Buy	\$1,236.86	3.37%	\$3,484.80
07/28/06	Sell	\$1,278.55		(\$9.60)
01/04/07	Buy	\$1,418.34	0.87%	\$1,185.10
01/17/07	Sell	\$1,430.62		(\$1,005.90)
09/12/07	Buy	\$1,471.56	3.14%	\$4,501.06
09/24/07	Sell	\$1,517.73		\$0.00
12/26/07	Buy	\$1,497.66	(7.18%)	\$0.00
01/08/08	Sell	\$1,390.18		(\$7,217.76)
02/22/08	Buy	\$1,353.11	(1.43%)	\$2,571.79
03/05/08	Sell	\$1,333.71		(\$3,337.56)
03/05/08	Buy	\$1,333.71	(4.28%)	\$0.00
03/17/08	Sell	\$1,276.60		(\$5,678.02)
09/03/08	Buy	\$1,274.99	(6.37%)	\$0.00
09/15/08	Sell	\$1,193.75		(\$6,336.72)

With the additional bearish studies tonight I've updated the [Aggregator](#) chart below:



Both the green Aggregator line and the black Differential line dropped further below 0 today. Expectations based on the studies remain net negative. Recent performance as illustrated by the Differential line has exceeded expectations. Both lines below 0 suggest a downside edge. I am short and will look to get shorter on Thursday.

Intermediate-term Outlook (2 weeks – 2 months)– updated 6/29 – neutral (near turning bearish)

There is still a bit of a mix among the intermediate-term indicators. From a price standpoint the SPX seems to be stuck in a consolidation following a rally (March – May). It really hasn't gone hardly anywhere for about a month and a half. It's dangerous to get too bearish before you actually see price break down. The 875-880 area appears important to hold.

The Nasdaq/NYSE volume indicator continues to suggest an unhealthy amount of interest in Nasdaq stocks. I noted this indicator in a study a few weeks ago (listed in the summary at the top of the Letter). It isn't one of my favorite indicators, though, because much of the suggestion from the indicators come from on time period – the 2000-2003 bear market.

Friday's nightly Subscriber Letter discussed the fact that the VIX:VXV Ratio had fallen below 0.9. This was a level that has historically suggested bearish consequences for the intermediate-term. I discussed a system first published in the 8/25/08 Letter that looked at shorting the market when the ratio fell below 0.9 and then covering on a move back

over 1. Though the system required patience and the trades averaged about 2.5 months, the results were solidly bearish. All the trades are listed below:

VIX:VXV Ratio crosses below 0.9. Short S&P 500 on close. Cover when ratio crosses above 1. \$100k/trade 8/2002-present.				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/02/03	Short	\$909.03	5.24%	\$5,425.20
01/24/03	Cover	\$861.40		(\$2,862.20)
08/12/03	Short	\$990.35	(5.38%)	\$999.00
11/17/03	Cover	\$1,043.63		(\$7,330.00)
01/16/04	Short	\$1,139.82	2.90%	\$2,953.65
03/11/04	Cover	\$1,106.79		(\$2,036.67)
03/25/04	Short	\$1,109.28	4.15%	\$4,234.50
08/12/04	Cover	\$1,063.23		(\$3,716.10)
08/25/04	Short	\$1,104.96	(2.28%)	\$1,329.30
10/29/04	Cover	\$1,130.20		(\$3,338.10)
12/09/04	Short	\$1,189.24	3.85%	\$3,974.88
04/15/05	Cover	\$1,143.43		(\$3,349.08)
06/02/05	Short	\$1,204.29	2.28%	\$2,995.47
10/13/05	Cover	\$1,176.84		(\$3,450.31)
11/25/05	Short	\$1,268.25	(2.91%)	\$1,755.78
05/01/06	Cover	\$1,305.19		(\$3,892.98)
07/03/06	Short	\$1,280.19	2.96%	\$3,023.28
07/13/06	Cover	\$1,242.28		\$0.00
08/16/06	Short	\$1,295.43	(8.01%)	\$457.38
02/27/07	Cover	\$1,399.14		(\$12,792.78)
06/19/07	Short	\$1,533.70	2.66%	\$2,805.40
06/26/07	Cover	\$1,492.89		(\$235.30)
10/09/07	Short	\$1,565.15	3.62%	\$4,762.17
11/01/07	Cover	\$1,508.45		(\$689.22)
12/20/07	Short	\$1,460.12	3.32%	\$3,327.24
01/04/08	Cover	\$1,411.62		(\$2,633.64)
05/12/08	Short	\$1,403.58	8.80%	\$9,342.18
06/30/08	Cover	\$1,280.00		(\$2,602.86)
08/21/08	Short	\$1,277.71	4.16%	\$4,717.44
09/09/08	Cover	\$1,224.54		(\$1,975.74)
06/25/09	Short	\$920.26	n/a	\$0.00
open	n/a	\$920.26		\$0.00

I then went on to examine how the VIX had performed over the same period. Below is an excerpt from Friday's Letter that discusses this:

I also decided to check performance if the same system was run against the VIX instead of the SPX. Obviously these trades could not have taken place since the VIX is not a traded index but it does let you know how the VIX performed. Note these are long trade instead of short.

VIX:VXV Ratio crosses below 0.9. Buy VIX on close. Sell when ratio crosses above 1. \$100k/trade 8/2002-present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/02/03	Buy	\$25.39	24.10%	\$24,100.56
01/24/03	Sell	\$31.51		(\$4,489.32)
08/12/03	Buy	\$17.94	3.68%	\$29,653.68
11/17/03	Sell	\$18.60		(\$11,984.10)
01/16/04	Buy	\$15.00	37.80%	\$37,929.54
03/11/04	Sell	\$20.67		(\$7,999.20)
03/25/04	Buy	\$17.88	6.71%	\$14,371.44
08/12/04	Sell	\$19.08		(\$27,904.08)
08/25/04	Buy	\$14.98	8.61%	\$12,615.75
10/29/04	Sell	\$16.27		(\$15,886.50)
12/09/04	Buy	\$12.88	37.73%	\$40,134.71
04/15/05	Sell	\$17.74		(\$15,370.74)
06/02/05	Buy	\$11.84	39.10%	\$45,180.75
10/13/05	Sell	\$16.47		(\$16,552.20)
11/25/05	Buy	\$10.88	15.26%	\$33,822.88
05/01/06	Sell	\$12.54		(\$6,709.43)
07/03/06	Buy	\$13.05	36.32%	\$36,624.36
07/13/06	Sell	\$17.79		(\$0.00)
08/16/06	Buy	\$12.41	47.54%	\$53,182.80
02/27/07	Sell	\$18.31		(\$24,335.16)
06/19/07	Buy	\$12.85	47.00%	\$47,003.28
06/26/07	Sell	\$18.89		(\$778.20)
10/09/07	Buy	\$16.12	43.98%	\$49,810.09
11/01/07	Sell	\$23.21		(\$248.12)
12/20/07	Buy	\$20.58	16.33%	\$18,075.48
01/04/08	Sell	\$23.94		(\$11,175.70)
05/12/08	Buy	\$17.79	34.63%	\$38,054.17
06/30/08	Sell	\$23.95		(\$11,073.37)
08/21/08	Buy	\$19.82	28.51%	\$29,563.70
09/09/08	Sell	\$25.47		(\$5,953.10)
06/25/09	Buy	\$26.36	n/a	\$0.00
open	n/a	\$26.36	Highest entry price	\$0.00

In every case the VIX was trading higher when the ratio crossed back above 1. There was only 1 instance out of the 15 where there wasn't at least some additional pullback. I also noted on the table above that this is the highest the VIX has ever traded when the VIX:VXV Ratio initially dropped below 20. Fifteen for fifteen winners is fairly impressive and would seem worthy of a trade, especially considering some of the % returns of several of the trades above. The AVERAGE trade saw the VIX gain 28.5%.

While the VIX isn't tradable, options, futures, or the fairly new VXX etf are all possibilities.

I'm a little concerned that basis risk in the futures along with fund expenses may cause erosion in the VXX. My concern seems unfounded when you look at the performance

since its inception at the end of January. Over that time the VIX has dropped 41% and the VXX only 32%. Still, while I think it could be worth a trade, I'm going to study the VXX a bit more tomorrow and perhaps ask some people with a better understanding of the complexities than me.

On Friday I shared the study and posed the following question to [Bill Luby of the VIX and More site](#) and [Adam Warner of the Daily Options Report](#).

“Do you believe VXX could be an appropriate intermediate-term trading vehicle, or does the structure of it suggest it is likely to erode over time (like a slow – motion Direxion triple ETF)?”

Their input was enlightening.

Bill did a nice job of explaining how the VXX worked and why it could suffer some erosion over time.

With the leveraged ETFs, the price decay is a function of volatility (and partly leverage). With VXX, things are a little different because they do daily rebalancing. The issue is one of term structure. In a contango (normal) environment, the VIX futures prices tend to slope upward the farther you go out in time to reflect greater uncertainty. When that happens, each day the VXX rebalances it sells 1/30 of the front month position and replaces it by adding 1/30 to the second month position at a higher price.

Right now that difference is about 75 cents, so we are talking something on the order of 2-3 cents per day ($1/30 * 0.75$) or maybe 50 cents per trading month.

Got it? So in a contango (normal) environment the VXX will likely see a small amount of erosion on a daily basis. Bill then goes on to say...

Of course the VIX is not always in contango. Sometimes the term structure is flat and sometimes it is in backwardation where the front month is more expensive than the back month (especially after a VIX spike). In these instances, the ETF would be making a profit in its daily roll/rebalance trade, as it would be selling the more expensive month (or at least 1/30 of that position) and replacing it with a cheaper month.

VIX futures were regularly in backwardation following the launch of VXX. Only recently has the term structure flattened out and started to go back to contango.

Adam also noted the VXX should see some erosion in a contango environment. He had some interesting thoughts about the current holiday schedule as well:

I'm a little skeptical of VIX/VXV around a holiday. VIX should act weak when a significant chunk of the 30 day period is early summer and pre-holiday blahs. It's 10 calendar days right now until July 6th. SPX traders will lower their bids ahead of anticipated slow trading stretches (remember real options have real time decay you need

to offset). So it's overwhelmingly likely VIX will be higher in 10 days than it is now and the VIX/VXV ratio will increase as VXV will not lift as much (10 days decay is not as meaningful in a 90 day option).

In normal circumstances, VXX will track about 40-50% of the VIX move, but will it track it that well now? VXX represents a 30 day (hypothetical) VIX future. A VIX future itself just takes a snapshot of where the VIX will be on expiration day. A holiday between now and then has no impact. VIX July's as I type are about 29, a 2+ premium to the VIX. So you'd first have to make that up before profiting on the VIX.

Now here's the kicker though. I show July as the worst cycle of the year in terms of average and median VIX readings. But if I divide it into the first half of cycle and 2nd half (2nd half always just the last 2 weeks, so if it's a 5 week cycle the first 3 weeks are defined as "half") it almost always lifts in the 2nd half. Which makes perfect sense given the holiday in the middle and then earnings season kicking in at the end.

So you're going to see the VIX trough pretty soon and then lift. Will the VXX lift with it? That I'm not as sure of.

So the current calendar could take some of the edge off a possible VXX trade, since there is a chance it won't track the VIX as closely as usual.

They sum up by stating the following:.

Bill:

The bottom line is that the idea of slow-motion time decay is probably appropriate. Unlike leveraged ETFs, however, where absolute volatility (and direction) determine the rate of decay, for VXX it is the term structure of the VIX futures -- or the relative volatility if you will.

Adam:

If the next month out has a premium to the nearer one, seems like they'll dribble a modest amount away each day. That being said, it's not crude oil here, premiums are often very modest if at all, and the roll should be perpetual and not a one-off deal like in crude.

Long story short...I don't think there's a major ETN structural problem in using VXX.

Now in addition to VXX, there is also a longer-dated volatility ETF (similar to VXV in the VIX:VXV ratio). That ETF is VXZ. It struck me that perhaps one way to offset the contango rolling risk in VXX might be to short VXZ at the same time. Bill informed me that he didn't believe you were allowed to short either of these. I called my broker to see if they were shortable and was told "not today". This does limit their usefulness quite a bit since they can really only be used 1) as a hedge or 2) as a bet on an increase in volatility. There's no way to bet on a decrease in volatility using these proxies.

I'm not going to track any official trade ideas based on VXX at the moment. I have put on a very small position myself for tracking purposes and may discuss any observations I have here after completion of the trade.

It's rare I discuss anyone else's work in the Subscriber Letter but both Bill and Adam really know their stuff. I encourage subscribers to check out their sites and should also let you know they are going to be publishing books. I'd be surprised if their books weren't both filled with nuggets such as those they provided above.

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	1.56	DJ US Financial	IYF	0.37
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	1.14
DJ US Oil Equip & Svcs	IEZ	2.13	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	2.94	DJ US Technology Sector	IYW	0.54
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.96	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 from the S&P 100 and ETF lists along with occasional other trade ideas to track below.

SPY – short 1/4 index position @ \$93.00 limit ON OPEN If not filled, wait until close and then sell short 1/4 index position @ \$92.34 limit ON CLOSE . Based on the short-term outlook above. I am only looking to add 1/4, so if filled in the morning the closing trade will be cancelled.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(s)	6/25/2009	\$91.15	\$92.33	-1.29%		
SPY(s)	6/26/2009	\$92.00	\$91.86	0.15%		covered on 6/30 @ \$91.86
SPY(s)	6/29/2009	\$92.70	\$92.33	0.40%		
DD(s)	6/30/2009	\$26.07	\$25.80	1.04%		cover on close < \$25.70

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