

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 13, 2009

Volume 2 Issue 132

## 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>					
July 13, 2009	1% drop then flat	1-4 days	Bearish	-1.35%	-2.00%
July 10, 2009	SPY weak vol bounce	1-2 days	Bearish		
7/8/2009 (also 7/6/09)	SPX 1% drop. Advance twice decliners	1-9 days	Bullish	2.80%	4.00%
<b>June 29, 2009</b>	<b>Low range and vol above 10ma</b>	<b>1-15 days</b>	<b>Bearish</b>	<b>-4.40%</b>	<b>-6.90%</b>
<b>Active - Long Term</b>					
July 13, 2009	Nasdaq/NYSE Volume High	1-20 days	Bearish		
June 26, 2009	VIX:VXV drops below 0.9	2-5 months	Bearish		
<b>June 22, 2009</b>	<b>VIX:VXV hits 100-day low</b>	<b>1-20 days</b>	<b>Bearish</b>	<b>-3.80%</b>	<b>-5.50%</b>
June 1, 2009	Nasdaq Relative Strength Leading		Bullish		
<b>Dropped Tonight</b>					
July 7, 2009	Weak breadth on up day	1-4 days	Bearish	-4.10%	-5.60%

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 7/13 – slightly bearish**

Friday was a slow market day and little was accomplished from a direction standpoint. The S&P and Dow closed down less than 0.5% and the Nasdaq was up slightly. NYSE breadth was a little weak. The Up Issues % came in at 48% and the Up Volume % at 32%. Total volume was the lowest of the week.

This choppy action that has seen the market go nowhere over the last few days has not triggered many of our past studies. The Quantifinder came up blank for the 2<sup>nd</sup> day in a row on Friday – a very unusual situation after close to a month without any days coming up blank.

In fact it is the quietness of the last 3 days that is most striking when looking at the market – especially considering the big moves down on Tuesday as well as Thursday the 2<sup>nd</sup>. I looked at other times the market flatlined so quickly after big drops like Tuesday's. I found the current situation is fairly rare.

SPX drops 1% on day 1. Then the next three days it closes within 0.25% of day 1's close. Buy on close. Sell X days later. \$100k/trade. 1960 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	-8,720.34	12	6	6	50.00	578.95	-2,032.34	0.28	0.28	-726.70
4	-8,979.46	12	3	9	25.00	996.35	-1,329.83	0.75	0.25	-748.29
3	-6,745.64	12	4	8	33.33	859.37	-1,272.89	0.68	0.34	-562.14
2	-5,736.49	12	5	7	41.67	689.59	-1,312.06	0.53	0.38	-478.04
1	-2,647.52	12	7	5	58.33	362.94	-1,037.63	0.35	0.49	-220.63

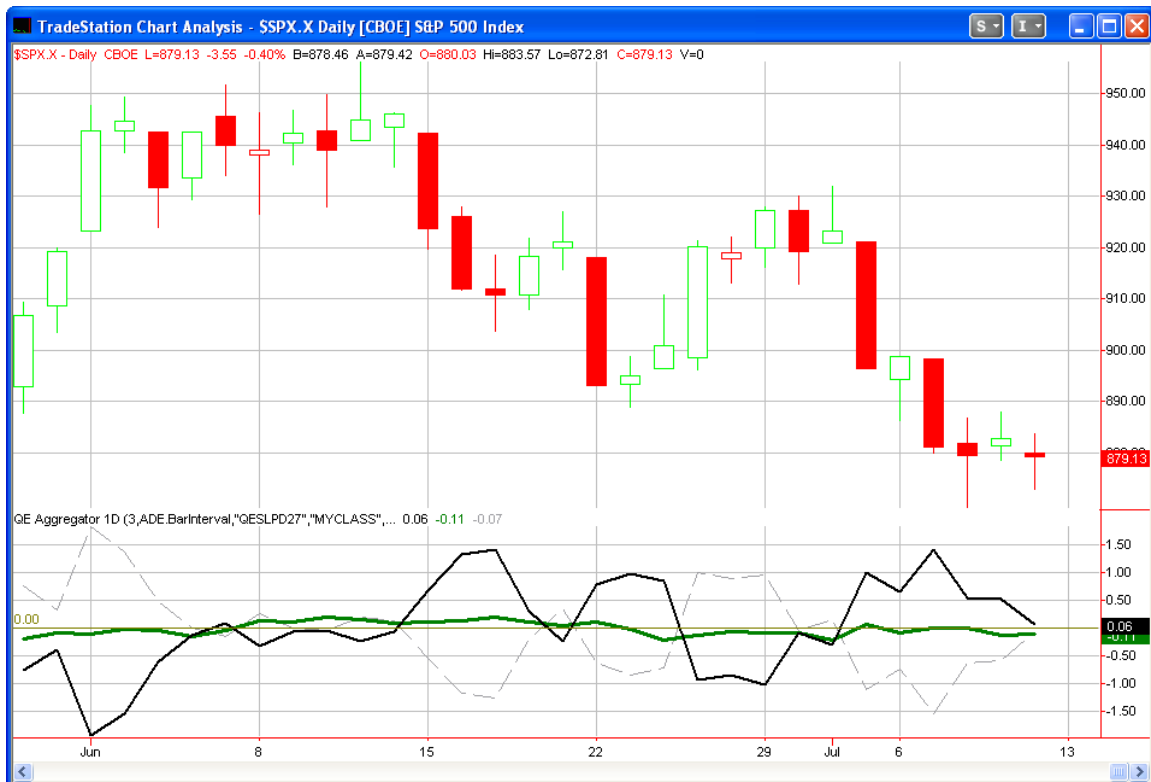
Instances are too small for much comfort, but there appears to be some tendency to sell off following the previous occurrences.

I also did a study looking at other situations where historical volatility has contracted rapidly like it has in the last 3 days. To do this I looked at the 3-day historical volatility and compared it to the 10-day historical volatility 3 days ago. In other words I divided Friday's 3-day historical volatility by Tuesday's 10-day historical volatility. A result below 1 would indicate the last 3 days have been less volatile than the previous 10. A number above 1 would indicate a recent uptick in volatility. Friday's 3-day over Tuesday's 10-day came in at a very low 0.23.

I then look to see what the 3-day historical volatility has typically been 3 days later. What does a sharp contraction over the last 3 days indicate you might expect over the next 3 days? What I found is that when the 3-day over the offset 10-day dropped to 0.25 or lower the next 3 days were 5.5 times as volatile as the recent 3 days. This is based on 1,111 trading days since 1960 – or about 9% of all trading days. Going back to just 1999 gave similar results, as the 3-day historical volatility increased by 5.4 times.

This suggests a move out of the recent 3-day range could be very sharp. It does not suggest direction, though. For help there we'll need to look at the other studies.

I've updated the [Aggregator](#) chart below:



The net expectations of the active studies remain negative over the next few days as illustrated by the green Aggregator line. Meanwhile the black Differential line is slightly above zero as the S&P has mildly underperformed expectations over the last 3 days.

The ideal configuration is to see both lines on the same side of zero. We're pretty close here. Aggressive traders could consider short entries. A possible stop could be Thursday's high around 888. Intraday traders could look for possible intraday patterns to get short and then hold a portion of it for longer should it move nicely in their direction.

Personally, I intend to wait for a bit more sizable edge before committing capital

***Intermediate-term Outlook (2 weeks – 2 months)– updated 7/13 – slightly bearish***

We tested and dipped below the 878 – 888 support level that I indicated last week may be important. So far the market has NOT made a decisive move out of that area. Both the short and long-term studies are currently suggesting the short side has better odds.

The long-term and short-term active studies from the list on the 1st page are generally suggesting downside. The one intermediate-term positive from the list was the Nasdaq / S&P 500 Lead/lag model. The Nasdaq continues to lead based on that study, which has historically been a good sign.

The VIX:VXV Ratio has again fallen close to 0.9 as it now sits at 0.92. A move much lower could trigger new opportunities for either S&P 500 shorts or VXX longs.

Also on the intermediate-term list is the Nasdaq/NYSE volume ratio. This is an indicator I discussed in some detail in the June 10<sup>th</sup> Letter. Below is an excerpt from that Letter:

*The Nasdaq/NYSE Volume Ratio is an indicator I haven't discussed in a while. It is hitting extreme levels at this time. Levels will vary depending on data provider. So while the extremes may differ depending on whose data you use, results should be comparable at those extremes. I use Tradestation. On Tuesday the Nasdaq volume more than doubled the NYSE for the 1<sup>st</sup> time a long time. This brought the 20-day average over 1.65. Below is a table showing 1-month returns based on this ratio.*

**20-day returns on 100k from 1981-present. Nasdaq / NYSE 20-day volume ratio exceeds X.**

Volume Ratio	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: Profit Factor	All: Avg Trade
1.65	-15,910.59	14	6	8	42.86	3,195.98	-4,385.81	0.73	0.55	-1,136.47
1.60	-13,593.74	18	7	11	38.89	5,445.53	-4,701.13	1.16	0.74	-755.21
1.55	-16,382.89	23	11	12	47.83	2,937.85	-4,058.27	0.72	0.66	-712.30
1.50	-22,014.66	28	12	16	42.86	4,276.69	-4,583.43	0.93	0.70	-786.24
1.45	-24,961.02	35	15	20	42.86	4,579.87	-4,682.95	0.98	0.73	-713.17
1.40	-32,117.05	44	20	24	45.45	3,723.72	-4,441.31	0.84	0.70	-729.93
1.35	-20,659.02	65	32	33	49.23	4,098.90	-4,600.72	0.89	0.86	-317.83
1.30	-46,707.09	89	48	41	53.93	3,071.34	-4,734.91	0.65	0.76	-524.80
1.25	-38,493.59	114	63	51	55.26	3,194.27	-4,700.64	0.68	0.84	-337.66
1.20	7,443.84	138	74	64	53.62	3,636.18	-4,088.02	0.89	1.03	53.94

*High levels of Nasdaq trading as opposed to NYSE suggest excessive speculation by investors. Once this level exceeds 1.4 it has generally indicated a bearish bias.*

Since I published the above study, the S&P has lost over 6.5%. Surprisingly this has not caused the ratio to fall at all. In fact, it has gone from 1.65% in June to about 2.0% now. This would suggest we may see additional downside.

Overall the market has not yet become decisively bearish. It appears to be on the precipice, though.

### **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.)***

<b>Index</b>	<b>ETF</b>	<b>CBI %</b>	<b>Index</b>	<b>ETF</b>	<b>CBI %</b>
DJ US Broker Dealers	IAI	0.00	DJ US Energy	IYE	0.00
DJ US Insurance Index	IAK	0.00	DJ US Financial	IYF	0.73
DJ US Regional Banks	IAT	2.99	DJ US Financial Services	IYG	1.56
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	0.74
DJ US Oil&Gas Expl & Prod	IEO	1.64	DJ US Industrial Sector	IYJ	1.52
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	0.00
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	2.56	DJ US Transportation	IYT	5.00
DJ US Aerospace & Defense	ITA	2.94	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	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.*

There were several good-looking triggers on the systems list night. A couple of these would include WYE and SLV. Since they all favor the long side and my outlook is slightly bearish with a good chance of increased volatility I'm going to pass. I think I'll give it another day and see what pops up Monday.

**Active Trades Table**

None

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