

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 14, 2009

Volume 2 Issue 133

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 14, 2009	SPX strong without dollar weakness	1-3 days	Bearish	-1.60%	-2.20%
July 13, 2009	1% drop then flat	1-4 days	Bearish	-1.35%	-2.00%
7/8/2009 (also 7/6/09)	SPX 1% drop. Advance twice decliners	1-9 days	Bullish	2.80%	4.00%
June 29, 2009	Low range and vol above 10ma	1-15 days	Bearish	-4.40%	-6.90%
Active - Long Term					
July 14, 2009	VIX:VXV hits 100-day low	1-20 days	Bearish	-3.80%	-5.50%
July 13, 2009	Nasdaq/NYSE Volume High	1-20 days	Bearish		
July 14, 2009	VIX:VXV drops below 0.9	2-5 months	Bearish		
June 1, 2009	Nasdaq Relative Strength Leading		Bullish		
Dropped Tonight					
July 10, 2009	SPY weak vol bounce	1-2 days	Bearish		

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 7/14 – somewhat bearish

The market put in a strong move higher on Monday. The major indices all closed between 2% and 2.5% higher. Breadth was strongly positive. The NYSE Up Issues % came in at 81% and the Up Volume % was 91% - making for a 90% up day. Total volume rose, but not in a big way. It was right around its 20-day average and lower than last Wednesday's reversal day.

The Quantifinder came up with a few notable studies tonight. It was interesting with the extremely strong breadth and sizable price movement that the studies that triggered were neither purely price nor breadth related. Instead two were sentiment focused and used the VIX:VXV ratio and the other was leadership based and looked at the SPX / US Dollar relationship.

The dollar study first appeared in the 6/19/09 Subscriber Letter. It found that since the beginning of 2008 there has been a strong inverse correlation between the SPX and the dollar. Times where significant strength in the SPX was not accompanied by significant weakness in the dollar have most often been followed by SPX pullbacks over the next

few days. The actual study was fairly long and detailed. Rather than replicating the whole thing here I've just included a link to that Subscriber Letter below:

[2009-06-19 QE Subscriber Letter.pdf](#)

We're again seeing notable action in the VIX:VXV ratio. In the past I've demonstrated a few edges with regards to this ratio. First below is an excerpt from a June 22nd study (not updated) that looked at SPX performance following 100-day lows in the ratio

VIXVXV 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	-11,643.27	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.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
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 1st trade in August of 2003.

Beyond just closing at a 100-day low, the VIX:VXV ratio also dropped below 0.9 today. 0.9 has been identified previously as a solid trigger level when considering short positions. I first showed this in the 8/25/08 Subscriber Letter and then updated the results on 6/26/09. Below is an excerpt:

One system I discussed...that gave some compelling numbers was to short the S&P 500 when the VIX:VXV dropped below 0.9 and then cover the trade when the ratio next crossed 1. (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.)

VIX:VXV Ratio crosses below 0.9. Short S&P 500 on close.
Cover when ratio crosses above 1. \$100k/trade 8/2002-present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$25,318.38	Profit Factor	2.37
Gross Profit	\$43,784.97	Gross Loss	(\$18,466.59)
Total Number of Trades	15	Percent Profitable	73.33%
Winning Trades	11	Losing Trades	4
Even Trades	0		
Avg. Trade Net Profit	\$1,687.89	Ratio Avg. Win:Avg. Loss	0.86
Avg. Winning Trade	\$3,980.45	Avg. Losing Trade	(\$4,616.65)
Largest Winning Trade	\$8,774.18	Largest Losing Trade	(\$7,985.67)
Max. Consecutive Winning Trades	5	Max. Consecutive Losing Trades	1
Avg. Bars in Winning Trades	38.45	Avg. Bars in Losing Trades	89.00
Avg. Bars in Total Trades	51.93		

One thing notable that I've circled above is the length of the trades. This is NOT a short-term system. Even the winning trades averaged close to 1 month. Many of these trades would've required some patience. Even with the extended trading period, the results are fairly strong – especially for a short-based system. Below I've listed all the trades.

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

While the timing may be off a bit, the patience was generally rewarded.

In addition to studying SPX action I also looked at the action in the VIX following such occurrences. What I found was that using the above system and trading a theoretical VIX position would have led to incredibly consistent and strong results. Unfortunately there is no exact proxy for the VIX index. Options, front month futures, and the VXX etf are the closest things. While they often move in similar directions they often have lower magnitude moves. I discussed the possibility of using the VXX as a proxy with Bill Luby of VIX and More and Adam Warner of the Daily Options report, and published both of their comments in the intermediate-term section of the 6/29/09 Subscriber Letter. Below is a link to that Letter if you'd like more information.

[2009-06-29 QE Subscriber Letter.pdf](#)

The bottom line of the discussion was that VXX was likely going to be subject to some erosion over time. It would most likely fail to reach the returns of a cash VIX. This erosion might not be as severe as other ETF's such as the Direxion triples.

Still, the theory remains that a move higher in the VIX will likely allow for profits if buying VXX. The July 9th Subscriber Letter discussed an alternate exit to waiting until the VIX:VXX ratio crossed back above 1. Exits could also be taken if the VIX closed more than 15% above its 10-day moving average. Based on the June trigger this would have resulted in an 18.7% gain in the VIX but less than 5% for VXX. I found the magnitude of the difference to be quite disappointing. Tonight again I will unofficially track an entry in a VXX position. In other words, it won't go into the Trade Ideas section below, but I'll keep an eye and see how the VXX performs compared to the VIX over the period a trade idea would have been active.

Tonight I also looked at SPX performance following 90% up days that immediately followed a 20-day low in the SPX. Previously I had looked at 50-day lows and found there to be an apparent tendency for the market to pull back after such occurrences. The number of instances was a bit low, though. Expanding the study to look at 20-day lows only generated 2 more trades. In other words only twice has the SPX managed to bounce off of 20-day low with a 90% up day when it was also trading above its 50day low. I didn't glean anything from those 2 instances.

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



The green Aggregator line remains below the 0 line, illustrating the negative expectation from the active studies over the next few days. The black Differential line spiked down sharply today as the SPX rallied. This line illustrates the sizable outperformance of the SPX versus expectations over the last few days.

Both lines below zero is the configuration I prefer when considering short positions. I will look to take advantage of the bearish outlook tomorrow, but not in an aggressive manner.

Last night's volatility study suggested we could have a few days of expanded volatility after the sharp contraction we saw last week. Monday certainly lived up to the hype. Continued strong movement could occur in the next few days.

Monday's move came off of a major support area which I've discussed several times in the last week and a half. Strong moves such as this from areas of major support are capable of generating confidence and leading to additional follow through. Monday was just the 1st day up, and without any price or breadth studies confirming the bearish outlook we may see this bounce last a bit longer. I'm planning on taking it slow but have laid out some parameters in the trade ideas section for a possible favorable entry on Tuesday.

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 10th 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 1st 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: ProfitFactor	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

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 ¼ index position @ \$91.00 limit. If not filled by the close then short ¼ index position at \$90.11 limit ON CLOSE. Based on the short-term market outlook.

Active Trades Table

None.

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