

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 21, 2009

Volume 2 Issue 138

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 20, 2009	SP low vol on op ex with low VIX	1-6 days	Bearish		
July 17, 2009	Adv: Decline 2 to 1 on lower volume	1-2 days	Bearish		
July 16, 2009	SPX strong without dollar weakness	1-3 days	Bearish	-1.60%	-2.20%
July 15, 2009	2 Days Up in Chop	1-4 days	Bearish		
July 15, 2009	WR10 NR10	1-5 days	Bearish		
June 29, 2009	Low range and vol above 10ma	1-15 days	Bearish	-4.40%	-6.90%
Active - Long Term					
July 17, 2009	Appel Daily Breadth	1-20 days	Bullish		
July 16, 2009	2 90% Up Days in 1 Week	1-25 days	Bullish		
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 16, 2009	SPY Gap n go to 10-high	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 7/21 – bearish

The melt up continued Monday. Overbought has become more overbought for the last few days. The Dow, Nasdaq, and S&P all closed over 1% higher after gapping up in the morning. Breadth was solidly positive. The NYSE Up Issues % came in at 76% and the Up Volume % at also at 76%. Total volume was lower than Friday but about average.

There wasn't a lot that was terribly notable about today's action. I examined the unfilled opening gap in the SPY a few different ways that would pertain to the current situation (above to 200ma, at a 20-day high, etc). Generally I found the price bar to provide little edge over the next few days.

Two studies that showed up in the Quantifnder tonight are worth mentioning. The 1st is the Nasdaq Up Volume % crossing above 64%. Below is a study from February that looked at other strong breadth moves in the Nasdaq:

Nasdaq Up Volume % 10-day ema crosses over 64%.										
Buy Nasdaq on close. Sell X days later. \$100k/trade. 1992-2/6/2009										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
30	\$75,056.27	19	13	6	68.42	\$7,414.21	(\$3,554.75)	2.09	4.52	\$3,950.33
20	\$65,533.02	20	16	4	80.00	\$5,134.87	(\$4,156.21)	1.24	4.94	\$3,276.65
15	\$51,774.69	23	15	8	65.22	\$4,863.23	(\$2,646.72)	1.84	3.45	\$2,251.07
10	\$18,455.29	23	17	6	73.91	\$1,742.47	(\$1,861.11)	0.94	2.65	\$802.40
9	\$27,723.57	23	16	7	69.57	\$2,339.08	(\$1,385.95)	1.69	3.86	\$1,205.37
8	\$28,370.26	24	18	6	75.00	\$2,136.44	(\$1,680.96)	1.27	3.81	\$1,182.09
7	\$16,080.32	24	15	9	62.50	\$1,827.48	(\$1,259.10)	1.45	2.42	\$670.01
6	\$10,124.79	24	14	10	58.33	\$1,949.10	(\$1,716.26)	1.14	1.59	\$421.87
5	\$4,087.16	24	12	12	50.00	\$1,708.39	(\$1,367.79)	1.25	1.25	\$170.30
4	\$9,701.14	25	15	10	60.00	\$1,637.33	(\$1,485.88)	1.10	1.65	\$388.05
3	(\$1,260.22)	28	16	12	57.14	\$1,643.20	(\$2,295.95)	0.72	0.95	(\$45.01)
2	(\$3,929.78)	29	18	11	62.07	\$955.48	(\$1,920.77)	0.50	0.81	(\$135.51)
1	(\$7,608.66)	29	14	15	48.28	\$731.38	(\$1,189.86)	0.61	0.57	(\$262.37)

While the long-term implications were strongly bullish, short-term there was often a pullback after hitting these elevated levels.

Also notable is that while breadth was strong today volume was underwhelming. Below is a study from the 5/15/09 Letter (not updated).

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)

What we've seen is a sizable edge over the last 2 years. Prior to that this edge didn't exist. It's also notable that this is the 3rd such occurrence in the last week. We'll see if the edge finally plays out this time.

Notable about the active studies table is the fact that several short-term bearish studies are expiring tonight. The Aggregator remains bearish but barring some bearish studies tomorrow it will likely flip to positive tomorrow evening.

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



The bearish inclination is a bit weaker than yesterday with all the studies coming off the active list. Still, with both the green Aggregator line illustrating the net negative expectation and the black Differential line illustrating the recent outperformance of the SPX, the outlook remains short-term bearish. As noted above this may change tomorrow if the studies are not predominantly bearish.

From a position standpoint there is little to do but manage the current index trade. Not much has been showing up on the system triggers list from an individual stock or ETF standpoint.

Intermediate-term Outlook (2 weeks – 2 months)– updated 7/20 – neutral

There were a few notable moves in key intermediate-term indicators this week. First, the VIX:VXV ratio again dropped below 0.9 and even below 0.85. I discussed the VIX:VXV ratio in great detail just a few weeks back. Basically the implication is bearish as short-term volatility appears to be strongly underestimating the longer-term. Therefore a pickup in volatility, and subsequent market decline, can often be expected. The discussion may be found in the intermediate-term section on the 6/29/09 Letter. I've provided a link below.

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

We also had two breadth studies trigger this week as advancers swamped decliners. The 1st to trigger was the Two 90% Up Volume % Days in a Week. Below is an excerpt from Wednesday night's Letter.

Wednesday was the 2nd 90% up day in the last 3 days. In March I showed a study that suggested tight clusters of 90% up days have almost always led to a further rally. I've updated that study below.

For the 2nd time in 5 days the NYSE Up Volume % exceeds 90%. Buy on close. Sell X days later. \$100k/trade. 1970-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	54,580.79	8	7	1	87.50	8,354.76	-3,902.52	2.14	14.99	6,822.60
24	58,100.12	8	7	1	87.50	8,512.27	-1,485.80	5.73	40.10	7,262.52
23	52,607.79	8	7	1	87.50	7,727.56	-1,485.12	5.20	36.42	6,575.97
22	50,622.94	8	7	1	87.50	7,238.84	-48.96	147.85	1,034.97	6,327.87
21	52,635.91	8	7	1	87.50	7,811.58	-2,045.12	3.82	26.74	6,579.49
20	50,358.17	8	7	1	87.50	7,432.10	-1,666.56	4.46	31.22	6,294.77
19	44,111.90	8	7	1	87.50	6,614.18	-2,187.36	3.02	21.17	5,513.99
18	43,599.28	8	7	1	87.50	6,620.79	-2,746.24	2.41	16.88	5,449.91
17	46,767.29	8	7	1	87.50	6,937.84	-1,797.60	3.86	27.02	5,845.91
16	46,953.80	8	7	1	87.50	6,794.05	-604.52	11.24	78.67	5,869.23
15	42,218.98	8	6	2	75.00	7,262.86	-679.08	10.70	32.09	5,277.37
14	39,588.88	8	7	1	87.50	5,791.94	-954.72	6.07	42.47	4,948.61
13	40,053.35	8	7	1	87.50	5,946.31	-1,570.80	3.79	26.50	5,006.67
12	30,553.53	8	6	2	75.00	5,460.99	-1,106.20	4.94	14.81	3,819.19
11	34,652.85	8	7	1	87.50	5,077.61	-890.40	5.70	39.92	4,331.61
10	34,572.38	8	7	1	87.50	5,164.35	-1,578.08	3.27	22.91	4,321.55
9	30,573.40	8	8	0	100.00	3,821.68	0.00	100.00	100.00	3,821.68
8	29,107.70	8	8	0	100.00	3,638.46	0.00	100.00	100.00	3,638.46
7	31,208.27	9	7	2	77.78	4,686.25	-797.73	5.87	20.56	3,467.59
6	16,037.37	9	6	3	66.67	3,422.71	-1,499.62	2.28	4.56	1,781.93
5	8,831.44	10	6	4	60.00	3,404.27	-2,898.55	1.17	1.76	883.14
4	15,716.46	10	6	4	60.00	3,509.18	-1,334.66	2.63	3.94	1,571.65
3	10,754.66	11	8	3	72.73	2,126.35	-2,085.39	1.02	2.72	977.70
2	1,198.79	11	7	4	63.64	1,496.80	-2,319.71	0.65	1.13	108.98
1	8,014.68	13	10	3	76.92	1,138.21	-1,122.47	1.01	3.38	616.51

Again instances are small, so it's dangerous to rely too much on the results, but you've typically seen very strong moves after these tandems of 90% Up Volume days. Below I've listed all the occurrences along with the 20-day return of the market after such occurrences.

For the 2nd time in 5 days the NYSE Up Volume % exceeds 90%.
Buy on close. Sell 20 days later. \$100k/trade. 1970-present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
11/29/71	Buy	\$93.41	9.14%	\$9,137.80
12/28/71	Sell	\$101.95		\$0.00
08/20/82	Buy	\$113.02	8.39%	\$11,103.04
09/20/82	Sell	\$122.50		(\$928.20)
08/02/84	Buy	\$157.99	5.45%	\$6,831.92
08/30/84	Sell	\$166.60		\$0.00
01/05/87	Buy	\$252.19	9.62%	\$11,388.96
02/02/87	Sell	\$276.44		(\$23.76)
08/31/07	Buy	\$1,473.99	4.96%	\$5,027.01
10/01/07	Sell	\$1,547.04		(\$2,324.90)
11/28/07	Buy	\$1,469.01	0.49%	\$3,710.08
12/27/07	Sell	\$1,476.27		(\$2,268.48)
11/26/08	Buy	\$887.68	(1.68%)	\$3,491.04
12/26/08	Sell	\$872.80		(\$8,062.88)
03/12/09	Buy	\$750.74	14.10%	\$14,120.61
04/09/09	Sell	\$856.56		(\$1,101.24)

This study would seem to suggest a bullish edge.

On Thursday Gerald Appel's Daily Breadth Thrust Signal triggered. I discussed this system in some detail in the 4/6/09 and 4/13/09 Letters. Below are excerpts:

I've mentioned before Gerald Appel's Daily Breadth Impulse Signal. It was published in his book "Technical Analysis - Power Tools for Active Investors". Essentially it looks to enter the market when the 10-day exponential average of advancers/decliners hits an extreme. The trade closes when the same measure eventually declines to a certain number. (Since it's not my system I'm not comfortable revealing it in whole but for those interested it can be found in chapter 6 on page 142.) A chart of the indicator can be found on the Quantifiable Edges charts page. The system triggered again at the close on Thursday.

Below is the long-term performance (from 4/6/09):

TradeStation Performance Summary

Collapse 

All Trades

Total Net Profit	\$86,964.45	Profit Factor	4.38
Gross Profit	\$112,698.81	Gross Loss	(\$25,734.36)
Roll Over Credit	\$0.00		
Open Position Profit/Loss	\$966.28		
Select Total Net Profit	\$86,964.45	Select Profit Factor	4.38
Select Gross Profit	\$112,698.81	Select Gross Loss	(\$25,734.36)
Adjusted Total Net Profit	\$55,846.57	Adjusted Profit Factor	2.63
Adjusted Gross Profit	\$90,159.05	Adjusted Gross Loss	(\$34,312.48)
Total Number of Trades	34	Percent Profitable	73.53%
Winning Trades	25	Losing Trades	9
Even Trades	0		
Avg. Trade Net Profit	\$2,557.78	Ratio Avg. Win:Avg. Loss	1.58
Avg. Winning Trade	\$4,507.95	Avg. Losing Trade	(\$2,859.37)
Largest Winning Trade	\$12,471.48	Largest Losing Trade	(\$7,424.82)
Largest Winner as % of Gross Profit	11.07%	Largest Loser as % of Gross Loss	28.85%

The problem as I noted then was that since publication in 2004 the system has performed poorly. Below are the results since the 2004 publication.

Appel Daily Breadth Impulse Signals since publication. \$100k/trade.				
11/04/04	Daily Breadth	\$1,161.67	1.33%	\$3,077.94
12/07/04	Sell	\$1,177.07		(\$112.66)
03/21/07	Daily Breadth	\$1,435.04	(1.24%)	\$265.65
03/28/07	Sell	\$1,417.23		(\$1,446.93)
01/02/09	Daily Breadth	\$931.80	(6.60%)	\$1,289.35
01/12/09	Sell	\$870.26		(\$7,220.36)
03/18/09	Daily Breadth	\$794.35	(0.86%)	\$4,825.00
03/30/09	Sell	\$787.53		(\$3,518.75)
04/02/09	Daily Breadth	\$834.38	5.94%	\$11,399.01
05/13/09	Sell	\$883.92		(\$2,362.15)
06/01/09	Daily Breadth	\$942.87	(2.03%)	\$1,416.16
06/15/09	Sell	\$923.72		(\$2,461.32)
07/16/09	Daily Breadth	\$940.74	n/a	\$121.90
open	n/a	\$940.38		(\$645.54)

As you can see the system has gone through a tough time. In the 4/13/09 Letter I did some robustness testing on the system and considered whether the positive results may have been due to over optimization.

One possible reason that a system could struggle like this after publication is that the system was over-optimized. One way to test this would be to run optimization reports

around the entry and exit criteria to see if the edge remains for similar setups. If so, this would suggest the design of the system is sound.

First I tested the entry criteria. I ran this test from 1970 – 7/2004. This excludes any instances post-publication. Those results are below:

Buy on close of day when 10-day EMA of Up Issues % closes above X.										
Sell when Appel daily breadth impulse exit signal triggers. \$100k/trade. 1970-7/2004.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
0.600	\$110,151.40	56	34	22	60.71	\$4,791.35	(\$2,397.94)	2.00	3.09	\$1,966.99
0.605	\$118,469.87	41	29	12	70.73	\$5,264.02	(\$2,848.90)	1.85	4.47	\$2,889.51
0.610	\$97,061.03	36	26	10	72.22	\$4,785.85	(\$2,737.10)	1.75	4.55	\$2,696.14
0.615	\$94,306.22	30	24	6	80.00	\$4,640.60	(\$2,844.70)	1.63	6.53	\$3,143.54
0.620	\$82,156.77	25	20	5	80.00	\$4,827.89	(\$2,880.22)	1.68	6.70	\$3,286.27
0.625	\$71,995.91	23	17	6	73.91	\$5,109.51	(\$2,477.62)	2.06	5.84	\$3,130.26
0.630	\$64,948.07	20	14	6	70.00	\$5,717.52	(\$2,516.19)	2.27	5.30	\$3,247.40
0.635	\$47,797.85	16	11	5	68.75	\$5,539.98	(\$2,628.39)	2.11	4.64	\$2,987.37

These results appear fairly robust, suggesting a true edge when there is a breadth thrust in the market.

Next I tested the exit criteria. Those results are below:

Appel daily breadth impulse signal triggers a buy of the S&P 500 on close.										
Sell when the 10-day EMA of the Up Issues % closes below X. \$100k/trade. 1970-7/2004										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
0.47	\$95,973.25	30	23	7	76.67	\$5,007.44	(\$2,742.56)	1.83	6.00	\$3,199.11
0.48	\$88,698.04	30	23	7	76.67	\$4,732.17	(\$2,877.41)	1.64	5.40	\$2,956.60
0.48	\$89,811.61	30	23	7	76.67	\$4,780.59	(\$2,877.41)	1.66	5.46	\$2,993.72
0.49	\$94,306.22	30	24	6	80.00	\$4,640.60	(\$2,844.70)	1.63	6.53	\$3,143.54
0.5	\$95,383.27	30	24	6	80.00	\$4,685.48	(\$2,844.70)	1.65	6.59	\$3,179.44
0.5	\$98,830.05	30	24	6	80.00	\$4,761.40	(\$2,573.91)	1.85	7.40	\$3,294.34
0.51	\$92,401.68	31	24	7	77.42	\$4,663.64	(\$2,789.37)	1.67	5.73	\$2,980.70

Here again we see strong results across the board. While there's a chance that the "best" results were chosen for publication, there's really no foul in doing that. The concept appears sound, which means the recent failures are likely either due to 1) bad luck or 2) a change in market dynamics. It could be a combination of the two. There hasn't been a market as weak as the current bear since well before the test period. It wouldn't be the first system to struggle in the recent environment. Bottom line is it appears it would be a mistake at this point to write off the system.

Overall, I'm seeing sentiment indicators such as VIX:VXV and the Nasdaq/NYSE volume suggesting caution. On the bullish side we have breadth, price momentum, and leadership all suggesting upside. Perhaps a slight edge to the bulls at this point. A move above the June highs in the other major indices would confirm the Nasdaq breakout and suggest another leg up. While last week the market was on the precipice of a breakdown, it is now very close to a breakout. The short-term analysis suggests it is not likely to happen right away. It will certainly be interesting to monitor, 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.

None tonight. All in with the SPY trade and not seeing anything too compelling on the triggers list.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/L	Stop	Notes
SPY(s)(1/4)	7/14/2009	\$90.61	\$95.13	-4.99%		
SPY(s)(1/4)	7/15/2009	\$91.81	\$95.13	-3.62%		
SPY(s)(1/4)	7/16/2009	\$93.15	\$95.13	-2.13%		
SPY(s)(1/4)	7/17/2009	\$94.25	\$95.13	-0.93%		

Average SPY price is \$92.46

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