

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 24, 2009

Volume 2 Issue 141

## 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
<b>Active</b>				
July 24, 2009	SPX much stronger than \$\$	1-4 days	Bearish	-1.60%
July 20, 2009	SP low vol on op ex with low VIX	1-6 days	Bearish	
<b>Active - Long Term</b>				
July 17, 2009	Appel Daily Breadth	1-20 days	Bullish	5.80%
July 16, 2009	2 90% Up Days in 1 Week	1-25 days	Bullish	5.30%
July 14, 2009	VIX:VXV hits 100-day low	1-20 days	Bearish	-3.80%
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	
<b>Dropped Tonight</b>				
July 22, 2009	SPX up. BKK < -2%	1-2 days	Bearish	
July 22, 2009	NYSE Up Vol% < 45%. SPX up.	1-2 days	Bearish	

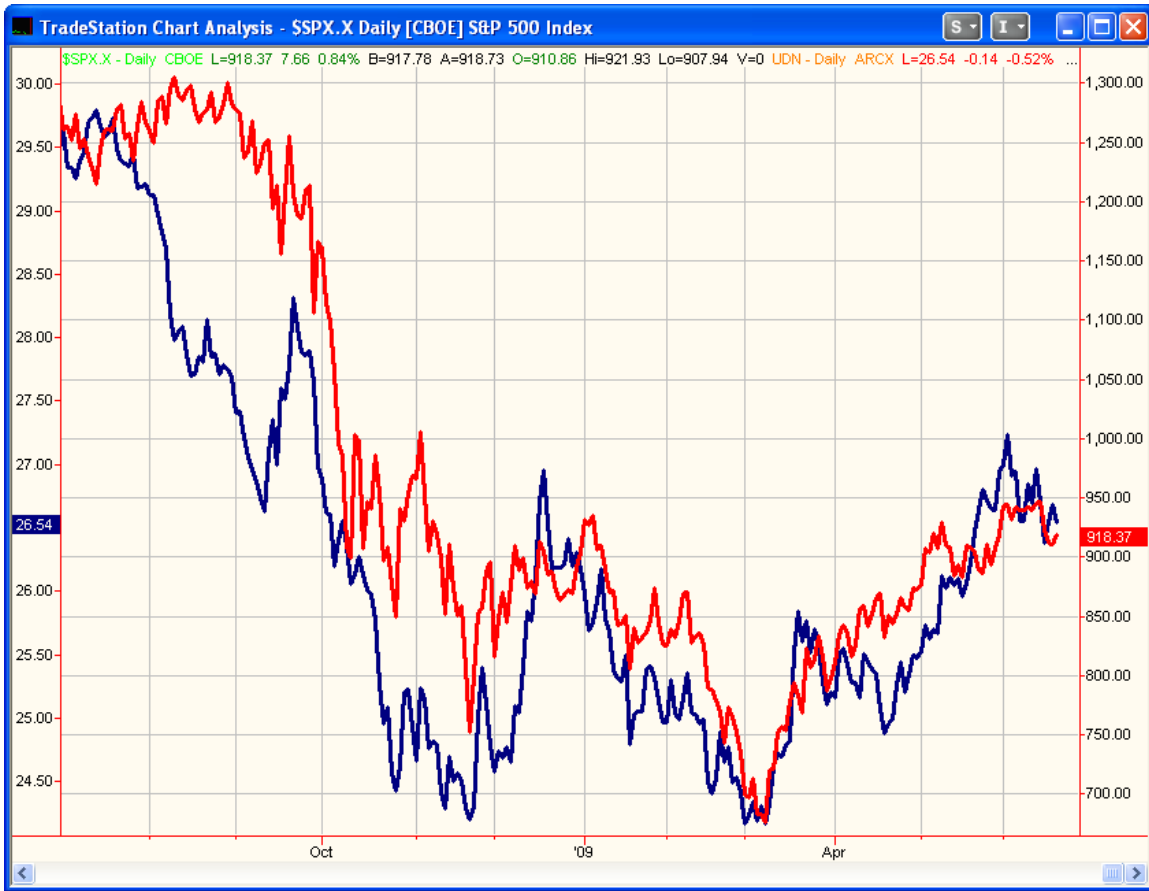
If the avg max move is achieved the study will appear in ***bold italic blue*** and no longer be active. ***With the reduced market volatility I am no longer requiring a move of Avg max + ½ Std Dev. To reach the target.***

## ***Short-term Outlook (1-5 days) – updated 7/23 –neutral***

The market exploded higher today with a trend-day breakout. The major indices all closed up over 2% and were well higher than that intraday before a little late selling. NYSE breadth was strong, with the Up Issues % closing at 84% and the Up Volume % at 83%. Total volume came in at the highest level in a little over 2 weeks.

Only one study appeared on the Quantifinder today. It was from the 6/19/09 Letter. I've pasted a detailed excerpt below:

*One relationship I've been watching lately is the S&P vs. the US dollar. To illustrate the relationship I've created a chart below. In red is the closing prices of the S&P 500. The blue is closing prices of UNP, which is the US Dollar Bearish Fund ETF.*



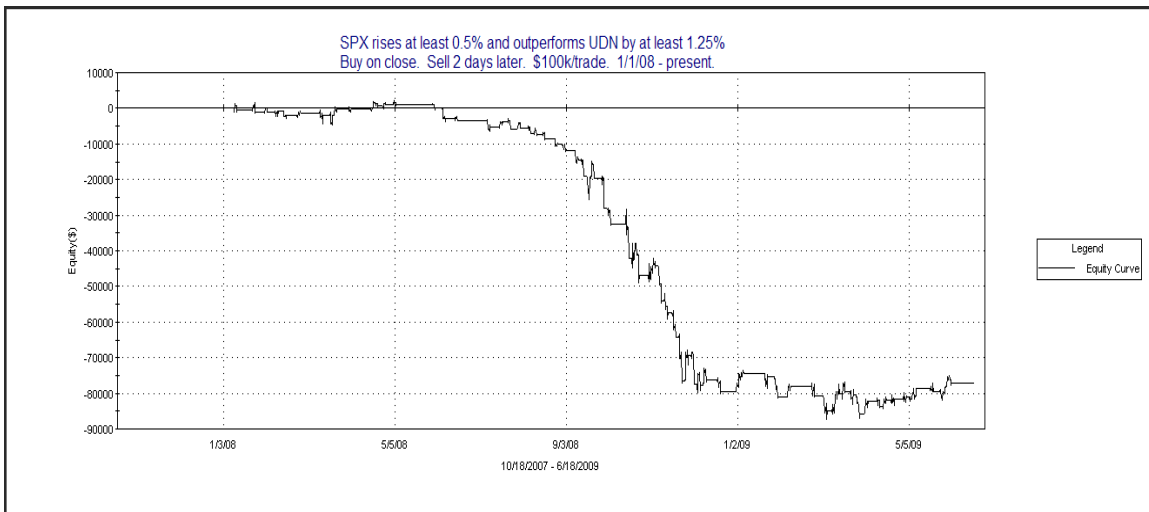
*As you can see they've pretty much moved in concert over the last year-plus. Since UNP is a bearish fund this means that the S&P has actually moved opposite the dollar. A weak dollar has been cause for celebration and a strong dollar has closely preceded most of the drops in the S&P.*

*A close look at the very right side of the chart shows that SPX and UDN moved in opposition on Thursday. In other words the S&P rose despite the strength in the dollar. I decided to run some tests on this relationship. Below is a study that looks at days like today where the S&P was up at least ½% and outperformed UDN by at least 1.25%.*

SPX rises at least 0.5% and outperforms UDN by at least 1.25%  
Buy on close. Sell X days later. \$100k/trade. 1/1/08 - present.

QE SOX down SPX up: 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
10	-80,168.91	29	10	19	34.48	2,584.82	-5,579.85	0.46	0.24	-2,764.45
9	-55,958.56	31	9	22	29.03	3,400.32	-3,934.61	0.86	0.35	-1,805.11
8	-64,489.33	33	15	18	45.45	2,455.17	-5,628.71	0.44	0.36	-1,954.22
7	-71,942.40	37	12	25	32.43	3,459.11	-4,538.07	0.76	0.37	-1,944.39
6	-40,327.92	40	15	25	37.50	2,666.71	-3,213.14	0.83	0.50	-1,008.20
5	-62,664.32	46	23	23	50.00	2,157.65	-4,882.19	0.44	0.44	-1,362.27
4	-58,997.28	52	19	33	36.54	2,717.41	-3,352.36	0.81	0.47	-1,134.56
3	-55,656.99	62	24	38	38.71	2,193.60	-2,850.09	0.77	0.49	-897.69
2	-76,984.57	69	27	42	39.13	1,786.36	-2,981.34	0.60	0.39	-1,115.72
1	-36,453.98	84	41	43	48.81	1,220.16	-2,011.18	0.61	0.58	-433.98

Results of this test appeared strongly bearish – both from a winning % and an average trade standpoint. Since the test was run during such a bearish period I wanted to look at the results in more detail. Some quick glances at the performance charts gave me pause about the bearish expectancy. Below is an example:

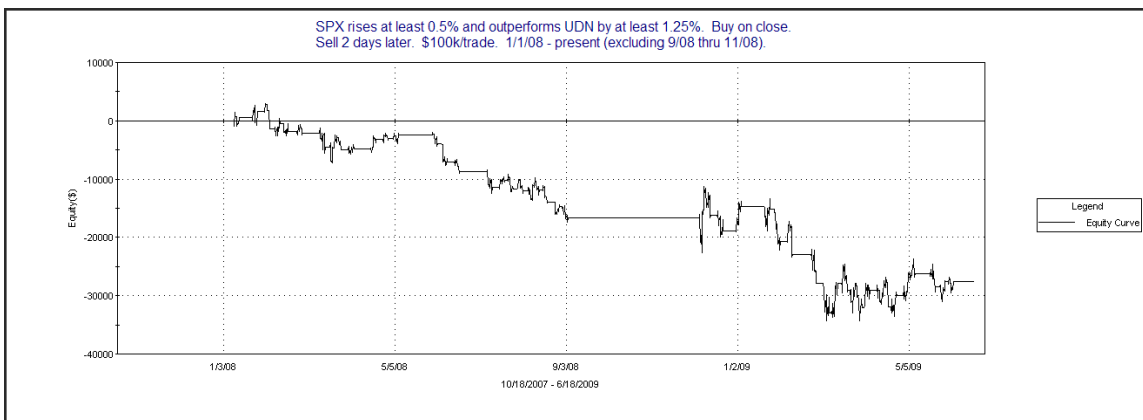


My concern when looking at the above chart is that nearly all of the edge appears to be due to a few trades in a relatively tight timeframe. I therefore decided to do something I almost never do. I cut out the period covering 9/08 through 11/08. I wanted to see how the market performed during the period that appeared more flat on the chart to better measure whether there might be an edge.

By doing this the results table then changed to the below:

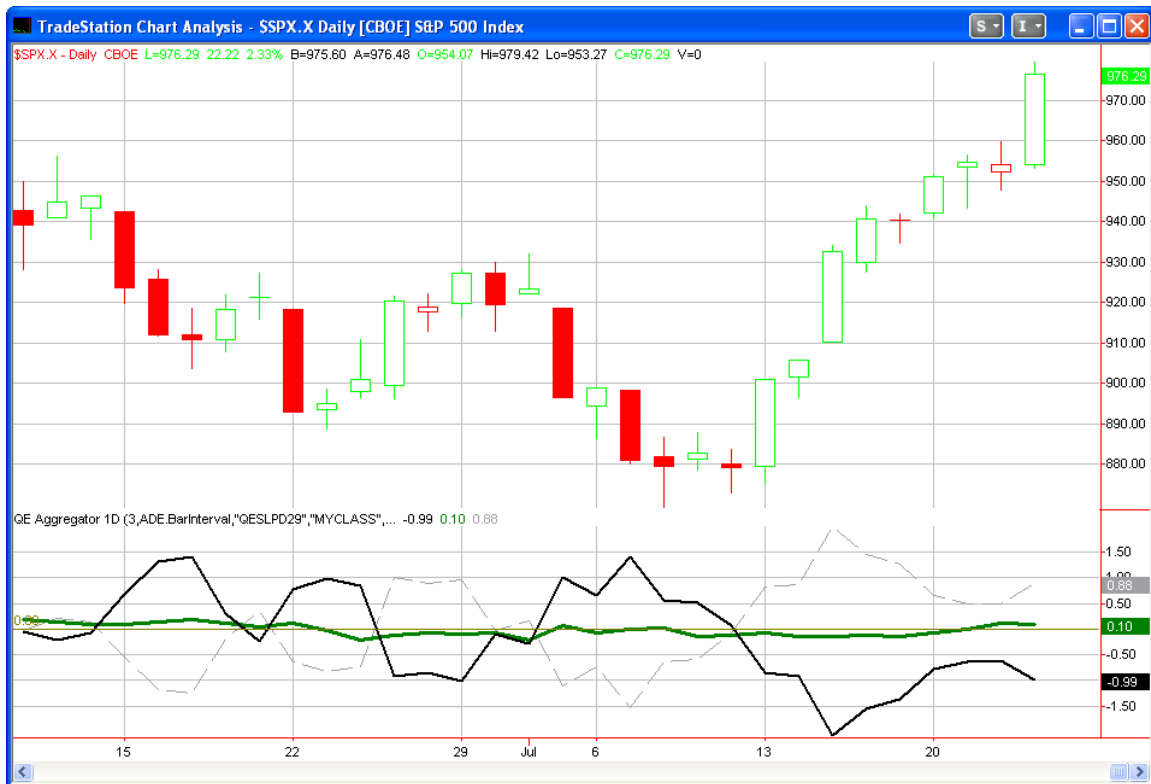
SPX rises at least 0.5% and outperforms UDN by at least 1.25%. Buy on close. Sell X days later. \$100k/trade. 1/1/08 - present (excluding 9/08 thru 11/08).										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	-21,630.09	23	11	12	47.83	2,698.88	-4,276.48	0.63	0.58	-940.44
9	-22,937.05	26	9	17	34.62	3,794.04	-3,357.85	1.13	0.60	-882.19
8	-23,812.44	27	13	14	48.15	2,153.23	-3,700.32	0.58	0.54	-881.94
7	-13,673.47	30	12	18	40.00	3,185.69	-2,883.43	1.10	0.74	-455.78
6	-13,580.52	32	14	18	43.75	2,550.93	-2,738.53	0.93	0.72	-424.39
5	-13,905.90	37	21	16	56.76	1,870.93	-3,324.72	0.56	0.74	-375.84
4	-22,761.04	42	18	24	42.86	2,167.28	-2,573.83	0.84	0.63	-541.93
3	-27,576.73	47	19	28	40.43	1,741.38	-2,166.53	0.80	0.55	-586.74
2	-10,466.69	52	23	29	44.23	1,516.44	-1,563.61	0.97	0.77	-201.28
1	-9,624.77	62	33	29	53.23	1,010.91	-1,482.23	0.68	0.78	-155.24

Even without the 3 month period I excluded there still appears to be a squarely bearish tilt to the results. This is especially apparent over the first 3 days. Below is an equity curve that illustrates the 3-day holding period.



You'll note the straight, flat, line in the middle when the strategy was turned off. Overall it appears to me that there is a decent short-side edge with the setup. It isn't nearly as pronounced as the very 1<sup>st</sup> test above may lead you to believe, but it still suggests short-term downside.

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



The Aggregator isn't largely changed from yesterday. It is still signaling a positive net expectation from the studies over the next few days. In the meantime the market is extremely overbought.

In an update this afternoon I identified 981.50 as a level where the bullish breadth studies would begin hitting their targets and would be taken off the active studies list. Should a move up occur tomorrow I expect we will see additional bearish studies arise again. A close above that level would probably move the green Aggregator line back below zero. If the market rises again tomorrow I will be looking to put one lot (1/4 share) back on at the close if SPX closes at 981.50 or higher. In all likelihood I will also then look to put the final lot back on Monday morning. I've listed this entry in the trade ideas section below.

*A quick side note about the current SPY trade idea:*

While I always suggest traders personalize any of my trade ideas and "trade them however you best see fit", I'm aware that some traders do follow them rather closely. While there have been trade ideas that have gone against the Subscriber Letter much harder than the current SPY trade, I can't recall feeling I mishandled any of them as poorly as I have the current SPY trade idea. I gave it too much room over the last couple of days when I should have taken a quicker exit on at least part of it. I am sorry if my own ideas about the recent market have influenced subscribers in a way that has caused them to suffer drawdowns this past week. I try very hard to give careful consideration to everything in the Letter.

As of now the SPY trade idea in total is about 6% underwater based on the full position. I still believe we will make up some of that on a pullback here. The persistency of this move has been nearly unprecedented as I've discussed the past couple of nights. Bear in mind a 6% loss on a single trade – even if it is a large position as it has been for me, is not anything that can't be overcome. My focus is always to evaluate probabilities and play the odds as best as I can. By consistently trading with an edge, I expect to continue to generate profits as I have done in the past. While my exit strategy for this current trade idea has not worked out well to this point, I'm optimistic it will soon be viewed as a minor detour on the road to profits.

***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 1<sup>st</sup> to trigger was the Two 90% Up Volume % Days in a Week. Below is an excerpt from Wednesday night's Letter.

*Wednesday was the 2<sup>nd</sup> 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 <span style="float: right;">Collapse ^</span>			
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:*

<b>Buy on close of day when 10-day EMA of Up Issues % closes above X.</b>										
<b>Sell when Appel daily breadth impulse exit signal triggers. \$100k/trade. 1970-7/2004.</b>										
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:*

<b>Appel daily breadth impulse signal triggers a buy of the S&amp;P 500 on close.</b>										
<b>Sell when the 10-day EMA of the Up Issues % closes below X. \$100k/trade. 1970-7/2004</b>										
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.

SPY – short ¼ position on CLOSE if SPX closes at 981.50 or higher. Based on short-term market outlook above.

### **Active Trades Table**

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(s)(1/4)	7/14/2009	\$90.61	\$97.86	-8.00%		stopped out intraday
SPY(s)(1/4)	7/15/2009	\$91.81	\$97.86	-6.59%		stopped out intraday
SPY(s)(1/4)	7/16/2009	\$93.15	\$97.66	-4.84%		
SPY(s)(1/4)	7/17/2009	\$94.25	\$97.66	-3.62%		

Average SPY price is \$92.46

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2009 Hanna Capital Management, LLC.