

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 27, 2009

Volume 2 Issue 142

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
Active				
July 27, 2009	2 Days Up In Chop	1-4 days	Bearish	
July 27, 2009	Gap Down and Reverse to New High	1-2 days	Bearish	
July 27, 2009	New Highs Contract at 50-day high	1 day	Bearish	
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	
Active - Long Term				
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	
Dropped Tonight				

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 7/27 –bearish

A gap down to start the day Friday couldn't thwart the current upmove. The market came back strong late in the day and the S&P 500 and Dow closed positive. The Nasdaq didn't get all the way back to breakeven and the 12-day winning streak is now over in that index. Breadth was mildly positive as the NYSE Up Issue % came in at 62% and the Up Volume % was 65%. Despite the action, volume declined substantially and was the lowest of the week.

I looked at days where the market gapped down and sold off before reversing upwards in the 2/6/09 nightly letter. For the most part they led to pullbacks over the next few days. This was found to be especially true when they did not correspond with a short-term low. Of course the current market is at a short-term high – nowhere near a short-term low. Therefore I decided to take some of those old parameters and see how the market performed when it was at a new high.

SPY gaps down at least 0.25%. It then trades at least 0.5% below the open before reversing to close positive on the day and at least 0.5% above the open. It also closes at a 10-day high. Buy on close. Sell X days later. \$100k/trade. 1993-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	-4,925.15	11	5	6	45.45	1,345.88	-1,942.42	0.69	0.58	-447.74
4	-12,787.95	11	6	5	54.55	1,064.09	-3,834.50	0.28	0.33	-1,162.54
3	-7,556.46	11	5	6	45.45	1,832.67	-2,786.63	0.66	0.55	-686.95
2	-15,663.74	12	3	8	25.00	1,373.20	-2,472.92	0.56	0.21	-1,305.31
1	-3,965.19	13	5	8	38.46	1,029.41	-1,139.03	0.90	0.56	-305.01

11 of 13 instances (85%) closed below the trigger day close within the next 2 days.

When looking at the 13 instances the only one that didn't experience some sort of pullback in the near term was 10/2/2001. This was just when the market had begun to take off following the September 11 attacks and subsequent bottom.

Also notable from Friday afternoon is the fact that new highs contracted substantially while the S&P made a 50-day high. The percentage of stocks hitting new 52 week high dropped from a little over 7% on Thursday to under 5% on Friday. I looked at other times the SPX made a 50-day high while the drop in new highs equaled 2% or more of the total issues.

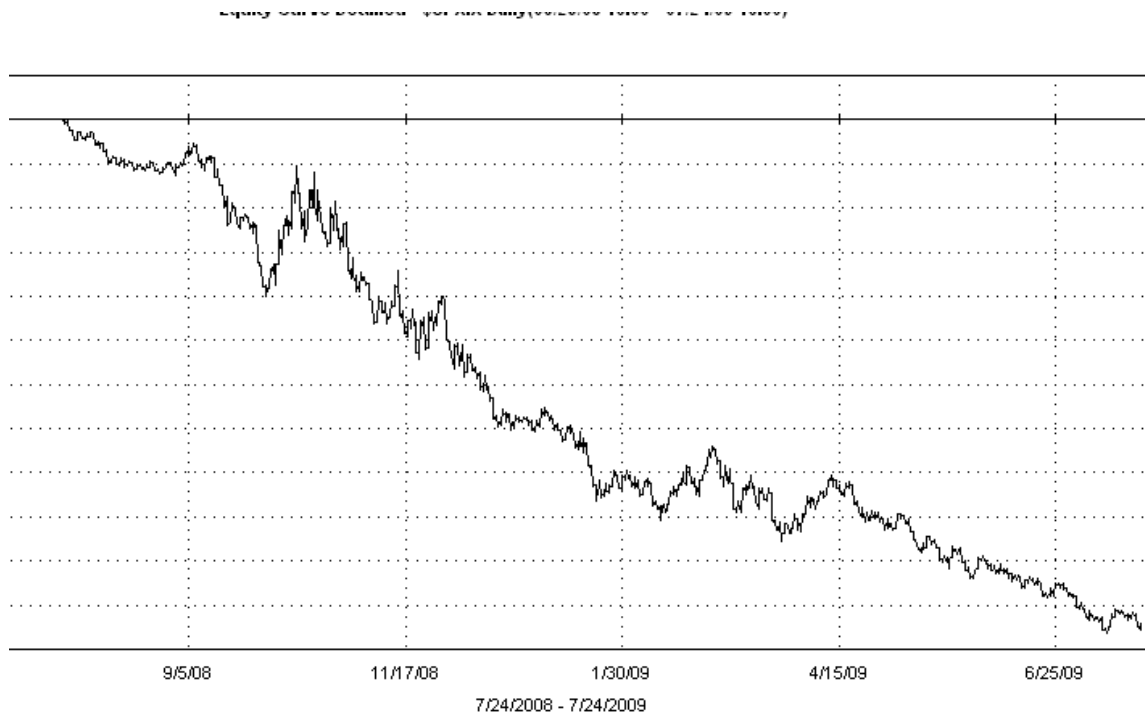
SPX makes a new 50-day high. The % of NYSE issues making new highs falls by at least 2%. Buy SPX on close. Sell X days later. \$100k/trade. 1970-present.

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
5	-11,292.12	35	15	20	42.86	945.88	-1,274.02	0.74	0.56	-322.63
4	-11,163.46	37	14	23	37.84	798.46	-971.39	0.82	0.50	-301.72
3	-5,056.20	37	17	20	45.95	529.91	-703.23	0.75	0.64	-136.65
2	-2,635.43	37	17	20	45.95	520.20	-573.94	0.91	0.77	-71.23
1	-8,607.99	39	14	24	35.90	243.46	-500.68	0.49	0.28	-220.72

95% of all instances closed lower than the trigger bar close within the next week.

What I found interesting and compelling about the above test was NOT the size of the average decline. In fact that was somewhat weak. It was the fact that 95% of instances closed below the trigger day close at some point in the next 5 days. This suggests that while the lagging new highs might not indicate an immediate selloff, the market has consistently struggled to move higher.

And of course being the 2nd higher close in a row, the SPX has now triggered the “2 Days Up In Chop” system. Over the last few months while the market has rallied strongly “2 Days Up In Chop” has struggled to make headway. As would be expected the gains have come much more consistently and strongly from the “2 Days Down In Chop” system. Still there is no sign that the environment is becoming any less choppy, even with this recent strong up move. Below is the “Trend vs. Chop” chart from the charts page on the website.



The downward slope indicates that chop continues to prevail.

Below are updated stats for the “2 Days Up In Chop” system:

SPX closes higher 2 days in a row. Short at close. Cover next profitable close up to 4 days later. At close of day 4 cover regardless of profitability.
\$100k/trade. 6/1/2007 - present.

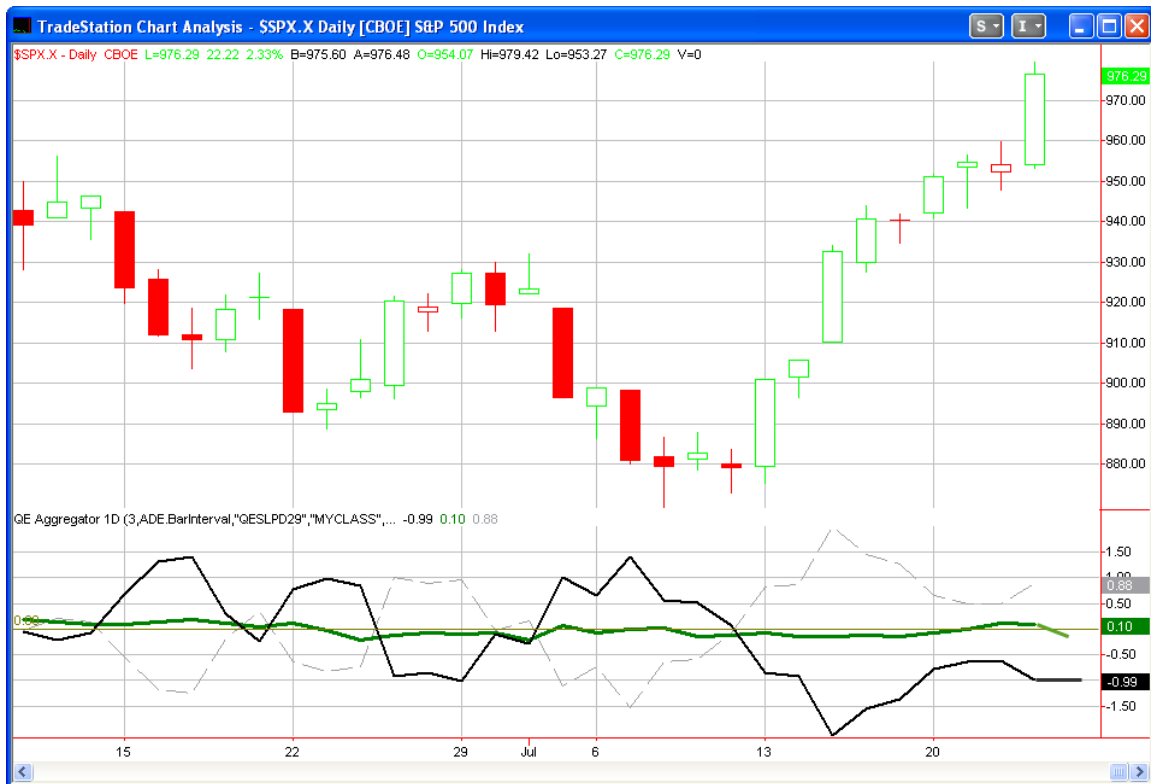
TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$68,297.53	Profit Factor	4.06
Gross Profit	\$90,628.47	Gross Loss	(\$22,330.94)
Total Number of Trades	70	Percent Profitable	88.57%
Winning Trades	62	Losing Trades	8
Even Trades	0		
Avg. Trade Net Profit	\$975.68	Ratio Avg. Win:Avg. Loss	0.52
Avg. Winning Trade	\$1,461.75	Avg. Losing Trade	(\$2,791.37)
Largest Winning Trade	\$8,783.02	Largest Losing Trade	(\$7,832.88)

And here is an equity curve showing that while the system has failed to make headway during this strong upmove the last few months, it hasn't produced substantial losses either.



So with the three unrelated studies above we are seeing more evidence that the market is likely to decline in the short term. Of course this has seemed to be the case for over a week now and so far the market has ignored all bearish indications.

The [Aggregator](#) chart is below. I use the “All Data Everywhere (ADE)” add on to produce the chart in Tradestation and for some reason I cannot get it to read my data tonight. It is giving me a terrible time and I’ve spent hours trying to troubleshoot it with no success. Hopefully I figure it out tomorrow. I’ve therefore just taken Thursday night’s charts and extended the green Aggregator and black Differential lines to show approximately where they should be at this point.



With the 3 bearish studies tonight the green Aggregator line has fallen back below 0 after spending the last 2 days above it. This indicates a net negative expectation for the SPX over the next few days. The black Aggregator line remains well below 0 indicating that the market has strongly outperformed expectations over the last few days. This is the configuration I prefer with initiating or holding short positions.

Already partially short I intend to add to the position Monday. It remains an incredibly tricky environment. While the historical studies have continually indicated a selloff is probable over the last couple of weeks, the market has ignored historical probabilities and continued higher. I still feel we are at a point where there is a downside edge and will look to take advantage of that edge.

Intermediate-term Outlook (2 weeks – 2 months)– updated 7/27 – neutral

Almost nothing has changed from an intermediate-term standpoint from last week. Therefore I will not spend too much time discussing it. From a bullish perspective the Nasdaq/S&P Relative strength indicator has been bullish and generally right for several weeks now. The breadth thrusts we saw off the failed head & shoulders pattern have also proven correct. I noted in the last couple of days that we are already close to the average maximum gains that are generated by the two breadth thrust studies listed in the intermediate-term section above. (See last week’s intermediate-term section for details on these.) This doesn’t mean that just because the average max move has been achieved the market will roll over. But from my perspective it means that further gains are likely due to influences other than the breadth thrust patterns. This is why I look to remove studies from the active list after they achieve their targets.

Bearish and so far wrong have been sentiment indicators such as the VIX:VXV ratio and the Nasdaq/NYSE Volume ratio. Neither of these has budged at all and it seems while their timing was off, at some point their bearish influence may take hold.

As I've demonstrated with some short-term trades lately this is a tough market to fight. While bearish indications remain, a neutral to slightly bullish intermediate-term outlook seems appropriate.

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 1/4 position @ \$98.30 limit . Based on short-term market outlook above. The trade idea from Friday nearly triggered. In the end it just missed. Another 2.5 SPX points or so and the positive breadth studies will begin to fall by the wayside. With the short-term outlook already bearish, this would move the Aggregator to an even more bearish position. As odd as the last 2 weeks have been, I believe odds favor a pullback so I'll look to reenter on some strength on Monday.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(s)(1/4)	7/16/09	\$93.15	\$97.99	-5.20%		
SPY(s)(1/4)	7/17/09	\$94.25	\$97.99	-3.97%		

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