

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 29, 2009

Volume 2 Issue 144

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 28, 2009	3/10 HV low. RSI(3)>70.	1-3 days	Bearish	
July 28, 2009	1 day down from RSI(2)>98	1-2 days	Bearish	
July 27, 2009	2 Days Up In Chop	1-4 days	Bearish	
July 24, 2009	SPX much stronger than \$\$	1-4 days	Bearish	-1.60%
Active - Long Term				
July 17, 2009	Appel Daily Breadth	1-20 days	Bullish	5.80%
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				
July 27, 2009	Gap Down and Reverse to New High	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 7/29 –bearish

While it traded lower for much of the day the market still has not managed to put in a decent down day. The major indices finished mixed. Breadth was mildly negative as the NYSE Up Issues % came in at 47% and the Up Volume % at 49%. Total volume came in higher than yesterday and above average.

After the strong move up last Thursday we've now had 3 days in a row where the SPX has closed very close to breakeven. This has greatly reduced the short-term historical volatility. In the July 13th Subscriber Letter I discussed a study that compared the 3-day historical volatility with the 10-day historical volatility (with a 3-day offset). An excerpt is below:

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.

The 3/10 offset HV came in at 0.24 today – qualifying for the above study. (I am a couple weeks behind in getting the Qauntfinder updated, but it should have this one included shortly.) Tonight I looked at situations where the 3/10 offset HV was contracted and the market was short-term overbought. To define overbought I used a 3-period RSI...

3/10 offset HV closes below 0.25 and RSI(3) > 70. Buy on close. Sell X days later. \$100k/trade. 2000-present.										
QE Hist Vol 3/10: ▾ 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
5	-27,791.40	51	25	26	49.02	1,125.97	-2,151.57	0.52	0.50	-544.93
4	-30,134.35	54	23	31	42.59	928.43	-1,660.91	0.56	0.41	-558.04
3	-41,478.40	54	20	34	37.04	795.12	-1,687.67	0.47	0.28	-768.12
2	-25,884.20	57	21	36	36.84	733.22	-1,146.72	0.64	0.37	-454.11
1	-16,724.63	70	32	38	45.71	680.98	-1,013.58	0.67	0.57	-238.92

Over the last 10+ years a consolidation while the market is short-term overbought has suggested a downside bias – especially over the first 2-3 days.

In an intraday update today I looked at how the market has performed following the 1st down day after a run-up. Below is a copy of those studies for anyone who didn't get a chance to read the intraday update:

I first looked at all down days:

SPX closes down. Buy on close. Sell X days later. \$100k/trade. 1999-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
10	21,106.43	242	137	105	56.61	2,412.94	-2,947.30	0.82	1.07	87.22
9	22,591.71	265	153	112	57.74	2,182.63	-2,779.91	0.79	1.07	85.25
8	39,118.62	298	172	126	57.72	2,163.04	-2,642.26	0.82	1.12	131.27
7	51,066.48	332	177	155	53.31	2,293.72	-2,289.82	1.00	1.14	153.81
6	40,063.10	380	202	178	53.16	2,208.39	-2,281.08	0.97	1.10	105.43
5	65,565.16	443	238	205	53.72	1,978.01	-1,976.59	1.00	1.16	148.00
4	49,041.34	536	278	258	51.87	1,953.24	-1,914.58	1.02	1.10	91.50
3	58,775.71	658	377	281	57.29	1,468.65	-1,761.23	0.83	1.12	89.32
2	99,435.18	892	474	418	53.14	1,420.88	-1,373.36	1.03	1.17	111.47
1	124,715.85	1,277	718	559	56.23	995.93	-1,056.11	0.94	1.21	97.66

As everyone likely suspected there is an upside bias following down days.

What if the market was extended upwards before the down day?

Yesterday's 2-period RSI > 90. Today the SPX closed down. Buy on close. Sell X days later. \$100k/trade. 1999 - 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
10	-47,507.60	128	65	63	50.78	1,968.40	-2,784.98	0.71	0.73	-371.15
9	-28,493.20	132	71	61	53.79	1,884.89	-2,660.99	0.71	0.82	-215.86
8	-48,894.62	141	73	68	51.77	1,752.86	-2,600.78	0.67	0.72	-346.77
7	-28,873.95	145	75	70	51.72	1,749.30	-2,286.73	0.76	0.82	-199.13
6	-16,098.28	150	79	71	52.67	1,528.86	-1,927.86	0.79	0.88	-107.32
5	-17,500.42	159	82	77	51.57	1,577.80	-1,907.54	0.83	0.88	-110.07
4	-2,208.10	171	88	83	51.46	1,424.41	-1,536.82	0.93	0.98	-12.91
3	9,499.11	179	95	84	53.07	1,277.13	-1,331.28	0.96	1.08	53.07
2	3,351.15	190	102	88	53.68	1,024.19	-1,149.05	0.89	1.03	17.64
1	-6,353.09	192	108	84	56.25	713.37	-992.83	0.72	0.92	-33.09

Now we see a bit of a downside bias. After rallying up the first day down may just be the beginning of the pullback. What if the market is VERY overbought as it is now?

Yesterday's 2-period RSI > 98. Today the SPX closed down.
Buy on close. Sell X days later. \$100k/trade. 1999 - 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
10	-9,811.89	22	14	8	63.64	1,231.51	-3,381.63	0.36	0.64	-446.00
9	-9,716.56	22	14	8	63.64	1,010.78	-2,983.44	0.34	0.59	-441.66
8	-11,721.05	22	12	10	54.55	1,575.49	-3,062.69	0.51	0.62	-532.78
7	-9,601.79	22	12	10	54.55	1,472.19	-2,726.81	0.54	0.65	-436.45
6	-12,285.74	23	11	12	47.83	1,458.87	-2,361.11	0.62	0.57	-534.16
5	-12,487.30	24	12	12	50.00	1,103.73	-2,144.34	0.51	0.51	-520.30
4	-9,161.60	24	11	13	45.83	1,232.72	-1,747.81	0.71	0.60	-381.73
3	-3,499.95	25	12	13	48.00	1,275.94	-1,447.02	0.88	0.81	-140.00
2	-7,416.70	25	12	13	48.00	741.54	-1,255.01	0.59	0.55	-296.67
1	-3,587.19	25	13	12	52.00	779.61	-1,143.51	0.68	0.74	-143.49

Here we see the risk reward shifts even greater to the downside. (Wins & losses are about the same though.)

Lastly, what if the drop is a substantial one?... There were only two instances of big declines from an RSI of 98, so I went back to 90 as the parameter:

Yesterday's 2-period RSI > 90. Today the SPX closed down more than 1%.
Buy on close. Sell X days later. \$100k/trade. 1999 - 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
10	-29,776.73	33	15	18	45.45	2,828.42	-4,011.28	0.71	0.59	-902.33
9	-24,849.86	33	13	20	39.39	3,174.23	-3,305.74	0.96	0.62	-753.03
8	-40,165.57	35	13	22	37.14	2,392.93	-3,239.71	0.74	0.44	-1,147.59
7	-21,504.13	36	17	19	47.22	2,318.31	-3,206.07	0.72	0.65	-597.34
6	-16,042.71	36	15	21	41.67	2,340.49	-2,435.71	0.96	0.69	-445.63
5	-17,189.79	36	17	19	47.22	2,288.04	-2,951.92	0.78	0.69	-477.49
4	-16,314.60	37	17	20	45.95	1,852.20	-2,390.10	0.77	0.66	-440.94
3	2,073.07	37	22	15	59.46	1,556.39	-2,144.51	0.73	1.06	56.03
2	-2,568.23	37	18	19	48.65	1,855.06	-1,892.60	0.98	0.93	-69.41
1	-12,201.57	37	20	17	54.05	954.65	-1,840.86	0.52	0.61	-329.77

Here there again seems to be a decent downside bias.

The last table here isn't applicable since the SPX rallied near the end of the day and only closed down slightly.

The [Aggregator](#) chart is updated below..



The green Aggregator line remains below 0, illustrating a net negative expectation from the studies over the next few days. The black differential line is now approaching 0 from below. This shows the market has slightly outperformed expectations over the last few days. It is still in a bearish configuration, though not as pronounced.

I'm not looking to add anything tomorrow. Traders should keep in mind the 3/10 offset HV study from above. It suggests there could be a sharp move over the next few days. Should the market go my way I may look to trail a stop down. I'd prefer to protect myself to avoid have the sharp move go against me.

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.

None tonight.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lc	Stop	Notes
SPY(s)(1/4)	7/16/2009	\$93.15	\$97.89	-5.09%		
SPY(s)(1/4)	7/17/2009	\$94.25	\$97.89	-3.86%		
SPY(s)(1/4)	7/27/2009	\$98.30	\$97.89	0.42%		

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