

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 26, 2009

Volume 2 Issue 163

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				
August 24, 2009	Strong breadth & vol breakout	1-5 days	Bullish	1.50%
August 24, 2009	Op-ex week positive return	1-5 days	Bearish	-0.90%
Active - Long Term				
August 4, 2009	75% Up Issues 2 of 3 Days	1-20 days	Bullish	4.80%
July 14, 2009	VIX:VXV drops below 0.9	2-5 months	Bearish	
Dropped Tonight				
August 20, 2009	2 Days Up In Chop	1-4 days	Bearish	

If the avg max move is achieved the study will appear in ***bold italic blue*** and no longer be active.

Short-term Outlook – updated 8/26

The Bottom Line

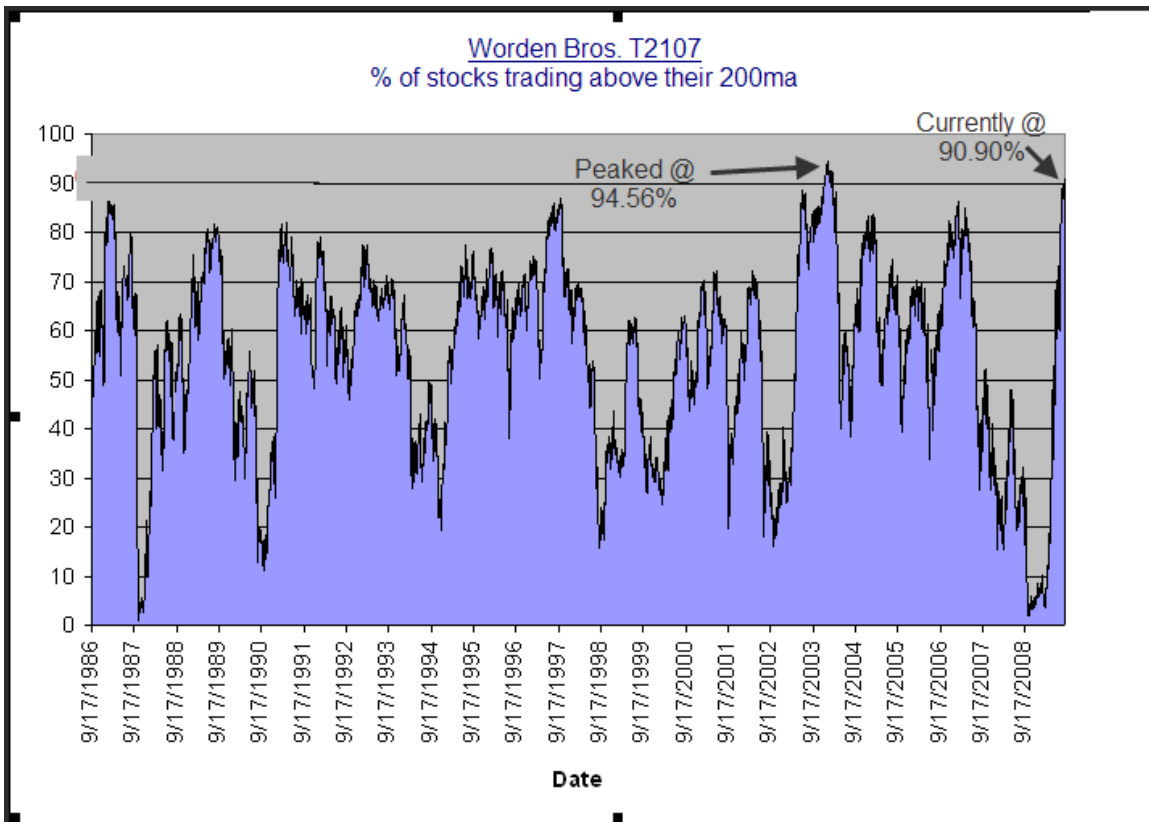
More uninspiring action is again leaving us without a clear edge. The 1 and 3 day risk/reward graphics are set to 0. In both timeframes the studies have a mild bullish tilt but the market remains overbought. After two days of consolidation it shouldn't take much more to begin to relieve the overbought condition. A down day on Wednesday could go a long way in setting up another leg higher. As of now I'm still not seeing a compelling edge.

The Proof

Tuesday wasn't much different than Monday. A gap up was followed by a new high that failed to spark excitement. The market then closed below its open and near breakeven. This time it was instead a slight gain rather than a slight loss. Breadth started off very strong but ended mildly positive. The NYSE Up Issues % came in at 60% with the Up Volume % at 59%. Total volume declined for the second day in a row.

Much like yesterday, today's action is not leaving much in the way of clues. I showed yesterday how reversals from highs were often inconclusive. I ran some additional tests tonight looking at reversals from new highs occurring 2 days in a row. Results were similar to last night in that they were inconclusive. I won't even bother showing them.

There are a few indicators that Worden Bros. tracks that look at stocks relative to their 200ma that are currently showing extreme readings. One is T2107, which simply looks at the percentage of stocks trading above their 200ma. The other is T2109, which looks at the percentage of stocks trading at least 1 standard deviation above their 200ma. Both indicators are near all time highs (dating back to 1986). In fact, the only period of time in which these indicators registered higher reading was in the beginning of 2004. Below is a chart of T2107 which illustrates this:



This demonstrates just how extreme the current move is in terms of breadth. Also interesting about the chart is that we aren't that far removed time-wise from extremely low readings. Extreme overbought doesn't necessarily mean a decline is about to begin.

In fact the last time these levels were reached in 2004, the market continued to trudge higher for about 2 ½ months before finally beginning a meaningful correction.

One astute subscriber noted that in terms of relative strength the S&P has been leading the Nasdaq, which has been leading the SOX. I've discussed several times and in numerous ways that the market has performed best when the SOX lead the others and when the Nasdaq led the S&P. So the question was, does the current configuration signal an imminent top? I ran studies a few different ways on this and the results were all fairly similar. Below is one example:

Over the last 15 days SPX outperforms the Nasdaq by at least 1% and the Nasdaq outperforms the SOX by at least 1%. Buy SPX on close. Sell X days later. \$100k/trade. 1995 - 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
40	15,147.67	57	33	24	57.89	4,564.53	-5,645.07	0.81	1.11	265.75
38	18,960.62	59	35	24	59.32	5,082.76	-6,622.34	0.77	1.12	321.37
36	8,886.97	60	37	23	61.67	4,213.09	-6,391.19	0.66	1.06	148.12
34	9,295.14	62	36	26	58.06	4,036.00	-5,230.80	0.77	1.07	149.92
32	-19,255.31	64	36	28	56.25	3,653.90	-5,385.56	0.68	0.87	-300.86
30	7,947.30	68	40	28	58.82	3,539.62	-4,772.77	0.74	1.06	116.87
28	11,978.09	71	38	33	53.52	4,239.04	-4,518.35	0.94	1.08	168.71
26	3,845.39	72	39	33	54.17	4,312.47	-4,980.03	0.87	1.02	53.41
24	18,595.25	75	43	32	57.33	3,583.55	-4,234.29	0.85	1.14	247.94
22	32,685.75	83	50	33	60.24	3,711.09	-4,632.39	0.80	1.21	393.80
20	30,240.81	87	48	39	55.17	3,887.81	-4,009.59	0.97	1.19	347.60
18	11,262.75	90	48	42	53.33	3,501.43	-3,733.48	0.94	1.07	125.14
16	-29,636.15	90	43	47	47.78	3,150.81	-3,513.21	0.90	0.82	-329.29
14	-1,804.48	106	52	54	49.06	3,572.56	-3,473.66	1.03	0.99	-17.02
12	-5,718.61	117	66	51	56.41	2,741.45	-3,659.89	0.75	0.97	-48.88
10	40,681.14	128	69	59	53.91	2,638.25	-2,395.90	1.10	1.29	317.82
8	18,658.40	145	80	65	55.17	2,206.35	-2,428.46	0.91	1.12	128.68
6	18,371.45	183	103	80	56.28	1,989.76	-2,332.17	0.85	1.10	100.39
4	15,724.31	237	133	104	56.12	1,750.71	-2,087.69	0.84	1.07	66.35
2	25,854.38	402	213	189	52.99	1,468.07	-1,517.69	0.97	1.09	64.31

Looking out as much as eight weeks we see the market has generally struggled to make headway. At the same time, this underperformance has not necessarily indicated a correction. As with the Nasdaq/S&P Relative strength indicator tracked on the charts page, we'd rather see the market configured the opposite way for a bullish edge, but the current configuration isn't damning.

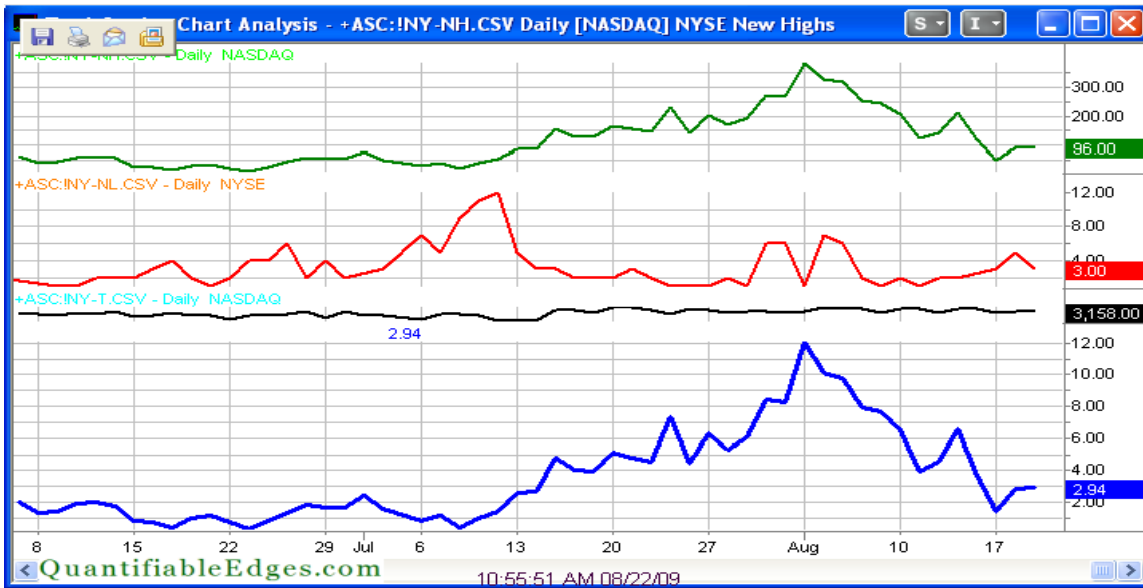
The [Aggregator](#) chart is updated below.



The active studies list has been trimmed substantially in the last few days as several studies have either met their targets or expired. With only 2 bullish and 1 bearish study currently active this is as small a number of active studies as there has been in the last several months. The green Aggregator line remains above zero, indicating the current active studies are suggesting a bullish edge over the next 3 days. The black differential line show that over the last 3 days the S&P has strongly outperformed expectations. So while the studies suggest we could go higher, the fact is the market is still overbought. Tomorrow night Friday's move will fall out of the calculation, which will relieve the overbought condition to a degree. So while there is little or no edge evident tonight, it may only take some mild selling to set up a long trade in the next few days.

Intermediate-term Outlook (2 weeks – 2 months)– updated 8/24 – very slightly bullish

Whether this rally can continue or whether it flounders may depend greatly on the breadth of the rally. Breadth is giving somewhat mixed signals lately. One oddity that traders may notice from the charts page is that while the market is now trading at new highs there has been a noticeable dropoff in the number of individual issues hitting new highs. Below is the chart from the website to demonstrate.



The blue line at the bottom is the net % of stocks hitting new 52-week highs. On August 1st this number was about 12%. Friday it was only 3% - a 9% dropoff. It's fairly rare to see a dropoff this large, but when I tested it I found that it wasn't necessarily bearish. For purposes of testing I lowered the dropoff required to 5% in order to get enough instances. Regardless of the cutoff I used I found the results to be inconsistent and neither bullish nor bearish. Below is one example of a test I ran.

SPX makes a 20-day intraday high and close above its 200ma. The net % of stocks hitting new highs on the NYSE is at least 5 points lower than its 20-day high.
Buy on close. Sell X days later. 1970 - present

QE NHs lag on rally: days in	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
20	16,885.06	26	16	10	61.54	2,088.30	-1,652.78	1.26	2.02	649.43
19	10,845.83	26	14	12	53.85	2,186.88	-1,647.54	1.33	1.55	417.15
18	2,558.27	26	14	12	53.85	1,831.28	-1,923.30	0.95	1.11	98.40
17	-356.37	27	14	13	51.85	1,681.95	-1,838.75	0.91	0.99	-13.20
16	-6,924.34	27	14	13	51.85	1,539.03	-2,190.06	0.70	0.76	-256.46
15	2,688.11	27	15	12	55.56	1,630.76	-1,814.45	0.90	1.12	99.56
14	-2,709.75	27	13	14	48.15	1,733.16	-1,802.92	0.96	0.89	-100.36
13	-1,942.53	29	14	15	48.28	1,922.41	-1,923.75	1.00	0.93	-66.98
12	3,525.81	29	16	13	55.17	1,503.91	-1,579.75	0.95	1.17	121.58
11	2,925.81	29	14	15	48.28	1,467.47	-1,174.59	1.25	1.17	100.89
10	2,778.74	30	15	15	50.00	1,426.81	-1,241.56	1.15	1.15	92.62
9	1,293.47	33	19	14	57.58	951.41	-1,198.80	0.79	1.08	39.20
8	2,294.14	35	20	15	57.14	1,165.27	-1,400.75	0.83	1.11	65.55
7	-2,728.57	38	21	17	55.26	1,212.78	-1,658.64	0.73	0.90	-71.80
6	-627.21	40	24	16	60.00	1,106.06	-1,698.29	0.65	0.98	-15.68
5	-13,004.25	40	17	23	42.50	1,053.26	-1,343.90	0.78	0.58	-325.11
4	-9,092.87	42	17	25	40.48	955.78	-1,013.64	0.94	0.64	-216.50
3	-7,474.66	46	23	23	50.00	664.15	-989.14	0.67	0.67	-162.49
2	-12,506.03	52	22	30	42.31	583.81	-845.00	0.69	0.51	-240.50
1	-8,443.40	67	30	37	44.78	441.60	-586.25	0.75	0.61	-126.02

Is it BETTER to have the number of new highs expanding? Yes. Below I show a similar test where net new highs are also hitting a new high:

SPX makes a 20-day intraday high and closes above its 200ma. The net % of stocks hitting new highs on the NYSE the highest in 20 days.
Buy on close. Sell X days later. 1970 - present

QE NHs lag on rally: daysin	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: WinLoss Ratio	All: ProfitFactor	All: Avg Trade
20	59,666.34	87	55	32	63.22	2,926.27	-3,164.95	0.92	1.59	685.82
19	82,536.66	91	59	32	64.84	2,958.05	-2,874.64	1.03	1.90	907.00
18	86,537.02	91	60	31	65.93	2,844.26	-2,713.51	1.05	2.03	950.96
17	65,533.97	93	57	36	61.29	2,718.05	-2,483.18	1.09	1.73	704.67
16	71,709.96	96	61	35	63.54	2,550.55	-2,396.39	1.06	1.85	746.98
15	72,810.49	99	63	36	63.64	2,537.90	-2,418.82	1.05	1.84	735.46
14	58,225.04	102	65	37	63.73	2,360.60	-2,573.34	0.92	1.61	570.83
13	64,551.10	105	72	33	68.57	2,039.31	-2,493.30	0.82	1.78	614.77
12	51,733.67	108	67	41	62.04	2,073.75	-2,127.01	0.97	1.59	479.02
11	51,450.24	112	70	42	62.50	1,997.82	-2,104.69	0.95	1.58	459.38
10	46,021.40	114	66	48	57.89	2,001.49	-1,793.27	1.12	1.53	403.70
9	52,224.07	115	72	43	62.61	1,816.61	-1,827.25	0.99	1.66	454.12
8	46,836.80	123	73	50	59.35	1,736.29	-1,598.25	1.09	1.59	380.79
7	43,034.75	124	73	51	58.87	1,640.14	-1,503.84	1.09	1.56	347.05
6	28,952.82	131	76	55	58.02	1,450.06	-1,477.31	0.98	1.36	221.01
5	19,908.03	138	79	59	57.25	1,285.57	-1,383.93	0.93	1.24	144.26
4	29,381.48	145	76	69	52.41	1,228.56	-927.38	1.32	1.46	202.63
3	23,529.89	153	84	69	54.90	988.79	-862.73	1.15	1.40	153.79
2	22,182.02	167	87	80	52.10	803.28	-596.29	1.35	1.46	132.83
1	17,266.09	217	118	99	54.38	558.37	-491.13	1.14	1.36	79.57

So if we see this number expand then that would help the rally's chances to continue. On the positive side the advance/decline line is hitting new highs. We also had a 90% day on Friday. As we saw in July, if we get a couple of 90% up days within close proximity then that can often be a decent intermediate-term buy signal. Therefore I'll be very interested to see if we get some additional days of extremely strong breadth this week.

Many of the negatives that had been present are still present, such as the low VIX:VXX ratio, the excessive Nasdaq vs. NYSE volume and the generally downsloping total volume over the last few months. Still, the negative effects of these influences has been slow to kick in.

Right now the market is still in rally mode, and betting against it for any extended period of time has not worked. Short trades need to be small and profits taken when available. I expect we're going to see a substantial selloff begin at some point in the next several months. I don't see evidence of it happening just yet.

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 – Neutral market bias and almost nothing showing up on the triggers page. Wait and see mode.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)(s)	8/20/2009	\$100.75	\$104.01	-3.24%	\$104.01	stopped out

A spike higher at 10am took out the stop on the small SPY position. It appears to have been a tough placement for the stop. With the current configuration I'm more comfortable stepping aside and hopefully getting an opportunity to take an aggressive position in the next few days. I noticed breadth was quite strong to start the day, which often does lead to a further move up rather than a pullback. Below is a link to a study from last year that examines this concept.

<http://quantifiableedges.blogspot.com/2008/04/morning-breadth.html>

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