

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 11, 2009

Volume 2 Issue 174

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				
September 9, 2009	Low range & vol 20 close > 10ma	1-5 days	Bearish	
September 9, 2009	SPY rising on falling volume	1-3 days	Bearish	
September 8, 2009	Strong Breadth No 10-high	1-8 days	Bearish	-4.20%
September 8, 2009	Rise into Labor Day	1-4 days	Bearish	-1.35%
Active - Long Term				
September 11, 2009	Appel Daily Breadth Impulse Signal	1-20 days	Bullish	5.00%
July 14, 2009	VIX:VXV drops below 0.9	2-5 months	Bearish	
Dropped Tonight				

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

Short-term Outlook – updated 9/11

The Bottom Line

The rally over the last week has been exceptionally strong. Rallies of this magnitude often manage additional upside over the next few weeks after a short-term pause or pullback. Breadth is so strong that some measures are signaling a further rally. On the other hand there are a historic number of stocks that are extended upwards at the present time. In the short term a pullback or consolidation appears most probable.

The Proof

The market put in another solid day higher today despite the many indications that a pullback was imminent. After breaking out of the morning range the SPY tacked on about another \$1.00. This despite last night's study suggesting an ORB to the upside was unlikely to succeed. Breadth was once again strong. The NYSE Up Issues % was 75%

and the Up Volume % registered 81%. Total volume rose a bit on the move to new highs.

Yesterday we saw a Nasdaq Up Volume % breadth thrust. Today the Appel Daily Breadth signal triggered at the close. 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 was published in 2004 and up until that time it had a terrific track record. Since then the system has floundered a bit, but it did capture some upside in both March and July.

Below is the long-term performance based on \$100k/trade using the SPX:

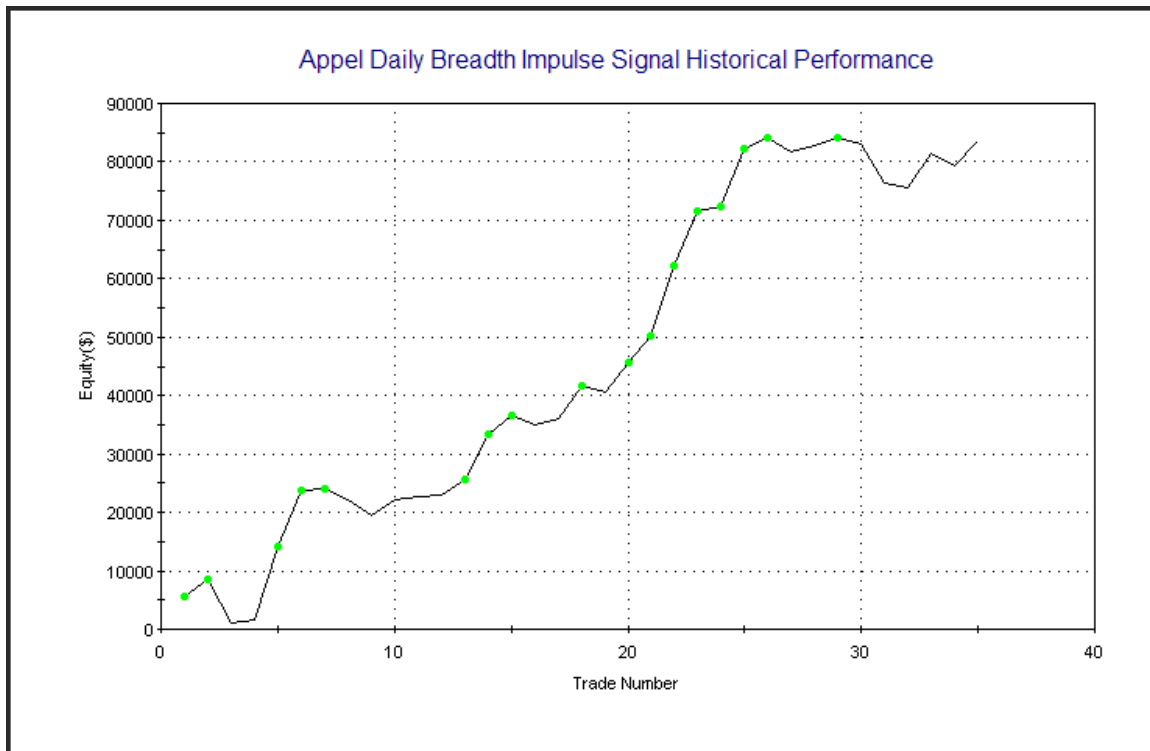
TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$83,573.33	Profit Factor	4.01
Gross Profit	\$111,337.59	Gross Loss	(\$27,764.26)
Total Number of Trades	35	Percent Profitable	71.43%
Winning Trades	25	Losing Trades	10
Even Trades	0		
Avg. Trade Net Profit	\$2,387.81	Ratio Avg. Win:Avg. Loss	1.60
Avg. Winning Trade	\$4,453.50	Avg. Losing Trade	(\$2,776.43)
Largest Winning Trade	\$12,471.48	Largest Losing Trade	(\$7,424.82)

I've listed below all of the trades since publication:

Appel Daily Breadth Impulse Signals since publication.
SPX used. \$100k/trade.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
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	4.14%	\$8,189.56
08/17/09	Sell	\$979.73		(\$645.54)

These six trades have an additive total of only 0.68%. And below is a profit curve to illustrate historical performance.



If you switch the exit to a simple time-based trigger, the results would look like this:

**Appel Daily Breadth Impulse Signal triggers. 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
20	108,651.79	38	29	9	76.32	4,706.71	-3,093.63	1.52	4.90	2,859.26
19	106,352.57	39	30	9	76.92	4,555.64	-3,368.50	1.35	4.51	2,726.99
18	97,228.66	40	30	10	75.00	4,278.85	-3,113.67	1.37	4.12	2,430.72
17	89,196.40	40	30	10	75.00	4,122.67	-3,448.36	1.20	3.59	2,229.91
16	89,654.76	40	29	11	72.50	4,271.52	-3,110.85	1.37	3.62	2,241.37
15	85,825.16	41	31	10	75.61	3,779.14	-3,132.81	1.21	3.74	2,093.30
14	78,180.30	41	31	10	75.61	3,452.69	-2,885.32	1.20	3.71	1,906.84
13	78,942.25	42	32	10	76.19	3,414.47	-3,032.08	1.13	3.60	1,879.58
12	70,846.37	43	31	12	72.09	3,341.24	-2,727.67	1.22	3.16	1,647.59
11	58,498.52	44	34	10	77.27	2,713.48	-3,375.97	0.80	2.73	1,329.51
10	62,718.10	45	35	10	77.78	2,580.13	-2,758.66	0.94	3.27	1,393.74
9	52,237.98	46	35	11	76.09	2,372.80	-2,800.90	0.85	2.70	1,135.61
8	48,461.73	49	34	15	69.39	2,509.16	-2,456.66	1.02	2.32	989.01
7	41,048.56	50	35	15	70.00	2,191.86	-2,377.76	0.92	2.15	820.97
6	40,044.47	50	34	16	68.00	2,097.48	-1,954.37	1.07	2.28	800.89
5	35,673.24	55	38	17	69.09	1,728.84	-1,766.03	0.98	2.19	648.60
4	10,220.23	56	29	27	51.79	1,580.89	-1,319.46	1.20	1.29	182.50
3	-7,297.76	59	27	32	45.76	1,492.14	-1,487.05	1.00	0.85	-123.69
2	752.13	63	35	28	55.56	952.59	-1,163.88	0.82	1.02	11.94
1	-579.76	63	34	29	53.97	721.69	-866.12	0.83	0.98	-9.20

The recent struggles are a concern when considering the edge this system may provide. Below is an excerpt from the 4/13/09 Subscriber Letter that addressed this concern.

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

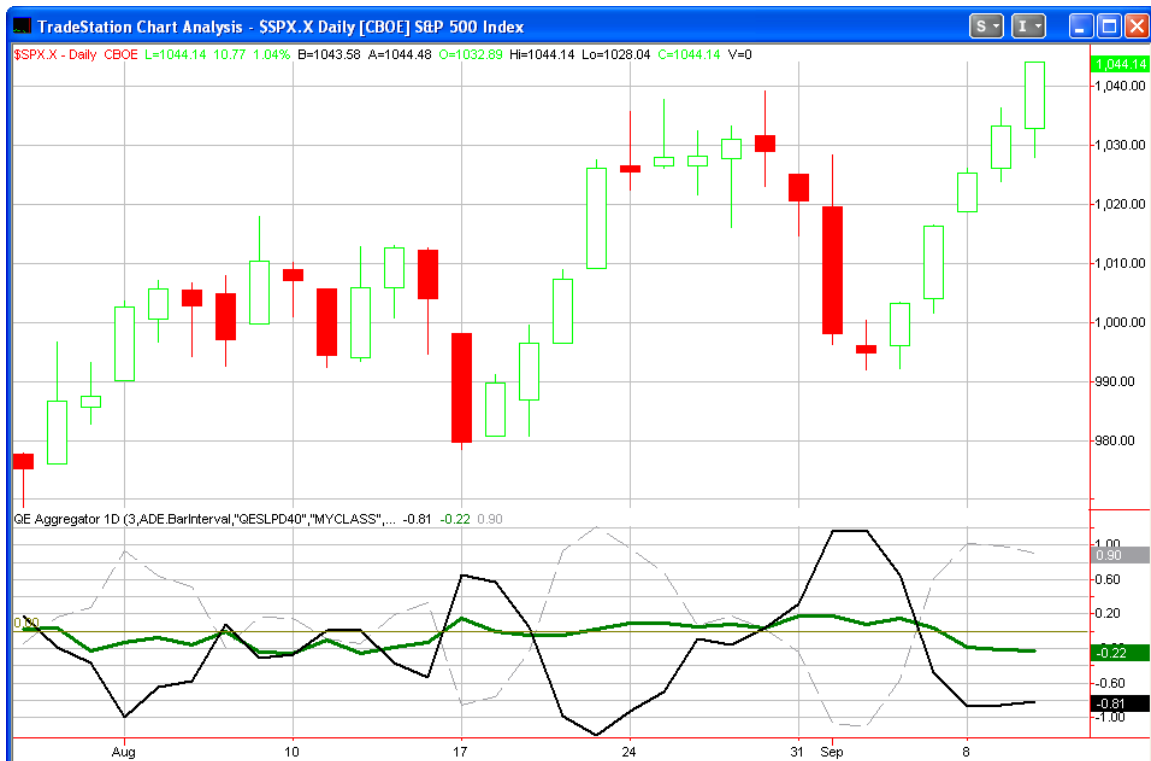
Here again we see strong results across the board. While there's a chance that the "best" results were chosen for publication, there's really no foul in doing that. The concept appears sound, which means the recent failures are likely either due to 1) bad luck or 2) a change in market dynamics. It could also be a combination of the two.

So while returns may not be as compelling as they once appeared, I believe the system still may provide a bit of an edge on the long side. I've decided to replace the Nasdaq Breadth Thrust system from last night with this one when calculating the Aggregator. They're very similar but this once is more geared for the S&P.

Also notable from Thursday's action is that the number of stocks trading above their 200-day moving average is hitting historic levels once again. I discussed this indicator in the [August 26th blog](#). At the time the % of stocks was up to 90.9%. Thursday it again entered territory only seen one other time (Jan 2004) since 1986 when the data began. It closed at 91.66%. This doesn't mean there will be an immediate correction. It does suggest perhaps that the market has come a bit too far too fast and that upside reward could be limited.

The 3/10 offset historical volatility indicator that I've referred to a fair amount lately remained exceptionally low today, coming in at 0.12. I look for move below 0.25 to suggest a likely substantial increase in volatility will occur. So there still remains a possibility that the market could move strongly (in either direction) over the next few days. Low readings like we have now are also advantageous when trading Opening Range Breakouts. Since I've found this indicator to be quite useful over the last couple of months I've decided to include it on the charts page. I've removed the TOV indicator, which I haven't had much use for.

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



Again we see little change in the configuration of the Aggregator. The green Aggregator line remains squarely below 0 illustrating the net negative expectations from the studies over the next few days. The black differential line is also well below zero as the market has outperformed expectations by a substantial amount over the last few days and is overbought. Overbought with negative expectations is what I look for when taking on short exposure.

So it still seems the market is likely to pull back over the next few days. It's seemed like that for 2 days now, though and the market hasn't cared. When the market is this strong it makes profiting on the short side difficult. While a pullback is likely, a strong market like this may manage to overshoot on the upside and still keep the initial pullback shallow. Therefore I'm not eager to get aggressive here. I will look to take a little more short exposure tomorrow if a favorable entry avails itself. Details in the trade idea section below.

Intermediate-term Outlook (2 weeks – 2 months)– updated 9/8 – neutral

There's little to say from an intermediate-term standpoint that I haven't said in the last couple of weeks. There are a fair amount of indicators suggesting downside but over the last month and a half or so those suggestions haven't been worth anything.

The VIX:VXV ratio again dropped below 0.9 on Friday as noted by the Quantifinder. From 2002 – mid 2009 this was a very reliable precursor to a market selloff. The selloffs didn't always occur immediately. In fact the average amount of time the signal took to completely wear off was close to 4 months. So the fact that it has been nearly 2 months and this indicator hasn't "worked" isn't entirely abnormal.

I believe breadth will be important to monitor as we move forward here. There have been some strong breadth numbers over the last couple of days. In the short-term outlook above I concluded that the combination of market structure and breadth suggested downside rather than upside. This could change should we continue to see strong advance/decline readings. Another breadth measure that may be worth watching is the NYSE Net New Highs %. I showed a couple of weeks ago that while a lagging number of new 52-week highs is not a death sentence, the market prospects can be substantially improved when new 52-week highs confirm new index price highs. So far we've got a ways to go before either is reached.

I've seen nothing that would cement the idea that the current rally is over. There's a decent amount of evidence that the market has come too far too fast and we'll likely see a pullback at some point here in the not-to-distant future.

The basic premise I'm working under remains that we are in a [1930's – style environment](#) in which both rallies and selloffs will be much more exaggerated than most market participants are used to. Just as the bear market up to March 2009 was incredibly extreme, so has been the rally since then. I believe there is going to be a lot of back and forth over the next few years and the swings will continue to feel extreme. It may be important to keep this in mind when considering market action.

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 index position @ \$105.35 limit ON OPEN. If not filled then short @ \$104.80 limit on close. Only take ¼ position on Friday. Based on the short-term market outlook above. Volatility is still low and I am expecting a sharp expansion. Most of what we're looking at suggests the short-side has higher risk/reward currently. Still risk remains somewhat elevated on the short side. Traders could consider trading the SPY using an Opening Range Breakout technique as well.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(s)(1/4)	9/9/2009	\$103.12	\$104.79	-1.62%		

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.