

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 21, 2009

Volume 2 Issue 180

## 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>				
September 21, 2009	5ma of Equity P/C 20% below 200ma	1-3 days	Bearish	
September 21, 2009	Op-ex week up 2%-3%	1-5 days	Bearish	-1.20%
<b>Active - Long Term</b>				
September 14, 2009	Nasdaq/S&P Lead/Lag Model		Bullish	
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	
<b>Dropped Tonight</b>				
September 17, 2009	Up Issues > 70% twice. Vol & close high	1-2 days	Bullish	

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

### **Short-term Outlook – updated 9/21**

#### **The Bottom Line**

The week after op-ex week is typically rough. This is especially true when op-ex week is strongly positive. The rise over the past week has also been accompanied by consistent very low readings in the CBOE Equity P/C Ratio. This also suggests a short-term bearish edge. The evidence suggests short-term risk/reward is favoring the downside. It may not take much of a pullback to flip the edge to the upside though.

#### **The Evidence**

After gapping higher the market traded in a fairly narrow range for most of the day. The S&P 500 and Nasdaq Composite both put in inside days before closing up about ¼%. Breadth was slightly positive. The NYSE Up Issues % came in at 57% and the Up Volume % at 51%. Total volume came in at the highest level in months – although it was aided by options expiration.

The CBOE Equity put/call ratio was consistently low last week. The 5-day average is 0.53, which is nearly 22% below the 200-day average of 0.68. We've seen numerous times lately how extremely low 1-day readings often lead to a pullback in the SPX the following day. When the 5-day average gets extremely low as it is now that can also lead to a short-term pullback. Below is a study that exemplifies this.

5-day ma of the CBOE Equity P/C Ratio falls more than 20% below the 200-day ma of the CBOE Equity P/C ratio. Buy on close. Sell when 5ma is no longer 20% below 200ma. \$100k/trade. 2004 - present.				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
03/13/09	Buy	\$756.55	(0.35%)	\$2,373.36
03/16/09	Sell	\$753.89		(\$419.76)
03/19/09	Buy	\$784.04	(1.98%)	\$584.20
03/20/09	Sell	\$768.54		(\$2,265.68)
03/23/09	Buy	\$822.92	1.21%	\$1,202.74
03/26/09	Sell	\$832.86		(\$3,817.55)
04/15/09	Buy	\$852.06	(2.31%)	\$2,757.69
04/20/09	Sell	\$832.39		(\$2,301.39)
05/05/09	Buy	\$903.80	0.60%	\$2,900.70
05/11/09	Sell	\$909.24		(\$268.40)
08/05/09	Buy	\$1,002.72	(0.56%)	\$516.78
08/06/09	Sell	\$997.08		(\$1,012.77)
08/10/09	Buy	\$1,007.10	(1.27%)	\$0.00
08/11/09	Sell	\$994.35		(\$1,455.30)
08/13/09	Buy	\$1,012.73	(0.85%)	\$0.00
08/14/09	Sell	\$1,004.09		(\$1,776.74)
08/24/09	Buy	\$1,025.57	0.33%	\$1,329.87
08/28/09	Sell	\$1,028.93		(\$908.89)
09/17/09	Buy	\$1,065.49	n/a	\$560.79
open	n/a	\$1,068.30		(\$113.46)

**All 9 instances posted a close below the entry trigger at some point in the next 6 days.**

Most notable and also most compelling about this study is the fact that all instances have occurred after the March bottom. Prior to that the 5-day ratio had never stretched 20% below the 200-day. This is another sign of just how extreme the current bull move has become. It also makes the results that much more impressive from a negative standpoint since they were achieved during a 60% run-up in the market.

I noted in Thursday night's Letter that strong expiration weeks are often followed by a pullback the following week. The excerpt below is one I ran Thursday night as well. It is from the July 20, 2009 Subscriber Letter.

Below are a couple of studies that appeared in the 4/20/09 Letter.

Today is option expiration Friday. SPX closes higher than 5 days ago. Buy SPX on close. Sell X days later. \$100k/trade. 1987-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	-48,586.20	157	69	88	43.95	1,306.43	-1,576.48	0.83	0.65	-309.47
4	-25,958.95	157	67	90	42.68	1,347.37	-1,291.47	1.04	0.78	-165.34
3	-23,790.49	157	70	87	44.59	1,163.03	-1,209.23	0.96	0.77	-151.53
2	-23,472.84	157	74	83	47.13	826.20	-1,019.41	0.81	0.72	-149.51
1	-14,676.80	157	60	97	38.22	905.38	-711.34	1.27	0.79	-93.48

When op-ex week closes higher there tends to be a bearish tilt to the following week. As in the 4/20/09 Letter I also broke down returns by the % gained option expirations week.

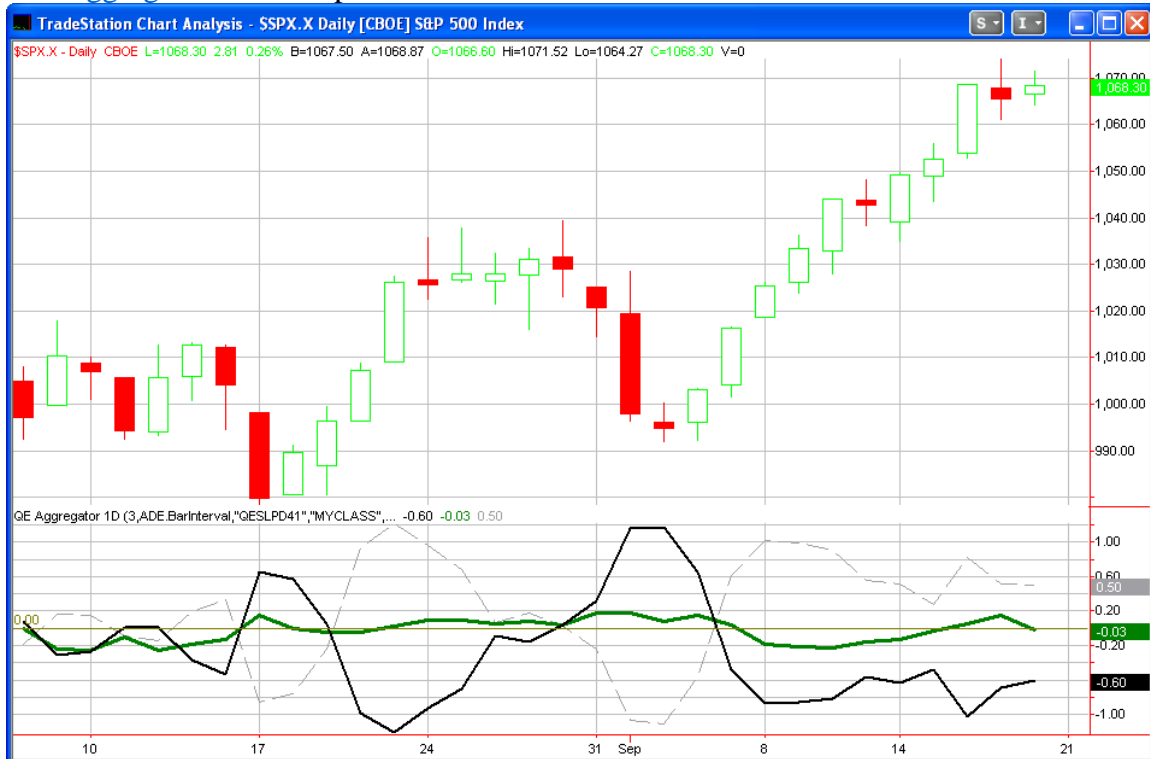
Today is option expiration Friday. SPX closes X% higher than 5 days ago. Buy SPX on close. Sell 5 days later. \$100k/trade. 1987-present.										
X%	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
3.0	-14,506.69	23	10	13	43.48	1,249.42	-2,076.99	0.60	0.46	-630.73
2.5	-20,533.49	37	16	21	43.24	1,027.96	-1,760.99	0.58	0.44	-554.96
2.0	-22,601.15	48	23	25	47.92	945.94	-1,774.31	0.53	0.49	-470.86
1.5	-33,930.33	75	32	43	42.67	1,211.70	-1,690.81	0.72	0.53	-452.40
1.0	-39,927.64	108	48	60	44.44	1,186.58	-1,614.73	0.73	0.59	-369.70
0.5	-45,793.17	135	59	76	43.70	1,290.06	-1,604.03	0.80	0.62	-339.21
0.0	-48,586.20	157	69	88	43.95	1,306.43	-1,576.48	0.83	0.65	-309.47

While the % winners doesn't change much, risk/reward tilts more negative the higher the op-ex week returns.

Tonight I decided to look at those instances where the market close between 2% and 3% higher like this past week.

Today is op-ex Friday. The SPX has closed between 2% and 3% higher than 5 days ago. Buy on close. Sell X days later. \$100k/trade. 1960 - 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
6	-9,589.49	26	10	16	38.46	1,135.00	-1,308.72	0.87	0.54	-368.83
5	-7,822.86	26	14	12	53.85	681.01	-1,446.41	0.47	0.55	-300.88
4	-263.98	26	14	12	53.85	1,060.85	-1,259.66	0.84	0.98	-10.15
3	323.86	26	14	12	53.85	830.49	-941.91	0.88	1.03	12.46
2	-2,352.85	26	11	15	42.31	756.65	-711.73	1.06	0.78	-90.49
1	3,637.81	26	12	14	46.15	786.28	-414.11	1.90	1.63	139.92

The **Aggregator** chart is updated below.



Between the CBOE Equity Put/Call Ratio study and the rise during op-ex week study the net expectation from the studies has now turned slightly negative. This can be seen with the green Aggregator line positioned at -0.03. Meanwhile the black Differential line remains solidly below zero as the market has strongly outperformed expectations over the last 3 days. Both lines below 0 means we are overbought and with bearish short-term expectations.

Tomorrow will be a key day for the next few days. Should the market drop we could see both bearish studies achieve their expectations fairly easily. The black differential line would also likely spike back up above zero in such a scenario since Wednesday's strong move higher will fall out of the calculation. The Aggregator is set to flip positive tomorrow without any additional studies or any of the current studies reaching expectations. In other words, a down day tomorrow would likely flip both lines above zero, leaving us with a bullish expectation going into Tuesday. An up day could lead to one or possibly both lines remaining below 0. For now the short-term edge is down. It could change quickly, though so make sure not to overstay your welcome if you're short. A good move lower tomorrow would eliminate much of the short-term edge and could be a nice opportunity to remove short exposure.

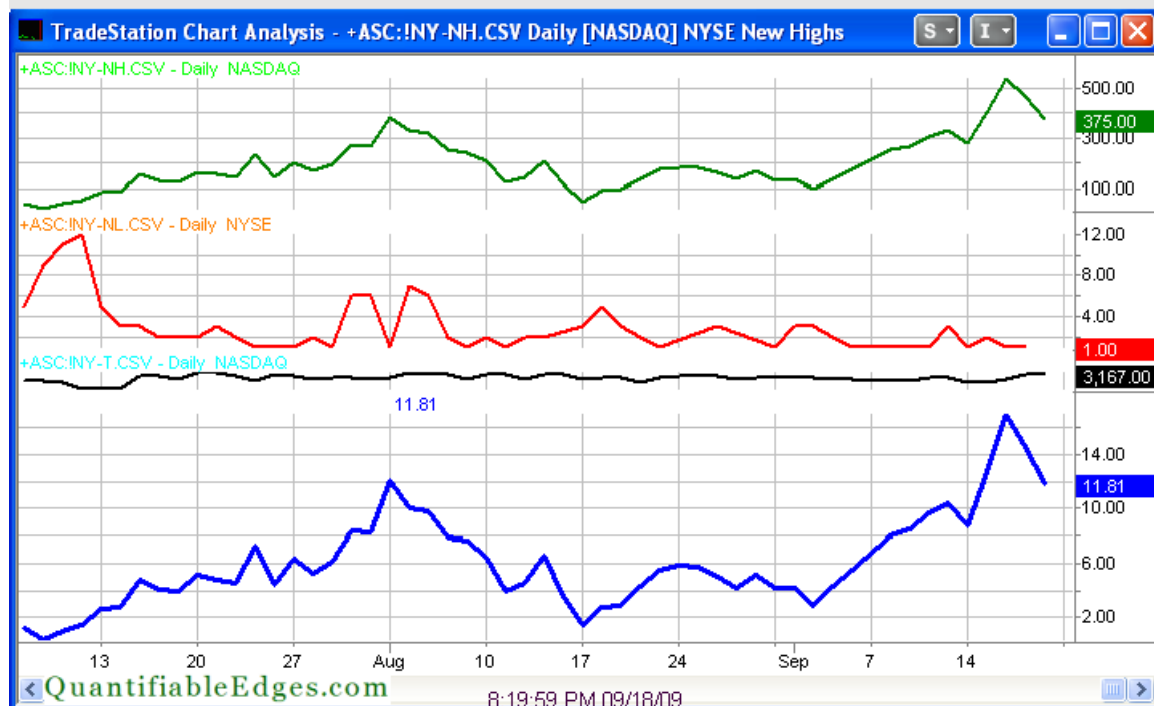
***Intermediate-term Outlook (2 weeks – 2 months)– updated 9/21 – somewhat bullish***

Nothing really has changed since last week from an intermediate-term standpoint. In last week's Letter we reviewed 2 bullish indications and one bearish. The bullish indications came from 1) the Nasdaq/S&P 500 Relative strength chart, which is tracked on the website and 2) The Appel Daily Breadth Thrust signal which is triggered by a high

reading in the Up Issues % 10-day ema. This can also be seen on the charts page. Both of these indicators remain bullish. We'll need to see continued outperformance by the Nasdaq and solid breadth readings this week for both indicators to remain bullish.

I also noted last week that it was worth keeping an eye on the NYSE Net New Highs %. It had failed to register a new high since August 1<sup>st</sup>, even while the indices had all been hitting new highs. My research showed that this was not a death sentence for the rally but that if the new highs could expand that would serve as confirmation for the rally. Under such circumstances the market has historically outperformed the times new highs weren't confirming. This week saw a large expansion of new highs and the August levels were easily taken out. Below is a copy of the chart kept on the website that illustrates this.

### NYSE Net New Highs



The current lone dissenter among the intermediate-term studies was the low VIX:VXV ratio study. This ratio remains stretched to the downside and is still suggesting an uptick in volatility, which would likely be accompanied by a market selloff. Interestingly, while this ratio remains stretched the VIX and the VXO are both right around their 10-day moving averages.

My conclusion remains the same as last week:

*As long as I see the Nasdaq lead, breadth remain strong, and the new highs continue to expand, I'll look for a continuation of the current rally. All of these indications can flip in a fairly short period so they will need to be monitored. At some point the market will likely undergo a sharp correction.*

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.

None tonight.

### **Active Trades Table**

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(s)(1/4)	9/9/2009	\$104.85	\$106.72	-1.78%		entry adj to reflect div

I will exit the last lot of the SPY on a close of \$106 or lower. Friday's stop is now removed. I will likely look to trail one tomorrow should the market head lower in the morning.

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