

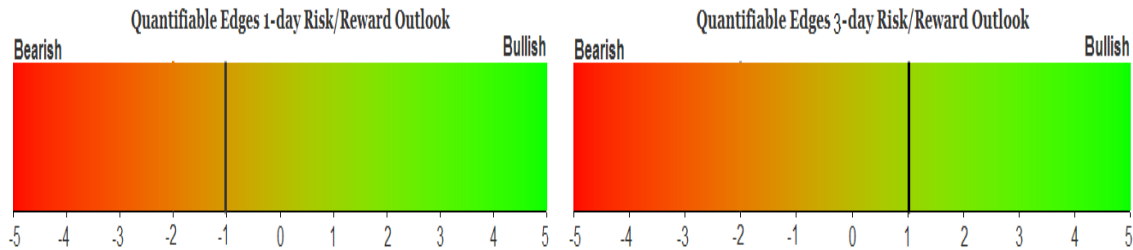
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 7, 2009

Volume 2 Issue 192

## 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>				
October 7, 2009	CBOE Equity P/C 25% below 200ma	1 day	Bearish	
October 7, 2009	2 75% Up Issue Days while SPX>200ma	1-4 days	Bullish	2.50%
<b>Active - Long Term</b>				
September 14, 2009	Nasdaq/S&P Lead/Lag Model		Bullish	
July 14, 2009	VIX:VXV drops below 0.9	2-5 months	Bearish	
<b>Dropped Tonight</b>				
<b>October 5, 2009</b>	<b>WR7 Down Followed By NR7</b>	<b>1-5 days</b>	<b>Bullish</b>	<b>1.90%</b>
<b>October 5, 2009</b>	<b>2 Down Totaling -1.5% to start month</b>	<b>1-4 days</b>	<b>Bullish</b>	<b>1.80%</b>
<b>October 2, 2009</b>	<b>2% drop over 200ma to 10-low bot10%</b>	<b>1-5 days</b>	<b>Bullish</b>	<b>2.80%</b>

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

### **Short-term Outlook – updated 10/7**

#### **The Bottom Line**

Two strong days in a row and the market is no longer oversold. The extremely strong breadth readings we've seen on this bounce suggest more upside to come. At the same time there are indications the bounce may already be getting ahead of itself. So while upside may continue to be favored, the position of the market suggests poor risk/reward for short-term long positions. The Aggregator System flipped back to neutral after posting a nice gain over the last 3 days. Neutral is right about where I'm feeling as well.

### The Evidence

Tuesday saw some nice follow through to Monday's bounce. After rising most of the morning, an early afternoon dip tested the lows. The market then rebounded to close well. The S&P 500 gained 1.4% while the Nasdaq tacked on 1.7%. Breadth was again strong. The NYSE Up Issues % came in at 79% and the Up Volume % at 82%. NYSE volume rose from Monday's level but was still below average.

In an intraday update today I noted that the 75% + Up Issues % two days in a row while failing to make a 10-day high had historically led to short-term upside. Below is the results table from the email:

NYSE Up Issues % closes above 75% for 2 days in a row. SPX fails to make a 10-day intraday high. Buy SPX on close. Sell X days later. \$100k/trade. 1969 - 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	-9,047.73	7	2	5	28.57	2,648.03	-2,868.76	0.92	0.37	-1,292.53
9	-10,493.61	7	2	5	28.57	3,126.00	-3,349.12	0.93	0.37	-1,499.09
8	-7,839.45	7	2	5	28.57	3,504.21	-2,969.57	1.18	0.47	-1,119.92
7	-5,976.10	7	2	5	28.57	3,691.24	-2,671.72	1.38	0.55	-853.73
6	-1,478.26	7	2	5	28.57	2,820.47	-1,423.84	1.98	0.79	-211.18
5	5,568.00	7	4	3	57.14	2,032.09	-853.45	2.38	3.17	795.43
4	10,466.40	7	7	0	100.00	1,495.20	0.00	100.00	100.00	1,495.20
3	8,551.41	7	5	2	71.43	2,272.51	-1,405.56	1.62	4.04	1,221.63
2	8,152.19	7	4	3	57.14	2,271.69	-311.52	7.29	9.72	1,164.60
1	8,216.41	8	5	3	62.50	1,976.39	-555.18	3.56	5.93	1,027.05

Tonight I also looked at this study without the considering the 10-day high but instead filtering on instances above their 200-day moving average.

NYSE Up Issues % closes above 75% for 2 days in a row. SPX closes > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1969 - 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	36,760.53	13	11	2	84.62	3,765.74	-2,331.33	1.62	8.88	2,827.73
9	32,481.18	13	10	3	76.92	3,994.50	-2,487.95	1.61	5.35	2,498.55
8	24,937.26	13	10	3	76.92	3,178.39	-2,282.22	1.39	4.64	1,918.25
7	24,885.36	13	9	4	69.23	3,309.12	-1,224.19	2.70	6.08	1,914.26
6	26,608.76	14	12	2	85.71	2,474.65	-1,543.55	1.60	9.62	1,900.63
5	23,556.31	14	10	4	71.43	2,647.06	-728.57	3.63	9.08	1,682.59
4	24,072.29	14	13	1	92.86	1,860.02	-108.00	17.22	223.89	1,719.45
3	18,287.39	14	11	3	78.57	1,855.86	-709.02	2.62	9.60	1,306.24
2	14,201.55	15	11	4	73.33	1,396.60	-290.27	4.81	13.23	946.77
1	6,038.15	17	11	6	64.71	796.48	-453.86	1.75	3.22	355.19

**100% of instances closed above the entry price at some point in the next 4 days.**

The strong breadth seems to be suggesting a nice upside edge over the next several days. On the other hand, the CBOE Equity Put/Call Ratio came in extremely low on Tuesday. Below is an excerpt from the September 17, 2009 Subscriber Letter (stats not updated).

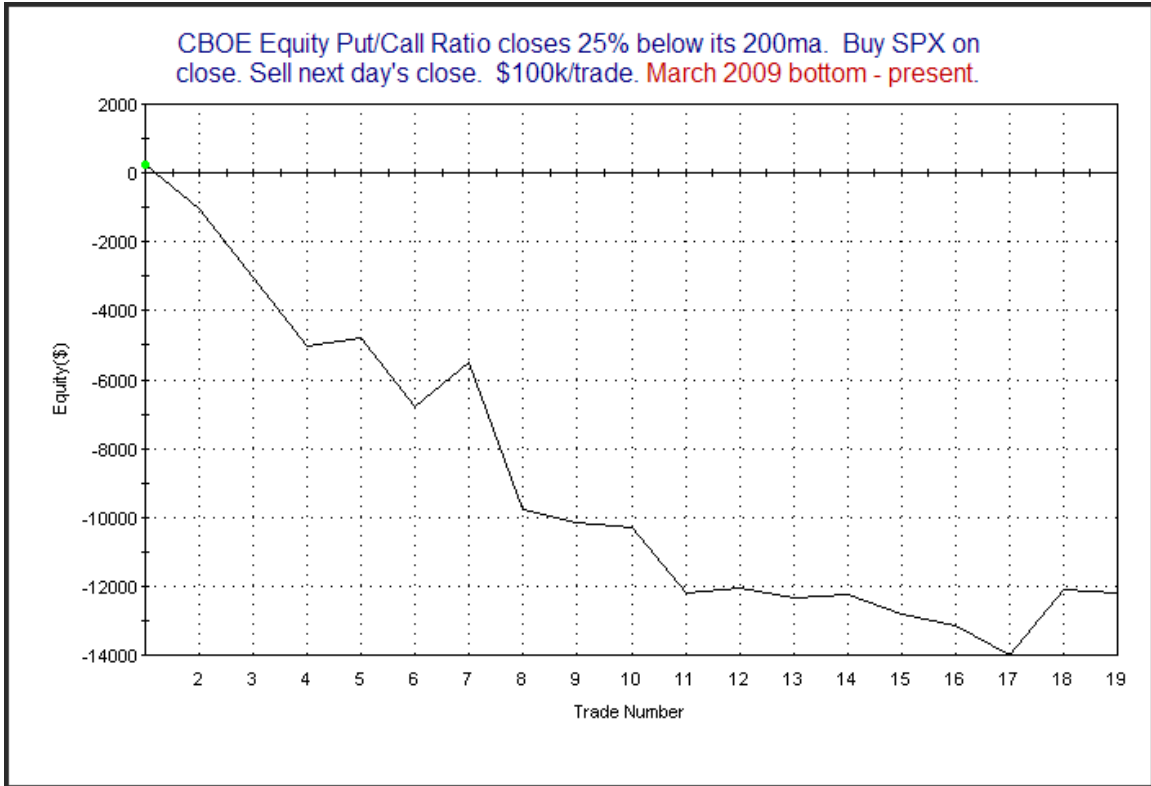
*The CBOE Equity Put/Call Ratio came in over 25% below its 200ma. Extremely low readings such as this have consistently led to selloffs the following day. Below is an updated performance report of the study that I<sup>st</sup> appeared in the 6/12/09 blog.*

CBOE Equity Put/Call Ratio closes 25% below its 200ma. Buy SPX on close. Sell next day's close. \$100k/trade. 2007 - present.			
TradeStation Performance Summary			Collapse ▲
All Trades			
Total Net Profit	(\$16,511.22)	Profit Factor	0.27
Gross Profit	\$6,120.95	Gross Loss	(\$22,632.17)
Total Number of Trades	25	Percent Profitable	32.00%
Winning Trades	8	Losing Trades	17
Even Trades	0		
Avg. Trade Net Profit	(\$660.45)	Ratio Avg. Win:Avg. Loss	0.57
Avg. Winning Trade	\$765.12	Avg. Losing Trade	(\$1,331.30)
Largest Winning Trade	\$1,857.24	Largest Losing Trade	(\$4,241.94)

*2007 is when this particular study really became effective, which is why the results show back to that date. Most interesting though is the fact that since the March lows it has been extremely prevalent and equally as effective.*

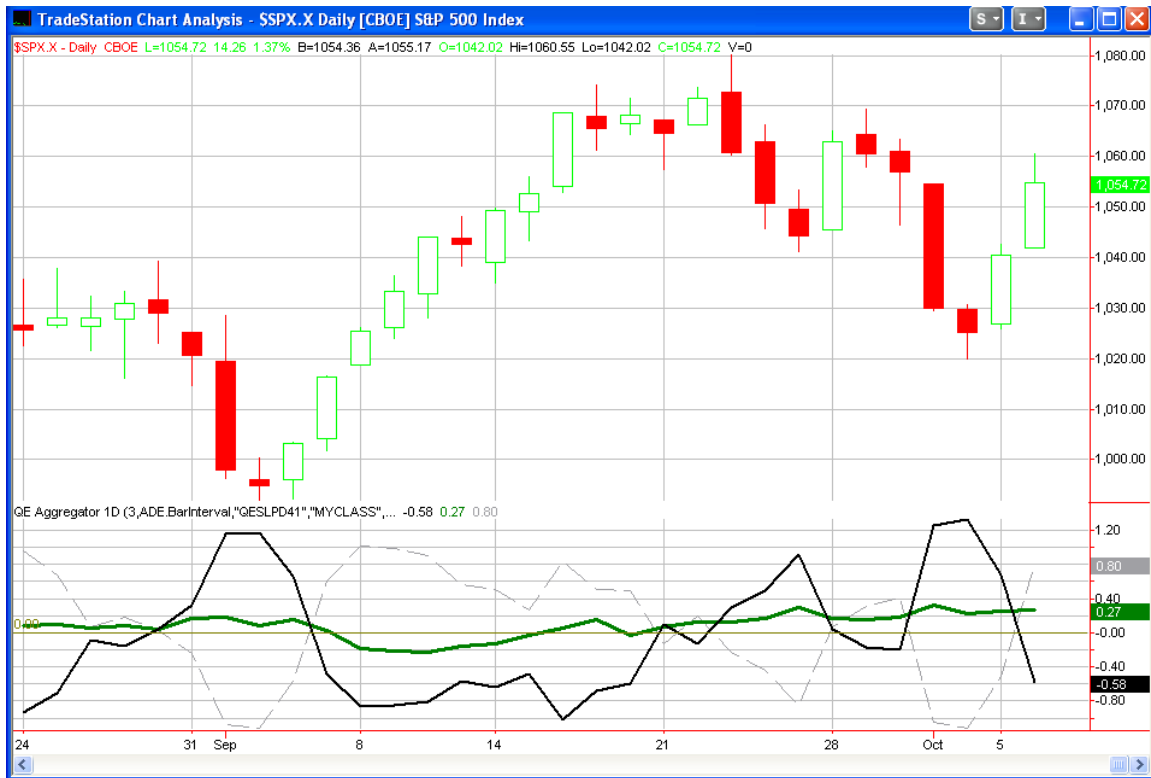
CBOE Equity Put/Call Ratio closes 25% below its 200ma. Buy SPX on close. Sell next day's close. \$100k/trade. March 2009 bottom - present.			
TradeStation Performance Summary			Collapse ▲
All Trades			
Total Net Profit	(\$12,176.05)	Profit Factor	0.24
Gross Profit	\$3,810.25	Gross Loss	(\$15,986.30)
Total Number of Trades	19	Percent Profitable	31.58%
Winning Trades	6	Losing Trades	13
Even Trades	0		
Avg. Trade Net Profit	(\$640.84)	Ratio Avg. Win:Avg. Loss	0.52
Avg. Winning Trade	\$635.04	Avg. Losing Trade	(\$1,229.72)
Largest Winning Trade	\$1,857.24	Largest Losing Trade	(\$4,241.94)

*Note that all of the key stats which I circled on the reports happen to match up very closely. Lastly, below is an equity curve showing the performance since the March bottom.*



Also notable about today's action is that it was strong enough to hit the targets in all of the active studies from last night. They have been removed and replaced with the 2 studies from tonight.

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



Tonight's studies have kept the green Aggregator line squarely above 0. This indicates a net positive expectation over the next 3 days. The black Differential line fell sharply though. Between today's sharp rise and the elimination of Thursday's big decline the SPX has moved from oversold vs. expectations to overbought vs. expectations very quickly. When the green Aggregator line and black Differential line are on opposite sides of 0, I typically consider that to be a neutral configuration.

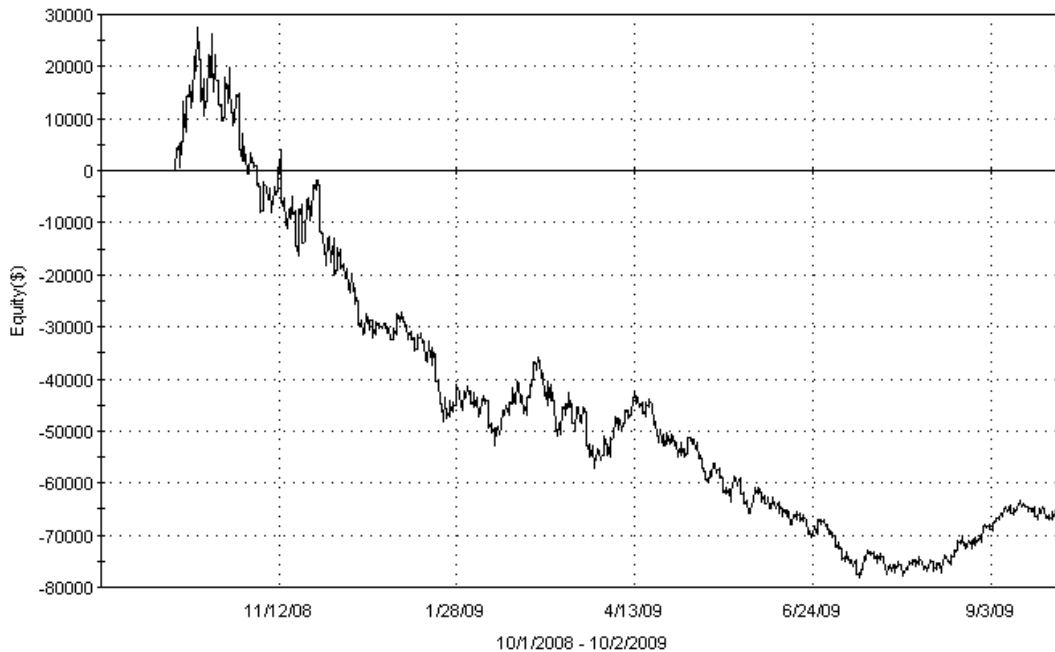
Most trade ideas were exited at today's close. I'll be waiting for a more pronounced edge before looking to add more exposure.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 10/5 – slightly bullish***

In last week's intermediate-term update I discussed the fact that the Trend vs. Chop chart had turned up over the last 3 months for the 1<sup>st</sup> time in 3 years. As a quick refresher the Trend vs. Chop chart looks at whether the market is following through on a daily bases or whether it is reversing. The chart is an equity curve of a simple strategy that goes long every up day and short every down day. Therefore a rising line illustrates a market whose moves are persisting from one day to the next. A declining line suggests the market is spending more energy chopping back and forth than following through. The dominant action over the last decade has been chop. Prior to that there was more of a tendency to see trendy behavior. For more detail on the Trend vs. Chart concept you may use this link:

<http://quantifiableedges.blogspot.com/search/label/Trend%20Vs.%20Chop>

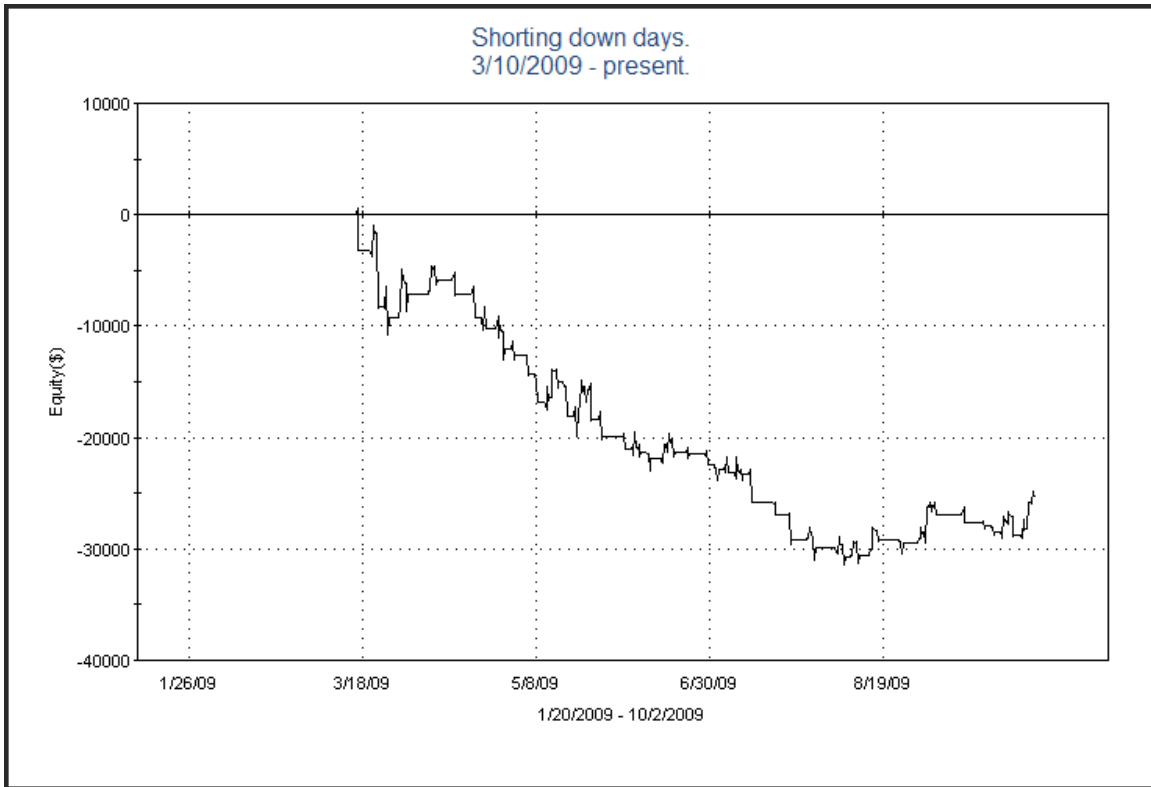
Below is a copy of the Trend vs. Chop chart from the website.



Two comments I had last week were 1) that the recent trendy behavior has made a difficult time for mean-reverting strategies and 2) I wasn't convinced it upturn was going to last. I didn't think it was time to break out strategies that rely on trendy day to day behavior. I received a few questions asking for more detail on my thinking here, so I thought I'd share a few more charts.

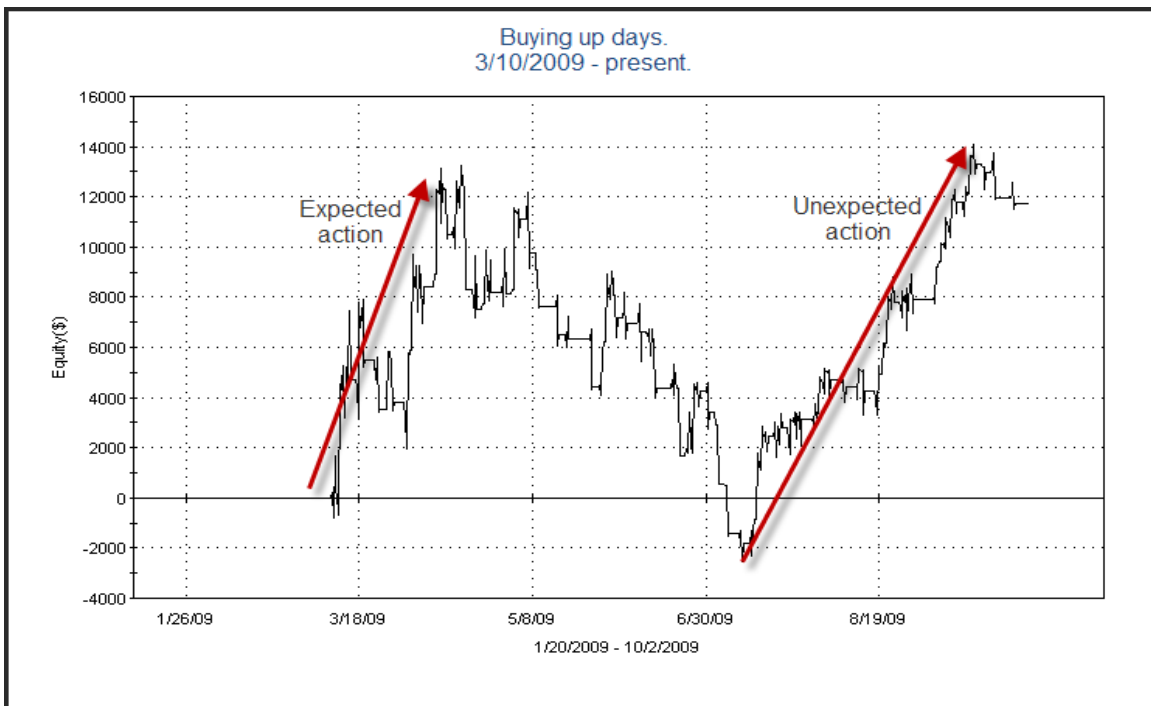
I've broken the above Trend vs. Chop chart down into two separate charts below. The first one looks at performance following down days and the second one looks at performance following up days. They both go back only as far as the March bottom. The primary follow through that has been seen in the last few months has been to the upside as the rally has been extremely strong.

First let's look at the market has done the day after a down day:



Until August down days were consistently met by up days. Since then it has been a little bit more of a crash. This past week and a half we saw a little bit of a spike up as the market has had very few up days.

Now let's look at the performance following up days.



There's two periods of extreme follow through noted on this chart. The 1<sup>st</sup> one I wrote "expected action" next to. Prior to the March bottom I discussed numerous times that bounces from extremely oversold conditions tend to be especially powerful and persistent. You can see in the above chart how right off the bat shorts were punished and the market had a steep rally. I expected this and therefore was very wary of the short side during that time. The move that started in July I did not expect. From late July to mid-September the market rallied about 180 points. Such powerful rallies are extremely unusual when not coming immediately after a deeply oversold bottom. This caused a sharp rise in upside follow through.

Now if you look back to the 1<sup>st</sup> Trend vs. Chop chart you'll see that this incredibly strong rally, with persistence stronger than anything seen since 2000, has barely been able to make the primary Trend vs. Chop chart curl. We already saw how choppy the decline was over the last few years, so it would seem the biggest threat to the chop is a persistent uptrend. While the rally may or may not be over at this point, the odds of it continuing much longer at a pace that was seen over the July –September period seem remote. Hence the reason for my current expectation that chop will most likely begin to prevail soon enough.

With regards to the intermediate-term, I'll just note a few things here. First, the market is making a lower low after a lower high, which could be the start of downtrend. The S&P 500 is currently sitting right near its 50-day moving average. This could provide short-term support. A sharp move through it would be another sign of a downtrend. The VIX:VXV ratio is almost back to 1 for the 1<sup>st</sup> time in several months. Moves much above 1 are potentially bullish. Lastly, the Nasdaq continues to outperform the S&P. This is preferred for the bullish scenario. The uptrend may not be dead quite yet, but it remains in a precarious position.

### **Catapult and Capitulative Breadth Statistics**

*(Catapult Presentation Part 1) (Catapult Presentation Part 2)*

#### ***Open Catapult Triggers***

*XXR 1/3 @ 7.68 – (filled @ \$7.32)*

#### ***Catapult for ETF's Trades***

*none*

#### ***Broad Market Large Cap CBI -1(XXR)***

### **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 – Without strong conviction I'd prefer to wait for a better entry point than to take pot shots.*

### **Active Trades Table**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Pr</b>	<b>% Gain/L</b>	<b>Stop</b>	<b>Notes</b>
IBB	10/1/2009	\$81.21	\$79.57	-2.02%		system 80609
SPY(1/4)	10/2/2009	\$102.49	\$105.25	2.69%	\$101.95	stopped out intraday
XRX(1/3)	10/2/2009	\$7.32	\$7.31	-0.14%	\$7.15	Catapult
UTX(1/3)	10/2/2009	\$59.38	\$61.49	3.55%	\$59.25	sold on close
UTX(1/3)	10/5/2009	\$59.63	\$61.49	3.12%	\$59.25	sold on close
HON(1/3)	10/5/2009	\$35.60	\$36.50	2.53%	\$35.39	stopped out intraday

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