

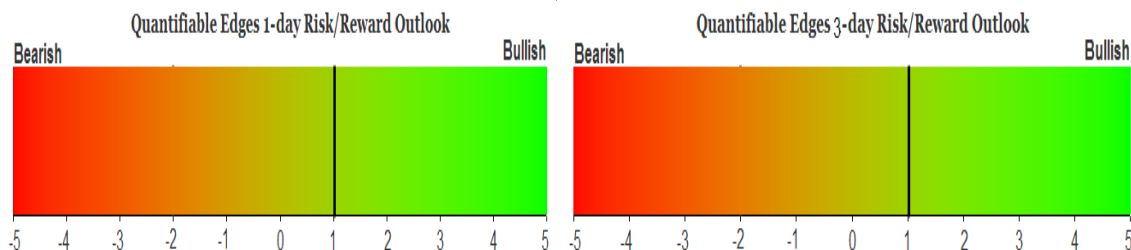
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 8, 2009

Volume 2 Issue 193

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				
October 7, 2009	2 75% Up Issue Days while SPX>200ma	1-4 days	Bullish	2.50%
Active - Long Term				
September 14, 2009	Nasdaq/S&P Lead/Lag Model		Bullish	
July 14, 2009	VIX:VXV drops below 0.9	2-5 months	Bearish	
Dropped Tonight				
October 7, 2009	CBOE Equity P/C 25% below 200ma	1 day	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 10/8

The Bottom Line

The tight range consolidation day gave little in the way of clues. With the uptrend in tact, failure to uncover bearish studies can be considered a positive. The fact that the market remains short-term overbought means upside risk/reward isn't as favorable as I'd like. The general outlook for tomorrow is neutral.

Of course the market looks to have a nice head start for a sizable gap up tomorrow as I write this late at night. Should this gap hold or increase as we approach the open, traders may want to [check out my gap studies](#).

The Evidence

Wednesday was generally a quiet trading day. The major indices didn't change much and the trading range was narrow. Breadth was close to breakeven. The NYSE Up Issues % came in at 52% and the Up Volume % was 54%. Volume was the lightest in over a week.

Tonight's studies are a clear example of why it is important to keep the long-term trend in mind when evaluating results. In April I did a study that appeared in the Quantifinder tonight. It looked at inside days when the SPY had closed higher for at least 3 days in a row.

SPY has inside day and has closed higher at least 3 days in a row. Buy on close. Sell X days later. \$100k/trade. 2001 - 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	-47,263.01	24	12	12	50.00	1,533.07	-5,471.65	0.28	0.28	-1,969.29
9	-39,539.26	24	14	9	58.33	1,442.13	-6,636.56	0.22	0.34	-1,647.47
8	-26,800.23	24	13	11	54.17	1,588.08	-4,313.21	0.37	0.44	-1,116.68
7	-35,226.98	24	13	11	54.17	1,182.96	-4,600.50	0.26	0.30	-1,467.79
6	-29,531.60	24	10	14	41.67	1,031.44	-2,846.14	0.36	0.26	-1,230.48
5	-22,357.24	24	9	15	37.50	1,197.58	-2,209.03	0.54	0.33	-931.55
4	-23,675.20	24	9	15	37.50	993.87	-2,174.67	0.46	0.27	-986.47
3	-27,490.35	24	6	18	25.00	1,312.21	-1,964.65	0.67	0.22	-1,145.43
2	-11,555.58	25	10	15	40.00	743.03	-1,265.73	0.59	0.39	-462.22
1	-5,002.22	25	12	13	48.00	945.29	-1,257.36	0.75	0.69	-200.09

From these results it appears that a consolidation day provided a significant hint that the run-up is running out of steam and the market is likely to drop. But what if we take these results and break them out by those times the market was in a long-term uptrend vs. a long-term downtrend? I used the 200-day moving average to measure trend. Downtrending situations first:

SPY has inside day and has closed higher at least 3 days in a row. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 2001 - 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	-55,854.65	9	1	8	11.11	1,459.77	-7,164.30	0.20	0.03	-6,206.07
9	-45,743.07	9	3	5	33.33	1,844.66	-10,255.41	0.18	0.11	-5,082.56
8	-34,994.47	9	3	6	33.33	1,841.00	-6,752.91	0.27	0.14	-3,888.27
7	-41,745.49	9	3	6	33.33	719.10	-7,317.13	0.10	0.05	-4,638.39
6	-29,956.59	9	3	6	33.33	798.80	-5,392.17	0.15	0.07	-3,328.51
5	-24,450.03	9	2	7	22.22	1,004.43	-3,779.84	0.27	0.08	-2,716.67
4	-22,191.81	9	2	7	22.22	603.80	-3,342.77	0.18	0.05	-2,465.76
3	-25,382.91	9	1	8	11.11	1,455.52	-3,354.80	0.43	0.05	-2,820.32
2	-11,820.10	9	3	6	33.33	616.23	-2,278.13	0.27	0.14	-1,313.34
1	-4,141.93	9	4	5	44.44	1,825.69	-2,288.94	0.80	0.64	-460.21

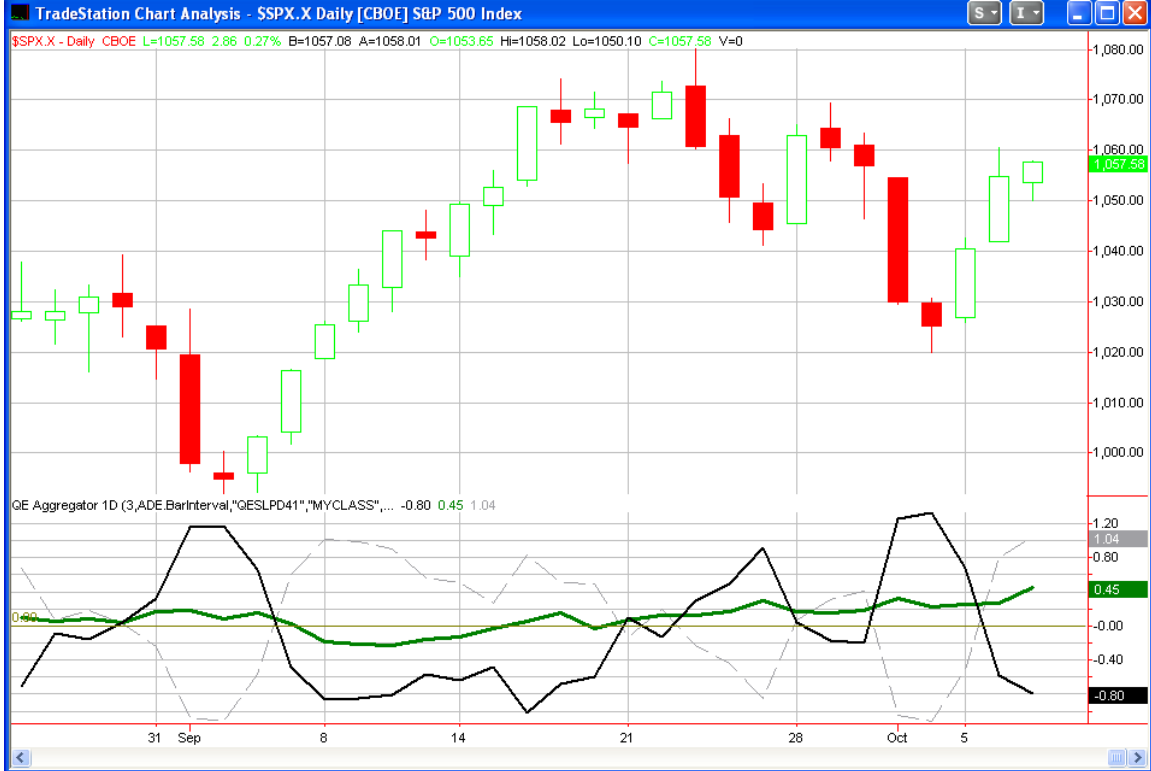
While instances are a bit low, the stats are extremely skewed to the bearish side. So how does this leave the instances above the 200ma?

**SPY has inside day and has closed higher at least 3 days in a row. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 2001 - 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: WinLoss Ratio	All: ProfitFactor	All: Avg Trade
10	8,591.64	15	11	4	73.33	1,539.73	-2,086.35	0.74	2.03	572.78
9	6,203.81	15	11	4	73.33	1,332.35	-2,113.00	0.63	1.73	413.59
8	8,194.24	15	10	5	66.67	1,512.21	-1,385.57	1.09	2.18	546.28
7	6,518.51	15	10	5	66.67	1,322.12	-1,340.54	0.99	1.97	434.57
6	424.99	15	7	8	46.67	1,131.14	-936.63	1.21	1.06	28.33
5	2,092.79	15	7	8	46.67	1,252.77	-834.58	1.50	1.31	139.52
4	-1,483.39	15	7	8	46.67	1,105.32	-1,152.58	0.96	0.84	-98.89
3	-2,107.44	15	5	10	33.33	1,283.55	-852.52	1.51	0.75	-140.50
2	264.52	16	7	9	43.75	797.37	-590.79	1.35	1.05	16.53
1	-860.29	16	8	8	50.00	505.09	-612.63	0.82	0.82	-53.77

What we see here is that there really isn't a substantial edge when the market is in an uptrend. Over the last few months we certainly have been in an uptrend. I don't see today's action as particularly significant based on this.

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



The Aggregator chart configuration remains much the same as yesterday. The green Aggregator line illustrates the positive expectations from the studies and the black

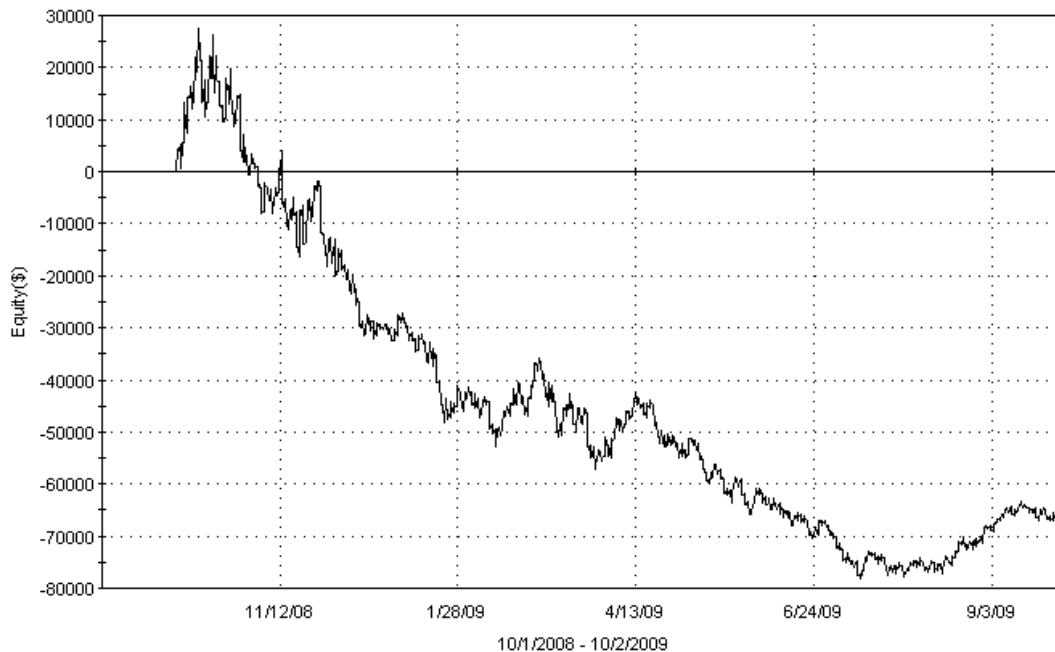
Differential line shows how the market is already substantially overbought vs. expectations. Both lines on the opposite side of 0 suggest poor risk/reward and a relatively neutral bias. The Aggregator system remains flat. I'm not looking to add more exposure at this time.

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 1st 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>

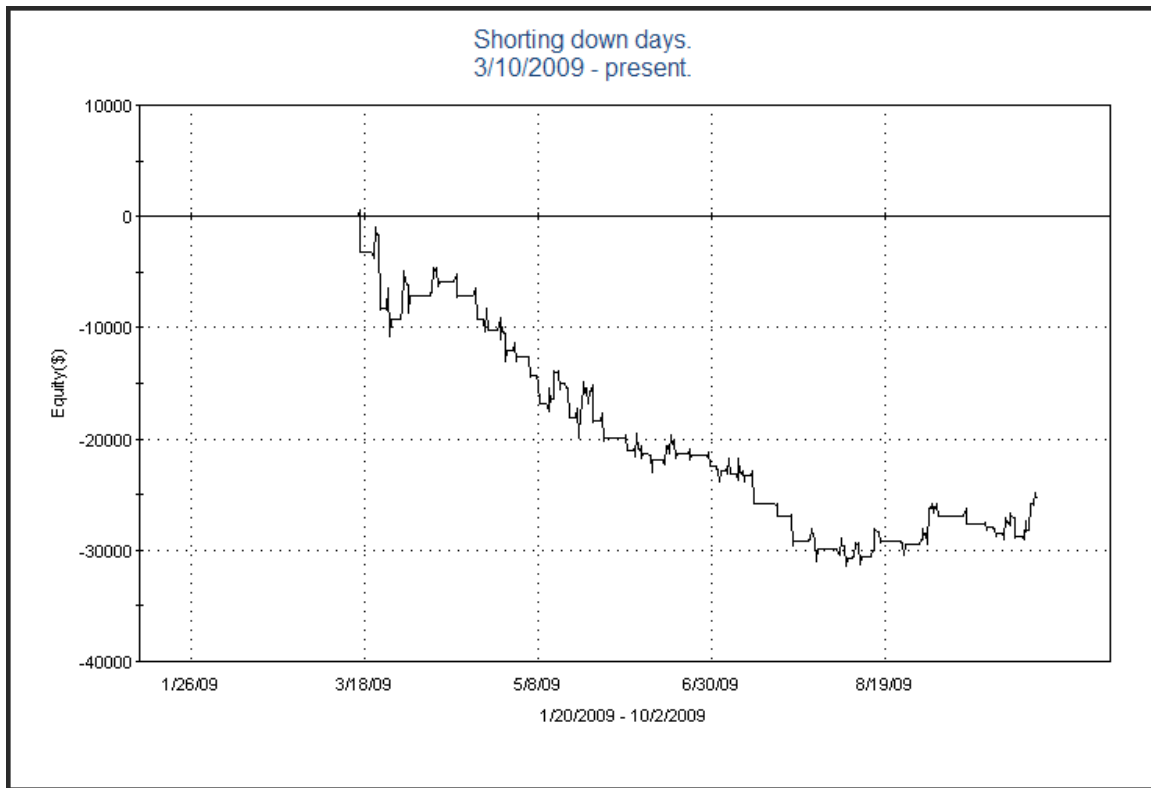
Below is a copy of the Trend vs. Chop chart from the website.



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 crapshoot. 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 1st 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 1st 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 1st 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

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
IBB	10/1/2009	\$81.21	\$79.33	-2.31%		system 80609
XXR(1/3)	10/2/2009	\$7.32	\$7.25	-0.96%	\$7.15	Catapult

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