

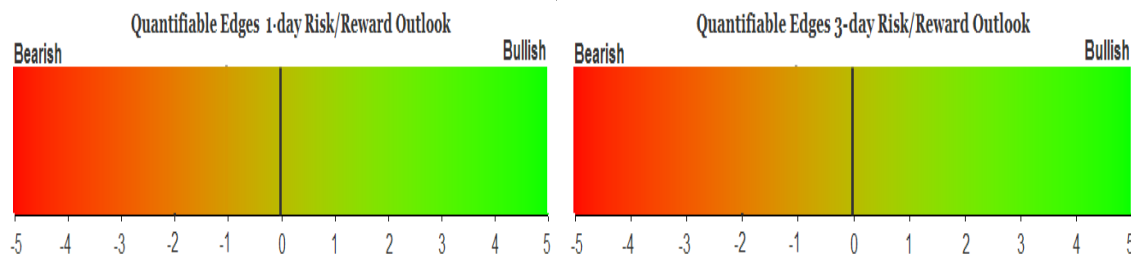
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 24, 2010

Volume 3 Issue 36

Market Overview



Tonight's Research Points

- Strong move down on 2:1 negative volume suggests bullish edge.
- QQQQ posting a new 5-day low for the 1st time in a while suggests bullish edge.
- The Aggregator System changed to flat.
- The NDX Aggressive Trend Timer remains flat.

Short-term Outlook – updated 2/24

The Bottom Line

There are some signs the selling on Tuesday is already enough to prompt a bounce. There still remain some bearish studies outstanding, though. These are managing to keep the net expectation from the Active Studies negative. With the edge unclear I'm happily flat and patiently awaiting the next substantial opportunity.

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				
February 24, 2010	1% drop and up issue % < 33.33%	1-9 days	Bullish	3.00%
February 23, 2010	SPY Lowest Vol 20 & Close > 10ma	1-5 days	Bearish	-2.10%
February 19, 2010	VXO 15% under 10ma. SPX > 200ma	1-5 days	Bearish	-1.80%
February 12, 2010	2 of 3 75% Up Issues % No 10-day high	1-9 days	Bearish	-4.40%
Active - Long Term				
February 22, 2010	VIX:VXV Ratio falls below 0.9	int. term	Bearish	
February 22, 2010	Good 5 days after FTD	int. term	Bullish	
February 16, 2010	Nasdaq/S&P RS Indicator Positive	int. term	Bullish	
February 12, 2010	IBD Follow Through Day	int. term	Bullish	
February 8, 2010	Worden %>200ma - %>40ma > 40	3 - 7 weeks	Bullish	
February 1, 2010	McClellan -60 for 6 days in a row	1-20 days	Bearish	
January 13, 2010	No bearish divergence at high	int. term	Bullish	

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

The Evidence

The pullback we've been expecting finally arrived on Tuesday – and so did the volatility increase. Anyone who played the 30-minute ORB as discussed last night would have done well – although it was tough to catch as the consumer confidence report sparked a very fast decline right after 10am. The indices all finished down substantially as the SPX, Nasdaq, and Russell all finished down between 1.1% and 1.3%. Breadth was strongly negative as the Up Issues % came in at 30% and the Up Volume % was 13%. Total volume rose to above average.

One aspect of the day's trading that I found interesting was that although there was a sizable selloff in the SPY from open to close, the 1-minute cumulative TICK reading (popularized by Dr. Brett Steenbarger) closed positive on the day. This is unusual but after examining it several different ways I didn't find it terribly predictive. There was some hint of a downside edge but that really only held true when the market was trading below its 200ma.

There were a few studies identified by the Quantifinder tonight that are worth noting. First, the strong selloff on 2 to 1 negative breadth brought about the below study from the 5/12/09 subscriber letter which I have updated.

SPX closes down over 1% and decliners double advancers. Yesterday did not close at a 20-day high. Buy on close. Sell X days later. \$100k/trade. 10/20/87 - 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	235,725.27	229	151	78	65.94	2,965.10	-2,718.01	1.09	2.11	1,029.37
9	275,998.54	238	168	70	70.59	2,801.49	-2,780.75	1.01	2.42	1,159.66
8	237,952.84	250	166	83	66.40	2,767.61	-2,668.33	1.04	2.07	951.81
7	234,252.83	268	169	99	63.06	2,640.53	-2,141.38	1.23	2.10	874.08
6	214,029.46	283	179	104	63.25	2,516.92	-2,274.03	1.11	1.90	756.29
5	198,277.21	306	186	120	60.78	2,332.79	-1,963.51	1.19	1.84	647.96
4	157,396.16	326	193	133	59.20	2,124.88	-1,900.04	1.12	1.62	482.81
3	160,749.71	357	223	134	62.46	1,831.31	-1,848.01	0.99	1.65	450.28
2	155,449.73	406	232	174	57.14	1,726.78	-1,408.99	1.23	1.63	382.88
1	103,402.22	455	268	187	58.90	1,144.88	-1,087.83	1.05	1.51	227.26

I filtered this one a few other ways as well but results weren't substantially different than the baseline shown here. It suggests a bullish edge over the next several days.

Another study that appeared involved QQQQ making a 5-day closing low for the 1st time in a while. This was from the 8/7/09 blog and I've updated it below.

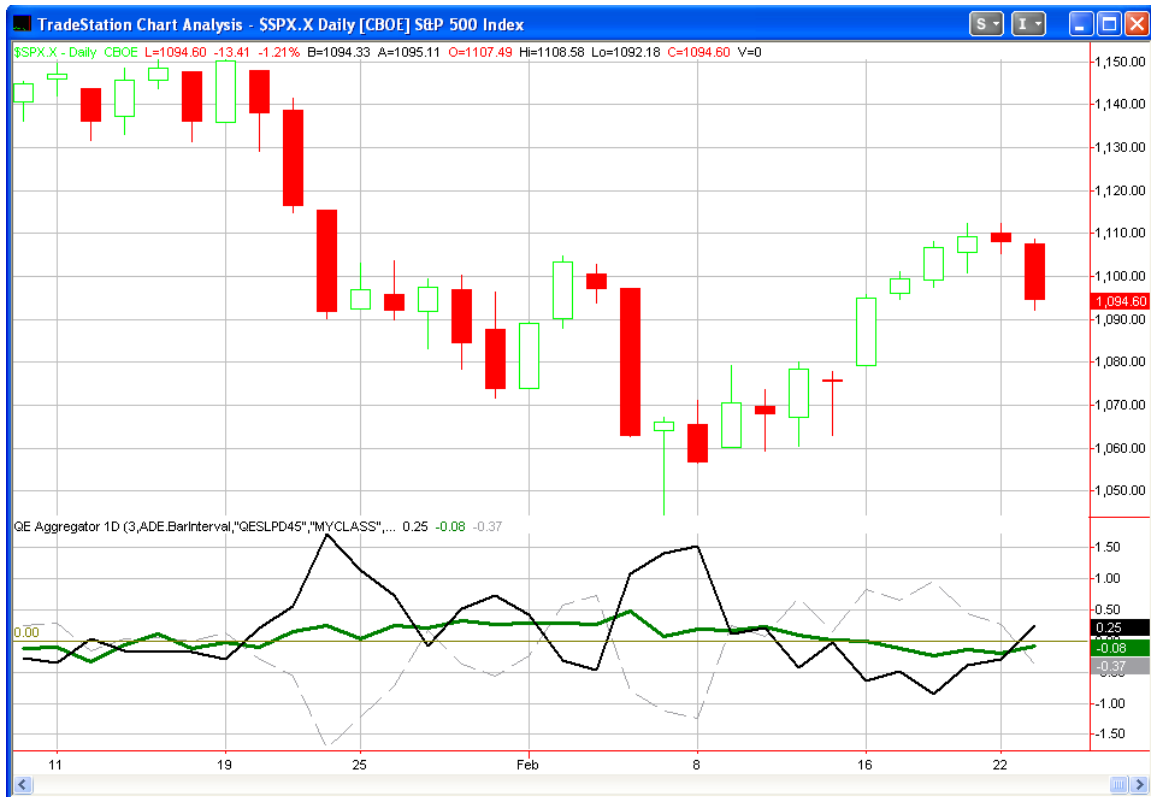
QQQQ closes at a 5-day low after not having done so for at least 10 days.
Buy on close. Sell X days later. \$100k/trade. 2000 - present.

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	55,541.42	59	36	22	61.02	3,610.18	-3,382.95	1.07	1.75	941.38
9	50,394.97	59	34	25	57.63	3,514.14	-2,763.43	1.27	1.73	854.15
8	42,250.13	59	33	25	55.93	3,542.74	-2,986.41	1.19	1.57	716.10
7	37,858.89	59	35	24	59.32	3,439.78	-3,438.89	1.00	1.46	641.68
6	46,450.58	59	32	27	54.24	3,711.53	-2,678.46	1.39	1.64	787.30
5	32,143.32	59	33	26	55.93	3,144.01	-2,754.20	1.14	1.45	544.80
4	14,892.31	59	34	24	57.63	2,449.40	-2,857.81	0.86	1.21	249.02
3	13,895.82	59	32	27	54.24	2,451.98	-2,391.39	1.03	1.22	235.52
2	24,613.73	59	38	21	64.41	1,554.89	-1,641.53	0.95	1.71	417.18
1	11,397.97	59	37	22	62.71	1,060.78	-1,265.95	0.84	1.41	193.19

78% of instances closed above the entry price on one of the next 2 days.

Here too we see a decent, though not overwhelming edge. In this case it relates to the QQQQ.

So the selloff has begun and we're already seeing some signs that the market is readying to bounce back up. We still have several bearish studies on the board, though. The market has not pulled back enough yet for these studies to reach their targets. A low in the SPX down around 1084 would see some targets being met and would make a substantial difference in the Aggregator calculation. So for now with the studies mixed the [Aggregator](#) chart is shown below.



Today's big move down resulted in a change to the configuration of the Aggregator chart. The black Differential line has crossed back above zero as the SPX has now underperformed expectations over the last few days. Meanwhile, the green Aggregator line remains below zero, signifying the net expectation from the active studies list is for more short-term downside. When downside is expected but the market is already oversold versus expectations that is considered a neutral configuration. It caused the Aggregator System to go flat at the close today. This last system trade took some patience but did close out with a gain of nearly 0.5% and put the Aggregator System at another new high.

Looking ahead the green Aggregator line is scheduled to remain negative tomorrow without some additional bullish evidence. The Differential pivot level is 1,103.55. So it would take an SPX close at or above this level to see the Differential flip back to negative territory.

Bottom line is whatever edge exists doesn't appear too strong at the moment. I'm glad to be flat and am awaiting the next substantial edge before putting capital at risk.

Intermediate-term Outlook (2 weeks – 2 months)– updated 2/22 – bullish

It has now been 5 trading days since the 2/11 classic Follow Through Day (a gain of 1% or more on higher volume). In the February 1, 2008 blog post I examined implications of market action directly after FTD's. In that post I found this early action to be a strong indication of whether a FTD was likely to succeed or not. I've pasted the pertinent information from that post below:

Is short-term success or failure indicative of long-term success or failure?

One interesting claim that IBD sometimes makes about Follow Through Days is that those that fail normally do so shortly after the Follow Through Day. I decided to also look at this concept tonight.

I broke the 64 Follow Through Days in my study up into two groups – the successful ones and the unsuccessful ones – to see if their early performance hinted at their chance of longer-term success. Below are the breakdowns – same as above - \$100,000/trade, long at the close of the Follow Through Day, and exit X days later.

Early action after Follow Through Days that eventually “succeeded”:

Successful FTD's										
Days Held	Net Profit	Trades	% Profitable	Wins	Losses	Avg Win	Avg Loss	Win/Loss Ratio	Avg Trade	ProfitFactor
10	\$78,896.61	35	71.43	25	10	\$3,547.95	(\$980.23)	3.62	\$2,254.19	9.05
5	\$62,786.42	35	77.14	27	8	\$2,795.15	(\$1,585.33)	1.76	\$1,793.90	5.95
4	\$53,316.64	35	68.57	24	11	\$2,754.82	(\$1,163.56)	2.37	\$1,523.33	5.17
3	\$52,666.31	35	65.71	23	12	\$2,773.65	(\$927.31)	2.99	\$1,504.75	5.73
2	\$52,742.34	35	71.43	25	10	\$2,508.30	(\$996.53)	2.52	\$1,506.92	6.29
1	\$25,494.79	35	57.14	20	15	\$1,690.62	(\$554.51)	3.05	\$728.42	4.07

Right off the bat most of these posted nice gains. The short-term winners among the group averaged another 2-3% upside in the first week. The short-term losers suffered 1-1.5% drops on average. Net profits were substantial.

Early action after Follow Through Days that eventually “failed”:

Unsuccessful FTD's										
Days Held	Net Profit	Trades	% Profitable	Wins	Losses	Avg Win	Avg Loss	Win/Loss Ratio	Avg Trade	ProfitFactor
10	(\$46,481.75)	29	34.48	10	19	\$1,818.19	(\$3,403.35)	0.53	(\$1,602.82)	0.28
5	(\$17,048.80)	29	48.28	14	15	\$1,651.24	(\$2,677.74)	0.62	(\$587.89)	0.58
4	(\$15,244.85)	29	44.83	13	16	\$1,465.84	(\$2,143.80)	0.68	(\$525.68)	0.56
3	(\$18,577.18)	29	44.83	13	16	\$1,358.57	(\$2,264.91)	0.60	(\$640.59)	0.49
2	(\$22,069.98)	29	37.93	11	18	\$764.94	(\$1,693.58)	0.45	(\$761.03)	0.28
1	(\$7,847.64)	29	41.38	12	17	\$425.76	(\$762.16)	0.56	(\$270.61)	0.39

Those that eventually failed tended to show signs of failure right away. Notable here is the average loss was appreciably higher than the average gain.

A basic rule of thumb is that the success or failure was determined with about 67% reliability within the first week after a Follow Through Day. For instance, note there were 41 total trades that were in the black after 5 days. About 2/3 of them went on to “successful” rallies. The same ratio applies for the losers. There were 23 losers after 5 days. 15 of them ended up with “failed” rallies and the other 8 were “successful”. The 2/3 rule holds fairly accurate whether you are looking at winners or losers over any period from 1-5 days after the Follow Through Day.

In the current situation “success” would be a move to 1,147.41 or higher. This is just barely under the recent high of 1,150.45. In other words, based on this study, there appears to be a good chance the market will at least test its January highs before it breaks its February lows. This is consistent with what some breadth-based studies have been suggesting as well. One thing to note is that there still has not been a FTD under the current IBD definition, so it will be interesting to see what happens here.

In the 8/25/08 Letter I took a look at the VIX:VXV Ratio. The VIX measures option volatility out 30 days. The VXV uses the same calculation but measures out 90 days. Their values and movement are frequently quite close. When the VIX moves significantly above or below the VXV then that can provide us clues about volatility expectations for the short and intermediate-term. It can also serve as a directional indicator.

Below is a study which shows how the market has performed in the past when the ratio has closed below 0.90. The VXV has only been around since December of 2006. The CBOE did calculate it back several more years though. I have been able to acquire their data back to 2002 and have included that in the below test. (This test is updated this evening.)

VIX:VXV Ratio closes below 0.9. Buy SPX on close. Sell X days later. \$100k/trade. 2002 - 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	-4,442.58	43	22	21	51.16	2,186.37	-2,502.04	0.87	0.92	-103.32
19	-10,329.29	43	21	22	48.84	2,220.84	-2,589.40	0.86	0.82	-240.22
18	-10,876.03	44	24	20	54.55	1,905.02	-2,829.82	0.67	0.81	-247.18
17	-14,987.62	47	21	26	44.68	2,028.94	-2,215.21	0.92	0.74	-318.89
16	-16,199.26	48	23	25	47.92	1,912.11	-2,407.11	0.79	0.73	-337.48
15	-21,761.97	50	21	29	42.00	1,949.85	-2,162.37	0.90	0.65	-435.24
14	-10,729.05	51	27	24	52.94	1,448.82	-2,076.96	0.70	0.78	-210.37
13	-13,941.59	53	27	26	50.94	1,456.47	-2,048.71	0.71	0.74	-263.05
12	-15,839.97	58	28	30	48.28	1,658.39	-2,075.83	0.80	0.75	-273.10
11	-17,699.50	64	29	35	45.31	1,562.96	-1,800.73	0.87	0.72	-276.55
10	-12,567.24	66	32	34	48.48	1,488.73	-1,770.78	0.84	0.79	-190.41
9	-14,368.33	69	34	35	49.28	1,367.34	-1,738.79	0.79	0.76	-208.24
8	-13,688.32	79	39	40	49.37	1,388.88	-1,696.36	0.82	0.80	-173.27
7	-9,774.28	85	41	44	48.24	1,391.65	-1,518.90	0.92	0.85	-114.99
6	2,022.44	94	54	40	57.45	1,072.94	-1,397.90	0.77	1.04	21.52
5	-3,073.73	112	59	53	52.68	1,077.12	-1,257.06	0.86	0.95	-27.44
4	-13,685.22	132	64	68	48.48	975.78	-1,119.64	0.87	0.82	-103.68
3	-3,066.23	165	82	83	49.70	907.91	-933.92	0.97	0.96	-18.58
2	-461.82	224	117	107	52.23	692.06	-761.05	0.91	0.99	-2.06
1	-2,914.87	408	223	185	54.66	452.16	-560.79	0.81	0.97	-7.14

In the 8/25/08 Letter the results appeared substantially more bearish. What we see here is a market that is more likely to struggle rather than a suggestion of a strong selloff. In that Letter I also looked at a strategy that would sell short the SPX on a cross below 0.9 and would cover the position only when the ratio moved back above 1. I have updated those results below:

VIX:VXV Ratio closes below 0.9. Buy SPX on close.
 Sell when VIX:VXV ratio closes > 1. \$100k/trade. 2002 - present.

TradeStation Performance Summary Collapse ↕			
All Trades			
Total Net Profit	\$15,335.22	Profit Factor	1.48
Gross Profit	\$47,017.77	Gross Loss	(\$31,682.55)
Total Number of Trades	18	Percent Profitable	72.22%
Winning Trades	13	Losing Trades	5
Even Trades	0		
Avg. Trade Net Profit	\$851.96	Ratio Avg. Win:Avg. Loss	0.57
Avg. Winning Trade	\$3,616.75	Avg. Losing Trade	(\$6,336.51)
Largest Winning Trade	\$8,774.18	Largest Losing Trade	(\$13,215.96)

While these appear to suggest a mild downside edge the stats are not nearly as convincing as they were a year and a half ago. If we look at the individual trade breakdown we can easily see why the stats have changed so dramatically.

VIX:VXV Ratio closes below 0.9. Buy SPX on close.
 Sell when VIX:VXV ratio closes > 1. \$100k/trade. 2002 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/02/03	Short	\$909.03	5.24%	\$5,425.20
01/24/03	Cover	\$861.40		(\$2,862.20)
08/12/03	Short	\$990.35	(5.38%)	\$999.00
11/17/03	Cover	\$1,043.63		(\$7,330.00)
01/16/04	Short	\$1,139.82	2.90%	\$2,953.65
03/11/04	Cover	\$1,106.79		(\$2,036.67)
03/25/04	Short	\$1,109.28	4.15%	\$4,234.50
08/12/04	Cover	\$1,063.23		(\$3,716.10)
08/25/04	Short	\$1,104.96	(2.28%)	\$1,329.30
10/29/04	Cover	\$1,130.20		(\$3,338.10)
12/09/04	Short	\$1,189.24	3.85%	\$3,974.88
04/15/05	Cover	\$1,143.43		(\$3,349.08)
06/02/05	Short	\$1,204.29	2.28%	\$2,995.47
10/13/05	Cover	\$1,176.84		(\$3,450.31)
11/25/05	Short	\$1,268.25	(2.91%)	\$1,755.78
05/01/06	Cover	\$1,305.19		(\$3,892.98)
07/03/06	Short	\$1,280.19	2.96%	\$3,023.28
07/13/06	Cover	\$1,242.28		\$0.00
08/16/06	Short	\$1,295.43	(8.01%)	\$457.38
02/27/07	Cover	\$1,399.14		(\$12,792.78)
06/19/07	Short	\$1,533.70	2.66%	\$2,805.40
06/26/07	Cover	\$1,492.89		(\$235.30)
10/09/07	Short	\$1,565.15	3.62%	\$4,762.17
11/01/07	Cover	\$1,508.45		(\$689.22)
12/20/07	Short	\$1,460.12	3.32%	\$3,327.24
01/04/08	Cover	\$1,411.62		(\$2,633.64)
05/12/08	Short	\$1,403.58	8.80%	\$9,342.18
06/30/08	Cover	\$1,280.00		(\$2,602.86)
08/21/08	Short	\$1,277.71	4.16%	\$4,717.44
09/09/08	Cover	\$1,224.54		(\$1,975.74)
06/25/09	Short	\$920.26	(13.30%)	\$5,501.52
10/28/09	Cover	\$1,042.63		(\$19,558.80)
11/17/09	Short	\$1,110.32	1.70%	\$2,392.20
11/27/09	Cover	\$1,091.50		(\$185.40)
12/01/09	Short	\$1,108.86	1.54%	\$2,034.00
01/22/10	Cover	\$1,091.76		(\$3,743.10)
02/19/10	Short	\$1,109.17	n/a	\$0.00
open	n/a	\$1,109.17		\$0.00

From the end of June to the end of October there was a strong rally in the face of a low VIX:VXV ratio. Was this rally an anomaly or has the indicator lost its edge? It's tough to tell. My inclination is that the rally over this time period was unusually strong in many ways and just because this indicator got run over then doesn't mean it's entirely useless. So I'll add it to the intermediate-term active studies as something to keep in mind but it won't be factoring in to the Aggregator calculation at this point.

So while we are short-term overbought and a pullback appears imminent, my intermediate-term bias is to the long side. I'm of the opinion that the market will at least test the January highs. If I'm right then I'll be looking for more clues as we approach that level that may hint whether the recent selloff was a warning shot and we're likely in a topping pattern, or whether the rally can gain enough momentum to put in another leg higher beyond the January highs.

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. Awaiting a better edge.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	2/18/2010	\$110.26	\$110.20	0.05%		closed
SPY(1/4)(s)	2/18/2010	\$110.91	\$110.20	0.64%		closed

In an intraday update sent to subscribers I placed a stop on the SPY trade idea at \$110.20. It's unclear whether this stop would've triggered. While I see it touching right on that number on the 5-minute chart I did have an actual stop set which didn't trigger. So it was likely either a bad tick or a trade that took place outside the bid/offer spread. In any case, hopefully traders managed to avoid being stopped out there and were able to fair a bit better. Since my stop never triggered I waited until just before the bell to close out my personal position. For trade idea tracking in the Letter I assumed the worst possible fill and included that in the table above.

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