

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 11, 2010

Volume 3 Issue 47

## Market Overview



## Tonight's Research Points

- VIX up & SPX up for a 2<sup>nd</sup> day in a row suggests short-term bearish implications.
- Hitting a new 15-day high on high volume no longer appears bullish as it once did.
- The Aggregator System remains flat.
- The NDX Aggressive Trend Timer remains flat.

## Short-term Outlook – updated 3/11

### The Bottom Line

Too overbought to buy. Not enough compelling downside evidence to short.

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	Avg MM - 1/3 Std Dev
<b>Active</b>					
March 11, 2010	SPX up VIX up > 200ma twice	1-3 days	Bearish	-1.20%	-0.80%
March 9, 2010	After 5 up, down today but > 200ma	1-10 days	Bullish	2.10%	1.60%
March 9, 2010	SPY 10-high low vol 20 > 200ma	1-4 days	Bearish	-1.70%	-1.30%
March 8, 2010	90% Up Vol on at least 3rd day up	1-7 days	Bullish	3.10%	2.20%
<b>Active - Long Term</b>					
March 10, 2010	Ttl Put/Call 40-low. SPX no 0.5% up.	1-5 weeks	Bearish	-4.90%	-3.30%
February 22, 2010	VIX:VXV Ratio falls below 0.9	int. term	Bearish		
February 16, 2010	Nasdaq/S&P RS Indicator Positive	int. term	Bullish		
February 8, 2010	Worden %>200ma - %>40ma > 40	3 - 7 weeks	Bullish		
January 13, 2010	No bearish divergence at high	int. term	Bullish		
<b>Dropped Tonight</b>					
February 22, 2010	Good 5 days after FTD	int. term	Bullish		
February 12, 2010	IBD Follow Through Day	int. term	Bullish		
March 10, 2010	SPX higher high, NH's contract. Cl>200	1 day	Bearish		

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

### The Evidence

The buying continued on Wall St. Gains were seen in all the major indices. The S&P rose 0.5% while the Nasdaq and Russell posted 0.8% gains. Breadth was solidly positive as the NYSE Up Issues % came in at 66% and the Up Volume % at 75%. Total NYSE volume rose to the highest level in over 3 weeks. Also notable is that the VIX rose along with the market.

Most often the VIX and SPX move in opposite directions, but today marked the 2<sup>nd</sup> day in a row where they both closed higher. Since 1998 such setups have carried a bearish edge. And although there were just a small number of instances that occurred with the SPX below its 200ma, I felt it important to separate them since results have been so extreme below the 200ma. First let's look at other times like the present where the SPX is trading above its 200ma.

SPX and VIX both close higher 2 days in a row. SPX closes > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1998 - 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	-776.87	14	9	5	64.29	1,084.62	-2,107.68	0.51	0.93	-55.49
4	-5,506.75	14	7	7	50.00	919.10	-1,705.78	0.54	0.54	-393.34
3	-5,196.82	14	6	8	42.86	786.53	-1,239.50	0.63	0.48	-371.20
2	-4,268.43	14	4	10	28.57	688.12	-702.09	0.98	0.39	-304.89
1	-3,544.21	17	6	11	35.29	220.62	-442.54	0.50	0.27	-208.48
<b>All 17 instances posted at least 1 close below the entry price within the next 3 days.</b>										

While the average trade stats aren't huge, the tendency to sell off soon after is 100% accurate. Now let's peek at those times in which the setup occurred with the SPX below its 200ma.

SPX and VIX both close higher 2 days in a row. SPX closes < 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1998 - 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	-16,342.21	4	0	4	0.00	0.00	-4,085.55	0.00	0.00	-4,085.55
4	-19,238.00	4	0	4	0.00	0.00	-4,809.50	0.00	0.00	-4,809.50
3	-17,313.63	4	0	4	0.00	0.00	-4,328.41	0.00	0.00	-4,328.41
2	-15,014.48	4	0	4	0.00	0.00	-3,753.62	0.00	0.00	-3,753.62
1	-5,986.26	4	1	3	25.00	912.33	-2,299.53	0.40	0.13	-1,496.57

While it's too few instances for statistical significance, inclusion of the above results into the original test dramatically alters the results. By segregating the results I believe you are seeing a more realistic expectation.

One study that appeared in the Quantifinder that I am now removing looked at a 15 day price high occurring along with a 15-day high in volume. The original test looked all the way back to 1960. Results were not scrutinized closely at the time of the original test since it was actually low volume rises that were being examined then. The original test suggested bullish implications. Unfortunately the setup was only really bullish up until mid 1998. This can be seen clearly by breaking the study down by time period.

First, pre-1998.

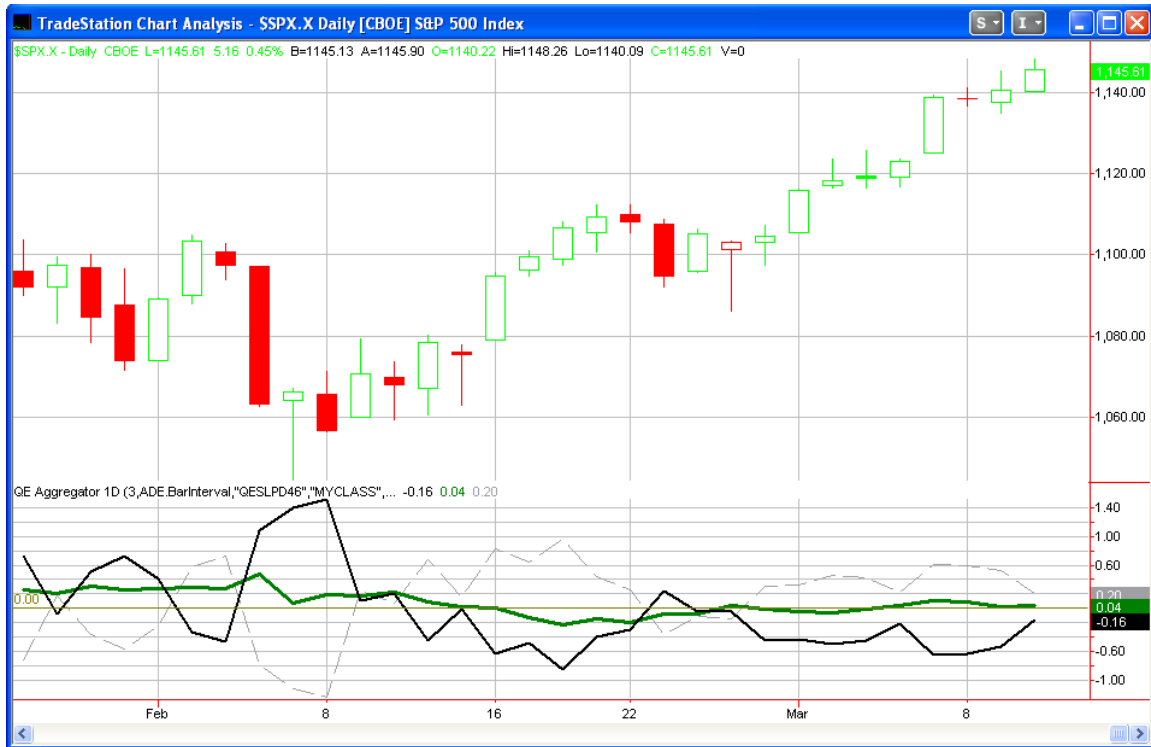
SPX makes highest close in 15 days on highest NYSE volume in 15 days. Buy on close. Sell X days later. \$100k/trade. 1970 - 6/98.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	75,067.57	173	102	71	58.96	2,165.74	-2,054.05	1.05	1.51	433.92
9	66,918.77	173	101	71	58.38	2,076.64	-2,011.57	1.03	1.47	386.81
8	55,278.19	175	95	80	54.29	2,059.54	-1,754.72	1.17	1.39	315.88
7	65,820.86	179	105	74	58.66	1,845.31	-1,728.87	1.07	1.51	367.71
6	66,505.61	189	110	78	58.20	1,744.11	-1,607.00	1.09	1.53	351.88
5	57,714.53	199	110	89	55.28	1,527.22	-1,239.09	1.23	1.52	290.02
4	60,263.64	202	116	86	57.43	1,298.96	-1,051.35	1.24	1.67	298.33
3	51,246.77	214	124	89	57.94	1,046.99	-882.92	1.19	1.65	239.47
2	50,815.36	224	125	98	55.80	897.26	-625.93	1.43	1.83	226.85
1	38,702.68	262	147	114	56.11	602.27	-437.11	1.38	1.78	147.72

Results here are plainly bullish. Now let's look at the same parameters from mid-98 through the present.

SPX makes highest close in 15 days on highest NYSE volume in 15 days. Buy on close. Sell X days later. \$100k/trade. 6/98 - 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	10,999.57	34	21	13	61.76	2,013.55	-2,406.54	0.84	1.35	323.52
9	9,211.40	34	20	14	58.82	1,934.63	-2,105.81	0.92	1.31	270.92
8	5,661.85	34	18	16	52.94	1,780.63	-1,649.34	1.08	1.21	166.53
7	-2,762.86	34	15	19	44.12	1,932.06	-1,670.73	1.16	0.91	-81.26
6	-13,140.65	34	14	20	41.18	1,819.69	-1,930.82	0.94	0.66	-386.49
5	-4,961.40	34	16	18	47.06	1,423.67	-1,541.12	0.92	0.82	-145.92
4	-3,200.84	36	15	21	41.67	1,490.18	-1,216.84	1.22	0.87	-88.91
3	-2,186.87	37	14	23	37.84	1,528.53	-1,025.49	1.49	0.91	-59.10
2	-3,487.39	38	17	21	44.74	678.91	-715.66	0.95	0.77	-91.77
1	-1,377.28	44	23	21	52.27	658.46	-786.76	0.84	0.92	-31.30

As you can see, there is no longer a bullish edge evident.

I've updated the [Aggregator](#) chart below.



Again we are seeing the same message from the Aggregator chart. This green Aggregator line in positive territory illustrates the expectation for upside from the studies over the next few days. Meanwhile the overbought condition of the market versus expectations can be easily seen with the black Differential line remaining solidly below 0. Overbought with positive expectations is considered a neutral configuration. The Aggregator System is again flat tonight.

Looking ahead the Aggregator line is set to remain positive for the next several days unless new studies are added or bullish target are achieved. The pivot level for the Differential line on Thursday will be 1,141.08. In other words, a close at or below this number would flip the Differential line positive.

Patience is required under the current circumstances. Just because the market is overbought doesn't mean it is a good short. The studies have kept me safely sidelined for the last several days and I'll continue to wait for a better risk/reward opportunity before putting capital to work.

### ***Intermediate-term Outlook (2 weeks – 2 months)– updated 3/8 – bullish***

With some intermediate-term breadth studies being incorporated into the short-term section this week I don't have much additional to discuss here. I do find it noteworthy that the follow through day study is very close to reaching its S&P target for a "successful" FTD. Meanwhile the Russell 2000 is already hitting new highs.

In the last few years IBD has changed their rules and stated that a 1.7% rally on higher volume should be required instead of a 1% rally. Ironically the first index to actually put in a 1.7% rally on higher volume since the February bottom is the Russell 2000, which

did it on Friday as it was hitting new highs. Not a great bottom call when you're already at new highs. Over the last few years I've suggested ignoring the new rule. In a study I did a little over 2 years ago [I showed how waiting for a 1.7% FTD would have missed several rallies](#). The current instance now serves as yet another example. Not that I see a huge value in the 1% FTD rule, but it has been at least marginally effective and can be used to set up a positive risk/reward scenario. Additionally, requiring a 1.7% FTD not only puts you at risk of missing the rally but it [also hasn't proven to be any more predictive than the original 1% requirement](#).

So short-term the market is overbought without convincing evidence suggesting an immediate decline, and the long-term is also not showing any compelling signs of a decline. I'll continue to stick with my bullish outlook in anticipation of more indices following the Russell 2000's lead and heading to new 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 – Patience remains key.*

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