

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 7, 2010

Volume 3 Issue 65

Market Overview



Tonight's Research Points

- Very low Equity Put/Call Ratio has led to downside in the past.
- The Aggregator System remained short at the close.
- The NDX Aggressive Trend Timer changed to long at the close.

Short-term Outlook – updated 4/7

The Bottom Line

The Put/Call ratio is now joining with the volume studies in suggesting downside lies ahead here soon. My short-term bias remains short and I am positioned to take advantage of it.

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
Active					
April 7, 2010	Equity P/C very low. SPX 50 high.	1-2 days	Bearish	-1.30%	-1.00%
April 6, 2010	70% Up Issues 2 days in row 50 high	1-8 days	Bullish	2.30%	1.60%
April 6, 2010	SPY 10 high and low vol 20	1-2 days	Bearish	-1.30%	-0.80%
April 5, 2010	High breadth 10, vol lower, SPX hi 10	1-3 days	Bearish	-1.10%	-0.70%
March 31, 2010	SPX up 3. Vol lower. Pct gain low.	1-5 days	Bearish	-1.70%	-1.30%
Active - Long Term					
April 6, 2010	SPX and TNX hit 50-day closing highs	int. term	Bearish		
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		
Dropped Tonight					
March 31, 2010	Low vol 20. SPX > 10ma & 200ma	1-3 days	Bearish	-1.20%	-0.80%

If the avg max move – 1/3 Std Dev is achieved the study will appear in **bold italic blue** and no longer be active.

The Evidence

More upside Tuesday as the relentless rally continues. After a gap down to open the day the major indices all finished higher. The SPX rose 0.2%, the Nasdaq 0.3% and the Russell 2000 finished up 0.6%. Breadth was mildly positive with the NYSE Up Issues % coming in at 56.5% and the Up Volume % at 63%. Total volume rose a bit from Monday's levels.

I've shown a lot of studies lately regarding price and especially volume. Tonight I'm going to show some research related to the CBOE Equity Put/Call ratio. When this ratio gets extremely low it can be viewed as a sign of over-optimism. It means people aren't willing to pay for put protection but may be buying up calls as a way to gain leverage. When studying Put/Call Ratios I always normalize using a long-term moving average. The primary reason for this is that "normal" put/call levels have varied greatly over time, and my studies are often looking for extremes. For further explanation you may see this old blog post from 2008:

<http://quantifiableedges.blogspot.com/2008/06/why-you-need-to-normalize-putcall-ratio.html>

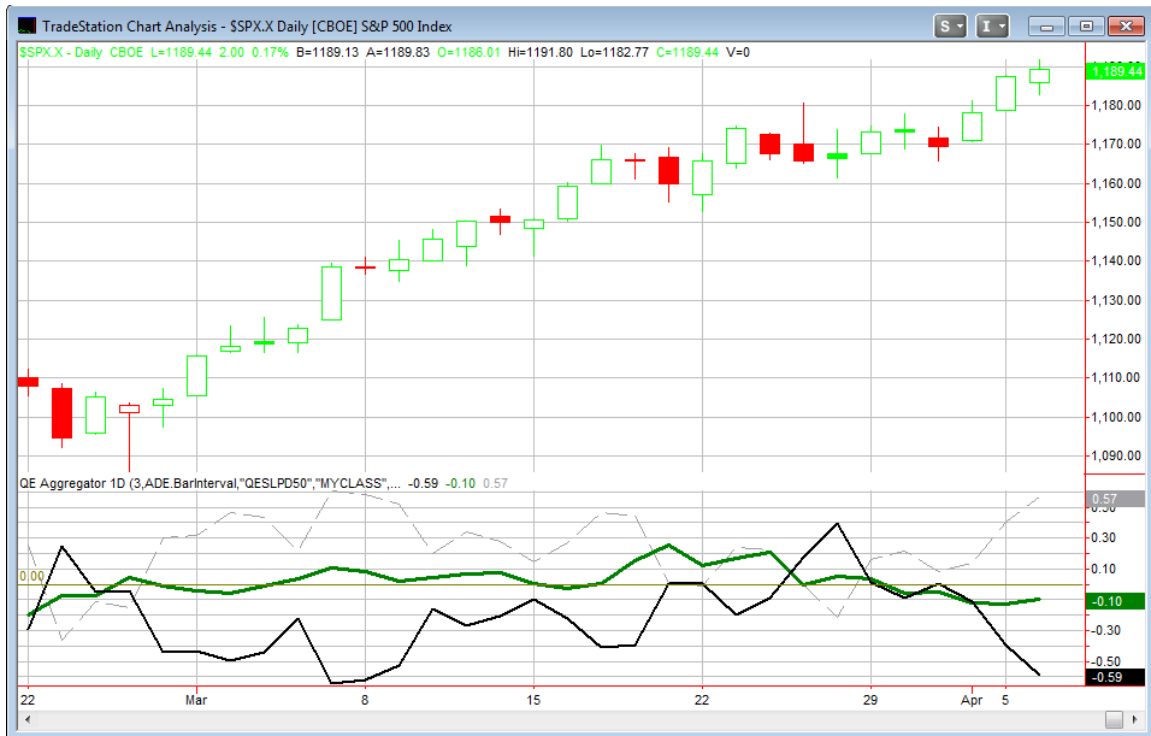
One moving average I look at with p/c ratios is the 10ma. Below is a study that looks at the level of the 10ma relative to the level of the 200ma.

10-day average of the CBOE Equity P/C Ratio is 15% below the 200-day average of the CBOE Equity P/C Ratio. SPX closes at a 50-day high. Buy SPX on close. Sell X days later. \$100k/trade. 2004-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	-7,160.94	11	5	6	45.45	873.09	-1,921.07	0.45	0.38	-650.99
9	-8,404.34	11	5	6	45.45	627.45	-1,923.60	0.33	0.27	-764.03
8	-8,288.26	11	5	6	45.45	597.40	-1,879.21	0.32	0.26	-753.48
7	-16,103.56	11	2	9	18.18	211.77	-1,836.34	0.12	0.03	-1,463.96
6	-8,450.89	12	3	9	25.00	698.47	-1,171.81	0.60	0.20	-704.24
5	-6,981.04	13	6	7	46.15	294.49	-1,249.71	0.24	0.20	-537.00
4	-10,576.19	16	5	11	31.25	391.08	-1,139.24	0.34	0.16	-661.01
3	-8,108.22	17	4	13	23.53	392.69	-744.54	0.53	0.16	-476.95
2	-14,159.63	21	6	15	28.57	331.54	-1,076.59	0.31	0.12	-674.27
1	-8,246.53	26	8	18	30.77	183.70	-539.78	0.34	0.15	-317.17

All 26 instances posted a close below the entry price at some point in the next 4 days.

A large portion of the downside edge is realized in the 1st 2-3 days. The edge does seem to play out a bit longer than that though. 100% of instances pulling back in short order is a compelling bit of evidence.

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



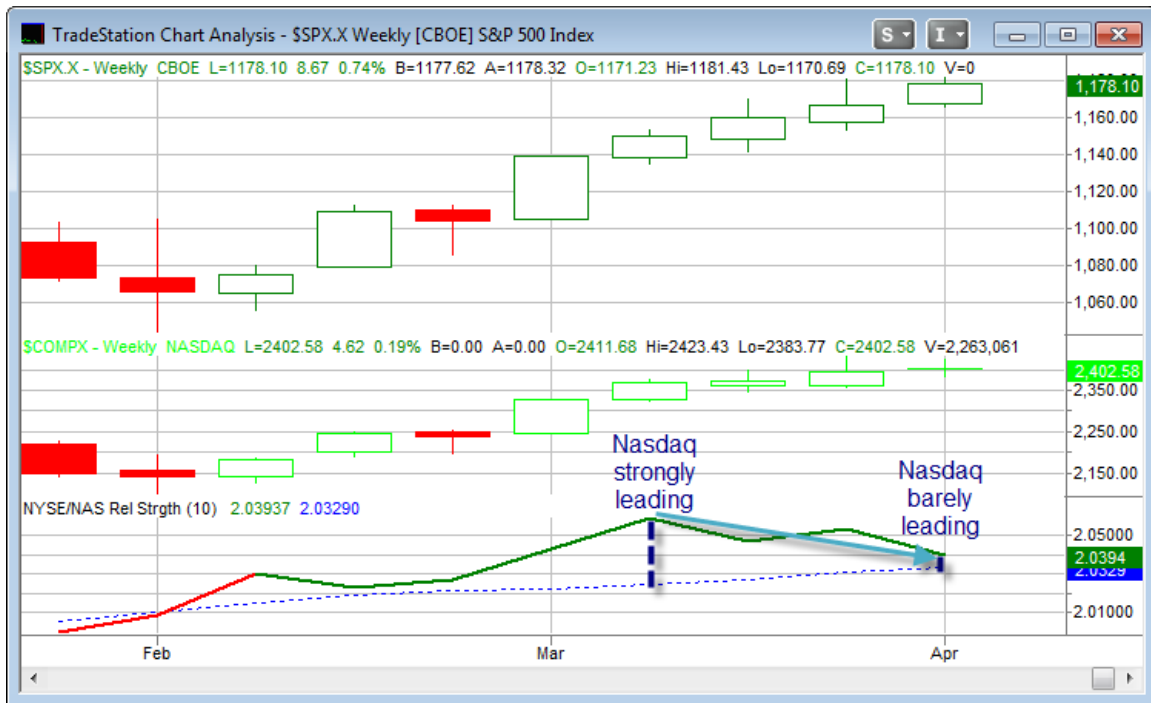
The configuration tonight is similar to last night. The green Aggregator line remains squarely below zero as bearish studies are expected to dominate over the next few days. Meanwhile the black Differential line is just about as negative as it was at any point in March. This illustrates the SPX's strong outperformance versus expectations over the last few days. Negative expectations and an overbought market have historically provided a downside edge. The Aggregator System remains short as of the close on Tuesday.

Looking ahead the green Aggregator line is again expected to remain negative tomorrow absent a large selloff or strongly bullish studies emerging. The Differential pivot will be at 1,175.35. In other words, it will take a close at or below this number in order to turn the Differential positive.

My bias remains short and I'll be looking to add the final piece to my short index position tomorrow should the market again move higher.

Intermediate-term Outlook (2 weeks – 2 months)– updated 4/5 slightly bullish

While the market hasn't really done anything wrong yet, it has failed to do much right recently. Volume is becoming a concern and we've seen studies this week suggesting some downside may be expected. Momentum has waned. And while the Nasdaq/S&P 500 relative strength indicator remains bullish, it's weakened quite a bit over the last few weeks. Below is a zoomed-in version of the chart that can be found on the charts page.



As a quick refresher, since the inception of the Nasdaq in 1971, nearly all of the S&P's gains have occurred while the Nasdaq was in a leading position. When the Nasdaq has been lagging the market has struggled to make any headway.

The chart above shows that while the Nasdaq is still in a leading position, that lead has been shrinking the last few weeks. It is at a point now where if the S&P outperforms this week there is a very good chance it will take over leadership.

I'm still favoring the long side but will be keeping an eye on these potential cracks.

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.

SPY – short 1/4 index position @ \$119.05 limit ON CLOSE. Based on short-term outlook above I am looking to add a the final piece.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	4/5/2010	\$118.25	\$119.05	-0.68%		
SPY(1/4)(s)	4/5/2010	\$118.76	\$119.05	-0.24%		
SPY(1/4)(s)	4/6/2010	\$118.76	\$119.05	-0.24%		

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