

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 15, 2010

Volume 3 Issue 71

Market Overview



Tonight's Research Points

- Lowest equity put/call ever seems to suggest a pullback likely.
- Tax Day and day after seasonally strong.
- Nasdaq 90% Up Volume day while SPX > 200ma has led to additional upside in the past.
- The Aggregator System went flat at the close.
- The NDX Aggressive Trend Timer remained flat.

Short-term Outlook – updated 4/15

The Bottom Line

We are again at a point where the market is so strong it may be suggesting more strength. Still, it is so overbought that a pullback is now necessary to find a lower-risk buy point. I'm sidelined and awaiting the next 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	Avg MM - 1/3 Std Dev
Active					
April 15, 2010	Tax Day	1-2 days	Bullish	1.50%	1.00%
April 15, 2010	Nasdaq 90% Up Vol	1-3 days	Bullish	1.60%	1.40%
April 15, 2010	New highwith put/call low	1-2 days	Bearish		
April 14, 2010	SPX up VIX up midweek at 50 high	1-2 days	Bearish	-0.80%	-0.60%
April 13, 2010	SPY up w/ vol low 3 days	1-3 days	Bearish		
Active - Long Term					
April 13, 2010	Ttl Put/Call 40-low. SPX no 0.5% up.	1-5 weeks	Bearish	-4.90%	-3.30%
April 13, 2010	VIX:VXV hits 100-day low	int. term	Bearish		
April 6, 2010	SPX and TNX hit 50-day closing highs	int. term	Bearish		
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					
April 6, 2010	70% Up Issues 2 days in row 50 hig	1-8 days	Bullish	2.30%	1.60%

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

The rally that has been so incredibly strong and persistent over the last couple of months actually gained steam on Wednesday. It started with a gap up thanks in large part to a positive earnings report from Intel. After consolidating early in the morning the market broke higher and put in an upside trend day. The SPX rose 1.1%, the Nasdaq was up 1.6% and the Russell 2000 posted a 2.2% gain. Breadth was strong. On the NYSE the Up Issues % came in at 76% and the Up Volume % at 82%. Nasdaq breadth was even stronger as the Nasdaq posted a 90% Up Volume day. Total volume was high, especially on the Nasdaq.

I'm beginning to see some remarkable readings during this rally. One is with the CBOE Equity Put/Call Ratio. On Wednesday it finished at 0.32. This means that there were more than twice as many calls traded as puts. Data goes back as 2004 and this is the first time in its history that this has happened. Low readings are often a sign of too much complacency and they lead to market pullbacks. Of course we've seen numerous low readings lately. Below is a study from Sunday night's Letter that triggered again today. (Stats not updated.)

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	-7,694.10	18	5	13	27.78	396.98	-744.54	0.53	0.21	-427.45
2	-14,411.63	22	6	16	27.27	331.54	-1,025.05	0.32	0.12	-655.07
1	-8,833.69	27	8	19	29.63	183.70	-542.28	0.34	0.14	-327.17

All 27 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. Of course it has triggered a couple of times in the last week and a half and is being run over. We also need to keep in mind that the current ratio is not just "low", but it is now the lowest ever. When things get this extreme, predicting outcomes becomes more difficult.

Also in Sunday night's Letter I discussed the positive bias on Tax Day and the day after. I've pasted that discussion below.


The reason tax day may be important is that it is the last day that people can make IRA contributions to count for the previous tax year. This can create a last-minute rush and

you will often have an inflow of funds heading into the market right around and on April 15th. Fund managers will often put this money to work immediately and it creates a positive bias for the market.

My research has found that some of the strongest influence occurs on tax day (normally April 15th) and the day immediately after. Below are some studies that demonstrate this.

SPX Tax Day Performance \$100k/trade. 1981 - 2009			
TradeStation Performance Summary			Collapse 
All Trades			
Total Net Profit	\$11,663.81	Profit Factor	3.84
Gross Profit	\$15,769.07	Gross Loss	(\$4,105.26)
Total Number of Trades	29	Percent Profitable	72.41%
Winning Trades	21	Losing Trades	8
Even Trades	0		
Avg. Trade Net Profit	\$402.20	Ratio Avg. Win:Avg. Loss	1.46
Avg. Winning Trade	\$750.91	Avg. Losing Trade	(\$513.16)
Largest Winning Trade	\$3,322.23	Largest Losing Trade	(\$1,601.32)

As a baseline the average day over this time period made about 0.036% (or \$36). The average tax day made 11 times that or 0.4%. The day after tax day has been even stronger. This can be seen below.

SPX Day After Tax Day Performance \$100k/trade. 1981 - 2009			
TradeStation Performance Summary			Collapse 
All Trades			
Total Net Profit	\$18,360.39	Profit Factor	5.86
Gross Profit	\$22,136.77	Gross Loss	(\$3,776.38)
Total Number of Trades	29	Percent Profitable	72.41%
Winning Trades	21	Losing Trades	8
Even Trades	0		
Avg. Trade Net Profit	\$633.12	Ratio Avg. Win:Avg. Loss	2.23
Avg. Winning Trade	\$1,054.13	Avg. Losing Trade	(\$472.05)
Largest Winning Trade	\$2,842.84	Largest Losing Trade	(\$1,220.80)

This shows an average return of over 17 times the average day.

Here are the combined returns for the two days.

SPX Performance on Tax Day & Day After \$100k/trade. 1981 - 2009			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$30,201.34	Profit Factor	6.81
Gross Profit	\$35,403.74	Gross Loss	(\$5,202.40)
Total Number of Trades	29	Percent Profitable	75.86%
Winning Trades	22	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	\$1,041.43	Ratio Avg. Win:Avg. Loss	2.17
Avg. Winning Trade	\$1,609.26	Avg. Losing Trade	(\$743.20)
Largest Winning Trade	\$6,245.15	Largest Losing Trade	(\$1,382.02)

Here we see the SPX move over the two day period was a gain of over 1%. Over the 29 year period there were only 4 years where the market did not close above the entry price on either day 1 or day 2.

Another extreme that was hit today was the exceptionally lopsided Nasdaq Up Volume %. Readings over 90% are quite rare – especially so when the market is in a long-term uptrend. As I showed in a study back in November, this combination has led to short-term upside in the past. Below I have updated the November study.

Nasdaq Up Vol % > 90% and SPX > 200ma. Buy SPX 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
5	6,307.63	8	5	3	62.50	1,658.15	-661.04	2.51	4.18	788.45
4	9,086.88	8	7	1	87.50	1,317.16	-133.25	9.88	69.19	1,135.86
3	9,817.24	8	7	1	87.50	1,424.41	-153.66	9.27	64.89	1,227.16
2	7,046.88	8	7	1	87.50	1,016.26	-66.95	15.18	106.26	880.86
1	1,511.77	8	4	4	50.00	617.61	-239.67	2.58	2.58	188.97

All 8 instances closed higher than the entry price on 1 of the next 2 days.

Instances are lower than I'd typically like to see, but with all 8 closing higher in the next day or 2, it appears worth noting this one. Extremely strong volume breadth going into riskier Nasdaq stocks has often led to some follow through when the market is in a long-term uptrend. Below I have listed all 8 instances with a 3-day exit.

Nasdaq Up Vol % > 90% and SPX > 200ma.
 Buy SPX on close. Sell 3 days later. \$100k/trade. 2001 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
03/25/04	Buy	\$1,109.28	1.60%	\$1,648.80
03/30/04	Sell	\$1,127.00		(\$283.50)
06/29/06	Buy	\$1,272.87	0.15%	\$585.78
07/05/06	Sell	\$1,270.90		(\$542.88)
08/15/06	Buy	\$1,285.58	1.30%	\$1,287.44
08/18/06	Sell	\$1,302.30		\$0.00
03/06/07	Buy	\$1,395.41	0.53%	\$1,046.54
03/09/07	Sell	\$1,402.85		(\$338.67)
08/29/07	Buy	\$1,463.76	1.75%	\$2,219.52
09/04/07	Sell	\$1,489.42		(\$850.68)
09/18/07	Buy	\$1,519.78	0.39%	\$1,232.40
09/21/07	Sell	\$1,525.75		(\$218.40)
07/15/09	Buy	\$932.68	1.98%	\$2,026.58
07/20/09	Sell	\$951.13		(\$559.61)
11/05/09	Buy	\$1,066.63	2.47%	\$2,770.47
11/10/09	Sell	\$1,093.01		(\$657.51)

Only instance without 1% runup. (0.15%)
 Worst drawdown (\$850.68)

Especially notable to me is the fact that the worst drawdown for any instance was only 0.85%. Meanwhile, only 1 instance didn't see a run-up of at least 1% within the next 3 days. This suggests downside may be limited.

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



Seasonality and a strong breadth thrust helped push the green aggregator line back above zero this evening. This means the net expectations from the Active Studies List is for a rise over the next few days. But the SPX is already overbought versus expectations and this can be seen in the solidly negative black Differential line. Overbought with positive expectations is considered a neutral configuration and the Aggregator System moved back to neutral today at the close.

Looking ahead to tomorrow the Aggregator value looks to remain squarely above zero unless some substantial bearish evidence arrives. Meanwhile the pivot value for the Differential line is 1,197.61 for tomorrow. In other words, it will take a close at or below this number to flip the black Differential line into positive territory. So unless we see a strong move or strong evidence emerge, it appears the best bet for tomorrow is another neutral outlook.

This upmove has been relentless, and while the Aggregator has kept us from getting short very much, the few shots it's taken lately have been run over. Meanwhile, without a decent pullback the Aggregator system has been unable to get long. From a trading standpoint it has been a frustrating market – and not just for the Aggregator. Still while April is off to a difficult start the previous few months were strong results wise for the Quantifiable Edges trade ideas.

When the market trades either abnormally or in a fashion that doesn't favor your trading style it is important traders keep a proper mindset. Capital preservation becomes more important. And don't panic and try and change your approach because of a minor cold streak. If you consistently trade with an edge the market will go your way more often than not and you'll benefit greatly over the long haul. Beginning traders often struggle because they are constantly trying to change their approach whenever a slight drawdown occurs. I always encourage people to study many methods, but when you find something that's profitable and generally comfortable to trade, stick with it and build around it. Create an arsenal of techniques rather than constantly trying to jump from one to the next.

Intermediate-term Outlook (2 weeks – 2 months)– updated 4/12 somewhat bullish

As we've been seeing for a while, the market is continuing to trudge ahead, but there are some mixed signs at the moment.

Two things the market really has going for it are breadth and leadership. Leadership can be seen in the form of the Nasdaq/S&P Relative Strength indicator that we track on the charts page. As most subscribers are well aware at this point the market has made nearly all of its gains in the last 40 years when relative strength is favoring the Nasdaq. Breadth also remains strong as the Advance/Decline line is still hitting new highs. New 52-week highs have lagged a little bit in the last few weeks but you typically need a divergence of AT LEAST two months before this will matter much and manifest itself in the form of a substantial selloff.

On the downside we see rising interest rates and complacency among options players. The complacency has been shown in studies we've looked at that have included both the VIX:VXV ratio and put/call ratios. None of these have proven to be great at exact

timing, but a pullback does generally occur when you hit readings around where we have been.

Volume has been another concern. We have seen several studies lately that have suggested some of the low-volume rallies we are seeing will often lead to a pullback. It has struck me that perhaps it might be worth looking at low-volume rallies in a slightly different way.

One tool that some analysts use is the concept of Distribution Days. Distribution days are basically days where the market sells off on relatively high volume. The theory is that when clusters of these days are seen near a market high it suggests an intermediate-term selloff is likely to ensue. Back in August I posted a study that examined this. [It found the concept to be dead wrong](#). It is most often better to buy into these clusters of high-volume selloffs rather than looking for further selling.

Below I re-ran the results of that August study back to 1988 using the same parameters.

Short S&P on close of 4th distribution day within the last 12 if it is above its 200ma and has come within 1% of its 200day high in the last 12 days. Cover X days later. \$100k/trade. 1988 - 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	-23,444.75	42	16	26	38.10	3,067.73	-2,789.56	1.10	0.68	-558.21
19	-13,934.99	42	19	23	45.24	2,776.66	-2,899.63	0.96	0.79	-331.79
18	-19,709.80	43	18	25	41.86	2,597.53	-2,658.61	0.98	0.70	-458.37
17	-24,561.58	43	14	29	32.56	2,796.48	-2,196.98	1.27	0.61	-571.20
16	-17,575.91	44	19	25	43.18	2,371.99	-2,505.75	0.95	0.72	-399.45
15	-20,928.08	44	19	25	43.18	2,242.65	-2,541.53	0.88	0.67	-475.64
14	-27,472.31	46	20	26	43.48	2,048.79	-2,632.62	0.78	0.60	-597.22
13	-23,605.57	47	19	28	40.43	2,376.08	-2,455.40	0.97	0.66	-502.25
12	-33,895.26	47	18	29	38.30	2,134.59	-2,493.72	0.86	0.53	-721.18
11	-30,321.93	47	21	26	44.68	1,531.91	-2,403.54	0.64	0.51	-645.15
10	-32,983.03	50	21	29	42.00	1,482.85	-2,211.13	0.67	0.49	-659.66
9	-31,417.17	57	23	34	40.35	1,555.74	-1,976.45	0.79	0.53	-551.18
8	-18,949.31	61	30	31	49.18	1,499.06	-2,061.97	0.73	0.70	-310.64
7	-28,801.36	65	33	32	50.77	1,143.62	-2,079.40	0.55	0.57	-443.10
6	-16,363.97	69	39	30	56.52	1,199.94	-2,105.39	0.57	0.74	-237.16
5	-23,773.09	76	35	41	46.05	1,537.10	-1,891.99	0.81	0.69	-312.80
4	-22,818.70	87	40	47	45.98	1,397.14	-1,674.56	0.83	0.71	-262.28
3	-10,693.88	102	45	57	44.12	1,262.41	-1,184.25	1.07	0.84	-104.84
2	-9,394.19	133	62	71	46.62	1,066.63	-1,063.74	1.00	0.88	-70.63
1	-9,354.53	225	97	128	43.11	764.99	-652.80	1.17	0.89	-41.58

Recall that this study looks to go short, rather than buy. Therefore you are looking at a market that typically rose following such clusters.

Next, instead of looking for clusters of distribution days, I decided to substitute days that rose on volume that was lower than the previous day's volume. Here's how those results came out.

Short S&P on close of 4th low-volume rally day within the last 12 if it is above its 200ma and has come within 1% of its 200day high in the last 12 days.
Cover X days later. \$100k/trade. 1988 - 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	13,120.79	72	27	45	37.50	3,503.32	-1,810.42	1.94	1.16	182.23
19	-5,895.61	75	26	49	34.67	3,303.96	-1,873.44	1.76	0.94	-78.61
18	-18,900.13	77	26	51	33.77	2,920.53	-1,859.49	1.57	0.80	-245.46
17	-13,391.61	77	28	49	36.36	2,934.41	-1,950.10	1.50	0.86	-173.92
16	-413.32	79	31	48	39.24	2,945.61	-1,910.99	1.54	1.00	-5.23
15	-5,288.20	82	34	48	41.46	2,642.74	-1,982.11	1.33	0.94	-64.49
14	-9,793.45	83	31	52	37.35	2,657.45	-1,772.58	1.50	0.89	-117.99
13	-18,465.24	84	31	53	36.90	2,280.87	-1,682.49	1.36	0.79	-219.82
12	-18,403.57	85	29	56	34.12	2,334.11	-1,537.37	1.52	0.79	-216.51
11	-26,667.98	91	34	57	37.36	2,029.38	-1,678.37	1.21	0.72	-293.05
10	6,235.13	96	43	53	44.79	2,209.87	-1,675.27	1.32	1.07	64.95
9	-5,306.79	101	42	59	41.58	2,179.16	-1,641.21	1.33	0.95	-52.54
8	10,014.12	109	46	63	42.20	2,246.45	-1,481.31	1.52	1.11	91.87
7	-6,014.40	119	50	69	42.02	1,645.44	-1,279.51	1.29	0.93	-50.54
6	-7,153.65	132	56	76	42.42	1,673.77	-1,327.43	1.26	0.93	-54.19
5	10,226.67	147	68	79	46.26	1,692.79	-1,327.63	1.28	1.10	69.57
4	-4,005.11	165	71	94	43.03	1,361.10	-1,070.68	1.27	0.96	-24.27
3	-17,750.27	200	87	113	43.50	1,076.17	-985.64	1.09	0.84	-88.75
2	-5,601.36	263	123	140	46.77	821.68	-761.92	1.08	0.95	-21.30
1	3,841.99	455	224	231	49.23	589.04	-554.56	1.06	1.03	8.44

It's interesting to see here that results are mixed rather than suggestive of upside as the distribution day clusters were. This isn't terribly surprising since many of the volume-related studies we see suggesting downside are due to low-volume rises rather than high-volume declines.

At this point the research is a bit half-baked, but I plan on expanding on this line of thought in the future.

So as far as the intermediate-term outlook, I like the current breadth and leadership. Interest rates, sentiment, and volume are suggesting a selloff is coming. At this point price has done nothing wrong. We are again at new highs and I'm inclined to stick with the trend until I see more convincing evidence that it is ending or done.

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.

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	4/5/2010	\$120.27	\$121.19	-0.76%		see below
SPY(1/4)(s)	4/6/2010	\$120.27	\$121.19	-0.76%		see below

I'll look to cover both lots at a limit of \$121.30. If the market gaps higher and then doesn't fill me in the 1st half hour or so I will likely enter a stop above the high of the day. Basically I want out but would prefer not to chase in this extremely overbought market.

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