

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 16, 2010

Volume 3 Issue 72

## Market Overview



## Tonight's Research Points

- The Put/Call and the VIX action are still suggesting a selloff is likely soon.
- The Aggregator System remained flat.
- The NDX Aggressive Trend Timer remained flat.

## Short-term Outlook – updated 4/16

### The Bottom Line

Still very overbought, but lacking substantial downside catalysts it is “wait and see” again tonight.

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>					
April 16, 2010	New high with put/call low	1-2 days	Bearish		
April 16, 2010	SPX up VIX up midweek at 50 high	1-2 days	Bearish	-0.80%	-0.60%
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%
<b>Active - Long Term</b>					
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		
<b>Dropped Tonight</b>					
April 13, 2010	SPY up w/ vol low 3 days	1-3 days	Bearish		

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

There wasn't a great deal of movement today. The major indices finished up with the S&P rising 0.1%, the Russell 0.3% and the Nasdaq 0.4%. Breadth was weak as the NYSE Up Issues % came in at 48% and the Up volume % was just 44%. Total NYSE volume rose for the 3<sup>rd</sup> straight day and hit the highest level since March options expiration.

Several of the same studies we've been seeing over the last few days area again showing up tonight. From a positive standpoint such strong momentum is normally followed by more upside. Unfortunately that upside can often be muted.

One study that appeared in the Quantifinder tonight looked at 15-day highs on a 15-day high in volume. It was from the 3/18/09 Subscriber Letter. I've reproduced and updated it below.

SPX posts highest close in 15 days on highest volume in 15 days. Buy on close. Sell X days later. \$100k/trade. 1960 - 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	55,001.22	235	128	107	54.47	1,507.97	-1,289.90	1.17	1.40	234.05
4	57,162.70	239	132	107	55.23	1,311.61	-1,083.82	1.21	1.49	239.17
3	50,757.75	253	140	112	55.34	1,092.31	-912.20	1.20	1.50	200.62
2	47,515.83	264	143	120	54.17	867.69	-638.03	1.36	1.62	179.98
1	37,994.55	309	173	135	55.99	603.16	-491.50	1.23	1.57	122.96

At first blush this study would seem to suggest further upside. When looking very long-term it is important to keep in mind that the market and its edges have evolved and changed over time. Below is the same study but this time I only ran it back to 1999.

SPX posts highest close in 15 days on highest volume in 15 days. Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-1,298.30	34	17	17	50.00	1,287.07	-1,363.44	0.94	0.94	-38.19
4	-4,722.80	35	15	20	42.86	1,282.70	-1,198.16	1.07	0.80	-134.94
3	-2,274.50	37	15	22	40.54	1,312.90	-998.55	1.31	0.90	-61.47
2	-2,619.34	38	17	21	44.74	624.54	-630.31	0.99	0.80	-68.93
1	223.19	45	25	20	55.56	582.76	-717.29	0.81	1.02	4.96

Here we see that over the last 11 years there has been no substantial directional edge provided. Rather than a bullish tilt such situations may now be deemed neutral.

The bearish studies again came in the form of overdone sentiment. The VIX and the Put/Call Ratio have both been exhibiting extreme behavior suggesting a downside edge. To this point the downside edges have not played out. At some point this extreme behavior should matter again.

The Put/Call study from last night's letter triggered again. Rather than waste space here again if you're interested you may review last night's letter.

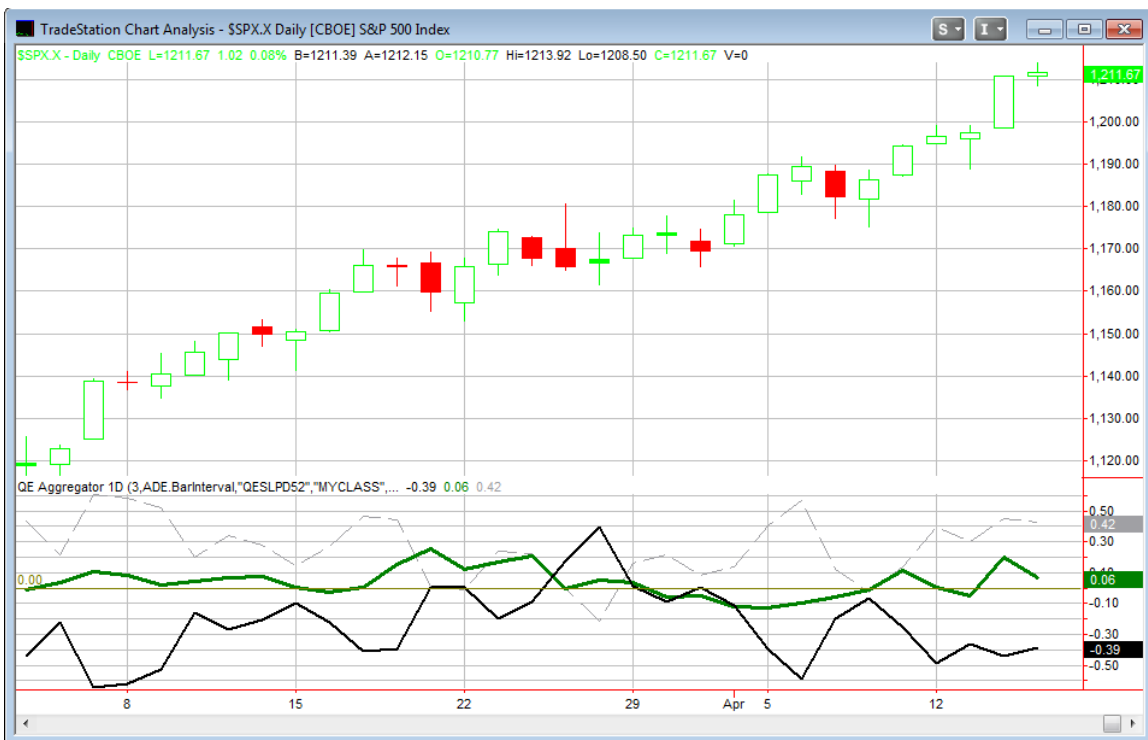
This last study uses the VIX and was last found in the 11/12/09 blog post. I've updated the stats below.

**SPX & VIX both close higher on a Tues, Wed, or Thurs. SPX > 200ma and at a 50-day high.  
Buy 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	-14,987.92	39	18	21	46.15	702.14	-1,315.54	0.53	0.46	-384.31
4	-9,365.05	41	16	25	39.02	905.86	-954.35	0.95	0.61	-228.42
3	-4,969.30	41	18	23	43.90	750.96	-803.76	0.93	0.73	-121.20
2	-9,199.62	42	13	29	30.95	707.26	-634.28	1.12	0.50	-219.04
1	-5,261.33	49	23	26	46.94	301.09	-468.71	0.64	0.57	-107.37

While not overwhelming, this study does suggest some short-term downside.

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



Not much change to the Aggregator chart tonight. Despite some new negatives the green Aggregator line remains above zero. This illustrates the net expectation from the Active Studies List is for upside over the next few days. Meanwhile the black Differential line remains squarely below 0, showing the SPX has easily outperformed expectations over the last few days. So while the SPX remains strongly overbought and could correct at any time, downside catalysts aren't substantial enough at the current time to warrant a

short position. With lines on opposite sides of 0 the current configuration is neutral and the Aggregator System remains flat.

Looking ahead the studies that are currently active are all scheduled to expire in the next few days. Therefore new studies that emerge will have a large affect on the Aggregator value and need to be watched. The Differential pivot will be 1,197.99 on Friday. In other words it will take a close below 1198 to flip the Differential line positive and make going long a possibility.

***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.*

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
SPY(1/4)(s)	4/14/2010	\$120.27	\$120.99	-0.60%		covered on open
SPY(1/4)(s)	4/14/2010	\$120.27	\$120.99	-0.60%		covered on open

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