

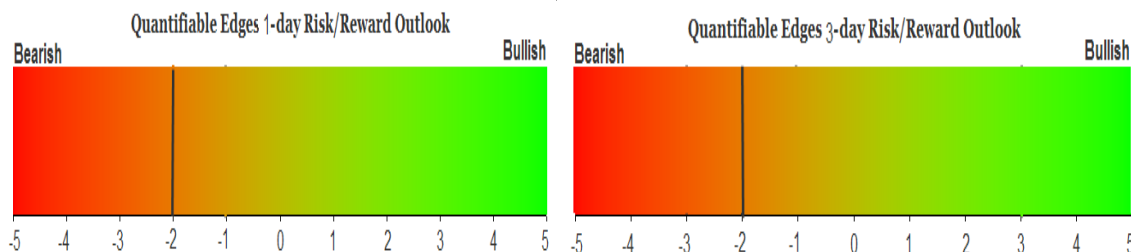
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 11, 2010

Volume 3 Issue 6

## Market Overview



## Tonight's Research Points

- I examine noted extremes such as the low equity put/call ratio on Friday, the RSI(2) close over 90 with the low HV and the 5 higher highs at a new high. In every case the edges are just no substantial base on the current market position.
- The number of NYSE new 52-week highs need to be monitored. It is very close to suggesting a continuation of the intermediate-term uptrend.
- The Aggregator System remains short.

## Short-term Outlook – updated 1/11

### The Bottom Line

The market remains overbought versus expectations. There are only a few studies suggesting anything significant at this time and the consensus is for a pullback. The Aggregator System remains short and so do I.

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
<b>Active</b>				
January 8, 2010	Outside day at a high w/ rising vol	1-3 days	Bearish	
January 5, 2010	5-day low to a 10-day high	1-5 days	Bearish	-1.90%
<b>Active - Long Term</b>				
December 23, 2009	SPX and TNX hit 50-day high	1-10 weeks	Bearish	
December 23, 2009	Low p/c without strong SPX rise	1-5 weeks	Bearish	
December 7, 2009	Nasdaq Leading S&P	int. term	Bullish	
December 2, 2009	VIX:VXV crosses below 0.9	2-5 months	Bearish	

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

### *The Evidence*

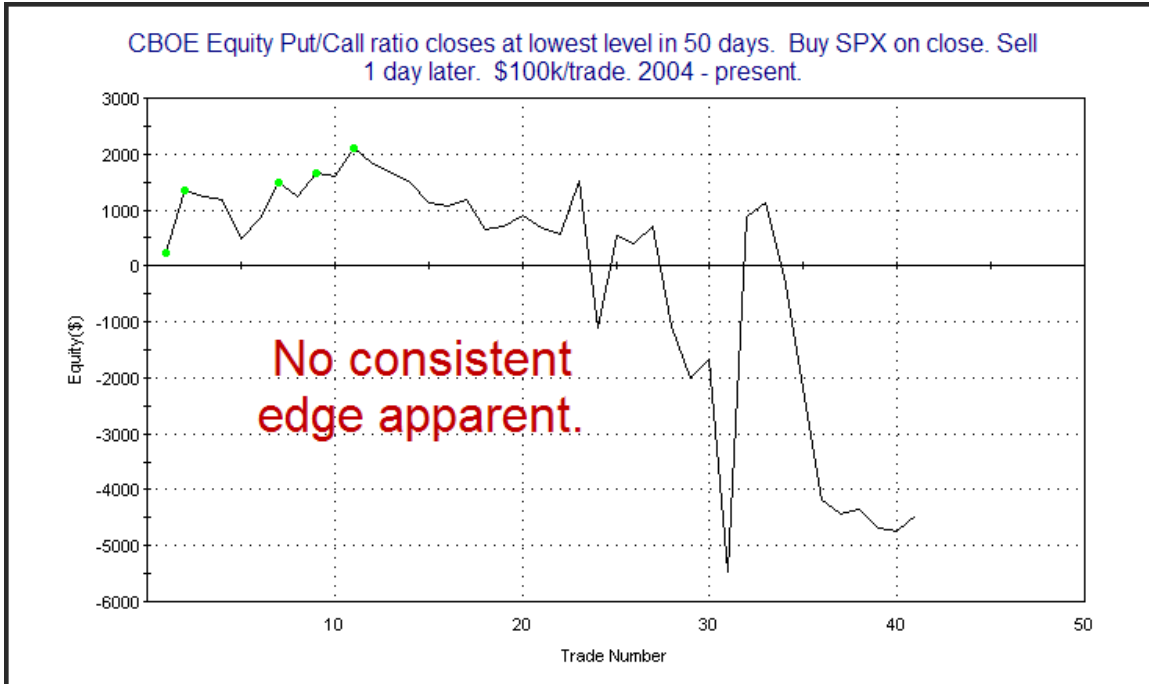
Despite the bearish implications of the active studies the market has trudged higher over the last few days. On Friday the S&P spent most of the day in negative territory before a rally in the last 20 minutes pushed it higher to finish with a mild gain on the day. It is beginning to appear as if the S&P may not have a down day at all in 2010. Breadth was again mildly positive as the NYSE Up Issue % came in at 61% and the Up Volume % was 52%. Total volume dropped on both the NYSE and the Nasdaq.

Just a brief glance at the Quantifinder this weekend would have been a little bit misleading. A fair amount of red showed up and that wasn't particularly bearish. And one green study showed up that wasn't particularly bullish.

One example is the studies related to the Equity Put/Call Ratio. Unfortunately, Tradestation's put/call ratio data isn't terribly accurate as it doesn't match the CBOE. I always use the CBOE data for testing but I use the Tradestation data to spot studies in the Quantifinder. I do this because I don't currently have a simple automated way to import the CBOE data. It appears I may need to take that on as a project at some point here. In any case, the studies that showed in the Quantifinder did not actually trigger. The equity p/c ratio was low. It just wasn't 25% below its 200ma as the Tradestation data suggested. And while it wasn't as stretched below normal as the other studies required, it DID register the lowest reading since early October. I therefore ran some test to see if just closing at a 50-day low was enough to provide an edge.

CBOE Equity Put/Call ratio closes at lowest level in 50 days. 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
5	12,698.15	33	20	13	60.61	1,586.05	-1,463.30	1.08	1.67	384.79
4	17,559.42	34	22	12	64.71	1,370.35	-1,049.03	1.31	2.39	516.45
3	15,085.91	38	23	15	60.53	1,483.20	-1,268.51	1.17	1.79	397.00
2	-5,638.56	38	17	21	44.74	1,131.30	-1,184.32	0.96	0.77	-148.38
1	-4,463.10	41	17	24	41.46	816.50	-764.32	1.07	0.76	-108.86

Results here are a bit choppy and don't appear terribly predictive. I did decide to zoom in on the 1-day return to see how that has evolved over time.



So the CBOE Equity P/C ratio was quite low on Friday. But it doesn't seem it was so low that it provides a substantial edge.

The Quantifinder also identified a few studies related to the 3/10 Offset HV indicator. They were quite similar with one looking at a RSI(3) > 70 and the other looking at a RSI(2) > 90. The former broke it down above and below the 200ma and showed that the real bearish edge was when the setup occurred in a downtrend. I didn't initially do that with the RSI(2) > 90 study, but I should have. Below I updated and adjusted that study from the 8/27/09 Letter. This first table looks at times the market is trading above the 200ma.

SPX 3/10 offset historical volatility closes under 0.25. The 2-day RSI > 90 and SPX closes > 200ma. Buy on close. Sell X days later. \$100k/trade. 1989 - 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	66,788.26	65	47	18	72.31	1,996.17	-1,501.77	1.33	3.47	1,027.51
9	55,246.93	65	43	22	66.15	1,958.58	-1,316.92	1.49	2.91	849.95
8	34,204.48	66	42	24	63.64	1,583.10	-1,345.25	1.18	2.06	518.25
7	37,856.48	69	44	25	63.77	1,571.44	-1,251.48	1.26	2.21	548.64
6	26,559.77	69	44	25	63.77	1,427.14	-1,449.38	0.98	1.73	384.92
5	14,480.83	70	43	27	61.43	1,319.10	-1,564.47	0.84	1.34	206.87
4	7,832.82	71	37	34	52.11	1,409.34	-1,303.32	1.08	1.18	110.32
3	-3,066.69	71	38	33	53.52	1,030.86	-1,279.98	0.81	0.93	-43.19
2	1,564.99	74	33	41	44.59	891.69	-679.53	1.31	1.06	21.15
1	-2,026.35	97	48	49	49.48	468.21	-500.01	0.94	0.92	-20.89

There's no real short-term edge apparent here. The stats flip-flop over the 1st few days. When you get further out it looks like a continuation of the uptrend is more likely. With the edge not really kicking in strongly until after day 8 I won't be including this in the Active Studies list. We do see that the setup isn't bearish though.

Now if we were trading below the 200ma...

SPX 3/10 offset historical volatility closes under 0.25. The 2-day RSI > 90 and SPX closes < 200ma. Buy on close. Sell X days later. \$100k/trade. 1989 - 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	-21,556.67	18	8	10	44.44	1,114.98	-3,047.65	0.37	0.29	-1,197.59
4	-22,178.89	18	5	13	27.78	1,192.56	-2,164.75	0.55	0.21	-1,232.16
3	-23,058.97	18	5	13	27.78	962.94	-2,144.13	0.45	0.17	-1,281.05
2	-25,168.36	18	2	16	11.11	1,415.62	-1,749.97	0.81	0.10	-1,398.24
1	-17,437.21	19	5	14	26.32	940.82	-1,581.52	0.59	0.21	-917.75

Here we see a strong inclination for almost immediate downside.

In general a very low 3/10 Offset Historical Volatility suggests a volatility expansion is likely. Back at the end of August I did a study that looked at using this indicator as a filter for trading Opening Range Breakouts (ORBs). My research suggested it provided a solid edge for intraday traders. Those who would like to read that report may use the link below:

[Quantifiable Edges ORBs Study.pdf](#)

The one bullish study that appeared in the Quantifinder this weekend looked at market runs of 5-days higher in a row. It last appeared in the 10/12/09 Letter. I have updated the stats below:

SPX posts 5 higher closes. Close > 200ma. 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
10	104,783.81	182	122	60	67.03	1,700.94	-1,712.17	0.99	2.02	575.74
9	92,874.14	186	115	71	61.83	1,750.60	-1,527.39	1.15	1.86	499.32
8	77,753.03	190	120	70	63.16	1,556.66	-1,557.80	1.00	1.71	409.23
7	86,468.27	196	126	69	64.29	1,488.43	-1,464.84	1.02	1.86	441.16
6	71,964.54	199	125	73	62.81	1,356.75	-1,337.38	1.01	1.74	361.63
5	70,344.15	199	129	70	64.82	1,218.57	-1,240.74	0.98	1.81	353.49
4	46,429.29	199	120	79	60.30	1,080.20	-1,053.09	1.03	1.56	233.31
3	35,194.66	199	119	80	59.80	918.82	-926.81	0.99	1.47	176.86
2	13,915.29	199	116	83	58.29	717.71	-835.41	0.86	1.20	69.93
1	8,109.40	199	111	88	55.78	465.50	-495.01	0.94	1.19	40.75

What I see here is a relatively mild upside edge. One thing I've often talked about is the important of market position when doing this type of analysis. Not only is the market above the 200ma, but it is also at a 50-day high. Let's see how the numbers change when this is taken into account.

SPX closes up 5 days in a row. Close > 200ma and at a 50-day high. 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
10	39,319.31	112	72	40	64.29	1,607.23	-1,910.04	0.84	1.51	351.07
9	31,604.38	116	70	46	60.34	1,596.95	-1,743.09	0.92	1.39	272.45
8	20,168.71	118	71	47	60.17	1,473.70	-1,797.11	0.82	1.24	170.92
7	33,654.58	121	77	43	63.64	1,375.03	-1,679.59	0.82	1.47	278.14
6	27,147.26	124	72	51	58.06	1,328.52	-1,343.26	0.99	1.40	218.93
5	33,812.83	124	77	47	62.10	1,215.87	-1,272.53	0.96	1.57	272.68
4	21,268.45	124	71	53	57.26	1,096.19	-1,067.19	1.03	1.38	171.52
3	11,348.37	124	70	54	56.45	854.38	-897.37	0.95	1.23	91.52
2	1,836.93	124	67	57	54.03	685.79	-773.88	0.89	1.04	14.81
1	869.48	124	64	60	51.61	440.75	-455.64	0.97	1.03	7.01

The mild edge that was seen above is now basically eliminated. These returns are pretty much in line with the long-term market drift. And in fact when looking at the 3 and 4-day exit strategies, most of the gains came in the 1960's. Since then the setup has led to basically flat trading.

To really see the affect that the 50-day high requirement has on the results I flipped the filter to require a 50-day closing high was not made.

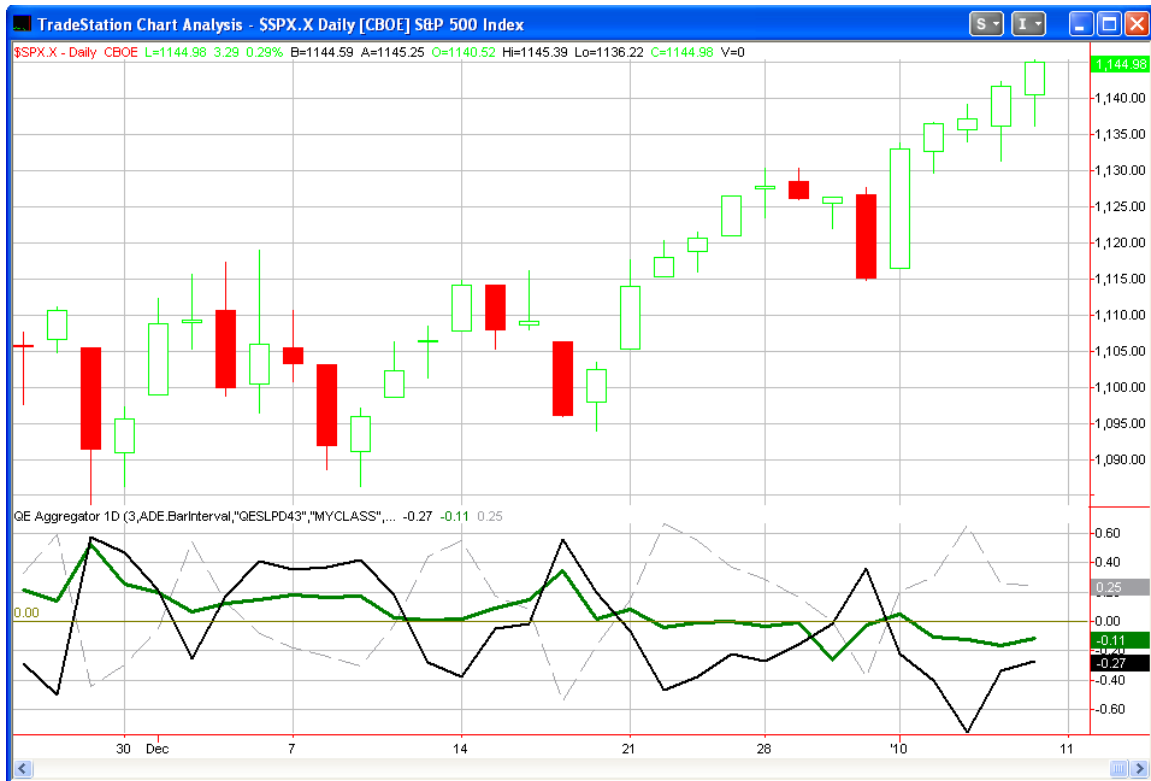
SPX closes up 5 days in a row. Close > 200ma but < 50-day high. Buy on close. Sell X days later. \$100k/trade. 1960 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	71,010.00	74	53	21	71.62	1,838.78	-1,259.29	1.46	3.69	959.59
9	65,557.49	74	49	25	66.22	1,914.69	-1,130.50	1.69	3.32	885.91
8	60,308.17	75	52	23	69.33	1,632.49	-1,068.76	1.53	3.45	804.11
7	52,813.69	75	49	26	65.33	1,666.64	-1,109.68	1.50	2.83	704.18
6	44,817.28	75	53	22	70.67	1,395.09	-1,323.75	1.05	2.54	597.56
5	36,531.32	75	52	23	69.33	1,222.58	-1,175.77	1.04	2.35	487.08
4	25,160.84	75	49	26	65.33	1,057.02	-1,024.35	1.03	1.94	335.48
3	23,846.29	75	49	26	65.33	1,010.88	-987.95	1.02	1.93	317.95
2	12,078.36	75	49	26	65.33	761.35	-970.30	0.78	1.48	161.04
1	7,239.92	75	47	28	62.67	499.21	-579.39	0.86	1.45	96.53

The stats here are substantially stronger. From winning % to win/loss ratio to profit factor to average trade.

The moral of the story is that this study is not suggesting a substantial edge based on the market's current position.

This slow drift with no substantial breadth or volume readings is not providing many clues at this point – at least for a swing time frame. Day-traders may want to examine the ORB's study mentioned above.

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



While the edge has become a bit milder the Aggregator is still suggesting downside is likely over the next few days. The green Aggregator line, which measures the net expectations for the Active Studies over the next few days, is below 0. The black Differential line, which measures the SPX's performance versus expectations over the last few days, is also below 0. Together the values are showing net expectations are negative and the SPX is overbought versus expectations over the last few days. This configuration has historically suggested a downside edge. Due to this the Aggregator System remains short.

The Aggregator is currently scheduled to remain negative. None of the active studies are terribly powerful, so it will be important to monitor action on Monday to see what else might be popping up to provide clues. The pivot number for the black Differential line is estimated to be 1,135.08. A close at or below this level would flip the Differential line into positive territory.

For now the Aggregator is still suggesting a downside edge. I'll continue to hold my ½ size short position. I'll also look to add to it if I get a favorable open or additional bearish evidence.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 1/4 –slightly bullish***

On Wednesday the NYSE New Highs reached 588. This was the highest level since 596 in October. It was also a good sign for the market. In the 10-12-09 Subscriber Letter I conducted a study of all the major market tops in the S&P 500 since 1970. What I found was that there was breadth deterioration evident in every case in either the advance/decline line, the new high %, or most often both. The advance/decline lines stopped showing a negative divergence a few weeks ago. Wednesday's move came within a whisker of eliminating the NH % divergence. You'd need to draw the trendline with an exceptionally sharp pencil to detect any kind of divergence at this point. In the study I showed that every major market top had a divergence in place for at least 2 months before price topped out. In most cases the divergence lasted significantly longer than that. Should we see new highs make a new high this week that should end all doubt about a divergence. It would also suggest we have at least 2 months before a significant price high will be established. A link to the 10/12/09 Letter is below.

[2009-10-12 QE Weekly Research Letter.pdf](#)

The Nasdaq continued to hold on to its leadership position this week although it looked dicey at times. As I often discuss, this is a positive.

On the negative side we still are showing some outstanding intermediate-term studies that suggest a pullback appears likely. These include studies related to volatility, bonds, and options action.

Even with these negatives the trend remains up, breadth is not diverging, and Nasdaq leadership remains in tact. That's not often a good combination to bet against. I'll exhibit a slightly bullish outlook for the time being.

**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 @ \$115.43 LIMIT ON OPEN. If not filled on open, cancel. A big gap up would do 2 things: 1) It would mean the “5 Up Days” study has hit its target and will be removed from the studies list, effectively leaving only bearish short-term studies and 2) Large gaps up from high levels have historically suggested a downside edge. See blog link below:*

<http://quantifiableedges.blogspot.com/2009/04/gaps-up-from-10-day-highs.html>

### **Active Trades Table**

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)(s)	1/5/2010	\$113.63	\$114.57	-0.83%		Aggregator
SPY(1/4)(s)	1/6/2010	\$113.63	\$114.57	-0.83%		Aggregator

*I'll look to cover all open lots of SPY should the SPX close at 1,135.08 or lower.*

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