

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 27, 2008

Issue 7

Market Overview

Summary of Recent Active Studies (see <http://QuantifiableEdges.blogspot.com> for details)

Study Date	Description	Time span	Bias
February 14, 2008	Count To Three	1-5 days	Bearish
February 25, 2008	Two Day Surge	1-10 days	Bearish
February 22, 2008	Triangles	intermediate	Bearish
February 12, 2008	Contraction of range	20 days	Bullish
February 1, 2008	FTD short-term implications	long-term	Bearish
January 27, 2008	Nasdaq/Russell Relationship	20 days	Bullish

Intermediate-term Outlook (2 weeks – 2 months) – positive – updated 2/26/2008

So far the January lows have held up. Some of the readings observed near the January bottom were severe enough that they have typically led to bull rallies in the past. These include the massive number of new lows, the high CBI, and the large reversals seen on January 22nd and 23rd. The huge jump in the McClellan Oscillator and strong overbought readings are also indicative of further strength in the intermediate-term. The huge increase in volatility was another clue suggesting further upside to come. In many cases in the past the market has retested its lows before strongly moving higher. Whether the lows posted on February 7th can be considered a retest is questionable.

We do have some negative studies active at this time. Still, the only one with longer-term implications is the FTD one from Feb. 1st. A downside break leading to a test of the January lows may have been preferable. Still, the fact that market continues to make higher lows should be considered a good thing. While there's a chance the market is in a longer-term bear market I still feel it is more likely to put in a good rally from here than it is to put in another leg down below the January lows.

Short-term Outlook (1-10 days) – negative – updated 2/27/08

Yesterday I discussed that the market was becoming overbought in a longer-term downtrend. The two studies I referenced last night were the [triangles study](#) and the [back to back surge days](#). Both showed bearish indications. The market put in a strong day today with the S&P rising another 0.69%. This puts the S&P in an even more overbought condition. As demonstrated in my [Count To Three study](#) on February 14th, three consecutive up days during a longer-term downtrend has typically preceded weakness.

When all three days are surges of 0.6% or more as they are now, this increases the downside market risk. Also notable is the fact that the VXO has finished significantly lower than its short-term moving averages for the 2nd day in a row. Historically, when the VXO has closed at least 10% below its 10-day moving average for two consecutive days, the S&P has shown a slight negative bias over the next 1-3 days.

This combination of negative factors has only happened a little more than a handful of times. Three up days in a row of greater than 0.6% when the S&P 500 is below its 200-day moving average and the VXO is stretched to the downside as described above for 2 straight days has occurred only 7 times. Six of those times the market was lower 1, 2, and 3 days lower. The sample size here is very small but the point is this: this market has a lot working against it and will likely need to pull back soon. Also notable is the fact that resistance is looming in the form of the 50-day moving average along with the February highs.

With overbought readings and the odds of a pullback increasing, I am going to scale in to another lot of SPY short. You'll find this trade in the "Additional New Trade Ideas" section below.

Catapult and Capitulative Breadth Statistics

Open Catapult Trades

Symbol	Trigger Date	Entry Price	Current Price	% Gain/Loss	Action
SLE	2/19/2008	\$13.10	\$13.05	-0.4%	bought @ \$13.10
SLE	2/20/2008	\$13.11	\$13.05	-0.5%	bought @ \$13.11
SLE	2/21/2008	\$13.02	\$13.05	0.2%	bought @ \$13.02

We were filled on our 3rd and final piece of the Sara Lee (SLE) trade on Friday at \$13.02. There are 2 possible exit targets for Catapult trades. One is based on an end-of-day target price while the other is based on an intraday target price. If either price is hit, it will trigger a sale near the open the following morning. (Not an intraday sale.) The target prices are based on a custom indicator and the calculations can not be completed until after the stock has opened. *An estimate of the intraday price target is \$13.25 for Wednesday.*

Open Big 50 Trades

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
STP	2/26/2008	\$36.90	\$40.77	10.5%	\$36.00	sell 3/4 of position @ \$40 limit

Amazingly, Suntech (STP) just missed triggering an exit signal. I don't see any point in being greedy when there is a 10.5% gain in one day. Therefore, I'm calling to sell ¾ of the position tomorrow morning as long as it doesn't gap down below \$40 and then put a stop in at \$36.00 for the small remaining portion.

Open Catapult for ETF's Trades

none

Broad Market Large Cap CBI – 3 (SLE)

While the basic reading is now a “3” it is only in one stock. This is not as significant as a “3” reading in 3 different stocks. On the blog I only show and evaluate the basic number. In the Subscriber Letter I will also discuss the complex count when the reading begins to reach significant levels.

Sector CBI Breakdown (% of stocks with active catapult triggers within each sector.)

Index	EIF	CBI%	Index	EIF	CBI%
DJ US Broker Dealers	IAI	0.00	DJ US Energy	IYE	0.00
DJ US Insurance Index	IAK	1.35	DJ US Financial	IYF	0.00
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	2.70	DJ US Healthcare	IYH	1.41
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	0.00
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	0.68
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	0.00
DJ US Healthcare Providers	IHF	0.00	DJ US Real Estate	IYR	0.00
DJ US Medical Devices	IHI	0.00	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	0.00	DJ US Technology Sector	IYW	0.50
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	5.26
DJ US Consumer Svcs	IYC	2.19	Nasdaq 100	QQQQ	0.00

No substantial capitulation evident among the sectors.

Additional New Trade Ideas

Longs

none

Shorts

SPY – Short at \$138.36 limit based on comments and studies in short-term overview above.

UNG – Short at \$45.71 limit. **Inside bars are generally bearish formations** for ETF's. While UNG today technically just missed being an inside bar by trading \$0.01 higher, it is within the spirit of the formation. I tested across all 114 ETF's on my “tradable” list for the following configuration: 1) A 20-day high is made yesterday or today. 2) Today comes within \$0.01 of being an inside day. Short at tomorrow at today's high and cover when the security closes below its 5-day moving average.

The limit short at today's high may look unusual here. Most traders would likely be looking at a stop short order near today's low instead. Inside bars – like triangles, have a tendency to post false breakouts. Shorting at the higher gives a better entry price, increases the winning percentage, and increases the profitability of the trade. UNG has only triggered once before with this setup. That was on 10/04/2007 and resulted in a

4.6% profit. Looking across all ETF's this setup would have resulted in 70% winners on 2503 trades. Losers were about 1.5x larger than winners. The profit factor was 1.6 and the average trade was good for a 0.34% profit. Not a spectacular edge, but with everything so short-term overbought (especially commodities) this one seems worth a shot.

Additional Trades Active Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY	2/26/2008	\$137.33	\$138.36	-0.8%	na	looking to add to position

Stocks and ETF's on my Radar

Ticker ***Notes***

DBA – Large range bars after an extended run can sometimes signal exhaustive behavior. This ETF has now had two wide range bars in a row and is due for a pullback. No obvious trigger yet.

Notable S&P 500 stocks outside my “tradable” radar

Oversold

none

Overbought

none.

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