

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 21, 2008

Issue 44

Market Overview

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

Study Date	Description	Time span	Bias
April 20, 2008	Double-Strong Breath	1-30 Days	Bullish
April 20, 2008	Sharp Rise-Weak Volume	1-10 Days	Bullish
April 20, 2008	Gap Up To High And Reverse	1-5 Days	Bearish
April 15, 2008	WR7 Down NR7	1-15 Days	Bullish
April 14, 2008	Sharp Selloff in Consolidation	20 days	Bearish
April 10, 2008	Relatively High Put/Call	20 days	Bullish
April 4, 2008	Trend Over Volatility (TOV)	20 days	Bullish
April 1, 2008	3 Surge Days	2-6 weeks	Bullish
February 1, 2008	FTD's Short-Term Implications	long-term	Bearish
March 24, 2008	Nasdaq Leadership Bullish	1-10 weeks	Bullish
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish

Short-term Outlook (1-5 days) –neutral – updated 4/21/08

The market gapped up Friday and put in another strong day. Wednesday and Friday both saw strong price movement and breadth. Volume was above recent levels both days but still below the 50-day moving average. The market now has some obstacles to overcome if it is going to continue to rally short-term. One of the most obvious is that it is bumping up against its February highs, which may act as resistance. There are also several signs the market is short-term overbought.

The Nasdaq 100 closed above its upper Bollinger Band, while the S&P spike above it but came short of closing there. Many time moves outside the Bollinger Bands lead to a pullback or consolidation.

The VXO closed more than 10% below its 10-day moving average. I've discussed in the past that the market tends to underperform over the next few days when this occurs.

Times when you had both a VXO downside stretch and a price upside stretch as defined above there has been a short-term negative expectancy. This can be seen in the table below:

SPX closes above Bollinger Band, VIX close 10% below 10ma - buy \$100,000 on close														
Days In	Net Profit	Gross Profit	Gross Loss	Trades	% Profitable	Wins	Losses	Max Win	Max Loss	Avg Win	Avg Loss	Win/Loss	Avg Trade	Profit Factor
10	\$13,508.28	\$37,043.92	(\$23,535.64)	36	58.33	21	15	\$5,362.56	(\$3,379.74)	\$1,764.00	(\$1,569.04)	1.12	\$375.23	1.57
9	\$17,804.32	\$42,038.51	(\$24,234.19)	36	63.89	23	13	\$5,183.64	(\$3,587.10)	\$1,827.76	(\$1,864.17)	0.98	\$494.56	1.73
8	\$13,100.84	\$37,110.15	(\$24,009.31)	36	66.67	24	12	\$5,324.76	(\$3,964.16)	\$1,546.26	(\$2,000.78)	0.77	\$363.91	1.55
7	\$3,195.88	\$27,954.04	(\$24,758.16)	36	55.56	20	16	\$5,675.04	(\$4,331.24)	\$1,397.70	(\$1,547.39)	0.90	\$88.77	1.13
6	(\$291.28)	\$23,799.93	(\$24,091.21)	36	58.33	21	15	\$5,150.88	(\$4,921.00)	\$1,133.33	(\$1,606.08)	0.71	(\$8.09)	0.99
5	\$1,406.74	\$18,567.30	(\$17,160.56)	36	47.22	17	19	\$5,108.04	(\$3,651.84)	\$1,092.19	(\$903.19)	1.21	\$39.08	1.08
4	(\$3,863.23)	\$15,939.87	(\$19,803.10)	36	52.78	19	17	\$4,614.12	(\$4,419.36)	\$838.94	(\$1,164.89)	0.72	(\$107.31)	0.80
3	(\$10,913.44)	\$10,055.12	(\$20,968.56)	37	51.35	19	17	\$2,426.76	(\$4,159.44)	\$529.22	(\$1,233.44)	0.43	(\$294.96)	0.48
2	(\$3,028.45)	\$10,058.75	(\$13,087.20)	39	43.59	17	22	\$2,021.04	(\$2,413.44)	\$591.69	(\$594.87)	0.99	(\$77.65)	0.77
1	(\$5,079.85)	\$10,798.30	(\$15,878.15)	48	35.42	17	31	\$2,119.29	(\$2,401.25)	\$635.19	(\$512.20)	1.24	(\$105.83)	0.68

Of course the SPX didn't quite finish above its upper Bollinger Band, but the point remains the same. Stretched price combined with negatively stretched sentiment often leads to challenging short-term conditions for the market.

I then looked at some scenarios that more accurately describe the current situation. First, I wanted to see if the relatively low volume during this price explosion was perhaps a cause for concern. I looked at all times the S&P has risen at least 4% in 3 days and the volume had been below the 50-day MA volume all three days. Results below:

SPX has risen at least 4 percent in the last 3 days and each day the volume has been beneath its 50ma - 1960 to present - \$100,000 per trade														
Days In	Net Profit	Gross Profit	Gross Loss	Trades	% Profitable	Wins	Losses	Max Win	Max Loss	Avg Win	Avg Loss	Win/Loss	Avg Trade	Profit Factor
10	\$8,878.76	\$13,858.17	(\$4,979.41)	9	55.56	5	4	\$4,339.80	(\$2,230.40)	\$2,771.63	(\$1,244.85)	2.23	\$986.53	2.78
9	\$6,193.21	\$15,308.69	(\$9,115.48)	9	44.44	4	5	\$5,946.60	(\$5,055.12)	\$3,827.17	(\$1,823.10)	2.10	\$688.13	1.68
8	\$5,370.94	\$15,556.45	(\$10,185.51)	9	66.67	6	3	\$4,479.20	(\$4,817.12)	\$2,592.74	(\$3,395.17)	0.76	\$596.77	1.53
7	\$5,714.17	\$16,260.20	(\$10,546.03)	9	66.67	6	3	\$3,453.30	(\$4,444.45)	\$2,710.03	(\$3,515.34)	0.77	\$634.91	1.54
6	\$2,939.35	\$12,874.47	(\$9,935.12)	9	44.44	4	5	\$4,626.60	(\$5,338.68)	\$3,218.62	(\$1,987.02)	1.62	\$326.59	1.30
5	\$5,796.05	\$11,084.59	(\$5,288.54)	9	66.67	6	3	\$3,581.50	(\$3,511.52)	\$1,847.43	(\$1,762.85)	1.05	\$644.01	2.10
4	\$7,496.38	\$11,303.54	(\$3,807.16)	9	66.67	6	3	\$3,067.74	(\$3,087.88)	\$1,883.92	(\$1,269.05)	1.48	\$832.93	2.97
3	\$6,591.14	\$11,045.09	(\$4,453.95)	9	77.78	7	2	\$3,504.90	(\$3,423.75)	\$1,577.87	(\$2,226.98)	0.71	\$732.35	2.48
2	\$1,616.96	\$6,067.56	(\$4,450.60)	9	55.56	5	4	\$2,541.63	(\$2,687.30)	\$1,213.51	(\$1,112.65)	1.09	\$179.66	1.36
1	\$2,567.38	\$6,070.85	(\$3,503.47)	11	63.64	7	4	\$1,527.75	(\$1,687.84)	\$867.26	(\$875.87)	0.99	\$233.40	1.73

While the test ran back to 1960, I didn't find any occurrences prior to 1990. Indications here were *not* negative. Actually, the *returns were above-average* over the next 1-10 days.

I then looked Friday's price action to see if there was anything to be gleaned from that:

SPY gapped up over 1%, made a 50-day high and closed below its open - 1993 to present - \$100,000 per trade														
Days In	Net Profit	Gross Profit	Gross Loss	Trades	% Profitable	Wins	Losses	Max Win	Max Loss	Avg Win	Avg Loss	Win/Loss	Avg Trade	Profit Factor
10	\$4,714.99	\$12,793.51	(\$8,078.52)	7	57.14	4	3	\$3,750.60	(\$3,088.96)	\$3,198.38	(\$2,692.84)	1.19	\$673.57	1.58
9	(\$890.34)	\$9,727.58	(\$10,617.92)	7	57.14	4	3	\$3,453.25	(\$5,106.14)	\$2,431.90	(\$3,539.31)	0.69	(\$127.19)	0.92
8	\$2,353.30	\$9,784.50	(\$7,431.20)	7	71.43	5	2	\$3,575.20	(\$3,849.44)	\$1,956.90	(\$3,715.60)	0.53	\$336.19	1.32
7	\$2,591.46	\$7,385.60	(\$4,794.14)	7	71.43	5	2	\$3,322.32	(\$3,571.10)	\$1,477.12	(\$2,397.07)	0.62	\$370.21	1.54
6	\$662.19	\$6,432.77	(\$5,770.58)	7	57.14	4	3	\$2,511.36	(\$3,656.38)	\$1,608.19	(\$1,923.53)	0.84	\$94.60	1.11
5	(\$3,200.50)	\$4,377.16	(\$7,577.66)	7	57.14	4	3	\$1,735.28	(\$4,935.58)	\$1,094.29	(\$3,788.83)	0.29	(\$457.21)	0.58
4	(\$5,059.80)	\$3,324.32	(\$8,384.12)	7	57.14	4	3	\$1,656.80	(\$5,119.52)	\$831.08	(\$2,794.71)	0.30	(\$722.83)	0.40
3	(\$3,332.31)	\$3,696.62	(\$7,028.93)	7	42.86	3	4	\$1,857.36	(\$3,426.08)	\$1,232.21	(\$1,757.23)	0.70	(\$476.04)	0.53
2	(\$1,254.93)	\$5,293.34	(\$6,548.27)	7	42.86	3	4	\$2,005.60	(\$2,744.00)	\$1,764.45	(\$1,637.07)	1.08	(\$179.28)	0.81
1	\$1,354.12	\$3,653.76	(\$2,299.64)	7	71.43	5	2	\$1,369.04	(\$1,343.16)	\$730.75	(\$1,149.82)	0.64	\$193.45	1.59

The gap up, new high, and failure to finish strong suggests the market may struggle over the next 2-5 days. The poor win/loss ratio (column just before Avg Trade) indicates risk is higher than potential reward at this juncture.

After looking at sentiment, volume, and price I decided to see if breadth action could tell me anything. Two of the last three days winners outnumbered losers by more than 3 to 1. I ran a test to see how the market performed under these circumstances in the past:

SPX had advance/decline ratio of 3:1 in two of last 3 days - 1969 to present - \$100,000 per trade														
Days In	Net Profit	Gross Profit	Gross Loss	Trades	% Profitable	Wins	Losses	Max Win	Max Loss	Avg Win	Avg Loss	Win/Loss	Avg Trade	Profit Factor
30	\$96,024.51	\$127,135.09	(\$31,110.58)	34	67.65	23	11	\$15,339.94	(\$7,141.96)	\$5,527.61	(\$2,828.23)	1.95	\$2,824.25	4.09
20	\$80,238.39	\$104,452.89	(\$24,214.50)	34	73.53	25	9	\$10,448.44	(\$8,527.56)	\$4,178.12	(\$2,690.50)	1.55	\$2,359.95	4.31
15	\$68,033.84	\$88,739.85	(\$20,706.01)	36	66.67	24	12	\$8,941.56	(\$6,277.02)	\$3,697.49	(\$1,725.50)	2.14	\$1,889.83	4.29
10	\$38,832.82	\$73,059.21	(\$34,226.39)	37	67.57	25	12	\$7,954.00	(\$11,137.06)	\$2,922.37	(\$2,852.20)	1.02	\$1,049.54	2.13
9	\$41,695.82	\$75,199.22	(\$33,503.40)	37	62.16	23	14	\$8,085.92	(\$9,568.46)	\$3,269.53	(\$2,393.10)	1.37	\$1,126.91	2.24
8	\$33,047.43	\$66,361.11	(\$33,313.68)	37	64.86	24	13	\$8,372.32	(\$9,554.20)	\$2,765.05	(\$2,562.59)	1.08	\$893.17	1.99
7	\$22,924.62	\$61,537.70	(\$38,613.08)	37	59.46	22	15	\$6,574.04	(\$9,340.30)	\$2,797.17	(\$2,574.21)	1.09	\$619.58	1.59
6	\$27,928.00	\$58,457.86	(\$30,529.86)	38	65.79	25	13	\$5,002.50	(\$7,343.90)	\$2,338.31	(\$2,348.45)	1.00	\$734.95	1.91
5	\$29,041.11	\$52,985.02	(\$23,943.91)	39	61.54	24	15	\$4,765.28	(\$5,176.38)	\$2,207.71	(\$1,596.26)	1.38	\$744.64	2.21
4	\$29,394.02	\$47,485.82	(\$18,091.80)	40	62.50	25	15	\$6,138.16	(\$4,296.18)	\$1,899.43	(\$1,206.12)	1.57	\$734.85	2.62
3	\$22,607.18	\$42,948.76	(\$20,341.58)	41	65.85	27	14	\$7,252.08	(\$5,878.78)	\$1,590.69	(\$1,452.97)	1.09	\$551.39	2.11
2	\$22,645.93	\$39,635.48	(\$16,989.55)	47	57.45	27	20	\$4,893.68	(\$3,311.34)	\$1,467.98	(\$849.48)	1.73	\$481.83	2.33
1	\$16,655.81	\$27,402.51	(\$10,746.70)	52	59.62	31	20	\$2,903.78	(\$1,786.20)	\$883.95	(\$537.34)	1.65	\$320.30	2.55

Here the results are significantly more positive, with even the short-term performing well.

So where does all this leave us? From my perspective it appears that the overbought nature of the market means it may struggle to add substantial gains over the next few days. The overbought condition does not provide reason to short, though. Any possible gains from shorting would likely be small compared to the potential losses. Another way to illustrate this would be to look at what would happen if you shorted the S&P 500 every time it closed above its Bollinger Band and then covered when the %b was equal to 75 or less. (A %b of 75 or less would mean a close halfway between the upper Bollinger Band and the 20-period moving average.) This simple system would have been profitable almost 60% of the time over the last forty years. Unfortunately, the average loss would have been 2.3% while the average gain was only 1.1% - therefore making the system as whole largely unprofitable. The Nasdaq produced even worse results.

From a short-term perspective, buying into an extended market is not appealing, especially one trading below resistance during a long-term downtrend. On the other hand, shorting doesn't seem to provide an edge. Therefore, it appears the most prudent course of action for the broad market may be to wait for a pullback and then look to initiate a long position.

Intermediate-term Outlook (2 weeks – 2 months) – bullish – updated 4/20/2008

From an intermediate-term perspective, most of the evidence I am seeing still points to a continuation of the move up. The April 14th “Sharp Selloff In Consolidation” study is the only recent one that has multi-week bearish implications. Since then we've now seen more evidence that favors the bullish case. The most recent of these studies is the Double-Strong Breath Study discussed above.

What I particularly like about the current intermediate-term studies is that they are mostly saying the same thing from very different perspectives. Bullish implications are being made from studies that look at price (3 Surge Days), volatility (Trend over volatility), sentiment (Relatively High Put/Call, and Consumer Sentiment Stretch), and now breadth. This kind of plurality makes a much stronger case than if we were only looking at price or only looking at sentiment for example. From an intermediate-term standpoint I believe this rally has further to go. I will be favoring long-side trades for the time-being.

Catapult and Capitulative Breadth Statistics

(Catapult Presentation Part 1) (Catapult Presentation Part 2)

Open Catapult Trades

none

Open Big 50 Trades

None

Open Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 0

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

Index	ETF	CBI %	Index	ETF	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	0.68
DJ US Regional Banks	IAT	2.50	DJ US Financial Services	IYG	1.40
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	0.00
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	0.00
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	1.35
DJ US Healthcare Providers	IHF	0.00	DJ US Real Estate	IYR	0.00
DJ US Medical Devices	IHI	2.44	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	0.00	DJ US Technology Sector	IYW	0.00
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	2.63
DJ US Consumer Svcs	IYC	0.44	Nasdaq 100	QQQQ	0.00

No signs of capitulative selling at the present time.

Additional New Trade Ideas

TLT – Buy @ \$92.77.

While stocks have rallied this past week, bonds have sold off. The correlation of stocks and bonds is dynamic. Sometimes they will move in opposite directions and sometimes they will move in unison. The bond selloff has now reached a point where I believe they are due for a bounce. I ran a test across my list of 111 highly traded ETF's. The strategy looked at the following conditions:

- 1) Closed down at least 5 days in a row.
- 2) Gapped lower this morning.
- 3) Opened below its lower Bollinger Band.
- 4) Closed above its open.

I then looked at two different exit strategies. Results below:

Exit Strategy	%b > 25	%b > 50 (c>20ma)
Trades	198	190
Winners	146	139
Losers	45	51
Pct Winners	74%	73%
Avg Win	2.4%	5.0%
Avg Loss	-2.1%	-4.4%
Avg Trade	1.3%	2.5%
Profit Factor	3.8	3.1

Results were impressive in either case. For now I'll look to sell ½ the position on a %b close over 25. I will then likely enter a stop to lock in gains and see if the position could reach the 2nd target of the 20ma to exit the rest.

TLT was not the only bond ETF that qualified. You could also consider SHY, IEF, or TIP. I simply chose TLT to track as the trade idea since it trades the highest volume. Should TLT gap up in the morning while one of the others doesn't then I will likely send out an email switching the symbol to one that could provide a fill.

Additional Trades Active Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SLB	4/8/2008	\$90.58	\$101.85	-12.4%		cover on close < 10ma
GRMN	4/11/2008	\$45.25	\$45.46	0.5%	\$45.25	sold 1/2 @ \$45.70
ABT	4/18/2008	\$50.93	\$50.72	-0.4%	\$44.94	filled

Obviously I've been too patient with SLB. This is turning into a terrible trade idea – the worst I've had by far. I will be looking to exit on almost any pullback at this point.

GRMN bounced very nicely today. We exited half @ \$45.70 per the email. I see no need to sit in this if it decides to make another leg down, and therefore have put in a stop on the remaining half at breakeven. Should it gap down, I would make \$45 the limit sell price rather than sell into the gap. It will also be exited if it can manage to close above its 10-period moving average.

ABT was filled and has not yet begun to bounce. A relatively tight stop on this one is keeping risk in check.

Stocks and ETF's on my Radar

ISRG – Uptrending stock got completely whacked on earnings. Could be playable for a bounce if it shows signs of stabilization.

DELL – Has made sharp bounce up to 50ma after breaking down a week and a half ago. Could be shortable with a potential stop above Fridays high.

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

Oversold

None

Overbought

None

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