

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 12, 2008

Issue 59

Market Overview

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

Study Date	Description	Time span	Bias
May 12, 2008	5 Lower Lows near 50-day high	1-11 days	Bearish
May 7, 2008	Equity Put/Call Stretch (Letter)	1-8 days	Bullish
May 1, 2008	3 Lower Closes (Letter not Blog)	1-10 days	Bullish
April 29, 2008	Narrow Range New High < 200	1-20 days	Bearish
April 20, 2008	Double-Strong Breath	1-30 Days	Bullish
February 1, 2008	FTD's Short-Term Implications	long-term	Bearish
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish

*Intermediate-term Outlook (2 weeks – 2 months) – **slightly bearish** – updated 5/12/2008*

Friday the S&P 500 posted its 5th consecutive lower low. As was discussed on Thursday, market action after a series of lower lows has been made is typically bullish. Markets often revert to a mean and therefore the selloff is often followed by a bounce. I was therefore expecting to be able to run some studies suggesting bullish tendencies for the next several days. What I uncovered was much different than I expected.

Notable to me about the recent price action is that it came after the market had made a strong run-up and posted multi-month highs. A pullback under this scenario would *seem* to be constructive. History suggests otherwise.

Below is a summary of market action after the S&P 500 has made 5 lower lows:

<i>SPX makes 5 lower lows. Buy on close. Exit "X" days later. \$100k per trade. 1978-now</i>											
Days In	Net Profit	Trades	% Profitable	Winners	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
20	\$123,926.79	88	62.50	55	\$18,816.00	(\$19,471.86)	\$4,735.52	(\$4,137.17)	1.14	\$1,408.26	1.91
15	\$72,451.90	89	58.43	52	\$11,214.84	(\$19,032.09)	\$3,918.71	(\$3,647.80)	1.07	\$814.07	1.55
10	\$41,837.33	95	50.53	48	\$15,280.64	(\$20,174.85)	\$3,377.02	(\$2,558.72)	1.32	\$440.39	1.35
9	\$54,551.36	97	57.73	56	\$14,515.20	(\$20,165.22)	\$2,890.53	(\$2,617.53)	1.10	\$562.39	1.51
8	\$63,300.77	98	55.10	54	\$15,738.88	(\$16,916.70)	\$3,177.87	(\$2,461.47)	1.29	\$645.93	1.58
7	\$58,432.29	100	61.00	61	\$13,776.64	(\$23,831.04)	\$2,599.19	(\$2,567.14)	1.01	\$584.32	1.58
6	\$37,714.30	102	61.76	63	\$14,240.00	(\$27,683.04)	\$2,160.64	(\$2,523.23)	0.86	\$369.75	1.38
5	\$37,999.21	102	53.92	55	\$13,135.00	(\$9,109.98)	\$2,276.11	(\$1,855.03)	1.23	\$372.54	1.44
4	\$44,251.48	102	58.82	60	\$13,377.28	(\$7,005.12)	\$2,035.46	(\$1,854.19)	1.10	\$433.84	1.57
3	\$50,593.90	102	58.82	60	\$8,279.04	(\$5,206.08)	\$1,774.94	(\$1,331.02)	1.33	\$496.02	1.91
2	\$55,453.87	102	62.75	64	\$7,495.68	(\$4,296.24)	\$1,455.02	(\$1,018.04)	1.43	\$543.67	2.47
1	\$45,948.76	102	61.76	63	\$9,089.88	(\$2,264.50)	\$1,099.62	(\$598.14)	1.84	\$450.48	2.97

As I suggested above, it is generally bullish. Now let's break it down into times when the market has recently made a 50-day high and times when it hasn't:

<i>SPX makes 5 lower lows and does not hit a 50-day high within the last 6 days. Buy on close. Exit "X" days later. \$100k per trade. 1978-now</i>											
Days In	Net Profit	Trades	% Profitable	Winners	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
20	\$127,256.34	70	70.00	49	\$18,816.00	(\$19,471.86)	\$4,834.23	(\$5,220.05)	0.93	\$1,817.95	2.16
15	\$85,702.59	71	66.20	47	\$11,214.84	(\$19,032.09)	\$3,941.29	(\$4,327.74)	0.91	\$1,207.08	1.86
10	\$65,250.22	73	60.27	44	\$15,280.64	(\$20,174.85)	\$3,527.65	(\$3,102.29)	1.14	\$893.84	1.73
9	\$73,534.05	75	64.00	48	\$14,515.20	(\$20,165.22)	\$3,223.79	(\$3,007.70)	1.07	\$980.45	1.91
8	\$78,893.20	75	61.33	46	\$15,738.88	(\$16,916.70)	\$3,521.04	(\$2,864.64)	1.23	\$1,051.91	1.95
7	\$64,572.46	77	63.64	49	\$13,776.64	(\$23,831.04)	\$2,976.75	(\$2,903.15)	1.03	\$838.60	1.79
6	\$41,077.82	79	64.56	51	\$14,240.00	(\$27,683.04)	\$2,461.14	(\$3,015.73)	0.82	\$519.97	1.49
5	\$45,511.66	79	58.23	46	\$13,135.00	(\$9,109.98)	\$2,461.61	(\$2,052.19)	1.20	\$576.10	1.67
4	\$45,526.40	79	63.29	50	\$13,377.28	(\$7,005.12)	\$2,183.93	(\$2,195.52)	0.99	\$576.28	1.72
3	\$54,518.86	79	62.03	49	\$8,279.04	(\$5,206.08)	\$1,974.56	(\$1,407.81)	1.40	\$690.11	2.29
2	\$57,658.73	79	68.35	54	\$7,495.68	(\$4,296.24)	\$1,550.08	(\$1,085.24)	1.43	\$729.86	3.21
1	\$47,449.28	79	65.82	52	\$9,089.88	(\$1,714.79)	\$1,208.79	(\$570.66)	2.12	\$600.62	4.08

<i>SPX makes 5 lower lows and hits a 50-day high within the last 6 days. Buy on close. Exit "X" days later. \$100k per trade. 1978-now</i>											
Days In	Net Profit	Trades	% Profitable	Winners	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
20	(\$3,515.91)	23	39.13	9	\$8,138.90	(\$5,452.37)	\$3,350.68	(\$2,405.15)	1.39	(\$152.87)	0.90
15	(\$7,181.21)	23	39.13	9	\$7,157.40	(\$6,791.22)	\$3,313.50	(\$2,643.05)	1.25	(\$312.23)	0.81
10	(\$21,322.13)	23	21.74	5	\$2,862.96	(\$4,893.35)	\$1,794.25	(\$1,682.96)	1.07	(\$927.05)	0.30
9	(\$16,031.61)	23	39.13	9	\$2,573.55	(\$4,505.90)	\$1,119.89	(\$1,865.05)	0.60	(\$697.03)	0.39
8	(\$15,592.43)	23	34.78	8	\$2,679.76	(\$5,166.06)	\$1,204.67	(\$1,681.98)	0.72	(\$677.93)	0.38
7	(\$6,140.17)	23	52.17	12	\$2,020.16	(\$5,975.16)	\$1,057.50	(\$1,711.83)	0.62	(\$266.96)	0.67
6	(\$3,363.52)	23	52.17	12	\$2,309.60	(\$2,919.84)	\$883.52	(\$1,269.61)	0.70	(\$146.24)	0.76
5	(\$7,512.45)	23	39.13	9	\$2,607.50	(\$2,847.04)	\$1,327.98	(\$1,390.30)	0.96	(\$326.63)	0.61
4	(\$1,274.92)	23	43.48	10	\$2,838.40	(\$2,115.19)	\$1,293.11	(\$1,092.77)	1.18	(\$55.43)	0.91
3	(\$3,924.96)	23	47.83	11	\$2,475.51	(\$2,958.97)	\$885.76	(\$1,139.03)	0.78	(\$170.65)	0.71
2	(\$2,204.86)	23	43.48	10	\$3,047.41	(\$2,120.93)	\$941.70	(\$893.99)	1.05	(\$95.86)	0.81
1	(\$1,500.52)	23	47.83	11	\$1,242.90	(\$2,264.50)	\$583.54	(\$659.95)	0.88	(\$65.24)	0.81

The difference here is striking. When 5 lower lows occur immediately following an intermediate-term high, the expectation has been more downside in the coming weeks. All other times the expectation is for more upside.

I decided to test this another way to confirm these findings. Here I looked at any time the market made 5 lower lows but closed above its 20-day moving average. The implication here is that the run-up must have been quite strong if a 5-day pullback doesn't even take it below its 20-day simple moving average. Only 9 instances showed up. Results are below:

<i>SPX makes 5 lower lows and close above 20ma. Buy on close. Exit "X" days later. \$100k per trade. 1978-now</i>											
Days In	Net Profit	Trades	% Profitable	Winners	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
20	(\$6,377.78)	9	44.44	4	\$7,964.21	(\$9,766.44)	\$2,608.03	(\$3,361.98)	0.78	(\$708.64)	0.62
15	(\$8,497.33)	9	33.33	3	\$4,378.64	(\$7,820.28)	\$2,037.81	(\$2,435.13)	0.84	(\$944.15)	0.42
10	(\$2,060.14)	9	33.33	3	\$3,563.28	(\$3,022.92)	\$1,934.88	(\$1,310.80)	1.48	(\$228.90)	0.74
9	(\$2,056.73)	9	44.44	4	\$3,789.52	(\$3,336.12)	\$1,993.38	(\$2,006.05)	0.99	(\$228.53)	0.79
8	\$1,767.21	9	44.44	4	\$3,740.03	(\$2,300.99)	\$2,010.04	(\$1,254.59)	1.60	\$196.36	1.28
7	\$7,115.60	9	55.56	5	\$3,103.65	(\$1,007.16)	\$1,882.83	(\$574.64)	3.28	\$790.62	4.10
6	\$7,361.68	9	66.67	6	\$3,775.38	(\$1,602.72)	\$1,555.48	(\$657.06)	2.37	\$817.96	4.73
5	\$2,181.00	9	66.67	6	\$3,124.94	(\$2,579.04)	\$1,325.78	(\$1,924.56)	0.69	\$242.33	1.38
4	\$3,281.24	9	66.67	6	\$3,831.94	(\$4,174.20)	\$1,629.48	(\$2,165.21)	0.75	\$364.58	1.51
3	\$2,015.23	9	55.56	5	\$2,700.74	(\$2,635.20)	\$1,156.96	(\$942.39)	1.23	\$223.91	1.53
2	\$378.25	9	55.56	5	\$2,771.44	(\$4,296.24)	\$1,180.30	(\$1,380.81)	0.85	\$42.03	1.07
1	(\$913.70)	9	55.56	5	\$888.00	(\$2,205.07)	\$410.19	(\$741.16)	0.55	(\$101.52)	0.69

Tough to read too much into such a small sample size, but these are not bullish numbers. There's a brief bout of positive expectancy between day 2 and 6, but then the market then heads lower as in our other study.

My next thought was that 5 consecutive lower lows may simply be more predictive of a bounce when the market is in a potentially exhaustive situation. To test this I looked at the results if the market made a 50-day low rather than a 50-day high:

SPX makes 5 lower lows and hits a 50-day low. Buy on close. Exit "X" days later. \$100k per trade. 1978-now											
Days In	Net Profit	Trades	% Profitable	Winners	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
20	\$89,425.93	25	76.00	19	\$18,816.00	(\$8,467.20)	\$5,790.96	(\$3,433.72)	1.69	\$3,577.04	5.34
15	\$71,851.37	26	73.08	19	\$14,585.60	(\$7,592.80)	\$4,898.33	(\$3,030.99)	1.62	\$2,763.51	4.39
10	\$56,201.98	26	65.38	17	\$15,280.64	(\$3,865.06)	\$4,191.22	(\$1,672.08)	2.51	\$2,161.61	4.73
9	\$59,799.77	26	73.08	19	\$14,515.20	(\$2,494.88)	\$3,700.63	(\$1,501.75)	2.46	\$2,299.99	6.69
8	\$54,282.92	26	61.54	16	\$15,738.88	(\$6,227.14)	\$4,630.02	(\$1,979.73)	2.34	\$2,087.80	3.74
7	\$49,740.87	26	69.23	18	\$13,776.64	(\$4,305.68)	\$3,634.09	(\$1,959.10)	1.85	\$1,913.11	4.17
6	\$39,725.62	26	69.23	18	\$14,240.00	(\$5,212.80)	\$3,197.77	(\$2,229.28)	1.43	\$1,527.91	3.23
5	\$33,754.74	26	65.38	17	\$13,135.00	(\$4,713.60)	\$2,954.33	(\$1,829.88)	1.61	\$1,298.26	3.05
4	\$28,235.48	26	69.23	18	\$13,377.28	(\$7,005.12)	\$2,968.71	(\$3,150.17)	0.94	\$1,085.98	2.12
3	\$26,889.26	26	57.69	15	\$8,279.04	(\$5,206.08)	\$2,802.21	(\$1,376.72)	2.04	\$1,034.20	2.78
2	\$29,120.91	26	65.38	17	\$7,495.68	(\$2,176.32)	\$2,344.43	(\$1,192.70)	1.97	\$1,120.04	3.71
1	\$27,509.83	26	65.38	17	\$9,089.88	(\$1,398.34)	\$1,942.12	(\$611.79)	3.17	\$1,058.07	6.00

This confirmed my thought about 5 lower lows possibly being more effective near an exhaustive bottom.

In summary, it appears a strongly up- trending healthy market should not make lower lows for 5 days in a row. It just did, though, which suggests perhaps the up-trend is not so healthy.

Additionally, put/call ratios remain low. Recall my findings from last weekend's Letter which suggested difficult market conditions for as long as this was the case:

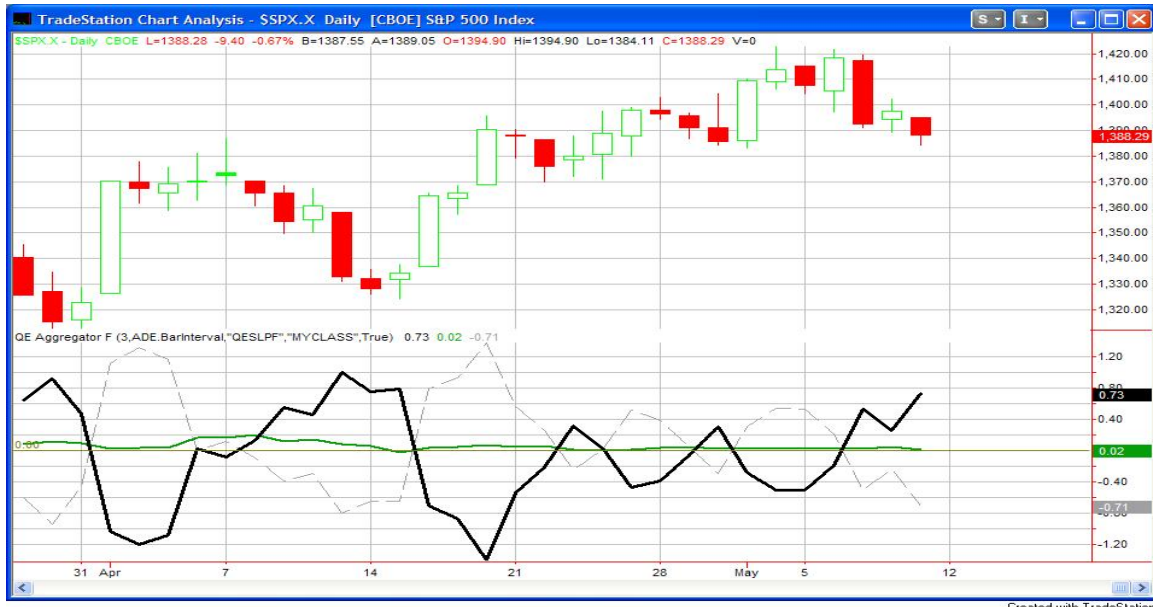
I first looked at the CBOE Equity Put/Call Ratio. My data went back to 8/31/04. Since that time through 4/25/08 when the 10-day MA of the equity put/call crossed below the 200-day, the S&P 500 has gained 293.61 points. It has gained 342.30 points when the 10ma is above the 200 and lost 48.69 points when the CBOE equity p/c 10ma is below the 200.

I then looked at the CBOE Total Put/Call Ratio. In this case the data went back to 8/6/96. In between 8/6/96 and 4/18/2008 the S&P 500 gained 728.01 points. In that time the 10ma over 200ma p/c formation gained 709.25 points and the 200ma over 10ma p/c formation gained only 18.76 points.

Most of the bullish studies that suggested solid market upside over the last month and a half are now dissipating. We now have four left in the summary shown at the top of the Letter. Three of those four will expire by the end of this week. If we don't get some action with bullish implications between now and Friday the only study remaining suggesting upside will be the Consumer Sentiment Stretch study from March 17th. This was a long-term study which doesn't provide significant influence on a day to day basis. The intermediate-term outlook is therefore moving from slightly bullish to slightly bearish. This means I will be demanding the best setups to take on long exposure and looking to trade a bit more aggressively from the short-side.

Short-term Outlook (1-5 days) – neutral – updated 5/12/08

As noted above, the market exhibited more weakness on Friday. In addition to the price action, breadth was also somewhat negative and volume was muted. Let's take a look at the Aggregator chart to see what it might be suggesting for the next few days.



Over the last three days the market has strongly underperformed expectations. This is evident by the high level of the black line (3 days expectations – 3 day performance). When the market underperforms expectations by such a significant amount it suggests additional downside may be limited. A strongly positive Aggregator would get me excited about the long side. Unfortunately the Aggregator (green line) is only showing a value of 0.02. This means the average of the active studies suggests a 0.02% rise over the next three days. This is below the long-term drift of the market which is 0.035%. Therefore, the Aggregator's current reading is neutral.

Over the next few days as some of the bullish studies expire the Aggregator is projected to move to a negative number. Of course these values are liquid and change on a nightly basis as new studies are performed. Rather than look to play a bounce at this point, my Aggregator analysis suggests we may be better off looking to short the potential bounce. Should the green and black lines be positioned strongly in the same direction that normally suggests an opportune time for an index trade entry. Coming into the weekend I was hoping they would both be stretching up. Tonight's research suggests we may have to hope for a stretch down for an index trade idea to trigger.

With three long positions already and the analysis turning bearish, I'm wary of additional longs at this point. The short-term oversold status of the market is leaving us without any short setups. I have shown two potential long setups in the "radar" section as I sometimes do when I am otherwise standing aside and looking for better opportunities. Aggressive traders may consider them but I'll let them go and not track them as "official" trade ideas.

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	1.16
DJ US Insurance Index	IAK	0.00	DJ US Financial	IYF	0.34
DJ US Regional Banks	IAT	1.25	DJ US Financial Services	IYG	0.70
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	1.41
DJ US Oil&Gas Expl & Prod	IEO	1.72	DJ US Industrial Sector	IYJ	0.00
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	1.36
DJ US Pharmaceuticals	IHE	2.70	DJ US Basic Materials	IYM	0.00
DJ US Healthcare Providers	IHF	2.04	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	0.00
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.00	Nasdaq 100	QQQQ	0.00

Not much showing up here.

Additional New Trade Ideas

None

Additional Trades Active Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
MCD	5/8/2008	\$59.38	\$59.24	-0.24%	\$58.69	exit if 2RSI closes > 14RSI
FXE	5/8/2008	\$154.13	\$154.96	0.54%	\$153.50	sell on close > 10ma
KO	5/9/2008	\$55.97	\$56.13	0.29%		bought on open

FXE did close above the 5ma on Friday. If there is early morning strength, I may look to take half profits rather than waiting to see if it holds throughout the day.

Stocks and ETF's on my Radar

PRU (Prudential) – In the 4/21/08 Subscriber Letter I unveiled the following system for an ETF trade:

- 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.

Buy this bar on close. Sell on a close above the 20-period moving average.

Over the last 10 years the strategy results for the S&P 100 components would have looked like this:

Trades	306
Winners	222
Losers	84
Pct Winners	73%
Avg Win	5.8%
Avg Loss	-6.7%
Avg Trade	2.4%
Profit Factor	2.3

Pretty good results for the system, but my market analysis has me cautious. This should only be considered for aggressive traders.

HIG (Hartford Financial) is also showing the same setup.

USO – possible short watch. Too far too fast? Looking for short triggers as this one may need to pull back soon.

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

Oversold

none

Overbought

None

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