

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

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May 15, 2008

Issue 62

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## Market Overview

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

Study Date	Description	Time span	Bias
May 13, 2008	1% Rally on Lowest Vol in 20	1-12 days	Bearish
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
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

### ***Short-term Outlook (1-5 days) – slightly bearish – updated 5/15/08***

After gapping up and rallying strongly in the morning, the market reversed hard on Wednesday afternoon. The Nasdaq gave back all its gains and closed lower on the day while the S&P and Dow managed to finish slightly positive. Bars like those seen today look rather ugly to technicians.

In the past I'd showed several examples of reversal bar formations near bottoms that proved fairly reliable in signaling at least a short-term change in direction. Upside reversals have a tendency to carry through for the next few days. Downside reversal bars coming off highs are not nearly as reliable. I ran a multitude of tests tonight looking at action following days similar to today where the market hits an intermediate-term high (20 days, 50 days, etc.) and then reverses to close poorly. Most of what I saw was simply chop with no results compelling enough to include as an official study.

I also looked at what happened if the selloff came specifically in the last hour of the day. Results here were a bit more bearish over days 2-4 but still nothing to hang your hat on.

In and of itself, today's price action was not necessarily bearish. It certainly wasn't bullish, though and combined with my other indicators and studies I still believe the market is likely to see more downside in the near future. The Aggregator chart is below:



Based on the current studies the Aggregator is scheduled to move from neutral (0.01) to negative (-0.02) tomorrow. It will become more negative over the next several days barring new official studies. To aggressively enter a position I prefer to see the black and green line either strongly positive or negative. An up day tomorrow should put us in a negative position. In the trade ideas section I've suggested another small lot of SPY short should the market once again attempt to rally tomorrow.

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

Friday the S&P 500 posted its 5<sup>th</sup> 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:

<b>SPX makes 5 lower lows. Buy on close. Exit "X" days later. \$100k per trade. 1978-now</b>											
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:

<b>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</b>											
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

<b>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</b>											
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:

<b>SPX makes 5 lower lows and close above 20ma. Buy on close. Exit "X" days later. \$100k per trade. 1978-now</b>											
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 17<sup>th</sup>. 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.

## **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.)***

<b>Index</b>	<b>ETF</b>	<b>CBI %</b>	<b>Index</b>	<b>ETF</b>	<b>CBI %</b>
DJ US Broker Dealers	IAI	0.00	DJ US Energy	IYE	1.16
DJ US Insurance Index	IAK	0.00	DJ US Financial	IYF	0.68
DJ US Regional Banks	IAT	0.00	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	0.68
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**

*SPY – Short at \$142.00.* One-quarter of the total SPY allocation was entered on Wednesday. I'm looking to enter another quarter should the market trade higher on Thursday.

### **Additional Trades Active Table**

<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(S)	5/14/2008	\$141.09	\$140.77	0.23%		bought on open
MDY(S)	5/14/2008	\$158.66	\$158.26	0.25%		exit on close < 10ma

Both trade ideas from last night were filled on the gap up Wednesday morning.

### **Stocks and ETF's on my Radar**

*Dow* – Overbought and getting stretched from its short-term moving averages. A reversal trigger could make for a nice short- setup.

*EP* – Retracement may be starting after recent sharp run-up.

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

#### ***Oversold***

*none*

#### ***Overbought***

None

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