

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 30, 2008

Issue 72

Market Overview

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

Study Date	Description	Time span	Bias
May 30, 2008	3 Up Days - Volume On Rise	1-10 days	Bullish
May 26, 2008	Put/Call 4ma spike (Letter)	1-10 days	Bullish
April 15 / May 23	WR7/NR7	1-15 days	Bullish
May 22, 2008	Sharp Drop from High	1-13 days	Bearish
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) –neutral – updated 5/30/08

The market rose Thursday for the 3rd day in a row, managing to close nicely positive despite giving back some gains in the afternoon. Breadth was positive. Volume edged up for the 2nd consecutive day.

In [tonight's blog](#) I looked at the effect volume had on a market that had risen three days in a row while trading under its 200-day moving average. Essentially I showed that a rising volume pattern like we've seen the last two trading sessions has generally been a positive. It managed to turn a series of 3 higher closes from a strongly negative expectancy to one that was solidly positive.

While that study used a 200-day moving average as a filter, I'm not certain how appropriate that filter currently is. This S&P 500 is below its 200-day ma – but not by much. It has been in an uptrend since bottoming over 2 months ago. In addition, some indices such as the Nasdaq 100 are already above their 200-day moving average. Therefore I decided to eliminate the 200-day moving average as a filter and re-run some results. Below is a snapshot of how the market has performed when the volume pattern of two higher days is not in place:

S&P 500 closes higher 3 days in a row. Volume doesn't rise last 2 days in row.									
Buy on close. Sell "X" days later. \$100,000 per trade. Last 35 years.									
X Days	Net Profit	Trades	Wins	% Profitable	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
10	(\$96,450.80)	347	168	48.41	\$1,945.47	(\$2,364.74)	0.82	(\$277.96)	0.77
9	(\$79,580.42)	358	169	47.21	\$1,959.31	(\$2,173.04)	0.90	(\$222.29)	0.81
8	(\$70,847.19)	375	193	51.47	\$1,695.84	(\$2,199.69)	0.77	(\$188.93)	0.82
7	(\$69,791.12)	385	191	49.61	\$1,709.79	(\$2,043.10)	0.84	(\$181.28)	0.82
6	(\$54,971.63)	409	209	51.10	\$1,658.02	(\$2,007.49)	0.83	(\$134.40)	0.86
5	(\$44,947.92)	427	224	52.46	\$1,550.22	(\$1,932.00)	0.80	(\$105.26)	0.89
4	(\$56,507.00)	450	233	51.78	\$1,343.93	(\$1,703.42)	0.79	(\$125.57)	0.85
3	(\$68,179.16)	450	221	49.11	\$1,160.77	(\$1,424.16)	0.82	(\$151.51)	0.79
2	(\$34,889.09)	450	222	49.33	\$918.90	(\$1,052.35)	0.87	(\$77.53)	0.85
1	\$22,260.53	450	220	48.89	\$716.99	(\$599.46)	1.20	\$49.47	1.16

Now, as in the blog, let's take a look at how the market has performed when it's had three higher closes and volume has risen both of the last two days:

S&P 500 closes higher 3 days in a row. Volume rises last 2 days.									
Buy on close. Sell "X" days later. \$100,000 per trade. Last 35 years.									
X Days	Net Profit	Trades	Wins	% Profitable	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
10	\$84,359.54	171	99	57.89	\$2,249.54	(\$1,921.45)	1.17	\$493.33	1.61
9	\$56,043.99	176	97	55.11	\$2,194.46	(\$2,010.49)	1.09	\$318.43	1.36
8	\$54,588.90	178	97	54.49	\$2,011.41	(\$1,778.70)	1.13	\$306.68	1.39
7	\$58,836.22	184	100	54.35	\$2,008.07	(\$1,710.49)	1.17	\$319.76	1.41
6	\$59,384.14	186	112	60.22	\$1,558.98	(\$1,557.04)	1.00	\$319.27	1.52
5	\$49,898.51	190	115	60.53	\$1,341.06	(\$1,390.98)	0.96	\$262.62	1.48
4	\$44,036.61	197	119	60.41	\$1,234.07	(\$1,318.18)	0.94	\$223.54	1.43
3	\$42,388.16	197	121	61.42	\$1,066.52	(\$1,140.27)	0.94	\$215.17	1.49
2	\$26,503.05	197	112	56.85	\$893.46	(\$886.32)	1.01	\$134.53	1.36
1	\$8,010.39	197	97	49.24	\$684.90	(\$584.25)	1.17	\$40.66	1.14

Again we see that the volume pattern makes a huge difference. This suggests bullish short-term implications for the S&P 500.

Tonight's Aggregator chart is below:



While expectations are beginning to turn positive again (green Aggregator line), the market has been exceeding those expectations over the last three days. This suggests that we should be waiting for a better setup before entering a new index trade. The fact that the S&P is back near the middle of its range also suggests an edge is unclear.

Unfortunately, I'm seeing more of the same from an individual stock standpoint. Lots of securities are trading in the middle of their ranges and providing no discernable edge. I won't be suggesting any official new trade ideas to track tonight. There are some securities in the "radar" section and there are also some exits shown on yesterday's positions.

Intermediate-term Outlook (1 week – 2 months) – neutral – updated 5/26/2008

Last week I noted a few things that had me greatly concerned about the rally's health and therefore taking short index positions. My studies indicated that the market had gotten far ahead of itself and that there were several bearish indications - from price action to volume to put/call ratios. While there are still definite intermediate-term concerns, some of what we were seeing last week has begun to abate.

One example is the CBOE Put/Call Ratio. While the longer-term 10ma/200ma ratio is still skewed a bit negative, the shorter-term averages have turned quickly. The 4-period CBOE Put/Call Ratios has jumped from 0.81 to 1.07 in the last 4 days. This is a fairly significant spike. I looked back in history to see other times when the 4ma jumped more than 0.25 points in 4 days. Below is a summary of S&P action going forward from such an event:

4-day MA of CBOE Put/Call Ratio Jumps 0.25 or more in 4 days. Buy on close. Sell "X"Days Later.											
\$100,000 per trade. September 1995 - present.											
X Days	Net Profit	Gross Profit	Gross Loss	Trades	Wins	% Profitable	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
10	\$30,092.13	\$45,901.56	(\$15,809.43)	28	19	67.86	\$2,415.87	(\$1,756.60)	1.38	\$1,074.72	2.90
9	\$26,587.53	\$43,892.38	(\$17,304.85)	28	17	60.71	\$2,581.90	(\$1,573.17)	1.64	\$949.55	2.54
8	\$21,397.54	\$40,540.59	(\$19,143.05)	28	19	67.86	\$2,133.72	(\$2,127.01)	1.00	\$764.20	2.12
7	\$22,970.78	\$41,885.40	(\$18,914.62)	28	19	67.86	\$2,204.49	(\$2,101.62)	1.05	\$820.39	2.21
6	\$15,976.12	\$40,559.09	(\$24,582.97)	28	17	60.71	\$2,385.83	(\$2,234.82)	1.07	\$570.58	1.65
5	\$6,128.50	\$35,600.90	(\$29,472.40)	28	16	57.14	\$2,225.06	(\$2,456.03)	0.91	\$218.88	1.21
4	\$2,749.38	\$23,983.33	(\$21,233.95)	28	18	64.29	\$1,332.41	(\$2,123.40)	0.63	\$98.19	1.13
3	\$4,768.20	\$23,345.52	(\$18,577.32)	31	18	58.06	\$1,296.97	(\$1,429.02)	0.91	\$153.81	1.26
2	(\$2,328.15)	\$19,931.35	(\$22,259.50)	34	18	52.94	\$1,107.30	(\$1,391.22)	0.80	(\$68.48)	0.90
1	(\$6,571.75)	\$19,282.72	(\$25,854.47)	51	28	54.90	\$688.67	(\$1,124.11)	0.61	(\$128.86)	0.75

While action over the first few days is sketchy, there seems to be a decided advantage once you get out 7-10 days. Two weeks out gains outsize losses by nearly 3:1 while winners outnumber losers by 2:1. The average two-week return was nearly 1.1% versus an average two-week return of less than 0.15% over the test period.

While the results seem quite positive, the market is in an unusual position to see such a spike occur. In most instances, such spikes occurred near market bottoms rather than tops. When I run a filter looking for instances when this occurred within 1 week of a 4-month (80 day) high, only three appear. One is 3/23/06. When looking at the data reported by the CBOE it appears there was either bad data or extremely unusual call activity on 3/16/06 which caused this spike a few days later. The put/call ratio on 3/16 was 0.32. No other day in the vicinity even came close. That days data shows nearly 3 times more calls bought than any other day near that date.

The other two occurrences appear legitimate. They appeared at very different times, though. The first was on 5/22/03 which was a couple of months after the March 2003 bottom. The second was on 2/26/07 which occurred when the market pulled back after a long extended drift higher. While a case could be made that the 3/2003 bottom is similar in that we are two months off the March 2008 bottom and have had a run higher, I'm not seeing a lot of other similarities to that period – especially from a breadth perspective. Regardless of whether the current situation matches up with something we've seen in the past, I believe the fact that market players are somewhat jittery and are flipping from complacent to fearful so quickly could be a positive.

We are going to see 3 of our bearish studies above lose their influence and drop from the list this week and one more next week. The two most recent studies have had a bullish tilt. Not listed is the [Nasdaq Net New High study](#) I published on the blog on Thursday. While it is difficult to quantify the implications of a study with such limited results, it does seem appropriate to keep the extremely bearish implications in mind.

I have moved the bias back from slightly bearish to neutral this week. It may be a bit early for that. There are some indications that the rally since March has been nothing but a bear market rally that could be ending. Still, we are at a juncture where I am willing to play both side of the market at this point.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

F (Ford) – Bought @ \$7.49 (1/3 position).

F (Ford) – Bought @ \$6.99 (1/3 position).

F (Ford) – Bought @ \$6.79 (1/3 position).

The CBI is now back to a neutral state at “3/1”.

Open Big 50 Trades

None

Open Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 3/1 (F-3)

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	0.00	DJ US Financial	IYF	1.03
DJ US Regional Banks	IAT	3.75	DJ US Financial Services	IYG	2.10
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	0.77
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	3.40
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	2.78	DJ US Technology Sector	IYW	1.01
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.88	Nasdaq 100	QQQQ	2.00

Nothing too extreme.

Additional New Trade Ideas

None

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
F	5/22/2008	\$7.49	\$6.71	-10.41%		
F	5/23/2008	\$6.99	\$6.71	-4.01%		
JNJ	5/23/2008	\$65.33	\$66.29	1.47%		sold on close>10ma
MER	5/23/2008	\$44.29	\$44.51	0.50%	\$42.34	sell % b close>25
F	5/27/2008	\$6.79	\$6.71	-1.18%		
GOOG	5/27/2008	\$544.62	\$574.79	5.54%		sold on open
S	5/28/2008	\$8.44	\$9.24	9.48%		sold at intraday stop

Subscribers were alerted to the closing of the S (Sprint) trade idea intraday. Those who didn't sell at the close could considering exiting at tomorrow's open.

Stocks and ETF's on my Radar

UNP – Has closed above 10-ma 31 days in a row. Made new high today. Could get stretched soon, in which case I'll look for a reversal bar or like setup.

TLT – Breaking down but getting a bit stretched to the downside. Could set up as a long in a few days.

Notable S&P 500 stocks outside my "tradable" radar

none

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