

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 2, 2008

Issue 73

## Market Overview

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

Study Date	Description	Time span	Bias
June 2, 2008	Put/Call 3 ma drop	1-2 days	Bearish
June 2, 2008	Inside NR7 in and uptrend	1-3 days	Bearish
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

### *Intermediate-term Outlook (1 week – 2 months) – neutral – updated 6/2/2008*

In [Thursday's blog](#) I showed a study that looked at how the market performed during times when the banking sector was either leading or lagging. This weekend I decided to perform similar analysis across all 9 S&P sector groups.

To do this I looked at the current ratio of each sectors ETF price and compared that to the closing price of the S&P 500. Using weekly data, I then compared that ratio to a 10-week average. If the current ratio was above it's 10ma that indicated the sector was leading, if it was below it's 10ma that indicated the sector was lagging. I ran the test back to 12/31/99 since 2000 was the first full year that my sector data went back to. While I would prefer to look back further this 7 ½ year snapshot may help to provide some clues as to what sector action can tell us about the health of the overall market. Below are the results of the test. The data is listed in order of most positive leading influence to most negative leading influence.

<b>S&amp;P 500 Performance from 12/31/99 through 5/31/08. Total points LOST by S&amp;P 500 over that time - 68.9</b>							
<b>Sector lead/lag breakdown based on 10-week relative strength.</b>							
ETF	Sector	S&P Pnts When Leading	S&P Pnts When Lagging	Lead - Lag Differential	Current	Since	Implication
XLK	Technology	194.10	(263.00)	457.10	Lead	3/28/2008	Bullish
XLP	Cons. Staples	64.12	(133.02)	197.14	Lag	5/30/2008	Bearish
XLU	Utilities	-113.69	44.79	(158.48)	Lead	5/23/2008	Bearish
XLV	Health Care	-175.16	106.26	(281.42)	Lag	2/15/2008	Bullish
XLI	Industrial	-224.49	155.59	(380.08)	Lead	5/30/2008	Bearish
XLF	Financial	-236.76	167.86	(404.62)	Lag	5/9/2008	Bullish
XLE	Energy	-463.37	394.47	(857.84)	Lead	3/28/2008	Bearish
XLY	Cons. Discretionary	-492.37	423.47	(915.84)	Lag	5/23/2008	Bullish
XLB	Materials	-665.64	596.74	(1262.38)	Lead	5/9/2008	Bearish

Not a lot of surprises here. Technology has long been considered a leading sector. Upcoming technology companies may experience rapid earnings growth. In a speculative and bullish market environment, investors are often willing to allocate more capital to this potentially high risk / high reward sector.

On the other hand sectors like Energy and Materials tend to do well when commodity prices rise. Rise commodity prices impact inflation. They can lead to difficulty for both the economy and the stock market. We'd prefer to see these lagging.

The position of the sectors as seen in the "Implication" column is extremely mixed. The market doesn't seem to be set up in a way that would suggest a high likelihood of either a rally or a selloff. Technology is leading, but so are Materials and Energy. The other sectors also remain mixed. While the sector analysis isn't providing an obvious edge at the current time, I will continue to monitor it for clues going forward.

The current mix of studies listed at the top doesn't seem to be providing any strong clues for the intermediate-term. As we near the end of the week a few of the bearish studies will begin to drop off the list. There does seem to be some potential for a continued rally after a brief pullback.

I do remain wary of the implications of a few sentiment-based indicators though. For example, the CBOE Put/Call 10ma/200ma ratio remains low and the VIX:VXV ratio does as well. This leaves open the possibility of a strong selloff beginning in the next several weeks.

Overall, I'm not seeing a whole lot that would cause me to develop a strong conviction either way at this point. Therefore, I will keep the intermediate-term market bias at neutral for the 2<sup>nd</sup> week in a row. A neutral intermediate-term bias means I'm willing to look for both long and short-trades and will defer most decision making to the short-term bias.

**Short-term Outlook (1-5 days) –slightly bearish – updated 6/2/08**

The market showed some signs of indecision on Friday. Price did little but churn while breadth figures came in close to neutral. Meanwhile, sentiment gauges such as the CBOE put/call index and the VIX both dropped a little, suggesting absence of fear among traders.

Let's break the short-term action down with a couple of studies. There were a few things notable about the quiet price action on Friday with regards to the SPY. First, it produced an "inside day" where there was both a lower high and higher low than the previous day. I've discussed inside days a few times on the blog. The implications are typically bearish. Second, Friday qualified as an NR7 day. This means that the range from high to low was the smallest of any of the last 7 days. Lastly, it closed higher for the fourth day in a row. I ran a study based on some of the above price criteria.

<b>SPY posts an NR7 and an inside day and the 2-period RSI closes above 65.</b>								
<b>Buy SPY at close. Sell "X" days later. \$100,000 per trade. 12/93-present</b>								
"X" Days	Net Profit	Trades	Wins	% Profitable	Avg Win	Avg Loss	W/L Ratio	Avg Trade
5	(\$7,429.15)	62	32	51.61	\$1,165.17	(\$1,541.88)	0.76	(119.83)
4	(\$12,048.61)	63	33	52.38	\$959.53	(\$1,457.10)	0.66	(191.25)
3	(\$23,562.46)	63	27	42.86	\$910.50	(\$1,375.60)	0.66	(374.01)
2	(\$12,199.16)	64	34	53.13	\$688.97	(\$1,187.47)	0.58	(190.61)
1	(\$3,613.23)	64	34	53.13	\$560.82	(\$782.11)	0.72	(56.46)

Over the following three days implications have been bearish. If I adjust the data and either require a higher RSI or an up close today then the implications become even more bearish – though not substantially.

Now let's look at the action in the CBOE Put/Call Ratio. In last week's intermediate-term update I showed a study that provided stats following a spike up in a short-term put/call moving average. Implications were fairly bullish up to two weeks out. Interestingly, the market has managed to spike higher immediately following this study and this has led the put/call ratio to now drop sharply. So tonight I looked at what happens when the put/call does drop somewhat sharply:

<b>3-period moving average of CBOE put/call ratio drops at least 0.15 points in the last 3 days.</b>								
<b>Buy SPX at close. Sell "X" days later. \$100,000 per trade. 1996-present</b>								
"X" Days	Net Profit	Trades	Wins	% Profitable	Avg Win	Avg Loss	W/L Ratio	Avg Trade
5	(\$212.15)	133	75	56.39	\$1,519.45	(\$1,968.46)	0.77	(1.60)
4	(\$9,001.52)	135	64	47.41	\$1,534.67	(\$1,510.14)	1.02	(66.68)
3	(\$4,243.94)	141	79	56.03	\$1,280.57	(\$1,700.14)	0.75	(30.10)
2	(\$12,122.95)	165	88	53.33	\$1,044.37	(\$1,351.00)	0.77	(73.47)
1	(\$98.07)	249	130	52.21	\$758.87	(\$829.84)	0.91	(0.39)

Based on the average trade, the short-term implications here are slightly bearish. Tonight's studies suggest the market is likely to give back some of its recent gains in the next 2-3 days. After a short-time, the bearish implications of these studies dissipates.

Tonight's Aggregator chart is below:



While expectations (green Aggregator line) are again above the 0 line, they sit at 0.03% tonight. This is essentially the same as the long-term drift of the stock market and a level I consider to be neutral. The market has outperformed expectations over the last few days, which many times will lead to a reversion. Still, I'd be more comfortable shorting if the S&P outperformance was more extreme or the green Aggregator line was to the south of 0. Ideally, I like to see both the green and black lines stretched in the same direction to aggressively allocate money towards index trades.

My inclination is that we are likely to see some downside over the next 2-3 days. The position of the Aggregator as discussed above plus the fact that risk/reward is not set up as well as I'd like has me staying on the sidelines, though for purposes of "official" trade ideas. I frequently like to view risk/reward in terms of the SPY's recent range. In this case, the immediate upside potential of the S&P would be the 5/19 high of 144.30 and the downside is the 5/23 low of 137.52. Even after 4 up days the SPY is still squarely in the bottom half of that range. I'd prefer to be in the top half where potential reward would be larger than potential risk before attempting a borderline trade. Risk would equal reward at about the \$141 level. I shall give the market another day to see if it can achieve this level before possibly taking on a short position.

From an individual stock standpoint I continue to see lots of securities trading in the middle of their recent ranges and providing no discernable edge. I won't be suggesting any official new trade ideas to track tonight.

## **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.)***

<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	0.00
DJ US Insurance Index	IAK	0.00	DJ US Financial	IYF	2.05
DJ US Regional Banks	IAT	7.50	DJ US Financial Services	IYG	4.20
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	0.38
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	0.00	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	0.44	Nasdaq 100	QQQQ	2.00

Regional banks are nearing an extreme level. They will bear watching in the next few days.

### **Additional New Trade Ideas**

None

### **Active Trades 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>
F	5/22/2008	\$7.49	\$6.80	-9.21%		
F	5/23/2008	\$6.99	\$6.80	-2.72%		
MER	5/23/2008	\$44.29	\$43.92	-0.84%	\$42.34	sell % b close>25
F	5/27/2008	\$6.79	\$6.80	0.15%		

The average price in F (Ford) is \$7.09.

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

UNP – Has closed above 10-ma 32 days in a row. Made new high today. I'm on the alert for a reversal short opportunity.

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

None

## **Closed Trades Ideas In May**

At the end of each month I post a review of the previous month's closed trade ideas. Below are May's trades along with an inception-to-date total.

This is not a performance record. I do not make recommendations in the Subscriber Letter. This is simply a listing of trade ideas. Past performance is not necessarily indicative of future results. That said, I sincerely hope all of you were able to derive value from the trade ideas.

Security	Type	Strategy	Position	Entry Dt	Entry Prc	Exit Date	Exit Prc	Pct G/L
SPY	Index	QE Index	Long	5/1/2008	\$138.40	5/1/2008	\$140.51	1.5%
GLD	ETF	QE System	Long	5/2/2008	\$83.96	5/5/2008	\$86.27	2.8%
MCD	Stock	QE System	Long	5/8/2008	\$59.38	5/12/2008	\$60.87	2.5%
FXE	ETF	QE System	Long	5/8/2008	\$154.13	5/12/2008	\$155.55	0.9%
KO	Stock	QE System	Long	5/9/2008	\$55.97	5/13/2008	\$56.50	0.9%
MDY	ETF	QE System	Short	5/14/2008	\$158.66	5/21/2008	\$157.87	0.5%
IWP	ETF	QE System	Short	5/16/2008	\$115.27	5/21/2008	\$112.10	2.8%
SPY	Index	QE Index	Short	5/14/2008	\$141.09	5/21/2008	\$140.83	0.2%
SPY	Index	QE Index	Short	5/15/2008	\$142.00	5/21/2008	\$140.83	0.8%
SPY	Index	QE Index	Short	5/19/2008	\$142.81	5/21/2008	\$140.83	1.4%
VLO	Stock	QE System	Short	5/21/2008	\$50.15	5/23/2008	\$48.61	3.1%
MA	Stock	QE System	Long	5/21/2008	\$277.40	5/23/2008	\$272.00	-1.9%
SPY	Index	QE Index	Short	5/19/2008	\$143.50	5/27/2008	\$137.80	4.0%
GOOG	Stock	Catapult	Long	5/27/2008	\$544.62	5/29/2008	\$574.79	5.5%
JNJ	Stock	QE System	Long	5/23/2008	\$65.33	5/29/2008	\$66.42	1.7%
S	Stock	Catapult	Long	5/28/2008	\$8.44	5/29/2008	\$9.26	9.7%

<b>Summary - May</b>			
Winners	15	Avg Win	2.55%
Losers	1	Avg Loss	-1.95%
Pct Winners	93.75%	Avg Trd Ide	2.27%
		Profit Factor	19.66
<b>Summary - Since 2/19/08 Inception</b>			
Winners	47	Avg Win	2.91%
Losers	12	Avg Loss	-2.65%
Pct Winners	79.66%	Avg Trd Ide	1.78%
		Profit Factor	4.29

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.