

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 5, 2008

Issue 76

Market Overview

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

Study Date	Description	Time span	Bias
June 5, 2008	SPX down NDX up 1%	1-4 days	Bullish
June 5, 2008	Put/Call 3ma spike (Letter)	1-10 days	Bullish
June 3, 2008	Big drop bad breadth	1-9 days	Bullish
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) – bullish – updated 6/5/08

Wall Street is a bit jumpy these with regards to bank news and comments from Bernanke. For the 2nd day in a row, those two excuses were used to sell a rally. Volume came in relatively strong. Breadth was once again negative but not to an extreme.

In [tonight's blog](#) I showed a study that looked at how the market performed following a day when the Nasdaq 100 rose over 1% while the S&P 500 closed down on the day. The results table from that study is below:

SPX closes lower while NDX rises at least 1%											
Buy S&P 500 at the close. Sell "X" Days later. \$100,000 per trade 1986 - present											
X Days	Net Profit	Trades	Wins	% Profitable	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
5	\$44,365.21	75	47	62.67	\$7,414.55	(\$10,592.64)	\$2,068.00	(\$1,886.81)	1.10	\$591.54	1.84
4	\$45,185.89	76	48	63.16	\$6,097.05	(\$7,579.44)	\$2,019.26	(\$1,847.81)	1.09	\$594.55	1.87
3	\$36,584.05	76	42	55.26	\$5,801.02	(\$4,083.51)	\$1,864.25	(\$1,226.89)	1.52	\$481.37	1.88
2	\$18,723.03	78	43	55.13	\$4,579.14	(\$4,296.24)	\$1,326.17	(\$1,094.35)	1.21	\$240.04	1.49
1	\$18,440.10	79	45	56.96	\$2,348.64	(\$3,794.40)	\$957.58	(\$725.03)	1.32	\$233.42	1.75

These results are quite positive. One week out 63% of the instances were positive. The average instance gained nearly 0.6% and net gains outsized net losses by almost 2:1.

I also decided to break this study down and look at it a few more ways. Below are the results when the instance occurs while the S&P is trading below its 200-day moving average:

S&P 500 closes lower while NDX rises at least 1%. S&P 500 closes under 200 day moving average.											
Buy S&P 500 at the close. Sell "X" Days later. \$100,000 per trade 1986 - present											
X Days	Net Profit	Trades	Wins	% Profitable	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
5	\$30,284.58	27	18	66.67	\$7,414.55	(\$10,592.64)	\$2,998.81	(\$2,632.67)	1.14	\$1,121.65	2.28
4	\$33,382.25	27	20	74.07	\$6,097.05	(\$7,579.44)	\$2,782.65	(\$3,181.52)	0.87	\$1,236.38	2.50
3	\$31,751.08	27	18	66.67	\$5,801.02	(\$3,927.96)	\$2,535.85	(\$1,543.79)	1.64	\$1,175.97	3.29
2	\$26,811.54	27	20	74.07	\$4,579.14	(\$4,296.24)	\$1,747.68	(\$1,163.15)	1.50	\$993.02	4.29
1	\$19,488.94	27	19	70.37	\$2,348.64	(\$1,834.92)	\$1,353.00	(\$777.26)	1.74	\$721.81	4.13

Returns are even more reliable and twice as profitable on average when this is the case.

I then looked at times when the Nasdaq 100 rose at least 1% and the S&P 500 dropped for at least the 3rd consecutive day:

S&P 500 closes lower while NDX rises at least 1%. S&P 500 closes lower for at least the 3rd consecutive day.											
Buy S&P 500 at the close. Sell "X" Days later. \$100,000 per trade 1986 - present											
X Days	Net Profit	Trades	Wins	% Profitable	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
5	\$19,253.97	13	9	69.23	\$5,834.40	(\$2,579.04)	\$2,734.16	(\$1,338.36)	2.04	\$1,481.07	4.60
4	\$19,401.97	13	10	76.92	\$5,728.32	(\$4,174.20)	\$2,470.86	(\$1,768.87)	1.40	\$1,492.46	4.66
3	\$16,332.60	13	8	61.54	\$5,801.02	(\$2,635.20)	\$2,873.16	(\$1,330.54)	2.16	\$1,256.35	3.46
2	\$6,910.64	13	9	69.23	\$3,583.44	(\$4,296.24)	\$1,626.64	(\$1,932.27)	0.84	\$531.59	1.89
1	\$10,149.99	13	10	76.92	\$2,286.08	(\$715.40)	\$1,134.10	(\$397.00)	2.86	\$780.77	9.52

More good news here. We are down to only 13 instances, but the numbers keep improving. I checked to see how many of the 13 made a higher close sometime in the next week. The number came to 12.

If I take it another step further and look at instances below the 200ma where the S&P was down for at least 3 days in a row then the results look like this:

S&P 500 closes lower while NDX rises at least 1%. S&P 500 closes lower for at least the 3rd consecutive day and under the 200ma.											
Buy S&P 500 at the close. Sell "X" Days later. \$100,000 per trade 1986 - present											
X Days	Net Profit	Trades	Wins	% Profitable	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
5	\$13,012.33	7	5	71.43	\$5,834.40	(\$2,579.04)	\$3,298.59	(\$1,740.32)	1.90	\$1,858.90	4.74
4	\$11,417.77	7	5	71.43	\$5,728.32	(\$4,174.20)	\$3,188.47	(\$2,262.30)	1.41	\$1,631.11	3.52
3	\$10,975.88	7	4	57.14	\$5,801.02	(\$2,635.20)	\$3,790.22	(\$1,395.00)	2.72	\$1,567.98	3.62
2	\$5,090.77	7	6	85.71	\$3,179.08	(\$4,296.24)	\$1,564.50	(\$4,296.24)	0.36	\$727.25	2.18
1	\$7,229.21	7	5	71.43	\$2,286.08	(\$715.40)	\$1,626.29	(\$451.12)	3.61	\$1,032.74	9.01

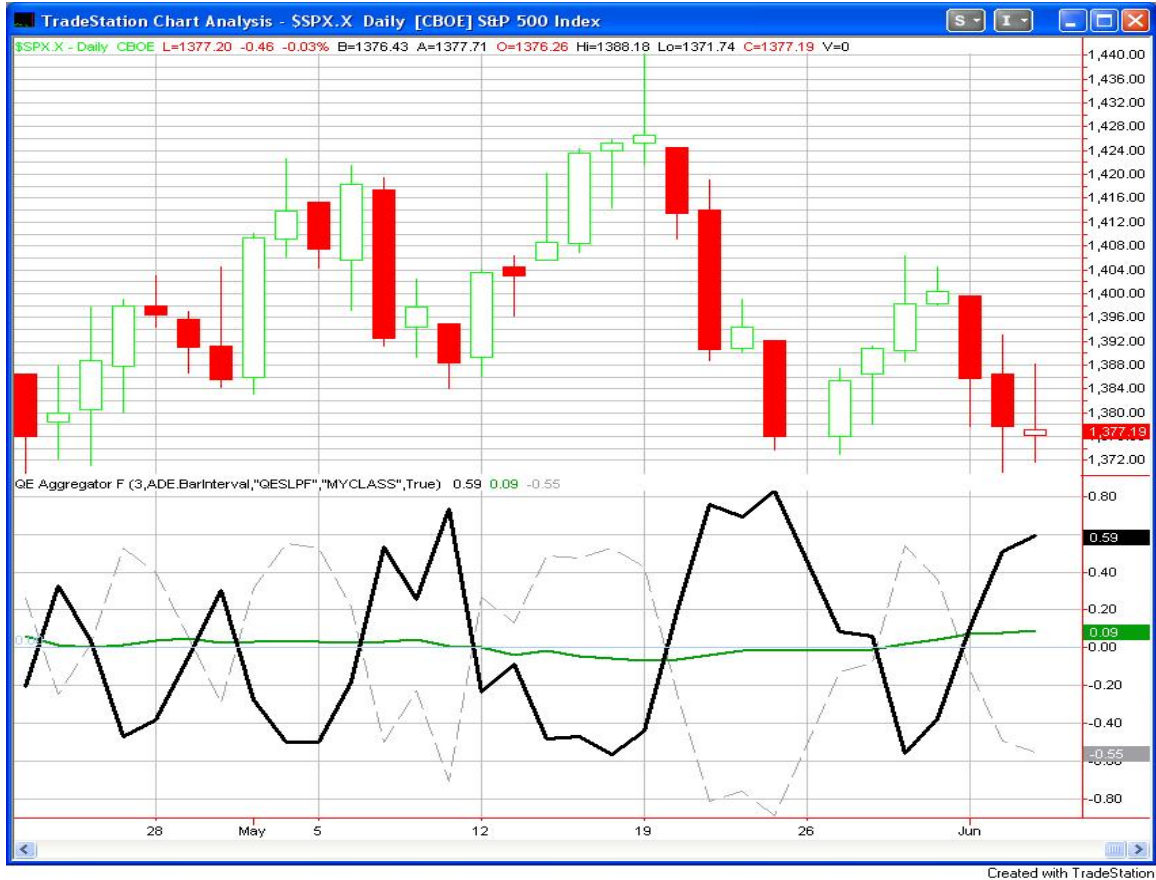
Sample size is getting a bit too small to mean much here but I thought it was interesting none the less.

Of further interest is the fact that the CBOE Put/Call ratio has jumped up over the last three days. I looked at quick jumps in short-term moving averages in the Put/Call ratio in the May 27th and June 2nd Subscriber Letters. Here's another study which matches the current situation:

3-period moving average of CBOE put/call ratio spikes at least 0.25 points in 3 days.											
Buy S&P 500 at the close. Sell "X" Days later. \$100,000 per trade 1986 - present											
X Days	Net Profit	Trades	Wins	% Profitable	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
20	\$47,924.31	28	20	71.43	\$12,586.62	(\$7,785.40)	\$3,741.39	(\$3,362.95)	1.11	\$1,711.58	2.78
10	\$28,091.98	32	22	68.75	\$8,192.79	(\$12,715.12)	\$2,830.25	(\$3,417.35)	0.83	\$877.87	1.82
9	\$25,805.52	32	22	68.75	\$7,037.93	(\$9,937.84)	\$2,734.43	(\$3,435.20)	0.80	\$806.42	1.75
8	\$20,836.21	33	20	60.61	\$7,949.70	(\$8,473.52)	\$2,663.86	(\$2,495.46)	1.07	\$631.40	1.64
7	\$16,820.06	33	21	63.64	\$7,662.81	(\$7,942.88)	\$2,451.89	(\$2,889.13)	0.85	\$509.70	1.49
6	\$12,760.31	34	21	61.76	\$8,870.96	(\$6,274.80)	\$2,449.17	(\$2,974.78)	0.82	\$375.30	1.33
5	\$3,934.64	34	18	52.94	\$5,393.97	(\$6,182.22)	\$2,100.25	(\$2,116.87)	0.99	\$115.72	1.12
4	\$12,628.05	34	22	64.71	\$5,731.96	(\$4,539.48)	\$1,745.13	(\$2,147.07)	0.81	\$371.41	1.49
3	\$2,830.41	34	22	64.71	\$5,215.85	(\$4,909.74)	\$1,394.64	(\$2,320.98)	0.60	\$83.25	1.10
2	\$3,272.79	39	21	53.85	\$6,245.15	(\$4,638.84)	\$1,413.80	(\$1,467.61)	0.96	\$83.92	1.12
1	\$8,847.29	52	33	63.46	\$3,322.23	(\$3,006.10)	\$807.16	(\$936.27)	0.86	\$170.14	1.50

Like the previous put/call ratio spike studies I've shown, this one seems to provide an edge, especially when looking out from 6-10 days.

Lastly, below is an updated look at the Aggregator chart:



You'll notice both the green Aggregator line and the black differential line are now stretched above the 0 line. This is exactly what we look for to go long. In English, based on the studies the market is expected to go up by a decent amount over the next 3 days (2-3 times normal) and over the last 3 days it has largely underperformed its expectations.

All of the studies the last few days seem to be saying go long. It is a shame the trade idea was stopped out this afternoon, but I am going to just look to get right back into it - with slightly larger size this time. Rather than scaling in $\frac{1}{4}$ at a time, I'll look to take a $\frac{1}{3}$ position tomorrow unless it gaps significantly and never looks back.

It is rare that I will let myself get stopped out like that on an index trade. The issue right now is that the market seems to be following banks and Bernanke a bit too closely. When the market starts reacting to rumors and comments those reactions can many times become overreactions. It is many times best to stand aside for these overreactions and then look to re-enter than it is to brave a possible waterfall. It didn't turn into a waterfall this time, and actually did little more than enough to force a scratch the trade idea.

I'm also seeing some interesting action in individual names and etf's that I've listed in the trade ideas section.

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.

S&P 500 Performance from 12/31/99 through 5/31/08. Total points LOST by S&P 500 over that time - 68.9							
Sector lead/lag breakdown based on 10-week relative strength.							
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 2nd 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.

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	2.05
DJ US Regional Banks	IAT	8.75	DJ US Financial Services	IYG	4.20
DJ US Utilities	IDU	1.35	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	2.72
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	2.44	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	0.00	DJ US Technology Sector	IYW	0.50
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.44	Nasdaq 100	QQQQ	1.00

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

Additional New Trade Ideas

1) *SPY* – buy 1/3 position at \$138.25 limit. As discussed in the market outlook section above.

2) *IAT* – *This one is not for the faint of heart. The banks have been beat up quite a bit in recent days. As noted above their CBI % is fairly high as well. This setup based on the following criteria: 1) Closes lower by 1% four days in a row. Over the last 10 years across my list of 104 highly liquid ETF's (many of which have nit been around 10 yrs.), buying this setup on the close and selling on a close above the 5-period moving average would have produced the following results:*

Trades	80
Winners	63
Pct Winners	78.8%
Avg Win	3.36%
Avg Loss	3.67%
Avg Trade	1.87%
Profit Factor	3.4

It has only happened once in *IAT*. That was 11/19/07. It was closed on 11/23/07 for a 0.9% gain.

3) *CME* triggered a system buy today based on criteria laid out in the 5/9 subscriber letter (and mentioned yesterday in the Radar area with regards to *IFN*.)

Setup based on the following criteria: 1) Closes below 10ma at least 10 days in a row. 2) Today it hit a 10-day low. 3) Yesterday it closed stretched further below the 10ma on a percent basis than any day of the selloff. 4) Today it again closed stretched further than any day of the selloff. Over the last 10 years across all current S&P 100 stocks, buy this setup on the close and selling on a close above the 5-period moving average would have produced the following results: (stats are from 5/9)

Trades	475
Winners	352
Pct Winners	74.1%
Avg Win	3.70%
Avg Loss	-4.93%
Avg Trade	1.55%
Profit Factor	2.3

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
F	5/22/2008	\$7.49	\$6.46	-13.75%		
F	5/23/2008	\$6.99	\$6.46	-7.58%		
F	5/27/2008	\$6.79	\$6.46	-4.86%		
EZA	6/3/2008	\$126.01	\$123.50	-1.99%		exit RSI4 closes > RSI15
SPY	6/4/2008	\$137.77	\$137.89	0.09%		bought and sold

The average price in F (Ford) is \$7.09 and the trade is looking so horrible I feel I should address it. I note in the Quantifiable Edges Subscriber Letter primer that I don't use stops with Catapult trades. (I will occasionally and have in the Subscriber Letter with Catapult-style Big 50 and Catapult for ETF trades which I don't normally scale in to.) There are a couple of reasons I don't use stops. The first is that I have yet to find a stop technique that would improve the returns of these trades. I tried basically everything I could think of. In every case using stops, whether they were based on support levels or percentages or anything, simply didn't help returns. That is why I consider position sizing to be important with these trades and why I always look to scale in rather than going for broke. The second reason I don't stop out of these is that they make up the CBI. While the individual Catapult trades have provided nice gains over time, it's the spikes in the CBI which have provided huge value. If I took stops in many of these positions, it could mess up the CBI count. As noted in the CBI powerpoint presentation, the worst trade I've had in trading these was an entry that finished down 14%. We're approaching that with this trade. Hopefully it doesn't break any records. While there are no guarantees, sitting though it is most often the right thing to do. Older subscribers may recall the NYX trade from March. It was entered on March 5th and didn't get an exit trigger until March 25th. The trade ended up making 0.2% but it dipped over 12.5% in the process of getting there. The Catapult trades can sometimes be difficult to sit through, but with conservative position sizing and patience, they tend to pay off in the long run. They also give us the CBI. Below are some summary stats of all Catapult-style trades taken in the Subscriber Letter to date. As you'll notice, they tend to be even more volatile than our other trades. (Does not include open Ford trades.)

<i>Catapult Trade Summary - Since 2/19/08 Inception</i>			
Winners	23	Avg Win	5.15%
Losers	14	Avg Loss	-2.15%
Pct Winners	60.90%	Avg Trd Idea	2.29%
		Profit Factor	3.73

Stocks and ETF's on my Radar

IFN – triggered system mentioned yesterday once again. I prefer CME, though.

Other stocks getting stretched from their MA's after spending a good amount of time below them include AA, EEM and FSLR. Traders could look for reversal plays in any of these extended securities.

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

None

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