

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 6, 2008

Issue 77

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) – neutral – updated 6/6/08

As the studies and the Aggregator chart suggested might happen, the market shot higher today with breadth coming in almost 3:1 positive on the NYSE. Unfortunately, it gapped up this morning and then shot higher after coming within \$0.07 of filling the Letter's suggested limit price. I'm fairly aggravated with how I handled the SPY trade idea yesterday and today and discuss it in more detail in the trades section below.

Below is the Aggregator chart.



As you can see, it took one very strong day to move the market from strongly underperforming to strongly overperforming. With the green and black lines on opposite sides of “0” it is now in an area where we would normally be looking to take profits rather than initiate new positions.

With the Lakers in town for the 1st Finals Game in 21 years, I took the opportunity to attend the Celtics game tonight. Therefore, the Subscriber Letter is heavily abbreviated for the 1st time. There is one new trade idea below.

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	1.35	DJ US Financial	IYF	2.40
DJ US Regional Banks	IAT	7.50	DJ US Financial Services	IYG	4.20
DJ US Utilities	IDU	1.35	DJ US Healthcare	IYH	0.70
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	2.04
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	0.00

Regional banks continue to post fairly significant numbers. I'll continue to watch for another entry.

Additional New Trade Ideas

ATI – buy @ \$67.81. Set stop @ \$65.84 if filled. This is the same system discussed last night for the CME trade idea. It was originally published in the 5/9 Subscriber Letter (“SL80509” for those who would like to download the code). I also like the fact that this one is attempting a hammer bottom near the March lows. Details below:

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	\$6.37	-14.95%		
F	5/23/2008	\$6.99	\$6.37	-8.87%		
F	5/27/2008	\$6.79	\$6.37	-6.19%		
EZA	6/3/2008	\$126.01	\$125.93	-0.06%		exit RSI4 closes > RSI15

The average price in F (Ford) is \$7.09. See yesterday's notes for further explanation of why no stops are used on official Catapult trades. Hopefully we get a nice bounce here soon to cut the losses a little bit.

From a trading and execution standpoint the last three days has been the most frustrating I've had since starting the Letter. I suggested strongly last night and the night before that the market was likely to rise. All of my recent studies were pointing in that direction, and from an execution standpoint, the trade ideas failed to capture the move. It started on Wednesday when the afternoon reversal stopped out the SPY trade for a very small gain. I rarely put stops in on the first day, but I hate to let a large winner (up over 1% in the morning) turn into a loser. Experience has conditioned me to exit and re-evaluate when that kind of late-day swoon occurs. So that is how I handled it. Wednesday night the research continued to scream buy. I therefore suggested a more aggressive allocation and put in a limit price above the closing price – increasing the chances of a fill. The market gapped up and then fell back to within 7 cents of the Subscriber Letter's suggested limit price before turning around and rocketing higher. Hopefully some subscribers played it more aggressively and were able to benefit from the run today anyway. Adding to the SPY frustration is the fact that the two other trades I put out there last night both gapped and didn't fill – meaning no entry. CME finished up about 6.5% and IAT up 1.3%. Meanwhile, two that I noted in the "Radar" section, AA and FSLR provided both fills and nice profits. Hopefully a few subscribers picked up on those. Throw in Ford which is turning into the worst trade idea of all time and my frustration is near a boil.

It's all part of trading, though. What has always been the most frustrating scenario for me as a trader has not been the times I've been wrong and lost money, but rather times when I'm right and failed to take advantage. The execution of the trade ideas the last few days are a prime example of that. Not to worry, though. I anticipate being back on my game in no time.

Stocks and ETF's on my Radar

none

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

None

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