

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 24, 2008

Issue 89

## Market Overview

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

Study Date	Description	Time span	Bias
June 11/24	Draggin Breadth	1-10 days	Bearish
June 24, 2008	WR7 High Vol Down / NR7	1-18 days	Bullish
June 23, 2008	SPX under BB VIX not stretched	1-12 days	Bearish
June 23, 2008	CBI = 8	1-5 days	Bullish
June 23, 2008	Friday-Monday Negative Momo	1-4 days	Bearish
June 23, 2008	Gap & Drop At 50-low	1-19 days	Bullish
June 17, 2008	3 up days - momentum slowing	1-10 days	Bearish
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish

### **Short-term Outlook (1-5 days) – slightly bullish – updated 6/24/08**

The market spent Monday in a very narrow range and traded on the lightest volume in over a month. The S&P 500 and Dow were basically flat. The Nasdaq was the lone mover, dropping 20 points. The flat closes in the Dow and S&P camouflaged internal weakness as advancers outnumbered decliners by about 2:1 on the NYSE.

In [tonight's blog](#) I looked at NR7 days that are preceded by 1) WR7 down days, or 2) high-volume down days. Friday and Monday's action could have been interpreted either way. In both cases, implications were bullish over the next 1-4 weeks. Below is a table that shows historical results following instances where the WR7 day was also a high volume day:

<b>S&amp;P 500 makes an WR7 down on highest volume in 10 days followed by a NR7. Buy at close. Hold X days. \$100,000 per trade. 1978-present</b>											
Days Held	Net Profit	Trades	Wins	% Profitable	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
20	\$32,719.04	11	9	81.82	\$15,826.70	(\$5,044.50)	\$4,362.74	(\$3,272.82)	1.33	\$2,974.46	6.00
19	\$34,146.75	11	10	90.91	\$15,087.38	(\$3,422.70)	\$3,756.95	(\$3,422.70)	1.10	\$3,104.25	10.98
18	\$34,451.66	11	9	81.82	\$13,569.35	(\$1,997.10)	\$4,102.60	(\$1,235.85)	3.32	\$3,131.97	14.94
15	\$26,099.36	11	8	72.73	\$11,549.35	(\$3,384.90)	\$3,876.06	(\$1,636.37)	2.37	\$2,372.67	6.32
10	\$22,113.02	11	10	90.91	\$8,721.35	(\$3,124.80)	\$2,523.78	(\$3,124.80)	0.81	\$2,010.27	8.08
9	\$22,857.50	11	9	81.82	\$9,514.20	(\$1,760.40)	\$2,783.86	(\$1,098.60)	2.53	\$2,077.95	11.40
8	\$24,585.61	11	9	81.82	\$8,645.60	(\$1,611.00)	\$3,007.80	(\$1,242.30)	2.42	\$2,235.06	10.90
7	\$19,580.67	11	8	72.73	\$8,044.65	(\$1,356.48)	\$2,882.06	(\$1,158.60)	2.49	\$1,780.06	6.63
6	\$15,541.17	11	8	72.73	\$7,888.10	(\$2,467.20)	\$2,305.59	(\$967.84)	2.38	\$1,412.83	6.35
5	\$16,867.02	11	10	90.91	\$7,282.10	(\$1,965.12)	\$1,883.21	(\$1,965.12)	0.96	\$1,533.37	9.58
4	\$13,922.26	11	8	72.73	\$6,383.20	(\$2,811.84)	\$2,163.09	(\$1,127.48)	1.92	\$1,265.66	5.12
3	\$4,826.45	11	8	72.73	\$2,146.25	(\$6,426.24)	\$1,435.52	(\$2,219.24)	0.65	\$438.77	1.72
2	\$1,854.66	11	8	72.73	\$2,138.60	(\$4,627.20)	\$1,014.46	(\$2,087.00)	0.49	\$168.61	1.30
1	\$1,252.01	11	6	54.55	\$2,045.97	(\$1,597.44)	\$1,047.85	(\$1,007.02)	1.04	\$113.82	1.25

A smaller number of instances than I normally like to consider, but results are strongly positive.

The weak breadth on a day where the S&P closes higher has traditionally been a negative. I discussed this in the [June 11<sup>th</sup> blog](#). Interestingly, this setup is looking quite similar to that one in that the CBI was just beginning to spike then, too.

As you'll see in the Catapult and CBI section below, the CBI closed at 8 today, with three new stocks triggering Catapults. One issue I'm having right now when considering the significance of the CBI relative to previous readings is that it is so heavily concentrated in Financials. The "B" in CBI stands for "Breadth", and when the sampling of trades that construct the index are so focused in one group it leads me to question its impact.

Should the market close lower tomorrow the CBI could easily jump from 8 to 13 or 14. But again, other than UNH, all of the potential candidates appear to be financials or financial-influenced (GM). I looked back to 1995 at all the Catapult clusters of 10 or more to try and find a similar situation where so much of the reading was due to one group. I couldn't find one. Even in 1998 when there was a financial crisis in August, there were still a substantial number of non-financial stocks that were triggering Catapults.

Financials are certainly overdone, though. The ferocity and persistence with which they have sold off is something I have not been able to find many good comparisons to. For instance in the June 19<sup>th</sup> Subscriber Letter I discussed the fact that RKH and KBE had both closed below their 10-day moving averages for 30 days in a row. In looking back 10 years on my list of 104 ETF's I was only able to find 20 other instances. Buying into these setups and selling on a close above the 10-day ma would have resulted in 19 of 20 winning trades. The average trade would have made about 3% and only 1 trade lasted longer than 6 days. The complete list of trades can be found in the June 19<sup>th</sup> Letter. Email me if you need a copy. RKH and KBE are now hitting new lows and it has been 33 days at this point. It would seem that a bounce should come soon.

I also looked back to try and find any time when two Catapults had gone as wrong as Ford and Regions Financial have lately. I could only find one other time with anything close. It was prior to September 11<sup>th</sup>, 2001 when LTD, AES and GM all triggered on the 7<sup>th</sup> and 10<sup>th</sup>. Needless to say, when the markets re-opened, they suffered heavy losses like everything else. In most large clusters, the later trades tend to make up for the early ones that get swept up in the downdraft. This is something I discuss in the Catapult presentation and is a reason I believe it is important to keep ample powder dry in case the cluster becomes extremely large. In this case, it seems unlikely that the losses in Ford and some of the banks would be immediately made up. If the market manages to react as it has in the past, though, then those losses should at least be reduced significantly.

Financials are oversold to a degree rarely seen. It appears probable that they will bounce in the near future. When they do bounce I'd anticipate it will be quite sharp as two kinds of buyers race each other into those shares: bottom pickers and short coverers. The combination can make for explosive short-term moves and it should not only impact the financials, but the market as a whole.

To help visualize the studies, below is an updated Aggregator chart:



The S&P has underperformed expectations by a substantial amount for about a week now. I have not looked to buy during this selloff because the studies, represented by the green Aggregator line had shown a neutral to negative expectation. Today the Aggregator still sits at -0.01. What can't be seen above is that with the current group of studies, the Aggregator is set to jump tomorrow up to about +0.10. Even with a slight rise tomorrow, the black differential line should also stay squarely above the "0" line. This is the kind of setup we would look to go long.

Of course Wednesday is a Fed announcement day and that could move the markets dramatically in either direction. Combining the Fed day with the concentrated CBI situation I discussed above has me a bit more cautious than I would normally be. I will be looking to scale in to ¼ of a full SPY allocation on Tuesday, but it is unlikely I will add to it prior to the Fed meeting. A overly negative initial reaction to the Fed on Wednesday could inspire me to get aggressive on the long side, though.

***Intermediate-term Outlook (1 week – 2 months) – neutral – updated 6/16/2008 – NO UPDATE TONIGHT***

From an intermediate-term perspective, direction remains unclear. The last few weeks the S&P retraced a little more than 50% of its move up from the March lows to the May highs. It has now bounced for a couple of days. On a positive note we've seen indicators become extreme at a higher level than before. This includes the CBI, the McClellan Oscillator and several other indicators I've shown in the studies over the last couple of weeks.

The studies based on these indicators have been mostly bullish lately, but they are also short-term in nature. In other words, the last few days were expected and we may see more of a bounce this week. It's what happens when this bounce fizzles out that is unclear. Will the market be able to put together some higher lows and rally to new highs? Or will it continue the short-term downtrend and test the March bottom? At this point I remain somewhat neutral from an intermediate-term standpoint.

Below is a chart that I found to be interesting which shows an example of how breadth has weakened, which I consider to be a bad sign. The top portion of the chart is the S&P 500 since shortly after the January low was made. The blue indicator on the bottom of the chart is the number of NYSE new lows. The vertical maroon lines found throughout the chart show each day that the price dropped down through 1335 as it did on last Wednesday. As you can see, since the January bottom no drop through 1335 was accompanied by more new lows that were found last Wednesday.



As I mentioned, I've yet to find anything too compelling which would suggest to me that the market is highly more likely to test new highs before testing new lows, or visa-versa. Therefore I'll look to the short-term outlook to determine the trading bias, with an open mind to both long and short.

## **Catapult and Capitulative Breadth Statistics**

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

### ***Open Catapult Trades***

RF – bought 1/3 position @ \$14.06  
WB – bought 1/3 position @ \$18.63  
RF – bought 1/3 position @ \$13.22  
GE – bought 1/3 position @ \$27.86  
GE – bought 1/3 position @ \$27.38

### **New Triggers**

BAC – buy @ \$25.88 limit  
UNH – buy @ \$26.39 limit  
GM – buy @ \$12.91 limit

### ***Open Big 50 Trades***

None

### ***Open Catapult for ETF's Trades***

None

***Broad Market Large Cap CBI – 8/6 (RF-2, WB, GE-2, BAC, UNH, GM)***

### ***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	6.76	DJ US Financial	IYF	7.88
DJ US Regional Banks	IAT	17.50	DJ US Financial Services	IYG	11.19
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	1.41
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	2.30
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	7.48
DJ US Pharmaceuticals	IHE	2.70	DJ US Basic Materials	IYM	0.00
DJ US Healthcare Providers	IHF	6.12	DJ US Real Estate	IYR	1.22
DJ US Medical Devices	IHI	2.44	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	11.11	DJ US Technology Sector	IYW	0.50
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	7.89
DJ US Consumer Svcs	IYC	3.95	Nasdaq 100	QQQQ	2.00

### **Additional New Trade Ideas**

*SPY – buy ¼ allocation @ \$131.45 limit – For explanation of trade see short-term outlook section above..*

Also make sure to check Catapult section for 3 additional triggers there.

### **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>
WB	6/10/2008	\$18.63	\$16.92	-9.18%		Catapult
RF	6/10/2008	\$14.06	\$10.87	-22.69%		Catapult
RF	6/16/2008	\$13.22	\$10.87	-17.78%		Catapult
GE	6/20/2008	\$27.86	\$27.40	-1.65%		Catapult
GE	6/23/2008	\$27.38	\$27.40	0.07%		Catapult

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

*KBE – If you don't have exposure to the Catapults, you could consider KBE based on the system described in the Short-term outlook section.*

*DVY – This actually triggered a Catapult for ETF trigger today. I didn't include it as a trade above because it is nearly 50% allocated to the financial sector. This would be another alternative to consider in lieu of the individual Catapults or KBE.*

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

*None*

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.