

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 27, 2008

Issue 92

Market Overview

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

Study Date	Description	Time span	Bias
June 27, 2008	Sharp Drop to 50 low w/ time str	1-10 days	Bullish
June 27, 2008	P/C Lackadaisical	1-8 days	Bullish
June 27, 2008	Stocks over 40ma < 15%	1-10 days	Bullish
June 25, 2008	Advancers Exp MA Ratio Study	1-20 days	Bullish
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	Gap & Drop At 50-low	1-19 days	Bullish
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish

Short-term Outlook (1-5 days) –bullish – updated 6/27/08

A sharp selloff today put the market in extreme territory as far as price movement and breadth but did little to invoke fear among participants. The Dow, S&P and Nasdaq all closed down about 3%. Decliners outnumbered advancers on the NYSE buy over 6:1 while down volume swamped up volume by over 9:1. Volume was heavy, but not to a great extreme.

After looking extensively tonight at several indicators it appears price and breadth measures are hitting extremes while sentiment is lagging. Let's examine an example from each. An example of a price-based study is below:

Days In	Net Profit	Gross Profit	Gross Loss	Trades	Wins	% Profitable	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
10	\$29,427.06	\$41,115.78	(\$11,688.72)	12	7	58.33	\$13,728.48	(\$7,063.04)	\$5,873.68	(\$2,337.74)	2.51	\$2,452.26	3.5175605
9	\$27,012.82	\$39,691.89	(\$12,679.07)	12	8	66.67	\$11,965.80	(\$6,755.52)	\$4,961.49	(\$3,169.77)	1.57	\$2,251.07	3.1305048
8	\$23,862.52	\$38,121.96	(\$14,259.44)	12	6	50.00	\$10,117.53	(\$5,133.24)	\$6,353.66	(\$2,376.57)	2.67	\$1,988.54	2.6734542
7	\$27,657.68	\$40,664.64	(\$13,006.96)	12	8	66.67	\$11,768.21	(\$3,497.66)	\$5,083.08	(\$3,251.74)	1.56	\$2,304.81	3.1263754
6	\$26,642.71	\$36,835.63	(\$10,192.92)	12	8	66.67	\$10,800.57	(\$3,035.52)	\$4,604.45	(\$2,548.23)	1.81	\$2,220.23	3.6138447
5	\$24,051.71	\$35,816.08	(\$11,764.37)	13	8	61.54	\$10,800.57	(\$4,969.92)	\$4,477.01	(\$2,352.87)	1.90	\$1,850.13	3.0444537
4	\$26,241.04	\$37,984.82	(\$11,743.78)	14	11	78.57	\$10,385.16	(\$7,005.12)	\$3,453.17	(\$3,914.59)	0.88	\$1,874.36	3.2344628
3	\$28,133.69	\$36,079.21	(\$7,945.52)	15	12	80.00	\$10,398.48	(\$5,206.08)	\$3,006.60	(\$2,648.51)	1.14	\$1,875.58	4.5408243
2	\$28,113.27	\$34,900.24	(\$6,786.97)	15	10	66.67	\$14,891.76	(\$2,176.32)	\$3,490.02	(\$1,357.39)	2.57	\$1,874.22	5.1422417
1	\$2,956.52	\$13,105.33	(\$10,148.81)	15	7	46.67	\$5,328.00	(\$2,680.15)	\$1,872.19	(\$1,268.60)	1.48	\$197.10	1.2913169

Over the last 20 years there have been 5 instances for the above study. Buying as outlined above and selling on a close above the 10ma would have resulted in 4 winning trades out of 5. The average trade netted 2.4%. The lone loser lost 1.9%. The average time in trade would be 8 days.

An example of breadth reaching an extreme is the number of NYSE stocks trading above their 40-day moving average. Today that number dropped to 15%. Below is a study looking at numbers this low:

Percent of NYSE stocks closing above their 40ma is <= 15. Buy at close. Sell when % rises above X. \$100,000/trade. 1987 - present													
X% Above	Net Profit	Gross Profit	Gross Loss	Trades	Wins	% Profitable	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Fact
50	\$39,407.77	\$54,843.10	(\$15,435.33)	13	11	84.62	\$15,897.60	(\$10,424.09)	\$4,985.74	(\$7,717.67)	0.65	\$3,031.37	3.55
45	\$36,230.98	\$52,537.12	(\$16,306.14)	13	11	84.62	\$14,585.60	(\$11,836.09)	\$4,776.10	(\$8,153.07)	0.59	\$2,787.00	3.22
40	\$32,097.53	\$50,119.93	(\$18,022.40)	13	11	84.62	\$15,738.88	(\$11,836.09)	\$4,556.36	(\$9,011.20)	0.51	\$2,469.04	2.78
35	\$27,347.87	\$45,494.37	(\$18,146.50)	13	11	84.62	\$15,738.88	(\$12,217.33)	\$4,135.85	(\$9,073.25)	0.46	\$2,103.68	2.51
30	\$19,417.03	\$40,461.97	(\$21,044.94)	14	10	71.43	\$13,377.28	(\$12,217.33)	\$4,046.20	(\$5,261.24)	0.77	\$1,386.93	1.92

The last 10 trades going back to 1991 have been profitable at the higher levels. The biggest loser triggered just prior to the Crash of '87. The average trade in this scenario was about 4-5 weeks though. Looking at the results broken down by # of days held over the last 20 years yields the following:

Percent of NYSE stocks closing above their 40ma is <= 15. Buy at close. Sell X days later. \$100,000/trade. 1988 - present												
Days In	Net Profit	Trades	Wins	% Profitable	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Fact	
10	\$48,556.11	17	13	76.47	\$15,280.64	(\$3,185.35)	\$4,301.41	(\$1,840.57)	2.34	\$2,856.24	7.60	
9	\$31,662.23	18	12	66.67	\$14,515.20	(\$7,029.72)	\$4,149.16	(\$3,021.27)	1.37	\$1,759.01	2.75	
8	\$41,449.41	19	15	78.95	\$15,738.88	(\$8,559.00)	\$3,679.18	(\$3,434.58)	1.07	\$2,181.55	4.02	
7	\$38,505.65	19	16	84.21	\$13,776.64	(\$8,046.00)	\$3,146.78	(\$3,947.60)	0.80	\$2,026.61	4.25	
6	\$21,706.17	19	16	84.21	\$13,112.32	(\$12,984.84)	\$2,697.98	(\$7,153.81)	0.38	\$1,142.43	2.01	
5	\$18,878.97	21	14	66.67	\$10,657.28	(\$10,592.64)	\$3,117.34	(\$3,537.68)	0.88	\$899.00	1.76	
4	\$23,818.59	21	16	76.19	\$13,377.28	(\$7,579.44)	\$2,721.49	(\$3,945.05)	0.69	\$1,134.22	2.21	
3	\$11,047.35	22	15	68.18	\$8,432.34	(\$9,476.18)	\$2,361.97	(\$3,483.16)	0.68	\$502.15	1.45	
2	\$1,688.37	23	13	56.52	\$7,495.68	(\$8,077.85)	\$2,181.81	(\$2,667.51)	0.82	\$73.41	1.06	
1	\$4,067.06	23	15	65.22	\$3,476.48	(\$3,820.53)	\$1,370.19	(\$2,060.72)	0.66	\$176.83	1.25	

So the extremes of breadth and price are suggesting a bounce will likely occur soon. The problem in most people's minds is sentiment. One measure of sentiment that is notably lagging is the CBOE Put/Call ratio. As of today the 10-day put/call was 101.3. This is actually lower than the 200-day moving average of 101.7. Below are two studies that show what has happened when negative price action has been accompanied by a lackadaisical put/call:

S&P 500 makes 50-day low and 10-day Put/Call closes below 200 day Put/Call. Buy \$100,000 on close. Sell X days later.												
Days In	Net Profit	Trades	Wins	% Profitable	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Fact	
10	\$8,234.87	8	6	75.00	\$9,177.24	(\$7,396.90)	\$3,218.36	(\$5,537.63)	0.58	\$1,029.36	1.74	
9	\$8,017.85	8	6	75.00	\$7,874.00	(\$6,368.60)	\$2,847.24	(\$4,532.80)	0.63	\$1,002.23	1.88	
8	\$10,924.34	8	5	62.50	\$11,801.08	(\$5,803.00)	\$3,933.13	(\$2,913.77)	1.35	\$1,365.54	2.25	
7	\$10,779.29	8	5	62.50	\$9,313.64	(\$3,009.30)	\$3,147.27	(\$1,652.36)	1.90	\$1,347.41	3.17	
6	\$10,086.92	8	5	62.50	\$9,087.96	(\$2,466.10)	\$2,906.91	(\$1,482.55)	1.96	\$1,260.87	3.27	
5	\$8,832.69	10	6	60.00	\$8,149.28	(\$3,017.16)	\$2,575.97	(\$1,655.78)	1.56	\$883.27	2.33	
4	\$10,494.12	10	6	60.00	\$7,695.44	(\$1,947.64)	\$2,427.44	(\$1,017.63)	2.39	\$1,049.41	3.58	
3	\$8,444.72	10	9	90.00	\$4,034.96	(\$864.03)	\$1,034.31	(\$864.03)	1.20	\$844.47	10.77	
2	\$10,585.49	12	7	58.33	\$3,865.08	(\$752.81)	\$1,835.54	(\$452.66)	4.05	\$882.12	5.68	
1	\$8,549.34	18	14	77.78	\$3,436.04	(\$2,726.40)	\$1,155.40	(\$1,906.56)	0.61	\$474.96	2.12	

S&P 500 falls 2.5% and 10-day Put/Call closes below 200 day Put/Call. Buy \$100,000 on close. Sell X days later.												
Days In	Net Profit	Trades	Wins	% Profitable	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Fact	
10	\$39,655.99	17	13	76.47	\$10,088.60	(\$3,945.63)	\$3,887.47	(\$2,720.27)	1.43	\$2,332.71	4.64	
9	\$42,309.21	17	14	82.35	\$10,875.66	(\$2,697.00)	\$3,490.08	(\$2,183.97)	1.60	\$2,488.78	7.46	
8	\$42,789.26	17	13	76.47	\$8,408.28	(\$2,065.96)	\$3,783.72	(\$1,599.79)	2.37	\$2,517.02	7.69	
7	\$35,460.11	17	13	76.47	\$8,184.42	(\$4,571.82)	\$3,340.76	(\$1,992.44)	1.68	\$2,085.89	5.45	
6	\$32,633.45	17	12	70.59	\$8,870.96	(\$3,614.82)	\$3,225.58	(\$1,214.69)	2.66	\$1,919.61	6.37	
5	\$20,662.15	17	10	58.82	\$6,803.13	(\$2,224.20)	\$2,776.25	(\$1,014.33)	2.74	\$1,215.42	3.91	
4	\$19,507.32	19	12	63.16	\$5,731.96	(\$2,964.25)	\$2,603.01	(\$1,675.55)	1.55	\$1,026.70	2.66	
3	\$26,034.87	19	14	73.68	\$5,215.85	(\$2,443.49)	\$2,255.97	(\$1,109.74)	2.03	\$1,370.26	5.69	
2	\$23,842.24	19	14	73.68	\$6,245.15	(\$1,471.99)	\$1,900.80	(\$553.78)	3.43	\$1,254.85	9.61	
1	\$10,861.40	19	15	78.95	\$3,322.23	(\$1,614.72)	\$941.48	(\$815.20)	1.15	\$571.65	4.33	

This second one I looked at both above and below the 200-day moving average, and it made little difference. The implication of the Put/Call tests seems to be that a relatively low Put/Call doesn't hurt the chance of a nice bounce. This was a bit surprising.

Earlier in the week I'd shown how a low VIX does bother the chances of a bounce. The VIX is still far from the levels it was at near the January and March bottoms, but it did perk up some on Thursday.

Below is tonight's Aggregator chart:



The green Aggregator line shows that the studies are suggesting bullish implications for the short-term. The black differential line shows that the S&P has greatly underperformed expectations over the last few days. This is the kind of formation that typically precedes a short-term move up. While I'd prefer to see evidence of fear among participants, tonight's studies suggest the lack of fear may not present difficulties.

I'd also prefer to see a higher broad CBI. There are still rather elevated CBI levels in the sectors, though. And while extreme CBI's have reliably led to bounces, they are not necessary.

Intermediate-term Outlook (1 week – 2 months) – slightly bullish – updated 6/25/2008

I am now starting to see some intermediate-term indications that lead me to believe the market will soon enter a rally phase. I discussed some breadth indicators above that are effective for short-term analysis. I'm now also seeing some breadth indicators with more intermediate-term influence reaching extreme levels. For instance the number of stocks trading above their 40-day moving average dipped below 20% today. Also the number that are trading at least 1 standard deviation below their 40-day moving average is up to over 70%. These are extreme readings that have frequently led to intermediate-term advances.

For instance, looking back to 1988 and buying the S&P when the number of stocks trading above their 40-ma dipped below 20% and then selling when this number rose back above 45% would have been profitable 20 of 22 (91%) times. The average trade would have lasted between 4 and 5 weeks and the average return would have been between 3.5% and 4.0%. Looking at various exit scenarios basically anything between 35% and 50% would have performed quite well.

In addition to the extreme breadth readings, consumer confidence continues to spiral downward. I looked at this in the blog back in March, and I intend to re-visit the study soon. The basic lesson from that study was that consumer confidence fell hard and bottomed near market bottoms. Returns going forward after similar deterioration in confidence were consistently good for the stock market.

The technical levels on everyone's minds are the March lows. The S&P and Nasdaq may or may not test/break these levels. If they do, by the time the market gets there (or a bit lower), I believe bearishness will reach such levels that the market will inevitably rally. At this point I would be surprised to see the selloff continue too much longer. I suspect a bottom at least as tradeable as the March bottom is likely to form soon.

I've moved the bias to "slightly bullish" rather than all-out "bullish" since I would like to see additional extremes or price confirmations before jumping in wholeheartedly.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

BAC – bought 1/3 position @ \$25.88

UNH – bought 1/3 position @ \$26.15

GM – bought 1/3 position @ \$12.76

Open Big 50 Trades

None

Open Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 3/3 (BAC, UNH, GM)

Sector CBI Breakdown (% of stocks with active catapult triggers within each sector.)

Index	ETF	CBI %	Index	ETF	CBI %
DJ US Broker Dealers	IAI	3.45	DJ US Energy	IYE	0.00
DJ US Insurance Index	IAK	10.81	DJ US Financial	IYF	5.82
DJ US Regional Banks	IAT	10.00	DJ US Financial Services	IYG	6.29
DJ US Utilities	IDU	4.05	DJ US Healthcare	IYH	2.82
DJ US Oil&Gas Expl & Prod	IEO	1.72	DJ US Industrial Sector	IYJ	3.83
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	8.84
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	1.35
DJ US Healthcare Providers	IHF	8.16	DJ US Real Estate	IYR	2.44
DJ US Medical Devices	IHI	0.00	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	13.89	DJ US Technology Sector	IYW	2.01
DJ US Home Construction	ITB	4.76	DJ US Telecommunications	IYZ	2.63
DJ US Consumer Svcs	IYC	3.07	Nasdaq 100	QQQQ	2.00

Additional New Trade Ideas

SPY – buy ¼ @ \$128.50. Reasons discussed in short-term outlook section. I will scale in to another ¼ position here. While I won't be able to adjust for gaps in the morning, traders should be aware that a large gap in either direction could lead to nice upside during the day. For more information see my posts on gaps in the blog.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
WB	6/10/2008	\$18.63	\$17.36	-6.82%		closed
RF	6/10/2008	\$14.06	\$11.40	-18.92%		closed
RF	6/16/2008	\$13.22	\$11.40	-13.77%		closed
GE	6/20/2008	\$27.86	\$27.59	-0.97%		closed
GE	6/23/2008	\$27.38	\$27.59	0.77%		closed
BAC	6/24/2008	\$25.88	\$24.81	-4.13%		Catapult
UNH	6/24/2008	\$26.15	\$25.97	-0.69%		Catapult
GM	6/24/2008	\$12.76	\$11.43	-10.42%		Catapult
SPY	6/24/2008	\$131.05	\$128.19	-2.18%		

The gap down this morning added a little lemon juice to the cuts of the WB, RF and GE Catapult trade ideas.

Stocks and ETF's on my Radar

none

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

None

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