

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 15, 2008

Issue 102

## Market Overview

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

Study Date	Description	Time span	Bias
July 15, 2008	Failed Gap Up in Downtrend	1-7 Days	Bullish
July 14, 2008	Drop prior to op-ex	1-4 days	Bullish
July 7, 2008	5 Weeks Lower	1-10 weeks	Bearish
July 2, 2008	CBI=10	1-8 days	Bullish
June 25, 2008	Advancers Exp MA Ratio Study	1-20 days	Bullish
June 24, 2008	WR7 High Vol Down / NR7	1-18 days	Bullish
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 7/15*

The market put in a very disappointing session today. The large gap up, which historically has provided an upside edge in downtrends, failed to create a short-covering stampede. Instead the market made a high in the first 5 minutes and spent most of the day in the red. Breadth was negative by almost 3:1. Volume was the lightest since the 3<sup>rd</sup> of July short session.

In [tonight's blog](#) I looked at times the SPY gapped up by a large amount and then closed down on the day. Results were generally positive going forward. I also ran this test a few other ways. Rather than looking at a close below the 200-day moving average, I looked at times it made a 100-day low.

<i>SPY gaps up at least 0.5% then closes down on the day and makes a 100 day low.</i>									
<i>Buy at close. Sell X days later. \$100,000 pertrade. 1994 - present</i>									
X Days	Trades	% Wins	Wins	Losses	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
12	5	100.00	5	0	\$3,036.08	\$0.00	100.00	\$3,036.08	100.00
11	5	100.00	5	0	\$2,942.58	\$0.00	100.00	\$2,942.58	100.00
10	5	100.00	5	0	\$2,227.37	\$0.00	100.00	\$2,227.37	100.00
9	5	60.00	3	2	\$3,921.82	(\$1,354.31)	2.90	\$1,811.37	4.34
8	5	80.00	4	1	\$2,955.39	(\$5,946.10)	0.50	\$1,175.09	1.99
7	5	80.00	4	1	\$3,000.99	(\$2,609.30)	1.15	\$1,878.93	4.60
6	6	66.67	4	2	\$3,241.04	(\$1,009.74)	3.21	\$1,824.11	6.42
5	6	66.67	4	2	\$3,158.72	(\$3,382.46)	0.93	\$978.33	1.87
4	6	66.67	4	2	\$1,227.67	(\$2,757.14)	0.45	(\$100.60)	0.89
3	6	83.33	5	1	\$1,235.94	(\$3,918.80)	0.32	\$376.82	1.58
2	6	83.33	5	1	\$2,088.24	(\$3,220.40)	0.65	\$1,203.47	3.24
1	6	50.00	3	3	\$2,670.49	(\$2,858.53)	0.93	(\$94.02)	0.93

Choppy to start followed by strongly positive over the next couple of weeks. To get more instances, I reduced the requirement to a 50-day low from 100:

<b>SPY gaps up at least 0.5% then closes down on the day and makes a 50 day low.</b>									
<b>Buy at close. Sell X days later. \$100,000 pertrade. 1994 - present</b>									
X Days	Trades	% Wins	Wins	Losses	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
12	10	70.00	7	3	\$3,957.12	(\$2,306.80)	1.72	\$2,077.95	4.00
11	10	80.00	8	2	\$3,676.77	(\$3,014.48)	1.22	\$2,338.52	4.88
10	10	80.00	8	2	\$2,592.74	(\$2,745.01)	0.94	\$1,525.19	3.78
9	10	60.00	6	4	\$3,353.75	(\$2,233.34)	1.50	\$1,118.91	2.25
8	11	63.64	7	4	\$3,088.52	(\$3,094.83)	1.00	\$840.03	1.75
7	11	72.73	8	3	\$3,419.17	(\$2,258.60)	1.51	\$1,870.69	4.04
6	12	75.00	9	3	\$3,069.70	(\$1,135.72)	2.70	\$2,018.35	8.11
5	12	66.67	8	4	\$2,620.40	(\$1,852.36)	1.41	\$1,129.48	2.83
4	12	66.67	8	4	\$1,137.31	(\$1,753.20)	0.65	\$173.81	1.30
3	12	66.67	8	4	\$1,453.58	(\$2,545.00)	0.57	\$120.72	1.14
2	12	83.33	10	2	\$1,731.48	(\$1,877.45)	0.92	\$1,129.99	4.61
1	12	66.67	8	4	\$1,554.18	(\$2,662.85)	0.58	\$148.50	1.17

Still not a huge number of instances, but overall some positive results.

Also notable about today's action was that the VIX spiked even further. It closed over 12% above its 10-day moving average and over 10% above the VXV. Generally, these kind of stretches have preceded bounces over the next few days. I discussed this in a bit more detail in last night's Subscriber Letter.

Overall, today's action changed very little for the short-term perspective. Oversold and fearful became more oversold and more fearful. The downside persistency is unmatched by anything we've seen over the last 25-30 and so the market has yet to bounce. I still believe the edge favors the upside over the short term.

#### **Intermediate-term Outlook (1 week – 2 months) -neutral – updated 7/14**

As I discussed last week, my biggest concern remains the persistency of the downtrend. The S&P 500 has now closed below its 10-day moving average for 25 day in a row. Going back to 1960 this has only happened 8 other times. I've updated last week's table to show all the instances and how long they lasted.

<b>25th Day Below</b>	<b>Total # of Days Below</b>
November 8, 1967	25
November 27, 1973	27
June 16, 1969	28
February 9, 1984	29
March 14, 1980	30
January 31, 1977	31
May 1, 1970	38
May 22, 1962	45

As you can see, 1984 was the last time this has happened. The good news is these streaks normally ended with sharp spikes up. Below I listed what happened for the 5 longest.

1962 – Jumped 8.5% in 7 days.

1970 – Jumped 13.3% in 7 days.

1977 – Lame bounce before more downside.

1980 – Jumped 4.5% in 4 days

1984 – Jumped 3.25% in two days.

Of course this probable spike doesn't necessarily bode well for the intermediate-term. Another example of persistent selling from this week is that this week the %b calculation for the default 20-period, 2 standard deviation bands on a weekly chart of the SPX closed at 5 or lower for the 3<sup>rd</sup> week in a row. This is fairly unusual. I ran a study to see the results of other times this had happened:

Using standard 20-period, 2 deviation Bollinger Bands on a weekly chart the SPX closes with a %b value of 5 or less three weeks in a row.												
Buy on close. Sell "X" weeks later. \$100,000 per trade. 1960 - present.												
Weeks	Net Profit	Trades	% Wins	Winners	Losers	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
5	(\$48,851.99)	22	45.45	10	12	\$7,397.91	(\$13,766.30)	\$2,914.21	(\$6,499.50)	0.45	(\$2,220.55)	0.37
4	(\$27,359.46)	22	36.36	8	14	\$10,298.34	(\$14,280.39)	\$3,759.10	(\$4,102.30)	0.92	(\$1,243.61)	0.52
3	(\$10,358.92)	22	50.00	11	11	\$8,883.81	(\$6,842.75)	\$2,172.40	(\$3,114.12)	0.70	(\$470.86)	0.70
2	(\$14,866.61)	22	54.55	12	10	\$6,528.60	(\$9,632.70)	\$2,856.27	(\$4,914.19)	0.58	(\$675.76)	0.70
1	(\$17,992.54)	22	54.55	12	10	\$4,850.40	(\$11,533.34)	\$1,396.76	(\$3,475.36)	0.40	(\$817.84)	0.48

Results here were quite poor over the subsequent five weeks.

Another interesting measure of breadth that hit an extreme on Friday was the number of NYSE stocks hitting new 52-week lows. Rather than just looking at 52-week lows, I typically like to look at the net number of new highs minus new lows. As with many of the indicators I use, I believe it's important to normalize the results when looking over long time periods. For this indicator the need to normalize springs from the fact that the total issues trading on the NYSE is significantly greater now than it was in the 1970's. Therefore I divide the raw result by the number of issues outstanding to get a percent figure. The total result on Friday was a net of just over 23% of the total issues traded on the NYSE. This is larger than the number seen at the March lows, but not quite as large as the 28% net seen at the January lows.

Rather than look for 1 day spiked I like to see what the result is over the course of several days. I looked back over 5 days and summed the results. Over the last 5 days the sum of (New highs – New lows) / Total Issues has been about -73%. I looked back in time to see what happened at other periods in time when this had occurred. The first set of results is from 1988 – present:

Sum of results of (NYSE New Highs - New Lows) / Total Issues over the last 5 days > 72.											
Buy at close. Sell "X" days later. \$100,000 per trade. 1988 - present.											
X Days	New Profit	Trades	% Profitable	Wins	Losses	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor	
20	\$38,392.87	7	100.00	7	0	\$5,484.70	\$0.00	100.00	\$5,484.70	100.00	
19	\$35,195.40	7	100.00	7	0	\$5,027.91	\$0.00	100.00	\$5,027.91	100.00	
18	\$39,111.80	7	100.00	7	0	\$5,587.40	\$0.00	100.00	\$5,587.40	100.00	
17	\$40,711.36	7	100.00	7	0	\$5,815.91	\$0.00	100.00	\$5,815.91	100.00	
16	\$34,106.48	7	100.00	7	0	\$4,872.35	\$0.00	100.00	\$4,872.35	100.00	
15	\$28,618.13	7	71.43	5	2	\$6,200.64	(\$1,192.53)	5.20	\$4,088.30	13.00	
14	\$26,312.79	7	71.43	5	2	\$5,803.48	(\$1,352.30)	4.29	\$3,758.97	10.73	
13	\$28,453.43	7	71.43	5	2	\$5,973.98	(\$708.24)	8.43	\$4,064.78	21.09	
12	\$29,208.47	7	85.71	6	1	\$5,142.21	(\$1,644.81)	3.13	\$4,172.64	18.76	
11	\$25,479.24	7	85.71	6	1	\$4,770.29	(\$3,142.47)	1.52	\$3,639.89	9.11	
10	\$24,057.46	7	85.71	6	1	\$4,264.64	(\$1,530.36)	2.79	\$3,436.78	16.72	
9	\$24,215.27	7	85.71	6	1	\$4,330.11	(\$1,765.40)	2.45	\$3,459.32	14.72	
8	\$21,669.42	7	71.43	5	2	\$5,455.04	(\$2,802.90)	1.95	\$3,095.63	4.87	
7	\$25,582.71	7	85.71	6	1	\$4,604.09	(\$2,041.85)	2.25	\$3,654.67	13.53	
6	\$27,727.31	7	85.71	6	1	\$4,682.65	(\$368.60)	12.70	\$3,961.04	76.22	
5	\$29,676.78	8	87.50	7	1	\$4,978.82	(\$5,174.95)	0.96	\$3,709.60	6.73	
4	\$23,740.30	8	75.00	6	2	\$4,718.73	(\$2,286.03)	2.06	\$2,967.54	6.19	
3	\$22,102.27	10	80.00	8	2	\$3,297.53	(\$2,139.00)	1.54	\$2,210.23	6.17	
2	\$20,052.60	11	81.82	9	2	\$2,717.07	(\$2,200.50)	1.23	\$1,822.96	5.56	
1	\$19,421.38	21	61.90	13	8	\$2,321.67	(\$1,345.04)	1.73	\$924.83	2.80	

Low instances but a nice edge once you get out 3 weeks. All winners for an average 5% gain.

The second set of results is from 1970-1981:

<b>Sum of results of (NYSE New Highs - New Lows) / Total Issues over the last 5 days &gt; 72.</b>										
<b>Buy at close. Sell "X" days later. \$100,000 per trade. 1970-1981.</b>										
X Days	New Profit	Trades	% Profitable	Wins	Losses	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
20	(\$11,851.10)	11	54.55	6	5	\$2,739.75	(\$5,657.91)	0.48	(\$1,077.37)	0.58
19	(\$16,516.59)	13	46.15	6	7	\$2,181.12	(\$4,229.05)	0.52	(\$1,270.51)	0.44
18	(\$12,089.70)	13	46.15	6	7	\$2,880.61	(\$4,196.19)	0.69	(\$929.98)	0.59
17	(\$11,679.24)	13	38.46	5	8	\$3,094.61	(\$3,394.04)	0.91	(\$898.40)	0.57
16	(\$13,648.70)	13	30.77	4	9	\$3,710.32	(\$3,165.55)	1.17	(\$1,049.90)	0.52
15	(\$15,034.15)	13	46.15	6	7	\$3,318.06	(\$4,991.78)	0.66	(\$1,156.47)	0.57
14	(\$12,823.66)	13	46.15	6	7	\$2,807.31	(\$4,238.22)	0.66	(\$986.44)	0.57
13	(\$13,512.35)	14	35.71	5	9	\$2,963.98	(\$3,148.03)	0.94	(\$965.17)	0.52
12	(\$11,924.34)	14	50.00	7	7	\$2,037.21	(\$3,740.68)	0.54	(\$851.74)	0.54
11	(\$2,946.35)	14	50.00	7	7	\$3,023.56	(\$3,444.47)	0.88	(\$210.45)	0.88
10	(\$5,645.63)	15	40.00	6	9	\$3,253.45	(\$2,796.26)	1.16	(\$376.38)	0.78
9	(\$14,979.74)	17	41.18	7	10	\$2,349.15	(\$3,142.38)	0.75	(\$881.16)	0.52
8	(\$3,013.85)	18	61.11	11	7	\$1,991.71	(\$3,560.39)	0.56	(\$167.44)	0.88
7	(\$718.49)	18	50.00	9	9	\$3,121.43	(\$3,201.26)	0.98	(\$39.92)	0.98
6	(\$6,065.44)	20	35.00	7	13	\$3,686.12	(\$2,451.41)	1.50	(\$303.27)	0.81
5	\$699.01	24	54.17	13	11	\$3,535.45	(\$4,114.71)	0.86	\$29.13	1.02
4	(\$422.54)	28	46.43	13	14	\$2,638.43	(\$2,480.15)	1.06	(\$15.09)	0.99
3	(\$2,512.22)	34	52.94	18	16	\$2,176.17	(\$2,605.21)	0.84	(\$73.89)	0.94
2	\$884.71	50	50.00	25	25	\$2,040.00	(\$2,004.61)	1.02	\$17.69	1.02
1	\$2,104.82	95	49.47	47	47	\$1,374.17	(\$1,329.38)	1.03	\$22.16	1.03

So here we have yet another example of an oversold breadth indicator that just didn't fare well in the 70's.

Below is a table showing the results with a 40-day holding period.

<b>Sum of results of (NYSE New Highs - New Lows) / Total Issues over the last 5 days &gt; 72.</b>				
<b>Hold for 40 days and then sell.</b>				
Date	Type	Price	% Profit	Run-up/Drawdown
4/23/1970	Buy	\$83.04	-7.86%	\$0.00
6/18/1970	Sell	\$76.51		(\$16,555.00)
3/22/1973	Buy	\$108.84	-4.58%	\$3,552.66
5/18/1973	Sell	\$103.86		(\$4,571.64)
5/18/1973	Buy	\$103.86	1.79%	\$4,261.66
7/17/1973	Sell	\$105.72		(\$2,481.96)
11/26/1973	Buy	\$96.58	0.51%	\$3,332.70
1/23/1974	Sell	\$97.07		(\$4,574.70)
4/29/1974	Buy	\$90.00	-1.13%	\$3,444.10
6/25/1974	Sell	\$88.98		(\$3,455.21)
7/2/1974	Buy	\$84.30	-16.06%	\$818.34
8/28/1974	Sell	\$70.76		(\$16,058.44)
8/28/1974	Buy	\$70.76	-0.76%	\$3,871.62
10/24/1974	Sell	\$70.22		(\$11,982.24)
3/27/1980	Buy	\$101.23	9.27%	\$9,998.31
5/23/1980	Sell	\$110.61		(\$3,464.37)
9/28/1981	Buy	\$115.52	5.26%	\$9,065.20
11/23/1981	Sell	\$121.60		(\$795.80)
10/19/1987	Buy	\$224.83	7.99%	\$15,286.92
12/15/1987	Sell	\$242.80		(\$3,716.28)
8/23/1990	Buy	\$307.06	1.76%	\$6,327.75
10/19/1990	Sell	\$312.47		(\$4,078.75)
8/28/1998	Buy	\$1,027.25	4.39%	\$5,509.60
10/26/1998	Sell	\$1,072.30		(\$10,083.15)
9/21/2001	Buy	\$965.80	17.90%	\$18,795.44
11/16/2001	Sell	\$1,138.65		\$0.00
7/24/2002	Buy	\$843.43	-0.01%	\$14,345.26
9/19/2002	Sell	\$843.32		(\$3,223.76)
8/16/2007	Buy	\$1,411.27	10.67%	\$11,537.40
10/12/2007	Sell	\$1,561.80		\$0.00
1/22/2008	Buy	\$1,310.51	-0.92%	\$6,498.76
3/19/2008	Sell	\$1,298.51		(\$4,068.28)

Since 1980 there appears to be a substantial upside edge. During the 70's the setup led to more downside.

I am going to remain neutral for my intermediate-term bias, effectively deferring to the short-term for most of my decision making. While persistence is suggesting we may be entering an environment more like the 60's and 70's than anything seen since, I'm still hesitant to completely discount the last 25-30 years of data. Most of the current studies are suggesting a short-term low should be near. If the market reacts to many of the recent breadth and sentiment readings the way it has for the last 25 years or so, there is a good chance an intermediate-term rally of several weeks to a few months could ensue. If not it could be a long and painful summer for the bulls. Rather than try and guess how significant the bounce may be for the intermediate-term, we may be better served by evaluating the action as it unfolds.

### **Catapult and Capitulative Breadth Statistics**

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

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

NYX – bought 1/3 position @ \$49.51

NYX – bought 1/3 position @ \$47.72

UNH – bought 1/3 position @ \$22.71

NYX – bought 1/3 position @ \$47.07

CBS – bought 1/3 position @ \$17.59

EP – bought 1/3 position @ \$18.91

#### ***New Catapult Triggers***

CBS – buy 1/3 position @ \$16.86

*Smaller than usual positions for Catapults remain advisable in this environment.*

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

None

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

MDY – bought @ \$141.67

***Broad Market Large Cap CBI – 7/4 ( NYX-3, UNH, CBS-2, EP)***

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

Index	ETF	CBI %	Index	ETF	CBI %
DJ US Broker Dealers	IAI	13.79	DJ US Energy	IYE	4.65
DJ US Insurance Index	IAK	12.16	DJ US Financial	IYF	11.64
DJ US Regional Banks	IAT	11.25	DJ US Financial Services	IYG	9.79
DJ US Utilities	IDU	1.35	DJ US Healthcare	IYH	2.11
DJ US Oil&Gas Expl & Prod	IEO	3.45	DJ US Industrial Sector	IYJ	4.60
DJ US Oil Equip & Svcs	IEZ	1.92	DJ US Consumer Goods	IYK	4.76
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	1.35
DJ US Healthcare Providers	IHF	6.12	DJ US Real Estate	IYR	10.98
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	6.53
DJ US Home Construction	ITB	9.52	DJ US Telecommunications	IYZ	2.63
DJ US Consumer Svcs	IYC	9.21	Nasdaq 100	QQQQ	5.00

**Additional New Trade Ideas**

SPY – buy last remaining ¼ position at \$122.72. All studies remain bullish. VIX is finally spiking. New lows have too. We’re in an options expirations week, which as we went over yesterday, have a tendency to reverse. Time to get the last piece in.

Also note the CBS trigger in the Catapult section.

**Active Trades Table**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY	6/24/2008	\$131.05	\$122.72	-6.36%		
SPY	6/27/2008	\$128.28	\$122.72	-4.33%		
SPY	7/1/2008	\$126.52	\$122.72	-3.00%		
NYX	7/2/2008	\$49.51	\$41.01	-17.17%		Catapult
NYX	7/3/2008	\$47.72	\$41.01	-14.06%		Catapult
NYX	7/7/2008	\$47.07	\$41.01	-12.87%		Catapult
UNH	7/7/2008	\$22.71	\$22.18	-2.33%		Catapult
CBS	7/8/2008	\$17.59	\$16.86	-4.15%		Catapult
MDY	7/8/2008	\$141.67	\$141.45	-0.16%		Catapult
EP	7/10/2008	\$18.90	\$19.71	4.29%		Catapult

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

There are a few "Big 50" trades triggering. If you're looking for possible bounce candidates these could be playable. I won't be officially tracking them as I'd prefer to just focus on standard Catapults at the moment. If the persistency of the downtrend had not been giving the Catapult trades such a difficult time, I would definitely be listing these. Possible trade candidates include:

NVDA  
VLO

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

*None*

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