

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 30, 2008

Issue 113

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 30, 2008	Big up after big down	1-12 days	Bullish
July 29, 2008	Down 1.5% lowest vol in 10 days	1-12 days	Bullish
July 29, 2008	Down 1.5% 2 of 3 - no 10 day low	1-10 days	Bullish
July 28, 2008	P/C 40-day low, SPX < 0.5 rise	1-20 days	Bearish
July 25, 2008	Down big after bounce from lows	1-8 days	Bearish
July 22, 2008	Breadth 3:2 +, SPX dn after high	1-10 days	Bullish
July 18, 2008	Big Volume Big Gain Under 200	1-18 days	Bullish
July 18, 2008	2% then 1% gains under the 200	1-19 days	Bullish
July 7, 2008	5 Weeks Lower	1-10 weeks	Bearish
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish

Short-term Outlook (1-5 days) – neutral – slightly bullish but overdone 7/30

The market rose sharply today, more than making up for all of yesterday's losses. Unfortunately for the Subscriber Letter, it gapped up and never pulled back to the entry point. Volume came in higher and advancers outnumbered decliners by over 3:1.

The price action today was quite positive. In tonight's blog I looked at large losses like yesterday that were recovered the next day. Action going forward was frequently bullish.

After some negative studies the tide has turned more bullish the last two nights. Even the July 25th study from the blog is looking less bearish at this point. From that study:

“Looking at the results of a 2% or greater drop after a bounce from a 200-day low I found that 47% of them went on to make new lows within the next 5 days. In every case where the market managed to hold above its recent lows for the next 5 days, it also held above them for at least 3 more weeks. The next five days may tell a lot about the sustainability of this attempted rally.”

It's only been three days but as of now the S&P is well above its 7/15 low. Therefore the only truly bearish short-term study at this point is the Put/Call one from Sunday night's Subscriber Letter. I tend to view sentiment as secondary to price, volume and breadth. The recent action appears constructive.

Unfortunately, after today the market is a bit overbought. Rather than try an entry under these circumstances, I'd prefer to see if the market can manage to pull back (without exhibiting bearish behavior) before attempting an entry.

Intermediate-term Outlook (1 week – 2 months) -neutral – updated 7/28

The ray of hope seen in last weeks Intermediate-term Outlook was generally provided by the fact that the market had posted a strong bounce from extremely oversold conditions. Breadth conditions as severe as we saw in mid-July have generally preceded strong rallies over the next 4-12 months. Short-term results were more mixed but with a slightly positive bias. Anyone that lacks a copy of this study may email me and I'll be happy to provide it.

It's a lot easier to predict a short-term bounce from extremely oversold conditions than it is to predict an area where the market will successfully put in a long-term bottom and embark on a meaningful rally. I discussed two widely used tools last week. The Follow Through Day (FTD), created by William O'Neil and the 90% Days, created by Lowry's Research. (Essentially a 90% day is a day where 90% of the total volume and points on the NYSE are in one direction.) Both of them tend to look for strong buying following a low point to signal a rally has strong buying conviction and is likely to become substantial. [I've looked at FTD's in great detail in the blog.](#) I'd encourage anyone who has seen that material yet to check it out.

One of the things I've discussed with regards to FTD's is that they are not terribly reliable. Using the most generous rules and definitions I could fairly concoct the success rate maxed out at around 55%. A more reasonable estimation would probably be around 40-45%. I decided to look at 90% upside days in relation to FTD's to see if the combination of the two tools may help to provide a better edge. First I checked to see if there were any successful FTD's that were not accompanied by either a 90% upside day or back to back 80% upside days (which Lowry's allows as a substitute for a 90% day). I was surprised to find that a significant number of rallies occurred without the aid of a 90% upside day.

FTD dates of "successful" market rallies that followed declines of at least 10% and were not accompanied by a 90% day within 3 weeks of the FTD.

August 29, 1973

December 14, 1973 - Fairly minor rally

October 9, 1974

October 30, 1979

October 8, 1986

February 7, 1990

April 22, 1997

November 13, 1997

October 27, 1999

October 17, 2002

To conduct this test I looked at market declines of at least 10% (as opposed to the 8% decline I normally looked at on the blog). A "failure" was declared if the S&P dropped below its recent low on an intraday basis. In all the study identified 59 FTD's since

1971. Only 23 of them were successful for a 39% success rate. So of those 23 “successful” FTD’s, 10 of them, or 43.5% achieved their success without the aide of a 90% upside day. This would seem to suggest that a 90% upside day is not needed and if you were to demand one before turning bullish you might miss out on a good number of rallies.

I then looked to see if a 90% day coming on the same day as a FTD was an especially good signal. I found 10 instances where this occurred. Four led to successful rallies: 9/19/75, 8/17/82, 8/1/84, and 10/29/87. One saw a 90% come on the 2nd FTD – that was 8/28/07 after the 8/22/07 FTD failed to produce a 90% day. That instance also led to a successful rally. There were also five instances of FTD/90% days that failed. They were 8/28/75, 11/10/77, 9/9/98, 7/29/02, and 4/1/08. The combination of a FTD and 90% doesn’t seem to provide any further assurance of success.

So while we have some indications that the market will likely be substantially higher several months from now, we have seen little that would suggest the market has put in a bottom. At this point it seems as though we’re looking at a tossup.

There is a bit more to note with regards to the CBOE Put/Call ratio. Dr. Brett Steenbarger of the Traderfeed blog has done some excellent work over the years in looking at these ratios. One tool he uses compares the 10-day average of the equity put/call ratio to the 200-day average. [His findings](#) have revealed an edge exists when the 10-day becomes stretched above the 200-day. I’ve used this tool to also look at the CBOE Total Put/Call Ratio.

In my case I do not require the 10-day MA to be stretched from the 200-day MA. I simply looked at how the market has performed when the 10-day MA is positioned either above or below the 200-day MA. Going back to 8/6/1996 through 7/25/2008 the S&P 500 has gained 595.44 points. When the 10-day MA of the Total Put/Call Ratio has been above the 200-day MA the S&P 500 *has gained 710.31 points*. When the 10-day MA has been below the 200-day MA the S&P 500 *has LOST 114.87 points*. Over that time period the 10 day-MA has been below the 200-day MA about 51% of the time. The 10-day MA dropped below the 200-day MA on Monday (7/21). This was only 4 days after the market bottomed. As it now stands the 200-day MA is 1.03 and the 10-day MA is 0.96. It would certainly help the bullish case if this recent put/call trend were to reverse.

I’ve moved the intermediate-term outlook back to neutral. While I believe we’ll be higher several months from now, it’s difficult to say whether the recent bottom will hold. Recent studies have turned out more bearish and I’d like to see some more positive signs before becoming aggressive. The further I look out the more bullish I am but there still may be some pain to endure.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

none

Open Big 50 Trades

None

Catapult for ETF's Trades

none

Broad Market Large Cap CBI – 0

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	1.16
DJ US Insurance Index	IAK	0.00	DJ US Financial	IYF	0.00
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	2.70	DJ US Healthcare	IYH	0.70
DJ US Oil&Gas Expl & Prod	IEO	3.45	DJ US Industrial Sector	IYJ	1.15
DJ US Oil Equip & Svcs	IEZ	1.92	DJ US Consumer Goods	IYK	0.00
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	1.35
DJ US Healthcare Providers	IHF	0.00	DJ US Real Estate	IYR	0.00
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	2.01
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.44	Nasdaq 100	QQQQ	2.00

There don't appear to be any groups undergoing capitulative selling at the moment.

Additional New Trade Ideas

None official. Look at the "radar" section for a setup in MER.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
DBA	7/21/2008	\$36.76	\$36.20	-1.52%	\$34.60	sell on close > 10ma
UNG	7/22/2008	\$47.57	\$42.25	-11.18%		sell on close > 10ma
RSX	7/25/2008	\$44.62	\$43.40	-2.73%		sell on close > 10ma

Stocks and ETF's on my Radar

MER – based on the following setup:

- 1) Made 50-day low today.
- 2) Closed higher by at least 5%
- 3) Volume was highest in last 20 days

Buying at the close under these conditions and selling on a close above the 10-day MA across the current S&P 100 over the last 10 years would have produced the following results:

Trades	29
Winners	24
Pct Winners	82.8%
Avg Win	5.43%
Avg Loss	-16.13%
Avg Trade	1.72%
Profit Factor	1.6

The average loss is so big due to a 58% loss in AAPL after a purchased triggered on 9/28/00 and it opened down close to 50% the next day. Excluding the AAPL trade, the average loss would have been about 4%.

With Tuesday's low almost 20% below the close, risk is extremely high in this one. From a pattern standpoint it looks good. Traders could mitigate the risk by trading options instead of the stock.

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

None

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