

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 31, 2008

Issue 114

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 – neutral 7/31

The market put in another strong move today. The major indices were all up with the S&P leading the charge and the Nasdaq bringing up the rear. Volume rose for the second day in a row and breadth was strongly positive.

In tonight's blog I discuss volume patterns. Of particular note is that the pattern of higher prices on higher volume as we've seen the last two days is much more positive than if volume was declining. This is the third recent example of volume doing the "right thing". The July 29th study where volume came in exceptionally low on a big selloff suggested bullish implications as did the July 18th "Big Volume Big Gain under the 200" study.

From a technical standpoint it should be noted that the major averages are all approaching their July 23rd highs. This could act as resistance. Short-term indicators like the 3-period RSI are approaching overbought levels and the upper Bollinger Band is close overhead. Also the market remains in a long-term downtrend. Overbought, near resistance, in a long-term downtrend doesn't sound like a favorable long entry point to me.

Below is an updated Aggregator chart:



The green Aggregator line is suggesting an upside bias over the next few days. The black differential line is telling us what we already knew – the market is getting a bit overdone short-term. A short with a tight stop near the July 23rd highs could offer some decent risk/reward. Unfortunately I’m not seeing much that would suggest downside other than the put/call data. This would suggest choppy action over the next few days. I’ll wait for a better setup before attempting an index trade.

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

Additional New Trade Ideas

Very little appears “overdone” at the moment. This happens after sharp moves in either direction. Rather than try and force something I’ll give it a day and see if any worthwhile setups reveal themselves.

One ETF I have my eye on is GLD. It put a reversal in today near the 200ma. IAU is another option.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
DBA	7/21/2008	\$36.76	\$36.79	0.08%		sold on close
UNG	7/22/2008	\$47.57	\$43.39	-8.79%		sell on close > 10ma
RSX	7/25/2008	\$44.62	\$45.30	1.52%	\$42.79	sell on close > 10ma sell 1/2 @ \$46.50

DBA closed above its 10-day MA today, triggering an exit. Quite a round-trip for a scratch. Unfortunately I was a little early on the entry.

I will look to sell ½ of the RSX position at \$46.50. This is the point where reward is equal to risk and will assure me of a breakeven on RSX barring a gap down through the stop.

Stocks and ETF’s on my Radar

GLD an IAU mentioned above.

Notable S&P 500 stocks outside my “tradable” radar

None

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