

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

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Issue 115

## 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 31, 2008	Strong move on rising volume	1-10 days	Bullish
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 – updated 8/1*

Overbought and near resistance the market fell apart Thursday afternoon. The S&P and Dow both finished over 1% lower while the Nasdaq managed just a mild loss. Breadth was negative by about 2 to 1. One apparent positive is that volume came in lighter.

This is the third time in the last six days that the S&P 500 has dropped at least 1.25% on lighter volume. In [tonight's](#) blog I showed what happened after the other occurrences. With the number of instances quite limited I decided to also expand the study and see if the positive bias still held up.

S&P 500 drops at least 1% on lower volume in 3 of last 6 days. Buy on close. Sell X days later. \$100k per trade. 1960-present														
X Days	Net Profit	Gross Profit	Gross Loss	Trades	Wins	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor	
10	\$29,926.30	\$52,700.28	(\$22,773.98)	21	12	57.14	\$13,815.90	(\$6,714.24)	\$4,391.69	(\$2,530.44)	1.74	\$1,425.06	2.31	
9	\$29,464.92	\$48,978.35	(\$19,513.43)	22	13	59.09	\$11,206.23	(\$6,173.44)	\$3,767.57	(\$2,168.16)	1.74	\$1,339.31	2.51	
8	\$35,534.67	\$53,535.63	(\$18,000.96)	22	12	54.55	\$11,382.35	(\$3,357.24)	\$4,461.30	(\$1,800.10)	2.48	\$1,615.21	2.97	
7	\$33,208.25	\$49,017.40	(\$15,809.15)	22	13	59.09	\$11,104.17	(\$3,348.80)	\$3,770.57	(\$1,756.57)	2.15	\$1,509.47	3.10	
6	\$21,350.00	\$43,098.07	(\$21,748.07)	22	11	50.00	\$10,034.53	(\$6,196.48)	\$3,918.01	(\$1,977.10)	1.98	\$970.45	1.98	
5	\$26,805.84	\$52,361.41	(\$25,555.57)	25	12	48.00	\$9,572.31	(\$6,286.72)	\$4,363.45	(\$1,965.81)	2.22	\$1,072.23	2.05	
4	\$31,474.32	\$49,957.78	(\$18,483.46)	26	15	57.69	\$13,377.28	(\$5,147.18)	\$3,330.52	(\$1,680.31)	1.98	\$1,210.55	2.70	
3	\$24,952.66	\$43,348.71	(\$18,396.05)	31	21	67.74	\$8,432.34	(\$4,617.28)	\$2,064.22	(\$1,839.61)	1.12	\$804.92	2.36	
2	\$19,654.49	\$41,145.00	(\$21,490.51)	37	24	64.86	\$7,495.68	(\$4,391.68)	\$1,714.38	(\$1,653.12)	1.04	\$531.20	1.91	
1	\$22,917.31	\$57,185.11	(\$34,267.80)	66	41	62.12	\$5,716.25	(\$2,723.75)	\$1,394.76	(\$1,370.71)	1.02	\$347.23	1.67	

S&P 500 drops at least 1.25% on lower volume in 3 of last 10 days. Buy on close. Sell X days later. \$100k per trade. 1960-present														
X Days	Net Profit	Gross Profit	Gross Loss	Trades	Wins	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor	
10	\$40,235.18	\$62,819.76	(\$22,584.58)	24	15	62.50	\$13,815.90	(\$6,714.24)	\$4,187.98	(\$2,509.40)	1.67	\$1,676.47	2.78	
9	\$35,353.93	\$59,000.30	(\$23,646.37)	24	14	58.33	\$11,435.28	(\$6,173.44)	\$4,214.31	(\$2,364.64)	1.78	\$1,473.08	2.50	
8	\$23,772.28	\$55,812.59	(\$32,040.31)	25	12	48.00	\$15,738.88	(\$6,073.20)	\$4,651.05	(\$2,464.64)	1.89	\$950.89	1.74	
7	\$41,962.16	\$68,258.88	(\$26,296.72)	30	19	63.33	\$11,104.17	(\$5,077.95)	\$3,592.57	(\$2,390.61)	1.50	\$1,398.74	2.60	
6	\$49,538.53	\$75,799.03	(\$26,260.50)	32	22	68.75	\$12,190.73	(\$6,196.48)	\$3,445.41	(\$2,626.05)	1.31	\$1,548.08	2.89	
5	\$34,980.36	\$75,224.68	(\$40,244.32)	35	24	68.57	\$9,572.31	(\$7,143.96)	\$3,134.36	(\$3,658.57)	0.86	\$999.44	1.87	
4	\$35,781.80	\$72,818.03	(\$37,036.23)	38	24	63.16	\$13,377.28	(\$6,289.92)	\$3,034.08	(\$2,645.45)	1.15	\$941.63	1.97	
3	\$43,222.21	\$73,247.46	(\$30,025.25)	47	30	63.83	\$9,591.40	(\$5,115.60)	\$2,441.58	(\$1,876.58)	1.30	\$919.62	2.44	
2	\$28,910.57	\$69,582.45	(\$40,671.88)	60	33	55.00	\$7,495.68	(\$4,391.68)	\$2,108.56	(\$1,506.37)	1.40	\$481.84	1.71	
1	\$35,375.98	\$99,107.74	(\$63,731.76)	109	62	56.88	\$5,716.25	(\$4,172.48)	\$1,598.51	(\$1,355.99)	1.18	\$324.55	1.56	

Expanding the study reduced the returns quite a bit. Still, it would appear that clusters of large, low-volume selloffs tend to exhibit a bullish bias over the short-term.

Not to overdo it with the volume analysis, but the recent pattern appears constructive. Price action, though is helter skelter and we are back near the middle of the recent range. I'm not seeing a significant edge over the next couple of days. Friday morning will be the employment report, which could once again make for some interesting trading.

#### ***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 2<sup>nd</sup> 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.)***

<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	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**

This constant whipsaw is making it difficult to find high probability opportunities. I'll stand aside for one more day and look for setups over the weekend.

## Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
UNG	7/22/2008	\$47.57	\$42.44	-10.78%		sell on close > 10ma
RSX	7/25/2008	\$44.62	\$45.19	1.28%	\$42.79	sell on close > 10ma

sell 1/2 @ \$46.50

I will look to sell 1/2 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

none

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

*None*

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