

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 6, 2008

Issue 118

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
August 6, 2008	Fed day spike	1-10 days	Bearish
August 6, 2008	Put/Call 100-day low	1-10 days	Bearish
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 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 8/6

As the studies indicated was likely, the market put in a strong day today with all the major indices rising over 2%. NYSE breadth was solid as advancing volume came in about four times higher than declining volume. Total volume rose some but only reached average levels.

I posted a study to the blog tonight which looked at [what has happened when the S&P has risen 1% or more on the day of a scheduled Fed meeting](#). The results were quite poor over the next two weeks. Although it reduced the number of instances some, I also ran the study to see what happened when the move higher was 1.5% or more.

<i>SPX closes higher by 1.5% or more on the day of a scheduled Fed meeting. Buy at close.</i>											
<i>Sell X days later. \$100k per trade. 1978-present</i>											
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor	
10	(\$10,684.11)	14	6	8	42.86	\$1,642.24	(\$2,567.19)	0.64	(763.15)	0.48	
9	(\$14,049.93)	14	7	7	50.00	\$1,369.84	(\$3,376.98)	0.41	(1003.57)	0.41	
8	(\$5,528.65)	14	6	8	42.86	\$1,596.12	(\$1,888.17)	0.85	(394.90)	0.63	
7	(\$4,296.50)	14	5	9	35.71	\$2,194.97	(\$1,696.81)	1.29	(306.89)	0.72	
6	\$1,786.21	14	7	7	50.00	\$1,436.73	(\$1,181.56)	1.22	127.59	1.22	
5	\$2,280.05	14	7	7	50.00	\$1,478.97	(\$1,153.25)	1.28	162.86	1.28	
4	\$1,755.83	14	9	5	64.29	\$1,021.75	(\$1,487.99)	0.69	125.42	1.24	
3	\$978.35	14	8	6	57.14	\$1,137.40	(\$1,353.47)	0.84	69.88	1.12	
2	\$2,629.83	14	10	4	71.43	\$486.36	(\$558.44)	0.87	187.85	2.18	
1	(\$3,651.25)	14	4	10	28.57	\$291.12	(\$481.57)	0.60	(260.80)	0.24	

Somewhat similar results with the rally peaking 2 days later.

In a rare 2-fer on the blog, I also looked at the [possible significance of the Put/Call Ratio hitting a 100-day low](#). I also decided to run this one again and filter it on those times when the S&P 500 is trading below its 200-day moving average. The number of instances dropped dramatically from 30 to 6. Results below:

CBOE Total Put/Call Ratio makes 100-day low. SPX closes < 200-day MA. Buy SPX at close.										
Sell X days later. \$100k per trade. 1994-present										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
10	(\$13,536.75)	6	1	5	16.67	\$440.19	(\$2,795.39)	0.16	(2256.13)	0.03
9	(\$13,093.56)	6	0	6	0.00	\$0.00	(\$2,182.26)	0.00	(2182.26)	0.00
8	(\$8,186.45)	6	1	5	16.67	\$2,233.07	(\$2,083.90)	1.07	(1364.41)	0.21
7	(\$2,154.01)	6	2	4	33.33	\$2,093.20	(\$1,585.10)	1.32	(359.00)	0.66
6	\$1,280.69	6	4	2	66.67	\$1,080.92	(\$1,521.50)	0.71	213.45	1.42
5	\$50.11	6	4	2	66.67	\$1,148.19	(\$2,271.32)	0.51	8.35	1.01
4	(\$547.94)	6	4	2	66.67	\$1,592.82	(\$3,459.60)	0.46	(91.32)	0.92
3	\$2,154.95	6	4	2	66.67	\$1,503.58	(\$1,929.68)	0.78	359.16	1.56
2	\$2,263.03	6	4	2	66.67	\$1,072.37	(\$1,013.23)	1.06	377.17	2.12
1	\$3,580.10	8	5	3	62.50	\$1,050.76	(\$557.90)	1.88	447.51	3.14

While the sample size is too small for comfort, the results appear notable. Days 8-10 are quite a bit worse than the original study.

I also tested a few numbers around 100 to make sure it wasn't just a lucky number of days to look back when testing lows. Below are the 10-day results for several look-back periods:

CBOE Total Put/Call hits X day low. Buy SPX at close. Sell 10 days later. \$100k per trade. 1994-present										
X Day Low	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
130	(\$13,157.18)	25	11	14	44.00	\$1,412.41	(\$2,049.55)	0.69	(526.29)	0.54
120	(\$13,157.18)	25	11	14	44.00	\$1,412.41	(\$2,049.55)	0.69	(526.29)	0.54
110	(\$12,513.90)	25	11	14	44.00	\$1,412.41	(\$2,003.60)	0.70	(500.56)	0.55
100	(\$21,376.77)	30	13	17	43.33	\$1,549.04	(\$2,442.01)	0.63	(712.56)	0.49
90	(\$16,242.11)	34	16	18	47.06	\$1,600.68	(\$2,325.17)	0.69	(477.71)	0.61
80	(\$15,011.64)	37	18	19	48.65	\$1,597.41	(\$2,303.42)	0.69	(405.72)	0.66
70	(\$10,833.24)	40	21	19	52.50	\$1,564.39	(\$2,299.23)	0.68	(270.83)	0.75
60	(\$2,449.12)	52	27	25	51.92	\$1,944.12	(\$2,197.61)	0.88	(47.10)	0.96
50	\$4,832.00	57	32	25	56.14	\$1,904.98	(\$2,245.09)	0.85	84.77	1.09

Once you get reach 80-day lows or more the study looks quite bearish.

The expected bounce arrived today. With the strong move we're already seeing indications that a pause or pullback is likely near. This caused me to take profits on the outstanding SPY trade idea. Should the market continue higher over the next day or two I may begin to look at the short side for an index trade.

Intermediate-term Outlook (1 week – 2 months) -neutral – updated 8/4

The intermediate-term outlook has a few positives right now, but now a whole lot. The fact that breadth and sentiment had become so extremely negative prior to the mid-July bottom is something that is frequently seen near important bottoms. I showed a study which looked at bounces after extreme breadth readings in the July 20th Letter. I have included a copy of this study in the addendum below.

The [consumer sentiment study](#) from March is still active and shows a positive bias as well. Additionally, I like [the volume pattern](#) that the market has exhibited recently.

There are concerns, though. The relatively low put/call ratio which I discussed [last week](#) remains low, suggesting complacency among option traders. The persistence shown during the selloff in June and early July is something that is not normally quickly overcome as discussed in the [July 7th study](#).

The “original rule” Follow Through Day (FTD) from July 22 has so far failed to ignite a further rally. [My findings have shown](#) that the first week after a FTD tends to be fairly predictive of whether the FTD will succeed or fail. There have been eight trading days since the FTD. The only days where the S&P closed above the close of the FTD were days 1 and 6. This would suggest about a 67% chance of failure for the signal, which would entail a trip below the July lows.

The fact that the past week saw a relatively wide range with a small relative percent change at the close has tended to have bearish implications when a long-term downtrend has been present.

Below I show how the market has performed the next week after a relatively large range closed varying levels of change from the week before:

SPX trades in > 2.5% range and closes within X% of last week's close. Also closes < 40 week MA.										
Buy on close. Sell 1 week later. \$100k/trade. 1960-present.										
X% Change	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
1	(\$1,208.28)	86	42	44	48.84	\$2,163.95	(\$2,093.05)	1.03	(\$14.05)	0.99
0.75	(\$9,456.60)	60	30	30	50.00	\$2,198.22	(\$2,513.44)	0.87	(\$157.61)	0.87
0.5	(\$3,044.96)	36	17	19	47.22	\$2,608.62	(\$2,494.29)	1.05	(\$84.58)	0.94
0.25	(\$16,069.95)	17	6	11	35.29	\$2,671.88	(\$2,918.29)	0.92	(\$945.29)	0.50

As you can see above the very tight closing change of 0.25% or less has severely underperformed larger % increases or decreases.

To see what affect the range portion of the equation has on results I looked at varying ranges. In this case I held the position for 5 weeks.

S&P has range > X% and change < 0.25% on the week. Close < 40wk ma. Buy on close. Sell 5 weeks later. \$100k/trade. 1960 -										
X Range	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
3.5	(\$15,423.33)	3	1	2	33.33	\$1,768.00	(\$8,595.67)	0.21	(\$5,141.11)	0.10
3	(\$17,772.44)	7	2	5	28.57	\$3,558.53	(\$4,977.90)	0.71	(\$2,538.92)	0.29
2.5	(\$24,572.95)	14	5	9	35.71	\$3,273.67	(\$4,549.04)	0.72	(\$1,755.21)	0.40
2	\$9,502.56	23	12	11	52.17	\$4,178.26	(\$3,694.24)	1.13	\$413.15	1.23
1.5	\$34,301.38	30	18	12	60.00	\$4,755.94	(\$4,275.46)	1.11	\$1,143.38	1.67
1	\$26,573.82	36	21	15	58.33	\$4,024.92	(\$3,863.30)	1.04	\$738.16	1.46
0.5	\$30,026.93	41	23	18	56.10	\$4,170.07	(\$3,660.26)	1.14	\$732.36	1.46
0	\$27,751.03	43	24	19	55.81	\$4,044.90	(\$3,648.76)	1.11	\$645.37	1.40

Here we can see that the wider ranges clearly underperform the tighter ranges when look at a small percent change on the week.

So using a 2.5% or greater range and a net change of less than 0.25% and looking out over the next 1-5 weeks I get the following results:

SPX range > 2.5% and net change < 0.25%. Close < 40 week MA. Buy SPX on close. Sell X Weeks later. \$100k/trade. 1960 -										
X Weeks	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
5	(\$24,572.95)	14	5	9	35.71	\$3,273.67	(\$4,549.04)	0.72	(\$1,755.21)	0.40
4	(\$39,054.28)	14	4	10	28.57	\$3,031.28	(\$5,117.94)	0.59	(\$2,789.59)	0.24
3	(\$25,944.94)	15	6	9	40.00	\$4,767.05	(\$6,060.80)	0.79	(\$1,729.66)	0.52
2	(\$23,594.20)	15	5	10	33.33	\$4,668.24	(\$4,693.54)	0.99	(\$1,572.95)	0.50
1	(\$16,069.95)	17	6	11	35.29	\$2,671.88	(\$2,918.29)	0.92	(\$945.29)	0.50

While the results may not be statistically significant due to the low number of instances, the negative bias in terms of wins to losses and average trade is notable nonetheless.

My intermediate-term outlook remains very similar to last week. While I believe the market will be higher and likely in the midst of a substantial rally 3-4 months from now, 3-4 weeks from now remains murky. Stronger breadth would go a long way toward making me more comfortable. Right now I'm taking things little by little and constantly re-evaluating.

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	3.49
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	0.00	DJ US Industrial Sector	IYJ	1.15
DJ US Oil Equip & Svcs	IEZ	7.69	DJ US Consumer Goods	IYK	0.68
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	0.50
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	5.26
DJ US Consumer Svcs	IYC	0.44	Nasdaq 100	QQQQ	1.00

Oil Equip and services is starting to get a bit overdone...

Additional New Trade Ideas

IP – short @ \$28.34 limit. If filled a stop may be place at \$29.51, which is around the recent swing high and 200-day moving average.. Below is a system from the 3/25/08 Subscriber Letter:

The following conditions are present: 1) %b closes at 98 or above 4 days in a row. 2) Today's close is lower than yesterdays. 3) Today's close is below the 200-day moving average. Looking back 10 years and shorting under these conditions and then covering when the %b closed below 75 would have produced 96 trades across all S&P 100 stocks. Seventy-five (78.1%) were winners. Gross gains outsized gross losses by 2.3 to 1. The expected value of each trade was a 1.9% gain.

MOS – buy @ \$110.47 limit. Enter stop @ \$103.90 if filled. Below is an excerpt from the 4/11/2008 Subscriber Letter:

I note the following conditions: 1) Made a 50-day low today. 2) Closed at least 1% higher. Buying the close and selling on a cross of the 10-sma over the last 10 years in all S&P 100 stocks would have produced the following results:

Trades – 1098

Winners – 779 (71%)

Avg gain – 3.8%

Avg Loss – 5.5%

Avg Trade – 1.15%

Profit Factor – 1.73

Several stocks put in this pattern today including AA, ATRE, ATI, EEB, EPP, ETR, EXC, RIG and XLB. I chose MOS to track for a couple of reasons: 1) I like the high volume on the turnaround. 2) I like how it dropped below and then recovered its 200-day MA intraday.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
RSX	7/25/2008	\$44.62	\$41.99	-5.89%	\$42.79	stopped out on open
SPY	8/4/2008	\$125.50	\$128.36	2.28%		sold on close

Stocks and ETF's on my Radar

Any symbol listed in the MOS trade idea.

Also looking at FXE for long opportunity or MOT for a short.

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

None

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