

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 7, 2008

Issue 119

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 7, 2008	20 day high on low volume	1-10 days	Bearish
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

After struggling for much of the morning, the market managed to rally a bit in the afternoon and finish in the green. The Nasdaq led the way, gaining over 1%, while the Dow and S&P showed mild gains. Breadth was only slightly positive. Volume came in lower than yesterday and also below its 10-day moving average.

I posted a study on the blog tonight which looked at times the S&P 500 has made a 20-day high while under its 200-day moving average and volume finished lower on the day. Results were quite negative over the next week or two.

For those subscribers that prefer the Nasdaq to the S&P I also ran the study on the Nasdaq composite which provided the same setup today.

<i>Nasdaq Composite makes 20-day high and closes under 200 day MA. Volume is lower than yesterday</i>										
<i>Buy at close. Sell X days later. \$100k per trade. 1993 - present.</i>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$1,821.25)	22	14	8	63.64	\$2,696.49	(\$4,946.51)	0.55	0.95	(\$82.78)
9	(\$215.23)	23	15	8	65.22	\$2,165.30	(\$4,086.84)	0.53	0.99	(\$9.36)
8	(\$5,594.31)	23	15	8	65.22	\$1,762.59	(\$4,004.14)	0.44	0.83	(\$243.23)
7	(\$12,332.22)	23	12	11	52.17	\$1,630.32	(\$2,899.64)	0.56	0.61	(\$536.18)
6	(\$10,167.13)	23	12	11	52.17	\$1,350.67	(\$2,397.75)	0.56	0.61	(\$442.05)
5	(\$15,276.63)	25	10	15	40.00	\$1,835.03	(\$2,241.79)	0.82	0.55	(\$611.07)
4	(\$10,656.75)	27	10	17	37.04	\$2,096.82	(\$1,860.29)	1.13	0.66	(\$394.69)
3	(\$10,089.05)	27	13	14	48.15	\$1,664.40	(\$2,266.16)	0.73	0.68	(\$373.67)
2	(\$15,764.27)	31	14	17	45.16	\$883.47	(\$1,654.87)	0.53	0.44	(\$508.52)
1	(\$12,965.47)	38	19	19	50.00	\$667.30	(\$1,349.70)	0.49	0.49	(\$341.20)

Similar results although the downside edge only lasts a week instead of 3.

Volume extremes are something I look for in not only indices but individual stocks as well. I use filters for high or low volume when designing strategies as well. An example is in tonight's FXE trade idea.

Tonight's Aggregator chart is below.



As you can see by the black differential line, the market has strongly outperformed expectations over the last three days. Still, the green aggregator line remains well above zero, signaling positive expectations over the next few days. The Aggregator simply takes an average of the studies when calculating. It basically represents a loose composite of the study results. What it doesn't include is a method for overweighting more recent studies. The last three studies have all been bearish. In this case we have a rare day where the Aggregator does a somewhat poor job of reflecting my opinion. Rather than wait for the Aggregator line to turn negative I will be looking to take on some short exposure tomorrow should the market continue higher.

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

SPY – short ¼ total index position at \$129.80. – Based on short-term market outlook above.

FXE – buy @ \$154.28. Based on the following setup:

- 1) Has closed at least 10 day in a row below its 10-day MA
- 2) Closed above its 200-day MA
- 3) Closed further below its 10-day MA than any time in the last 10 days.
- 4) Lowest volume in 5 days.

Buying any of the 104 ETF's in my "highly liquid" list and sell on a cross of the 10-ma would have produced the following results over the last 10 years:

Trades – 49

Wins – 43

Losses – 6

Pct Wins – 88%

Avg Win. – 3.9%

Avg Loss – 6.2%

Avg Trade – 2.7%

Profit Factor – 4.6

No stop was used in the test. I will place one below \$153, which is fairly tight, but below recent support.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
IP(S)	8/6/2008	\$28.34	\$28.58	-0.85%	\$29.51	cover on %b < 75
MOS	8/6/2008	\$110.47	\$112.94	2.24%	\$103.90	sell on close > 10ma

Stocks and ETF's on my Radar

none

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

None

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