

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 12, 2008

Issue 122

## Market Overview

*Summary of Recent Active Studies (see <http://QuantifiableEdges.blogspot.com> or Letters from listed dates for details)*

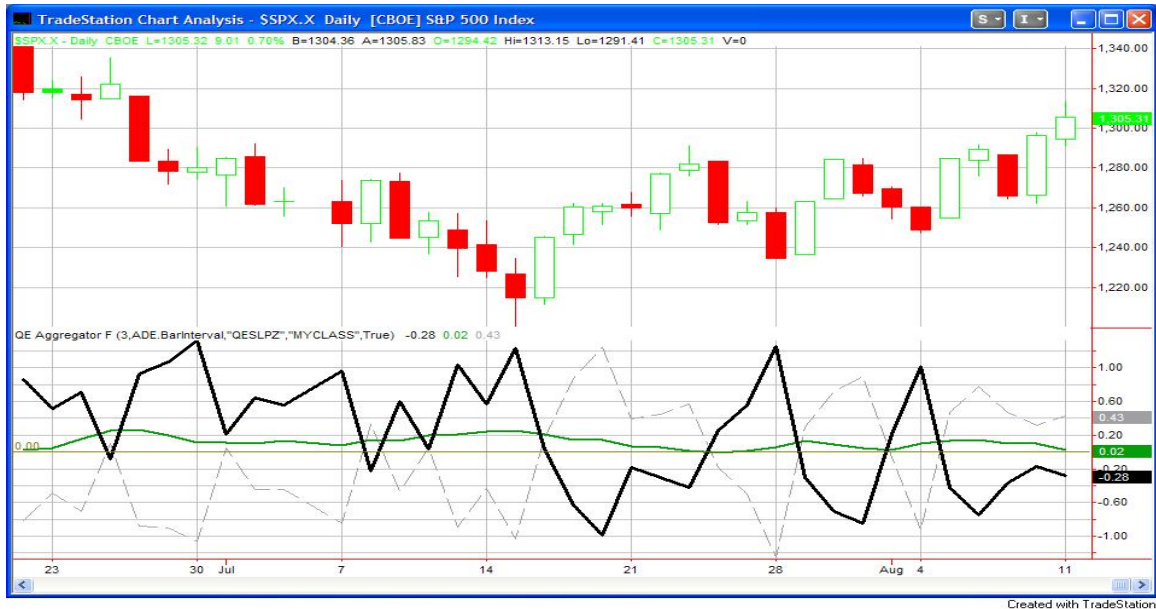
Study Date	Description	Time span	Bias
August 10, 2008	Strong Friday	1-4 Days	Bullish
7/30 & 8/10	Big up after big down	1-12 days	Bullish
August 8, 2008	Nasdaq Dn Sox Up	1-30 Days	Bullish
August 7, 2008	20 day high on low volume	1-10 days	Bearish
August 6, 2008	Fed day spike	1-10 days	Bearish
August 6, 2008	Put/Call 100-day low	1-10 days	Bearish
July 31, 2008	Strong move on rising volume	1-10 days	Bullish
July 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 8/12*

The Friday-Monday momentum I discussed last night carried through as the market tacked on some decent gains today. Breadth was positive by about 2 to 1. Volume increased over yesterday, which is a positive.

I posted a chart tonight on the blog showing all the recent instances where the S&P 500 closed higher for at least 2 days in a row. Over the last two months such an occurrence has basically hit a brick wall.

Below is tonight's [Aggregator](#) chart:



The green Aggregator line is approaching 0 and will dip below it tomorrow without any additional bullish studies. The black differential line shows the S&P has outperformed expectations over the last three days. The differential line will be losing last Thursday's selloff on Tuesday and will therefore also move lower unless Tuesday is a big down day. I'm expecting the market to begin to struggle here for a few days.

### ***Intermediate-term Outlook (1 week – 2 months) -neutral – updated 8/11***

The market has continued to rally and put in a series of higher highs and higher lows since the July bottom. As I noted in the short-term outlook above, price action has been quite strong. Also in the bullish camp is the fact that the market bounced after such extremely poor breadth readings in July. This was discussed in the July 20<sup>th</sup> Letter. (Feel free to email me if you need a copy.)

Up until this week the volume pattern had been about picture perfect. With the studies noted above, that has changed over the last few days. There are also some other indicators which have received some attention this week that could have bearish implications.

The first is the ratio of Nasdaq volume to NYSE volume. I saw this keenly noted on both MarketTells.com and also on Cobra's Market View blog. The basic idea with the indicator is that when Nasdaq volume becomes extreme compared to NYSE volume, that suggests that more activity is occurring in more speculative stocks. Speculative alpha chasing is the type of behavior often associated with tops.

Over the last three days Nasdaq volume has exceeded NYSE by over 1.8 times on average. Below are some study results showing S&P performance after such occurrences. Note that the sizable discrepancy in instances is due to significant overlap.

<b>Nasdaq volume exceeds NYSE volume by an average of 1.8 times over the last 3 days. Buy at close. Sell X days later. \$100k/trade. 1991-present.</b>											
X Days	Trades	% Wins	Wins	Losses	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
40	8	12.50	1	7	\$13,176.96	(\$23,376.92)	\$13,176.96	(\$15,904.75)	0.83	0.12	(\$12,269.54)
35	9	33.33	3	6	\$13,052.40	(\$18,057.60)	\$8,523.49	(\$10,092.96)	0.84	0.42	(\$3,887.48)
30	10	20.00	2	8	\$10,660.08	(\$16,490.88)	\$7,402.89	(\$8,728.64)	0.85	0.21	(\$5,502.33)
25	10	50.00	5	5	\$13,586.28	(\$20,825.68)	\$7,000.58	(\$8,489.70)	0.82	0.82	(\$744.56)
21	12	33.33	4	8	\$11,888.40	(\$10,968.87)	\$6,923.14	(\$7,178.38)	0.96	0.48	(\$2,477.88)
20	12	41.67	5	7	\$8,590.80	(\$17,959.41)	\$4,126.97	(\$8,380.84)	0.49	0.35	(\$3,169.25)
19	12	41.67	5	7	\$8,500.58	(\$23,213.34)	\$4,415.80	(\$9,129.53)	0.48	0.35	(\$3,485.64)
18	13	53.85	7	6	\$12,472.20	(\$23,902.20)	\$4,909.63	(\$11,416.69)	0.43	0.50	(\$2,625.60)
17	13	46.15	6	7	\$9,881.04	(\$20,850.20)	\$4,013.81	(\$9,268.36)	0.43	0.37	(\$3,138.13)
16	13	46.15	6	7	\$12,002.34	(\$20,064.80)	\$5,807.00	(\$8,444.60)	0.69	0.59	(\$1,866.94)
15	13	53.85	7	6	\$12,336.24	(\$15,990.52)	\$5,982.35	(\$7,896.37)	0.76	0.88	(\$423.21)
10	17	52.94	9	8	\$19,103.70	(\$13,342.28)	\$5,212.24	(\$6,833.32)	0.76	0.86	(\$456.26)
9	18	33.33	6	12	\$16,181.10	(\$14,900.50)	\$6,617.99	(\$4,286.15)	1.54	0.77	(\$651.44)
8	20	45.00	9	11	\$13,582.20	(\$14,101.50)	\$4,747.81	(\$5,396.13)	0.88	0.72	(\$831.35)
7	21	38.10	8	13	\$11,615.94	(\$20,116.10)	\$5,733.21	(\$5,153.48)	1.11	0.68	(\$1,006.17)
6	23	34.78	8	15	\$11,698.20	(\$20,365.66)	\$4,370.65	(\$6,723.92)	0.65	0.35	(\$2,864.94)
5	24	41.67	10	14	\$10,069.18	(\$14,282.04)	\$3,891.48	(\$5,881.82)	0.66	0.47	(\$1,809.61)
4	27	44.44	12	15	\$9,677.70	(\$10,446.50)	\$4,128.53	(\$5,153.36)	0.80	0.64	(\$1,028.08)
3	32	46.88	15	17	\$11,553.60	(\$9,696.48)	\$3,106.19	(\$4,564.24)	0.68	0.60	(\$968.73)
2	41	36.59	15	26	\$14,168.40	(\$7,943.52)	\$3,734.31	(\$3,312.52)	1.13	0.65	(\$734.41)
1	76	43.42	33	43	\$13,967.69	(\$7,146.40)	\$2,333.51	(\$2,237.73)	1.04	0.80	(\$252.85)

It's fairly apparent why others track this indicator. I'm not quite sure how I feel about the study at the present time, though. While I'd rather the market weren't producing such readings, it seems as though "speculative excess" is an unlikely issue with the current market. With consumer and investor sentiment posting extremely low levels by numerous measures I'm having a hard time believing that's a problem. And even if the market did sell off from here, I don't believe anybody would refer to the current levels as a "top". So while historically similar readings have frequently led to weakness, the premise of the indicator seems off. For now I'm simply going to keep this indicator in mind and not necessarily include it in the Aggregator.

Another issue that I've seen noted a few different places is the low number of new highs versus new lows. On the surface this seemed to be potentially concerning to me so I took a look:

<b>S&amp;P 500 makes highest high and highest close in 30 days. New 52 week lows exceed new 52 week highs. Buy SPX on close. Sell X days later. \$100k per trade. 1970 - present.</b>												
X Days	Net Profit	Trades	% Wins	Wins	Losses	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
30	\$6,646.50	8	62.50	5	3	\$5,520.40	(\$5,127.30)	\$3,249.86	(\$3,200.94)	1.02	1.69	\$830.81
20	\$5,376.89	8	75.00	6	2	\$5,489.32	(\$7,374.60)	\$2,814.87	(\$5,756.16)	0.49	1.47	\$672.11
10	\$7,555.25	11	72.73	8	3	\$2,887.48	(\$2,409.62)	\$1,494.66	(\$1,467.34)	1.02	2.72	\$686.84
9	\$945.02	12	58.33	7	5	\$2,295.48	(\$3,732.52)	\$1,582.86	(\$2,027.00)	0.78	1.09	\$78.75
8	(\$1,138.05)	12	58.33	7	5	\$2,995.40	(\$3,823.64)	\$1,420.52	(\$2,216.34)	0.64	0.90	(\$94.84)
7	(\$805.32)	12	58.33	7	5	\$2,945.08	(\$4,006.56)	\$1,503.46	(\$2,265.90)	0.66	0.93	(\$67.11)
6	\$3,426.73	13	53.85	7	6	\$4,035.12	(\$3,429.12)	\$1,725.15	(\$1,441.55)	1.20	1.40	\$263.59
5	\$10,266.56	13	69.23	9	4	\$4,290.80	(\$2,424.39)	\$1,635.13	(\$1,112.40)	1.47	3.31	\$789.74
4	\$4,532.00	15	66.67	10	5	\$4,275.84	(\$4,240.48)	\$1,290.30	(\$1,674.19)	0.77	1.54	\$302.13
3	(\$424.13)	16	62.50	10	6	\$2,458.20	(\$4,080.75)	\$930.76	(\$1,621.95)	0.57	0.96	(\$26.51)
2	\$4,905.55	17	58.82	10	7	\$2,212.98	(\$1,664.97)	\$1,056.50	(\$808.49)	1.31	1.87	\$288.56
1	\$1,498.52	18	50.00	9	9	\$1,516.26	(\$1,294.50)	\$576.14	(\$409.64)	1.41	1.41	\$83.25

Results appear choppy and under perform a random sampling. The instances are quite small, and before jumping to conclusions it's important to isolate the affect of the indicator. So below is the same test when news highs exceeded new lows:

S&P 500 makes highest high and highest close in 30 days. New 52 week highs exceed new 52 week lows.												
Buy SPX on close. Sell X days later. \$100k per trade. 1970 - present.												
X Days	Net Profit	Trades	% Wins	Wins	Losses	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
30	\$45,407.22	76	60.53	46	30	\$10,181.64	(\$16,698.36)	\$3,357.61	(\$3,634.76)	0.92	1.42	\$597.46
20	\$46,874.84	95	67.37	64	31	\$9,782.36	(\$12,082.93)	\$2,259.23	(\$3,152.12)	0.72	1.48	\$493.42
10	(\$7,081.82)	152	49.34	75	77	\$5,768.50	(\$7,084.34)	\$1,726.07	(\$1,773.21)	0.97	0.95	(\$46.59)
9	(\$1,724.40)	157	52.23	82	75	\$4,946.98	(\$8,605.65)	\$1,509.54	(\$1,673.42)	0.90	0.99	(\$10.98)
8	(\$5,070.33)	164	50.61	83	81	\$4,503.68	(\$7,137.90)	\$1,422.91	(\$1,520.64)	0.94	0.96	(\$30.92)
7	(\$237.39)	179	48.60	87	92	\$4,443.12	(\$8,722.04)	\$1,446.51	(\$1,370.48)	1.06	1.00	(\$1.33)
6	(\$622.58)	192	52.08	100	92	\$5,064.60	(\$4,802.89)	\$1,180.83	(\$1,290.28)	0.92	0.99	(\$3.24)
5	(\$13,249.83)	211	50.71	107	104	\$4,683.84	(\$4,624.70)	\$1,071.24	(\$1,229.55)	0.87	0.90	(\$62.80)
4	(\$8,503.07)	228	52.63	120	108	\$3,276.08	(\$4,617.49)	\$914.93	(\$1,095.32)	0.84	0.93	(\$37.29)
3	(\$17,401.51)	264	50.76	134	130	\$3,578.64	(\$4,034.70)	\$837.79	(\$997.42)	0.84	0.87	(\$65.91)
2	(\$14,754.10)	322	50.31	162	160	\$3,061.60	(\$4,033.80)	\$672.02	(\$772.64)	0.87	0.88	(\$45.82)
1	(\$5,741.46)	463	49.24	228	235	\$2,286.84	(\$3,515.37)	\$442.73	(\$453.98)	0.98	0.95	(\$12.40)

These results are worse than the 1<sup>st</sup> case where lows exceeded highs. So while the market may pull back (which it frequently does after making 30-day highs), the blame shouldn't be laid on the lagging number of new highs.

Overall, the intermediate-term outlook hasn't changed much from last week. I'm still expecting stronger conditions down the road, but the next few weeks appear less certain. I believe volume will be a key component to watch. Hopefully some of the volume indicators and patterns discussed lately can improve. It would also be nice to see stronger breadth participation. Those are two areas I will be watching especially carefully as I believe they should help to provide some clues.

### **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	0.00	DJ US Healthcare	IYH	0.70
DJ US Oil&Gas Expl & Prod	IEO	1.72	DJ US Industrial Sector	IYJ	0.77
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	0.00
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	1.01
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	5.26
DJ US Consumer Svcs	IYC	0.00	Nasdaq 100	QQQQ	2.00

**Additional New Trade Ideas**

SPY – short  $\frac{1}{4}$  of index position at \$130.71. Could be a little early, but I’m looking to begin to scale in to a short here. Reasons based on studies as displayed in the Aggregator chart and discussed in the short-term outlook.

SLE – short @ \$14.90. Cover stop @ \$15.16. This is based on the following setup:

- 1) Closed above 10-day ma for at least 20 days in a row
- 2) Today’s high was the highest of the run-up
- 3) The stock closed above it upper Bollinger Band (20ma, 2 std dev)
- 4) Volume was the lowest in 3 days.

Shorting under these conditions and covering on a close below the 10-day ma would have produced the following results in the current S&P 100 over the last 10 years:

Trades	60
Winners	41
Losers	19
Pct Winners	68.3%
Avg Win	2.72%
Avg Loss	-2.12%
Avg Trade	1.19%
Profit Factor	2.8

No stop was factored into the results. I will use one above Monday’s high.

## Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
IP(S)	8/6/2008	\$28.34	\$29.24	-3.18%	\$29.51	cover on %b < 75

## Stocks and ETF's on my Radar

Semiconductor ETF's: SMH, IGW, PSI, and XSD. A pullback entry could offer nice longer-term risk/reward.

USO – pulling back sharply and nearing the 200-day ma support. Qualifies under the system published 4/2/08 that required 10 closes below the 10ma, a close above the 200ma and the lowest close in 10 days. A close above the 10ma was the exit criteria.

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