

QUANTIFIABLE EDGES

SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

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Issue 137

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	Avg Max Move	Avg MM + 1 Std Dev
August 31, 2008	Gap Dn then Drop No 3day Lo	1-3 days	Bullish	2.50%	4.30%
August 31, 2008	Gap Up Gap Down	1-6 days	Bearish	-2.60%	-4.80%
August 29, 2008	2 Days 75% Brdth-No 10 hi	1-10 days	Bearish	-3.27%	-5.69%
August 27, 2008	Weak Bounce	1-17 days	Bearish	-5.30%	-8.90%
August 26, 2008	Bad Breadth & Volume	1-15 days	Bullish	3.54%	6.37%
August 25, 2008	3 Up While Volume Declines	1-13 days	Bearish	-2.76%	-5.24%
8/19 & 8/31	1% Drop Extreme Low Vol	1-10 days	Bearish	-4.04%	-7.14%
August 15, 2008	SPX up 0.5 Vol Lowest in 20	1-20 days	Bearish		
August 8, 2008	Nasdaq Dn Sox Up	1-30 Days	Bullish		
July 7, 2008	5 Weeks Lower	1-10 weeks	Bearish		
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish		

If the avg max move is achieved it will appear in **bold and green**. If the avg + 1 std deviation is achieved, the study will be removed from active status.

Short-term Outlook (1-5 days) –slightly bullish – updated 9/3

After gapping up strongly the market gave back its gains and more by the afternoon. Volume came in relatively strong. Oddly, advancers led decliners.

The failed gap up looks ugly on a chart but is actually a bullish pattern. I looked at this a few times in the blog - in [July](#) and [February](#). Tonight I loosened the criteria a bit for SPY and re-ran it. Results below:

SPY gaps up 0.75 and closes lower on day. Buy SPY on close. Sell "X" days later. \$100k/trade. 1993-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	All: Avg Tr
10	\$26,436.19	37	23	14	62.16	2210.01	(1742.43)	1.27	2.08	\$714.49
9	\$25,381.19	37	24	13	64.86	2164.16	(2042.97)	1.06	1.96	\$685.98
8	\$34,244.57	40	27	13	67.50	2327.37	(2199.57)	1.06	2.20	\$856.11
7	\$40,550.12	40	29	11	72.50	2439.05	(2743.85)	0.89	2.34	\$1,013.75
6	\$41,016.77	43	32	11	74.42	2203.03	(2680.03)	0.82	2.39	\$953.88
5	\$41,532.08	45	32	13	71.11	2280.96	(2419.89)	0.94	2.32	\$922.94
4	\$26,200.88	46	30	16	65.22	2122.60	(2342.33)	0.91	1.70	\$569.58
3	\$22,040.90	46	27	19	58.70	1870.56	(1498.11)	1.25	1.77	\$479.15
2	\$11,802.75	47	28	19	59.57	1608.45	(1749.14)	0.92	1.36	\$251.12
1	(\$18,787.57)	47	22	25	46.81	1124.17	(1740.77)	0.65	0.57	(\$399.74)

Choppy at first, but some solid risk/reward 5-7 days out.

Also notable about today is that it is the 2nd down day in a row. In [tonight's blog](#) I show a study that displays S&P 500 performance following two consecutive down days over the last 15 months. The results are bullish and show how even though the trend has been bearish, the general tendency has been chop.

One sector that dropped hard today was oil. I ran a study back to 2001 showing other time the CBOE Oil Index dropped at least 4% and the S&P 500 finished down.

OIX closes down 4% and SPX also closes down. Buy SPX on close. Sell X days later. \$100k.trade. 2001-										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	All: Avg Tr
10	\$23,125.65	9	8	1	88.89	2985.24	(756.24)	3.95	31.58	\$2,569.52
9	\$25,431.30	10	8	2	80.00	3538.93	(1440.05)	2.46	9.83	\$2,543.13
8	\$29,873.41	10	9	1	90.00	3324.92	(50.85)	65.39	588.48	\$2,987.34
7	\$24,172.18	10	9	1	90.00	2857.68	(1546.98)	1.85	16.63	\$2,417.22
6	\$28,305.98	10	10	0	100.00	2830.60	0.00	100.00	100.00	\$2,830.60
5	\$21,910.92	10	8	2	80.00	2900.82	(647.84)	4.48	17.91	\$2,191.09
4	\$16,963.22	10	7	3	70.00	2755.90	(776.03)	3.55	8.29	\$1,696.32
3	\$9,878.40	10	7	3	70.00	2065.53	(1526.77)	1.35	3.16	\$987.84
2	\$1,028.80	11	7	4	63.64	2499.91	(4117.65)	0.61	1.06	\$93.53
1	\$2,646.33	12	8	4	66.67	1748.89	(2836.20)	0.62	1.23	\$220.53

More evidence suggesting a bounce is near.

The last thing I want to mention tonight is the VIX:VXV ratio. I've discussed a bit the last couple of weeks. Basically, a move below 0.9 can be considered a bearish indication. There was some question whether the ratio was artificially low because the VIX was being discounted due to slow end-of-August trading. The real test came today since the summer vacation pressure was no longer keeping the VIX low. This morning while the market was higher, the VXV was lower as you'd expect, but the VIX was actually higher. The close today carried a final reading of about 0.95. Subscribers may remember from a couple of weeks ago that this is the lower end of the profit-taking level for short trades. Due to this, I am eliminating the VIX:VXV ratio studies from consideration for the time being. Should the ratio move back below 0.90 I will once again consider it a negative influence and a factor in my decision making.

Most of what I'm seeing is pointing up for the short-term. Trade ideas may be found in the trade ideas and radar sections today.

Intermediate-term Outlook (1 week – 2 months)–neutral to slightly bearish-updated 9/2

I've been looking for a sign that the market is ready to launch a new bull move higher and I've yet to find it. In fact, over the last couple of weeks I've begun to see some negatives line up.

Last week I showed a detailed study of the VIX:VXV ratio. The bottom line was that a move below 0.90 in the ratio tended to have bearish implications over the intermediate-term timeframe. With the slow end-of-August trading being factored in it was suggested that the VIX may be a bit lower than normal. August is now behind us. Even with the sharp drop on Friday the ratio still lies only at 0.91. A move below 0.9 from here on out

would act as confirmation of last week's signal. It would suggest a difficult environment could ensue over the next couple of months.

Another indicator that is continuing to suggest bearish consequences is the Nasdaq to NYSE volume ratio. I discussed this ratio two weeks ago as we saw a bit of a spike up at the time. Historically, when the Nasdaq volume begins to run high as compared to NYSE volume, it suggests excessive speculation. Often this leads to a selloff. On Wednesday we once again saw the ratio spike to a high level. Below is another study with bearish intermediate-term results.

<i>The Nasdaq to NYSE volume ratio spikes to its highest level in 50 days. Buy Nasdaq on close. Sell X days later. \$100k/trade. 1990-present.</i>														
X Days	Net Profit	Gross Profit	Gross Loss	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
100	(\$98,072.66)	\$31,638.53	(\$129,711.19)	9	2	7	22.22	\$28,138.25	(\$33,591.28)	\$15,819.27	(\$18,530.17)	0.85	0.24	(\$10,896.96)
90	(\$73,409.68)	\$28,803.37	(\$102,213.05)	9	2	7	22.22	\$28,253.89	(\$34,478.16)	\$14,401.69	(\$14,601.86)	0.99	0.28	(\$8,156.63)
80	(\$94,741.02)	\$21,928.48	(\$116,669.50)	11	2	9	18.18	\$20,499.64	(\$34,290.24)	\$10,964.24	(\$12,963.28)	0.85	0.19	(\$8,612.82)
70	(\$77,732.46)	\$48,082.63	(\$125,815.09)	12	4	8	33.33	\$19,992.90	(\$35,851.86)	\$12,020.66	(\$15,726.89)	0.76	0.38	(\$6,477.71)
60	(\$60,856.11)	\$62,770.12	(\$123,626.23)	12	3	9	25.00	\$24,212.50	(\$31,756.56)	\$20,923.37	(\$13,736.25)	1.52	0.51	(\$5,071.34)
50	(\$45,819.16)	\$57,358.79	(\$103,177.95)	12	3	9	25.00	\$26,868.75	(\$27,780.84)	\$19,119.60	(\$11,464.22)	1.67	0.56	(\$3,818.26)
40	(\$17,620.68)	\$54,249.53	(\$71,870.21)	12	5	7	41.67	\$19,144.30	(\$19,988.54)	\$10,849.91	(\$10,267.17)	1.06	0.75	(\$1,468.39)
30	(\$64,499.31)	\$31,294.45	(\$95,793.76)	15	4	11	26.67	\$14,911.19	(\$16,804.34)	\$7,823.61	(\$8,708.52)	0.90	0.33	(\$4,299.95)
20	(\$36,431.57)	\$29,892.79	(\$66,324.36)	15	8	7	53.33	\$8,590.80	(\$16,200.36)	\$3,736.60	(\$9,474.91)	0.39	0.45	(\$2,428.77)
10	(\$21,436.04)	\$38,595.57	(\$60,031.61)	20	8	12	40.00	\$19,103.70	(\$17,212.14)	\$4,824.45	(\$5,002.63)	0.96	0.64	(\$1,071.80)
5	(\$47,022.63)	\$19,545.49	(\$66,568.12)	21	7	14	33.33	\$4,835.70	(\$12,889.14)	\$2,792.21	(\$4,754.87)	0.59	0.29	(\$2,239.17)

There is deterioration in the number of trades because of the amount of overlap when looking at longer periods. These results are shockingly bad when you consider the fact that the Nasdaq made strong gains over the test period. Looking out 100 days, 7 of 9 trades were losers. The average loss was 18%. There were two wins, one that gained 28% and the other that only scratched out a 3% rise. A few weeks ago I dismissed the spike in this ratio, because I found the concept of excessive speculation to be questionable due to the high levels of bearishness in both consumer and market sentiment indicators. I no longer feel it should be dismissed, but rather considered carefully.

A few weeks ago the price action in the Nasdaq, and especially in the SOX, had provided some bullish implications going forward. Upside leadership in these areas tends to act as a positive for the entire market. Over the last two weeks this has changed. The Nasdaq and SOX indices have pulled back much sharper than the broader market. In fact, while the S&P 500 is in the middle of its three-week range, the Nasdaq is at the lower end of its range and the SOX rolled over on Friday to post a 3-week low.

I did run some studies to see if there were ominous implications when the Nasdaq was in a position of leadership and then pulled back sharply in comparison to the NYSE. Results weren't terribly compelling but they did have a bullish tilt. They suggested you're normally better off just buying sharp pullbacks and not worrying about deteriorating leadership. With the studies we've seen over the last few weeks suggesting strong SOX leadership is a positive, studies showing bullish implications with regards to failing leadership would have to be much more convincing before I'd believe the SOX breakdown could possibly be a good thing.

In summary, the current studies are mixed with a slightly bearish tilt. Volume patterns remain weak. Breadth has picked up, but not to the levels that would imply a bullish outlook based on Lowry's research of 90% upside days. (These were discussed about a month ago – email me if you need that report.) Rather we've been treated to upside days of between 75% and 80% which haven't provided bullish expectations. The combination of the VIX:VXV ratio and the Nasdaq:NYSE Volume ratio suggests investors may be getting a bit careless. Individually, these kinds of readings carry negative expectations. The volume and volatility based studies may be questioned due to the slow summer trading but that should end this week as traders get back to work. The next week or two could be critical as the market may tip its hand

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	0.00
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	1.41
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	0.00
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	0.68
DJ US Pharmaceuticals	IHE	2.70	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	0.00
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	5.26
DJ US Consumer Svcs	IYC	0.44	Nasdaq 100	QQQQ	0.00

Additional New Trade Ideas

SPY – buy 1/4 position @ \$127. Looking to start scaling in on further weakness tomorrow.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
BBH	8/22/2008	\$199.79	\$198.52	-0.64%	#####	sold
SPY(S)	8/28/2008	\$129.28	\$129.00	0.22%		covered

Stocks and ETF's on my Radar

Yesterday's GILD idea is below. Two more securities are now set up in the same way – CELG and IBB (Biotech ETF). Should the market begin to bounce. Biotech could provide some nice short-term opportunity.

GILD – This has triggered a setup first published in the 4/2 Subscriber Letter. It is a setup that I prefer to use for ETF's rather than individual stocks as it tends to perform better with ETF's. Should it continue to stretch or form a doji or narrow range bar I may consider an entry. The setup along with current stats is below:

- 1) Closes under 10-day moving average for at least 10 days.
- 2) Closes above 200-day MA.
- 3) Today is makes its lowest low in 10 days.

Buy on close. Sell on close above the 10-day MA. Over the last 10 years across the current S&P 100 stocks the following stats would apply:

Trades	752
Wins	557
Losses	192
Win %	74.1%
Avg Win	2.6%
Avg Loss	-4.3%
Avg Trade	0.8%
Profit Factor	1.74

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