

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 5, 2008

Issue 139

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
September 5, 2008	Acceleration Down	1-5 days	Bullish	3.09%	5.45%
September 4, 2008	SOX down DJ up	1-3 days	Bearish	-2.47%	-4.50%
September 3, 2008	OIX down 4% SPX Down	1-6 days	Bullish		
September 3, 2008	Large Gap Fail	1-7 days	Bullish		
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%(1230.91)	-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.

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

After 3 down days the market not only failed to bounce, but it completely collapsed today. The Dow, S&P and Nasdaq all dropped about 3% today on heavy volume. Breadth was extremely negative as advancers outnumbered decliners by about 5 to 1 and down volume accounted for 90% of total volume on the NYSE.

The fact that we saw extreme acceleration in the price decline after already being down for a few days is short-term bullish. [Tonight's blog focuses on this setup](#). The 90% downside breadth after 3 previous lower closes also hints at a rebound. Below is a study that addresses this:

<i>SPX drops for at least the 4th day in a row. Today downside volume accounts for over 90% of total NYSE volume.</i>										
<i>Buy SPX on close. Sell 1st profitable exit up to X days later. \$100k/trade. Last 20 years.</i>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$45,974.53	28	16	12	57.14	\$4,550.72	(\$2,236.41)	2.03	2.71	\$1,641.95
9	\$49,312.90	28	20	8	71.43	\$3,512.49	(\$2,617.11)	1.34	3.36	\$1,761.18
8	\$52,887.16	29	22	7	75.86	\$3,040.40	(\$2,000.23)	1.52	4.78	\$1,823.70
7	\$42,261.61	29	20	9	68.97	\$2,949.52	(\$1,858.76)	1.59	3.53	\$1,457.30
6	\$56,284.59	29	21	8	72.41	\$3,315.83	(\$1,668.49)	1.99	5.22	\$1,940.85
5	\$46,510.46	29	18	11	62.07	\$3,544.84	(\$1,572.43)	2.25	3.69	\$1,603.81
4	\$40,681.54	29	21	8	72.41	\$2,588.54	(\$1,709.74)	1.51	3.97	\$1,402.81
3	\$27,017.00	30	17	12	56.67	\$2,644.12	(\$1,494.42)	1.77	2.51	\$900.57
2	\$31,217.01	30	19	11	63.33	\$2,456.80	(\$1,405.65)	1.75	3.02	\$1,040.57
1	\$23,550.75	31	21	10	67.74	\$1,657.19	(\$1,125.03)	1.47	3.09	\$759.70

Like the blog study, the edge here is also dissipates after about a week.

Below is a look at the standard Aggregator chart:



The black differential line is about as stretched as it has gotten in months – indicating severe underperformance relative to expectations for the S&P 500 over the last 3 days. The green Aggregator has poked into positive territory, but just barely. What I find interesting about the studies tonight is that so many of the bearish ones have reached their “Avg maximum move”. Deciding the best time to remove studies requires some subjectivity. Under most circumstances I simply let them remain for the entire time frame. When an anticipated move is achieved, though, it suggests the studies ability to affect more downside may be limited. The avg max +1 standard deviation is an area I’ve suggested could be useful. A case could also be made for removing studies after they complete the “Average Maximum Move”. If instead I were to do this the current green Aggregator line would have a very bullish 0.15 reading and would look a bit like this:



This would suggest a more aggressive approach could be taken. Either way, I'm still interested in the longside. In the trades section I continue to scale into the SPY trade. I also show a few Catapults that have triggered.

As a final note I've listed below the 14 instances that were used in calculating the 3rd table in the blog study tonight:

SPX drops for at least the 4th day in a row.			
Today's drop is at least twice as large as any previous during downmove.			
Buy SPX on close. Sell 5 days later. \$100k/trade. Last 20 years.			
Trade	Type	Date	% Profit
1	Buy	6/13/1989	
	Sell	6/20/1989	-0.82%
2	Buy	10/13/1989	
	Sell	10/20/1989	4.05%
3	Buy	10/26/1989	
	Sell	11/2/1989	0.16%
4	Buy	6/8/1990	
	Sell	6/15/1990	1.17%
5	Buy	3/11/1991	
	Sell	3/18/1991	-0.23%
6	Buy	7/2/1993	
	Sell	7/12/1993	0.70%
7	Buy	11/22/1994	
	Sell	11/30/1994	0.80%
8	Buy	10/27/1997	
	Sell	11/3/1997	7.07%
9	Buy	12/11/1997	
	Sell	12/18/1997	0.04%
10	Buy	1/9/1998	
	Sell	1/16/1998	3.65%
11	Buy	4/14/2000	
	Sell	4/24/2000	5.45%
12	Buy	9/3/2002	
	Sell	9/10/2002	3.59%
13	Buy	3/31/2003	
	Sell	4/7/2003	3.74%
14	Buy	2/27/2007	
	Sell	3/6/2007	-0.27%

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

DELL –bought 1/3 position at \$20.22

New

AES – buy 1/3 position @ \$14.47.

Open Big 50 Trades

None

Catapult for ETF's Trades

New

VWO – buy @ \$38.00

FXE – buy @ \$143.34

Broad Market Large Cap CBI – 2 (DELL,AES)

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	4.05	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	0.00	DJ US Consumer Goods	IYK	0.68
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	2.70
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	1.51
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	2.63
DJ US Consumer Svcs	IYC	0.00	Nasdaq 100	QQQQ	1.00

Additional New Trade Ideas

SPY – buy 1/4 position @ \$124.03. Looking to add to today’s position based on market overview.

Also note the catapult and catapult for RTF trae ideas in the Catapult section.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY	9/3/2008	\$127.00	\$124.03	-2.34%		
SPY	9/4/2008	\$126.97	\$124.03	-2.32%		
DELL	9/4/2008	\$20.22	\$20.36	0.69%		Catapult

Stocks and ETF’s on my Radar

QCOM – collapsing after recent gap up. Could be playable for a bounce soon.

RIMM – getting overdone and nearing support area

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