

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 9, 2008

Issue 141

## 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	<b>3.09%</b>	5.45%
September 3, 2008	OIX down 4% SPX Down	1-6 days	Bullish		
September 3, 2008	Large Gap Fail	1-7 days	Bullish		
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%
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		
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 in *bold italic blue*.

### *Short-term Outlook (1-5 days) –neutral – updated 9/9*

After gapping up over 2% Monday morning the market spent most of the morning selling off. The Dow and S&P remained in positive territory the entire time. It found support and closed well of its lows, but still quite a bit below the open. Volume was heavy. NYSE advancers outnumbered decliners by almost 2 to 1.

The performance wasn't good all around, though, as the NDX closed lower once again. The market action is extremely unusual at the moment and I found it quite difficult tonight to find comparable periods. Let's look at a few examples of what I'm seeing so you can understand where I'm coming from.

Comparing the S&P 500 to the Nasdaq 100, I looked at other times the S&P has risen at least 2% while the NDX close lower on the day. I only found 2 instances – 3/15/00 and 1/23/08. It's difficult to extract meaningful information from a study with only 2 instances.

I showed a few gap stats this morning. Looking back to the inception of the SPY there have been 18 gaps of 2% or more. Most of the time they have given back some gains over the next day or two. Once you begin parsing the data in different ways – looking at the close as compared to the open, high, or low for instance, you end up with too few instances to garner much value and inconsistent results.

Today's action left the S&P near mid-range of last Tuesday's high to Friday's low. Mid-range without a clear edge is not a position I look to trade from. One index that is at a range extreme is the NDX.

The NDX has actually now closed below its lower Bollinger Band for 5 days in a row. I ran some tests to examine this:

<i>NDX closes below lower Bolinger Band 5 days in a row. Buy on close sell X days later. \$100k/trade. 1986-present</i>												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Fac	Avg Trade
20	\$16,149.19	6	2	4	33.33	19416.32	(3045.83)	11834.83	(1880.12)	6.29	3.15	\$2,691.53
19	\$7,837.84	6	2	4	33.33	17897.44	(4374.51)	10775.29	(3428.18)	3.14	1.57	\$1,306.31
18	\$6,616.41	6	2	4	33.33	16530.80	(5087.72)	9828.91	(3260.35)	3.01	1.51	\$1,102.74
17	\$18,493.85	6	2	4	33.33	24451.68	(4873.20)	13826.40	(2289.74)	6.04	3.02	\$3,082.31
16	\$17,707.06	6	3	3	50.00	22173.36	(2972.28)	8585.51	(2683.16)	3.20	3.20	\$2,951.18
15	\$21,565.15	6	3	3	50.00	23486.32	(3466.26)	9954.78	(2766.40)	3.60	3.60	\$3,594.19
14	\$18,930.29	6	3	3	50.00	23136.96	(6515.94)	10064.12	(3754.03)	2.68	2.68	\$3,155.05
13	\$10,710.66	6	3	3	50.00	15640.24	(5997.18)	7421.57	(3851.35)	1.93	1.93	\$1,785.11
12	\$9,179.33	6	3	3	50.00	10349.68	(5184.98)	5911.81	(2852.03)	2.07	2.07	\$1,529.89
11	\$16,565.99	6	4	2	66.67	13435.84	(3657.52)	5441.53	(2600.07)	2.09	4.19	\$2,761.00
10	\$14,147.43	6	4	2	66.67	12740.64	(3825.20)	5153.28	(3232.84)	1.59	3.19	\$2,357.91
9	\$13,589.57	6	3	3	50.00	11766.48	(3406.00)	6083.44	(1553.59)	3.92	3.92	\$2,264.93
8	\$14,641.33	6	4	2	66.67	10776.48	(1712.44)	4402.19	(1483.71)	2.97	5.93	\$2,440.22
7	\$12,331.75	6	6	0	100.00	3462.38	0.00	2055.29	0.00	100.00	100.00	\$2,055.29
6	\$10,601.10	6	6	0	100.00	3430.83	0.00	1766.85	0.00	100.00	100.00	\$1,766.85
5	\$12,840.16	6	5	1	83.33	3838.38	(1161.26)	2800.28	(1161.26)	2.41	12.06	\$2,140.03
4	\$7,266.95	6	5	1	83.33	2608.32	(1853.80)	1824.15	(1853.80)	0.98	4.92	\$1,211.16
3	\$7,175.08	6	4	2	66.67	2373.72	(889.08)	2120.89	(654.24)	3.24	6.48	\$1,195.85
2	\$6,036.46	6	4	2	66.67	5352.16	(1379.36)	2170.32	(1322.41)	1.64	3.28	\$1,006.08
1	\$4,762.06	6	4	2	66.67	5638.16	(1533.14)	1756.70	(1132.37)	1.55	3.10	\$793.68

Again, we're only dealing with 6 other occurrences ever. Over the following 5-7 days there was a tendency to bounce. In most cases this bounce was short-lived. Those wishing to play an oversold bounce in the NDX should make sure they don't overstay their welcome. Note the positive net returns between days 8-20 are completely due to the single Max Win.

A few years ago I sold a system through TradingMarkets that would primarily look to put on hedge trades when the market was deemed to be near a turning point. In designing the system I learned several things about sector interaction. One interesting finding was that the most oversold groups would perform the best when the market made its directional swings. The long part of the trade, therefore, always looked to the worst group.

With the unique market action and mixed study results, picking a general direction is quite difficult at the present. One possible trade that could be considered in this environment would be a long QQQQ / short SPY type combo. A SOX proxy (SMH, IGW, etc) could also be used instead of the QQQQ. This would anticipate that the QQQQ would bounce better, or at least sell of less than the SPY over the next several days. When developing the system I spoke of above, I found that scaling into the trades often improved results. The exit could be tricky, but I would be looking to take profits quite quickly if I were to initiate such a trade.

I won't be initiating such a trade for official listing below as I'd rather wait for a better defined directional edge. There is no Aggregator chart tonight. I don't see the need to post more evidence of unclear edges.

***Intermediate-term Outlook (1 week – 2 months)–neutral to slightly bearish-updated 9/8***

While the drop last week was sharp there is little sign from an intermediate-term standpoint that it was exhaustive in any way. The recent studies which have shown bullish implications are short-term in nature. Most of them will lose their influence by the end of this week.

The drop this week broke the market out of its 5-6 week consolidation and the July lows are the next level of support. At this point, many of the breadth and other exhaustive measures I look at have yet to reach significant levels. Examples of indicators that are nowhere near their mid-July levels include New 52-week lows, the % of Stocks Closing Below Their 40-day MA, the VIX and VIX:VXV Ratio, the CBI, which currently stands at 4, and sentiment surveys.

It's not surprising that panic has not set in since the move down is fairly new. Should the market reach its July lows, it will then be important to monitor these indicators to see if divergences or panic readings develop.

One notable index that broke down to new 52-week lows this week is the Semiconductors (SOX). I've shown some studies in the past that indicators the SOX can act as a leading indicator for the rest of the market. Those studies may be found [here](#) and [here](#). You may also find an interesting and related study on the MarketSci blog [here](#). So if the SOX does a nice job of leading the market to the upside, does a breakdown to a new low serve as a bad omen?

I looked back to 1995 to find all the times the SOX has broken to a 52-week low ahead of the S&P 500. I wanted to see whether the S&P 500 often followed it and also hit a 52-week low. Of the 10 instances I found of the SOX hitting a 52-week low without the S&P, only 3 of them led to a breakdown in the S&P within the next 20 days. Those three were 11/10/2000, 9/5/02, and 10/26/07. The seven instances that didn't lead to an S&P breakdown occurred on 1/15/96, 7/11/96, 12/12/97, 6/3/98, 8/27/98, 7/15/04, and 7/7/06. So while you would rather see the SOX running up and leading the market higher, it doesn't appear to be any kind of death sentence that it has broken down.

In summary it simply appears too early to tell whether the market is going to crack the July lows or not. I am not seeing strong evidence line up for either the bullish or bearish case for the long-term. It will be important to take things as they come at this point and evaluate the market with fresh eyes on a daily basis.

## **Catapult and Capitulative Breadth Statistics**

*(Catapult Presentation Part 1) (Catapult Presentation Part 2)*

### ***Open Catapult Trades***

DELL –bought 1/3 position at \$20.22

ETR – bought 1/3 position @ \$96.85

### ***New***

EXC – buy 1/3 position @ \$63.97 limit

### ***Open Big 50 Trades***

None

### ***Catapult for ETF's Trades***

VWO – bought and listed in trades section

FXE – bought and listed in trades section

### ***Broad Market Large Cap CBI – 3 (DELL,EXC,ETR)***

### ***Sector CBI Breakdown (% of stocks with active catapult triggers within each sector.)***

<b>Index</b>	<b>ETF</b>	<b>CBI %</b>	<b>Index</b>	<b>ETF</b>	<b>CBI %</b>
DJ US Broker Dealers	IAI	0.00	DJ US Energy	IYE	1.16
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	8.11	DJ US Healthcare	IYH	1.41
DJ US Oil&Gas Expl & Prod	IEO	6.90	DJ US Industrial Sector	IYJ	1.15
DJ US Oil Equip & Svcs	IEZ	1.92	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	2.04	DJ US Real Estate	IYR	0.00
DJ US Medical Devices	IHI	2.44	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	0.00	DJ US Technology Sector	IYW	3.02
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	2.63
DJ US Consumer Svcs	IYC	0.44	Nasdaq 100	QQQQ	2.00

### **Additional New Trade Ideas**

*One possible catapult is listed above.*

With the short-term market outlook so questionable, I'm going to wait another night before looking to initiate any other new positions.

### Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY	9/3/2008	\$127.00	\$128.04	0.82%		sold on open
SPY	9/4/2008	\$126.97	\$128.04	0.84%		sold on open
SPY	9/5/2008	\$123.29	\$126.50	2.60%		hit intraday stop
DELL	9/4/2008	\$20.22	\$20.17	-0.25%		Catapult
FXE	9/5/2008	\$143.20	\$141.62	-1.10%		Catapult
VWO	9/5/2008	\$37.50	\$38.49	2.64%		Catapult
AES	9/5/2008	\$14.42	\$14.95	3.68%		Sell on open
ETR	9/8/2008	\$96.85	\$97.66	0.84%		Catapult

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