

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 15, 2008

Issue 145

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 15, 2008	3 Up Days In Choppy Market	1-4 Days	Bearish	-4.10%	-5.85%
September 12, 2008	20-Day Reversal Bar	1-17 days	Bullish	4.93%	9.39%
September 11, 2008	Bad Breadth Rebound	1-6 Days	Bearish	-4.10%	-5.85%
8/27 & 9/11	Weak Bounce	1-17 days	Bearish	-5.30%	-8.90%
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		
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) –bearish – updated 9/15

The market closed higher on Friday for the 3rd day in a row. Breadth was mildly positive. Volume shrunk from the previous few days. It was the 2nd day in a row that the S&P 500 gapped lower by over 0.75% and then closed higher on the day. I checked for other times there have been back to back gaps lower of this magnitude where the SPY closed higher both times. In the history of the SPY it has never happened.

I've [discussed in the past](#) that 3 higher closes when the market is trading under its 200-day moving average has provided a downside edge over time. This has been especially true recently. Not all three-day rises are created equal and the last three days have had some unusual characteristics. I thought it would be worthwhile examining some of these characteristics. To first provide a baseline for these tests I ran the basic setup back to 1960:

S&P 500 closes higher for the 3rd day in a row and under its 200-day MA.										
Buy S&P on close. Sell X days later. \$100k/trade. 1960-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$76,174.48)	178	81	97	45.51	\$2,455.72	(\$2,835.96)	0.87	0.72	(\$427.95)
9	(\$66,406.35)	184	84	100	45.65	\$2,410.74	(\$2,689.09)	0.90	0.75	(\$360.90)
8	(\$68,926.99)	192	87	104	45.31	\$2,368.67	(\$2,644.24)	0.90	0.75	(\$358.99)
7	(\$60,047.07)	200	88	112	44.00	\$2,363.49	(\$2,393.16)	0.99	0.78	(\$300.24)
6	(\$48,680.34)	209	102	107	48.80	\$2,039.13	(\$2,398.80)	0.85	0.81	(\$232.92)
5	(\$42,771.24)	217	112	105	51.61	\$1,794.65	(\$2,321.64)	0.77	0.82	(\$197.10)
4	(\$47,193.29)	232	120	112	51.72	\$1,485.39	(\$2,012.86)	0.74	0.79	(\$203.42)
3	(\$37,062.98)	232	119	113	51.29	\$1,297.88	(\$1,694.78)	0.77	0.81	(\$159.75)
2	(\$32,582.61)	232	113	119	48.71	\$1,088.13	(\$1,307.07)	0.83	0.79	(\$140.44)
1	\$13,906.94	232	113	117	48.71	\$863.44	(\$715.06)	1.21	1.17	\$59.94

The first thing that struck me is that although the market has closed higher three days in a row, it has not been a steady rise. In fact both Thursday and Friday saw sharp intraday pullbacks. The question is whether those intraday pullbacks can satisfy the market in such a way that the pattern of 3 higher closes no longer carries a negative expectancy. Is the market really due for a pullback, or did it already have one on both Thursday and Friday?

S&P 500 closes higher for the 3rd day in a row and under its 200-day MA. Either today's low or yesterday's low was over 1% below the previous day's close. Buy S&P on close. Sell X days later. \$100k/trade. 1960-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$16,412.18)	17	8	9	47.06	\$1,727.03	(\$3,358.71)	0.51	0.46	(\$965.42)
9	(\$10,247.42)	17	8	9	47.06	\$1,881.43	(\$2,810.99)	0.67	0.59	(\$602.79)
8	(\$3,725.51)	17	8	9	47.06	\$2,058.13	(\$2,243.39)	0.92	0.82	(\$219.15)
7	(\$9,718.43)	17	7	10	41.18	\$1,868.53	(\$2,279.82)	0.82	0.57	(\$571.67)
6	(\$6,119.47)	17	7	10	41.18	\$1,951.63	(\$1,978.09)	0.99	0.69	(\$359.97)
5	(\$124.80)	17	8	9	47.06	\$2,245.19	(\$2,009.59)	1.12	0.99	(\$7.34)
4	(\$6,330.26)	17	8	9	47.06	\$1,441.40	(\$1,984.60)	0.73	0.65	(\$372.37)
3	(\$8,474.52)	17	7	10	41.18	\$1,397.04	(\$1,825.38)	0.77	0.54	(\$498.50)
2	\$384.51	17	8	9	47.06	\$1,738.99	(\$1,503.04)	1.16	1.03	\$22.62
1	\$2,237.85	17	7	10	41.18	\$1,371.60	(\$736.34)	1.86	1.30	\$131.64

The number of instances is a little bit low. Still, there is no indication of better statistics than the previous test without the 1% intraday drop filter. To include more instances, I loosened the requirement to a 0.75% intraday drop.

S&P 500 closes higher for the 3rd day in a row and under its 200-day MA. Either today's low or yesterday's low was over 0.75% below the previous day's close. Buy S&P on close. Sell X days later. \$100k/trade. 1960-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$24,142.21)	24	10	14	41.67	\$2,136.55	(\$3,250.55)	0.66	0.47	(\$1,005.93)
9	(\$13,985.71)	24	10	14	41.67	\$2,526.31	(\$2,803.48)	0.90	0.64	(\$582.74)
8	(\$9,764.91)	24	12	12	50.00	\$2,018.87	(\$2,832.62)	0.71	0.71	(\$406.87)
7	(\$12,574.66)	24	12	12	50.00	\$1,892.34	(\$2,940.23)	0.64	0.64	(\$523.94)
6	(\$2,561.32)	25	13	12	52.00	\$2,221.59	(\$2,620.16)	0.85	0.92	(\$102.45)
5	(\$1,287.75)	27	14	13	51.85	\$2,159.93	(\$2,425.14)	0.89	0.96	(\$47.69)
4	(\$7,141.48)	27	14	13	51.85	\$1,542.98	(\$2,211.01)	0.70	0.75	(\$264.50)
3	(\$9,564.22)	27	13	14	48.15	\$1,508.52	(\$2,083.93)	0.72	0.67	(\$354.23)
2	(\$4,624.05)	27	14	13	51.85	\$1,470.23	(\$1,939.02)	0.76	0.82	(\$171.26)
1	\$5,190.65	27	13	14	48.15	\$1,395.54	(\$925.10)	1.51	1.40	\$192.25

Still no evidence that a sharp intraday drop does anything to erode the downside bias after 3 up days. In fact, most of these stats are worse than the baseline.

The other action I found to be notable about this rally is the weak volume on Friday and the consistently weak breadth. Let's look at the volume first. Friday was the lowest volume day of the week. My inclination when I see weak volume like this is that it may signal buying interest is drying up. To test this I looked at 3-up days where the latest day had the lowest volume:

S&P 500 closes higher for the 3rd day in a row and under its 200-day MA. Today's volume was the lowest of the last 3 days.										
Buy S&P on close. Sell X days later. \$100k/trade. 1960-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$68,236.50)	67	26	41	38.81	\$2,229.56	(\$3,078.17)	0.72	0.46	(\$1,018.46)
9	(\$53,830.44)	68	29	39	42.65	\$2,100.09	(\$2,941.87)	0.71	0.53	(\$791.62)
8	(\$54,533.16)	68	31	37	45.59	\$1,746.57	(\$2,937.21)	0.59	0.50	(\$801.96)
7	(\$33,635.76)	68	30	38	44.12	\$2,143.95	(\$2,577.74)	0.83	0.66	(\$494.64)
6	(\$33,994.47)	69	32	37	46.38	\$1,861.26	(\$2,528.51)	0.74	0.64	(\$492.67)
5	(\$17,959.10)	69	33	36	47.83	\$2,075.34	(\$2,401.26)	0.86	0.79	(\$260.28)
4	(\$21,674.15)	69	34	35	49.28	\$1,462.97	(\$2,040.43)	0.72	0.70	(\$314.12)
3	(\$16,987.68)	69	31	38	44.93	\$1,428.01	(\$1,612.00)	0.89	0.72	(\$246.20)
2	(\$12,014.38)	69	31	38	44.93	\$1,308.45	(\$1,383.59)	0.95	0.77	(\$174.12)
1	\$9,556.77	69	33	34	47.83	\$1,049.42	(\$737.47)	1.42	1.38	\$138.50

When compared with the baseline test, you can see that these results are indeed quite a bit weaker. Since it was the lowest volume of the week and not just of the last 3 days, I also ran another test:

S&P 500 closes higher for the 3rd day in a row and under its 200-day MA. Today's volume was the lowest of the last 5 days.										
Buy S&P on close. Sell X days later. \$100k/trade. 1960-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$54,248.83)	37	14	23	37.84	\$2,140.29	(\$3,661.43)	0.58	0.36	(\$1,466.18)
9	(\$42,375.27)	37	15	22	40.54	\$2,161.28	(\$3,399.75)	0.64	0.43	(\$1,145.28)
8	(\$38,190.03)	37	16	21	43.24	\$1,795.15	(\$3,186.30)	0.56	0.43	(\$1,032.16)
7	(\$25,931.29)	37	15	22	40.54	\$2,090.66	(\$2,604.15)	0.80	0.55	(\$700.85)
6	(\$22,717.01)	37	17	20	45.95	\$1,703.91	(\$2,584.17)	0.66	0.56	(\$613.97)
5	(\$19,933.42)	37	16	21	43.24	\$1,970.47	(\$2,450.52)	0.80	0.61	(\$538.74)
4	(\$20,575.64)	37	19	18	51.35	\$1,267.40	(\$2,480.90)	0.51	0.54	(\$556.10)
3	(\$13,743.82)	37	16	21	43.24	\$1,375.81	(\$1,702.71)	0.81	0.62	(\$371.45)
2	(\$9,451.67)	37	16	21	43.24	\$1,281.59	(\$1,426.53)	0.90	0.68	(\$255.45)
1	\$5,574.43	37	18	17	48.65	\$1,122.94	(\$861.09)	1.30	1.38	\$150.66

The results are even more bearish here.

But what about my breadth observation? What struck me is that of the 3 up days the market just experienced, none of them came on strong breadth. According to my data the % of issues advancing on the NYSE was just below 55% on Friday. Friday was the strongest of the 3 days. I then looked at other situations where up issues didn't account for X% of total issues on any of the 3 positive closes:

S&P 500 closes higher for the 3rd day in a row and under its 200-day MA. Up issues did not account for X% of total issues on any of the 3 days. Buy S&P on close. Sell 5 days later. \$100k/trade. 1960-present.										
X% Issues	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
80%	(\$52,082.70)	154	75	79	48.70	\$1,703.22	(\$2,276.25)	0.75	0.71	(\$338.20)
75%	(\$58,636.34)	130	63	67	48.46	\$1,507.01	(\$2,292.21)	0.66	0.62	(\$451.05)
70%	(\$54,487.01)	105	53	52	50.48	\$1,341.64	(\$2,415.27)	0.56	0.57	(\$518.92)
65%	(\$38,161.26)	62	30	32	48.39	\$1,293.09	(\$2,404.81)	0.54	0.50	(\$615.50)
60%	(\$18,808.68)	28	15	13	53.57	\$1,355.89	(\$3,011.31)	0.45	0.52	(\$671.74)

As you can see, lower advance %'s generally meant sharper downside. This would imply that the weak breadth reading the last few days were in fact bearish. Let's now flip it around and see what results look like if you get at least 1 strong breadth day among the 3:

S&P 500 closes higher for the 3rd day in a row and under its 200-day MA. Up issues accounted for over X% of total issues on at least 1 of the 3 days. Buy S&P on close. Sell 5 days later. \$100k/trade. 1960-present.										
X% Issues	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
75%	\$8,294.44	52	31	21	59.62	\$2,252.60	(\$2,930.30)	0.77	1.13	\$159.51
70%	(\$4,028.74)	85	47	38	55.29	\$2,059.00	(\$2,652.67)	0.78	0.96	(\$47.40)
65%	(\$19,912.77)	123	66	57	53.66	\$1,911.29	(\$2,562.42)	0.75	0.86	(\$161.89)
60%	(\$49,119.11)	153	77	76	50.33	\$1,796.81	(\$2,466.76)	0.73	0.74	(\$321.04)

So it would appear under most circumstances that the action of the last 3 days would provide a bearish setup. Three positive closes under the 200ma by itself is short-term bearish. If there happens to be intraday downside volatility during the 3-day rise, that does nothing to negate the negative bias. If volume is especially weak on the 3rd day that indicates the downside bias is even greater. Consistently weak breadth also enhances the bearish implications.

Now let's consider the current environment. As I noted recently in my trend vs. chop series on the blog, the market has become much more prone to chop over the last several years. The daily timeframe is what we're discussing here and [that has been extremely choppy for the last 15-18 months](#). Therefore, I thought it would be appropriate to show how 3 up days have fared in the recent environment:

S&P 500 closes higher for the 3rd day in a row. Buy S&P on close. Sell X days later. \$100k/trade. June 2007-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$10,025.69)	13	6	7	46.15	\$1,732.87	(\$2,917.56)	0.59	0.51	(\$771.21)
9	(\$14,216.19)	14	7	7	50.00	\$1,350.27	(\$3,381.15)	0.40	0.40	(\$1,015.44)
8	(\$21,543.16)	16	7	9	43.75	\$1,477.29	(\$3,542.69)	0.42	0.32	(\$1,346.45)
7	(\$15,869.39)	16	7	9	43.75	\$1,564.51	(\$2,980.10)	0.52	0.41	(\$991.84)
6	(\$20,119.01)	18	6	12	33.33	\$1,840.19	(\$2,596.68)	0.71	0.35	(\$1,117.72)
5	(\$17,957.55)	18	7	11	38.89	\$1,548.25	(\$2,617.75)	0.59	0.38	(\$997.64)
4	(\$22,692.48)	19	6	13	31.58	\$1,102.86	(\$2,254.59)	0.49	0.23	(\$1,194.34)
3	(\$19,839.07)	19	3	16	15.79	\$1,617.61	(\$1,543.24)	1.05	0.20	(\$1,044.16)
2	(\$14,031.53)	19	5	14	26.32	\$719.29	(\$1,259.14)	0.57	0.20	(\$738.50)
1	(\$6,931.25)	19	7	12	36.84	\$464.24	(\$848.41)	0.55	0.32	(\$364.80)

I also showed [a simple system for handling the chop](#) in the blog. The system basically went short any time there were 2 up closes in a row and covered at the first profitable close. The trade was closed out after 4 days regardless. Below are the results of a similar system looking at 3 up days instead of 2:

S&P 500 closes higher for the 3rd day in a row. Short S&P on close. Cover 1st profitable close or X days later. \$100k/trade. June 2007-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
3	\$14,435.49	19	18	1	94.74	\$844.11	(\$758.47)	1.11	20.03	\$759.76
2	\$11,476.09	19	16	3	84.21	\$858.10	(\$751.14)	1.14	6.09	\$604.00
1	\$6,931.25	19	12	7	63.16	\$848.41	(\$464.24)	1.83	3.13	\$364.80

Eighteen for nineteen with a 3-day maximum holding period indicates the downside edge appears particularly strong.

I received a few notes about the VIX and VXO action and thought I would address that as well. Most of the time the VIX will trade counter to the S&P. Often times when we see

a divergence from a norm it can indicate an edge. Over the last few days the VIX has remained near its recent highs even while the S&P 500 rose. The theory proposed by a few people was that the rising VIX might allow for the rally to continue. I looked at this a couple of different ways.

S&P 500 closes higher for the 3rd day in a row and the VXO is stretched more than 10% above its 10-day MA..										
Buy S&P on close. Sell X days later. \$100k/trade. 1987-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	(\$6,410.05)	8	2	6	25.00	\$6,107.28	(\$3,104.10)	1.97	0.66	(\$801.26)
19	(\$8,057.42)	8	3	5	37.50	\$3,564.65	(\$3,750.27)	0.95	0.57	(\$1,007.18)
18	(\$4,223.14)	8	3	5	37.50	\$3,728.70	(\$3,081.85)	1.21	0.73	(\$527.89)
17	(\$1,637.43)	8	3	5	37.50	\$4,122.58	(\$2,801.03)	1.47	0.88	(\$204.68)
16	(\$2,337.85)	8	4	4	50.00	\$3,322.28	(\$3,906.74)	0.85	0.85	(\$292.23)
15	(\$2,531.72)	8	3	5	37.50	\$4,187.92	(\$3,019.10)	1.39	0.83	(\$316.47)
14	\$3,648.83	8	4	4	50.00	\$2,964.64	(\$2,052.43)	1.44	1.44	\$456.10
13	\$1,796.47	8	4	4	50.00	\$2,441.28	(\$1,992.16)	1.23	1.23	\$224.56
12	\$3,938.92	8	4	4	50.00	\$2,105.63	(\$1,120.90)	1.88	1.88	\$492.37
11	\$6,802.56	8	5	3	62.50	\$2,019.46	(\$1,098.24)	1.84	3.06	\$850.32
10	\$10,877.08	8	7	1	87.50	\$1,593.70	(\$278.80)	5.72	40.01	\$1,359.64
9	\$8,410.51	8	4	3	50.00	\$2,544.97	(\$589.79)	4.32	5.75	\$1,051.31
8	\$3,704.65	8	4	4	50.00	\$2,484.43	(\$1,558.27)	1.59	1.59	\$463.08
7	\$1,369.45	8	5	3	62.50	\$1,742.67	(\$2,447.97)	0.71	1.19	\$171.18
6	\$746.13	8	4	4	50.00	\$1,739.30	(\$1,552.77)	1.12	1.12	\$93.27
5	(\$1,457.58)	8	4	4	50.00	\$1,585.91	(\$1,950.30)	0.81	0.81	(\$182.20)
4	\$1,960.28	8	5	3	62.50	\$1,635.82	(\$2,072.95)	0.79	1.32	\$245.04
3	\$1,749.38	9	6	3	66.67	\$1,114.40	(\$1,645.67)	0.68	1.35	\$194.38
2	(\$132.08)	10	7	3	70.00	\$823.53	(\$1,965.60)	0.42	0.98	(\$13.21)
1	\$3,060.43	16	10	6	62.50	\$530.06	(\$373.36)	1.42	2.37	\$191.28

Instances are quite low here but there is no indication that the high VIX is a good thing. The 2nd way I looked at it within the context of this week's action provided several more instances:

S&P 500 closes higher while the VXO closes higher by at least 5%.										
Buy S&P on close. Sell X days later. \$100k/trade. 1987-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	\$15,614.17	54	32	22	59.26	\$2,835.51	(\$3,414.65)	0.83	1.21	\$289.15
19	\$31,810.52	54	34	20	62.96	\$2,964.57	(\$3,449.24)	0.86	1.46	\$589.08
18	\$29,828.74	54	32	22	59.26	\$3,106.20	(\$3,162.26)	0.98	1.43	\$552.38
17	\$31,001.78	54	30	24	55.56	\$3,338.26	(\$2,881.09)	1.16	1.45	\$574.11
16	\$35,571.31	54	32	22	59.26	\$3,138.24	(\$2,947.84)	1.06	1.55	\$658.73
15	\$38,959.30	57	32	25	56.14	\$2,894.68	(\$2,146.82)	1.35	1.73	\$683.50
14	\$42,003.21	57	33	24	57.89	\$2,677.14	(\$1,930.93)	1.39	1.91	\$736.90
13	\$39,276.36	57	34	23	59.65	\$2,324.93	(\$1,729.18)	1.34	1.99	\$689.06
12	\$33,125.66	57	34	23	59.65	\$2,183.42	(\$1,787.42)	1.22	1.81	\$581.15
11	\$41,038.51	58	39	18	67.24	\$2,101.23	(\$2,272.75)	0.92	2.00	\$707.56
10	\$41,029.44	59	37	22	62.71	\$2,237.20	(\$1,897.58)	1.18	1.98	\$695.41
9	\$20,657.02	62	34	27	54.84	\$2,127.33	(\$1,913.79)	1.11	1.40	\$333.18
8	\$24,650.55	64	36	28	56.25	\$1,942.10	(\$1,616.61)	1.20	1.54	\$385.16
7	\$22,127.14	67	40	27	59.70	\$1,687.65	(\$1,680.70)	1.00	1.49	\$330.26
6	\$21,493.14	68	39	29	57.35	\$1,500.88	(\$1,277.28)	1.18	1.58	\$316.08
5	\$26,852.85	68	40	28	58.82	\$1,532.11	(\$1,229.70)	1.25	1.78	\$394.89
4	\$18,967.42	69	40	29	57.97	\$1,211.18	(\$1,016.55)	1.19	1.64	\$274.89
3	\$15,880.19	73	46	27	63.01	\$958.65	(\$1,045.11)	0.92	1.56	\$217.54
2	\$8,189.74	74	41	33	55.41	\$761.93	(\$698.47)	1.09	1.36	\$110.67
1	\$4,107.82	79	43	36	54.43	\$503.64	(\$487.47)	1.03	1.23	\$52.00

Results here are slightly positive, but still no better than random. I certainly wouldn't want to go long based on this setup.

Let's take a look at the [Aggregator](#):



With the current studies overwhelmingly bearish the green Aggregator line is as low as it's been in a long time. At the same time the S&P has largely outperformed expectations over the last few days, putting the black differential line squarely below 0. This is a bearish formation and the kind of setup I like to short. Needless to say, based on all the evidence above, my inclination for at least the beginning of the week is bearish. One caveat will be the Fed meeting on Tuesday. If large short profits are in hand leading up to that, it could be a good idea to take them.

Intermediate-term Outlook (1 week – 2 months)–neutral / slightly bearish–updated 9/15

The song remains the same this week from an intermediate-term standpoint. I am not seeing any evidence that the market is ready to take off. There has been no strong accumulation evidenced by surges in breadth and volume. At the same time the market has also not reached the kind of selling extremes that it hit at past bottoms.

The low this week was fairly close to the July low, yet many of the indicators that suggest panic or capitulation have not provided any such readings. For example the VIX is far below where it reached when the market bottomed in July, March and January. Another example would be the number of new lows. At the July bottom there were over 1150 new lows. On Thursday this number peaked at 370. You could also look at the % of

stocks closing above their 40-day moving average. This indicator reached about 37% this past week. At the July, March, January, and November bottoms it dropped below 20%. The CBI, which I track closely in the blog has yet to move above 3. At the other bottoms over the past year it reached 10 or higher every time.

Some might say there is a positive divergence setting up. For there to be a true divergence, though, you'd need to see price fall below the July levels without the indicators doing so. Perhaps the indicators are showing strength. Perhaps they are signaling we could have a lot further to fall. I don't know the answer to that. What I do know is that they are not suggesting the type of panic readings that provide high risk/reward opportunities to try and buy into.

One reader suggested to me that the relatively high volume this week along with the fact that market stopped falling might have suggested institutional support. I decided to test this theory. Below is what I came up with:

<i>After closing lower 3 weeks in a row the S&P 500 closes higher on its highest weekly volume in 4 weeks.</i>											
<i>Buy S&P on close. Sell X weeks later. \$100k/trade. 1960-present.</i>											
X Weeks	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade	
6	\$2,067.00	33	16	17	48.48	\$4,943.25	(\$4,530.88)	1.09	1.03	\$62.64	
5	(\$7,095.66)	33	17	16	51.52	\$4,384.26	(\$5,101.75)	0.86	0.91	(\$215.02)	
4	\$18,156.80	34	19	15	55.88	\$4,339.62	(\$4,286.40)	1.01	1.28	\$534.02	
3	\$18,582.61	34	21	13	61.76	\$3,600.14	(\$4,386.17)	0.82	1.33	\$546.55	
2	\$16,128.88	34	19	15	55.88	\$3,044.95	(\$2,781.68)	1.09	1.39	\$474.38	
1	(\$3,545.72)	34	18	16	52.94	\$1,535.01	(\$1,948.49)	0.79	0.89	(\$104.29)	

These numbers would indicate no upside edge. I decided to also look at times the market is trading below its 40-week MA:

<i>After closing lower 3 weeks in a row the S&P 500 closes higher on its highest weekly volume in 4 weeks. It closes below its 40-week MA. Buy S&P on close. Sell X weeks later. \$100k/trade. 1960-present.</i>											
X Weeks	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade	
6	(\$7,999.57)	20	9	11	45.00	\$5,891.22	(\$5,547.32)	1.06	0.87	(\$399.98)	
5	(\$22,319.28)	20	9	11	45.00	\$5,246.65	(\$6,321.74)	0.83	0.68	(\$1,115.96)	
4	\$8,169.60	21	10	11	47.62	\$6,132.56	(\$4,832.36)	1.27	1.15	\$389.03	
3	\$14,728.84	21	14	7	66.67	\$4,040.96	(\$5,977.81)	0.68	1.35	\$701.37	
2	\$18,671.68	21	13	8	61.90	\$3,735.45	(\$3,736.15)	1.00	1.62	\$889.13	
1	(\$4,264.58)	21	10	11	47.62	\$2,009.25	(\$2,214.28)	0.91	0.82	(\$203.08)	

This is even worse.

At the very least I will remain extremely cautious of the long side until I see either 1) more extreme readings from capitulative indicators, or 2) evidence of strength pushing the market higher. I've yet to see much, if any, of either.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

DELL –bought 1/3 position at \$20.22

DELL – bought 1/3 position \$19.30

New

DELL – buy last 1/3 position at \$19.04

Open Big 50 Trades

None

Catapult for ETF's Trades

VWO – bought and listed in trades section

Broad Market Large Cap CBI – 3/1 (3 DELL)

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

Index	ETF	CBI %	Index	ETF	CBI %
DJ US Broker Dealers	IAI	3.45	DJ US Energy	IYE	2.33
DJ US Insurance Index	IAK	0.00	DJ US Financial	IYF	0.34
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.70
DJ US Utilities	IDU	2.70	DJ US Healthcare	IYH	0.70
DJ US Oil&Gas Expl & Prod	IEO	6.90	DJ US Industrial Sector	IYJ	1.53
DJ US Oil Equip & Svcs	IEZ	3.85	DJ US Consumer Goods	IYK	0.00
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	2.44	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	2.78	DJ US Technology Sector	IYW	4.02
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	2.63
DJ US Consumer Svcs	IYC	1.32	Nasdaq 100	QQQQ	3.00

Additional New Trade Ideas

See the DELL Catapult trigger above.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
DELL	9/4/2008	\$20.22	\$19.04	-5.84%		Catapult
FXE	9/5/2008	\$143.20	\$142.38	-0.57%		exit
VWO	9/5/2008	\$37.50	\$37.27	-0.61%		Catapult
EXC	9/9/2008	\$64.97	\$68.39	5.26%		exit
DELL	9/4/2008	\$19.30	\$19.04	-1.35%		Catapult
SPY(S)	9/12/2008	\$126.09	\$126.09	0.00%		shorted on close

I will cover ½ the short SPY trade idea on an open of \$123.50 or lower.

Stocks and ETF's on my Radar

None

Additional Note

Obviously, all the research was done before the Lehman news hit. I likely wouldn't have wasted my energy had I known the futures were going to tank that much tonight. If it holds until the open I'll likely look to cover the SPY trade completely tomorrow. I see no point in putting out additional trade ideas tonight. The market will open far away from most entries. Catapults are always "taken" because they are needed to track the CBI. For those who trade intraday, you may want to review some of my older [research on large gaps down](#).

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