

QUANTIFIABLE EDGES

SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 25, 2008

Issue 153

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 25, 2008	Pullback at decreasing rate	1-10 days	Bullish	3.55%	7.16%
September 25, 2008	3 Down In Chop	1-3 days	Bullish	1.39%	2.44%
September 23, 2008	Pullback from strong bounce	1-3 days	Bullish	2.58%	5.15%
September 19, 2008	Big Reversal Days	1-18 days	Bullish	6.30%	10.00%
8/27 & 9/11	Weak Bounce	1-17 days	Bearish	-5.30%	-8.90%
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* and will be removed tomorrow.

Short-term Outlook (1-5 days) – bullish – updated 9/25

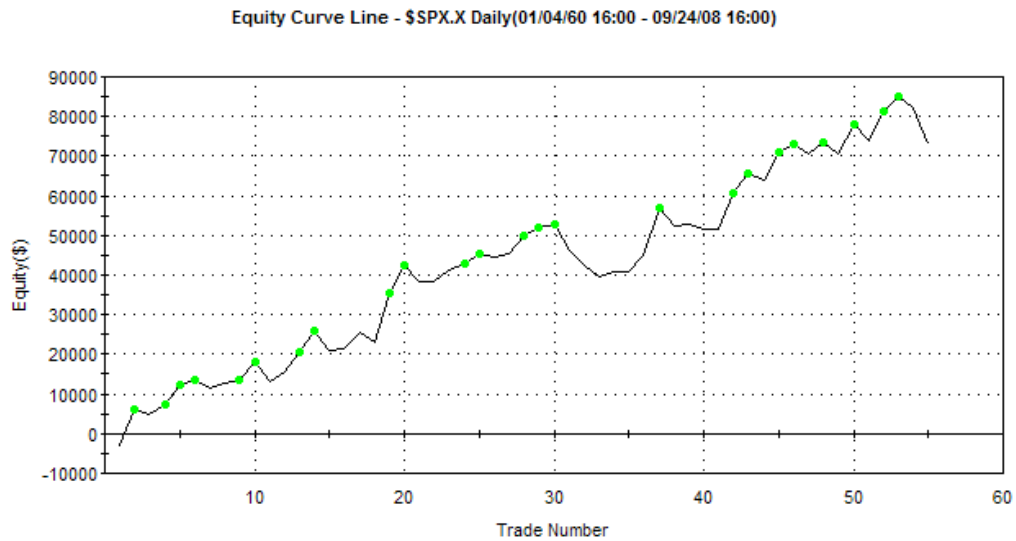
After trading in a relatively narrow range for most of the day, the S&P broke down with less than ½ hour to go. It recovered quickly from the breakdown but still finished lower by about two points today. Volume declined for the 3rd day in a row. Breadth was once again negative.

One assumption I've been working under for the last month and a half or so is that market conditions are especially choppy. This generally has meant once the market moves in one direction for more than one or two days we have frequently been looking for a countermove. June 1, 2008 is the date I've been using for the chop-related systems. It was around that time that [the market began to turn especially choppy](#). In last night's Letter I mentioned the post in the blog that looked at [buying the market any time it closed lower 2 days in a row](#). Waiting for the third day down to enter and then closing on the first profitable exit or the close of day 3 would have yielded 12 winning trades of 16 the next day. 14 of 16 (87.5%) were profitable by day 3. The average trade gained about 0.9%.

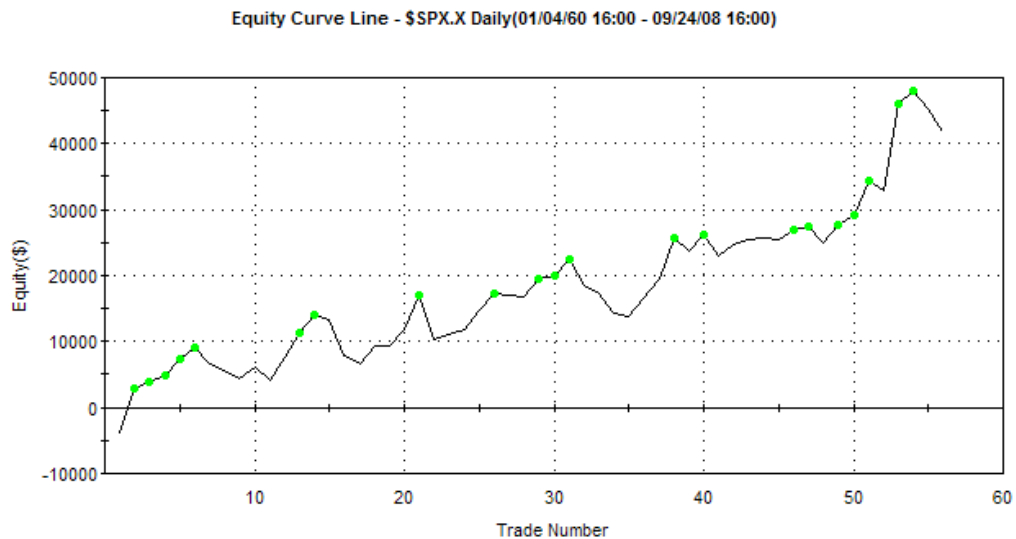
Recall I consider this an environmental system rather than a robust one. In other words, we are simply looking to take advantage of how the market has been acting lately. If my view of conditions were to change I would quickly eliminate simple environmental systems such as this.

In [tonight's blog](#) I discussed the fact that the rate of decline in the selloff has tapered off the last two days. Over time this has provided a bullish edge. Below is a chart showing the equity curve of the setup shown in the blog where a decline of at least 3 days is

bought if the last 2 days show a decrease in the rate of decline. The equity curve below assumes a 10-day exit.



The steady upward slope suggests the setup stands the test of time. I also looked at the curve of the 5-day exit:



A fairly steady rise similar to the 10-day exit suggests the setup is robust.

With two bullish studies added to the list tonight the Aggregator chart is below:



The green Aggregator line is squarely positive while the 3-day differential line shows the S&P has underperformed expectations to a large degree. With both lines above the 0 line, this is considered a bullish formation. Already 50% long, I'm going to wait at least a day before adding any more long exposure. While under more normal circumstances I'd likely continue to add to the position, I'm playing it a bit more conservative due to 1) recent volatility and 2) the fact that the market appears captive to bailout plan news. On an individual stock and sector basis I am seeing very little that interests me at all.

Intermediate-term Outlook (1 week – 2 months)–somewhat bullish -updated 9/22

The force of the bounce the last few days has been astonishing. From a percentage standpoint, a volume standpoint, and a breadth standpoint there has been exceptional strength. The fact that conditions were so overstretched to the downside makes the intermediate-term potential even better.

From a breadth standpoint, Friday marked the 2nd consecutive day with 80% or better up volume. According to Lowry's research, two consecutive 80% up days can be substituted for a 90% up day when looking for a market bottom. The market had put in a 90% down day just 1 day before and 4 90% down days within the last month. For those who have not read the Lowry's paper on market bottoms, it can be found [here](#). It is an excellent read.

The number of new lows had also hit an extreme last week. The net number of new lows minus new highs divided by the total number of issues traded on the NYSE was in excess of 30%. Amazingly, with the sharp 2-day reversal, new highs outnumbered new lows on

Friday. This is the 1st time going back to 1970 (as far as I have the data) that new lows have been that negative and then been outnumbered by new highs just 2 days later. It's another sign of the amazing strength of the move.

On a percentage basis, the S&P 500 rallied over 11.5% from its low on Thursday to its high on Friday. I was only able to find two other instances of a 11.5% rally in such a short period of time – 10/10/74 and 10/21/87. In both cases a low was in place but it took some backing and filling before the market was actually able to launch its rally in earnest. Loosening the requirement a little bit there have been 6 times when the S&P has managed to rally over 8% from low to high in 2 days. Three months later the market has always been higher. Five of those times by greater than 5%.

One sign that many traders will be looking for is a Follow Through Day (FTD). Popularized by William O'Neil the FTD is a high-volume rally that comes 4 or more days after the low. While no rally back to 1970 has occurred without a FTD of at least 1%, they are not terribly accurate. There has been about a 50% success rate according to my research. Traders who wish to learn more about the quantitative value of FTD's may read the [research I posted in the blog](#). A few of the more interesting facts to keep in mind include:

- 1) FTD's coming more than 10 days after the low have been better at predicting rallies, not worse, as Investors Business Daily frequently suggests.
- 2) While the FTD is only 50% accurate, success or failure can be predicted about 2/3 of the time by how the market performs in the 1st five days following a FTD.

Another positive sign for the market is the fact that although we've had a huge rally the last two days, there still seems to be a good amount of fear out there. The VIX remains stretched far above its 10-day moving average and the VIX:VXV ratio still sits at a whopping 1.15. There is a large amount of doubt out there with regards to the rally. If the rally can continue those doubters can help provide fuel as they throw in the towel and either start to chase or provide support on pullbacks.

One rationalization I've heard for doubting this rally attempt is that it has basically been constructed by government intervention. While this might seem logical on the surface, it should be kept in mind that nearly every bottom in the last 21 years was aided by government intervention.

Over the next few days and weeks, it will be important to watch and see whether the market can follow through in a meaningful way and how it acts on pullbacks.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

AAPL – 1/3 @ 127.83

Catapult for ETF's Trades

None

Broad Market Large Cap CBI –1 (AAPL)

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	2.70	DJ US Healthcare	IYH	0.70
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	0.38
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	1.35
DJ US Healthcare Providers	IHF	2.04	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	0.00
DJ US Consumer Svcs	IYC	1.32	Nasdaq 100	QQQQ	3.00

Additional New Trade Ideas

None tonight.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY	9/23/2008	\$118.55	\$118.93	0.32%		bought at close
SPY	9/24/2008	\$118.93	\$118.93	0.00%		bought at close

Stocks and ETF's on my Radar

While the Catapult remains open on AAPL, profits were taken on Friday. I may look to re-enter this one yet.

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