

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 29, 2008

Issue 155

## 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 28, 2008	2 Days Higher Since 6/07	1-4 days	Bearish	-1.22%	-2.13%
September 28, 2008	Gap Down 1% & Close Positive	1-7 days	Bullish	2.80%	4.97%
September 28, 2008	SP up on Bad Breadth	1-3 days	Bearish	-1.96%	-3.27%
September 26, 2008	FTD short-term	1-5 days	Bullish	2.25%	4.44%
September 25, 2008	Pullback at decreasing rate	1-10 days	Bullish	3.55%	7.16%
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) – neutral – updated 9/29*

After gapping down big at the open Friday the market quickly found its lows and rallied nicely. By the end of the day the losses had been recovered and the indices had small gains. Volume came in both below average and below Thursday's level. Breadth was strongly negative. Decliners outnumbered advancers by over 2 to 1. Meanwhile, down volume led up volume by about 3:2.

For the very short-term (1-3 days), most of what is described in the 1<sup>st</sup> paragraph is bad news. First, you'd prefer to see volume rise on the move higher. Second, the fact that the market is already up two days in a row in this choppy environment has been a pretty good short signal on its own for the past 16 months. The poor breadth is a negative and even the pattern of recovering from a large gap down is negative for a couple of days. Let's break a few of these down.

I've *shown in the past* and mentioned again last weekend how two up days in this extremely choppy and downtrending market has been an incredibly reliable short signal. It played out again last week as Monday was a huge down day following a strong rally the previous Thursday and Friday. The "system" is incredibly simple. It is not reliable in all kinds of markets, but is one way to take advantage of the extreme choppiness combined with the downtrend of the past 16 months. Below are update statistics showing the performance of 1) Shorting if the SPX closes up 2 days in a row and 2) Covering at the 1<sup>st</sup> profitable close within the next 4 days or 3) exiting at the day 4 close whether it's profitable or not.

## TradeStation Performance Summary

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### All Trades

Total Net Profit	\$40,393.17	Profit Factor	10.97
Gross Profit	\$44,445.16	Gross Loss	(\$4,051.99)
Total Number of Trades	47	Percent Profitable	95.74%
Winning Trades	45	Losing Trades	2
Even Trades	0		
Avg. Trade Net Profit	\$859.43	Ratio Avg. Win:Avg. Loss	0.49
Avg. Winning Trade	\$987.67	Avg. Losing Trade	(\$2,026.00)
Largest Winning Trade	\$4,424.00	Largest Losing Trade	(\$3,230.74)
Max. Consecutive Winning Trades	18	Max. Consecutive Losing Trades	1
Avg. Bars in Winning Trades	2.73	Avg. Bars in Losing Trades	5.00
Avg. Bars in Total Trades	2.83		

I also looked at how the SPY has performed in the past after gapping down by 1% or more and then managing to close positive on the day.

SPY gaps lower by 1% and then closes higher on the day. Buy on close. Sell X days Later. \$100k/trade. 1993-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
7	\$23,885.80	24	16	8	66.67	\$6,606.02	(\$4,106.97)	\$2,616.38	(\$2,247.04)	1.16	2.33	\$995.24
6	\$20,750.29	25	15	10	60.00	\$5,799.54	(\$3,814.65)	\$2,589.70	(\$1,809.53)	1.43	2.15	\$830.01
5	\$3,990.64	25	14	11	56.00	\$7,631.40	(\$5,005.35)	\$2,311.27	(\$2,578.83)	0.90	1.14	\$159.63
4	(\$2,126.50)	25	12	13	48.00	\$7,370.70	(\$7,084.40)	\$2,209.42	(\$2,203.04)	1.00	0.93	(\$85.06)
3	(\$3,868.87)	26	13	13	50.00	\$5,984.25	(\$3,999.87)	\$1,635.37	(\$1,932.98)	0.85	0.85	(\$148.80)
2	(\$14,222.83)	26	11	15	42.31	\$2,277.12	(\$4,314.32)	\$1,100.93	(\$1,755.54)	0.63	0.46	(\$547.03)
1	(\$6,074.84)	26	10	16	38.46	\$4,827.02	(\$4,496.31)	\$1,381.91	(\$1,243.37)	1.11	0.69	(\$233.65)

The results suggest a pattern of a short-term pullback followed by a rebound.

Some of the most interesting results for short-term analysis came from looking at the poor breadth experienced on Friday. Poor NYSE breadth on a day the S&P closes higher is a bad sign for the market over the short-term. This has not always been the case, though.

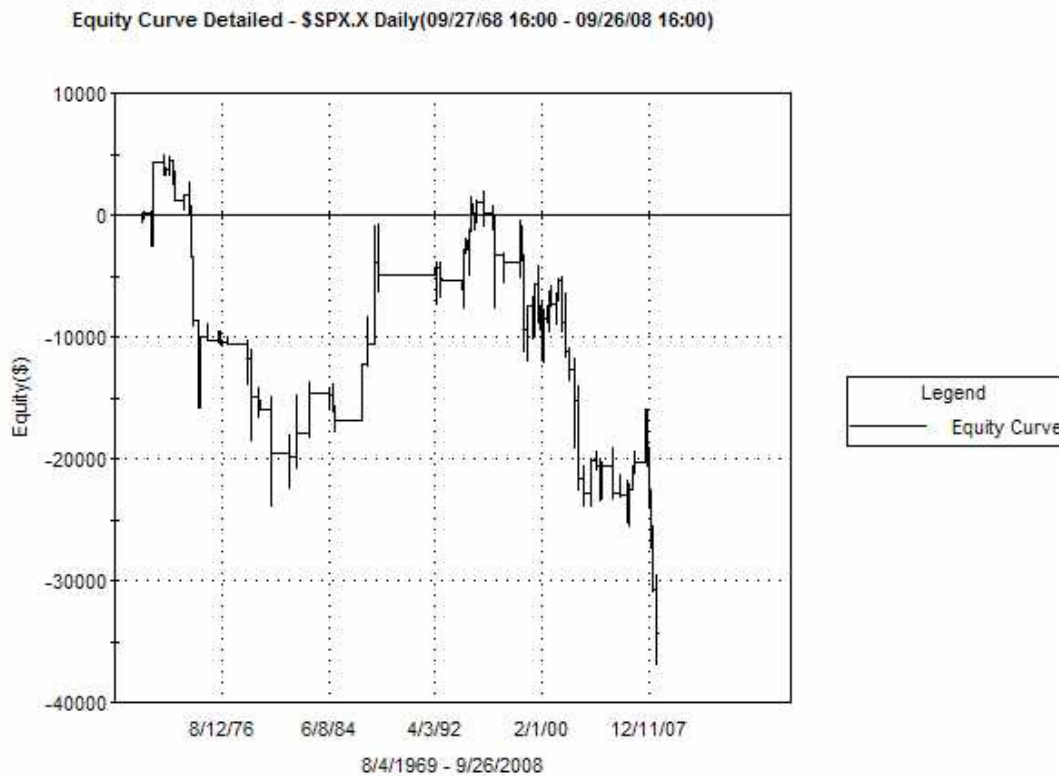
To illustrate my point, below are two runs of the same setup. One from 1970 – present and the other from 2000- present. First, the longer-term look:

SPX rises while up volume makes up less than X pct of total volume. Buy on close. Sell 5 days Later. \$100k/trade. 1970-present.												
X %	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
45%	(\$34,269.33)	97	39	58	40.21	\$6,895.05	(\$7,087.84)	\$1,894.95	(\$1,865.04)	1.02	0.68	(\$353.29)
44%	(\$24,318.87)	72	27	45	37.50	\$5,743.68	(\$6,118.00)	\$1,663.91	(\$1,538.77)	1.08	0.65	(\$337.76)
43%	(\$22,563.46)	57	20	37	35.09	\$5,743.68	(\$6,118.00)	\$1,643.59	(\$1,498.25)	1.10	0.59	(\$395.85)
42%	(\$16,862.25)	43	14	29	32.56	\$5,743.68	(\$6,118.00)	\$2,010.49	(\$1,552.04)	1.30	0.63	(\$392.15)
41%	(\$17,100.63)	34	12	22	35.29	\$4,666.20	(\$6,118.00)	\$1,714.22	(\$1,712.33)	1.00	0.55	(\$502.96)
40%	(\$7,762.01)	22	8	14	36.36	\$4,666.20	(\$4,430.00)	\$2,029.17	(\$1,713.95)	1.18	0.68	(\$352.82)
39%	(\$4,827.75)	17	7	10	41.18	\$4,666.20	(\$4,430.00)	\$2,012.75	(\$1,891.70)	1.06	0.74	(\$283.99)

As you can see, returns 5 days out have been negative following an up day with low levels of up volume. The overall influence is about -0.3% to -0.5%. Not huge, but notable. Now we'll look at the same setup but just over the last 8 years:

SPX rises while up volume makes up less than X pct of total volume. Buy on close. Sell 5 days Later. \$100k/trade. 2000-present.												
X %	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
45%	(\$26,491.84)	34	11	23	32.35	\$3,586.80	(\$6,428.80)	\$1,815.49	(\$2,020.10)	0.90	0.43	(\$779.17)
44%	(\$10,519.58)	24	8	16	33.33	\$3,586.80	(\$4,346.25)	\$1,945.47	(\$1,630.21)	1.19	0.60	(\$438.32)
43%	(\$13,200.79)	19	5	14	26.32	\$2,828.00	(\$3,419.12)	\$1,687.74	(\$1,545.68)	1.09	0.39	(\$694.78)
42%	(\$8,148.44)	13	4	9	30.77	\$2,828.00	(\$3,419.12)	\$1,751.49	(\$1,683.82)	1.04	0.46	(\$626.80)
41%	(\$4,702.86)	11	4	7	36.36	\$2,828.00	(\$2,902.32)	\$1,751.49	(\$1,672.69)	1.05	0.60	(\$427.53)
40%	(\$5,913.53)	9	3	6	33.33	\$2,828.00	(\$2,902.32)	\$1,885.15	(\$1,928.17)	0.98	0.49	(\$657.06)
39%	(\$5,155.27)	7	2	5	28.57	\$2,828.00	(\$2,851.50)	\$1,755.70	(\$1,733.33)	1.01	0.41	(\$736.47)

Not nearly as many instances but generally you're looking at between -0.4% and -0.8%, which is almost double in most cases. This doesn't quite paint the whole picture, though, because the last 8 years is included in the longer-term results. Therefore, let's look at a historical graph using the 45% level:



You can see here that the setup since around 2000 has been especially foreboding.

Not only was the up volume % poor, but the up issues % was also poor on Friday. In fact, that was even worse. Results were similar when looking at up issues in that it has been more ominous since the late 90's / 2000. There have been very few instances where the S&P finished higher with the up issue % below 33% as it was Friday. Therefore I again showed a broad sampling:

<i>SPX rises while up issues make up less than X pct of total issues. Buy on close. Sell 5 days Later. \$100k/trade. 2000-present.</i>												
X %	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
45%	(\$40,053.78)	46	17	29	36.96	\$8,658.92	(\$11,533.34)	\$2,166.09	(\$2,650.94)	0.82	0.48	(\$870.73)
44%	(\$32,178.96)	42	16	26	38.10	\$8,658.92	(\$11,533.34)	\$2,200.60	(\$2,591.87)	0.85	0.52	(\$766.17)
43%	(\$18,020.01)	36	14	22	38.89	\$8,658.92	(\$11,533.34)	\$2,335.62	(\$2,305.40)	1.01	0.64	(\$500.56)
42%	(\$27,754.05)	30	10	20	33.33	\$5,396.71	(\$11,533.34)	\$1,986.56	(\$2,380.98)	0.83	0.42	(\$925.14)
41%	(\$33,089.66)	20	4	16	20.00	\$3,850.49	(\$11,533.34)	\$1,256.83	(\$2,382.31)	0.53	0.13	(\$1,654.48)
40%	(\$27,068.28)	16	4	12	25.00	\$3,850.49	(\$11,533.34)	\$1,256.83	(\$2,674.63)	0.47	0.16	(\$1,691.77)
39%	(\$29,201.19)	13	2	11	15.38	\$683.40	(\$11,533.34)	\$425.53	(\$2,732.02)	0.16	0.03	(\$2,246.25)
38%	(\$21,531.04)	11	2	9	18.18	\$683.40	(\$11,533.34)	\$425.53	(\$2,486.90)	0.17	0.04	(\$1,957.37)
37%	(\$21,007.44)	10	2	8	20.00	\$683.40	(\$11,533.34)	\$425.53	(\$2,732.31)	0.16	0.04	(\$2,100.74)
36%	(\$9,038.77)	6	1	5	16.67	\$683.40	(\$2,902.32)	\$683.40	(\$1,944.43)	0.35	0.07	(\$1,506.46)
35%	(\$8,813.54)	5	1	4	20.00	\$683.40	(\$2,902.32)	\$683.40	(\$2,374.24)	0.29	0.07	(\$1,762.71)

For the 1-week period shown in the above studies up issues % is even more bearish than looking at volume %.

By combining both issues and volume we can see the short-term affect has been fairly strong over the next 3 days:

<i>SPX rises while up issues make up less than 45% of total issues and up volume make up less than 45% of total volume.</i>												
<i>Buy on close. Sell X days Later. \$100k/trade. 2000-present</i>												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	(\$16,418.04)	21	6	15	28.57	\$3,586.80	(\$6,428.80)	\$1,907.01	(\$1,857.34)	1.03	0.41	(\$781.81)
4	(\$22,409.11)	21	6	15	28.57	\$3,696.70	(\$5,119.52)	\$1,352.53	(\$2,034.95)	0.66	0.27	(\$1,067.10)
3	(\$26,748.62)	22	5	17	22.73	\$2,510.20	(\$5,351.36)	\$954.63	(\$1,854.22)	0.51	0.15	(\$1,215.85)
2	(\$10,889.91)	22	9	13	40.91	\$2,400.30	(\$2,848.17)	\$953.76	(\$1,497.98)	0.64	0.44	(\$495.00)
1	(\$2,782.55)	22	8	14	36.36	\$2,427.60	(\$2,079.70)	\$893.72	(\$709.45)	1.26	0.72	(\$126.48)

I especially took note of the extremely low winning percentages.

With all of these short-term studies factored in, the Quantifiable Edges [Aggregator](#) now looks like this:



The current mix of bullish and bearish studies are doing a good job of canceling each other out over the next few days. The neutral positioning of the green Aggregator line likely won't shift substantially without a strong market move. A strong move in the next couple of days could cause the current studies to satisfy their targets and spark additional studies. The black differential line is showing that expectations have been exceeded over the last few days. I'm not currently excited about either direction for a short-term trade and will wait for a better edge to avail itself before putting short-term capital to work.

### ***Intermediate-term Outlook (1 week – 2 months)–somewhat bullish -updated 9/29***

Last weekend I noted that the strong move the market made from extremely oversold and stretched conditions was something that could bode well for the intermediate-term. Along with being extremely strong from a percent move standpoint, the 18<sup>th</sup> and 19<sup>th</sup> were back-to-back 80% breadth days, which for Lowry's is a substitute for one 90% breadth day. This is a good sign.

The Lowry's signal was followed up this past week with an IBD Follow Through Day (FTD) on Thursday. Since 1970 the 5-days following a FTD have predicted the success or failure of the rally about 70% of the time – a much more reliable indicator than the FTD itself. This would suggest that the performance between now and Thursday should be watched carefully since it could have intermediate-term implications. Much more information on FTD's can be [found on the blog](#).

Another interesting facet of the current market environment is the extreme volatility that has been experienced. One way to notice the volatility is by taking a quick look at the VIX. It has been consistently above 30 over the last two weeks and even spiked above 40

on the 18<sup>th</sup>. As many people are aware large spikes in volatility are often associated with bottoms. There are other ways to examine volatility, though.

One way to view volatility is by examining the daily true range of the market. Dr. Steenbarger had an [interesting study about this on his Traderfeed blog](#) this past week. I decided to also take a look at range in a slightly different way. Here we see range expansions at different multiples since the inception of the SPY:

SPY 10-day average true range crosses over X times the 100-day average true range. Buy on close. Sell 20 days Later. \$100k/trade. 1993-present.												
X * Normal	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
2	\$8,894.13	4	4	0	100.00	\$3,071.64	\$0.00	\$2,223.53	\$0.00	100.00	100.00	\$2,223.53
1.75	\$44,244.60	12	10	2	83.33	\$13,070.55	(\$1,394.86)	\$4,701.15	(\$1,383.43)	3.40	16.99	\$3,687.05
1.5	\$48,433.58	23	15	8	65.22	\$13,380.02	(\$7,534.80)	\$4,728.97	(\$2,812.62)	1.68	3.15	\$2,105.81
1.25	\$53,265.08	47	29	18	61.70	\$12,068.76	(\$19,949.25)	\$3,867.86	(\$3,272.39)	1.18	1.90	\$1,133.30

Recent market action saw the ratio spike just over 2 on the 22<sup>nd</sup>.

Even more remarkable than the daily true range expansion the market has seen is the expansion in the size of the overnight gaps. When the market consistently gaps by significant amounts overnight it suggests skittish and news-dependent behavior. During good times, the market is not highly news-driven. People are more comfortable holding overnight or over the weekend and are not as reactive. It's during downtrends and near bottoms that market reactions to company and economic news and reports become more volatile. Using a normalization similar to the average true range formula from the study above, I measured the average absolute gap.

By measuring the absolute gap I did not factor direction into the equation. A large gap up is just as "reactive" as a large gap down. The 10-day average absolute gap is currently about 3 times as large as the 100-day average absolute gap. It peaked at nearly 3.5% on the 19<sup>th</sup>. The only other time since the inception of the SPY that this ratio has been this high is after 9/11/2001. The study below looks at 20-day performance after different multiples have been achieved.

SPY 10-day average absolute gap crosses over X times the 100-day average absolute gap. Buy on close. Sell 20 days Later. \$100k/trade. 1993-present.												
X * Normal	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
2.5	\$20,676.45	6	6	0	100.00	\$4,810.00	\$0.00	\$3,446.08	\$0.00	100.00	100.00	\$3,446.08
2.25	\$14,823.24	8	5	3	62.50	\$6,572.70	(\$4,295.34)	\$4,365.38	(\$2,334.55)	1.87	3.12	\$1,852.91
2	\$14,961.38	15	9	6	60.00	\$9,694.00	(\$14,090.44)	\$4,138.57	(\$3,714.30)	1.11	1.67	\$997.43
1.75	\$31,566.88	31	20	11	64.52	\$13,380.02	(\$14,090.44)	\$3,641.97	(\$3,752.04)	0.97	1.76	\$1,018.29
1.5	\$75,645.57	44	31	13	70.45	\$17,860.41	(\$14,396.16)	\$4,319.10	(\$4,480.51)	0.96	2.30	\$1,719.22

These results are strongly suggestive of an intermediate-term upside edge. The 2.5 multiple, while a bit low on instances, shows a powerful return. The table below shows the returns achieved at this level over the next 1-4 months:

<b>SPY 10-day average absolute gap crosses over 2.5 times the 100-day average absolute gap. Buy on close. Sell X days Later. \$100k/trade. 1993-present.</b>												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
90	\$67,398.04	6	6	0	100.00	\$22,205.97	\$0.00	\$11,233.01	\$0.00	100.00	100.00	\$11,233.01
60	\$45,408.27	6	5	1	83.33	\$14,872.79	(\$697.91)	\$9,221.24	(\$697.91)	13.21	66.06	\$7,568.05
50	\$52,322.91	6	6	0	100.00	\$17,202.50	\$0.00	\$8,720.49	\$0.00	100.00	100.00	\$8,720.49
40	\$44,259.55	6	6	0	100.00	\$9,957.79	\$0.00	\$7,376.59	\$0.00	100.00	100.00	\$7,376.59
30	\$30,263.33	6	6	0	100.00	\$7,284.03	\$0.00	\$5,043.89	\$0.00	100.00	100.00	\$5,043.89
20	\$20,676.45	6	6	0	100.00	\$4,810.00	\$0.00	\$3,446.08	\$0.00	100.00	100.00	\$3,446.08

The gains hardly let up after the 1-month 3.5% move. Below are the list of trades along with the 90-day returns:

Date	Signal	Price	% Profit
12/19/1996	Buy	\$74.73	
4/30/1997	Sell	\$79.74	6.70%
11/3/1997	Buy	\$94.03	
3/18/1998	Sell	\$108.53	15.42%
9/17/1998	Buy	\$101.65	
1/27/1999	Sell	\$124.24	22.22%
9/17/2001	Buy	\$103.95	
1/25/2002	Sell	\$113.20	8.90%
3/6/2007	Buy	\$139.70	
7/13/2007	Sell	\$154.85	10.84%
8/17/2007	Buy	\$144.71	
12/26/2007	Sell	\$149.55	3.34%

In summary, volatility levels, Lowry's 90% days, and Investor's Business Daily's FTD are all suggesting a bottom may be at hand. For a rally to actually occur we will need to see better follow-through from the market. Strong up days should not be quickly erased by strong down days as happened in the early part of this past week. Look for several days up in a row to suggest the choppy environment may be changing to a trending one. Continue to watch indications of breadth and volume. They should both be strong coming off a bottom if a substantial rally is going to take hold. Decreased volatility and reactivity to news and reports would also be a good sign. There's been enough fear in the market that in most cases prices would be washed out enough that a strong multi-week or multi-month rally could ensue. There appears to be an upside edge for the intermediate-term. The risk is that the markets fears continue to be realized. This could quickly lead to further deterioration.

### **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.)***

<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	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	1.35	DJ US Healthcare	IYH	0.00
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	0.00
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	0.00
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	0.50
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.00	Nasdaq 100	QQQQ	1.00

**Additional New Trade Ideas**

*None tonight.*

**Active Trades Table**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
SPY	9/23/2008	\$118.55	\$118.75	0.17%	\$118.75	stop hit

**Stocks and ETF's on my Radar**

A few overdone symbols to consider:

S&P 100 stocks:

DD, MDT (testing 200 ma).

Other S&P 500 stocks:

HOT, ITW, JNPR, JWN.

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