

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 3, 2008

Issue 159

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
October 4, 2008	4% Selloff	1 day	Bullish	2.90%	5.30%
September 28, 2008	Gap Down 1% & Close Positive	1-7 days	Bullish	2.80%	4.97%
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%
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish		

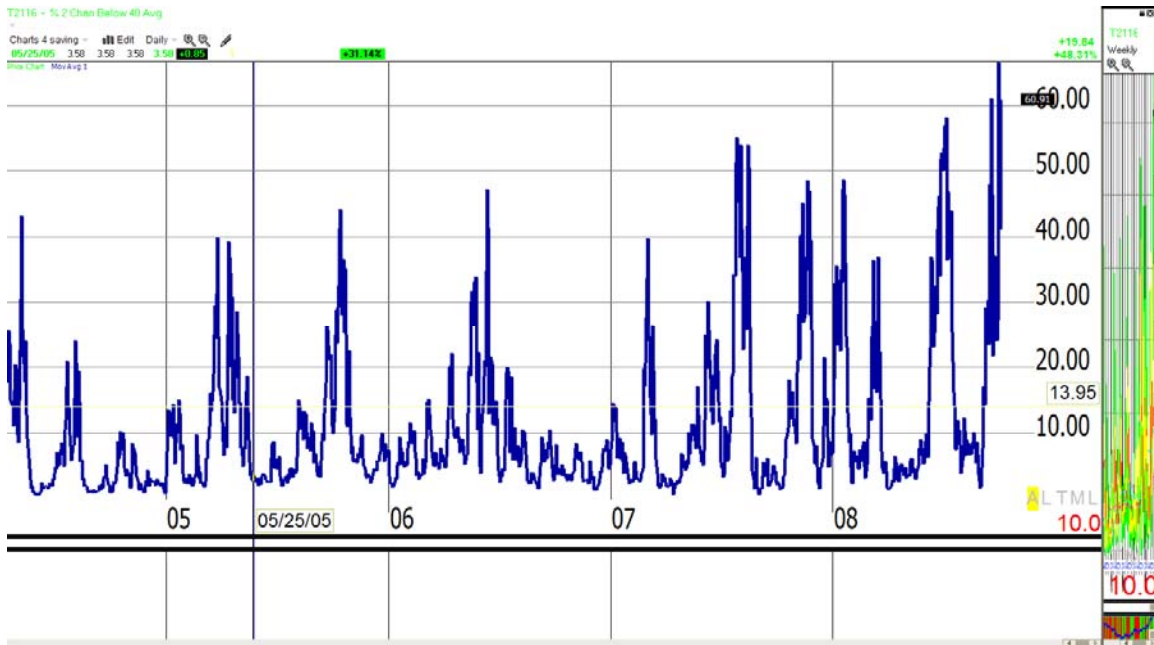
If the avg max move is achieved it will appear in **bold and green**. If the avg + 1 std deviation is achieved, the study will in *bold italic blue* and will be removed tomorrow.

Short-term Outlook (1-5 days) – neutral – updated 10/3

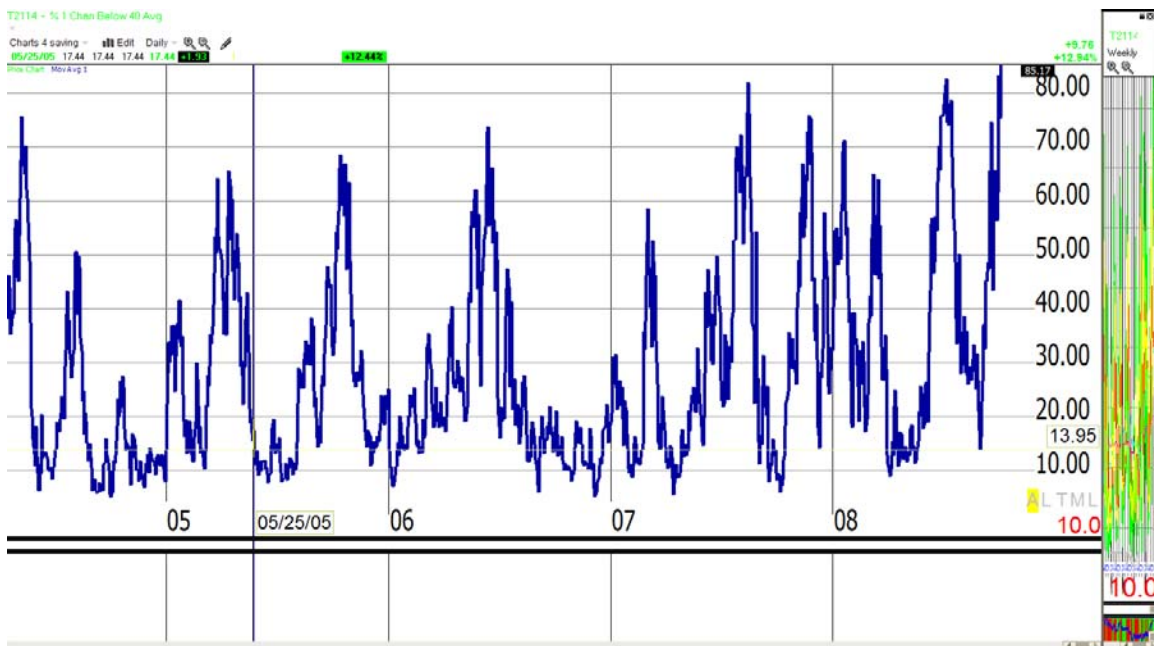
The market plummeted again today. Monday's lows were taken out on most major indices, including the Nasdaq Composite, Nasdaq 100, Russell 2000, and S&P Midcaps. Only the S&P 500 and Dow managed to hold barely above it. Volume came in higher, but not much. NYSE volume came in almost 90% to the downside, while declining issues led advancing by over 5:1.

We're at one of those points again where I could throw out any number of studies and they'll all come up with similar dates. Measures of breadth and volatility are hitting extremes rarely – if ever – seen. With volatility you can look at measures like the VIX, the average true range, or the absolute average gap, which I discussed on Monday. Today was the 2nd day this week the VIX closed above 45. Prior to this it had only happened 3 times ever. [Bill Luby showed a nice table on VIX and More with the highest ever closes listed](#). The absolute average gap is an indicator along with average true range that I discussed in Monday's Subscriber Letter. They both remain at extremes that are suggesting an upside edge.

While the CBI is not yet spiking, some other breadth indicators I use are. Worden Bros. T2116 is one such indicator that [I discussed in the blog in July](#). Basically it looks at the percent of stocks that are trading at least 2 standard deviations below their 40-day moving average. As you can see below it is higher than even those rare July levels.



T2114 is its cousin that looks at the percent of stocks trading at least 1 standard deviation below their 40-day moving average. T2114 hit new multi-year highs on Thursday:



Times when these indicators have reached such extremes are those that you would expect: July 2002, September 2001, August of 1998 and October of 1987.

All these indicators are suggesting panic conditions. I'm sure that's no surprise to anyone. Price action has suggested panic as well. The crash on Monday was worse than

any of those dates except for 1987. Here's another remarkable stat: including Thursday there have been 18 days since 1960 where the S&P 500 has closed down 4% or more. Four of them have come in the last 3 weeks. The only other period to come close was the Crash of '87 when it occurred on 10/16, 10/19, and 10/26. Of the previous 17, the market finished higher the next day 14 times. All instances are listed below:

Performance the day following a 4% drop in the S&P.			
Signal	Date	Price	% Profit
Buy	9/11/1986	\$235.17	-1.92%
Sell	9/12/1986	\$230.66	
Buy	10/16/1987	\$282.69	-20.47%
Sell	10/19/1987	\$224.83	
Buy	10/19/1987	\$224.83	5.34%
Sell	10/20/1987	\$236.83	
Buy	10/26/1987	\$227.66	2.43%
Sell	10/27/1987	\$233.19	
Buy	11/30/1987	\$230.30	0.74%
Sell	12/1/1987	\$232.00	
Buy	1/8/1988	\$243.39	1.68%
Sell	1/11/1988	\$247.49	
Buy	4/14/1988	\$259.75	0.01%
Sell	4/15/1988	\$259.77	
Buy	10/13/1989	\$333.64	2.76%
Sell	10/16/1989	\$342.85	
Buy	10/27/1997	\$876.97	5.12%
Sell	10/28/1997	\$921.86	
Buy	8/31/1998	\$957.55	3.83%
Sell	9/1/1998	\$994.25	
Buy	4/14/2000	\$1,356.02	3.36%
Sell	4/17/2000	\$1,401.53	
Buy	3/12/2001	\$1,180.30	1.47%
Sell	3/13/2001	\$1,197.68	
Buy	9/17/2001	\$1,038.77	-0.58%
Sell	9/18/2001	\$1,032.74	
Buy	9/3/2002	\$878.02	1.75%
Sell	9/4/2002	\$893.40	
Buy	9/15/2008	\$1,193.75	1.66%
Sell	9/16/2008	\$1,213.57	
Buy	9/17/2008	\$1,156.42	4.33%
Sell	9/18/2008	\$1,206.51	
Buy	9/29/2008	\$1,106.42	5.28%
Sell	9/30/2008	\$1,164.89	

The 3 we just had are among those that are strongly positive.

In the September 18th Subscriber Letter I wrote the following, which again holds true today:

The bottom line is that we are in the midst of a historic selloff. It is now panic mode. In the past, panic mode has not lasted very long before there is a rebound. Unfortunately, there is no telling how far the market may fall before that rebound occurs...

Volatility is through the roof right now and there is huge opportunity to profit. Traders need to really think about how they can most comfortably take advantage of the situation. You could buy now and hope there isn't much farther to fall and that the round trip will make you enough money to be worth the pain. You could wait for a reversal to try and enter... You could wait for a bounce and a pullback. Whatever the decision, make sure you have the ability to execute.

As I did that day I will be putting out a long SPY trade idea tonight. This position must be scaled into with a small size or managed closely. Sizing is especially important if you can't manage the position closely intraday. For purposes of trade idea tracking I will be putting it out there with the intention of continuing to scale in more next week should the market fall further tomorrow.

Lastly, a quick non-quantified thought for tomorrow – with bailout news due the market perception is one of great risk. Monday's debacle is fresh on people's minds. There is a chance that even if the bill passes the market could go down. I don't think that will happen immediately, though. If they pass the bill, the government leaders are going to want it to look like they did a good thing. They will likely use any tools at their disposal to ensure a rally. I wouldn't be shocked to hear news from the SEC or the Fed if needed. I'd be surprised if employment numbers released tomorrow – whatever they read – aren't adjusted lower next month. The hope with this bailout bill is that it can restore confidence. They're trying to prop the markets up. I think they can for 1 day. If not, the negative reaction won't be mild.

Intermediate-term Outlook (1 week – 2 months)–neutral -updated 9/30

Most of the positives I wrote about last night have been wiped away. The FTD and the Lowry's signal both failed as the recent lows were taken out in a big way. The market has yet to show any ability to follow through to the upside. About the only thing going for it is that we have once again reached such extreme conditions that it's possible an intermediate-term bottom could be carved out. I will look to provide more expansive intermediate-term analysis in the next few days. For now I am moving from "somewhat bullish" to "neutral".

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

AAPL – @ 127.83

HAL – @ \$30.29

AA – @ \$21.38

GD – bought 1/3 @ \$71.40

Catapult for ETF's Trades

none

Broad Market Large Cap CBI –4 (AAPL,HAL,AA,GD)

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	4.65
DJ US Insurance Index	IAK	1.35	DJ US Financial	IYF	0.34
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	5.17	DJ US Industrial Sector	IYJ	1.53
DJ US Oil Equip & Svcs	IEZ	5.77	DJ US Consumer Goods	IYK	3.40
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	4.05
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	5.56	DJ US Technology Sector	IYW	2.51
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	2.63
DJ US Consumer Svcs	IYC	1.32	Nasdaq 100	QQQQ	2.00

Additional New Trade Ideas

SPY – buy 1/4 position @ \$112.25. I'm willing to pay up a little into a gap up. Too large of a gap would force traders to use intraday techniques for entry. \$112.25 is about 1% above the recent lows if traders wanted to use it as a stop. For the Subscriber Letter where it's difficult to be nimble and still allow subscribers the opportunity to follow the picks, I always prefer to simply scale in. More nimble traders may be able to take better advantage of the move and effectively use a stop.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
GD	9/30/2008	\$71.40	\$70.26	-1.60%		Catapult
KOL	9/30/2008	\$27.19	\$27.52	1.21%		exited remaining

Stopped out of the remaining KOL. “Current” price is the average exit. All the bounces the last few days have now reversed hard.

Stocks and ETF's on my Radar

AAPL, HAL, and AA while not active among the trade ideas are still “open” based on the Catapult system. When they bounce, they should bounce strong and so I will monitor them for signs of a reversal.

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