

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 7, 2008

Issue 161

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 5, 2008	VIX > 40 2 days in row	1-7 days	Bullish	8.50%	12.30%
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) – bullish – updated 10/7

After dropping over 8% intraday the S&P 500 closed down “only” 3.85%. Volume came in high and breadth was extremely weak as both up issues and up volume were under 10%. The late-day rebound looked nice on some charts but didn’t accomplish much.

Many technicians may view today’s daily chart pattern as bullish due to the long tail. I have found no evidence that a long tail is a good thing. For one, if you are going to look at the low as a potential support point, wouldn’t you rather the tail wasn’t so long? That’s a long way to fall before getting stopped out of a trade. Secondly, the statistics don’t seem to indicate a bullish edge. Below I ran tests on both the SPY and QQQQ:

<i>SPY makes 100 day low. Open and close are in top half of day's range. Buy on close. Sell X days later. \$100k/trade.</i>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	\$17,472.66	16	9	7	56.25	\$6,246.35	(\$5,534.93)	1.13	1.45	\$1,092.04
19	\$22,411.36	16	11	5	68.75	\$5,262.89	(\$7,096.09)	0.74	1.63	\$1,400.71
18	\$18,782.00	16	11	5	68.75	\$5,045.23	(\$7,343.11)	0.69	1.51	\$1,173.88
17	\$18,476.77	16	9	7	56.25	\$5,565.05	(\$4,515.52)	1.23	1.58	\$1,154.80
16	\$18,044.06	17	9	8	52.94	\$5,918.99	(\$4,403.36)	1.34	1.51	\$1,061.42
15	\$19,632.32	17	10	7	58.82	\$5,268.79	(\$4,722.22)	1.12	1.59	\$1,154.84
14	\$17,420.09	17	10	7	58.82	\$4,633.32	(\$4,130.45)	1.12	1.60	\$1,024.71
13	\$9,367.02	17	9	8	52.94	\$4,271.73	(\$3,634.82)	1.18	1.32	\$551.00
12	(\$8,463.78)	19	10	9	52.63	\$4,037.80	(\$5,426.86)	0.74	0.83	(\$445.46)
11	(\$870.73)	19	8	11	42.11	\$4,758.51	(\$3,539.89)	1.34	0.98	(\$45.83)
10	\$7,921.13	19	10	8	52.63	\$4,320.97	(\$4,411.07)	0.98	1.22	\$416.90
9	\$3,182.61	19	10	9	52.63	\$4,139.53	(\$4,245.86)	0.97	1.08	\$167.51
8	(\$8,829.56)	19	8	11	42.11	\$4,796.01	(\$4,290.69)	1.12	0.81	(\$464.71)
7	(\$19,111.68)	20	9	11	45.00	\$4,240.40	(\$5,206.84)	0.81	0.67	(\$955.58)
6	(\$17,864.17)	21	10	11	47.62	\$3,324.56	(\$4,646.34)	0.72	0.65	(\$850.67)
5	(\$2,845.20)	22	12	10	54.55	\$2,762.98	(\$3,600.10)	0.77	0.92	(\$129.33)
4	(\$1,372.49)	23	11	12	47.83	\$2,680.44	(\$2,571.44)	1.04	0.96	(\$59.67)
3	\$10,399.30	23	13	10	56.52	\$2,434.17	(\$2,124.49)	1.15	1.49	\$452.14
2	\$15,030.63	24	18	6	75.00	\$1,637.94	(\$2,408.70)	0.68	2.04	\$626.28
1	\$7,433.89	25	13	12	52.00	\$1,780.67	(\$1,309.56)	1.36	1.47	\$297.36

QQQQ makes 100 day low. Open and close are in top alf of day's range. Buy on close. Sell X days later. \$100k/trade.											
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade	
20	(\$24,957.74)	12	4	8	33.33	\$11,572.52	(\$8,905.98)	1.30	0.65	(\$2,079.81)	
19	(\$40,149.49)	12	5	7	41.67	\$8,223.91	(\$11,609.86)	0.71	0.51	(\$3,345.79)	
18	(\$40,314.91)	12	5	7	41.67	\$7,150.55	(\$10,866.81)	0.66	0.47	(\$3,359.58)	
17	(\$34,463.99)	12	5	7	41.67	\$7,178.91	(\$10,051.22)	0.71	0.51	(\$2,872.00)	
16	(\$38,845.44)	12	5	7	41.67	\$6,421.65	(\$10,136.24)	0.63	0.45	(\$3,237.12)	
15	(\$29,115.23)	12	5	7	41.67	\$7,754.33	(\$9,698.13)	0.80	0.57	(\$2,426.27)	
14	(\$14,629.95)	12	5	7	41.67	\$8,999.19	(\$8,517.98)	1.06	0.75	(\$1,219.16)	
13	(\$7,886.22)	14	6	8	42.86	\$9,176.63	(\$7,868.25)	1.17	0.87	(\$563.30)	
12	(\$23,969.18)	14	6	8	42.86	\$8,011.46	(\$9,004.75)	0.89	0.67	(\$1,712.08)	
11	(\$28,418.48)	14	6	8	42.86	\$5,850.16	(\$7,939.93)	0.74	0.55	(\$2,029.89)	
10	(\$19,711.22)	14	5	9	35.71	\$4,709.86	(\$4,806.73)	0.98	0.54	(\$1,407.94)	
9	(\$16,187.11)	15	7	8	46.67	\$4,840.36	(\$6,258.71)	0.77	0.68	(\$1,079.14)	
8	(\$10,682.42)	15	8	7	53.33	\$4,021.65	(\$6,122.23)	0.66	0.75	(\$712.16)	
7	(\$22,796.04)	15	7	8	46.67	\$2,804.38	(\$5,303.34)	0.53	0.46	(\$1,519.74)	
6	(\$45,853.17)	16	5	11	31.25	\$2,370.27	(\$5,245.86)	0.45	0.21	(\$2,865.82)	
5	(\$30,704.11)	16	7	9	43.75	\$2,103.33	(\$5,047.49)	0.42	0.32	(\$1,919.01)	
4	(\$40,584.50)	16	6	10	37.50	\$958.78	(\$4,633.72)	0.21	0.12	(\$2,536.53)	
3	(\$44,001.06)	16	2	14	12.50	\$2,210.16	(\$3,458.67)	0.64	0.09	(\$2,750.07)	
2	(\$39,413.19)	16	3	13	18.75	\$1,527.43	(\$3,384.27)	0.45	0.10	(\$2,463.32)	
1	(\$19,940.60)	18	6	12	33.33	\$1,517.66	(\$2,420.54)	0.63	0.31	(\$1,107.81)	

Many of the indicators mentioned as extreme in the last few letters, such as the VIX and the % of Stocks Trading 1 Standard Deviation Below Their 40ma (along the 2-std deviation cousin) went from extreme to either unheard of, or “only in a crash” levels today. Another breadth indicator that hit an extreme was the McClellan Oscillator as measure by Worden Bros., which closed at -240. I showed [a system on the blog in June](#) that indicated a decided bullish edge when readings dropped below -200. That particular instance led to the 1st losing trade.

The Aggregator is below:



The song remains the same. All indicators are extreme enough that a bounce should be imminent. The market has underperformed expectations over the last 3 days by a higher degree than at any other time since the Aggregator was created earlier this year. I will continue to look to scale into an index position. There are also some new Catapult trades if you'd prefer to spread it around a bit.

Intermediate-term Outlook (1 week – 2 months)–neutral -updated 10/6

The freefall the market is in has become extreme enough by numerous counts that a bounce at this point COULD mark an intermediate-term low. Extremes of breadth and volatility discussed above have reached levels that many times will lead to an intermediate-term low. Below are a few other indications that the selloff may be reaching an intermediate-term low.

From a price standpoint the weekly 3-period RSI of the S&P 500 closed at just under 4. Looking back to 1960, this has only happened a dozen times. It has always led to a bounce within the next few weeks:

SPX weekly chart 3-period RSI closes under 5. Buy on close. Sell close of 1st week that is profitable up to 5 weeks out.												
\$100,000/trade. 1960-present.												
X Weeks	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	\$21,670.11	12	12	0	100.00	\$5,088.86	\$0.00	\$1,805.84	\$0.00	100.00	100.00	\$1,805.84
4	\$15,804.07	12	10	2	83.33	\$5,088.86	(\$3,497.00)	\$2,067.81	(\$2,437.00)	0.85	4.24	\$1,317.01
3	\$13,556.87	12	10	2	83.33	\$5,088.86	(\$6,172.20)	\$2,067.81	(\$3,560.60)	0.58	2.90	\$1,129.74
2	\$10,279.29	12	9	3	75.00	\$5,088.86	(\$7,403.40)	\$2,241.91	(\$3,299.29)	0.68	2.04	\$856.61
1	\$10,932.64	16	12	4	75.00	\$5,951.20	(\$7,953.12)	\$2,634.45	(\$5,170.20)	0.51	1.53	\$683.29

Another exit strategy could be to sell when the 3-period RSI rises back above X on a weekly basis. This would have produced the following results:

SPX weekly chart 3-period RSI closes under 5. Buy on close. Sell when weekly 3-period RSI closes above X.												
\$100,000/trade. 1960-present.												
X RSI	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
80	\$34,532.22	11	9	2	81.82	\$12,537.06	(\$7,692.72)	\$4,717.64	(\$3,963.27)	1.19	5.36	\$3,139.29
75	\$24,835.67	11	8	3	72.73	\$11,261.50	(\$7,692.72)	\$4,610.55	(\$4,016.25)	1.15	3.06	\$2,257.79
70	\$23,483.22	11	9	2	81.82	\$11,261.50	(\$7,692.72)	\$3,616.99	(\$4,534.86)	0.80	3.59	\$2,134.84
65	\$18,227.06	11	9	2	81.82	\$11,261.50	(\$10,342.08)	\$3,327.35	(\$5,859.54)	0.57	2.56	\$1,657.01
60	\$17,775.46	11	9	2	81.82	\$11,261.50	(\$10,342.08)	\$3,277.17	(\$5,859.54)	0.56	2.52	\$1,615.95

One astute reader this week noted that although the market put in a strong bounce on Tuesday, new lows remained fairly elevated throughout the week. I wondered if this might be something to look for as a warning sign that a rally would be less likely to succeed. I looked at all times where the market reversed strongly off of a 100-day low and a few days later made a low that was at least 3% higher than the 100-day low. I then checked for instances where the net new lows exceeded 5% of the total issues of the NYSE. Since 1992, it has only happened 2 other times: 9/26/01 and 7/25/02. Both of those times the rally succeeded. In other words, seeing new lows contract shortly after a potential bottom does not seem to be important.

Before I can get excited about the intermediate-term I'll need to see a bounce and some evidence that the bounce is strong enough to last. In the past I've shown large amounts of research with regards to 1) IBD follow-through days, 2) Lowry's 90% days, and 3)

Reversal days. You basically want to see a rally begin with an explosive short-covering rally off the bottom. The more explosive the day-1 action the better. Strong breadth and volume are also helpful. IBD readers typically look at the 1st strong up day after a rally attempt is 4 days old. I have found this to be less than 50% reliable, although watching the action following such days has been 65%-70% accurate in predicting whether the rally attempt will succeed.

Should the market bounce this week as I expect it will, I will discuss in more detail next weekend how the bounce is stacking up and what that indicates about its chances of success.

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

New Catapult Triggers

AES – buy 1/3 position @ \$8.83

TWX – buy 1/3 position @ \$11.23

Catapult for ETF's Trades

New Triggers

DBA buy @ \$25.70

XLB buy @ \$28.70

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	6.98
DJ US Insurance Index	IAK	1.35	DJ US Financial	IYF	0.68
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	6.76	DJ US Healthcare	IYH	6.34
DJ US Oil&Gas Expl & Prod	IEO	5.17	DJ US Industrial Sector	IYJ	3.07
DJ US Oil Equip & Svcs	IEZ	7.69	DJ US Consumer Goods	IYK	4.76
DJ US Pharmaceuticals	IHE	2.70	DJ US Basic Materials	IYM	8.11
DJ US Healthcare Providers	IHF	6.12	DJ US Real Estate	IYR	1.22
DJ US Medical Devices	IHI	4.88	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	5.56	DJ US Technology Sector	IYW	6.03
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	2.63
DJ US Consumer Svcs	IYC	3.51	Nasdaq 100	QQQQ	6.00

CBI levels are beginning to creep up, with Basic Materials, Energy, and Oil Equip leading the capitulative charge.

Additional New Trade Ideas

SPY – Looking to buy as much as the remaining ½ allocation left in the following was:

- 1) *Buy ¼ SPY allocation @ \$105.00*
- 2) *Buy final ¼ SPY allocation on close lower.*

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
GD	9/30/2008	\$71.40	\$65.29	-8.56%		Catapult
SPY (1/4)	10/3/2008	\$112.00	\$104.72	-6.50%		
SPY (1/4)	10/6/2008	\$107.15	\$104.72	-2.27%		

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. AAPL actually made a strong move today and could be playable.

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