

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 9, 2008

Issue 163

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 9, 2008	5 Lower Lows & 100-day low	1-12 days	Bullish	2.28%	4.58%
October 5, 2008	VIX > 40 2 days in row	1-7 days	Bullish	8.50%	12.30%
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 10/9

Huge whipsaws led to another down day. Global rate cuts and government interventions have failed to quell the tide at all recently. Breadth was once again solidly negative, with just under 2:1 downside volume and just over 3:1 downside issues on the NYSE. Volume came in at the highest level since September 19th.

In tonight's blog I showed a table which listed a number of current extreme market conditions. I have discussed all of these in recent Letters. Below is a copy of the table from the blog:

Current Condition	Severity
<i>Breadth Extremes</i>	
Worden Bros McClellan Oscillator	All time lows of -301 Tues and -308 Wed (data back to 1986)
% Stocks 2 Std Dev Below 40 MA = 87.7%	Surpassed only on 10/19 and 10/20 1987
% Stocks 1 Std Dev Below 40 MA = 95%	Surpassed only in days following crash of '87
Net New Lows on the NYSE = 57.41%	May 26, 1970 only day to nudge today out with 57.66%
Net New Lows on Nasdaq = 30.36%	Lowest in my database going back to 1994.
<i>Price Extremes</i>	
SPX over 11% below 10ma	Since 1960 it has only happened during crash of '87
SPX over 15% below 20ma	Since 1960 it has only happened during crash of '87
SPX 19.8% below 50ma	Since 1960 it has only happened during crash of '87 & on 7/23/02
SPX over 22% below 100ma	Since 1960 its happened on 10/3/74, following crash of '87, and 7/22 & 7/23/02
SPX over 25% below 200ma	Since 1960 it happened in Sep and Oct. of 1974 and on 7/23/02
<i>Volatility Extremes</i>	
VIX close @ 57.53 and high @ 59.06	Both all time high (back to 1990)
SPY 10-period Avg True Range = 5.22%	Highest since SPY inception
SPY 20-period Absolute Avg Gap = 1.68%	Highest since SPY inception
S&P 500 10-per. Avg True Range = 5.16%	Only exceeded in days following crash of '87 (back to 1960)

Also notable is that the S&P 500 made its 5th consecutive lower low today while also making a 50-day low. This is a condition we discussed in the May 12th Subscriber Letter. Generally, while many people consider 5 lower lows a bullish signal, it really depends on where the market is trading. If it is also making new intermediate-term lows, then that is a plus. Below are some tables to illustrate this:

1st –without a 50-day low.

S&P makes 5 lower lows but does not make a 50-day low.										
Buy on close. Sell X days later. \$100k/trade. 1978-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	\$24,840.31	70	39	31	55.71	\$4,025.92	(\$4,263.56)	0.94	1.19	\$354.86
15	\$15,235.94	71	37	33	52.11	\$3,509.44	(\$3,473.14)	1.01	1.13	\$214.59
14	(\$1,005.71)	71	37	34	52.11	\$3,363.84	(\$3,690.23)	0.91	0.99	(\$14.16)
13	(\$10,569.55)	71	34	37	47.89	\$3,384.44	(\$3,395.69)	1.00	0.92	(\$148.87)
12	(\$20,502.97)	72	35	37	48.61	\$3,153.06	(\$3,536.76)	0.89	0.84	(\$284.76)
11	(\$21,238.40)	73	32	41	43.84	\$3,035.19	(\$2,886.94)	1.05	0.82	(\$290.94)
10	(\$11,034.31)	74	33	41	44.59	\$2,962.78	(\$2,653.81)	1.12	0.90	(\$149.11)
9	(\$2,530.40)	76	39	37	51.32	\$2,563.55	(\$2,770.51)	0.93	0.98	(\$33.29)
8	\$5,822.77	77	40	37	51.95	\$2,600.20	(\$2,653.66)	0.98	1.06	\$75.62
7	\$4,127.12	79	44	35	55.70	\$2,157.87	(\$2,594.84)	0.83	1.05	\$52.24
6	(\$3,518.14)	79	46	33	58.23	\$1,767.85	(\$2,570.89)	0.69	0.96	(\$44.53)
5	\$6,313.27	79	40	39	50.63	\$1,959.52	(\$1,847.89)	1.06	1.09	\$79.91
4	\$17,655.36	79	44	35	55.70	\$1,631.14	(\$1,546.14)	1.05	1.33	\$223.49
3	\$22,941.99	79	46	33	58.23	\$1,433.23	(\$1,302.62)	1.10	1.53	\$290.40
2	\$24,992.45	79	48	31	60.76	\$1,131.79	(\$946.24)	1.20	1.85	\$316.36
1	\$20,735.26	79	48	31	60.76	\$820.84	(\$602.09)	1.36	2.11	\$262.47

No real edge here. Now with a 50-day low:

S&P makes 5 lower lows and a 50-day low.										
Buy on close. Sell X days later. \$100k/trade. 1978-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	\$88,179.54	26	19	7	73.08	\$5,790.96	(\$3,121.24)	1.86	5.04	\$3,391.52
15	\$70,417.47	27	19	8	70.37	\$4,898.33	(\$2,831.36)	1.73	4.11	\$2,608.05
14	\$64,655.54	27	18	9	66.67	\$4,915.81	(\$2,647.68)	1.86	3.71	\$2,394.65
13	\$56,344.23	27	18	9	66.67	\$4,847.25	(\$3,434.03)	1.41	2.82	\$2,086.82
12	\$60,120.88	27	18	9	66.67	\$4,724.79	(\$2,769.48)	1.71	3.41	\$2,226.70
11	\$42,305.42	27	18	9	66.67	\$3,566.79	(\$2,432.97)	1.47	2.93	\$1,566.87
10	\$54,668.81	27	17	10	62.96	\$4,191.22	(\$1,658.19)	2.53	4.30	\$2,024.77
9	\$58,972.52	27	19	8	70.37	\$3,700.63	(\$1,417.44)	2.61	6.20	\$2,184.17
8	\$53,676.27	27	16	11	59.26	\$4,630.02	(\$1,854.91)	2.50	3.63	\$1,988.01
7	\$49,652.63	27	18	9	66.67	\$3,634.09	(\$1,751.23)	2.08	4.15	\$1,838.99
6	\$38,898.37	27	18	9	66.67	\$3,197.77	(\$2,073.50)	1.54	3.08	\$1,440.68
5	\$32,420.11	27	17	10	62.96	\$2,954.33	(\$1,780.36)	1.66	2.82	\$1,200.74
4	\$27,198.66	27	18	9	66.67	\$2,968.71	(\$2,915.35)	1.02	2.04	\$1,007.36
3	\$25,995.83	27	15	12	55.56	\$2,802.21	(\$1,336.45)	2.10	2.62	\$962.81
2	\$28,139.24	27	17	10	62.96	\$2,344.43	(\$1,171.60)	2.00	3.40	\$1,042.19
1	\$26,991.42	27	17	10	62.96	\$1,942.12	(\$602.45)	3.22	5.48	\$999.68

Much better in all categories.

It also seems that the longer-term the low, the better the stats. For example:

S&P makes 5 lower lows and a 100-day low.										
Buy on close. Sell X days later. \$100k/trade. 1978-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	\$63,880.37	16	13	3	81.25	\$5,693.62	(\$3,378.88)	1.69	7.30	\$3,992.52
15	\$60,759.01	17	15	2	88.24	\$4,652.38	(\$4,513.35)	1.03	7.73	\$3,574.06
14	\$58,523.98	17	14	3	82.35	\$4,810.15	(\$2,939.37)	1.64	7.64	\$3,442.59
13	\$59,657.38	17	14	3	82.35	\$4,920.97	(\$3,078.73)	1.60	7.46	\$3,509.26
12	\$59,810.21	17	14	3	82.35	\$4,693.17	(\$1,964.70)	2.39	11.15	\$3,518.25
11	\$40,722.06	17	13	4	76.47	\$3,713.49	(\$1,888.33)	1.97	6.39	\$2,395.42
10	\$47,157.42	17	12	5	70.59	\$4,292.70	(\$870.99)	4.93	11.83	\$2,773.97
9	\$48,764.94	17	14	3	82.35	\$3,700.68	(\$1,014.85)	3.65	17.02	\$2,868.53
8	\$48,855.06	17	12	5	70.59	\$4,438.23	(\$880.75)	5.04	12.09	\$2,873.83
7	\$40,576.88	17	13	4	76.47	\$3,437.95	(\$1,029.12)	3.34	10.86	\$2,386.88
6	\$28,807.03	17	11	6	64.71	\$3,319.96	(\$1,285.43)	2.58	4.74	\$1,694.53
5	\$24,332.65	17	11	6	64.71	\$3,001.91	(\$1,448.07)	2.07	3.80	\$1,431.33
4	\$15,634.78	17	12	5	70.59	\$2,642.11	(\$3,214.10)	0.82	1.97	\$919.69
3	\$16,267.48	17	10	7	58.82	\$2,753.81	(\$1,610.09)	1.71	2.44	\$956.91
2	\$20,103.26	17	12	5	70.59	\$2,275.80	(\$1,441.26)	1.58	3.79	\$1,182.54
1	\$24,892.70	17	12	5	70.59	\$2,261.06	(\$447.99)	5.05	12.11	\$1,464.28

Lastly, while instances are low, the fact that Wednesday's volume was higher also seems to be a positive – especially when considering “% Wins”:

S&P makes 5 lower lows and a 50-day low. Today's volume is highest of the 5 days.										
Buy on close. Sell X days later. \$100k/trade. 1978-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	\$41,804.17	13	11	2	84.62	\$4,137.98	(\$1,856.80)	2.23	12.26	\$3,215.71
15	\$34,206.84	13	11	2	84.62	\$3,326.47	(\$1,192.15)	2.79	15.35	\$2,631.30
14	\$25,739.82	13	10	3	76.92	\$3,159.87	(\$1,952.97)	1.62	5.39	\$1,979.99
13	\$25,176.26	13	10	3	76.92	\$3,186.53	(\$2,229.66)	1.43	4.76	\$1,936.64
12	\$23,600.64	13	10	3	76.92	\$2,755.32	(\$1,317.50)	2.09	6.97	\$1,815.43
11	\$15,748.31	13	9	4	69.23	\$2,162.32	(\$928.13)	2.33	5.24	\$1,211.41
10	\$20,331.59	13	9	4	69.23	\$2,729.88	(\$1,059.34)	2.58	5.80	\$1,563.97
9	\$21,982.07	13	10	3	76.92	\$2,597.23	(\$1,330.07)	1.95	6.51	\$1,690.93
8	\$21,716.97	13	9	4	69.23	\$3,166.13	(\$1,694.55)	1.87	4.20	\$1,670.54
7	\$18,866.85	13	10	3	76.92	\$2,475.64	(\$1,963.17)	1.26	4.20	\$1,451.30
6	\$5,716.53	13	8	5	61.54	\$2,150.99	(\$2,298.27)	0.94	1.50	\$439.73
5	\$5,047.87	13	8	5	61.54	\$2,010.36	(\$2,206.99)	0.91	1.46	\$388.30
4	(\$1,220.60)	13	9	4	69.23	\$1,703.10	(\$4,137.12)	0.41	0.93	(\$93.89)
3	\$7,721.65	13	8	5	61.54	\$2,223.27	(\$2,012.89)	1.10	1.77	\$593.97
2	\$11,325.21	13	8	5	61.54	\$2,264.84	(\$1,358.70)	1.67	2.67	\$871.17
1	\$18,252.08	13	10	3	76.92	\$1,972.44	(\$490.76)	4.02	13.40	\$1,404.01

I didn't create the Aggregator chart tonight, but the story remains the same. The short-term studies are all bullish and the S&P has severely underperformed expectations over the last few days. The edge still appears to favor the upside based on our indicators and studies. Unfortunately, we're in a bit of uncharted territory here as is evidenced by the “extreme conditions” table above. I am holding firm to current positions. Those looking for more exposure could consider the additional Catapults tonight. Also, etf's in some of the most oversold areas should provide the best snap-back on a bounce. See the CBI % table for some ideas there.

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:

<i>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.</i>												
<i>\$100,000/trade. 1960-present.</i>												
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:

<i>SPX weekly chart 3-period RSI closes under 5. Buy on close. Sell when weekly 3-period RSI closes above X.</i>												
<i>\$100,000/trade. 1960-present.</i>												
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
AES – bought 1/3 position @ \$8.83
TWX – bought 1/3 position @ \$11.23
TWX –1/6 position @ \$10.40
TYC –1/6 @ \$28.35
BHI –1/6 @ \$39.93
XRX –1/6 @ \$8.45
HAL –1/6 @ \$21.13
AA –1/6 @ \$15.16

New Catapult Triggers

TYC – buy 1/6 @ \$28.6 limit
XRX – buy 1/6 @ \$8.65 limit
HAL – buy 1/6 @ \$20.99 limit (final entry)
AA – buy 1/6 @ \$14.71 limit (final entry)
DELL – buy 1/6 @ \$13.50 limit
HON – buy 1/6 @ \$34.08 limit

Catapult for ETF's Trades

XLB - @ \$28.70
QQQQ – @ \$31.95

Broad Market Large Cap CBI –18/11 (AAPL, HAL(3) ,AA(3), GD, TWX(2), AES, TYC(2), BHI, XRX(2), DELL, HON)

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	27.91
DJ US Insurance Index	IAK	2.70	DJ US Financial	IYF	2.40
DJ US Regional Banks	IAT	2.50	DJ US Financial Services	IYG	1.40
DJ US Utilities	IDU	12.16	DJ US Healthcare	IYH	8.45
DJ US Oil&Gas Expl & Prod	IEO	18.97	DJ US Industrial Sector	IYJ	10.73
DJ US Oil Equip & Svcs	IEZ	38.46	DJ US Consumer Goods	IYK	8.16
DJ US Pharmaceuticals	IHE	5.41	DJ US Basic Materials	IYM	24.32
DJ US Healthcare Providers	IHF	8.16	DJ US Real Estate	IYR	3.66
DJ US Medical Devices	IHI	4.88	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	8.33	DJ US Technology Sector	IYW	17.09
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	7.89
DJ US Consumer Svcs	IYC	7.89	Nasdaq 100	QQQQ	14.00

Some remarkable spikes.

Additional New Trade Ideas

See Catapult section

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
GD	9/30/2008	\$71.40	\$65.56	-8.18%		Catapult
SPY (1/4)	10/3/2008	\$112.00	\$97.51	-12.94%		
SPY (1/4)	10/6/2008	\$107.15	\$97.51	-9.00%		
SPY (1/4)	10/7/2008	\$105.00	\$97.51	-7.13%		
SPY (1/4)	10/7/2008	\$100.03	\$97.51	-2.52%		
XLB	10/7/2008	\$28.70	\$28.10	-2.09%		Catapult
AES	10/7/2008	\$8.83	\$9.09	2.94%		Catapult
TWX	10/7/2008	\$11.23	\$10.78	-4.01%		Catapult
TWX	10/8/2008	\$10.40	\$10.78	3.65%		Catapult
TYC	10/8/2008	\$28.35	\$28.60	0.88%		Catapult
BHI	10/8/2008	\$39.93	\$41.42	3.73%		Catapult
XRX	10/8/2008	\$8.45	\$8.15	-3.55%		Catapult
HAL	10/8/2008	\$21.13	\$20.99	-0.66%		Catapult
AA	10/8/2008	\$15.16	\$14.71	-2.97%		Catapult
QQQQ	10/8/2008	\$31.95	\$32.39	1.38%		Catapult

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