

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 10, 2008

Issue 164

## 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 10/10*

Crash. Repeat. Crash. Repeat. More carnage today. The Dow and S&P both sank over 7% again today. Volume came in lighter. Breadth was heavily negative as you'd expect.

I have very little to say tonight. There remain no close historical comparisons. In 1929 the Dow dropped from 341 to 300 in 6 days. And then the next two days it fell to 230. Eight days for a 33% loss. Two of those days were up. In 1931 it took eight days to fall from 116 to 86.5 – about a 25% decline. Again it was interrupted by 2 up days. The crash of '87, while more severe to this point, only lasted 4 days before there was a significant bounce. The market has now fallen 7 days in a row. S&P 500 losses total over 18% in the last 7 trading days. Over the last 9 days we are down 25%. And it hasn't relented for a single day yet.

In all these instances the bounce was extremely strong, but not long lasting. That is what I am looking for at this point. As you would expect, there are a multitude of Catapults today. If you desire more long exposure, then they should be some of the best bouncers should we get a bounce in the next couple of days.

On another note, Lehman credit default swaps are set to be priced tomorrow, which I've seen a bit of talk about. It appears around 10:30 they'll be announcing initial prices. Traders may want to be near their screens at that time.

### *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 1<sup>st</sup> 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 (all at a limit of 10/9 close)**

**With 13 triggers, position size for each would be reduced to 1/13 based on the max per day rule.**

AIG (not recommended and won't be tracked), BA, CMCSA, COV, CPB, DELL, EXC, GOOG, HON, IP, MS, PM, TYC, XRX

### ***Catapult for ETF's Trades***

XLB - @ \$28.70  
QQQQ – @ \$31.95

### ***Broad Market Large Cap CBI –32/21***

#### ***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	3.45	DJ US Energy	IYE	38.37
DJ US Insurance Index	IAK	14.86	DJ US Financial	IYF	10.62
DJ US Regional Banks	IAT	12.50	DJ US Financial Services	IYG	8.39
DJ US Utilities	IDU	27.03	DJ US Healthcare	IYH	22.54
DJ US Oil&Gas Expl & Prod	IEO	32.76	DJ US Industrial Sector	IYJ	20.31
DJ US Oil Equip & Svcs	IEZ	57.69	DJ US Consumer Goods	IYK	14.97
DJ US Pharmaceuticals	IHE	24.32	DJ US Basic Materials	IYM	32.43
DJ US Healthcare Providers	IHF	22.45	DJ US Real Estate	IYR	8.54
DJ US Medical Devices	IHI	21.95	DJ US Transportation	IYT	14.29
DJ US Aerospace & Defense	ITA	33.33	DJ US Technology Sector	IYW	30.15
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	18.42
DJ US Consumer Svcs	IYC	17.11	Nasdaq 100	QQQQ	27.00

*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	\$60.92	-14.68%		Catapult
SPY (1/4)	10/3/2008	\$112.00	\$90.70	-19.02%		
SPY (1/4)	10/6/2008	\$107.15	\$90.70	-15.35%		
SPY (1/4)	10/7/2008	\$105.00	\$90.70	-13.62%		
SPY (1/4)	10/7/2008	\$100.03	\$90.70	-9.33%		
XLB	10/7/2008	\$28.70	\$26.30	-8.36%		Catapult
AES	10/7/2008	\$8.83	\$8.63	-2.27%		Catapult
TWX	10/7/2008	\$11.23	\$10.09	-10.15%		Catapult
TWX	10/8/2008	\$10.40	\$10.09	-2.98%		Catapult
TYC	10/8/2008	\$28.35	\$26.85	-5.29%		Catapult
BHI	10/8/2008	\$39.93	\$37.40	-6.34%		Catapult
XRX	10/8/2008	\$8.45	\$8.03	-4.97%		Catapult
HAL	10/8/2008	\$21.13	\$18.94	-10.36%		Catapult
AA	10/8/2008	\$15.16	\$12.46	-17.81%		Catapult
QQQQ	10/8/2008	\$31.95	\$31.52	-1.35%		Catapult
TYC	10/9/2008	\$28.60	\$26.85	-6.12%		Catapult
XRX	10/9/2008	\$8.15	\$8.03	-1.47%		Catapult
HAL	10/9/2008	\$20.99	\$18.94	-9.77%		Catapult
DELL	10/9/2008	\$13.50	\$13.43	-0.52%		Catapult
AA	10/9/2008	\$14.71	\$12.46	-15.30%		Catapult
HON	10/9/2008	\$34.08	\$31.39	-7.89%		Catapult

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