

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 13, 2008

Issue 165

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 10/13

Friday's action was the wildest we've seen so far. There were basically 4 swings of 10% or so in the S&P 500. When it was over the S&P 500 and Dow both finished down over 1% and the Nasdaq managed to post a small gain. NYSE breadth was nearly 2:1 negative. The net % of new lows hit on both exchanges was the highest by a wide margin as far as my data goes back (1970 for NYSE and 1994 or Nasdaq).

The market has continued to hit incredibly oversold levels in numerous indicators. At nearly any other time in history the extremes reached 3 or 4 days ago would have been enough to prompt a sharp rally. The only sharp rallies seen this past week were of the intraday variety as the selloff worsened each day. In Wednesday night's blog I posted a list of indicators that was at extreme levels. The continued selling has made the stats on that list obsolete. Below is an updated version:

Current Condition	Severity
<i>Breadth Extremes</i>	
Worden Bros McClellan Oscillator	Now -324.58 has made 4 lowest closes ever Tues-Fri. Thurs was lowest @ -363
% Stocks 2 Std Dev Below 40 MA = 90%	Thursday's 92% only surpassed by 10/20/87 94%
% Stocks 1 Std Dev Below 40 MA = 97%	Oct. 20th 1987 was only fractionally higher than Thursday's 98%
Net New Lows on the NYSE = 75.00%	Lowest in my database going back to 1970.
Net New Lows on Nasdaq = 43.90%	Lowest in my database going back to 1994.
<i>Price Extremes</i>	
SPX over 14% below 10ma	Since 1960 it has only happened on 10/19 & 10/20/1987
SPX over 20% below 20ma	Since 1960 it has only happened on 10/19, 10/20 & 10/26/1987
SPX over 25% below 50ma	Since 1960 it has only happened on 10/19, 10/20 & 10/26/1987
SPX over 28.5% below 100ma	Since 1960 this is the lowest
SPX over 31.6% below 200ma	Since 1960 this is the lowest
<i>Volatility Extremes</i>	
VIX close @ 69.95 and high @ 76.94	Both all time high (back to 1990)
SPY 10-period Avg True Range = 6.90%	Highest since SPY inception
SPY 20-period Absolute Avg Gap = 1.90%	Highest since SPY inception
S&P 500 10-per. Avg True Range = 6.70%	Only exceeded in days following crash of '87 (back to 1960)

Another notable extreme is the fact that the CBI now stands at 47, which is only surpassed by a 52 reading in July of 2002.

There's very little testing to be done tonight because there are no real historical comparisons to the current situation. For instance, the S&P 500 has now closed at least 1% lower *for 7 days in a row*. I could find no other instance of this happening in the S&P or Dow. Looking back to 1960 for the S&P there were 5 instances where it closed down 1%+ for four days in a row. Every instance led to a short, sharp bounce. The dates were 5/11/62, 6/14/62, 10/19/87, 7/23/02, and 10/7/02. I'm sure the last 3 dates look familiar to most readers. Below are some short-term stats following those dates:

S&P 500 closes lower by 1%+ for four days in row. Buy on close. Sell X days later. \$100k/trade. 1960-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	Avg Trade
4	\$32,268.62	5	5	0	100	\$12,657.50	\$0.00	\$6,453.72	\$0.00	\$6,453.72
3	\$24,470.18	5	5	0	100	\$10,398.48	\$0.00	\$4,894.04	\$0.00	\$4,894.04
2	\$24,144.06	5	4	1	80	\$14,891.76	(\$1,082.04)	\$6,306.53	(\$1,082.04)	\$4,828.81
1	\$16,318.14	5	5	0	100	\$5,716.25	\$0.00	\$3,263.63	\$0.00	\$3,263.63

I did find one instance where the Nasdaq Composite Index fell 1% or more for 7 days in a row. It happened on 12/20/2000 and the Nasdaq rallied nearly 8% in the next 2 days.

While we obviously didn't get the sharp bounce after day 4 as in the past, this does seem to suggest that a sharp multi-day bounce is near.

All the government meetings over the weekend seem to be creating significant positive energy for the futures market this evening. As I've been preparing the report the S&P 500 futures have held steady up over 3.5%. *I've shown in the past* that sharp gaps higher in a downtrend have a bullish tendency. Many times they will lead to short-covering rallies as all the shorts get trapped at the open and are forced to chase the market higher throughout the day.

I looked a bit more specifically tonight for other times where the market made a 200-day low and then gapped up at least 1% the next morning. It happened twice in September and both rally attempts soon failed. The dates were 9/19 and 9/30. Prior to those instances the record was quite good of launching at least multi-week rallies off such gaps. Below are the 7 other instances where SPY made a 200-day low and the gapped up at least 1% the next morning:

- 4/5/94 – Marked 1994 bottom.
- 10/19/00 – 2 week + rally
- 12/22/00 – 5 week rally
- 3/23/01 – 2 month rally
- 9/24/01 – Marked 2001 bottom
- 7/5/02 – Failed miserably
- 10/11/02 – Marked bear market bottom

Perhaps it's more difficult to create a short-covering rally when large restrictions are placed on shorting, or perhaps the market simply wasn't ready to bounce in September.

Whatever the reason, prior to the recent instances, returns had generally been quite positive, with reward far outsizeing risk. Perhaps this time the market can get a little upside follow through.

With relatively few active studies listed, below is tonight's [Aggregator](#):



The Aggregator chart isn't telling us anything enlightening here. The market is extremely oversold. The recent studies are all anticipating a sharp bounce. Unfortunately the anticipation on this leg down was early and the selloff one of the sharpest in history. Still, until the extremely oversold conditions are relieved I believe a bounce will appear more playable than further selling.

Intermediate-term Outlook (1 week – 2 months)–neutral -updated 10/13

As I stated last week, 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. Such extremes as those listed near the top of this report are frequently found near bottoms. Of course just because the market is down 40% doesn't mean it can't drop another 40%. Still, as extreme as short-term conditions are I feel the best course of action is to wait for the bounce, monitor the action there, and then further evaluate intermediate-term prospects. Obviously I'll be looking for indications of institutional buying along with strong breadth and volume patterns. From an intermediate-term perspective it now appears too late to short and too early to buy.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

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

XXR –1/6 @ \$8.45

HAL –1/6 @ \$21.13

AA –1/6 @ \$15.16

TYC – buy 1/6 @ \$28.6 limit

XXR – 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

AIG

BA

CMCSA

COV

CPB

DELL

EXC

GOOG

HON

IP

MS

PM

TYC (final entry)

XXR (final entry)

New Catapult Triggers (all at a limit of 10/9 close)

With 16 triggers, position size for each would be reduced to 1/16 based on the max per day rule.

AIG (won't be tracked), BA, BHI, BUD, CBS, CMCSA, COV, CPB, DELL, EMC, EP, EXC, HON, IP, MS, TWX

Catapult for ETF's Trades

XLB - @ \$28.70

QQQQ – @ \$31.95

Broad Market Large Cap CBI –47/21

Sector CBI Breakdown (% of stocks with active catapult triggers within each sector.)

Index	ETF	CBI %	Index	ETF	CBI %
DJ US Broker Dealers	IAI	3.45	DJ US Energy	IYE	50.00
DJ US Insurance Index	IAK	16.22	DJ US Financial	IYF	10.96
DJ US Regional Banks	IAT	11.25	DJ US Financial Services	IYG	8.39
DJ US Utilities	IDU	28.38	DJ US Healthcare	IYH	25.35
DJ US Oil&Gas Expl & Prod	IEO	37.93	DJ US Industrial Sector	IYJ	23.37
DJ US Oil Equip & Svcs	IEZ	67.31	DJ US Consumer Goods	IYK	16.33
DJ US Pharmaceuticals	IHE	24.32	DJ US Basic Materials	IYM	33.78
DJ US Healthcare Providers	IHF	28.57	DJ US Real Estate	IYR	8.54
DJ US Medical Devices	IHI	29.27	DJ US Transportation	IYT	9.52
DJ US Aerospace & Defense	ITA	38.89	DJ US Technology Sector	IYW	31.66
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	15.79
DJ US Consumer Svcs	IYC	19.30	Nasdaq 100	QQQQ	28.00

Some remarkable spikes.

Additional New Trade Ideas

See Catapult section

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
AA	10/8/2008	\$15.16	\$11.25	-25.79%		Catapult
AA	10/9/2008	\$14.71	\$11.25	-23.52%		Catapult
AES	10/7/2008	\$8.83	\$7.63	-13.59%		Catapult
BA	10/10/2008	\$40.13	41.8	4.16%		Catapult
BHI	10/8/2008	\$39.93	\$32.80	-17.86%		Catapult
CMCSA	10/10/2008	\$15.93	15.36	-3.58%		Catapult
COV	10/10/2008	\$41.82	42.15	0.79%		Catapult
CPB	10/10/2008	\$32.45	34.12	5.15%		Catapult
DELL	10/9/2008	\$13.50	\$13.29	-1.56%		Catapult
DELL	10/10/2008	\$12.80	13.29	3.83%		Catapult
EXC	10/10/2008	\$46.46	47.38	1.98%		Catapult
GD	9/30/2008	\$71.40	\$57.39	-19.62%		Catapult
GOOG	10/10/2008	\$313.16	332	6.02%		Catapult
HAL	10/8/2008	\$21.13	\$17.41	-17.61%		Catapult
HAL	10/9/2008	\$20.99	\$17.41	-17.06%		Catapult
HON	10/9/2008	\$34.08	\$30.60	-10.21%		Catapult
HON	10/10/2008	\$29.28	30.6	4.51%		Catapult
IP	10/10/2008	\$18.95	19.32	1.95%		Catapult
MS	10/10/2008	\$9.19	9.68	5.33%		Catapult
PM	10/10/2008	\$37.01	39.74	7.38%		Catapult
QQQQ	10/8/2008	\$31.95	\$31.32	-1.97%		Catapult
SPY (1/4)	10/3/2008	\$112.00	\$88.50	-20.98%		
SPY (1/4)	10/6/2008	\$107.15	\$88.50	-17.41%		
SPY (1/4)	10/7/2008	\$105.00	\$88.50	-15.71%		
SPY (1/4)	10/7/2008	\$100.03	\$88.50	-11.53%		
TWX	10/7/2008	\$11.23	\$9.19	-18.17%		Catapult
TWX	10/8/2008	\$10.40	\$9.19	-11.63%		Catapult
TYC	10/8/2008	\$28.35	\$26.19	-7.62%		Catapult
TYC	10/9/2008	\$28.60	\$26.19	-8.43%		Catapult
TYC	10/10/2008	\$25.73	26.19	1.79%		Catapult
XLB	10/7/2008	\$28.70	\$25.68	-10.52%		Catapult
XXR	10/8/2008	\$8.45	\$7.87	-6.86%		Catapult
XXR	10/9/2008	\$8.15	\$7.87	-3.44%		Catapult
XXR	10/10/2008	\$7.68	7.87	2.47%		Catapult

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