

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 21, 2008

Issue 171

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 19, 2008	Op-ex Friday < 200ma & down	1-2 days	Bearish	-1.60%	-3.00%
October 17, 2008	100-day high VIX no low SPX	1-10 days	Bullish	3.50%	6.90%
October 17, 2008	SPX retest succeeds	1-3 days	Bullish		
October 16, 2008	SPX big drop 50 low 5	1-17 days	Bearish	-3.40%	-5.90%
October 14, 2008	Nasdaq up 3% lowest vol in 5	1-17 days	Bearish	-10.00%	-17.63%
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) – slightly bearish – updated 10/21

A 2% gap higher this morning was followed by steady buying throughout the day. When it was all over the S&P and Dow were both up over 4% and the Nasdaq up over 3%. Breadth was strong as advancers outpaced decliners on the NYSE by over 4 to 1. Volume was extremely light, though, and the volume pattern could be a warning.

When the SPY gaps up 2% or more it typically closes below the gap open at some point in the next 3 days.

In a blog entry last week I showed a setup for the Nasdaq 100 where a 2% rise on the lightest volume in 5 days suggested bearish implications. Today that setup not only materialized again in the Nasdaq, but the S&P 500 as well.

NYSE volume is the lowest in 5 days while SPX closes 2% or more higher.										
Buy on close. Sell X days later. \$100k/trade. 1960-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$17,112.61)	21	8	13	38.10	\$2,647.49	(\$2,945.58)	0.90	0.55	(\$814.89)
9	(\$11,430.17)	21	9	12	42.86	\$2,495.64	(\$2,824.24)	0.88	0.66	(\$544.29)
8	(\$6,809.75)	21	13	8	61.90	\$2,008.24	(\$4,114.60)	0.49	0.79	(\$324.27)
7	(\$12,456.87)	21	9	12	42.86	\$2,588.09	(\$2,979.14)	0.87	0.65	(\$593.18)
6	(\$7,684.96)	21	12	9	57.14	\$2,277.14	(\$3,890.07)	0.59	0.78	(\$365.95)
5	(\$11,924.08)	21	11	10	52.38	\$1,973.44	(\$3,363.20)	0.59	0.65	(\$567.81)
4	(\$11,494.63)	21	11	10	52.38	\$1,746.29	(\$3,070.38)	0.57	0.63	(\$547.36)
3	(\$10,092.79)	21	9	12	42.86	\$1,491.30	(\$1,959.54)	0.76	0.57	(\$480.61)
2	\$2,573.28	21	11	10	52.38	\$1,335.41	(\$1,211.62)	1.10	1.21	\$122.54
1	\$5,080.30	21	11	10	52.38	\$954.73	(\$542.17)	1.76	1.94	\$241.92

Here we see more evidence that extremely light volume on strong up days tends to act as a negative.

The low overall volume wasn't the only volume warning today. Our [S&P 500 Volume SPYX](#) closed at 36. On its own, a reading that low would suggest underperformance. When combined with the fact that the reading came on a day that the S&P 500 rose over 2%, results look short-term bearish:

S&P 500 rises over 2%. S&P volume Spyx closes under 50.										
Buy on close. Sell X days later. \$100k/trade. Last 8 years.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$29,922.82)	20	7	13	35.00	\$3,675.94	(\$4,281.11)	0.86	0.46	(\$1,496.14)
9	(\$20,545.37)	21	10	11	47.62	\$2,960.08	(\$4,558.74)	0.65	0.59	(\$978.35)
8	(\$32,545.83)	22	8	14	36.36	\$3,132.86	(\$4,114.91)	0.76	0.44	(\$1,479.36)
7	(\$56,657.79)	24	7	17	29.17	\$3,225.70	(\$4,661.04)	0.69	0.28	(\$2,360.74)
6	(\$45,400.90)	24	7	17	29.17	\$2,665.77	(\$3,768.31)	0.71	0.29	(\$1,891.70)
5	(\$25,603.21)	26	10	16	38.46	\$1,998.31	(\$2,849.15)	0.70	0.44	(\$984.74)
4	(\$21,543.32)	28	14	14	50.00	\$1,267.03	(\$2,805.84)	0.45	0.45	(\$769.40)
3	(\$18,910.98)	28	11	17	39.29	\$1,411.48	(\$2,025.72)	0.70	0.45	(\$675.39)
2	(\$21,469.58)	29	9	20	31.03	\$1,650.80	(\$1,816.34)	0.91	0.41	(\$740.33)
1	(\$1,801.41)	30	15	15	50.00	\$1,002.61	(\$1,122.70)	0.89	0.89	(\$60.05)

The 2% gain on its own is not a bad thing. To illustrate this below are the stats for a 2% gain accompanied by a SPYX reading above 50:

S&P 500 rises over 2%. S&P volume Spyx closes OVER 50.										
Buy on close. Sell X days later. \$100k/trade. Last 8 years.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$1,290.82	30	15	15	50.00	\$2,778.06	(\$2,692.01)	1.03	1.03	\$43.03
9	\$8,173.14	30	15	15	50.00	\$3,068.95	(\$2,524.07)	1.22	1.22	\$272.44
8	\$16,602.09	32	18	14	56.25	\$3,015.28	(\$2,690.92)	1.12	1.44	\$518.82
7	\$11,127.46	32	17	15	53.13	\$3,135.93	(\$2,812.22)	1.12	1.26	\$347.73
6	\$21,088.19	35	21	14	60.00	\$2,904.44	(\$2,850.35)	1.02	1.53	\$602.52
5	\$17,957.41	37	23	14	62.16	\$2,210.37	(\$2,348.65)	0.94	1.55	\$485.34
4	\$8,296.93	38	21	17	55.26	\$2,264.81	(\$2,309.65)	0.98	1.21	\$218.34
3	\$12,880.57	40	23	17	57.50	\$2,314.67	(\$2,373.93)	0.98	1.32	\$322.01
2	\$11,634.86	44	26	18	59.09	\$1,566.07	(\$1,615.71)	0.97	1.40	\$264.43
1	(\$702.35)	45	23	22	51.11	\$1,057.76	(\$1,137.76)	0.93	0.97	(\$15.61)

Higher SPYX readings along with the 2% gain actually produce positive results. In other words, the reading appears to be acting as it has been designed and providing us an edge here. I'll be posting more information on Volume SPYX in the detailed charts area shortly.

The sharp rise today also caused some of the indicators I mentioned last night to move off their extremes. The CBI dropped from 13 to 7. Several components are near their exit triggers and I will send out intraday updates tomorrow should the number drop back near neutral. T2114, which measure the pct of stocks trading at least one standard deviation below their 40-ma dropped from 90 to 78 today. The drops in both of these indicators were sizable. In both cases the readings still remain somewhat elevated, but not nearly as extreme as before Monday's rally.

The VIX on the other hand, went from over 10% above its 10-ma yesterday to over 10% below its 10-ma today. I checked and this has only happened once before – 6/15/06. It's not good practice to try and draw conclusions from only one instance, but below is a chart for those who are curious:



Lastly, tonight's **Aggregator** chart is below:



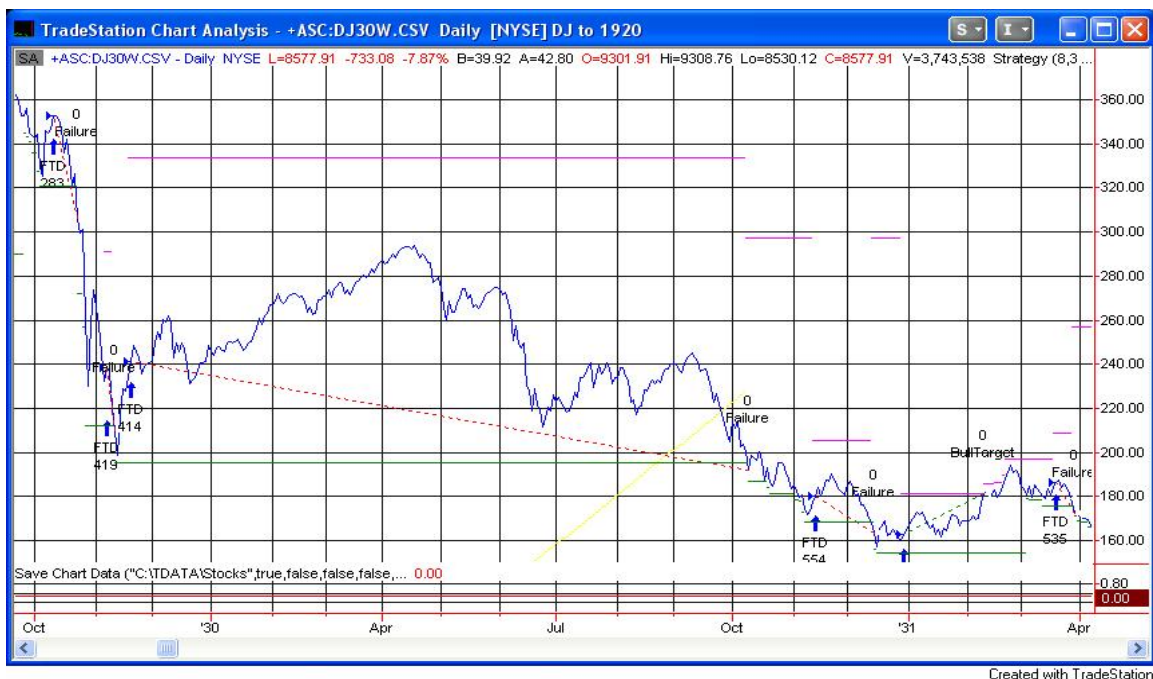
Both the green Aggregator Line and the black differential lone have moved below 0. This suggests a bearish outlook over the next few days. It is a setup I would normally look for to go short. As I've mentioned in the past, when coming off of potential bottoms the market is more capable of turning overbought and staying there than at any other time. Due to this, shorting can carry more risk than usual. Therefore, rather than looking to simply short at Monday's closing price, I'm going to require the SPY to move up a bit more before beginning to scale in. Details in the trade idea section below.

Intermediate-term Outlook (1 week – 2 months)–neutral -updated 10//20

From an intermediate-term standpoint it appears we are at a point where the upside potential is significantly greater than the downside risk of the market. Extremes noted last week were massive. Most of them have begun to back off – with the notable exceptions being the VIX and the average true range %'s discussed above. Extremes anywhere near the magnitudes we've seen have typically been followed by a tradeable multi-week or multi-month bounce.

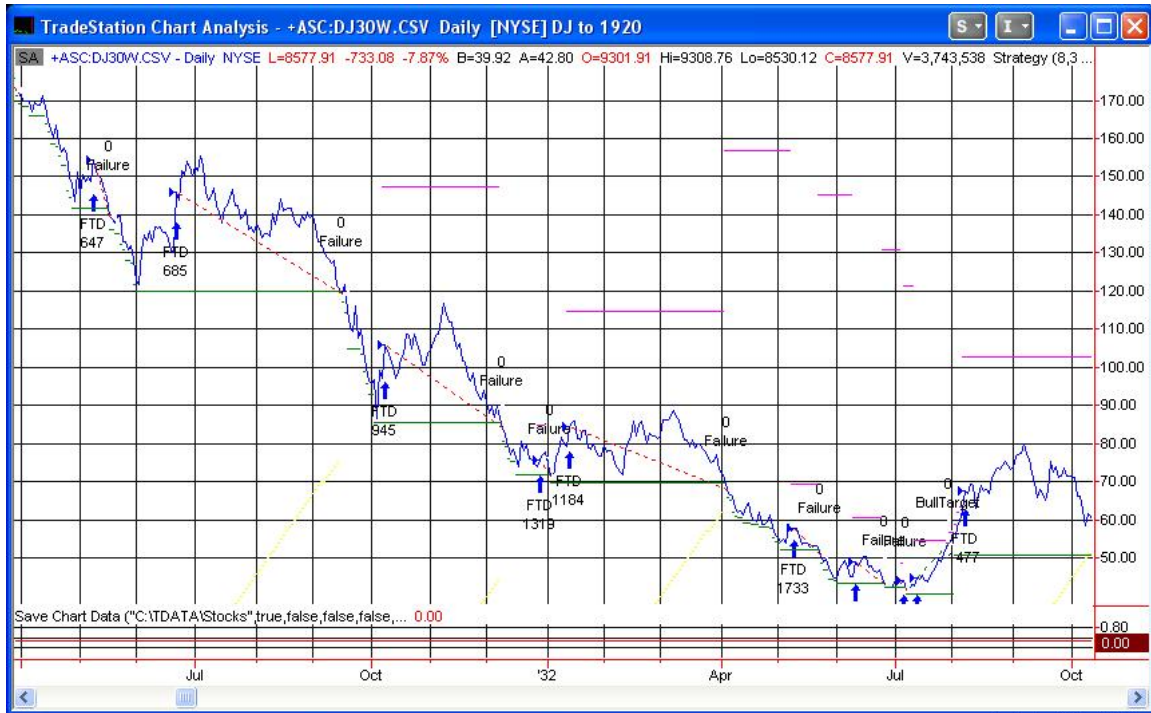
We did see some signs of strength this past week, with strong moves on both Monday and Thursday. Monday qualified as a 90% upside day according to Lowry's definition and study. Thursday met the criteria for a Follow-Through-Day (FTD). I've previously shown both studies to be about 50% reliable in the S&P 500 since about 1970.

In [Wednesday's blog](#) I compared the current market crash to the one in 1929. I thought it would be interesting to see how FTD's performed following the 1929 crash. As a brief reminder, "success" for a FTD would entail either 1) The market making a new high or 2) a rally from the close of the FTD that equals at least twice the distance from the low to the FTD. Below are charts spanning the period from 1929 to in 1932.



In this chart we see several failures and one FTD that led to a rally meeting its target. While it didn't meet the definition of success, the rally in the early part of 1930 was actually the best over the time period.

Next is '31 – '32:



Created with TradeStation

Plenty more failures are seen here before the market finally bottoms in mid-1932. All told there were 13 failed FTD's and one successful one before the 1932 bottom arrived. So far since the top in 2007 we have seen 5 FTD's lead to failed rallies.

Even assuming the fact that FTD's are especially unreliable in environments such as the current one, I still feel the market is near a point where a tradeable rally should emerge. It could happen immediately. It could happen after another sharp leg down as happened in 1929. It could happen after drifting sideways for several weeks a la 1987. In any case I anticipate favoring long-side opportunities over short-side opportunities during the coming weeks. Even if we do get the tradeable rally I'm anticipating, I would not be surprised if the market revisited or exceeded the current lows once the rally had run its course over the next few weeks or months.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

Although I closed out all open Catapult trades Tuesday morning, 7 Catapults triggers have not yet officially satisfied their exit criteria. They are listed below under "Broad Market Large Cap CBI". They could provide 2nd entry opportunities.

Catapult for ETF's Trades

None

Broad Market Large Cap CBI -7/4 (AA-3, AIG-2, CBS, 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	0.00	DJ US Financial	IYF	1.03
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	3.52
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	1.92
DJ US Oil Equip & Svcs	IEZ	9.62	DJ US Consumer Goods	IYK	5.44
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	2.70
DJ US Healthcare Providers	IHF	8.16	DJ US Real Estate	IYR	0.00
DJ US Medical Devices	IHI	4.88	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	2.78	DJ US Technology Sector	IYW	2.01
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	2.63
DJ US Consumer Svcs	IYC	5.26	Nasdaq 100	QQQQ	3.00

CBI levels continue to drop.

Additional New Trade Ideas

SPY – short 1/4 position @ \$101.50 limit or short on close above \$99.00. Due to the extra risk inherent with shorting after an intermediate-term low along with the slightly positive intermediate-term outlook, I'd like to get in to this one a bit higher. I'll take an entry on either an intraday spike or a close higher. Two up closes have been a solid short signal over the last 16 months, which would add to the bearish short-term outlook.

Active Trades Table

None

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