

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 22, 2008

Issue 172

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 22, 2008	NR10 Low Vol 10 SPX under 200	1-12 days	Bearish	-4.05%	-8.48%
October 21, 2008	S&P up 2% - SPYX under 50	1-7 days	Bearish	-4.20%	-8.96%
October 17, 2008	100-day high VIX no low SPX	1-10 days	Bullish	3.50%	6.90%
October 16, 2008	SPX big drop 50 low 5	1-17 days	Bearish	-3.40%	-5.90%
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 10/22

The large gap lower this morning led to another choppy day. At the end the markets ended up with sizable losses. Breadth was strongly negative as decliners doubled advancers and down volume outnumbered up volume by 4 to 1. Volume came very light for the 2nd day in a row. Other notable action included the fact that it was the narrowest range in 2 weeks and despite the 3% drop in the SPX, the VXO barely budged.

The VXO in fact closed over 15% below its 10-day MA for the 2nd day in a row. I looked for other times when the S&P fell 3% and the VXO closed 15% below its 10-period moving average. This was the first. In fact, only once has there been a 3% SPX drop where the VXO closed below its 10ma at all. That was on 3/24/03.

I loosened the criteria and looked at 1% SPX drops where the VXO closed 10% below its 10ma:

SPX loses at least 1% today. VXO closes 10% below its 10ma.										
Buy on close. Sell X days later. \$100k/trade. 1986-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
6	(\$6,648.94)	8	3	5	37.50	\$1,595.44	(\$2,287.05)	0.70	0.42	(\$831.12)
5	(\$4,667.81)	8	3	5	37.50	\$1,919.49	(\$2,085.26)	0.92	0.55	(\$583.48)
4	(\$2,317.97)	9	5	4	55.56	\$1,683.10	(\$2,683.36)	0.63	0.78	(\$257.55)
3	(\$1,009.74)	10	5	5	50.00	\$1,274.39	(\$1,476.34)	0.86	0.86	(\$100.97)
2	(\$968.64)	10	6	4	60.00	\$1,254.45	(\$2,123.83)	0.59	0.89	(\$96.86)
1	(\$2,586.01)	11	5	5	45.45	\$704.97	(\$1,222.18)	0.58	0.58	(\$235.09)

There appears to be a slight downside edge over the following week+, but the number of instances is too small for comfort. This study, while interesting, does not qualify for the “Active List”.

In tomorrow’s blog I’ll show S&P performance following other times the VXO closed 15% below its 10ma for 2 days in a row. Most traders will be surprised to see it does NOT provide a short-term bearish edge.

The range and volume contraction were seemingly more significant when assessing today’s action. Below is a study related to that:

SPX has NR10 day on lightest volume in 10 days and closes under 200ma.
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
15	(\$76,172.38)	65	30	35	46.15	\$2,570.70	(\$4,379.81)	0.59	0.50	(\$1,171.88)
14	(\$78,978.32)	67	35	32	52.24	\$2,170.02	(\$4,841.54)	0.45	0.49	(\$1,178.78)
13	(\$80,586.51)	68	35	33	51.47	\$2,030.89	(\$4,595.99)	0.44	0.47	(\$1,185.10)
12	(\$79,385.70)	68	35	33	51.47	\$1,934.73	(\$4,457.61)	0.43	0.46	(\$1,167.44)
11	(\$67,494.74)	72	33	39	45.83	\$2,206.21	(\$3,597.43)	0.61	0.52	(\$937.43)
10	(\$45,223.74)	74	38	36	51.35	\$2,139.86	(\$3,514.96)	0.61	0.64	(\$611.13)
9	(\$42,040.54)	74	39	35	52.70	\$1,865.02	(\$3,279.33)	0.57	0.63	(\$568.12)
8	(\$37,100.86)	74	37	37	50.00	\$1,977.66	(\$2,980.39)	0.66	0.66	(\$501.36)
7	(\$40,311.84)	74	33	41	44.59	\$2,182.89	(\$2,740.18)	0.80	0.64	(\$544.75)
6	(\$51,911.03)	76	32	44	42.11	\$1,882.40	(\$2,548.81)	0.74	0.54	(\$683.04)
5	(\$37,012.97)	78	36	42	46.15	\$1,823.63	(\$2,444.37)	0.75	0.64	(\$474.53)
4	(\$45,070.12)	79	34	45	43.04	\$1,499.34	(\$2,134.40)	0.70	0.53	(\$570.51)
3	(\$41,288.21)	79	30	48	37.97	\$1,553.33	(\$1,831.00)	0.85	0.53	(\$522.64)
2	(\$29,729.41)	79	33	46	41.77	\$1,271.03	(\$1,558.12)	0.82	0.59	(\$376.32)
1	(\$18,586.01)	84	35	49	41.67	\$928.49	(\$1,042.52)	0.89	0.64	(\$221.26)

Results over the following 3 weeks were consistently negative. Also notable is that 80% of the instances had a close lower than the entry trigger within the first week.

Tonight’s [Aggregator](#) chart is below:



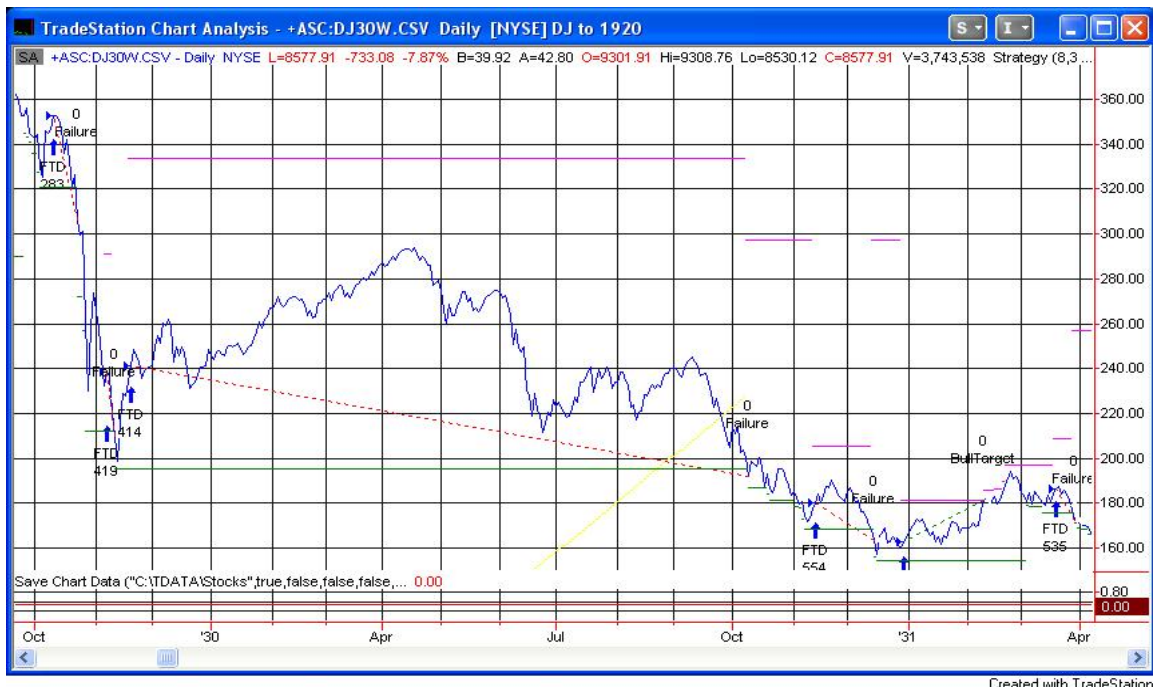
Both the green Aggregator Line and the black differential line remain below 0. This again suggests a bearish outlook over the next few days. The only thing keeping me from attempting a short entry is the position of the market. I normally like to buy at the outer ends of ranges. I don't like the fact that the market fell 3% today and is squarely in the middle of its 7-day range from the lowest low to the high of the bounce. While the studies are suggesting bearish implications, mid-range means risk/reward is near break-even, rather than strongly in our favor. Therefore, I will be passing on a possible entry again tonight so that I may wait for a better one in the coming days.

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:



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	3.49
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	0.00	DJ US Healthcare	IYH	2.82
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	1.92
DJ US Oil Equip & Svcs	IEZ	5.77	DJ US Consumer Goods	IYK	4.08
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	2.70
DJ US Healthcare Providers	IHF	4.08	DJ US Real Estate	IYR	1.22
DJ US Medical Devices	IHI	2.44	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	3.95	Nasdaq 100	QQQQ	2.00

No longer is significant Capitulation being seen in any of the sectors tracked.

Additional New Trade Ideas

None tonight. The choppy narrowing action has most stocks and ETF's on the target list sitting mid-range as well. I'm simply not seeing any strong edges right now and am continuing to exercise caution until I do.

Active Trades Table

None

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