

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 23, 2008

Issue 173

## 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 20	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.

Note – The 10/22 study came within less than 1 S&P point of reach the Avg Max + 1 Std Dev. I'm calling it "close enough". The study will be removed from the active list.

### *Short-term Outlook (1-5 days) – approaching bullish – updated 10/23*

Another strong selloff today put the SPX and the NDX at new closing lows for the bear. Volume rose and breadth was extremely negative. Action was pretty typical of the kind we've seen on these big selloff days in the last month.

How incredible has the market action been of late? Since 1960 the S&P has had 14 days where the market sold off 5% or more. The 1987 crash accounted for 3 of them. The 2000-2002 bear market only had 1 – on 4/14/2000. In the last month the S&P 500 has seen 5 days with losses of 5% or more.

While the drop was sharp today I'm not seeing the kind of stretched readings that would get me excited about buying just yet. As I discussed last night, I prefer not to trade within ranges except near the outer edge. We're nearing the outer edge but not yet there. If the market continues to sell off there is a good chance I'll see some strong indications to buy. To illustrate the significance of being range-bound I've produced the following study:

SPX closes down at least 2% and makes a 5-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
5	\$63,122.16	120	66	54	55.00	\$2,740.99	(\$2,181.17)	1.26	1.54	\$526.02
4	\$23,400.62	125	66	59	52.80	\$2,353.47	(\$2,236.08)	1.05	1.18	\$187.20
3	\$44,959.11	132	77	55	58.33	\$2,309.62	(\$2,416.03)	0.96	1.34	\$340.60
2	\$53,762.33	139	80	59	57.55	\$2,149.45	(\$2,003.28)	1.07	1.45	\$386.78
1	\$17,141.78	147	83	64	56.46	\$1,356.96	(\$1,491.97)	0.91	1.18	\$116.61

The above results show that buy a strong selloff of 2% or more have been net positive over the last 30 years when the selling results in new short-term lows. Now the same test with the stipulation that no 5-day low is made (similar to Wednesday):

SPX closes down at least 2% but doesn't make a 5-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
5	(\$34,488.07)	45	22	23	48.89	\$2,527.76	(\$3,917.34)	0.65	0.62	(\$766.40)
4	(\$4,436.02)	45	21	24	46.67	\$3,000.35	(\$2,810.14)	1.07	0.93	(\$98.58)
3	(\$6,030.00)	47	24	23	51.06	\$2,463.34	(\$2,832.61)	0.87	0.91	(\$128.30)
2	(\$4,537.06)	48	24	24	50.00	\$2,138.27	(\$2,327.31)	0.92	0.92	(\$94.52)
1	(\$896.49)	50	25	25	50.00	\$1,432.77	(\$1,468.63)	0.98	0.98	(\$17.93)

Here we go from net profitable for each time frame to unprofitable for each time frame.

The 2% gap open this morning may be looked at as a positive for the next few days. Last week I showed that 2% gaps up have a tendency to reverse course at some point over the next few days. Amazingly we've seen it happen three times since then. The edge isn't quite as strong for 2% gaps down, but they to have a strong tendency to reverse over the next few days. I'm hoping to post a study to the blog tonight or tomorrow illustrating this.

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



The elimination of the two bearish studies tonight has flipped the green Aggregator line positive, but only to the point where it's about equivalent with the long-term drift of the

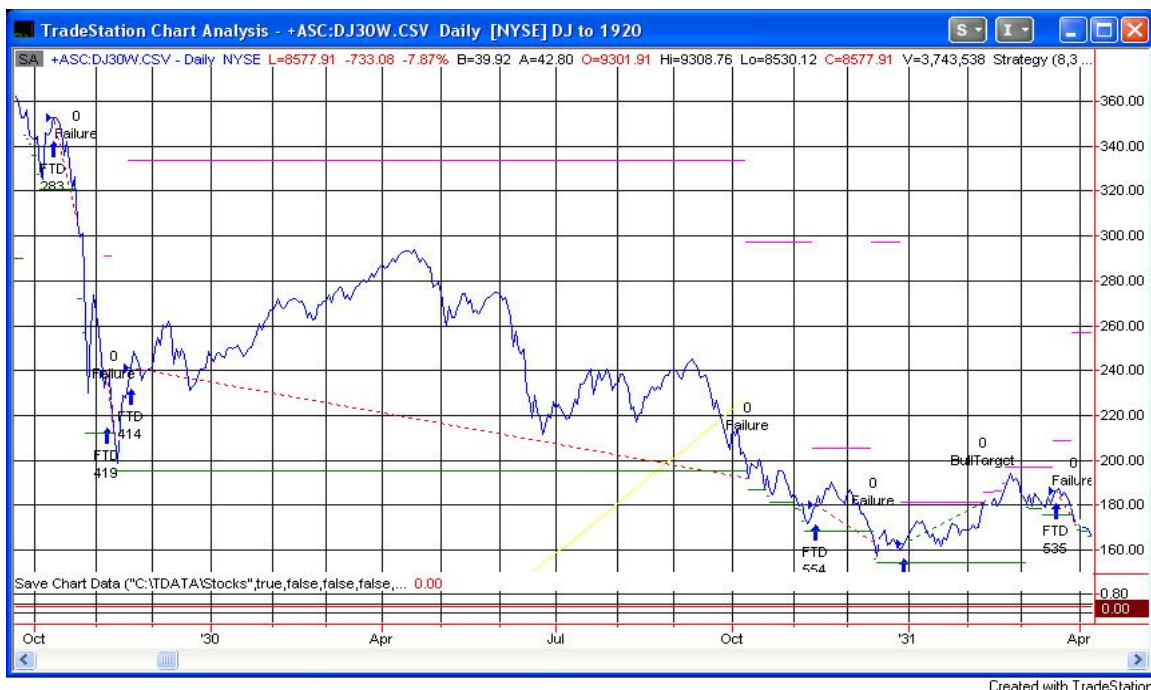
market. The black differential line is now strongly positive – meaning the market has largely underperformed even the bearish expectations we had over the last 3 days. A little more selling and we could be nearing a buy area worth taking a shot.

***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.

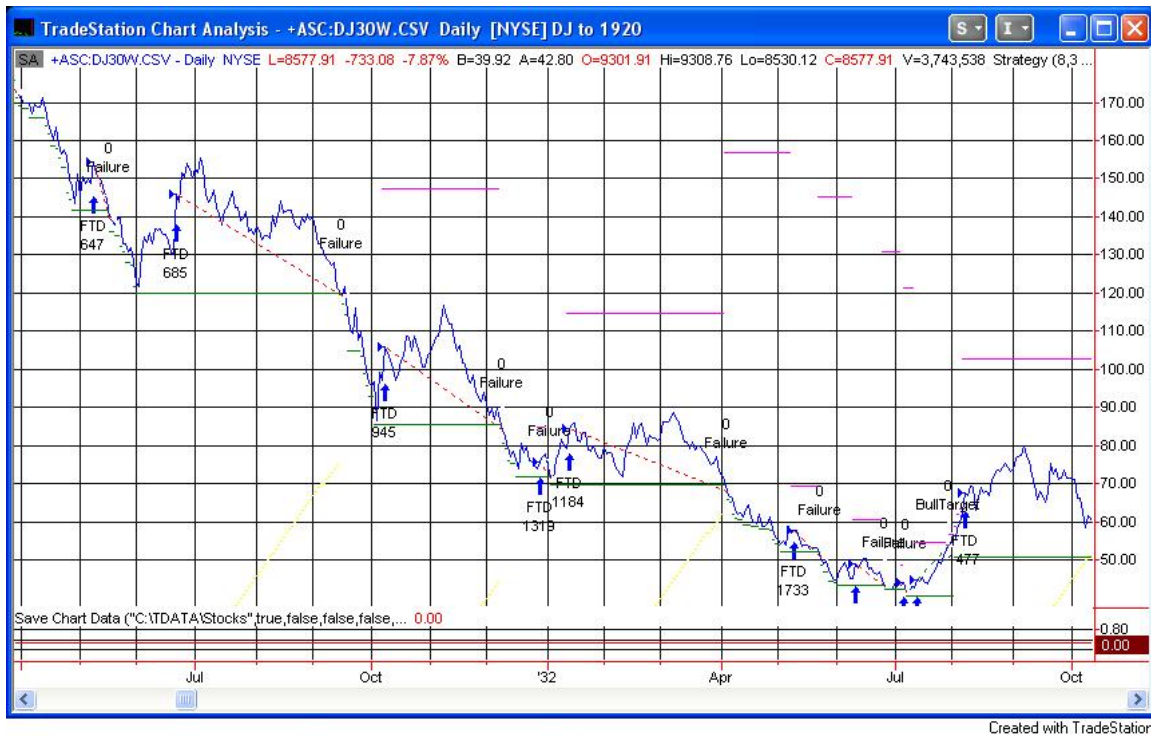
We did see some signs of strength this past week, with strong moves on both Monday and Thursday. Monday qualified as a 90% upside day according to Lowry’s definition and study. Thursday met the criteria for a Follow-Through-Day (FTD). I’ve previously shown both studies to be about 50% reliable in the 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 2<sup>nd</sup> 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.)***

<b>Index</b>	<b>ETF</b>	<b>CBI %</b>	<b>Index</b>	<b>ETF</b>	<b>CBI %</b>
DJ US Broker Dealers	IAI	0.00	DJ US Energy	IYE	3.49
DJ US Insurance Index	IAK	1.35	DJ US Financial	IYF	2.05
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	2.11
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	2.30
DJ US Oil Equip & Svcs	IEZ	5.77	DJ US Consumer Goods	IYK	6.12
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	4.05
DJ US Healthcare Providers	IHF	4.08	DJ US Real Estate	IYR	6.10
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	6.14	Nasdaq 100	QQQQ	4.00

*Not much of a spike today anywhere. We likely won't see real large spikes unless the 10/10 lows are broken..*

**Additional New Trade Ideas**

*None tonight. I'm still seeing next to nothing that interests me.*

One notable on my radar that could lead to an entry in the next night or two is FXE. It has closed lower 6 days in a row and today the selloff accelerated. It's looking primed for a reversal.

**Active Trades Table**

*None*

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2008 Hanna Capital Management, LLC