

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 27, 2008

Issue 175

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 27, 2008	Gap Dn 2% & Rvs Up Still Close <	1-2 Days	Bullish	1.80%	3.00%
October 27, 2008	Up Iss 10 MA<.375 SP 100 low	1-10 Days	Bullish	4.57%	9.12%
October 24, 2008	Up Issues < 40% on Up Day	1-5 days	Bearish	-3.35%	-6.50%
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 bullish – updated 10/27

The market seemed to avoid a global crash Friday – at least for a day. Before the market open the futures were locked limit down in the Dow, S&P, and Nasdaq. The SPY opened over 8% lower and buying began immediately at the opening bell. It rallied until just after 11:30, at which point the market settled into a wide range. Near its highs with only a few minutes to go, some strong selling arrived in the last few minutes. At the end the S&P finished down about 3.5%, the Dow 3.6% and the Nasdaq 3.2%. The range was once again extremely large. Volume, meanwhile was quite light. It came in lower than the day before and also under its 10-day average. Breadth was strongly negative as down issues outnumbered up issues on both the NYSE and Nasdaq by about 4:1. The up volume : down volume ratios were a bit worse than that.

While the Nasdaq made new lows, the S&P 500 managed to hold above the October 10 lows both with the index and the SPY. This is a bit deceiving, though. While futures were locked limit down pre-open, the SPY was still trading. The October 10 low for the SPY was \$83.58. With about 15 minutes to go before the open the SPY was trading at \$83.38. It was only a quick rally within the 15 minutes before the open that kept the SPY from showing a lower low on the daily charts.

I first looked at the pattern of a big gap down that rises from open to close but still finishes down on the day:

<i>SPY gapped lower by at least 2%, closed above its open but under yesterday's close.</i>												
<i>Buy on close. Sell X days later. \$100k/trade. 1993-present.</i>												
X Days	Net Profits	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
6	\$34,497.53	17	11	6	64.71	\$11,639.99	(\$5,563.56)	\$4,530.61	(\$2,556.53)	1.77	3.25	\$2,029.27
5	\$26,721.36	17	9	8	52.94	\$9,745.82	(\$4,592.28)	\$4,981.92	(\$2,264.50)	2.20	2.48	\$1,571.84
4	\$26,294.70	18	11	7	61.11	\$7,370.70	(\$6,753.24)	\$4,153.25	(\$2,770.15)	1.50	2.36	\$1,460.82
3	\$23,404.17	18	12	6	66.67	\$5,984.25	(\$5,377.58)	\$2,790.73	(\$1,680.77)	1.66	3.32	\$1,300.23
2	\$27,672.88	18	13	5	72.22	\$12,814.15	(\$2,480.64)	\$2,961.22	(\$2,164.60)	1.37	3.56	\$1,537.38
1	\$23,519.14	19	11	8	57.89	\$14,507.65	(\$4,496.31)	\$3,052.17	(\$1,256.84)	2.43	3.34	\$1,237.85

While the number of instances is a little low, there's a decent tendency to see some upside in the next couple of days. The Max Win should be noted though, since it does skew the other stats a bit. Even without that trade, after 2 days the SPY has risen 12 of 17 times and the Average Trade would have been about 0.9%. Of the 19 instances, 17 of them (89.5%) finished above the entry trigger at some point within 4 days. Looking out 9 days, all instances would have had a close above the trigger price.

From a breadth standpoint the 10-period EMA of the Up Issues % has now reached below 37.5% - a number that has typically led to short-term market reversals. More information and research on this indicator can be found on its [chart page](#). I looked at other times this indicator has been stretched below 37.5% and the SPX has made a 100-day low:

10-day Exp MA of Advancers / (Advancers + Decliners) < 0.375. S&P 500 closes at 100-day low.												
Buy on close. Sell X days later. \$100k/trade. 1982-present.												
X Days	Net Profits	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	\$70,547.28	22	16	6	72.73	\$18,816.00	(\$21,377.88)	\$6,824.26	(\$6,440.14)	1.06	2.83	\$3,206.69
15	\$53,260.32	22	15	7	68.18	\$14,585.60	(\$14,747.28)	\$5,743.73	(\$4,699.37)	1.22	2.62	\$2,420.92
10	\$52,314.65	24	17	7	70.83	\$15,280.64	(\$10,911.23)	\$4,449.09	(\$3,331.41)	1.34	3.24	\$2,179.78
9	\$32,596.88	24	16	8	66.67	\$14,515.20	(\$13,385.76)	\$4,158.90	(\$4,243.18)	0.98	1.96	\$1,358.20
8	\$27,700.04	26	18	8	69.23	\$15,738.88	(\$18,505.77)	\$4,300.12	(\$6,212.76)	0.69	1.56	\$1,065.39
7	\$22,635.00	26	16	10	61.54	\$13,776.64	(\$17,473.50)	\$4,160.30	(\$4,392.97)	0.95	1.52	\$870.58
6	\$14,814.01	26	16	10	61.54	\$13,112.32	(\$19,425.59)	\$4,246.60	(\$5,313.15)	0.80	1.28	\$569.77
5	\$5,313.79	26	15	11	57.69	\$10,657.28	(\$12,167.91)	\$2,782.13	(\$3,310.74)	0.84	1.15	\$204.38
4	\$3,166.66	30	19	11	63.33	\$13,377.28	(\$14,820.98)	\$2,723.39	(\$4,416.16)	0.62	1.07	\$105.56
3	\$17,847.72	33	20	13	60.61	\$9,601.81	(\$13,815.18)	\$3,125.10	(\$3,434.94)	0.91	1.40	\$540.84
2	\$15,516.32	41	25	16	60.98	\$10,965.69	(\$16,188.58)	\$3,223.83	(\$4,067.47)	0.79	1.24	\$378.45
1	(\$1,022.28)	56	30	26	53.57	\$11,558.43	(\$20,424.58)	\$2,269.84	(\$2,658.37)	0.85	0.99	(\$18.26)

It has commonly led to some fairly strong returns over the next few weeks.

Interestingly, the Nasdaq also triggered this same setup on Thursday. My data for the Nasdaq does not go back as far. Below are results of the same test as was above from 1998-present for the Nasdaq:

Nasdaq 10-day Exp MA of Advancers / (Advancers + Decliners) < 0.375. Nasdaq closes at 100-day low.												
Buy on close. Sell X days later. \$100k/trade. 1998-present												
X Days	Net Profits	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
15	\$38,785.31	11	9	2	81.82	\$12,317.76	(\$20,163.36)	\$6,656.89	(\$10,563.36)	0.63	2.84	\$3,525.94
14	\$47,136.76	11	10	1	90.91	\$14,865.90	(\$17,517.48)	\$6,465.42	(\$17,517.48)	0.37	3.69	\$4,285.16
13	\$42,739.91	11	10	1	90.91	\$11,968.50	(\$16,913.64)	\$5,965.36	(\$16,913.64)	0.35	3.53	\$3,885.45
12	\$39,133.62	11	10	1	90.91	\$11,576.10	(\$12,786.21)	\$5,191.98	(\$12,786.21)	0.41	4.06	\$3,557.60
11	\$32,244.33	11	9	2	81.82	\$13,924.80	(\$9,045.36)	\$5,198.28	(\$7,270.11)	0.72	3.22	\$2,931.30
10	\$24,113.57	11	8	3	72.73	\$19,103.70	(\$12,041.10)	\$5,311.37	(\$6,125.79)	0.87	2.31	\$2,192.14
9	\$24,678.47	11	7	4	63.64	\$16,181.10	(\$11,713.68)	\$6,221.73	(\$4,718.40)	1.32	2.31	\$2,243.50
8	\$26,854.77	11	9	2	81.82	\$13,582.50	(\$16,272.06)	\$5,623.75	(\$11,879.49)	0.47	2.13	\$2,441.34
7	\$4,241.40	12	7	5	58.33	\$12,691.84	(\$8,587.38)	\$4,498.30	(\$5,449.33)	0.83	1.16	\$353.45
6	\$33,266.88	12	8	4	66.67	\$13,144.00	(\$5,260.14)	\$6,110.44	(\$3,904.16)	1.57	3.13	\$2,772.24
5	\$14,800.45	12	8	4	66.67	\$11,091.84	(\$15,461.16)	\$5,247.76	(\$6,795.40)	0.77	1.54	\$1,233.37
4	\$15,929.96	14	10	4	71.43	\$9,677.70	(\$15,415.77)	\$4,397.25	(\$7,010.63)	0.63	1.57	\$1,137.85
3	\$32,952.18	14	11	3	78.57	\$11,553.60	(\$10,560.06)	\$4,644.03	(\$6,044.04)	0.77	2.82	\$2,353.73
2	\$40,448.62	16	12	4	75.00	\$14,168.40	(\$9,818.01)	\$5,539.42	(\$6,506.12)	0.85	2.55	\$2,528.04
1	\$24,745.36	22	12	10	54.55	\$12,001.20	(\$5,728.24)	\$4,539.49	(\$2,972.86)	1.53	1.83	\$1,124.79

Low instances, but some strong returns over the next few weeks. Of note is that from 12-14 days out there was only one losing trade. That trade was the last one triggered on 10/3/08.

The percentage of stocks hitting new lows has once again increased to extreme levels typically seen prior to sharp reversals. The Nasdaq saw 23.6% of issues traded hit new lows. While this is far below the 44% that was achieved earlier in the month, it is still more extreme than anything seen during the 2000-2002 bear market where the Nasdaq lost about 80% of its value. My data for the Nasdaq only goes back to 1994, but other than 2 days in 1998, and earlier this month, this is most extreme reading that has been seen over that time period.

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



The green Aggregator line is slightly bullish. With the incredible volatility the market has experienced lately, it's making the green Aggregator line appear almost flat. Meanwhile, the black differential line is showing that the market has strongly underperformed expectations over the last 3 days. Based on the current studies, the green Aggregator is set to weaken over the next couple of days. There does appear to be a bit of a short-term upside edge. In a market as volatile as this one though, I'd prefer to wait for a stronger edge before risking too much capital. I'll use weakness early in the week to scale into some positions in anticipation of a bounce. Should the weakness not arrive – I'll pass and wait for the next edge to appear.

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

I generally list the time frame of the Intermediate-term Outlook to be 2 weeks – 3 months. In this market environment 3 months appears to be farther out than I'd be comfortable anticipating. By several measures I've discussed lately the action over the past 4 weeks has been worse than anything ever witnessed. Historical comparisons are few outside of the Crash of '29 and to a lesser degree the Crash of '87. More than anything this suggests to me that we are at a period in time that is unique in many ways.

It is very difficult to time the market when many indicators have posted and continue to post readings that have rarely or never been seen before. A couple of weeks ago I showed a table with some incredible historical extremes I was seeing. The suggestion was that the market was more overdue for a bounce than it had ever been by many measures. That bounce arrived on 10/13. It was one of the strongest one-day rallies in the history of the market. It lasted until just after the opening bell the next day.

Rallies from conditions as extreme as we saw 2 weeks ago should last longer than 1-2 days – especially when they begin so strong. We are now hitting new extremes for several of the same indicators along with some new ones:

Current Condition	Severity
Breadth Extremes	
% Stocks 2 Std Dev Below 200 MA = 86%	Highest since data available back to 1986
% Stocks 1 Std Dev Below 200 MA = 95%	Highest since data available back to 1986
Price Extremes	
SPX over 32% below 200ma	Since 1960 (as far back as data goes) this is the lowest
Dow Industrials 29% below 200ma	10/10/2008 was slightly lower - other than that this is the lowest since 1938.
Volatility Extremes	
VIX close @ 79.13 and high @ 89.53	Both all time high (back to 1990)
SPY 20-period Avg True Range = 7.6%	Highest since SPY inception
SPY 10-period Absolute Avg Gap = 3.07%	Highest since SPY inception
S&P 500 20-per. Avg True Range = 6.70%	Highest since at least 1960

Some truly incredible numbers here. Most astonishing to me is the fact that the SPY has gapped an AVERAGE of 3% during the last 2 weeks. Again, this is suggesting a bounce should be in the cards here fairly soon. I believe the next strong bounce is likely to result in at least a multi-week rally similar to those we saw coming off the January, March and July “bottoms”.

My visibility beyond that is poor and will depend largely upon how the world economies react to the global stimulus plans currently in place.

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.

New Triggers

MA – buy 1/3 @ \$130.62 – 2nd trigger for MA. The first one was good for a nice day-trade on Friday. I will look to open a new 1/3 position in MA on Monday based on the new trigger.

Catapult for ETF’s Trades

None

Broad Market Large Cap CBI –9/5 (AA-3, AIG-2, CBS, GD, MA-2)

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	7.88
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	1.40
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	6.34
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	7.28
DJ US Oil Equip & Svcs	IEZ	5.77	DJ US Consumer Goods	IYK	12.24
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	5.41
DJ US Healthcare Providers	IHF	14.29	DJ US Real Estate	IYR	24.39
DJ US Medical Devices	IHI	12.20	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	5.56	DJ US Technology Sector	IYW	7.04
DJ US Home Construction	ITB	4.76	DJ US Telecommunications	IYZ	5.26
DJ US Consumer Svcs	IYC	15.35	Nasdaq 100	QQQQ	8.00

Two notables that made big jumps this week are Consumer Services and Real Estate. The suggests two things to me: 1) They should bounce strongly when the market bounces. And 2) A strong bounce in these areas should not be mistaken for true strength or leadership. They will likely bounce the most because they're stretched the farthest. Much of the expected bounce in those areas will likely be due to short-covering.

Additional New Trade Ideas

SPY – buy ¼ position on *close* below \$86.50. As discussed in short-term market outlook above, I will look to take advantage of weakness this week. The first possible buy would be at tomorrow's close.

Also see new MA trade idea in Catapult section.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
MA	10/24/2008	\$121.01	\$131.00	8.26%		closed

MA was closed based on the \$131 stop sent out as an intraday update.

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