

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 31, 2008

Issue 179

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 31, 2008	2 Strong Breadth Days Under 200	1-5 days	Bearish	-3.20%	-5.90%
October 31, 2008	3 Up Days & Low Spyx Reading	1-10 days	Bearish	-4.60%	-7.58%
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) – neutral – updated 10/31

The market put in a strong day today. The S&P gapped higher by close to 3% and the Nasdaq over 2%. After some intraday give-back the market managed a strong finish. The major indices all closed higher by 2% or more and above their opening gaps. Breadth was strong as advancers outpaced decliners on the NYSE by more than 4 to 1. Volume was weak, though as it declined for a 2nd day in a row.

As I noted in the [blog recently](#), very large gaps of 2% or more have a tendency to pull back at some point over the following few days. The fact that the market added to its opening gains today suggests a pullback is likely within the next few days. [Tonight's blog shows](#) that late surges as the market experienced in the last 10 minutes today have a tendency to reverse the next day.

In addition to that, the action in the Nasdaq seems to be providing a bit of an edge from a few perspectives. First, breadth has become a bit overdone:

<i>Nasdaq Advancers Outnumber Decliners By At Least 3 to 2 for 3 Days In A Row</i>										
<i>Buy on close. Sell X days later. \$100k/trade. 1999 - present.</i>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	(\$3,789.60)	15	7	8	46.67	\$916.32	(\$1,275.48)	0.72	0.63	(\$252.64)
4	(\$4,997.74)	15	5	10	33.33	\$858.55	(\$929.05)	0.92	0.46	(\$333.18)
3	(\$3,556.59)	15	6	9	40.00	\$989.16	(\$1,054.61)	0.94	0.63	(\$237.11)
2	(\$9,845.33)	15	4	11	26.67	\$585.77	(\$1,108.04)	0.53	0.19	(\$656.36)
1	(\$3,798.95)	16	5	11	31.25	\$830.72	(\$722.96)	1.15	0.52	(\$237.43)

While instances are a bit low, there does appear to be a bit of a bearish bias over the next couple of days.

When considering the stats with the Nasdaq trading under its 200-day moving average, the sample size was too small. I therefore lowered the required number of strong consecutive breadth days to 2 for the next study:

Nasdaq Advancers Outnumber Decliners By At Least 3 to 2 the Last 2 Days & Closes Under 200ma										
Buy on close. Sell X days later. \$100k/trade. 1999 - present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	(\$25,491.14)	22	7	15	31.82	\$3,124.28	(\$3,157.41)	0.99	0.46	(\$1,158.69)
4	(\$17,520.57)	22	12	10	54.55	\$2,010.98	(\$4,165.23)	0.48	0.58	(\$796.39)
3	(\$21,675.47)	24	11	13	45.83	\$1,315.37	(\$2,780.35)	0.47	0.40	(\$903.14)
2	(\$4,326.86)	25	11	14	44.00	\$2,138.10	(\$1,989.00)	1.07	0.84	(\$173.07)
1	(\$2,521.76)	30	17	13	56.67	\$856.67	(\$1,314.24)	0.65	0.85	(\$84.06)

Again we see a negative bias. This time carrying out a bit longer.

I've discussed how consecutive days higher during a long-term downtrend can provide a bearish edge. Below you can see how the Nasdaq has performed since 2000 when 3 up days occur while it closes under the 200-day moving average:

Nasdaq Closes Higher 3 Days In A Row While Under The 200ma										
Buy on close. Sell X days later. \$100k/trade. 2000 - present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
10	(\$162,450.50)	93	39	52	41.94	\$2,052.93	(\$4,663.74)	0.44	0.33	(\$1,746.78)
9	(\$149,496.08)	93	37	55	39.78	\$2,045.35	(\$4,094.07)	0.50	0.34	(\$1,607.48)
8	(\$104,329.41)	93	39	51	41.94	\$2,432.83	(\$3,906.07)	0.62	0.48	(\$1,121.82)
7	(\$75,841.45)	93	33	55	35.48	\$2,732.50	(\$3,018.43)	0.91	0.54	(\$815.50)
6	(\$33,411.58)	93	36	52	38.71	\$3,037.09	(\$2,745.13)	1.11	0.77	(\$359.26)
5	\$1,073.13	93	44	45	47.31	\$2,635.84	(\$2,553.42)	1.03	1.01	\$11.54

The edge didn't really reveal itself here until you were out about 1 week. Between 5 and 10 days out, though, the negative bias becomes substantial.

One indicator that posted a fairly extreme reading today was the Nasdaq Volume Spyx as is shown [each night on the charts page](#). As I've shown in detail with the [S&P 500 volume spyx](#), a bearish tendency arises when the readings get extremely low. This is also true with the Nasdaq. I intend to soon publish more detailed research on the Nasdaq indicator readings. On its own a reading as low as this carries a negative expectation.

Below you can see that when the low Nasdaq Spyx reading is combined with the higher closes study above, the edge becomes even more pronounced:

Nasdaq Closes Higher 3 Days In A Row While Under The 200ma and The Spyx Closes < 30										
Buy on close. Sell X days later. \$100k/trade. 2000 - present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
10	(\$68,676.92)	30	10	20	33.33	\$2,025.33	(\$4,446.51)	0.46	0.23	(\$2,289.23)
9	(\$48,973.08)	30	13	17	43.33	\$1,653.95	(\$4,145.56)	0.40	0.31	(\$1,632.44)
8	(\$35,915.84)	30	13	17	43.33	\$2,229.32	(\$3,817.47)	0.58	0.45	(\$1,197.19)
7	(\$41,423.50)	30	9	20	30.00	\$2,243.69	(\$3,080.84)	0.73	0.33	(\$1,380.78)
6	(\$34,096.87)	30	11	19	36.67	\$1,805.82	(\$2,840.05)	0.64	0.37	(\$1,136.56)
5	(\$9,465.52)	30	14	15	46.67	\$1,636.69	(\$2,158.61)	0.76	0.71	(\$315.52)

Tonight's Aggregator chart can be seen below:



The green Aggregator line remains a bit below the zero line, indicating the studies are suggesting a bearish bias over the next few days. Meanwhile the black differential line positioned far below 0 shows that the market has outperformed expectations by a huge amount over the last 3 days. Both lines below the 0 line is typically what we look for when considering short positions. Based on the low Spyx reading and the consecutive higher closes, I am more interested in shorting the Nasdaq than the S&P at this point. I shall look to take a small short position as described in the trade ideas section below.

Intermediate-term Outlook (1 week – 2 months)–slightly bullish -updated 10/27

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

AIG - no official entries.

Catapult for ETF's Trades

None

Broad Market Large Cap CBI –3/1 (AIG-3)

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	0.00
DJ US Insurance Index	IAK	4.05	DJ US Financial	IYF	3.42
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	8.45
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	3.83
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	5.44
DJ US Pharmaceuticals	IHE	2.70	DJ US Basic Materials	IYM	2.70
DJ US Healthcare Providers	IHF	10.20	DJ US Real Estate	IYR	10.98
DJ US Medical Devices	IHI	9.76	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	2.78	DJ US Technology Sector	IYW	3.02
DJ US Home Construction	ITB	4.76	DJ US Telecommunications	IYZ	7.89
DJ US Consumer Svcs	IYC	2.19	Nasdaq 100	QQQQ	1.00

Additional New Trade Ideas

Short 1/4 position in QQQQ – Based on the short-term market outlook above. I will start small since the market has more of an ability to get and remain overbought when coming off bottoms that at other times.

Active Trades Table

None

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