

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 4, 2008

Issue 181

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
November 4, 2008	SP 10-day %R>80 Spyx < 0	1-5 days	Bearish	-1.90%	-3.10%
November 4, 2008	SP 10day %R>80 Inside Day<200	1-3 days	Bearish	-2.10%	-3.69%
November 3, 2008	SP 500 Up 2 Days Since 6/1/07	1-3 days	Bearish	-1.38%	-2.79%
November 3, 2008	Nas 3-day RSI > 75, Spyx <30	1-5 days	Bearish	-3.20%	-6.55%
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) –somewhat bearish – updated 11/4

It appeared most traders weren't aware the market was open today. Both range and volume contracted in a big way as the S&P 500 and Dow closed down slightly and the Nasdaq Composite closed up slightly. Breadth remained positive, though, as the NYSE and Nasdaq both saw over 55% of their issues trade higher for the 5th day in a row.

Some of the most notable extremes I spotted tonight were with the volume Spyx indicators for both the S&P and the Nasdaq. The Nasdaq volume Spyx closed at -20. The only time it has closed lower than that since 1999 is on 7/1/02. Below is a summary of all the time since '99 that it has closed under minus 10:

<i>Nasdaq Spyx closes under minus 10.</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 Factor	Avg Trade
2	(\$18,610.55)	13	2	11	15.38	\$1,675.72	(\$1,996.54)	0.84	0.15	(\$1,431.58)
1	(\$11,969.76)	13	4	9	30.77	\$365.17	(\$1,492.27)	0.24	0.11	(\$920.75)

The S&P 500 volume Spyx closed at almost negative 14. As I discussed last night when looking at the low Nasdaq Spyx level, an overbought security along with a low Spyx reading frequently leads to a pullback. Even though the S&P 500 finished slightly lower today, it still remains near the top of its recent range.

S&P 500 10-day %R >80 and Spyx < 0.										
Buy on close. Sell X days later. \$100k/trade. 1995-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	(\$15,000.06)	16	3	13	18.75	\$1,264.48	(\$1,445.65)	0.87	0.20	(\$937.50)
4	(\$13,834.69)	16	4	12	25.00	\$810.87	(\$1,423.18)	0.57	0.19	(\$864.67)
3	(\$7,822.63)	16	6	10	37.50	\$647.64	(\$1,170.84)	0.55	0.33	(\$488.91)
2	(\$7,940.60)	17	7	10	41.18	\$620.08	(\$1,228.12)	0.50	0.35	(\$467.09)
1	(\$5,976.80)	18	7	11	38.89	\$519.79	(\$874.12)	0.59	0.38	(\$332.04)

Instances are a little low, but the statistics are strongly bearish.

The reduced range today led to an inside day. I wrote about inside days that close lower last winter, and showed that they generally had a negative expectation. The current setup shows an inside day occurring near the top of the recent range during a long-term downtrend:

S&P 10-day %R over 80 and today's an inside day. S&P 500 closes under 200ma.										
Buy on close. Sell X days later. \$100k/trade. Last 25 years.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
3	(\$29,648.58)	29	11	18	37.93	\$712.41	(\$2,082.50)	0.34	0.21	(\$1,022.36)
2	(\$25,276.02)	29	8	21	27.59	\$868.91	(\$1,534.63)	0.57	0.22	(\$871.59)
1	(\$10,120.67)	29	12	17	41.38	\$589.38	(\$1,011.36)	0.58	0.41	(\$348.99)

Expectations are short-term bearish here as well. Of the 29 instances, 26 of them (89.7%) closed lower at some point within the next 2 days. Over the next 5 days, 28 of 29 (96.5%) posted a close lower than the entry.

Tonight's Aggregator chart is below:



The Aggregator is little changed since yesterday. Both the green Aggregator and black differential lines remain below 0 suggesting a short trade may be appropriate. Already short since Thursday afternoon in the QQQQ, I have the same hang-ups as last night about adding more exposure. The market is bouncing off a long-term low and therefore is more likely to remain overbought for a sustained period. Also, my intermediate-term outlook is bullish. Therefore, rather than add more exposure at the same level here, I'll again wait another day before considering a more aggressive stance.

Intermediate-term Outlook (1 week – 2 months)– bullish -updated 11/3

Last week I highlighted several extremes that the market had reached. They included extremes of breadth, price, and volatility. Several of them with shorter histories only going back 22 years or so were hitting all-time extremes. Others were matched only in the 1930's. These extremes suggested that the market was more overdue for a bounce than it had ever been by several measures. Almost right on cue, the market put in a huge rally on Tuesday and was able to extend it through the end of the week.

This is the 2nd time this has happened this month – 10/13 being the first time. In that instance the market failed to hold its gains and the next leg down soon began. In most cases large numbers of breadth, price, and volatility extremes have instead led to significant rallies over a period of several weeks to months. This appears to be the 2nd attempt to generate a decent rally following extreme readings.

One concern several traders have expressed is that so far this rally appears to be a short covering rally. It is a topic that I actually received a few emails about this week. The reason it appears to be driven by short-covering is that the areas that were beaten down the most actually bounced the best. Studies I've conducted in the past have indicated when the market becomes extremely oversold, it is typical that the most oversold areas bounce the best. [One such study I posted to the blog in January](#). The follow-up to that post [can be found here \(2nd paragraph\)](#). Studies like these suggest that a rally that begins with short-covering is typical and not doomed to fail as some would believe.

But do short covering rallies actually stand a BETTER chance of success? There is some evidence they do.

One tool I like to use to measure how leading stocks are doing versus the overall market is the IBD 100. The IBD 100 is an index published by Investors Business Daily. A description from their website states *“The IBD 100 Index tracks the performance of stocks listed in the IBD 100, a proprietary list of the 100 top-ranked companies published every Monday* in Investor's Business Daily. Companies are ranked based on superior earnings, strong price performance, and leadership within their respective industries.”*

Last week the IBD 100's return trailed that of the S&P 500. This would suggest that the strongest stocks entering the week were not the ones that performed the best during the week.

I decided to look at how the market performed after bouncing off a low when the S&P led the IBD 100 versus when the IBD 100 led the S&P. My data for the IBD 100 only

goes back to April of 2004, but the results are quite interesting nonetheless. With a relatively short history, rather than use tables, I'll show some charts below.

The top pane is the S&P 500 and the bottom is the IBD 100. The chart is weekly going back to 2004. A buy signal is triggered any time the market closes higher after making a 10-week closing low and the *IBD 100 outperforms the S&P 500* on the week of the rebound (leaders outperform laggards):



Here we see there have been 8 instances. Three times the S&P 500 went on to make further gains over the next 6 weeks and 5 times it fell over the next 6 weeks.

Below we see times the market closed higher after making a 10-week closing low and the *S&P 500 led the IBD 100* on the week of the rebound (laggards outperform leaders). This is the situation we are in now.



In this case there have also been 8 instances since 2004. But here we see that all eight went on to post successful rallies over the following 6 weeks. The size of the gains on winning trades is also a bit larger. These results would suggest that not only is it **normal** for the laggards to outperform the leaders when the market is attempting to rally from a low, but it is **desirable**.

The incredibly negative and volatile action the market has experienced the last 2 months should be sufficient to have washed out enough sellers that the market could put in a bit of a rally at this stage. Whether the lows are able to hold on a longer-term basis is beyond my vision at this point. I do believe the market is more likely to rally than to collapse over the next several weeks and possibly longer. I expect to trade more aggressively from the long side than the short side in the immediate future.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

none

Catapult for ETF's Trades

None

Broad Market Large Cap CBI - 0

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	0.00	DJ US Financial	IYF	0.34
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	1.41
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	0.00
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	1.36
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	0.00
DJ US Healthcare Providers	IHF	2.04	DJ US Real Estate	IYR	1.22
DJ US Medical Devices	IHI	0.00	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	0.00	DJ US Technology Sector	IYW	0.00
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	2.63
DJ US Consumer Svcs	IYC	0.44	Nasdaq 100	QQQQ	0.00

Nothing even remotely high anymore.

Additional New Trade Ideas

None – The QQQQ is still very close to the short entry from Friday. Still just waiting as mentioned in the short-term market outlook.

No system triggers again today. This is the 3rd day in a row, which is quite unusual. Choppy trading in a narrowing range will sometimes do that, though.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
QQQQ (S)	10/31/2008	\$32.84	\$32.82	0.06%		

Depending on how the market trades tomorrow I may send out an intraday update on the QQQQ position with exit criteria.

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