

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 5, 2008

Issue 182

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 5, 2008	VXO closes 20% under 10ma	1-5 days	Bearish	-3.58%	-7.03%
November 5, 2008	SP Rises 3%, Vol under 10ma	1-3 days	Bearish	-3.74%	-7.16%
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 11/5

The market moved up substantially today. The S&P gained over 4% while the Nasdaq rose about 3%. Breadth was solid, but not overwhelming. Up volume failed to hit 90% on both the NYSE and the Nasdaq.

What stood out to me most about today's action was the low volume and the extremely low VXO. [In tonight's blog I looked at the VXO setup.](#) The conclusion was that extremely stretched VXO readings seem to affect a bearish influence on the market.

Big rises should be accompanied by big volume. When volume comes in light it can often signal a lack of enthusiasm. This tends to be short-term bearish. I've shown several volume-related studies in the past that suggested this. Below is another that is applicable to today's situation:

S&P 500 rises at least 3% on volume that is under its 10-day moving average.												
Buy on close. Sell X days later. \$100k/trade. 1960 - present.												
X Days	Net Profits	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$25,682.83)	11	6	5	54.55	\$3,491.60	(\$14,309.75)	\$1,416.76	(\$6,836.67)	0.21	0.25	(\$2,334.80)
9	(\$40,984.45)	11	5	6	45.45	\$2,424.75	(\$13,855.85)	\$1,090.55	(\$7,739.54)	0.14	0.12	(\$3,725.86)
8	(\$41,472.81)	12	5	7	41.67	\$3,516.70	(\$22,706.90)	\$1,931.46	(\$7,304.30)	0.26	0.19	(\$3,456.07)
7	(\$47,606.08)	12	3	9	25.00	\$4,976.40	(\$21,797.40)	\$2,863.10	(\$6,243.93)	0.46	0.15	(\$3,967.17)
6	(\$34,052.62)	12	5	7	41.67	\$3,626.00	(\$15,420.70)	\$2,309.50	(\$6,514.31)	0.35	0.25	(\$2,837.72)
5	(\$39,163.75)	14	7	7	50.00	\$3,957.60	(\$14,461.05)	\$1,828.37	(\$7,423.19)	0.25	0.25	(\$2,797.41)
4	(\$34,515.11)	14	6	8	42.86	\$3,364.90	(\$10,971.63)	\$1,543.33	(\$5,471.88)	0.28	0.21	(\$2,465.37)
3	(\$22,005.87)	14	4	10	28.57	\$4,039.00	(\$6,924.56)	\$2,212.56	(\$3,085.61)	0.72	0.29	(\$1,571.85)
2	(\$20,933.90)	15	5	10	33.33	\$4,479.84	(\$9,455.49)	\$2,575.80	(\$3,381.29)	0.76	0.38	(\$1,395.59)
1	(\$7,508.80)	15	5	10	33.33	\$2,860.08	(\$3,065.35)	\$897.25	(\$1,199.51)	0.75	0.37	(\$500.59)

Most of the damage here is done in days 1-3 except for the outlier trades. Interesting that 13 of 15 instances posted a close lower than the trigger within 3 days – including the last 9 occurrences going back to July 2002. Only 1 instance failed to close lower within 7 days – 10/19/98, which traded sideways for 7 days before beginning a new leg up.

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



The huge number of bearish studies and lack of bullish studies has left the Aggregator strongly negative. The recent outperformance of the S&P places the black differential line in a strongly negative position as well. So far on this bounce the market has exhibited extraordinary strength. Coming off a long-term low I suggested it may continue to rise in the face over overbought conditions. This, along with my intermediate-term outlook led me to keep the QQQQ position sizes quite small. Still, with all the bearish studies it appears we are reaching an area where adding short exposure may be an attractive option. I will be looking to take on the 2nd ¼ position in the QQQQ tomorrow. My approach is described in the Trade Ideas section below.

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.

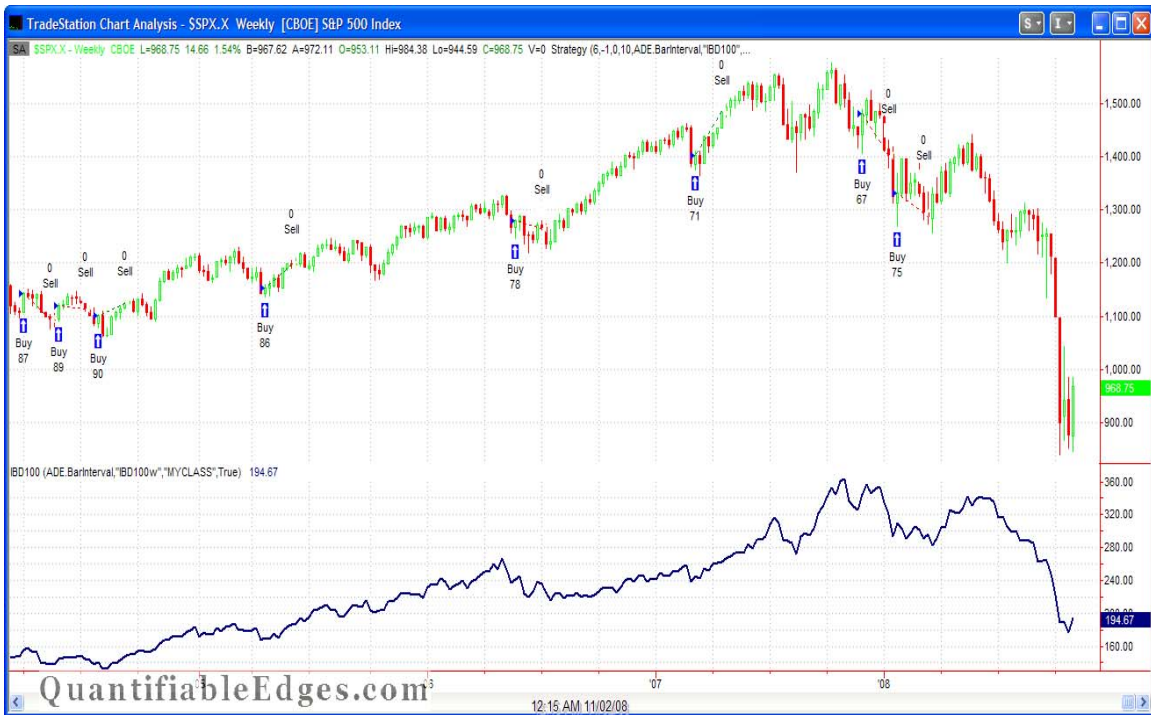
But do short covering rallies actually stand a BETTER chance of success? There is some evidence they do.

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	0.00
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	0.00
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	0.00
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	0.00
DJ US Consumer Svcs	IYC	0.00	Nasdaq 100	QQQQ	0.00

Nothing even remotely high anymore.

Additional New Trade Ideas

QQQQ short 1/4 position under either scenario (but not both).

- 1) The QQQQ gaps up to \$34.10 in the morning – short on open.*
- 2) The QQQQ closes higher on the day – short on close.*

In either case we'll look to take on the 2nd 1/4 position – adding to last Friday's 1/4 position.

No system triggers again today. This is the 4th day in a row, which is very unusual.

On the radar

BA – No official trade here but BA has risen 6 days in a row, gapped up near its 50-ma on Tuesday and failed to follow through. A short entry in this area with a stop above the 50-day moving average could provide a decent risk/reward setup.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
QQQQ (S)	10/31/2008	\$32.84	\$33.75	-2.77%		

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