

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 10, 2008

Issue 185

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 9, 2008	2.5% Rally On Poor Volume	1-7 days	Bearish	-5.15%	-10.10%
November 7, 2008	2 Lower Closes On High Volume	1-3 days	Bearish		
November 7, 2008	Dow Double 4% Drop	1-2 days	Bullish		
November 6, 2008	S&P 500 Drops 5% today	1-4 days	Bullish	5.28%	8.43%
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish		

If the avg max move is achieved it will appear in **bold and brown**. 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 11/10

Wall St. looked past a poor employment report on Friday and the market moved nicely higher. Breadth was solid without hitting extreme levels. One the NYSE advancers outnumbered decliners by about 2:1 and up volume exceeded down volume by about 4:1. While the Spyx was middle of the road, total volume came in very light. Monday was the only day with lighter volume in the last 12 trading sessions.

Friday didn't produce much of interest from a statistical standpoint. The one red flag was the low volume on the rally. Strong up days on low volume have been creamed lately. A few recent examples would include 9/30, 10/13, 10/20, and 11/4. The table below shows results following all one-day gains of 2.5% or more that were accompanied by volume under the 10-day average.

S&P 500 Rises 2.5% and volume is BELOW its 10-day moving average.										
Buy on close. Sell X days later. \$100k/trade. 1960 - present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fac	Avg Trade
10	(\$23,977.93)	22	10	12	45.45	\$2,388.27	(\$3,988.39)	0.60	0.50	(\$1,089.91)
9	(\$43,049.42)	22	10	12	45.45	\$1,838.12	(\$5,119.22)	0.36	0.30	(\$1,956.79)
8	(\$49,291.22)	24	11	13	45.83	\$2,136.09	(\$5,599.09)	0.38	0.32	(\$2,053.80)
7	(\$62,171.89)	24	7	17	29.17	\$2,279.45	(\$4,595.77)	0.50	0.20	(\$2,590.50)
6	(\$42,017.21)	25	11	14	44.00	\$2,554.82	(\$5,008.58)	0.51	0.40	(\$1,680.69)
5	(\$55,560.20)	27	12	15	44.44	\$1,879.59	(\$5,207.68)	0.36	0.29	(\$2,057.79)
4	(\$41,777.29)	28	10	18	35.71	\$2,154.66	(\$3,518.00)	0.61	0.34	(\$1,492.05)
3	(\$31,665.29)	30	9	21	30.00	\$3,063.37	(\$2,820.74)	1.09	0.47	(\$1,055.51)
2	(\$32,509.42)	31	11	20	35.48	\$2,085.35	(\$2,772.41)	0.75	0.41	(\$1,048.69)
1	(\$8,288.43)	32	14	18	43.75	\$1,001.34	(\$1,239.28)	0.81	0.63	(\$259.01)

The next two weeks haven't been pretty. The negative impact seems to dissipate after 7 days.

Lest anyone believe the short-term negative returns were due to the 2.5% rise and not the low volume, I've run a similar test showing results when volume finished above the 10-day average:

S&P 500 Rises 2.5% and volume is ABOVE its 10-day moving average.										
Buy on close. Sell X days later. \$100k/trade. 1960 - present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
10	\$57,780.09	78	45	33	57.69	\$3,766.33	(\$3,385.00)	1.11	1.52	\$740.77
9	\$73,718.10	80	46	34	57.50	\$3,869.64	(\$3,067.21)	1.26	1.71	\$921.48
8	\$67,649.51	83	49	34	59.04	\$3,478.80	(\$3,023.87)	1.15	1.66	\$815.05
7	\$62,452.89	83	51	32	61.45	\$3,309.24	(\$3,322.45)	1.00	1.59	\$752.44
6	\$80,755.76	83	53	30	63.86	\$3,177.78	(\$2,922.21)	1.09	1.92	\$972.96
5	\$102,436.02	84	57	27	67.86	\$3,002.98	(\$2,545.70)	1.18	2.49	\$1,219.48
4	\$81,766.36	88	62	26	70.45	\$2,354.25	(\$2,469.11)	0.95	2.27	\$929.16
3	\$73,604.71	92	62	30	67.39	\$2,006.92	(\$1,694.14)	1.18	2.45	\$800.05
2	\$47,409.46	94	60	34	63.83	\$1,530.29	(\$1,306.11)	1.17	2.07	\$504.36
1	\$37,162.96	101	61	40	60.40	\$1,233.34	(\$951.77)	1.30	1.98	\$367.95

When volume comes in relatively strong, rather than relatively weak, the expectation changes from strongly bearish to strongly bullish. This is especially true over the first week.

In looking closer at the results, I noticed that the setup has become more prevalent since 2001. The results have also been significantly worse over this more recent time period.

S&P 500 Rises 2.5% and volume is BELOW its 10-day moving average.										
Buy on close. Sell X days later. \$100k/trade. 2001 - present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
10	(\$40,833.37)	9	2	7	22.22	\$1,036.62	(\$6,129.52)	0.17	0.05	(\$4,537.04)
9	(\$49,069.90)	9	2	7	22.22	\$1,749.62	(\$7,509.88)	0.23	0.07	(\$5,452.21)
8	(\$51,567.71)	10	3	7	30.00	\$2,143.48	(\$8,285.45)	0.26	0.11	(\$5,156.77)
7	(\$54,330.02)	10	2	8	20.00	\$2,820.45	(\$7,496.37)	0.38	0.09	(\$5,433.00)
6	(\$48,374.48)	11	1	10	9.09	\$6,965.80	(\$5,534.03)	1.26	0.13	(\$4,397.68)
5	(\$61,452.19)	13	3	10	23.08	\$1,464.75	(\$6,584.64)	0.22	0.07	(\$4,727.09)
4	(\$46,238.44)	13	2	11	15.38	\$3,400.47	(\$4,821.76)	0.71	0.13	(\$3,556.80)
3	(\$33,111.36)	14	3	11	21.43	\$4,167.50	(\$4,146.72)	1.01	0.27	(\$2,365.10)
2	(\$36,025.84)	15	3	12	20.00	\$2,666.11	(\$3,668.68)	0.73	0.18	(\$2,401.72)
1	(\$12,897.11)	15	5	10	33.33	\$877.36	(\$1,728.39)	0.51	0.25	(\$859.81)

I also decided to take a closer look at the possible impact of the magnitude of the move. To do this I kept the volume requirement steady while testing different levels of gains.

S&P 500 up X%. Volume under 10-day average.										
Buy on close. Sell 5 days later. \$100k/trade. 1960-present										
X% Rise	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
4	(\$31,045.19)	7	3	4	42.86	\$2,040.45	(\$9,291.64)	0.22	0.16	(\$4,435.03)
3.5	(\$37,122.33)	9	4	5	44.44	\$1,718.96	(\$8,799.64)	0.20	0.16	(\$4,124.70)
3	(\$39,163.75)	14	7	7	50.00	\$1,828.37	(\$7,423.19)	0.25	0.25	(\$2,797.41)
2.5	(\$55,560.20)	27	12	15	44.44	\$1,879.59	(\$5,207.68)	0.36	0.29	(\$2,057.79)
2	(\$45,407.27)	54	27	27	50.00	\$2,116.65	(\$3,798.40)	0.56	0.56	(\$840.88)
1.5	(\$24,539.75)	124	67	57	54.03	\$2,015.61	(\$2,799.75)	0.72	0.85	(\$197.90)

It appears based on these results that the taller they are the harder they fall. Bigger gains saw bigger average pullbacks.

Here also I decided to look at the more recent results of 2001 – present.

S&P 500 up X%. Volume under 10-day average.										
Buy on close. Sell 5 days later. \$100k/trade. 2001 -present.										
X% Rise	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
4	(\$36,385.04)	5	1	4	20.00	\$781.50	(\$9,291.64)	0.08	0.02	(\$7,277.01)
3.5	(\$42,462.18)	7	2	5	28.57	\$768.00	(\$8,799.64)	0.09	0.03	(\$6,066.03)
3	(\$39,735.28)	8	3	5	37.50	\$1,420.97	(\$8,799.64)	0.16	0.10	(\$4,966.91)
2.5	(\$61,452.19)	13	3	10	23.08	\$1,464.75	(\$6,584.64)	0.22	0.07	(\$4,727.09)
2	(\$59,990.56)	21	7	14	33.33	\$1,539.20	(\$5,054.64)	0.30	0.15	(\$2,856.69)
1.5	(\$42,651.46)	40	17	23	42.50	\$1,710.16	(\$3,118.45)	0.55	0.41	(\$1,066.29)

More of the same here. Strong moves on weak volume have suffered greatly the last 8 years. The stronger the move, the more the suffering.

The observation I made earlier about how dire a signal it has been lately is also notable. The 9/30/08 signal led to a 14.6% decline over the next 5 days and the 10/20 signal led to a 13.9% decline over the next 5 days. I decided to eliminate the last month plus from the test and see how results would look then. First – going back to 1960:

S&P 500 up X%. Volume under 10-day average.										
Buy on close. Sell 5 days later. \$100k/trade. 1960-9/26/2008.										
X% Rise	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
3.5	(\$7,099.75)	6	4	2	66.67	\$1,718.96	(\$6,987.80)	0.25	0.49	(\$1,183.29)
3	(\$9,141.17)	11	7	4	63.64	\$1,828.37	(\$5,484.95)	0.33	0.58	(\$831.02)
2.5	(\$20,419.78)	23	12	11	52.17	\$1,879.59	(\$3,906.80)	0.48	0.52	(\$887.82)
2	(\$10,266.85)	50	27	23	54.00	\$2,116.65	(\$2,931.15)	0.72	0.85	(\$205.34)
1.5	\$3,928.80	120	67	53	55.83	\$2,015.61	(\$2,473.91)	0.81	1.03	\$32.74

Even eliminating the 2 largest losses by eliminating the last month the large average losses dwarf the average wins once you get above a 2% day. This keeps the results solidly bearish. Next I ran this same test from 2001 – 9/26/08:

S&P 500 up X%. Volume under 10-day average.										
Buy on close. Sell 5 days later. \$100k/trade. 2001-9/26/08.										
X% Rise	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
2.5	(\$26,311.77)	9	3	6	33.33	\$1,464.75	(\$5,117.67)	0.29	0.14	(\$2,923.53)
2	(\$24,850.14)	17	7	10	41.18	\$1,539.20	(\$3,562.45)	0.43	0.30	(\$1,461.77)
1.5	(\$14,182.91)	36	17	19	47.22	\$1,710.16	(\$2,276.62)	0.75	0.67	(\$393.97)

As you'd expect the results over the last 8 years – even without the last month plus - are quite bearish from most every standpoint.

Lastly, I re-ran the original 2.5% test over X days from 1960 – 9/26/08.

S&P 500 Rises 2.5% and volume is BELOW its 10-day moving average.										
Buy on close. Sell X days later. \$100k/trade. 1960 - 9/26/08.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
10	(\$7,739.08)	20	10	10	50.00	\$2,388.27	(\$3,162.18)	0.76	0.76	(\$386.95)
9	(\$16,662.15)	20	10	10	50.00	\$1,838.12	(\$3,504.34)	0.52	0.52	(\$833.11)
8	(\$17,155.56)	22	11	11	50.00	\$2,136.09	(\$3,695.68)	0.58	0.58	(\$779.80)
7	(\$29,824.06)	22	7	15	31.82	\$2,279.45	(\$3,052.01)	0.75	0.35	(\$1,355.64)
6	(\$19,412.41)	22	11	11	50.00	\$2,554.82	(\$4,319.58)	0.59	0.59	(\$882.38)
5	(\$20,419.78)	23	12	11	52.17	\$1,879.59	(\$3,906.80)	0.48	0.52	(\$887.82)
4	(\$15,146.23)	24	10	14	41.67	\$2,154.66	(\$2,620.92)	0.82	0.59	(\$631.09)
3	(\$10,489.27)	25	8	17	32.00	\$2,774.71	(\$1,922.76)	1.44	0.68	(\$419.57)
2	(\$960.22)	26	10	16	38.46	\$2,166.90	(\$1,414.33)	1.53	0.96	(\$36.93)
1	(\$523.54)	27	13	14	48.15	\$961.08	(\$929.83)	1.03	0.96	(\$19.39)

The bottom line is this. Big moves up are most often accompanied by above average volume. When this occurs it can often lead to further gains. When the volume is below average, as we saw on Friday, it raises a **bright red flag**.

Tonight's **Aggregator** chart is below:



The strong move down on Wednesday and Thursday fulfilled a large list of bearish studies, which were then eliminated while some short-term bullish studies kicked in. This can be seen in the move of the green Aggregator line from negative to positive Thursday night. Those bullish studies were very short-term in nature and will be dropping off the books over the next couple of days. The Aggregator has already started to head lower. Without further bullish studies it will cross back below 0 tomorrow night. The black differential line remains far above the 0 line, although this too will likely head

lower over the next few couple of days as the back to back 5% drops come off the books. The current Aggregator and differential positioning suggest more upside follow-through is possible, but it could be short-lived. The gap up on Friday was unfortunate in the sense that the SPY trade never received a fill. Rather than chase here I'll wait for the next opportunity.

Intermediate-term Outlook (1 week – 2 months)– bullish -updated 11/10

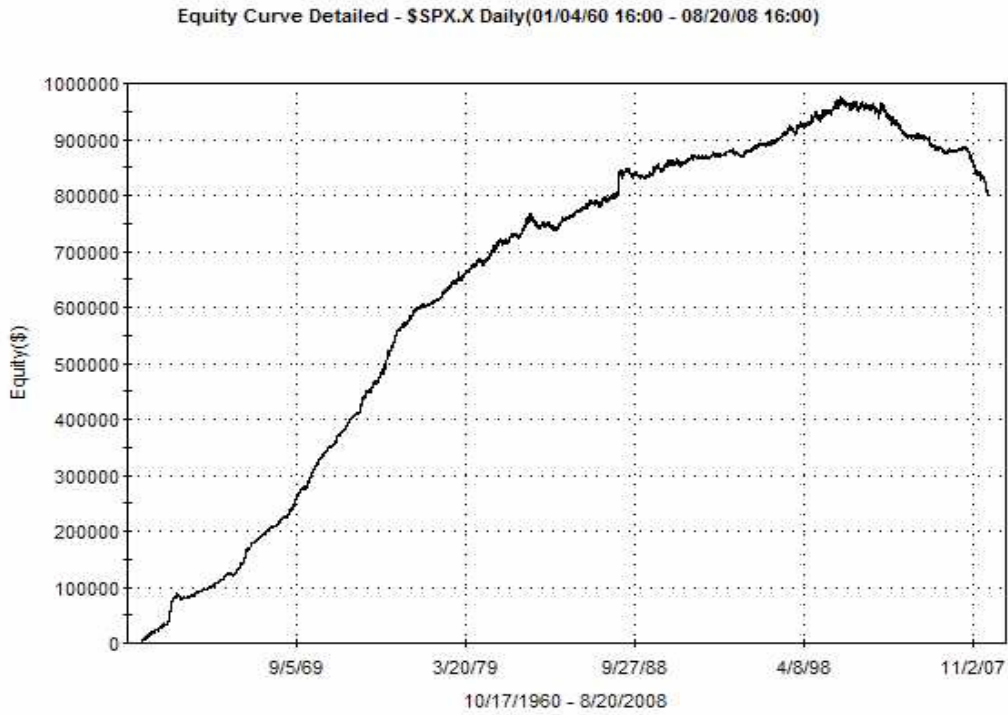
While the market did suffer a steep drop mid-week, it did manage to hold substantially above its October lows. Extremes anywhere close to those we saw at the October lows that I've previously outlined have almost always led to rallies lasting a few weeks to a few months. Much of this was discussed in the 10/26 intermediate-term outlook.

Last week I looked at the short-covering component of the rally, and what that suggested. That research indicated rallies that begin with short covering tend to serve a *better* chance of continuing than those that are led by previously strong stocks. The outperformance of the S&P 500 over the IBD 100 off the recent lows suggested there was a good chance the rally would continue through November.

As of yet the market has shown nothing to dissuade me from the idea that it could continue upwards through at least November and perhaps longer.

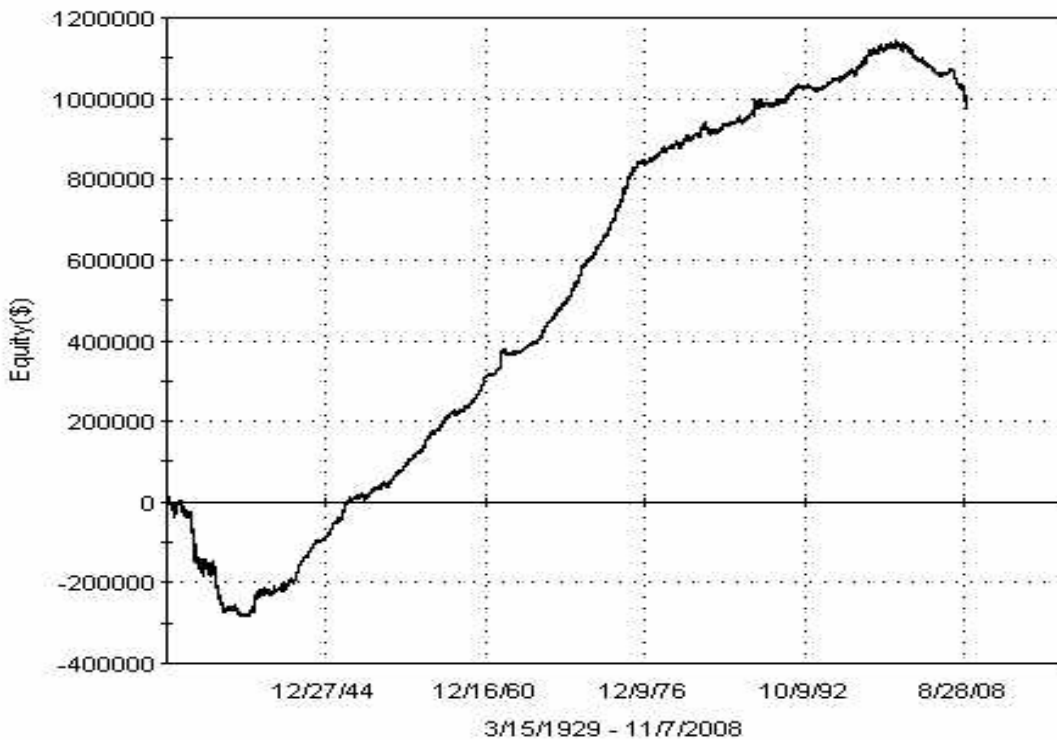
Some of the more interesting research I've done in the last few months had to do with the recent [tendency of the market to chop rather than trend](#). One of the findings of that research was that prior to 2000 the S&P 500 has most often followed up days with more positive days and down days with more negative days. The market had a strong tendency to trend in this way. In 2000 this reversed and starting in 2007 the tendency to chop has accelerated. The test went back to 1960, which is as far back as my S&P data went.

The chart below is taken from that study. It shows the results of buying the S&P on any up day and then selling and reversing the position short on any down day. An uptrending graph suggests follow-through prevails, while a downtrending graph suggests choppy conditions prevail:



As you can see, trendiness dominated until 2000 – even during bear market periods. This weekend I decided to run the same test on my Dow data going back to the beginning of 1929. Once again I found the results very interesting:

Equity Curve Detailed - +ASC:DJ30W.CSV Daily(01/02/29 16:00 - 11/07/08 16:00)



Here we see that by extending the study beyond the original 1960 date there is one more period in history where chop was as prevalent as it is today – the Great Depression. There are many differences in what is happening now versus what happened then. The world is certainly not the same as it was 70-80 years ago. But as I noted on the blog recently, study after study of historical extremes and market action are continuing to point back to this period in time as the only resemblance of today.

Difficult to see in the chart above is that the market changed from a choppy to a trending behavior about a year prior to the 1937 bottom – which was the ultimate low for the period. I believe there are several reasons it would be well worth monitoring the trend vs. chop market behavior going forward. One reason is that a shift back to a trending environment may either confirm or anticipate a bottom of some importance as it did in the 1930's. I shall be adding trend vs. chop charts to the charts section of the website this week.

In summary I believe the market has set up for a tradable rally here. I am not terribly optimistic that it will be the start of the next great bull market and that we will see steadily rising prices for the next 10 years. I am also not ready to suggest we will continue to see lower lows for the next several years. I do think we are in a very tricky period where constant evaluation and study will be important. I intend to handle it in just that way.

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	2.11
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	0.77
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	0.68
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	0.00
DJ US Healthcare Providers	IHF	0.00	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	1.51
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

Additional New Trade Ideas

None – Setups have been scarce the last few days, which happens when the market is in a range. Patience is key though. Forcing trades just to trade has never served me well.

Active Trades Table

none

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