

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 12, 2008

Issue 187

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 12, 2008 | 2 Days Lower In Chop | 1-2 days | Bullish | 1.50% | 3.20% |
| November 12, 2008 | SPY gap dn no fill %R < 10 | 1 day | Bullish | 1.60% | 2.80% |
| November 11, 2008 | SPY Gap Up Fail < 200 Low Vol | 1-2 days | Bullish | 2.50% | 4.80% |
| November 9, 2008 | 2.5% Rally On Poor Volume | 1-7 days | Bearish | -5.15% | -10.10% |
| 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) – slightly bullish – updated 11/12

Another roller coaster ride for the market on Tuesday. It gapped lower by 2%, sold off further, rallied without ever quite getting back to breakeven, and then sold off again. When it was over most of the major indices were lower by 2% or more. Volume rose, although it was still below average. Breadth was negative as you'd expect.

The extremely simple 2-day pullback system that has worked well under the choppy market conditions since last June triggered again today. This system has had success due to the markets propensity to chop. I fully expect the market to move from choppy to trending at some point and for my chop-based systems to be punished when it does. For now I'm inclined to go with what's working until it's no longer is working.

If the S&P 500 falls 2 days in a row, buy on close. Sell at first close where the trade is profitable. Sell 3 days later regardless of profitability.

All Trades

| | | | |
|---------------------------------|-------------|--------------------------------|---------------|
| Total Net Profit | \$30,998.11 | Profit Factor | 2.32 |
| Gross Profit | \$54,430.85 | Gross Loss | (\$23,432.74) |
| Total Number of Trades | 45 | Percent Profitable | 86.67% |
| Winning Trades | 39 | Losing Trades | 6 |
| Even Trades | 0 | | |
| Avg. Trade Net Profit | \$688.85 | Ratio Avg. Win:Avg. Loss | 0.36 |
| Avg. Winning Trade | \$1,395.66 | Avg. Losing Trade | (\$3,905.46) |
| Largest Winning Trade | \$10,716.03 | Largest Losing Trade | (\$10,506.45) |
| Max. Consecutive Winning Trades | 17 | Max. Consecutive Losing Trades | 2 |
| Avg. Bars in Winning Trades | 2.38 | Avg. Bars in Losing Trades | 4.00 |
| Avg. Bars in Total Trades | 2.60 | | |

31% return in a long-only system over the last year and a half exemplifies just how choppy the market has been.

Tuesday's price pattern was also interesting in that the gap down never filled and the SPY is now at the lower end of its 10-day range.

SPY gaps lower by 0.5%, never reaches yesterday's close, closes lower than the open and with a 10-day %R under 10.
Buy on close. Sell X days later. \$100k/trade. 1993-present.

| X Days | Net Profit | Trades | Wins | Losses | % Wins | Avg Win | Avg Loss | W/L Ratio | Profit Factor | Avg Trade |
|--------|-------------|--------|------|--------|--------|------------|--------------|-----------|---------------|-----------|
| 5 | \$53,757.25 | 55 | 32 | 22 | 58.18 | \$3,049.49 | (\$1,992.11) | 1.53 | 2.23 | \$977.40 |
| 4 | \$42,580.71 | 56 | 29 | 27 | 51.79 | \$3,108.64 | (\$1,761.85) | 1.76 | 1.90 | \$760.37 |
| 3 | \$31,834.75 | 60 | 35 | 25 | 58.33 | \$2,447.54 | (\$2,153.17) | 1.14 | 1.59 | \$530.58 |
| 2 | \$44,501.59 | 62 | 35 | 27 | 56.45 | \$2,595.41 | (\$1,716.21) | 1.51 | 1.96 | \$717.77 |
| 1 | \$44,527.79 | 62 | 41 | 21 | 66.13 | \$1,526.53 | (\$860.00) | 1.78 | 3.47 | \$718.19 |

Not a huge edge here, but about 2/3 closed higher the next day. Not visible is that within the next 3 days 81% of them closed higher at some point.

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



Both the green Aggregator and the black Differential line remain slightly above 0, still suggesting a bounce appears likely. With the high probabilities of the chop-based system and the fact that we are now in the lower half of the recent range, I'm beginning to warm up to the idea of taking on some short-term index exposure to the long side. See trade ideas section for details of how I'm looking to play it.

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

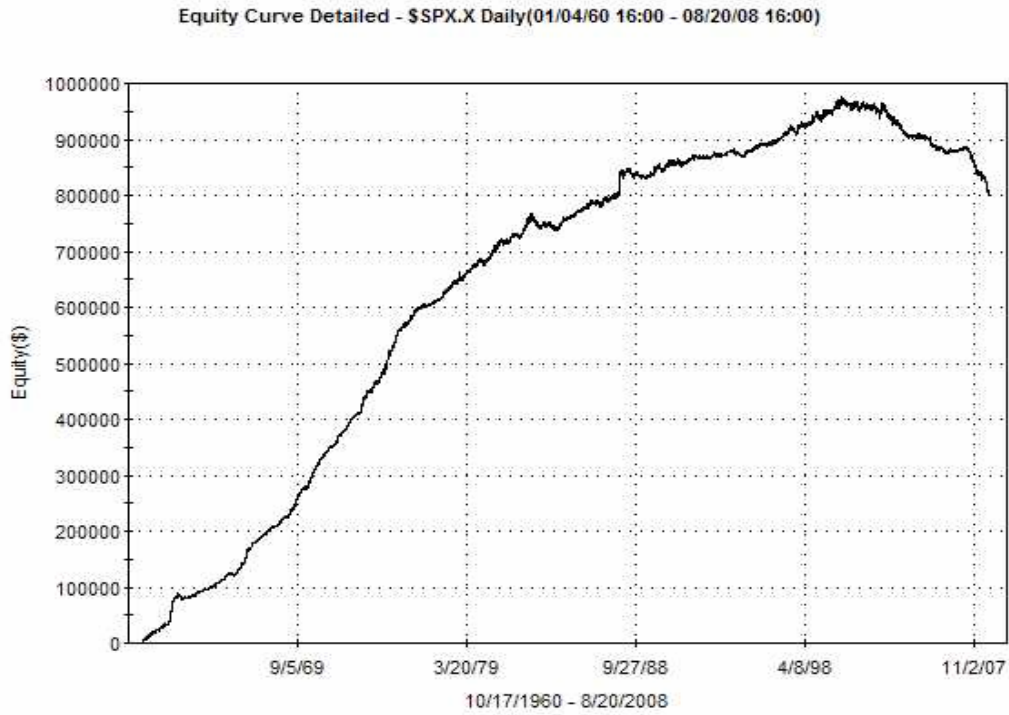
While the market did suffer a steep drop mid-week, it did manage to hold substantially above its October lows. Extremes anywhere close to those we saw at the October lows that I've previously outlined have almost always led to rallies lasting a few weeks to a few months. Much of this was discussed in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

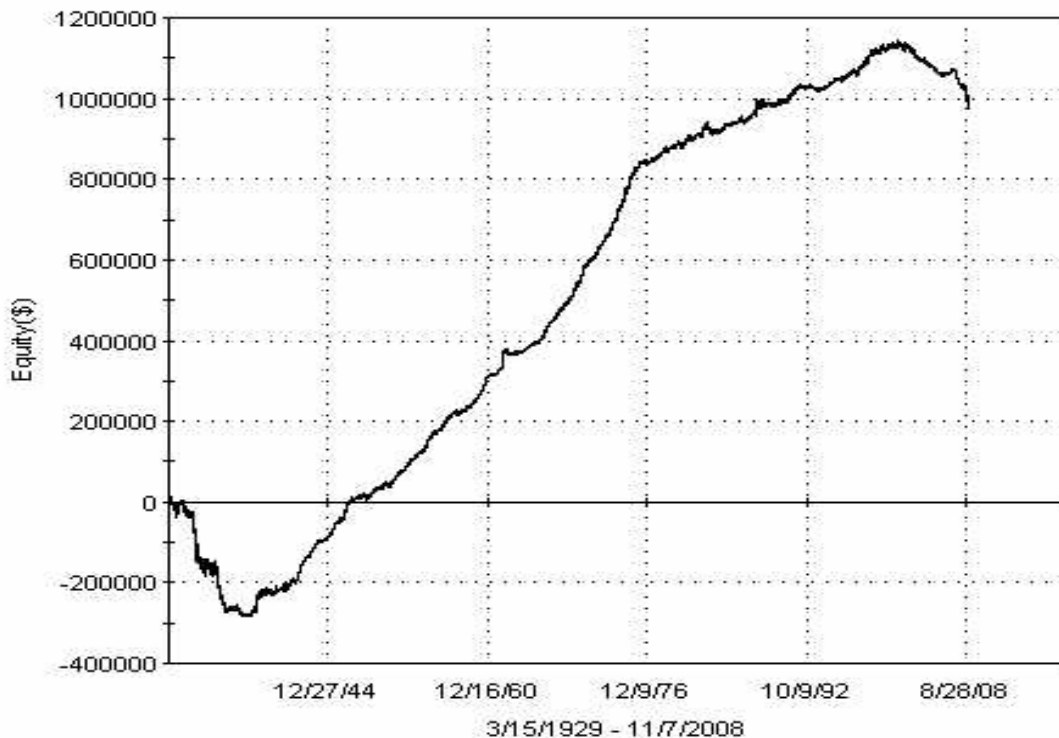
Some of the more interesting research I've done in the last few months had to do with the recent [tendency of the market to chop rather than trend](#). One of the findings of that research was that prior to 2000 the S&P 500 has most often followed up days with more positive days and down days with more 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 | 1.16 |
| 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 | 1.72 | DJ US Industrial Sector | IYJ | 0.77 |
| DJ US Oil Equip & Svcs | IEZ | 0.00 | DJ US Consumer Goods | IYK | 2.72 |
| DJ US Pharmaceuticals | IHE | 0.00 | DJ US Basic Materials | IYM | 0.00 |
| DJ US Healthcare Providers | IHF | 4.08 | DJ US Real Estate | IYR | 3.66 |
| DJ US Medical Devices | IHI | 2.44 | DJ US Transportation | IYT | 0.00 |
| DJ US Aerospace & Defense | ITA | 2.78 | DJ US Technology Sector | IYW | 2.01 |
| DJ US Home Construction | ITB | 4.76 | DJ US Telecommunications | IYZ | 2.63 |
| DJ US Consumer Svcs | IYC | 2.63 | Nasdaq 100 | QQQQ | 0.00 |

Additional New Trade Ideas

1) SPY – buy ¼ position on 1) open below \$89.77 or 2) close below \$89.77. No outstanding limit order during the day. If purchase is made on open I will look to sell entire position on a **profitable** close below \$90.75. I will sell ½ on a close ABOVE \$90.75. A close lower if the position is already opened will not induce additional buying or selling.

I'm willing to take some small exposure. If the market opens higher and then heads south I don't want to get caught in a runaway down move during the day – hence the open or close order.

2) GOOG – buy @ \$311.46 limit - System 80421 triggered in a few stocks tonight and GOOG looked the most appealing to me. I ran the system back 10 years across the current S&P 100 and updated the system page with those stats. From the system page:

Quantifiable Edges Trading System 80421

Originally published in the 4/21/2008 Quantifiable Edges Subscriber Letter this system looks to go long securities that have been selling off over the course of several days that then gap lower and reverse up.

Entry Conditions

- 1) *Has closed lower at least 5 days in a row.*
- 2) *The security gapped lower this morning to a level below today's closing lower Bollinger Band (20ma, 2 standard deviations).*
- 3) *It closed higher than the open.*

Exit Criteria

Two possible exit strategies for this one. Below are results for closing the position on a Bollinger %b value above 25 and above 50. %b measures the position in relation to the Bollinger Bands. A %b of 0 is right at the lower band. A %b of 100 is at the upper band. A %b of 50 is at the moving average. The system requires a close over halfway between the lower Bollinger Band and the 20-period moving average..

Historical Backtest Results

| <i>Across ETF List</i> | | | <i>Across "current" S&P 100</i> | | |
|---|-------------------|-------------------|--|-----------------|-----------------|
| <i>Last tested:</i> <i>4/21/2008</i> | | | <i>Last tested:</i> <i>11/11/2008</i> | | |
| <i>Exit Strategy</i> | <i>%b > 25</i> | <i>%b > 50</i> | | <i>%b>25</i> | <i>%b>50</i> |
| <i>Trades</i> | 198 | 190 | <i>Trades</i> | 355 | 348 |
| <i>Winners</i> | 146 | 139 | <i>Winners</i> | 247 | 254 |
| <i>Pct Winners</i> | 74% | 73% | <i>Pct Winners</i> | 70% | 73% |
| <i>Avg Win</i> | 2.4% | 5.0% | <i>Avg Win</i> | 6.1% | 7.3% |
| <i>Avg Loss</i> | -2.1% | -4.4% | <i>Avg Loss</i> | 5.0% | 7.1% |
| <i>Avg Trade</i> | 1.3% | 2.5% | <i>Avg Trade</i> | 2.7% | 3.4% |
| <i>Profit Factor</i> | 3.8 | 3.1 | <i>Profit Factor</i> | 2.8 | 2.8 |
| | | | | | |
| <i>All tests were run back a period of 10 years from the test date.</i> | | | | | |

With the market conditions both choppy and downtrending I'll look to exit on when the %b closes > 25 for the GOOG trade idea.

Active Trades Table

none

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