

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 13, 2008

Issue 188

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 13, 2008	5% Drop	1-4 days	Bullish	4.00%	7.00%
November 13, 2008	95% Down Volume	1 day	Bullish	2.50%	3.25%
November 12, 2008	2 Days Lower In Chop	1-2 days	Bullish	1.50%	3.20%
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 11/13

The market got clobbered again on Wednesday. The S&P closed lower by over 5%, marking the 8th time in the last two months that the S&P has dropped at least 5%. This matches the number of 5% drops seen over the entire period of 1960-2007. That's forty-seven years worth of huge drops in just two months. Breadth was extremely negative. The NYSE saw down volume account for close to 97% of volume. Total volume was noticeably light for such a sharp selloff. While it was above yesterday's level it didn't even reach the 50-day average. Perhaps the light volume is a sign that there are significantly fewer traders than there were a few months ago. I have received several emails in the past few months from people who lost a lot and are either afraid or unable to trade anymore.

A couple of notables from today's statistics suggest a bounce is likely – but only very short-term. The first is the 5% drop. Drops of this magnitude have typically been followed by rebounds in the next few days. The obvious recent exception was the November 5th drop which was followed by another 5% drop on the 6th. The 6th did see a rebound the next day of over 2.5%. Below is the table from the November 6th Letter that includes all of the previous 5% drops:

S&P 500 Drops 5% Today		
Instance	Date	Closed > Close of -5% Day
1	October 16, 1987	NO
2	October 19, 1987	Next day
3	October 26, 1987	Next day
4	January 8, 1988	Next day
5	October 13, 1989	Next day
6	October 27, 1997	Next day
7	August 31, 1998	Next day
8	April 14, 2000	Next day
9	September 29, 2008	Next day
10	October 7, 2008	4 days later
11	October 9, 2008	2 Days Later
12	October 15, 2008	Next day
13	October 22, 2008	Next day

The caveat with this study now is that 5% drops are becoming normal. The knee-jerk bounce may not be as reliable these days. Past 5% drops were often considered extreme overreactions. With so many occurring recently, it may be viewed more as a normal, although somewhat strong reaction. The relatively low volume that the three most recent 5% drops have occurred on is somewhat startling. Assuming the number of traders in the pool isn't greatly diminished, it would stand to reason that such sharp moves would be accompanied by a spike in volume. The lack of a volume spike suggests the 5% drop is simply not as emotional as it once was. I still believe the 5% drop may provide a long-side edge for the next day, but perhaps a greatly diminished one.

The down volume coming in at over 95% of (up volume + down volume) is something that has provided a short-term upside edge.

NYSE down volume comprises over 95% of (up volume plus down volume).										
Buy on close. Sell X bars later. \$100k/trade. 1970-present.										
X days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	\$34,088.23	26	14	12	53.85	\$4,519.10	(\$2,431.60)	1.86	2.17	\$1,311.09
4	\$24,574.68	27	15	12	55.56	\$3,792.67	(\$2,692.95)	1.41	1.76	\$910.17
3	\$8,230.81	27	14	13	51.85	\$3,276.72	(\$2,895.64)	1.13	1.22	\$304.84
2	\$8,702.82	27	17	10	62.96	\$2,566.13	(\$3,492.15)	0.73	1.25	\$322.33
1	\$18,612.40	28	20	8	71.43	\$2,267.76	(\$3,342.84)	0.68	1.70	\$664.73

Unfortunately the apparent edge here is very short-term as the stats generally fall off after day 1. Below is a listing of all the 1-day trades since 1970.

95% Down volume trades. One-day holding period.				
#	Date	Signal	Price	% Profit
1	11/18/74	Buy	\$69.27	
	11/19/74	Sell	\$68.20	-1.54%
2	12/18/78	Buy	\$93.44	
	12/19/78	Sell	\$94.24	0.86%
3	5/7/79	Buy	\$99.02	
	5/8/79	Sell	\$99.16	0.14%
4	10/9/79	Buy	\$106.63	
	10/10/79	Sell	\$105.30	-1.25%
5	3/24/80	Buy	\$99.27	
	3/25/80	Sell	\$99.19	-0.08%
6	12/8/80	Buy	\$130.61	
	12/9/80	Sell	\$130.47	-0.11%
7	8/24/81	Buy	\$125.50	
	8/25/81	Sell	\$125.13	-0.29%
8	10/25/82	Buy	\$133.32	
	10/26/82	Sell	\$134.47	0.86%
9	9/11/86	Buy	\$235.17	
	9/12/86	Sell	\$230.66	-1.92%
10	11/18/86	Buy	\$236.77	
	11/19/86	Sell	\$237.66	0.38%
11	10/16/87	Buy	\$282.69	
	10/19/87	Sell	\$224.83	-20.47%
12	10/19/87	Buy	\$224.83	
	10/20/87	Sell	\$236.83	5.34%
13	10/26/87	Buy	\$227.66	
	10/27/87	Sell	\$233.19	2.43%
14	11/30/87	Buy	\$230.30	
	12/1/87	Sell	\$232.00	0.74%
15	1/8/88	Buy	\$243.39	
	1/11/88	Sell	\$247.49	1.68%
16	4/14/88	Buy	\$259.75	
	4/15/88	Sell	\$259.77	0.01%
17	10/13/89	Buy	\$333.64	
	10/16/89	Sell	\$342.85	2.76%
18	8/23/90	Buy	\$307.06	
	8/24/90	Sell	\$311.51	1.45%
19	10/27/97	Buy	\$876.97	
	10/28/97	Sell	\$921.86	5.12%
20	8/31/98	Buy	\$957.55	
	9/1/98	Sell	\$994.25	3.83%
21	4/14/00	Buy	\$1,356.02	
	4/17/00	Sell	\$1,401.53	3.36%
22	2/27/07	Buy	\$1,399.14	
	2/28/07	Sell	\$1,406.82	0.55%
23	8/28/07	Buy	\$1,432.36	
	8/29/07	Sell	\$1,463.76	2.19%
24	9/29/08	Buy	\$1,106.42	
	9/30/08	Sell	\$1,166.36	5.42%
25	10/7/08	Buy	\$996.23	
	10/8/08	Sell	\$984.94	-1.13%
26	10/15/08	Buy	\$907.84	
	10/16/08	Sell	\$946.43	4.25%
27	10/22/08	Buy	\$896.78	
	10/23/08	Sell	\$908.11	1.26%
28	11/6/08	Buy	\$904.88	
	11/7/08	Sell	\$930.99	2.89%
29	11/12/08	Buy	\$852.30	
	open	n/a	\$852.30	n/a

A couple of things to note: 1) The results are still strong even though they need to absorb the crash of '87. 2) Since the Crash of '87 the signal has been quite reliable as the market has risen 16 of 17 times the following day. 10/7 was the lone failure.

Should the S&P close down about 4 points tomorrow, it will mean a new closing low for the bear and will also be the 4th day lower in a row. I suspected that when the market is extended in this manner, the likelihood of a quick reversal would increase substantially. So I ran some tests. First a fresh breakdown to a 100-day closing low that doesn't coincide with 4 consecutive lower closes:

S&P 500 makes 100-day low for the 1st time in at least 10 days. It does not mark the 4th+ day in a row lower.										
Buy on close. Sell X bars later. \$100k/trade. 1960-present.										
X days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$8,606.70)	48	24	24	50.00	\$2,844.80	(\$3,203.42)	0.89	0.89	(\$179.31)
9	(\$21,491.08)	48	20	28	41.67	\$3,043.90	(\$2,941.75)	1.03	0.74	(\$447.73)
8	(\$11,164.81)	48	22	26	45.83	\$3,096.31	(\$3,049.37)	1.02	0.86	(\$232.60)
7	(\$9,533.17)	48	22	26	45.83	\$2,643.79	(\$2,603.72)	1.02	0.86	(\$198.61)
6	(\$18,149.54)	48	20	28	41.67	\$2,521.74	(\$2,449.44)	1.03	0.74	(\$378.12)
5	(\$7,983.95)	48	25	23	52.08	\$1,798.95	(\$2,302.51)	0.78	0.85	(\$166.33)
4	(\$14,554.64)	48	24	24	50.00	\$1,876.25	(\$2,482.69)	0.76	0.76	(\$303.22)
3	(\$4,644.80)	48	23	25	47.92	\$1,771.93	(\$1,815.97)	0.98	0.90	(\$96.77)
2	(\$14,188.51)	48	23	25	47.92	\$1,365.92	(\$1,824.19)	0.75	0.69	(\$295.59)
1	(\$17,747.10)	48	21	27	43.75	\$990.93	(\$1,428.02)	0.69	0.54	(\$369.73)

Results here show more suffering has generally occurred following the breakdown. But let's see what happens when the market makes at least a 4th lower close in conjunction with the breakdown:

S&P 500 makes 100-day low for the 1st time in at least 10 days. It occurs on at least the 4th day lower in a row.										
Buy on close. Sell X bars later. \$100k/trade. 1960-present.										
X days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$15,738.02	28	14	14	50.00	\$3,830.95	(\$2,706.80)	1.42	1.42	\$562.07
9	\$24,761.72	28	15	13	53.57	\$3,514.78	(\$2,150.77)	1.63	1.89	\$884.35
8	\$27,472.59	28	18	10	64.29	\$2,712.42	(\$2,135.10)	1.27	2.29	\$981.16
7	\$23,793.14	28	17	11	60.71	\$2,666.99	(\$1,958.70)	1.36	2.10	\$849.76
6	\$30,348.57	28	17	11	60.71	\$2,867.16	(\$1,672.10)	1.71	2.65	\$1,083.88
5	\$20,958.56	28	16	12	57.14	\$2,482.09	(\$1,562.90)	1.59	2.12	\$748.52
4	\$11,430.29	28	16	12	57.14	\$1,825.37	(\$1,481.30)	1.23	1.64	\$408.22
3	\$2,840.60	28	13	15	46.43	\$1,617.52	(\$1,212.48)	1.33	1.16	\$101.45
2	(\$5,350.22)	28	12	16	42.86	\$968.80	(\$1,060.99)	0.91	0.68	(\$191.08)
1	(\$3,767.77)	28	12	16	42.86	\$904.37	(\$913.76)	0.99	0.74	(\$134.56)

The stats are better than above, but still not near what you would look for when trying to identify a long-side edge. In fact during the 1st 2 days there's a slight edge to the downside. Better than the 1st scenario but still bad. Almost like Anthony Michael Hall when he proclaimed himself "King of the Dipshits" in Sixteen Candles.

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



Both the green Aggregator and the black Differential line remain above 0 – and now squarely so. The market is very oversold and right near a potential support level. This could set up a long-side trade with a very favorable risk/reward scenario for agile intraday traders. Somewhat hampered by the newsletter format, I'm going to sit out a day here and see what happens. It's so close to new lows that it could hit them and cascade from there. If another massive selloff a la October does ensue I want to have plenty of capital available to buy into it. I already have some index exposure and there are 2 Catapult trades listed below which will allow more money to be put to work. There's a possibility if we get another move lower tomorrow I'll be looking to scale in a bit more to the SPY trade tomorrow night. For now I'll hold off on it though.

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

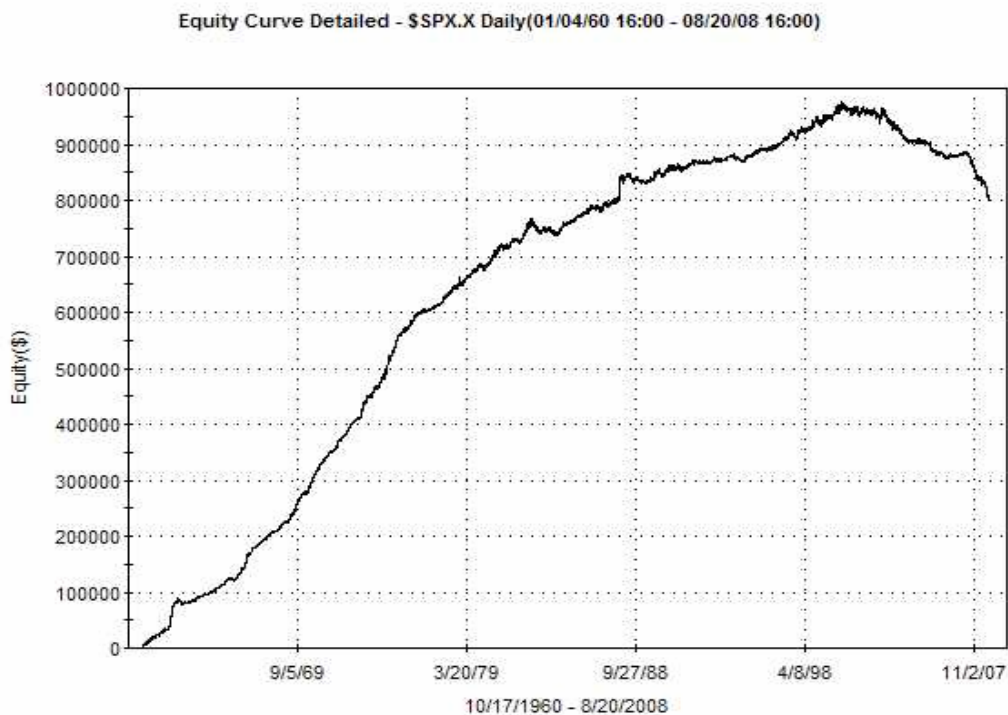
While the market did suffer a steep drop mid-week, it did manage to hold substantially above its October lows. Extremes anywhere close to those we saw at the October lows that I've previously outlined have almost always led to rallies lasting a few weeks to a few months. Much of this was discussed in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

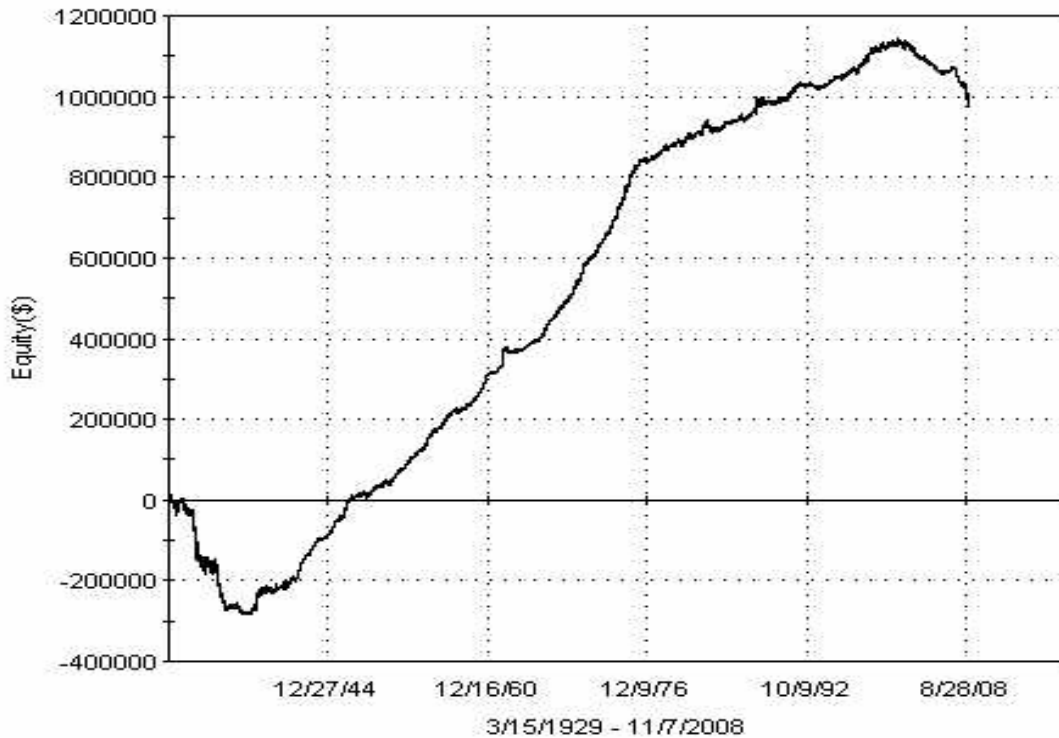
Some of the more interesting research I've done in the last few months had to do with the recent [tendency of the market to chop rather than trend](#). One of the findings of that research was that prior to 2000 the S&P 500 has most often followed up days with more positive days and down days with more 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

New

IP - buy @ \$11.77 limit

CBS – buy @ \$6.07 limit

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 2 (IP,CBS)

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	5.81
DJ US Insurance Index	IAK	1.35	DJ US Financial	IYF	2.40
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	1.40
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	11.97
DJ US Oil&Gas Expl & Prod	IEO	5.17	DJ US Industrial Sector	IYJ	8.43
DJ US Oil Equip & Svcs	IEZ	9.62	DJ US Consumer Goods	IYK	14.29
DJ US Pharmaceuticals	IHE	2.70	DJ US Basic Materials	IYM	2.70
DJ US Healthcare Providers	IHF	14.29	DJ US Real Estate	IYR	4.88
DJ US Medical Devices	IHI	12.20	DJ US Transportation	IYT	4.76
DJ US Aerospace & Defense	ITA	5.56	DJ US Technology Sector	IYW	8.54
DJ US Home Construction	ITB	9.52	DJ US Telecommunications	IYZ	5.26
DJ US Consumer Svcs	IYC	10.96	Nasdaq 100	QQQQ	2.00

There have been some quick spikes in sectors like Medical and Consumer.

Additional New Trade Ideas

See Catapult section above for 2 trade ideas.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY (1/4)	11/12/08	\$88.23	\$85.82	-2.73%		bought on open
GOOG	11/12/08	\$302.05	\$291.00	-3.66%		bought on open

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