

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 1, 2008

Issue 199

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
December 1, 2008	Wed-Fri Thanksgiving Rally	1-3 days	Bearish	-1.50%	-2.90%
November 28, 2008	3 Spyx Under 30	1-7 days	Bearish	-2.50%	-5.10%
November 28, 2008	Gap Dn 0.75% Close Up 0.75%	1-2 days	Bearish	-2.35%	-4.70%
November 28, 2008	RSI Thrust	1-4 days	Bullish	1.70%	3.60%
November 25, 2008	Up 3% with Poor Spyx or Vol	1-2 days	Bearish	-3.30%	-6.70%
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) –somewhat bearish – updated 12/1

The Friday after Thanksgiving was a shortened trading session. It is typically light volume and low volatility. This Friday was pretty standard. Volume was greatly reduced across the board. A tight morning range did give way to an eventual rally and the S&P closed nearly 1% higher. Breadth was strong as both NYSE up issues and up volume exceeded down by about 2:1.

Consistently strong breadth as we've seen the last 5 days is quite rare. I looked at other similar instances below:

NYSE up volume % > 65% 5 days in a row.										
Buy SPX on close. Sell X days later. \$100k/trade. 1970-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$18,563.98	12	8	4	66.67	\$2,667.28	(\$693.56)	3.85	7.69	\$1,547.00
9	\$20,803.89	12	9	3	75.00	\$2,608.97	(\$892.27)	2.92	8.77	\$1,733.66
8	\$19,982.48	12	9	3	75.00	\$2,572.56	(\$1,056.86)	2.43	7.30	\$1,665.21
7	\$23,727.14	12	9	3	75.00	\$3,003.12	(\$1,100.32)	2.73	8.19	\$1,977.26
6	\$18,893.55	12	9	3	75.00	\$2,329.22	(\$689.80)	3.38	10.13	\$1,574.46
5	\$18,194.11	12	9	3	75.00	\$2,206.25	(\$554.03)	3.98	11.95	\$1,516.18
4	\$13,438.48	12	9	3	75.00	\$1,881.58	(\$1,165.26)	1.61	4.84	\$1,119.87
3	\$10,636.42	12	9	3	75.00	\$1,426.41	(\$733.77)	1.94	5.83	\$886.37
2	\$9,161.21	13	10	3	76.92	\$1,132.54	(\$721.39)	1.57	5.23	\$704.71
1	\$4,832.61	17	10	7	58.82	\$610.71	(\$182.07)	3.35	4.79	\$284.27

Too few instances to read much into, but more often than not rallies on such good breadth have led to further upside over the next 1-2 weeks.

In the last Letter I indicated that if the market moved higher the VXO index would likely fall to a level that was 20% under its 20-day moving average. If this happened, it would trigger a bullish setup we looked at a few weeks ago. While the S&P rose nearly 1%, the VXO rose over 2%. The VXO rising on an up market day is unusual, but it's not terribly predictive:

VXO closes 2% higher and SPX closes at least 0.5% higher.										
Buy SPX on close. Sell X days later. \$100k/trade. 1986-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$12,635.29	64	31	33	48.44	\$1,894.26	(\$1,396.57)	1.36	1.27	\$197.43
9	\$1,906.96	65	28	37	43.08	\$1,949.45	(\$1,423.72)	1.37	1.04	\$29.34
8	(\$5,128.03)	65	29	36	44.62	\$1,797.90	(\$1,590.76)	1.13	0.91	(\$78.89)
7	(\$12,283.49)	65	33	32	50.77	\$1,494.82	(\$1,925.39)	0.78	0.80	(\$188.98)
6	\$3,587.54	65	34	31	52.31	\$1,589.10	(\$1,627.16)	0.98	1.07	\$55.19
5	(\$5,495.93)	67	33	34	49.25	\$1,525.46	(\$1,642.23)	0.93	0.90	(\$82.03)
4	\$3,958.45	69	35	34	50.72	\$1,451.09	(\$1,377.35)	1.05	1.08	\$57.37
3	(\$3,444.16)	71	33	38	46.48	\$1,143.50	(\$1,083.68)	1.06	0.92	(\$48.51)
2	\$1,396.74	73	41	32	56.16	\$847.58	(\$1,042.31)	0.81	1.04	\$19.13
1	(\$7,410.93)	73	35	38	47.95	\$409.12	(\$571.85)	0.72	0.66	(\$101.52)

Choppy action and slight underperformance over the next few weeks provides no real edge.

While it's difficult to discern much from Friday's shortened session, we can hope to learn something about short and long-term probabilities based on how strongly the market pulls back when it eventually does have a down day. Below I looked at all instances from 1960 for the S&P 500 when after a rally of at least 5 days in a row, the market then pulled back by less than 1% on its first down day:

After closing higher for at least 5 days in a row the SPX closes lower by less than 1%.										
Buy SPX 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 Factor	Avg Trade
20	\$109,219.11	159	98	61	61.64	\$2,721.66	(\$2,582.03)	1.05	1.69	\$686.91
15	\$78,517.24	178	106	71	59.55	\$2,411.42	(\$2,494.28)	0.97	1.44	\$441.11
10	\$76,437.24	194	120	74	61.86	\$1,798.13	(\$1,882.95)	0.95	1.55	\$394.01
9	\$69,274.49	199	125	74	62.81	\$1,623.67	(\$1,806.54)	0.90	1.52	\$348.11
8	\$63,647.29	201	119	82	59.20	\$1,609.36	(\$1,559.35)	1.03	1.50	\$316.65
7	\$48,039.30	204	119	85	58.33	\$1,489.14	(\$1,519.62)	0.98	1.37	\$235.49
6	\$47,235.08	209	123	86	58.85	\$1,344.41	(\$1,373.57)	0.98	1.40	\$226.01
5	\$41,926.95	209	125	84	59.81	\$1,210.07	(\$1,301.57)	0.93	1.38	\$200.61
4	\$46,929.30	209	126	83	60.29	\$1,081.64	(\$1,076.60)	1.00	1.53	\$224.54
3	\$29,602.67	209	123	85	58.85	\$934.84	(\$1,004.50)	0.93	1.35	\$141.64
2	\$34,888.65	209	127	82	60.77	\$737.16	(\$716.22)	1.03	1.59	\$166.93
1	\$14,271.09	209	108	100	51.67	\$577.55	(\$481.05)	1.20	1.30	\$68.28

Here we see that a mild pullback of less than 1% is typically followed by upside right from the start. Looking out 3-4 weeks the positive bias seems to carry through.

But what if the first pullback day was especially sharp? Let's look at that below:

After closing higher for at least 5 days in a row the SPX closes lower by greater than 1%.										
Buy SPX 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 Factor	Avg Trade
20	\$31,520.47	26	14	12	53.85	\$4,497.57	(\$2,620.46)	1.72	2.00	\$1,212.33
15	\$40,066.31	26	17	9	65.38	\$3,633.06	(\$2,410.63)	1.51	2.85	\$1,541.01
10	\$15,564.47	26	18	8	69.23	\$2,280.65	(\$3,185.91)	0.72	1.61	\$598.63
9	\$21,212.96	27	19	8	70.37	\$2,436.77	(\$3,135.72)	0.78	1.85	\$785.67
8	\$14,200.15	27	19	8	70.37	\$2,174.97	(\$3,390.53)	0.64	1.52	\$525.93
7	\$8,144.70	27	17	10	62.96	\$1,886.12	(\$2,391.93)	0.79	1.34	\$301.66
6	(\$5,669.43)	27	12	15	44.44	\$2,045.49	(\$2,014.36)	1.02	0.81	(\$209.98)
5	(\$11,068.82)	27	12	15	44.44	\$1,790.05	(\$2,169.96)	0.82	0.66	(\$409.96)
4	(\$8,103.25)	27	13	14	48.15	\$1,370.88	(\$1,851.76)	0.74	0.69	(\$300.12)
3	(\$5,313.40)	27	12	15	44.44	\$1,033.53	(\$1,181.05)	0.88	0.70	(\$196.79)
2	\$24.82	27	14	13	51.85	\$1,141.85	(\$1,227.77)	0.93	1.00	\$0.92
1	(\$8,275.02)	27	13	14	48.15	\$646.95	(\$1,191.81)	0.54	0.50	(\$306.48)

A few things to note above. First, when the market pulls back strongly to start, it often continues to head south over the next week. This negative bias does not persist though as returns appear even more bullish than above when looking out 2-4 weeks. Part of the difference is due to some unusually large successes, but you can at least say that the short-term negative connotations of a sharp pullback do not carry through over the longer-term.

I ran some tests last week showing the market behaved differently when coming off a potential bottom than it did at other times. [Wednesday's blog post](#) looked at this in some detail. I therefore decided to see how the above tests would look if the market was coming off a 50-day closing low prior to the 5+ day run-up:

After making a 50-day low and then closing higher for at least 5 days in a row the SPX closes lower by less than 1%.										
Buy SPX 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 Factor	Avg Trade
20	\$25,930.50	14	10	4	71.43	\$3,163.42	(\$1,425.92)	2.22	5.55	\$1,852.18
15	\$16,620.50	14	8	5	57.14	\$3,042.78	(\$1,544.35)	1.97	3.15	\$1,187.18
10	\$6,673.89	15	8	7	53.33	\$1,915.38	(\$1,235.59)	1.55	1.77	\$444.93
9	\$5,623.12	15	9	6	60.00	\$1,444.92	(\$1,230.20)	1.17	1.76	\$374.87
8	\$5,066.46	15	9	6	60.00	\$1,452.57	(\$1,334.45)	1.09	1.63	\$337.76
7	\$882.69	15	9	6	60.00	\$1,207.07	(\$1,663.49)	0.73	1.09	\$58.85
6	(\$2,736.45)	15	8	7	53.33	\$910.73	(\$1,431.76)	0.64	0.73	(\$182.43)
5	(\$333.46)	15	7	8	46.67	\$1,258.57	(\$1,142.93)	1.10	0.96	(\$22.23)
4	\$2,469.32	15	10	5	66.67	\$956.00	(\$1,418.13)	0.67	1.35	\$164.62
3	\$1,363.64	15	9	6	60.00	\$915.19	(\$1,145.51)	0.80	1.20	\$90.91
2	\$4,772.56	15	10	5	66.67	\$887.03	(\$819.55)	1.08	2.16	\$318.17
1	\$3,079.47	15	8	7	53.33	\$818.34	(\$495.32)	1.65	1.89	\$205.30

Instances are low. The ones available show more chop over the first week but better results looking out 3-4 weeks.

I also looked at drops > 1% in such cases as I did earlier:

After making a 50-day low and then closing higher for at least 5 days in a row the SPX closes lower by greater than 1%.										
Buy SPX 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 Factor	Avg Trade
20	\$28,934.99	8	7	1	87.50	\$4,715.97	(\$4,076.80)	1.16	8.10	\$3,616.87
15	\$27,576.84	8	8	0	100.00	\$3,447.11	\$0.00	100.00	100.00	\$3,447.11
10	\$6,043.42	8	7	1	87.50	\$1,782.89	(\$6,436.80)	0.28	1.94	\$755.43
9	\$2,782.34	8	6	2	75.00	\$2,187.30	(\$5,170.73)	0.42	1.27	\$347.79
8	\$411.88	8	7	1	87.50	\$1,527.64	(\$10,281.60)	0.15	1.04	\$51.49
7	(\$3,039.29)	8	6	2	75.00	\$1,033.30	(\$4,619.55)	0.22	0.67	(\$379.91)
6	(\$10,889.02)	8	2	6	25.00	\$1,636.48	(\$2,360.33)	0.69	0.23	(\$1,361.13)
5	(\$10,914.98)	8	2	6	25.00	\$1,931.36	(\$2,462.95)	0.78	0.26	(\$1,364.37)
4	(\$7,068.87)	8	3	5	37.50	\$1,336.10	(\$2,215.43)	0.60	0.36	(\$883.61)
3	(\$3,320.50)	8	4	4	50.00	\$1,243.37	(\$2,073.50)	0.60	0.60	(\$415.06)
2	(\$3,647.98)	8	3	5	37.50	\$1,506.15	(\$1,633.29)	0.92	0.55	(\$456.00)
1	(\$5,704.63)	8	4	4	50.00	\$709.03	(\$2,135.19)	0.33	0.33	(\$713.08)

Instances again quite low, but the results are also very pronounced. The short-term negative implication is amplified as is the intermediate-term bullish implication.

My take-away from all this is if we get a mild looking pullback, it may be a better idea to cut bait on the short-trade and take a loss. A stronger pullback could ignite further short-term selling and holding for another few days might be the best option.

The one study I showed in the November 28th Subscriber Letter that did trigger was the action following a solid rise over the Wednesday and Friday surrounding Thanksgiving:

SPX rises > 0.5% from Tuesday before Thanksgiving's close until Friday after Thanksgivings open.										
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 Factor	Avg Trade
5	(\$12,338.58)	29	14	15	48.28	\$1,591.25	(\$2,307.74)	0.69	0.64	(\$425.47)
4	(\$16,886.15)	29	10	19	34.48	\$1,706.86	(\$1,787.09)	0.96	0.50	(\$582.28)
3	(\$16,891.30)	29	8	21	27.59	\$1,885.43	(\$1,522.61)	1.24	0.47	(\$582.46)
2	(\$15,201.84)	29	10	19	34.48	\$1,130.01	(\$1,394.84)	0.81	0.43	(\$524.20)
1	(\$9,438.12)	29	10	19	34.48	\$859.26	(\$948.98)	0.91	0.48	(\$325.45)

Implications of this are bearish through Wednesday and it has been added to the Active Studies List above.

The [Aggregator](#) chart is updated below:



As can be seen by the black differential line, the rally has slowed a bit over the last couple of days. Still it has far exceeded expectations. The green Aggregator line remains below zero. (Note there was a slight error in the Aggregator line on Thursday night and it appeared slightly positive when in fact it should have been slightly negative). It is scheduled to remain negative for the next few days. The short-term edge still appears to be to the downside as last weeks rally has the market short-term overdone by a number of measures. Bearish studies include a spectrum of indicators related to such things as volume, price, chop and seasonality. I will continue to look to scale in on the short side in anticipation of a retracement of part of last week's rally.

Intermediate-term Outlook (2 weeks – 2 months)–slightly bullish -updated 12/1

The market has managed to bounce strongly from levels that were **extremely oversold based on historical measures**. Most of the time in the past this has led to continued follow through over the next few weeks or months. This is the third try for such a rally since early October. The first two attempts quickly died out.

The S&P has already rallied over 19% off its lows. It rallied about 12% just last week. In the November 2nd Letter I showed a study that compared the 1st week gains of the S&P off the lows with the 1st week gains of the IBD 100. The IBD 100 is an active index whose components change from week to week. It is compiled and tracked by Investors Business Daily and it is supposed to represent leading stocks.

The premise of the study was that outperformance of the S&P 500 over the IBD 100 could suggest a rally driven by short-covering as laggards were outperforming leaders. What was found out was that this kind of short-covering is desirable at the beginning of a

new rally. Those attempts that saw the IBD 100 lag in week one actually performed quite a bit better than those that didn't. While the October attempts struggled I'd still consider it a good sign that the S&P has performed so strongly as compared to the IBD 100 over the last week.

Another notable occurrence from last week is the possible direction change in the trend vs. chop chart, which can be found on the website [by clicking here](#). While it's too early to know for sure, it appears the trend vs. chop chart is also attempting to put in a bottom. This would signal a character change for the market as the environment could move from one where directional moves are more often reversed strongly on a daily basis to one that favors follow-through day to day. The last such attempt to move from a choppy to a trendy environment was in early October and that reverted to choppy very quickly. I'll continue to keep an eye on this attempt.

Basically I'm seeing evidence that would suggest the market got so overdone and has bounced so violently that it is likely to put in a rally that could last from a few weeks to a few months. Unfortunately many of the same indications were given at the October rally attempts. Should the pullback manage to put in a higher low, which seems likely at this point, I will likely begin to trade with a bit of a bullish bias.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

MDT is still officially open although we exited a while ago.

Catapult for ETF's Trades

None new

Broad Market Large Cap CBI – 1 (MDT)

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	2.82
DJ US Oil&Gas Expl & Prod	IEO	3.45	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	1.35
DJ US Healthcare Providers	IHF	4.08	DJ US Real Estate	IYR	1.22
DJ US Medical Devices	IHI	4.88	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	0.00	DJ US Technology Sector	IYW	0.50
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	2.19	Nasdaq 100	QQQQ	2.00

As would be expected after this rally, nearly all oversold conditions have been worked off.

Additional New Trade Ideas

SPY – short 1/4 index position @ \$90.09 limit on close. Continue to gradually add to our position should the market close higher. This 3rd quarter would give us a 3/4 index position. Reasons for this are laid out in the short-term overview section above.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(s) 1/4	11/26/2008	\$86.05	\$90.09	-4.69%		
SPY(s) 1/4	11/28/2008	\$90.09	\$90.09	0.00%		

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