

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 2, 2008

Issue 200

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 2, 2008	5% Drop	1-4 days	Bullish	5.30%	8.50%
<i>December 1, 2008</i>	<i>Wed-Fri Thanksgiving Rally</i>	<i>1-3 days</i>	<i>Bearish</i>	<i>-1.50%</i>	<i>-2.90%</i>
<i>November 28, 2008</i>	<i>3 Spyx Under 30</i>	<i>1-7 days</i>	<i>Bearish</i>	<i>-2.50%</i>	<i>-5.10%</i>
November 28, 2008	RSI Thrust	1-4 days	Bullish	1.70%	3.60%
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 12/2

The market got clobbered today. The S&P 500 and Nasdaq lost 9%, the Dow lost almost 8% and the Russell 2000 lost close to 12%. Breadth was extremely bad. Down volume made up nearly 99% of all volume and about 89% of all issues declined. Volume was light and didn't even reach its 50-day average.

Most of the time very strong reactions are overreactions. They often reverse and retrace at least part of the move shortly following the overreaction. While today could be viewed as a reaction to the overreaction from last week, it's possible today's 9% drop was also an overreaction. In November I posted a table on the blog that showed all days where the S&P dropped 5% and how long it took for the market to close above that day's closing level. That table is reproduced below:

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

There have now been 6 more 5% drops since this was posted. Below are those results (today's drop is not listed):

S&P Drops 5% Today		
Instance	Date	Closed > Close of -5% Day
14	November 5, 2008	No
15	November 6, 2008	Next day
16	November 12, 2008	Next day
17	November 19, 2008	3 days later
18	November 20, 2008	Next day

In 16 of 18 cases there was some kind of bounce in the next few days. I'm glad to be off the SPY short position at this point. I'm not quite ready to go long, though.

So far the SPY has retraced about 50% of the move from the previous week. There's no support nearby and potential risk equals potential reward using the recent high and low to measure. I'd rather wait for a bit more downside before taking a stab long.

Additionally, I don't consider the light volume to be a good thing. I've shown some studies such as [this one back in March](#) which have not supported the theory that when the first day of a pullback is on light volume it bodes well for the rebound.

This is the 11th 5% single day drop since September. I can only spot 3 others that occurred on volume below the 50-day average. They were 11/5, 11/6, and 11/19. Both 11/5 and 11/19 were followed by another 5%+ drop the next day. 11/6 came on the heels of 11/5. It led to a lame 1-day bounce that quickly rolled over. When big moves down occur on light volume it often means that buyers stepped away. Many times that void will be filled the next day by sellers aggressively entering the market.

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



Both the green Aggregator line and the black differential line flipped to strongly positive on Monday. This is normally a bullish setup, but when dealing with such large drops, especially in the middle of a range on light volume, I'd prefer to sit out another day. I may look to take a position at the close tomorrow for the right price. Both the Aggregator and the differential lines are set to move higher unless there is a strong up day or bearish studies arise. Also, tomorrow will be the 2nd day in a row lower, which would signal our [2 Days Down In Chop](#) trigger that's been highly reliable in this extremely choppy environment. Entry details in trade idea section below.

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.)

Unable to update tonight – apologies.

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

Additional New Trade Ideas

SPY – buy 1/4 index position @ \$80.00 limit *on close*. Looking to take on a little long exposure should the market continue to sell off tomorrow.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(s) 1/4	11/26/2008	\$86.05	\$85.00	1.22%		intraday update target
SPY(s) 1/4	11/28/2008	\$90.09	\$82.11	8.86%		covered rest on close

The average gain on the 2 lots of SPY short was 5.04%.

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