

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 16, 2008

Issue 210

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 15, 2008	Gap Down & Reverse	1-2 days	Bearish	-2.30%	-4.60%
December 15, 2008	December Op-Ex Week	1-5 days	Bullish	1.90%	3.10%
December 10, 2008	SOX Up SPX Down	1-8 days	Bullish	5.70%	9.10%
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) – neutral – updated 12/16

The market sold off most of the day Monday. Only a late-day buying surge kept the final numbers from looking too bad. The S&P dropped 1.3%, the Nasdaq 2.1% and the Russell 3.4%. Breadth was strongly negative as NYSE up issues % and Up Volume % both came in between 25%-30%. Volume fell substantially ahead of tomorrow's Fed meeting.

The action today left me with very few ideas for testing. The S&P has reversed every day for the past 5 days, providing little in the way of overbought/oversold. One indicator that posted quite a low reading tonight was the Volume Spyx. Readings between 0 and 25 have been followed by a slight overall loss the next day. On its own it certainly isn't enough to use as a consideration. The core focus tomorrow will be the Fed meeting.

I have posted [several studies to the blog in the past on Fed meetings](#) and market action surrounding them. The choppy action leading up to this meeting doesn't leave us a whole lot to go on as far as guessing direction. Where we may find an edge is in the action following the Fed meeting. I have shown studies which looked at strong moves **both up** and **down** following a Fed announcement. What I found was that the initial direction tended to reverse after just a day or two. Traders may want to review some of the Fed studies in preparation for tomorrow.

I have updated the [Aggregator](#) chart below:



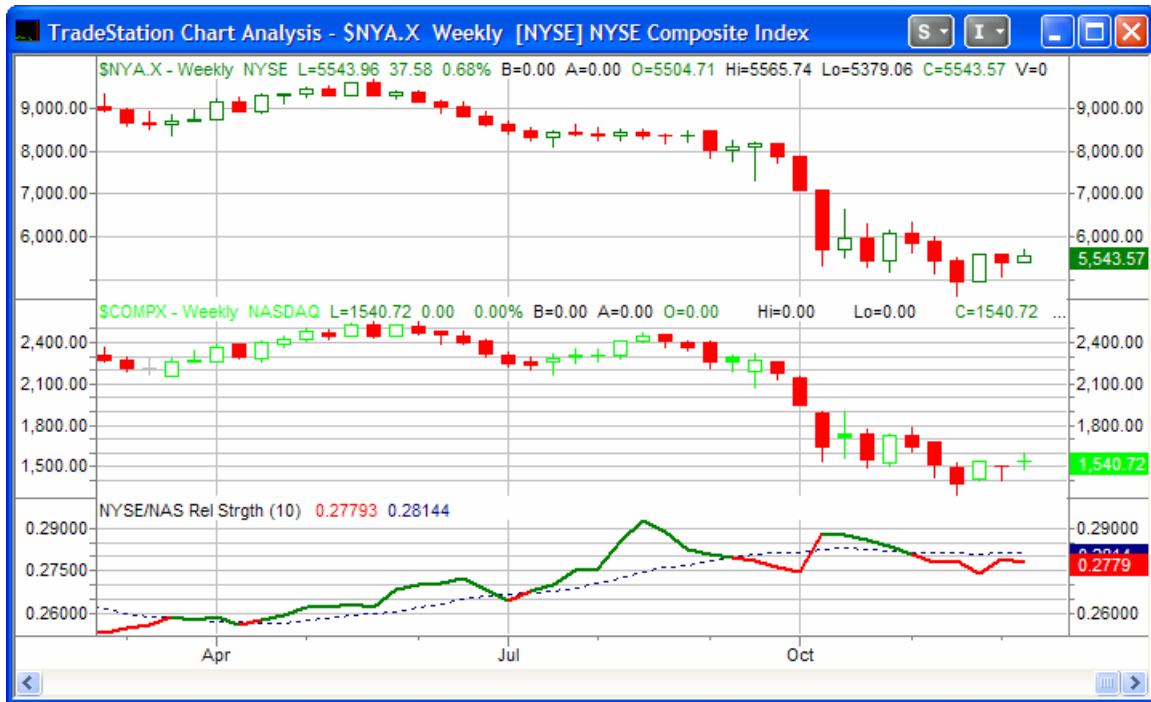
The S&P has now clearly underperformed expectations over the last 3 days. Meanwhile, expectations are positive and slated to become more so. With both the green Aggregator and the black differential line squarely above the zero line, the formation is currently bullish. Rather than try and game the Fed I'd rather hope to get a good entry price after the news is out. A negative reaction to the Fed would keep the black differential line in solidly bullish territory. It would also likely trigger a bullish Fed reversal study such as [this one](#). Lastly it would give us two consecutive days lower, triggering the “2 Days Down in Chop” system. With all that potentially going for it, I'll be looking to get long tomorrow if the market closes substantially lower. Details are in the trade idea section below.

Intermediate-term Outlook (2 weeks – 2 months)–slightly bullish -updated 12/15

Little has changed this week with regards to the intermediate-term. The market is still attempting to put together a rally off of extremely oversold conditions. Last week I looked at such ideas as divergences and the ability of the market to rally during overbought conditions. Much of what I looked at is still intact. Results suggested a couple of things. First, that the current rally attempt was showing several indicators that would suggest a rally is likely if the market was in a secular bull market mode. Second, since we aren't in secular bull market mode at the time being, those indicators are simply not reliable.

One indicator that is yet to fire a bullish signal is the Nasdaq/NYSE Relative Strength indicator I use. Below is a weekly chart with a 10-week ema of the Nasdaq/NYSE ratio shown in the bottom pane. When the solid thick line is above the dotted line it turns green and signals the Nasdaq has been outperforming the NYSE. When it is red, the

NYSE has been leading. Historically, a leading Nasdaq has been a positive sign for the stock market.



Going back to January 1972 the NYSE composite has gained 5792 points when the Nasdaq has been leading. Over the same time period the NYSE Composite has lost 855 points when it has led the Nasdaq. While a leading Nasdaq is no layup to further gains, it's something I'd prefer to see, especially considering how the market has struggled over the last 36 years when it hasn't led.

I remain somewhat optimistic that the market will be able to put together some kind of multi-month rally here soon. I also anticipate I will remain wary of getting too aggressive trying to play momentum with any such rally. This is not the typical bear market and the first concerted rally attempt will likely not be typical either.

Seasonal Testing

One seasonal tendency that you may see mentioned in the next few weeks in the January Effect. The January Effect suggests that small caps (especially beaten down ones) tend to outperform large caps in January (and part of December). I decided to run some simple tests based on this hypothesis.

I found that over the last 20 years from December 15th (or the next trading day if that is a weekend) to February 1st the Russell 2000 has outperformed the S&P 500 12 times. While that isn't a sizeable winning percentage the total gains have outsized the total losses by about 5 to 1.

Even more interesting is the action the last few weeks of December. Again buying at the close on the 15th and this time selling at the close of the 1st day of the New Year, the

Russell 2000 has outperformed the S&P 500 15 of the last 20 years. Gross gains have been 27.61% or 1.84%/win average. Gross losses have been only -5.15%, or -1.03% per average loss. The net gain was 22.46% or 1.12% per trade. This is a sizable difference when talking about a relatively short-term spread between 2 indices.

There are a number of ways to play this. The simplest of which perhaps would be to wait for a day or two of outperformance by the S&P and then enter a spread transaction in anticipation of both a mean reversion and a seasonal tendency.

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	0.00
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	0.00
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	0.38
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	0.00
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	1.35
DJ US Healthcare Providers	IHF	2.04	DJ US Real Estate	IYR	0.00
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	0.50
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.44	Nasdaq 100	QQQQ	0.00

No capitulative action evident.

Additional New Trade Ideas

HAL – short @ \$17.48 limit. Cover stop at \$18.41 if filled. This is another setup based on system “-80403”. DD and AMAT both triggered this system last week as noted in the 12/11 newsletter. Both of those triggers would have led to gains based in the systems exit strategy. I like HAL here because it just formed a potential reversal bar at the declining 50-day moving average. This gives us a support area fairly nearby. System details are copied from last week.

I haven't yet created the system page for -80403. It was a short system originally published in the April 3rd Subscriber Letter. Below is the description from that letter:

- 1) Close < 200-day moving average. (Long term downtrend)
- 2) Has closed higher at least 7 days in a row. (Short-term overbought).
- 3) Today is the lightest volume in 5 days. (The low volume is a clue that the buying enthusiasm is drying up.)

Shorting this setup and covering on a close below the 5-day MA in the S&P 100 stocks over the last 10 years would have produced the following results:

50 trades.

41 winners (82%)

Avg win = 2.2%

Avg Loss = 2.8%

Avg Trade = 1.3%

Profit Factor = 3.54

SPY buy ¼ position @ \$87.05 limit on close. Based on short-term outlook above I'm looking for a long entry on a close a bit lower.

Active Trades Table

none

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