

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 17, 2008

Issue 211

## 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
<b>Active</b>					
December 17, 2008	S&P up 4% on mediocre volume	1-4 days	Bearish	-5.70%	-10.60%
December 17, 2008	1.5% Fed Day Spike	1 day	Bearish	-0.90%	-1.90%
<b>December 15, 2008</b>	<b>December Op-Ex Week</b>	<b>1-5 days</b>	<b>Bullish</b>	<b>1.90%</b>	<b>3.10%</b>
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		

### **Dropped Tonight**

<b>December 15, 2008</b>	<b>Gap Down &amp; Reverse</b>	<b>1-2 days</b>	<b>Bearish</b>	<b>-2.30%</b>	<b>-4.60%</b>
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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 12/17**

The market popped sharply on Tuesday as the Fed statement suggested they will do whatever it takes to jump start the economy. The major indices all closed over 5% higher. Breadth was strong with up volume over 90% on both the NYSE and Nasdaq. Total volume increased but still fell shy of 50-day average volume.

The Fed meeting was the focus of the day and the market rallied sharply following their release. The only other time we've seen a rally of 5% in the S&P 500 on a Fed day was 1/3/01. In that case the market pulled back sharply over the next 3 days, actually giving up all its gains on an intraday basis. It then rallied for the next 3 weeks.

Loosening the parameters to a 1.5% spike on a Fed day, you start to get a decent sample size:

S&P 500 rises > 1.5% on a Fed day.												
Buy on close. Sell X days later. \$100k/trade. 1982 - present.												
X days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
2	(\$1,547.07)	23	13	10	56.52	\$2,212.98	(\$3,630.44)	\$578.56	(\$906.84)	0.64	0.83	(\$67.26)
1	(\$9,218.37)	23	9	14	39.13	\$1,240.00	(\$4,686.30)	\$479.63	(\$966.79)	0.50	0.32	(\$400.80)

In this case there appears to be a slight downside edge. It really only lasts for 1 day though.

I looked at all times the S&P 500 rose 1% or more on a Fed day and closed at a 10-day high:

S&P 500 rises > 1% on a Fed day and closes at a 10-day high.												
Buy on close. Sell X days later. \$100k/trade. 1982 - present.												
X days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
10	(\$28,517.79)	27	10	17	37.04	\$4,389.95	(\$9,625.50)	\$1,858.21	(\$2,770.58)	0.67	0.39	(\$1,056.21)
9	(\$27,932.00)	27	9	18	33.33	\$3,671.75	(\$12,928.50)	\$2,103.28	(\$2,603.42)	0.81	0.40	(\$1,034.52)
8	(\$19,320.11)	27	12	15	44.44	\$3,830.40	(\$7,050.88)	\$1,521.81	(\$2,505.46)	0.61	0.49	(\$715.56)
7	(\$9,017.60)	27	11	16	40.74	\$4,379.50	(\$6,122.88)	\$1,799.66	(\$1,800.87)	1.00	0.69	(\$333.99)
6	(\$1,656.21)	27	15	12	55.56	\$2,817.70	(\$4,948.52)	\$1,220.31	(\$1,663.40)	0.73	0.92	(\$61.34)
5	(\$5,323.00)	27	12	15	44.44	\$3,055.05	(\$5,099.06)	\$1,384.07	(\$1,462.12)	0.95	0.76	(\$197.15)
4	(\$5,021.74)	27	13	14	48.15	\$2,072.97	(\$4,296.18)	\$1,140.79	(\$1,418.01)	0.80	0.75	(\$185.99)
3	(\$7,412.81)	27	15	12	55.56	\$2,932.29	(\$5,878.78)	\$1,009.65	(\$1,879.80)	0.54	0.67	(\$274.55)
2	\$2,768.58	27	16	11	59.26	\$2,212.98	(\$3,630.44)	\$822.45	(\$944.61)	0.87	1.27	\$102.54
1	(\$398.24)	27	13	14	48.15	\$1,990.25	(\$2,617.60)	\$683.73	(\$663.34)	1.03	0.96	(\$14.75)

Here the edge isn't as prevalent initially, but over the next 2 weeks a downside tendency can be observed. Not shown above is that 70% of all instances closed below the close of the Fed day within the next 3 days. While this isn't one of the strongest edges we've seen, it does suggest a pullback is the odds-on play.

About a month ago on the blog I discussed S&P [performance following 5% up days](#). There appeared to be a rather strong tendency for some of those gains to be given back over the next few days. Below is an updated list of all the instances where the S&P rose 5% in one day along with its performance the next day.

Day following a 5% up day:

Date/Time	Signal	Price	Roll Over USD/Lot	Shares/Ctrts Profit	Net Profit Cum Net Profit	% Profit
05/27/70	Buy	\$72.77	\$0.00	1374	\$2,528.16	2.53%
05/28/70	Sell	\$74.61		\$2,528.16	\$2,528.16	
10/20/87	Buy	\$236.83	\$0.00	422	\$9,089.88	9.10%
10/21/87	Sell	\$258.37		\$9,089.88	\$11,618.04	
10/21/87	Buy	\$258.37	\$0.00	387	(\$3,916.44)	(3.92%)
10/22/87	Sell	\$248.25		(\$3,916.44)	\$7,701.60	
10/28/97	Buy	\$921.86	\$0.00	108	(\$291.60)	(0.29%)
10/29/97	Sell	\$919.16		(\$291.60)	\$7,410.00	
09/08/98	Buy	\$1,023.45	\$0.00	97	(\$1,673.25)	(1.69%)
09/09/98	Sell	\$1,006.20		(\$1,673.25)	\$5,736.75	
01/03/01	Buy	\$1,347.53	\$0.00	74	(\$1,053.76)	(1.06%)
01/04/01	Sell	\$1,333.29		(\$1,053.76)	\$4,682.99	
07/24/02	Buy	\$843.43	\$0.00	118	(\$560.50)	(0.56%)
07/25/02	Sell	\$838.68		(\$560.50)	\$4,122.49	
07/29/02	Buy	\$898.96	\$0.00	111	\$424.02	0.42%
07/30/02	Sell	\$902.78		\$424.02	\$4,546.51	
09/30/08	Buy	\$1,166.36	\$0.00	85	(\$450.50)	(0.45%)
10/01/08	Sell	\$1,161.06		(\$450.50)	\$4,096.01	
10/13/08	Buy	\$1,003.35	\$0.00	99	(\$528.66)	(0.53%)
10/14/08	Sell	\$998.01		(\$528.66)	\$3,567.35	
10/28/08	Buy	\$940.51	\$0.00	106	(\$1,104.52)	(1.11%)
10/29/08	Sell	\$930.09		(\$1,104.52)	\$2,462.83	
11/13/08	Buy	\$911.29	\$0.00	109	(\$4,142.00)	(4.17%)
11/14/08	Sell	\$873.29		(\$4,142.00)	(\$1,679.17)	
11/21/08	Buy	\$800.03	\$0.00	124	\$6,420.72	6.47%
11/24/08	Sell	\$851.81		\$6,420.72	\$4,741.55	
11/24/08	Buy	\$851.81	\$0.00	117	\$652.86	0.66%
11/25/08	Sell	\$857.39		\$652.86	\$5,394.41	
12/16/08 open	Buy	\$913.18		109	n/a	n/a
	n/a	\$913.18		n/a	n/a	

Further observation reveals that 12 out of 14 5% days closed lower than the 5% day close at some point in the next 5 days. The only ones that didn't were 11/21/8 and 5/27/70.

A bit discouraging about Tuesday's action was the fact that the volume wasn't very high. Using volume as a filter I devised the following test:

S&P rises > 5%. Today's volume is NOT the highest in the last 10 days.												
Buy on close. Sell X days later. \$100k/trade. 1982 - present.												
X days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
7	(\$42,355.26)	7	0	7	0.00	\$0.00	(\$21,797.40)	\$0.00	(\$6,050.75)	0.00	0.00	(\$6,050.75)
6	(\$24,184.67)	7	3	4	42.86	\$2,214.81	(\$15,420.70)	\$1,884.41	(\$7,459.47)	0.25	0.19	(\$3,454.95)
5	(\$25,149.07)	7	2	5	28.57	\$6,915.44	(\$14,461.05)	\$4,148.85	(\$6,689.35)	0.62	0.25	(\$3,592.72)
4	(\$29,945.94)	7	2	5	28.57	\$2,733.74	(\$9,744.66)	\$1,670.00	(\$6,657.19)	0.25	0.10	(\$4,277.99)
3	(\$18,018.25)	7	2	5	28.57	\$5,198.31	(\$11,884.77)	\$4,095.88	(\$5,242.00)	0.78	0.31	(\$2,574.04)
2	(\$14,964.06)	7	3	4	42.86	\$4,196.79	(\$9,455.49)	\$2,347.18	(\$5,501.40)	0.43	0.32	(\$2,137.72)
1	(\$6,596.49)	7	2	5	28.57	\$652.86	(\$3,916.44)	\$538.44	(\$1,534.67)	0.35	0.14	(\$942.36)

In this case all 7 instances closed lower than the close of the 5% day at some point in the next 4 days.

Loosening the parameters to 4% yielded the following:

S&P rises > 4%. Today's volume is NOT the highest in the last 10 days.												
Buy on close. Sell X days later. \$100k/trade. 1982 - present.												
X days	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
7	(\$39,135.50)	15	5	10	33.33	\$8,279.82	(\$21,797.40)	\$3,307.59	(\$5,567.35)	0.59	0.30	(\$2,609.03)
6	(\$21,376.37)	16	9	7	56.25	\$9,988.11	(\$15,420.70)	\$3,211.19	(\$7,182.44)	0.45	0.57	(\$1,336.02)
5	(\$31,918.62)	18	9	9	50.00	\$11,988.81	(\$14,461.05)	\$3,882.60	(\$7,429.11)	0.52	0.52	(\$1,773.26)
4	(\$40,099.22)	18	9	9	50.00	\$9,526.41	(\$10,971.63)	\$2,630.28	(\$7,085.75)	0.37	0.37	(\$2,227.73)
3	(\$17,427.48)	18	10	8	55.56	\$7,448.76	(\$11,884.77)	\$2,717.71	(\$5,575.57)	0.49	0.61	(\$968.19)
2	(\$28,697.92)	19	8	11	42.11	\$4,479.84	(\$9,986.13)	\$2,804.23	(\$4,648.34)	0.60	0.44	(\$1,510.42)
1	(\$23,768.83)	19	5	14	26.32	\$2,860.08	(\$5,245.02)	\$1,186.10	(\$2,121.38)	0.56	0.20	(\$1,250.99)

In this case 16 of 19 (84%) closed lower than the entry price at some point in the next 4 days.

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

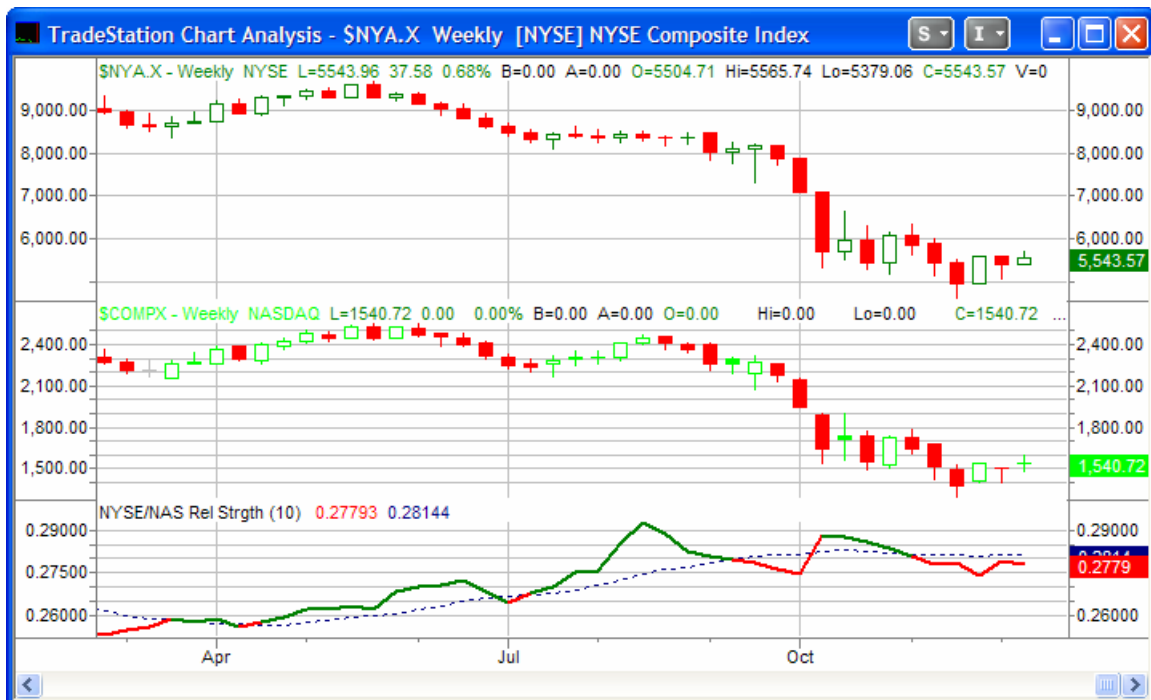


Even with tonight's studies the green Aggregator line hasn't managed to flip completely negative. Instead it is sitting neutral and suggesting a return equal to market drift. It is currently set up to turn negative as of tomorrow. The black differential line is solidly below the line, illustrating the market has outperformed expectations over the last few days. An up day tomorrow would trigger the "2 days up in chop" system that has performed so well for the last year and a half. With the Aggregator potentially turning green and more bearish studies and systems ready to trigger on a higher close, I'll be looking to get short on any close higher tomorrow. The fact that the market has reversed direction every day for the past 6 days has made it difficult to locate good entry points for swing trades. This has made trading extremely slow in December.

**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 15<sup>th</sup> (or the next trading day if that is a weekend) to February 1<sup>st</sup> 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 15<sup>th</sup> and this time selling at the close of the 1<sup>st</sup> 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**

*SPY* – short  $\frac{1}{4}$  index position @ \$91.88 *limit on close*. Based on short-term market overview above.

### **Active Trades Table**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
HAL(s)	12/16/2008	\$17.48	\$18.41	-5.32%		<i>stopped out for loss</i>

Our 1<sup>st</sup> losing trade in a while turned bad almost immediately.

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