

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 18, 2008

Issue 212

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

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 12/18

The market never really got moving too much in either direction today. Most index charts have that “consolidation day” look to them. Breadth was mixed as advancers outnumbered decliners but down volume led up volume. Volume overall was weak. Small caps rose while the large caps fell. The small cap outperformance tendency from the 15th-31st that I noted on Sunday has been playing out perfectly. Since Monday’s close the S&P is up 4.1%. Meanwhile the Russell 2000 is up 7.5%.

I spent far too much time tonight looking for clues that just aren’t there. When I have a difficult time finding an edge, it often means there isn’t a strong directional bias.

Positive breadth on a day when the S&P closed lower by ½% or more has led to mixed short-term results. It is not bullish as some would infer. I demonstrated this in my [September 4th blog post](#). The S&P Volume Spyx reading came in low, but that’s more indicative of a selloff if the market closes higher at the same time.

Despite the drop in the S&P the VIX also dropped and is now more than 10% below its 10-day moving average. It’s a common misconception that this is a bearish setup when in fact [I have found that the market has outperformed when VIX readings are 10-20% below their 10ma](#).

It’s not terribly surprising that the VIX has been dropping. Volatility has also. The 10-day Avg True Range %, and the 10-day Average Absolute Gap are both below their 100-day average readings. These are two ways to see that volatility levels have dropped to below normal over the past 2 weeks. (Normal being the 100-day averages.)

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

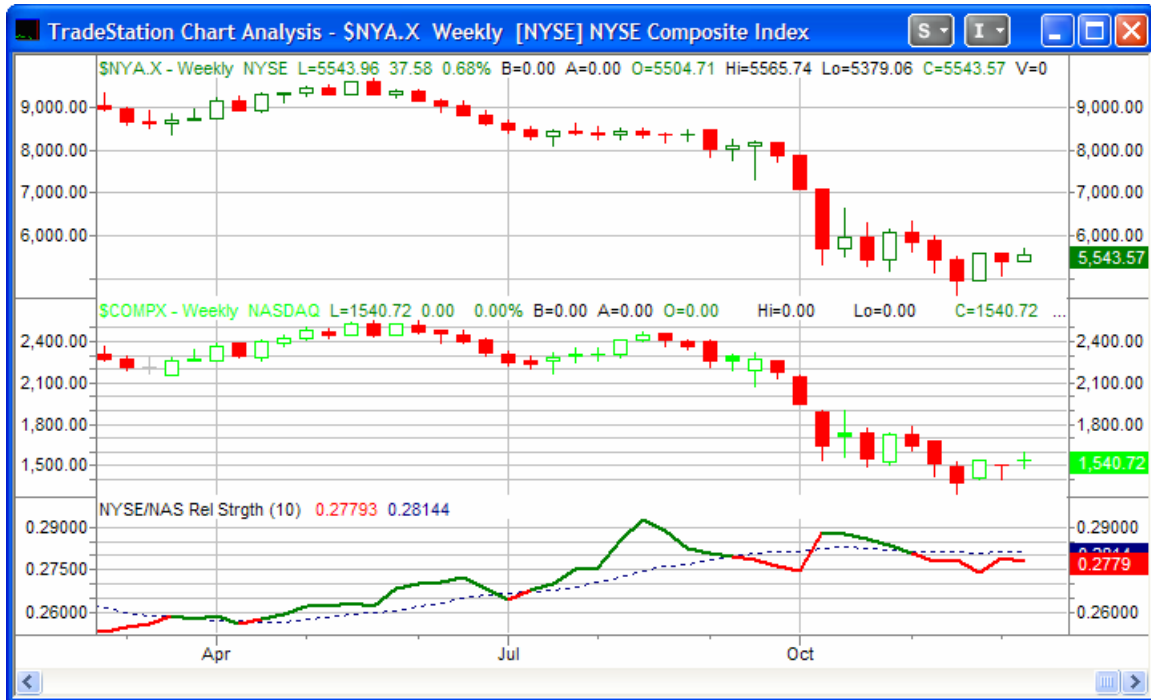


The black differential line remains below the zero line and the green Aggregator has flipped there as well. None of the things I looked at tonight were worthwhile enough for inclusion. The positioning of the lines suggests a possible short play. I'm not going to bite with an index trade immediately. From last night's Letter I was looking to get short on Wednesday if the S&P closed higher. That was very close to happening with about 10 minutes left in the day. Unfortunately a late swoon kept the trade idea from filling. Should anyone have played it more aggressively there may still be some room to the downside. With the downside edge fairly small and the fact that the S&P has changed direction 7 days in a row now I'd prefer to wait another day to see if an edge becomes more clear. There are some system triggers discussed in the trade idea section.

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	0.00	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	0.88	Nasdaq 100	QQQQ	0.00

No capitulative action evident.

Additional New Trade Ideas

The triggers list on the website tonight has all dollar/bond-related plays. TLT and IEF are triggering -80514 and FXE is now triggering -80505 after triggering -81217 last night. Another option with the same theme for those trading IRA's and unable to go short would be a long in UUP.

I'll look to enter FXE short @ \$144.18 limit as tonight's trade idea. It likely doesn't matter which one you choose at this point. FXE is basically the only one near potential resistance so it's my choice.

I did update the ETF performance numbers for both -80514 and -80505 tonight on the site. -80505 was originally designed as a stock system. There have only ever been 4 other triggers among my list of 120 ETF's. In other words, the ETF stats are basically useless for this setup. FXE is still active with the -81217 setup from last night, though.

Active Trades Table

None

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