

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 22, 2008

Issue 214

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 22, 2008	Nasdaq Volume Spyx < -5	1-6 days	Bearish	-4.50%	-9.20%
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 19, 2008	2 Down In Chop	1-2 days	Bullish	1.67%	3.50%

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) –b – updated 12/22

The market failed to hold a large gap up on Friday. The major indices closed mixed, with the Dow lower, the S&P slightly higher and the Nasdaq up 0.8%. One group that did perform well was smallcaps, which rose 1.5%. Advancers led decliners by 3 to 2 on the NYSE while up volume edged out down volume. Volume overall was quite high – no doubt partially due to options expiration.

Most notable on the volume front was that the S&P and Nasdaq Volume Spyx readings were extremely low. This was especially true for the Nasdaq which came in at negative 18.66. Readings that low are quite rare. Of course options expiration may have had something to do with the unusually low reading, but rather than try and justify it away let's look at other times where the Nasdaq Volume Spyx came in extremely low. I first looked at results following all instances with a Nasdaq Spyx reading under negative 10:

<i>Nasdaq Volume Spyx daily chart closes under negative 10</i>										
<i>Buy on close. Sell X days later. \$100k/trade. 2000-present.</i>										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$21,569.24)	12	6	6	50.00	\$3,472.66	(\$7,067.53)	0.49	0.49	(\$1,797.44)
9	(\$25,601.01)	12	5	7	41.67	\$3,201.83	(\$5,944.31)	0.54	0.38	(\$2,133.42)
8	(\$14,188.39)	12	6	6	50.00	\$3,199.75	(\$5,564.48)	0.58	0.58	(\$1,182.37)
7	(\$33,950.66)	12	7	5	58.33	\$2,086.31	(\$9,710.97)	0.21	0.30	(\$2,829.22)
6	(\$32,604.30)	12	5	7	41.67	\$1,759.01	(\$5,914.19)	0.30	0.21	(\$2,717.03)
5	(\$28,030.15)	13	5	8	38.46	\$1,173.01	(\$4,236.90)	0.28	0.17	(\$2,156.17)
4	(\$22,557.15)	13	4	9	30.77	\$1,982.57	(\$3,387.49)	0.59	0.26	(\$1,735.17)
3	(\$28,885.24)	13	3	10	23.08	\$1,649.10	(\$3,383.25)	0.49	0.15	(\$2,221.94)
2	(\$31,578.83)	13	2	11	15.38	\$873.06	(\$3,029.54)	0.29	0.05	(\$2,429.14)
1	(\$21,736.69)	15	6	9	40.00	\$858.83	(\$2,987.74)	0.29	0.19	(\$1,449.11)

Results were strongly bearish but instances were a bit low. Three days out looked especially interesting. I loosened the parameters to negative 5 to get a better sample size:

Nasdaq Volume Spyx daily chart closes under negative 5										
Buy on close. Sell X days later. \$100k/trade. 2000-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$34,443.31)	20	9	11	45.00	\$2,940.21	(\$5,536.84)	0.53	0.43	(\$1,722.17)
9	(\$41,310.65)	20	6	14	30.00	\$2,983.72	(\$4,229.50)	0.71	0.30	(\$2,065.53)
8	(\$39,217.53)	20	7	13	35.00	\$2,936.26	(\$4,597.80)	0.64	0.34	(\$1,960.88)
7	(\$45,583.56)	20	8	12	40.00	\$2,020.77	(\$5,145.81)	0.39	0.26	(\$2,279.18)
6	(\$43,157.03)	20	6	14	30.00	\$2,349.96	(\$4,089.77)	0.57	0.25	(\$2,157.85)
5	(\$36,233.00)	21	7	14	33.33	\$1,482.01	(\$3,329.08)	0.45	0.22	(\$1,725.38)
4	(\$33,681.22)	21	5	16	23.81	\$1,912.71	(\$2,702.80)	0.71	0.22	(\$1,603.87)
3	(\$30,635.07)	22	6	16	27.27	\$1,484.33	(\$2,471.32)	0.60	0.23	(\$1,392.50)
2	(\$34,529.24)	23	7	16	30.43	\$910.14	(\$2,556.27)	0.36	0.16	(\$1,501.27)
1	(\$27,736.71)	26	10	16	38.46	\$649.33	(\$2,139.38)	0.30	0.19	(\$1,066.80)

Even with the loosened parameters the results are still decidedly bearish. Most interesting is the fact that of the 26 occurrences, every single one of them posted a close below the trigger day close within 3 trading days. This is an extremely high percentage for such a short exit time.

Some of the most curious action this week has been in the VIX. It has dropped sharply even though the S&P spent much of the week dropping and barely eeked out a gain thanks to Tuesday's big Fed rally. I've seen this action pointed out by several other market observers who've mostly stated it was bearish. While it would seem that a pullback that doesn't scare anyone may need to continue pulling back until it does, I haven't found that to be the case in testing. Thursday night I showed some tests which suggested the VIX action was neutral to very slightly bearish. Tonight I ran another test which simply looked at market performance following a drop in the VIX for 4 days in a row.

VIX falls 4 days in a row										
Buy on close. Sell X days later. \$100k/trade. 1990-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	(\$37,062.89)	152	76	76	50.00	\$1,326.65	(\$1,814.32)	0.73	0.73	(\$243.83)
4	(\$30,422.50)	152	75	77	49.34	\$1,194.41	(\$1,558.49)	0.77	0.75	(\$200.15)
3	(\$16,685.81)	152	79	73	51.97	\$1,087.26	(\$1,405.19)	0.77	0.84	(\$109.78)
2	(\$10,072.42)	152	79	73	51.97	\$935.18	(\$1,150.03)	0.81	0.88	(\$66.27)
1	(\$1,786.77)	152	76	75	50.00	\$679.46	(\$712.34)	0.95	0.97	(\$11.76)

Wins and losses are almost dead even over the next 1-5 days. There is a slight bearish tilt in that the losses outsize the winners. Risks are a bit higher therefore as complacent market participants are more likely to become fearful and bail out of the market in a big swing down as they are to suddenly become aggressive buyers.

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



The green Aggregator line is strongly below the 0 line thanks to some substantially bearish studies. The fact that the market has spent most of the last 3 days pulling back is leaving the black Aggregator line above the 0 line. This is not an ideal setup as I normally prefer to have both lines on the same side of zero to initiate a position. Should tomorrow close up the “2 Days Up In Chop” system will trigger, adding to the bearish list. I’ll be looking for short opportunities then. In this case I’d favor the QQQQ over the SPY due to the extremely low Nasdaq Spyx reading.

Intermediate-term Outlook (2 weeks – 2 months)– very slightly bullish -updated 12/22

The market has stumbled higher off its mid-November lows. Some key ingredients for an intermediate-term rally were in place as I discussed at the time. These included extremely oversold conditions followed by sharp rallies higher and bullish divergences. The pullbacks have been fairly mild and the market has worked its way higher.

Notable this week was that the S&P closed above its 50-day moving average for the first time in a long time. [I posted a study on the blog a few days ago](#) that looked at other times the S&P had spent a long time below its 50 and then moved above it. The results suggested a trading range was more likely than a strong market move in either direction. Results were also slightly bullish.

Last week I noted the Nasdaq had so far failed to take on a leadership role. This is a bit concerning since the market has achieved over 100% of its gains in the last 38 years while the Nasdaq was leading. As you can see below, the Nasdaq has still failed to take on a leadership role (relative strength line that the bottom is red).



This weekend I looked at other times the market has come off an intermediate-term bottom and after five weeks the Nasdaq had still failed to take on a leadership role. Surprisingly, results were not materially different from those where the Nasdaq quickly began to lead.

I also noticed that it was not only the daily Nasdaq Volume Spyx that posted an extreme reading Friday, but the weekly Nasdaq Volume Spyx closed extremely low as well. I've included a chart of it below:



The 0.61 reading is exceptionally low. I ran a test back to 2000 to see how the Nasdaq performed following readings below 10:

<i>Nas Spyx Weekly closes below 10.</i>											
<i>Buy on close. Sell X days later. \$1mil/trade. 2000-present. (One entry at a time.)</i>											
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade	
13	(\$69,942.29)	9	4	5	44.44	\$91,331.55	(\$87,053.70)	1.05	0.84	(\$7,771.37)	
12	\$48,468.49	9	4	5	44.44	\$94,100.62	(\$65,586.80)	1.43	1.15	\$5,385.39	
11	\$167,927.75	9	4	5	44.44	\$108,411.96	(\$53,144.02)	2.04	1.63	\$18,658.64	
10	\$130,824.68	10	6	4	60.00	\$64,729.34	(\$64,387.83)	1.01	1.51	\$13,082.47	
9	(\$58,162.56)	12	6	6	50.00	\$74,164.03	(\$83,857.79)	0.88	0.88	(\$4,846.88)	
8	(\$139,047.47)	12	6	6	50.00	\$54,592.55	(\$77,767.13)	0.70	0.70	(\$11,587.29)	
7	(\$112,341.13)	13	5	8	38.46	\$47,663.04	(\$43,832.04)	1.09	0.68	(\$8,641.63)	
6	(\$177,179.20)	13	4	9	30.77	\$59,619.19	(\$46,184.00)	1.29	0.57	(\$13,629.17)	
5	(\$261,007.76)	14	4	10	28.57	\$56,164.53	(\$48,566.59)	1.16	0.46	(\$18,643.41)	
4	(\$267,695.62)	14	5	9	35.71	\$42,002.62	(\$53,078.75)	0.79	0.44	(\$19,121.12)	
3	(\$28,192.81)	16	8	8	50.00	\$46,429.31	(\$49,953.41)	0.93	0.93	(\$1,762.05)	
2	(\$111,156.21)	18	8	10	44.44	\$40,635.74	(\$43,624.21)	0.93	0.75	(\$6,175.35)	
1	(\$33,565.97)	22	10	12	45.45	\$23,571.01	(\$22,439.67)	1.05	0.88	(\$1,525.73)	

These numbers look a bit bigger than most tests because it was run using a \$1mil/trade instead on \$100k. The Nasdaq has struggled over the following five weeks or so by a fairly sizable amount.

For most tests I only allow one entry at a time. This way there is no double-counting on certain weeks. Sometimes I'll run them and allow multiple positions to be active at one time. I decided to do that here and have posted those results below:

<i>Nas Spyx Weekly closes below 10.</i>											
<i>Buy on close. Sell X days later. \$1mil/trade. 2000-present. (Multiple entries at a time.)</i>											
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade	
13	(\$781,862.96)	22	7	15	31.82	\$85,053.99	(\$91,816.06)	0.93	0.43	(\$35,539.23)	
12	(\$613,187.24)	22	8	14	36.36	\$77,306.95	(\$87,974.49)	0.88	0.50	(\$27,872.15)	
11	(\$416,236.65)	22	7	15	31.82	\$105,589.40	(\$77,024.17)	1.37	0.64	(\$18,919.85)	
10	(\$377,068.42)	22	9	13	40.91	\$75,966.77	(\$81,597.64)	0.93	0.64	(\$17,139.47)	
9	(\$228,620.32)	22	10	12	45.45	\$72,780.38	(\$79,702.01)	0.91	0.76	(\$10,391.83)	
8	(\$290,904.91)	22	10	12	45.45	\$56,955.03	(\$71,704.60)	0.79	0.66	(\$13,222.95)	
7	(\$147,928.86)	22	8	14	36.36	\$53,951.24	(\$41,395.63)	1.30	0.74	(\$6,724.04)	
6	(\$265,528.77)	22	7	15	31.82	\$58,952.31	(\$45,212.99)	1.30	0.61	(\$12,069.49)	
5	(\$343,882.18)	22	7	15	31.82	\$56,905.58	(\$49,481.42)	1.15	0.54	(\$15,631.01)	
4	(\$421,294.95)	22	8	14	36.36	\$45,679.29	(\$56,194.95)	0.81	0.46	(\$19,149.77)	
3	(\$197,222.46)	22	10	12	45.45	\$43,699.31	(\$52,851.29)	0.83	0.69	(\$8,964.66)	
2	(\$154,309.00)	22	10	12	45.45	\$38,003.11	(\$44,528.34)	0.85	0.71	(\$7,014.05)	
1	(\$33,565.97)	22	10	12	45.45	\$23,571.01	(\$22,439.67)	1.05	0.88	(\$1,525.73)	

Results appear even more negative here. This isn't surprising considering there are some bad weeks that are being double counted.

Overall, the market is still stair-stepping it way higher. We're near a seasonally bullish time of year. The government has indicated it is going to do whatever it takes to get the economy moving again. Aside from the Nasdaq Volume Spyx readings I'm not seeing much that would suggest a selloff is imminent. It does appear unlikely that the market is just going to blast off from here, though. Right now a range bound scenario appears the

most likely to me. If forced to pick a direction beyond a few weeks, I'd likely lean bullish.

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	0.34
DJ US Regional Banks	IAT	1.25	DJ US Financial Services	IYG	0.70
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	0.00
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	0.00
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.00	Nasdaq 100	QQQQ	0.00

No capitulative action evident.

Additional New Trade Ideas

*QQQQ – short 1/4 index position @ \$30.50 limit. If not filled during day short @ \$30 limit on close. – Based on short-term market overview above. Should neither get filled but the S&P manages to rally, I will look to short the SPY **instead** at \$88.19 limit on close.*

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
FXE(s)	12/18/2008	\$145.27	\$139.13	4.23%		covered on close < 5ma
IEF(s)	12/19/2008	\$99.85	\$99.20	0.65%		cover on close < 10ma

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