

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 7, 2009

Volume 2 Issue 4

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 - Short Term					
January 5, 2009	Appel Breadth Thrust	1-20 days	Bullish	4.60%	7.80%
January 5, 2009	1st Friday of month spike	1-5 days	Bearish	-2.60%	-5.60%
January 5, 2009	S&P Higher Hi but NH Issues Low	1-4 Days	Bearish	-4.30%	-8.90%
January 2, 2009	New Year Following Bad Year	1-4 Days	Bullish	3.70%	5.70%
January 2, 2009	2 Days Up In Chop	1-4 Days	Bearish	-1.50%	-3.00%
December 31, 2008	10/200 Put/Call < 0.85	1-9 days	Bearish	-2.70%	-5.00%
December 29, 2008	10/100 ATR < 0.60	n/a	Bearish	n/a	n/a
Active - Long Term					
January 5, 2009	Appel Breadth Thrust	5 weeks avg	Bullish		
December 18, 2008	Break above 50-day		Neutral - Trading Range		
December 21, 2008	Nasdaq Lagging		Bearish		
December 21, 2008	Nasdaq Vol Spyx Low	1-5 weeks	Bearish		
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish		
Dropped Tonight - none					

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) – somewhat bearish – updated 01/07

The market gapped up Tuesday and chopped around for most of the day. After it was over the major averages all finished below their open but still positive on the day. Volume was down a little from Monday. Breadth remained strong as both NYSE Up Issues and Up Volume came in at over 75%. Oddly, the number of New Highs on the NYSE dropped for the third day in a row, even while the S&P has continued to make higher highs.

Most notable about the recent action is the incredible extremes some breadth indicators have reached. The McClellan Oscillator for instance hit 376 according to my data today. (This varies slightly from the McClellan's reading of 386.) This is the highest reading going back to at least 1965 – which is as far as my breadth data goes. The only other times it reached above even 300 was April of 2004 and November 2008. Typically when the Oscillator has crossed above 200 it has led to a short-term pullback.

McClellan Oscillator moves over 200.										
Buy S&P on close. Sell X days later. 100k/trade. 1965-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$33,169.08)	17	7	10	41.18	\$1,817.33	(\$4,589.04)	0.40	0.28	(\$1,951.12)
9	(\$29,636.29)	18	5	13	27.78	\$2,172.60	(\$3,115.33)	0.70	0.27	(\$1,646.46)
8	(\$36,449.26)	19	6	13	31.58	\$1,915.01	(\$3,687.64)	0.52	0.24	(\$1,918.38)
7	(\$36,082.63)	19	5	14	26.32	\$1,428.08	(\$3,087.36)	0.46	0.17	(\$1,899.09)
6	(\$24,015.14)	19	8	11	42.11	\$1,249.04	(\$3,091.59)	0.40	0.29	(\$1,263.95)
5	(\$31,185.87)	22	8	14	36.36	\$1,227.18	(\$2,928.81)	0.42	0.24	(\$1,417.54)
4	(\$39,177.19)	22	3	19	13.64	\$1,563.16	(\$2,308.77)	0.68	0.11	(\$1,780.78)
3	(\$22,759.01)	24	8	16	33.33	\$1,784.08	(\$2,314.48)	0.77	0.39	(\$948.29)
2	(\$25,118.52)	27	8	19	29.63	\$1,453.65	(\$1,934.09)	0.75	0.32	(\$930.32)
1	(\$23,057.39)	27	8	19	29.63	\$1,380.37	(\$1,794.76)	0.77	0.32	(\$853.98)

Four days out 86% of the instances saw the S&P trading lower. The only 3 that didn't were 10/19/98, 10/30/98 and 5/24/05. While I would normally include this study in the Aggregator, it actually crossed 200 on December 31st, so tomorrow Wednesday would be the 4th day. Still it seems likely that the market should pull back being that the reading is now stratospheric.

The McClellan Oscillator is not the only breadth indicator hitting extremes. Worden Brothers tracks the percentage of stocks trading above their 200ma and the percentage of stocks trading above their 40ma. On Tuesday 89% of stocks closed above their 40ma but only 8% above their 200ma. The difference of 81% is by far the biggest on record going back to 1986. The only other time the difference was even over 50% was in January of 1988 when it peaked at 63%. That led to a short-term pullback and then a multi-week rally.

While it's difficult to determine much from such a unique occurrence the fact that it is so overbought short-term relative to the long-term would seem to again argue for a short-term pullback. The extreme level could also be suggestive of the possibility of a more sustained multi-week rally following this pullback. Evidence of this can be seen in looking at the Appel Daily Breadth Thrust Signal discussed on Sunday night with results also shown in the intermediate-term outlook section below.

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



The overall chart has not changed much from yesterday. The green Aggregator line is still slightly bearish and the black differential line remains well below 0 indicating the S&P has outperformed expectations over the last few days. This still suggests a short-term pullback appears likely.

Intermediate-term Outlook (2 weeks – 2 months)– slightly bullish -updated 1/5/9

The spike on Friday pushed the S&P to its highest levels since mid-November. This breakout will be widely watched by technicians. Some may even view it as an imperfect looking inverted head and shoulders bottom.

Prices have stabilized, although based on last week’s average true range and absolute average gap studies, they may have stabilized a bit too quick. Rapid deceleration of range has most often led to a selloff.

The two other negatives I’m still watching involve the Nasdaq. First, it continued to lag the NYSE Composite Index. Historically, the Nasdaq has led during strong upmoves. The 2nd issue with the Nasdaq is the poor weekly volume Spyx readings it has been posting. The December 21st Letter discussed this in some detail and it suggested bearish implications.

On the positive side we have the breadth thrust signal discussed in the short-term outlook section today. Using the data in my database, I was able to nearly replicate the trades listed in Mr. Appel’s book. Below is a performance report based on his entry and exit criteria:

All Trades

Total Net Profit	\$94,401.73	Profit Factor	6.16
Gross Profit	\$112,698.81	Gross Loss	(\$18,297.08)
Total Number of Trades	32	Percent Profitable	78.13%
Winning Trades	25	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	\$2,950.05	Ratio Avg. Win:Avg. Loss	1.72
Avg. Winning Trade	\$4,507.95	Avg. Losing Trade	(\$2,613.87)
Largest Winning Trade	\$12,471.48	Largest Losing Trade	(\$7,424.82)
Max. Consecutive Winning Trades	7	Max. Consecutive Losing Trades	2
Avg. Bars in Winning Trades	28.92	Avg. Bars in Losing Trades	11.71
Avg. Bars in Total Trades	25.16		

On average you're in a trade for about 5 weeks. One nice thing about this system is that the losing trades don't normally last very long. You relatively quickly whether the trade is working or not.

While the market is quite overbought in the short-term, between the price breakout and the breadth thrust there may be some hope for an intermediate-term rally. I'm slightly bullish right now and without further evidence that the rally is likely to fail I may begin to buy oversold conditions more aggressively than I short overbought ones.

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	0.00
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	0.44	Nasdaq 100	QQQQ	0.00

I can't recall the last time I saw readings as dormant as this. There are no sectors undergoing capitulative selling.

Additional New Trade Ideas

TGT – Short @ \$39. From the triggers list I'll look to take this trade idea on further upside tomorrow.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(s) 1/4	12/30/2008	\$88.97	\$93.47	-5.06%		
SPY(s) 1/4	12/31/2008	\$90.24	\$93.47	-3.58%		
XLU(s)	1/2/2009	\$29.34	\$29.70	-1.23%		
XLE(s)	1/5/2009	\$50.15	\$51.89	-3.47%		
SPY(s) 1/4	1/6/2008	\$93.64	\$93.47	0.18%		entered at open
SPY(s) 1/4	1/6/2008	\$94.25	\$93.47	0.83%		entered at limit

The average price for the full SPY position is \$91.775.

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2008 Hanna Capital Management, LLC