

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 8, 2009

Volume 2 Issue 5

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 | | | | | |
| January 8, 2009 | Gap n Crap From Sht Term OvrB | 1-3 days | Bearish | -2.70% | -5.20% |
| January 8, 2009 | 2.5% - 5% Declines In Bear | 1-3 days | Bearish | -4.96% | -9.70% |
| January 5, 2009 | Appel Breadth Thrust | 1-20 days | Bullish | 3.70% | 5.70% |
| 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 | | | | | |
| 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 | | | | | |
| January 5, 2009 | S&P Higher Hi but NH Issues Lo | 1-4 Days | Bearish | -1.50% | -3.00% |
| January 2, 2009 | 2 Days Up In Chop | 1-4 Days | Bearish | -1.50% | -3.00% |
| January 2, 2009 | New Year Following Bad Year | 1-4 Days | Bullish | 3.70% | 5.70% |

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**.

Short-term Outlook (1-5 days) –neutral – updated 01/08

The market finally began to pull back like I've been expecting. Wednesday started off with a sizable gap down. The bounce off the open was brief and the market made its way lower for most of the day. Volume came in lighter than on Tuesday. Breadth was strongly negative as the NYSE Up Issue % was 20% and the Up Volume % only 12%.

I ran a few tests tonight based on the price action. I first look at this kind of "gap -n-crap" action where the SPY gaps lower and then continues to drop. I looked at it in the context of being short-term overbought in a longer-term downtrend:

| SPY gaps lower by 0.5%, does not fill its gap and closes below the open. Yesterday's 3-period RSI was over 60. Close < 200ma. | | | | | | | | | | |
|---|----------------------|-----------|-----------|-----------|--------------|-------------------|--------------------|-------------|---------------|-------------------|
| Buy SPY on close. Sell X bars later. \$100k/trade. 1993-present. | | | | | | | | | | |
| X Days | Net Profit | Trades | Wins | Losses | % Wins | Avg Win | Avg Loss | W/L Ratio | Profit Factor | Avg Trade |
| 10 | (\$20,954.55) | 24 | 11 | 13 | 45.83 | \$2,723.34 | -\$3,916.26 | 0.70 | 0.59 | (\$873.11) |
| 9 | (\$20,015.54) | 25 | 11 | 14 | 44.00 | \$2,188.36 | -\$3,149.11 | 0.69 | 0.55 | (\$800.62) |
| 8 | (\$20,439.35) | 25 | 12 | 13 | 48.00 | \$1,721.57 | -\$3,161.40 | 0.54 | 0.50 | (\$817.57) |
| 7 | (\$2,717.42) | 26 | 10 | 16 | 38.46 | \$3,394.06 | -\$2,291.13 | 1.48 | 0.93 | (\$104.52) |
| 6 | (\$6,677.70) | 26 | 13 | 13 | 50.00 | \$1,928.77 | -\$2,442.44 | 0.79 | 0.79 | (\$256.83) |
| 5 | (\$12,869.54) | 27 | 11 | 16 | 40.74 | \$2,525.32 | -\$2,540.50 | 0.99 | 0.68 | (\$476.65) |
| 4 | (\$12,918.84) | 27 | 12 | 15 | 44.44 | \$2,740.19 | -\$3,053.41 | 0.90 | 0.72 | (\$478.48) |
| 3 | (\$18,570.84) | 29 | 13 | 16 | 44.83 | \$1,709.94 | -\$2,550.00 | 0.67 | 0.54 | (\$640.37) |
| 2 | (\$4,106.84) | 29 | 13 | 16 | 44.83 | \$2,135.11 | -\$1,991.45 | 1.07 | 0.87 | (\$141.62) |
| 1 | (\$8,385.07) | 30 | 14 | 16 | 46.67 | \$1,262.62 | -\$1,628.86 | 0.78 | 0.68 | (\$279.50) |

In this case it appears the edge appears to be for further downside. Within the 1st three days 67% of the instances posted at least one close lower then the trigger price. Looking out a little further the percentage rises to 75% over 6 days or 89% over 9 days.

Requiring the SPY to close at least 1% below its open price as it did on Wednesday produces even more bearish results:

| <i>SPY gaps lower by 0.5%, does not fill its gap and closes 1% below the open. Yesterday's 3-period RSI was over 60. Close < 200ma.</i> | | | | | | | | | | |
|--|---------------|--------|------|--------|--------|------------|-------------|-----------|---------------|--------------|
| <i>Buy SPY on close. Sell X bars later. \$100k/trade. 1993-present.</i> | | | | | | | | | | |
| X Days | Net Profit | Trades | Wins | Losses | % Wins | Avg Win | Avg Loss | W/L Ratio | Profit Factor | Avg Trade |
| 10 | (\$8,915.77) | 14 | 8 | 6 | 57.14 | \$2,956.38 | -\$5,427.81 | 0.54 | 0.73 | (\$636.84) |
| 9 | (\$6,858.95) | 14 | 7 | 7 | 50.00 | \$2,777.96 | -\$3,757.81 | 0.74 | 0.74 | (\$489.93) |
| 8 | (\$18,402.00) | 14 | 6 | 8 | 42.86 | \$2,071.01 | -\$3,853.51 | 0.54 | 0.40 | (\$1,314.43) |
| 7 | (\$12,025.66) | 14 | 4 | 10 | 28.57 | \$3,901.62 | -\$2,763.21 | 1.41 | 0.56 | (\$858.98) |
| 6 | (\$9,678.82) | 14 | 6 | 8 | 42.86 | \$2,465.44 | -\$3,058.93 | 0.81 | 0.60 | (\$691.34) |
| 5 | (\$11,340.83) | 14 | 4 | 10 | 28.57 | \$3,696.74 | -\$2,612.78 | 1.41 | 0.57 | (\$810.06) |
| 4 | (\$17,959.98) | 14 | 5 | 9 | 35.71 | \$2,950.97 | -\$3,634.98 | 0.81 | 0.45 | (\$1,282.86) |
| 3 | (\$19,473.47) | 15 | 6 | 9 | 40.00 | \$1,524.44 | -\$3,180.01 | 0.48 | 0.32 | (\$1,298.23) |
| 2 | (\$3,032.83) | 15 | 7 | 8 | 46.67 | \$2,125.75 | -\$2,239.14 | 0.95 | 0.83 | (\$202.19) |
| 1 | (\$7,875.33) | 15 | 7 | 8 | 46.67 | \$1,156.54 | -\$1,996.39 | 0.58 | 0.51 | (\$525.02) |

In this case 12 of 15 (80%) closed below the trigger price at some point in the next 3 days. Looking out 7 days that improves to 14 of 15 (93%).

The SPX closed lower by 3% today. I've looked at drops of 5% or more in depth in the last few months and found there to be a tendency for a short-term bounce following such steep drops. Tonight I decided to see how drops between 2.5% and 5% have fared since the beginning of the bear market.

| <i>S&P 500 drops between 2.5% and 5% today.</i> | | | | | | | | | | | | |
|---|---------------|--------|------|--------|--------|-------------|---------------|------------|--------------|-----------|---------------|--------------|
| <i>Buy S&P 500 on close. Sell X days later. \$100k/trade. October 2007 - present.</i> | | | | | | | | | | | | |
| X Days | Net Profit | Trades | Wins | Losses | % Wins | Max Win | Max Loss | Avg Win | Avg Loss | W/L Ratio | Profit Factor | Avg Trade |
| 5 | (\$34,836.66) | 13 | 4 | 9 | 30.77 | \$2,645.28 | (\$18,908.10) | \$1,373.48 | (\$4,481.17) | 0.31 | 0.14 | (\$2,679.74) |
| 4 | (\$18,265.70) | 15 | 6 | 9 | 40.00 | \$15,340.08 | (\$12,819.96) | \$3,971.86 | (\$4,677.43) | 0.85 | 0.57 | (\$1,217.71) |
| 3 | (\$32,234.93) | 17 | 5 | 12 | 29.41 | \$14,708.85 | (\$11,518.47) | \$3,738.22 | (\$4,243.84) | 0.88 | 0.37 | (\$1,896.17) |
| 2 | (\$4,040.95) | 18 | 8 | 10 | 44.44 | \$10,873.83 | (\$9,320.67) | \$3,227.76 | (\$2,986.30) | 1.08 | 0.86 | (\$224.50) |
| 1 | (\$5,345.95) | 20 | 9 | 11 | 45.00 | \$11,683.71 | (\$6,980.25) | \$2,787.84 | (\$2,766.95) | 1.01 | 0.82 | (\$267.30) |

In these cases further downside was more common. 84% of instances closed below the trigger price at some point in the next 3 days.

Notable from the studies list is that the "2 days down in chop" system failed to deliver a short-side gain before being closed out after day 4 (Wednesday). This is the 1st loser in 24 trades dating back to last April. It will be important to monitor near-term performance here. Continued failure could indicate a change in character for the market. Rather than just selling into mildly overbought conditions the market may begin to forge through such conditions if it is going to rally. In such cases it may not pullback until it becomes severely overbought. The reversals down may also not be as drastic.

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



Tonight's studies suggested there may be more downside to come in the next few days. This has pushed the green Aggregator line even further south. The black differential line spiked up today and is now squarely above 0. Overall this could be interpreted to mean that the studies are suggesting more downside is likely but the market has already underperformed expectations over the past few days. When the black Differential line crosses as strongly as it did today I normally read the chart as neutral and consider it a profit taking opportunity. That's what led me to cover the entire trade idea at the close.

With the intermediate-term outlook slightly bullish I may look for a long opportunity if it pulls back a bit more over the next few days and some short-term bullish indications reveal themselves. In any case, I may have been early to cover today but the choppy action and the spike in the differential line leads me to believe taking profits was the proper thing to do. Now we wait and see how the next edges unfold.

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 | 0.00 | Nasdaq 100 | QQQQ | 0.00 |

Nothing doing.

Additional New Trade Ideas

None – I'd prefer to wait for a better defined edge.

Active Trades Table

| Symbol | Entry Date | Entry Price | Current Price | % Gain/Loss | Stop | Notes |
|------------|------------|-------------|---------------|-------------|------|-----------------|
| SPY(s) 1/4 | 12/30/2008 | \$88.97 | \$90.67 | -1.91% | | covered @ close |
| SPY(s) 1/4 | 12/31/2008 | \$90.24 | \$90.67 | -0.48% | | covered @ close |
| XLU(s) | 1/2/2009 | \$29.34 | \$29.46 | -0.41% | | covered @ close |
| XLE(s) | 1/5/2009 | \$50.15 | \$49.69 | 0.92% | | covered @ close |
| SPY(s) 1/4 | 1/6/2008 | \$93.64 | \$90.67 | 3.17% | | covered @ close |
| SPY(s) 1/4 | 1/6/2008 | \$94.25 | \$90.67 | 3.80% | | covered @ close |

The average price for the full SPY position was \$91.775. Subscribers were notified via intraday updates that I was looking to exit the positions at the close. These aren't the greatest trade ideas we've had, but sometimes you end up with singles instead of home runs. Overall the profits were ok.

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