

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 20, 2009

Volume 2 Issue 12

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 20, 2009	2 Days Up In Chop	1-4 days	Bearish	-1.50%	-2.90%
January 16, 2009	Weak Breadth Rebound	1-10 days	Bearish	-4.10%	-5.70%
January 16, 2009	Weak Bounce	1-10 days	Bearish	-4.30%	-8.65%
January 5, 2009	Appel Breadth Thrust	1-20 days	Bullish	3.70%	5.70%
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 Vol Spyx Low	1-5 weeks	Bearish		
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish		
Dropped Tonight					
January 15, 2009	5 Lower Lows & Biggest Drop	1-2 days	Bullish	3.10%	6.38%
January 9, 2009	NDX 1% while SOX down	1-6 days	Bearish	-4.70%	-9.60%
December 21, 2008	Nasdaq Lagging		Bearish		

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) –slightly bearish – updated 1/20

After gapping higher the market made its high within the first few minutes of the day on Friday. It then sold off hard the rest of the morning, with the S&P 500 losing about 3.5% from morning high to low. Around 12:30 it did an about face, though. The afternoon rally put the S&P back in positive territory although still a bit below the open. Breadth was somewhat positive. The NYSE Up Issues % came in at 64% and the Up Volume % was 62%. Total volume declined from Thursday's level. After posting extremely high readings the last two days, the S&P 500 Volume Spyx indicator moved back down near neutral.

I'm not seeing a whole lot today beyond what was gone over in the last few days. Two studies dropped off tonight, including 1 of only 2 bullish ones. After two days higher the 5 Lower Lows study has panned out and expired. The NDX/SOX study led to a sell in its' timeframe and also worked as expected.

Two consecutive days higher over the last year and a half has consistently led to downside within the next few days. Our "2 Days Up In Chop" system looks to short the

S&P 500 any time it closes higher 2 days in a row. It then covers the short on the 1st profitable close. At the close of the 4th days it covers regardless of profitability. After 23 winners in a row the last trade resulted in a loser. The loss was a mere 0.38%. Below are updated results of the “system” since June 1, 2007 (\$100k/trade):

All Trades			
Total Net Profit	\$58,630.24	Profit Factor	14.25
Gross Profit	\$63,056.23	Gross Loss	(\$4,425.99)
Roll Over Credit	\$0.00		
Open Position Profit/Loss	\$0.00		
Select Total Net Profit	\$49,847.22	Select Profit Factor	12.26
Select Gross Profit	\$54,273.21	Select Gross Loss	(\$4,425.99)
Adjusted Total Net Profit	\$47,245.26	Adjusted Profit Factor	7.77
Adjusted Gross Profit	\$54,226.59	Adjusted Gross Loss	(\$6,981.34)
Total Number of Trades	54	Percent Profitable	94.44%
Winning Trades	51	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	\$1,085.75	Ratio Avg. Win:Avg. Loss	0.84
Avg. Winning Trade	\$1,236.40	Avg. Losing Trade	(\$1,475.33)
Largest Winning Trade	\$8,783.02	Largest Losing Trade	(\$3,230.74)

It will be interesting to see whether the latest loss signals a change in character for the market or whether it was just and inevitable blip on the screen.

This two day bounce has been about as weak as they get. As we saw with a few of the studies last week, strong selloffs *should* lead to strong reflex rallies. When they don't it is often a bearish indication.

News this week will be dominated by earnings as well as the Obama inauguration. I've posted some [inauguration-based studies to the blog](#) that may be of interest. While not statistically significant, they do seem to suggest that over the next few months a rally could unfold.

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



Friday did little to change the look of the chart. The green Aggregator line remains below zero, indicating a negative expectation from the studies over the next few days. The black differential line has remained above zero as the S&P has underperformed expectations over the last 3 days. Unless the market tumbles on Tuesday, this line will take a dive as last Wednesday's performance is dropped from the calculation. This could possibly provide a nice short entry if the market moves higher on Tuesday.

Intermediate-term Outlook (2 weeks – 2 months)–neutral -updated 1/20

Notable for the bullish case this week is that the Nasdaq has taken the lead from the NYSE based on the 10-week EMA relative strength. This can be seen in the chart below with the RS indicator in the bottom pane crossing above the dashed line:



I've discussed this chart in the past. Historically the market has made nearly all its gains while the Nasdaq has been in a leading position. In looking at relative strength crosses as we've seen above I found little to no value in using them as a timing indicator. Still, the market is typically better off with the Nasdaq leading so I consider this development to be a positive one.

The break below the 850 support level this past week suggests this latest rally may be on life support. The exceptionally weak bounce leaves me no confidence that Thursday's intraday low will hold, allowing the market to avoid another swing lower. We're still quite a ways from the November lows of 741 so there remains plenty of room for the market to be able to right itself before those would be taken out.

I believe we will get a strong rally of intermediate-term duration at some point here, but so far the market has given little indication that it is imminent. The inauguration studies posted to the blog and mentioned above provide some hope that optimism will prevail over the coming weeks and months. For now I'm keeping an open mind and a neutral intermediate-term bias until I see more evidence that a strong trending move is emerging.

This means I shall be favoring neither bullish nor bearish setups but rather be looking to trade both sides as the setups dictate.

Catapult and Capitulative Breadth Statistics

(Catapult Presentation Part 1) (Catapult Presentation Part 2)

Open Catapult Trades

New

BAC – buy @ \$7.18 (not recommended and won't be tracked)

BAC triggered the first Catapult in a couple of months. Those brave of heart could consider it. The risk of an awful blowup here has me taking a rare pass on this one. I'd suggest very conservative position sizing for anyone considering a trade here.

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1 (BAC)

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	0.68
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.70
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	0.70
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	2.70	DJ US Basic Materials	IYM	0.00
DJ US Healthcare Providers	IHF	2.04	DJ US Real Estate	IYR	1.22
DJ US Medical Devices	IHI	2.44	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	5.26
DJ US Consumer Svcs	IYC	0.00	Nasdaq 100	QQQQ	0.00

Lots of selling. Very little capitulation.

Additional New Trade Ideas

SPY – short 1/4 index position on CLOSE limit of \$85.07. A close higher tomorrow could setup a pullback as discussed in the short-term outlook above.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	1/15/2009	\$84.12	\$85.43	1.56%		sold

Half of the SPY position was exited on Friday's open. The other half was sold via an \$85 stop price as sent out intraday on Friday.

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