

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 3, 2009

Volume 2 Issue 41

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					
March 3, 2009	CBI >= 10	1-3 days	Bullish	3.40%	7.30%
March 2, 2009	2% Gap Down	1-3 days	Bullish	2.70%	5.30%
March 2, 2009	Gap Dn to 50 low and Close Lower	1-5 days	Bullish	6.30%	12.20%
February 27, 2009	2 Days Dow In Chop	1-3 days	Bullish		
February 26, 2009	SPX down 1% while SOX up 1%	1-15 days	Bullish	4.60%	7.10%
February 25, 2009	Recover drop of 1.5% at 50 low	1-5 days	Bullish	3.40%	6.40%
Active - Long Term					
none					
Dropped Tonight					
March 2, 2009	Last Friday 1% Drop	1 day	Bearish	-1.50%	-3.20%

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) – updated 3/2 – bullish

For the 2nd day in a row the market experienced a large gap down that closed lower than the open. Selling was fierce. The major indices all fell at least 4%. Breadth was abysmal. The NYSE Up Issues % came in at 6% and the Up Volume % at 3%. Total volume actually shrank from Friday's levels.

The S&P 500 has fallen near 20% from its February 9th high and is beginning to post some truly extreme readings. The McClellan Oscillator as tracked by Worden Bros. for instance closed at -299 today. Reading outside of -200 are quite rare. Additionally, Worden tracks a couple of other breadth indicators that show the percent of stocks trading 1 standard deviation and 2 standard deviations below their 40-day moving average. Nearly 85% of all stocks are now trading at least 1 standard deviation below their 40-day moving average. There have only been 6 other periods where these levels were reached they were 1) 10/19/87 – 10/29/87, 2) 8/31/98, 3) 9/21/01, 4) 7/23/02, 5) 10/2/08-10/17/08, and 6) 11/20/08. You'll note that all of these marked market bottoms and 4 of 6 instances only lasted a single day.

The amount of stocks trading at least 2 standard deviations below their 40-day moving average is 65%. This is actually even more extreme than the above reading. This has only been reached on three other occasions: 10/19/87 – 10/28/87, 9/20/01 – 9/21/01, and 10/6/08 – 10/10/08.

Another indicator hitting an extreme today was the CBI. Four new Catapult triggers brought the CBI reading up to 12. As many readers are likely aware, I've often mentioned 10 as a level where there is a strong bullish edge. A system I've shown in the past that could take advantage of this would be to buy the S&P when the CBI rose to 10 or above and then sell it on a return to 3 or below. This was an extremely reliable system until 2008 when it proved a bit early during the July and October selloffs. In November it nailed the bottom exactly. Below is the complete list of 22 instances from 1995 – present.

Date/Time	Signal	Price	Roll Over USD/Lot	Shares/Ctrts Profit	Net Profit Cum Net Profit	% Profit
12/04/96	Buy	\$745.10	\$0.00	134	\$89.78	0.09%
12/19/96	Sell	\$745.77		\$89.78	\$89.78	
04/03/97	Buy	\$750.32	\$0.00	133	\$585.20	0.59%
04/15/97	Sell	\$754.72		\$585.20	\$674.98	
08/14/97	Buy	\$924.77	\$0.00	108	\$1,574.64	1.58%
08/20/97	Sell	\$939.35		\$1,574.64	\$2,249.62	
08/28/98	Buy	\$1,027.25	\$0.00	97	\$237.65	0.24%
09/14/98	Sell	\$1,029.70		\$237.65	\$2,487.27	
10/18/99	Buy	\$1,254.13	\$0.00	79	\$3,363.82	3.40%
10/27/99	Sell	\$1,296.71		\$3,363.82	\$5,851.09	
01/26/00	Buy	\$1,404.09	\$0.00	71	\$368.49	0.37%
02/01/00	Sell	\$1,409.28		\$368.49	\$6,219.58	
10/18/00	Buy	\$1,342.11	\$0.00	74	\$3,971.58	4.00%
10/23/00	Sell	\$1,395.78		\$3,971.58	\$10,191.16	
09/18/01	Buy	\$1,032.74	\$0.00	96	\$3,795.84	3.83%
10/03/01	Sell	\$1,072.28		\$3,795.84	\$13,987.00	
06/12/02	Buy	\$1,020.26	\$0.00	98	\$1,559.18	1.56%
06/17/02	Sell	\$1,036.17		\$1,559.18	\$15,546.18	
07/18/02	Buy	\$881.56	\$0.00	113	\$2,397.86	2.41%
07/30/02	Sell	\$902.78		\$2,397.86	\$17,944.04	
02/02/04	Buy	\$1,135.26	\$0.00	88	\$400.40	0.40%
02/09/04	Sell	\$1,139.81		\$400.40	\$18,344.44	
08/09/04	Buy	\$1,065.22	\$0.00	93	\$2,785.35	2.81%
08/18/04	Sell	\$1,095.17		\$2,785.35	\$21,129.79	
03/23/05	Buy	\$1,172.53	\$0.00	85	\$754.80	0.76%
03/30/05	Sell	\$1,181.41		\$754.80	\$21,884.59	
04/18/05	Buy	\$1,145.98	\$0.00	87	\$533.31	0.53%
04/22/05	Sell	\$1,152.11		\$533.31	\$22,417.90	
03/05/07	Buy	\$1,374.12	\$0.00	72	\$2,338.56	2.36%
03/12/07	Sell	\$1,406.60		\$2,338.56	\$24,756.46	
11/21/07	Buy	\$1,416.76	\$0.00	70	\$3,657.50	3.69%
11/28/07	Sell	\$1,469.01		\$3,657.50	\$28,413.96	
01/22/08	Buy	\$1,310.51	\$0.00	76	\$5,157.36	5.18%
01/31/08	Sell	\$1,378.37		\$5,157.36	\$33,571.32	
03/07/08	Buy	\$1,293.37	\$0.00	77	\$1,702.47	1.71%
03/13/08	Sell	\$1,315.48		\$1,702.47	\$35,273.79	
07/01/08	Buy	\$1,284.92	\$0.00	77	(\$1,868.02)	(1.89%)
07/18/08	Sell	\$1,260.66		(\$1,868.02)	\$33,405.77	
10/07/08	Buy	\$996.23	\$0.00	100	(\$4,214.00)	(4.23%)
10/30/08	Sell	\$954.09		(\$4,214.00)	\$29,191.77	
11/20/08	Buy	\$752.44	\$0.00	132	\$18,981.60	19.11%
11/28/08	Sell	\$896.24		\$18,981.60	\$48,173.37	
03/02/09	Buy	\$700.82		142	n/a	n/a

Another notable indication of overdone breadth can be seen on the systems triggers page. Tonight 146 of the S&P 500 triggered at least 1 buy setup. This is the most since I began publishing the page in early November. The only time to come close to this was when there was 138 setups for November 21st.

The large gap lower to a 50-day low and a close below the open triggered the study from last night for the 2nd day in a row. Below is an excerpt from last night:

SPY gaps down at least 1% then closes under open and at 50-day low.												
Buy on close. Sell X days later. \$100k/trade. 1993-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	Max Win	Max Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$40,304.85	17	11	6	64.71	\$6,250.84	(\$4,742.40)	\$15,560.60	(\$8,996.91)	1.32	2.42	\$2,370.87
9	\$37,627.43	17	11	6	64.71	\$6,512.76	(\$5,668.83)	\$14,686.12	(\$20,523.36)	1.15	2.11	\$2,213.38
8	\$24,792.99	19	12	7	63.16	\$5,589.26	(\$6,039.73)	\$15,522.02	(\$18,549.96)	0.93	1.59	\$1,304.89
7	\$25,891.77	20	11	9	55.00	\$5,702.23	(\$4,092.53)	\$14,577.84	(\$12,441.39)	1.39	1.70	\$1,294.59
6	\$37,207.92	20	10	10	50.00	\$7,480.88	(\$3,760.08)	\$19,603.86	(\$10,180.95)	1.99	1.99	\$1,860.40
5	\$32,814.48	20	12	8	60.00	\$5,603.42	(\$4,303.32)	\$15,673.56	(\$11,755.88)	1.30	1.95	\$1,640.72
4	\$19,934.46	20	13	7	65.00	\$4,889.61	(\$6,232.92)	\$15,340.08	(\$15,473.88)	0.78	1.46	\$996.72
3	\$19,341.23	21	15	6	71.43	\$3,298.14	(\$5,021.81)	\$14,708.85	(\$13,375.08)	0.66	1.64	\$921.01
2	\$3,870.10	23	11	12	47.83	\$4,514.31	(\$3,815.61)	\$10,873.83	(\$9,235.25)	1.18	1.08	\$168.27
1	\$11,478.12	24	12	12	50.00	\$3,296.09	(\$2,339.58)	\$11,683.71	(\$7,417.30)	1.41	1.41	\$478.26

Here we see bullish tendencies. Apologies if the numbers look a bit scrunched. I added Max Win and Max Loss columns since they were so large. I highlighted those along with Avg Win and Avg Loss. What's remarkable about this study is the volatility average gains of 5% - 7% and average losses of 4% - 6% are extraordinary for such a short time period.

In the above test we require that the SPY closes at a 50-day low. What if we also require it to open at a 50-day low?

SPY gaps down at least 1% to 50-day low then closes under open.												
Buy on close. Sell X days later. \$100k/trade. 1993-present.												
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	Max Win	Max Loss	W/L Ratio	Profit Factor	Avg Trade
10	\$54,993.78	13	9	4	69.23	\$7,662.78	(\$3,492.81)	\$16,536.00	(\$5,638.14)	2.19	4.94	\$4,230.29
9	\$47,954.29	13	8	5	61.54	\$8,129.54	(\$3,416.40)	\$14,686.12	(\$10,980.54)	2.38	3.81	\$3,688.79
8	\$31,290.91	15	9	6	60.00	\$7,207.78	(\$5,596.53)	\$15,727.75	(\$10,446.30)	1.29	1.93	\$2,086.06
7	\$36,381.38	15	10	5	66.67	\$6,498.97	(\$5,721.66)	\$14,577.84	(\$14,023.80)	1.14	2.27	\$2,425.43
6	\$46,341.32	15	9	6	60.00	\$7,243.47	(\$3,141.66)	\$19,603.86	(\$6,470.72)	2.31	3.46	\$3,089.42
5	\$47,013.19	15	10	5	66.67	\$6,733.09	(\$4,063.54)	\$19,027.00	(\$11,755.88)	1.66	3.31	\$3,134.21
4	\$33,839.09	15	11	4	73.33	\$6,080.53	(\$8,261.69)	\$17,914.00	(\$15,473.88)	0.74	2.02	\$2,255.94
3	\$33,857.00	16	13	3	81.25	\$4,306.58	(\$7,376.16)	\$14,708.85	(\$13,375.08)	0.58	2.53	\$2,116.06
2	\$20,000.28	17	9	8	52.94	\$5,471.52	(\$3,655.43)	\$12,693.50	(\$9,235.25)	1.50	1.68	\$1,176.49
1	\$7,203.85	17	8	9	47.06	\$3,330.42	(\$2,159.95)	\$11,683.71	(\$6,980.25)	1.54	1.37	\$423.76

Instances are getting a bit low but there are some even more compelling numbers here. 13 of 16 are profitable after 3 days. The average 1-week return is over 3%. The average winner after 9 days is up over 8%. There are some strongly bullish numbers here. The caveat? The average losses are also huge. When wrong the results are not mildly negative. It's a potentially big, sharp, drop.

Tonight's [Aggregator](#) chart is below:



As the market has continued to slide the edge has grown more bullish. With both the green aggregator line and the black differential line strongly above zero, the studies and market positioning are suggesting a strong bounce is likely. Looking at some of the extreme breadth readings I discussed above you'll note that the bounces from those lows were incredibly strong. While the timing is tricky I'm trying to capture some of that bounce through both the index and the Catapult trades. Tomorrow I'll be looking to add more exposure.

It's highly probable that there will be a viscous bounce in the next few days. What's unknown is when the bounce will occur and from what level? An additional 5% drop could easily happen. It could happen in a hour. Still, the edge and potential reward are large enough at this point that I'm willing to sit through some pain in order to hopefully achieve a portion of the anticipated sharp gains.

Intermediate-term Outlook (2 weeks – 2 months)–neutral -updated 2/23

Another down week. Another new low. 'm seeing nothing from an intermediate-standpoint that has me excited about either side right now. Too low to aggressively short and no evidence of an ability to rally. Most notable from a technical perspective is that the S&P 500 broke its last nearby level of technical support this past week. There's no telling where it might next find support. Still, the overall intermediate-term mantra will remain the same as it has:

I expect we're likely to see a decent rally of 30% or more lasting at least 2-3 months emerge here at some point. I have serious doubts that next rally will lead to a multi-year bull market run, though. Until I see signs otherwise, I'm treating this market as one that is more similar to the 1930's than any other period in time. Past evidence of this includes volatility studies, Dow Trend vs. Chop studies, and studies of severe selloffs such as we saw in the fall. I'll be sure to revisit these studies when appropriate. For now my focus remains short-term.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Triggers

DOW (Dow Chemical) –@ \$9.29 (1/3)

DOW (Dow Chemical) –@ \$8.62 (1/3)

DOW (Dow Chemical) – bought last 1/3 position @ \$8.60

CAT – bought 1/3 position @ \$28.44

CAT – bought 1/3 position @ \$26.14

CAT – bought final 1/3 position @ \$26.66

PFE – bought 1/3 position @ \$13.27

PM – bought 1/3 position @ \$32.79

New

PM – buy 1/3 position @ \$32.75 limit

PFE – buy 1/3 position @ \$11.66 limit

BA – buy 1/3 position @ \$29.51 limit

RTN – buy 1/3 position @ \$37.71 limit

Catapult for ETF's Trades

DIA – bought @ \$73.73 limit

Broad Market Large Cap CBI – 12/6 (DOW-3, CAT-3, PFE-2, PM-2, BA, RTN)

Sector CBI Breakdown (% of stocks with active catapult triggers within each sector.)

Index	ETF	CBI %	Index	ETF	CBI %
DJ US Broker Dealers	IAI	3.45	DJ US Energy	IYE	4.65
DJ US Insurance Index	IAK	10.81	DJ US Financial	IYF	3.08
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.70
DJ US Utilities	IDU	10.81	DJ US Healthcare	IYH	8.45
DJ US Oil&Gas Expl & Prod	IEO	6.90	DJ US Industrial Sector	IYJ	8.05
DJ US Oil Equip & Svcs	IEZ	5.77	DJ US Consumer Goods	IYK	5.44
DJ US Pharmaceuticals	IHE	13.51	DJ US Basic Materials	IYM	10.81
DJ US Healthcare Providers	IHF	4.08	DJ US Real Estate	IYR	2.44
DJ US Medical Devices	IHI	9.76	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	11.11	DJ US Technology Sector	IYW	5.03
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	3.51	Nasdaq 100	QQQQ	2.00

No huge standouts like banks were last week before their bounce.

Additional New Trade Ideas

SPY – buy final 1/4 index position @ \$69.20 limit. If not filled during day, buy it @ \$70.60 limit on CLOSE. Looking to add the final piece on a dip or close lower tomorrow.

See PM, PFE, BA and RTN in the Catapult section above.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
DOW(1/3)	2/17/2009	\$9.29	\$6.94	-25.30%		Catapult
DOW(1/3)	2/18/2009	\$8.62	\$6.94	-19.49%		Catapult
SPY(1/4)	2/18/2009	\$79.22	\$70.60	-10.88%		
DOW(1/3)	2/19/2009	\$8.60	\$6.94	-19.30%		Catapult
CAT(1/3)	2/19/2009	\$28.44	\$22.17	-22.05%		Catapult
SPY(1/4)	2/19/2009	\$78.18	\$70.60	-9.70%		
CAT(1/3)	2/20/2009	\$26.14	\$22.17	-15.19%		Catapult
CAT(1/3)	2/23/2009	\$26.66	\$22.17	-16.84%		Catapult
DIA	2/23/2009	\$73.73	\$67.83	-8.00%		Catapult
PFE	2/24/2009	\$13.27	\$11.66	-12.13%		Catapult
SPY(1/4)	3/2/2009	\$72.52	\$70.60	-2.65%		
PM	3/2/2009	\$32.79	\$32.75	-0.12%		Catapult

Should we fail to see a “turnaround Tuesday” tomorrow, it is likely the CBI will spike quite a bit higher. I will update subscribers intraday of probable triggers and CBI levels.

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