

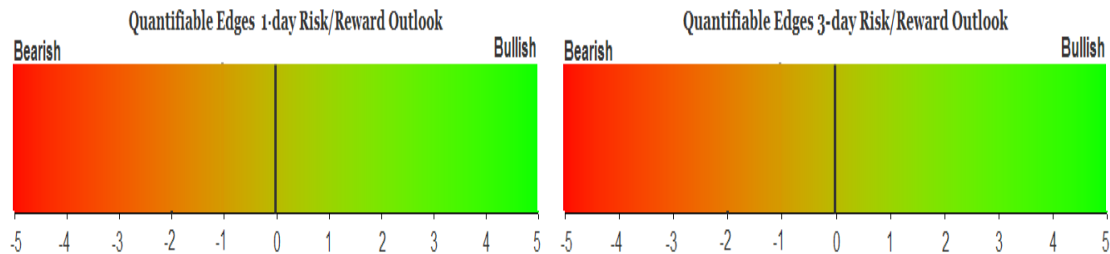
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 7, 2010

Volume 3 Issue 235

## Market Overview



## Tonight's Research Points

- The SPY pullback with a higher high and higher low after 3 HLC up days suggest a short-term bullish edge.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

## Short-term Outlook

### The Bottom Line

The market consolidated Monday. Not much of an edge right now, but the Aggregator System could go long again tomorrow and I'm eager to add back exposure. I'll be looking to do so if we close even a little lower on Tuesday.

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
<b>Active</b>				
December 7, 2010	SPY 3 up H,L,C then down C but up H,L	1-4 days	Bullish	1.60%
December 6, 2010	VIX 10% up to 10% dn in 1 week	1-5 days	Bullish	1.60%
<b>Active - Long Term</b>				
December 6, 2010	SPY 3 lower volume up days	1-19 days	Bearish	
December 2, 2010	2 90% Up Volume % days in 5 days	1-16 days	Bullish	
November 22, 2010	High number of POMO Days recently	int term	Bullish	
November 15, 2010	QQQQ 5 lower lows and large drop	1-20 days	Bullish	
November 15, 2010	SPX down 1% SOX Up	1-20 days	Bullish	
November 5, 2010	Very strong breadth & 50-day high	1-30 days	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
September 20, 2010	Nas/SPX RS favors Nasdaq	int term	Bullish	
<b>Dropped Tonight</b>				
December 6, 2010	Low Volume Rally > 200ma	1 day	Bearish	
December 2, 2010	10-day price & up vol% high. Low vol	1-3 days	Bearish	-1.10%

If the avg max move is achieved the study will appear in **bold italic blue** and no longer be active.

***The Evidence***

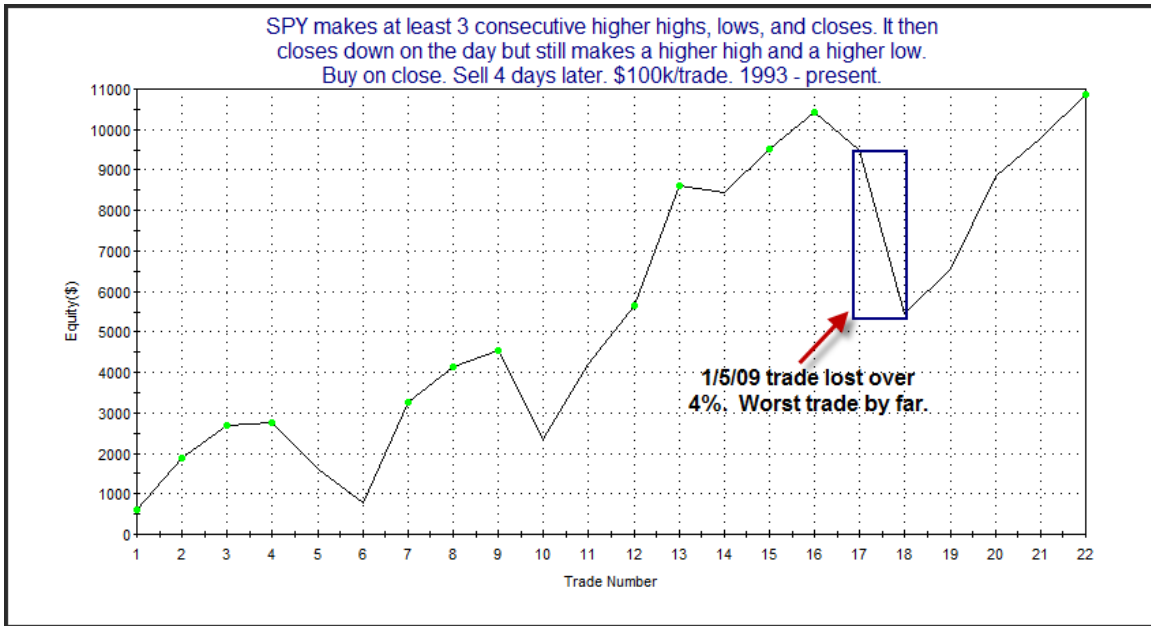
The market was quiet for much of the day. A mild gap down took about an hour to fill, but didn't get beyond that level until late afternoon. After again coming very close to new highs the SPX sold off in the last 15 minutes. It finished down slightly though the majors were mixed. The final numbers showed the SPX down 0.1%, the Nasdaq up 0.1% and the Russell up 0.6%. Breadth was very slightly negative as the NYSE Up Issues % came in just under 50% and the Up Volume % was 47%. Total volume sank for the 4<sup>th</sup> day in a row.

Potential studies changed numerous times in the Quantifinder as the SPX flirted with posting both a very low range inside day and a 50-day high breakout. In the end neither happened. So we were left with a few studies – only 1 of which appeared significant when considering the current trend and position of the market. It was a SPY pullback pattern that I last showed on 7/28/10. I've updated the study below.

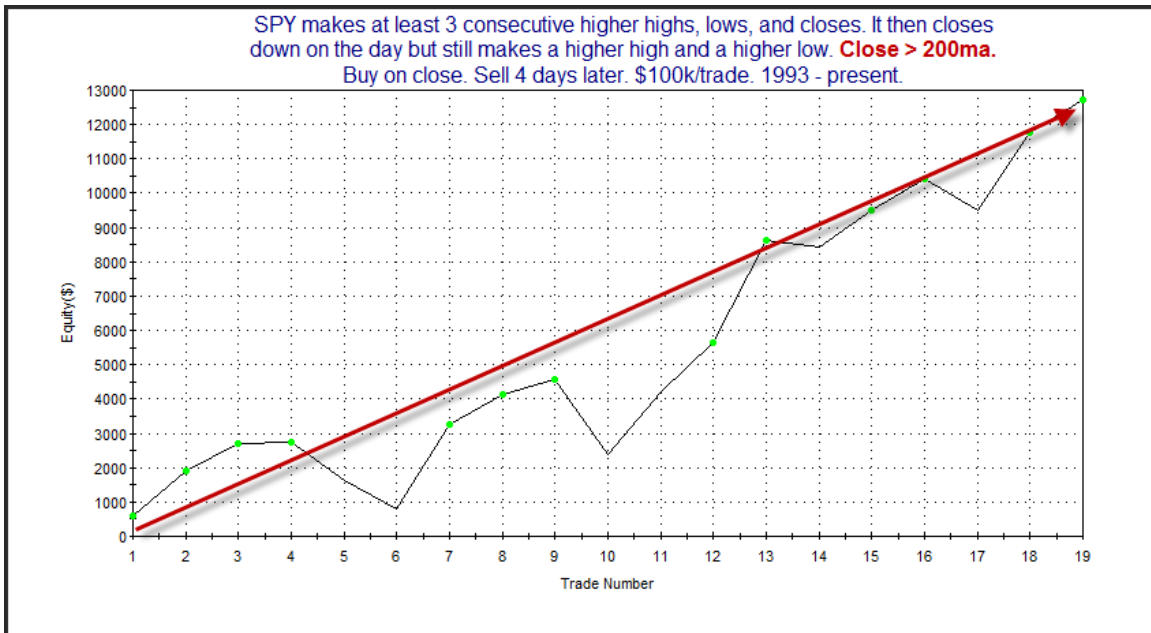
SPY makes at least 3 consecutive higher highs, lows, and closes. It then closes down on the day but still makes a higher high and a higher low. Buy on close. Sell X days later. \$100k/trade. 1993 - present.											
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade	
5	11,722.81	22	14	8	63.64	1,875.50	-1,816.77	1.03	1.81	532.86	
4	10,870.27	22	16	6	72.73	1,264.21	-1,559.53	0.81	2.16	494.10	
3	7,290.94	22	14	8	63.64	1,184.23	-1,161.03	1.02	1.78	331.41	
2	6,486.08	22	16	6	72.73	927.07	-1,391.17	0.67	1.78	294.82	
1	6,388.10	22	13	9	59.09	751.20	-375.28	2.00	2.89	290.37	

20 of 22 instances (91%) closed above the entry price at some point in the next 4 days.

The stats table is shows some strong numbers over the 1<sup>st</sup> week. Below I ran the equity curve for the 4-day exit strategy.



Quite a bit of volatility in this equity curve. Still, it has managed to stair-step higher and the stats remain compelling. Despite the low number of trades I also decided to filter on the 200ma. Sometimes volatility is dampened above the 200ma so I wondered whether that was true in this case.



There were only 3 instances below the 200ma, but if you filter them out both the largest winner and the largest loser are eliminated, thus making for a much smoother equity curve. This makes the setup more attractive. The overall stats looked much the same. See below.

SPY makes at least 3 consecutive higher highs, lows, and closes. It then closes down on the day but still makes a higher high and a higher low. **Close > 200ma.**  
Buy on close. Sell X days later. \$100k/trade. 1993 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	9,094.31	19	12	7	63.16	1,439.51	-1,168.55	1.23	2.11	478.65
4	12,715.33	19	14	5	73.68	1,287.36	-1,061.53	1.21	3.40	669.23
3	6,327.75	19	13	6	68.42	963.06	-1,032.00	0.93	2.02	333.04
2	4,598.64	19	15	4	78.95	631.25	-1,217.55	0.52	1.94	242.03
1	3,307.72	19	11	8	57.89	549.11	-341.56	1.61	2.21	174.09

I am going to include this setup among the active studies.

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



I mentioned last night that the green Aggregator line was set up to move back above zero. Tonight's bullish study gave it a little extra boost. The positive value indicates the net expectation from the Active Studies over the next few days is for a move higher. I also mentioned the overbought condition could be worked off with either a pullback or a consolidation. As you can see Monday's consolidation moved the Differential Line higher so that the SPX is now "less overbought". The still negative value means the SPX has outperformed expectations over the last few days. So we have positive expectations but an overbought market. This is considered a neutral configuration. A neutral configuration occurs whenever the Aggregator and Differential lines are on opposite sides of 0. Due to this the Aggregator System turned flat at the close.

The green Aggregator line is set up to remain positive tomorrow. Studies remain low, though, so some bearish evidence could switch this. Meanwhile the Differential Pivot will be 1,222.48. This is only about a half a point below Monday's close. So almost any down day would cause the Differential line to move back above zero. It appears likely that a down day would trigger a fresh long signal in the Aggregator.

With a bullish intermediate-term outlook my game plan continues to be to play the short side conservatively and the long side aggressively. Therefore I won't wait for confirmation in tomorrow night's research. Instead I will assume the Aggregator line will remain positive should the SPX close lower and I will look to start scaling in on a close below the Differential pivot on Tuesday. Details in the trade idea section below.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 12/6 – bullish***

The SPY study from the short-term section above (12/6) is the first study we've seen in a while with bearish intermediate-term implications. I'll be on the lookout for additional evidence that the rally could be in danger of serious correction. One concern I've brought up a few times recently is the divergence in the number of stocks making 52-week highs as opposed to other recent peaks. Below is a chart that demonstrates what I am talking about. The top line is the SPX and the bottom indicator is the NYSE 52-week highs.

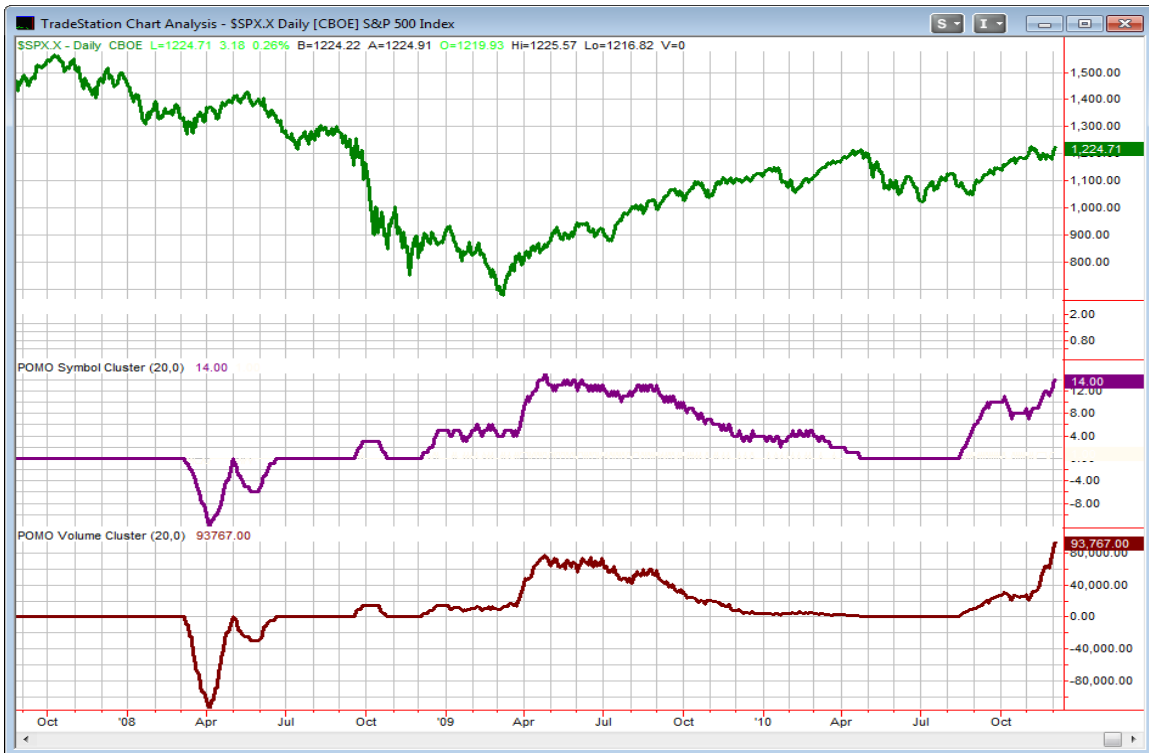


When the SPX made a new high in November we saw a divergence in the new highs versus April levels. To this point that divergence has persisted and appears to be worsening. Though the SPX is extremely close to a new high, the number of stocks making new highs is about half of what we saw last month.

I did a fair amount of research on broadening and narrowing rallies last winter. I found that divergences like this can persist for some time before the market actually suffers a substantial pullback. What was more interesting was that without such a divergence it was highly unlikely that a serious market correction would take place. So as long as we continue to see this divergence the market may be susceptible to a decline, but if the number of new highs expands and the divergence is eliminated, then that would be a strong positive for the market. I'll likely conduct further research this week should the magnitude of the divergence remain so large and the SPX actually make it to new highs.

A bullish indicator I've been showing the last few weeks is the POMO activity. Below is a refresher from last week.

*POMO stands for Permanent Open Market Operations and it is how the Fed goes into the open market to buy securities. The net effect of this buying is an influx of cash into the system. It appears a portion of that cash makes its way to the stock market and works as a bullish influence. A “POMO Day” is simply a day where these operations take place... The chart below (shows a couple of POMO indicators). The top pane is the S&P 500. The middle pane is the rolling number of days in the last 20 that have been POMO days. The bottom pane is the total amount of money infused into the system over the previous 20 days.*



As you can see monetary POMO stimulus over the last 20 days has now spiked to an all-time high – far exceeding even the levels reached in the summer of 2009. I suspect this will act as a strong bullish force on the market.

In addition to POMO there are still several other intermediate-term studies on the active list with bullish implications. They include studies related to breadth, price patterns, leadership (relative strength), and momentum. We are also about to enter some seasonally strong periods. I’ll be discussing them in more detail in the next few weeks. For those that might want a preview I’ve posted links to some old blog posts below. Bottom line is that I’ll continue to favor the long side and trade extra selectively from the short side.

<http://quantifiableedges.blogspot.com/2009/12/most-wonderful-tiiiiime-of-yearrrrrr.html>

<http://quantifiableedges.blogspot.com/2009/12/twill-be-3-nights-before-christmas.html>

## **Catapult and Capitulative Breadth Statistics**

*[Catapult & CBI Presentation Link](#)*

### ***Open Catapult Triggers***

*none*

### ***Catapult for ETF's Trades***

*None*

### ***Broad Market Large Cap CBI – 0***

## **Additional New Trade Ideas**

*A full listing of system triggers can be found at the [system triggers page](#) each night. I will cherry pick some of my favorite setups from the S&P 100 and ETF lists along with occasional other trade ideas to track below.*

*SPY – but 1/4 index position on SPX close of 1,222.48 or lower. This is based on the short-term outlook above.*

## **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
GOOG(1/3)	11/15/2010	\$603.00	\$578.36	-4.09%		exit on open
GOOG(1/3)	11/16/2010	\$593.39	\$578.36	-2.53%		exit on open
GOOG(1/3)	11/17/2010	\$583.72	\$578.36	-0.92%		exit on open

GOOG hit its target and will be exited at Tuesday's open.

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