

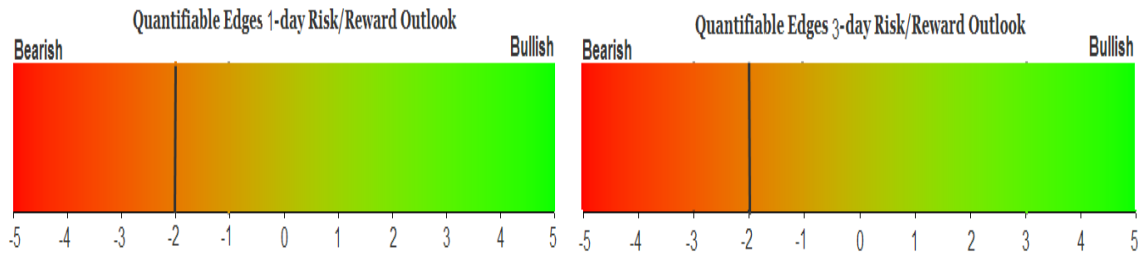
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 11, 2011

Volume 4 Issue 29

## Market Overview



## Tonight's Research Points

- SPX closes up slightly but at the very top of its range is often followed by a down day.
- The Aggregator System is short.
- The NDX Aggressive Trend Timer is flat.

## Short-term Outlook

### The Bottom Line

The short-term bearish edge remains but it is weakening. Bearish studies are expiring and the market is becoming less overbought through time. I'm still short. I am looking to exit tomorrow should the market finally pull back as expected.

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>				
February 11, 2011	SPX up < 0.25% and top 10% of range	1 day	Bearish	
February 10, 2011	SPY 8-day avg closing range > 75	1-2 days	Bearish	-1.50%
February 8, 2011	20-day high on 20-day low vol.	1-4 days	Bearish	-1.65%
February 7, 2011	200-day high on 1st Friday of Month	1-6 days	Bearish	-1.90%
<b>Active - Long Term</b>				
January 21, 2011	SPY 1st close < 10ma in over 25 days	1-20 days	Bullish	
January 19, 2011	SPX 20-day high. Vol 20-day high.	int term	Bullish	
December 16, 2010	2 Hindenburg Signals	1-50 days	Bearish	
December 9, 2010	SPX & TNX 50-day highs	1-50 days	Bearish	
November 22, 2010	High number of POMO Days recently	int term	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
<b>Dropped Tonight</b>				
February 9, 2011	SPY 50 hi 2 days. Vol lowest in 20.	1-2 days	Bearish	-1.35%
February 3, 2011	Pullback from 50-high on 10-low vol	1-6 days	Bearish	-1.80%

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

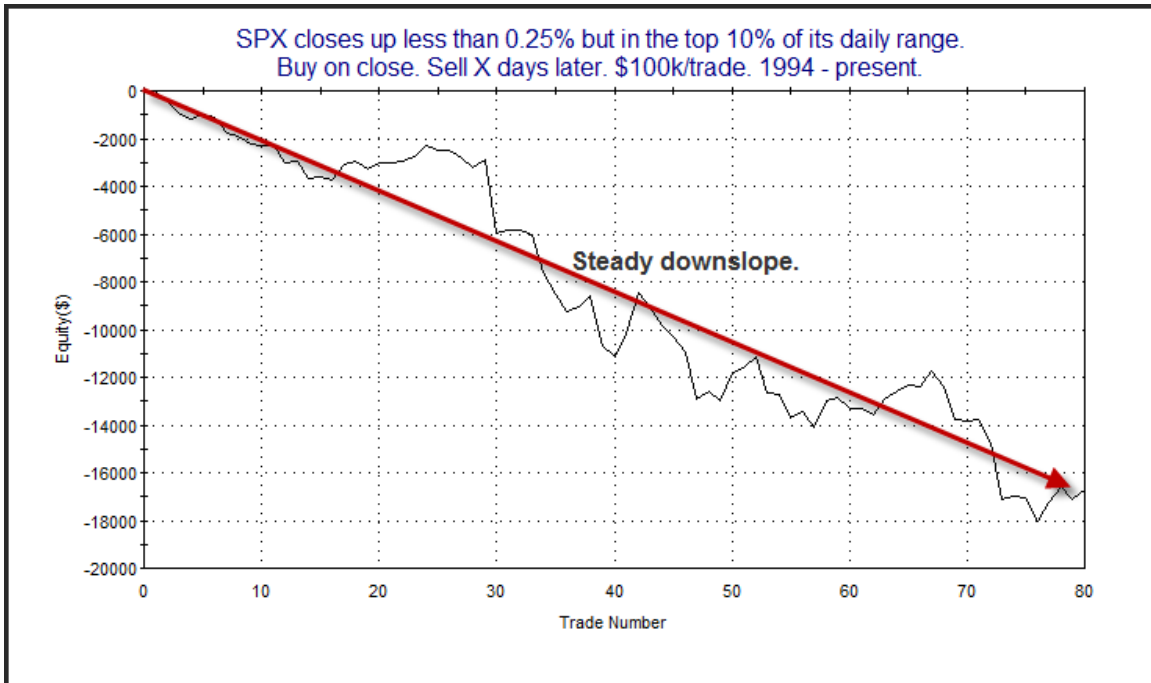
### *The Evidence*

Each day seems like the last lately. A morning dip led to an afternoon rally that saw the market close near its highs. Despite a tough start most of the major indices finished higher on Thursday, though gains were minimal. The SPX and Nasdaq both rose less than 0.1% while the Russell 2000 gained 0.4%. Breadth was mixed as the NYSE Up Issues % came in at 51% and the Up Volume % was 46%. Total volume rose for the 3<sup>rd</sup> day in a row.

As often happens when the market change is minimal, not many studies triggered. There was just one suggesting an edge. It was last shown in the 4/23/10 letter and it look at times the market closed up minimally but still in the very top of its range. I have updated that study below.

SPX closes up less than 0.25% but in the top 10% of its daily range. Buy on close. Sell X days later. \$100k/trade. 1994 - 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
3	-19,593.30	75	37	38	49.33	943.10	-1,433.90	0.66	0.64	-261.24
2	-15,535.56	78	39	39	50.00	620.32	-1,018.66	0.61	0.61	-199.17
1	-16,717.39	80	33	47	41.25	407.03	-641.48	0.63	0.45	-208.97

Results haven't changed much from the last time I examined this. It seems to suggest a very short-term downside edge. Below is an equity curve using a 1-day exit strategy.



The chart shows the downside inclination has persisted for quite a while. I've added this study to the Active List.

One interesting aspect of Thursday's action is that both the SPX and the VIX closed higher. This is fairly unusual. I examined mid-week occurrences of this in the 10/29/10 Subscriber Letter. The reason I separate mid-week occurrences is that there is a natural tendency for the VIX to fall on Fridays and rise on Mondays. Below is an excerpt from the 10/29/10 Letter. (I have not updated the studies shown.)

*First, I'll show VIX up & SPX up when the market is below the 200ma.*

SPX & VIX both close higher on a Tuesday, Wednesday, or Thursday. Close < 200ma.  
Buy on close. Sell X days later. \$100k/trade. 1998 - 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	-24,224.60	24	9	15	37.50	1,380.04	-2,443.00	0.56	0.34	-1,009.36
4	-39,097.95	25	7	18	28.00	1,214.18	-2,644.29	0.46	0.18	-1,563.92
3	-27,223.53	25	8	17	32.00	1,251.28	-2,190.22	0.57	0.27	-1,088.94
2	-22,321.60	25	8	17	32.00	1,567.26	-2,050.57	0.76	0.36	-892.86
1	-5,491.11	26	13	13	50.00	1,064.74	-1,487.14	0.72	0.72	-211.20

*This obviously seems to suggest a downside edge.*

*Now let's look at occurrences above the 200ma.*

SPX & VIX both close higher on a Tuesday, Wednesday, or Thursday. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	-2,942.28	74	40	34	54.05	1,139.38	-1,426.98	0.80	0.94	-39.76
4	-7,634.07	77	35	42	45.45	1,218.04	-1,196.80	1.02	0.85	-99.14
3	-7,628.93	81	40	41	49.38	976.25	-1,138.51	0.86	0.84	-94.18
2	-3,838.43	83	37	46	44.58	871.55	-784.48	1.11	0.89	-46.25
1	-5,424.97	91	44	47	48.35	483.23	-567.81	0.85	0.80	-59.62

*Here there doesn't seem to be an obvious edge. But I also broke it down by times the SPX was hitting a new 50-day high versus times it wasn't. First I'll show times it was hitting a 50-day high.*

SPX & VIX both close higher on a Tuesday, Wednesday, or Thursday. Close > 200ma and at a 50-day high. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	-14,562.80	36	17	19	47.22	683.01	-1,377.57	0.50	0.44	-404.52
4	-10,833.53	38	14	24	36.84	921.44	-988.91	0.93	0.54	-285.09
3	-6,291.18	38	16	22	42.11	752.26	-833.06	0.90	0.66	-165.56
2	-9,224.51	38	11	27	28.95	669.26	-614.31	1.09	0.44	-242.75
1	-4,146.32	45	21	24	46.67	252.04	-393.30	0.64	0.56	-92.14

**92% of instances closed lower than the entry price at some point in the next week.**

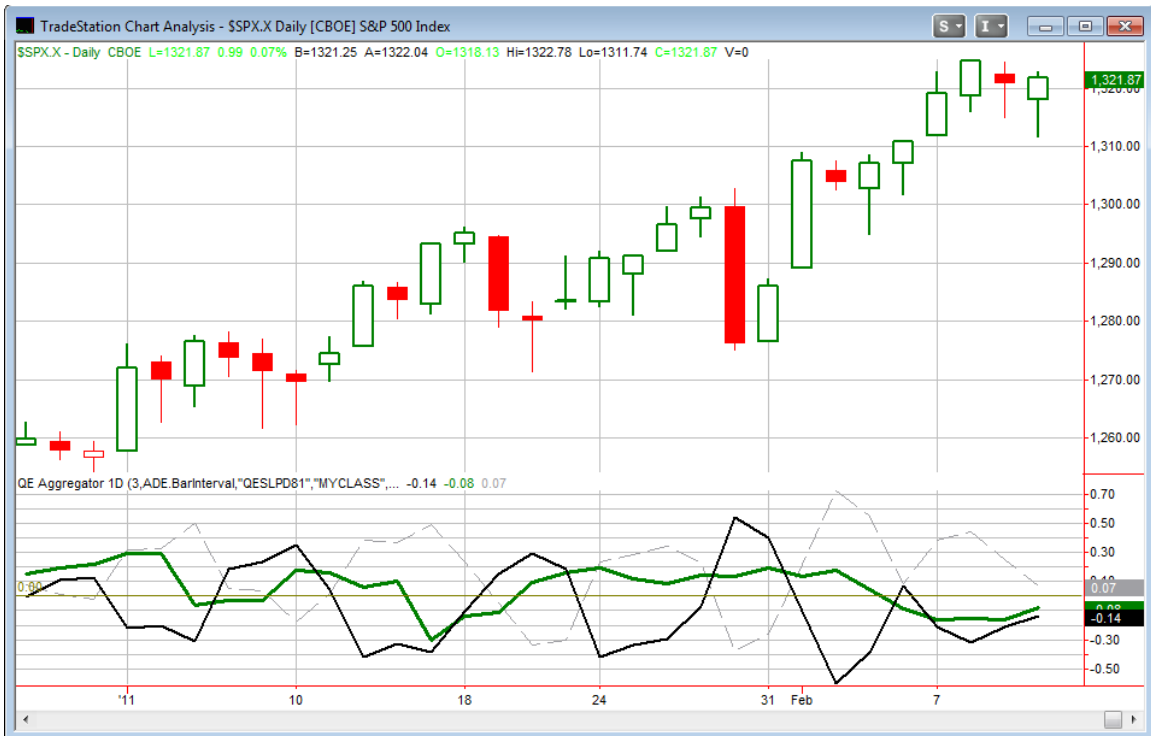
*This does appear to suggest a downside edge. Now times like now where the market is in an uptrend but is not hitting a new high.*

SPX & VIX both close higher on a Tuesday, Wednesday, or Thursday. Close > 200ma but below a 50-day high. Buy on close. Sell X days later. 1998 - 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	7,851.19	42	24	18	57.14	1,435.64	-1,478.01	0.97	1.30	186.93
4	2,581.86	42	22	20	52.38	1,367.94	-1,375.64	0.99	1.09	61.47
3	-1,316.30	44	25	19	56.82	1,081.42	-1,492.20	0.72	0.95	-29.92
2	5,386.08	45	26	19	57.78	957.14	-1,026.29	0.93	1.28	119.69
1	-1,278.65	46	23	23	50.00	694.31	-749.90	0.93	0.93	-27.80

*This is the kind of situation the market is currently dealing with. So while this is all interesting to me, it isn't terribly predictive today.*

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



There is still nothing but bearish studies for the short-term so the green Aggregator line remains squarely below zero. The negative value means the net expectation from the

Active Studies List is for downside over the next few days. Meanwhile the black Differential line is also below 0. This means the SPX has outperformed expectations over the last few days. So net expectations are for downside and the SPX has outperformed recent expectations. Historically this configuration has suggested a bearish edge. A bearish configuration is evident on the chart whenever both lines are below zero. Due to this the Aggregator System remained short at the close.

Based on the current active studies the green Aggregator line is set to remain below 0 on Friday. This could change if even moderate bullish evidence emerges. Meanwhile the Differential Pivot will be at 1,319.17. This is 0.2% below Thursday's close. For the Differential Line to move back above zero it would require the SPX to drop at least this much.

There are a few things to think about with regards to the market and the studies. For one, the number of short-term active studies is low and is dropping quickly. After Friday, only one of the current short-term studies will continue to be active. This means that market action in the next day or so and the studies that emerge will have a very strong impact on the Aggregator.

It's also worth noting that the SPX has become substantially less overbought versus expectations over the last few days. There are two ways to work off overbought (or oversold) conditions. One is by a price reversion and the other is through time. Obviously when in a trade we prefer price movement. But if an overbought condition gets worked off more through time than price, then it is still important realize that and adjust expectations or take an exit.

There still appears to be a downside edge and I am still positioned to take advantage of it. I'll be watching action carefully over the next few days to determine if the edge is eliminated or changed.

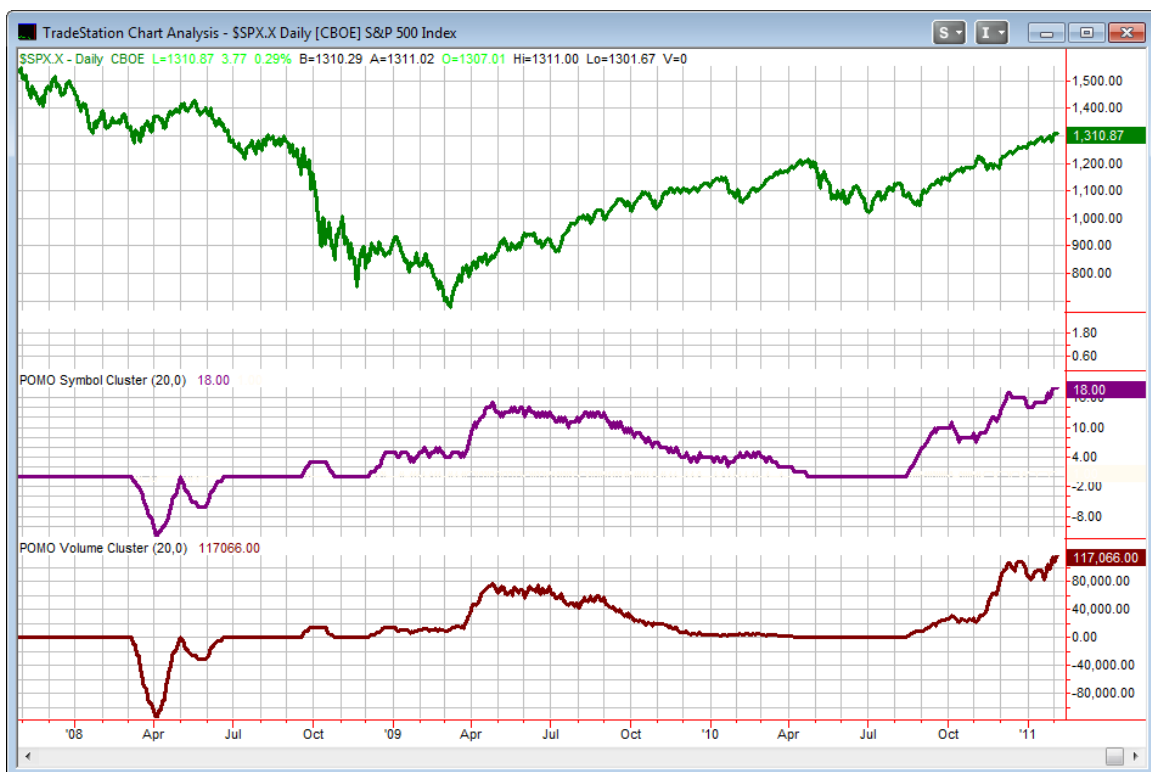
***Intermediate-term Outlook (2 weeks – 2 months)– updated 2/7 - bullish***

The market continues to make new highs. There can be no doubt we are in an intermediate-term uptrend. And while evidence is mixed, most signs continue to point up.

I've been updating the POMO chart most weekends in the letter. For those who may not recall below is a brief refresher on POMO. Beneath that I have updated our POMO indicator chart.

*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. Information on acquiring the data and constructing the chart can be found in the January 3<sup>rd</sup> POMO presentation linked below. (Not available for trial users.)*

<http://www.quantifiableedges.com/members/pomo.php>



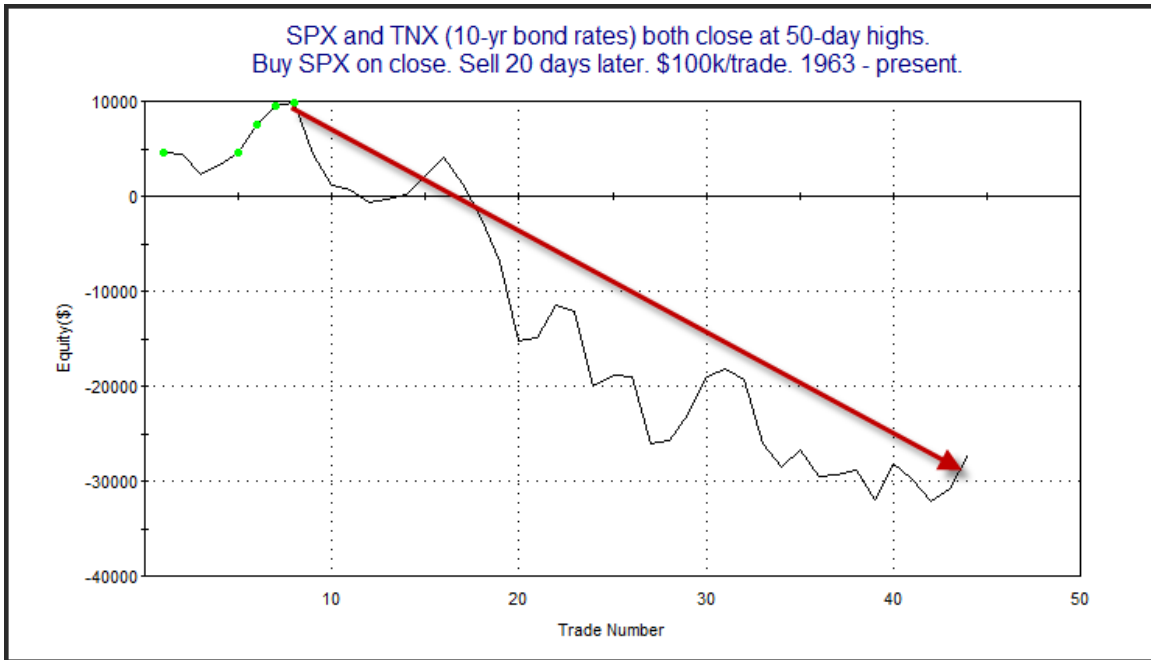
We are now at new record levels for both POMO indicators on the chart above. Activity this last month has been stronger than ever. With all this Fed stimulus the market continues its relentless rise. This coming week will be interesting for POMO watchers. Monday, Tuesday, and Wednesday are all scheduled POMO buying days, and Thursday at 2 PM the Fed is scheduled to release its operations schedule for the next month. Below is a link to the tentative operations page that will be updated on Thursday.

[http://www.newyorkfed.org/markets/tot\\_operation\\_schedule.html](http://www.newyorkfed.org/markets/tot_operation_schedule.html)

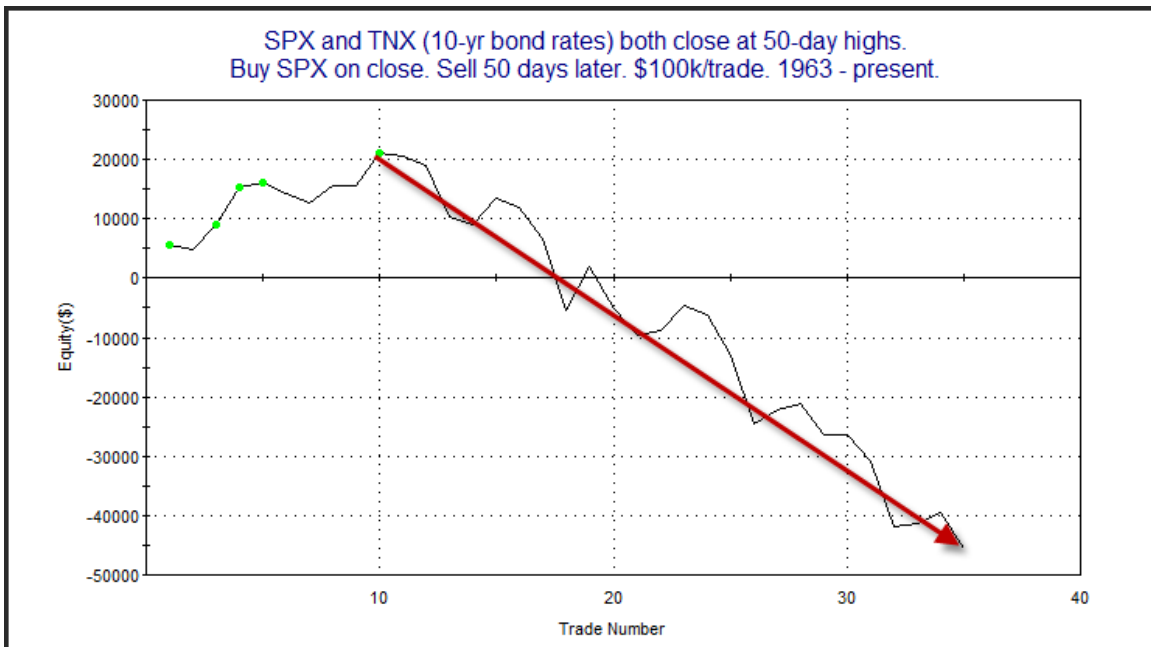
The fact that the 10-year bond rates hit new highs Friday along with the SPX is also notable. The study below last appeared in the 12/9/10 letter. Stats are updated.

SPX and TNX (10-yr bond rates) both close at 50-day highs. Buy SPX on close. Sell X days later. \$100k/trade. 1963 - 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
50	-45,542.79	35	15	20	42.86	3,202.43	-4,678.96	0.68	0.51	-1,301.22
45	-39,401.07	36	15	21	41.67	3,787.60	-4,581.67	0.83	0.59	-1,094.47
40	-19,283.93	38	18	20	47.37	3,912.18	-4,485.16	0.87	0.79	-507.47
35	-26,508.60	40	18	22	45.00	3,350.01	-3,945.85	0.85	0.69	-662.72
30	-15,725.48	41	17	24	41.46	3,582.60	-3,192.90	1.12	0.79	-383.55
25	-3,159.70	42	19	23	45.24	2,969.29	-2,590.27	1.15	0.95	-75.23
20	-27,184.54	44	23	21	52.27	1,781.90	-3,246.11	0.55	0.60	-617.83
15	-25,104.25	44	23	21	52.27	1,700.03	-3,057.37	0.56	0.61	-570.55
10	-7,819.95	49	29	20	59.18	1,287.83	-2,258.36	0.57	0.83	-159.59
5	-5,191.54	65	35	30	53.85	1,028.57	-1,373.05	0.75	0.87	-79.87

Generally it seems that higher interest rates have often made bonds an attractive investment. This may lead people to forsake stocks in favor of lower risk returns with improved yield. Implications of this study appear to be longer-term in nature than we usually see. We are still not 50 days out from the 12/8/10 occurrence, but that one appears unlikely to finish in the red. To help visualize how this edge has played out over time I have pasted below equity curves using a 20-day and a 50-day exit strategy. First let's examine the 20-day exit strategy equity curve.



Bearish results started appearing around 1965 and they've generally remained bearish ever since. Next is the equity curve for the 50-day exit strategy.



This one looks very similar to the 20-day exit strategy. In this case the downside edge didn't begin to exert itself until the 1970s but it too has persisted lower for a long time.

Bulls still have POMO, trend, and momentum on their side, while the bears hopes continue to hinge on breadth and bond action. Short-term evidence is suggesting a

pullback, but there is little suggesting that a pullback would mark the end of the uptrend. I'll continue to side with the bulls. From my standpoint this means I'll trade the long side more aggressively and the short side more conservatively.

### **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.*

*No new trade ideas tonight.*

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	2/7/2011	\$131.97	\$132.32	-0.27%		Aggregator
SPY(1/4)(s)	2/8/2011	\$132.57	\$132.32	0.19%		Aggregator

The SPY exit was just missed on Thursday. I will look to exit both lots if the SPX closes at or below the Differential pivot of 1,319.17.

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