

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 24, 2011

Volume 4 Issue 37

Market Overview



Tonight's Research Points

- The high put/call ratio suggests a possible bounce.
- There are hints the SPX is overdone to the downside.
- Bullish evidence is seeming to prevail, but just barely.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

The Aggregator system is now pointing up but the evidence is fairly marginal. We should get a bounce at some point in the next few days, but I am wary of getting too aggressive too fast. I will look to dip my toe long tomorrow.

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
Active				
February 24, 2011	Down 1.75% and the between .25-.75%	1-5 days	Bullish	
February 23, 2011	SPX 10-high to 10-low in 1 day	1-3 days	Bearish	-1.40%
Active - Long Term				
February 23, 2011	From 2- hi to 1st 5low in 10 days.	1-11 days	Bullish	
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	
Dropped Tonight				
February 23, 2011	VIX spikes 20% in 1 day	1 day	Bullish	
February 23, 2011	SPX 1% drop from 50hi. Breadth 2:1 neg	1 day	Bullish	
February 23, 2011	SPY Unfilled gap down from 50-da	1-2 days	Bearish	-1.00%

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

The Evidence

After a nasty drop to start the short week on Tuesday, the market again fell on Wednesday. The selling quite wasn't as severe, and the market closed near the middle of the day's range after bottoming out around 1:30. In the end the SPX fell 0.6%, the Nasdaq closed down 1.2% and the Russell 2000 lost 1.6%. Breadth was negative but not terribly so. The NYSE Up Issues % and the Up Volume % both came in at 35%. Total NYSE volume actually rose above Tuesday's levels.

I looked at a LOT tonight. Evidence was surprisingly very weak. While the Quantifinder showed a few green studies, they really weren't terribly compelling. Below are a few studies that I thought were worth at least mentioning.

Option traders continued to show signs of skittishness on Wednesday. Last night I showed a study that suggested the extremely sharp move in the VIX could provide a short term bullish influence. The rebound did not occur Wednesday despite that VIX spike. The VIX does remain extremely elevated but when I looked at it tonight I did not see an apparent edge based on the VIX measures. Also posting notable readings over the last two days is the CBOE Equity Put/Call Ratio. It posted a reading well above average for the second day in a row. In fact the two day average is now more than 27% above the 100 day average. Below is a study that looks at other spikes in the 2-day versus the 100 day average.

2-day Average CBOE Equity P/C Ratio Crosses Over 25% Higher Than the 100-day Average.
Buy SPX on close. Sell X days later. \$100k/trade. 2003 - 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
10	22,830.65	26	17	9	65.38	2,596.01	-2,366.84	1.10	2.07	878.10
9	32,838.17	26	17	9	65.38	2,984.53	-1,988.75	1.50	2.83	1,263.01
8	29,329.74	28	20	8	71.43	2,414.59	-2,370.25	1.02	2.55	1,047.49
7	27,252.66	28	20	8	71.43	2,361.32	-2,496.71	0.95	2.36	973.31
6	34,104.35	29	17	12	58.62	3,471.10	-2,075.36	1.67	2.37	1,176.01
5	14,062.46	31	18	13	58.06	2,622.02	-2,548.76	1.03	1.42	453.63
4	11,151.06	32	18	14	56.25	2,116.39	-1,924.57	1.10	1.41	348.47
3	1,764.64	35	21	14	60.00	1,362.79	-1,918.15	0.71	1.07	50.42
2	10,388.96	36	21	15	58.33	1,602.46	-1,550.84	1.03	1.45	288.58
1	7,895.26	36	22	14	61.11	1,331.68	-1,528.69	0.87	1.37	219.31

30 of 26 instances (83%) posted a close above the entry price at some point in the next 3 days.

Results here appear modestly bullish. My issue with including this study among the active studies, though, is that this is the first time the set up has ever occurred when the high of the last five days in the SPX is equal to the 50 day high. Spikes of this magnitude typically do not occur near an intermediate-term high.

I examined other ways of describing the sharp 2-day selloff from an intermediate-term high. Results among these studies were consistently inconclusive. Below is one example.

After closing at a 50-day high 2 days ago, SPX declines 2 days in a row. The percent drop over the last 2 days is the highest of any 2-day period in the last 50 days.
Buy SPX on close. Sell X days later. \$100k/trade. 1960 - 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
10	10,960.14	33	18	15	54.55	2,118.73	-1,811.80	1.17	1.40	332.13
9	12,025.32	33	19	14	57.58	1,953.61	-1,792.38	1.09	1.48	364.40
8	10,058.14	33	19	14	57.58	1,932.25	-1,903.90	1.01	1.38	304.79
7	4,953.58	33	18	15	54.55	1,774.76	-1,799.47	0.99	1.18	150.11
6	-340.65	33	18	15	54.55	1,500.60	-1,823.43	0.82	0.99	-10.32
5	7,012.22	33	17	16	51.52	1,907.84	-1,588.82	1.20	1.28	212.49
4	13,602.37	33	18	15	54.55	1,752.48	-1,196.15	1.47	1.76	412.19
3	6,710.17	33	17	16	51.52	1,410.76	-1,079.55	1.31	1.39	203.34
2	-1,358.27	33	15	18	45.45	1,005.70	-913.55	1.10	0.92	-41.16
1	-2,562.29	33	17	16	51.52	607.53	-805.65	0.75	0.80	-77.65

Very strong selloffs from intermediate-term highs don't appear to provide reliable bounces. Most selloffs are not as extreme as we've seen. When selling is this extreme off a high there is a 50/50 chance that it will be followed by more selling.

The Quantifinder did identify one study that I thought was worth a bit further examination. It was from 10/2009 and it looked at times the market fell at least 1.75% one day and between 0.25% and 0.75% the next. I added a 200ma filter to this study and found the results to be worth noting.

After dropping at least 1.75% yesterday the SPX falls again today by between 0.25% and 0.75%. Close > 200ma. Buy on close. Sell x days later. \$100k/trade. 1980 - 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
10	40,284.50	20	15	5	75.00	3,493.75	-2,424.35	1.44	4.32	2,014.23
9	36,948.77	20	15	5	75.00	3,296.15	-2,498.71	1.32	3.96	1,847.44
8	37,807.64	20	14	6	70.00	3,324.81	-1,456.63	2.28	5.33	1,890.38
7	27,606.44	20	14	6	70.00	2,656.64	-1,597.75	1.66	3.88	1,380.32
6	22,933.69	20	15	5	75.00	2,136.60	-1,823.07	1.17	3.52	1,146.68
5	20,634.64	20	15	5	75.00	1,932.56	-1,670.74	1.16	3.47	1,031.73
4	13,063.13	20	13	7	65.00	1,874.04	-1,614.20	1.16	2.16	653.16
3	7,878.08	20	11	9	55.00	1,859.22	-1,397.04	1.33	1.63	393.90
2	-0.93	21	13	8	61.90	1,207.33	-1,962.02	0.62	1.00	-0.04
1	-4,729.43	21	13	8	61.90	819.48	-1,922.83	0.43	0.69	-225.21

90% of instances closed above the entry price at some point in the next week, and 95% within 6 days.

Day 1 saw a bit of a dip, but buying was strong and consistent for the next couple of weeks following day 1. I decided this study was worth inclusion on the active list.

Personally, I didn't find any of the studies I looked at tonight to be terribly compelling. The study from last night that took into account the market's persistent upmove was much more compelling than anything I saw tonight. But like the study I showed immediately above, that study from last night was inconclusive over the first few days.

Prior persistence, a strong uptrend, and POMO activity all seem to favor the bullish case. Unfortunately there is nothing suggesting the bounce is immediate. A bounce is likely forthcoming in the next few days. While I'm complaining a bit about the weak short-term bullish evidence, bearish evidence is even weaker.

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



The green Aggregator line did manage to poke back above 0. The positive value means the net expectation from the Active Studies List is for upside over the next few days. Meanwhile the black Differential line remains highly positive. Readings above 0 mean the SPX has underperformed expectations over the last few days. So net expectations are for upside and the SPX has underperformed recent expectations. Historically this combination has provided an upside edge, and is considered bullish. It is evident on the chart whenever both lines are above zero. Due to this the Aggregator System turned from flat to long at the close.

Based on the current active studies the green Aggregator line is set to remain above 0 on Thursday. This could easily change since evidence is so weak. Meanwhile the Differential Pivot will be at 1,339.40. This is nearly 2.5% above Wednesday's close. For the Differential Line to fall back below zero it would require the SPX to rally at least this much.

So the Aggregator is positive, but the evidence is quite weak. I'm not terribly enthused about trying to catch this knife. I do think it's worth starting a small position if I can get a good entry price. Additionally, some catapult trades did trigger tonight. Those I almost never ignore and I will look to track them. Details in the catapult and trade ideas sections below.

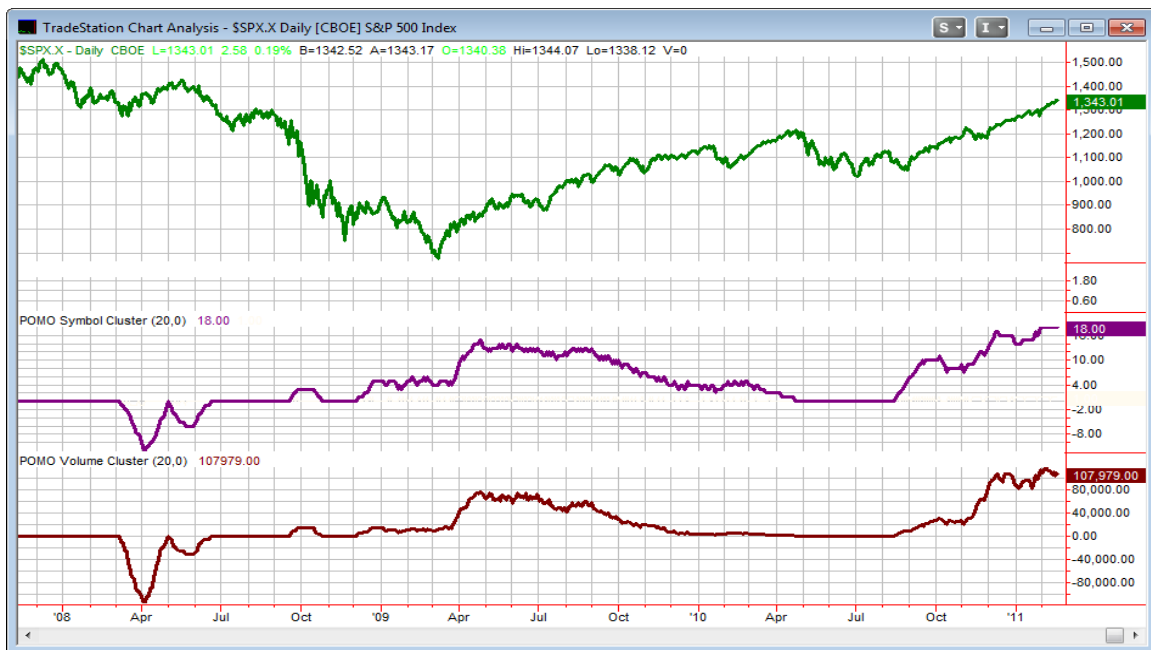
Intermediate-term Outlook (2 weeks – 2 months)– updated 2/22 - bullish

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 3rd POMO presentation linked below. (Not available for trial users.)

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



POMO levels remain at or near all-time highs. This has almost certainly provided a strong boost to the market. POMO activity is expected to remain strong over at least the next 3 weeks according to the tentative operations schedule. Operations are scheduled almost every day, and most days look to have a substantial amount of buying. This should continue to put a nice wind at the market's back.

http://www.newyorkfed.org/markets/tot_operation_schedule.html

Bulls still have POMO, trend, and momentum on their side, while the bears hopes continue to hinge on 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

New

GE – buy 1/3 @ \$20.37

HPQ – buy 1/3 @ \$43.59

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 2 (GE, HPQ)

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.

GE – buy 1/3 position @ \$20.37 limit.

HPQ – buy 1/3 position @ \$43.59 limit

These two traders are both Catapults. We have not seen any catapult trades in a long time. Those new to them and anyone who would like a refresher is encouraged to review the Catapult & CBI presentation in the videos section of the website.

SPY – buy ¼ index position at \$130.00 limit. If not filled by end of day, then buy ¼ index position @ \$131.00 LIMIT ON CLOSE. I'll look to start scaling in based on the Aggregator, but only dipping my toe, and only at a favorable price.

Current Open Trade Ideas

None.

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