

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 2, 2011

Volume 4 Issue 41

Market Overview



Tonight's Research Points

- 1% drops on 2:1 negative breadth have historically been followed by upside over the next 1-9 days.
- Tuesday's multi-day engulfing down suggests a bounce.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

Evidence remains bullish. Tuesday's strong selling moved the SPX out of overbought territory. With only 1 day of selling and bullish evidence somewhat marginal, I'm only moderately bullish.

Summary of Recent Active Studies (see <http://QuantifiableEdges.blogspot.com> or Letters from listed dates for details)

Study Date	Description	Time span	Bias
Active			
March 2, 2011	1% drop and decliners 2x advancers	1-9 days	Bullish
February 28, 2011	Bounce from low still not overbought	1-4 days	Bullish
February 25, 2011	3 days dn. Drop slowing.	1-4 days	Bullish
February 24, 2011	Down 1.75% and the between .25-.75%	1-5 days	Bullish
Active - Long Term			
March 2, 2011	Outside 2 days and 3-day low close	4-10 days	Bullish
February 23, 2011	From 20 hi to 1st 5low in 10 days.	1-11 days	Bullish
November 22, 2010	High number of POMO Days recently	int term	Bullish
October 25, 2010	SPX Golden Cross	int term	Bullish

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

The Evidence

I discussed last night that Tuesday might not have the same bullish tendencies as other recent 1st days of the month. March hasn't been particularly bullish for 1st days and the market was a bit overbought. Still, the carnage that ensued today was far more than I expected. The SPX and Nasdaq both dropped 1.6% while the Russell 2000 lost 2.0%. Breadth was strongly negative as the NYSE Up Issues % came in at 25% and the Up volume % was just 11%. Total volume spiked as the selling persisted all day.

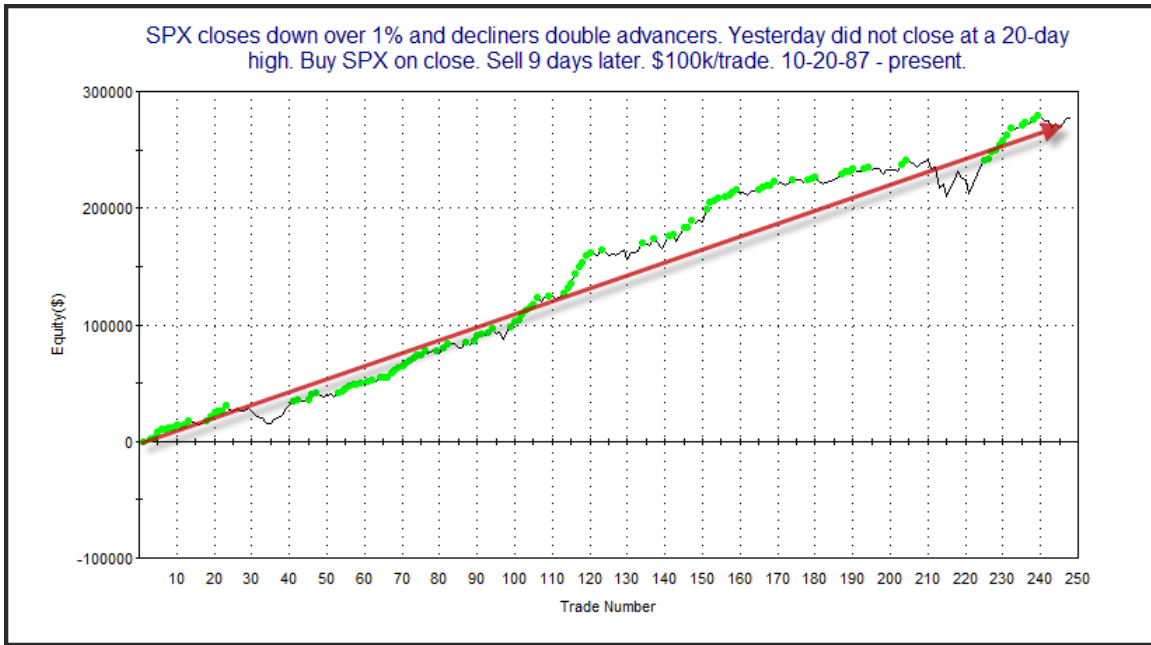
Today's selloff didn't trigger a whole lot via the Quantifinder. One study that did appear is the one below, which was last seen in the 11/15/10 Subscriber Letter. I have updated the results to present.

SPX closes down over 1% and decliners double advancers. Yesterday did not close at a 20-day high. Buy SPX on close. Sell X days later. \$100k/trade. 10-20-87 - 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	236,526.93	238	155	83	65.13	2,981.90	-2,718.89	1.10	2.05	993.81
9	276,787.04	248	173	75	69.76	2,813.18	-2,798.57	1.01	2.32	1,116.08
8	246,546.36	261	173	87	66.28	2,790.96	-2,715.98	1.03	2.04	944.62
7	233,825.31	280	175	105	62.50	2,654.12	-2,196.62	1.21	2.01	835.09
6	212,008.99	295	184	111	62.37	2,533.84	-2,290.25	1.11	1.83	718.67
5	201,170.17	321	195	126	60.75	2,330.54	-2,010.20	1.16	1.79	626.70
4	159,256.88	342	200	142	58.48	2,132.98	-1,882.68	1.13	1.60	465.66
3	165,051.23	376	234	142	62.23	1,817.94	-1,833.43	0.99	1.63	438.97
2	155,109.82	429	244	185	56.88	1,714.58	-1,422.96	1.20	1.59	361.56
1	113,564.34	481	284	197	59.04	1,144.52	-1,073.50	1.07	1.54	236.10

84.5% of instances posted a close above the entry price at some point in the next week.

Prior to the Crash of '87, very weak breadth days were often followed by more weakness. This changed after the crash. This is the reason that I only run this test back until just after the crash. As you can see there have been a large number of instances over the last 23 years. The edge appears to be very solid as well. Below is the equity curve using a 9-day exit.



While there have been some brief dips the equity curve has been incredibly steady for such a common setup over such a long period.

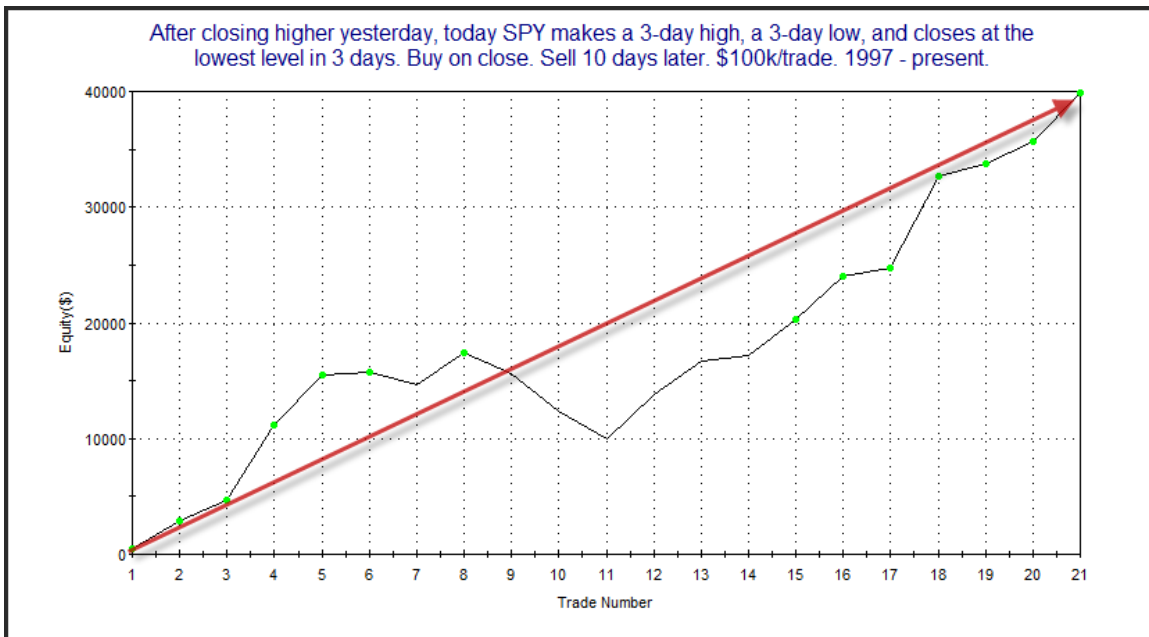
I also explored several other ideas tonight. I examined other times the market dropped strongly on the 1st day of the month, other times the SPX fell sharply while oil rose sharply, some gap and reverse ideas, and more. The study below is the only one I found to be remotely appealing. It examines times like Tuesday where SPY makes an outside day covering both of the last 2 days and closes lower.

After closing higher yesterday, today SPY makes a 3-day high, a 3-day low, and closes at the lowest level in 3 days. Buy on close. Sell X days later. \$100k/trade. 1997 - 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	39,918.71	21	17	4	80.95	2,848.05	-2,124.55	1.34	5.70	1,900.89
9	34,042.06	22	17	5	77.27	2,892.40	-3,025.74	0.96	3.25	1,547.37
8	21,378.27	22	14	7	63.64	2,970.93	-2,887.82	1.03	2.06	971.74
7	26,640.71	23	15	8	65.22	2,717.47	-1,765.16	1.54	2.89	1,158.29
6	21,789.00	23	15	8	65.22	2,375.33	-1,730.11	1.37	2.57	947.35
5	20,372.40	23	17	6	73.91	2,017.15	-2,319.86	0.87	2.46	885.76
4	8,805.57	23	14	9	60.87	2,035.31	-2,187.64	0.93	1.45	382.85
3	2,388.32	23	12	11	52.17	2,120.05	-2,095.66	1.01	1.10	103.84
2	1,159.17	23	12	11	52.17	1,795.29	-1,853.11	0.97	1.06	50.40
1	-5,996.80	23	13	10	56.52	730.05	-1,548.75	0.47	0.61	-260.73

20 of 23 instances (87%) posted a close above the entry price at some point in the next week.

While the immediate 1-3 reaction has been unreliable, these extreme outside days with poor closes have commonly been followed by upside over the 4-10 day period. Below is an equity curve that incorporates a 10-day exit strategy.



With only 1 brief dip, this curve suggests solid consistency.

I also decided to run the above test and use the 200ma as a filter. Those results are below.

After closing higher yesterday, today SPY makes a 3-day high, a 3-day low, and closes at the lowest level in 3 days. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1997 - 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	35,110.56	14	13	1	92.86	2,781.55	-1,049.58	2.65	34.45	2,507.90
9	33,248.85	15	13	2	86.67	2,832.33	-1,785.73	1.59	10.31	2,216.59
8	24,665.19	15	11	3	73.33	3,000.23	-2,779.10	1.08	3.96	1,644.35
7	28,026.11	15	11	4	73.33	2,948.35	-1,101.42	2.68	7.36	1,868.41
6	26,529.24	15	12	3	80.00	2,337.81	-508.15	4.60	18.40	1,768.62
5	25,270.87	15	13	2	86.67	1,989.81	-298.33	6.67	43.35	1,684.72
4	13,674.50	15	10	5	66.67	1,892.94	-1,050.98	1.80	3.60	911.63
3	471.78	15	8	7	53.33	1,972.38	-2,186.75	0.90	1.03	31.45
2	926.51	15	8	7	53.33	1,601.01	-1,697.36	0.94	1.08	61.77
1	-1,532.00	15	9	6	60.00	671.77	-1,262.99	0.53	0.80	-102.13

Results over the 4-10 day period are even stronger here. I have elected to include this study as part of the intermediate-term active list.

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



The green Aggregator line is still well above 0. The positive value means the net expectation from the Active Studies List is for upside over the next few days. This is no surprise since all the active short-term studies remain bullish. Meanwhile the black Differential line has move back into positive territory. 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 suggested an upside edge. It can be seen on the chart whenever both lines are above zero. Due to this the Aggregator System turned long at the close.

Based on the current active studies the green Aggregator line is set to remain above 0 on Wednesday. This could change should strong bearish evidence emerge. Meanwhile the Differential Pivot will rise to 1,326.75. This is over 1.5% above Tuesday's close. So for the Differential line to drop back below 0 the SPX would need to rally at least this much. Otherwise, the Aggregator will likely continue on a long signal for another day.

The studies suggest the market is likely to head higher in the short term. The Differential line is showing the market is not already overbought and risk/reward is favorable. Still, I'm somewhat underwhelmed by the current evidence. Primarily because the most compelling evidence I saw tonight for the 1-3 day timeframe was based on a very broad study. I also think the positive Differential line may be understating risk a bit. The SPX is back down near its recent swing lows. A break below there could lead to more sharp

selling. Additionally, the SPX is only down 1 day. While that 1 day was sharp and it could have contained the entire move, some additional selling is plausible.

I'm therefore going to carefully step into this one. I'll add more exposure in the next few days should we get further selling and more compelling bullish evidence. Details are in the trade ideas section below.

Intermediate-term Outlook (2 weeks – 2 months)– updated 2/28 - bullish

This week was the 1st in which the SPX failed to make a new high since November. Prior to this it had been 12 straight weeks of higher intraweek highs. I took a look at other times such streaks existed and what happened after they ended.

After making a higher high for at least 12 weeks in a row, SPX fails to do so this week. Buy on close. Sell X weeks later. \$100/trade. 1961 - present.										
X Weeks	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
13	13,100.76	5	5	0	100.00	2,620.15	0.00	100.00	100.00	2,620.15
12	9,579.51	5	4	1	80.00	2,640.27	-981.56	2.69	10.76	1,915.90
11	10,875.23	5	5	0	100.00	2,175.05	0.00	100.00	100.00	2,175.05
10	14,113.96	5	5	0	100.00	2,822.79	0.00	100.00	100.00	2,822.79
9	9,505.39	5	4	1	80.00	2,867.63	-1,965.12	1.46	5.84	1,901.08
8	7,833.41	5	3	2	60.00	3,794.92	-1,775.68	2.14	3.21	1,566.68
7	8,288.25	5	2	3	40.00	5,233.05	-725.95	7.21	4.81	1,657.65
6	2,747.41	5	2	3	40.00	3,065.90	-1,128.13	2.72	1.81	549.48
5	8,325.31	5	3	2	60.00	3,344.10	-853.50	3.92	5.88	1,665.06
4	6,536.42	5	3	2	60.00	2,990.58	-1,217.66	2.46	3.68	1,307.28
3	5,310.43	5	3	2	60.00	2,325.31	-832.75	2.79	4.19	1,062.09
2	537.56	5	1	4	20.00	1,644.98	-276.86	5.94	1.49	107.51
1	2,913.38	5	3	2	60.00	1,534.25	-844.69	1.82	2.72	582.68

The 5 instances were 11/5/65, 3/17/72, 1/8/93, 8/15/97, and 4/17/98.

I wouldn't try and draw too much from just 5 instances. Early indications suggest the market is not immune from a short-term pullback, but that past instances have not marked major tops. I decided to also loosen the criteria a bit and see how the results looked.

After making a higher high for at least 10 weeks in a row, SPX fails to do so this week.
Buy on close. Sell X weeks later. \$100/trade. 1961 - present.

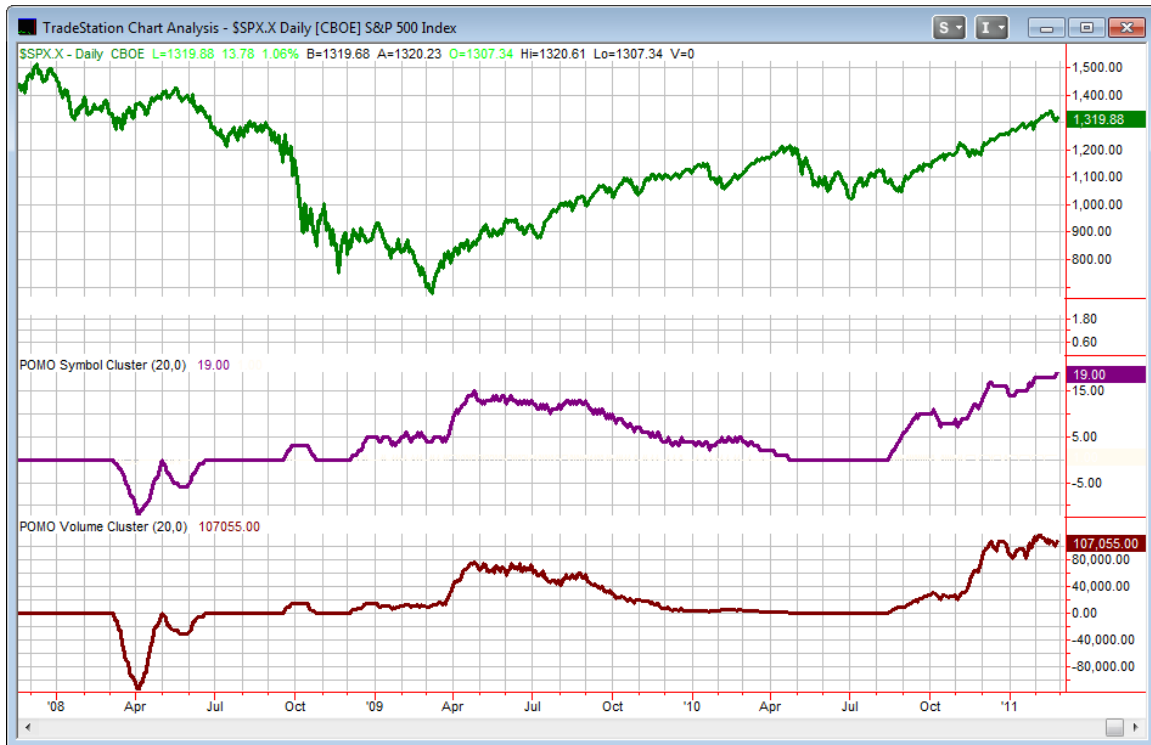
X Weeks	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
13	67,421.97	13	12	1	92.31	5,938.01	-3,834.09	1.55	18.58	5,186.31
12	55,142.15	13	10	3	76.92	5,990.29	-1,586.92	3.77	12.58	4,241.70
11	61,513.42	13	11	2	84.62	5,613.39	-116.93	48.01	264.05	4,731.80
10	57,749.01	13	12	1	92.31	4,871.87	-713.40	6.83	81.95	4,442.23
9	47,972.48	13	10	3	76.92	5,126.18	-1,096.43	4.68	15.58	3,690.19
8	42,950.42	13	9	4	69.23	5,201.66	-966.13	5.38	12.11	3,303.88
7	35,810.03	13	8	5	61.54	5,151.16	-1,079.85	4.77	7.63	2,754.62
6	29,305.82	13	9	4	69.23	3,951.44	-1,564.28	2.53	5.68	2,254.29
5	30,275.76	13	10	3	76.92	3,391.07	-1,211.64	2.80	9.33	2,328.90
4	24,184.17	13	10	3	76.92	2,814.11	-1,318.98	2.13	7.11	1,860.32
3	18,712.83	13	10	3	76.92	2,094.60	-744.38	2.81	9.38	1,439.45
2	7,111.18	13	6	7	46.15	1,970.84	-673.41	2.93	2.51	547.01
1	13,005.40	13	11	2	84.62	1,335.89	-844.69	1.58	8.70	1,000.42

Inclinations don't appear much different based on this table.

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>



The POMO Days indicator hit a new high on Monday as 19 of the last 20 days have now seen POMO buying. The POMO Volume indicator is also still hovering near all-time highs. POMO activity is expected to remain strong as every one of the next 8 days is scheduled for buying according to the tentative operations schedule. This should continue to put a nice wind at the market's back.

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

Intermediate-term evidence continues to point higher. POMO, trend, momentum, and price patterns all suggest the rally is not over. While the market got a bit of a scare this past week it seems unlikely that this will mark the end of the rally. I still favor a bullish outlook. 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

HPQ -1/3 @ \$43.59

HPQ -1/3 @ \$42.17 (not filled)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 2 (HPQ-2)

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 – buy 1/4 index position at \$130.93 LIMIT. Based on short-term outlook above. I'll look to get a small piece at Tuesday's close or better.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
GE(1/3)	2/24/2011	\$20.12	\$21.12	4.97%		sold on open
HPQ (1/3)	2/24/2011	\$43.16	\$42.91	-0.58%		Catapult

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