

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 3, 2011

Volume 4 Issue 42

## Market Overview



## Tonight's Research Points

- The SPX price pattern the last 2 days suggests a failure by the bears. Bulls have a chance to take charge over the next few days.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is flat.

## Short-term Outlook

### The Bottom Line

Tonight I am seeing more bullish evidence and still a complete lack of bearish evidence. With the market still underperforming recent expectations the Aggregator System remains long. I have some exposure and will look to take on a little more via a Catapult trade.

*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>				
March 3, 2011	Higher high dn then lower low up	1-4 days	Bullish	1.60%
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	1.60%
<b>Active - Long Term</b>				
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	
<b>Dropped Tonight</b>				
February 25, 2011	3 days dn. Drop slowing.	1-4 days	Bullish	2.00%
February 24, 2011	Down 1.75% and the between .25-.75%	1-5 days	Bullish	

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

### *The Evidence*

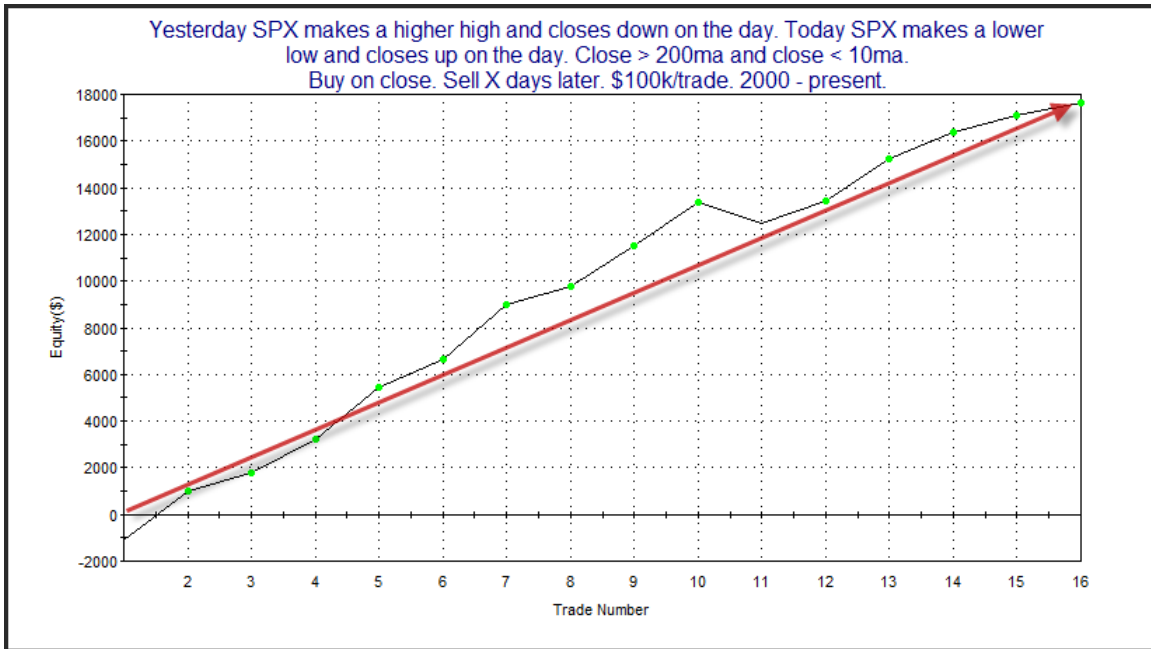
After a big drop on Tuesday, action quieted a bit on Wednesday. The bears took a few shots to push the market lower - near the open and around noon – but neither attempt succeeded and the major indices finished the day in the green. The SPX ended up with a 0.2% gain, the Nasdaq rose 0.4%, and the Russell 2000 rallied 0.5%. Breadth was moderately positive as the NYSE Up Issues % and the Up Volume % both came in at 62%. Total NYSE volume dipped from Tuesday’s levels.

On Tuesday the bulls tried to make a move higher and failed, making for a higher high and a lower close. On Wednesday the opposite happened. The bears failed in their attempt at a move lower. In the 11/11/10 Subscriber Letter I looked two-day moves like this. I found results to be substantially different based on whether the market is near the top or the bottom of its short-term range. When the pattern occurs in the lower end of the short-term range it has been consistently bullish over the next 4-5 days. This can be seen in the below test, which I have updated.

Yesterday SPX makes a higher high and closes down on the day. Today SPX makes a lower low and closes up on the day. Close > 200ma and close < 10ma. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	22,311.86	16	12	4	75.00	1,878.92	-58.78	31.97	95.90	1,394.49
4	17,625.41	16	14	2	87.50	1,398.90	-979.62	1.43	10.00	1,101.59
3	7,534.21	16	11	5	68.75	1,211.07	-1,157.51	1.05	2.30	470.89
2	4,686.46	16	10	6	62.50	1,194.39	-1,209.57	0.99	1.65	292.90
1	1,630.01	16	8	8	50.00	762.62	-558.87	1.36	1.36	101.88

**The only instance that did NOT post a close above the entry price at some point in the next week was the 1st one on 1/25/00.**

Odds strongly favor a move higher and the win: loss ratio and profit factors are very impressive. Instances are a little lower than I would prefer but the evidence is so lopsided it appears worthy of consideration. Below is an equity curve using a 4-day exit strategy to see how the edge has played out over time.



The strong, steady rise is impressive.

While not applicable to the current situation, I thought I'd also show the results when the pattern occurred and the SPX closed above the 10ma. This table is taken from the 11/11/10 letter and has not been updated.

Yesterday SPX makes a higher high and closes down on the day. Today SPX makes a lower low and closes up on the day. Close > 200ma and **close > 10ma**.  
Buy on close. Sell X days later. \$100k/trade. 2000 - 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	-6,292.70	30	17	13	56.67	845.56	-1,589.79	0.53	0.70	-209.76
4	-10,035.81	32	16	16	50.00	860.42	-1,487.66	0.58	0.58	-313.62
3	-6,997.35	32	16	16	50.00	900.83	-1,338.16	0.67	0.67	-218.67
2	-1,667.30	32	18	14	56.25	533.59	-805.13	0.66	0.85	-52.10
1	761.94	32	17	15	53.13	453.12	-462.74	0.98	1.11	23.81

We see here that the winning % is a tossup and the downside risk has outsized the upside reward. In this case implications are not bullish. With the 50% winning % and the fairly mild average decline I'm not sure I'd call it bearish either.

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 continues to edge higher. 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 remained long at the close.

Based on the current active studies the green Aggregator line is set to remain above 0 on Thursday. This could change should strong bearish evidence emerge. Meanwhile the Differential Pivot will rise to 1,336.12. This is over 2.1% above Wednesday'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 bears had their chances to drive the market lower Wednesday and they couldn't take advantage. With the market trading near the lower end of its range and the differential value nicely positive this suggests the bulls should have the advantage over the next few days.

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

This week was the 1<sup>st</sup> 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.

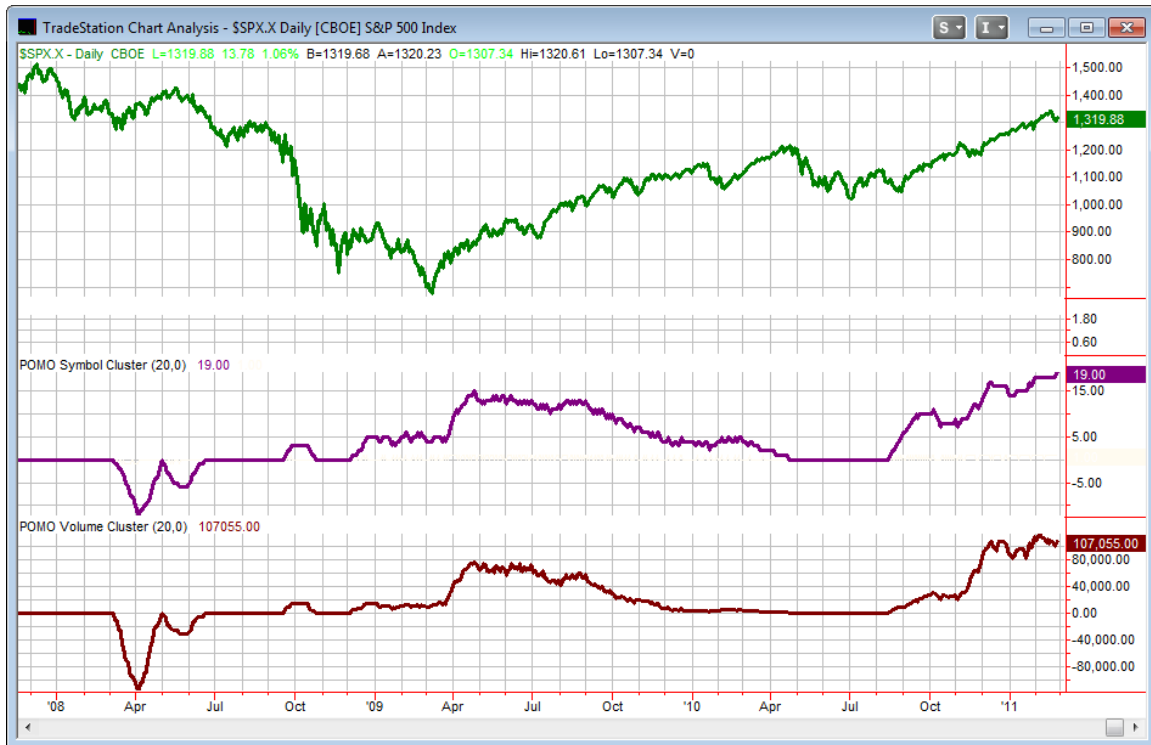
X Weeks	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
13	67,421.97	13	12	1	92.31	5,938.01	-3,834.09	1.55	18.58	5,186.31
12	55,142.15	13	10	3	76.92	5,990.29	-1,586.92	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 3<sup>rd</sup> 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 markets back.

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

COF – 1/3 @ \$47.91

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

None

### **Broad Market Large Cap CBI – 3 (HPQ-2, COF)**

### **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.

COF – buy 1/3 position @ \$47.91 limit. This is a Catapult trade.

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
HPQ (1/3)	2/24/2011	\$43.16	\$43.24	0.19%		Catapult
SPY(1/4)	3/2/2011	\$130.75	\$131.21	0.35%		bought on open

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