

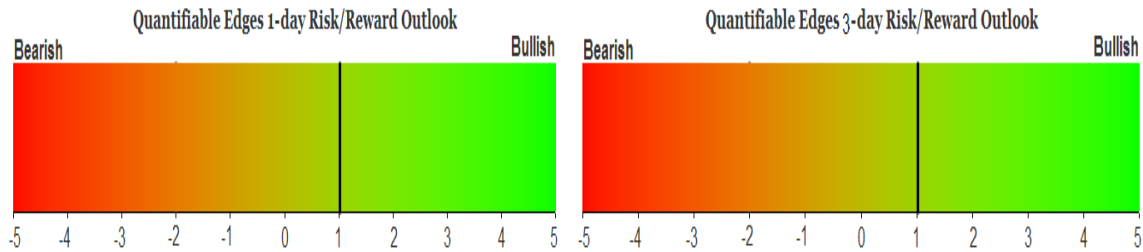
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 4, 2011

Volume 4 Issue 43

## Market Overview



## Tonight's Research Points

- Strong moves in congestion tend to favor a continuation of that move.
- A strong gain the day before employment day has frequently been followed by further gains on employment day.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is flat.

## Short-term Outlook

### The Bottom Line

Despite the rise the last couple of days, odds seem to favor a continuation. I am still long but will be looking to take profits on Friday.

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 4, 2011	1% Rise Before Emplment Report	1 day	Bullish	
March 4, 2011	Unfilled gap-n-go under 10-high	1-3 days	Bullish	1.40%
March 2, 2011	1% drop and decliners 2x advancers	1-9 days	Bullish	3.00%
<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>				
<b>March 3, 2011</b>	<b>Higher high dn then lower low up</b>	<b>1-4 days</b>	<b>Bullish</b>	<b>1.60%</b>
February 28, 2011	Bounce from low still not overbought	1-4 days	Bullish	1.60%

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

## *The Evidence*

As appeared was likely the bulls took charge on Thursday. The major indices all gapped up and never looked back. In the end the SPX had gained 1.7%, the Nasdaq was up 1.8%, and the Russell 2000 rose 2.2%. Breadth was very strong as the NYSE Up Issues % came in at 80% and the Up Volume % was 88%. Total NYSE volume rose above Wednesday's level.

Often times the most difficult place to find an edge is in the middle of a trading range. The market has done quite a bit of chopping around over the last 8-9 days. Even with Thursday's strong move the SPX remains below recent highs. The Quantifinder didn't like this and came up with a rare blank. Even with all the studies we track, that still happens a couple of times a month on average.

The strong move did result in last night's study rapidly reaching its target. Combined with the expiration of the February 28<sup>th</sup> study this only left one study on the short-term active list.

When the market moves nicely in my direction as it has the last 2 days, I often find myself looking for reasons to take profits. I looked at things from a few different angles trying to determine whether this strong move that is occurring in the middle of the range could possibly suggest an upside or downside edge.

I first decided to look at similar setups that have occurred since the 2009 bottom.

SPX closes up for at least the 2nd day in a row. Today it gains at least 1.5%. It closes below the highest close of the last 10 days. Buy on close. Sell X days later. \$100k/trade. 3/11/09 - 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	5,047.73	6	4	2	66.67	2,056.88	-1,589.90	1.29	2.59	841.29
4	8,037.27	6	6	0	100.00	1,339.55	0.00	100.00	100.00	1,339.55
3	6,617.61	6	4	2	66.67	2,010.95	-713.10	2.82	5.64	1,102.94
2	7,561.59	6	5	1	83.33	1,766.93	-1,273.05	1.39	6.94	1,260.27
1	3,154.97	6	4	2	66.67	1,076.16	-574.84	1.87	3.74	525.83

I required yesterday to also be higher to ensure that the move today was not the 1<sup>st</sup> rebound day coming off an extremely oversold condition. The close below a 10-day high ensures we are still in the range and there has not been a breakout. The results are strongly positive but the number of instances is a bit low for comfort.

I therefore decided to look at the same setup much further back in time, but with a 200ma filter added to it.

SPX closes up for at least the 2nd day in a row. Today it gains at least 1.5%. It closes below the highest close of the last 10 days. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1970 - 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	31,322.77	33	20	13	60.61	2,754.69	-1,828.54	1.51	2.32	949.17
9	36,499.64	35	21	14	60.00	2,801.66	-1,595.38	1.76	2.63	1,042.85
8	25,340.41	37	23	14	62.16	2,352.67	-2,055.06	1.14	1.88	684.88
7	11,266.75	37	21	16	56.76	2,368.29	-2,404.21	0.99	1.29	304.51
6	16,563.25	37	23	14	62.16	2,159.73	-2,365.04	0.91	1.50	447.66
5	11,094.45	37	21	16	56.76	2,001.65	-1,933.76	1.04	1.36	299.85
4	7,224.84	37	21	16	56.76	1,707.95	-1,790.13	0.95	1.25	195.27
3	4,407.94	37	19	18	51.35	1,430.93	-1,265.54	1.13	1.19	119.13
2	8,475.98	37	21	16	56.76	1,066.36	-869.85	1.23	1.61	229.08
1	9,536.40	39	26	13	66.67	720.81	-708.05	1.02	2.04	244.52

Results here appear modestly bullish. Most of the gains early on were thanks to a strong day 1. I also loosened the requirement from a 1.5% gain to a 1.0% gain and saw very similar results.

Rather than demand a move of a certain %, I also thought the pattern of an unfilled gap with a close above the open was suggestive of strength on the day. I used those parameters and examined SPY performance since its inception.

After closing up yesterday SPY posts and unfilled gap up and close above the open but below a 10-day closing high. 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
10	55,148.40	86	61	25	70.93	2,302.71	-3,412.67	0.67	1.65	641.26
9	59,326.02	88	61	27	69.32	2,164.95	-2,693.92	0.80	1.82	674.16
8	52,599.84	91	61	29	67.03	2,055.08	-2,508.97	0.82	1.72	578.02
7	23,830.81	92	55	36	59.78	2,041.34	-2,456.75	0.83	1.27	259.03
6	31,023.19	92	55	37	59.78	2,019.63	-2,163.68	0.93	1.39	337.21
5	17,130.41	93	53	40	56.99	1,693.05	-1,815.03	0.93	1.24	184.20
4	22,810.64	94	59	35	62.77	1,369.88	-1,657.49	0.83	1.39	242.67
3	30,843.50	96	58	38	60.42	1,244.88	-1,088.41	1.14	1.75	321.29
2	18,570.01	97	57	39	58.76	1,055.39	-1,066.34	0.99	1.45	191.44
1	7,429.02	103	59	42	57.28	605.23	-673.32	0.90	1.26	72.13

85% of instances posted a close above the entry price at some point in the next week.

Gains here are a little modest, but the consistency is very good. The stat noted in the bottom of the table is especially impressive considering the setup requires the SPY to have already risen the last 2 days. I did peek at performance above and below the 200ma and found little difference between the 2. Therefore I decided it wasn't worthwhile to distinguish for this study.

Being that all of these studies require a close within the recent trading range, I decided it would also be interesting to see how the results would change if instead the move occurred in conjunction with a breakout. Those results are below.

After closing up yesterday SPY posts and unfilled gap up and close above the open and at a 10-day closing high. 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
10	-21,801.84	125	68	56	54.40	1,976.89	-2,789.83	0.71	0.86	-174.41
9	-29,137.43	130	73	57	56.15	1,756.18	-2,760.32	0.64	0.81	-224.13
8	-33,947.08	136	75	60	55.15	1,474.36	-2,408.73	0.61	0.77	-249.61
7	-34,849.18	140	75	63	53.57	1,347.46	-2,157.28	0.62	0.74	-248.92
6	-36,273.54	145	73	71	50.34	1,290.44	-1,837.68	0.70	0.72	-250.16
5	-37,600.67	148	73	73	49.32	1,190.72	-1,705.79	0.70	0.70	-254.06
4	-37,875.67	154	83	70	53.90	1,043.68	-1,778.58	0.59	0.70	-245.95
3	-49,787.36	156	83	71	53.21	780.12	-1,613.20	0.48	0.57	-319.15
2	-23,869.03	160	91	67	56.88	621.91	-1,200.94	0.52	0.70	-149.18
1	-13,927.96	170	83	87	48.82	486.46	-624.18	0.78	0.74	-81.93

When the SPY is no longer contained by the trading range then risk/reward suffers. Under such circumstances expectations would change from positive to negative.

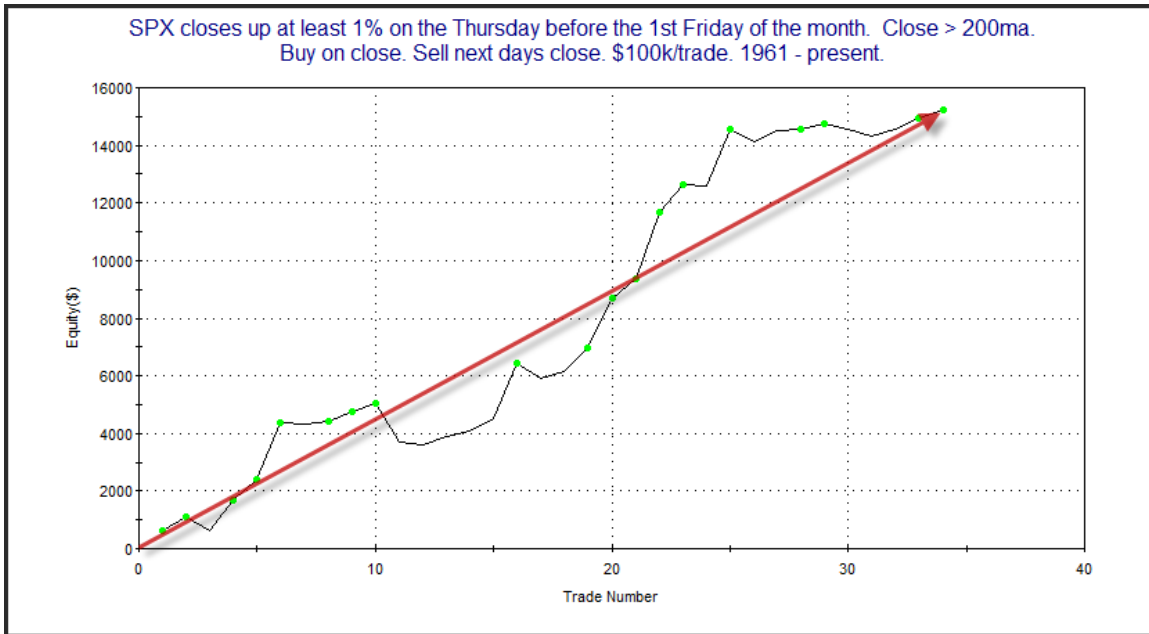
Bottom line is that no matter how I approached it, strong mid-range moves consistently failed to deliver bearish results. And in many cases it suggested moderately bullish implications.

Of course there is one wildcard out there Friday which is on the minds of many traders. It is the employment report, and it will be released an hour before the NYSE opening bell. The employment report, which is typically released on the 1<sup>st</sup> Friday of every month, has long been a market mover.

I wondered whether a strong move up just prior to the report might set the market up for disappointment. The study below takes a long-term look at this.

SPX closes up at least 1% on the Thursday before the 1st Friday of the month. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1961 - 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	6,288.99	34	19	15	55.88	1,503.68	-1,485.39	1.01	1.28	184.97
4	12,187.71	34	18	16	52.94	1,598.00	-1,036.01	1.54	1.74	358.46
3	12,387.29	34	21	13	61.76	1,247.66	-1,062.58	1.17	1.90	364.33
2	16,313.37	34	27	7	79.41	856.33	-972.50	0.88	3.40	479.81
1	15,218.95	34	25	9	73.53	744.47	-376.97	1.97	5.49	447.62

The first 2 days here show a high propensity for further upside, even though the market just put in a +1% day. Below is a long-term equity curve using a 1-day holding period.



Some ups and downs but the general slope has remained positive for a long time. I also decided to zoom in a little to see how the stats would look over a more recent period.

SPX closes up at least 1% on the Thursday before the 1st Friday of the month. Close > 200ma.  
Buy on close. Sell X days later. \$100k/trade. 1988 - 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	6,450.16	20	10	10	50.00	1,544.00	-898.99	1.72	1.72	322.51
4	6,381.24	20	10	10	50.00	1,578.67	-940.55	1.68	1.68	319.06
3	6,610.69	20	11	9	55.00	1,233.50	-773.09	1.60	1.95	330.53
2	11,392.54	20	15	5	75.00	931.04	-514.60	1.81	5.43	569.63
1	11,124.34	20	15	5	75.00	835.07	-280.35	2.98	8.94	556.22

Day 1 certainly seems to suggest an upside edge, and I have included it among the active studies. I also ran the test using a 1.5% requirement and a 1-day exit. Those 8 instances are all listed below.

SPX closes up at least 1.5% on the Thursday before the 1st Friday of the month.  
Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1988 - present.

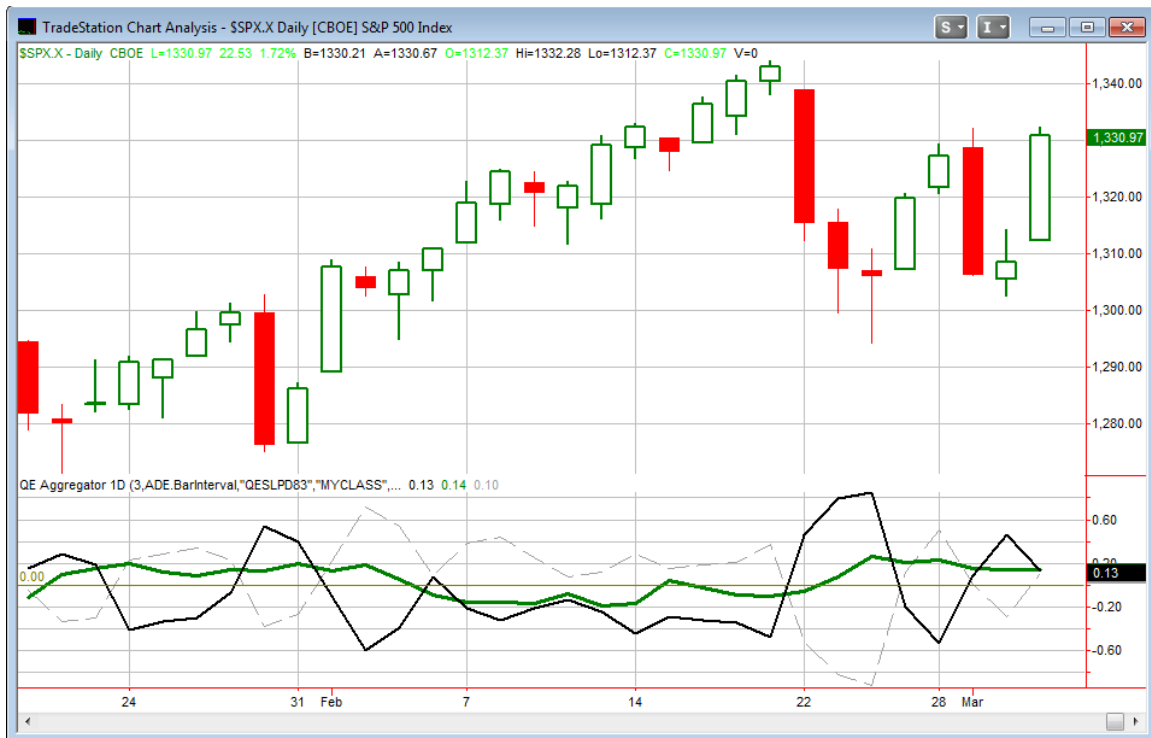
Date/Time	Signal	Price	% Profit	Run-up DrawDown
08/01/96	Buy	\$650.01	1.92%	\$1,909.44
08/02/96	Sell	\$662.49		\$0.00
04/30/98	Buy	\$1,111.75	0.83%	\$825.03
05/01/98	Sell	\$1,121.02		\$0.00
03/04/99	Buy	\$1,246.64	2.31%	\$2,323.20
03/05/99	Sell	\$1,275.47		\$0.00
06/01/00	Buy	\$1,448.80	1.96%	\$2,375.67
06/02/00	Sell	\$1,477.26		\$0.00
11/04/04	Buy	\$1,161.67	0.39%	\$791.20
11/05/04	Sell	\$1,166.17		(\$112.66)
12/06/07	Buy	\$1,507.34	(0.18%)	\$217.14
12/07/07	Sell	\$1,504.65		(\$308.88)
11/05/09	Buy	\$1,066.63	0.25%	\$451.05
11/06/09	Sell	\$1,069.30		(\$657.51)
11/04/10	Buy	\$1,221.06	0.39%	\$487.62
11/05/10	Sell	\$1,225.85		(\$62.37)

**The average runup is nearly 1.20% and the average closing gain is just under 1.00% while the average drawdown is less than 0.15%**

We see here more lopsided evidence suggesting a bullish edge.

The employment report can be a market mover. And typically there is nothing wrong with taking some profits ahead of a news event like this. But in this case it appears there is actually an edge in holding for another day. As I mentioned before I could find no compelling reason to take profits on Thursday based on the current setup.

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 still remains above 0 as well. 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 Friday. This could change should strong bearish evidence emerge. Meanwhile, with Tuesday's big drop exiting the calculation the Differential Pivot will drop to 1,313.78. This is about 1.3% below Thursday's close. This means that unless the SPX closes down 1.3% or more on Friday the Differential Line will drop below 0. This would signal the SPX is "overbought" versus expectations. It also means that barring a sharp selloff Friday the Aggregator System will come off its long signal.

The current market setup has me in profit taking mode. Unless there is a strong move down Friday I will be looking to get out by the end of the day. Should the market

consolidate or stair-step higher during the day, I may look to place or trail a stop under intraday support areas to protect my profits against an afternoon selloff.

**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.

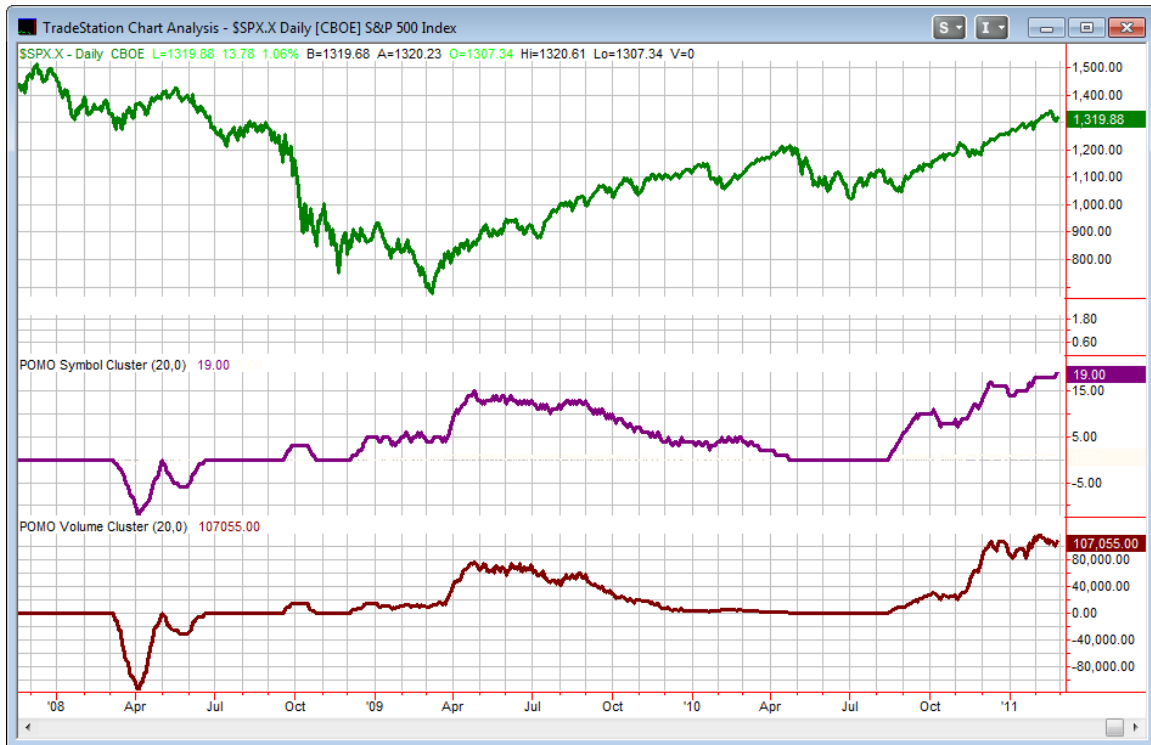
X Weeks	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
13	67,421.97	13	12	1	92.31	5,938.01	-3,834.09	1.55	18.58	5,186.31
12	55,142.15	13	10	3	76.92	5,990.29	-1,586.92	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 (not filled)

### **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.

None tonight.

## **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
HPQ (1/3)	2/24/2011	\$43.16	\$43.20	0.09%		Catapult
SPY(1/4)	3/2/2011	\$130.75	\$133.47	2.08%		Aggregator

I will look to exit the SPY trade idea on an SPX close > 1,313.78. I may also look to place a stop under intraday support levels Friday, allowing me to lock in some profits and protect against a late-day selloff.

HPQ will trigger an exit if it trades above \$43.71 intraday or closes above \$43.54. In either case HPQ would be sold at Monday's open.

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