

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 10, 2011

Volume 4 Issue 47

Market Overview



Tonight's Research Points

- Back to back inside days in a long-term uptrend have suggested an upside tendency. There are too few instances to draw solid conclusions, though.
- Triangle breakouts reverse much more often than they follow through.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

The tight range will have to break soon. Bullish inclinations are still dominating and I expect to see a move up in the next few days. Even if we get a breakdown first, it appears likely we'll see a reversal back higher. I'm not looking to get aggressive in this environment. I will take profits if the market can hold up 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				
March 9, 2011	5 days inside 1% SPX drop day. Uptrend.	1-3 days	Bullish	1.40%
March 2, 2011	1% drop and decliners 2x advancers	1-9 days	Bullish	3.00%
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

The market gapped down to start the day. And though the SPY and IWM managed to fill their gaps, the bulls never really got anything going. At the end of the day the major indices were all lower. The SPX was down just 0.1%. The NASDAQ lost 0.5% and the Russell 2000 lost 0.4%. Technology served as a big drag on the NASDAQ as the SOX dropped close to 3%. Breadth was modestly negative as the NYSE Up Issues % came in at 47% and the Up Volume % was 48%. Total NYSE volume declined for the fourth day in a row. The trading range continued and the consolidation appears to be tightening.

As has been happening some lately with the market locked in this consolidation, the Quantifinder again struggled to find any substantial edges this afternoon. One oddity I noticed was that today was the 2nd inside day in a row for the SPY. I mentioned yesterday that inside days tend to be bearish when the market is locked in a long-term downtrend, but that bearish edge does not hold true in an uptrend. I thought today I would look at instances of back to back inside days and break them out by whether they are above or below the 200ma.

Let's first look at instances below the 200ma.

SPY posts an inside day for the 2nd day in a row. Close < 200ma. 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
5	-6,579.29	6	4	2	66.67	2,762.27	-8,814.18	0.31	0.63	-1,096.55
4	-5,224.83	6	3	3	50.00	3,483.43	-5,225.04	0.67	0.67	-870.81
3	-7,217.60	6	2	4	33.33	2,406.84	-3,007.82	0.80	0.40	-1,202.93
2	-6,373.65	6	2	3	33.33	705.85	-2,595.11	0.27	0.18	-1,062.28
1	-5,121.99	6	2	4	33.33	505.69	-1,533.34	0.33	0.16	-853.67

We know from past studies that inside days under the 200ma can be bearish. There are too few back to back ones to draw any solid conclusion, but they certainly seem to go along with that premise.

So now let's look at back to back inside days above the 200ma.

SPY posts an inside day for the 2nd day in a row. Close > 200ma. 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
5	1,525.84	5	2	3	40.00	1,347.19	-389.51	3.46	2.31	305.17
4	1,785.16	5	3	2	60.00	969.75	-562.05	1.73	2.59	357.03
3	3,004.44	5	4	1	80.00	758.83	-30.88	24.57	98.29	600.89
2	1,326.53	5	3	2	60.00	799.76	-536.38	1.49	2.24	265.31
1	1,047.14	5	3	2	60.00	695.18	-519.20	1.34	2.01	209.43

All 5 instances posted a close above the entry price at some point in the next 3 days.

The table here looks a lot different. Again there are too few instances to show a significant bias, but early indications suggest tight consolidations in uptrends may be more likely to resolve upwards. This is a theme that was demonstrated in a more significant way in last night's letter. For those that would like to dig a little deeper I have listed all 5 instances below along with their 3-day returns.

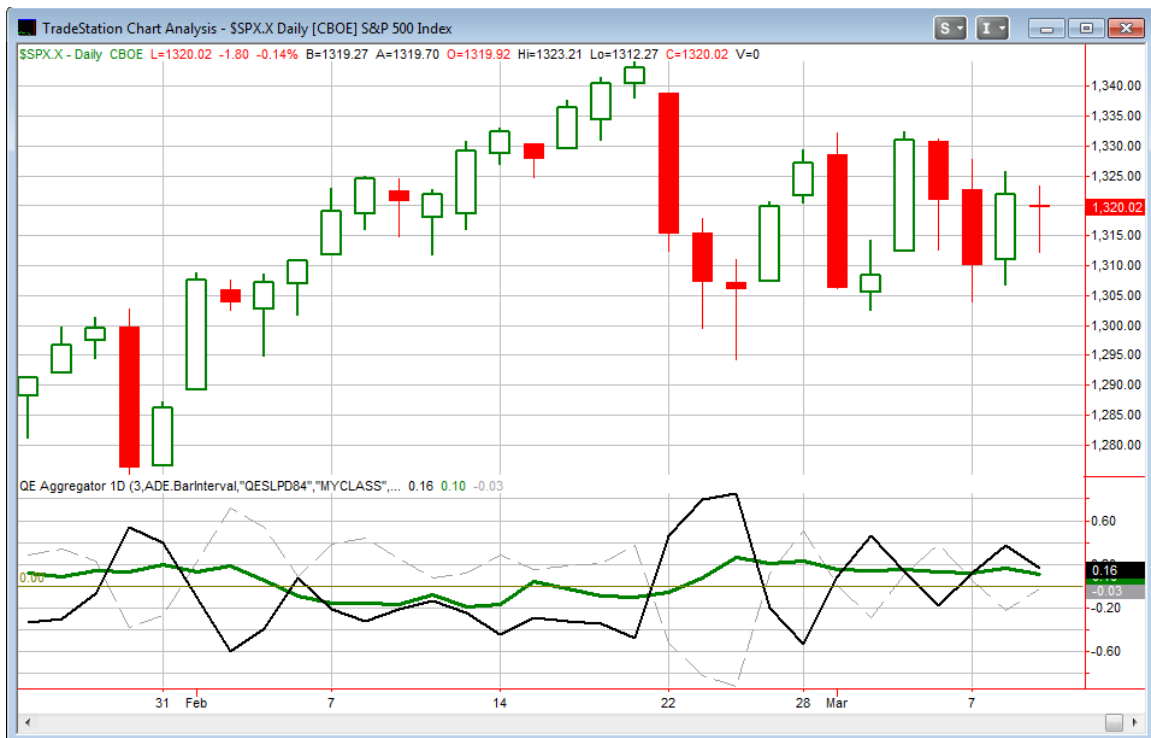
SPY posts an inside day for the 2nd day in a row. Close > 200ma. Buy on close. Sell 3 days later. \$100k/trade. 1994 - present.				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
12/23/94	Buy	\$46.06	0.11%	\$759.85
12/29/94	Sell	\$46.11		(\$195.39)
03/09/95	Buy	\$48.56	2.10%	\$2,223.72
03/14/95	Sell	\$49.58		(\$61.77)
07/23/03	Buy	\$99.24	0.62%	\$1,258.75
07/28/03	Sell	\$99.86		(\$1,208.40)
07/22/05	Buy	\$123.54	0.20%	\$331.69
07/27/05	Sell	\$123.79		(\$946.53)
02/24/06	Buy	\$129.41	(0.03%)	\$486.36
03/01/06	Sell	\$129.37		(\$988.16)

Of course the range hasn't just contracted the last 2 days. It has been contracting for weeks. Nearly every chart I see posted in the last few days has a triangle drawn on it. Triangles serve as consolidations patterns. A common way that people trade triangles is to buy or short the breakout. When the market is coiled as happens when a triangle is formed, the breakout can sometimes be very sharp. A common way to project a target for a triangle breakout is to measure the width of the triangle from its high to its low and add (or subtract) that distance from the breakout point. [In the blog 3 years ago I looked at](#)

triangles a few different ways. I tested across a large number of stocks. Results suggested that a triangle breakout strategy would've struggled mightily over the previous 15 years. About 2/3 of all trades would have failed and total gains and losses would've been about even.

I played around with the concept again tonight and looked specifically at SPX returns. Based on what I saw it appeared that playing triangle breakouts using a target as described above and a stop on the opposite side of the triangle would've been a substantial loser. I am not going to go into the results in detail tonight because I wasn't completely happy with the code. Instead I will say that based on early results it appears fading the breakout would've been a much more profitable strategy – and on a consistent basis. Additionally, I will post the code to the Downloads page sometime on Thursday so that any subscriber that wishes may play around with it. I would welcome suggestions for improvement and will be happy to share detailed results once I am comfortable with it.

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



The green Aggregator line is still 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 for the umpteenth day in a row. Meanwhile the black Differential line is also greater than 0. 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 has provided 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 stay above 0 on Thursday. This could easily change should bearish evidence emerge. Meanwhile, the Differential Pivot will be 1,315.24. This is nearly 0.4% *below* Wednesday's close. This means that the Differential line will flip to negative on any close higher and even if there is a slight decline tomorrow. This would also take the Aggregator System off its current buy signal.

The tight consolidation has me a bit wary. Despite the Aggregator still being positive I am not going to look to add to my position immediately. I prefer it small at this point. If SPX can close above the Differential pivot then I will take profits. If it breaks down then I will likely be looking at some buy setups tomorrow. Not only will the triangle break suggest a reversal but we also still have some bullish studies on the board.

Intermediate-term Outlook (2 weeks – 2 months)– updated 3/7 - bullish

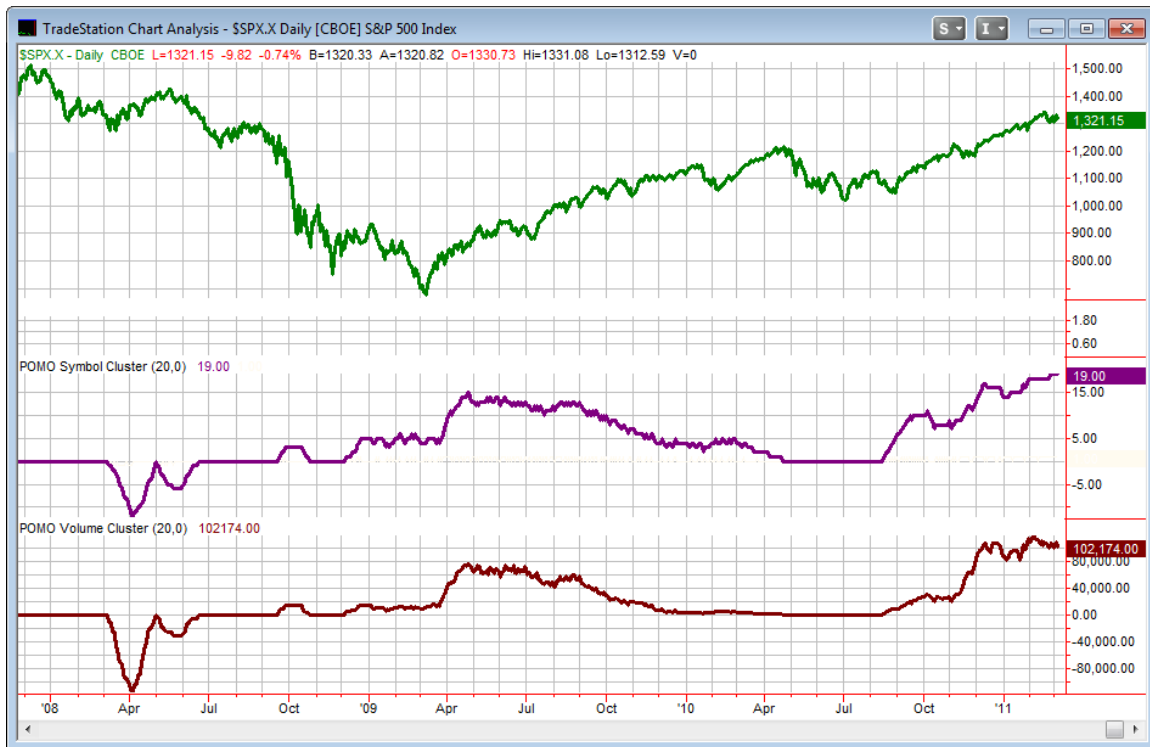
Very little was accomplished this week price-wise. Both the NASDAQ and the S&P finished up just a smidge. Both also formed inside weeks, and it's possible they are beginning triangle formations. At this point the consolidation doesn't appear so tight that it is notable. And though it is tough to predict, it will be interesting to see which way it eventually breaks. I'm still leaning long.

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 remained at 19 this entire week. In fact February 10th is the only day since the end of January when there hasn't been POMO activity. February 10th was the day the last tentative operations schedule was released. The next day where no POMO activity is currently scheduled is this Thursday, March 10. March 10 is also the day the next tentative operations schedule is set to be released. So Thursday should be an interesting day since we'll get a glimpse of the scheduled buying activity for the next month. The POMO Volume indicator is also still hovering near all-time highs. Barring a notable reduction in scheduled buying activity appearing on Thursday, I expect POMO to continue to provide a steady wind at the market's back. The link below is to the tentative operations page. Does the page that will be updated on Thursday when the new schedule comes out.

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. And frankly I'm not seeing anything suggesting an intermediate-term selloff is about to start. Due to this, 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.

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	\$42.05	-2.57%		Catapult
SPY(1/4)	3/8/2011	\$131.43	\$132.39	0.73%		bought on open

I will look to sell the SPY position at the close if SPX closes at 1,315.24 or above.

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