

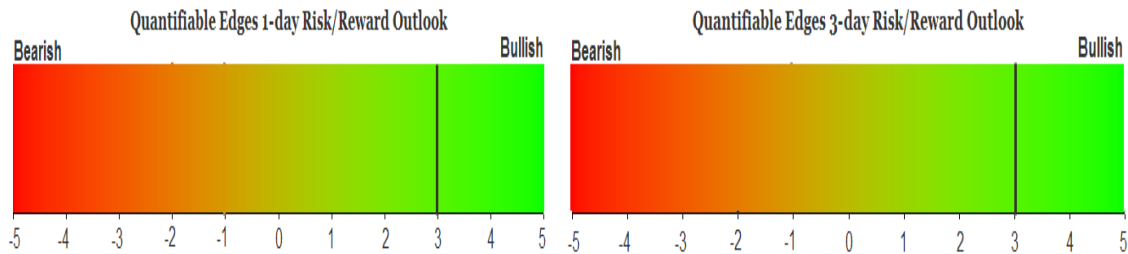
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 18, 2011

Volume 4 Issue 53

## Market Overview



## Tonight's Research Points

- A move up in the CBI to 10 suggests an upside edge.
- Thursday's bounce was the "right" size to suggest a continuation.
- Volume studies were inconclusive.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is flat.

## *Short-term Outlook*

### *The Bottom Line*

Thursday saw the market bounce and studies trigger with implications suggesting there should be more upside before this bounce is done. I'm still long.

*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 18, 2011	Sweet spot bounce	1-5 days	Bullish	3.10%
March 17, 2011	VIX up 25% & more than 25% > 10ma	1-2 days	Bullish	
March 16, 2011	5 Gaps Down	1-3 days	Bullish	
March 16, 2011	2 Unfilled Down Gaps > 200ma	1-5 days	Bullish	
March 16, 2011	McClellan 50-day Bounded Low 4 days	1-5 days	Bullish	
March 16, 2011	VIX 100-high. SPX no 100-low	1-6 days	Bullish	
March 14, 2011	Outside day frm sh-term low in uptrend	1-6 days	Bullish	2.00%
March 11, 2011	20-day low. High vol. Lrg drop. >200.	1-7 days	Bullish	2.65%
<b>Active - Long Term</b>				
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>				
March 14, 2011	March Op-ex Week	1-4 days	Bullish	1.70%
March 16, 2011	SPY 1% > open but down on day	1-2 days	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 rebounded a bit on Thursday after suffering several days of selling. The major indices all gained. The SPX led the way with a 1.3% gain, while the NASDAQ rose 0.3% and the Russell 2000 and finished up 0.4%. Breadth was solidly positive as the NYSE Up Issues % came in at 72% and the Up Volume % was 81%. Total NYSE volume declined from the levels of the last two days.

There were again a number of interesting developments among the indicators and studies we follow. For one the Quantifiable Edges Capitulative Breadth Indicator (CBI) moved up to 10. This is the first reading of 10 or higher since July 2010. Typically when this many Catapult triggers are active at once it means that not only are there a large number of individual stocks capitulating and primed for a bounce, but the market as a whole is also very likely to bounce. Below is an update of a strategy I've shown many times before in the blog, the subscriber letter, and the Catapult & CBI video from last June. It looks at entering the market when a large number of stocks triggered Catapults and then exiting the SPX when most of those stocks revert and hit their exit triggers.

Quantifiable Edges Capitulative Breadth Indicator (CBI) spikes to 10 or higher. Buy on close. Exit when CBI closes <= 3. \$100k/trade. 1995 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$56,568.27	Profit Factor	8.48
Gross Profit	\$64,128.99	Gross Loss	(\$7,560.72)
Total Number of Trades	24	Percent Profitable	87.50%
Winning Trades	21	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	\$2,357.01	Ratio Avg. Win:Avg. Loss	1.21
Avg. Winning Trade	\$3,053.76	Avg. Losing Trade	(\$2,520.24)
Largest Winning Trade	\$18,981.60	Largest Losing Trade	(\$4,214.00)

It normally takes a few days for all of the catapult stocks to reach their exit triggers. But when the market reaches such high levels of capitulation, the bounce that ensues will often persist for several days. Exits for this strategy will often not be as quick as, say, the Aggregator System. The average trade lasts 8 days. Often when this set up triggers I will therefore look to hold a piece of my position until the CBI returns down to three or less. I may do that here as well.

This next study will look familiar to almost everyone. That is because it was last seen just a few days ago and covered in Monday's Subscriber Letter. The study found that after large drops like we saw on Wednesday, the best case scenario has been a rebound next day of between 0.25% and 0.75% of the previous day's loss. I have updated the results below.

SPX falls at least 1.75% yesterday. Today it makes up between 25% and 75% of yesterday's loss. 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	64,943.03	31	30	1	96.77	2,235.29	-2,115.67	1.06	31.70	2,094.94	
4	50,992.05	32	28	4	87.50	1,983.56	-1,136.89	1.74	12.21	1,593.50	
3	47,184.74	32	30	2	93.75	1,718.97	-2,192.16	0.78	11.76	1,474.52	
2	32,208.37	32	22	10	68.75	1,842.13	-831.85	2.21	4.87	1,006.51	
1	27,466.55	32	24	8	75.00	1,252.00	-322.69	3.88	11.64	858.33	
<b>The only instance not to close above the entry price at some point in the next 4 days was the one that triggered last Friday.</b>											

The instance that triggered last Friday is the first one to log a complete failure. I can certainly forgive it at this point. I am pretty sure it is the only instance that triggered alongside a major earthquake, a tsunami, and a potential nuclear meltdown. Overall results still remain very strongly bullish and I have reset it on the active studies list. Anyone who would like to see a list of the instances should refer back to Monday's letter.

There were a couple of studies that triggered which took special note of the lower volume on Thursday. This first one below was last shown in the 11/24/08 subscriber letter.

Yesterday SPX closes at a 50-day low on the highest NYSE volume in 20 days. Today it closes up on lower volume. 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
10	-37,911.97	15	5	10	33.33	1,674.41	-4,628.40	0.36	0.18	-2,527.46
9	-40,833.35	15	3	12	20.00	1,442.98	-3,763.53	0.38	0.10	-2,722.22
8	-25,659.13	15	3	12	20.00	1,908.84	-2,615.47	0.73	0.18	-1,710.61
7	-23,614.02	15	6	9	40.00	1,661.10	-3,731.18	0.45	0.30	-1,574.27
6	-13,599.36	16	8	8	50.00	1,570.63	-3,270.55	0.48	0.48	-849.96
5	-15,468.12	17	7	10	41.18	2,066.88	-2,993.63	0.69	0.48	-909.89
4	-23,987.53	17	7	10	41.18	1,325.66	-3,326.72	0.40	0.28	-1,411.03
3	-26,155.11	18	7	11	38.89	1,257.31	-3,177.85	0.40	0.25	-1,453.06
2	-22,654.57	19	6	13	31.58	1,836.44	-2,590.25	0.71	0.33	-1,192.35
1	-11,579.13	19	7	12	36.84	703.44	-1,375.27	0.51	0.30	-609.43

Implications here appear bearish. Interestingly, this wasn't the only volume-related study to trigger, though. This next study from the 5/11/10 Subscriber Letter seems to suggest there is no negative impact from the lower volume level.

Yesterday SPX RSI(2) closed < 5. Today the SPX closes up on lower NYSE volume. 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	12,885.15	29	14	15	48.28	3,306.87	-2,227.40	1.48	1.39	444.32
9	19,817.41	30	19	11	63.33	2,671.97	-2,813.63	0.95	1.64	660.58
8	10,274.39	30	19	11	63.33	2,276.48	-2,998.07	0.76	1.31	342.48
7	28,692.90	30	21	9	70.00	2,361.01	-2,320.92	1.02	2.37	956.43
6	25,264.28	31	21	10	67.74	2,056.92	-1,793.10	1.15	2.41	814.98
5	21,412.37	31	18	13	58.06	2,444.62	-1,737.75	1.41	1.95	690.72
4	20,599.35	33	20	13	60.61	1,967.65	-1,442.58	1.36	2.10	624.22
3	15,647.17	33	19	14	57.58	1,664.18	-1,140.88	1.46	1.98	474.16
2	19,822.05	33	22	11	66.67	1,476.50	-1,150.99	1.28	2.57	600.67
1	12,965.23	33	21	12	63.64	1,056.50	-768.44	1.37	2.41	392.89

28 of 31 instances (90%) closed above the entry price at some point in the next week.

It could be the position of the market that flips this last study from bearish to bullish, or it could be the fact that it is measuring oversold via a short-term measure rather than a long-term method. In any case, results directly oppose the previous study. Rather than spending too much time trying to unravel the reasons why, I am inclined to simply avoid the situation by ignoring both studies this evening.

As we'll see with the Aggregator chart below, on the whole the studies are still strongly suggesting more upside. Should we get the expected bounce over the next few days it will be interesting to monitor how it unfolds. At this point it is impossible for me to tell whether the bounce is signaling a strong leg higher and a run at the old highs, or whether it would provide an opportunity to sell short and capture the next leg down. I'll be watching closely and with an open mind over the next few days for hints to better assess the possibilities.

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



The green Aggregator line is again very strongly above 0. The positive value means the net expectation from the Active Studies List is for upside over the next few days. As has been the case lately, all the active short-term studies remain bullish. Meanwhile the black Differential line remains very stretched. Readings above 0 mean the SPX has underperformed expectations over the last few days. So net expectations are for upside and the SPX is strongly oversold. Historically this combination 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 Friday. This could change should strong bearish evidence emerge. Meanwhile, the Differential Pivot will be 1,293.68. This is about 1.6% above Thursday's close. It will therefore take a strong bounce on Friday in order to trigger an exit from the current Aggregator System long signal.

With the market already up strong on Thursday, I'm not inclined to aggressively pursue more index exposure. This is especially true considering the futures are much higher overnight thanks to a Japanese currency intervention by the G7. A pullback to a more buyable area on Friday could simply be a prelude to an afternoon selloff ahead of the weekend. Traders may decide they are not inclined to carry a lot of exposure over the weekend due to the risk of bad news being announced. So despite the CBI spiking to 10, I'm simply looking to add exposure via individual catapult trades rather than maxing out my index position just yet. Details in the Trade Ideas section below.

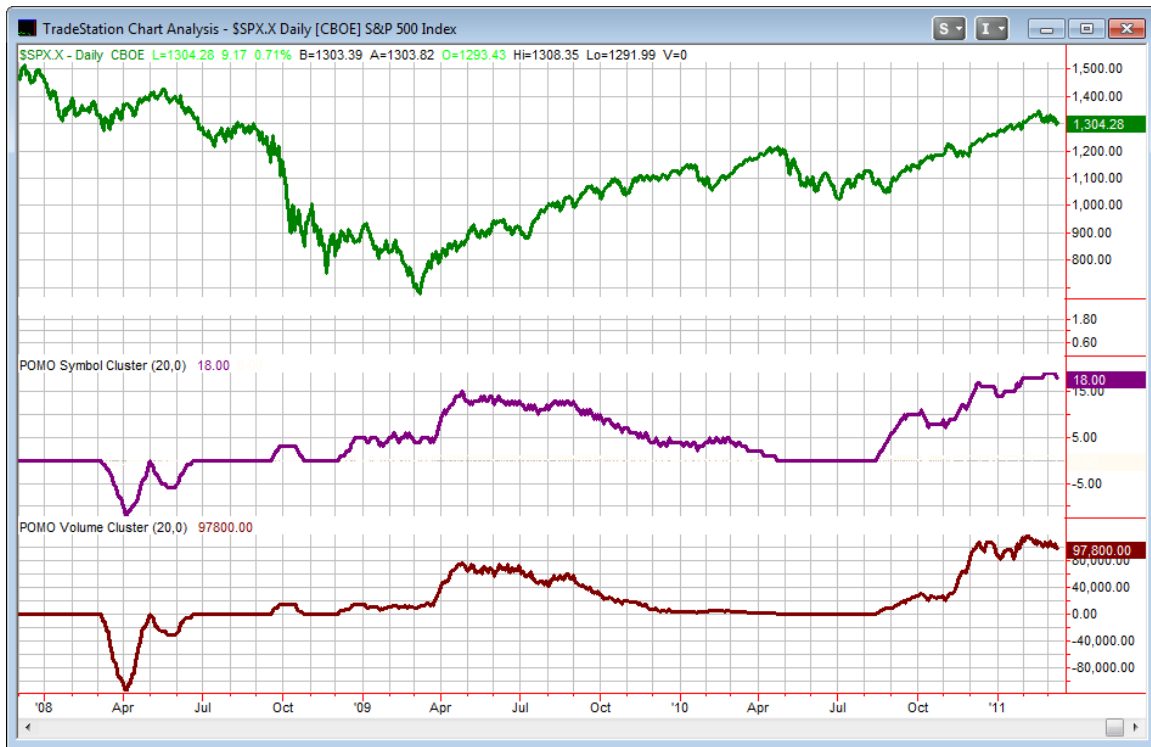
***Intermediate-term Outlook (2 weeks – 2 months)– updated 3/14 - bullish***

It was a difficult week for the market. From a technical standpoint the big news was the triangle breakdown on Thursday. This was seen by many as a potential topping event indicating further selling. This is not what my research showed though. The triangle breakdown study I published Thursday night suggested a strong intermediate-term upside bias. All (non-trial) subscribers can find the triangle studies, as well some additional performance reports and Tradestation code in the [downloads section of the website](#).

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 is still extremely elevated at 18. The Fed released the new tentative operations schedule on Thursday. It doesn't appear quite as busy as the last couple of months but there is still buying scheduled for around 4 days per week. This upcoming week Tuesday is the only non-POMO day. The POMO Volume indicator has dipped a little bit but is still at a very elevated level, with plenty of money having gone in to the system over the last month. I expect POMO to continue to provide a steady wind at the market's back. For those that would like to view the upcoming schedule I have provided a link below.

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

I still feel odds favor a continued rise over the next several weeks. POMO, trend, momentum, and price patterns (including the new triangle breakdown study) all suggest the rally is not over. There also continues to be a complete lack of intermediate-term bearish evidence. 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*

*XOM – 1/3 @ \$81.31*

*CSCO – 1/3 @ \$17.39*

*MO – 1/3 @ \$24.29*

*PM – 1/3 @ \$61.87*

*CSCO – 1/3 @ \$17.05 (2<sup>nd</sup> lot)*

*PG – 1/3 @ \$59.73*

***NEW***

*CSCO – 1/3 @ \$17.00 (3<sup>rd</sup> lot)*

*PM – 1/3 @ \$61.79 (2<sup>nd</sup> lot)*

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

*None*

***Broad Market Large Cap CBI – 10/6 (HPQ-2, XOM, CSCO-3, MO, PM-2, PG)***

### **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.*

*I'll be looking to enter the following Catapults (all 1/3 positions size) at the limits listed:*

*PG – 1/3 @ \$59.73*

*MO – 1/3 @ \$24.29*

*PM – 1/3 @ \$61.79*

*CSCO – 1/3 @ \$17.00*

The PG and MO trade ideas are leftover from yesterday. They didn't fill. I am giving them another chance on Friday.

### Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
HPQ (1/3)	2/24/2011	\$43.16	\$41.43	-4.01%		Catapult
SPY(1/4)	3/8/2011	\$131.43	\$127.85	-2.72%		Aggregator
SPY(1/4)	3/11/2011	\$129.52	\$127.85	-1.29%		Aggregator
HPQ (1/3)	3/11/2011	\$41.42	\$41.43	0.02%		Catapult
XOM(1/3)	3/11/2011	\$81.02	\$81.16	0.17%		Catapult
SPY(1/4)	3/16/2011	\$128.15	\$127.85	-0.23%		Aggregator
CSCO(1/3)	3/16/2011	\$17.33	\$17.00	-1.90%		Catapult
CSCO(1/3)	3/17/2011	\$17.05	\$17.00	-0.29%		Catapult
PM(1/3)	3/17/2011	\$61.87	\$61.79	-0.13%		Catapult

*I will look to exit 2 lots of the SPY on an SPX close  $\geq$  1,293.68.*

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