

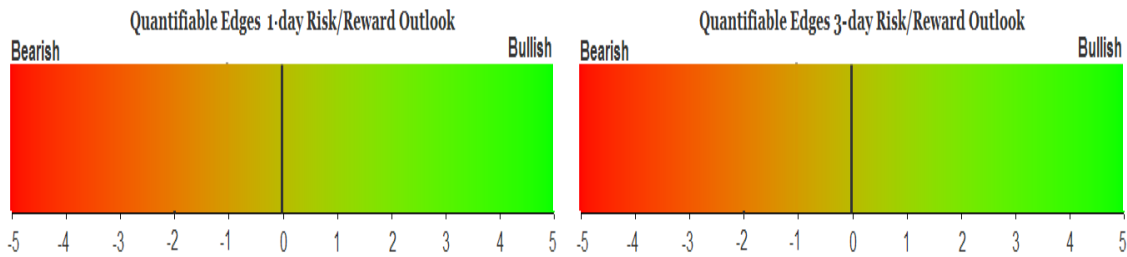
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 22, 2011

Volume 4 Issue 55

Market Overview



Tonight's Research Points

- 15% drops in the VIX have led to a move lower within 2 days in every one of the 18 instances since 1998.
- 3 strong breadth days in a row suggest both a short and intermediate-term upside edge.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

The bounce has now exceeded expectations and I have taken profits. Now sidelined.

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 22, 2011	VIX drops 15%	1-2 days	Bearish	
March 22, 2011	3 Days Up Issues % > 70%	1-2 days	Bullish	
March 21, 2011	2 up after 1.75% down. C>200ma	1-5 days	Bullish	2.30%
March 18, 2011	Sweet spot bounce	1-5 days	Bullish	3.10%
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	
Active - Long Term				
March 22, 2011	3 Days Up Issues % > 70%	int term	Bullish	
November 22, 2010	High number of POMO Days recently	int term	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
Dropped Tonight				
March 14, 2011	Outside day frm sh-term low in uptrend	1-6 days	Bullish	2.00%

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

The Evidence

The market put in its 3rd strong day in a row, finally realizing some of the bullish potential that has been suggested by recent studies. It gapped up over 1% to start the day and never dipped below the low of the 1st 5 minutes. The major indices all posted strong gains. The SPX rose 1.5%, the Nasdaq was up 1.8%, and the Russell 2000 made 2.3%. Breadth was again strong as the NYSE Up Issues % came in at 80% and the Up Volume % was 72%. Total volume declined substantially from Friday's op-ex volume.

I'm seeing mixed evidence tonight based on what appeared in the Quantifinder this afternoon. For the first time in a while a compelling case could be made for either the bull or the bear case depending on your market indicator. Let's first look at a bearish study.

In the 2/25/09 Subscriber Letter I showed a study that examined 1-day drops in the VXO of 15% or greater. I used to use the VXO, which is the old version of the VIX, much more often than the current VIX. Since the VIX is the more widely watched, these days I will more often base my studies on it. So I took that old VXO study, and I looked at what happened if we had that same drop in the VIX.

VIX drops 15% in one day. Buy SPX on close. Sell X days later. \$100k/trade. 1998 - 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	-19,733.02	14	5	9	35.71	2,736.47	-3,712.82	0.74	0.41	-1,409.50
9	-35,394.51	15	4	11	26.67	2,473.66	-4,117.19	0.60	0.22	-2,359.63
8	-50,235.37	15	4	11	26.67	1,132.61	-4,978.71	0.23	0.08	-3,349.02
7	-45,072.84	15	4	11	26.67	1,228.33	-4,544.20	0.27	0.10	-3,004.86
6	-31,283.15	15	5	10	33.33	956.62	-3,606.62	0.27	0.13	-2,085.54
5	-25,006.58	16	6	10	37.50	2,635.33	-4,081.86	0.65	0.39	-1,562.91
4	-22,384.30	17	8	9	47.06	1,331.66	-3,670.84	0.36	0.32	-1,316.72
3	-26,256.47	18	5	13	27.78	1,242.28	-2,497.53	0.50	0.19	-1,458.69
2	-32,697.82	18	4	14	22.22	874.34	-2,585.37	0.34	0.10	-1,816.55
1	-10,767.90	18	3	15	16.67	706.39	-859.14	0.82	0.16	-598.22

All 18 instances closed below the entry price on either day 1 or day 2.

The consistency has been remarkable and the downside edge appears very strong. Results are even stronger than the VXO results. The edge is largely exhausted in the first 2 days, though. Below is the full list of instances with a 2-day exit.

VIX drops 15% in one day.
Buy SPX on close. Sell 2 days later. \$100k/trade. 1998 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
09/01/98	Buy	\$994.25	(1.21%)	\$1,895.00
09/03/98	Sell	\$982.25		(\$2,495.00)
01/07/00	Buy	\$1,441.47	(0.20%)	\$1,579.41
01/11/00	Sell	\$1,438.56		(\$486.45)
06/15/06	Buy	\$1,256.16	(1.28%)	\$8.69
06/19/06	Sell	\$1,240.14		(\$1,500.21)
06/29/06	Buy	\$1,272.87	0.58%	\$585.78
07/03/06	Sell	\$1,280.19		(\$184.86)
02/28/07	Buy	\$1,406.82	(1.40%)	\$187.44
03/02/07	Sell	\$1,387.17		(\$1,842.45)
03/06/07	Buy	\$1,395.41	0.46%	\$888.92
03/08/07	Sell	\$1,401.89		(\$338.67)
06/27/07	Buy	\$1,506.34	(0.20%)	\$738.54
06/29/07	Sell	\$1,503.35		(\$840.18)
09/18/07	Buy	\$1,519.78	(0.07%)	\$1,232.40
09/20/07	Sell	\$1,518.75		(\$218.40)
11/13/07	Buy	\$1,481.01	(2.02%)	\$745.71
11/15/07	Sell	\$1,451.16		(\$2,513.84)
03/18/08	Buy	\$1,330.71	(0.09%)	\$810.00
03/20/08	Sell	\$1,329.51		(\$2,661.75)
09/30/08	Buy	\$1,166.36	(4.47%)	\$56.95
10/02/08	Sell	\$1,114.28		(\$4,669.05)
10/13/08	Buy	\$1,003.35	(9.52%)	\$4,055.04
10/15/08	Sell	\$907.84		(\$9,751.50)
10/20/08	Buy	\$985.40	(8.99%)	\$4.04
10/22/08	Sell	\$896.78		(\$11,068.59)
10/28/08	Buy	\$940.51	1.44%	\$3,105.80
10/30/08	Sell	\$954.09		(\$1,934.50)
01/21/09	Buy	\$840.24	(0.99%)	\$0.00
01/23/09	Sell	\$831.95		(\$4,066.23)
05/10/10	Buy	\$1,159.73	1.03%	\$1,130.04
05/12/10	Sell	\$1,171.67		(\$1,033.72)
05/27/10	Buy	\$1,103.06	(2.93%)	\$0.00
06/01/10	Sell	\$1,070.71		(\$2,985.30)
06/02/10	Buy	\$1,098.38	(3.05%)	\$663.39
06/04/10	Sell	\$1,064.88		(\$3,447.08)

This would seem to confirm the substantial downside edge suggesting by the results table.

But while VIX action on Monday was strongly bearish, breadth was saying something else. We have now had 3 days in a row where the NYSE Up Issues % came in > 70%. This is a rare type of breadth thrust that was last examined in the 7/27/10 Subscriber Letter. I have updated those results below.

NYSE Up Issues % > 70% for the 3rd day in a row.
Buy SPX on close. Sell X days later. \$100k/trade. 1967 - 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	26,652.70	17	13	4	76.47	3,262.61	-3,940.32	0.83	2.69	1,567.81
9	25,308.53	17	13	4	76.47	3,165.79	-3,961.70	0.80	2.60	1,488.74
8	21,820.45	17	11	6	64.71	3,252.84	-2,326.80	1.40	2.56	1,283.56
7	26,332.84	17	13	4	76.47	2,757.14	-2,377.48	1.16	3.77	1,548.99
6	29,736.88	17	12	5	70.59	3,299.38	-1,971.13	1.67	4.02	1,749.23
5	24,472.96	17	12	5	70.59	2,743.57	-1,689.99	1.62	3.90	1,439.59
4	18,872.03	17	11	6	64.71	2,217.75	-920.53	2.41	4.42	1,110.12
3	13,437.13	17	9	8	52.94	2,647.91	-1,299.26	2.04	2.29	790.42
2	17,783.53	17	16	1	94.12	1,160.87	-790.32	1.47	23.50	1,046.09
1	10,219.01	17	12	4	70.59	929.64	-234.18	3.97	11.91	601.12

The one instance that wasn't positive on day 2 was positive by day 5.

Stats here are overwhelmingly bullish – especially for the 1st 2 days. Below are all the instances using a 2-day exit for this setup.

NYSE Up Issues % > 70% for the 3rd day in a row.
Buy SPX on close. Sell 2 days later. \$100k/trade. 1967 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/09/67	Buy	\$82.81	0.80%	\$796.62
01/11/67	Sell	\$83.47		\$0.00
05/29/70	Buy	\$76.55	1.69%	\$1,684.74
06/02/70	Sell	\$77.84		\$0.00
10/11/74	Buy	\$71.14	0.42%	\$2,248.00
10/15/74	Sell	\$71.44		\$0.00
01/03/75	Buy	\$70.71	0.44%	\$509.04
01/07/75	Sell	\$71.02		\$0.00
01/05/76	Buy	\$92.58	1.48%	\$1,479.60
01/07/76	Sell	\$93.95		\$0.00
01/05/79	Buy	\$99.13	0.20%	\$836.64
01/09/79	Sell	\$99.33		(\$1,310.40)
08/18/82	Buy	\$108.52	4.15%	\$4,577.37
08/20/82	Sell	\$113.02		(\$1,077.57)
10/08/82	Buy	\$131.05	2.59%	\$4,555.11
10/12/82	Sell	\$134.44		\$0.00
03/03/83	Buy	\$153.47	0.12%	\$956.97
03/07/83	Sell	\$153.66		(\$1,269.45)
08/03/84	Buy	\$162.35	0.22%	\$1,795.80
08/07/84	Sell	\$162.71		(\$953.25)
12/26/91	Buy	\$404.84	2.54%	\$2,541.63
12/30/91	Sell	\$415.13		(\$61.75)
03/21/07	Buy	\$1,435.04	0.07%	\$265.65
03/23/07	Sell	\$1,436.11		(\$356.04)
01/02/09	Buy	\$931.80	0.31%	\$1,289.35
01/06/09	Sell	\$934.70		(\$1,312.89)
04/02/09	Buy	\$834.38	0.13%	\$966.28
04/06/09	Sell	\$835.48		(\$1,379.21)
09/08/09	Buy	\$1,025.39	1.83%	\$1,818.75
09/10/09	Sell	\$1,044.14		(\$137.74)
07/09/10	Buy	\$1,077.95	1.61%	\$1,978.92
07/13/10	Sell	\$1,095.34		(\$690.00)
07/26/10	Buy	\$1,115.01	(0.80%)	\$528.66
07/28/10	Sell	\$1,106.13		(\$1,059.10)

The last instance was followed by a shallow 3-day pullback before resuming its move higher.

I became a member of AAPTA (American Association of Professional Technical Analysts) a few months back, and a post by fellow member Wayne Whaley today showed he identified a similar 3-day breadth thrust pattern. His results looked out months rather than days. Inspired by his work I decided to take a peek at longer-term returns following this setup.

NYSE Up Issues % > 70% for the 3rd day in a row.
Buy SPX on close. Sell X days later. \$100k/trade. 1967 - 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
200	165,783.08	10	8	2	80.00	20,992.50	-1,078.46	19.47	77.86	16,578.31
190	179,921.56	10	10	0	100.00	17,992.16	0.00	100.00	100.00	17,992.16
180	189,510.43	10	10	0	100.00	18,951.04	0.00	100.00	100.00	18,951.04
170	193,444.26	12	12	0	100.00	16,120.36	0.00	100.00	100.00	16,120.36
160	190,654.61	12	12	0	100.00	15,887.88	0.00	100.00	100.00	15,887.88
150	189,374.16	12	12	0	100.00	15,781.18	0.00	100.00	100.00	15,781.18
140	174,839.17	12	12	0	100.00	14,569.93	0.00	100.00	100.00	14,569.93
130	155,443.52	13	12	1	92.31	13,423.27	-5,635.69	2.38	28.58	11,957.19
120	124,165.35	13	11	2	84.62	11,457.94	-936.02	12.24	67.33	9,551.18
110	114,709.32	13	13	0	100.00	8,823.79	0.00	100.00	100.00	8,823.79
100	108,917.44	13	11	2	84.62	10,146.31	-1,345.98	7.54	41.46	8,378.26
90	112,591.69	13	11	2	84.62	10,792.99	-3,065.58	3.52	19.36	8,660.90
80	106,199.39	13	12	1	92.31	9,368.54	-6,223.12	1.51	18.07	8,169.18
70	80,683.41	13	12	1	92.31	7,434.63	-8,532.18	0.87	10.46	6,206.42
60	82,174.40	14	12	2	85.71	8,170.87	-7,938.01	1.03	6.18	5,869.60
50	81,600.52	15	12	3	80.00	8,814.94	-8,059.59	1.09	4.37	5,440.03
40	56,862.16	15	12	3	80.00	7,577.48	-11,355.88	0.67	2.67	3,790.81
30	46,902.20	16	11	5	68.75	6,278.54	-4,432.34	1.42	3.12	2,931.39
20	55,292.65	16	13	3	81.25	5,463.75	-5,245.36	1.04	4.51	3,455.79
10	26,652.70	17	13	4	76.47	3,262.61	-3,940.32	0.83	2.69	1,567.81

The long-term consistency is quite amazing. The average trade appears quite large as well. I've listed below all 12 instances with a 170-day exit.

NYSE Up Issues % > 70% for the 3rd day in a row.
Buy SPX on close. Sell 170 days later. \$100k/trade. 1967 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/09/67	Buy	\$82.81	14.16%	\$15,715.14
09/11/67	Sell	\$94.54		\$0.00
05/29/70	Buy	\$76.55	25.25%	\$25,244.98
01/29/71	Sell	\$95.88		(\$6,947.92)
10/11/74	Buy	\$71.14	28.56%	\$30,558.75
06/16/75	Sell	\$91.46		(\$8,612.65)
01/05/76	Buy	\$92.58	12.66%	\$14,439.60
09/03/76	Sell	\$104.30		\$0.00
01/05/79	Buy	\$99.13	8.60%	\$10,785.60
09/07/79	Sell	\$107.66		(\$3,780.00)
08/18/82	Buy	\$108.52	48.09%	\$48,997.20
04/20/83	Sell	\$160.71		(\$1,077.57)
08/03/84	Buy	\$162.35	9.65%	\$13,277.85
04/08/85	Sell	\$178.02		(\$1,432.95)
12/26/91	Buy	\$404.84	2.15%	\$5,011.63
08/27/92	Sell	\$413.53		(\$3,072.68)
03/21/07	Buy	\$1,435.04	0.32%	\$9,732.45
11/20/07	Sell	\$1,439.70		(\$4,446.36)
01/02/09	Buy	\$931.80	9.08%	\$11,500.36
09/04/09	Sell	\$1,016.40		(\$28,356.07)
09/08/09	Buy	\$1,025.39	14.27%	\$18,857.77
05/12/10	Sell	\$1,171.67		(\$527.68)
07/09/10	Buy	\$1,077.95	21.00%	\$24,483.04
03/11/11	Sell	\$1,304.28		(\$3,519.00)
The average runup was 19% and the average drawdown was 5%.				

As you can see, 7 of the 12 made double-digit returns over the 170 days. The lowest runup of 5% is equal to the average drawdown, and 10 of 12 instances saw double digit runups during the 170 periods. I have added this study to the intermediate-term active list as well as the short-term active list.

It is very rare to have 2 studies with such compelling results oppose each other on the same night. I liken it to the “Battle of Wits” from The Princess Bride. “VIX...So I can clearly not choose the wine in front of me (bullish case)”, but breadth...”So I can clearly not choose the wine in front of you (bearish case).” For those wondering what I am talking about, you may click the link below.

<http://www.youtube.com/watch?v=eQNHBuqfLnM>

While my intellect isn't as dizzying as Viscini's, I can deduce that something will likely give. With such strong crosswinds the Aggregator reading has also dipped.

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. Meanwhile the black Differential line remains took a nosedive down below 0. Readings below 0 mean the SPX has outperformed expectations over the last few days. So net expectations are for upside but the SPX is relatively overbought. This is considered a neutral configuration. It can be seen on the Aggregator chart whenever the Aggregator and Differential lines are on opposite sides of 0. Due to this the Aggregator System turned flat at the close.

Based on the current active studies the green Aggregator line is set to stay above 0 on Tuesday. This could change should strong bearish evidence emerge. Meanwhile, the Differential Pivot will be 1,283.87. This is about 1.1% below Monday's close. In other words it would take a drop of at least this much to move the Differential Line back above zero.

I'm sidelined right now. As I indicated in the intraday updates, all open trade ideas were exited at the close on Monday.

Additional thoughts on recent trades

While the trades were a bit hairy, the end result was some nice gains. If you were long and feeling panicked last week as the market was dropping, then I would encourage you to take note of how this all played out. In the 3/16 Subscriber Letter I discussed in detail how I had received several emails from traders that were worried about large losses. I discussed that while that is always a possibility, the probabilities continued to favor a bounce. I frequently say I have 2 trading rules 1) If there is an edge, take a position, and 2) when the edge is no longer there, get out. I should probably add a third rule that says "stick with the position as long as the edge persists". That is the part that traders were struggling with last week.

But the part that traders need to adhere to now is the exit. And if you went "all in" on the 1st SPY lot for instance and are still slightly underwater on that, then you need to keep in mind that doesn't matter. The market doesn't care what your entry price was, and neither should you. Whether it is a big loss, a small loss, a big gain, or a small gain, the trade needs to be exited when the edge is gone. Failing to do so means managing trades in a less-than-optimal manner and putting capital at risk during times when you don't truly have an edge. Doing those things will hurt in the long run.

Now this of course doesn't mean intermediate-term trend following positions should be exited as soon as the market becomes overbought. It means that if you have a system with an edge, you need to trade that system as designed in order to be able to fully take advantage of that edge. As of now I am seeing "Princess Bride" evidence and a neutral Aggregator in a volatile environment. I'll wait for the next edge to emerge before putting money back to work.

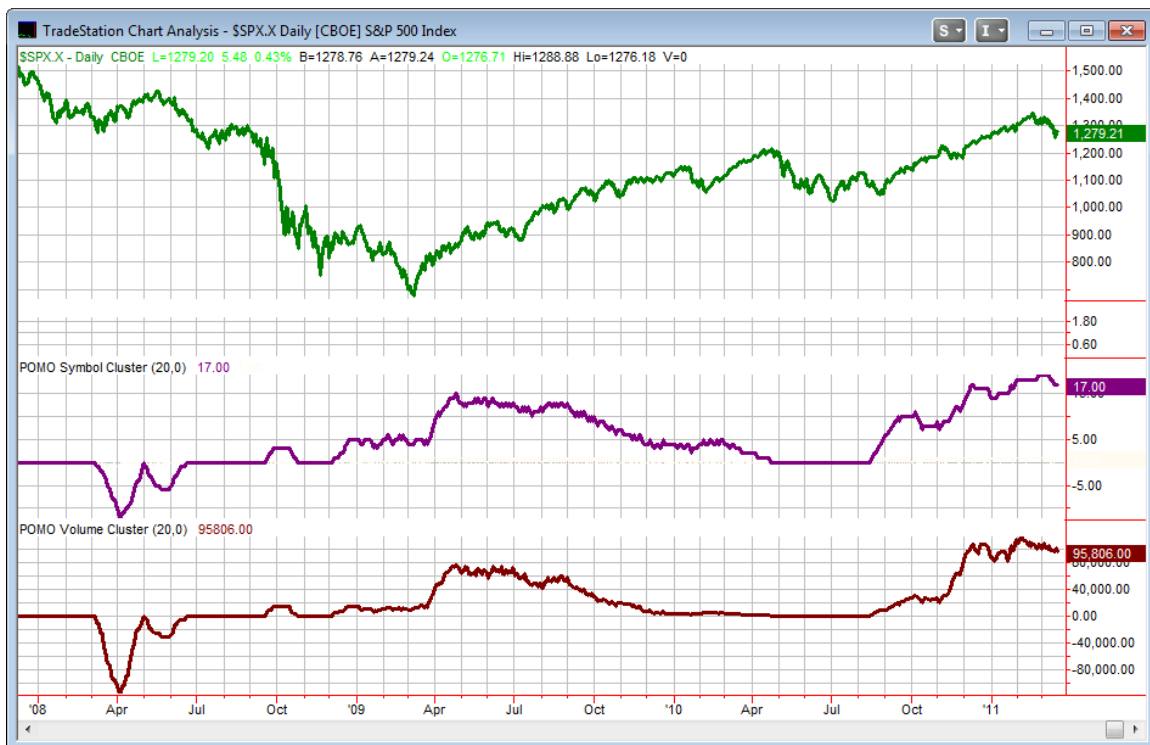
Intermediate-term Outlook (2 weeks – 2 months)– updated 3/21 – slightly bullish

It's now been about a month since the market peaked. And while it's still a good ways above its 200ma, it also just made 50-day lows. So it seems to be a bit of an intermediate-term downtrend, but still in a larger uptrend. The selloff, which under more "normal" circumstances may have been less severe, has likely been exacerbated by foreign news about an earthquake, a tsunami, a possible nuclear meltdown, and a Middle East war. That is a lot to contend with. So the question now is whether these events may have helped to kick off a more substantial move south, or whether they just made what may have been a short-term pullback more severe. If this is the case, the market may stand a decent chance to right itself and reassume its uptrend.

One factor arguing for the bullish case would be the Fed's current POMO activity. 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 is still extremely elevated at 17. According to the tentative operations schedule every day this upcoming week POMO buying is planned. It doesn't appear as if either of the POMO Days or POMO Volume indicators are likely to decline.

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

Though I looked at quite a number of concepts this week, I did not unearth anything terribly compelling for either the bull or bear case from an intermediate-term standpoint. I'm still inclined to slightly favor the bullish side. I suspect the next few days may tell us a lot about whether this bounce is likely to succeed or fail. From my standpoint this simply means I'll be a bit more conservative with bearish setups than bullish ones.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

None

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 0

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.

No new trade ideas tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
HPQ (1/3)	2/24/2011	\$43.16	\$41.85	-3.04%		sold on open
SPY(1/4)	3/8/2011	\$131.43	\$130.10	-1.01%		stopped out intraday
SPY(1/4)	3/11/2011	\$129.52	\$130.29	0.60%		sold on close
HPQ (1/3)	3/11/2011	\$41.42	\$41.85	1.04%		sold on open
XOM(1/3)	3/11/2011	\$81.02	\$82.84	2.25%		sold on close
SPY(1/4)	3/16/2011	\$128.15	\$130.29	1.67%		sold on close
CSCO(1/3)	3/16/2011	\$17.33	\$17.39	0.35%		sold on close
CSCO(1/3)	3/17/2011	\$17.05	\$17.39	1.99%		sold on close
PM(1/3)	3/17/2011	\$61.87	\$62.95	1.75%		sold on close
PM(1/3)	3/17/2011	\$61.70	\$62.95	2.03%		sold on close

Note that the SPY exit prices are adjusted to include the dividend of \$0.55332, earned and payable in a few weeks.

All open trade ideas were exited at the close as per the intraday updates.

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2010 Hanna Capital Management, LLC.