

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 23, 2011

Volume 4 Issue 56

Market Overview



Tonight's Research Points

- When the VIX moves from strongly overbought to strongly oversold in a short period of time it appears to suggest an upside market edge.
- Tuesday's very weak volume suggests a pullback may be in the cards.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

Expectations remain slightly positive but the SPX is moderately overbought vs. recent expectations. I'm not seeing a strong edge and am in "wait and see" mode.

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	Lowest volume 20. Close >10&200ma	1-3 days	Bearish	-1.10%
March 22, 2011	VIX from 10% above to 10% below 10ma	1-8 days	Bullish	2.10%
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	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 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	

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

The Evidence

After opening flat on Tuesday the market saw a mild morning selloff. After that...nothing. The day saw very little action and a narrow range. The major indices all finished with moderate losses. The SPX closed down 0.4%, the NASDAQ was down 0.3%, and the Russell 2000 dropped 0.5%. Breadth was negative as the NYSE Up Issues % came in at 43% and the Up Volume % was 32%. Total NYSE volume was exceptionally light, and came in at the lowest level in over a month.

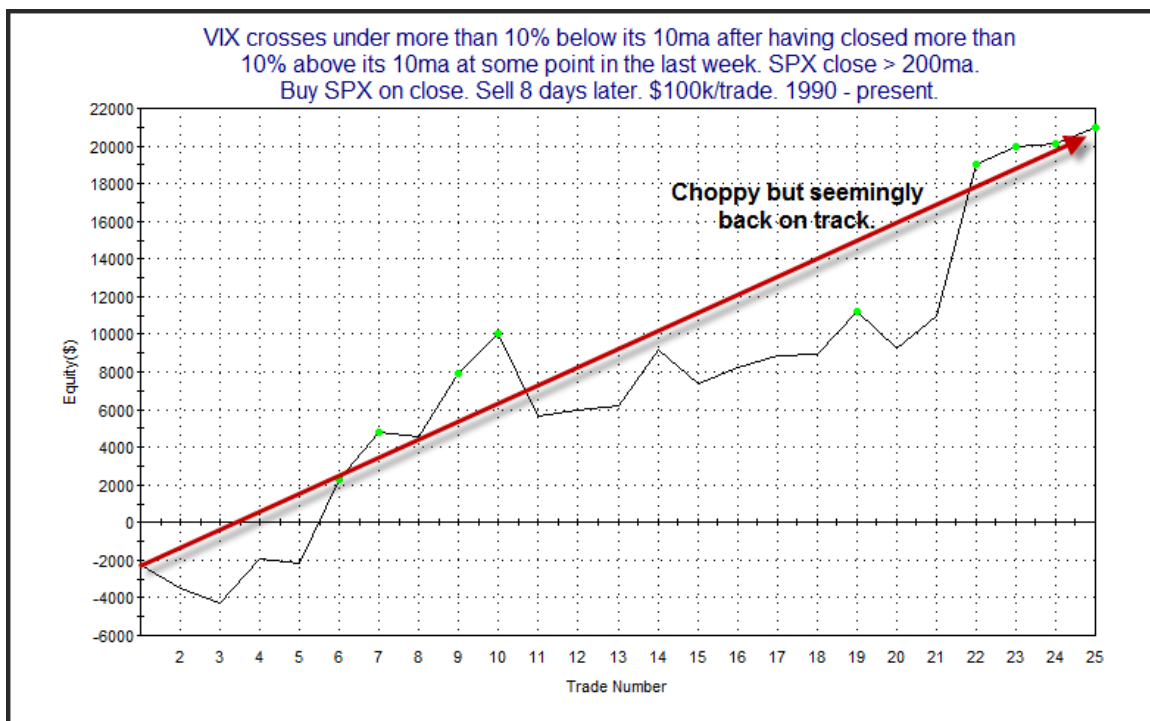
In the Breadth vs. VIX battle I discussed last night, the VIX took round one as the SPX declined. Tuesday's action also brought about mixed studies, though none of them are nearly as compelling as the studies we saw last night. Interestingly, while the bearish study from last night was based on the VIX, tonight a bullish VIX study triggered.

From the 12/6/10 Subscriber Letter the following study looks at times the VIX moves from an extremely overbought to an extremely oversold condition within a short period of time. All stats have been updated.

VIX crosses under more than 10% below its 10ma after having closed more than 10% above its 10ma at some point in the last week. SPX close > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1990 - 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	23,487.63	25	16	9	64.00	2,519.93	-1,870.13	1.35	2.40	939.51
9	22,760.11	25	14	11	56.00	2,410.53	-998.84	2.41	3.07	910.40
8	20,997.05	25	17	8	68.00	1,991.20	-1,606.67	1.24	2.63	839.88
7	17,751.16	26	16	10	61.54	2,101.07	-1,586.60	1.32	2.12	682.74
6	16,802.82	26	14	12	53.85	2,096.68	-1,045.89	2.00	2.34	646.26
5	14,396.54	26	15	11	57.69	1,829.01	-1,185.33	1.54	2.10	553.71
4	8,847.47	26	16	10	61.54	1,399.36	-1,354.22	1.03	1.65	340.29
3	5,818.96	27	16	11	59.26	976.38	-891.20	1.10	1.59	215.52
2	4,308.26	27	12	15	44.44	1,102.05	-594.42	1.85	1.48	159.57
1	5,964.50	27	13	14	48.15	915.96	-424.50	2.16	2.00	220.91
23 of 27 instances (85%) closed above the entry price at some point in the next 4 days.										

Often a strong market move will be an overreaction, and lead to a quick reaction in the opposite direction. This was something we saw with last night's VIX study. But when a move shows exceptional strength over multiple days, sometimes results will suggest that

such strength is likely to beget more strength. An example of this would be the breadth study we saw last night. The VIX study I show above appears to be more along these lines. The market condition that would typically accompany such VIX movement is one where you see a strong rebound from a sharp decline during a long-term uptrend. Results over the first 2-3 days are somewhat sketchy, but once you get out beyond that they become more consistent and more powerful. So a quick 15% drop in the VIX like we saw last night suggests 1-2 days of downside, but multi-day action as we've seen over the last few days suggests those 1-2 days are likely all the decline you are going to see. Below is an equity curve using an 8-day exit strategy.



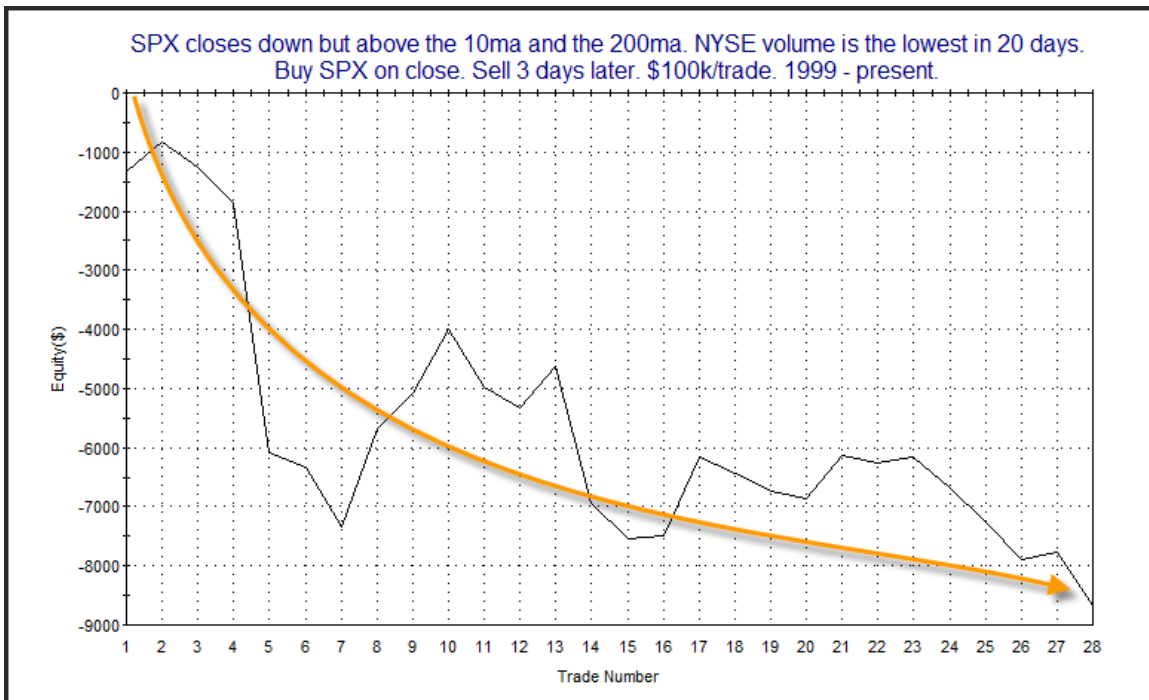
As noted, returns have seen some choppiness. The upside edge now appears to be back on track with the last five instances all going to the bulls.

There were also a few bearish studies that triggered tonight. They all revolve around the themes of tight ranges and/or low volume. In the 10/25/10 subscriber letter I examined days that posted 20-day lows in volume while the SPX was above both the 10ma and 200ma. I found the results to be generally bearish, but there was some difference between those times the set up occurred on an up day versus a down day. With Tuesday being a down day, I ran those results below.

SPX closes down but above the 10ma and the 200ma. NYSE volume is the lowest in 20 days.
Buy SPX on close. Sell X days later. \$100k/trade. 1999 - present.

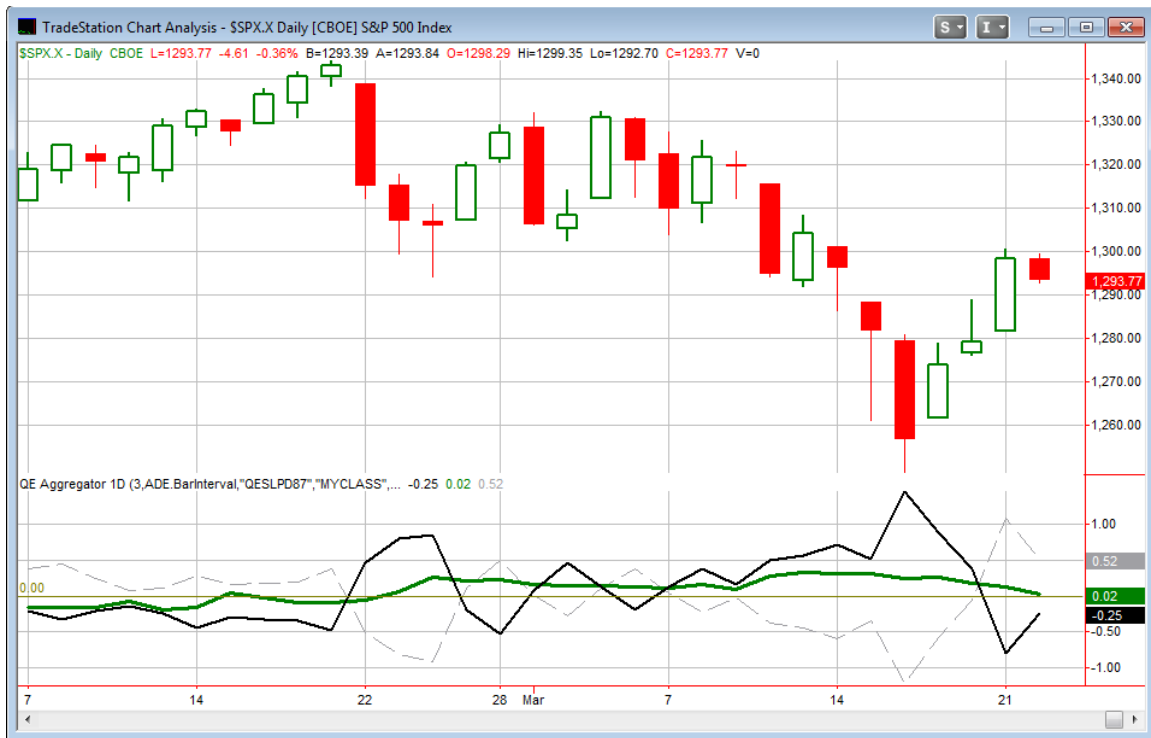
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-9,868.31	26	12	14	46.15	951.58	-1,520.52	0.63	0.54	-379.55
4	-14,509.48	28	13	15	46.43	630.46	-1,513.70	0.42	0.36	-518.20
3	-8,675.59	28	10	18	35.71	685.92	-863.04	0.79	0.44	-309.84
2	-5,829.37	28	13	15	46.43	757.98	-1,045.54	0.72	0.63	-208.19
1	2,673.09	28	20	8	71.43	487.91	-885.63	0.55	1.38	95.47

We see here what appears to be 3-4 days of potential downside. I should also note that the 200ma makes a big difference. Narrow range bars, inside bars, and very low volume are all substantially more suggestive of a bearish edge when the market is below its 200ma. Below is a graphical representation of the 3-day edge from above.



Based on the equity curve above it appears the edge may not be as strong as it once appeared to be. Still, it is downward sloping and appears worthy of consideration.

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



The green Aggregator line is still above 0, but just barely. 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 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 remained flat at the close.

Based on the current active studies the green Aggregator line is set to stay above 0 on Wednesday. This could change should a bit more bearish evidence emerge. Meanwhile, the Differential Pivot will be 1,287.91. This is about 0.5% below Tuesday's close. In other words it would take a drop of at least this much to move the Differential Line back above zero.

So after three strong days of buying, the SPX has taken a pause around the midpoint of its recent range and just under its 50ma. There really isn't a strong inclination for either the bull or the bear case. I'm seeing studies suggest that either direction appears possible over the next few days. The net expectations are just slightly bullish, and with the SPX moderately overbought versus recent expectations I'm not inclined to take chances.

Therefore, I am going to stand aside for at least another day here and carefully monitor action to see when the next strong edge appears.

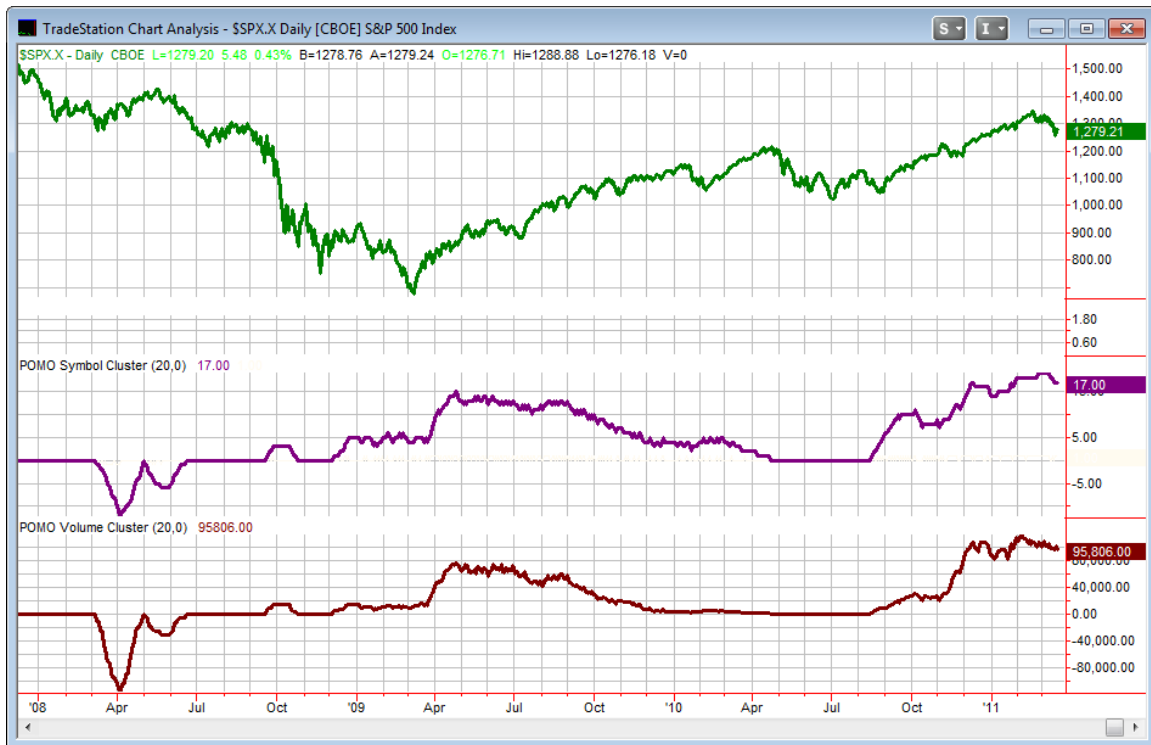
Intermediate-term Outlook (2 weeks – 2 months)– updated 3/21 – slightly bullish

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

None.

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