

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 25, 2011

Volume 4 Issue 58

Market Overview



Tonight's Research Points

- When the VXO has been stretched more than 15% below its 10ma it has led to negative returns for the SPX.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

Again I have positive expectations but the market remains overbought. So I'm neutral on the market and 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 24, 2011	VIX 15% below 10ma	1 day	Bearish	
March 23, 2011	Lowest volume 20. Close >10&200ma	1-3 days	Bearish	-1.10%
March 23, 2011	VIX from 10% above to 10% below 10ma	1-8 days	Bullish	2.10%
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 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%

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

The Evidence

After gapping up strongly to start the day SPY dipped right from the open. It came within a penny of filling its opening gap before reversing higher around 10 o'clock and then trending higher for the rest of the day. Final numbers were strong. The SPX gained 0.9% the NASDAQ was up 1.4% and the Russell 2000 added 0.7%. Breadth was solidly positive as the NYSE Up Issues % came in at 67% and the Up Volume % was 78%. Total NYSE volume came in slightly lower than Wednesday's levels.

The Quantifinder was void of anything new and compelling. Therefore I thought I would show you a study I mentioned in the intraday Quantifinder notes that nearly triggered. We saw in last night's letter that a VXO close of more than 15% below its 10ma tends to suggest bearish SPX inclinations. Thursday the VXO closed over 18% below its 10ma. Had it reached 20% it would have triggered the following study.

VXO closes over 20% below 10ma. Buy SPX 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	-50,739.17	20	6	14	30.00	1,222.66	-4,148.22	0.29	0.13	-2,536.96
4	-44,557.40	20	6	14	30.00	763.59	-3,509.92	0.22	0.09	-2,227.87
3	-32,950.25	21	6	15	28.57	901.55	-2,557.30	0.35	0.14	-1,569.06
2	-43,281.90	22	5	17	22.73	1,449.08	-2,972.19	0.49	0.14	-1,967.36
1	-20,104.76	27	7	20	25.93	1,187.39	-1,420.82	0.84	0.29	-744.62

As you can see, numbers here are substantially more bearish than just a 15% stretch. Of course this study does not contain a long-term trend filter. Below are the results if I filter by the 200ma.

VXO closes over 20% below 10ma. SPX > 200ma. Buy SPX 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	-8,488.86	7	3	4	42.86	429.63	-2,444.44	0.18	0.13	-1,212.69
4	-6,063.93	7	3	4	42.86	441.98	-1,847.47	0.24	0.18	-866.28
3	-3,623.87	7	3	4	42.86	442.83	-1,238.09	0.36	0.27	-517.70
2	-8,429.99	7	1	6	14.29	73.83	-1,417.30	0.05	0.01	-1,204.28
1	-4,803.05	7	0	7	0.00	0.00	-686.15	0.00	0.00	-686.15

Instances are very low, but all seven closed lower the next day. And looking out 2 days the edge appears even more pronounced. Below is a list of all the individual occurrences. It assumes a 1-day holding period.

VXO closes over 20% below 10ma. SPX > 200ma. Buy SPX on close. Sell next days close. \$100k/trade. 1988 - present.				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
11/17/89	Buy	\$341.61	(0.66%)	\$81.76
11/20/89	Sell	\$339.35		(\$969.44)
09/23/98	Buy	\$1,066.10	(2.19%)	\$0.00
09/24/98	Sell	\$1,042.70		(\$3,073.65)
12/23/98	Buy	\$1,228.54	(0.19%)	\$95.58
12/24/98	Sell	\$1,226.26		(\$299.70)
03/21/07	Buy	\$1,435.04	(0.03%)	\$180.78
03/22/07	Sell	\$1,434.54		(\$356.04)
08/24/07	Buy	\$1,479.37	(0.85%)	\$0.00
08/27/07	Sell	\$1,466.79		(\$897.13)
09/21/07	Buy	\$1,525.75	(0.53%)	\$287.95
09/24/07	Sell	\$1,517.73		(\$624.00)
06/18/10	Buy	\$1,117.51	(0.39%)	\$1,221.08
06/21/10	Sell	\$1,113.20		(\$825.03)
Avg Runup: 0.27% Avg Drawdown: -1.01%				

In addition to the fact that they all closed down, I also note that the average drawdown the next day was nearly 4 times the average run-up. I also created the list for a 2-day holding period.

VXO closes over 20% below 10ma. SPX > 200ma.
Buy SPX on close. Sell 2 days later. \$100k/trade. 1988 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
11/17/89	Buy	\$341.61	(0.59%)	\$81.76
11/21/89	Sell	\$339.59		(\$1,191.36)
09/23/98	Buy	\$1,066.10	(2.00%)	\$0.00
09/25/98	Sell	\$1,044.75		(\$3,073.65)
12/23/98	Buy	\$1,228.54	(0.25%)	\$241.38
12/28/98	Sell	\$1,225.48		(\$597.78)
03/21/07	Buy	\$1,435.04	0.07%	\$265.65
03/23/07	Sell	\$1,436.11		(\$356.04)
08/24/07	Buy	\$1,479.37	(3.18%)	\$0.00
08/28/07	Sell	\$1,432.36		(\$3,173.12)
09/21/07	Buy	\$1,525.75	(0.56%)	\$287.95
09/25/07	Sell	\$1,517.21		(\$1,210.30)
06/18/10	Buy	\$1,117.51	(1.99%)	\$1,221.08
06/22/10	Sell	\$1,095.31		(\$2,076.37)
Avg Runup: 0.30% Avg Drawdown: -1.67%				

Here too the strong downside inclinations are confirmed. In this case the downside risk is about 5 1/2 times as much as upside reward.

But alas, since the VXO did not manage to close 20% below its 10ma, these studies are not relevant to the current situation. What is relevant is the 15% stretch study that I showed last night. It's also notable that the "sweet spot" bounce study from Sunday night reached its target and is being removed early from the Active Studies List.

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



The green Aggregator line is still a bit 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 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 Thursday. This could change should more bearish evidence emerge. Meanwhile, the Differential Pivot will be 1,297.87. This is about 0.9% below Thursday's close. So for the Differential Line to rise back above 0 (and the SPX to be considered underperforming) the SPX will need to decline at least this much.

Like yesterday, while expectations are positive over the 3-day period, 1-day expectations are slightly negative. This is reflected in the 1-day Risk/Reward graphic at the top of the letter. It's not enough to set up a trade, though. While it is sometimes frustrating to see the market chug higher while being sidelined (and with positive expectations), I've found it worthwhile to only put capital at risk when risk/reward was strongly in my favor. That doesn't seem to be the case just yet.

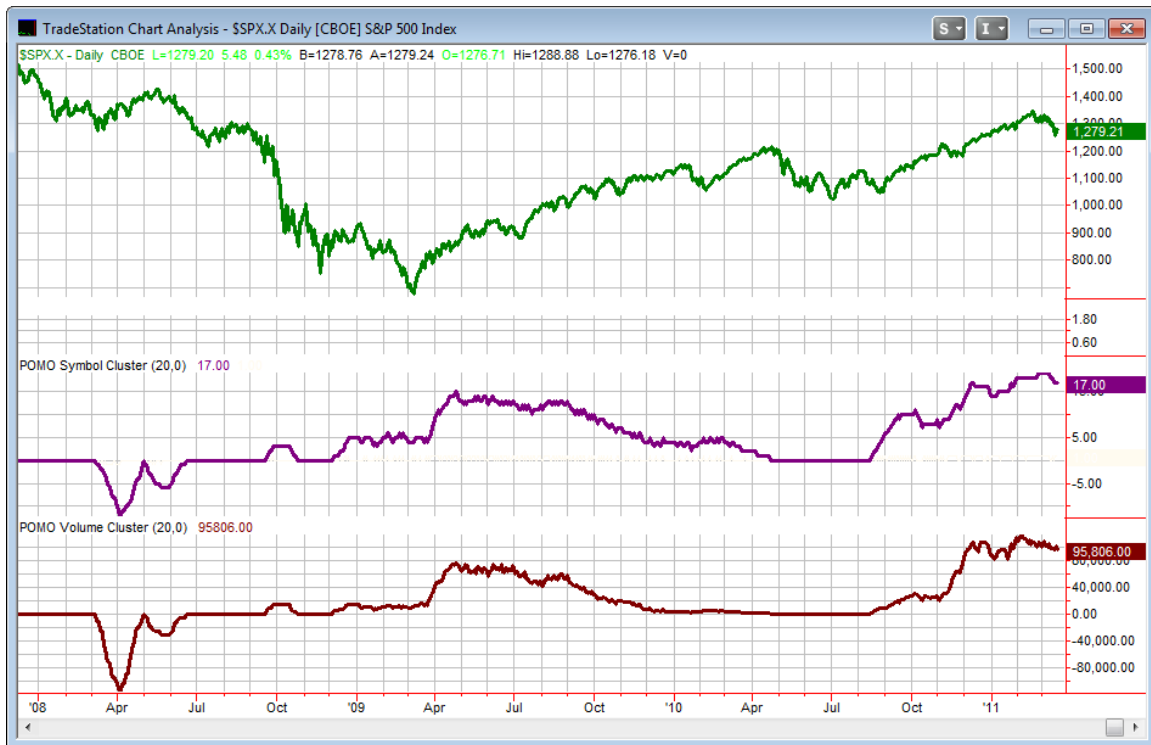
Intermediate-term Outlook (2 weeks – 2 months)– updated 3/21 – slightly bullish

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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