

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 4, 2011

Volume 4 Issue 149

Market Overview



Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Long	100% Long XIV	100% Long XIV	Long

Tonight's Research Points

- Closing strongly above the days lows id potentially bullish.
- High volume on the bounce appears to be a positive.
- The moderate breadth would have been a warning at one point. But over the last few years this has not been the case.

Short-term Outlook

The Bottom Line

Wednesday's reversal appears to be the start of a long-awaited bounce. Follow through over the next few days appears likely. I'm heavily long and holding tight for now.

Summary of Recent Active Studies (see Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Max Move
Active				
August 4, 2011	50 low yest. High volume rally 2day	1-4 days	Bullish	2.70%
August 4, 2011	1.75% drop.Next day big intraday bounce	1-5 days	Bullish	3.50%
August 3, 2011	RSI < 2 & 50-day low.	1-2 days	Bullish	
August 3, 2011	McClellan Osc % Rank < 2, 50 day low	1-2 days	Bullish	
August 2, 2011	Turnaround Tuesday	1-3 days	Bullish	2.90%
August 1, 2011	Down last 3 days of month	1-5 days	Bullish	2.60%
July 29, 2011	4 lower lows. 20-day low. Close >200	1-8 days	Bullish	2.40%
July 28, 2011	system 110524	1-6 days	Bullish	
Active - Long Term				
July 22, 2011	Up Issue% > 75% 2 of 3. Close 10 high.	1-20 days	Bullish	5.50%
July 5, 2011	QE2 Over	int term	Bearish	
July 5, 2011	3 days higher. Up vol % > 90% today.	1-20 days	Bullish	5.00%
May 31, 2011	4 Weeks Down. Close > 40ma.	1-10 weeks	Bullish	9.00%
March 22, 2011	3 Days Up Issues % > 70%	8 months	Bullish	19.00%
October 25, 2010	SPX Golden Cross	int term	Bullish	
Dropped Tonight				
August 1, 2011	SPY gap dn and partial reverse	1-3 days	Bullish	1.50%
June 22, 2011	FTD with Up Issues % 1-yr Rank > 95%	int term	Bullish	
July 28, 2011	3 dn. Big drop.	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

It was a scary ride for some on Wednesday but in the end the market managed to turn around and finish moderately higher. The SPX gained 0.5%, the Nasdaq rose 0.9%, and the Russell 2000 added 0.7%. Breadth was only mildly positive as the NYSE Up Issues % came in at 57% and the Up Volume % was 58%. Total NYSE volume again hit the highest level since June.

The first day of a bounce will often provide hints as to whether the bounce is likely to continue or to quickly roll over. Often very weak bounces will roll over. If you just looked at the closing numbers for the SPX you might think this was a rather timid bounce compared to the selloff that ensued over the last several days. But what makes Wednesday's bounce impressive is that it came from such a deep intraday hole. The strong intraday reversal increases the odds that the reversal will stick. This concept is demonstrated by a study I last showed in the 5/18/10 subscriber letter. This study looked at bounces that occurred the day after a drop of 1.75% or more and made up less than 0.25% of the previous day's losses. I broke them down based on how strong the intraday reversal was.

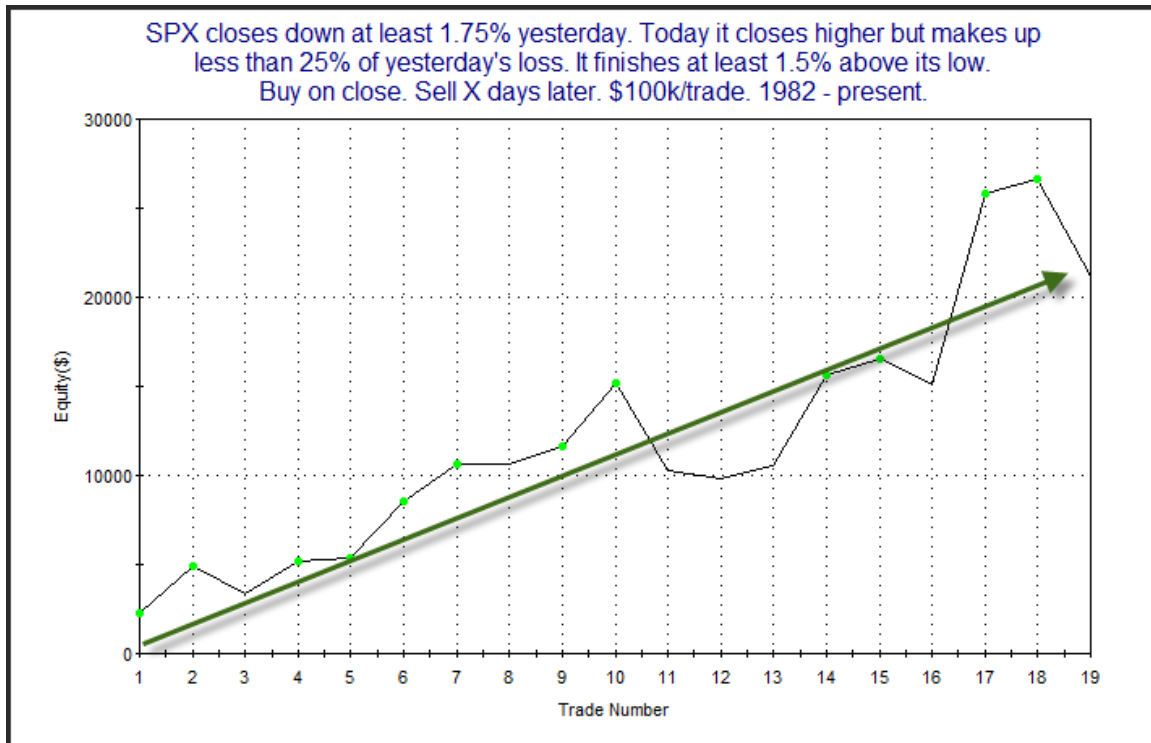
First let's look at instances without a strong intraday reversal

SPX closes down at least 1.75% yesterday. Today it closes higher but makes up less than 25% of yesterday's loss. It finishes less than 1.5% above its low. Buy on close. Sell X days later. \$100k/trade. 1982 - 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	-54,536.79	49	16	33	32.65	3,085.01	-3,148.39	0.98	0.48	-1,113.00
9	-54,553.53	50	18	32	36.00	2,391.34	-3,049.93	0.78	0.44	-1,091.07
8	-33,816.71	52	20	32	38.46	2,488.86	-2,606.06	0.96	0.60	-646.48
7	-35,526.73	53	24	29	45.28	2,266.77	-3,101.00	0.73	0.60	-670.32
6	-26,379.85	53	23	30	43.40	2,214.79	-2,577.33	0.86	0.66	-497.73
5	-42,146.96	55	23	32	41.82	1,944.81	-2,714.93	0.72	0.51	-766.31
4	-41,017.17	55	21	34	38.18	1,811.39	-2,325.19	0.78	0.48	-745.77
3	-35,786.92	56	19	37	33.93	1,732.71	-1,856.99	0.93	0.48	-639.05
2	-23,671.30	57	25	32	43.86	1,145.44	-1,634.60	0.70	0.55	-415.29
1	-22,675.74	57	24	33	42.11	737.82	-1,223.74	0.60	0.44	-397.82

These results suggest a downside edge. Now let's look at times like now where a strong intraday reversal did occur.

SPX closes down at least 1.75% yesterday. Today it closes higher but makes up less than 25% of yesterday's loss. It finishes at least 1.5% above its low. Buy on close. Sell X days later. \$100k/trade. 1982 - 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	34,432.06	19	14	5	73.68	3,807.98	-3,775.93	1.01	2.82	1,812.21
9	43,551.37	19	14	5	73.68	4,336.79	-3,432.75	1.26	3.54	2,292.18
8	45,296.30	19	14	5	73.68	5,147.12	-5,352.69	0.96	2.69	2,384.02
7	28,130.91	19	12	7	63.16	4,494.55	-3,686.25	1.22	2.09	1,480.57
6	17,231.27	19	10	9	52.63	3,958.59	-2,483.85	1.59	1.77	906.91
5	21,167.14	19	13	6	68.42	2,698.34	-2,318.55	1.16	2.52	1,114.06
4	12,538.12	19	11	8	57.89	2,755.29	-2,221.26	1.24	1.71	659.90
3	10,819.83	19	10	9	52.63	2,983.90	-2,113.24	1.41	1.57	569.46
2	5,435.80	19	10	9	52.63	2,481.79	-2,153.57	1.15	1.28	286.09
1	7,244.24	19	10	9	52.63	1,718.08	-1,104.06	1.56	1.73	381.28

Here it appears that not only is the downside edge eliminated but it is actually reversed. We now see a possible upside edge based on these 19 instances. Below is an equity curve showing how the edge has played out over time.



Results aren't exactly smooth but the upslope has been fairly persistent.

In the 2/2/10 subscriber letter I examined bounces from 50-day lows based on the volume. I found that when the 1st day had very low volume or very high volume the probabilities of follow-through increased substantially. Days where volume did not hit an extreme showed no bullish edge going forward. If you would like to see the whole discussion you may use the link below to quickly access the letter.

[2010-02-02 QE Subscriber Letter.pdf](#)

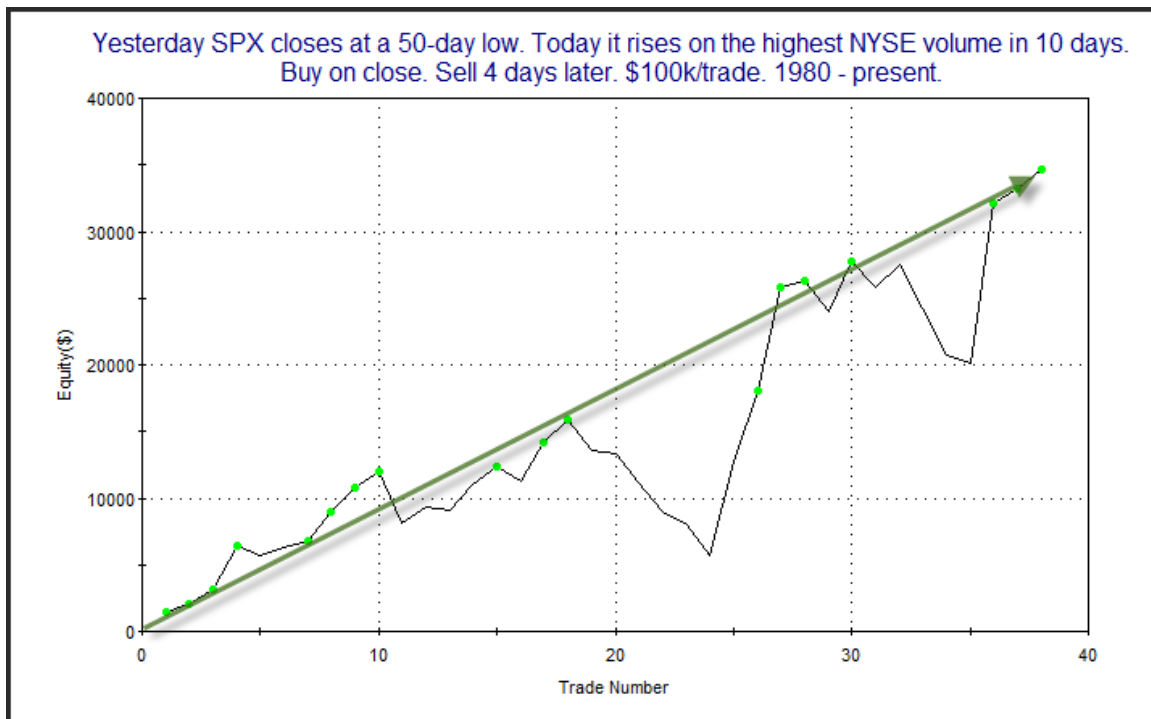
Tonight I have re-run the stats for setups like Wednesday where the NYSE posted the highest volume in the last 10 days.

Yesterday SPX closes at a 50-day low. Today it rises on the highest NYSE volume in 10 days.
Buy on close. Sell X days later. \$100k/trade. 1980 - 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	42,492.65	34	22	12	64.71	3,769.40	-3,369.52	1.12	2.05	1,249.78
9	45,437.90	37	20	17	54.05	4,514.36	-2,638.19	1.71	2.01	1,228.05
8	28,224.05	38	22	16	57.89	3,579.25	-3,157.46	1.13	1.56	742.74
7	32,609.37	38	20	18	52.63	3,952.98	-2,580.57	1.53	1.70	858.14
6	16,553.68	38	19	19	50.00	3,257.59	-2,386.34	1.37	1.37	435.62
5	30,099.41	38	26	12	68.42	2,381.00	-2,650.55	0.90	1.95	792.09
4	34,628.76	38	23	15	60.53	2,706.18	-1,840.88	1.47	2.25	911.28
3	31,411.46	39	23	16	58.97	2,474.38	-1,593.71	1.55	2.23	805.42
2	24,636.72	41	24	17	58.54	1,721.55	-981.20	1.75	2.48	600.90
1	22,610.75	41	23	18	56.10	1,856.59	-1,116.16	1.66	2.13	551.48

87% of instances posted a close above the entry price at some point in the next week.

The stats here appear to favor follow-through over the next couple of weeks. Much of the edge has come in the 1st 4 days. Below is an equity curve using a 4-day holding period.



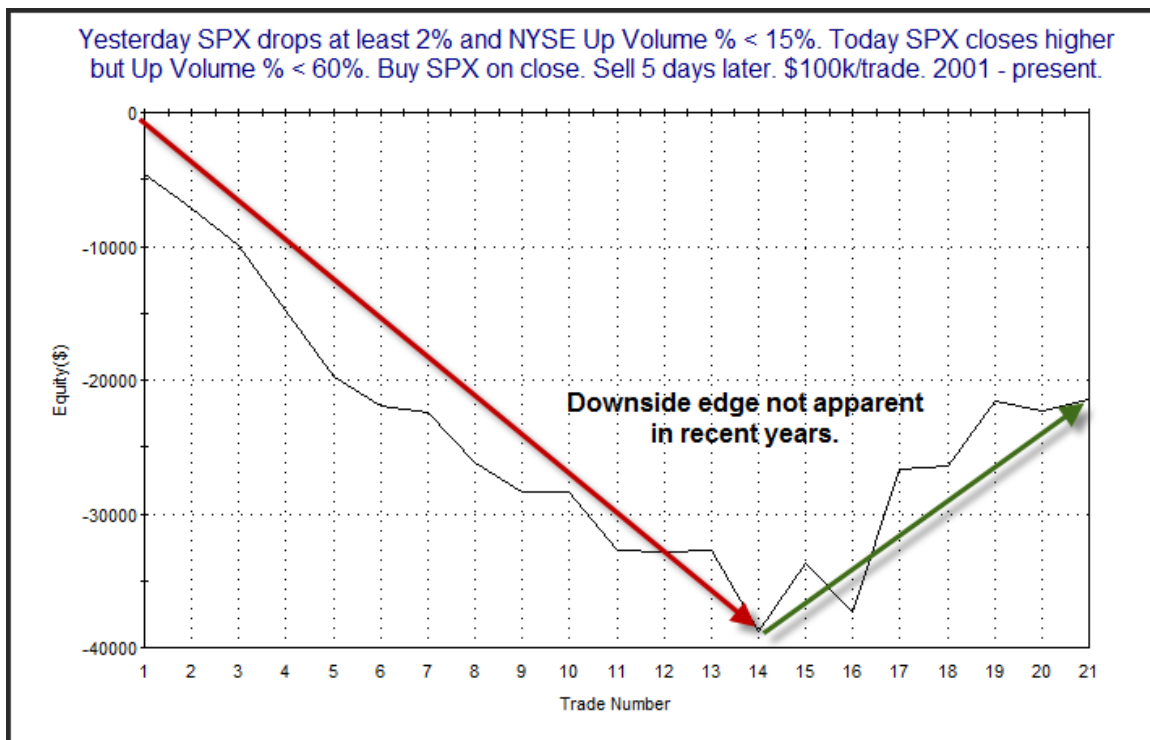
Again we see a good amount of chop but the bullish edge appears to be back on track.

There were a couple of studies that triggered in the Quantifinder that suggested the moderate breadth readings may be troubling to the bounce. I reviewed them some more tonight and it appears more recent activity suggests the bearish inclinations may no longer hold true. The study below was last shown in the 1/26/10 blog. All stats are updated.

Yesterday SPX drops at least 2% and NYSE Up Volume % < 15%. Today SPX closes higher but Up Volume % < 60%. Buy SPX on close. Sell X days later. \$100k/trade. 2001 - 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	-21,449.60	21	7	14	33.33	3,120.08	-3,092.15	1.01	0.50	-1,021.41
4	-21,051.25	21	6	15	28.57	2,965.26	-2,589.52	1.15	0.46	-1,002.44
3	-17,402.87	21	6	15	28.57	2,321.38	-2,088.74	1.11	0.44	-828.71
2	-19,751.08	23	9	14	39.13	1,265.54	-2,224.35	0.57	0.37	-858.74
1	-15,212.33	23	7	16	30.43	1,023.68	-1,398.63	0.73	0.32	-661.41

The broad statistics still appear to suggest a downside edge. The edge comes into question when looking at the equity curves. Below is an equity curve assuming a 5-day holding period.



So what once appeared to be almost a sure thing no longer appears that way at all. I have not included this study on the Active List tonight.

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



With bullish studies continuing to dominate the short-term the green Aggregator line remained strongly positive tonight. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the Differential Line is also very high. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are strongly positive and the SPX is extremely oversold versus recent expectations. Historically this combination has provided a bullish edge. It can be seen on the Aggregator chart whenever both lines are above 0. Due to this the Aggregator System remained long at the close.

With the current studies in place the green Aggregator line is again set to close above 0 on Thursday. This is again highly unlikely to change. Meanwhile, the Differential Pivot

will be 1,296.51. Despite Wednesday's positive close this is still 2.9% above the close and unlikely to be achieved on Thursday. At this point it will still likely take a couple of up days in order to flip the Differential Line negative and put an end to the long Aggregator signal. So we are looking for a strong multi-day bounce at this point.

I'm "all in" on my index trade now and awaiting a stronger bounce before looking to exit. Despite the fact that we still haven't seen a spike in either the VIX or the CBI I still feel the market is primed for a bit of a rally. As such, I'm holding tight to my current long positions.

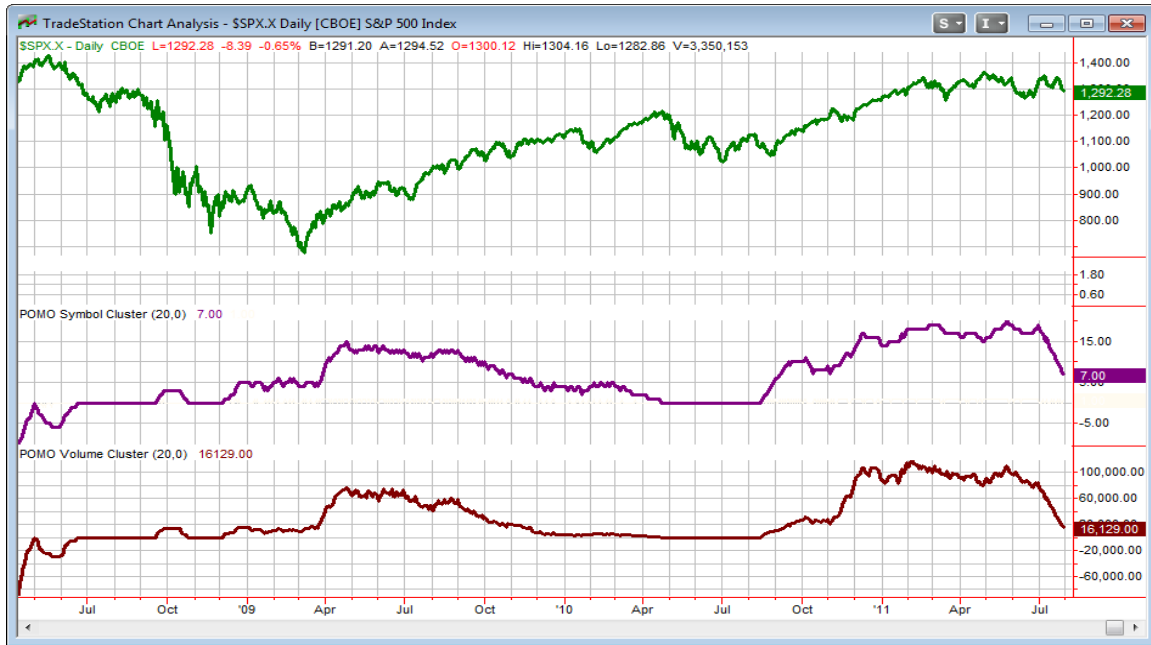
Intermediate-term Outlook (2 weeks – 2 months)– updated 8/1 – moderately bullish

The market closed down every day this past week. Bulls failed to continue the previous week's rally and break the early July highs. As I showed above, this week's selling has brought about a strong short-term bullish edge. For the intermediate-term, not much of significance seemed to occur.

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>



It has now been a full month since the end of QE2. This means our POMO calculations no longer include QE2 pumping. The levels we are seeing above are probably close to what we can expect moving forward. While it is well below the level of stimulus the market had received over the previous 10 months or so, there still appears to be a decent amount of liquidity pumping. Whether it is enough to support the market's rally going forward is unclear, but it is well above the "0" levels that were followed by such strong selloffs over the last several years.

As of now there is only one day of buying scheduled for this week, and one day the following week. The current schedule only runs through August 9. The next schedule is set to be posted on August 10. Below is a link to the current schedule.

http://www.newyorkfed.org/markets/tot_operation_schedule.html

There remain a number of intermediate-term market studies suggesting positive implications. Some of them are set to expire in the next week or so though. Breadth, a high-probability Follow-Through Day signal, Nasdaq leadership, and price action and momentum are providing positive indications. The big concern remains POMO activity. I should also note the SPX is now only barely above its 200ma. Should this level fail I will examine possible implications. Right now the combination of evidence is enough to keep me slightly favoring the bull side.

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
SPY(1/4)	7/26/2011	\$133.33	\$126.17	-5.37%		Aggregator
SPY(1/4)	7/28/2011	\$130.60	\$126.17	-3.39%		Aggregator
SPY(1/4)	7/28/2011	\$130.22	\$126.17	-3.11%		Aggregator
PG	8/1/2011	\$61.43	\$60.73	-1.14%		system 80509
SPY(1/4)	8/3/2011	\$125.49	\$126.17	0.54%		Aggregator

Tip of the Day

Whenever "current" conditions remind you of other times since Feb, 2008 you can peruse the "Archives - Nightly" page on the members site. Reading letters during similar times you can see some of the studies I was looking at and you can also examine some of the trade ideas that were tracked to see how they worked out. That could help provide confidence with the "current" setup or perhaps you'll devise ideas to better handle certain scenarios than I was able to. <http://www.quantifiableedges.com/members/archives.php>

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