

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 9, 2011

Volume 4 Issue 152

Market Overview



Signals Overview

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

Tonight's Research Points

- Extremes are being reached with regards to volatility, price action, breadth and volume.
- 5% down days are typically followed by a bounce.
- CBI readings ≥ 10 suggest a strong upside edge.

Short-term Outlook

The Bottom Line

The market is trading at historical extremes. This means risk is hard to define since we have gone beyond where we ever have before using certain metrics. I continue to hold for a bounce though the ride is harrowing. I am also adding new Catapults as discussed on the trade ideas section below.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
August 8, 2011	High Volume 100-day lows	1-3 days	Bullish	
August 5, 2011	5 lower lows. Today is larges.	1-2 days	Bullish	
August 5, 2011	VIX crosses > 35% over 10ma.	1-2 days	Bullish	
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 bound	1-5 days	Bullish	3.50%
July 29, 2011	4 lower lows. 20-day low. Close >200	1-8 days	Bullish	2.40%
Active - Long Term				
August 8, 2011	SPX Down 9 of 10 days and > 7.5%	1-20 days	Bullish	13.30%
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	
March 22, 2011	3 Days Up Issues % > 70%	8 months	Bullish	19.00%
October 25, 2010	SPX Golden Cross	int term	Bullish	
Dropped Tonight				
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%
August 1, 2011	Down last 3 days of month	1-5 days	Bullish	2.60%

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

The Evidence

The Crash of 2011 is officially here. Stocks were pummeled again on Monday and the selling is so extreme we are seeing some new all-time records being hit in a number of indicators. The SPX fell 6.7%, the Nasdaq lost 6.9%, and the Russell 2000 dropped 8.9%. According to my database, breadth was the worst ever when looking at the NYSE Up Issues %. It came in at 1.5%. The Up Volume % was 1.27% (not the worst ever). Volume was enormous as it posted the highest level in over a year for the 3rd day in a row.

Historical analysis and expectation setting become extremely difficult when extremes are reached that have rarely or never been achieved before. Extremes abound no matter what view you take of the market. Below I have listed some notable observations from Monday's trading. You'll note that we are seeing historical extremes in volatility, price action, breadth, and volume all at once.

Notable Statistics from 8/8/11.

Category	Stat	Note
Volatility	VIX rises 100% in 3 days	1st time ever (since 1990 inception. \$VXO would have during crash of '87)
Volatility	VIX 74% above 10ma	1st time ever (since 1990 inception. \$VXO would have during crash of '87)
Price	SPX > 10% below 10ma	Crash of '87, August '98, and Crash of 2008 only other instances
Breadth	NYSE Up Issues % = 1.5%	worst since 5/13/1940
Breadth	McClellan Oscillator	lowest ever
Breadth	Ratio Adj McClellan Oscillator	3rd worst behind 10/19/87 and 10/27/78
Volume	NYSE Vol highest in 1 yr. for 3rd day in a row	10/20/87 only other instance going back to 1970

These kinds of readings are incredible. They're impossible to anticipate using historical analysis and extremely difficult to use as predictive information. Throughout history whenever anything close to what we are seeing has occurred it has been soon followed by a very sharp bounce. Often that bounce only lasts a few days before pulling back again.

I sent out a tweet after the bell. It linked to a post from 2008 that discussed SPX reaction following other 5% down days. A link to that post is below. It does not include the last instance from 1/20/09 which saw a bounce of about 4% the next day.

<http://quantifiableedges.blogspot.com/2008/12/5-drops-revisited.html>

Below I have run stats showing the next week after 5% down days.

SPX closes down at least 5% on the day. Buy on close. Sell X days later. \$100k/trade. 1960 - 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	35,876.38	16	11	5	68.75	6,319.70	-6,728.07	0.94	2.07	2,242.27
4	37,959.88	16	13	3	81.25	4,335.51	-6,133.90	0.71	3.06	2,372.49
3	16,144.02	16	11	5	68.75	3,946.73	-5,454.00	0.72	1.59	1,009.00
2	20,477.41	17	12	5	70.59	4,215.74	-6,022.29	0.70	1.68	1,204.55
1	25,359.91	20	15	5	75.00	3,981.30	-6,871.93	0.58	1.74	1,268.00

If not for the Crash of '87 these stats would look quite a bit more positive. The 20%+ drop on 10/19/87 followed a drop of over 5% on Friday the 16th.

While many indicators have been at extremes for at least a week now, the Quantifiable Edges Capitulative Breadth Indicator (CBI) just reached an extreme reading on Monday as it quickly jumped from 3 to 13. 10 is considered strongly oversold and likely to bounce. The record high reading (going back to 1995) is 52 on 7/23/02. We are obviously quite far from that. Below is a little system I have shown many times before, which looks to buy the SPX when the CBI hits 10 and then exit when it returns to 3 or lower.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$58,491.75	Profit Factor	8.74
Gross Profit	\$66,052.47	Gross Loss	(\$7,560.72)
Total Number of Trades	25	Percent Profitable	88.00%
Winning Trades	22	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	\$2,339.67	Ratio Avg. Win:Avg. Loss	1.19
Avg. Winning Trade	\$3,002.39	Avg. Losing Trade	(\$2,520.24)
Largest Winning Trade	\$18,981.60	Largest Losing Trade	(\$4,214.00)

As you can see, stats are overwhelmingly positive. When a large number of securities signal capitulative selling, then that strongly suggests the market as a whole is likely to bounce. This next table also examines spikes in the CBI of 10 or higher, but it looks at performance over the next several days rather than using a dynamic exit.

Buy SPX when CBI crosses over 9. Sell X days later. \$100k/trade. 1995 - 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
12	64,220.41	26	20	6	76.92	4,264.34	-3,511.06	1.21	4.05	2,470.02
11	68,778.90	26	20	6	76.92	4,509.00	-3,566.85	1.26	4.21	2,645.34
10	65,471.87	26	20	6	76.92	4,096.85	-2,744.18	1.49	4.98	2,518.15
9	69,004.05	27	20	6	74.07	4,265.87	-2,718.88	1.57	5.23	2,555.71
8	52,800.30	27	20	7	74.07	3,736.57	-3,133.02	1.19	3.41	1,955.57
7	47,044.15	27	18	9	66.67	3,646.10	-2,065.08	1.77	3.53	1,742.38
6	35,094.55	27	17	10	62.96	3,472.70	-2,394.14	1.45	2.47	1,299.80
5	46,035.94	27	19	8	70.37	3,451.74	-2,443.39	1.41	3.36	1,705.03
4	47,531.98	27	19	8	70.37	3,368.50	-2,058.70	1.64	3.89	1,760.44
3	11,017.45	28	16	11	57.14	3,071.70	-3,466.35	0.89	1.29	393.48
2	12,673.95	28	15	13	53.57	3,184.26	-2,699.23	1.18	1.36	452.64
1	11,368.64	28	15	13	53.57	2,258.95	-1,731.97	1.30	1.50	406.02

Here again we see the upside tendency suggested by the CBI.

I have added the above studies to the Active List, though I could pick an awful lot to examine. No matter how I look at it we are going to get the same message: a bounce is long overdue and it will likely be very sharp.

Lastly, I should point out that tomorrow is a Fed Day. Fed Days have historically been very positive, especially when the market closes poorly going into it. Below is a study from the 6/21/11 subscriber letter (not updated) that demonstrates this.

SPY closes in bottom 25% of daily range. Tomorrow is a Fed Day. Buy on close. Sell Fed Day close. \$100k/trade. 3/1/93 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$17,309.06	Profit Factor	5.74
Gross Profit	\$20,959.35	Gross Loss	(\$3,650.29)
Total Number of Trades	31	Percent Profitable	77.42%
Winning Trades	24	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	\$558.36	Ratio Avg. Win:Avg. Loss	1.67
Avg. Winning Trade	\$873.31	Avg. Losing Trade	(\$521.47)
Largest Winning Trade	\$2,696.00	Largest Losing Trade	(\$1,141.01)

Tonight I also filtered to see other times the SPX closed at a 20-day low when the above setup occurred. Results were nearly the same with fewer instances using that filter.

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



Extreme readings continue to suggest a reversal and the green Aggregator remains extremely stretched. Levels above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the Differential Line is also extraordinarily 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 Tuesday. This is again highly unlikely to change. Meanwhile, the Differential Pivot will be 1,205.81. This is a whopping 7.7% above Monday's close. Obviously it is

unlikely that the Aggregator will signal an exit on Tuesday. It will almost certainly take a multi-day bounce.

The bottom line is that the market is experiencing a historic selloff. All selloffs in the past have either reversed before reaching these levels or just after. There is no precedent suggesting substantial further selling. That said, this market is setting new precedents so risk remains elevated. I hold quite a bit long and am looking to add a number of Catapult signals.

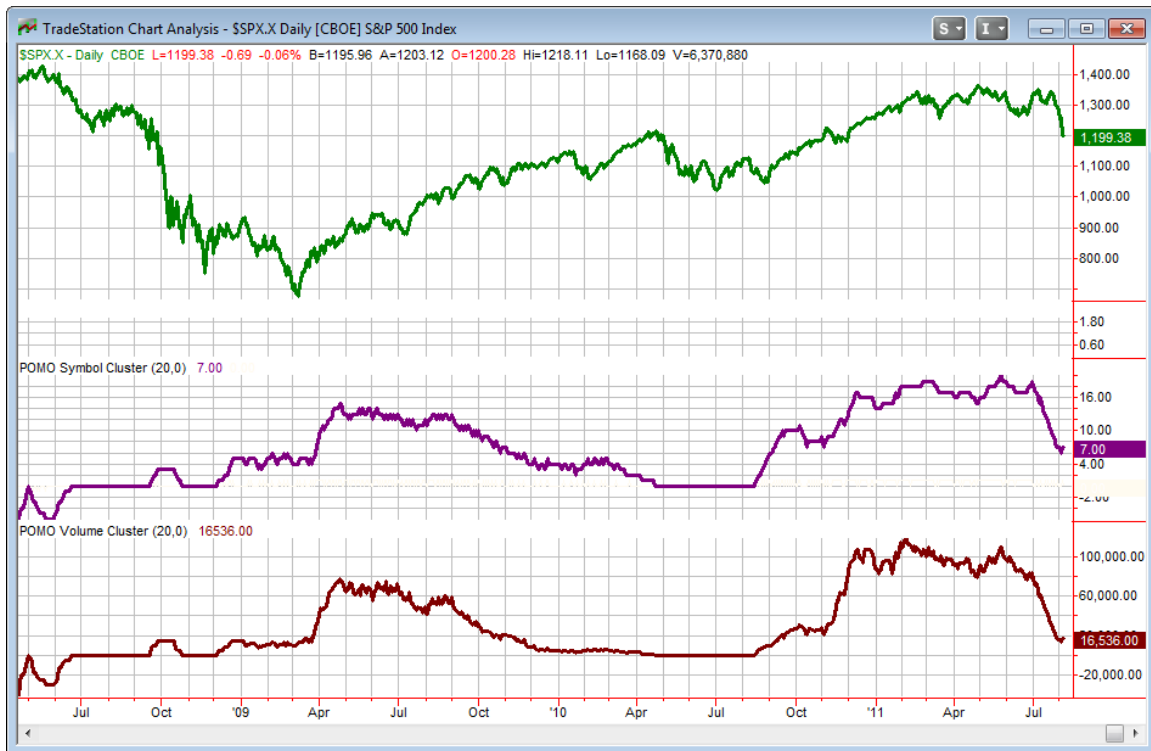
Intermediate-term Outlook (2 weeks – 2 months)– updated 8/8 – neutral

The market got hammered this week. From high to low it dropped over 13% in the last 2 weeks. We've seen a few intermediate-term studies either expire or be turned off. It also appears the "9/10 down days and 7.5% drop" study from the short-term outlook suggests bullish implication over the next month.

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>



POMO indicators barely budged this past week as they now seem to be settling in at their new (and ineffective?) levels. We should hear quite a bit from the Fed this week with the Fed meeting taking place and the next POMO schedule to be released on the 10th. The link below shows the current schedule but it will also work if you want to view the new schedule after 2pm on Wednesday.

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

So we are short-term oversold, and there is still some evidence suggesting bullish implications. The trend is clearly down now and this will increase risk for long-side trades. Also, the light amount of POMO buying that has been occurring doesn't seem to be providing much help to the market. I've changed my outlook to intermediate-term neutral. This means I will approach both long and short trades with some caution.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

WAG – 1/3 @ \$37.05

WAG – 1/3 @ \$37.03

BAC – 1/3 @ \$8.17

New

WAG – 1/3 @ \$35.22 (final lot)

ALL – 1/3 @ \$24.57

BAC – 1/3 @ \$6.51 (2nd lot)

BAX – 1/3 @ \$50.31

COF – 1/3 @ \$37.63

EXC – 1/3 @ \$39.94

F – 1/3 @ \$9.93

HON – 1/3 @ \$44.29

RTN – 1/3 @ \$39.41

TXN – 1/3 @ \$26.19

Catapult for ETF's Trades

None.

Broad Market Large Cap CBI – 13 (WAG-3, BAC-2, ALL, BAX, COF, EXC, F, HON, RTN, TXN)

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.

1/3 positions in all Catapult trades listed under “New” in Catapult section above. Use posted limits.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	7/26/2011	\$133.33	\$112.26	-15.80%		Aggregator
SPY(1/4)	7/28/2011	\$130.60	\$112.26	-14.04%		Aggregator
SPY(1/4)	7/28/2011	\$130.22	\$112.26	-13.79%		Aggregator
PG	8/1/2011	\$61.43	\$59.29	-3.48%		system 80509
SPY(1/4)	8/3/2011	\$125.49	\$112.26	-10.54%		Aggregator
WAG(1/3)	8/5/2011	\$37.05	\$35.22	-4.94%		Catapult
XIV	8/5/2011	\$12.50	\$10.00	-20.00%		VIX System
WAG(1/3)	8/8/2011	\$36.00	\$35.22	-2.17%		Catapult
BAC(1/3)	8/8/2011	\$7.40	\$6.51	-12.03%		Catapult

Though there are much fewer Catapults active presently, the current SPY entries rival the most underwater I've been on any SPY trades. The Crash of 2008 was a bit worse. In that case the bounce was incredibly strong and I was able to escape with little damage to the SPY trades and strong Catapult profits. Things look awfully bad right now, but past trades suggest total despair is not warranted and hope should remain for anyone who remains long as I do. To see the period I am referring to, traders can visit the Nightly Archives page and download the 10/13/08 and 10/15/08 subscriber letters.

Tip of the Day

Full CBI history (1995 – present) may be downloaded from the Proprietary Historical Data Download page at any time. A link to this page can be found on the charts page near the top on the right hand side. The file is updated each night.

<http://www.quantifiableedges.com/members/data.php>

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 © 2011 Hanna Capital Management, LLC.