

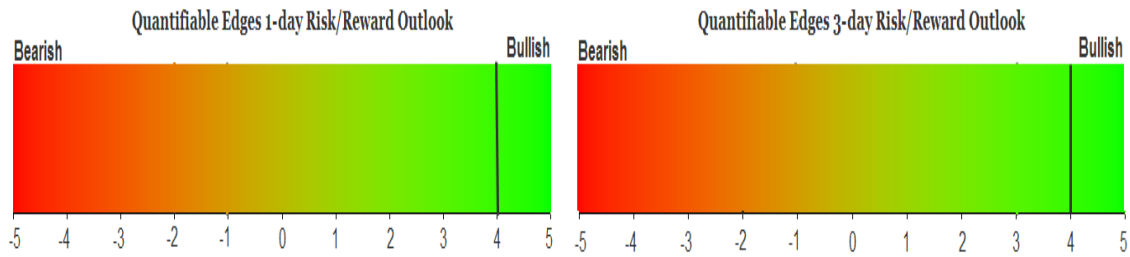
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 11, 2011

Volume 4 Issue 154

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- The reversal and then giveback over the last 2 days appears to be a bullish setup.
- 2 1.75% drops in 3 days and no 7-day low today suggests an upside edge.
- Another VIX spike is suggesting a bullish edge for Thursday.

## *Short-term Outlook*

### *The Bottom Line*

Evidence tonight is quite bullish. The market remains oversold. I am very long already. Should we get a bounce tomorrow I will lighten up a little but maintain the majority of my position.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
August 11, 2011	VIX spikes 20%	1 day	Bullish	
August 11, 2011	2 1.75% drops. No 7-day low.	1-3 days	Bullish	
August 11, 2011	Reversal from low then dip	1-3 days	Bullish	3.50%
August 10, 2011	VXO drops 20%	1-3 days	Bearish	
August 9, 2011	CBI >= 10	1-4 days	Bullish	
August 9, 2011	High Volume 100-day lows	1-3 days	Bullish	
<b>Active - Long Term</b>				
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	
<b>Dropped Tonight</b>				
August 4, 2011	1.75% drop.Next day big intraday bounce	1-5 days	Bullish	3.50%
<b>August 10, 2011</b>	<b>90% breadth from 50-day low</b>	<b>1 day</b>	<b>Bearish</b>	

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

**The Evidence**

After screaming higher into the close Tuesday and finishing up over 4.7%, Wednesday it gapped down, never touched Tuesday's close, and eventually gave up almost all of Tuesday's gains. The SPX lost 4.4%, the Nasdaq fell 4.1% and the Russell 2000 finished down 5.1%. Breadth was extremely poor once again. The NYSE Up Issue % came in at 25% and the Up Volume % was 6%. Total volume declined slightly for the 2<sup>nd</sup> day in a row but is still running extremely high.

The market remains challenging on many fronts. The volatility and the inability to sustain a bounce has made trading extremely difficult. It has also made historical analysis very difficult. As I've discussed the last few days, we are now at a point where comparisons are few. The Quantifinder is full of studies but nothing is as extreme as current market conditions. Therefore the studies are a bit loose.

As an example I looked for other instances where the SPX fell 4% on day 1, rose > 4% on day 2, and then fell again on day 3 > 4%. The only instance I could find was in November of 2008. I also looked at times the SPX closed down 4% in 3 of the last 6 days. There were a couple of instances but again they only took place in November of

2008. So rather than worry so much about the magnitude of the move I instead examined some past studies with similar patterns. This first study was last seen in the 8/31/10 subscriber letter. Stats are updated.

SPY either closes at a 20-day low 2 days ago or makes a 20-day intraday low yesterday. Yesterday of closed up. Today is an inside day with a down close. Buy on close. Sell X days later. \$100k/trade. 1993 - 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	50,457.31	12	12	0	100.00	4,204.78	0.00	100.00	100.00	4,204.78
9	37,246.46	12	10	2	83.33	4,100.06	-1,877.08	2.18	10.92	3,103.87
8	29,926.71	12	9	3	75.00	4,290.85	-2,896.97	1.48	4.44	2,493.89
7	22,942.16	12	8	4	66.67	4,655.15	-3,574.77	1.30	2.60	1,911.85
6	19,056.39	12	8	4	66.67	4,081.54	-3,398.97	1.20	2.40	1,588.03
5	4,596.93	12	7	5	58.33	3,966.52	-4,633.75	0.86	1.20	383.08
4	16,596.27	12	8	4	66.67	4,051.37	-3,953.68	1.02	2.05	1,383.02
3	15,811.42	12	9	3	75.00	3,116.43	-4,078.81	0.76	2.29	1,317.62
2	14,077.49	12	9	3	75.00	2,423.14	-2,576.91	0.94	2.82	1,173.12
1	8,717.84	12	7	4	58.33	2,064.02	-1,432.57	1.44	2.52	726.49

The stats certainly appear bullish and the edge seems to occur both right off the bat and after a couple of weeks. In the table below I show dates and stats for both 3-day and 10-day holding periods.

SPY either closes at a 20-day low 2 days ago or makes a 20-day intraday low yesterday. Yesterday of closed up. Today is an inside day with a down close. Buy on close. Sell 3 & 10 days later. \$100k/trade. 1993 - present.						
Date/Time	Signal	Price	3-day % Profit	Run-up Drawdown	10-day % Profit	Run-up Drawdown
03/03/94	Buy	\$46.56	0.82%	\$944.68	1.48%	\$1,631.72
03/07/94	Sell	\$46.94		(\$300.58)		(\$300.58)
01/06/00	Buy	\$137.75	6.17%	\$6,641.00	4.86%	\$7,134.00
01/10/00	Sell	\$146.25		\$0.00		\$0.00
05/09/02	Buy	\$107.75	0.11%	\$278.40	2.18%	\$3,248.00
05/13/02	Sell	\$107.87		(\$1,995.20)		(\$1,995.20)
07/16/02	Buy	\$90.56	(3.05%)	\$3,024.96	0.42%	\$3,024.96
07/18/02	Sell	\$87.80		(\$3,102.24)		(\$14,219.52)
10/02/02	Buy	\$83.15	(2.83%)	\$1,742.90	4.09%	\$6,695.14
10/04/02	Sell	\$80.80		(\$4,291.14)		(\$7,308.16)
12/17/02	Buy	\$90.85	(1.86%)	\$0.00	0.24%	\$495.00
12/19/02	Sell	\$89.16		(\$2,475.00)		(\$4,114.00)
08/30/05	Buy	\$121.05	1.19%	\$1,734.60	1.78%	\$3,047.94
09/01/05	Sell	\$122.49		(\$256.06)		(\$256.06)
01/22/09	Buy	\$82.75	1.12%	\$3,152.88	2.20%	\$6,281.60
01/26/09	Sell	\$83.68		(\$2,633.44)		(\$2,633.44)
03/09/09	Buy	\$68.11	6.65%	\$8,279.52	20.72%	\$20,816.24
03/11/09	Sell	\$72.64		\$0.00		\$0.00
05/28/10	Buy	\$109.37	0.88%	\$886.58	0.13%	\$1,599.50
06/02/10	Sell	\$110.33		(\$1,828.00)		(\$4,314.08)
08/30/10	Buy	\$105.31	2.99%	\$3,131.70	6.97%	\$7,573.02
09/01/10	Sell	\$108.46		(\$778.18)		(\$778.18)
06/17/11	Buy	\$127.05	1.89%	\$2,085.55	5.41%	\$5,548.35
06/21/11	Sell	\$129.45		(\$369.89)		(\$676.82)

Examining the instances closer gives me additional confidence in the edge.

Another study that drew my interest was last seen in the 3/3109 subscriber letter. Since SPY typically shows more accurate highs and lows I changed that study from SPX to SPY and updated the results.

SPY drops > 1.75% today and either yesterday or the day before. Today's low is > the 7-day low. Buy on close. Sell X days later. \$100k/trade. 1993 - 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	16,508.83	11	7	4	63.64	5,518.38	-5,529.96	1.00	1.75	1,500.80
9	41,060.85	11	10	1	90.91	5,271.95	-11,658.69	0.45	4.52	3,732.80
8	28,428.84	11	9	2	81.82	4,349.58	-5,358.71	0.81	3.65	2,584.44
7	20,537.77	11	8	3	72.73	3,954.24	-3,698.70	1.07	2.85	1,867.07
6	24,886.87	11	8	3	72.73	3,885.82	-2,066.56	1.88	5.01	2,262.44
5	10,288.44	11	7	4	63.64	3,185.91	-3,003.23	1.06	1.86	935.31
4	9,712.26	12	9	3	75.00	3,432.35	-7,059.63	0.49	1.46	809.35
3	10,419.61	12	9	3	75.00	2,808.68	-4,952.82	0.57	1.70	868.30
2	21,698.84	13	10	3	76.92	2,763.21	-1,977.75	1.40	4.66	1,669.14
1	12,247.03	13	10	3	76.92	1,735.49	-1,702.63	1.02	3.40	942.08

Similar to the last study there appears to be an edge both very short-term and a couple of weeks out. Below I have listed all instances assuming a 2-day holding period.

SPY drops > 1.75% today and either yesterday or the day before. Today's low is > the 7-day low. Buy on close. Sell 2 days later. \$100k/trade. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
09/10/98	Buy	\$97.25	6.37%	\$7,391.32
09/14/98	Sell	\$103.44		(\$257.00)
01/14/99	Buy	\$121.22	3.28%	\$5,150.00
01/19/99	Sell	\$125.19		\$0.00
01/02/01	Buy	\$128.81	3.66%	\$5,579.44
01/04/01	Sell	\$133.53		(\$892.40)
02/21/02	Buy	\$108.30	2.91%	\$3,239.73
02/25/02	Sell	\$111.45		(\$396.89)
06/21/02	Buy	\$99.28	(1.73%)	\$1,621.27
06/25/02	Sell	\$97.56		(\$2,044.21)
06/25/02	Buy	\$97.56	1.92%	\$1,978.25
06/27/02	Sell	\$99.43		(\$2,429.25)
08/02/02	Buy	\$86.79	(0.23%)	\$1,278.72
08/06/02	Sell	\$86.59		(\$3,732.48)
09/23/08	Buy	\$118.55	1.89%	\$2,832.48
09/25/08	Sell	\$120.79		(\$640.68)
10/22/08	Buy	\$90.64	(3.97%)	\$1,996.43
10/24/08	Sell	\$87.04		(\$7,323.92)
11/14/08	Buy	\$86.62	0.53%	\$2,238.76
11/18/08	Sell	\$87.08		(\$4,281.34)
01/30/09	Buy	\$82.83	1.10%	\$1,846.71
02/03/09	Sell	\$83.74		(\$1,834.64)
03/24/09	Buy	\$80.60	3.11%	\$3,348.00
03/26/09	Sell	\$83.11		(\$1,909.60)
03/30/09	Buy	\$78.79	2.88%	\$3,337.47
04/01/09	Sell	\$81.06		(\$583.74)

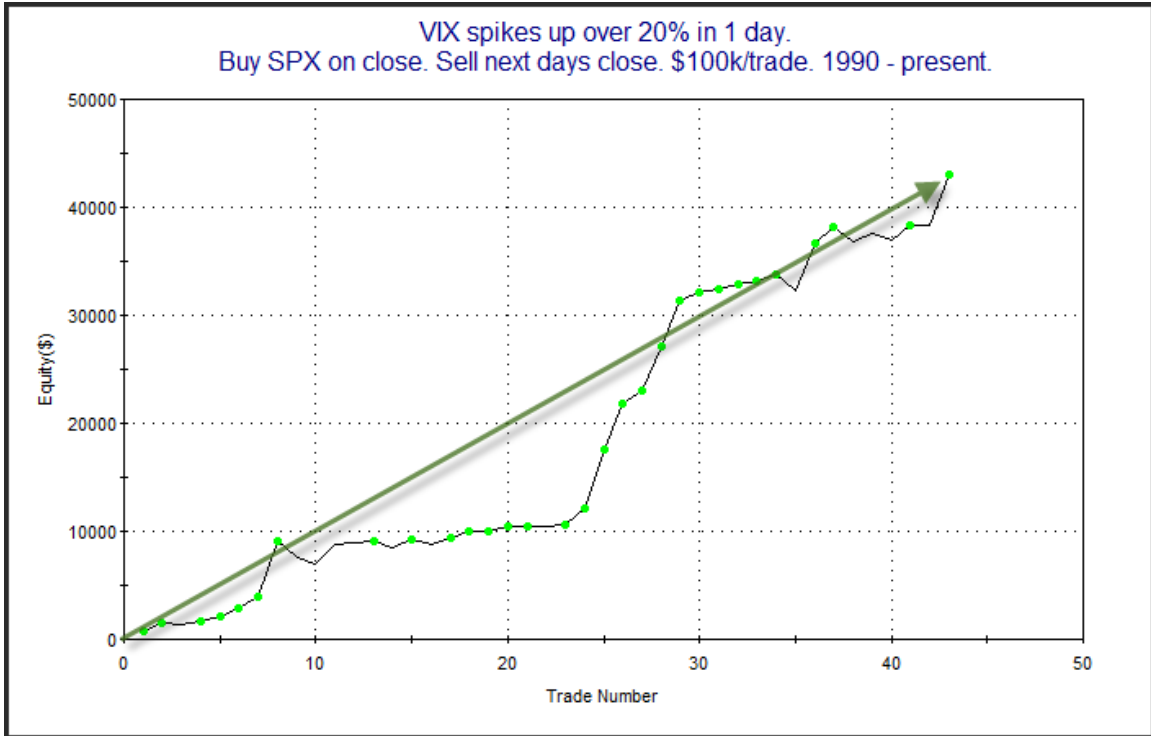
Though most results were positive they almost all showed some volatility.

Speaking of volatility, the VIX spiked up again on Wednesday. This triggered again the below study from the 2/23/11 letter.

VIX spikes up over 20% in 1 day.  
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
5	42,669.15	39	26	13	66.67	2,638.83	-1,995.42	1.32	2.64	1,094.08
4	36,479.21	41	28	13	68.29	2,399.36	-2,361.75	1.02	2.19	889.74
3	19,143.65	41	28	13	68.29	1,677.67	-2,140.85	0.78	1.69	466.92
2	18,437.57	42	25	17	59.52	1,865.83	-1,659.30	1.12	1.65	438.99
1	42,993.99	43	33	10	76.74	1,512.30	-691.19	2.19	7.22	999.86

In most cases the upside edge largely played out on day 1. Below is an equity curve assuming a 1-day exit.



Just as last night we saw ample bearish evidence, we are seeing a good amount of bullish evidence tonight.

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



Bullish studies tonight helped pop the green Aggregator line a bit higher. Levels above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the Differential Line is still high above 0. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are positive and the SPX is 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 Wednesday. This could change should strong bearish evidence emerge. Meanwhile, the Differential Pivot will be 1,130.98. This is a little less than 1% above Wednesday's close. The sharp drop is because Monday's action will be exiting the equation. Therefore expectations will be measured from Monday's close.

I was torn last night after seeing all the bearish evidence whether I should lighten up or not. I decided not to, and it didn't really matter anyway. With the gap down I wouldn't have gotten a fill on a limit order and I doubt I would've chased it down after the bell.

Most interesting about current setup is the action unfolding with regards to the Differential Pivot. The Differential calculation primarily looks back over the last 3 days. Recent market whipsaws will also cause whipsaws in the Differential line. So Thursday's Differential Pivot is only about 1% above Wednesday's close, but Friday the pivot will be about 50 points above that (because Tuesday's action will fall out of the calculation). Under most circumstances, once the Aggregator signal comes off I generally exit the trade. In this case I will do a partial exit, but I will keep the majority of the position because I still feel a strong rebound is likely to emerge.

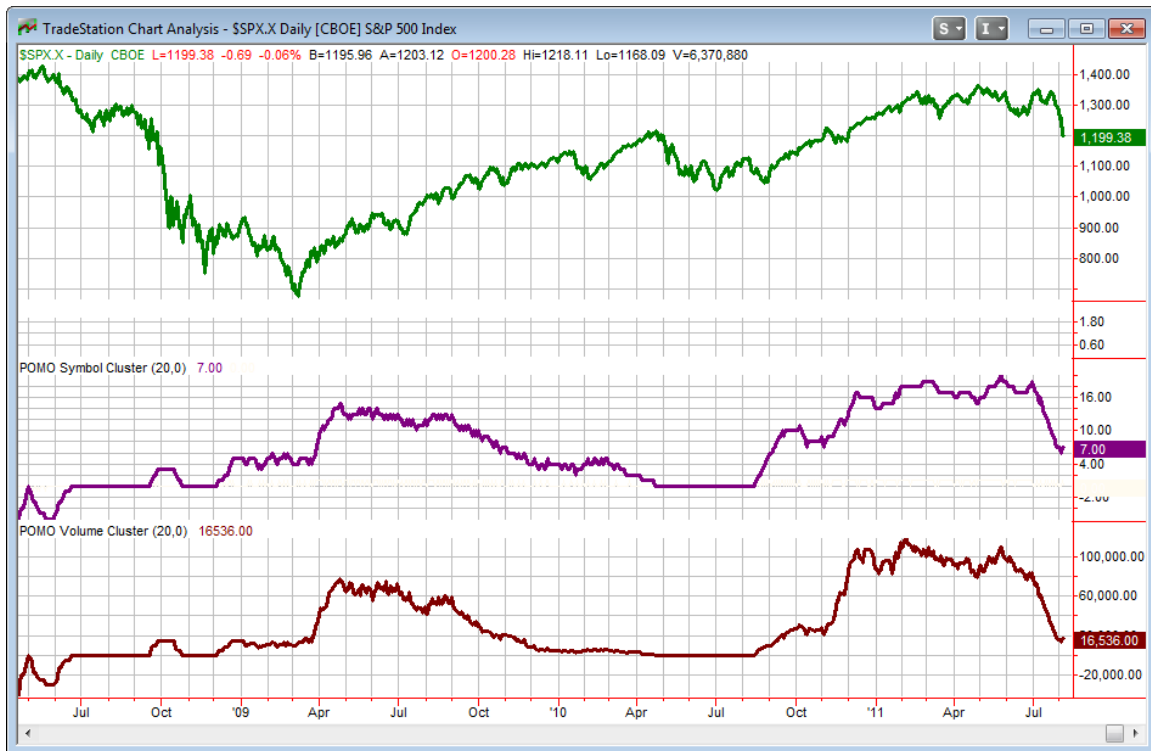
***Intermediate-term Outlook (2 weeks – 2 months)– updated 8/8 – neutral***

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 3<sup>rd</sup> 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 10<sup>th</sup>. 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](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

WAG – 1/3 @ \$35.22 (final lot)

ALL – 1/3 @ \$24.57

BAC – 1/3 @ \$6.51 (2<sup>nd</sup> lot) *not filled (and not looking for entry)*

BAX – 1/3 @ \$50.31

COF – 1/3 @ \$37.63

EXC – 1/3 @ \$39.94

F – 1/3 @ \$9.93 *not filled (and not looking for entry)*

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.*

*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	\$112.29	-15.78%		Aggregator
SPY(1/4)	7/28/2011	\$130.60	\$112.29	-14.02%		Aggregator
SPY(1/4)	7/28/2011	\$130.22	\$112.29	-13.77%		Aggregator
PG	8/1/2011	\$61.43	\$58.51	-4.75%		system 80509
SPY(1/4)	8/3/2011	\$125.49	\$112.29	-10.52%		sell on SPX close>1131
WAG(1/3)	8/5/2011	\$37.05	\$34.72	-6.29%		Catapult
XIV	8/5/2011	\$12.50	\$9.25	-26.00%		VIX System
WAG(1/3)	8/8/2011	\$36.00	\$34.72	-3.56%		Catapult
BAC(1/3)	8/8/2011	\$7.40	\$6.77	-8.51%		Catapult
WAG(1/3)	8/9/2011	\$35.22	\$34.72	-1.42%		Catapult
ALL(1/3)	8/9/2011	\$24.57	\$24.32	-1.02%		Catapult
EXC(1/3)	8/9/2011	\$39.94	\$40.33	0.98%		Catapult
HON(1/3)	8/9/2011	\$44.29	\$43.22	-2.42%		Catapult
RTN(1/3)	8/9/2011	\$39.41	\$39.00	-1.04%		Catapult
TXN(1/3)	8/9/2011	\$26.19	\$26.50	1.18%		Catapult
COF(1/3)	8/9/2011	\$37.63	\$41.05	9.09%		Catapult
BAX(1/3)	8/9/2011	\$50.31	\$50.49	0.36%		Catapult

*For now I will only look to exit 1 lot of the SPY if the market closes above the differential pivot.*

*I will send out notification intraday if any of the Catapult trades hit their exit trigger. The "standard" exit for a Catapult is the market open on the morning after the target is hit.*

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