

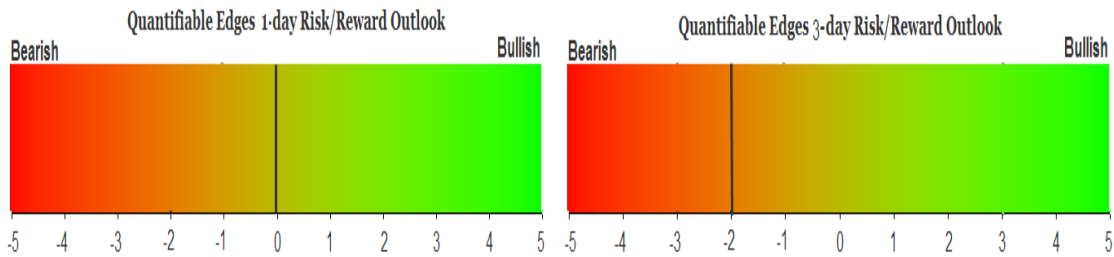
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 12, 2011

Volume 4 Issue 155

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Short	100% Long VXX	100% Long VXX	Long

## Tonight's Research Points

- Weak volume on the bounce Thursday appears short-term bearish.
- Extremely positive breadth after an extremely negative breadth day suggest downside.
- Wednesday's gap-n-go move in the SPY has historically favored a pullback.
- The late-day pullback leaves open the possibility of more upside over the next few days.
- The CBI is still elevated, suggesting an upside edge.

## *Short-term Outlook*

### *The Bottom Line*

Evidence flipped bearish and the SPX is now overbought. This triggered a short signal in the Aggregator. Therefore I will be looking to exit my long index positions and possibly establish a small short.

**Summary of Recent Active Studies (see Letters from listed dates for details) *Not updated tonight***

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***

Thursday was another big reversal for the market. After a huge drop Wednesday the major indices bounced back in a big way. The SPX gained 4.6%, the Nasdaq rose 4.7% and the Russell 2000 rallied 5.4%. Breadth was again heavily lopsided for the 4<sup>th</sup> day in a row. The NYSE Up Issues % came in at 90% and the Up Volume % was a whopping 97%. Total NYSE volume pulled back to its lowest level in a week.

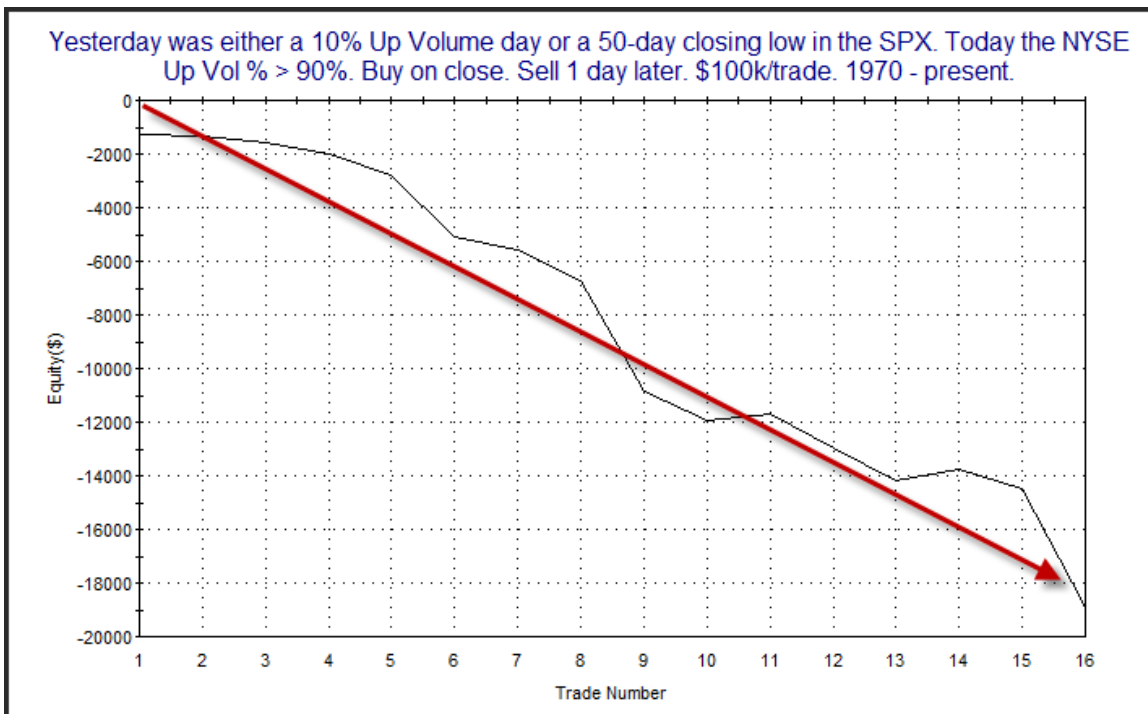
The studies Tuesday night were pretty clearly bearish. Last night they were all bullish. Tonight we have more of a mix, but the most compelling results and the net totals appear to favor the bears. Let's review the evidence below.

This first study was last seen 2 days ago in the 8/10 letter. It examines the extremely strong breadth. Past studies have found that lopsided breadth following either new lows or extreme down days the day before has often been followed by a short-term pullback. I've updated the results again below.

Yesterday was either a 10% Up Volume day or a 50-day closing low in the SPX. Today the NYSE Up Vol % > 90%. Buy on close. Sell X days later. \$100k/trade. 1970 - 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	-20,665.17	12	4	8	33.33	4,330.40	-4,748.35	0.91	0.46	-1,722.10
9	-23,492.75	12	4	8	33.33	4,436.23	-5,154.71	0.86	0.43	-1,957.73
8	-26,982.22	12	4	8	33.33	2,691.32	-4,718.44	0.57	0.29	-2,248.52
7	-25,983.56	14	4	10	28.57	3,361.41	-3,942.92	0.85	0.34	-1,855.97
6	-19,843.10	14	4	10	28.57	3,997.73	-3,583.40	1.12	0.45	-1,417.36
5	-18,674.42	14	6	8	42.86	3,477.61	-4,942.51	0.70	0.53	-1,333.89
4	-20,040.71	14	8	6	57.14	1,654.30	-5,545.86	0.30	0.40	-1,431.48
3	-15,436.34	15	5	10	33.33	2,463.81	-2,775.54	0.89	0.44	-1,029.09
2	-22,839.76	16	6	10	37.50	1,246.57	-3,031.92	0.41	0.25	-1,427.49
1	-18,914.68	16	2	14	12.50	323.92	-1,397.32	0.23	0.03	-1,182.17

The stats seem to strongly favor a pullback, especially over the next 1-2 days. Below is an equity curve with a 1-day holding period.



Nothing wrong with this curve.

Alongside the overdone breadth another indicator that was flashing a warning was volume. Despite Thursday rallying so strongly, volume was relatively low. It registered

the lowest NYSE reading in over a week. There were several studies that appeared in the Quantifinder that noted the weak volume. When the market makes a strong price move then the volume can be a great short-term clue. This first study examines rallies of 3%+ on the heaviest volume in at least a week.

SPX rises 3%+ on highest NYSE volume in 5 days. 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	47,928.50	41	30	11	73.17	3,049.36	-3,959.31	0.77	2.10	1,168.99
4	40,979.73	41	29	12	70.73	2,839.41	-3,446.92	0.82	1.99	999.51
3	39,291.57	41	24	17	58.54	3,064.61	-2,015.24	1.52	2.15	958.33
2	21,741.02	41	23	18	56.10	2,163.98	-1,557.25	1.39	1.78	530.27
1	24,393.71	41	24	17	58.54	1,791.07	-1,093.64	1.64	2.31	594.97

The stats suggest a clear bullish edge. Unfortunately this edge does not hold true when volume is very light like it was on Thursday. This can be seen in the study below, which was last seen in the 6/3/10 letter.

SPX rises 3%+ on lowest NYSE volume in 5 days. 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	-28,319.60	7	3	4	42.86	1,398.67	-8,128.90	0.17	0.13	-4,045.66
4	-19,340.05	7	2	5	28.57	3,042.92	-5,085.18	0.60	0.24	-2,762.86
3	-25,077.28	7	0	7	0.00	0.00	-3,582.47	0.00	0.00	-3,582.47
2	-18,273.35	7	3	4	42.86	1,006.09	-5,322.91	0.19	0.14	-2,610.48
1	-1,022.43	7	3	4	42.86	1,153.39	-1,120.65	1.03	0.77	-146.06

Instances are lower than I would prefer but the evidence is so overwhelming I decided to include it in the Aggregator. I also took a close look at the instances and have listed them below.

SPX rises 3%+ on lowest NYSE volume in 5 days.  
Buy on close. Sell 3 days later. \$100k/trade. 1960 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
08/27/90	Buy	\$321.43	(0.85%)	\$1,368.40
08/30/90	Sell	\$318.70		(\$1,122.71)
07/05/02	Buy	\$989.03	(6.93%)	\$457.53
07/10/02	Sell	\$920.47		(\$6,942.74)
07/29/02	Buy	\$898.96	(1.59%)	\$1,407.48
08/01/02	Sell	\$884.66		(\$1,829.28)
10/20/08	Buy	\$985.40	(7.84%)	\$4.04
10/23/08	Sell	\$908.11		(\$12,822.96)
11/26/08	Buy	\$887.68	(4.38%)	\$959.84
12/02/08	Sell	\$848.81		(\$8,062.88)
03/17/09	Buy	\$778.12	(1.23%)	\$3,215.36
03/20/09	Sell	\$768.54		(\$1,597.44)
05/18/09	Buy	\$909.71	(2.35%)	\$1,623.01
05/21/09	Sell	\$888.33		(\$3,280.90)

Perhaps most impressive in my eyes is that every instance saw a decline of at least 1% during the next 3 days.

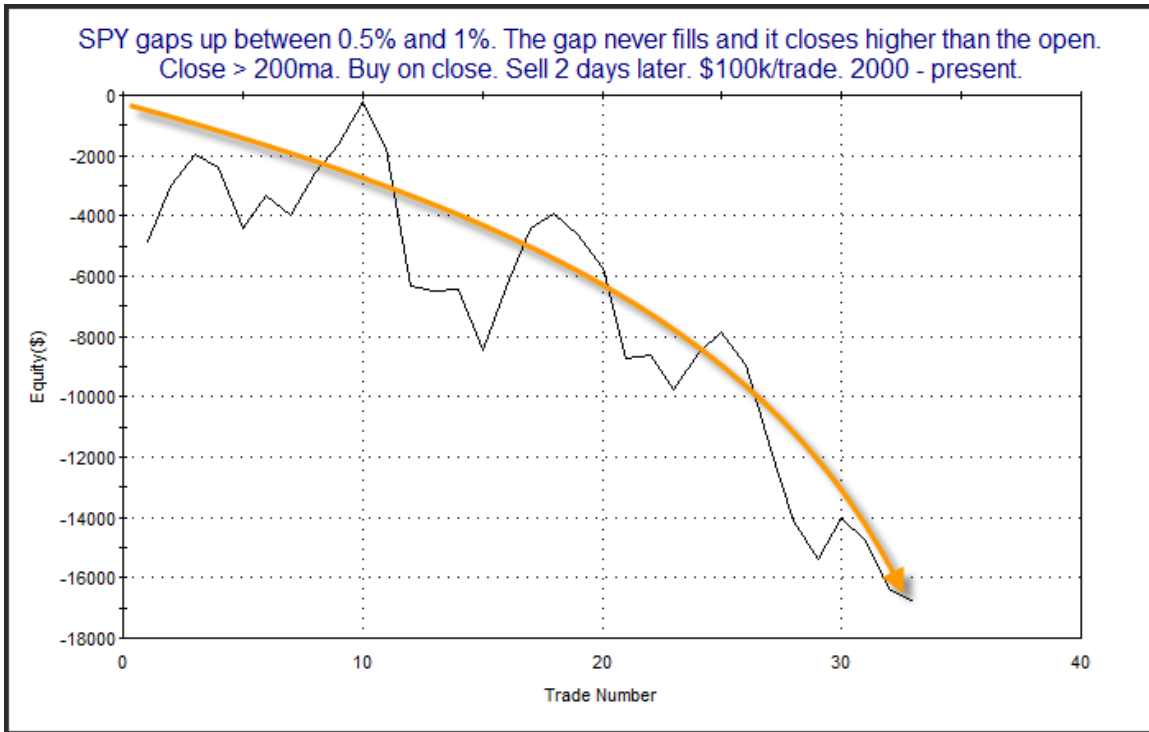
Aside from breadth and volume there was also some pattern-based bearish evidence to consider. The study below last appeared in the 8/18/10 letter. I have updated the results.

SPY gaps up between 0.5% and 1%. The gap never fills and it closes higher than the open.  
Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	-18,173.59	32	19	13	59.38	1,543.81	-3,654.31	0.42	0.62	-567.92
4	-21,892.78	33	17	16	51.52	1,583.26	-3,050.51	0.52	0.55	-663.42
3	-11,698.99	33	18	15	54.55	1,314.22	-2,357.00	0.56	0.67	-354.51
2	-16,791.20	33	14	19	42.42	1,124.40	-1,712.25	0.66	0.48	-508.82
1	-7,569.02	34	16	18	47.06	749.51	-1,086.73	0.69	0.61	-222.62

Only 24 of 33 instances (73%) closed below the entry price at some point in the next week. 23 of those 24 did it in the 1st 2 days.

Consistency appeared somewhat weak, which gave me some pause. Therefore, I thought it important to consider the equity curve when considering whether to incorporate the study into the Aggregator.



The curve actually looks fairly compelling. I decided this study was worth consideration.

There were some studies with bullish inclinations. The one below considers strong days with weak closes.

SPY closes 1% below its high but still up over 1% on the day. Close < 200ma.  
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
5	21,525.79	16	10	6	62.50	3,609.55	-2,428.28	1.49	2.48	1,345.36
4	18,033.33	17	9	8	52.94	4,297.48	-2,580.50	1.67	1.87	1,060.78
3	15,100.77	17	9	8	52.94	3,949.69	-2,555.80	1.55	1.74	888.28
2	17,103.67	17	14	3	82.35	1,859.02	-2,974.19	0.63	2.92	1,006.10
1	7,972.49	20	13	7	65.00	1,612.71	-1,856.11	0.87	1.61	398.62

The weak close seems to favor the bulls.

Lastly, I still feel the fact that the CBI is so elevated is important. The below excerpt is from the 8/10 letter just a couple of days ago.

*I also am always wary about downside inclinations when the CBI is elevated. The study below looks at other instances where the SPX posted very strong gains but the CBI still remained  $\geq 10$ .*

SPX closes up 3% but CBI is still $\geq 10$ . Buy on close. 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
20	24,057.83	7	5	2	71.43	6,950.94	-5,348.43	1.30	3.25	3,436.83
19	27,953.18	7	5	2	71.43	7,552.02	-4,903.47	1.54	3.85	3,993.31
18	28,275.37	7	5	2	71.43	7,803.14	-5,370.17	1.45	3.63	4,039.34
17	33,381.17	7	5	2	71.43	7,817.22	-2,852.46	2.74	6.85	4,768.74
16	43,234.97	7	7	0	100.00	6,176.42	0.00	100.00	100.00	6,176.42
15	34,390.15	7	6	1	85.71	6,343.02	-3,667.95	1.73	10.38	4,912.88
14	28,421.94	7	6	1	85.71	5,307.89	-3,425.40	1.55	9.30	4,060.28
13	24,829.88	7	6	1	85.71	4,951.10	-4,876.74	1.02	6.09	3,547.13
12	23,692.84	7	5	2	71.43	6,270.72	-3,830.37	1.64	4.09	3,384.69
11	19,001.74	7	5	2	71.43	5,286.32	-3,714.93	1.42	3.56	2,714.53
10	13,714.24	7	5	2	71.43	6,006.84	-8,159.99	0.74	1.84	1,959.18
9	10,837.08	7	5	2	71.43	4,965.66	-6,995.61	0.71	1.77	1,548.15
8	3,157.64	7	4	3	57.14	4,472.91	-4,911.33	0.91	1.21	451.09
7	5,936.46	7	5	2	71.43	4,036.46	-7,122.92	0.57	1.42	848.07
6	3,073.68	7	3	4	42.86	5,217.99	-3,145.07	1.66	1.24	439.10
5	10,263.89	7	5	2	71.43	3,095.43	-2,606.63	1.19	2.97	1,466.27
4	16,023.20	7	4	3	57.14	6,391.21	-3,180.55	2.01	2.68	2,289.03
3	8,393.20	8	3	4	37.50	6,307.33	-2,632.20	2.40	1.80	1,049.15
2	-1,284.46	8	4	4	50.00	3,167.57	-3,488.69	0.91	0.91	-160.56
1	3,092.84	8	2	6	25.00	3,646.95	-700.18	5.21	1.74	386.61

*The first few days appear to be a bit of a tossup. When you look out a little ways it seems the market typically works its way higher to eliminate the oversold condition.*

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



In a move that was somewhat surprising to me the green Aggregator line flipped negative tonight. Levels below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the Differential Line also dropped below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are negative and the SPX is overbought versus recent expectations. Historically this combination has provided a bearish edge. It can be seen on the Aggregator chart whenever both lines are below 0. Due to this the Aggregator System flipped to short.

With the current studies in place the green Aggregator line is again set to close below 0 on Friday. This could change should bullish evidence emerge. Meanwhile, the Differential Pivot will be 1,181.37. This is about 0.75% above Thursday's close. This means it would take a rally of at least this much on Friday in order to keep the short signal active.

I'm very torn on how to handle the current setup. I learned a long time ago that the most dangerous time to short is when the market is emerging from an intermediate-term low and undergoing a strong bounce. It seems to be one market condition where overbought can get out of hand. I therefore almost always keep at least a small portion of my long

position on until the CBI drops back into neutral territory of 3 or less, even if the Aggregator turns neutral. But tonight we have an outright short signal and evidence is so compelling that it would seem foolish of me to ignore it. Therefore I will look to step out of my index positions Friday if I can get a decent fill. I will also consider a small short position if the market rallies and closes above the Differential Pivot (keeping the short signal in place). If the market gaps down and never provides a decent exit opportunity then I will not chase it down and sell my long index trades. The reason is that under these circumstances it is likely the Aggregator would turn back to bullish tomorrow afternoon. Details in the trade ideas section below.

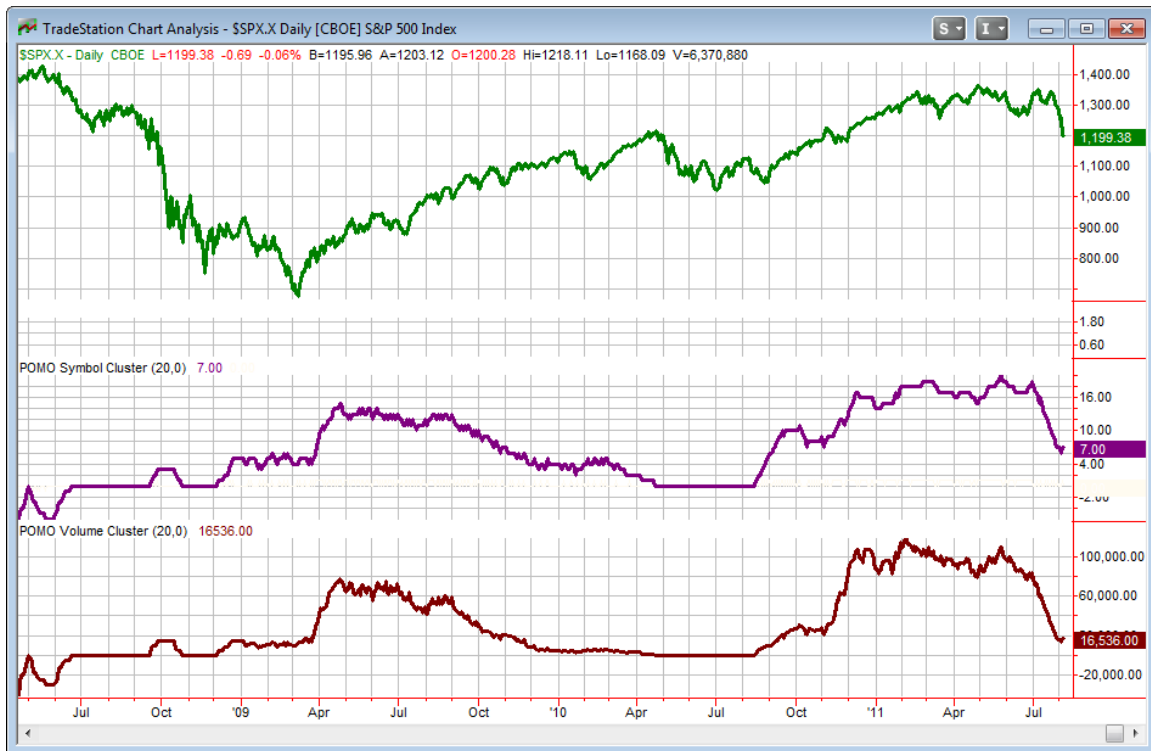
***Intermediate-term Outlook (2 weeks – 2 months)– updated 8/8 – neutral***

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

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 – 12 (WAG-3, BAC-2, ALL, BAX, 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.*

*SPY – short ¼ index position if SPX closes  $\geq$  1,181.37. Based on short-term outlook above.*

## Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	7/26/2011	\$133.33	\$117.33	-12.00%		<i>sell @ \$117.25 limit</i>
SPY(1/4)	7/28/2011	\$130.60	\$117.33	-10.16%		<i>sell @ \$117.25 limit</i>
SPY(1/4)	7/28/2011	\$130.22	\$117.33	-9.90%		<i>sell on SPX close &gt; 1,181.36</i>
<b>PG</b>	<b>8/1/2011</b>	<b>\$61.43</b>	<b>\$60.45</b>	<b>-1.60%</b>		<b>sold on close</b>
<b>SPY(1/4)</b>	<b>8/3/2011</b>	<b>\$125.49</b>	<b>\$117.33</b>	<b>-6.50%</b>		<b>sold on close</b>
WAG(1/3)	8/5/2011	\$37.05	\$34.74	-6.23%		Catapult
XIV	8/5/2011	\$12.50	\$9.61	-23.12%		<i>sell @ \$9.75 limit</i>
WAG(1/3)	8/8/2011	\$36.00	\$34.74	-3.50%		Catapult
BAC(1/3)	8/8/2011	\$7.40	\$7.25	-2.03%		Catapult
WAG(1/3)	8/9/2011	\$35.22	\$34.74	-1.36%		Catapult
ALL(1/3)	8/9/2011	\$24.57	\$25.67	4.48%		Catapult
EXC(1/3)	8/9/2011	\$39.94	\$41.08	2.85%		Catapult
HON(1/3)	8/9/2011	\$44.29	\$44.63	0.77%		Catapult
RTN(1/3)	8/9/2011	\$39.41	\$40.32	2.31%		Catapult
TXN(1/3)	8/9/2011	\$26.19	\$27.30	4.24%		Catapult
COF(1/3)	8/9/2011	\$37.63	\$44.14	17.30%		<i>Sell on open</i>
BAX(1/3)	8/9/2011	\$50.31	\$52.61	4.57%		Catapult

*COF hit its target. I will exit at the open.*

*2 of the 3 SPY lots I will sell if they get close to Thursday's close. The third I will sell on the close if it closes above the Differential Pivot (keeping the short signal in place).*

*I will also exit the XIV if I can get a good fill.*

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