

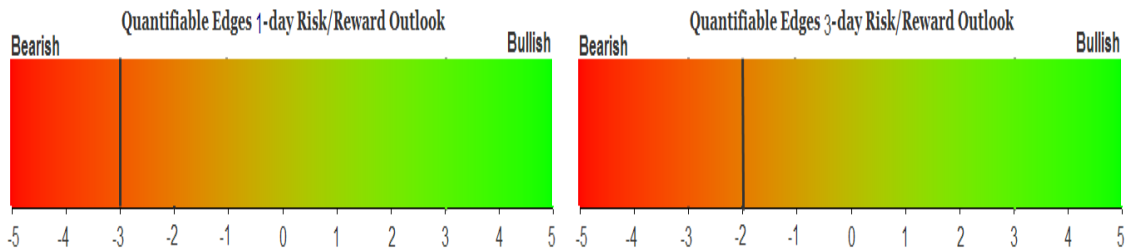
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 18, 2011

Volume 4 Issue 159

Market Overview



Signals Overview

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

Tonight's Research Points

- When the SPY has closed positive but well off its high that has often been followed by upside over the next few days.
- The VXO is now stretched to the point where the SPX will tend to struggle.
- The very low volume on the move up today is also somewhat concerning, especially considering the markets current position.

Short-term Outlook

The Bottom Line

The market is still marginally overbought and expectations are still for lower prices. That could all change tomorrow but for the time being I'm still looking for a pullback.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
August 18, 2011	VXO 15% below 10ma	1-3 days	Bearish	-3.50%
August 18, 2011	SPX up on lowest volume in 10 days	1-2 days	Bearish	-1.80%
August 18, 2011	SPY closes up but 1% below high. C<200	1-2 days	Bullish	2.40%
August 16, 2011	90% Up Vol on 3rd day higher	1-7 days	Bullish	
August 16, 2011	SPY up 3. Vol down 3 days.	1-3 days	Bearish	
Active - Long Term				
August 16, 2011	90% Up Vol on 3rd day higher	1-14 days	Bullish	
August 16, 2011	SPY up 3. Vol down 3 days.	1-20 days	Bearish	
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				
August 16, 2011	VXO drops 15%-20%	1-2 days	Bearish	

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

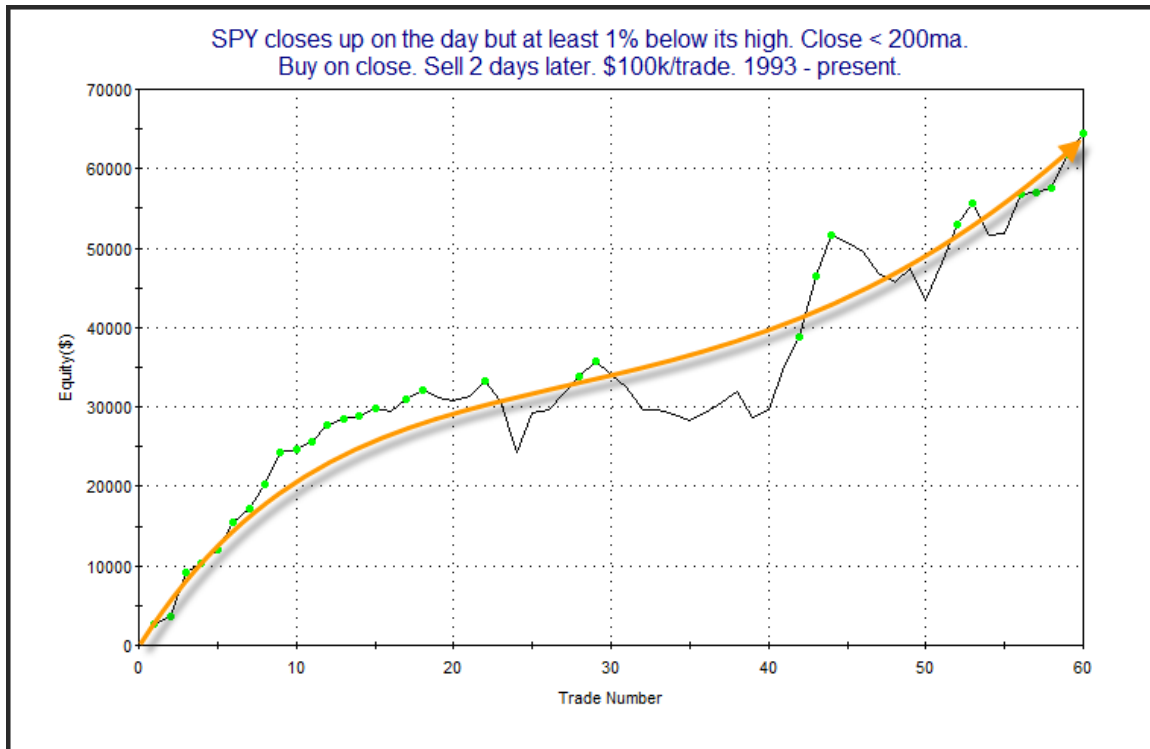
The Evidence

After gapping higher and making a strong push up in the morning the market reversed and traded lower in the afternoon. It rebounded some near the end of the day and the indices finished mixed. The SPX closed up 0.1%, the Nasdaq was down 0.5%, and the Russell 2000 lost 0.1%. Breadth came in positive as both the NYSE Up Issues % and Up Volume % registered 59%. Total NYSE volume came in at the lowest level so far this month.

The fact that the SPY managed to close positively but so far off the highs of the day has typically been a good thing going forward. Perhaps this is because having already probed higher levels there is little resistance until you get back up there. In any case the study below was last seen in the 7/7/10 subscriber letter. I have updated all the stats.

SPY closes up on the day but at least 1% below its high. 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	40,683.36	51	28	22	54.90	3,678.85	-2,832.93	1.30	1.65	797.71
4	41,823.64	54	32	22	59.26	3,316.25	-2,922.57	1.13	1.65	774.51
3	50,640.71	55	33	22	60.00	3,090.90	-2,334.50	1.32	1.99	920.74
2	64,511.73	60	42	18	70.00	2,382.76	-1,975.79	1.21	2.81	1,075.20
1	32,462.22	67	43	24	64.18	1,718.98	-1,727.24	1.00	1.78	484.51

Based on the stats table this pattern appears to suggest a solid upside edge over the next couple of days. Below I have produced an equity curve to see how the edge has played out over time.



The edge seemed to take a break in the middle of the chart (which was between mid-2001 and mid-2008) but it now appears to be back on track. I find the recent action encouraging and have included this study on the Active List.

But indications from today's action weren't all bullish. One potential problem indicator for the bulls is the VXO. It's been dropping fast and closed the day 18.5% below its 10ma. Such rapid down moves often see a quick reversion, and that reversion to the upside in the VXO normally means a move down in the SPX. The study below is from the 9/7/10 subscriber letter. Stats are updated.

VXO crosses down more than 15% below its 10ma on a closing basis. SPX < 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1987 - 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	-35,283.65	28	12	16	42.86	1,911.48	-3,638.84	0.53	0.39	-1,260.13
4	-30,832.76	29	11	18	37.93	1,422.87	-2,582.46	0.55	0.34	-1,063.20
3	-36,292.45	32	11	21	34.38	1,497.30	-2,512.51	0.60	0.31	-1,134.14
2	-25,182.59	32	15	17	46.88	1,311.22	-2,638.29	0.50	0.44	-786.96
1	-1,279.23	32	15	17	46.88	1,033.48	-987.14	1.05	0.92	-39.98

As you can see the odds seem to strongly favor the bear case over the next 1-5 days. The downside edge seems to generally peak around day 3. When I looked at this study in more detail tonight I found that prior to 2002 the edge was somewhat minimal. Since then there has been a strong acceleration in downside consequences. So below I re-ran the results to show only the period from 2002 – present.

VXO crosses down more than 15% below its 10ma on a closing basis. SPX < 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 2002 - 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	-38,948.37	15	4	11	26.67	1,937.37	-4,245.26	0.46	0.17	-2,596.56
4	-29,379.49	16	4	12	25.00	1,340.68	-2,895.18	0.46	0.15	-1,836.22
3	-40,207.82	18	2	16	11.11	1,550.82	-2,706.84	0.57	0.07	-2,233.77
2	-34,100.42	18	5	13	27.78	1,073.87	-3,036.14	0.35	0.14	-1,894.47
1	-5,118.02	18	7	11	38.89	1,109.26	-1,171.17	0.95	0.60	-284.33

As you can see losers have swamped winners over the last 10 years, and they've also been stronger than the winners. This skews risk/reward strongly in favor of the bears. The table below shows all 18 instances and assumes a 3-day exit strategy.

VXO crosses down more than 15% below its 10ma on a closing basis. SPX < 200ma.
Buy SPX on close. Sell 3 days later. \$100k/trade. 2002 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
07/29/02	Buy	\$898.96	(1.59%)	\$1,407.48
08/01/02	Sell	\$884.66		(\$1,829.28)
08/15/02	Buy	\$930.25	0.77%	\$2,238.44
08/20/02	Sell	\$937.43		(\$1,502.28)
11/21/02	Buy	\$933.76	(2.19%)	\$375.57
11/26/02	Sell	\$913.31		(\$2,316.55)
06/15/06	Buy	\$1,256.16	(1.28%)	\$8.69
06/20/06	Sell	\$1,240.12		(\$1,500.21)
06/21/06	Buy	\$1,252.20	(0.13%)	\$73.47
06/26/06	Sell	\$1,250.56		(\$850.83)
12/21/07	Buy	\$1,484.50	(0.55%)	\$961.45
12/27/07	Sell	\$1,476.27		(\$578.88)
05/19/08	Buy	\$1,426.63	(2.26%)	\$0.00
05/22/08	Sell	\$1,394.35		(\$2,647.40)
07/22/08	Buy	\$1,277.01	(1.51%)	\$1,104.48
07/25/08	Sell	\$1,257.77		(\$1,991.34)
10/20/08	Buy	\$985.40	(7.84%)	\$4.04
10/23/08	Sell	\$908.11		(\$12,822.96)
11/03/08	Buy	\$966.30	(6.36%)	\$4,244.63
11/06/08	Sell	\$904.88		(\$6,855.68)
11/26/08	Buy	\$887.68	(4.38%)	\$959.84
12/02/08	Sell	\$848.81		(\$8,062.88)
12/19/08	Buy	\$887.88	(2.22%)	\$0.00
12/24/08	Sell	\$868.15		(\$3,448.48)
01/28/09	Buy	\$874.09	(5.57%)	\$0.00
02/02/09	Sell	\$825.43		(\$6,979.08)
05/27/10	Buy	\$1,103.06	(0.42%)	\$0.00
06/02/10	Sell	\$1,098.38		(\$2,985.30)
06/02/10	Buy	\$1,098.38	(4.36%)	\$663.39
06/07/10	Sell	\$1,050.47		(\$4,415.32)
07/08/10	Buy	\$1,070.25	2.34%	\$2,716.53
07/13/10	Sell	\$1,095.34		(\$199.95)
07/13/10	Buy	\$1,095.34	(2.78%)	\$340.34
07/16/10	Sell	\$1,064.88		(\$2,913.82)
09/03/10	Buy	\$1,104.51	(0.03%)	\$518.40
09/09/10	Sell	\$1,104.18		(\$1,202.40)

I see nothing here that would cause me concern about the validity of the downside edge. One last thing I decided to do was isolate moves where the downside VXO stretch finished between 15%-20% from the 10ma. This eliminated any exceptionally strong stretches, of which there were only 4 during this time period. The results of this test can be seen below.

VXO crosses down more than 15% below its 10ma (but not as much as 20%) on a closing basis. SPX < 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 2002 - 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	-14,052.37	11	4	7	36.36	1,937.37	-3,114.55	0.62	0.36	-1,277.49
4	-7,679.80	12	4	8	33.33	1,340.68	-1,630.31	0.82	0.41	-639.98
3	-27,053.92	14	2	12	14.29	1,550.82	-2,512.96	0.62	0.10	-1,932.42
2	-22,134.34	14	4	10	28.57	991.03	-2,609.84	0.38	0.15	-1,581.02
1	-1,949.01	14	5	9	35.71	1,388.75	-988.09	1.41	0.78	-139.21

So this last filter eliminated 4 winners, but it still didn't raise any concerns about the current configuration. I've decided to include this study on the Active List as well.

Lastly, there was one Quantifinder study that suggested the very low volume on Wednesday could present a problem over the next few days. The study below was last seen in the 2/2/10 subscriber letter. I have also updated this one.

SPX rises today on the lightest volume in 10 days. Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-54,349.34	159	76	83	47.80	1,774.11	-2,279.30	0.78	0.71	-341.82
4	-41,445.37	164	78	86	47.56	1,525.08	-1,865.13	0.82	0.74	-252.72
3	-43,159.77	171	85	85	49.71	1,251.83	-1,759.59	0.71	0.71	-252.40
2	-26,256.39	178	87	91	48.88	1,036.84	-1,279.80	0.81	0.77	-147.51
1	-5,901.16	203	105	98	51.72	769.23	-884.39	0.87	0.93	-29.07

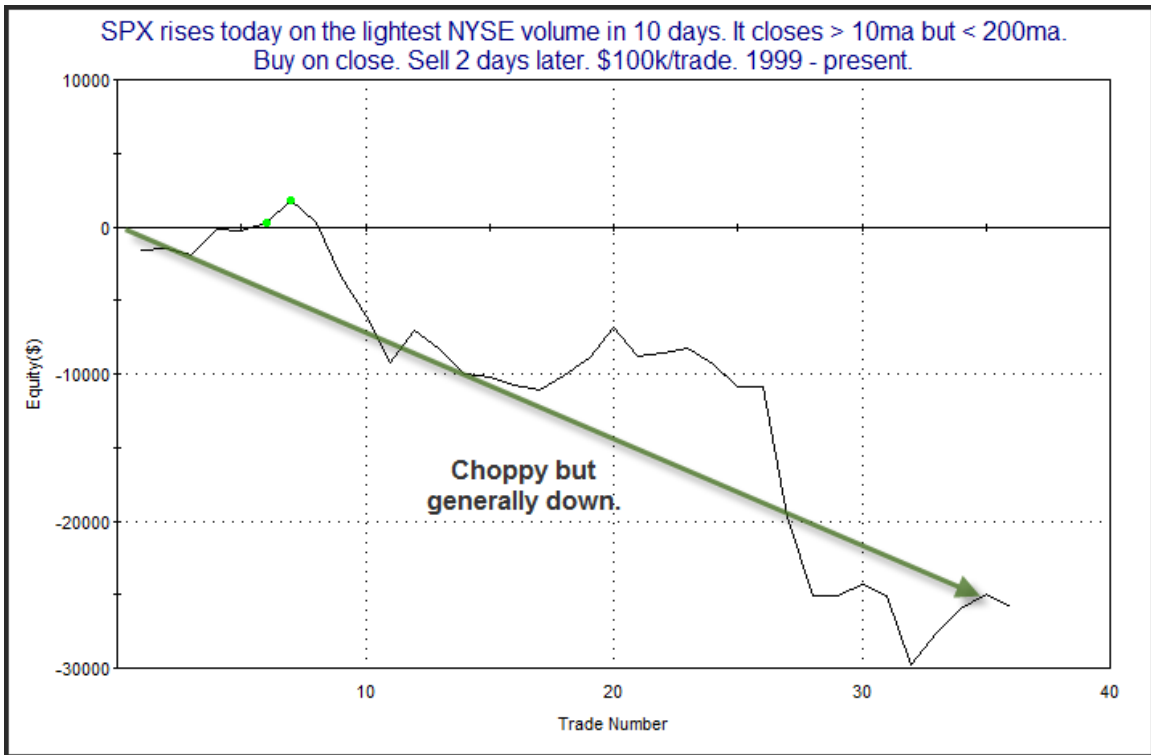
Based on this it appears very-light volume up days will often reverse over the next few sessions. The sample size is very large and the study does not take into account current market conditions. Therefore, I decided to add a few simple filters that considered where the market was trading in relation to short and long-term moving averages. The results of this new test are below.

SPX rises today on the lightest NYSE volume in 10 days. It closes > 10ma but < 200ma.
Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-38,512.34	34	12	22	35.29	2,186.34	-2,943.11	0.74	0.41	-1,132.72
4	-29,952.69	34	15	19	44.12	2,068.02	-3,209.10	0.64	0.51	-880.96
3	-21,590.33	35	14	21	40.00	1,833.87	-2,250.69	0.81	0.54	-616.87
2	-25,838.33	36	15	21	41.67	1,109.40	-2,022.83	0.55	0.39	-717.73
1	-6,029.91	41	19	22	46.34	1,189.65	-1,301.51	0.91	0.79	-147.07

92% of instances closed below the entry price at some point in the next week.

It appears that under circumstances similar to present market conditions the downside edge is elevated beyond what we saw with just a low-volume up day. The equity curve below assumes a 2-day holding period.



It isn't the smoothest equity curve I've ever produced but it still seems worthy of inclusion on the Active List. So the Aggregator will be considering 2 new bearish studies (based on sentiment and volume) and one new bullish study (based on price action).

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



With tonight's mix of studies factored in the green Aggregator line remained moderately 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 stayed a little 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 modestly overbought versus recent expectations. Historically this combination has suggested a downside edge. Bearish configurations can be seen on the Aggregator chart whenever both lines are below 0. Due to this the Aggregator System remained short at the close.

Based on the current studies the green Aggregator line is set up to finish slightly negative again on Thursday. Of course this could change if new bullish evidence emerges. Meanwhile, the Differential Pivot is will be 1,197.59. This is about 0.3% *above* Wednesday's close. In other words, if the SPX trades flat tomorrow the Differential Line will rise from negative to positive. It will take a move higher of at least 0.3% to prevent this from happening.

When a flat close will flip the Differential Line I sometimes refer to that as an “inverted pivot”. It requires some extra consideration when you are in a trade. I failed to get any exposure on this particular short signal, but if I had some I would be looking to take profits tomorrow. Knowing that the market would need to rise 0.3% in order to keep my Aggregator short trigger active I would consider trailing a stop lower on my short position if the market sold off intraday. This would allow me to lock in profits in case the market reverses. And if it reverses so much that it closes above the Differential Pivot then I would have the option of re-entering at a better price near the close. Of course since the subscriber letter doesn’t hold a short position currently that is moot except for those of you who took a more aggressive approach and may have entered short ahead of me.

The systems triggered spreadsheet has been a barren wasteland the past 2-3 days. It appears most stocks are taking some time to set up in regular patterns again after the massive selloff over the past few weeks. With nothing looking very appealing to me at the moment I am not looking to put additional capital to work.

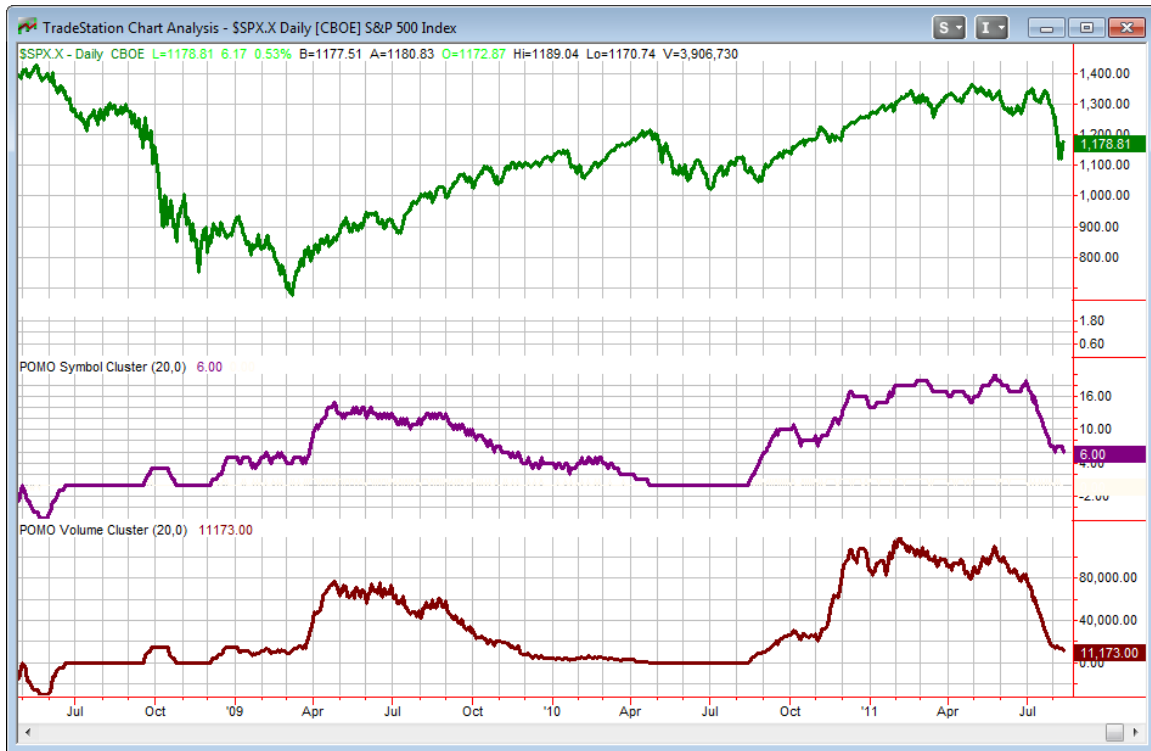
Intermediate-term Outlook (2 weeks – 2 months)– updated 8/15 – neutral

The trend is obviously down at this point. Some readings were reached this past week that were so extreme that they suggested a long-term bottom could be in place. Still, the market has yet to provide any confirmation of that beyond a few up days. To me it appears dangerous to bet big on either side at the moment.

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 dipped a little more this past week. In the past when POMO stimulus ended – it ended. This time the end of QE2 marked a period of substantially less stimulus, rather than none. This made it tricky in determining whether the end of QE2 would completely pull the rug out from under the market. At this point it appears it has. The new operations schedule was released by the Fed on Wednesday and it is calling for about the same level of stimulus as we saw this past month. While there IS still liquidity pumping going on, it appears the reduced level is akin to providing a heroin addict a couple of aspirin to try and get high. The link below shows the new schedule.

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

If you click it you will notice there is a tab on the page where you can see “All Schedules” rather than just the “Current Schedule”. Clicking that tab you will see that the monthly estimate of POMO activity for last month and this month is about \$14 billion. During QE2 the level was normally around \$100 billion/month. So is the market capable of mounting a serious new bull move with the modest amount of stimulus currently being provided? So far I have seen no evidence of that.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

ALL – 1/3 @ \$24.57

Catapult for ETF's Trades

None.

Broad Market Large Cap CBI – 1 (ALL)

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.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
ALL(1/3)	8/9/2011	\$24.57	\$25.48	3.70%		Catapult

Should ALL come close to an exit trigger tomorrow I will send out an intraday email.

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