QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 30, 2011 Volume 4 Issue 167

Market Overview

Signals Overview

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

Tonight's Research Points

- If you don't using the hurricane as an excuse for Monday's low volume, then the low volume appears to be quite bearish.
- 2 strong up days and a short-term high during a long-term downtrend have historically provided a downside edge.
- The 1-day gap up and strong move higher to a short-term high in a downtrend also suggests a downside edge.

Short-term Outlook

The Bottom Line

Monday was extremely strong but the market appears to be reaching a point where it has typically pulled back in the past. I am short and looking to get shorter.

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
August 30, 2011	1% Up 2 days. 10 high and < 200ma	1-3 days	Bearish	-3.20%
August 29, 2011	Gap dn and reverse higher	1-2 days	Bearish	-3.10%
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 5, 2011	QE2 Over	int term	Bearish	
March 22, 2011	3 Days Up Issues % > 70%	8 months	Bullish	19.00%
Dropped Tonight				
August 26, 2011	***1% drop. Decliners 2x advancers.***	***1-3 days***	***Bullish***	
August 29, 2011	***1% up, 1% down, 1% up***	***1 day***	***Bullish***	

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

The Evidence

The market gapped up big and never looked back. That may have been partially due to relief that Irene damage was not as bad as feared. I am still without power but have made out much better than some others in my neighborhood who had trees come crashing down on their houses or cars. According to the latest rumor I will likely have power back on Wednesday. Between now and then I will try and make the disruption to my life and routine transparent to Quantifiable Edges subscribers. The strong rally Monday left the SPX 2.8% higher while the Nasdaq gained 3.3% and the Russell 2000 rose a whopping 4.8%. Breadth was incredibly strong as the NYSE Up Issues % came in at 90% and the Up Volume % was 97%. Volume lagged greatly though as the NYSE volume came in at the lowest level in over a month.

Volume and breadth being so extreme triggered a large number of Quantifinder studies at the close on Monday. The breadth studies I looked at were mixed and none of them seemed to suggest a consistent edge under similar market conditions. The volume studies were decidedly bearish. But when approximately 4 million homes along the east coast of the US are without power, you would expect volume to come in substantially lighter. The extraordinary circumstances that accompanied the low volume have led me to discount it altogether. Of course an argument could be made that institutions used the low volume to push prices higher in the hopes of selling at those higher prices in the next few days as more and more traders get back to work and online.

For those subscribers that may disagree with me and don't care to discount the importance of volume I have included one volume-related study below.

SPX rises at least 1% on lower NYSE volume for the 2nd day in a row. Close < 200ma. 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
5	-16,322.78	13	4	9	30.77	2,079.38	-2,737.81	0.76	0.34	-1,255.60
4	-14,063.67	13	3	10	23.08	2,292.25	-2,094.04	1.09	0.33	-1,081.82
3	-12,482.21	13	2	11	15.38	2,692.03	-1,624.21	1.66	0.30	-960.17
2	-13,170.43	13	7	6	53.85	846.05	-3,182.13	0.27	0.31	-1,013.11
1	-4,278.73	13	5	8	38.46	991.26	-1,154.38	0.86	0.54	-329.13

All 13 instances posted a close below the entry price at some point in the next 3 days.

The average trade is fairly powerful but what struck me most about these results is the consistency as shown in the note at the bottom of the table. Below is a list of all 13 instances assuming a 3-day holding period.

SPX rises at least 1% on lower NYSE volume for the 2nd day in a row. Close < 200ma. Buy on close. Sell X days later. $100k/trade. 1970 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
12/10/73	Buy	$97.95	(5.69%)	$0.00
12/13/73	Sell	$92.38		($5,681.40)
10/14/74	Buy	$72.74	(2.16%)	$0.00
10/17/74	Sell	$71.17		($3,311.34)
12/26/78	Buy	$97.52	(1.45%)	$0.00
12/29/78	Sell	$96.11		($2,101.25)
08/27/90	Buy	$321.43	(0.85%)	$1,368.40
08/30/90	Sell	$318.70		($1,122.71)
09/14/98	Buy	$1,029.70	(1.05%)	$1,585.95
09/17/98	Sell	$1,018.85		($1,324.05)
10/12/98	Buy	$997.70	4.99%	$5,545.00
10/15/98	Sell	$1,047.50		($1,015.00)
03/26/01	Buy	$1,152.72	(0.41%)	$2,634.18
03/29/01	Sell	$1,147.95		($1,415.56)
02/11/02	Buy	$1,111.94	0.41%	$1,137.42
02/14/02	Sell	$1,116.48		($797.44)
07/29/02	Buy	$898.96	(1.59%)	$1,407.48
08/01/02	Sell	$884.66		($1,829.28)
09/09/02	Buy	$902.96	(1.78%)	$2,312.20
09/12/02	Sell	$886.91		($1,986.60)
09/26/02	Buy	$854.95	(0.82%)	$0.00
10/01/02	Sell	$847.91		($6,344.04)
02/18/03	Buy	$851.17	(0.35%)	$129.87
02/21/03	Sell	$848.17		($2,303.73)
04/16/09	Buy	$865.30	(1.76%)	$1,187.95
04/21/09	Sell	$850.08		($4,424.05)

If not for the hurricane I certainly would be including this study among those on the Active List.

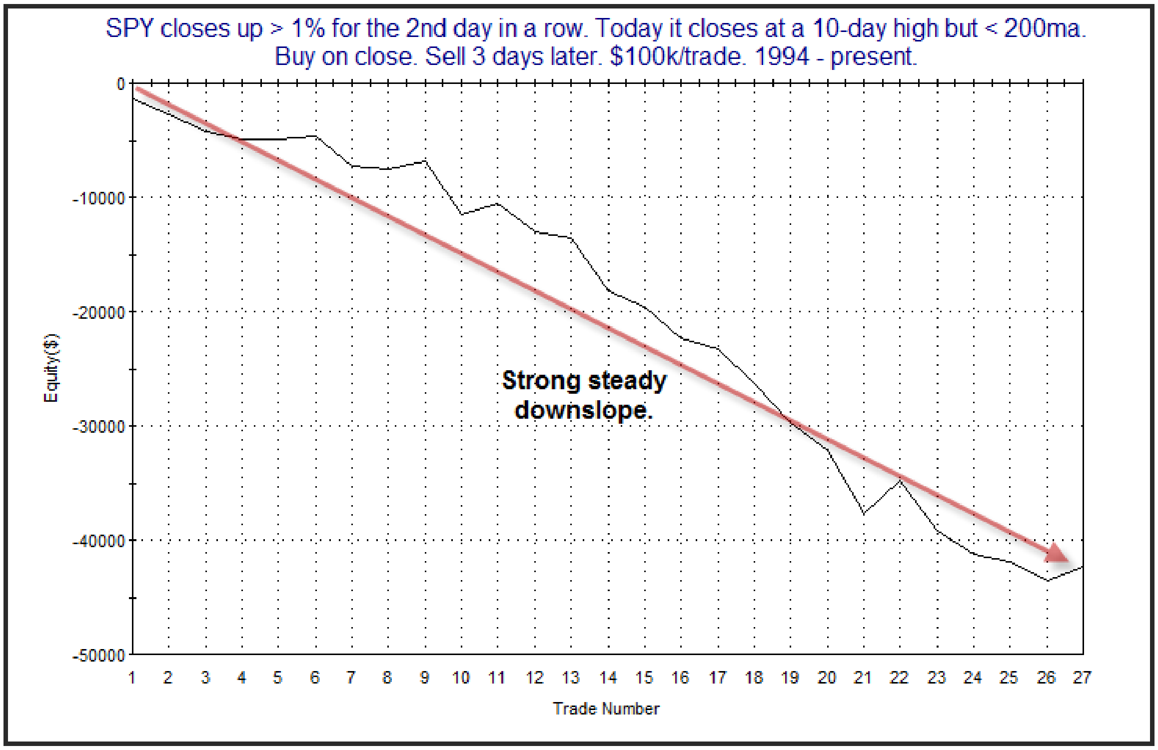
But even without breadth or volume taken into consideration, price action seemed to provide some hints of a downside edge. The study below also required two 1% up days, but it did not consider volume as part of the equation. It did require a 10-day closing high.

SPY closes up > 1% for the 2nd day in a row. Today it closes at a 10-day high but < 200ma.
Buy on close. Sell X days later. $100k/trade. 1994 - 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	-29,883.99	26	9	17	34.62	1,702.66	-2,659.29	0.64	0.34	-1,149.38
4	-44,919.58	27	5	22	18.52	1,281.81	-2,333.12	0.55	0.12	-1,663.69
3	-42,380.16	27	5	22	18.52	1,185.41	-2,195.78	0.54	0.12	-1,569.64
2	-35,419.47	27	8	19	29.63	937.92	-2,259.10	0.42	0.17	-1,311.83
1	-20,022.62	28	10	18	35.71	675.79	-1,487.81	0.45	0.25	-715.09

27 of 28 instances closed below the entry price at some point in the next 3 days. The lone holdout was the most recent instance on 5/20/09.

Implications appear clearly bearish over the 1st 1-4 days. And the consistency here is also quite remarkable with all but the most recent instance making a close below the entry price at some point within the next 3 days. I've included an equity curve below that shows how the edge has played out over time.



The strong steady downslope makes the setup even more appealing and confirms the downside edge suggested by the stats table.

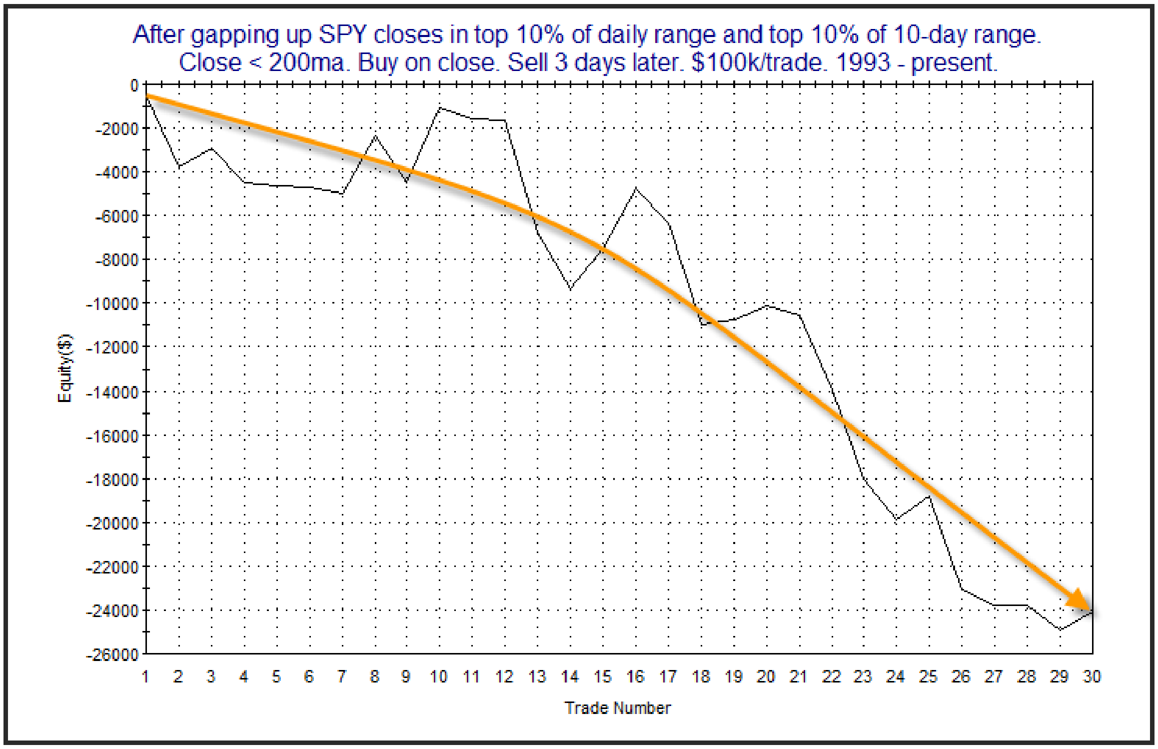
Even discounting the fact that Monday was the 2nd strong day in a row, if you just looked at the strength of Monday's session and considered the fact that it was making a new high during a downtrend, numbers came out bearish. Below is one way in which I looked at it.

After gapping up SPY closes in top 10% of daily range and top 10% of 10-day range.
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	-13,929.26	27	15	11	55.56	1,251.78	-2,973.27	0.42	0.57	-515.90
4	-12,774.49	29	14	15	48.28	1,396.94	-2,155.44	0.65	0.60	-440.50
3	-24,063.85	30	9	21	30.00	1,585.71	-1,825.49	0.87	0.37	-802.13
2	-22,506.86	32	12	20	37.50	914.84	-1,674.25	0.55	0.33	-703.34
1	-10,374.95	33	14	19	42.42	737.67	-1,089.60	0.68	0.50	-314.39

28 of 33 instances (85%) closed below the entry price at some point in the next week.

Here again we see an apparent downside edge. Below is an equity curve.



Not as smooth or as powerful as the previous test, but still we have an arrow clearly pointing down.

I have updated the Aggregator chart below.

The green Aggregator line dropped sharply and is now strongly negative. Levels below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the Differential Line is also below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are decidedly negative and the SPX is strongly overbought versus recent expectations. Historically this combination has suggested a downside edge. It can be seen on the Aggregator chart whenever both lines are below 0. Due to this the Aggregator System remained short at the close.

At this point the green Aggregator line is set to close negative on Tuesday. But with so few studies on the board this could change if bullish evidence emerges. Meanwhile, the Differential Pivot will be 1,156.78. This is a massive 4.4% below Monday's close. This means it would take a drop of at least this much in order to move the SPX in "oversold" territory. Since that is extremely unlikely, it would probably take a multi-day move lower at this point to flip the Differential line.

We have had a couple of rally attempts in the last couple of weeks and neither turned into a runaway up move. I was quite cautious about shorting those and only did so in ¼ size.

The most likely time for a runaway up move to occur is coming off a v-bottom. There is also some danger of it right after a Follow Through Day. At this point the market has endured quite a bit of chop and we are not emerging from an extremely oversold condition. Therefore it is somewhat less likely that this move turns into a runaway up move. The one caveat is that it appears to be breaking out of its recent range so there is a chance that the range breakout could spark some additional upside momentum.

I did run some tests along these lines. For instance I looked at times the SPX made a 10-day high for the first time in over 20 days but closed below its 200ma. Over the next 1-10 days there was no consistency nor decided edge. Results were basically a coin flip. With this in mind I am slightly more inclined to take a position larger than I had been. I will therefore be looking to continue to scale in and up my short position to ½ size on Tuesday.

Intermediate-term Outlook (2 weeks – 2 months)– updated 8/29 – neutral

The SPX rose 4 out of 5 days this past week and posted a gain of close to 5%. It also posted an IBD Follow Through Day (FTD) on 8/23. FTD's are intermediate-term timing tools that are supposed to signal the beginning of a new uptrend after the market has made an extended move lower. Overall, their track record isn't great, but sometimes they can provide nice hints when combined with other factors.

One plus that Tuesday's FTD had going for it was that it came on very strong breadth. The NYSE Up Issues % came in higher than 98% of all other days over the past year. In the 6/22/11 subscriber letter I showed how strong breadth on a FTD appeared to have a positive influence on its chances of success. Below is an excerpt from that letter. (Charts and stats are not updated.)

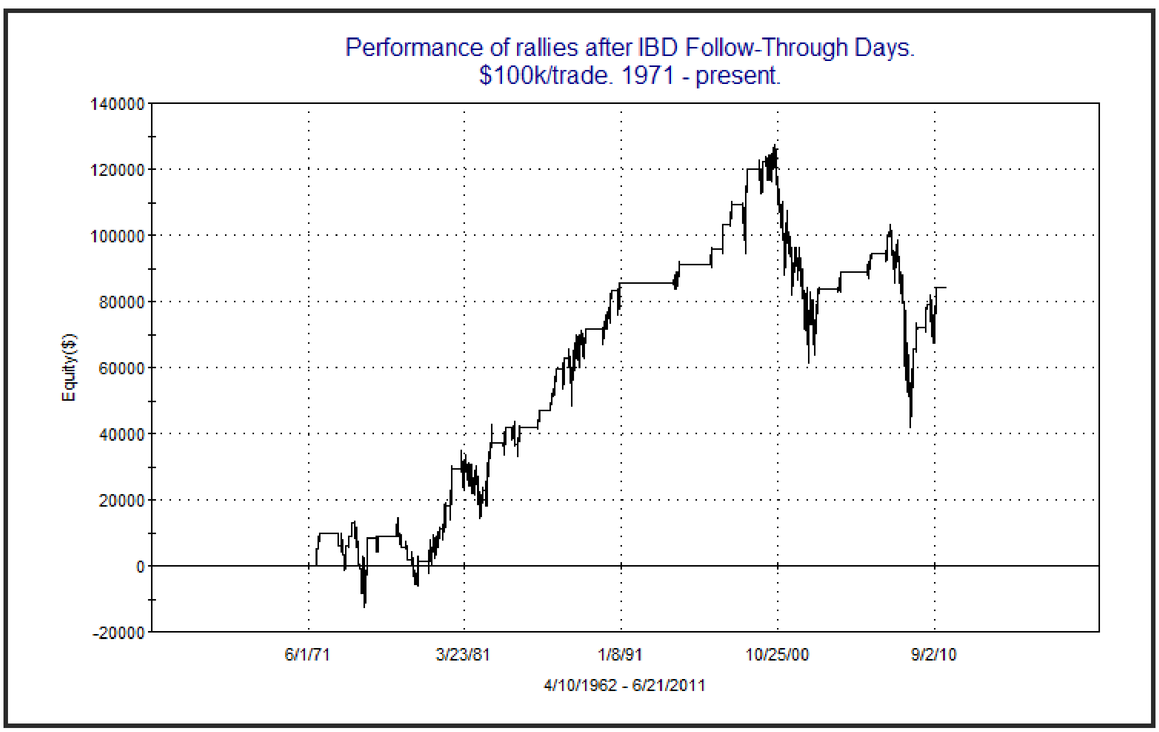
I ran several tests that examined how strong breadth on a FTD might affect its chances of success.

Before I show those tests I thought I would point you to the rules of FTDs and some of the assumptions I used in testing them. I basically followed all of the rules as IBD laid them out. Two rules that IBD has never clearly defined are what entails "success" or "failure". I defined "failure" to be a close below the intraday low of the bottom prior to the FTD. I defined "success" as a move either 1) twice as large as the distance from the low of the potential bottom to the close of the FTD, or 2) a new 52-week high. More detailed explanations of the rules may be found using the link below:

http://quantifiableedges.blogspot.com/2008/01/ibd-follow-through-days-pt-1-are-they.html

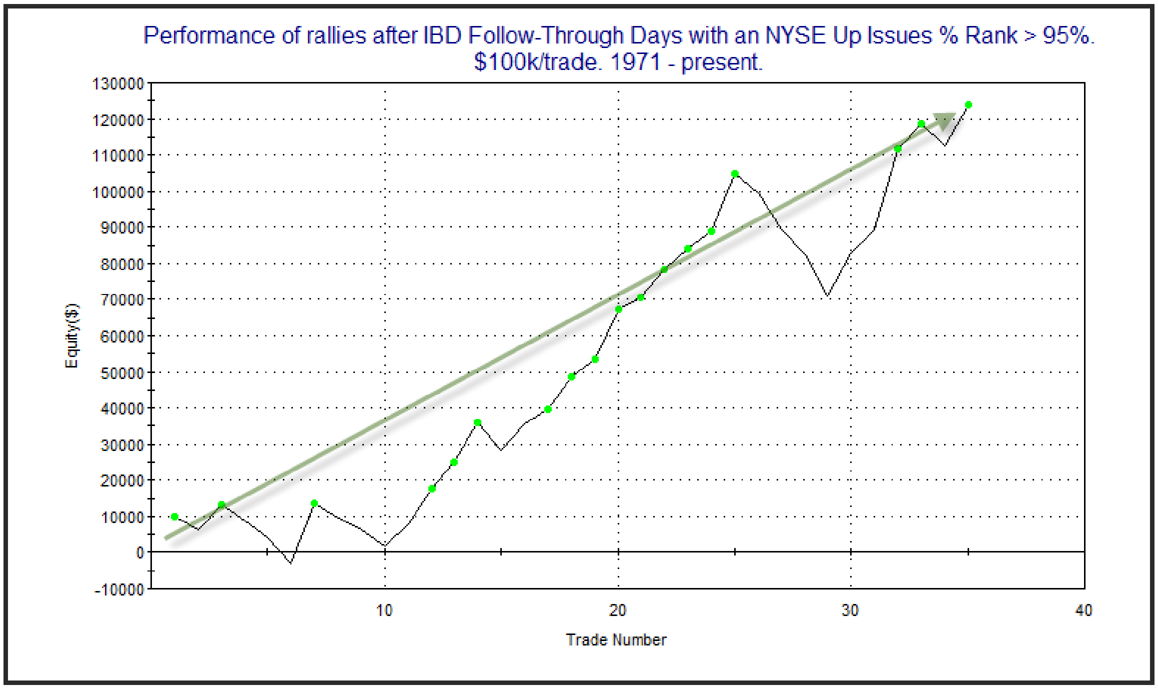
Whether a FTD successfully predicts a rally is not an indication of whether someone trading individual stocks using IBD's techniques would make money or not. What it does measure is the usefulness of FTDs as a market timing indicator. I believe this is a fair way to test them since IBD claims they are extremely valuable in identifying when downtrends are ending and new uptrends are emerging.

Using the original parameters as described in the post I linked to above there have been 74 FTDs since 1971. Thirty-eight of them (53%) led to successful rallies. This is an interesting stat but it doesn't tell the whole story. Below is an equity curve that I don't believe I've ever shown before. It shows how someone trading the SPX would have performed using FTDs as a buy trigger and then exiting the trade when the rally either "succeeded" or "failed".



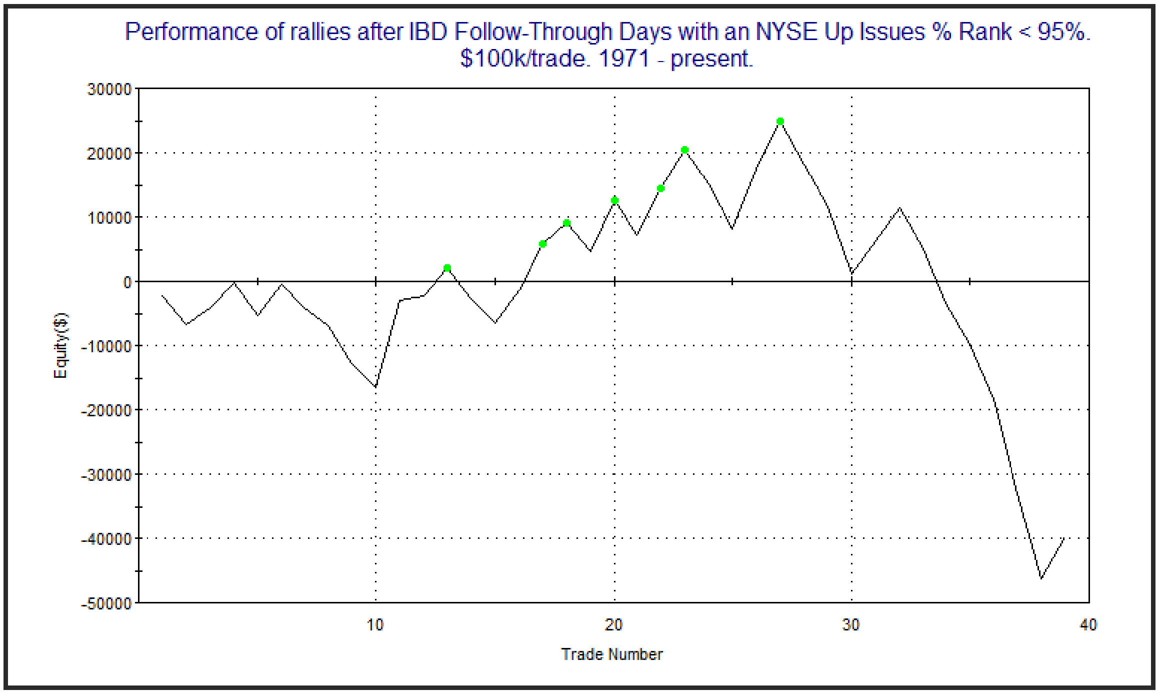
As you can see FTDs worked very well during the long bull market of the 80s and 90s. But in the 70s, and again since 2000, FTDs have struggled as a market timing tool.

As I mentioned earlier breadth was also very strong on Tuesday. When compared to the past year the Up Issues % on the NYSE was higher than 98.4% of all days. I used the Up Issues % Rank to normalize breadth over the long test period, and broke down FTD results based on those times the % Rank was > 95% and those times it was < 95%. First let's look at times like now where the NYSE Up Issues % Rank was > 95%.



In this case 22 of 35 FTDs (63%) have been followed by successful rallies and gains have been fairly steady over the years.

Now let's look at FTDs that came without very strong relative breadth.



Results here were never strong and they've turned quite negative in recent years. Rather than a 63% success rate as happened with strong breadth, only 44% of instances here succeeded.

In addition to the strong breadth there were also some other factors that I discussed a few days ago in the 8/24/11 subscriber letter that may also affect this rallies chances of success. Below is an excerpt from that letter.

Tuesday was day 11 of the attempted rally off the 8/8/11 closing low. Investors' Business Daily teaches that FTDs after day 10 are less reliable. Evidence suggests this is not the case. This is the first FTD that has occurred after day 10 since 3/15/2000. Since 1971 there have been 8 FTDs that occurred after day 10. Seven of the eight have been followed by successful intermediate-term rallies. The list below is taken from the 2/29/08 blog post that examined such occurrences.

Date	Day #	Succesful?
October 2, 1975	12	Yes
December 1, 1978	24	Yes
July 9, 1984	14	No
October 16, 1985	14	Yes
April 21, 1994	13	Yes
August 1, 1996	12	Yes
November 13, 1997	13	Yes
March 15, 2000	13	Yes

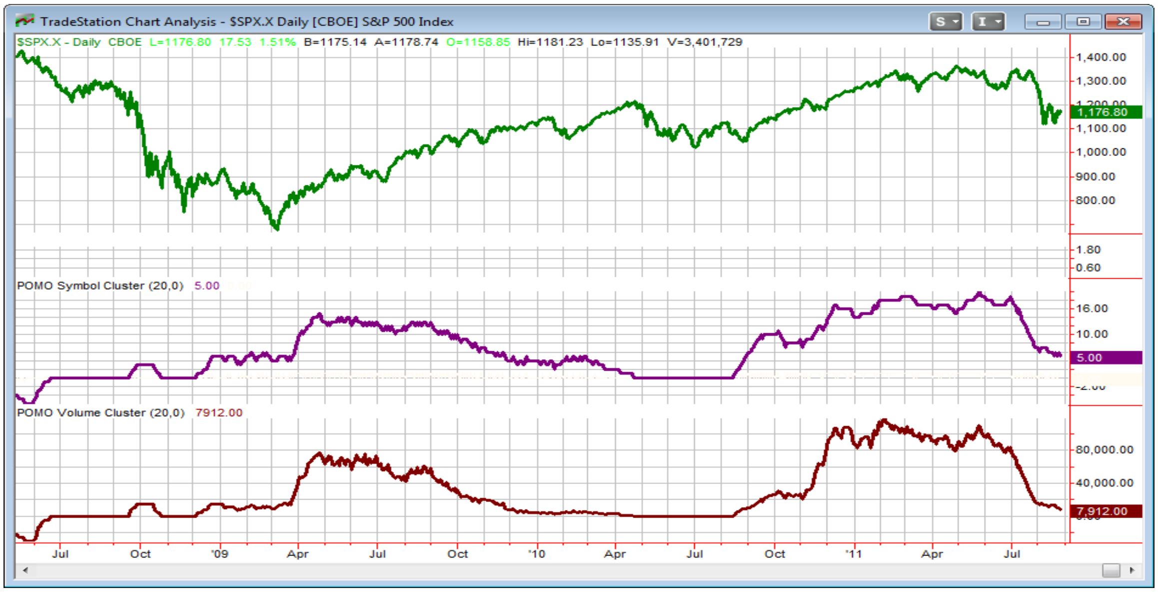
So the fact that the FTD is coming later than usual appears to be a good thing. But a warning flag goes up when you consider the size of the market drop prior to the FTD. In the 2/15/2008 blog post I examined success and failure of rallies following FTDs that came after large vs. small market declines. I showed that a FTD after a 5% decline was much more likely to succeed than a FTD after a 12%+ correction. Since then the stats have even worsened. Since 1971 there have been 44 FTDs following market declines of at least 12%. Only 18 of them (41%) have led to successful rallies.

Bottom line with the FTD at this point is that it came with some positive aspects, but after such a large decline the chances of success aren't quite as good as they would normally be. One last thing to watch in regards to the FTD is the action in the week following it. I have shown in the past that the week following the FTD has correctly predicted its success or failure about 2/3 of the time. In other words, if the SPX closed higher than the close of the FTD on the 5th day following it then the rally was successful about 2/3 of the time. If the SPX closed lower 5 days after the FTD then the rally failed about 2/3 of the time. This suggests Monday's and Tuesday's action could be important.

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 fell a bit further this week. The Fed's published schedule is calling for about $14billion in purchases each month. Over the last 20 trading days there have only been $8 billion in purchases. So at this point stimulus appears to be coming in at lower levels than advertised. Bernanke's speech on Friday was highly anticipated and some wondered whether he would announce a QE3-type plan. Instead he gave the same line he has been using for a long time saying that the Fed has many tools at their disposal and they will use them if necessary.

Regardless of what I or anyone else believes the Fed and the rest of the government should do to promote a healthy long-term economy, the market has shown a strong propensity to rally when there has been stimulus and to struggle when there hasn't been. Eventually the market will need to put together a rally on its own. And it's easier to start a rally when the market has undergone a sharp correction. We've had a sharp correction, but at this point there is no telling whether it has been deep enough.

Overall, intermediate-term indicators remain mixed. POMO remains a negative along with a volume study from a couple of weeks ago. On the other hand last Tuesday's FTD does provide some hope, and there are also some older breadth thrust signals still on the intermediate-term Active List. I'm not terribly excited about either direction right now and will continue to take quick stabs at both long and short positions as opportunities avail themselves.

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.

.

SPY – short ¼ index position @ $121.36 limit. Based on short-term outlook above, I will look to add a 2nd piece to my short position.

Current Open Trade Ideas

Symbol	**Entry Date**	**Entry Price**	**Current Price**	**% Gain/Loss**	**Stop**	**Notes**
SPY(1/4)(s)	8/30/2011	$119.56	$121.36	-1.51%		bought on open

HPQ, the last open Catapult trigger, hit its exit target at the close. Unfortunately we never received a fill on that one. This officially closes out the most recent Catapult cluster. The net result for the cluster was again positive. These trades have done quite well during selloffs over the years. The last losing cluster was about 2½ years ago. I'd encourage traders who haven't explored the information on the website with regards to the Catapult & CBI to do so when they have a chance. The webinar on the videos page is a good place to start.