

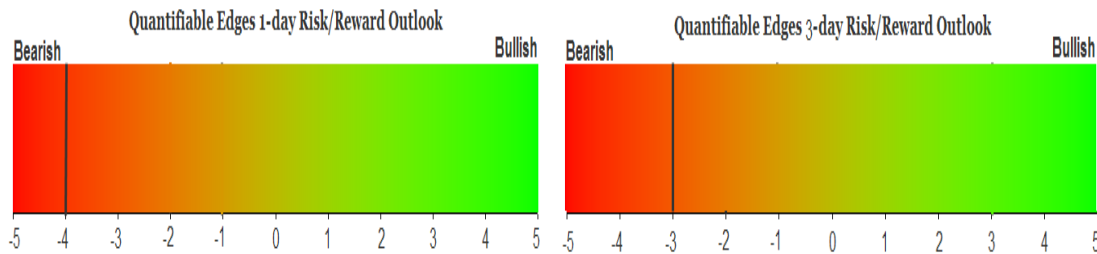
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 1, 2011

Volume 4 Issue 169

Market Overview



Signals Overview

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

Tonight's Research Points

- 3 10-day closing highs during a long-term downtrend has historically led to a pullback.
- SPY closing up but 1% below its high suggests downside.
- The 1st of the month is bullish – except during times like the present where the market has risen 3+ days in a row.
- September looks to be volatile.

Short-term Outlook

The Bottom Line

Indications appear mixed tonight but the net expectation remains bearish over the next few days. I have a sizable short position. I am not looking to add any more to it on Thursday.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
September 1, 2011	3 10-day highs under the 200ma	1-3 days	Bearish	
September 1, 2011	SPY up but 1% below high	1-2 days	Bullish	
August 31, 2011	Gap dn and reverse higher	1-2 days	Bearish	-3.00%
August 31, 2011	SPX up < 0.25%. VIX up midweek.	1-2 days	Bearish	-3.40%
August 31, 2011	3 up days < 200ma. No 50-low.	1-2 days	Bearish	-2.20%
August 30, 2011	1% Up 2 days. 10 high and < 200ma	1-3 days	Bearish	-3.20%
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%

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

The Evidence

After starting the day off strong the market had a difficult time picking a direction. In the end a strong last half-hour left the indices mixed. The SPX gained 0.5% and the Nasdaq was up 0.1%, but the Russell 2000 dropped 0.2%. Breadth was squarely positive on the NYSE as the Up Issues % came in at 65% and the Up Volume % was 72%. Total NYSE volume rose from Tuesday's level.

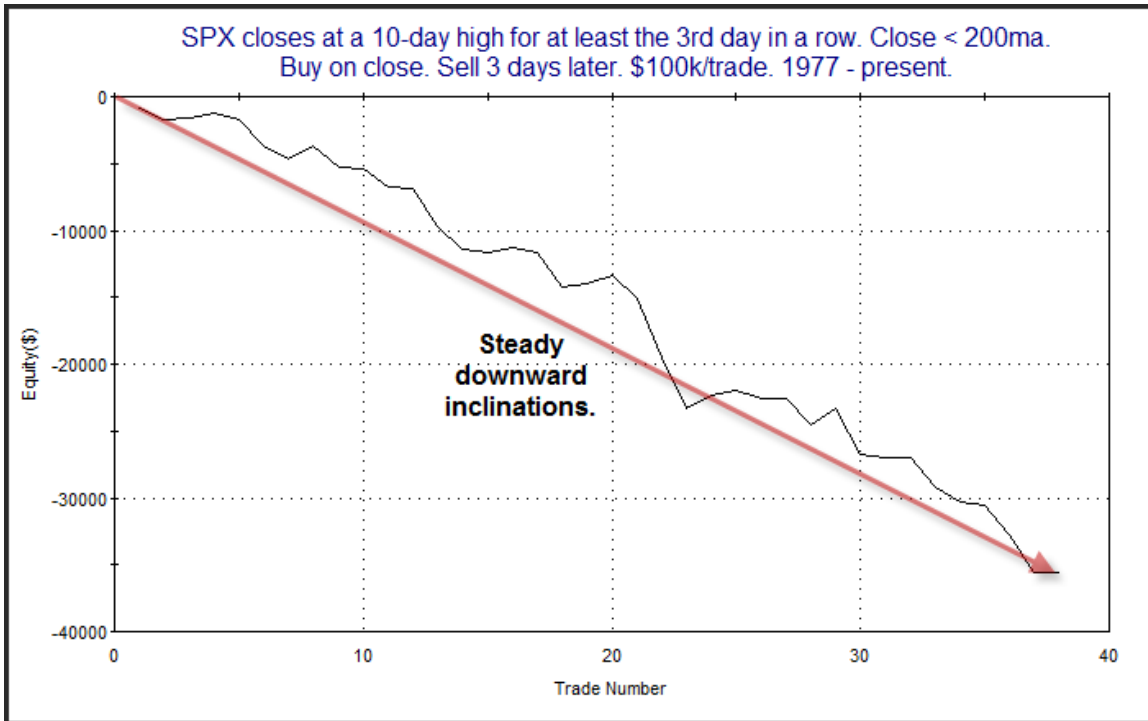
The Quantifinder continues to identify studies suggesting the market has become overbought. Runs of 3+ days higher and the SPX hitting 10-day highs during a long term downtrend are two common themes. But now the SPX has reached a point where it has actually closed at a 10-day high for 3 days in a row. Overbought has become more over bought and more overbought. On occasion such persistent strength will suggest further upside rather than a pullback. So I decided to see how the SPX has performed after other times in which it has posted 3 consecutive 10-day highs while under the 200ma.

SPX closes at a 10-day high for at least the 3rd day in a row. Close < 200ma.
Buy on close. Sell X days later. \$100k/trade. 1977 - 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	-15,594.88	36	16	20	44.44	1,194.86	-1,735.64	0.69	0.55	-433.19
4	-28,394.21	38	16	22	42.11	791.63	-1,866.38	0.42	0.31	-747.22
3	-35,559.34	38	11	27	28.95	506.69	-1,523.44	0.33	0.14	-935.77
2	-16,260.78	38	17	21	44.74	668.96	-1,315.86	0.51	0.41	-427.92
1	-7,445.77	38	15	23	39.47	661.91	-755.41	0.88	0.57	-195.94

35 of 38 instances (92%) closed below the entry price at some point in the next 4 days.

Based on the statistics it appears that this kind of overbought condition almost always leads to a pullback. Below is an equity curve that assumes a 3-day holding period.



This is a very smooth looking downslope, which serves as further evidence of the downside edge. Since the study covers such a long period of time I also ran a curve so you could more easily see the timing of the trades.



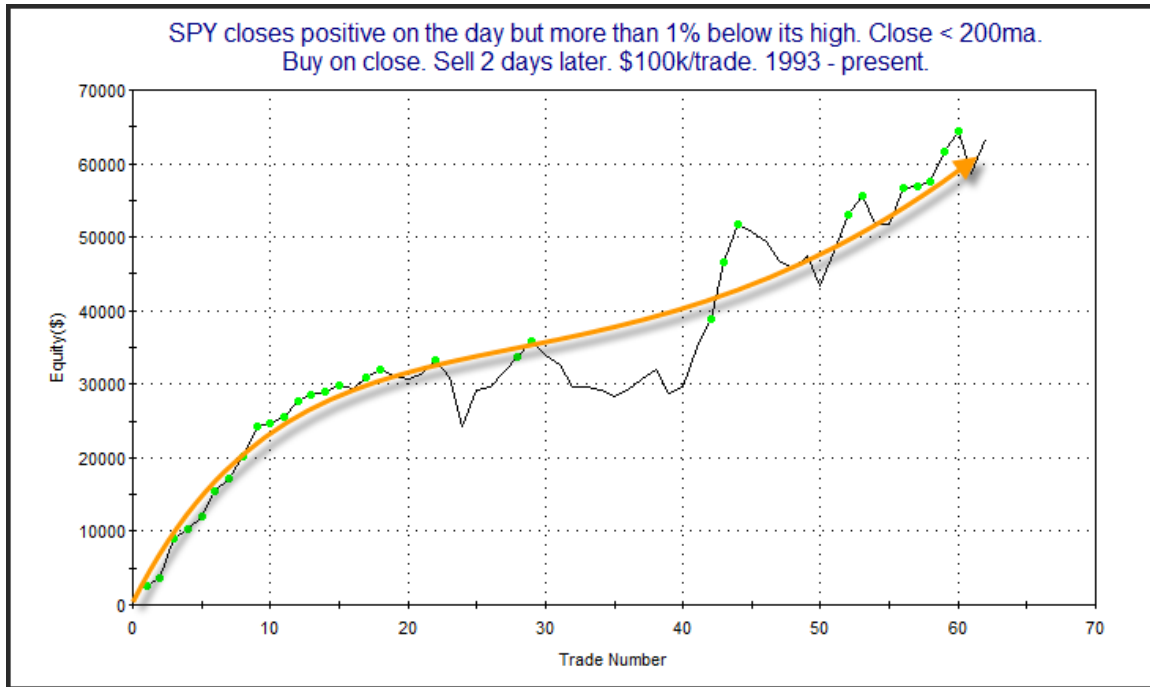
They were actually fairly consistent. The 200ma filter did lead to a lower number of trades and little downward progress in the 90s.

Not everything appears bearish tonight, though. The fact that the SPY managed to close up, and yet so far below its intraday high, suggests it could head back up there in the next few days. The study below is from the 8/23/11 subscriber letter. Results have been updated.

SPY closes positive on the day but more than 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	45,935.53	53	29	23	54.72	3,815.95	-2,814.22	1.36	1.71	866.71
4	39,126.59	55	32	23	58.18	3,316.25	-2,912.76	1.14	1.58	711.39
3	47,994.67	57	34	23	59.65	3,092.60	-2,484.95	1.24	1.84	842.01
2	63,387.14	62	43	19	69.35	2,437.71	-2,180.75	1.12	2.53	1,022.37
1	31,444.39	69	44	25	63.77	1,754.70	-1,830.50	0.96	1.69	455.72

Based on the stats table this pattern appears to suggest a solid upside edge over the next couple of days. The “avg trade” appears especially sizable for a study with so many instances. Below I have produced an equity curve to see how the edge has played out over time.



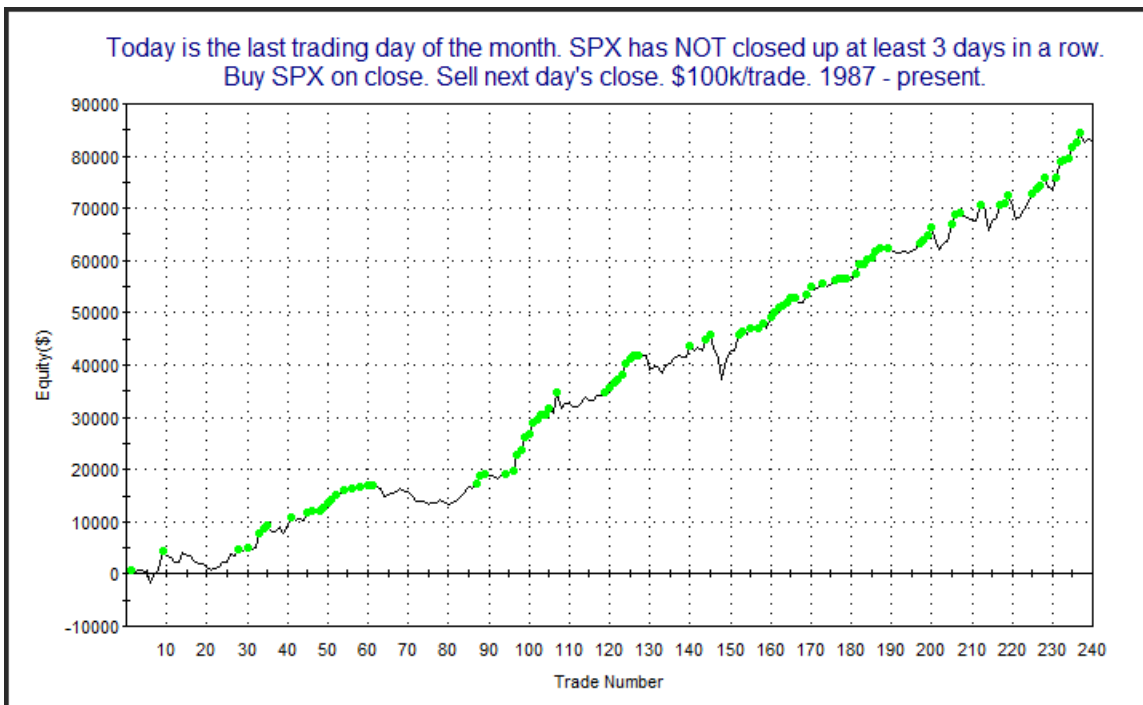
The edge seemed to take a break in the middle of the chart (which was between mid-2001 and mid-2008) but it now appears to be back on track. I find the recent action encouraging and have included this study on the Active List.

The 1st trading day of the month is well renowned for its strong performance. I’ve shown before that this is not the case when the market has had a run at the end of the month. I looked at this a bit closer today. When the SPX has risen exactly 2 days at the end of the month, then it is basically a coin flip as to whether the 1st of the next month closes up or down. Winners in this case are a bit larger than losers so there is still a decent positive expectancy. The positive expectancy no longer exists once you see 3 or more up days to finish a month. Below I have broken out the 1st day of the month by whether the SPX has already risen 3 days or more or not.

Today is the last trading day of the month. SPX has NOT closed up at least 3 days in a row.
Buy SPX on close. Sell next day's close. \$100k/trade. 1987 - present.

TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$82,864.70	Profit Factor	2.25
Gross Profit	\$149,211.75	Gross Loss	(\$66,347.05)
Total Number of Trades	240	Percent Profitable	64.17%
Winning Trades	154	Losing Trades	86
Even Trades	0		
Avg. Trade Net Profit	\$345.27	Ratio Avg. Win:Avg. Loss	1.26
Avg. Winning Trade	\$968.91	Avg. Losing Trade	(\$771.48)
Largest Winning Trade	\$3,980.86	Largest Losing Trade	(\$4,660.72)

The stats suggest a strong inclination for upside on day 1...



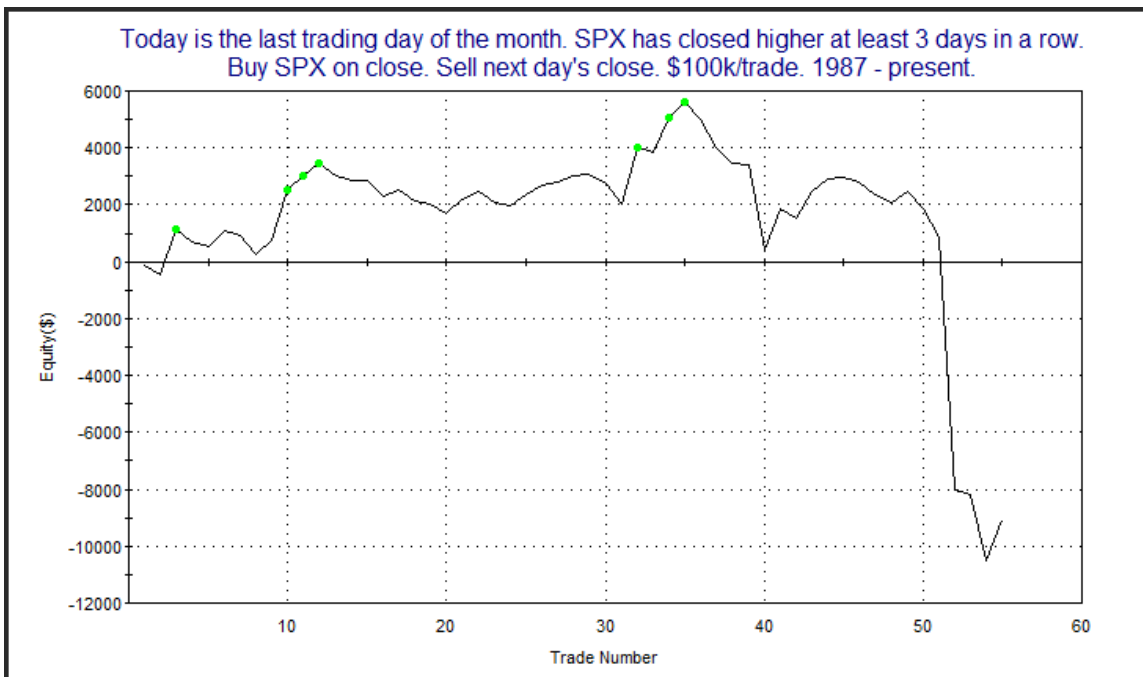
...and this is confirmed by the strong, consistent equity curve.

Now let's look at instances where the SPX *has* closed higher for at least 3 days in a row.

Today is the last trading day of the month. SPX has closed higher at least 3 days in a row.
Buy SPX on close. Sell next day's close. \$100k/trade. 1987 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	(\$9,058.13)	Profit Factor	0.64
Gross Profit	\$15,840.84	Gross Loss	(\$24,898.97)
Total Number of Trades	55	Percent Profitable	43.64%
Winning Trades	24	Losing Trades	31
Even Trades	0		
Avg. Trade Net Profit	(\$164.69)	Ratio Avg. Win:Avg. Loss	0.82
Avg. Winning Trade	\$660.03	Avg. Losing Trade	(\$803.19)
Largest Winning Trade	\$2,015.52	Largest Losing Trade	(\$8,883.33)

Here we see that expectancy actually turns negative and there are more losers than winners. Below is an equity curve.



Much of the negative return is thanks to the one huge drop. I'm therefore not comfortable suggesting a downside edge. But even without that trade the 1st of the month upside edge is eliminated.

Another seasonal tendency that I will discuss tomorrow is that the Friday before Labor Day has a strong upside history.

September has a well-earned reputation as the worst month of the year for the stock market. Last year (9/1/10) I looked at September performance following very weak August performance. This year we again have suffered a difficult August with the SPX closing down about 5.6%. Below is an updated version of the study I showed last year.

SPX closes down at least 4% for August. Buy SPX on close of last day of August. Sell close the last day of September. \$100k/trade. 1961 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
08/31/66	Buy	\$77.10	(0.70%)	\$3,865.06
09/30/66	Sell	\$76.56		(\$1,361.85)
08/30/74	Buy	\$72.15	(11.93%)	\$0.00
09/30/74	Sell	\$63.54		(\$11,933.46)
08/31/81	Buy	\$122.78	(5.38%)	\$1,465.20
09/30/81	Sell	\$116.17		(\$10,248.26)
08/31/90	Buy	\$322.56	(5.12%)	\$1,230.70
09/28/90	Sell	\$306.05		(\$8,242.90)
08/29/97	Buy	\$899.47	5.32%	\$6,784.32
09/30/97	Sell	\$947.28		\$0.00
08/31/98	Buy	\$957.55	6.21%	\$11,289.20
09/30/98	Sell	\$1,017.05		(\$1,825.20)
08/31/01	Buy	\$1,133.58	(8.17%)	\$1,920.16
09/28/01	Sell	\$1,040.94		(\$16,617.04)
08/31/10	Buy	\$1,049.33	8.76%	\$10,243.85
09/30/10	Sell	\$1,141.20		\$0.00

Perhaps the negative directional edge that the early data hinted at is not present, but one thing that is evident in all of these Septembers is that there was high volatility. The 1966 instance saw the smallest range with the market moving a little over 5% from high to low. Six of the eight instances saw ranges of 9.5%+ in September. So I would not look for the action to dull this month.

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



The mix of studies tonight kept the green Aggregator line squarely 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 well 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 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 again on Thursday. But without many studies active this could change if strong bullish evidence emerges. Meanwhile, the Differential Pivot will be 1,202.37. This is about 1.4% below Wednesday's close. This means it would take a drop of at least this much in order to move the SPX in "oversold" territory and flip the Differential line to positive.

Persistent moves often present challenges when swing trading. The current move has shown unusual persistence. At this point there still appears to be a solid downside edge. I am $\frac{3}{4}$ short. With Friday's strong seasonality and the 3-day weekend on tap in the U.S.

I don't intend to take on more index exposure before next week. My numbered systems are coming up dry tonight, so Thursday appears to be a good day to sit tight and evaluate my current exposure. Should the market tumble and the SPX closes below the Differential Pivot, I will look to cover all 3 lots. Otherwise I will monitor the Quantifinder closely and send out an intraday alert if I elect to trim my position.

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

You may use the link below to access the 8/29 letter with the full intermediate-term outlook.

[2011-08-29 QE Subscriber Letter.pdf](#)

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.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	8/29/2011	\$119.56	\$122.22	-2.22%		Aggregator
SPY(1/4)(s)	8/30/2011	\$121.36	\$122.22	-0.71%		Aggregator
SPY(1/4)(s)	8/31/2011	\$122.42	\$122.22	0.16%		shorted on open

Cover all 3 lots on an SPX close < 1,202.75.

Note to subscribers

I received several notes today from subscribers that use gmail and HAVE been getting the letters. There still appear to be a few that aren't. One subscriber sent me the below link which will "whitelist" Quantifiable Edges emails for your gmail account. This effectively allows all QE emails to get through gmail filters. I do not know whether this will work, but I am hopeful. If you have been experiencing problems and do try it, please let me know your results. Thanks.

http://email.about.com/od/gmailtips/qt/et_whitelist.htm

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