

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 2, 2011

Volume 4 Issue 170

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- The Friday before Labor Day is seasonally bullish.
- A strong pullback from a 20-day high typically suggests a 1-day upside edge.

## *Short-term Outlook*

### *The Bottom Line*

There are some bullish indications for Friday. Beyond that expectations are negative but highly dependent on what emerges on Friday. I am flat and won't be looking to get back in until after the long weekend.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
September 2, 2011	Friday before Labor Day	1 day	Bullish	
September 2, 2011	1% drop from 20-high decliners 2x adv	1 day	Bullish	
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	
<b>Active - Long Term</b>				
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%
<b>Dropped Tonight</b>				
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%

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

**The Evidence**

Aside from a quick 5-minute spike higher on news around 10am, the market spent most of the day meandering lower. The major indices all closed down quite a bit. The SPX lost 1.2%, the Nasdaq dropped 1.3%, and the Russell 2000 closed down 2.4%. Breadth was strongly negative as the NYSE Up Issues % came in at 26% and the Up Volume % was 14%. Total NYSE volume dipped a bit from Wednesday's level.

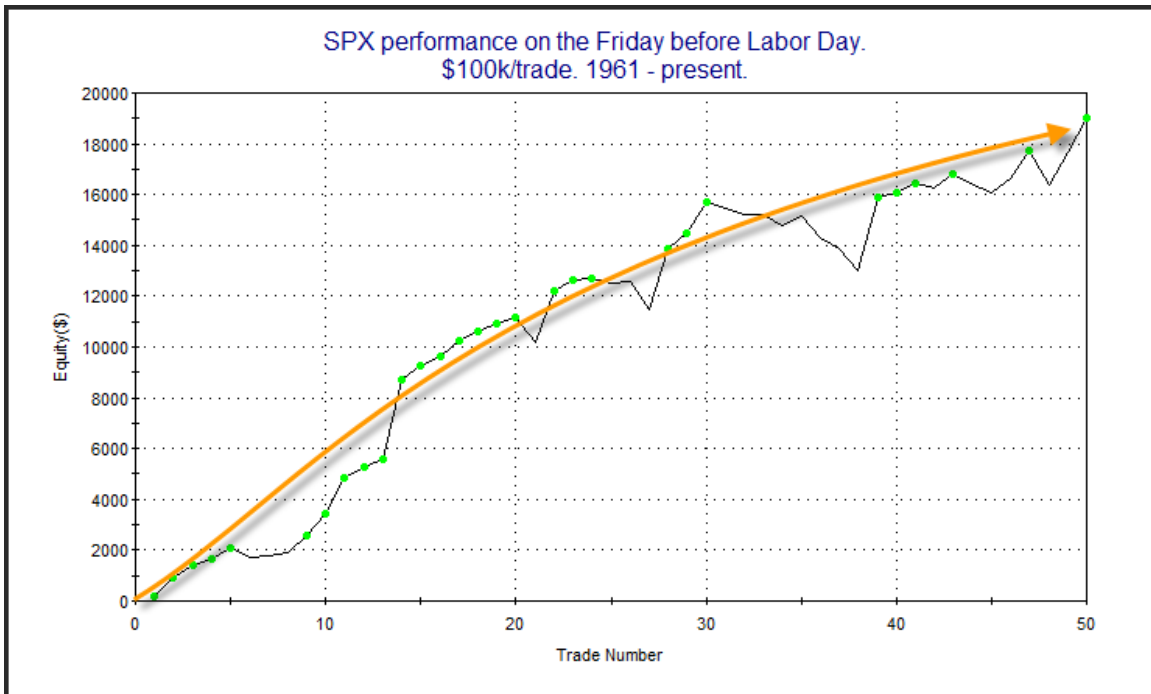
There are a few studies worth discussing tonight based on seasonality and price action. As we approached the close it appeared to me the studies were likely lining up for positive expectations. This would have moved the Aggregator System signal to flat since we closed above the Differential Pivot. Upon closer examination this evening that no longer appears to be the case and instead the Aggregator signal remains short. Of course the Aggregator looks out over a few days. And while net expectations over the next few days appear negative, Friday actually looks bullish. While the 3:50 estimate that I post to the systems page matches what the night's research says about 99% of the time, there are 2-3 occasions per year where the evening research suggests something unexpected. This is one of them.

The Friday before Labor Day has long been a strong seasonal day for the market. Below is a stats table based on buying the Thursday before Labor Day and selling the close on Friday.

SPX performance on the Friday before Labor Day.  
\$100k/trade. 1961 - present.

TradeStation Performance Summary		Collapse ▲	
<b>All Trades</b>			
Total Net Profit	\$19,001.52	Profit Factor	3.41
Gross Profit	\$26,889.10	Gross Loss	(\$7,887.58)
Total Number of Trades	50	Percent Profitable	72.00%
Winning Trades	36	Losing Trades	14
Even Trades	0		
Avg. Trade Net Profit	\$380.03	Ratio Avg. Win:Avg. Loss	1.33
Avg. Winning Trade	\$746.92	Avg. Losing Trade	(\$563.40)
Largest Winning Trade	\$3,084.48	Largest Losing Trade	(\$1,361.16)

With 72% of the days finishing higher, a profit factor of over 3, and an average trade of nearly 0.4% the stats are strongly compelling. Below you can see how the edge has evolved over time.



While the 60s and 70s appear a little stronger the upside edge certainly appears to be intact.

Days like today where the market drops strongly on very negative breadth will often suggest an upside edge over the next 1-2 weeks. I've shown this repeatedly over the years. One exception to this rule is that when the market is coming off a 20-day high then the upside edge no longer persists beyond day 1. This can be seen in the studies below. First let's look at times like the present that immediately follow a 20-day high. This study is updated from the 1/31/11 subscriber letter.

**SPX drops over 1% and decliners more than double advancers. Yesterday SPX closed at a 20-day high. Buy on close. Sell X days later. \$100k/trade. 10/20/87 - 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	660.98	37	26	11	70.27	1,833.72	-4,274.15	0.43	1.01	17.86
9	4,200.39	37	25	12	67.57	1,918.54	-3,646.92	0.53	1.10	113.52
8	-877.46	38	24	14	63.16	1,890.75	-3,303.96	0.57	0.98	-23.09
7	8,421.96	39	23	16	58.97	2,069.50	-2,448.53	0.85	1.21	215.95
6	3,190.17	39	23	16	58.97	1,716.83	-2,268.55	0.76	1.09	81.80
5	-6,830.06	39	22	17	56.41	1,601.43	-2,474.21	0.65	0.84	-175.13
4	-389.10	41	23	18	56.10	1,432.93	-1,852.59	0.77	0.99	-9.49
3	12,568.55	43	29	14	67.44	1,164.35	-1,514.11	0.77	1.59	292.29
2	7,496.05	44	25	19	56.82	1,191.44	-1,173.16	1.02	1.34	170.36
1	10,023.29	44	31	13	70.45	839.34	-1,230.48	0.68	1.63	227.80

As you can see there has been a strong possibility of a 1-day bounce. After that, returns don't suggest any edge. This next study, which has also been shown before, shows the same setup except that the SPX is NOT coming off a 20-day high.

**SPX drops over 1% and decliners more than double advancers. Yesterday SPX did NOT close at a 20-day high. Buy on close. Sell X days later. \$100k/trade. 10/20/87 - 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	231,905.47	247	160	87	64.78	2,992.24	-2,837.40	1.05	1.94	938.89
9	276,591.34	257	178	79	69.26	2,815.93	-2,843.60	0.99	2.23	1,076.23
8	244,682.61	271	178	92	65.68	2,807.68	-2,772.66	1.01	1.96	902.89
7	240,208.86	291	181	110	62.20	2,664.68	-2,200.90	1.21	1.99	825.46
6	208,156.53	306	190	116	62.09	2,502.54	-2,304.54	1.09	1.78	680.25
5	202,051.53	333	201	132	60.36	2,320.71	-2,003.12	1.16	1.76	606.76
4	158,230.44	356	207	149	58.15	2,158.17	-1,936.32	1.11	1.55	444.47
3	170,496.47	392	242	150	61.73	1,826.75	-1,810.51	1.01	1.63	434.94
2	154,612.19	447	253	194	56.60	1,715.13	-1,439.77	1.19	1.55	345.89
1	123,874.17	501	296	205	59.08	1,148.34	-1,053.83	1.09	1.57	247.25

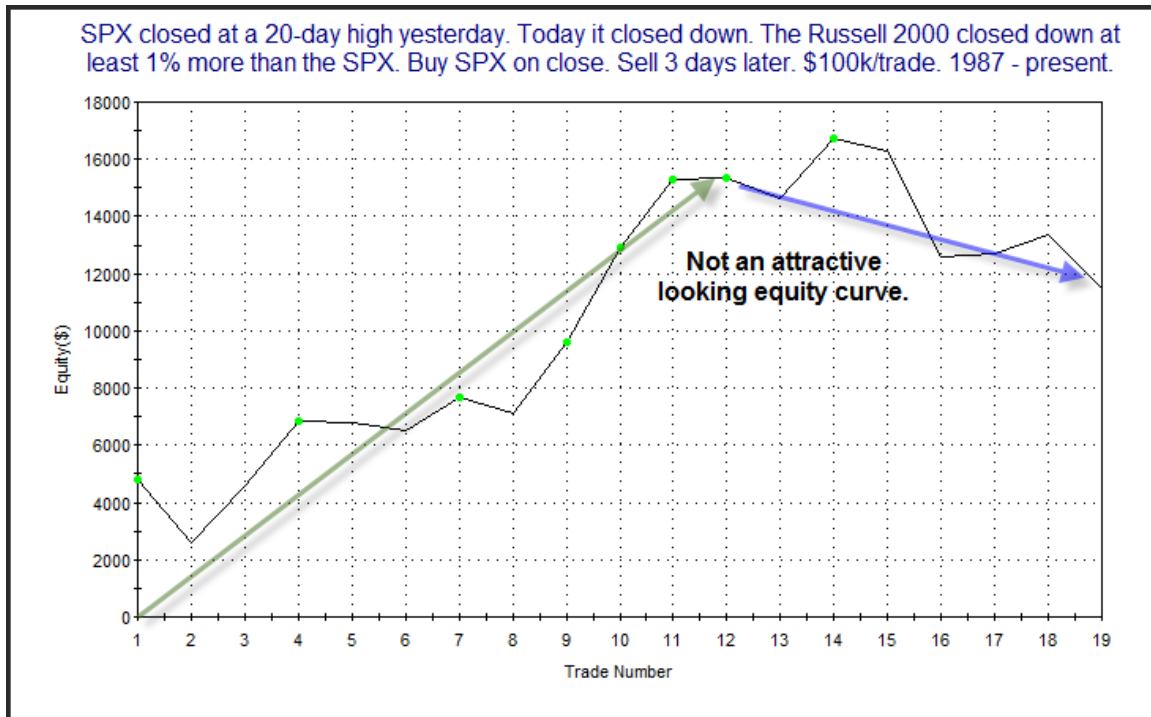
Here you see the upside edge has a tendency to persist over the next couple of weeks.

One other study from the Quantifinder tonight that I thought was worth mentioning is the one below. It was last seen in the 5/3/11 subscriber letter and it considers the possible impact of the strong underperformance of the Russell 2000 when pulling back from an intermediate-term high.

SPX closed at a 20-day high yesterday. Today it closed down. The Russell 2000 closed down at least 1% more than the SPX. 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
15	26,189.44	13	11	2	84.62	3,300.58	-5,058.48	0.65	3.59	2,014.57
14	24,656.00	14	9	5	64.29	3,730.94	-1,784.49	2.09	3.76	1,761.14
13	20,647.82	14	9	5	64.29	3,518.63	-2,203.97	1.60	2.87	1,474.84
12	19,355.50	14	10	4	71.43	2,727.23	-1,979.19	1.38	3.44	1,382.54
11	11,155.14	14	10	4	71.43	2,140.80	-2,563.22	0.84	2.09	796.80
10	12,253.46	15	11	4	73.33	1,943.04	-2,280.00	0.85	2.34	816.90
9	23,520.51	16	11	5	68.75	2,657.10	-1,141.51	2.33	5.12	1,470.03
8	23,893.63	16	13	3	81.25	2,156.28	-1,379.32	1.56	6.77	1,493.35
7	21,361.04	16	13	3	81.25	2,098.41	-1,972.77	1.06	4.61	1,335.06
6	12,430.34	16	13	3	81.25	1,501.55	-2,363.25	0.64	2.75	776.90
5	7,105.27	16	10	6	62.50	1,608.82	-1,497.16	1.07	1.79	444.08
4	6,066.78	17	9	8	52.94	2,105.44	-1,610.27	1.31	1.47	356.87
3	11,473.05	19	11	8	57.89	1,946.02	-1,241.64	1.57	2.16	603.84
2	4,300.64	19	12	7	63.16	1,349.19	-1,698.52	0.79	1.36	226.35
1	-3,145.38	19	10	9	52.63	1,169.26	-1,648.66	0.71	0.79	-165.55

When I ran this test originally the results looked quite bullish. Over the last few instances they have appeared less and less so. While I once considered this study worth inclusion in the Aggregator, I no longer do. To see why let's take a look at the equity curve. The curve below assumes a 3-day holding period. Three days is the length of the initial thrust. It is also the period I previously used to generate estimates.



At one point the curve appeared quite bullish as it rose on a consistent basis. But over the last 40% of the curve no progress has been made and in fact the strategy has lost money. Curves using different holding periods look similar as the setup has struggled a bit recently. It is because of this that I decided not to include it.

So while we have 2 bullish studies being added to the Active List tonight, each of them only suggests a 1-day upside edge. After that they have no predictive value. This is why we see nothing but bullish studies and yet the next expectations over the next few days remain negative.

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



Despite the 1-day bullish edges suggested by the studies tonight the green Aggregator line remained negative. Levels below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the Differential Line closed just slightly 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 mildly 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 Friday. That's primarily due to the "3 closes at 10-day highs" study from last night. With so little on the board beyond Friday, expectations will be strongly influenced by what studies emerge on Friday. Meanwhile, the Differential Pivot will be 1,197.53. This is about 0.6% below Thursday'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.

I exited my short index positions at the close this afternoon when it appeared expectations were likely to close positive. As it turns out I may have been a little early in closing out

the position. Still, with positive expectations on Friday plus the big employment report on tap in the a.m. I would have been looking to take part of the position off anyway. If Friday plays out as expected with an up day then it could provide another nice short entry. With so much dependent on Friday's studies, though, I won't anticipate anything here. Instead I'll sit out the expected up day and look to re-enter after the 3-day weekend if it still looks like a solid risk/reward opportunity.

***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
<i>SPY(1/4)(s)</i>	<i>8/29/2011</i>	<i>\$119.56</i>	<i>\$120.94</i>	<i>-1.15%</i>		<i>covered on close</i>
<i>SPY(1/4)(s)</i>	<i>8/30/2011</i>	<i>\$121.36</i>	<i>\$120.94</i>	<i>0.35%</i>		<i>covered on close</i>
<i>SPY(1/4)(s)</i>	<i>8/31/2011</i>	<i>\$122.42</i>	<i>\$120.94</i>	<i>1.21%</i>		<i>covered on close</i>

All 3 lots were covered on the close as specified I would do in the intraday update sent to gold subscribers at about 3:30pm.

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