

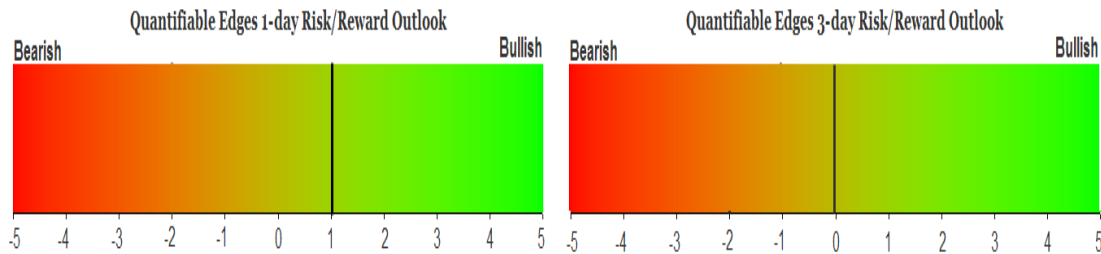
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 6, 2011

Volume 4 Issue 171

Market Overview



Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Flat	Flat	Flat	Long

Tonight's Research Points

- 2 days of very weak breadth during a downtrend have typically been followed by upside.
- Very weak Fridays often provide a short-term upside edge.
- Employment Days that gap lower and never fill often see further selling the next day.
- Poor performance before a 3-day weekend has been a bad omen both short and intermediate-term.

Short-term Outlook

The Bottom Line

Indications are mixed. The strong selling the past few days has the market strongly oversold, but net expectations remain negative. I'm not looking to take on exposure without a stronger edge.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
September 6, 2011	1% drop prior to 3-day US weekend	1-4 days	Bearish	-3.20%
September 6, 2011	1% unfilled gap down on jobs day	1 day	Bearish	
September 6, 2011	33% Up Vol 2 days < 200ma	1-2 days	Bullish	
September 6, 2011	2.5% drop on a Friday	1-2 days	Bullish	
Active - Long Term				
September 6, 2011	1% drop prior to 3-day US weekend	1-20 days	Bearish	
August 24, 2011	IBD Follow Through Day strong breadth	int term	Bullish	
August 16, 2011	SPY up 3. Vol down 3 days.	1-20 days	Bearish	
July 5, 2011	QE2 Over	int term	Bearish	
March 22, 2011	3 Days Up Issues % > 70%	8 months	Bullish	19.00%
Dropped Tonight				
August 8, 2011	SPX Down 9 of 10 days and > 7.5%	1-20 days	Bullish	13.30%
August 16, 2011	90% Up Vol on 3rd day higher	1-14 days	Bullish	
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	-1.70%
September 1, 2011	SPY up but 1% below high	1-2 days	Bullish	

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

The Evidence

Friday marked the second tough day in a row for the market. The employment numbers disappointed, helping to cause a gap down of over 2%. The market never put in a strong bid to recover from the opening gap and after meandering for much of the day, it closed poorly. The SPX finished down 2.5%, the NASDAQ closed 2.6% lower, and the Russell 2000 lost 3.6%. Breadth was extremely weak as the NYSE Up Issues % came in at 15% and the Up Volume % was just 4%. Total volume declined from Thursday's levels as many traders took off ahead of the long weekend.

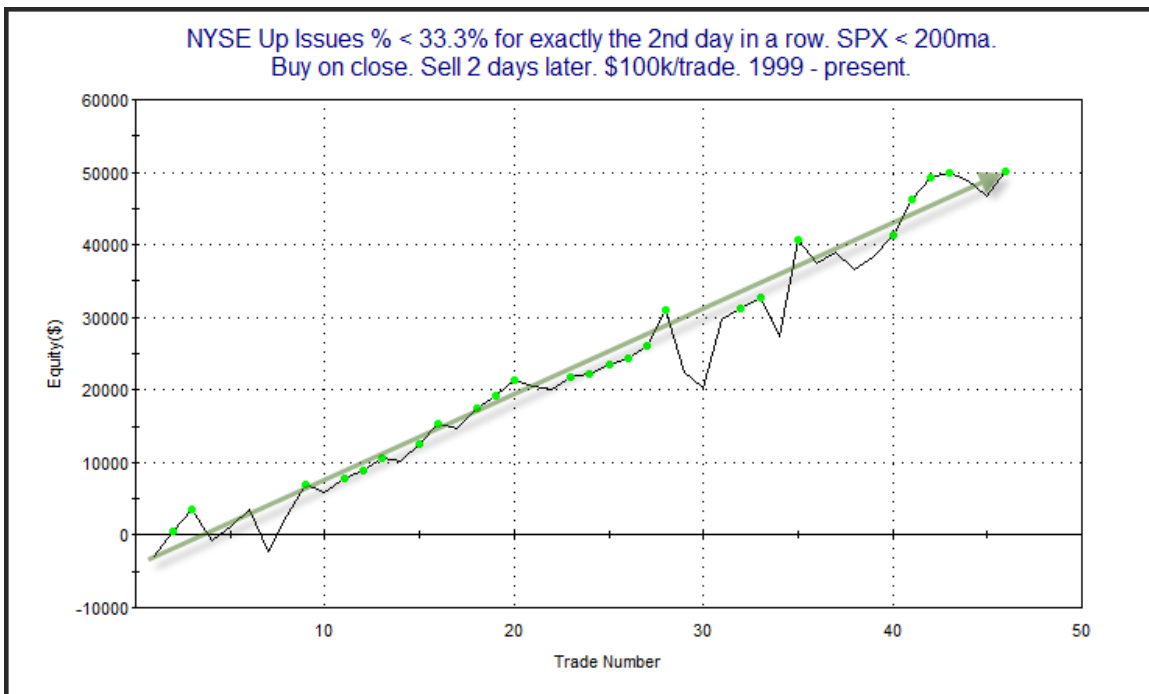
Two days of such strong selling during a long-term downtrend will often lead to a short-term bounce. The study below is one we just saw recently in the 8/22/11 subscriber letter. It looks for multiple days of very poor breadth during a long-term downtrend. All results are updated.

NYSE Up Issues % < 33.3% for exactly the 2nd day in a row. SPX < 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	55,494.71	41	30	11	73.17	3,008.71	-3,160.61	0.95	2.60	1,353.53
4	32,633.05	43	26	17	60.47	3,042.77	-2,734.06	1.11	1.70	758.91
3	35,499.15	46	27	19	58.70	3,612.99	-3,265.88	1.11	1.57	771.72
2	50,098.26	46	31	15	67.39	2,938.29	-2,732.59	1.08	2.22	1,089.09
1	38,805.67	46	30	16	65.22	2,100.68	-1,513.43	1.39	2.60	843.60

44 of 46 instances (96%) closed above the entry price at some point in the next week. 45 of 46 did so within 6 trading days.

For the considerable sample size and low number of criteria the results are astonishingly consistent. The stat at the bottom of the table is what seems most striking. Below is an equity curve using a 2-day exit.



Aside from the other obvious bullish qualities I especially like this study because it has produced such consistently positive returns in a downtrending environment.

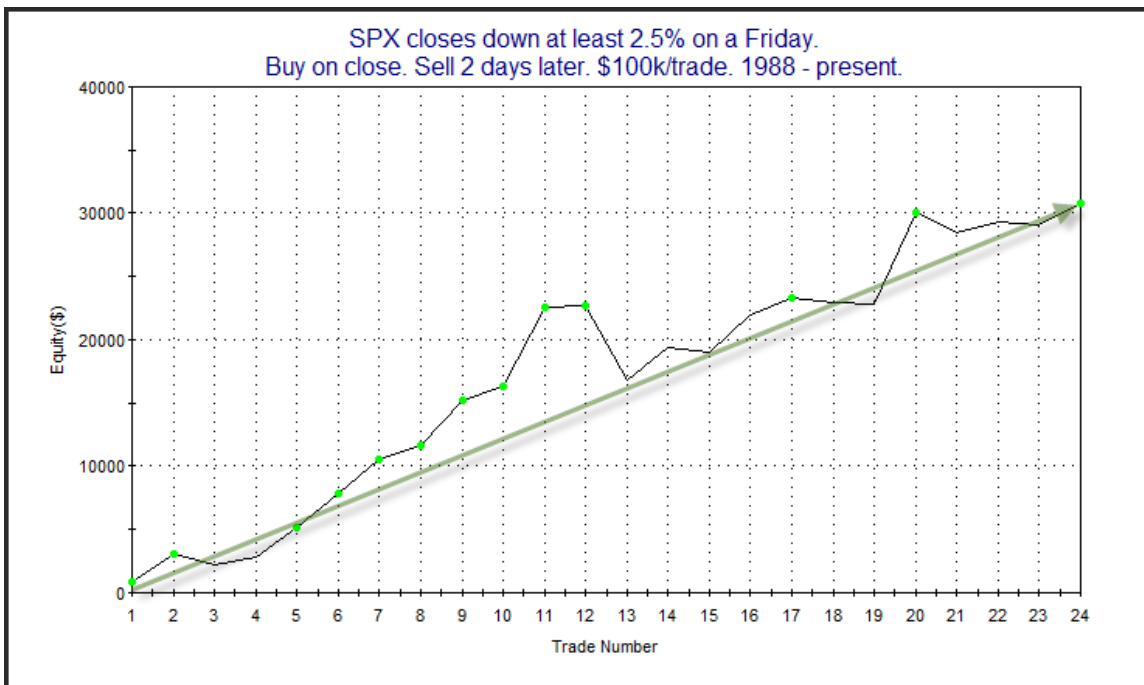
It's also notable that the strong drop occurred on a Friday. Prior to the Crash of '87, which occurred on a Monday, the market dropped over 6% on Friday. The Crash of '29 also happened on a Monday. Perhaps these events have played into the psyche of traders when the market is suffering a big drop on a Friday, because since the Crash of '87 big drops on Fridays have shown a substantial tendency to bounce over the next few days. I last showed this in the 6/7/10 subscriber letter and have updated the study below:

**SPX closes down at least 2.5% on a Friday.
Buy on close. Sell X days later. \$100k/trade. 1988 - 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	42,175.56	24	18	6	75.00	3,273.67	-2,791.74	1.17	3.52	1,757.32
4	26,022.92	24	16	8	66.67	3,056.60	-2,860.33	1.07	2.14	1,084.29
3	30,785.87	24	19	5	79.17	2,244.20	-2,370.78	0.95	3.60	1,282.74
2	30,816.53	24	17	7	70.83	2,362.55	-1,335.25	1.77	4.30	1,284.02
1	6,835.50	24	17	7	70.83	1,202.81	-1,944.61	0.62	1.50	284.81

23 of 24 instances (96%) closed above the entry price at some point in the next 5 days. The 11/14/08 instance took 8 days.

These stats appear quite bullish for the short-term. Below is an equity curve that assumes a two day holding period.



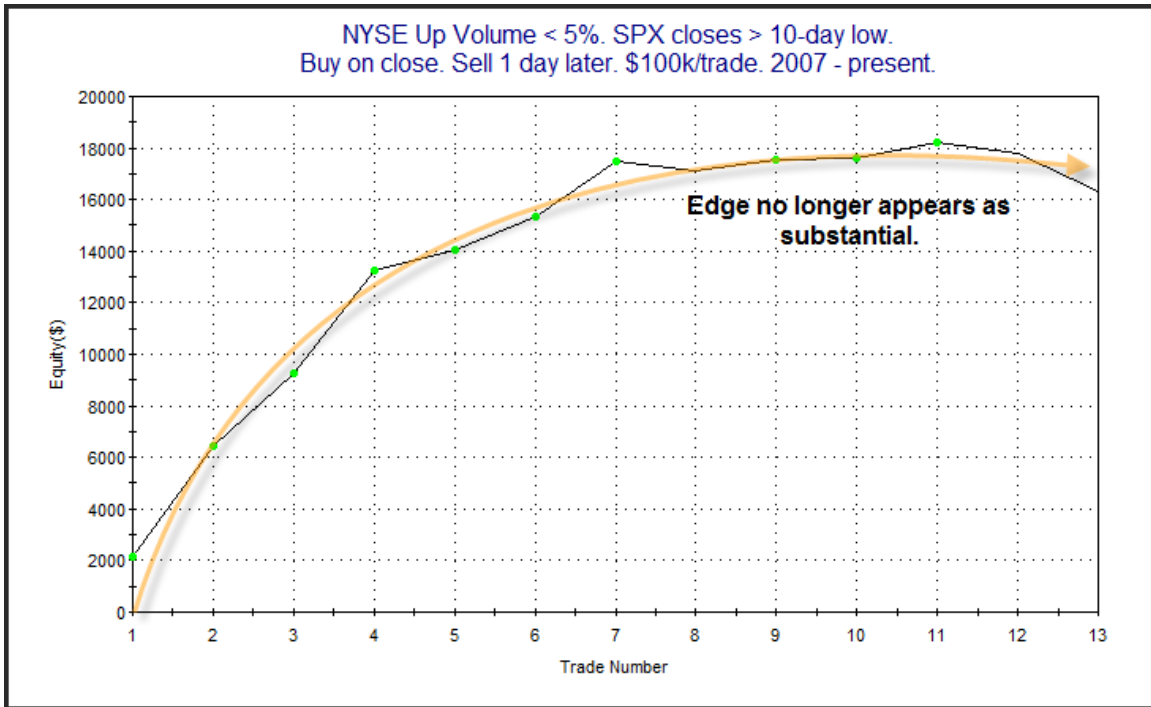
The strong upslope here seems to confirm the bullish edge.

There was one other notable breadth and priced-based study identified by the Quantifinder. It looked at extreme down volume % days like Friday in which the SPX did not make a short-term low. I last looked at this study in the 7/12/11 subscriber letter and have updated all statistics.

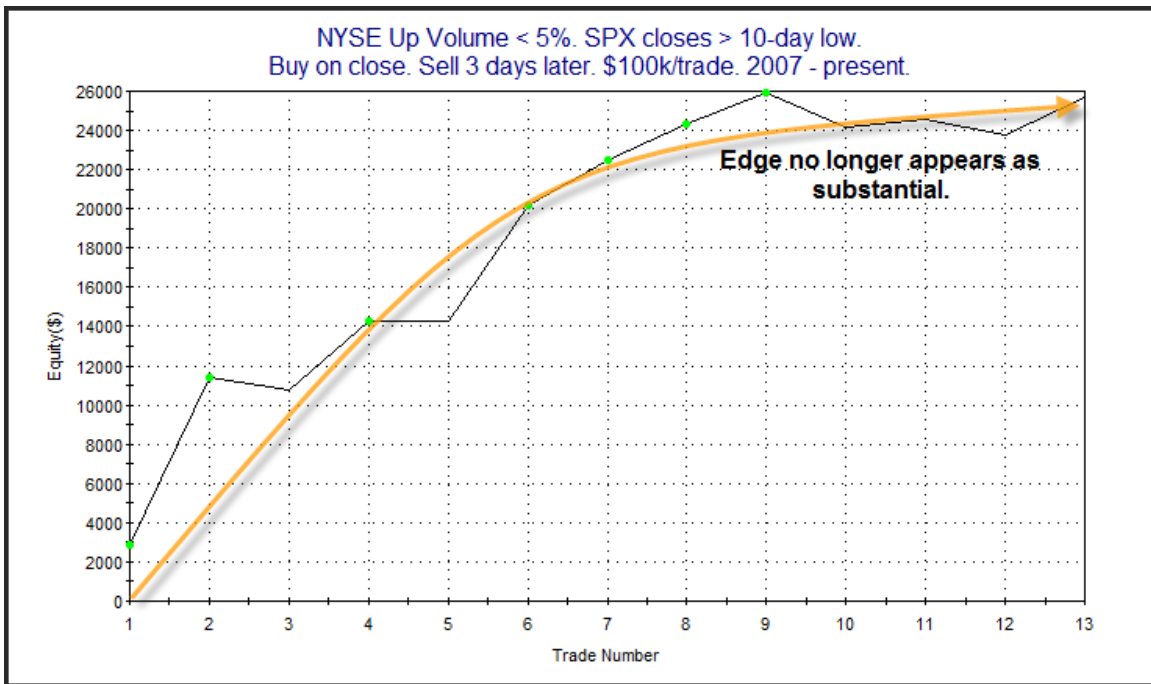
NYSE Up Volume < 5%. SPX closes > 10-day low. Buy on close. Sell X days later. \$100k/trade. 2007 - present. (No instances from 1989 - 2006.)										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	22,764.04	13	9	4	69.23	3,767.37	-2,785.57	1.35	3.04	1,751.08
4	20,579.75	13	9	4	69.23	4,090.39	-4,058.44	1.01	2.27	1,583.06
3	25,663.62	13	9	4	69.23	3,218.47	-825.66	3.90	8.77	1,974.12
2	19,764.64	13	10	3	76.92	2,267.10	-968.80	2.34	7.80	1,520.36
1	16,297.97	13	10	3	76.92	1,855.52	-752.40	2.47	8.22	1,253.69

12 of 13 instances (92%) closed above the entry price at some point in the next 3 days. All 13 did so within 6 trading days.

The stats all appear quite compelling. Unfortunately the equity curves look a bit weak. To see why I say this I have produced both the 1-day and 3-day equity curves below.



Here it appears that of the 13 instances, the first seven showed strong bullish tendencies and the last six haven't done much of anything. Now let's look at the 3-day equity curve.



Here too we see the curve is flattening out. In this case it's really just the last four instances that have failed to make much progress. In a larger sample set this wouldn't bother me, but since you're talking about close to 1/3 of the sample, I'm inclined to ignore this study for now and simply defer to the ones above to generate estimates based on price and breadth action.

So price and breadth are showing a very short term upside inclination. But as you'll see below such sizable price moves seasonally can be a powerful negative.

As I mentioned earlier, Friday was an Employment Day. Employment Days will often occur in conjunction with a strong price move because the employment report is frequently viewed as an important piece of economic data. More often than not employment days have done well. And even times when the report has disappointed, there has generally been an intraday recovery. It is quite rare to see the employment report lead to a large gap down that never fills. When this has happened in the past selling has generally continued into the next trading session. This is something I last showed in the 7/11/11 subscriber letter. I have updated that study below.

Today is an employment day. SPY gaps down over 1% and fails to close the gap.
Buy on close. Sell next day's close. \$100k/trade. 1993 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	(\$2,822.68)	Profit Factor	0.48
Gross Profit	\$2,588.17	Gross Loss	(\$5,410.85)
Total Number of Trades	10	Percent Profitable	20.00%
Winning Trades	2	Losing Trades	8
Even Trades	0		
Avg. Trade Net Profit	(\$282.27)	Ratio Avg. Win:Avg. Loss	1.91
Avg. Winning Trade	\$1,294.08	Avg. Losing Trade	(\$676.36)
Largest Winning Trade	\$1,439.15	Largest Losing Trade	(\$1,807.92)

The number of instances is a bit low but stats appear overwhelmingly negative. Below is a list of all instances.

Today is an employment day. SPY gaps down over 1% and fails to close the gap.
Buy on close. Sell next day's close. \$100k/trade. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
03/08/96	Buy	\$63.50	1.15%	\$1,306.42
03/11/96	Sell	\$64.23		(\$676.82)
07/05/96	Buy	\$65.58	(0.41%)	\$624.84
07/08/96	Sell	\$65.31		(\$685.80)
12/06/96	Buy	\$74.31	1.44%	\$1,492.95
12/09/96	Sell	\$75.38		\$0.00
11/07/97	Buy	\$92.94	(0.60%)	\$967.50
11/10/97	Sell	\$92.38		(\$1,010.50)
09/07/07	Buy	\$146.07	(0.19%)	\$444.60
09/10/07	Sell	\$145.79		(\$1,190.16)
01/04/08	Buy	\$141.31	(0.08%)	\$650.44
01/07/08	Sell	\$141.19		(\$855.47)
07/02/09	Buy	\$89.81	(0.01%)	\$133.56
07/06/09	Sell	\$89.80		(\$1,279.95)
06/04/10	Buy	\$106.82	(1.25%)	\$739.44
06/07/10	Sell	\$105.49		(\$1,319.76)
06/03/11	Buy	\$130.42	(1.06%)	\$0.00
06/06/11	Sell	\$129.04		(\$1,187.30)
07/08/11	Buy	\$134.40	(1.81%)	\$0.00
07/11/11	Sell	\$131.97		(\$2,038.56)

Since 1996 not only have all instances closed negative, but intraday drawdown has been larger than intraday run-up in every case.

Thursday night I discussed how the Friday before Labor Day has had bullish inclinations over the last 50 years. It has been extremely rare to see the market selloff so hard on this day. In fact there've only been two other times when the SPX has lost more than 1% on this Friday. Those two instances occurred in 1987 and 2008. Those are the two years we saw large crashes occur in the fall. Of course you can't draw any solid conclusions from just two instances, but I thought it would be interesting to look and see how the market has performed following large selloffs prior to three day weekends. I also decided to exclude weekends surrounding Christmas, New Year's, and Easter. Doing so didn't affect results greatly, but by focusing on Labor Day, Martin Luther King Day, Presidents' Day, Memorial Day, and Fourth of July I was able to incorporate the fact that foreign markets will be open while the US is closed on Monday. Since 2000 there have been 11 instances where there was a large selloff prior to the US-only 3-day weekend. Statistics from 1-20 days out are shown in the table below.

SPX closes down > 1% on the day before a U.S.-only 3-day weekend.
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
20	-27,403.36	11	3	8	27.27	7,938.45	-6,402.34	1.24	0.46	-2,491.21
19	-23,253.23	11	3	8	27.27	8,121.65	-5,952.27	1.36	0.51	-2,113.93
18	-22,409.74	11	3	8	27.27	7,150.85	-5,482.79	1.30	0.49	-2,037.25
17	-28,296.89	11	4	7	36.36	4,348.85	-6,527.47	0.67	0.38	-2,572.44
16	-23,556.38	11	4	7	36.36	4,137.36	-5,729.40	0.72	0.41	-2,141.49
15	-20,285.38	11	4	7	36.36	4,976.14	-5,741.42	0.87	0.50	-1,844.13
14	-14,062.79	11	4	7	36.36	5,114.72	-4,931.67	1.04	0.59	-1,278.44
13	-18,283.71	11	4	7	36.36	4,436.12	-5,146.88	0.86	0.49	-1,662.16
12	-18,588.32	11	4	7	36.36	3,887.17	-4,876.71	0.80	0.46	-1,689.85
11	-14,255.12	11	4	7	36.36	3,226.01	-3,879.88	0.83	0.48	-1,295.92
10	-15,125.23	11	4	7	36.36	3,178.26	-3,976.90	0.80	0.46	-1,375.02
9	-13,073.25	11	4	7	36.36	3,067.68	-3,620.57	0.85	0.48	-1,188.48
8	-14,424.90	11	4	7	36.36	2,229.10	-3,334.47	0.67	0.38	-1,311.35
7	-19,002.80	11	3	8	27.27	1,336.31	-2,876.46	0.46	0.17	-1,727.53
6	-19,815.64	11	5	6	45.45	610.48	-3,811.34	0.16	0.13	-1,801.42
5	-22,103.65	11	3	8	27.27	439.85	-2,927.90	0.15	0.06	-2,009.42
4	-22,816.92	11	1	10	9.09	1,758.24	-2,457.52	0.72	0.07	-2,074.27
3	-14,618.49	11	3	8	27.27	1,124.05	-2,248.83	0.50	0.19	-1,328.95
2	-9,615.29	11	4	7	36.36	786.77	-1,823.19	0.43	0.25	-874.12
1	-6,241.18	11	4	7	36.36	658.27	-1,267.75	0.52	0.30	-567.38

The initial reaction over the 1-4 day shortened week has been for downside follow-through. But even beyond that, we've seen continued weakness for at least a month. Below I have listed all 11 instances and assumed a 4-day holding period.

SPX closes down > 1% on the day before a U.S.-only 3-day weekend.
Buy on close. Sell 4 days later. \$100k/trade. 2000 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
02/18/00	Buy	\$1,346.09	(0.95%)	\$1,777.48
02/25/00	Sell	\$1,333.36		(\$1,253.56)
02/16/01	Buy	\$1,301.47	(4.30%)	\$432.44
02/23/01	Sell	\$1,245.47		(\$6,538.28)
05/25/01	Buy	\$1,277.90	(1.35%)	\$40.56
06/01/01	Sell	\$1,260.67		(\$2,491.32)
02/15/02	Buy	\$1,104.18	(1.30%)	\$0.00
02/22/02	Sell	\$1,089.84		(\$2,683.80)
05/24/02	Buy	\$1,083.82	(1.54%)	\$198.72
05/31/02	Sell	\$1,067.14		(\$2,719.52)
01/17/03	Buy	\$901.78	(4.48%)	\$464.20
01/24/03	Sell	\$861.40		(\$4,627.70)
05/23/08	Buy	\$1,375.93	1.77%	\$2,188.08
05/30/08	Sell	\$1,400.35		(\$205.92)
08/29/08	Buy	\$1,282.74	(3.15%)	\$1,563.10
09/05/08	Sell	\$1,242.31		(\$5,044.27)
07/02/09	Buy	\$896.42	(1.53%)	\$255.30
07/09/09	Sell	\$882.68		(\$3,008.10)
01/15/10	Buy	\$1,136.03	(3.90%)	\$1,268.96
01/22/10	Sell	\$1,091.76		(\$4,034.80)
05/28/10	Buy	\$1,089.41	(2.25%)	\$1,479.66
06/04/10	Sell	\$1,064.88		(\$2,630.81)

With the average drawdown reaching over 3.2% and the average run-up only a little less than 0.9% downside risk has been over 3.5 times the size of upside reward.

Prior to examining this study over the weekend it appeared that the Aggregator would show bullish expectations based on the studies shown earlier. With this now taken into account net expectations are slightly bullish over the next two days but bearish on days three and four. I actually looked at the study a number of different ways to determine whether I was giving it too much weight. Varying the lookback and/or including Christmas, New Year's, and Easter did not alter the end result, as expectations appeared negative any way I looked at.

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



Largely thanks to the strongly negative seasonal studies 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 large selloff caused the Differential Line to jump back above 0. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are negative but the SPX is already oversold versus recent expectations. This is considered a neutral configuration. Neutral configurations can be seen on the chart whenever both lines close on opposite sides of 0. Due to this the Aggregator System changed from short to flat at the close.

It's going to take more bullish evidence to move the Aggregator line back into positive territory. Meanwhile, the Differential Pivot will be 1,200.21. This is about 2.2% above Friday's close. So unless the SPX rallies at least this much the differential line will remain positive, suggesting an oversold market.

I normally like to buy into sharp selloffs like we've seen the last two days, but the strong bearish evidence suggested by the last two studies has me standing aside for now. With the market below its 200ma bearish studies trigger more easily and bullish ones tend to be very short-term in nature. This is what we've seen over the last couple of days. I'm sidelined for now and awaiting a more substantial edge before looking to add exposure in either direction.

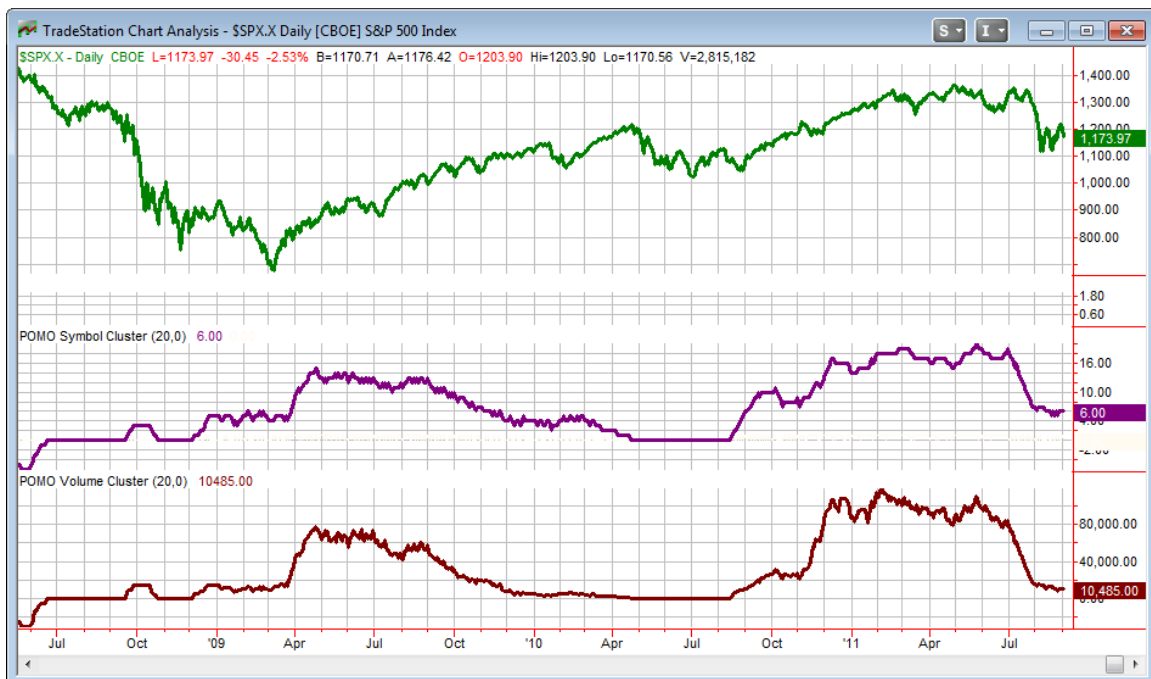
Intermediate-term Outlook (2 weeks – 2 months)– updated 7/6 – slightly bearish

Thursday and Friday's losses wiped out the gains from Monday through Wednesday and the market finished moderately lower this past week. Intermediate-term bullish evidence is fairly weak right now, with the most prominent bullish study being based on the 8/23 Follow-Through Day.

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 continue to flat line. While the Fed's published schedule is calling for about \$14billion in purchases each month, actual purchases have been a bit below that level. We keep waiting for the market to prove it can rally without substantial stimulus. So far it has not managed to do so.

Intermediate-term indicators remain mixed, but now appear to have a downside tilt. Bearish studies are associated with volume, liquidity (POMO), and seasonality. Bulls may find hope in the August FTD study and the breadth study from several months back. Though I'm not wed to either direction I'm now somewhat inclined to play the short side a little more aggressively and take a more conservative approach to longs.

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

None.

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